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OPINION OF THE EUROPEAN CENTRAL BANK

of 15 December 2023

on the imposition of a tax on credit institutions

(CON/2023/45)

Introduction and legal basis

On 6 November 2023 the European Central Bank (ECB) received a request from the Dutch Ministry of Finance for an opinion on a proposal of the Dutch House of Representatives to amend certain provisions of the Law on bank tax (hereinafter the 'draft proposal').

The ECB's competence to deliver an opinion is based on Article 127(4), second paragraph, and Article 282(5) of the Treaty on the Functioning of the European Union, as the draft proposal relates to the European System of Central Banks' task to contribute to the smooth conduct of policies relating to the stability of the financial system pursuant to Article 127(5) of the Treaty 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 proposal

1.1 The draft proposal proposes to amend the Law on bank tax, which was introduced in 2012 and imposed a tax applicable to credit institutions with activities in the Netherlands. According to the explanatory memorandum to the Law on bank tax, the tax was imposed after the financial crisis in order to put a price tag on the implicit State guarantee that the Dutch government provides to credit institutions in the Netherlands. To a lesser extent, by taxing certain parts of a credit institution's balance sheet, the original aim of the Law on bank tax was to discourage credit institutions from financing activities using unsecured debts. Finally, the Law on bank tax was intended to counteract perverse incentives within a board's remuneration policies.

1.2 Under the Law on bank tax, the tax is levied on the balance sheet total resulting from the credit institution's commercial annual accounts. However, certain elements of that balance sheet total are exempt from the taxable amount. Regulatory capital, deposits covered by the national deposit guarantee scheme (DGS) and liabilities related to the business of insurer are not counted. The remaining debts on the balance sheet are only taxed to the extent that they exceed a minimum threshold of EUR 23.5 billion (the 'efficiency exemption').

1.3 Under the Law on bank tax, the amount of the tax comprises the sum of: (1) 0.044 % of the part of the taxable amount (balance sheet total after the deductions of regulatory capital, DGS covered deposits, insurance business liabilities and the efficiency exemption) obtained by multiplying the taxable amount by A/B, where A is the total amount of the debts on the balance sheet or consolidated balance sheet to be taken into account that have a term of less than one year and B is the total amount of all debts on that balance sheet or consolidated balance sheet, and (2) 0.022 % on the remaining part of the taxable amount.

1.4 Under the draft proposal the amount of the tax would be raised from 0.044 % to 0.058 % of the taxable amount set out under point (1) in paragraph 1.3 of this opinion and from 0.022 % to 0.029 % of the remaining taxable amount under point (2) in paragraph 1.3 of this opinion.

1.5 According to the Ministry of Finance, the Law on bank tax in its existing form raises approximately EUR 470 million per year. Under the draft proposal, the tax would be increased by EUR 150 million in aggregate per year.

1.6 As noted in the draft proposal, the amendment aims to structurally cover part of the costs of raising the social minimum of households, for instance by increasing the minimum wage.

2. General observations

2.1 The ECB recently adopted opinions on a draft Slovenian law on the imposition of a temporary tax on credit institutions[1], a draft Italian law on the imposition of an extraordinary tax on credit institutions[2], a draft Lithuanian law establishing a temporary solidarity contribution applicable to credit institutions[3] and a draft Spanish law on the imposition of temporary levies on operators in the energy sector, credit institutions and financial credit establishments[4]. In these opinions, the ECB considered legislative initiatives introducing temporary levies and taxes from the monetary policy, financial stability and prudential supervision perspectives.

2.2 The ECB was not consulted on the adoption of the Law on bank tax. Therefore, this opinion considers the draft proposal in conjunction with the Law on bank tax.

