25 September 2024

To
The Chair
Finance and Expenditure Committee
Parliament Buildings
Wellington

From
The NBDTs listed in the Schedule

By Email

Dear Finance and Expenditure Committee Chair

Inquiry into banking competition

This submission is made on behalf of a number of non-bank deposit takers (**NBDT**s) listed in the schedule to this letter. Many of those NBDTs will also be making separate submissions setting out their own experience on the constraints to banking competition.

The NBDTs wish to make an oral submission to the Finance and Expenditure Committee (**FEC**).

Terms of reference

The terms of reference for the banking inquiry include two specific questions for NBDTs, being:

(a) what are the barriers preventing competition that have limited growth for NBDTs; and

(b) what is the impact of the regulatory environment on competition including, in particular, the impact of prudential regulation on risk allocation and more generally for NBDTs.

Issues

In practice, the questions on limitation of growth and the impact of prudential regulation on NBDTs are linked. Without a doubt, the biggest constraint to competition for the NBDTs is the regulatory environment that they operate in. For example:

- costs associated with regulatory compliance have impacted profitability and added costs for consumers;
- NBDTs suffer from a lack of recognition as an adequate alternative to a main bank for deposit taking services and products despite the similarity in their prudential regulatory environment and supervision because they cannot call themselves a bank.
- risk weightings applicable to NBDTs (which are significantly more conservative than even for small banks) has resulted in their capital ratios being distorted (for example looking undercapitalised relative to small banks) and made some areas of lending uneconomic; and
- in some cases, the costs of compliance (and the risks of non-compliance) under the Credit Contracts and Consumer Finance Act 2003 (**CCCFA**) have resulted in lenders either withdrawing from the consumer lending market or not entering it at all; and

- regulatory risk and regulatory uncertainty has impacted the NBDTs ability to raise capital and hence grow – a comment that has been made on a number of occasions to the Reserve Bank of New Zealand (**Reserve Bank**).

Commerce Commission personal banking study

The NBDTs believe that the Commerce Commission, in its final competition report into personal banking services (**Commerce Commission Report**), has provided a comprehensive analysis of the constraints affecting banking competition in New Zealand.

The NBDTs support the findings of the Commerce Commission and support the recommendations made.

For the purposes of this submission, the NBDTs have classified those recommendations into:

- quick wins; and
- longer term structural changes.

Quick wins

The Commerce Commission made a number of specific suggestions for regulatory change which could improve competition in the banking sector. Some of those can be actioned by politicians, but others will require the Reserve Bank to implement changes. In relation to the changes which politicians can control the NBDTs urge the FEC to:

- amend the Banking (Prudential Supervision) Act 1989 to permit any prudentially regulated entities (banks and non-bank deposit takers) to call themselves a bank. This amendment should also be made to the Deposit Takers Act 2023;
- change the Deposit Takers (Credit Ratings, Capital Ratios and Related Party Exposures) Regulations 2010 by removing the schedule of risk weights and replacing it with BPR131 Standardised Credit Risk RWAs that is applicable to small-medium banks. This is bringing forward the adoption of the framework that is expected to be applied to group 3 deposit takers under the Deposit Takers Act 2023 from 1 July 2028 onwards;

  (We urge that the above two changes come into effect by the commencement of the Deposit Compensation Scheme, which is scheduled for 1st July 2025); and
- ensure that regulations relating to the Depositor Compensation Scheme provide a standard flat-rate levy for at least the first 5 years of the scheme.

The FEC should ask the Reserve Bank to finalise its policy on exchange settlement accounts (**ESAS**) and require them to be available to all prudentially regulated entities.

While not raised by the Commerce Commission, we also believe the Reserve Bank should be asked to provide liquidity facilities to all prudentially regulated entities (not just banks). Both this and access to ESAS accounts would have significant positive impacts on both competition and financial stability.

Structural changes

Conduct regulation

In the NBDTs view, New Zealand's conduct regulation is unnecessarily complex, expensive to comply with, and in many cases, has disproportionately severe consequences for non-compliance. During the last decade or so any spare investment resource they have had has been diverted into compliance, at the expense of innovation and supporting customers. The biggest growth area in the NBDTs' businesses has been in their back-office compliance teams – which have grown significantly, with very little (if any) growth in customer facing roles.

The worst example of over-regulation is under the CCCFA. The NBDTs welcome the review which this government has started. If the government wants to create any meaningful competition in the consumer lending area, the CCCFA must be significantly overhauled. This is particularly in relation to the disclosure requirements – where there are eight separate types of disclosure required, very little of which provides meaningful value to consumers. However, the risks of non-compliance for even a technical breach can be extremely severe, being in the most extreme cases refunding the whole cost of borrowing, not just the margin earned on loans.

