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Public version

Personal banking services

Final competition report – Abridged version

(Executive summary and chapter summaries)

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Contents

Executive summary

This report sets out our findings on factors affecting competition for personal banking services in New Zealand and our recommendations to improve competition.

The report is the result of a detailed process of information gathering and engagement with a wide range of stakeholders, including providers of personal banking services, consumers and Māori. We thank all parties for the information they have provided and for their engagement throughout this study.

The major banks do not face strong competition

Our view is that New Zealand's four largest banks – ANZ, ASB, BNZ and Westpac (the major banks) – do not face strong competition when providing personal banking services.

The major banks and Kiwibank are the main providers of personal banking services, particularly for the products that we have focused on in the study (home loans and deposit accounts).

There is a stable oligopoly with no maverick provider

There is a two-tier market, with the major banks in a stable oligopoly in the first tier, smaller providers in the second tier, and Kiwibank currently sitting between the two tiers. The major banks in the first tier have high and largely stable market shares, holding 85-90% of the assets of all registered banks in New Zealand.

No new entrants have been able to meaningfully increase the competition faced by the major banks since the establishment of Kiwibank in 2001. Kiwibank imposes some constraint on the major banks but lacks the scale and capital backing to consistently drive stronger competition. None of the smaller providers, including smaller banks, non-bank deposit takers and financial technology companies (fintechs), are exerting strong competitive pressure on the major banks.

Smaller providers lack the scale to compete with the major banks and tend to focus their effort on specific regions, products or consumer groups. The major banks typically only closely monitor the other majors and Kiwibank, indicating that smaller providers are not regarded as a significant competitive threat.

There is currently no maverick – a particularly aggressive or innovative provider – disrupting the major banks. Kiwibank does not have sufficient capital or differentiation from the majors to be considered a maverick. Fintechs have the potential to be a disruptive competitive force, but their impact in the New Zealand market has been modest to date due to challenges they face in entering and expanding.

We do not observe consistently strong rivalry between the major banks

The intensity of competition between the major banks appears to be sporadic for home loans and deposit accounts. There have been times of relatively intense competition and other times where some or all of the major banks pull back, choosing to put more focus on maintaining profit margins than competing harder to gain market share.

We have not observed an ongoing struggle – with competitors constantly trying to “injure” each other by taking sales away from their rivals – as we would expect in *strongly* competitive markets. Nor do we consider there is an observable tendency towards strong competition. Instead, we see little strategic differentiation between the major banks and growth targets which balance market share aspirations with protecting margins and avoiding significant competitive responses.

Price matching is a prevalent strategy of the major banks. The major banks are aware of, and respond rapidly to, each other’s changes in interest rates and other credit settings – both for headline rates and discretionary rates (case-by-case reductions below headline rates). They generally ensure their advertised rates are in line with each other. They are also prepared to match competing offers, for example through discretionary discounts for home loans.

Over time, the prevalence of price matching is likely to have reduced the incentives to compete hard on interest rates. Providers know that if they introduce a new promotion or better interest rate, this will likely be quickly matched by competitors – limiting the gains from the offer.

For home loans, discretionary discounting and price matching enable banks to selectively compete to win or retain price-sensitive (engaged) customers, while offering higher interest rates for less price-sensitive customers. This means that the benefits of competition mostly accrue to those customers who are willing and able to shop around for the best deals – but many customers do not.

It appears to require external factors to destabilise the prevailing competitive dynamic between the major banks and bring out more intense price competition. For example, there was more intense competition for home lending from early 2022 to early 2023, coinciding with a rapidly rising interest rate environment.

Limited investment in innovation by the banks

We have been surprised by the limited investment by the major banks and Kiwibank in upgrading to modern core banking systems and the low prioritisation given to this. Legacy systems constrain the ability of banks to innovate and compete. They also constrain and delay fintechs’ ability to introduce innovative services – due to the need to interface with banks’ legacy systems.

We have seen limited innovation across the industry. Innovation has tended to occur around the edges of the customer experience, such as enhancements to mobile apps, rather than at the core of product and pricing structures. In a competitive market we would expect to see greater investment in innovation so competitors could stay ahead of their rivals.

The major banks and Kiwibank are planning or progressing transformation programmes. However, they have yet to complete core systems upgrades, despite the resources available to them.

The major banks have told us that their limited investment in core systems has been largely due to the need to keep pace with changing regulatory requirements. We do not accept that this is a satisfactory or complete explanation – particularly given the ability of the Australian parent banks to balance similar investment demands. We see fully depreciated core systems as an indicator of sustained under-investment reflecting a lack of competitive pressure over an extended period.

The NZ banking sector has sustained high levels of profitability

The New Zealand banking sector has demonstrated sustained high levels of profitability relative to international peers. Between 2010 and 2021, New Zealand's banking sector has, on average, performed in the upper quartile relative to peer nations on three important measures: return on equity, return on assets, and net interest margin. Cross-checks we have undertaken since our draft report was issued produce consistent results and provide us with greater confidence in our findings.

We consider that at least part of the profitability we see is explained by the market power of the major banks. We considered non-competition explanations that have been put forward, but they do not explain the profitability we observe.

New Zealand's banking sector is relatively low risk because it is more heavily weighted towards traditional (vanilla) banking activities (like home lending) than many peer nations. Because these activities are lower risk, if competition was working well, we would expect the New Zealand banking sector to derive lower returns relative to riskier banking sectors overseas.

The major banks have experienced high average returns on equity relative to smaller New Zealand banks since 2018. This is consistent with the two-tier market we have observed in personal banking, where smaller providers struggle to exert significant competitive pressure on the major banks.

