DAY 1 – PERSONAL BANKING SERVICES MARKET STUDY CONFERENCE

SESSION 3 – PRUDENTIAL CAPITAL REQUIREMENTS AND OTHER REGULATORY FACTORS (CONTINUED)

13 MAY 2024

Lunch adjournment from 12.29 pm to 1.32 pm

BRYAN CHAPPLE: Okay everyone, we might just get started again. Thank you, thanks very much for the discussion this morning. John has just had to pop out to take an urgent phone call, but has asked to us carry on and Rakihia is just sitting down the back, so he is still here, Tristan's online.

Sorry, Tex, we were going to come to you but on reflection just over lunch we had a couple of things on the DCS that we just wanted to go back to and then we'll come back to the broader question about competition and the Reserve Bank's policy-making.

So I just wanted to go to the question, I think maybe you might have mentioned it, Mike, in terms of -- no, actually it was Larissa from TSB mentioned it -- the different risk buckets that the Reserve Bank used to calculate risk. So there's capital adequacy, you did mention that, capital adequacy, liquidity and profitability as a proxy for management quality.

I just wondered whether any, you know, we had a few comments on the appropriateness or otherwise of those, I just wondered whether anyone wanted to make any comments on those things and just expand on their submissions, or give us any views on whether you think those three buckets or those three factors make sense? Yeah, down the --

KEVIN HUGHES: Kevin Hughes from Unity. I think our view would be that the liquidity and capital measures are the most relevant for financial stability. Obviously the sort of misnomer of a not-for-profit being measured by profitability doesn't make a lot of sense from our point of view. And I think Larissa mentioned it before, an organisation like TSB which is putting a certain amount of funds back in the community, which effectively is them redistributing their profit, and for them to be penalised for doing that effectively, I just don't think that's the right way to go.

So we have a view that liquidity and capital are by far the most relevant pieces and the best measures of whether you're going to be financially resilient or not.

BRYAN CHAPPLE: Any others on that topic? Thanks Kevin. No? Okay, then the only other question I wanted to ask about was in our Draft Report we touched on the question of how you deal with systemic risk in the DCS. So if you're levying the individual institutions based on their institutional risk of failure and accepting that there's differing views from people about the extent to which the current levies appropriately capture that on both sides of the argument, there's also a question, or is there a question about how you deal with systemic risk in the sense that, as I think one person did mention earlier, might have been Brent from General Finance, if one smaller institution fails, that's unlikely to have the same kind of contagion effects as a larger one. Did anyone want to comment on that question? Andrew.

ANDREW BODY: Hi, Andrew Body. Is it worthwhile asking the big banks whether they think that they are too big to fail, in that they have an implicit government guarantee?

BRYAN CHAPPLE: So one of the rules John set out at the beginning was that we weren't going to have people asking each other questions, so I should hold to that. But I will comment that I think whether or not you think there is an implicit government guarantee now, and reasonable people can differ on that; there's a new insurance scheme, the Depositor Compensation Scheme coming in, which actually broadens it to all NBDTs, so I think that question becomes more academic. Yes, Martin.

MARTIN TAYLOR: Martin Taylor from Positive Money. Can I just make a point that the total quantum of the insurance fund, as far as I recall, was about $2 billion. So in the context of banks with assets that are larger than the total government debt in some cases, it is very insignificant, and it would be probably fair to say that is really a scheme for small banks and should be treated as such, not by way of how it's paid for, but by way of how it's used.

So for example, if a deposit taker's deposit insurance was weighted so that small banks receive more cover for the dollar, way more cover for the dollar than a big bank, that would implicitly help to avoid what is actually the biggest systemic risk we face probably, at least in terms of practical terms, which is that in the event of a nervous market, the run is on otherwise sound small banks. We saw that, of course, with the Silicon Valley bank in the US and so on. Because the natural impetus is for the public to rush to what they see as safety, and they see as safety the government-guaranteed big bank.

So in a way they don't need deposit takers' insurance and they certainly don't benefit from $2 billion worth because that's just not even a blip in the assets. And I think a weighting that really emphasise that the insurance is there for small deposit takers, not big, would be very valuable.

BRYAN CHAPPLE: I was just actually looking to check that it is $2 billion or not, but I don't have a number for that.

PENNY DELL: It's 0.8% of (inaudible) balances.

BRYAN CHAPPLE: 0.8% of total deposits, yeah, so I don't know what that translates through until --

PENNY DELL: (Inaudible).

BRYAN CHAPPLE: Yeah. Okay, thank you. Adam.

ADAM BOYD: Adam Boyd from ASB. I'm not sure if this is where you were going, Bryan, but I guess to the point around systemic risk, I mean certainly that may be true if one small institution was to run into difficulty, but certainly when you look at how these things tend to play out in markets, at least historically, usually that's not the case. So if you think about the GFC, one institution failing led to many others. And certainly if you think about the most recent events in the US, similar things have played out over history. So I think some of those smaller institutions can end up having more systemic risk than you might look at, just at face value.

