Major Banks targeted by the Federal Government to fund the deficit

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Background

At the 2017 Federal budget, the Treasury signalled a $3.2 billion increase in budget revenues for 2017-18. Half of this will be funded by a bank levy for Authorised Deposit-taking Institutions (ADI's) with licensed entity liabilities of at least $100 billion, from 1 July 2017. This levy is expected to apply to the big four banks (Westpac, ANZ, NAB and CBA) and Macquarie Group. This is forecast to cost the financial institutions around $1.6 billion per annum or $6.2 billion over the next four years.

The Levy will be calculated quarterly as 0.015 per cent of an ADI's licensed entity liabilities as at each Australian Prudential Regulation Authority (APRA) mandated quarterly reporting date (for an annualised rate of 0.06 per cent).

Liabilities subject to the Levy will include items such as corporate bonds, commercial paper, certificates of deposit, and Tier 2 capital instruments. The Levy will not apply to the following liabilities: additional Tier 1 capital and deposits of individuals, businesses and other entities protected by the Financial Claims Scheme.

The proposal is expected to be passed by both houses of Parliament, with the opposition Labour Party indicating endorsement.

What are the market implications?

In the first year and assuming no offsets, it will take around 5% off the profits base of these five institutions. It is also equivalent to 1-2% of the Australian share market (as measured by the S&P/ASX 200) profits and therefore will be a moderate drag on corporate profits.

It is expected that over time these costs will be passed on to customers via higher mortgage interest rates, lower deposit rates, and/or lower dividends. The flow through effect could be a slowing in lending growth and consumer spending leading to softer economic conditions and lower bank valuations (lower share price).

Westpac has announced that the new tax may cost them approximately $370 million per year, with an after-tax impact of $260 million per annum. Westpac has made no decision on how they will respond to the new levy but indicated if borne by just shareholders alone, it will likely be equivalent to 8 cents per share or 4.3% of dividends paid.

It is important to realise that approximately 75% of the combined $32 billion or so of the major banks' annual profits are returned to mainly Australian investors via fully franked dividends. Retail investors account for approximately 50% of the major bank shareholder base.

How did the market react to the news?

The targeted banks' share prices reacted negatively to the surprise news when it was leaked in the afternoon prior to the budget release on the evening of May 9, 2017 (see table 1 below). The share prices of five targeted banks declined an average of 3% on the day, with the market capitalisation of the targeted banks falling approximately $14 billion in total. By the end of the week, Westpac had fallen 4.4%, CBA was down 4.3%, ANZ down 2.4%, NAB down 2.3% and MQG down 1.8%. While the broader Australian share market (S&P/ASX 200) fell only 0.6%.

Since the 8th of May the market has re-rated the major banks and therefore share prices have tumbled with Westpac down 10.2%, CBA down 4.7%, NAB down 9.8%, ANZ down 4.4%, and MQG down 5.9%. They have underperformed the Australian share market which has only fallen 1.4% over the same period.

Closing Price	Monday 8th	Tuesday 9th Night of the Budget	Wed 10th	Thurs 11th	Friday 12th	Weekly change (% and $)	Current Share Price (Thursday 25th 2017)
Westpac	$34.08	$32.88	$32.65	$32.62	$32.57	-$1.51 (-4.4%)	$30.60 (-10.2%)
ANZ	$29.95	$29.16	$29.39	$29.30	$29.22	-$0.73 (-2.4%)	$28.64 (-4.4%)
CBA	$85.30	$82.02	$81.73	$82.07	$81.67	-$3.63 (-4.3%)	$81.26 (-4.7%)
NAB	$33.10	$32.42	$32.20	$32.30	$32.33	-$0.77 (-2.3%)	$29.86 (-9.8%)
MQG	$94.33	$92.46	$91.46	$93.60	$92.63	-$1.70 (-1.8%)	$88.80 (-5.9%)
S&P/ASX 200*	5870.89	5839.90	5875.44	5878.34	5836.90	-33.99 (-0.6%)	5789.60 (-1.4%)

Table 1: Westpac, ANZ, NAB, CBA, Macquarie and the Australian Share market closing prices, percentage and dollar changes for the week - Monday 8th – Friday 12th & share price as at Thursday 25th 2017.
*Australian Share Market

What are the implications of holding Banks in your portfolio?

