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ASB cross submission on the Commerce Commission's Preliminary Issues paper for the market study into personal banking services

Introduction

ASB Bank Limited (**ASB**) welcomes the opportunity to respond to the submissions made on the Commerce Commission (**Commission**)'s Preliminary Issues paper (**PIP**) for the market study into personal banking services.

This cross submission comments on some key themes in PIP submissions. As such, it should not be inferred from the absence of a specific response to a particular PIP submission comment that ASB agrees with it.

1. Impact of Regulation

- 1.1 In ASB's view, the most notable aspect of the various submissions is the overarching message that the current and proposed regulatory burden is having a significant impact on the competitive landscape. While there were nuances in the arguments, its impact on current competition, the scope for new entry, and the level of innovation, was a strong theme.
- 1.2 As we noted in our PIP submission, we acknowledge that the regulatory framework reflects policy decisions motivated by the importance of a strong and stable banking system, but PIP submissions across the board make clear the implications for competition.

2. RBNZ rules are not tilted in favour of the Domestic Systemically Important Banks (D-SIBs)

- 2.1 ASB has reviewed the joint response to the PIP by The Co-operative Bank Limited, Kiwibank Limited, SBS Bank and TSB Bank Limited (the **Joint Submission**).
- 2.2 ASB does not agree that D-SIBs benefit from a material capital advantage due to the RBNZ capital requirements. The RBNZ's 2019 capital review (**RBNZ reforms**) introduced a number of changes that *only* impacted and had a cost for the D-SIBs vis-à-vis the smaller banks. The timing for implementation benefits smaller banks, as we explain below.
- 2.3 In particular, ASB disagrees with the Joint Submission's comment that the riskiness of a loan is deemed to have increased by 45% when transferred from a D-SIB that uses internal ratings-based risk modelling (**IRB modelling**) to a smaller bank that does not. Potentially, the submitters have overestimated the uplift by not allowing for the 20% scalar applied to IRB risk weights and the more conservative IRB approach for measuring exposure at default.
- 2.4 We demonstrate in **Annex 1** that reverting to standardised modelling can uplift whole-of-bank reported risk exposure by a maximum of 18% compared to IRB modelling.¹ For ASB's home lending portfolio, the uplift is [Redacted] which is materially lower than the 45% reported in the Joint Submission. Further, while IRB modelling can allow D-SIBs to calculate risk exposure more

¹ As we outline below, the uplift could theoretically be higher for individual asset classes (e.g. home lending), but it is constrained by the RBNZ to even out to 18% across the bank's lending activities.

precisely than smaller banks, we demonstrate in Annex 1 *that any advantage is almost completely offset* by D-SIBs having to hold more Common equity Tier 1 (**CET 1**) capital than smaller banks.

3. Recent Trust and Consumer Satisfaction changes are not indicative of a lack of competitive constraint

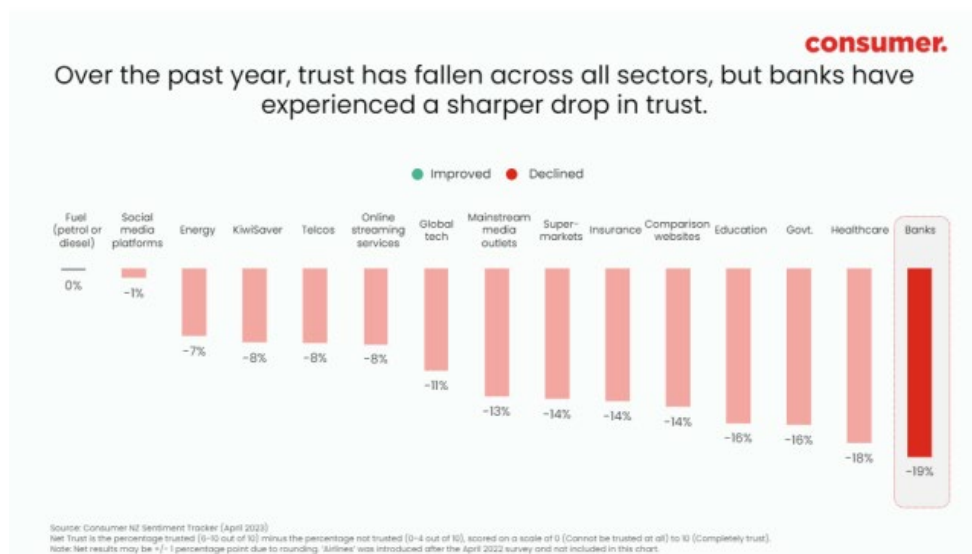
3.1 ASB works hard to support its customers and the community at large, and we are pleased to have been recognised in the latest RepTrak data as the leading financial institution in terms of reputation and trust in New Zealand, and were ranked fifth out of the 25 largest companies in New Zealand based on revenue.² In terms of the sector more generally, Kiwibank and Rabobank were also in the top 10, with ANZ just outside at number 11. Understanding the needs and views of our customers, and meeting those needs is very important to us.

