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News Bulletin

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UK Proposals for Bank Levies under the June 2010 Emergency Budget

On 22 June 2010, the UK Chancellor, George Osborne MP, of the Conservative-led UK government (the "Govt."), delivered the keenly anticipated "emergency" budget ("2010 Budget"),[1] which will introduce a host of changes to the UK tax system, with far-reaching consequences for the future of the UK financial services industry and its wider economy.

Of special import to the banking industry are the announcements (foreshadowed in the Coalition Programme[2] published on 20 May 2010 and the Chancellor's Mansion House speech the previous week[3]) that the Govt. will start imposing a bank levy on banks' balance sheets from 1 January 2011 and will consider introducing further restraints on bank remuneration, which may include another levy on banks' profits and remuneration.

We summarise below the main aspects of the 2010 Budget announcement as they relate to banks and other financial institutions in the UK.

Bank Levy

The 2010 Budget announced that it will introduce a bank levy based on banks' balance sheets from 1 January 2011. The stated intention of the levy is to encourage banks to adopt less risky funding profiles, with the result of rebalancing the tax burden between banking and other sectors.

Final details of the levy will be published later in 2010, following public consultation by HMT over the summer. However, shortly after the 2010 Budget, the HM Treasury ("HMT") published on 22 June 2010 a separate document entitled "Bank Levy" which set out some basic details of the new levy.[4]

The following are its main features, as proposed in the Govt. announcements (to date):

Scope

The levy will apply to the following types of banks (and their balance sheets), where their "aggregate liabilities" amount to £20 billion or more:

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[1] 2010 Budget (22 June 2010), http://www.hm-treasury.gov.uk/d/junebudget_complete.pdf.
[2] The Coalition: Our Programme for Government (20 May 2010), http://programmeforgovernment.hmg.gov.uk/files/2010/05/coalition-programme.pdf and the related section by section online guide, http://programmeforgovernment.hmg.gov.uk/. *See also*, Conservative-Liberal Democrat Coalition Agreement (11 May 2010), http://conservativehome.blogs.com/files/conlib-agreement-1.pdf.
[3] Speech at the Lord Mayor's Dinner for Bankers & Merchants of the City of London by the Chancellor of the Exchequer, The Rt Hon George Osborne MP, at Mansion House (16 June 2010), http://www.hm-treasury.gov.uk/press_12_10.htm.
[4] HM Treasury document on Bank Levy (22 June 2010), http://www.hm-treasury.gov.uk/d/junebudget_bank_levy.pdf.

- ***UK banks*:**
  - UK banking groups and building societies (consolidated balance sheets); and
  - UK banks in non-banking groups (balance sheets).
- ***Foreign banks*:** Non-UK banks and banking groups operating in the UK (aggregated balance sheets of UK subsidiaries and branches).

Applicable Rates

- ***Normal rate*:** The levy is initially proposed be charged at the lower rate of 0.04%, then raised to 0.07% from 1 January 2012.
- ***Longer-maturity wholesale funding*:** Only half of the normal rate would be charged to longer-maturity (i.e., more than one year remaining) wholesale funding, i.e., initially 0.02% and rising to 0.035% from 1 January 2011.

Calculating the Levy

- ***Total liabilities*:** The levy will be based on total liabilities (i.e., both short- and long-term) *excluding*:
  - Tier 1 capital;
  - insured retail deposits;
  - policyholder liabilities of retail insurance business; and
  - repos secured on sovereign debt.
- ***Derivative liabilities*:** The Govt. proposes to take into account net derivative positions only, subject to "technical details and other aspects of the levy design" which may develop from the public consultation.
- ***Branch liabilities and Tier 1 capital*:** The Govt. proposes to apply the capital attribution methodology under corporation tax rules to calculate branch liabilities and Tier 1 capital.

Other Features

- ***Non-deductibility*:** The levy will not be deductible for corporation tax.
- ***Anti-avoidance*:** There will be anti-avoidance provisions.

Bank Renumeration

As the Chancellor warned in his Mansion House Speech, the Govt. announced further measures in the 2010 Budget against "unacceptable bank bonuses" to complement the bank levy.

Remuneration Disclosure Scheme ("RDS")

As the 2010 Budget has announced that the Govt. will consult on a RDS, a consultation paper may be expected from HMT in due course.

The Financial Services Act 2010 ("FS Act"),[5] which came into force on 8 June 2010, gives HMT the power to make regulations for authorised firms to prepare, approve and disclose their executives' remuneration reports.

The preceding Labour government had already commenced work on a RDS, with HMT publishing the draft regulations on 10 March 2010,[6] and announced that it would consult on executives' remuneration disclosure.

