

**EXPLANATORY MEMORANDUM TO
THE FINANCE ACT 2011 (BANK LEVY: AMENDMENT OF NETTING
AGREEMENTS PROVISIONS) ORDER 2011**

2011 No. 3015

1. This explanatory memorandum has been prepared by HM Revenue and Customs (“HMRC”) on behalf of HM Treasury and is laid before the House of Commons by Command of Her Majesty.

This memorandum contains information for the Select Committee on Statutory Instruments.

2. **Purpose of the instrument**

- 2.1 The tax called the bank levy is charged upon the total chargeable equity and liabilities reported in a bank’s or a banking group’s balance sheet at the end of the chargeable period. In certain circumstances the liabilities on a balance sheet are permitted to be reduced by the netting off of any asset balances recognised on the balance sheet of a relevant member of the group. This statutory instrument amends the provisions of Schedule 19 to the Finance Act 2011 which detail the netting provisions.

3. **Matters of special interest to the Select Committee on Statutory Instruments**

- 3.1 This Order will have effect in relation to chargeable periods ending on or after 1 January 2011. The power to make an Order with retrospective effect is contained within paragraph 40(3) of Schedule 19 to the Finance Act 2011 (“Schedule 19”).

4. **Legislative Context**

- 4.1 Schedule 19 introduced a new tax, the bank levy. It applies for periods of account of UK banking groups, standalone banks and building societies, foreign banking groups and relevant non-banking groups (“banks”) which end on or after 1st January 2011.

- 4.2 In calculating the equity and liabilities that are chargeable equity and liabilities for the purposes of the bank levy, the legislation permits, in certain specific circumstances, certain liabilities and assets of any relevant member to be netted off against each other and reduced as far as possible (but not below zero).

- 4.3 The bank levy netting provisions are contained in:

- Paragraph 16 (UK banking groups)

- Paragraph 18 (Foreign banking groups)
- Paragraph 20 (Relevant non banking groups)
- Paragraph 22 (Banks and Building Societies that are not members of a group), and,
- Paragraph 25 (UK permanent establishments of foreign banks)

4.4 These provisions permit certain liabilities that are recognised on a balance sheet of any relevant member to be reduced as far as possible (but not below zero) by netting off from them any asset balances. The remaining net balance is the figure to be taken into consideration when calculating the chargeable equity and liabilities.

4.5 The specific circumstances mentioned above require the liabilities and assets recognised on the balance sheets of the relevant member to be:

- with the same counterparty or a member of the counterparty's group;
- covered by the same legally enforceable netting agreement, and
- for the counterparty to be either a third party or a group company whose liabilities are not subject to the bank levy.

4.6 Paragraph 40 of Schedule 19 gives HM Treasury the power to add, repeal or amend paragraphs 16, 18(8) to (17), 20(8) to (17), 22 and 25 of Schedule 19.

5. Territorial Extent and Application

5.1 This instrument applies to all of the United Kingdom.

6. European Convention on Human Rights

6.1 The Financial Secretary to the Treasury has made the following statement regarding Human Rights:

6.2 In my view the provisions of the Finance Act 2011 (Bank Levy: Amendment of Netting Agreements Provisions) Order 2011 are compatible with the Convention rights.

7. Policy background

7.1 Bank levies were proposed in a paper by the International Monetary Fund to the G20 entitled "A Fair and Substantial Contribution by the Financial Sector" following the 2008 global banking crisis. The UK Government, through Schedule 19, introduced the bank levy in relation to periods of account (chargeable periods) ending on or after 1 January 2011 to address the risk that bank's pose to the UK financial system and wider economy and to encourage banks to move more stable, long term less risky funding.