3.2 While we want to be clear that we support the important work Consumer NZ does on behalf of Kiwi consumers, we do have a different view as to the inferences which can be drawn from the Consumer NZ data in its PIP submission.

Comments regarding changes in the level of trust

3.3 In support of an assertion that competition is not working well, Consumer NZ provides the following graph from its April '23 Sentiment Tracker which shows the *change* in the level of trust over a 12 month period among those surveyed.

Figure 1: Consumer NZ PIP Graph (12 month change in trust), April 23 Sentiment Tracker



Source: Consumer NZ's April 2023 Sentiment Tracker (as included in its PIP response at Image 3).

3.4 However, while the above figure shows the *change* over the last 12 months, this was a period in which there have been substantial OCR increases, leading to a very fast rise in interest rates, and higher scam and fraud losses more generally across the sector. The following data from a more recent Consumer NZ Sentiment Tracker (July 23) shows that in terms of the actual **level** of trust, banks are still net trusted.

² RepTrak, April-June 2023, 7 August 2023.

Figure 2: Consumer NZ Sentiment Insight Report - Snapshot 9, Jul 2023³

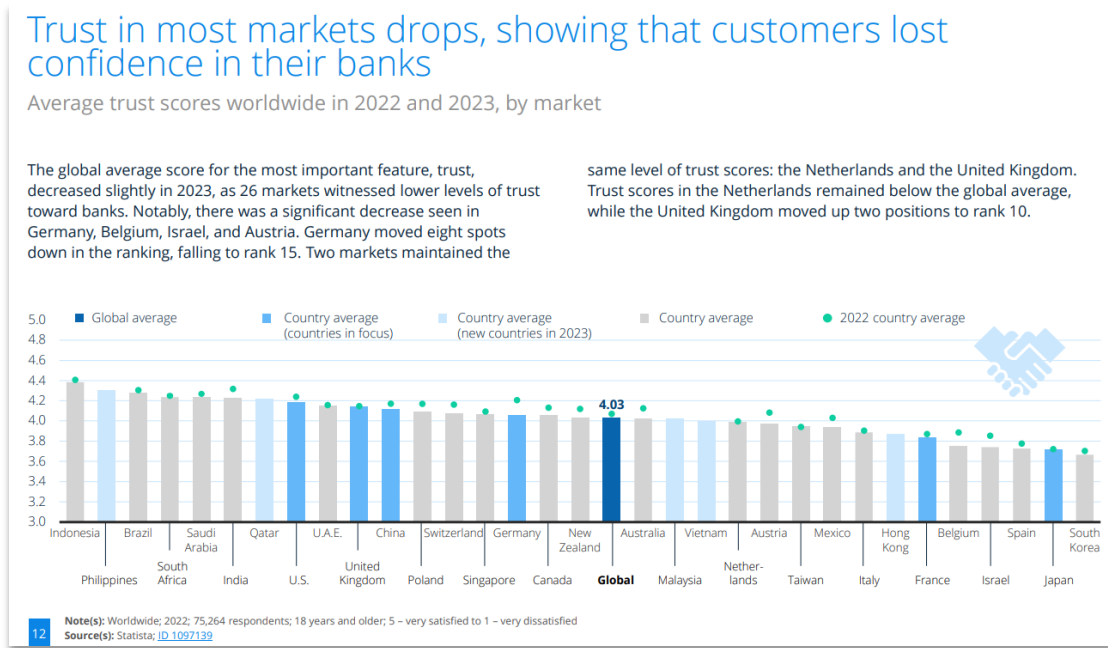
Source: Consumer NZ's July 2023 Sentiment Report.

