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14 June 2017

Submission to the Senate Economics Legislation Committee's Inquiry into the Major Bank Levy Bill 2017

The Westpac Group (Westpac) is pleased to provide a submission to the Senate Economics Legislation Committee's Inquiry into the Major Bank Levy Bill 2017.

Executive Summary

This submission outlines Westpac's suggested amendments to improve the operation of this Levy. We suggest making the following amendments to the Bill:

- the legislation should be changed to ensure that foreign banks are subject to the Levy in order to maintain international competitiveness and not advantage offshore bank investors;
- the liability base attracting the levy should be narrowed to exclude products/transactions where the imposition of the Levy could have an adverse impact on liquidity and pricing – e.g. funding of trade finance and repurchase agreements;
- the Bill should contain a sunset clause to align with the Government's stated position that the Levy is for Budget repair; and
- there should be a mechanism to suspend the Levy if paying it would place an Authorised Deposit-taking Institution (ADI) under financial stress.

Support for Economic Growth and implications of the Levy

The Westpac Group is one of the four major banking organisations in Australia. Founded in 1817, Westpac was the first bank established in Australia and for 200 years has contributed to the economic prosperity of the nation.

Westpac is Australia's 2nd largest taxpayer, paying over $3 billion in income tax for 2016. It has approximately 33,000 Australian employees, helps over 12 million Australian customers (retail, SME and institutional) with their financial goals and is an important investment for over 620,000 shareholders. In 2016 Westpac returned 80% of its profits to these 620,000 shareholders.

Westpac does not support the introduction of a new tax on Australia's major banks, which are already some of Australia's highest taxpayers. We believe the Levy is questionable policy and sets a poor precedent in tax policy.

Such a Levy cannot be absorbed by the banks, as some have suggested. From a financial perspective the key stakeholders in the bank are customers, employees, shareholders and suppliers. This means the impact of the Levy will be borne either by one or some combination of those four groups. This is recognised in the Explanatory Memorandum for the Bill.

Banks protect the savings of all Australians and play a vital role in credit intermediation. They provide the broadest reach of credit provision, ranging from large corporates to Small and Medium Enterprises (SMEs) and households. Banks are also an important investment for many retirement funds of the Australian community. The retirement portfolios of many ordinary Australians involve a significant holding of bank shares and many rely on bank dividends to fund their retirement.

Banks employ a significant number of people, and procure a large number of services from both large corporates and SMEs.

As a result of these deep interactions with the whole of society, (and, while Westpac has not yet determined its proposed response to the Levy) most Australians will ultimately be impacted by the cost of the Levy.

In addition, Westpac believes the Levy does not meet the standard tests of efficiency and equity for sound tax policy. It is a tax on economic growth. It taxes the raw materials of the banks, and the cost of the Levy increases as the banks' provide increased loan finance, irrespective of profitability.

The Australian economy relies on credit availability for growth, and most of the credit is provided through the banking system. As a result, the Levy directly and intentionally raises the cost of providing loans to Australian businesses and families provided by our nation's major credit providing institutions.

Notwithstanding these general flaws in the Levy, Westpac expects the Bill to be enacted. Therefore we would like to take this opportunity to provide the Committee with our suggestions as to how the legislation can be improved. The detailed suggestions that follow revolve around the need to maintain international competitiveness and to ensure the Levy has minimal adverse impact to markets and the economy.

International competitiveness

Australia's sophisticated, well-regulated and competitive financial sector has attracted many large multinational foreign banks. Globally these banks have large balance sheets and substantial ability to compete in the Australian market. They are generally more active in the institutional banking market than the retail banking market (in contrast to the Australian regional banks which are predominantly retail banks), but increasingly we see many of them expanding into retail banking either directly or providing funding to third parties.

In a number of institutional banking segments international banks are significant competitors to the Australian major banks. The imposition of the Levy on major Australian banks to the exclusion of large multinational foreign banks places Australian banks at a competitive disadvantage in these key markets. This will likely result in business transferring from the Australian Banks to the large foreign banks, and as a result, it may even deplete the tax base for the Levy. In effect, Australians will be subsidising foreign bank shareholders.

