



HM Revenue
& Customs

Bank Levy Review 2013

Summary of Responses

10 December 2013

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Executive Summary

The bank levy (the levy) was announced in the June 2010 Budget. The purpose of the levy is to ensure that the banking sector makes a fair contribution, which reflects the risks they pose to the financial system and the wider economy. It took effect from 1 January 2011, and the relevant legislation is included in Schedule 19 Finance Act 2011.

From the outset, consistent with its commitment to improving the tax policy making process, the Government set out an intention to review the levy in 2013 to ensure it is operating efficiently.

A consultation document was therefore published on 4 July 2013, setting out the parameters of the bank levy review and the specific issues on which the Government sought views. The review focussed on operational and compliance aspects of the levy, rather than its fundamental design. The Government believes the levy's objectives, and the consequent overarching structural features of the levy remain appropriate at this time.

Responses to the consultation indicated that the bank levy is generally operating as intended, providing the right incentives for banks to improve their funding profiles whilst minimising costs of compliance and administration. The process of understanding and implementing the levy has taken time. However, with systems and processes now in place to comply with the levy, banks generally did not favour significant operational changes.

In line with these responses, the Government has focused on changes to the bank levy that bring about real benefits in terms of simplification, fairness and alignment with regulation.

These changes, which are to be legislated in Finance Bill 2014, are as follows:

- Removal of the link between the excluded amount of protected deposits and any premium paid in respect of the deposit protection scheme.
- Deemed short term treatment of all derivative contract liabilities.
- High Quality Liquid Assets (HQLA) deduction to be given effect at the rate applicable to long term liabilities only.
- Transition the definition of Tier 1 regulatory capital to reflect the new regulatory definition arising from the Capital Requirements Directive IV (CRD IV).

- Exclude from charge certain liabilities arising from client clearing activities.
- Widening the scope of the power at paragraph 81 to include new regulatory requirements that are introduced by any EU or other legislation.

Taken together, these changes have the effect of widening the bank levy tax base and compensating to an extent for the downward revision in forecasts for future years' receipts between Budget 2013 and the 2013 Autumn Statement. To ensure that receipts meet Government targets and take account of the benefit of corporation tax cuts to the sector, the rate of the levy will also be increased to 0.156 per cent in January 2014.

Following these changes, the levy is now forecast to raise £2.7bn in 2014-15 and £2.9bn in 2015-16.

Responses to the consultation also highlighted a number of regulatory and commercial issues which may have implications for the operation of the bank levy in the short to medium term. These issues include among others: the Banking Recovery and Resolution Directive (BRRD); Basel III and CRD IV / the Capital Requirements Regulation (CRR) and the recommendations of the Independent Commission on Banking (ICB).

The regulatory landscape is evolving rapidly. For this reason it has not been possible to reflect these issues as part of the current consultation. When the impact of these regulatory changes becomes clearer, the Government will consider the implications for the bank levy's design and discuss further with stakeholders as appropriate.

1. Introduction

The Consultation Process

- 1.1 When the levy was introduced, the Government announced that it would review the design of the levy in 2013 to ensure it is operating efficiently. In line with this, a formal consultation was published in July 2013.
- 1.2 This consultation considered operational and compliance aspects of the levy particularly: simplification, removal of burdens, fairness and consistency, better targeting of risk and alignment with regulation. It also looked at improving understanding of the factors that drive balance sheets and levy revenues. Fundamental design features of the levy, for example the revenue target and £20bn allowance, were not consulted on.
- 1.3 The consultation formed Stages 1 and 2 of the Tax Consultation Framework.¹ A number of meetings were held to raise awareness of the consultation and to obtain views from a broad range of interested parties. HMRC ran an open forum event which attracted approximately 35 attendees, undertook three working groups and a number of bilateral meetings with representative bodies, advisers and banks.
- 1.4 The consultation ran for twelve weeks. Seventeen written responses were received and a final open day was held to feed back and test responses received. The Government would like to thank respondents for taking the time to submit these helpful responses, and for the input of banks, representative bodies and advisers at meetings and working groups.
- 1.5 In addition to summarising the responses received HMRC is also publishing today draft legislation, to be introduced in Finance Bill 2014. This forms stage 3 of the Tax Consultation Framework, and **HMRC welcomes further comments on these documents**. Comments should be sent to:

