EUROPEAN CENTRAL BANK

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OPINION OF THE EUROPEAN CENTRAL BANK

of 12 September 2023

on the imposition of an extraordinary tax on credit institutions

(CON/2023/26)

Introduction and legal basis

On 11 August 2023 the European Central Bank (ECB) received a request from the Italian Ministry of Economy and Finance for an opinion on a Decree Law introducing urgent measures on consumers' protection and on economic activities and strategic investments (hereinafter the 'Decree Law')[1].

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 sixth indent of Article 2(1) of Council Decision 98/415/EC[2], as the Decree Law concerns, inter alia, 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 Decree Law

1.1 The Decree Law introduces, inter alia, an extraordinary tax applicable to credit institutions[3]. The tax is determined by applying a rate of 40 % to the greater value of:

- the amount of the interest margin referred to in item 30 of the profit and loss account, drawn up in accordance with the schemes approved by the Banca d'Italia, for the financial year before the one pending as of 1 January 2023, which exceeds by at least 5 % the same margin for the financial year before the one pending as of 1 January 2022; or
- the amount of the interest margin referred to in item 30 of the profit and loss account, drawn up in accordance with the schemes approved by the Banca d'Italia, for the financial year before the one pending as of 1 January 2024, which exceeds by at least 10 % the same margin for the financial year before the one pending as of 1 January 2022.

1.2 The amount of the extraordinary tax for each credit institution, in any case, cannot be greater than a share equal to 0.1 % of the total of its assets for the financial year preceding 1 January 2023.

1.3 The extraordinary tax is to be paid in the course of 2024. It is to be paid within the sixth month

1 Decreto Legge 10 Agosto 2023 n. 104, Disposizioni urgenti a tutela degli utenti, in materia di attivita' economiche e finanziarie e investimenti strategici, pubblicato nella Gazzetta Ufficiale n. 186 del 10 Agosto 2023.

2 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).

3 See Article 26 of the Decree Law.

subsequent to the end of the financial year preceding that in progress as of 1 January 2024. Taxpayers who approve their budget beyond the deadline of four months from the close of the financial year are required to make the payment within the month subsequent to the approval of the budget. Taxpayers whose financial year does not coincide with the calendar year are required to make the payment in 2024 and, in any case, by 31 January if the term referred to expires in 2023. The extraordinary tax paid cannot be deducted from taxable income for the purposes of corporate income tax and regional tax on productive activities. The ordinary provisions of income tax law will apply for the purposes of assessment, penalties, the collection of and litigation related to the extraordinary tax.

1.4 The higher revenue from this tax will be allocated to the financing of the fund for mortgages on first homes and for interventions aimed at reducing the tax burden of households and businesses.

1.5 The Decree Law is not accompanied by any explanatory memorandum explaining its rationale. Furthermore, the technical documentation submitted to the Italian Senate on the Decree Law contains a summary of the main legislative provisions but no explanation of the rationale underpinning the Decree Law.

2. General observation

The ECB recently adopted an opinion on a Spanish draft law on the imposition of temporary levies on operators in the energy sector, credit institutions and financial credit establishments[4] and an opinion on a Lithuanian draft law establishing a temporary solidarity contribution applicable to credit institutions, including branches of other Member States' credit institutions and foreign banks established in Lithuania[5]. In both of these opinions the ECB considered similar initiatives to the Decree Law from the monetary policy, financial stability and prudential supervision perspectives.

3. Monetary policy context

3.1 The ECB understands[6] that the Italian Government's decision is motivated by the potentially large social costs for households and firms associated with the high interest rate environment.

3.2 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[7], the ECB has taken determined action to ensure a timely return of inflation to the 2 % target over the medium term. Key ECB policy rates have been raised with the intention of dampening 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 to the ECB's medium-term target and to preserve the smooth

4 See Opinion CON/2022/36. All ECB opinions are published on EUR-Lex.

5 See Opinion CON/2023/9.

6 See the Italian Government - Presidency of the Council of Ministers website at www.governo.it.

7 See Article 127(1) of the Treaty.

functioning of monetary policy transmission[8].

3.3 As key ECB interest rates will be set 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 operations always have some distributional implications. Naturally, 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[9].

3.4 Evidence shows that net interest income typically tends to expand on impact as policy rates increase. This effect is faster the greater the weight of short-term or variable interest rate loans within bank 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.