Some groups are not well served by competition alone

Some consumers are particularly vulnerable to financial exclusion and find it difficult to access personal banking services, like a basic bank account.

We also heard about barriers to accessing personal banking services that are unique to Māori. These include lack of Māori representation in the banking sector and difficulty in accessing finance for housing on Māori freehold land.

Five main factors are limiting competition

We have identified five main factors limiting competition for personal banking services in New Zealand. These factors overlap and can be mutually reinforcing.

Structural advantages of the major banks

The major banks have scale, scope and funding cost advantages, which make it very challenging for smaller providers to compete with them. They also have nationwide networks with broad reach and established brand recognition. Consumers perceive large banks as safer and more stable, so are more likely to trust them to look after their money.

Retail deposits (funds held in deposit accounts) are crucial to bank funding and are typically the lowest cost source of funding available to banks. Because the major banks hold a higher proportion of deposits in transaction accounts (which generally do not pay interest), they have a significant funding cost advantage over smaller banks. This reflects advantages the major banks have in winning and maintaining main bank relationships with customers.[1]

Regulatory barriers to entry and expansion

Regulation shapes competition in personal banking. It has been a universal theme of our engagements with stakeholders that regulation is the single most important factor constraining new entry and the ability of existing providers to expand and compete.

While the regulatory burden affects all providers, it affects the smaller providers disproportionately more due to their lack of scale. Consequently, proportionality in regulatory policy settings is critical to increasing competition.

Prudential capital requirements in particular have affected competition. Prior to the Reserve Bank's 2019 Capital Review, these requirements gave the major banks a material competitive advantage over Kiwibank and smaller providers. While the Capital Review largely addressed the difference in capital requirements, we think the Reserve Bank can do more within its current legislative framework to further level the playing field when implementing prudential capital requirements and other policies within its remit.

The Government may need to amend legislative settings if it prefers a different balance between competition and financial stability.

Barriers to consumer switching and engagement

There is significant customer inertia for personal banking services. Consumers tend to be sticky – they often remain inactive or disengaged, rarely switching between banks.[2] This favours the major banks who hold most of the main bank relationships with customers.

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1 Main bank relationships (where customers do most of their day-to-day banking) are valuable for providers. Our consumer survey (undertaken by Verian) found that 92% of customers consider one of the five largest banks (the major banks and Kiwibank) to be their main bank.

2 Our consumer survey found that 54% of customers have never switched their main bank.

When consumers do engage, it can be hard for them to find the best deal. Comparing offers from different banks is challenging for consumers due to the various strategies employed by banks in marketing their interest rates, fees and cash back incentives, and in promoting the quality of their mobile apps and online banking services. For example, discretionary discounts off headline rates for home loans – combined with the need to go through the loan application process to get an offer – means that it is not possible for consumers to determine the best price in market without significant effort or assistance.

There are both real and perceived logistical difficulties with switching providers which reduce the competitive pressure on the major banks. The industry-led account switching service run by Payments NZ has not been effective. Some consumers are also deterred by the compliance requirements driven by the Anti-Money Laundering and Countering Financing of Terrorism Act (AML/CFT Act) and/or the Credit Contracts and Consumer Finance Act (CCCF Act). These include customer identification processes to open a new account and the processes and evidence required to demonstrate loan affordability.

Impediments to innovation by fintechs

Fintechs are a potential source of disruptive innovation and competition. They leverage modern core banking systems and alternative business models to deliver low-cost digital-only services.

However, fintechs face several impediments to entry and expansion such as: opening and maintaining a business bank account, meeting the costs and complexity of regulatory requirements, obtaining sufficient capital, gaining access to the consumer data they need to provide their services, and restrictions on use of the terms 'bank' and 'banking services'.

Open banking has enabled fintechs to compete in the UK and Australia. Open banking lets consumers authorise third party businesses such as fintechs or other banks to receive their banking data (such as transaction history) or make payments on their behalf.

Progress towards open banking in New Zealand has been too slow because the major banks have been left to set the nature and the pace of change. As a result, New Zealand consumers are missing out on the competition and innovation open banking can provide.

Industry is progressing open banking through Payments NZ and the API Centre, while the Government is progressing the Customer and Product Data (CPD) Bill which will introduce a regulatory framework for open banking. There is a risk of current industry work stalling while CPD processes are worked through, and an opportunity now to accelerate and better co-ordinate progress.

Mortgage advisers and banks are not driving price competition for home loans

Mortgage advisers are increasingly being used by consumers to navigate the complexity of home loans. They can help with the process of obtaining a home loan, and finding lenders who are willing to fund less straightforward purchases.

Mortgage advisers should be champions of price competition, while continuing to provide holistic financial advice.

- Banks’ systems need to improve to make it easier for mortgage advisers to focus on getting the best deals for their clients. Manual application processes and a lack of standardisation between banks make it needlessly time-consuming for consumers and advisers to shop around for offers of finance. Lender practices also discourage advisers from lodging multiple loan applications per client.
- Mortgage advisers should also put more emphasis on price when recommending a provider. This includes being more transparent about gaps in their lender coverage and highlighting any superior headline rates offered by providers outside of their panel of lenders.

Multi-faceted solutions are needed to improve competition

Improving competition requires multi-faceted solutions. Overseas experience suggests that the scale and brand advantages of large banks and consumer inertia are difficult to overcome, even where open banking is well-established.

Our recommendations are designed to work together to support new entry and expansion, reduce the regulatory barriers to competition and 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.

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 the Exchange Settlement Account System; 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.

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.

Chapter summaries

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.

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.

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.

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.

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.

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.

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.**

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.

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.

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.