anthony.c.fawcett@hmrc.gsi.gov.uk or samantha.brown@hmrc.gsi.gov.uk
- 1.6 Thirty questions were asked as part of the consultation document and HMRC responses to these are set out in Chapter 2.

¹ There are five stages to the development and implementation of tax policy. Full details are set out in the Government's "Tax Consultation Framework", available at: <http://www.hmrc.gov.uk/consultations/tax-consultation-framework.pdf>

2. Responses

Objectives and overarching design

- 2.1 The purpose of the bank levy is to ensure that banks make a fair contribution, reflecting the risks they pose to the financial system and the wider economy. The levy is also designed to create appropriate incentives to contain systemic risk and encourage banks to move away from riskier funding models.
- 2.2 The Government believes these objectives remain appropriate. In light of this, the consultation document made clear that the Government believes the overarching structural features of the levy remain appropriate, and therefore was not considering any fundamental changes to these core design aspects.
- 2.3 Respondents generally agreed that the bank levy is operating effectively and is achieving its objective of incentivising stable funding. Most responses acknowledged that the current design of the levy is well understood and embedded, and also noted that banks have invested significant time and resource to comply with bank levy requirements. There was a common desire to avoid fundamental changes which would render current systems and processes redundant.
- 2.4 A number of responses noted that the forthcoming BRRD may have an impact on the levy. The draft Directive contains a carve out which will allow EU States to use existing bank levies, providing they comply with certain requirements, as mechanisms for raising a recovery and resolution fund. There was significant support for using the bank levy as a method for establishing such a fund in the UK, rather than applying an additional fee.
- 2.5 Whilst the consultation did not contain proposals in relation to the fundamental design of the levy, most respondents provided some comment about the scope of the levy and its revenue target.
- some responses suggested that the levy should charge UK banks on their UK operations, rather than their global consolidated balance sheets, to reflect the global move towards local capitalisation and regulation and the potential for the levy to impact on UK banks' competitiveness in foreign markets.
 - some respondents advocated removal of foreign banks from the scope of the levy on the basis that they would not be resolved by the UK authorities if they got into financial difficulty.
 - respondents noted an apparent tension between the bank levy's revenue target and its aim to incentivise safer balance sheets. They noted that multiple increases to the rate of the levy negatively impact on the certainty of the UK tax system.

Government response

- 2.6 The Government believes that the scope of the bank levy remains appropriate. While there remains uncertainty about the process of international bank resolution, it is important to note that the levy is not just designed to target direct risk to the UK from a taxpayer bailout but also address indirect risk and the harm that a bank's failure would cause to the UK economy.
- 2.7 From the outset, the Government has stated that it expects the levy to raise £2½ billion a year. This is an appropriate contribution in light of the possible costs related to systemic risk that balances fairness with the competitiveness of the UK banking sector. Rate increases announced since the levy was first introduced have been designed to ensure that the value of the contribution remains in line with previous expectations, and can be seen to reinforce the incentives for banks to move to safer funding profiles. They also recognise the extent of the support given to banks during the financial crisis.
- 2.8 The Government recognises that wider future regulatory changes, such as the BRRD, have the potential to impact on the operation of the levy. The Government will continue to monitor these developments, and their potential interaction with the bank levy, and discuss with stakeholders as and when appropriate.