BRYAN CHAPPLE: Which was, I think, Martin's point as well. Okay, thank you Adam. Okay, I think that might bring us to the end of that topic. Thank you everyone. I'll hand over to John for the next bit of the discussion.

JOHN SMALL: Yeah, thanks Bryan. Right, so this is really -- it's on the slide as the role of competition in the Reserve Bank's policy-making. And you probably remember that in the Draft Report we expressed the view that the Reserve Bank should transparently articulate the competition effects of its decision, including when it's setting standards, given the new purposes and principles under the Deposit Takers Act, and that competition should be factored into prudential regulatory settings. And we noted that we did not think financial stability and competition are necessarily mutually exclusive objectives. However, at some points there will be trade-offs between them.

And finally, we suggested that the competition principle in the Deposit Takers Act should be amended to require the Reserve Bank to promote rather than simply maintain competition. And we got a fair bit of pushback on those views. People felt that the Reserve Bank had adequately considered competition impacts of the Deposit Takers Act and the DCS. Some felt that our approach was inconsistent with international practice for a prudential regulator, and that it would create legal uncertainty and a risk to financial stability as a result of trying to achieve or pursue both of those principles.

And others said that instead of promote or maintain, a better balance might be struck if the Reserve Bank was required to not undermine competition. And other submitters further stated it's not appropriate for the Reserve Bank to promote competition and that financial stability must not be superseded by competitive neutrality. I suppose this is, to some extent, analogous to some of the other questions, broader questions about the Reserve Bank's mandate, like employment and that kind of thing potentially.

However, other submitters felt there was still room for the Reserve Bank to be more explicit with regards to how it bounces off financial stability and competition. And, for example, Kiwibank suggested that the Reserve Bank had not sufficiently explained the policy justification and competitive effect of its choice when setting the strength risk indicator. And Positive Money Aotearoa and Rewiring Aotearoa agreed with our recommendation about promoting competition, and Habilis felt that the policy objectives were a bit over-weighted in favour of financial stability.

So this is a chance to ventilate your views on these general points and then, once we've done a bit of that, we'll see if we can come to some sort of landing. And since Tex was about to launch forth on this topic before lunch, I'll ask him to comment first.

TEX EDWARDS: Thank you Chairman Small. May I just apologise to my fellow conference attendees for using the word "prefect". I profusely apologise. But I'm using it to anchor a point here and a very important point I'd like to anchor with the Commerce Commission. There's very important stakeholders that have missed this conference and there's very important stakeholders that are in the room that positions are not being expressed of; and that is of the shareholders.

I urge the Commission to catalogue with BlackRock, Fidelity, Templeton, Barclays Capital investors and the NZ Super Fund, just to mention a few, of what their ESG requirements of the banks they own are. And we'll soon find that some of these goody two-shoes initiatives by the New Zealand banks to do environmental funding of insulation, solar panels, double glazing, and what have you at preferential rates are actually set as look-through requirements from ESG shareholders.

And that's an important point, because these, I won't call them teachers, but these very senior shareholders have a massive influence on how banks conduct themselves. And I note that we've had a change in the board composition of some of the banks before this conference, and I note that we've had a substantial share buy-back announced in Australia. And I put to the Commission that they review very seriously the look-through impact of ESG on the banks.

The second comment is something easy to connect with for the Final Report of the Commission, in that I think that we're seeing the same movie in the banking market study that we saw in building, and that the regulator is being used as a barrier to entry and to distort the level playing field.

I'll close out on the role of competition in the Reserve Bank policy. We believe that the central bank, the Reserve Bank should be pricing up the value of the "too big to fail" guarantee. It's really important that one of the CEO's organisations at this conference has gone broke three times and the New Zealand government's bailed them out three times. And we all know that in the dealing room when you're laying off 5 million bucks, you've only got grandma sold her house for 2 million, she's laying it off with the bank, the implied informal value of that "too big to fail" guarantee is absolutely order of magnitude, and we urge the Commission, we urge the Commission to put a price on it in the Final Report.

And it's noteworthy that we also ask the Commission, the central bank not only looks at the role of competition in pricing, but also in household asset allocation. New Zealand is a global disgrace in its over asset allocation to residential real estate. And we put to the Commission, and we've submitted on the point with OECD benchmarks, but we put to the Commission that actually it's not just pricing, it's household asset allocation has distorted in New Zealand as a consequence of the turbo-charged profitability of mortgages versus other asset class, particularly Kiwisaver. Thank you very much.

JOHN SMALL: Thank you, some provocative statements there to get us started, thank you. Someone over the back there was there?

