Commonwealth Bank
Commonwealth Bank of Australia
ABN 48 123 123 124

Andrew Hall
Executive General Manager
Corporate Affairs
Level 5, Darling Park Tower 1
201 Sussex Street, Sydney, NSW 2000

15 June 2017

Senator Jane Hume
Chair
Senate Economics Legislation Committee
PO Box 6100
Parliament House
CANBERRA ACT 2600

Via email: economics.sen@aph.gov.au

Dear Chair,

Major Bank Levy Bill 2017

This submission provides feedback from Commonwealth Bank in relation to the Major Bank Levy Bill 2017 (the Bill). Commonwealth Bank has significant concerns about the Bill and encourages the Committee to consider the amendments outlined below and in the attached document to ensure its effective implementation.

Commonwealth Bank lodged a submission to Treasury on 15 May 2017 in response to the Government's announcement of the levy (attached). Many of the key points raised in our submission have not been addressed. The outstanding issues of concern include but are not limited to:

- the levy creates disincentives for banks to build liquidity and funding buffers, a critical part of being "unquestionably strong"; and
- the levy undermines the confidence of stakeholders, including global funders, in Australia's most important financial institutions.

Of particular concern is the purpose of the levy. We submit that clarity is required around the true objective of the Bill to ensure the appropriate policy settings are contained in the legislation.

If the levy is to address competition in the financial services sector, the best course of action would be to await the outcome of the Productivity Commission Inquiry into Competition in the Australian Financial System. If the levy has been introduced to assist with Budget repair, the Bill should include a sunset clause for when the Budget returns to surplus. If the rationale for the introduction of the levy is that banks should make a contribution for the 'implicit guarantee', this would run counter to the findings of the government's own Financial System Inquiry. If the policy objective of the levy is to complement prudential reforms, then options are available to support the stability of the system which do not seem to have been considered, such as differential rates of the levy applying to short and long term debt, as applies in the United Kingdom (UK).

We also note that since the introduction of the bank levy in the UK, the UK Government has assessed the effectiveness of the liability-based model in achieving the policy objective of targeting excessive leverage. As a result of its comprehensive review with stakeholders, in 2015 the UK Government announced a "phase down" of the liability model in favour of a profits based model.

Recommendations for consideration

This submission does not reiterate in detail all the arguments Commonwealth Bank has outlined in our previous submission, but instead highlights three key amendments we believe should be made to the legislation.

1. *Introduce a sunset clause*

As outlined above, if the purpose of the levy is to help return the budget to surplus we submit that the levy should be removed beyond the forward estimates once a surplus has been reached. There should be a positive obligation on the Parliament to decide to extend the operation of the levy. This could be achieved by introducing a mechanism such as a sunset clause.

Recommendation:

The Committee should recommend an amendment to introduce a sunset clause for the levy.

2. *Extend the levy to include foreign banks*

If large Australian banks are to be covered by the levy, we believe it should be extended to also include very large foreign banks active in Australia.

We are concerned that the Australian Government appears to be adopting a policy that deliberately favours foreign companies over domestic competitors. While we welcome competition in the sector, we believe in the principle of competitive neutrality. This neutrality is important so that domestic industries have an equal opportunity to grow and remain competitive globally, for the benefit of all Australians.

Much of the recent debate has focused on retail banking, particularly home loans. A number of foreign banks are particularly active in retail banking and we can see no credible policy rationale why the Government would wish to disadvantage large Australian banks relative to their global competitors in relation to (for example) home loans and credit cards.

A further key market for domestic banks is corporate and institutional lending and deposit taking. Small and medium-sized Australian lenders have not typically been active in the corporate lending market. The foreign banks however are already competing aggressively in non-housing related loans, last year growing their balances by 11.2 per cent whilst the major banks experienced growth of 3.9 per cent.

Our experience is that the segments in which the foreign banks operate are highly competitive and often sensitive to changes in the cost of borrowing. In light of the current low interest rate environment, where Australian bank margins have been under pressure and overall competition heightened, we believe the imposition of the levy only on the major banks will give foreign banks a pricing advantage in these segments. This would be in addition to the competitive advantage foreign banks already have from less conservative regulatory requirements, and therefore carry substantially less capital than their Australian peers, including in retail lending (as illustrated in Appendix 1).

In light of the above issues, we recommend the levy be amended to include foreign banks based on their global scale. This can be achieved by amending the levy to be based on the global balance sheet of all banks active in Australia. The levy would then still be applied to the same set of domestic liabilities. Such a change would have the additional advantage of increasing revenue and accelerating budget repair.

Recommendation:

The Committee should recommend amendments such that any bank whose global liabilities exceed A$100 billion (or foreign currency equivalent) is required to pay the levy on domestic liabilities.

3. Require a review of the operation of the legislation after two years

The rushed manner in which this levy has been announced has led to lost opportunities to align this policy with broader public policy settings.

Many foreign bank levy models were introduced in response to the Global Financial Crisis to recoup government costs or to build up stability funds to support the strength of their financial system. Neither of those rationales apply to the implementation of the Australian bank levy.