- 3.5 Additionally, Figure 2 shows a non-negligible increase in bank trust between April 2023 (being the grey circle and the date of the data used in the Consumer NZ PIP graph) and July 2023 (green circle), rebounding almost halfway back to July 2022 (black circle) levels. Other material 'rebounds' can be seen in many other sectors including insurance, airlines, and healthcare. Several more data points would be needed to establish any trend given this level of time series variability.
- 3.6 Further reinforcing the danger of focussing on short term swings, healthcare fares very poorly in the Consumer NZ PIP graph yet remains very high overall in terms of trust, with the position for fuel the opposite. In short, the level of trust that Kiwi consumers have in their banks does not, in our view, suggest there is a competition problem.
- 3.7 In fact, 'The global bank customer satisfaction survey' from Statista⁴ (involving a survey of more than 75,000 bank customers across 32 markets worldwide) shows that the New Zealand average trust in 2023 (4.03) is slightly higher than the global average trust (4.02) and was slightly below NZ's 2022 average, see Figure 3 below. Trust in most markets dropped between 2022 and 2023. (The underlying survey asked consumers to rank their overall satisfaction and trust in banks on a scale from 1 to 5, among other metrics.)

³ The data responds to the question, "On a scale of 0 to 10, how much do you trust companies and organisations in each of the following sectors?" Consumer NZ notes that "Net trust is the percentage trusted (6-10 out of 10) minus the percentage not trusted (0-4 out of 10), scored on a scale of 0 (cannot be trusted at all) to 10 (completely trust). Net results may not add to 100% due to rounding. 'Airlines' added after Apr '22 survey." The black circles are for July '22 and the grey circles are April '23.

⁴ <https://www.statista.com/study/73636/the-global-bank-customer-satisfaction-survey/>

Figure 3: Statista Data (Consumer trust in banks by country)⁵

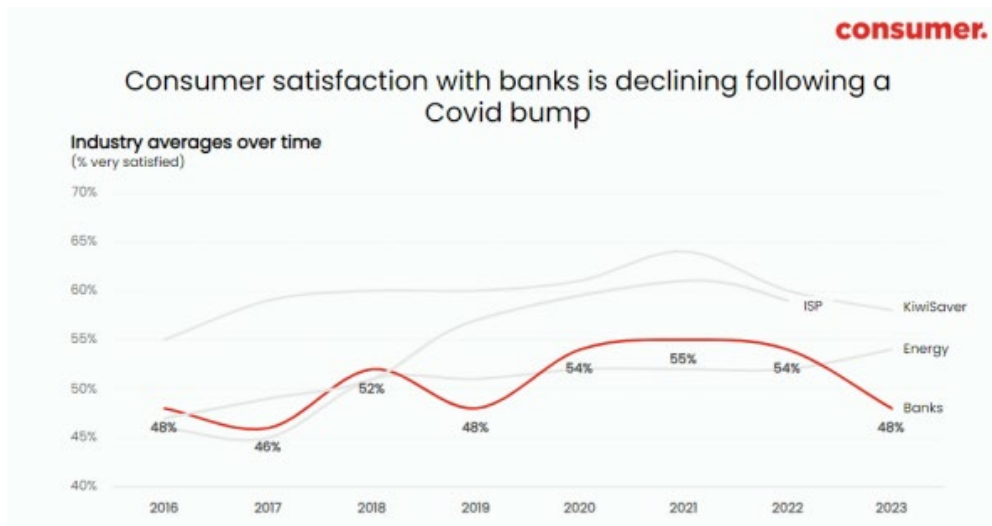


Source: Statista

Comments regarding changes in the level of consumer satisfaction

- 3.8 Secondly, Consumer NZ includes the following graph and invites the Commission to draw competition conclusions from a drop in consumer satisfaction in 2023.

Figure 4: Consumer NZ PIP Graph (Change in satisfaction over time)



