Kiwibank's response to the Commerce Commission's Preliminary Issues Paper – 7 September 2023

Executive Summary

Kiwibank welcomes the opportunity to submit on the Commerce Commission's Preliminary Issues Paper into Retail Banking in New Zealand (**Paper**).

Overall, Kiwibank agrees with the issues contained in the Paper and considers the Commission is focusing on the correct personal banking services and issues impacting the competitive nature of the market. Kiwibank is supportive of the Commission's work on this study as it is aligned to Kiwibank's own purpose of Kiwi Making Kiwi Better Off. A key aspect of this purpose is ensuring that all Kiwi in Aotearoa have simple and easy access to the right personal banking services for them. A truly competitive market will work to ensure that outcome for all New Zealanders.

Kiwibank supports the Commission's narrowing of the study's scope to focus on home loans and deposits. Certain issues raised in the Paper, such as the Commission's focus on profitability, cannot be considered solely by refence to profits from personal banking services - they need to be considered from a whole of bank perspective. Kiwibank also appreciates that the market study is a significant piece of work for the Commission. Consequently, Kiwibank is keen to better understand how other issues, such as Māori access to capital and access to banking for particular groups (such as Māori, Pasifika, rural and elderly New Zealanders), can be solved for in the market study context when they are also being considered in other regulatory contexts.

Kiwibank considers question 16 of the Paper to be the most important question for the Commission to address:

> *"Which conditions of entry or expansion in the personal banking sector most significantly affect competition?"*

We have provided our responses to each of the Commission's questions below and have also participated in a joint submission with The Co-operative Bank Limited, SBS Bank and TSB Bank Limited on this question. There is commonality in the issues we face as we try to expand and compete in a market where the Commission has rightly noted the four Australian-owned banks (classified by the RBNZ as Domestic Systemically Important Banks (**D-SIBs**)) hold a combined 88% of the assets of all registered banks in New Zealand (paragraph 84 of the Paper).

Kiwibank would be happy to meet with the Commission to discuss any aspect of our submission in more detail.

Questions on the overview of personal banking services in New Zealand

The following questions relate to paragraphs 32-133 of the Paper.

Q1 Do you agree with our description of the structure of the personal banking sector? If not, please explain.

Kiwibank agrees with the Commission's description of the structure of the personal banking sector. Kiwibank notes that, while the graphs in figures 5 to 7 are helpful in indicating that the supply of key personal banking services is concentrated with the D-SIBs, that data does not show the full extent of the scale of the D-SIBs. This is because other services, including business and institutional banking services, contribute to that scale.

Q1.1 Are there any other key participants or stakeholders that play a major role in the sector that we have not mentioned in this paper? If so, please identify them and explain their role.

As set out in the Paper, the Commission intends to refine the scope of the study to home loans and deposits. Kiwibank supports the narrowing of the Commission's focus and further supports the Commission thinking about deposits in the way described in Figure 12 of the Paper. Transactional accounts, savings accounts and term deposits each play a slightly different role in a bank's funding and have differing levels of innovation attached to them. Kiwibank does not consider there are any key participants or stakeholders in these areas that have not been identified.

Q1.2 What are useful measures of concentration/market share within the personal banking sector? Please describe the measures and explain your reasoning.

Three key sources of information about market share are the RBNZ Bank Financial Strength Dashboard, the LINZ database and market analysis conducted by third party providers.

<u>RBNZ Bank Financial Strength Dashboard</u>

Registered banks are required to report detailed financial data, including the value of their home loans and deposits, to RBNZ on a monthly basis. RBNZ publishes industry level statistics monthly and provides a breakdown for all registered banks quarterly.

The RBNZ reports can be used to measure market share of deposits and home loans by value. They are a comprehensive source of information and utilise consistent data sets collected from all registered banks.

<u>LINZ database</u>

Home loans are invariably secured through a mortgage over a property. Details of mortgages, including the name of the mortgagee, are recorded in the LINZ database. The LINZ database can be used to determine how many mortgage registrations note a particular lender as mortgagee.

This provides a useful measure of market share of home loans based on share of mortgage registrations. It is also helpful for understanding refinancing movements and changes in market share.

Market analysis by third-party providers

From time to time, third party providers conduct market analysis that market peer groups can participate in. Participants typically receive anonymised market comparisons.

These market reviews are useful for obtaining information on specific focus areas or for using different data sets to those available through RBNZ and LINZ.

Q2 Do you agree with our description of the regulatory environment for the personal banking sector? If not, please explain.

Kiwibank generally agrees with the Commission's description of the regulatory environment for the personal banking sector – the regulation and legislation in Table 1 accurately summarises the regulation of personal banking services. However, one area that the Commission has not listed is the different licensing regimes that banks need to comply with and the ongoing reporting obligations connected to those licenses, which create a significant compliance burden for banks, particularly smaller domestic banks. The regulatory landscape within which banks operate is complex. We also note that banks are subject to other legislation and regulation which is not directly related to personal banking services, but which nevertheless impose obligations on banks (for example, AML legislation). We are happy to provide additional examples to the Commission if that would be helpful.

Q3 Please describe any other legislation, regulations, or other regulatory instruments that may be relevant to understanding competition in the personal banking sector.

