The tiny tax with global ramifications.

Are you ready?

Industry survey 2013
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Introduction

The proposed EU Financial Transaction Tax (EU FTT) has been a source of concern and debate for the financial services industry for two years. Our survey, issued in September 2013, is designed to capture and aggregate the opinions of market participants with respect to a number of features of the proposed tax, including timing of implementation, commercial implications, the future scope of the tax and the implications for operations and technology.

The plans for EU FTT will continue to evolve during 2013 and 2014; however, we have drawn some valuable and interesting “point in time” conclusions based on the responses:

- We invited senior representatives from tax, finance, operations, risk and technology functions to participate.
- We had 46 respondents from across the financial services Industry.
- Respondents represented 12 countries from within and outside of the EU. Respondents from the EU included those from participating and non-participating Member States.
Executive summary

The findings of the survey are summarized as follows:

Scope and timing
The implementation date is expected to be 2015 at the earliest. Only one-third of respondents consider a 2014 implementation date to be possible.

The features of the proposed tax that respondents felt most likely to change included:
- Exemptions for repo transactions
- Removal of the counterparty principle
- Introduction of different rates for OTC and exchange-traded transactions.

Commercial impact
Commercial impact would be felt most acutely for the following products:
- Equity derivatives
- Stock lending/borrowing
- Repos/reverse repos

Respondents felt that the features that present the largest challenge included:
- The lack of an exemption for repo transactions
- The inclusion of the counterparty principle
- The likely implementation timeframe

The fact that respondents felt that their top two concerns related to the features of the tax they considered most likely to change suggest there is some optimism that some of the concerns raised by the industry could be addressed by the time the tax is finalized.

Effort, budget and engagement
Respondents ranked EU FTT alongside FATCA in terms of the effort that might be expended in 2014, and ahead of Dodd Frank and European Market Infrastructure Regulation (EMIR).

Over one-third of organizations, however, were not sure how much budget would be allocated to EU FTT. Nine percent of respondents expect the implementation costs to exceed £10m, much of which would be spent during 2014.

The function most engaged in EU FTT tends to be tax, closely followed by operations and middle office.

Impact on process and technology
Respondents expect front-office processes (trade execution and trade support) to be most impacted, followed by tax reporting and settlement. Client onboarding was ranked as the least impacted process, potentially reflecting an expectation that the counterparty principle might be removed.

The areas where technology solutions are most widely expected to add value include:
- Reporting
- Post-trade rules processing
- Pre-trade rules processing

Nearly one quarter of participants expressed a lack of confidence that the quality of their data would support FTT requirements.
Scope and timing

Expected compliance date
Two-thirds of respondents expect an implementation date in 2015 at the earliest.

EY commentary:
We agree that an implementation date before 2015 is highly unlikely. There are a number of factors that could lead to further delays. These include:

- The lack of a defined timeline for finalizing the tax
- The wait to form a German Government
- Legal opinions and challenges
- Clarity with respect to collection, reporting and settlement mechanisms
- Differences of opinion between certain participating Member States with respect to the final shape of the tax

When do you believe organizations will need to comply with the EU FTT directive?

<table>
<thead>
<tr>
<th>Quarter</th>
<th>2014</th>
<th>2015</th>
<th>2016</th>
</tr>
</thead>
<tbody>
<tr>
<td>Q1</td>
<td>11%</td>
<td>2%</td>
<td>4%</td>
</tr>
<tr>
<td>Q2</td>
<td>22%</td>
<td>4%</td>
<td>4%</td>
</tr>
<tr>
<td>Q3</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Q4</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

- 52% in Q1 2015
Final scope of the tax

The most expected likely changes are an exemption/dispensation for repos and removal of counterparty principle.

EY commentary:

- Given the potential implications for overnight funding, we agree that some sort of dispensation for repos is likely to be granted.
- The recently leaked Council Legal Service opinion and the UK’s challenge to EU FTT also suggest that the counterparty principle is unlikely to remain, at least not in its current form.
- Differential rates for OTC and ETD transactions would be consistent with a broader regulatory push to move transactions on to exchanges.
Commercial impact

Impact on products
The most significant impact is expected on equity derivatives, stock lending, repos and corporate bonds.