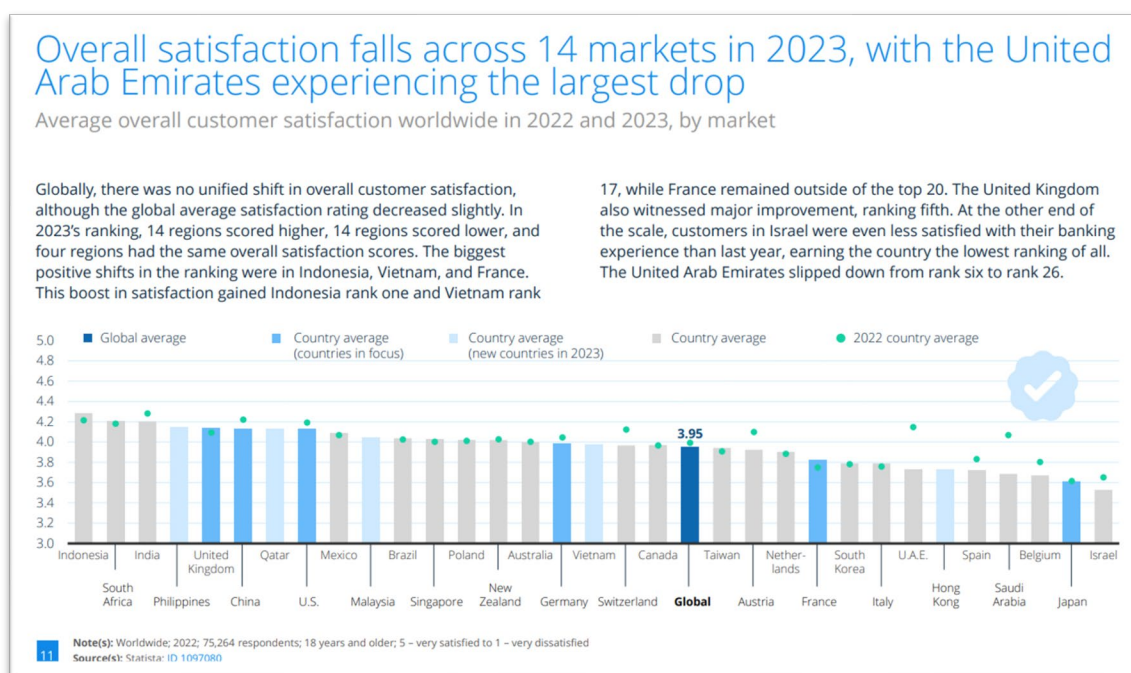
Source: Consumer NZ Market Research 2016-2023. Energy, Banking & KiwiSaver, Telecommunications Satisfaction Surveys (as included in its PIP response at Image 1).

- 3.9 The percentage of customers reporting to be 'very satisfied' has been variable over the timeframe of the data. The drop since 2021 is within the general variability seen over the time period.

⁵ The 2023 scores are drawn from a survey conducted during calendar weeks 45-49 of 2022. The 2022 scores are drawn from a survey conducted during calendar weeks 45-49 of 2021. All financial institutions offering a checking and/or savings account were considered.

- 3.10 Further, the rise in the percentage of ‘very satisfied’ consumers from 2019 through 2021 is described in the Consumer NZ submission as being a “Covid bump”, i.e., nothing to do with changes in competition, but the Commission is invited to draw a competition conclusion from the fall in 2023. This illustrates the importance of being cautious to ascribe these (partial) survey results as reflecting anything about the level of competition – they might be affected by a variety of factors.
- 3.11 Again, Statista data is insightful. The data below in Figure 5 shows that the New Zealand average bank satisfaction in 2023 (4.02) is higher than the global average satisfaction (3.94) and was roughly equal to NZ’s 2022 average. Satisfaction fell in 14 of the surveyed markets between 2022 and 2023.

Figure 5: Statista Data (Overall consumer satisfaction with banks by country)⁶



Source: Statista

4. Open Banking

- 4.1 There is a reasonably common theme across submissions that open banking has the potential to give rise to positive consumer outcomes, but that it should be introduced carefully, with numerous submitters noting the associated issues of scams, frauds and privacy issues. Submitters also noted that uptake can be fairly limited.⁷
- 4.2 ASB agrees with these points. In our view, it is critical that any initiatives in this area are focussed on ensuring government, public sector and industry alignment on the roadmap for delivering a safe and secure Consumer Data Right (CDR) and open banking framework, and ensuring that payments modernisation is preceded by an aligned, simple and accessible digital identity framework. That will help develop consumer trust and promote wider uptake of open banking than we have seen in overseas jurisdictions, while combatting rising frauds and scams, a key priority for ASB.
- 4.3 Turning to some specific comments, Kiwibank has suggested that the obligations under the Deposit Takers Act 2023 and CDR, if they are introduced, should either be staggered (whereby

⁶ The 2023 scores are drawn from a survey conducted during calendar weeks 45-49 of 2022. The 2022 scores are drawn from a survey conducted during calendar weeks 45-49 of 2021. All financial institutions offering a checking and/or savings account were considered.

