Market study into personal banking services

This submission responds to the Commission's issues-paper dated 10 august 2023.

In general the Commission has presented a paper that is well grounded.

Various studies and inquiries along similar lines across the ditch are likely to be relevant, especially given the prominent role Australian banks play in the NZ financial system. More generally these issues are recurrent themes in reports from other countries in the usual reference group.

There is one feature of these retail banking systems, globally, that seems to demand particular attention in the context of the competitiveness, efficiency and fairness of retail banking operations.

That feature is the non payment of interest on most deposits in transaction accounts.

Going back to the 1930s, at least, it has been common for retail banking industries to either require, or, as now, permit banks to not pay interest of any material consequence on 'at call' deposits in transaction accounts – cheque accounts originally but now embracing 'digital deposits' generally.

The point raised is sharpened by the observation that it is the major banks, holding most of the deposits in transaction accounts, that routinely do not pay interest on these deposits.

One counterpoint is that these major banks are routinely inclined to provide account keeping and transaction services either free-of-charge or under-priced – taken together with credit-card schemes it is usually substantially the case that the customers see the retail payments transactions provided 'free of charge'.

The combination of 'not paying interest' with 'free services' raises the issue of a major industry being permitted to engage in a barter scheme that avoids the payment of tax on the income paid to depositors in-kind rather than as interest explicitly.

One corollary of this is a major national industry operating without the discipline of a pricing system guiding the provision and use of services with very different costs. Historically this practice has played into the hands of major banks providing 'free' services in ways that underwrite their market power (e.g. cheque writing facilities that would have been withdrawn if customers paid anything like a cost-related price – and the same goes for credit-card and BNPL schemes recovering their inflated costs in higher retail prices charged by retailers).

The policy puzzle, of course, is the global ubiquity of these practices – why do national banking and competition regulators let these arrangements run on unchecked.

One might say that this puzzle presents New Zealand with a unique opportunity to assess the failure of public policy, globally, to deal with the inherent flaw and more generally challenge the global complacency.

A case for fundamental reform is set out in a few bullet points:

- Most, including commercial bankers and central bankers, understand that the anonymity of banknotes (essentially deposits with the central bank) precludes the payment of interest to the holders of banknote-deposits. The central bank holds interest-earning assets, government bonds, funded by the banknote deposits.

- Taken together, the central bank makes a profit from investing the interest-free deposits. – the profit is duly passed over to Treasury as funds available to pay for government outlays.

- Extending the story to the banking arena reveals a prevailing reality that is remarkable and, in my view, untenable.

- These days, by value, most payments are made by electronic transfers of money held as digital-deposits in accounts with banks. The remarkable reality is that no interest of material consequence is paid on most digital-deposits held in transaction accounts with banks.

- What is considered untenable, is banks' being entitled to the profit on their investment of the free-deposit funds. This profit does not fairly belong in banks hands. Rather, banks could and should pay interest at a market rate to their depositors on all deposits – not least the deposits in transaction accounts.

End piece

On the face of it the proposal for banks to pay a market rate of interest, at least the cash-rate, on all deposits has merit.

The Commerce Commission is asked to address this issue in its findings.

The proposed policy reform would be contentious. Adopting it would best be deftly managed so all will be able to properly anticipate and plan for its implementation.

Peter Mair

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[PS: The Commerce Commission may also like to reflect on the question of why per-capita holdings of banknotes in New Zealand are only some one-third of per-capita note holdings in Australia.]

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