

15 May 2017

Ms Diane Brown  
Financial System Division, Markets Group  
The Treasury

Dear Diane

Thank you for the opportunity to comment on the design of the legislation.

I refer to our meeting on 11 May 2017 (the meeting) in relation to the implementation of the Bank Levy outlined in the budget (the Levy). As requested at the meeting, we set out below the matters that we believe should be reflected in the design of the Levy.

Westpac is concerned at the rush with which the Levy is proposed to be passed into legislation and the lack of a thorough consultation process. Westpac encourages the implementation of a model that is equitable to market participants (including that corporate structure doesn't distort the Levy allocation), mitigates unintended consequences and has minimal impact on the efficient operation of financial markets.

In the limited time made available to us, it is unlikely that we have been able to contemplate all such issues and therefore we recommend continued monitoring of the impact of the Levy and the need to be able to quickly adjust the Levy framework to correct for unintended consequences. We recommend that legislation be drafted with this intent in mind.

### Proposed Application

Our understanding of the Levy is that it will apply to Authorised Deposit Taking Institutions (ADIs), with licensed entity liabilities of at least \$100 billion. Practically, it is expected to apply to the five largest banks in Australia. It is proposed to apply to liabilities of the licensed ADI, including those of its' offshore branches. It will not apply to liabilities of subsidiaries. There are exclusions for Additional Tier 1 capital and deposits protected by the Financial Claims Scheme. It will apply to the relevant liabilities at the rate 0.06% per annum.

Westpac is assuming that it only applies to Westpac Banking Corporation ABN 33 007 457 141.

### Executive Summary

In summary, we recommend the following be included when drafting the legislation:

- Large multinational foreign banks should be included within the scope of the Levy so as to avoid Australian banks being at a competitive disadvantage in the Australian market to globally active foreign banks.
- The following liabilities should be excluded from the scope of the Levy, as including them has the potential to create pricing distortions in markets or reduce market liquidity:
  - Bank cash management and payment system flows;
  - Interbank cash transactions and short term money markets borrowings;
  - Self-funding transactions (e.g. repos and secured funding); while

- Derivatives should be netted.
- The following liabilities should be excluded from the scope of the Levy as corporate structures should not influence the calculation of the Levy:
  - Intragroup liabilities; and
  - Foreign branches.
- Other matters:
  - Given the stated purpose of the Levy is for budget repair, the legislation should include a clause that the Levy ceases once the budget moves to surplus;
  - We recommend that the government should be able to suspend the Levy if payment of the Levy places undue stress on the ADI including if the payment would result in the entity reporting a loss;
  - The interaction of the Levy with Total Loss Absorbing Capital (TLAC) proposals is unclear. Should TLAC be introduced in Australia, the Levy should be reviewed; and
  - Ensure that the legislation makes it clear that the Levy is deductible in Australia.

We set out further detail on these matters below.

## Remove Potential Competitive Distortions

Australia's financial system is dynamic, diverse and competitive. It provides a broad range of financial services to individuals, small businesses, large corporates (including multinational companies) and governments. Products provided include deposits, lending, payments and treasury and risk management.

In each of these areas significant competitors include other major banks, foreign banks and regional banks. Having a financial system that is both competitive and stable is vital to the financial system's capacity to support economic growth.

### **Recommendation 1 - Change the definition of the liabilities test to be based on total Global liabilities of banks**

There is no policy basis for excluding foreign banks that operate in Australia from the Levy.

In most cases, these banks are very large global businesses with significant ability to compete in the Australian market. The imposition of a Levy on Australian institutions to the exclusion of large multinational foreign banks places us at a competitive disadvantage in key markets (such as purchase and sale of government/corporate securities, short term lending such as trade finance and corporate/institutional deposits). These businesses often run at small margins so excluding significant competitors from the Levy places the banks included at a competitive disadvantage to large multinational foreign banks.

Including foreign banks within the scope of the Levy is consistent with the position adopted in the UK.

