A comparable landscape: ascertaining the policy in Australia's bank levy

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Abstract: When the government released its 2017-18 Budget, one of the more surprising announcements was the proposal of a bank levy targeting the five major Australian banks. The full policy objectives of the balance sheet-based bank levy were not clearly articulated and raised further questions. These questions appeared to be answered when the Major Bank Levy Bill 2017 and accompanying explanatory memorandum were introduced into parliament. However, the purposes of the bank levy appeared manifold and represented a confusing policy cocktail that paid homage to international experience but did not draw as strong a connection between the design of the levy and its policy. This article explores the policy reasons for the implementation of the bank levy, and includes a discussion of whether the design of the levy is appropriate in light of the objectives stated by the government. The article also considers the experiences of certain European countries which have implemented a bank levy in recent years, and the policy rationale employed in those instances.

Introduction

When the Australian Government released its 2017-18 Budget, headlines followed.[1] One of the more surprising announcements was the proposal of a bank levy targeting the five major Australian banks. The banks in turn opposed what they viewed as an ostensible revenue grab.[2] A notoriously short consultation period[3] for the immediately affected stakeholders was followed by the release of draft legislation a few weeks after the Budget announcement. The explanatory memorandum (EM) accompanying the Major Bank Levy Bill 2017 attempted to reflect a more principled approach than the justifications expressed in the Budget paper — albeit still less cohesively articulated when compared to some other jurisdictions which have adopted similar measures in recent years, and which the Australian levy seeks to align itself with. Indeed, while the Australian bank levy only applies to Australian banks, the Australian bank levy cannot be viewed in isolation without reference to the international picture, and the international regulatory frameworks which have come into place following the global financial crisis of 2007-08. However, given certain idiosyncratic features of the Australian bank levy, such a comparison raises further questions.

This article will explore the policy reasons for the implementation of the bank levy in Australia, and include a discussion of whether the design of the levy is appropriate in light of the objectives stated by the government. To this end, this article will also consider the experiences of certain European countries which have implemented a bank levy in recent years and, in particular, the policy rationale employed in those instances.

Background: "too-big-to-fail" and the G20's search for a solution

The global financial crisis brought the question of how to prepare for and resolve future financial failures to the forefront. Of particular concern were the systemic risks and moral hazard associated with institutions so large, interconnected and important to the market that their distress or failure would have severe repercussions for the rest of the financial system. This danger of a systemically important financial institution failing and requiring a bailout sourced out of public funds in order to avert further economic damage and financial instability is often described as the "too-big-to-fail" (TBTF) problem.[4]

Following the collapses of large institutions such as Lehman Brothers, bailouts of Fannie Mae and Freddie Mac in the United States, as well as the bailouts which occurred in other countries as governments scrambled to ensure their countries' systemically important financial institutions did not fail, it became evident that further action was necessary. Ahead of their June 2010 meeting, the G20 leaders requested the International Monetary Fund (IMF) prepare a report detailing options for how the financial sector might contribute to the cost of any future government assistance required.[5] The report was titled *A fair and substantial contribution by the financial sector*, and its recommendations have been instrumental in the design of several European bank levies. Consequently, before considering individual countries' approaches to bank levies, it is useful to begin with a discussion of the recommendations in the IMF paper.

Given the integral role of financial institutions to the economy at large, regulation and taxation are both viewed as viable means toward improving financial system resilience. Capital requirements[6] effectively create a buffer at the institution level and thus reduce the likelihood of individual failure, while revenue from a corrective tax could also provide a system-level buffer. According to the IMF, the two methods could be structured in such a way as to complement one another. Whichever method was pursued, it would be essential to ensure an improved resolution mechanism to address the moral hazard concerns which arise in the context of expected government intervention.[7] If levies or taxes on financial institutions were to be pursued, the IMF recommended that these be structured such that the financial sector would meet the cost of future support; future failures would be less likely and less devastating through the facilitation of an effective resolution scheme; and that the levies should be "reasonably easy to implement", while taking into account international coordination.[8]

After canvassing a number of options, the IMF report proposed two forms a bank tax could take. The first was a "financial stability contribution" tightly linked to an effective and credible resolution mechanism. In this design, a levy would pay for the (fiscal) cost of future government support to the financial sector. The revenue could either be paid into a dedicated fund or to the general revenue. The IMF recommended that such a levy should be borne by all financial institutions, initially at a flat rate, but with rates adjusted over time to reflect an individual institution's risk profile and contribution to systemic risk.[9] In addressing moral hazard, the IMF stressed the importance of an effective resolution regime in tandem with the levies in order to avoid the perception that levy revenue would be used to bail out failing institutions, rather than resolve them.[10]