Australian major banks have made significant gains in recent months, on the back of the “Trump Trade”, global bank rally and the recent reporting season. Between November 8, the day of the US election, and May 1, NAB’s share price increased 29.8%, CBA rose 21.4%, ANZ added 21.9% while Westpac rose 16.7%.

However, since the start of May, Australia’s big four banks have lost a combined $50 billion in market capitalisation and between 10.2% and 4.4% off their share prices as they went ex-dividend, were hit by a banking levy and new macroprudential regulations (limit interest-only flow to 30% of total new residential lending will impact future credit growth). The major banks valuations could no longer be justified and the market has accordingly revised downward the banks fair value.

Most Australian share portfolios have a significant exposure to the big four banks which represent 29% of the S&P/ASX 200 Accumulation Index and therefore the investors performance is heavily reliant on the major financial institutions. If there is a de-rating of the banks, such as there was in September 2015 as the banks raised capital to increase capital buffers this would see the S&P/ASX 200 dragged down and the performance of many investors portfolios.

Going forward, further share price falls may be caused by dividend cuts, slowing of credit growth (tighter macro prudential controls) or further capital raisings (Basel III capital requirements). It is estimated that the major banks will need approximately $20 billion in new capital during the next three to four years to fund asset growth and satisfy higher future capital requirements.

To reduce the impact that banks have on our portfolios and total returns, we diversify across investments and asset classes. If diversified portfolios are constructed based only on total return objectives and not inclusive of downside risk then it will likely leave the portfolio highly susceptible to volatility and market downturns.

We should remember that banks have always been an excellent source of high and stable dividends (including franking credits) in investment portfolios for decades and if investors can tolerate price fluctuations in the short term, banks merit inclusion.

A Super Balancing Act

Steve Blaker
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At retirement, it is common that one partner will have the majority of a couple's accumulated superannuation savings. In these situations, it may be more effective to balance superannuation benefits more evenly between both members of the couple.

This is especially applicable now given that from July 1, 2017 the pension transfer balance cap will limit the amount that each person can rollover to income streams to $1.6m. In addition to this, having more equal amounts in super may help to protect against future policy and legislative changes in relation to access and/or taxation of superannuation.

Evening out balances can be done by making spouse contributions and contribution splitting over a number of years. Both strategies are discussed in more detail below.

It is important to note that for both strategies, a spouse is a person who is either legally married or in a de facto relationship. The couple must be living together on a permanent, bona fide domestic basis (including same sex couples) or only temporarily separated. A married couple who are living separately on a permanent basis do not qualify.

Kate Cramsie
Financial Adviser

Spouse contributions

A spouse contribution is a contribution made to a complying superannuation fund on behalf of their spouse. The contributing spouse may be eligible for a tax offset up to $540 per annum. The contribution is treated as a non-concessional contribution and subject to the non-concessional contributions cap.

The contributions should come from an account in the contributing spouse's name or in joint names. It is important that the contributor can show they had control of the funds and chose to make the contribution on behalf of their spouse.

Contributing spouse

The contributing spouse must be the spouse of the receiver at the time the contribution is made. They can be any age. This means that a person over age 65 and not working, still qualifies to make a spouse contribution, even though they can make contributions into their own super.

Receiving spouse

The receiving spouse does not need to be an Australian resident or taxpayer to receive the contribution, but they do need to be an Australian resident if the contributor wants to claim the tax offset. The receiving spouse must be under age 70 when the contributions are made.

If the receiving spouse is age 65-69 (inclusive) they will need to have met the work test for the year before spouse contributions can be made. This requires the completion of at least 40 hours of gainful employment within a consecutive 30 days period.

Tax offset

The maximum tax offset the contributing spouse can receive in a financial year is $540 (even if entitled to the offset for more than one spouse). This is based on 18% on the first $3,000 of eligible contributions.