By contrast, the Australian Government is using tax policy to disadvantage a small number of companies in one industry, with a view to engineering a desired competitive outcome and in advance of the government's own review of competition in the sector. This approach to encouraging competition runs counter to the overall direction of microeconomic reforms pursued by successive Australian governments since the early 1980s. To our knowledge, no government review of taxation or competition policy concluded in the subsequent decades has recommended such an approach.

Further, the Government has recently announced a Productivity Commission review of competition in the sector. It is essential that a mechanism be available so that the findings of that inquiry can be factored into the design of the Bill.

It is also evident that opportunities have been lost to align the policy with broader public policy settings and a review would allow for a more fulsome consideration of policy options. For example, in the United Kingdom a discounted rate applies to long term debt to encourage banks to raise funding in a way that maximises the stability of the system, however this has not been factored into the Australian model.

In the interests of good public policy, the Committee should recommend that the Government legislate a review of the operation of the levy after a defined period of time to ensure it is consistent with broader competition, prudential, taxation and economy policy settings.

Recommendation:

The Committee should recommend amendments such that a review of the levy is conducted within two years of its legislation, and this should include an analysis of the efficiency of the levy in terms of its stated objectives and the distortions it creates.

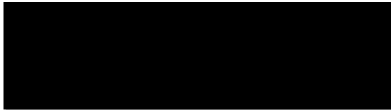
Other matters

We are concerned by the level of discretion that the Bill provides the Minister to make changes to the levy. Of particular concern are the discretions contained in subsections 8(2) and 8(3). We ask the Committee to consider these powers and question why these discretionary powers need to be included in the form in which they are currently drafted.

Conclusion

We trust that our concerns will be carefully considered. We remain available to consult with the Committee on any potential amendments or issues around implementation, should this be of value.

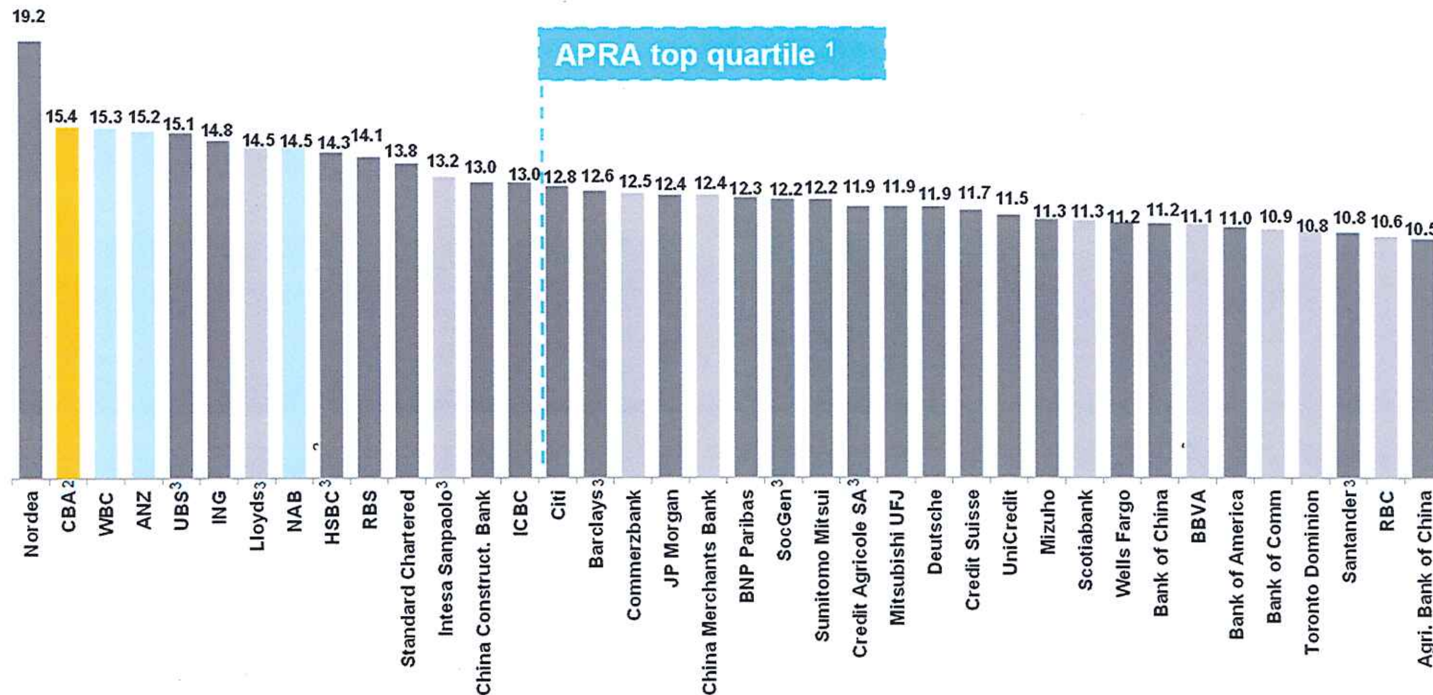
Yours sincerely



Andrew Hall
Executive General Manager
Corporate Affairs

Appendix 1– Australian major banks are safer than their global peers

International CET1 ratios



Source: Morgan Stanley and CBA. Based on last reported CET1 ratios up to 31 May 2017 assuming Basel III capital reforms fully implemented. Peer group comprises listed commercial banks with total assets in excess of A$750 billion and which have disclosed fully implemented Basel III ratios or provided sufficient disclosure for a Morgan Stanley estimate.

