ISBN no. 978-1-991287-00-7
Project no. 21.01/ PRJ0046760

Public version

Personal banking services market study

Draft report

Date: 21 March 2024

Karakia

Tuia ki runga
Tuia ki raro
Tuia ki roto
Tuia ki waho

Tūturu o whiti

Whakamaua kia tina. Tina!

Haumi e, hui e

Taiki e!

In connecting to all elements that provide for the well-being of the person, this karakia is responsive to te taha pūtea (the banking system) and the importance of how personal banking contributes to the well-being of the person, the whānau and wider groupings.

Ngā Ihirangi

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Glossary | *Kuputaka*

ACCC	Australian Competition and Consumer Commission.
AML/CFT Act	Anti-Money Laundering and Countering Financing of Terrorism Act 2009.
ANZ	ANZ Bank New Zealand Limited (a New Zealand registered bank), owned by Australia and New Zealand Banking Group Limited.
API	Application Programming Interface. An API is a set of routines, protocols, and tools for building software applications and specifying how software components should interact.
API Centre	Established by Payments NZ, the API Centre develops, maintains and publishes API Standards, and governs their use by registered API providers and third parties.
ASB	ASB Bank Limited (a New Zealand registered bank), owned by Commonwealth Bank of Australia Limited.
ATM	Automated Teller Machines.
Banking services	Includes personal banking services, corporate, institutional, commercial, agricultural and small to medium enterprise (SME) banking services.
Banks	Entities registered with Reserve Bank as operating a bank. Banks are either incorporated in New Zealand, or operating as branches of overseas incorporated banks.
BNZ	Bank of New Zealand (a New Zeasland registered bank), owned by National Australia Bank Limited.
Cashback	A form of incentive offered to buyers of certain products whereby they receive a cash refund after making their purchase. Providers may offer a flat dollar amount cashback or a percentage cashback when someone takes out a mortgage (eg, 1% cashback on a home loan of $250,000 or more).
CASS	The Current Account Switch Service in the United Kingdom.
CCCF Act	Credit Contracts and Consumer Finance Act 2003.
CDR	Consumer Data Right, to be enacted under the Consumer and Product Data Bill.
CET1	Common Equity Tier 1 capital (CET1) is the highest quality form of capital and must provide a permanent and unrestricted commitment of funds, must be freely available to absorb losses, and must not

	impose any unavoidable servicing charge against earnings. Among other things, it is comprised of paid-up ordinary shares and retained earnings.
Clawback	The act of retrieving money already paid out. For example, a cashback can be taken back by the bank if the customer refinances a mortgage to a competitor within a contracted period (commonly three years).
CoFR	Council of Financial Regulators, Kaunihera Kaiwhakarite Ahumoni, made up of the Reserve Bank, FMA, Commerce Commission, MBIE, and the Treasury.
DCS	Depositor Compensation Scheme.
Deposit	Money deposited in a bank account.
Deposit account	Includes transaction, savings, and term deposit accounts, as well as any associated overdraft facilities (ie, a line of credit, whether arranged or unarranged, that allows the account balance to go below zero to cover transactions). Some deposit accounts are also sometimes referred to as current accounts.
D-SIB	Domestic systematically important bank.
DT Act	Deposit Takers Act 2023.
Easy Switch	A switching service for transaction accounts based on industry standards and protocols set by Payments NZ.
ESAS	Exchange settlement account system, operated and maintained by the Reserve Bank.
Fintech	A firm that uses digital information and automation technology in providing innovative financial services.
FMA	Financial Markets Authority, Te Mana Tātai Hokohoko.
Home loan	A loan made by a bank (or other lender) to a property owner (for example, to enable the owner to buy the property, to buy land for the construction of a new house, or to renovate an existing house). Home loans are almost always secured through a mortgage over the property, and the terms “home loan” and “mortgage” are sometimes used interchangeably. See definition of “residential mortgage”.
Interest	A payment from a borrower or deposit-taking institution to a lender or depositor, that is not the repayment of the principal sum, calculated as a percentage rate. It is distinct from a fee which the borrower may pay the lender.
Kiwibank	Kiwibank Limited (a New Zealand registered bank), a subsidiary of Kiwi Group Capital Limited which is owned by the New Zealand Government.

Loan-to-value ratio (LVR)	The loan amount divided by the value of the asset or collateral being borrowed against. In the case of a mortgage, this would be the mortgage amount divided by the property's value.
Major banks	ANZ, ASB, BNZ and Westpac.
MBIE	Ministry of Business, Innovation & Employment, Hīkina Whakatutuki.
Mortgage advisor	A person or company that can act on behalf of the borrower in arranging a home loan (typically secured by a mortgage) from a bank or other lender. A mortgage advisor (also known as a mortgage broker) may facilitate access to a range of home loan products from different lenders.
NBDT	Non-bank deposit-taker. A business, other than a registered bank, that makes an NBDT-regulated offer of debt securities and carries on the business of borrowing and lending money or providing financial services (or both). NBDTs include finance companies that raise funds from the public, as well as most building societies and credit unions.
NIM	Net interest margin.
Non-bank providers	Non-bank providers of personal banking services, including NBDTs (such as credit unions and building societies), other finance companies (including peer-to-peer lenders) and fintechs.
NZBA	New Zealand Banking Association.
OCR	Official cash rate. The OCR is the overnight interest rate set by the Reserve Bank.
Payments NZ	Payments NZ Limited, which has as its objectives to govern and manage payment system rules and standards as well as to promote interoperable, innovative, safe, open, and efficient payments systems. Payments NZ is owned by eight banks, including the four major banks.
Personal banking services	A subset of banking services, personal banking services are banking services ordinarily acquired for personal, domestic, or household use.
Profitability	Measures a firm's profit performance as a ratio rather than in dollars, often to account for scale.
Providers	Suppliers of personal banking services in New Zealand, including major banks, smaller banks and non-bank providers.
Reserve Bank	Reserve Bank of New Zealand, Te Pūtea Matua.
Residential mortgage	A legal instrument registered on a residential property's title in order to secure the payment of a loan made by a bank (or other lender) to the property owner (for example, to enable the owner to buy the property, to buy land for the construction of a new house, or to

	renovate an existing house). A mortgage allows the lender to sell the property as a last resort if the borrower is unable to pay back the loan. A mortgage registered on the title is separate to the underlying loan agreement. If the loan is paid back, the property owner can apply to the lender (usually through a lawyer) for removal of the lender's mortgage from the title. Lenders often refer to a loan related to residential properties as a "home loan" and the terms "home loan" and "mortgage" are sometimes used interchangeably.
Retained earnings	The cumulative net profits of a company after accounting for dividend payments.
ROA	Return on assets.
ROE	Return on equity.
Servicing sensitivity rate (SSR)	The interest rate a bank uses during a mortgage application to test whether borrowers will be able to continue making loan repayments if interest rates rise significantly. The purpose is to take into account that interest rates can move over the term of a loan.
Smaller banks	Registered banks other than the major banks and Kiwibank. For example, this includes Co-operative Bank, Heartland Bank, SBS, and TSB.
Smaller providers	Smaller banks and non-bank providers.
Westpac	Westpac New Zealand Limited (a New Zealand registered bank), owned by Westpac Banking Corporation.
Whenua Māori	Types of whenua Māori (Māori land) are Māori freehold land, Māori customary land and general land privately owned by Māori. In this paper we largely refer to Māori freehold land. This is land where Māori customary interests have been converted to freehold title by the Māori Land Court or its predecessors by a freehold order.

Chapter 1 Introduction and purpose | *Whakatakinga me te koronga*

Summary of preliminary findings

- **This draft report contains our preliminary findings regarding factors that, in our view, are affecting competition in personal banking and outlines options for recommendations to improve competition.** The aim of a market study is to promote competition for the long-term benefit of consumers in New Zealand.
- **We must carry out this study in accordance with the terms of reference issued by the Minister.** We may also consider any ancillary matters that are related to, but not explicitly covered by, the terms of reference.
- **We have focused on deposit accounts and home loans because they are focal points for competition in personal banking services and because they matter to many New Zealanders.** We have, however, considered a wider range of personal banking services in some aspects of our analysis.
- This market study is the first opportunity to consider and evaluate in-depth whether competition in personal banking is promoting outcomes that benefit New Zealand consumers over the long-term.
- **Over 20 years on from the last merger where we considered competition in the banking sector (the ANZ/National Bank merger), we observe a different competitive dynamic.** None of the major banks appears currently to be acting as a disruptor in a sustained way.
- **While our focus is on competition, we are conscious that there are other important policy objectives in a well-functioning banking system.** For example, in some cases trade-offs may need to be made between competition, financial stability and consumer protection. However, financial stability and competition are not necessarily opposed, and we have not found compelling evidence of greater competition negatively affecting financial stability.
- **We have not undertaken cost-benefit analysis when developing our draft recommendations.** Formal cost-benefit analysis falls outside the scope of our study. Policy makers may undertake that analysis while developing, or giving effect to, any of our final recommendations the Government wishes to take forward.
- **We invite market participants and interested parties, including members of the public, to comment on the preliminary findings and draft recommendations in this draft report.**

Purpose | *Koronga*

1.1 We are undertaking a study into factors that may affect competition for the supply or acquisition of personal banking services (the study). This is our draft report for the study.

1.2 This draft report contains our preliminary findings regarding factors that, in our view, are affecting competition in personal banking and outlines options for recommendations to improve competition. The aim of a market study is to promote competition for the long-term benefit of consumers in New Zealand.

1.3 We invite comments on our preliminary findings and draft recommendations from market participants and interested parties, including members of the public. We are required to make our final report for the Minister of Commerce and Consumer Affairs (the Minister) publicly available by 20 August 2024.

1.4 This chapter describes the focus of the study, the structure of this draft report, our process so far, and next steps (including how you can have your say).

Scope of the study and our focus areas | *Te whānuitanga o te rangahau me ngā aronga ake*

The Minister issued terms of reference for a competition study into personal banking services

1.5 On 20 June 2023, the Hon Dr Duncan Webb, the then Minister, published a notice under section 51(1) of the Commerce Act 1986 (the Commerce Act) requiring us to undertake a competition study into any factors that may affect competition for personal banking services.

1.6 We must carry out this study in accordance with the terms of reference issued by the Minister. However, we may also consider any ancillary matters that are related to, but not explicitly covered by, the terms of reference.[1]

[1] Section 51A(4)(b) of the Commerce Act.

1.7 These are the terms of reference for this study:[2]

Notice for Commerce Commission Competition Study into Personal Banking Services

I, the Honourable Dr Duncan Webb, Minister of Commerce and Consumer Affairs, pursuant to section 51 of Part 3A of the Commerce Act 1986, require the Commerce Commission to carry out a competition study into any factors that may affect competition for the supply or acquisition of personal banking services. For the purposes of this study, personal banking services are banking services ordinarily acquired for personal, domestic, or household use.

Matters to be considered in the study may include, but are not restricted to:

- The structure of the industry and the nature of competition.
- The conditions for entry by potential competitors and the conditions for expansion.
- Any barriers to consumers comparing bank offers or switching banks, including the extent to which products or services may be tied or bundled.
- Any impediments to new or innovative banking products or services.
- Comparative indicators of bank financial performance (including profitability).

Should the Commission be of the view that one or more matters listed above, or any additional matters not listed, are likely to provide special insight into competition for the supply and acquisition of personal banking services then the Commission may focus on those aspects.

The Commerce Commission should make its report publicly available by **20 August 2024**.

Consistent with previous market studies, I expect the Commission will produce a Preliminary Issues paper into the sector by the end of August 2023.

1.8 The Minister considered it in the public interest to require a study into personal banking services because:[3]

1.8.1 there are existing indications of possible competition problems in the market (such as high prices, low levels of innovation, low levels of service, and/or a lack of dynamism between market participants);

1.8.2 the market is of strategic importance to the New Zealand economy or businesses, or of significant importance to consumers;

1.8.3 it is likely that there will be viable solutions to any issues that are found; and

2 "Notice for Commerce Commission Competition Study into Personal Banking Services" (20 June 2023) *New Zealand Gazette* No 2023-go2632, available at: https://gazette.govt.nz/notice/id/2023-go2632.

3 MBIE "Cabinet Paper – Initiating a Market Study into Personal Banking Services" (28 June 2023), available at: www.mbie.govt.nz/dmsdocument/26848-initiating-a-market-study-into-personal-banking-services-proactiverelease-pdf.

1.8.4 a formal study by the Commission would add value above work that could be done by other agencies.

We have focused on deposit accounts and home loans

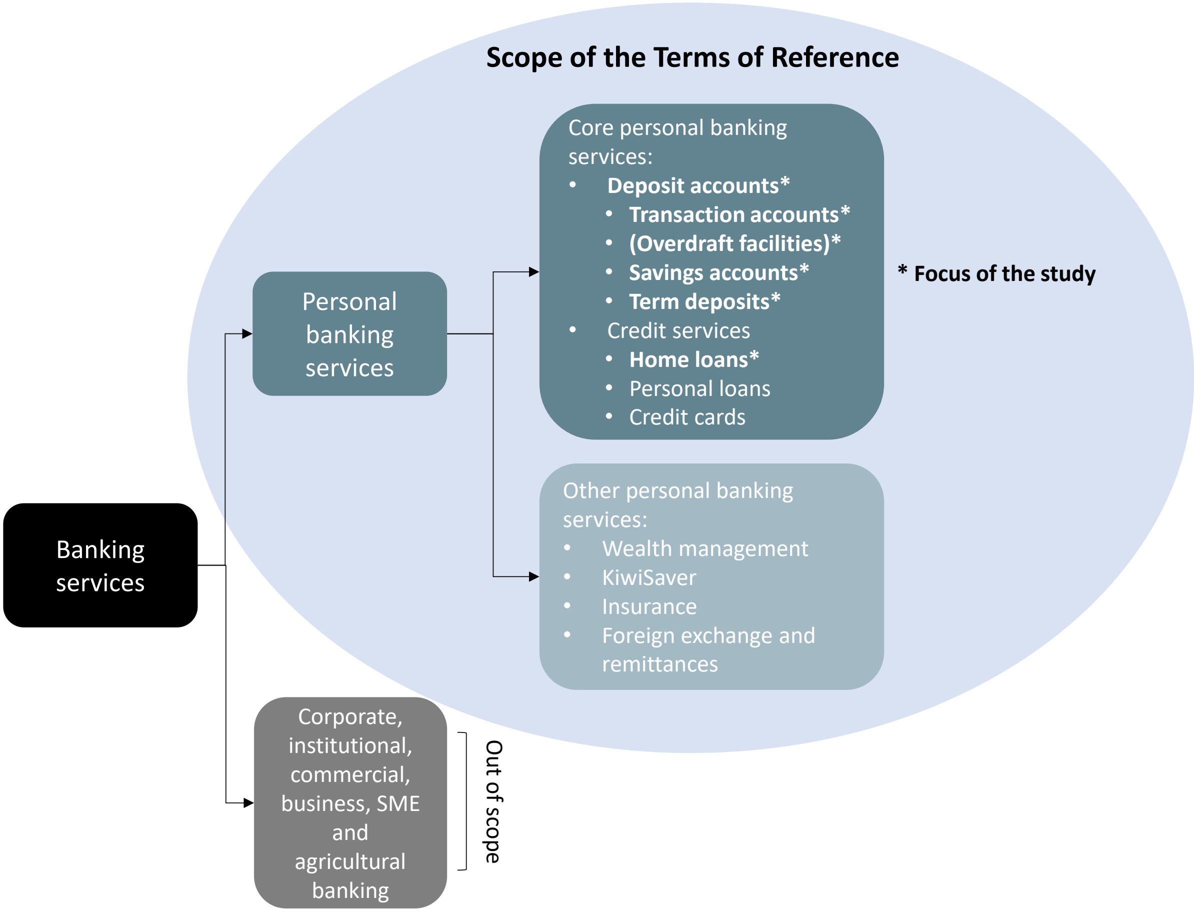
1.9 Personal banking covers a range of services, including deposit accounts, credit cards, personal loans, home loans, international money transfers, and KiwiSaver. Corporate and institutional banking, commercial banking, business, and agricultural banking services are not within the scope of this study.

1.10 We have discretion to focus the study on particular services. As summarised in Figure 1.1 below, we have focused on:

1.10.1 deposit accounts, being transaction, savings, and term deposit accounts (including overdraft facilities); and

1.10.2 home loans.

Figure 1.1 Focus of the study



1.11 In keeping with the Minister's intent we have mainly focused on core personal banking services and, within that set, on deposit accounts and home loans.[4]

1.12 In identifying the focus of the study, we considered how best to promote the long-term benefit of consumers and what is in the public interest (including how these concepts were articulated in the Cabinet Paper).[5,6,7] We have focused on deposit accounts and home loans because they are focal points for competition in personal banking services and because they matter to many New Zealanders.

1.13 The result of this approach is that we have not focused on some services often associated with personal banking.[8] We have, however, considered a wider range of personal banking services in some aspects of our analysis.[9]

1.14 We sought feedback on our proposed focus within the scope of the study.[10] Feedback received was largely supportive of the focus on home loans and deposit accounts.

We have not materially expanded the focus of the study

1.15 While we received several submissions suggesting that we expand the study to cover business or rural business banking, those services are not within the scope of the terms of reference.[11]

1.16 The distinction between personal banking and business or rural business banking is not always clear cut (for example, where a family home may be used as security for a business loan). Where these services are intertwined, recommendations we make with respect to personal banking services might also benefit business banking and rural business banking consumers, even though those segments of banking are not the focus of this study.

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4 MBIE "Cabinet Paper – Initiating a Market Study into Personal Banking Services" (28 June 2023), at para 24, available at: https://www.mbie.govt.nz/dmsdocument/26848-initiating-a-market-study-into-personal-banking-services-proactiverelease-pdf.

5 Commerce Act 1986, s 1A.

6 The Commission can undertake a market study if either the Minister or Commission consider it to be in the public interest, Commerce Act 1986, ss 50 and 51.

7 MBIE "Cabinet Paper – Initiating a Market Study into Personal Banking Services" (28 June 2023), at para 16, available at: https://www.mbie.govt.nz/dmsdocument/26848-initiating-a-market-study-into-personal-banking-services-proactiverelease-pdf.

8 For example, credit cards, Kiwisaver, wealth management and financial advice.

9 For example, we have taken a high level view of firms' activities across a broad range of services when seeking to understand bank financial performance.

10 We sought feedback via the Preliminary Issues paper, discussed in paragraphs 1.48 to 1.49 below.

11 First Union "Submission on Market study into personal banking services - Preliminary Issues paper" (7 September 2023), at p. 3; Federated Farmers of NZ "Submission on Market study into personal banking services - Preliminary Issues paper" (7 September 2023), at paras 4.4-4.7, and Habilis Ltd NZ "Cross submission on Market study into personal banking services - Preliminary Issues paper" (5 October 2023), at p. 9.

1.17 We also received submissions suggesting that we expand our focus to examine other types of credit (such as credit cards and personal loans), and remittances, international payments, and foreign exchange.[12]

1.18 We undertook desktop research in relation to international money transfers. That preliminary work, discussed in Attachment E, suggests possible useful lines of enquiry for further study or analysis as it does seem to us that there is room to improve competition for these services.[13]

1.19 We decided against focusing on other types of credit, such as personal loans and credit cards, because supply of these services is less concentrated, and they are not as important to understanding the competitive dynamic of personal banking services as home loans and deposit accounts are. Studying these services would also take away from resources available to study home loans and deposit accounts.

Providers of personal banking services in New Zealand | *Ngā kaituku ratonga pēke whaiaro i Aotearoa*

1.20 There is a range of providers of personal banking services in New Zealand, including:

1.20.1 registered banks; and

1.20.2 non-bank providers, including non-bank deposit takers (NBDTs), financial technology companies (fintechs), finance companies, peer-to-peer lenders, and other providers of different types of credit.

1.21 These providers are briefly described below, as they are referred to throughout this draft report.

Registered banks are the main providers of personal banking services

1.22 There are currently 27 registered banks operating in New Zealand, though only 17 of these are unique banks that offer personal banking services.[14] Registered banks are the primary providers of personal banking services in New Zealand.[15]

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12 Consumer NZ "Submission on Market study into personal banking services - Preliminary Issues paper" (7 September 2023), at p. 3, David Tripe "Submission on Market study into personal banking services - Preliminary Issues paper" (6 September 2023), at p. 1, and ASB "Submission on Market study into personal banking services - Preliminary Issues paper" (7 September 2023), at paras 8.1-8.7.

13 We have not focused on remittances and international money transfers to the same extent as deposit accounts and home loans because they do not appear to be as important to the wider competitive dynamics of the sector, and because focusing on them would take away from resources available to the rest of the study.

14 Seven of the 27 registered banks are the overseas group entity of a New Zealand subsidiary, and others do not appear to offer personal banking services in New Zealand.

15 For example, as at January 2024, 96% of housing and personal consumer lending was provided by registered banks, Reserve Bank “Registered banks and non-bank lending institutions: sector lending” (29 February 2024), available at: http://www.rbnz.govt.nz/statistics/series/lending-and-monetary/registered-banks-and-non-bank-lending-institutions-sector-lending.

1.23 The four largest banks in New Zealand (measured by total assets) are ANZ, ASB, BNZ, and Westpac. We refer to these banks as the 'major banks'.

1.24 Other registered banks which focus on personal banking services include Kiwibank, TSB, SBS, Heartland Bank and Co-operative Bank.[16]

1.25 Figure 1.2 below provides a list of registered banks in New Zealand that offer personal banking services, grouped by ownership.

[16] Rabobank NZ is currently the sixth largest bank in New Zealand (based on total assets) but is focused on serving rural and agribusiness needs. Rabobank "Our Story", available at: https://www.rabobank.co.nz/our-story/.

Figure 1.2 Ownership of registered banks in New Zealand that offer personal banking services

Domestic ownership	Australian ownership	Rest of world
Kiwi bank.	bnz	HSBC
sbs	ANZ	बैंक ऑफ़ बड़ौदा Bank of Baroda
The Cooperative Bank	ASB	中國銀行(香港) BANK OF CHINA (HONG KONG)
HEARTLAND BANK	Westpac	Rabobank
TSB		KB Kookmin Bank
		Bank of India
		ICBC New Zealand
		China Construction Bank

Source: Commerce Commission.[17]

[17] Reserve Bank "Banks currently registered in New Zealand", available at: https://www.rbnz.govt.nz/regulation-and-supervision/cross-sector-oversight/registers-of-entities-we-regulate/registered-banks-in-new-zealand; New Zealand Companies Office "Companies Register" https://companies-register.companiesoffice.govt.nz/. Note that HSBC is winding down its Wealth and Personal Banking business in New Zealand, see: https://www.hsbc.co.nz/wind-down/.

There is also a range of non-bank providers of personal banking services

1.26 In addition to registered banks, there is a range of non-bank businesses providing personal banking services. This includes:

1.26.1 15 licensed NBDTs, such as credit unions and building societies (eg, First Credit Union, Heretaunga Building Society);[18]

1.26.2 other finance companies, including peer-to-peer lenders (eg, Squirrel); and

1.26.3 fintechs, who use digital information and automation technology in providing innovative financial services (eg, Akahu, Revolut, Wise).

1.27 Some of these businesses are licensed as NBDTs by the Reserve Bank of New Zealand, Te Pūtea Matua (Reserve Bank). Others are licensed under the Financial Markets Conduct Act 2013 by the Financial Markets Authority, Te Mana Tātai Hokohoko (FMA) and/or certified by the Commerce Commission under the Credit Contracts and Consumer Finance Act 2003 (CCCF Act) (unless exempt).

This is the first competition study of personal banking services in New Zealand | *Ko tēnei te rangahau whakataetaetanga tuatahi mō ngā ratonga pēke whaiaro i Aotearoa*

1.28 Although we have previously considered competition in the banking sector in the context of specific merger decisions, this market study is the first opportunity to consider and evaluate in-depth whether competition in personal banking is promoting outcomes that benefit New Zealand consumers over the long-term.

1.29 The last merger where we considered competition in the banking sector was the acquisition by ANZ Banking Group (New Zealand) Limited of The National Bank of New Zealand Limited (the ANZ/National Bank merger). That merger was cleared by the Commerce Commission on 25 September 2003.

1.30 The ANZ/National Bank merger was cleared because it was considered unlikely to substantially lessen competition in the relevant markets. Although the merger was expected to lead to reduction in choice and quality of service in the supply of transaction accounts and small to medium enterprise (SME) banking, any of loss of competition in these markets was not considered to be substantial. This was due to competition from the three other main competitors, particularly ASB.[19]

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[18] Reserve Bank "Register of non-bank deposit takers in New Zealand" (2 February 2024), available at: https://www.rbnz.govt.nz/regulation-and-supervision/cross-sector-oversight/registers-of-entities-we-regulate/register-of-non-bank-deposit-takers-in-new-zealand.

[19] Commerce Commission "Decision No. 507: Determination pursuant to the Commerce Act 1986 in the matter of an application for clearance of a business acquisition involving ANZ Banking Group (New Zealand) Limited and NBNZ Holdings Limited" (25 September 2003), at para 19.

1.31 ASB was considered a particular constraint on the other major banks at the time. For example, the clearance decision noted:[20]

> ASB has been growing successfully and was considered by one market participant as a maverick player. ASB was the first to introduce internet banking. Given ASB's growth and high customer satisfaction levels, it is unlikely that it would have an incentive to participate in coordinated market power to maximise profits, at the expense of its expansion.

1.32 Over 20 years later, we observe a different competitive dynamic. None of the major banks appear currently to be acting as a disruptor in a sustained way. Although each of the major banks has their own strategies and focus areas, overall they have very similar price (ie, interest rates and fees) and non-price (ie, service) offerings, and shares of supply have been stable for some years. Kiwibank does not currently have the scale or capital backing to continuously challenge the major banks aggressively, and smaller providers do not appear to be a significant competitive threat for a range of reasons. Our views on the nature of competition for personal banking services are discussed in more detail in Chapter 2.

1.33 Other jurisdictions have also carried out competition studies into their banking sectors in recent years, sometimes in a staged process where a broader study into the banking sector is undertaken first, followed by narrower studies into particular services (such as home loans or deposit accounts).

1.34 Although New Zealand's personal banking sector has its own history, structure, and regulatory environment, we have drawn from other jurisdictions' studies to the extent we consider their findings or recommendations are relevant.[21] Studies of particular relevance include:

1.34.1 the United Kingdom Competition and Markets Authority (UK CMA) "*Retail banking market investigation*"(2016);[22]

1.34.2 the UK Financial Conduct Authority (UK FCA) "*Strategic review of retail banking business models*" (2018 and 2022);[23]

1.34.3 the UK FCA "*Mortgages Market Study*" (2019);[24]

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20 Commerce Commission "Decision No. 507: Determination pursuant to the Commerce Act 1986 in the matter of an application for clearance of a business acquisition involving ANZ Banking Group (New Zealand) Limited and NBNZ Holdings Limited" (25 September 2003), at para 332.

21 Our Preliminary Issues paper contains further details regarding the history of New Zealand's banking sector. Commerce Commission "Market study into personal banking services – Preliminary Issues paper" (10 August 2023), at paras 56-67.

22 UK CMA "Retail banking market investigation", available at: https://www.gov.uk/cma-cases/review-of-banking-for-small-and-medium-sized-businesses-smes-in-the-uk.

23 UK FCA "Strategic review of retail banking business models", available at: www.fca.org.uk/publications/multi-firm-reviews/strategic-review-retail-banking-business-models.

24 UK FCA "Mortgages Market Study" www.fca.org.uk/publications/market-studies/mortgages-market-study.

1.34.4 the Australian Productivity Commission "*Competition in the Australian Financial System*" (2018);[25]

1.34.5 the Australian Competition and Consumer Commission (ACCC) "*Residential mortgage products price inquiry*" (2018);[26]

1.34.6 the ACCC "*Home loan price inquiry*" (2020);[27] and

1.34.7 the ACCC "Retail deposits inquiry" (2023).[28]

Our framework for analysing competition | *Te anga hei tātari whakataetaetanga*

We have considered whether competition is working well for consumers

1.35 This study considers whether competition is working well for consumers of personal banking services. Its purpose is to identify and assess any factors that may affect competition for the supply or acquisition of personal banking services, and to make any recommendations that we consider may improve competition.[29]

1.36 This study does not consider compliance with the provisions of the Commerce Act relating to anti-competitive conduct. A conclusion that particular conduct affects competition, and may be the subject of a recommendation, does not mean that it breaches the Commerce Act.

1.37 We can separately investigate anti-competitive conduct if we have reason to believe that anti-competitive conduct may be occurring. Similarly, we may separately investigate conduct which we consider could breach the Fair Trading Act 1986 or the CCCF Act.

1.38 The overriding aim of this study is the same as the purpose of the Commerce Act – to promote competition in markets for the long-term benefit of consumers within New Zealand.[30]

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25 Australian Productivity Commission "Competition in the Australian Financial System", available at: www.pc.gov.au/inquiries/completed/financial-system/report.

26 ACCC "Residential mortgage products price inquiry 2017-18", available at: www.accc.gov.au/inquiries-and-consultations/finalised-inquiries/residential-mortgage-products-price-inquiry-2017-18.

27 ACCC "Home loan price inquiry 2019-20", available at: www.accc.gov.au/inquiries-and-consultations/finalised-inquiries/home-loan-price-inquiry-2019-20.

28 ACCC "Retail deposits inquiry 2023", available at: www.accc.gov.au/inquiries-and-consultations/retail-deposits-inquiry-2023.

29 Sections 48, 51A and 51B of the Commerce Act and our terms of reference. We have published Market Studies Guidelines to assist interested parties to understand our approach to a market study. These Guidelines describe characteristics of competitive markets that are working well and those that may be observed in markets that are not working well. They also describe market features that could affect competition and that are relevant to this study.

30 Section 1A of the Commerce Act. This was emphasised by the Transport and Infrastructure Select Committee in its report back to Parliament on the draft market studies legislation – Commerce Amendment Bill 2018 (45-2) (Select Committee report) at 1, available at: https://www.parliament.nz/en/pb/sc/reports/document/SCR_80263/commerceamendment-bill.

1.39 Competition is defined in the Commerce Act as meaning workable or effective competition.[31] It does not mean the theoretical concept of perfect competition. The High Court has noted that there is no consensus on precise conditions that define workable competition, rather:[32]

> … workable competition is a practical description of the state of an industry where government intervention to make the market work better is not justified because the socially desirable outcomes generated by competition already exist to a satisfactory degree.
>
> A workably competitive market is one that provides outcomes that are reasonably close to those found in strongly competitive markets…

We have identified draft recommendations to enhance competition

1.40 We present in this draft report our preliminary findings and options for improving competition in personal banking. Our draft recommendations are intended to produce better long-term market outcomes for consumers, including in respect of prices, quality, range, and service levels.

1.41 While our focus is on competition, we are conscious that there are other important policy objectives in a well-functioning banking system. For example, in some cases trade-offs may need to be made between competition, financial stability and consumer protection.

