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German Bank Levy
Federal Government Issues Restructuring Fund Regulation

The German Restructuring Act (*Restrukturierungsgesetz*) was approved by the German upper house (*Bundesrat*) on November 26, 2010, and announced in the Federal Law Gazette on December 14, 2010.

The Restructuring Act sets out a regulatory framework for the organized restructuring and reorganization of distressed German banks. It also includes a Restructuring Fund Act (*Restrukturierungsfondsgesetz*) providing for a EUR 70bn bailout fund that will be financed by a levy imposed on credit institutions. Parts of the new legislation came into effect in December 2010 and the remainder entered into force on January 1, 2011. Various details regarding the assessment base and assessment rate of the bank levy are to be determined by a regulation (Restructuring Fund Regulation; *Restrukturierungsfonds-Verordnung*). A government draft of such regulation was issued on March 2, 2011. The government draft still needs to be approved by the German Federal Parliament and the German Federal Council.

I. Design of the Bank Levy

The bank levy serves as a funding mechanism for a newly established Restructuring Fund (*Restrukturierungsfonds*) to be managed by the Federal Agency for Financial Market Stability (*Bundesanstalt für Finanzmarktstabilisierung*, FMSA), which again is supervised by the German Federal Ministry of Finance (*Bundesministerium der Finanzen*, BMF). In general, banks are obliged to contribute annually to the Restructuring Fund (due date: September 30). The money accrued in the Restructuring Fund will be used by the FMSA to overcome future crises of German banks and to cover the Restructuring Fund's administrative costs. For this purpose, the Restructuring Fund may, *inter alia*, engage in establishing so-called bridge banks, acquire participations, grant guarantees and participate in recapitalizations. Bridge banks are banks that can be established under the Restructuring Act as a vehicle for the reorganization of failing banks. If the Restructuring Fund does not have sufficient funds to perform its functions under the Restructuring Act, the BMF is entitled to borrow additional funds (up to EUR 20bn and subject to certain further limitations) on behalf of the Fund.

II. Scope of Application

The bank levy covers all credit institutions as defined in Section 1(1) of the German Banking Act (*KWG*) holding a German banking license pursuant to Section 32 KWG. This should include German subsidiaries of foreign (*i.e.* third-country and EEA-country) banks and, in general, also German branches of third-country (*i.e.* non-EEA) banks under Section 53 KWG. German branches of EEA-country banks operating under a European Passport pursuant to Section 53b KWG do not require a German banking license and, therefore, should not be subject to the levy.

Financial service institutions, financial enterprises and other financial sector entities, such as insurance companies or investment management companies are not subject to the levy. Moreover, the levy does not apply to hedge funds. Bridge banks, the German Federal Bank, the Reconstruction Loan Corporation (*KfW*) and other tax-exempt banks are exempted from the levy.

German savings banks and cooperative banks demanded to be exempted from the bank levy because, in their view, they do not create any risk for the financial system. However, such proposal was rejected by the legislator.

III. Computation and Assessment

The amount of the annual contribution to the Restructuring Fund will be determined according to the systemic risk of the respective bank. The Restructuring Fund Act provides that this risk shall be assessed on the basis of two balance sheet based parameters, *i.e.*, contribution relevant liabilities (*beitragserhebliche Passiva*) on the one hand, and contribution relevant derivatives (*beitragserhebliche Derivate*) on the other hand. Liabilities to external customers (deposits), jouissance right capital with a maturity of at least two years, certain reserves (funds for general banking risks) and the bank's equity are not considered contribution relevant liabilities.

Given that only the entity holding a German banking license is subject to the levy, the amount of the annual contribution is calculated on a single entity basis and not on a (consolidated) group basis. Therefore, it should not cover foreign subsidiaries of German banks (which are separate entities).