⁷ For example, see ANZ PIP Submission at paragraphs 102 and 103 and Wise PIP Submission at page 8.

large banks should be required to implement first to provide 'learnings' for smaller banks), or in the case of CDR either delayed or entirely optional for smaller banks.⁸

- 4.4 ASB disagrees with any notion that regulation should be imposed (or imposed first) on only a subset of market participants. We have consistently said that regulation should focus on the activity, not the entity.⁹ This is especially so where the rationale for a differential approach is that a group of firms should be required to 'go first' in order to provide 'learnings' for a number of their competitors, so those other competitors can benefit from cost savings. Further, ASB can see no proper basis for the notion that Kiwibank and other banks' customers should not enjoy the (apparent) benefits of a CDR, so that Kiwibank and those other banks can improve their financial performance by avoiding the cost of complying with that regulation. We note that Kiwibank, for example, has in excess of one million customers in New Zealand.¹⁰

5. Using NIM and ROE in isolation

- 5.1 Several submissions called for caution in using measures such as NIM, ROA and ROE in isolation. Without repeating what was said in all submissions, we do note David Tripe's comments that:¹¹

- (a) the owners of a business are more interested in post-tax returns, and that there are no significant tax concessions available to New Zealand banks, which may not always be the case in other jurisdictions, and may thus undermine comparisons between the returns shown for different countries; and
- (b) interest spread is a better measure than NIM, noting that at an aggregate level the March and June quarters of 2023, show "a significant reduction, compared to the previous elevated levels", which David Tripe says "reflects a catch-up of banks' funding costs, which are inclined to lag changes in the general level of interest rates".

6. Other

6.1 Broker closure rates

- (a) ASB notes Aera's submission that mortgage broker closure rates are disincentivising them from requesting competitive tenders for their customers.
- (b) ASB does not set any expectation on its brokers regarding closure rates, clawback rates or refinancing results.

6.2 Branch availability in regions

- (a) ASB acknowledges that, while New Zealand is generally well placed in terms of digital connectivity, some submitters raised that this is not necessarily the case for all banking customers. This, coupled with other accessibility issues, means that access to branches is important for some of ASB's customers. As ASB emphasised in its PIP response at paragraph 10.19, a physical branch network remains an important component of ASB's competitive offering. However, it is also true that more and more can be done online without visiting a physical branch, and customers are increasingly comfortable doing so. ASB has therefore sought to strike a balance in terms of its digital offering and physical branch network.
- (b) As part of striking this balance, ASB is involved in the regional banking hub pilot program with five other banks, which focuses on providing regional hubs in areas where ASB and the other banks cannot justify standalone physical branches. Three new regional hubs were launched in July and August 2023, which are located in Waimate, Whangamatā and

⁸ Kiwibank PIP Submission at page 3.

⁹ ASB PIP Submission at paragraphs 3.4 and 32.3.

¹⁰ See <https://www.kiwibank.co.nz/about-us/who-we-are/blue-history/>.

¹¹ David Tripe's PIP Submission at page 2.

Ōpōtiki.¹² ASB is working to tailor and evolve the regional hubs informed by these pilots. The hubs are evolving from a Phase 1 offering, which included basic banking services (such as ATMs for deposits and withdrawals, iPads for internet banking and phones for direct access to a bank's customer service team) to Phase 2, which includes the ability to book appointments with personal bankers for face to face or virtual meetings for more complex financial advice and guidance. ASB remains committed to ensuring branch availability that matches customer demand in the regions.

- (c) ASB is also focused on supporting customers via a variety of different means beyond branch availability, providing internet banking, phone banking, and mobile banking channels. Initiatives to support customers as they utilise these channels include (as set out further in ASB's PIP submission in section 15):
- (i) community bankers who visit local libraries, community centres and aged care facilities, to support customers with online banking;
 - (ii) in FY23 the rural banking team completed over 2,000 farm walks with customers, and expects to complete over 2,000 farm walks again this financial year;
 - (iii) a dedicated seniors' line in its Contact Centre for over 65 year old customers that gives them priority service and access to ASB's most experienced agents. ASB also offers a dedicated priority hour from 9am to 10am in branch for senior and more vulnerable customers; and
 - (iv) Better Banking Workshops, which are designed to support customers who want to use technology to do their banking but lack the confidence and knowledge to do it.