Financial Activities Tax ("FAT")

The Govt. will explore, in collaboration with international partners, the costs and benefits of a global FAT on profits and remuneration. (See below under "Related EU & G20 Proposals.")

Review of the Remuneration Code

The Govt. has asked the Financial Services Authority ("FSA") to consider in its forthcoming review of the Remuneration Code:[7]

- imposing more stringent requirements on deferral and award of variable pay;
- strengthening the link between performance and remuneration, which aligns incentives with the firm's long-term performance; and
- varying capital requirements to offset risks in remuneration practices.

The FS Act mandates FSA to make general rules for remuneration policies, including new powers:

- to prohibit certain persons from being remunerated in a specified way;
- to specify that any contractual remuneration provision which contravenes such prohibition shall be void; and
- to recover any payment or property transferred where the remuneration is void.

On 26 April 2010, FSA stated in its consultation paper (CP10/11) on implementing aspects of the FS Act, that it intends to publish a separate consultation paper on remuneration before the end of the second quarter of 2010.[8]

Related EU and G20 Proposals

The introduction of a bank levy or tax has also been mooted by the European Union ("EU") and by the G20 and the International Monetary Fund ("IMF").

EU Proposals

On 26 May 2010, the European Commission ("EU Commission") proposed a levy on banks and transactions, aimed at pre-funding an EU network of national bank resolution funds to be established as part of a wider set of

[5] Financial Services Act 2010, http://www.opsi.gov.uk/acts/acts2010/pdf/ukpga_20100028_en.pdf.
[6] *See* the (draft) Executives' Remuneration Reports Regulations 2010, http://www.hm-treasury.gov.uk/d/fsbill_draftregs100310.pdf.
[7] *See* Senior Management Arrangements, Systems & Controls (Remuneration Code) Instrument 2009, appended to the FSA Policy Statement (PS09/15): Reforming remuneration practices in financial service and its Handbook Notice 91 (12 August 2009), http://www.fsa.gov.uk/pubs/policy/ps09_15.pdf.
[8] FSA consultation paper (CP10/11): Implementing aspects of the Financial Services Act 2010 (26 April 2010), http://www.fsa.gov.uk/pubs/cp/cp10_11.pdf.

initiatives designed to strengthen EU crisis management.[9] The EU Commission is expected to publish detailed legislative proposals to implement its plans for the EU crisis management framework, with a view to adopting the relevant legislation in early 2011.

HMT has not yet indicated how the EU's proposals may affect or fit together with the UK's banking levy, which will take effect from 1 January 2011.

G20 Toronto Summit (26-27 June 2010)[10]

In a joint statement dated 22 June 2010, the UK, French and German governments confirmed their commitment to introducing bank levies based on banks' balance sheets, ahead of the forthcoming G20 Toronto summit.[11]

In a similar vein, the EU Commission and Council sent a joint letter dated 22 June 2010 to the G20 leaders which called on them to reaffirm their commitment to financial reforms at the G20 Toronto summit and which set out a number of policy proposals, *inter alia*:

- uniform implementation of the strict remuneration standards agreed at the G20 Pittsburgh summit (24-25 September 2009);[12] and
- international work on levies and taxes on financial institutions, including exploring the introduction of a global FAT.[13]

Contrary to these urgings, however, the G20 Toronto summit did not result in an agreement to implement a global banking levy. Instead, whilst reiterating that "the financial sector should make a fair and substantial contribution towards paying for any burdens associated with government interventions" the G20 leaders simply stated that they recognised that there are "a range of policy approaches to this end" and that "[s]ome countries are pursuing a financial levy."

In its final report for the G20 Toronto summit dated June 2010,[14] the IMF reviewed the range of different measures which have been introduced or proposed by different countries, but also stopped short of recommending the adoption of uniform global levies or taxes to be implemented by all countries.

Previously, in its interim report for the G20 dated 16 April 2010,[15] IMF had recommended two types of global bank levy (or tax) to compel banks to pay a fairer share of the public costs of supporting the banking sector through (both past and future) financial crises, i.e.:

- a "Financial Stability Contribution" to fund a resolution scheme, payable either into the resolution fund or into general revenue. The rate should be initially flat, but varied over time to reflect the systemic risk posed by the financial institution; and
- a FAT on the sum of the profits and remuneration of financial institutions, payable into general revenue.

