EUROPEAN CENTRAL BANK
EUROSYSTEM

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OPINION OF THE EUROPEAN CENTRAL BANK

of 14 February 2024

on a special levy for credit institutions

(CON/2024/4)

Introduction and legal basis

On 19 December 2023 the National Council of the Slovak Republic adopted Law No 530/2023 which amends and supplements several laws in relation to improving the state of public finances[1] (hereinafter the 'adopted law'). The European Central Bank (ECB) has not been consulted by the Slovak authorities on the adopted law.

The ECB has decided to deliver an own initiative opinion on the adopted law. 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 adopted law 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 adopted law

1.1 The adopted law amended and supplemented Law No 235/2012 on a special levy on business in regulated industries[2] (hereinafter 'Law No 235/2012'). In particular, the adopted law expanded the scope of regulated persons that are to be subject to a special levy to include persons or branches of foreign persons that are authorised to perform activities based on an authorisation issued or granted by Národná banka Slovenska (NBS). Considering this new broader scope of regulated persons subject to Law No 235/2012, the adopted law introduced a special levy with respect to credit institutions authorised by the NBS or in other European Economic Area Member States.

1.2 The monthly special levy for credit institutions is computed by multiplying the levy base by the levy rate. The levy base for the special levy is the gross profit reported for the accounting period in which the regulated person is authorised to carry out regulated activities multiplied by a coefficient representing a ratio between the revenue from regulated activities and the total revenue belonging to the accounting period for which the reported economic result was used for the calculation of the

1 Zákon č. 530/2023 Z.z. z 19. decembra 2023, ktorým sa menia a dopĺňajú niektoré zákony v súvislosti so zlepšením stavu verejných financií.

2 Zákon č. 235/2012 Z.z. z 26. júla 2012, o osobitnom odvode z podnikania v regulovaných odvetviach a o zmene a doplnení niektorých zákonov v znení neskorších predpisov.

levy[3]. The levy rate introduced for credit institutions equals 0.025 for the accounting period starting after 31 December 2023, 0.0208 for the accounting period starting after 31 December 2024, 0.0167 for the accounting period starting after 31 December 2025, 0.0125 for the accounting period starting after 31 December 2026, and 0.00363 for the accounting periods starting after 31 December 2027.

1.3 The explanatory memorandum that accompanied the adopted law when it was presented to the National Council of the Slovak Republic sets out the Ministry of Finance's view that the special levy on credit institutions will, on a net basis[4],increase the income of the public budget by EUR 335,600,000 in 2024, EUR 281,300,000 in 2025 and EUR 237,900,000 in 2026.

1.4 According to the explanatory memorandum, developments in the European economy, the increase in interest rates by the ECB and other measures created the conditions for increased profitability in the banking sector, with the expectation that such higher profitability would be maintained. The explanatory memorandum identified credit institutions as market participants with high profits and thus with a higher potential to be taxed compared to entities in other regulated sectors. The explanatory memorandum considered the profits in the banking sector as excessive, as these profits did not result from credit institutions' business activities, but rather from unexpected developments in financial markets which allowed credit institutions to have higher profitability than other entrepreneurs. The explanatory memorandum considered that this anomaly allowed the State to adopt measures to establish equilibrium so that credit institutions would bear a higher tax burden and thus, based on tax solidarity, contribute to an improvement to public finances. Overall, in view of the higher profitability of credit institutions caused by developments in interest rates, the explanatory memorandum did not consider the proposed tax burden as excessive, but rather reflected the aim of achieving a fair balance between the public interest and impacted legal persons.

1.5 Finally, the explanatory memorandum noted that the increased profitability of credit institutions also contributed to the adoption of restrictive tax measures in other Member States, such as Hungary, Czechia, Spain, Lithuania, Italy and Sweden, and also in the United Kingdom, while noting Slovenia's plans to introduce increased taxation of credit institutions.

2. General observations

2.1 The ECB understands that the special levy imposed on credit institutions translates into an additional taxation of gross profits at an annual rate of 30 % in 2024, 24.96 % in 2025, 20.04 % in 2026, 15 % in 2027, and 4.356 % in 2028 and in the following years. The ECB also understands that the current income tax applicable to legal persons in Slovakia is 21 % and that the payment of the special levy partially decreases payments under income tax[5], which translates into an effective tax burden applicable to credit institutions amounting to 44.7 % in 2024, 40.7 % in 2025, 36.8 % in 2026, 32.9 % in 2027 and 24.4 % in 2028, respectively.

3 The ECB understands that the coefficient for credit institutions is likely to equal one or be close to one.

4 The explanatory memorandum explains that the special levy will decrease the tax basis for the income tax of legal persons and thus the fiscal benefit of the special levy will be partially offset by lower income from corporate taxes.

5 See footnote 4.

2.2 The ECB recently adopted opinions on a draft Dutch law on the imposition of a tax on credit institutions[6], a draft Slovenian law on the imposition of a temporary tax on credit institutions[7], a draft Italian law on the imposition of an extraordinary tax on credit institutions[8], a draft Lithuanian law establishing a temporary solidarity contribution applicable to credit institutions[9] and a draft Spanish law on the imposition of temporary levies on operators in the energy sector, credit institutions and financial credit establishments[10]. In these opinions, the ECB considered legislative initiatives introducing temporary levies and taxes from the monetary policy, financial stability and prudential supervision perspectives.

