BUDDLE FINDLAY

22 November 2023

To
[redacted]

From
Simon Jensen

By Email
[redacted]

Dear Jessica,

NBDT Responses to Commerce Commission Topics

1. INTRODUCTION

1.1 We refer to your email on 3 November 2023 where you requested that the group of non-bank deposit takers (**NBDTs**) who attended the initial meeting with the Commerce Commission (**Commission**) provide specific responses to a series of topics (**Requested Topics**).

1.2 Having had a chance to discuss the matters further with the NBDTs we set out below the NBDTs responses and view on each of the Requested Topics – with specific responses to each of the three specific questions asked by the Commission.

2. THE RESERVE BANK OF NEW ZEALAND'S (RBNZ) PROPOSED PROPORTIONALITY FRAMEWORK UNDER THE DEPOSIT TAKERS ACT 2023 (DTA)

What are the specific regulatory requirements that most affect your ability to compete to provide customers with personal banking services? How and why?

2.1 There are no specific legal requirements in the proportionality framework. However, this is intended to be the key safeguard in the Deposit Takers Act against the wide discretion given to the Reserve Bank to set standards that could make smaller entities unviable – reducing competition and diversity of providers in the market and enhancing barriers to entry. The specific concern that the NBDTs have in relation to the proposed proportionality framework is the consistent statements by the Reserve Bank of New Zealand (**RBNZ**) alluding to increases in prudential supervision standards for small deposit-takers, and in particular NBDTs. The comments in question include:[1]

(a) "Some deposit takers may need to modify their business model to meet the minimum standards"; and

[1] Reserve Bank of New Zealand *Proportionality Framework: for developing Standards under the Deposit Takers Act* (Consultation Paper, 31 July 2023) pp 5 & 11.

(b) "Others may need to assess their viability in line with operating in a well-regulated competitive marketplace".

2.2 There is no explanation of the basis for these comments – the review of the Reserve Bank of New Zealand Act 1989 and the development of the Deposit Takers Act 2023 was undertaken following the International Monetary Fund's (**IMF**) Financial System Stability Assessment of New Zealand. The IMF's Report following the assessment called for enhanced *supervision* by the RBNZ, noting that its hands-off approach to prudential supervision was out of step with international norms. The IMF did not identify any issues with the regulatory standards, nor have we seen any evidence that the RBNZ has assessed the standards as inadequate.

2.3 The Deposit Takers Act expressly requires the RBNZ to consider compliance costs and competition when designing a prudential regime. Further it runs counter to the Parliamentary purpose of including the proportionality framework in the Deposit Takers Act. The chair of the Finance and Expenditure Committee expressly stated in the third reading that she wanted it recorded in Hansard that Parliament recognised the importance of the NBDTs and their contribution to the New Zealand financial system and this was the reason for that committee requiring the RBNZ to design a proportionality framework.

2.4 The NBDTs consistently sought clarification of what the regime would look like for us as the most affected sector, noting its importance for providing competition for personal banking services. Instead, the ongoing regulatory uncertainty with the proportionality framework has been harmful for competition in personal banking because it has reduced NBDTs ability to plan for growth and investment.

Please describe the impact of each requirement identified in your response to question 1 on your ability to compete to provide personal banking services.

2.5 Increasing prudential regulation will, as the RBNZ has expressly recognised, impact the competitive viability of NBDTs in comparison to banks by increasing compliance costs and forcing some to merge or withdraw from the market because they cannot absorb those costs. This will significantly impact both the ability of existing small competitors to continue and for competitors to enter the market. Under the current regime there have been no new competitors in a decade, so intensifying regulation will only exacerbate the problem.

2.6 We anticipate that capital and liquidity standards have the potential to be the most problematic for us because of the costs of high levels of capital and funding may become prohibitive. In addition to the increased costs of capital and funding, increased volume and complexity of prudential regulation generally will increase our compliance cost centre. The level of consultation, and compliance implementation (on top of ongoing compliance requirements) is increasingly where all our resources are having to focus, not leaving any room for process improvements and business development.

2.7 This level of regulatory uncertainty has had a significant impact on existing NBDTs ability to raise capital to grow our businesses in the last 4 years. In one instance an impact investor who was otherwise keen to invest (with limited regard to financial return) because of the impact of the institution on financial inclusion ultimately decided not to because they were concerned about the

unknown of the future regulatory burden and the impact it could have on the viability of the entity. In other instances, difficulties raising capital have simply impeded growth plans for some NBDTs.

