Box 2.3

ECB OPINION ON THE PROPOSED TEMPORARY LEVY ON THE SPANISH BANKING SECTOR

As noted in the main body of this Report, a draft law to establish a temporary levy on credit institutions and specialised lending institutions is currently before the Spanish parliament. The proposed levy is expected to be in force from 2023 to 2024 and would apply to entities exceeding a minimum gross interest income and fee and commission income threshold in 2019 set at €800 million. The tax rate would be 4.8% and the base would be the total 2022-2023 net interest income and net fee and commission income. Moreover, the draft law states that the amount of the levy and its advance payment will have no economic repercussion. In other words, the levy cannot be passed on to the customers of the credit and financial institutions affected.[1]

The measure seeks to raise around €1.5 billion a year. On the Banco de España's estimates, this would be 0.11% of the risk-weighted assets (RWAs) of the institutions affected at December 2021, and 0.10% of the RWAs of all deposit institutions (Total DIs).[2] The levy amounts to 0.87% of the common equity tier 1 (CET 1) capital of the institutions affected at December 2021 (0.77% in the case of Total DIs). It also represents 12% of the net profit from business in Spain of the institutions affected (10.8% for the Total DIs). In any event, it should be borne in mind that the relative impact this measure ultimately has will depend on how profits and balance sheet growth develop in 2022 and 2023. As analysed in Box 2.2, the measure could have a greater relative impact in an adverse scenario.[3]

On 23 September 2022 the European Central Bank (ECB) received a request from the Banco de España, on behalf of the Spanish Parliament, for an opinion on the draft law. The ECB's competence to deliver an opinion is based on the Treaty on the Functioning of the European Union and on Council Decision 98/415/EC, as the draft law concerns the Banco de España, 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. In accordance with the ECB's Rules of Procedure, the opinion was adopted by the Governing Council on 2 November 2022.[4] The content of the opinion, which focuses on several aspects from a monetary policy, financial stability and banking supervision standpoint, is summarised below.

First, the opinion describes the current monetary policy context, marked by high inflation, which has led the ECB, in line with its primary objective of maintaining price stability in the medium term, to embark on a process of monetary policy normalisation. From this perspective, the opinion notes that credit institutions play a special role for ensuring the smooth transmission of monetary policy measures to the wider economy. Thus, an adequate capital position helps credit institutions to avoid abrupt adjustments to their lending to the real economy.

Evidence shows that net interest income typically tends to expand on impact as policy rates increase, and this effect is higher the lower the weight of long-term loans and, among these, the lower the proportion of fixed interest rate operations. However, this effect can be offset by lower lending volumes, by losses recorded in the securities portfolio and by an increase in provisions resulting from a 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. The net effect of monetary policy normalisation on credit institutions' profitability might, therefore, be less positive, or even negative, over an extended horizon.

Thus, as the determination of the addressees of the temporary levy is based on total reported interest and fee commission income in 2019, the ECB opinion notes that these institutions may record low profits or losses at the point in time when the levy is actually collected. It concludes that if the ability of credit institutions to attain adequate capital positions is damaged, this could endanger a smooth bank-based transmission of monetary policy measures to the wider economy.

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1 As per the draft law, the National Commission on Markets and Competition (CNMC) is responsible for ensuring compliance with this obligation, without prejudice to the competences of the Banco de España and its duty to cooperate in this respect.

2 Overall, the banks that would exceed the income threshold triggering the levy account for more than 90% of the RWAs of Total DIs, so the impact of the measure in proportion to their profits or balance sheet is close to that for all deposit institutions in Spain.

3 See Chart 10 in Box 2.2, where the impact of the levy is analysed relative to 2024 RWAs under two simulated macroeconomic scenarios. This may give rise to differences in terms of the impact on the 2021 RWAs considered here.

4 See ECB Opinion CON/2022/36 of 2 November 2022 on Draft Law 122/000247 for the establishment of temporary levies on energy and on credit institutions and specialised lending institutions.