2.3 The ECB has been consulted by the Slovakian Ministry of Finance on six occasions from 2011 to 2020 on draft laws introducing, amending and abolishing a special levy on financial institutions, including credit institutions, operating in Slovakia. The ECB has adopted opinions in response to five of these consultation requests[11].

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[12], the ECB has taken determined action to ensure a timely return of inflation to its medium-term 2 % target. Key ECB policy rates were 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, the pandemic emergency purchase programme's portfolio is intended to be reduced starting from the second half of 2024, and the ECB remains ready to adjust all instruments within its mandate to ensure that inflation returns to the ECB's medium-term target and to preserve the smooth functioning of monetary policy transmission[13].

3.2 As key ECB interest rates will be set at sufficiently restrictive levels for as long as necessary to ensure 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[14].

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6 See Opinion CON/2023/45. All ECB opinions are published on EUR-Lex.
7 See Opinion CON/2023/35.
8 See Opinion CON/2023/26.
9 See Opinion CON/2023/9.
10 See Opinion CON/2022/36.
11 See Opinions CON/2011/66, CON/2012/53, CON/2015/43, CON/2019/40 and CON/2020/28.
12 See Article 127(1) of the Treaty.
13 See paragraph 2.1 of Opinion CON/2023/9 and paragraph 3.1 of Opinion CON/2023/45.
14 See paragraph 2.2 of Opinion CON/2022/36, paragraph 2.2 of Opinion CON/2023/9 and paragraph 3.2 of Opinion CON/2023/45.

3.3 Evidence shows that net interest income of credit institutions typically expands 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[15].

3.4 Thus, with respect to the special levy introduced by the adopted law, and, while it is acknowledged that the decrease of the special levy over time mitigates the effects of this additional burden on credit institutions over time, the risks to economic growth, and therefore to the overall position of credit institutions, remain tilted to the downside.

3.5 More generally, a cautious approach must be taken to ensure that the special levy does not impact the ability of individual credit institutions to build strong capital bases, to adequately provide for increased impairments and deterioration in credit quality. 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.

4. Financial stability context

4.1 The ECB has previously opined on draft legislation introducing taxes applicable to credit institutions in several Member States[16]. It has, in this respect, underscored that imposing a special 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 so that they can fulfil their role as credit intermediaries. Higher costs and reduced credit supply, or higher costs of other banking services, can adversely affect real economic growth[17].

4.2 As noted in paragraph 3, 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. In that regard, taxes applicable to credit institutions may put

15 See paragraph 3.4 of Opinion CON/2023/26, paragraph 3.4 of Opinion CON/2023/35 and paragraph 3.3 of Opinion CON/2023/45.

16 See Opinions CON/2016/1, CON/2019/18, CON/2019/40, CON/2019/44, CON/2020/28, CON/2023/26 and CON/2023/45.

17 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, paragraph 4.1 of Opinion CON/2023/26 and paragraph 4.1 of Opinion CON/2023/45.

additional pressure on their capacity to maintain a solid capital position or to rebuild buffers in an environment in which profits are lower and (credit) losses may occur. These different factors should be properly evaluated in order to ensure that credit institutions remain well positioned to absorb potential future losses[18].

4.3 The introduction of taxes applicable to credit institutions may lead to fragmentation in the European financial system because of the heterogeneous nature of such taxes across Member States. 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 In the light of the above, the ECB is of the view that the adopted law should have been accompanied by a thorough analysis of potential negative consequences for the banking sector in order to assess whether it poses risks to financial stability, and in particular its potential to impair the banking sector's resilience and cause market distortion[19]. The ECB acknowledges that the special levy is based on gross profits and decreases over the five-year period between 2024 and 2028 to more sustainable levels. The ECB considers these elements of the adopted law crucial for financial stability, as keeping special levy rates at such high levels could seriously hamper the longer-term capital generation capacity of credit institutions. The ECB has also previously recommended a clear separation of the proceeds of special levies, similar to the adopted law, from the general budgetary resources of a government to avoid their use for general fiscal consolidation purposes[20].

5. Considerations relating to the prudential supervision of credit institutions

5.1 The ECB understands that the special levy applies to all credit institutions, including significant institutions directly supervised by the ECB[21].

5.2 As pointed out above, the special levy does not seem to fully take into consideration the full business cycle. Thus, the amount of the tax might not be commensurate with the longer-term profitability of a credit institution and its capital generation capacity. Also, as a result of the general application of the tax to the banking sector, 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[22], an improved capital position was a key factor in helping banks stay resilient amidst highly adverse conditions.

18 See paragraph 3.2 of Opinion CON/2023/9, paragraph 4.3 of Opinion CON/2023/26 and paragraph 4.2 of Opinion CON/2023/45.

19 See paragraph 3.4 of Opinion CON/2022/36, paragraph 3.7 of Opinion CON/2023/9, paragraph 4.6 of Opinion CON/2023/26 and paragraph 4.5 of Opinion CON/2023/45.

20 See paragraph 3.1 of Opinion CON/2022/36 and paragraph 3.4 of Opinion CON/2023/9.

21 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).

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

This opinion will be published on EUR-Lex.

Done at Frankfurt am Main, 14 February 2024.

[signed]

The President of the ECB

Christine LAGARDE