15 June 2017

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

economics.sen@aph.gov.au

Dear Senator Hume,

Major Bank Levy

The Bendigo and Adelaide Bank (BEN) appreciates the opportunity to provide a submission to the Senate Economics Legislation Committee on the Major Bank Levy Bill.

We accept this Committee has a vital role to play to ensure the Bill is subject to adequate public scrutiny that enables all viewpoints to be heard. In particular, the Committee should give weight to the intention of the levy and consider the administrative approach to its regulation.

BEN's Context

BEN is predominantly a retail bank that operates in over 750 locations Australia wide. In more than 300 of those locations, BEN branches are run in partnership with the local community. Revenue is shared between BEN and the community, with the profits of the community company being reinvested for community benefit. Since inception, over $165m has been invested in 18 years and that amount is currently growing at the rate of $20m a year. This model is unique in banking globally and in 90 Australian communities it has enabled the retention of branch banking where that may not otherwise have been possible.

BEN has been able to achieve this outcome in spite of the uneven playing field that exists in Australian banking. The competition impediment that is inherent in the industry was acknowledged in the Murray review into Australia's financial system and it arises from three main drivers:

The Bendigo Centre
PO Box 480
Bendigo Victoria 3552
Telephone 1300 361 911
Facsimile +61 3 5485 7000
www.bendigoadelaide.com.au
Bendigo and Adelaide Bank Limited
ABN 11 068 049 178 AFSL 237879

1. The implementation of the Basel II prudential framework that has seen the major banks and Macquarie use the internal models approach to capital adequacy while the remaining Australian ADI's are on the standardised models. This difference in prudential supervision has allowed the major banks to increase the amount they leverage their capital base relative to standardised ADI's through applying lower capital against the credit risk they assume, particularly in respect of home loans. As they have a lower capital holding against each loan they are able to charge a lower rate than others and achieve the same return. This difference has seen the major banks grow at a significantly faster rate than competitors like BEN. It has also influenced a change in where capital is allocated by the major banks away from business and towards housing in terms of balance sheet mix. i.e. because housing loans require less capital than business loans, relatively more credit has flowed to financing home loans since the adoption of Basel II.

2. The pricing of the Government Guarantee for wholesale funding during the GFC artificially enhanced the competitive advantage of the major banks during the period of its existence. As major banks paid 75bp to use the guarantee versus 150bp for the majority of other ADI's, the cost of and access to funding for the major banks enabled them to grow at a much faster rate than had been the case prior to the guarantee being introduced. Whilst this advantage no longer exists, the change in market share over that period has largely been sustained and remains a driver of major bank profits.

3. The ratings agencies provide major banks with the benefit of an implicit guarantee from the Australian Government (taxpayer). This comes about because the ratings agencies assume the major banks will receive timely government support to resolve any viability issues the major banks may face. In the case of Standard & Poors (S&P), this means the major banks receive a 3 notch upgrade to their stand-alone credit ratings, taking them from A- to AA-. The manifestation of that is a reduction in the cost of borrowing in wholesale markets by up to 30bp in our estimate. This 3 notch rating was recently upgraded from 2 notches when S&P downgraded the Australian banking industry one notch. When there was a 2 notch benefit the RBA estimated that to be worth up to $3.8bn to the major banks, according to an FOI request in 2013. *Ceteris paribus* that benefit would now be worth $5.7bn with the additional notch of support now factored in by S&P. That benefit is effectively an undue benefit that accrues to major bank shareholders in BEN's view.

<u>The Levy</u>

To the extent that the Major Bank Levy Bill will go some way to addressing the uneven playing field as described above, BEN supports its adoption. We note that the Bill's Explanatory Memorandum (EM) identifies a levelling of the playing field as being part of the context for its introduction and the analysis we have provided above supports this.

Additionally, the EM identifies at 2.7 "Repairing the budget and maintaining the Australian Government's AAA credit rating will also benefit the largest banks, as their credit ratings, and hence funding costs, are more closely linked to the Government's credit rating." We concur and the evidence above underlines the veracity of that point. The major banks' contribution to budget repair will simply shore up the unearned benefit they currently receive.

While we strongly support a considered approach to legislating and implementing the levy, we acknowledge the logic behind it.

We are happy to answer any questions the Committee may have in respect of our submission.

Yours sincerely,

[redacted]

Mike Hirst
Managing Director
Bendigo and Adelaide Bank