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

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

Dear Senator Hume

Major Bank Levy Senate Inquiry

Suncorp welcomes the opportunity to provide a submission to the Senate Inquiry into the Major Bank Levy Bill 2017.

Suncorp Group Limited is a top 20 ASX-listed company with $96 billion in assets. The Group employs approximately 13,500 people and serves close to nine million customers through a range of trusted brands, including one million personal, SME and agribusiness customers served by our Banking and Wealth team.

Rationale for the levy

As a general principle, Suncorp does not support the imposition of new or increased taxes on Australian businesses. Higher taxes stifle business innovation and growth, and ultimately lead to poorer outcomes for all Australians.

However, we welcome any initiative which helps to improve competitive neutrality in the banking sector, and believe that the proposal in the Bill currently before the Senate has the potential to help support a more level playing field.

As the Committee would be aware, the Financial System Inquiry (FSI) handed down major findings to support competitive neutrality and some remain unfinished business to this day. Through the passage of time, the need to address these issues has become increasingly urgent, to deliver both better outcomes for bank customers and also to support an even stronger banking sector.

In the banking industry, there are features of the regulatory system that give major banks a clear advantage over the rest of the sector. In particular, the major banks currently enjoy an artificial funding cost advantage over the rest of the sector by virtue of their status as being “too big to fail.”

Since these banks are considered too big to fail, it is commonly accepted that they would receive Government support if they ever found themselves in financial difficulty. In effect, it is assumed the Government implicitly guarantees these institutions, which leads to them enjoying higher credit ratings than they otherwise would. S&P has consistently stated that it values the Australian Government’s implicit support as being worth a two-notch uplift, and that the credit ratings of these institutions are therefore two notches higher than they would be in the absence of this support.

This uplift has a direct impact on major bank funding costs, making them lower than they would otherwise be, and providing them with an artificial advantage not available to the rest of the sector.

While difficult to quantify the value of the uplift, it is clearly significant. Credible and independent commentators assert the advantage sits well above six basis points.

More recently, the scale of this advantage has become even greater. Late last month, S&P announced that it had lowered the credit ratings of 23 Australian financial institutions, but left the credit ratings of the major banks and Macquarie unchanged. In explaining this decision, S&P stated that while it had downgraded the Stand-Alone Credit Profile (SACP) of the majors by one notch, their overall issuer ratings remained unchanged, "…reflecting our expectation of likely timely financial support from the Australian Government, if needed…"[3] In effect, this means the two notch upgrade that was previously enjoyed by the majors banks has now been increased to three notches.

Seen in this context, a six basis point levy, while representing an improvement to competitive neutrality at the margin, does not fully offset the artificial funding cost advantage enjoyed by the majors.

In addition to reducing major bank funding costs, the credit rating uplift also makes it easier to access funds, and thus the uplift affects not just the cost of funds but also the quantum. Given that the aggregate pool of funding available in the market is finite, the credit rating uplift indirectly makes it more difficult for other banks to access funding, and this inequity is to the detriment of competition.

Application of the levy

While we are supportive of the Bill as it is currently drafted, we also believe that it could be improved by directly linking the levy with the credit rating uplift delivered by the implicit government guarantee. We believe that the levy should only be imposed on those institutions that enjoy a credit rating uplift, and that it would be inequitable for the levy to be imposed on banks that do not enjoy this advantage, simply because they are seen to be large and profitable.

We note that the proposed $100 billion threshold currently achieves this objective, in that it captures the five banks that enjoy an uplift, while excluding the rest of the sector. However, it is possible to envisage a future scenario where a bank crosses the $100 billion threshold without receiving a credit rating uplift, undermining the levy's usefulness as a tool to improve competitive neutrality.

We recommend that this risk be addressed by replacing the current $100 billion floor with a different metric which directly links the application of the levy to the existence of a credit rating uplift and the related funding cost advantage.

Furthermore, we note certain arguments being made for a sunset clause that abolishes the levy once surplus is achieved on the basis that it is a form of budget repair. However, the other objective of the levy – achieving a more level playing field – must not be forgotten. If a sunset clause is to be contemplated, it must be coupled with an alternative policy approach that more effectively addresses the major banks' funding advantages.

Supporting competitive neutrality and a level playing field

The implicit government guarantee is just one area where the major banks enjoy an artificial competitive advantage over the rest of the sector, and there are many other areas where more needs to be done to achieve a level playing field. Suncorp continues to advocate for the recommendations detailed in the FSI, and other related measures designed to support this goal. In particular, we would highlight the following areas that require further attention:

> ***Risk Weights:*** The current dual system of estimating risk weight assets allows the major banks to use their own internal modelling, while other banks have a fixed risk weight floor set at a significantly higher level. This allows the major banks to hold less capital for the loans they write which in turn improves their return on equity. The gap between the two systems is greatest for the safest categories of residential mortgages, which makes it particularly challenging for small banks to compete for this business. For example, low risk owner-occupied principal and interest mortgages are assigned a risk weight of 35 per cent when held by smaller banks, while the risk weights for the same loans can potentially be less than 5 per cent when held by a major bank. While the FSI recommended a partial narrowing of the gap between the two approaches, we believe that further reform is warranted.

[3] S&P, *RatingsDirect – Ratings on 23 Australian Financial Institutions Lowered on Buildup of Economic Imbalances,* May 2017, p. 3.

The non-ADI sector: Governments have typically imposed lighter regulatory requirements on the non-ADI (ie shadow banking sector), given that these institutions do not make use of deposits as a source of funds. However, increasingly onerous capital and regulatory rules are pushing a greater amount of intermediation into the shadow banking sector. Improving the harmonisation of regulatory settings between the two sectors would help to address this issue.

Macroprudential settings: In 2015, and again in 2017, APRA imposed caps on investor loans and interest only lending for macroprudential reasons. The blunt nature of these instruments does have competitive neutrality consequences. In particular, the arbitrary nature of growth caps can effectively freeze each institution's market share at its current level, in effect entrenching the dominant position of the largest institutions.

Regulatory burden: While it is inevitable that the financial services sector will be highly regulated, it is important to be conscious of the reality that regulatory compliance burdens will always have a disproportionate impact on smaller banks.

A strong and competitive banking sector, where all banks can compete on a level playing field, will ensure a sustainably diverse and vibrant industry, providing customers with the flexibility to choose the products and services that best meet their financial needs. Any regulatory reforms which move the sector closer to this ideal will help to drive innovation and ultimately deliver better outcomes for all bank customers.

As previously noted, the Major Bank Levy has the potential to support a more level playing field. If Suncorp and other smaller banks can compete on a more equal footing with the major banks, it can only result in a good outcome for bank customers in Australia, and could spur innovations and better services that will help to build an even stronger bank system.

Should you have any questions or require more information, please contact Government and Public Policy Manager, Micah Green

Yours sincerely

David Carter
Chief Executive Officer Banking & Wealth

cc Micah Green, Government and Public Policy Manager, Suncorp Group Limited