Global Systemically Important Banks (G-SIBs) are shown in dark grey

1. APRA Insight Issue Two "International capital comparison update" (4 July 2016)
2. Domestic peer figures as at 31 March 2017
3. Deduction for accrued expected future dividends added back for comparability

Commonwealth Bank
Commonwealth Bank of Australia
ABN 48 123 123 124

Level 19
Darling Park Tower 1
201 Sussex Street
Sydney NSW 2000

GPO Box 2719
Sydney NSW 2000

Ian Narev
Chief Executive Officer

15 May 2017

Mr John Fraser
Secretary to the Treasury
The Treasury
Langton Crescent
Parkes ACT 2600

Via email

Dear John,

Proposed Australian bank levy

As discussed, we present through this letter our submission in relation to the Australian levy announced by the Government last Tuesday.

We have already conveyed to you our significant concerns about the levy. For many years, and particularly since the Global Financial Crisis, we have heard both the Treasurer's Office and The Treasury emphasise the importance of a strong and fair banking system for Australia's economic prosperity. We were surprised to see the sector singled out for this levy; and we remain very concerned at the speed with which the levy is being introduced, and the significant risk of unintended consequences that could impact the stability and effectiveness of the banking system. We exist to safeguard the savings of, and extend credit to, Australia's families and businesses. In doing so, we want to invest in service levels, create jobs, conduct business ethically and sustainably, and provide good returns to the 800,000 families who own the Commonwealth Bank and the millions more who own us through their superannuation. We are very concerned that the levy undermines our ability to achieve these goals.

We will continue to express these concerns. In parallel, however, we are committed to working constructively with The Treasury to ensure that, even if this is bad policy, it is implemented as well as possible. Subject matter specialists from amongst my senior management are highly experienced in reform and implementation issues. I have made it their priority to assist your team. Their contact details are provided later in this submission.

Beyond our overall concerns about the levy, the major themes in this submission focus on the following major risks:

- the levy becomes an on-going tool for Governments to fill Budget gaps at the expense of the banking industry, or indeed other industries in the future, and through them ordinary Australian taxpayers;
- the levy creates disincentives for banks to build liquidity and funding buffers, a critical part of being "unquestionably strong";
- the levy creates an uncompetitive environment in Australia that favours non-Australian banks, including some globally systemically important banks, over Australia's own banks; and
- the levy undermines the confidence of stakeholders, including global funders, in Australia's most important financial institutions.

We have divided our submission into three sections:

- **Policy issues** – submissions relating to the overall policy underpinning the levy;
- **Design issues** – submissions relating to the calculation of the levy; and
- **Timing and implementation issues** – submissions relating to the manner in which the levy is implemented.

We have included specific recommendations throughout each section. For ease of reference, we have also included a full list of the recommendations in Appendix B.

Where relevant, we have drawn on examples from overseas jurisdictions, including examples in which some of our team members have been directly involved. In doing so, we emphasise that through a combination of good policy, good regulation, good management and good luck, the Australian banking system has become as strong, effective and efficient as any in the developed world. We must always look for opportunities to improve and, as you are aware, both individually and through the Australian Bankers' Association initiatives, the major banks are well progressed in ensuring that our policies and practices better meet public expectations. However, we must also be wary of adopting overseas policies that were born out of major banking crises in those jurisdictions.

Ultimately, Australia's on-going prosperity depends on all stakeholders working together co-operatively to ensure that our banking system remains strong and fair. To that end, we must be, and will be, prepared to speak openly about policies that could weaken our banks. But we are also committed to working constructively and collaboratively to ensure that our banks remain able to play our critical role for all our stakeholders as well as we can.

A. Policy issues

1. Rationale for a levy

At the meeting between The Treasury and the Chief Financial Officers of the affected banks last Thursday, The Treasury explained the rationale for a levy as including the following:

- Assisting to return the Federal Budget to surplus;

- Complementing other measures undertaken to ensure that the Australian banks are "unquestionably strong";
- Levelling the playing field in the Australian banking industry; and
- Charging for the implicit Government guarantee of the major banks[1].

1.1 Returning the Federal Budget to surplus

The banks are a key part of the Australian economy and the major banks together contributed up to $14bn in tax last year.

The Commonwealth Bank is the largest taxpayer in Australia and paid $3.6bn in tax last year. The addition of the levy requires us to bear a disproportionate share of the Budget. No other sector of the economy pays such a disproportionate amount of tax. It is bad policy to impose this on a sector which funds and vitally supports Australia's prosperity.