1.42 That said, financial stability and competition are not necessarily opposed, and we have not found compelling evidence of greater competition negatively affecting financial stability.[33] A 2016 article in the *Banking & Finance Law Review* found that:[34]

> … there has been a violent swing from the liberalisation before the financial crisis to the preference of stability over competition after the crisis. We have shown that the policy settings in both cases were problematic and that preferencing competition over stability is a relatively low-risk strategy. If the promotion of competition in retail financial services is adopted with both a reduction of entry and exit barriers and a policy of improved financial literacy, then the consumer welfare benefits of competition in the financial services sector can be enjoyed without increasing systemic risk.

1.43 Our draft recommendations seek to identify feasible options that will tangibly improve competition without undermining other important policy objectives. The aim is to produce better long-term outcomes for consumers.

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31 Section 3(1) of the Commerce Act.

32 *Wellington International Airport Ltd and Others v Commerce Commission* [2013] NZHC 3289 at para 13-15, 18 and 22.

33 The literature on this topic is mixed and context specific. See D. Anginer, A Demirguc-Kunt & M. Zhu "How does competition affect bank systemic risk?" *Journal of Financial Intermediation* 23 (2014), at p. 1–26; C. Silva-Buston "Systemic risk and competition revisited" *Journal of Banking and Finance* 101 (2019) 188–205, and Z. Fungácová, Shamshur & L. Weill "Does bank competition reduce cost of credit? Cross-country evidence from Europe" *Journal of Banking and Finance* 83 (2017), at p. 104–120.

34 D. Healey and R. Nicholls "Should Stability Reign? The Consumer Downside of Foregone Competition in Retail Banking Markets" (2016) *Banking and Finance Law Review*, at p. 69 – 101.

1.44 We have not undertaken cost-benefit analysis when developing our draft recommendations. We consider that formal cost-benefit analysis falls outside the scope of our study. Policy makers may undertake that analysis while developing, or giving effect to, any of our final recommendations the Government wishes to take forward.

Structure of this draft report | *Te hanga o tēnei pūrongo tuatahi*

1.45 The structure of this draft report is as follows:

1.45.1 **Chapter 2: Nature of competition** discusses how providers of personal banking services compete (including on interest rates, fees, and non-price features), and provides our views on the intensity of that competition currently.

1.45.2 **Chapter 3: Māori perspectives on competition for personal banking services** describes Māori perspectives on competition in the sector (for both supply and acquisition of personal banking services), based on the key themes of our Māori stakeholder engagement so far.

1.45.3 **Chapter 4: Competition for home loans** discusses our preliminary findings regarding competition for home loans – one of the services we have focused on in the study.

1.45.4 **Chapter 5: Competition for deposit accounts** discusses our preliminary findings regarding competition for deposit accounts (including transaction accounts, overdraft facilities, savings accounts, and term deposits). Deposit accounts is the other main category of personal banking services we have focused on in the study.

1.45.5 **Chapter 6: Profitability of New Zealand's banking sector** discusses how profitability measures compare between New Zealand banks, and across other jurisdictions.

1.45.6 **Chapter 7: Regulatory factors affecting competition** discusses conditions for providers to enter, or expand their presence in, the New Zealand personal banking services sector. This chapter discusses the regulatory factors that we have identified as affecting market entry and, particularly, expansion.

1.45.7 **Chapter 8: Consumer search and switching behaviour** discusses the extent to which consumers switch between providers of personal banking services and the challenges they face when attempting to switch.

1.45.8 **Chapter 9: Digital disruption and impediments to innovation** discusses the conditions for innovation in personal banking in New Zealand, with reference to global trends. It particularly focuses on the importance of technology systems in enabling competition and the potential for "open banking" to lead to greater innovation and disruption in the sector.

1.45.9 **Chapter 10: Draft recommendations** sets out options for recommendations that seek to improve competition and produce better long-term market outcomes for consumers.

1.46 We have included additional information in the attachments to our draft report:

1.46.1 **Attachment A: Next steps and how you can have your say** provides information on how you can have your say on this draft report and details about our consultation conference.

1.46.2 **Attachment B: Overview of the personal banking services industry** provides background information on the New Zealand personal banking sector, including further details on the main market participants and products, and the importance of personal banking services to New Zealanders.

1.46.3 **Attachment C: Further details on profitability analysis** includes additional details about how we have assessed profitability of the New Zealand banking sector, including responses to submissions received on our Preliminary Issues paper.

1.46.4 **Attachment D: Competition for different consumer groups** considers whether competition is delivering good outcomes for all consumers.

1.46.5 **Attachment E: International money transfers** describes the research we have undertaken on competition for remittances, international payments, and foreign exchange.

1.47 Alongside our draft report, we have also published:

1.47.1 An executive summary and an abridged version of our draft report with our summarised preliminary findings and draft recommendations.

1.47.2 Consumer research undertaken on our behalf by Verian.[35] This includes the results of a survey regarding consumer switching behaviour for personal banking services. As a supplement to Verian's quantitative survey findings, qualitative interviews were also conducted to create maps of typical consumer switching experiences across a range of different scenarios.

1.47.3 Econometric analysis on measures of efficiency, including cost and profit efficiency, economies of scale, market concentration and market power for New Zealand banks, undertaken by Professor Dimitris Margaritis and Dr Maryam Hasannasab from the University of Auckland.[36] We engaged Professor Margaritis and Dr Hasannasab to undertake this analysis for the study.

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35 Verian "Personal banking services market study – Research report" (February 2024).

36 Dimitris Margaritis and Maryam Hasannasab "Market power in banking: A study of New Zealand banks" (March 2024).

1.47.4 A summary of the key themes discussed at a wānanga with Māori stakeholders, held on 30 October 2023 in Wellington.[37]

1.47.5 A summary of the key themes discussed at a workshop with Fintech NZ members, held online on 27 November 2023.[38]

Our process so far | *Te ara i whāia*

We previously published a Statement of Process and a Preliminary Issues paper

1.48 On 22 June 2023, we released a Statement of Process, outlining the process we intended to follow over the course of this study.[39]

1.49 On 10 August 2023, we released a Preliminary Issues paper, seeking responses from interested parties on the preliminary issues we intended to explore during this study.[40] We received submissions from 28 parties on our Preliminary Issues paper.

1.50 On 21 September 2023, we sought cross-submissions on our Preliminary Issues paper. We received cross-submissions from nine parties by the due date and a further five submissions subsequently.

1.51 Copies of the papers we published, and all the public versions of the submissions we received in response, are available on our website.

We gathered information from a diverse range of market participants

1.52 The personal banking services industry includes a diverse range of participants. We have therefore sought to collect information from a wide range of sources and to meet with a wide range of parties. These parties have included consumer representative groups, major banks, smaller banks, NBDTs, fintechs, and both domestic and international regulators of personal banking services (including the Reserve Bank and FMA). We have held meetings with over 50 parties so far when undertaking the study.[41]

1.53 We thank all these parties for the information they have provided, and for their ongoing engagement in this study.

37 Commerce Commission "Summary of views expressed from Te Komihana Tauhokohoko wānanga" (14 February 2024).
38 Commerce Commission "Summary of views expressed FinTechNZ/Commerce Commission workshop – Competition for personal banking services in New Zealand" (14 February 2024).
39 Commerce Commission "Market study into personal banking services – Statement of Process" (22 June 2023).
40 Commerce Commission "Market study into personal banking services – Preliminary Issues paper" (10 August 2023).
41 [ ].

1.54 We received around 100 responses from consumers to a feedback form made available on our website.[42] The feedback received has been valuable for informing this study and has contributed to the findings set out in our report.

1.55 As noted above, we engaged Verian to undertake consumer research on our behalf, focusing on consumer decision-making (particularly switching) for personal banking services. That research included:

1.55.1 a nationwide survey of 2,140 consumers aged 18 and over. A mixed-method approach was used, with 1,039 consumers surveyed online, 1,001 by phone and 100 face-to-face.

1.55.2 16 in-depth interviews to supplement the quantitative survey, conducted to better understand consumers' switching experiences.

We engaged with Māori stakeholders during the study

1.56 As an Independent Crown Entity, we support the Crown's obligations as a Treaty partner under the Treaty of Waitangi (the Treaty).[43] We are committed to engaging with Māori and supporting future-focused Māori-Crown relationships, through taking a good-faith, collaborative approach to engaging with Māori on our work.

1.57 We are listening to a range of views, from both providers and consumers, about how competition for personal banking services is impacting Māori. Key engagements to date include:

1.57.1 a wānanga, held on 30 October 2023, which included participants who could bring a consumer, entrepreneurial, and community provider perspective on competition issues affecting Māori in the personal banking sector;[44] and

1.57.2 meetings with Tāwhia, the Māori bankers' rōpū.[45]

1.58 We set out the key themes from our engagement with Māori in Chapter 3. We have also incorporated information shared with us throughout the relevant sections of our report.

42 A consumer feedback form is available on our webpage for the study. We promoted the web form through social media to help reach a wider audience.

43 The Treaty of Waitangi/Te Tiriti o Waitangi is a founding document of government in New Zealand and is one of the major sources of New Zealand's constitution. Our reference to "the Treaty" is to both the English and Te Reo versions.

44 A summary of the wānanga is available on our website.

45 Tāwhia consists of senior Māori representatives from ANZ, ASB, BNZ, Heartland Bank, Kiwi Bank, TSB, and Westpac.

1.59 Hearing from Māori about their experiences of the personal banking services industry has enabled us to better understand Māori perspectives, concerns, and aspirations regarding the industry. We acknowledge the diversity in views and perspectives we heard. Hearing a range of Māori voices necessarily means there was a variety of perspectives expressed. We also acknowledge that the comments we heard do not represent the views of all Māori.

Some information we have received is confidential

1.60 We have endeavoured to make our report as accessible to interested parties as possible. However, some information within our report must out of necessity be redacted from view, as is indicated by the use of square brackets like this: [ ].

1.61 Much of the information we have collected in the course of this study is considered confidential or commercially sensitive by the supplying party. It is important that interested parties and others providing us with relevant information continue to feel confident participating in this study and supplying us with information that we can use to develop our views.

1.62 Accordingly, when deciding whether information provided to us is commercially sensitive and/or confidential or can be published, we consult with the party who has provided it and balance these considerations against our obligations to adhere to the principles of natural justice in the course of this study, operate as transparently as practicable, and comply with our legal obligations under the Official Information Act 1982 (OIA).

1.63 If we receive a request for any information referred to or collected in connection with this report, we will consider whether to make the information available in accordance with the OIA.

1.64 Our Market Studies Guidelines contain further information about how we protect confidential information provided to us during this study and how we respond to OIA requests related to this study.[46]

Next steps and how you can have your say | *Ngā mahi āmuri me te ara kōrero mai māu*

We are consulting on this draft report

1.65 We invite interested parties to provide written submissions on this draft report. You can comment on any aspect of our draft report, including any issues you consider relevant that have not been covered.

1.66 We will have regard to any submissions received on our draft report within the time allowed.

[46] Commerce Commission "Market Studies Guidelines" (19 November 2020).

1.67 We are seeking feedback on our draft report in the following ways:

1.67.1 written submissions on our draft report, which are due by **4pm, Thursday 18 April 2024**;

1.67.2 a consultation conference to be held in central Auckland and online in the week commencing **Monday 13 May 2024**; and

1.67.3 final submissions, including cross-submissions on matters raised at the conference and in published submissions made by others, which are due by **4pm, Thursday 30 May 2024**;

1.68 Please see Attachment A for further information about how to provide written submissions and on our consultation conference. Registration details and a registration link for those wanting to attend the conference will be sent out in due course.

1.69 With regard to the econometric analysis by Professor Dimitris Margaritis and Dr Maryam Hasannasab from the University of Auckland, we requested this analysis because we wanted a different view to that offered by the standard measures of profitability in banking like return on assets, return on equity and net interest margin and to inform our assessment of the reasons for the profitability we observe using these standard measures.

1.70 We have found the analysis helpful. Our preliminary view of the analysis is that, in several respects, it is supportive of our qualitative findings, but we have not relied heavily on it in arriving at our preliminary findings and draft recommendations.

1.71 We invite any written submissions from interested parties on this analysis by **4pm, Thursday 2 May 2024**.

We will publish our final report in August 2024, after considering feedback received

1.72 In accordance with the terms of reference, we must publish our final report by **20 August 2024**.[47]

1.73 Our final report will set out the findings of this study and any recommendations that we make to the Minister to improve competition, having had regard to comments we have received on our draft report.

1.74 We are not obliged to make any recommendations, but if we do, we have a broad scope in how we do so, as set out in section 51B(3) of the Commerce Act.

1.75 The Minister is required to respond to our final report within a reasonable time after it is made publicly available.[48]

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47 We are required to make our final report available to the Minister at least 5 working days prior to publishing our final report on 20 August 2024 (see section 51D(1) of the Commerce Act).

48 Section 51E of the Commerce Act.

Chapter 2 The nature of competition in personal banking | *Ko te āhua o te whakataetaetanga i roto i te pēke whaiaro*

Summary of preliminary findings

- **The major banks, ANZ, ASB, BNZ and Westpac, do not currently face strong competition when providing personal banking services.** This is evidenced by their high and largely stable shares of supply, barriers to entry and expansion, lack of entry and disruption, limited constraint from smaller providers, sporadic price competition, a lack of consumer switching, lack of investment in innovation (including core systems), and the high and sustained profitability of the sector.
- **Providers of personal banking services can be split into two-tiers.** The first tier comprises the four major banks. The second tier comprises the smaller registered banks and non-banks. Kiwibank is 'stuck in the middle' of these two-tiers; being larger than the smaller providers but having less scale than the major banks.
- **Banks' customers tend to be 'sticky'.** 'Main bank' relationships (held predominantly by the four major banks) are beneficial because these customers often default to their existing service provider when adding or renewing services. Once a customer is committed to the same provider for several services, they are significantly more likely to stay with that provider. This is reinforced by switching barriers and the tendency of the major banks to only offer the best deals to customers who shop around.
- **Competition between the major banks and Kiwibank appears to be sporadic and limited, for deposit accounts and home loans.** We observe some periods of relatively intense competition, and other periods where some or all of the major banks pull back and are more focused on maintaining their profit margins.
- **The second tier of providers does not exert significant competitive pressure on the larger banks due to lack of scale, higher cost of funding, weaker brand awareness and smaller shares of main bank customers.**
- **There is a degree of non-price competition on metrics like brand reputation and service. The strong brands of the major banks reinforce the current market structure, whereas customer service levels do not appear to materially impact shares of supply.** Smaller providers have less resource to invest in brand development and non-price offerings, limiting their ability to exert significant competitive pressure on the major banks.
- **There is a risk of accommodating behaviour (or tacit coordination).** The major banks have broadly similar cost structures, can readily observe and respond to each other's pricing, interact regularly across a range of services, and the threat of disruption by smaller providers or new entrants is low. These features of the sector potentially make it prone to accommodating behaviour between the major banks, and we cannot rule out the possibility that tacit coordination may be occurring.
- **Some consumer groups are not well-served by competition alone.** For some this is having an unintended consequence of financial exclusion, with issues accessing even a basic bank account. Possible solutions can be shared with New Zealand policy makers, regulators, and industry for collective social impact and increased financial inclusion.

Introduction | *Whakatakinga*

2.1 This chapter describes how providers of personal banking services compete and provides our views on the intensity of that competition. It discusses how providers seek to win and retain customers, and how customers engage with providers for these services.

2.2 We then describe the structure of the market and the competition that takes place within and between the different levels of providers. Finally, the chapter considers how well competition is working well for different consumer groups.

Main bank relationships are an important focus for competition but customers also multi-bank | *He aronga nui ngā hononga o ngā pēke nui mō te whakataetae heoi ka whai pēke maha ngā kiritaki*

Main bank relationships

2.3 Although competition in personal banking services takes place across a range of individual services, a key focus for providers is to build 'main bank' relationships with customers. Customers will often turn to their main bank provider for their changing banking needs over time. These customers generally receive their income into a transaction account held with their main bank and use this account for the majority of their day-to-day transactions.[49]

2.4 Main bank customers are very valuable to banks because:

2.4.1 they are likely to acquire a wider range of services from their provider, so generate greater revenue;[50,51,52]

2.4.2 they are a source of profit to the provider over a longer timeframe because of the lower likelihood of switching – consumer research conducted by Verian on our behalf indicates that 54% of respondents have never switched from their main bank;[53] and

2.4.3 as discussed in Chapter 5, funds in the deposit accounts of main bank customers provide a stable low-cost funding source.

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49 Banks often use criteria such as a certain amount of deposits, a minimum level of transactions or receipt of payments such as salary over a specific time period when identifying main bank customers.

50 Australian Consumer and Competition Commission - "Retail deposits inquiry final report" (December 2023), at p. 38, available at: https://www.accc.gov.au/about-us/publications/retail-deposits-inquiry-final-report.

51 [ ].

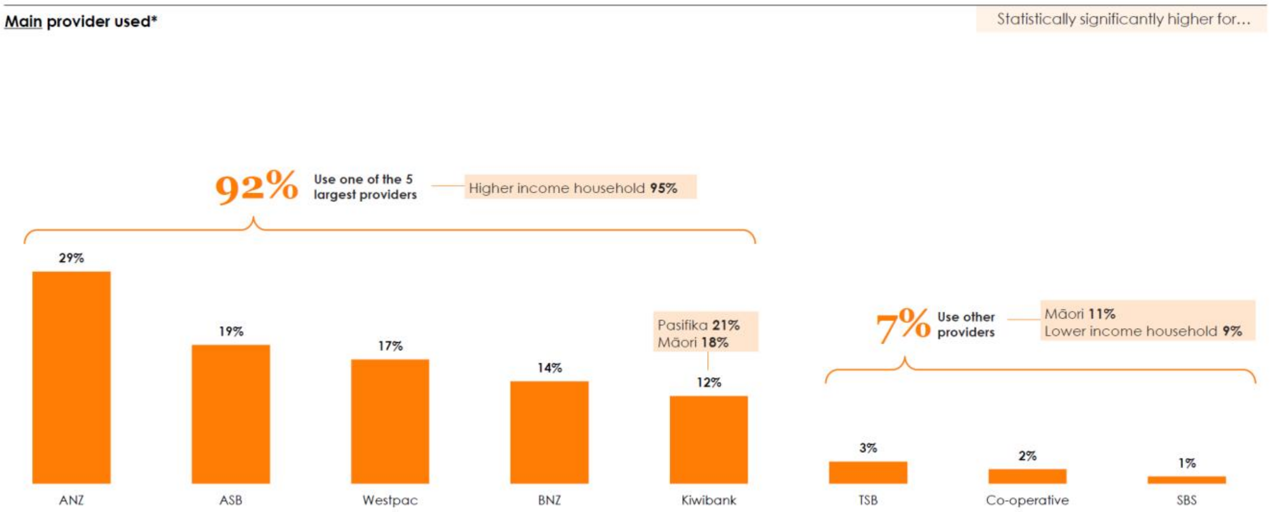
52 [ ].

53 Verian "Personal banking services market study - Research report" (February 2024), at p. 32.

2.5 The four major banks classify over half of their customers to be main bank customers, whereas this is lower for Kiwibank and smaller providers.[54,55,56]

2.6 Verian's research also indicates that 92% of consumers consider one of the five largest banks to be their main bank (where income or benefit is paid or where most day-to-day transactions take place) and 94% of transaction accounts are also held with these banks.[57] Only 7% use other providers as their main bank. See Figure 2.1 below:

Figure 2.1 Main bank relationships reported by consumers



Source: Verian.[58]

2.7 Smaller providers have told us they struggle to acquire main bank customers because they are unable to offer the same quality mobile banking apps as the major banks. Smaller providers do not have the same scale advantages as the major banks and spend proportionately more on regulatory compliance. This leads to less available resource for providing full-service offerings that main bank customers prefer.[59,60]

54 [ ].
55 [ ].
56 [ ].
57 Verian "Personal banking services market study – Research report" (February 2024), at p. 14.
58 Verian "Personal banking services market study – Research report" (February 2024), at p. 15.
59 [ ].
60 [ ].

2.8 The difficulties smaller providers face when competing for main bank relationships weakens competition for personal banking services. This is because the existing main bank relationship creates a high likelihood that the main bank provider will be the first, or only, choice for a customer seeking additional personal banking services.[61] Customer research also indicates a main bank relationship is a key driver for a customer choosing their existing bank for a different service.[62] This is often described as providing a pipeline of customers.

Multi-banking by customers is increasing

2.9 Although main bank relationships are important, consumers increasingly have relationships with multiple providers, and a major bank has said that "…approximately every second person has accounts with more than one bank."[63] This is broadly consistent with our consumer research which found 1.6 provider relationships per customer on average.[64] Many customers, for example, have a main bank their salary is be paid into and a different bank for a service such as a term deposit.

2.10 Customers frequently bank across a number of providers because of low or no fees on transaction accounts, or to take advantage of more favourable rates on savings accounts or term deposits. We have heard that "banking providers are generally added rather than replaced…" for this purpose.[65]

2.11 The growing prevalence of multi-banking might suggest the competitive advantage the larger banks have in establishing main bank relationships is weakening. However, banks continue to pursue these relationships.

2.12 Smaller providers consider that a low proportion of their own customers bank solely with them.[66] These providers hold a higher percentage of customers who are often lower value because they are not main bank customers, are more engaged in the competitive process and more likely to switch provider.

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61 [ ].

62 [ ].

63 ANZ "Market study into personal banking services Preliminary Issues paper submission" (7 September 2023), at p. 34

64 Verian report "Personal banking services market study – Research report" (February 2024), at p. 16.

65 BNZ "Submission on the Commerce Commission's Preliminary Issues paper regarding the market study into personal banking services" (7 September 2023), at para 2.23.

66 [ ].

Customer engagement is often triggered by key life events | *Mō te nuinga o ngā kiritaki ina pā mai tētahi tūāhua nui kātahi anō ka anga atu ai*

2.13 Many customers are disengaged and are more likely to have chosen their banking provider based on brand reputation, convenience or recommendations from family and friends rather than actively searching for the best offer.[67,68] This represents an incumbency advantage for the major banks over smaller providers and constitutes a barrier to organic customer expansion for smaller and new providers who are disproportionately vying for the relatively small subset of engaged customers, who tend to be more price sensitive. We heard from smaller providers that this is the case:[69]

> …the larger and more established banks, which account for 85-90% of the market, enjoy the benefits of a large inert customer base that they have built up over many years making it harder for smaller and newer banks to attract customers.

2.14 While "engaged" customers are willing and able to shop around to find the best deals to suit their needs, many customers do not and could be described as "disengaged".

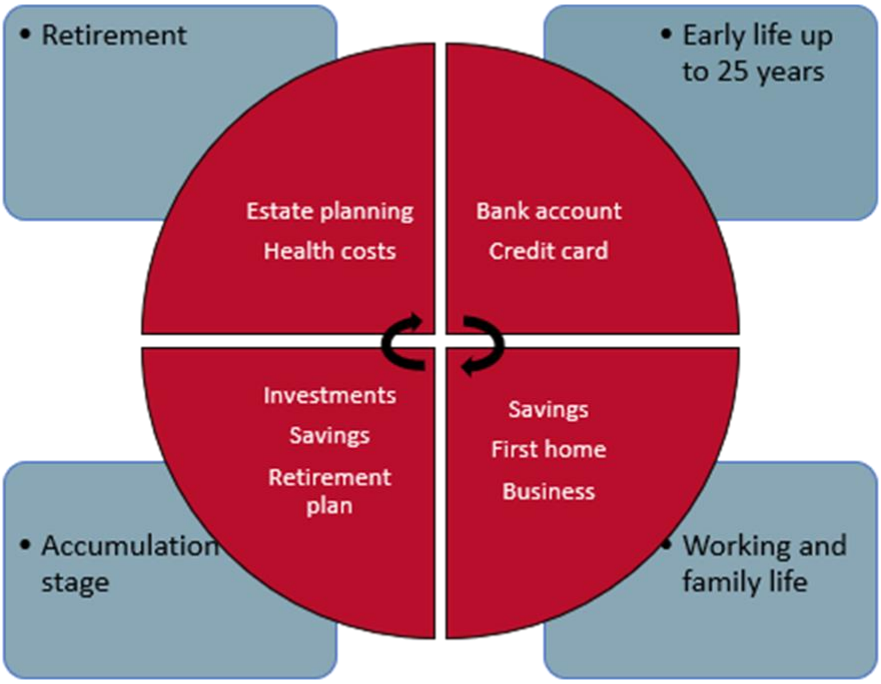
2.15 The extent of engagement in the market affects competition: when the demand side works well, competing firms will win customers when they offer the best deals, and not otherwise. If customers do not readily search out and switch to the best deal, the incentives amongst suppliers to compete on price and quality are limited and this in turn weakens competition.

2.16 Providers attach importance to attracting customers to everyday banking services such as transaction accounts early on in their lives. Often school age children and young adults are targeted to develop and maintain an ongoing and commercially valuable relationship.[70,71] Many young people stay with the bank that their parents set them up with, at least until they leave home and often longer.[72]

2.17 Some customers do not actively engage with personal banking services on a regular basis, adopting more of a 'set and forget' approach. However, certain life events such as a first job, first home, marriage or other significant life events can present triggers for customers to engage more actively in choosing their provider.[73] Banks develop services for customers to use at each life stage and often focus their competitive efforts on these life events to try to gain a competitive advantage.

67 Verian "Personal banking services market study – Research report" (February 2024), at p. 36.
68 [ ].
69 TSB, Co-op, Kiwibank, SBS (Joint Submission) "Submission on Market Study into personal banking services –Preliminary Issues paper" (7 September 2023), at p. 6.
70 [ ].
71 [ ].
72 [ ].
73 [ ].

Figure 2.2 Customer life journey and life events where engagement often takes place



Source: Commerce Commission.[74]

2.18 When customers do engage, as set out in Chapter 8, it can be difficult for them to access and use the information they need to make informed choices about services and service providers. Search costs are high for some services such as home loans and difficulty accessing like-for-like comparisons limits the competitive pressure of even engaged customers.

Barriers to entry and expansion are high | *He nui ngā tauārai ki te whakaurunga me te whakawhānuitanga*

2.19 There are high barriers to sustainable new entry and expansion in personal banking services.

2.20 The major banks have significant scale, scope and incumbency advantages over potential new entrants and existing smaller providers, including:

2.20.1 Economies of scale – there are significant fixed costs in providing banking services. Banks that can spread their fixed costs across more customers and products can achieve higher operating profit margins on their borrowing and lending activities. This is reflected in lower observed cost to income (CTI) ratios of the major banks and higher returns. This is discussed further in Chapter 6.

74 [ ].

2.20.2 Advantages in relation to regulatory and prudential settings. Personal banking services and providers (especially banks) are highly regulated in the interests of financial system stability, consumer protection and other policy objectives. Regulation is a condition of market entry but also shapes the environment within which existing providers compete to expand. Regulatory factors affecting competition are discussed further in Chapter 7.

2.20.3 Advantages in access to funding. The major banks benefit from lower average funding costs than smaller banks and an ability to access a variety of funding sources that may not be available to smaller providers such as international markets for wholesale funding. This is discussed further in Chapter 5.

2.20.4 Brand recognition and customer inertia which favour incumbent providers ie, the major banks. This is discussed further in Chapter 8.

2.20.5 Fintechs seeking to operate in New Zealand can face significant challenges in entering and expanding. This is discussed further in Chapter 9.

2.21 The significance of these barriers to entry and expansion is reflected in the lack of sustainable entry or expansion in the New Zealand personal banking sector in the last decade. Smaller banks have not been able to overcome the challenges associated with competing against much larger providers that benefit from these scale and scope advantages.

Two-tiers of providers for personal banking services | *E rua ngā taumata o ngā kaituku ratonga pēke whaiaro*

2.22 The sector is dominated by a stable oligopoly of major banks with no maverick to disrupt them. There are two main tiers of providers:

2.22.1 the four major Australian-owned banks, who hold around 90% of the total assets of registered banks in New Zealand;[75] and

2.22.2 the remainder of the providers of personal banking services, namely the smaller banks, NBDTs and non-bank lenders.

2.23 We see Kiwibank as sitting between the two tiers of providers of personal banking services in relation to the various dynamics we have considered that impact competition.

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75 Reserve Bank "Bank Financial Strength Dashboard – Balance sheet" (30 September 2023), available at: https://bankdashboard.rbnz.govt.nz/balance-sheet.

2.23.1 Kiwibank is the fifth largest registered bank, has increased its share of supply since entering the market in 2002, and in 2023 announced an injection of $225 million to accelerate growth and provide further competition.[76,77] All of the major banks consider Kiwibank as a competitor.[78]

2.23.2 Kiwibank is domestically owned but is not classified as a domestic systemically important bank (D-SIB) by the Reserve Bank.[79] Kiwibank does not yet have the scale or capital backing of the major banks.[80]

2.24 As Figure 2.3 shows, in terms of total assets, ANZ is significantly larger holding around 30% than ASB, BNZ and Westpac which each hold around 18-20%.

76 [ ].

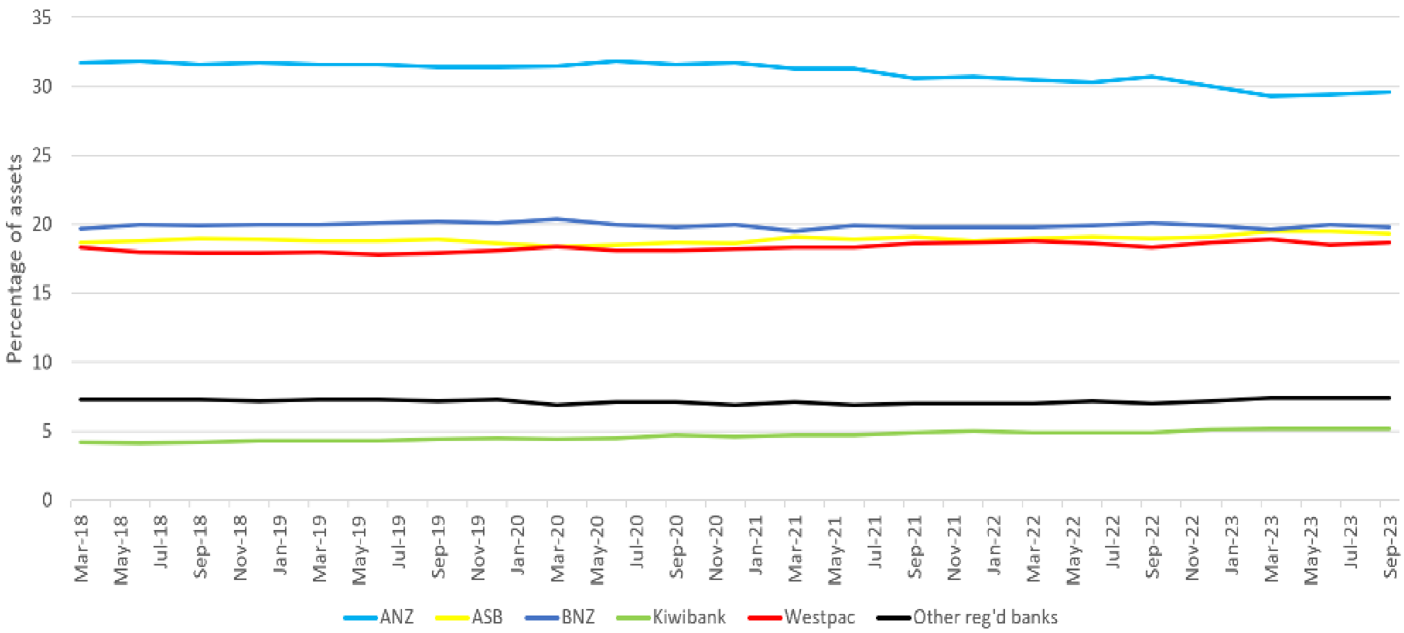
77 Kiwibank "Kiwi Group Capital invests $225 million into Kiwibank to accelerate growth" (1 August 2023) available at: https://www.kiwibank.co.nz/about-us/news-and-updates/media-releases/kiwi-group-capital-invests-225-million-into-kiwibank-to-accelerate-growth/.