Protected Deposits

2.9 Protected deposits are excluded from the levy charge. This exclusion has two policy objectives - to identify and remove from charge deposits which are likely to remain available to the bank in a time of stress (i.e. a stable source of funding), and also to prevent a double imposition where a deposit protection fee is charged by the FSCS or a comparable overseas scheme.

2.10 The consultation sought views on whether a change to the definition should be considered in order to address potential compliance burdens, and included the following questions.

Q1 Which definition most accurately reflects the concept of “sticky deposits”?

- All retail deposits.
- All smaller retail deposits below a certain fixed amount, say £50,000.
- All deposits protected by a deposit protection scheme – up to the scheme limit.

Q2 The Government is aware that banks may have built systems to comply with the current protected deposits rules and we would like to ensure that we do not make changes that may make these systems redundant. With that in mind, would any of the proxies for sticky deposits at Q1 above cause significant compliance burdens?

Q3 If respondents consider that retail deposits (or a proportion thereof) most accurately reflect the concept of stickiness, is it possible to arrive at a definition of “retail deposits” that would be readily applicable to all banks?

Q4 If sticky deposits continue to be defined by reference to deposit protection schemes, would removing the link to the scheme fee significantly reduce compliance burdens?

2.11 The majority of respondents agreed that protection in the form of a government guarantee or deposit protection scheme remains the best, most practical, proxy for sticky deposits. A definition based on retail deposits was thought, by most, to be arbitrary and too broad in application.

2.12 Some respondents suggested alternatives, for example a proxy based on definitions taken from the Liquidity Coverage Ratio in the CRR.² However, these suggestions, which were also explored in working group discussions, did not receive substantial support. There were widespread concerns that foreign banks would not be subject to these regulatory requirements, and therefore would have to

² Regulation (EU) No 575/2013 of the European Parliament and of the Council

carry out additional work to arrive at the numbers if they were required for levy purposes.

- 2.13 In relation to the proposal to remove the link between the excluded amount and the scheme fee, responses were mixed. Some respondents favoured this approach, agreeing that it would remove significant compliance burdens. Whilst others were concerned that adoption of this proposal would mean that the levy no longer provides a remedy for double imposition.

Government response

- 2.14 The Government believes that deposit protection remains the most robust and practical measure of stickiness and does not propose to change the basis of the exclusion.
- 2.15 However, the Government believes that simplification can be achieved by removing the link between the excluded amount and any fee paid by the bank in respect of the deposit protection scheme. This means that the excluded sum will now be the amount of the deposit that is protected by the scheme. Banks will no longer be able to exclude deposits above the level of the scheme cap, even where they pay a premium on those deposits.
- 2.16 The Government believes that this change brings the treatment of protected deposits closer in line with the policy rationale of identifying sticky deposits. When viewed from a depositor perspective, only deposits up to the scheme cap are protected and so these will be the deposits least likely to be withdrawn in the event of a crisis.
- 2.17 The amended exclusion will continue to remove from charge insured liabilities up to the level of any scheme cap. The Government believes that this is an appropriate and proportionate method for removing double imposition. The amended exclusion will also negate some of the anomalous results currently arising from the application of the bank levy rules to foreign deposit protection schemes.

Netting

2.18 The levy includes netting provisions, reflecting the fact that such netting arrangements are effective in reducing the funding risk of the bank. Operational experience is that the netting provisions have worked well, but there have been some practical issues identified with the current rules. The consultation therefore sought views on the following issues.

- Q1** Would removing the netting rules and moving to a system that charges derivative contract liabilities at a lower rate lead to a simpler, fairer and less burdensome regime?
- Q2** If not, would short term treatment of all derivative contract liabilities, for the purposes of the bank levy, simplify the netting provisions?
- Q3** With the expectation that all banks will have, or will put in place, systems and processes that can cope with the more intricate elements of the netting rules, should they remain unchanged?
- Q4** How could “common law” netting agreements which genuinely reduce risk be included in the bank levy rules, without damaging the sound principles on which they are based?

