Market Study into Personal Banking Services Preliminary Issues Paper

Federated Farmers of New Zealand

7 September 2023

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MARKET STUDY INTO PERSONAL BANKING SERVICES PRELIMINARY ISSUES PAPER

TO: Commerce Commission

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ADDRESS FOR SERVICE

Name	Position	Phone	Email Address
Nick Clark	Manager National Policy	027 217 6731	nclark@fedfarm.org.nz

OTHER CONTACTS

Richard McIntyre	Federated Farmers Banking Spokesperson	021 143 1588	rmcintyre@fedfarm.org.nz
Wayne Langford	Federated Farmers of NZ National President	027 525 7377	wlangford@fedfarm.org.nz
Paul Melville	General Manager Policy & Advocacy	021 812 423	pmelville@fedfarm.org.nz

Federated Farmers of New Zealand
PO Box 715
WELLINGTON 6140

ABOUT FEDERATED FARMERS

Federated Farmers of New Zealand is a membership organisation, which is mandated by its members to advocate on their behalf and ensure representation of their views. Federated Farmers does not collect a compulsory levy under the commodities levy act and is funded from voluntary membership.

Federated Farmers represents rural and farming businesses throughout New Zealand. We have a long and proud history of representing the needs and interests of New Zealand's farmers.

Federated Farmers aims to empower farmers to excel in farming. Our key strategic outcomes include provision for an economic and social environment within which:

- Our members may operate their business in a fair and flexible commercial environment;
- Our members' families and their staff have access to services essential to the needs of a vibrant rural community; and
- Our members adopt responsible management and sustainable food production practices.

SUBMISSION ON MARKET STUDY INTO PERSONAL BANKING SERVICES PRELIMINARY ISSUES PAPER

1. INTRODUCTION

1.1 Federated Farmers of New Zealand welcomes the opportunity to submit to the Commerce Commission on the preliminary issues paper for its Market Study into Personal Banking Services.

1.2 Federated Farmers takes a close interest in banking services. Farming has been and will continue to be reliant on bank capital for investment to grow the business, become more productive and to respond to environmental requirements, for seasonal finance, and in some cases for survival (especially in the current economic climate). Banks' decisions can have a huge impact on farm businesses and farming families' economic and social well-being.

1.3 Agricultural sector lending exceeds $63 billion[1]. For some farmers, interest is the largest single farm expense and a 1 percentage point change in interest rates is worth more than $63 million per annum to farmers as a whole. Taking data from Federated Farmers' May 2023 Banking Survey, a farm with an average mortgage of $4.3 million paying average interest rates of 3.79 percent in May 2021 and 7.84 percent in May 2023 will have seen its annual interest cost increase from $163,300 in 2021 to $337,800 in 2023, over a time when farm incomes (and profitability) have been falling.

1.4 This Market Study has been prompted by public concern about persistently large profits recorded by banks, especially the large Australian-owned banks, and whether there is sufficient competition in banking services. Farmers share this concern.

1.5 Federated Farmers supports this Market Study. A strong and profitable banking system is strategically important for the economy and provides security to customers, but it is also important that the banking system is competitive and is not harming consumer welfare through high prices, low levels of innovation, low levels of services, and/or a lack of dynamism between banks.

1.6 This Market Study is for personal banking services, with a particular focus on deposit accounts and home loans. Personal banking services are very important for farmers, their families, their employees, and rural people generally. Business banking services are out of scope for the Market Study but for farmers living on their farms personal banking services are often intertwined with farm business banking services.

1.7 Recognising the intertwining of personal and business banking, Federated Farmers' comments in this submission will be general, reflecting our members' experiences and perceptions of banking services.

1.8 However, we also submit that competition issues relating specifically to rural business banking should be subject to a similar market study.

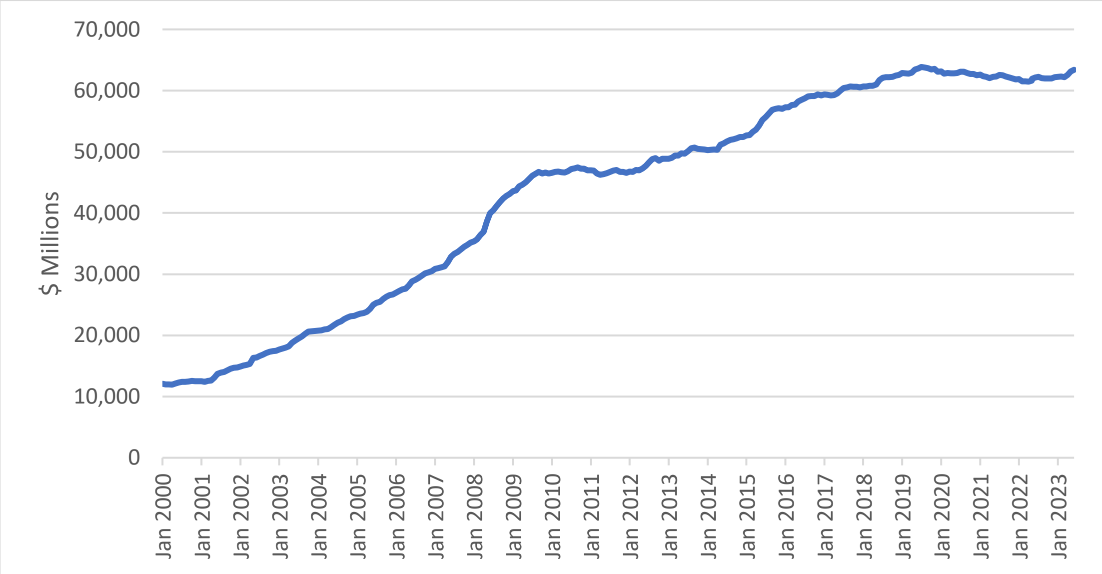
[1] Reserve Bank of NZ Sector Lending Statistics (C5) - https://www.rbnz.govt.nz/statistics/series/lending-and-monetary/registered-banks-and-non-bank-lending-institutions-sector-lending

2. AGRICULTURAL SECTOR LENDING

2.1 As discussed above, Federated Farmers takes a close interest in banking services. Although farmers have deposit accounts, most concern from farmers is about bank lending, particularly for farm mortgages and overdrafts/seasonal finance. Banks' decisions can have a huge impact on farm businesses and farming families' economic and social well-being.

2.2 Since 2000, agricultural debt has increased dramatically. Figure 1 below shows agricultural debt rising from $12.1 billion in January 2000 to $63.4 billion in July 2023, a more than five-fold increase. This is similar to the growth in household and personal consumer debt, which together has also increased more than five-fold, but more than the growth in business debt, which has increased a little more than three-fold[2].