78 [ ].

79 The Reserve Bank consulted on a framework for identifying D-SIBs in 2019, and concluded that D-SIBs (currently ANZ, ASB, BNZ and Westpac) would be classified as such due to their size (between them holding almost 90% of banking system assets), interconnectedness, lack of substitutability and complexity. The effect of classification as a D-SIB is that they must have additional loss-absorbency requirements in the form of additional CET1 capital. Reserve Bank "Requirements for domestic systemically important banks" (28 February 2022) available at: https://www.rbnz.govt.nz/regulation-and-supervision/oversight-of-banks/standards-and-requirements-for-banks/requirements-for-domestic-systemically-important-banks

80 Radio New Zealand "Kiwibank. government ownership a setback for competition, fund manager says" (23 August 2022) available at: https://www.rnz.co.nz/news/business/473331/kiwibank-government-ownership-a-setback-for-competition-fund-manager-says.

Figure 2.3 Share of total banking assets 2018 – 2023



Source: Reserve Bank.[81]

2.25 Several factors contribute to this structure:

2.25.1 **Mergers**. The history of mergers, including ANZ's acquisition of National Bank in 2003, as discussed in our Preliminary Issues paper.[82]

2.25.2 **Regulation**. Prudential capital requirements in particular have helped to entrench the two tier oligopoly by allowing the major banks to hold less capital than smaller banks for lending with equivalent risks.[83] This is discussed further in Chapter 7: Regulatory factors affecting competition.

2.25.3 **Main bank relationships and switching barriers**. The depth of services and prevalence of main bank relationships leads to the major banks acquiring a large, sticky customer base from which growth is more easily achieved.

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81 Reserve Bank "Bank Financial Strength Dashboard" available at: https://bankdashboard.rbnz.govt.nz/profitability.

82 Commerce Commission "Market study into personal banking services – Preliminary Issues paper" (10 August 2023), at p. 33, available at: https://comcom.govt.nz/__data/assets/pdf_file/0032/324779/Preliminary-Issues-paper-Personal-banking-services-market-study-10-August-2023.pdf.

83 The major banks which are accredited to use the internal models-based (IRB) approach to calculate their capital requirements. All other banks must use the standardised approach. The effect of being able to use the IRB approach is to enable the accredited bank to apply lower risk-weightings to determine the value of assets to which capital ratios apply. See Reserve Bank "Capital requirements for banks in New Zealand" (1 July 2022) available at: https://www.rbnz.govt.nz/regulation-and-supervision/oversight-of-banks/standards-and-requirements-for-banks/capital-requirements-for-banks-in-new-zealand#:~:text=Under%20Basel%202%2C%20banks%20may,sometimes%20called%20'IRB%20banks'.

Second tier providers face disadvantages compared to major banks which limits the competitive pressure they exert

2.26 The major banks hold advantages which make it difficult for smaller second tier providers to compete with them and this lack of constraint helps to sustain the stable oligopoly.

2.27 We observe that the five largest banks focus largely on each other when setting interest rates in home loans and deposits (see also Chapter 4 and Chapter 5). They do not appear to have regard to the pricing decisions of smaller lenders or deposit takers, indicating that they are not a significant competitive threat. Similarly, smaller lenders and deposit takers primarily track the interest rates of the large banks when making pricing decisions.

2.28 It is difficult for smaller providers to compete with major banks on interest rates, because of their cost disadvantage compared with the major banks. Where smaller providers do offer attractive rates, the major banks and Kiwibank have the ability to quickly match (or better) their offers which is discussed further in Chapter 4. Smaller providers also struggle to compete on non-price dimensions, such as the quality of their mobile banking apps, because they have less resources to put into developing their service offerings.[84]

2.29 The major personal banking providers also tend to benefit from economies of scale and scope, up to a point. For example, a larger provider has lower wholesale funding costs because the fixed transaction costs are spread across a larger issuance. The four major banks also have the benefit of wholesale lenders recognising the buying-power of the parent companies. Professor Margaritis and Dr Hasannasab found that most banks operate under economies of scale in relation to loans, with the exception of Kiwibank after 2021. The smaller banks have the potential to benefit from larger size with the exception of Kiwibank after 2020.[85]

2.30 Lower funding costs enable investment over longer periods and the marginal cost of growth is lower for major banks than for smaller banks. This allows major banks to invest in services such as transaction accounts which are required to attract main bank customers.[86] For example, approximately $58b of non-interest bearing transaction deposits are held by the five largest banks which assists the loan books of these banks. Funding costs advantages of the major banks are discussed further in Chapter 5.

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84 [ ].

85 The findings are based on their estimate of the cost elasticity of scale. This is a measure of the responsiveness of costs to changes in the size of a bank's operations. It is the inverse of scale elasticity which is an empirical measure of economies of scale. Dimitris Margaritis and Maryam Hasannasab "Market power in banking: A study of New Zealand banks" (March 2024), at p. 14-15.

86 Kiwibank "Response to the Commerce Commission's Preliminary Issues paper" (7 September 2023), at p. 7.

2.31 The larger scale and presence of the major banks also gives rise to higher brand awareness from consumers, which is a competitive advantage. Verian's research indicates only 17% of respondents considered smaller banks when choosing their home loan provider, only 6% considered non-banks and 88% considered the five largest banks.[87] In comparison, 42% would only consider the five largest banks when choosing a main bank while 30% would consider other banks and non-banks.[88]

2.32 Brand awareness also gives the perception of safety and security; only a registered bank may state it provides banking services while non-banks need to overcome the barrier of articulating what services they offer to customers.[89] Similarly, physical presence offers reassurance and larger providers have a nationwide physical presence.[90]

2.33 Banking regulation also imposes disproportionate costs on smaller providers which constrains the inability to invest in innovation and therefore to compete in terms of price or through innovative services or systems.[91] This is discussed further in Chapter 7 and Chapter 9.

2.34 In view of these factors, it is not surprising to see smaller banks focus their competitive offering as a main bank regionally, or for specific services or customer segments.[92]

2.35 Providers, such as credit unions and building societies, have different ownership and business models and different sources of funding from banks. Many of these providers exist to provide services that New Zealand consumers and businesses require that banks, "… because of their size, innate conservatism and profit-driven nature, are unable to…" such as lending to those to whom banks will not lend.[93]

2.36 Providers who offer potentially disruptive business models and new services have been and are trying to enter the market. Some offer standalone services such as home loans and deposit accounts. Others look to use application programming interface (API) functionality to build 'over-the-top' services to leverage consumer data held by incumbent banks.

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87 Verian "Personal banking services market study -Research report" (February 2024), at p. 35.

88 Verian "Personal banking services market study - Research Report" (February 2024), at p. 45.

89 [ ].

90 Kiwibank "Response to the Commerce Commission's Preliminary Issues paper" (7 September 2023), at p. 10.

91 TSB, Co-op, Kiwibank, SBS Bank (Joint Submission) "Submission on Market Study into personal banking services –Preliminary Issues paper" (7 September 2023), at p. 1.

92 [ ].

93 Financial Services Federation "Submission on Market study into personal banking services Preliminary Issues paper" (7 September 2023), at p. 3.

2.37 The major banks contend that these providers of new technology will in fact disrupt the market. However, banks have often sought to partner, rather than compete with, these new entrants and they have yet to have a significant impact on share of supply for home loans and deposit accounts.[94] A number of reasons have been advanced for this, including the small size of the New Zealand market, major bank concentration providing a significant hurdle for disruptors to scale-up growth, slow progress on open banking and a lack of capital.[95] These factors are discussed further in Chapter 9.

2.38 The major constraint for smaller providers, including new entrants, is the difficulty in achieving the necessary scale. This requires significant investment initially and on an ongoing basis.[96] The concentration of the larger banks also represents a significant hurdle for smaller providers and new entrants looking to scale-up, particularly in terms of deposit funding.[97]

Competition between first tier providers is limited and sporadic

2.39 We observe that competition between the major banks is limited. This is demonstrated by:

2.39.1 **High and stable share of supply.** The supply of personal banking services exhibits largely stable shares of total assets since 2018, as noted in Figure 2.3 above. Professor Margaritis and Dr Hasannasab have estimated the Herfindahl-Hirschman Index (HHI) for total deposits, total loans, and total assets over the period 2016 to 2022. These indices encompass all banking services and suggest some reduction in concentration during that time. Nevertheless, the HHI's have remained at all times during this period at the level of concentration that is usually described as moderate to high.[98] The major banks say that they compete fiercely to increase their share of supply, and for some services more intensely than others. For some services, such as home loans, market shares are more dynamic over short periods of time. Nevertheless, if competition works well, we expect to see more movement in shares of supply generally over a longer term.

94 [ ].

95 [ ].

96 [ ].

97 [ ].

98 The authors describe their findings as indicating moderate concentration. We note however, that the US Department of Justice and Federal Trade Commission's 2023 Merger Guidelines, 2023, describe a HHI above 1800 as 'high concentrated'. The UK's CMA has described a HHI above 2000 as highly concentrated (CMA, The State of UK Competition Report, April 2022). Dimitris Margaritis and Maryam Hasannasab "Market power in banking: A study of New Zealand banks" (March 2024), at p. 6-7.

2.39.2 **Sporadic competition.** There are times when competition is more intense with lower margins, but other times where competition is less intense.[99] This is particularly true of home loans and term deposits. We would expect to see a higher frequency of more intense competition if there were stronger competition.

2.39.3 **Lack of ambitious growth targets and strategic differentiation.** We observe little strategic differentiation between the major banks.[100] Growth targets generally balance share of supply growth with protecting margins.[101] The targets are a symptom of limited competition, where providers can make offers which are just enough to achieve growth objectives or maintain share of supply and avoid a strong response from competitors.

2.39.4 **Lack of investment in technology and innovation.** We understand that the major banks are operating legacy technology systems (with some apparently dating back to the wave of bank mergers and acquisitions in the 1990s and 2000s).[102] This sustained lack of major investment is consistent with weak competition over an extended period. Similarly, we observed a slow pace of significant innovation in recent years, for example in developing open banking APIs, or investing in or partnering with fintechs. It appears that the major banks know that their peers are in a similar position with a lack of investment in systems and are choosing to "sweat" legacy assets and ration investments in innovation, to focus on ongoing regulatory requirements. By contrast, if there was a strongly competitive market, we would expect to see investment and innovation driven by competition even when there are regulatory costs. This is discussed further in Chapter 9.

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99 Econometric estimation of the degree of pricing power held by individual banks indicates that pricing power has varied as between banks and over time over the past few years for some broad product groups (Panzar-Rosse H index during the period 2016-2023, and Lerner Index 2018-2023). Pricing power is the extent to which businesses are able to price above their marginal costs. Pricing power may provide insights into the strength of competition, with a generally inverse relationship between pricing power and the degree of competition. We note that this analysis is broader than personal banking services. Dimitris Margaritis and Maryam Hasannasab "Market power in banking: A study of New Zealand banks" (March 2024), at p. 16-19.

100 [ ].

101 [ ].

102 [ ].

2.39.5 **High profitability.** As shown in Chapter 6, we consider that the profitability of the New Zealand banking sector is high relative to peer countries. We are also not satisfied that the information provided fully explains the profitability of the bulk of the New Zealand banking sector since 2010. We therefore consider that at least part of the profitability is explained by the market power of some participants and that New Zealand's banking sector profits are higher than what would be expected if the major banks faced greater competition.

2.39.6 **Services are largely homogenous.** Competition between major banks seems to be strongest for certain focal services such as fixed rate home loans and term deposits.[103] These are focal services because they come into play at contestable times (ie, when a customer makes a key life decision).[104] However, we also observe that the major banks can price discriminate their rate offerings to different customers rather than make their best offers across the board and many customers are disengaged.

2.39.7 **There has been a lack of noteworthy entry or expansion.** In the last decade only Bank of China and China Construction Bank (both in 2014) have entered whereas HSBC (2023) has left the personal banking services market.[105,106] A number of new entrants such as Wise, Dosh, Squirrel and Simplicity offer a narrow range of services.[107] However, none of these participants has gained a significant share of supply in any of the markets in which they participate. In well-functioning markets, higher profitability provides a signal for other providers to enter and expand. In the personal banking market, we see limited entry and exit and relatively high profitability persisting over time, reinforcing our conclusion that competition is not strong.

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103 As a result of financial conduct reviews, such as the joint Reserve Bank and FMA culture and conduct review in 2018, there has been a simplification of services offered by providers. This has contributed to the current homogeneity of products.

104 [ ].

105 Reserve Bank "Registered banks in New Zealand" (28 February 2022) available at: https://www.rbnz.govt.nz/regulation-and-supervision/cross-sector-oversight/registers-of-entities-we-regulate/registered-banks-in-new-zealand.

106 HSBC "Latest update on the wind down of our deposit business" (undated) available at: https://www.hsbc.co.nz/wind-down/.

107 ANZ "Market study into personal banking services Preliminary Issues paper" (7 September 2023), at para 105.

Price competition varies by product and is sporadic, not sustained | *He rerekē te whakataetae ā-utu i runga i te āhua o tēnā, o tēnā hua, ā, he tāmutumutu te āhua*

Banks consider pricing for home loans and deposit accounts together

2.40 The basic business model for a bank involves borrowing funds from depositors and from capital markets and lending funds to borrowers at higher interest rates to the cost of borrowing. The interest rate margin between a bank's lending and borrowing activities must cover the costs of doing business for the bank to be profitable. This includes accounting for risks, operating costs, and the cost of capital.

2.41 Banks typically manage their risks through an internal treasury function. A bank's treasury is responsible for taking a pan-business view of deposit volumes (transactional accounts, savings accounts, and term deposits) and lending volumes (such as home loans, credit cards and commercial loans), and taking account of the important interplay between these deposit and lending services and their risks.

2.42 Notably, the balance between lending and deposit volumes is actively managed so they grow together since deposits are a key funding source for a bank's lending activities. In addition, the Treasury function needs to manage prudential capital and liquidity requirements.

2.43 Because of the interdependencies between the two sides of a bank's balance sheet, we heard from many of the major banks that the pricing and margins for different lending and deposit services are considered together.[108]

2.44 From a customer perspective, personal banking services are also typically highly interconnected. An everyday banking customer may also be an existing or future home loan customer and may have multiple other savings services with a provider. It is important to keep these connections in mind when discussing any personal banking service, because the interplay between the services has important implications for competition.

Price competition varies over time and focuses on matching

2.45 The major banks say pricing is highly competitive.[109] The banks regularly consider and set prices and a range of internal and external considerations are taken into account.

2.46 Although there is evidence of some price competition between providers, it appears to be sporadic.

2.46.1 For home loans, price competition is sporadic, and the benefits are often limited to engaged customers, excluding those who do not actively seek the best deals.

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108 [ ].

109 [ ].

2.46.2 For deposit accounts, price (interest rate) competition appears to be sharpest for term deposits, and to a lesser extent savings accounts. While there appears to be some sporadic price competition for savings deposits, large banks are able to attract deposits at lower interest rates than smaller providers offer.

2.46.3 There appears to be little price competition on transaction accounts: indeed, many transaction services are priced at zero.

2.47 There is a high degree of transparency which enables the major banks to quickly detect and respond to any changes in their rivals' competitive strategy. Competitors often match rates rather than beat them.[110,111]

2.48 This reduces the incentives to compete strongly because aggressive or ongoing price competition is unlikely to lead to sustained changes in share of supply.

2.49 One example of the major banks matching rather than beating each other's competitive offers is in 'green home loan top-up' offerings as shown in Figure 2.4 below.[112]

110 [ ].

111 [ ].

112 We note that prior to this activity, Kiwibank created an offer for cash bonuses when loans were taken for sustainable energy products (such as solar power). We do not see this offer as being part of the competitive playing field because of the narrow coverage, the lack of an interest rate that is unique to the offer, and because Kiwibank has not participated in matching the offers from other banks.

Figure 2.4 Timeline of "green home loan top-up" offers

Source: Commerce Commission.[113]

2.50 After an initial competitive move by ANZ, the playing field evened out as the banks started to match each other in loan terms and coverage. BNZ matched ANZ's offer, followed by ASB, and Westpac updated its offer twice to match aspects of the competing offers. ANZ initially 'beat' Westpac's offer, but there was no further notable innovation in the available offers. The result is a near homogenous set of offers from the four major banks.

2.51 We observe a market where there are strong incentives for players to match one another, but not to beat one another. Incentives to innovate and produce offers like the green loan might be dampened by the knowledge that competitors will quickly follow.

2.52 Smaller providers are largely unable to compete on the prices offered by major banks – such as the level of cashback offered by the major banks. This is due to a higher cost of funds and smaller scale.[114] Further, lowering lending rates or raising deposit rates would come at the expense of returns to fund long-term growth.[115]

113 [ ].
114 Heartland Bank "Submission on the Commerce Commission's Market study into personal banking services – Preliminary Issues paper" (7 September 2023), at p. 2.
115 [ ].

2.53 Competition for home loans and deposit accounts (including term deposits) are discussed in Chapter 4 and Chapter 5.

2.54 The responses to Verian's recent survey indicate that, across personal banking services, pricing is not a key driver for choosing a provider initially. This is consistent with the concept of main bank customers who start their relationship with the bank early in life and have their bank chosen for them. On average, only 35% of respondents said pricing was a key factor in choosing a provider.[116] However, for those customers switching services in the last three years, price was the biggest reason for those switching providers of savings accounts (23%), term deposits (38%) and home loans (31%).[117]

Non-price competition can be a driver of customers' choice of provider | *Mā te korenga o te whakataetae ā-utu e whakaaweawe i tā te kiritaki kōwhiri kaituku*

2.55 With customers having diverse needs and preferences, non-price aspects of competition are important considerations for consumers; research shows that some customers are willing to pay more for quality and service.[118] Providers compete on non-price measures such as range of products, service, perceptions of trust and security, digital capabilities and brand awareness to meet these needs.[119] Major banks place much focus on non-price offerings, for example approval times for home loan approvals, because it makes a difference to customers' needs.[120] Smaller providers also focus on implementing strong non-price offerings to drive customer growth.[121]

2.56 Marketing and branding are particularly important tools that providers use to compete. Perceptions of trust and security are often cited as important factors in consumers choosing major banks; consumers "…do trust banks to keep their money safe and to keep their information secure."[122]

2.57 Verian's recent consumer survey suggests that perceptions, including of security, are more important than specific product features when considering one of the major banks.[123] However, when considering smaller providers, domestic ownership is more important.

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116 Average calculated from positive responses to rates and fees being a driver for choosing a provider for transaction accounts, savings accounts, term deposits and home loans. Verian "Personal banking services market study - Research report" (February 2024), at p. 36.

117 Verian "Personal banking services market study - Research report" (February 2024), at p. 22.

118 [ ].

119 BNZ "Submission on the Commerce Commission's Preliminary Issues paper regarding the market study into personal banking services" (7 September 2023), at para 2.8.

120 [ ].

121 [ ].

122 ACCC "Retail deposits inquiry final report" (December 2023), at p. 23, available at: https://www.accc.gov.au/about-us/publications/retail-deposits-inquiry-final-report.

123 Verian "Personal banking services market study – Research report (February 2024), at p. 46.

2.58 Brand awareness is also particularly important as major banks spend a considerable amount on brand advertising as against specific services. Smaller providers are unable to match this spending.[124] Some providers consider brand is a point of leverage in the market and say that "…it is necessary to have a trusted brand."[125,126]

2.59 Marketing can take the form of community support which seeks to drive positive perceptions and positive experiences.

2.60 Major banks place a large amount of emphasis on service as they seek to provide a full product range, make experiences simple for customers and lessen the need for customers to switch providers.[127,128] Smaller providers also see service as important.

2.61 All of the major banks monitor Net Promoter Scores (NPS) which measure customer satisfaction.[129] Smaller providers often score higher than major banks in respect of customer service but do not see an increase in their shares of supply as a result.[130]

2.62 Despite the emphasis that providers place on non-price competition, it appears that there are limits to which customers' non-price needs and preferences are currently being met.

2.62.1 Small providers cannot match the large providers' investments in brand and consequently face difficulties attracting customers who place a high-value on perceived safety and trust.

2.62.2 Smaller providers face challenges in expanding their product range and this limits their ability to compete 'head-to-head' with major banks.

2.62.3 Customers continue to perceive that 'all banks are the same', with a homogeneous offering.[131] This might suggest that product range and service offerings from the major banks do not meet the diverse needs and preferences of customers. Despite this, there is limited switching to providers who may offer better products and services.

2.62.4 Some customers face difficulties in accessing some products and services (see discussion below).

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124 [ ].

125 [ ].

126 BNZ "Submission on Market study into personal banking services Preliminary Issues paper" (7 September 2023), at p. 65.

127 [ ].

128 [ ].

129 [ ].

130 Consumer NZ "Bank satisfaction survey 2022" (22 April 2022) available at: https://www.consumer.org.nz/articles/bank-satisfaction-survey-2022.

131 Verian "Personal banking services market study – Research report" (February 2024), at p. 54.

2.62.5 Fintechs and other digital providers who have the potential to offer a broader range of services and strengthen non-price competition have limited presence to date.

Features of the sector raise concerns about accommodating behaviour | *Ka ara ake ētahi āwangawanga i te āhua o te rāngai me tāna hei whakaawe whanonga*

2.63 Several features of the sector suggest it is prone to accommodating behaviour (or 'tacit coordination').

2.64 There are weak incentives, currently, on the major banks to engage in stronger price and non-price competition, in part as a consequence of the oligopolistic interdependence and the general stability in the sector.

2.65 Explicit coordination may be harmful and breach the Commerce Act prohibitions on cartels and anti-competitive agreements and understandings. We have not seen any evidence to suggest explicit coordination.

2.66 Accommodating behaviour (or 'tacit coordination') requires evidence of direct or indirect communication, or exchange of information, giving rise to an understanding. This is difficult to identify, and while we have not seen evidence of it, nor can we rule out the possibility that there could be accommodating behaviour occurring.

2.67 Many of our observations regarding the state of competition for personal banking services are consistent with the conditions for coordination. This includes:

2.67.1 concentrated supply and high barriers to entry and expansion;

2.67.2 the major banks' focus on maintaining existing share of supply and margins with sporadic competition;

2.67.3 persistently high profitability;

2.67.4 homogenous products;

2.67.5 ability of providers to readily observe each other's prices and volumes and a tendency to match prices;

2.67.6 limited innovation, stable demand, and a lack of market volatility; and

2.67.7 low rates of customer switching and high customer inertia which makes potential coordination easier to sustain.

2.68 The ACCC has also highlighted the risk of coordination in personal banking markets in Australia in considering ANZ Banking Group's proposed acquisition of Suncorp Bank. The Australian market has similarities to New Zealand, and the parent companies of New Zealand's four major banks supply most of the market. The ACCC said: "coordination [in the market for home loans] is most likely to involve the major banks engaging, either expressly or tacitly, in a 'live and let live' style of conduct or pattern of behaviour to achieve 'soft' or 'muted' price or non-price competition sufficient to either maintain and/or protect their existing share of supply and/or to not challenge the status quo."[132]

2.69 The Australian Competition Tribunal, in recently upholding an appeal of the ACCC's decision to decline authorisation, agreed with the ACCC that the home loans market in Australia is conducive to coordination, not least because the major banks have a combined share of banking system assets of 72%. That is less than the major banks' combined share of nearly 90% in New Zealand.

2.70 The Tribunal considered that the conditions for coordination in Australia have "recently reduced and are likely to continue to reduce in the foreseeable future" due to asymmetry in the market shares of the major banks, the emergence of Macquarie Bank as a "maverick" in the market, and the increasing use of brokers that has reduced customer choice frictions so facilitating greater switching.[133]

2.71 Although we have also observed an increasing use of mortgage brokers in New Zealand, in our view the changing conditions that the Tribunal mentions do not otherwise exist in New Zealand yet or to the same degree. In particular, there is no "maverick" currently and a number of choice frictions and impediments to switching.

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132 ACCC "Reasons for Determination ANZ Banking Group Limited and Suncorp Bank" (4 August 2023), at p. 7, available at: https://www.accc.gov.au/system/files/public-registers/documents/Reasons%20for%20determination%20-%2007.08.23%20-%20PR%20-%20MA1000023%20ANZ%20Suncorp.pdf. The ACCC also considered the market for retail deposits to have features making it similarly conducive to coordination as the market for home loans, but that a key difference was that home lending was usually the use to which retail deposits are traditionally put and, therefore, the major banks are less likely to be motivated to coordinate in relation to retail deposits than in relation to home loans.

133 Australian Competition Tribunal, ACT 1 of 2023 "Summary of reasons for determination" (20 February 2024), at para 17, available at: https://www.competitiontribunal.gov.au/__data/assets/pdf_file/0004/115942/240220-Summary-of-Reasons-for-Determination.pdf.

Competition is not working well for some consumer groups | *Kāore he painga o te whakataetaetanga mō ētahi rōpu kaiwhakapeto*

2.72 In addition to considering the overall state of competition in personal banking services, we have considered the more specific issue of whether there are differences in the intensity of competition to serve certain consumer groups.

2.73 Some consumer groups are particularly vulnerable to financial exclusion and find it difficult to access personal banking services, like a basic bank account or lines of credit. This includes consumers with learning and physical disabilities, recent migrants, those with low level financial capabilities, and those for whom digital barriers make it difficult to navigate banking options.

2.74 To understand this issue better, we sought feedback from a diverse range of consumer groups, charitable trusts, and stakeholders such as Consumer NZ, Christians Against Poverty New Zealand (CAP), FinCap, and Community Law centres. The wānanga we conducted with Māori representatives also contributed to this workstream.[134]

2.75 We have heard that there are vulnerable groups of consumers facing (potentially overlapping) issues regarding:

2.75.1 **Access to bank accounts.** Basic banking services are important for consumers to go about their daily lives. Some consumers – such as those who have a poor credit history, are experiencing insolvency, are fleeing domestic violence, have been declared bankrupt, or are former prisoners – can struggle to get access to basic bank accounts, which locks them out of the benefits of competition.

2.75.2 **Overdrafts leading to difficulties in switching.** Customers with overdrafts appear less likely to change banks once a main bank relationship has been established. This may be due to barriers, such as having unsecured debt or lower credit scores, which can make moving banks more complex. The CCCF Act contains responsible lending principles that provide important protections for indebted consumers but can act as a barrier to switching in some circumstances.

2.75.3 **Regulation leading to greater financial exclusion**. Some consumers have difficulties in providing suitable identification to meet AML/CFT processes. Without access to key documents, such as proof of address or a driver's licence, this creates an unintended barrier to enter or stay in the banking system.[135]

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[134] Commerce Commission "Summary of views expressed from Te Komihana Tauhokohoko wānanga" (14 February 2024).

[135] Australian Government AUSTRAC "Assisting customers who don't have standard forms of identification" available at: https://www.austrac.gov.au/business/core-guidance/customer-identification-and-verification/assisting-customers-who-dont-have-standard-forms-identification.

2.75.4 **Access to face-to-face banking at physical branches**. Branch closures and increased digitisation of personal banking services can particularly affect older consumers (who may be less familiar with digital services), consumers living with disabilities (eg, hearing or eyesight impaired, or mobility issues), or rural consumers (who need to travel further to visit a branch).

2.75.5 **Financial literacy.** Some consumers face difficulties in understanding banks' terms and conditions, interest rates, and comparing products and services. This limits their ability to choose the provider and product that best meets their needs. In some cases, consumers are more focused on simply accessing the services they require, rather than attempting to seek out or negotiate better interest rates.

2.76 These are areas where solutions could be more widely distributed for social good as competition alone is unlikely to lead to the needs of these vulnerable consumers being met.

2.77 We support existing work that is underway to help vulnerable consumer groups affected by these issues. Financial inclusion is one of the Council of Financial Regulators', Kaunihera Kaiwhakarite Ahumoni (CoFR) five priority themes.[136] CoFR collaborates on work underway within government to tackle different issues related to financial inclusion.[137]

2.78 The Conduct of Financial Institutions (CoFI) regime, which commences on 31 March 2025, includes an overarching "fair conduct" principle requiring financial institutions to treat consumers fairly.[138] The Retirement Commission, Te Ara Ahunga Ora has also been undertaking research on financial literacy.[139] This is aimed at providing a deeper understanding of the level of financial capability in New Zealand and how this compares internationally.

2.79 The CCCF Act is aimed at protecting consumers from irresponsible lending practices when they enter consumer credit contracts. Among other things lenders are required to make inquiries before entering consumer loans to check that loans are suitable and affordable, assist the borrower to understand the loan, and to treat the borrower reasonably and ethically when problems arise. We have heard that some consumers continue to fall into debt traps which perpetuate their financial difficulties.[140] This reinforces the need for consumer protection laws and strong regulatory oversight.

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136 CoFR, available at: https://www.cofr.govt.nz/priority-themes/inclusion.html.

137 Reserve Bank "Financial Inclusion – our approach at RBNZ – final report" (September 2023), available at: https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/publications/our-approach-to-financial-inclusion/our-approach-to-financial-inclusion.pdf.

138 Available at: https://www.mbie.govt.nz/business-and-employment/business/financial-markets-regulation/conduct-of-financial-institutions-regime/.

139 Retirement Commission "Financial Capability Research" available at: https://retirement.govt.nz/financial-capability/research/.

140 [ ].

2.80 Further details about our assessment of how competition is working for different consumer groups is included in Attachment D.

