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30 May 2024

To
The Reserve Bank of New Zealand
Te Pūtea Matua
Wellington

From
Simon Jensen

Cross submission

on

The Reserve Bank of New Zealand's submission on
"Personal banking services market study: draft report"

This cross- submission is made in a personal capacity.

However, I acknowledge that my views are influenced by a number of non-bank deposit takers and fintech's whom I have supported from time to time.

Report Emphasis

1. While I agree it is important to adopt "a *holistic approach focussed on promoting an ecosystem that enables disruption through innovation*", it is fundamental to achieving this that the regulatory disadvantages that smaller banks and fintechs face are removed and historic inequities redressed.

2. I do not agree that this is implicitly subsidising the smaller banks, particularly when the larger banks have had a long-term implicit subsidy from perceived taxpayer support – not just in the eyes of their customers but also in the eyes of rating agencies.

3. In addition, the extensive regulatory burden on the financial sector gives the big banks an implicit scale advantage in their ability to absorb regulatory costs. I believe the focus of prudential regulation increasingly needs to be on how to help small banks succeed, rather than the historic focus on how to prevent them from failing. If this is implicitly subsidising the smaller banks, then this is a good thing both from a financial stability perspective (mitigating the concentration risk of the 4 big banks) and a competition perspective.

4. I also do not agree that the draft report should place more emphasis on matters such as open banking and account switching when, unless the existing regulatory barriers to competition are addressed, open banking and switching will only take place largely between the existing big banks. Open banking will undoubtedly aid innovation in payments, but on its own this is likely to have a limited impact on competition – that requires the holistic approach advocated by the Reserve Bank including changes in prudential regulation.

5. As the payment regulator, the Reserve Bank will have been aware of issues with account switching for some time. One of those issues is the fact that the Reserve Bank's restrictions on ESAS access

have made it harder for smaller institutions and new providers to compete with transaction accounts (there is currently limited competition benefit in switching between the big banks).

6. The Reserve Bank should also be well aware of the challenges to number portability with the current system. This is a "real' barrier to competition in transaction accounts. While proxy identifiers may be a partial answer to this – my understanding is they are likely years away.

7. While switching is relevant to improving competition in banking, it is important not to over-estimate that value before access to ESAS and proxy identifiers have been dealt with.

Balancing Financial Stability with other matters

8. It is reassuring to note the Reserve Bank's comments in its submission that:

> "*With that said, we recognise that financial stability is not an end in itself, but a means to supporting a productive and inclusive economy*."

9. However, it is not clear from its submission how

    - the Reserve Bank ensures that its financial stability goals do not adversely affect a productive and inclusive economy, nor
    - how and when it might make compromises on financial stability, where the benefits to a productive and inclusive economy outweigh the impact on financial stability.

    This is a key challenge for a regulator with such a dominant mandate. Pursuing its mandate might actually do more harm than good in a range of circumstances. It seems reasonably clear from the draft report that, in fact, the Reserve Bank's approach has compromised the competitiveness of the New Zealand market for personal banking services in favour of financial stability.

10. The Reserve Bank have openly acknowledged that it adopts a conservative approach to financial stability and that it is more conservative than its peer regulators. This should now be reviewed in light of the draft report.

Market Structure

11. The Reserve Bank's submission comments:

> "*Like many jurisdictions around the world, the New Zealand banking market is characterised by a small number of large banks commanding a high market share*"

12. The key questions is what level of concentration is acceptable. The Commerce Commission draft report states the big 4 banks in Australia have a 72% market share. In New Zealand the market share of the 4 big banks is 88%.

13. It seems hard to find any comparable market with that level of concentration – especially where all the large banks are all based offshore in the same country. That certainly does not appear to be the case in the markets we often look to – such as the United Kingdom, Canada, the United States and Singapore.

14. To my mind, New Zealand’s market structure indicates a market failure. New Zealand has had no new non-bank deposit takers since the regime was introduced and indeed with mergers (often forced by the prudential regulatory burden) now has substantially fewer non-bank deposit takers. The only banks to meaningfully enter the New Zealand market in the last decade are the Chinese

banks and they are constrained on the competition they can provide by the Reserve Bank's policy on branches of overseas banks.

Proportionality

15. The Reserve Bank's submission comments that:

> "*… associated Proportionality Framework is appropriately calibrated to enable taking competition into account, among its principles*."