Figure 1: Agricultural Sector Lending 2000-23



Source: Reserve Bank of NZ Sector Lending Statistics (C5)

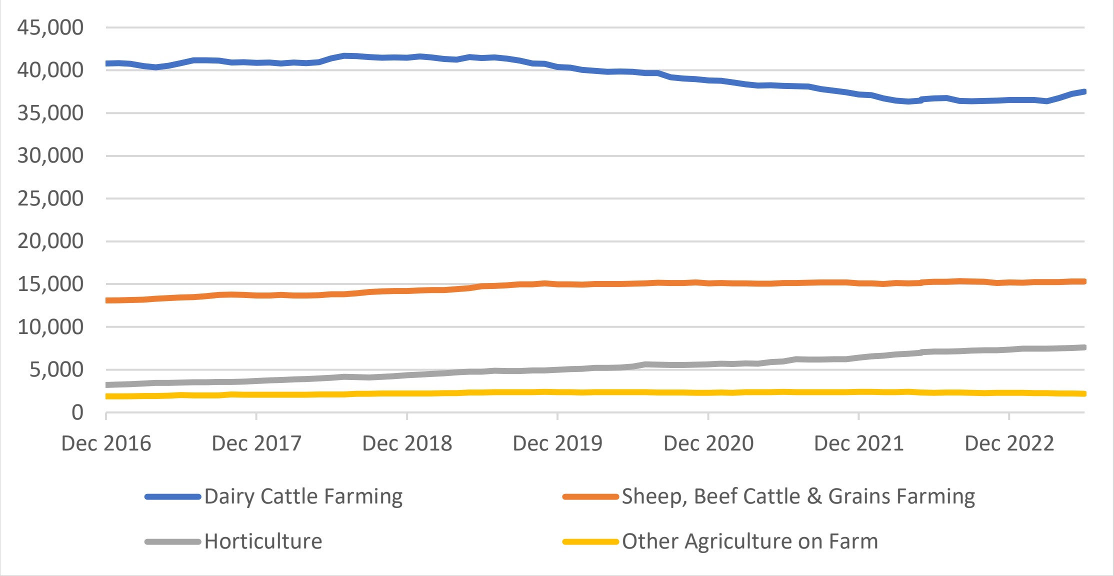
2.3 As shown in Figure 1 there was very rapid growth agricultural debt during the 2000s driven largely by expansion of dairying from new conversions but also investment in making existing dairy farms more productive. After a flat period in the years after the Global Financial Crisis, debt increased again in 2014-16 as banks supported farmers through a prolonged downturn in dairy prices. With the recovery in farm incomes and profitability from 2017, growth in debt moderated and levels declined slightly from 2019 until 2022 when falling incomes and surging costs squeezed farm profitability and has seen debt rise again.

2.5 Dairy farmers hold collectively around three-fifths of total agricultural debt ($37.5 billion as at July 2023). For some time, the Reserve Bank's six-monthly Financial Stability Reports included dairy sector indebtedness as one of the financial sector's key vulnerabilities, but the work done from 2019-23 to reduce dairy debt (from a peak of $41.5 billion in July 2019 to $36.4 billion in March 2023) saw it dropped as a key vulnerability. Figure 2 shows how lending has changed for dairy cattle farming; sheep, beef cattle and grains farming; horticulture; and other agriculture on-farm.

[2] Reserve Bank of NZ Sector Credit Statistics: https://www.rbnz.govt.nz/statistics/c5

2.6 While dairy lending has fallen over recent years, horticulture lending has increased strongly as banks have diversified their rural lending. Lending for sheep, beef cattle, and grains farming has been relatively stable.

Figure 2: Agricultural Sector Lending by Sub-Sector 2016-23



Source: Reserve Bank of NZ Bank Assets – Loans by Purpose (C31)

3. FEDERATED FARMERS BANKING SURVEYS

3.1 In 2015, farmer concerns about financial pressure during the 2014-16 downturn in farm incomes and profitability prompted Federated Farmers to begin surveying its members on their relationships with banks. These surveys were initially quarterly but since 2017 they have been undertaken on a six-monthly basis.

3.2 During the 2014-16 downturn farmers were very satisfied with their banks and relatively few felt the pressure they were under was ‘undue’. Satisfaction began to slip after 2017, once farm incomes and profitability were recovering. This was as banks pulled back the support they had provided during the downturn and wanted farmers to be in a better position for the next downturn – including requiring principal and interest payments. After 2017 those feeling under ‘undue’ pressure rose, due to many farmers feeling that banks were being overly tough considering their improved profitability.

3.3` There was a recovery in sentiment during the Covid-19 pandemic, as banks again moved to support their customers, but they have deteriorated again since 2021. Interest rates for mortgages and overdrafts have climbed rapidly on the back of monetary policy tightening and this has come at a time when farm incomes have dropped (due to falls in international commodity prices) and farm input costs have surged putting intense pressure on profitability. Federated Farmers has called on banks to support their otherwise viable clients – as they did during 2014-16 and the pandemic. High and increasing interest rates are a significant difference between now and then, however.

3.4 A copy of the report of the most recent May 2023 survey is attached and reproduced below are some key results from the survey. The survey was undertaken prior to the start of the current 2023/24 season, which is proving to be tough for all farmers. Although Fonterra’s recent cuts in forecast farmgate milk price have grabbed attention[3], commodity prices and farmgate incomes have been falling across the board at a time of high inflation of farm input costs and rising interest rates.

3.5 The next survey will be undertaken in November 2023, which will reflect the current challenging financial climate for farmers.

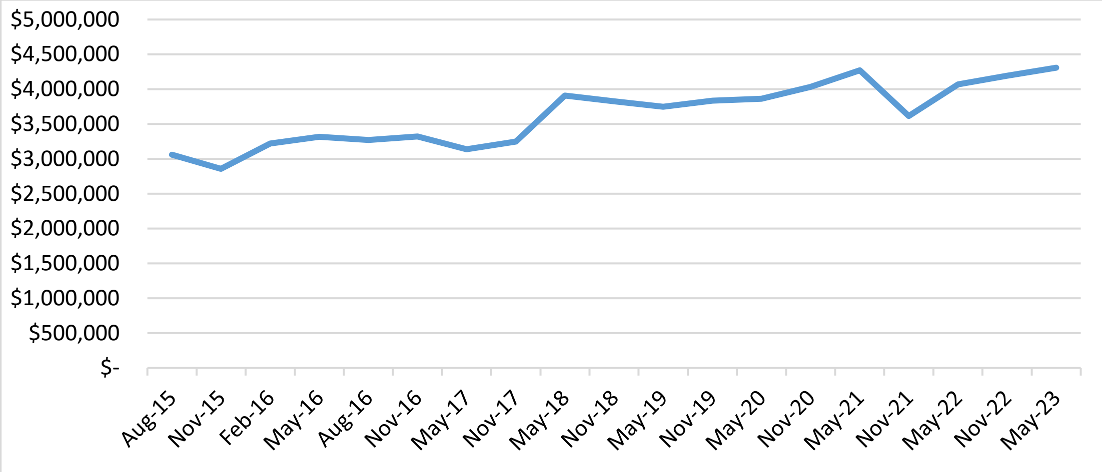
Bank Mortgages and Overdrafts

3.6 79 percent of farmers said they had a mortgage. This was up 2 points from November 2022. Arable farmers were most likely to have a mortgage at 89 percent. Sharemilkers were least likely at 67 percent.