Chapter 3 Māori perspectives on competition for personal banking services | *Ngā tirohanga Māori mō te whakataetaetanga mō ngā ratonga pēke whaiaro*

Summary of preliminary findings

- **'Access' was a key theme that emerged from our engagements to understand Māori perspectives and interactions with personal banking services**.
- **Māori are a diverse group**. While many Māori may be satisfied with their access to personal banking products and services, we heard from stakeholders that, for some Māori, access to personal banking services can be disproportionately limited by factors such as location (with rural areas having fewer physical branches and ATMs) or limited access to online services, exclusion from basic banking services, or lower financial literacy and confidence engaging with providers.
- **We also heard about barriers to accessing personal banking services that are unique to Māori.** These include perceptions of racism and bias towards Māori from banks, lack of Māori representation in the banking sector, lack of understanding regarding Māori cultural and whānau dynamics, lack of data on Māori demographics, Māori SMEs, and the Māori economy, difficulty accessing finance for housing on Māori freehold land. These barriers, whether individually or together, can prevent Māori benefiting from the value and choice competition offers and make it more difficult for Māori to switch providers or assess the services that best meet their needs.
- **There are initiatives underway by Māori groups, government, and industry to address some of these challenges**. Although the efficacy of some of these initiatives is uncertain, we support continued efforts to overcome challenges specific to Māori. We are particularly supportive of initiatives where they align with solutions identified or endorsed by Māori.
- **One of the more prominent and unique issues affecting Māori is access to capital for housing on Māori freehold land**. About 5% of New Zealand is Māori freehold land, and this can provide a place for Māori to build homes. However, the legal restrictions on the land (which are in place to prevent the land being alienated from Māori ownership) make using it as security for loans more difficult and expensive.
- **To address these issues, a small number of bespoke home loan products have been created for Māori seeking to build papakāinga housing on Māori freehold land**. For example, the Kāinga Whenua Loan Scheme, leasehold lending supported by a partnership agreement, or shared equity arrangements. These products are typically created as partnerships between iwi, service providers, and/or government.
- **The uptake of these products has been limited to date.** It is not clear what is causing this, but it may be a combination of whether the product is attractive to Māori consumers, the high cost to banks to provide bespoke products and limited promotion of the products.
- **We support reducing the barriers Māori face when seeking access to personal banking services**, particularly initiatives to make home loan products for Māori freehold land more readily accessible.

Introduction | *Whakatakinga*

3.1 This chapter summarises Māori perspectives on competition in the sector based on the key themes of our Māori stakeholder engagement during the study.

We have sought to hear a diverse range of perspectives to understand how competition is working for Māori in the supply and acquisition of personal banking services

3.2 The Commission is listening to a wide range of viewpoints from both the providers and consumers of personal banking services to comprehend how competition is impacting Māori. Our work to date includes:

3.2.1 a wānanga, held on 30 October 2023, which included participants who brought a consumer, entrepreneurial, and community provider perspective on competition issues affecting Māori in the personal banking sector;[141]

3.2.2 engagement with Tāwhia, the Māori bankers' rōpū which consists of senior Māori representatives from ANZ, ASB, BNZ, Heartland Bank, Kiwibank, TSB, and Westpac;

3.2.3 engagement with other public sector agencies, including the Reserve Bank, Treasury and the Ministry for Housing and Urban Development, and Te Tūāpapa Kura Kāinga, on their related work on improving access to capital, and housing outcomes for Māori;[142]

3.2.4 a literature search on historic and current Māori interactions with banking and personal finance; and

3.2.5 engagement with consumer organisations that assist Māori (and other consumer groups) to navigate personal banking services.

3.3 We acknowledge that the views we have heard do not represent the views of all Māori. Further, it is important to recognise that Māori are a diverse group, and many Māori may be satisfied with their personal banking products and services. The engagement we have had, and the research we have drawn on, however, has often focused on where these services do not work for Māori.

3.4 Our engagements with stakeholders, including Māori stakeholders, are ongoing. We will continue to seek out views to further our understanding of how competition for the supply and acquisition of personal banking services affects Māori, as we engage with and respond to feedback on this draft report and prepare our final report.

141 We have published a summary of the views expressed at the wānanga, Commerce Commission "Summary of views expressed from Te Komihana Tauhokohoko wānanga" (14 February 2024).

142 While there is an interrelationship between these agencies' work and ours, our work more narrowly focusses on personal banking services – as a means through which individuals may access capital and consequentially obtain housing – and we apply a competition lens to our work.

Historical and cultural context are relevant to how Māori interact with personal banking services

3.5 We've heard that tikanga Māori[143] is important and relevant to understanding Māori interactions with personal banking services.[144] The importance of tikanga in the context of personal banking services was also a theme for discussion at our wānanga.[145]

3.6 The literature search we have undertaken suggests that, although approaches and attitudes will vary, traditional Māori values can still be relevant to the ways in which many Māori carry out economic activity (including personal banking and finances).[146,147] In particular, that whānau relationships are a key driver of attitudes and behaviour towards money. Sharing and lending money to whānau, travelling to spend time with whānau, and contributing financially to collective whānau needs are commonplace.[148] In addition, money is often used to support and benefit the larger family group, as well as for individual purposes, leading to "micro-economies" within whānau with income, expenses and assets shared through a kaitiaki approach.[149]

3.7 This is in contrast with what has been described as the predominant European/Pākehā approach to economic activity, and attitudes and behaviour towards money and wealth. This may be more individualistic, focusing on the dependent nuclear family, with the general belief that money gifts are only acceptable between close family members and individual responsibility for money is emphasised.[150]

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143 Tikanga is the customary system of values and practices that have developed over time and are deeply embedded in the Māori social context. It is made up of 'tika', which means correct or right, and 'ngā' which is the plural of something. It captures the norms for Māori across concepts such as culture, protocols, guidelines, etiquettes, ethics, and law. That is, to understand tikanga is to be able to be culturally competent.

144 [ ];
[ ];
[ ].

145 Commerce Commission "Summary of views expressed from Te Komihana Tauhokohoko wānanga" (14 February 2024), at p. 8 and 12.

146 Houkamau, Carla A., Sibley, Chris G. "The role of culture and identity for economic values: a quantitative study of Māori attitudes" Journal of the Royal Society of New Zealand: Vol 49, No S1, 2019, at p. 118-136; Houkamau, Carla A., Stevens, Alexander, Oakes, Danielle, & Blank, Marino "Embedding Tikanga Māori into financial literacy training for Māori" (March 2020) Te Arotahi Series Paper No. 05, at p. 4, available at: https://www.maramatanga.ac.nz/media/5909/download?attachment.

147 Manaakitanga – caring for others, generosity; Mana – power, status, influence; Whanaungatanga – whakapapa based relationships; Utu – balance, reciprocity.

148 Houkamau, Carla A., Stevens, Alexander, Oakes, Danielle, & Blank, Marino "Embedding Tikanga Māori into financial literacy training for Māori" (March 2020) Te Arotahi Series Paper No. 05, at p. 2.

149 Houkamau, Carla A., Stevens, Alexander, Oakes, Danielle, & Blank, Marino "Embedding Tikanga Māori into financial literacy training for Māori" (March 2020) Te Arotahi Series Paper No. 05, at p. 4; [ ]; Kiwibank "Submission on market study into personal banking services – Preliminary Issues paper" (7 September 2023), at p. 4.

150 Houkamau, Carla A., Stevens, Alexander, Oakes, Danielle, & Blank, Marino "Embedding Tikanga Māori into financial literacy training for Māori" (March 2020) Te Arotahi Series Paper No. 05, at p. 3-4.

3.8 These different world views appear to manifest themselves as different preferences held by some Māori with regards to personal banking services. This can raise some distinct issues for Māori when seeking those services. This is explored further below.

Māori consumers face a range of barriers to accessing personal banking services | *Arā ngā tauārai ki ngā kiritaki Māori kia taea e rātou ngā ratonga pēke whaiaro*

3.9 Many population groups face barriers to accessing suitable personal banking services. We discuss some of these in more detail in Chapter 2 and Attachment D. We are interested in barriers to accessing personal banking services because they prevent consumers benefiting from the value and choice competition can offer.

3.10 We have heard that Māori are likely to experience some of these barriers disproportionately, and that there are also barriers that are unique to Māori.

3.11 We do not have good data on the impact these barriers are having on Māori. But it is likely that these issues, together or individually, are preventing some Māori from gaining the full benefits of competition for personal banking services.

3.12 Barriers to access mean some Māori are acquiring fewer services than they want – and missing out on the opportunities that personal banking services provide. These issues may also prevent Māori from being able to choose the services or service providers that best meet their needs. Providers are also unlikely to be able to best serve their Māori customers if their staff do not reflect the communities they serve, or do not have a good understanding of their preferences and aspirations.

Māori can experience some access issues disproportionately to other New Zealanders

3.13 Barriers facing New Zealand consumers when accessing personal banking services can disproportionately impact some Māori, including:

3.13.1 restricted access to personal banking services associated with rural living and digital exclusion;

3.13.2 exclusion from basic personal banking services;

3.13.3 financial literacy and confidence when engaging with providers of personal banking services; and

3.13.4 lack of transparency in how banks make decisions.

Access can be challenging for those that live rurally or are digitally excluded

3.14 We have heard that the lack of physical access to banks is an issue for some Māori, particularly in rural areas.[151] A higher proportion of Māori live in small urban areas (14.7% of the Māori population) and rural areas (18.0% of the Māori population), compared with the total population (10.0% and 16.3% respectively).[152] Reduced access and limited choice for Māori (and other New Zealanders) living rurally was also a theme of our 2022 retail grocery sector study.[153]

3.15 We also heard that some Māori consumers don't have basic digital access to engage in online banking services.[154] This is reflected in research which finds Māori are one of the groups with relatively low access to the internet.[155]

Exclusion from accessing basic personal banking services

3.16 We heard some Māori consumers don't have ready access to identification, and some can't obtain proof of address to open accounts.[156] This aligns with a recent report by Citizens Advice Bureau on Māori engagement, which noted that 'clients seek our help for obtaining ID that will enable them to open or access a bank account, especially if they do not have all the information or paperwork required to do so.'[157]

3.17 We also heard that exclusion from basic personal banking services is often associated with wider systemic barriers and have a negative flow-on impact for whānau in the banking system. For example, turning to loan sharks if mainstream banks are inaccessible.[158]

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151 Commerce Commission "Summary of views expressed from Te Komihana Tauhokohoko wānanga" (14 February 2024), at p. 5.

152 https://www.ehinz.ac.nz/indicators/population-vulnerability/urbanrural-profile/.

153 Commerce Commission "Market study into the retail grocery sector – Final Report" (8 March 2022), at para 4.4, available at: https://comcom.govt.nz/__data/assets/pdf_file/0024/278403/Market-Study-into-the-retail-grocery-sector-Final-report-8-March-2022.pdf.

154 Commerce Commission "Summary of views expressed from Te Komihana Tauhokohoko wānanga" (14 February 2024), at p. 5.

155 Grimes, Arthur, White, Dominic, Motu Economic and Public Policy Research "A report to Department of Internal Affairs: Digital inclusion and well-being in New Zealand, Motu Working Paper 19-17" (October 2019), at p. 7, available at: https://motu-www.motu.org.nz/wpapers/19_17.pdf.

156 Commerce Commission "Summary of views expressed from Te Komihana Tauhokohoko wānanga" (14 February 2024), at p. 6.

157 Citizens Advice Bureau New Zealand "Māori Engagement with Citizens Advice Bureau: A CAB Spotlight Report into Inequity Experienced by Māori in Aotearoa" (2023).

158 Commerce Commission "Summary of views expressed from Te Komihana Tauhokohoko wānanga" (14 February 2024), at p. 6.

Financial literacy can impact the quality of personal banking services Māori access

3.18 We heard that some Māori consumers tend to accept the first offer of services and rates that are made to them, and some do not know how or when to ask, or may be uncomfortable asking, for better services or rates – nor have they been offered the opportunity by providers to easily engage in these types of 'option and choice' conversations.[159]

3.19 While these experiences are not unique to Māori, research by the FMA and Te Ara Ahunga Ora Retirement Commission has found self-rated financial knowledge and understanding is significantly lower among Māori, as compared to the European/Pākehā population.[160]

Lack of transparency on how decisions are made

3.20 We heard that some Māori consumers are being declined products, such as home loans, without being given an explanation. This lack of explanation may leave them unable to change financial habits or behaviour so that the product can be obtained in the future.[161] A lack of transparency contributes to a lack of confidence and trust in the banking system.

3.21 These experiences align with research by the FMA which found that Māori are less likely to trust banks than people of other ethnicities.[162]

There are also some access issues that are unique to Māori consumers

3.22 Issues around accessing personal banking services that are unique to Māori consumers include:

3.22.1 the perception of racism and institutional bias towards Māori from banks;

3.22.2 a lack of Māori representation in the banking sector (frontline staff and leadership);

3.22.3 a lack of understanding regarding Māori cultural and whānau dynamics;

3.22.4 a lack of good data being collected about Māori as a demographic; and

3.22.5 difficulty around accessing lending for building or living on Māori freehold land.

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159 Commerce Commission "Summary of views expressed from Te Komihana Tauhokohoko wānanga" (14 February 2024), at p. 6.

160 FMA "Consumer Experience within the Financial Sector Survey" (July 2022), at p. 20, available at: https://www.fma.govt.nz/assets/Reports/FMA-Consumer-Experience-with-the-Financial-Sector-Survey-2022.pdf; Te Ara Ahunga Ora Retirement Commission "New Zealand Financial Capability Survey 2021" (2021), at p. 11, available at: https://assets.retirement.govt.nz/public/Uploads/Research/TAAO-RC-NZ-FinCap-Survey-Report.pdf.

161 Commerce Commission "Summary of views expressed from Te Komihana Tauhokohoko wānanga" (14 February 2024), at p. 6, 8.

162 FMA "Consumer Experience within the Financial Sector Survey" (July 2022), at p. 36-38.

The perception of racism and institutional bias from banks

3.23 We heard that some Māori seeking personal banking services feel there is a degree of judgement and bias when Māori consumers engage with personal banking services.[163] We heard of experiences with personal banking service providers, such as having a sense of being racially profiled, and service providers failing to understand whānau dynamic and circumstances.[164]

3.24 We also heard from some wānanga attendees that they automatically expect to be told “no” when engaging with personal banking providers (for example, for a home loan or to open a bank account). We heard that for some Māori, banks continue to be seen as part of the overall distrusted government system.[165]

3.25 These experiences align with research by the FMA which found Māori are less likely to trust banks than people of other ethnicities.[166] What we heard at our wānanga also aligns with research conducted by Ngā Pae o Te Māramatanga (the Māori Centre of Research Excellence) who reported, in a study conducted on embedding tikanga into financial literacy, that participants experienced racism or feeling judged or looked down upon when visiting banks, and saw banks as Pākehā institutions.[167]

Lack of representation in the supply of personal banking services

3.26 We heard that Māori consumers perceive there to be a low number of Māori staff working in the personal banking sector, and that the workforce composition does not reflect the composition of the communities and populations that they work within.[168] We understand that as a result of this, some Māori may feel as though their needs are not being catered for.

3.27 We have also heard there is a lack of knowledge of whether there are currently any Māori owned or led personal banking service providers that would apply a Māori cultural lens and perspective to a European/Pākehā concept.[169] This aligns with our research that suggests there are few such providers (aside from iwi savings schemes) and those that operate are limited in their focus.

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163 Commerce Commission “Summary of views expressed from Te Komihana Tauhokohoko wānanga” (14 February 2024), at p. 6.

164 Commerce Commission “Summary of views expressed from Te Komihana Tauhokohoko wānanga” (14 February 2024), at p. 8.

165 Commerce Commission “Summary of views expressed from Te Komihana Tauhokohoko wānanga” (14 February 2024), at p. 6.

166 FMA “Consumer Experience within the Financial Sector Survey” (July 2022), at p. 37.

167 Houkamau, Carla A., Stevens, Alexander, Oakes, Danielle, & Blank, Marino “Embedding Tikanga Māori into financial literacy training for Māori” (March 2020) Te Arotahi Series Paper No. 05, at p. 9.

168 Commerce Commission “Summary of views expressed from Te Komihana Tauhokohoko wānanga” (14 February 2024), at p. 6.

169 Commerce Commission “Summary of views expressed from Te Komihana Tauhokohoko wānanga” (14 February 2024), at p. 8.

Lack of understanding regarding Māori cultural and whānau dynamics

3.28 We heard at the wānanga that mainstream banks are not innovating to respond to Māori consumer needs, and that banks are perceived as not serving or educating Māori sufficiently to meet their needs.[170]

3.29 These experiences align with research by Te Māngai Penapena Pūtea - Financial Literacy and Savings Partner working group that found there was a general "lack of fit" between mainstream banking services and Māori.[171] Numerous stakeholders that it heard from stated that banks tailor and market banking products to suit a standard template of life stages that may not suit Māori as well as other segments of the population. It provided, as an example, the difficulty involved with using funds contributed on a collective basis as security against lending to an individual, for example in situations where a wider whānau pools funds as security for a mortgage to be issued to an individual. While the working group noted that it is 'reasonable for banks to rely on standardised criteria in considering mortgage applications, the nature of these criteria has the unintended consequence of making mortgages more difficult for Māori to obtain in comparison to other segments of the population.'

3.30 A report published by the Reserve Bank in 2021, which focused on examining whether the financial system was adequately meeting the needs of all New Zealanders, and in particular Māori, found that the 'financial system may not be adequately tailored for Māori needs or circumstances, which may contribute to reduced access to financial services'.[172]

3.31 Financial institutions currently have an insufficient understanding of the needs and preferences of Māori. This reduces the ability of financial institutions to engage with Māori customers effectively or offer products that target the Māori economy.[173]

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170 Commerce Commission "Summary of views expressed from Te Komihana Tauhokohoko wānanga" (14 February 2024), at p. 7.

171 Te Māngai Penapena Pūtea – Financial Literacy and Savings Partner working group "Whānau and Low-Income Household Savings Report" (April 2015), at p. 18, available at: https://www.mbie.govt.nz/dmsdocument/1064-hkkar-whanau-and-low-income-household-savings-report-pdf.

172 Reserve Bank, McLeod, Roanna and Lam, Victor "An overview of Māori Financial Services Institutions and Arrangements" (15 April 2021), at p. 4, available at: https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/publications/analytical-notes/2021/AN2021-04.pdf.

173 ANZ "Submission on market study into personal banking services – Preliminary Issues paper" (7 September 2023), at para 18; [ ].

Lack of good data

3.32 It appears that many personal banking service providers do not collect data on or analyse Māori consumers as a demographic to compete for.[174] One option to support this process is to develop a common and consistent set of indicators such as compound or correlative measures of financial inclusion.[175]

3.33 The lack of hard data collection on Māori consumers is consistent with the Reserve Bank's findings in its Improving Māori Access to Capital Issues Paper – that there is a shortage of hard data on Māori SME and the Māori economy.[176] Factors such as providers' limited understanding of the needs and preferences of Māori, combined with a lack of hard data on Māori as a consumer group, likely further contribute to Māori facing distinct challenges in obtaining personal banking services and being less able to benefit from competition as a result.[177]

Māori freehold land

3.34 Obtaining a home loan for building on Māori freehold land can be difficult. Under Te Ture Whenua Māori Act 1993 (Te Ture Whenua Māori), Māori freehold land cannot be alienated from Māori ownership (except under certain conditions which must satisfy the Māori Land Court). This means that lenders typically will not accept Māori freehold land as security for the loan. During our 2022 residential building supplies study we heard from Māori about the difficulties raising finance to build papakāinga.[178]

3.35 Some initiatives have been designed especially for lending on Māori freehold land, however we understand that the cost to serve ratio for these products is high and they are generally non-scalable – leading to them being non-prioritised by lenders, and not easily accessible for those consumers who might wish to access them.

3.36 Further detail around obtaining a home loan over Māori freehold land, as an issue that is unique to Māori consumers, is set out later in this chapter.

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174 Financial Services Federation "Submission on market study into personal banking services – Preliminary Issues paper" (7 September 2023), at p. 7 and 10; We understand that personal banking service providers – particularly the major 4 banks – collect data on various demographics including [ ] See for example [ ]; [ ]; [ ]; [ ]; [ ]. However there appears to be a lack of data collected by those banks on Māori as a demographic.

175 [ ].

176 Reserve Bank "Improving Access to Capital Issues Paper" (August 2022), p 6, available at: https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/consultations/maori-access-to-capital/improving-maori-access-to-capital-issues-paper.pdf.

177 ANZ "Submission on market study into personal banking services – Preliminary Issues paper" (7 September 2023), at para 18.

178 Commerce Commission "Residential building supplies market study – Final Report" (6 December 2022), para 3.17, available at: https://comcom.govt.nz/__data/assets/pdf_file/0014/300704/Residential-Building-Supplies-Market-Study-Final-report-6-December-2022.pdf.

We are aware of a range of initiatives to address the access issues discussed above

3.37 The issues we heard at the wānanga and which we describe above are not new, and in many cases, are not unique to Māori. We describe below initiatives we are aware of that seek to address these issues, including work to:

3.37.1 enhance cultural competency within service providers;

3.37.2 increase Māori representation in the sector;

3.37.3 promote financial literacy for Māori; and

3.37.4 other initiatives that may address the issues we have identified.

Addressing a lack of understanding regarding Māori cultural and whānau dynamics

3.38 Ensuring banks have a better understanding of tikanga Māori and te reo was identified by wānanga participants as a potential contributor to better access.[179]

3.39 Several of the larger banks have programmes in place that seek to improve the cultural competency, confidence, and te reo Māori skills of their staff.[180]

3.40 We are not aware of any evidence supporting the efficacy of these programmes within banks and note that issues such as a lack of understanding of tikanga appear to persist despite the programmes being in place. Nonetheless, we consider these types of initiatives are likely helpful, and they appear to be the types of initiatives supported by Māori we spoke to. We recognise that changing cultures within institutions, and perceptions of those institutions amongst Māori, is unlikely to be a quick or simple task. We support these initiatives by banks to better understand their customers.

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179 Commerce Commission "Summary of views expressed from Te Komihana Tauhokohoko wānanga" (14 February 2024), at p. 8 and 12.

180 ANZ "Submission on market study into personal banking services – Preliminary Issues paper" (7 September 2023), at para 20, [ ], ASB "Submission on market study into personal banking services – Preliminary Issues paper" (7 September 2023), at para 4.2; [ ], [ ].

Addressing financial literacy and confidence in engaging with financial institutions

3.41 We are aware of a range of initiatives to address financial literacy and confidence for Māori in particular:

3.41.1 Tāwhia, the Māori bankers' rōpū, have partnered with Te Ara Ahunga Ora Retirement Commission and Te Rangapū Pēke – the NZBA, to develop a pilot programme called Te Rito Hou, a financial well-being programme aimed at providing Māori with trusted information so that they can make good financial decisions for their whānau. The programme also includes connecting whānau with local bankers to create a trusted connection and further break down barriers in relation to financial services. Te Rito Hou is delivered through Sorted.[181] The programme has been created 'for Māori by Māori.'[182]

3.41.2 Separate to Te Rito Hou, Sorted Kāinga Ora is a programme that builds the financial capability of whānau so they can make choices about how to meet their housing aspirations. It was developed jointly by Te Puni Kōkiri and Te Ara Ahunga Ora Retirement Commission.[183]

3.41.3 Individual banks are independently taking a range of approaches to the issue of financial literacy. Some have generic financial literacy programmes, others have programmes that are specifically targeted at, and created for, Māori. Some have stated an intent to create programmes specifically for Māori.[184]

3.42 Improving the financial literacy of whānau Māori was one of the suggested solutions to access issues that was discussed at our wānanga,[185] and contributing to financial literacy of Māori, Te Poutokomanawa, is one of three Tāwhia Pou.[186]

3.43 Financial literacy is certainly not an issue unique to Māori (we discuss financial literacy with respect to all New Zealanders in Chapter 2 and Attachment D). We support the efforts around financial literacy being undertaken by providers of personal banking services to date and encourage the continuation of such initiatives.

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181 See https://www.nzba.org.nz/2023/09/14/wananga-launched-to-support-whanau-financial-literacy/

182 [ ].

183 See: https://www.tpk.govt.nz/en/nga-putea-me-nga-ratonga/maori-housing-support/financial-capability-programmes-sorted-kainga-ora.

184 ASB "Submission on market study into personal banking services – Preliminary Issues paper" (7 September 2023), para 4.4(b)(ii)-(iii), [ ], [ ], [ ].

185 Commerce Commission "Summary of views expressed from Te Komihana Tauhokohoko wānanga" (14 February 2024), at p. 7.

186 See: https://www.linkedin.com/company/t%C4%81whia-m%C4%81ori-bankers-r%C5%8Dp%C5%AB/.

Addressing lack of Māori representation in the supply of personal banking services

3.44 Some providers of personal banking services have told us they are focused on increasing Māori representation in the banking sector, including in particular:

3.44.1 in leadership roles;[187]

3.44.2 by setting targets for representation of Māori within their business;[188] and

3.44.3 by supporting career pathways, internships, and graduate programmes for Māori.[189]

3.45 We are aware of BlinkPay, a payments fintech, that describes itself as Māori-owned, managed and funded.[190] However, we are not aware of any other Māori owned or led providers of personal banking services (aside from iwi savings schemes), and attendees at our wānanga were not aware of any others either.[191]

3.46 Increasing Māori representation in the supply of personal banking appears to have scope to address some of the access issues we heard at the wānanga, including issues around suspicion and perception of racial profiling, trust in institutions, and lack of understanding of Māori cultural and whānau dynamics.[192] Working with the financial sector to boost Māori employment across banks aligns to Tāwhia Pou, Te Pou Tū-a-rongo.[193]

3.47 We were told at the wānanga that Māori-owned or led providers of personal banking services might result in more active participation from whānau in personal banking. We were also told that Māori-owned or Māori-led providers of personal banking services would help make the banking system easier for Māori to navigate and that there would be increased opportunity for Māori to be employed and advance their careers in the sector.[194]

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187 [ ], Kiwibank "Submission on market study into personal banking services – Preliminary Issues paper" (7 September 2023), p 12.

188 Kiwibank "Submission on market study into personal banking services – Preliminary Issues paper" (7 September 2023), p 12.

189 ASB "Submission on market study into personal banking services – Preliminary Issues paper" (7 September 2023), para 4.2, [ ].

190 See: https://www.blinkpay.co.nz/.

191 Commerce Commission "Summary of views expressed from Te Komihana Tauhokohoko wānanga" (14 February 2024), at p. 8.

192 Commerce Commission "Summary of views expressed from Te Komihana Tauhokohoko wānanga" (14 February 2024), at p. 7.

193 See: https://www.linkedin.com/company/t%C4%81whia-m%C4%81ori-bankers-r%C5%8Dp%C5%AB/.

194 Commerce Commission "Summary of views expressed from Te Komihana Tauhokohoko wānanga" (14 February 2024), at p. 9.

3.48 We support efforts by personal banking service providers to increase Māori representation in the supply of personal banking services. These initiatives are aligned with the Reserve Bank's broader support of the promotion of greater representation of Māori across the governance, leadership, and operation of organisations, as a potential pathway to address financial service providers – and in particular banks' – decision-making, in relation to Māori access to capital.[195]

Other initiatives we are aware of

3.49 There are other initiatives in place which we consider may address the issues that Māori face:

3.49.1 the Reserve Bank is investigating suitable indicators for financial inclusion, which would assist with data collection on Māori accessing personal banking services;[196] and

3.49.2 other initiatives that are not specifically targeted at Māori but all consumers, but that we believe may address some of the issues that Māori face, are set out in Chapter 2 and Attachment D. These include greater access to bank accounts, physical bank branches, and financial literacy initiatives.

Māori freehold land presents unique challenges for Māori and home loan providers | *Kei ngā whenua herekore Māori he wero mā te Māori me ngā kaituku moni taurewa kāinga*

Māori freehold land is inalienable, and most Māori freehold land is multiply-owned

3.50 Māori freehold land is freehold land that has never been out of Māori ownership. It makes up roughly 5% of land in Aotearoa.[197]

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195 Reserve Bank "Public Feedback on Improving Māori Access to Capital Issues Paper: Summary of Submissions" (October 2022), p 7, available at: https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/consultations/maori-access-to-capital/public-feedback-on-improving-maori-access-to-capital-issues-paper.pdf.

196 [ ].

197 Community Law "Status of Māori land", available at: https://communitylaw.org.nz/community-law-manual/test/status-of-maori-land/.

3.51 There are certain characteristics of Māori freehold land that make it different to general freehold land when considering building on it or buying and relocating an existing house on it. In particular:

3.51.1 Te Ture Whenua Māori protects Māori freehold land by prohibiting it from being alienated from Māori ownership (except under certain conditions that satisfy the Māori Land Court).[198] In the event of default, the Te Ture Whenua Māori would generally prevent a lender from being able to take possession of and sell the land to recover borrowed amounts. This means that lenders cannot take security over Māori freehold land.

3.51.2 Most, if not all, Māori freehold land has multiple owners, with large amounts of it being held in trusts created by the Māori Land Court under Te Ture Whenua Māori. This means that there are many interests in the land which can affect lenders' obligations under the AML/CFT Act, as well as borrowers' obligations should they wish to access products such as a Kāinga Whenua Loan (discussed further below).

3.52 These characteristics make it difficult to obtain finance for housing on Māori freehold land.

Some home loan providers have found ways to lend money for housing on Māori freehold land, often in partnership with Māori, Iwi, or government

3.53 Home loan providers have a range of initiatives to overcome some of the difficulties associated with lending money for housing on Māori freehold land. Examples we are aware of include:

3.53.1 BNZ has sought to address the characteristics of Māori freehold land through an alternative tenure arrangement – leasehold lending supported by a partnership agreement (involving a guarantee from the borrower's iwi).[199]

3.53.2 Westpac has used shared equity agreements supporting lending over Māori freehold land. While it appears that each of the arrangements is tailored to the needs of iwi they were developed for, a fundamental component is iwi involvement in the mortgage that is entered into between whānau and the bank - whether as a guarantor, or by providing a portion of equity that the whānau then pays back over time.[200]

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198 Part 7, Part 8, Te Ture Whenua Māori Act 1993.

199 See: https://blog.bnz.co.nz/2024/01/unlocking-home-ownership-aspirations-for-iwi-housing-bnz-and-ngati-whatua-orakei-collaborate-on-papakainga-development

200 See: https://www.westpac.co.nz/rednews/relationship-with-iwi-leads-to-innovative-papakainga-shared-equity-model-for-whanau/ and https://www.westpac.co.nz/rednews/waikato-tainui-sign-shared-equity-agreement-to-build-50-homes-for-whanau/.

3.54 Kiwibank has approached lending on Māori freehold land through a collaborative approach with government. It supports the Kāinga Whenua Loan Scheme, administered by Kāinga Ora and Te Puni Kōkiri. Under the Kāinga Whenua Loan Scheme, loans can be provided to individuals or trusts to build on Māori freehold land, however, the loan is supplied only for the house (not the land) and security is only taken over the house. This means that the house built or located on the land must meet certain criteria. Other criteria must also be met to obtain a Kāinga Whenua loan including obtaining a right to occupy the land from the Māori Land Court.

3.55 More generally, some banks have amended their standard home loan policies to allow lending on Māori freehold land:

3.55.1 In 2021 BNZ amended its policy on loans secured against Māori freehold land. If the land had been valued by an acceptable registered valuer, BNZ can adopt the same security value for Māori freehold land as it would for an equivalent parcel of land held in general title.[201]

3.55.2 ASB's lending standard provides for Māori freehold land to be an acceptable security, however it can only apply lending for Māori freehold land where the land is held by a sole owner, joint tenants, or owners in common (up to a limited number), Te Ture Whenua Māori constituted trusts, or incorporations.[202]

3.55.3 ANZ has informed us that its policies provide for borrowing against general freehold land in collective Māori ownership and Māori freehold land.[203]

These existing initiatives appear promising, but we understand the cost to serve the loans is still considerable, leading to non-prioritisation

3.56 The initiatives by banks that we described above appear to address some of the issues associated with lending on Māori freehold land. We've heard, and agree, that there are no simple solutions to these issues,[204] and that a collaborative approach is likely to be an appropriate way forward.[205]

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201 BNZ "Submission on market study into personal banking services – Preliminary Issues paper" (7 September 2023), at para 6.18.

