PositiveMoneyNZ

Submission to Commerce Commission

Response to Draft Report, Personal banking services market study

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Please note that our submission responses relate to the questions and numbering system from Commission's online survey form.

Introduction

1. Positive Money welcomes the Commission's inquiry, especially its focus on retail banking.
2. The main point we would like to make is that the answer to competition in this market is more banks, not bigger banks and this should inform the role that Kiwibank might play.
3. Like the Commission, we believe Kiwibank has a central role to play. But that role is not to scale up and compete on a "business as usual" basis so that it can join the

ranks of the biggest banks. This is unlikely to lead to long term competitive pressure. It will simply mean that five banks share 90 per cent of the market instead of four.

4. Kiwibank will be most effective as a disruptor if it is used to support small banks and new entrants with services and regulatory support to address the scale, technology and entry barriers they face. See in particular our response to Recommendation #2.
5. There is also a significant role for the Reserve Bank to play. Its legislative mandates, their interpretation and implementation have contributed to weak market competition and will continue to work against competition if they are not addressed.

Responses to survey form questions

Response to Q1: *Nature of competition*

Do you agree with our preliminary findings on the nature of competition?

Our preliminary findings include that New Zealand's four largest banks – ANZ, ASB, BNZ and Westpac – do not face strong competition when providing personal banking services, and that competition between them is sporadic rather than strong and sustained. Kiwibank imposes some constraint on the four largest banks but currently lacks the capital backing to consistently drive stronger competition in the market, and other smaller providers have not been able to exert any meaningful constraint on the four largest banks.

6. We AGREE.

Response to Q2: *Factors affecting competition*

Do you agree with our preliminary findings on the factors affecting competition?

Our preliminary findings include that there are four main factors limiting competition for personal banking services: structural advantages of the four largest banks over the smaller providers (particularly their scale, scope and funding cost advantages); regulatory barriers to entry and expansion (particularly bank prudential capital requirements); barriers to consumer switching and engagement; and impediments to innovation by fintechs (particularly delays to open banking).

7. We AGREE.

Responses to Q3: *Draft recommendations*

Response to Recommendation #1: Reserve Bank prudential capital settings

The Reserve Bank should review its prudential capital settings to ensure they are competitively neutral and smaller players are better able to compete

8. We SUPPORT a review of the Reserve Bank's prudential capital settings.

9. We DO NOT SUPPORT competitive neutrality. Instead, for a period of time settings are needed that actively favour small banks and new entrants.
10. In the short to medium term, smaller players should be given a capital advantage over the domestic systematically important banks (**D-SIB**s) – the 'oligopoly' identified in the *Draft Report* – reversing the current situation where D-SIBs aregiven a capital advantage over smaller banks.
11. Competitive neutrality of capital settings will not contribute adequately to competition in a market where the D-SIBs' oligopoly is supported by a suite of competitive advantages.
12. Capital ratios have been identified by potential challenger banks as one of the most important issues (e.g. *Draft Report*, 10.15), so switching the capital advantage from large to small banks will have a big impact on improving competition.
13. A period of pro-competitive capital regulation is both justified and necessary. Regulation can move to competitive neutrality once effective banking market competition is restored.

Response to Recommendation #2: Kiwibank as a disruptive competitor

Kiwibank's owner should consider what is necessary to make it a disruptive competitor, including how to provide it with access to more capital

14. We SUPPORT Kiwibank's role as a disruptive competitor but we believe the best way to achieve this is for Kiwibank to support the emergence of new challenger banks, both branch-based and digital, rather than being the challenger bank itself.
15. For **sustainable** competition, we need more banks, not bigger banks. A vibrant small-bank and fintech sector will collectively make a bigger dent on the oligolpoly's total market share and are more likely to deliver ongoing competitive pressure.
16. The biggest risk with using Kiwibank to challenge the oligopoly head-on is not that it would fail, but that it would succeed and join the comfortable "business as usual" ranks of the oligopoly. We will simply end up with five big banks sharing 90 per cent of the market instead of four.
17. We propose that Kiwibank become the disruptor by establishing a 'banking services hub' to help small banks and new entrants overcome scale disadvantages and entry barriers.
18. This should include setting up a dedicated unit to operate as a Banking as a Service (BaaS) provider.
19. By making it easier for banks to start and operate profitably, and safer for their customers through best-practice support, it should encourage iwi, regional groups, corporates, global fintechs and local startups to offer banking services.
20. As a BaaS, it can partner on commercial terms with small banks and new entrants, both digital and branch-based. As suggested in the *Draft Report* (paragraphs 10.14, 10.15, emphasis ours):