## Applying the Levy to certain liabilities could impact market liquidity and pricing

### **Recommendation 2 – Narrow the base to remove certain liabilities to avoid impacts on market liquidity or pricing impacts.**

The application of the Levy to certain liabilities is likely to adversely impact the financial markets in the following areas:

#### Bank cash management and payment system flows

Money market flows that facilitate bank cash management enable an efficient functioning payment system and support central bank operations. These should be excluded from the scope of the Levy. Such an exemption would prevent any unnecessary disruption to normal

treasury cash management procedures, and limit impact on the efficient functioning of the payment system.

Interbank cash transactions and short term money markets

If the Levy applied to interbank cash and short term money market transactions, there is a real risk that this would limit the number of transactions entered into. This would impact the liquidity of these markets, which are essential for a healthy financial system and for the efficient conduct of monetary policy.

Self-funding transactions (e.g. repos and secured funding)

Self-funding transactions (e.g. repos, including RBA Open Market Operations repos) provide significant liquidity for the financial system and smooth functioning of the payments system. Application of the Levy to these transactions will increase the cost of execution, deter market participation, reduce market liquidity and adversely impact functioning of the payments system.

Derivatives should be netted

The current proposal is that the Levy should apply to “out of the money” derivatives (or those recorded on the balance sheet as liabilities).

The Australian banks are required to prepare their financial statements in accordance with Australian Accounting Standards. These require each derivative contract to be presented as an asset or liability with related collateral separately recognised. Very limited balance sheet netting occurs even where the positions are covered by a master netting agreement.

This gross presentation methodology does not reflect the bank’s exposure/liability or a “funding position” in the same way other liabilities such as deposits do. This is better presented by netting various asset/liability positions across the balance sheet including taking into account collateral and netting arrangements.

In addition a significant volume of derivatives hedge foreign denominated term funding and therefore this will impact the calculation. Further work will be required to confirm how this volatility can be removed.

## **Corporate Structures may impact the equitable allocation of the Levy**

### **Recommendation 3 – Narrow the base to remove intragroup liabilities and foreign branches to ensure that the allocation of the Levy is equitable.**

Intra group liabilities with subsidiaries should be excluded

The choice of corporate structure will influence the level of intragroup liabilities. Corporate structures can also be adjusted over time to remove these impacts.

We recommend removing the intragroup funding arrangements from the base.

Foreign Branches should be excluded

The choice of corporate structure will influence the level of foreign branch liabilities. If foreign branches are included, banks will be incentivised to move the activities into a subsidiary which means under the current proposal the base will fall in any case.

We have had insufficient time to assess the potential for double taxation of foreign operations. This is a further reason for excluding foreign branches.

We recommend removing foreign branches from the base.

## **Other Matters**

### **Confirmation that Levy can be suspended by the government if paying the Levy would place undue stress on the ADI**

The Levy design appears to assume the Banks were at all times profitable.

We believe the government should have the ability to suspend payment if paying the Levy would place undue stress on the ADI. For example, should a licensed ADI be in loss, or payment of the Levy would put the ADI into loss, then the Levy should not be payable. This is consistent with the policy of the Levy, and will also assist with the financial viability of the ADI involved.

### **Ensure that the legislation makes it clear that the whole Levy is deductible in Australia**

The legislation should be drafted to make it clear that the whole Levy is deductible in Australia. This can be achieved through either a specific provision in the Tax Act which provides that the Levy is tax deductible in Australia or defining the purpose of the Levy as directly incurred for the purpose of deriving Australian taxable income.

### **Implications for Total Loss Absorbing Capital**

At the request of the government, APRA is investigating the merits of introducing TLAC in Australia. Based on the budget announcement it is unclear how the interaction between the Levy and TLAC has been considered from a policy perspective. Westpac submits that should TLAC be introduced in Australia the Levy will need to be reviewed.

### **Impact of FX translation**

As mentioned previously, the impact of FX translation will see volatility in the balance sheet (both up and down). We have not had sufficient time to consider implications of this and we will need further engagement.

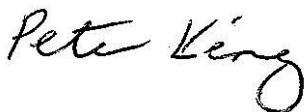
### **The Form that information should be presented in for calculation of the Levy**

The proposal was that the Banks report on APRA form ARF323. Westpac would prefer a standard template be agreed with APRA to calculate the Levy.

### **Further Information**

Should you require further information, please contact me.

Yours sincerely,



Peter King  
Chief Financial Officer