202 ASB "Submission on market study into personal banking services – Preliminary Issues paper" (7 September 2023), at para 4.4.

203 [ ].

204 [ ].

205 Commerce Commission "Summary of views expressed from Te Komihana Tauhokohoko wānanga" (14 February 2024), at p. 12; [ ].

3.57 That said, uptake of these services appears to be slow. BNZ has told us that there has been low uptake for home lending over Māori freehold land despite its change to its general policy, however it is still investigating why.[206] ASB has also told us that it is working on clarifying its position on lending over Māori freehold land to the market,[207] indicating that uptake has been low. There has also been low uptake of the Kāinga Whenua Loan.[208] However we understand that the Ministry for Housing and Urban Development and Kāinga Ora plan to review the Kāinga Whenua Loan Scheme, with a focus on increasing its uptake.[209]

3.58 Low uptake of these services may be driven by a range of factors, including:

3.58.1 The services themselves may be seen as undesirable. For example, Kāinga Whenua Loans are only available for housing, and not the underlying land. This means houses must be transportable – placing restrictions on the size of homes.[210]

3.58.2 The cost to provide these services is high.[211] Reasons include:

3.58.2.1 Each initiative is unique and tailored to the needs of the iwi, hapū or whānau. Many of the systems and processes used are not easily repeatable or scalable.[212]

3.58.2.2 The regulatory environment creates significant costs associated with these transactions. For example, we understand the way that Māori land trusts are currently assessed under the AML/CFT Act is disproportionate to their relatively low-risk. This is described further below, along with other aspects of regulation that do not appear to be a good fit when applied to lending on Māori freehold land.

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206 BNZ “Submission on market study into personal banking services – Preliminary Issues paper” (7 September 2023), para 6.18.

207 ASB “Submission on market study into personal banking services – Preliminary Issues paper” (7 September 2023), para 4.4.

208 We understand that in 2022, in the 12 years since the loan scheme was launched, only 63 loans had been issued. See: https://www.nzherald.co.nz/nz/the-land-laid-bare-why-maori-cant-build-on-their-whenua/6DHW6TDQO37EXWRKMDLNNRHML4/.

209 Ministry of Housing and Urban Development “Annual Report 2022/23”, at p. 41, available at: https://www.hud.govt.nz/assets/Uploads/Documents/Te-Tuapapa-Kura-Kainga-Annual-Report-2023.pdf.

210 See: https://kaingaora.govt.nz/en_NZ/home-ownership/kainga-whenua/kainga-whenua-loans-for-individuals/

211 [ ]; [ ].

212 [ ].

3.58.2.3 There may be difficulty engaging between providers (who may lack cultural capability) and borrowers (who may lack financial literacy), particularly when borrowers are physically remote (for example, living rurally without access to a physical bank branch).[213]

3.58.3 It is unclear whether banks are prioritising these products.[214]

3.59 We are aware of some initiatives and potential options to address these issues and discuss them below.

Regulation and policy such as the AML/CFT Act, risk-weighted asset, and loan-to-value ratio (LVR) not being a good fit when applied to the provision of bespoke home loan products created for Māori

3.60 AML/CFT and prudential regulation were not designed with Māori freehold land in mind. This can make it difficult, and create unintended consequences, when applying those regulations to home loan products created for Māori.[215] As a result, Māori can remain disadvantaged, even when trying to access products that were created to work around the inalienability and multiple ownership of Māori freehold land.

3.61 Under the AML/CFT Act, all trusts are subject to enhanced customer due diligence (ECDD) due to trusts being categorised as higher risk in the AML/CFT Act. ECDD includes providing copies of the original trust deed, any amendments to the trust, including changes to trustees or beneficiaries since the inception of the trust, and verifying the source of funds or wealth for the trusts. This can be difficult for Māori land trusts constituted by the Māori Land Court, given the trustees change on a regular basis, the trusts can be a lot older than a general trust, and the central access point for historic records is the Māori Land Court, all of which makes providing the information required for ECDD difficult and time consuming.[216]

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213 [ ].

214 [ ].

215 Kiwibank "Submission on market study into personal banking services – Preliminary Issues paper" (7 September 2023), p 4; [ ]; [ ].

216 [ ].

3.62 In relation to the risk-weighted asset and LVR set by the Reserve Bank, we have been told that a risk weighting and LVR set specifically for Māori freehold land would make this lending more attractive to banks.[217]

3.63 Making lending over Māori freehold land more attractive to banks would potentially address some of the competition issues associated with the non-prioritisation of these products.

There may be scope to reduce costs by enhancing the scale and reach of existing initiatives

3.64 We consider there may be scope for providers of these alternative loan products to develop common frameworks and models, and to promote the use of existing initiatives that are working, such that the cost to serve is reduced. We discuss these ideas further in Chapter 10.

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217 Kiwibank "Submission on market study into personal banking services – Preliminary Issues paper" (7 September 2023), p 4.
[

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Chapter 4 Competition for home loans | *Te whakataetaetanga mō ngā pūtea tārewa kāinga*

Summary of preliminary findings

- **Home lending is the most important personal banking product for providers, due to both the size of the portfolio and its contribution to overall revenue.** Home lending customers also tend to be valuable and 'sticky'.
- **The vast majority of home lending is provided by the major banks and Kiwibank, collectively representing around 95% of all home lending by registered banks**. ANZ has the largest home lending portfolio with around 30% of lending, followed by ASB (21%), Westpac (19%), BNZ (17%), and Kiwibank (7%). These shares have been very stable in recent years, partially reflecting the long-term nature of home lending portfolios.
- **Competition between the major banks is sporadic.** Each of the major banks has a greater or lesser growth ambitions at any point in time, but none are consistently offering 'best in market' home lending interest rates.
- **The major banks and Kiwibank do not face strong competition from smaller banks and other lenders.** When setting interest rates, the major banks and Kiwibank focus largely on each other, with little or no regard to the pricing decisions of smaller lenders.
- **Kiwibank's portfolio has grown steadily and at a faster rate than the major banks over the last five years, but from a much lower base.** Its growth has not been fast enough for Kiwibank to be a significant competitive disrupter.
- **Established patterns of price matching behaviour reduce the incentives to compete hard on interest rates, because the larger providers know that if they introduce a new promotion or lower interest rate, it will quickly be matched by competitors.** We are concerned that this could have the effect of muting price competition overall.
- **Discretionary discounting and price matching enable banks to selectively compete to win or retain more valuable customers, while increasing their interest rates for less price sensitive customers**. An important consequence of these price matching strategies is that the benefits of competition accrue only to those customers who are willing and able to shop around for the best deals.
- **Although the best way to negotiate a good deal is to shop around, customers seldom do.** Around half of customers considered only one bank when they first chose their home loan provider. This inertia serves to re-enforce the market positions of the major banks over the other providers.
- **As well as inertia, some features of home lending inhibit switching** – such as the prevalence of splitting loans into tranches of different durations, cashback offers with corresponding lock in periods, and mortgage advisor commissions with corresponding clawback periods if the customer refinances away from the bank.
- **Mortgage advisors are an increasing feature of the market and have the potential to be pro-competitive.** However, some arrangements appear to be inhibiting this potential, including commissions that align the incentives of advisors with home loan providers (rather than with their customers), practices that tend to favour incumbent providers, and limitations in the monitoring of whether advisors are acting in the best interests of their clients.

Introduction | *Whakatakinga*

4.1 This chapter discusses:

4.1.1 the key features of home lending in New Zealand;

4.1.2 how customers choose their home loan provider and products;

4.1.3 how banks set interest rates on home loans;

4.1.4 competition amongst providers for home lending customers; and

4.1.5 the role of mortgage advisors in supporting the market for home lending.

Home lending is the most important product for personal banking providers | *Ko te tuku moni taurewa te kaupapa tino whaitake rawa ki ngā kaituku pēke whaiaro*

4.2 Home lending is the most important product for personal banking due to both the size of the portfolio and its contribution to overall revenue. Providers describe home lending as the key value driver in their business.[218]

4.3 Home lending is a large and growing proportion of banks' activities and revenue:

4.3.1 In November 2023, home lending to owner-occupiers represented around 46% of total lending and around 36% of the total assets of registered banks in New Zealand.[219] These proportions have generally increased since 2017 (shown in Figure 4.1 below).[220]

4.3.2 For the 12 months to September 2023, interest on residential mortgage lending totalled $16.5 billion, representing 45% of the total interest income of registered banks in that period.[221]

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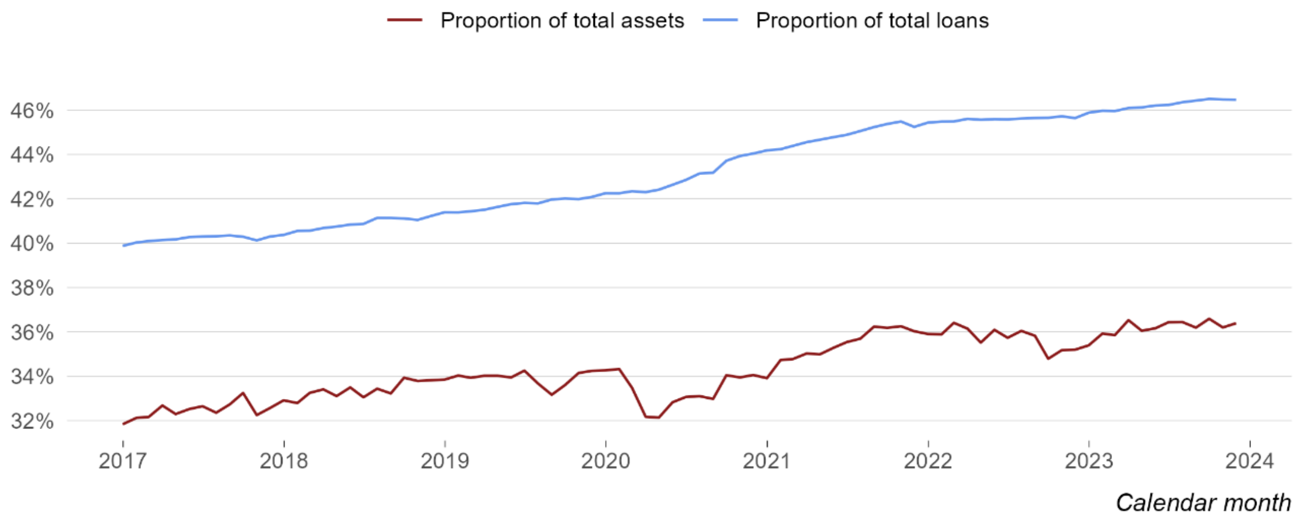
218 [ ].

219 We have limited our focus to owner-occupier loans, reflecting the scope of this market study. However, lenders offer loans to both owner-occupiers and investors. In some cases it has not been possible to exclude investor loans from the data we present in this chapter. Where this is the case, we label these data as "all residential mortgage lending (including investor loans)".

220 Calculated from Reserve Bank data for registered banks. Reserve Bank "Banks: Assets – Loans by purpose (S31)" (November 2023); Reserve Bank "Banks: Balance sheet (S10)" (November 2023).

221 These figures are for all residential mortgage lending including to property investors and businesses. Reserve Bank "Banks: Income statement (S21)" (November 2023).

Figure 4.1 Residential mortgage lending to owner-occupiers vs total assets and total lending of registered banks



Source: Calculated from Reserve Bank data for registered banks.[222]

4.4 Home lending customers are even more valuable to banks than the home loans they take out. That is because these customers are more likely to have a deeper range of personal banking products with their provider, and are 'more sticky' – that is, less likely to switch providers (once their home loan is established). [223] Within this customer segment, first home buyers are often a target group for providers, described by one provider as 'incubators of future bank value'.[224]

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222 Reserve Bank "Banks: Assets – Loans by purpose (S31)" (November 2023);https://www.rbnz.govt.nz/statistics/series/registered-banks/banks-assets-loans-by-purpose; Reserve Bank "Banks: Balance sheet (S10)" (November 2023). [ ].

223 [ ]; [ ].

224 [ ].

Key features of home lending in New Zealand | *Ngā tino āhuatanga o te tuku moni taurewa i Aotearoa*

Who provides home lending services in New Zealand

4.5 The vast majority of home lending is provided by the major banks and Kiwibank, representing around 95% of home lending by all registered banks.[225] While some smaller providers have grown their individual shares of supply in recent times, the overall share of supply by smaller providers has not changed materially over the last five years.[226]

4.6 ANZ has the largest home lending portfolio (with around 30.4% of lending), followed by ASB (21.3%), Westpac (19.0%) and BNZ (16.7%). Kiwibank is the next largest at 7.3% of total residential mortgage lending, followed by TSB (1.8%) and SBS (1.2%). The remaining registered banks make up 2.2% of residential mortgage lending.[227]

4.7 Figure 4.2 below shows that the shares of supply for total residential mortgage lending have been stable over the past five years.

4.8 NBDTs and non-bank institutions that are not funded with deposits also supply home loans, although the stock of loans provided by this group is very small compared to the portfolios of registered banks.[228] As noted by the Reserve Bank, non-deposit-taking lenders complement the lending activities of the banking sector by generally providing loans to borrowers who cannot meet the requirements to obtain a loan from a bank. Some of these borrowers have higher credit risk, and this risk is reflected in the lending rates of these institutions, which tend to be higher than bank lending rates.[229] These providers are not competing head-to-head with banks but perform an important role in the broader ecosystem in enabling access to finance.

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225 Figures calculated for all residential mortgage lending including to owner-occupiers and property investors. New Zealand incorporated companies only (eg, using ANZ rather than ANZ Group data). Reserve Bank "Bank Financial Strength Dashboard" (30 September 2023), series id DBB.QIC20.P1. [ ].

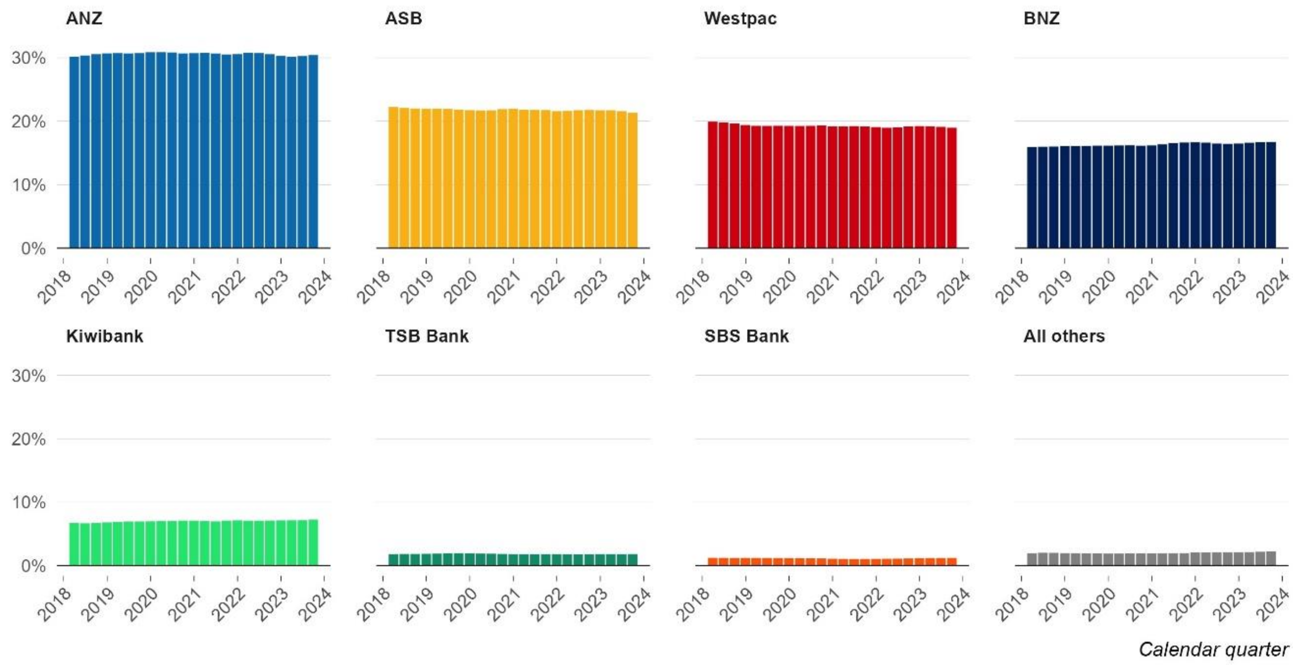
226 The stable positions of the major banks and Kiwibank and the limited are consistent with our draft findings of a stable two tier oligopoly, with significant barriers to entry and expansion for smaller and new providers.

227 Figures calculated for all residential mortgage lending including to owner-occupiers and property investors. New Zealand incorporated companies only (eg, using ANZ rather than ANZ Group data). Reserve Bank "Bank Financial Strength Dashboard" (30 September 2023), series id DBB.QIC20.P1. [ ].

228 Examples of non-deposit-taking lenders include Pepper Money, Resimac and Simplicity. Reserve Bank data, comparing non-bank housing lending of $6,266 million with owner-occupied lending of $259,333 million in December 2023. Reserve Bank "Registered banks and non-bank lending institutions: Sector lending" (31 December 2023), series Id CRD.MNA311; Reserve Bank "Banks: Assets – Loans by purpose" (31 December 2023), series Id BSPA.MAM2A4.P1. [ ].

229 Some borrowers switch from non-bank lenders to banks when they have established a better credit history. Reserve Bank "Lending by non-deposit-taking institutions" (2 November 2022), available at: https://www.rbnz.govt.nz/hub/publications/financial-stability-report/2022/nov-2022/fsr-nov-22-box-d.

Figure 4.2 Residential mortgage lending - shares of supply for registered banks



Source: Calculated from Reserve Bank data for registered banks. Figures calculated for all residential mortgage lending (including investors loans).[230]

4.9 Home loans are long-term products, and the total portfolio of lending is generally very large relative to the flow of new lending. Given the low levels of switching between providers once a home loan is taken out, shares of total home loans reflect how competition has played out over several years, rather than providing a current snapshot of how competition is playing out today.

4.10 To get a richer sense for how competition is playing out over time, we also reviewed confidential data on monthly new lending to owner-occupiers.[231] These data show that shares of new lending are more dynamic, but tend to follow the same pattern over time, with the majority of lending provided by the major banks and Kiwibank.[232]

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230 New Zealand incorporated companies only (eg, using ANZ rather than ANZ Group data). Reserve Bank "Bank Financial Strength Dashboard" (30 September 2023), series id DBB.QIC20.P1, available at: https://bankdashboard.rbnz.govt.nz/summary. [ ].

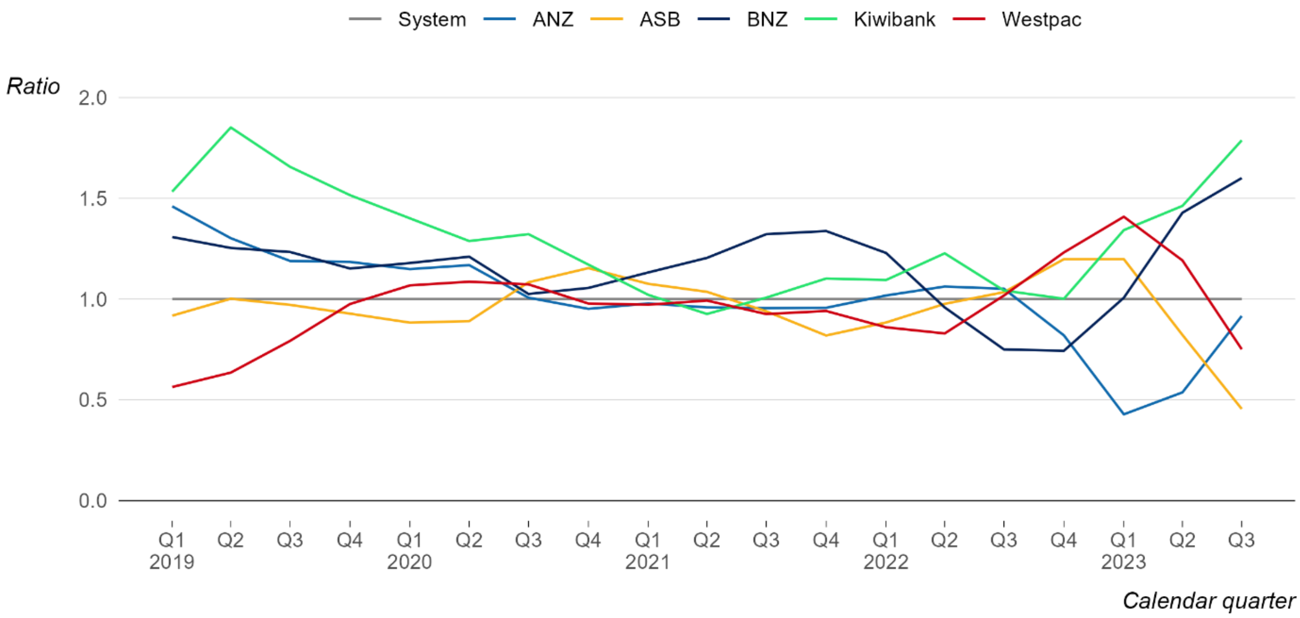
231 Data provided confidentially to the Commission through RFI responses by ANZ, ASB, Westpac, BNZ, Kiwibank, Heartland Bank, SBS and Co-op, referred to as "data provided confidentially to the Commission by banks" for the remainder of this chapter.

232 [ ].

4.11 Many home lending providers compare their home lending growth to the overall growth of home lending in the New Zealand market ('system growth'). These providers also often set their performance targets in this way, such to grow at '*1x system*' or '*1.2x system'*.[233]

4.12 Using data, we compared the relative growth in home lending for each of the major banks and Kiwibank to the overall system growth over the period, presented in Figure 4.3 below.

Figure 4.3 Quarterly home lending growth as a multiple of system growth for the major banks and Kiwibank, Q1 (March) 2019 – Q3 (September) 2023



Source: Calculated from Reserve Bank data.[234]

4.13 We observe from Figure 4.3 that:

4.13.1 there is some dynamism in the relative growth of home lending providers' portfolios over time;

233 [ ]

234 Monthly data has been taken from RBNZ's reporting on total bank loans by purpose in addition to Reserve Bank quarterly reporting data on individual bank asset quality as found in the Reserve Bank Dashboard. Reserve Bank Banks: Assets – Loans by purpose (S31) and Reserve Bank Dashboard Asset Quality, (March 2019 – September 2023).
[ ].

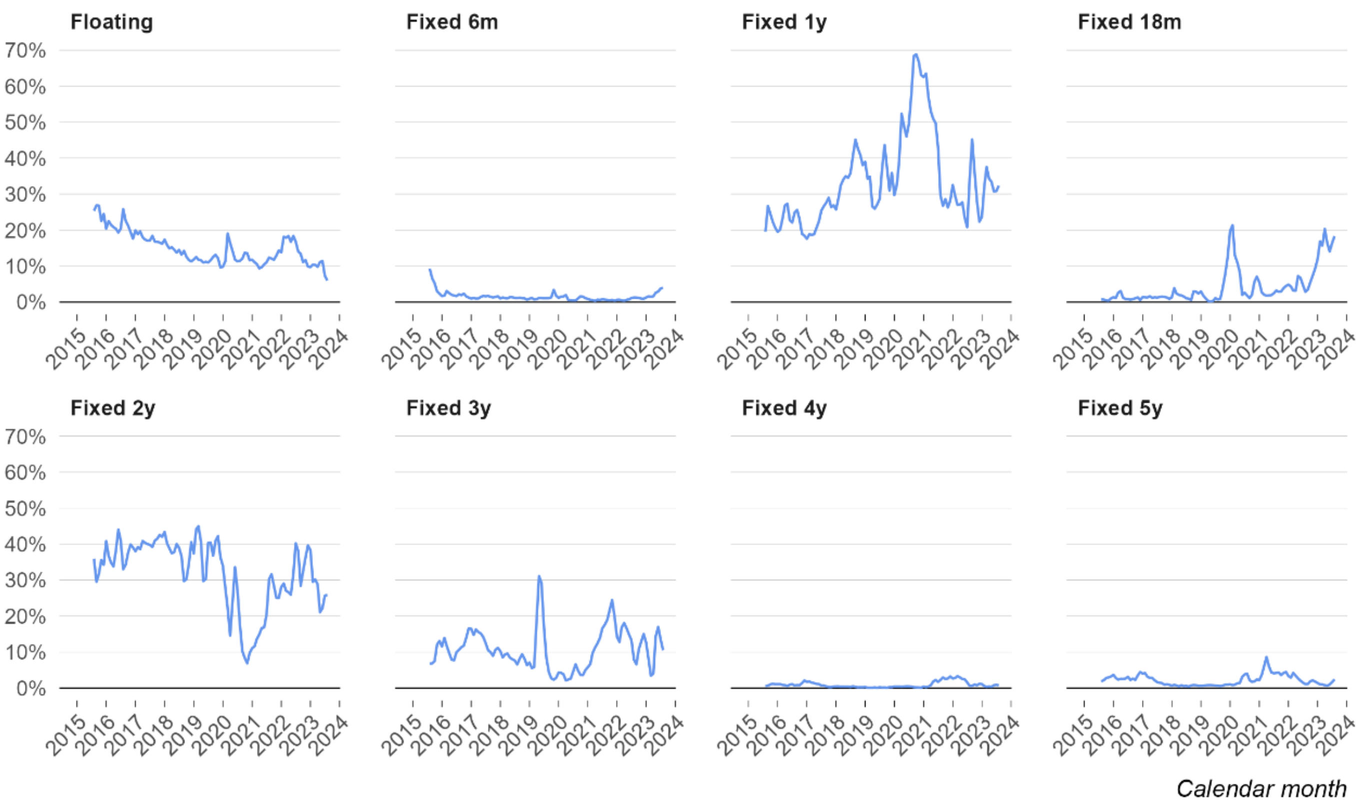
4.13.2 growth appears to occur in waves - we can observe periods where each bank has demonstrated strong growth, as well as periods where they appear to have pulled back; and

4.13.3 notably, Kiwibank stands out as the only provider that has grown consistently at or above system growth over the four-year period.

Fixed rate home loans are much more prevalent than floating rate home loans

4.14 New Zealand home loan customers predominantly take out fixed rate loan terms, most commonly of one-year and two-year durations.[235] These accounted for around 30% and 25% of new lending to owner-occupiers, respectively in August 2023. There is generally very little take-up of fixed rate home loan products with terms beyond two years in recent years (see Figure 4.4 below).

Figure 4.4 Proportion of new home lending to owner-occupiers by term



Source: Calculated from data provided confidentially to the Commission by banks.[236]

235 When a fixed rate home loan comes to the end of its term, the customer has the opportunity to choose a new fixed-term product ('refix') or roll onto a floating rate. The customer may also refinance with a new provider. Customers can choose between fixed rate products of different terms, and floating rates, over the total duration of the loan – which is typically around 30 years. Data available at: Reserve Bank "Banks: Assets – Loans fully secured by residential mortgage by repricing - S33 (Dec 2016 - current)" and Banks: Assets – Floating and fixed loans fully secured by residential mortgage - S33 (Dec 2004 – current).

236 Banks: Assets – Floating and fixed loans fully secured by residential mortgage - S33 (Dec 2004 – current). [ ].

Splitting total borrowing into tranches is common

4.15 Lenders typically enable borrowers to split their total borrowing into separate loan accounts or tranches. For example, a customer could have some of their lending at a floating interest rate, and other portions at different fixed rate maturities. This enables borrowers to limit their exposure to large changes in interest rates (and therefore the size of their repayments) at any particular point in time.[237]

4.16 As of August 2023, data provided by banks indicate that around half of new home lending to owner-occupiers was split into two or more tranches.[238]

'LVR special' lending is around 80% of all lending

4.17 The LVR is a measure of how much a bank lends against a mortgage property, compared to the market value of that property at the time of lending.[239]

4.18 Most providers advertise a preferential LVR special set of fixed-term interest rates to customers who have an LVR of less than 80%, and 'standard rates' for all other customers.[240] ASB is the exception in this regard, offering only one set of home loan rates regardless of LVR.[241, 242]

4.19 Data provided by banks to the Commission indicate that around 70-80% of all new lending to owner-occupiers is 'LVR special' lending and this proportion has been relatively stable over the past five years.[243]

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237 To give effect to this arrangement, the borrower will usually have multiple loan accounts, one for each home lending product or 'tranche'.

238 Calculated from data provided confidentially to the Commission by banks. [ ].

239 For example, if a bank lends $800,000 to a borrower with a $200,000 deposit and the customer buys a $1,000,000 property, then the LVR is 80% (= $800,000/$1,000,000).

240 The proportion of lending that is 'LVR special' is likely to be materially affected by Reserve Bank's restrictions on the volume a bank can lend in respect of low deposit/'high LVR' transactions. For occupied property, the current policy restricts high-LVR lending to no more than 15% of a bank's total new lending (which has recently increased from 10% on 1 June 2023). See Reserve Bank "LVR restriction easing confirmed" (26 May 2023), available at: https://www.rbnz.govt.nz/hub/news/2023/05/lvr-restriction-easing-confirmed.

241 From 16 July 2020, ASB stopped offering special rates for customers with 20% equity and a set of 'standard rates' for all other customers, in a move that ASB stated would allow all customers to access lower rates, irrespective of their equity levels. See ASB "ASB moves to a single fixed home loan rate card to support first home buyers" (16 July 2020), available at: https://www.asb.co.nz/documents/media-centre/media-releases/asb-moves-to-a-single-fixed-home-loan-rate-card-to-support-first-home-buyers.html.

242 Later in this chapter, we compare headline interest rates across providers, including ASB, using 'LVR special' rates where available. This comparison is chosen because of the large majority of lending that occurs at 'LVR special' rates across providers. For ASB, this is not an exact like-for-like comparison because it reflects the rates that ASB would offer customers with a high-LVR. If we had instead compared 'standard' rates, ASB's rates would appear more favourable than is a fair reflection of overall market lending, because we would be comparing rates that ASB offers to so-called LVR special customers with rates offered to non-LVR special customers at other providers.

243 [ ].

4.20 The stable proportions of LVR special lending and the prevalence of preferential LVR special interest rates are both likely to be closely related to the Reserve Bank's restrictions on high-LVR residential mortgage lending, which have set 'speed limits' on how much new low deposit lending banks can do. For owner-occupier loans, these limits restrict high-LVR lending to no more than 15% of a bank's total new owner-occupier lending (where high-LVR is a loan with less than a 20% deposit).[244]

4.21 The Reserve Bank has recently consulted on activating debt to income (DTI) restrictions and loosening its restrictions on LVRs for residential lending.[245] This could have material consequences for the make-up of banks' balance sheets. It could also affect the extent to which special interest rates are made available on the basis of LVR distinctions.

