

Intended Consequences

The Short Life and Death of the “Bank Tax”

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EXECUTIVE SUMMARY

This evening, the Conference Committee reconvened to replace the \$19 billion “bank tax” that it had approved just last Friday morning.

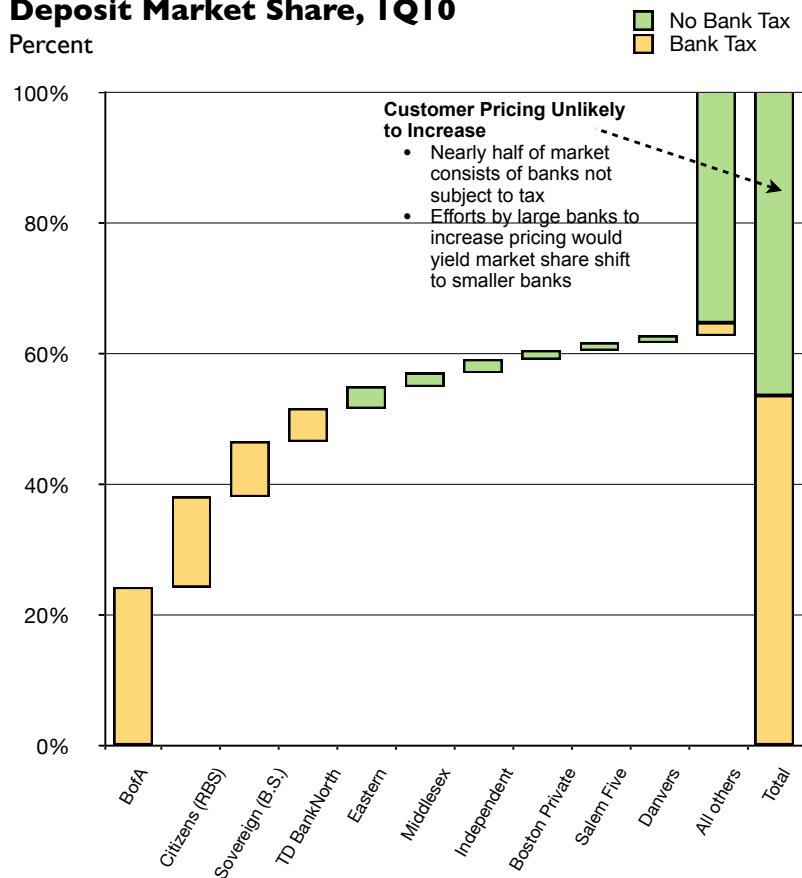
- **Bank tax would have targeted largest, riskiest firms.** In its original incarnation, the levy would have targeted only banks with greater than \$50 billion in assets, and only those hedge funds with more than \$10 billion in assets under management. Moreover, the tax was apparently meant to disproportionately affect the firms with riskiest asset and liability profiles.
- **Critics argued banks would pass tax burden to customers.** Apparently led by three New England Senators, critics of the bank tax successfully argued that any attempts to tax large banks would inevitably lead to higher pricing on customers and small businesses.
- **The bank tax actually would have had negligible customer impact.** Lost in today’s hurried debate was the absence of any empirical backing for the critics’ argument. Indeed, two factors would have likely combined to render the impact on customer pricing trivial.
 - First, only large banks would have been subject to the tax, so efforts to raise large-bank customer pricing, in many product markets, would have simply caused a market share shift to the smaller banks not subject to the levy. Ironically, the Massachusetts retail deposit business is a clear example of such a market.
 - Second, even in those product markets dominated by large banks, the bank tax was so small that, even if its burden could have been shifted completely to customers, the impact would have been, in practical terms, undetectable.

The ability of banks to substantially pass most of the tax's burden to their customers would have depended, in large measure, on the structure of individual product markets. For example, the core retail and commercial deposit business, even in a mature market like Massachusetts, would have been unlikely to see higher pricing as a result of the bank tax, because nearly half the market consists of community banks not subject to the levy in the first place. The credit card business, to take the most extreme counter-example, is dominated by large firms that would be subject to the tax, so it seems more likely that customer pricing would increase in that market. However . . .

