COMMERCE COMMISSION NEW ZEALAND
Te Komihana Tauhokohoko

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Personal banking services

Final competition report

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Karakia

Tuia ki runga
Tuia ki raro
Tuia ki roto
Tuia ki waho

Tūturu o whiti

Whakamaua kia tina. Tina!

Haumi ē, hui ē

Tāiki ē!

In connecting to all elements that provide for the wellbeing of the person, this karakia is responsive to te taha pūtea (the banking system) and the importance of how personal banking contributes to the wellbeing of the person, the whānau and wider groupings.

Ngā ihirangi

Contents

Glossary | *Kuputaka*

ACCC	Australian Competition and Consumer Commission.
AML/CFT	Anti-money laundering and countering the financing of terrorism.
AML/CFT Act	Anti-Money Laundering and Countering Financing of Terrorism Act 2009.
ANZ	ANZ Bank New Zealand Limited (a New Zealand registered bank), owned by Australia and New Zealand Banking Group Limited.
API	Application programming interface. An API is a set of routines, protocols and tools for building software applications and specifying how software components should interact.
API Centre	Established by Payments NZ, the API Centre develops, maintains and publishes API standards and governs their use by registered API providers and third parties.
ASB	ASB Bank Limited (a New Zealand registered bank), owned by Commonwealth Bank of Australia Limited.
ASIC	Australian Securities and Investment Commission. ASIC is Australia's corporate, markets and financial services regulator.
ATM	Automated teller machine.
bank	An entity registered with the Reserve Bank as operating a bank. Banks are either incorporated in New Zealand or operating as branches of overseas incorporated banks.
banking services	Includes personal banking services, corporate, institutional, commercial, agricultural and small and medium-sized enterprise (SME) banking services.
BECS	Bulk Electronic Clearing System.
BNZ	Bank of New Zealand (a New Zealand registered bank), owned by National Australia Bank Limited.
cashback (or cash contribution)	A form of incentive offered to buyers of certain products whereby they receive a cash refund after making their purchase. Providers may offer a flat dollar amount cashback or a percentage cashback when someone takes out a mortgage (for example, 1% cashback on a home loan of $250,000 or more).
CASS	Current Account Switch Service (UK).
CCCF Act	Credit Contracts and Consumer Finance Act 2003.

CDD	Customer due diligence.
CDR	Consumer data right to be enacted under the Customer and Product Data Bill. The industry-specific application of a CDR in banking is “open banking”.
CECS	Consumer Electronic Clearing System.
CET1	Common Equity Tier 1 capital is the highest-quality form of capital and must provide a permanent and unrestricted commitment of funds, must be freely available to absorb losses and must not impose any unavoidable servicing charge against earnings. CET1 is comprised of among other things paid-up ordinary shares and retained earnings.
clawback	The act of retrieving money already paid out. For example, a cashback can be taken back by the bank if the customer refinances a mortgage to a competitor within a contracted period (commonly 3 years).
CMA	Competition and Markets Authority (UK).
CoFI	Conduct of Financial Institutions.
CoFI Act	Financial Markets (Conduct of Institutions) Amendment Act 2022.
CoFR	Council of Financial Regulators Kaunihera Kaiwhakarite Ahumoni, made up of the Reserve Bank, FMA, Commerce Commission, MBIE and the Treasury.
CPD Bill	Customer and Product Data Bill, which, if passed, will introduce a consumer data right into law in New Zealand. Banking and electricity are expected to be the first sectors to be designated under the CPD Bill.
CRA	Charles River Associates.
CTI ratio	Cost-to-income ratio.
DCS	Depositor Compensation Scheme. The Deposit Takers Act will establish a new Depositor Compensation Scheme to protect up to $100,000 per depositor per deposit taker in the event of a failure.
deposit	Money deposited in a bank account.
deposit account	Includes transaction, savings and term deposit accounts as well as any associated overdraft facilities (a line of credit, whether arranged or unarranged, that allows the account balance to go below zero to cover transactions). Some deposit accounts are also sometimes referred to as current accounts.
DIA	Department of Internal Affairs Te Tari Taiwhenua.
Digital Identity Act	Digital Identity Services Trust Framework Act 2023.

D-SIB	Domestic systemically important bank.
DT Act	Deposit Takers Act 2023.
DTI ratio	Debt-to-income ratio.
Easy Switch	A switching service for transaction accounts based on industry standards and protocols set by Payments NZ.
ECDD	Enhanced customer due diligence.
EFTPOS	Electronic Funds Transfer at Point Of Sale.
EMPR	Empowering Migrants through Pacific Remittances.
ESAS	Exchange Settlement Account System operated and maintained by the Reserve Bank.
FAP	Financial advice provider.
FAMNZ	Finance and Mortgage Advisers Association of New Zealand.
FCA	Financial Conduct Authority (UK).
fintech	Financial technology company. A firm that uses digital information and automation technology in providing innovative financial services.
FLP	Funding for Lending Programme.
FMA	Financial Markets Authority Te Mana Tātai Hokohoko.
FMC Act	Financial Markets Conduct Act 2013.
FMI	Financial market infrastructure.
FMI Act	Financial Market Infrastructures Act 2021.
GDP	Gross domestic product.
GFC	Global financial crisis.
home loan	A loan made by a bank (or other lender) to a property owner (for example, to enable the owner to buy the property, to buy land for the construction of a new house or to renovate an existing house). Home loans are almost always secured through a mortgage over the property, and the terms home loan and mortgage are sometimes used interchangeably. See residential mortgage.
HVCS	High Value Clearing System.
IMT	International money transfer.
interest	A payment from a borrower or deposit-taking institution to a lender or depositor that is not the repayment of the principal sum, calculated as

	a percentage rate. It is distinct from a fee that a borrower may pay a lender.
IRB	Internal ratings-based approach. Locally incorporated registered banks in New Zealand may apply to the Reserve Bank to be accredited to estimate their risk-weighted assets for prudential capital purposes using IRB models (as opposed to using standardised risk weightings).
Kiwibank	Kiwibank Limited (a New Zealand registered bank), a subsidiary of Kiwi Group Capital Limited, which is owned by the New Zealand Government.
KPI	Key performance indicator.
KYC	Know your customer.
LSAP	Large scale asset purchase.
LVR	Loan-to-value ratio. The loan amount divided by the value of the asset or collateral being borrowed against. In the case of a mortgage, this would be the mortgage amount divided by the property's value.
major banks	ANZ, ASB, BNZ and Westpac.
MBIE	Ministry of Business, Innovation and Employment Hīkina Whakatutuki.
MoJ	Ministry of Justice Tāhū o te Ture.
mortgage adviser	A person or company that can act on behalf of the borrower in arranging a home loan (typically secured by a mortgage) from a bank or other lender. A mortgage adviser (also known as a mortgage broker) may facilitate access to a range of home loan products from different lenders.
MTO	Money transfer operator.
NBDT	Non-bank deposit taker. A business, other than a registered bank, that makes an NBDT-regulated offer of debt securities and carries on the business of borrowing and lending money or providing financial services (or both). NBDTs include finance companies that raise funds from the public as well as most building societies and credit unions.
NBDT Act	Non-bank Deposit Takers Act 2013.
NIM	Net interest margin.
non-bank providers	Non-bank providers of personal banking services, including NBDTs (such as credit unions and building societies), other finance companies (including peer-to-peer lenders) and fintechs.
NZBA	New Zealand Banking Association Te Rangapū Pēke.

NZTA	NZ Transport Agency Waka Kotahi.
OBIE	Open Banking Implementation Entity.
OCR	Official cash rate. The OCR is the overnight interest rate set by the Reserve Bank.
OLS	Ordinary least squares.
open banking	A system in which consumers can make payments and instruct their banks to share their financial data such as account information and transaction data with third-party providers such as fintechs.
Payments NZ	Payments NZ Limited, which has as its objectives to govern and manage payment system rules and standards as well as to promote interoperable, innovative, safe, open and efficient payment systems. Payments NZ is owned by eight banks, including the four major banks.
personal banking services	A subset of banking services, personal banking services are banking services ordinarily acquired for personal, domestic or household use.
profitability	Measures a firm's profit performance as a ratio rather than in dollars, often to account for scale.
providers	Suppliers of personal banking services in New Zealand, including major banks, smaller banks and non-bank providers.
Reserve Bank	Reserve Bank of New Zealand Te Pūtea Matua.
residential mortgage	A legal instrument registered on a residential property's title in order to secure the payment of a loan made by a bank (or other lender) to the property owner (for example, to enable the owner to buy the property, to buy land for the construction of a new house or to renovate an existing house). A mortgage allows the lender to sell the property as a last resort if the borrower is unable to pay back the loan. While a mortgage registered on the title is separate to the underlying loan agreement, lending related to residential property is commonly referred to as a home loan, and the terms home loan and mortgage are sometimes used interchangeably.
retained earnings	The cumulative net profits of a company after accounting for dividend payments.
ROA	Return on assets.
ROE	Return on equity.
RWA	Risk-weighted asset. Risk weights are used to convert the actual size of an exposure into a risk-weighted asset. RWAs are used in capital ratio calculations to determine the minimum amount of capital that banks must hold.

SBI	Settlement Before Interchange.
smaller banks	Registered banks other than the major banks and Kiwibank. For example, this includes Co-operative Bank, Heartland Bank, SBS Bank and TSB.
smaller providers	Smaller banks and non-bank providers.
TAMRP	Tax-adjusted market risk premium.
Tāwhia	The Māori bankers rōpū (group), the current members of which are representatives from ANZ, ASB, BNZ, Heartland Bank, Kiwibank, Westpac, TSB and the Reserve Bank.
VAR	Vector autoregression.
Westpac	Westpac New Zealand Limited (a New Zealand registered bank), owned by Westpac Banking Corporation.
whenua Māori	Types of whenua Māori (Māori land) are Māori freehold land, Māori customary land and general land privately owned by Māori. In this paper, we largely refer to Māori freehold land. This is land where Māori customary interests have been converted to freehold title by the Māori Land Court or its predecessors by a freehold order.

Chapter 1 Introduction and purpose | *Whakatakinga me te koronga*

Summary of findings

- **This report contains our findings regarding factors that, in our view, are affecting competition in personal banking and our recommendations for improving competition.** The aim of a market study is to promote competition for the long-term benefit of consumers in New Zealand.
- **We have carried out this study in accordance with the terms of reference issued by the Minister.** We may also consider any ancillary matters that are related to but not explicitly covered by the terms of reference.
- **We focused our analysis on deposit accounts and home loans because they are focal points for competition in personal banking services and because they matter to many New Zealanders.** We have, however, considered a wider range of personal banking services in some aspects of our analysis.
- This study is the first opportunity to thoroughly consider and evaluate whether competition in personal banking is promoting outcomes that benefit New Zealand consumers over the long term.

Purpose | *Koronga*

1.1 This is our final competition report on the factors that, in our view, are affecting competition for the supply or acquisition of personal banking services and our recommendations for improving competition in personal banking in New Zealand. The aim of a competition study (or market study) is to promote competition for the long-term benefit of consumers in New Zealand.[1]

1.2 This chapter describes the focus of the study, the structure of this report and our process.

Scope of the study and our focus areas | *Te whānuitanga o te rangahau me ngā aronga ake*

The Minister issued terms of reference for a competition study into personal banking services

1.3 On 20 June 2023, the Hon. Dr Duncan Webb, the then Minister of Commerce and Consumer Affairs (the Minister), published a notice under section 51(1) of the Commerce Act 1986 requiring us to undertake a competition study into any factors that may affect competition for personal banking services.

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1 Competition study is the term used in Part 3A of the Commerce Act. Competition studies are commonly referred to as market studies.

1.4 We must carry out a study in accordance with the terms of reference issued by the Minister. However, we may also consider any ancillary matters that are related to but not explicitly covered by the terms of reference.[2]

1.5 These are the terms of reference for this study:[3]

Notice for Commerce Commission Competition Study into Personal Banking Services

I, the Honourable Dr Duncan Webb, Minister of Commerce and Consumer Affairs, pursuant to section 51 of Part 3A of the Commerce Act 1986, require the Commerce Commission to carry out a competition study into any factors that may affect competition for the supply or acquisition of personal banking services. For the purposes of this study, personal banking services are banking services ordinarily acquired for personal, domestic, or household use.

Matters to be considered in the study may include, but are not restricted to:

- The structure of the industry and the nature of competition.
- The conditions for entry by potential competitors and the conditions for expansion.
- Any barriers to consumers comparing bank offers or switching banks, including the extent to which products or services may be tied or bundled.
- Any impediments to new or innovative banking products or services.
- Comparative indicators of bank financial performance (including profitability).

Should the Commission be of the view that one or more matters listed above, or any additional matters not listed, are likely to provide special insight into competition for the supply and acquisition of personal banking services then the Commission may focus on those aspects.

The Commerce Commission should make its report publicly available by **20 August 2024**.

Consistent with previous market studies, I expect the Commission will produce a preliminary issues paper into the sector by the end of August 2023.

1.6 The Minister considered it in the public interest to require a competition study into personal banking services because:[4]

1.6.1 there are existing indications of possible competition problems in the market (such as high prices, low levels of innovation, low levels of service and/or a lack of dynamism between market participants);

2 Commerce Act, s 51A(4)(b).

3 "Notice for Commerce Commission Competition Study into Personal Banking Services" (20 June 2023) *New Zealand Gazette* No 2023-go2632, https://gazette.govt.nz/notice/id/2023-go2632

4 MBIE "Cabinet Paper – Initiating a Market Study into Personal Banking Services" (28 June 2023), https://www.mbie.govt.nz/dmsdocument/26848-initiating-a-market-study-into-personal-banking-services-proactivereleas-pdf

1.6.2 the market is of strategic importance to the New Zealand economy or businesses or of significant importance to consumers;

1.6.3 it is likely that there will be viable solutions to any issues that are found; and

1.6.4 a formal study by the Commission would add value above work that could be done by other agencies.

We have focused on deposit accounts and home loans

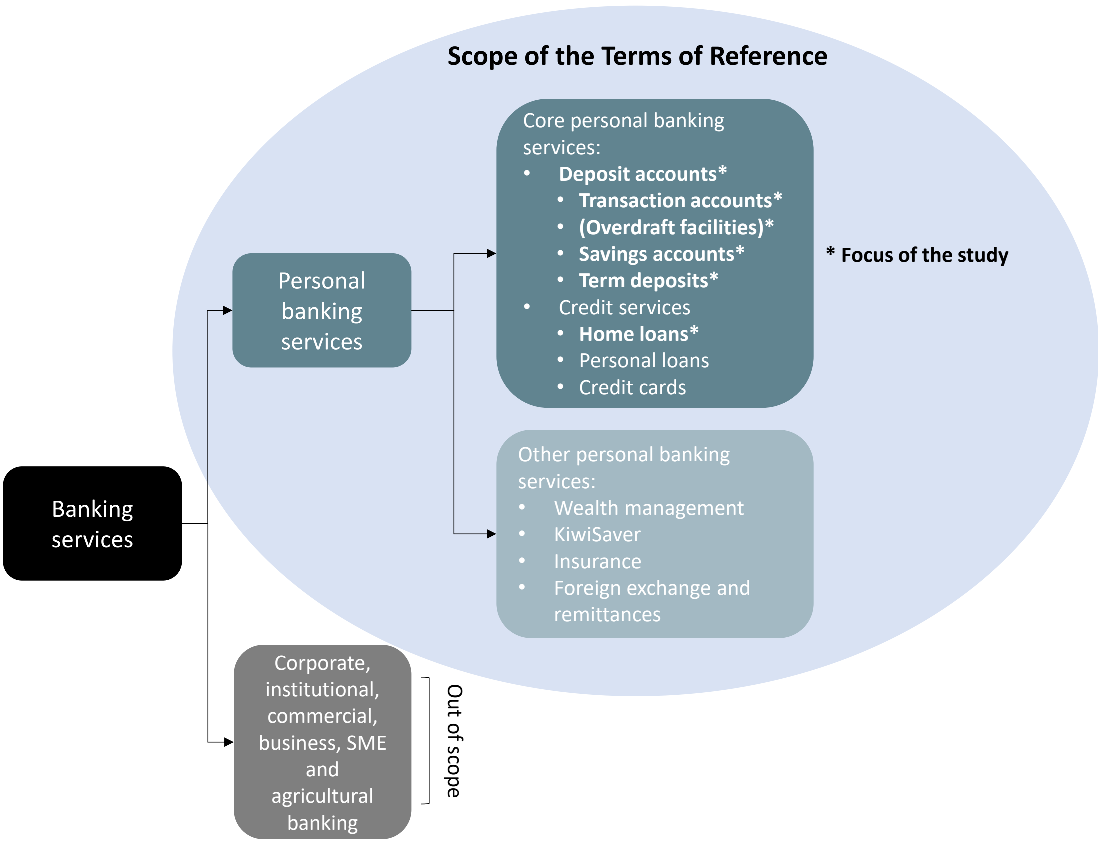
1.7 Personal banking covers a range of services, including deposit accounts, credit cards, personal loans, home loans, international money transfers and KiwiSaver. Corporate and institutional banking, commercial banking, business and agricultural banking services are not within the scope of this study.

1.8 We have discretion to focus the study on particular services. As summarised in Figure 1.1 below, we have focused on:

1.8.1 deposit accounts, being transaction, savings and term deposit accounts (including overdraft facilities); and

1.8.2 home loans.

Figure 1.1 Focus of the study



Source: Commerce Commission

1.9 In keeping with the Minister's intent, we have mainly focused on core personal banking services and, within that set, on deposit accounts and home loans.[5]

1.10 In identifying the focus of the study, we considered how best to promote the long-term benefit of consumers and what is in the public interest (including how these concepts were articulated in the Cabinet paper).[6,7,8] We have focused on deposit accounts and home loans because they are focal points for competition in personal banking services and because they matter to many New Zealanders.

1.11 The result of this approach is that we have not focused on some services often associated with personal banking.[9] We have, however, considered a wider range of personal banking services in some aspects of our analysis.[10]

1.12 In our Preliminary Issues paper,[11] we sought feedback on our proposed focus within the scope of the study. Feedback received was largely supportive of the focus on home loans and deposit accounts.[12]

Providers of personal banking services in New Zealand | *Ngā kaituku ratonga pēke whaiaro i Aotearoa*

1.13 There is a range of providers of personal banking services in New Zealand, including:

1.13.1 registered banks; and

1.13.2 non-bank providers, including non-bank deposit takers (NBDTs), financial technology companies (fintechs), finance companies, peer-to-peer lenders, other providers of different types of credit and payment services providers.

1.14 These providers are briefly described below as they are referred to throughout this report.

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5 MBIE "Cabinet Paper – Initiating a Market Study into Personal Banking Services" (28 June 2023), para 24.

6 Commerce Act, s 1A.

7 The Commission can undertake a market study if either the Minister or Commission consider it to be in the public interest, Commerce Act, ss 50 and 51.

8 MBIE "Cabinet Paper – Initiating a Market Study into Personal Banking Services" (28 June 2023), para 16.

9 For example, credit cards, KiwiSaver, wealth management and financial advice.

10 For example, we have taken a high-level view of firms' activities across a broad range of services when seeking to understand bank financial performance.

11 Commerce Commission "Market study into personal banking services – Preliminary Issues paper" (10 August 2023).

12 See paragraphs 1.15–1.19 of the draft report for further discussion about the scope and focus of the study: Commerce Commission "Personal banking services market study – Draft report" (21 March 2024). We received submissions suggesting that we expand our focus to examine other types of credit (such as credit cards and personal loans), remittances, international payments and foreign exchange. We undertook desktop research in relation to international money transfers. That research, discussed in Attachment E, suggests possible useful lines of enquiry for further study or analysis as it appears that there is room to improve competition for these services.

Registered banks are the main providers of personal banking services

1.15 There are currently 27 registered banks in New Zealand, although only 16 of these are unique banks that offer personal banking services.[13] Registered banks are the primary providers of personal banking services in New Zealand.[14]

1.16 The four largest banks in New Zealand (measured by total assets) are ANZ, ASB, BNZ and Westpac. We refer to these banks as the major banks.

1.17 Other registered banks that focus on personal banking services include Kiwibank, TSB, SBS Bank, Heartland Bank and Co-operative Bank.[15]

1.18 Figure 1.2 below shows logos of the registered banks in New Zealand that offer personal banking services, grouped by ownership.

13 The 27 registered banks include several overseas group entities that have New Zealand subsidiaries and other banks that do not appear to offer personal banking services in New Zealand.

14 For example, as at January 2024, 96% of housing and personal consumer lending was provided by registered banks: Reserve Bank "Registered banks and non-bank lending institutions: Sector lending" (29 February 2024), http://www.rbnz.govt.nz/statistics/series/lending-and-monetary/registered-banks-and-non-bank-lending-institutions-sector-lending

15 Rabobank NZ is currently the sixth-largest bank in New Zealand (based on total assets) but is focused on serving rural and agribusiness needs. Rabobank "Our Story", https://www.rabobank.co.nz/why-rabobank/our-story

Figure 1.2 Ownership of registered banks in New Zealand that offer personal banking services

Domestic ownership	Australian ownership	Rest of world
Kiwi bank.	bnz	बैंक ऑफ़ बड़ौदा Bank of Baroda
sbs BANK	ANZ	中国银行(香港) BANK OF CHINA (HONG KONG)
The Cooperative Bank	ASB	Rabobank
HEARTLAND BANK	Westpac	KB Kookmin Bank
TSB		Bank of India
		ICBC New Zealand
		China Construction Bank

Source: Commerce Commission.[16]

16 Reserve Bank "Registered banks in New Zealand" (28 February 2022), https://www.rbnz.govt.nz/regulation-and-supervision/cross-sector-oversight/registers-of-entities-we-regulate/registered-banks-in-new-zealand; New Zealand Companies Office "Companies Register", https://companies-register.companiesoffice.govt.nz/

There is also a range of non-bank providers of personal banking services

1.19 In addition to registered banks, there is a range of non-bank businesses providing personal banking services. This includes:

1.19.1 15 licensed NBDTs such as credit unions and building societies (for example, First Credit Union and Heretaunga Building Society);[17]

1.19.2 other finance companies, including peer-to-peer lenders (for example, Squirrel); and

1.19.3 fintechs, who use digital information and automation technology in providing innovative financial services (for example, Akahu, Revolut and Wise).

1.20 Some of these businesses are deposit takers, licensed as NBDTs by the Reserve Bank of New Zealand Te Pūtea Matua (Reserve Bank).

1.21 Others are licensed under the Financial Markets Conduct Act 2013 (FMC Act) by the Financial Markets Authority Te Mana Tātai Hokohoko (FMA) and/or certified (unless exempt from certification) by the Commission under the Credit Contracts and Consumer Finance Act 2003 (CCCF Act).

1.22 Some have alternative businesses models providing some but not all of the suite of traditional banking services (such as payment services only or lending supported by wholesale funding sources rather than or in addition to consumer deposits).

This is the first competition study of personal banking services in New Zealand | *Ko tēnei te rangahau whakataetaetanga tuatahi mō ngā ratonga pēke whaiaro i Aotearoa*

1.23 Although the Commission has previously considered competition in the banking sector in the context of specific merger decisions, this competition study is the first opportunity to consider and evaluate in depth whether competition in personal banking is promoting outcomes that benefit New Zealand consumers over the long term.

1.24 The last merger where we considered competition in the banking sector was the acquisition by ANZ Banking Group (New Zealand) Limited of The National Bank of New Zealand Limited (the ANZ/National Bank merger). That merger was cleared by the Commission on 25 September 2003.

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17 Reserve Bank "Register of non-bank deposit takers in New Zealand" (20 June 2024), https://www.rbnz.govt.nz/regulation-and-supervision/cross-sector-oversight/registers-of-entities-we-regulate/register-of-non-bank-deposit-takers-in-new-zealand

1.25 The ANZ/National Bank merger was cleared because it was considered unlikely to substantially lessen competition in the relevant markets. Although the merger was expected to lead to reduction in choice and quality of service in the supply of transaction accounts and small and medium-sized enterprise (SME) banking, any loss of competition in these markets was not considered to be substantial. This was due to competition from the three other main competitors, particularly ASB.[18]

1.26 ASB was considered a particular constraint on the other major banks at the time. For example, the clearance decision noted:[19]

> ASB has been growing successfully and was considered by one market participant as a maverick player. ASB was the first to introduce internet banking. Given ASB's growth and high customer satisfaction levels, it is unlikely that it would have an incentive to participate in coordinated market power to maximise profits, at the expense of its expansion.

1.27 Over 20 years later, we observe a different competitive dynamic. None of the major banks appear currently to be acting as a disruptor in personal banking services. Although each of the major banks has its own strategies and focus areas, they have very similar price offerings (interest rates and fees) and non-price offerings (service) overall, and shares of supply have been stable for some years. While Kiwibank competes with the major banks, it does not currently have the scale or resources (including capital) to challenge the major banks aggressively. Smaller providers are even less of a competitive threat for a range of reasons. Our views on the nature of competition for personal banking services are discussed in more detail in Chapter 2.

1.28 Other jurisdictions have also carried out competition studies into their banking sectors in recent years, sometimes in a staged process where a broader study into the banking sector is undertaken first followed by narrower studies into particular services (such as home loans or deposit accounts).

1.29 Although New Zealand's personal banking sector has its own history, structure and regulatory environment, we have drawn from other jurisdictions' studies to the extent we consider their findings or recommendations are relevant.[20] Studies of particular relevance include:

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18 Commerce Commission "Decision No. 507: Determination pursuant to the Commerce Act 1986 in the matter of an application for clearance of a business acquisition involving ANZ Banking Group (New Zealand) Limited and NBNZ Holdings Limited" (25 September 2003), para 19, https://comcom.govt.nz/__data/assets/pdf_file/0024/73608/507.pdf

19 Commerce Commission "Decision No. 507: Determination pursuant to the Commerce Act 1986 in the matter of an application for clearance of a business acquisition involving ANZ Banking Group (New Zealand) Limited and NBNZ Holdings Limited" (25 September 2003), para 332.

20 Our Preliminary Issues paper contains further details regarding the history of New Zealand's banking sector: Commerce Commission "Market study into personal banking services – Preliminary Issues paper" (10 August 2023), paras 56–67.

1.29.1 the UK Competition and Markets Authority (CMA) "Retail banking market investigation" (2016);[21]

1.29.2 the UK Financial Conduct Authority (FCA) "Strategic review of retail banking business models" (2018 and 2022);[22]

1.29.3 the FCA "Mortgages Market Study" (2019);[23]

1.29.4 the Australian Productivity Commission "Competition in the Australian Financial System" (2018);[24]

1.29.5 the Australian Competition and Consumer Commission (ACCC) "Residential mortgage products price inquiry" (2018);[25]

1.29.6 the ACCC "Home loan price inquiry" (2020);[26] and

1.29.7 the ACCC "Retail deposits inquiry" (2023).[27]

Our framework for analysing competition | *Te anga hei tātari whakataetaetanga*

We have considered whether competition is working well for consumers

1.30 This study considers whether competition is working well for consumers of personal banking services. Its purpose is to identify and assess any factors that may affect competition for the supply or acquisition of personal banking services and to make any recommendations that we consider may improve competition.[28]

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21 CMA "Retail banking market investigation", https://www.gov.uk/cma-cases/review-of-banking-for-small-and-medium-sized-businesses-smes-in-the-uk

22 FCA "Strategic review of retail banking business models", https://www.fca.org.uk/publications/multi-firm-reviews/strategic-review-retail-banking-business-models

23 FCA "Mortgages Market Study", https://www.fca.org.uk/publications/market-studies/mortgages-market-study

24 Australian Productivity Commission "Competition in the Australian Financial System", https://www.pc.gov.au/inquiries/completed/financial-system/report

25 ACCC "Residential mortgage products price inquiry 2017-18", https://www.accc.gov.au/inquiries-and-consultations/finalised-inquiries/residential-mortgage-products-price-inquiry-2017-18

26 ACCC "Home loan price inquiry 2019-20", https://www.accc.gov.au/inquiries-and-consultations/finalised-inquiries/home-loan-price-inquiry-2019-20

27 ACCC "Retail deposits inquiry 2023", https://www.accc.gov.au/inquiries-and-consultations/retail-deposits-inquiry-2023

28 Commerce Act, ss 48, 51A and 51B and our terms of reference. We have published Market Studies Guidelines to assist interested parties to understand our approach to a market study: Commerce Commission "Market Studies Guidelines" (19 November 2020), https://comcom.govt.nz/__data/assets/pdf_file/0029/228476/Market-studies-guidelines.pdf. These describe characteristics of competitive markets that are working well and those that may be observed in markets that are not working well. They also describe market features that could affect competition and that are relevant to this study.

1.31 This study does not consider compliance with the provisions of the Commerce Act relating to anti-competitive conduct. A conclusion that particular conduct restricts competition, even if it is the subject of a recommendation, does not mean we have concluded that it breaches the Commerce Act.

1.32 We can and do separately investigate anti-competitive conduct identified in market studies if we have reason to believe that the Commerce Act may have been breached. Similarly, we may separately investigate conduct that we consider could breach the Fair Trading Act 1986, the Retail Payment System Act 2022 or the CCCF Act.[29]

1.33 The overriding aim of this study is the same as the purpose of the Commerce Act – to promote competition in markets for the long-term benefit of consumers within New Zealand.[30]

1.34 Competition is defined in the Commerce Act as meaning workable or effective competition.[31] It does not mean the theoretical concept of perfect competition. The High Court has noted that there is no consensus on precise conditions that define workable competition, rather:[32]

> [13] …workable competition is a practical description of the state of an industry where government intervention to make the market work better is not justified because the socially desirable outcomes generated by competition already exist to a satisfactory degree.
>
> [14] A workably competitive market is one that provides outcomes that are reasonably close to those found in strongly competitive markets. Such outcomes are summarised in economic terminology by the term "economic efficiency" with its familiar components: technical efficiency, allocative efficiency and dynamic efficiency. Closely associated with the idea of efficiency is the condition that prices reflect efficient costs (including the cost of capital, and thus a reasonable level of profit).
>
> [15] There is a large body of theoretical literature about the relationship between prices, incentives, efficiency and market outcomes. But the practical context is the existence of sufficient rivalry between firms (sellers) to push prices close to efficient costs. The degree of rivalry is critical. In a workably competitive market no firm has significant market power and consequently prices are not too much or for too long significantly above costs.

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29 The Government has announced that it will transfer responsibility for the CCCF Act from the Commission to the FMA: MBIE "2024 financial services reforms" (10 July 2024), https://www.mbie.govt.nz/business-and-employment/business/financial-markets-regulation/2024-financial-services-reforms

30 Commerce Act, s 1A. This was emphasised by the Transport and Infrastructure Select Committee in its report back to Parliament on the draft market studies legislation: Commerce Amendment Bill 2018 (45-2) (Select Committee report) (12 September 2018), 1, https://www.parliament.nz/en/pb/sc/reports/document/SCR_80263/commerceamendment-bill

31 Commerce Act, s 3(1).

32 *Wellington International Airport Ltd and Others v Commerce Commission* [2013] NZHC 3289 at [13]–[23].

> [16] These terms are admittedly not precise. No two markets are the same and no single market stays the same. Whether workably competitive conditions exist is a judgement to be made in the light of all the information available, rather than something that can be ascertained by testing whether certain precise conditions are satisfied…
>
> [18] In our view, what matters is that workably competitive markets have a tendency towards generating certain outcomes. These outcomes include the earning by firms of normal rates of return, and the existence of prices that reflect such normal rates of return, after covering the firms' efficient costs.
>
> [19] Of course, firms may earn higher than normal rates of return for extended periods. On the other hand, firms may earn rates of return less than they expected and less than commensurate with the risks faced by their owners when they made their investments. They may even make losses for extended periods. Prices in workably competitive markets may never exactly reflect efficient costs, including a normal rate of return…
>
> [22] In short, the tendencies in workably competitive markets will be towards the outcomes produced in strongly competitive markets. The process of rivalry is what creates incentives for efficient investment, for innovation, and for improved efficiency. The process of rivalry prevents the keeping of all the gains of improved efficiency from consumers, and similarly limits the ability to extract excessive profits.
>
> [23] Indeed, the term "workably competitive markets" means markets in which these tendencies are seen. The more those tendencies are seen in a market, the more the market can be regarded as workably competitive. And of course, the more competitive the market, the more those tendencies will be seen.

1.35 Further, and as the High Court observed, actual markets demonstrate varying levels of competition.

We make a number of recommendations to enhance competition

1.36 We present in this report our findings and our recommendations for improving competition in personal banking. Our recommendations are intended to produce better long-term market outcomes for consumers, including in respect of prices, quality, range and service levels.

1.37 While our focus is on competition, we are conscious that there are other important policy objectives in a well-functioning banking system – financial stability and consumer protection being obvious examples. Financial stability and consumer protection are not necessarily in conflict with competition. On the contrary, a diverse and unconcentrated (competitive) personal banking sector is likely to be stable and protect consumer interests. We accept that trade-offs might be required under some specific conditions.

1.38 The literature is of some assistance on this point, although local factual details remain important. As regards financial stability and competition, we have not found compelling evidence of greater competition negatively affecting financial stability.[33] A 2016 article in the *Banking and Finance Law Review* found (emphasis added):[34]

> …there has been a violent swing from the liberalisation before the financial crisis to the preference of stability over competition after the crisis. We have shown that the policy settings in both cases were problematic and that *preferencing competition over stability is a relatively low-risk strategy*. If the promotion of competition in retail financial services is adopted with both a reduction of entry and exit barriers and a policy of improved financial literacy, then the consumer welfare benefits of competition in the financial services sector can be enjoyed without increasing systemic risk.

1.39 Several of the final recommendations that we make in Chapter 10 differ to those that were in our draft report.[35] We found the engagement with stakeholders through submissions on our draft report and at our consultation conference helpful in refining our recommendations.

1.40 Our suite of final recommendations seeks to identify feasible options for tangible improvements to competition without undermining other important policy objectives. The aim is to produce better long-term outcomes for consumers.

1.41 We have not undertaken cost-benefit analysis when developing our recommendations. Formal cost-benefit analysis falls outside the scope of our study. Policy makers may undertake that analysis while developing or giving effect to any of our recommendations the Government wishes to consider further.

Structure of this report | *Te takoto o tēnei pūrongo*

1.42 The structure of this report is as follows.

1.42.1 **Chapter 2: The nature of competition in personal banking** discusses how providers of personal banking services compete (including on interest rates, fees and non-price features) and provides our views on the intensity of that competition currently.

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33 The literature on this topic is mixed and context specific. See Deniz Anginer, Asli Demirgüç-Kunt and Min Zhu "How does competition affect bank systemic risk?" *Journal of Financial Intermediation* 23(1) (2014) 1–26; Consuelo Silva-Buston "Systemic risk and competition revisited" *Journal of Banking and Finance* 101 (2019) 188–205; and Zuzana Fungáčová, Anastasiya Shamshur and Laurent Weill "Does bank competition reduce cost of credit? Cross-country evidence from Europe" *Journal of Banking and Finance* 83(C) (2017) 104–120.

34 Deborah Healey and Rob Nicholls "Should stability reign? The consumer downside of foregone competition in retail banking markets" *Banking and Finance Law Review* 32 (2016) 69–101.

35 Commerce Commission "Personal banking services market study – Draft report" (21 March 2024), chapter 10.

1.42.2 **Chapter 3: Māori perspectives on competition for personal banking services** describes Māori perspectives on competition in the sector (for both supply and acquisition of personal banking services) based on the key themes of our Māori stakeholder engagement.

1.42.3 **Chapter 4: Competition for home loans** discusses our findings regarding competition for home loans – one of the services we have focused on in the study.

1.42.4 **Chapter 5: Competition for deposit accounts** discusses our findings regarding competition for deposit accounts (including transaction accounts, overdraft facilities, savings accounts and term deposits).

1.42.5 **Chapter 6: Profitability of New Zealand's banking sector** discusses how profitability measures for New Zealand's banking sector compare with relevant benchmarks.

1.42.6 **Chapter 7: Regulatory factors affecting competition** further discusses financial stability and competition and the regulatory factors that we have identified as affecting market entry and expansion.

1.42.7 **Chapter 8: Consumer search and switching behaviour** discusses the extent to which consumers switch between providers of personal banking services and the challenges they face when attempting to switch.

1.42.8 **Chapter 9: Digital disruption and impediments to innovation** discusses the conditions for innovation in personal banking in New Zealand with reference to global trends. It particularly focuses on the importance of technology systems in enabling competition and the potential for open banking to lead to greater innovation and disruption in the sector.

1.42.9 **Chapter 10: Recommendations** sets out our recommendations for improving competition to produce better long-term market outcomes for consumers.

1.43 We have included additional information in the attachments to our report:

1.43.1 **Attachment A: Overview of the personal banking services industry** provides background information on the New Zealand personal banking sector, including further details on the main market participants and products and the importance of personal banking services to New Zealanders.

1.43.2 **Attachment B: Further details on our analysis of bank profitability** includes additional details about our approach to assessing the profitability of New Zealand's banking sector.

1.43.3 **Attachment C: Further details on potential explanations for bank profitability** includes responses to submissions on possible explanations for the observed levels of profitability in New Zealand.

1.43.4 **Attachment D: Competition for different consumer groups** considers whether competition is delivering good outcomes for all consumers.

1.43.5 **Attachment E: International money transfers** describes the preliminary research we have undertaken on competition for remittances, international payments and foreign exchange.

Our process | *Tā mātou tukanga*

Papers we have published

1.44 On 22 June 2023, we released a Statement of Process, outlining the process we intended to follow over the course of this study.[36]

1.45 On 10 August 2023, we released a Preliminary Issues paper, seeking responses from interested parties on the preliminary issues we intended to explore during this study.[37] We received submissions from 28 parties on our Preliminary Issues paper.

1.46 On 21 September 2023, we sought cross-submissions on our Preliminary Issues paper. We received cross-submissions from nine parties by the due date and a further five submissions subsequently.

1.47 We hosted a wānanga with Māori stakeholders in Wellington on 30 October 2023 and an online workshop with FinTechNZ members on 27 November 2023. We published summaries of both of those engagements on our website.[38]

1.48 On 21 March 2024, we released a draft report and sought comment from stakeholders and interested parties on our preliminary findings and draft recommendations.[39] We received submissions from 34 parties.

1.49 Alongside our draft report, we published the following.

1.49.1 Consumer research undertaken on our behalf by Verian.[40]

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[36] Commerce Commission "Market study into personal banking services – Statement of Process" (22 June 2023).

[37] Commerce Commission "Market study into personal banking services – Preliminary Issues paper" (10 August 2023).

[38] Commerce Commission "Summary of views expressed – Te Komihana Tauhokohoko wānanga – Competition for personal banking services in New Zealand" (14 February 2024); Commerce Commission "Summary of views expressed – FinTechNZ/Commerce Commission workshop – Competition for personal banking services in New Zealand" (14 February 2024).

[39] Commerce Commission "Personal banking services market study – Draft report" (21 March 2024).

[40] Verian "Personal banking services market study – Research report" (February 2024), https://comcom.govt.nz/__data/assets/pdf_file/0030/347376/Verian-Personal-Banking-Survey-Report-February-2024.pdf.

1.49.2 Econometric analysis on measures of efficiency, including cost and profit efficiency, economies of scale, market concentration and market power for New Zealand banks, undertaken by Professor Dimitris Margaritis and Dr Maryam Hasannasab of the University of Auckland.[41] We invited submissions on this econometric analysis and received two submissions.

1.50 On 13–16 May 2024, we hosted a consultation conference in central Auckland and online to hear further views from stakeholders and interested parties.[42] Following the conference, we sought cross-submissions. We received post-conference cross-submissions from 13 parties.

1.51 Copies of the papers that we published, public versions of the submissions that we received, our draft report and related documents are available on our website.

We gathered information from a diverse range of market participants

1.52 The personal banking services industry includes a diverse range of participants. We therefore sought to collect information from a wide range of sources and to meet with a wide range of parties. These parties included consumer representative groups, major banks, smaller banks, NBDTs, fintechs and both domestic and international regulators of personal banking services (including the Reserve Bank and FMA).[43] We have held meetings with over 70 parties when undertaking the study.[44]

1.53 We thank all these parties for the information they have provided and for their engagement in this study.

1.54 We received over 100 responses from consumers to feedback forms made available on our website during the study.[45] The feedback received has been valuable for informing this study and has contributed to the findings set out in our report.

1.55 As noted above, we engaged Verian to undertake consumer research on our behalf, focusing on consumer decision making (particularly switching) for personal banking services.[46] That research included:

1.55.1 a nationwide survey of 2,140 consumers aged 18 and over using a mixed-method approach – 1,039 consumers surveyed online, 1,001 by phone and 100 face to face

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41 Dimitris Margaritis and Maryam Hasannasab "Market power in banking: A study of New Zealand banks" (March 2024), https://comcom.govt.nz/__data/assets/pdf_file/0029/347375/Dimitris-Margaritis2C-Maryam-Hasannasab-Market-power-in-banking-A-study-of-New-Zealand-banks-March-2024.pdf

42 Conference transcripts are available on our website.

43 Commerce Commission "Summary of views expressed – FinTechNZ/Commerce Commission workshop – Competition for personal banking services in New Zealand" (14 February 2024).

44 [ ].

45 [ ].

46 Verian "Personal banking services market study – Research report" (February 2024).

1.55.2 16 in-depth interviews to supplement the quantitative survey, conducted to better understand consumers' switching experiences.

We engaged with Māori stakeholders during the study

1.56 As an independent Crown entity, we support the Crown's obligations as a Treaty partner under the Treaty of Waitangi.[47] We are committed to engaging with Māori and supporting future-focused Māori-Crown relationships through taking a good-faith, collaborative approach to engaging with Māori on our work.

1.57 We heard a range of views from providers and consumers about how competition for personal banking services is impacting Māori. Key engagements included:

1.57.1 the wānanga on 30 October 2023, which included participants who brought consumer, entrepreneurial and community provider perspectives on competition issues affecting Māori in the personal banking sector;[48]

1.57.2 meetings with Tāwhia, the Māori bankers' rōpū;[49] and

1.57.3 a session at our consultation conference on promoting competition for lending for housing on Māori freehold land.[50]

1.58 We set out the key themes from our engagement with Māori in Chapter 3. We have also incorporated information shared with us throughout the relevant sections of our report.

1.59 Hearing from Māori about their experiences of the personal banking services industry has enabled us to better understand Māori perspectives, concerns and aspirations regarding the industry. We acknowledge the diversity in views and perspectives we heard. Hearing a range of Māori voices necessarily means there was a variety of perspectives expressed. We also acknowledge that the comments we heard do not represent the views of all Māori.

Some information we have received is confidential

1.60 We have endeavoured to make our report as accessible to interested parties as possible. However, some information within our report must out of necessity be redacted from view, as is indicated by the use of square brackets like this: [ ].

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47 Te Tiriti o Waitangi | Treaty of Waitangi is a founding document of government in New Zealand and is one of the major sources of New Zealand's constitution. Our reference to the Treaty is to both the English and te reo Māori versions.

48 Commerce Commission "Summary of views expressed – Te Komihana Tauhokohoko wānanga – Competition for personal banking services in New Zealand" (14 February 2024).

49 Tāwhia consists of senior Māori representatives from ANZ, ASB, BNZ, Heartland Bank, Kiwibank, TSB and Westpac.

50 Commerce Commission "Day 3 Personal banking services market study conference – Session 7 Promoting competition for lending on Māori freehold land" (15 May 2024).

1.61 Much of the information we have collected in the course of this study is considered confidential or commercially sensitive by the supplying party. It is important that interested parties who provided us with relevant information during this study feel confident in how we treat and handle confidential and commercially sensitive information.

1.62 Accordingly, when deciding whether information provided to us is commercially sensitive and/or confidential or can be published, we consult with the party who has provided it and balance these considerations against our obligations to adhere to the principles of natural justice in the course of this study, operate as transparently as practicable and comply with our legal obligations under the Official Information Act 1982.

1.63 If we receive a request for any information referred to or collected in connection with this report, we will consider whether to make the information available in accordance with the Official Information Act.

1.64 Our Market Studies Guidelines contain further information about how we protect confidential information provided to us during a competition study and how we respond to Official Information Act requests related to a study.[51]

Next steps | *Ngā mahi ā muri*

1.65 This is our final competition report for this study. It sets out our findings and our recommendations for improving competition in personal banking having had regard to the comments that we have received on our draft report.

1.66 Our recommendations are not binding on the Government, but the Minister is required to respond to our final report within a reasonable time after it is made publicly available.[52]

[51] Commerce Commission “Market Studies Guidelines” (19 November 2020).
[52] Commerce Act, s 51E.

Chapter 2 The nature of competition in personal banking | *Ko te āhua o te whakataetaetanga i te pēke whaiaro*

Summary of findings

- **Providers of personal banking services can be split into two tiers.** The first tier consists of the four major banks. The second tier consists of smaller registered banks and non-banks.
- **The major banks in the first tier have high and largely stable market shares.** They hold around 85–90% of the assets of all registered banks in New Zealand. This has been the case since at least 2018.
- **The second tier of providers does not exert significant competitive pressure on the larger banks** due to lack of scale, higher cost of funding, weaker brand awareness and smaller shares of main bank customers. There has been no significant new entry at scale since Kiwibank entered the market.
- **Kiwibank sits between the two tiers of providers.** Kiwibank imposes some constraint on the major banks but currently lacks the scale and capital backing to consistently drive stronger competition in the market.
- **There is no disruptive maverick provider.** No particularly aggressive or innovative provider exerts disruptive competitive pressure on the major banks. Kiwibank does not have sufficient capital or differentiation from the major banks to be considered a maverick, and comparisons between Kiwibank and Macquarie (which has been characterised as a maverick in the Australian market) are not like for like.
- **We do not consistently observe strong rivalry between the major banks, and price competition is sporadic.** There have been times of relatively intense competition and times where some or all of the major banks pull back and put more focus on maintaining profit margins than gaining market share. Rather than competing consistently hard on price, emphasis is instead placed on differentiating the non-price dimensions of their offerings such as service quality, credit settings and processing times.
- **Price matching is a prevalent strategy of the major banks.** The major banks and Kiwibank generally ensure their advertised rates are in line with each other and are also prepared to match discretionary discounts (case-by-case reductions below those advertised rates). Over time, price matching among the banks is likely to have diminished incentives to compete hard on interest rates.
- **There is a risk of accommodating behaviour.** We have not found evidence of explicit collusion. However, the major banks have broadly similar cost structures, can readily observe and respond to each other's pricing, interact regularly across a range of services, and the threat of disruption by smaller providers or new entrants is low. These features make the sector prone to accommodating behaviour.

Summary of findings (continued)

- **Banks' customers tend to be sticky.** The four major banks have the vast majority of main bank relationships, which provides them with an advantage over smaller banks. Main bank customers are more likely to add new products and to renew their services with their existing provider.
- **Some consumer groups are not well served by competition alone.** This is having an unintended consequence of financial exclusion, where challenges can be encountered gaining access to even a basic bank account.

Introduction | *Whakatakinga*

2.1 This chapter describes how providers of personal banking services compete and provides our views on the intensity of that competition.

2.2 It discusses the structure of the market and the competition that takes place within and between different levels of providers. It also describes how providers seek to win and retain customers and how customers engage with providers for these services. Finally, the chapter considers how well competition is working for different consumer groups.

There are two tiers of providers for personal banking services | *E rua ngā taumata o ngā kaituku ratonga pēke whaiaro*

2.3 The personal banking sector is dominated by a stable oligopoly of major banks which do not face strong competition. There are two main tiers of providers.

2.3.1 The first tier is the four major banks.

2.3.2 The second tier includes other providers of personal banking services, including smaller banks, NBDTs, non-bank lenders and fintechs.

2.4 Kiwibank currently sits between these two tiers.

The major banks in the first tier have high and stable shares of supply

2.5 The first tier of providers consists of the four major banks, who currently hold 85–90% of the total assets of registered banks in New Zealand.[53]

2.6 As Figure 2.1 shows, the major banks have had high and stable shares of total assets for an extended period. ANZ is significantly larger than the other major banks, holding around 30% of total assets, although this has decreased over time. ASB, BNZ and Westpac each hold around 18–20%, and those shares have remained fairly constant. No smaller bank has increased its share much past 5% (Kiwibank is currently sitting at around 5%).[54]

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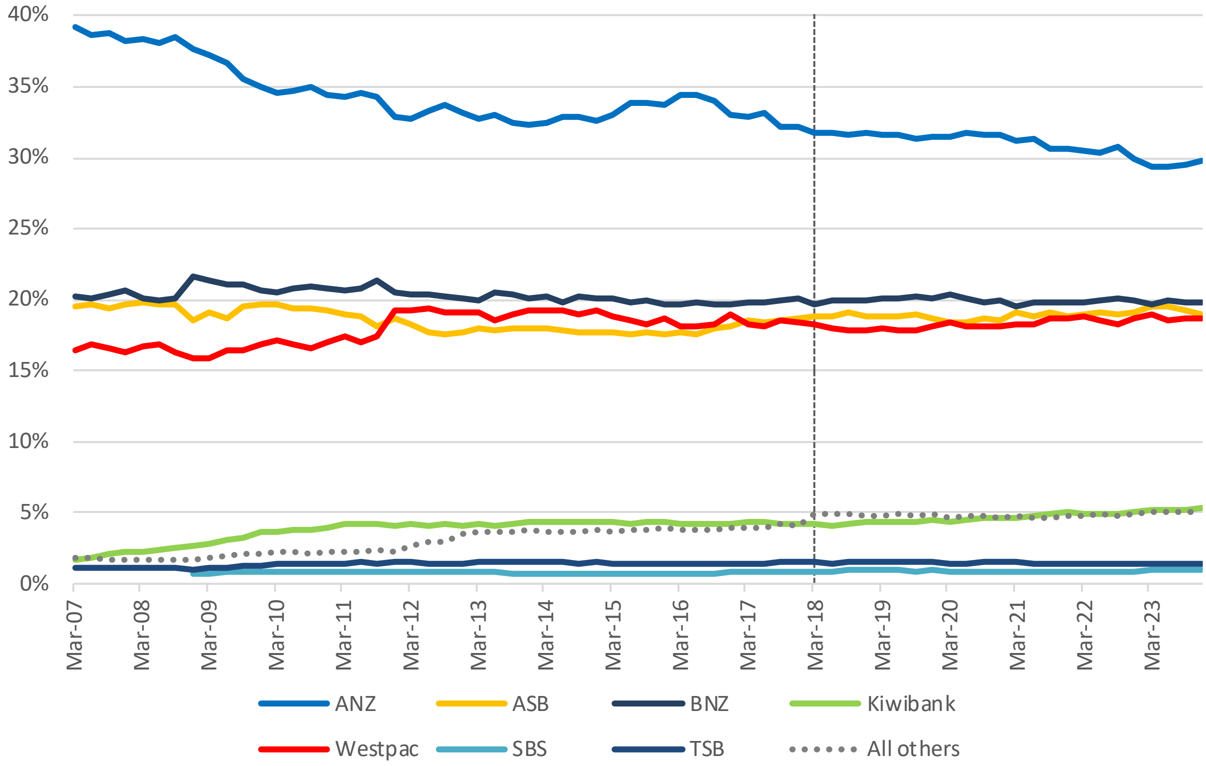
53 Reserve Bank "Bank Financial Strength Dashboard – Balance sheet", https://bankdashboard.rbnz.govt.nz/balance-sheet

54 [ ].

Figure 2.1 Share of total banking assets March 2007 – December 2023



Source: Calculated from Reserve Bank data.[55]

2.7 Figure 2.2 shows that home loan shares have also been largely stable since 2018. Prior to this period, ANZ gained share at the expense of the three other major banks. No other provider has significantly increased its share of supply. Kiwibank's share of home loans is around 7%.

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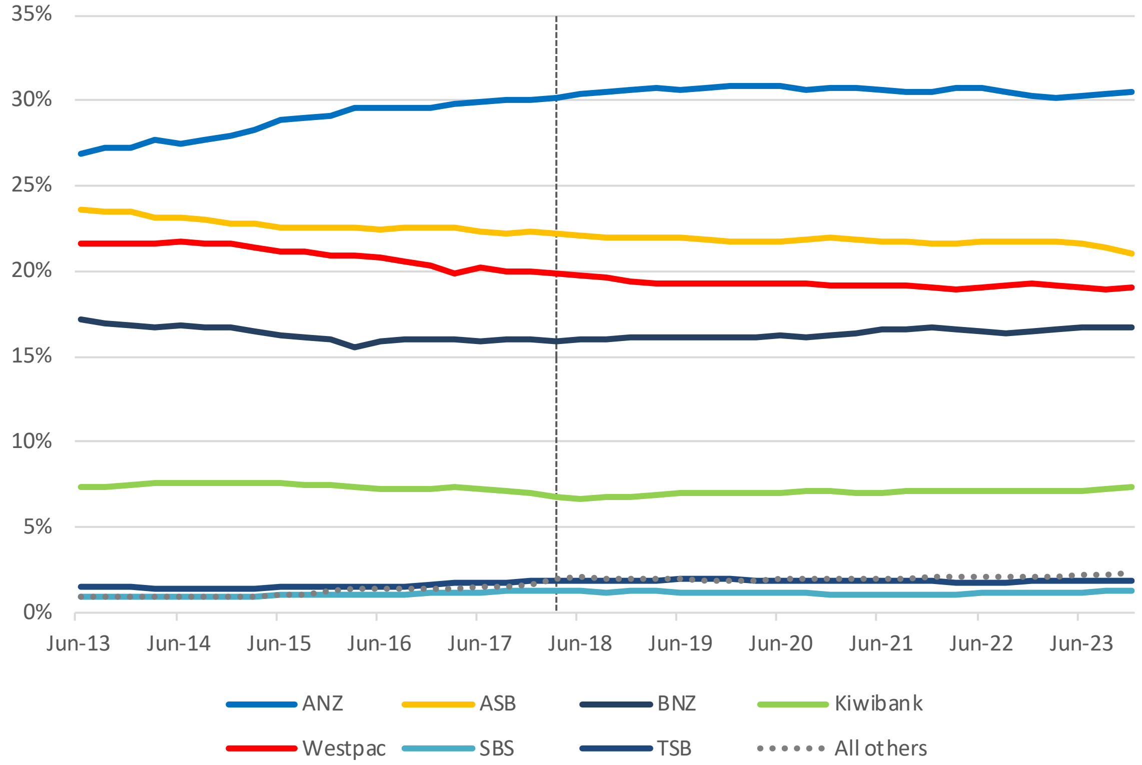
55 This chart combines two Reserve Bank data sources. The dotted vertical line indicates the break in the series between the datasets. Prior to March 2018, quarterly data is sourced from Reserve Bank "Summary information for locally incorporated banks (G1)" (discontinued August 2018), https://www.rbnz.govt.nz/hub/statistics/discontinued/summary-information-for-locally-incorporated-banks. From March 2018, data is sourced from Reserve Bank "Bank Financial Strength Dashboard", https://bankdashboard.rbnz.govt.nz/summary. [ ].

Figure 2.2 Share of home loans June 2013 – December 2023



Source: Calculated from Reserve Bank data.[56]

2.8 Home loans are long-term products. The total portfolio of existing lending is generally very large relative to the flow of new lending.[57] For reasons examined in more detail subsequently, once a home loan is taken out, the level of switching between providers is very low. This means the current volume of home loans is indicative of how competition has played out over several years rather than providing a contemporaneous account of how competition is playing out today.

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56 See footnote 55 for details of the two Reserve Bank data sources used to produce Figure 2.2. The dotted vertical line indicates the break in the series between the datasets. [ ].

57 Reserve Bank "New and existing residential mortgage lending by payment type (C32)" (24 July 2024), https://www.rbnz.govt.nz/statistics/series/lending-and-monetary/new-and-existing-residential-mortgage-lending-by-payment-type

2.9 To get a richer sense for how competition is playing out over time, we also reviewed confidential data on monthly new lending to owner-occupiers.[58] This data shows that shares of new lending are more dynamic. Nevertheless, the data tends to follow the same general pattern over time, with the majority of new lending being provided by the major banks and Kiwibank.[59]

2.10 Many home lending providers compare their home lending growth to the overall rate of growth in the New Zealand market as a whole (system growth). These providers also often set their performance targets in this way. For example, a bank may aim to grow its home loan book at 1x system or 1.2x system.[60]

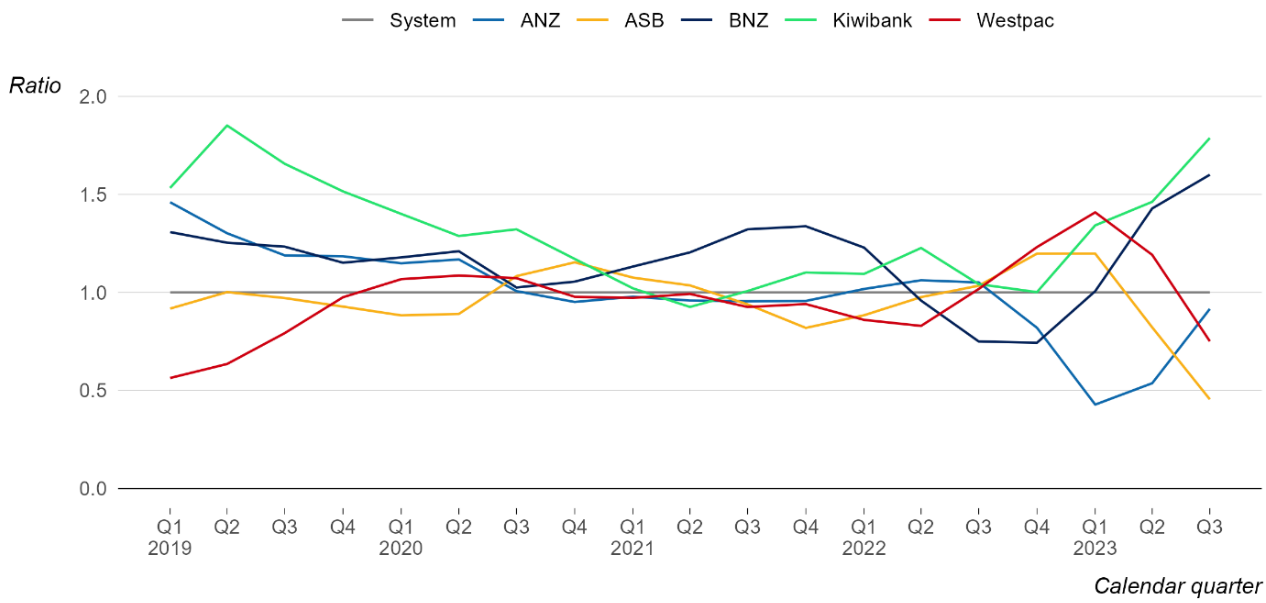
2.11 We compared the relative growth in quarterly home lending for each of the major banks and Kiwibank to the rate of overall system growth for the period 2019–2023. This is presented in Figure 2.3 below.

58 Data provided confidentially to the Commission through request for information responses by ANZ, ASB, Westpac, BNZ, Kiwibank, Heartland Bank, SBS Bank and Co-operative Bank.

59 [ ].

60 [ ].

Figure 2.3 Quarterly home lending growth as a multiple of system growth for the major banks and Kiwibank, Q1 (March) 2019 – Q3 (September) 2023



Source: Calculated from Reserve Bank data.[61]

2.12 We observe the following from Figure 2.3.

2.12.1 There is some dynamism in the relative growth of home lending providers' portfolios over time.

2.12.2 Growth appears to occur in waves – we can observe periods where each bank has demonstrated strong growth as well as periods where they appear to have pulled back, growing at less than system.

2.12.3 Kiwibank stands out as the only provider that has grown consistently at or above system growth over the 4-year period.

2.12.4 Kiwibank and BNZ's above-system growth since the start of 2023 implies that each has gained home loan market shares. However, it is unclear how long this will continue given it is a relatively short window that coincides with some of the major banks pulling back to restore margins.[62]

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61 Monthly data has been taken from the Reserve Bank's reporting on total bank loans by purpose in addition to Reserve Bank quarterly reporting data on individual bank asset quality: Reserve Bank "Banks: Assets – Loans by purpose (S31)", https://www.rbnz.govt.nz/statistics/series/registered-banks/banks-assets-loans-by-purpose; and Reserve Bank "Bank Financial Strength Dashboard – Asset quality" (March 2019 – September 2023), https://bankdashboard.rbnz.govt.nz/asset-quality [ ].

62 See paragraph 2.88 for further discussion.

The second tier is smaller providers who do not exert significant competitive pressure

2.13 The second tier of providers consists of smaller banks, NBDTs, non-bank lenders and fintechs.

2.14 There has been a lack of notable entry or expansion by providers of personal banking services in New Zealand recently. In the last decade, only Bank of China and China Construction Bank have entered (both in 2014).[63] Meanwhile, HSBC has exited the personal banking services market.[64] There has also been a reduction in NBDTs, as noted in Chapter 7.[65]

2.15 There has been some new entry from fintechs with non-traditional business models, offering a limited range of services. Examples include Dosh, Revolut, Simplicity, Squirrel and Wise.[66] Increasingly, disruptive competition is most likely to driven by fintechs, but their impact in the New Zealand market has been modest to date due to challenges they face in entering and expanding. These challenges are discussed in Chapter 9.

2.16 None of these participants has gained a significant share of any of the markets in which they operate. In well-functioning markets, higher profitability incentivises new entry and expansion, which restores returns to normal levels over time. For personal banking services, we see limited entry and exit and relatively high profitability of the major banks persisting for prolonged periods.

2.17 Professor Margaritis and Dr Hasannasab have estimated the Herfindahl-Hirschman Index (HHI) for total deposits, total loans and total assets over the period 2016–2022.[67] These concentration indices encompass all banking services and suggest some reduction in concentration during that time. However, the metrics have remained at all times in the range that Professor Margaritis and Dr Hasannasab describe as indicating moderate concentration.[68]

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63 Reserve Bank “Registered banks in New Zealand” (28 February 2022).

64 HSBC “Personal Banking FAQs”, https://www.about.hsbc.co.nz/personal-banking-faqs

65 See paragraph 7.7.

66 ANZ, Submission on Preliminary Issues paper (7 September 2023), para 105.

67 The HHI is an indicator of concentration that is found by summing the squares of the shares of each firm in a market. It ranges from close to 0, indicating perfect competition, to 10,000 indicating a monopoly.

68 In some years, the HHIs estimated by Professor Margaritis and Dr Hasannasab are at the level that some agencies may describe as suggesting high concentration: Dimitris Margaritis and Maryam Hasannasab “Market power in banking: A study of New Zealand banks” (March 2024), pp. 6–7. For example, the US Department of Justice and Federal Trade Commission describe an HHI above 1800 as highly concentrated: Department of Justice and Federal Trade Commission “Merger Guidelines” (18 December 2023), p. 5, https://www.ftc.gov/system/files/ftc_gov/pdf/2023_merger_guidelines_final_12.18.2023.pdf. The UK CMA has described an HHI above 2,000 as highly concentrated: CMA “The State of UK Competition” (29 April 2022), p. 9, https://www.gov.uk/government/publications/state-of-uk-competition-report-2022

2.18 The five largest banks do not appear to have close regard to the pricing decisions of smaller lenders or deposit takers, indicating that they are not a significant competitive threat.[69] Rather, as noted in Chapters 4 and 5, the major banks focus largely on each other when setting interest rates for home loans and deposits. Similarly, smaller lenders and deposit takers primarily track the interest rates of the large banks when making pricing decisions.[70]

2.19 Factors contributing to the limited competitive pressure from smaller providers and the high and stable shares of the major banks are discussed in paragraphs 2.30 –2.45 below.

Kiwibank sits between the two tiers of providers

2.20 Kiwibank is the fifth-largest registered bank and has significantly increased its share of supply since entering the market in 2001. In 2023, Kiwibank announced an injection of $225m to accelerate growth and provide further competition.[71]

2.21 The major banks have characterised Kiwibank as a close competitive threat. In doing so, they have referred to the growth Kiwibank has achieved (particularly in home loans) and to projections of future growth.[72]

2.22 Given Kiwibank's size, scale and influence, it cannot reasonably be characterised as a small bank (it does not sit comfortably in the second tier). However, Kiwibank does not sit alongside the four major banks in the first tier of providers – at least not yet.

2.23 We consider that Kiwibank sits between the two tiers of providers for several reasons.

2.23.1 Kiwibank does not currently have the scale or capital backing of the major banks.[73]

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69 [ ]; [ ].

70 [ ].

71 Kiwibank "Kiwi Group Capital invests $225 million into Kiwibank to accelerate growth" (1 August 2023), https://www.kiwibank.co.nz/about-us/news-and-updates/media-releases/kiwi-group-capital-invests-225-million-into-kiwibank-to-accelerate-growth/

72 For example, ANZ, Submission on draft report (18 April 2024), paras 66–68; ASB, Submission on draft report (18 April 2024), at Part A, paras 4.1–4.3.

73 Radio New Zealand "Kiwibank government ownership a setback for competition, fund manager says" (23 August 2022), https://www.rnz.co.nz/news/business/473331/kiwibank-government-ownership-a-setback-for-competition-fund-manager-says

2.23.2 Kiwibank is not classified as a domestic systemically important bank (D-SIB) by the Reserve Bank, unlike the major banks.[74]

2.23.3 Kiwibank's share of total assets and total home lending is well below that of the smallest major bank and well above the largest of the smaller banks and non-bank providers. Its home lending portfolio is less than half the size of BNZ's and around four times the size of TSB's.[75]

2.23.4 While the four biggest banks contend that Kiwibank is a major bank, it does not see itself that way. Kiwibank does not consider its home lending interest rates provide a strong competitive constraint on the major banks' home lending strategies.[76] Some support for this view can be found in an internal document from a major bank, which notes that Kiwibank's advertised rates have minimal impacts on its own performance.[77]

2.23.5 Although Kiwibank's total assets have increased from $1.8b in 2005 to $35.8b in 2023, its returns on equity and assets are on average significantly lower than the major banks.[78]

2.24 None of this means that Kiwibank is not a competitor for the major banks – its pricing places some constraint on the major banks. However, the strength of that constraint is weaker than the influence exerted by the four major banks. Although Kiwibank's growth has been strong and consistent, its capacity to disrupt the stable oligopoly is limited – particularly by its scale and capital constraints.

There is no disruptive maverick provider

2.25 We have not seen entry or expansion by particularly disruptive or aggressive providers having a material impact on the sector – at least not over the time period we have examined. As noted earlier, there has been some entry and expansion but nothing on a scale to disrupt or prompt a significant reaction from the major banks.

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74 The Reserve Bank consulted on a framework for identifying D-SIBs in 2019 and concluded that D-SIBs (currently ANZ, ASB, BNZ and Westpac) would be classified as such due to their size (between them holding almost 90% of banking system assets), interconnectedness, lack of substitutability and complexity. The effect of classification as a D-SIB is that they must have additional loss-absorbency requirements in the form of additional Common Equity Tier 1 (CET1) capital: Reserve Bank "Requirements for domestic systemically important banks" (28 February 2022), https://www.rbnz.govt.nz/regulation-and-supervision/oversight-of-banks/standards-and-requirements-for-banks/requirements-for-domestic-systemically-important-banks

75 Reserve Bank "Bank Financial Strength Dashboard". Figures are for all residential mortgage lending, including to owner-occupiers and property investors.

76 Commerce Commission "Personal banking services market study – Draft report" (21 March 2024), paras 4.48–4.53, includes further detail, including discussion of a report submitted by Link Economics (for Kiwibank).

77 [ ].

78 See Chapter 6 and Reserve Bank "Bank Financial Strength Dashboard"; [ ].

2.26 Some submissions suggested Kiwibank is a maverick competitor capable of causing this disruption. They cited apparent similarities to Macquarie in Australia.[79,80] Macquarie is a relative newcomer to personal banking services that has rapidly grown its share of Australia's home loan market of late. This resulted in it being characterised as a maverick by the Australian Competition Tribunal.[81]

2.27 A maverick competitor is a firm that deviates significantly from the norm – it is different in a material way. Kiwibank's business model does not appear to vary significantly from the four major banks. It offers similar products at similar prices through similar sales channels.

2.28 There are several significant differences between Kiwibank and Macquarie.

2.28.1 Macquarie has grown its share of home loans very quickly – from 2.7% in early 2020 to 5.3% by the end of 2023.[82] In contrast, Kiwibank's share of home loans in New Zealand has remained at around 7–8% over the past decade – although the rate of growth has accelerated somewhat in recent months as some major banks have pulled back.[83]

2.28.2 Macquarie operates modern, digitally advanced and highly automated technology systems. Kiwibank does not. Macquarie has used these systems to successfully target growth through the broker channel.[84]

2.28.3 Macquarie is already an established global financial services group.

2.28.4 Macquarie is much larger than Kiwibank and has ready access to capital. Kiwibank's total assets amount to around $35.8b while Macquarie's amount to around AU$403.4b.[85,86]

2.29 For these reasons, we do not consider comparisons between Kiwibank and Macquarie to be like for like. In our view, Kiwibank does not bear the conventional hallmarks of a maverick competitor – at least not currently.

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79 BNZ, Submission on draft report (18 April 2024), para 3.6.

80 ANZ, Submission on draft report (18 April 2024), para 73.

81 Australian Competition Tribunal "ACT 1 of 2023: Summary of reasons for determination" (20 February 2024), para 17, https://www.competitiontribunal.gov.au/__data/assets/pdf_file/0004/115942/240220-Summary-of-Reasons-for-Determination.pdf

82 Rommel Lontayao "Macquarie reports strong growth in home loan market share" (14 February 2024), https://www.mpamag.com/au/news/general/macquarie-reports-strong-growth-in-home-loan-market-share/476967

83 See paragraphs 2.11–2.12 and 2.88.

84 [ ].

85 Reserve Bank "Bank Financial Strength Dashboard".

86 Macquarie Group "2024 Annual Report" (31 March 2024), p. 7, https://www.macquarie.com/assets/macq/investor/reports/2024/macquarie-group-fy24-annual-report.pdf

Second-tier providers face disadvantages that limit the competitive pressure they exert | *Inā ngā taumahatanga mō ngā kaituku taumata rua hei whakaiti i tō rātou kaha ki te kōkirikiri*

Barriers to entry and expansion are high

2.30 Barriers to sustainable new entry and expansion in personal banking services are very high.

2.31 The major banks have significant scale, scope and incumbency advantages over potential new entrants and existing smaller providers.

2.31.1 Economies of scale. There are significant fixed costs associated with providing banking services. Banks that can spread their fixed costs across more customers and products can achieve higher operating profit margins on their borrowing and lending activities. This is reflected in the major banks generally having a lower cost structure and higher returns than the smaller banks and Kiwibank. This is discussed further in Chapter 6 and Attachment C.[87]

2.31.2 Advantages as regards the impact of regulatory and prudential settings. Personal banking services and providers (especially banks) are highly regulated. These constraints seek to promote financial system stability, protect consumers and advance various other policy objectives. Market participants must comply with regulatory requirements, which have a considerable bearing on the environment within which providers compete. Regulatory factors affecting competition are discussed further in Chapter 7.

2.31.3 Advantages in access to funding. The major banks benefit from lower average funding costs than smaller banks. They are also able to access a variety of funding sources that may not be available to smaller providers such as international markets for wholesale funding. This is discussed further in Chapter 5.

2.31.4 Brand recognition and customer inertia, which favour incumbent providers (the major banks). This is discussed further in Chapter 8.

2.31.5 Fintechs seeking to operate in New Zealand can face significant challenges in entering and expanding. This is discussed further in Chapter 9.

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87 We specifically observe that the major banks generally have lower operating costs to total assets and a lower cost-to-income (CTI) ratio than other banks operating in New Zealand.

These barriers limit the competitive pressure smaller providers exert

2.32 These considerable barriers to entry and expansion are a key reason why there has been limited entry or expansion of note in New Zealand's personal banking sector in the last decade. Smaller providers have not been able to overcome the challenges posed by the scale, scope and incumbency advantages enjoyed by the larger providers.

2.33 It is difficult for smaller providers to compete with major banks on interest rates because of their relative cost disadvantages. When smaller providers offer attractive rates, the major banks and Kiwibank can quickly match (or better) those offers if they choose. Smaller providers also struggle to compete on non-price dimensions such as the quality of their mobile banking apps because they have fewer resources to invest in developing those aspects of their services.[88]

2.34 The major banks also benefit from economies of scale and scope, albeit up to a point. For example, larger providers' fixed transaction costs are typically spread across a larger issuance, reducing average wholesale funding costs. The four major banks may also have a more favourable rating for the equivalent risk, which provides a significant cost of funding benefit from wholesale lenders.[89] Professor Margaritis and Dr Hasannasab found that most banks operate under economies of scale in relation to loans, which suggests the smaller banks have the potential to benefit from larger size.[90]

2.35 The larger scale and presence of the major banks also gives rise to higher brand awareness from consumers, which is a competitive advantage. Verian's research indicates that 88% of respondents considered the five largest banks when choosing their home loan provider. In contrast, only 17% of respondents considered smaller banks and 6% considered non-banks.[91] Similarly, 42% of respondents said they would *only* consider the five largest banks when choosing a main bank – outweighing the 30% who said they would also consider other banks and non-banks.[92]

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88 [ ].

89 TSB, Co-operative Bank, Kiwibank and SBS Bank, Submission on Preliminary Issues paper (7 September 2023), p. 4.

90 The findings are based on their estimate of the cost elasticity of scale. This is a measure of the responsiveness of costs to changes in the size of a bank's operations. It is the inverse of scale elasticity, which is an empirical measure of economies of scale. Dimitris Margaritis and Maryam Hasannasab "Market power in banking: A study of New Zealand banks" (March 2024), pp. 14–15.

91 Verian "Personal banking services market study – Research report" (February 2024), p. 35.

92 Verian "Personal banking services market study – Research Report" (February 2024), p. 45.

2.36 Non-banks also need to overcome the barrier of articulating the services they offer to customers.[93] Most notably, only registered banks are legally permitted to state that they provide 'banking' services even though many non-banks offer very similar services.[94] This may have the unintended consequence of providing customers with the impression that only traditional banks can provide 'banking services', whereas there is increasing diversity in the range of business models offering different mixes of personal banking services.

2.37 Larger providers will often also have a nationwide physical presence, which can provide a further degree of reassurance to their customers.[95]

2.38 Banking regulation imposes disproportionate costs on smaller providers. This may hinder a smaller firm's ability to invest in innovation and, in turn, compete via those initiatives.[96] This is discussed further in Chapter 7 and Chapter 9.

Smaller providers tend to focus their effort on specific regions, products or consumer groups

2.39 The substantial barriers to entry and expansion described above often cause smaller providers to focus their competitive offering on specific geographic regions or on specific services or customer segments.[97]

2.40 Deloitte Access Economics examined regional differences in a report prepared on behalf of BNZ. It analysed data from Land Information New Zealand on the share of mortgages (new and refixed) issued by banks from 1 January to 6 December 2023. Deloitte suggested this data revealed that providers are able to exercise significant competitive pressure on the major banks in specific market segments or geographies, which it claimed was not consistent with a stable accommodating oligopoly.[98]

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93 [ ].

94 Reserve Bank "Restrictions on use of the word 'bank'" (1 August 2024), https://www.rbnz.govt.nz/regulation-and-supervision/oversight-of-banks/standards-and-requirements-for-banks/restrictions-on-use-of-the-word-bank

95 Kiwibank, Submission on Preliminary Issues paper (7 September 2023), p. 10.

96 TSB, Co-operative Bank, Kiwibank and SBS Bank, Submission on Preliminary Issues paper (7 September 2023), p. 1.

97 [ ]; [ ].

98 Deloitte Access Economics [for BNZ] "Personal banking services market study – Review of the Commerce Commission's draft report" (18 April 2024), paras 35–36, https://comcom.govt.nz/__data/assets/pdf_file/0018/350910/BNZ-Submission-on-Market-study-into-personal-banking-services-Draft-report-18-April-2024-Attachment-A-Deloitte-report.pdf. Analysis based on modelling of Land Information New Zealand new and refixed mortgage registration data from 2023.

2.41 This data clearly shows that some smaller providers are regionally focused. However, we disagree with Deloitte Access Economics' conclusion for several reasons.[99]

2.41.1 Deloitte's analysis was static – it looked only at 2023 (or the vast majority thereof). It is difficult to draw any meaningful conclusions about the stability of a market by looking at a snapshot in time.

2.41.2 Market shares can differ materially across regions yet still result in a stable oligopoly. Many real-world examples of explicit collusion have involved practices such as geographic market sharing that resulted in significant differences in shares across regions.

2.41.3 Finally, a smaller bank having a higher market share in a particular region does not necessarily make it a significant competitive force nationally.

2.42 Regarding non-bank providers such as credit unions and building societies, there are several significant differences from banks that influence the manner in which the NBDTs compete. For example, they have different ownership and business models and different sources of funding. We have also heard that these providers sometimes serve customers that banks will not "because of their size, innate conservatism and profit-driven nature".[100]

2.43 There has been some entry and expansion by providers (such as fintechs) employing potentially disruptive business models and offering new services. As mentioned earlier, the scale and scope of that entry and expansion has so far been modest. We heard at our conference that a number of these firms have exited or been mothballed recently.[101] Some of these suppliers offer stand-alone services such as home loans and deposit accounts. Others look to use application programming interface (API) functionality to build over-the-top services that leverage consumer data held by incumbent banks.

2.44 The major banks contend that these providers of new technologies will disrupt the market and materially affect the competitive dynamics. However, we have seen little to no evidence of this to date.

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99 Elsewhere in its report, Deloitte Access Economics characterised smaller banks as marginal producers who determine the prevailing market prices. However, as Charles River Associates (CRA) highlighted in a report prepared on behalf of ANZ, this theory is based on an economic model that does not fit the evidence or the characteristics of the market: CRA [for ANZ] "Personal Banking Services Market Study – Comments following conference" (4 June 2024), p. 12, https://comcom.govt.nz/about-us/our-role/competition-studies/market-study-into-personal-banking-services/post-conference-cross-submissions-close-end-of-may/ANZ-Cross-submission-on-Market-Study-into-personal-banking-services-Draft-report-Annex-B-CRA-report-30-May-2024.pdf. Most notably, the major banks have limited regard to smaller banks when setting their prices.

100 Financial Services Federation, Submission on Preliminary Issues paper (7 September 2023), p. 3.

101 Commerce Commission "Day 2 Personal banking services market study conference – Session 6 Other enablers and barriers for fintechs" (14 May 2024), p. 13 (lines 21–-25).

2.45 These new entrants have not yet had any significant impact on the existing market shares for home loans and deposit accounts.[102] A number of reasons have been advanced for this, including the small size of the New Zealand market, major bank concentration providing a significant hurdle for disruptors to scale up growth, slow progress on open banking and a lack of capital.[103] These factors are discussed further in Chapter 7 and Chapter 9.

We do not observe consistently strong rivalry between the major banks | *Kāore i auau te kitea o te tauwhāinga kaha i waenga i ngā pēke matua*

2.46 Based on the information we have gathered and considered throughout this market study, we are not convinced that competition between the major banks is strong and sustained. Although there are periods of relatively intense competition, there are also other periods during which some or all of the major banks pull back and place more focus on maintaining profit margins than competing strongly to gain market share.

2.47 We do not expect rivalry between banks to reflect textbook perfect competition.[104] Such rivalry is seldom (if ever) seen in real-world markets. Competition is instead defined in the Commerce Act as meaning "workable or effective competition".[105] Although there is no unambiguous checklist of conditions for workable competition, courts on both sides of the Tasman have provided some useful guidance.

2.48 The High Court of New Zealand has observed that workably competitive markets have a tendency "towards the outcomes produced in *strongly* competitive markets" (emphasis added).[106] Similarly, the High Court in Australia has noted that competition is, by its nature, an ongoing struggle (emphasis added):[107]

> Competition by its very nature is deliberate and ruthless. Competitors jockey for sales, the more effective competitors injuring the less effective by taking sales away. Competitors *almost always* try to "injure" each other in this way.

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102 [ ].

103 [ ].

104 The distinguishing characteristics of perfect competition are seldom (if ever) seen in markets. Sellers generally are not pure price takers, and parties are almost never perfectly informed. Goods are rarely homogeneous. Barriers to entry and expansion may exist. Firms may not be able to rapidly adjust supply up or down by acquiring or disposing of assets in response to changing market conditions. Entry and exit may not be easy or swift, with supply-side constraints hindering both processes.

105 Commerce Act, s 3(1).

106 *Wellington International Airport Ltd and Others v Commerce Commission* [2013] NZHC 3289 at [13]–[15], [18] and [22].

107 *Queensland Wire Industries Pty Ltd v Broken Hill Pty Co Ltd* [1989] HCA 6; (1989) 167 CLR 177 (8 February 1989) at [24].

2.49 Some consistent themes emerge from these precedents. First, although workable competition is, by definition, less than perfect, it nevertheless tends towards *strong* competition. Second, workable competition is ongoing and inherently injurious. Competitors in such markets are constantly jostling to improve their market share. They do not seek to accommodate with their rivals – they seek to do them harm by winning their customers.

2.50 ANZ offered a different perspective in its submission on the draft report. It stated that "if a market has more than 'little or no competition', then it has 'workable' competition". In reaching this view, ANZ compared the market study function under Part 3A of the Commerce Act with markets regulated under Part 4 of the Act due to having "little or no competition and little or no likelihood of a substantial increase in competition".[108,109]

2.51 ANZ's characterisation of workable competition is, however, clearly inconsistent with the New Zealand High Court's interpretation. A market can have more than little or no competition yet still fail to yield outcomes produced in workably competitive markets. We therefore do not consider ANZ's proposed threshold to be appropriate in the circumstances.

2.52 If a hallmark of workable competition is continual struggle with rivals almost always seeking to do each other harm, the rivalry between the major banks appears to lack this essential trait. Although the banks jostle relatively constantly for position on the non-price dimensions of their offerings (for example, their marketing and customer service elements), the intensity of price competition varies over time. Sometimes it appears to be strong, but other times it does not.

2.53 The major banks are constantly mindful of one another's likely responses when setting prices.[110] Over time, these relatively well-matched suppliers appear to have settled into a situation where they each individually recognise their interdependence.

2.54 We have observed some periods of more intense price competition. However, a confluence of external factors often seems to be required to destabilise the typical dynamics (for example, significant changes in macroeconomic conditions). At other times, we have observed one or more of the major banks consciously pulling back to focus on preserving margins – even at the expense of market share. That is not what we would expect to observe under conditions of workable competition.

108 Section 52 of the Commerce Act; Overview of Part 4.
109 ANZ, Cross-submission on draft report (30 May 2024), para 35.
110 [ ].

Banks balance both sides of the book and growth targets lack ambition

2.55 At its core, banking involves borrowing funds from depositors and from capital markets and then lending those funds to borrowers. For this activity to be profitable, the interest rates received on loans must exceed the cost of borrowing. Combined with any fees charged, a bank's interest rate margin must, in turn, cover the costs associated with doing business accounting for risks, operating costs and the cost of capital.

2.56 Banks typically manage their risks through an internal treasury function. A bank's treasury is responsible for taking a pan-business view of deposit volumes (transactional accounts, savings accounts and term deposits) and lending volumes (such as home loans, credit cards and commercial loans). The treasury takes account of the important interplay between these deposit and lending services and their risks when setting internal transfer prices.

2.57 Notably, the balance between lending and deposit volumes is actively managed via the internal transfer pricing function so these two sides of the business grow at similar rates. For example, deposits are a key funding source for a bank's lending activities. Consequently, it is important for a bank to ensure any significant increase in lending (an outflow of funds) is offset by any necessary corresponding increase in deposits and/or wholesale funding (an inflow of funds). In addition, the treasury function needs to manage prudential capital and liquidity requirements.

2.58 Because of the interdependencies between the two sides of a bank's balance sheet, we heard from many of the major banks that the pricing and margins for different lending and deposit services are considered together.[111]

2.59 The two-sided nature of banking means that there will sometimes be opportunities for banks to push on one side of the market because of circumstances arising on the other. For instance, if a bank has experienced a significant uptick in deposits, this may create some headroom for more lending and an opportunity to cut lending rates.

2.60 The flip side is that there may be occasions when the extent to which a bank can press on one side of the market may be limited by how things sit on the other. For example, it may not be possible for a bank to significantly expand its lending volumes because of the state of the other side of its balance sheet. In other words, banks may sometimes have to pull back.

2.61 However, the constraints exerted by the two-sided nature of banking do not necessarily mean the major banks could not be competing more vigorously overall. Those constraints also do not preclude banks from attempting to grow both sides of their business at the same time by accepting reduced margins due to more competitive lending and deposit pricing.

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[111] [ ].

2.62 Furthermore, these commercial realities do not explain why we see banks commonly setting growth targets of seemingly limited ambition over periods that extend beyond what might reasonably be attributed to temporary misalignments. A near-term imbalance might explain a bank pulling back for, say, a few months. However, it does not explain a bank seeking to grow its loan or deposit volumes at, say, 1x system growth (sometimes less) for an entire financial year. Such strategies appear to reflect decisions to avoid competing too vigorously and instead seek mutually accommodating growth targets.

2.63 We observe little strategic differentiation in this regard between the major banks.[112] Their overall growth targets appear to be frequently designed to balance market share aspirations with protecting margins and avoiding significant competitive responses.[113,114] Although some major banks occasionally adopt more ambitious growth targets, unambitious goals appear more common.[115] As noted earlier, internal bank documents often describe growth targets at or close to system growth over extended periods.[116]

2.64 ANZ suggested this should not be any cause for alarm. It submitted that "firms in effectively competitive markets will need to balance share growth with the need to remain profitable, so there should be no concern with the banks seeking to do this".[117]

2.65 We do not dispute that firms must be sufficiently profitable through time if they wish to remain in business. However, in workably competitive markets, firms compete as hard as they can all of the time – this process is a constant struggle. Firms jockey for sales, seeking to win market share by offering a better price/service proposition (while covering their costs). Those who do so successfully earn higher profits, and those that do not typically lose market share and suffer adverse financial consequences.

2.66 In other words, competition is the *process* by which profitability outcomes are decided. Firms compete as hard as they can, and profits are determined by how well they perform. Less successful firms might exit the market or be taken over, and new firms with different business models enter.

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112 [ ].

113 [ ].

114 [ ].

115 [ ].

116 [ ].

117 CRA [for ANZ] "Personal Banking Services Market Study – Comments on the Commerce Commission's Draft Report and the Margaritis and Hasannasab paper on 'Market Power in Banking'" (17 April 2024), para 33, https://comcom.govt.nz/__data/assets/pdf_file/0023/350906/ANZ-Submission-on-Market-study-into-personal-banking-services-Draft-report-18-April-2024-Attachment-B-Submission-on-econometric-analysis-report.pdf

2.67 In contrast, the major banks start by setting overall growth targets – often relatively modest ones expected to maintain profit levels given each other's anticipated responses. They then work towards achieving those targets. This seems to flip the usual competitive dynamic on its head.

2.68 If all the major banks are adopting similar strategies and those targets accommodate the likely actions of rivals, in the absence of some form of disruption (either from external macroeconomic forces or from other market participants), they risk becoming self-fulfilling prophecies.

2.69 In our view, the common adoption of unambitious growth targets is therefore symptomatic of less-than-workable competition. These targets are likely to incentivise the major banks to make offers that are just enough to achieve their growth objectives without prompting strong responses from rivals that might compromise their overall profitability.

Price matching is a prevalent strategy of the major banks

2.70 It is common across personal banking services to have both:

2.70.1 The headline rates that banks advertise. Any customer that meets the qualifying criteria can obtain a loan or place a deposit and pay or receive these rates (as the case may be).

2.70.2 Discretionary rates that are frequently offered to those customers who shop around for a better deal – either by themselves or by retaining the services of a mortgage adviser.

2.71 Pricing of headline rates and discretionary discounts is discussed in turn below.

Pricing of headline rates

2.72 There is a high degree of transparency surrounding banks' headline rates. For example, they are published on banks' websites and comparison websites such as interest.co.nz. These rates tend to be very similar across the major banks. This is unsurprising given the market structure – the more relevant question is how often those headline rates move and the way that occurs.

2.73 When a major bank reduces its headline loan rates (or lifts its deposit rates), a common response is for the other majors to match that move. If one bank shifts its headline rates – for example, in response to a movement in the official cash rate (OCR) or wholesale funding costs – the others will generally match relatively quickly, restoring the status quo of similarly-priced headline rates. It is less common for banks to respond to a rate reduction by cutting rates even further (a *sequence* of reductions in succession).

2.74 Such price matching coupled with the less-than-ambitious growth targets described earlier results in prolonged periods where the level of rivalry appears subdued.[118] We see little evidence of the major banks striving constantly to grow their market share by sacrificing near-term returns. Instead, they seem content to push only when circumstances are particularly conducive – for example, when there is an imbalance on one side of their ledger or when the market is hit by external shocks.

2.75 Our preliminary findings on price matching were challenged in submissions by some respondents. In a report prepared on behalf of ANZ, Charles River Associates (CRA) suggested that, if banks continuously undercut each other's prices (rather than simply matching), this would lead to them quickly going out of business.[119]

2.76 CRA's observation appears to reflect a misunderstanding of our draft report. We were not suggesting banks should constantly be undercutting each other to the point of bankruptcy. Rather, our view is that, if competition was working effectively:

2.76.1 we might expect to see undercutting each other's headline rates with greater frequency (less price matching);

2.76.2 we might also expect to see banks leading prices down more often (initiating price reductions rather than simply reacting to them), particularly where they are experiencing high profitability; and

2.76.3 we would not expect to observe prolonged periods of stable pricing and stable market shares.

2.77 CRA also pointed to the pricing of green home loan top-up products as an example of banks undercutting one another's prices. As the draft report explained, ANZ was the first to offer this type of product and the other banks responded with their own offerings and prices.[120] CRA described this as an example of continuous innovation with adjustments until they reach "a competitive equilibrium involving differentiated offers, with beating as well as matching along the way".[121]

2.78 We agree that the green home loan top-up products have exhibited elements of both price matching and undercutting. However, in our view, this example does not detract from our general conclusion.

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118 Relevant literature on price matching includes Ivan Png and David Hirshleifer "Price discrimination through offers to match price" *The Journal of Business* 60(3) (1987), 365–383; Aaron Edlin "Do guaranteed-low-price policies guarantee high Prices, and can antitrust rise to the challenge?" *Harvard Law Review* 111(2) (1997), 528–575.

119 CRA [for ANZ] "Personal Banking Services Market Study – Comments on the Commerce Commission's Draft Report and the Margaritis and Hasannasab paper on 'Market Power in Banking'" (17 April 2024), para 52.

120 Commerce Commission "Personal banking services market study – Draft report" (21 March 2024), para 2.50.

121 CRA [for ANZ] "Personal Banking Services Market Study – Comments on the Commerce Commission's Draft Report and the Margaritis and Hasannasab paper on 'Market Power in Banking'" (17 April 2024), para 39.

2.78.1 It represents a single, somewhat isolated example of banks sequentially undercutting prices for a particular product over a relatively condensed period of time.

2.78.2 After this initial period, the banks settled into an equilibrium. However, workably competitive markets are seldom in equilibrium. Workable competition is not a process with a beginning and an end – it is a constant struggle.

2.78.3 As the Banking Reform Coalition has noted, other considerations may have influenced the banks' pricing of green home loan top-up products (such as ESG considerations).[122]

2.79 Deloitte Access Economics also made some observations about the significance of movements in advertised headline rates in a report prepared on behalf of BNZ. It performed vector autoregression (VAR) modelling on banks' advertised headline rates to test whether certain factors were having a causal impact on those observed market prices. It concluded that there were no discernible or predictable patterns in headline price movements. This was suggested to be evidence that competition was more dynamic than we had indicated in our draft report.[123]

2.80 In our view, Deloitte Access Economics' VAR modelling does not support this conclusion or provide meaningful insights regarding the nature of competition more generally. The main reason for this is the reliance on weekly headline pricing data. This means the modelling is unable to detect contemporaneous or sequential movements within a week (intra-week pricing movements). Any leader-follower behaviour that involved banks moving prices at different times within the same week would be missed by the VAR model. This limitation is likely to explain some peculiar results of the modelling.[124]

2.81 Consequently, these submissions have not materially changed our views regarding banks' practices for headline rates. We remain of the view that, if competition was working effectively, banks would be offering sharper rates more frequently and responding to price changes by bettering their competitors more regularly (rather than simply matching any superior offers).

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122 Banking Reform Coalition, Cross-submission on draft report (30 May 2024), p. 2.

123 Deloitte Access Economics [for BNZ] "Personal banking services market study – Review of the Commerce Commission's draft report" (18 April 2024), para 28.

124 Consider Deloitte's results for the 5-year home loan. It is unclear why BNZ's rates would have a causal impact upon Westpac's rates but no other banks. It is similarly unclear why ANZ's rates influence the rates charged by the other smaller banks (or their average rate) but no-one else's. Likewise, it is not clear why the average rate changed by smaller banks would have a causal effect on the rates charged by ANZ, ASB, BNZ and Kiwibank when internal documents suggest those larger banks typically have limited regard to smaller providers when setting prices, and it is unclear why Westpac would not also be on that list.

Pricing of discretionary rates

2.82 Advertised headline rates are often only a starting point – they are effectively a price ceiling. Banks' frontline staff are generally permitted to offer some form of discount on those rates (or increment for deposits). The magnitude of those discounts or increments may depend on many factors, including the characteristics of the customer in question.

2.83 These discretionary discounts are often triggered when a customer presents a bank with a written offer (either directly or through a mortgage adviser) from another provider specifying a lower rate. The frontline staff at the major banks are often permitted to match any offer by another major bank or Kiwibank.[125] It appears to be standard practice to match any lower rate.[126,127] At the conference, mortgage advisers explained that:[128]

> We also pretty much know at the moment that the banks will match each other on rates. So, they are seeing what is out there in the market. If somebody's got a market leading two-year rate, it doesn't normally take 24 hours for the other banks to be matching that market rate.

2.84 In other words, much as with headline rates, discretionary discounts are generally matched rather than undercut.[129] Our views on this are the same as for headline rates – it is likely to be a symptom of a lack of competition. Under workable competition, we would expect the major banks to be undercutting those discounts more often as well as leading those prices down (initiating heavier discounting rather than simply responding to cuts).

2.85 Discretionary discounting has another important impact on the market dynamics due to the lack of transparency for consumers. There is a significant imbalance between what banks know about the prevailing levels of discretionary discounts and the information immediately accessible to customers. This asymmetry arises for the following reasons.

2.85.1 Customers can quickly and easily find banks' headline rates, but to find the best deal – the sharpest discretionary rate – customers need to shop around (either by themselves or through a mortgage adviser).

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125 [ ].

126 [ ].

127 [ ].

128 Commerce Commission "Day 3 Personal banking services market study conference – Session 8 Mortgage advisers" (15 May 2024), p. 11 (lines 4–11).

129 We note that, in CRA's report prepared on behalf of ANZ, it claimed that the Commission did not know whether banks engaged in widespread price matching because we did not have adequate information on discretionary discounting practices. However, price matching is prevalent for both headline and discounted rates as discussed above. CRA [for ANZ] "Personal Banking Services Market Study – Comments on the Commerce Commission's Draft Report and the Margaritis and Hasannasab paper on 'Market Power in Banking'" (17 April 2024), para 47.

2.85.2 In contrast, banks receive information on discretionary rates offered by their competitors in near real time from their customers and mortgage advisers. As noted earlier, if a bank is being undercut by a competitor, it will quickly become aware of this.[130]

2.86 This significant difference in the degree of price transparency between banks and their customers is likely to help enable banks to profitably segment the market. Specifically, it allows banks to distinguish between engaged and disengaged customers and treat those groups differently.

2.86.1 Engaged customers who shop around or retain the services of a mortgage adviser are more likely to receive lower rates and benefit from discretionary price-matched discounts.

2.86.2 Conversely, disengaged customers who do not shop around and go through the process of seeking quotes are more likely to pay higher advertised headline rates (and miss out on the benefit of additional rivalry associated with discretionary discounts). Shopping around typically involves submitting loan applications to get offers of finance with price and terms. As we note in Chapter 4 there are several impediments to doing that with multiple lenders currently.

It appears to require a range of external factors to bring about more intense competition

2.87 The period from mid-2021 to early 2023 saw rising interest rates, falling volumes of house sales and, from 2022, reductions in median house prices.[131] This resulted in reductions in home lending volumes, which made it more difficult for providers to reach specified volume targets on their home lending portfolios.

2.88 Throughout this period of rising interest rates, two distinct fluctuations in the intensity of competition in home lending can be observed.

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130 It is common for a customer to present a bank with a written offer from a competing provider specifying a lower rate (either by the customer or by a mortgage adviser). The bank will then be privy to what that competitor is offering customers of that criteria (with that credit rating, upfront deposit and so on) for that type of loan.

131 interest.co.nz "Volumes sold – REINZ" (1 August 2024), https://www.interest.co.nz/charts/real-estate/volumes-sold-reinz; and interest.co.nz "Median price – REINZ" (1 August 2024), https://www.interest.co.nz/charts/real-estate/median-price-reinz

2.88.1 There was a period of more intense competition from early 2022 to early 2023 during which many providers (including the major banks and Kiwibank) engaged in aggressive home lending campaigns, including significant discounts on headline rates and more generous cashback offers.[132] During this period, the major banks and Kiwibank reported lower returns on capital in respect of their home lending portfolios.[133,134]

2.88.2 In the latter half of 2023, some major banks decided to pull back and seek to increase their profit margins on new lending by increasing interest rates and reducing the value of cashback offers even if that meant growing their portfolios more slowly (or seeing them shrink) and/or sacrificing market share to rivals.[135,136]

2.89 In our draft report, we characterised pricing for home loans during 2021–2023 as an example of sporadic competition in a rising interest rate environment.

2.90 In response, CRA (for ANZ) submitted that the pricing of home loans in 2022 and the first half of 2023 "appears to have been financially unsustainable" and is therefore not a reasonable benchmark for effective competition.[137,138]

2.91 We understand that home lending rates for some banks, at an individual product level, fell below their internal transfer prices at this point in time.[139] However, in our view, that does not mean the resulting prices were financially unsustainable or unrepeatable.

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132 Rob Stock "Secret mortgage war: BNZ offers 4.99% one-year rate to new customers" (22 February 2023), https://www.stuff.co.nz/business/131300030/secret-mortgage-war-bnz-offers-499-oneyear-rate-to-new-customers; Rob Stock "ASB matches BNZ's 4.99% one-year fixed mortgage rate in behind-closed-doors deal" (2 March 2023), https://www.stuff.co.nz/business/money/131369192/asb-matches-bnzs-499-oneyear-fixed-mortgage-rate-in-behindcloseddoors-deal

133 [ ]; [ ]; [ ].

134 Gareth Vaughan "Pricing of NZ mortgage interest rates 'difficult to reconcile' and offers 'unsustainable returns', says CEO of ASB's Aussie parent bank CBA" (20 August 2023), https://www.interest.co.nz/banking/123688/pricing-nz-mortgage-interest-rates-difficult-reconcile-and-offer-unsustainable

135 [ ].

136 [ ].

137 CRA [for ANZ] "Personal Banking Services Market Study – Comments on the Commerce Commission's Draft Report and the Margaritis and Hasannasab paper on 'Market Power in Banking'" (17 April 2024), para 36.

138 Similarly, some providers reported that margins on home loans fell below the cost of capital during the period of intense competition in 2022–2023. For example, ASB noted "the combined impact of strong competition and elevated wholesale rates has resulted in a significant volume of new mortgagees being written below ASB's current cost of capital": ASB, Submission on Preliminary Issues paper (7 September 2023), para 1.5. This sentiment was also reflected in media released by CBA Chief Executive Matt Comyn: Gareth Vaughan "ASB CEO Vittoria Shortt says bank's lending contraction evidence of an unusual, challenging time" (15 February 2024), https://www.interest.co.nz/banking/126382/asb-ceo-vittoria-shortt-says-banks-lending-contraction-evidence-unusual-challenging

139 [ ].

2.91.1 If an individual product's price falls below its applicable internal transfer price that does not necessarily make it unprofitable or unsustainable in a broader sense. Long-term profitability depends on many factors, including sales of complementary products, future rate changes and default rates.

2.91.2 Even if the rates were unprofitable in the short term, loss leading is a common feature of workable competition. Firms will often reduce substantially the price of one product to spur sales of others and/or to win customers who will deliver higher returns over the longer term.

2.92 Most fundamentally, even if the prevailing rates during this period were irrationally low due to a confluence of factors (for example, uncertainties from COVID-19 and a rising interest rate environment), it does not mean rivalry of this kind should not be observed more frequently. Even if this competition was unsustainable (which we do not accept), it still does not explain why we do not see sustainable variants of similar levels of competition. It also fails to explain why a confluence of external factors appears to be needed to destabilise the status quo and bring out more intense competition.

Other factors also indicate competition between the major banks is limited

2.93 Other factors discussed in this report also suggest a lack of competition between the major banks and limited constraint from other providers more generally.

2.93.1 **Lack of investment in technology and innovation.** We understand that the major banks are operating legacy technology systems (with some apparently dating back to the wave of bank mergers and acquisitions in the 1990s and 2000s).[140] This sustained lack of major investment to modernise core systems is suggestive of weak competition over an extended period. Similarly, we have observed a slow pace of significant innovation in recent years, for example, in the development of open banking APIs and investment by (or partnering with) fintechs. It appears that the major banks know that their peers are in similar positions and appear to have chosen to sweat legacy assets and ration investments in innovation and focus instead on ongoing regulatory requirements. If competition was working effectively, we would expect to see ongoing investment and innovation by banks seeking to gain an edge on their rivals – even if they must also navigate additional regulatory requirements. This is discussed further in Chapter 9.

140 [ ].

2.93.2 **High profitability.** As shown in Chapter 6, we consider that the profitability of the New Zealand banking sector is high relative to peer countries. We are also not satisfied that the information provided in submissions fully explains the profitability of the bulk of the New Zealand banking sector since 2010. We therefore consider that the high profitability we have observed is at least partly attributable to the market power possessed by some participants. Overall, we remain of the view that the profitability of New Zealand's banking sector exceeds what we would expect to see if the major banks faced effective competition.

Features of the sector raise concerns about accommodating behaviour | *Ka ara ake ētahi āwangawanga i te āhua o te rāngai me tāna hei whakaawe whanonga*

2.94 In highly concentrated markets, large relatively well-matched competitors – of similar size and cost structures – cannot ignore each other's price and non-price initiatives.

2.95 Sometimes this results in vigorous competition, with businesses constantly seeking to gain an edge by cutting prices and/or investing in new and innovative non-price service dimensions. Such outcomes are especially likely if customers are highly engaged and prone to switching. Effective rivalry is even more probable when there is a credible threat of entry or expansion on a significant scale by smaller firms (especially by a maverick).

2.96 In other cases, over time, the vigour of competition between similarly matched oligopolists may wane. Large incumbents may individually recognise their interdependence and seek to avoid competing as hard on price and/or non-price dimensions. Prices may stabilise above the level that would arise in a workably competitive market, and the quality of service may deteriorate as the pace and scale of investment and innovation declines. This may allow those providers to experience high profitability – for prolonged periods – without explicit collusion.[141] We have not seen any evidence to suggest explicit coordination is occurring in the personal banking sector.

2.97 This implicit form of coordination or accommodating behaviour is feasible due to the nature of oligopoly competition itself. If the conditions are conducive, incumbent suppliers may each arrive (independently) at the realisation through their repeated interactions that it is more profitable for them collectively not to compete vigorously all of the time.

141 Explicit coordination is a harmful form of conduct that may breach the Commerce Act prohibitions on cartels and anti-competitive agreements and understandings.

2.98 There is a broadly settled list of characteristics that are thought to facilitate this type of accommodating behaviour.[142] There is no definitive answer to how many of these factors must be present for competition to be impacted adversely. However, several of the features of the personal banking sector make it prone to accommodating behaviour from the major banks.

2.98.1 There is a high degree of supplier concentration, leaving fewer businesses whose activities need to be monitored. The four major banks pay close attention to each other – and to Kiwibank to a lesser degree – but are able to have limited regard to smaller providers' offerings.

2.98.2 There are high barriers to entry and expansion, which means any softening in the rivalry between the major banks does not necessarily provide ready opportunities for smaller providers to entice away significant volumes of customers by offering more attractive prices and services.

2.98.3 There is a high degree of transparency surrounding the prices that rivals are charging – the major banks are aware of their rivals' headline rates and the discretionary discounts being offered.[143] Importantly, the prevailing discretionary rates are significantly less visible to customers.

2.98.4 There is information available on volumes, market shares and profitability metrics (for example, via the Reserve Bank's Bank Financial Strength Dashboard) and on credit policy setting (via mortgage advisers).[144] Banks therefore know that any significant changes will be swiftly detected by their rivals.

2.98.5 There is a significant level of customer disengagement. This means that, even if the major banks are not offering the lowest rates or the best quality of service to those customers, many consumers still will not switch – which makes it harder for smaller providers to compete.