Considering our unique place in the Australian economy, where we are responsible for 20% of all business lending in Australia and for 8% or $148bn of shareholder wealth accumulated in this country[2], this cost will be unfairly borne by families and businesses who are our customers and shareholders. The realities of running a business, whether small or large, are that higher costs are either passed on to customers through reduced service levels or higher pricing, or to shareholders through lower returns. There is no middle option to absorb costs. Our shareholders include 800,000 families who own the Commonwealth Bank, and the millions more who own us through their superannuation. Thus, the levy will impact those who least deserve it.

The levy works against a number of the Government's core economic goals, including supporting business to invest and create jobs, and attracting capital to Australia. It contradicts the idea that we want people and businesses in Australia to be productive and successful. The levy implies that being profitable is a negative when, in fact, the banking industry's profitability benefits and supports the whole economy.

We have been advised that the levy is to be permanent. This will even more significantly penalise our customers and shareholders for dealing with, and investing in, us.

To minimise this unfair penalty on our customers and shareholders, **a future Budget surplus must trigger a review of the levy and should result in it being abolished (ie, there should be a "sunset" on the levy)**. At the very least, the levy must be **designed so it can be set to zero at the right time**. It is not appropriate for the levy to become an on-going tool for Governments to fill budget gaps at the expense of the banking industry, or indeed other industries in the future, and through them ordinary Australian taxpayers.

In the same vein, the levy **must be set at a fixed rate**. It must not vary year by year according to the Budget deficit or be viewed as a soft option for future tax increases, otherwise it will undermine investor confidence and affect the major banks' perception as unquestionably strong.

---

[1] We have discussed this matter with The Treasury over a number of years, and have not dealt with it again in this submission

[2] As at 31 March 2017

1.2 Complementing "unquestionably strong"

The Australian banks need to be perceived as unquestionably strong. This is critical to maintaining our customers' confidence in our products and services, which make a real difference to their financial security.

Investor perception of our strength is important to our ability to compete for funding and capital, particularly in offshore markets. This is important both in good markets as well as in times of stress.

The concept of "unquestionably strong" has generally been associated with the banks' capital levels. In tougher times when there are constrained profits, the levy will continue to apply because it is based on liabilities, not profit. The burden at this time will become even greater, and will constrain capital accumulation and the ability to attract capital from investors. Further, our strength also depends on our liquidity and funding levels, and on investor confidence in our bank.

(a) Investor confidence

Investor confidence in a given bank is based on both confidence in that bank and the broader framework within which it operates, including the political, legal and taxation frameworks.

Presently, the levy has already undermined investor confidence. On the day of the announcement, as a result of rumours of the imposition of the levy, a stock market sell-off of bank shares wiped $14bn from the wealth of hundreds of thousands of shareholders.

A number of equity analysts have attempted to calculate the amount of the levy to be collected from the Commonwealth Bank, and have failed to unanimously agree on the value. Their estimates have ranged between $323m[3] and $449m[4] for the 2017/18 financial year. This profit impact has already led to a change in one buy/sell recommendation in relation to our shares[5].

Discussions with investors, as well as commentary in the media, has highlighted concerns that the banking industry is being singled out; that it could be repeatedly targeted through variation of the levy rate in future years; and that the major banks and Macquarie Bank are now having their returns regulated and are on the road to nationalisation. Political risk is viewed as a significant risk in Australia, and business leaders and commentators beyond banking have expressed concern about contagion to other industries.

The levy must avoid the creation of uncertainty for stakeholders. Lack of investor confidence will affect our ability to compete for funding and capital unless the subsequent **design and implementation of the levy is fair and predictable**.

---

[3] CLSA

[4] JP Morgan

[5] Macquarie Securities (Australia) Limited changed their rating for the Commonwealth Bank from Neutral to Underperform

(b) Liquidity coverage ratio (LCR)

The levy will undermine the LCR reforms implemented as part of Basel III. We fund our holdings of high quality liquid assets (HQLA) to satisfy our LCR requirements through debt, with an aim of funding them through the lowest cost debt due to the low returns on HQLA. The levy adds up to an additional 6 basis points (bps) cost to the funding of our HQLAs, creating a disincentive for us to hold more than the minimum amount of HQLAs. This is counter to our discussions with the Australian Prudential Regulation Authority (APRA) in relation to holding a buffer above the minimum LCR ratio. The levy must be **designed so that it does not apply to debt used to fund HQLA**.

(c) Net stable funding ratio (NSFR)

Similarly, the levy will undermine the NSFR reforms, which require us to hold higher levels of long-term debt. The levy creates a disincentive for us to hold more than the minimum amount of long-term debt. Again, this is counter to our discussions with APRA in relation to holding a buffer above the minimum NSFR ratio. The levy must be **designed so that it distinguishes between short-term debt and long-term debt**.

(d) Tier 2 capital

The levy will not apply to equity or Additional Tier 1 capital issuance, which recognises the importance of supporting the banks' capital requirements.

However, the banks also hold Tier 2 capital to meet their capital requirements and, in the future, will be required to hold significant levels of total loss absorbing capacity (TLAC) securities. **Both Tier 2 capital issuance and TLAC must be excluded from the levy.** Failure to exclude such capital creates a disincentive for the banks to hold more than the minimum amount of capital to absorb losses and protect the Australian banking system from bank failures.