DANIEL McGRATH: Hi, my name's Daniel McGrath, I'm from XCEDA, one of the NBDTs. In terms of the role of the Reserve Bank in setting competition, we were, as an NBDT sector, we were very pleased to see that, as a result of the select committee process, a proportionality framework was introduced which set three tiers of effectively licensed deposit takers in New Zealand. So I guess when the core standards get rolled out in terms of capital and liquidity shortly, it will be very interesting to see how proportionality is applied over those three tiers. One would hope that if they've created three tiers that there would be some level of differentiation between those three groups of licensed deposit takers.

From our perspective as the NBDTs and certainly XCEDA's perspective, areas that we've been focused on during this study, and also in the DTA process, are areas that we see don't create a level playing field to allow us to foster for growth. And if you look at, say, an Australian context where you're seeing some ADIs that are emerging that are quite powerful in terms of providing competition, we see ourselves as the potential of that growth sector. Areas such as the lack of access to ESAS accounts for liquidity and payments, we see as something that would give us a greater ability to compete rather than having to put our own liquidity at banks, which we currently do at the moment, to be able to have that sort of access.

And just going back to issues that we talked about earlier regarding LVRs and risk ratings, in terms of the competition around home lending, NBDT sector currently has a set of regulations and standards that are pretty antiquated, they were put in place after the GFC, for good reason. But certainly on those levels, we are certainly behind the 8 ball in terms of competing on issues such as providing home loans, because our LVRs are quite constricted in terms of an acceleration of our risk weighting.

Finally, I think in terms of the ability of the customer to be able to differentiate who is a licensed deposit taker has been a big issue for us, and certainly something that we've raised with the Reserve Bank. Because we're very keen to ensure that customers know, for example, who is subject to the compensation scheme. But just generally, we believe that with the level of compliance that we have, even as, let's call us the tier 3 of licensed deposit takers, we believe it's very important for customers to understand who we are and the regulation that is pertaining to us. So things like the ability to call ourselves a bank, such as ADIs in Australia do, I think is a really important step in trying to ensure that we are able to distinguish ourselves from the non-prudentially regulated sector.

All of this that I'm talking to really points towards an ability of us to keep growing capital and to keep growing within the sector, ideally moving up the tiers as you go through. XCEDA is a finance company, so we are a for profit, and Kevin's talked to the issues facing the mutuals. From our perspective at the moment, as we look at a lot of uncertainty around capital, it's very hard for us to go to shareholders, or future shareholders, particularly if we want to go to institutional shareholders, which we would need as we grow, to be able to say to them these are the rules in place for us, this is the view of the Reserve Bank in terms of competition.

And as I say, I point again to -- and there've been some mistakes and there've been some issues in the ADI regime in Australia, but certainly from discussions that we have around institutions in Australia, they certainly understand the concepts of investing into a licensed deposit taker and we'd like to see the same here in New Zealand.

JOHN SMALL: Thanks for that. Do I take it that you're, I guess, recommending to us the ADI system in Australia as being a sort of a benchmark of sorts that we should look at?

DANIEL McGRATH: I think at a higher level it's really trying to get an understanding from the Reserve Bank as to is there an appetite for growth of the smaller deposit takers, do we want to see a challenger bank emerge? We've heard from, I guess, the bigger of the second tier banks here today. That's one aspect. We haven't really heard yet from the RBNZ during the process so we're very keen to understand that.

In terms of the ADI regime, one example is there is a minimum amount of capital required for an applicant under an ADI. That sets a very clear benchmark as to what somebody would need to enter the market. At the moment there are no such minimum levels for, say, a non-bank deposit taker. So it would be very interesting when the core standards, as I say, come out in the next few weeks as to what capital is required. But certainty around capital, as well as risk ratings and how we can lend money and compete, is very important to the smaller part of this sector.

JOHN SMALL: Okay, thanks very much for that. Yes, over the back.

SHANE MARSH: Hi, Shane Marsh from Dosh. Actually just to follow on from some of those comments; I thought it would be useful to give some insights into what competition looks like for a new entrant into the market, particularly barriers to competition.

So some background. Dosh is a digital banking provider. We'll be a leading start-up in the consumer space and over the last three years we've been building a digital bank, having just completed a spend, save and then on Friday a borrow capability for consumers in New Zealand.

Our focus is on digital natives and that's where I think our greatest concern is, about what the next generation of Kiwis will need from a financial services provider and whether the current innovation in the market is enough to meet the needs of that customer segment.

It's important to note that Dosh is not a bank, a registered bank in New Zealand. We're not allowed to use the word "bank" or say what we're providing is banking, and if the transcript doesn't capture that I've noted that, I could go to jail for 12 months, so please do.

JOHN SMALL: We'll make sure that's noted.

SHANE MARSH: In our view, the market has all the hallmarks of a market that lacks competition. So there's major barriers to entry, the playing field is not level, and there's excessive profits by the top players in the market. So I think for a lot of this discussion it should be less about is the market lacking competition, and more about why is it and what do we need to do to be able to bring competition in the market.