With respect to the base of the levy, the IMF recommended a broad balance sheet base, preferably on liabilities, with an allowance for insured liabilities, including certain off-balance sheet items,[11] and excluding capital (eg tier 1 capital for banks), as the best model to ensure the objectives of reduced risk, enhanced fairness and relatively efficient revenue raising.[12] It should be noted that the IMF recommended that the perimeter of the levy (ie which institutions would pay it) be broad enough to encompass all financial institutions. Singling out specific institutions (ie a narrow perimeter) could create incentives for systemic risks to migrate or worsen moral hazard — as it could suggest these institutions were less likely to fail than those excluded. Conversely, a broad perimeter would help address these concerns and recognise that all financial institutions benefit from the public good of enhanced financial stability (provided for by the resolution scheme). Further, in the IMF's view, the purpose of the bank levy should be to "ensure that financial institutions face an appropriate cost structure".[13] They recommended that the levy should be tax deductible, and that consequently, this should factor into the rate setting (since tax deductibility would consequently reduce revenues from corporate tax). Tax deductibility was viewed as appropriate in light of the possibility that the cost of the levy could be passed on to end users, either wholly or in part.[14]

Second, the IMF recommended that a financial activities tax (FAT) could be used as a top-up where financial stability contribution revenue was insufficient to meet the desired contribution from the financial sector. A FAT would be levied on profits and remuneration, and rather than set aside in a separate fund, would be paid into general revenue.[15] The FAT could be levelled on profits (with an adjustment to exclude "normal" capital returns)[16] and very high remuneration — thus approximating a tax on economic rent, to the extent a portion of economic rent translates to high remuneration at the management level. Alternatively, the FAT could be designed to include not just high levels of remuneration, but all remuneration, which would bring the tax more into line with the VAT/GST (noting that financial services in most European countries are generally exempt from VAT; similarly, in Australia, GST is not levied on most financial services).[17]

> "*Singling out specific institutions … could create incentives for systemic risks to migrate or worsen moral hazard …*"

Country-specific approaches to bank levy policy and design

The purpose of the Australian levy

When the Australian Government released its 2017-18 Budget paper on 9 May 2017, the full policy objectives of the balance sheet-based bank levy were not clearly articulated. While the aim to improve competition in the banking sector was repeatedly stated, the phrase "fair additional contribution to assist with budget repair" also appeared in the context of the new revenue raising measure, with no mention of the term "systemic risk".[18] The paper did make reference to recent APRA[19] and government reforms and said that the levy would complement these. However, it did not explicitly indicate which measures it was referring to. At the time the measure was announced, basing the levy on liabilities (with certain exclusions) appeared somewhat arbitrary without any further explanation.

Answers to the policy–design question appeared to be in order when the Major Bank Levy Bill 2017 was introduced to the House of Representatives on 30 May 2017. The Bill was accompanied by an EM[20] setting out the reasons for the design and policy behind the Australian bank levy. The levy is imposed quarterly, at a rate of 0.015% on certain liabilities of authorised deposit-taking institutions (ADIs) with total liabilities of greater than AU$100b (0.06% on an annualised basis). The total of the reported liabilities is reduced by the total additional tier 1 capital (AT1C), the deposits protected by the Financial Claims Scheme, the exchange settlement account balance held with the Reserve Bank of Australia (RBA), and an amount equal to the lesser of derivative assets and liabilities at the end of the quarter. The legislation enacting the levy was also accompanied by a new anti-avoidance law[21] designed to deter ADIs from entering into schemes to reduce their bank levy liabilities. There is no sunset clause, and the major banks have been advised that the levy is to be permanent.[22]

The purposes of the bank levy gleaned from the EM accompanying the draft legislation appeared manifold:

- contributing to Budget repair in the short term;
- contributing to a stronger structural position of the budget for the long term — "providing greater fiscal capacity to deal with shocks such as those seen in the global financial crisis";
- ensuring "a fair contribution from major banks to the economy given risks to the economy arising from large leveraged banks", noting that they are "highly profitable" and "amongst the most profitable banks in the advanced world";[23]
- providing "a more level playing field" for smaller competitors in the banking sector; and

- complementing broader prudential reforms to improve financial system resilience (specifically, "unquestionably strong" capital levels and appropriate loss absorbing capacity for banks, and stronger crisis management powers for APRA).[24]

A Senate submission from one of the major banks also indicates that the policy justifications presented to these banks in discussions with Treasury were an ad hoc set; the Treasurer's second reading speech also canvassed multiple objectives.[25] The interaction of these distinct objectives is not clearly articulated, and, as will be explained, some apparent contradictions exist in the explanations. In contrast, when Germany and the United Kingdom introduced their bank levies, the measures were accompanied by a more straightforward articulation of purpose.