Channels for originating home lending

4.22 Home lending can be arranged directly between providers and their customers (direct channels) or through mortgage advisors.

4.23 As shown in Figure 4.5, as of August 2023, around two-thirds of new home lending to owner-occupiers by value occurred through mortgage advisors. This proportion has increased rapidly over the past eight years.

4.24 It is less common for advisors to be involved in repricing or re-fixing of existing lending, with advisors currently accounting for around only 22% of such transactions by value.

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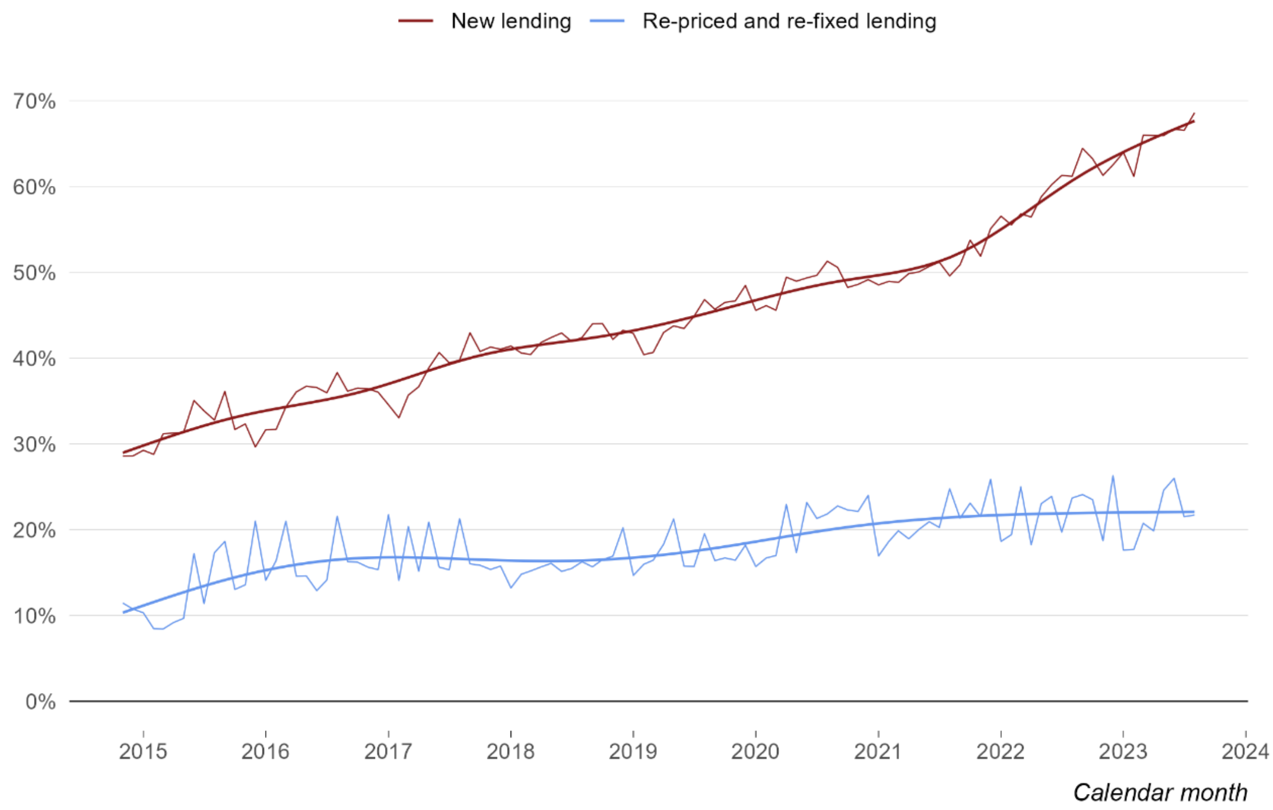
244 Reserve Bank first introduced LVRs in October 2013. LVR restrictions were removed in April 2020 to ensure they did not interfere with COVID-19 policy responses. The restrictions were reinstated from 1 March 2021. Reserve Bank "Loan-to-value ratio restrictions" (28 February 2022), available at: https://www.rbnz.govt.nz/regulation-and-supervision/oversight-of-banks/standards-and-requirements-for-banks/macroprudential-policy/loan-to-value-ratio-restrictions.

245 Consultation closed on 12 March 2024. See Reserve Bank "Consultation on DTI and LVR settings" (23 January 2024), available at: https://www.rbnz.govt.nz/hub/news/2024/consultation-on-dti-and-lvr-settings.

Figure 4.5 Mortgage advisor proportion of floating and fixed-term lending up to two years to owner-occupiers (monthly values and smoothed trends)



Source: Calculated from data provided by banks to the Commission.[246]

How do banks set interest rates? | *He pēhea e whakarite ai te pēke i ngā rēti itarete?*

4.25 The interest rate on a home loan is agreed between the lender and the borrower. Providers set:

4.25.1 headline or carded interest rates, which are advertised publicly; and

4.25.2 discretionary discount policies which set a minimum interest rate (or 'interest rate floor') that can be offered to the customer.

4.26 Discretionary discounts for individual borrowers are common amongst many home lending providers – our analysis of home loan data found that recently around 50-60% of lending (by volume) was associated with a discount.[247] Our analysis also found that:

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246 [ ].

247 Calculated from data provided confidentially to the Commission by banks. [ ].

4.26.1 the major banks and Kiwibank were more likely to offer discretionary discounts than smaller banks; and

4.26.2 the size of these discounts are generally small (typically ten to 20 basis points and usually less than 50 basis points across the range of providers for which data were available), although there are differences across providers.

4.27 Many of the banks have discounting policies that allow more senior employees to offer larger discounts, meaning requests for discounts are progressively escalated to senior staff.

Pricing committees

4.28 For many home lending providers, including all the major banks and Kiwibank, decisions on headline interest rates and discretionary discounts are made by a formal pricing committee made up of senior executives. In most cases, the committee will cover pricing across the bank's entire business (loans and deposits).

4.29 In respect of the major banks and Kiwibank, pricing committees meet regularly (for example, weekly), as well as, for example, in response to major events such as in anticipation of, or in response to, a change in the official cash rate (OCR). The decision-making process usually involves staff presenting a proposal for the decision makers to consider.

4.30 In reviewing an interest rate proposal, pricing committees may review for example:

4.30.1 the provider's recent volumes and retention rates;

4.30.2 current and proposed new headline interest rates, including how they compare to the other major banks' and Kiwibank headline rates;

4.30.3 movements in relevant benchmark and wholesale rates such as the OCR, relevant swap rates and market reference rates.[248] In New Zealand, the leading set of reference rates are the Bank Bill Reference Rates (BKBM);

4.30.4 Treasury department considerations, including the relative volume and growth in customer deposits and the interest rates associated with these deposits; and

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248 Transactions between participants in a financial market that happen often enough to reliably measure, and which are often used as a benchmark for pricing bonds and other debt securities.

4.30.5 how the current and proposed headline and discounted rates will affect new lending margins (where that margin is calculated compared to the relevant internal funds transfer price(s))[249], and any other relevant performance targets.[250]

4.31 The OCR is just one of the factors that banks consider when setting home loan interest rates. This is because (i) the OCR is not the only driver of a bank's funding costs, and (ii) funding costs are not the only drivers of interest rates (explained below).[251] As such, we would not expect to see a one-for-one relationship between the OCR and home lending interest rates.

Funding costs do not move in lockstep with the OCR

4.32 Deposits from New Zealand households and businesses account for the majority of New Zealand banks' total funding (representing around two-thirds of each major banks' funding). Banks can also fund their operations by issuing bonds and other debt securities in financial markets. Other sources of funding like equity represent the remainder of banks' funding.

4.33 The OCR has an important role in determining the interest rates on banks' funding sources, but the interest rates that banks pay for different sources of funding do not necessarily move by the same amount or at the same speed as a change in the OCR, in part because competition over deposit rates is imperfect.[252] Wholesale funding, which is influenced by international rates, also contributes to a disconnect between the OCR and home loan interest rates.

4.34 Other monetary policy tools can also have implications for banks' funding costs, such as the Reserve Bank's recent Funding for Lending Program (FLP), which allowed banks to borrow funding from the Reserve Bank at the OCR for an extended period.[253]

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249 In this chapter, where we refer to home loan margins, these are not robust, fully loaded price-cost margins at the product level. They are estimates of new lending margins calculated relative to an internal funds transfer price. A fully loaded price-cost margin would be inherently uncertain and subjective because of the difficulties of allocating common/shared costs and risks (such as branch costs and head office costs) to individual products and/or customers.

250 Some banks have explicit regard to ROE, eg [ ]; [ ].

251 [ ].

252 As a short-term interest rate, the OCR is more likely to influence floating rates. Banks' expectations about future interest rates will influence how they set fixed-term lending rates.

253 FLP is a tool used by the Reserve Bank, designed to lower banks' funding costs during the Covid-19 pandemic in a context where the OCR may have reached its lowest practical level. The rationale is that banks would pass these cost reductions through to their customers in the form of lower mortgage and business lending rates, encouraging households and businesses to spend and invest. See RNZ "Funding for lending programme" (28 February 2022), available at: https://www.rbnz.govt.nz/monetary-policy/monetary-policy-tools/funding-for-lending-programme.

4.35 Professor Margaritis and Dr Hasannasab considered the speed of pass-through of OCR changes to home loan interest rates in their report. They found that "banks tend to respond faster to increases in the OCR and that this asymmetry holds for both the short- and the long-run."[254]

Competition for home lending | *Te whakataetae mō te moni taurewa ā-kāinga*

4.36 We outline in the remainder of this chapter our preliminary view that:

4.36.1 the major banks compete most closely with one another, and the intensity of that competition is sporadic – rising and falling in intensity at different points in time. Individually, each of the major banks has competitive ambitions that vary with their individual circumstances and strategies;

4.36.2 Kiwibank is considered a relevant competitor by the major banks, although perhaps to a lesser extent than the major banks; and

4.36.3 smaller banks, NBDTs and non-deposit-taking non-banks do not provide a meaningful competitive constraint on the major banks. Smaller banks need to maintain an 'always on' growth strategy in order to grow (or even to maintain) their positions in home lending.

The major banks have limited to no regard to the conduct of smaller providers

4.37 When setting interest rates, the major banks and Kiwibank focus largely on each other, with little or no regard to the pricing decisions of smaller lenders.[255]

4.38 Similarly, smaller lenders primarily track and focus on the interest rates of the major banks and Kiwibank when making pricing decisions.

4.39 The level of focus and influence that the interest rate decisions of the major banks and Kiwibank have on one another are not uniform.[256]

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254 Dimitris Margaritis and Maryam Hasannasab "Market power in banking: A study of New Zealand banks" (March 2024) at p. 6.

255 [ ].

256 [ ]; [ ].

Competition between the major banks is sporadic

4.40 The extent to which banks compete with one another for home lending customers (or segments within home lending) can vary significantly from month to month or even week to week. Each of the major banks will have greater or lesser growth ambitions at any point in time, reflecting their individual circumstances and strategies.

4.41 For example, we observed references in bank pricing strategy documents to statements like 'in and out' or 'timed' pricing positions.[257] Our analysis of headline interest rates, described in more detail below, is consistent with these intermittent strategies of offering best in market interest rates (or not). We found that none of the major banks or Kiwibank are consistently offering the lowest headline interest rates.

4.42 Similarly, in its submission to the Preliminary Issues paper, ASB stated that: 'Banks will make major marketing pushes relative to others at seemingly random times – with these periods of high marketing spend generally accompanied by very competitive interest rates.'[258]

4.43 Fluctuations in the intensity of competition can often be related to the broader economic environment – including the state of the property market, the interest rate cycle, inflation and/or wholesale funding markets. They can also be driven by factors at the provider level, such as:

4.43.1 higher level bank strategy, for example if senior management is seeking to grow a bank's portfolio on a particular product segment;

4.43.2 the need to balance growth across both sides of the balance sheet – the majority of lending is funded by customer deposits. When a lending unit seeks to issue more loans, this will need to be funded through either customer deposits or wholesale funding. One consequence of this interdependency is that a bank's decisions about home lending interest rates are not based on the circumstances of the home lending environment alone – there may be times where a bank is disinclined to seek growth in home lending, due to factors in play on the other side of the bank's balance sheet;

4.43.3 limitations or pressure on back-end systems that limit the ability to service high volumes of new customers, which will diminish their ability (or appetite) to chase new customers; and

4.43.4 other constraints on the ability to service customer volumes.

257 [ ].

258 ASB "Submission on Market study into personal banking services - Preliminary Issues paper" (7 September 2023), at para 9.12.

4.44 Consequently, there are periods during which each of the major banks appears to have:

4.44.1 competed more strongly – more actively pursuing home loan customers using a combination of low headline interest rates, stronger discounting and retention strategies, cashback offers, and competition on important non-price factors such as turnaround time, training of frontline staff, advertising and marketing strategies, and investment into mortgage advisor relationships;

4.44.2 sought to maintain or defend market position by 'growing at system' – usually this is reflected in taking 'mid-market' positions on pricing;[259] or

4.44.3 'down times' where they have no ambitions for growth in share of supply – this would be reflected in an expectation for growth at 'less than system', setting interest rates above that of competitors and/or (less commonly) with less willingness to match competitors' offers with discretionary deals for valued customers, and in some cases, taking steps to reduce volumes that could otherwise be generated via mortgage advisors.

4.45 When the strategy of each of the major banks coincides, this leads to periods of relative intensity when all the banks are competing harder, and other periods where all the major banks pull back at the same time. ASB has referred to particular providers "leading bouts of competition in light of their individual (and different) strategies at particular times, leading to considerable variation in share, but no clear patterns over time."[260]

4.46 In circumstances where a major bank has low or no ambitions for growth in share of supply, that bank will likely continue to grow its home loans portfolio, albeit at a slower rate (below system). This in part is due to the pipeline of customers that choose their banking provider based on their existing relationship, a recommendation from friend or family, or on the basis of brand – ie, without shopping around on interest rates.[261]

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260 ASB "Submission on Market study into personal banking services - Preliminary Issues paper" (7 September 2023), at para 9.10.

261 See Chapter 2 for discussion of the benefits to major banks from having strong brands and an existing pipeline of customers, which give them an advantage over smaller providers.

4.47 In contrast, smaller banks are in less advantageous positions. As we explain below, smaller banks appear to need an 'always on' strategy – consistently in the market with strong home loan propositions (or to target a particular customer segment) in order to attract new customers and win share of supply. [262]

An example of sporadic competition in the rising interest rate environment (2021-2023)

Interest rates have been increasing in New Zealand since mid-2021, driven by the Reserve Bank's tightening monetary policy.[263]

As a result of rising interest rates, the volume of housing transactions slowed significantly from mid-2021 through to early 2023,[264] and median house prices fell.[265] These declines in sales volumes and prices directly flow through to reductions in home lending volumes, making it more difficult for providers to reach volume targets on their home lending portfolios.

During this period of rising interest rates, we have observed two distinctive fluctuations in the intensity of competition in home lending, being:

- a period of more intense competition for home lending customers during 2022-early 2023,[266] where many providers (including the major banks and Kiwibank) engaged in aggressive home lending campaigns, including significant discounts off headline rates and cashback offers.[267] During this period, the major banks and Kiwibank reported lower returns on capital in respect of their home lending portfolios; [268] and
- a period where many of the major banks pulled back and competition diminished – the latter half of 2023 saw some of the major banks make active decisions to accept slower growth or falling volumes in favour

262 [ ]

263 Reserve Bank "Financial Stability Report" (3 May 2023), Topic 1 at p. 16.

264 See, for example, Interest.co.nz "Volumes sold – REINZ", available at: https://www.interest.co.nz/charts/real-estate/volumes-sold-reinz, which shows the monthly total number of house-sales transactions that went unconditional across New Zealand, as recorded by REINZ's reporting members. The total number of transactions in March 2021 was just over 10,000, while the corresponding number for January 2023 was 2,855.

265 See Interest.co.nz "Median price – REINZ", available at: https://www.interest.co.nz/charts/real-estate/median-price-reinz, according to data sourced by REINZ.

266 Stuff "Secret mortgage war: BNZ offers 4.99% one-year rate to new customers" (22 February 2023), available at: https://www.stuff.co.nz/business/131300030/secret-mortgage-war-bnz-offers-499-oneyear-rate-to-new-customers; Stuff "ASB matches BNZ's 4.99% one-year fixed mortgage rate in behind-closed-doors deal" (2 March 2023), available at: https://www.stuff.co.nz/business/money/131369192/asb-matches-bnzs-499-oneyear-fixed-mortgage-rate-in-behindcloseddoors-deal.

267 See Interest.co.nz "Pricing of NZ mortgage interest rates 'difficult to reconcile' and offers 'unsustainable returns', says CEO of ASB's Aussie parent bank CBA" (20 August 2023), available at: https://www.interest.co.nz/banking/123688/pricing-nz-mortgage-interest-rates-difficult-reconcile-and-offer-unsustainable.

268 [ ]; [ ]; [ ].

of improving their profit margins on new lending by increasing interest rates.[269] During this period we observed major banks reducing the value of their cashback offers.[270]

- Some providers reported that margins on new home lending fell well below the cost of capital (where the cost of capital is the financial return required to cover a business's cost of debt and equity) during the period of intense competition in 2022-2023. For example, in its submission on the Preliminary Issues paper, ASB stated that "the combined impact of strong competition and elevated wholesale rates has resulted in a significant volume of new mortgages being written below ASB's current cost of capital."[271]
- Providers have been willing to lend to home loan customers at margins below their (internally determined) cost of capital for a period of time for (at least) two key reasons:
- home lending customers are high-value, long-term propositions: they tend to be more engaged, more likely to hold a greater number of banking products with the provider, and less likely to switch away to another provider[272] – so these customers represent long-term value to the bank. The low margin lending environment by contrast is likely to be short-term and to abate over time. This results in a willingness to 'look through' the short-term pricing environment in favour of the long-term strategy to build home lending portfolios and long-term customer relationships;[273] and
- there are important interdependencies between the lending and deposit units of the bank. At a bank level, profits depend on the difference between the interest paid on deposits (liabilities) and the interest received on lending (assets).[274]

A number of providers told us that their strategies are actively mindful of these factors and the balance to be struck in setting their home lending strategies having regard to both volume growth and margin, and with product pricing across the balance sheet seen as both an art and a science.[275]

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271 ASB "Submission on Market study into personal banking services – Preliminary Issues paper" (7 September 2023), at para 1.5. This sentiment was also reflected in media released by CBA Chief Executive Matt Comyn, see for example Australian Financial Review "The New Zealand market isn't quite as grim as CBA has you believe" (21 August 2023), available at: https://www.afr.com/companies/financial-services/the-new-zealand-market-isn-t-quite-as-grim-as-cba-has-you-believe-20230821-p5dy4h.

272 [ ].

273 [ ].

274 [ ]; [ ].

275 [ ]; [ ]; [ ]; [ ].

The unique position of Kiwibank

4.48 Kiwibank's share of total home lending is well below that of the smallest major banks, and well above the largest of the smaller banks and non-bank providers. As such, it does not sit comfortably in either group. Kiwibank's home lending portfolio is:

4.48.1 less than half the size of BNZ's (where BNZ has the smallest home lending portfolio of the major banks), and less than one-quarter of the size of ANZ's;[276] while it is also

4.48.2 almost four times the size of TSB's (the next largest home lending portfolio after Kiwibank).

4.49 One major bank strategy document describes Kiwibank's brand position as "the default alternative to the main banks".[277]

4.50 Kiwibank's home loan portfolio has performed strongly in recent years, consistently returning higher growth (in percentage terms) than the major banks. However, this growth comes off a much lower base than that of the major banks and has come at a sacrifice of returns. As noted in Chapter 6, Kiwibank has had a lower return on equity than the major banks on average since March 2018.

4.51 Kiwibank does not consider itself to be one of the 'major banks'. It says its home lending interest rates do not provide a strong competitive constraint on the major banks' home lending strategies. In cross-submissions on the Preliminary Issues paper, Kiwibank submitted a report from Link Economics which sought to examine whether the major banks responded to Kiwibank's home loan rates, and found that the largest four banks face little or no constraint from smaller lenders, including Kiwibank.[278] This was followed by submissions from Frontier Economics (for ANZ) and Deloitte Access Economics (for BNZ), which set out their concerns regarding the methodology used by Link Economics.[279] Link Economics (for Kiwibank) then provided a further response to the concerns raised.[280]

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276 Data from Reserve Bank "Bank Financial Strength Dashboard" (30 September 2023), available at: https://bankdashboard.rbnz.govt.nz/summary. Figures are for all residential mortgage lending including to owner-occupiers and property investors.

277 [ ].

278 Kiwibank "Cross submission on Market study into personal banking services - Preliminary Issues paper - Attachment A - Link report" (5 October 2023), at para 5.

279 Deloitte Access Economics "Cross submission on Market study into personal banking services" (1 December 2023) and Frontier Economics "Cross submission on Market study into personal banking services" (7 December 2023).

280 Link Economics "Comments on econometric analysis of the relationship between the home loan interest rates of Kiwibank and larger banks" (27 February 2024).

4.52 While we note the methodological differences in opinion between submitters, we reviewed a broader evidence base for our assessment. This included major banks' internal strategy and pricing documents, and the home lending data provided by banks to the Commission (the latter of which enables us to review actual agreed interest rates across the banks, rather than the headline interest rates).

4.53 On review of all the available evidence, our preliminary view is that Kiwibank's pricing places some constraint on the major banks, but not to the same extent as pricing for the other major banks. Kiwibank's position in the market is neither one of the major banks, nor one of the smaller fringe providers, but rather it sits somewhere in the middle of these two groups. While its growth has been strong and consistent, it is not a disrupter of the stable oligopoly.

There is no clear 'best in market' leader on interest rates

4.54 Each of the major banks and Kiwibank have at different times taken best in market positions in each of the key home lending products, reflecting their individual strategies at these times. None of these five providers consistently offers the lowest headline interest rates over time.

4.55 Using data provided by interest.co.nz, we examined the movements in key headline interest rates over the 5-year period to 22 September 2023.

4.56 We found that there is no clear 'best in market leader' on headline interest rates. Instead, banks periodically take leading or mid-market positions, and some banks take targeted positions on one or two key home loan products. For example:

4.56.1 across key home lending products, each of the major banks and Kiwibank had the lowest headline rate among those banks at some point in time over a recent 5-year period (Figure 4.6);[281]

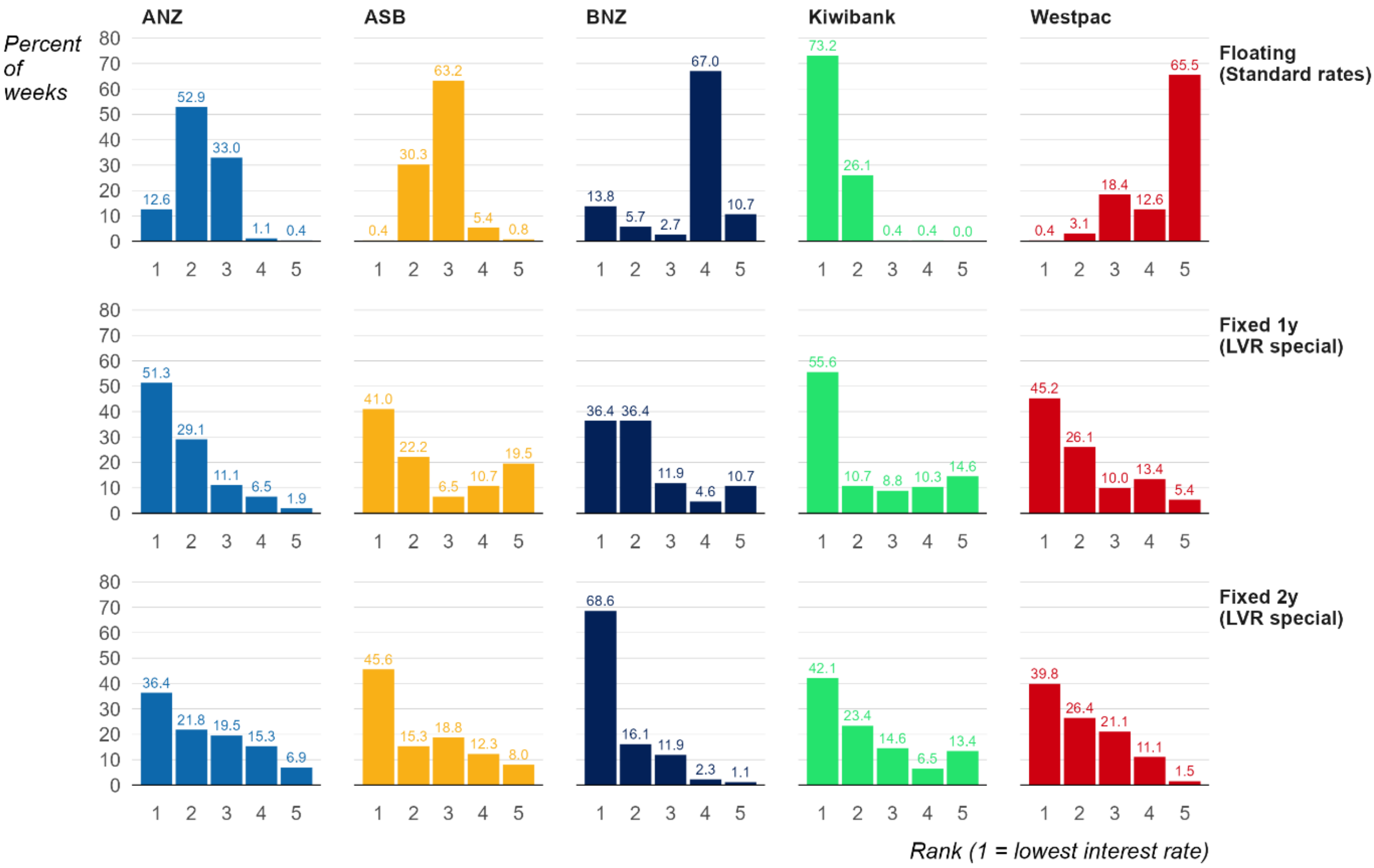
4.56.2 on floating rates, Kiwibank and ANZ have most often offered the lowest headline rates, while ASB's rates tend to be in the middle of the pack. BNZ and Westpac have most often had the highest rates;

4.56.3 for fixed one-year rates, the rankings are more evenly distributed, although Kiwibank has most often had the lowest headline rate; and

4.56.4 BNZ appears to have most often focused on offering a best in market two-year fixed rate.

281 It is common for banks to have identical headline rates in a given week. Where ties occur, the rankings shown in Figure 4.6 assign the lowest applicable rank to all tied banks. For example, if interest rates are 5.0%, 5.0%, 5.1%, 5.2%, and 5.3%, the corresponding ranks are 1, 1, 3, 4, 5. This means that the sum of percentages across banks for a given rank typically adds to more than 100%.

Figure 4.6 Rankings of selected weekly headline mortgage rates of the major banks and Kiwibank over five years to 22 September 2023



Source: Calculated from data provided by interest.co.nz.[282]

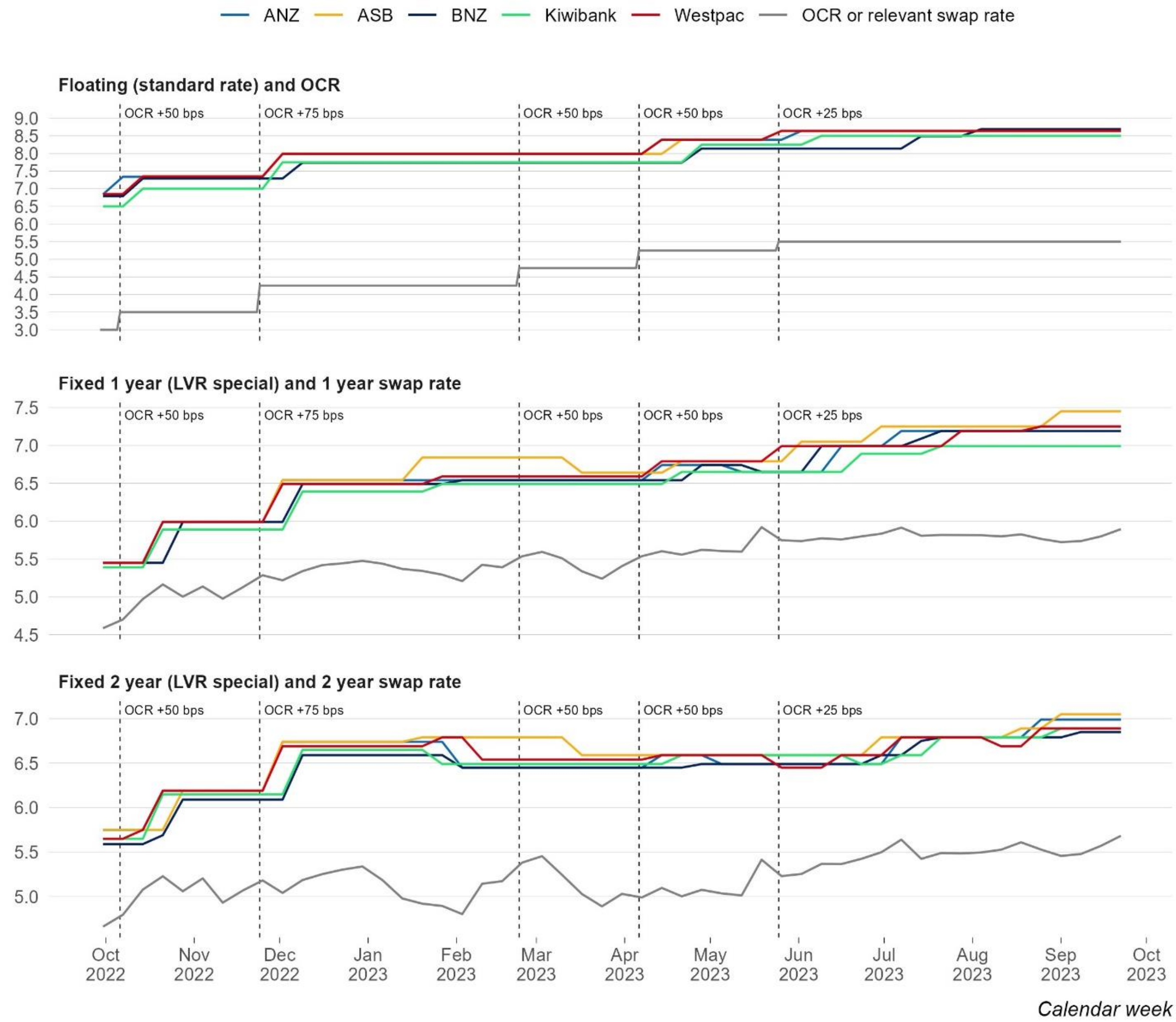
4.57 Figure 4.7 below shows key headline rates of the major banks and Kiwibank over a recent one-year period. It reveals that:

4.57.1 changes to floating rates were generally synchronised across banks and coincide with changes to the OCR in most (but not all) cases; and

4.57.2 the fixed one-year and two-year rates fall in a narrow range across these banks, but there is some evidence of less alignment compared to the floating rate.