2.8 While intensified prudential regulation may not have a major impact on competition at a macro level, that is because New Zealand already suffers from a highly concentrated and non-competitive market. The impact of increased prudential regulation will be harmful for both NBDT, largely eliminating their opportunity to grow and compete in the longer term and will harm consumers who rely on the NBDTs. In particular, it will reduce their ability to operate in niche markets that are underserved by the banks – notably places like South Auckland and the regions, for customers such as sole traders, and in relation to markets like non-standard mortgage lending This is not so much as a result of the price of services but more about the availability and the quality of service (much more personalised) that the NBDTs provide (and how they tend to compete).

What specifically could be done in relation to each requirement identified in your response to question 1 to better achieve the purposes of the Act/Regulation/Policy with least negative impact on competition?

2.9 The NBDTs should be grandfathered into the new Deposit Takers Act based on the standards currently applicable to them under the NBDT regime. The prudential supervision standards for NBDTs are currently working and have not been changed since they were introduced about a decade ago. Any modernisation can and should happen progressively rather than as part of a proposed "big bang" for NBDTs. The proposed relicensing will be a time consuming, distracting and largely pointless exercise.

2.10 In addition, the RBNZ should be accountable for its development and application of the proportionality framework and in particular the impact of their standards and supervision on competition and compliance costs (ultimately borne by consumers). This could include narrowing the scope of their discretion in the Deposit Takers Act by setting how standards must be created proportionately. Alternatively, it could operate in the same way we understand the Bank of England is accountable in respect of its "Strong but Simple" framework. This would involve the RBNZ reporting to the Finance and Expenditure Committee each year on how it applied its proportionality framework having regard to the broader objectives – with the opportunity for regulated entities also to appear and possibly for an independent report to be produced from Treasury with input from the Commerce Commission.

3. THE PROPOSED LEVY FUNDING ARRANAGEMENTS FOR THE DEPOSITOR COMPENSATION SCHEME (DCS)

What are the specific regulatory requirements that most affect your ability to compete to provide customers with personal banking services? How and why?

3.1 Our concern is the size of the levies that may be imposed on us will at best have a substantial impact on our ability to offer competitive products and at worst impact our viability. The RBNZ is only consulting on two risk-based approaches. If either of the risk-based approaches (using either credit ratings as risk measures or the composite risk indicator matrix) to calculating the DCS levy

are adopted, then the NBDTs fees will represent a significantly higher proportion of their profits that the banks.

3.2 For certain NBDTs the DCS levy may represent up to 40% of their profit. Based on the RBNZ data, the DCS levy in most circumstances will represent closer to 2-3% of profits of banks.

3.3 There is no evidence provided to explain why such a disproportionate approach is justifiable. In fact, we understand that the approach taken in the vast majority of countries is to introduce deposit insurance with flat fees while evidence and data is collected to better inform the nature and likelihood of relevant risks. The proposed risk-based approaches demonstrate an absence of understanding of the risks with one NBDT falling under the riskiest category under one approach and the least risky under the other. For that NBDT this means the difference between 2% of profits and 40% of profits.

3.4 While the Reserve Bank have argued that it is appropriate as we will benefit from the DCS, they have provided no evidence for that assertion. In our view, the level of the cap on deposit insurance is also more likely to adversely impact the NBDTs, many of whom have large depositors who are at risk of deposit splitting when insurance is put in place.

Please describe the impact of each requirement identified in your response to question 1 on your ability to compete to provide personal banking services.

3.5 The NBDTs believe that the DCS levy proposal will disproportionately drive up NBDT costs when compared with banks and put significant portions of our funding at risk without a clear justification for the approach. We rely on deposits to fund our lending activities and any reduction will negatively impact our growth.

3.6 The NBDTs believe the proposal undervalues the risk of the large banks and overstates it for the NBDTs. It will effectively create another regulatory driven advantage for the large banks (without an evidential basis for doing so). It is also completely unnecessary from a funding perspective as the contribution to the deposit compensation fund by the NBDTs is in reality a rounding error for the big banks.