1.3 Levelling the playing field with non-Australian banks

The levy does not apply to overseas-owned multinational banks and therefore favours them at the expense of Australia's own banks. Most overseas banks operating in Australia are substantially larger than the Australian major banks, yet they will not be subject to the same additional cost.

This will enable the non-Australian banks to compete more aggressively for deposits (ING, HSBC and Rabobank, for example, are significant deposit-takers in Australia) which they can do without the additional cost of the levy. Based on recent APRA statistics, the overseas banks operating in Australia take 9% by value of all deposits in Australia. This equates to $161bn and is in contrast to the $114bn of deposits able to be accessed by the second tier banks (Suncorp, Bank of Queensland, and Bendigo and Adelaide Bank).

The levy must be **designed to also apply to the non-Australian banks** on a fair basis – a basis which levels the playing field between all banks operating in the Australian market, whether major banks, non-major banks, or non-Australian banks. While the non-Australian banks may be subject to

levies, taxes and regulations in their own jurisdictions, when they come to Australia they must be prepared to compete on a level playing field. When the Australian banks go to an overseas jurisdiction, we expect to compete on a playing field which is level, no more and no less.

Design of the levy must also take into consideration the opportunity this will offer the shadow banking industry to compete in the Australian market. A number of companies already successfully operate on lower cost structures and with tax advantages due to offshore structures and transfer pricing. These companies are not fully regulated and a failure of these companies will impact on millions of Australian users.

We note that the Treasurer in his Budget speech argued that the levy would "even up the playing field for smaller banks". As a result of the Financial System Inquiry's recommendation to assist banking competition, the major banks have already accepted significant increases in mortgage risk-weights. The Financial System Inquiry did not recommend a bank levy. Last Friday, the Government appointed the Productivity Commission to undertake a 12 month inquiry into competition in the Australian financial system. The Government appears to have formed a view on this issue before allowing the Commission to do its work, but we intend to contribute to the Commission's inquiry to enable a thorough examination of the issues involved for the sake of the whole system.

2. Scope of the levy

2.1 Funding liabilities only

While it is clear the Government has chosen a levy model which taxes liabilities, the reasons for doing so, and therefore the liabilities intended to be taxed, are not clear. Usually, models focused on liabilities are adopted to discourage excessive leverage of bank balance sheets, which was a contributor to the Financial Crisis. If this is the Government's intention, **this must be made clear** so that it can inform design and implementation. Further, the levy should be targeted at funding liabilities (i.e., funding which leverages the balance sheet), and should be **designed to exclude non-funding liabilities**. Failure to exclude non-funding liabilities unfairly penalises the banks for items which are often unnecessary gross ups of balance sheets due to accounting rules. Important exclusions are discussed further in section B.

2.2 No foreign liabilities

The levy will not apply to the liabilities of our foreign subsidiaries but will apply to the liabilities of our foreign branches.

Our business in overseas jurisdictions supports many Australian customers operating in those countries. The levy will affect our ability to support $148bn of customer business through our overseas operations, and therefore the levy must be **designed to exclude the liabilities of both foreign branches and foreign subsidiaries**.

We also note that we may become subject to bank levies in some of the jurisdictions in which we operate. To avoid double taxation, we should be entitled to **claim a credit against the Australian levy for the equivalent amount of all overseas levies paid**.

3. Impact on functioning of the monetary system

The major banks are critical to the efficient functioning of the Australian monetary system. The levy will constrain our ability to participate in interbank lending and Reserve Bank of Australia (RBA) market operations. There will be severe distortions around quarterly dates and, for example, in relation to rate setting, two significantly different rates will need to be recognised – one including the participation of the major banks and Macquarie Bank; and one including the participation of the other banks, in effect, allowing the rate to be set by non-Australian banks who are not affected by the levy.

In June 2016, Guy Debelle, now Deputy Governor of the RBA, noted the importance of the role of the domestic banks in Government bond liquidity. Their 30% holding of Government bonds balances the more than 60% held by non-Australian investors:

> *"Banks' holdings of government bonds have increased to around 30 per cent of the market. The RBA's judgement is that a greater holding than 30 per cent may impair the functioning of the government bond markets. In coming to that assessment, one of the considerations is the sizeable share of government securities held by offshore investors. In the case of AGS, this currently amounts to more than 60 per cent of the stock. Many of these investors are buy-and-hold investors. They generally do not undertake securities lending. As a result, these bond holdings are not contributing to the liquidity of the market"[6].*

Design of the levy must take into consideration the potential impact on the monetary system and ensure that it does not compromise the system. The RBA must be consulted.

B. Design issues

We raise a number of design issues. Each of the items discussed is identifiable and real – it is either identified in our accounting balance sheet or in a return lodged with APRA. We note that these may add complexity to the levy framework, but are necessary to support policy objectives.

1. Exclusion for all regulatory capital

As discussed above, to be consistent with the exclusion of equity and Additional Tier 1 capital issuance which recognises the importance of supporting the banks' capital requirements, both **Tier 2 capital issuance and TLAC must be excluded from the levy**.