THEORETICAL BANK TAX “PASS-THROUGH” WOULD VARY

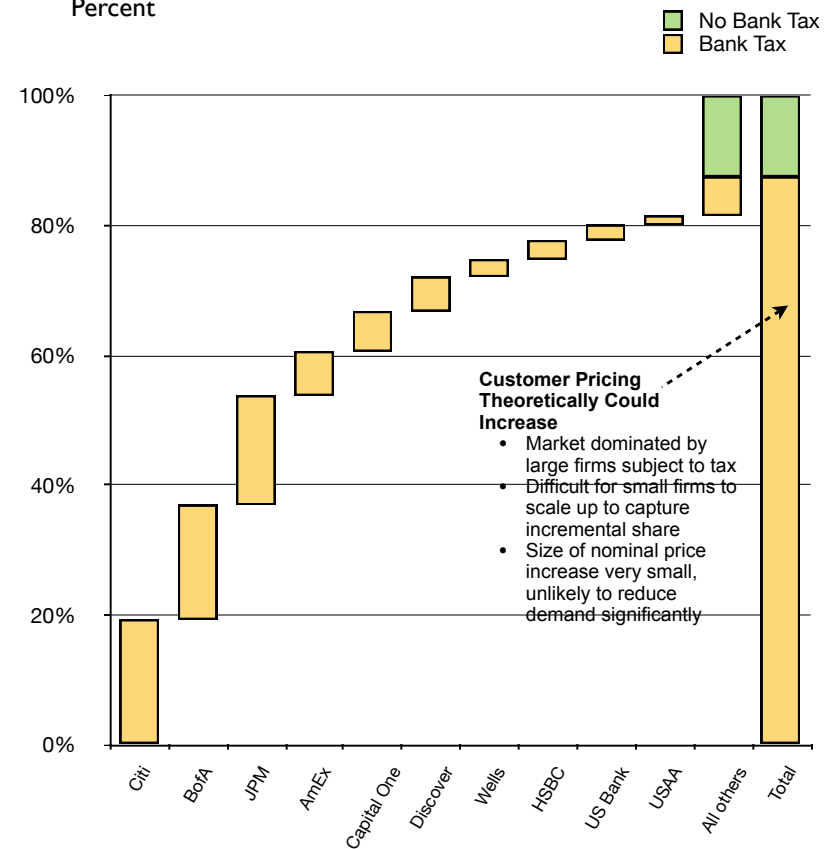
Massachusetts Retail & Commercial Deposit Market Share, IQ10

Percent



U.S. Credit Card Market Share, 4Q09

Percent



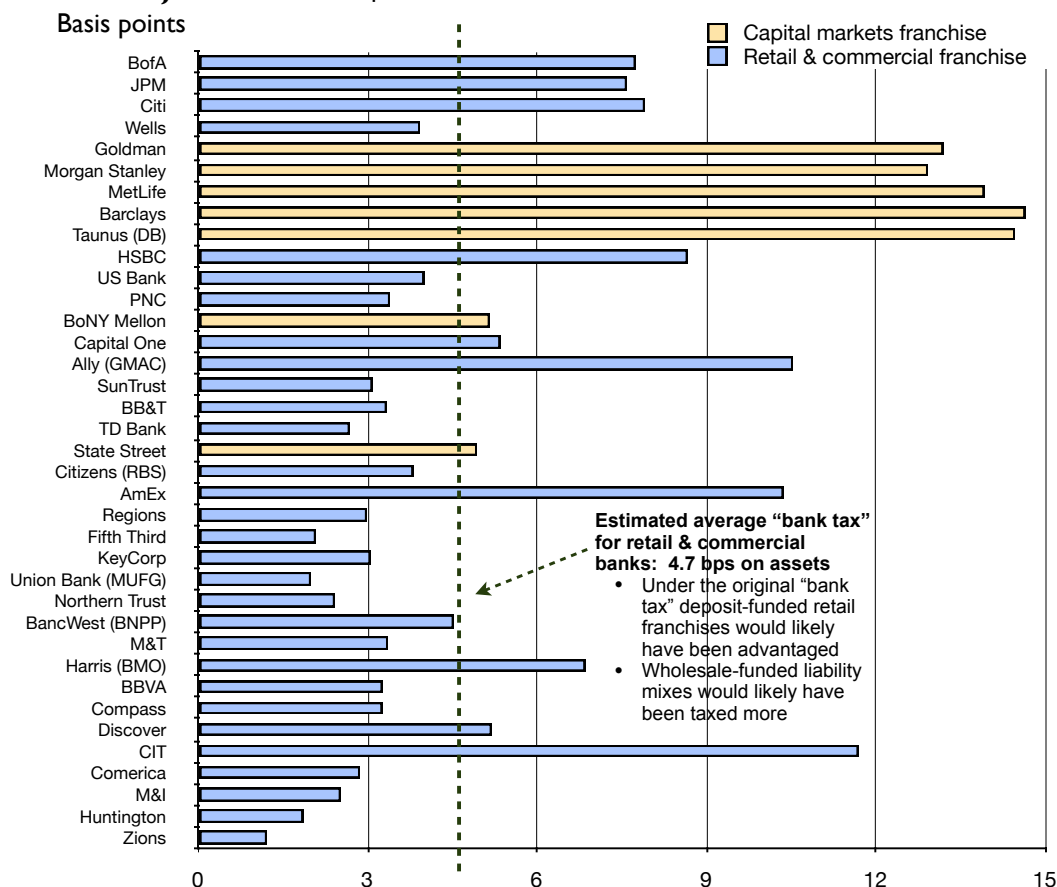
Source: SNL; Federal Reserve; Nilson; Cambridge Winter Center analysis

