// Banking on an impact

The impact of the bank levy on the average Australian superannuation account

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Summary

There is intense speculation about who will ultimately be affected by the new bank levy that has been proposed in the 2017-18 budget. In broad terms the levy could be passed onto either the customers of the big banks or it could be passed through to bank shareholders in the form of reduced dividends.

The largest banks and their lobbying body the Australian Bankers Association (ABA) are keen to convince the general public that in either case average people will be substantially impacted. While convincing the general public that they will be impacted might help the big banks in their fight against the introduction of the levy, the problem they have is that it will have almost no impact on the general public.

If it is passed through to shareholders, the banks claim it will impact on people's superannuation balances. But an analysis by this paper shows if it the bank levy was passed through in full to shareholders in the form of reduced dividends then at most it would impact the average superannuation balance by $7 a year.

If the banks pass some or the entire levy into customers this will not affect the many smaller banks and credit unions. Bank customers who are concerned about the financial impact the bank levy will have on them can shop around for a better deal. As this paper shows, customers that shop around could save over $6,000 in interest on an average sized mortgage in addition to avoiding the impact of the bank levy.

While it might be surprising that the impact of the bank levy will be so small it should be remembered that it is only 0.06 per cent or six cents in every $100. It is also being levelled on Australia's most profitable industry. The big four banks made pre-tax profits of $42 billion last year.

While the banks and their lobbyists are keen to convince the wider Australian population that the levy will hurt them significantly, the reality is the impacts will be tiny and some of the impacts are completely avoidable.

Who will the bank levy impact?

There is intense speculation about who will ultimately be affected by the new bank levy that has been proposed in the 2017-18 budget. This levy will impact only Australia's largest five banks, the Commonwealth Bank, Westpac, ANZ, NAB and Macquarie Bank. From the 1st July 2017 these banks will be pay a levy of 0.06 per cent of their licensed entity liabilities. According to the budget papers the levy is expected to raise $6.2 billion over the next four years.

The banks reaction to the levy has been predictable. Rather than talk about how the levy will impact them they have been keen to focus attention on how the levy is bad for ordinary Australians. They use two main arguments to justify their conclusion that the bank levy is bad for ordinary Australians.

The first is that the banks will past some or all of the levy along to customers. In today's modern society it is almost impossible for a household not to have a bank account. Virtually all income is paid into a bank account including all welfare payments. This means almost all Australian households are bank customers and so the claim that the levy will impact bank customers is effectively a claim that it will impact all Australian households.

The second claim the banks make is that the levy will decrease dividend payments which will impact on shareholders. As Anna Bligh, the CEO of the Australian Bankers Association said;

> *I think it would be good for the treasurer to come and tell banks exactly where they should take it from. You know, once you take it off the profits of banks it hits shareholders. Once you hit the bank's bottom line, it has got to come from somewhere.*[1]

Anna Bligh further claimed that everyone who has a superannuation fund is a bank shareholder and so if it impacts on shareholders it will impact everyone's superannuation.

> *If you are a working Australian and you have a superannuation account, then you own shares in one of the major banks in Australia, and the treasurer is saying this tax should be passed on to your investments.*[2]

The banks argument is essentially that the bank levy will impact all Australians not just the big profitable banks. The reason that the big banks are claiming that the impacts will be wide spread can be best understood by the fact that they're deeply unpopular with the Australian public. This means that a direct appeal by the banks to protect their interests would be unlikely to garner much public support. So rather than talk about how this levy will affect the big banks, they instead are trying to reframe this as an impact on ordinary Australians.

This paper will examine both these claims and attempt to determine the likely impacts the bank levy will have on ordinary Australians.

Passing the levy onto bank customers

The first claim is that some or the entire levy will be passed onto customers. The government has confirmed that it will not directly control bank fees or the interest rates that banks charge. Bank fees and interest rates are a commercial decision for the big banks and as such they can choose to pass on any increase in their costs to customers.