3. Monetary policy context

3.1 The euro area inflation rate reached record levels over the course of 2022 and posed significant challenges for the conduct of monetary policy. Guided by its primary objective of maintaining price stability[5], the ECB has taken determined action to ensure a timely return of inflation to its medium-term 2 % target. Key ECB policy rates have been raised by a cumulative 450 basis points between July 2022 and September 2023, with the intention of decreasing demand and guarding against the risk of a persistent upward shift in inflation expectations. In parallel, net purchases of assets have ended, the asset purchase programme’s portfolio is declining at a measured and predictable pace, and the ECB stands ready to adjust all instruments within its mandate to ensure that inflation returns

1 See Opinion CON/2023/35. All ECB opinions are published on EUR-Lex.
2 See Opinion CON/2023/26.
3 See Opinion CON/2023/9.
4 See Opinion CON/2022/36.
5 See Article 127(1) of the Treaty.

to the ECB's medium-term target and to preserve the smooth functioning of monetary policy transmission[6].

3.2 As key ECB interest rates will remain at sufficiently restrictive levels for as long as is necessary to achieve a timely return of inflation to the 2 % medium-term target, it is important to keep in mind that monetary policy decisions always have some distributional implications. In particular, they have effects on incomes and the profitability of credit institutions. From a monetary policy perspective, credit institutions play a special role in ensuring the smooth transmission of monetary policy measures to the wider economy. In this context maintaining an adequate capital position helps credit institutions to avoid abrupt adjustments to their lending to the real economy[7].

3.3 Evidence shows that net interest income typically expands on impact as policy rates increase. This effect is faster the greater the weight of short-term or variable interest rate loans on the asset side of banks' balance sheets. However, as the tightening cycle proceeds, this positive income effect can be offset by lower lending volumes, a higher cost of funding, losses recorded in the securities portfolio and an increase in provisions resulting from potential 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 and translate into lower bank profitability. The net effect of tighter monetary policy on bank profitability when measured across the policy cycle may therefore be less positive, or even negative, over an extended horizon[8].

3.4 More generally, caution must be taken to ensure that the tax does not impact the ability of individual credit institutions to build strong capital bases, adequately provide for increased impairments and deterioration in credit quality. While the ECB notes that regulatory capital is exempt from this tax, curtailing the ability of credit institutions to maintain adequate capital positions or to prudently build provisions against the backdrop of a possible downturn in credit quality could endanger a smooth bank-based transmission of monetary policy measures to the wider economy.

3.5 The ECB also takes note of the fact that the tax is levied on the total bank balance sheet less some specific deductions. Caution must be taken so that such a tax base does not incentivise credit institutions to contract their balance sheet by reducing their lending activity beyond what would be warranted from a monetary policy perspective[9]. Moreover, the incentive scheme embedded in the tax risks reducing the remuneration of shorter-term deposits that are not covered by the DGS as these are subject to a higher tax rate. This distorts the competitive pressures that are an integral part of the impact of the transmission of the tightened monetary policy on composite deposit rates and broader financing conditions.

4. Financial stability context

4.1 The ECB has previously opined on draft legislation introducing taxes applicable to credit institutions in several Member States[10]. It has, in this respect, underscored in general that imposing a special

6 See paragraph 2.1 of Opinion CON/2023/9.

7 See paragraph 2.2 of Opinion CON/2022/36 and paragraph 2.2 of Opinion CON/2023/9.

8 See paragraph 3.4 of Opinion CON/2023/26 and paragraph 3.4 of Opinion CON/2023/35.

9 See paragraph 3.5 of Opinion CON/2023/35.

10 See Opinions CON/2016/1, CON/2019/18, CON/2019/40, CON/2019/44, CON/2020/28 and CON/2023/26.

tax on the banking sector could make it more difficult for credit institutions to build up additional capital buffers, as their retained earnings will be reduced, making them less resilient to economic shocks. In effect, such taxes could have negative economic effects by limiting credit institutions' ability to provide credit, contributing to less favourable terms for customers when providing loans and other services. It is essential that credit institutions have a sound capital base for them to fulfil their role as credit intermediaries within the economy. Higher costs and reduced credit supply, or higher costs of other banking services, can adversely affect real economic growth[11].