Kiwibank agrees that there are significant upcoming and proposed changes to the regulatory framework relevant to personal banking services that the Commission outlined in Table 2 on pages 27- 29 of the Paper. Because of timing, Table 2 does not include the recent further review of the Credit Contracts and Consumer Finance Act 2003 (**CCCFA**) that was announced by Minister Webb in early August 2023 or the Commission's consultation on designating Payments NZ under the Retail Payment System Act 2022 released on 31 July 2023. Both are significant pieces of work for the banks in addition to the current regulatory load. And, as noted above, there are other changes to the regulatory environment (for example, changes to the AML regime that impact Kiwibank). This is in addition to the last decade of banks being subject to much "once in a generation" change that has been implemented at speed and that has significantly increased the complexity of the regulatory system.

Kiwibank submits that the Commission should consider if the consultations that are in train at present enhance or diminish competition between the banks. For example, both the Deposit Takers Act 2023 and the Consumer Data Right (**CDR**), if it is ultimately introduced, could lessen competition due to the outsized impact they will have on the smaller banks compared to the larger banks. Kiwibank advocates for a proportional approach to the way in which they are introduced to the market. For example, where changes required for compliance require a high level of investment in interpretation and design, a staggered approach that enables the smaller banks to have greater clarity on more detailed requirements identified by learning from larger bank implementations would reduce the cost of change for smaller banks. In addition, where changes are required to support industry innovation and change but carry uncertainty regarding customer and market impacts (e.g. the CDR), the obligations should apply first to the large banks and either be voluntary for smaller banks or have a delayed implementation for smaller banks. Where changes such as the CDR are being implemented by banks, which enable other third parties to enter the market, consideration should be given to the funding model, including costs being shared in a proportionate way based on size. That would enable smaller banks to avoid trade-offs with other investments and innovation until the customer outcomes are defined and it would reduce the cost of change.

Q4 What aspects of competition in the personal banking sector have a particular impact on Māori?

It is well documented that Māori have a unique approach to finance and ownership. Within whānau there are micro economies with income, expenses and assets shared through a kaitiaki approach. It is also well known that Māori move and operate in groups. This has provided a challenge for the banks when using a traditional banking approach to provide access to personal banking services for Māori. However, as many of these issues are already being considered in other regulatory contexts by the banks and other fora, Kiwibank is keen to better understand how this issue, and access to banking for other particular groups (such as Māori, Pasifika, rural and elderly New Zealanders), can be solved in the market study context.

More generally, in relation to personal banking services, Kiwibank has been working to recognise the strength of the collective and has been working to support Māori access to personal banking services through the following initiatives:

- The home loan proposition Co-Own (which allows whānau and friends to borrow a home loan together) to reduce barriers to home ownership (not just for Māori but for everyone).
- The Kāinga Whenua scheme, which is a partnership between Kiwibank and Kāinga Ora with support from Te Puni Kōkiri to enable home ownership on multiple-owned Māori land. The Ministry of Housing and Urban Development finished a review of the scheme in October 2022 and Kāinga Ora is deciding what recommendations it will implement from the review. To improve customer experience, Kiwibank has established a group of specialist lenders to deliver the scheme. Kiwibank would welcome one of the other banks joining the Kāinga Whenua scheme to create more competition in this space.
- **Through our rautaki Māori - Hoake Ki Uta, Kiwibank is taking an inside out approach** to building a relationship with Māori in a way that informs our policies and processes to remove the barriers to access for Māori at an enterprise level.

Kiwibank would like the RBNZ to provide a Risk Weighted Asset (**RWA**) and LVR specifically for Māori land to help remove the barrier to access and make this lending more attractive to the banks. AML for Māori trusts has also been a challenge for a long time given legislation does not differentiate between a Māori trust established through the Māori land court and a standard family trust or asset owning trust. Kiwibank would like to see a more defined AML requirement for Māori trusts established through the Māori land court.

Q5 Do you agree with our preliminary observations of publicly available bank financial performance data (including those set out in Attachment C)? If not, please explain.

As previously noted, the Commission needs to take care in extrapolating themes from bank profitability data that is drawn from each bank's entire business. Kiwibank would like to highlight that the ROE, ROA and NIM measures apply at a whole-of-entity level. These measures do not account for differences between banks, such as the size of their nonpersonal banking activity, their customer bases or their lending risk profiles. If these measures are used to draw general conclusions, the limitations of those conclusions should be recognised.

For example, paragraphs C63 and C64 of Attachment C to the Paper state:

> *Domestically, the major banks have outperformed the smaller banks with respect to ROE. In relation to ROA, Heartland Bank Limited (Heartland) derived the highest returns over the period, while ASB, ANZ, BNZ also performed strongly relative to the smaller banks included in our sample.*
>
> *However, the largest four banks did not outperform relative to our sample of NZ banks in relation to NIM.*

This does not adequately consider the following factors:

(a) **Risk**: The lending risk profile of each bank impacts on returns. For example, Heartland and SBS have a higher lending risk profile than the D-SIBs, which have more diversified lending portfolios. In a competitive market, the returns on higher risk lending portfolios should be higher than the returns on more diversified lending portfolios. Accordingly, it is not meaningful that the D-SIBs did not 'outperform' on a NIM comparison of NZ banks.

(b) **Size**: Smaller banks are not large enough to move the market. Additionally, smaller banks need to generate profits to enable further growth, so that they can maintain and grow market share. In this context, smaller banks typically follow the pricing set by the D-SIBs so that they can maximise growth while remaining competitive. Even where smaller banks earn a comparable NIM, their profit margins will be lower than the D-SIBs due to higher fixed operational costs.