It is important to note that the bank levy will only impact five banks. As such there are many banks that will not be impacted by the levy and so will not be changing their fees or interest rates because of the levy. If the big banks pass on the levy this will make the smaller banks more competitive and bank customers of the big banks could take this opportunity to investigate if they're getting the best deal for their banking services.

Let's look at an example using home loan rates. Table 1 looks at the big four banks standard variable mortgage rate for home loans and the simple average for all four banks. These interest rates were current as of 16th May 2017 before the introduction of the bank levy.

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[1] Chan (2017) *Customers beware! Bankers Association warns levy has to come from somewhere*
[2] AAP (2017) *Big banks hit back at government over levy*

Table 1 – Standard variable mortgage rate for owner occupiers for big 4 banks

Bank	Interest rate
Commonwealth Bank	5.39%
Westpac	5.46%
ANZ	5.35%
NAB	5.45%
Average	**5.41%**

Source: Various bank websites

We can compare these rates to four of the largest banks that are not impacted by the bank levy. Table 2 shows these four banks standard variable mortgage rates as well as the simple average of the four. It also shows the best interest rate that the author could find.

Table 2 – Standard variable mortgage rates for owner occupiers for large banks not impacted by levy

Bank	Interest rate
Bendigo Bank	4.56%
Bank of Queensland	4.60%
Suncorp Bank	4.38%
AMP	3.96%
Average	**4.38%**
UBank (best rate found)	3.74%

Source: Various bank websites

We can see from this comparison that even before the introduction of the bank levy the big four banks have considerably higher interest rates than the four largest banks unaffected by the bank levy. The gap between the averages is just over one percent.

The average home mortgage is $365,000.[3] If someone with this sized mortgage paid the average interest rate for the largest four banks that will be unaffected by the bank levy instead of the average interest rate of the big four banks then they would save $3,760 in interest per year.

If they paid the lowest interest rate of 3.74% instead of the average rate of the big 4 banks on an average mortgage amount then they would save $6,096 in interest per year. This is over $500 per month.

If the big four banks choose to pass on the bank levy then the savings that can be made from swapping home loans would be even greater. This means that people who are concerned about the impact of the bank levy on their home loan should shop around for a better deal. Not only would they avoid any impact of the bank levy but they might save a significant amount of money in interest charges each year.

Passing the levy onto shareholders

The second argument that the big banks and their lobby group the ABA have put up is that if the levy is not passed onto customers then the cost will flow through to shareholders through reduced

[3] ABS (2017) *5609 – Housing Finance Australia February 2017* Table 1

dividends. They further explain that substantial owners of the big banks are superannuation funds. Working Australians with superannuation accounts are therefore owners of banks and, they claim, will be impacted if banks pass through the levy to shareholders.

The banks are correct that some of their shareholders are superannuation funds. But what is lacking is any analysis of the size of any impact on an average superannuation balance if the bank levy was passed through to shareholders. While superannuation funds might be substantial shareholders in the big four banks, these same super funds also have millions of separate super accounts. What is relevant is the impact on each super account.

If we look at the impact on average super accounts we find that it is very small. This is because the bank levy will only reduce bank profits by a small amount (about 4.5 per cent). Even if all the decrease is fully passed through to bank shareholders, bank shares make up only a tiny part of people's superannuation accounts (less than six per cent). The total impact will therefore be far less than one per cent. A detailed analysis of the impact is presented below.

For this analysis we will assume that the whole bank levy is absorbed as reduced profits (that is none is passed onto bank customers) and the reduction in profit is then fully passed through as a reduction in dividend payments. This could be considered a worst case scenario for bank shareholders as even if the whole impact is to reduce bank profits, it is not likely that this will be passed on in full as reduced dividends. Banks do not pass on all their profits to shareholders but keep much of it in their business as retained earnings.