3.7 The NBDTs also believe based on international experience that the transition risk of the introduction of deposit compensation with inadequate data is most likely to adversely affect them much more than the large banks. This will affect the cost and availability of funding for the NBDTs and there is a significant risk funding becomes more expensive relative to the current pricing differential and that will affect their ability to price competitively or worse still funding dries up at the prices they can offer and so forcing them to sell, probably to the major banks.

3.8 Given the proposed cap is lower than NBDTs believed was appropriate for the New Zealand market and they believe they are most at risk of deposit splitting there is concern that the DCS will push deposits amounts in excess of the deposit compensation limit to large banks without the correspondent deposits being picked up by the NBDTs because they tend to be more regionally based and rely on personal service as a key part of their value proposition.

What specifically could be done in relation to each requirement identified in your response to question 1 to better achieve the purposes of the Act/Regulation/Policy with least negative impact on competition?

3.9 The NBDTs propose that they should be exempt from the DCS Levy for the first five years of the DCS. This would allow the NBDTs to continue to grow, as they will have more money available to invest into growth projects and this would allow the NBDTs to keep their deposit products competitively priced (by not having to re-price and lower profit margins on their deposit products).

3.10 This approach would better achieve the following principles and purposes in the DTA:

(a) supporting New Zealanders having reasonable access to financial products and services provided by the deposit-taking sector;

(b) the desirability of:

(i) taking a proportionate approach to regulation and supervision; and

(ii) the deposit-taking sector comprising a diversity of institutions to provide access to financial products and services to a diverse range of New Zealanders; and

(c) the need to maintain competition within the deposit-taking sector;

3.11 This approach would support competition within the personal banking services sector, as the NBDTs will be more fairly placed to offer deposit products on closer terms to the banks and afford the NBDTs ability to grow and further support their communities. In effect it is one small thing that can be done to redress inequities in banking regulation that the NBDTs have faced particularly in recent times during the Covid period (where government support has effectively left the banks' balance sheets in much stronger position – because they have not passed on the funding benefits the RBNZ in particular have given them). Certainly, they have not been passed on the NBDTs in spite of comments to the NBDT from the RBNZ that it was what was expected to happen.

4. ACCESS TO THE EXCHANGE SETTLEMENT ACCOUNT SYSTEM (ESAS)

What are the specific regulatory requirements that most affect your ability to compete to provide customers with personal banking services? How and why?

4.1 NBDTs are currently unable to access ESAS accounts as a result of RBNZ policy or more particularly a lack of policy which the RBNZ has not finalised following an initial review nearly a decade ago. The statutory framework, section 116(e) of the Reserve Bank of New Zealand Act 2021, allows for NBDTs (or indeed any other entity approved by the RBNZ) to be able to access ESAS accounts with approval from the RBNZ. Despite this broad discretion, no NBDTs have an exchange settlement account and the RBNZ has closed all applications for non-banks since 17 May 2022 after receiving increasing pressure to provide clarity on the access requirements. NBDTs also understand the lack of access to ESAS accounts has been a major impediment in fintech's ability to compete as well.

4.2 By using ESAS accounts to implement quantitative easing during the Covid-19 pandemic in 2020 the banks immediately benefitted from holding substantial parts of their liquidity in ESAS accounts

and benefited from receiving higher margins on their deposits (particularly because of the increase to the overnight cash rate from 0.25% to 5.5%). It gives them an immediate margin in a risk free, zero risk weighted on call asset being the ESAS account. We understand that it potentially accounts for around $2 billion of bank profits on customer call accounts – as well as giving them a risk-free margin on funds deposited with them by NBDTs.

4.3 By contrast, NBDTs have to deposit their funds with the banks and maintain their liquidity with the banks. These are risk weighted at 20% and prudently structured over a period of maturities to maximise returns. They do not have the luxury of earning 5.5% on call in a zero risk weighted asset. Furthermore, during Covid when some needed to break deposits to manage liquidity risk or potentially access standby facilities with banks it became reasonably apparent that the commercial banks were unwilling to allow them to break and unlikely to actually fund under standby facilities. In contrast the banks could rely on the RBNZ for not just access to ESAS funds but the various funding and standby funding it was prepared to provide them).

4.4 This means that banks have a material competitive advantage in the deposit and transactional banking market because of the easy risk-free margin available to them not available to NBDTs. Given ESAS accounts must always have credit balances there is no credit related reason for the RBNZ to deny access.