(c) **Capital Requirements**: As noted previously, the RBNZ's capital requirements for home lending impact smaller banks differently. This has provided a distinct advantage to the D-SIBs for many years that has led to them growing in size and scale (we discuss this further in our joint submission).

(d) **Customer Base**: The D-SIBs have institutional customers, which may suppress their NIM at a whole-of-entity level. This is because institutional customers have greater ability to negotiate pricing, meaning banks may generate a lower NIM from institutional lending. In addition, they may earn revenue from institutional lending in fees which are not captured by their NIM.

Q6 Please describe the factors that have the most influence on the financial performance of New Zealand personal banking service providers.

The most significant drivers of a bank's financial performance across personal banking are balance sheet scale in home lending, margin, and costs relative to their balance sheet scale.

The key drivers for growing balance sheet scale in home lending are:

- Supply and demand across the housing market which drives the level of system growth in home loans.
- Share of home buyers that a bank has an existing main bank relationship with. Most Kiwi that buy a new house have a significantly higher propensity to choose their existing bank as their home loan provider. This has been further reinforced by the affordability changes to the CCCFA that require customers to provide large amounts of information to any new lender to meet the suitability and affordability tests.

- Reach and relevance with both existing and potential new customers that are seeking a home loan. Beyond small differences between home loan products and credit policies, a bank's reach with prospective customers is increasingly about the number of brokers it partners with as more Kiwi choose their home loans with independent advisers. We estimate that over half of new mortgages in New Zealand are now applied for via mortgage brokers.
- Ability to retain existing borrowers through the on-going quality of their offer and customer experience through the lifetime of their customer relationship.

The key drivers of margin for a bank are:

- Risk appetite – where banks can earn a higher margin for accepting more risk from borrowers.
- The competitive environment – where the large banks set market pricing for lending and smaller banks are typically price takers.
- The cost and mix of funds on a bank's balance sheet, which is determined by its access to different sources of funding. Key sources of funding include:
    - Customer deposits. Banks with larger main bank customer bases have access to more low or non-interest-bearing deposits, resulting in a lower cost of funds. Banks with smaller main bank customer bases must compete more actively on price to win a greater share of deposits from second bank customer relationships.
    - Wholesale funding. Banks with high credit ratings have access to a deeper pool of lower cost wholesale funding. We note that the New Zealand subsidiaries of offshore banks benefit from rating agencies' perception of foreign government support, which provides an uplift to their credit ratings. Smaller banks have either less or no access to wholesale funding. The funding they source from wholesale markets is more expensive than for larger and higher rated banks. This is discussed more in our joint submission with the other domestic banks.
- The volatility of central bank interest rates. Margins will tend to be higher in more volatile conditions as there are asymmetric time lags between changes in wholesale funding costs, consumer savings behaviours, and borrowers' behaviours. There are also differences in the speed of reactions and types of behaviours we see between main bank customers and second bank savers which impact banks differently depending on whether they have a large or small main bank customer base. For example, when interest rates hit record lows, many consumers saw little incentive to hold deposits at multiple banks which disproportionately impacted smaller banks.

Banks' costs are largely within their own control, noting the following distinctions:

- Where there are requirements for regulatory or externally driven change, these changes typically represent a larger share of the available investment cost for smaller banks; and
- D-SIBs tend to have simpler and more automated operational cost bases that are more fixed relative to smaller banks' cost bases (i.e. D-SIBs' marginal cost to grow is much lower). They have been able make significant investments over a longer period in a way that smaller banks have not for the following reasons. Their economies of scale have enabled investment business cases for investment to deliver higher ROI than for smaller banks, some of those investments are not

economically feasible until smaller banks achieve more scale. Much of the investment the D-SIBs made occurred at a time when they were able to make greater profits from physical branch cost reductions and through their capital advantage, enabling greater reinvestments into these activities. As a result, smaller banks today face higher marginal costs for growth today. Equally, as smaller banks make investments to automate and 'catch up' to this operating advantage as they achieve more scale, they are not able to do this in the same advantageous market context as the larger banks operated in through the 2000s and 2010s. Instead, they face tougher trade-offs with mandatory investments in a heightened regulatory change environment and where adoption of new digital technologies is happening at a faster rate.

Q7 Do you agree with our description of the digital innovation and digital disruption trends in New Zealand and overseas? If not, please explain.

Kiwibank welcomes innovation and seeks to partner with digital innovators.

Kiwibank agrees that there has been greater digital innovation in overseas markets such as the United Kingdom. However, digital innovation is not always disruptive with larger players quick to adapt to new trends. Additionally, well publicised examples of digital innovation do not always deliver the best value for customers. For example, a recent Statutory Review of the Australian CDR by the Australian Government noted stakeholder feedback of very little awareness of CDR and consequent low uptake. Additionally, the review found that the size, complexity, and prescriptiveness of the regime prevented participants from focussing on developing new products and services, and created a barrier to participation in the regime by smaller business.

On the other hand, some smaller or less publicised examples of digital innovation, such as mobile banking features, have been highly valuable to customers. This is evidenced by high uptake by customers. For example, Kiwibank introduced the ability to set PIN numbers digitally in March 2022, and now 61% of PIN numbers are set digitally.