For us, the major barrier to entry is the Reserve Bank's $30 million capital requirement to operate as a bank in New Zealand. We don't have $30 million and we don't believe we should have to provide $30 million to be able to register as a bank. If you look at other markets, they have tried to bring in new competition and new entrants in the market to raise the level of innovation and better value for consumers. So, for example, the UK has a £1 million requirement for capital to start a bank. Singapore is S$15 million, Australia is AU$15 million, and New Zealand is NZ$30 million. We'd like to see that brought down.

One of the reasons for having a $30 million buffer, we understand, is from a financial stability perspective. I would argue very strongly that if Dosh was to go under, there'd be very little risk to the financial system in New Zealand.

When other markets have brought in new competition, we've seen an influx of providers into the market. If you look at some of the more prominent ones, Up Bank in Australia with a million customers, Monzo in the UK with 9 million customers and Nubank in South America with 100 million customers, bringing in new services, new levels of competition and the overall tide rises because all the existing incumbent players need to compete harder from an innovation perspective as well.

We are concerned about the long-term impact on New Zealand through not having new entrants into the market. The only entrant of note in the last 25 years is Kiwibank and they were government-backed. So from our perspective, as part of the outcome of this Commerce Commission review, we'd like to see recommendations on what the right level of capital should be for new entrants into the market.

JOHN SMALL: Thanks Shane.

SIMON JENSEN: Hi, Simon Jensen. Just like to support your comments and Daniel's comments. There have been no NBDTs since the regime came into place, no new NBDTs. It always has struck me as relatively nuts in the New Zealand market that somebody that provides banking services can't call themselves a bank, almost the opposite of what you would say as a Commerce Commission regulator.

But what I really want to talk a little bit about the role of competition in the Reserve Bank's policy-making. The Reserve Bank hate dual mandates. I mean we found this with monetary policy where it's financial, well, where they don't like the employment part of it. They're on record as saying they don't like the subsidiary elements of the financial stability policy.

I personally think the real issue is in the level of delegation and accountability that we've given to the Reserve Bank governor as a regulator. That's fine in relation to monetary policy and international conventions, but not in relation to prudential policy. They have far greater delegations than you would have as the Commerce Commission regulator, or the FMA. And they do that against an almost myopic lens of financial stability.

And just to give a couple of relatively probably provocative examples, but during the initial phases of Covid when I ended up helping a lot of the NBDTs in the New Zealand market, the Reserve Bank were quite open with me that this is all about financial stability and it's helping the big banks through this Covid. We accept and, quote/unquote, "there will be rough justice in what we're doing". And that rough justice was for the NBDTs and the smaller deposit takers.

It's never been redressed. Things like funding for lending, the business guarantee scheme, the exemptions from the CCCFA, the changes to the ESAS account system; there are a plethora of changes that were all designed, for financial stability reasons and entirely reasonable, but that created a level of rough justice for the smaller sector, which has never been redressed.

The second comment I guess I'd make in relation to this, because I ultimately think, as I say, competition, the Reserve Bank don't actually have a great deal of expertise in it, it should be a tension of ideas between the Commerce Commission and the Reserve Bank on competition.

But one of the things for me is how does the Reserve Bank Governor get to make a decision to make the New Zealand economy, the New Zealand financial system twice as secure as anywhere else in the world? Why is that a Reserve Bank Governor decision? To me the shape of our financial sector is ultimately a political decision, the Finance and Expenditure Committee, Chloe Swarbrick absolutely got that. It should be for politicians to decide what the shape of the system is, not the Reserve Bank.

So to me the role of competition and the Reserve Bank's policy-making, it absolutely needs to be there but it's not them, they need to work with you as the regulator because they don't have the expertise. Thank you.

JOHN SMALL: Thank you Simon. That was a very provocative comment. That separation that you made there between monetary policy and essentially industry regulation is an interesting one. I wonder whether any of the larger banks would care to comment on that as to whether it's -- I mean it's a new idea from my point of view, what do you think about it? Sam. Is there a difference, are they separable, I suppose is the obvious first question?

SAM PERKINS: I was sort of going to ask -- Sam Perkins, BNZ -- I was really just going to ask the question, is that what we've got in Australia in terms of the RBA and APRA, is that what the description was?

SIMON JENSEN: You said you had a separate regulator from New Zealand and Australia, in terms of monetary policy my understanding is that came from basically the Muldoon era and the infamous "Schnapps election" and the cycle of monetary policy being used by governments as way of influencing elections. So it was absolutely perceived to be a different need for an independent party than prudential regulation, which is just like conduct regulation, it's just another form of regulatory regime for which the same level of political accountability should be there.

BRYAN CHAPPLE: I think the issue in Australia is not that there's separation between the Reserve Bank and APRA. APRA does in Australia and has similar, as I understand it, level of autonomy to what the Reserve Bank has here with respect to financial policy.