Please describe the impact of each requirement identified in your response to question 1 on your ability to compete to provide personal banking services.

4.5 As a result of holding liquidity in banks, the NBDTs return on investment for this liquidity is lower than if liquidity was held with the RBNZ in an ESAS Account (which would attract interest equal to the OCR rather than the commercial rates offered by the banks and for capital purposes would be risk weighted at zero). In addition, the NBDTs are subsidising the earnings of the banks (who are able to deposit NBDT funds into their own ESAS accounts and earn higher margins).

4.6 The Banks access to ESAS accounts also assists with their financial stability compared to NBDTs because of the large percentage of high yielding on call liquidity they hold with no constraints on access – unlike NBDTs. Banks also have access to other low-cost liquidity from the RBNZ which further de risks them relative to NBDTs – again purely because of the regulatory advantage they are given.

4.7 In summary, this gives the banks a major competitive advantage over the NBDTs and hinders their ability to continue to invest and grow their businesses, including in the area of personal banking services, because NBDTs are required to hold liquidity in ways that significantly reduce their profitability.

What specifically could be done in relation to each requirement identified in your response to question 1 to better achieve the purposes of the Act/Regulation/Policy with least negative impact on competition?

4.8 The RBNZ should be required to provide ESAS accounts to NBDTs as well as banks now. The RBNZ should also provide equivalent funding to that which it provides banks but, on a risk, adjusted basis so that NBDTs do not have to go through the expensive exercise of securitising mortgages

but can provide similar security (e.g., under the trust deed) but also pay for the funding at a risk adjusted rate (i.e., higher than banks pay residential mortgage-backed funding).

5. CCCFA REQUIREMENTS

What are the specific regulatory requirements that most affect your ability to compete to provide customers with personal banking services? How and why?

5.1 The specific sections of the CCCFA that most affect the NBDT's ability to compete are as follows:

(a) Section 9C(3)(a)(i), and in particular regulations 4AA-4AO of the Credit Contracts and Consumer Finance Regulations 2004 (**Affordability and Suitability Requirements**); and

(b) Sections 17, 18, 22 and 23 (among other equivalent provisions for guarantors etc.) (**Disclosure Requirements**).

5.2 The NBDTs view the above two requirements as posing competition issues for the following reasons:

(a) NBDTs are restricted in their ability to provide timely and tailored support to customers – this is an important point of competition for NBDTs and is the NBDTs key value proposition.

(b) the cost per loan for NBDTs is disproportionately high as there is no proportionality in the CCCFA's application (particularly for smaller value loans which many of us have ceased to provide); and

(c) it is costly and challenging for NBDTs to provide niche, or more nuanced, loan products – it is an important point of competition that they are able to compete on product features as opposed to just price.

Please describe the impact of each requirement identified in your response to question 1 on your ability to compete to provide personal banking services.

5.3 The cost per loan for NBDTs is disproportionately high because NBDTs (primarily) have largely manual disclosure processes for their loans (which is time consuming and expensive) in comparison to banks who have streamlined, automated processes. NBDTs simply cannot afford to have fully automated processes to assist them with disclosure because of highly prescriptive nature of the disclosure requirements and complexity of applying them to individual circumstances which were often never contemplated by the original legislation and the difficulty of programming for them. This means that the compliance costs per loan becomes disproportionately higher. The above factors similarly apply to the NBDTs inability to provide smaller value loans. The cost per loan (which is largely the same regardless of the value of the loan) is too high to make smaller loans economic.

5.4 NBDTs struggle to provide the tailored loan products where they are most competitive with the banks because typically the disclosure requirements for these products are extremely complex and uncertain and the consequences of failure to make proper disclosure extraordinary draconian relative to any other financial compliance consequences. The Disclosure Requirements have led to NBDTs tending towards simpler products to ensure that they are able to comply with the Disclosure

Requirements. This is problematic because, as NBDTs realistically do not have the scale to compete strictly on price, the NBDTs prefer to compete on product features. A simple example of this is the ability for customers to backdate an interest rate where the customer forgot to refix in time and rolled onto a higher floating rate. Most NBDTs, that would seek to provide that flexibility to customers have ceased this practice because it is inconsistent with disclosure requirements.

