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Cross- Submission on Market Study into Personal Banking Services

Dear Sir/Madam

I appreciate your invitation to make a cross-submission on responses to the "Preliminary Issues Paper".

Rate of Return and Cost of Capital

The Commission has received reports from Incenta Economic Consulting and Nera seeking to justify the reported rates of return on equity (ROE) of the commercial banks.

I submit that the Commission is prevented from agreeing with these perspectives and must maintain the same standard for its conclusions as it applies in calculating allowable WACC that it imposes on regulated industries in New Zealand (See Commerce Commission, Guidelines for WACC determinations under the cost of capital input methodologies (17 January 2023); and Cost of capital determination for disclosure year 2024 for information disclosure regulation (1 August 2023)). In those August determinations, the maximum cost of equity applied was 8.28%, far below the 12.2% that Incenta calculates as being a "normal" return for commercial banks.

That I am comparing ROE of different industries is notable, but I am submitting that the ROE ought to be lower in commercial banks than those imposed on the regulated industries because the banks collectively control almost all the elements of their business and financial risk in a way that is simply not available to those other (regulated) industries. Such controls are:

- Decreasing the LVR limit they require of borrowers which provide banks a larger equity buffer from the fluctuations of price of the underlying assets.
- Decreasing the DTI limit they require of borrowers which will allow banks to increase the scheduled rate of amortisation of the loan so further increasing the equity buffer.

Banks are risky only because of the choices they collectively make, and because they are incentivised[1] to compete for growth on the acceptance of risk by their own choice of lax loan-underwriting standards.

However, I am not advocating for the imposition of WACC limits by regulation on commercial banks. As outlined in my submission, economic efficiency will be improved and bank competition in the markets for loans and deposit-money will be greater if the demand-supply dynamics of their markets are normalised such that growth is from productive improvement in the economy and not from the illusory growth

[1] The underlying incentives for banks and their managers are described in their most extreme by William Black in his book "The Best Way to Rob a Bank is to Own One".

derived from the financialisation of assets. I have advocated in my first submission that this normalisation and associated efficiencies can be achieved by LVR and DTI limits on lending being permanently imposed on commercial banks and set at meaningful levels[2]. With normalisation of the structure of these markets by the elimination of excess money creation, competition on price and service between banks will cause the current excess ROE to be self correcting.

Thank you for the opportunity to make a cross-submission. I consider improving minimum standards for lending by commercial banks has the best potential for the greatest long-term gains for ordinary New Zealanders.

Yours faithfully,

M E Jackson

[2] DTI limit at 4.5 (years), and LVR limit of 62%, with exceptions for new building and first-home buyers.