EY commentary:

- Equity derivatives are clearly within the sights of the draft Directive. However, it will be interesting to see the scope of the final draft; if the counterparty principle is removed then it seems likely that there will be a significant relocation risk for derivatives business. This is consistent with our understanding of market developments following the introduction of the Italian FTT (which also extends to equity derivatives).

- Stock lending and repos would be expected to be severely affected if an exemption/dispensation is not introduced.

- It is possible that the introduction of the EU FTT on corporate bonds could be deferred.

- We understand that government bonds seem likely to be exempted from the EU FTT following pressure from participating Member States concerned with their borrowing costs.

According to your view of the final shape of the EU FTT directive, for the products listed below please indicate the expected commercial impact:

<table>
<thead>
<tr>
<th>Product</th>
<th>1 = little or no expected impact</th>
<th>2 = little expected impact</th>
<th>3 = moderate expected impact</th>
<th>4 = significant expected impact</th>
<th>5 = significant commercial impact</th>
</tr>
</thead>
<tbody>
<tr>
<td>Equity derivatives</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>3.88</td>
</tr>
<tr>
<td>Stock lending/borrowing</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>3.71</td>
</tr>
<tr>
<td>Repos/reverse repos</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>3.65</td>
</tr>
<tr>
<td>Corporate bonds</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>3.62</td>
</tr>
<tr>
<td>Cash Equities</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>3.50</td>
</tr>
<tr>
<td>Fixed Income derivatives(Rates, FX and Credit)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>3.41</td>
</tr>
<tr>
<td>Depository receipts</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>3.17</td>
</tr>
<tr>
<td>Government bonds of participating Member States</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>3.03</td>
</tr>
<tr>
<td>Money market instruments</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>2.94</td>
</tr>
<tr>
<td>Spot FX</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>2.19</td>
</tr>
</tbody>
</table>

1 = little or no expected impact
5 = significant commercial impact
Impact of specific features of the EU FTT

The lack of an exemption for repos and the counterparty principle give the greatest causes for concern, followed by the envisaged implementation timeframe.

EY commentary:

- The fact that respondents felt that their top two concerns related to the features of the tax they considered most likely to change suggest there is some optimism that some of the concerns raised by the industry could be addressed by the time the tax is finalized.
- The implementation timeframes mentioned in the draft Directive were challenging. Organizations were also required to work to short timeframes for the implementation of the French and Italian FTT; this resulted in deployment of tactical solutions.
- If the remaining key principles were removed, the EU FTT would bear more resemblance to the French FTT and UK stamp duty, which would be easier to implement than the tax proposed in the draft Directive.
Third-party impact

The results showed that many organizations have yet to give consideration to how the EU FTT might impact third parties on which they depend.

EY commentary:

- We believe that this is an operational aspect of the EU FTT that has not yet been fully considered by the industry.
- Failure of third parties to be ready for the EU FTT could well impact the business of others. In the worst case scenario, systemic risk could be introduced if organizations are unable to transact efficiently, or if system infrastructure fails.
- We recommend that early validation of the plans and readiness of third parties forms part of the scope of work of the EU FTT implementation programs.

How many of your existing third-party service provider/vendor contracts (e.g., custodian, market data services, market infrastructure access, IT vendor and outsourcing) are likely to be impacted by the EU FTT?

<table>
<thead>
<tr>
<th>Number of Contracts</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>100+</td>
<td>38%</td>
</tr>
<tr>
<td>50-100</td>
<td>19%</td>
</tr>
<tr>
<td>20-50</td>
<td>19%</td>
</tr>
<tr>
<td>11-20</td>
<td>16%</td>
</tr>
<tr>
<td>1-10</td>
<td>6%</td>
</tr>
<tr>
<td>Don't know</td>
<td>3%</td>
</tr>
</tbody>
</table>
Effort, budget and engagement

EU FTT ranks alongside FATCA in terms of the effort that could be expended in 2014.