Pursuant to the government draft of the Restructuring Fund Regulation, the amount of the annual contribution will be computed as the sum of (i) a fixed rate of 0.00015% applied on the nominal volume of all contribution relevant, unsettled derivatives (within the meaning of Section 36 of the Credit Institution Accounting Regulation; *Kreditinstituts-Rechnungslegungsverordnung*) and (ii) a progressive, variable rate applied on all contribution relevant liabilities. The variable rate is staggered as follows: a rate of 0.02% applies to contribution relevant liabilities of up to EUR 10bn, a rate of 0.03% applies to contribution relevant liabilities between EUR 10bn and EUR 100bn, and a rate of 0.04% applies to all contribution relevant liabilities in excess of EUR 100bn. In general, the amount of the annual contribution will be determined on the basis of the approved annual statements for the last business year ending prior to March 1 of the relevant contribution year.

The annual contribution shall be capped at a maximum amount of 15% of the bank's annual surplus, subject to certain adjustments (*e.g.* profit transfers under a profit-and-loss transfer agreement and provisions for contributions to the Restructuring Fund shall be disregarded). At a minimum, however, the levy shall amount to 5% of the regular annual contribution (so-called annual minimum contribution), calculated as described above (not taking into account the cap). If the annual contribution is capped in a particular year, the difference between the regular annual contribution and the capped amount shall be assessed in subsequent years, provided that in each year the sum of the current annual contribution and the subsequently assessed contributions must not exceed the aforementioned 15% cap.

If the Restructuring Fund does not have sufficient funds, the FMSA may collect extraordinary contributions – even several times a year. Subject to certain exceptions, the amount of each extraordinary contribution is to be calculated on the basis of the ratio of the average annual contributions collected over the previous three years from an individual credit institution to the respective average contributions collected from all credit institutions being subject to the levy. Under the Restructuring Fund Act, the aggregate maximum amount of extraordinary contributions that can be collected from a bank in a particular year is capped and must not exceed the threefold average of the annual contributions of the previous three years.

Pursuant to the government draft of the Restructuring Fund Regulation, the aggregate maximum amount of all contributions (including annual contributions, subsequently assessed annual contributions and extraordinary contributions) that can be collected from a bank in a particular year must not exceed 50% of the average annual surplus of the three preceding years, provided that annual deficits shall be disregarded (*i.e.* counted as breakeven results). In years where extraordinary contributions are collected, however, a credit institution shall be required to pay at least the sum of the annual minimum contributions of the preceding three years or, if lower, the sum of the annual contribution, the subsequently assessed contributions and the extraordinary contribution assessed for the current contribution year.

The contributions to the Restructuring Fund are not deductible for corporate income and trade tax purposes.

Credit institutions are obliged to provide the FMSA with the data required to calculate and assess the levy. In general, the accuracy of the information needs to be confirmed by the credit institution's management board and an auditor. If the aforementioned notification requirements are not met, the bank levy can be assessed on the basis of an estimate and further disadvantages may apply.

IV. <u>Size of Restructuring Fund</u>

The target size of the Restructuring Fund is EUR 70bn. The German Minister of Finance expects that the bank levy will regularly raise about EUR 1bn to EUR 1.2bn per year. By a number of experts, this amount is considered insufficient to effectively prevent or overcome a future financial crisis. Against this background, the Restructuring Fund's competence to collect extraordinary contributions might have a considerable impact on the effective amounts to be paid annually by the banks.

V. <u>Risk of Double Charging</u>

According to the new legislation, the German bank levy should apply to the following entities or branches:

- licensed German parent banks (headquarters),
- licensed German subsidiaries of German and foreign (*i.e.* EEA-country and third-country) banks,
- licensed German branches of non-EEA banks, and

- foreign branches of German banks (as they are not excluded from the assessment base of their headquarter entity).

Foreign subsidiaries of German banks (without a German license), and passported German branches of EEA banks should not be subject to the levy.