2.98.6 Despite some submitters' suggestion that Kiwibank is a maverick, we consider there is no such competitor in the market at present. Specifically, there is no provider of any significant scale adopting a significantly different business strategy or offering a novel product offering.

2.98.7 The market shares of the major banks have remained largely stable across the major product categories for an extended period of time. This suggests that the competitive environment has been relatively stable.

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142 The first of which was George Stigler "A theory of oligopoly" *Journal of Political Economy* 72(1) (1964) 44–61.

143 As noted in paragraph 2.85.2, banks quickly discover the levels of discretionary discounts rivals are offering via customers presenting competing offers and through mortgage advisers.

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2.98.8 Although banks can and do compete on the non-price elements of their service offerings, there remains only limited product differentiation. The major banks also all supply multiple products in the sector and have frequent interactions with one another across multiple markets.[145]

2.99 Deloitte Access Economics (on behalf of BNZ) presented a different perspective. It submitted that "the market is unlikely to be conducive to a situation where banks can reach mutually acceptable outcomes that are workably uncompetitive".[146] In particular, it suggested that the prevalence of discretionary pricing detracts from price transparency, reducing the risk of coordination.[147]

2.100 We disagree. It is clear that the major banks are aware of the discretionary discounts that are being offered by their rivals. There is a prevalent strategy of matching those discounts. As discussed earlier, major banks know that any such discounts will likely be swiftly detected and matched, diminishing their incentives to reduce prices. Further, Deloitte appears to overlook the information asymmetry associated with discretionary discounts – customers must invest time and effort shopping around to discover those prices (contributing to consumer disengagement).

2.101 The ACCC highlighted the risk of coordination in personal banking markets when considering ANZ Banking Group's proposed acquisition of Suncorp Bank. The Australian market has similarities to New Zealand, and the parent companies of New Zealand's four major banks supply most of the market. The ACCC said:[148]

> …coordination [in the market for home loans] is most likely to involve the major banks engaging, either expressly or tacitly, in a 'live and let live' style of conduct or pattern of behaviour to achieve 'soft' or 'muted' price or non-price competition sufficient to either maintain and/or protect their existing share of supply and/or to not challenge the status quo.

2.102 The Australian Competition Tribunal agreed with the ACCC that Australia's home loans market is conducive to coordination, not least because the major banks have a combined share of banking system assets of 72%. That share is significantly less than the four major banks' combined share of 85–90% of New Zealand's market.

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145 Even more so for the major banks where the parent banks are also interacting in overseas markets and particularly in Australia.

146 Deloitte Access Economics [for BNZ] "Personal banking services market study – Review of the Commerce Commission's draft report" (18 April 2024), p. 6.

147 Deloitte Access Economics [for BNZ] "Personal banking services market study – Review of the Commerce Commission's draft report" (18 April 2024), para 51.

148 ACCC "Reasons for Determination – Application for merger authorisation lodged by Australia and New Zealand Banking Group Limited in respect of its proposed acquisition of Suncorp Bank" (4 August 2023), p. 7, https://www.accc.gov.au/system/files/public-registers/documents/Reasons%20for%20determination%20-%2007.08.23%20-%20PR%20-%20MA1000023%20ANZ%20Suncorp.pdf. The ACCC also considered the market for retail deposits to have features making it similarly conducive to coordination as the market for home loans. However, the ACCC considered a key difference was that home lending was usually the use to which retail deposits are traditionally put, and therefore the major banks are less likely to be motivated to coordinate in relation to retail deposits than in relation to home loans.

2.103 The Australian Competition Tribunal also observed that the conditions for coordination in Australia have "recently reduced and are likely to continue to reduce in the foreseeable future" due to a number of factors. These included the asymmetry in the market shares of the major banks, Macquarie Bank's emergence as a maverick and the increasing use of brokers that had reduced customer choice frictions and facilitated more switching.[149]

2.104 These offsetting factors either do not exist in New Zealand or not to the same degree. In particular, there is no maverick competitor currently, and although we have observed increased use of mortgage advisers, the sector here operates differently to that in Australia and does not appear to have significantly reduced customer inertia or prompted a material increase in switching.

Banks' customers tend to be sticky | *He horokukū te āhua o ngā kiritaki*

2.105 A key factor affecting competition for personal banking services is that customers tend to be sticky rather than actively seeking out and switching to providers that best meet their needs. This stickiness reduces providers' incentives to compete hard to win and retain customers. Customer inertia is discussed further in Chapter 8.

Main bank relationships are an important focus for competition

2.106 Although competition in personal banking services takes place across a range of individual services, a key focus for providers is to build main bank relationships with customers. Customers will often turn to their main bank provider for their changing banking needs over time. These customers generally receive their income into a transaction account held with their main bank and use this account for the majority of their day-to-day transactions.[150]

2.107 Main bank customers are very valuable to banks because:

2.107.1 they are likely to acquire a wider range of services from their provider and generate greater revenue as a consequence;[151,152,153]

2.107.2 consumer research conducted by Verian indicates that 54% of respondents have never switched from their main bank – that inertia provides a reliable ongoing source of revenue (and profit) over an extended timeframe;[154] and

2.107.3 as discussed in Chapter 5, the funds contained in the deposit accounts of main bank customers provide a stable low-cost funding source.

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149 Australian Competition Tribunal "ACT 1 of 2023: Summary of reasons for determination" (20 February 2024), para 17.

150 Banks often use criteria such as a certain amount of deposits, a minimum level of transactions or receipt of payments such as salary over a specific time period when identifying main bank customers.

151 ACCC "Retail deposits inquiry – Final report" (December 2023), p. 38, https://www.accc.gov.au/about-us/publications/retail-deposits-inquiry-final-report

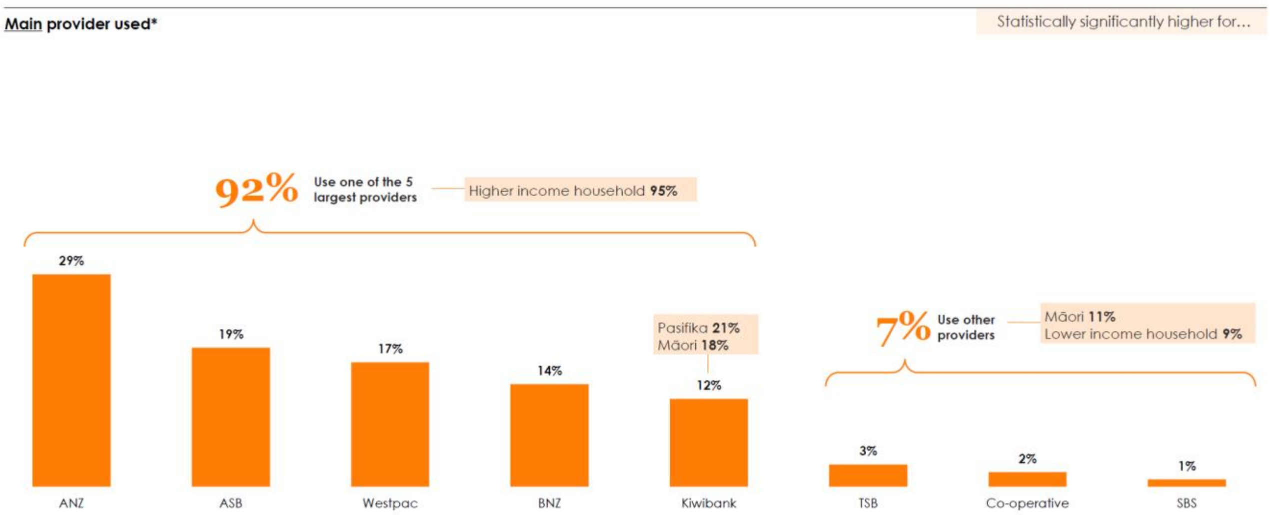
152 [ ].

153 [ ].

154 Verian "Personal banking services market study – Research report" (February 2024), p. 31.

2.108 The four major banks classify over half of their customers as main bank customers, whereas this is lower for Kiwibank and other smaller providers.[155] Verian's research also indicates that 92% of consumers consider one of the five largest banks to be their main bank and 94% of transaction accounts are also held with these providers.[156,157] Only 7% use other providers as their main bank (see Figure 2.4 below).

Figure 2.4 Main bank relationships reported by consumers



Source: Verian.[158]

2.109 Smaller providers struggle to acquire main bank customers for a variety of reasons.

2.109.1 A customer's first bank account is likely to be opened by their parent or guardian, often with the same bank. Given the major banks have the most customers (ie, most parents and guardians bank with the largest providers), this creates a steady inflow of new main banking customers for the major banks.

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155 [ ].

156 Where a main bank is defined as the financial institution into which income or benefit is paid or where most day-to-day transactions take place.

157 Verian "Personal banking services market study – Research report" (February 2024), pp. 14 and 15.

158 Verian "Personal banking services market study – Research report" (February 2024), p. 15.

2.109.2 It is challenging for smaller banks to win main banking customers by offering innovative products. Because they do not have the same scale advantages and the associated financial resources of the major banks, a greater proportion of institutional time and capital must be dedicated to business-as-usual functions such as regulatory compliance. This leaves fewer resources available for providing full-service offerings that main bank customers prefer such as high-quality mobile banking apps.[159,160]

2.110 The difficulties smaller providers face when competing for main bank relationships weakens their ability to compete effectively with the larger providers. The major banks are substantially more likely to have the main banking relationship with a customer, and once that relationship is formed, that provider will often be the first (or only) choice for additional personal banking services.[161]

Multi-banking by customers is increasing

2.111 Although main bank relationships are important, consumers are increasingly establishing relationships with multiple providers. ANZ indicated in a submission that "approximately every second person has accounts with more than one bank".[162] This is broadly consistent with our consumer research, which found 1.6 provider relationships per customer on average.[163] For example, customers may have their salary paid into their main bank (for example, into a transaction or savings account) and have a term deposit at a different bank.

2.112 Customers frequently bank across a number of providers because of low or no fees on transaction accounts or to take advantage of more favourable rates on savings accounts or term deposits. We have heard that "banking providers are generally added rather than replaced" for this purpose.[164] This might suggest the competitive advantages the larger banks have historically enjoyed through establishing main bank relationships is weakening. However, banks continue to pursue those main banking relationships – presumably because of the advantages described above.

2.113 Smaller providers consider that a low proportion of their own customers bank solely with them.[165] A greater proportion of these banks' customers are likely to be of the engaged customer variety described earlier. They may have their main banking relationship elsewhere but turn to smaller providers for bespoke services (for example, deposits on more favourable terms). A higher proportion of smaller providers' customers are consequently lower value and more likely to switch.

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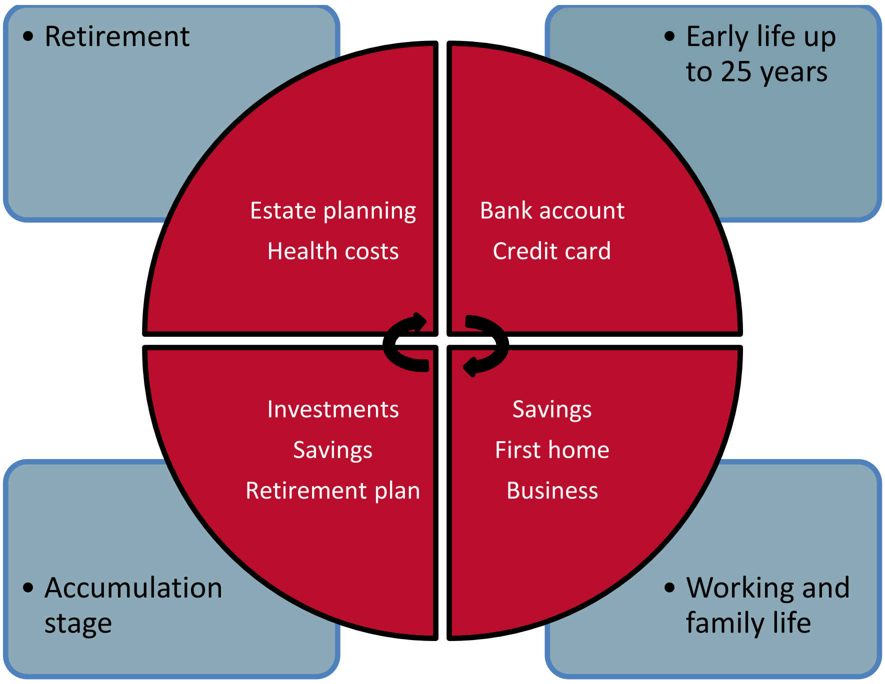
159 [ ].
160 [ ].
161 [ ].
162 ANZ, Submission on Preliminary Issues paper (7 September 2023), para 112.
163 Verian "Personal banking services market study – Research report" (February 2024), p. 16.
164 BNZ, Submission on Preliminary Issues paper (7 September 2023), para 2.23.
165 [ ].

Customer engagement is often triggered by key life events

2.114 Providers attach importance to attracting customers to everyday banking services such as transaction accounts early on in their lives. Often school-age children and young adults are targeted to develop and maintain an ongoing and commercially valuable relationship.[166,167] Many young people stay with the bank that their parents set them up with at least until they leave home and often longer.[168]

2.115 Some customers do not actively engage with personal banking services on a regular basis, adopting more of a set and forget approach. However, certain life events such as a first job, first home, marriage or other significant life events can present triggers for customers to engage more actively in choosing their providers (see Figure 2.5).[169] Banks develop services for customers to use at each life stage and often focus their competitive efforts on these life events to try to gain a competitive advantage.

Figure 2.5 Customer life journey and life events where engagement often takes place



Source: Commerce Commission.[170]

166 [ ].
167 [ ].
168 [ ].
169 [ ].
170 [ ].

2.116 As Chapter 8 explains in more detail, when customers do engage, it can be difficult for them to access and use the information they need to make informed choices about services and service providers. Search costs are high for some services such as home loans. It can also be difficult for customers to compare product offerings on a like-for-like basis. These obstacles can reduce the effectiveness of competition for that small subset of engaged customers seeking to switch.

Customer disengagement makes it harder for smaller providers to compete

2.117 Many customers are disengaged and are more likely to have chosen their banking provider based on brand reputation, convenience or recommendations from family and friends rather than actively searching for the best offer.[171,172] This does not mean that consumers do not value price and cost. Rather, it likely reflects the challenges consumers face in comparing complex product offerings, particularly for mortgages (as discussed in Chapter 4).

2.118 The larger banks are substantially more likely to have disengaged customers for this reason. Furthermore, those customers are then much less likely to switch subsequently. It is more likely they will be paying higher prices than engaged customers who shop around (for example, they may be paying headline rates rather than discretionary rates).

2.119 Customer disengagement represents a significant incumbency advantage for the major banks over smaller providers. It enables the major banks to segment the market and charge disengaged customers higher prices, leaving smaller providers vying primarily for the smaller subset of engaged customers who are more price sensitive and less lucrative. We heard from smaller providers that:[173]

> …the larger and more established banks, which account for 85-90% of the market, enjoy the benefits of a large inert customer base that they have built up over many years making it harder for smaller and newer banks to attract customers.

2.120 The extent of customer engagement in the market has a significant bearing on the effectiveness of competition. If firms know that they must offer an attractive price/quality proposition or risk losing customers to rivals, they will have stronger incentives to offer the best deals.

2.121 Customer disengagement also hinders the ability of smaller providers to enter and expand. If a large volume of customers will not be enticed by the prospect of paying lower prices or potentially experiencing a superior quality of service, this makes it very difficult for new suppliers to compete. Winning sufficient volumes to gain critical scale becomes substantially more difficult and, as noted above, the customers smaller providers do attract tend to be the engaged variety and lower value.

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171 Verian "Personal banking services market study – Research report" (February 2024), p. 36.

172 [ ].

173 TSB, Co-operative Bank, Kiwibank and SBS Bank, Submission on Preliminary Issues paper (7 September 2023), p. 3.

Non-price competition can be a driver of customers' choice of provider | *Mā te korenga o te whakataetae ā-utu e whakaaweawe i tā te kiritaki kōwhiri kaituku*

2.122 Personal banking customers have diverse needs and preferences. The non-price dimensions of banks' offerings are consequently important considerations for consumers when choosing a provider. Research shows that some customers are willing to pay more for quality and service.[174] Providers compete on non-price measures such as ranges of products, service levels, perceptions of trust and security, digital capabilities and brand awareness.[175]

2.123 Major banks place considerable emphasis on the non-price aspects of their offerings. They seek to provide all the products their customers might need and to make their experience as seamless as possible, reducing inclinations to switch.[176,177] For example, a core area of focus is approval times for home loans because this makes a significant difference to customers' overall experiences as well as creating an important first impression.[178] ANZ stated in its submission that "non-price competition is important, and sustained" and "the larger banks compete strongly against each other with non-price brand advertising and sponsorship activity".[179]

2.124 Smaller providers also focus on implementing strong non-price offerings to drive customer growth.[180] However, as mentioned previously, the extent to which they can do so may be limited by their more modest financial and institutional resources. For example, smaller banks told us they spend a disproportionate amount of time and money on regulatory compliance, which makes it much more difficult for them to invest in things like mobile banking apps.[181]

2.125 Perceptions of trust and security can also have an important bearing on customers' choice of bank. Consumers "trust banks to keep their money safe and to keep their information secure".[182] The major banks have an advantage in this area because they are perceived to be more safe and secure. This is often cited as an important factor in consumers choosing major banks.[183]

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174 [ ].

175 BNZ, Submission on Preliminary Issues paper (7 September 2023), para 2.8.

176 [ ].

177 [ ].

178 [ ].

179 ANZ, Submission on draft report (18 April 2024), para 37.

180 [ ].

181 [ ].

182 ACCC "Retail deposits inquiry – Final report" (December 2023), p. 23.

183 Verian's consumer survey suggests that perceptions, including of security, are more important than specific product features when considering one of the major banks: Verian "Personal banking services market study – Research report (February 2024), p. 46. However, when customers are considering smaller providers, domestic ownership is considered a more important selling point.

2.126 Marketing and branding are particularly important tools that providers use to compete. Major banks spend a considerable amount on brand advertising for specific services. Smaller providers are unable to match this spending.[184] Some providers consider brand is a point of leverage in the market.[185] Others note "it is necessary to have a trusted brand".[186] Marketing can also take the form of community support, which seeks to drive positive perceptions and positive experiences.

2.127 All of the major banks monitor net promoter scores (NPS), which measure customer satisfaction.[187] Despite the numerous disadvantages smaller providers face competing on non-price dimensions, they often score higher than major banks in respect of customer service. However, this has not translated into any significant movements in market shares.

2.128 Despite the emphasis that providers place on non-price competition, it is not clear that customers' preferences are being met as well as they could be if competition was working more effectively.

2.128.1 Smaller providers cannot match the large providers' investments in marketing and branding and consequently face difficulties attracting customers who place a high value on perceived safety and trust. More generally, smaller providers face challenges in expanding, and this limits their ability to compete head to head with major banks.

2.128.2 Customers continue to perceive that all banks are the same with a homogeneous offering.[188] This might suggest that product ranges and service offerings from the major banks do not meet the diverse needs and preferences of customers. Despite this, there is limited switching to providers who may offer better products and services (this is discussed further in Chapter 8).

2.128.3 There has been only limited entry and expansion by fintechs and other digital providers who might be capable of offering a broader range of services that would strengthen non-price competition.

2.128.4 Some customers face difficulties in accessing some products and services (see discussion below).

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184 [ ].

185 [ ].

186 BNZ, Submission on Preliminary Issues paper (7 September 2023), p. 65.

187 [ ].

188 Verian "Personal banking services market study – Research report" (February 2024), p. 54.

Competition is not working well for some consumer groups | *Kāore he painga o te whakataetaetanga mō ētahi rōpu kaiwhakapeto*

2.129 In addition to considering the overall state of competition in personal banking services, we have also considered whether there are groups of customers who encounter additional difficulties navigating the market. In particular, we have looked at whether there are any consumer groups that may warrant specific attention or interventions.

2.130 For example, some consumer groups are particularly vulnerable to financial exclusion and find it difficult to access personal banking services – even a basic bank account or a line of credit. This includes consumers with learning and physical disabilities, recent migrants, those with low-level financial capabilities and those for whom digital barriers make it difficult to navigate banking options.

2.131 To understand this issue better, we sought feedback from a diverse range of consumer groups and charitable trusts. We consulted stakeholders such as Consumer NZ, Christians Against Poverty New Zealand, FinCap, Community Networks Aotearoa, Rural Women New Zealand and Community Law centres. The wānanga we conducted with Māori representatives also contributed to this workstream, as did the conference we held in May.[189]

2.132 This consultation revealed a number of issues.

2.132.1 **Access to bank accounts.** Some consumers can struggle to get access to even a basic bank account. This may include customers with poor credit histories, those experiencing insolvency or bankruptcy, those fleeing domestic violence, youth in Oranga Tamariki care or former prisoners. Like all consumers, they need access to basic banking services in order to go about their daily lives.

2.132.2 **Overdrafts leading to difficulties in switching.** Customers with overdrafts appear less likely to change banks once a main bank relationship has been established. This may be due to barriers such as having unsecured debt or lower credit scores, which can make moving banks more complex. The CCCF Act contains responsible lending principles that provide important protections for indebted consumers but can act as a barrier to switching in some circumstances.[190]

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189 Commerce Commission "Summary of views expressed – Te Komihana Tauhokohoko wānanga – Competition for personal banking services in New Zealand" (14 February 2024); Commerce Commission "Day 3 Personal banking services market study conference – Session 9 Consumer experiences" (15 May 2024).

190 Commerce Commission "Lender responsibility principles", https://comcom.govt.nz/business/credit-providers/the-lender-responsibility-principles

2.132.3 **Regulation leading to greater financial exclusion**. Some consumers have difficulties in providing suitable identification to meet anti-money laundering and countering the financing of terrorism (AML/CFT) processes. Without access to key documents such as proof of address or a driver licence, this creates an unintended barrier to enter or remain in the banking system.[191]

2.132.4 **Access to face-to-face banking at physical branches**. Branch closures and increased digitisation of personal banking services can particularly affect older consumers (who may be less familiar with digital services), consumers living with disabilities (for example, hearing or eyesight impaired or mobility issues) or rural consumers (who need to travel further to visit a branch).

2.132.5 **Financial literacy.** Some consumers face difficulties in understanding banks' terms and conditions, interest rates and comparing products and services. This limits their ability to choose the provider and product that best meets their needs. In some cases, consumers are more focused on simply accessing the services they require rather than attempting to seek out or negotiate better interest rates.

2.133 These are areas where solutions could be more widely distributed for social good as competition alone is unlikely to lead to the needs of these poorly served consumers being met.

2.134 There is existing work under way by industry to help poorly served consumer groups affected by issues connected to financial inclusion.[192] Financial inclusion is one of the five priority themes of the Council of Financial Regulators Kaunihera Kaiwhakarite Ahumoni (CoFR).[193] CoFR collaborates on work under way within government to tackle different issues related to financial inclusion.[194]

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191 Westpac "Westpac NZ Access to Banking in Aotearoa Report" (April 2023), pp. 9 and 14, https://www.westpac.co.nz/assets/Personal/life-money/documents/Westpac-NZ-Access-to-Banking-in-Aotearoa-Report.pdf; AUSTRAC "Assisting customers who don't have standard forms of identification", https://www.austrac.gov.au/business/core-guidance/customer-identification-and-verification/assisting-customers-who-dont-have-standard-forms-identification

192 For example, Westpac "Helping released prisoners reintegrate with 'New Start' bank accounts" (17 February 2022), https://www.westpac.co.nz/rednews/helping-released-prisoners-reintegrate-with-new-start-bank-accounts/

193 CoFR "Financial Inclusion", https://www.cofr.govt.nz/priority-themes/inclusion.html

194 Reserve Bank "Financial Inclusion – Our approach at the Reserve Bank of New Zealand" (29 September 2023), p. 11, https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/publications/our-approach-to-financial-inclusion/our-approach-to-financial-inclusion.pdf

2.135 The Conduct of Financial Institutions (CoFI) regime, which commences on 31 March 2025, includes an overarching fair conduct principle requiring financial institutions to treat consumers fairly.[195] The Retirement Commission Te Ara Ahunga Ora has also been undertaking research on financial literacy.[196] This is aimed at providing a deeper understanding of the level of financial capability in New Zealand and how this compares internationally.

2.136 The CCCF Act is aimed at protecting consumers from irresponsible lending practices when they enter consumer credit contracts. Among other things, lenders are required to make inquiries before entering consumer loans to check that loans are suitable and affordable, to assist the borrower to understand the loan and to treat the borrower reasonably and ethically when problems arise.[197] We have heard that some consumers continue to fall into debt traps that perpetuate their financial difficulties.[198] This reinforces the need for consumer protection laws and strong regulatory oversight.

2.137 Further details about our assessment of how competition is working for different consumer groups is included in Attachment D.

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195 MBIE "Conduct of financial institutions regime" (22 April 2024), https://www.mbie.govt.nz/business-and-employment/business/financial-markets-regulation/conduct-of-financial-institutions-regime/

196 Retirement Commission "Financial Capability Research", https://retirement.govt.nz/financial-capability/research/

197 Commerce Commission "The Credit Contracts and Consumer Finance Act – Fact sheet" (November 2021), https://comcom.govt.nz/__data/assets/pdf_file/0021/272424/The-CCCFA-Fact-sheet-November-2021.pdf

198 [ ].

Chapter 3 Māori perspectives on competition for personal banking services | *Ngā tirohanga Māori mō te whakataetaetanga mō ngā ratonga pēke whaiaro*

Summary of findings

- **Māori are a diverse group**. While many Māori may be satisfied with their personal banking products and services, there are some Māori who face restricted access to personal banking services due to factors such as location, with rural areas having fewer physical branches and ATMs, limited access to online services, exclusion from basic banking services or lower financial literacy and confidence engaging with providers.
- **Access was a key theme that emerged from our engagements to understand Māori perspectives and interactions with personal banking services.**
- **There are barriers to accessing personal banking services that are unique to Māori.** These include perceptions of racism and bias towards Māori from banks, lack of Māori representation in the banking sector, lack of understanding regarding Māori cultural and whānau dynamics from banks and lack of data on Māori demographics, Māori SMEs and the Māori economy. These barriers, whether individually or together, can prevent Māori benefiting from the value and choice competition offers and make it more difficult for Māori to switch providers or access the services that best meet their needs.
- **There are initiatives under way by Māori groups, government and industry to address some of these challenges**. Although the efficacy of these initiatives is uncertain, we support continued efforts to overcome challenges specific to Māori. We are particularly supportive of initiatives where they align with solutions identified or endorsed by Māori.
- **One of the more unique issues affecting Māori is access to capital for housing on Māori freehold land**. About 5% of land in New Zealand is Māori freehold land, which can provide a place for Māori to build individual (whānau) or collective (papakāinga) housing. However, it has features that can make it challenging to acquire finance for housing.
- **Only a limited number of products are available for Māori freehold land**, with the most prominent of these being the Kāinga Whenua Loan. There are a small number of other products (for example, leasehold lending or shared equity arrangements), but these products have been privately organised by large iwi for their whānau, and in some instances, are for lending on general freehold land rather than Māori freehold land.
- **The uptake of these products has been limited to date.** Reasons for this include the complexity of accessing such products (for example, the Kāinga Whenua Loan requires significant project planning and AML/CFT compliance) as well as the high cost for banks to create bespoke arrangements (such as shared equity arrangements). There has also been limited promotion of these products.
- **We support reducing the barriers Māori face when seeking access to personal banking services**, particularly initiatives to make home loan products for Māori freehold land more readily accessible. We make a recommendation to support this in Chapter 10.

Introduction | *Whakatakinga*

3.1 This chapter summarises Māori perspectives on competition in the sector based on the key themes of our Māori stakeholder engagement during the study. While we identified a range of issues that affect Māori (which are detailed later in the chapter), a unique issue facing Māori is the ability to access sufficient capital for housing on Māori freehold land.

Accessing finance for housing on Māori freehold land presents unique challenges for Māori and lenders | *Ka ara ake ngā wero ki te Māori me ngā kaituku moni taurewa ina toro pūtea ana hei hanga whare i runga whenua Māori herekore*

3.2 There are certain characteristics of Māori freehold land that can make it more difficult and expensive to access finance for building or buying houses on it. There are only a limited number of products available for Māori freehold land, and uptake to date has been limited. This means that Māori seeking finance for housing on Māori freehold land may not be benefiting from the choice or value that competition can bring.

Māori freehold land is subject to legal protections, and most Māori freehold land is multiply-owned

3.3 Māori freehold land is freehold land that has never been out of Māori ownership. It makes up roughly 5% of land in Aotearoa.[199]

3.4 There are certain characteristics of Māori freehold land that distinguish it from general freehold land when considering building on it or buying and relocating an existing house on it.

3.4.1 Te Ture Whenua Maori Act 1993 protects Māori freehold land by restricting the circumstances in which it can be alienated.[200] These restrictions can impact the land's value and impose transaction costs that would not arise when dealing with general freehold land.

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199 Community Law "Status of Māori land", https://communitylaw.org.nz/community-law-manual/test/status-of-maori-land/

200 Te Ture Whenua Maori Act, s 146: "No person has the capacity to alienate any interest in Maori freehold land otherwise than in accordance with this Act." Under s 4(a) of Te Ture Whenua Maori Act, an "alienation of land" includes every form of disposition of Māori land or of any legal or equitable interest in Māori land, whether divided or undivided, the making or grant of any lease, licence, profit, mortgage, charge, encumbrance or trust over or in respect of Māori land, any contract or arrangement to dispose of Māori land or any interest in Māori land. Note that under s 4(c)(vii), a disposition by way of sale by a mortgagee pursuant to a power express or implied in a mortgage instrument does not constitute an "alienation" of Māori land. Circumstances under which an alienation of land is permitted are set out at sections 147–150C of Te Ture Whenua Maori Act. In short, all of these circumstances require the consent of the land owners or the discretion of the Māori Land Court.

3.4.2 Even so, it is possible to use Māori freehold land as security for a loan. Te Kooti Whenua Māori Māori Land Court recently published a practice note about lending on Māori freehold land, clarifying that a mortgagee sale of Māori freehold land will not constitute a prohibited "alienation" of the land.[201] We agree with the Reserve Bank, which said the practice note should help landowners, lawyers and the banking sector to understand the mortgage process on whenua Māori, potentially reducing transaction costs, and increasing efficiencies.[202] Several lenders have advised us their policies and procedures allow for using Māori freehold land as security for lending subject to certain conditions (which, we understand, are different for each lender).[203]

3.4.3 Regardless of the clarification provided by the Māori Land Court practice note, banks can be wary of the reputational risk associated with selling Māori land in the event of a mortgagee sale.[204]

3.4.4 Most, if not all, Māori freehold land has multiple owners, with large amounts of it being held in trusts created by the Māori Land Court under Te Ture Whenua Maori Act. This can create practical difficulties in coordinating decision making about the use of land in a way that lines up with bank and Māori Land Court processes.[205] It also means there are many interests in the land, which can affect lenders' obligations under the Anti-Money Laundering and Countering Financing of Terrorism Act 2009 (AML/CFT Act) as well as borrowers' obligations should they wish to access products such as a Kāinga Whenua Loan (discussed further below).

3.5 There are other barriers to building housing on Māori freehold land such as regional planning rules, development economics and access.[206] These processes require a certain degree of familiarity with financial services and administrative/bureaucratic processes in order to navigate both how to get permission to build on Māori freehold land and how to obtain finance to build on Māori freehold land. We have heard that many whānau do not have the necessary experience, support or resources required to navigate these processes.[207]

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201 Māori Land Court "Practice Note for Lending on Whenua Māori" (29 February 2024), paras 22–24, https://www.xn--morilandcourt-wqb.govt.nz/assets/Documents/Practice-notes/Banking-Practice-Note.pdf

202 Reserve Bank, Submission on draft report (18 April 2024), p. 11.

203 ANZ, Submission on draft report (18 April 2024), para 238; Kiwibank, Submission on draft report (18 April 2024), p. 8; Commerce Commission "Day 3 Personal banking services market study conference – Session 7 Promoting competition for lending on Māori freehold land" (15 May 2024), p. 11 (lines 3–4).

204 Commerce Commission "Day 3 Personal banking services market study conference – Session 7 Promoting competition for lending on Māori freehold land" (15 May 2024), p. 11 (lines 4–7).

205 Commerce Commission "Day 3 Personal banking services market study conference – Session 7 Promoting competition for lending on Māori freehold land" (15 May 2024), pp. 10 (lines 27–33) and 11 (lines 1–2 and 15–31).

206 Commerce Commission "Day 3 Personal banking services market study conference – Session 7 Promoting competition for lending on Māori freehold land" (15 May 2024), p. 9 (lines 15–23) and 14 (lines 17–23).

207 [ ].

Some home loan providers have found ways to lend money for papakāinga developments and for building on Māori freehold land, often in partnership with iwi or government

3.6 Some home loan providers have created lending initiatives for iwi-led papakāinga developments on general freehold land (rather than lending for building on Māori freehold land). Accordingly, in these instances, lending has been secured against the land and/or the iwi's other assets. We are aware of these examples.

3.6.1 BNZ has entered into an alternative tenure arrangement – leasehold lending supported by a partnership agreement (involving a guarantee from the borrower's iwi). BNZ's arrangement is in relation to general freehold land on which a papakāinga development is being built (rather than in relation to Māori freehold land).[208]

3.6.2 Westpac has used shared equity agreements to support Māori and iwi accessing finance for housing. While it appears that each of the arrangements is tailored to the needs of iwi they were developed for, a fundamental component is iwi involvement in the mortgage that is entered into between whānau and the bank – whether as a guarantor or by providing a portion of equity that the whānau then pays back over time.[209] We are aware that at least one of Westpac's shared equity arrangements is in relation to general freehold land on which a papakāinga development is being built (rather than in relation to Māori freehold land).[210]

3.7 In relation to lending over Māori freehold land, Kiwibank has taken a collaborative approach with government. It supports the Kāinga Whenua Loan Scheme, administered by Kāinga Ora – Homes and Communities. Under the Kāinga Whenua Loan Scheme, loans can be provided to individuals/whānau or trusts to build on Māori freehold land. However, the loan is supplied only for the house (not the land) and security is only taken over the house. This means that the house built or located on the land must meet certain criteria. Other criteria must also be met to obtain a Kāinga Whenua Loan, including, in the case of an individual/whānau, obtaining a licence to occupy the land from the Māori Land Court.[211]

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208 BNZ "Unlocking home ownership aspirations for iwi housing – BNZ and Ngāti Whātua Ōrākei collaborate on papakāinga development" (11 January 2024), https://blog.bnz.co.nz/2024/01/unlocking-home-ownership-aspirations-for-iwi-housing-bnz-and-ngati-whatua-orakei-collaborate-on-papakainga-development

209 Westpac "Relationship with iwi leads to innovative papakāinga shared-equity model for whānau" (11 October 2019), https://www.westpac.co.nz/rednews/relationship-with-iwi-leads-to-innovative-papakainga-shared-equity-model-for-whanau/; and Westpac "Waikato-Tainui sign shared equity agreement to build 50 homes for whānau" (25 June 2020), https://www.westpac.co.nz/rednews/waikato-tainui-sign-shared-equity-agreement-to-build-50-homes-for-whanau/

210 Ngāti Whātua Ōrākei's Hawaiki Street development, which Westpac is involved with, is not on Māori freehold land. Commerce Commission "Day 3 Personal banking services market study conference – Session 7 Promoting competition for lending on Māori freehold land" (15 May 2024), p. 5 (lines 13–17).

211 Kāinga Ora "Buying or building a new home with a Kāinga Whenua Loan" (June 2024), https://kaingaora.govt.nz/assets/Home-ownership/Kainga-Whenua-brochures/Kainga-Whenua-Loan-Brochure.pdf

3.8 More generally, some banks have amended their standard home loan policies to allow lending on Māori freehold land. However, we do not have confirmation of the extent to which lending over Māori freehold land has occurred.

3.8.1 In 2021, BNZ amended its policy on loans secured against Māori freehold land. If the land had been valued by an acceptable registered valuer, BNZ can adopt the same security value for Māori freehold land as it would for an equivalent parcel of land held in general title.[212]

3.8.2 ASB's lending standard provides for Māori freehold land to be an acceptable security. However, it can only apply lending for Māori freehold land where the land is held by a sole owner, joint tenants or owners in common (up to a limited number), or Te Ture Whenua Maori Act constituted trusts or incorporations.[213]

3.8.3 ANZ's existing policies provide for borrowing against general freehold land in collective Māori ownership and Māori freehold land.[214]

These existing initiatives appear promising, but some issues remain

3.9 The initiatives by banks that we described above appear to address some of the issues associated with whānau and iwi accessing finance for housing either on Māori freehold land or on general freehold land. We have heard – and agree – that there are no simple solutions to these issues[215] and that a collaborative approach is likely to be an appropriate way forward.[216]

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212 BNZ, Submission on Preliminary Issues paper (7 September 2023), para 6.18.

213 ASB, Submission on Preliminary Issues paper (7 September 2023), p. 15.

214 ANZ, Submission on draft report (18 April 2024), para 238.

215 [ ].

216 Commerce Commission "Summary of views expressed – Te Komihana Tauhokohoko wānanga – Competition for personal banking services in New Zealand" (14 February 2024), p. 12; [ ].

3.10 That said, uptake of these services appears to be slow. BNZ has told us that there has been low uptake for home lending over Māori freehold land despite its change to its general policy. However, it is still investigating why.[217] ASB has also told us that it is working on clarifying its position on lending over Māori freehold land to the market,[218] indicating that uptake has been low. There has also been low uptake of the Kāinga Whenua Loan, although this has increased in the past several years, coinciding with changes made to the scheme and the way Kiwibank operates the scheme.[219] The Ministry of Housing and Urban Development Te Tūāpapa Kura Kāinga and Kāinga Ora have recently reviewed the Kāinga Whenua Loan Scheme with changes to the scheme expected to be announced later this year.[220]

3.11 Low uptake of these services may be driven by a range of factors.

3.11.1 The services themselves may be seen as undesirable. For example, Kāinga Whenua Loans are only available for housing and not the underlying land, and the houses must be transportable – restricting the size of homes.[221]

3.11.2 In addition, we have heard that, historically, there has been a range of barriers associated with the Kāinga Whenua Loan.

3.11.2.1 Some bank staff have insufficient knowledge about the product and therefore are unable to provide guidance to customers wishing to access the product.[222]

3.11.2.2 High administrative requirements associated with the loan such as, in the case of a Kāinga Whenua Loan for an individual, seeking the consent of all other land owners, to live on the land, obtaining a licence to occupy from the Court after consent has been granted from all landowners and producing a project budget and a plan. We have heard that, in some instances, it can take several years for these requirements to be satisfied and for the loan to be drawn down under the scheme.[223]

217 BNZ, Submission on Preliminary Issues paper (7 September 2023), paras 6.18–6.19.

218 ASB, Submission on Preliminary Issues paper (7 September 2023), p. 15.

219 Commerce Commission “Day 3 Personal banking services market study conference – Session 7 Promoting competition for lending on Māori freehold land” (15 May 2024), pp.4 (lines 10–25), 15 (lines 28–34) and 16 (lines 1–3).

220 Commerce Commission “Day 3 Personal banking services market study conference – Session 7 Promoting competition for lending on Māori freehold land” (15 May 2024), p. 15 (lines 7–13).

221 Kāinga Ora “Kāinga Whenua Loans for individuals” (31 May 2024), https://kaingaora.govt.nz/en_NZ/home-ownership/kainga-whenua/kainga-whenua-loans-for-individuals/

222 [ ].

223 [ ].

3.11.3 The cost to provide these services is high.[224] These are some of the reasons we've been given for this.

3.11.3.1 Each initiative is unique and tailored to the needs of the iwi, hapū or whānau.[225] Many of the systems and processes used are not easily repeatable or scalable.[226]

3.11.3.2 The regulatory environment creates significant costs associated with these transactions. For example, the way that Māori land trusts are currently assessed under the AML/CFT Act is disproportionate to their relatively low risk. This is described further below along with other aspects of regulation that do not appear to be a good fit when applied to lending on Māori freehold land.

3.11.3.3 It can be difficult for providers (who may lack cultural capability) and borrowers (who may lack financial literacy) to engage, particularly when borrowers are physically remote (for example, living rurally without access to a physical bank branch).[227]

3.11.4 It is unclear whether banks are prioritising these products.[228]

3.11.5 There are barriers associated with AML/CFT obligations in relation to individuals and Māori Land Court constituted trusts who seek loans for Māori freehold land (or in relation to papakāinga being built on general freehold land).

224 [ ]; [ ].

225 ANZ, Submission on draft report (18 April 2024), para 238.

226 [ ].

227 [ ].

228 [ ]; [ ].

3.11.5.1 For example, for Kiwibank to meet its AML/CFT Act obligations for an individual who is accessing lending via an individual Kāinga Whenua Loan, the individual must onboard with the bank and provide the relevant documents.[229] The trust (from whom the individual has obtained a licence to occupy) must also onboard with the bank. This is because the Kāinga Whenua Loan requires a multi-party agreement to be entered into in respect of the loan, one of such parties to the agreement being the trust that owns the land. Consequently, each trustee must provide relevant documentation to the bank under the AML/CFT Act.[230]

3.11.5.2 We have been told that, in many cases, the trustees of land-owning trusts are elderly and live rurally so often have difficulty accessing a physical branch to provide such documentation.[231] The issue of barriers relating to rural and digital access for Māori is discussed in further detail below and more generally in Chapter 2 and Attachment D.

3.11.5.3 Additionally, under the AML/CFT Act, all trusts are subject to enhanced customer due diligence (ECDD) due to trusts being categorised as higher risk in the AML/CFT Act. ECDD includes providing copies of the original trust deed, any amendments to the trust, including changes to trustees or beneficiaries since the inception of the trust, and verifying the source of funds or wealth for the trusts. This can be difficult for Māori land trusts constituted by the Māori Land Court given the trustees change on a regular basis, the trusts can be a lot older than a general trust and the central access point for historical records is the Māori Land Court. These requirements make providing the information required for ECDD difficult and time consuming.[232]

3.11.6 There appears to be a lack of consideration for Māori freehold land when prudential policy is set.

229 [ ].

230 [ ].

231 [ ].

232 [ ].

3.11.6.1 Banks are not currently treating lending for collective housing (such as papakāinga) as residential mortgage lending and instead are treating such lending for risk weighting purposes under the Reserve Bank's corporate lending category.[233] As a result, the loans are likely to attract higher lending rates. In the process of securing the lending, iwi must interact with the corporate arm of banks, while whānau who are going to be paying the mortgage must go through the retail arm. We have been told that, administratively, this is burdensome as coordination between the corporate and retail arms of a bank must then be facilitated in respect of the loan.[234]

3.11.6.2 There is no loan-to-value ratio (LVR) or standardised risk weight specifically for lending for housing on Māori freehold land, which may pose a barrier to banks providing or promoting this lending.[235]

3.12 We are aware of some initiatives and potential options to address these issues.

3.12.1 A 2022 review of the AML/CFT regime by the Ministry of Justice Tāhū o te Ture (MoJ) included consideration of the extent to which the regime supports or undermines the ability of some Māori trusts to operate effectively and efficiently.[236] The Associate Minister of Justice signalled an intention to reform the AML/CFT regime in May 2024,[237] and we make a recommendation in Chapter 10 as to how those reforms could better support competition, including in respect of its treatment of Māori trusts.

3.12.2 In relation to prudential settings relating to Māori freehold land and lending for papakāinga, in Chapters 7 and 10, we have encouraged the Reserve Bank to review standardised risk weight for home loans as a matter of priority against the more granular Basel III risk weights. We suggest that, as part of this review of the standardised risk weights, risk weights for collective and social housing (papakāinga) and for lending over Māori freehold land be developed.

3.12.3 We have been told that an LVR set specifically for Māori freehold land would make this lending more attractive to banks,[238] which would potentially address some of the competition issues associated with the non-prioritisation of these products.

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233 Andrew Body, Cross-submission on draft report (22 May 2024).

234 [ ].

235 Kiwibank, Submission on Preliminary Issues paper (7 September 2023), p. 4.

236 MoJ "Report on the review of the Anti-Money Laundering and Countering Financing of Terrorism Act 2009" (July 2022), https://www.justice.govt.nz/assets/AMLCFT-Statutory-Review-Final-Report.pdf

237 Gareth Vaughan "Associate Minister of Justice Nicole McKee sets sights on reforming anti-money laundering laws" (16 May 2024), https://www.interest.co.nz/business/127748/associate-minister-justice%C2%A0nicole-mckee-sets-sights-reforming-anti-money-laundering

238 Kiwibank, Submission on Preliminary Issues paper (7 September 2023), p. 4.

3.12.4 We also consider there may be scope for providers of these alternative loan products to develop common frameworks and models and to promote the use of existing initiatives that are working such that the cost to serve is reduced. A particularly promising opportunity in this regard is having more providers support the Kāinga Whenua Loan Scheme. We discuss these ideas further in Chapter 10.

Māori consumers face a range of barriers to accessing personal banking services | *Arā ngā tauārai ki ngā kiritaki Māori kia taea e rātou ngā ratonga pēke whaiaro*

3.13 Many population groups face barriers to accessing suitable personal banking services. We discuss some of these in more detail in Chapter 2 and Attachment D. Barriers to accessing personal banking services prevent consumers benefiting from the value and choice competition can offer.

3.14 Māori are disproportionately more likely to experience some of these barriers, while other barriers are unique to Māori.

3.15 We do not have good data on the impact these barriers are having on Māori, but it is likely that these issues, together or individually, are preventing some Māori from gaining the full benefits of competition for personal banking services.

3.16 Barriers to access mean some Māori are acquiring fewer services than they want – and missing out on the opportunities that personal banking services provide. These issues may also prevent Māori from being able to choose the services or service providers that best meet their needs. Providers are also unlikely to be able to best serve their Māori customers if their staff do not reflect the communities they serve or do not have a good understanding of their customers' preferences and aspirations.

Māori are disproportionately more likely to experience some access issues compared to other New Zealanders

3.17 Barriers facing New Zealand consumers when accessing personal banking services can disproportionately impact some Māori, including:

3.17.1 restricted access to personal banking services associated with rural living and digital exclusion;

3.17.2 exclusion from basic personal banking services;

3.17.3 financial literacy and confidence when engaging with providers of personal banking services; and

3.17.4 lack of transparency in how banks make decisions.

3.18 Barriers to accessing personal banking services are discussed more generally in Chapter 2 and Attachment D, including topics such as access to basic banking services, financial literacy and issues associated with digital exclusion and living rurally.

Access can be challenging for those that live rurally or are digitally excluded

3.19 We have heard that the lack of physical access to banks is an issue for some Māori, particularly in rural areas.[239] A higher proportion of Māori live in small urban areas (14.7% of the Māori population) and rural areas (18.0% of the Māori population) compared to the total population (10.0% and 16.3% respectively).[240] Reduced access and limited choice for Māori (and other New Zealanders) living rurally was also a theme of our 2022 retail grocery sector study.[241]

3.20 We also heard that some Māori consumers don't have basic digital access to engage in online banking services.[242] This is reflected in research that finds Māori are one of the groups with relatively low access to the internet.[243]

Exclusion from accessing basic personal banking services

3.21 We heard some Māori consumers don't have ready access to identification, and some can't obtain proof of address to open accounts.[244] This aligns with a recent report by Citizens Advice Bureau on Māori engagement, which noted that "[c]lients seek our help for obtaining ID that will enable them to open or access a bank account, especially if they do not have all the information or paperwork required to do so".[245]

3.22 We also heard that exclusion from basic personal banking services is often associated with wider systemic barriers and has a negative flow-on impact for whānau in the banking system, for example, turning to higher-cost lenders if mainstream banks are inaccessible.[246]

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239 Commerce Commission "Summary of views expressed – Te Komihana Tauhokohoko wānanga – Competition for personal banking services in New Zealand" (14 February 2024), p. 5.

240 Environmental Health Intelligence New Zealand "Urban-rural profile", https://www.ehinz.ac.nz/indicators/population-vulnerability/urbanrural-profile/

241 Commerce Commission "Market study into the retail grocery sector – Final Report" (8 March 2022), para 4.4, https://comcom.govt.nz/__data/assets/pdf_file/0024/278403/Market-Study-into-the-retail-grocery-sector-Final-report-8-March-2022.pdf

242 Commerce Commission "Summary of views expressed – Te Komihana Tauhokohoko wānanga – Competition for personal banking services in New Zealand" (14 February 2024), p. 5.

243 Arthur Grimes and Dominic White "Digital inclusion and wellbeing in New Zealand – Motu Working Paper 19-17" (October 2019), p. 7, https://motu-www.motu.org.nz/wpapers/19_17.pdf

244 Commerce Commission "Summary of views expressed– Te Komihana Tauhokohoko wānanga – Competition for personal banking services in New Zealand" (14 February 2024), p. 6.

245 Citizens Advice Bureau "Māori Engagement with Citizens Advice Bureau: A Spotlight Report into the Issues Faced by Māori Clients of the CAB" (July 2024), p. 32, https://www.cab.org.nz/assets/Documents/Maori-Engagement-Report/FINAL-REPORT_Maori-engagement-with-CAB_public-release.pdf

246 Commerce Commission "Summary of views expressed – Te Komihana Tauhokohoko wānanga – Competition for personal banking services in New Zealand" (14 February 2024), p. 6.

Financial literacy can impact the quality of personal banking services that Māori access

3.23 We heard that some Māori consumers tend to accept the first offer of services and rates that are made to them, and some do not know how or when to ask or may be uncomfortable asking for better services or rates – nor have they been offered the opportunity by providers to easily engage in these types of option and choice conversations.[247]

3.24 While these experiences are not unique to Māori, research by the FMA and the Retirement Commission has found self-rated financial knowledge and understanding is significantly lower among Māori compared to the European/Pākehā population.[248]

Lack of transparency on how decisions are made

3.25 We heard that some Māori consumers are being declined products such as home loans without being given an explanation. This lack of explanation may leave them unable to change financial habits or behaviour so that the product can be obtained in the future.[249] A lack of transparency contributes to a lack of confidence and trust in the banking system.

3.26 These experiences align with research by the FMA that found that Māori are less likely than people of other ethnicities to trust banks.[250]

There are also some access issues that are unique to Māori consumers

3.27 Issues around accessing personal banking services that are unique to Māori consumers include:

3.27.1 the perception of racism and institutional bias towards Māori from banks;

3.27.2 a lack of Māori representation in the banking sector (frontline staff and leadership);

3.27.3 a lack of understanding regarding Māori cultural and whānau dynamics; and

3.27.4 a lack of good data being collected about Māori as a demographic.

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247 Commerce Commission "Summary of views expressed – Te Komihana Tauhokohoko wānanga – Competition for personal banking services in New Zealand" (14 February 2024), p. 6.

248 FMA "Consumer experience with the financial sector" (July 2022), p. 20, https://www.fma.govt.nz/assets/Reports/FMA-Consumer-Experience-with-the-Financial-Sector-Survey-2022.pdf; Celestyna Galicki "New Zealand Financial Capability Survey 2021" (2021), p. 11, https://assets.retirement.govt.nz/public/Uploads/Research/TAAO-RC-NZ-FinCap-Survey-Report.pdf.

249 Commerce Commission "Summary of views expressed – Te Komihana Tauhokohoko wānanga – Competition for personal banking services in New Zealand" (14 February 2024), pp. 6 and 8.

250 FMA "Consumer experience with the financial sector" (July 2022), pp. 36–38.

The perception of racism and institutional bias from banks

3.28 We heard that some Māori seeking personal banking services feel there is a degree of judgement and bias when Māori consumers engage with personal banking services.[251] We heard of experiences with personal banking service providers such as having a sense of being racially profiled and service providers failing to understand whānau dynamic and circumstances.[252]

3.29 We also heard from some wānanga attendees that they automatically expect to be told no when engaging with personal banking providers (for example, for a home loan or to open a bank account). We heard that, for some Māori, banks continue to be seen as part of the overall distrusted government system.[253]

3.30 These experiences align with research by the FMA that found Māori are less likely to trust banks than people of other ethnicities.[254] What we heard at our wānanga also aligns with research conducted by Ngā Pae o Te Māramatanga Māori Centre of Research Excellence that found in a study conducted on embedding tikanga into financial literacy that participants experienced racism or felt judged or looked down upon when visiting banks and saw banks as Pākehā institutions.[255]

Lack of representation in the supply of personal banking services

3.31 We heard that Māori consumers perceive there to be a low number of Māori staff working in the personal banking sector and that the workforce composition does not reflect the composition of the communities and populations that they work within.[256] We understand that, as a result of this, some Māori may feel as though their needs are not being catered for.

3.32 We have also heard there is a lack of knowledge of whether there are currently any Māori-owned or Māori-led personal banking service providers that would apply a Māori cultural lens and perspective to a European/Pākehā concept.[257] This aligns with our research that suggests there are few such providers (aside from iwi savings schemes) and those that operate are limited in their focus.

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251 Commerce Commission "Summary of views expressed – Te Komihana Tauhokohoko wānanga – Competition for personal banking services in New Zealand" (14 February 2024), p. 6.

252 Commerce Commission "Summary of views expressed – Te Komihana Tauhokohoko wānanga – Competition for personal banking services in New Zealand" (14 February 2024), p. 8.

253 Commerce Commission "Summary of views expressed – Te Komihana Tauhokohoko wānanga – Competition for personal banking services in New Zealand" (14 February 2024), p. 6.

254 FMA "Consumer experience with the financial sector" (July 2022), p. 37.

255 Carla Houkamau, Alexander Stevens, Danielle Oakes and Marino Blank "Embedding tikanga Māori into financial literacy training for Māori" (March 2020), p. 9, https://www.maramatanga.ac.nz/media/5909/download?attachment

256 Commerce Commission "Summary of views expressed – Te Komihana Tauhokohoko wānanga – Competition for personal banking services in New Zealand" (14 February 2024), p. 6.

257 Commerce Commission "Summary of views expressed – Te Komihana Tauhokohoko wānanga – Competition for personal banking services in New Zealand" (14 February 2024), p. 8.

Lack of understanding regarding Māori cultural and whānau dynamics

3.33 We heard at the wānanga that mainstream banks are not innovating to respond to Māori consumer needs and that banks are perceived as not serving or educating Māori sufficiently to meet their needs.[258]

3.34 These experiences align with research by Te Māngai Penapena Pūtea Financial Literacy and Savings Partner Working Group that found there was a general "lack of fit" between mainstream banking services and Māori.[259] Numerous stakeholders that the working group heard from stated that banks tailor and market banking products to suit a standard template of life stages that may not suit Māori as well as other segments of the population. It provided, as an example, the difficulty involved with using funds contributed on a collective basis as security against lending to an individual, for example, in situations where a wider whānau pools funds as security for a mortgage to be issued to an individual. While the working group noted that it is "reasonable for banks to rely on standardised criteria in considering mortgage applications, the nature of these criteria has the unintended consequence of making mortgages more difficult for Māori to obtain in comparison to other segments of the population".

3.35 A report published by the Reserve Bank in 2021 that focused on examining whether the financial system was adequately meeting the needs of all New Zealanders, and in particular Māori, found that the "financial system may not be adequately tailored for Māori needs or circumstances, which may contribute to reduced access to financial services".[260]

3.36 Financial institutions currently have an insufficient understanding of the needs and preferences of Māori. This reduces the ability of financial institutions to engage with Māori customers effectively or offer products that target the Māori economy.[261]

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258 Commerce Commission "Summary of views expressed – Te Komihana Tauhokohoko wānanga – Competition for personal banking services in New Zealand" (14 February 2024), p. 7.

259 Te Māngai Penapena Pūtea Financial Literacy and Savings Partner Working Group "Whānau and Low-Income Household Savings Report" (April 2015), p. 18, https://www.mbie.govt.nz/dmsdocument/1064-hkkar-whanau-and-low-income-household-savings-report-pdf

260 Roanna McLeod and Victor Lam "An Overview of Māori Financial Services Institutions and Arrangements" (15 April 2021), p. 4, https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/publications/analytical-notes/2021/AN2021-04.pdf

261 ANZ, Submission on Preliminary Issues paper (7 September 2023), para 18; [ ].

Lack of good data

3.37 It appears that many personal banking service providers do not collect data on or analyse Māori consumers as a demographic to compete for.[262] One option to support this process is to develop a common and consistent set of indicators such as compound or correlative measures of financial inclusion.[263]

3.38 The lack of hard data collection on Māori consumers is consistent with the Reserve Bank's findings that there is a shortage of hard data on Māori SMEs and the Māori economy.[264] Factors such as providers' limited understanding of the needs and preferences of Māori combined with a lack of hard data on Māori as a consumer group likely further contribute to Māori facing distinct challenges in obtaining personal banking services and being less able to benefit from competition as a result.[265]

We are aware of a range of initiatives to address the access issues discussed above

3.39 The issues we heard at the wānanga and describe above are not new and in many cases are not unique to Māori. We describe below initiatives we are aware of that seek to address these issues, including work to:

3.39.1 enhance cultural competency within service providers;

3.39.2 increase Māori representation in the sector;

3.39.3 promote financial literacy for Māori; and

3.39.4 address other issues we have identified.

Addressing a lack of understanding regarding Māori cultural and whānau dynamics

3.40 Ensuring banks have a better understanding of tikanga Māori and te reo Māori was identified by wānanga participants as a potential contributor to better access.[266]

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262 Financial Services Federation, Submission on Preliminary Issues paper (7 September 2023), pp. 7 and 10. We understand that personal banking service providers – particularly the major four banks – collect data on various demographics, including [ ] See for example [ ]; [ ]; [ ]; [ ]; [ ]. However, there appears to be a lack of data collected by those banks on Māori as a demographic.

263 [ ].

264 Reserve Bank "Improving Māori Access to Capital – Issues Paper" (August 2022), p. 6, https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/consultations/maori-access-to-capital/improving-maori-access-to-capital-issues-paper.pdf

265 ANZ, Submission on Preliminary Issues paper (7 September 2023), para 18.

266 Commerce Commission "Summary of views expressed – Te Komihana Tauhokohoko wānanga – Competition for personal banking services in New Zealand" (14 February 2024), pp. 8 and 12.

3.41 Several of the larger banks have programmes in place that seek to improve the cultural competency, confidence and te reo Māori skills of their staff.[267]

3.42 We are not aware of any evidence supporting the efficacy of these programmes within banks and note that issues such as a lack of understanding of tikanga appear to persist despite the programmes being in place. Nonetheless, we consider these types of initiatives are likely helpful, and they appear to be the types of initiatives supported by Māori we spoke with. We recognise that changing cultures within institutions and perceptions of those institutions among Māori is unlikely to be a quick or simple task. We support these initiatives by banks to better understand their customers.

Addressing financial literacy and confidence in engaging with financial institutions

3.43 We are aware of a range of initiatives to address financial literacy and confidence for Māori in particular.

3.43.1 Tāwhia, the Māori bankers' rōpū, has partnered with the Retirement Commission and New Zealand Banking Association Te Rangapū Pēke (NZBA), to develop a pilot programme called Te Rito Hou, a financial wellbeing programme aimed at providing Māori with trusted information so that they can make good financial decisions for their whānau. The programme also includes connecting whānau with local bankers to create a trusted connection and further break down barriers in relation to financial services. Te Rito Hou is delivered through Sorted.[268] The programme has been created for Māori by Māori.[269]

3.43.2 Separate to Te Rito Hou, Sorted Kāinga Ora is a programme that builds the financial capability of whānau so they can make choices about how to meet their housing aspirations. It was developed jointly by Te Puni Kōkiri and the Retirement Commission.[270]

3.43.3 Individual banks are independently taking a range of approaches to the issue of financial literacy. Some have generic financial literacy programmes while others have programmes that are specifically targeted at and created for Māori. Some have stated an intent to create programmes specifically for Māori.[271]

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267 ANZ, Submission on draft report (18 April 2024), para 234; [ ]; ASB, Submission on Preliminary Issues paper (7 September 2023), para 4.2; [ ], [ ].

268 NZBA "Wānanga launched to support whānau financial literacy" (14 September 2023), https://www.nzba.org.nz/2023/09/14/wananga-launched-to-support-whanau-financial-literacy/

269 [ ].

270 Te Puni Kōkiri "Financial capability programmes – Sorted Kāinga Ora" (6 December 2022), https://www.tpk.govt.nz/en/nga-putea-me-nga-ratonga/maori-housing-support/financial-capability-programmes-sorted-kainga-ora

271 ASB, Submission on Preliminary Issues paper (7 September 2023), para 4.4(b)(ii)–(iii); [ ]; [ ], [ ].

3.44 Improving the financial literacy of whānau Māori was one of the suggested solutions to access issues that was discussed at our wānanga.[272] Te Poutokomanawa, contributing to financial literacy of Māori, is one of three Tāwhia pou.[273]

3.45 Financial literacy is certainly not an issue unique to Māori (we discuss financial literacy with respect to all New Zealanders in Chapter 2 and Attachment D). We support the efforts around financial literacy being undertaken by providers of personal banking services to date and encourage the continuation of such initiatives.

Addressing lack of Māori representation in the supply of personal banking services

3.46 Some providers of personal banking services have told us they are focused on increasing Māori representation in the banking sector, including in particular:

3.46.1 in leadership roles;[274]

3.46.2 by setting targets for representation of Māori within their business;[275] and

3.46.3 by supporting career pathways, internships and graduate programmes for Māori.[276]

3.47 We are aware of BlinkPay, a payments fintech, that describes itself as Māori-owned, managed and funded.[277] However, we are not aware of any other Māori-owned or Māori-led providers of personal banking services (aside from iwi savings schemes), and attendees at our wānanga were not aware of any others either.[278]

3.48 Increasing Māori representation in the supply of personal banking appears to have scope to address some of the access issues we heard at the wānanga, including issues around suspicion and perception of racial profiling, trust in institutions and lack of understanding of Māori cultural and whānau dynamics.[279] Working with the financial sector to boost Māori employment across banks aligns to the Tāwhia pou Te Pou Tū-a-rongo.[280]

272 Commerce Commission "Summary of views expressed – Te Komihana Tauhokohoko wānanga – Competition for personal banking services in New Zealand" (14 February 2024), p. 7.

273 NZBA "Wānanga launched to support whānau financial literacy" (14 September 2023).

274 [ ]; Kiwibank, Submission on Preliminary Issues paper (7 September 2023), p. 12.

275 Kiwibank, Submission on Preliminary Issues paper (7 September 2023), p. 12.

276 ASB, Submission on Preliminary Issues paper (7 September 2023), para 4.2; [ ].

277 See https://www.blinkpay.co.nz/

278 Commerce Commission "Summary of views expressed – Te Komihana Tauhokohoko wānanga – Competition for personal banking services in New Zealand" (14 February 2024), p. 8.

279 Commerce Commission "Summary of views expressed – Te Komihana Tauhokohoko wānanga – Competition for personal banking services in New Zealand" (14 February 2024), p. 7.

280 See https://www.linkedin.com/company/t%C4%81whia-m%C4%81ori-bankers-r%C5%8Dp%C5%AB/

3.49 We were told at the wānanga that Māori-owned or Māori-led providers of personal banking services might result in more active participation from whānau in personal banking. We were also told that Māori-owned or Māori-led providers of personal banking services would help make the banking system easier for Māori to navigate and that there would be increased opportunity for Māori to be employed and advance their careers in the sector.[281]

3.50 We support efforts by personal banking service providers to increase Māori representation in the supply of personal banking services. These initiatives are aligned with the Reserve Bank's broader support of the promotion of greater representation of Māori across the governance, leadership and operation of organisations as a potential pathway to address decision making by financial service providers – and in particular banks – in relation to Māori access to capital.[282]

Other initiatives we are aware of

3.51 There are other initiatives in place that we consider may address the issues that Māori face.

3.51.1 The Reserve Bank is investigating suitable indicators for financial inclusion, which would assist with data collection on Māori accessing personal banking services.[283]

3.51.2 Other initiatives that are not specifically targeted at Māori but at all consumers that we believe may address some of the issues that Māori face are set out in Chapter 2 and Attachment D. These include greater access to bank accounts, physical bank branches and financial literacy initiatives.

281 Commerce Commission "Summary of views expressed – Te Komihana Tauhokohoko wānanga – Competition for personal banking services in New Zealand" (14 February 2024), p. 9.

282 Reserve Bank "Public Feedback on Improving Māori Access to Capital Issues Paper – Summary of Submissions" (October 2022), p. 7, https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/consultations/maori-access-to-capital/public-feedback-on-improving-maori-access-to-capital-issues-paper.pdf

283 [ ].

Our engagement process and the importance of tikanga | *Tā mātou tukunga whakaanga me te hirahira o te tikanga*

Historical and cultural context are relevant to how Māori interact with personal banking services

3.52 We've heard that tikanga Māori is important and relevant to understanding Māori interactions with personal banking services.[284,285] The importance of tikanga in the context of personal banking services was also a theme of discussion at our wānanga.[286]

3.53 The literature search we have undertaken suggests that, although approaches and attitudes will vary, traditional Māori values can still be relevant to the ways in which many Māori carry out economic activity (including personal banking and finances).[287,288] In particular, whānau relationships are a key driver of attitudes and behaviour towards money. Sharing and lending money to whānau, travelling to spend time with whānau and contributing financially to collective whānau needs are commonplace.[289] In addition, money is often used to support and benefit the larger family group as well as for individual purposes, leading to micro-economies within whānau with income, expenses and assets shared through a kaitiaki approach.[290]

3.54 This is in contrast with what has been described as the predominant European/Pākehā approach to economic activity and attitudes and behaviour towards money and wealth. This has been described as more individualistic, focusing on the dependent nuclear family, with the general belief that money gifts are only acceptable between close family members and individual responsibility for money is emphasised.[291]

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284 Tikanga is the customary system of values and practices that has developed over time and is deeply embedded in the Māori social context. Tika means correct or right. It captures the norms for Māori across concepts such as culture, protocols, guidelines, etiquettes, ethics and law. To understand tikanga is to be able to be culturally competent.

285 [ ];
[ ];
[ ].

286 Commerce Commission "Summary of views expressed – Te Komihana Tauhokohoko wānanga – Competition for personal banking services in New Zealand" (14 February 2024), pp. 8 and 12.

287 Carla Houkamau and Chris Sibley. "The role of culture and identity for economic values: a quantitative study of Māori attitudes" *Journal of the Royal Society of New Zealand* 49(S1) (2019), 118–136; Carla Houkamau, Alexander Stevens, Danielle Oakes and Marino Blank "Embedding tikanga Māori into financial literacy training for Māori" (March 2020).

288 Manaakitanga – caring for others, generosity; mana – power, status, influence; whanaungatanga – whakapapa-based relationships; utu – balance, reciprocity.

289 Carla Houkamau, Alexander Stevens, Danielle Oakes and Marino Blank "Embedding tikanga Māori into financial literacy training for Māori" (March 2020), p. 2.

290 Carla Houkamau, Alexander Stevens, Danielle Oakes and Marino Blank "Embedding tikanga Māori into financial literacy training for Māori" (March 2020), p. 4; [ ]; Kiwibank, Submission on Preliminary Issues paper (7 September 2023), p. 4.

291 Carla Houkamau, Alexander Stevens, Danielle Oakes and Marino Blank "Embedding tikanga Māori into financial literacy training for Māori" (March 2020), pp. 3–4.

3.55 These descriptions of Māori and European/Pākehā world views are, by necessity, generalisations that obscure diversity within and overlap between these two groups. These different world views appear to manifest themselves as different preferences held by some Māori with regards to personal banking services. This can raise some distinct issues for Māori when seeking those services, which we outlined earlier in this chapter.

We sought a diverse range of perspectives on how competition is working for Māori in the supply and acquisition of personal banking services

3.56 The Commission met and listened to a wide range of stakeholders across providers and consumers of personal banking services as well as interested parties such as government agencies and advocacy groups to understand how competition is impacting Māori. These engagements include:

3.56.1 a wānanga, held in October 2023, which included participants who brought a consumer, entrepreneurial and community provider perspective on competition issues affecting Māori in the personal banking sector;[292]

3.56.2 engagement with Tāwhia, the Māori bankers' rōpū, which consists of senior Māori representatives from ANZ, ASB, BNZ, Heartland Bank, Kiwibank, TSB and Westpac;

3.56.3 engagement with other public sector agencies, including the Reserve Bank, the Treasury Te Tai Ōhanga, the Ministry of Housing and Urban Development and Te Puni Kōkiri on their related work on improving access to capital and housing outcomes for Māori;[293]

3.56.4 a panel discussion on promoting competition for lending on Māori freehold land at our consultation conference held on 13–15 May 2024;[294]

3.56.5 a literature search on historical and current Māori interactions with banking and personal finance; and

3.56.6 engagement with consumer organisations that assist Māori (and other consumer groups) to navigate personal banking services and access housing.

292 We have published a summary of the views expressed at the wānanga: Commerce Commission "Summary of views expressed – Te Komihana Tauhokohoko wānanga – Competition for personal banking services in New Zealand" (14 February 2024).

293 While there is an interrelationship between these agencies' work and ours, our work more narrowly focuses on personal banking services as a means through which individuals may access capital and consequentially obtain housing, and we apply a competition lens to our work.

294 We have published transcripts of our conference, including the panel discussion, on our website: https://comcom.govt.nz/about-us/our-role/competition-studies/market-study-into-personal-banking-services?target=documents&root=353730

3.57 The views we heard do not represent all Māori. Māori are a diverse group, and many Māori may be satisfied with their personal banking products and services. However, the engagement we have had and the research we have drawn on have often focused on where these services do not work for Māori.

Chapter 4 Competition for home loans | *Te whakataetaetanga mō ngā pūtea tārewa kāinga*

Summary of findings

- **Home lending is the most important personal banking product for those with mortgages or looking to buy a first home.** It is also the most important personal banking service for providers by size of portfolio and contribution to overall revenue. The major banks and Kiwibank collectively represent about 95% of all home lending by registered banks.
- **It is difficult and time consuming for consumers to compare products between lenders.** Although headline interest rates are clearly advertised, cashbacks offers and below-the-line discretionary discounts affect the total cost of lending. Discretionary discounts are common and support price matching practices (rather than price beating) to win or retain customers.
- **Actual offers depend on customers' personal and lending characteristics and how effectively they engage with lenders to shop around.** Each bank has credit settings that affect willingness to lend and are largely undisclosed to consumers. Decisions on price, loan size and loan availability reflect individual circumstances, in large part to meet prudential and other regulatory requirements. They also reflect the effort customers put in to negotiate hard on prices.
- **Mortgage advisers are increasingly being used by customers to navigate the complexity.** They assist customers with the process of obtaining a home loan and can help find lenders who are willing to fund loans that are less straightforward.
- **Although the best way to negotiate a good deal is to shop around, customers seldom do.** Around half of customers consider only one bank when they first choose their home loan provider. This inertia serves to reinforce the market positions of the major banks. Customers looking to switch an existing mortgage may face additional barriers, including from break fees, clawback of cashback offers and mortgage adviser fees.
- **Manual bank processes make it time consuming to shop around despite the time-sensitive nature of home loan applications.** To compare actual offers, consumers (and advisers) must lodge loan applications with multiple providers. Manual processes and a lack of standardisation between banks make the process needlessly time consuming, particularly for customers under time pressure to secure finance. This contrasts with better processes in Australia. Furthermore, lender practices that discourage advisers from lodging multiple loan applications per client throttle their ability to shop around on a client's behalf.
- **Mortgage advisers should become champions of price competition while continuing to provide holistic financial advice.** Banks' processes need to improve to make it easier for mortgage advisers to focus on price and choice of provider. Where possible, advisers should present at least three actual offers. Mortgage advisers should highlight gaps in their panel to clients and identify any superior headline rates offered by providers outside of their panel.

Introduction | *Whakatakinga*

4.1 This chapter discusses:

4.1.1 the importance of competition in home lending;

4.1.2 key features of competition for home lending in New Zealand;

4.1.3 consumer engagement and shopping around;

4.1.4 reducing barriers to price discovery;

4.1.5 reducing barriers to assessing information;

4.1.6 reducing the cost of switching; and

4.1.7 how mortgage advisers could help drive stronger competition for home loans.

The importance of competition in home lending | *Te hirahira o te whakataetaetanga mō te tuku moni taurewa kāinga*

4.2 For people and households with mortgages or looking to buy a first home, home lending is undoubtedly the most important personal banking service. This is because mortgage payments will be a large ongoing expense and so the financial ramifications of decisions, including how much to borrow and how long to fix a mortgage, have a big impact on household expenses over a short period of time.

4.3 Most New Zealand households with mortgages have recent first-hand experience of the potential impacts of unexpected interest rate increases. Interest rates increased in New Zealand from mid-2021, driven by the Reserve Bank's tightening monetary policy.[295] This flowed through to sharp increases in mortgage payments when households rolled off existing fixed-term interest rates.[296] In 2023 alone, average mortgage payments increased by 27% to over $600 per week, eclipsing the 5% increase a year earlier and the average 3% increase since 2008.[297] In this context, strong competition in the home loan market is more important than ever.

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295 Reserve Bank "Financial Stability Report" (3 May 2023), p. 16, https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/publications/financial-stability-reports/2023/may-2023/fsr-may-23.pdf

296 As discussed below, home loan customers in New Zealand predominantly take out fixed rate loan terms of 1-year and 2-year durations. The predominance of short-term fixed interest rates in New Zealand means that increases in the cost of lending flow through to households relatively quickly.

297 Stats NZ "Household income and housing-cost statistics: Year ended June 2023", Table 9, https://www.stats.govt.nz/information-releases/household-income-and-housing-cost-statistics-year-ended-june-2023/ [ ]

4.4 While there are real and perceived costs of switching, the potential gains from being engaged in the market and making informed decisions can be significant. This includes direct benefits through relatively lower interest rates over the long term for individual consumers as well the flow-on effects of increased competition more generally. Whether or not consumers switch, a more credible threat of switching can place demand-side pressure on lenders to innovate and offer better products and lower prices to attract and retain borrowers.[298] There is then the potential for those benefits to flow through to those who are less engaged.

4.5 For banks, home lending is the most important product for personal banking due to both the size of the portfolio and its contribution to overall revenue.[299] Providers describe home lending as the key value driver in their business.[300] Home lending is a large and growing proportion of banks' activities. In March 2024, home lending represented about 65% of total lending and about 53% of the total assets of registered banks in New Zealand (up from 58% and 49%, respectively, in March 2018). This means that registered banks are lending relatively less to the productive economy (for example, business and agricultural lending) and relatively more to housing than in the past.[301]

4.6 Home lending customers are even more valuable to banks than the home loans they take out. That is because these customers are more likely to have a deeper range of personal banking products with their provider and are therefore more sticky and less likely to switch providers (once their home loan is established).[302] Within this customer segment, first-home buyers are often a target group for providers, described by one provider as "incubat[ors] of future bank value".[303]

298 ACCC "Home loan price inquiry – Final report" (November 2020), p. 5, https://www.accc.gov.au/system/files/Home%20loan%20price%20inquiry%20-%20final%20report.pdf

299 Commerce Commission "Personal banking services market study – Draft report" (21 March 2024), paras 4.2–4.3 and Figure 4.1.

300 [ ].

301 As at March 2024, business and agricultural lending represented 20% and 11% of registered banks' total lending respectively. [ ].

302 [ ]; [ ].

303 [ ].

The major banks dominate home lending supply

4.7 The vast majority of home lending is provided by the major banks and Kiwibank, representing about 95% of home lending by all registered banks in December 2023. ANZ has the largest home lending portfolio (with about 30% of lending), followed by ASB (21%), Westpac (19%) and BNZ (16%). Kiwibank is the next largest at 7% of total residential mortgage lending, followed by TSB (2%) and SBS Bank (1%). The remaining registered banks make up about 2% of residential mortgage lending.[304]

4.8 NBDTs and non-bank institutions that are not funded with deposits also supply home loans, although the stock of loans provided by this group is very small compared to the portfolios of registered banks.[305] As noted by the Reserve Bank, non-deposit-taking lenders complement the lending activities of the banking sector by providing loans to borrowers who cannot meet the requirements to obtain a loan from a bank. Some of these borrowers have higher credit risk. This is reflected in the lending rates of these institutions, which tend to be higher than bank lending rates.[306] These providers are not competing head to head with banks but perform an important role in the broader ecosystem in enabling access to finance.

Key features of competition for home lending in New Zealand | *Ngā tino āhuatanga o te whakataetaetanga mō te tuku moni taurewa kāinga i Aotearoa*

Relatively complex product offerings make comparisons difficult

4.9 Searching for a home loan and assessing the value of different products can be a daunting process. Regardless of whether a customer is looking for new lending (such as a first-home buyer) or is looking to shop around to refinance an existing mortgage, it is difficult and time consuming for consumers to compare products between lenders.

4.10 While banks advertise headline interest rates to consumers, there are a number of complex product features that make it hard for consumers to make like-for-like price comparisons. Consumers must consider the following.

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304 Figures calculated for all residential mortgage lending, including to owner-occupiers and property investors. New Zealand incorporated companies only (for example, using ANZ rather than ANZ Group data). Reserve Bank "Bank Financial Strength Dashboard" (30 September 2023), series id DBB.QIC20.P1. [ ].

305 Examples of non-deposit-taking lenders include Pepper Money and Simplicity. Reserve Bank data, comparing non-bank housing lending of $6.3b with total owner-occupied lending of $259.3b in December 2023. Reserve Bank "Registered banks and non-bank lending institutions: Sector lending" (31 December 2023), series Id CRD.MNA311; Reserve Bank "Banks: Assets – Loans by purpose" (31 December 2023), series Id BSPA.MAM2A4.P1. [ ].

306 Some borrowers switch from non-bank lenders to banks when they have established a better credit history. Reserve Bank "Lending by non-deposit-taking institutions" (2 November 2022), https://www.rbnz.govt.nz/hub/publications/financial-stability-report/2022/nov-2022/fsr-nov-22-box-d

4.10.1 Whether to fix interest rates for an agreed period. In New Zealand, advertised or headline fixed interest rates are typically lower than headline variable rates.[307] In 2023, about 90% of new home lending to owner-occupiers was fixed-term lending mostly of 1-year and 2-year durations.[308]

4.10.2 Whether to break their mortgage up into tranches with different fixed or variable interest rates. Home loan customers can arrange their lending into tranches to manage exposure to interest rate changes.[309] As of August 2023, about half of new home lending to owner-occupiers was split into two or more tranches.[310]

4.10.3 Whether to accept a cashback offer. Cashback offers (often called cash contributions) are a popular feature for home lending customers.[311] Offers are typically a percentage of the loan amount up to a maximum or a fixed amount (for example $5,000 for first-home buyers). Cashback offers reduce the effective interest rate[312] being offered to consumers but must typically be repaid (or clawed back) if consumers switch to another provider within a set period (such as 3 years).[313]

4.11 Borrowers also need to decide how much value they place on non-price or service quality features that differentiate lenders.

4.11.1 Home loan application turnaround times. This can be a deal breaker for time-sensitive applications.[314]

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307 According to the Reserve Bank, there has only been one instance of average advertised variable rates being lower than short-term fixed rates from 2004 to 2024. This was in March 2011, around the time of the Canterbury earthquakes. Reserve Bank "New residential mortgage standard interest rates (B20)" (5 July 2024), https://www.rbnz.govt.nz/statistics/series/exchange-and-interest-rates/new-residential-mortgage-standard-interest-rates

308 Commerce Commission "Personal banking services market study – Draft report" (21 March 2024), Figure 4.4.

309 For example, we heard that "tranche lending is done to hedge and safeguard the clients' personal budgets from increases in interest rates. The last few years have been a good example of this, where interest rates have doubled for some households.": Hamish Patel (Mortgages Online), Submission on draft report (17 April 2024), p. 2.

310 Calculated from data provided confidentially to the Commission by banks. [ ].

311 Commerce Commission "Personal banking services market study – Draft report" (21 March 2024), Figure 4.8. The average cashback on new home lending was 0.9% of lending in August 2023, which was a significant increase from 2020.

312 As noted at paragraph 4.89, we heard from banks that cashback offers are considered quite separately from interest rates and are not considered as a package.

313 We discuss issues relating to commission clawback below.

314 We heard from a number of parties at the consultation conference about the importance of loan turnaround times. For example, Antonia Watson, ANZ CEO, stated: "Turnaround times we've just talked about. That is a massive point of competition sometimes. If one bank is taking two weeks to turn something around and a customer's there going "well, I need to know now if I can buy this house" and another bank can turn it around in a day or two, that's a big strong point of competition.": Commerce Commission "Day 3 Personal banking services market study conference – Session 8 Mortgage advisers" (15 May 2024), p. 16 (lines 9–12).

4.11.2 Online experiences. This includes the ability to easily refix interest rates when fixed rate periods expire.[315]

4.11.3 The availability of branches, in-person services and advice more generally.

4.11.4 Brand awareness and loyalty promoted through advertising and marketing strategies.

4.11.5 Preferences or requirements[316] to consolidate all personal banking services with one provider.[317]

4.12 As we discuss below, the common practice of discretionary discounting of interest rates and variations in lenders' willingness to lend to different customers (or credit policies) mean that consumers need to make loan applications to know if finance is available and to get actual interest rates for their circumstances. This compounds the challenges for consumers to shop around.

Discretionary discounting is a common feature of competition for home loans

4.13 While all banks advertise headline interest rates, the actual home loan interest rates that an individual consumer may be offered can vary significantly from these headline rates. Actual offers depend on a customer's personal and lending characteristics and how effectively they engage with lenders to shop around.

4.14 Discretionary discounts (guided by credit policy settings, discussed below) are what enable banks to "make a risk-based decision for every single home loan".[318] Banks stress that individual decisions on price, loan size and loan availability need to reflect individual circumstances,[319] in large part to meet prudential and other regulatory requirements (discussed further in Chapter 7).

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315 This was an area discussed at the market study conference. For example, comments made by Dan Huggins, ASB CEO: Commerce Commission "Day 3 Personal banking services market study conference – Session 8 Mortgage advisers" (15 May 2024), p. 18 (lines 1–4).

316 As discussed in Chapter 8, banks require home loan customers to also have a transaction account with their home loan provider, and some special offers are conditional on the customer's salary being direct credited to that transaction account.

317 Consumer preferences will also be influenced by impressions of different experiences with lenders' websites, online banking, phone apps and payment options as well as the options of easily refixing interest rates when fixed rate periods expire.

318 Antonia Watson: Commerce Commission "Day 3 Personal banking services market study conference – Session 9 Consumer experiences" (15 May 2024), p. 11.

319 Antonia Watson and Dan Huggins: Commerce Commission "Day 3 Personal banking services market study conference – Session 9 Consumer experiences" (15 May 2024), p. 11.

4.15 More pertinently to competition, these discretionary discounts are also used to attract new customers and retain existing customers that are willing to shop around. Providers can compete harder for these customer segments at the same time as retaining the ability to use less-competitive interest rates (headline rates or offering smaller discounts) for customers who are less price sensitive, are locked in by their circumstances or are otherwise considered less valuable.[320]

4.16 Banks' discretionary discount policies typically set a minimum interest rate (or interest rate floor) that can be offered to the customer.[321] Major banks typically set their pricing discretions so they can price match any written or advertised fixed rate offer from the other major banks or Kiwibank (discussed further in Chapter 2).

4.17 Discretionary discounts are offered selectively to customers who meet certain criteria, which may include proving evidence of a competing offer in writing (if that offer is below the advertised fixed rate).[322] In these situations, there is a very foreseeable possibility of the customer taking their business elsewhere.

4.18 Discretionary discounting and cashback offers also serve as retention strategies.[323] Providers can often identify customers who are at risk of refinancing (for example, because they ask for a settlement statement or because they are rolling off their fixed term) and use the opportunity to offer these customers preferential interest rates or retention cash contributions to preserve these relationships. We understand it is common for banks to proactively offer customers coming up for fixed term renewal some form of discretionary discounts and options that can be actioned directly through the bank's app and/or internet banking platform.[324]

4.19 Discretionary discounts and cashback offers provide flexibility for bank staff to offer more favourable pricing for consumers as part of negotiations either directly with the bank or through a mortgage adviser (we discuss the increasing role of mortgage advisers below). Many of the banks have discounting policies that allow more-senior employees to offer larger discounts, meaning requests for discounts are progressively escalated to senior staff.[325]

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320 In Australia, the ACCC also pointed to this observation: "One Inquiry Bank has stated that this enables it to attract and retain borrowers through actions such as offering larger discounts to borrowers who might otherwise switch to another lender, while limiting discounts to those borrowers who are considered unlikely to switch.": ACCC "Residential mortgage price inquiry – Interim report" (15 March 2018), p. 20, https://www.accc.gov.au/system/files/Residential%20Mortgage%20price%20inquiry%20interim%20report.PDF?ref=0&download=y

321 [ ].

322 [ ].

323 [ ].

324 For example, ANZ and ASB offer automatic discretionary discounts through internet banking: CRA [for ANZ] "Personal Banking Services Market Study – Comments following conference" (4 June 2024), para 25; and Commerce Commission "Day 1 Personal banking services market study conference – Session 1 Competition in personal banking" (13 May 2024), p. 19 (lines 28–32).

325 [ ].

4.20 Our analysis of home loan data found that discretionary discounting is a common feature of competition for home loans in New Zealand, particularly for the larger banks. Most lending (by volume) was associated with a discount,[326] and the major banks were more likely to offer discretionary discounts than smaller banks.[327] In contrast, smaller banks need to offer market-leading headline rates to attract customers and win market share.[328]

Credit policies add further complexity for consumers

4.21 At any point in time, banks and other lenders tightly control who they are willing to lend to and on what terms through credit policy settings. We heard from mortgage advisers that this affects which banks they can take applications to at different times, borrowing amounts and home loan structures.[329] Banks and advisers both noted the importance of credit policy settings to how competition currently works for home loans.[330]

4.22 In recent years, the most conspicuous credit policy affecting home loan borrowers has been the LVR. The LVR is a measure of how much a bank lends against a mortgaged property compared to the market value of that property at the time of lending. For many years, banks have restricted lending availability to customers with lower deposits[331] in response to Reserve Bank LVR restrictions[332] while offering lower interest rates for borrowers with more than 20% deposit.[333] Cashbacks are also substantially higher on average for low LVR customers.[334]

326 Using data provided confidentially to the Commission by banks, we calculated that recently about 50–60% of lending (by volume) was associated with a discount. [ ].

327 Calculated from data provided confidentially to the Commission by banks. [ ].

328 Commerce Commission “Personal banking services market study – Draft report” (21 March 2024), paras 4.83–4.85.

329 For example, FAMNZ, Cross-submission on draft report (30 May 2024), p. 3.

330 See for example, Karen Renwick (Mortgage Link Albany), Submission on draft report (18 April 2024), p. 1; and Antonia Watson: Commerce Commission “Day 3 Personal banking services market study conference – Session 8 Mortgage advisers” (15 May 2024), p. 16 (lines 1–8).

331 A point raised in a cross-submission: Andrew Perry (Mortgage Market), Cross-submission on draft report (23 May 2024), p. 1.

332 The Reserve Bank imposes restrictions on how much new low-deposit lending banks can make. LVR restrictions were first introduced in 2013 “in response to rapid house price growth, especially in Auckland, accompanied by a sharp increase in the use of low-deposit loans”. The Reserve Bank temporarily removed LVR restrictions from April 2020 to 1 March 2021 to “ensure they did not interfere with COVID-19 policy responses”: Reserve Bank “Loan-to-value ratio restrictions” (1 July 2024), https://www.rbnz.govt.nz/regulation-and-supervision/oversight-of-banks/standards-and-requirements-for-banks/macroprudential-policy/loan-to-value-ratio-restrictions

333 This tends to be implemented through a low equity margin or premium on top of standard interest rates for high LVR loans. See for example (as of 24 July 2024) ASB “Low Equity Margin (LEM)”, https://www.asb.co.nz/lending/aia-interest-rates-fees.html; and ANZ “Low Equity Premium (LEP)”, https://www.anz.co.nz/rates-fees-agreements/home-loans/

334 Commerce Commission “Personal banking services market study – Draft report” (21 March 2024), Figure 4.8.

4.23 On 1 July 2024, the Reserve Bank loosened LVR restrictions while activating new debt-to-income (DTI) restrictions for residential lending. The Reserve Bank expects that:[335]

> …[the new] restrictions are likely to bind most on investors and higher-income owner-occupiers, who borrow at higher DTI ratios on average. They would bind least on first-home buyers and lower income owner-occupiers, who generally borrow at lower DTI ratios. In addition, the DTI framework incorporates an exemption for Kainga Ora First Home Loans, which are only available to first-home buyers whose income falls below a certain threshold.

4.24 The new DTI restrictions and loosening of LVR restrictions will undoubtably have material consequences for lender credit policy settings.

4.25 Lender credit policies also include the following.[336]

4.25.1 Existing bank relationships. It is often much easier to get lending from a customer's existing main bank. We heard that, on occasion, a customer's main bank may be the only home loan provider willing to lend.[337]

4.25.2 Owner-occupier versus investors. With the introduction of DTI ratios, we may see higher interest rates for investors.

4.25.3 Risk of disaster (earthquake prone, leaky building, flood risk). Lenders will typically avoid lending altogether in many cases.

4.25.4 Reverse mortgages. Only a small number of providers such as Heartland Bank[338] offer reverse mortgages, and where they are offered, the interest rates are typically higher than those available for lower-risk lending.

4.26 With the exception of differential rates by LVR,[339] credit policy settings are largely internal to the banks and not disclosed to consumers, yet they can be the factor that determines whether an applicant obtains a loan and/or the amount of the loan. The need to take a loan application to the point where a bank applies its credit settings and makes an offer increases the time and effort involved with shopping around for consumers who are often under pressure to secure finance in order to make an unconditional offer.

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335 Reserve Bank "Framework for Debt-to-Income Restrictions – Regulatory Impact Assessment" (3 April 2023), para 30, https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/consultations/banks/debt-serviceability-restrictions/dti-framework-regulatory-impact-assessment.pdf

336 [ ]

337 For example, Karen Renwick (Mortgage Link Albany), Submission on draft report (18 April 2024), p. 7.

338 See Heartland Bank "Heartland Reverse Mortgages", https://www.heartland.co.nz/reverse-mortgage

339 We note that New Zealand banks only typically advertise different rates for above and below 80% LVR (or equivalently advertise a low equity premium on standard rates). In contrast, Australian banks often advertise rates for more disaggregate LVR categories. For example, Westpac Australia advertises different rates for <20, 20–30 and ≥30 LVR by owner-occupier or investor status: Westpac "Home Loan Interest Rates", https://www.westpac.com.au/personal-banking/home-loans/all-interest-rates/

4.27 To compare actual offers, consumers (or mortgage advisers, discussed below) must lodge loan applications with multiple providers. Borrowers cannot easily determine which lenders are likely to lend to them and by how much without making enquiries direct with multiple lenders.

4.28 While lower-risk borrowers may be able to rely on advertised rates as an indication of lender availability, more complex and higher-risk borrowers may find that largely undisclosed credit policies make them ineligible for lending at the advertised rate (let alone being eligible for an additional discretionary discount).

Mortgage advisers are increasingly being used to navigate the complexity

4.29 Consumers that understand the value of shopping around, including those that are aware of the existence of discretionary discounting and/or understand credit policies and wish to compare offers, face a choice of either going it alone and applying for loans with multiple banks or using mortgage advisers. Mortgage advisers are intermediaries that recommend home loans to prospective borrowers and submit loan applications to lenders on borrowers' behalf.

4.30 As shown in Figure 4.1, as of August 2023, about two-thirds of new home lending to owner-occupiers by value occurred through mortgage advisers. Mortgage advisers are a key distribution channel for home loan providers, accounting for a rapidly increasing proportion of home lending. In 2014, just under 30% of new lending and about 11% of repriced lending was facilitated via advisers. By 2023, those figures had increased to 66% and 20%, respectively (Figure 4.1). This trend mirrors the rise of advisers in Australia and the UK.[340]

4.31 In Australia, mortgage advisers have supported smaller banks to compete more effectively in home lending. There, advisers are increasingly recommending non-major lenders to borrowers, citing the more compelling interest rate offers of these smaller providers.[341]

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340 Mitch Kornman, Nuno Meneses, Joydeep Sengupta and Ben Stretch "Brokering growth in the mortgage market" (16 November 2023), https://www.mckinsey.com/industries/financial-services/our-insights/brokering-growth-in-the-mortgage-market

341 Broker Pulse "Non-majors lead on pricing as rates rise" (22 January 2023), https://www.brokerpulse.com.au/news/non-majors-hold-lead-on-pricing-as-rates-rise

4.32 Macquarie Bank provides one notable example. Success in the adviser channel has been a key part of Macquarie Bank's rapid growth in home lending in Australia over the last decade[342] where it has emerged as a competitive maverick.[343] To achieve this growth, Macquarie Bank committed to delivering strong service through the adviser channel.[344,345]

4.33 We do not observe a similar prevalence of non-major bank lending through the adviser channel in New Zealand. Mortgage adviser-led lending volumes mostly go to the major banks and Kiwibank, broadly in proportion with their existing shares of supply in home lending.[346]

4.34 Mortgage advisers have the potential to help consumers navigate complex and ever-changing product offerings[347] and make the total cost of borrowing (including interest rates) more transparent. This is because a well-informed adviser will have up-to-date information about the home loan deals available through each lender (including discretionary discounts that are not publicly available).

4.35 An adviser should also be able to help clients understand the pros and cons of different service offerings and in many instances supplant the face-to-face services that banks would otherwise offer through their in-house channel.

4.36 Advisers can also play a role in helping consumers navigate credit policy settings, matching more complex or high-risk borrowers with providers that are willing to lend. We heard from advisers that they often match borrowers who have struggled to get lending approved from larger banks with smaller lenders.[348]

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342 Karen Maley "Macquarie unveils its major mortgage market ambitions" (13 February 2024), https://www.afr.com/companies/financial-services/macquarie-unveils-its-major-mortgage-market-ambitions-20240213-p5f4k6

343 Australian Competition Tribunal "ACT 1 of 2023: Summary of reasons for determination" (20 February 2024), para 17.

344 Charbel Kadib "Macquarie CEO holds firm on broker support" (6 May 2019), https://www.theadvisor.com.au/breaking-news/39069-macquarie-ceo-holds-firm-on-broker-support

345 Macquarie Bank also ranked first for two consecutive years in the Mortgage Professional Australia Brokers on Banks survey: MPA "Brokers on Banks 2022"(March 2022), https://www.mpamag.com/au/best-in-mortgage/brokers-on-banks-2022/398757; Antony Field "Revealed: The winners of Brokers on Banks 2023" (21 March 2023), https://www.mpamag.com/au/news/general/revealed-the-winners-of-brokers-on-banks-2023/440058

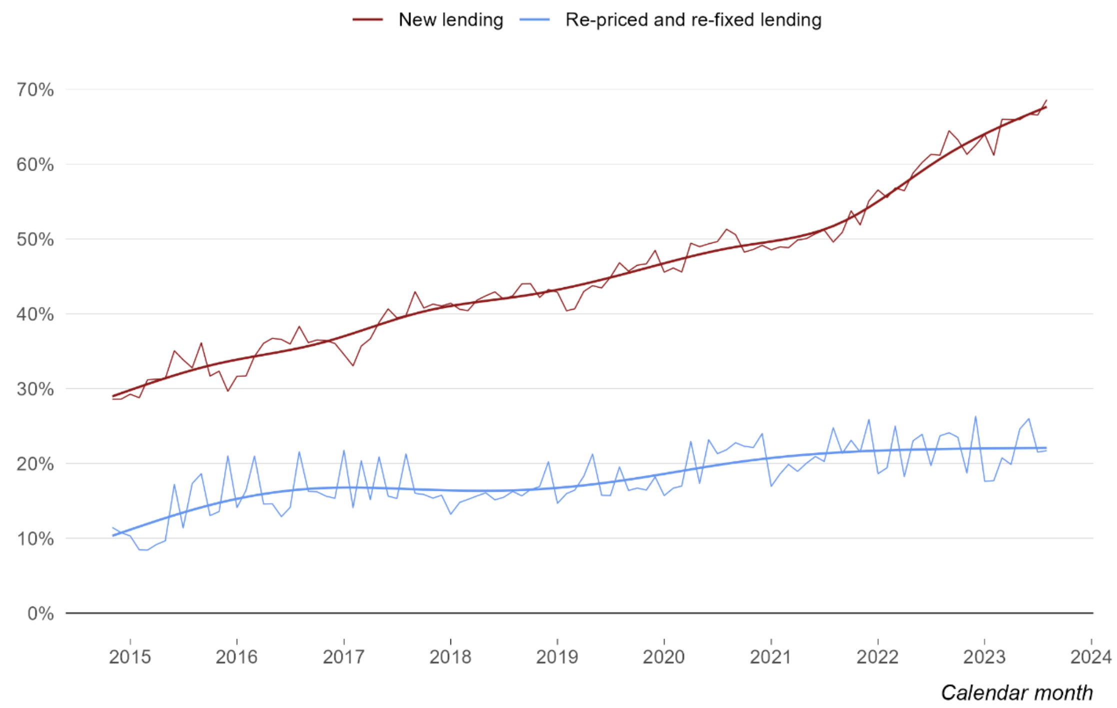
346 [ ].

347 A point noted by Sarah Curtis in a submission on our draft report: "New Zealanders don't have the time, knowledge or ability to keep up with the fast-paced changes we see in the industry. Lending policies, criteria and terms offered by respective institutions can and frequently do change, making it difficult for a consumer to stay current & informed if they complete their own research. As your figures suggest more consumers are seeking the support of advisers, and these could well be the root causes." Sarah Curtis (Sarah Curtis Mortgages and Insurance), Submission on draft report (18 April 2024), p. 1.

348 [ ].

4.37 It is worth noting that banks' pricing policies generally treat customers the same regardless of channel.[349] That is, for a specific customer risk profile, a customer could in theory access the same minimum interest rates as a mortgage adviser could. The implication of this is that, for an adviser to get the best rates for their client, they still need to shop around or, as discussed below, use their market knowledge to negotiate a lower rate (see from paragraph 4.63).

Figure 4.1 Mortgage adviser proportion of floating and fixed-term lending up to 2 years to owner-occupiers (monthly values and smoothed trends)



Source: Calculated from data provided by banks to the Commission.[350]

4.38 Mortgage advisers are predominantly paid by commissions from lenders rather than charging consumers directly for their services. This includes upfront and trail commissions.

4.38.1 Upfront commissions are calculated as a proportion of the loan principal (paid by the lender when the loan is taken out).

4.38.2 Trail commissions are calculated as a proportion of the loan principal (paid by the lender each month while the loan is active).

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349 [ ]; [ ].

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4.39 Trail commissions are regular payments calculated as a proportion of the loan principal and paid by the lender to the adviser (via the relevant aggregator) each month while the loan is active. We heard that trail commissions remunerate advisers for providing ongoing services to their clients such as advice on refixing or restructuring options over the life of the home loan.[351]

4.40 The structure and level of commissions vary between lenders. Some lenders only offer upfront commissions, while others offer a combination of upfront and trail commissions. For example, Mortgage Lab has published some information about commission rates across providers on its website, as of 21 June 2022, set out in Table 4.1 below. In general, Table 4.1 was representative of commission structures in the industry at the time, but commissions by lender can vary between mortgage aggregator groups.[352]

351 The FMA has been clear to advisers that this is their expectation: Link Financial Group, Submission on draft report (18 April 2024), p. 4.

352 [ ].

Table 4.1 Commission structures of home lending providers according to mortgagelab.co.nz, 21 June 2022

Lender	Upfront	Trail	Refix
ANZ	0.85%	N/a	$150
BNZ	0.55%	0.15%	N/a
ASB	0.85%	N/a	$150
KiwiBank	0.55%	0.15%	N/a
Westpac	0.60%	0.20%	N /a
Sovereign Home Loans	0.60%	0.20%	N/a
TSB	0.85%	N/a	N/a
ASAP Finance Limited	Fee Charged	N/a	N/a
Avanti Finance	Up to 0.80%	N/a	N/a
Cressida	Fee Charged	N/a	N/a
DBR	Fee Charged	N/a	N/a
First Mortgage Trust	Fee Charged	N/a	N/a
Heartland Bank (Reverse Mortgage)	1.50%	N/a	N/a
Liberty Financial	0.60%	0.15%	N/a
NZCU (Personal Loans)	1.00%	N/a	N/a
RESIMAC	0.60%	0.15%	N/a
SBS Bank	0.80%	N/a	$150
Southern Cross	Fee Charged	N/a	N/a
The Co-operative Bank	0.70%	N/A	$150

Source: Mortgage Lab.[353]

4.41 Commissions paid by banks give rise to potential conflicts of interest, which are managed under a relatively new regime, introduced in 2021, through amendments to the FMC Act. This regime is monitored and enforced by the FMA. We discuss how the regime manages potential conflicts of interest below (see from paragraph 4.111).

4.42 Mortgage advisers generally need to be part of a mortgage aggregator network in order to submit loan applications to lenders. NZ Financial Services Group (NZFSG) and Kiwi Adviser Network (KAN) are two of the main groups.

353 Mortgage Lab "How much do mortgage brokers charge?" (21 June 2022), https://mortgagelab.co.nz/ufaqs/how-much-do-mortgage-brokers-charge/

4.43 Aggregators act between advisers and lenders and are key players in the mortgage advice sector. They develop the panel of lenders from which advisers can recommend loans and provide the contractual arrangements associated with that panel. That includes negotiating commissions with banks. Aggregators collect and pass on commissions from lenders to advisers and provide advisers with technology, administrative support and professional development in exchange for a membership fee or percentage of the advisers' commission income.

Interest rate offers move with changes in funding costs and competitive dynamics

4.44 A number of factors affect credit criteria and the interest rates and other deals (including cashbacks) that are made available to different consumers. These factors can limit whether a bank is willing to lend at all for a given customer and property type. Broadly speaking, the key factors either relate to funding costs or competitive dynamics. Changes in the regulatory environment are also highly important (discussed in further detail in Chapter 7).

4.45 The OCR has an important role in determining the interest rates on banks' lending because it influences the cost of funds. However, the interest rates that banks pay for different sources of funding do not necessarily move by the same amount or at the same speed as a change in the OCR, in part because it also depends on the level of competition for deposits. Funding costs are discussed further in Chapter 5.[354]

4.46 Headline interest rates for home loans generally move closely with the OCR, although there is evidence that this occurs faster on the upside than the downside (a phenomenon commonly referred to as 'rockets and feathers'). Professor Margaritis and Dr Hasannasab considered the speed of pass-through of OCR changes to floating home loan interest rates in their report. They found that banks' floating rates tend to respond faster to increases in the OCR in the short run.[355,356]

4.47 Competitive dynamics also play a significant role in banks' home loan pricing strategies. Lenders are highly cognisant of the expected strategic response from other banks – especially the majors – and of the relative intensity of competition in the market at any point in time.

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354 Commerce Commission "Personal banking services market study – Draft report" (21 March 2024), paras 4.32–4.34.

355 Dimitris Margaritis and Maryam Hasannasab "Market power in banking: A study of New Zealand banks" (March 2024), p. 6. The draft report cites the results of an earlier model with fewer lags. That model indicates asymmetry in response to OCR changes in both the short run and long run. The finding of short-run asymmetry is robust regardless of the lag structure of the model. [ ].

356 These findings only apply to floating interest rates: CRA [for ANZ] "Personal Banking Services Market Study – Comments on the Commerce Commission's Draft Report and the Margaritis and Hasannasab paper on 'Market Power in Banking'" (17 April 2024), para 88. Nonetheless, these findings hold for a material portion of home loans. Fixed rates generally move closely with floating rates: Reserve Bank "New residential mortgage standard interest rates (B20)" (5 July 2024). We have no reason to expect that similar analysis for fixed mortgage rates would be significantly different (no evidence was provided in submissions to the contrary).

4.47.1 When setting interest rates, the major banks and Kiwibank focus largely on each other, with little regard to the pricing decisions of smaller lenders.[357] Major banks may also make active decisions to accept slower growth or falling volumes in favour of improving their profit margins on new lending by increasing interest rates or to balance growth across both sides of the balance sheet (the majority of lending is funded by customer deposits).[358] In such down times, banks may intentionally set headline interest rates above that of competitors and/or (less commonly) be less willing to offer discretionary discounts, and in some cases, take steps to reduce volumes through mortgage advisers.[359]

4.47.2 While smaller banks can also offer discretionary discounts, they generally need to maintain an always-on growth strategy in order to grow (or even to maintain) their positions in home lending.[360] This is despite having higher funding and other costs than major banks, making this strategy more difficult.[361] Doing so requires leading on headline interest rates for mass market customers or targeting certain niche customer segments.[362] This is because customers may not think to consider a smaller bank in the absence of a clear prompt, without which it is very hard to start conversations with prospective customers.

