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MACQUARIE

Mr Mark Fitt
Committee Secretary
Senate Economics Legislation Committee
PO Box 6100
PARLIAMENT HOUSE ACT 2600

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

Dear Mr Fitt

MAJOR BANK LEVY BILL INQUIRY

Thank you for the opportunity to make a submission to the Committee's inquiry into the Major Bank Levy Bill.

About Macquarie

In making our submission, it is important to highlight the uniqueness of Macquarie in terms of both its structure and operations.

Macquarie operates both banking and non-banking businesses. Macquarie Group Limited ("Macquarie Group") is an ASX-listed financial services group that includes Macquarie Bank Limited ("Macquarie Bank"), the Authorised Deposit-taking Institution ("ADI") to which the Major Bank Levy is to apply. The non-banking business of Macquarie Group is outside the scope of the Levy.

In the latest financial results, Macquarie Group earned a profit of $A2.2 billion with Macquarie Bank and Macquarie Non-Bank each contributing approximately 50%. The overall return on equity ("ROE") for Macquarie Group was 15.2%, with ROE for Macquarie Bank 10%.

Macquarie's business activities are primarily conducted in wholesale markets for institutional clients, with approximately two-thirds of our income derived outside of Australia. This makes Macquarie Group a significant exporter of Australian financial services. In our latest results, Macquarie Group earned more than $A10 billion[1] of

[1] A$5.8 billion of which was earned by Macquarie Bank.

revenue globally, of which we estimate $A4 billion was returned to Australia through the payment of Federal and State taxes, employee salaries, payments to suppliers and dividends to Australian shareholders including superannuation funds.

Impact of Major Bank Levy on Macquarie Bank

The Major Bank Levy will have a disproportionate impact on Macquarie Bank and is likely to have unintended consequences.

We operate in highly competitive domestic and international markets, retail and wholesale. The Major Bank Levy will increase the cost of the products that we offer and will make us less competitive.

This will reduce competition in the domestic retail market and inhibit our ability to export financial services globally.

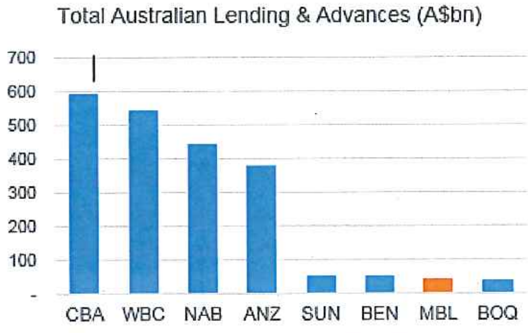
Impact on Macquarie Bank's competitiveness in Australian retail banking

Macquarie Bank is not a "major bank".

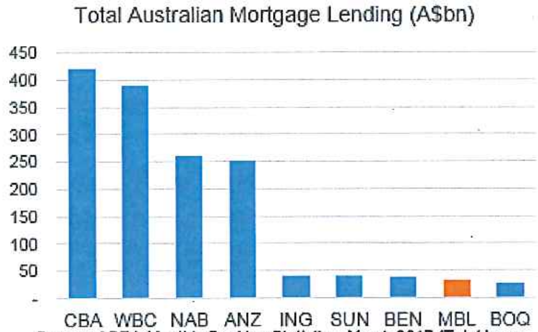
One of the stated objectives of the Major Bank Levy is to provide "*a more level playing field for smaller banks and non-bank competitors*". The Explanatory Memorandum accompanying the Major Bank Levy Bill states that the five banks that are subject to the Levy "*represent 80% of the bank deposit market, 80% of all credit provided by banks and around three quarters of the credit card market*".

Macquarie Bank, however, has a less than 2% market share in domestic mortgages, less than 2.5% in deposits, less than 2% of Total Australian Lending and Advances and less than 1.5% of the credit card market.