- 7.2 The bank levy applies to UK banks, building societies, banking and building society groups and banking sub groups within non banking groups and to foreign banks, banking groups and banking sub groups in non banking groups where the bank or group has banking interests in the UK.
- 7.3 The bank levy is charged upon a bank or banking group's chargeable equity and liabilities for a chargeable period.
- 7.4 Banks enter into many transactions with counterparties some of which may give rise to assets and some to liabilities. The bank and counterparty will often enter into bilateral or multilateral netting agreements.
- 7.5 Multi lateral agreements allow a member or different members of the same banking group to enter into a net settlement agreement with the same counterparties should either party become bankrupt or insolvent. If such a netting event occurs all of the liabilities and assets of the entities that are covered by the netting agreement will be settled net; that is settled by a single payment.
- 7.6 As one of the objectives of the bank levy is to encourage banks to move away from short term or riskier funding the calculation of the chargeable equity and liabilities needs to reflect the correct funding position of the bank where such netting arrangements exist: it is only the net position which gives rise to chargeable equity and liabilities.
- 7.7 The arrangements covered by netting agreements are often very complex financial transactions. Therefore, in order to ensure that the rules achieve the policy ambition of attaching a charge only to the net amounts of equity and liabilities an amendment was made to Schedule 19 at the Report Stage of Finance Bill 2011 to give HM Treasury a power to amend the netting provisions as and when necessary to cater for appropriate netting arrangements.
- 7.8 Since Finance Act 2011 received Royal Assent HMRC have become aware of some transactions that are included within netting agreements that are not catered for in the legislation, in particular where the netting includes 'short selling' and situations where shares or securities are posted as collateral against liabilities.
- 7.9 HMRC has discussed the details of these arrangements with the banks, advisors and the Financial Services Authority (FSA). These discussions have shown that the policy in terms of the wider rationale for the levy is met in relation to these newly advised arrangements and that where short transactions are covered by a netting agreement or where shares or securities are used as collateral there is no more counterparty risk to the bank than any other netting scenario.

- 7.10 Therefore if Schedule 19 was not amended a significant minority of taxpayers would be adversely affected by the existing netting rules (in particular those firms with significant broker-dealer operations) and there would be an aspect of Schedule 19 which may not, in the light of the additional information received, appropriately meet the policy aims.
- 7.11 The Order therefore amends the paragraphs within Schedule 19 that cover netting in order that these transactions are covered by the netting provisions so that these equity and liabilities do not form part of the chargeable equity and liabilities. As a result of these changes the netting provisions operate consistently and reflect real commercial practice.

8. Consultation outcome

- 8.1 The format and scope of netting arrangements entered into formed a substantial part of the main bank levy consultation held in the summer of 2010. The consultation sought views on options for determining the bank levy liabilities and in particular the approach to be taken for netting. Following discussion with affected parties a principles-based approach was decided upon, enabling the netting to reflect the assets and liabilities included within netting agreements. This approach was favoured by the banks and has been used as the basis for the netting approach taken with Schedule 19.
- 8.2 However since Schedule 19 was published HMRC has continued to informally consult on the netting provisions. This statutory instrument deals with netting scenarios brought to HMRC attention during this process.
- 8.3 A short informal consultation on the statutory instrument itself has been undertaken with the stakeholder who brought these matters to the attention of HMRC and they are content that the arrangements identified by them are covered by these amendments.

9. Guidance

- 9.1 The current version of The Bank Levy Manual (published on HMRC internet site) contains a chapter outlining how the netting will operate. This version will be updated to include comprehensive guidance around the changes that this instrument will make to the netting process.
- 9.2 The updated guidance will be published shortly after this instrument comes into force and a notice will be placed on the HMRC website informing stakeholders of the publication of the Order.

10. Impact

- 10.1 As the bank levy only applies to banks, building societies and banking or buildings society groups, the impact of this Order on wider business, charities or voluntary bodies is nil.
- 10.2 The impact on the public sector is expected to be minimal.
- 10.3 A Tax Information and Impact Note covering this instrument was published on 23 March 2011 alongside draft legislation for the Bank Levy and is available on the HMRC website at <http://www.hmrc.gov.uk/thelibrary/tiins.htm> .

It remains an accurate summary of the impacts that apply to this instrument.

11. Regulating small business

- 11.1 This legislation does not apply to small businesses.

12. Monitoring & review

- 12.1 HMRC will monitor and review the legislation to ensure that the bank levy is operating efficiently and tax is being paid and relief given as intended.
- 12.2 The Government will review the design of the levy in 2013 to ensure that it is operating efficiently.

13. Contact

Anthony Fawcett at HMRC can answer any queries regarding the instrument.

Tel: 020 7147 0654

anthony.c.fawcett@hmrc.gsi.gov.uk