2.19 The vast majority of respondents felt that the netting provisions work well and should be retained. Generally responses indicated that netting genuinely reduces banks’ exposure and counter party risk, and should be recognised by a levy which is designed to incentivise safer funding profiles.

2.20 A small number of respondents proposed alternatives to netting, for instance a lower or staged rate applicable to the notional value of derivatives. These alternatives, also explored as part of working group discussions, met with little support from the majority who argued that gross derivative liabilities are highly variable and an inaccurate representation of risk.

2.21 Responses were split as to whether all derivatives should be treated as short term. Some respondents were content to see this change made, whilst others thought that the work required to identify maturity is commensurate to the benefit they receive. The latter group favoured no changes in this area.

2.22 A number of banks who responded noted that derivatives do not form part of their funding. Therefore, the bank levy’s behavioural incentive to hold longer term funding does not and cannot apply to derivatives.

Government response

2.23 The Government accepts that netting is an effective mechanism for reducing risk, and has therefore concluded that the bank levy’s netting provisions should remain in place. However, a change will be made to simplify the treatment of derivative

contract liabilities so that they are deemed to be always short term liabilities for levy purposes.

2.24 The Government believes that there is a clear policy rationale for this change. The vast majority of derivatives held by banks are held as trading assets, which fundamentally do not have maturity in the same way as capital assets.

2.25 Particular problems arise from identifying the maturity of derivatives because accounting standards do not require maturity analysis of derivatives held for trading. Banks' reporting systems are therefore not set up to produce these figures. The Government acknowledges that some banks have put in place systems and processes to identify maturity for bank levy purposes, however these systems will all, to a greater or lesser extent, require manual input year on year.

2.26 Every bank has approached identification of maturity differently, carrying out varying levels of work. This change will ensure fairness and put all of the population on an equal footing.

Allocation of liabilities to UK branches of foreign banks

2.27 Foreign banking groups carry on banking activities in the UK through both subsidiaries and permanent establishments (branches) of foreign banks, both of which are included within the scope of the levy.

2.28 Unlike subsidiaries, a branch's assets and liabilities are simply part of the assets and liabilities of the foreign bank. A method is therefore required to determine how much of the foreign bank's equities and liabilities should be brought within the bank levy charge. The following questions were posed in regards to this in the consultation document.

- Q1 Does the current methodology produce an advantageous result for UK branches of foreign banks? If so, what measures could be introduced to ensure fairness?**
- Q2 Do the information gathering issues that arise from the branch allocation method lead to unreasonable compliance burdens?**
- Q3 If so, how do respondents suggest that this aspect of the methodology could be improved?**
- Q4 Basing the bank levy upon the initial part of the CATA adjustment will lead to increased compliance activity in this area. Do banks feel that this will lead to excessive administrative burdens?**
- Q5 Are there ways in which the branch allocation method could be simplified so that it reduces administrative and compliance burdens, but still meets the policy aims?**
- Q6 Should UK branches of non-banking entities that form part of a foreign banking group also be included within the levy?**

2.29 Respondents noted that the method attributes a proportion of the global balance sheet liabilities, rather than looking at the specific activities undertaken by the UK branch. Several suggested this could create an advantage for UK branches of foreign banks, for example where the branch benefits from the allocation of excluded liabilities such as protected deposits, which may not relate to activities carried out in the UK. However, a number of responses also argued UK branches could be disadvantaged in situations where the UK activities are more heavily related to excluded liabilities, e.g. sovereign repos or HQLA, than the overall global balance sheet.

2.30 Some respondents therefore argued that the levy's allocation methodology should take account of particularly low or high risk activity that is carried out in the UK to a significantly greater extent than in the rest of the foreign bank. Despite this, responses showed no appetite for an alternative method based on the separate enterprise principle, whereby liabilities are allocated as if the branch were an

entirely separate, individually capitalised, entity. It was thought that a separate enterprise method would be extremely difficult to apply in practice.