3.7 Over the past six months, the average farm mortgage value has increased from $4.2 million to $4.3 million while the median increased from $2.5 million to $2.8 million. Figure 3 shows how the average mortgage has tracked over the life of the survey.

[3] Fonterra’s opening forecast, set on 25 May 2023, provided for a range of $7.25-$8.75 per kgMS (with a midpoint of $8.00). On 4 August it reduced the forecast to a range of $6.25 to $7.75 per kgMS (with a midpoint of $7.00). Then only two weeks later, on 18 August, it reduced it again to a range of $6.00 to $7.50 per kgMS (with a midpoint of $6.75).

Figure 3. Average Current Mortgage* 2015-23

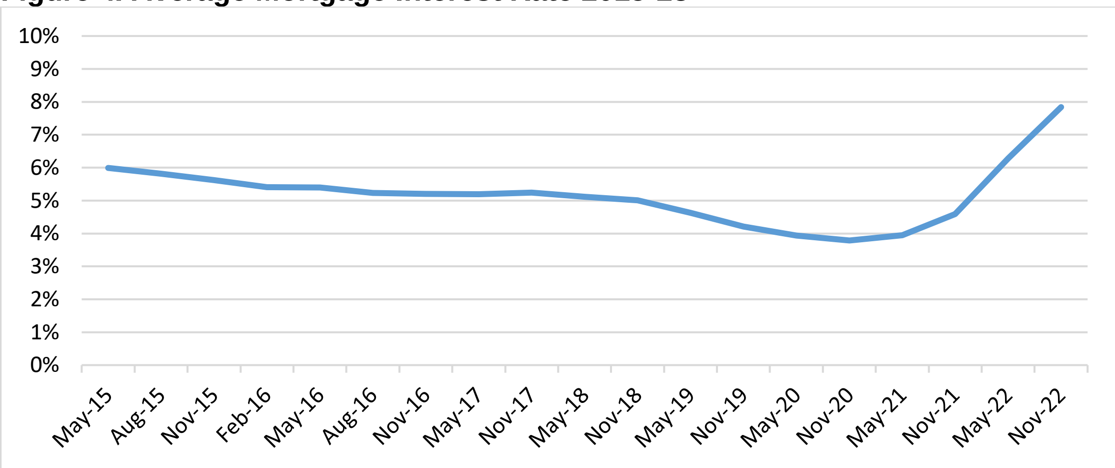


* *Excluding outliers*

3.8 The average mortgage interest rate increased from 6.29 percent to 7.84 percent, up 155 basis points since November 2022 (and up 405 basis points since its lowest point in May 2021). Sharemilkers had the highest average mortgage interest rate of 8.41 percent and Other Industry Groups the lowest of 7.67 percent. Figure 4 shows how the average mortgage interest rate has tracked over the life of the survey.

3.9 What this means is that a farm with an average mortgage of $4.3 million paying average interest rates of 3.79 percent in May 2021 and 7.84 percent in May 2023 will have seen its annual interest cost increase from $163,300 in 2021 to $337,800 in 2023, over a time when farm incomes (and profitability) have been falling.

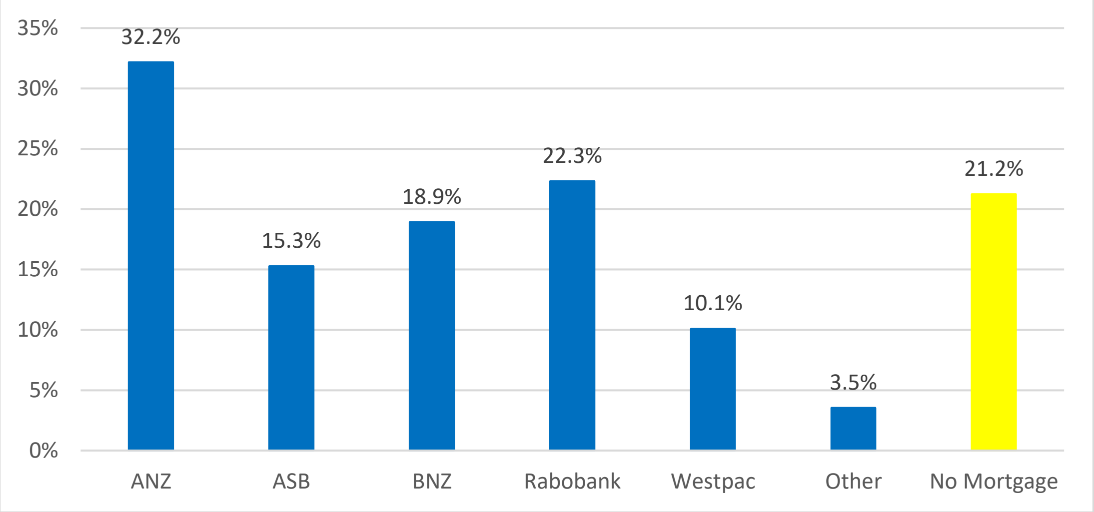
Figure 4. Average Mortgage Interest Rate 2015-23



3.10 Overall, 2.1 percent of farmers were paying a mortgage interest rate of less than 5 percent, down from 10 percent in November 2022 (and from a peak of 91 percent in May 2021). Meanwhile, 1.8 percent were paying a mortgage interest rate higher than 10 percent, compared to 0.3 percent in November 2022.