Consumer engagement and shopping around | *Te whakaanga kaiwhakapeto me te tirotiro haere*

4.48 The most important take-away for home lending customers is that, to get the best deal on your home loan, you need to shop around.

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357 [ ].

358 [ ].

359 Growth targets and the two-sided nature of banking are discussed further in Chapter 2.

360 [ ]

361 Funding costs are discussed in Chapter 5.

362 [ ].

Customers are not shopping around

4.49 Our consumer survey undertaken by Verian (discussed further in Chapter 8) found that about 12% of all home loan customers have switched bank in the last 3 years.[363,364] This estimate of home loan switching rates appears low relative to some other essential services. For example, about 20% of all electricity consumers switch retailer each year.[365,366]

4.50 This could be because the majority of customers are engaged customers that are happy where they are and have taken up home loan products on terms that suit them well. Indeed, our survey found that the majority of those that have not considered switching reported having no reason to (61%).[367]

4.51 However, this survey result could be driven by a potentially erroneous belief that their current bank's interest rates are competitive (as discussed below) and/or an awareness that full engagement with the market will raise very complex issues.

4.51.1 Engaging in the home loan market, let alone switching from one lender to another, is more complex than engaging with suppliers of many other products and services.

4.51.2 Internal bank documents often describe customer decisions as inertia based. For example, home lending customers were identified as making an automatic decision to stick with their current provider rather than on the basis of their product features or interest rates (as discussed in Chapter 8).

4.52 A telling statistic for consumer engagement is that 49% of people in our survey considered only one provider when first choosing their home loan – nearly half of all home loan customers report not shopping around.[368] Other estimates in some internal bank documents suggest this percentage is even higher.[369]

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363 Verian "Personal banking services market study – Research report" (February 2024), p. 39.

364 This rate is similar to a 2019 survey in Australia: Deloitte "Open banking: switch or stick? Insights into customer switching behaviour and trust" (October 2019), p. 49, https://www.ausbanking.org.au/wp-content/uploads/2022/06/Open-Banking-Switch-or-Stick-Insights-Into-Customer-Switching-Behaviour-and-Trust-Deloitte-2019.pdf

365 Electricity Authority "EMI Dashboard: Switching trends (12-month rolling rate)", https://www.emi.ea.govt.nz/Retail/Reports/R_SwT_C?_rsdr=ALL&ShowAs=Rate12M&_si=v|3

366 The very high proportion of 1–3-year fixed rate home lending in New Zealand means that there are regular prompts for customers to make decisions about their home loan terms unlike many other home loan markets around the world, including Australia. Nevertheless, we have found that switching and engagement with the market appears low. This suggests that the prompt to refix does not translate for all customers into a prompt to engage more holistically with the market for a better deal or that other barriers inhibit them from doing so.

367 Verian "Personal banking services market study – Research report" (February 2024), p. 32.

368 Verian "Personal banking services market study – Research report" (February 2024), p. 40.

369 [ ].

4.53 This low level of engagement from people first choosing their home loan provider is concerning. Unlike existing home loan customers, first-home buyers and other parties first choosing their home loan provider face very few *actual* barriers to choosing an alternative provider to their existing bank (we discuss refinancing issues below).

4.54 Furthermore, they have nothing to lose from at least *considering* other providers if it signals a stronger negotiating position, even if they want to remain with their existing bank. Customers that do not consider other providers are potentially foregoing significant gains for themselves, with detrimental effects on competition more generally, especially if this lack of engagement continues for the life of the loan.

Consumers may perceive they are getting a good deal

4.55 For customers to want to engage actively with the market, they have to believe that the time and effort in doing so will be worth it. Some consumers may make this assessment without being fully aware of how the market works.

4.56 In New Zealand, the practice of discretionary discounting and the fact that home loan interest rates are a negotiation has not been clearly advertised by any of the major banks. We note the contrast with Australian banks where discounting on advertised rates is also prevalent but is more clearly advertised by at least some of the major banks.[370]

4.57 It would be entirely reasonable for consumers that are unaware of the practice of discretionary discounting to not engage in the market on the basis that headline interest rates appear similar across the major banks and Kiwibank. Among those that have switched or considered switching, our survey found 56% of people sought information online (including websites of new and existing providers), of which 20% of people checked an independent website.[371]

4.58 While there is some variation in headline interest rates between the majors and Kiwibank and other advertised offers such as green home loan products (discussed in Chapter 2), they generally move together and are quite similar (Figure 4.2).

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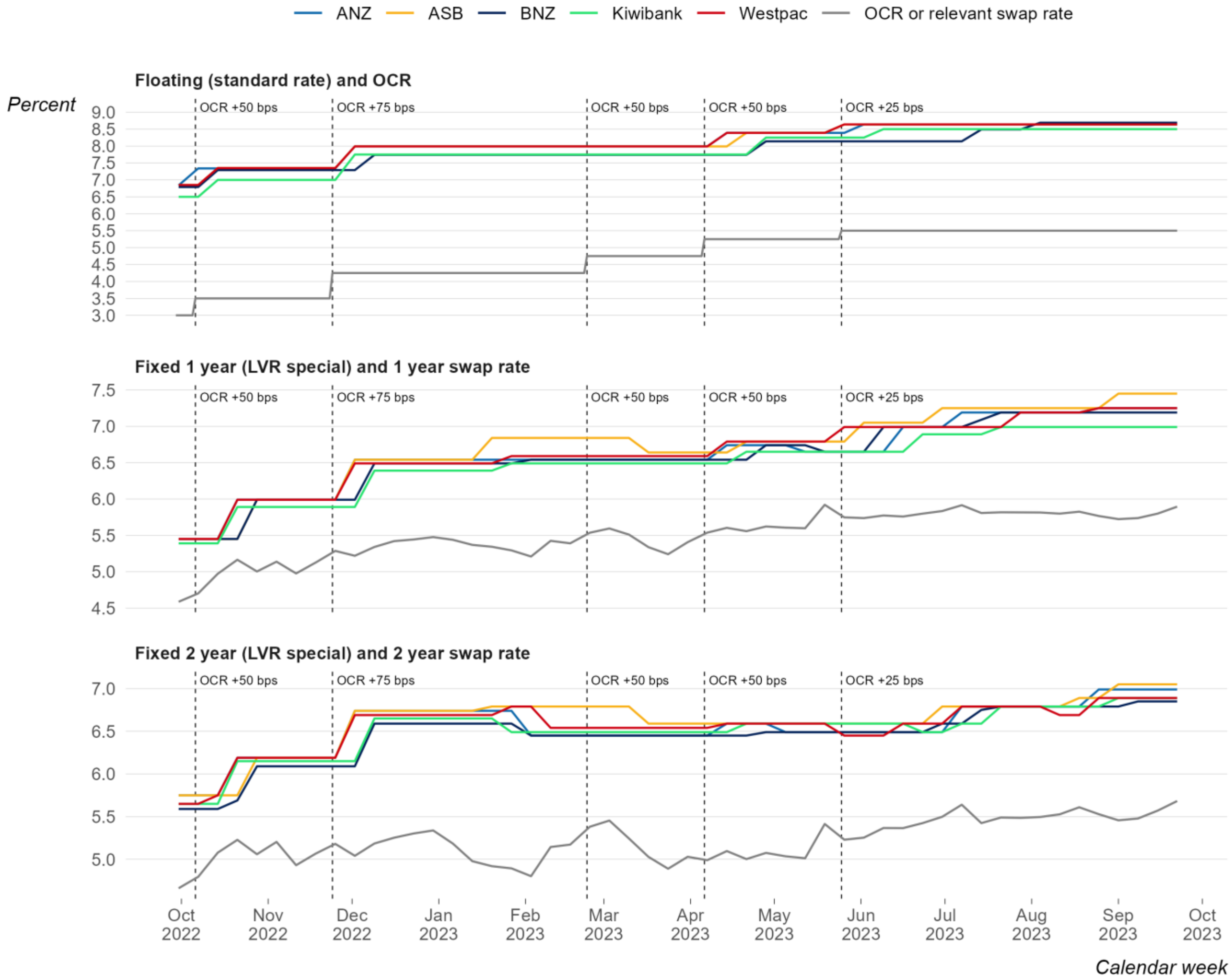
370 For example, Westpac Australia states: “Negotiate your rate – So, you’re wondering ‘how can I get a special deal?’”: Westpac “Home Loans” (accessed 11 July 2024), https://www.westpac.com.au/personal-banking/home-loans/; NAB states that rates can be “tailored” and consumers can “Enjoy … a rate suitable to your situation…”: NAB “Home Loans – Tailored variable with offset” (accessed 11 July 2024), https://www.nab.com.au/personal/home-loans/nab-variable-rate-offset-home-loan. In contrast, our scan of home loan landing pages for the major banks in Zealand gave no obvious indication of the prevalence of discretionary discounting and that rates are a negotiation.

371 Including price comparison websites. Verian “Personal banking services market study – Research report” (February 2024), p. 29.

Figure 4.2 Selected weekly headline mortgage rates (%) of the major banks and Kiwibank over the 52 weeks from 30 September 2022 to 22 September 2023



Source: Data on headline (published) interest rates for mortgage products was provided to the Commission by interest.co.nz. Data on OCR or relevant swap rates was sourced from Reserve Bank.[372]

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372 Reserve Bank "Wholesale interest rates (B2)", https://www.rbnz.govt.nz/statistics/series/exchange-and-interest-rates/wholesale-interest-rates
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4.59 A consumer unaware of the common practice of discretionary discounting could be forgiven for thinking that interest rates are all the same – and essentially a take it or leave it offer – rather than a negotiation that depends on the effort the consumer (or mortgage adviser) puts in to negotiate hard on prices. Another consumer may even be offered a discretionary discount – and perceive they are getting a market-leading deal – when in reality they could have had an even better deal if they had chosen another provider or negotiated harder with their existing bank.[373]

4.60 Consequently, consumers need to be cautious of making decisions based on quick comparisons of headline interest rates from the major banks and be aware of the practice of discretionary discounting and how to effectively shop around to help negotiate a lower rate. Otherwise, our analysis that follows suggests consumers risk financial loss if they decide to engage with the market on headline rates alone.

Consumers need to shop around to get the best deal

4.61 Consumers cannot rely on headline rates as an indicator of good value once discretionary discounts are applied.

4.61.1 Using confidential data provided to the Commission, we found only a weak correlation between headline interest rates and actual interest rates on new lending across banks.[374]

4.61.2 In particular, the bank with the lowest headline interest rates is not always the bank with the lowest average rates paid by borrowers.

4.61.3 A customer who quite reasonably assumes that the bank with the lowest headline rate is the one that will offer them the best deal may inadvertently end up paying more than they would if they had approached a bank with higher advertised rates and negotiated a discount.

4.62 Consumers need to actively shop around to get the best deal. Practically, this means lodging loan applications with multiple providers.

373 We heard from banks that they make discretionary discounts available through their online experiences (discussed above). However, we also heard from a mortgage adviser that these automatic offers may not always be the best offer a customer can get. See Karen Renwick (Mortgage Link Albany), Submission on draft report (18 April 2024), p. 3.

374 Our analysis of monthly home lending data provided by banks and headline interest rate data from interest.co.nz found correlations between banks' relative monthly average headline and agreed interest rates of around 0.25–0.40 among the major banks and Kiwibank. Correlations were calculated for each combination of bank and loan term (floating, fixed 1-year and fixed 2-year rates only) and averaged across banks. To account for trends in the levels of interest rates over time, headline and agreed rates were first de-meaned by subtracting the average headline and agreed rates across banks for each loan term in each month. These de-meaned values were then used to calculate the correlations. [ ].

4.62.1 Discretionary discount offers are made by lenders on a case-by-case basis, and the exact terms of lending can only be provided by considering a borrower's home loan application. Therefore, in most cases, consumers (or advisers on their behalf) will still need to go through the process of applying for a home loan with a lender to determine the actual home loan offer price and terms.

4.62.2 To find which bank is offering the best deal for their circumstances, customers (or advisers) need to lodge loan applications with multiple providers and compare offers.

4.62.3 This significantly increases the time and effort associated with shopping around.

Reducing barriers to price discovery | *Te whakaheke tauārai ki te tīwhiri utu*

Interest rates have not been a strong focal point when selecting a lender, even for mortgage advisers

4.63 A key observation we have made for home loans is the historical lack of focus on interest rates when an individual chooses a home loan provider and that this lack of focus also extends to mortgage advisers.[375]

4.63.1 Our survey found that only 36% of home loan customers said that good interest rates were a reason why they first chose their home loan provider.[376,377]

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376 Verian "Personal banking services market study – Research report" (February 2024), p. 36.

377 However, because home loans are long-term products, this evidence could reflect a historical position rather than engagement in the market today. These statistics should be considered in context of the low interest rates of the last decade, where home loans may have been a less material financial concern (as a lower proportion of household spending).

4.63.2 Mortgage advisers we spoke with often described interest rates as a secondary consideration when choosing a home loan provider. Rather, advisers would focus more on navigating lender credit policies (discussed above) and matching customers to providers that are willing to lend the right amount at the right time.[378,379,380,381]

4.64 While these observations could indicate that consumers value other factors over price (such as avoiding the cost of switching banks), we also heard from mortgage advisers that, when consumers first come in the door, price or interest rates *is* typically the focus.[382,383] This aligns with research by Consumer NZ for the New Zealand banking sector and also with research by the Australian Securities and Investment Commission (ASIC), the Australian regulator for mortgage brokers (as mortgage advisers are referred to in Australia).

4.64.1 Consumer NZ's 2024 banking survey showed that "fees and interest rates are the top two factors considered by consumers when comparing banks, with 46% of customers rating fees as the most important factor, and 39% of customers rating interest rates as the most important factor".[384]

4.64.2 ASIC found that "the key focus for consumers is finding the 'best loan', usually in reference to a low or competitive interest rate. The cost of the home loan was generally considered the most important feature, with flexibility also being important for some consumers."[385]

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378 See for example, Karen Renwick (Mortgage Link Albany), Submission on draft report (18 April 2024), p. 2: "Lender appetite will also determine where an application is placed, for example, two lenders have been closed to pre-approval applications for clients who do not currently bank with them. If a client requires pre-approval, this would mean another lender would need to be considered at this time, nothing to do with the bank's policy, processes or any remuneration received."

379 ANZ CEO Antonia Watson: "[There are a lot of other ways [banks] compete, and I haven't heard anyone talk about things like how much you can borrow. That's down to individual bank credit policies.": Commerce Commission "Day 3 Personal banking services market study conference – Session 8 Mortgage advisers" (15 May 2024), p. 16 (lines 4–6).

380 Jeff Royle: "I still believe that price is inherently important and it's often the starting point of a conversation. That very quickly leads into policy.": Commerce Commission "Day 3 Personal banking services market study conference – Session 8 Mortgage advisers" (15 May 2024), p. 19 (lines 23–24).

381 Andrew Perry noted some of the particular challenges with getting pre-approval for low equity borrowers, including first-home borrowers. Andrew Perry (Mortgage Market), Cross-submission on draft report (23 May 2024), p. 1.

382 For example, Patricia Marden: "[M]any people will say that it is the interest rate that is of the highest priority when they first come in, because it is one of the few things that they can quantify that they'll be focused on. It's also the major thing that lenders, banks in particular, will market themselves on a certain particular special." Commerce Commission "Day 3 Personal banking services market study conference – Session 8 Mortgage advisers" (15 May 2024), p. 9 (lines 25–29).

383 FAMNZ stated that "Advertised special rates that the banks publish are not often what the customer ends up with, but it brings them into talk to a mortgage adviser as a starting point and then the true advice process begins.": FAMNZ, Cross-submission on draft report (30 May 2024), p. 3.

384 Consumer NZ, Submission on draft report (18 April 2024), p. 5.

385 ASIC "Mortgage brokers: Best interests duty – Regulatory Guide 273" (24 June 2020), https://download.asic.gov.au/media/5641325/rg273-published-24-june-2020.pdf

4.65 ASIC also notes that "consumers who use a mortgage broker also tend to have a higher loan-to-income ratio and greater leverage. This suggests that lower costs and affordable repayments may be a priority and are likely to be consistent with those consumers' best interests."[386]

4.66 Despite customers' obvious reasons for focusing on price, mortgage advisers told us that interest rates do not really matter when choosing a lender to recommend to their clients. This disconnect stems from the role that mortgage advisers and aggregators currently play in the industry given the prevalence of discretionary discounting.

4.67 Advisers told us that they focus on lender credit policies because they perceive that price matching by lenders will allow them to get the market leading rates, whichever lender they choose.[387,388,389,390]

4.68 Even if an adviser did want to shop around on price before choosing a lender, they would face many of the same challenges that an individual faces to discover actual interest rate offers.

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386 ASIC "Mortgage brokers: Best interests duty – Regulatory Guide 273" (24 June 2020).

387 Sarah Curtis: "So, yeah, we can get that from most of the other big banks. Lots of those conversations that we have start with price, they do start with price because people normally see something that triggers them to have a conversation with us. But it's not something that ends up being the deciding factor between going to one of the providers.": Commerce Commission "Day 3 Personal banking services market study conference – Session 8 Mortgage advisers" (15 May 2024), p. 12 (lines 24–27).

388 Link Financial Group: "In our experience, consumers value more than interest rate prices alone in an environment where main bank offer generally similar interest rates (especially taking discretionary price-matching into account) … A savvy borrower may also understand that discretionary price matching can be offered to them by an existing lender in order to match the offer by another lender to refinance, therefore reducing the need to go through the cost of refinancing but achieving the same outcome.": Link Financial Group, Submission on draft report (18 April 2024), p. 1.

389 Hamish Patel: "With all due respect – when the banks are giving money at 0-1% there is little room left for competition. The difference has been in terms of the credit terms, some banks will do a short term only – others will revert to normally priced 30 year term at the end of the discounted interest period. Not ideal for batteries which may need replacing in ten years.": Hamish Patel (Mortgages Online), Submission on draft report (17 April 2024), pp. 1–2.

390 We note comments made by ANZ CEO Antonia Watson that seem to corroborate this from a lender's perspective: "I think some really strong points were made that if there's a good price out there you'll be able to get it for your customer": Commerce Commission "Day 3 Personal banking services market study conference – Session 8 Mortgage advisers" (15 May 2024), p. 16. ANZ also reaffirmed this observation by advisers: ANZ, Cross-submission on draft report (30 May 2024), para 63.

4.69 While a reasonable consumer might walk into a mortgage adviser service assuming that the adviser can easily access interest rates for a wide panel of providers, including all the major banks and Kiwibank, the reality is different. This is because access to lenders can be limited and (as discussed below) advisers are constrained by *lenders* from properly shopping around on a customer's behalf. As a result, we heard from advisers that they may typically only get actual interest rate offers from one or two providers.[391,392]

4.70 Advisers may have a general understanding of the discounts available, especially if they actively work with a broad range of lenders, but even their customers may still miss out on the best deal for their individual circumstance due to lender constraints on advisers (discussed further below).

It is more difficult than it needs to be for consumers (and advisers) to discover price

4.71 Our customer survey found that 40% of those home loan customers who thought about switching but did not actually switch said it was too much effort to switch or too hard to find the relevant information.[393]

4.72 In our draft report, we highlighted survey data that some advisers clearly prefer working with some banks' systems and processes over others.[394]

  4.72.1 This could be because of differing degrees of investment by banks in systems and processes to support the adviser channel.

  4.72.2 It may just reflect that some advisers are more familiar with some banks' systems over others. We heard that banks are a primary recruitment opportunity for the adviser channel.[395]

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391 [ ].

392 The choice of provider(s) to apply to will be informed by a number of things, including panel access, lender accreditation, knowledge of credit settings and application turnaround times, established relationships and familiarity.

393 Verian "Personal banking services market study – Research report" (February 2024), p. 27.

394 Commerce Commission "Personal banking services market study – Draft report" (21 March 2024), paras 4.131–4.136.

395 [ ].

4.73 From our engagement with mortgage advisers and lenders since publishing the draft report, it has become clear that, in general, systems and processes for managing home loan applications in New Zealand are relatively manual. Specifically, there is limited standardisation between lenders with how loans are processed, and communications between banks and advisers on loan applications are predominantly by email or phone.[396]

4.74 It is also challenging for consumers to go direct to banks. We observe that low-paperwork (often 10–15 minutes to apply) digital home loan offers with faster loan approvals for low-risk lending are now standard products offered by major banks in Australia.[397] We are not aware of any such offerings by a major bank in New Zealand.[398]

4.75 While we understand and acknowledge that processing loan applications is not without cost, we do not have to look far to see how to reduce costs. In Australia, mortgage advisers can easily access actual prices for multiple providers, and loan applications are placed through standardised online portals rather than by email or phone.[399] We understand that these investments were made to drive efficiency.[400]

4.76 By contrast, New Zealand providers have moved on from fax machines to email technology to manage loan applications, but the process remains needlessly time consuming for customers who often are under pressure to secure finance in order to make an unconditional offer. Lagging in this area adds to our broader concern about the strength of competition in New Zealand.

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396 At the consultation conference, FAMNZ CEO Leigh Hodgetts highlighted this point: “Mortgage advisers put a lot of time and effort into getting the best outcomes for their clients, or their customers, but the process slows everybody down considerably. And it’s emails, it’s chasing people on the phone, it’s archaic”: Commerce Commission “Day 3 Personal banking services market study conference – Session 8 Mortgage advisers” (15 May 2024), p. 14 (lines 28–30).

397 For example, CBA “Digi Home Loan”, https://www.commbank.com.au/home-loans/digi-home-loan.html; Westpac Australia “Hassle-free home loan: Westpac set to launch fast approval digital mortgage” (27 July 2022), https://www.westpac.com.au/about-westpac/media/media-releases/2022/27-july2/; ANZ Plus “Refinance your home loan from the comfort of home”, https://www.anz.com.au/plus/digital-home-loans/; according to Savings.com.au., at NAB “[m]ore than a third (35%) of eligible customers are approved in less than an hour, while 50% of applicants receive a decision within 24 hours”: Harry O’Sullivan “Lenders with fast home loan approval times” (13 March 2024), https://www.savings.com.au/home-loans/lenders-with-fast-home-loan-approval-times; and Bendigo Bank “Quick online pre-approval with Express home loan”, https://www.bendigobank.com.au/campaigns/express-home-loan/

398 [ ].

399 We note the concerns raised by Andrew Perry in relation to the historical use of portals by some New Zealand banks and potential issues with portals in Australia. We agree with Andrew that “Portals which enable brokers to give better information to consumers are useful, those which delay submission are not”: Andrew Perry (Mortgage Market), Cross-submission on draft report (23 May 2024), p. 2.

400 [ ].

4.77 It is particularly concerning that (in New Zealand) the competitive potential of the mortgage adviser channel in relation to interest rates is being curtailed by lenders' systems and processes.

4.78 Lack of investment in this area means that lenders cannot cope with more applications from advisers so they need to manage adviser volumes.[401] They can do this by limiting adviser accreditation (essentially a lender licence to provide advice on that lender's products and services) and by limiting credit policy settings for the adviser channel.[402] We also understand that lenders have different teams to manage applications that come from the in-house and adviser channels. To the extent that the adviser channel is under-resourced at any point in time, this can throttle mortgage adviser volumes (and greatly slow loan processing times).[403,404]

4.79 Up until quite recently, Kiwibank had been conspicuous in its *absence* from mortgage adviser panels. We understand that advisers have wanted Kiwibank on their panels but that Kiwibank has not had the resources to support more adviser accreditation. We understand from Kiwibank and advisers that, in the last year, it has invested significantly to extend its reach to more mortgage advisers.[405,406]

Lender practices that discourage multiple applications need to change

4.80 The threat of losing lender accreditation is limiting competition in the adviser channel by reinforcing the practice of advisers only making one or two loan applications per customer.

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401 For example, we have heard that smaller banks have from time to time become overwhelmed by application volumes (particularly if they have a best-in-market rate on offer) and had to pause their new lending via mortgage advisers until their systems could catch up.
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402 We note that a reduction in commission payments would reduce the financial incentives for an adviser to recommend one lender over another. Differences in commission payments create a potential conflict of interest. As we discuss below, conflicts of interest are managed under the FMC Act. Reducing commissions should therefore not be a successful strategy by lenders for managing application volumes.

403 In addition, banks' approved loans and prices are typically time limited, which adds to the difficulty with comparing prices if loan applications are not processed within similar timeframes. Loan approval timeframes were discussed at the consultation conference, for example, by Hamish Patel. Commerce Commission "Day 3 Personal banking services market study conference – Session 8 Mortgage advisers" (15 May 2024), p. 11 (from line 31).

404 We heard from advisers that lenders often under-resource the adviser channel, for example, Patricia Marsden. Commerce Commission "Day 3 Personal banking services market study conference – Session 8 Mortgage advisers" (15 May 2024), p. 17 (lines 12–22). ANZ responded in its cross-submission that "ANZ does not discriminate on processing time between proprietary and mortgage adviser channels, as turnaround times are similar across both channels over time.": ANZ, Cross-submission on draft report (30 May 2024), para 74.

405 Kiwibank stated that "in the last 12 months we've brought on board 479 advisers". Commerce Commission "Day 3 Personal banking services market study conference – Session 8 Mortgage advisers" (15 May 2024), p. 8 (lines 12–13).

406 Andrew Perry from Mortgage Market also noted in a cross-submission that "In the current environment I have found [Kiwibank] are very aggressive at onboarding brokers and it is an area they are continuing to grow.": Andrew Perry (Mortgage Market), Cross-submission on draft report (23 May 2024), p. 3.

4.81 Accreditation to a lender comes with strict conditions and the threat of accreditation being revoked if the adviser breaches those conditions. Lenders use accreditation to manage concerns about the quality (from its perspective) of loan applications from advisers. This may include concerns about the following.

4.81.1 The costs involved with processing loan applications. Banks would prefer to only process accurate and complete applications that are a suitable match between the lender and borrower and so will likely result in new or retained business.[407]

4.81.2 Advisers inappropriately churning customers to other lenders for the adviser's personal gain, thus earning additional upfront commission. We heard from a lender that trail commissions are a deterrent for engaging in churn.[408] Churn may or not be beneficial to an individual consumer, but it is clearly detrimental to the losing bank and beneficial to the adviser.[409] Given current switching rates, it would be hard to argue that more switching would be detrimental to consumers as a whole.

4.82 To address concerns about the quality of applications (from a lender's perspective), lenders make maintaining accreditation conditional on not making too many *unsuccessful* loan applications. Advisers we spoke with told us of conversion targets from providers as a means for adviser quality control by lenders.[410]

4.83 This reinforces the perception among advisers that they should not apply to too many banks. There is a perceived threat of punishment from banks if they provide too many dud applications. Banks actively monitor application numbers, and some contract terms we have reviewed appear to back this up.[411] An adviser concerned about their livelihood could be forgiven for being cautious with submitting loan applications in these circumstances.

Lenders need to make it easier for consumers (and advisers) to quickly discover price

4.84 Ultimately, New Zealand banks have created a dynamic in which consumers must shop around in order to get a good deal but have not invested in the systems that would assist this process. Consequently, it is unnecessarily difficult and time consuming to get several quotes so competition is much weaker.

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408 [ ].

409 It is worth stressing that churn would not be a problem if advisers were remunerated by consumer fees for service rather than by lenders.

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4.85 New Zealand's major banks only have to look to their Australian parents to see that processing loan applications could be much easier than it is. In Australia, there is standardisation of data exchange and home loan applications between lenders and advisers, supported by the LIXI standards,[412] and greater use of automated systems.

4.86 Competition more generally has the potential to solve many of these problems and motivate banks to invest in more-efficient systems and processes. Our entire suite of recommendations can promote more competitive conditions where lenders, particularly the major banks, are forced to invest in modern systems.

4.87 As discussed in Chapter 10, we are also recommending that lenders proactively work with aggregators and advisers on system standardisation to make it easier for advisers to submit multiple qualifying applications on their clients' behalf and make it more efficient for lenders to quickly process loan applications.[413]

Reducing barriers to assessing information | *Te whakaheke tauārai ki te whiriwhiri mōhiohio*

Cashback offers make it more difficult to compare offers between providers

4.88 In theory, banks can compete for customers either by offering higher cashbacks or by lowering interest rates. It is possible the higher cashbacks that have been observed in recent years (see Figure 4.8 of our draft report) have come at the expense of higher interest rates – in their absence, interest rates would have been lower on average.

4.89 We heard from banks that cashback offers are considered quite separately from interest rates and are not considered as a package.[414] The internal evidence we have reviewed about the relation between cashback offers and interest rates generally aligns with this.[415] This surprises us since both are relevant to the customer's perception of value as well as the overall profitability of a loan.

412 See https://lixi.org.au/about-lixi/

413 We note there is also an opportunity for lenders to help improve consumers' outcomes by reminding customers who use mortgage advisers that it may be beneficial to seek advice from their adviser prior to refixing when fixed interest rates expire (including through banks' online experiences). This was discussed at the consultation conference: Commerce Commission "Day 3 Personal banking services market study conference – Session 8 Mortgage advisers" (15 May 2024), pp. 17–20.

414 [ ].

415 [ ].

4.90 Although cashbacks are a popular feature for home lending customers, cashbacks make it more difficult to compare offers between providers.[416] For example, if one bank is offering a slightly higher interest rate but a more generous cashback offer, it is not straightforward to weigh these two factors against one another. When customers find it difficult to compare offers, they are less able to help drive competition and may default to choosing on the basis of existing relationship or brand,[417] benefiting the major banks.

Lenders need to make it easier for consumers to assess the value of cashback offers

4.91 In our draft report, we recommended that home loan providers should present offers in a readily comparable manner. We noted that:[418,419]

> For example, customers should be shown how the cash contribution offered (if any) translates into effective interest rate terms, having regard to the duration of any fixed rate products taken out as well as the ‘clawback’ period to which the cash contribution applies. If the clawback period is a three-year term, the cash contribution should be spread across three years when converted to an effective interest rate.

4.92 While some submitters raised concerns about being too prescriptive with such a requirement, we are retaining this as a final recommendation while noting that the specific information that must be presented should be informed by consumer testing to ensure it is effective and relevant to consumer switching decisions. This is discussed further in Chapter 10.

4.93 We also consider that mortgage advisers should help consumers compare the costs and benefits of complex product offerings such as cashback offers. After all, mortgage advisers are first and foremost financial advisers. If mortgage advisers were to provide each customer with a cost assessment for their expected individual circumstances, competition between lenders would be stronger.

Reducing the cost of switching | *Te whakaheke i te utu hei whakawhiti*

Frictions inhibit switching (refinancing) in home lending

4.94 For households that already have a mortgage, there are additional costs from switching providers that limit their willingness and ability to engage in the market.

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416 This is self-evident but was also raised by Heartland Bank. Heartland Bank, Submission on Preliminary Issues paper (7 September 2023), para 11c.

417 See Chapter 8.

418 Commerce Commission “Personal banking services market study – Draft report” (21 March 2024), para 4.82.

419 If a customer does decide to switch within the agreed cashback period, they will generally have to repay some (or all) of the cashback amount. This is referred to as a cashback (or cash contribution) clawback.

4.94.1 Repayment of cash contributions. Cashback offers operate as a retention device as they are provided in exchange for a commitment that the customer does not switch away from the bank or otherwise repay their home loan for a period of time (usually 3 years). If a customer does decide to switch within the agreed cashback period, they will generally have to repay some (or all)[420] of the cashback amount. Consumers may be able to get a new cash contribution from their new lender[421] (or not) but they will still face significant personal one-off costs to switch.

4.94.2 Early repayment fees if repaying a home loan during a fixed rate period. The prevalence of tranche lending increases switching costs. This is because customers either need to wait until they can align the end dates for different tranches (which can take a number of years) or potentially pay break fees in respect of one or more tranches.

4.94.3 Potential fees from mortgage advisers if the refinancing activity triggers a commission clawback between provider and adviser.[422] If a customer refinances away from a provider within 27–28 months, the lender will typically claw back some proportion of the adviser's commission, and the adviser will typically charge the customer a fee.

4.95 Reflecting these frictions, a survey of mortgage advisers conducted by interest.co.nz in early 2023 found that mortgage advisers estimated that only 31% of their customers on average could refinance with another lender after their fixed-term loan period ended.[423]

4.96 We consider that lengthy cashback and mortgage adviser fees associated with clawback provisions create the most friction in switching lenders because they explicitly act to lock customers in with a particular provider for a set period. The terms of the clawback arrangements exceed the periods of the most popular fixed rate home lending products, meaning that these lock-in provisions are likely to directly discourage switching at a customer's first (and perhaps second) opportunity to refix or refinance their home loan(s).

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421 Which may offset the financial costs of switching: Hamish Patel (Mortgages Online), Submission on draft report (17 April 2024), p. 2; Westpac, Submission on draft report (18 April 2024), para 68.

422 Commissions are technically clawed back from mortgage aggregators rather than advisers themselves. Mortgage aggregators work between lenders and providers.

423 This survey of mortgage advisers was conducted by Curia Market Research on behalf of interest.co.nz in February and March 2023. There were 160 respondents. Banks asked about in the survey were ANZ, ASB, BNZ, Kiwibank, Co-operative Bank, Heartland Bank, HSBC, SBS Bank, TSB and Westpac: interest.co.nz "Mortgage brokers' customers 'stuck' with their current lenders", https://www.interest.co.nz/banking/broker-survey-april-2023-part-3

Pro-rating cashback clawback arrangements would make switching easier

4.97 Our review of cash contribution policies found that some providers are exacerbating switching costs through these policies. While most banks pro-rate the repayment obligations so that the size of the repayment is roughly proportional to the time remaining in the commitment period, some banks do not pro-rate at all.[424] Others use extremely blunt terms for calculating the repayment, for example, 100% repayment in the first 2 years and 50% repayment in the remainder of a commitment period.[425]

4.98 To minimise the extent of unnecessary switching costs for customers, we are recommending that industry practices for clawback of cash contributions are changed so that the clawback amount recovered from consumers is pro-rated, diminishing on a linear basis and calculated monthly. This is discussed further in Chapter 10.

Pro-rating mortgage adviser commission clawback would also reduce market frictions

4.99 Contract terms allowing clawback of commission payments from aggregators (and ultimately advisers) if a loan is repaid or discharged early are a common feature.[426] For example, this may occur if a borrower refinances to another bank within a set period, often 27–28 months.

4.100 In these circumstances, the aggregator will be required to repay the upfront commission already received (most often pro-rated). In some cases, the aggregator is also required to pay back any trail commissions received to date. In all cases, the aggregator will lose the right to any future trail commissions on that loan.

4.101 If a lender claws back a commission payment, mortgage advisers will typically (although not always) charge the borrower a fee for service associated with providing the home loan advice.[427] This is usually calculated on the basis of time and cost. The potential to incur these fees from the adviser adds significantly to the total switching costs faced by a borrower who might otherwise consider refinancing to another provider.

4.102 There are two features of these arrangements that appear to give rise to unnecessary impediments to switching for consumers.

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4.102.1 First, adviser fees that are dependent on a 27–28-month clawback period will disincentivise refinancing up until the first opportunity to refinance after the clawback period ends, which for most borrowers is likely to be at least 3 years (36 months) given the prevalence of 1-year and 2-year fixed rate borrowing in New Zealand (and may be longer due to tranche lending practices).

4.102.2 Second, although the clawback arrangements are generally pro-rated, the pro-rated arrangements are very lumpy and are not always linear. For example, at least two banks had the ability to clawback 100% of the upfront commission from advisers for a period that exceeded 12 months (as at November 2023).[428]

4.103 To the extent that advisers respond to commission clawback by imposing a fee on consumers, these arrangements can have significant implications for customers.[429] While consumers must be made aware of the risk and consequences of commission clawback when taking out a loan, consumers may soon forget these obligations.

4.104 As discussed in Chapter 10, we are recommending that industry practices around clawback of commissions are changed so that clawback periods (which apply to advisers and their clients) are no longer than 2 years and that commission clawbacks (from advisers to lenders) diminish smoothly over time.[430,431] Together, these measures should reduce the need for advisers to charge unexpected fees to consumers.

4.105 We also note that, in some instances, lenders should take more responsibility for reminding consumers that use mortgage advisers of the risk and consequences of commission clawback. One specific example is where a consumer repays a loan early.[432] In these circumstances, lenders should look to remind consumers for which their loan was recently arranged by a mortgage adviser that they may be on the hook for fees that are triggered by commission clawback.[433]

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428 [ ].

429 We heard from advisers that contracts with clients typically include maximum possible fees that can be clawed back in these circumstances and that some advisers do not claw back commissions. For example, Hamish Patel (Mortgages Online), Submission on draft report (17 April 2024), p. 2.

430 In Australia, the clawback period for upfront commissions is generally 12–24 months: Annie Kane "CBA updates clawback policy" (5 July 2023), https://www.theadvisor.com.au/lender/44538-cba-updates-clawback-policy

431 Kiwibank raised concerns about the costs of system changes to enable more granular clawback of commissions: Kiwibank, Submission on draft report (18 April 2024), p. 8. While we note these concerns, we remain of the view that more granularity of clawback would benefit consumers as discussed in Chapter 10.

432 Karen Renwick (Mortgage Link Albany), Submission on draft report (18 April 2024), p. 6.

433 We understand from Jeff Royle at the consultation conference that this has been the practice of Resimac. Commerce Commission "Day 3 Personal banking services market study conference – Session 8 Mortgage advisers" (15 May 2024), p. 22 (lines 20–25).

Mortgage advisers could help to drive stronger competition for home loans | *Tērā pea ka āhei ngā kaitohu mōkete ki te ā haere i te whakataetae mō ngā moni tārewa ā-kāinga*

Mortgage advisers can drive better outcomes for consumers

4.106 Mortgage advisers are increasingly being used by consumers to navigate the complexity of getting a home loan. This provides an opportunity for advisers to drive better outcomes for consumers and increase competition between lenders.

4.107 Mortgage advisers can provide consumers with holistic financial advice that helps them to better understand and compare complex product offerings. This is especially important in New Zealand given that low financial literacy capabilities can mean consumers often face difficulties in understanding banks' terms and conditions, interest rates and fees and in comparing products and services (discussed further in Attachment D).

4.108 Mortgage advisers have the potential to make competition for home loans more effective by:

4.108.1 increasing consumers' knowledge of loan products and assisting customers to choose products that are a good fit for them;

4.108.2 exerting competitive pressure on lenders on behalf of consumers, inviting lenders to compete more strongly with each other for business; and

4.108.3 providing a broader distribution channel for lenders – this can be particularly valuable for enabling small lenders to compete more effectively with big lenders.

4.109 Encouragingly, our Verian survey found a correlation between the use of mortgage advisers and higher rates of switching, which suggests they play a pro-competitive role in the market.[434]

4.109.1 Two-thirds of customers that have switched their home loan in the last 3 years have used a mortgage adviser compared to 40% of all home loan customers.

4.109.2 Of those who considered switching but didn't, only one-third of customers used an adviser compared to 40% of all home loan customers.

4.110 While these results could partly be driven by selection bias,[435] they suggest that mortgage advisers can help to put more pressure on lenders than customers can without an adviser.

434 Verian "Personal banking services market study – Research report" (February 2024), p. 39.

435 This is because a customer who has a reasonable willingness or appetite to change their provider may be more likely to seek out a mortgage adviser, while a customer with a strong preference for approaching their existing provider is less likely to seek out an adviser.

Mortgage advisers must provide suitable advice and put their clients' interests first

4.111 Mortgage advisers face a potential conflict of interest with their clients because they may be incentivised to recommend a lender that pays them the best commissions even if that lender is not the best fit for the borrower. This includes potential conflicts of interest in relation to:[436]

4.111.1 lender choice – whereby the adviser has an incentive to favour lenders that pay preferential commissions[437] or has no incentive to alert clients to lenders that are not on their panel (for which they are not remunerated);[438] and

4.111.2 loan size – an adviser may favour borrowers taking out higher loans (and have less incentive to serve customers who may not have large borrowing needs such as lower-income borrowers or older borrowers) and may have the incentive to maximise the amount that the consumer borrows.

4.112 Commissions also incentivise advisers to process loan applications as quickly as possible (successful applications will maximise commission income) and to switch consumers to alternative lenders to earn additional commission income (churn, as discussed above). These incentives may or may not align with consumers' interests. Advisers also face pressure from lenders to minimise unsuccessful loan applications, which is hindering price competition and is not in consumer interests (see above).

4.113 In response to the draft report, mortgage advisers we heard from strongly disputed any suggestion that their own advice would be materially influenced by potential conflicts of interest under the current regulatory regime.[439] They highlighted the extensive regulatory changes that have occurred over a number of years to better manage conflicts of interest.[440]

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436 ASIC "Review of mortgage broker remuneration – Report 516" (March 2017), para 29, https://download.asic.gov.au/media/4213629/rep516-published-16-3-2017-1.pdf; and Australian Productivity Commission "Competition in the Australian Financial System" (29 June 2018), p. 320, https://www.pc.gov.au/inquiries/completed/financial-system/report/financial-system.pdf

437 We understand that, in the past, individual banks also offered mortgage advisers additional incentives for hitting volume targets. We understand from our discussions with mortgage advisers that these types of incentives have largely disappeared. [ ].

438 These incentives could be affected by more than simply differences in commission size. For example, some advisers may prefer one commission structure over another for cashflow reasons.

439 Although acknowledged the potential for conflicts of interest. For example, Hamish Patel (Mortgages Online), Submission on draft report (17 April 2024), p. 3.

440 [ ].

4.114 Indeed, the regulatory regime for financial advice (which includes mortgage advice) has undergone significant regulatory change in recent years and only came into full effect on 17 March 2023, following a 2-year transitional period. The new regime centres on amendments to the FMC Act[441] and the Financial Markets Conduct Regulations 2014.[442]

4.115 To provide financial advice (including mortgage advice), you must now be licensed as a financial advice provider (or operating under a financial advice provider licence). There are also new duties, disclosure requirements and a Code of Professional Conduct for Financial Advice Services that applies when giving financial advice, setting sector-wide standards for conduct, client care and competence. As part of complying with these requirements, advisers must provide suitable advice and "give priority to their clients' interests".[443]

4.116 In our draft report, we expressed concern about ineffective disclosure requirements for conflicts of interest and that there appeared to be no substantive guidance on how to give advice that is suitable and to give priority to clients' interests.

4.117 After further engagement with the FMA and the sector coordinated with the assistance of Financial Advice New Zealand and the Finance and Mortgage Advisers Association of New Zealand (FAMNZ), we are now more comfortable that there are relatively clear expectations on mortgage advisers for managing potential conflicts of interest and what constitutes suitable advice.[444] The advice industry has also worked closely with the FMA to understand the new requirements.

4.118 The FMA has released guidance on how to give priority to clients' interests, and the code of conduct includes further guidance on advice suitability.

 4.118.1 This guidance makes it clear that "[y]ou must put your client's interests first when giving advice" and that an adviser "should only recommend products most suitable" for their client. The FMA poses the question to advisers "would the advice be the same in the absence of the conflict?"[445]

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441 Amended by the Financial Services Legislation Amendment Act 2019.

442 Amended by the Financial Markets Conduct (Regulated Financial Advice Disclosure) Amendment Regulations 2020.

443 FMA "Financial Advice Provider Monitoring Insights" (May 2024), p. 12, https://www.fma.govt.nz/assets/Reports/Financial-Advice-Provider-Monitoring-Insights.pdf

444 [ ].

445 FMA "Meeting your obligations under the new financial advice regime" (14 March 2023), https://www.fma.govt.nz/assets/Information-sheets/Meeting-your-obligations-under-the-new-regime.pdf

4.118.2 The code of conduct further outlines expectations about suitable advice. Central to this is "having reasonable grounds for the financial advice". The code expects that, if the advice compares two or more products, the advice "should be based on an assessment of each product".[446]

4.118.3 The code defines reasonable to mean that a "prudent" mortgage adviser "would consider to be appropriate in the same circumstances".

4.119 The FMA also provides further guidance on what are "reasonable grounds for the financial advice". Key principles of that guidance are to:[447]

4.119.1 meet your professional responsibilities to your client;

4.119.2 give financial advice that's within scope of your professional services and competence;

4.119.3 exercise professional judgement (apply cogent reason – not irrational or uninformed factors – to the formulation of your financial advice);

4.119.4 consider relevant, material and sufficient information (apply your professional judgement);

4.119.5 communicate clearly with your client;

4.119.6 consider your client's relevant circumstances; and

4.119.7 keep adequate records.

4.120 We also understand there are very clear expectations on mortgage advisers to disclose specific information about who they work with and potential conflicts of interests at different stages in the advice process. This includes:[448]

4.120.1 publicly disclosing that advisers are remunerated by commissions and have an obligation to manage these as a potential conflict of interest;[449]

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446 Code Committee "Code of Professional Conduct for Financial Advice Services" (March 2021), https://financialadvicecode.govt.nz/wp-content/uploads/2021/03/codeofprofessionalconduct-march2021.pdf

447 FMA "Reasonable grounds for financial advice about financial products" (February 2023), https://www.fma.govt.nz/assets/Guidance/Reasonable-grounds-for-financial-advice-about-financial-products.pdf

448 As discussed in the industry-developed guidance for financial advisers: Financial Services Council "Disclosure: A guide for financial advisers" (January 2021), pp. 9, 17 and 20, https://f.hubspotusercontent10.net/hubfs/7422267/FSC%20Corporate/Professional%20advice/Financial%20Services%20Council%20-%20Disclosure%20Guide%202021.pdf

449 We note there is significant variation in practice for public disclosure. The detailed disclosure by Mortgage Lab (Table 4.1) above is atypical, with most advisers disclosing only a range of possible commissions that is not specific to individual providers.

4.120.2 disclosing at the point of engagement when the nature and scope of advice is known the possible range of commissions that an adviser could earn; and

4.120.3 disclosing when making a recommendation the actual commission payable and any associated provisions relating to commission clawback.

Advisers appear to be making good progress in the transition to the new regulatory regime

4.121 In our draft report, we noted the need to monitor mortgage advisers' compliance with their duties under the FMC Act.[450] Since then, the FMA has released its first monitoring report into financial advisers. The report made some general findings that applied to all financial advisers (including mortgage advisers).

4.122 The FMA noted that "[o]verall, from our reviews we are encouraged by the progress made and the transition to the new requirements".[451] However, it also called out poor practices by some financial advisers (not specific to mortgage advisers). This included:[452]

4.122.1 not demonstrating reasonable grounds to ensure their advice was suitable to their clients;

4.122.2 switching clients to a product provider that paid higher levels of commission for the adviser without demonstrating how they prioritised the clients' interest; and

4.122.3 a lack of detail in disclosure of commissions and incentives, untimely disclosure and missing disclosure related to complaints and the availability of dispute resolution services.

4.123 The only specific references to mortgage advisers in the report were favourable observations.

4.123.1 Recommending that clients borrow less than approved to support affordable loan repayments despite it resulting in lower commission for the adviser.[453]

4.123.2 Going "beyond being a broker" by "sharing more of their expertise and knowledge with their clients, to help them navigate the complexity of obtaining a loan. The result is advice the client can understand."[454]

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450 Commerce Commission "Personal banking services market study – Draft report" (21 March 2024), para 10.81.

451 See FMA "Financial Advice Provider Monitoring Insights" (May 2024), p. 5.

452 FMA "FMA publishes first monitoring insights report into Financial Advice Providers" (30 May 2024), https://www.fma.govt.nz/news/all-releases/media-releases/fap-monitoring-insights-report/

453 FMA "Financial Advice Provider Monitoring Insights" (May 2024), p. 12.

454 FMA "Financial Advice Provider Monitoring Insights" (May 2024), p. 14.

4.123.3 Disclosing commissions in "easy-to-understand" tables that "clearly showed when the commission would be given, who would pay and receive it, and the value. Where approximations or percentages were given in the early stage of the advice process, the final amount was later disclosed. Providing it in this form made it easy for clients to understand, and allowed advisers to demonstrate how they met the obligation to disclose this information."[455]

4.123.4 Taking a "considered approach" to continuing professional development. The FMA noted that mortgage advisers' "competency was often supported by keeping their knowledge on the economic situation current, to help navigate an ever-changing environment of rising interest rates, increasing house prices, and the slowdown of some industries as a result of the pandemic. Having this up-to-date understanding allowed their clients to have accurate information during a time of uncertainty, and to make informed decisions."[456]

Advisers should become champions of price competition

4.124 These results from the FMA's monitoring are encouraging. They also align with what we heard through our engagement with the sector. Mortgage advisers we met with conveyed that they work very hard for their clients to provide suitable advice and give priority to clients' interests.[457]

4.125 However, we believe that the industry needs to go further to promote the *best* interests of consumers. This requires mortgage advisers to be champions of price competition while also providing holistic financial advice for the long-term benefit of consumers.[458] We do not accept that price (or cost more broadly – acknowledging the long-term nature of home loans) should not be the number one priority for lenders *and* mortgage advisers.

4.126 Some responsibility lies with lenders who need to make it easier for mortgage advisers to properly shop around on consumers' behalf. We are recommending that lenders proactively work with aggregators and advisers on system standardisation to make it easier for advisers to submit multiple applications on a client's behalf and make it more efficient for lenders to process loan applications. The sector cannot promote the best interests of consumers if it cannot provide timely access to competitive offers for each client. We consider this means mortgage advisers providing clients with a least three actual offers to consider, where possible.

455 FMA "Financial Advice Provider Monitoring Insights" (May 2024), p. 16.
456 FMA "Financial Advice Provider Monitoring Insights" (May 2024), p. 17.
457 [ ].
458 We note concern from NZHL Group about a "focus on price competition over holistic financial Advice" but we do not see this as a trade-off. NZHL, Cross-submission on draft report (30 May 2024), p. 3.

4.127 There are also some opportunities for advisers to change practices now that would likely result in better outcomes for consumers and competition more generally. For the rest of this chapter, we outline how being more transparent about the limitations of their services and having regard to providers outside of their panel when providing advice to clients would help achieve this.

Mortgage advisers need to make clearer the limitations of their services

4.128 Through our engagement with the mortgage advisers' sector, it has become apparent that there are a lot of different business models that fit under the umbrella term of mortgage adviser. While most mortgage advisers appear to have broad panels with at least the major banks, some mortgage advisers only work with a subset of the larger banks.[459]

4.129 In an ideal world, all mortgage advisers would have representative panels. To call yourself a mortgage adviser, we consider that you should be able to independently advise on the whole market. Any reasonable consumer would be surprised to learn that some mortgage advisers only consider a small subset of lenders.

4.130 When first approaching a mortgage adviser – or as commonly occurs with the sector being referred by a friend or family member – it is generally a lucky dip as to whether you are approaching a mortgage adviser that can actually provide complete mortgage advice. While by law, an adviser must disclose who they do work with, it is up to the consumer to realise which providers are missing.

4.131 In the consultation conference, we discussed the idea of negative disclosure.[460] This would involve providers having an obligation to disclose which providers they do not work with in addition to who they do work with. This idea was criticised by mortgage advisers as impractical and unhelpful for consumers given the large number of lenders.[461]

4.132 We acknowledge that a long list of lenders an adviser does not work with is probably unhelpful for most consumers, but we would expect that advisers would always disclose publicly and discuss with potential clients up front if they cannot work with any of the registered banks that offer residential mortgages. For advisers with a broad panel, we would not expect this to be a very long list at all.[462]

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459 There are a range of different business models as discussed by mortgage advisers at the consultation conference. Commerce Commission "Day 3 Personal banking services market study conference – Session 8 Mortgage advisers" (15 May 2024), pp. 4–7. See also Link Financial Group, Submission on draft report (18 April 2024), p. 2.

460 Sarah Curtis (Sarah Curtis Mortgages and Insurance), Submission on draft report (18 April 2024), p. 1.

461 See Commerce Commission "Day 3 Personal banking services market study conference – Session 8 Mortgage advisers" (15 May 2024), p. 5.

462 As noted in Chapter 1, there are currently 27 registered banks in New Zealand, though only 16 of these are unique banks that offer personal banking services.

4.133 We also see benefits in advisers being more upfront about who they *prefer* working with. While an adviser may have a broad panel, they may prefer working with a much smaller subset of lenders.[463] There are many reasons why an adviser might prefer working with one lender over another, but we consider that advisers have nothing to hide by giving some indications of who they actually tend to work with, and customers have a right to know. For example, an idea raised at the market study conference was that advisers could disclose any provider on their panel for which they had not provided business at all to in the last 2 years.[464]

Advisers need to have a view beyond their panel to be champions of price competition

4.134 There are a range of reasons why mortgage advisers may not have broad panels. This ranges from adviser business models that restrict panel size to lenders rejecting accreditation despite demand from advisers. Also, some providers do not pay commissions and so are not even part of the mortgage advice ecosystem.

4.135 We do not think these factors provide an excuse for mortgage advisers not to consider providers beyond their panel. It seems that the industry is unduly focused on concerns that doing so would go beyond giving "financial advice that's within scope of your professional services and competence". While we understand that this limits advisers' ability to *recommend* products outside their panel, it does not restrict advisers from *considering* if providers beyond their panel may better meet the needs of their client than those on their panel.[465]

4.136 Rather, we would expect that, if a lender outside of an adviser's panel has better headline rates than the best offer an adviser can negotiate with someone on their panel, the adviser should make that clear to their client in their final recommendation.

4.137 Advisers already have terms in their contracts with clients that allow them to charge fees if, after providing advice, the client chooses to go elsewhere, so such practices do not need to leave advisers out of pocket.[466] However, if for whatever reason advisers were being left out of pocket under current remuneration structures, mortgage aggregators would need to work with lenders to evolve remuneration models so that fee-for-service is at least an option for clients that want truly independent mortgage advice.[467]

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463 We note NZHL suggests it is only 5–7 lenders on average. NZHL, Cross-submission on draft report (30 May 2024), p. 3.

464 Raised by Hamish Patel (Mortgages Online) at the consultation conference. Commerce Commission "Day 3 Personal banking services market study conference – Session 8 Mortgage advisers" (15 May 2024), p. 4 (lines 4–6).

465 Recommend in the sense of giving regulated financial advice: FMC Act, ss 431C and 431J.

466 [ ].

467 We note NZHL stated: "It's our view that changing the remuneration structure from a supplier commission-based model to a fee-for-service model would provide a deterrent for New Zealanders able to access qualified financial advice. New Zealand's financial literacy is low and limiting access to qualified advisers would exacerbate this gap, creating further vulnerability for a large percentage of the population." NZHL, Cross-submission on draft report (30 May 2024), p. 4.

4.138 We note that, in Australia, mortgage brokers (as they continue to be called) have a best-interest duty to their clients. To meet this duty, ASIC expects brokers to have representative panels and consider providers beyond their panels. If they cannot be satisfied that the providers in their panel can meet the best interests of a client, they must decline working for the client and should recommend the client goes elsewhere.[468,469] In order to meet the best interest of the client, cost factors such as interest rates, cashback offers and loan repayments are expected to be prioritised over other factors.

4.139 It is worth noting that we do not have an explicit best-interest duty for financial advisers in New Zealand. Advisers must provide advice that is suitable and put their clients' interests ahead of their own. We note that the FMA's guidance states that advisers should only recommend products *most* suitable to consumers (emphasis added).[470] If the sector embraces the *most* suitable product as if it were the product that is in the best interest of consumers, advisers may be the key to unlocking competition in the home loan market.

4.140 It is too early to assess whether the current New Zealand mortgage adviser regulatory regime will effectively promote pro-competitive behaviour from the banking sector. However, Australia provides a clear example of how the adviser channel can do more to support competition between lenders while continuing to be predominantly paid by commissions. For advisers to promote more competition in New Zealand will require policy settings to evolve to ensure that advisers work in consumers' best interests. This does not necessarily require copying the ASIC regime, but it does require the whole sector, with the FMA's oversight, to emphasise the importance of promoting those factors that will result in stronger competitive outcomes.

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468 ASIC "Mortgage brokers: Best interests duty – Regulatory Guide 273" (24 June 2020), p. 25.

469 We note that NZHL (a subsidiary of Kiwibank Holdings), which only provides its loan product via Kiwibank and ASB, will refer clients "who do not fit with NZHL's proposition, or prefer another lender … to NZHL Advisory – which under the Group can access LFG's full panel of lenders." NZHL, Cross-submission on draft report (30 May 2024), p. 2.

470 FMA "Meeting your obligations under the new financial advice regime" (14 March 2023), p.2.

Chapter 5 Competition for deposit accounts | *Te whakataetaetanga mō ngā kaute whakaputu*

Summary of findings

- **Deposit accounts include transaction accounts, savings accounts and term deposits.** Transaction accounts form the basis of main bank relationships, which are an important focus for competition in personal banking.
- **Retail deposits (funds held in deposit accounts) are crucial to bank funding.** They are typically the lowest cost source of funding available to banks and represent approximately 65% of funding for the major banks and Kiwibank and 80% of funding for smaller banks.
- **Transaction deposits are particularly valuable, as a significant portion of transaction deposits are non-interest bearing.** Overall, the major banks and Kiwibank hold approximately $58b of non-interest-bearing deposits.
- **The major banks have been able to attract a greater proportion of transaction deposits than small New Zealand banks.** This reflects advantages the major banks have in winning and maintaining main banking relationships.
- **The major banks and Kiwibank have (on average) a 50–60 basis point cost of funds advantage over the small New Zealand banks for the retail deposits they hold.** This is because the major banks and Kiwibank hold a higher proportion of transaction deposits that they pay little to no interest on. Given the major banks and Kiwibank have a total deposit balance of $395b, this presents a substantial cost advantage. Additionally the major banks have better access to wholesale funding and small New Zealand banks rely more heavily on retail deposits.
- **This difference in the cost of funds negatively affects the ability of small banks to competitively constrain the major banks in home loan and other lending markets.** For example, the major banks can choose to match and outlast the promotions of smaller providers. Over the long term, this further entrenches the stable two-tier oligopoly market structure.
- **Generally there are no (or low) fees charged on transaction accounts** so there is little price competition for this key product in the main bank relationship. Given the high volume of payment activities, non-price factors such as quality of service are likely to be more important to consumers than earning interest. Switching transaction account providers can be particularly challenging compared to savings or term deposits.
- **The major banks and Kiwibank typically set prices for savings and term deposits with regard to one another**, having little regard to smaller providers. Incentives to engage in strong price competition appear to be limited, and major banks tend to respond very closely to each other's offers rather than compete intensely on price.
- **Our recommendations for open banking and broadening Exchange Settlement Account System (ESAS) access are expected to promote competition** by helping smaller providers to compete for transaction deposits and reducing their dependency on agency banks.

Deposit account services include transaction accounts, savings accounts and term deposits | *Ka whāiti mai ki ngā ratonga kaute whakaputu ko ngā kaute kurutete, kaute penapena pūtea me ngā kuhunga tūmau*

5.1 This section describes the different types of deposit accounts and their notable features and the importance of deposit accounts to banks and competition.

5.2 **Transaction accounts** are used for everyday banking such as receiving income, making payments and managing the day-to-day flow of money. Therefore, transaction accounts are likely to generate a high volume of transactions compared to other deposit account types.[471] Payment cards such as electronic funds transfer at point of sale (EFTPOS) or debit are usually linked to transaction accounts. As discussed in Chapter 2, main bank relationships centre on transaction accounts.

5.3 Deposits in transaction accounts are available immediately (referred to as on call), and generally interest is not paid on them.

5.4 Overdrafts are provided through transaction accounts. An overdraft is an extension of credit when a withdrawal is attempted that exceeds the balance of the account. Overdrafts can be arranged in advance or provided on an unarranged basis (typically at a higher cost).[472]

5.5 **Savings accounts** are primarily for saving and earning an interest return. A common feature of savings accounts is a bonus interest rate if certain conditions are met.[473] Common conditions include a minimum deposit balance, a maximum number of transactions in a period, a notice period before withdrawal or a minimum monthly deposit amount.

5.6 Similar to transaction accounts, balances on most savings accounts are available on call, although there may be disincentives for using savings deposits for transactions. For example, customers may lose a bonus rate if they make a withdrawal or keep a bonus rate if withdrawals are delayed by a fixed period.

5.7 **Term deposits** are similar to savings accounts in that they provide an interest return for deposits and are used for saving. Term deposits are fixed-term deposits with a maturity of more than 1 day. Ending a term deposit before the agreed maturity date can incur a break penalty.

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471 Transaction accounts can also be referred to as current accounts or personal current accounts (a term common in the UK that refers to both transaction accounts and savings accounts).

472 For example, ANZ "Overdrafts and overdrawing your account rates, fees, and agreements", https://www.anz.co.nz/rates-fees-agreements/overdrafts-overdrawing/

473 Customers who maximise the value from these products first need transparent information on eligibility criteria for the bonus rate and bank month. A bank month, which can apply as the relevant time period for bonus interest rates, is different from a calendar month. It runs from the last business day of the previous calendar month to the second-to-last business day of the current calendar month. [ ].

5.8 Term deposits typically offer higher interest rates than other types of deposit accounts, and there is a wide range of alternative investment products that offer comparable rates.

Retail deposits are an important source of funding for banks

5.9 Funds stored in deposit accounts are referred to as retail deposits, and they are an important source of funding for banks.

5.10 Banks benefit from deposit account customers in part through charging fees but primarily through the interest margin generated from lending retail deposit funds back to consumers (for example, through home loans). New Zealand banks generally earn less from fee income than banks in many other jurisdictions and therefore the interest margin generated from retail deposits is important for them.[474]

Major banks, Kiwibank and small domestic banks are the main providers of deposit account services to New Zealand consumers

5.11 This chapter focuses on those registered banks that compete broadly for personal deposit account services and are the primary holders of consumer deposits.

5.12 Credit unions and building societies offer many of the same products as banks but are relatively small competitors for deposit products with less than 1% of total deposit-taker assets.[475] NBDTs also compete for deposit services although generally for niche markets rather than in direct competition with banks.[476]

5.13 Some deposit takers choose to target certain customer segments (for example, Rabobank emphasises agriculture banking) or may not offer a broad range of services to consumers. We find that these deposit takers do not provide a strong competitive pressure on the larger banks.

5.14 There are other providers of transaction account services such as fintech payment providers that do not take deposits (discussed in Chapter 9).

How providers compete for deposit account customers | *Te whakataetae a ngā kaituku ratonga mō ngā kiritaki kaute whakaputu*

5.15 There is a range of drivers of competition for deposit account customers and a range of strategies that banks employ depending on the type of deposit account for which they are competing.

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474 David Tripe, Submission on Preliminary Issues paper (6 September 2023), p. 2.

475 We note deposits are not assets and use this measure to reflect the size of this group. [ ].

476 [ ].

5.16 As described in Chapter 2, banks compete to win a customer's main banking relationship (which centres on a transaction account). Main bank relationships provide a range of benefits to the bank such as the ability to cross-sell more services as well as deposits held in transaction accounts providing banks with a low-cost funding source.

5.17 The intensity of competition for deposit accounts depends on a range of market, external and provider level factors for each bank. These factors are described in more detail in Chapter 2 and apply similarly to deposits. Due to the interdependencies across the balance sheet (where deposits are a key funding source for lending activities) and drivers of consumer choice, the same factors can impact competition for deposit accounts and home loans.

5.18 Brand reputation plays an important role in competition for deposit accounts. For savings and term deposits, trust and security are important drivers of consumer choice, while brand presence may be more important for transaction accounts.

5.19 From mid-2025, the Reserve Bank will be introducing a Depositor Compensation Scheme (DCS), which will provide insurance for consumer deposits that are held with banks, credit unions, building societies or finance companies.[477] As discussed in Chapter 7, the Reserve Bank suggests the DCS will support small providers ability to attract deposits, although NBDTs continue to question the competitive benefits of the scheme.[478] We have heard that, in Australia where a similar scheme is in place, there appears to be an enduring consumer perception that major banks are safer even though other deposit takers are covered by the scheme.[479]

Price is not a significant feature of competition for transaction accounts

5.20 Most personal transaction account products do not pay interest on balances,[480] and many account fees have reduced or been removed in recent years. As such, the price that consumers pay (or earn) for transaction deposits is not a strong factor that consumers consider when choosing a transaction deposit account.

5.21 As transaction accounts are likely to have a high volume of daily activity, the quality dimensions of transaction account services are more relevant to consumers than price when choosing a transaction account service provider.[481] Quality dimensions include the quality of the bank's internet banking, mobile apps or the availability of features such as Apple Pay and Google Pay.

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477 Reserve Bank "Depositor Compensation Scheme" (5 March 2024), https://www.rbnz.govt.nz/regulation-and-supervision/depositor-compensation-scheme

478 Financial Services Federation, Submission on draft report (17 April 2024), pp. 5–6; Commerce Commission "Day 1 Personal banking services market study conference – Session 2 Prudential capital requirements and other regulatory factors" (13 May 2024), p. 22 (lines 7–26).

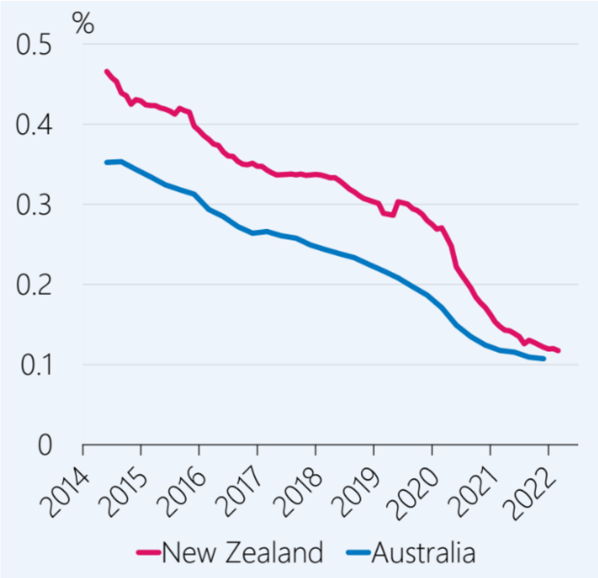
479 ACCC "Retail deposits inquiry – Final report" (December 2023), pp. 21–23; [ ].

480 However, some business transaction accounts do provide interest return on transaction account balances as we note some banks offer interest on business transaction accounts.

481 [ ]; [ ].

5.22 As shown in Figure 5.1, there has been a decline in fees on transaction accounts in recent years, and we have observed a shift towards removing deposit account fees more broadly.

Figure 5.1 Transaction and call deposit account fees (% of average balances)



Source: Reserve Bank.[482]

5.23 Declining fees may be attributed to banks placing more focus on interest income generated by lending out retail deposits and therefore reducing fees to attract retail deposits. It may also reflect ongoing decline in bank operating costs due to digitalisation.[483]

Transaction accounts face higher barriers to switching than savings or term deposits

5.24 Several features prevent more switching between providers of deposit accounts. Some of these switching barriers are common across any product for customers moving to a new bank such as identification checks to meet AML/CFT and know your customer (KYC) requirements, and other barriers are unique to certain deposit account products.

5.25 The actual or perceived costs for switching transaction account providers benefit the major banks proportionately more as they have large existing customer bases. These switching costs make it more difficult for smaller providers to attract retail deposits and grow.

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482 Reserve Bank "Financial Stability Report" (4 May 2022), p. 37, https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/publications/financial-stability-reports/2022/fsr-may-22.pdf

483 Reserve Bank "Financial Stability Report" (4 May 2022), p. 37.

5.26 Transaction accounts can be cumbersome and time consuming to switch due to the numerous contingent payment arrangements and associated day-to-day activities that need to move.[484] This can include updating the account number that income is paid to, transferring automatic payments and direct debits, EFTPOS and debit card arrangements, setting up a different banking mobile app and migrating saved information.

5.27 A switching service run by Payments NZ is available that can support migrating some but not all payment arrangements (which we describe in Chapter 8). Awareness and use of the switching service appears to be low, and it provides only limited support to consumers seeking to switch transaction account providers.

5.28 Savings and term deposits have fewer contingent arrangements to migrate, so switching these is easier than for transaction accounts. However, consumers will still face AML/CFT and KYC checks when opening a new account in order to switch to a new bank.

5.29 Switching term deposits (without a potential penalty) is only possible at the end of any fixed maturity period, but this appears to be relatively easy for consumers to manage as the term commitment is transparent and chosen by the consumer.

5.30 Chapter 8 discusses in more depth consumers' ability to search for and switch to another bank provider.

Some transaction account services can be difficult to provide without holding deposits

5.31 Consumers generally use the transaction account services of the bank that they store their deposits with (for example, payment and money management services provided through a mobile banking app). We have observed some challengers (such as Dolla)[485] seeking to offer alternative transaction account services, but these apps have seen limited uptake in New Zealand to date. This is a reflection of the broader challenges facing open banking in New Zealand described in Chapter 9.

5.32 A fintech seeking to introduce an innovative transaction account service may currently find that they also need to vertically integrate to hold deposits. This can decrease a consumer's likelihood to switch to such a service (given the importance consumers place on safety and security of their money) and to engage in deposit taking would mean needing to meet regulatory requirements for deposit taking. This dynamic is currently making it more difficult for competition to emerge from innovative payment and money management services.

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484 In this section, when we discuss a consumer switching their transaction account, we are referring to switching of the main banking relationship – the consumer's primary transaction account that is used day to day. As discussed in Chapter 8, many consumers may or may not close their previous transaction account when they switch to a new provider. This is sometimes referred to as a hard switch or soft switch. While a soft switch provides a consumer more time to migrate their service to the new provider, the distinction is otherwise not relevant for this section of the report.

485 For example, Dolla provides a mobile app that is compatible with all large banks and provides a range of services without requiring funds to be transferred to a Dolla account.

Banks compete on price for savings accounts and term deposits

5.33 Price competition in the form of interest rates and/or fees appears to be the key driver of consumer choice for term deposits and to a lesser extent for savings accounts. Aside from the term and the interest rate, term deposit products are relatively homogeneous.

5.34 Consumers are more price sensitive for term deposits than for savings accounts, and other forms of interest-bearing investment (for example, managed funds) can be alternative options. Price is not the only factor to consider when comparing these products – a consumer's risk tolerance is also a key factor, as is the term commitment, and typically term deposits are viewed as a low-risk product compared to other investments. As discussed in paragraph 5.18, trust and security of a brand – rather than product – do play a role.[486]

5.35 While savings accounts are primarily used to earn an interest return, there are other features that may be important for consumers such as the convenience of an account from the same provider as a main transaction account (the main bank relationship).

5.36 As consumers are price sensitive for savings accounts and term deposits, banks are able to attract deposits to meet their funding needs through adjusting interest rates on these interest-bearing products. By contrast, seeking to attract transaction deposits appears more likely to require enhancements to non-price features (for example, a good app), which take longer to develop.

5.37 Engaged consumers appear to be able to get better term deposit rates by comparing and negotiating with providers.[487] We understand a bank's internal pricing discretion framework typically enables frontline staff to escalate pricing requests on term deposits and in some cases gives frontline staff authority to immediately apply pricing discretion within set limits.[488]

5.38 Our review of bank pricing strategies found that key considerations when setting interest rates include current market conditions, competitor rate movement, core funding strategy and market share objectives as well as other internal factors such as broader bank strategy.[489]

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486 For example, see MoneyHub "Compare the Best Term Deposit Rates in New Zealand" (29 July 2024), https://www.moneyhub.co.nz/term-deposit-rates.html; and FMA "Cash investments" (4 March 2020), https://www.fma.govt.nz/consumer/investing/types-of-investments/cash-investments/

487 As we have observed, discretionary discounting is available for term deposits although this can depend on the intensity of competition.

488 [ ].

489 We have observed that a key role of a bank's pricing committee is to provide insights and information to review and approve pricing for savings accounts and term deposits (across multiple terms). [ ].

5.39 The major banks and Kiwibank tend to closely monitor each other's interest rates, with limited consideration of smaller banks or non-banks.[490] This suggests that they do not face strong competitive pressure from smaller providers on price.

5.40 Some banks have been moving to simplify their savings accounts and provide greater value for customers. In some cases, this has meant a move away from base and bonus interest rates towards one flat interest rate on savings products.[491]

5.41 Training is provided to frontline staff to support proactive and consistent application of discretions and to balance customer outcomes with customer retention. When considering a pricing escalation, bank staff consider factors such as funds under management, the length of time a customer has been with the bank and current competitor rates.[492]

5.42 As we describe in Chapter 4, the OCR is one important factor that providers have regard to when setting interest rates. However, we would not expect to see a one-for-one relationship between the OCR and savings or term deposit interest rates because these interest rates are also influenced by other factors such as wholesale funding conditions and the intensity in competition among banks to attract deposit funding.

Price comparison between banks

5.43 Figure 5.2 compares weekly deposit rates for savings and term deposit products across selected banks.[493] Interest rates offered for term deposits tend to be similar across the most popular 3-month, 6-month and 12-month terms.

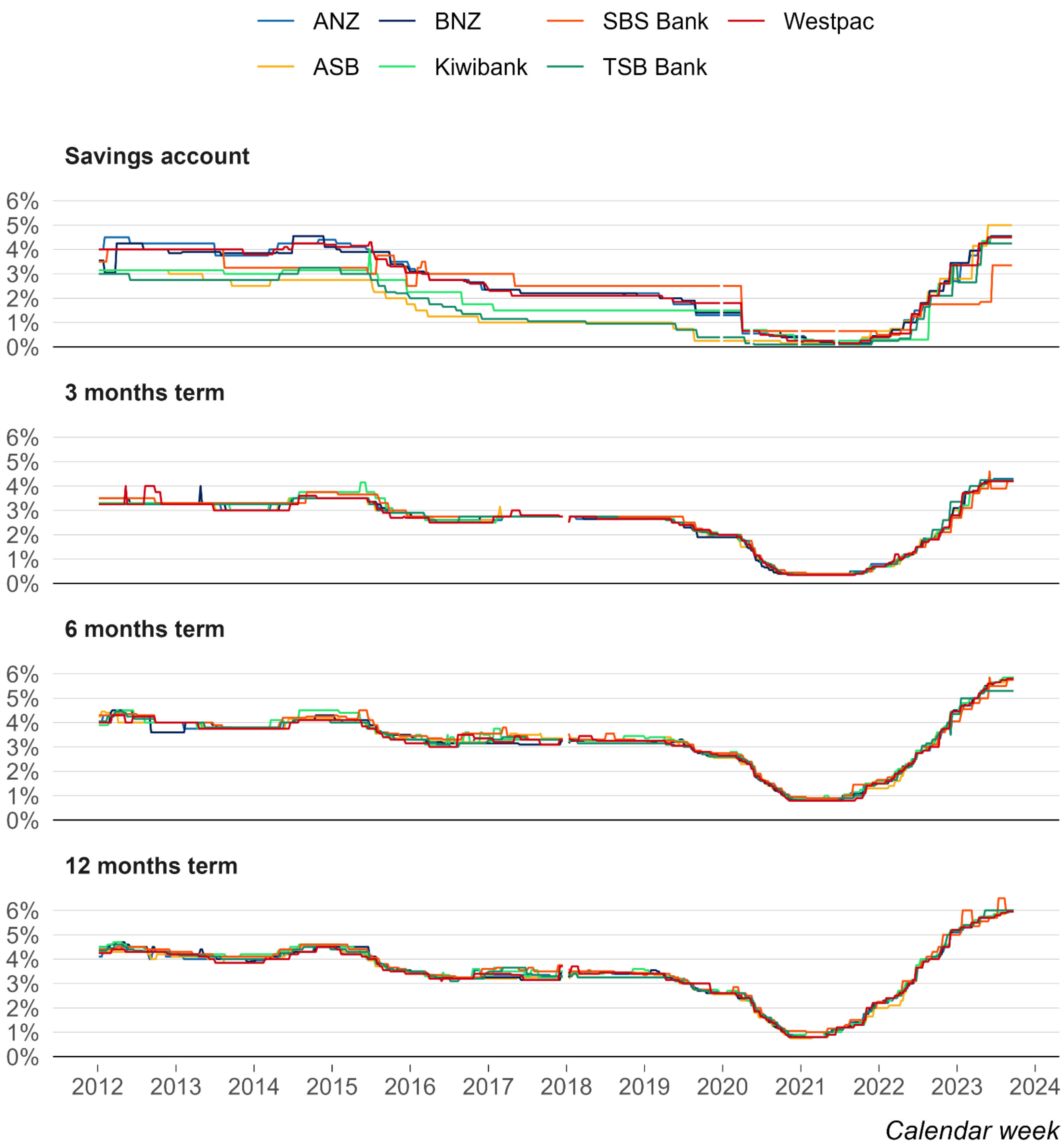
490 [ ]; [ ]; [ ]; [ ]; [ ]; [ ].

491 [ ].

492 [ ].

493 The banks included in Figure 5.2 are the main providers of personal deposit accounts for which the necessary pricing data is available.

Figure 5.2 Weekly deposit interest rates



Source: Our analysis of data provided by interest.co.nz.[494]

494 Chart includes the interest rates for savings account products where the minimum balance necessary is $2 or less. Savings accounts with a higher minimum balance are excluded from this analysis. Prices for term deposits are for products with a minimum deposit balance of $10,000 or less. Term deposits with a higher minimum balance requirement are excluded. [ ].

5.44 We have seen that the major banks and Kiwibank respond very closely to changes in interest rates for term deposits by their competitors. This may reflect that consumers are sensitive on price for term deposits. We note in Chapter 2 there are features of retail deposits that suggest that, similar to home loans, the market could be prone to accommodating behaviour. However, there may be less risk in deposits than for home loans.[495]

5.45 As observed in paragraph 5.6, savings deposits can have a two-tier base and bonus interest structure. Small banks with a strategy to grow market share seem to generally offer a low entry interest rate and a higher bonus interest rate if certain conditions are met (such as minimum balance or maximum number of withdrawals in a period). Large banks, on the other hand, are more likely to offer one flat interest rate.[496]

5.46 It appears that consumers have a high tendency to access the bonus savings rates of the smaller banks.[497] This implies that small banks may be more likely to attract more price-sensitive and engaged savings customers.

Arranged overdraft fees are required to be cost reflective under the CCCF Act

5.47 Overdraft services are provided via transaction accounts and can be arranged or unarranged. Overdraft services typically incur fees and interest expense on the overdraft balance.

5.48 The CCCF Act, which regulates credit and default fees charged on home loans and arranged overdrafts, essentially requires that these fees are cost reflective.[498]

5.49 About a third of deposit account consumers were charged overdraft fees in the 2022/23 financial year. Most overdraft fees are charged by a consumer's main bank (the bank that consumers do most of their everyday banking with).[499]

5.50 While we have not looked closely at the distribution of consumers paying fees, we consider that some consumers may be attracting unnecessary overdraft fees, particularly where they have money sitting in other accounts that could have been used to avoid the fees. Some also pay fees on an ongoing basis where another product might be more suitable.

495 ACCC "Reasons for Determination – Application for merger authorisation lodged by Australia and New Zealand Banking Group Limited in respect of its proposed acquisition of Suncorp Bank" (4 August 2023), p. 9.

496 This may reflect large banks seeking to maintain their existing customer bases.

497 This is because our analysis has found that the major banks and Kiwibank pay a lower interest cost than small New Zealand banks for savings deposits.
[ ].

498 CCCF Act, ss 41–44.

499 [ ].

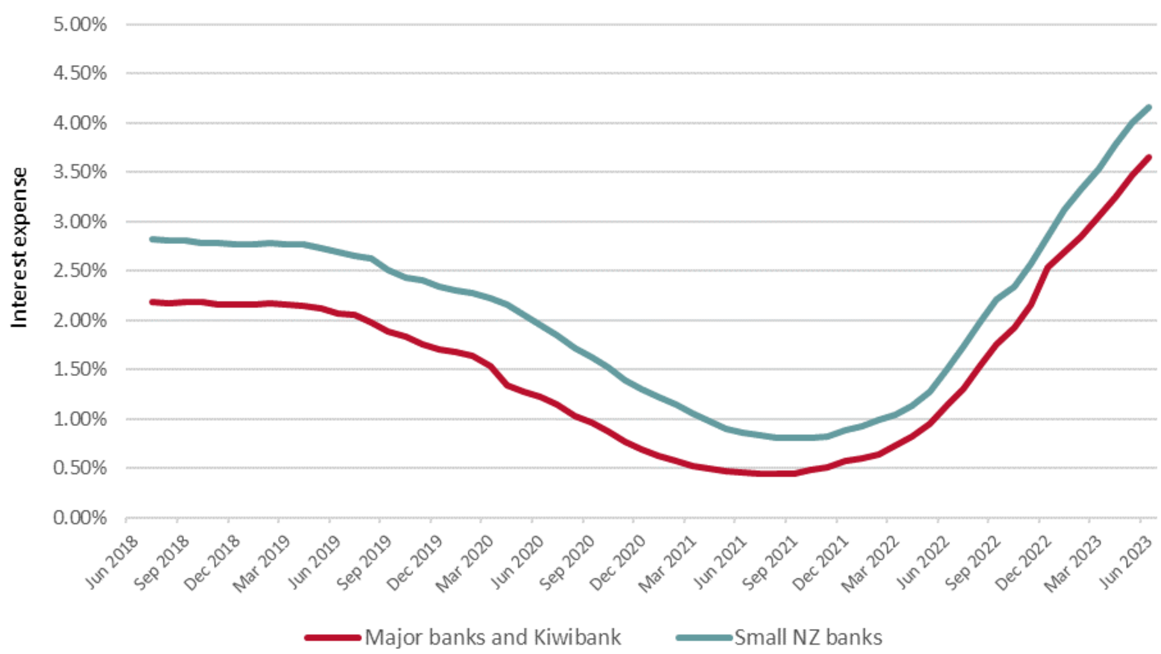
5.51 Interest rates for overdraft balances can be high and are often higher for unarranged overdrafts compared to arranged overdrafts. Overdraft interest rates are similar to cash advance interest rates for credit cards, which may reflect the short-term, limited-notice and unsecured nature of the lending.[500]

5.52 Arranged overdraft fees, while cost reflective, are somewhat widespread, and they can be harmful for some consumers. We discuss arranged and unarranged overdrafts further in Attachment D.

Retail deposits provide large banks with a significant funding advantage | *Ka whai huanga nui ngā pēke nui i ngā whakaputu hoko*

5.53 Retail deposits (funds stored in transaction, savings and term deposit accounts) are generally a stable, secure and relatively cheap source of bank funding.

Figure 5.3 Interest cost of total retail deposits



Source: Our analysis of data provided by Reserve Bank.[501]

500 For interest rates for most overdraft accounts, see MoneyHub "Best Overdraft Bank Accounts – Save on Your Interest Costs" (11 July 2024), https://www.moneyhub.co.nz/overdraft.html. For interest rates for most credit cards, see interest.co.nz "Credit cards", https://www.interest.co.nz/borrowing/credit-cards

501 Calculated as the monthly interest expense for retail deposits over the average monthly deposits balance. [ ].

5.54 As shown in Figure 5.3, the major banks and Kiwibank benefit from approximately a 50–60 basis points cost of funds advantage over small New Zealand banks for the retail deposits they hold.[502] Across the total amount of retail deposits that major banks and Kiwibank hold (approximately $395b), this is a significant advantage for larger banks.

5.55 A bank's ability to attract retail deposits at competitive rates can have a significant impact on its overall cost of funding, profitability and ability to expand. We understand that it is very difficult for smaller banks or other challengers to attract a material amount of retail deposits and particularly transaction deposits.[503] Overseas studies have also found that retail deposits are particularly sticky towards large incumbent banks.

Retail deposits are an important source of funding for a bank's lending activities

5.56 Banks seek retail deposits to fund lending activities. Other sources of funds include short-term and long-term wholesale debt and equity. Deposits are a high-quality source of funding for meeting banks' core funding requirements.

5.57 Taking deposits is one side of a bank's core intermediation function.[504] A bank pays interest on deposits that it holds and earns interest revenue from lending those deposits (and other sources of funds) through home, personal and business loans.

5.58 The cost of retail deposits as well as cost of wholesale funding and cost of equity make up a bank's total cost of funding. In general, retail deposits are cheaper sources of funding than wholesale or equity funding.

5.59 Figure 5.4 below shows the funding mix of large and small New Zealand banks. It shows that retail deposits make up around 65% of larger banks' total funding and 80% of small New Zealand banks' funding.

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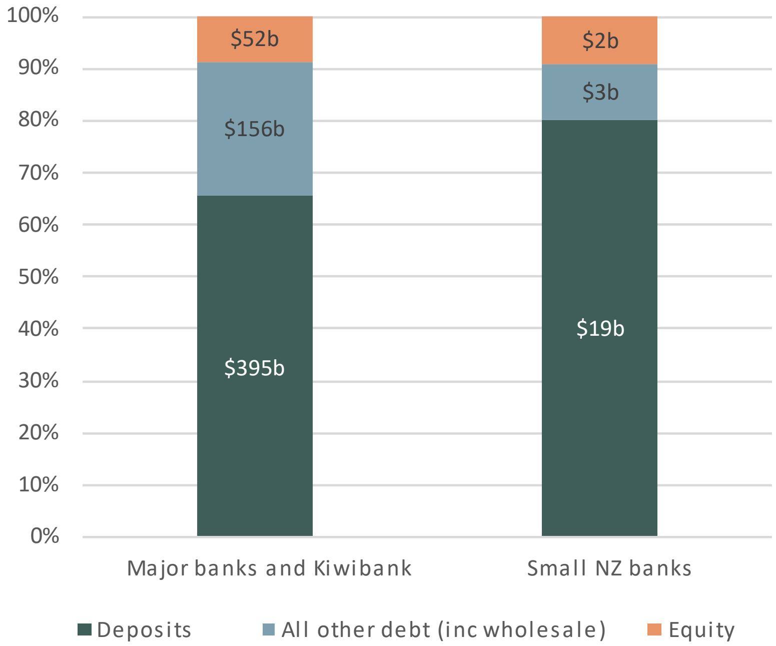
502 When rounded to the nearest 5 basis points, the average differential across June 2018 to June 2023 is 55bps, with a minimum of 30bps and a maximum of 80bps.
[ ].

503 The ACCC finds that retail deposit market share has remained relatively stable for the past 20 years: ACCC "Retail deposits inquiry – Final report" (December 2023), pp. 26–27. The FCA found that, while digital challengers are gaining market share for personal current accounts, this isn't the case for main bank relationships and retail deposit balances: FCA "Strategic Review of Retail Banking Business Models – Final Report (January 2022), p. 4, https://www.fca.org.uk/publication/multi-firm-reviews/strategic-review-retail-banking-business-models-final-report-2022.pdf
[ ].

504 Commerce Commission "Market study into personal banking services – Preliminary Issues paper" (10 August 2023), footnote 20.

Figure 5.4 Total bank funding composition as at 30 June 2023



Source: Our analysis of data provided by Reserve Bank.[505]

5.60 While small New Zealand banks hold a higher proportion of retail deposits than the larger banks, the dollar balance of their retail deposits is considerably smaller. Larger banks also have better access to wholesale funding sources while smaller banks rely more heavily on retail deposits.

5.61 Following the global financial crisis (GFC), there has been a shift in focus from wholesale funding (particularly short-term wholesale) to retail deposits due to retail deposits being a more stable source of bank funding than securitised products.[506,507]

5.62 The Reserve Bank sets a core funding ratio (CFR), which requires banks to hold a minimum amount of its funding from stable sources.[508] Core funding includes deposits with a maturity of greater than 1 year, and the CFR is currently set to 75%. The level of the CFR can influence banks' decisions regarding whether to seek retail deposits or wholesale funding.

505 [ ].

506 This is also reflected by the ACCC for Australian banks: ACCC "Retail deposits inquiry – Final report" (December 2023), p. 57.

507 Jason Wong "Bank funding – the change in composition and pricing" (2012), pp. 15–17, https://www.rbnz.govt.nz/-/media/ced9ce19786246819c727cefb6467bb7.ashx

508 Reserve Bank "Liquidity policy for banks" (21 December 2022), https://www.rbnz.govt.nz/regulation-and-supervision/oversight-of-banks/standards-and-requirements-for-banks/liquidity-policy-for-banks

5.63 We have heard that smaller providers such as NBDTs are disadvantaged as they are unable to access ESAS accounts directly.[509] ESAS accounts (among other things) provide access to the OCR for on-call deposits, which can support better prices (interest rates) for deposit products. NBDTs have stated that this gives the banks who can access ESAS:[510]

> "…an immediate margin in a risk-free, zero risk-weighted on call asset being the ESAS account. We understand that it potentially accounts for around $2 billion of bank profits on customer call accounts – as well as giving them a risk-free margin on funds deposited with them by NBDTs."

5.64 We have heard that Funding for Lending Programme (FLP) had a short-term impact on competition for deposits.[511] FLP was a low-cost source of funds available to ESAS account holders, which contributed to reductions in the interest cost that participating ESAS account holders paid for all retail deposits.[512] While the FLP was a COVID-19 pandemic response measure, it reduced competition for deposits.[513] In addition, the impact of FLP was not evenly distributed given the benefits were only available to some deposit takers.

Transaction deposits are particularly valuable for banks

5.65 Banks pay considerably less for transaction deposits than savings or term deposits as most transaction account products are non-interest bearing.[514] Savings deposits are also a cheap funding source (although to a lesser extent than transaction deposits), while term deposits are generally the most expensive source of deposit funding.[515]

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509 As discussed in Chapter 9, currently only a limited number of industry parties have direct access to ESAS. Current ESAS account holders include several registered banks, the Reserve Bank, CLS Bank and New Zealand Depository Limited: Reserve Bank "ESAS overview, governance and channels" (1 March 2024), https://www.rbnz.govt.nz/payments-and-settlement-systems/exchange-settlements-account-system/esas-overview-governance-and-channels

510 [ ].

511 FLP was a tool used by the Reserve Bank designed to lower banks' funding costs during the COVID-19 pandemic in a context where the OCR may have reached its lowest practical level.

512 Figure 5.2 highlights the reduction in deposit rates for the December 2020 to December 2022 period that FLP was available. [ ].

513 Reserve Bank "Financial Stability Report" (1 November 2023), p. 39, https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/publications/financial-stability-reports/2023/nov-2023/fsr-nov-23.pdf

514 [ ].

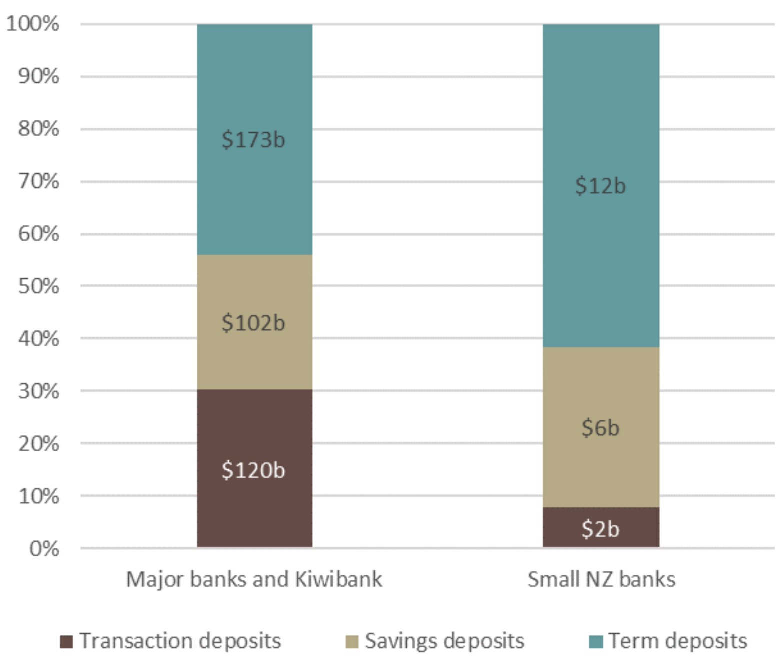
515 [ ]; [ ].

5.66 Combined, the major banks and Kiwibank hold in excess of $58b in deposits not bearing interest.[516] When contrasted with market lending rates, this contributes to overall profitability, particularly in a rising interest rate environment.[517]

5.67 As noted in paragraph 5.17, interdependencies across the balance sheet can impact competition for deposit accounts and home loans. For example, in a period of rising interest rates and weak housing demand, the higher interest margins generated by deposits can more than offset the impact to the net interest margin (NIM) of lower margins of a relatively competitive market for new mortgages.[518]

5.68 Figure 5.5 shows that the major banks and Kiwibank hold proportionally more transaction deposits than small New Zealand banks. This contributes to an overall funding advantage to the larger banks because transaction deposits are typically the cheapest source of funding (followed by savings deposits, then term deposits).

Figure 5.5 Deposits mix as at 30 June 2023



Source: Our analysis of data provided by Reserve Bank.[519]

516 Calculated using bank disclosure statements for 2023. This is an approximate calculation as the dates for disclosure statements do not align (some are as of 30 June while others are as of 30 September). We acknowledge that deposits not bearing interest are not zero cost for banks – for example, banks may hedge non-interest-bearing call deposits to a 90-day rate (known as maturity transformation) at a cost to the bank.

517 The Treasury "Windfall gains in the New Zealand banking sector, and responses" (10 February 2023), para 81, https://www.treasury.govt.nz/sites/default/files/2023-07/b23-tax-4791084.pdf

518 Reserve Bank "Financial Stability Report" (3 May 2023), p. 38.

519 [ ].

5.69 Transaction deposits are largely derived from the main bank relationship where consumers do most of their everyday banking activity. The higher proportion of transaction deposits held by the larger banks reflects the strong position they have in main bank relationships, as discussed in Chapters 2 and 9.[520]

5.70 While a significant proportion of the deposits are on call, we have found that consumer switching rates are very low and therefore these deposits are reasonably stable. Although on-call deposits may have a fluctuating balance for individual accounts, when aggregated across a large customer base, they provide a bank with stable funds that are often as sticky as the customer relationship.[521]

5.71 During the recent period of rising interest rates, consumers have shifted some deposits away from low (or no) interest call accounts towards higher-return term deposits. Nevertheless, the balance of deposits not bearing interest remains high.[522] This is likely to reflect a high proportion of transaction deposits that consumers access for day-to-day banking and therefore cannot easily be stored in an interest-bearing account.

5.72 Where deposits are not bearing interest and not used for day-to-day banking, there is an opportunity for consumers to engage in the market and earn an interest return and an opportunity for services that can support this.

Improving competition for retail deposits | *Te whakapai ake i te whakataetaetanga mō ngā putunga hoko*

5.73 The nature of the funding advantage to large banks from retail deposits is an issue that is inherent in personal banking and a common feature observed in the UK and Australia.[523]

5.74 Some submissions proposed recommendations regarding the lack of interest payments on transaction deposits. One suggested banks pay interest on all deposits, including transaction deposits, at a market rate (at least the cash rate).[524] Consumer NZ suggested a consumer duty similar to the UK, which requires firms to be able to evidence fair value of their products and services, stating that this would require banks to justify low or no interest on deposits as fair value.[525]

5.75 We have focused our recommendations on measures to reduce barriers to competition more generally rather than specific proposals to reduce the funding advantage.

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520 [ ].

521 [ ].

522 [ ].

523 Australian Productivity Commission "Competition in the Australian Financial System" (29 June 2018), p. 224; FCA "Strategic Review of Retail Banking Business Models – Final Report (January 2022), p. 3.

524 Peter Mair, Submission on draft report (4 April 2024), p. 14.

525 Consumer NZ, Submission on draft report (18 April 2024), p. 6.

5.76 In principle, the DCS may support competition for retail deposits by helping promote consumer trust in smaller deposit takers. However, as noted above, NBDTs continue to question the competitive benefits of the scheme, and there appears to be an enduring consumer perception in Australia that the major banks are safer (where a similar scheme is in place).

5.77 Open banking shows real promise to improve competition for the long term for both transaction account services and retail deposits by enabling competition without consumers switching from their main bank and decoupling competition for account services and deposit funds (as described from paragraph 5.31 above). We expect that, over time, this will improve other providers' ability to compete for transaction deposits.

5.78 Broadening access to ESAS, which provides the OCR on overnight deposits, is expected to enable firms to better compete on price. We have heard from challenger deposit service providers that access to ESAS provides a material competitive advantage to banks.[526] Broader ESAS access may also help smaller competitors more generally through a reduced dependency on larger banks' agency banking services,[527] as described in Chapter 9.

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526 [ ].

527 [ ]; [ ].

Chapter 6 Profitability of New Zealand's banking sector | *Te whiwhinga huamoni a te rāngai pēke ki Aotearoa*

Summary of findings

- **The profitability of the New Zealand banking sector is high relative to banking sectors in peer nations**. Between 2010 and 2021, New Zealand's banking sector profitability has, on average, performed in the upper quartile relative to peer nations on three important measures: return on equity (ROE), return on assets (ROA) and NIM. We placed the greatest weight on ROE, consistent with the feedback we received from submitters (including the major banks) that this is the better measure of bank profitability.
- **Additional cross-checks produce consistent results and provide us with a higher degree of confidence in this finding.** Since our draft report, we have done further work to test our preliminary finding that the profitability of the New Zealand banking sector appears high. Overall, we observed consistent results across multiple methods and samples, which increases our confidence in our profitability assessment.
- **The major banks make significant profits each year. However, they are among New Zealand's largest companies so the dollar value of profits (on its own) tells us little about competition.** Measures of profitability (returns in percentage terms), on the other hand, are more relevant to our assessment.
- **New Zealand's major banks have consistently achieved higher average returns on equity than other New Zealand banks.** This is consistent with the two-tier structure described in Chapter 2.
- **Non-competition explanations put forward for the New Zealand banking sector's levels of profitability do not explain the profitability we observe since 2010.** We consider that at least part of the level of profitability is explained by the market power of the major banks. New Zealand's banking sector profits are higher than what would be expected if they faced greater competition.
- **The focus of New Zealand banks on lower-risk activities should see lower profits.** A business that takes on higher risk can expect to have higher profitability over time. The New Zealand banking sector is relatively low risk in nature because it is more heavily weighted towards traditional banking activities than many peer nations, yet we see higher levels of profitability in New Zealand relative to peer nations.

Introduction | *Whakatakinga*

6.1 This chapter assesses indicators of banking sector profitability at a whole-of-bank level to understand:[528]

6.1.1 how the profitability of the New Zealand banking sector compares to the profitability of banking sectors in other jurisdictions; and

6.1.2 the relative profitability between banks operating in New Zealand.

6.2 Although not always determinative, an assessment of profitability over time can provide some insights into the strength of competition in a market.

6.3 Attachment B describes our approach in more detail while Attachment C contains a more detailed assessment of the possible explanations put forward for observed profitability trends. The latter includes a more detailed assessment of Incenta's alternative approach to international comparisons (as described in its submissions for ANZ).

Assessing banking sector profitability | *Te aromatawai i te whiwhinga huamoni a te rāngai pēke*

Persistently high profitability may indicate that competition is not working well

6.4 Outcomes of the competitive process that can be observed, including the prices charged by firms and their profitability, can serve as indicators of the intensity of competition.

6.5 In a well-functioning competitive market, firms are typically expected to earn profits that approximate their opportunity cost of capital. This is often referred to as a normal rate of return. There are two main exceptions to this. Some firms might have unusually productive assets and may therefore be able to sustain higher profits over time even in a competitive market. Similarly, profit levels across a competitive industry may vary over a business cycle and a firm might even incur losses from time to time.[529]

6.6 However, where firms that represent a substantial part of the market persistently derive returns that significantly exceed their opportunity cost of capital, this indicates that the competitive process is not working well.

6.7 Observing that profitability across a market is consistently high does not mean that the market could be more competitive. It may be that there is no way to force stronger competition.

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528 Our profitability assessment is undertaken across all of banks' activities, including personal, corporate, institutional, commercial, business, SME and agricultural banking. This is what we mean by assessing profitability at a whole-of-bank level. Further explanation is included at paragraphs 6.15 to 6.19 below.

529 *Wellington International Airport Ltd and Others v Commerce Commission* [2013] NZHC 3289 at [19].

6.8 It is important that a banking sector remains well capitalised. This maintains confidence in the banking system that supports financial stability by improving banks' ability to access funding, by improving resilience to shocks throughout the business cycle and by reducing the probability of bank runs.[530] Well capitalised banks can withstand fluctuations in profitability, including losses. Like any business, though, a sequence of losses will pose challenges. If competition was effective, on average across a sector and through time, we would expect to observe normal levels of profitability in the sector.

Bank profitability is best assessed using profitability ratios at the whole-of-bank level

6.9 As explained in our Preliminary Issues paper, our approach to assessing banking sector profitability has been to draw on existing information and analyses prepared by the Reserve Bank.[531] In May 2023, the Reserve Bank concluded that "the large New Zealand banks have been more profitable than the rest of the New Zealand banking sector and large banks in a number of comparable economies in recent years".[532]

6.10 We have used publicly available data from the Reserve Bank and World Bank to compare the profitability of banks operating in New Zealand and to compare New Zealand's banking sector internationally. We describe both the Reserve Bank and World Bank datasets and our approach to assessing profitability in greater detail in Attachment B. We have not included non-bank providers in our profitability analysis.

We have focused on three profitability measures and place the greatest weight on ROE

6.11 Much of the recent media commentary on profitability in the banking sector has reported on the total dollar amounts of bank profits.[533] Given the large size of the major banks, we would expect these firms to earn high dollar values of profit on average over time even in a competitive market. Profitability ratios on the other hand account for factors such as the scale of the firm. Consequently, ratios may be compared across firms.

530 Reserve Bank "Financial Stability Report" (3 May 2023), p. 22; Andrea Enria "The many roads to return on equity and the profitability challenge facing euro area banks" (22 September 2021), https://www.bankingsupervision.europa.eu/press/speeches/date/2021/html/ssm.sp210922~df2b18acb9.en.html

531 Commerce Commission "Market study into personal banking services – Preliminary Issues paper" (10 August 2023), para 114.

532 Reserve Bank "Financial Stability Report" (3 May 2023), p. 24.

533 For example, Tamsyn Parker "Record profits: Banks made $7 billion last year – a billion-dollar increase on 2021" (14 March 2023), https://www.nzherald.co.nz/business/record-profits-banks-made-7-billion-last-year-a-billion-dollar-increase-on-2021/RNSQD7UTENHRZPCZEDDN5MSBTY/

6.12 We have focused on three measures of banking profitability: ROE, ROA and NIM. Professor Margaritis and Dr Hasannasab have also examined the relationship between these measures and market power.[534] We have also, to a lesser extent, considered CTI ratios. Each measure is explained in greater detail in Attachment B.

6.13 Each ratio is only a partial measure of profitability. We therefore consider the outcomes we observe across multiple measures. However, we have consistently heard from a range of parties, including the major banks, that ROE is the preferred measure of bank profitability. This is supported by observations in the banks' key performance indicators.[535,536]

6.14 We therefore place the greatest weight on ROE and focus our analysis on this measure. We look at other profitability measures in reaching our findings on profitability. However, we provide only limited commentary on these other measures in this report.

We have assessed profitability at the whole-of-bank level

6.15 These profitability measures are at the whole-of-bank level and include activities that do not relate to personal banking services, including business banking.

6.16 Banks internally assess their own profitability at a variety of different levels below a whole-of-bank level. Margins are a common measure of the profitability of individual product categories or business units.[537] Often these margins are measured against a bank's internal transfer price or another interest rate benchmark so they are difficult to compare across banks. Other measures are used less frequently.[538] Margins allow a bank to understand the profitability of particular segments of the bank, particular product types or even as granular as the profitability of particular product terms (for example, 1-year versus 2-year fixed rate home loans).

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534 Dimitris Margaritis and Maryam Hasannasab "Market power in banking: A study of New Zealand banks" (March 2024), p. 20.

535 We have heard from multiple sources that return on equity is the most appropriate measure of bank profitability. ANZ, Submission on Preliminary Issues paper (7 September 2023), para 8; [ ].

536 [ ].

537 [ ].

538 [ ].

6.17 However, it is not feasible to robustly compare profitability for *personal* banking services across banks. Banks pool various sources of funding and have unique internal approaches to transfer pricing meaning it is difficult to robustly allocate costs in a consistent way.[539,540] There are also differences in how each bank defines their business units and product segments so that comparisons would not necessarily be like for like.

6.18 Given these limitations, we have elected to assess profitability at the whole-of-bank level. This aligns with the Cabinet paper, which envisaged that an assessment of financial performance as part of this market study would be conducted at a whole-of-bank level as opposed to just personal banking services.[541] Care must therefore be taken when interpreting our results as conclusions cannot be interpreted with regard to personal banking services alone.

6.19 We received submissions on our approach to assessing profitability and the results set out in our draft report. We have therefore used several methods to cross-check our work and results as discussed below where relevant.

New Zealand's banking sector profitability has been high relative to a range of peer nations over the past decade | *Ka nui te whiwhinga huamoni a te rāngai pēke o Aotearoa i tērā o ētahi atu whenua o te ao i te tekau tau kua hipa*

6.20 We have compared the profitability of New Zealand's banking sector against a sample of peer nations using World Bank data and several performance ratios. Attachment B describes the World Bank dataset and our approach in more detail. We have found that the New Zealand banking sector's profitability has been high relative to a range of peer countries over the past decade.