- 2.31 Responses from banks currently applying the methodology by and large stated that the work required to carry out the calculation is reasonable and does not result in undue administrative burdens. It was noted that the bank levy's reliance on CATA will inevitably lead to greater compliance work in this area; banks did not feel that this was unjustified. Generally there were no specific workable suggestions made for how the methodology could be simplified.
- 2.32 The majority of respondents who commented on the final question in this section noted that there is no policy reason to treat UK branches of non-banks any differently to UK branches of banks. However, no material examples of such entities were uncovered in either written responses or oral discussions. It was also noted that there would be practical challenges in allocating liabilities to non-bank branches as they are unlikely to be required to apply CATA for corporation tax purposes.

Government response

- 2.33 The Government believes that the current method remains an appropriate and effective way of identifying the funding of a UK branch.
- 2.34 The levy is designed to target and charge riskier funding rather than riskier activities, which remain the remit of the Regulator. Therefore it is correct that funding should remain the primary target of the levy rather than the activities that are undertaken by UK branches.
- 2.35 The current allocation method recognises that it is the funding profile of the overall entity, of which the branch is only a part, which gives rise to funding risks. As a result, whatever the activities carried out by the UK branch, it will still benefit from a proportion of the total entity's funding because it is legally indistinguishable from the foreign bank. The Government believes that adaptations to the current method to take into account the riskiness of branch activities would damage the integrity of the methodology and diminish the levy's policy of targeting funding.
- 2.36 Consultation responses have highlighted that the process required to allocate the liabilities of these branches may be complex and burdensome. The Government has concluded that currently the risks do not warrant a change to the legislation in this area. However, the position will continue to be monitored as part of the normal policy making process and if necessary, changes will be made in future.

High Quality Liquid Assets (HQLA)

2.37 Responses to the July 2010 bank levy consultation noted that liabilities incurred in order to fund banks' liquidity buffers would be charged to the levy. The margin on assets within the buffer is small and it was feared that without some form of relief, the bank levy charge could make it uneconomic for banks to hold these assets, undermining an important regulatory objective. As the funding of these assets was derived from fungible sources it was not possible to identify the particular liabilities funding these assets. The deduction for HQLA was therefore included in the levy design.

Q1 Do the current HQLA rules target the correct base of assets that banks hold for liquidity purposes?

Q2 Will changes in the regulatory world cause difficulties with the current HQLA deduction method?

Q3 Would excluding the funding supporting assets held within the regulatory liquid asset buffer be a better approach and what compliance burdens would such an approach bring?

2.38 In the main, respondents acknowledged that the HQLA deduction is operating effectively. There were no respondents who suggested that identifying and excluding the funding underlying HQLA would present a better alternative to the current rules. It was noted and agreed by all that identifying the liabilities underlying HQLA would be incredibly difficult, if not impossible, due to the fungibility of the funding.

2.39 A number of respondents raised concerns regarding high quality assets that banks must hold to satisfy the requirements of a foreign regulator, which do not qualify for the PRA's liquid assets buffer and therefore do not qualify for a HQLA deduction for levy purposes. In particular, banks often hold sovereign debt issued by countries other than those listed in BIPRU 12.7. Respondents suggested that these sovereigns should qualify for the HQLA deduction where they are of sufficient quality.

2.40 Some respondents referred to the new Basel III definition of Tier 1 assets, which will be implemented in the EU via CRD IV. They noted that sovereign debt issued by any country may qualify as a Tier 1 asset, as long as the issuing country meets certain credit rating criteria. Respondents suggested that the bank levy definition of HQLA should be altered to reflect the CRD IV definition of Tier 1 assets.

2.41 It was noted by a small number of respondents that the current obligation to offset HQLA first against long term liabilities indirectly favours those banks with only short term liabilities left in charge. Effectively banks with only short term liabilities benefit from the HQLA deduction at the full rate of bank levy, whereas banks with more long term liabilities than HQLA only receive the benefit of the HQLA deduction at the half rate.