3.5 As the determination of the addressees of the extraordinary tax is also based on net interest income in 2023, these credit institutions may record lower profits or losses at the point in time when the tax is actually collected. In addition, a tax levied on net interest income under the Decree Law would still be binding even if the credit institutions subject to that tax were making losses on the non-net interest income components of their profits. More generally, caution must be taken to ensure that the extraordinary tax does not impact the ability of individual credit institutions to build strong capital bases and adequately provision for increased impairments and a 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[10]. It has, in this respect, underscored in general that imposing an extraordinary 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 extraordinary 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 in order for them to fulfil their role as credit intermediaries within the economy. Higher costs and

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

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

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

reduced credit supply, or higher costs of other banking services, can adversely affect real economic growth[11].

4.2 The Decree Law envisages that the extraordinary tax is to be one-off in nature. In this respect, the ECB has previously recommended that a clear separation is necessary between the extraordinary nature of the proceeds and the general budgetary resources of a government to avoid their use for general fiscal consolidation purposes[12].

4.3 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. These effects are not taken into account by the design of the extraordinary tax, as this latter is calculated on the net interest margin and not on net profits. These different factors should be properly evaluated in order to ensure that credit institutions remain well positioned to absorb potential future losses[13].

4.4 The extraordinary tax may make attracting new equity capital and wholesale funding more costly for banks, as domestic and foreign investors may have less appetite to invest in Italian credit institutions that have a more uncertain outlook. Moreover, the introduction of an ad hoc retroactive tax unduly increases policy uncertainty regarding the tax framework, damaging investor confidence and potentially also affecting the cost of funding for non-financial corporations. In addition, its retroactive nature may fuel perceptions of an uncertain taxation framework and give rise to extensive litigation, creating problems of legal uncertainty.

4.5 The extraordinary 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 that also operate through branches in other jurisdictions where an extraordinary tax is also levied may be a further source of such fragmentation.

4.6 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 Decree Law be accompanied by a thorough analysis of potential negative consequences for the banking sector[14]. This analysis should detail, in particular, the specific impact of the extraordinary tax on credit institutions' longer-term profitability and capital base, 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 extraordinary tax would, as a practical matter, apply to both significant credit institutions directly supervised by the ECB and less significant credit institutions directly

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 and paragraph 3.1 of Opinion CON/2023/9.

12 See paragraph 3.2.2 of Opinion CON/2010/62, paragraph 3.1 of Opinion CON/2022/36 and paragraph 3.4 of Opinion CON/2023/9.

13 See paragraph 3.2 of Opinion CON/2023/9.

14 See paragraph 3.4 of Opinion CON/2022/36 and paragraph 3.7 of Opinion CON/2023/9.

supervised by national competent authorities under the oversight of the ECB within the framework of the Single Supervisory Mechanism. On this point, the ECB stresses that the extraordinary tax will particularly affect less significant institutions, which tend to be more concentrated on lending activity, while significant institutions tend to have a larger proportion of fee-based income.

5.2 The basis on which the extraordinary 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 extraordinary 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 extraordinary tax, credit institutions that have lower solvency positions or are more focused on lending activity (such as small banks) 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[15], improved capital position was a key factor in helping banks stay resilient amidst highly adverse conditions.

5.3 The ECB understands that the amount of the extraordinary tax would not, in any event, exceed a share of 0.1 % of the total assets for the financial year preceding the current financial year to 1 January 2023. It is not fully clear whether the notion of total assets refers to the same perimeter as for the computation of the tax, or whether it refers to total assets at consolidated level. Further clarification on this point would be welcome for determining the foreseeable charge applicable to credit institutions directly supervised by the ECB, which consolidate assets of non-domestic entities, and whose assets include insurance operations and, in turn, the implications of the extraordinary tax for their profitability and capital position.

5.4 The Decree Law neither considers nor clarifies the treatment of credit institutions with mergers and acquisitions occurring during the estimation period for the calculation of the tax and the related impact, in terms of different perimeters at the different reference dates, on the calculation of the extraordinary tax. The ECB would welcome further clarification of this aspect.

This opinion will be published on EUR-Lex.

Done at Frankfurt am Main, 12 September 2023.

[signed]

The President of the ECB

Christine LAGARDE

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