SAM PERKINS: Yeah. This is obviously a question very much for the government rather than for any of us here.

BRYAN CHAPPLE: Sure.

SAM PERKINS: I was really just trying to interrogate the problem, or the challenge; because obviously interest rates setting, and that sort of stuff, is all run by the RBA. And prudential kind of stability, which is incredibly important for the country as a whole, whether it's 1 in 200 or 1 in 400 or 1 in 100 is a matter for the RBNZ. And I think the RBNZ does as good a job as they can at separating those two remits.

JOHN SMALL: Yeah, but you are kind of -- I think you're buying into Simon's characterisation that they are separate things and not necessarily -- do they have cross-over? I'm just getting my head around this myself. No?

SAM PERKINS: Not really and ideally not.

JOHN SMALL: Okay. Anyone else?

KENT DUSTON: Kent Duston, Habilis, again sorry. I just want to draw attention to the fact that back in 2003 the Commission produced the merger report between ANZ and National. Now, irrespective of what was said about competition at the time and how that has subsequently played out, one of the things that's very interesting about that report is there's a section going to barriers to entry for new banks to enter the market.

And in fact it's a very, very short section, it's really only about three paragraphs long, because at that point in 2003 believably the barriers to entry were very significantly lower than they are today. So at the time, the Commission didn't really see any particular challenge to new entrants arriving in the market.

Now, since then, of course, the market study has come out and it would be safe to say that the market study has gone into, you know, a lot more than three paragraphs to address the barriers to entry question. And we know that those barriers to entry by and large, the vast majority of them are under the control of the RBNZ. So in a space of about 20 years, the barriers to entry to new banks arriving in the New Zealand market have got significantly higher.

Now, in its submission to the draft study, the Reserve Bank notes that our vision for the financial system is that it is inclusive, trusted and resilient while also being efficient and competitive. Now, my mate Google and I had a bit of a rove around the RBNZ. There's no evidence at all that the Reserve Bank pays the slightest attention to efficiency and competition. For instance, every six months the Reserve Bank produces a market stability report. We've yet to see a market efficiency report. There is no, as far as we can tell, work programmes that are orientated towards the efficiency of the financial sector. There are no metrics kept, as far as we can tell, there are no reports produced and there are no KPIs.

So in the sense that RBNZ is very concerned with stability, that's fine, you can see the work programme. But there's no evidence at all that RBNZ is concerned with efficiency, and on those circumstances I'd support the view that that particular, what's currently a work of fiction in their submission, is taken out of the hands of the RBNZ, because the country is not being well-served by an organisation that has measurably increased the barriers to entry in the banking market.

JOHN SMALL: Thank you Kent.

BRYAN CHAPPLE: Can I just try and think about how we frame this up, or find another way into it maybe. So I think we would generally agree that financial stability is an important objective for society, we all have an interest in that. I think we'd probably agree that competition is also an important objective. A lot of the time there's no trade-off, or you can get quite a lot of financial stability gains without giving up much in terms of competition. And at times it might go the other way, that you get the other one but not financial stability.

But there's an area sort of in the middle, if you like, if you're an economist you think about this as sort of some kind of, like a production possibility frontier or something, where you're trying to, you know, wherever you are on that curve is equally good potentially. But obviously the Reserve Bank's setting a bar in terms of financial stability, and there's a choice about how, at the moment under the current regime, it makes that trade-off around competition at the margin, without going to the point of having financial instability.

So, you know, how as a society do we think about that question and what's the best way of having that debate and finding the right settings that take account of this? Because I think that is really at the heart of what we're trying to deal with here. So I don't want this to be a big beat-up on the Reserve Bank, but I think there is a genuine question about how to think about these issues.

So I've got a couple have got their hands up. Andrew and the gentleman from Dosh and then Martin, no doubt others.

ANDREW BODY: You really need to put a price on stability in order to understand the trade-offs. You know, it seems to be a big externality floating around here in the form of the government's, you know, the implicit guarantee. And until you actually price that, you're going to be left wondering what stability, you know, costs and is worth.

If you took a thought experiment and said well, you know, let's charge for -- let's make the guarantee a little less implicit in some way and we're going to charge for it, and let's start thinking about regulation being, you know, that there is a trade-off and there is an optimisation question here, then the structure of the banking sector in New Zealand would be quite different.

What appears to have happened in New Zealand is, you know, pick up Tex's point about the same movie, is we've had a whole lot of sort of siloed regulation going on where no one's had to think about the trade-offs, with an implicit government guarantee and a whole lot of legacy technology which, you know, banking technology which, you know, those things take you to one point only.

JOHN SMALL: Which is Bryan's corner solution of --

ANDREW BODY: Magnificent corner solution, particularly for the big banks.