---

[6] Guy Debelle, Reserve Bank of Australia, "Liquidity in Australian fixed income markets", 21 June 2016

The Dutch bank levy excludes Tier 2 capital, and this is also the case under the Portuguese bank levy framework.

2. Exclusion for HQLA

As discussed above, to support the LCR, **debt used to fund HQLA must be excluded from the levy**.

Similarly, **liabilities which fund repo-eligible securities that are counted as HQLA must be excluded**. This is critical to the Australian banks' ability to comply with their LCR requirements through the Committed Liquidity Facility (CLF) in a situation where there is insufficient Government and high-grade corporate bond issuance to otherwise satisfy this requirement.

The United Kingdom (UK) bank levy excludes debt used to fund HQLA.

3. Concessional rate for long-term debt

As discussed above, to support the NSFR, the levy must distinguish between short-term debt and long-term debt, and must **concessionally tax long-term debt** to encourage holding of long-term debt over short-term debt and also the holding of buffers above the minimum NSFR ratio.

The UK bank levy defines long-term liabilities as liabilities not due within 12 months, and taxes them at only 50% of the main levy rate.

4. Exclusion for Exchange Settlement Account (ESA) balances

The major banks contribute to the efficient functioning of the monetary system by depositing, and borrowing, monies through their ESAs with the RBA.

To ensure that efficient functioning of the system is not compromised, **ESA balances (funded by repo with the RBA) must be excluded**.

5. Exclusion for non-funding liabilities

As discussed above, **non-funding liabilities should be excluded** to avoid unfairly penalising the banks for items which are often unnecessary gross ups of balance sheets due to accounting rules. Although a large amount of derivative liabilities are covered by enforceable netting arrangements, or similar agreements with counterparties, they do not qualify for set-off under accounting rules. Similarly, a bank's "payable to other institution" balance contains collateral pledged by those institutions when entering into repo and derivative agreements with the bank. This means the bank's reported liabilities double count derivative and collateral amounts which are netted in practice. Using these balances for the levy would have the unintended consequence of penalising the bank for inflated balances that do not reflect true funding liabilities.

Non-funding liabilities that should be excluded include:

- derivative liabilities;
- collateral;

- provisions;
- tax liabilities;
- client monies; and
- defined benefit employee plans.

The UK bank levy excludes many of these items.

Any double counting of liabilities as a result of the accounting treatment of trusts used to issue residential mortgage-backed securities and covered bonds must also be addressed.

6. Anti-avoidance provisions must be commercially-orientated

We have been advised that the relevant legislation will include anti-avoidance provisions to prevent the banks from artificially restructuring their liabilities to avoid or reduce the levy.

Bank activity is complex, and the anti-avoidance provisions must not capture incidents merely because they are complex or where they provide a non-material benefit. **They must be commercially-orientated** and not hinder proper business decision-making, business activity and especially not the appropriate management of risk.

A potential precedent are the general anti-avoidance rules (GAAR) within the income tax law. Over time, it has become clear from the GAAR that the key principles for effective and enforceable anti-avoidance rules are:

- the bank must obtain a material benefit (being avoidance or reduction of the levy) from the restructuring of their liabilities. Enforcement of incidents relating to non-material benefits are a waste of resources;
- the bank must have a sole or dominant purpose of obtaining a benefit. Actions genuinely taken for commercial reasons, such as a change in funding mix to satisfy the LCR or NSFR, must not be captured; and
- it must be clear that the bank has entered into an artificial or contrived arrangement.

“Good behaviour” which the levy seeks to incentivise should not be caught, by specifically excluding it from the application of the anti-avoidance provisions. This would include where a bank increases its regulatory capital, reduces its liabilities, swaps short-term funding for long-term funding, or otherwise changes its funding mix to satisfy the LCR or NSFR.

C. Timing and implementation issues

1. Sourcing appropriate information

Based on our understanding of the levy as currently proposed, it will not be efficient to start the calculation of a bank’s levy base using its statutory liabilities nor its accounting balance sheet.

Instead, the appropriate definition of the levy base is a bank’s liabilities relating to its Australian banking business (excluding liabilities of Extended

Licensed Entities, subsidiaries and intra-group liabilities). This information is reported to APRA through its reporting form ARF 320. However, ARF 320 would need to be updated to collect information about Financial Claims Scheme (FCS) deposits. There is no APRA form which currently collects this information. Further comments about the adaptation of ARF 320 for the levy are included in Appendix C.

We understand that the regulator for the levy will be the Australian Taxation Office (ATO) and that the Business Activity Statements (BAS) system will be used for reporting and payments. There is currently no technology platform through which ARF 320 could be submitted to the BAS system, and this will need to be built.

2. Timing and implementation

The proposed date for the introduction of legislation for the levy, given the amount of design work required, and the need to update ARF 320 and relevant technology, is not only ambitious but risks poor implementation and ultimately implementation failure.

