CUSTOMER OWNED BANKING ASSOCIATION

www.customerownedbanking.asn.au

LEVEL 11, 35 CLARENCE STREET, SYDNEY NSW 2000 GPO BOX 4686, SYDNEY NSW 2001

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Senate Standing Committees on Economics
PO Box 6100
Parliament House
Canberra ACT 2600

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

Dear Committee Secretariat

Senate Economics Legislation Committee Inquiry into the Major Bank Levy Bill 2017

COBA thanks the Committee for the opportunity to provide a submission on this legislation.

About COBA and its members

COBA is the industry association for Australia's customer owned banking institutions, i.e. mutual banks, credit unions and building societies. Collectively, the sector we represent has $106 billion in assets and 10 per cent of the household deposits market.

The customer owned model provides a genuine alternative to the listed bank model and delivers consistently market-leading customer satisfaction.

Customer owned banking institutions are eager to build on their 4-million strong customer base, but we need a fairer regulatory framework.

Competition in retail banking

COBA welcomes the Treasurer's announcement in his second reading speech on this Bill that the Government is unwilling to accept the current state of competition in the banking market.

The Treasurer noted that:

- the banking sector is an oligopoly and that the largest banks have significant pricing power which they have used to the detriment of everyday Australians
- the banking system is highly concentrated
- major banks benefit from a regulatory system, including mortgage risk weight settings, that has helped embed their dominant position, and
- the Government and APRA will continue to take steps to force the major banks to take greater responsibility for their own resilience and avoid the need for taxpayer funded bailouts.

Objectives of Major Bank Levy

COBA supports measures to reduce unfair competitive advantages enjoyed by the major banks.

In addition to contributing to budget repair, we note that the major bank levy is intended to have a number of other beneficial impacts related to ongoing stability and competition settings, including providing a more level playing field for smaller banks.

COBA welcomes the levy as a modest step towards reducing the unfair funding cost advantage enjoyed by major banks as a result of the implicit guarantee provided by taxpayers due to the perception that the major banks are 'too big to fail'.

We also welcome the Government's intention that the levy will complement broader prudential reforms being implemented by APRA and the Government.

The 'too big to fail' problem is the target of Recommendation 3 of the 2014 Financial System Inquiry report:

> *Loss absorbing and recapitalisation capacity* - Implement a framework for minimum loss absorbing and recapitalisation capacity in line with emerging international practice, sufficient to facilitate the orderly resolution of Australian ADIs and minimise taxpayer support.

The Government's 2015 response to this recommendation has no specific implementation date:

> The Government agrees that steps should be taken to reduce any implicit government guarantee and the perception that some banks are too big to fail. Should an ADI fail, greater loss absorbing capital will facilitate orderly resolution. We endorse APRA as Australia's prudential regulator to implement this recommendation in line with emerging international practice.

The international standard in this area, known as the total loss absorbing capacity (TLAC) framework, is the G20's response to the problem of 'too big to fail' financial institutions. The Financial Stability Board issued the final TLAC standard for the largest global banks in November 2015.

The idea of a loss absorbency framework is to require banks to maintain minimum loss absorbing capacity over and above their regulatory capital requirements, which means that costs of failure are more likely to be borne by a failed bank's shareholders and creditors rather than taxpayers. The introduction of this framework is likely to lead to credit rating agencies changing their view of about the implicit guarantee.

As noted above, COBA welcomes the commitment of the Government and APRA to achieving a long-term solution to the 'too big to fail' problem but we need a solution sooner rather than later.

The 'too big to fail' problem tends to get worse over time as the funding cost advantage creates incentives for major banks to become even bigger and more complex.

The FSI report said perceptions of implicit guarantees have costs, creating a contingent liability for the Government and distortions in the market. "Credit ratings agencies explicitly factor in ratings upgrades for banks they perceive to benefit from Government support, directly benefiting those banks," the FSI report said. "Currently, the major banks receive a two-notch upgrade on the basis of expected Government support."

Last month, credit ratings agency Standard & Poor's effectively increased that two-notch upgrade to three notches. S&P lowered ratings of 'stand-alone credit profiles' (SACPs) by one notch across the banking sector, including the major banks, but at the same time left the "issuer ratings" of the four major banks unchanged.

> "We have affirmed our long-term issuer credit ratings on these banks reflecting our expectations of likely timely financial support from the Australian

> government, if needed – which in our view offsets the deterioration in these banks' SACPs."[1]

For COBA's second-round submission to the FSI in 2014, we commissioned an independent assessment of the value to the major banks of the unfair funding cost advantage. This work estimated that it was worth 22-34 basis points or between $2.9 billion and $4.5 billion a year.

The RBA subsequently did its own research on the implicit subsidy, noting that the major banks have received an unexplained funding advantage over smaller banks of around 20 to 40 basis points on average since 2000. The RBA's dollar value estimate of the implicit subsidy to the major banks was estimated at around $1.9 billion.[2]

COBA's key messages to the Committee on the major bank levy Bill are:

- the levy is a modest but welcome step toward a more level playing field in banking
- the implicit guarantee is distorting the banking market by providing the biggest players with an unfair funding cost advantage and this unfair funding cost advantage is getting worse
- recommendations 1, 2 and 3 of the 2014 Financial System Inquiry (FSI) are aimed at improving resilience and levelling the playing field, including by tackling the 'too big to fail' problem and associated implicit guarantee, and
- we encourage the Government and APRA to act with greater urgency to implement these recommendations.

Please contact me on [redacted] or Luke Lawler, Head of Public Affairs on [redacted] if you wish to discuss any aspect of this submission.

Yours sincerely

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MARK DEGOTARDI
Chief Executive Officer

[1] See S&P statement "Ratings On 23 Australian Financial Institutions Lowered On Buildup Of Economic Imbalances" 21 May 2017.
[2] See RBA Freedom of Information request 151609, Documents containing information relating to a calculation of the value of the implicit government guarantee of Australian banks as a group, or of any subset of that group, 25 May 2016, http://www.rba.gov.au/information/foi/disclosure-log/rbafoi-151609.html