The $3,000 amount is reduced by $1 for each $1 that the receiving spouse’s income exceeds the lower threshold. The threshold is $10,800 for 2016/17 and will increase to $37,000 for 2017/18. No offset applies once the receiving spouse’s income reaches the upper threshold ($13,800 for 2016/17 and will increase to $40,000 for 2017/18). Income is defined as assessable income plus reportable super contributions plus reportable fringe benefits (i.e. employer contributions in excess of the compulsory 9.5% SG, including salary sacrifice).

No income limit applies to the contributing spouse.

To be eligible for a tax offset on these contributions:

- The contribution must be paid into a complying superannuation fund
- The contributing spouse must not be entitled to a deduction as an employer of the spouse (The receiving spouse's income* needs to be less than $13,800 (increases to $40,000 from July 1, 2017)
- Both spouses must be Australian residents and not living separately on a permanent basis
- From July 1, 2017, the receiving spouse needs to have a total superannuation balance immediately before the financial year less than the general transfer balance cap of $1.6m.
- From July 1, 2017, the receiving spouse's non-concessional contributions for the financial year cannot exceed their non-concessional contributions cap.

Spouse contribution splitting

A person may be able to choose to split eligible concessional superannuation contributions with their spouse.

This choice can be made each year in relation to the concessional contributions paid into their account in the previous financial year. Any contributions split to a spouse can be transferred to an account in the spouse's name within the same fund or be rolled over to another fund.

Superannuation contributions splitting will generally only apply to accumulation funds. Defined benefit funds are likely to only offer this if there is an identifiable accumulation component.

The split cannot be made to a spouse who has already met a condition of release (e.g. over 65 or retired) as the funds need to be transferred as preserved funds.

Splittable contributions

Splitting only applies to concessional contributions, including:

- Personal deductible contributions
- Employer contributions (salary sacrifice, voluntary contributions and superannuation guarantee).

Non-concessional contributions, rollovers, and superannuation lump sums transferred from foreign superannuation funds cannot be split.

The contribution splitting rules only apply to concessional contributions made in the previous financial year. For example, if concessional contributions are made in 2015/16 any decision to split the contributions must be advised to the super fund trustee (and effected) between 1 July 2016 and 30 June 2017.

How much can be split?

Splittable super contributions generally come from a taxed superannuation fund. In these funds, concessional contributions have been subject to 15% contributions tax, so only 85% of the contributions remains eligible to be split. Only up to the concessional contribution cap can be split i.e. excess concessional contributions cannot be split.

Employer contributions made to a public sector super scheme may be classified as ‘untaxed splittable employer contributions’. As contributions tax has not been deducted from these amounts, 100% of untaxed splittable employer contributions made in the financial year can be split to a spouse provided the contribution cap has not been exceeded.

Timing of application

If a superannuation fund offers contribution splitting, members can choose to split eligible concessional contributions made in the previous financial year. A fund may stipulate a cut-off date earlier than 30 June of the applicable financial year to allow for processing.

If the contributions to be split include personal deductible contributions, the client must lodge a Notice of intent to claim or vary a deduction for personal super contributions (NAT 71121) with the trustee of their fund (and receive notification back) before making a request to split the contributions. This will all need to be done before 30 June of the year following the year in which the contributions were made.

Treatment of the amount split

The split is effected as a rollover. Therefore, contributions tax is not payable by the receiving spouse on the rollover. Any tax payable was deducted from the original spouse's account.

The split contributions count against the original spouse's concessional contributions cap, they do not count against the receiving spouse’s contribution cap.

Some words of caution

Superannuation contributions are subject to preservation and generally cannot be accessed until at least age 55 and retired, or reaching age 65.

- Where members of a couple have a significant age difference, by splitting contributions towards a younger spouse, the couple may not be able to access the funds until much later. However conversely, if contributions are split to an older member of the couple, they may be able to access their superannuation sooner.
- It is not compulsory for super funds to allow members to split contributions. If offered, a fee can be charged for the transaction at the discretion of the trustee. This would be detailed in the Product Disclosure Statement (PDS).
- In the case of an SMSF, the trust deed must permit contributions splitting.

If you would like to know more about making a spouse contribution or arranging contributions splitting, please contact us and we will assist.

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