16. However, the Reserve Bank's submission does not acknowledge that the Proportionality Framework was only included after lobbying by the non-bank deposit takers with the Finance and Expenditure Committee. The Proportionality Framework wouldn't exist otherwise and is not something that the Reserve Bank has historically considered (although there is evidence it is doing so now);

17. Furthermore, the statement seems at odds with what the Reserve Bank expressly stated at the Financial and Expenditure committee on 10 April 2024. In response to a question, the Reserve Bank said that competition was not a factor that it took into account when developing the Proportionality Framework – although it would when the specific policies were developed.

18. Indeed, much of the published material from the Reserve Bank relating to the Proportionality Framework talks about how an increase in regulation will be applied proportionally. It does not address the existing framework and the extent to which, for example, existing prudential requirements on tier 2 and tier 3 banks could be relaxed. In contrast, the Commerce Commission have identified competition problems created by the existing framework.

Consistency internationally

19. The Reserve Bank submission comments that:

> "*We must also be mindful that we operate in a global context with key prudential requirements based on international developed standards, with adherence to these standards enhancing international confidence in the New Zealand financial system*".

20. The Reserve Bank submission does not address the fact that the Financial Action Taskforce in 2017 was more concerned with the approach to supervision by the Reserve Bank than with the standards applying to banks in New Zealand. The FATF advocated a more conventional approach to prudential supervision (e.g through greater on-site supervision).

21. While the Reserve Bank appear to have taken this onboard, New Zealand still has a number of key prudential policies that are outliers with no international equivalent.

For example:

- the level of capital required in New Zealand for banks in New Zealand is significantly higher when compared to other international banks. We operate on a 1- 200 year failure tolerance as opposed to the 1-100 year failure tolerance I understand is accepted by most if not all other developed countries;
- the nature of instruments that will be accepted as alternative tier 1 capital in New Zealand is more limited than is the case internationally- with no particular reason why they would not be just as effective in New Zealand

- the treatment of risk weights for various alternative and community housing tenures inconsistent with Basel 3.

22. We also have unique policies which create significant regulatory burden without international precedent such as:

    - the outsourcing policy;
    - open bank resolution;
    - the branch policy (and particularly the one to one rule applying to the Chinese banks);
    - the attitude to the use of the word bank by those providing banking services who are not registered banks – where the approach in New Zealand is more conservative than Australia and the United Kingdom, for example; and
    - The lack of a separate regime for payment service providers.

Risk Weights and Capital

23. While it seems clear that the competition impact of the difference between the IRB and standardised approaches to capital has narrowed in respect of banks, this is not the case in relation to non-bank deposit takers. It is disappointing that this has not been acknowledged in the Reserve Bank submission. The Reserve Bank's recent policy consultation on core standards identifies the fact that a change even to the standardised risk weights will, for non-bank deposit takers, likely result in them having a between 10 and 30% uplift in their regulatory capital ratios.

24. It is axiomatic that the current risk weights have put non-bank deposit takers at a disadvantage, even relative to the tier 2 banks on a standardised approach to capital. Even worse in some cases the particularly onerous requirement to risk weight other assets at 350% of the value has at times put non-bank deposit takers unnecessarily at risk of breaching capital ratios.

25. This has been, particularly, the case in relation to the capitalisation of technology. There is no question that in one case this will have a material impact on financial inclusion and could potentially have been avoided.

26. Furthermore, there is evidence that some risk weights, such as those for business lending and alternative housing structures are wrong. It is perhaps hardly surprising then that lack of capital and funding are problems in both cases and this is impacting productivity and closing off innovation in housing that could help address New Zealand's housing problems.

Other Comments

27. The Reserve Bank submission addresses:

    - **mutual capital instruments**. These are important because they can make a difference to the prudential soundness for mutual institutions. For this reason it is disappointing that it took at least six years to develop them even though they largely replicate what was approved in the United Kingdom over a decade ago. It is likely this delay has negatively impacted access to capital and credit ratings for some institutions and therefore competition in New Zealand;
    - **Exchange Settlement Accounts** – The Reserve Bank talk about broadening access to these accounts and introducing new policy later this year. Unfortunately, it has taken the Reserve

Bank seven years (and counting) to develop a policy. Developing a policy is not hard – the only substantive issue is in relation to managing anti-money laundering obligations of participants (which if they are banks and non-bank deposit takers, the Reserve Bank has control over because it is the regulator). In my view the delays in coming up with a policy have both:

- been a factor in the lack of a fintech market in New Zealand; and
- significantly prejudiced non-bank deposit takers who haven't had the same ability to place liquidity at the Reserve Bank on-call at overnight cash rates with a zero rated (for capital purposes) institution – unlike the large banks.

Yours faithfully,

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Simon Jensen

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