Kiwibank considers there are two barriers to digital innovation and disruption that are specific to New Zealand. The first is that New Zealand is a small market, meaning it is less appealing to digital innovators than larger overseas markets. In particular, scale is needed for products that earn lower income, such as transactional accounts, to be profitable. The second barrier is that in New Zealand financial services are highly regulated. There is no provision for regulatory sandboxes and almost all elements of the regulatory framework apply regardless of whether the participant is considered systemically important or not. In this context, it may be costly for innovators to establish themselves in New Zealand, and difficult for them to operate within a strict regulatory framework.

Kiwibank has supported wider innovation in the industry via the Fin Tech Accelerator programme (leading to the creation of platforms like Sharesies and Hnry). We also note our innovative partnerships with Banqer (financial education in schools) and Ngā Tāngata Microfinance (funding the lending by a charity to customers experiencing vulnerability) that further our purpose of Kiwi Making Kiwi Better Off.

Question on the services that we will focus on in the study

The following question relates to paragraphs 134-162 of the Paper.

Q8 Do you agree with our initial choice of personal banking services to focus on? If so, why? If not, which services should we focus on, and why?

Kiwibank agrees with the Commission's focus on deposits and home lending. At paragraph 156 of the Paper, the Commission cites the UK CMA finding that customers' ability to access information and identify the best-value account for their needs is likely to be impaired by the complexity involved in comparing different personal current account pricing structures. Kiwibank does not consider the pricing structures of the different types of deposit accounts to be complex but acknowledges that banks will have a range of features associated with these accounts.

Questions on the nature of competition

The following questions relate to paragraphs 167-177 of the Paper.

Q9 Is competition more or less intense between or within any particular group of providers? Please explain your reasoning. For example, is competition most intense between bigger banks and smaller banks? Or most intense within fintech?

For the purposes of this question, Kiwibank has commented on how competitors respond to changes made by others to customer offerings.

D-SIBs respond quickly to changes by each other. Most recently this has been illustrated in three of the largest banks lifting mortgage and deposit rates within days of each other in August 2023. In contrast, the D-SIBs typically do not respond quickly (if at all) to improvements made by smaller banks. Examples of this include:

(a) When smaller banks make significant pricing moves, the D-SIBs typically do not follow. For example, in June 2020 Kiwibank reduced its variable rate for home loans to 3.40% and its revolving rate for home loans to 3.45%, which was more than 1% below the next best rate offered by a bank. The D-SIBs did not respond with lower carded rates.

(b) When smaller banks begin offering more attractive product propositions or switching processes, the D-SIBs may not follow, or may be slow to follow. For example, Kiwibank has partnered with a law firm to offer a refinancing package. Under the refinancing package, Kiwibank covers the costs of legal services for customers with simple arrangements. Kiwibank understands that only more recently has one of the large banks started to consider an equivalent offer.

Q10 Please describe how personal banking service providers compete to gain and retain customers. Please explain your answers and provide examples.

Banks compete to be the <u>active</u> provider of products and services that meet customers' financial needs. As such, the way banks compete is not just about how they initially identify and meet a customer need, they also need to compete to remain relevant and retain customers.

Banks compete in several ways to achieve this:

- Banks will build relevance with their customers through their brands by maintaining access to a full set of basic banking products and services, by launching new products and features, and through the quality of the experiences they deliver via their interactions with customers. Examples of this include advertising, sponsorships, marketing communications, the launch of more banking app functions, improving banking app usability, simplifying processes, improving ways to access customer support and growing the skills and capabilities of their bankers to deal with a wider range of customer needs.

- Banks will grow reach with customers through partnerships, making it easier for customers to choose their products and services when it is relevant. Examples of this include partnerships with mortgage advisers, insurance or wealth providers, and technology companies such as Apple or Google for payments.
- Banks will compete through their pricing and incentives. Examples of this include headline pricing for interest rates, price matching, cashbacks, Airpoints and other incentives/rewards for credit cards and fees.

We note that the mix and impact of the factors described will vary as drivers of choice for different customer segments. For example, non-customers that are choosing a bank will not directly experience the range of a bank's service experiences in the same way as existing customers. Customers that have large deposit balances or home loan needs will tend to be more price sensitive when making their choices. Equally, some customers have a preference to manage all of their banking with one provider and will be less price sensitive.

For example:

Q10.1 Do providers put the same amount of effort into gaining and retaining customers?

Banks focus on net customer growth. Success requires both new customer acquisition and the retention of existing customers. Banks need to maintain a balance of effort between new customer growth and serving existing customers well to retain and grow these relationships.

Banks are constantly working to improve and simplify the products, services, and experiences delivered to existing customers. It is important for banks to focus on delivering improvements for existing customers and ensuring that they can access their products when and where they need them. If an existing customer has a positive experience, they are more likely to stay with and fulfil further financial needs with their main bank. They are also more likely to encourage others to join that bank. For example, an improved mobile app experience or a delivery of simpler banking processes and customer experiences would benefit both existing customers and provide features that can be promoted to attract new customers.

Q10.2 Which services are subject to greater competition and which services are subject to less competition?

The greatest competition within personal banking services is for home lending, deposits and credit cards. These products are the most price sensitive and customers are more open to switching or starting a relationship with a second bank to take advantage of better offers or rewards and bonus offers in the case of credit cards.

