Market study into personal banking services

I respond to the Commerce Commission's invitation for cross-submissions to its study into personal banking services. Considering submissions made, I take exception to claims that 'bank fees are low'. Frankly, this submission could be sub-titled 'very-cross'.

It is usual with similar studies and inquiries across the ditch, for the input from major banks to be less than candid. Important issues for the general community are not recognised or addressed. Monetary and banking authorities are similarly reluctant to openly discuss flaws in the provision of retail banking and payments system services. Politically, there could be an outbreak of emotional incontinence if the issues were mentioned openly. All up - it is agreed, let's all keep mum!

New Zealand and Australia are not alone. The changing technology for retail payments can appear like 'competition' even though the system is operating akin to a monopolistic cartel by a few dominant players. Customers of banks worldwide would be pleased to see some open discussion of the issues.

As is, bank customers could be forgiven for thinking that retail banking is mostly free of charge. For most customers there are no prices (or full-cost prices) explicitly charged for basic bank account keeping and transaction services. Bank customers are (mis)led to believe that basic banking services are free of charge.

The illusion of 'free banking' could not be further from the truth. Major banks do not pay interest on most deposits in transaction accounts – they do earn interest on loans and investments funded by these 'free deposits'. In short, it is the interest that is not paid to the customers that, as bank profits, is partly used to cross-subsidise the appearance of 'free banking'.

The illusion of 'free banking' is compounded by the terms on which banks provide credit-card and debit card (and BNPL) transactions. Transactions that appear to be free to card holders are subject to excessive fees paid by participating retailers. Ultimately the high costs paid to banks by retailers are recovered from customers in higher retail prices.

The issues to be exposed and discussed are illustrated by the sharp increase in interest rates paid to banks on bonds and loans recently. Where did this profit surge go? Who should have benefited from the higher earnings on free-deposits in transaction accounts with banks?

Into the bargain also, low-cost digital payments have displaced high-cost operations with manually handled and transported cash and cheques processed in ever fewer branches. Banks costs to be recovered were steadily lower – the savings went to profits rather than customers.

In short, drawing a sharp inference:

Major banks in New Zealand could be asked to address the fair prospect of paying interest, at least the cash rate, on all deposits – including deposits in transaction accounts.

An appendix forms part of this submission – it edits some of the text presented earlier.

Peter Mair   25 September 2023

APPENDIX

Market study into personal banking services

[extract from the 14 August 2023 response to the Commission's issues-paper]

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

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

These banks routinely provide account keeping and transaction services either free-of-charge or under-priced. Taken together with credit-card and debit-card schemes, bank customers see retail banking and payments facilities provided 'free of charge'. The truth is quite to the contrary – indirectly the customers are grossly overcharged in ways they do not see or understand.

Coupling 'not paying interest' with 'free services' sees a major industry engaged in a barter scheme that avoids the payment of tax on the income paid to depositors in-kind (as free services) rather than as taxable interest income. A major national industry is operating without a pricing system so essential to guiding the provision and use of services with very different costs. Consequently the retail banking system is inefficient and unfair to its customers because it is not competitive.

The major banks have an unassailable competitive advantage improperly gifted by their regulators.

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

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

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

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

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

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