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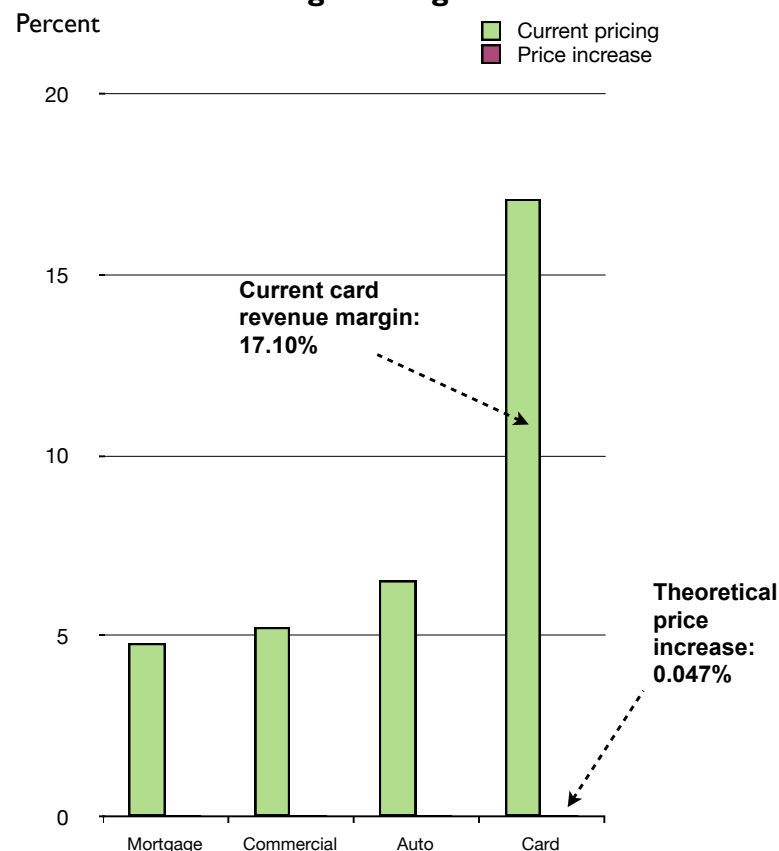
... even in the credit card business, and even assuming that the *entire* tax were passed through to customers, the actual impact on pricing would have been trivial. This should not be a surprising outcome. After all, customer pricing is measured in double-digit percentage points; the change in pricing due to the tax, at the most, would have been measured in single-digit basis points. Customers, therefore, cannot be said to have benefitted meaningfully by virtue of today's bank tax elimination. Indeed, the only clear winners appear to be a handful of very large capital market-facing banks, including Goldman Sachs, Morgan Stanley, Bank of New York Mellon, and State Street.

IN PRACTICE, NEGLIGIBLE CUSTOMER PRICING IMPACT

Estimated Annual "Bank Tax" as Fraction of Assets, BHCs Over \$50 Billion Assets*



Customer Pricing Impact of Entire Retail "Bank Tax" Passing Through to Customers



*Estimates are based on Obama Administration "Financial Crisis Responsibility Fee" proposal, as Conference Committee bank tax lacked sufficient specificity for analysis

** Mortgage is conforming 30-year fixed rate; commercial is prime+2%; Auto is new car finance at banks; Card is Capital One revenue margin

Source: SNL; Federal Reserve; Wall Street Journal; Cambridge Winter Center analysis

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