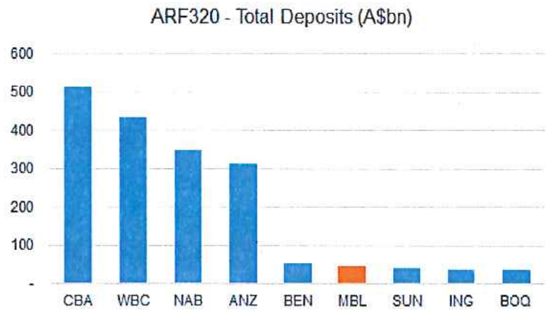
Putting this into perspective, Macquarie Bank's Australian mortgage business is not the fifth largest in Australia but eighth, ranking behind ING, Suncorp and Bendigo Bank and just ahead of Bank of Queensland - see graphs below.



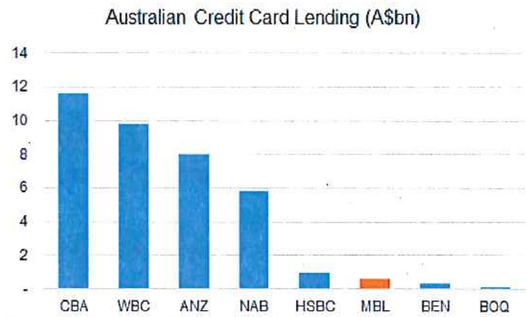
Source: APRA Monthly Banking Statistics, March 2017



Source: APRA Monthly Banking Statistics, March 2017 (Total loans to households, excluding credit cards)



Source: APRA Monthly Banking Statistics, March 2017



Source: APRA Monthly Banking Statistics, March 2017

Macquarie Bank is a price taker in the retail products that it offers (that is, the market determines the price of these products). Our ability to compete rests on our ability to provide products at the lowest possible cost. The Major Bank Levy will increase these costs. When viewed as a tax on Macquarie Bank's Australian business, the Major Bank Levy will have the effect of increasing the effective tax rate on this business from the current 34% to 41%, well above the 30% company tax rate.

Notwithstanding its relatively small market share, Macquarie Bank has a history of driving innovation in retail banking that has led to greater competition, more choice for consumers and has lowered the cost of retail products. These include:

- The introduction of the AAA-rated Cash Management Trust in the 1980s to allow retail investors for the first time to access wholesale short-term money markets leading to increased deposit rates across the Australian market.
- The development of the Australian mortgage securitisation market in the 1990s which allowed non-bank entrants such as Aussie Home Loans to compete against Australian banks in mortgage products, reducing mortgage rate margins by over 200 basis points.
- Development of the market-leading Wrap platform which allows advisers and their clients to cost-effectively manage their investments and meet all their reporting, regulatory and tax obligations.
- As a retail bank without branches, Macquarie Bank is at the forefront of delivering to our retail customers a world-leading low cost digital banking experience and has spent over $A300 million on this digital platform.

The imposition of the Major Bank Levy will affect Macquarie Bank's ability to continue delivering innovation to the Australian retail market.

We note that the Explanatory Memorandum also identifies the profitability of the five banks as being another key reason for their inclusion in the scope of the Levy. More particularly, it states that *"the major Australian banks are amongst the most profitable in the advanced world. Rates of return of equity of Australia's largest banks have averaged around 15% over the last five years far exceeding those in [other countries]".* Macquarie Bank's return on equity has averaged approximately 10% for the last five years.

Macquarie Group is predominantly a wholesale business and exporter of financial services

Macquarie Group is a major exporter of financial services and this brings significant benefits to the Australian economy.

Approximately two-thirds of Macquarie Group's income is earned offshore through the provision of financial services, predominantly to institutional clients. Last financial year Macquarie Group revenues exceeded $A10 billion, and we estimate that over $A4 billion was returned to Australia through the payment of Australian taxes, employee salaries, payments to suppliers and dividends to Australian shareholders including superannuation funds.

As a major exporter of financial services, Macquarie's products compete in international markets where our competitors will largely not be subject to the Levy.

The imposition of the Major Bank Levy will increase the cost of these products, reduce our ability to compete in offshore markets and effectively act as a tax on exports.