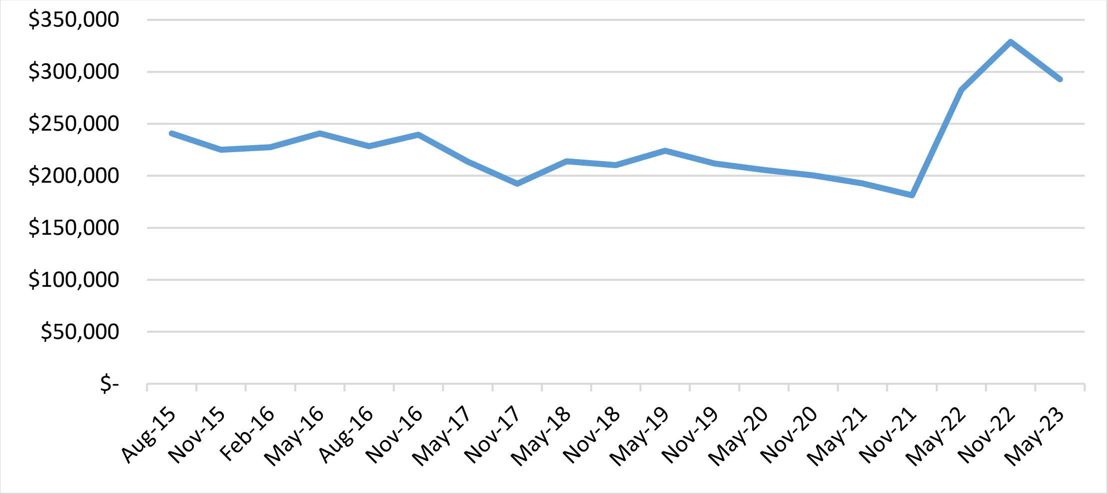
3.11 ANZ is by some margin the bank with the largest market share for farm lending. This is a legacy of its acquisition in 2003 of National Bank, which had in turn acquired the Rural Bank in 1988. Figure 5 shows the banks with which farmers have a mortgage.

Figure 5. Banks with which Farmers have a Mortgage, May 2023



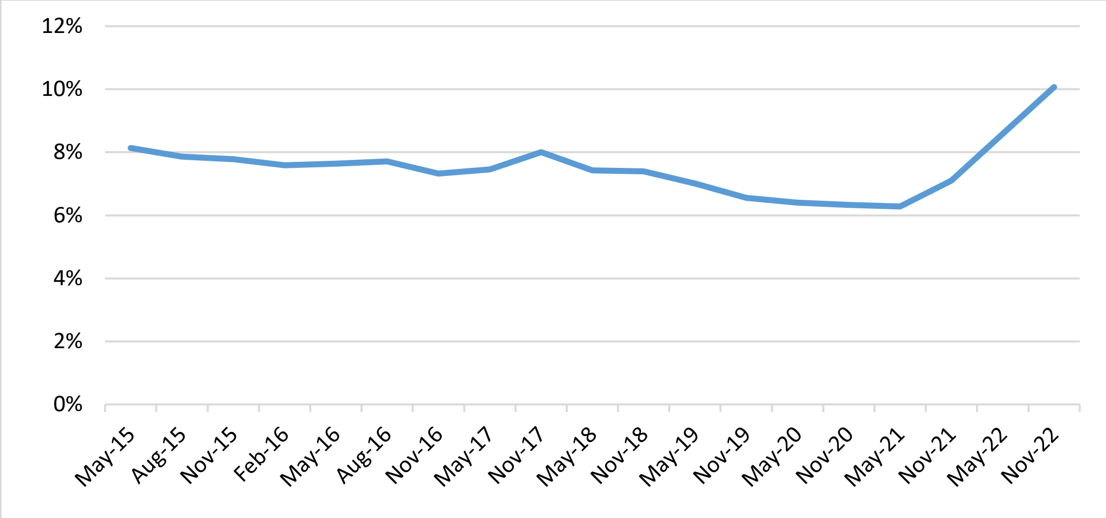
3.12 74 percent of farmers had an overdraft facility, a little higher than November 2022. The average overdraft limit was $293,000, a $35,800 decrease, while the median limit was unchanged at $150,000. Figure 6 shows the average overdraft limit over the life of the survey.

Figure 6. Average Overdraft Limits 2015-23



3.13 The average overdraft interest rate increased from 8.59 percent to 10.07, up 148 basis points since November 2022 (and up 379 points since its lowest point in November 2021. Dairy had the highest average of 10.49 percent and Other Industry Groups the lowest of 9.64 percent. Figure 7 shows the average overdraft interest rate over the life of the survey.

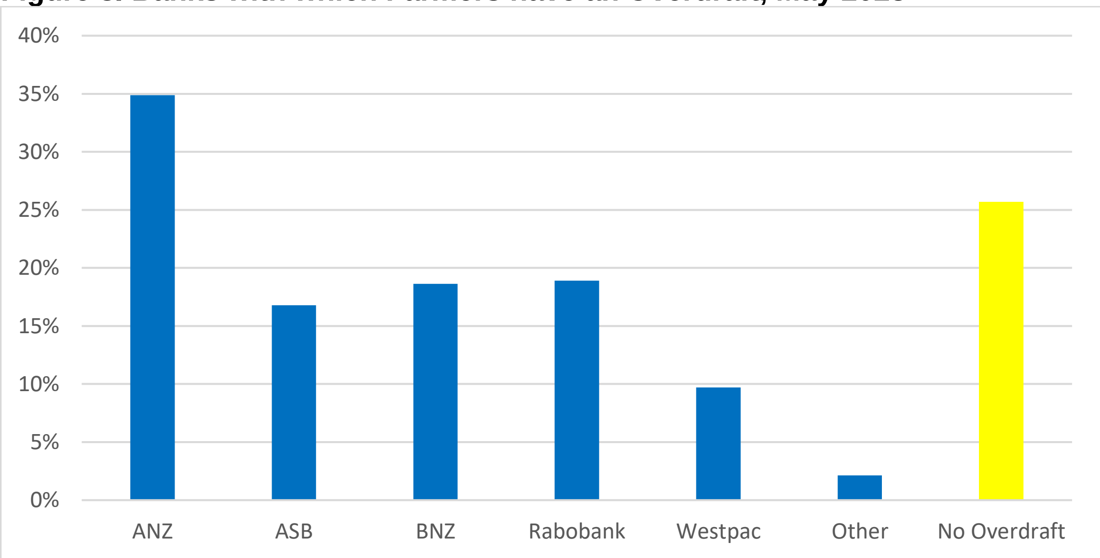
Figure 7. Average Overdraft Interest Rate 2015-23



3.14 Overall, only 0.3 percent of farmers were paying an overdraft interest rate less than 5 percent, almost the same as in November 2022 (and down from a peak of 20 percent in November 2021). Meanwhile, 34 percent were paying an overdraft interest rate of more than 10 percent, up from 14 percent in November 2022.

3.15 As with mortgages, ANZ had by some margin the largest market share for bank overdrafts. Figure 8 shows the banks with which farmers have an overdraft.

Figure 8. Banks with which Farmers have an Overdraft, May 2023



<u>Relationship Perceptions</u>

3.16 Farmer satisfaction with their bank relationship continues to slip. Although a majority remain satisfied with their banks, with 56 percent saying they were very satisfied or satisfied with their bank relationship, this was down 3 points from the previous survey in November 2022 and is the lowest since the survey began in May 2015. Arable farmers were most satisfied of industry groups, while Sharemilkers were the least satisfied with barely half saying they were very satisfied or satisfied.