According to APRA the average superannuation balance in June 2016 was $55,777.[4] APRA also tells us that on average 22 per cent of superannuation assets were held as Australian equity in June 2016.[5] The rest of the assets were held in the form of other assets like property, bonds or infrastructure assets. From this we can calculate that the average superannuation balance holds $12,271 in Australian equities.

As at March 2017 the market capitalisation of firms listed on the ASX was $1.82 trillion.[6] The market capitalisation of the five banks impacted by the bank levy is set out in Table 3

Table 3 – Market capitalisation of the five banks impacted by the bank levy

Bank	Market capitalisation (billions)
Commonwealth Bank	$144.76
Westpac	$113.3
ANZ	$89.73
NAB	$86.41
Macquarie	$31.65
Total	**$465.85**

Source: Bank capitalisation as at closing price 5th May 2017

4 APRA (2016) *Annual Superannuation Bulletin* Table 11b
5 APRA (2017) Quarterly Superannuation Performance Table 1d
6 ASX (2017) *End of Month Values*

The five banks affected by the bank levy therefore represent 25.6% of the ASX capitalisation. This means that the average superannuation balance holds $3,141 of shares in these five banks.

The after tax profits of the five banks affected by the bank levy was $24.9 billion. The bank levy is predicted to raise $1.6 billion in 2017/18. But the bank levy is tax deductable which means that the bank only pays 70% of the levy. This means the actual cost of the levy to the five banks is $1.12 billion. Therefore the bank levy represents 4.5 per cent of the five banks after tax profits.

Table 4 looks at the yields for 2015-16 for the five banks affected by the bank levy.

Table 4 – Yields for the five banks affected by the bank levy (2015-16)

Bank	Yield
Commonwealth Bank	5.11%
Westpac	5.73%
ANZ	5.44%
NAB	6.07%
Macquarie	5.12%
Weighted Average	**5.3%**

Source: Invest smart[7]

Therefore the $3,141 of shares in the five banks affected by the levy would have paid out $166 in dividends to the average super members.

If the entire bank levy was absorbed as a reduction in profit and this reduction in profit was fully passed onto dividend payments then it would reduce the $166 in dividend payments by 4.5 per cent (the percentage of profits that the levy represents). Therefore the average superannuation fund member could expect to lose $7 per year. This is about 60 cents a month.

This analysis shows that the bank levy will have a very limited impact on the average super account. While the banks and their lobby group might like to refer to this impact, the reality is even in the worst case for shareholders, it will be tiny.

Conclusion

The bank levy is unlikely to have any major impacts on ordinary Australians. The biggest impact is likely to be the pass through of the levy to bank customers. But because the levy is only charged on the biggest five banks, this impact is avoidable if those customers shop around for a better deal. In fact if customers hear their bank talking about how they are going to pass through the bank levy to them, they should take this as an opportunity to look at how much they may be able to save if they switch to a bank unaffected by the levy.

The impact of the bank levy on the average super account, even in a worst case scenario for shareholders, is expected to be tiny. The impact will be about $7 per year or about 60 cents a month. This assumes that the banks pass through the whole levy in lower dividends to shareholders.

[7] InvestSMART (2017) *Share Research* for CBA, WBC, ANZ, NAB and MQG

This is unlikely. The chairman of the National Australia Bank, Ken Henry has said he expects most of the levy to be passed onto customers.[8]

The reality is the banks are very profitable enterprises. Before tax profits for the big four banks are $42 billion or almost three per cent of Gross Domestic Product. This means that for every $100 of income earned in the economy, $3 of it goes to the owners of the big four banks.

The big banks might want people to believe that they will be significantly impacted by the bank levy but any impact is likely to be small and in most cases avoidable. The reason that banks feel they can pass on the levy to customers is that they think that customers won't look around for a better deal. This levy and the big banks response to it might be an opportunity to inject more competition into the banking system. If this happens it will benefit all Australians.

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