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539 Deloitte Access Economics pointed to work by the CMA where they considered possible methods to assess the profitability of banks in more granular relevant markets. However, the CMA concluded that "there were inherent difficulties with such an exercise which would mean that such an analysis would not be sufficiently reliable to inform our assessment of competition": CMA "Retail banking market investigation – Final report" (9 August 2016), paras 32–33, https://assets.publishing.service.gov.uk/media/57ac9667e5274a0f6c00007a/retail-banking-market-investigation-full-final-report.pdf

540 [ ].

541 MBIE "Cabinet Paper – Initiating a Market Study into Personal Banking Services" (28 June 2023), para 23.

6.21 To compare levels of profitability requires a threshold at which, if New Zealand's profitability exceeded it, we would consider the level of profitability to be high. For the purpose of this analysis, we have considered the upper quartile of our sample of peer countries to be this threshold for ROE, ROA and NIM.[542] We note, however, that a lower CTI ratio reflects a more profitable bank. Therefore, we compare New Zealand's CTI ratio to the lower quartile of the sample.

6.22 Given that competition is a long-run process during which profitability can fluctuate over time, we focus on average profitability over a period of time – 2010 to 2021.

6.23 The analysis in our draft report was based on the sample of 21 countries (including New Zealand) used by the Reserve Bank in its May 2023 Financial Stability Report (see Table B1).[543]

Table 6.1 New Zealand's average annual banking sector profitability ratios between 2010 and 2021 relative to the Reserve Bank's sample of comparator countries

Measure	New Zealand average	Reserve Bank sample
		Upper quartile
ROE	**12.61%**	**10.55%**
ROA	**0.92%**	**0.80%**
NIM	**2.03%**	**1.65%**
		Lower quartile
CTI	**43.3%**	**52.8%**

Source: Commerce Commission analysis of World Bank data.[544]

6.24 Table 6.1 shows that the average annual profitability of the New Zealand banking sector between 2010 and 2021 has exceeded the upper quartile of the Reserve Bank comparator sample for post-tax ROE, post-tax ROA and NIM.[545] New Zealand has similarly outperformed the sample of peer countries on average CTI ratio over the period, with a ratio of 43% relative to the sample's lower quartile of 53%.[546]

542 Note that quartile and median values have been calculated from the sample of comparator countries, excluding New Zealand. The quartiles in this chapter have been calculated using the inclusive method, which returns the quartile of a dataset based on percentile values from zero to one, inclusive.

543 Reserve Bank "Financial Stability Report" (3 May 2023), Figure 2.12.

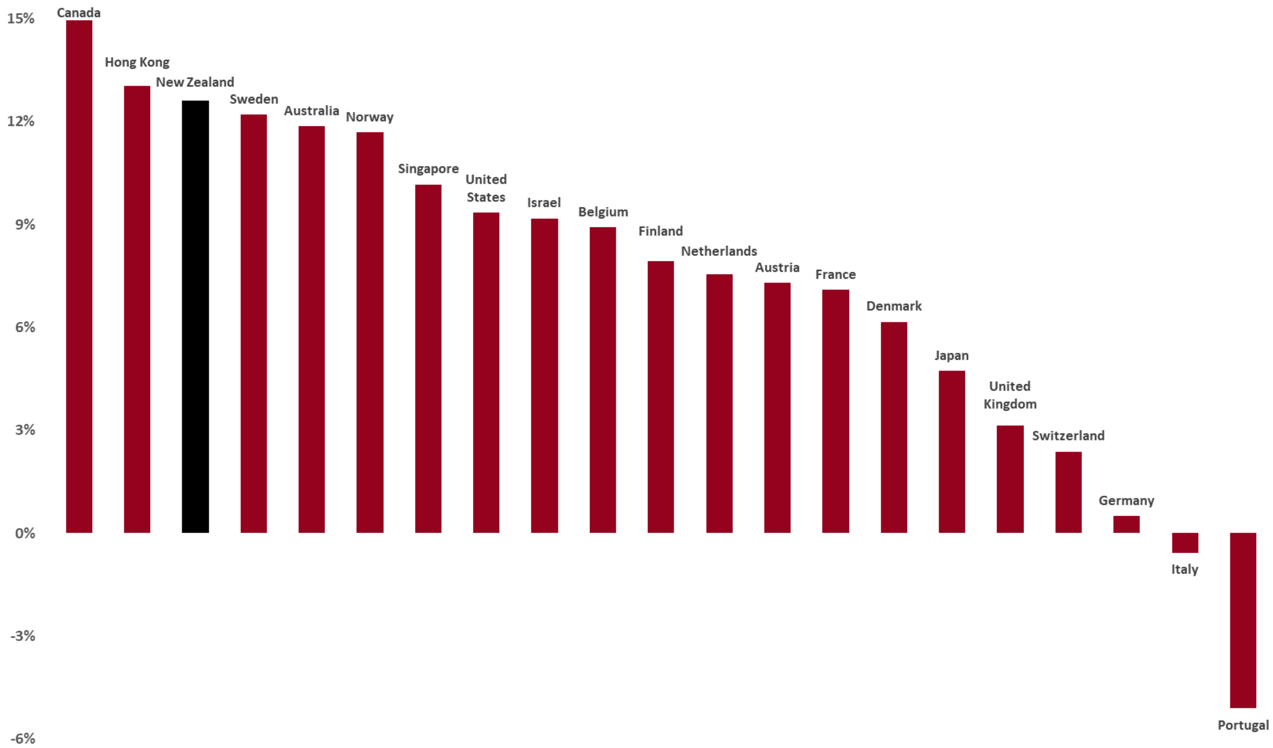
544 World Bank Global Financial Development Database [ ].

545 The upper quartile values in Table 6.1 represent the upper quartile of country-level averages between 2010 and 2021 for each profitability measure. Note that the upper quartile calculation excludes New Zealand.

546 The lower quartile CTI ratio of peer countries represents the lower quartile of country-level averages between 2010 and 2021. Note that the lower quartile calculation excludes New Zealand.

6.25 Figure 6.1 shows that New Zealand had the third-highest average post-tax ROE relative to the 20 comparator countries. Only Canada and Hong Kong had higher average ROE over the same period.

Figure 6.1 Country-level average annual banking sector post-tax ROE between 2010 and 2021



Source: Commerce Commission analysis of World Bank data.[547]

6.26 Figure 6.2 shows that New Zealand's banking sector has consistently performed in the upper quartile since 2011 on post-tax ROE. We observe the same trend on our three other profitability measures, where New Zealand exceeds our threshold to be high for most of, if not our entire, analysis period.[548]

6.27 Given that New Zealand has ranked in the upper quartile (or lower quartile for the CTI ratio) on each measure of profitability that we have considered, we reached the preliminary view that the profitability of the New Zealand banking sector is high relative to peer countries. This validated the finding of the Reserve Bank that the New Zealand banking sector's profitability has been high relative to banking sectors in comparable economies in recent years.[549]

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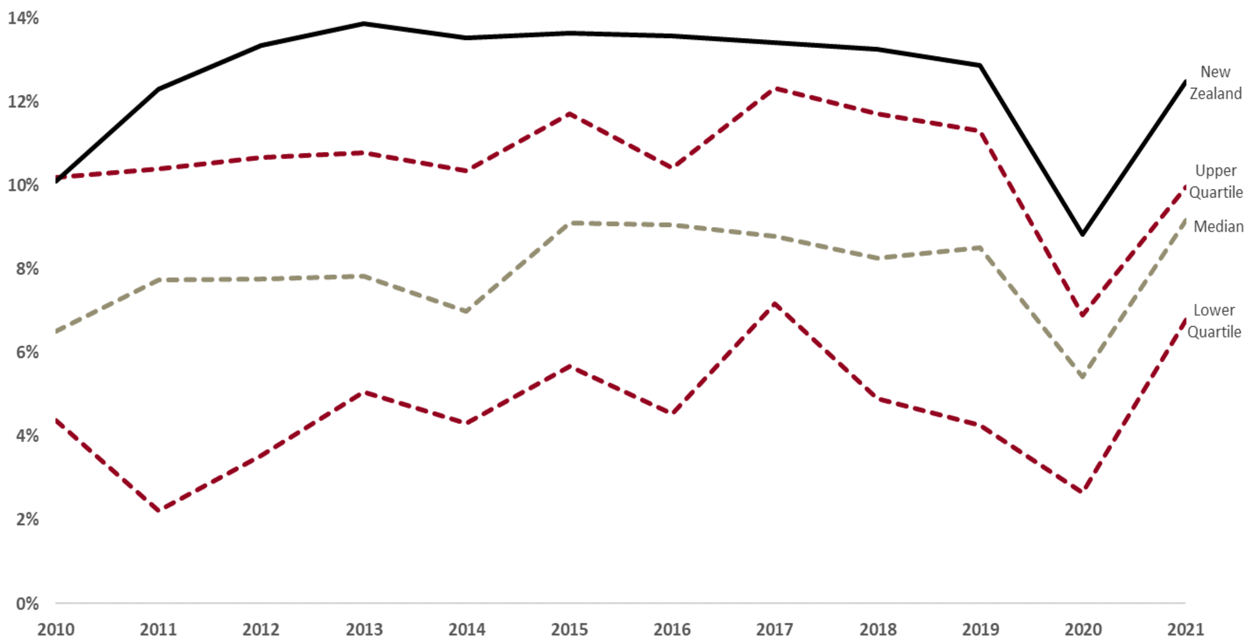
547 World Bank Global Financial Development Database [ ].

548 Commerce Commission "Personal banking services market study – Draft report" (21 March 2024), para 6.27 and Figures 6.3–6.5.

549 Reserve Bank "Financial Stability Report" (3 May 2023), p. 24.

Figure 6.2 New Zealand's annual post-tax ROE relative to the inter-quartile range and median of peer countries between 2010 and 2021



Source: Commerce Commission analysis of World Bank data.[550]

Further work corroborates our finding that the profitability of the New Zealand banking sector has been high

6.28 We received several submissions that critiqued the approach to international profitability comparisons in the draft report. We respond to these submissions in greater detail in Attachment C.

6.29 The key critiques we respond to in this section are that:

6.29.1 we did not justify our selection of the Reserve Bank sample;[551] and

6.29.2 the Reserve Bank sample is biased by the inclusion of so-called crisis countries (EU countries, the UK and Japan).[552]

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550 World Bank Global Financial Development Database [ ].

551 Incenta [for ANZ] "Personal banking services market study – response to the Commission's draft report" (18 April 2024), paras 48–49, https://comcom.govt.nz/__data/assets/pdf_file/0022/350905/ANZ-Submission-on-Market-study-into-personal-banking-services-Draft-report-18-April-2024-Attachment-A-Incenta-report.pdf

552 Incenta [for ANZ] "Personal banking services market study – response to the Commission's draft report" (18 April 2024), para 50; and Incenta [for ANZ] "Market review of personal banking – post conference submission" (30 May 2024), para 4, https://comcom.govt.nz/about-us/our-role/competition-studies/market-study-into-personal-banking-services/post-conference-cross-submissions-close-end-of-may/ANZ-Cross-submission-on-Market-Study-into-personal-banking-services-Draft-report-Annex-A-Incenta-report-30-May-2024.pdf

6.30 In our view, we should not *a priori* exclude countries that have suffered recent banking crises (crisis countries) when attempting to compare the profitability of the New Zealand banking sector to comparable overseas banking sectors. This is because bank profitability tends to be pro-cyclical with external macroeconomic conditions.[553] Excluding crisis countries that experienced adverse macroeconomic conditions that could happen in New Zealand, even if they did not, risks biasing the sample towards high-return countries/banks.

6.31 Our view is that the macroeconomic events that occurred in the EU, UK and Japan reflect outcomes that may occur in New Zealand. Even if we could rule out the possibility of similar crises happening in New Zealand, we would also need to exclude from our sample all other countries in which similar crises could also happen but did not. It is not sufficient to exclude from the sample countries where the crises did happen.

6.32 However, we acknowledge that some submitters do not share our view.[554] We also consider that the sample used for profitability comparisons should appropriately reflect the specific characteristics of the New Zealand banking sector so that our findings are not biased.

6.33 We therefore used cross-checks to test the robustness of our findings. Our cross-checks used two approaches:

6.33.1 Regression analysis to control for pro-cyclicality while also including variables that control for differences in banking sector characteristics.

6.33.2 Developing a sample of countries that reflects the characteristics of the New Zealand banking sector and rerunning our analysis using this sample.

New Zealand banking sector profitability remains high when the three least profitable countries are excluded from the Reserve Bank sample

6.34 While we do not agree with the exclusion of crisis countries, we endeavoured to test whether the inclusion of countries with the lowest rates of profitability affected our results.

6.35 We first removed countries that had a ROE or ROA that was negative on average over our analysis period. This resulted in the exclusion of three countries from the Reserve Bank sample – Portugal, Italy and Germany.[555]

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553 For example, see Claudio Borio, Craig Furfine and Philip Lowe "Procyclicality of the financial system and financial stability: issues and policy options" (1 March 2001), p. 17, https://www.bis.org/publ/bppdf/bispap01a.pdf

554 Incenta [for ANZ] "Personal banking services market study – response to the Commission's draft report" (18 April 2024), para 50; Incenta [for ANZ] "Market review of personal banking – post conference submission" (30 May 2024), para 4; [ ].

555 While Germany's average ROA over the period rounds to a value of zero to two decimal places, the underlying value is negative.

6.36 As Table 6.2 shows, on all four measures, New Zealand remains in the upper quartile (or lower quartile for CTI) even after these lowest-performing countries are excluded.

Table 6.2 New Zealand's average annual banking sector profitability ratios between 2010 and 2021 relative to the Reserve Bank's sample of comparator countries (excluding Portugal, Italy and Germany)

Measure	New Zealand average	Adjusted Reserve Bank sample
		Upper quartile
ROE	**12.61%**	**11.68%**
ROA	**0.92%**	**0.91%**
NIM	**2.03%**	**1.74%**
		Lower quartile
CTI	**43.3%**	**52.2%**

Source: Commerce Commission analysis of World Bank data.[556]

New Zealand's banking sector ROE remains high after controlling for pro-cyclicality

6.37 We next developed a regression model in which we regress annual country-level post-tax ROE against gross domestic product (GDP) growth per capita (in current USD) to control for pro-cyclicality.[557] We used this approach to test robustness, including across different sample definitions.

6.38 We also controlled for other differences in banking sector characteristics through the inclusion of additional independent variables that we expect would drive differences in banking sector profitability. Due to data limitations, our primary models only consider the period 2010 to 2020.

6.39 After controlling for these factors, we can identify whether other countries' banking sector ROEs are statistically significantly different from New Zealand. We provide the regression output tables and more details on our approach in Attachment B.

6.40 Our models show a statistically significant relationship between GDP per capita and banking sector ROE, implying that our model is capturing the business cycle.[558] Across our models, we identify that, for every 1 percentage point increase in an economy's GDP growth per capita, banks have received a ROE (post-tax) increase of between 0.15 and 0.47 percentage points, on average, which indicates that bank profits are strongly pro-cyclical.[559]

556 World Bank Global Financial Development Database [ ].

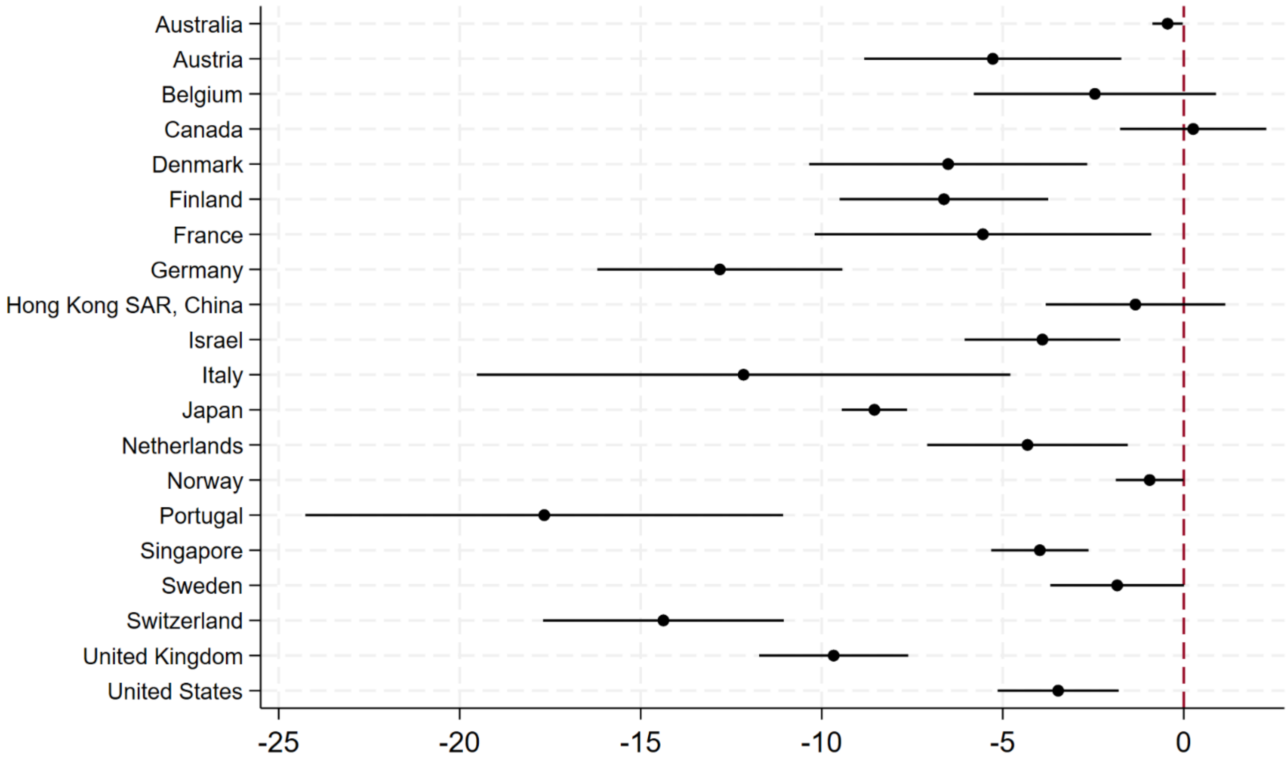
557 We specifically develop a pooled ordinary least squares (OLS) model.

558 We include the full regression output tables of coefficients at Table B4 and Table B5 in Attachment B.

559 Five of our six models produce coefficients greater than 0.4. We note that our tests do not imply causality.

6.41 When we include only the countries in the Reserve Bank's sample and control for pro-cyclicality, no country in the sample has a ROE statistically significantly higher than New Zealand.[560] We observe largely the same result across various model specifications.

Figure 6.3 Country ROE estimates relative to New Zealand for the Reserve Bank sample



Source: Commerce Commission analysis of World Bank data.[561]

6.42 Figure 6.3 shows the results of the regression. Each dot reflects each country's estimated coefficient in our primary model using the Reserve Bank's sample.[562] New Zealand is the reference country so other countries' coefficients are estimates of the average expected percentage point difference in post-tax ROE from New Zealand after controlling for pro-cyclicality and other factors. The horizontal lines reflect the 95% confidence interval for each estimate.

560 We include the full regression output tables of coefficients at Table B4 in Attachment B.

561 World Bank Global Financial Development Database and World Bank data for indicator codes NY.GDP.PCAP.KD.ZG, FP.CPI.TOTL.ZG and NY.GDP.MKTP.CD. [ ].

562 This primary model, as shown in Table B4, includes the variables GDP growth per capita in current USD, non-interest income to total income and the natural logs of both 1-year lagged inflation and non-performing loans to gross loans.

6.43 Only Canada has a positive coefficient in the primary model specification. However, this is not statistically significant, meaning we cannot be confident that Canada's post-tax ROE is different from New Zealand's.

6.44 We also consider a broader sample of 78 countries (the Broad sample). This sample considers the largest sample for which reasonable data is available. We begin with all countries in the World Bank dataset and exclude countries with more than three missing datapoints for post-tax ROE during our analysis period and countries/ datapoints where we observe material standard errors or outliers.[563] We discuss our method to obtain this sample in greater detail in Attachment B.

6.45 In our primary model for the Broad sample,[564] once pro-cyclicality and other factors are controlled for, only 13 countries have statistically significantly higher ROEs than New Zealand at the 5% significance level. In contrast, 46 countries have statistically lower returns on equity at the same significance level. This can be seen in Figure 6.4, where the majority of coefficients are located in the negative territory of the graph. This implies that New Zealand's profitability is in the 60th to 85th percentile for this sample after controlling for a range of factors.

6.46 We observe broadly similar results across multiple model specifications as shown in Table B5 of Attachment B.

6.47 Both samples corroborate our finding that New Zealand banking sector profitability is high. We also have a greater degree of confidence that the inclusion of crisis countries is unlikely to be biasing our results and that our results are not sample sensitive given we see consistent results for our Broad sample.

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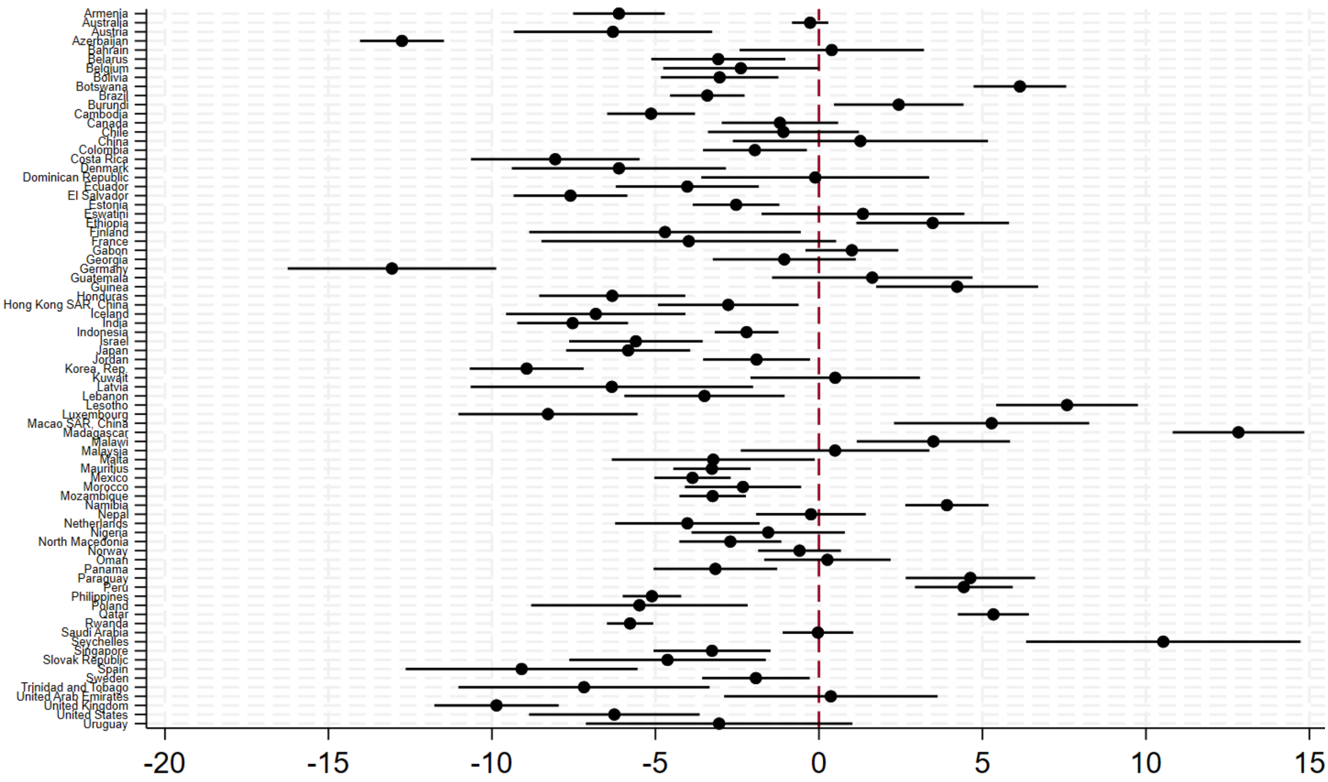
563 Countries are additionally excluded from particular model specifications where that country has no available data for an included variable.

564 This primary model, as shown in Table B5, includes the variables GDP growth per capita (current USD), non-interest income to total income, 1-year lagged inflation, country income level and the natural logs of both non-performing loans to gross loans and overhead costs to total assets.

Figure 6.4 Country ROE estimates relative to New Zealand for our Broad sample



Source: Commerce Commission analysis of World Bank data.[565]

New Zealand's banking sector ROE remains high relative to an alternative sample of countries with similar characteristics to New Zealand

6.48 To further test the sensitivity of our findings to sample selection, we developed a secondary sample to compare New Zealand's banking sector profitability against (the Alternative sample).

6.49 We developed this sample using criteria based on *a priori* drivers of bank financial performance to select countries with similar characteristics to New Zealand. These are the criteria we used:[566]

6.49.1 Non-interest income to total income of less than 40% to capture business mix (New Zealand has a value of 22%).[567]

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565 World Bank Global Financial Development Database and World Bank data for indicator codes NY.GDP.PCAP.KD.ZG, FP.CPI.TOTL.ZG and NY.GDP.MKTP.CD. [ ].

566 We explored the inclusion of additional variables for our sampling process. However, we identified data and economic limitations for many of these variables. We additionally aimed to balance the inclusion of additional variables against the need to expand our thresholds to obtain a sufficient sample size.

567 The thresholds on non-interest income to total income and overhead costs to total assets was reached by doubling New Zealand's value for each, then rounding down to obtain a sample closer to that of the Reserve Bank sample of 20 countries.

6.49.2 Overhead costs to total assets of less than 2% to capture cost structure (New Zealand has a value of 1.05%).

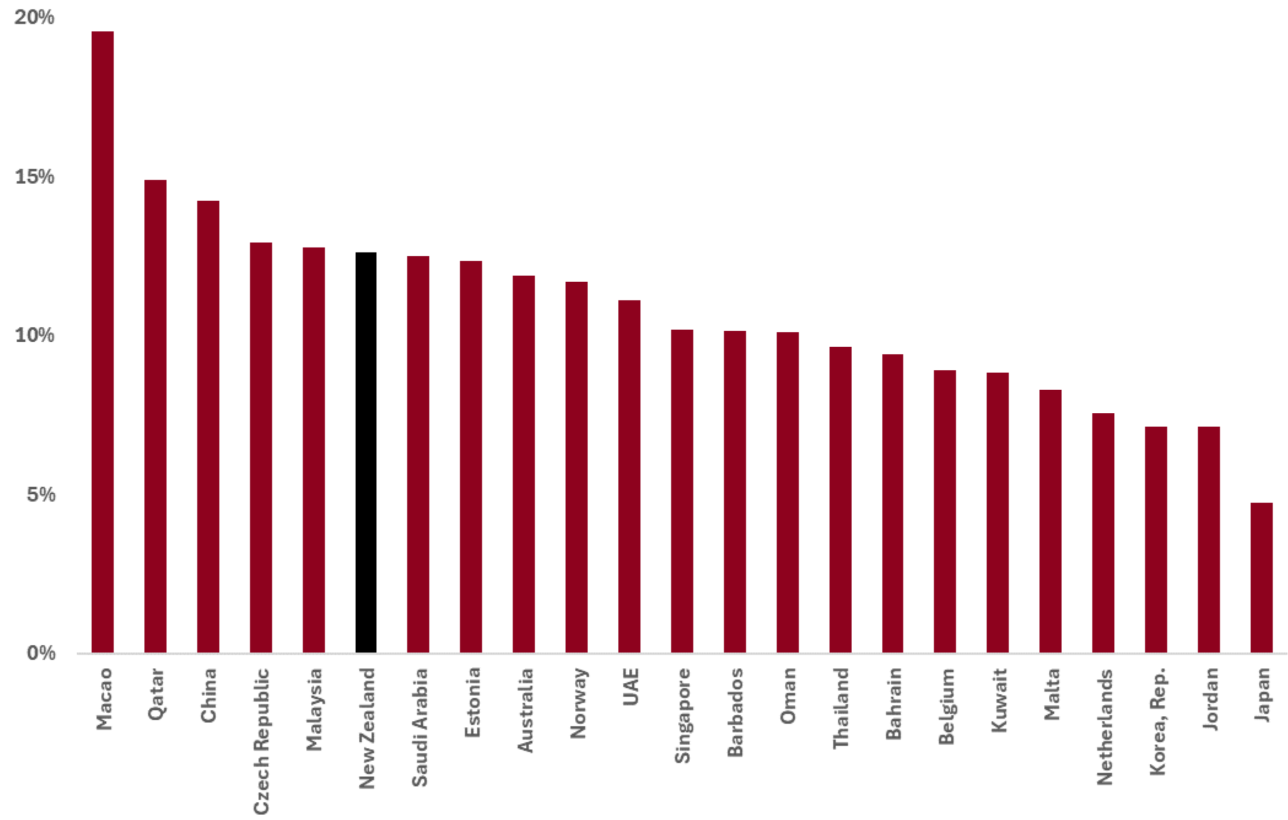
6.49.3 Countries must be classified as upper middle income or high income by the World Bank to capture the economic development of the economy.

6.49.4 We exclude countries with a negative average ROE between 2010 and 2021 to exclude outliers and obtain a conservative estimate.

6.49.5 To ensure data completeness, we exclude countries with more than 3 years of missing ROE data.

6.50 These criteria produce a sample of 23 countries (including New Zealand), seven of which were also in the Reserve Bank sample. The countries in our Alternative sample can be seen in Figure 6.5.

Figure 6.5 Country-level average annual banking sector post-tax ROE between 2010 and 2021 for our Alternative sample



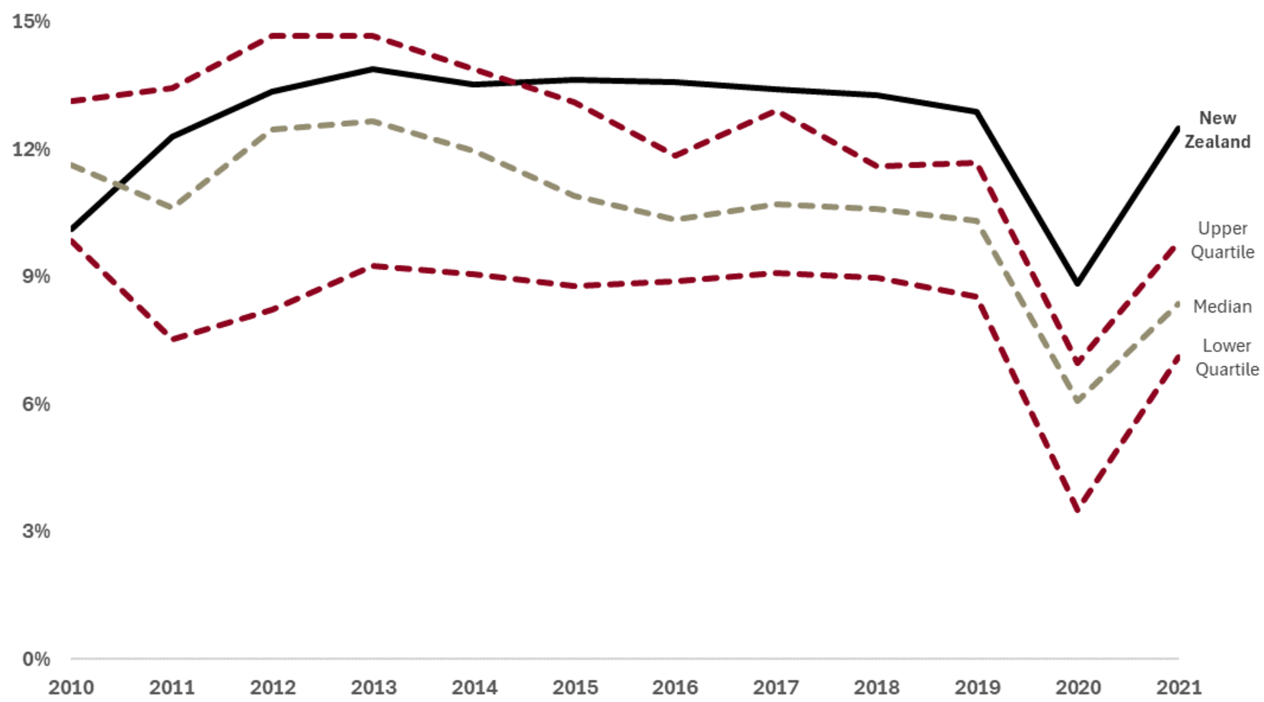
Source: Commerce Commission analysis of World Bank data.[568]

568 World Bank Global Financial Development Database [ ].

6.51 Comparing New Zealand to our Alternative sample of countries, we observe that New Zealand's average ROE of 12.61% exceeds the sample's upper quartile of 12.46% over our analysis period.[569] Figure 6.5 shows that New Zealand had the 6th highest ROE out of the sample.

6.52 Figure 6.6 shows that New Zealand's annual ROE relative to our Alternative sample has been increasing since 2010. New Zealand's banking sector ROE was near to the lower quartile in 2010. However, it has performed in the upper quartile since 2015.

Figure 6.6 New Zealand's ROE trend relative to our Alternative sample between 2010 and 2021



Source: Commerce Commission analysis of World Bank data.[570]

We have a higher degree of confidence following the draft report that New Zealand's banking sector profitability is high relative to peer nations

6.53 While each individual approach we have undertaken to assess the profitability of the New Zealand banking sector has some limitations, we observe largely consistent results across these approaches. This provides us with a higher degree of confidence in the robustness of our finding.

569 Commerce Commission analysis of World Bank data [ ].

570 World Bank Global Financial Development Database [ ].

6.54 We observe that New Zealand exceeds our threshold to be high relative to the Reserve Bank sample of countries. Our cross-checks show that bank profits are pro-cyclical and that our conclusion is robust to the choice of sample.

6.55 We therefore conclude that the profitability of the New Zealand banking sector is high relative to peer countries. Our finding corroborates the findings of the Reserve Bank that the New Zealand banking sector's profitability has been high relative to banking sectors in comparable economies in recent years.

The four major banks have experienced the highest ROEs of banks operating in New Zealand since 2018 | *Kua whai ngā pēke matua e whā i te ROE nui rawa o ngā pēke e mahi ana i Aotearoa mai i 2018*

6.56 This section focuses on New Zealand only. Using publicly available Reserve Bank data, we find that New Zealand's major banks (ANZ, ASB, BNZ and Westpac) have achieved higher average returns than other New Zealand banks.[571]

The major banks' ROE has been higher than most other New Zealand banks

6.57 Figure 6.7 below shows the average quarterly post-tax ROE for 15 banks operating in New Zealand since the March 2018 quarter.[572] It shows that the four major banks had the highest average ROEs over this period.[573]

6.58 Heartland Bank's profitability is strong on ROE, performing similarly well to the major banks, with an average ROE that is approximately only 32 basis points below Westpac's.[574] We understand that Heartland Bank's product mix is distinct from other providers, focusing on being the best or only provider of its products and that it has a higher lending risk profile than the major banks.[575,576] These factors may mean that Heartland Bank's shareholders could reasonably expect to earn higher returns.

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571 We provide greater detail on the Reserve Bank dataset and our approach in Attachment B.

572 This comprises all locally incorporated banks and the consolidated New Zealand-based activities of dual registered banking groups. Reserve Bank "Bank Financial Strength Dashboard – Frequently asked questions: Does the Bank Financial Strength Dashboard include information on all banks in New Zealand?", https://bankdashboard.rbnz.govt.nz/faqs

573 Professor Margaritis and Dr Hasannasab plot aggregated ROE by four groups of banks in New Zealand. They identify that Group 4, which contains smaller foreign-owned banks operating in New Zealand, achieve the highest ROE. Figure 6.7 is based on a Reserve Bank dataset that excludes several banks contained in Professor Margaritis and Dr Hassanasab's analysis, in particular, those that are not locally incorporated or a dual registered banking group. Dimitris Margaritis and Maryam Hasannasab "Market power in banking: A study of New Zealand banks" (March 2024), pp. 24–25.

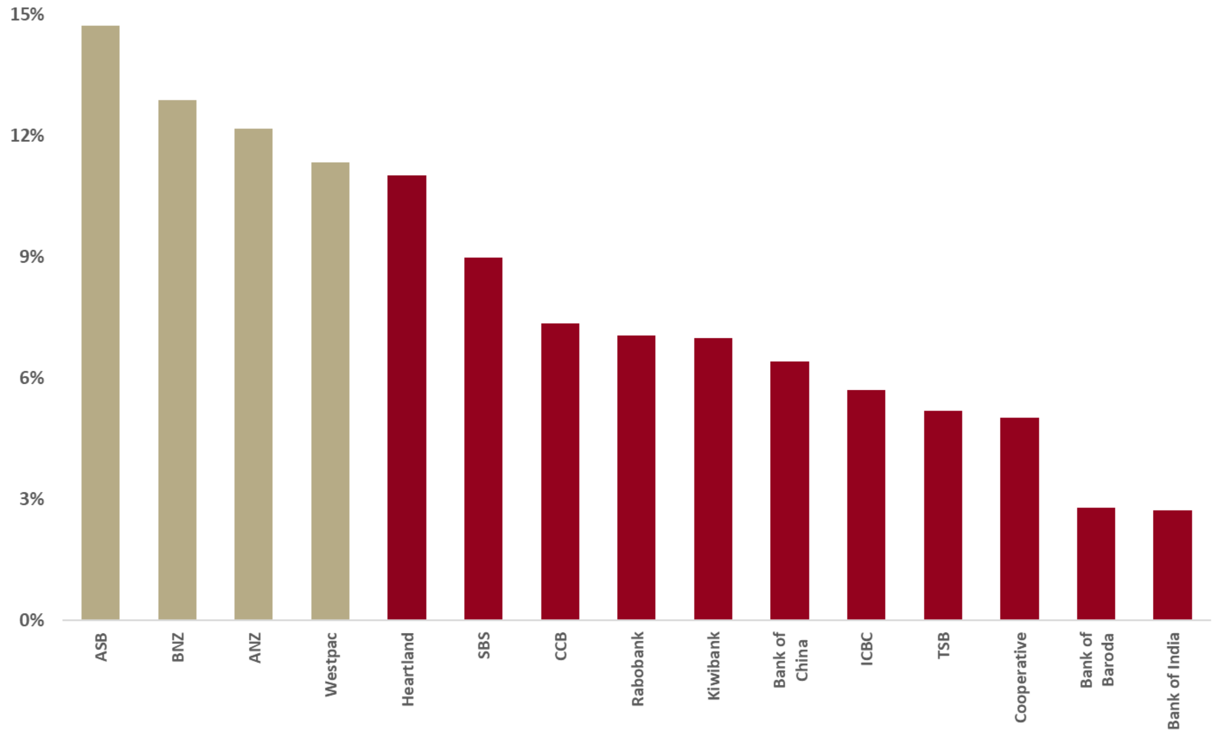
574 Commerce Commission analysis of Reserve Bank Bank Financial Strength Dashboard data. [ ].

575 Heartland Group "Our story", https://www.heartlandgroup.info/about-heartland/our-brand-story; Kiwibank, Submission on Preliminary Issues paper (7 September 2023), p. 5; [ ].

576 We note that Heartland Bank claims it is transitioning towards higher-quality and lower-risk assets. Heartland "Heartland announces record FY2022 profit, and equity raising to retire bridge debt and fund growth ambitions for existing business" (23 August 2022), p. 5, https://api.nzx.com/public/announcement/397408/attachment/377166/397408-377166.pdf

6.59 While Kiwibank is the fifth-largest bank in New Zealand by total banking assets,[577] Kiwibank's greater scale relative to smaller banks does not appear to have led to higher profitability. Kiwibank's ROE over this period was on average 435 basis points lower than Westpac, who had the lowest average ROE out of the major banks. As Figure 6.7 shows, this ranked Kiwibank as having only the ninth-highest average ROE between the March 2018 and March 2024 quarters. Similarly, Kiwibank had the third-lowest ROA on average over the same period.

Figure 6.7 Average quarterly bank post-tax ROE between the March 2018 and March 2024 quarters



Source: Commerce Commission analysis of Reserve Bank data.[578]

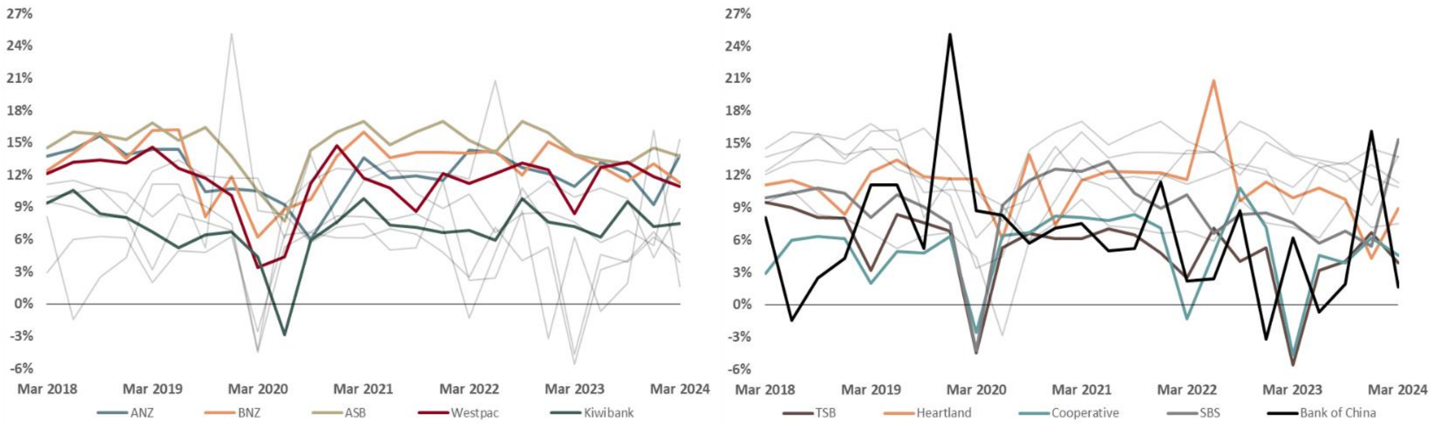
6.60 The strong performance of the major banks on ROE can be observed in individual quarters of our analysis period. Figure 6.8 shows the quarterly post-tax ROE trend for the 10 largest banks in the Reserve Bank dataset.[579] In particular, ANZ, ASB and BNZ are in the top four performing banks in most quarters.

577 See Figure 2.1 and Figure A3 of this report.

578 Reserve Bank "Bank Financial Strength Dashboard" [ ].

579 Largest refers to a bank's average risk-adjusted assets (residential mortgages only) over the analysis period. Data is drawn from series DBB.QIB70 of the Reserve Bank Bank Financial Strength Dashboard.

Figure 6.8 Quarterly bank-level post-tax ROE between the March 2018 and March 2024 quarters



Source: Commerce Commission analysis of Reserve Bank data.[580]

6.61 Some second-tier banks performed more strongly relative to the major banks on ROE in the middle of the period. Between the December 2019 and June 2021 quarters, two second-tier banks performed in the top four in all but two quarters.[581]

Recent bank profitability supports the finding that the New Zealand banking sector has a two-tier dynamic

6.62 Looking at recent profitability data, there appears to be a clear distinction between the major banks' ROE and the ROE of Kiwibank and most of the smaller banks.

6.63 This aligns with the Reserve Bank's finding that the major New Zealand banks have been more profitable than the rest of the New Zealand banking sector in recent years.[582]

6.64 As discussed elsewhere in this report, we have also identified barriers to smaller banks expanding to compete more effectively and we have identified that there are weak incentives for the major banks to compete strongly with each other.

6.65 The observations that the major banks' profitability is higher than other firms in the sector and that they appear to face limited constraint from smaller rivals indicates that providers of personal banking services can be split into two tiers. We discuss this two-tier dynamic in greater detail in Chapter 2.

580 Reserve Bank "Bank Financial Strength Dashboard" [ ].
581 Commerce Commission analysis of Reserve Bank Bank Financial Strength Dashboard data [ ].

582 Reserve Bank "Financial Stability Report" (3 May 2023), p. 24.

We are not satisfied that differences in goodwill and leverage between banks or the ownership structure of certain banks sufficiently explain the two-tier dynamic that we observe

6.66 Incenta adjusts the ROE of banks operating in New Zealand to reflect the goodwill and leverage of ANZ. Incenta submits that this results in Heartland Bank having the highest average ROE of all New Zealand banks and that four other banks increase to become materially the same as the large New Zealand banks.[583] Incenta further submits that differences depend on ownership arrangements and more specifically "the pressure to earn a commercial return on equity capital".[584]

6.67 While Incenta's goodwill and leverage adjustments reduce the differential between the major banks and these smaller banks, Incenta's results show that ASB, ANZ and BNZ still noticeably outperform the majority of the smaller banks.[585] We have previously discussed Westpac's weaker and Heartland Bank's stronger profitability relative to the other major banks and so Incenta's findings do not change our finding relating to a two-tier dynamic.[586] Additionally, we see no legitimate basis for assuming ANZ's leverage and goodwill to be representative of other banks. Nor do we accept that goodwill should be included in this analysis.

6.68 We accept that the government or cooperative ownership structure of some New Zealand-owned banks may affect the returns they derive. As discussed at paragraph C100, we place weight on the effect of these ownership structures on a bank's ability to raise capital.[587] However, many smaller banks operating in New Zealand do not face these constraints, yet we still observe a two-tier dynamic even if we incorporate Incenta's leverage and goodwill adjustments.

6.69 We have additionally seen no evidence to support Incenta's claim that, as Bank of China and Industrial and Commercial Bank of China are local subsidiaries of extremely large majority government-owned banks, "it is possible that strategic considerations have had a bearing on the returns the banks have been willing to accept".[588]

6.70 We are not satisfied that these explanations reasonably explain the two-tier dynamic that we observe between the profitability of the major banks relative to Kiwibank and the smaller banks in the New Zealand banking market.

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583 Incenta [for ANZ] "Market review of personal banking – post conference submission" (30 May 2024), paras 32–32b.

584 Incenta [for ANZ] "Market review of personal banking – post conference submission" (30 May 2024), paras 33–34.

585 Incenta [for ANZ] "Market review of personal banking – post conference submission" (30 May 2024), Table 3.

586 See paragraph 6.58 and Commerce Commission "Personal banking services market study – Draft report" (21 March 2024), para 6.38.

587 We note that we heard from Kiwibank that, as it has debt instruments listed on the New Zealand Exchange and is owned by all of Aotearoa, it takes return discipline as seriously as the major banks. Commerce Commission "Day 1 Personal banking services market study conference – Session 1 Competition in personal banking" (13 May 2024), pp. 29–30.

588 Incenta [for ANZ] "Market review of personal banking – post conference submission" (30 May 2024), para 33.

We are not satisfied that the non-competition explanations provided explain the high returns observed in the New Zealand banking sector | *Kāore mātou e rata ki ngā whakamārama mai hei whakamārama i ngā hua moni nui a te rāngai pēke o Aotearoa*

6.71 Profitability is affected by a range of factors beyond just competition. The appearance of high profitability relative to peer nations may instead indicate differences in factors such as relative risk, ownership structure, macroeconomic conditions and the regulatory landscape.[589]

6.72 We sought submissions that explain the apparent high profitability of New Zealand's major banks and of the New Zealand banking sector relative to international peers.[590] We have considered a range of potential reasons that were put forward that might explain the relatively high level of recent profitability observed in the New Zealand banking sector.

6.73 We received several submissions from Incenta (representing ANZ) that assessed ANZ's level of profitability relative to a sample of international banks and against a bottom-up estimate of the cost of equity.[591] Incenta offered a number of potential explanations for the observed level of profitability in New Zealand that it incorporated into its analysis with various adjustments (for example, for differences in goodwill, the risk-free rate and leverage).[592]

6.74 We considered many of the potential explanations submitted by a range of parties in our draft report and our position has not materially changed through the consultation process. We remain unsatisfied that the factors we considered in the draft report suitably explain the levels of profitability that we observe in the New Zealand banking sector.

6.75 Consequently, this section focuses on our view of Incenta's alternative approach to international benchmarking.

6.76 We summarise our views on Incenta's approach and adjustments for factors that may affect relative levels of bank profitability in this section. We include more detailed discussion of our views on factors affecting relative profitability (including Incenta's analysis) in Attachment C**.**

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589 Reserve Bank "Financial Stability Report" (3 May 2023), p. 24.

590 Commerce Commission "Market study into personal banking services – Preliminary Issues paper" (10 August 2023), para 122.

591 Incenta [for ANZ] "Benchmarking the profitability of the New Zealand Banks against international peers" (7 September 2023), https://comcom.govt.nz/__data/assets/pdf_file/0025/329029/ANZ-Submission-on-Market-study-into-personal-banking-services-Preliminary-Issues-paper-7-September-2023-Annex-1.pdf; Incenta [for ANZ] "Personal banking services market study – response to the Commission's draft report" (18 April 2024); and Incenta [for ANZ] "Market review of personal banking – post conference submission" (30 May 2024).

592 Incenta [for ANZ] "Benchmarking the profitability of the New Zealand Banks against international peers" (7 September 2023), para 54 and Table 3.

We disagree with Incenta's approach to international profitability benchmarking

6.77 Incenta's submissions have been critical of our approach to international profitability benchmarking, and Incenta put forward an alternative benchmarking analysis and results.

6.78 Across its submissions, Incenta has raised five main criticisms of our approach to assessing profitability:

6.78.1 We have departed from our past approach.

6.78.2 The World Bank dataset faces various limitations.

6.78.3 Incenta disagrees with the inclusion of certain countries in our sample.

6.78.4 We lack regard for drivers of differences in profitability.

6.78.5 We have not estimated a cost of capital benchmark.

6.79 Given these criticisms, Incenta presents an alternative benchmarking approach focused on comparing ANZ's profitability to overseas banks that, Incenta submits, are relevant comparators to ANZ.

6.80 For the reasons summarised below, we disagree with Incenta's criticisms of our approach and disagree with a number of assumptions that Incenta makes to reach its conclusions.

We have good reason for departing from our approach in previous studies

6.81 Incenta says the Commission should have used an approach to profitability analysis that we used in two previous market studies and that there are "substantial shortcomings" with using the World Bank database because:[593]

6.81.1 there is no visibility as to which banks are included for each country nor of the weight that is attached to each bank; and

6.81.2 the World Bank database is incomplete and does not include information on leverage or the level of booked intangible assets (goodwill), both of which are required to create robust profitability benchmarks.

6.82 We disagree. All sectors are different and we choose our methods accordingly. From the outset of this study, we have made it clear that we are primarily interested in international comparisons of profitability rather than comparisons against cost estimates. Data on banking profitability metrics for a comprehensive set of countries is available off the shelf from a reputable source (the World Bank). Such a dataset did not exist when we undertook international profitability comparisons in previous market studies into the retail fuel and retail grocery sectors.

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593 Incenta [for ANZ] "Personal banking services market study – response to the Commission's draft report" (18 April 2024), para 14.

6.83 We understand that Incenta wants to focus on comparing ANZ's ROE with selected overseas banks that, Incenta says, are comparable to ANZ. However, we are primarily interested in comparing the profitability of the New Zealand banking sector with other countries, not the profitability of a single bank. The World Bank dataset is well suited to comparing sector-wide profitability across countries.

Incenta's sample does not appropriately reflect fundamental drivers of bank profitability

6.84 Incenta emphasises the importance of selecting a group of comparator businesses that are materially similar to the large New Zealand banks. Incenta argues the draft report incorrectly dismisses issues that are important for understanding profitability of New Zealand banks, including differences in the risk-free rate between countries, relative leverage of New Zealand banks and the importance of intangible assets such as goodwill.[594]

6.85 While Incenta emphasises the importance of selecting suitable comparator banks when benchmarking the profitability of New Zealand's banks, in our view, Incenta does not do so appropriately in its analysis for ANZ.

6.86 The business mix of the New Zealand banking sector is more heavily weighted towards traditional (vanilla) banking activities than in many peer nations.[595] These activities tend to be lower risk, meaning we would expect returns in New Zealand to be lower than peer nations on average.

6.87 Incenta does exclude diversified banks from its sample, but New Zealand's major banks have a very high proportion of (low-risk) housing loans relative to Incenta's sample. Incenta's analysis does not account for this fundamental driver of business risk when selecting comparators.

6.88 Incenta also disagrees with including countries affected by banking crises in our international comparator sample, claiming "[a]lmost all of the Commission's key conclusions are tainted by including the crisis countries in its sample".[596] As we have outlined above, when the analytical approach takes proper account of the business cycle and other factors relevant to bank profits, it is possible (and informative) to use a broader sample.

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594 Incenta [for ANZ] "Personal banking services market study – response to the Commission's draft report" (18 April 2024), para 5(b).

595 Reserve Bank "Financial Stability Report" (3 May 2023), p. 24; Reserve Bank "Learnings from the Global Financial Crisis" (September 2012), p. 58, https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/publications/bulletins/2012/2012sep75-3bollardng.pdf; Morningstar DBRS "Australia and New Zealand Banking Group Limited: Rating Report" (17 December 2019), pp. 2 and 4, https://dbrs.morningstar.com/research/354733/australia-and-new-zealand-banking-group-limited-rating-report [ ]; JP Morgan "Westpac Banking Corporation: FY23 result: Valuation looks fair but multi-year tech simplification could unlock ROE upside if executed well" (November 2023), p. 9, [ ].

596 Incenta [for ANZ] "Personal banking services market study – response to the Commission's draft report" (18 April 2024), para 50.

6.89 By contrast, Incenta's approach is to narrow the sample rather than seeking to understand the differences. We consider that bias is likely to be introduced by the exclusion of countries affected by recent banking crises (Incenta's crisis countries). Bank returns tend to be highly pro-cyclical, so Incenta's exclusion of countries that have ever experienced adverse macroeconomic conditions over the relevant period biases its sample towards high-return countries/banks/time-periods. Excluding banks that have experienced a particular set of external shocks, where those shocks could happen in New Zealand, results in a sample distribution that will not be representative of the range of possible outcomes in New Zealand (so the estimate will be biased).

We disagree with several of Incenta's adjustments

6.90 Even if we were to accept Incenta's exclusion of crisis countries (and we do not), the raw results of Incenta's benchmarking show that ANZ's ROE (12.3%) is above its comparator sample (11.0%).[597] Incenta reaches its conclusions that ANZ's returns are "materially the same as its peer group of comparable banks" and "normal" only by making what are, in our view, questionable adjustments relating to goodwill and the equity beta.

6.91 Our position in previous market studies has been that goodwill should be excluded when assessing profitability.[598] We accept that some intangible assets are required to operate a bank. However, we have not seen any evidence that a materially higher amount of intangible assets is required to operate ANZ compared to another New Zealand bank or a bank in a foreign country so we see no sound basis for Incenta's assumption that all comparator banks have the same proportion of goodwill as ANZ.

6.92 If any adjustments were to be made to ensure comparability of goodwill, our view is that goodwill should be removed. Excluding goodwill for both ANZ and the banks in Incenta's sample results in a ROE for ANZ of 16.7%, which exceeds the average for Incenta's sample of 12.9% (before Incenta's risk-free rate and leverage adjustments).[599]

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597 Incenta [for ANZ] "Benchmarking the profitability of the New Zealand Banks against international peers" (7 September 2023), Table 3.

598 Commerce Commission "Market study into the retail grocery sector – Final report" (8 March 2022), paras 3.33, B85.5 and B98–B100.

599 The average ROE for Incenta's sample increases to 14% by incorporating Incenta's risk-free rate adjustment and 16.2% after including both Incenta's risk-free rate and leverage adjustments. Commerce Commission analysis of Incenta's underlying workings using data from disclosure statements and Bloomberg [ ].

6.93 Incenta notes that we have not made a comparison against a bottom-up estimate of the cost of capital. While Incenta cautioned about the weight that should be placed on comparisons against a bottom-up estimate, it argues that its own analysis shows the average returns of the New Zealand banks have been within the range of normal returns.[600]

6.94 In putting forward this analysis, Incenta claims to follow the Commission's standard approach to estimating the cost of equity. However, Incenta's methodology, which adjusts the average equity beta for its comparator sample to be consistent with ANZ's leverage, differs materially from our standard approach.[601] First, Incenta has not de-levered equity betas for each comparator into asset betas before re-levering the average asset beta using notional leverage. Second, the Commission does not adjust beta estimates to reflect the leverage of a particular firm.[602]

6.95 Using the Commission's standard approach but keeping Incenta's other inputs constant produces a range for the cost of equity of 10.6–11.2%.[603] ANZ's ROE, both including and excluding goodwill (12.3% and 16.7%, respectively), exceeds the top of this range, implying ANZ is earning above normal returns.

6.96 Such adjustments, which we have considered in testing and having regard to Incenta and ANZ's submissions, produce what we consider to be conservative estimates. If we adjusted for other assumptions that we disagree with (such as the exclusion of crisis countries), ANZ's returns would likely exceed these benchmarks by a greater margin. However, as we have said, we did not set out to determine the extent to which any particular bank's returns may exceed a notionally reasonable rate of return.

Part of the profitability that we observe is explained by the market power of some participants

6.97 Based on the evidence and our analysis of it, we remain of the view that bank profits in New Zealand are high relative to international benchmarks and that weak competition is a contributing factor.

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600 Incenta [for ANZ] "Personal banking services market study – response to the Commission's draft report" (18 April 2024), para 5(c).

601 Commerce Commission "Part 4 Input Methodologies Review 2023 – Final decision: Cost of capital topic paper" (13 December 2023), paras 4.54–4.54.6, 5.7–5.9 and A27–A28, https://comcom.govt.nz/__data/assets/pdf_file/0022/337612/Part-4-IM-Review-2023-Final-decision-Cost-of-capital-topic-paper-13-December-2023.pdf

602 Rather, we use notional leverage, calculated as the average leverage of the comparator set, to re-lever the average asset beta to an equity beta.

603 Commerce Commission analysis of Incenta's underlying workings using data from disclosure statements and Bloomberg [ ].

6.98 Assessments of individual banks' or banking sector profitability could be approached in a variety of different ways. Incenta's method of using bank-level data to create an international benchmark for ANZ is one way of approaching such an assessment. However, we disagree with a number of the assumptions that Incenta makes in reaching its conclusions.

6.99 We acknowledge that some factors, including a relatively higher risk-free rate than other countries in our sample, the Australian ownership structure of New Zealand's major banks and recent monetary policy may partially explain elevated profits. However, for the reasons outlined in Attachment C, we are not sufficiently satisfied with the merits or scale of these factors and so place less weight on them. These explanations must also be balanced against the relatively low-risk nature of the New Zealand banking sector, which would, all else being equal, generate lower expected returns.

6.100 We therefore consider that at least part of the profitability we observe is explained by the market power of some participants and that New Zealand's banking sector profits are higher than what would be expected if the major banks faced greater competition.

6.101 Professor Margaritis and Dr Hasannasab found evidence of what they described as "moderate market power" in the market for loans and across the banking sector more generally based on their estimates of the Lerner index and the Panzar-Rosse H statistic respectively. They also found statistically significant and positive associations between ROE, ROA and NIM and the Lerner index of market power, although we note that their findings do not indicate a causal relationship.[604]

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[604] Dimitris Margaritis and Maryam Hasannasab "Market power in banking: A study of New Zealand banks" (March 2024), pp. 16–20.

6.102 We acknowledge that each measure faces limitations, and no measure of market power (or profitability) is perfect.[605] It is well established in the literature that the Lerner index is the preferred measure of market power by economists and policy makers.[606] A usual critique is the exclusion of fixed costs. However, the index can be amended to account for fixed costs by adjusting the standard formula to be decreasing with greater operating leverage.[607] Operating leverage tends to vary inversely with financial leverage,[608] and recognising that banks operate with high financial leverage, this suggests adjustments to the index can be expected to be only minor. While the Panzar-Rosse H statistic similarly faces limitations, the model results are consistent with the authors' cost-based estimates of the Lerner index.

6.103 We have done sufficient analysis to be confident in our finding that the profitability of the New Zealand banking sector on a whole-of-bank basis is high and that this indicator supports the findings, throughout this report, that competition in personal banking is limited.

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605 CRA [for ANZ] "Personal Banking Services Market Study – Comments on the Commerce Commission's Draft Report and the Margaritis and Hasannasab paper on 'Market Power in Banking'" (17 April 2024), paras 77 and 82; and NERA [for ASB] "Review of "Market Power in Banking: A Study of New Zealand Banks" (2024) by D. Margaritis and M. Hasannasab" (2 May 2024), paras 5–16, https://comcom.govt.nz/__data/assets/pdf_file/0015/352032/ASB-Submission-on-econometric-analysis-NERA-report-2-May-2024.pdf

606 For example, see Sherrill Shaffer and Laura Spierdijk "Measuring multi-product banks' market power using the Lerner index" *Journal of Banking and Finance* 117 (2020), 1–16.

607 Cecilia Bustamante and Andres Donangelo "Product market competition and industry returns" *The Review of Financial Studies* 30(12) (2016) 4216–4266.

608 Amihud Dotan and Abraham Ravid "On the interaction of real and financial decisions of the firm under uncertainty" *The Journal of Finance* 40(2) (1985) 501–517.

Chapter 7 Regulatory factors affecting competition | *Ngā pānga ā-ture mai ki te whakataetaetanga*

Summary of findings

- **The overall regulatory burden on providers of personal banking services is high.** Regulation shapes the competitive environment, and it has been a common theme that the extent of regulation is the primary constraint on growing competition.
- **Regulatory requirements impose substantial fixed costs on market participation and this is limiting the ability of the smaller banks, NBDTs and fintechs to compete** as they do not have the scale of business of the major banks and Kiwibank. Regulation imposes a disproportionately greater draw on the time and resources of smaller providers. It is notable that no new provider of any scale has entered the market since Kiwibank in 2001. Consequently, creating proportionality in regulatory policy settings is critical to increasing competition.
- **Bank prudential capital requirements have affected competition and, prior to the Reserve Bank's Capital Review, gave the major banks a material competitive advantage over Kiwibank and the smaller banks and NBDTs.** Changes made by the Reserve Bank through the Capital Review have reduced, but not eliminated, this advantage. To further reduce the advantage, we recommend that the Reserve Bank permits smaller providers to use more granular standardised risk weightings. This would allow them to match the risk weightings they apply more closely to the actual risks their loans create and likely reduce the capital they need to hold.
- **The Reserve Bank must take competition into account.** Under the new regulatory framework of the Deposit Takers Act 2023 (DT Act), the Reserve Bank must, in addition to considering financial stability and individual entity soundness, take into account "the need to maintain competition within the deposit-taking sector" when setting core standards and other policies. An appropriate balance should be struck between financial stability and competition.
- **We consider that the Reserve Bank needs to broaden its competition assessments and place greater focus on reducing barriers to the entry or expansion of smaller providers.** To date, we have seen a heavy emphasis placed on individual entity soundness and protecting firms from the risk of failure. This only maintains competition in the limited sense that the providers who can meet the resulting regulatory requirements are unlikely to fail. However, the Reserve Bank's narrow competition assessments could lead to the exit of smaller providers because they cannot meet the regulatory burden. That risks weakening competition by excluding innovative entrants with the potential to disrupt traditional providers.

Summary of findings (continued)

- **Policy decisions where competition could be improved include:**
  - **Setting the levy on deposit takers that will fund the new DCS.** This will be a material additional cost for smaller providers, and given the lack of effective competition in personal banking, our view is that Government should err on the side of not adding to the burden on small deposit takers until more is known about the impacts of introducing the DCS, including the relative costs different deposit takers will impose on the scheme.
  - **Setting minimum capital requirements for the smallest deposit takers.** The Reserve Bank should ensure that it sets those requirements in way that encourages competition.
  - **Setting a policy on which deposit takers will be able to call themselves banks.** The Reserve Bank should permit the broadest possible range of providers to refer to themselves as a bank or to the services that they provide as banking services, which should enhance their ability to compete.
  - **Setting a policy on which providers can access ESAS.** Allowing smaller providers and fintechs access to ESAS will reduce the need for them to hold bank accounts with competitors and support greater innovation in payments.
- We have concentrated on areas where a greater emphasis on competition would be beneficial, but we acknowledge that Reserve Bank's main purpose is protecting and promoting financial stability. **The Government may need to amend legislative settings if it prefers a different balance between competition and stability.**

Introduction | *Whakatakinga*

7.1 The terms of reference for our study require us to consider conditions for entry by potential competitors and the conditions for expansion in personal banking.

7.2 Conditions for entry and expansion are important for competition because they affect the extent to which existing providers are constrained in their decision-making about prices, products and service levels by:

7.2.1 the potential for their existing competitors to expand their sales; and/or

7.2.2 the potential for new competitors to enter and effectively compete with them.

7.3 The conditions for entry and expansion are relevant to personal banking services generally as well as to both home loans and deposit accounts.

7.4 Regulation shapes the competitive environment in personal banking, and this chapter focuses on the regulatory conditions that we have identified as most affecting entry and expansion. Other relevant conditions of entry and expansion, including customer inertia and regulatory and other barriers facing consumers when switching, and impediments that are particular to innovation are discussed in Chapters 8 and 9.

Entry and expansion in personal banking services has been limited | *Kua herea te whakaurunga ki ngā ratonga pēke whaiaro me tōna whakawhānuitanga hoki*

7.5 As noted in Chapter 2, there has been a lack of noteworthy entry or expansion in personal banking service providers since Kiwibank entered in 2001.

7.6 Since 2014, there have been less than a handful of new bank registrations: Bank of China (New Zealand) Limited and China Construction Bank (New Zealand) Limited (both in 2014), branch registrations of their overseas parent banks and branch registration of Industrial and Commercial Bank of China Limited. HSBC ceased providing personal banking services in 2023.[609]

7.7 There have been no new-entrant NBDTs since the Non-bank Deposit Takers Act 2013 (NBDT Act) was introduced to prudentially regulate the NBDTs and bring them under Reserve Bank supervision.[610] In fact, a number have since closed so there are now fewer NBDTs than when the regime was introduced.

7.8 As noted in Chapter 9, there has been some new entry from fintechs with non-traditional-banking business models offering some but not all of the personal banking services provided by traditional banks.

7.8.1 Dosh (established 2021) offers a money app that helps consumers spend, save and borrow.[611] Dosh recently announced that it has initiated an application to the Reserve Bank to become a registered bank.[612]

7.8.2 Revolut (which launched in New Zealand in 2023) similarly offers an app to help consumers hold, send and spend in multiple currencies locally and when travelling, as well as save, track and manage all their finances in one digital location.[613]

7.8.3 Simplicity, which began offering first-home loans to its KiwiSaver scheme members in 2019.[614]

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609 HSBC "HSBC to wind down retail banking business in New Zealand" (13 June 2023), https://www.about.hsbc.co.nz/-/media/new-zealand/en/news-and-media/230620-hsbc-to-wind-down-retail-banking-business-in-new-zealand.pdf

610 NBDTs are also subject to the FMC Act, which requires each NBDT to have a trust deed that sets out its prudential requirements such as prudential capital requirements, in compliance with the NBDT Act: Reserve Bank "Overview of non-bank deposit takers regime" (28 February 2022), https://www.rbnz.govt.nz/regulation-and-supervision/oversight-of-non-bank-deposit-takers/how-we-oversee-non-bank-deposit-takers/overview-of-non-bank-deposit-takers-regime

611 Dosh "About us", https://www.dosh.nz/about

612 Dosh "Dosh applies to become a registered Bank in New Zealand", https://www.dosh.nz/blog/dosh-applies-to-become-registered-bank-in-new-zealand

613 Revolut "Revolut launches in New Zealand" (3 July 2023), https://www.revolut.com/en-NZ/news/revolut_launches_in_new_zealand/

614 Simplicity "First home loans", https://simplicity.kiwi/simplicity-first-home-loans

7.8.4 Squirrel, which began offering peer-to-peer lending services in 2015.[615]

7.8.5 Wise, which launched its borderless account in New Zealand in 2018.[616]

7.9 At this point, however, the competition from such non-traditional business models is nascent; these fintechs are dwarfed by the major banks and Kiwibank and are not at a scale to present any real competitive constraint.

Regulation shapes the competitive environment | *Mā te taha ture e hanga te taiao whakataetae*

7.10 A common theme from our engagement with providers is that regulation shapes competition in personal banking and is the primary constraint on growing competition.[617]

7.11 Parties across the sector told us that they prioritise regulatory compliance and actions to respond to regulatory change. They explained that this focus can take away time and resource that could have been used for investing in the business or developing innovative solutions to improve competitive offerings.

7.12 Regulatory requirements and regulatory change initiatives affect all parties that come within the remit of the regime. They are part of the fixed cost of entry and market participation.

7.13 This does, however, affect competition in personal banking services particularly for smaller providers, the smaller banks, NBDTs and fintechs, which do not have the scale of business of the major banks and Kiwibank. As they do not have the scale to spread high fixed costs, regulation imposes a proportionately greater burden on them.[618] This makes the concept of proportionality in regulatory policy settings important for competition.

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615 Squirrel "The history of Squirrel", https://www.squirrel.co.nz/about-squirrel/the-history-of-squirrel

616 Wise "Kia ora New Zealand! The Wise borderless account has landed" (3 December 2018), https://wise.com/au/blog/launching-borderless-new-zealand

617 [ ]; [ ]; [ ]; [ ]; ANZ, Submission on Preliminary Issues paper (7 September 2023), paras 23–24; ASB, Submission on Preliminary Issues paper (7 September 2023), paras 2.1 and 2.5; BNZ, Submission on Preliminary Issues paper (7 September 2023), para 5.3; Westpac, Submission on Preliminary Issues paper (7 September 2023), paras 2.2–2.5; Kiwibank, Submission on Preliminary Issues paper (7 September 2023), pp. 12–13; Heartland Bank, Submission on Preliminary Issues paper (7 September 2023), para 11(d)–(f); TSB, Co-operative Bank, Kiwibank and SBS Bank, Submission on Preliminary Issues paper (7 September 2023), pp. 1–3.

618 [ ]; [ ]; [ ]; [ ]; [ ].

7.14 The regulatory conditions that we have identified as most affecting entry and expansion in personal banking services are:

7.14.1 prudential capital requirements;

7.14.2 other policies within the remit of the Reserve Bank; and

7.14.3 the overall regulatory burden, together with certain aspects of specific regulation (such as the CCCF Act and the AML/CFT Act).

7.15 This chapter discusses each of the above in turn.

7.16 Ultimately, the issue raised is how best to strike the appropriate balance between the policy goals of financial stability, consumer protection and competition.

7.17 In our Competition Assessment Guidelines, we note that government policy and action in markets is often motivated by important goals other than the promotion and/or protection of competition. Government can also affect the incentives or ability of businesses to compete and can therefore impact consumers, productivity, growth, efficiency and innovation in markets. Sometimes it may be necessary to reduce competition to implement a particular policy. This can create a tension between meeting the policy goal and maintaining competition in markets.[619]

7.18 What matters is striking appropriate balances and, as much as possible, having policy settings that, if not actively promoting competition in aiming to achieve other policy objectives, restrict competition to the least extent possible.

Prudential capital requirements have affected competition in personal banking | *He pānga anō o ngā herenga pūrawa ki te whakataetaetanga pēke whaiaro*

7.19 Capital generally refers to the amount of money provided by the owners (shareholders) of a bank. Usually, around 10% of a bank's funding is provided by its owners to ensure they have a meaningful stake in their business and enough incentive to ensure the bank is run properly. The remaining 90% of a bank's money is borrowed (including, in the case of banks and NBDTs, deposits from ordinary New Zealanders).[620]

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619 Commerce Commission "Competition Assessment Guidelines", https://comcom.govt.nz/__data/assets/pdf_file/0022/293143/Competition-Assessment-Guidelines-January-2023.pdf

620 Reserve Bank "Capital Review: Decisions 2019" (December 2019), p. 2, https://rbnz.govt.nz/-/media/project/sites/rbnz/files/consultations/banks/review-capital-adequacy-framework-for-registered-banks/decisions/capital-review-decisions.pdf

7.20 Bank capital serves to protect a bank from failing. When a bank loses money, these losses decrease the bank's capital, so higher levels of capital provide a bank with greater protection from failure.[621] The more capital banks hold, the more resilient New Zealand's banking system will be to any financial and economic shocks.[622] Capital requirements are, self-evidently, also a regulatory restriction on entry and expansion.

7.21 Under the current regulatory framework, the Reserve Bank's policy is that a locally incorporated bank must have a minimum of $30m in capital in order to be registered as a bank.[623] Non-banks are not currently subject to any minimum dollar amount of capital, although they are subject to capital ratios.[624]

Prior to the Reserve Bank's Capital Review, prudential capital requirements were giving the major banks a material competitive advantage

7.22 Between 2008 and 2022, the overall effect of prudential capital settings was to allow the four major banks to hold materially less capital than Kiwibank and smaller banks for assets with the same or similar risk. This was a result of the permitted use by the four major banks of an internal ratings-based (IRB) approach to the calculation of risk-weighted assets (RWAs) for capital ratios, and the outcomes under that approach compared to the outcomes for non-IRB banks using the standardised approach.[625]

7.23 This advantage for the major banks extended to being an advantage over Kiwibank as Kiwibank was not, and is still not, an IRB-accredited bank.

7.24 As we stated in our draft report:

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621 Reserve Bank "Capital Review: Decisions 2019" (December 2019), p. 2.

622 Reserve Bank "Capital Review: Decisions 2019" (December 2019), p. 2.

623 Reserve Bank "Statement of Principles – Bank Registration and Supervision" (October 2021), available at https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/regulation-and-supervision/banks/banking-supervision-handbook/bs1-statement-of-principles.pdf,
paras 43–44, https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/regulation-and-supervision/banks/banking-supervision-handbook/bs1-statement-of-principles.pdf. Note that branches of overseas banks are not subject to the $30m minimum, but the Reserve Bank states that it will wish to satisfy itself that the global bank of which the branch is a part has a level of capital exceeding $30m.

624 See Deposit Takers (Credit Ratings, Capital Ratios, and Related Party Exposures) Regulations 2010, Part 3.

625 Commerce Commission "Personal banking services market study – Draft report" (21 March 2024), para 7.42.1.

7.24.1 This gave the major banks a head start on growth since 2008, particularly in home loans, and the ability of the smaller banks to compete was restricted.[626] This, combined with New Zealand's significant growth in demand for home loans amid rising house prices in that same period and lower capital requirements for the major banks, meant that the IRB-accredited banks were able to use relatively more funding for lending.[627] They were also able to choose where to invest funding in initiatives aimed at growth.[628]

7.24.2 In contrast, the smaller banks had significantly less funding available for growth, innovation and investment because they had to hold more as capital.[629]

7.24.3 The implications from a competition perspective have been that:[630]

7.24.3.1 smaller banks have found it difficult to compete with the major banks on price (interest rates) on home loans and deposits over a sustained period, which in part explains why smaller banks struggle to attract customers away from the major banks;[631] and

7.24.3.2 smaller banks have had higher cost structures and less funding for growth, whether that be through making funding available for lending, investment in innovations like mobile applications (for example, to help attract customers away from major banks) and other initiatives to achieve growth such as marketing.[632]

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626 Commerce Commission "Personal banking services market study – Draft report" (21 March 2024), para 7.53.

627 [ ]; see also Link Economics [for Kiwibank] "The nature of competition for personal banking services" (5 October 2023), para 74, https://comcom.govt.nz/__data/assets/pdf_file/0023/331682/Kiwibank-Cross-submission-on-Market-study-into-personal-banking-services-Preliminary-Issues-paper-5-October-2023-Attachment-A-Link-report.pdf

628 [ ]; [ ].

629 Commerce Commission "Personal banking services market study – Draft report" (21 March 2024), para 7.54.

630 Commerce Commission "Personal banking services market study – Draft report" (21 March 2024), para 7.57.

631 TSB, Co-operative Bank, Kiwibank and SBS Bank, Submission on draft report (18 April 2024), p. 5; [ ]; [ ].

632 TSB, Co-operative Bank, Kiwibank and SBS Bank, Submission on draft report (18 April 2024), p. 5; [ ]; [ ].

7.25 The policy decision to permit IRB modelling drew upon the internationally recognised Basel II capital framework. The purpose of it is to enable IRB-accredited banks to develop a more sophisticated understanding of the risk associated with their assets.

7.26 That capital framework led to differences in risk weights and capital outcomes as between the IRB and non-IRB banks.[633] The Reserve Bank sought, as part of its Capital Review, to address those differences.[634]

7.27 The Reserve Bank notes that funding cost advantage for the IRB banks would have been relatively small historically, particularly when compared to other costs.[635] But this overlooks the fact that smaller lenders tend to be capital constrained. The requirement to hold greater capital than IRB banks is likely to have constrained competition from smaller lenders by limiting growth.[636]

7.28 Post initial implementation from 1 January 2022 of the Reserve Bank's 2019 Capital Review decisions, the Reserve Bank and major banks consider that any differences in capital requirements that previously existed have since been eliminated.[637] Kiwibank and the smaller banks dispute this.[638]

The Reserve Bank's Capital Review decisions have reduced the difference, but a difference remains

7.29 In 2017, the Reserve Bank launched a comprehensive review of its capital framework for banks (the Capital Review).

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633 The Reserve Bank acknowledges that outcomes in RWA calculations for the IRB banks, which are the four major banks, were around 70–75% of what would be calculated under the standardised approach: [ ]. The smaller domestic banks, including Kiwibank, point out that this was an average and that there was a range across the IRB banks, meaning certain of them would have been holding even less capital: TSB, Co-operative Bank, Kiwibank and SBS Bank, Submission on draft report (18 April 2024), p. 2.

634 The Reserve Bank's Capital Review was a multi-year process to review the capital adequacy rules for locally incorporated, registered banks in New Zealand that commenced in 2017. Final decisions are in the process of being implemented and will be fully in effect in 2027. For an overview of the Capital Review and links to all the related consultations, decision-making papers and external expert review papers, see https://www.rbnz.govt.nz/regulation-and-supervision/oversight-of-banks/how-we-regulate-and-supervise-banks/our-policy-work-for-bank-oversight/capital-review

635 Reserve Bank, Submission on draft report (18 April 2024), p. 5.

636 TSB, Co-operative Bank, SBS and Kiwibank , Submission on draft report (18 April 2024), p.1-2; Kiwibank Submission on draft report" (18 April 2024), p. 1;
[ ];
[ ].

637 ANZ, Submission on draft report (18 April 2024), pp. 39–43; BNZ, Submission on draft report (18 April 2024), para 2.7; ASB, Submission on draft report (18 April 2024), paras 3.4–3.5; Reserve Bank, Submission on draft report (18 April 2024), pp. 6–7.

638 TSB, Co-operative Bank, Kiwibank and SBS Bank, Submission on draft report (18 April 2024), p. 1.

7.30 As part of the Capital Review, the Reserve Bank identified that the average risk weights under the IRB approach were lower than those under the standardised approach across most asset classes. It also identified that, for several asset classes, IRB risk weights were also lower than the lowest possible risk weights under the standardised approaches, including, relevantly, the residential mortgage asset class.[639]

7.31 The Reserve Bank considered that there were cases where the gap in risk weights between the IRB and standardised approaches was not justifiable on the basis of a different level of underlying risk or better information about risk. However, it did not consider that the IRB outcome was incorrect, nor did it consider that there was evidence that the standardised risk weights were miscalibrated.[640]

7.32 The Reserve Bank also found that the IRB approach should be retained because it offers improved risk differentiation compared to the standardised approach.[641]

Key changes as a result of the Capital Review

7.33 The Reserve Bank made several key changes in the Capital Review:

7.33.1 **An increase to the scaling factor to be applied to IRB banks' RWA calculations to 1.2x (from 1.06x)**. Prior to the Capital Review decisions, the scaling factor applied to banks' IRB calculations was 1.06x – consistent with the Basel II framework.[642] The Reserve Bank felt that increasing the scaling factor to 1.2x would do most of the heavy lifting in terms of reducing the gap between average IRB and standardised outcomes while preserving the risk differentiation of the IRB approach.[643]

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639 Reserve Bank "Consultation Paper: Review of the Capital Adequacy Framework for locally incorporated banks: calculation of risk weighted assets" (December 2017), para 47, https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/consultations/banks/review-capital-adequacy-framework-for-registered-banks/capital-review-denominator-consultation-paper-002191217.pdf

640 Reserve Bank "Consultation Paper: Review of the Capital Adequacy Framework for locally incorporated banks: calculation of risk weighted assets" (December 2017), para 56.

641 Reserve Bank "Capital Review: Setting an output floor for the IRB approach" (7 November 2018), p. 5, https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/regulation-and-supervision/banks/capital-review/capital-review-setting-the-output-floor-for-the-irb-approach.pdf

642 The Basel Committee had included the scaling factor for all exposures subject to the IRB approach in its framework to give prudential supervisors a level of comfort about the capital impact of the IRB approach. Because the scalar applies equally across all IRB exposures, it increases overall capital calculated using the IRB approach while fully preserving the IRB approach's risk differentiation: Reserve Bank "Capital Review: Setting an output floor for the IRB approach" (7 November 2018), p. 4.

643 Reserve Bank "Capital Review: Setting an output floor for the IRB approach" (7 November 2018), p. 8, https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/regulation-and-supervision/banks/capital-review/capital-review-setting-the-output-floor-for-the-irb-approach.pdf. The scalar operates to increase the RWA calculation from IRB outputs by 20%, providing a margin of conservatism.

7.33.2 **Introducing an 85% output floor**. The application of an output floor means that IRB-accredited banks cannot have capital lower than 85% of what they would have had if they had used the standardised approach.[644] The Reserve Bank introduced the output floor to serve as a backstop so that any outlier RWA calculations would be raised if still needed after the application of a higher scalar.[645]

7.33.3 **Introducing a 2% buffer applicable to all D-SIBs**. In its 2019 decisions, the Reserve Bank decided that the D-SIBs (the four major/IRB banks) would be required to hold an additional 2% of prudential capital (the 2% D-SIB buffer) to reflect the difference in risk to the economy posed by the failure of a systemically important bank compared to other banks.[646] The Reserve Bank was clear that this buffer was not intended to offset lower capital holdings of IRB banks and it should be considered separately.[647]

7.33.4 **Significantly increasing capital requirements for all banks.** The Reserve Bank decided to increase the minimum capital ratios for all banks to improve the resilience of New Zealand's banking system.[648] The increased minimum capital requirements will be phased in by 2028.

7.33.5 To require dual reporting from the IRB banks of the outcomes under both their IRB modelling and application of the standardised approach.

7.34 Following initial stage implementation of the Capital Review decisions, the Reserve Bank and the four major/D-SIB/IRB banks are of the view that the capital stacks of the major banks and smaller/non-D-SIB/non-IRB banks have been evened out.

7.35 They point out that the increase in the scalar and the introduction of the 85% output floor have reduced the gap in outcomes and that there is now much less difference between the capital a large bank and a smaller bank must have for a particular loan, that the remaining funding cost advantage is small (the Reserve Bank's estimate is approximately 6 basis points post the Capital Review) and that the funding cost advantage is removed by the impact of the 2% D-SIB buffer.[649,650]

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644 Reserve Bank "Capital Review: Decisions 2019" (December 2019), p. 4.

645 Reserve Bank "Capital Review: Setting an output floor for the IRB approach" (7 November 2018), p. 8.

646 Reserve Bank "Capital Review: Decisions 2019" (December 2019), p. 17.

647 Reserve Bank "Capital Review: Consultation Paper 4: How much capital is enough? – Response to submissions", p. 31, https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/regulation-and-supervision/banks/capital-review/capital-review-hmcie-response-to-submissions.pdf. In response to suggestions from submitters to use the D-SIB buffer framework to narrow differences in the regulatory capital outcomes between the four IRB banks and other banks, the Reserve Bank noted that the objective of the D-SIB buffer is to reduce the likelihood of failure of D-SIBs and that it did not think that the D-SIB buffer and efforts to close the gap between the IRB and standardised approach should be conflated.

648 Reserve Bank "Capital Review: Decisions 2019" (December 2019), p. 4.

649 Reserve Bank "Deposit Takers Core Standards – Policy proposals" (16 May 2024), para 318, https://consultations.rbnz.govt.nz/dta-and-dcs/deposit-takers-core-standards/user_uploads/deposit-takers-core-standards-consultation-paper.pdf

650 Reserve Bank "Deposit Takers Core Standards – Policy proposals" (16 May 2024), Table I and para 321.

7.36 The Reserve Bank made essentially the same points in its submission on our draft report. It did say that it would build in a review of the IRB approach following implementation of standards under the DT Act, which likely would include consideration of more granular standardised risk weightings.

7.37 The smaller/non-D-SIB/non-IRB banks maintain that, if the purpose behind the D-SIB buffer is to reflect systemic risk, there should be equivalence in capital requirements for assets with the same or similar risks before the 2% D-SIB buffer is applied.[651] They suggest that, in order to achieve this, the Reserve Bank should disallow IRB modelling of credit risk in favour of a single standardised methodology for all banks, applying more granular Basel III risk weights.[652]

Our view on IRB modelling, risk weights and the D-SIB buffer

7.38 Ultimately, this comes down to differences of view as to the purpose and effect of the 2% D-SIB buffer and the extent to which lower capital requirements are an incentive for the IRB banks to maintain IRB modelling.

7.39 Our view is that, while the two policy choices effectively net out, they were introduced for different purposes (as the Reserve Bank acknowledges): the IRB approach to encourage a more sophisticated understanding of risk and closer (more efficient) matching of capital held against those risks, and the D-SIB buffer to reduce the likelihood of failure of D-SIBs.

7.40 A focus on what the Reserve Bank considers to be a small remaining funding cost advantage overlooks that an effect is also to require non-D-SIB/non-IRB banks to hold more capital, which can constrain efforts to expand because many of the smaller providers already face capital constraints.

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651 Commerce Commission "Day 1 Personal banking services market study conference – Session 2 Prudential capital requirements" (13 May 2024), pp. 3 (lines 22-33) and 4 (lines 2-4); TSB, Co-operative Bank, Kiwibank and SBS Bank, Submission on draft report (18 April 2024), p. 1.

652 The Reserve Bank applies risk weights to residential mortgages for owner-occupied properties depending on the LVR. This approach is consistent with Basel III, under which revisions were made to the standardised approach for credit risk to improve granularity and risk sensitivity and apply depending on the LVR. But the Reserve Bank's level of risk weightings are higher than those under Basel III for all LVR bands and are also less graduated to LVR bands. As a result, under the Reserve Bank's approach, more capital must be held against the residential mortgage by standardised banks than under the Basel III approach. Notably, the Australian Prudential Regulatory Authority (APRA) equivalent risk weights are more closely aligned with Basel III. See Basel Committee on Banking Supervision "High-level summary of Basel III reforms" (December 2017), Table 1, https://www.bis.org/bcbs/publ/d424_hlsummary.pdf; Reserve Bank "BPR131: Standardised Credit Risk RWAs" (July 2021), Table C3.10, https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/consultations/banks/review-capital-adequacy-framework-for-registered-banks/bpr-documents/bpr131-standardised-credit-risk-rwas.pdf; APRA "Prudential Standard APS 112 – Capital Adequacy: Standardised Approach to Credit Risk" (January 2023), Table 1, https://www.apra.gov.au/sites/default/files/2021-11/Final%20Prudential%20Standard%20APS%20112%20-%20Capital%20Adequacy%20-%20Standardised%20Approach%20to%20Credit%20Risk.pdf

7.41 Putting aside the D-SIB buffer, the question is whether the balance between the prudential requirements on the IRB banks and other providers is appropriate. The scalar and the 85% output floor have reduced the gap.

7.42 Given that the Reserve Bank and international standards require a relatively costly degree of modelling to maintain IRB accreditation, we have altered the proposed recommendation in our draft report of allowing for easier IRB accreditation to instead recommending more granular standardised risk weightings. This would allow the risk weightings of smaller providers to match actual risks more closely.

7.43 Currently, the standardised approach is, by design, conservative because it is trying to cater for all outcomes. This disadvantages smaller providers.

7.44 The NBDTs were not directly impacted by the Capital Review as those decisions related to banks and not the NBDTs. The Reserve Bank is, however, currently in the process of determining whether and how these and other prudential requirements will carry over from the existing regulatory frameworks and policies into the new framework and standards under the DT Act. As the DT Act combines the currently separate regulatory regimes for banks and NBDTs into a unified prudential regime for all deposit takers, these decisions will also affect the NBDTs.

7.45 Related to risk weightings, we heard that the major/IRB banks and Kiwibank are treating lending to housing cooperatives and community housing providers that is backed by residential mortgages as a type of corporate lending.[653] This means that this lending is being treated as carrying a level of risk that is higher than the likely actual risk. In turn, it means that borrowers pay corporate rather than residential lending interest rates, which are higher, as well as having to accept more onerous borrowing terms (such as higher equity requirements).[654] To enhance competition for this type of lending, we recommend that the Reserve Bank considers implementing a retail, rather than corporate, risk classification for mortgage-backed lending to housing cooperatives and community housing providers so that loans that effectively carry the same risk are treated in the same manner.

653 Andrew Body, Cross-submission on draft report (22 May 2024); Commerce Commission "Day 1 Personal banking services market study conference – Session 2 Prudential capital requirements and other regulatory factors" (13 May 2024), pp. 16 (lines 22-34) and 17 (lines 1-30). This is also noted in the recent review of Kāinga Ora: see Sir Bill English, Ceinwen McNeill and Simon Allen "Independent Review of Kāinga Ora – Homes and Communities" (March 2024), p. 30, https://www.beehive.govt.nz/sites/default/files/2024-05/Independent%20Review%20of%20Kainga%20Ora.pdf

654 Commerce Commission "Personal banking services market study – Draft report" (21 March 2024), footnote 519, where we recorded our draft view that these issues were outside of the scope of this study into personal banking services. Having received Andrew Body's submission, we now understand that the risk weightings being applied to lending of this kind are within scope because they ultimately relate to individuals purchasing homes to live in through housing cooperatives and community housing, and the effect of the treatment of that lending by those entities in accordance with risk weightings set by the Reserve Bank directly affects the terms of lending with the individuals. We therefore consider that it is within scope.

The Deposit Takers Act 2023 – purpose and principles

7.46 The DT Act brings in changes to the Reserve Bank's prudential regulatory and supervision role for both banks and NBDTs. The DT Act is coming into effect progressively and will fully take effect in 2029.

7.47 The main purpose of the DT Act is "to promote the prosperity and well-being of New Zealanders and contribute to a sustainable and productive economy by protecting and promoting the stability of the financial system".[655] This main purpose gives primacy to financial stability.

7.48 However, the DT Act also has the additional purposes:[656]

7.48.1 to promote the safety and soundness of each deposit taker;

7.48.2 to promote public confidence in the financial system;

7.48.3 to avoid or mitigate the adverse effects of risks to the stability of the financial system and risks from the financial system that may damage the broader economy; and

7.48.4 to the extent not inconsistent with the purposes outlined above, to support New Zealanders having reasonable access to financial products and services provided by the deposit-taking sector.

7.49 In achieving the purposes of the DT Act and in setting standards under it, the Reserve Bank must take into account certain principles, including:

7.49.1 the desirability of taking a proportionate approach to regulation and supervision (the proportionality principle);[657]

7.49.2 the desirability of the deposit-taking sector comprising a diversity of institutions to provide access to financial products and services to a diverse range of New Zealanders;[658]

7.49.3 the need to maintain competition within the deposit-taking sector;[659] and

7.49.4 the need to avoid unnecessary compliance costs.[660]

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655 DT Act, s 3(1).
656 DT Act, s 3(2)(a)-(d).
657 DT Act, s 4(a)(i).
658 DT Act, s 4(a)(iii).
659 DT Act, s 4(b).
660 DT Act, s 4(c).

7.50 Under the DT Act, the Reserve Bank must develop prudential standards to replace current prudential requirements. The prudential standards will be the primary tool for imposing prudential requirements on deposit takers.[661]

7.51 The DT Act requires the Reserve Bank to prepare and publish a framework for taking into account the proportionality principle when developing standards.[662] The Reserve Bank published its Proportionality Framework in March 2024.[663]

The Proportionality Framework

7.52 Under its Proportionality Framework, the Reserve Bank has interpreted "proportionality" consistent with the Bank for International Settlements' definition of proportionality: ensuring that applicable rules and supervision practices are consistent with banks' systemic importance and risk profile and are appropriate for the broader characteristics of a particular financial system.[664]

7.53 The Reserve Bank states that, in taking a proportionate approach, it will balance the cost and benefits of regulatory requirements in relation to different types of deposit takers.[665] It has further noted that, while the Proportionality Framework does not set out its approach to other principles (such as competition and diversity), those principles will also be taken into account when developing standards.[666]

7.54 Under the Proportionality Framework, the Reserve Bank has divided locally incorporated deposit takers into three groups for the purposes of developing standards:[667]

7.54.1 **Group 1**: deposit takers with total assets of NZ$100b or more. The deposit takers in Group 1 are recognised as the D-SIBs.

7.54.2 **Group 2**: Deposit takers with total assets of NZ$2b or more but less than NZ$100b. The deposit takers in Group 2 are the non-D-SIBs.

7.54.3 **Group 3**: Deposit takers with total assets of less than NZ$2b. Deposit takers in Group 3 are the NBDTs.

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661 Reserve Bank "DTA legislation and regulation" (1 July 2024), https://www.rbnz.govt.nz/regulation-and-supervision/depositor-compensation-scheme/regulatory-environment-under-the-dta

662 DT Act, s 77.

663 Reserve Bank "Proportionality Framework for Developing Standards Under the Deposit Takers Act" (March 2024), https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/regulation-and-supervision/dta-and-dcs/the-proportionality-framework-under-the-dta.pdf

664 Reserve Bank "Proportionality Framework for Developing Standards under the Deposit Takers Act" (March 2024), p. 4.

665 Reserve Bank "Proportionality Framework for Developing Standards under the Deposit Takers Act" (March 2024), p. 2.

666 Reserve Bank "Proportionality Framework for Developing Standards under the Deposit Takers Act" (March 2024), p. 3.

667 Reserve Bank "Proportionality Framework for Developing Standards under the Deposit Takers Act" (March 2024), p. 7.

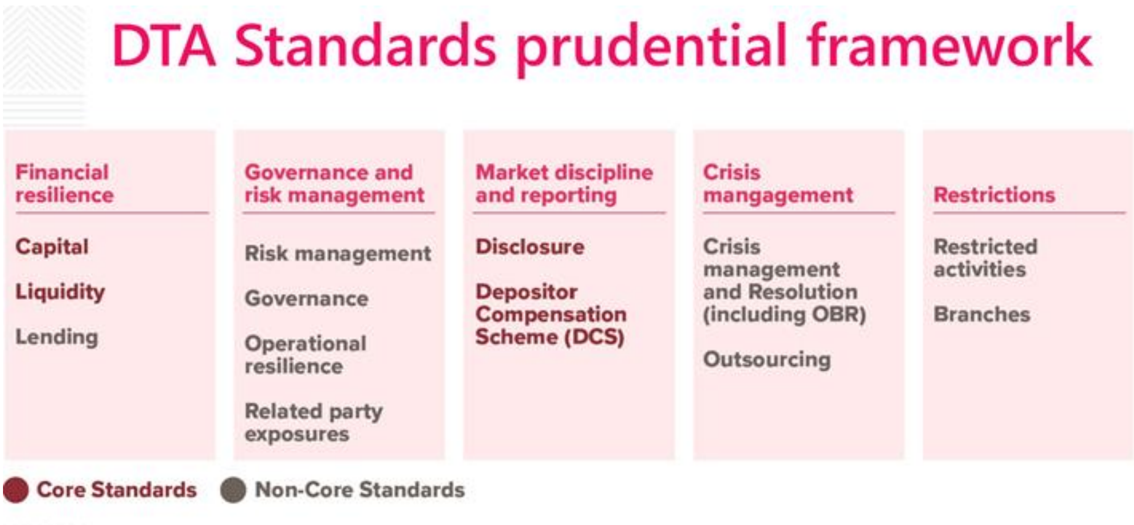
The Reserve Bank must also take into account the competition principle in the development of new prudential standards and has done so…

Development of new prudential standards and how the Reserve Bank considers competition

7.55 The Reserve Bank has recently completed consultation on policy proposals for new prudential standards to be made under the DT Act.[668] The Reserve Bank describes the DT Act as representing a paradigm shift in the way that it approaches financial stability, in that the introduction of the DCS and its new regulatory powers have come with statutory purposes that focus not just on systemic stability but also on individual entity soundness.[669]

7.56 In May 2024, the Reserve Bank released a consultation paper with policy proposals for the four core standards, which will be used as the criteria to determine the eligibility of existing banks and NBDTs for licences under the DT Act. It expects to release a further consultation paper on nine non-core standards later this year. See Figure 7.1 below.[670]

Figure 7.1 DTA standards prudential framework



Source: Reserve Bank.

7.57 Of the core and non-core standards, it is the capital standard and the DCS standard (both core standards) that are most relevant for competition, entry and expansion. We therefore focus on these although acknowledge that non-core standards will likely require Group 3 deposit takers to lift capability and so will carry a compliance cost.

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668 Consultation closed on 27 July 2024. See Reserve Bank ”Deposit Takers Core Standards Policy Proposals” (16 May 2024), https://consultations.rbnz.govt.nz/dta-and-dcs/deposit-takers-core-standards/user_uploads/deposit-takers-core-standards-consultation-paper.pdf.

669 Reserve Bank “Deposit Takers Core Standards – Policy proposals” (16 May 2024), para 5.

670 Reserve Bank “Deposit Takers Core Standards – Policy Proposals” (16 May 2024), p. 14.

Competition and financial stability

7.58 In the executive summary of the core standards policy proposals consultation paper, the Reserve Bank explains the relevance of minimum levels of capital to financial stability, acknowledging that capital has a cost and that there are complex trade-offs. There is a discussion of the proportionality, diversity and competition principles.[671]

7.59 In relation to competition, the consultation paper states:[672]

> **Considering competition**
>
> 90. Competition is an important consideration in our prudential decision making, as it has a strong connection to efficiency. Moreover, as outlined above, the need to maintain competition within the deposit-taking sector is one of the principles we need to consider when developing standards under the DTA. We consider that the need to maintain competition is always a relevant principle, given all prudential regulation tends to have some impact on competition (even if it is minimal), such as through altering compliance costs the setting of capital or liquidity requirements, or through other mechanisms. Consideration of competition is also closely linked to some other principles, such as avoiding unnecessary compliance costs, proportionality, and the desirability of the deposit-taking sector comprising a diversity of institutions. In some circumstances a prudential requirement may have a marginal negative impact on competition, but this will be justified on a net benefit basis when considering the societal costs of deposit taker failure, the risks to the DCS funds and in light of our financial stability objective.
>
> 91. We consider that the DTA and, by extension, the DTA standards will have both positive and negative impacts on competition in the deposit-taking market. Some positive effects include the benefits that smaller players receive by having their relative risk (as compared with larger deposit takers) reduced through the DCS, the reduction in the risk that larger deposit takers pose to smaller deposit takers through enhanced prudential regulation, and the greater chance of smaller and more vulnerable deposit takers surviving a banking crisis because of enhanced regulation putting them in a better prudential position. Another benefit to competition will come from reducing expansion costs from the single regime for all deposit takers under the DTA. (For example, under the DTA standards we are proposing that risk weights for credit risk will be calculated in the same way for Group 2 and Group 3, reducing the costs for Group 3 entities transitioning into Group 2.) We are also proposing a more unified disclosure regime, which should better drive competition and help consumers make more informed decisions.
>
> 92. However, there may be some negative effects (the magnitude of which are uncertain). These include:
>
> - potentially higher DCS levies for smaller and riskier entities because of higher relative risk (albeit offset by the benefit of the DCS protection)
> - regulatory transition costs for existing NBDTs that may adversely affect their ability to compete in the short term
> - higher costs of participating in the market in the long term, potentially deterring new entrants who could otherwise have more disruptive effects on competition in the deposit taker market.
>
> 93. Given these competing factors it is difficult to assess the overall impacts of the change in both the near term and in the long term, and we are interested in your views on the impact of the DTA standards on competition.

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671 Reserve Bank "Deposit Takers Core Standards – Policy proposals" (16 May 2024), paras 12–27.
672 Reserve Bank "Deposit Takers Core Standards – Policy proposals" (16 May 2024), pp. 20–21.

7.60 The Reserve Bank's assessments of possible impacts on competition and sector diversity are then further explained in the core standards chapters where those principles are relevant, generally under headings for "Maintaining competition and sector diversity". With the core standards chapters structured by deposit taker group, this further discussion is set in the context of the Reserve Bank's discussion of the proportionality principle and its application of the Proportionality Framework.

The core capital standards proposals

7.61 Briefly summarised, these are the core capital standard proposals for the three groups under the Reserve Bank's Proportionality Framework.[673]

7.61.1 For **Group 1** deposit takers (the D-SIBs/IRB banks): to carry over most aspects of the existing capital requirements (including the decisions made as a result of the Capital Review such as the 1.2x scalar, the 85% output floor and the 2% D-SIB buffer) to the capital standard. There would be some minor changes, including to modernise the credit, market and operational risk frameworks (although these are not relevant for our purposes).[674]

7.61.2 For **Group 2** deposit takers (non-D-SIB/non-IRB banks): to carry over most aspects of the existing capital requirements to the capital standard with the same modifications as for Group 1.

7.61.3 For **Group 3** deposit takers (NBDTs): closer alignment with the capital requirements for Groups 1 and 2 "but applied in a proportionate way".[675] The effect of the current proposals would require the Group 3 deposit takers to increase the capital they hold compared to existing requirements, but this would be offset with a reduction in risk weights (which the Reserve estimates to be around 10–30%), reducing the impact of higher capital requirements.[676] It is also proposed to introduce a minimum capital requirement in the range of $5m to $10m for the Group 3 deposit takers.

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673 Reserve Bank "Deposit Takers Core Standards – Policy proposals" (16 May 2024), paras 134–190, https://consultations.rbnz.govt.nz/dta-and-dcs/deposit-takers-core-standards/user_uploads/deposit-takers-core-standards-consultation-paper.pdf

674 Reserve Bank "Deposit Takers Core Standards – Policy proposals" (16 May 2024), paras 139–303.

675 Reserve Bank "Deposit Takers Core Standards – Policy proposals" (16 May 2024), para 23; see generally paras 335-535.

676 Reserve Bank "Deposit Takers Core Standards – Policy proposals" (16 May 2024), para 26.

7.62 We understand that, once the new capital standards come into effect, the Reserve Bank's current policy that banks must have a minimum of $30m in capital in order to be registered will fall away.[677] Therefore, the only applicable minimum dollar capital requirement for personal banking service providers (that will be deposit takers) would be the one for the Group 3 deposit takers as set out above. This would be a new requirement for those providers as they are not currently subject to any minimum dollar value of capital.

7.63 The consultation paper discusses the Reserve Bank's assessments of the impact of the proposed capital standard on competition in respect of each of the three groups. Similar logic is set out for each of Groups 1, 2 and 3 deposit takers.

7.63.1 For Group 1: "Sound and well capitalised Group 1 deposit takers reduce the risk of failure of one off those deposit takers … This supports the provision of services and competition by ensuring those deposit takers are more likely to remain viable."[678]

7.63.2 For Group 2: "Competition is not effective if new entrants do not have the resilience to remain in business; early failure of new entrants can lead to distrust in novelty and innovation, which are otherwise desirable characteristics in a financially inclusive society. By maintaining competition within the deposit-taking sector in this manner, we are continuing to support the diversity of institutions".[679]

7.63.3 For Group 3: "Sound and well-capitalised Group 3 deposit takers reduce the risk of failure of a Group 3 deposit taker. This means that deposit takers remain in business and continue to provide financial products and services. This supports provision of services and competition as those deposit takers are more likely to remain viable."[680]

7.64 In addition, in the Group 2 deposit takers section of the consultation paper, there is a discussion on risk weights under the IRB and standardised approaches in response to the views expressed by the some of the smaller (Group 2 and Group 3) banks that they are at a disadvantage in not being able to use the IRB modelling approach.[681]

7.65 The Reserve Bank expresses the view that:

7.65.1 there is not a significant competitive edge for the IRB banks over other banks from risk weights;[682]

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677 This is because the $30m capital requirement is contained in the Reserve Bank's bank registration policy, which is currently made under legislation that will be replaced by the DT Act. However, it is possible that the Reserve Bank may impose some kind of capital minimum on the use of the term "bank" and other restricted terms.