Government response

- 2.42 The HQLA deduction is broadly working as intended, and removes the pressure that the levy would otherwise impose on the margin between the income of the HQLA and the cost of the funding. No attempt will be made to require banks to identify and exclude funding liabilities underlying HQLA.
- 2.43 As noted elsewhere, the levy is intended to encourage banks to move towards safer funding models, and for this reason the design includes a reduced rate for longer-term funding. However, the review has exposed the fact that the application of the HQLA rules can create a perverse outcome, whereby banks with a reliance on short term funding benefit more from the HQLA deduction than those banks with substantial long term funding.
- 2.44 The Government has therefore concluded it is necessary to amend the rules to address this issue. Where HQLA is deducted from long term liabilities, it will be deducted at full value, however where it is deducted from short term liabilities, HQLA will be deducted at 50 per cent of its value. This will ensure that the levy continues to relieve the costs of holding assets qualifying for liquidity buffers, without creating an unacceptable narrowing in the levy base that a more generous relief would create.
- 2.45 The Government does intend to amend its definition of HQLA to reflect the new regulatory definition of Tier 1 assets being introduced by CRD IV. However, it does not intend to pre-empt the actions of the PRA, who have yet to adopt the definition of Tier 1 assets in place of the current BIPRU 12.7 rules. As such, no changes will be made in Finance Bill 2014 to the definition of HQLA.
- 2.46 However, the Government will extend the delegated power of the Treasury to make secondary legislation to reflect regulatory changes implemented by EU law. This will ensure that the Government can respond quickly to amend the bank levy rules when the PRA adopts the CRD IV definition of Tier 1 assets.

Regulatory Capital

2.47 The bank levy excludes all Tier 1 capital from charge. From the outset, the Government committed to keeping this exemption under review in light of regulatory developments, and in particular the outcome of the Basel III consultation on contingent capital.

Q1 Should the Tier One exclusion be restricted to just Common Equity Tier 1?

Q2 If the answer to Q1 is no, please explain why not.

2.48 Responses overwhelmingly favoured retaining an exclusion for all Tier 1 capital. It was argued that the loss absorbency of Additional Tier 1 (AT1) will be superior to that of the previous “hybrid” or “innovative” Tier 1 capital, which is excluded from the levy charge. It was argued that a change which resulted in AT1 falling into charge would fail to recognise the loss absorbency of this capital and would go against the grain of regulation.

2.49 Respondents did not believe that excluding AT1 from the bank levy as well as allowing a CT deduction for this form of capital would discourage banks from holding Common Equity Tier 1 (CET), the most loss absorbing form of capital. They noted that banks have no choice but to hold CET because they are required to do so for regulatory purposes.

Government response

2.50 The bank levy will continue to exclude all Tier 1 capital. However the Government has identified a need to align the bank levy definition of Tier 1 capital with the new regulatory definition resulting from CRD IV and the CRR.

2.51 As such, changes to legislation to reflect the new regulatory definition will be made in Finance Bill 2014 and will have effect from 1 January 2014. This will mean that the bank levy changes will be effective from the same date that the CRR comes into effect, ensuring that banks will not have to calculate their regulatory capital under both old and new rules.

Non-Funding Liabilities

2.52 A number of liabilities unconnected with funding are excluded from the scope of the levy. As noted in the consultation document, the Government has been made aware of a number of other non-funding liabilities which should potentially be removed from the scope of the bank levy. However, further exclusions could add complexity to the levy, and, given the revenue target, a reduction in the tax base would imply, all other things being equal, an offsetting increase in the levy rate. The consultation posed the following questions.

Q7.1 Would an exclusion for liabilities owed to HMRC in respect of VAT, PAYE and TDSI lead to unreasonable compliance burdens?