3.17 Figure 9 shows farmer satisfaction with their bank over the life of the survey. Figure 10 shows this by bank for the May 2023 survey.

Figure 9. Proportion 'Satisfied' + 'Very Satisfied' with their Bank 2015-23

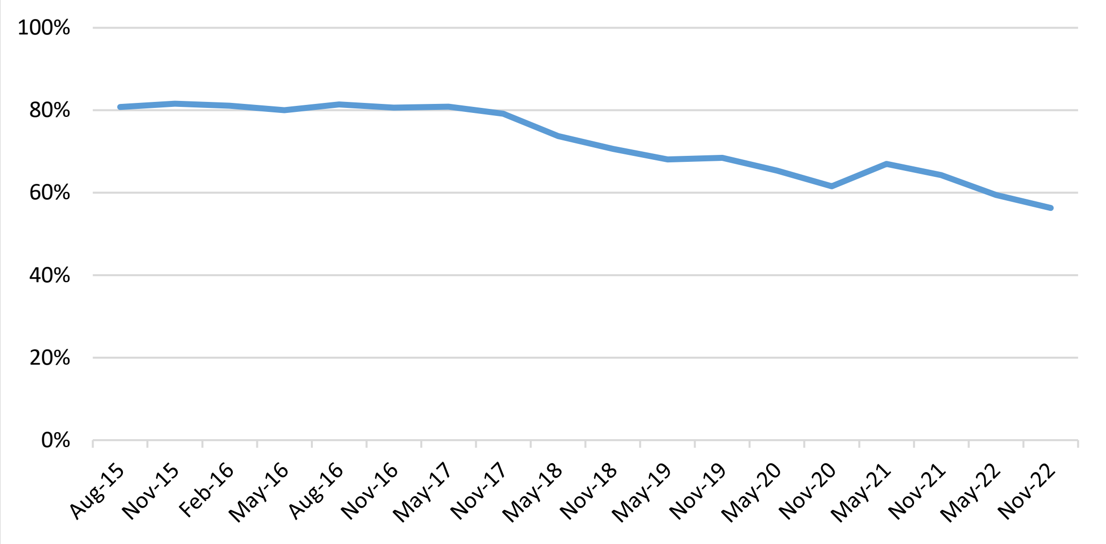
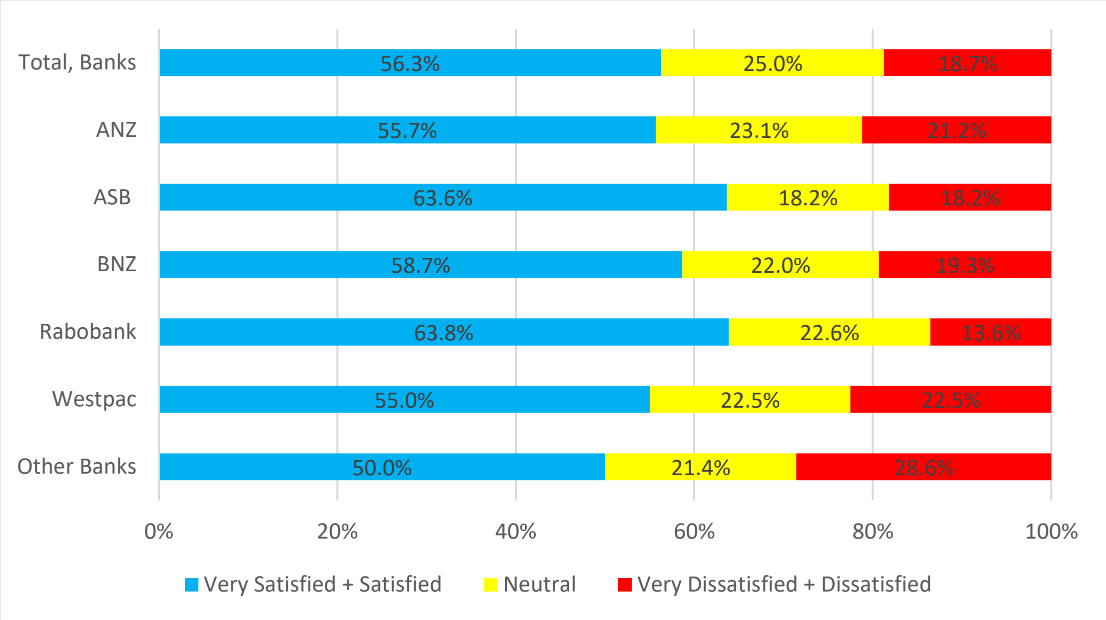


Figure 10. Bank Satisfaction by Bank, May 2023



3.18 24 percent of farmers perceived they had come under 'undue pressure' over the past six months, up 6 points from November 2022. All industry groups had higher proportions compared to six months ago and all were over 20 percent. Dairy farmers felt the most under pressure and Meat & Wool farmers felt the least pressure.

3.19 Figure 11 shows farmers feeling undue pressure from their bank over the life of the survey. Figure 12 shows this by bank for the May 2023 survey.