> *"Given the limited prospect of new entrants from offshore into personal banking at scale,* ***the best prospect for more competition in the near term is one or more of the smaller banks or non-banks acting as a disrupter*** *by seeking to grow rapidly. Most of the smaller providers we've heard from are capital constrained due to their ownership structure. Many stakeholders*

have told us that regulatory capital requirements are the single biggest factor affecting expansion by smaller banks and NBDTs in personal banking. For those providers to grow rapidly they may need to review their legal and ownership structures or ***consider other ways to reduce scale disadvantage, such as shared services*** *or consolidation."*

21. Kiwibank with the addition of such a unit could support most or all of the areas identified in the *Draft Report* as barriers to entry and growth. For example:
    a. Opening and maintaining a business bank account
    b. Deposit accounts – holding deposits for fintech partners
    c. Technology provision – back office, API support, retail apps
    d. Regulatory support
    e. Agency arrangements for banking products
22. The investment required by Kiwibank's owners to pursue this strategy will be much less than the cost of capital and resources that would be needed to take on the oligopoly head-on.
23. By encouraging new entrants into the market, Kiwibank's move will indirectly expand the total new capital available to take market share from the oligopoly.
24. There is plenty of room for growth in the number and variety of banks and banking service providers. The US has one bank for every 70,000 people, Germany one for every 45,000, but New Zealand has one for every 567,000. New Zealand has strong regulation and no small bank has ever failed here.
25. A strategy to expand the number of banks will also deliver wider economic, regional and customer benefits, and a greater chance that there will be a permanent increase in market competitiveness.
26. One further benefit – it could **help with the successful establishment of retail Central Bank Digital Currency (CBDC)** by providing expanded public channels to market for the Reserve Bank's proposed retail CBDC product.
27. There are critical currency sovereignty issues that will be challenged as a retail CBDC is introduced. A strong retail distribution option that is independent of the big four banks can serve to reduce their negotiating leverage when a retail CBDC is introduced.

Response to Recommendation #3: Deadlines for open banking

The Government should set clear deadlines and work with industry to ensure open banking is fully operational by June 2026

28. As we have noted in our response to question 2, we believe that early, easy and widespread access to open banking is essential to the emergence of effective and sustainable competition.
29. We have noted the key role that we believe Kiwibank should play as a public entity with a public good (as opposed to shareholder value) mandate. Kiwibank's disruptor strategy should be evaluated on the basis of benefits that will accrue to the wider economy rather than to Kiwibank itself.
30. Open banking essentially deals with the digital infrastructure of all future banking, including the introduction of a retail CBDC to eventually replace physical cash as the anchor of our sovereign currency. There is a strong case for investment in some

critical parts of the infrastructure to be in public hands, at least in the short to medium term, to support the successful introduction of digital public money (a retail CBDC).

31. To support these wider economic and monetary goals, we believe it is essential that Kiwibank remains in 100 per cent public ownership during this technology and competition-driven market transition phase.

Response to Recommendation #7: ESAS account access

The Reserve Bank should consider broadening access to Exchange Settlement Account System (ESAS) accounts. (ESAS is the system for the processing and settling of payments between banks and other financial institutions.)

32. We AGREE. This is essential for the growth of a diverse range of banking services and competition.
33. Its effectiveness can be seen from the Bank of England's experience opening up its settlement system with its support for the development of a wide range of bank and payment services.
34. Another benefit will be in levelling the playing field between ESAS and non-ESAS banks by allowing smaller banks to hold funds in OCR interest-bearing ESAS accounts.