5.5 NBDTs struggle to provide support to customers who want to change their arrangements as a result of the Disclosure Requirements. As any agreed variation requires variation disclosure under section 22 of the CCCFA to be made, NBDTs are often better off not agreeing to customer requests than risk the consequences of not making proper disclosure of full particulars of what was agreed. This greatly inhibits the NBDTs' abilities to provide high quality customer service and flexibility – which is the core element they mostly want to compete on, and which tends to be most valued by their customers.

5.6 The NBDTs are aware of some of their competitors leaving the consumer lending market and some have themselves withdrawn from this activity because the regulatory burden of the CCCFA is too high and the consequences too severe.

What specifically could be done in relation to each requirement identified in your response to question 1 to better achieve the purposes of the Act/Regulation/Policy with least negative impact on competition?

5.7 The NBDTs believe that the CCCFA should have an objective of fair, efficient and transparent credit markets (mirroring the wording the FMCA) and a full review of the CCCFA be undertaken with that lens. We note the outgoing government had commenced a more limited review of the CCCFA and that the National Party had a review of the CCCFA as one of its policy positions.

5.8 As an interim measure:

(a) the responsible lending principles should be substantially simplified and returned at least to the pre 2021 principles – so that who can be lent to is less prescribed by government and NBDTs and others given more scope to lend to customers choked off from credit by the big banks. The Commerce Commission could rely more on the hardship provisions in the CCCFA to ensure that any change is not abused – and there is no evidence that has ever happened with NBDTs.

(b) The agreed variation rules could be replaced with request disclosure rules, so disclosure is only required if asked for.

(c) The consequences – especially the draconian "cost of borrowing" consequences for both initial and variation disclosure should be repealed now.

5.9 In addition, we propose that a financial threshold (for example $20,000) for when a loan is not required to comply with the CCCFA (or at least not required to comply with the Affordability and Suitability Requirements and Disclosure Requirements) be inserted into the CCCFA.

5.10 This solution means that consumers will retain the significant protections of the CCCFA regime when higher values of credit are involved, but that flexibility will be preserved when there are smaller value loans.

6. THE RELATIVE BURDEN AND BENEFIT OF THE REGULATORY FRAMEWORK IN GENERAL

What are the specific regulatory requirements that most affect your ability to compete to provide customers with personal banking services? How and why?

Non-Bank Deposit Takers Act 2013

6.1 While the NBDT Act in general has provided a reasonably proportionate approach to the burden prudential regulation, it does not provide for any of the benefits the banks get under the Banking (Prudential Supervision) Act 1989. In particular*:*

- Banks do not have to pay for regulatory supervision but NBDT's do because they have to pay statutory supervisors who effectively do the RBNZ supervision job for them.
- They cannot call themselves banks or what they do as banking – even though that is exactly what many NBDT's do – provide banking services to their customers and that is how their customers think of them.
- As explained above they do not get the liquidity support the banks get from the RBNZ.
- When relief was provided during COVID to banks it generally wasn't to NBDTs.

6.2 Issues such as credit ratings, legislative requirements that require things like bonds to be with banks but not NBDTs and differential risk weightings are dealt with below.

Credit Risk Weighting

6.3 There remains significant uncertainty about, in relation to the implementation of the DTA, what the credit risk weighting for different assets will be for NBDTs. Currently NBDTs are required to risk weight assets at higher levels than banks – which means that the cost of capital and liquidity for NBDTs is more expensive than it is for banks.

6.4 This adds significant costs to NBDTs, as they are required to hold more retained earnings (as this is 0% risk weighted) instead of investing this money, for example by increasing lending, in order to get a higher return on capital. Banks, as noted previously, can leave money in ESAS accounts which is risk weighted at 0% and receives a return on investment equal to the official cash rate.

Legislative Preference for registered banks

6.5 The recent enactment of the Construction Contracts (Retention Money) Amendment Act 2023 has highlighted the fact that there are numerous statutes that require money to be held with a registered bank, for example, retention money in relation to a construction contract is required to be held at a registered bank.[2] This specific requirement has had a direct impact on one NBDT because a

[2] Section 18E of the Construction Contracts (Retention Money) Amendment Act 2023.

construction company previously happy to deposit its retention money with that company no longer can.