The purpose of the German and UK bank levies

The German bank levy, introduced in 2011, was part of a new regulatory framework for bank restructuring and resolution.[26] The policy rationale stated was that credit institutions should bear the fiscal cost of any future distress by virtue of their contribution to systemic risk, which would otherwise fall on the greater economy. To target funding risk which was perceived as causing negative externalities during times of distress, the levy was based on contribution-relevant liabilities as well as derivative exposures.[27] In contrast to the approach of some other European Union states, where the amounts raised from the levy were paid into the general revenue, the German legislation introduced a separate restructuring fund for the accumulation of levy contributions. A reason for this is that Germany's constitution requires that, where a tax is levied on a specific class/group of taxpayer, those funds are to be earmarked for the benefit of those who bear the tax incidence.[28] In this respect, the German levy followed the IMF recommendations regarding linking the levy to a resolution scheme, as well as the arguments in favour of a dedicated resolution fund.

The UK bank levy, introduced in 2010, evinced dual aims of raising revenue from the banks in a manner commensurate with the risks posed by the banks to the UK economy and creating appropriate incentives to contain systemic risk by reducing funding risk, complementing wider regulatory measures to "improve regulatory standards and enhance financial stability".[29] In 2013, the UK Government again opened the bank levy up for consultation, to ensure that the levy was operating efficiently, and considered its articulation of the underlying policy remained appropriate.[30] Specific aspects of levy design and policy reasons behind these will be explored further below.

While the Australian approach is more closely aligned with that of the UK, the emphasis on Budget repair and improving competition adds a level of complexity regarding whether the levy's base is appropriately connected to its purpose.

> *"The European Commission specifically warned that while using levies to reduce public deficits would be an attractive option, failure to establish a dedicated resolution fund in the long term could reinforce moral hazard …"*

Budget repair and financial system resilience

The majority of G20 "advanced economies"[31] provided significant support to their financial sectors in the period June 2007 to December 2009, in various forms including recapitalisations, asset purchases and swaps, asset/liability guarantees, liquidity support, and deposit insurance.[32] Notably, out of these advanced economies, Australia was the only country whose financial sector did not require any capital injection, asset purchases or treasury lending.[33] It did, however, provide a guarantee scheme for wholesale funding to assist ADIs for a fee paid by the institutions, with fees expected to amount to $5b over the life of the scheme. The scheme was a response to the difficulties Australian banks faced in borrowing overseas in late 2008.[34]

Justifying the payment of the levy into general revenue is conceptually easier if the case exists for an ex-post recovery of public funds employed in preventing the collapse of financial institutions, as was the case for many G20 advanced economies in the 2007-08 crisis — including the UK.[35] However, it becomes harder to justify revenue collection for the purpose of Budget repair when public funds were not in fact used for recapitalisation or asset purchases, as was the case in Australia. The European Commission specifically warned that while using levies to reduce public deficits would be an attractive option, failure to establish a dedicated resolution fund in the long term could reinforce moral hazard associated with TBTF institutions and increase the financial sector's dependence on public funds in the event of a crisis. It also voiced the concern that levies paid into the general budget would risk being diverted for other uses.[36] Indeed, it has been argued that the projected revenue generated from Australia's bank levy has already been effectively spent given the other measures announced in the 2017-18 Budget.[37] Even while the UK levy drew a closer connection between revenue raised from its bank levy and systemic risk in the financial sector, there is an argument that because the funds are channelled into general revenue rather than a dedicated stability fund, the justification for a bank levy becomes more tenuous — even if the charge is for an implicit guarantee. This is because while a dedicated stability fund such as Germany's earmarks the funds to be used for the banks (should the need arise), there is no similar requirement for the UK Government to use the money for resolution, for the very reason that the funds are paid into general revenue.[38] Whether the levy is sufficiently linked to a resolution scheme as envisioned in the IMF recommendations is then called into question.

