Position Paper on

The Financial Transaction Tax & Energy Trading

Introduction

The completion of the European internal energy market constitutes a major policy goal of the European Union.[1] In this context, wholesale energy trading, on both derivative and spot markets, plays a vital role in rendering European energy markets liquid and transparent, and helps to further integrate national markets at regional and European level. In addition, energy trading serves as a key risk mitigation tool for the real economy as it allows for comprehensive price risk management and reduces overall price volatility. **While we highly welcome the exemption of physical (energy) spot contracts from the scope of the FTT, we are deeply convinced of the necessity that it should be further extended to energy derivative contracts as well.**

Impact of the FTT in the context of energy trading

If the FTT was to enter into force in its current form, it would have a major negative impact on energy markets and the real economy:

(1) Disturbances in the price formation mechanism in addition to higher trading costs would be passed on to the real economy as well as to end-consumers, and would ultimately result in higher energy prices for all.

(2) The expected significant decrease in liquidity and a loss / limitation of price signals for the real economy would not only put the efficient functioning of the energy derivative markets in existential danger but would also take away the price indication for the closely interconnected energy spot markets.

(3) Regional differences in trading costs would lead to a split of existing regional markets and would stop further market integration at regional and European level. This cost deviation would therefore undermine the policy goal of the completion of the European internal energy market.

(4) If the proposed exclusion of OTC traded derivatives from the *issuance principle* was maintained, a migration of trading away from energy exchanges towards non-regulated and less transparent OTC markets seems very likely. This would be indeed in clear opposition to the G-20 Pittsburgh commitments as well as to the very intention of the current overall EU's financial regulation review. In addition, it would clearly undermine the level playing field between exchanges and the OTC sector.

(5) Given that the present FTT proposal comprises a clear reference to the definition of financial instruments in the Markets in Financial Instruments Directive (MiFID), we believe that it is crucial to closely align the current discussion on the FTT with the on-going MiFID review. In this

[1]Cf. Conclusions of the European Council, 4 February 2011: http://register.consilium.europa.eu/pdf/en/11/st00/st00002-re01.en11.pdf

context, it is of great importance that the definition of financial instruments (as defined in Annex I Section C of MiFID II) allows for a level playing field between Regulated Markets (RMs), Multilateral Trading Facilities (MTFs) and Organised Trading Facilities (OTFs) in relation to physically settled commodity derivatives. A different treatment of OTFs is neither intended by the 2009 G-20 Pittsburgh commitments nor by MiFID itself. Hence, there should be no legislative loophole for the taxation of OTC transactions in derivatives.

(6) Central clearing would face higher costs due to the FTT double-taxation of transactions between Non-Clearing Members (NCMs) and Clearing Members (CMs) as part of the clearing transaction chain with the Central Counterparty (CCP). Given that all exchange traded contracts are automatically cleared, this would again threaten the level playing field vis-à-vis the OTC sector. The consequential migration of liquidity to non-cleared, less transparent OTC trading would ultimately result in an increase of systemic risk. This is in absolute opposition to the objectives put forward by the recently adopted European Market Infrastructure Regulation (EMIR) and again by the G-20 Pittsburgh commitments.

(7) Against the background of the exemption of companies whose financial transactions constitute less than fifty per cent of their overall average net annual turnover, anonymous trading on exchanges would be disadvantaged in comparison to OTC trading as market parties would be unable to anticipate whether the taxation applies to a specific transaction or not. IT solutions that could potentially identify the tax liability in advance would have a substantial fragmenting effect on the relevant exchange traded markets, and would lead to significant operational costs for the adaptation of existing trading systems.

(8) The commonly applied cascadation of energy derivative contracts would multiply the overall cost of the FTT for energy trading. Shortly before their expiration date, physically settled derivative contracts are automatically cascaded ('broken down') into multiple smaller contracts which translates into new taxable 'transactions' for each cascadation step. The standard cascadation of, e.g., a year contract into three month and three quarter contracts and then further down into another three month and two quarter contracts etc. would result in a multiple taxation of essentially the same contract while no actual transaction to a third party is involved.

(9) Due to lower market liquidity and eventual tax evasion efforts by individual companies, it seems very likely that specialised energy trading jobs and companies would relocate outside the FTT-zone.

➔ The very cost-benefit ratio of including energy derivatives into the scope of the FTT would be highly disproportionate vis-à-vis fairly small gains in tax revenues. **Keeping energy in for the sake of legislative homogeneity does neither outweigh the expected detrimental effects on the European internal energy market nor rising energy prices for European consumers and businesses.** Given the clearly distinguishable physical underlying of energy derivatives, a clear-cut exemption clause could be easily introduced in the legislative proposal.