Q10.3 Please describe how important national branding is to competing for personal banking services.

Kiwibank has found that national branding (i.e. having a nationwide presence expressed through a bank's brand and reinforced through a physical presence) is important to a wide range of Kiwi consumer audiences. Customer research shows that it drives higher brand consideration and relevance for a larger audience than brands with a more regional brand or a limited physical presence are able to achieve.

Q10.4 Please describe how important having a physical presence is (eg, branch network) to competing for personal banking services.

Kiwibank's view is that having a physical presence (e.g. branch network) is important to competing for personal banking services. A nationwide presence provides broader reach and relevance for customers and provides brand presence. The importance of this is mixed for different segments and declining as more customers choose to bank via remote channels. However, regardless of whether people use a branch or not, the physical presence still engenders high trust. Customers have a place to go and an accountable person to talk to in person if something does not work or if they have complex banking needs. Branches also provide general guidance and advice, work directly with customers who may be experiencing vulnerability, and can assist with digital education to help customers become more comfortable with online banking. This needs to be balanced with fewer people choosing to use the branch at all every year, with more people calling or using online methods when they need support and cannot self-serve.

The branch network therefore plays a role in competition in the market as it can act as a barrier to entry for new participants in New Zealand who may consider it necessary to have a physical presence to reach customers. It can also impact on profitability for smaller banks wanting to maintain the same reach and presence as the larger banks. Branches have been traversed extensively by the Government and its work with the New Zealand Banking Association in this area, including the setup of the regional hubs.

Q10.5 Please describe how competition for personal banking services varies between regions.

Where a region has a local bank brand, it will present stronger competition to the other banks in that location. Generally, all banks will view Auckland as being the main regional market in New Zealand due to it having the largest population, largest average loan sizes and the highest concentration of wealth and businesses.

Q11 How varied are home loans and deposit accounts between providers? What are the key features by which these services are differentiated?

Banking products are commoditised and home loan and deposit offerings are fairly standardised across the banks. In the past few years, banks have tended to simplify their product sets off the back of the findings of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry in Australia. As a result, there are some product rule differences between the bank offerings but all tend to achieve the same overall outcome. Term deposit and transactional accounts in particular are standardised, with banks tending to have a main savings offering that is differentiated from other banks via particular features.

With home loans there is some difference between the banks in the product offerings. For example, in additional to the standard home loan offering, Kiwibank also offers two home loan offerings that are unique to the market:

- Kāinga Whenua Loan Scheme – initiative between Kāinga Ora and Kiwibank to help Māori achieve home ownership on their multiple-owned land; and
- Co-Own – a home lending product that allows customers (whether they are friends or whānau) to team up and buy property together.

Q12 What interactions do banks and other providers of personal banking services have with each other?

Banks engage with each other in several industry related fora. Kiwibank engages in the following:

- New Zealand Banking Association, especially on regulatory submissions
- Risk Managers' Round Table
- Māori Bankers' Rōpū (Tāwhia)
- Payments NZ
- API Centre.

Kiwibank is also member of the New Zealand Financial Markets Association. This forum is focussed on wholesale financial markets and is not relevant to personal banking services.

Q13 What role do mortgage brokers or other intermediaries play in the market? What is their impact on competition?

Borrowers are increasingly choosing to arrange mortgages through mortgage brokers. Mortgage brokers can guide borrowers through the process of assessing and selecting home loan providers, applying for a home loan and negotiating rates and other terms. Mortgage brokers can also help borrowers with a range of needs beyond mortgage advice, including more general financial advice and budgeting. Significantly, mortgages brokers can help borrowers to assess whether they will meet affordability and suitability criteria and take steps to help them improve their position.

Mortgage brokers have positive impacts on competition in the following ways:

(a) **Informed decisions**: Mortgage brokers have significant knowledge about what different lenders can offer, including how product offerings, credit criteria, and service levels differ. Mortgage brokers can assist borrowers to make informed decisions about which lender's offer will best meet their needs and help them with the application form given the changes to the CCCFA referred to earlier that make it more complicated and require customers to provide extensive information to meet the affordability criteria. This creates an environment in which lenders must compete to differentiate themselves.

(b) **Feedback**: Mortgage brokers develop a broad understanding of what does and does not work for borrowers and can provide lenders with feedback to help them improve their offerings. This helps lenders to keep their offerings competitive.

(c) **Negotiation**: Mortgage brokers can help borrowers to negotiate home lending terms, including rates, where customers might not otherwise have the knowledge or the confidence to do so. This places pressure on lenders to offer competitive terms.

There may be a perception that mortgage brokers are inclined to encourage borrowers to select their existing transactional bank because a mortgage broker typically includes their existing bank. However, it makes sense for a borrower to consider their existing bank (usually alongside at least one other) because the CCCFA regulatory framework makes applying to another bank more challenging. For example, when making a home loan application, borrowers are required to submit information about their income and expenses so that banks can carry out suitability and affordability assessments. Recent changes to the CCCFA have required banks to collect more information and this has become an even more challenging process for borrowers. The process is typically easier if the borrower is applying to their existing transactional bank because that bank will already hold most of the information required.

Questions on how competition works for different population groups

The following questions relate to paragraphs 178-186 of the Paper.

Q14 How do banks and other service providers segment their customers? Why?