As a consequence, there is a risk of double charging for:

- licensed German subsidiaries of foreign banks if, in the jurisdiction of their parent, a bank levy exists that is calculated on a consolidated group basis (*e.g.* France),

- licensed German branches of non-EEA banks if, in the jurisdiction of the non-EEA bank's headquarter, a bank levy is imposed and foreign (*e.g.* German) branches are not excluded from the assessment base, and

- foreign branches of German banks if the branches are subject to a bank levy in the jurisdiction in which they have been established (*e.g.* UK).

The Restructuring Act itself does not provide for remedies to prevent or at least alleviate double charging. As the German bank levy is not considered a tax in a technical sense but rather a special contribution, the national provisions in the German Income Tax Act that reduce the risk of double taxation do not apply to the bank levy. For the same reason, the German bank levy is not covered by existing double taxation treaties.

Double charging concerns were raised as a matter of urgency at the Ecofin summit in October 2010. Pursuant to an Ecofin report to the Council of the European Union on Levies and Taxes on Financial Institutions dated October 21, 2010, a minimum level of coordination should be achieved in the short-term, which means that the national regulations should at least have enough flexibility to be adjusted to a potential European solution once it will have been adopted. Moreover, the Council urges the maintenance of a level playing field across Member States. This would require at EU level an agreement on the scope of application of the national levies in order to avoid double charging between Member States.

VI. Tax on Financial Transactions and Financial Activities

The German Minister of Finance also favored the introduction of a tax on financial transactions. The purpose underlying such tax on the nominal value of financial transactions would be to curtail short-term capital speculations, which are considered the cause of instability of the financial markets. However, the introduction of a tax on financial transactions has been heavily criticized by high-ranking politicians and various banking sector lobbyists. Such tax, if not introduced globally, could cause the migration of financial industries to countries that do not impose the tax. But even if the tax were introduced globally, the tax revenue would not be shared equally. Countries where large financial markets are located would benefit disproportionately. It is also argued that financing for companies would become more expensive because of the tax. This would reduce corporate profits and, as a consequence, have negative effects on growth.

After the idea of a tax on financial transactions had been rejected, both internationally at the G20 summit in June 2010 and at the EU-level at the Ecofin summit in September 2010, the German Minister of Finance announced that he will not introduce such tax, which under these circumstances would be an exclusively German approach.

However, until now the German Minister of Finance has not completely abandoned the introduction of a tax on financial transactions and is reportedly considering the idea of joining forces with France and Austria. Moreover, a financial activities tax, which would be based on profits and wage costs, is considered. In accordance with medium-term finance plans, the German Minister of Finance intends to derive EUR 2bn per year in additional revenues from the financial sector starting from 2012 and, therefore, it appears likely that the tax discussion will be continued this year.

On February 22, 2011, the European Commission launched a public consultation (see http://ec.europa.eu/taxation_customs/common/consultations/tax/2011_02_financial_sector_taxation_en.htm) in order to receive feedback from market participants, regulators, social partners, NGOs and other stakeholders on its initiative for the taxation of the financial sector. The policy measures that are analyzed include a financial transactions tax and a financial activities tax.

VII. Materials

Restructuring Act adopted by Parliament (*Bundestag*) and approved by the German Upper House (*Bundesrat*):

http://www.bundesrat.de/cln_179/nn_8336/SharedDocs/Drucksachen/2010/0601-700/681-10,templateId=raw,property=publicationFile.pdf/681-10.pdf

http://www.bgbl.de/Xaver/start.xav?startbk=Bundesanzeiger_BGBl&bk=Bundesanzeiger_BGBl&start=//*%5B@attr_id=%27bgbl110s1900.pdf%27%5D

Government Draft of the Restructuring Fund Regulation:

http://www.bundesfinanzministerium.de/DE/Wirtschaft__und__Verwaltung/Geld__und__Kredit/Kapitalmarktpolitik/02032011-Restrukturierungsfondverordnung,templateId=raw,property=publicationFile.pdf

Public Consultation Paper issued by the European Commission:

http://ec.europa.eu/taxation_customs/resources/documents/common/consultations/tax/financial_sector/consultation_document.doc

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