¹² See New Zealand Banking Association's media release: <https://www.nzba.org.nz/2023/07/17/banks-launch-three-new-hubs-in-regional-banking-trial/>.

Annex 1 – Effect of RBNZ capital requirements

1. IRB modelling allows a bank to calculate its risk exposure more precisely

- 1.1 Before the RBNZ reforms, all banks were effectively required to hold 7.0% CET1 capital (4.5% plus a 2.5% buffer). By the end of the reforms, non-D-SIB banks will be required to hold 11.5% CET1 capital while D-SIB banks will be required to hold 13.5% CET1 capital. The difference is because of the 2% “D-SIB buffer”.¹³
- 1.2 The denominator of these capital ratios is the value of risk-weighted assets (**RWA**).¹⁴ Therefore, reporting lower RWA benefits a bank by enabling it to achieve its minimum capital ratio with less capital, all else equal. Intuitively, this is because lower RWA signifies the bank is less exposed to risk, and a bank that takes on less risk requires less capital.
- 1.3 As the Joint Submission describes, the use of IRB modelling can allow a bank to report lower RWA than if the same bank used the standardised models provided by the RBNZ. However, we emphasise that IRB modelling does not allow a bank to *understate* its risk exposure. The bank is simply able to calculate its exposure more precisely by using internal history to determine probability of default for each group of loans, using certain parameters specified by the RBNZ.

2. The benefit that a bank can obtain by using IRB modelling is capped by RBNZ constraints

- 2.1 One of the changes arising from the RBNZ reforms was to implement an 85% “output floor”, which came into force in January 2022.¹⁵ This meant that a bank using an IRB model could not report RWA at a bank level any lower than 85% of the standardised outcome.
- 2.2 Banks must apply an IRB scalar to adjust upward their RWAs calculated using an approved IRB model. The RBNZ reforms increased the value of this scalar from 1.06 to 1.20 as of October 2022.¹⁶
- 2.3 The IRB scalar and output floor (**RBNZ Constraints**) interact to offset and cap the benefit that IRB banks can obtain from more sophisticated capital modelling. They require IRB banks to:
- calculate RWA (using their RBNZ approved IRB model) and a standardised RWA (using the standardised RBNZ model);
 - increase their IRB RWA by 20% (the scalar) to determine their *adjusted* RWA; and
 - compute their capital ratios using their *effective* RWA, which is the higher of the adjusted RWA or 85% of the standardised RWA.
- 2.4 At its maximum, IRB modelling can reduce a bank’s RWA by 15% (i.e. to 85% of the standardised outcome). Or, conversely, reverting to standardised modelling could increase a bank’s RWA by a maximum of 18%.¹⁷

A bank’s home lending portfolio is one component of its total risk weighted assets

- 2.5 The RBNZ Constraints apply at the whole-of-bank level, which means the standardised weights of any *individual asset class* may be more than 18% higher than the IRB weights (even after multiplying the IRB weights by 1.20). For example, the effective standardised weights of a bank’s *home lending portfolio* may exceed IRB weights by more than 18% as long as this is evened out

¹³ <https://www.rbnz.govt.nz/regulation-and-supervision/oversight-of-banks/standards-and-requirements-for-banks/capital-requirements-for-banks-in-new-zealand>

¹⁴ <https://bankdashboard.rbnz.govt.nz/capital-adequacy>

¹⁵ <https://www.rbnz.govt.nz/regulation-and-supervision/oversight-of-banks/standards-and-requirements-for-banks/capital-requirements-for-banks-in-new-zealand>

¹⁶ <https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/consultations/banks/review-capital-adequacy-framework-for-registered-banks/bpr-documents/bpr130-credit-risk-rwas-overview.pdf>

¹⁷ This is a mathematical rearranging: if X is 85% of Y, Y is 118% of X (because $100/85 = 1.176$).

by the bank's other assets. This is one of the complexities of only reviewing a subset of a bank's activities.

2.6 The standardised weight for ASB's home lending portfolio is actually [Redacted] than its adjusted IRB weights. Put another way, the riskiness of any loan in this portfolio would be deemed to have increased by [Redacted] were it to be transferred to a smaller bank that does not use IRB modelling. This is materially lower than the 45% uplift reported in the Joint Submission.

3. The D-SIB buffer almost completely offsets the maximum possible benefit from using IRB modelling

3.1 A bank that uses IRB modelling to reduce its RWA by up to 15% (i.e. the maximum possible reduction) can then reduce its capital held by up to 15% while maintaining an equivalent or higher capital ratio.