ARF 320 is used to collect information for market share statistics produced by APRA, the RBA and the Australian Bureau of Statistics. It has not been updated for some time, and contains a number of old definitions. It does not collect all the information relevant to the levy. For example, section B4 of ARF 320 collects a lot of data about deposits, but does not collect any data about FCS deposits. The form is currently part of APRA's Economic and Financial Statistics (EFS) program, which is reviewing statistical returns. The EFS program has been running since January 2017 and more time is still required to review and amend all forms.

Systems which provide the data for ARF 320 will need to be re-programed to include FCS criteria. It is estimated that such a project will take up to 12 months to fully complete.

We recommend delaying the introduction of the legislation to closer to 30 September 2017, in order to have some time to prepare for implementation and reporting. On this timeframe, the first reports will be completed manually and will be on a "best endeavours" basis.

3. Consultation

Once implemented, the levy will be a significant part of the infrastructure of the Australian banking system. It is critical that all participants in the banking system have an opportunity to contribute to its good design and implementation, in order to ensure the least possible risk of damaging the system's stability.

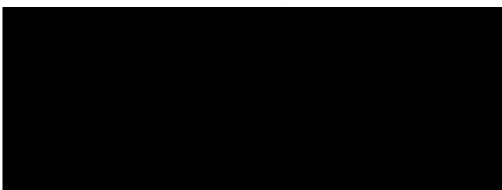
Consultation with the major banks and Macquarie Bank is critical to ensure proper implementation. Consultation with APRA is critical to ensure that it is consistent with prudential requirements and does not undermine them. Consultation with the Australian Competition and Consumer Commission (ACCC) is important to understand how the anti-avoidance provisions will be administered and how pricing reviews will be conducted. Uncertainty or delay in relation to banks' ability to make pricing decisions will affect the range and value of products and services provided to Australian customers.

Appropriate time to review the draft legislation, and provide comments, is critical. We request copies of the draft legislation, explanatory memorandum and regulatory impact statement urgently.

D. Subject matter specialists

Treasury	▪ Direct experience with UK bank levy ▪ Liquidity, funding and capital ▪ Market implications ▪ RBA liaison	Paolo Tonnuci Group Treasurer *Paolo was Barclay plc's liaison with the UK Treasury for the implementation of the UK bank levy*
Financial industry reform	▪ Comparison of bank levy and prudential frameworks globally ▪ Liquidity, funding and capital ▪ Prudential reporting ▪ APRA liaison	Tricia Ho-Hudson Head of Capital & Regulatory Strategy
Legal	▪ ACCC liaison	Anna Lenahan Group General Counsel
Taxation	▪ BAS reporting ▪ ATO liaison	Gavin Marjoram Head of Group Tax

Yours sincerely



Ian Narev
Chief Executive Officer
Commonwealth Bank of Australia

cc Ms Diane Brown, Division Head, Financial System Division, The Treasury

cc Ms Lynn Kelly, Chief Adviser, Corporate and International Tax Division, The Treasury

Appendix A

Glossary of terms

ABS	Australian Bureau of Statistics
ACCC	Australian Competition and Consumer Commission
AGS	Australian Government Securities
APRA	Australian Prudential Regulation Authority
ATO	Australian Taxation Office
ARF	APRA Reporting Form
ARF 320	APRA Reporting Form ARF 320.0 Statement of Financial Position (Domestic Books)
Basel III	A comprehensive set of reforms developed by the Basel Committee on Banking Supervision, to strengthen the regulation, supervision and risk management of the banking sector
BAS	Business Activity Statement
Bps	Basis points
ESA	Exchange Settlement Account
EFS	Economic and Financial Statistics program, a program reviewing statistical returns currently being run by APRA
EFT	Electronic funds transfer
FCS	Financial Claims Scheme
FBT	Fringe Benefits Tax
GST	Goods and Services Tax
HQLA	High-Quality Liquid Assets (HQLA) as defined in APRA Prudential Standard APS 210 Liquidity
HSBC	HSBC Bank Australia Limited
Implicit Government guarantee	A view that Australia's major banks are too big to be allowed to fail and therefore there is an implicit Government guarantee of those banks
ING	ING Bank (Australia) Limited (trading as ING Direct)
LCR	Liquidity Coverage Ratio (LCR) as defined in APRA Prudential Standard APS 210 Liquidity
Major banks	Commonwealth Bank of Australia, Australia and New Zealand Banking Group Limited, National Australia Bank Limited and Westpac Banking Corporation
Minimum LCR rate	100% minimum under Basel III

Minimum NSFR rate	100% minimum under Basel III
NSFR	Net Stable Funding Ratio as defined in APRA Prudential Standard APS 210 Liquidity
RBA	Reserve Bank of Australia
Repo	Repurchase agreement
Repo eligible securities	Securities purchased under a repurchase agreement which are eligible for use in the RBA's domestic market operations
Second tier banks	Bank of Queensland Limited, Bendigo and Adelaide Bank Limited and Suncorp-Metway Limited
Additional Tier 1 capital	Additional Tier 1 capital as defined in APRA Prudential Standard APS111
Tier 2 capital	Tier 2 capital as defined in APRA Prudential Standard APS111
TLAC	Total Loss Absorbing Capacity
UK	United Kingdom