6.6 Attached is a summary of all the legislation we have identified that has mandated the use of registered banks.

Credit Ratings

6.7 The use of credit ratings is mandated by section 23 of the Non-bank Deposit Takers Act 2013 unless the requirements in the Non-bank Deposit Takers (Credit Ratings Minimum Threshold) Exemption Notice 2016 are met, largely being that average consolidated liabilities of the NBDT are less than $40 million. That number has not changed in close to a decade and even though one NBDT has applied for the threshold to be increased it has taken the RBNZ months to consider it and it still has not responded. This is in spite of the fact that credit ratings are an anachronism relatively unique to New Zealand's prudential regulation and from an era when the RBNZ felt they could be used to reduce moral hazard and compensate for its lack of onsite supervision. That is no longer the case and credit ratings serve a very limited prudential purpose.

Anti-Money Laundering and Countering Financing of Terrorism Act 2009 (AML/CFT Act)

6.8 The customer due-diligence requirements, in sections 14, 18 and 22 of the AML/CFT Act, make it so that customers are unwilling to move between banking service providers. These sections create a high level of customer inertia, because (from a customer perspective) signing up to a new banking service provider is a significant administrative burden. As a result, the NBDTs ability to compete to attract customers already receiving personal banking services is significantly inhibited.

6.9 The costs that NBDTs incur in relation to suspicious activity reporting (under section 40) and auditing (under section 59(2)) are disproportionately high in comparison to banks.

6.10 For suspicious activity reporting, NBDTs do this manually by constant and continuous monitoring of customer accounts, whereas banks have automated processes which are comparatively cheaper on a customer-by-customer basis. For auditing, the costs faced by NBDTs (as charged by audit providers) are disproportionate to the costs faced by banks.

Conduct of Financial Institutions (COFI)

6.11 The NBDTs primary concern with the COFI regime is the fact it only applies to banks and NBDTs and that it covers not just deposit products but also lending products. COFI was applied to the NBDTs even though they were not subject to the investigation done by the RBNZ and FMA and no conduct issues were identified with them. Furthermore. as it applies to lending activities it means that most of the lenders who have conduct issues, being the wholesale funded finance companies (who will be well known to the Commerce Commission) are not even covered. This places the NBDTs in the worst of all worlds where they are regulated like banks, without the issues banks have had with conduct but without any of the benefits and exemptions provided to banks whereas some of their key competitors are not subject to a compliance burden in the one area they should be subject to one. This is particularly highlighted in the mortgage broker market where because of the

compliance issues imposed by COFI it will be much easier for brokers to deal with the unregulated finance companies.

6.12 In addition, the NBDTs are concerned about the sheer number of licenses and registrations which they are required to hold, and the cost of both applying for these and complying with the ongoing requirements. The licences/registrations which the average NBDT is required to hold are as follows:

(a) NBDT licence under the NBDT Act 2013 – with an associated burden with compliance with trust deeds that in many cases have not kept up with market trends.

(b) COFI market services licence under part 6 of the Financial Markets Conduct Act 2013.

(c) CCCFA fit and proper certification.

(d) Financial advice provider market services licence under part 6 of the Financial Markets Conduct Act 2013; and

(e) Registration on the financial service providers register as a financial service provider.

The cost of applying for and maintaining these licences and registrations adds significant compliance costs for little benefit.

Please describe the impact of each requirement identified in your response to question 1 on your ability to compete to provide personal banking services.

Non-bank Deposit Takers Act 2013

6.13 NBDTs being required to pay for direct supervision from trustees when banks are not required to pay for direct supervision from the RBNZ has the impact of further increasing the disparity between banks and NBDTs. Both NBDTs and banks are required to have direct supervision, yet only the NBDTs are required to pay for this and this amounts to a significant compliance cost for NBDTs.

6.14 The inability for NBDTs to call themselves banks leads to a public perception that NBDTs are not as safe as banks or are not prudential regulated, when this is untrue. NBDTs and banks provide the same personal banking services and yet only banks are able to call themselves a "bank". The NBDTs view this as a significant barrier to competition because of the public perception of the term "bank".

6.15 As previously indicated, the lack of liquidity support (and general relief) for NBDTs from the RBNZ results in significant costs that banks are not required to pay. NBDTs are presently unable to access RBNZ liquidity and are instead required to holds funds at registered banks, these funds have both a higher credit risk weighting, earn less return on investment and directly provide risk free investment for banks. The impact of this consistent level of non-support for NBDTs means that NBDTs are unable to effectively grow and are reliant on directly increasing bank profits.