4.2 Higher net interest income of credit institutions can initially ensue as interest rates increase. But increasing interest rates can also contribute to a higher cost of funding and eventual losses on outstanding bank securities portfolios. Moreover, in a long-term perspective, higher interest rates may negatively impact borrowers' financial situations, thereby increasing credit risk and reducing bank profitability. As the tax is calculated on certain parts of the balance sheet total and not on net profits, it also applies to credit institutions that are recording net losses, further damaging their resilience[12]. In that regard, the tax may put additional pressure on banks' capacity to maintain a solid capital position or to rebuild buffers in an environment in which profits are lower and (credit) losses occur. These different factors should be properly evaluated in order to ensure that credit institutions remain well positioned to absorb potential future losses[13].

4.3 The tax may lead to fragmentation in the European financial system because of the heterogeneous nature of such taxes for the banking sector. The risk of double taxation for credit institutions in other jurisdictions where a special bank tax is also levied may be a further source of such fragmentation.

4.4 A structural increase of the tax is at odds with the developments since it was originally imposed. As noted in paragraph 1.1, the tax was originally imposed to put a price tag on the implicit State guarantee that the Dutch government provides to credit institutions in the Netherlands. Although this implicit guarantee might still exist, as demonstrated by the evaluation of the tax that took place in 2021, its scope has been limited by, inter alia, the establishment of the resolution scheme, the creation of the Single Resolution Fund, and the phase-in of buffers for systemically important institutions[14].

4.5 In the light of the above, the ECB recommends that, in order to assess whether its application poses risks to financial stability, and in particular whether it has the potential to impair the banking sector's resilience and cause market distortion, the draft proposal should be accompanied by a thorough analysis of potential negative consequences for the banking sector[15]. This analysis should set out in detail, the specific impact of the tax on credit institutions' longer-term profitability and capital base,

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11 See paragraph 3.2.1 of Opinion CON/2010/62, paragraph 2.1 of Opinion CON/2011/29, paragraph 3.1 of Opinion CON/2022/36, paragraph 3.1 of Opinion CON/2023/9 and paragraph 4.1 of Opinion CON/2023/26.

12 See paragraph 3.3 of Opinion CON/2022/36.

13 See paragraph 3.2 of Opinion CON/2023/9 and paragraph 4.3 of Opinion CON/2023/26.

14 See the letter and in particular attachment 1 sent to the parliament on 11 November 2021 by the Dutch Ministry of Finance, available on the website of the Government of the Netherlands at www.government.nl. See also Financial Stability Board (2021), 'Evaluation of the Effects of Too-Big-To-Fail Reforms', available on the Financial Stability Board's website at www.fsb.org.

15 See paragraph 3.4 of Opinion CON/2022/36, paragraph 3.7 of Opinion CON/2023/9 and paragraph 4.6 of Opinion CON/2023/26.

access to funding and the provision of new lending and competition conditions in the market, and its potential impact on liquidity.

5. Considerations relating to the prudential supervision of credit institutions

5.1 The ECB understands that the higher tax percentage envisaged by the draft proposal will in practice, as is the case for the Law on bank tax in its existing form, currently apply only to significant institutions directly supervised by the ECB[16] given the impact of the efficiency exemption on the calculation of the tax.

5.2 The basis on which the tax 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 stated above. As a result, the amount of the tax might not be commensurate with the longer-term profitability of a credit institution and its capital generation capacity. As a result of the general application of the tax, credit institutions that have lower solvency positions or have challenging capital projections could become less able to absorb the potential downside risks of an economic downturn. As noted in the ECB's press release of 28 July 2023 on the 2023 stress test[17], improved capital position was a key factor in helping banks stay resilient amidst highly adverse conditions.

This opinion will be published on EUR-Lex.

Done at Frankfurt am Main, 15 December 2023.

[signed]

The President of the ECB

Christine LAGARDE

16 In the meaning of Article 6(4), third paragraph, of Council Regulation (EU) No 1024/2013 of 15 October 2013 conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions (OJ L 287, 29.10.2013, p. 63).

17 Available on the ECB's banking supervision website at www.bankingsupervision.europa.eu.