JOHN SMALL: I think this is a really interesting line of discussion, really, to see if it's possible to conceive of a way that both of these objectives can get a fair crack in policy-making, so welcome that.

BRYAN CHAPPLE: Dosh and then Martin.

PRIYA GAJADHAR: Martin's got the --

BRYAN CHAPPLE: Okay, you've got the mic, sorry. Yeah, go, Martin, while you've got the mic, that's fine.

MARTIN TAYLOR: Yeah, sorry, promise very short. I'd just like to suggest in the competition versus stability test, I think we need to really hold the Reserve Bank to account here, because they've actually failed on both. It's not a case of just having stability and failing on competition, and of course they're intimately connected.

If we think back in history, you know, before the 1989 Reserve Bank Act and the changes around that, the bank inherited a very diverse market in which no bank had failed. And in its approach to competition, or rather to regulation in 30 years, it's created a market with four banks that are so big that they're actually putting our entire economy at risk.

So on a financial stability mode, whatever their approach to competition is has failed on financial stability as well. And I think if they don't understand that, then we're going to be missing the boat in terms of a lot of very good competition issues that are not there at the expense of financial stability. I think they really need to understand they haven't helped us by creating this situation of D-SIBs. Thank you.

BRYAN CHAPPLE: When I worked at the Reserve Bank in 1989, or in the years just after, I remember a bulletin article saying how it would be a good thing to have bank failures every so often.

SHANE MARSH: Shane Marsh from Dosh. I think every market around the world was grappling with this question of how do you bring in, enable competition, while also maintaining financial stability. I don't think this is just a New Zealand topic, it's just New Zealand is a long way behind the rest of the world. So I'd very much recommend we look at how other markets have approached this.

In terms of new entrants in the market, other markets have taken a tiered approach. So say, for example, if you're going to raise up to $100 million you need to put aside $10 million in capital with the Reserve Bank. So that lets someone get started, but it caps them at a ceiling as to how far they can go and then there's more tiers upon that. So that way they're actually enabling organisations to come in and participate, but not have the burden as if they were a full size, fully operating bank. And a number of leading markets have brought these in in the last five years. So I don't think we necessarily need to come up with all the answers ourselves as if this is a new topic.

BRYAN CHAPPLE: But isn't that similar to the regime we have with the different tiers now?

SHANE MARSH: Not for new entrants sorry.

BRYAN CHAPPLE: You can be a non-bank new entrant and not meet those requirements but carry out similar activities.

SHANE MARSH: So if you want to call yourself a bank --

BRYAN CHAPPLE: So you're talking about call yourself a bank, to use that particular term rather than the actual --

SHANE MARSH: Yeah, I think we were kind of chatting about this earlier, right, that if you are in all parts offering banking services, its very confusing to market yourself as not doing so. So how are you supposed to grow a business if you're not able to talk about what you're actually doing?

BRYAN CHAPPLE: Understand, thank you.

SHANE MARSH: So I see all sorts of interesting versions of this in the market at the moment.

There's another start-up in the business banking space that says "we're better than business banking", for example. Because they can't say they're business banking, but they just want to say that they're in that space. So I think we can take the rouse out of it and just let's be honest about what we're offering and enable us to compete.

BRYAN CHAPPLE: Thank you.

GRANT KNUCKEY: The framing, I like the framing of thinking about it as an efficient frontier, so to speak, I think that makes sense. I think the problem is having a data-driven way of whether you're on the frontier or not, because otherwise it's opinion, or ideology, or --

BRYAN CHAPPLE: It's kind of hypothetical, yeah.

GRANT KNUCKEY: Yeah. I think one thing to consider, though, is that there's a potential asymmetric outcome negatively from being wrong on the stability setting. So that's certainly something to think about.

BRYAN CHAPPLE: Well, I mean, yeah, it's kind of very visible if you're -- I mean, yeah, I agree they're asymmetric. It's not obvious that over time, you know, you have a one -- if you have too little stability and you get that wrong you have a very visible event. If you have too much stability it's not so visible, but there's potentially a drag in terms of competition.

GRANT KNUCKEY: Yes, agree.

BRYAN CHAPPLE: So that is the question of how you deal with that. I was really just trying to crowd-source ideas for --

JOHN SMALL: We might get one from our friend Kent, let's see.

BRYAN CHAPPLE: Solutions, yeah.

KENT DUSTON: Coming to solutions. The challenge here in terms of stability is only because we have D-SIBs. If we did not have domestic systemically important banks, if they weren't too big to fail, then we could allow banks to do what they do and for the market to work efficiently, because none of them can independently bring down the financial system and none of them can bring down the economy. So this is, to some degree, a function of "too big to fail".

And the challenge here is not necessarily a size issue but very much a vertical integration issue, and therefore we can suffer contagion all the way through the system. So we have retail banks, we have clearing banks and we have a payment system, all vertically integrated owned by the same entities. And the Reserve Bank is obviously concerned about the contagion that could occur if there is a failure at some level, because it's very difficult to stop.