In 2011, shortly after the introduction of the UK bank levy, Michael Devereux, an academic at Oxford University, raised the question of whether a bank levy would complement the Basel III framework to make a financial crisis less likely. He also hypothesised that while the levy could encourage banks to pursue a higher capital:asset ratio, it could also increase the average risk of assets.[39] Since then, Devereux, and fellow academics Johannesen and Vela, have studied the behavioural responses to bank levies in eleven European countries which have implemented liability-based levies in recent years: Australia, Belgium, Cyprus, Germany, Latvia, Portugal, Romania, Slovakia, Sweden, the Netherlands and the UK.[40]

In a 2015 paper, Devereux, Johannesen, and Vela concluded that, while the bank levies in a number of European countries achieved "some reduction of risk", two fundamental weaknesses impeded their efficiency. First, the design of the levies allowed banks to substitute portfolio risk for funding risk (thus undermining the policy aim of reducing bank's total risk), and secondly, weakly capitalised banks (those viewed as posing the greatest threat to financial stability) had stronger incentives to engage in such risk shifting behaviour, instead of risk reduction.[41] Further, the study also suggested the leverage ratio under the Basel III regulatory framework also suffered from similar constraints, as it is only designed to limit funding risk. The liability-based Australian bank levy would consequently face the same inherent design limitations with regard to overall reduction of systemic risk.

In 2012, the IMF undertook a financial system stability assessment of Australia.[42] The report found Australia's financial system generally "sound, resilient, and well-managed".[43] Further, the report noted that the major banks were conservatively run, well capitalised, profitable, and likely able to withstand severe shocks.[44]

Interestingly, the EM also states "APRA has confirmed that the payment of the major bank levy will not have a material impact on the resilience of the banking system and that it does not harm its prudential policy objectives".[45] The statement that the bank levy will not have a material impact on banking system resilience appears to directly contradict the statement in the preceding paragraph within the EM that the levy is intended to complement other prudential reforms to improve financial system resilience.[46]

If the government and APRA have formed the view that the levy will have minimal impact on financial system resilience, then the question of what it is really for becomes more open to interpretation.

Competition and economic rent

A major difference between the Australian bank levy and other European bank levies is the express target of improving competition. The EM stated the findings of the House of Representatives Standing Committee on Economics that the size and market dominance of the four largest banks "affords them significant funding cost advantages and pricing power at the expense of their customers".[47] However, RBA research found that while it appeared the major banks received a "small funding advantage" of around 20 to 40 basis points (a figure that the Treasurer has cited previously),[48] the data supporting this finding contained constraints, including limited data on bond issuance from Australian banks.[49] A separate Productivity Commission inquiry into competition in the financial system was commissioned by the government, the findings of which would help determine the extent of major banks' regulatory privileges. However, the final report is not expected to be issued until July 2018,[50] and some have noted that the move to introduce measures aimed at improving competition should have waited until the findings of this Commission are available.[51] Evidence from overseas studies indicates that banks are likely to pass on the cost of levies to customers in a number of circumstances.[52] If it is accepted that the Australian banking landscape is an oligopoly, this could further increase the likelihood of such an occurrence.[53] In an effort to prevent the banks from passing on the cost of the levy to customers, the Australian Competition and Consumer Commission will undertake an inquiry into residential mortgage pricing.[54]

There is a further difficulty with the target of improving domestic competition when Australia is viewed in the context of the Asia–Pacific region, rather than in isolation. The Financial System Inquiry (FSI) noted that Australia "is a capital-importing nation with a significant component of domestic investment funded by foreign savings channelled through the banking system" and "Australia's use of offshore funding, while beneficial to economic growth, makes the country vulnerable to sudden changes in international investor sentiment. Because of this, it is critical that the Australian financial system is resilient".[55] In the Asia–Pacific region, the only country which has implemented a bank levy to date is South Korea.[56] Even within Europe, and even among the countries there which implemented a bank levy, country-by-country differences in the designs (eg with regard to base and tax deductibility) were viewed as having the potential to create competitive distortions.[57] Multiple rate changes to the UK levy in particular were perceived as having negatively impacted on the certainty of the UK tax system.[58] Issues with predictability, including possible multiple rate changes and a potentially wide ambit for ministerial discretion are concerns for the major Australian banks.[59] Investor confidence, at not only the bank level, but also as regards the regulatory and legal framework, is crucial to the ability of banks to compete for funding and capital.[60] Announcing a levy without first consulting industry increases regulatory risk and has raised questions as to what this might mean for other profitable sectors. Qantas CEO Alan Joyce said, "Are we going to just start having an imposition on any profitable business out there and a policy for more taxes when businesses do well?".[61]