All banks will have different ways they segment their customers depending on the purpose for which they want to use the data. For example, understanding customer trends and behaviour, understanding product use and performance or understanding use of channels and digital services. Ways banks may choose to segment their customers include: retail vs business divisions, depth of banking relationship (e.g. main bank vs second bank), life stage (e.g. youth vs retiree), new joiners, a specific product category (e.g. home loan vs credit card) or for a particular marketing purpose.

Q15 How well is competition for personal banking services working for different population groups in New Zealand? Why/why not? For example, how well is competition working for rural, Pacific, older or Māori populations?

Access to banking for different population groups is an important issue for Kiwibank as it aligns to our purpose of Kiwi Making Kiwi Better Off. We have noted that these issues are being discussed in different fora as noted in our answer to Question 4. For example, in the vulnerable customer area, a Vulnerability Working Group of the New Zealand Banking Association has been set up specifically to focus on customers that might be experiencing vulnerability and the actions the industry can take to support these customers. Within that context, Kiwibank is keen to understand how this important issue can be furthered through the market study/competitive efficiency perspective.

At a system level, banks need to reflect the communities they work in. For example, Kiwibank recognises that to better represent the needs of Māori and Pasifika we need to increase representation across our organisation, including in leadership and decision-making roles. To ensure this happens, representation targets have been established to reach 15% Pasifika and 19% Māori representation across each business unit and tier of the bank by 2030.

Questions on conditions of entry and expansion

The following questions relate to paragraphs 187-196 of the Paper.

Q16 Which conditions of entry or expansion in the personal banking sector most significantly affect competition?

Kiwibank has identified the following areas of focus for considering competitive constraints which hinder smaller banks from growing market share in relation to personal banking services:

- The current RBNZ capital rules have historically and continue to favour the D-SIBs.

- More generally, banking regulation imposes disproportionate costs on non-D-SIB banks.
- Smaller banks are materially constrained in their ability to compete through investment and innovation because of those regulatory obligations and non-scalable operating costs.
- Low “main bank” switching rates and ineffective switching processes reinforce the market position of D-SIBs.
- Finally, the D-SIBs have more funding options and these generally lead to a lower cost of funding and entrench the ability of D-SIBs to compete in an enhanced manner relative to smaller banks.

The large market share held by the D-SIBs, the economies of scale this creates, and access to resources from their parents, provide them with distinct advantages over other New Zealand banks. Market dynamics cannot be understood without appropriate consideration of these endowments which result in additional advantages for D-SIBs, while consequently constraining smaller banks that try to compete with them.

Given the importance of this question and the similarities faced, Kiwibank has participated in the **attached** joint submission on this question with The Co-operative Bank Limited, Kiwibank Limited, SBS Bank, and TSB Bank Limited.

Q17 How does the regulatory environment impact on entry or expansion in the personal banking sector?

See the joint submission in answer to question 16 above.

Q18 How do you expect proposed open banking reforms to affect conditions of entry and expansion in the personal banking sector? Please explain your reasoning.

Kiwibank submits that a full cost benefit analysis of open banking/CDR needs to occur before the legislative framework is passed. This should consider both the recent reviews of comparable overseas regimes and the relatively small size of the New Zealand banking market. Open banking reforms are currently being put forward as having the potential to remove barriers to entry and expansion in the personal banking sector, as well as other benefits such as reducing fraud (as suggested recently by Parliament’s Finance and Expenditure Committee). However, Kiwibank submits that the size of those benefits must be measured against the cost of the changes and the potential detrimental effects on competition, as well as the capacity for open banking to increase the prevalence of fraud and other crimes.

The proposed open banking reforms aim to increase competition by enabling consumers to ask banks and other providers that hold their data (**Data Holders**) to share it with third parties (**Data Recipients**). This could provide an easy mechanism for customers who want to switch providers to transfer required data from their existing provider to their new provider (especially for compliance with AML and CCCFA obligations). This could in turn reduce barriers to entry and expansion in the personal banking sector.

However, there are good reasons to question whether the open banking reforms in the full form proposed are necessary to achieve these outcomes. The success of open banking reforms hinges on the system being secure and easy for consumers and Data Recipients to use. Banking data is extremely sensitive, and there are currently high levels of concern about data security in New Zealand due to numerous recent high-profile scams and data breaches. Additionally, a recent review of the Australian open banking regime contained findings about the complexity of the processes for consumers. This highlights the risk of low uptake of any open banking regime, which could mean it does not deliver value to consumers, or assist smaller participants to be more competitive. Kiwibank would be supportive of fully understanding the uptake of CDR in Australia against the cost base invested by the banks to understand the opportunity.

Additionally, an open banking regime could reduce competition in other areas. To carry out the costly and complex changes required to support open banking, banks (and particularly non-D-SIBs like Kiwibank) would need to make trade-offs with other investments and innovations. For example, the Australian open banking review identified participant concerns around complex and overly prescriptive rules and standards that have prevented focus on developing new products and services.

Finally, implementing the open banking regime would have a disproportionately negative impact on non-D-SIB banks, for marginal gain. Smaller banks have fewer resources to implement costly and complex changes and have to make more significant trade-off with other innovations, investments and growth than larger banks. Additionally, the participation of the D-SIBs would provide access to open banking for most banking customers in New Zealand, noting the Commission's own data that they hold 88% of the assets of all registered banks in New Zealand (paragraph 84 of the Paper). On the other hand, applying the requirements to smaller banks would only marginally expand access.