Now, in the Reserve Bank's approach to this, it seems to be like building a ship with no watertight compartments in it. And the solution to this is to make the hull as thick as we possibly can and build a lot of pumps and employ a lot of people to wander around with flashlights to make sure the thing doesn't sink. But if that hull is ever breached it will absolutely sink.

The solution would seem to be to create the watertight compartments through structural separation of the banking system; separate the retail banks, from the clearing banks, from the payment system. That way, we can have competition at each of those levels, as I think Martin highlighted earlier in the day, and that would enable each of those markets to function efficiently.

But at the point where we have vertical integration of the banking sector, it's very, very difficult to see how we can get high quality competitive outcomes on the one hand, and also still preserve the financial stability of the system when each of those four major players is really too big to fail.

JOHN SMALL: I can see microphones in the hands of -- it was in your hand a minute ago, Antonia, why don't you say something about this.

ANTONIA WATSON: I was going to point out that a lot of the regulation that was talked about that has changed since 2003 was in the wake of the GFC, and that wasn't the big banks that failed then.

JOHN SMALL: True. Mike.

MIKE HENDRIKSEN: I'm going somewhere else, so if people still have the thought on stability versus competition, I'm happy to wait until the end.

JOHN SMALL: Let's just stick with --

BRYAN CHAPPLE: Simon then Dan.

SIMON JENSEN: Just an observation, really, and I don't think this is about stability. But I think there are certainly some economists will say that we've moved on from "too big to fail" and in fact we have banks in New Zealand that are "too big to save". And so we've created a bigger stability issue because of the consolidation in the sector than we as a government are capable of dealing with. And certainly I know, as I say, there was Professor Kaufman who was out here with the Reserve Bank about a decade ago talked quite a bit about that particular problem that we now have. But it's not a competition problem, it's a stability problem probably.

JOHN SMALL: Okay, thank you.

DAN HUGGINS: Dan Huggins, BNZ. I guess at the risk of becoming the customer guy in the room, I do think we need to be careful about suggestions of well, the outcomes for

New Zealand and New Zealanders is going to be much better if we just end up with a massively atomised financial system. The costs of that system will not deliver better outcomes for New Zealand.

JOHN SMALL: Thank you. Yes, and then Vittoria.

SHAUN FORGIE: Yeah, hi, Shaun Forgie from Bill Rush. I'd like to -- the observation I'm coming from is more of a utility. Are we able to think about banking and financial services as a utility? Because there's analogy in the utility sector around creating modularity and separation. And that's proved to be a very good model and I believe that to be the future and the way forward for us in New Zealand?

VITTORIA SHORTT: Just to build on a couple of thoughts. You know, one is this concept of the atomisation, if you like, of banking that is exactly what happened in the US on home loans. And we know how that played out quite badly when you don't understand the risk of what you're doing, and if you're not holding it, if you're passing it on. We've learned a lot of those lessons. So this idea that we can split things up into lots of pieces and that somehow produces a better outcome for the customer, I'm not so convinced on this idea of this atomisation.

You know, and to the point of what is a bank actually is a really interesting question. What is a bank if it doesn't involve payments? I think that's a -- I can't quite fathom that in my own mind. I think a core of what banks do is make payments, receive payments. So, interesting ideas.

I was going to offer one other thought, though, is, you know, you can see from some of our submissions we're very supportive of supporting other participants in the market to have access to some of the things that currently banks do today. What we would say is that we'd like to see that continue actually. We'd like to see the regulation of how people participate rather than regulation at an entity level.

I think that's one of the things that regulators, and whether it's the RB, whether it's ComCom, whether it's FMA, but all regulators think about the future of regulation and what may come. You'll see in our submission we've pointed out that we can see that Apple today is 80% of the tap and pay payments market in Australia; completely unregulated. That's an example where we think if you're a significant participant in the activity, you should be part of that regulation. But you should also have the benefits of the regulation as well. So we would advocate for regulation of activity rather than just the entity, and there's lots of examples, I've just used one.

JOHN SMALL: But that Apple one sounds like an entity one doesn't it? Or have I got that wrong?

VITTORIA SHORTT: Because they're not a bank, quote/unquote.

BRYAN CHAPPLE: They're not a deposit taker?

VITTORIA SHORTT: They're not a deposit taker so they sit outside of the regime.

JOHN SMALL: I see, so that activity should be regulated even though -- which essentially means regulating that entity, but because it's doing the --

VITTORIA SHORTT: Of activity, though.

JOHN SMALL: Because it's doing that activity, yeah, I'm with you?

VITTORIA SHORTT: Yeah.

BRYAN CHAPPLE: Should be a payments regulator, John.

JOHN SMALL: Yes, there probably should be, Bryan, yes.

