

OPINION OF THE EUROPEAN CENTRAL BANK
of 2 November 2022
on the imposition of temporary levies on certain credit institutions
(CON/2022/36)

Introduction and legal basis

On 23 September 2022 the European Central Bank (ECB) received a request from the Banco de España, on behalf of the Spanish Parliament, for an opinion on a draft law on the imposition of temporary levies on operators in the energy sector, credit institutions and financial credit establishments (hereinafter the 'draft law').

The ECB's competence to deliver an opinion is based on Articles 127(4) and 282(5) of the Treaty on the Functioning of the European Union and the third and sixth indents of Article 2(1) of Council Decision 98/415/EC¹, as the draft law concerns the Banco de España, rules applicable to financial institutions insofar as they materially influence the stability of financial institutions and markets, and the ECB's tasks concerning the prudential supervision of credit institutions pursuant to Article 127(6) of the Treaty. In accordance with the first sentence of Article 17.5 of the Rules of Procedure of the European Central Bank, the Governing Council has adopted this opinion.

1. Purpose of the draft law

- 1.1 The draft law imposes an obligation on certain credit institutions and financial credit establishments, as well as operators in the energy sector, to pay temporary levies. The statement of reasons accompanying the draft law identifies the banking and energy sectors as sectors where inflation may further increase profits. However, for wages the situation is different as they are increasing below the rate of inflation, which reduces the purchasing power of households. In this regard, and in relation to the banking sector, reference is made to the Banco de España's Spring 2022 Financial Stability Report, which states that a possible increase in interest rates could have a positive impact on banks' interest margins. It is intended that the proceeds from these temporary levies should contribute to the national income pact (*pacto de rentas*) to ensure an equitable distribution of the burden of inflation across Spanish society. The national income pact is considered a key element in enabling public authorities to adopt measures to sustain the population, particularly certain vulnerable citizens, in a climate of substantial inflation.

¹ Council Decision 98/415/EC of 29 June 1998 on the consultation of the European Central Bank by national authorities regarding draft legislative provisions (OJ L 189, 3.7.1998, p. 42).

- 1.2 As concerns credit institutions and financial credit establishments, the draft law provides that credit institutions and financial credit establishments, including consolidated tax groups that encompass credit institutions and financial credit establishments ('affected credit and financial institutions'), whose total reported interest income and commission income for 2019 equals or exceeds EUR 800 million, are required to pay a temporary levy². For the affected credit and financial institutions, the levy would be paid in 2023 and 2024. The amount of the temporary levy is 4.8 % of the sum of the net interest income and the net fees and commission income shown in the relevant institution's profit and loss account corresponding to the calendar year prior to the date on which the obligation to pay arises.
- 1.3 The obligation imposed by the draft law arises on the first day of the relevant calendar years. Without prejudice to an advance payment to be made during the first twenty calendar days of February, which amounts to 50 % of the total levy for the given year, the levy must be paid in full by the end of the twentieth calendar day of September.
- 1.4 The draft law provides that the amount of the temporary levy and its advance payment will not have any direct or indirect financial impact, meaning that the levy may not be passed on to the clients of the affected credit and financial institutions. A breach of this requirement is considered a serious infringement subject to a proportional pecuniary fine of 150 % of the amount passed on to the institution's clients. The Comisión Nacional de los Mercados y la Competencia (National Markets and Competition Commission, CNMC) is responsible for ensuring compliance with this obligation, without prejudice to the competences of the Banco de España and its duty to cooperate in this respect.
- 1.5 The proceeds from the temporary levy are to be paid to the State Treasury.

2. Monetary policy context

- 2.1 The current surge in euro area inflation in relation to the Harmonised Index of Consumer Prices has reached record levels and poses significant challenges for the conduct of monetary policy. Energy price inflation continues to be the dominant component of overall inflation. However, inflation has become broad-based. In view of these developments, and guided by the ECB's primary objective to maintain price stability over the medium term³, determined action has been taken to ensure a timely return of inflation to the target of 2 %. Net purchases of assets have ended, policy rates have been raised, and further rate increases are expected along this normalisation path, with the intention of dampening demand and guarding against the risk of a persistent upward shift in inflation expectations.
- 2.2 As the normalisation of the ECB's monetary policy continues, it is important to recall that monetary policy operations always have distributional implications. Naturally, they have effects on incomes and the profitability of credit institutions. From a monetary policy perspective, credit institutions play

² Affected credit and financial institutions with a total reported interest income and commission income lower than EUR 800 million for 2019 are exempt from paying the temporary levy.