If the underlying aim were to tax profit or economic rent instead of purely addressing funding risk, the nexus between the liability base of the levy and its purpose would appear remote, and would necessitate consideration of other designs. The Australian Centre for Financial Studies in its Senate submission took the opportunity to propose GST on the banking sector as an alternative to the bank levy. Historically, many financial services have not been subject to GST on the basis that applying GST is not straightforward, eg the relevant inputs and outputs may be difficult to identify.[62] The IMF, in justifying a FAT designed to approximate VAT, has previously noted that the existing VAT-exemptions for financial services may mean the sector is under-taxed and "too big" as a result.[63]

One of the drawbacks to a levy based on balance sheet rather than profit is that a bank would still be required to pay the levy even if its earnings plummeted. Yet the above-market returns of these "highly profitable" banks were highlighted in both the Treasurer's second reading speech and the EM in support of the levy. If the aim of a tax were to capture economic rent (ie profit above the minimum required by shareholders), a tax in the form of a surcharge on taxable profit (net of an "allowance for corporate equity")[64] and high remuneration[65] could be considered. However, Australia has experienced some difficulty with taxing economic rent in the past, including the notable failure of a rent tax on the mining sector due to lobbying pressures.[66] A corporation tax surcharge in the form the UK has recently adopted could be an alternative method to increase revenue by additionally taxing profits in the financial sector.[67] In theory, using a base with an existing statutory formulation such as taxable profit or a more "neutral" VAT-type formula, provided the rate is not set too high, may be less distortionary than a liabilities based-approach[68] requiring its own anti-avoidance law, if the justification for the liabilities approach is not sufficiently strong.

Design considerations and interaction with APRA reforms

The Basel III reform measures[69] developed by the Basel Committee on Banking Supervision aim, among other things, to improve the ability of the banking sector to absorb shocks arising from financial and economic stress. To do so, the measures are aimed at both the microprudential (bank) and macroprudential (system-wide) level. Regulation at the microprudential level seeks to improve the resilience of individual banking institutions in stress periods, and at the macroprudential level targets system-wide risks built up in the banking sector over time and procyclical amplification of such risks.[70] In Australia, APRA has largely adopted the measures contained in the Basel III framework.[71]

At first glance, the exclusion of AT1C and protected deposits under the Australian levy appears to follow the approach of the UK levy. From a policy perspective, since AT1C is viewed as relatively high loss absorbing, and counted in capital ratios required by APRA/under the Basel III framework, this exclusion is justified as it complements regulatory reform. If there is a regulatory aim to reduce funding risk, then the levy should not operate on an inconsistent basis. However, the rationale behind excluding protected deposits in the Australian levy design may be less principled than the UK's approach, for the reason that the protected deposits in these two countries are funded differently. In the UK, the Financial Services Compensation Scheme is funded ex-ante by levies on authorised financial services firms[72] and protects deposits up to the value of GB£85,000.[73] Excluding such amounts from the base of the UK bank levy is necessary to avoid double taxation. Meanwhile in Australia, the Financial Claims Scheme which guarantees deposits up to AU$250,000 is ex-post funded, meaning that payments would first be made by the government, the government would then seek to recover costs in the liquidation of the failing institution and potentially impose a levy on the financial sector for any shortfall. A former Australian Government plan to implement ex-ante funding[74] announced in 2013 was never implemented. While the IMF had also suggested that Australia should move to an ex-ante model,[75] the FSI rejected this proposition in 2015. The FSI recommended maintaining the ex-post funding model on the basis that an ex-ante levy would be an ongoing cost for ADIs and that the case for such a levy was made weaker in the presence of the FSI's other recommendations to strengthen the resilience of the Australian financial sector.[76] The FSI did not make any recommendations for the imposition of a bank levy. The EM states that this protected deposits exclusion "creates an additional incentive for affected banks to move towards more stable, deposit-based funding".[77] Potter argues that guaranteed deposits actually increase systemic risk, due to the fact that guaranteed deposits contain an inherently explicit bailout promise (to the extent of the cap), rather than reduce it.[78]

> *"If there is a regulatory aim to reduce funding risk, then the levy should not operate on an inconsistent basis."*