[9] European Commission Communication: Bank Resolution Funds (26 May 2010), http://ec.europa.eu/internal_market/bank/docs/crisis-management/funds/com2010_254_en.pdf. *See also* EU Commission & Council joint letter to G20 leaders (22 June 2010), http://ec.europa.eu/commission_2010-2014/president/news/speeches-statements/pdf/20100623_1_en.pdf.
[10] G-20 Toronto Summit Declaration (27 June 2010), http://g20.gc.ca/wp-content/uploads/2010/06/g20_declaration_en.pdf.
[11] Joint statement by French, UK and German governments on bank levies (22 June 2010), http://www.hm-treasury.gov.uk/d/junebudget_joint_statement.pdf.
[12] *See* G20 Pittsburgh Summit: Leaders' Statement (25 September 2009), http://www.pittsburghsummit.gov/mediacenter/129639.htm.
[13] EU Commission & Council joint letter to G20 leaders (22 June 2010), http://ec.europa.eu/commission_2010-2014/president/news/speeches-statements/pdf/20100623_1_en.pdf.
[14] IMF Final Report for the G20: A fair and substantial contribution by the financial sector (June 2010), http://www.imf.org/external/np/g20/pdf/062710b.pdf.
[15] IMF Interim Report for the G20: "A fair and substantial contribution by the financial sector" (16 April 2010), http://globalpolicy.org/images/pdfs/2010_04_20_imf_g20_interim_report_2.pdf.

However, a proposal for a global banking levy was also not included in the final communiqué of the G20 Busan meeting of finance ministers and central bank governors (4-5 June 2010), and the press had attributed this to strong objections from other G20 members.[16]

Conclusion

The proposals on the bank levy and bank remuneration had been expected for quite some time, and the immediate reaction from banks was somewhat muted, some claiming that the levy, expected to raise over £2 billion annually, was not as bad as they had expected. By comparison, the US had proposed to impose a much higher 0.15% "financial crisis responsibility fee" on the balance sheets of banks and other financial institutions with assets of more than US$50 billion.

According the latest press, several market analysts have put forward comments including, e.g., that:

- UK banks would be paying the bulk of the new bank levy, and the impact of the levy on US and other foreign banks operating in the UK would likely be minimal;
- at the same time, some UK banks will be hit harder than others, such as Royal Bank of Scotland and Barclays Bank, which have large balance sheets, substantial short-term funding and low asset margins; and
- large cross-border banking groups will be exploring ways to reduce the net impact of the levy, through "balance sheet management," group restructuring (e.g., HSBC could benefit by booking some trades on a Hong Kong, rather than UK, balance sheet) or even relocating their operations outside the UK depending upon whether similar levies are imposed in other jurisdictions.[17]

As discussed above, many vital provisions that will determine the application and mechanics of the bank levy have yet to be refined or developed. The Govt. has promised to consult with the banking industry prior to finalising and publishing the relevant legislation in full text. Until then, the cumulative impact of the various pending proposals will be that banks will continue to face a substantial degree of uncertainty and confusion.

In addition, the possibility of multiple overlapping levies cannot be discounted, as EU and G20 (as well as many national governments) are currently working on their own respective proposals for bank levies and FATs on profits and remuneration. Therefore, the banking industry may have to wait still further to discover how these proposals will all fit together with the UK's bank levy (and any FAT).

Also of relevance, the Govt. has not yet elaborated on the free National Financial Advice Service ("NFAS"), or the "social responsibility" levy on the financial services sector, which is intended to fund the NFAS, another potential levy on banks which was mentioned in the Govt.'s Coalition Programme (Section 1 (Banking)) as part of the banking reforms.

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[16] *See*, e.g., *Financial Times* article, "Proposal for a global banking levy scrapped" (7 June 2010), www.ft.com/cms/s/0/a77578e8-71ca-11df-8eec-00144feabdc0.html. *Cf.* G20 Communiqué: Meeting of Finance Ministers and Central Bank Governors, Busan, Republic of Korea (5 June 2010), http://www.g20.org/Documents/201006_Communique_Busan.pdf.

[17] *See*, e.g., Bloomberg articles: "British Banks Move Offshore to Avoid Levy" (24 June 2010), http://www.businessweek.com/globalbiz/content/jun2010/gb20100624_078643.htm; "UK banks get a 'good result' as Osborne levy targets short-term funding" (23 June 2010), http://www.bloomberg.com/news/2010-06-22/u-k-banks-get-a-good-result-as-osborne-imposes-balance-sheet-levy.html; "Goldman Sachs, US investment banks face 'minimal' impact from UK levy" (23 June 2010), http://www.businessweek.com/news/2010-06-23/goldman-sachs-u-s-banks-face-minimal-impact-from-u-k-levy.html; and *Financial Times* article: "Domestic banks to pay bulk of new £2bn levy" (24 June 2010); http://www.ft.com/cms/s/0/08df010a-7f34-11df-84a3-00144feabdc0.html.

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