Q19 What are recent examples of actual or potential entry, expansion or exit in the sector that we should be aware of? Please provide as much detail as possible.

Recent examples include:

- HSBC announcing in June 2023 that it was exiting its retail banking offering in New Zealand to focus solely on commercial banking. Pepper Money announcing in September 2023 that it has entered into a binding arrangement with HSBC to acquire its residential mortgage portfolio.
- Revolut entering the market in the online personal banking services space with a digital offering in July 2023.
- Sharesies expanding into personal banking services with a digital no fees savings account offering in July 2023.
- Shinsei Bank buying the UDC car loan portfolio from ANZ in 2020.
- Industrial and Commercial Bank of China Limited registered as bank to provide banking services in New Zealand in May 2020.
- Simplicity entering the home lending market in October 2019 for customers meeting certain criteria.

Questions on consumer search and switch

The following questions relate to paragraphs 197-211 of the Paper.

Q20 How do personal banking consumers select their first bank or personal banking service provider?

Customers typically select their first bank or personal banking provider by considering brand, reputation, recommendations by family or friends and online tools. Interest rates may be a factor, depending on the customer and their needs. Many of the customers selecting a bank or personal banking provider for the first time will be youth or migrants. These customer groups may initially have more limited financial needs to satisfy with a New Zealand provider, meaning interest rates may be less relevant to their decision.

Q21 How often and why do personal banking consumers :

Q21.1 search for a new service provider?

Q21.2 switch to a new service provider?

Personal banking customers may search for and/or switch to a new service provider in the following circumstances:

- When they are searching for their first bank or personal banking provider. As noted above, many of the customers in this group are youth or migrants.
- At key life stages that give rise to different financial needs, such as starting university, going flatting, entering a first job, moving or returning from working overseas, getting married (or committing to living together long term) or buying a first home.
- When they want to seek out better rates or features.
- When they want to diversify where their savings are held.
- When they are seeking a better customer experience.

Where customers search for and select a new provider, they might switch, or they might start a second relationship with the new provider. Customers are more likely to switch when they have fewer financial needs (because this makes it easier to switch), when they decide to take out a home loan with a new provider and it is more convenient to have their banking in one place, or when they've encountered an issue with their current bank.

Q22 Please describe any factors that might prompt or hinder a consumer searching and/or switching to an alternative provider of personal banking services.

Some factors that might prompt or hinder a consumer searching or switching to an alternate provider of personal banking services are:

(a) **Degree of difficulty**: The actual or perceived difficulty of switching providers can prompt or hinder customers from searching for a new provider or taking the initial steps to switch.

(b) **Switching processes**: Easy switching processes can prompt a customer to switch. One example of this is Kiwibank's home lending refinance process. Kiwibank has partnered with a law firm to facilitate the legal services customers need to refinance. This simplifies the process and reduces the legal costs of refinancing for borrowers. Conversely, difficult switching processes may hinder customers from switching. Some examples of this are:

    (i) Joining processes, including customer due diligence, may be difficult for customers to complete.

    (ii) The Easy Switch process, governed by Payments NZ, is intended to make it easier for customers that move their transactional banking arrangements to a new bank to re-establish payment instructions such as automatic payments and direct debits. However, the Easy Switch process does not include arrangements to switch direct credits, such as income payments and there is experience of some companies not accepting the mandate to switch a customer's payments meaning a sub optimal experience for the customer when not all payments are switched.

(iii) CCCFA requirements that require extensive information meaning customers do not switch or fully close accounts because they need the transaction history.

(c) Home loan profile and features:

(i) Break fees on fixed rates loans. Most customers split their loans into tranches, often with different tenures, meaning there can be the risk of a break fee on a portion of the lending.

(ii) Existing term deposits and any associated break fees.

Q23 What tools are available to help consumers search, compare, and switch providers of personal banking services?

Tools available to customers to help consumers search, compare and switch providers of personal banking services include bank websites(e.g. home loan calculators), independent websites (e.g. interest.co.nz, Consumer NZ or Canstar), or the use of a mortgage broker. As noted by the Commission already, an easy switch process run by Payments NZ is available to customers if they want to switch banks.

Q24 Please identify any personal banking services that are either tied or bundled with other services. Please describe the impact on competition.

A product or service is bound to another product or service when it cannot function independently, and therefore must be sold in conjunction with another product or service. An example of this is an overdraft that is applied to an underlying transactional account.

A product or service can be tied (i.e. associated) or paired with another product or service. This may be due to an internal policy or preference based on efficiencies for the customer or for the bank. An example of this is a home loan that requires a particular account to be used for the deduction of the regular repayments (but does not require a main bank relationship) or an online savings investment that requires money to be moved via a particular nominated account.

Questions on innovation

The following questions relate to paragraphs 212-221 of the Paper.

Q25 Please describe the innovation you have observed in the personal banking sector in New Zealand over the past five years? Please describe and give examples.

We note three main sources and drivers of innovations across the personal banking sector:

- Industry led innovations such as the recent introduction of seven-day payments through Payments NZ.
- Individual bank-led innovations which tend to be focussed on changes that will have higher adoption and make the biggest impact across their existing customer bases;
    - Improving digital access, customer self-service, and support options that offer customers more control over their banking and access to services where and when they want access.
    - Improving the ease and relevance of banking services by simplifying bank products, services and processes and by better using customer data to make services and information more relevant to individual customers. Examples include

digital applications, savings tools, home loan calculators and the reduction and simplification of product sets.