Q7.2 Should the Government consider excluding any further liabilities on the basis that they do not represent funding?

2.53 Most respondents recognised that whilst excluding liabilities to HMRC is sensible in principle, the change would not have a material impact. It was suggested that benefit of such an exclusion would not warrant the additional administrative burden.

2.54 In addition, a number of respondents noted that they would anticipate excluding additional non-funding liabilities would affect the bank levy paying population equally, and would therefore be unlikely to have any impact if offset with a corresponding rate rise.

Government response

2.55 Given the views of the respondents, the Government does not intend to make any changes in this area.

Deposits from Authorised Persons

2.56 Deposits from authorised persons are treated as either short or long term, depending on their contractual maturity. However, the Government had been made aware that a number of banks have had difficulty identifying the maturity of these deposits, and the consultation therefore asked the following.

Q1 Would treating all deposits from authorised persons as short term simplify the bank levy calculation?

2.57 A limited number of respondents commented on this issue. Those that did generally thought that banks should be given the option to carry out work to identify maturity where they found it cost effective to do so and where work is not carried out, deposits should default to short term.

2.58 Some respondents explained that the administrative burdens in this area stem from identifying which depositors are Authorised Persons. Once this classification has been carried out it is relatively straightforward to determine the maturity of the deposits.

Government response

2.59 No changes will be made to the rules on deposits from Authorised Persons.

2.60 Based on the responses received the Government does not believe that treatment of all deposits from Authorised Persons as short term liabilities would materially simplify this element of the bank levy calculation.

Collateral Upgrades and Liquidity Swaps

2.61 The consultation document noted that the levy contains certain provisions which may interact with collateral upgrades, and therefore asked the following questions.

- Q1 Do temporary exchanges of assets of unequal quality genuinely improve the liquidity of the party receiving the higher quality asset?**
- Q2 Can the same asset, in reality, improve the liquidity of one party whilst securing the liabilities of another?**
- Q3 Should short term reverse repo or swap transactions receive the same treatment as longer ones, and if not at what point in time should the position change?**

2.62 Responses provided some helpful commercial context around collateral upgrades.

2.63 These transactions generally last for at least three months to ensure that the party providing the high quality assets (often an insurer) will make sufficient return to justify the transaction. PRA rules acknowledge that an asset will improve the liquidity of a bank when it has the right to hold the asset for at least 90 days (under CRR this will change to 30 days).

2.64 Collateral upgrades could be used over shorter periods as a method of avoiding bank levy, however a very short term transaction would usually be un-commercial as the bank's counterparty would be unlikely to make a material return.

Government response

2.65 No changes will be made to the bank levy rules in respect of collateral upgrade transactions.

2.66 The bank levy contains anti-avoidance provisions and, on the basis of current evidence, the Government believes that these are sufficient to tackle any short term un-commercial transactions.

Client Clearing

2.67 The consultation document noted that regulators are encouraging banks to act as clearing members of regulated central counterparties (CCPs), to facilitate the transactions. Some banks had raised concerns that, due to the very small margins on these transactions, the levy may make this activity uneconomic, and the consultation therefore sought to explore this further.

Q1 Will central clearing be implemented materially differently in the EU and the US, if so please give details of the differences?

2.68 Responses acknowledged that, if the levy is not to contradict regulation in this area, then liabilities in respect of client collateral should be excluded from charge. It was noted that given the restrictions on the way banks can deal with the collateral provided by their clients, the liabilities cannot be used by the bank as funding and have many similarities with client money and so they should be excluded in the same way.

Government response

2.69 The Government will legislate to exclude liabilities that arise on banks' balance sheets in respect of collateral that they have passed on to a CCP authorised or recognised under European Markets Infrastructure Regulations (EMIR). This change will take effect from 1 January 2014, and be legislated in Finance Bill 2014.

2.70 This will ensure that banks are not disincentivised from acting as clearing members and will complement incoming regulation, which is designed to prevent problems in individual financial institutions from propagating to the financial system more widely.