Credit Risk Weightings

6.16 As NBDTs are required to risk weight their capital at higher rates than banks are (despite the underlying asset being identical), the impact is that NBDTs pay a higher "price" for their capital and are correspondingly required to hold higher amount of lower credit risk capital (i.e., holding funds as

retained earnings or depositing funds with a bank). NBDTs are again paying higher prices (and inflating profits for banks) for the same underlying asset in comparison to banks.

6.17 NBDTs as a result of having to commit higher amounts of capital to satisfy their regulatory capital requirements, have less cash on hand to engage in growth or technology upgrades.

Legislative preferences for banks

6.18 Certain Acts specifying that funds must be held with banks creates situations where NBDTs are unable to compete for certain customers. This situation has already arisen for one NBDT in relation to construction bonds. This is an express restriction on NBDTs ability to provide banking services in certain situations and means that there is zero possible competition in these scenarios for NBDTs.

Credit Ratings

6.19 The exception limit for credit ratings under the Non-bank Deposit Takers (Credit Ratings Minimum Threshold) Exemption Notice 2016 is no longer fit for purpose given the NBDTs have continued to grow since its commencement. As a result, more NBDTs have been required to hold credit ratings, which are expensive and require ongoing cost for credit rating agencies to maintain a rating. Separately, the holding of a credit rating does not improve the financial or prudential stability of NBDTs and largely serves no valuable purpose. The impact of this requirement is that NBDTs are required to pay for a service with no meaningful benefit.

Anti-Money Laundering and Countering Financing of Terrorism Act 2009

6.20 The impact of the cumbersome customer due-diligence requirements is that customers are unwilling to move between providers of personal banking services. This means that competition for customers who already receiving personal banking services is very minimal and as a result NBDTs who have significantly lower market share) struggle significantly to attract new customers and grow.

Conduct of Financial Institutions

6.21 The impact of COFI is that NBDTs are being held to the regulatory standard equivalent to banks despite a lack of the relevant conduct issues which COFI was enacted to address. As a result, NBDTs are required to incur significant compliance costs in order to comply with a regime which largely provides no benefit to their customers (as there were no conduct issues with NBDTs to begin with). Key competitors of NBDTs, wholesale funded finance companies, who may have conduct issues are not required to incur these costs. This means that the prices for NBDT product will comparatively become more expense (and less competitive) against wholesale funded finance companies, once COFI compliance costs are factored in.

6.22 Additionally, NBDTs will continue to incur higher compliance costs as a result of having to hold and comply with requirements for three different licenses and separate registration as a financial service provider. These compliance costs are significant and disproportionate for NBDTs (for example the financial advice licence and CoFI licence have the same flat licencing fee payable irrespective of size) and profit is impacted at a significantly higher scale than banks.

What specifically could be done in relation to each requirement identified in your response to question 1 to better achieve the purposes of the Act/Regulation/Policy with least negative impact on competition?

NBDT Act

6.23 Transitional changes could be made:

(a) enabling NBDTs that provide banking services to describe themselves as bankers.

(b) increasing the threshold for the requirement for a credit rating to $100 million.

(c) Adjusting the credit risk weightings for NBDTs to the same as the banks on the standardised capital regime.

(d) Requiring the RBNZ to absorb the costs of supervision provided by statutory supervisors until they take that role on themselves – which might also accelerate the transition to the Deposit Takers Act.

Legislative Preference

6.24 All references to registered banks should be deemed to included licenced NBDTs – perhaps by an amendment to the Interpretation Act.

Anti-Money Laundering and Countering Financing of Terrorism Act 2009

6.25 The NBDTs' view is that they should be able to rely on customer due diligence conducted by other parties, i.e., banks, rather than have to collect this information themselves. This would make it significantly easier for customers to move between personal banking service providers, as they would not have to go through a new AML/CFT process to do so. The result for competition is that customers will be more willing to change banking service providers incentivising a better product and making it possible to actively compete for customers.

Conduct of Financial Institutions

6.26 The easiest solution is to remove the requirement for a licence and reporting obligations to the FMA. This would cut down the compliance costs for NBDTs. The principles could remain and be applied not just to deposit takers but to all entities required to hold a licence under the FSPA., This would remove any regulatory arbitrage for the very parties most likely to take advantage of it to the disadvantage of consumers.