Under the Australian bank levy, the base excludes an amount equal to the lesser of the derivative assets and derivative liabilities at the end of the quarter.[79] The rationale for this aspect of the design is not articulated in the EM. However, it is useful to consider the UK approach in ascertaining possible purpose. Under the UK bank levy, derivative assets and liabilities are netted, provided there is a legally effective and enforceable netting agreement. As a matter of practice, derivative liabilities are netted with derivative assets, and there is a general presumption that netting arrangements reduce both the funding risk of the bank and the exposure of the counterparty in the event of insolvency. A 2013 UK bank levy interim review found that this netting approach was generally working well in the UK from both an industry and government perspective.[80] While it may not be apparent on the wording at first glance, the Australian approach effectively allows a simplified version of derivatives netting rather than a precise calculation, thus potentially reducing the compliance burden.

Unlike the UK levy, the Australian levy contains no exclusion for the funding of high quality liquid assets (HQLA) — which is at odds with the liquidity coverage ratio requirements implemented as part of Basel III.[81] The UK levy allows a deduction for HQLA, on the basis that the holding of such assets is an important regulatory objective, and they did not want the design of the levy to undermine this.[82] CBA's Senate submission noted this aspect of the levy design creates a disincentive for the major banks to hold more than the minimum amount of HQLA.[83] Further, the Australian levy does not distinguish between long-term and short-term debt funding, meaning that there is no incentive to hold long-term debt. By contrast, the UK levy distinguishes between long-term and short-term debt with a 50% concession for the former. The policy rationale for this treatment in the UK is that long-term debt is viewed as more stable (due to increased funding certainty and reduced refinancing risk, as funds are rolled over less frequently), and is in line with the net stable funding ratio (NSFR) requirements implemented as part of Basel III,[84] which require higher levels of long-term debt. CBA's submission noted further that "this is counter to our discussions with APRA in relation to holding a buffer above the minimum NSFR ratio".[85]

Lastly, the FSI recommended capital standards should be set such that Australian ADI capital ratios would be "unquestionably strong", with the target that the Australian banks would be in the top quartile internationally.[86] The Financial Stability Board, in its report on Basel III implementation, noted that the majority of increases in regulatory capital for "group 1" banks since 2010 were financed from retained earnings rather than additional external funding.[87] In the 2013 UK consultation, respondents noted "an apparent tension between the bank levy's revenue target and its aim to incentivise safer balance sheets".[88] It should be noted that there is some conceptual difficulty with the proposition that the bank levy complements that goal of "unquestionably strong" capital levels, for the axiomatic reason that the incidence of bank levies initially reduces bank profits. If the Australian Government were successful in its stated goal to prevent the pass-through of levies to customers[89] such that the banks alone would bear the full cost of the levies, this would translate to lower retained earnings. Consequently, it could reduce the level of "high-quality" tier 1 equity capital held by an affected institution (to the extent profits are retained in the company, as opposed to distributions by way of dividend). A lower equity capital position is a weaker financial position, which in turn can increase the cost of borrowing. When the cost of borrowing increases, this deteriorates margins further. Because ADIs are profit-seeking institutions, they may seek returns elsewhere to compensate this reduction, which could also result in taking on increased risk. There is thus some difficulty in reconciling the Treasurer's statement in his second reading speech that "[t]he major bank levy will build on … critical prudential reforms by making stable and secure funding sources relatively less expensive".[90]

Conclusion

As of 1 July 2017, the major bank levy is now in effect — in a space of less than two months since the measure was first announced by the government. In some respects, it represents a confusing policy cocktail that pays homage to international experience, but does not draw as strong a connection between the design of the levy and its policy — because it aims to do many different things.

The bank levy raises revenue from the major banks, and purports to do so in a manner which is intended to encourage a reduction of funding risk. The presence of certain exclusions, and the exclusion of others, raise questions as to whether the levy is sufficiently thought through in its attempt to address systemic risk, as does the statement within the EM that the levy is not expected to have a material impact on the resilience of the banking system. Further, singling out the major domestic banks for the imposition of the tax risks the perception of a "perverse"[91] reverse protectionism, and while the government has refrained from an explicit acknowledgement of TBTF, this move could reinforce moral hazard concerns on two fronts: first, by not following IMF recommendations for a broad perimeter; and second, by virtue of the revenue raised being paid into the general budget, for the reasons canvassed above. There are inherent tensions between capital adequacy reforms and the current design of the levy, and whether a liabilities-based levy is appropriate is further called into question given the emphasis on profit (possibly suggesting an attempt to tax economic rent) and the stated goal of improving competition.