Other Design Issues

Q1 In addition to the areas already set out, could any of the other incentives and reliefs within the bank levy be amended to better reflect the risks that banks pose?

Q2 Are there any regulatory or accounting changes on the horizon that may require definitions within the bank levy to be revised?

2.71 A number of responses noted that the forthcoming BRRD may have an impact on the levy. The Directive contains a carve out which would allow EU States to use existing bank levies, providing they comply with certain requirements, as mechanisms for raising a recovery and resolution fund. There was significant support for using the bank levy as a method for establishing such a fund in the UK, rather than applying an additional fee.

2.72 Some responses highlighted upcoming changes to the definition of Tier 1 capital and HQLA arising from CRD IV and the CRR. They explained that as the bank levy applies the current regulatory definitions of Tier 1 and HQLA, changes should be made to ensure that the levy adopts the changes and remains aligned with regulation.

Government response

2.73 The Government intends to set up a resolution financing arrangement, as prescribed by the BRRD, and will comment further on this issue once the text of the BRRD is finalised.

2.74 The Government's responses to changes in the regulatory definitions of Tier 1 capital and HQLA can be found respectively at paragraphs 2.43 and 2.36 above.

Revenue Drivers

Q1 What factors will be important in shaping banks' balance sheets over the next few years and how might these impact upon levy payments?

- 2.75 Respondents provided a lot of helpful and informative feedback in this area, offering insight into the major factors that determine banks' exposure to the bank levy.
- 2.76 Responses indicated that, since the introduction of the levy in 2011, the amount payable by banks has been affected by an increasing understanding of the levy's incentives and an enhanced ability, through improved systems and processes, to mine data to make use of these incentives. However, there is general agreement that the biggest impact on bank levy payments stems from shrinkage in banks' balance sheets, caused by regulatory and economic factors.
- 2.77 All respondents explained that it is exceptionally difficult to forecast how balance sheets will move over the next few years and most declined to comment on the position after 2016 on the basis that the picture is too uncertain.
- 2.78 Uncertainty arises from the unknown impact of certain regulatory changes and commercial developments. It was noted that the interplay between leverage ratios and risk weighted assets may constrain each bank in different ways, meaning that it is difficult to arrive at homogenised forecasts across the sector. However, most responses suggested that banks, particularly European banks, are still deleveraging, which will have an impact on the bank levy tax base.
- 2.79 A number of respondents suggested that were the bank levy to be charged on opening rather than closing balance sheets, this would remove some of the difficulty in forecasting receipts.

Government Response

- 2.80 The Government would like to thank all respondents for their contributions. We have received a significant amount of information which will be used to update and refine the bank levy forecasting methodology and assumptions. This should mean that our forecasts better reflect likely developments. However, unsurprisingly, our discussions have exposed the fact that a lot of uncertainty exists in relation to future development of bank balance sheets.
- 2.81 The Government does not intend to switch the basis for the levy from closing balance sheets to opening ones. There would inevitably be transitional costs associated with making such a change, which would also diminish the behavioural incentives deliberately built into the levy and constrain the Government's ability to change the levy rate in response to forecast changes in the yield from the levy.

3. Next steps

Draft Legislation: Finance Bill 2014

The Government has today published draft legislation, to be introduced in Finance Bill 2014. We welcome further comments on these documents.

Annexe A: List of stakeholders consulted

1. AFME (Association for Financial Markets in Europe)
2. Bank of New York Mellon
3. Barclays
4. BNP Paribas
5. British Bankers Association (BBA)
6. Building Society Association (BSA)
7. HSBC
8. ING
9. JP Morgan
10. KPMG LLP
11. Lloyds
12. Morgan Stanley
13. Pricewaterhousecoopers (PWC)
14. Societe Generale
15. Standard Chartered
16. UBS
17. Unicredit