Figure 11. Proportion of Farmers feeling Undue Pressure from Bank 2015-23

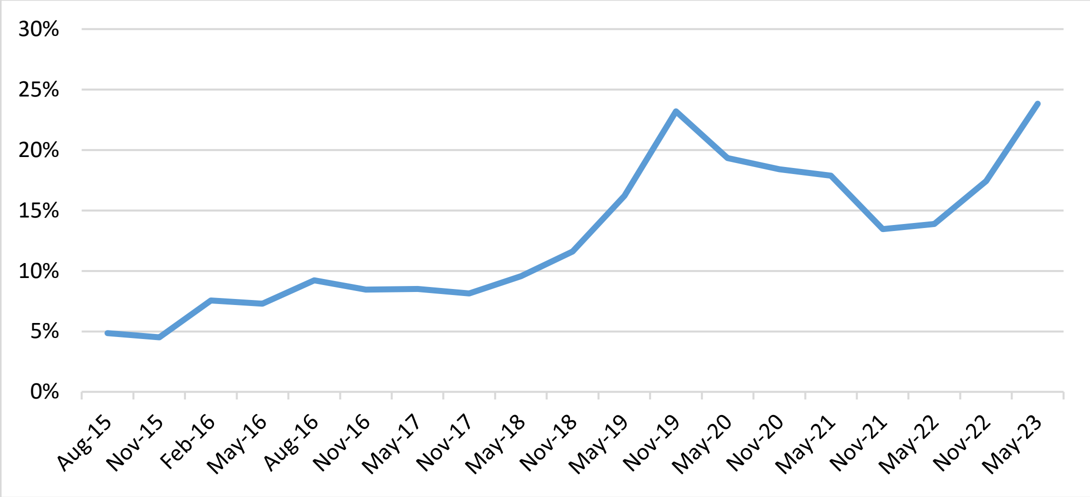
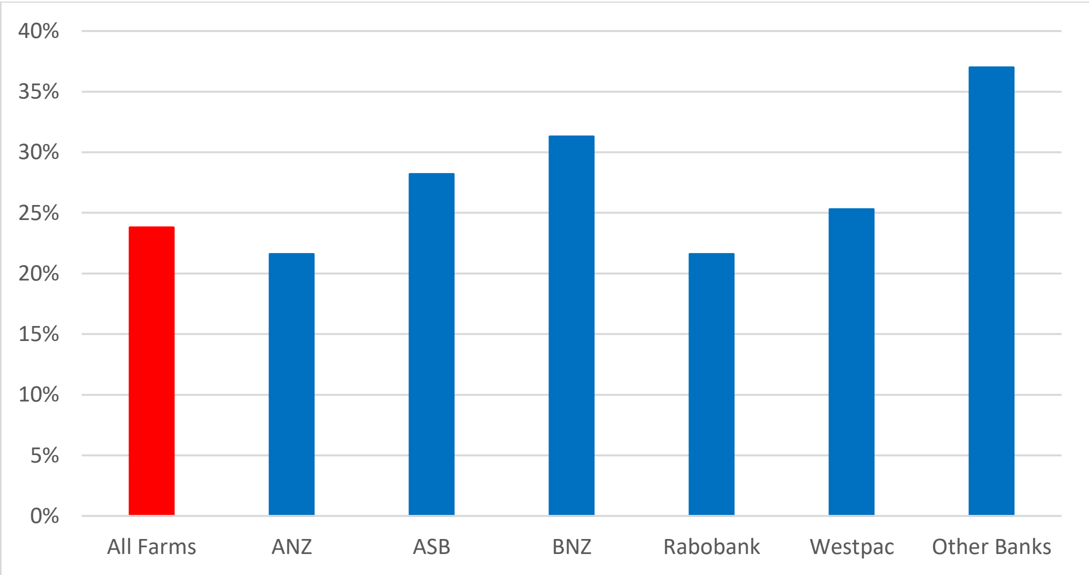


Figure 12: Feelings of Undue Pressure from Bank, by Bank, May 2023



3.20 44 percent of farmers felt their mental wellbeing had been affected by their debt levels, interest rates, changing condition, or other forms of pressure, up 3 points from November 2022, when we first asked the question. 47 percent felt it had not been affected, down 2 points. The remaining 9 percent were unsure. Other Industry Groups were most likely to say 'yes' and Arable least likely.

3.21 Overall, banks' conditions for lending became tougher rather than easier for all farm types, with 3.1 percent reporting easier conditions (down 0.2 points from November 2022) and 31 percent reporting tougher conditions (up 4 points). Arable farmers were most likely to report tougher conditions.

3.22 Perceptions of the quality of bank communication eased further, continuing their decline over the past five years. 53 percent said their bank communications had been very good or good, down 1 point from November 2022. Arable farmers rated their quality of communication the highest. Sharemilkers had the most negative perceptions. Those without bank loans were particularly unhappy with communication.

3.23 Figure 13 shows farmer perceptions with bank communication over the life of the survey. Figure 14 shows this by bank for the May 2023 survey.

Figure 13. 'Very Good' + 'Good' Bank Communication 2015-23

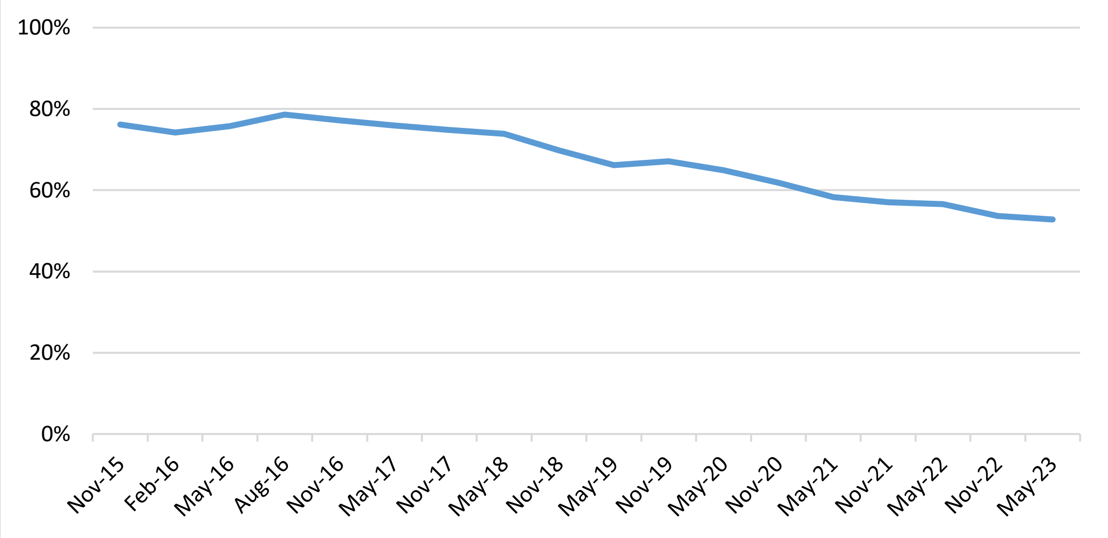
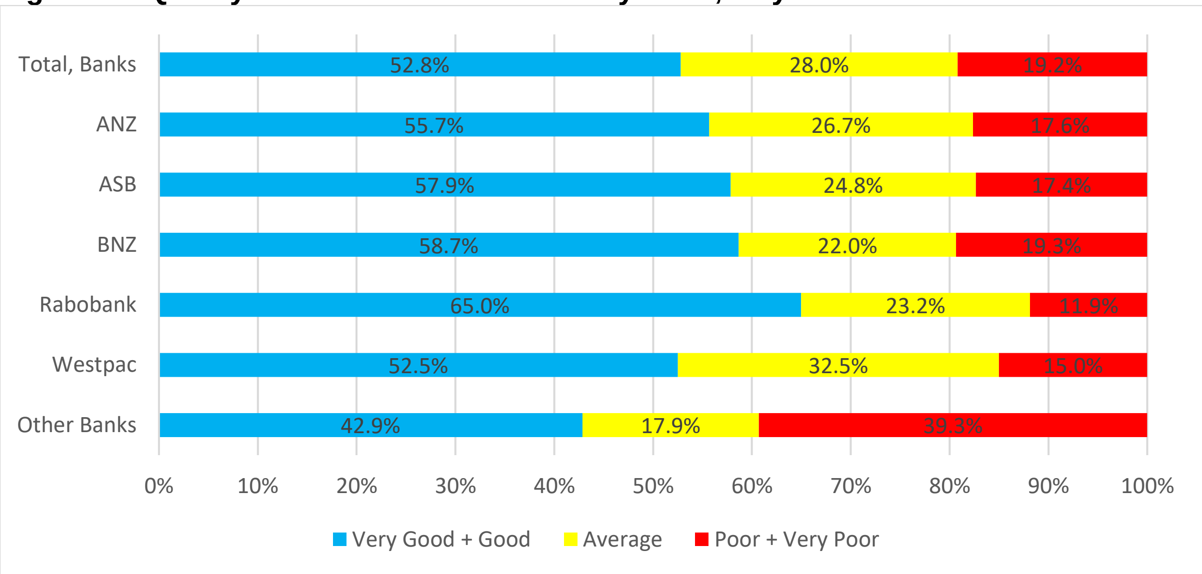