Appendix B

Recommendations checklist

Major risk 1:	**The levy becomes an on-going tool for Governments to fill Budget gaps at the expense of the banking industry, or indeed other industries in the future, and through them ordinary Australian taxpayers**	
1	A future Budget surplus must trigger a review of the levy and should result in it being abolished	☐
2	Levy must be designed so it can be set to zero	☐
3	Levy must be set at a fixed rate	☐
Major risk 2:	**The levy creates disincentives for banks to build liquidity and funding buffers, a critical part of being "unquestionably strong"**	
4	Levy must be consistent with other prudential objectives (e.g. banks being unquestionably strong)	☐
5	Levy must exclude Tier 2 capital issuance and TLAC	☐
6	Levy must not apply to debt used to fund assets that count towards the LCR (including repo-eligible securities)	☐
7	Levy must distinguish between short-term and long-term debt and provide concessions for long-term debt	☐
8	Levy must exclude ESA balances	☐
9	Levy must exclude non-funding liabilities	☐
10	Levy must not affect a bank's competitiveness internationally	☐
11	Levy must not have unintended consequences on the functioning of the monetary system	☐
12	Anti-avoidance provisions must be commercially-oriented	☐
Major risk 3:	**The levy creates an uncompetitive environment in Australia that favours non-Australian banks, including some globally systemically important banks, over Australia's own banks**	
13	Non-Australian banks must be subject to the levy	☐

14	Levy must exclude the liabilities of Australian banks' foreign branches and foreign subsidiaries	☐
15	If Australian bank's foreign branches are not excluded, the levy should alternatively allow the Australian banks to claim a credit against the Australian levy for the equivalent amount of overseas bank levies paid in those jurisdictions	☐

Major risk 4: The levy undermines the confidence of stakeholders, including global funders, which could impact on their confidence in Australia's most important financial institutions

1	A future Budget surplus must trigger a review of the levy and should result in it being abolished	☐
5	Levy must be consistent with other prudential objectives (e.g. banks being unquestionably strong)	☐
16	Levy design and implementation must be fair and predictable	☐

Timing / implementation

17	A sufficient amount of implementation time is required to ensure accurate, complete and reconcilable data is used	☐
18	ARF 320 should be updated or a new return used	☐
19	Updates to ARF 320 and/or a new return should be incorporated into the EFS program	☐
20	APRA and the ATO should consider the issues arising from resubmissions of ARF 320 and the consequential impact on the levy	☐
21	The BAS form should be updated or a new specific form for banks be used	☐
22	APRA, the ATO and the banks need to build a technology platform through which ARF 320 can be submitted to the BAS system and payments made	☐

Appendix C

Practical implementation issues

Issue: The regulator and the banks need sufficient implementation time to ensure accurate and complete compliance
Recommendation: ▪ Subject to the scoping of the relevant liabilities, the banks need to appropriately source any additional data; update, test and implement systems; and update their data governance processes ▪ The banks need to assess the impact on financial statement disclosures and tighten the governance process if additional disclosures are required ▪ We recommend that there be a well thought through and planned implementation timeline that has been agreed with APRA, the ATO and the banks to ensure accurate, complete and reconcilable data is used

Issue: The banks need to report the information necessary to calculate the levy
Recommendation: ▪ The Government has advised that the levy will apply to most liabilities excluding FCS deposits and Additional Tier 1 capital. It will apply to Australian liabilities ▪ APRA reporting form ARF 320 currently collects the information that is closest to this requirement: - Australian balance sheet, including liabilities - No domestic or foreign subsidiaries - No Extended Licensed Entities ▪ ARF 320 would need to be amended to collect the following: - FCS deposits - Foreign branches (if required) ▪ We recommend that an updated ARF 320 or a new return is used to report

Issue: The banks need to be consulted on any reporting misalignments with the EFS program
Recommendation: ▪ The industry has been in discussion with APRA, RBA and ABS since January 2017 with respect to the EFS program

- As a result of this extensive consultation, a number of inconsistencies have been identified with respect to the reporting instructions and the interpretation of those instructions across the banks and the regulators
- We recommend that the updates to ARF 320 and/or a new return are incorporated into the EFS program

Issue: On occasions, the banks are required to re-submit ARF returns for prior periods

Recommendation:

- Restatements are required if the banks identify any improvements in data quality and/or the regulator requires amendments to past returns
- The tax legislation also allows for amendments to tax returns within 4 years of lodgement of the tax return. Interest is charged on any additional tax payable from the date it was due until it is paid and, conversely, interest is paid (at a lower rate) on any tax refundable
- We recommend that APRA and the ATO consider the issues that arise from resubmissions and the consequential impacts on the levy

Issue: The banks need to efficiently pay the levy

Recommendation:

- The Government has advised that the payment of the levy will be via the BAS system
- We recommend that an updated BAS or a new specific form for banks is used to report and pay the levy on a quarterly basis
- APRA, the ATO and the banks need to build a technology platform through which ARF 320 can be submitted to the BAS system and payments made
- We also recommend that the ATO create a unique electronic funds transfer (EFT) code and running balance account for each bank for this unique type of payment (this is currently available for income tax, GST, FBT, etc.)