We have provided two examples below of market segments in which the Australian banks compete with foreign banks that we believe will be directly affected by the imposition of the Levy.

Trade finance

Banks provide various forms of financial support to exporters and importers to facilitate domestic and international trade. The Australian major banks and foreign banks are the main participants in this market. Many of these products require funding from bank balance sheets (i.e. bank liabilities).

Export finance will be particularly affected by the Levy, which will increase the cost of funding such activities for the major Australian banks, making them less competitive in this market. It will give the large foreign banks a competitive advantage to win more business (by more aggressively pricing these transactions), and may also result in a reduction in such activity by the majors. This also reduces the tax base for the levy.

Repurchase agreements (repos)

A repurchase agreement (repo) allows for the simultaneous sale of fixed income securities (held to manage liquidity or for the facilitation of customer fixed income flows) for receipt of funds combined with an additional forward agreement to buy the bonds back at a purchase price linked to the return of funds with interest at a future date.

The Australian majors and large foreign banks acquire Government and Semi-Government securities which they repo with the market. This provides the counterparty with fixed income securities and the bank with cash, for a specified period of time.

The current size of the repo market is in excess of $100 billion, with the Australian majors being large providers in this market.

We expect the Levy to increase the cost of market making in Government and Semi-Government securities for Major Banks and to reduce liquidity within the overall repo market.

Spreads in the market making of government and semi-government securities are less than 1bp hence the imposition of the Levy would significantly increase the cost of supporting these products. The impact could drive the major Australian banks to potentially exit some or all of that business, thus increasing foreign bank market share. This would have the effect of decreasing the tax base for the Levy. It may also concentrate market making support within the foreign banks and could potentially increase the cost of funding for the issuance of government and semi-government bonds.

Further, the reduction in liquidity will impact other financial entities such as superannuation firms. Over recent times the Australian repo market has lacked depth and volume, and the additional cost of the Levy adds to liquidity concerns for the market. Global derivative reform requires a functioning repo market. Financial firms such as superannuation funds will be required to post and receive collateral based on their derivative positions. A lack of liquidity within the repo market would increase their liquidity risks and impact their returns through higher transaction costs and the additional need to hold cash collateral to meet their obligations.

Recommendations

Westpac recommends the following amendments be made to maintain international competitiveness and ensure minimal adverse impact to markets and the economy.

1. Change the mechanism of the legislation to include foreign banks; and
2. Narrow the liability base, to exclude products/transactions where the imposition of the Levy would have an adverse impact on liquidity and pricing – i.e. funding of trade finance, repos and money market transactions that facilitate bank cash management and enable efficient functioning of the payment system.

Inclusion of a sunset clause

The Government has stated that the primary purpose of the Levy is for budget repair. If this is the case, then the Levy should only be a temporary measure. The legislation should include a clause providing that the Levy ceases at the end of the current budget cycle (in 2021). This is consistent with the approach adopted for the temporary Budget Repair Levy applied to high income earners from 2014 to 2017.

By not including a sunset clause market uncertainty is created which increasingly will be a factor for domestic and institutional investors in deciding whether to invest in Australia and Australian major banks.

Suspension of the Levy for ADIs in stress

The Levy is imposed on the liabilities of an ADI, and its design appears to assume the banks are at all times profitable. As the Levy is a tax on the size of balance sheets rather than profits, when there is an economic downturn the Levy will have a disproportionate impact on earnings.

The Government should have the ability to suspend payment if paying the Levy would place undue stress on the ADI. This will assist with the financial viability of the affected ADI and the stability of the banking sector in times of economic downturn.

For further information in relation to any matters raised in this submission, please contact Brett Gale, Group Head of Government Affairs and Communication Strategy on [redacted] or [redacted]

Yours sincerely

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