Figure 14. Quality of Bank Communication by Bank, May 2023



3.24 Although many respondents were very complimentary about their banking relationships, comments from other respondents highlighted the size and speed of interest rate increases on top of continued concern about tough lending policies for rural purposes, less frequent communication, bank branch closures and consolidation of rural staff into larger centres more remote from rural areas, high turnover of bank staff, and staff having less understanding of farming. Some commented specifically on large bank profits. Respondent comments from the May 2023 survey are included as an Appendix.

Budgeting

3.25 More farmers had budgets compared to six months before. This reflects tougher times financially from falling incomes and rising costs. 68 percent of farmers had an up-to-date budget for the 2022/23 season and 41 percent had an up-to-date budget for (at the time) the upcoming 2023/24 season. Both are record highs since the survey began in 2015. Figures 15 and 16 show how these have tracked over the life of the survey. The 'future seasons' budget results tend to bounce around with the May peaks reflecting the survey timing being close to the start of the upcoming season (1 June for dairy).

Figure 15. Budget for the Current Season 2015-23

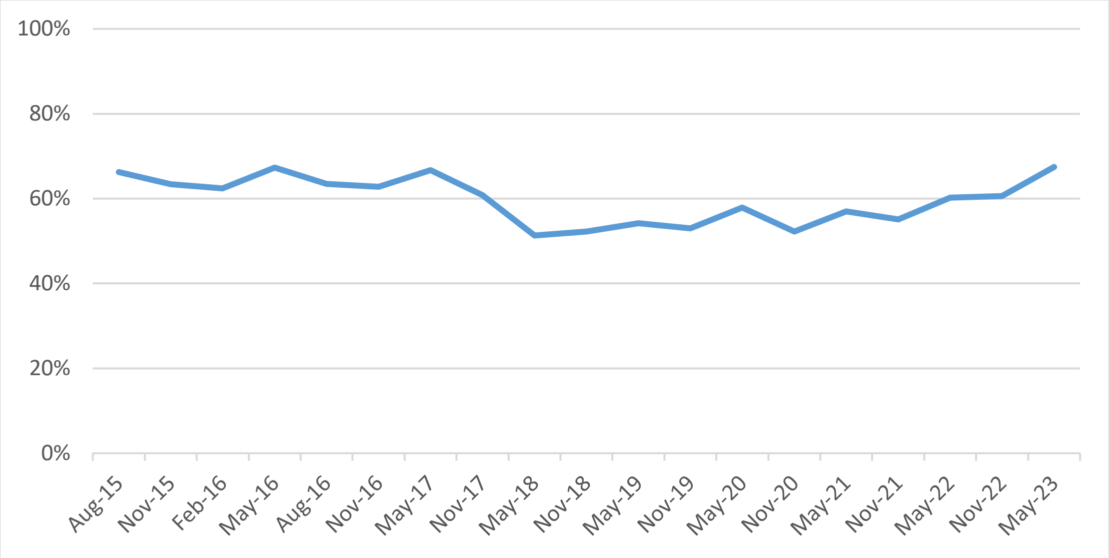
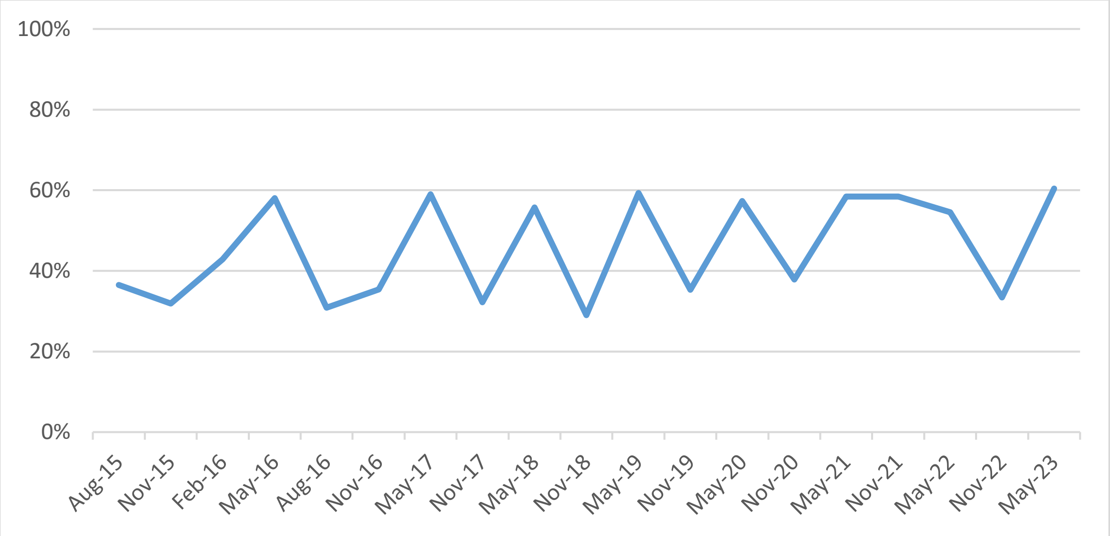


Figure 16. Budget for Future Seasons 2015-23



3.26 Having a detailed, up-to-date budget is consistently far more prevalent among Sharemilkers than any other group of farmers.

4. COMMENT ON PRELIMINARY ISSUES PAPER

4.1 Federated Farmers believes the preliminary issues paper is a good 'first cut' of the issues with personal banking services. This section of the submission provides brief comments on each section of the paper.

Our role and the process for the study.

4.2 Given the terms-of-reference of the Market Study, set by the Minister, we are comfortable with the Commission's role and process. As mentioned above we believe the experiences of farmers should be 'in scope' due to the intertwined nature of banking services to farmers and that many farmers live in a house on the farmland which secures their farm mortgages.

Overview of personal banking services in New Zealand.

4.3 The overview provides useful background information and context of personal banking services, including definitions of personal banking services; New Zealand regulation of banking; history of banking in New Zealand; structure of the New Zealand banking sector; that New Zealand banks are financially strong and stable and enjoying persistently high profits; and global trends toward digital innovations and digital disruption. We do not have any additional comment on this section of the paper.