7. OVERLAPS IN SUPERVISION BY THE RBNZ, FMA AND COMMISSION

What are the specific regulatory requirements that most affect your ability to compete to provide customers with personal banking services? How and why?

7.1 The NBDTs are subject to supervision by three regulators which gives rise to significant inefficiencies. The resource required to manage this impacts our ability to grow and, at times, poses a risk to our viability. The NBDTs' have the following concerns as a result of the overlapping supervision by the RBNZ, FMA, Commission and others (including the trustees who directly supervise NBDTs):

(a) Under the NBDT Act the RBNZ's function is to be the "prudential regulator and licensing authority for NBDTs", however in reality the trustees (as statutory supervisors) take on the role of the day-to-day supervision of NBDTs. This creates situations, particularly in challenging times when an NBDT is facing financial difficulty, where NBDTs are required to provide information to, and actively deal with, both the RBNZ and the respective trustee. This leads to a duplication of supervision and reporting, which can be costly and time inefficient.

(b) The FMA is the regulator of COFI, however COFI contains a number of requirements in relation to lending and fair dealing which have traditionally fallen within the Commission's regulatory purview. The concern of the NBDTs is that this will lead to the situation where NBDTs are forced to balance the regulatory expectations of both the FMA and Commission in relation to the same business activities, and this will be particularly challenging and costly in the circumstance where these regulatory expectations are contradictory.

(c) The RBNZ has shown a tendency to factor and consider conduct issues in relation to its role of prudential decision making (for example in the development of the DCS and mutual capital instruments). Sometimes this may lead to options for NBDTs being eliminated before they even reach the conduct regulator who is better placed to consider the relevant issues.

(d) NBDTs' may be required to obtain consents from multiple persons, including the RBNZ and relevant Registrars (the Registrar of Building Societies etc.) in relation to changes in ownership, acquisitions and the appointment of new directors. This can lead to long period of time before consent is granted and significant delays for NBDTs which can impact their prudential management and financial stability.

(e) The Council of Financial Regulators (**COFR**) has been unsuccessful in co-ordinating the release of consultation papers. This year there have only been a handful of consultation papers which have been published on the same day. The NBDTs' concern is that they are consistently responding to consultation papers which appear to be uncoordinated and non-collective. The burden of engaging on these matters could quite easily be reduced.

(f) There are inconsistencies in AML reporting between the three AML supervisors (RBNZ, FMA and Department of Internal Affairs). Accordingly, NBDTs, who are supervised by the RBNZ, are on occasion required to comply with the AML/CFT Act (or required to satisfy the RBNZ's understanding of the AML/CFT Act) to a higher standard than entities who are supervised by either the FMA or DIA. This means that in certain circumstances entities such as wholesale funded finance companies that provide personal banking services are subject to lower level of compliance, whereas NBDTs are subject to the same level of compliance as banks (with no proportionate application).

(g) There are inconsistencies in the requirements for financial reporting between the RBNZ, FMA and the different registrars which the NBDTs are required to provide financial reports to (Registrar of Building Societies etc.). These inconsistencies are both in relation to timing and content, in particular financial statements may be required by different regulators quarterly, on a half year basis and on a full year basis depending on the requirement. This leads to situations where the NBDTs are expending significant amounts of time and effort to prepare

and lodge a variety of different financial statements, with a variety of different persons and different times and in different formats.

Please describe the impact of each requirement identified in your response to question 1 on your ability to compete to provide personal banking services.

7.2 Overall, the above concerns show that the NBDTs are, in multiple different areas, required double up on their compliance (leading to extra costs and time spent) and having to spend significant amount of extra time on consultations or reporting. The compliance burden has become so significant that it is impacting our ability to grow our businesses because so much time and resource is diverted to compliance and dealing with regulators. One of the NBDTs has previously noted that he receives two regulator emails for every one client email.

What specifically could be done in relation to each requirement identified in your response to question 1 to better achieve the purposes of the Act/Regulation/Policy with least negative impact on competition?

7.3 The NBDTs' solution to this problem would be to extend the mandate of the COFR to require the COFR to remove, to the extent possible, all regulatory overlap and ensure that there is alignment between all regulators on the regulatory purview for each regulator and on core topics such as consumer harm and enforcement.

Please let us know if you have any questions or require any further information.

Yours sincerely

Simon Jensen
Consultant

[redacted]