SIMON JENKINS: I think in Australia they are regulated but not as a bank. We don't have that here for payments, so we have (inaudible) --

JOHN SMALL: The Payment Systems Board, yeah.

SIMON JENKINS: -- in New Zealand, but they will be in Australia for that activity.

JOHN SMALL: Just on the atomisation point which was, you know, take your point and obviously -- and Dan made the same point, which is essentially arguing that there's economies of scope between these activities, it's cheaper to do them in one entity than to atomise them. But the loan thing, that was really securitisation, really, wasn't it, rather than atomisation?

VITTORIA SHORTT: There's many parts of how that -- if you put your customer hat on, who have you got your home loan with and how does that play out in the US market versus the New Zealand market? It's really just an example of where if you start disaggregating risk owners, risk prices, you know, we've seen how that plays through, it's very difficult, and particularly for customers. So today a customer in the US, their loan can just be passed on to anybody. You just get a letter in the mail saying your loan is now with X or Y. And so I think it's really important when we're understanding and learning from other markets that we understand the totality of the impact, not just one component part.

JOHN SMALL: Yeah, good point. So I think we now can go somewhere different. Mike Hendriksen.

MIKE HENDRIKSEN: Mike Hendriksen, Kiwibank. It might be similar to a point I made earlier because I only tend to make two points. But I thought it might be worth elevating the conversation beyond just the RB, because in our minds there's two things, and it was the subject of the joint submission from the domestic banks; so proportionality and competition. You at least have both of those in the DTA. So there should be a discipline that can be applied to do the counterweight between stability and those two, or sometimes all three flow in the same direction.

Not apparent in any of the other key pieces of legislation that determine the regulatory ecosystem for New Zealand. So if you think about the palaver that was the CCCFA affordability tinkering, proportionality and maintenance of competition didn't feature heavily there.

So I suppose our goal is to say everyone who is making fundamental decisions about the ecosystem should be sort of constrained by that discipline of having the, you know, consumer protection versus competition, whatever the two counterweights might be, but it feels like there's got to be more of that discipline. And particularly in circumstances where the legislation now is principle-based, so it gets through parliament relatively easily and then there's secondary and tertiary legislation which doesn't have the same discipline, so how do we impose that discipline to get to a good result for Aotearoa. Thank you.

JOHN SMALL: Yeah, that's a good point, that last one particularly -- I'm not sure if you've made that before, I think that's a new one, the secondary legislation. And, yeah, it would be interesting to ponder whether there's some ways of hardwiring some additional considerations in through that.

KEVIN HUGHES: I was probably going to say a similar thing around that proportionality thing. I think the brochureware I think it was described before from the Reserve Bank around competition, their sort of language around competition; there's proof points about to come up, right?

So with the new code, the updates from the DTA etc, this is where the Reserve Bank can actually do the whole show me rather than tell me piece around this. I think that's the bit that we're all waiting for, I think, around this proportionality piece, Daniel's point before. So I think we feel like we're in a point where we're just at the cusp of seeing some proof, or unfortunately we suspect more brochureware around that language.

JOHN SMALL: Yeah, I think you're dead right in terms of the timing of this project with respect to what's going on there. I think from our point of view all the more reason for us, I think, to sort out what we really think about this, and so that's why we're trying to get your --

KEVIN HUGHES: Just an extra point there, I think the proportionality potentially is the way you balance the stability with the competition. The point made before, the big bank scale and the ability of them to do things at an efficient rate, how efficient they are or not, but more efficient than everyone else is a benefit to New Zealand. But we need players in the market who are effectively encouraged by some settings to be able to experiment and innovate. That's where I think the proportionality will help that.

JOHN SMALL: Yeah, that is exactly what we're after, that sort of ecosystem of innovation, yeah. Brent.

BRENT KING: One of the things that we're seeing is the number of transactions in financial services that are outside of the regulation. So transactions that are not CCCFA controlled, and deposits and investments that are outside of that because the investors are large, or experienced investors. Of course we've seen Afterpay find ways through things and become huge.

But it's an interesting development that we're seeing. Around New Zealand you've got lots of groups of farmers who are doing things that are outside of the regulatory model, and I think that's exploding right now. So I just throw that in as a bit of a provocative. But the concept now, I'm sure there are far more outside than there were, say, five or ten years ago.

JOHN SMALL: Yeah, it's probably a fact of human nature, right, that people want to find ways around things that are difficult and it's the constant chase.

BRENT KING: And that's where the money is.

JOHN SMALL: Indeed. So I think we may have come to the end of what we need to talk about. This last hour has been really excellent and certainly given us plenty to think about. Unless anyone's got something else burning to say, I think we might be able to give you back a half hour of your time. Okay, let's do that. We'll see you at 9 o'clock in the morning, those of you who can be here, and I'm aware that some can't.

Conference adjourned at 2.27 pm to Tuesday, 14 May 2024 at 9.00 am