Australia's major banks are central to its economy. They collectively employ over 160,000 people, pay more than $10b in taxes each year, are either directly owned or indirectly owned (through superannuation) by most of the Australian population, finance over 70% of Australia's lending, and are the country's main conduit to offshore funding.[92] Evidence from other countries suggests that part, if not all, of the cost of the levy is likely to migrate to other stakeholders, particularly customers.

As a revenue raising measure for the purpose of Budget repair, the levy will raise revenue. However, given the complexity of the policy backdrop, whether the other goals of the levy will be met by virtue of its operation, given the dissonance between aspects of design and policy, remains to be seen.

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Disclaimer

The views expressed in this article are those of the author and not of Deloitte. An earlier draft of this article was submitted as part of the author's coursework in the Master of Laws program at the University of Sydney.

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9 IMF report 2010, pp 4, 13-14. Factors influencing systemic risks include those related to size, interconnectedness and substitutability: IMF report 2010.

10 IMF report 2010, p 13. For example, a dedicated resolution fund could help empower a resolution agency that could step in to temporarily operate failing institutions, dispose of assets, and sell business units: IMF report 2010, p 15.

11 To the extent such items represent a significant source of systemic risk, noting that any treatment of derivatives should conform to Basel Committee guidelines on leverage ratios, and taking into account accounting standards: IMF report 2010, p 17.

12 IMF report 2010, pp 5, 46.

13 IMF report 2010, p 14, para 21, fn 11.

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and "charging for the implicit Government guarantee of the major banks": CBA submission, pp 2-3; Commonwealth, *Parliamentary debates*, House of Representatives, 30 May 2017, pp 1-4 (Scott Morrison).

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31 Comprising Australia, Canada, France, Germany, Italy, Japan, Korea, the UK and the US.

32 IMF report 2010, pp 31, 35.

33 IMF report 2010, p 36, Table A1.5: Financial sector support utilized relative to announcement, by country.

34 Treasury, "Report on the operation of the guarantee scheme for large deposits and wholesale funding", 13 October 2011.

35 IMF report 2010, Appendix 1.

36 IMF report 2010, p 46.

37 M Potter, *The major bank levy* (2017), Centre for Independent Studies, research report no. 29, p 5. Noting that the net increase in spending is greater than the expected revenue to be generated from the levy over the next four years according to government modelling. See also Commonwealth of Australia*, Budget measures*, Budget paper no. 2, 2017-18, 9 May 2017, pp 24, 60.

38 W Schön, "Regulation and taxation of the financial markets", (2016) 2 *European Company and Financial Law Review* 424,438.

39 M Devereux, "Will the bank levy meet its objectives?", (2011) *British Tax Review* 33-39.

40 M Devereux, and N Johannesen and J Vella, *Can taxes tame the banks? Evidence from the European bank levies*, 23 April 2015, Saïd Business School WP 2015-5. The base of the levy in the countries studied is broadly based on total liabilities net of equity and insured deposits, with some variances: additionally, the UK levy base also allows for netting of gross assets and liabilities against the same counterpart as well as a deduction for liquid assets; the Cyprus levy is based on total liabilities net of equity; and Portugal's levy is based on total liabilities net of equity and subordinated debt. While France, Hungary, and Slovenia have also implemented bank levies, these were excluded from the study on the bases that the structure of these levies was not sufficiently similar to that of the other countries: ibid, table 1, p 8.

41 Ibid p 33.

42 International Monetary Fund, *Australia: Financial System Stability Assessment*, November 2012, IMF country report no. 12/308.

43 Ibid pp 1, 5.

44 International Monetary Fund, *Australia: Financial System Stability Assessment*, November 2012, IMF country report no. 12/308, pp 10-23.

45 Para 1.8 of the EM.

46 Para 1.7 of the EM.

47 Para 1.9 of the EM.

48 Scott Morrison, interview with Barrie Cassidy, *ABC Insiders*, 14 May 2017, cited in M Potter, *The major bank levy* (2017), Centre for Independent Studies, research report no. 29, p 5.

49 Reserve Bank of Australia, RBAFOI-151609 documents released, 2016, pp 4, 9.

50 Productivity Commission, *Competition in the Australian financial system*. Available at www.pc.gov.au/inquiries/current/financial-system.

51 See, eg, CBA submission, p 6; M Potter, *The major bank levy* (2017), Centre for Independent Studies, research report no. 29, p 5.