678 Reserve Bank "Deposit Takers Core Standards – Policy proposals" (16 May 2024), para 170.

679 Reserve Bank "Deposit Takers Core Standards – Policy proposals" (16 May 2024), para 323.

680 Reserve Bank "Deposit Takers Core Standards – Policy proposals" (16 May 2024), para 376.

681 Reserve Bank "Deposit Takers Core Standards – Policy proposals" (16 May 2024), paras 314–323.

682 Reserve Bank "Deposit Takers Core Standards – Policy proposals" (16 May 2024), para 322.

7.65.2 the increase in scalar and the introduction of the 85% output floor as part of the Capital Review have reduced the gap in outcomes and there is now "much less difference" between the capital a large bank and a smaller bank must have for a particular loan;[683] and

7.65.3 RWA outcomes for IRB banks are expected to be approximately 90% of what would be calculated under the standardised approach – an increase from a level of around 70-75% in prior years.[684]

7.66 The conclusion that the Reserve Bank reaches in the consultation paper is that there is no significant advantage to the four major/D-SIB/IRB banks (or disadvantage to the smaller non-D-SIB/non-IRB deposit takers) from the capital settings post the Capital Review and that no further material changes are needed in setting the new prudential standards.[685] Otherwise, capital requirements go to resilience and reduce the risk of failure. The Reserve Bank's view is that resilience to remain in business maintains competition within the deposit-taking sector and supports the diversity of institutions.[686]

…but in our view needs to expand its competition assessments

7.67 We recognise that the Reserve Bank has done a great deal of work in developing its Proportionality Framework and applying it in its core standards proposals, and in its competition and sector diversity assessments in the core standards consultation paper.

7.68 However, there are further considerations.

7.68.1 The Reserve Bank's competition assessments place a heavy emphasis on individual entity soundness and protecting firms from the risk of failure. This is only consistent with maintaining competition in the sense that the providers that are able to meet the resulting regulatory requirements are unlikely to fail.

7.68.2 It does not maintain competition if a smaller provider exits as a consequence of being unable to meet these requirements, and more generally, this approach will tend to weaken competition by excluding some innovative entrants.

683 Reserve Bank "Deposit Takers Core Standards – Policy proposals" (16 May 2024), para 318.
684 Reserve Bank "Deposit Takers Core Standards – Policy proposals" (16 May 2024), para 319.
685 Reserve Bank "Deposit Takers Core Standards – Policy proposals" (16 May 2024), p. 27.
686 Reserve Bank "Deposit Takers Core Standards – Policy proposals" (16 May 2024), para 323.

7.68.3 Our sense is that the negative impacts on competition (potentially higher DCS levies for smaller providers, regulatory transition costs for existing NBDTs and higher costs of participating in the market in the long term, potentially deterring new entrants) are relatively clear and certain; whereas several of the positive impacts (benefits to smaller providers of the DCS and reduced expansion costs from a single prudential regime) are less certain.

7.68.4 Smaller providers are more capital constrained than the major banks, so any extra impost has a larger effect on them than on the major banks. Smaller providers also pose less systemic risk than the major banks.

7.69 We therefore consider it possible to enable more competition at the smaller provider end of the market without compromising the main objective of protecting and promoting a stable financial system.

7.70 Our view is as follows.

7.70.1 The Reserve Bank's competition assessments seem fundamentally to equate capital requirements with resilience and the maintenance of competition within the deposit-taking sector.

7.70.2 It is not a sufficient competition assessment to equate capital requirements with resilience and resilience with maintaining competition, or to dismiss the effect of differences between requirements as they affect Group 1 and Group 2/3 deposit takers as having only a small cost when there is also an effect on how much capital is held.

7.70.3 The Reserve Bank's competition assessments must place greater focus on the risk of driving existing firms out, and on reducing any barriers to the entry or expansion of smaller providers, including in relation to minimum dollar capital requirements and risk weightings for capital ratios. Greater consideration needs to be given to whether proposed policy measures either could enhance or might compromise the ability of smaller providers to enter and expand (and, through efforts to expand, put greater competitive pressure on the major banks).

7.70.4 The Reserve Bank should also explicitly and transparently consider whether any regulatory requirements within its remit may be able to be relaxed further to better enable the entry and expansion of smaller providers.

7.70.5 Given our view that potential for disruptive competition in the longer term is likely to come from businesses that do not resemble traditional banks and may fall outside the regulatory perimeter of the DT Act, the Reserve Bank and policy makers should consider what can be done from a regulatory perspective to encourage entry and expansion by such businesses.

7.71 We recognise that the Reserve Bank may find some aspects of this difficult within the legislative framework of the DT Act in which competition, and "maintaining competition within the deposit-taking sector", is effectively a secondary consideration and subject always to the DT Act's main purpose of financial stability. However, we see no reason why the Reserve Bank cannot, within that framework, approach its competition assessments and consideration of the competition principle with a closer focus on whether its policy decisions impose the least possible restrictions on competition and in particular on the entry and expansion prospects of smaller providers.

7.72 We make some specific recommendations for the Reserve Bank to consider in Chapter 10.

Other Reserve Bank policies and advice also have potential to affect competition | *Tērā hoki he pānga ā te Pūtea Matua kaupapa here, tohutohu hoki ki te whakataetaetanga*

7.73 In addition to new prudential standards under the DT Act and a new core capital standard, certain other policies and advice that fall to the Reserve Bank are currently, or will shortly be, under consideration. The key ones identified in this study are:

7.73.1 levy advice to the Minister of Finance before regulations are set to provide for levies to fund the DCS;

7.73.2 the setting of a policy to govern which deposit takers will be able to use the terms 'bank' and 'banking services'; and

7.73.3 the setting of a revised policy for access to the ESAS.

7.74 These policies have potential to affect competition in personal banking either positively or negatively. It is therefore important that the Reserve Bank considers carefully the trade-offs that these policy decisions raise between financial stability and competition. This is particularly the case given that there is potential for competition in personal banking over the longer term from businesses that do not have a traditional bank business model.

The DCS levy will be a material cost, particularly for smaller deposit takers

The DCS and the DCS levy

7.75 As mentioned in Chapter 5, the DT Act will introduce a deposit insurance scheme in New Zealand with the DCS. The DCS will provide protection of up to $100,000 per eligible depositor per deposit taker in the event of deposit taker failure.[687] The DCS is intended to come into effect in mid-2025.[688]

687 Reserve Bank "Depositor Compensation Scheme Regulations – Consultation Paper" (11 March 2024), p. 1, https://consultations.rbnz.govt.nz/dta-and-dcs/dcs-regulations/user_uploads/dcs-regulations-consultation-paper.pdf

688 Reserve Bank "Depositor Compensation Scheme Regulations – Consultation Paper" (11 March 2024), p. 7.

7.76 The DCS fund is to be set up by collecting levies from deposit takers until the fund reaches the target size.[689] The Minister of Finance sets the final levies charged under the DCS Regulations on advice from the Reserve Bank. The Reserve Bank recently consulted on its proposed approach to levy setting and is in the process of finalising its advice to the Minister of Finance.[690]

A simplified composite risk-based approach is the Reserve Bank's preferred option

7.77 The Reserve Bank is proposing that levies be set on a simplified composite risk-based approach (as opposed to either a flat-rate or credit ratings-based approach).[691]

7.78 Under the simplified composite risk-based approach:

7.78.1 levies would be calculated based on three risk indicators: capital, liquidity and business model and management (proxied by profitability); and

7.78.2 following the calculation of the levy, deposit takers will fall into one of four levy risk buckets, which will act as a multiplier (from 1 to 4 times) for the levy calculated based on the above risk indicators.[692]

7.79 As regards the other options that were consulted on, being either a flat-rate or a credit ratings-based approach, the Reserve Bank has indicated as follows.

7.79.1 It will not be recommending a flat-rate approach because it is not risk based and so does not account for the likelihood of a compensation event. While it acknowledges that there may be proportionality and competition benefits for smaller deposit takers from a flat-rate approach, it considers a lack of risk-based pricing results in incentives for all deposit takers to increase their risk. It considers that the moral hazard of insurance would have a detrimental impact on the soundness of deposit takers and wider financial stability in the long term.[693]

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689 Reserve Bank "Depositor Compensation Scheme Regulations – Consultation Paper" (11 March 2024), p. 1. The Treasury published the first Statement of Funding Approach (SoFA) for the DCS in July 2024. It outlined that the target DCS fund size is 0.8% of all protected deposits to be built over 20 years. The SoFA will be updated at least every 5 years, with out-of-cycle adjustments being made in certain situations (such as fund targets being met, significant failure events or significant changes in risk information).

690 As the Reserve Bank is required to do under the DT Act, ss 245–247.

691 Reserve Bank "Depositor Compensation Scheme Regulations – Consultation Paper" (11 March 2024), p. 10.

692 Reserve Bank "Depositor Compensation Scheme Regulations – Consultation Paper" (11 March 2024), p. 11.

693 Reserve Bank "Depositor Compensation Scheme Regulations – Consultation Paper" (11 March 2024), p. 18.

7.79.2 It will also not be recommending a credit ratings-based approach as it is less sensitive to changes in the riskiness of deposit takers, credit rating agencies review and adjust ratings on average every 12 months, it may not reflect the true underlying risk of DCS payout of the deposit taker and not all deposit takers have credit ratings.[694]

7.80 The Reserve Bank acknowledges that the impact of DCS levies for each deposit taker remains uncertain and will be unique to each deposit taker. It states that the impact of the DCS levy on a deposit taker's profitability will depend on factors such as the ability of the deposit taker to attract deposits through consumers' deposit splitting, offering insured deposits at competitive deposit rates and/or passing on the levy cost without losing deposits.[695] However, it expects that:

7.80.1 for small deposit takers, the cost of the DCS levy may be offset by consumers deposit splitting and the ability of small deposit takers (particularly finance companies, which have generally higher deposit rates) to reduce their deposit rates for insured deposits;[696] and

7.80.2 for larger banks, the impact of the DCS levy may be minimal but their ability to pass on the levy costs to consumers may be reduced by the increased competition in the industry as a result of the ability of small deposit takers to reduce their deposit rates.[697]

7.81 The Reserve Bank acknowledges that any risk-based approach is likely to result in, on average, smaller deposit takers paying higher levies as a proportion of their covered deposits than larger deposit takers.[698] On the other hand, the Reserve Bank's view is that a risk-based approach is appropriate because it is the smaller deposit takers (which the Reserve Bank considers are generally more risky) who are expected to benefit most from the DCS. On this basis, it is recommending DCS levies be set based on a simplified composite risk-based approach (which is a risk-based approach with some refinements to the composite risk indicators).[699]

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694 Reserve Bank "Depositor Compensation Scheme Regulations – Consultation Paper" (11 March 2024), p. 18.

695 Reserve Bank "Depositor Compensation Scheme Regulations – Consultation Paper" (11 March 2024), p. 16.

696 Reserve Bank "Depositor Compensation Scheme Regulations – Consultation Paper" (11 March 2024), p. 16.

697 Reserve Bank "Depositor Compensation Scheme Regulations – Consultation Paper" (11 March 2024), p. 16.

698 Reserve Bank "Depositor Compensation Scheme Regulations – Consultation Paper" (11 March 2024), p. 12.

699 Reserve Bank "Depositor Compensation Scheme Regulations – Consultation Paper" (11 March 2024), p. 10.

Smaller deposit takers have concerns with the cost of the levy even under a simplified composite risk-based approach

7.82 Following the Reserve Bank's initial consultation in 2023, a composite risk-based approach had been favoured by large and medium-sized deposit takers whereas submissions from small deposit takers mostly favoured the flat-rate approach.[700] Some small deposit takers cited proportionality or competitiveness reasons in support of that approach, for example, because the cost of a risk-based measure would drive up operational costs and reduce their ability to compete.[701]

7.83 Smaller deposit takers remain concerned about the capital, liquidity and profitability indicators even with the simplified composite risk-based approach.[702]

7.83.1 Some of the smaller deposit takers' business models see their profits distributed into the community (rather than as shareholder distributions/profits).[703]

7.83.2 The capital indicator does not differentiate between deposit takers that calculate their capital ratios using the standardised versus the IRB approaches, nor does it discount the effect of the 2% D-SIB buffer (which is intended to reflect the additional systemic risk posed by a D-SIB). As such, the capital risk indicator would treat IRB banks as safer than deposit takers using the standardised approach.[704]

7.83.3 All of the indicators are weighted equally. Some small deposit takers consider they would be disadvantaged by the profitability indicator as the current weighting at 33% favours the major banks due to their scale.[705]

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700 Reserve Bank "Depositor Compensation Scheme Regulations – Consultation Paper" (11 March 2024), p. 10.

701 Reserve Bank "Depositor Compensation Scheme Regulations – Consultation Paper" (11 March 2024), p. 10.

702 Commerce Commission "Day 1 Personal banking services market study conference – Session 2 Prudential capital requirements" (13 May 2024), pp. 22–23.

703 NBDT Group "Submission on the Levy Framework for the Depositor Compensation Scheme" (25 September 2023), p. 17, https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/consultations/deposit-takers-act/dcs-levy-submissions.pdf; NBDT Group, "Submission on the Depositor Compensation Scheme Regulations Consultation Paper" (10 May 2024), para 10.

704 Commerce Commission "Day 1 Personal banking services market study conference – Session 2 Prudential capital requirements" (13 May 2024), pp. 22–23; Reserve Bank "Depositor Compensation Scheme – Levy Framework Consultation: Kiwibank submission to the Reserve Bank of New Zealand (RBNZ) and The Treasury" (12 December 2023), p. 65 (paras 20–22), https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/consultations/deposit-takers-act/dcs-levy-submissions.pdf

705 NBDT Group "Submission on the Depositor Compensation Scheme Regulations Consultation Paper" (10 May 2024), para 11.

7.84 Group 3 deposit takers, in particular, are concerned about the levy multipliers and consider that the multipliers between the four risk buckets is too significant. They believe that the current proposed multipliers make it likely that the risk represented by deposit takers will frequently be disproportionate to the levy paid and that those who will be impacted most by this will be those entities deemed by the Reserve Bank to represent higher levels of risk, typically being the smaller deposit takers, who are largely NBDTs.[706] They also state that a minor increase in the composite risk score for an entity on the boundary of risk buckets will result in a significant increase in levy payments, which would place a heavy strain on that entity's ability to compete and be profitable.[707]

7.85 More fundamentally, smaller deposit takers have these concerns.

7.85.1 The Reserve Bank appears to have made assumptions as to the competition impacts of the DCS, and these assumptions appear to be informing the recommendation to use a simplified composite risk-based approach in setting DCS levies. Smaller deposit takers, in particular the NBDTs, are not convinced that consumer behaviour will change after the introduction of the DCS such that smaller deposit takers will be able to compete more vigorously for deposits due to depositors' deposit splitting. They consider the Reserve Bank has been naïve in its assumption that the DCS will bring about competition benefits to the smaller deposit takers.[708]

7.85.2 The Reserve Bank appears to be interpreting risk in the context of each deposit taker's credit risk rather than the systemic risk that the major banks carry due to their size.[709] Smaller deposit takers have told us that the impact of an NBDT failure will be virtually negligible and will not require a significant call on the DCS fund compared to the failure of a D-SIB, which would be systemic across banks and would impose a large call on the DCS fund.[710]

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706 NBDT Group "Submission on the Depositor Compensation Scheme Regulations Consultation Paper" (10 May 2024), para 17; Christian Savings Limited "Submission on Consultation Paper – DCS Levy Framework" (25 September 2023), p.23-26, https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/consultations/deposit-takers-act/dcs-levy-submissions.pdf

707 NBDT Group "Submission on the Depositor Compensation Scheme Regulations Consultation Paper" (10 May 2024), para 18.

708 Commerce Commission "Day 1 Personal banking services market study conference – Session 2 Prudential capital requirements" (13 May 2024), pp. 22–23.

709 Commerce Commission "Day 1 Personal banking services market study conference – Session 2 Prudential capital requirements" (13 May 2024), pp. 22–23; [ ].

710 Commerce Commission "Day 1 Personal banking services market study conference – Session 2 Prudential capital requirements" (13 May 2024), pp. 22–23.

Until the effects of the DCS become clearer, the Government should err on the side of not adding to the burden of smaller deposit takers

7.86 It remains to be seen precisely what effects the DCS will have on consumer behaviours and competition for deposits and, in particular, whether introducing a DCS will enable smaller deposit takers to attract more deposits than previously.

7.87 We acknowledge that credit ratings agencies rate smaller institutions as more likely to fail and that, based solely on credit ratings for the NBDTs that have them, the riskiest NBDT is 6 times more likely to default than the safest.[711]

7.88 The Reserve Bank is proposing a system that is not unusual internationally and compresses the spread of riskiness in credit ratings.

7.89 There may be some gain for smaller institutions in having insurance through the DCS, although experience in other markets suggests that any impact will be modest. In Australia, for example, the ACCC recently concluded that there is still a perception that large banks are safer even though all authorised deposit takers are covered by the same compensation scheme.[712]

7.90 At this point, we know very little about the relative riskiness of smaller providers under the new and still to be fully implemented DT Act regime. The failures of the finance companies from the GFC are also not useful information given the more stringent regulatory settings now in place under the NBDT Act and those that will come into force with the DT Act and standards. We also know that credit ratings are imperfect indicators of risk of failure.

7.91 If a large institution was to fail, there would be likely some contagion to the rest of the financial system so losses may be greater than just their own deposits (and, to that extent, would not be covered by the DCS). That is less likely with smaller providers. All else being equal, that would imply a larger premium for the larger deposit takers. We have not seen any indication that the potential systemic risks of a large bank failure have been considered in the Reserve Bank's analysis.

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711 This can be inferred from the spread of ratings and outlook information for NBDTs on the Reserve Bank's register of NBDTs. The highest credit rating is BBB and the lowest is B, Negative The approximate probability of default over 5 years for BBB (adequate) is 1 in 30; B (more vulnerable) 1 in 5. A probability of 0.2 is 6x greater than a probability of 0.0333. The major banks each have an AA rating (very strong), which implies that the chance of default is approximately 1 in 300 over the next 5 years. The Register of NBDTs including their credit ratings is available at https://www.rbnz.govt.nz/regulation-and-supervision/cross-sector-oversight/registers-of-entities-we-regulate/register-of-non-bank-deposit-takers-in-new-zealand and the equivalent for banks is available at https://www.rbnz.govt.nz/regulation-and-supervision/cross-sector-oversight/registers-of-entities-we-regulate/registered-banks-in-new-zealand

712 ACCC "Retail Deposits Inquiry – Final report" (December 2023), p. 45.

7.92 There are some concerns about moral hazard – that lower premia for riskier deposit takers may encourage riskier behaviour in order to attract more deposits to be placed with them and therefore increase risk to the system. Arguably, that risk will apply even with risk-based premia given the challenges for smaller entities to attract deposits at the same interest rates as larger ones. Our view is that any impact is likely to be minimal given the regulatory regime in place.

7.93 Balancing these considerations requires judgement. Given our concerns about the lack of effective competition in the market, our view is that Government should err on the side of not adding to the burden on smaller providers. While any impact may be relatively small, given the challenges smaller providers face, we consider that it is important to do as much as is possible to support their continued presence in the market.

7.94 In addition, if there is to be a risk-based levy, we see limited justification for profitability to be one of the factors determining risk levels – particularly given our findings that large banks are an oligopoly earning greater levels of profit than would be expected in a competitive market.

7.95 In our view, the government should consider a flat-rate levy (per dollar of insured assets) in the first years of the scheme until there is more information on the costs and benefits of the scheme.

7.96 If risk-based levies are maintained, we suggest removing or reducing the weight on profitability as an indicator of risk (and, if maintained, ensuring that it takes adequate account of not-for-profit providers).

Providers other than banks offer personal banking services

Currently only registered banks can use the terms 'bank' and 'banking services'

7.97 There are statutory restrictions on the use of the terms 'bank', 'banker' and 'banking'. Under the current law, those words can only be used in a name or title, or in relation to an activity, by either a registered bank or a person that is authorised by the Reserve Bank to do so (in accordance with any conditions that the Reserve Bank imposes).[713]

7.98 We are not currently aware of any circumstances in which the Reserve Bank has previously given authorisation to a person that is not a registered bank to use the term bank or the other restricted terms.

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713 Under the current law, these restrictions are set out in the Banking (Prudential Supervision) Act 1989, s 64. Similar restrictions are replicated in the new DT Act, which will take effect once the current law is repealed in around 2028 (s 477(a)). It is worth noting that any person can apply to be registered as a bank, but the Reserve Bank can only register an applicant if it is satisfied that the person carries on the business (at least to a substantial extent) of the borrowing and lending of money or the provision of other financial services or both: Banking (Prudential Supervision) Act 1989, s 73(1).

7.99 In future, the Reserve Bank will be explicitly required by the DT Act to outline in its statement of prudential policy what the minimum requirements are, in general terms, for a deposit taker to be authorised to use a name or title that includes a restricted word.[714] The example given in the legislation is that "[a] deposit taker that is authorised to use 'bank' may be required to comply with higher financial strength requirements than those that would otherwise apply".

7.100 While the Reserve Bank is currently consulting on draft core prudential standards, it is yet to formulate or consult on this policy. We understand that it anticipates developing the policy once it is clear what the calibration of the prudential standards will mean for the overall soundness of the financial system.

Some NBDTs and fintechs want to use the terms 'bank' and 'banking services'

7.101 Traditionally, all banks generally offered the same kinds of services and were more or less full service.

7.102 While there is a history of some financial institutions offering some but not all of the services of traditional banks (such as payments by card companies, and limited deposit and/or lending services by some NBDTs and finance companies), technology and other innovations are increasingly facilitating a broader range of institutions to offer subsets of personal banking services, and consumers can mix and match the services available.

7.103 Some Group 3 deposit takers (the NBDTs) and fintechs consider it important to be able to refer to themselves as a 'bank' or to the services that they provide as 'banking services' to enable them to compete with larger providers. One NBDT told us that being able to call itself a bank is important to being able to distinguish itself from the non-prudentially-regulated sector.[715] Dosh recently announced that it has applied to the Reserve Bank for bank registration. At the same time, there are some institutions registered as banks in New Zealand and, under the current law, are able to use the word 'bank' in their name (such as Citibank), which do not offer any banking services to retail customers here.

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714 DT Act, s 431.

715 Commerce Commission "Day 1 Personal banking services market study conference – Session 3 Prudential capital requirements and other regulatory factors (continued)" (13 May 2024), pp. 6 (lines 16–18) and 8 (lines 22–24).

Restrictions on the terms 'bank' and 'banking services' should go no further than necessary

7.104 In our view, institutions should be regulated based on the activities they undertake. Competition would be best served by allowing institutions to offer personal banking services where they see gaps in the market, and being able to describe themselves in ways that they choose as long as those descriptions are accurate. To this end, the DT Act gives the Reserve Bank significant freedom to determine which financial service providers should be able to use the restricted terms. In particular, the Reserve Bank is empowered to authorise a person that either is or intends to become a financial service provider to use a name or title that includes a restricted word, whether or not they are a deposit taker.[716] Such a person may be authorised even if providing financial services is not the provider's only or principal business.[717]

7.105 In setting its new policy under the DT Act and considering what providers should be authorised to use the restricted terms, the Reserve Bank should permit a greater range of providers – including all Group 3 deposit takers and providers that are not deposit takers – to use the word 'bank' and 'banking' in recognition of the types of services that they provide. This would be consistent with the fact that all Group 3 deposit takers will have to meet minimum standards and be regulated by the Reserve Bank. It is also consistent with the statutory scheme, which clearly contemplates use of the restricted terms by entities beyond deposit takers.[718]

Broadening access to ESAS would assist competition

7.106 Traditionally most payments in the economy have been made through banks. This has allowed the Reserve Bank to use ESAS accounts to both facilitate payments and to operationalise monetary policy by paying the OCR on banks' ESAS account balances.

7.107 The following is discussed in more detail in Chapter 9.

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716 DT Act, s 428(d).

717 DT Act, ss 428(d) and 6.

718 See for example DT Act, s 434, which contemplates the use of restricted words by persons other than deposit takers in their advertising (which must include a statement that they are not a deposit taker and state the extent to which they are regulated or supervised by the Reserve Bank).

7.107.1 ESAS is a designated payments and settlement system used for processing and settling payments between banks and other approved financial organisations in New Zealand.[719] It is owned and operated by the Reserve Bank.[720] The Reserve Bank is also the sole regulator of ESAS as a pure payment system under the Financial Market Infrastructures Act 2021 (FMI Act).[721]

7.107.2 ESAS is one of a number of payment clearing and settlement systems that personal banking service providers may need to access to provide services to consumers. Other payment clearing and settlement systems – the High Value Clearing System (HVCS), Bulk Electronic Clearing System (BECS), Consumer Electronic Clearing System (CECS) and Settlement Before Interchange (SBI) system – are owned by Payments NZ.[722] HVCS, BECS, CECS and SBI are not currently designated under the FMI Act.[723]

7.107.3 In order to access the systems owned by Payments NZ, a personal banking service provider must apply to become a Payments NZ participant. Becoming a participant involves complying with access criteria and entering into a multilateral participation agreement with other participants containing the Payments NZ rules and standards.[724] Importantly, access to ESAS is a key requirement for participation in Payments NZ's clearing systems (HVCS, BECS, CECS and SBI).[725]

7.107.4 Only a limited number of industry parties currently have direct access to ESAS (and therefore the other clearing systems). These include the four major banks, Kiwibank and TSB.[726]

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719 Reserve Bank "Exchange Settlement Account System" (28 February 2022), https://www.rbnz.govt.nz/payments-and-settlement-systems/exchange-settlements-account-system

720 Reserve Bank "Register of designated settlement systems in New Zealand" (28 February 2022), https://www.rbnz.govt.nz/regulation-and-supervision/cross-sector-oversight/registers-of-entities-we-regulate/register-of-designated-settlement-systems-in-new-zealand

721 FMI Act, s 10(1). An FMI is a pure payment system if the FMI is a designated FMI and the FMI's designation notice specifies that the FMI is a pure payment system or if the FMI is not a designated FMI but the FMI is a multilateral system solely for the clearing or settlement of payment obligations: FMI Act, s 10(2).

722 The HVCS governs large payments that cannot be reversed such as house settlements. The BECS governs how direct debits, automatic payments, bill payments and direct credits work. The CECS governs how consumer payments such as EFTPOS (debit card) payments and mobile payments work. The SBI system is a payment settlement and interchange system used by BECS and CECS participants: Payments NZ "Our payment systems", https://www.paymentsnz.co.nz/our-work/our-payment-systems/

723 Reserve Bank "Register of designated settlement systems in New Zealand" (28 February 2022).

724 Payments NZ "Participation", https://www.paymentsnz.co.nz/join-us/participation/

725 Payments NZ "ESAS Access Review: Risk Assessment Framework for ESAS – Submission" (27 July 2023), p. 2, https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/consultations/esas/esas-access-review-consultation-submissions.pdf

726 Gareth Vaughan "Banks may have profited by $2b on customer call accounts through RBNZ using settlement accounts for its LSAP programme, consultant tells Commerce Commission" (17 February 2024), https://www.interest.co.nz/banking/126402/banks-may-have-profited-2b-customer-call-accounts-through-rbnz-using-settlement

7.107.5 Personal banking service providers who require ESAS access, but do not have direct access, must enter into an agency banking arrangement with a provider who does have access. Agency banks and providers seeking an agency arrangement are generally competing with each other either directly or at the fringes. This means providers who do not have ESAS access are dependent on competitor agency banks to clear and settle their customers' payments. We understand agency banking arrangements also mean that the ESAS banks have visibility of their competitors' payment flows.[727] We have also been told that there is a cost associated with the agency banking arrangement.[728]

The Reserve Bank's consultation on its policy on ESAS access

7.108 Currently, the Reserve Bank only grants direct ESAS access to financial institutions that "meet requirements regarding the soundness and efficiency of the financial system, that have a legitimate business interest, and demonstrate a lack of risks to the Reserve Bank".[729]

7.109 As part of the Reserve Bank's central bank functions, it may provide a settlement account to any person approved by it.[730] In light of this function, the Reserve Bank initiated a review of its access policy and criteria for deciding applications to open ESAS (settlement) accounts, with the initial round of consultations taking place in 2023. The initial consultation considered a Risk Assessment Framework proposed to evaluate applications to open an ESAS account, which would form part of its revised ESAS access policy and criteria.[731]

7.110 The Reserve Bank is intending to open a second consultation on the access policy and proposed Risk Assessment Framework in the fourth quarter of 2024, stating that it is still in the process of ensuring how accessing can be broadened safely. As part of broadening access to ESAS, it must consult and seek approval from the Reserve Bank's Board.[732]

7.111 While ESAS access is being reviewed, the Reserve Bank will not be processing new applications (received after 17 May 2022) until the ESAS access review is completed and the new access policy and criteria are in place.[733]

727 Reserve Bank "Summary of Submissions and Next Steps on the ESAS Access Review (Risk Assessment Framework) Consultation Paper" (October 2023), p. 4, https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/consultations/esas/esas-access-review-consultation-summary-of-submissions.pdf

728 [ ].

729 Reserve Bank "ESAS Access Review: Risk Assessment Framework for ESAS – Consultation Paper" (15 June 2023), p. 9, https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/consultations/esas/esas-risk-assessment-framework-consultation.pdf

730 Reserve Bank of New Zealand Act 2021, s 116(e).

731 Reserve Bank "Our policy on access to Exchange Settlement accounts" (5 March 2024), https://www.rbnz.govt.nz/payments-and-settlement-systems/exchange-settlements-account-system/our-policy-on-access-to-exchange-settlement-accounts

732 Reserve Bank "Our policy on access to Exchange Settlement accounts" (5 March 2024).

733 Reserve Bank "Our policy on access to Exchange Settlement accounts" (5 March 2024).

Broader access to ESAS would reduce barriers to existing providers' expansion

7.112 Currently, a large number of the smaller banks, Group 3 NBDTs, and all non-bank payment service providers (such Dosh and Revolut) do not have direct access to ESAS.

7.113 Submissions to the Reserve Bank during its review have commented that the innovation and competition objectives of ESAS have not been met. The Reserve Bank has reported stakeholder concerns relating to agency arrangements and that fewer ESAS members had led to there being less innovation and less competition.[734]

7.114 From a competition viewpoint, we consider that broadening direct access to ESAS is important for the entry and expansion of personal banking service providers.

7.115 As acknowledged by the Reserve Bank, direct access to ESAS could achieve the following.

7.115.1 Promote competition and support innovation by more participants having direct access to the payments system. It has stated that, as more participants join ESAS, competition and innovation benefits will become greater as, ultimately, ESAS facilitates more competition in the market and supports innovation in payment services through, for example, making a business/service more profitable by reducing its costs or barriers to entry, leading more broadly to economic benefits to New Zealand.[735]

7.115.2 Remove existing firms' (such as non-bank payment service providers) reliance on agency banks (incumbents).[736] Coupled with an ability to refer to the services offered as banking services, this would be an advancement. It would mean firms have the ability to run their own business without reliance on the major banks. We understand that this could enable the expansion of these existing firms as they would no longer need to pay for an agency arrangement with a major bank. They would also be able to take advantage of the interest earned on ESAS account balances. This additional/freed-up resource could be diverted to initiatives associated with expansion. However, the Reserve Bank notes that the overall potential cost reduction is unclear as direct access also comes with its own costs (for example, technological capacity to service payment functions).[737]

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734 Reserve Bank "Summary of Submissions and Next Steps on the ESAS Access Review (Risk Assessment Framework) Consultation Paper" (October 2023), pp. 3–4.

735 Reserve Bank "ESAS Access Review: Risk Assessment Framework for ESAS – Consultation Paper" (15 June 2023), p. 13.

736 Reserve Bank "ESAS Access Review: Risk Assessment Framework for ESAS – Consultation Paper" (15 June 2023), p. 12.

737 Reserve Bank "ESAS Access Review: Risk Assessment Framework for ESAS – Consultation Paper" (15 June 2023), p. 13.

7.115.3 Allow new firms to enter the payments landscape and offer new types of improved services. New firms could provide competitive constraint on the four major banks at the fringes.

7.115.4 Opening direct access to ESAS as wide as is possible will ensure that existing banks are not at any competitive advantage from the interest earned on ESAS account balances or by preferential access to other payment systems (such as those owned by Payments NZ). It will also be essential if open banking is to change the competitive landscape rather than simply reinforce the position of existing players. The Reserve Bank has pointed out the potential risks of broadening access, including financial, legal and operational risks.[738] We query whether these risks are already present in the system indirectly under agency banking arrangements but with less Reserve Bank visibility.

7.116 At a high level, ESAS alongside the other payment clearing and settlement systems are all financial market infrastructures (FMIs). FMIs provide channels through which payments, securities, derivatives or other financial transactions are cleared, settled or recorded.[739]

7.117 The Reserve Bank has stated that well-functioning and efficient FMIs can strengthen the markets they serve and play a critical role in promoting financial stability and economic growth, but they can also pose significant risks to the financial system (particularly through contagion). The Reserve Bank therefore considers that a stable financial system depends on the careful management of FMIs.[740]

7.118 In relation to ESAS, it appears that, in its consultation paper on the Risk Assessment Framework, the Reserve Bank is well aware of the potential competition benefits that would come with broadening access to ESAS. The consideration of these competition benefits is in line with one of the Reserve Bank's objectives for ESAS: that it "…contributes to payments systems being efficient by being open to innovation and supporting competition, without creating undue risks to the payments system".[741] The Reserve Bank has stated that many submitters on the proposed Risk Assessment Framework agreed that opening up ESAS to a broader range of participants would potentially enhance competition and support further innovation.[742]

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738 Reserve Bank "ESAS Access Review: Risk Assessment Framework for ESAS – Consultation Paper" (15 June 2023), p. 14.

739 Reserve Bank "Oversight of Financial Market Infrastructure in New Zealand (FMI1)" (March 2015), p. 1, https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/regulation-and-supervision/financial-market-infrastructure-oversight/oversight-of-financial-market-infrastructures-in-new-zealand.pdf

740 Reserve Bank "Oversight of Financial Market Infrastructure in New Zealand (FMI1)" (March 2015), p. 1.

741 Reserve Bank "ESAS Access Review: Risk Assessment Framework for ESAS – Consultation Paper" (15 June 2023), p. 7.

742 Reserve Bank "Summary of Submissions and Next Steps on the ESAS Access Review (Risk Assessment Framework) Consultation Paper" (October 2023), p. 4.

7.119 We would encourage the Reserve Bank to continue to give such weight to the competition and innovation objectives of ESAS as it continues its consultation on the Risk Assessment Framework and access policy and in particular as it clarifies what it means by innovation and competition and their priorities relative to other objectives such as integrity and reliability.[743]

Competition and financial stability – a last word

7.120 Consistent with our focus in this study, we have concentrated on areas where we consider that a greater emphasis on competition would be beneficial, but we acknowledge that the Reserve Bank's main purpose is protecting and promoting financial stability.

7.121 Competition is a process. It is not always easy to see when it is improved or to measure the gains to society from it. Financial stability is similarly mainly observed in the breach, albeit that institutional failures are highly visible.

7.122 In a number of respects, the prudential regulatory settings in New Zealand are conservative by comparison internationally, which tends to restrict competition. The Reserve Bank acknowledges as much, noting that it has a "relatively conservative approach to bank capital policy".[744]

7.123 Some of the examples of conservative settings that stakeholders and interested parties have pointed to in this study include capital requirements designed for a 1 in 200 year adverse risk event (rather than 1 in 100 years, which is common in other jurisdictions), the nature of instruments accepted as Alternative Tier 1 capital being more limited than the case internationally (noting that the Reserve Bank has recently allowed for Mutual Capital Instruments) and the outsourcing policy (BS 11).[745] Stakeholders also highlighted the Reserve Bank's recent change to its policy on the scope of operations of branches of overseas banks. The new policy restricts all branches to engaging in wholesale business (with corporates, institutions and wholesale investors), meaning they cannot take retail deposits or offer products or services to retail customers.[746]

7.124 In addition, New Zealand is unique in that the Reserve Bank both advises on legislative policy and then sets and enforces prudential policy. For example, it advises Ministers on the DT Act and associated regulations, and then sets and enforces prudential standards under that Act.

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743 Reserve Bank "Summary of Submissions and Next Steps on the ESAS Access Review (Risk Assessment Framework) Consultation Paper" (October 2023), p. 6.

744 Reserve Bank "The Reserve Bank's application of the Basel III capital requirements for banks" (June 2015), p. 3, https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/publications/bulletins/2015/2015may78-5.pdf

745 Simon Jensen "Cross submission on Personal banking services market study - Draft report" (30 May 2024), paras 10, 21-22.

746 Reserve Bank "Review of Policy for Branches of Overseas Banks – Regulatory Impact Statement" (7 November 2023), p.1, https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/consultations/banks/overseas-branches/review-of-policy-for-branches-of-overseas-banks-ris.pdf

7.125 The Reserve Bank is, of course, bound and directed by its legislative framework.

7.126 We have already noted the place of the competition principle as a secondary consideration in the hierarchy (and the fact that it is one of “maintain[ing] competition in the deposit-taking sector”) and always subject to the main purpose of protecting and promoting financial stability.

7.127 If Government prefers a different balance between competition and stability it may need to consider legislative change.

The overall regulatory burden on personal banking service providers is high, affecting all providers’ ability to compete but particularly smaller providers | *Inā te kaha o ngā kawenga ā-ture ki ngā ratonga pēke whaiaro, ka pā mai ana ki te āheinga o ngā kaituku katoa ki te whakataetae, otirā ki ngā kaituku iti*

7.128 Putting aside prudential capital and other policy matters that fall to the Reserve Bank, the overall regulatory burden in financial services is high and constrains providers’ expansion efforts.

7.129 As we have noted already, while regulatory requirements and regulatory change initiatives affect all providers, they can affect competition in that the smaller providers – the smaller banks, NBDTs and fintechs – do not have the scale of the major banks, so regulation imposes a proportionately greater burden on their time and resources.[747]

7.130 In this section, we discuss:

7.130.1 the fast-paced and broad-ranging nature of regulatory change affecting personal banking service providers;

7.130.2 that some legislation and policy is not competitively neutral and actively favours the competitive position of the major banks; and

7.130.3 that fragmentation of financial services legislation and oversight in New Zealand may be exacerbating the regulatory burden.

The overall regulatory burden in personal banking services is high

7.131 Any provider that wishes to offer personal banking services must comply with a broad range of relevant regulatory requirements.

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747 [ ]; [ ]; [ ]; [ ]; [ ].

7.132 Those requirements are many and complex. They reflect many important policy objectives, including financial stability, consumer protection and the need to detect and prevent financial crime. We have heard that the high volume of regulation associated with personal banking as well as the fast pace of significant regulatory change are affecting entry and – especially – expansion of providers in personal banking.

7.133 Overall, the regulatory burden draws resources away from innovation and efforts to compete harder. We have heard that the cost of regulatory compliance consumes providers' physical resources (such as IT systems), financial resources and human resources that may otherwise be available for spending on innovation and growth.[748] This is discussed further in Chapter 9.

7.134 Smaller providers are disproportionately affected by the overall regulatory burden due to their lack of scale, constraining their ability to expand, innovate, grow and ultimately compete harder against the major banks.

Providers have given examples of particularly burdensome regulation

7.135 In addition to the regulatory burden of the prudential capital requirements and other policies/requirements set by the Reserve Bank (as discussed in the previous sections), there are components of the personal banking regulatory regime outside of the Reserve Bank's ambit that contribute to overall regulatory burden and affect competition. These include the CCCF Act and the AML/CFT Act.

7.136 Iterative changes to the CCCF Act, as well as the complexity of complying with the law, has placed a substantial cost burden on all providers of consumer credit. In our draft report, we described the overall regulatory burden associated with the CCCF Act and its Regulations, which were commonly brought up by stakeholders as a good example of regulatory burden due to the prescriptive affordability and suitability assessment obligations and the ongoing changes being made to the legislation (requiring corresponding, ongoing spend by providers to update their systems to ensure compliance) and the strict penalty regime (including the inability of lenders' directors and senior managers to obtain indemnities).[749] We also heard that CCCF Act changes have constrained providers' ability to automate their processes for onboarding customers or processing credit applications.[750]

7.137 We consider that the consumer credit regime overall has had unintended negative consequences for competition.[751]

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748 [ ]; [ ]; [ ]; [ ]; [ ]; [ ]; [ ].

749 Commerce Commission "Personal banking services market study – Draft report" (21 March 2024), paras 7.93–7.94.

750 [ ]; [ ].

751 Commerce Commission "Personal banking services market study – Draft report" (21 March 2024), para 7.93.

7.138 The recent announcement of the intention to review financial services regulation to simplify requirements and remove areas of overlap and duplication by regulators appears to have the potential to address some of the regulatory overlap that we have been told about in respect of the CCCF Act and thereby reduce the regulatory burden on personal banking providers. In broad terms, the intention of the review is to move to a simplified model of a single prudential regulator (the Reserve Bank) and a single conduct regulator (the FMA), which would include the oversight of the CCCF Act transferring from the Commission to the FMA.[752]

7.139 As well as the CCCF Act, the AML/CFT Act places obligations on a range of New Zealand organisations, including financial institutions, to detect and deter money laundering and terrorism financing.

7.140 In addition, specific aspects of the regulatory burden of the CCCF Act and AML/CFT Act have also led to unintended consequences, including deterring consumers from switching. These specific aspects of the CCCF Act and AML/CFT Act therefore affect competition. This is discussed further at Chapter 8.

7.141 There are other contributors to the overall regulatory burden.

7.141.1 Financial services licensing under the FMC Act. Under this regime, providers need a licence from the FMA to provide certain services such as financial advice.

7.141.2 The new financial services licence that will be required under the Financial Markets (Conduct of Institutions) Amendment Act 2022 (CoFI Act) and administered by the FMA.[753]

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752 Hon Andrew Bayly "Reducing barriers for financial services" (31 January 2024), https://www.beehive.govt.nz/release/reducing-barriers-financial-services

753 https://www.fma.govt.nz/business/legislation/conduct-of-financial-institutions-cofi-legislation/. The CoFI Act arose out of joint reviews by the Reserve Bank and the FMA into the conduct and culture of banks (and life insurers) in New Zealand in 2018 and 2019. These reforms are intended to address the issues identified in the reviews that banks and insurers were not putting in place systems and processes to ensure consumers were treated fairly. The new regime will fully come into effect on 31 March 2025. At that point, institutions subject to the CoFI Act, including personal banking service providers, will be required to obtain a market services licence and implement a fair conduct programme. Notably, CoFI has been applied to the NBDTs even though they were not subject to the investigation that the Reserve Bank and FMA were, and no NBDT conduct issues were identified.

7.141.3 For banks, open banking both in terms of the work being done by Payments NZ and the development of the Customer and Product Data Bill (CPD Bill). To be able to use the standardised APIs developed by Payments NZ, banks must meet minimum requirements.[754] As discussed in Chapter 9, we see the CPD Bill and meeting Payments NZ's minimum requirements as important steps towards open banking, which will support increased competition.

7.142 Policy makers with responsibilities that affect personal banking service providers need to transparently and explicitly consider the effects of policies on competition to ensure that changes do not have unintended negative effects for competition.

We are not convinced that New Zealand is experiencing more regulatory change than other countries

7.143 It has been suggested to us that the pace and extent of regulatory change in New Zealand is higher than in other jurisdictions, and it has been suggested that this may account for the lower levels of innovation here.[755]

7.144 However, from our perspective, the overall regulatory burden for personal banking service providers in New Zealand (in terms of the amount of regulation and the pace at which it is being implemented/changed) does not appear to have been greater than other jurisdictions. We acknowledge that the regulatory burden is high, but that seems at best only a partial explanation for the limited competition and innovation that we have observed.

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754 Specifically, to be eligible for registration with Payments NZ as an API Provider that is a Standards User, minimum requirements must be met, and then a set of standard terms and conditions must be complied with. See: https://www.apicentre.paymentsnz.co.nz/join/api-standards-user/api-provider-criteria/. Note that, on 16 January 2024, the Commission received an application for authorisation by Payments NZ to work with current and future providers of APIs (banks) and third parties (fintechs) to develop and apply a partnering framework relating to the provision of API services. On 1 July 2024, the Commission issued a draft determination proposing to grant conditional authorisation to Payments NZ. See Chapter 9 for more information.

755 Financial Services Federation, Submission on Preliminary Issues paper (7 September 2023), pp. 2 and 12–13; ASB, Cross-submission on Preliminary Issues paper (5 October 2023), paras 1.2 and 2.1–2.2; ANZ, Submission on Preliminary Issues paper (7 September 2023), paras 25–27; ANZ, Submission on draft report (18 April 2023), para 23; ASB, Submission on Preliminary Issues paper (7 September 2023), paras 2.2–2.3; TSB, Co-operative Bank, Kiwibank and SBS Bank, Submission on Preliminary Issues paper (7 September 2023), p. 3; Westpac, Submission on Preliminary Issues paper (7 September 2023), para 2.4; [ ].

Other policies have constrained competition

Some legislation appears to favour registered banks over other providers of personal banking services

7.145 In our draft report, we provided examples of legislation that mandate the use of a registered bank to hold deposits and that the effect of this legislation has had an impact of excluding NBDTs from being able to provide the equivalent services.[756]

7.146 The NBDTs told us that there are certain pieces of legislation that require money to be held with a registered bank, consequently favouring banks.[757] We have been told, for example, that retention money in relation to a construction contract is required to be held at a registered bank.[758] This specific requirement has had a direct impact on one NBDT as a construction company previously happy to deposit its retention money with that NBDT no longer can.[759] Other examples of legislation that mandate the use of banks include the AML/CFT Act, the Companies Act 1993 and the Education and Training Act 2020.[760]

7.147 In response to the examples of legislation mandating the use of a 'registered bank':

7.147.1 Kiwibank submitted that the policy reasons for the differential treatment of registered banks is justified although it acknowledges that this legislation may have unintentionally caused disadvantage to some entities.[761]

7.147.2 ANZ submitted that much of the legislation requiring services to be provided with a registered bank relates to the safekeeping of money by a third party or third parties who do not otherwise control where the money is deposited and are not intending to make risk/reward evaluation. As such, it submits that it is generally appropriate for a more conservative approach to be taken to minimise the loss of the money given it considers that NBDTs are usually smaller and riskier entities.[762]

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756 Commerce Commission "Personal banking services market study – Draft report" (21 March 2024), paras 7.107–7.108.

757 [ ].

758 Construction Contracts (Retention Money) Amendment Act 2023, s 18E.

759 [ ].

760 Commerce Commission "Personal banking services market study – Draft report" (21 March 2024), paras 7.107.1–7.107.4 and 7.108.

761 Kiwibank, Submission on draft report (18 April 2024), p. 6.

762 ANZ, Submission on draft report (18 April 2024), para 213.

Some emergency regulation that has been passed has not appropriately balanced competition against other policy objectives

7.148 Our draft report also set out examples of regulation made under emergency (the COVID-19 pandemic and Cyclone Gabrielle) that applied to the major banks but not other providers such that competition – particularly the ability of smaller providers to expand – was negatively affected.[763]

7.149 These examples were provided.

7.149.1 Amendments were made to the CCCF Act regime during the COVID-19 pandemic in 2020 and following certain severe weather events in 2023 to make accessing credit easier for affected consumers.[764]

7.149.2 During the COVID-19 pandemic, small banks and NBDTs were unable to access the Reserve Bank's FLP that was introduced with the intention of lowering the cost of funding for banks and increasing lending by giving banks access to long-term funding at the OCR.

7.150 We noted in our draft report that, although regulation made in emergency situations is intended to effect changes broadly and rapidly, it is nevertheless important that the competition effect of the exemption or regime on all providers is carefully considered. This is particularly important if the exemption would effectively improve the position of the major banks (whether because of their entity type, the nature of their products or the fact they have more customers) who are already in a strong competitive position, even if this was not the intended outcome.[765]

There is a significant degree of fragmentation in personal banking services legislation and in supervision by regulatory bodies

7.151 Notwithstanding our views that New Zealand is not unique in having a high regulatory burden on personal banking service providers and that the competitive effect of regulatory changes need to be more consistently considered, there appears to be more fragmentation in New Zealand's approach to financial services regulation than there is in other countries.

7.152 This fragmentation is evident both in terms of the legislation and the regulatory bodies who administer this legislation. We consider that this fragmentation makes it more difficult to tackle the overall regulatory burden in personal banking.

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763 Commerce Commission "Personal banking services market study – Draft report" (21 March 2024), paras 7.109–7.110.

764 Commerce Commission "Personal banking services market study – Draft report" (21 March 2024), para 7.110.

765 Commerce Commission "Personal banking services market study – Draft report" (21 March 2024), para 7.111.

Examples of fragmentation in legislation and in regulatory bodies' supervision

7.153 We observe and relevant regulators acknowledge that there is a degree of fragmentation in legislation and regulatory oversight of personal banking services.

7.154 Submitters pointed to overlaps in regulatory requirements or duplication in regulators' ambits. Unnecessary overlaps create inefficiencies and disproportionately impact smaller providers' resources, which are already limited. These are some examples we have heard about.

7.154.1 Banks must be registered as a bank with the Reserve Bank. They must also be registered on the Register of Financial Services Providers and hold a separate licence or certification for the types of services that they wish to provide (for example, a financial advice provider licence). The latter regimes are administered by the FMA. Upcoming additional CoFI licensing requirements (also with the FMA) and a deposit taker's licence (with the Reserve Bank) will also be required.[766]

7.154.2 Annual reporting under the CCCF Act (administered by the Commission) and the FMC Act (administered by the FMA) use the same database. We also understand that the Commission and FMA may request information from banks on the same topic, albeit for different purposes, as part of business-as-usual investigation activity, regulator stakeholder engagement and/or proactive monitoring.[767]

7.154.3 The same or similar prudential information must be shared between the Reserve Bank and FMA.[768]

7.154.4 The same or similar cyber reports and privacy incident reports must be made to the Reserve Bank, FMA and Privacy Commissioner.[769]

7.154.5 The same or similar reports on the impact of certain events (such as the COVID-19 pandemic and Cyclone Gabrielle) are required to be made to the Reserve Bank and FMA.[770]

7.154.6 A provider who wishes to provide more than one product or service must obtain a different licence under the FMCA for each product they wish to provide.[771] For example, one provider may hold licences issued by the FMA for changing foreign currency, providing financial advice services, giving financial guarantees, issuing or managing means of payment and managed investment schemes.

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7.155 There is a further potential area of overlap between the CCCF Act regime and CoFI in respect of banks and NBDTs (although there is no overlap for the majority of the consumer lenders such as motor vehicle lenders, who are not subject to CoFI). This is because consumer credit contracts also fall within the new CoFI regime and lenders are subject to the CoFI obligation to treat consumers fairly.[772] There will also be an ongoing regulatory return requirement associated with the CoFI licence that has the potential to be duplicative with the annual return requirement under the CCCF Act.[773]

7.156 No single regulator or policy agency has overall responsibility for this sector. The Ministry of Business, Innovation and Employment Hīkina Whakatutuki (MBIE), the Treasury, the Reserve Bank, the FMA and the Commission each have key and overlapping responsibilities.

7.157 In recognition of this, the CoFR brings together these regulators and has a work programme aimed at regulatory overlaps. CoFR has recognised that there are a number of areas of overlap between the Reserve Bank, FMA and Commission both in terms of remit overlaps (where different regulators oversee the same systems or regimes) and entity overlaps (where different regulators have oversight of the same financial institution but for different purposes).[774] However, CoFR's ability to address this is limited. It already publishes a regulatory initiatives roadmap/quarterly update that does a reasonable job of pulling all the upcoming changes into one place.

7.158 New Zealand appears to be unique in having this number of policy agencies overseeing the personal banking services sector. In other countries, the equivalent of the Ministry of Finance or Treasury leads all financial policy work, but in New Zealand, this work is split across MBIE, the Treasury and the Reserve Bank. Simply having multiple policy agencies involved in this work makes it harder to coordinate.

7.159 It is encouraging that the Minister of Commerce and Consumer Affairs has announced an intention to review aspects of the regulatory regime for the financial sector.[775]

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772 There is also a slight overlap in the information that will be required under the CCCF Act and CoFI regime. Under the CCCF Act annual return, lenders need to provide information that includes the number and value of consumer loans, the number and value of loan top-ups and the number of times exceptions in the Regulations have been relied upon. Under the CoFI application, lenders will have to provide information that includes the number of consumers they advise for consumer loans.

773 FMA "Standards Conditions for financial institution licences" (November 2022), p. 4, https://www.fma.govt.nz/assets/Compliance/Standard-conditions-for-financial-institutions.pdf

774 Council of Financial Regulators "Regulatory effectiveness", https://www.cofr.govt.nz/priority-themes/regulatory-effectiveness.html

775 MBIE "2024 financial services reforms" (10 July 2024).

7.160 This provides an opportunity to ensure that any requirements on providers are as streamlined as possible and that competition is not unduly restricted by the other policy objectives that the relevant legislation seeks to achieve (for example, consumer protection or the detection and prevention of financial crime). This would increase resource efficiency, assist productivity and lead to pro-competitive outcomes for all providers of personal banking services.

Chapter 8 Consumer search and switching behaviour | *Te rangahau kaiwhakapeto me te panoni o te whanonga*

Summary of findings

- **There is a significant degree of customer inertia in personal banking.** Our survey found that around half of personal banking customers have never changed their main bank. Customers have relatively low levels of confidence in their ability to access information in the market, assess that information to decide on a provider and act on that information by switching. This inertia causes customer stickiness.
- **Many consumers perceive banks as broadly the same so see a lack of obvious benefit in switching.** Often this is because they do not have a good understanding of the availability of alternatives and the best rates available (given discretionary rates are opaque). Some customers only consider switching when they can see clear value to them in dollar terms.
- **There are actual and perceived barriers for consumers in shopping around and in switching between providers. These barriers limit competition.** For transaction accounts, it is primarily the "hassle factor" associated with opening new accounts and reorganising the direction of salary and other regular payments. For home loan customers, there is a range of potential switching costs, including the cost of instructing solicitors, bank fees to discharge a mortgage, the repayment of cash contributions, early repayment fees (if customers want to break a fixed-term home loan) and fees from mortgage advisers. Switching costs for savings accounts and term deposits are generally lower.
- **Compounding these barriers are two pieces of legislation** that create friction for customers seeking to switch providers: the AML/CFT Act and the CCCF Act.
- **The industry-led switching service for transaction accounts is not working well.** Awareness and take-up of the Payments NZ switching service are low, and there are operational issues in practice such as inability to forward on or redirect payments. Payments NZ does not undertake any self-assessment of the quality or speed of its switching service.
- **Smaller and newer providers face greater challenges with building customer bases.** Our survey found that the vast majority of people considered only the major banks and Kiwibank when taking out their home loan. Similarly, when prompted about which banks they might consider in the future for their main banking provider, nearly half (42%) of New Zealanders would only consider ANZ, ASB, BNZ, Westpac or Kiwibank.
- **Barriers to searching and switching reduces competitive pressure on the major banks.** These impediments to consumers switching exacerbate the difficulties faced by new entrants and smaller providers in expanding their operations organically and building their customer bases. This reduces the competitive pressure they can exert on the major banks in personal banking.

Introduction | *Whakatakinga*

8.1 When customers are well informed, engaged and able to respond to the best offers in the market, suppliers are forced to compete on price and quality in order to win and retain customers. By contrast, if consumers are less engaged or there are significant barriers to shopping around and switching, competition is likely to suffer.

8.2 This chapter presents available evidence on the extent of customer engagement in personal banking services in New Zealand. It sets out the key barriers and impediments to shopping around or switching providers that are currently dampening competition.

8.3 In our assessment of customer engagement, we have considered a range of customer activities that drive competition between providers, including:

8.3.1 customers that switch to a new provider and close their old accounts (hard switching);

8.3.2 customers that may open a new account with a new provider while keeping their account with their old provider (soft switching);

8.3.3 customers who actively negotiate with their existing provider for a better deal, for example, by threatening to switch to another provider; and

8.3.4 customers who multi-bank or multi-home by having personal banking relationships with two or more providers regardless of whether they have switched.

Customer inertia is a key feature of personal banking markets | *Ko te tūpuku kaiwhakapeto tētahi tino āhuatanga o ngā mākete pēke whaiaro*

8.4 We find that there is evidence of a significant degree of customer inertia in personal banking.[776] While some customers do shop around for the best deals, on average, a customer's existing banking relationship(s) is the strongest predictor of the provider they will choose in the future.[777,778,779]

8.5 Our consumer survey, undertaken by Verian, found that:[780]

8.5.1 the majority (62%) of personal banking customers neither switched nor considered switching over the last 3 years;[781]

8.5.2 around half of personal banking customers have never changed their main bank;[782]

8.5.3 only 15% of New Zealand adults have switched one or more personal banking products in the last 3 years,[783] but if we also include customers who internally switched by renegotiating a better deal with their existing provider, this number increases to 17%;[784]

8.5.4 23% of people considered switching at least one product in the last 3 years but did not actually go through with it;[785]

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776 Inertia is the tendency of consumers to choose the same products or providers over time for reasons other than the fundamental attributes of those products or providers. It is a state of disengagement from making informed decisions that preferences their status quo or previous choice.

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780 These findings are consistent with the customer research undertaken by providers and internal documents provided to the Commission as part of this market study.

781 Verian "Personal banking services market study – Research report" (February 2024), p. 31.

782 Verian "Personal banking services market study – Research report" (February 2024), p. 31.

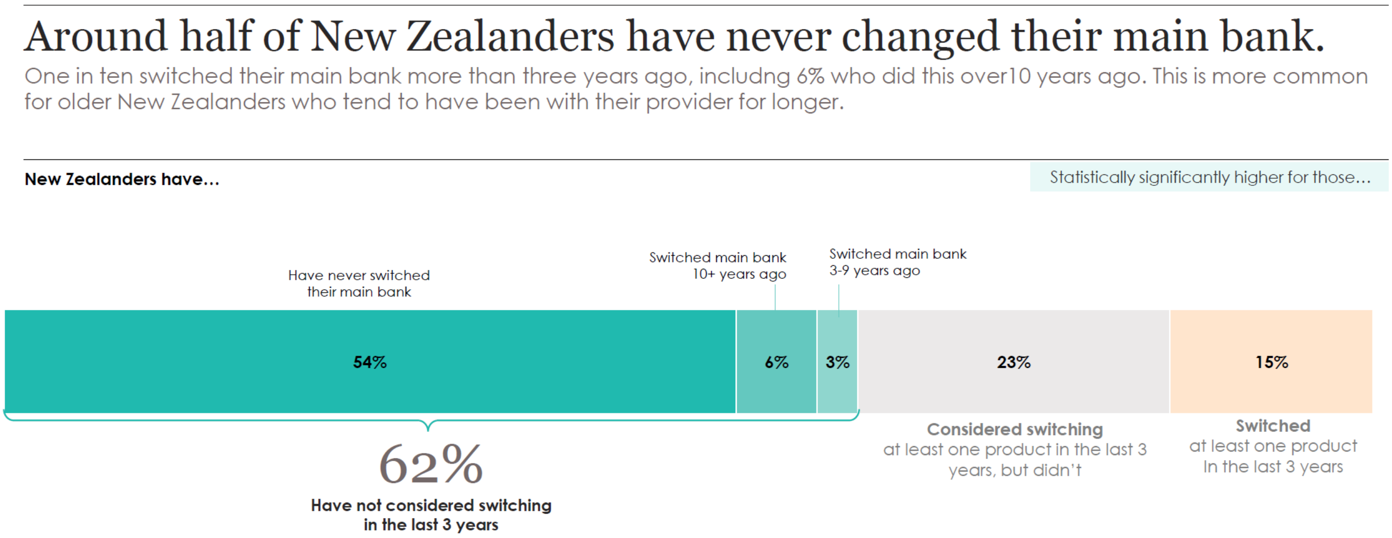
783 Verian "Personal banking services market study – Research report" (February 2024), p. 31.

784 1.8% of New Zealand adults considered switching but didn't follow through because their provider offered a better deal. Information provided to the Commission by Verian, drawing on further analysis of survey data.

785 Verian "Personal banking services market study – Research report" (February 2024), p. 31.

8.5.5 future switching intentions are also low – 11% of New Zealanders said they were likely to switch their main bank in the next 12 months.[786]

Figure 8.1 Customer inertia in New Zealand personal banking



Source: Verian.[787]

8.6 Some banks suggested we have overstated the extent of customer inertia for personal banking services and that many consumers have not switched because they are happy with their current provider.[788]

8.7 However, our survey findings are consistent with internal research undertaken by banks that we have reviewed during the study, which often describes customer decisions as inertia based. For example, home lending customers often make an automatic decision to stick with their current provider rather than choose on the basis of the product features or interest rates.[789,790]

8.8 The effect of this inertia is shown in responses to Consumer NZ's latest banking survey. Consumer NZ's survey found that 15% of respondents are likely to switch from their primary bank in the next 12 months, 3% have switched from their primary bank in the last 12 months and 84% of those who had not switched have been with their bank for 5 years or more.[791]

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786 Verian "Personal banking services market study – Research report" (February 2024), p. 42.

787 Verian "Personal banking services market study – Research report" (February 2024), p. 31.

788 For example, ANZ, Submission on draft report (18 April 2024), paras 86 and 91; and BNZ, Submission on draft report (18 April 2024), para 3.13.

789 [ ].

790 [ ].

791 Consumer NZ, Submission on draft report (18 April 2024), p. 9.

8.9 Low levels of switching could partially reflect that many consumers are happy with the value they receive from their existing provider(s). However, it could also reflect that consumers are time-poor and prioritise other administrative tasks, a lack of willingness to consider alternatives, a lack of engagement or an inability to make informed decisions about whether any benefits obtainable from switching are worth the time and effort.

8.10 There are a number of reasons why some customers do not shop around or actively engage in relation to their personal banking services.

8.10.1 The expectation that the time and effort in doing so will not be worth it.[792] Internal bank research provides evidence that, to understand the true value of offers, consumers need them explained clearly in dollar terms (rather than percentages).[793]

8.10.2 A perception that all the banks are broadly the same, offering the same products/services at more or less the same price. This may be reinforced by the similarity of headline rates. A bank's internal research report noted that, for most customers, getting a good deal is about getting the market rate, this rate being a "good enough" price.[794]

8.11 Consumer NZ's latest banking survey found the factors most likely to deter consumers from switching.[795]

Satisfied with my current bank	**45%**
Lack of obvious benefit	**38%**
Lack of difference between banks	**26%**
Difficulty switching	**25%**
Time it takes to switch	**23%**
Loyalty	**20%**
Access to a branch	**14%**
Online security	**14%**
Too hard to compare banks	**13%**
Breaking fixed-term loan/s with current bank	**13%**
Breaking fixed-term investment/s with current bank	**9%**
Other	**2%**

792 [ ].

793 [ ].

794 [ ] and [ ].

795 Consumer NZ, Submission on draft report (18 April 2024), pp. 9–10.

8.12 Although Consumer NZ's survey found that 45% of consumers were satisfied with their current bank, this should be read in the context of the other responses. For example, a respondent may have indicated they are satisfied with their current bank because they could not see an obvious benefit from switching or differences between banks and there were difficulties in switching.

8.13 In other words, there is an important distinction between a consumer who reports that they are satisfied with their current provider due to:

8.13.1 a well-informed decision that their current provider is offering them the best deal available in the market; or

8.13.2 an impression that all banks are broadly the same and that switching is difficult so it is not worth the time and effort of shopping around.

8.14 We consider it unlikely that the 54% of consumers who have never changed their main bank have done so because of a well-informed decision that their current provider best meets their needs. Rather, the evidence we have reviewed suggests that there is significant consumer inertia that deters the careful scrutiny that is required for a well-informed and regular review of the choice of provider for personal banking services.

Engaged and non-engaged customers

8.15 Customers are most likely to review their personal banking needs and the suitability of their provider at key life moments or milestones that have implications for their income or where a bank or another provider has a role to play. For example, bank documents note that starting a new job, a new business or university, buying a new home or vehicle, changes in family situation, unexpected loss of income and retirement may provoke choice.[796] Outside of these moments, customers may not have regular reasons to review their personal banking needs or provider.

8.16 More generally, there are two pools of customers (although a person can move between these pools over time).

8.16.1 Engaged customers – these customers are willing and able to shop around and switch providers in order to obtain the best value from providers.

8.16.2 Non-engaged customers – these customers are sticky in that they are unlikely to have switched or to consider switching providers in the future.

8.17 In Australia, the ACCC similarly has observed that a large proportion of customers could be described as inert or non-engaged.

796 [ ].

8.17.1 **In respect of retail deposits**: "there is a high degree of consumer inertia when it comes to retail deposit products. In general, retail deposits customers are 'sticky', and the more established banks tend to retain a cohort of retail deposits customers who consider their bank to be their 'main financial institution' (MFI), and do not have a high propensity to switch."[797]

8.17.2 **In respect of home loans:** "there is widespread consumer inertia. Many existing residential mortgage borrowers do not regularly review their choice of lender."[798]

8.18 Likewise, in the UK, the CMA, FCA, Social Market Foundation and Frontier Economics have presented reports describing a clear picture of these two groups of customers in banking markets: switchers and non-switchers.[799]

Multi-banking is increasingly common

8.19 Multi-banking is common. Its use has increased over time as barriers have reduced such as the move to zero fees on transaction accounts.

8.20 ANZ has submitted that approximately every second person has accounts with more than one bank.[800] Similarly, BNZ stated that customers frequently multi-home across a number of banks.[801] ASB and Westpac have made similar points.[802,803]

8.21 Customers can multi-bank to achieve a range of outcomes such as obtaining low-interest rates on loans or higher interest rates on deposits to better managing their money and monitor spending, to create an extra sense of security or to try out a smaller or new provider while still retaining their long-standing relationship with their main provider.[804]

8.22 Some submissions on the draft report suggested switching rates understate the level of consumer engagement due to the prevalence of multi-banking.[805] BNZ noted that "customers pick and choose between their existing providers for different services without regarding that as a 'switch'".[806]

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797 ACCC "Retail deposits inquiry – Final report" (December 2023), p. 38.

798 ACCC "Residential mortgage price inquiry – Final report" (November 2018), p. 66, https://www.accc.gov.au/system/files/ACCC%20Residential%20mortgage%20price%20inquiry%20-%20Final%20report%20November%202018_1.pdf

799 Pay.UK "Eight million switches: making changing bank accounts simple and stress-free" (October 2022), pp. 19–21, https://newseventsinsights.wearepay.uk/media/pjna0pof/cass-banking-habits.pdf

800 ANZ, Submission on Preliminary Issues paper (7 September 2023), para 112.

801 BNZ, Submission on Preliminary Issues paper (7 September 2023), para 2.23.

802 ASB, Submission on Preliminary Issues paper (7 September 2023), para 22.4.

803 Westpac, Submission on Preliminary Issues paper (7 September 2023), para 3.1(c).

804 Pay.UK "Eight million switches: making changing bank accounts simple and stress-free" (October 2022), p. 24.

805 For example, ANZ, Submission on draft report (18 April 2024), paras 88–90.

806 BNZ, Submission on draft report (18 April 2024), para 3.13(d)(i).

8.23 However, increased multi-banking does not necessarily mean that consumers are more engaged. In many cases, multi-banking reflects customers having accounts that they are not using rather than actively splitting their banking services across providers. There is no cost to keeping an old or inactive account open and some incentive to do so as this makes it easier to switch back to a previous provider by avoiding needing to reverify your identity.

8.24 We also heard that, if competition was working well, banks would seek to attract all of a customer's business rather than just pieces of it.[807] We consider that multi-banking does not imply strong competition. Switching rates for main bank relationships are low and there is a large and inert group of customers who are not engaged.

Smaller and newer providers face barriers to new customer acquisition | *Arā ngā tauārai ki ngā kaituku iti, kaituku hou hoki kia whiwhi kiritaki hou*

Many customers would only consider the largest five providers for their personal banking needs

8.25 Our survey found that the vast majority of people considered only the five largest banks when taking out their home loan. Only 17% considered other banks, of which the majority were already smaller bank users.[808]

8.26 Similarly, when prompted about which banks they might consider in the future for their main banking provider, our survey found that 42% of people would only consider ANZ, ASB, BNZ, Westpac or Kiwibank (see Figure 8.2 below). A further 18% simply have no intention of switching.

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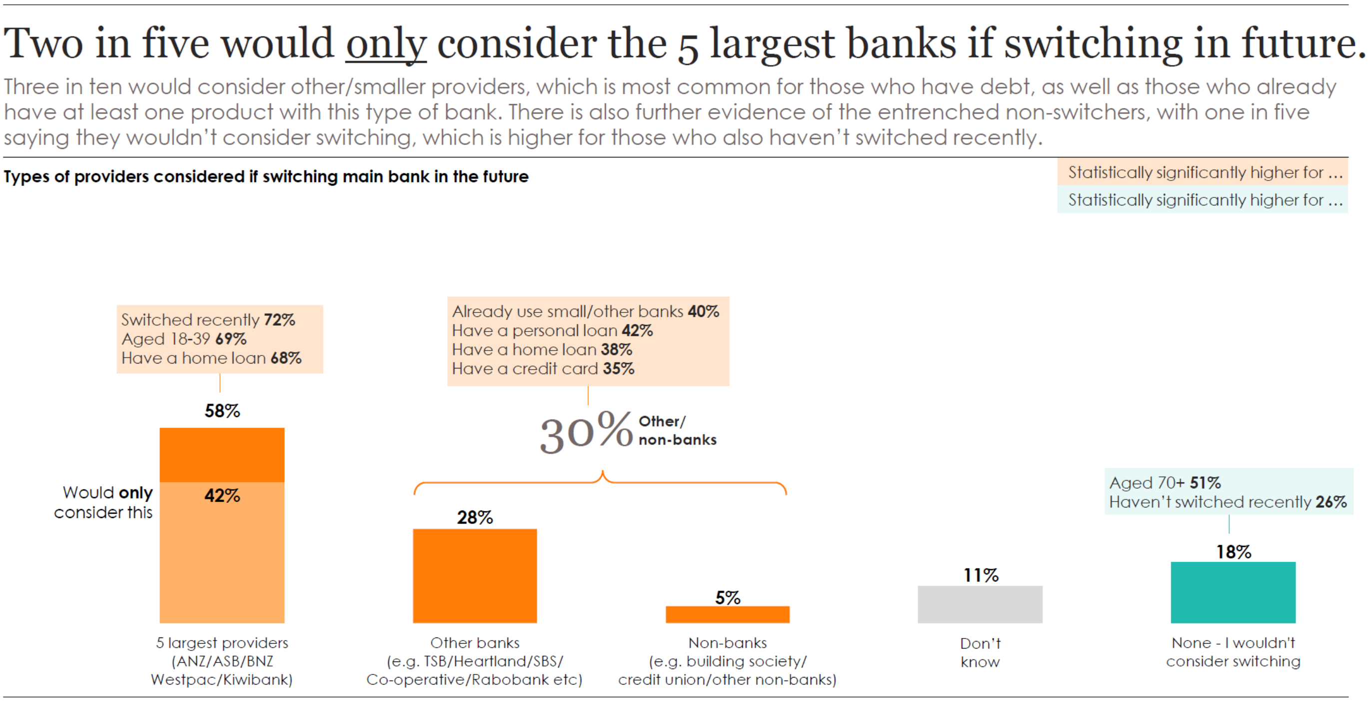
807 Commerce Commission "Day 3 Personal banking services market study conference – Session 9 consumer experiences" (15 May 2024), p. 3 (lines 14–16).

808 Verian "Personal banking services market study – Research report" (February 2024), p. 35.

Figure 8.2 Future switching intention by provider type



Source: Verian.[809]

8.27 This leaves only a small minority of customers who *say they would consider* the smaller banks (28%, of which 40% are already customers of a small/other bank).[810]

8.28 We understand that those most open to switching banks include those with fewer products (because it is less complicated to switch) and younger customers who tend to have less attachment to suppliers.[811] Younger customers are also most likely to have fewer products.[812] These customers reflect a long-term value proposition but do not generate the highest value to banks in the present.

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809 Verian "Personal banking services market study – Research report" (February 2024), p. 45.

810 [ ].

811 [ ].

812 [ ].

8.29 Taking the low rates of switching together with the large proportion of customers who would not consider smaller banks or non-bank providers, we find that the low customer engagement in personal banking constitutes an ongoing barrier to entry and expansion for small and newer providers. Consequently, this reduces the competitive pressure they can exert on the dominant players in the market.[813,814]

8.30 This finding corresponds with what we've heard from smaller banks during this market study. For example, in their joint submission on the Preliminary Issues paper:[815]

> There are low levels of main bank switching in the market. Essentially, the larger and more established banks, which account for 85-90% of the market, enjoy the benefits of a large inert customer base that they have built up over many years making it harder for smaller and newer banks to attract customers.

8.31 We set out in Chapter 2 that this group of inert customers who have strong ties to their main bank are particularly valuable because they provide more stable, lower-cost funding and are likely to acquire a range of services from the bank (and go directly to their main bank when they have a new banking need).

8.32 Internal documents provided to the Commission by banks suggest that the extent of customer inertia varies across banking providers, with the largest banks having the greatest proportion of inert customers.[816,817]

8.33 Consequently, new entrants and smaller banks are disproportionately vying for the engaged customer segment. By definition, this group is likely to be especially price sensitive and may be more likely to subsequently switch away if their provider does not continue to offer best-in-market price and services.[818]

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813 This was similarly observed by the CMA: CMA "Retail banking market investigation – Final report" (9 August 2016), para 120.

814 Moderate switching costs could also be conducive to entry as they make incumbents less likely to react aggressively to new entry, and in cases where switching costs increase the profitability of markets, this can also encourage entry. See: NERA "Switching costs – Part one: Economic models and policy implications – Economic Discussion Paper 5" (April 2003), p. 2, https://webarchive.nationalarchives.gov.uk/ukgwa/20140402142426/http:/www.oft.gov.uk/shared_oft/reports/comp_policy/oft655.pdf

815 TSB, Co-operative Bank, Kiwibank and SBS Bank, Submission on Preliminary Issues paper (7 September 2023), p. 3.

816 [ ].

817 [ ].

818 TSB, Co-operative Bank, Kiwibank and SBS Bank, Submission on Preliminary Issues paper (7 September 2023), p. 4: "the D-SIBs benefit from a much larger share of customer choice by being the default main bank for most of the market. This enables them to compete less than challengers on price or features and still gain a large market share while also gaining a large market share of new business."

8.34 For example, there is evidence that home loan refinancers are more likely to refinance again in the future and are price sensitive.[819,820] This affects smaller banks because these providers tend to obtain more new customers through refinancing than new home lending channels.[821]

There are some barriers preventing customers from making effective choices in personal banking services | *Tērā ētahi tauārai e aukati ana i te kiritaki ki te whakaoti whakatau tika mōna i roto i ngā ratonga pēke whaiaro*

8.35 There are barriers at each stage of the process of searching and switching.

8.35.1 Search costs are high for some products such as home loans and are exacerbated by behavioural factors that limit customers' ability to engage with the market.

8.35.2 Switch costs can be high for some products, particularly transaction accounts.

8.36 These barriers are reflected in our survey results, which found that customers have relatively low levels of confidence in their ability to access information in the market, assess that information to decide on a provider and act on that information by actually switching (Figure 8.3 below).

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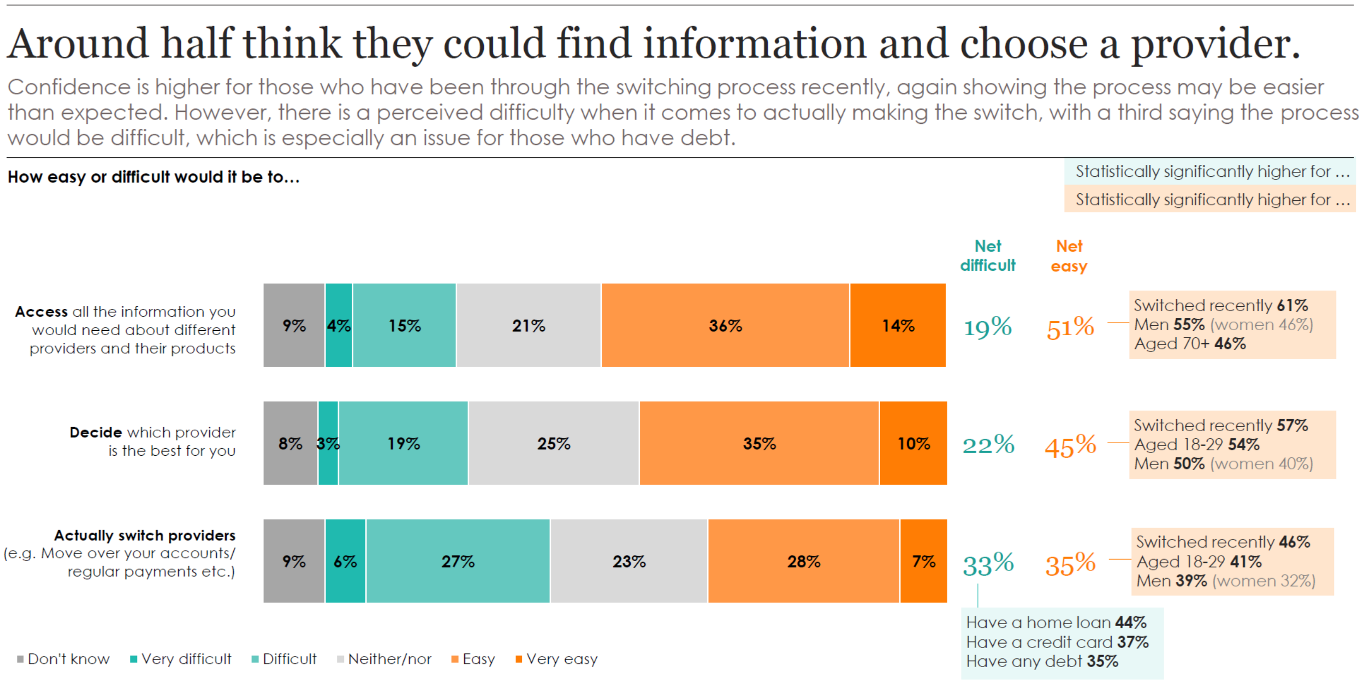
820 [ ].

821 [ ].

Figure 8.3 Confidence in shopping around and switching in personal banking markets



Source: Verian.[822]

Search costs are high for some banking products

8.37 For consumers to shop around effectively, there needs to be readily available information that is reliable and that covers all the relevant aspects of the banking providers and product(s) in question.

8.38 By search costs, we mean how easy it is for consumers to access information about different providers and the price and quality of the services they offer.[823]

8.39 Our survey found that:

8.39.1 19% reported it being difficult or very difficult to access information;

8.39.2 22% said it would be difficult or very difficult to decide which provider is best; and

8.39.3 33% said it would be difficult or very difficult to actually switch providers, increasing to 44% of those with a home loan.[824]

822 Verian "Personal banking services market study – Research report" (February 2024), p. 44.

823 Search costs may vary for different customers on the basis of the products/services they hold and the relative importance placed on different features of those products and services.

824 Verian "Personal banking services market study – Research report" (February 2024), p. 44.

8.40 There are several sources of information available to consumers that help to compare different banks and banking services such as interest.co.nz, canstar.co.nz and sorted.org.nz. The banks submitted that these services allow consumers to easily compare rates, services or returns on products.[825]

8.41 However, our survey found that only a minority of customers are using these services. We found that:[826]

8.41.1 for home loans, only 22% of those who switched or considered switching to another provider used an independent or other website for information;

8.41.2 for transaction accounts, this proportion is 18%;

8.41.3 for savings accounts – 23%; and

8.41.4 for term deposits – 44%.

8.42 The most commonly used sources of information on banking products are the bank websites themselves, with around 35–40% of customers seeking out information on a new provider's website.[827] It can be difficult for consumers to compare across multiple websites because it takes extra time and effort to visit multiple sites and because there is no standardised way of presenting key terms and conditions to consumers to enable a like-for-like comparison across banks.[828]

Search costs for particular personal banking products

8.43 In respect of home loans, search costs are significantly increased by opaque pricing/discretionary discounts and other below-the-line campaigns (such as cashbacks).[829] This means that a customer can only be certain of the terms and conditions of their deal with a particular provider (including interest rate and cashback offer) after going through a full application process. This results in much higher search costs overall, particularly if the customer wants to accurately compare multiple offers (requiring multiple application processes).

8.44 For transaction accounts, search costs primarily relate to making an assessment on aspects of service quality, noting that most providers offer transaction accounts that do not carry monthly account fees. Aspects of service quality include:[830]

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825 Deloitte Access Economics [for BNZ] "Personal banking services: Consumer switching, conditions of entry and expansion, profitability and innovation" (7 September 2023), para 48.

826 Verian "Personal banking services market study – Research report" (February 2024), p. 29.

827 Note that the survey allowed for multiple responses so the different categories of information cannot be added together and may not add up to 100%. Verian "Personal banking services market study – Research report" (February 2024), p. 29.

828 The ACCC also made this observation: ACCC "Retail deposits inquiry – Final report" (December 2023), p. 124.

829 Once a home loan is drawn down, a mortgage provider will pay an agreed amount to the borrower, usually a percentage of the initial home loan. Offers tend to range from 0.10% to 1.00% or be a fixed sum.

830 BNZ, Submission on Preliminary Issues paper (7 September 2023), para 2.8.

8.44.1 quality of customer service;

8.44.2 the capability of digital channels such as mobile apps and internet banking;

8.44.3 other digital capabilities, technology and innovation (including tools to support customers' budgeting and savings goals);

8.44.4 rewards such as Airpoints; and

8.44.5 perceptions of trust and security.

8.45 We have not identified any comprehensive tools that allow consumers to compare banks on their service quality. The most popular comparison websites (interest.co.nz, consumer.org.nz, sorted.org.nz, canstar.co.nz and moneyhub.co.nz) focus on price but not service quality.[831] Canstar's website does include a Most Satisfied Customers Banking Award, although the criteria and survey results used to inform the judgement on the award are not presented in a way that allows comparison on different aspects of service quality.[832]

8.46 Because there is a lack of good information on service quality, consumers have to rely on doing their own research and word of mouth to effectively compare banks on the basis of service quality.

8.47 For **savings and term deposits**, search costs appear to be lower than for other products. Decisions about which provider to choose are more likely to be driven by interest rates, and this information is readily available on comparison websites and on banks' websites. Even so, there can be complexity in deciphering some aspects of these terms and conditions.

8.47.1 For **savings accounts** – the conditions for bonus interest rates, if any.

8.47.2 For **term deposits** – whether interest is reinvested during the period and whether interest is compounded monthly, quarterly, over a different term or at maturity. These features can make a significant difference to the overall interest associated with the deposit and their implications may not be immediately obvious.

Switching costs can be high, deterring customers from acting on the best deals

8.48 Switching costs are the real and/or perceived costs associated with changing a supplier (but that would not be incurred by remaining with the current supplier). Switching costs are difficult to quantify and will differ across customers and product types.

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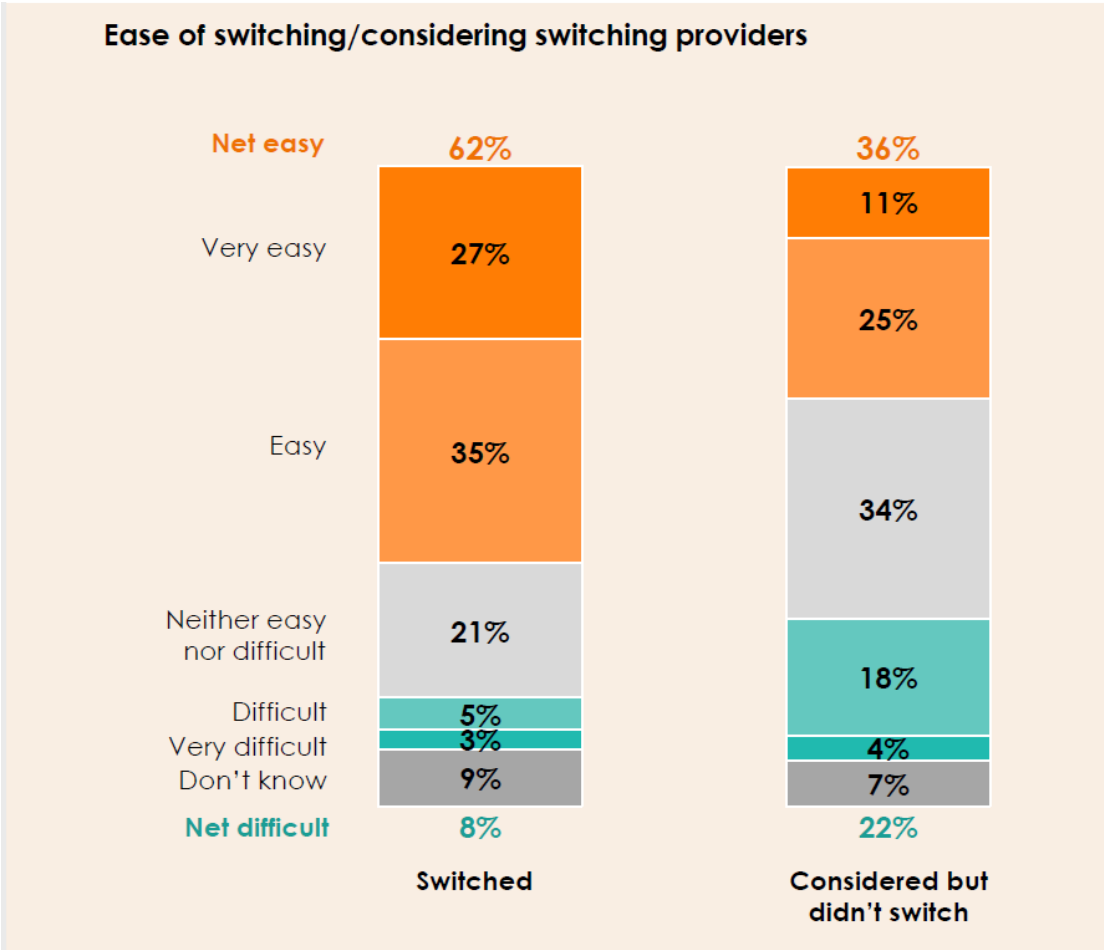
831 interest.co.nz has a tool to compare *asset quality* by bank, which is related to trust and security (one aspect of quality): interest.co.nz "Key bank metrics", https://www.interest.co.nz/saving/bank-financial-comparator

832 Canstar "2023 Most Satisfied Customers Banking Award", https://www.canstar.co.nz/star-rating-reports/msc-award-banking/

8.49 We heard from providers that switching is easy. For example, BNZ said that "BNZ's experience is that consumers can readily switch some or all of their banking between providers, and that switching between products / services (including switching between banks or switching to other non-bank competitors) is generally not complicated".[833]

8.50 Our survey found that 62% of customers who have actually switched provider in the last 3 years did report it to be easy or very easy. However, for those that only considered switching (but did not follow through), only 36% thought it would be easy or very easy to do so, as shown in Figure 8.4 below.

Figure 8.4 Ease of switching/considering switching providers by those who have switched and those who considered but didn't switch in the past 3 years



Source: Verian.[834]

833 BNZ, Submission on Preliminary Issues paper (7 September 2023), para 2.19.

834 Verian "Personal banking services market study – Research report" (February 2024), p. 28.

8.51 These differences in survey responses across groups may reflect a combination of:

8.51.1 a perceptions gap where the process is perceived to be more difficult than it is in practice; and/or

8.51.2 differences in the complexity of what was involved in the switch (such as the number/type of accounts/products).[835]

8.52 Behavioural theory suggests that, the more consumers do something, the more familiar and confident they become and the more likely they are to do it again. Once consumers have completed the process of switching, it lowers the perceived barrier to switching and they are more likely to switch again. Equally, a bad experience reinforces a reluctance to do it again. Poor switching processes therefore reinforce the status quo.

8.53 We have heard that barriers to customers switching are largely perceived rather than real.[836] Our consumer survey results above also show that 62% of those who did switch found it easy or very easy.

8.54 However, the adverse effects of low switching rates on competition remain regardless of whether consumers' views of the difficulties of switching are perceived rather than real. To the extent that there is a perceptions gap, competition in personal banking in New Zealand could be enhanced by ensuring that consumers have confidence in the switching process. We discuss this in more detail in Chapter 10.

8.55 In addition, we heard from many banks that aspects of the regulatory environment create friction for consumers seeking to switch, which we return to in detail later in this chapter.

8.56 We describe the key switching costs for home loans, transaction accounts and term deposit accounts below.

Switching costs for home loans

8.57 There are several potential switching costs in respect of home loan products.

8.57.1 The cost of instructing solicitors to discharge their existing lender's mortgage and register a new mortgage. In addition, some lenders charge fees to discharge a mortgage or release other security.[837]

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836 For example, BNZ, Submission on draft report (18 April 2024), para 3.13c.

837 For example, ANZ's fee is $100: ANZ, Submission on Preliminary Issues paper (7 September 2023), para 125; [ ].

8.57.2 Repayment of cash contribution if the customer received a cash contribution and is leaving in advance of the specified commitment period.[838]

8.57.3 Early repayment fees, if repaying a home loan during a fixed rate period.[839] In our focus on home loans, we found that a large proportion of home loan customers arrange their lending into tranches to manage exposure to interest rate changes. One consequence of doing so is that a customer could face early repayment fees in respect of one or more tranches (although these are not always payable) or to face a long lead time to align these tranches to facilitate refinancing to another provider.

8.57.4 Fees from mortgage advisers if the refinancing activity triggers a commission clawback between provider and adviser. Commission clawbacks are discussed in more detail in Chapter 4.

8.58 Sometimes switching costs are offset to some extent by a cash contribution from the new home loan provider.

8.59 Customers who have a home loan at a bank are required to also have a transaction account with their home loan provider. In addition, some banks have offered special home loan rates to customers on the condition that the customer's salary is direct credited to that transaction account.[840] Therefore, it is likely that some of the transaction account switching costs also apply when a customer switches their home loan, at least for some customers.

8.60 More generally, switching costs will tend to increase with the number of products a customer plans to switch across to a new provider.

Switching costs for term deposits

8.61 Actual and perceived switching costs for savings accounts and term deposits are generally low, which may partially reflect the more experienced nature of term deposit customers.[841,842] Qualitative research undertaken by Verian found that term deposits are the easiest to compare and the switching process is seen to be straightforward.[843]

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838 ANZ, Submission on Preliminary Issues paper (7 September 2023), para 127.

839 We understand that these fees compensate providers for the cost of hedging arrangements that were in place but are no longer required. See for example, ANZ, Submission on Preliminary Issues paper (7 September 2023), para 126.

840 ANZ "Home loan rates, fees and agreements", https://www.anz.co.nz/rates-fees-agreements/home-loans/

841 Like transaction accounts, the main switching cost is the hassle factor associated with opening new accounts with new providers. This may include providing identification for AML requirements.

842 Based on Verian's observation that these customers are often "quite financially experienced". Verian "Personal banking services market study – Research report" (February 2024), p. 53.

843 Verian "Personal banking services market study – Research report" (February 2024), p. 49.

8.62 There are some considerations associated with switching a term deposit if a customer would like to break a deposit before the fixed term ends such as requirements to give notice and pay break fees – reflective of the nature of term deposit products.

Switching costs for transaction accounts

8.63 For transaction accounts, switching costs primarily relate to the time and effort to fill out paperwork, cancel old accounts and open new accounts (the hassle factor) and to notify employers or other regular payees.

8.64 We heard from many banks that switching is easy and that all receiving banks offer support to new customers looking to switch their transaction accounts.[844] Many have dedicated teams that work with other banks to transfer funds, set up new payments and cancel old payments.[845] There is also an industry body (Payments NZ) that provides a switching service (discussed below).

8.65 Nonetheless, there are many perceived and actual switching costs associated with transaction accounts.

8.65.1 The hassle factor associated with opening new accounts.[846]

8.65.2 Customers may have concerns or lack confidence about whether direct payments will be transferred and the potential to incur additional fees if this does not occur smoothly or to be left temporarily out of pocket if salary and other details are not updated correctly to the new bank and in a timely manner.[847]

8.65.3 A customer will be required to manually update their payment card details in any service where their old card was on file.[848] This could include apps, websites, charitable donations and shopping services.[849]

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844 ANZ, Submission on Preliminary Issues paper (7 September 2023), Appendix 1 para 119.

845 BNZ, Submission on Preliminary Issues paper (7 September 2023), para 2.20(a)(ii).

846 Verian “Personal banking services market study – Research report” (February 2024), p. 43.

847 Verian “Personal banking services market study – Research report” (February 2024), p. 43.

848 ANZ, Submission on Preliminary Issues paper (7 September 2023), Appendix 1 para 131.

849 West Monroe “The State of Subscription Services Spending” (August 2021), pp. 3 and 8, https://www.westmonroe.com/perspectives/report/the-state-of-subscription-services-spending
For some consumers, the process of switching to a new everyday banking account and associated credit or debit card may also generate benefits because it requires customers to review their ongoing payments. Many subscription service providers benefit from consumer inertia, which can result in continued subscription payments for services that customers may no longer value.

8.66 There may be material differences in perceived switching costs across customers. For example, in the UK, the CMA found that customers with a higher number of transactions are less likely to both search and switch, suggesting that a more intensive use of one's personal current account may be associated with higher perceived costs of switching.[850]

There is limited uptake of the Payments NZ Easy Switch service for transaction account switching

8.67 Customers generally have two options when seeking to move their transaction account(s) to a new provider.

8.67.1 They can apply DIY (do it yourself) by opening new accounts with the new provider, manually moving any recurring incoming and outgoing payments to their new provider (as required) and deciding whether to keep their previous accounts open or not.

8.67.2 The new provider can facilitate the switch for them through a free switching service (referred to here as the Easy Switch service). The new provider itself will arrange to move customers' recurring payments such as automatic payments and direct debits. Customers taking this option can complete a Switching Request Form and present this to their new bank, which handles the switching process by working with the old bank.

8.68 The Easy Switch service is supported by an industry-wide account switching arrangement established by Payments NZ, which sets industry standards and protocols for transferring transaction accounts and recurring payment instructions from one bank to another. These protocols include:[851]

8.68.1 a timeframe of 5 business days to complete the switching process;

8.68.2 a standardised switching form and authority to re-establish customer payment instructions by the new bank; and

8.68.3 a dedicated team at each bank for processing customer account switching requests.

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850 CMA "Searching and switching in retail banking – Economics Working Paper" (September 2018), p. 12, https://assets.publishing.service.gov.uk/media/5bc49dfe40f0b63873bce868/searching_and_switching_in_retail_banking.pdf

851 Payments NZ "Switching banks", https://www.paymentsnz.co.nz/resources/switching-banks/

8.69 Despite these industry arrangements, active recommendation of the Payments NZ switching service by the major banks to customers is limited.[852] Awareness and take-up of the service are therefore low, and there are operational issues in practice.[853]

8.69.1 The service does not include arrangements to switch the customer's income payments with their employer or to switch other direct credits such as payments from government.[854]

8.69.2 Some companies that hold direct debit mandates do not confirm or make changes to their records for future payments when requested by a bank on behalf of a customer – customers of these companies need to contact them directly to make the changes required.[855]

8.69.3 One provider told us that both frontline staff and consumers did not mention the service during recent branch visits.[856]

8.69.4 Although the switching service is advertised as taking 5 working days, in practice, it can take-up to 9 working days, which can leave a customer in limbo for up to 2 weeks while payments are being shifted over.[857]

8.69.5 There is no ability to forward on or redirect payments from old to new accounts.

8.70 There is also a lack of information about how well the Payments NZ switching service is performing. For instance, there is no record of the number of consumers that use it each year, the average time it takes to execute a switch, the proportion of switches that are successful in that they occur without raising any issues for customers and whether there are differences across providers in terms of the timing and success.

8.71 Overall, we find that, in the current state, the Easy Switch service falls short of offering a meaningful contribution to the competitive process.

The sector lacks a switching champion like in the UK

8.72 An effective switching service can stimulate competition in personal banking by making the process of switching providers quick and easy, thereby minimising any unnecessary barriers to switching.

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8.73 For such a switching service to work effectively, there are (at least) three essential elements.

8.73.1 Awareness of the service.

8.73.2 Confidence in the service.

8.73.3 Capability to deliver the service in a comprehensive and timely way.

8.74 New Zealand's industry-led arrangement sits in stark contrast with the UK's switching service – Current Account Switch Service (CASS). CASS is overseen by Pay.UK, which has a statutory mandate to encourage switching and produce annual reporting against CASS's key performance indicators (KPIs), including:[858]

8.74.1 awareness of the service (76% in 2022 against a KPI of 75%);

8.74.2 satisfaction with the service (91% in 2022 against a KPI of 90%); and

8.74.3 completion within a 7-day period (99% in 2022 against a KPI of 99%).

8.75 Pay.UK delivers advertising campaigns designed to maximise awareness among consumers about how to switch, why to switch and the guarantees of doing so through the service. It also holds an annual CASS strategy day with representatives from the banking sector to ensure that CASS remains representative of the marketplace and consumer markets.[859]

8.76 We consider that New Zealand's switching service could be improved through the adoption of a model similar to that in the UK or by specific incentives being imposed on Payments NZ to improve its switching service and monitor its performance.

8.77 In 2014, the Productivity Commission recommended the Payments NZ switching service be better publicised and more transparent.[860] These recommendations have not been implemented.

8.78 As discussed in Chapter 10, our recommendation is to build on the existing switching process by adopting the changes previously proposed by the Productivity Commission to include greater transparency, accountability, promotion, enhanced functionality and guaranteed minimum standards. Banks are generally supportive of Payments NZ continuing to run the switching service with these improvements.[861,862]

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858 Pay.UK "Current Account Switch Service Annual Report 2022", p. 5, https://www.wearepay.uk/wp-content/uploads/2023/03/CASS-Annual-Report-2022.pdf

859 Pay.UK "Current Account Switch Service Annual Report 2022", p. 8.

860 New Zealand Productivity Commission "Boosting productivity in the services sector" (May 2014), pp. 5 and 21, https://www.treasury.govt.nz/sites/default/files/2024-05/pc-inq-bssp-summary-of-final-report-boosting-productivity-in-the-services-sector.pdf. This included recommendations to provide statistics around number of bank switches per year and time taken per switch.

861 Commerce Commission "Day 3 Personal banking services market study conference – Session 9 Consumer experiences" (15 May 2024), p. 14 (lines 30–33).

862 ASB, Submission on draft report (18 April 2024), pp. 17–18.

Payments NZ

8.79 Payments NZ is the governance body for the core payment system. It was established in 2010 by the banking industry. It is jointly owned by eight banks that contributed to the development of the payment system rules: ANZ, ASB, BNZ, Citibank, HSBC, Kiwibank, TSB and Westpac.[863] As we discuss in Chapter 9, Payments NZ has also established an API Centre that, to date, has been leading work on standards development for open banking.

8.80 Payments NZ acts as an industry association and its core functions are to:[864]

8.80.1 develop and manage the rules and standards that govern the core payment clearing systems in New Zealand;

8.80.2 encourage and facilitate new participants to join the payment clearing systems;

8.80.3 facilitate the interoperability of payments between participants; and

8.80.4 promote interoperable, innovative, safe, open and efficient payment systems.

8.81 Overseeing the switching process is not seen by Payments NZ as a core function and is not mentioned in its forward work programme.[865]

8.82 Payments NZ has no current mandate or incentive to support or develop the switching service in New Zealand to ensure it is fit for purpose. We understand that it does not have any requirement or incentive to track or report on awareness or satisfaction with the Easy Switch service or whether agreed timeframes are met, and it has not run any campaigns in relation to the switching service protocols.[866]

Behavioural factors affect many consumers' ability to navigate personal banking

8.83 Faced with significant real or perceived search and/or switching costs, consumers may find it difficult to navigate personal banking markets, in part because we all have in-built behavioural responses that make it hard to be completely objective.

8.84 These are the most common and relevant behavioural biases for this market study.[867]

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863 Payments NZ "About us", https://www.paymentsnz.co.nz/about-us/

864 Payments NZ "About us", https://www.paymentsnz.co.nz/about-us/

865 Payments NZ "Payments Direction" https://www.paymentsnz.co.nz/our-work/payments-direction/

866 [ ].

867 Amelia Fletcher "The Role of Demand-Side Remedies in Driving Effective Competition: A Review for Which?" (7 November 2016), p. 17, https://www.regulation.org.uk/library/2016-CCP-Demand_Side_Remedies.pdf

8.84.1 Status quo bias and loss aversion – these effectively involve consumers giving disproportionate weight to the benefits of their existing situation, which can exacerbate the perceived costs of switching providers and lead to customer stickiness.

8.84.2 Present bias and hyperbolic discounting – these involve consumers giving disproportionate weight to the present and insufficient weight to the future. In doing so, consumers may be expected to, for example, place large weighting on a cashback offer as part of a home loan deal with limited regard for the consequences of making a commitment not to switch providers for a certain period in exchange for the cashback deal or to tend towards over-indebtedness.

8.84.3 Default bias, saliency bias and other forms of framing – these biases reflect shortcuts for simplifying decision making, which may involve adopting the default option, choosing a provider based on family and friends' recommendation or brand recognition rather than on the value for money reflected in the personal banking offers.

8.85 Many of these biases (including status quo bias/loss aversion and default bias) increase customer stickiness and therefore favour the incumbent providers (the major banks).

Regulation creates friction for customers seeking to switch providers | *Ka puta i te ture ētahi hanga whakararu mō te kaiwhakapeto e hiahia ana ki te whakawhiti kaituku*

8.86 Banks identified two pieces of legislation that create friction for customers seeking to switch providers.

8.86.1 The AML/CFT Act.

8.86.2 The CCCF Act and associated Credit Contracts and Consumer Finance Regulations 2004 (Regulations).

Providing information to help providers meet their AML obligations can be time consuming and prohibitive for customers seeking to switch providers

8.87 The AML/CFT Act places obligations on New Zealand's financial institutions to detect and deter money laundering and terrorism financing. To carry out this purpose, the AML/CFT Act requires financial institutions to conduct a range of checks when onboarding new customers (such as opening a bank account with that institution for the first time) or when there is a material change in the business's relationship with the customer. These checks involve gathering information about a customer's identity, address and source of funds and are known as due diligence.

8.88 Due diligence requirements under the AML/CFT Act create impediments to switching because of the customer identification and verification processes.[868] Put simply, they add to the overall hassle factor in signing up to a new banking service, which contributes to customer inertia.[869]

8.89 There are some regulatory processes recently implemented or under way to address the overall burden caused by the AML/CFT Act. Some of these initiatives may ease the friction for customers seeking to switch personal banking providers.

8.90 The MoJ has recently reviewed the AML/CFT Act and its report recommended reducing address verification requirements by switching to a risk-based approach.[870] This would reduce some of the administrative burden for customers wishing to switch by reducing the amount of information that needs to be provided. This recommendation has not yet been implemented.

8.91 The Digital Identity Services Trust Framework Act 2023 (Digital Identity Act) aims to establish a legal framework for the use of digital identities and foster the growth of a digital identity network in New Zealand.[871]

8.92 The current proposed framework is an opt-in decentralised framework for the provision of safe, secure and trusted digital identity services in New Zealand.[872] However, the major banks have indicated they are unlikely to participate as ID providers.[873]

8.93 We understand that, under the current proposed framework, an authority to be established within the Department of Internal Affairs Te Tari Taiwhenua (DIA) and operating from 1 July 2024 will accredit digital identity services, including potential credential providers such as RealMe (identity) and NZ Transport Agency Waka Kotahi (NZTA) (driver licences). Users would then be able to provide a third party such as a personal banking service provider with their credentials.

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868 ANZ, Submission on Preliminary Issues paper (7 September 2023), para 22.2; ASB, Submission on Preliminary Issues paper (7 September 2023), para 22.7; Deloitte Access Economics [for BNZ] "Personal banking services: Consumer switching, conditions of entry and expansion, profitability and innovation" (7 September 2023), para 17.2.

869 [ ].

870 MoJ "AML/CFT 'Early' Regulatory Package: Exposure Draft" (February 2023), p. 29, https://www.justice.govt.nz/assets/Documents/Publications/Consultation-Document-AML-CFT-Early-Regulatory-Package-Exposure-Draft-February-2023.pdf

871 Digital Identity Services Trust Framework Act 2023, s 3.

872 digital.govt.nz "Concepts of the trust framework" (27 June 2024), https://www.digital.govt.nz/standards-and-guidance/identity/trust-framework/concepts/ https://www.digital.govt.nz/digital-government/programmes-and-projects/digital-identity-programme/trust-framework/key-concepts/

873 Commerce Commission "Day 2 Personal banking services market study conference – Session 5 Open banking (continued)" (14 May 2024), p. 21 (lines 19–23), https://comcom.govt.nz/__data/assets/pdf_file/0029/353738/Personal-banking-conference-transcript-Session-5-Open-banking-continued-14-May-2024.pdf

8.94 This would allow customers to share their credentials (including identity) digitally, reducing the administrative burden on a customer to collate documents for providers' AML/CFT Act requirements and enable customers to more easily satisfy AML/CFT Act requirements without physically visiting a branch.[874]

Unintended consequences of CCCF Act for switching

8.95 As discussed in Chapter 7, over the past decade, numerous changes have been made to the CCCF Act and Regulations to improve consumer protection for vulnerable borrowers.