EY commentary:

- The ranking of the EU FTT alongside FATCA in terms of likely effort is somewhat surprising, however this could be explained by the fact that many FATCA programs are well underway and working to a July 2014 deadline. It is possible, however, that the remediation aspect of FATCA could have been overlooked.
- The challenge in implementing the EU FTT will be to identify all the relevant dependencies with other change initiatives. Smart organizations will plan strategically, and seek to avoid “digging up the road” multiple times.

Rank the following parallel initiatives (where relevant to your organization) in terms of where you believe you will expend most effort in 2014:

<table>
<thead>
<tr>
<th>Initiative</th>
<th>Relative importance</th>
</tr>
</thead>
<tbody>
<tr>
<td>EU FTT</td>
<td>7.52</td>
</tr>
<tr>
<td>FATCA</td>
<td>7.48</td>
</tr>
<tr>
<td>Dodd Frank</td>
<td>6.65</td>
</tr>
<tr>
<td>EMIR</td>
<td>5.89</td>
</tr>
<tr>
<td>Italian FTT</td>
<td>5.70</td>
</tr>
<tr>
<td>Tax transparency</td>
<td>5.63</td>
</tr>
<tr>
<td>MiFID 2</td>
<td>5.57</td>
</tr>
<tr>
<td>Basel III</td>
<td>5.13</td>
</tr>
<tr>
<td>KYC/AML</td>
<td>4.00</td>
</tr>
<tr>
<td>Legal entity rationalization</td>
<td></td>
</tr>
<tr>
<td>Recovery and resolution planing (R&amp;R)</td>
<td></td>
</tr>
</tbody>
</table>

1 = least effort, 11 = most effort
Effort, budget and engagement

Estimated budgets
Thirty-eight percent of respondents were not clear on their budget for an EU FTT solution. This is not surprising given the uncertainty around the timeframe and the scope.

EY commentary:
- The budget required in relation to the EU FTT will become clearer once the final scope and timeframe have been defined.
- Organizations are finding it hard to budget with any degree of confidence at this stage, with many assigning placeholder budgets.
- The draft Directive is silent on many of the specifics that would be required to define the solution – namely the collection and reporting mechanisms.
- Nine percent of respondents believe that the implementation costs could exceed £10m.
- We agree that complex institutions will face a significant cost of implementation, based on the number of front to back systems and processes that may need to be changed.

What do you believe you will have to budget in total for ensuring compliance with the EU FTT?

- £10m+: 38%
- £5m-£10m: 18%
- £1m-£5m: 24%
- £0.5m-£1m: 6%
- £0-£0.5m: 6%
- Don’t know: 9%
Levels of engagement

Most tax functions are fully engaged, and most other functions are engaged to some degree, other than portfolio management.

EY commentary:

- The tax function appears to be the most engaged, however we did note that 44% of our respondents were part of their organization’s tax function.
- The results confirm that in most organizations, there is widespread engagement across multiple functions.
- We agree that this is appropriate. The EU FTT has many potential implications for front, middle and back offices, and coming up with a solution for the EU FTT will require a significant team effort from multiple stakeholders.
- Organizations with the most IT engagement tended to be the global financial institutions.
Progress to date

Organizations appear to have made the most progress with respect to commercial impact assessments, however few had completed them.

What progress have you made with the following?

<table>
<thead>
<tr>
<th></th>
<th>1 = not considered</th>
<th>2 = considering</th>
<th>3 = planned</th>
<th>4 = in progress</th>
<th>5 = complete</th>
</tr>
</thead>
<tbody>
<tr>
<td>Commercial impact assessment</td>
<td>3.44</td>
<td>3.31</td>
<td>3.22</td>
<td>2.90</td>
<td>2.40</td>
</tr>
<tr>
<td>Operational impact assessment</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Lobbying</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Technology impact assessment</td>
<td></td>
<td></td>
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<td></td>
<td></td>
</tr>
<tr>
<td>Delivery/program setup</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

1 = not considered, 2 = considering, 3 = planned, 4 = in progress, 5 = complete

EY commentary:

- The results suggest that while most organizations have performed some preliminary work, few organizations have completed impact assessments.