³ See Article 127(1) of the Treaty.

a special role for ensuring the smooth transmission of monetary policy measures to the wider economy. In this context, an adequate capital position helps credit institutions to avoid abrupt adjustments to their lending to the real economy.

Evidence shows that net interest income typically tends to expand on impact as policy rates increase, and this effect is higher the lower the weight of long-term loans and, among these, the lower the proportion of fixed interest rate operations. However, this effect can be offset by lower lending volumes, by losses recorded in the securities portfolio and by an increase in provisions resulting from a deterioration of the quality of the credit portfolio. The realisation of downside risks in the current environment may significantly reduce the repayment capacity of debtors. The net effect of monetary policy normalisation on bank profitability might therefore be less positive, or even negative, possibly over an extended horizon. As the determination of the addressees of the temporary levy is based on total reported interest and fee commission income in 2019, it may be that these institutions record low profits or losses at the point in time when the levy will actually be collected. If the ability of credit institutions to attain adequate capital positions is damaged, this could endanger a smooth bank-based transmission of monetary policy measures to the wider economy.

- 2.3 The strong rise of energy prices is reducing the incomes of households and companies with diverse implications for different sectors and activities. Low-income households are hit harder as they typically spend a higher proportion of their budget on energy-related goods. Concerns about an equitable income and profit distribution need to be addressed by appropriate fiscal measures. From a monetary policy perspective, these measures – depending on their design – may entail different implications for macroeconomic stabilisation and sustainability. For a good policy mix, fiscal support measures to cushion the impact of higher energy prices should be temporary and targeted at the most vulnerable households and companies to limit the risk of fuelling inflationary pressures, to enhance the efficiency of public spending and to preserve debt sustainability.

3. Financial stability context

- 3.1 The ECB has previously opined on draft legislation introducing levies for credit institutions in several Member States⁴. In this respect the ECB has stated that it would be undesirable to use the proceeds from taxes levied against credit institutions for general budgetary purposes if and to the extent that doing so would make credit institutions less resilient to economic shocks and, as a result, limit their ability to provide credit, pushing them to offer less favourable terms to customers when providing loans and other services and reducing certain activities. This would create uncertainty and adversely affect real economic growth⁵. In line with these considerations, the ECB has recommended in the past that a clear separation is necessary between the extraordinary account created out of the levy proceeds and the general budgetary resources of a government to avoid their use for general fiscal consolidation purposes⁶.

⁴ See Opinion CON/2020/28, Opinion CON/2019/44, Opinion CON/2019/40, Opinion CON/2019/18 and Opinion CON/2016/1. All ECB opinions are published on EUR-Lex.

⁵ See paragraph 2.1 of Opinion CON/2011/29 and paragraph 3.2.1 of Opinion CON/2010/62

⁶ See paragraph 2.1 of Opinion CON/2019/40 and paragraph 3.2.2 of Opinion CON/2010/62.

- 3.2 Imposing any ad hoc taxes or levies on credit institutions for general budgetary purposes should be preceded by a thorough analysis of potential negative consequences for the banking sector to ensure that such taxes do not pose risks to financial stability, banking sector resilience and to the provision of credit, which could eventually adversely affect real economic growth. Hence, the levy should be carefully considered with regard to its impact on the profitability of affected credit institutions, and thereby on their internal capital generation and lending.
- 3.3 Furthermore, in the event that an affected credit institution might qualify as a temporary levy payer while it is recording net losses, such a situation would be significantly distorting and would further damage the resilience of a loss-making bank. Moreover, the application of the levy only to certain Spanish credit institutions could distort market competition and impair the level playing field both within the country and across the banking union.
- 3.4 In light of the above, the ECB recommends that the legislative proposal be accompanied by a thorough analysis of potential negative consequences for the banking sector, detailing in particular the specific impact of the temporary levy on the profitability of the affected credit and financial institutions and on the competition conditions in the market to ensure that its application does not pose risks to financial stability, banking sector resilience and the provision of credit. This request is particularly relevant in the current economic and financial environment, which features high uncertainty, and credit institutions' loan loss provisions are expected to increase due to a foreseen marked slow-down in real economic activity⁷. In this context, it should be taken into consideration that credit institutions have already had to record higher provisions with respect to their exposure to non-financial corporates active in high energy-intensive sectors⁸.