8.96 Our study has identified several instances where the CCCF Act is unintentionally impacting competition and where changes could better promote competition. Since the start of our study, MBIE has commenced a two-phased reform of New Zealand's financial services regulation, including the CCCF Act, with the purpose of streamlining the financial services regulatory landscape and removing unnecessary compliance costs.[875] We support the focus on removing unnecessary costs and note the potential competition benefits to reforming the Responsible Lending Code under the CCCF Act to smooth the process of switching home loan providers.

8.97 Consumers refinancing a home loan with a new provider may trigger an affordability assessment under the CCCF Act that would not arise if they stayed with their original loan provider. This creates a barrier to consumers switching home loan providers, advantaging incumbent providers and impacting competition.

8.98 This was an issue under the CCCF Act prior to the Government's current reforms and may still be an issue even though the prescriptive affordability assessment regulations have been revoked. A lender offering to refinance a home loan for a customer is still required to comply with the responsible lending principle to make reasonable inquiries to be satisfied that it is likely that the borrower can afford the home loan repayments without suffering substantial hardship.[876] That same customer would not need to go through this process if they were refixing their home loan with their current provider (for example, where they refix interest rates at the end of a fixed rate period).[877] The need to go through this process may deter some consumers from considering their options.

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874 [ ].

875 MBIE "2024 financial services reforms" (10 July 2024).

876 CCCF Act, s 9C(3)(a)(ii).

877 Unless a material change is being made to the home loan agreement. Under s 9C(8) of the CCCF Act, a material change means an additional amount is being advanced (such as a home loan top-up) or an increase to a revolving loan credit limit.

8.99 The newly revised Responsible Lending Code, which took effect on 31 July 2024, provides guidance on situations where a lender may make less-extensive inquiries when undertaking an affordability assessment.[878] However, refinancing a home loan with a new provider, even when the new provider is offering lower payments than the existing provider, may not clearly meet the criteria for less-extensive inquiries in the Responsible Lending Code. Furthermore, in a rising interest rate environment the new lender may be offering a more affordable deal than the existing lender but this is not captured in Code guidance.

8.100 These aspects of the CCCF Act and Responsible Lending Code appear to create an unnecessary barrier to consumers switching providers of home loans, potentially impacting competition. In circumstances where a borrower is seeking to refinance a home loan, we recommend that the Responsible Lending Code is clarified and revised to make it clear that a new lender offering the same or better terms to the borrower as the existing lender can opt to make less-extensive affordability inquiries (unless there is evidence of payment difficulties with the existing loan). This includes situations of a rising interest rate environment. We consider that this will help remove one of the barriers to switching home loan providers.

8.101 We received feedback that our draft recommendation (to make the CCCF Act competitively neutral with respect to home loan refinancing) may lead to increased risk of consumer harm.[879] We think this concern is addressed by our recommendation because it would result in new lenders still having an obligation to conduct an affordability assessment on a home loan refinance (albeit with lesser inquiries). In any event, based on our experience of enforcing the CCCF Act, we do not consider the risk of consumer harm to be significant provided appropriate safeguards are built into the revised Responsible Lending Code guidance.

Tying and bundling does not appear to be affecting competition | *Te āhua nei kāore he pānga mai o te paihere, te whakatōpū rānei ki te whakataetaetanga*

8.102 Tying and bundling can make it harder for consumers to switch individual products, potentially reducing competition. If the firm engaging in the tying or bundling strategy has market power, tying or bundling can also impede the ability of rival players to compete.

8.103 There is currently limited tying and bundling of personal banking services in New Zealand. Given tying and bundling is not a material feature of the market, it does not appear to be materially affecting consumers' ability to switch providers.

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878 MBIE "Responsible Lending Code" (31 July 2024), para 5.27, https://www.mbie.govt.nz/dmsdocument/28548-responsible-lending-code-july-2024

879 Consumer NZ, Submission on draft report (18 April 2024), p. 14; and FinCap, Submission on draft report (18 April 2024), p. 1.

8.104 Services are tied if the purchase of one service is conditional on also purchasing another service.[880] Bundling refers to the practice of selling two services together.[881]

8.105 In the past, tying and bundling of personal banking services by New Zealand banks was common – for example, offering customers package deals if they take out certain insurance policies together with their home loans. However, we found that there are few tied or bundled personal banking services in New Zealand at present.[882]

8.106 Following the conduct and culture review undertaken by the FMA and Reserve Bank in 2018, banks have looked to simplify service offerings to customers, including by removing the sale of bundled packages.[883] We have heard that banks' systems and controls are currently not suitable to reliably deliver tied or bundled packages to customers and add operational risk to the banks.[884,885]

8.107 This simplification of banks' offerings following the conduct and culture review means that tying and bundling is no longer a prominent feature of the market.

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880 Jean Tirole "The analysis of tying cases: A primer" *Competition Policy International* 1(1) (2005) 1–25.

881 Bundles can be pure, where the two services are only available together, or mixed if the products are each available separately as well as together in the bundle.

882 Some limited examples are observed in the combining of transaction and loan accounts such as the requirement to have a transaction account with a home loan. [ ].

883 [ ].

884 [ ].

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Chapter 9 Digital disruption and impediments to innovation | *Te tauwhatinga matihiko me ngā ārai ki te auahatanga*

Summary of findings

- **The major banks and Kiwibank have not prioritised upgrading to modern core banking systems.** Legacy systems constrain the ability of banks and fintechs to innovate and compete. Innovation has tended to occur around the edges of the customer experience rather than at the core of product and pricing structures.
- **We consider that the lack of investment in modern core systems is a symptom of weak competition** and also holds back competition from innovative business models**.** By contrast, in Australia, there has been more innovation by the parents of the four large New Zealand banks.
- **Regulatory costs have impacted all banks in recent years. Smaller banks have been disproportionately impacted, further constraining their ability to innovate.** This has enabled the major banks' service offering to stay just ahead of smaller banks, countering the ability of the smaller banks to compete for main bank relationships.
- **We have not seen disruptive innovations observed overseas from fintechs** such as Revolut, Monzo and Rocket Mortgage, as fintechs here face a range of impediments to entering and expanding. These impediments are structural, regulatory and strategic in nature. Simply opening and maintaining a business bank account are key challenges that fintechs face.
- **Consequently, we lack the innovative responses seen in Australia by the parents of the major banks**, for example, with digital-only subsidiaries or flanking brands like ubank by National Australia Bank (NAB) and Unloan by Commonwealth Bank of Australia (CBA) or rapid home loan applications enabled by modern core banking systems.
- **Progress towards open banking has been too slow.** Open banking has enabled smaller challengers overseas, and we expect it to boost innovation and competition for personal banking services in New Zealand. However, progress in New Zealand has been too slow because without a regulatory backstop the major banks have been left to set the nature and the pace of change. As a result, New Zealand is now falling behind the rest of the world, and industry have recognised the value of regulatory input into the coordination that is required.
- **There is a risk of industry work stalling while processes for a consumer data right (CDR) are worked through and an opportunity now to accelerate progress.** An interbank payments network designation would provide a regulatory backstop to speed up open banking (by an estimated 12 months) and enable MBIE to focus on the CPD Bill. We consider that regulator involvement is necessary to coordinate industry and government to ensure the potential of open banking is realised as soon as possible. Industry and government should work towards open banking being fully operational by June 2026.

Innovation is important for competition | *He mea whaitake te auahatanga mō te whakataetaetanga*

9.1 Workably competitive markets encourage firms to innovate to differentiate themselves, attract more customers and seek a competitive advantage over their rivals.

9.2 We have sought to assess levels of innovation in personal banking, recognising that innovation is both a driver and an outcome of the competitive process.[886]

9.3 The terms of reference for this study require us to specifically consider any impediments to new or innovative banking products or services.

9.4 Overall, our view is that innovation is limited, reflecting the oligopolistic nature of competition between the major banks. Fintechs are an important potential source of more radical and disruptive innovation but presently face challenges entering the market and expanding. Open banking will increase competition, and progress towards it needs to accelerate.

The innovation we observe currently is incremental and constrained by ageing core systems | *Ko te auahatanga e kitea ana he mea iti noa, he mea taparere hoki nā te kaumātuatanga o ngā pūnaha taketake*

9.5 The innovation we observe currently across the industry in personal banking is limited and occurring incrementally around the edges of the customer experience.

9.6 For the major banks and Kiwibank, it is seen, for example, in simplification or streamlining of products, enhancements to cards and mobile app services, calculator tools and digital onboarding processes.[887]

9.7 We have not seen significant disruptive innovations observed overseas from fintechs such as Revolut (Europe), Monzo (UK) and Rocket Mortgage (US), which have delivered new products, enhanced services and low-cost digital personal banking services.

9.8 Although Revolut and other fintechs such as Dosh, Wise and Squirrel have entered the market here, their potential to disrupt is currently limited as they face a range of impediments to expanding. Nor do we observe the sort of innovative responses seen in Australia by the parents of the major banks, for example, with digital-only subsidiaries or flanking brands like ubank by NAB and Unloan by CBA.[888] Well-established innovations in Australia such as rapid home loans applications (which we mention below), have not flowed through to New Zealand.

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886 OECD "Competition and Innovation: A Theoretical Perspective" (5 May 2023), p. 17, https://www.oecd-ilibrary.org/docserver/4632227c-en.pdf

887 [ ].

888 A flanking brand is a new brand introduced by an established provider that can compete in a new category or customer group.

9.9 While incremental, many of the innovations of the major banks are aimed at maintaining main bank relationships. Staying in line with competitors' service offering enables them to maintain market share.[889]

9.10 Due to their scale, smaller banks and non-banks face comparatively higher constraints on their ability to innovate, limiting their ability to compete with the major banks and Kiwibank for main bank relationships.

The major banks innovate enough to maintain market share but significant investment to modernise core systems is needed

9.11 A number of banks, including the major banks, Kiwibank and some smaller banks, have worked to simplify their product suites.[890]

9.12 A key aim of those programmes has been to get back to core banking activities and to reduce business risk from more complex and legacy products and systems.

9.13 Simplification work stemmed from the joint Reserve Bank and FMA conduct and culture review of retail banks in New Zealand,[891] which followed the review by the Australian Royal Commission into misconduct in the banking, superannuation and financial services industry.[892]

9.14 Simplification efforts have, in part, helped the banks to position for digital transformation. Modern core systems that are more capable of supporting and delivering digitised offerings are needed for digital transformation.

9.15 While the major banks and Kiwibank are planning or progressing transformation programmes, they have yet to complete core systems upgrades despite the resources available to them.[893] Across the board, there are ageing interconnected systems, many now fully depreciated. ANZ has provided us with examples of investments in their core systems that appear to be largely updates or maintenance to existing legacy systems rather than more substantive transformation to modernise.[894]

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889 [ ]; [ ].

890 BNZ, Submission on Preliminary Issues paper (7 September 2023), p. 38; Kiwibank, Submission on Preliminary Issues paper (7 September 2023), p. 16; ASB, Submission on Preliminary Issues paper (7 September 2023), para 10.7(f); [ ]; [ ].

891 FMA and Reserve Bank "Bank Conduct and Culture" (November 2018), https://www.fma.govt.nz/assets/Reports/Bank-Conduct-and-Culture-Review.pdf. The review led to the introduction of the Financial Markets (Conduct of Institutions) Amendment Act 2022: FMA "Conduct of Financial Institutions (CoFI) legislation" (14 June 2024), https://www.fma.govt.nz/business/legislation/conduct-of-financial-institutions-cofi-legislation/

892 Royal Commission "Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry – Final Report" (4 February 2019), https://www.royalcommission.gov.au/banking/final-report

893 [ ]; [ ]; [ ].

894 ANZ, Submission on draft report (18 April 2024), para 158.

9.16 We have been surprised at the limited investment in modernising core systems and the low prioritisation given to it. Fully depreciated systems can indicate ongoing underinvestment and an ability to sweat legacy assets without fear of being competitively disadvantaged.

9.17 Consumer NZ has noted a lack of innovation and investment for scams and fraud.[895] We understand protections for scams and fraud are interrelated with investment in core systems, having heard that modern core systems can provide additional tools for fraud and scam prevention.[896]

Legacy core systems limit the banks and constrain innovation and competition by others

9.18 Modern core banking systems would enable greater innovation (as well as reducing operating costs and costs of regulatory change) and facilitate easier interoperability with third-party systems.[897]

9.19 The major banks and Kiwibank have acknowledged the limitations of their legacy systems and the need to invest.[898] The major banks acknowledge that their legacy core systems can add additional time, cost and complexity to work required for regulatory change and compliance.[899] We have also heard examples where banks' inflexible systems appear to constrain the banks' ability to work with iwi to provide finance for housing.[900]

895 Consumer NZ, Submission on draft report (18 April 2024), pp. 11–12.

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900 Commerce Commission "Day 3 Personal banking services market study conference – Session 7 Promoting competition for lending on Māori freehold land" (15 May 2024), p. 6.

9.20 Aspects of the personal banking sector depend on interconnecting networks. Interoperability between industry participants is critical to doing this efficiently. Ageing core banking systems therefore constrain, delay or make more complex what are necessarily joint development efforts such as 7-day payments,[901] standardised APIs,[902] confirmation of payee and real-time payments.[903]

9.21 The interoperable nature of the sector means that one provider may not realise the full benefits of modernising their systems until other banks follow. Where one provider moves first (for example, BNZ has been an early adopter of APIs), that provider may not realise the full benefits of that investment until a critical mass of the other providers (particularly the major banks with their extensive coverage) follow. This interdependence and delay also affect fintechs and other third-party providers seeking to connect into the banks (and for whom coverage is important) or provide over-the-top services.[904,905]

9.22 We understand that a lack of investment in systems is limiting capacity to process home loan applications, which impacts consumers' ability to shop around. We have heard from mortgage advisers that applications in New Zealand are handled by email communications and manual processing.[906] This has been contrasted with the Australian parents of the major banks, which leverage LIXI data standards and modern systems using artificial intelligence (AI) to process applications more efficiently.[907] This is discussed further in Chapter 4.

The banks say that limited investment in modernising core systems to date has been due to regulatory change but we consider limited competition to be a contributing factor

9.23 The banks maintain that the limited investment in core systems to date is largely due to the need to keep pace with changing regulatory requirements.

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901 Known as SBI365, 7-day payments was introduced in New Zealand on 26 May 2023: Payments NZ "Payments every day arrives in Aotearoa New Zealand" (22 May 2023), https://www.paymentsnz.co.nz/resources/articles/payments-every-day-arrives-in-aotearoa-new-zealand/

902 [ ].

903 New Zealand is one of two OECD countries without real-time payments. Payments NZ envisages that, by 2030, consumers will be able to pay in real time: Gareth Vaughan "Ten NZ banks to start offering 365-day a year payments in 2023 but real-time payments still some way down the road" (15 June 2022), https://www.interest.co.nz/personal-finance/116348/ten-nz-banks-start-offering-365-day-year-payments-2023-real-time-payments

904 In this context, an over-the-top service refers to a service that is provided on top of an existing relationship that a customer has with their bank, often using APIs that enable a third party to perform actions on behalf of the customer. We understand that ageing systems limit the functionality and performance that fintechs can tap into to provide products and services to consumers.

905 Commerce Commission "Day 2 Personal banking services market study conference – Session 5 Open banking (continued)" (14 May 2024), pp. 18–19; Worldline, Submission on draft report (18 April 2024), para 34; [ ].

906 Commerce Commission Day 3 Personal banking services market study conference – Session 8 Mortgage advisers" (15 May 2024), p. 14.

907 [ ].

9.24 They highlight the need to balance growth and innovation with regulatory change and compliance-driven work, with priority always given to the delivery of regulatory and compliance activity.[908] The major banks have observed that there is an overall limit to the amount of core system change projects that can be undertaken at once and a limit to available expertise.

9.25 While there has been significant and ongoing regulatory change and an increase in regulatory spend,[909] for the major banks:

9.25.1 there have been similarly changing regulatory demands in Australia where their parent banks are based;

9.25.2 shareholder returns over the period have been consistently high so the availability of funding is not a constraining factor, and the major banks have been able to maintain shareholder returns, keep pace with regulatory change and innovate enough to keep up with one another; and

9.25.3 due to their size and scale, the major banks are the best placed and have the greatest resources to manage the demands of regulatory change while also upgrading core systems – and have not yet done so.

9.26 Kiwibank is in a similar position to the major banks as regards its core systems. It has not had the capital backing to accelerate its transformation programme and, we were told, is often outbid by the major banks when it comes to engaging consultants and contractors.[910]

9.27 Smaller banks have faced comparatively higher constraints to innovate, which they have characterised as running to stand still. Chapter 7 finds that, due to their smaller scale, the overall regulatory burden disproportionately affects smaller banks.

9.28 Some smaller banks have told us that they have had to delay exploring options such as adopting Apple Pay or Google Pay because they must prioritise spend on regulatory compliance.[911] Others have decided to provide only basic functionality on their mobile phone application pending further development.[912]

9.29 Despite significant and ongoing regulatory change and an increase in regulatory spend for the major banks, we consider that limited competition is a contributing factor to the lack of investment in core systems to date and the lack of more extensive innovation in the industry.

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908 ASB, Submission on Preliminary Issues paper (7 September 2023), para 2.2; ANZ, Submission on Preliminary Issues paper (7 September 2023), para 26; [ ]; [ ].

909 [ ]; [ ]; [ ]; [ ].

910 Kiwibank, Submission on Preliminary Issues paper (7 September 2023), Q29; TSB, Co-operative Bank, Kiwibank and SBS Bank, Submission on Preliminary Issues paper (7 September 2023), pp. 2–3.

911 [ ].

912 [ ].

Fintechs are a potential source of more radical, disruptive innovation but face challenges in entering and expanding | *Ko ngā Fintech pea te ara e kaha ai te auahatanga tauwhati, heoi he uaua te whakauru me te whakawhānui*

9.30 Fintechs are firms that use digital information and technology in providing innovative financial services.[913]

9.31 While some fintechs offer services that are complementary to banks (such as credit assessment), some also compete more directly with banks.

Fintechs have potential to innovate and disrupt the market

9.32 Fintechs are often described as digital native firms, meaning their services are provided primarily over digital channels and from modern software and technology, contributing to lower cost and more personalised consumer experiences.

9.33 Further advantages can potentially flow from a fintech's more targeted (or narrow) service offer where it may specialise in a specific service rather than the broad range of services provided by traditional banks.

9.34 Internationally, we have seen fintechs emerge as a potential source of significant disruption in markets for personal banking services. In the UK, for example, digital challengers have been able to rapidly gain share in certain markets even though they face scale challenges after a certain point.[914]

9.35 Examples of fintechs that have disrupted markets overseas include Revolut (Europe), Monzo (UK) and Rocket Mortgages (USA).[915] These disruptive fintechs have rapidly gained significant market share from incumbent providers, which can prompt a competitive response from the incumbent banks, catalysing innovation in financial services that can benefit many consumers.[916]

9.36 In New Zealand, fintechs are not yet seen as, and do not yet impose, a strong competitive constraint on banks.

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913 While there are a broad range of fintechs offering a similarly broad range of services, we have generally focused on fintechs that seek to provide personal banking services. We have not closely considered digital currency providers, which can face similar but also unique challenges in competition for personal banking services.

914 In the UK, fintech challengers rapidly gained 8% of the personal current and business current (personal and business deposit) accounts market: FCA "Strategic Review of Retail Banking Business Models – Final Report" (January 2022).

915 Disruption could also come from large tech firms such as Apple and Google. However, prospects of entry have been speculative, for example, in Australia: ACCC "Retail deposits inquiry – Final report" (December 2023), p. 43.

916 FCA "The potential competition impacts of Big Tech entry and expansion in retail financial services – Discussion Paper" (October 2022), https://www.fca.org.uk/publication/discussion/dp22-5.pdf

Fintechs face challenges entering and expanding

9.37 While there is an established fintech community in New Zealand, we have been told that they face significant impediments to both entering and expanding in the personal banking sector, limiting their contribution to competition.[917]

9.38 We have identified structural, regulatory and strategic challenges for fintechs seeking to provide personal banking services, which include:

9.38.1 opening and maintaining a business bank account;

9.38.2 access to ESAS and agency banking arrangements;

9.38.3 cost and complexity of the regulatory environment;

9.38.4 adoption by customers;

9.38.5 access to funding and restricted use of the term bank; and

9.38.6 access to data.

9.39 We expand on each of these impediments that fintechs face below.

Opening and maintaining a business bank account

9.40 A key concern that fintechs raised with us is the difficulty in opening a business bank account with a bank.[918] For those who are successful in getting banked, there is an ongoing risk that a bank may close a fintech's bank account (known as de-banking), which would have clearly detrimental consequences for the fintech's business.

9.41 As with most other businesses, a business bank account is a fundamental operating need. Aside from the typical use of a business banking transaction account, fintechs may seek agency banking services, which involves the on-selling or provision of banking services to an end user.[919]

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917 Commerce Commission "Summary of views expressed – FinTechNZ/Commerce Commission workshop– Competition for personal banking services in New Zealand" (14 February 2024), pp. 4–7.

918 Commerce Commission "Summary of views expressed – FinTechNZ/Commerce Commission workshop – Competition for personal banking services in New Zealand" (14 February 2024), p. 4; [ ]; [ ].

919 For example, agency services can include access to payments infrastructure such as ESAS or holding consumer deposits. [ ].

9.42 Only a limited number of banks in New Zealand can meet the banking needs of fintechs, particularly for agency banking services. This can increase the dependency that a fintech has on their bank and limit their ability to negotiate terms.[920] If a bank declines or de-banks a fintech, that fintech may not have another viable option it can approach.

9.43 There is a perception that banks have both the incentive and the opportunity to restrict fintechs' ability to compete with them through limiting fintechs' access to business bank accounts and some suggestion that this may occur from time to time.[921]

9.44 Banks have said this isn't the case, and the internal bank processes and guidance we reviewed are appropriately competitively neutral and do not lend support to the perception,[922] although the reasons behind a bank's decision to decline a fintech's (or other customer's) application for services are not always made clear.

9.45 AML/CFT compliance risk is commonly identified as a reason for a cautious approach to providing services to fintechs. Under the AML/CFT Act, a fintech needs to develop a risk-based AML/CFT programme, conduct customer due diligence (CDD), conduct audits, submit annual reports and report suspicious activity to the New Zealand Police Financial Intelligence Unit.

9.46 When a bank onboards a fintech, it also accepts the compliance risk of the fintech not meeting AML/CFT requirements. Therefore, banks can be concerned about the compliance, credit and reputational risk of providing bank account services to a fintech.[923]

9.47 Due to the nature of their business, fintechs are almost always high-risk entities under the AML/CFT regime, and therefore the bank must undertake enhanced customer due diligence (ECDD) of the fintech.[924] ECDD requires more processes and assurances that fintechs need to provide. It also requires banks to conduct ongoing monitoring and assessments of its customers.

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920 [ ]; [ ].

921 We have heard anecdotally that banks are asking fintechs whether they are in competition to or complementary of the banks' service. Commerce Commission "Summary of views expressed – FinTechNZ/Commerce Commission workshop – Competition for personal banking services in New Zealand" (14 February 2024), p. 4; [ ].

922 [ ]; [ ]; [ ]; [ ]; [ ].

923 This can include risk that the fintech may breach international sanctions. [ ].

924 This can be a blanket categorisation for a diverse set of fintechs that can include providers of personal banking services, money remittance and digital currency (cryptocurrency) service providers. Each firm can present a different AML/CFT risk to a bank. In this section, we are concerned with fintechs that are not seeking to provide a digital currency service.

9.48 We heard criticism from various parties that the rapid implementation of AML/CFT in New Zealand has resulted in blunt requirements that can unnecessarily shift cost to industry and that clear guidance on how banks and fintechs can meet requirements is limited.[925]

9.49 The expectations that fintechs face can be different for each bank, and expectations may not be transparent. Each bank interprets its requirements under AML/CFT to determine its own necessary checks and processes to undertake in considering providing services to a fintech. This creates challenges for fintechs seeking to shop around or establish accounts at multiple banks.

9.50 We have also heard that banks may be uncomfortable providing clear direction to a fintech on how it can meet a bank's expectation as this may shift the legal burden and potentially responsibility onto banks.

9.51 Sometimes the overall cost of initial and ongoing due diligence can outweigh the commercial benefits to a bank of a fintech customer.[926]

9.52 We have heard that banks may prefer not to provide reasons for declining services to avoid reputational risks that can flow from fintech reliance of the reasoning, and case law supports banks' right to decline service without needing to provide reasoning.[927] There are also circumstances in which the AML/CFT regime restricts a bank from providing a reason for de-banking or declining to provide further services if that could disclose information relating to a suspicious activity report.[928]

9.53 Some banks are more active and receptive to onboarding fintechs, while other banks appear to have engaged less.[929] This can significantly increase the bargaining position of the bank when a fintech has only one or two prospective banks it can approach for services.

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925 [ ]; [ ].

926 [ ].

927 *E-Trans International Finance Ltd v Kiwibank Ltd* [2016] NZHC 1031, [2016] 3 NZLR 241 at [83]–[97]. The outcome in that case appears to have been driven by a relevant contractual provision that specifically said that Kiwibank did not need to provide reasons. Therefore, that case is not authority for the general proposition that reasons never need to be provided. [ ].

928 AML/CFT Act, ss 94 and 37;
[ ].

929 We have heard that some banks are much better than others at working with a fintech to support an onboarding request. [ ].

9.54 In its 2022 report on its review of the AML/CFT Act, the MoJ noted that, in some high-risk sectors, entities have no specific AML/CFT registration. It recommended a licensing framework for high-risk sectors where licensing would be undertaken by the AML/CFT supervisor or another appropriate body.[930] It said that licensing high-risk sectors will allow supervisors to better manage the risks within the sector.

9.55 A licensing framework also has the potential to address competition concerns for business bank accounts by:

9.55.1 providing fintechs with greater certainty of expectations for meeting AML/CFT requirements by shifting assessments from individual banks, which each have potentially bespoke requirements, to a single agency that may also be more willing to provide guidance for fintechs;

9.55.2 reducing the perception that AML/CFT compliance risk might be being used as a reason for declining services to a competing business; and

9.55.3 making it easier for fintechs to shop around for business banking services once they have a licence.[931]

Access to ESAS and agency banking

9.56 ESAS is the system used for processing and settling payments between banks and other financial institutions in New Zealand. It is a key input into the provision of personal banking services through its function as a settlement system (enabling payments between banks) and an account system. ESAS balances must remain in credit and are paid interest at the OCR on overnight balances.

9.57 ESAS is one of several payment clearing and settlement systems that providers of personal banking services may need to provide services to consumers.[932] While ESAS is operated by the Reserve Bank, other relevant payment clearing systems are operated by Payments NZ.[933]

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930 MoJ "Report on the review of the Anti-Money Laundering and Countering Financing of Terrorism Act 2009" (July 2022), recommendation #92.
[
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931 Commerce Commission "Day 2 Personal banking services market study conference – Session 6 Other enablers and barriers for fintechs" (14 May 2024), pp. 1–8.

932 Other systems include HVCS, BECS, CECS and SBI. The High Value Clearing System (HVCS) governs large payments that cannot be reversed such as house settlements. The Bulk Electronic Clearing System (BECS) governs how direct debits, automatic payments, bill payments and direct credits work. The Consumer Electronic Clearing System (CECS) governs how consumer payments such as EFTPOS (debit card) payments and mobile payments, work. The Settlement Before Interchange (SBI) system is a payment settlement and interchange system used by BECS and CECS participants: Payments NZ "Our payment systems".

933 Access to ESAS is also a key requirement for participation in Payments NZ's clearing systems, including BECS, HVCS and CECS. Payments NZ "ESAS Access Review: Risk Assessment Framework for ESAS – Submission" (27 July 2023), p. 2.

9.58 Providers can either access ESAS (and other payment clearing systems) directly through its operator, or indirectly through a bank that has an ESAS account (through what is known as an agency banking arrangement).

9.59 Currently, only a limited number of industry parties have direct access to ESAS.[934] A lack of access or indirect access (through an agency banking arrangement) to ESAS is likely to be limiting some fintechs' and other providers' ability to provide innovative services and compete more generally for personal banking services.[935]

9.60 Agency banking arrangements create dependency of smaller banks and non-banks on the large incumbents (with which they compete). They also require payment, which acts as a tax on the earnings of the smaller parties,[936] and provide major banks with an inside view of their competitors' business.[937]

9.61 Our discussions with fintechs and others with an interest in ESAS indicate significant demand for ESAS access. While some fintechs have stated that direct access is not viable for a start-up, other more established firms seeking direct access have noted that seeking access can take a very long time while also expressing frustration with agency banking arrangements.[938]

9.62 We think there are likely to be benefits to both innovation and competition of allowing wider ESAS access – both in its use as an input into payment services as well as an account that provides access to OCR returns (as described in Chapter 5). With the FMI Act in force, the Reserve Bank will need to consider the efficiency of the market for personal banking services, which ESAS serves.

Cost and complexity of regulatory environment

9.63 We have heard that the overall cost and complexity of regulatory compliance contributes to high fixed start-up costs for fintechs, which are often resource constrained during this phase of their business. We have also heard it can be difficult to innovate within a strict regulatory framework.

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934 [ ].

935 Commerce Commission "Summary of views expressed – FinTechNZ/Commerce Commission workshop – Competition for personal banking services in New Zealand" (14 February 2024), p. 6;
[ ];
[ ].

936 [ ].

937 For example, agent banks having visibility of firms' payment flows through this arrangement. Reserve Bank "Summary of Submissions and Next Steps on the ESAS Access Review (Risk Assessment Framework) Consultation Paper" (October 2023), p. 4.

938 [ ].

9.64 Other jurisdictions provide support for innovators through operating environments such as regulatory sandboxes[939] or regulatory guidance through innovation hubs[940] that help fintechs test products or concepts and help all parties (including regulators) to better understand where regulation is warranted.

9.65 The design of regulatory sandboxes can be difficult to get right. Our preferred alternative is for regulators to be agile and supportive of innovative business models.

9.66 We therefore support the work of CoFR's Fintech Forum work, coordinated by the FMA.[941,942]

9.67 The Fintech Forum operates in a similar way to an innovation hub and provides coordinated information and guidelines to help fintechs navigate New Zealand's financial regulatory system. It also helps identify elements of the system that may hinder fintechs' innovation, and it can provide input into appropriate operational and regulatory solutions.

Adoption by customers

9.68 As discussed in Chapter 8, personal banking is characterised by a significant degree of customer inertia and limited switching away from the major banks. Internationally, it is common for challengers to struggle to gain significant market share from large incumbent banks.

9.69 Consumer willingness to consider switching to alternative providers is an important driver of competition, particularly for new organisations seeking to grow. We have heard that there is a significant drop-off in consumer engagement if the consumer experiences a delay to use a service such as waiting for funds to transfer to the new provider before it can be used with that service.[943]

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939 A regulatory sandbox is a separate regulatory framework where there is some relaxation of the application of an existing regulatory framework that would otherwise apply to the business. There is close monitoring of the development of the product in sandbox testing: World Bank "Global Experiences from Regulatory Sandboxes" (2020), https://documents1.worldbank.org/curated/en/912001605241080935/pdf/Global-Experiences-from-Regulatory-Sandboxes.pdf

940 An innovation hub operates within the existing regulatory framework and involves regulators providing the business informal guidance and knowledge: Radostina Parenti "Regulatory Sandboxes and Innovation Hubs for FinTech" (September 2020), https://www.europarl.europa.eu/RegData/etudes/STUD/2020/652752/IPOL_STU(2020)652752_EN.pdf

941 See https://fintech.govt.nz/

942 We've heard positive feedback of FMA's support and guidance to support innovation. [ ].

943 Commerce Commission "Day 2 Personal banking services market study conference – Session 5 Open banking (continued)" (14 May 2024), p. 4; [ ].

Access to funding and restricted use of the term bank

9.70 We have heard that fintechs are facing challenges accessing capital and wholesale funding necessary to launch a product or grow their business. Requirements for capital or wholesale funding depend on the fintechs' business model. In 2023, there was a very significant drop in capital investment in the fintech sector.[944]

9.71 There are many non-bank fintech business models, and in general, they can struggle to secure capital or other wholesale funding.[945] This can be in part because of the various challenges this chapter points to, which can increase the risk (or perception of risk) of a business failing.

9.72 Start-up fintechs can face significant challenges securing timely investment capital (depending on their business model) and have a limited capital runway to launch a service. Uncertainty and delays with setting up business bank accounts or partnering for APIs can add to these challenges and can result in shelving of product concepts or deferring capital-raising effort until conditions are more favourable.[946]

9.73 Some fintechs seeking to provide banking services have trouble meeting the minimum prudential capital requirements necessary to register as a bank (which include minimum capital of $30m under the current banking prudential requirements set by the Reserve Bank). We have heard that a key benefit of bank registration is an entity being able to market itself as a 'bank' that offers 'banking services'.[947]

9.74 In addition, fintechs may wish to offer some but not all traditional banking services. At present, only the registered banks can use the words 'bank' and 'banking' to describe themselves and their services. However, under the DT Act, the Reserve Bank is specifically empowered to authorise anyone that "is, or intends to become, a financial service provider" to use those words.[948]

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944 Total investment capital raised in 2023 was down 88.9% to $20.5m, down from $185.5m in 2022 and $165.6m in 2021: Technology Investment Network (TIN) "New Zealand Fintech Report 2024" (May 2024), p. 4, https://tin100.com/nz-tech-sector-facts/2024-nz-fintech-report/ [ ].

945 Including access to funding for lending. Commerce Commission "Summary of views expressed – FinTechNZ/Commerce Commission workshop – Competition for personal banking services in New Zealand" (14 February 2024), p. 7; [ ]; [ ].

946 We, we understand that mothballing of fintech companies or projects has occurred. Commerce Commission "Day 2 Personal banking services market study conference – Session 6 Other enablers and barriers for fintechs" (14 May 2024), p. 13; [ ]; [ ].

947 Commerce Commission "Day 1 Personal banking services market study conference – Session 2 Prudential capital requirements and other regulatory factors" (13 May 2024), p. 13 (lines 26–32). [ ]; [ ]; [ ]

948 DT Act, s 428(d).

9.75 New Zealand currently lacks stepping stones towards banking licences that would support growth and the pathway towards full bank registration. Stakeholders have pointed to overseas jurisdictions that offer alternative banking licences that better support growth and expansion such as a small banking licence or digital banking licence.[949]

9.76 We understand that the Reserve Bank, in developing the core capital standard under the DT Act, is considering whether it should set a minimum dollar amount of capital required to become a deposit taker as part of the capital standard. Separately, the Reserve Bank is required to develop a policy for the use of the restricted term 'bank' under the DT Act and is specifically empowered to authorise the use of that term by non-deposit takers. These topics are discussed in more detail in Chapter 7.

9.77 We are aware of several fintechs (including Debut, Dosh and Emerge)[950] that are seeking to expand to provide digital banking services. Obtaining bank registration under the current regulatory framework and particularly the $30m prudential capital requirement for bank registration are major hurdles for digital banks.[951] Dosh, Emerge and Debut note that, although they provide some personal banking services, they are not registered banks. Dosh and Debut aspire to become registered banks under the current regulatory framework, and Dosh has recently applied for bank registration under the existing banking supervision regime.[952]

9.78 The DT Act will not be operational for several years. As noted above, fintechs typically have a limited capital runway so cannot wait several years, and the outcome of the Reserve Bank's core capital standard for deposit takers is uncertain.[953]

Access to data

9.79 Fintechs seek access to customer banking data to develop new innovations and services, to provide services over the top of incumbent services and to leverage valuable consumer data held by the incumbent banks.

9.80 Open banking would enable, among other things, access to customer banking data, but New Zealand does not yet have a developed open banking framework. Some fintechs (such as Akahu) are finding workarounds, which can include solutions that are suboptimal[954] and appear to have gained limited consumer traction.

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949 [ ]; [ ].

950 See https://www.makingdebutbank.co.nz/; https://www.dosh.nz/; and https://www.emerge.nz/about

951 FinTechNZ "The rise of digital banks" (25 July 2024), https://fintechnz.org.nz/2024/07/25/the-rise-of-digital-banks

952 Dosh "Dosh applies to become a registered Bank in New Zealand".

953 [ ].

954 Commerce Commission "Retail Payment System – Payments Between Bank Accounts – Request for views on payments made over the interbank payment network" (31 July 2023), para 2.22, https://comcom.govt.nz/__data/assets/pdf_file/0016/323602/Retail-Payment-System-Payments-Between-Bank-Accounts-Request-for-views-paper-31-July-2023.pdf

9.81 Discussed at paragraph 9.114, we find that the major banks limited investment in core banking systems has hindered progress on open banking. This means that fintechs have struggled to provide innovative services to consumers that leverage their data held by the major banks.

9.82 The following section describes the benefits of open banking for competition and innovation more broadly, and its development in New Zealand to date.

Open banking will increase competition and progress towards it needs to be accelerated | *Mā te pēke tuwhera noa e nui ake te whakataetaetanga, ā, kia kaha te whakatere ake i tōna putanga mai*

9.83 Open banking refers to a system in which consumers can make payments and instruct their banks to share their financial data such as account information and transaction data, with third-party providers such as fintechs or other banks.[955] If implemented well, it has the potential to be an ongoing disruptor to competition in personal banking among both existing providers and through the entry of fintechs.[956]

9.84 New Zealand lags other countries in developing open banking, and ongoing effort by both industry and government is needed to ensure benefits to New Zealand businesses and consumers are realised in a reasonable period of time.

9.85 We see no reason why New Zealand can't learn from, and leapfrog, progress in other jurisdictions. Although not a 'silver bullet', open banking has potential to promote competition and to complement other potential reforms. We see greater potential for uptake than in other countries (such as the UK – which has seen modest uptake in the 5 years since its implementation), as fintechs have had time to develop ideas, products and innovations, and to learn from overseas successes.

Open banking drives competition and innovation

9.86 The potential benefits of open banking include products and services for consumers from both existing providers and new entrants:

9.86.1 Facilitate consumers' ability to search and compare personal banking services. Third parties could, potentially, present offers from several providers simultaneously and use a consumer's data to compare (in, for example, a budgeting tool) how different products might best suit their needs.

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955 API Centre "Open banking implementation timeline set for largest banks" (30 May 2023), https://www.apicentre.paymentsnz.co.nz/news/articles/open-banking-implementation-timeline-set-for-largest-banks/

956 Open banking is not account number portability. Account number portability refers to a consumer taking their account number from their previous bank to another provider when they switch banks. Open banking enables other providers to provide banking services to a consumer without them moving their bank account (and bank account number).

9.86.2 Leverage consumers' data held by the incumbent banks. This can support digital challengers in overcoming the advantages of consumer data held with the incumbent providers.

9.86.3 Facilitate fintechs in providing over-the-top services (for example, transaction services) that are not dependent on or are less dependent on winning over main bank relationships. This reduces the link between where money is held and who provides transactions and other services, overcoming some of the switching inertia of consumers that prefer to have their funds with a bank.

9.87 In the box below, we have described the types of products that consumers may benefit from with open banking fully operational.

Open banking products and services for consumers

Open banking provides innovators with a new set of tools (called APIs) that can be used to build and deliver personal banking services to consumers.

Consumers don't need to leave their bank to try out new services

Consumers grant permission for a third-party innovator to use their banking information, or initiate a payment on their behalf. It enables new providers to offer innovative or improved banking services over the top of a main banking relationship (it doesn't require a consumer to switch away from their existing bank). Consumers remain in control by granting (or revoking) permission for the third party to access their information or act on their behalf.

This makes it easier for innovators to establish a business and provide a service. It means they do not necessarily have to provide a full suite of banking services or win a customer's main banking relationship.

Potential innovative products

Examples of products that are powered by open banking.

- **Aggregating banking information from multiple banks.** Mobile banking apps can connect with different banks, collect transaction history and aggregate the information. They can also be used to manage money and make payments across multiple banks.
- **Alternative mobile apps.** Innovators can offer alternative mobile banking apps to replace a main bank app, operating on the same underlying information. These can offer innovative money management tools or simplify navigating and summarising transaction history.
- **Simplify and speed up loan applications.** Credit and home loan providers can use open banking APIs to retrieve a customer's banking information from a range of bank providers. This can support and simplify a lending application (such as for a home loan) by removing the need to source bank statements.
- **Compare services.** Open banking can facilitate comparing a new service against an existing one by using a consumer's actual usage information to provide an accurate comparison based on a consumer's specific circumstances.

- **Easing the transition to a new provider.** The account information API can be used to retrieve information (such as transaction history) from a current bank to a new provider.
- **Enable new types of payment services** that may be cheaper and easier to use.
    - More secure one-time payment solutions that are convenient and safe ways for consumer to make payments online and for businesses to accept them.
    - Better direct debit options for consumers that notify the customer if there is an upcoming payment and they do not have sufficient funds in the account. This reduces the costs of chasing missed payments and provides customers with tools to better manage their finances, reduce late fees and overdraft costs.
    - New ways for consumers to make payments in store either through quick response (QR) codes or digital wallets on their phone. These solutions can be more convenient for consumers and lower cost for businesses. Further, with the appropriate regulatory environment, we expect open banking payments to become a viable alternative to the EFTPOS network, providing flexible and low-cost payment methods.
    - Better options for businesses to make payments. These options include the ability to initiate payments through their accounting software, improving productivity.

A toolset that can unlock new and creative innovations

While some of the more obvious uses are discussed above, the possible uses of open banking go beyond this.

For example, an innovative (and not necessarily predictable) use case is from Cogo. Cogo's service can use open banking APIs to retrieve a consumer's transaction history and analyse it to provide carbon emissions insights, making it simpler for New Zealanders to accurately understand the emissions impact of their spending.

9.88 There is a risk that, if not done well, open banking may entrench the position of the incumbent major banks.[957] If barriers for smaller providers (including fintechs) are not addressed, major banks may be the main providers of open banking.

Fully operational open banking requires more than just APIs

9.89 For open banking to be fully operational and for its benefits to be realised, the right building blocks need to be in place. While API-enabled payments are the defining feature of open banking, there are other essential building blocks to support its operation and uptake by consumers. These essential building blocks include a digital identity and the modernisation of our payments network.

9.90 Policy design and implementation work across these complementary building blocks needs to be aligned and progressed in parallel. It requires coordination across government-led initiatives, the active and constructive involvement of industry and the modernisation of the banks' core systems.

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957 Alan Mayo, Submission on draft report (18 April 2024), p. 3.

Minimum requirements for API-enabled payments

9.91 API-enabled payments are at the heart of open banking. Through our payments regulation work, we have identified minimum requirements for a thriving API-enabled payments ecosystem.[958]

9.91.1 **Third-party participation.** Third-party providers are present, willing and able to develop products and services that work over the top of a customer's existing banking relationship by leveraging open banking APIs and customer banking data. Third parties include fintechs, and smaller and larger banks that will only participate under the right commercial settings.

9.91.2 **Standardised APIs.** In open banking, APIs provide a secure connection that enables systems to communicate to facilitate requests for and the secure exchange of data.[959] APIs require sufficient performance and functionality for the products and services designed by third parties.

9.91.3 **Partnering.** Banks entering into commercial agreements with third parties for the use of APIs. This includes an accreditation framework or similar that ensures third-party providers are able to enter into agreements for the use of APIs.

9.91.4 **Confidence.** Consumers and banks need to trust that the ecosystem is operating safely and securely. This is particularly important as open banking requires consumers to be confident in authorising third parties to access and use their data and confident using new products and services for the full benefits to be realised.

A consumer digital identity is important for trust and confidence in open banking

9.92 The verification of a consumer's identity in a digital context will be fundamental to open banking.

9.93 The Digital Identity Act provides a legal framework to assist the development of trusted, people-centred digital identity services.[960]

9.94 Holders of identity information such as DIA (birth certificates, passports), NZTA (driver licences), universities (qualifications) or banks (bank account numbers) will be able to issue digital credentials. The Digital Identity Act adds a regulatory framework for participating providers, enabling better trust and confidence in the service.

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958 Commerce Commission "Retail Payment System – Update on our Payments Between Bank Accounts work" (22 February 2024), Annex A, https://comcom.govt.nz/__data/assets/pdf_file/0017/344132/Retail-Payment-System-Update-on-our-Payments-Between-Bank-Accounts-work-22-February-2024.pdf

959 An API is a set of routines, protocols and tools for building software applications. An API specifies how software components should interact.

960 digital.govt.nz "Trust framework for digital identity", https://www.digital.govt.nz/standards-and-guidance/identity/trust-framework/

9.95 Users will then provide their credentials to third parties (known as relying parties) who are the consumers of this identity information.[961]

9.96 This would allow, for example, an agency such as DIA to issue a digital identification and customers to share this identity digitally with a bank. There is the potential for this to help address some of the pain points we have discussed with customer switching such as the need to verify identification for AML/CFT requirements, sometimes multiple times, and the need for consumers to physically visit bank branches to open accounts.

9.97 DIA is engaging with MBIE, Payments NZ and other industry players to ensure alignment between the Digital Identity Act and the API Centre work, a consumer data right (CDR) and potential banking sector designation.

9.98 Participation in the scheme is voluntary and there may not be sufficient commercial incentives for individual banks to participate[962] as the benefit of the framework will be shared across the sector (and wider economy).[963]

9.99 The Australian Government is also in the process of developing its digital identity regulatory system.[964] Under this system, the ACCC will accredit entities providing digital identity services, approving entities that participate, monitoring compliance and enforcement.[965]

Modernising our payments network

9.100 A lack of modern payment features such as real-time payments, confirmation of payee, rich payment data and modern scam and fraud protection measures may inhibit the potential of open banking.

9.101 Payments are currently controlled by banks, and open banking is expected to also deliver benefits in this area. We have heard a consistent theme that real-time payments are important for an efficient and competitive payments network and that the richer payments data that this would result in will be key to unlocking yet further innovation.[966] There are several payment systems, noted in paragraph 9.57 above, that contribute to an efficient and competitive payments network.

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961 [ ].

962 ANZ has expressed interest in participating in digital identity but not as a digital ID provider alongside other banks. Our view is that banks are active participants as providers and digital identity should be included in the set of June 2026 milestones. Commerce Commission "Day 2 Personal banking services market study conference – Session 5 Open banking (continued)" (14 May 2024), p. 21 (lines 19–23).

963 [ ]; [ ].

964 See https://www.digitalidentity.gov.au/

965 ACCC "Digital identity" https://www.accc.gov.au/by-industry/digital-platforms-and-services/digital-identity

966 Consumer NZ, Submission on Preliminary Issues paper (7 September 2023), p. 12; ASB, Submission on Preliminary Issues paper (7 September 2023), para 3.6; [ ]; [ ]; [ ].

9.102 Payments NZ, as part of its next generation payments work,[967] has plans to modernise the payment system in New Zealand. This may include, for example real-time payment capabilities, simple verification, payee identifiers, rich data, improved fraud solutions, greater payment choices and cross-border payment corridors.

9.103 Alongside other expectations in a July 2023 letter,[968] the Reserve Bank has set clear expectations that the private sector should lead this work.

9.104 We understand that Payments NZ has initiated a governance review to consider, in part, whether the governance of the organisation is fit for its next generation payments work.[969] The Reserve Bank and the Commission have written to Payments NZ requesting to be engaged through this governance review.[970]

9.105 The review is an opportunity to consider how industry participates in and contributes to the Payments NZ work. Given the Reserve Bank's preference for the private sector to lead progress on real-time account-to-account payments capability,[971] it is important that the priorities and interests of Payments NZ reflect the sector and stakeholders that it serves.

9.106 Our view is that the UK's Open Banking Implementation Entity (OBIE) governance structure is a good example to work towards, which includes balanced industry participant representation, payments customer representation (both consumer and SME) and payments regulatory oversight.

New Zealand lags behind other countries in developing open banking

9.107 Progress on the delivery and adoption of open banking payment solutions has been slow, and competitive third parties are waiting in the ranks. Disruption to competition in the longer term is likely to come from non-traditional banks that typically leverage a lower cost base and modern systems. Fully operational open banking is a key input they need to compete and disrupt competition.

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967 Payments NZ "Next generation payments", https://www.paymentsnz.co.nz/our-work/next-generation-payments/. While decisions for specific plans are yet to be made, Payments NZ is working to the assumption that building blocks will need to be in place by 2030: Payments NZ "Payments Modernisation Plan" (September 2020), p. 10, https://www.paymentsnz.co.nz/documents/309/Payments_NZ_Payments_Modernisation_Plan.pdf

968 Reserve Bank letter to Payments NZ "Reserve Bank position on Aotearoa New Zealand's need for real-time payment capability" (10 July 2023), available at: https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/publications/information-releases/2023/letter-to-payments-nz-on-nzs-need-for-real-time-payments-10-july-2023.pdf

969 Payments NZ "2023 Report" (December 2023), p. 21. Available at: https://www.paymentsnz.co.nz/documents/367/PAYMENTSNZ-YEAR-IN-REVIEW-2023.pdf; [ ].

970 Reserve Bank "Reserve Bank position on Aotearoa New Zealand's need for real-time payment capability" (10 July 2023); Commerce Commission "Retail Payment System – Update on our Payments Between Bank Accounts work" (22 February 2024), expectation 4.

971 Reserve Bank "Reserve Bank position on Aotearoa New Zealand's need for real-time payment capability" (10 July 2023), p. 2.

9.108 Internationally, New Zealand lags other countries in progress towards open banking. For example, Australia, through its CDR legislation, has had partial open banking in operation since 2020, while open banking has been operational in the UK for 5 years.

9.109 The UK and Australia have taken different approaches to implementing open banking, particularly with respect to their breadth versus depth scope. The Australian CDR is a broad cross-sector framework for data exchange but has been implemented with less core functionality than open banking in the UK (which is more narrowly focused on banking but with both read and write functionality).[972]

9.110 There are benefits to each approach. The depth of the UK approach has driven greater innovations and uptake, while the broad approach of Australia's CDR has the potential for economy-wide benefits.[973]

9.111 A common feature of open banking in other countries is that widespread take-up has required government involvement. A reason why a purely industry-led approach is unlikely to succeed is that open banking depends on banks to build APIs and partner with fintechs, which in some cases will be competing to take some of their business. Additionally, strong network effects also mean that, if a single major bank does not participate, the benefits of open banking to customers (and fintech providers) diminish considerably.

9.112 Work to date on the development of open banking in New Zealand has been largely industry-led and payments-driven, although government has been progressively becoming more involved in ensuring progress is made. While some aspects of open banking are operational, we are still a while away from a thriving open banking ecosystem.

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972 Read access is where a third party can only read and display consumer data, and write access is where a third party can change consumer data with the consumer's consent. At its introduction, the Australian CDR incorporates a read access function but not a write access function (which is also referred to as action initiation).

973 Write access can unlock significant innovation potential by enabling a third-party provider to perform banking actions on a consumer's behalf (such as making a payment). For example, NatWest notes that the write access of the UK's open banking framework is often lauded as a having turbocharged the regime in terms of consumer uptake and the sophistication of product offerings (compared to just read access of the Australian CDR). NatWest "Lessons Learned from Australia and the United Kingdom – The Consumer Data Right and Open Banking" (2023), p. 2, https://news.nab.com.au/wp-content/uploads/2023/02/NAB-and-NatWest-Open-Banking-Whitepaper-2023.pdf.

9.113 Successive Ministers have called for progress on API standards, dating back as far as Minister Dean in 2017.[974] Despite industry work beginning at this time and Minister Faafoi expressing concern with the pace of progress in 2019,[975] open banking is not yet fully operational in New Zealand in 2024 and falls short of expectations set by Minister Faafoi in 2019.

9.114 Limited investment from the major banks to modernise core systems has also hindered open banking progress. We understand that ageing core systems increase the complexity of deploying APIs and inhibit their performance.[976]

9.115 We've heard acknowledgement that more could have been done for scam and fraud prevention,[977] and (as described in paragraph 9.17 above) we consider that limited investment in core systems has contributed to lagging scam and fraud prevention. Delayed progress in scam and fraud prevention risks consumers' confidence and therefore uptake in open banking services.

Government and industry are working to progress open banking

9.116 There are three workstreams supporting the progress of APIs in New Zealand: the industry-led API Centre, MBIE's work on a CDR and the Commerce Commission's retail payments regulation.

9.116.1 **Industry-led API Centre.** Initial industry work began around 2017 with a set of guiding principles and objectives for common API standards motivated by moves towards open banking in Australia and the UK.[978] The bank-owned industry body (Payments NZ) then established the API Centre in May 2019 to develop and publish the API standards needed for banks and third parties to form partnerships to deliver open banking innovation.[979]

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974 Gareth Vaughan "Commerce & Consumer Affairs Minister Jacqui Dean pushing for open banking in NZ as part of greater retail payments competition. Notes regulation limiting merchant fees, open access to bank data common overseas" (7 October 2017), https://www.interest.co.nz/business/90193/commerce-consumer-affairs-minister-jacqui-dean-pushing-open-banking-nz-part-greater

975 In an open letter, Minister Faafoi sets short-term expectations for the implementation of v2.0 of API standards, bilateral agreements with third parties on reasonable terms and within reasonable timeframes and a range of products available. Hon Kris Faafoi "Open letter to API Providers regarding industry progress on API-enabled data sharing and open banking" (December 2019), https://www.mbie.govt.nz/assets/open-letter-to-api-providers-regarding-industry-progress-on-api-enabled-data-sharing-and-open-banking.pdf

976 Commerce Commission "Day 2 Personal banking services market study conference – Session 5 Open banking (continued)" (14 May 2024), p. 18 (lines 13–33); [ ].

977 Commerce Commission "Day 2 Personal banking services market study conference – Session 5 Open banking (continued)" (14 May 2024), p. 25 (lines 4–21).

978 CMA "Retail banking market investigation – Final report" (9 August 2016); CMA "CMA paves the way for Open Banking revolution" (9 August 2016), https://www.gov.uk/government/news/cma-paves-the-way-for-open-banking-revolution

979 See https://www.apicentre.paymentsnz.co.nz/about/

9.116.2 **MBIE-led CDR.** MBIE has been progressing an economy-wide CDR to give individuals and businesses greater choice and control over their data, following a 2019 open letter from the Minister of Commerce and Consumer Affairs to API providers expressing concern at the slow pace of progress.[980] On 16 May 2024, the CPD Bill (which provides for a CDR) was introduced to the House[981] and was read for the first time on 23 July 2024. MBIE will also consult on banking designation rules.

9.116.3 **Commerce Commission retail payments regulation.** In 2022, the Retail Payment System Act (RPS Act) was passed, which introduced a new regulatory regime and conferred certain functions and powers on the Commission. Under our role, we have set expectations for industry and have recommended designation of the interbank payment network to support the delivery of open banking.

9.116.4 In addition, the DIA is progressing work on a digital identity framework, and Payments NZ and regulators (through CoFR) are progressing with the modernisation of our payments network.

9.117 It is important that the technical standards and IT solutions are led by industry. This helps ensure buy-in of work and that design and implementation of standards are fit for purpose and reflect the needs of industry participants.

The Commission has a competition role in regulating payments

9.118 Under the RPS Act, the Commission, as competition regulator, has a specific role in the retail payments aspects of open banking. Our immediate focus was to monitor and provide guidance on interchange network fees.[982] We then undertook work to promote competition for payments between bank accounts including through the use of APIs to improve competition and innovation for payments.[983]

980 Hon Kris Faafoi "Open letter to API Providers regarding industry progress on API-enabled data sharing and open banking" (December 2019). A legislative CDR would allow consumers to request that their personal data, including product data, be shared securely with trusted third parties.

981 MBIE "Cabinet Paper – Customer and Product Data Bill – Approval for Introduction (21 June 2024), https://www.mbie.govt.nz/dmsdocument/28538-customer-and-product-data-bill-approval-for-introduction-proactiverelease-pdf

982 Commerce Commission "Retail Payment System Act 2022 – Guidance on the initial pricing standard" (15 December 2022), https://comcom.govt.nz/__data/assets/pdf_file/0015/301821/Retail-Payment-System-Guidance-on-the-initial-pricing-standard-15-December-2022.pdf

983 Commerce Commission "Retail Payment System – Payments Between Bank Accounts – Request for views on payments made over the interbank payment network" (31 July 2023), p. 30.

9.119 On 22 February 2024, Commission Chair Dr John Small wrote to participants in the retail payment system noting that, while there is currently good momentum in developing APIs to support open payments, progress has tended to stall in the past.[984] The open letter summarises our assessment of the current state of work and how the industry and other government work programmes potentially address some of the minimum requirements. It includes expectations for industry aimed at supporting the development of a thriving API-enabled payments ecosystem.

9.120 Additionally, we have recommended to the Minister of Commerce and Consumer Affairs that he designate the interbank payment network under the RPS Act.[985] A designation would better enable us to support the delivery of open banking. It would provide us with the ability to set rules and standards for the interbank payment network and act as a regulatory backstop for industry work developing APIs.

Banks have begun to deploy APIs and have taken steps towards a standardised partnering framework

9.121 There has more recently been some gathering momentum in progress towards open banking. Banks have begun deploying APIs and partnering with third parties, and Payments NZ has progressed an accreditation scheme and standard terms and conditions for partnering.

9.122 In May 2023, the API Centre published a Minimum Open Banking Implementation Plan setting out milestone delivery dates for payment initiation and account information APIs for participating banks.[986] In line with the plan, ASB, BNZ and Westpac delivered the payment initiation API on 30 May 2024.

9.123 Delivery of the implementation plan is uncertain. ANZ requested an extension for some aspects of the payment initiation API,[987] and ANZ and Westpac are at risk of not meeting the account information API implementation date of 30 November 2024.[988]

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984 Commerce Commission "Retail Payment System – Update on our Payments Between Bank Accounts work" (22 February 2024).

985 See Commerce Commission 'Retail payment system', available at: https://comcom.govt.nz/regulated-industries/retail-payment-system.

986 API Centre "Minimum Open Banking Implementation Plan" (30 May 2023), https://www.apicentre.paymentsnz.co.nz/standards/implementation/minimum-open-banking-implementation-plan/

987 As of 2 July 2024, ANZ is reporting amber progress for delivery of the payment initiation API v2.1: API Centre "Implementation Reporting", https://www.apicentre.paymentsnz.co.nz/standards/implementation/implementation-reporting/

988 As of 2 August 2024, ANZ and Westpac are reporting amber progress delivery of the account information API v2.1: API Centre "Implementation Reporting". Akahu has said that that two large banks decided not to deliver some of the API standards by the 30 May 2024 deadline despite co-designing and voting to approve these standards. Akahu "Payments NZ Authorisation – Feedback on the draft determination" (11 July 2024), p. 3, https://comcom.govt.nz/__data/assets/pdf_file/0027/359514/Akahu-Submission-in-response-to-Payments-NZ-Authorisation-Draft-Determination-11-July-2024.pdf

9.124 Banks are currently at different stages of API deployment. We have heard that the major banks have begun partnering but agreement on key terms (such as price) has hindered some partnering.[989]

9.125 On 16 January 2024, Payments NZ submitted an application to the Commission for authorisation to work with API providers and third parties to develop arrangements that, according to Payments NZ, will facilitate a more well-utilised, secure and innovative open banking framework.[990]

9.126 The proposed partnering framework involves the joint development of:

9.126.1 an accreditation scheme (including accreditation criteria) for third parties; and

9.126.2 default standard terms and conditions on which API providers would contract with third parties who meet the accreditation criteria.[991]

9.127 The Commission published its draft decision on 1 July 2024 indicating potential to approve the authorisation subject to conditions.[992] Those conditions seek to minimise the conflict of interest arising from the decision-making processes for the development of the proposed partnering framework and limit the authorisation to an 18-month window to facilitate timely joint negotiations.

Concerns with Payments NZ governance and oversight of the API Centre

9.128 It is important that the technical aspects of API development are led by industry to ensure that they are fit for purpose. However, while Payments NZ is leading useful work, there are concerns with its governance structure and the implementation of its work by the major banks and Kiwibank. Stakeholders (outside of the shareholder banks) have expressed concerns with the incentives and governance of Payments NZ and the API Centre.

9.129 While the conditions of our draft decision seek to minimise the conflict of interest for the development of the proposed partnering framework, broader concerns remain with the governance of Payments NZ.

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989 Commerce Commission "Day 2 Personal banking services market study conference – Session 5 Open banking (continued)" (14 May 2024), from p. 13 (line 28).

990 Commerce Commission "Case register – Payments NZ Limited", https://comcom.govt.nz/case-register/case-register-entries/payments-nz-limited

991 Payments NZ "Commerce Act 1986: Application for Authorisation of Restrictive Trade Practices" (7 December 2023), https://comcom.govt.nz/__data/assets/pdf_file/0026/340586/Payments-NZ-Limited-Authorisation-application-16-January-2024.pdf

992 Commerce Commission "Draft Determination – Payments NZ Limited" (1 July 2024), https://comcom.govt.nz/__data/assets/pdf_file/0019/357031/Payments-NZ-Limited-Draft-Determination-1-July-2024.pdf

9.130 Payments NZ is the governance body for the core payment system. It was established in 2010 by the banking industry. It is jointly owned by eight banks that contribute to the development of the payment system rules: ANZ, ASB, BNZ, Citibank, HSBC, Kiwibank, TSB and Westpac.[993]

9.131 The Payments NZ Board comprises up to 11 directors, which includes eight directors each appointed by one shareholder organisation (the eight banks) and up to three independent directors of which one is the Chair.

9.132 While the API Council is delegated authority by the Payments NZ Board for its day-to-day operations and other responsibilities, the Payments NZ Board oversees the functions of the API Centre.[994]

9.133 Despite some separation, the API Centre is ultimately overseen by the Payments NZ Board (which has 3 independent and 8 bank appointed directors). We consider that there is a conflict of interest within the Payments NZ Board because the banks may have different incentives from other participants regarding the delivery of the API Centre's work. We note similar concerns in Chapter 8 regarding Payments NZ's incentives to promote an effective switching service.

9.134 Some parties, for example, have voiced concern that there is no incentive for Payments NZ's API Centre to quickly progress the development of open banking due to the governance and effective control of Payments NZ being with the major banks.[995]

9.135 Similar concerns have also been expressed to the Commission through Payments NZ's authorisation application.[996] Public submissions to us in response to the authorisation application highlighted the conflict of Payments NZ ownership and governance and advocated for an independent body to oversee the roll-out and governance of open banking. Some submitters are concerned that the Payments NZ Board continues to have a role in setting the mandate and funding for the API Centre.

9.136 We consider that the concerns expressed of governance with respect to open banking also likely apply to other Payments NZ roles related to competition for personal banking. Payments NZ:

9.136.1 operates the switching service;

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993 Payments NZ "About us", https://www.paymentsnz.co.nz/about-us/

994 The API Council includes up to six registered API providers (banks), up to six registered third parties and three independent members (including the Chair).

995 Commerce Commission "Summary of views expressed – FinTechNZ/Commerce Commission workshop– Competition for personal banking services in New Zealand" (14 February 2024), p. 6.

996 Akahu, Submission in response to Payments NZ Authorisation Statement of Preliminary Issues (26 February 2024); Dosh, Submission in response to Payments NZ Authorisation Statement of Preliminary Issues (22 February 2024); PaySauce, Submission in response to Payments NZ Authorisation Statement of Preliminary Issues (23 February 2024); and Squirrel, Submission in response to Payments NZ Authorisation Statement of Preliminary Issues (26 February 2024), https://comcom.govt.nz/case-register/case-register-entries/payments-nz-limited

9.136.2 leads industry work on open banking;

9.136.3 operates a number of payment clearing systems; and

9.136.4 has a leadership role in modernising the payment system.

9.137 Industry contribution is critical for these important roles and will help minimise the need for regulatory interventions by government agencies. As noted at paragraph 9.105 above, the governance review is an opportunity to address ongoing concerns of the conflict of interest at Payments NZ Board level, and monitoring and reporting on progress provide an accountability check that will support industry confidence in Payments NZ work.[997]

We recommend a coordinated plan with milestone dates and industry commitment

9.138 There was a lot of industry support for open banking at our conference. Stakeholders told us, and we agree, that what is needed is a coordinated plan with milestone dates and accountability and that regulatory oversight is critical to success.

9.139 In Chapter 10, we recommend that industry and Government commit to delivering a series of ambitious milestones by June 2026 to ensure open banking's full potential is realised and work together to achieve them. If the Government accepts our recommendation, we propose to convene an open banking steering group, enabled by designation of the interbank network under the RPS Act. The steering group will coordinate across industry and government, develop a plan and seek industry commitment to achieve fully operational open banking by June 2026 and ensure progress accelerates in the crucial next 12 months.

9.140 While we have set milestones that we consider will see open banking fully operational, open banking and the development of API standards is a continuing and evolving process as needs and use cases develop over time. Our milestone is intended to accelerate progress towards June 2026. However, enduring regulator presence is necessary to drive progress beyond June 2026 and the currently envisaged use cases and to remove barriers as they appear.

9.141 Based on the work of our study, including stakeholder feedback, we have proposed a set of milestones that, if achieved by June 2026, would give us confidence that open banking is fully operational and its benefits are being fully realised.

9.141.1 **There is widespread and growing use of open banking-enabled services by consumers.** At paragraph 9.87 above, we have described the types of services that consumers may benefit from.

[997] For example, through our role in retail payments regulation.

9.141.2 **APIs enable a range of products and services.** The development of APIs has continued at pace both in depth and breadth, concentrating on those APIs most likely to bring new or improved services to the market. A range of third parties have been actively engaged in the industry process for standards development. Each of the larger banks is deploying the most recent version of APIs, and smaller banks and non-banks have made commitments for their implementation. There are performance standards in place for APIs, and performance is monitored and reported on. There is a transparent plan for ongoing development work.

9.141.3 **Partnering.** There is a standardised accreditation process recognised by all API providers. There are standard terms and conditions of partnering, and API providers can onboard new partners within a short time (for example, 2 weeks).

9.141.4 **Widespread use of APIs.** We expect to see widespread partnering between banks and fintechs, including individual fintechs who have partnered with each of the larger banks. We also expect to see non-banks become API providers and for banks to become third parties and partner with API providers. There are transparent, standardised, sustainable pricing structures that allow a range of viable business models for third parties while also providing a reasonable return for API Providers.

9.141.5 **Industry work efficiently integrated into the CPD framework.** Industry-led processes and work of the API Centre is of a suitable quality and is widely accepted by industry and government stakeholders such that government has confidence to adopt it with minimal changes in setting the initial requirements under the CPD Bill. Industry's ongoing role within the CPD framework is clear, and industry knowledge and expertise is effectively leveraged on an ongoing basis within the framework.

9.141.6 **Active participation in the digital identity market.** Banks should be actively participating in the digital identity market through both providing verified digital bank account number and identity credentials and accepting digital identity credentials from a wide range of third parties accredited under the trust framework. Key government agencies that hold identifying information should prioritise providing verified digital identity credentials. For example, DIA, which holds birth certificates and passports, MBIE, which knows the identity of all immigrants, and the MoJ, which may be able to support with digital identity for prisoners.

9.141.7 **Trust and confidence.** There is widespread use and acceptance by customers of open banking-enabled services and a reduction or discontinuation of riskier activities where an open banking alternative is available. There is publicly available information on open banking activities and performance.

Lessons from open banking in the UK and Australia

9.142 There are lessons from the implementation of open banking in the UK and Australia that can potentially be applied here. While there are some differences in the approach between the two countries and New Zealand, there are also similarities and overlap. For example, the innovation benefits of the depth of UK's approach (to introduce both read and write access), which is similar in depth to New Zealand's CDR, and the long-term potential of the breadth of Australia's cross-sector approach is similar to ours.

9.143 We heard positive feedback on the governance structure of the OBIE in the UK and the agreed timetable and project plan it produced.[998] The creation of OBIE was directed by the CMA following its 2016 market investigation. The CMA tasked OBIE to agree, consult upon, implement, maintain and make widely available, without charge, open and common banking standards.[999]

9.144 We have learned the following.

9.144.1 The CMA required the implementation entity to propose a project plan and timetable, which became the agreed timetable and project plan.[1000] This approach helped to provide certainty for investment and coordinate government and industry activities, and the agreement of the plan placed public accountability on the banks to deliver.

9.144.2 The governance structure of OBIE provided for focused and balanced sector engagement. There were equal voting rights between the CMA9 and other industry representatives,[1001] and we heard that participation of senior members of the CMA9 banks supported the appropriate focus and resourcing by the banks.[1002] It appears that there may have been too much power vested in the Independent Chair,[1003] and we consider that strong regulator leadership is necessary to manage conflicting interests.

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998 OBIE is now Open Banking Limited (OBL). See https://www.openbanking.org.uk/about-us/
[ ].

999 CMA "The Retail Banking Market Investigation Order 2017" (February 2017), p. 19, https://assets.publishing.service.gov.uk/media/5a759cc7ed915d506ee80283/retail-banking-market-investigation-order-2017.pdf

1000 CMA "The Retail Banking Market Investigation Order 2017" (February 2017), Article 10.5.

1001 The CMA9 refers to the nine largest banks in the UK as determined by the CMA at the time. Other industry representatives included representatives for fintechs, payment service providers, third parties and challenger banks. CMA "The Retail Banking Market Investigation Order 2017 – Explanatory Note" (February 2017), Schedule 1 Part A, https://assets.publishing.service.gov.uk/media/6101219cd3bf7f044ee52340/retail-banking-explanatory-note.pdf

1002 [ ].

1003 Alison White "Investigation of Open Banking Limited" (1 October 2021), p. 14, https://assets.publishing.service.gov.uk/media/6156c8fee90e071979dfeb2d/Independent_report.pdf

9.144.3 The establishment and task of the implementation entity was backed by the Retail Banking Market Investigation Order 2017, which provided a strong regulatory incentive for banks to comply. We consider that a strong regulatory backing is necessary here to overcome the conflicting interests of the banks. This is (in part) why we consider that the interbank payment network designation is necessary to support the proposed steering group.

9.144.4 For the Australian CDR, we understand that the Australian Treasury leading the development of API standards has made it challenging to win industry buy-in.[1004] The ACCC also led the implementation of necessary technical IT solutions. We see it as crucial for industry rather than government to lead the technical development of API standards and IT solutions to ensure that they are fit-for-purpose.

9.144.5 The Australian approach staged the implementation of functionality – initially implementing read access and delaying the implementation of action initiation. This has been identified as a key reason for the limited uptake of open banking in Australia.[1005] Both the UK and the proposed New Zealand CDR include the implementation of both read access and action initiation,[1006] which unlocks significant potential for open banking and payments.

We have recommended the Minister designate the interbank payment network to support the immediate and long-term progress of open banking

9.145 We have written to the Minister of Commerce and Consumer Affairs, recommending that he designate the interbank payment network under the RPS Act.[1007] Designation will enable us to use our full suite of regulatory tools to achieve the purpose of the RPS Act and would allow us to accelerate the progress of open banking ahead of the full CDR implementation.

9.146 Designation of the interbank payment network is a necessary tool to underpin our proposed open banking steering group. It would provide regulatory tools that will support buy-in of our proposed plan for fully operational open banking by June 2026.

1004 Internally, within the Treasury, the Data Standards Body (DSB) is responsible for developing the standards that dictate the procedures for data sharing under the CDR. Accenture "Consumer Data Right Strategic Review" (July 2024), at p7, https://www.ausbanking.org.au/wp-content/uploads/2024/07/CDR-Strategic-Review_July-2024.pdf. [ ].

1005 NatWest "Lessons Learned from Australia and the United Kingdom – The Consumer Data Right and Open Banking" (2023), p. 2.

1006 Referred to as write access in the UK.

1007 See Commerce Commission 'Retail payment system', https://comcom.govt.nz/regulated-industries/retail-payment-system

9.147 The timing of a banking designation under the CPD Bill and subsequent implementation is uncertain.[1008] Existing initiatives such as the API Centre's work on API standards and Payments NZ's work on an accreditation framework (subject to authorisation) must continue at pace in the immediate future.

9.148 There is opportunity for the industry to lead and deliver frameworks that align with government initiatives and promote competition in personal banking services. There is, for example, the opportunity that the industry's work on API standards and partnering framework could be adopted and applied through designation of the banking sector under a CPD Act.

9.149 In our view, broad and balanced industry engagement in the development of industry API standards and the accreditation framework will support MBIE to have confidence that:

9.149.1 the API standards and accreditation framework are competitively neutral; and

9.149.2 existing industry APIs would be suitable for adoption under the CPD Bill with few amendments.

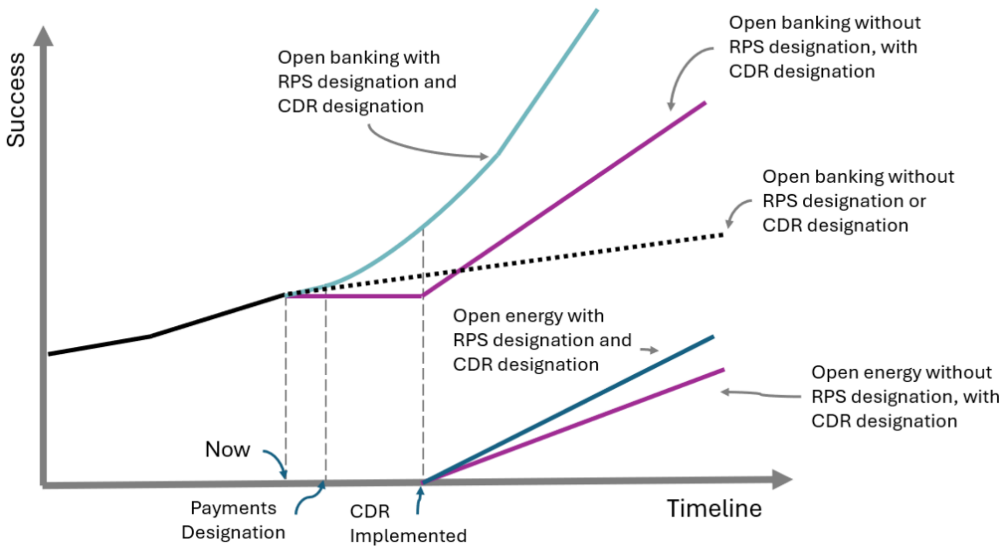
9.150 There is also opportunity for the industry's work to benefit frameworks and outcomes for other industries under a CDR, such as electricity.

9.151 The Commission can support this more immediate work. While designation will provide regulatory tools, it will also provide a more immediate credible threat that will enable us to begin work straight away. As legislation for designation is already in place, it is a fast and low-cost solution for bridging the gap until the CPD banking designation is operational. Without an RPS Act designation, there is a risk that progress will stall until the CPD Bill and associated regulations and standards are in place. An RPS Act designation could therefore bring forward implementation of open banking by around 12 months.

9.152 In Figure 9.1 below, we have depicted the approximate timeline and success of open banking with or without an interbank network designation.

1008 As noted above, the CPD Bill was introduced to the House on 16 May 2024 and was read for the first time on 23 July 2024.

Figure 9.1 Indicative timeline and success of open banking



Source: Commerce Commission.[1009]

9.153 As the general competition and payments regulator, the Commission can provide ongoing support for open banking as it evolves. Under a designation, the Commission would be able to address barriers to open banking within the payment system, including participant conduct, governance, pricing and adoption issues that cannot all be resolved under the CDR.

1009 The reference to designation in this chart refers to the potential designation of the interbank payment network.

Chapter 10 Recommendations | *Ngā tūtohunga*

Summary of recommendations

Improving competition for personal banking services requires multi-faceted solutions and our recommendations are designed to work together to support new entry and expansion, to reduce the regulatory barriers to competition and to empower consumers to get better prices and services.

Capitalise Kiwibank

1. **The Government, as Kiwibank's owner, should consider what is necessary to make Kiwibank a disruptive competitor, including how to provide it with access to more capital.** In the shorter term, capitalising Kiwibank appears to have the greatest potential to constrain the major banks and disrupt a market that is otherwise stable due to lack of competition.

Accelerate and co-ordinate progress on open banking

2. **Industry and the Government should commit to ensuring open banking is fully operational by June 2026.** In the medium to long-term, open banking has the greatest potential to promote ongoing disruptive competition for personal banking services. Commitment to ambitious milestones and coordinated work between industry and Government, particularly over the next 12 months, will bring early gains to consumers.
3. **The Government should support open banking by being an early adopter**, and taking an all-of-government approach to adopting payments enabled by open banking functionality. For example, by supporting new payment methods for taxes, welfare and Government services such as vehicle licensing. This will help build confidence in open banking and assist in developing a market for open banking-enabled products and services. Early adoption by Government will accelerate progress on open banking.

Ensure the regulatory environment better supports competition

4. **The Reserve Bank should broaden the way it undertakes competition assessments under the Deposit Takers Act and place more focus on reducing barriers to entry and expansion in the banking sector**. There is scope for the Reserve Bank to do this within its statutory framework while striking an appropriate balance between financial stability and competition.

Summary of recommendations (continued)

5. **The Reserve Bank should place greater emphasis on competition in specific upcoming decisions**. Competition would be improved if the Reserve Bank took upcoming opportunities to support competition in personal banking within its new regulatory framework by:
   - implementing more granular standardised risk weightings for home loans, and considering the merits of standardised risk weights specifically for lending for housing on Māori freehold land;
   - setting minimum capital standards that encourage new competitors;
   - permitting more entities to be a ‘bank’ and provide ‘banking services’;
   - widening access to ESAS accounts; and
   - reducing the risk rating of lending to housing co-operatives and community housing providers to lower, and more accurate, levels.

   We also recommend the Government introduce an initial flat-rate rate levy for the Depositor Compensation Scheme.
6. **The Government should ensure that existing legislation and future decisions do not unintentionally favour banks, particularly larger banks, over other providers.** The Government should review existing legislation that favours some providers (for example, registered banks) over others, particularly when prescribing where deposits must be held. The Government should also ensure future decisions are competitively neutral, even when made under urgency such as during a national emergency.
7. **The Government should lessen barriers to switching home loan providers as part of CCCF Act reforms.** The Responsible Lending Code should set out guidance making it easier for consumers to switch to lenders who offer better terms, including in a rising interest rate environment.
8. **The Government should prioritise competition concerns when reforming the AML/CFT regime.** Reforms to the AML/CFT regime should identify and prioritise opportunities to promote competition and access to personal banking services.

Empower consumers

9. **Industry should invest in making improvements to its switching service.** The bank-owned Payments NZ service needs improvement, starting with greater promotion of the service and monitoring and reporting on service standards.
10. **Home loan providers should present offers in a readily comparable manner, accounting specifically for the effective value of cash contributions.** Industry should create a standard means of comparing home loan offers across all providers such as through a single effective interest rate that incorporates the effect of cash contributions over the clawback period to help consumers compare the cost of different loan offers.

Summary of recommendations (continued)

11. **Home loan providers should pro-rate all clawbacks for mortgage adviser commissions and bank cash contributions.** Some clawback practices impose unjustifiable costs on consumers looking to switch lender. Competition would be promoted if consumers faced lower and more certain costs when switching home loan providers.

12. **Mortgage advisers and banks should make changes to promote price competition and choice for home loans.**

    - Banks’ processes need to improve to make it easier for mortgage advisers to submit multiple applications on behalf of their clients and more efficient for lenders to quickly process loan applications.
    - Banks should ensure that “conversion rate” targets for mortgage advisers (whereby a specific percentage of applications must be accepted) are not discouraging mortgage advisers from submitting qualifying home loan applications to multiple lenders as this reduces competition.
    - Advisers should highlight gaps in their panel to clients and identify any superior headline rates offered by providers outside of their panel.
    - Where possible, advisers should present at least three actual offers to their clients to ensure consumers are making informed choices.

    As the financial advice regulatory regime develops, the Financial Markets Authority should take steps to ensure that the mortgage adviser channel fulfils its potential to provide suitable advice that promotes price competition and consumer choice.

13. **Industry and the Government should prioritise reducing barriers to lending for housing on Māori freehold land.** Lenders should support existing successful models for lending for housing on Māori freehold land, including by explicitly considering joining the Kāinga Whenua Loan Scheme. The Government should address the unjustified level of scrutiny on Māori land trusts as part of its AML/CFT reforms.

14. **Industry should co-operate to make basic bank accounts widely available**, including minimum standards, promotion among relevant population groups and ensuring frontline staff are appropriately trained and supported.

Introduction | *Whakatakinga*

10.1 New Zealand's four largest banks – ANZ, ASB, BNZ and Westpac (the major banks) – do not face strong competition when providing personal banking services. There are limited constraints from outside the four major banks, and we have not observed consistently strong rivalry between them.

10.2 This chapter describes opportunities we have identified to disrupt the status quo and promote competition for personal banking services for the long-term benefit of consumers in New Zealand. Our recommendations are arranged into three themes.

10.3 Over time, the best prospect for greater competition in the sector, including between the large four banks, will come from our recommendations to accelerate open banking and to lower some of regulatory barriers to entry and expansion. Until those changes fully take effect, the best prospects to stimulate competition are in our recommendations to better capitalise Kiwibank, for industry to improve the bank switching service and changes to ensure that consumers are better able to assess competing home loan offers.

Capitalise Kiwibank | *Whakapūrawatia a Kiwibank*

1 – The Government, as Kiwibank's owner, should consider what is necessary to make Kiwibank a disruptive competitor, including how to provide it with access to more capital

10.4 The four major banks do not face strong competition when providing personal banking services.

10.5 Kiwibank appears to have the greatest potential to constrain the major banks in the near term and disrupt a market that is otherwise stable due to lack of competition. However, Kiwibank does not yet have the sufficient capital or the systems required to continuously challenge the major banks aggressively.[1010]

10.6 To change this the Government, as Kiwibank's owner, should consider increasing its access to capital and supporting a strategic refocus of Kiwibank's efforts to compete more strongly with the major banks (which could involve significant systems development).

1010 [ ].

10.7 We acknowledge concerns about Kiwibank's suitability to be a maverick disruptor, including its customer satisfaction ratings,[1011] Fair Trading Act charges,[1012] its state ownership[1013] and its efficiency and profitability.[1014] We also recognise that merely increasing the number of large competitors will not address the underlying factors affecting competition that we have identified. Nonetheless, we see this as an option worth exploring for the Government, as Kiwibank's owner, as it appears to be the best option in the short to medium term to meaningfully promote competition.

10.8 Capitalising Kiwibank may allow it to become a maverick disruptor in the short term, but without an explicit ongoing disruption mandate its conduct may become less aggressive over the longer term. In any case, promoting competition for personal banking services in a sustainable way over the longer term will require addressing the underlying factors affecting competition in a systemic way. This is what our recommendations in their entirety seek to achieve.

Accelerate and co-ordinate progress on open banking | *Ka whakatere ake, ka ruruku hoki i te koke haere i te pēke tuwhera*

2 – Industry and the Government should commit to ensuring open banking is fully operational by June 2026

10.9 There is near universal support for the proposal that open banking is an opportunity to promote competition for personal banking services.

10.10 To realise the full potential of open banking to promote competition, we recommend that industry and the Government commit to delivering a series of ambitious milestones by June 2026 and coordinate their respective work to ensure open banking's full potential is realised. This would deliver many of the early gains from open banking to New Zealanders ahead of what could be achieved otherwise. Crucially, it will accelerate progress over the next 12 months as the CPD regime is enacted and implemented.

1011 Consumer NZ, Submission on draft report (18 April 2024), p. 13.

1012 Commerce Commission "Kiwibank faces criminal charges following issues that caused over $7m in overcharges" (11 June 2024), https://comcom.govt.nz/news-and-media/media-releases/2024/kiwibank-faces-criminal-charges-following-issues-that-caused-over-$7m-in-overcharges

1013 Martien Lubberink, Submission on draft report (18 April 2024), p. 5; Monopoly Watch NZ, Submission on draft report (22 April 2024), p. 3.

1014 Dimitris Margaritis and Maryam Hasannasab "Market power in banking: A study of New Zealand banks" (March 2024).

10.11 Without a strong focus on implementation, there is a risk that momentum will be lost. Worse, poor execution risks further entrenching the existing major banks' position rather than stimulating competition. In response to stakeholders at our conference, who expressed support for a detailed 'roadmap' and regulator involvement,[1015] we think careful implementation with an actively engaged regulator will be needed to achieve the desired outcomes.

10.12 A designation for the Commission under the Retail Payment System Act would allow us to take an active role in coordinating action within and between industry and the Government. Designation could be made relatively quickly, giving us the tools to accelerate progress in the crucial next 12 months. Under a designation, the Commission would be able to address barriers to open banking within the payment system, including participant conduct, governance, payment system-wide pricing and adoption issues that cannot be resolved under the CPD regime.

10.13 If the Government accepts our recommendation, we will convene an open banking steering group within 2 months. Our proposed steering group would have the following characteristics.

10.13.1 **Membership:** we would invite senior staff from a broad and representative range of stakeholders, including across different segments of industry, the Government and consumer representatives.

10.13.2 **Mandate:** the steering group would have a wide mandate to consider what is necessary or desirable to accelerate the benefits of open banking across both industry and government.

10.13.3 **Functions:** the steering group would be tasked with:

10.13.3.1 **agreeing a set of milestones** to achieve thriving open banking by June 2026 across both industry and government;

10.13.3.2 **publishing a detailed plan**, including interim milestones and priorities, for how to achieve those milestones by June 2026;

10.13.3.3 **agreeing priorities and milestones beyond June 2026** to ensure that progress is ongoing;

10.13.3.4 **coordinating industry and government activity**; and

10.13.3.5 **monitoring and holding stakeholders accountable** for progress against the plan.

1015 Commerce Commission "Day 2 Personal banking conference– Session 5 Open banking (continued)" (14 May 2024), p. 2, (lines 13-18), p. 3 (lines 13-17), p. 8 (line 31) – p. 9 (line 10), p. 10 (line 23) – p. 11 (line 8).

10.14 The steering group would complement and coordinate existing work across industry and government. We would expect existing initiatives such as the API Centre's work on API standards and Payments NZ's work on an accreditation framework (subject to authorisation) to continue.

10.15 The steering group would be responsible for setting milestones for industry and the Government. Based on the work of our study, including stakeholder feedback, we have drafted a proposed set of milestones for consideration by the steering group that, if achieved by June 2026, would give us confidence that open banking is thriving. We describe these milestones and what achieving them would mean for consumers in Chapter 9.

10.16 We note that Kiwibank did not support its inclusion in targets for banks to accelerate the progress of open banking which we included in our draft report. It considered that its inclusion in those targets would unduly impact it and jeopardise its core systems investment programme. We are concerned that the exclusion of even one significant bank from open banking milestones could have an outsized influence and delay the realisation of benefits for consumers and businesses. Under our proposal, the commitments expected of Kiwibank could be reviewed by the steering group to ensure that progress is as rapid as possible.

3 – The Government should support open banking by being an early adopter

10.17 The Government should take an all-of-government approach and commit to being an early adopter of payments enabled by open banking functionality. This will help build confidence in open banking and assist in developing a market for open banking-enabled products and services. Early adoption by Government will accelerate progress on open banking.

10.18 Government is a large user of payment services across many domains, including tax, welfare, and sale of goods and services. Early and widespread adoption by Government of open banking-enabled payments can help drive consumer familiarity, and engender trust and confidence – one of the minimum requirements for a thriving API-enabled payments ecosystem. Familiarity with a single use case, like paying taxes or vehicle licensing (registration) fees can improve consumer sentiment and increase adoption of other use cases.[1016]

10.19 Early and widespread adoption by Government could also create significant demand for these types of services, providing businesses confidence to invest and a focus for improved functionality and innovation. We've heard that some parts of Government are reluctant or unwilling to adopt new payment methods until they are offered by the major banks and Kiwibank.[1017] We think this type of approach to adopting new payment methods risks unnecessarily delaying the benefits of open banking.

1016 Commerce Commission "Day 2 Personal banking conference– Session 4 Open banking" (14 May 2024), p. 20 (line 24) – p. 21 (line 5).

1017 Commerce Commission "Day 2 Personal banking conference– Session 5 Open banking (continued)" (14 May 2024), p. 1 (lines 20-25).

10.20 There are also likely to be significant benefits to Government. Open banking payments can be more secure and have potential to improve productivity and efficiency for Government.

Ensure the regulatory environment better supports competition | *Me whakarite kia pai ake i tā te taha ture tautoko i te whakataetaetanga*

10.21 Regulation shapes the environment within which competition for personal banking services takes place. Regulation might promote competition, be competitively neutral in effect or cut across competition to achieve other policy objectives. It can also have unintended consequences.

10.22 This section sets out recommendations that seek to ensure that the regulatory environment promotes competition where possible and limits the negative impact on competition where it is not and that unintended consequences are minimised.

4 – The Reserve Bank should broaden the way it undertakes competition assessments under the Deposit Takers Act and place more focus on reducing barriers to entry and expansion in the banking sector

10.23 The Reserve Bank is responsible for the most impactful regulation applying to personal banking service providers. The Reserve Bank's primary focus as a regulator is on stability of the financial system, including the soundness of each deposit taker. That said, its new regulatory framework (the DT Act) requires it to take account of secondary considerations, including those related to competition, proportionality and diversity. We acknowledge that the Reserve Bank's mandate constrains its ability to actively promote competition.

10.24 However, within its new framework, we think the Reserve Bank can improve the way it assesses and considers the impact on competition of its decisions. Our work has led us to question whether there could be a better balance between financial stability and competition outcomes – both of which have important benefits for the economy and consumers.

10.25 Our most significant recommendation to the Reserve Bank is that it reviews the *way* it assesses the competitive impacts of its actions.

10.25.1 The Reserve Bank should use a definition of competition that emphasises competition as a dynamic process, the importance of entry and expansion (including the threat of) and the role of competition in disciplining firms that are inefficient or not otherwise meeting consumer preferences.

10.25.2 The Reserve Bank should explicitly and transparently articulate how its actions impact competition and, if they negatively impact competition, explain why such a trade-off is necessary or desirable to achieve a given level of stability.

10.26 We consider there is scope within the Reserve Bank's existing statutory framework for it to focus more closely on whether its policy proposals and priorities impose the least possible restrictions on competition and on the entry and expansion prospects of smaller providers.

10.27 If the Government wants a greater focus on competitive outcomes, it will need to consider other options that could include providing direction to the Reserve Bank, change to its statutory framework or consideration of its role in advising on legislative policy.

5 – The Reserve Bank should place greater emphasis on competition in specific upcoming decisions

10.28 Regardless of the Reserve Bank's response to our recommendation above, we set out below specific examples of upcoming opportunities for it to better support competition in personal banking within its new regulatory framework. Action in these areas should happen as quickly as possible to support competition and allow open banking to develop rapidly.

Prioritise more granular standardised risk weightings

10.29 We recommend the Reserve Bank prioritises developing more granular standardised risk weightings to help further level the playing field between the major banks and other providers (Kiwibank, the smaller banks and NBDTs) particularly when it comes to home loans.

10.30 We also recommend the Reserve Bank consider the merits of developing standardised risk weights specifically for lending for housing on Māori freehold land.

Lower minimum capital thresholds for new providers

10.31 We recommend that, under the DT Act, the Reserve Bank sets any new minimum capital values at levels that encourage new entry into the sector and do not put existing providers at risk of having to exit. The minimum standards have been $30m for bank registration, and the Reserve Bank is considering much lower levels of $5m to $10m for deposit takers.

Permit more entities to call themselves banks

10.32 We recommend that, under the DT Act, the Reserve Bank permits the broadest possible range of providers to use restricted words like 'bank' and 'banking services'– whether or not they are deposit takers.

10.33 This should enable businesses that provide personal banking services to describe those services as such and enhance their ability to compete.

Widen access to ESAS accounts

10.34 We recommend the Reserve Bank broaden access to ESAS accounts as part of its review of ESAS access policy and criteria. Broader access to ESAS accounts will benefit both innovation and competition through its use as an input into payment services as well as an account that provides access to OCR returns.

Reduce the impact of the DCS levy on smaller providers

10.35 We are not convinced that the benefits of a risk-based levy imposed on providers to fund the new DCS outweigh the adverse impacts on smaller players. If there is to be a risk-based levy, we see little justification for profitability to be one of the factors determining risk levels – particularly given our findings that large banks are an oligopoly earning greater levels of profit than would be expected in a competitive market.

10.36 We recommend that the Government introduces a flat-rate levy (per dollar of insured assets) in the first 5–10 years of the scheme until we have more information on the costs and benefits of the scheme. There is little evidence on the relative risks to the fund from different sized entities, especially given the current changes to regulatory settings. In addition, we saw no indication that the potential systemic risks of a large bank failure have been considered to date in considering the approach to setting levy rates.

10.37 If risk-based levies are maintained, we recommend removing or reducing the weight on profitability as an indicator of risk (and, if maintained, ensuring that it takes adequate account of not-for-profit providers).

Support mortgage lending to housing cooperatives and community housing providers

10.38 We recommend the Reserve Bank implements a retail (as opposed to a corporate) classification of risk for mortgage-backed lending to housing cooperatives and community housing providers (including standardised risk weightings). This would reflect that the level of risk associated with this lending is more akin to the risk associated with residential mortgage lending rather than corporate lending and should mean that that type of lending is more available to borrowers and is provided on more favourable terms.

10.39 This recommendation, if implemented, may also assist with building papakāinga on Māori freehold land, as discussed in Chapter 3.

6 – The Government should ensure that existing legislation and future decisions do not unintentionally favour banks, particularly larger banks, over other providers

10.40 In Chapter 7, we outline a number of small but pervasive examples where legislation and Government decision-making appear to have unintentionally favoured major banks (and disadvantaged other banks and non-bank providers) or ignored the existence of non-bank providers entirely. These include where requirements in legislation are described with respect to the form or regulatory status of an entity without apparent consideration of the underlying outcomes sought and where decisions are made under urgency.

10.41 These laws and decisions have limited or are limiting the ability of smaller providers to compete. Although most of the examples are relatively narrow in scope and it appears the negative effect on competition is unintended, they have had the effect of helping to sustain the current two-tier oligopoly and limiting smaller providers' ability to compete.

10.42 We recommend that the Government and regulators:

10.42.1 consider the effect on competition of all future decisions;

10.42.2 prepare guidance ahead of time for considering the competitive effect of decisions made under urgency, drawing on our Competition Assessment Guidelines;

10.42.3 review existing legislation to ensure it is competitively neutral unless justified by other policy considerations; and

10.42.4 review the various legislative provisions requiring money to be held in certain types of institutions so as to be competitively neutral between deposit takers.

7 – The Government should lessen barriers to switching home loan providers as part of CCCF Act reforms

10.43 In circumstances where a borrower is seeking to refinance a home loan, we recommend that guidance in the Responsible Lending Code is revised to make it clear that a new lender offering the same or better terms to the borrower as the existing lender can choose to make less extensive affordability inquiries (unless there is evidence of payment difficulties with the existing loan). This should be the case even in a rising interest environment. Addressing this issue will help remove one of the barriers to switching home loan providers where CCCF Act processes have in the past advantaged existing lenders over any rivals during the term of a home loan.

8 – The Government should prioritise competition concerns when reforming the AML/CFT regime

10.44 Our study has identified several ways in which New Zealand’s AML/CFT regime negatively impacts competition for personal banking services. Some of these impacts appear to be unintentional and unnecessary for achieving the purposes of the AML/CFT regime. A 2022 statutory review of the AML/CFT Act by the MoJ acknowledged the potential for serious negative and unintended consequences of misapplying AML/CFT measures, including financial exclusion and closing bank accounts of risky businesses.[1018] Many of the issues we identify in our study are already the subject of recommendations from the 2022 review – although many important recommendations have not yet been implemented.

10.45 Associate Minister of Justice Hon. Nicole McKee recently signalled an intention to reform New Zealand’s AML/CFT regime with a focus on improving its effectiveness and efficiency as a whole.[1019]

1018 MoJ “Report on the review of the Anti-Money Laundering and Countering Financing of Terrorism Act 2009” (July 2022), para 460.

1019 Gareth Vaughan “Associate Minister of Justice Nicole McKee sets sights on reforming anti-money laundering laws” (16 May 2024).

10.46 We support this review and many of the MoJ's recommendations and recommend the Government prioritise opportunities to strengthen competition as part of the reform process, including those we identify below. Changes could be made as part of the reform process or delivered more quickly through existing exemption powers in the AML/CFT Act.[1020]

Reducing address verification requirements could help vulnerable customers and reduce switching barriers

10.47 The 2022 MoJ report recommended "significantly reducing address verification requirements" and exploring whether further regulatory exemptions are necessary to address financial inclusion challenges.[1021]

10.48 We support these recommendations because they may help address financial inclusion issues we have identified, including reducing barriers to accessing basic banking services. We also support them because they would remove some of the complexity of switching generally and especially for vulnerable customers.

The unjustified level of scrutiny on Māori land trusts should be reduced

10.49 The 2022 MoJ report made several recommendations in the context of the unjustified level of scrutiny on Māori land trusts imposed by the AML/CFT regime. These include relaxing mandatory requirements to conduct ECDD of Māori trusts, providing clarity on terms of being a beneficial owner and allowing alternative sources of information to verify identity.[1022] Some have been implemented and some are yet to be considered by the Government and the relevant regulators.

10.50 Our view is that competition would be promoted by reducing the regulatory burden imposed on Māori land trusts under the AML/CFT Act. We recommend that the Government prioritises this issue in its AML/CFT reforms, engages with Māori stakeholders to find solutions and makes the necessary policy and legislative changes to reduce the unjustified level of scrutiny on Māori land trusts imposed by the AML/CFT.

Licensing fintechs may improve their access to banking services

10.51 The 2022 MoJ report recommended that AML/CFT supervisors develop a code of practice for reporting entities (banks in particular) to onboard high-risk businesses and that there should be a licensing framework applied to high-risk sectors.[1023]

1020 AML/CFT Act, s 157.

1021 MoJ "Report on the review of the Anti-Money Laundering and Countering Financing of Terrorism Act 2009" (July 2022), pp. 145–146 and 193–194.

1022 MoJ "Report on the review of the Anti-Money Laundering and Countering Financing of Terrorism Act 2009" (July 2022), p. 101.

1023 MoJ "Report on the review of the Anti-Money Laundering and Countering Financing of Terrorism Act 2009" (July 2022), pp. 144–145.

10.52 We consider that the MoJ's approach could benefit fintechs seeking to open bank accounts to start new businesses and recommend the Government explore ways to reduce the actual and perceived risks to banks under the AML/CFT regime when providing bank accounts to fintechs.

Empower consumers | *Te whakakaha kaiwhakapeto*

10.53 Barriers to consumers shopping around and switching between providers limit competition. This section identifies opportunities to empower consumers to seek out and switch to providers that best meet their needs and to benefit from the value and choice that competition can bring.

9 – Industry should invest in making improvements to its switching service

10.54 It is fundamental to improving competition for personal banking services that consumers more actively engage with the market, consider their options and are empowered to easily switch to providers that best meet their needs.

10.55 New Zealand's bank account switching service established by Payments NZ does not currently fulfil its potential to do any of these things and is not strongly or consistently promoted by the banks. There are no publicly available statistics on its performance (despite a Productivity Commission recommendation in 2014 to collect and publish statistics on the service to demonstrate its effectiveness).[1024]

10.56 We have considered whether it is necessary to create a switching service independent of Payments NZ and/or impose any formal government oversight of the service. However, at least in the first instance, we consider that the fastest and most cost-effective option to improve consumer outcomes is to allow industry an opportunity to build on the Payments NZ switching service.

10.57 We recommend that industry enhances the Payments NZ transaction account switching service with the following features:

10.57.1 **Visible.** The service and the benefits of engaging with the market should be much more actively promoted by the banks and Payments NZ.

10.57.2 **Transparent and accountable.** KPIs for the service should be set and performance against those KPIs monitored and reported on. For example, the service should collect and publish statistics on how often it is used and how it meets quality measures such as time to switch.

1024 New Zealand Productivity Commission "Boosting productivity in the services sector" (May 2014), p. 114.

10.57.3 **Better functionality.** The service should continue to evolve in response to consumer demand and preferences with a focus on reforms being informed by consumer research and engagement. An initial focus should be how to enable a comprehensive move from one provider to another, including recurring outgoing payments, incoming payments (redirection service of at least 3 years), overdrafts, transaction history and payment recipients. This would address the major hassles we have heard about.

10.57.4 **Guaranteed minimum standards.** The service should include guaranteed minimum standards for the timeliness and quality of the switch backed by an undertaking to provide compensation in the event of loss caused by a failure to meet the guarantee. This would be consistent with the standard of service offered in the UK by the CASS.

10.57.5 **Future proof.** The service should be open to new participants, new product features and the arrival of open banking.

10.57.6 **Appropriately funded.** Payments NZ indicated in its submission that it was willing and able to provide greater visibility on the performance of the service and investigate enhancements to it.[1025] Payments NZ must be appropriately resourced to take on this task, and we think it appropriate that its current owners support it financially to do so.

10.58 If the Government supports these recommendations, we intend to monitor industry progress and would invite the Government to intervene if industry progress appears slow or to stall.

10 – Home loan providers should present offers in a readily comparable manner, accounting specifically for the effective value of cash contributions

10.59 Competition would be promoted by home loan providers being more transparent with consumers about pricing practices and policies and by making it easier for consumers to assess which products and providers best meet their needs.

10.60 We recommend that home loan providers present their offers in a way that is more easily understood and makes it straightforward for consumers to compare products and offers across different providers. Specifically, we recommend that industry creates a standard means of comparing home loan offers across all providers, including a single effective interest rate that incorporates the effect of cash contributions over the clawback period, to help consumers compare the cost of different loan offers. This information would be particularly useful for first-home buyers who do not face the additional financial costs of switching such as break fees, administrative costs and professional fees. The specific information that must be presented should be informed by consumer testing to ensure it is effective and relevant to consumer switching decisions.

1025 Payments NZ, Submission on draft report (18 April 2024), pp. 5–6.

10.61 If the Government supports these recommendations, we intend to monitor industry progress and would invite the Government to intervene if industry progress appears slow or to stall.

11 – Home loan providers pro-rate all clawbacks for mortgage adviser commissions and bank cash contributions

10.62 Some industry practices by lenders, aggregators and mortgage advisers around adviser commission clawbacks and cash contribution clawbacks are imposing an unjustifiably high financial disincentive on consumers switching home loan providers. Competition would be promoted if consumers faced lower and more certain costs when switching home loan providers. These costs relate to clawbacks that are common for adviser commissions and cash contributions paid by lenders (discussed in Chapter 4).

10.63 We recommend home loan providers change their practices around clawback of commissions and cash contributions so that the clawback amounts recovered from consumers or advisers are pro-rated, diminishing on a linear basis and calculated monthly.

10.64 For commission clawbacks, we also recommend pro-rated arrangements are limited to a maximum of 24 months. For commission clawbacks, the clawback period is even more important than the clawback amount. This is because adviser-client contracts typically require consumers to pay a fee for service if the client's actions trigger a commission clawback from adviser to lender. While consumers must be made aware of the risk and consequences of commission clawback when taking out a loan, consumers may soon forget these obligations. A shorter clawback period in conjunction with more granularity of commission clawbacks should reduce the need for advisers to charge fees to consumers that may be unexpected.

10.65 This recommendation will likely require changes to the contractual relationships between the relevant parties (lenders, aggregators, mortgage advisers and borrowers).

10.66 If the Government supports these recommendations, we intend to monitor industry progress and would invite the Government to intervene if industry progress appears slow or to stall.

12 – Mortgage advisers and banks should make changes to promote price competition and choice for home loans

10.67 There are aspects of the mortgage advice industry, including aspects of the lender, aggregator and mortgage adviser relationship, that could be improved to promote competition and good outcomes for consumers generally. Mortgage advisers should be champions of price competition, while continuing to provide holistic financial advice.

10.68 We recommend that home loan providers make two changes to make it easier for mortgage advisers to focus on price and choice of provider.

10.68.1 Lenders should proactively work with aggregators and advisers to increase standardisation of data exchange within the industry, including consideration of adopting a common data standard (such as the LIXI standard), increased standardisation of home loan applications and greater use of automated systems.

10.68.2 Lenders should stop current behaviours that discourage advisers from acquiring prices from multiple lenders. In particular, the implicit and explicit restrictions and discouragement to advisers placing more than one or two qualifying applications per client must stop. This means that lenders should not use conversion rates to measure adviser performance and remove contractual or accreditation requirements that set minimum targets for conversion rates to assess the quality of adviser performance. Lenders should not otherwise seek to limit the number of applications an adviser makes on behalf of its clients without clear references to evidence of poor quality (incomplete and inaccurate) applications or adviser misconduct.

10.69 Lenders can mitigate the cost of processing more applications by investing in better and more-efficient systems. They could also employ other mitigants to reduce the incidence of wasted application processing by making it easier for advisers (and consumers) to access conditional rate quotes early in the engagement process. This could include having more granular advertised prices that better reflect the wide range of consumers and property risk profiles or being more transparent about the range of discretionary discounts that are available if borrowers meet certain conditions.