282 [ ].

Figure 4.7 Selected weekly headline mortgage rates (%) of the major banks and Kiwibank over the 52 weeks from 30 September 2022 to 22 September 2023



Source: Data on headline (published) interest rates for mortgage products was provided to the Commission by interest.co.nz. Data on "OCR or relevant swap rates" was sourced from Reserve Bank.[283]

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283 Reserve Bank "Wholesale interest rates (B2)", available at: https://www.rbnz.govt.nz/statistics/series/exchange-and-interest-rates/wholesale-interest-rates. [ ].

4.58 While headline rates of the major banks and Kiwibank tend to move together (more so for floating rates than fixed rates, as noted above) and tend to stay within a relatively narrow range, our data analysis found no evidence that any one provider has been leading headline interest rate changes.[284]

4.59 Because customers regularly obtain discounts on headline interest rates, we also analysed whether there were any patterns in average agreed interest rates charged by providers. Using data provided to the Commission by banks on average monthly interest rates on new lending to owner-occupiers, we found:

4.59.1 no evidence that one provider was consistently offering best in market interest rates (nor consistently offering the highest-in-market agreed interest rates); and

4.59.2 a weak relationship between relative headline interest rates and relative observed average interest rates on new lending across banks.[285]

4.60 A price conscious customer in the market for a home loan would ideally have regard to not only which provider has the best interest rates and home lending products that serve them *today*, but which is likely to continue to offer those things *into the future* – so as to minimise the hassle and switching costs of moving their loan, and to have confidence in splitting their loan into tranches so as to manage their interest rate exposure over time, without unduly locking themselves in with a provider who is no longer offering preferential rates.

4.61 However, our findings as to the lack of consistency in relative prices and more generally, the sporadic nature of competition, means that a customer cannot have confidence that the provider it chooses, on the basis of interest rates today, will best serve their home lending needs into the future.

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284 Leader-follower behaviour refers to a method of tacit coordination whereby one firm in the market (the leader) increases its price on the common understanding that other firms in the market (followers) will at least match this price increase with their own price change, and failure to do so will result in reversion to the original price. Our analysis of changes in headline rates was limited by the weekly frequency of the data available to the Commission, ie, the exact timing of rate changes within each week is not recorded. It is possible that higher frequency data would support different findings.

285 Our analysis of monthly home lending data provided by banks and headline interest rate data from interest.co.nz found correlations between banks' relative monthly average headline and agreed interest rates of around 0.25 to 0.40 among the major banks and Kiwibank. Correlations were calculated for each combination of bank and loan term (floating, fixed 1-year and fixed 2-year rates only), then averaged across banks. To account for trends in the levels of interest rates over time, headline and agreed rates were first 'de-meaned' by subtracting the average headline and agreed rates across banks for each loan term in each month. These de-meaned values were then used to calculate the correlations. [ ].

Price matching strategies are prevalent

4.62 Despite differences in headline rates, the major banks typically set their pricing discretions so they can match any written or advertised fixed rate offer from the other major banks or Kiwibank.[286]

4.63 Price-matched discounts are offered selectively to customers who meet certain criteria and who have evidence of a competing offer in writing (if that offer is below the advertised fixed rate). These practices enable providers to provide discounts selectively to customers who shop around, while continuing to charge higher home loan interest rates to customers who do not do so.[287]

4.64 An important consequence of these price matching strategies is that the benefits of competition accrue only to those customers who are willing and able to shop around for the best deals. By contrast, in markets where it is not possible to price discriminate in this way, customers who shop around generally provide a positive benefit for all customers (by driving prices down for everyone).

4.65 Established patterns of price matching also reduce the incentives to compete hard on interest rates, because all providers know that if they introduce a new promotion or lower interest rate, it will quickly be matched by competitors – eliminating the gains from the price strategy.[288, 289]

4.66 The major banks maintain good information about one another's advertised interest rate offers as well as their credit settings, discretionary discounts and offers (which by definition are not public). There are a number of ways that this information may be sourced, including through relationships with mortgage advisors and through potential borrowers presenting competing offers for them to match.

4.67 We found some evidence that these providers are cognisant of the limited benefits of price competition because any new discretionary discount or promotion could easily be matched by other providers in near-to-real-time. We are concerned that this could have the effect of muting price competition overall.

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286 [ ].

287 Relevant literature on price matching includes Png, I. P. L. and Hirshleifer, D. "Price Discrimination through Offers to Match Price" The Journal of Business: Vol 60, No. 3, July 1987, p 365-383 and Edlin, Aaron S. "Do Guaranteed-Low-Price Policies Guarantee High Prices, and Can Antitrust Rise to the Challenge?" Harvard Law Review: Vol. 111, No. 2, December 1997, p 528-575.

288 S Moorthy and R Winter "Price Matching guarantees", Review of Marketing Science Working Papers, 2002, Volume 2, Issue 1, Article 2, p 1.

289 [

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4.68 In Australia, The ACCC Residential Mortgage Price Inquiry observed that some of the Inquiry Banks use this knowledge to refine their offers to ensure they set their prices no lower than they need to be to win or retain borrowers,[290] and this finding is consistent with our observations in New Zealand in relation to the major banks.

Discretionary discounts enable price discrimination for valuable customers

4.69 Related to the price matching strategies described above, discretionary discounts more generally enable providers to selectively target those customers that best reflect the highest potential value and lowest risk, and/or those who are the most price sensitive. For example, discounts can be available only for customers with certain desirable characteristics, including low LVRs (ie, large deposits), a diverse range of banking needs (or potential needs into the future), or who otherwise are considered to have high potential value to the provider.[291]

4.70 Providers can compete hard for these valuable customer segments at the same time as retaining the ability to set less competitive interest rates for customers who are not price sensitive, are locked in by their circumstances, or who are otherwise considered less valuable.[292]

4.71 It appears that because these strategies are inherently flexible, they enable banks to respond rapidly to competitor price changes.[293]

4.72 Discretionary discounting also serves as a retention strategy. Providers can often identify customers who are at risk of refinancing (for example because they ask for a settlement statement, or because they are rolling off their fixed terms) and use the opportunity to offer these customers preferential interest rates or retention cash contributions to preserve these relationships.

4.73 Where banks seek to prioritise margins over new lending volumes, these strategies can be an important element of the broader strategy to improve margins on new lending, while minimising the loss of valued customers.[294]

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290 ACCC "Residential mortgage products price inquiry 2017-18 - Interim report" (15 March 2018), p 18, available at: https://www.accc.gov.au/inquiries-and-consultations/finalised-inquiries/residential-mortgage-products-price-inquiry-2017-18/interim-report.

291 [ ].

292 In Australia, the ACCC Residential mortgage price inquiry Interim report also pointed to this observation, noting that "one Inquiry Bank has stated that this enables it to attract and retain borrowers through actions such as offering larger discounts to borrowers who might otherwise switch to another lender, while limiting discounts to those borrowers who are considered unlikely to switch". ACCC "Residential mortgage products price inquiry 2017-18 - Interim report" (15 March 2018), p 20.

293 [ ].

294 [ ].

4.74 Discretionary discounting can also provide a significant competitive advantage to larger, incumbent providers because they have a disproportionately large pool of more passive/disengaged customers. The larger the bank's pool of passive customers, the larger discounts it can offer to other customers without affecting overall profits. This reflects the strongly self-sustaining market position of the major banks.

Cashback offers appear to move together across providers

4.75 Cashback offers are an increasing feature of the market for new lending. The average cashback on new home lending was 0.9% of lending in August 2023, which represents a significant increase since 2020, as shown in Figure 4.8.[295]

4.76 Cashbacks are substantially higher for low LVR customers, where the loan represents a more modest fraction of the value of the property. As Figure 4.8 reveals:

4.76.1 customers borrowing at LVR special rates (with loan amounts that are less than 80% of the relevant properties' values) currently receive an average cashback of around 1.0%; and

4.76.2 customers borrowing a greater proportion of the purchase price (ie, more than 80% of the home's value) and thereby receiving the 'standard' rate receive an average cashback of only around 0.5%.

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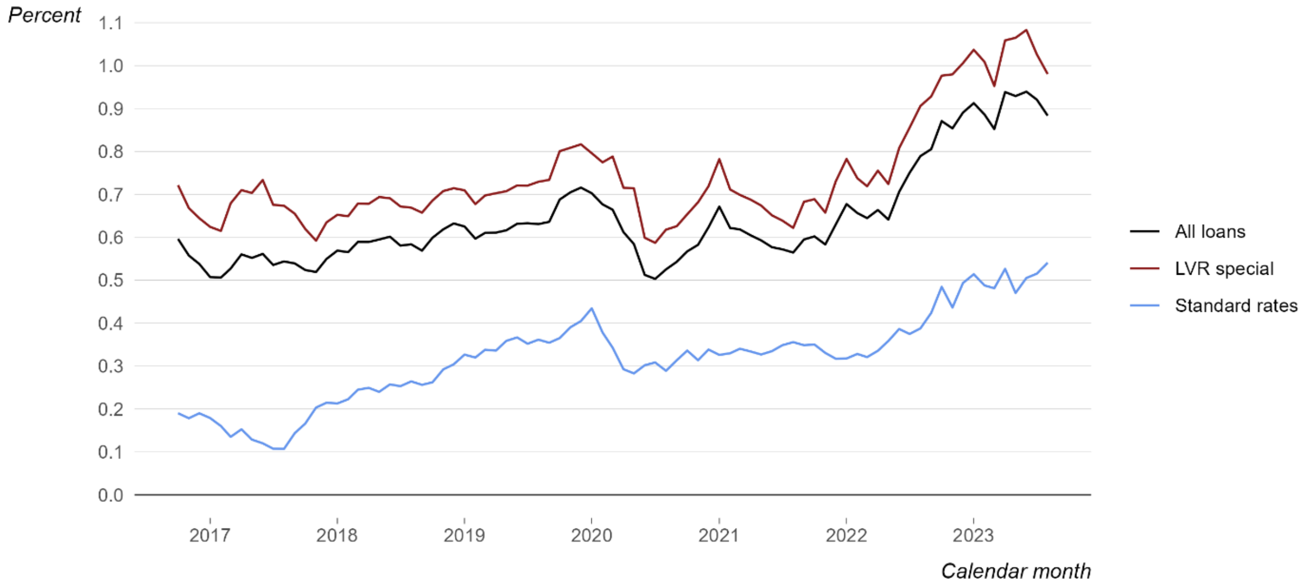
Figure 4.8 Overall cashbacks paid by the major banks and Kiwibank as a percentage of new home lending to owner-occupiers



Source: Calculated from home lending data provided confidentially to the Commission by banks.[296]

4.77 In theory, banks can compete for customers either by offering higher cashbacks *or* by lowering interest rates. It is possible the higher cashbacks that have been observed in recent years have come at the expense of higher interest rates, ie, that in their absence, interest rates would have been lower, on average.

4.78 We heard from banks that cashback offers are considered quite separately from interest rates and are not considered as a package.[297] The internal evidence we have reviewed about the relation between cashback offers and interest rates generally aligns with this.[298] This surprises us, since both are relevant to the customer's perception of value as well as the overall profitability of a loan.

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4.79 Cashbacks have (at least) three features that would make their use appealing as an alternative to lower interest rates amongst major banks:

4.79.1 first, although cashbacks are a popular feature for home lending customers, cashbacks are likely to make it more difficult to compare offers between providers.[299] For example, if one bank is offering a slightly higher interest rate but a more generous cashback offer, it is not straightforward to weigh these two factors against one another. When customers find it difficult to compare offers, they may default to choosing on the basis of existing relationship or brand,[300] benefiting the major banks;

4.79.2 second, cashback offers operate as a retention device, as they are provided in exchange for a commitment that the customer does not switch away from the bank or otherwise repay their home loan for a period of time (usually three years). If the customer decides to switch or repay the loan during the committed period, they are generally required to repay the cash to the bank in full or in part. Cashbacks therefore make customers less likely to switch during this period; and

4.79.3 third, we heard from smaller banks that they find it harder to compete on cashback offers. Heartland Bank submitted that "these cashbacks can have a similar distorting impact to mortgage broker incentives due to also requiring an initial cash outlay which favours large banks who have the scale to cover this outlay".[301]

4.80 Our review of cash contribution policies found that some providers are exacerbating switching costs through these policies. While most banks 'pro-rate' the repayment obligations so that the size of the repayment is roughly proportional to the time remaining in the commitment period, some banks do not pro-rate at all.[302] And others use extremely blunt terms for calculating the repayment, for example, 100% repayment in the first two years, and 50% repayment in the remainder of a commitment period.[303]

4.81 To minimise the extent of unnecessary switching costs for customers, our draft recommendation is that industry practices for clawback of cash contributions are changed so that the clawback amount recovered from consumers is pro-rated, diminishing on a linear basis and calculated monthly.

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299 This is self-evident but was also raised by Heartland Bank. Heartland Bank "Submission on the Commerce Commission's Market study into personal banking services – Preliminary Issues paper" (7 September 2023), p 2.

300 See Chapter 8.

301 Heartland Bank "Submission on the Commerce Commission's Market study into personal banking services – Preliminary Issues paper" (7 September 2023), at p. 2.

302 [ ].

303 [ ].

4.82 In addition, providers should make it easier to compare across offers with different features (see our draft recommendations in Chapter 10). For example, customers should be shown how the cash contribution offered (if any) translates into effective interest rate terms, having regard to the duration of any fixed rate products taken out as well as the clawback period to which the cash contribution applies. If the clawback is a three-year term, the cash should be spread across three years when converted to an effective interest rate.

Small banks need to offer market leading rates to attract customers and win market share

4.83 We set out above that the major banks do not need to always compete vigorously in order to grow their home loan portfolios – at least not for all customers.

4.84 Conversely, we heard from smaller banks that there is little prospect for home loan portfolio growth if they do not have at least one attractive headline rate in a key lending product (such as the one- or two-year fixed rate). This is because customers will not think to consider a smaller bank in the absence of a clear prompt, without which it is very hard to start conversations with prospective customers.

4.85 Although the strategies of each of the smaller banks differ from one another and over time, we observe that at a high level, the smaller banks are required to have an 'always on' strategy in home lending to build market share and customer awareness,[304] which could include:

4.85.1 consistently setting interest rates that are at least 'in the pack' with the major banks,[305] with at least one particularly attractive key rate (despite having higher funding and other costs than major banks, in part due to prudential regulatory settings, making this strategy more difficult);

4.85.2 retention strategies that enable staff to match a major bank's competing offer (for customers that are perceived as sufficiently valuable);[306] and/or

4.85.3 targeting certain niche customer segments to gain brand awareness and build customer bases without competing head-to-head in the 'mass market' propositions of the major banks.[307]

304 [ ]; [ ].

305 [ ].

306 [ ].

307 [ ].

Non-price competition

4.86 Home lending providers compete on several important non-price levers, including speed of service, credit policy settings, and investing in strong relationships with mortgage advisors.[308]

4.87 At times, the major banks have used these non-price levers as substitutes for price competition in driving growth. For example, if a bank sets its home loan interest rates above its competitors, it might simultaneously increase its efforts to compete through various non-price levers to minimise the volume impact of the higher interest rates.[309]

4.88 The major banks also track the performance of one another in this regard. For example, they may hold good quality, timely information on one another's credit policy settings, speed of service and mortgage advisor footprints.[310]

4.89 Smaller banks often have constraints that limit their ability to compete effectively on many of these dimensions. For example, we have heard that smaller banks have from time to time become overwhelmed by application volumes (particularly if they have a best in market rate on offer) and had to pause their new lending via mortgage advisors until their systems could catch up.[311]

4.90 Banks also compete at the bank level on the strength of their brands and other factors which enable them to more easily attract customers.

4.91 Further discussion on non-price competition is included in Chapter 2.

Potential for coordination in home lending | *Te āhei kia mahitahi i roto i te tuku moni taurewa*

4.92 As discussed in Chapter 2, several features of personal banking make these markets conducive to coordination. These features are particularly relevant in home lending.

4.93 The market for home lending is served by an established oligopoly, where smaller providers and non-banks provide limited to no competitive constraint on the major banks in the top tier. Added to this, are other hallmarks that lead to a risk of coordination. There is limited product differentiation and frequent interaction across multiple markets (even more so for the major banks where the parent banks are also interacting in overseas markets and particularly in Australia). There is customer inertia resulting in low switching, high barriers to entry and a lack of a 'maverick' or disrupter from outside the major banks.

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308 [ ].

309 [ ].

310 [ ].

311 [ ].

4.94 Importantly, the major banks are able to closely track one another on a number of important aspects of competition, including in relation to:

4.94.1 headline interest rates, eg, via interest.co.nz;

4.94.2 discretionary discounting strategies, through information provided to pricing desk about customers with competing offers and through mortgage advisors – this enables close to real-time ability to price match;

4.94.3 volumes/market shares of lending and deposits, via Reserve Bank dashboard;[312]

4.94.4 profitability (return on equity (ROE), return on assets (ROA), net interest margin (NIM), via Reserve Bank dashboard; and

4.94.5 credit policy settings (via mortgage advisors).

4.95 Price matching strategies are also associated with the potential for coordination because they remove the incentive to undercut one another. That is, a firm who commits to price matching for its customers is guaranteeing to its competitors that any lower price by them would be matched immediately, eliminating the gains from price competition.[313]

4.96 Based on the information we have reviewed so far, we cannot rule out that tacit coordination is occurring in home lending, with the sporadic increases in competition a temporary diversion from the long run state of tacit coordination. Similar observations were made by Mary Starks in her expert report for the ACCC as part of its consideration of ANZ's proposed acquisition of Suncorp as a 'live and let live' form of coordination where the major banks tacitly agree to refrain from vigorous competition on prices.[314]

Shopping around gets you the best deal | *Me tirotiro haere kia rawe ai te whiwhi*

4.97 The most important take away for home lending customers is that, to get the best deal on your home loan, you need to shop around.

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312 [ ].

313 Salop,S. (1982) "Practices that (Credibly) Facilitate Oligopoly Coordination", published in J.Stiglitz and F. Mathewson, eds., New Developments in the Analysis of Market Structure, Cambridge, MA: The MIT Press (1986), available at: https://www.ftc.gov/system/files/documents/reports/practices-credibly-facilitate-oligopolistic-coordination/wp073.pdf.

314 Mary Starks, Independent expert report for the ACCC, 16 June 2023, paras 9.66 and 9.67: https://www.accc.gov.au/system/files/public-registers/documents/Mary%20Starks%20independent%20report%20for%20the%20ACCC%20-%2016.06.23%20-%20PR%20VERSION%20-%20MA1000023%20ANZ%20Suncorp.pdf

Shopping around gets you the best deal…

4.98 The major banks' advertised headline rates are often not the lowest rates that a customer could get. In addition, our analysis of data provided by banks found that the bank with the lowest headline interest rates is not always the bank with the lowest average rates paid by borrowers.[315]

4.99 The most common circumstance in which a customer is offered the highest level of discretionary discount available is when the customer can provide written evidence of a competing offer from a major bank. In these situations, there is a very foreseeable possibility of the customer taking his or her business elsewhere.

4.100 As a result of these dynamics, customers who shop around:

4.100.1 will likely find themselves weighing up multiple offers that differ from the relevant banks' advertised rates; and

4.100.2 cannot get a reliable indication of which major bank is offering the best rates by looking at the publicly available headline rates alone.

4.101 By contrast, customers who do not shop around, but who reasonably assume that the bank with the lowest headline rate is the one that will offer them the best deal, may inadvertently end up paying more than they would if they had approached a bank with higher advertised rates and negotiated a discount.

… but doing so takes time and effort

4.102 For a customer to independently discern which bank is offering the best deal (ie, without engaging a mortgage advisor) and to ultimately obtain the highest possible discount, customers need to lodge loan applications with multiple providers.

4.103 Only by doing this will the customer be able to confirm the applicable interest rate and to use these offers in their negotiations to get the best deal(s). This significantly increases the time and effort associated with shopping around.

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315 Our analysis of monthly home lending data provided by banks and headline interest rate data from interest.co.nz found correlations between banks' relative monthly average headline and agreed interest rates of around 0.25 to 0.40 among the major banks and Kiwibank. Correlations were calculated for each combination of bank and loan term (floating, fixed 1-year and fixed 2-year rates only), then averaged across banks. To account for trends in the levels of interest rates over time, headline and agreed rates were first 'de-meaned' by subtracting the average headline and agreed rates across banks for each loan term in each month. These de-meaned values were then used to calculate the correlations. [ ].

… and people seldom do

4.104 Our consumer survey, undertaken by Verian, (discussed further in Chapter 8) found that 49% of people only considered one provider when first choosing their home loan – that is, nearly half of all home loan customers do not shop around.[316] Other estimates in some internal bank documents suggest this percentage is even higher.[317] Further, only 36% of home loan customers said that good interest rates were a reason why they first chose their home loan provider.[318]

4.105 These findings suggest that many consumers have not historically put strong (if any) competitive pressure on home loan providers, particularly in relation to interest rates.

4.106 However, because home loans are long-term products, this evidence could reflect a historical position rather than engagement in the market today. These statistics should be considered in context of the low interest rates of the last decade, where home loans may have been a less material financial concern (ie, a lower proportion of household spending).

Switching rates reflect customer inertia and barriers to switching

4.107 Our consumer survey found that around 12% of home loan customers have switched bank in the last three years.[319] Of those that switched, 43% reported being motivated to do so by interest rates, fees, rewards and/or incentives.[320] This could be because the majority of customers are happy where they are and have taken up home loan products on terms that suit them well. Indeed, our survey found that the majority of those that haven't considered switching reported having no reason to (61%).[321]

4.108 The very high proportion of 1-3 year fixed rate home lending in New Zealand means that there are regular prompts for customers to make decisions about their home loan terms, unlike many other home loan markets around the world.[322] Nevertheless, we have found that switching and engagement with the market remains low. This suggests that the prompt to refix does not translate for all customers into a prompt to engage more holistically with the market for a better deal, or that other barriers inhibit them from doing so.

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316 Verian "Personal banking services market study – Research report" (February 2024) p.40 Q8(a).

317 [ ].

318 Verian "Personal banking services market study – Research report" (February 2024) p.36 Q11(a).

319 Verian "Personal banking services market study – Research report" (February 2024) p.39 Q10(a/b).

320 Verian "Personal banking services market study – Research report" (February 2024) p.22 Q14(a).

321 Verian "Personal banking services market study – Research report" (February 2024) p.32 Q22(a).

322 Variable rate home loans do not have natural trigger points that require customers to make decisions about their home loans. In Australia, variable rate home loans are significantly more common than fixed rate home loans: See ACCC "Home loan price inquiry - Interim report" (30 March 2020), p 15. In the United States, for example, 30-year fixed rate mortgages account for the majority of home loans, and for more than 90% of new home lending in late 2023. See https://www.imf.org/en/Blogs/Articles/2024/01/11/housing-affordability-remains-stretched-amid-higher-interest-rate-environment.

Frictions inhibit switching (refinancing) in home lending

4.109 We found that several features of the home loans market result in customers being locked in for periods that exceed their fixed interest rate periods, including:

4.109.1 the prevalence of tranche lending – if a home loan customer has two or more loan accounts (tranches) that roll off fixed interest rate periods at different times, that customer will face higher switching costs. This is because they will either need to wait until they can align the end dates for these tranches (which can take a number of years) or potentially pay break fees in respect of one or more tranches – and this is unlikely to be front of mind for customers when arranging their home loan;

4.109.2 cashback deals – these are typically provided in exchange for an agreement not to refinance away from the provider for a period of 3-4 years (while the majority of home lending customers take out fixed rate home loan products of 1-2 years). If a customer does decide to switch within the agreed cashback period, they will have to repay some (or all)[323] of the cashback amount; and

4.109.3 mortgage advisor commissions – if a customer refinances away from the provider within 27-28 months, the lender will typically 'claw back' some proportion of the advisor's commission, and the advisor will typically charge the customer a fee.

4.110 These lengthy cashback and mortgage advisor clawback provisions act to lock customers in. The terms of the clawback arrangements exceed the periods of the most popular fixed rate home lending products, meaning that these lock in provisions are likely to directly discourage switching at a customer's first (and perhaps second) opportunity to refix or refinance their home loan(s).

4.111 Reflecting these frictions, a survey of mortgage advisors conducted by interest.co.nz in early 2023 found that mortgage advisors estimated that only 31% of their customers on average could refinance with another lender after their fixed-term loan period ends.[324]

323 [ ].

324 This survey of mortgage advisors was conducted by Curia Market Research on behalf of interest.co.nz in February and March 2023. There were 160 respondents. Banks asked about in the survey were ANZ, ASB, BNZ, Kiwibank, Co-op, Heartland Bank, HSBC, SBS, TSB and Westpac. See: https://www.interest.co.nz/banking/broker-survey-april-2023-part-3

Inertia and information barriers are limiting switching behaviour for some customers

4.112 We heard from stakeholders that there is good information about prices and other features of providers' home lending offers that is readily available online.[325] However, our evidence suggests that the majority of customers are not engaging with this information.

4.113 Our customer survey found that 40% of those home loan customers who thought about switching but did not actually switch said it was too much effort to switch or too hard to find the relevant information.[326]

4.114 Amongst those that have switched or considered switching, our survey found 56% of people sought information online (including websites of new and existing providers), but only 20% of people checked an independent website.[327]

As a result, many customers are leaving money on the table in home loan negotiations

4.115 Taken together, the evidence suggests an ongoing lack of engagement by many home loans customers. These customers are not getting the best deal that would be available to them if they shopped around. Our preliminary findings suggest that there are distinct opportunities to improve consumer outcomes.

4.116 Stakeholders said that mortgage advisors can help consumers navigate the market and promote competition between banks, including by facilitating 'shopping around'.[328]

4.117 Mortgage advisors can help borrowers navigate the market, because they have up to date information about the home loan deals available through each lender (including discretionary discounts that are not publicly available).

4.118 However, ultimately these decisions are made by lenders on a case-by-case basis, and the exact terms of lending can only be provided by considering a borrower's home loan application. Therefore, in most cases consumers (or advisors on their behalf) will still need to go through the process of applying for a home loan with a lender to determine the actual home loan price.

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325 For example, BNZ stated that "[t]here are numerous tools to assist consumers to engage in price discovery and switching, including online tools (such as calculators and comparison websites)…". BNZ "Submission on Market study into personal banking services - Preliminary Issues paper" (7 September 2023), at para 2.28.

326 Verian "Personal banking services market study – Research report" (February 2024) p.27 Q17(a).

327 Including price comparison websites. Verian "Personal banking services market study – Research report" (February 2024) p.29 Q18.

328 ANZ "Submission on Market study into personal banking services - Preliminary Issues paper" (7 September 2023), at para 78.

Mortgage advisors could help to drive stronger competition for home loans | *Tērā pea ka āhei ngā kaitohu mōkete ki te ā haere i te whakataetae mō ngā moni tārewa ā-kāinga*

A brief description of mortgage advisors and aggregators

Mortgage advisors help customers navigate the home loan market and application process

4.119 Mortgage advisors are intermediaries that recommend home loans to prospective borrowers and submit loan applications to lenders on borrowers' behalf.

4.120 In order to submit loan applications to a lender, advisors generally need to be part of a mortgage aggregator network, such as NZ Financial Services Group (NZFSG) or Kiwi Advisor Network (KAN) and submit the application through that aggregator.

4.121 Aggregators act between advisors and lenders. They develop the panel of lenders from which advisors can recommend loans and provide the contractual arrangements associated with that panel. Aggregators pass on commissions from lenders to advisors, and provide advisors with technology, administrative support, and professional development in exchange for a membership fee or percentage of the advisors' commission income.

4.122 The mortgage aggregator panels that we reviewed are broad, but none span the full set of home lending providers.[329] In addition, an individual mortgage advisor business may only deal with a subset of the panel or may work more closely with a subset of the panel.

4.123 Mortgage advisors are a key distribution channel for home loans, accounting for an increasing proportion of home lending: in 2014, just under 30% of new lending and around 11% of re-priced lending was facilitated via advisors. By 2023, those figures had increased steadily to 66% and 20%, respectively (Figure 4.5). This trend mirrors the rise of advisors in Australia and the United Kingdom.[330]

4.124 Mortgage advisors have the potential to make competition for home loans more effective, by:[331]

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329 For example, New Zealand Financial Services Group's panel includes ANZ, ASB, BNZ, Westpac, Kiwibank, TSB, SBS, First Mortgage Trust, Sovereign, Co-op Bank, ASAP Finance Limited, Avanti Finance, Basecorp Finance, Cressida Capital, DBR, Heartland Bank, Liberty Financial, Prospa, Resimac, Southern Cross, Select, XE Money Transfer. https://www.nzfsg.co.nz/. Kiwi Advisor Network's panel includes ANZ, ASB, BNZ, Westpac, ASAP Finance, Avanti, Bank of China, Co-operative Bank, Cressida Capital, DBR, First Mortgage Trust, Funding Partners (CFML), Heartland Bank, ICBC, Libert, Pallas Capital, Pepper Money, Plus Finance, Prospa, Resimac, SBS, Southern Cross Partners, Unity, AIA/Sovereign Home Loans, Kiwibank and TSB. https://www.kiwiadvisornetwork.co.nz/Disclosure.

330 https://www.mckinsey.com/industries/financial-services/our-insights/brokering-growth-in-the-mortgage-market.

331 These benefits were noted by ASIC. ASIC "Report 516: Review of mortgage broker remuneration" (March 2017), para 22, available at: https://download.asic.gov.au/media/4213629/rep516-published-16-3-2017-1.pdf.

4.124.1 increasing consumers' knowledge of loan products and assisting customers to choose products that are a good fit for them;

4.124.2 exerting competitive pressure on lenders on behalf of consumers, inviting lenders to compete more strongly with each other for business; and

4.124.3 providing a distribution channel for lenders – this can be particularly valuable for enabling small lenders to compete more effectively with big lenders.

4.125 Encouragingly, our survey found that mortgage advisors do appear to be correlated with higher rates of switching, suggesting they play a pro-competitive role in the market:[332]

4.125.1 two-thirds of customers that have switched their home loan in the last three years have used a mortgage advisor, compared to 40% of all home loan customers; and

4.125.2 of those who considered switching but didn't, only one-third of customers used an advisor (compared to 40% of all home loan customers).

4.126 These results suggest that mortgage advisors can help to put more pressure on lenders than customers can without an advisor. However, they could also be driven by selection bias, at least in part. This is because a customer who has a reasonable willingness or appetite to change their provider may be more likely to seek out a mortgage advisor, while a customer with a strong preference for approaching their existing provider is less likely to seek out an advisor.

4.127 In Australia, mortgage advisors have supported smaller banks to compete more effectively in home lending. Advisors are increasingly recommending non-major lenders to borrowers due to the more compelling interest rate offers of these smaller providers.[333]

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[332] Verian "Personal banking services market study – Research report" (February 2024), p.39 Q6a, 10a/b.