The major markets in which we compete include the United States, the United Kingdom and Asia. Neither the United States nor any countries in Asia impose a bank levy. The United Kingdom, which has a bank levy (but a lower rate of corporate tax), has recently announced it will reduce the bank levy and limit its application to domestic UK business only, recognising the impediment the bank levy represents to UK banks competing in foreign markets.

As a result, the application of the Major Bank Levy to Macquarie Bank will place it at a competitive disadvantage in offshore markets and may lead to it no longer being able to compete in some products.

Policy considerations

The Levy's design should be altered from that outlined in the Bill in order to achieve the overall goals of Budget repair and greater competition, whilst minimising unintended consequences. Alterations should include:

1. ***Increase the threshold.*** The setting of the threshold level for banks to be included in the Major Bank Levy should be increased. The levy threshold has been set high enough to exclude regional banks whose domestic presence is larger than Macquarie Bank's but low enough to ensure Macquarie Bank's inclusion. To achieve the stated objective of improving competition in the domestic retail market and to ensure Macquarie's continued success in exporting financial services globally, the threshold should be raised to exclude Macquarie Bank. This would have minimal impact on the government's revenue raising targets.

2. ***Consistency in exclusion of foreign operating entities.*** Foreign subsidiaries are excluded from the definition of liabilities for the purposes of calculating the levy payable. This exclusion should be extended to foreign branches to achieve

consistency and ensure the foreign operations of Australian banks remain globally competitive.

3. ***Consistency in exclusion of 'non-funding' liabilities.*** The Bill recognises the non-funding nature of certain liabilities in calculating the 'Applicable Liabilities Amount', namely for derivative-related assets and liabilities. We have previously identified to Treasury a number of liabilities that are also non-funding in nature, and these should also be excluded:

- *Client segregated funds*: These arise, for example, where Macquarie Bank receives margins from clients and posts these to the futures exchange on their behalf. Like derivatives, we see no reason why these gross exposures should not be considered on a net basis – these amounts do not represent funding raised by the ADI. Further, where this margin is posted with Australia's major banks, the Levy would be charged twice on the same money.
- *Derivative margin related balances*: Margin balances posted against derivatives act as a contra to derivative revaluation balances/exposures of an ADI. Margin balances should therefore also be assessed on a net basis (in line with the general netting treatment permitted for derivatives under the Bill).
- *Trade timing differences, deferred tax liabilities and internal liabilities funded by internal assets*: These balances fluctuate and do not provide funding.
- *Employee, maintenance and any other provisions:* These balances do not provide funding and represent reservation of profit to meet future expenses.
- *Intercompany funding arrangements, and other accounting gross-ups* where legal rights of set-off exist but accounting standards require the balances to be represented gross.

4. ***Remove uncertainty of future changes.*** The Bill creates uncertainty by basing the calculation of total liabilities and deductions used to calculate the applicable liabilities amount on APRA reporting standards. There would appear to be no restrictions on APRA's ability to change what liabilities are to be included in reporting standards. Furthermore, the Bill delegates authority to the Minister to change the liabilities to which the Levy applies by way of legislative Instrument. This creates uncertainty as to the future application of the Levy and should be removed.

5. ***Anti-avoidance provisions.*** The Explanatory Memorandum to the Bill states that the Levy anti-avoidance provisions are intended to focus on arrangements that are artificial or contrived, or give rise to transient reductions in liabilities by way of "window dressing" to achieve an effect over a quarter end. We think that this intent should be reflected more clearly in the Bill. To this end, the anti-avoidance provisions in the Bill should provide a clear and express exclusion for transactions that permanently reduce liabilities of an ADI.

Conclusion

We remain surprised the Major Bank Levy applies to Macquarie Bank given our size, the benefit we bring to competition in the domestic retail market and the role we play in bringing export income into the Australian economy.

Whilst we recognise and respect the Government's right to introduce laws and impose taxes for the good of the Australian community, we are concerned that the impact of the Major Bank Levy on Macquarie Group is not fully understood and that unintended consequences may result.

We have suggested changes to the Bank Levy which address these concerns and will have minimal impact on the Government's revenue raising objective.

Yours sincerely [redacted]

Patrick Upfold
Chief Financial Officer