3.2 However, this is almost entirely offset by the requirement to hold the D-SIB buffer. The true comparison is a minimum CET1 capital to *standardised* RWA ratio of 11.475% for D-SIBs versus 11.5% for non-D-SIBs.¹⁸ This is demonstrated by Table 1.

Table 1: Example of effect of IRB modelling on required CET1 capital

	D-SIB using standardised weights	The same D-SIB achieving the best possible outcome using IRB weights	Non-D-SIB with the same risk profile using standardised weights
a) RBNZ-required minimum CET1 capital ratio	13.5%	13.5%	11.5%
b) Total assets	\$1 billion	\$1 billion	\$100 million
c) Effective risk weights	10%	8.5%	10%
d) Risk weighted assets [(b) × (c) = (d)]	\$100 million	\$85 million	\$10 million
e) CET1 capital required [(e) / (d) = (a)]	\$13.5 million	\$11.475 million	\$1.15 million
f) CET1 capital required as a % of standardised RWA [(e) / (10%×(b)) = (f)]	13.5%	11.475%	11.5%

Note: This is a simplified illustration of the capital ratio calculation. It assumes the standardised RBNZ models provide risk weights of 10% for both the D-SIB and the non-D-SIB because they have the same *risk profile*, even though the D-SIB has 10x more assets. It also assumes they could both achieve risk weights even lower than 8.5% with IRB modelling, but the RBNZ output floor sets a minimum risk weight of 8.5% (85% of the standardised outcome). Therefore, the D-SIB's *effective* risk weights are 8.5% when using IRB modelling, and both face *effective* risk weights of 10% using standardised modelling.

3.3 Accordingly, there is no net material advantage or "drag on competitiveness" arising from D-SIBs' use of IRB modelling due to the higher D-SIB capital requirement. Indeed, Figure 9 of ASB's original response to the PIP shows that Kiwibank is growing above the market rate in home lending while three of the four D-SIBs have lost share since June 2018.

¹⁸ Assuming the D-SIB uses IRB modelling to reduce its effective RWA to 85% of standardised RWA, and assuming the non D-SIB is not IRB accredited.

4. The timing of the RBNZ reform implementation has the effect of supporting smaller banks

4.1 Figure 6 below shows the implementation timeline for the RBNZ reforms, including some of the changes discussed above. It can be seen that the changes only impacting the D-SIBs (changes to the D-SIB buffer and IRB scalar) were made by July 2023, while the later changes are those that will affect all banks.

Figure 6: Implementation timeline of RBNZ reforms

1 January 2022	<ul style="list-style-type: none"> • Derecognition of non-qualifying AT1 and Tier 2 instruments begins • IRB banks required to report IRB and Standardised capital calculations (dual reporting) • Output floor on IRB exposures set at 85% • For IRB banks, Sovereign and Bank exposures move to Standardised approach
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The phasing of the implementation of the increase in capital buffers and the IRB scalar is shown below:

1 July 2022¹	<ul style="list-style-type: none"> • D-SIB buffer set at 1%
1 October 2022	<ul style="list-style-type: none"> • IRB scalar increases from 1.06 to 1.2
1 July 2023	<ul style="list-style-type: none"> • D-SIB buffer increases from 1% to 2%
1 July 2024	<ul style="list-style-type: none"> • Minimum Tier 1 capital requirement increases from 6% to 7% • Minimum Total capital requirement increases from 8% to 9%
1 July 2025	<ul style="list-style-type: none"> • Conservation buffer increases from 2.5% to 3.5%
1 July 2026	<ul style="list-style-type: none"> • Conservation buffer increases from 3.5% to 4.5%
1 July 2027	<ul style="list-style-type: none"> • Conservation buffer increases from 4.5% to 5.5%
1 July 2028	<ul style="list-style-type: none"> • Countercyclical capital buffer set at 1.5% • Non-qualifying AT1 and Tier 2 instruments fully derecognised

¹ Changes take effect from this date, meaning the 1% D-SIB buffer would be reflected in D-SIB banks' reporting, e.g. on the RBNZ Dashboard, for 30 September 2022 (not 30 June 2022). This logic also applies to the IRB scalar and other capital ratio changes.

Source: RBNZ, Updated Capital Review Implementation Timeline as at 22 February 2022