Second, from a financial stability standpoint, the ECB has issued previous opinions on other draft legislation introducing levies on credit institutions in several Member States. In this respect, the ECB has declared that using the proceeds from taxes levied on credit institutions for general budgetary purposes is not desirable if, and to the extent that, it makes them less resilient to economic shocks and, in consequence, limits their ability to provide credit, resulting in less favourable conditions being offered to customers for loans and other services and reductions in certain activities, which would create uncertainty and adversely affect real economic growth. In line with these considerations, in the past the ECB has recommended that a clear separation is needed between the extraordinary account created out of the proceeds from the levies and general government's general budgetary resources, to avoid their being used for general fiscal consolidation purposes.

The opinion also indicates that imposing ad hoc taxes or levies on credit institutions for general budgetary purposes should be preceded by a thorough analysis of potential negative consequences for the banking sector, to ensure that these taxes do not pose risks to financial stability, banking sector resilience or the provision of credit, which could adversely affect real economic growth. Consequently, the levy should be carefully considered as regards its impact on the profitability of the credit institutions affected and, therefore, on their internal credit generation and lending.

Further, it states that imposing a temporary tax on a credit institution recording net losses would significantly distort and even further damage the resilience of a loss-making bank. Moreover, levying a tax only on certain Spanish credit institutions could distort market competition and impair the level playing field both within the country and across the banking union.

Accordingly, the ECB recommends that the draft legislation be accompanied by a thorough analysis of the potential negative consequences for the banking sector, detailing in particular the specific impact of the temporary tax on the profitability of the credit and financial institutions affected and on the market competition conditions, to ensure that the levy of the tax poses no risks to financial stability, banking sector resilience or the provision of credit.

According to the opinion, this recommendation is particularly relevant in the current economic and financial environment, which features high uncertainty and the prospect of increasing loan loss provisions having to be made by credit institutions owing to the sharp expected slowdown in real economic activity. In this setting, it should be taken into consideration that credit institutions have already had to record higher provisions for their exposure to non-financial corporations operating in high energy-intensive sectors.

Third, from a prudential supervisory standpoint, the ECB understands that, given that the basis on which the temporary levy would be established does not take into account the full business cycle and does not include, inter alia, either operating expenses or the cost of credit risk, the amount of the temporary levy might not be commensurate with the profitability of a credit institution. Accordingly, as a result of the general application of the temporary levy, credit institutions that are not necessarily benefitting from current market conditions could become less able to absorb the potential downside risks of an economic recession.

The ECB also understands that the generic provision stating that the temporary levy cannot be passed on to credit institutions' customers could generate uncertainty, as well as related operational and reputational risks for those institutions. It points out that price increases applied to customers owing to (i) cost increases other than the temporary levy, such as operating, funding or capital costs, (ii) cost increases relating to risk coverage, and (iii) commercial margin adjustments, are all legitimate increases. In general, the ECB expects credit institutions, in accordance with international best practice, to consider and reflect in their loan pricing all relevant costs, including tax considerations. The ECB also asks for clarification as to which verification mechanisms the CNMC will use to ensure compliance with this requirement. Given the whole range of circumstances that might lead to price increases in the current setting of interest rate rises, inflation and deteriorating risk premia, it seems it would be difficult to determine whether or not the temporary tax was actually being passed through to customers.

Lastly, a number of additional considerations are made. First, the opinion indicates that there is a discrepancy between the wording used in the draft legislation to establish the criteria determining which credit and financial institutions would be affected by the temporary levy, which refers to "the total interest income and commission income, as determined in accordance with the applicable accounting legislation", and the wording used to determine the base to

Box 2.3
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which the 4.8% temporary levy applies, which refers to "the sum of the interest margin and commission income and expenses shown in their profit and loss account for the previous calendar year". In this respect, and as regards the determination of the base for the temporary levy, the ECB understands that the levy applies to net interest income and net fee and commission income. Accordingly, it concludes that a clearer terminology in the final text on the criteria for determining the credit and financial institutions affected would be desirable for the purposes of greater legal certainty. Second, the opinion states that the cooperation role assigned to the Banco de España to ensure that credit institutions comply with the requirement established in the draft legislation as regards not passing on the amount of the temporary levy to their customers is not clear. In this respect, the ECB underlines that this matter could be further clarified, specifying that it does not amount to any new task being conferred upon the Banco de España.