Hi there

At the Commission's consultation conference on Monday 13 May I made a point about banks being paid for risks that they are not taking.

I was using this as an example of how competition is not working in the NZ banking sector and consequently bank profits are higher than they should be. I also made a subsidiary point about how this effects equity and productivity in New Zealand. My conclusion is that competition is not working in large part because of RBNZ prudential management settings.

At the conference I used two examples of banks being paid for risks that they are not taking.

Relative risk and risk weightings

My analysis, based on New Zealand's large bank disclosure statements. suggests that compared to residential mortgage lending, corporate lending is about 190% more risky (measured by the net credit impairment charge), but the RBNZ's corporate risk weights are about 230% larger. Because pricing of lending is heavily influenced by risk weights that determine the amount of equity required for the loan the RBNZ is effectively causing the banks to overcharge.

The table below summarises the analysis. BNZ is not making disclosure statements that allow inclusion in the analysis.

$m		ANZ	ASB	BNZ	Westpac		Total		Multiple of Corporate Lending to RML
Total net credit impairment charge FY2008 to FY2022 $m									
Corporate Lending		1,391	515		1,018		2,924		188%
Residential Mortgage Lending		522	377		654		1,553		
IRB Exposure At Default (EAD) FY2008 to FY2022 $m (stock)									
Corporate Lending		710,858	320,323		408,478		1,439,659		
Residential Mortgage Lending		1,065,730	824,417		742,208		2,632,355		
Risk Weighted Exposure FY2008 to FY2022 $m (stock)									
Corporate Lending		418,356	204,927		247,000		870,283		
Residential Mortgage Lending		232,107	238,407		218,458		688,972		
RWE/EAD weighted average FY2008 to FY2022									
Corporate Lending		59%	64%		60%		60%		231%
Residential Mortgage Lending		22%	29%		29%		26%		

The analysis is replicable by the Commerce Commission, which could achieve a more focussed analysis by asking the large banks to provide private information that splits out the all-important SME business lending.

Housing cooperatives and community housing providers

New Zealand's internal-ratings based banks (ANZ, ASB, BNZ and Westpac) and Kiwibank are not treating lending to housing co-operatives (HC's) and community housing providers (CHP's) for ownership of their homes as residential mortgage lending. Instead, these banks are treating such lending for risk weighting purposes as specialised lending for income-producing real estate under the RBNZ's corporate lending category, using the supervisory slotting appraoch.

This means that HC and CHP borrowers, based on current RBNZ risk classifications and risk weights pay corporate lending rates for corporate loans that do not meet their requirements (term, amortisation profile, loan-to-value ratio, terms and conditions). HC's and CHP's cannot be appropriately and efficiently financed in New Zealand at the moment.

The impact on their total cost of capital of higher than necessary borrowing costs, higher equity requirements and periodic refinancing is in the order 100 to 150 basis points per annum, which translates to higher than necessary total cost of ownership of 15 to 20 percent. This is a an unjustifiable transfer to the banks.

I attach a detailed analysis of the problem which highlights the RBNZ's prudential management as the cause.

Regards

Andrew Body
[ ]