4. Considerations relating to the prudential supervision of credit institutions

- 4.1 The ECB understands that the temporary levy would, as a practical matter, only apply to credit institutions directly supervised by the ECB within the framework of the Single Supervisory Mechanism (SSM).
- 4.2 The basis on which the temporary levy would be established does not take into consideration the full business cycle and does not include, inter alia, operational expenses and the cost of credit risk. As a result, as already stated, the amount of the temporary levy might not be commensurate with the profitability of a credit institution. Thus, as a result of the general application of the temporary levy, credit institutions that are not necessarily benefitting from current market conditions could become less able to absorb the potential downside risks of an economic downturn.
- 4.3 A generic provision stating that the temporary levy may not be passed on to the clients of credit institutions might generate uncertainty, as well as related operational and reputational risks for those institutions. It is appropriate to clarify that increases in prices to be applicable to customers

⁷ The Banco de España's Spring 2022 Financial Stability Report not only identified the effect of higher rate scenarios on net interest income, but also explored the net effects on profitability and solvency of the overall, potentially adverse scenarios, in which those rises can take place. These net effects can be negative if the scenarios are adverse enough. See pp. 89-90 and 105-108.

⁸ On this topic see for example, speech by Governor Pablo Hernandez de Cos (2022), "The Spanish banking industry and the economic challenges ahead", *Meeting with the Spanish Financial Press Association / Menéndez Pelayo*.

due to: (i) increases in costs other than the temporary levy, such as operational, funding and capital costs; (ii) increases in costs relating to covering risks; and (iii) adjustments of commercial margins, are all legitimate increases. Moreover, the ECB generally expects credit institutions, in accordance with international best practices, to consider and reflect in loan pricing all relevant costs, including tax considerations, when relevant⁹. In addition, it should be clarified which verification mechanisms will be implemented by the CNMC to ensure compliance with this requirement. Considering all the different circumstances that may cause an increase in prices in the current context of interest rate rises, inflation or deteriorating risk premia, it appears to be difficult to differentiate whether the temporary levy would actually be passed on to clients or not.

5. Miscellaneous

- 5.1 There is a discrepancy between the wording used in the draft law in order to establish the criterion to determine those credit and financial institutions affected by the temporary levy, which makes reference to “the total interest income and commission income, as determined in accordance with the applicable accounting legislation”¹⁰, and the wording for determining the base to which the 4.8 % temporary levy is applied, which refers to “the sum of the interest margin and commission income and expenses shown in its profits and loss account for the preceding calendar year”¹¹. In this respect, and as concerns the determination of the base to which the temporary levy is applied, the ECB understands that the temporary levy is applicable to the net interest income and net fee and commission income. A clearer terminology in the final text in the criterion to determine the affected credit and financial institutions for the purpose of legal certainty may be desirable in this context.
- 5.2 It is not clear what the cooperation role of the Banco de España will be as regards ensuring compliance by credit institutions with the requirement established in the draft law of not passing on the amount of the temporary levy to their clients. In this respect, the ECB underlines that this matter could be further clarified, in particular, that this does not amount to the conferral of any new task on the Banco de España.

This opinion will be published on EUR-Lex.

⁹ For instance, EBA/GL/2020/06, Guidelines on loan origination and monitoring, states as follows in paragraph 202 (e): *“Institutions should consider, and reflect in loan pricing, all relevant costs until the next repricing date or maturity, including, among others, any other real costs associated with the loan in question, including tax considerations, when relevant”*.

¹⁰ Article 2.1 of the draft law.

¹¹ Article 2.4 of the draft law.

Done at Frankfurt am Main, 2 November 2022.

[signed]

The President of the ECB

Christine LAGARDE