In many cases, the over-regulation has had more adverse effects on the sector (and ultimately, customers) than it has benefits to the customers; despite the overarching purpose of the regulation. This has meant that the NBDTs have struggled to dedicate the necessary time and resources to create meaningful value to their customers.

The NBDTs had hoped that the new regime would be an improvement for the sector. The NBDT's listed in Schedule One represent a significant portion of the dwindling New Zealand-owned financial sector struggling to survive in an environment of increasingly burdensome financial regulations. The NBDT's bank mātua and tamariki, whānau, new businesses, iwi and charities that the big banks do not help because they are not seen as profitable, they are in regions, or simply do not fit with the banks' standardised models for lending.

The NBDTs believe that government (and government agencies) should apply the same test to themselves as they require of the NBDTs. If the NBDTs disclosure to customers must be "clear and concise" then surely consumer protection statutes must satisfy the same test.

While the Financial Markets Conduct Act 2013 (**FMCA**) does not have the same level of issues as the CCCFA it does still require multiple licences and covers the same consumer protection objectives in multiple different ways. Both the licensing and the statutory provisions relating to customer dealings can be substantially simplified. For example, there are two acts (the FMCA (fair dealing section) and the Fair Trading Act 1986) that cover misleading and deceptive conduct by financial institutions. The CCCFA has very similar provisions in its responsible lending requirements. Further, under a financial advice provider licence, financial institutions must put the customers interests first and under a conduct licence financial institutions are required to treat customers fairly.

Any simplification is welcome and will remove both uncertainty and unnecessary cost. This should be considered going forward also. For example, we understand that the Financial Markets Authority is considering retaining product disclosure requirements for group 3 deposit takers despite all licenced deposit takers be exempted from this requirement under the Deposit Takers Act 2013. There is no reason to treat group 3 deposit takers different from any others and this would create duplication of both disclosure requirements and regulatory oversight.

Prudential regulation

The NBDTs have noticed a change in the approach to prudential regulation by the Reserve Bank since the FEC intervened to require a proportionality framework to be included in the Deposit Takers Act 2023 and subsequently with the release of the draft Commerce Commission Report. While, in the NBDTs views, this certainly seems to have had an impact, there are still areas that require rebalancing.

While the NBDTs understand that the FEC does attempt to hold the Reserve Bank to account in relation to the application of proportionality framework, they still believe that the Reserve Bank should have a statutory obligation to report at least annually to the FEC on its application of the proportionality framework. This will help continue with progress towards a more proportionate regime, and also help prevent regulatory creep in the future.

In the NBDTs opinion, the FEC should require the Reserve Bank to review its risk appetite. The Reserve Bank currently acknowledges that it has a conservative approach to financial stability (compared to its peer central banks in overseas jurisdictions). The Reserve Bank should move from its openly adopted "conservative" approach to a "balanced" approach to financial stability which takes more account of competition.

Further, there should be no need for a relicensing regime under the Deposit Takers Act 2023. This is essentially a "make work" exercise, and all existing prudentially regulated entities should be grandfathered into the new regime. If any entity has difficulty complying with the regime, it should be dealt with in the same way that it would be dealt with if current standards were changed, and the entity could not comply. Realistically, not re-licensing a bank or a NBDT would have catastrophic and unnecessary consequences for that entity's depositors.

Finally, the NBDTs believe that more guidance should be required from the Reserve Bank in relation to its expectations for decision-making. In some cases, NBDTs have found the decision-making process to be extraordinarily slow (compared to other regulators). Access to exchange settlement accounts is a prime example of this, where access has been suspended now for over two years and the Reserve Bank has been developing a policy for the last seven years. The NBDTs do not believe that access to ESAS is a complex issue, and the delays in decision making have already come at a significant cost for them.

However, the NBDTs do want to stress that while they believe in a more balanced approach to prudential supervision they are not advocating for light-handed regulation. Light-handed regulation did not work in the 1980s and the NBDTs do not believe it is any more likely to work now.

Trust is something which is built up slowly and, collectively, the NBDTs have spent the last 150 years building trust up in New Zealand. We do not wish to see that trust undermined by a regime that it too light-handed and allows entities without a sufficient track record to become banks – when their failure could undermine the trust which the NBDTs have spent considerable effort building up over the years. The NBDTs are advocating for nothing more than a proportionate regime in which those that meet the core standards have the benefits of being prudentially regulated and not just the burdens – as has been the case largely to date.

Schedule One

This letter is on behalf of the following NBDTs:

- Heretaunga Building Society
- Finance Direct Limited
- General Finance Limited
- Wairarapa Building Society
- Xceda Finance Limited
- Mutual Credit Finance Limited
- Gold Band Finance Limited
- Christian Savings Limited
- Nelson Building Society
- Unity Credit Union