10.70 We have also identified opportunities for mortgage advisers to drive good outcomes for consumers by promoting stronger competition for home loans. As the new regulatory regime for financial advisers continues to settle in, we think there is an opportunity for the sector to focus more strongly on getting the *best* outcome for consumers. This opportunity is discussed in more detail in Chapter 4. It includes a stronger focus on price and choice, enhanced disclosure and considering a broader range of providers. For example, advisers should, where possible, present at least three actual offers for their clients to consider, and should highlight gaps in their panel to clients and identify any superior headline rates offered by providers outside of their panel.

10.71 It is too early to assess whether the current New Zealand mortgage adviser regulatory regime will effectively promote pro-competitive behaviour from the banking sector. However, Australia provides a clear example of how the adviser channel can do more to support competition between lenders while continuing to be predominantly paid by commissions. For advisers to promote more competition in New Zealand will require policy settings to evolve to ensure that advisers work in consumers' best interests. This does not necessarily require copying the ASIC regime, but it does require the whole sector, with the FMA's oversight, to emphasise the importance of promoting those factors that will result in stronger competitive outcomes.

10.72 We recommend that, as the regime develops, the FMA takes steps to ensure that the mortgage adviser channel fulfils its potential to provide suitable advice that promotes competition and choice.

10.73 If the Government supports these recommendations, we intend to monitor industry progress and would invite the Government to intervene if industry progress appears slow or to stall.

13 – Industry and the Government should prioritise reducing barriers to lending for housing on Māori freehold land

10.74 The options available for Māori to secure finance for housing on Māori freehold land are limited. In Chapter 3, we discuss some of the factors affecting this limited availability. These factors increase the cost for providers to supply these loans, reducing competition to supply them and limiting the choice of providers available to Māori.

10.75 There are existing initiatives by banks, Māori, iwi and Government to overcome barriers to Māori securing finance for housing on Māori freehold land. We recommend these parties continue to explore ways to replicate and build on the success of existing initiatives by expanding their scope, scale and participation.

10.76 We consider there is greater scope for successful models to be shared and used by more providers. In particular the Kāinga Whenua Loan Scheme is a mature initiative that assists Māori to achieve home ownership on Māori freehold land. The scheme is currently operated by Kāinga Ora and Kiwibank. However, the scheme is open to other providers and has recently been reviewed, with changes being rolled out to better meet customer demand. We recommend all home loan providers and in particular the major banks explicitly consider joining the scheme within the next 12 months.

10.77 If the Government supports these recommendations, we intend to monitor industry progress and would invite the Government to intervene if industry progress appears slow or to stall.

10.78 Competition law is sometimes perceived as a barrier to greater cooperation between competing providers on initiatives to better enable Māori to access lending for housing on Māori freehold land.[1026] On the face of it, we think there is greater scope for cooperation of this nature within the bounds of competition law and the recent collaboration guidelines we have published.[1027] We welcome interested parties to contact us if they have a specific proposal they would like to discuss.

1026 [ ].

1027 Commerce Commission "Collaboration and Sustainability Guidelines" (November 2023), https://comcom.govt.nz/__data/assets/pdf_file/0033/335985/Collaboration-and-Sustainability-Guidelines-30-November-2023.pdf

10.79 We also consider that competition would be promoted by reducing the regulatory burden imposed on Māori land trusts under the AML/CFT Act to the extent that the current level burden is unjustified with respect to the purposes of the AML/CFT regime. We make a separate recommendation to the Government regarding upcoming reforms to the AML/CFT regime.

10.80 We have made separate recommendations to the Reserve Bank to consider the merits of developing standardised risk weights specifically for lending for housing on Māori freehold land, and to implement a retail classification of risk for mortgage-banked lending to housing co-operatives and community housing providers. Each of these recommendations, if implemented, may also reduce barriers to lending for housing on Māori freehold land.

14 – Industry should cooperate to make basic bank accounts widely available

10.81 Although being unbanked is not common in New Zealand, its negative impacts are significant. Not having or using a bank account can have far-reaching consequences for people's lives, including difficulty receiving wages, salary and benefits, reduced access to credit and being vulnerable to exploitation.[1028] Lack of access or reduced access to personal banking services lessens the choice and value consumers can gain from competition.

10.82 We recommend that industry work to ensure widespread availability and awareness of basic bank accounts. This would include agreeing minimum standards for basic bank accounts, a coordinated approach to rolling them out, a plan to ensure awareness of their existence among relevant population groups, promoting their availability to suitable customers and ensuring frontline staff are appropriately trained and supported.

10.83 We recommend that industry work closely with CoFR to leverage its existing knowledge and ongoing research into this topic.

10.84 We also recommend the Government, including the Reserve Bank, monitor industry progress and is prepared to intervene if progress is slow or stalls.

Improving competition requires multi-faceted solutions | *Mā ngā rongoā maha e pai ake ai te whakataetaetanga*

10.85 Our recommendations seek to promote competition by addressing the factors we have identified as affecting competition for personal banking services in New Zealand. Addressing these factors will enhance competition between the major banks and reduce barriers to competition for those seeking to challenge them by encouraging market entry and expansion for innovative players and empowering consumers to make informed decisions about their banking providers.

1028 Westpac "Westpac NZ Access to Banking in Aotearoa Report" (April 2023), p. 2; [ ].

10.86 It is important our recommendations are considered as a whole. The current state of competition is being reinforced by several interrelated factors, some of which have been operating for many years. Our recommendations are similarly interrelated. Some will have an impact in the shorter term while others will likely take several years to come into effect. Taken together, we expect them to promote competition in personal banking services for the long-term benefit of consumers.

10.87 We would also expect our recommendations, if implemented, to reduce the potential for accommodating behaviour between the major banks. The most effective way of reducing this risk and disrupting any coordination that is occurring is to introduce a stronger challenger or challengers, reduce switching barriers and encourage more consumers to engage and be prepared to change providers. This is what our suite of recommendations aims to achieve.

10.88 The focus of our study has been identifying and addressing factors affecting competition. We acknowledge that competition is rarely the only relevant factor when policy decisions are being made. The regulatory environment for the personal banking sector has strong and sometimes conflicting policy goals. We have sought to identify opportunities to promote competition without compromising other policy goals.

10.89 We acknowledge the feedback that many of our recommendations will require industry to do more, when one of our findings is that obligations imposed by regulators have contributed to the current state of limited competition. Many of our recommendations are addressed to industry in the first instance with Government oversight and intervention only to the extent necessary and contingent on industry inaction. We do not assume that regulation is the best answer, and our approach gives industry the opportunity to address issues in a flexible and efficient manner while also holding them accountable if this opportunity is not taken up.

10.90 In responding to our recommendations addressed to industry, we suggest the Government set clear deadlines for industry and clear consequences if those deadlines are not met. We think 12 months is sufficient time for industry to implement most recommendations. We think this approach would benefit from industry producing implementation plans with specific milestones that can be used to monitor and track delivery and regular reporting against the plans and milestones. This will reduce the need for government intervention and support the Government to act in a timely manner where necessary.

10.91 We can assist the Government to monitor and assess industry progress on our recommendations.

10.92 Competition law may be perceived as a barrier to industry working together to address our recommendations. There is scope for industry to cooperate in response to our recommendations within the bounds of competition law and the recent collaboration guidelines we have published.[1029] We welcome contact from industry if there are specific concerns about where competition law might constrain them in progressing our recommendations.

1029 Commerce Commission "Collaboration and Sustainability Guidelines" (November 2023).

Attachment A Overview of the personal banking services industry | *Tirohanga whānui ki te ahumahi ratonga pēke whaiaro*

The financial system plays a fundamental role in the functioning of our economy

A1 The financial system and its participants contribute to economic development by providing services necessary for economic activity such as clearing and settlement systems to facilitate trade, channelling financial resources between savers and borrowers and providing methods of payment.

A2 The financial system is constituted by institutions, markets and infrastructures that interact between themselves and with their customers to help New Zealanders in their work, the set-up and running of a business, saving, spending, obtaining insurance and investing.

A3 The interaction between the financial entities and their customers is what creates a financial system that facilitates the distribution of financial resources and supports economic development.

A4 The financial system is a large ecosystem that includes not only banks and other non-bank lending institutions but also financial market infrastructures, investment platforms (such as managed funds, KiwiSaver and shares), financial markets (such as foreign exchange, swaps and bonds) and insurance.[1030]

A5 Within this more complex ecosystem, banks, non-bank lending institutions and finance companies are the major providers of personal banking services. The range of personal banking services is discussed in Chapter 1.

The New Zealand banking system is relatively simple

A6 The New Zealand banking system has been described as plain vanilla due to the fact that a large proportion of the bank assets are loans to households and businesses and their funding is mainly sourced (as shown in Figure A1) from deposits and equity rather than other securitisation channels.[1031,1032]

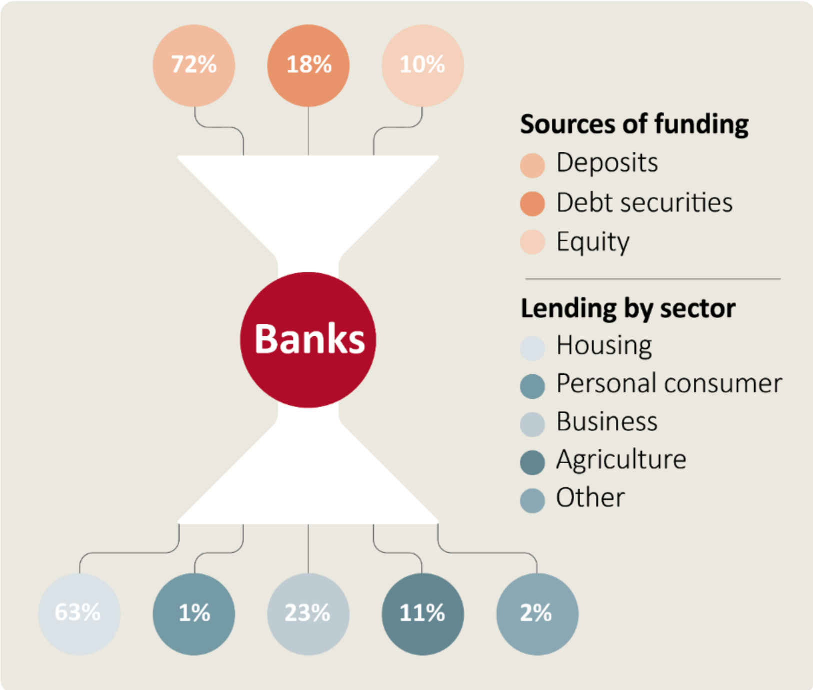
1030 Financial market infrastructures are systems or arrangements that facilitate the clearing, settlement and recording of payments, security, derivatives and other financial transactions: Reserve Bank "Financial market infrastructures" (13 December 2021), https://www.rbnz.govt.nz/financial-stability/about-the-new-zealand-financial-system/financial-market-infrastructures

1031 Reserve Bank "The role of banks in the economy – improving the performance of the New Zealand banking system after the Global Financial Crisis" (6 August 2011), https://www.rbnz.govt.nz/hub/publications/speech/2011/speech2011-08-06

1032 Securitisation is a process through which a pool of assets (typically home loans, which are an illiquid asset) are packaged and sold as marketable securities. This transforms long-term illiquid assets into tradeable liquid assets. These assets are sold to other financial institutions or investors, freeing up capital for the original lender to expand its lending operation.

A7 Figure A1 shows the different sources of funding that registered banks in New Zealand use, their relative size and the sectors that registered banks lend to. The numbers used in Figure A1 are illustrative only and are intended to provide a sense of the relative significance of each source of funding and each lending sector.

Figure A1 Sources of registered bank funding and sector lending



Source: Commerce Commission with data from the Reserve Bank.[1033]

A8 Registered banks are prudentially supervised by the Reserve Bank and are allowed to refer to themselves as a bank (the term is otherwise restricted). Registered banks' business activities primarily consist of the borrowing and lending of money or the provision of other financial services. This is also true of a range of non-bank businesses (such as NBDTs, non-bank lending institutions and fintechs) that offer personal banking services. Registered banks are the primary providers of deposit accounts and home loans, which are the personal banking services of primary interest in this study.

A9 Banks also offer services in other areas such as insurance, financial advice, wealth management (including KiwiSaver) and other financial services provided to corporate, business and personal customers in competition with non-banks.

1033 Reserve Bank "Banks: Balance sheet (S10)", https://www.rbnz.govt.nz/statistics/series/registered-banks/banks-balance-sheet; Reserve Bank "Banks: Assets – Loans by sector (S30)", https://www.rbnz.govt.nz/statistics/series/registered-banks/banks-assets-loans-by-sector [ ].

Banks dominate the New Zealand financial system and a few overseas-owned entities dominate the banking sector

A10 The New Zealand financial system is dominated by registered banks that do most of the lending to the non-financial private sector in New Zealand. Lending by non-bank lending institutions accounts for only 4% of lending to this sector (Figure A2).

A11 Despite banks' dominance of the financial system, New Zealand's banking sector is quite small by international standards. In March 2022, banks had total assets of just over NZ$667b. This is around 188% of our GDP and is at the lower end of the range for OECD countries.[1034]

Figure A2 Lending by financial institution type (bank and non-bank) and by bank ownership type (December 2023)

Source: Commerce Commission with data from the Reserve Bank.[1035]

A12 ANZ, BNZ, ASB and Westpac represent 87% of the total bank assets in New Zealand in the March 2024 quarter.[1036] All four banks are overseas owned and are each subsidiaries of Australian banks.[1037] Their parent entities ANZ Group Holdings, NAB, CBA and Westpac Banking Corporation are the four largest banks operating in Australia. Figure A3 shows the total assets of banks operating in New Zealand.

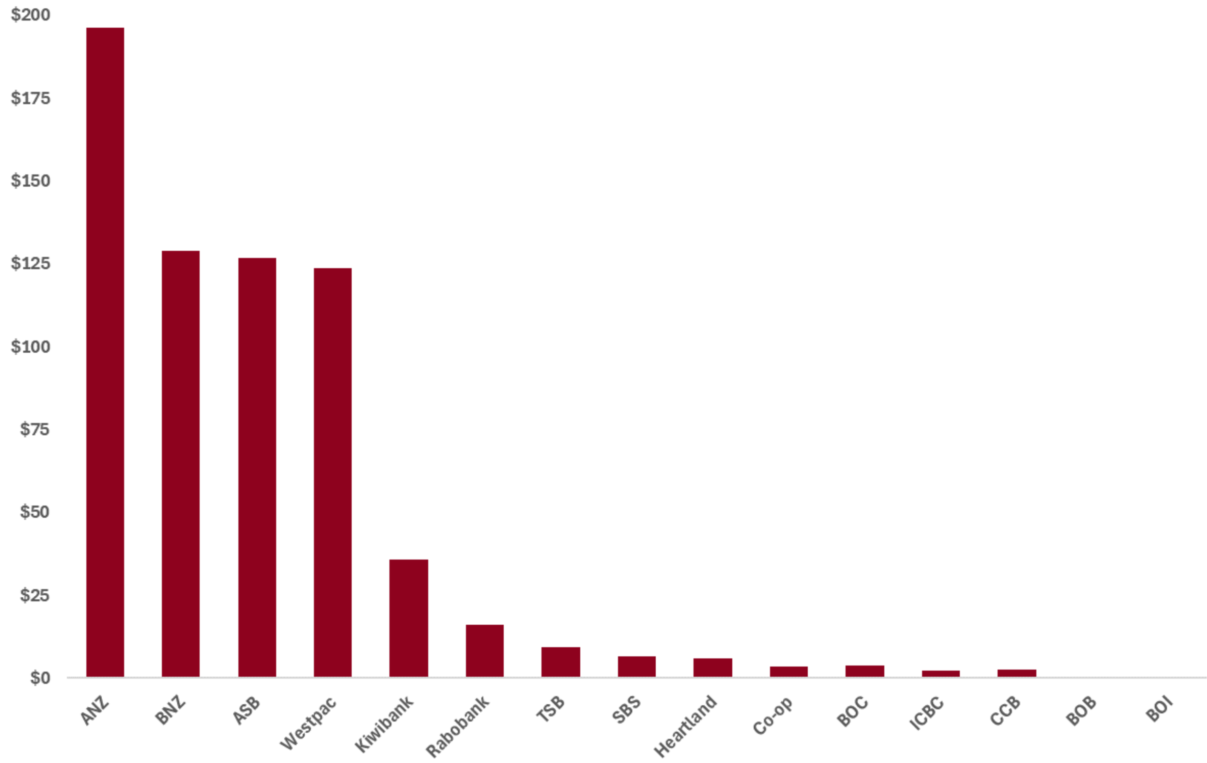
1034 Reserve Bank "The banking sector" (18 May 2022), https://www.rbnz.govt.nz/financial-stability/about-the-new-zealand-financial-system/the-banking-sector

1035 Reserve Bank "Bank Financial Strength Dashboard" and Reserve Bank "Registered banks and non-bank lending institutions: Sector lending (C5)", https://www.rbnz.govt.nz/statistics/series/lending-and-monetary/registered-banks-and-non-bank-lending-institutions-sector-lending [ ].

1036 Commerce Commission analysis of Reserve Bank Bank Financial Strength Dashboard [ ].

1037 See Companies Office for ANZ (https://app.companiesoffice.govt.nz/companies/app/ui/pages/companies/35976); ,BNZ (https://app.companiesoffice.govt.nz/companies/app/ui/pages/companies/428849); ASB (https://app.companiesoffice.govt.nz/companies/app/ui/pages/companies/398445); and Westpac (https://app.companiesoffice.govt.nz/companies/app/ui/pages/companies/1856466).

Figure A3 Bank total assets ($b) as at the March 2024 quarter



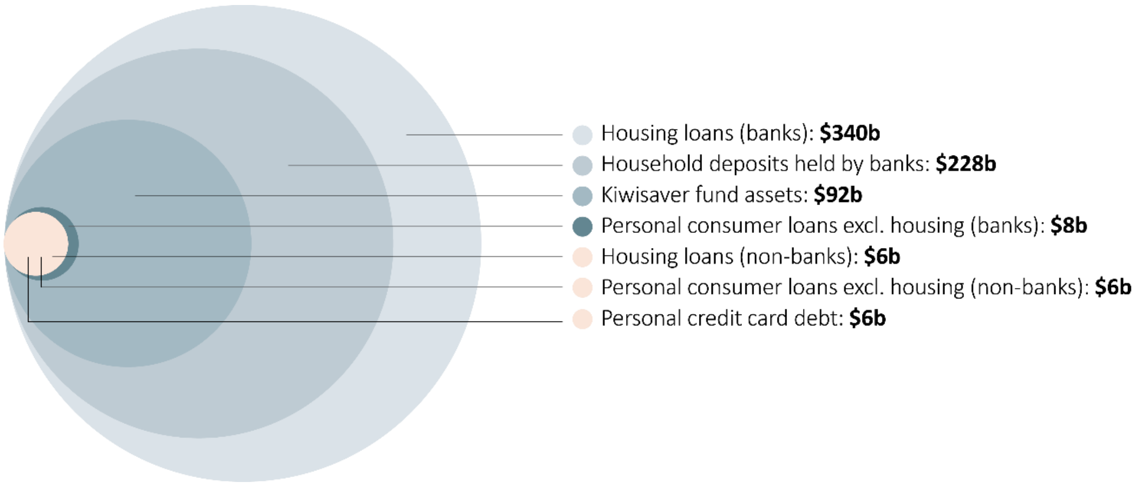
Source: Commerce Commission with data from the Reserve Bank.[1038]

Banks offer a variety of personal banking services but increasingly focus on housing loans

A13 Housing loan and household deposits constitute the most significant personal banking products offered by the banks (by value), as highlighted in Figure A4.

1038 Reserve Bank "Bank Financial Strength Dashboard" [ ].

Figure A4 Relative size of selected personal banking services (December 2022)



Source: Commerce Commission with data from the Reserve Bank.[1039]

A14 Increasingly, banks in New Zealand appear to be focused on core business products, particularly home loans and deposits, and have reduced their exposure to other types of financial services. Examples of this include ANZ's sale of UDC Finance to Shinsei Bank in 2020, Kiwibank's sale of Kiwi Wealth to Fisher Funds in 2022, and divestment from life insurance and unsecured personal lending products by several banks.[1040,1041] Banks may still offer these products as intermediaries.

A15 It is also apparent that, over the past few years, housing loans have acquired an increasing importance for the banks' lending portfolio. Figure A5 reflects how, between December 2016 and December 2023, housing lending has increased from 56.19% to 62.82% of all bank loans. There are several potential factors at work, including sharp increases in housing prices, changing risk appetite and changes in the regulatory environment.

A16 Over the same period, there has been a 5% drop in share of business and agricultural loans in total bank lending (from 38.3% to 33.5%). Consumer lending has remained comparatively small, with a decreasing percentage of the portfolio composition in the period.

A17 The shift towards residential housing can also be seen through changes in total dollar value lending by banks to sectors over this period. Housing lending increased by 53%, business lending increased by 28%, agricultural lending growth held at 4% and consumer lending decreased by 35%.[1042]

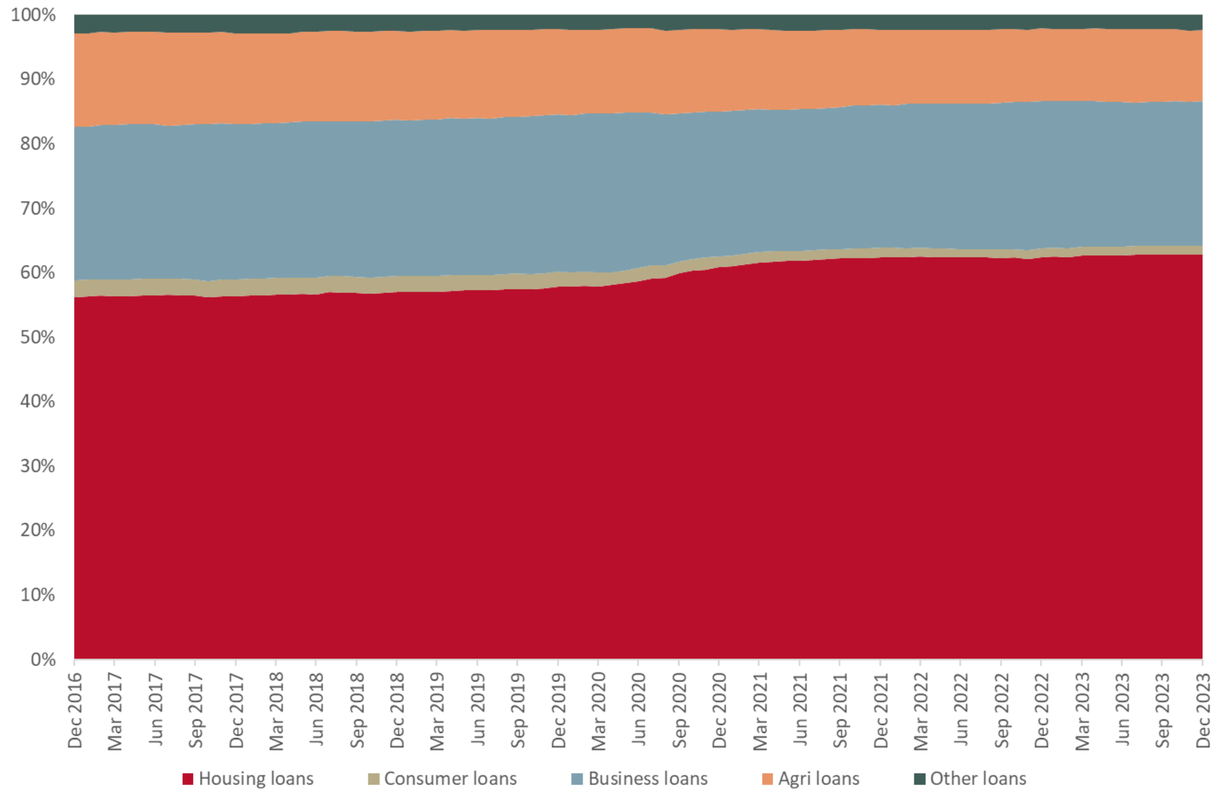
1039 Reserve Bank "Banks: Balance sheet (S10)"; Reserve Bank "Banks: Assets – Loans by sector (S30)" [ ].

1040 MinterEllisonRuddWatts "Non-insurers retreat from the insurance market" (4 November 2022), https://www.minterellison.co.nz/insights/non-insurers-retreat-from-the-insurance-market. ANZ, BNZ, Westpac and Kiwibank have sold their insurance business over the past 5 years.

1041 As an example, both Kiwibank and TSB stopped offering personal consumer lending to their customers.

1042 Reserve Bank "Banks: Assets – Loans by purpose (S31)".

Figure A5 New Zealand banks loan composition by sector as percentage of total (December 2016 to December 2023)



Source: Commerce Commission with data from the Reserve Bank.[1043]

Lending by non-bank providers caters for different groups of consumers and is growing

A18 Personal banking services are provided by a diverse group of non-bank entities. These include lenders who also take customer deposits – NBDTs (such as credit unions and building societies) and non-deposit-taking lending institutions such as finance companies, buy-now-pay-later platforms, peer-to-peer lenders and digital wallet providers.

A19 The distinction between lenders who take deposits and those who do not is important to the level of regulatory oversight and ultimately relevant to entry and expansion.

A20 The non-bank lending sector is highly diverse with a range of operating structures, geographic distribution, ownership and strategies.[1044] Some lenders focus on personal loans (including car finance) while others focus on mortgage lending or property development.

1043 Reserve Bank "Banks: Assets – Loans by purpose (S31)". Note that our other loans category includes both the Reserve Bank's financial institution loans and other loans categories [ ].

1044 The non-bank lending sector comprises NBDTs and NBDT finance companies.

A21 The sector can service borrowers who may otherwise have difficulty accessing personal banking services through a bank due to a range of factors, including having an adverse credit history or an unusual business model.

A22 As they typically assume higher levels of risk compared to banks and have more costly sources of capital, non-bank lending institutions are likely to charge higher interest rates compared to banks.[1045] Customers may look to shift to bank lending when they can.

A23 The non-bank lending sector grew rapidly in the lead-up to the GFC in 2008. Partly due to poor supervision, the GFC resulted in the failure of nearly 70 finance companies in New Zealand and 170,000 depositors were adversely affected.[1046,1047] This resulted in the Reserve Bank assuming supervision of NBDTs as a means to improve resilience of the sector and restore confidence in the sector.[1048]

A24 Over the past few years, lending by companies that do not also take a customer's deposits has grown significantly faster compared to lending by NBDTs.

A25 The Reserve Bank points out that the value of mortgage lending by non-deposit-taking lending companies has more than doubled in the period between 2019 and 2022 compared to a growth of 25% for banks and NBDTs.[1049] This is shown in Figure A6.

1045 Not having access to deposit or wholesale rates may mean that the access and cost of capital to finance lending is more restricted and therefore expensive.

1046 interest.co.nz "Deep freeze list – Finance industry failures", https://www.interest.co.nz/saving/deep-freeze-list

1047 Reserve Bank "A tale of small branches: NBDT sector performance under increased regulatory scrutiny" (May 2019), https://www.rbnz.govt.nz/-/media/40e4ae45a189452ebefb3ca632ae9bd3.ashx?sc_lang=en

1048 Reserve Bank "Register of non-bank deposit takers in New Zealand" (20 June 2024).

1049 Reserve Bank "Lending by non-deposit-taking institutions" (2 November 2022).

Figure A6 Residential mortgage lending by banks, NBDTs and non-deposit lending institutions

	Total Mortgage lending ($mil)			% Growth over the previous 12 months		
Period	Banks	NBDTs	Non-deposit lenders	Banks	NBDTs	non-deposit lenders
Aug-19	267,200	980	1,910	6.3	0.5	31.3
Aug-20	284,400	1,030	2,350	6.4	4.3	22.9
Aug-21	317,000	1,150	3,320	11.5	12.4	41.3
Aug-22	335,200	1,280	4,820	5.7	10.7	45

Source: Reserve Bank.[1050]

A26 The Reserve Bank suggests that the lending growth by non-deposit takers may be linked to several factors, including more flexible access to funding, supportive monetary conditions, flexible credit policies (for instance, the absence of an LVR test) and lower costs of regulatory compliance.[1051]

A27 Whether the growth is ongoing will likely be tested by the current economic environment. A KPMG sector review in 2023 suggested that profitability for the sampled group had decreased but asset growth had continued.[1052]

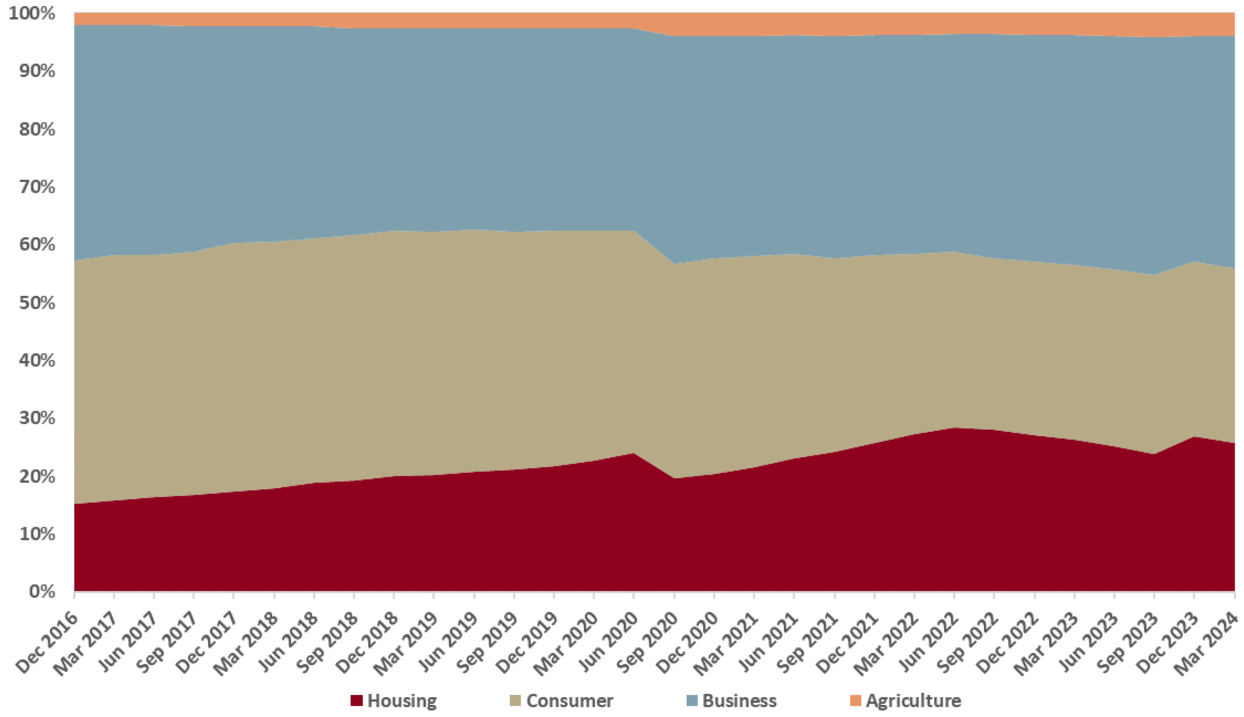
A28 The distribution of products on offer by non-bank lenders is shown in Figure A7. This shows that lending is distributed fairly evenly between mortgage lending, personal and business lending. This differs from the product distribution for banks (Figure A5), which shows a preference by banks for housing lending.

1050 Reserve Bank “Lending by non-deposit-taking institutions.” (2 November 2022), Table D.1.

1051 Reserve Bank "“Lending by non-deposit-taking institutions.” (2 November 2022), Table D.1

1052 KPMG “Financial Institutions Performance Survey – Non-Bank– Review of 2023”,” (December 2023), https://assets.kpmg.com/content/dam/kpmg/nz/pdf/2023/12/fips-non-banks-2023-v3.pdf. The review notes that only four of the 28 companies experienced a loss.

Figure A7 Quarterly non-bank lending by sector as a percentage of total lending (December 2016 to March 2024 quarters)



Source: Commerce Commission with data from the Reserve Bank.[1053]

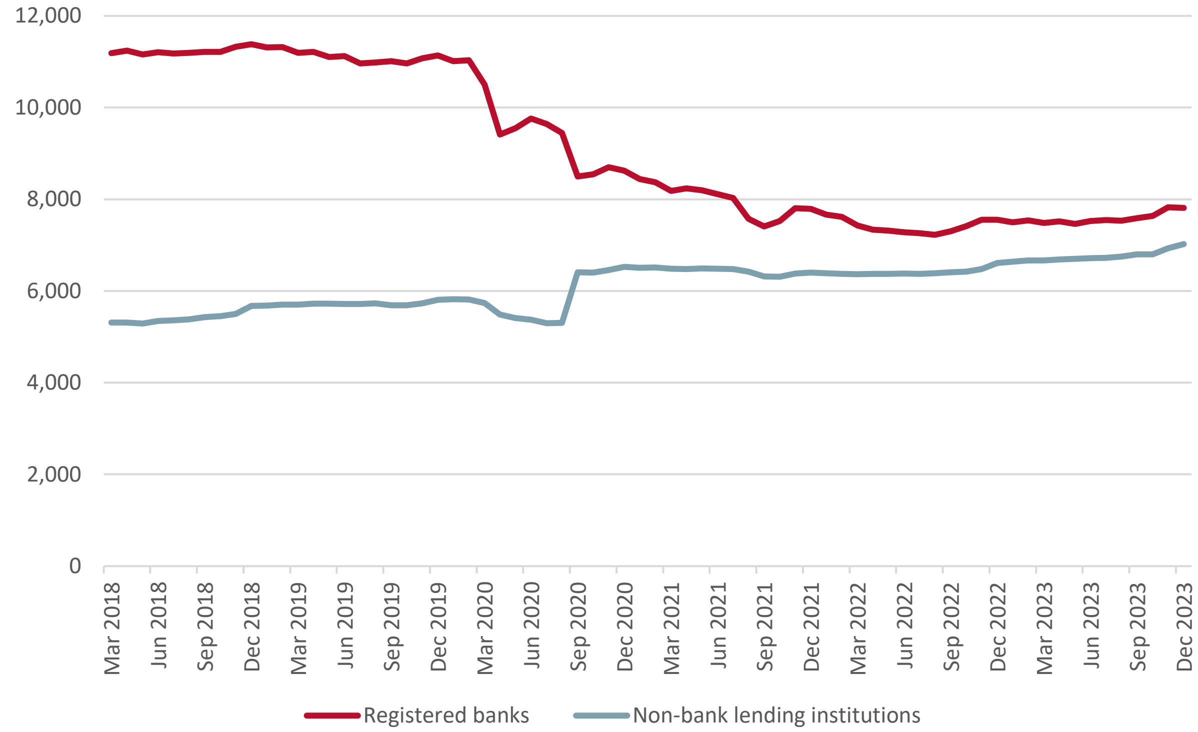
A29 While non-deposit-taking lenders are not prudentially regulated by the Reserve Bank, they still must be prudent with their lending practices, including compliance with the CCCF Act and any capital covenants or risk restrictions that may be imposed by the funding parties.

A30 Despite their growth, non-bank lenders still only represent a small portion of the lending sector, as shown in Figure A2. However, while their mortgage lending figure is still small, the progressive reduction of consumer lending offered by banks, as shown in Figure A8, has increased the significance of these companies as an alternative source of funding for consumer borrowing purposes.

A31 Figure A8 shows that, while the non-bank lender value of consumer lending has remained relatively steady, banks have decreased their consumer lending.

1053 Reserve Bank "Non banks: Funding and claims by sector (T4)", https://www.rbnz.govt.nz/statistics/series/non-banks-and-other-financial-institutions/non-banks-funding-and-claims-by-sector [ ].

Figure A8 Value of personal consumer loans by registered banks and non-bank lenders (December 2016 to December 2023) ($m)



Source: Commerce Commission with data from the Reserve Bank.[1054]

Non-bank finance providers play a modest role in responding to evolving customer needs

A32 There is an evolving landscape of bank and non-bank providers offering personal banking sector products. The change reflects the fact that both banks and financial providers such as fintechs have become increasingly attuned to how to address customers' needs and expectations, with the aim of being a central touchpoint.

A33 Data and analysis are becoming increasingly important in understanding and anticipating customer needs. Until open banking is under way, this gives incumbent banks a head start over fintech rivals in the race to proactively develop and offer services that are tailored to specific needs.

A34 Buy-now-pay-later products, which charge merchants for extended consumer credit, are considered a disruptor for credit card services and personal loans. This model has been unregulated and is now having to adapt to the same rules as other providers of consumer credit.[1055]

1054 Reserve Bank "Registered banks and non-bank lending institutions: Sector lending (C5)" [ ].

1055 Although this is set to change in September 2024 following the introduction of consumer protection regulations.MBIE "Buy Now Pay Later" (31 August 2023), https://www.mbie.govt.nz/business-and-employment/consumer-protection/buy-now-pay-later/

A35 Fintechs vary in their product and service offering. Some such as Revolut and Wise focus on money transfer and foreign account options but also assist with budgeting and payments.[1056,1057] Other companies like Sharesies, Dosh and Aera have started offering interest-bearing accounts.[1058,1059,1060] The payment industry is increasingly being disrupted by digital wallet options such as Apple Pay and Google Pay.

A36 While some of the fintechs (or neobanks) tend to specialise in specific personal banking services or customers' needs, some (like Revolut) have ambitions around diversifying the range of products on offer to become a money hub and attract customers in the process.[1061]

A37 Chapter 9 discusses the innovation and competition potential of fintech providers and identifies a number of challenges that fintechs face in entering and expanding in the personal banking sector.

1056 See https://www.revolut.com/en-NZ/
1057 See https://wise.com/nz/
1058 See https://www.sharesies.nz/save
1059 See https://www.dosh.nz/
1060 See https://www.aera.nz/deposit-accelerator
1061 Revolut being the clearest example: see https://www.revolut.com/en-NZ/about/

Attachment B Further details on our analysis of bank profitability | *Ētahi taipitopito anō mō tā mātou tātari i tā te pēke whai huamoni*

Introduction | *Whakatakinga*

B1 This attachment supplements our analysis contained in Chapter 6 of this report by setting out more detail on our approach to assessing bank profitability.[1062] In particular, we provide additional details on:

B1.1 the primary datasets and the profitability measures that we use; and

B1.2 our method to cross-check our international comparisons analysis.

We have focused on three measures of profitability | *E toru ngā inenga o te whai huamoni i arongia*

B2 We have focused our analysis on three profitability ratios.

B2.1 **ROE (post-tax)** is calculated as net income divided by shareholders' equity and provides a direct assessment of financial return to shareholders. The measure is only a partial measure of profitability. It depends upon a firm's leverage such that a high ROE may simply reflect limited equity capital and it is not risk sensitive.[1063,1064]

B2.2 **ROA (post-tax)** is calculated as net income divided by total assets and is a measure of how efficiently a bank uses its assets to generate returns. A core benefit of ROA, because of the long-term nature of many assets, is it is less sensitive to short-term gaming than other measures.[1065] However, it is not suitable for cross-sector comparisons because it is sensitive to the total quantum of assets that may be affected by varying levels of capital intensity in each sector.

1062 We have not included non-bank providers in our profitability analysis.

1063 For example, in 2022, all four of the largest Australian banks completed share buy-backs (in Australia), increasing their ROE without a change in prices or costs.

1064 European Central Bank "Beyond ROE – how to measure bank performance: Appendix to the report on EU banking structures" (September 2010), p. 5, https://www.ecb.europa.eu/pub/pdf/other/beyondroehowtomeasurebankperformance201009en.pdf

1065 Deloitte "Success or struggle: ROA as a true measure of business performance" (31 October 2013), https://www2.deloitte.com/us/en/insights/topics/operations/success-or-struggle-roa-as-a-true-measure-of-business-performance.html

B2.3 **NIM** refers to the difference between what banks earn on their lending assets and their borrowing costs (net interest income), divided by their interest earning assets to account for scale. NIM is particularly useful in the New Zealand context given that net interest income is a primary driver of New Zealand banks' earnings.[1066] However, NIMs do not account for all revenues and costs. Importantly, as NERA submits, NIMs exclude the cost of equity funding and can be skewed by greater non-interest-bearing deposits.[1067]

B3 To a lesser extent, we have considered the CTI ratio. This measure reflects a bank's costs divided by revenues. The World Bank dataset we use for our analysis defines CTI as operating expenses as a share of the sum of net interest revenue and other operating income.[1068] We included the CTI ratio because costs are relevant to profits and this measure frequently appears in bank's internal reporting and KPIs.[1069]

B4 Each ratio is only a partial measure of profitability, so we consider the outcomes we observe across multiple measures. However, we have consistently heard from a range of parties, including the major banks, that ROE is the better measure of bank profitability.[1070] This is supported by observations in the banks' KPIs.[1071] We therefore place the greatest weight on ROE and focus our analysis on this measure.

We have used two publicly available datasets | *E rua ngā huinga raraunga tūmatanui i whakamahia*

B5 We sought out publicly available datasets on bank profitability from established, reputable sources. We identified two robust data sources.

B5.1 World Bank Global Financial Development Database: Annual country-level data, including data on banking sector characteristics and profitability.

B5.2 Reserve Bank Bank Financial Strength Dashboard: Quarterly bank-level data for New Zealand banks.

1066 Reserve Bank "Financial Stability Report" (3 May 2023), footnote 11; ANZ Submission on Preliminary Issues paper (7 September 2023), Appendix 1 para 25.4.

1067 NERA [for ASB] "Personal banking services market study – review of Attachment C to PIP" (7 September 2023), para 20, https://comcom.govt.nz/__data/assets/pdf_file/0018/329031/ASB-Submission-on-Market-study-into-personal-banking-services-Preliminary-Issues-paper-7-September-2023-Attachment-A.pdf; [ ].

1068 World Bank Global Financial Development Database (September 2022), metadata for the series GFDD.EI.07, https://databank.worldbank.org/source/global-financial-development

1069 [ ].

1070 ANZ, Submission on Preliminary Issues paper (7 September 2023), para 8; [ ].

1071 [ ].

World Bank dataset

B6 The World Bank publishes annual country-level data on measures of financial development and financial system characteristics for 214 economies.[1072] This allows us to compare New Zealand's banking sector profitability to other countries.

B7 The profitability measures we use in our analysis are ROE (post-tax),[1073] ROA (post-tax),[1074] NIM[1075] and CTI ratio.[1076] For each profitability indicator, data for the numerator and the denominator is aggregated from a bank level to a national level before the value is calculated.[1077]

B8 Data on these indicators is available for many countries over the period from 2000 to 2021. However, New Zealand's data is only available from 2007. We have limited our analysis of the World Bank database to the period from 2010 to 2021 to account for the availability of New Zealand data, to limit the number of missing or excluded values for other countries and to remove the years relating to the GFC.

B9 The key benefits of the World Bank's data are the comprehensive list of countries data is available for, the wide range of variables included and the fact that the data covers a longer period than the Reserve Bank's data we use for domestic comparisons (described below).

B10 The key limitation of the World Bank's data relates to its aggregated nature. It is not clear which banks are included for each country and it is not possible to disaggregate the data to construct a sample at the bank level.[1078] Additionally, while profitability data is largely complete over our analysis period, for other variables we use (for example, for sampling or testing potential explanations for New Zealand's level of profitability), the World Bank dataset is often missing data for a range of countries or all countries in particular years. This affects our ability to incorporate certain variables or countries into our cross-checks.

1072 For more detail on the dataset, see World Bank "Global Financial Development Database", https://www.worldbank.org/en/publication/gfdr/data/global-financial-development-database

1073 Defined by the World Bank as the ratio of commercial banks' after-tax income to yearly averaged equity. Series: GFDD.EI.06.

1074 Defined by the World Bank as the ratio of commercial banks' after-tax income to yearly averaged total assets. Series: GFDD.EI.05.

1075 Defined by the World Bank as accounting value of banks' net interest revenue as a share of its average interest-bearing assets. Series: GFDD.EI.01.

1076 Defined by the World Bank as operating expenses of a bank as a share of sum of net interest revenue and other operating income. Series: GFDD.EI.07.

1077 The World Bank notes that the banks included may vary between indicators for the same country. Data is also calculated from underlying bank-by-bank unconsolidated data from Bankscope and Orbis. Consequently, there may be some inter-country and intra-country inconsistencies that may affect the interpretation of results.

1078 Incenta [for ANZ] "Benchmarking the profitability of the New Zealand Banks against international peers" (7 September 2023), paras 7(a) and 27(a).

B11 For our international comparisons of bank profitability, we initially focus our analysis on the sample of peer countries the Reserve Bank used in its May 2023 Financial Stability Report (the Reserve Bank sample).[1079] The list of countries can be seen in Table B1. As explained in our Preliminary Issues paper, our approach to assessing banking sector profitability has been to draw on existing information and analyses prepared by the Reserve Bank.[1080] Using its sample allows us to do this.

B12 We have constructed additional samples to cross-check our finding and describe each later in this attachment where we describe these various cross-checks.

Table B1 List of countries in the Reserve Bank sample that we use to compare New Zealand's relative levels of bank profitability

Australia (AUS)	Germany (DEU)	Norway (NOR)
Austria (AUT)	Hong Kong (HKG)	Portugal (PRT)
Belgium (BEL)	Israel (ISR)	Singapore (SGP)
Canada (CAN)	Italy (ITA)	Sweden (SWE)
Denmark (DNK)	Japan (JPN)	Switzerland (CHE)
Finland (FIN)	Netherlands (NLD)	United Kingdom (GBR)
France (FRA)	New Zealand (NZL)	United States (USA)

Source: Reserve Bank.[1081]

Reserve Bank dataset

B13 The Reserve Bank publishes a dashboard that presents measures of bank financial strength.[1082] This includes measures of profitability, liquidity and asset quality among others.

1079 Reserve Bank "Financial Stability Report" (3 May 2023), Figure 2.12.
1080 Commerce Commission "Market study into personal banking services – Preliminary Issues paper" (10 August 2023), para 114.
1081 Reserve Bank "Financial Stability Report" (3 May 2023), Figure 2.12.
1082 Reserve Bank "Bank Financial Strength Dashboard – Profitability", https://bankdashboard.rbnz.govt.nz/profitability

B14 The data is reported quarterly at a bank level for up to 22 banks and groups operating in New Zealand.[1083] We present only the data relating to the 15 locally incorporated banks contained within the dataset, excluding groups.[1084] The dataset does not include data on branches of overseas incorporated banks such as HSBC and Kookmin Bank.

B15 The data covers the period from the March 2018 to the March 2024 quarter at the time of our analysis and includes data on ROE (post-tax),[1085] ROA (post-tax)[1086] and NIM.[1087] The raw data has been supplied to the Reserve Bank by each individual bank.

B16 The key benefits of the Reserve Bank dataset are that:

B16.1 it allows for the assessment of each individual bank's performance over time;

B16.2 quarterly data allows us to understand intra-year variation; and

B16.3 it is complete and the Reserve Bank's compulsory reporting ensures that a system is in place to minimise inconsistencies across banks.

B17 The key limitations of this dataset are that data is only available from 2018 and the dataset does not include data on the CTI ratio of banks in New Zealand.

Our methodology to cross-check our international comparisons analysis | *Te tikanga i whāia hei takitaki i ā mātou tātaringa whakaturitenga ā-ao*

B18 We received several submissions critiquing our approach to comparing international banking sector profitability in the draft report. We respond to these submissions (including Incenta's alternative approach to international benchmarking) in Chapter 6 and provide greater detail in Attachment C.

B19 In this section, we describe our approaches to test two particular critiques of the sample of countries underlying our analysis and findings in the draft report, being that:

1083 We use the Reserve Bank's definitions for these terms and refer to locally incorporated banks as banks and the consolidated New Zealand-based activities of dual-registered banking groups as groups: Reserve Bank "Bank Financial Strength Dashboard – Frequently asked questions".

1084 The banking group data includes both the activities of the New Zealand incorporated company and the activities of any New Zealand branches of affiliated overseas companies. We understand that the provision of personal banking services occurs through the New Zealand incorporated companies rather than through the New Zealand branches of overseas companies so we have removed the banking groups from our dataset.

1085 The Reserve Bank defines ROE (post-tax) as the ratio of profit after tax to average equity over the quarter.

1086 The Reserve Bank defines ROA (post-tax) as profit after tax as a percentage of average total assets over the quarter.

1087 The Reserve Bank defines NIM as the ratio of net interest income to average interest-bearing assets where net interest income is interest received less interest paid.

B19.1 we did not "provide any substantive guidance on what caused it to adopt the 21 country comparator sample (20 countries excluding New Zealand) that it has used";[1088] and

B19.2 that "[a]lmost all of the Commission's key conclusions are tainted by including the crisis countries in its sample".[1089]

B20 Our approach to profitability, as set out in the Preliminary Issues paper, builds on existing analyses of bank profitability by the Reserve Bank – and using its sample allows us to do this. We disagree that countries that have experienced recent banking crisis (crisis countries) should be automatically excluded from our sample, as we explain in Attachment C.[1090]

Table B2 Summary of country samples used in our profitability analysis

Sample	Purpose	Size (excl. NZ)
Reserve Bank sample	Our primary sample. Used for both our international benchmarking and regression analysis.	20 countries
Adjusted Reserve Bank sample	Excludes from the Reserve Bank sample the three countries with a negative average ROE or ROA. This sample forms part of our tests of the effect of including crisis countries in the Reserve Bank sample.	17 countries
Broad sample	Tests whether the results of our regression analysis are consistent when using a larger sample of countries.	78 countries[1091]
Alternative sample	This sample responds to submissions on the limitations of the Reserve Bank sample. It includes countries with a similar business mix, cost structure and economic development to New Zealand's banking sector.	22 countries

Source: Commerce Commission

B21 Nevertheless, we acknowledge that some submitters do not share our views.[1092] We therefore used cross-checks to test the robustness of our findings. Our cross-checks use two approaches.

B21.1 Regression analysis to control for pro-cyclicality while also including variables that control for differences in banking sector characteristics.

1088 Incenta [for ANZ] "Personal banking services market study – response to the Commission's draft report" (18 April 2024), paras 48–49.

1089 Incenta [for ANZ] "Personal banking services market study – response to the Commission's draft report" (18 April 2024), para 50.

1090 See paragraphs C21 to C29.

1091 This sample is specific to the model specification that has been used. Countries are excluded from this sample where that country has no available data for a variable included in a particular model specification. The Broad sample used for our primary model specification contains 78 countries.

1092 Incenta [for ANZ] "Personal banking services market study – response to the Commission's draft report" (18 April 2024), para 50; Incenta [for ANZ] "Market review of personal banking – post conference submission" (30 May 2024), para 4; [ ].

B21.2 Developing a sample of countries that reflects the characteristics of the New Zealand banking sector and rerunning our analysis using this sample.

B22 We consider a range of samples across our various analyses and cross-checks. For reference, we outline these samples in Table B2 above.

Regression cross-check

B23 To test the sensitivity of our results to the inclusion of crisis countries, we employ econometric techniques to control for a country's GDP growth in our international profitability comparisons.

B24 Banking sector profitability is very pro-cyclical, meaning it tends to move in tandem with the economic cycle.[1093] This implies that a country's banking sector profitability is likely to be correlated with its economic growth rate. We therefore use a country's economic growth rate to capture the economic cycle and, consequently, periods of banking crisis.

B25 Controlling for pro-cyclicality (including crisis periods) gives us a deeper understanding of how New Zealand's banking sector profitability compares to other countries.

B26 In short, we have sought to answer two questions.

B26.1 Are our results when using the Reserve Bank sample of countries sensitive to the inclusion of crisis countries?

B26.2 Are our results robust across a broader set of countries?

B27 The first question requires us to run our model using the Reserve Bank sample of countries (see Table B1). This sample was our primary sample for international comparisons and is the sample of countries Incenta submits is biased by the inclusion of crisis countries.[1094] Using this sample allows us to directly test that submission.

B28 The second question seeks to understand whether our results are sample specific or whether our results are robust to other sample definitions.

Data and variables

B29 Our dataset is constructed from the World Bank Global Financial Development Database described above from paragraph B6.[1095] This dataset includes our model's sector-specific variables such as our dependent variable: post-tax ROE. We only include data for the years 2010 to 2021 to ensure consistency with the period used for our international comparisons.

1093 For example, see Claudio Borio, Craig Furfine and Philip Lowe "Procyclicality of the financial system and financial stability: issues and policy options" (1 March 2001), p. 17.

1094 Incenta [for ANZ] "Personal banking services market study – response to the Commission's draft report" (18 April 2024), para 50.

1095 See paragraphs B6–B11.

B30 We include a country categorical variable to allow us to identify country variation in banking sector profitability. We index the variable in our model so that we have a dummy variable for all but one country (the base category) in the model.

B31 New Zealand is our base category so that each country coefficient can therefore be interpreted as the average percentage point difference in that country's post-tax ROE from New Zealand's when pro-cyclicality and other factors are controlled for. The confidence interval around these country coefficients (relative to New Zealand's coefficient of zero) allows us to identify whether New Zealand's average post-tax ROE is statistically significantly different from the sample of countries.

B32 The literature suggests that banking sector profitability is driven by internal (bank/sector specific), external (macroeconomic) and market structure (for example, market concentration) characteristics.[1096] We included a range of these characteristics as independent variables (covariates) in our model so that our country coefficients more accurately capture country-level variation in banking sector profitability that is not reasonably explainable by these observable characteristics.

B33 The Global Financial Development Database allows us to capture internal or sectoral characteristics. However, it does not include macroeconomic variables. We incorporated two macroeconomic variables from additional World Bank datasets for real GDP per capita growth and inflation.[1097] The former is our key regressor, which we use to control for pro-cyclicality. Using a numeric variable to capture pro-cyclicality (rather than a banking crisis dummy variable) allows us to control for the scale and timing of macroeconomic variation, not just whether or not a crisis occurred. Both macroeconomic variables are reported annually at the country level, and we include 2008 and 2009 data to construct lagged variables.

B34 While the Global Financial Development Database also includes market characteristic variables, we largely excluded these variables from our models. For example, market structure can be correlated with the state of competition.[1098] We aim to capture any variation as a result of differences in the state of competition in our country variable. However, we do include the three firm concentration ratio in our dataset and include it in a sensitivity test of our model.

1096 For example, Asli Demirgüç-Kunt and Harry Huizinga "Determinants of commercial bank interest margins and profitability: some international evidence" *The World Bank Economic Review*, 13(2) (1998) 379–408; Andreas Dietrich and Gabrielle Wanzenried "The determinants of commercial banking profitability in low-, middle-, and high-income countries" *The Quarterly Review of Economics and Finance* 54(3) (2013) 337–354; European Central Bank "Financial Stability Review" (December 2005), pp. 159–167, https://www.ecb.europa.eu/pub/pdf/fsr/financialstabilityreview200512en.pdf; Allen Berger "The relationship between capital and earnings in banking" *Journal of Money, Credit and Banking* 27(2) (1995) 432–456; and Panayiotis Athanasoglou, Sophocles Brissimis and Matthaios Delis "Bank-specific, industry-specific and macroeconomic determinants of bank profitability" *Journal of International Financial Markets, Institutions and Money* 18(2) (2008) 121–136. https://doi.org/10.1016/j.intfin.2006.07.001.

1097 World Bank data for indicator codes NY.GDP.PCAP.KD.ZG and FP.CPI.TOTL.ZG: https://data.worldbank.org/indicator/NY.GDP.PCAP.KD.ZG; and https://data.worldbank.org/indicator/FP.CPI.TOTL.ZG

1098 CMA "The State of UK Competition" (29 April 2022), para 2.4–2.8.

B35 Our final dataset contains variables relating to macroeconomic conditions, business mix, cost structure, credit risk, capital ratios, stock market performance, foreign ownership and scale.[1099] As described below from paragraph B41, some of these variables were excluded from our final models during our model specification process.

Approach to develop our Broad sample of countries

B36 As mentioned above, this analysis seeks to understand whether New Zealand's profitability remains high after controlling for pro-cyclicality based on an analysis of the Reserve Bank sample of countries and a broader sample of countries. This section describes our approach to developing our Broad sample. We have already discussed the Reserve Bank sample from paragraph B11.

B37 Our Broad sample considers the largest sample for which reasonable data is available. To develop the sample, we begin with all 214 economies in the World Bank dataset. As our dependent variable is ROE, to ensure data completeness, we exclude all countries with more than 3 years of missing ROE data. This excludes 62 countries.

B38 We next exclude countries that exhibit high standard errors in their country coefficient in our initial regressions. We describe at paragraph B44.3 where this step fits into our process. Given that our regression introduces an additional dummy variable for each country in our sample, these countries adversely affect the model's degrees of freedom without providing a meaningful estimate of the country's relative profitability. We ran this check twice, each time excluding countries with standard errors greater than 3.5.[1100] We additionally exclude countries and datapoints that we identify as outliers. These steps removed an additional 33 countries from our sample.

B39 Finally, our model excludes from the sample countries that do not have data available for a variable that has been included in the model or that exhibits collinearity. Because we run several model specifications for this sample (see paragraph B49), the final sample size is dependent on the specific model specification being estimated. For our preferred model (the primary model), the Broad sample contains 78 countries (plus New Zealand).

B40 The countries included in the Broad sample for each model specification can be seen in Table B5.

1099 We estimated scale by calculating a country's total value of deposit bank assets in a year using the share of deposit bank assets to GDP from the Global Financial Development Database [series: GFDD.DI.02] and World Bank GDP (in current USD) data [source: NY.GDP.MKTP.CD]: https://data.worldbank.org/indicator/NY.GDP.MKTP.CD. By using only deposit bank assets, we intended to predominantly capture the scale of banks in a country that are more similar to those in New Zealand.

1100 We acknowledge that this threshold is relatively arbitrary. We selected it because it equated to 2.5 times the standard deviation of standard errors remaining in the model. Upon a visual inspection of these standard errors, this threshold excluded the clearest outliers, and we were satisfied that the resulting sample was of a sufficient size to be able to draw meaningful results.

Model specification

B41 We developed a pooled ordinary least squares (OLS) regression model and regress each country's banking sector annual post-tax ROE against:

B41.1 GDP growth per capita in current USD to control for pro-cyclicality;

B41.2 a selection of covariates to control for additional drivers of banking sector profitability;[1101] and

B41.3 a vector of country-level dummy variables with New Zealand as the base category so that each country's coefficient may be interpreted as the average difference in ROE compared to New Zealand.

B42 Our model includes country-level clustered standard errors to capture the panel nature of our data and to control for heteroskedasticity and autocorrelation in the model.[1102,1103] We note that clustered standard errors allow for autocorrelation within an entity (within a country in this case).

B43 We focused our model specification tests on our Broad sample of countries. By testing the goodness of fit against the larger sample, we ensure our model is specified based on a sample that is more likely to be representative of the true distribution of global banking sector characteristics. In contrast, the Reserve Bank sample contains only high-income countries with mature banking sectors, which is unlikely to represent a true random sample.[1104]

B44 We undertook a multi-stage approach to improving the goodness of fit of our model specification beginning with all variables in the model and then applying the following process.

B44.1 Test the exclusion of variables that we identify as facing either data or econometric limitations. This included removing variables with material missing data or collinearity issues.[1105]

1101 Covariates are independent variables in a model that provide explanatory power but are not of direct interest. All variables except our dependent variable (ROE post-tax) and GDP growth are covariates in our models.

1102 Christoph Hanck, Martin Arnold, Alexander Gerber and Martin "Introduction to Econometrics with R" (13 February 2024), section 10.5, https://www.econometrics-with-r.org/10.5-tferaaseffer.html

1103 Heteroskedasticity is present when the variance of the error term, conditional on the explanatory variables in a model, is not constant (the error term is not constant for any given value of the explanatory variable). Autocorrelation occurs when error terms are correlated across time. Neither heteroskedasticity nor autocorrelation produce biased estimators. However, each can affect the estimation of standard errors: Jeffrey Wooldridge "Introductory Econometrics: A Modern Approach" (2012), pp. 51, 268 and 353–354.

1104 Random sampling is a core assumption to obtain an unbiased estimator: Jeffrey Wooldridge "Introductory Econometrics: A Modern Approach" (2012), pp. 45 and 84.

1105 Collinearity occurs when a linear relationship exists between independent variables in a model. While OLS only requires there be no *perfect* collinearity (an exact linear relationship), high collinearity may still affect the estimation of standard errors: Jeffrey Wooldridge "Introductory Econometrics: A Modern Approach" (2012), pp. 95–96.

B44.2 Test the exclusion of different combinations of our macroeconomic variables and their 1-year and 2-year lags.

B44.3 Identify and remove countries that exhibit material standard errors. We have discussed this process at paragraph B38.

B44.4 Test the removal of variables that we identified as being statistically insignificant at the 10% significance level in the model created following the previous three steps.[1106] We test the exclusion of each variable both individually and in combination with other variables that we identify as statistically insignificant.

B44.5 Post-estimation tests of OLS assumptions, including removing outliers and testing the inclusion of the natural log of variables. This includes testing for heteroskedasticity, collinearity, non-linearity and non-normality.

B45 To test the exclusion of variables, we used a range of goodness of fit measures. This included the adjusted R-squared, Akaike's information criterion (including the corrected and consistent methods) and Schwarz's Bayesian information criterion.[1107] Goodness of fit measures provide an indication of how well a set of explanatory variables (a model specification) explains variation in a dependent variable.[1108]

B46 Following our model specification process, our final primary models for the Reserve Bank sample and Broad sample, respectively, were (see Table B3 for more detail on each variable):

$$\begin{aligned} ROE_{it}^{RBNZ} = \beta_0 + \beta_1 GDP\ growth_{it} + \beta_2 ln\ (inflation)_{it-1} + \beta_3 non\ interest\ inc_{it} \\ + \beta_4 ln(non\ performing\ loans)_{it} + \beta_6 country_i + u_{it} \end{aligned}$$

$$\begin{aligned} ROE_{it}^{Broad} = \beta_0 + \beta_1 GDP\ growth_{it} + \beta_2\ inflation_{it-1} + \beta_3 non\ interest\ inc_{it} \\ + \beta_4 ln(overhead\ costs)_{it} + \beta_5 ln(non\ performing\ loans\ )_{it} \\ + \beta_5 country\ income_{it} + \beta_6 country_i + u_{it} \end{aligned}$$

B47 We exclude the variables overhead costs to total assets and country income level from all Reserve Bank sample models. Our model specification process identified that overhead costs provided no additional predictive power for this sample. There is also no variation in the country income variable. All countries in the Reserve Bank sample are classified as high income, meaning the variable provides no predictive power to the model.

1106 We used the 10% significance level to minimise the risk of omitted variable bias. We use the 5% significance level when we interpret our final models.

1107 Rob Hyndman and George Athanasopoulos "Forecasting: Principles and Practice" (2018), section 5.5, https://otexts.com/fpp2/selecting-predictors.html

1108 Jeffrey Wooldridge "Introductory Econometrics: A Modern Approach" (2012), p. 849.

B48 Our dependent variable and the majority of our independent variables are in percentage units. This implies that the estimated coefficient (β) for the variable can be interpreted as a 1 percentage point increase in the n^{th} independent variable on average and all else held equal is associated with a β_n percentage point increase in ROE.[1109] As categorical variables, our country variable shows the percentage point difference relative to New Zealand while our country income variable shows the percentage point difference relative to the low-income category.

Table B3 Description of variables included in our primary regression models

Variable	Long name	Source	Series ID from source
ROE	Post-tax return on equity.	World Bank Global Financial Development Database	GFDD.EI.06
GDP growth	Annual percentage change in GDP growth per capita in current USD.	World Bank	NY.GDP.MKTP.KD.ZG[1110]
inflation	Annual percentage change in the consumer price index (CPI). Note that we use the 1-year lag of inflation, and for the Reserve Bank sample, we use the natural log of this variable.	World Bank	FP.CPI.TOTL.ZG[1111]
non interest inc	*Non-interest income to total income.* Bank income that has been generated by non-interest-related activities as a percentage of total income.	World Bank Global Financial Development Database	GFDD.EI.03
non performing loans	*Non-performing loans to gross loans.* The ratio of defaulting loans (payments of interest and principal past due by 90 days or more) to total gross loans. Note we use the natural log of this variable in both models.	World Bank Global Financial Development Database	GFDD.SI.02
overhead costs	*Overhead costs to total assets.* Operating expenses as a share of the value of all assets held. Note we use the natural log of this variable in our Broad sample model.	World Bank Global Financial Development Database	GFDD.EI.04
country	Categorical variable for countries included in our model. New Zealand is our base category.	World Bank Global Financial Development Database	'country'
country income	Categorical variable for a country's income level based on gross national income per capita (current USD) data. There are four categories: low (base category), lower middle, upper middle and high.	World Bank Global Financial Development Database	'income'

Source: World Bank data.

1109 Where we include the natural log of an independent variable, it is instead interpreted as a 1% change in the independent variable is associated with a $\left(\frac{\beta_n}{100}\right)$ percentage point change in ROE.

1110 See https://data.worldbank.org/indicator/NY.GDP.MKTP.KD.ZG

1111 See https://data.worldbank.org/indicator/FP.CPI.TOTL.ZG

Sensitivity analysis

B49 While we focus on these two specifications, we estimate additional specifications to understand how the results vary with the inclusion/exclusion of particular variables. We undertake these tests as part of our robustness checks and sensitivity analysis. However, we do not discuss these results in detail. We use the following alternative specifications.

B49.1 We include the three firm concentration ratio (CR_3) to understand how the results change when including a market structure variable as a competition proxy.[1112] We note the limitations of concentration ratios as a measure of competition and place minimal weight on this specification.[1113]

B49.2 For our Broad sample of countries, we ran a specification where we excluded non-performing loans to gross loans. There is no 2021 data for this variable meaning that our primary models can only be interpreted for the period 2010 to 2020. By excluding the variable, we can identify whether our results materially change when we consider the same sample period as we have used for our other international comparisons. We did not exclude the variable from our primary model because the variable provides an important control for credit risk and our tests suggest our model's goodness of fit improves when it is included.[1114]

B49.3 In testing the robustness of our models, we identify heteroskedasticity concerns with the Reserve Bank sample. While this will not bias the coefficients, it can affect the standard errors.[1115] Heteroskedasticity is most prominent at lower ROE values and so we run a specification where we exclude from our sample countries that had negative average ROE or ROA – Portugal, Italy and Germany (the Adjusted Reserve Bank sample).[1116]

Overview of findings and regression output tables

B50 The results of our regression analysis suggest the following.

B50.1 As can be seen across all models in Table B4, after controlling for pro-cyclicality, no country in the Reserve Bank sample has a ROE statistically significantly higher than New Zealand. While omitting relevant data can introduce bias into econometric estimates (shift the point estimate from reality), the cost of being over-inclusive is inefficiency, which shows up in wider confidence intervals. This is a further reason that we are comfortable about the inclusion of crisis countries in the Reserve Bank sample.

1112 World Bank Global Financial Development Database series: GFDD.OI.01.

1113 See model (3) of Table B4 and see model (2) of Table B5.

1114 See model (3) of Table B5.

1115 Jeffrey Wooldridge "Introductory Econometrics: A Modern Approach" (2012), pp. 268–269.

1116 While Germany's average ROA over the period rounds to a value of zero to two decimal places, the underlying value is negative. See model (2) of Table B4.

B50.2 As can be seen in model 1 in Table B5, against our Broad sample of countries, once pro-cyclicality and other factors are controlled for, only 13 countries have statistically significantly higher ROEs than New Zealand at the 5% significance level. In contrast, 46 countries have statistically lower ROEs.[1117] This implies that New Zealand's profitability is in the 60th to 85th percentile for this sample, even after controlling for a range of factors.

B50.3 We observe broadly similar results across our various model specifications for both samples.

B50.4 Both samples corroborate our finding that New Zealand banking sector profitability is high by international standards. We have a greater degree of confidence that the inclusion of crisis countries is unlikely to be biasing our results and that our results are not sample sensitive given we see consistent results for our broader sample.

B51 We include a more fulsome discussion of our results in Chapter 6 and include our regression coefficients in Table B4 and Table B5 below.

B52 Stars next to a coefficient reflect the p-value for the estimated coefficient. Three stars represents a p-value of 0.01 (or the 99% significance level). One and two stars represent p-values of 0.1 and 0.05, respectively. No star represents a coefficient that is not statistically significantly different from zero. Country coefficients that are in red text represents coefficients that are both positive and statistically significant at the 95% significance level.

Table B4 Regression coefficients: Reserve Bank sample of countries

	(1)	(2)	(3)
VARIABLES	Reserve Bank sample – primary model	Adjusted Reserve Bank sample – primary model	Reserve Bank sample – w/ 3CR
GDP Growth per capita in current USD	0.454***	0.470***	0.461***
	(0.000)	(0.000)	(0.000)
ln(Inflation (1 year lag))	-0.592**	-0.557**	-0.552**
	(0.023)	(0.031)	(0.028)
Non-interest income to total income	0.052	0.038	0.050
	(0.189)	(0.405)	(0.221)
ln(non-performing loans to gross loans)	-1.722	-0.984	-1.618
	(0.211)	(0.350)	(0.236)
Three firm concentration ratio			-0.107
			(0.307)
Base "New Zealand"			
Australia	-0.446**	-0.428**	-0.524***
	(0.038)	(0.047)	(0.006)
Austria	-5.275***	-5.445***	-6.496***
	(0.006)	(0.008)	(0.000)
Belgium	-2.454	-2.974*	-2.441
	(0.141)	(0.056)	(0.160)
Canada	0.261	1.058	-0.655
	(0.791)	(0.205)	(0.665)
Denmark	-6.508***	-6.881***	-5.172*
	(0.002)	(0.002)	(0.092)
Finland	-6.624***	-6.275***	-4.320
	(0.000)	(0.001)	(0.182)
France	-5.548**	-5.859**	-6.236***
	(0.022)	(0.023)	(0.004)
Hong Kong SAR, China	-1.334	-0.547	-2.213
	(0.275)	(0.626)	(0.154)

1117 We include the full regression output table of coefficients at Table B5.

Israel	-3.903***	-4.166***	-3.126*
	(0.001)	(0.001)	(0.075)
Japan	-8.545***	-8.476***	-11.224***
	(0.000)	(0.000)	(0.000)
Netherlands	-4.316***	-4.683***	-2.842
	(0.004)	(0.002)	(0.280)
Norway	-0.942**	-0.751	1.954
	(0.048)	(0.146)	(0.506)
Singapore	-3.975***	-3.754***	-2.233
	(0.000)	(0.000)	(0.255)
Sweden	-1.838*	-1.107	0.540
	(0.051)	(0.160)	(0.810)
Switzerland	-14.373***	-13.343***	-13.723***
	(0.000)	(0.000)	(0.000)
United Kingdom	-9.670***	-9.688***	-11.501***
	(0.000)	(0.000)	(0.000)
United States	-3.469***	-3.510***	-6.868**
	(0.000)	(0.001)	(0.023)
Germany	-12.815***		-12.284***
	(0.000)		(0.000)
Italy	-12.159***		-13.065***
	(0.003)		(0.000)
Portugal	-17.665***		-17.293***
	(0.000)		(0.000)
Constant	11.425***	11.614***	18.990**
	(0.000)	(0.000)	(0.023)
Observations	194	165	190
Adjusted R-squared	0.714	0.693	0.717

Robust p value in parentheses
*** p<0.01, ** p<0.05, * p<0.1

Source: World Bank data.[1118]

Table B5 Regression coefficients: Broad sample of countries

	(1)	(2)	(3)
VARIABLES	Primary model	Primary model w/ 3CR	Primary model w/o non-performing loans/gross loans
GDP Growth per capita in current USD	0.407***	0.407***	0.152**
	(0.000)	(0.000)	(0.045)
Inflation (1 year lag)	0.092	0.095	0.002
	(0.342)	(0.327)	(0.736)
Non-interest income to total income	0.044	0.043	0.069*
	(0.329)	(0.345)	(0.057)
ln(overhead costs to total assets)	2.982**	3.031**	2.748**
	(0.040)	(0.040)	(0.010)
ln(non-performing loans to gross loans)	-1.560*	-1.582*	
	(0.066)	(0.067)	
Three firm concentration ratio		-0.012	
		(0.716)	
Base "Low income"			
Lower middle income	1.759	1.812	-2.195**
	(0.166)	(0.163)	(0.032)
Upper middle income	-0.491	-0.131	-2.036**
	(0.726)	(0.942)	(0.010)
High income	0.280	0.565	1.917
	(0.921)	(0.849)	(0.314)
Base "New Zealand"			
Afghanistan			-9.314***
			(0.000)
Angola			4.173***
			(0.000)
Armenia	-6.116***	-6.479***	-4.584***
	(0.000)	(0.000)	(0.000)
Australia	-0.269	-0.268	-0.834***
	(0.339)	(0.341)	(0.000)

1118 World Bank Global Financial Development Database and data for indicator codes NY.GDP.PCAP.KD.ZG and FP.CPI.TOTL.ZG.

Austria	-6.298*** (0.000)	-6.412*** (0.000)	-8.370*** (0.000)
Azerbaijan	-12.752*** (0.000)	-13.091*** (0.000)	-5.122*** (0.000)
The Bahamas			-7.934*** (0.000)
Bahrain	0.394 (0.782)	0.632 (0.699)	-4.210*** (0.000)
Barbados			-2.219*** (0.000)
Belarus	-3.078*** (0.004)	-3.345** (0.011)	-2.431*** (0.007)
Belgium	-2.388** (0.049)	-2.323* (0.063)	-4.757*** (0.000)
Benin			-3.665*** (0.001)
Bolivia	-3.036*** (0.001)	-3.099*** (0.002)	0.659 (0.596)
Botswana	6.146*** (0.000)	5.968*** (0.000)	10.413*** (0.000)
Brazil	-3.414*** (0.000)	-3.565*** (0.000)	-1.761*** (0.001)
Burkina Faso			3.978*** (0.000)
Burundi	2.441** (0.016)	2.966 (0.114)	5.358*** (0.000)
Cabo Verde			-1.316 (0.434)
Cambodia	-5.133*** (0.000)	-5.205*** (0.000)	0.775 (0.682)
Canada	-1.194 (0.186)	-1.336 (0.211)	-0.939 (0.378)
Chile	-1.085 (0.353)	-1.149 (0.338)	-1.841** (0.026)
China	1.268 (0.520)	0.989 (0.630)	5.098*** (0.000)
Colombia	-1.958** (0.016)	-2.036** (0.019)	-1.730*** (0.001)
Congo, Dem. Rep.			-15.556*** (0.000)
Costa Rica	-8.065*** (0.000)	-8.323*** (0.000)	-5.382*** (0.000)
Denmark	-6.117*** (0.000)	-5.911*** (0.001)	-8.489*** (0.000)
Dominican Republic	-0.113 (0.949)	-0.223 (0.903)	3.326*** (0.000)
Ecuador	-4.026*** (0.000)	-4.327*** (0.004)	-3.145*** (0.000)
El Salvador	-7.598*** (0.000)	-7.427*** (0.000)	-3.094** (0.047)
Estonia	-2.534*** (0.000)	-2.234** (0.030)	-2.791*** (0.000)
Eswatini	1.347 (0.390)	1.811 (0.356)	4.219*** (0.000)
Ethiopia	3.479*** (0.004)	3.807** (0.018)	11.723*** (0.000)
Finland	-4.706** (0.027)	-4.402* (0.061)	-5.313*** (0.000)
France	-3.980* (0.083)	-3.985* (0.084)	-7.286*** (0.000)
Gabon	1.008 (0.162)	1.093 (0.142)	1.505** (0.024)
Georgia	-1.058 (0.338)	-0.998 (0.372)	2.338*** (0.000)
Germany	-13.058*** (0.000)	-12.966*** (0.000)	-15.300*** (0.000)
Guatemala	1.631 (0.293)	1.444 (0.391)	4.567*** (0.000)
Guinea	4.227*** (0.001)	4.534*** (0.005)	6.654*** (0.000)
Guyana			4.417*** (0.000)
Haiti			9.526*** (0.000)
Honduras	-6.321***	-6.396***	-2.117*

	(0.000)	(0.000)	(0.067)
Hong Kong SAR, China	-2.773**	-2.896**	-2.976**
	(0.012)	(0.016)	(0.012)
Iceland	-6.826***	-6.476***	-5.592***
	(0.000)	(0.000)	(0.000)
India	-7.532***	-7.761***	-3.135
	(0.000)	(0.000)	(0.103)
Indonesia	-2.212***	-2.390***	2.836*
	(0.000)	(0.002)	(0.073)
Iraq			-3.013*
			(0.065)
Israel	-5.597***	-5.526***	-6.220***
	(0.000)	(0.000)	(0.000)
Jamaica			-0.819
			(0.268)
Japan	-5.834***	-6.113***	-7.034***
	(0.000)	(0.000)	(0.000)
Jordan	-1.907**	-2.035**	-3.145***
	(0.023)	(0.020)	(0.000)
Korea, Rep.	-8.937***	-9.103***	-7.247***
	(0.000)	(0.000)	(0.000)
Kuwait	0.497	0.856	-4.135***
	(0.704)	(0.619)	(0.000)
Lao PDR			-0.640
			(0.723)
Latvia	-6.333***	-6.427***	-9.147***
	(0.005)	(0.004)	(0.000)
Lebanon	-3.501***	-3.556***	-1.104
	(0.006)	(0.005)	(0.587)
Lesotho	7.587***	8.078***	9.330***
	(0.000)	(0.000)	(0.000)
Libya			-3.254
			(0.111)
Luxembourg	-8.286***	-8.688***	-8.136***
	(0.000)	(0.000)	(0.000)
Macao SAR, China	5.282***	5.340***	7.570***
	(0.001)	(0.001)	(0.000)
Madagascar	12.831***	13.254***	11.089***
	(0.000)	(0.000)	(0.000)
Malawi	3.502***	3.692***	7.878***
	(0.004)	(0.005)	(0.000)
Malaysia	0.494	0.241	2.694***
	(0.734)	(0.877)	(0.007)
Mali			-2.746***
			(0.001)
Malta	-3.233**	-2.971*	-6.043***
	(0.041)	(0.099)	(0.000)
Mauritius	-3.272***	-3.592***	-2.358***
	(0.000)	(0.000)	(0.000)
Mexico	-3.867***	-4.236***	-1.841***
	(0.000)	(0.001)	(0.000)
Mongolia			1.629
			(0.360)
Montenegro			-15.254***
			(0.000)
Morocco	-2.321**	-2.056*	-0.739
	(0.011)	(0.092)	(0.664)
Mozambique	-3.250***	-2.888**	-1.687***
	(0.000)	(0.010)	(0.000)
Myanmar			6.246***
			(0.007)
Namibia	3.912***	3.971***	5.527***
	(0.000)	(0.000)	(0.000)
Nepal	-0.244	-0.704	6.772***
	(0.773)	(0.647)	(0.001)
Netherlands	-4.023***	-3.813***	-6.044***
	(0.001)	(0.004)	(0.000)
Nicaragua			3.784***
			(0.001)
Niger			1.574**
			(0.046)
Nigeria	-1.552	-1.737	1.605
	(0.192)	(0.191)	(0.129)
North Macedonia	-2.709***	-2.815***	-2.600***
	(0.001)	(0.001)	(0.000)

Norway	-0.593	0.210	-1.428***
	(0.354)	(0.865)	(0.005)
Oman	0.260	0.241	-4.017***
	(0.790)	(0.807)	(0.000)
Panama	-3.167***	-3.460**	-3.294***
	(0.001)	(0.011)	(0.000)
Paraguay	4.631***	4.254***	6.614***
	(0.000)	(0.007)	(0.000)
Peru	4.432***	4.370***	5.394***
	(0.000)	(0.000)	(0.000)
Philippines	-5.108***	-5.217***	-0.096
	(0.000)	(0.000)	(0.954)
Poland	-5.489***	-5.807***	-7.624***
	(0.001)	(0.003)	(0.000)
Qatar	5.336***	5.583***	2.869***
	(0.000)	(0.000)	(0.000)
Rwanda	-5.775***	-5.636***	-5.093***
	(0.000)	(0.000)	(0.000)
Saudi Arabia	-0.029	-0.202	-1.218***
	(0.958)	(0.781)	(0.001)
Seychelles	10.531***	10.902***	7.898***
	(0.000)	(0.000)	(0.000)
Singapore	-3.268***	-3.051***	-3.553***
	(0.000)	(0.008)	(0.000)
Slovak Republic	-4.631***	-4.618***	-6.446***
	(0.003)	(0.003)	(0.000)
South Africa			0.777
			(0.248)
Spain	-9.093***	-9.153***	-12.242***
	(0.000)	(0.000)	(0.000)
Sri Lanka			4.360**
			(0.013)
Sweden	-1.928**	-1.647	-2.211***
	(0.022)	(0.138)	(0.010)
Syrian Arab Republic			-7.018***
			(0.000)
Togo			4.667***
			(0.000)
Trinidad and Tobago	-7.184***	-6.867***	-9.551***
	(0.000)	(0.001)	(0.000)
United Arab Emirates	0.364	0.316	-2.909***
	(0.825)	(0.848)	(0.000)
United Kingdom	-9.860***	-10.049***	-10.969***
	(0.000)	(0.000)	(0.000)
United States	-6.256***	-6.676***	-6.981***
	(0.000)	(0.001)	(0.000)
Uruguay	-3.052	-3.158	-2.781*
	(0.140)	(0.137)	(0.062)
Constant	10.639***	11.242***	8.816***
	(0.001)	(0.002)	(0.000)
Observations	785	781	1,199
Adjusted R-squared	0.674	0.674	0.505

Robust p value in parentheses
*** p<0.01, ** p<0.05, * p<0.1

Source: World Bank data.[1119]

[1119] World Bank Global Financial Development Database and data for indicator codes NY.GDP.PCAP.KD.ZG and FP.CPI.TOTL.ZG.

Alternative sample cross-check

B53 Our second cross-check tests whether our results are sensitive to using the Reserve Bank's sample of countries (see Table B1) for our international comparisons. While we use the Reserve Bank sample to build on existing work by the Reserve Bank, Incenta submits that this sample faces a number of limitations and that we did not provide any substantive guidance on why we adopted this sample.[1120]

B54 To test these concerns, we develop a second sample (the Alternative sample) of countries and re-ran our analysis to identify whether we observe the same outcomes. We again use the World Bank dataset (described from paragraph B6) for profitability and characteristics data.

B55 To construct our Alternative sample, we develop criteria that build on the variables we identify as relevant in our regression analysis and in a review of the literature.[1121] Our criteria aim to capture *a priori* drivers of bank financial performance to develop a sample of banking sectors with similar characteristics to New Zealand.

B56 We used five criteria to develop this sample.

B56.1 Non-interest income to total income of less than 40% to capture business mix.

B56.2 Overhead costs to total assets of less than 2% to capture cost structure.[1122]

B56.3 Either a country income level of upper middle or high to capture economic development.[1123]

B56.4 For data completeness, we exclude countries that between 2010 and 2021 are missing more than 3 years of ROE data.

B56.5 To test Incenta's concern, we exclude countries whose average ROE was negative between 2010 and 2021.

1120 Incenta [for ANZ] "Personal banking services market study – response to the Commission's draft report" (18 April 2024), paras 48–49.

1121 For example, Asli Demirgüç-Kunt and Harry Huizinga "Determinants of commercial bank interest margins and profitability: some international evidence" *The World Bank Economic Review*, 13(2) (1998) 379–408; Andreas Dietrich and Gabrielle Wanzenried "The determinants of commercial banking profitability in low-, middle-, and high-income countries" *The Quarterly Review of Economics and Finance* 54(3) (2013) 337–354; European Central Bank "Financial Stability Review" (December 2005), pp. 159–167; Allen Berger "The relationship between capital and earnings in banking" *Journal of Money, Credit and Banking* 27(2) (1995) 432–456; and Panayiotis Athanasoglou, Sophocles Brissimis and Matthaios Delis "Bank-specific, industry-specific and macroeconomic determinants of bank profitability" *Journal of International Financial Markets, Institutions and Money* 18(2) (2008) 121–136.

1122 Our non-interest income and overhead cost thresholds were developed by doubling New Zealand's values for each (22% and 1.05%, respectively) and rounding down to obtain a sample size more similar to our initial Reserve Bank sample.

1123 The country income variable is time variant. However, over our analysis period, there are no countries that moved between the lower middle income and upper middle income classifications that also meet our data completeness criterion.

B57 We considered a range of additional variables but identified issues with their inclusion.

B57.1 Macroeconomic, stock market and credit provisioning variables will, to some extent, capture pro-cyclicality and periods of banking crisis. As we discuss in Attachment C, we disagree that we should sample on this basis.[1124]

B57.2 Market structure variables can capture competitive dynamics, which we aim to observe in our country variables.

B57.3 Our capital ratio, scale and foreign ownership variables had many missing datapoints so that we could not calculate a reliable estimate of each country's average characteristics over our assessment period.

B58 In selecting our criteria, we had to balance the inclusion of additional variables against the need to widen our thresholds to obtain a suitable sample size. Each additional variable we include into our criteria will exclude additional countries, reducing the sample size and requiring wider thresholds to build a large enough sample.[1125] We acknowledge that there is a level of subjectivity in striking this balance.

B59 We also acknowledge that using non-interest income to total income as a measure of business mix has its limitations.[1126] However, it is a measure commonly used in the literature to proxy business mix in banking, and we see no reason why it would be unsuitable for our purposes.[1127]

B60 Applying our sampling technique produces a sample of 22 countries (excluding New Zealand) as shown in Table B6. Six of these countries are also in the Reserve Bank sample.

1124 See paragraphs C21 to C29.

1125 We endeavoured to build a sample that was of a similar size to the Reserve Bank sample of countries. The Reserve Bank sample is comprised of 20 countries. Our Alternative sample is comprised of 22.

1126 Incenta [for ANZ] "Personal banking services market study – response to the Commission's draft report" (18 April 2024), paras 79–82.

1127 For example, Asli Demirgüç-Kunt and Harry Huizinga "Determinants of commercial bank interest margins and profitability: some international evidence" *The World Bank Economic Review*, 13(2) (1998) 379–408; Andreas Dietrich and Gabrielle Wanzenried "The determinants of commercial banking profitability in low-, middle-, and high-income countries" *The Quarterly Review of Economics and Finance* 54(3) (2013) 337–354. https://doi.org/10.1016/j.qref.2014.03.001; and European Central Bank ""Financial Stability Review" (December 2005), p. 160.

Table B6 List of countries in our Alternative sample for international comparisons (excluding New Zealand)

Australia (AUS)*	Bahrain (BHR)	Barbados (BRB)	Belgium (BEL)*
China (CHN)	Czech Republic (CZE)	Estonia (EST)	Japan (JPN)*
Jordan (JOR)	Korean Republic (KOR)	Kuwait (KWT)	Macao (MAC)
Malaysia (MYS)	Malta (MLT)	Netherlands (NLD)*	Norway (NOR)*
Oman (OMN)	Qatar (QAT)	Saudi Arabia (SAU)	Singapore (SGP)*
Thailand (THA)	UAE (ARE)		

Source: Reserve Bank.[1128]
* Countries that were also in the Reserve Bank sample.

B61 Using this Alternative sample, we re-run our international comparisons analysis as we did with the Reserve Bank sample. We compare New Zealand's average ROE (post-tax) between 2010 and 2021 against the upper quartile of our Alternative sample.[1129] We also assess New Zealand's profitability trend against that sample.

B62 Comparing New Zealand to our Alternative sample, we find that New Zealand's average ROE between 2010 and 2021 exceeds the upper quartile for our Alternative sample.[1130] New Zealand's annual profitability trend has also been increasing relative to the sample on ROE.

Conclusions from our cross-checks

B63 We consider that this analysis strongly reinforces the view that bank profitability in New Zealand is high by international standards.

B64 We acknowledge that each of our cross-checks faces limitations, as do all empirical comparisons of profitability. Other modellers might reasonably prefer a different model specification process, for example, and some might object to the inclusion of countries quite unlike New Zealand in our Broad sample. We also acknowledge that the modelling philosophy underlying our approach is not the same as that advocated by Incenta for ANZ (whose work we examine in more detail in Attachment C).

1128 Reserve Bank "Financial Stability Report" (3 May 2023), Figure 2.12.

1129 We do not compare New Zealand's NIM and CTI ratio to the Alternative sample. Non-interest income to total income and overhead costs to total assets can be expected to be correlated with NIM and CTI, respectively. Given that our sample is constructed to have similar non-interest income to total income and overhead costs to total assets as New Zealand, we inevitably create a sample in which you would expect New Zealand to perform near the middle on NIM and CTI ratio.

1130 We acknowledge that New Zealand's ROA does not exceed the upper quartile on ROA.

B65 However, we observe largely consistent results across multiple approaches. This provides us with a higher degree of confidence in the robustness of our finding.

Attachment C Further details on potential explanations for bank profitability| *Ētahi taipitopito anō mō ngā take hei whakamārama i tā te pēke whai huamoni*

Introduction | *Whakatakinga*

C1 This attachment supplements our analysis contained in Chapter 6 of this report by setting out more detail on our assessment of potential explanations for the observed levels of profitability in New Zealand.

C2 Profitability is affected by a range of factors beyond just competition. The appearance of high profitability relative to peer nations may instead indicate differences in factors such as relative risk, ownership structure, macroeconomic conditions and the regulatory landscape.[1131]

C3 We sought submissions that explain the apparent high profitability of New Zealand's major banks and of the New Zealand banking sector relative to international peers.[1132] We received a range of submissions on this topic, including from Incenta (representing ANZ) who assessed ANZ's level of profitability relative to a sample of international banks and against a bottom-up estimate of the cost of equity.[1133] Incenta offered a number of potential explanations for the observed level of profitability in New Zealand, which it incorporated into its analysis with various adjustments (for example, for differences in goodwill, the risk-free rate and leverage).[1134]

C4 We discuss submissions on potential explanations for the observed levels of profitability in two parts.

C4.1 We first provide further detail on our view of Incenta's alternative approach to international benchmarking.

C4.2 We then provide our assessment of other potential explanations for the observed level of banking sector profitability in New Zealand that we do not capture in our discussion on Incenta's analysis.

1131 Reserve Bank "Financial Stability Report" (3 May 2023), p. 24.

1132 Commerce Commission "Market study into personal banking services – Preliminary Issues paper" (10 August 2023), para 122.

1133 Incenta [for ANZ] "Benchmarking the profitability of the New Zealand Banks against international peers" (7 September 2023); Incenta [for ANZ] "Personal banking services market study – response to the Commission's draft report" (18 April 2024); and Incenta [for ANZ] "Market review of personal banking – post conference submission" (30 May 2024).

1134 Incenta [for ANZ] "Benchmarking the profitability of the New Zealand Banks against international peers" (7 September 2023), para 54 and Table 3.

We disagree with Incenta's approach to international profitability benchmarking | *Kāore mātou e whakaae ki tā Incenta tikanga hei whakarite paerewa whai huamoni ā-ao*

C5 Incenta's submissions have been critical of our approach to international profitability benchmarking. Across its submissions, Incenta has raised five main criticisms of our approach to assessing profitability.

C5.1 **Departure from past approach.** Incenta claims that our draft report departed significantly from the approach the Commission has previously and consistently taken when undertaking similar analysis, without explanation. Incenta says we have previously assessed profitability by deriving a sample of comparable firms listed on share markets and sourcing the relevant financial information from Bloomberg.[1135]

C5.2 **Limitations of World Bank data.** Incenta considers that there are "substantial shortcomings" with using the World Bank database because there is no visibility as to which banks are included for each country nor of the weight that is attached to each bank and the World Bank database is incomplete and does not include information on leverage or the level of booked intangible assets (goodwill), both of which are required to create robust profitability benchmarks.[1136]

C5.3 **Countries included in sample.** Incenta disagrees with including countries affected by banking crises in our international comparator sample, claiming "[a]lmost all of the Commission's key conclusions are tainted by including the crisis countries in its sample". Incenta also notes it is unclear how the sample of 20 comparators used in the draft report were chosen, given the Commission has relied on the Reserve Bank's sample without further analysis/elaboration.[1137]

C5.4 **Lack of regard to drivers of differences in profitability.** Incenta emphasises the importance of selecting a group of comparator businesses that are materially similar to the large New Zealand banks. Incenta argues the draft report incorrectly dismisses issues that are important for understanding profitability of New Zealand banks, including differences in the risk-free rate between countries, relative leverage of New Zealand banks and the importance of intangible assets such as goodwill.[1138]

1135 Incenta [for ANZ] "Benchmarking the profitability of the New Zealand Banks against international peers" (7 September 2023), para 8(a).

1136 Incenta [for ANZ] "Personal banking services market study – response to the Commission's draft report" (18 April 2024), para 14.

1137 Incenta [for ANZ] "Personal banking services market study – response to the Commission's draft report" (18 April 2024), paras 48–50.

1138 Incenta [for ANZ] "Personal banking services market study – response to the Commission's draft report" (18 April 2024), para 5(b).

C5.5 **Lack of cost of capital benchmark.** Incenta notes we have not made a comparison against a bottom-up estimate of the cost of capital. However, Incenta also cautioned about the weight that should be placed on comparisons against a bottom-up estimate.[1139]

C6 Given these criticisms, Incenta presents an alternative benchmarking approach focused on comparing ANZ's profitability to overseas banks.

C7 Incenta develops a sample of 26 banks using data sourced from Bloomberg. Incenta starts with the 20 countries from our sample in the draft report. It then uses three main filters relating to bank size, country operating environments and comparability of operations.[1140]

C8 These filters produce a final sample of 26 banks whose average ROE between 2010 to 2021 is 11.0%.[1141] This is below ANZ's average ROE for the same period of 12.3%.

C9 However, Incenta considers that these numbers are not comparable so makes three adjustments to the ROE figures for overseas banks in its sample.[1142]

C9.1 **Goodwill adjustment.** Incenta adjusts each bank's ROE and equity ratio to have the same level of goodwill as a proportion of total assets as ANZ.[1143]

C9.2 **Risk-free rate adjustment.** Incenta adjusts the ROE figures for each bank for the difference between the 10-year risk-free rate of return between New Zealand and the country in which the peer firm operates.

C9.3 **Equity ratio (leverage) adjustment.** Incenta adjusts for the difference between the cost of equity that it estimates on a bottom-up basis for ANZ using the peer group equity ratio and the cost of equity that is consistent with ANZ's equity ratio.

C10 After making these adjustments, Incenta finds that ANZ's average post-tax ROE (12.3%) over the 2010 to 2021 period was materially the same as the average post-tax ROE of its peer group of international banks (12.2%).[1144]

1139 Incenta [for ANZ] "Personal banking services market study – response to the Commission's draft report" (18 April 2024), para 5(c).

1140 Incenta [for ANZ] "Benchmarking the profitability of the New Zealand Banks against international peers" (7 September 2023), paras 38–47.

1141 Incenta [for ANZ] "Benchmarking the profitability of the New Zealand Banks against international peers" (7 September 2023), para 39 and Table 3.

1142 Incenta [for ANZ] "Benchmarking the profitability of the New Zealand Banks against international peers" (7 September 2023), paras 52–57.

1143 ANZ has goodwill on its balance sheet arising from the merger with National Bank in 2003. Goodwill produces comparability issues because goodwill only enters the balance sheet when one business acquires another.

1144 Incenta [for ANZ] "Benchmarking the profitability of the New Zealand Banks against international peers" (7 September 2023), Table 3.

C11 Incenta then compares ANZ's ROE to a bottom-up estimate of the cost of equity, which it says it has estimated "using the Commission's standard approach". Incenta estimates a range for the cost of equity of 12.1% to 12.8% and so concludes ANZ has been earning "normal" returns.[1145]

We have good reason to depart from our approach in previous market studies

C12 In two previous market studies, we developed a company-level comparator set of profitability indicators using Bloomberg data.

C13 However, there are good reasons for taking a different approach in this study. In particular, there is publicly available data on a comprehensive set of banking profitability metrics available off the shelf from a reputable source (the World Bank). Similar profitability data did not exist for sectors considered in previous market studies.

C14 We also share Incenta's reservations about comparing observed profitability to an estimate of the weighted average cost of capital in the context of a market study.[1146] If the question is whether a sector is unusually profitable in New Zealand, the relevant comparators are international rather than with estimates of the weighted average cost of capital.

Incenta focuses on ANZ's profitability rather than New Zealand's banking sector

C15 We are interested in benchmarking the profitability of the New Zealand banking sector rather than of a single firm. World Bank data is well suited for this purpose given it includes country-level profitability metrics.

C16 Incenta's approach, on the other hand, is focused on comparing the profitability of ANZ with overseas banks. Incenta makes adjustments to the observed returns of overseas banks to make them look more like ANZ.

C17 Comparing ANZ's profitability with overseas banks tells us little about profitability of the New Zealand banking sector or the state of competition in it. There are many reasons why an individual firm may have relatively high or relatively low profitability, particularly in the short term. However, as Schmalensee notes, persistent excess profits can provide a good indication of long-run market power.[1147]

1145 Incenta [for ANZ] "Benchmarking the profitability of the New Zealand Banks against international peers" (7 September 2023), paras 58–69.

1146 Incenta [for ANZ] "Personal banking services market study – response to the Commission's draft report" (18 April 2024), para 5(c).

1147 Richard Schmalensee "Another Look at Market Power" *Harvard Law Review* 95(8) (1982) 1789–1816, at pp. 1805–1806.

C18 Regardless, it is important to consider the profitability of the New Zealand banking sector more widely, including both larger and smaller banks, to draw meaningful insights about competition in the sector. By focusing on ANZ's returns, Incenta has not undertaken this analysis.[1148]

We have concerns with Incenta's sample

C19 We have two key concerns with Incenta's sample and they are interrelated. We disagree with its exclusion of crisis countries, and we do not think it has adequately considered key drivers of business risk. We discuss both concerns in detail below.

C20 We also have concerns with Incenta's scale criteria. Incenta excludes banks with a market capitalisation less than $US10b (or less than $US5b if classified as domestically systemically significant). This restriction is subjective and not evidenced. Excluding small banks risks introducing upwards bias into the returns reported by Incenta. As shown by Table 1 of Incenta's post conference submission, the country-average raw ROE figures (which exclude smaller banks) are typically higher than those reported by the World Bank.[1149,1150]

We disagree with Incenta's exclusion of crisis countries

C21 We acknowledge that New Zealand has weathered recent global banking crises well relative to many other countries.[1151] However, in our view, it is not appropriate to exclude countries that have suffered banking crises (crisis countries) when attempting to benchmark the profitability of New Zealand's banks.

1148 Incenta's analysis could be replicated for the other major banks. However, given its methodology relies on accounting adjustments to the ROE of overseas banks to reflect *ANZ's* goodwill and equity ratio, four sets of results would be produced (reflecting equivalent adjustments to the overseas banks using each of the New Zealand major banks' goodwill and equity ratio). This analysis would also continue to exclude the remaining banks that operate in New Zealand. Therefore, Incenta's approach to making accounting adjustments to the ROE figures for overseas banks complicates reaching a *sector-wide* view of New Zealand banking sector profitability.

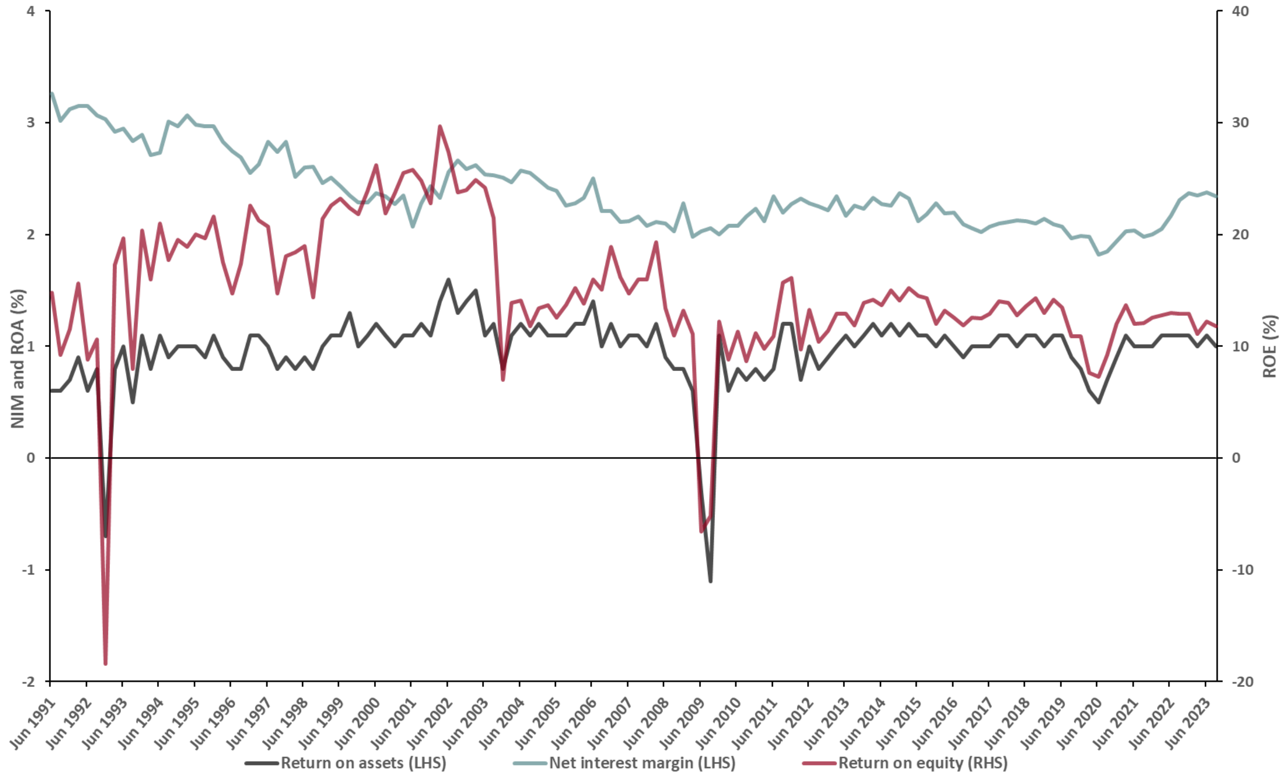
1149 Incenta [for ANZ] "Market review of personal banking – post conference submission" (30 May 2024), Table 1.

1150 We note that Incenta's sample includes only one bank from Norway despite Bloomberg reporting data for 38 publicly listed banks.

1151 Reserve Bank "Learnings from the Global Financial Crisis" (September 2012), p. 58; Reserve Bank "Financial Stability – risky, safe or just right?" (13 November 2018), https://www.rbnz.govt.nz/hub/news/2018/11/financial-stability-risky-safe-or-just-right; and Chris Hunt "Banking crises in New Zealand – an historical perspective" (1 December 2009), p. 26, https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/publications/bulletins/2009/2009dec72-4hunt.pdf.

C22 All countries can experience banking crises from time to time. Dr Yueh notes that "banking crises happen with alarming regularity".[1152] Figure C1 shows that New Zealand's banking sector experienced reductions in ROA and ROE that align with banking crises in the late 1980s, the GFC and European sovereign debt crisis between 2008 and 2010 and the COVID-19 pandemic throughout 2020.

Figure C1 New Zealand banking sector quarterly ROE, ROA and NIM between June 1991 and September 2023



Source: Commerce Commission analysis of Reserve Bank data.[1153]

C23 There are also reasonable questions to ask about what constitutes a banking crisis. New Zealand also suffered a series of finance company collapses between 2006 and 2012, resulting in the Government spending $2b to bail out these companies, in part because it was worried about the potential impacts on the financial sector.[1154]

1152 Linda Yueh "What can we learn from banking crises of the past?" (5 September 2023), https://www.economicsobservatory.com/what-can-we-learn-from-banking-crises-of-the-past. Dr Linda Yueh is Fellow in Economics at St Edmund Hall, Oxford University, and Adjunct Professor of Economics at London Business School.

1153 Reserve Bank "Banks: Summary income statement and related ratios (S20)", https://www.rbnz.govt.nz/statistics/series/registered-banks/banks-summary-income-statement-and-related-ratios [ ].

1154 The Crown Deposit Guarantee Scheme (CDGS) was implemented in October 2008 and matured in December 2011. The Government paid out $2b to 42,000 depositors under the scheme: The Treasury and Reserve Bank "Safeguarding the future of our financial system: The role of the Reserve Bank and how it should be governed" (November 2018), footnote 21 and p. 53, https://www.treasury.govt.nz/sites/default/files/2019-03/rbnz-safeguarding-future-financial-system-c1.pdf

C24 Similarly, Incenta includes US banks in its sample, even though it took swift action by US banking regulators to avert a possible crisis when three small-medium banks failed in 5 days in March 2023.[1155,1156] Further, the Federal Deposit Insurance Corporation (FDIC) notes there were 567 bank failures in the US from 2001 through 2024.[1157]

C25 Bank profits are very pro-cyclical, so excluding countries based on adverse macroeconomic conditions (including arbitrary definitions of crisis) risks biasing the sample towards high-return countries/banks.[1158]

C26 If we exclude from our sample banks that have experienced a specific set of external shocks even though those shocks could happen in New Zealand, the distribution in the sample will not be representative of the range of possible outcomes for New Zealand. In other words, the estimate will be biased.