Proposed focus of the Market Study – deposit accounts and home loans.

4.4 As mentioned above, Federated Farmers recognises that business banking services are out of scope for the Market Study but for farmers living on their farms personal banking services are often intertwined with farm business banking services.

4.5 We agree that the Market Study should seek to understand how competition is working for New Zealanders as a whole as well as for different population groups. This needs to include rural New Zealanders, especially considering the closure of bank branches in many rural areas and the increased digitisation of banking services at a time when many rural people continue to struggle to get decent internet connectivity and/or mobile phone coverage. We are pleased the preliminary issues paper recognises that rural people's perspectives will be considered.

4.6 With regard to the proposed focus on deposit accounts and home loans, farmers have deposit accounts, but most concern from farmers is about bank lending, where farm mortgages will often cover their homes. Banks' decisions on interest rates and lending conditions can have a huge impact on farm businesses and, importantly for this Market Study, farming families' economic and social well-being.

4.7 In the context of this Market Study into personal banking services, we have had feedback that banks should treat lending for a farmhouse and curtilage as a housing loan (and therefore be subject to interest rates that prevail for housing lending) separately from the loan for a farm business. We encourage the Market Study to consider the desirability and practicality of such an approach.

Analysis we intend to undertake to identify any factors affecting competition.

4.8 Regarding conditions for entry and expansion, rural banking services are heavily concentrated. According to Reserve Bank statistics, more than 98 percent of agricultural loans are held by five banks (ANZ, BNZ, Rabobank, ASB, and Westpac)[4], with the remaining held by a further 10 banks (with almost of all that remainder held by two banks – TSB and Heartland). The equivalent percentages for the top five banks for housing loans (95 percent), consumer loans (82 percent), and business loans (95 percent) are all lower.

4.9 Rural banking is highly specialised, requiring staff that are knowledgeable and experienced in farming and rural business and requiring local and regional infrastructure, such as branches and offices. It would be challenging for existing non-rural New Zealand banks let alone new entrants to banking in New Zealand expand into rural banking, even if they wanted to.

4.10 We also think it is important to look into regulatory environment, including its impact on interest rates, such as through risk margins and how they are influenced by regulation such as bank capital requirements and sector risk weightings. This has been cited as a reason for higher interest rates for rural lending compared to residential lending. We encourage the Market Study to consider whether regulations distort allocation of capital and influence the cost of capital for different sectors.

4.11 Regarding the nature of competition, even among the banks actively engaged in rural banking, recent years have seen them adopt lower appetites for risk, especially for dairy farming, meaning less pursuit of market share or growing their rural 'books'. Farmers have also told us that there is less personal service, and that the quality of communication has deteriorated. Closure of bank branches (where rural services were often based), consolidation of services into regional or even national offices, high staff turnover, and Covid work arrangements meaning less travel to farms, have all been remarked upon.

4.12 On the matter of bank branch closures, Federated Farmers is aware of the regional banking hubs initiative (mentioned on page 74 of the preliminary issues paper). We are a member of a stakeholder panel for the initiative facilitated by the New Zealand Bankers' Association. We support the hubs initiative, as a 'next best' solution, but the services provided in the hubs are relatively basic and they are not a substitute for rural banking services necessary for the more complex needs of farm businesses.

4.13 Regarding consumers' ability to search for and switch to alternative providers, it can be difficult for farmers to switch banks for the reasons mentioned in paragraphs 4.8 to 4.11 above. While high performing farm businesses remain attractive to rural lenders, we have been told by farmers that banks are often reluctant to take on new rural customers even if they have relatively low debt, are profitable, and have a clean history of repayments. There was even a case of a major rural lender telling *existing* customers in 2021 that it would no longer offer transaction accounts because they did not have loans with the bank[5]. This angered a number of farmers, many of whom had been longstanding customers, and caused them stress in finding alternative banking arrangements at short notice. There might be a case for a minimum notice period when banking services are being withdrawn to allow rural people to find alternative services given the difficulty in accessing bank branches in rural areas and the problems with rural connectivity. We encourage the Market Study to consider such a requirement.

4.14 Regarding impediments to innovation, Federated Farmers agrees that it is important to consider the degree of innovation that is occurring in the market and, where it is

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[4] Reserve Bank of New Zealand Bank Strength Financial Dashboard – Asset Quality, March 2023 quarter
[5] https://www.nzherald.co.nz/whanganui-chronicle/news/farmers-frustrated-at-rabobanks-decision-to-close-accounts/RBFPLBKZD5LHJFWUVCRBLFEYBE/

occurring, who benefits from it (i.e., banks and shareholders versus customers). This is very relevant in the rural setting where banks' reliance on digital platforms and communication can be problematic for customers without decent broadband internet and/or mobile phone coverage. Indeed, Federated Farmers' annual Rural Connectivity Survey (copy of 2022 Report attached) has shown that internet and mobile phone services have been worsening for many rural people.

4.15 We encourage the Market Study to consider the ability of rural people to fully participate in digital banking innovation and what can be done either to (a) improve their ability to fully participate or (b) retain non-digital options.

4.16 Regarding bank performance indicators, Federated Farmers agrees with the use of three key measures of performance (net interest margin, return on equity, and return on assets). We also agree that the two datasets used in the preliminary issues paper (Reserve Bank of New Zealand's Financial Strength Dashboard and the World Bank's Global Financial Development Database) are robust.

4.17 According to the data, the largest four (Australian-owned) banks have the strongest performance, especially for return on equity, and that their returns over time have been less volatile than for the other smaller banks. We believe the reasons need to be assessed in this Market Study.

4.18 It is also evident from the international comparisons that the New Zealand banking sector's profitability is considerably stronger than overseas – including Australia. We believe the reasons need to be assessed in this Market Study.

4.19 Federated Farmers notes that the Financial Strength Dashboard's data appears to be presented at a bank's macro level. A question is whether it includes returns from non-banking financial services such as KiwiSaver, wealth management, insurance, foreign exchange, etc. If they are included, these should be stripped out.

4.20 As well as assessing banks' profitability for banking versus non-banking financial services, we also believe that in any further analysis of banking profitability it would be necessary to go deeper and measure and assess performance by asset category (i.e., housing loans, consumer loans, business loans, agricultural loans, and other loans).

4.21 It has long been a perception of many farmers that margins from agricultural loans are used to subsidise banks' chasing of market share in housing loans and/or contributing in an outsized manner to their large overall profits. If there is any truth to this, then it would be relevant to any consideration of the competitiveness of personal banking services.

4.22 We encourage the Market Study to look into the sectoral profitability of housing, consumer, business, agriculture, and other bank business.

ENDS