- Competition from non-bank challengers, including FinTechs. Key innovations in this space include:
  - Better access to a wider range of investment and insurance options for more Kiwi through challenger-propositions such as Sharesies, InvestNow, Hatch, Kernel, Ando and Quashed.
  - New transactional services including Dosh, Cogo, Hnry, and the recent entry of Revolut to the New Zealand market.
  - The growth of BNPL as an alternative to credit cards, overdrafts and personal loans.

Q26 How does innovation in the personal banking sector in New Zealand compare to overseas markets? Please describe and give examples.

In our answer to question 7, we have set out our view that there are two barriers to digital innovation and disruption that are specific to New Zealand. The first is that New Zealand is a small market, meaning it is less appealing to digital innovators than larger overseas markets. In particular, scale is needed for products that earn lower income, such as transactional accounts, to be profitable. The second barrier is that in New Zealand financial services are highly regulated. There is no provision for regulatory sandboxes, and almost all elements of the regulatory framework apply regardless of whether the participant is considered systemically important or not. In this context, it may be costly for innovators to establish themselves in New Zealand, and difficult for them to operate within a strict regulatory framework. This is highlighted by there being fewer FinTech startups compared to other markets and no digital bank start-ups. We note that a significant barrier for this will be the limited potential to achieve scale within the New Zealand market and become profitable (and needs to be balanced with ensuring customers are protected with a regulatory environment).

Q27 Please describe any latent demand for new personal banking services that is currently being unmet. Please describe and give examples.

Aligned to our purpose to make Kiwi better off, Kiwibank considers an area of latent demand is how we can help more Kiwi to understand and practice better financial literacy through their everyday decisions and long-term financial planning. This aligns with our purpose of Kiwi Making Kiwi Better Off and one of our three purpose goals of supporting two million Kiwi to take action to be secure in their financial future by 2030. Recent press coverage of Consumer New Zealand's latest quarterly Sentiment Tracker survey suggests 65% of Kiwi save less than 5% of their income or nothing at all. The suggestion being that half the population is either anxious about their level of savings, or have none to speak of, which is the highest level of concern Consumer NZ has seen in two years.

The challenge is finding new ways to assist and engage customers around these choices as they engage less often with banks for this purpose as they are coming into branches less often, with research showing they are taking this advice from family, friends and social media. Kiwibank's partnership with the Banqer programme in schools to build financial literacy and financial wellbeing programme for its kaimahi are ways Kiwibank is seeking to fulfil this demand.

Q28 What are the main incentives for providers to innovate in the personal banking sector? Please describe the nature and strength of these incentives.

We note that in both Aotearoa and in other markets, innovation in banking does not usually create long term sustainable competitive advantages for banks. Other banks are fast followers of successful innovations.

Instead banking innovations support banks to maintain relevance with existing customers and grow advocacy with new customers. This in turn helps them to be their customers' preferred financial services provider as they meet their subsequent financial needs.

For Kiwibank, our purpose goals are a significant driver for how we view innovation. Our purpose goals maintain a focus on how we are helping all Kiwi to grow their financial literacy and wellbeing and support two million Kiwi to take action to be secure in their financial future by 2030. We prioritise making changes to our products, services, and propositions based on the impact we can have with both our customers and other Kiwi audiences.

Q29 What are the most significant impediments to innovation in the personal banking sector in New Zealand? Please describe and give examples.

Smaller banks must make bigger trade-offs about where they will focus their innovation relative to those larger banks who have larger profits to invest with larger scale and fewer operating costs. We have discussed this in our joint submission to question 16.

In summary, banking regulation and its technical requirements have imposed significant costs which has been an impediment to innovation. Over the past 10 years, the financial services sector has faced an unprecedented number of regulatory changes. Having to implement these changes has had a flow on effect on the amount of innovation in the market. Compliance with regulation and banking transformation will always take precedence over innovation, particularly for the smaller banks that are having to make trade-offs due to their smaller profits and size. The same can be said for the large-scale rise in fraud and the need for banks to invest in this area having the flow on effect of driving money away from innovation.

Q30 What impact, if any, does ownership structure have on providers' ability and incentive to innovate?

Kiwibank has had to make difficult choices and trade-offs around where to innovate due to its size compared to the D-SIBs. With less profitability, and higher cost to income ratios than larger banks (including the cost of remaining compliant with its regulatory obligations), there is less to spend on innovation compared to the larger banks. The D-SIBs are also able to leverage their parent for the know-how behind any innovation if it has been rolled out in Australia first. A recent example of this is CDR, which has already been rolled out in Australia, providing the Australian banks in New Zealand with a competitive advantage when preparing for CDR in New Zealand.

Questions on other analyses, factors, and priority

The following questions relate to paragraphs 222-223 of the Paper:

Q31 Are there any other analyses or factors not raised in this paper that could be relevant to this study? Please explain your answer.

At this stage, nothing other than the issues raised in this submission.

Q32 Which analyses and factors do you think should be a priority for the Commission to focus on? Please explain your answer.

We consider the Commission should be focusing on the factors outlined in response to Question 16.