C27 In particular, if we exclude from the sample countries that have experienced poor macroeconomic performance (provided we assume this could happen in New Zealand), estimates based on the remaining sample will tend to overestimate the expected return on banks in New Zealand.

C28 Even if we could assert that particular economic shocks will not happen in New Zealand, leaving jurisdictions in the sample where an adverse event could happen (regardless of whether it did) again biases estimates based on this sample upwards. Presumably the returns in these countries must be higher in the good states of the world to offset lower returns under worse macroeconomic conditions.

C29 Our view is that the macroeconomic events that occurred in the EU, the UK and Japan reflect outcomes that may occur (and have, on occasion, occurred) in New Zealand. Therefore, we consider that Incenta's exclusion of these countries is likely to over-estimate the appropriate returns for banks in New Zealand.

1155 Board of Governors of the Federal Reserve System "Federal Reserve Board announces it will make available additional funding to eligible depository institutions to help assure banks have the ability to meet the needs of all their depositors" (12 March 2023), https://www.federalreserve.gov/newsevents/pressreleases/monetary20230312a.htm

1156 Although the 2023 bank failures were outside our assessment period (2010 to 2021), this demonstrates that the risk of significant bank failures existed during the period. This is relevant because, presumably, returns would be higher in good states of the world to offset lower returns under worse macroeconomic conditions.

1157 FDIC "Bank Failures in Brief – Summary", https://www.fdic.gov/resources/resolutions/bank-failures/in-brief/

1158 Amending Incenta's sample to include non-diversified banks from the EU, UK and Japan (which Incenta identifies as facing recent crises) decreases the average (unadjusted) ROE from 11.0% to 9.2%. We have excluded banks classified by Bloomberg as diversified when calculating this revised ROE figure.

Incenta has not adequately considered key drivers of business risk

C30 Although Incenta refers to the importance of selecting a comparator set that is "materially similar" to New Zealand banks, in our view, it has not adequately considered the low-risk nature of banking activities undertaken by ANZ (and other major New Zealand banks).

C31 The operations of New Zealand banks are generally lower risk than many banking sectors overseas. New Zealand banks are more heavily weighted towards traditional (vanilla) banking activities (including personal and business banking) and have been simplifying their offerings in recent years.[1159] Overseas banks are more heavily weighted towards institutional, insurance and investment type activities.

C32 On average between 2010 and 2021, New Zealand's banking sector had the lowest proportion of non-interest income to total income out of countries in the Reserve Bank sample.[1160,1161] A large proportion of bank assets in New Zealand are loans to households and businesses funded mainly from deposits and equity rather than other securitisations.[1162]

C33 Traditional banking activities carry less risk than other forms of banking and are often lower cost. For example, the more vanilla nature of New Zealand and Australia's banking systems resulted in both economies' banking sectors only facing relatively mild effects during the GFC.[1163] Additionally, diversification into wider forms of banking and into a larger geographic scope increases complexity and cost.[1164]

1159 Reserve Bank "Financial Stability Report" (3 May 2023), p. 24; Reserve Bank "Learnings from the Global Financial Crisis" (September 2012), p. 58; Morningstar DBRS "Australia and New Zealand Banking Group Limited: Rating Report" (17 December 2019), pp. 2 and 4 [ ]; JP Morgan "Westpac Banking Corporation: FY23 result: Valuation looks fair but multi-year tech simplification could unlock ROE upside if executed well" (November 2023), p. 9, [ ].

1160 Commerce Commission "Personal banking services market study – Draft report" (21 March 2024), Figure C2.

1161 As discussed at paragraph B59, we acknowledge the limitations of measuring business mix using non-interest income share. We also acknowledge that the low fee structure of New Zealand banking may also drive New Zealand's lower value. Deloitte Access Economics [for BNZ] "Personal banking services: Consumer switching, conditions of entry and expansion, profitability and innovation" (7 September 2023), para 112; [ ].

1162 See Figure A1 and paragraph A6 of this report.

1163 Reserve Bank "Learnings from the Global Financial Crisis" (September 2012), p. 58.

1164 Reserve Bank "Learnings from the Global Financial Crisis" (September 2012), p. 58; [ ].

C34 Given the lower risk operations of New Zealand banks, it is unsurprising that we observe relatively stable banking sector ROEs in New Zealand since 2010. Figure C2 shows that New Zealand had near to the least volatile returns (measured by standard deviation of ROE) out of our Alternative sample of countries.[1165] Figure C5 of our draft report showed a similar outcome for the Reserve Bank sample.[1166]

C35 While these returns have been stable, New Zealand experienced one of the highest average ROEs over the period – all countries that experienced higher average returns also experienced greater volatility.

Figure C2 Country-level standard deviation of ROE against mean ROE between 2010 and 2021 for our Alternative sample of countries

Source: Commerce Commission analysis of World Bank data.[1167]

C36 Standard & Poor's has also previously referred to the conservative risk appetite of New Zealand banks:[1168]

1165 We describe our Alternative sample at paragraphs B53 to B62 and the Reserve Bank sample at paragraph B11.

1166 Incenta submitted that Figure C5 of the draft report demonstrated a counter-intuitive inverse relationship between risk and return. We note that our Alternative sample exhibits the expected positive relationship. Incenta [for ANZ] "Personal banking services market study – response to the Commission's draft report" (18 April 2024), paras 53–55.

1167 World Bank Global Financial Development Database [ ].

1168 S&P Global "Banking Industry Country Risk Assessment: New Zealand" (22 July 2020), https://www.spglobal.com/ratings/en/research/articles/200722-banking-industry-country-risk-assessment-new-zealand-11577129

> We consider that New Zealand's prudential regulatory standards remain conservative relative to international minimum standards. We are of the view that the risk appetite settings of banks are also conservative and that the industry structure is stable--an oligopoly dominated by four large banks.

C37 Risk and return finance principles state that risk-averse investors ask for compensation or a risk premium for taking on higher-risk investments.[1169] Consequently, riskier activities can earn higher long-run returns although they will be more volatile. We would expect that the lower-risk nature of New Zealand's core banking activities would, other things equal, result in lower long-run returns than the banking sectors of economies that have a riskier business mix.[1170]

C38 Incenta has defined its sample to reflect differences in business mix across banks by excluding banks classified as diversified from its sample.[1171]

C39 However, New Zealand's major banks still have a higher proportion of lower-risk mortgage lending than other banks in Incenta's sample. Figure C3 shows that, as a proportion of total assets, ASB, Westpac and ANZ have the three highest proportions of lower-risk mortgage lending while BNZ has the sixth.[1172]

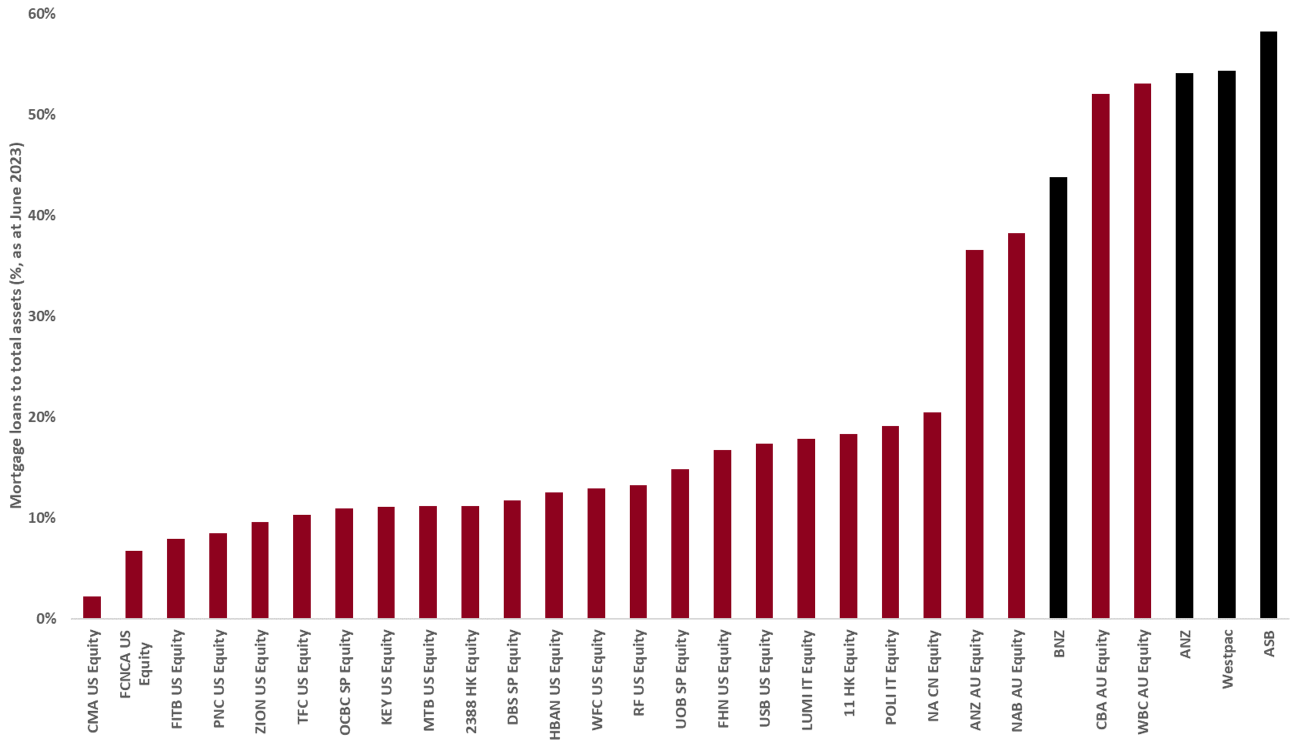
1169 Formally, risk and return principles under the CAPM model should be in terms of systematic risk – we discuss this later in this attachment. Dirk Schoenmaker and Willem Schramade "Corporate Finance for Long-Term Value" (2023), p. 325 and section 12.3, https://link.springer.com/content/pdf/10.1007/978-3-031-35009-2.pdf

1170 [ ].

1171 Incenta [for ANZ] "Benchmarking the profitability of the New Zealand Banks against international peers" (7 September 2023), para 38b.

1172 We note that we use different data sources for the major banks and international equities. For New Zealand banks, we use the Reserve Bank Bank Financial Strength Dashboard series DBB.QIC20.P1 and DBB.QIG10. For international equities, we use Bloomberg data BS_1_4_FAMILY_RESIDENTIAL_LOANS and BS_TOT_ASSET.

Figure C3 Mortgage loans to total assets – Incenta sample (FY2023) compared to major New Zealand banks (June 2023 quarter)



Source: Commerce Commission analysis of Bloomberg and Reserve Bank data.[1173]

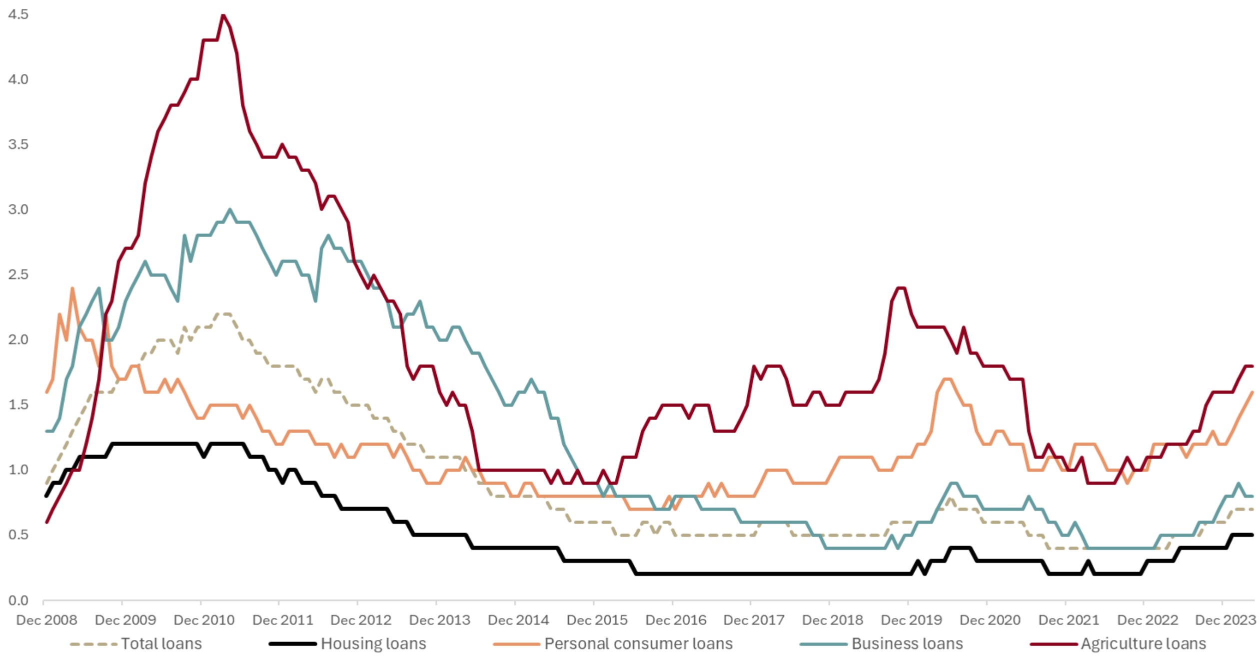
C40 The low-risk nature of housing lending is demonstrated in Figure C4, which shows that the percentage of non-performing loans is significantly lower for housing than for other categories of lending in New Zealand.[1174]

C41 We are therefore not satisfied that Incenta's sample adequately reflects the nature of banking activities in New Zealand.

1173 For overseas banks, we used the following Bloomberg fields: BS_TOT_ASSET and BS_1_4_FAMILY_RESIDENTIAL_LOANS. For Reserve Bank data we used the series: DBB.QIG10 and DBB.QIC20.P1 [ ].

1174 Also see Reserve Bank "Financial Stability Report" (1 May 2024), p. 5, https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/publications/financial-stability-reports/2024/may-2024/fsr-may-24.pdf

Figure C4 New Zealand banking sector's monthly non-performing loans ratios for different lending types between December 2008 and April 2024



Source: Commerce Commission analysis of Reserve Bank data.[1175]

We disagree with some of Incenta's adjustments

C42 Even if you accept Incenta's sample (which we do not), you can only reach the conclusion that ANZ's returns are "materially the same as its peer group of comparable banks" and "normal" by making what are, in our view, questionable adjustments.[1176] The two main adjustments we disagree with are Incenta's approach to goodwill and equity beta.

If any adjustment is to be made for goodwill, we think it should be removed

C43 Our position in previous market studies (fuel and groceries) has been that goodwill should be excluded when assessing profitability. For example, in the grocery market study, we said:[1177]

> We have removed goodwill because it is not an asset that is employed in generating earnings – rather, it reflects future expected earnings. Therefore, including goodwill may capture the expectation of excessive profits in the future.

1175 Reserve Bank "Banks: Assets – Loans by asset quality (S50)", series: BSAQS.MAR2A4.P, BSAQS.MAR2A4.P1, BSAQS.MAR2A4.P2, BSAQS.MAR2A4.P3, BSAQS.MAR2A4.P4A, https://www.rbnz.govt.nz/statistics/series/registered-banks/banks-assets-loans-by-asset-quality [ ].

1176 Incenta [for ANZ] "Benchmarking the profitability of the New Zealand Banks against international peers" (7 September 2023), pp. 2–3.

1177 Commerce Commission "Market study into the retail grocery sector – Final report" (8 March 2022), para 3.33.

C44 Incenta argues goodwill should be retained in ANZ's assets when assessing profitability for the following reasons.[1178]

C44.1 There is a substantial financial economics literature that concludes that unbooked intangible assets are becoming an increasingly important focus of investment by modern firms. However, accounting rules typically do not permit investment in these intangible assets to be capitalised. The one time an accounting value may be generated is where an asset is acquired and an explicit payment is made for the intangible assets. As the underlying assets ordinarily cannot be capitalised, they are required to be reported as goodwill.

C44.2 There is much less risk that the goodwill reported on ANZ's balance sheet may in fact have been a capitalisation of expected monopoly rents. This is because the Commission cleared ANZ's acquisition of National Bank on the basis that the acquisition would not substantially lessen competition. Additionally, ANZ's average goodwill (as a share of total assets) is only marginally above the average for US banks over the same period.

C45 Incenta also submits that it is incorrect to simply compare an accounting rate of return against a cost of capital because the denominator of the former will exclude important assets.[1179] However, our analysis does not compare ANZ's or any other bank's accounting rates of return with the cost of capital. Rather, we compare the rates of return earned by New Zealand banks against the rates of return earned by banks in 20 other countries (or 22 countries in our Alternative sample).

C46 We accept that some intangible assets are required to operate a bank. However, we do not see any evidence before us that a materially different amount of intangible assets is required to operate a bank in New Zealand than in any of the other countries included in our analysis. Therefore, we do not think it is necessary to attempt to value the intangible assets required by banks in the countries that we analyse. Even if we did, there is very little reliable information on which to do so – this is a key reason why the international accounting standards permit the capitalisation of only some intangible assets.

C47 Even if expenditure on intangibles is not capitalised, the ongoing expenditure on intangibles is still captured in the analysis – it will reduce net profit in the numerator of ROE. Unless there are systematic and large differences between the nature and profile of expenditure on intangible assets required to operate a bank in New Zealand relative to other countries, the comparison of relative rates of return across countries is unlikely to be materially affected. There is no evidence before us to suggest any difference exists.

1178 Incenta [for ANZ] "Benchmarking the profitability of the New Zealand Banks against international peers" (7 September 2023), paras 70–71.

1179 Incenta [for ANZ] "Benchmarking the profitability of the New Zealand Banks against international peers" (7 September 2023), para 71(a).

C48 Incenta submits that, to address comparability issues between ANZ and peer firms, all of the comparator banks should be assumed to have the same level of goodwill as ANZ.[1180] Incenta adjusts each comparators' assets and equity to have the same proportion of goodwill to total assets as ANZ.

C49 In our view, there is no legitimate basis for the goodwill adjustments made by Incenta. Goodwill is the amount by which the price paid for a business exceeds the fair value of all the identifiable assets acquired. The amount of goodwill is transaction specific and is materially affected by the price paid for a business. We see no valid reason why the amount of goodwill ANZ paid for National Bank in 2003 should be considered representative of the value of intangible assets for other banks.

C50 We consider that, *if* any adjustment were to be made to ensure comparability of goodwill, it should be removed when calculating ROE for both ANZ and the comparator banks.

C51 To test the impact of that approach, we have adjusted Incenta's calculations to remove goodwill from both ANZ and Incenta's comparator banks. The removal of goodwill results in a ROE for ANZ of 16.7% (relative to 12.3% with goodwill), which exceeds the average for Incenta's sample of 12.9%.[1181]

C52 Incenta makes further adjustments to account for differences in equity ratios (leverage) between banks and differences in the risk-free rate between countries. However, it is unclear why ANZ's leverage should be considered representative of other banks. The countries included in the analysis will all be subject to regulation to limit the risk of bank failures – how this impacts individual banks will depend on a number of factors that may be specific to each bank or country.[1182]

C53 Even if we incorporate these leverage and risk-free rate adjustments, ANZ still exceeds the adjusted average for Incenta's sample of banks, which has a ROE of 14% after just the risk-free rate adjustment and 16.2% after both adjustments.[1183]

1180 Incenta [for ANZ] "Benchmarking the profitability of the New Zealand Banks against international peers" (7 September 2023), para 54(a).

1181 Commerce Commission analysis of Incenta's underlying workings using data from disclosure statements and Bloomberg [ ].

1182 ANZ's relatively high leverage (low equity ratio) compared to Incenta's sample may be a function of its high proportion of low-risk housing lending, which means it is required to hold less regulatory capital compared to other categories of lending.

1183 Commerce Commission analysis of Incenta's underlying workings using data from disclosure statements and Bloomberg [ ].

Incenta's equity beta (and resulting cost of equity) estimate is inconsistent with the Commission's standard approach

C54 While Incenta cautioned about the weight that should be placed on comparisons against a bottom-up estimate of the cost of capital,[1184] Incenta estimates the cost of equity and claims that its analysis shows that the average returns of ANZ have been within the range of normal returns.[1185] As discussed in our Preliminary Issues paper, we have not estimated a weighted average cost of capital.[1186]

C55 Incenta increases the average equity beta for its comparator sample from 1.19 to 1.41 to reflect an adjustment for leverage. ANZ's equity ratio (8.7%) is lower than the adjusted leverage ratio for the comparator set (10.3%, after Incenta's goodwill adjustment).[1187] Incenta adjusts the average equity beta for its comparator sample to be consistent with ANZ's leverage.

C56 Incenta claims to have followed the Commission's standard approach to estimating the cost of equity. However, Incenta's methodology differs from our standard methodology for estimating the equity beta in two main respects.[1188]

C56.1 Incenta has not de-levered equity betas for each comparator into asset betas before re-levering the average asset beta using notional leverage (the average leverage of the sample).

C56.2 The Commission does not adjust beta estimates to reflect the leverage of a particular firm. We use the average leverage of the comparator set to re-lever the average asset beta to an equity beta.

C57 We estimate an equity beta of 1.20 using Incenta's comparator sample and data but applying the Commission's standard beta de-levering/re-levering approach. This leads to a range for the cost of equity of 10.6% to 11.2%, keeping other inputs used by Incenta constant.[1189] ANZ's ROE between 2010 and 2021 of 12.3% (including goodwill) or 16.7% (excluding goodwill) is above the top of this range, implying it is earning above normal returns.

1184 Incenta [for ANZ] "Benchmarking the profitability of the New Zealand Banks against international peers" (7 September 2023), para 14; Incenta [for ANZ] "Personal banking services market study – response to the Commission's draft report" (18 April 2024), para 83; and Incenta [for ANZ] "Market review of personal banking – post conference submission" (30 May 2024), para 16.

1185 Incenta [for ANZ] "Benchmarking the profitability of the New Zealand Banks against international peers" (7 September 2023), para 68; Incenta [for ANZ] "Personal banking services market study – response to the Commission's draft report" (18 April 2024), para 85; and Incenta [for ANZ] "Market review of personal banking – post conference submission" (30 May 2024), para 18.

1186 Commerce Commission "Market study into personal banking services – Preliminary Issues paper" (10 August 2023), para 117.

1187 Incenta [for ANZ] "Benchmarking the profitability of the New Zealand Banks against international peers" (7 September 2023), para 66.

1188 Commerce Commission "Part 4 Input Methodologies Review 2023 – Final decision: Cost of capital topic paper" (13 December 2023), paras 4.54–4.54.6, 5.7–5.9 and A27–A28.

1189 Commerce Commission analysis of Incenta's underlying workings using data from disclosure statements and Bloomberg [ ].

C58 Such adjustments to remove goodwill and to estimate the equity beta (consistent with the Commission's standard approach), which we have considered in testing and having regard to Incenta and ANZ's submissions, produce what we consider to be conservative estimates. If we adjusted for other assumptions that we disagree with (such as the exclusion of crisis countries), ANZ's returns would likely exceed these benchmarks by a greater margin.

C59 However, as we have said, we did not set out to determine the extent to which any particular bank's returns may exceed a notionally reasonable rate of return.

We are unsatisfied that the remaining explanations we have been provided reasonably explain the levels of profitability we observe in New Zealand | *Kāore mātou e rata ki ngā whakamārama mai hei whakamārama pai i ngā taumata o te whai huamonitanga e kitea ana i Aotearoa*

C60 We have considered a range of additional potential explanations for the observed levels of banking sector profitability in New Zealand that we have not yet discussed in our response to Incenta.

C61 This section sets out our views on these additional factors, which includes:

C61.1 differences in risk-free rates and market risk premia between countries;

C61.2 differences in leverage between banks;

C61.3 the effect of recent monetary policy responses;

C61.4 the effects of the foreign ownership of the major banks.

New Zealand's higher risk-free rate and the existence of a premium in wholesale markets for New Zealand banks do not materially drive higher profitability in New Zealand

C62 The prevailing risk-free rate and the market risk premium both affect investors' expected level of return.

New Zealand's higher risk-free rate is not materially driving differences in ROE

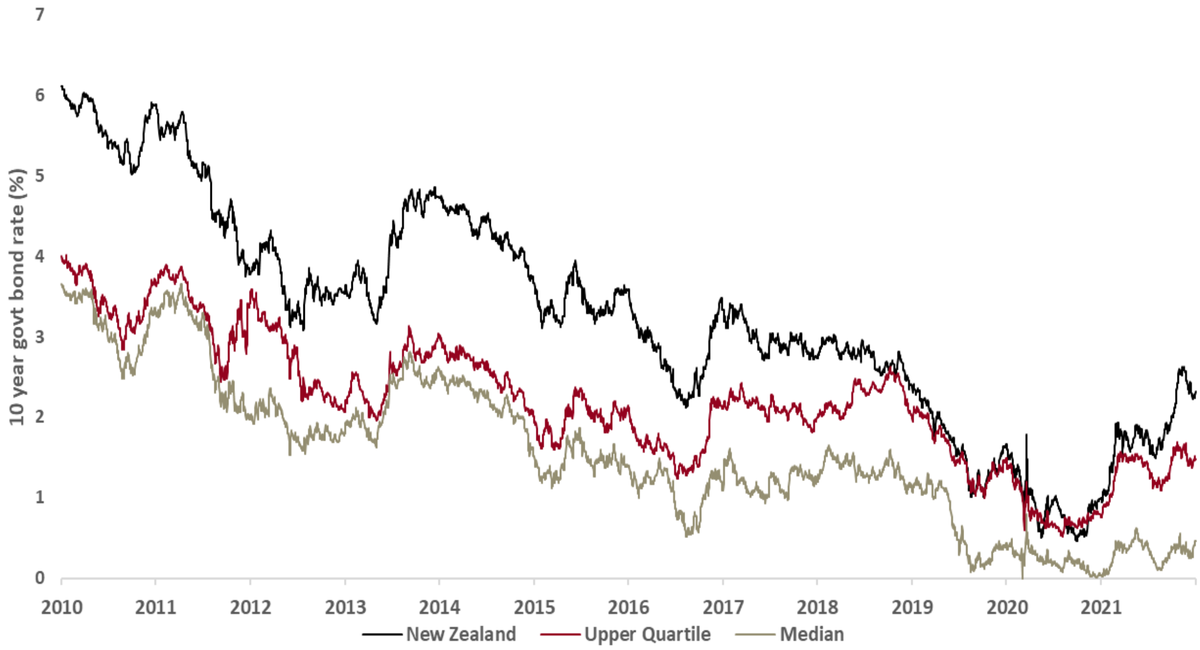
C63 The risk-free rate is the rate of return expected when there is no risk of default. When estimating the cost of capital as the benchmark for assessing profitability, the risk-free rate is explicitly relevant to the calculation of the cost of debt and cost of equity.[1190] All else equal, if the risk-free rate increases, an investor would expect a higher rate of return.

[1190] Commerce Commission "Part 4 Input Methodologies Review 2023: Final decision – Cost of capital topic paper" (December 2023), para 4.357.

C64 Debt issued by the New Zealand Government and denominated in New Zealand dollars is considered to be free of default risk, and we have used 10-year government bond yields to measure the risk-free rate in previous market studies.[1191] In this case, we have compared New Zealand's 10-year government bond yields between 1 January 2010 to 31 December 2021 to the 10-year government bond yields of countries in the Reserve Bank sample for which data was available.[1192]

C65 As can be seen in Figure C5, New Zealand is in the upper quartile of this sample for much of the period and in fact had the highest average risk-free rate of the sample. All else equal, this would suggest that New Zealand firms would expect a higher level of profitability over this period relative to the countries in the sample.

Figure C5 New Zealand's daily 10-year government bond rate between 1 January 2010 and 31 December 2021 relative to the upper quartile of comparator countries



Source: Commerce Commission analysis of Wall Street Journal data.[1193]

1191 Commerce Commission "Market study into the retail grocery sector – Final report" (8 March 2022), paras B13–B14.

1192 Data was available for all countries in our sample except Austria, Finland, Hong Kong, Israel and Switzerland. We have used the daily day close value for each country. Where data was unavailable for a particular day, we have used the previous day close value as a proxy.

1193 Wall Street Journal 10-year government bond yield data for each country in the Reserve Bank sample except Austria, Finland, Hong Kong, Israel and Switzerland [ ].

C66 However, when we adjust the ROE for countries in the Reserve Bank sample (for which we have data) to reflect differences in each country's average risk-free rate relative to New Zealand's, New Zealand remains in the upper quartile.[1194,1195] We estimate an adjusted upper quartile of 11.80%, relative to New Zealand's average ROE of 12.61%. We include our adjustment to each country's ROE in Table C1.

C67 While the upper quartile of the sample does increase with this adjustment, New Zealand remains in the upper quartile. Therefore, we are not satisfied that New Zealand's higher risk-free rate reasonably explains a material proportion of New Zealand's relatively higher ROE.

Table C1 Risk-free rate adjusted average ROE for countries in the Reserve Bank sample for which data was available between 2010 and 2021

Country	Average ROE	Average risk-free rate	Differential to New Zealand	Adjusted ROE
Canada	14.95%	1.91%	1.33%	16.29%
Sweden	12.20%	1.13%	2.11%	14.32%
Norway	11.68%	1.98%	1.27%	12.95%
New Zealand	**12.61%**	**3.25%**	**0.00%**	**12.61%**
Australia	11.87%	2.95%	0.29%	12.16%
Singapore	10.17%	1.97%	1.28%	11.45%
Belgium	8.92%	1.46%	1.79%	10.71%
United States	9.35%	2.19%	1.05%	10.40%
Netherlands	7.55%	1.07%	2.18%	9.72%
France	7.09%	1.30%	1.95%	9.04%
Denmark	6.16%	0.98%	2.27%	8.43%
Japan	4.73%	0.40%	2.84%	7.57%
United Kingdom	3.13%	1.72%	1.53%	4.66%
Germany	0.51%	0.86%	2.38%	2.89%
Italy	-0.57%	2.79%	0.45%	-0.12%
Portugal	-5.11%	3.22%	0.02%	-5.08%

Source: Commerce Commission analysis of Wall Street Journal and Reserve Bank (Bank Financial Strength Dashboard) data.[1196]

1194 Average risk-free rates are appropriate when assessing the profitability of an unregulated firm over time. Commerce Commission "Market study into the retail grocery sector – Final report" (8 March 2022), paras B15–B15.3.

1195 Commerce Commission analysis of Wall Street Journal data and Reserve Bank Bank Financial Strength Dashboard data [ ].

1196 Commerce Commission analysis of Reserve Bank Bank Financial Strength Dashboard data and Wall Street Journal 10-year government bond yield data for each country in our Reserve Bank sample except Austria, Finland, Hong Kong, Israel and Switzerland [ ].

We are not satisfied that differences in market risk premia between New Zealand and comparator countries explain New Zealand's relatively high profitability

C68 The market risk premium is also relevant to shareholders' expected returns and reflects investors' expected return above the risk-free rate for bearing systematic (market) risk.[1197]

C69 As we have not conducted a full cost of capital exercise, we have not endeavoured to estimate New Zealand's market risk premium relative to other countries in our sample.

C70 We understand that investing in New Zealand could carry higher risk than other developed economies, which could translate into New Zealand banks needing to pay a premium to debt and equity investors.[1198,1199]

C71 In respect of debt, we have sector-specific information that New Zealand banks pay a premium in wholesale markets because of country-specific risk.[1200] This is significant given that New Zealand faces a mismatch between deposits and credit demand so that there is a reliance on wholesale funding at the margin.[1201] However the evidence suggests that this risk premium is very low.[1202]

1197 Commerce Commission "Part 4 Input Methodologies Review 2023: Final decision – Cost of capital topic paper" (13 December 2023), para 4.337.

1198 [ ]; [ ]; [ ].

1199 BNZ, Submission on draft report (18 April 2024), para 3.15b; Deloitte Access Economics [for BNZ] "Personal banking services market study – Review of the Commerce Commission's draft report" (18 April 2024), para 50; Incenta [for ANZ] "Market review of personal banking – post conference submission" (30 May 2024), para 20; [ ]; [ ].

1200 [ ]; [ ]; [ ]; Deloitte Access Economics [for BNZ] "Personal banking services market study – Review of the Commerce Commission's draft report" (18 April 2024), para 50.

1201 Deloitte Access Economics [for BNZ] "Personal banking services: Consumer switching, conditions of entry and expansion, profitability and innovation" (7 September 2023), paras 124–125; [ ]; [ ].

1202 [ ]; [ ].

C72 Dr Martin Lally estimated the tax-adjusted market risk premium (TAMRP) for New Zealand in April 2023. These estimates are used in the Commission's regulatory work. He concludes that New Zealand's median TAMRP across various methodologies is the same as the sample TAMRP for a sample of comparator countries when rounded to the nearest 0.5%, as is the Commission's standard practice.[1203,1204]

C73 There are country-specific risks for international investors in all countries. New Zealand's risks are assessed as being broadly similar to those of other developed countries, so we do not consider country-specific risk to be an explanation for high bank profits in New Zealand relative to comparator countries.

There is little evidence that New Zealand banks are particularly more leveraged than peers

C74 The degree of leverage can affect bank profitability as a more leveraged bank may expect to earn a higher ROE largely due to the higher associated risk of greater liability funding.[1205] The Modigliani-Miller theorem concludes that, in theory, a leveraged firm cannot command a premium over an unleveraged firm. However, we note that, in practice, higher leverage can increase expected returns at certain levels of leverage.[1206]

C75 It has been submitted to us that the New Zealand banks are more highly leveraged than international peers.[1207] One measure of leverage is the equity ratio, which shows total equity as a proportion of total assets. A more leveraged bank would have a higher proportion of debt funding and so a lower equity ratio.

C76 Because the World Bank dataset does not include data that would allow for the assessment of leverage at the national level, we compare the average equity ratio for ANZ, BNZ, ASB and Westpac against the average equity ratio of banks in Incenta's wider non-diversified sample between 2018 to 2022.[1208]

1203 Martin Lally "Estimation of the TAMRP" (10 April 2023), p. 25, https://comcom.govt.nz/__data/assets/pdf_file/0024/318462/Dr-Martin-Lally-Estimation-of-TAMRP-report-10-April-2023.pdf; and Commerce Commission "Part 4 Input Methodologies Review 2023: Final decision – Cost of capital topic paper" (13 December 2023), para 4.372–4.379.

1204 BNZ submits concerns with rounding to the nearest 0.5%, claiming it is not insignificant when seeking to make cross-country comparisons. However, the Commission's view is that estimating the TAMRP to a high level of accuracy is not practically achievable. BNZ, Submission on draft report (18 April 2024), para 3.15c; and Commerce Commission "Part 4 Input Methodologies Review 2023: Final decision – Cost of capital topic paper" (13 December 2023), para 4.379.

1205 European Central Bank "Beyond ROE – how to measure bank performance: Appendix to the report on EU banking structures" (September 2010), pp. 5 and 18.

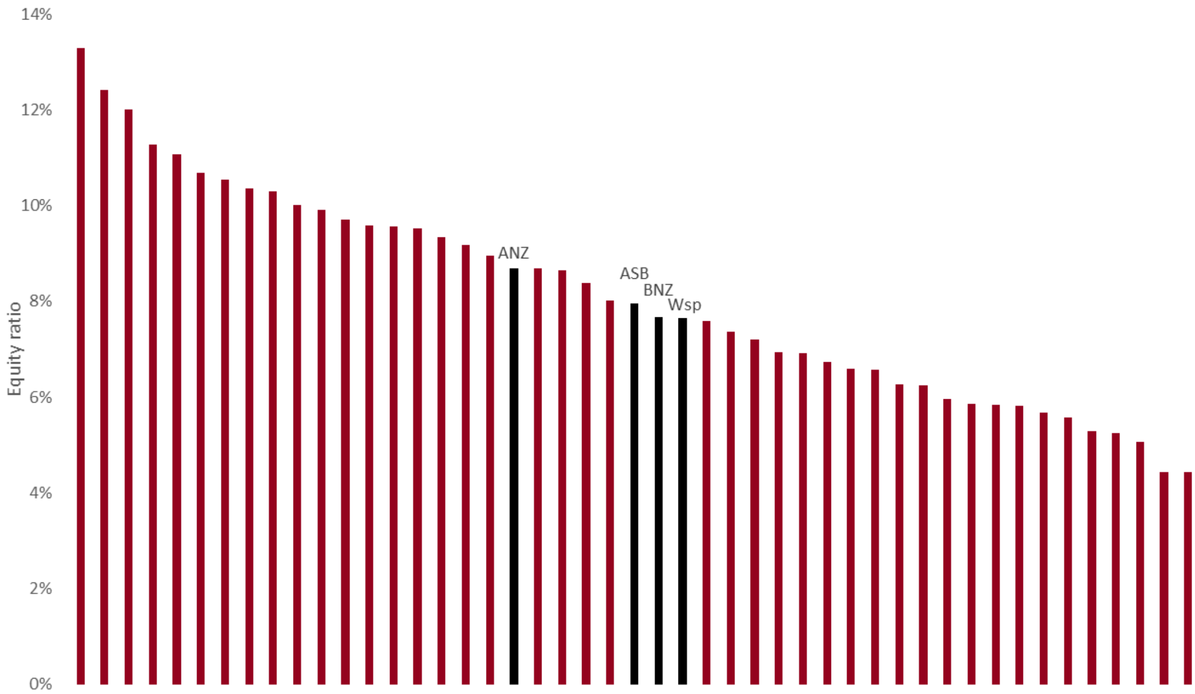
1206 Franco Modigliani and Merton Miller "The cost of capital, corporation finance and the theory of investment" *The American Economic Review* 48(3) (1958) 261–297, p. 270.

1207 Incenta [for ANZ] "Personal banking services market study – response to the Commission's draft report" (18 April 2024), para 65.

1208 The list of comparator banks match those in Incenta [for ANZ] "Benchmarking the profitability of the New Zealand Banks against international peers" (7 September 2023), Tables 5 and 7. As Incenta uses financial year data, to ensure consistency, we use Reserve Bank data for New Zealand banks between June 2018 and June 2022.

C77 Care must be taken when interpreting these results. New Zealand banks' data is captured from the Reserve Bank dataset, while international banks' data is captured through Bloomberg. Different datasets may not be directly comparable. Additionally, Bloomberg data is annual while Reserve Bank data is quarterly.[1209]

Figure C6 Average bank-level equity ratio for ANZ, ASB, BNZ and Westpac relative to overseas banks between 2018 to 2022



Source: Commerce Commission analysis of Reserve Bank and Bloomberg data.[1210]

C78 While not determinative due to these data limitations, Figure C6 shows that the major New Zealand banks' equity ratios have on average been near the middle of Incenta's sample. This does not support the view that New Zealand's major banks' profits are explainable by higher leverage.

C79 Incenta submitted that this finding is wholly driven by including banks from crisis countries in our comparison.[1211] However, for the reasons expressed at paragraphs C21 to C29, we disagree with the exclusion of crisis countries. Even if we were to exclude those countries from the sample, our adjustments to Incenta's sample, as discussed at paragraph C52, shows that ANZ's returns still exceed the average for Incenta's sample after adjusting for leverage.

1209 The use of averages will partly mitigate the effect of quarterly fluctuations, including seasonality.

1210 Reserve Bank "Bank Financial Strength Dashboard" [ ].

1211 Incenta [for ANZ] "Personal banking services market study – response to the Commission's draft report" (18 April 2024), para 67.

C80 In a submission to the Reserve Bank in May 2019, the New Zealand Banking Association points to work by PricewaterhouseCoopers (PwC) that claims that the capital ratios of New Zealand's major banks are in the top quartile of large international banks and are above what the Australian Prudential Regulatory Authority would consider to be "unquestionably strong".[1212] A higher proportion of capital implies that the major New Zealand banks are less leveraged than international peers.

C81 Additionally, our analysis in Chapter 6 shows that the profitability of New Zealand's banking sector has also been high relative to the Reserve Bank sample over the past decade on ROA, which adjusts for the effect of leverage.[1213]

The macroeconomic and regulatory environment can affect profitability

C82 The macroeconomic and regulatory environment can materially influence actual and expected shareholder returns relative to international peers.

C83 New Zealand's banking sector is experiencing a period of significant regulatory change. For example, the recent implementation of the outsourcing policy (BS11), the ongoing implementation of the uplift in capital requirements to 2028, the upcoming potential changes of other prudential requirements as they are shifted under the DT Act and a host of other concurrent regulatory changes require investment from banks not only to implement the changes but to ensure ongoing compliance.[1214]

C84 The cost of complying with these changes is asymmetric and affects smaller and less well-resourced banks more substantially than larger ones as they lack the ability to deal with the ongoing and upcoming regulatory burden (in terms of both pace and substance).[1215]

1212 NZBA "Submission to the Reserve Bank of New Zealand on the Consultation Paper: How much capital is enough?" (17 May 2019), para 18, https://www.nzba.org.nz/wp-content/uploads/2019/05/190517-NZBA-submission-How-much-capital-is-enough.pdf; and PwC "International comparability of the capital ratios of New Zealand's major banks – update paper" (17 May 2019), pp. 4, 6 and 14, https://www.nzba.org.nz/wp-content/uploads/2019/05/Appendix-Two-International-comparability-of-capital-ratios-2019.pdf

1213 European Central Bank "Beyond ROE – how to measure bank performance: Appendix to the report on EU banking structures" (September 2010), p. 19.

1214 Kiwibank, Submission on Preliminary Issues paper (7 September 2023), p. 3;
[ ].

1215 Heartland Bank, Submission on Preliminary Issues paper (7 September 2023), para 11(e); Kiwibank, Submission on Preliminary Issues paper (7 September 2023), pp. 6–7, 13–14 and 18; and TSB, Co-operative Bank, Kiwibank and SBS Bank, Submission on Preliminary Issues paper (7 September 2023), pp. 1–2; [ ].

Recent monetary policy responses have supported banking sector profitability during a period of heightened macroeconomic uncertainty

C85 Banking sector profitability has been affected in recent years by the COVID-19 pandemic and the Reserve Bank's resulting monetary policy measures, including the FLP and large scale asset purchase (LSAP) programmes and the reduction and subsequent raising of the OCR.

C86 This section solely discusses these policies in the context of banking sector profitability with respect to competition and does not comment on the appropriateness of these policies with respect to wider policy objectives, including financial stability and expansionary or contractionary monetary policy.

C87 FLP aimed to lower interest rates to encourage household and business spending by allowing banks to borrow from the Reserve Bank at the OCR.[1216] LSAP aimed to lower borrowing costs to households and businesses by injecting money into the economy through the purchase of various government bonds.[1217]

C88 FLP may have distorted competition to an extent as access to funding was limited to particular banks so that providers who could not access the programme were unable to access cheap funding.[1218] Consequently, those smaller banks would have faced a funding disadvantage.

C89 Both programmes were expansionary and resulted in an injection of liquidity into the economy.[1219] This weakened bank competition for deposits as banks could access cheap funding through the FLP programme and faced increased deposit supply through LSAP.[1220] We note that this effect may have been partly offset by banks taking more conservative approaches (due to macroeconomic uncertainty) by maintaining high levels of liquidity.[1221]

1216 Reserve Bank "Funding for Lending Programme Terms" (December 2020), p. 1, https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/markets/domestic-markets/flp-term-sheet-december-2020.pdf

1217 Reserve Bank "Large scale asset purchase programme" (23 March 2022), https://www.rbnz.govt.nz/monetary-policy/monetary-policy-tools/large-scale-asset-purchase-programme

1218 Reserve Bank "Financial Stability Report" (1 November 2023), p. 39; Heartland Bank, Submission on Preliminary Issues paper (7 September 2023), para 11(f).

1219 Reserve Bank "Funding for Lending Programme Terms" (December 2020), p. 1; New Zealand Parliament "Library research brief – Large Scale Asset Purchase (LSAP) programme" (28 October 2020), https://www.parliament.nz/mi/pb/library-research-papers/research-papers/library-research-brief-large-scale-asset-purchase-lsap-programme/

1220 [ ].

1221 [ ].

C90 Simultaneously, customers had weighted their deposits towards on-call transaction accounts or savings accounts (often bearing little to no interest) due to the low interest rate environment at the time.[1222] Greater non-interest-bearing deposits bolster NIMs by essentially providing banks with free funding as these deposits bear no or low interest expense.[1223]

C91 All together this supported NIM stability with New Zealand's banking sector's NIM increasing by 10 basis points between 2020 and 2021, while the upper-quartile NIM of peer countries in the Reserve Bank sample declined by 1 basis point and the median declined by 14 basis points.[1224] The Reserve Bank noted that, during the period of monetary policy tightening, "banks have experienced higher than average net interest margins (NIMs), as the interest income earned on their assets has grown faster than the interest costs paid on their funding".[1225]

C92 We note that the effect of FLP was partly offset by banks largely focusing this funding into discounted lending products.[1226] Some banks indicated that they ringfenced the funding to offer discounted rates on a range of targeted lending products.[1227] This may have reduced the magnitude by which the programme increased bank profitability.

1222 [ ].

1223 The Treasury "Budget 2023 Tax Initiatives Information Release" (July 2023), para 81, https://www.treasury.govt.nz/sites/default/files/2023-07/b23-tax-4791084.pdf

1224 Based on Commerce Commission analysis of World Bank data [ ].

1225 Reserve Bank "Financial Stability Report" (1 November 2023), p. 40.

1226 We asked the major banks for information on whether the FLP funding was all completely passed through into lower interest rates or whether it also contributed to higher profits. The major banks stated that they did not directly profit from the FLP programme but not all had records that could demonstrate directly how the lower-cost funding was completely passed through to customers and we have not confirmed the accuracy of the banks' claims. [ ].

1227 These targeted products often focused on loans to build new housing or for environmental purposes. [ ].

C93 In the rising interest rate environment that followed, we saw NIMs increase largely due to non-interest-bearing deposits while certain interest rate spreads decreased.[1228,1229] This was partly offset by pressures on lending margins, customers shifting to interest-bearing deposits as interest rates increased and the ending of the FLP and LSAP programmes.[1230]

C94 Each of these policy interventions may have increased New Zealand's relative bank profitability (particularly NIMs) in more recent years. However, our international comparisons consider a longer period back to 2010, and so while these policies may explain more recent profitability trends, they do not explain what we have observed over our entire analysis period.

The major banks' Australian ownership may provide cost advantages over domestic banks but is unlikely to explain international variation

C95 New Zealand's four major banks are subsidiaries of Australian parent companies. ANZ and Westpac are owned by the Australian firms by the same name, while BNZ is owned by NAB and ASB by CBA.

We would expect competitive dynamics to at least partially erode the benefits from the lower-cost structure of New Zealand's major banks

C96 We observe that New Zealand banks have a relatively low cost structure in comparison to overseas banks. As we show in Chapter 6, New Zealand has a relatively low CTI ratio,[1231] and of 152 countries, New Zealand has the 12th-lowest average overhead costs to total assets between 2010 and 2021.[1232] Professor Margaritis and Dr Hasannasab found that New Zealand banks operate with high cost-efficiency, generally in the 80–90% range.[1233]

1228 Commerce Commission "Personal banking services market study – Draft report" (21 March 2024), Figure 6.9.

1229 Based on Commerce Commission analysis of interest.co.nz data on LVR special headline 1-year fixed mortgage rate versus the highest available 1-year term deposit rate for each bank. [ ].

1230 [ ].

1231 See paragraph 6.24.

1232 These 152 countries are those that met our data completeness criterion for our Broad sample of countries by having no more than 3 years of missing post-tax ROE data in the World Bank dataset. Commerce Commission analysis of World Bank data [ ].

1233 Cost-efficiency is a measure of how effectively banks minimise costs given their level of outputs and input costs: Dimitris Margaritis and Maryam Hasannasab "Market power in banking: A study of New Zealand banks" (March 2024), pp. 7–10.

C97 The relatively vanilla operations of New Zealand's banking sector, the major banks possessing a higher proportion of transaction deposits (which includes non-interest-bearing deposits) relative to smaller banks and underinvestment in core systems (as discussed in Chapter 9) likely drive some of these differences.[1234,1235]

C98 However, the Australian ownership of New Zealand's major banks appears to drive additional cost efficiencies. We acknowledge that smaller entrants and competitors may benefit from not operating legacy systems or having only small (and sometimes no) physical branch network to maintain.[1236] However, we observe that the major banks' average operating expenses as a share of total assets has on average been lower than the average for other banks operating in New Zealand between March 2018 and March 2024.[1237] We also observe that the major banks generally have a lower CTI ratio than the smaller banks and Kiwibank.[1238]

C99 The major banks benefit from scale efficiencies from being subsidiaries of their Australian parent company. This includes savings relating to group strategy and investor relations generated from the Australian business.[1239] The banks may also benefit from group-wide investment and funding when access to wholesale markets is disrupted.[1240]

1234 Relative proportions of transaction deposits can be seen at Figure 5.5 of this report.

1235 [ ].

1236 BNZ, Submission on draft report (18 April 2024), para 3.12b.

1237 Based on Commerce Commission analysis of Reserve Bank (Bank Financial Strength Dashboard) data [ ]. Only China Construction Bank, Bank of China and Industrial and Commercial Bank of China had lower average values over the period.

1238 [ ].

1239 BNZ, Submission on Preliminary Issues paper (7 September 2023), para 4.29; [ ].

1240 [ ].

C100 We additionally observe that the major banks generally have the highest credit ratings of the banks operating in New Zealand (as shown in Table C2) and the strength of the Australian parent companies appears to partly drive this difference.[1241] Smaller banks' organisational structures may instead constrain their ability to raise capital, for example, if they have a cooperative or mutual membership structure.[1242] This provides the major banks with a funding advantage in wholesale markets over smaller banks operating in New Zealand.[1243]

Table C2 Credit rating for banks operating in New Zealand in the March 2024 quarter

Bank name	Fitch	Moody's	S&P Global
Kiwibank	AA	A1	
ANZ	A+	A1	AA-
ASB	A+	A1	AA-
BNZ	A+	A1	AA-
Westpac	A+	A1	AA-
China Construction Bank	A	A1	
TSB	A-		
Heartland Bank	BBB		
SBS Bank	BBB		
Co-operative Bank	BBB		
Bank of India	BBB-		
Bank of Baroda	BBB-		
Rabobank			A
Industrial and Commercial Bank of China		A1	A
Bank of China		A1	A

Source: Commerce Commission analysis of Reserve Bank data.[1244]

C101 We acknowledge that, in a workably competitive market, more-efficient firms can extract greater returns. However, in a workably competitive market, we would also expect that competitive pressure would at least partially erode this. We do not observe this in New Zealand.

1241 ASB, Cross-submission on draft report (31 May 2024), para 7.6; NERA [for ASB] "Personal banking services market study – review of Attachment C to PIP" (7 September 2023), paras 66–70. [ ].

1242 TSB, Co-operative Bank, Kiwibank and SBS Bank, Submission on Preliminary Issues paper (7 September 2023), p. 4; NZBA "Submission to the Reserve Bank of New Zealand on the Consultation Paper: How much capital is enough?" (17 May 2019), para 46; and Incenta [for ANZ] "Market review of personal banking – post conference submission" (30 May 2024), para 33.

1243 NERA [for ASB] "Personal banking services market study – review of Attachment C to PIP" (7 September 2023), paras 69–70; ASB, Submission on Preliminary Issues paper (7 September 2023), para 31.3; Deloitte Access Economics [for BNZ] "Personal banking services: Consumer switching, conditions of entry and expansion, profitability and innovation" (7 September 2023), paras 126–127; [ ].

1244 Reserve Bank "Bank Financial Strength Dashboard" [ ].

C102 The major banks possess approximately 85–90% of total banking assets in New Zealand and comprise the entirety of the first-tier providers.[1245] If this tier was workably competitive, we would expect that the first-tier banks would have competed away profits attributable to their relatively lower CTI ratio. We have not seen evidence of this occurring.

C103 Deloitte Access Economics (representing BNZ) submitted that, in a competitive market, more-efficient firms can earn above normal profits because the market price in equilibrium is set by the highest-cost marginal producer.[1246]

C104 We consider that, for this argument to hold, two conditions must be true.

C104.1 The major banks must be incapable of supplying all market demand so that higher-cost firms are required to clear the market.

C104.2 The major banks must place material weight on the smaller banks when setting prices.

C105 We have not seen sufficient evidence to suggest that the market for personal banking services meets either criterion. CRA (representing ANZ) also submitted that Deloitte's model does not reflect banking because "products are differentiated, non-price dimensions of competition are important, banks are not obviously tightly capacity constrained, and it is also not obvious that marginal costs differ much".[1247]

C106 In a workably competitive market, we would also expect to see less-efficient firms seeking to capture and compete away some of those higher returns by expanding. More-efficient firms would consequently need to seek out additional efficiencies to maintain their superior returns.

C107 As we discuss in Chapter 2, however, we do not observe this competitive dynamic in New Zealand because smaller providers face various barriers to expansion. Shielded from the threat of significant competition and disruption from smaller providers, the oligopolistic large providers, who have similar cost structures, have weak incentives to compete strongly to achieve additional cost advantages.

1245 Reserve Bank "Bank Financial Strength Dashboard – Balance sheet".

1246 Deloitte Access Economics [for BNZ] "Personal banking services market study – Review of the Commerce Commission's draft report" (18 April 2024), paras 118–119.

1247 CRA [for ANZ] "Personal Banking Services Market Study – Comments following conference" (4 June 2024), paras 41–43.

C108 Deloitte invited us to consider "whether regulatory settings designed to ensure financial stability explain, in large part, the persistence of the relatively higher profitability" by imposing conditions that inhibit entry, exit or expansion.[1248] We agree that regulatory barriers to entry or expansion likely contribute to high profitability of the New Zealand banking sector. We have identified regulatory barriers as one of the main factors affecting competition in the sector (see Chapter 7 for further discussion). We have made recommendations to reduce these regulatory barriers in Chapter 10, which we expect to enhance competition over time.

C109 We are not persuaded that, as NERA submitted, Australian investors take on materially more risk investing into New Zealand by bearing the cost of insulating their subsidiaries from shocks.[1249] We have seen no evidence that the risk borne by shareholders of New Zealand's major banks is larger than that borne by any other investor in a bank operating in New Zealand. Even if Australian shareholders did bear additional risk, the above-mentioned wholesale funding advantage as a result of the strength of the Australian parent company would negate some of this effect.

C110 While Australian ownership and any related cost efficiencies may drive differences between New Zealand's major banks and Kiwibank and the smaller domestic banks, the largest New Zealand banks are small by international standards.[1250] It therefore does not follow that foreign ownership would provide a funding advantage or an economies of scale benefit relative to banks in larger banking sectors.

We do not accept that shareholder expectations are affected by the transferability of imputation credits

C111 Australian resident shareholders, including those of New Zealand's major banks, cannot access imputation credits on the profits of the New Zealand subsidiary.[1251] Imputation credits (franking credits in Australia's tax system) allow shareholders receiving a dividend to benefit from the income tax paid by the company on its profits by claiming the credit against their income tax liability.[1252]

1248 Deloitte Access Economics [for BNZ] "Personal banking services market study – Review of the Commerce Commission's draft report" (18 April 2024), paras 126–128.

1249 ASB, Cross-submission on draft report (31 May 2024), paras 7.1–7.9; and NERA [for ASB] "Personal banking services market study – review of Attachment C to PIP" (7 September 2023), paras 62–72.

1250 Reserve Bank "The banking sector" (18 May 2022); Deloitte Access Economics [for BNZ] "Personal banking services: Consumer switching, conditions of entry and expansion, profitability and innovation" (7 September 2023), Figure 17 and para 85; [ ].

1251 Australian Taxation Office "Trans-Tasman imputation special rules", https://www.ato.gov.au/businesses-and-organisations/corporate-tax-measures-and-assurance/imputation/in-detail/trans-tasman-imputation-special-rules

1252 Inland Revenue "Imputation: A guide for New Zealand companies" (July 2022), p. 4, https://www.ird.govt.nz/-/media/project/ir/home/documents/forms-and-guides/ir200---ir299/ir274/ir274-jul-2022.pdf?modified=20230330231847&modified=20230330231847

C112 NERA submitted that an Australian-owned bank would require a higher pre-tax return to ensure the same post-tax profitability because the New Zealand shareholders can receive imputation credits on these profits.[1253] ASB submitted that shareholders "have real choices about where and when they deploy capital and the marginal returns on capital across various opportunities is a key component of this".[1254]

C113 It is not clear to us whether this is a material issue in practice given that the dollar value of profits stemming from the New Zealand businesses are only small relative to the profits of each banking group, and we see no evidence that Australian dividends are regularly partially franked in practice.

C114 On average, ANZ, Westpac, ASB and BNZ's 2023 financial year profit in New Zealand comprised approximately 20% of the whole group's profits.[1255] Simultaneously, the banks tend to target a dividend payout ratio of only 60–80%.[1256] Consequently, the Australian dividend may be entirely comprised of Australian profits while New Zealand profits are held as retained earnings. These Australian profits could be fully franked in the Australian tax system.

C115 If it were the case that the non-transferability of imputation credits materially affected the cost of equity of the major banks, one would expect Australian dividends to consistently be only partially franked. However, over the past two decades, ANZ, CBA, NAB and Westpac have fully franked their Australian dividends at most payments.[1257] The only examples of partially franked dividends over this period are NAB between 2005 and 2007 and ANZ in December 2019, December 2023 and July 2024.

C116 We are therefore not persuaded that Australian resident shareholders face a tax disadvantage through not having access to New Zealand imputation credits.

1253 NERA [for ASB] "Personal banking services market study – review of Attachment C to PIP" (7 September 2023), paras 76–78.

1254 ASB, Cross-submission on draft report (31 May 2024), para 7.10.

1255 Calculated by comparing net profit in each bank's full-year 2023 New Zealand disclosure statements converted to Australian dollars using the average exchange rate for the year ended 30 September 2023 against the net profit attributable to shareholders/owners in each bank's Australian full-year 2023 financial statements. This figure is the average of all four banks' values. [ ].

1256 Westpac "2023 Annual Report", p. 4, https://www.westpac.com.au/content/dam/public/wbc/documents/pdf/aw/ic/WG-AnnualReport-2023.pdf; CBA "2023 Annual Report", p. 51, https://www.commbank.com.au/content/dam/commbank-assets/investors/docs/results/fy23/2023-Annual-Report-Spreads.pdf; NAB "Full Year Results 2023", p. 11, https://www.nab.com.au/content/dam/nab/documents/reports/corporate/2023-full-year-results.pdf; ANZ "2023 Annual Report", p. 14, https://www.anz.com/content/dam/anzcom/shareholder/ANZ-Annual-Report-2023.pdf

1257 ANZ "Dividend Information", https://www.anz.com/shareholder/centre/your-shareholding/dividend-information/; NAB "NAB's dividend payment history", https://www.nab.com.au/about-us/shareholder-centre/dividend-information/payment-history; CBA "Dividend information", https://www.commbank.com.au/about-us/investors/dividend-information.html; Westpac "Dividend payment history", https://www.westpac.com.au/about-westpac/investor-centre/dividend-information/dividend-payment-history/

Attachment D Competition for different consumer groups | *Te whakataetae mō ngā rōpū kaiwhakapeto*

D1 In considering the factors affecting competition in personal banking, we have asked whether competition is delivering good outcomes for all consumers. Our overall conclusion is that certain consumer groups are not particularly well served by competition, and for certain pockets of the population, the outcomes are worse. There are some individuals in New Zealand who experience financial exclusion more than others. This segment of consumers, referred to as poorly served consumers, can be unduly affected by lack of competition.[1258]

D2 Although not an exhaustive list, poorly served consumers in New Zealand can be consumers who are living rurally, are elderly, are disabled, are recent migrants, have no fixed abode, are experiencing a relationship breakdown, are going through insolvency, have an undesirable credit rating, are experiencing digital exclusion, have financial literacy barriers, are coming out of prison or rely on government support as the main line of income.[1259]

D3 To understand this issue better, we sought feedback from a diverse range of consumer groups, charitable trusts and other relevant stakeholders. We spoke with Consumer NZ, Christians Against Poverty New Zealand (CAP), FinCap, Community Networks Aotearoa, Rural Women New Zealand and Community Law centres. The wānanga we conducted with Māori representatives also contributed to this workstream as did the consultation conference we held in May 2024.[1260]

D4 Other relevant research included a consumer feedback form hosted on our website, submissions on the Preliminary Issues paper and draft report, related reports, online articles and the consumer research undertaken by Verian on our behalf.[1261]

1258 CoFR "Consumer Vulnerability Framework", https://www.cofr.govt.nz/files/consumer-vulnerability-framework.pdf

1259 FinCap "Voices – Indicators of financial wellbeing for whānau supported by financial mentors in 2021 and 2022" (September 2023), part three, https://www.fincap.org.nz/images/files/FinCap-Voices-report-2022.pdf

1260 Commerce Commission "Summary of views expressed – Te Komihana Tauhokohoko wānanga – Competition for personal banking services in New Zealand" (14 February 2024); Commerce Commission "Day 3 Personal banking services market study conference – Session 9 Consumer experiences" (15 May 2024).

1261 Verian "Personal banking services market study – Research report" (February 2024).

D5 Our analysis of the information provided by stakeholders revealed that competition is not providing the products and service quality standards that meet the needs of some consumers. A consumer's financial situation can change quickly, and even short periods of financial vulnerability have potential to cause greater harm if not carefully navigated and supported by the consumer's bank.[1262] Continued research and engagement with individuals and community groups is important to better understand this issue.

D6 We identified five areas where some consumers are not being well served by competition alone or where enhanced consumer protection would be strongly advisable. These are:

D6.1 access to bank accounts;

D6.2 consumers with overdrafts may face difficulties in switching;

D6.3 unintended consequences of regulation;

D6.4 access to face-to-face banking; and

D6.5 financial literacy.

D7 Possible solutions to these issues can be shared with New Zealand policy makers, regulators and industry for collective social impact and increased financial inclusion.

Access to bank accounts | *Te uru ki ngā pēke putea*

D8 Access to a bank account is of primary importance to raising levels of financial inclusion in New Zealand.[1263] In some circumstances, vulnerable consumers find it difficult to obtain or retain a bank account or access credit.[1264]

D9 Access to a bank account is especially important to allow vulnerable consumers to access lower-cost credit and relevant services when facing financial hardship.[1265] Financial inclusion allows a pathway forward by facilitating day-to-day transactions as well as the ability to plan towards future goals.

1262 [ ].

1263 A 2012 report by the World Bank, which included New Zealand in the dataset, observed: "Overall, the results suggest that policies to reduce barriers to financial inclusion may expand the pool of eligible account users and encourage existing account holders to use their accounts with greater frequency and for the purpose of saving.": Franklin Allen, Asli Demirgüç-Kunt, Leora Klapper and Maria Soledad Martinez Peria "The foundations of financial inclusion: Understanding ownership and use of formal accounts" (December 2012), https://documents.worldbank.org/en/publication/documents-reports/documentdetail/348241468329061640/the-foundations-of-financial-inclusion-understanding-ownership-and-use-of-formal-accounts

1264 Reserve Bank "Financial Inclusion – Our approach at the Reserve Bank of New Zealand" (29 September 2023), p. 9.

1265 World Bank "Financial Inclusion" (13 September 2022), https://www.worldbank.org/en/topic/financialinclusion/overview

D10 Vulnerable consumers such as someone fleeing domestic violence, youth in Oranga Tamariki care, individuals under 18 living independently, recent migrants and freed prisoners can struggle to obtain access to a bank account. Reasons for this may be that the consumer is unable to meet AML/CFT identity documentation requirements, has negative or no credit history or is deemed high risk by a bank.[1266]

D11 We understand that Westpac recently updated its certification processes to make it easier for young people aged 15–17 in Oranga Tamariki care to access bank accounts.[1267] In addition to this, Westpac has a New Start programme, which is designed to help soon-to-be-released prisoners access identity documentation, a bank account and debit card.[1268] These initiatives serve as an example of industry-led solutions that enable access to bank accounts.

D12 Lack of access to a bank account (being unbanked) disproportionately affects vulnerable consumers.[1269] The World Bank estimates that 1.25% of the population, more than 50,000 people, over the age of 15 in New Zealand are unbanked.[1270]

D13 We have heard that access to banking services can be removed, often with only 7–14 days' notice, by having access to a bank account suspended or terminated.[1271] This action commonly affects those going through insolvency and bankruptcy.[1272] Being de-banked can also affect consumers that banks may view as undesirable.[1273] Often there is no other viable alternatives to safely access financial services. The consequences of this can leave some susceptible to exploitation.[1274]

1266 [ ]; Lisa Cowe, Submission on Preliminary Issues paper (6 September 2023).

1267 Andrew Bevin "A small win for youth in care just the start for bank account access", 21 June 2024, https://newsroom.co.nz/2024/06/21/a-small-win-for-youth-in-care-just-the-start-for-bank-account-access/

1268 Westpac "Helping released prisoners reintegrate with 'New Start' bank accounts" (17 February 2022).

1269 Westpac "Westpac NZ Access to Banking in Aotearoa Report" (April 2023), p. 5.

1270 Westpac "Westpac NZ Access to Banking in Aotearoa Report" (April 2023), p. 5; World Bank "Account ownership at a financial institution or with a mobile-money-service provider (% of population ages 15+) – New Zealand, American Samoa", https://data.worldbank.org/indicator/FX.OWN.TOTL.ZS?locations=NZ-AS.

1271 [ ].

1272 [ ].

1273 Gloriavale Christian Community, Submission on Preliminary Issues paper (7 September 2023).

1274 For example, those who are on benefits sometimes don't have access to their own account and so must nominate another person to receive their benefit. At times, this power imbalance can have negative outcomes for the vulnerable consumer such as relationship strain, lack of dignity and risk of financial harm. [ ].

D14 We agree with the view that, to improve financial inclusion, a basic bank account should be treated as an essential service that all New Zealanders have access to.[1275] A basic bank account allows the account owner to receive payments such as wages, benefits and pensions and to pay for things or take out cash with a debit card, transfer money to pay bills or other people.[1276]

D15 Some of the key drivers of banking access issues in New Zealand include:

D15.1 limited competition in affordable products and services designed for vulnerable consumers (who are perceived by banks as commercially unattractive);

D15.2 legal requirements in the customer onboarding process;

D15.3 affordability of and trust in products and providers;

D15.4 the availability of infrastructure and support (such as extra-care units and cultural capability among frontline staff); and

D15.5 financial capability and awareness of available products and services.[1277]

D16 Widespread availability and awareness of basic bank accounts could address many of these drivers. The definition of a basic bank account varies between jurisdictions but at its core is a transaction account that customers are entitled to (customers are unable to be de-banked arbitrarily) that can perform basic banking functionality (sending and receiving payments), has no account fees (and no or low other fees) and is unable to go into debt (no overdraft facility, arranged or unarranged).[1278]

D17 Westpac's 2023 report on access to banking noted that accounts meeting these criteria (particularly the inability to go into debt) are not widely available in New Zealand.[1279] This aligns with what we were told in submissions to our Preliminary Issues paper and draft report.[1280]

1275 Westpac "Westpac NZ Access to Banking in Aotearoa Report" (April 2023), p. 7; [ ].

1276 MoneyHelper "Fee-free basic bank accounts", https://www.moneyhelper.org.uk/en/everyday-money/banking/basic-bank-accounts

1277 [ ].

1278 Australian Banking Association "Banking Code of Practice" (5 October 2021), chapter 16, https://www.ausbanking.org.au/wp-content/uploads/2021/10/2021-5-Oct-Banking-Code-WEB.pdf; MoneyHelper "Fee-free basic bank accounts"; [ ].

1279 Westpac "Westpac NZ Access to Banking in Aotearoa Report" (April 2023), p. 9.

1280 Lisa Cowe, Submission on Preliminary Issues paper (6 September 2023).

D18 There appears to be widespread support among the larger banks for a basic bank account, in response to our draft report.[1281] We heard that basic bank accounts could be delivered with a principles-based approach with the design of the product as plain as possible and with exceptions continuing to be in place for those customers who may be violent or abusive towards bank staff and those who do not meet basic AML/CFT checks.[1282]

D19 We have heard that, for a basic bank account offering to be successfully adopted by industry, there would need to be:

D19.1 a regulatory and industry monitoring and oversight framework, which would ensure that each bank is providing a fair share of these accounts (for example, CoFR could facilitate and monitor progress of the banks and coordinate a response if progress stalls); and

D19.2 clarity on the purpose and functionality of the account (volume or value restrictions, no credit and a clear path beyond the basic account so the customer can access additional services when appropriate, including credit facilities).[1283]

D20 Policy measures can support financial participation, especially policy initiatives designed to improve financial inclusion outcomes in New Zealand.[1284] Notably, there is work under way by CoFR and the Reserve Bank on the topic of financial inclusion.[1285,1286]

Consumers with overdrafts may face difficulties in switching | *Ko ngā kaiwhakapeto kua tango moni tarepa ka raru pea ki te whakawhiti*

D21 Once a bank account has been acquired, the ability to shop around for suitable banking products and services and the potential to switch banks is important for competition. There is a perception among some consumers that it is hard to switch banks.[1287] Poorly served consumers appear less likely to change banks once a main bank relationship has been established. This may be due to barriers such as having unsecured debt or lower credit scores, which can make moving banks more complex.

1281 Financial Services Federation, Submission on Draft report (17 April 2024), p. 4; ANZ, Submission on draft report (18 April 2024), p. 61.

1282 Commerce Commission “Day 3 Personal banking services market study conference – Session 9 Consumer experiences” (15 May 2024), pp. 25–28.

1283 Commerce Commission “Day 3 Personal banking services market study conference – Session 9 Consumer experiences” (15 May 2024), pp. 25–28.

1284 NZBA “Submission to the Ministry of Business, Innovation and Employment on the Conduct of Financial Institutions – Discussion Documents” (June 2021), https://www.mbie.govt.nz/dmsdocument/17415-nzba-conduct-of-financial-institutions-regulations-submission-pdf

1285 The statutory function of CoFR is to “facilitate co-operation and co-ordination between members of the council to support effective and responsive regulation in the financial system in New Zealand”.

1286 CoFR “Financial Inclusion”; Reserve Bank “Financial Inclusion – Our approach at the Reserve Bank of New Zealand” (29 September 2023), p. 11.

1287 [ ].

D22 An overdraft is a common form of unsecured debt. There are two key types of overdrafts with different associated fee structures: arranged overdrafts and unarranged overdrafts. We have heard arranged overdrafts are often marketed for flexibility and designed to be short term.[1288] However, some consumers may not be able to manage this type of product as it is intended.[1289]

D23 Our review of the broader evidence base has shown the average fee cost for an arranged overdraft to be fairly low with the major banks having low or no overdraft management fee. Data we have seen shows that an unarranged overdraft fee can range anywhere from $3 to $10 per month. We found that the applicable interest charges for both products appear to be similar.[1290] Poorly served consumers are more at risk of sliding into unarranged overdraft.

D24 The fixed nature of bank fees and charges means they have a more significant impact on consumers with smaller account balances.[1291] Unsecured lending that is unmanageable can create a debt trap for a consumer, especially when compounded with avoidable fees and charges.[1292]

D25 We have observed that overdraft issues are being addressed by banks, with initiatives and mitigation measures designed to ensure consumers are aware of avoidable fees that they may have recently incurred. Some banks contact a subset of these consumers every month to provide information to help them avoid such fees in the future.[1293] Several banks have established business units aimed at supporting financial literacy, financial capability and financial wellbeing.[1294] Banks also provide frontline staff with awareness training to enable broader conversations with consumers.[1295]

D26 The primary purpose of the CCCF Act is to protect the interests of consumers entering into consumer credit agreements. The CCCF Act contains responsible lending principles requiring lenders to exercise care, diligence and skill in their dealings with consumers. The obligations on lenders include:

D26.1 making reasonable inquiries before entering into a loan to be satisfied that the loan is suitable and affordable for the borrower and to assist the borrower to make an informed decision to enter the loan; and

1288 [ ].

1289 [ ].

1290 [ ]; [ ]; [ ]; [ ]; [ ]; For example, as at 5 March 2023, ASB's website shows it charges 19.5% pa for an unsecured overdraft and 22.5% for an unarranged overdraft. Westpac charges 19.95% for both arranged and unarranged personal overdrafts.

1291 ACCC "Retail deposits inquiry – Final report" (December 2023), p. 8.

1292 [ ].

1293 [ ].

1294 [ ].

1295 [ ].

D26.2 treating the borrower reasonably and in an ethical manner when problems arise (for example, payment difficulties).

D27 While the requirement to assess credit affordability can limit the ability of consumers with overdrafts to switch banks, the CCCF Act does provide important protections for consumers having debt.[1296] This reinforces the need for strong regulatory oversight.

Unintended consequences of regulation | *Ngā hua ohorere o te ture*

D28 Current AML/CFT regulation, the application of KYC identification process and CDD risk assessment process can adversely impact some consumers. We have heard that supplying the required identification can be the most challenging factor. Without access to key documents such as proof of address or a driver licence, this creates an unintended barrier to enter or stay in the banking system.[1297]

D29 The AML/CFT regime requires banks to have appropriate exception handling procedures for identity verification for low to medium-risk consumers.[1298] We understand that wider application of simplified due diligence could work to reduce AML/CFT barriers for low-risk consumers. Our findings indicate that there is more work to be done by policy makers, regulators and industry to ensure consumers understand how to meet the identification requirements.

D30 The MoJ has recently reviewed the AML/CFT Act and the accompanying regulations and guidance. Recommended changes include expanded application of AML exemptions, simplified CDD and alternative pathways to meeting AML documentation requirements.[1299] Although no timeframe has been given on the implementation of these risk-based measures, this work could support identification procedures that more low to medium-risk consumers are able to meet.

D31 In May 2024, Associate Minister of Justice Hon. Nicole McKee signalled an intention to reform New Zealand's AML/CFT regime with the scope of the AML/CFT work currently being determined.[1300] We recommend in Chapter 10 that this reform work include removing or reducing unnecessary barriers to consumers entering or staying in the banking system.

1296 Unarranged overdrafts are not consumer credit for the purposes of the CCCF Act and are excluded from the consumer protections: CCCF Act, s 15(1)(b).

1297 Westpac "Westpac NZ Access to Banking in Aotearoa Report" (April 2023), pp. 9 and 14; AUSTRAC "Assisting customers who don't have standard forms of identification".

1298 Reserve Bank "AML/CFT guidance and resources" (17 May 2024), https://www.rbnz.govt.nz/regulation-and-supervision/anti-money-laundering-and-countering-terrorism-financing/aml-cft-guidance-and-resources

1299 MoJ "Report on the review of the Anti-Money Laundering and Countering Financing of Terrorism Act 2009" (July 2022), pp. 145–146, https://www.justice.govt.nz/assets/Documents/Publications/AMLCFT-Statutory-Review-Final-Report-v2.pdf

1300 Gareth Vaughan, "Associate Minister of Justice Nicole McKee sets sights on reforming anti-money laundering laws" (16 May 2024).

Face-to-face banking | *Pēke kanohi ki te kanohi*

D32 We have heard that face-to-face banking is a crucial factor to maintain consumer relationships and support consumer confidence. Nevertheless, this is becoming ever more challenging to deliver and receive due to branch closures and increased digitisation of personal banking services.[1301] Reduced access to face-to-face services can particularly affect older consumers (who may be less familiar with digital services), consumers living with disability (for example, hearing or eyesight impaired or living with mobility issues) or rural consumers (who need to travel further to visit a branch).[1302]

D33 Our evidence indicates New Zealand currently has just under 500 branches and bricks-and-mortar stores, excluding bank hubs.[1303] Reduction in the physical branch network can lead to greater financial exclusion due to time and travel costs to get to the nearest bank branch, lack of reliable internet and mobile coverage in some rural areas and the requirement for sound digital literacy.[1304]

D34 To potentially mitigate barriers faced by poorly served consumers, the major banks in New Zealand voluntarily signed up to a banking hub pilot run by the NZBA.[1305] The NZBA regional banking hub pilot was run in partnership with six New Zealand banks.[1306] The banking hub approach aims to provide and maintain banking services in small regional communities.[1307]

D35 Consumers have continued to question the depth of services provided by the banking hubs. To enhance social inclusion, consumers appeal for more meaningful presence of banking services in rural areas via digital offerings, ATMs and physical banking options.[1308] In May 2024, as part of the conclusion of the regional banking hubs pilot, the five leading retail banks committed to no more regional branch closures for the next 3 years.[1309]

D36 While the mix of digital and physical banking options offers consumer choice, there can still be unintended barriers that arise. For blind and vision-impaired people, we understand that newer ATMs and EFTPOS machines that are touchscreen only (with no physical buttons) have created unintended barriers to financial inclusion.

1301 [ ].

1302 [ ].

1303 [ ]; [ ]; [ ]; [ ]; [ ]; [ ].

1304 Westpac “Westpac NZ Access to Banking in Aotearoa Report” (April 2023), pp. 7 and 15.

1305 Nikki-Lee Birdsey “Bank branch closures: are banking hubs the answer?” (5 July 2021), https://www.consumer.org.nz/articles/bank-branch-closures-are-banking-hubs-the-answer

1306 ANZ, ASB, BNZ, Kiwibank, TSB and Westpac.

1307 [ ].

1308 [ ], Rural Women New Zealand, Submission on draft report (17 April 2024), p. 3.

1309 NZBA “Banks extend commitment to keep regional branches open for three more years” (31 May 2024), https://www.nzba.org.nz/2024/05/31/banks-extend-commitment-to-keep-regional-branches-open-for-three-more-years/

D37 There are multiple methods in which the consumer can contact their bank or their bank can contact them, for example, via a call centre, internet banking or mobile app, by post or by visiting a physical branch.[1310] Service quality, service time, consumer wellbeing, bank staff capacity and consistency across all service channels remain key.[1311]

D38 Smaller providers such as NBDTs, credit unions and building societies and smaller banks (TSB, Co-operative Bank and Heartland Bank) deliver additional physical access to banking services in regional areas. We have heard that NBDTs and credit unions and building societies often provide services such as transaction accounts to consumers refused service by banks and serve a higher proportion of low-income customers.[1312]

D39 Demand remains high for poorly served consumers to have straightforward access to face-to-face banking. While it is encouraging to see initiatives under way, there is more work to be done by industry to overcome barriers of meaningful participation across all available service channels, whether that be digital or physical.[1313]

Financial literacy | *Te matatau ki te penapena pūtea*

D40 Financial inclusion can be a leading factor in reducing financial hardship, growing innovation in financial services and fostering opportunities for economic growth.[1314] The Reserve Bank broadly defines financial inclusion as a system in "which all Aotearoa have reasonable access to financial products and services that meet their needs".[1315]

1310 [ ].

1311 [ ]; [ ].

1312 Financial Services Federation, Submission to Reserve Bank on the exposure draft of the Deposit Takers Bill (February 2022), https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/proactive-releases/submissions/financial-services-federation-fsf-submission-on-dt-billpdf.pdf; [ ].

1313 [ ].

1314 World Bank "UFA2020 Overview: Universal Financial Access by 2020" (1 October 2018), https://www.worldbank.org/en/topic/financialinclusion/brief/achieving-universal-financial-access-by-2020

1315 Reserve Bank "Financial Inclusion – Our approach at the Reserve Bank of New Zealand" (29 September 2023), p. 2.

D41 We heard that poorly served consumers often need additional support such as budgeting advice and guidance on navigating financial matters.[1316] Low financial literacy capabilities across New Zealand can mean consumers often face difficulties in understanding banks' terms and conditions, interest rates and fees and comparing products and services.[1317] To support financial literacy, consumers need clearer and more transparent information to enable them to better understand banks' decision making and compare bank services and product offerings, especially when experiencing hardship.

D42 We observed that banks are aware of this issue and act to provide in-house support as well as encouragement of community-based avenues to improve financial capabilities. Other ways that banks can assist to increase financial literacy and capabilities across New Zealand are clearer reporting, targeted training courses for frontline staff, additional in-house support services, actively promoting access to budgeting mentors and increased preventive action around scams and fraud.[1318]

D43 The incoming CoFI legislation includes a fair conduct principle that requires financial institutions to ensure that services and products are likely to meet the requirements and objectives of the consumers expected to use them.[1319]

D44 The Retirement Commission has also undertaken research and evaluation projects aimed to give a deeper understanding of the level of financial capability in New Zealand and how it compares internationally.[1320] Education programmes that are run in New Zealand secondary schools also support raising financial capability.[1321]

D45 To improve financial literacy outcomes, we have heard that greater use of plain English in loan contracts is required. The Retirement Commission's "de-jargoning money" glossary is a good example of plain language for the financial industry.[1322] We have also heard that, to educate and raise financial awareness, increased Government funding for the financial mentor sector would be beneficial as well as banks promoting partnership with the financial mentor sector.[1323]

1316 [ ].

1317 [ ].

1318 Community Networks Aotearoa "Better Banking" (2023), https://irp.cdn-website.com/96a27c73/files/uploaded/Community%20Networks%20Aotearoa%20_%20Better%20Banking%202023%20Report.pdf

1319 MBIE "Conduct of financial institutions regime" (22 April 2024).

1320 Retirement Commission "Financial Capability Research"https://retirement.govt.nz/financial-capability/research/.

1321 Sorted in Schools "FAQs", https://sortedinschools.org.nz/about/support/faqs/

1322 Retirement Commission "De-jargoning Money: A financial glossary of plain language for the finance sector and beyond", https://assets.retirement.govt.nz/public/Uploads/National-Strategy/De-jargoning-Money_Glossary_TAAO.pdf

1323 Retirement Commission "National Strategy for Financial Capability: Conference recordings 2024", https://retirement.govt.nz/financial-capability/national-strategy/schedule

Attachment E International money transfers | *Whakawhitinga Moni ā-Ao*

E1 During the initial stages of our study, we received stakeholder feedback suggesting we expand our focus to include remittances, international payments and foreign exchange.[1324] We have not expanded the scope of our study in this way because these services do not appear to be relevant to understanding the wider competitive dynamics for personal banking services and focusing on them would take away from resources available to the rest of the study.

E2 However, during our exploratory research, we identified features of these services that suggest there may be room to improve competition, particularly around international money transfers (IMTs). This attachment sets out the findings of our research on IMTs. We use the term international money transfer interchangeably with remittances throughout this attachment.

E3 The information we have analysed includes submissions received during the study, various reports and reviews as well as information readily available online and to the public, including older material and material from other jurisdictions. At least one stakeholder considers this exploratory research should be removed from our final report. However, we have decided to include it because it may be of interest to other stakeholders and because it may be of assistance to the announced select committee inquiry into rural banking.[1325,1326]

E4 We identified two issues that may impact competition.

E4.1 Difficulty in opening or maintaining a bank account for smaller remittance providers.

E4.2 A lack of transparency on pricing of IMT services.

1324 Wise, Submission on Preliminary Issues paper (7 September 2023), pp. 4–5; [ ]; [ ]; [ ].

1325 ANZ, Submission on draft report (18 April 2024), paras 247–248.

1326 Hon Nicola Willis "Inquiry requested into rural banking" (13 June 2024), https://www.beehive.govt.nz/release/inquiry-requested-rural-banking

E5 Difficulties in opening and maintaining a bank account for smaller remittance providers is a complex and ongoing issue related to AML/CFT regimes globally, including in New Zealand. This issue appears to have the greatest impact on New Zealanders who send remittances to the Pacific Islands. There are strong and important policy considerations that underpin New Zealand's AML/CFT regime. The 2022 MoJ report appears to support the view that more could be done to address this issue without undermining AML/CFT policy goals, and we make a recommendation in Chapter 10 that upcoming reforms of the AML/CFT regime include consideration of the competition impacts we describe in this report.[1327]

E6 The magnitude of the issues around IMT pricing transparency is unclear. This issue would benefit from further investigation to understand the nature and size of the problem in New Zealand. If pricing transparency problems are found to be material and impacting competition, there are interventions that appear to have been successful in Australia that could be considered.

We have focused on IMTs and not other types of remittances

E7 Remittances are the transfer of funds between parties in the form of a bill, invoice or gift. More commonly, remittances are referred to when workers or migrants send home part of their earnings to support their families.[1328]

E8 An IMT is an electronic transfer of funds in a specific currency to an overseas recipient.[1329] Our exploratory research focused on IMTs and not other types of remittances (for example, transfer of gifts or physical items of value).

E9 The ACCC conducted an inquiry into the supply of foreign currency conversion services in Australia in 2019.[1330] The inquiry covered four related services: IMT services, foreign cash services, payment card foreign exchange services and travel card services. The ACCC observed that IMTs were significant because the other services it reviewed were not generally substitutable for IMTs, and that they had larger transaction sizes than the other services.[1331]

1327 MoJ "Report on the review of the Anti-Money Laundering and Countering Financing of Terrorism Act 2009" (July 2022).

1328 Dilip Ratha "What Are Remittances?", p. 1, https://www.imf.org/external/pubs/ft/fandd/basics/pdf/ratha-remittances.pdf

1329 Banking Ombudsman Scheme "International Money Transfers" (January 2024), https://bankomb.org.nz/guides-and-cases/quick-guides/payment-systems/telegraphic-transfers

1330 ACCC "Foreign currency conversion services inquiry" (July 2019), https://www.accc.gov.au/system/files/Foreign%20currency%20conversion%20services%20inquiry%20-%20final%20report_0.PDF

1331 ACCC "Foreign currency conversion services inquiry" (July 2019), pp. 18–19.

Remittances are significant to Pacific Island countries

E10 In 2022, New Zealand received over US$677m and paid (transferred out) over US$889m in personal remittances.[1332,1333] Although small in value compared to other personal banking services, they are important for Pacific countries and the people involved. The magnitude of remittances to Pacific countries has grown significantly over the past 20 years.

E11 In 2022, over US$1.16b of remittances were received by the small island states in the Pacific.[1334] Remittances make up a large portion of some Pacific countries' national economy, averaging 12.5% of GDP in smaller states in 2021 and as high as 46.5% of GDP in Tonga.[1335] Remittances from New Zealand are a vital source of income for many families in these countries.[1336]

Remittance providers can be grouped into three categories

E12 A 2016 report prepared by Deloitte for the Treasury identified three main types of money remittance providers that operate between New Zealand and the Pacific Islands.[1337] Many of these remittance providers also operate in other parts of the world. They are:

E12.1 banks;

E12.2 global money transfer operators (MTOs); and

E12.3 corridor specialists.[1338]

1332 World Bank "Personal remittances, received (current US$) – New Zealand", https://data.worldbank.org/indicator/BX.TRF.PWKR.CD.DT?locations=NZ&year=2022

1333 World Bank "Personal remittances, paid (current US$) – New Zealand", https://data.worldbank.org/indicator/BM.TRF.PWKR.CD.DT?end=2022&locations=NZ&start=1972&view=chart

1334 Defined by the World Bank to include Fiji, Kiribati, Marshall Islands, Federated States of Micronesia, Nauru, Palau, Samoa, Solomon Islands, Tonga, Tuvalu and Vanuatu: World Bank "Pacific Island small states", https://data.worldbank.org/region/pacific-island-small-states

1335 Glenn Cummings and Erin Corvisy "Empowering Migrants through Pacific Remittances (EMPR)" (June 2023), p. 4, https://www.dfat.gov.au/sites/default/files/empr-mid-term-review.pdf

1336 Reserve Bank "Our work in the Pacific" (13 December 2022), https://www.rbnz.govt.nz/regulation-and-supervision/cross-sector-oversight/our-relationship-with-other-financial-regulators/pacific-remittances-project

1337 Deloitte "Review of the Money Remittance Market in New Zealand: A report on the problems affecting the remittance services between New Zealand and the Pacific" (August 2016), p. 5, https://www.treasury.govt.nz/sites/default/files/2013-06/remittance-review.pdf

1338 Corridor specialists are MTOs that operate in a specific region or corridor: Marco Nicoli "De-risking and remittances: the myth of the "underlying transaction" debunked" (13 June 2018), https://blogs.worldbank.org/psd/de-risking-and-remittances-myth-underlying-transaction-debunked

E13 Banks that offer remittance services have the support of their reputation as an established financial institution. They have history with customers and will have access to most currencies globally through their international banking networks.[1339] They also tend to be more costly.[1340]

E14 Global MTOs are financial businesses that use internal systems or access to cross-border banking networks to transfer funds across borders. MTOs have access to their own outlets or various transfer agents such as exchange bureaus, post offices and other intermediaries to deliver their remittances in the destination countries.[1341]

E15 The 2016, Deloitte report found that corridor specialists have a large share of the remittance market in a number of Pacific Island countries.[1342] This is largely due to them offering lower prices and being more accessible than other remitters.[1343]

Issues potentially affecting competition for IMTs | *Ngā take ka tūpono pā ki te whakataetae mō ngā IMT*

There is an ongoing issue of smaller remittance providers being de-banked

E16 Smaller providers maintain that they have been de-banked and that banks are restricting services to them and this has a significant impact on the ability of smaller providers to compete.[1344]

E17 This appears to be an unintended and complex issue associated with New Zealand's AML/CFT regime as well as international AML/CFT regimes New Zealand banks interact with.[1345]

E18 There are recent government reports that discuss this issue in New Zealand and one by the ACCC in Australia.

1339 International Monetary Fund "Understanding Remittances: Demography, Transaction Channels, and Regulatory Aspects" (October 2009), p. 8, https://www.imf.org/external/np/sta/bop/2008/rcg/pdf/ch2.pdf

1340 World Bank "Remittances Remain Resilient but Likely to Slow" (13 June 2023), https://www.worldbank.org/en/news/press-release/2023/06/13/remittances-remain-resilient-likely-to-slow

1341 International Monetary Fund "Understanding Remittances: Demography, Transaction Channels, and Regulatory Aspects" (October 2009), p. 9.

1342 Deloitte "Review of the Money Remittance Market in New Zealand: A report on the problems affecting the remittance services between New Zealand and the Pacific" (August 2016), p. 75 definition of corridor specialist.

1343 Deloitte "Review of the Money Remittance Market in New Zealand: A report on the problems affecting the remittance services between New Zealand and the Pacific" (August 2016), p. 5.

1344 [ ]; [ ].

1345 Reserve Bank "Statement about banks closing accounts of money remitters" (28 January 2015), https://www.rbnz.govt.nz/hub/news/2015/01/statement-about-banks-closing-accounts-of-money-remitters

E19 The 2016 Deloitte report identified three key concerns New Zealand banks have in relation to AML/CFT regulation and maintaining banking services for MTOs:[1346]

E19.1 Under the AML/CFT Act, banks are liable for all transactions processed by them. This includes transactions submitted by MTOs that are non-compliant with AML/CFT requirements. There is also a risk where, although MTOs are compliant in New Zealand, they may not be compliant with corresponding banking partners who may have access to a wider range of data.

E19.2 The AML/CFT compliance costs are high for wire transfer services. These costs mean that MTOs are usually not profitable enough for banks to justify providing accounts.

E19.3 Globally, correspondent banks have been heavily fined for breaches of AML/CFT regulations.[1347] This has resulted in banks strengthening their AML/CFT requirements and increasing the level of evidence required for foreign currency conversion transactions. Failure of New Zealand banks to comply with correspondent banks' requirements could see services limited or even terminated. Services terminated from a US banking partner for example could lead to New Zealand banks being shut out from global currency conversion markets.[1348]

E20 The 2022 MoJ report found the AML/CFT regime had unintentionally made it harder for remittance providers to open or maintain a bank account. If banks prefer to avoid rather than manage the risk associated with IMT providers, they may de-bank remittance providers, negatively impacting communities in New Zealand and overseas (and increasing risk).[1349]

E21 The 2019 ACCC report addresses consumer issues in the foreign exchange market and focuses on the importance of competition. One of the key findings of the inquiry was that de-banking is a significant threat to competition in the IMT market. De-banking or the risk of de-banking results in costs being raised in order to comply and maintain access to banking services. This becomes a barrier for entry in the market and therefore lessens competition.[1350]

1346 Deloitte "Review of the Money Remittance Market in New Zealand: A report on the problems affecting the remittance services between New Zealand and the Pacific" (August 2016), p. 6.

1347 Correspondent banking is defined by the Reserve Bank of Australia as "a financial institution (the 'correspondent') providing a deposit account and related payment services to another financial institution (the 'respondent') for the purposes of currency exchange, the execution of third-party payments, trade finance and cross-border money transfers": Michael Davies "Correspondent Banking in the South Pacific" (June 2023), https://www.rba.gov.au/publications/bulletin/2023/jun/pdf/correspondent-banking-in-the-south-pacific.pdf

1348 Deloitte "Review of the Money Remittance Market in New Zealand: A report on the problems affecting the remittance services between New Zealand and the Pacific" (August 2016), p. 6.

1349 MoJ "Report on the review of the Anti-Money Laundering and Countering Financing of Terrorism Act 2009" (July 2022), p. 144.

1350 ACCC "Foreign currency conversion services inquiry" (July 2019), p. 14.

E22 Global MTOs provide a cheaper service than that offered by banks.[1351] With these providers being unable to operate, consumers have fewer options to choose from.

E23 We discuss the issue of de-banking more broadly in Chapter 9 in the context of fintechs being able to open and maintain bank accounts. Based on our exploratory research and our understanding of de-banking with respect to fintechs, we consider denial of service to smaller remittance providers (corridor specialists) could be impacting competition for remittance services. This is particularly the case as these providers may have lower fees or have better service.[1352] These providers are also likely to have greater penetration in some communities due to them using agents that operate out of dairies and small shops.[1353]

Various government agencies have made recommendations or are undertaking initiatives to address these issues, but progress is slow

E24 We identified a range of options being considered and implemented by various government agencies in New Zealand, as well as in Australia. These options are in line with the importance of AML/CFT policy considerations, including New Zealand's alignment with international partners.

E25 The Reserve Bank set up the Pacific Remittances Project in 2022 to analyse the challenges that affect Pacific nations in the remittance market. These challenges include banks in Pacific nations struggling to access global financial services and international regulations and associated de-risking. The goals of the project were to increase operational efficiency, reduce cost, reduce the likelihood of de-risking, improve the standards of culture and compliance, better detect and deter financial crime and improve financial inclusion.[1354]

E26 The Reserve Bank has stated that it expects banks to manage and mitigate risk rather than avoid risk, arguing that anti-money laundering laws are not an excuse to de-bank or de-risk from the Pacific Islands.[1355]

E27 The Pacific Remittances Project explored unintended consequences of AML standards, made recommendations to inform the review of New Zealand's AML/CFT legislation, increased collaboration with banks across the Pacific and developed a business case regarding potential development of a regional electronic KYC facility.[1356]

1351 Deloitte "Review of the Money Remittance Market in New Zealand: A report on the problems affecting the remittance services between New Zealand and the Pacific" (August 2016), p. 19.
1352 ACCC "Foreign currency conversion services inquiry" (July 2019), p. 51.
1353 Deloitte "Review of the Money Remittance Market in New Zealand: A report on the problems affecting the remittance services between New Zealand and the Pacific" (August 2016), p. 4.
1354 Reserve Bank "Our work in the Pacific" (13 December 2022).
1355 Reserve Bank "Keeping the bank door open for Pacific peoples" (27 April 2021), https://www.rbnz.govt.nz/hub/news/2021/04/keeping-the-bank-door-open-for-pacific-peoples
1356 Reserve Bank "Our work in the Pacific" (13 December 2022).

E28 The 2016 Deloitte report outlined a number of recommendations relevant to the de-banking of smaller MTOs. These included:[1357]

E28.1 having industry-specific regulations in order to increase banks' confidence when applying AML/CFT compliance to MTOs;

E28.2 granting limited licences to banks in the Pacific, enabling them to bank MTOs in send and receive markets;

E28.3 encouraging competition from government-owned banks or credit card companies with the use of incentives when appropriate;

E28.4 influencing US bank positions in international forums; and

E28.5 using a common regulatory approach within a single reporting agency.

E29 The 2022 MoJ report made recommendations relevant to this issue.[1358]

E29.1 AML/CFT supervisors develop a code of practice or guidance for businesses (particularly banks) to refer to when onboarding or reviewing high-risk businesses and customers, including remittance providers.[1359]

E29.2 Amend the AML/CFT Act to include a licensing framework for high-risk sectors (that are not licensed under other legislations). Licensing should be undertaken by AML/CFT supervisors and be a pre-requisite for registration on the Financial Services Providers Register to provide the relevant service.

E30 We understand that neither of these two recommendations has been actioned to date.[1360]

E31 The 2019 ACCC report recommended the formation of a working group tasked with consulting on the development of a scheme where IMT providers can address the AML/CFT compliance requirements.[1361]

1357 Deloitte "Review of the Money Remittance Market in New Zealand: A report on the problems affecting the remittance services between New Zealand and the Pacific" (August 2016), p. 44.

1358 MoJ "Report on the review of the Anti-Money Laundering and Countering Financing of Terrorism Act 2009" (July 2022), pp. 22 and 27.

1359 The three AML/CFT supervisors are the Reserve Bank, FMA and DIA: Reserve Bank "Supervising agencies for anti-money laundering and countering terrorism financing" (27 March 2023), https://www.rbnz.govt.nz/regulation-and-supervision/anti-money-laundering-and-countering-terrorism-financing/supervising-agencies-for-anti-money-laundering-and-countering-terrorism-financing

1360 [ ].

1361 ACCC "Foreign currency conversion services inquiry" (July 2019), p. 11.

We have heard that opaque pricing of IMTs may limit consumers' ability to shop around and find the best value provider

E32 We understand pricing of money transfer services is complex and depend on various factors. The price of a money transfer can include the following.[1362]

E32.1 **A fee charged by the provider.** This fee is charged by the sending bank and may change depending on the amount customers are sending. It may also have a minimum or maximum value. Factors banks could take into consideration when setting these fees could include the currency, speed of transfer and payment method.

E32.2 **An exchange rate spread.** Many providers make a margin (or place a mark-up) on the exchange rate offered as part of the transfer service. They offer more (or less) than the mid-market wholesale exchange rate when selling (or buying) currency.

E32.3 **Other fees** may include fees charged by intermediary banks that facilitate money transfers between the sending bank and the receiving bank. Receiving banks may also charge a fee for their customers to withdraw the sent funds.

E33 The existence of some of these price components and their significance may not be readily apparent without further work by the customer. For example, we've heard that many banks advertise headline exchange rates with a significant margin.[1363] Customers may be able to secure a more favourable exchange rate if they ask for one, but this can take time and effort.

E34 Time-limited quotes may also make it difficult for consumers to compare prices between providers. With the quotes constantly changing on each individual site, it becomes harder to accurately compare rates. We do not know how widespread this practice is, but it could further reduce the ability of consumers to effectively compare providers.

E35 There are various comparison sites available to customers looking to compare IMT providers. These include:

E35.1 interest.co.nz;[1364]

E35.2 RemitFinder;[1365]

E35.3 Monito;[1366]

1362 ACCC "Foreign currency conversion services inquiry" (July 2019), p. 9.
1363 Wise, Submission on Preliminary Issues paper (7 September 2023), p. 6.
1364 See https://www.interest.co.nz/currencies/buying-foreign-currency
1365 See https://www.remitfinder.com/
1366 See https://www.monito.com/

E35.4 Currency-Shop;[1367]

E35.5 Wise;[1368] and

E35.6 SendMoneyPacific.[1369]

E36 However, it is not clear that these websites offer a complete solution to the issue of opaque prices. For example, some only compare a limited number of providers or appear to only compare headline rates. Some are also IMT providers themselves.

E37 A submission to our Preliminary Issues paper referred to a report from the UK Government Behavioural Insights Team. One of the findings was that, when individuals are given more transparency on pricing, they make better decisions. It also found that the positive effect of price information is notably stronger for individuals without foreign exchange experience.[1370]

E38 The 2019 ACCC study on foreign currency conversion services in Australia found that consumers need to be able to compare total 'price' of services to get the best deal, but this can be difficult because:[1371]

E38.1 prices are complex;

E38.2 prices are presented in different ways by different suppliers; and

E38.3 prices lack transparency.

E39 The World Bank has stated that "one of the most important factors leading to high remittance prices is a lack of transparency in the market".[1372]

E40 The ACCC found that the difficulties in comparing prices as well as customer inertia, appeared to be limiting the growth of smaller providers, even if they offered cheaper services. The ACCC also found that the big four banks in Australia were consistently more expensive than some other providers and that there were significant savings from shopping around.[1373]

1367 See https://www.thecurrencyshop.co.nz/international-money-transfers/send-money-to-new-zealand

1368 See https://wise.com/gb/compare/

1369 See https://sendmoneypacific.org/

1370 The Behavioural Insights Team "The impact of improved transparency of foreign money transfers for consumers and SMEs: Final Report" (March 2018), pp. 25–26, https://www.bi.team/wp-content/uploads/2018/03/The-impact-of-improved-transparency-on-foreign-money-transfers-for-consumers-and-SMEs_WEB.pdf

1371 ACCC "Foreign currency conversion services inquiry" (July 2019), p. 10.

1372 World Bank "Remittance Prices Worldwide", https://remittanceprices.worldbank.org/about-remittance-prices-worldwide

1373 ACCC "Foreign currency conversion services inquiry" (July 2019), pp. 10–11.

E41 Empowering Migrants through Pacific Remittances (EMPR) is a programme jointly funded by the New Zealand Ministry of Foreign Affairs and Trade, Manatū Aorere and the Australian Department of Foreign Affairs and Trade. The programme was designed to allow people living in Australia and New Zealand remitting to the Pacific to engage with the remittance provider market, select the right providers and get the most value when sending remittances to Pacific households.[1374]

E42 The programme saw the development of the SendMoneyPacific website which has since become the main tool for EMPR.[1375] SendMoneyPacific operates as a remittance price comparison site where it returns rates based on the user's selected country of destination.

E43 The programme is still running and has seen a significant decrease in the cost of sending money in the past decade. Remittance costs to Fiji have decreased by 43% since 2011, and Vanuatu, Samoa and Tonga have seen a decrease in cost of 17–21% over the 10-year period.[1376]

E44 There appears to be merit in undertaking further research to understand the size and nature of pricing issues, particularly around transparency, and how they may be affecting competition for IMTs and other foreign exchange services.

Potential policy options

E45 In response to findings about opaque prices and customer inertia in its 2019 foreign currency inquiry, the ACCC:

E45.1 made four recommendations to providers aimed at improving how prices are presented to customers, including providing certainty of correspondent banking fees, digital tools to calculate the total price of a service, better information for in-store customers and better disclosure of international transaction fees; and[1377]

E45.2 published guidance focusing on assisting consumers to find and use foreign exchange services that best meet their needs.[1378]

1374 Glenn Cummings and Erin Corvisy "Empowering Migrants through Pacific Remittances (EMPR)" (June 2023), p. 6.

1375 Glenn Cummings and Erin Corvisy "Empowering Migrants through Pacific Remittances (EMPR)" (June 2023), p. 4.

1376 Glenn Cummings and Erin Corvisy "Empowering Migrants through Pacific Remittances (EMPR)" (June 2023), p. 4.

1377 ACCC "Foreign currency conversion services inquiry" (July 2019), p. 12.

1378 ACCC "Transparent pricing of foreign currency conversion services"(December 2019), https://www.accc.gov.au/system/files/1651FAC_FX%20busines%20guide%20Transparent%20pricing%20D02.pdf

E46 Since publishing the report on foreign currency conversion services, the ACCC has conducted further reviews into price transparency. In 2021, it found that the majority of remittance providers it reviewed were giving consumers the correct tools they need to readily compare the total price of IMTs.[1379]

E47 A recent study into IMT calculators conducted by the Behavioural Economics Team of the Australian Government saw that, although businesses now provide IMT calculators, they all differ from each other and give varying results.[1380] The study found that subtracting fees and adding a comparison prompt would result in the highest performance both when reviewing a stand-alone offer and when comparing multiple offers.[1381]

E48 The 2016 Deloitte report also included recommendations relevant to the issue of opaque prices impacting the ability of consumers to shop around, including options to require greater disclosure of costs by remittance providers at the point of purchase of the service to their customers and to require greater disclosure of transaction data to a regulatory agency.[1382]

E49 A submission to our Preliminary Issues paper suggested requiring providers of IMTs and payments to provide the total cost of their transactions inclusive of all fees and rates up-front. The submission also suggested a currency calculator be integrated into their services to enable consumers to compare prices with other providers.[1383]

1379 ACCC "Money remitters improve price transparency after ACCC inquiry" (10 August 2021), https://www.accc.gov.au/media-release/money-remitters-improve-price-transparency-after-accc-inquiry

1380 Behavioural Economics Team of the Australian Government "Subtracting fees to subtract confusion" (June 2024), p. 4, https://behaviouraleconomics.pmc.gov.au/sites/default/files/projects/subtracting-fees-to-subtract-confusion.pdf

1381 Behavioural Economics Team of the Australian Government "Subtracting fees to subtract confusion" (June 2024), p. 4.

1382 Deloitte "Review of the Money Remittance Market in New Zealand: A report on the problems affecting the remittance services between New Zealand and the Pacific" (August 2016), p. 59.

1383 Wise, Submission on Preliminary Issues paper (7 September 2023), p. 10.