52 G Capelle-Blancard and O Havrylchyk, "Incidence of bank levy and bank market power", CEPII working paper, 2013; M Kogler, *On the incidence of bank levies: theory and evidence*, University of St. Gallen, Institute of Economics, 2015.

53 Capelle-Blancard and Havrylchyk's research showed that, in the case of Hungary, which is considered to have an oligopoly-type banking landscape, the levy was effectively shifted to customers with the smallest demand elasticity of credit, eg households: ibid. See also J Molnár, M Nagy and C Horváth, "A structural empirical analysis of retail banking competition: the case of Hungary", MNB working papers, 2007/1, 2007.

54 Commonwealth, *Parliamentary debates*, House of Representatives, 30 May 2017, pp 1, 3 (Scott Morrison).

55 Commonwealth of Australia, *Financial System Inquiry: final report*, November 2014, pp 5, 34. Note, this was also acknowledged by APRA in APRA, "Basel III liquidity – the net stable funding ratio and the liquid assets requirement for foreign ADIs", discussion paper, March 2016, p 8.

56 Korea implemented its levy in 2011: OECD, "Classification of bank levies, financial stability fees and deposit insurance", Revenue Statistics 1965-2012, 2013, p 49.

57 HU Lauermann, K Struve, "Bank levies: a step toward harmonisation", 17 June 2014, *International Tax Review.* Available at www.internationaltaxreview.com/Article/3352677/Bank-levies-A-step-toward-harmonisation.html.

58 HM Treasury, "Bank Levy Review 2013: summary of responses", 10 December 2013, p 6.

59 See, eg, CBA submission. At the same time, the ability to make changes via regulation could also be favourable from the banks' perspectives due to the potential for further exclusion of certain non-funding liabilities, including provisions for the bank tax as well as other non-tax-related provision accounts.

60 Commonwealth of Australia, *Financial System Inquiry: final report*, November 2014.

61 P Durkin (2017) "Bank 'tax grab' will spook investors: Don Argus, Alan Joyce, Andrew Thorburn" *Australian Financial Review*, 11 May 2017.

62 Australian Centre for Financial Studies, submission no. 14 to the Senate Economics Legislation Committee in relation to the Major Bank Levy Bill, 15 June 2017.

63 IMF report 2010, p 22, Appendix 5.

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65 As canvassed in the section above, "Background: "too-big-to-fail" and the G20's search for a solution".

66 See D Kraal, "Australia's petroleum resource rent tax: Paul Keating, Peter Walsh and other game changers", (2016) 25 *Griffith Law Review* 492 for a discussion of the lobbying campaign surrounding the resource super profits tax and subsequent minerals resource rent tax, which was repealed in the *Minerals Resource Rent Tax Repeal and other Measures Act 2014* (Cth).

67 HM Revenue, *Bank corporation tax surcharge*, policy paper, 8 July 2015.

68 The IMF suggested that if a FAT were structured to approximate VAT, the rate should be lower than the VAT rate, as it was concerned that setting the rate too high could incentivise distortionary behaviour: IMF report 2010.

69 Bank for International Settlements, *Basel III: a global regulatory framework for more resilient banks and banking systems*, June 2011.

70 Bank for International Settlements, *Basel III: international regulatory framework for banks.* Available at www.bis.org/bcbs/basel3.htm.

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74 Commonwealth of Australia, *Economic statement, August 2013*, statement by the Hon. Chris Bowen MP and Senator the Hon. Penny Wong, Canberra, 2013.

75 International Monetary Fund, "Australia: financial system stability assessment", IMF, Washington DC, 2012.

76 Commonwealth of Australia, *Financial System Inquiry: final report*, November 2014, recommendation 6, pp 82-83.The other recommendations in Chapter 1 (Resilience) of the report included setting unquestionably strong bank capital ratios and sufficient loss absorbing and recapitalisation capacity for ADIs, and expanding crisis management powers.

77 Para 2.20 of the EM.

78 M Potter, *The major bank levy* (2017), Centre for Independent Studies, research report no. 29, pp 9-10.

79 S 5(2)(iii) of the *Major Bank Levy Act 2017* (Cth).

80 HM Treasury, "Bank levy review 2013", 4 July 2013, pp 10-13.

81 Prudential Standard APS 210: Liquidity. The liquidity coverage ratio came into force in Australia on 1 January 2015.

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83 CBA submission.

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86 Commonwealth of Australia, *Financial System Inquiry: final report*, November 2014, p 41.

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