Response to Recommendation #8: Amendments to the DT Act

The Government should amend the DT Act to allow the Reserve Bank to promote competition, rather than maintain competition

35. We AGREE. As noted in our response to Recommendation #1 above, legislative change should support providing insurance coverage that is **more favourable** to smaller banks (and possibly NBDTs) relative to the D-SIB banks.
36. This is justified in order to partially offset the public's perception of greater risk when their money is held with smaller institutions. This perception of risk arises in significant part from the perceived "Government guarantee" that comes with these "too-big-to-fail" D-SIBs. This perception is confirmed by the Reserve Bank's own D-SIB classification. An insurance advantage for smaller banks can help to offset this market distortion. It is further justified because actual historical evidence shows that our well-regulated and managed small banks have been 100% safe.

Response to Recommendation #9: Competitive neutrality

The Government and policy makers should seek competitive neutrality across banks and other providers in their decision-making wherever possible

37. We DISAGREE in the short to medium term, but AGREE in the longer term.
38. In the short-to-medium term, the playing field should be selectively tilted in favour of smaller banks, e.g. through more favourable capital treatment to assist them to expand and compete on price; and DTA rules that provide higher deposit insurance cover (and lower relative insurance costs) for small banks to help offset the D-SIBs' perceived "Government guarantee" and scale advantages.

Response to Q4: *Recommendations most likely to improve competition*

Which of the draft recommendations do you think is most likely to improve competition for personal banking services? Why or why not?

39. Recommendation #2, **provided that** it is applied to Kiwibank as a disruptor through its support of new entrants and small banks, rather than Kiwibank as a "business as usual" competitor seeking to achieve scale advantage in its own right.
40. See our response to Recommendation #2 above.

Response to Q5: *Recommendations least likely to improve competition*

Which of the draft recommendations do you think is least likely to improve competition for personal banking services, and why?

41. Recommendation #2, if Kiwibank is capitalised to become a "business as usual" competitor seeking to achieve competition through scale advantage in its own right.
42. This will be a wasted opportunity and is most likely to lead to a comfortable oligoploly of five rather than four banks holding 90 per cent of the market, especially if Kiwibank's capital increase comes from a partial public listing and its mandate shifts from public interest to shareholder value.

Response to Q7: Recommendations that may not have been considered

What recommendations would you add that we may not have considered?

43. We believe that the Commission should consider the **separation of retail banking from other activities in our "too-big-to-fail" (D-SIB) banks**. They should be separated to service two distinct markets with different needs:
    a. **Retail banking**—for consumers and small businesses, offering payment services, savings, mortgages and small business banking – the subject of this market study
    b. **Corporate and wholesale banking** for corporations, institutions and investors with more sophisticated needs – most of the areas that fall outside this market study
44. These two distinct areas of banking can be separately regulated in ways suited to each sector's needs, competitive environment and with a banking culture to match.
45. A range of approaches can be considered, from operational separation to breakups.
46. The clearer distinction between the different types of banking will further encourage retail competition by improving the regulatory environment and reducing the scale advantages of the D-SIBs.

47. This is likely to strengthen the banking system by replacing a handful of too-big-to-fail banks with smaller banks whose primary domestic retail deposit-taking activities operate in a lower risk environment.
48. At the same time, it can potentially improve economic efficiency by sharpening corporate focus and reducing regulations that impede business investment.
49. There are precedents for this approach. In the UK, which has a highly-concentrated banking market like ours, the Bank of England has required the big banks to separate retail operations from their other banking through a process it calls ring-fencing. This is an operational separation rather than a full breakup but can provide a foundation for separate regulatory treatment.
50. In New Zealand, there are precedents. Our dominant telecommunications provider, Telecom, was broken up into a wholesale operation, Chorus, and a retail business, Spark, leading to greater competition and improved services.
51. The Commission's own recent inquiry into supermarkets included breakup options among its considerations, including possible separation of wholesale and retail operations to support a more competitive market.
52. We believe the lack of consideration of separation is a notable absence which the Commission should remedy in its final report.

About Positive Money NZ, Inc

Positive Money NZ is an independent, non-profit group. For more than a decade, we have advocated for a fairer, more productive monetary system that benefits everyone, not just a few. Our patron is Bryan Gould and we are part of a global movement of organisations campaigning to change money and banking so they serve society better.