FIRST Union submission

To the

Commerce Commission

Regarding the

Preliminary Issues paper
Market study into personal banking services

Introduction

We wish to thank the Commission for the opportunity to submit on this topic.

FIRST Union[1] represents more than 3000 workers in the banking and finance industries, most of whom are frontline staff. Moreover, our 31,000 members across the New Zealand economy are all bank users whose weekly or fortnightly is deposited into their bank accounts, from which they pay their mortgages, rent, utilities and most of their other costs.

Bank profitability and competition

FIRST Union has long raised issues around the degree of profitability of New Zealand banks, and competition in the sector. Excessive bank profitability imposes immense costs on our communities, entrenching and exacerbating inequality while damaging national productivity. In the decade to 2022 alone, the big four offshore-owned banks have earned almost $47 billion in net profit after tax, distributed more than $36 billion in dividends to their shareholders (a distribution rate of 77 percent). Those distributions surged in 2018 and 2019, when the big four distributed more than $14 billion to their shareholders, despite earning only $10 billion in net profit after tax in those years.

In March 2023 at the time that the inquiry was announced, FIRST Union released preliminary analysis of the World Bank data on the average return on equity of banking services in a range of standard comparator countries. Our main finding was that New Zealand banks had the second highest return on equity of any of our standard comparator countries, bested only by Canada. Regardless of the findings of the inquiry, we argued that the Government should impose an immediate five percent levy on the profits of any bank earning more than half a billion in annual profits to fund the establishment and operation of a Ministry of Green Works.[2]

We are pleased to see that more detalied analysis has now been produced by both the Reserve Bank of New Zealand and the Commerce Commission. As well as reviewing NZ banks' net interest margins and return on equity, the Reserve Bank of New Zealand sought to try and explain NZ banks high profitability, noting that "volatility of earnings, a standard measure of risk, has been relatively low in New Zealand compared to other countries in recent recades. This suggests that risk does not fully explain the relatively higher returns of New Zealand banks... The difference in risk-adjusted profitability may reflect a lack of competition."[3]

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[1] FIRST Union was formed in 2011 from the merger of the National Distribution Union and Finsec, the finance sector union.

[2] FIRST Union "Banking Union Calls For Levy On Bank Profits" (21 March 2023). https://www.scoop.co.nz/stories/PO2303/S00157/banking-union-calls-for-levy-on-bank-profits.htm. For further information on the proposed Ministry of Green Works, *See* Max Harris and Jacqueline Paul "A Ministry of Green Works for Aotearoa New Zealand: An ambitious approach to housing, infrastructure and climate change" (28 October 2021) *FIRST Union*. https://apo.org.au/node/315499.

[3] "Trends in bank profitability" in "Financial Stability Report" (May 2023) *Reserve Bank of New Zealand,* pp22 – 25. https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/publications/financial-stability-reports/2023/may-2023/fsr-may-23.pdf

Responses to questions in the preliminary issues paper

Below are responses to some of the questions outlined in Attachment B. We have not answered all questions, but we have kept the numbering consistent with that document.

1.1 Bank workers – particularly the customer-facing workforce – have an important role to play in the sector and have received no discussion whatsoever. While their level of recompense doesn't impact measures like return on equity or the net interest margin, it does impact operational expenses and thereby reduce measures like net profit and net profit after tax.

Pressure on bank workers to sell financial products and meet sales targets – previously discussed in the FMA's Culture and Conduct review – is another component of bank profitability that flows from the competition deficit in the sector. Banks ceremoniously dropped sales targets in 2018, only to see them return in various forms and under other names. While the CoFI Act puts some controls around how consumers are treated, the Act has only just been implemented and the Big Four are already in enviable market positions that deter incumbents.

1.2 The best measures for this purpose is the HHI (Herfindahl-Hirschman Index) and the Concentration Ratio. These account for the fact that while there are 27 registered banks in New Zealand, the Big Four control roughly 85 – 90 percent of the market, depending on the measure used.

2 The description is generally accurate, however there is an historical lacuna in the development of pre-1984 banking regulation. Historically workers and their unions have played an active constructive role in the sector. Unions again have the capacity to represent individuals both as consumers of banking services and as employees of banks themselves.

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5 The observations outlined in Attachment C by and large reflect our own considerations. One area that seems relevant for consideration is whether comparator states have sought to address their relatively high net interest margins or returns on equity through the tax system. In this regard Canada is worth considering, because it is the only country with a higher ROE than NZ over the period 2010 – 2021, but then used a kind of windfall profit tax (the Canada Recovery Dividend) to redistribute the costs of excessive profitability back into the general taxation.

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8 We think a broader approach that includes business banking would be more beneficial. This is because of the relatively high number of small and medium enterprises in Aotearoa New Zealand, particularly in the agriculture and residential construction industries (which have accounted for a significant proportion of cost pressure during the cost of living crisis). SMEs in this industries often rely heavily on revolving credit, and therefore end up passing on additionaly costs from a non-competitive banking industry to consumers.

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20-24 Banking service providers are often historical (family) decisions, and limited competition within the market means there is limited impetus to change providers, or to seek different providers for different kinds of services (i.e. savings account, mortgages, Kiwisaver providers, and even insurance products). It is important to note that this has historically been a function of how the sales targets systems work, wherein bank employees are encouraged to upsell additional products to consumers to ensure they can generate maximum profitability per consumer.

Lack of portability measures means that most customers have a limited understanding of how to change banks. Banks do little to promote or advertise these services.

For a number of years our union has worked with a number of credit unions to inform heavily-indebted members about their options to shift their financial affairs into less punitive accounts or relationships, however many are concerned about moving to smaller institutions.

25-30 Limited competition in the sector has discouraged market participants from innovation and promoted the streamlining of bank income into dividends. As mentioned earlier in this submission, the Big Four banks have distributed 77 percent of profits (net profit after tax) as dividends to shareholders over the last decade, more than $36 billion off almost $47 billion in net profit after tax. These would likely have been even higher had NZ banks' dividend distributions not been speed-limited by the Reserve Bank in the wake of the pandemic. This is particularly severe at ANZ, who distributed $16.1 billion off $17.5 billion (a 92 percent distribution rate), and Westpac, who distributed $8.5 billion off $8.8 billion (a 97 percent distribution rate). In reality, this leave next to nothing for investment into innovation of banking services.

The ownership model of these banks is crucial to this discussion. While the Big Four – ANZ, ASB, BNZ and Westpac – have often been referred to as Australian-owned banks. The reality is that those banks are now owned by a mix of offshore entities, including asset management funds like Blackrock, Vanguard and State Street, pension funds like Norges, and other institutional investors. These funds have standard earnings expectations that ratchet up over time, and the desirability of bank shares are determined by these distributions. Ownership therefore represents a structural barrier to innovation.