



HM Treasury, 1 Horse Guards Road, London, SW1A 2HQ

31 March 2010

**G20 Colleagues**

Dear Colleague

### **FINANCIAL SECTOR REFORM AND SYSTEMIC RISK LEVIES OR TAXES**

Last year, we took decisive and concerted action to stabilise and strengthen the global financial sector. These actions prevented a breakdown in the global financial system, but you will agree that we still have a lot of work to do to rebuild it and deliver lasting stability. Economic growth must be underpinned by a strong, resilient and efficient global financial sector and we cannot allow harmful divergences or uncoordinated approaches to bring new risks by creating further opportunities for regulatory arbitrage.

The foundation of the new global banking system must be a robust, internationally consistent regime for capital. As we agreed last year, the Basel process needs by the end of this year to deliver strengthened international rules on capital, leverage and liquidity while ensuring that the transition to stricter regulatory standards does not slow down the pace of recovery. However, there are other areas where we also need to make rapid progress. In particular, we need additional measures aimed at those financial institutions that pose the greatest risks to financial stability. We also need to continue to strengthen the infrastructures of key financial markets in order to enhance their resilience to shocks and reduce risks of contagion. Finally, it is vital that we carefully assess the cumulative effectiveness of all of these measures and their impact on the financial sector and the wider economy.

If financial institutions do nonetheless fail, the impact on the financial system, the wider economy and the taxpayer must be minimised. As this financial crisis has shown, the failure or distress of large and interconnected financial institutions can impose a huge cost to the economy, one that is much wider than just the direct fiscal cost of any government interventions. To that end, I very much look forward to the forthcoming interim report from the IMF on options for ensuring that the financial sector makes a fair and substantial contribution toward paying for any burdens associated with government interventions to repair the banking system, which we commissioned last year.

The UK Government has also been considering this issue. In December 2009 the Treasury published 'Risk, Reward and Responsibility: the financial sector and society', a report discussing options to rebalance the costs between the financial sector and society. In January 2010, we organised a seminar that brought together international policymakers to explore these questions in more detail.

In my Budget last week I provided an update on how we believe an internationally co-ordinated systemic risk levy or tax could be an important part of ensuring that the costs of systemic crises are better reflected in the activities of financial institutions. In Chapter 3 of the report, which can be found at [http://www.hm-treasury.gov.uk/d/budget2010\\_chapter3.pdf](http://www.hm-treasury.gov.uk/d/budget2010_chapter3.pdf), I have set out the following principles that the UK Government thinks should underpin a systemic risk levy or tax:

First and foremost, a systemic risk levy or tax should be coordinated internationally to minimise competitive distortions, and issues of double-taxation and arbitrage risks will need to be resolved;

This should complement but not substitute existing G20 regulatory initiatives aimed at addressing systemic risk. In particular the work of the Financial Stability Board on reducing the probability and impact of an individual firms' failure and to streamline the process of dealing with failures if they nevertheless occur remains of vital importance;

While internationally coordinated, the proceeds of any levy should be for national governments to use. A systemic risk levy should not be seen as an insurance policy to benefit individual institutions, shareholders or creditors. To minimise moral hazard the proceeds of a levy should go into general taxation rather than a stand-alone fund.

Calibration and implementation must take account of the wider regulatory reform programme and the cumulative impact of all reforms to strengthen financial stability, as well as the timing and strength of the economic recovery to ensure that any levy is fair and measured. As our Deputies have agreed, we should ask the IMF, FSB and BCBS to undertake work to assess the cumulative impact of reforms on the financial sector.

The tax base should be as simple as possible, to minimise arbitrage and help international replicability, while taking account of the characteristics of a firms business that give rise to systemic risk. In particular it should take into consideration size, interconnectedness and substitutability, while accepting that a precisely calibrated measure might not be achievable.



This should cover all financial institutions that might contribute significantly to systemic risk, to address level-playing-field concerns and minimise arbitrage.

I very much hope that when we next meet we make progress on the ambitious regulatory reform agenda we have already agreed and discuss how to take forward further international work on systemic risk levies and taxes.

I am copying this letter to the heads of the IMF, World Bank and FSB.

Yours sincerely

**ALISTAIR DARLING**