- In most cases, the EU FTT program teams are still being mobilized. Coupled with the lack of a defined budget, uncertainty around time, scope and requirements, it is not surprising that delivery is not yet well advanced.

- We note that a few organizations have finished lobbying. We expect further lobbying to take place when more information is released with respect to the final shape of the tax.
Process and technology impact

Trade execution and trade support are the business processes expected to be most impacted, followed by reporting and settlement.

EY commentary:

- Firms are right to recognize the implications of the EU FTT on the front office.
- The lack of direction around collection and reporting is a cause for concern. We know that a number of possible collection models are under consideration and further clarity will emerge in 2014.
- While some firms cited client onboarding as an impacted process, the majority ranked it toward the bottom. This would be consistent with an expectation that the counterparty principle might be removed from the final scope.

With respect to key business processes, rank the following in the order impacted by the EU FTT:

1. Trade execution
2. Trade support
3. Tax reporting
4. Settlements/clearing
5. Asset servicing
6. Reporting (including client and regulatory)
7. Portfolio management and performance analysis
8. Product management and control
9. Sales
10. Reference data management
11. Risk, funding and liquidity management
12. Documentation management
13. Client onboarding

1 = least impact, 13 = most impact
Software vendors are starting to offer solutions for the FTT. Please tick which of the following aspects of the EU FTT you think might be best served by third-party software packages. Choose all that apply:

- Process and technology impact
- Technology solutions
- Firms thought that the areas where FTT software would most likely add value included reporting, and the processing of FTT rules post- and pre-trade.

EY commentary:
- The results are consistent with the conversations that we have held with industry participants and software vendors.
- We envisage a major challenge with respect to data sourcing due to the fragmentation we typically see in firms’ source transaction and reference data systems.
- From our conversations in the industry, most firms have chosen to wait for further clarity of requirements before investing heavily in systems. Most would agree that the tactical solutions implemented for the French and Italian FTT would not be sufficiently scalable or adaptable to address the challenges that would be presented by the EU FTT.
Process and technology impact

Data sourcing and quality

Only 20% of organizations seemed highly confident that their data quality and availability would support the EU FTT processes. More than one-third either did not have a view or lacked confidence.

EY commentary:

- We would share concerns with respect to availability and quality of data.
- It is likely that in order to process FTT rules, the existing attributes on trade files would need to be extended, and additional reference data would need to be sourced.
- Further clarity on the collection and reporting mechanism as well as the nature of any changes to the proposed tax will allow firms to better assess the size of their data challenge.

On the basis of your understanding of the EU FTT directive, how confident are you that your data quality (availability, accuracy and timeliness) is sufficient to support EU FTT-compliant processes?

- 45% 8 to 10
- 23% 5 to 7
- 19% 1 to 4
- 13% Don't know

1 = low confidence
10 = high confidence
Appendix: Knowledge gaps

The survey has highlighted a number of areas where firms are short of information, or have not yet formed conclusions.

These include:

- **Budget** – with the majority of budget cycles taking place in Q3/early Q4, and in the absence of further clarity on the shape of the tax, it is not surprising that many firms are unclear on the implementation costs of the EU FTT.

- **Data quality** – without firmer requirements, many firms cannot say for sure whether data quality and availability presents an issue.

- **Third parties** – generally the industry has not been attentive to the dependency on third parties.

Within the granular impact questions in the survey, we also noted a number of areas where respondents were unable to comment. These included:

- Thresholds for determination of FI status
- Settlement timeframes
- Implications for high-frequency trading
- Implications for depository receipts
- Implications for money-market instruments
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