[333] See, for eg, https://www.brokerpulse.com.au/news/non-majors-hold-lead-on-pricing-as-rates-rise.

4.128 Macquarie Bank provides one notable example. Success in the advisor channel has been a key part of Macquarie Bank's rapid growth in home lending in Australia over the last decade,[334] where it has emerged as a competitive "maverick".[335] To achieve this growth, Macquarie Bank committed to delivering strong service through the advisor channel.[336, 337]

4.129 We do not observe similar prevalence of non-major banks amongst advisors in New Zealand. Mortgage advisor-led lending volumes mostly go to the major banks and Kiwibank, broadly in proportion with their existing shares of supply in home lending.[338]

4.130 One hypothesis for the success of the major banks and to a lesser extent, Kiwibank, in the advisor channel, is that these providers (like Macquarie) have committed the most time and effort into their advisor channel.

4.131 A survey of mortgage advisors conducted by interest.co.nz in early 2023, asked mortgage advisors which (three) banks have been the most and least competitive with interest rates and offers over the last three months (which would broadly correspond to the period 1 December 2022–31 March 2023),[339] and which banks have the best and worst processes and systems for loan processing, credit assessment and loan approval, shown in Table 4.1.

Table 4.1 Interest.co.nz mortgage advisor survey results 2023

Bank	Processes and systems				Competitive rates		
	Best	Middle	Worst		Best	Middle	Worst
ANZ	64%	21%	15%		60%	17%	23%
ASB	76%	12%	12%		44%	20%	35%
BNZ	20%	21%	59%		68%	16%	16%

334 See https://www.afr.com/companies/financial-services/macquarie-unveils-its-major-mortgage-market-ambitions-20240213-p5f4k6.

335 Australian Competition Tribunal "ACT 1 of 2023: Applications by Australia and New Zealand Banking Group Limited and Suncorp Group Limited, Summary of Reasons for Determination" (20 February 2024), para 17, available at: https://www.competitiontribunal.gov.au/__data/assets/pdf_file/0004/115942/240220-Summary-of-Reasons-for-Determination.pdf.

336 See, for eg, https://www.theadvisor.com.au/breaking-news/39069-macquarie-ceo-holds-firm-on-broker-support.

337 Macquarie Bank also ranked first for 2 consecutive years in the Mortgage Professional Australia "Broker on Banks" survey (2022 and 2023). https://www.mpamag.com/au/best-in-mortgage/brokers-on-banks-2022/39875; https://www.mpamag.com/au/news/general/revealed-the-winners-of-brokers-on-banks-2023/440058.

338 [ ].

339 We note that the survey question specifically asked advisors to reflect on the three-month period to February/March 2023. This would be unlikely to distort the results in respect of processes and systems but may influence results as they relate to interest rates, since as we have seen in this chapter, the relative competitiveness of home lending providers changes over time.

Kiwibank	26%	45%	29%		17%	58%	25%
Westpac	43%	28%	29%		21%	30%	49%
Co-operative Bank	8%	59%	33%		13%	61%	26%
Heartland Bank	3%	80%	17%		9%	85%	6%
HSBC	1%	85%	14%		1%	90%	9%
SBS	21%	56%	23%		28%	57%	15%
TSB	14%	69%	17%		25%	67%	8%

Source: Interest.co.nz.[340]

4.132 On the basis of these results:

4.132.1 ASB and ANZ appear to have invested most heavily in their processes and systems relating to advisors, while BNZ comes out as the worst provider in this regard; and

4.132.2 BNZ and ANZ compare favourably to the group on the competitiveness of interest rates over this period. While Westpac and Co-operative Bank compare least favourably.

4.133 Looking across the results, ANZ performs strongly overall (with high incidence of being identified as the best and low incidence of being identified as the worst in both categories). This could explain the high proportion of advisor-led lending that is directed to ANZ. However, the results across the remainder of providers do not obviously explain the volumes of advisor-led lending that go to the other major banks.

4.134 One striking observation in these survey results is the extent of variance in their assessment of the banks:

4.134.1 while the majority of advisors identified BNZ as one of the three providers with the worst processes and systems for loan processing, credit assessment and loan approval – 20% of advisors chose BNZ as one of the best three providers for the same question; and

4.134.2 while nearly half of advisors (44%) identified ASB as the most competitive on interest rates, 35% identified ASB as the least competitive on interest rates; and, similarly

4.134.3 while nearly half of advisors (49%) identified Westpac as the least competitive on interest rates, 21% said that Westpac was one of the three most competitive.

340 Interest.co.nz "How NZ mortgage brokers assess individual banks" (April 2023), available at: https://www.interest.co.nz/node/120783.

4.135 These variances are hard to reconcile. They could reflect individual differences by region, the customer demographic that a particular advisor has specialised in, or different experiences depending on key contact(s) at each lender. However, they could also reflect a lack of consistency in approach by the advisor channel when they assess the banks' offerings.

4.136 Overall, this evidence raises questions about whether advisors are delivering on their pro-competitive potential in respect of home lending in New Zealand. They may be reflective of a poorly functioning channel, whereby many advisors are not well informed about the relative quality of the offers from each provider and are making recommendations to customers based on poor quality information, habit, or other incentives.

4.137 In the remainder of this section, we describe the roles of mortgage advisors and aggregators in home lending. In doing so, we observe a number of arrangements that appear to be inhibiting the pro-competitive potential of the advisor channel.

Mortgage advisors are not getting lower interest rates for their customers (on average)

4.138 We heard from many of the providers that their pricing frameworks means that the same customer would generally obtain the same deal, irrespective of whether they came directly to the bank or via an advisor.[341]

4.139 ANZ Australia touched on this point in its submission to the Australian Productivity Commission review:[342]

> … we would suggest that a competitive market would deliver convergence of the rates. If one channel delivered better rates through better negotiating power or market insight, it would be reasonable to expect the other channel to drop its rates in response.

4.140 We heard from mortgage aggregators that one of the main ways that mortgage advisors help their customers is by increasing the customer's awareness of different lenders and advising them about which lender is best suited to serve their particular needs.[343] In this way, their service may still result in the customer getting a better deal than they would have if they hadn't worked with a mortgage advisor (because they approached different lenders than the customer would have done in the absence of the advice).

4.141 However, use of any intermediary means that there is potential for conduct that serves the best interests of that intermediary, rather than or in addition to the best interests of the customer.

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341 [ ]; [ ].

342 ANZ "Productivity Commission Inquiry into competition in the Australian financial system: Response to draft report" (March 2018), sub DR74, p. 21, available at: https://www.pc.gov.au/__data/assets/pdf_file/0018/226134/subdr074-financial-system.pdf. Cited by Australian Productivity Commission in its Final Report at p. 309.

343 Mortgage advisors may also help consumers with affordability assessments.

Commission arrangements tend to align the incentives of advisors with providers, not with customers

Mortgage advisors receive commission income from lenders

4.142 Mortgage advisors receive commission income paid by the lender. The structure of these commissions can be grouped into the following categories:

4.142.1 up-front commissions calculated as a proportion of the loan principal (paid by the lender when the loan is taken out); and

4.142.2 trail commissions calculated as a proportion of the loan principal (paid by the lender each month while the loan is active).

4.143 Although mortgage advisors are remunerated based on commissions calculated on loan principal, the size of the loan is not closely related to the effort or the quality of the service provided by the advisor.[344] The commission payment tends to reflect the value that the loan represents to the lender, rather than the effort involved.[345]

4.144 The levels of commissions vary between lenders, but not within lenders (that is, each lender offers the same commission structure to each aggregator group).

4.145 Some lenders only offer up-front commissions, while others offer a combination of up-front and trail commissions.[346] For example, Mortgage Lab has published some information about commission rates across providers on its website, as of 21 June 2022, set out in Table 4.2 below.

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344 This point was also noted by ASIC in its review of mortgage broker remuneration. ASIC "Report 516: Review of mortgage broker remuneration" (March 2017), para 462, available at: https://download.asic.gov.au/media/4213629/rep516-published-16-3-2017-1.pdf.

345 Australian Productivity Commission "Competition in the Australian financial system" (2018), p 320, available at: https://www.pc.gov.au/inquiries/completed/financial-system/report.

346 We presume that providers set their commission rates in a manner that serves them best (to help them to win business, while being mindful of the cost associated with paying commissions over time).

Table 4.2 Commission structures of home lending providers according to Mortgagelab.co.nz, 21 June 2022

Lender	Upfront	Trail	Refix
ANZ	0.85%	N/a	$150
BNZ	0.55%	0.15%	N/a
ASB	0.85%	N/a	$150
KiwiBank	0.55%	0.15%	N/a
Westpac	0.60%	0.20%	N /a
Sovereign Home Loans	0.60%	0.20%	N/a
TSB	0.85%	N/a	N/a
ASAP Finance Limited	Fee Charged	N/a	N/a
Avanti Finance	Up to 0.80%	N/a	N/a
Cressida	Fee Charged	N/a	N/a
DBR	Fee Charged	N/a	N/a
First Mortgage Trust	Fee Charged	N/a	N/a
Heartland Bank (Reverse Mortgage)	1.50%	N/a	N/a
Liberty Financial	0.60%	0.15%	N/a
NZCU (Personal Loans)	1.00%	N/a	N/a
RESIMAC	0.60%	0.15%	N/a
SBS Bank	0.80%	N/a	$150
Southern Cross	Fee Charged	N/a	N/a
The Co-operative Bank	0.70%	N/A	$150

Source: Mortgage Lab.[347]

4.146 Although it is not immediately obvious whether a particular advisor would prefer an up-front commission (alone) or a combination of up-front and trail commissions, it is easy to observe that ANZ, ASB and TSB's commission structure would be preferable from the perspective of an advisor to that of SBS or Co-op, while Westpac and Sovereign's would be preferable to Kiwibank and BNZ's.[348]

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347 Mortgage Lab "How much do mortgage brokers charge?" (21 June 2022), available at: https://mortgagelab.co.nz/ufaqs/how-much-do-mortgage-brokers-charge/.

348 We have heard, for example, that an advisor may prefer a larger up-front commission early in their career (for cashflow reasons), while an advisor may prefer trail commissions if they are considering the sale of their business, where a strong book of trail commissions would be appealing to a prospective buyer. [ ]

4.147 Mortgage advisors may face a conflict of interest with their clients because they are incentivised to recommend a lender that pays them the best commissions, even if that lender is not the best fit for the borrower. This includes potential conflicts of interest in relation to:[349]

4.147.1 lender choice – whereby the advisor has an incentive to favour lenders that pay preferential commissions;[350] and

4.147.2 loan size – an advisor may favour borrowers taking out higher loans (and have less incentive to serve customers who may not have large borrowing needs, such as lower income borrowers or older borrowers), and may have the incentive to maximise the amount that consumer borrows.

4.148 Because commission payments are made by lenders, not borrowers, it is more difficult to determine for whom an advisor acts – the lender or the borrower.

4.149 Separately, because commission payments are made by lenders to advisors, the immediate sting of the payment is not felt by the borrower.[351] Nevertheless, these costs will ultimately affect interest rates and fees paid by all customers in the market.

4.150 Two immediate consequences of this disconnect are:

4.150.1 customers cannot realistically weigh up whether the expected benefits of using an advisor makes doing so worthwhile (ie, whether the benefit of a better home loan offer obtained through an advisor exceeds the commission payment that the advisor receives in exchange); and

4.150.2 because would-be borrowers are likely to view an advisor's service as 'free', there are very limited incentives for customers to negotiate over fees or shop around for an advisor.[352]

Trail commissions

4.151 Trail commissions are regular payments calculated as a proportion of the loan principal and paid by the lender to the advisor (via the relevant aggregator) each month while the loan is active.

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349 See ASIC "Report 516: Review of mortgage broker remuneration" (March 2017), para 29 and Australian Productivity Commission "Competition in the Australian financial system" (2018), p 320.

350 These incentives could be affected by more than simply differences in commission size. For example, we heard some evidence that the nature of commissions offered by different providers (up-front only or up-front and trail) may have differing appealing to advisors at different stages in their careers: a mortgage advisor who is just starting out in setting up their own business may prefer higher up-front commissions, while an advisor that may be near retirement and planning to sell their business or portfolio may prefer trail commissions as an appealing ongoing revenue stream for a potential buyer. [ ]

351 Hayne Commission "Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry" (1 February 2019), volume 1, p 65-66.

352 Nadel, Mark S. "A Critical Assessment of the Traditional Residential Real Estate Broker Commission Rate Structure (Unabridged)." (2007), p. 22, available at: https://ecommons.cornell.edu/items/dfb50af2-b642-4c31-bf7b-35edfcf24e90.

4.152 We heard from lenders that trail commissions are designed to operate as a deterrent for engaging in 'churn', whereby mortgage advisors might otherwise arbitrarily seek to refinance their customers from one lender to another to maximise up-front commissions.

4.153 We also heard that trail commissions remunerate advisors for providing ongoing services to their clients, such as re-fixing and re-structuring over the life of the home loan. However, we are not aware of any formal commitment that such services be performed.

4.154 More generally, it seems that trail commissions serve to align the advisor's interests with that of the lender, rather than of the borrower, by reducing the likelihood that an advisor will recommend refinancing to another bank (even if doing so is in the best interests of the borrower).

Clawback arrangements disincentivise switching

4.155 Contract terms allowing clawback of commission payments from aggregators (and ultimately, advisors) if a loan is repaid or discharged early are a common feature.[353] For example, this may occur if a borrower refinances to another bank within a set period, often 27-28 months.

4.156 In these circumstances, the aggregator will be required to repay the up-front commission already received (most often pro-rated). In some cases, the aggregator is also required to pay back any trail commissions received to date. In all cases, the aggregator will lose the right to any future trail commissions on that loan.

4.157 We understand that if a lender claws back a commission payment, the mortgage advisor will charge the borrower a fee for service associated with providing the home loan advice.[354] This is calculated on the basis of time and cost.[355] The potential to incur these fees from the advisor adds significantly to the total switching costs faced by a borrower who might otherwise consider refinancing to another provider.

4.158 There are two features of these arrangements which appear to give rise to unnecessary impediments to switching for consumers.

4.158.1 First, a 27–28-month clawback period will disincentivise refinancing up until the first opportunity to refinance after the clawback period ends, which for most borrowers is likely to be at least three years (36 months), given the prevalence of 1- and 2-year fixed rate borrowing in New Zealand (and may be longer due to tranche lending practices).

353 [ ]

354 [ ]; [ ].

355 Therefore, it is likely to differ from the quantum of the commission clawback but may be capped at the size of that amount.

4.158.2 Second, although the clawback arrangements are generally pro-rated, the pro-rata arrangements are very lumpy and are not always linear. For example, at least two banks have the ability to clawback 100% of the up-front commission from advisors for a period that exceeds 12 months. Since the cost of these clawback arrangements are passed on to consumers via a fee for service, these arrangements have significant implications for customers.

4.159 As discussed in Chapter 10, our draft recommendation is that industry practices around clawback of commissions are changed so that the clawback amounts recovered from advisors are pro-rated, diminishing on a linear basis and calculated monthly. Pro-rata arrangements for clawback of commissions should be limited to a maximum of 24 months, which would bring them into line with common practice in Australia.[356]

Arrangements and practices relating to advisors that may be inhibiting competition

4.160 We have also become aware that some major banks have clauses in their contracts with mortgage aggregators that place conditions on advisor's discretion to switch an existing customer of those banks to a different bank.[357]

4.161 We have made inquiries of the relevant parties to better understand the rationale for these clauses, how they work in practice, and the extent to which they sit consistently (or not) with the advisor's client's interests. We are continuing to assess the competition effects of these provisions.

4.162 We also heard that advisors may ask new customers who their existing banking provider is, and whether they are happy with that provider. This can form an important part of their assessment of which provider(s) to approach.[358]

4.163 We are continuing to engage with parties to better understand the role of mortgage advisors in the industry, and whether there are ways to improve their potential for promoting competition between home lending providers.

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356 In Australia, the clawback period for up-front commissions is generally 12-24 months. See for example https://www.theadvisor.com.au/lender/44538-cba-updates-clawback-policy.

357 [ ]; [ ].

358 [ ].

Existing regulatory settings do not go far enough to ensure advisors are acting in the best interests of customers

4.164 The Financial Markets Conduct Act 2013 (FMC Act) imposes duties on financial advisors (including mortgage advisors) to ensure all New Zealanders have access to quality financial advice, and to help build public confidence in advisors.[359] This includes section 431O which imposes a duty to disclose certain information when providing financial advice.

4.165 In addition to the FMC Act obligations on mortgage advisors, there is likely potential impact under the upcoming CoFI regime on how mortgage advisors must act, as set out by the fair conduct principle.[360]

Disclosure may not be effective

4.166 The disclosure requirements require mortgage advisors to disclose information relating to the commissions, incentives, or other conflicts of interest that a client might perceive as having potential to materially influence the financial advice.[361]

4.167 However, it is not clear whether a difference between commission structures (such as ANZ's 0.85% compared to SBS's 0.80%) would meet the threshold for materially influencing the financial advice.

4.168 It is also not clear whether an advisor is required to disclose how their actual commission compares to the amount they *would have received* had they recommended a different provider.[362] As such, the customer is unlikely to have visibility over whether the advisor has made a recommendation that also happens to be in the best financial interests of the advisor, or not.

Clear guidance should be provided

4.169 Although mortgage advisors are required to give advice that is 'suitable' and to 'give priority to client's interests,[363] there appears to be no substantive guidance on what these obligations mean or how they should be interpreted. Further, we are not aware of any case law or disciplinary decisions on breaches of the duty to give priority to client's interests (in the context of mortgage advisors or otherwise).

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359 See FMA "Meeting your obligations under the new financial advice regime", available at: https://www.fma.govt.nz/assets/Information-sheets/Meeting-your-obligations-under-the-new-regime.pdf.

360 CoFI comes fully into force on 31 March 2025 and introduces a new regulatory regime to ensure 'financial institutions' (as defined in s 446E of the CoFI to include registered bank, licensed insurer, or licensed NBDT) treat consumers fairly.

361 See, for example, regulations 229D and 229E, and clauses 2, 5 and 6 of Schedule 21A of the Financial Markets Conduct Regulations 2014.

362 [ ].

363 Subpart 5A of Part 6 of the FMC Act, s431K: duty to give priority to client's interests. Mortgage advisors give 'regulated financial advice', as set out in the Standard Conditions for licensed financial advice providers. Persons giving regulated financial advice are bound by the duties in the FMCA.

4.170 We also understand that quality of the documentation typically provided by mortgage advisors to evidence that their advice is ‘suitable’ has historically been very low.[364]

4.171 Our draft recommendation is that the FMA issues specific guidance on mortgage advisor duties, and monitors the mortgage advisor sector, engaging with advisors and their clients. The particular factors that we recommend that the FMA should consider are discussed in chapter 10.

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364 [ ]

Chapter 5 Competition for deposit accounts | *Te whakataetaetanga mō ngā kaute whakaputu*

Summary of preliminary findings

- **Deposit accounts include transaction accounts, savings accounts, and term deposits.** Transaction accounts form the basis of main bank relationships, which are an important focus for competition in personal banking.
- **Retail deposits (funds held in deposit accounts) are crucial to bank funding.** They are typically the lowest cost source of funding available to banks and represent approximately 65% of funding for the major banks and Kiwibank, and 80% of funding for smaller banks.
- **Transaction deposits are particularly valuable, as a significant portion of transaction deposits are non-interest bearing.** Overall, the major banks and Kiwibank hold approximately $58b of non-interest bearing deposits.
- **The major banks have been able to attract a greater proportion of transaction deposits than small NZ banks.** This reflects advantages the major banks have in winning and maintaining main banking relationships.
- **Because they hold a higher proportion of transaction deposits, the major banks and Kiwibank on average pay between 50-60 basis points less for retail deposits than the small New Zealand banks.** Given the major banks and Kiwibank have a total deposit balance of $395b, this presents a substantial cost advantage. While the major banks have better access to wholesale funding sources, small NZ banks rely more heavily on retail deposits.
- **This difference in the cost of funds limits the ability of small banks to competitively constrain the major banks in home loan and other lending markets.** For example, we have found that the major banks can, at their discretion, match and outlast the promotions of smaller providers. Over the long-term, this contributed to entrenching the stable two tier oligopoly market structure.
- **Competition amongst the major banks and Kiwibank for deposit funds is sporadic.** We have seen some evidence that the intensity of competition can flip between lending and deposit sides of the market, depending on a range of external market factors and internal bank strategy.
- **Generally there are no (or low) fees on transaction accounts** (and no price competition in that sense) reflecting the position of transaction accounts as key products to main bank relationships. Given the high volume of payment activities in transaction accounts, non-price factors such as quality of service are likely to be more important to consumers than seeking an interest return. Switching transaction account providers can be particularly challenging, compared with savings or term deposits.
- **The major banks and Kiwibank typically set prices for savings and term deposit accounts with regards to one another**, having limited regard to smaller providers. Incentives to engage in strong price competition appears to be limited, and major banks tend to match each other's offers rather than compete intensely on price.

Deposit account services include transaction accounts, savings accounts, and term deposits | *Ka whāiti mai ki ngā ratonga kaute whakaputu ko ngā kaute kurutete, kaute penapena pūtea me ngā kuhunga tūmau*

5.1 This section describes the different types of deposit accounts and their notable features, and the importance of deposit accounts to banks and competition.

5.2 **Transaction accounts** are used for everyday banking such as receiving income, making payments, and managing the day-to-day flow of money. Therefore, transaction accounts are likely to generate a high volume of transactions compared with other deposit account types.[365] Payment cards (such as EFTPOS or debit) are usually linked to transaction accounts. As discussed in Chapter 2, main bank relationships centre on transaction accounts.

5.3 Deposits in transaction accounts are available immediately (referred to as 'on call') and generally, interest is not paid on them.

5.4 Overdrafts are provided through transaction accounts. An overdraft is an extension of credit when a withdrawal is attempted that exceeds the balance of the account. Overdrafts can be arranged in advance or provided on an unarranged basis (typically at a higher cost).[366]

5.5 **Savings accounts** are primarily for saving and earning an interest return. A common feature of savings accounts is a bonus interest rate if certain conditions are met.[367] Common conditions include a minimum deposit balance, a maximum number of transactions in a period, a notice period before withdrawal, or a minimum monthly deposit amount.

5.6 Similar to transaction accounts, balances on most savings accounts are available on call, although there may be disincentives for using savings deposits for transactions. For example, customers may lose a bonus rate if they make a withdrawal or keep a bonus rate if withdrawals are delayed by a fixed period.

5.7 **Term deposits** are similar to savings accounts in that they provide an interest return for deposits and are used for saving. Term deposits are fixed-term deposits with a maturity of more than one day. Ending a term deposit before the agreed maturity date can incur a break penalty.

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365 Transaction accounts can also be referred to as 'current accounts' or 'personal current accounts' (PCAs). PCA is a term common in the UK and refers to both transaction accounts and savings accounts.

366 For example, ANZ Overdrafts and overdrawing your account rates, fees, and agreements, available at: https://www.anz.co.nz/rates-fees-agreements/overdrafts-overdrawing/

367 Customers who maximise the value from these products first need transparent information on eligibility criteria for the bonus rate and 'bank month'. A 'bank month', which can apply as the relevant time period for bonus interest rates, is different from a calendar month. It runs from the last business day of the previous calendar month to the second to last business day of the current calendar month. [ ].

5.8 Term deposits typically offer higher interest rates than other types of deposit accounts, although there are a wide range of alternative investment products that offer comparable rates.

Retail deposits are an important source of funding for banks

5.9 Funds stored in deposit accounts are referred to as 'retail deposits', which are a crucial source of bank funding.

5.10 Banks benefit from deposit account customers in part through charging fees, but primarily through the interest margin generated from lending retail deposit funds back to consumers (for example through home loans). New Zealand banks generally earn less from fee income than banks in many other jurisdictions, therefore the interest margin generated from retail deposits is important for them.[368]

Major banks, Kiwibank, and small domestic banks are the main providers of deposit account services to New Zealand consumers

5.11 This chapter focuses on those registered banks that compete broadly for personal deposit account services and are the primary holders of consumer deposits. There are other providers of transaction account services (such as payment providers) that do not take deposits and are discussed in Chapter 9.

5.12 Some deposit takers choose to target certain customer segments (for example, Rabobank emphasises agriculture banking), or may not offer a broad range of services to consumers. We find that these deposit takers do not provide a strong competitive pressure on the larger banks.

5.13 Credit unions and building societies (CUBS) offer many of the same products as banks, but are relatively small competitors for deposit products, with less than 1% of total deposit-taker assets.[369] NBDTs also compete for deposit services, though generally for niche markets rather than in direct competition with banks.[370]

How providers compete for deposit account customers | *Te whakataetae a ngā kaituku ratonga mō ngā kiritaki kaute whakaputu*

5.14 There is a range of drivers of competition for deposit account customers, and a range of strategies that banks employ depending on the type of deposit account for which they are competing.

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368 David Tripe "Submission on Market study into personal banking services - Preliminary Issues paper" (6 September 2023), at p. 2.

369 We note deposits are not assets and use this measure to reflect the size of this group. [ ].

370 [ ].

5.15 As described in Chapter 2, banks compete to win a customer's main banking relationship (which centres on a transaction account). Main bank relationships provide a range of benefits to the bank such as the ability to cross sell more services as well as deposits held in transaction accounts providing banks with a low-cost funding source.

5.16 The intensity of competition for deposit accounts is sporadic and depends on a range of market, external and provider level factors for each bank. These factors are described in more detail in Chapter 4 and apply similarly to deposits. Due to the interdependencies across the balance sheet (where deposits are a key funding source for lending activities) and drivers of consumer choice, the same factors can impact competition for deposit accounts and home loans.

5.17 Brand reputation plays an important role in competition for deposit accounts. For savings and term deposits, trust and security are important drivers of consumer choice, while brand presence may be more important for transaction accounts.

5.18 From mid-2025, the Reserve Bank will be introducing a Depositor Compensation Scheme (DCS), which will provide insurance for consumer deposits that are held with banks, credit unions, building societies or finance companies.[371] While this could increase consumer trust in smaller providers, we have heard that in Australia where a similar scheme is in place, there appears to be an enduring consumer perception that major banks are safer, even though other deposit takers are covered by the scheme.[372]

Price is not a significant feature of competition for transaction accounts

5.19 Most personal transaction account products do not pay interest on balances,[373] and many account fees have reduced or been removed in recent years. As such, the price that consumers pay (or earn) for transaction deposits is not a strong factor that consumers consider when choosing a transaction deposit account.

5.20 As transaction accounts are likely to have a high volume of daily activity, the quality dimensions of transaction account services are more relevant to consumers than price when choosing a transaction account service provider.[374] Quality dimensions include the quality of the banks' mobile apps, or features such as Apple and Google Pay.

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371 https://www.rbnz.govt.nz/regulation-and-supervision/depositor-compensation-scheme.

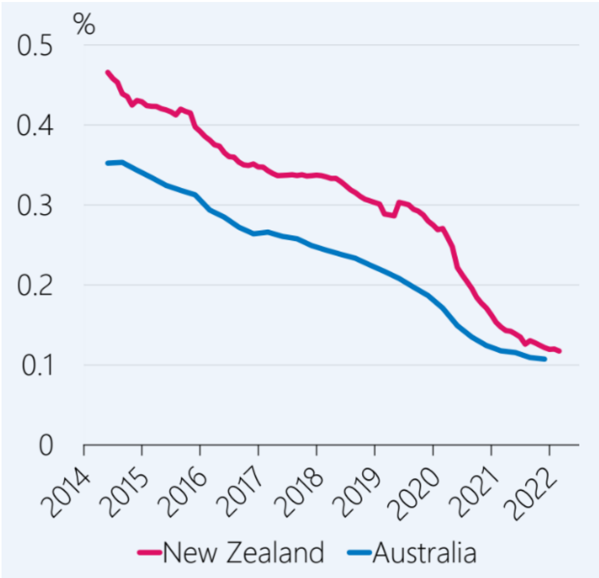
372 ACCC "Retail Deposits Inquiry Final Report" (December 2023), at p. 21-23, available at: https://www.accc.gov.au/system/files/Retail-deposits-inquiry-final-report.pdf; [ ].

373 However some business transaction accounts do provide interest return on transaction account balances, as we note some banks offer interest on business transaction accounts.

374 [ ]; [ ].

5.21 As shown in Figure 5.1, there has been a decline in fees on transaction accounts in recent years, and we have observed a shift towards removing deposit account fees more broadly.

Figure 5.1 Transaction and call deposit account fees (% of average balances)



Source: Reserve Bank.[375]

5.22 Declining fees may be attributed to banks placing more focus on interest income generated by lending out retail deposits, and therefore reducing fees to attract retail deposits. It may also reflect ongoing decline in bank operating costs due to digitalisation.[376]

Transaction accounts face higher barriers to switching than savings or term deposits

5.23 Several features prevent more switching of providers of deposit accounts. Some of these switching barriers are common across any product when you move to a new bank (such as identification checks to meet AML and Know Your Customer (KYC) requirements), and other barriers are unique to certain deposit account products.

5.24 The actual or perceived costs for switching transaction account providers benefit the major banks proportionately more, as they have large existing customer bases. These switching costs makes it more difficult for smaller providers to attract retail deposits and grow.

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375 Reserve Bank "Financial Stability Report" (4 May 2022), at p. 37, available at: https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/publications/financial-stability-reports/2022/fsr-may-22.pdf.

376 Reserve Bank "Financial Stability Report" (4 May 2022), at p. 37.

5.25 Transaction accounts can be cumbersome and time consuming to switch, due to the numerous contingent payment arrangements and associated day-to-day activities that need to move.[377] This can include updating the account number that income is paid to, transferring automatic payments and direct debits, EFTPOS, and debit card arrangements, and setting up a different banking mobile app and migrating saved information.

5.26 As discussed in Chapter 8, a switching service run by Payments NZ is available which can support migrating some, but not all, payment arrangements. Awareness and use of the switching service appears to be low, and it provides only limited support to consumers seeking to switch transaction account providers.

5.27 Savings and term deposits have fewer contingent arrangements to migrate, so switching is easier for transaction accounts. However consumers will still face AML and KYC checks when opening a new account in order to switch to a new bank.

5.28 Switching (without a potential penalty) is only possible at the end of a fixed maturity period, but this appears to be relatively easy for consumers to manage, as the term commitment is transparent and chosen by the consumer.

5.29 Chapter 8 discusses consumers' ability to search for, and switch to, another bank provider in more depth.

Open banking can enable greater competition without consumers switching from their main bank

5.30 Consumers generally use the transaction account services of the bank that they store their deposits with (for example payment and money management services provided through a mobile banking app). We have observed some challengers (such as Dolla)[378] seeking to offer alternative transaction account services but these apps have seen limited uptake in New Zealand to date. This is a reflection of the broader challenges facing open banking in New Zealand described in Chapter 9.

5.31 In the absence of open banking, a fintech seeking to introduce an innovative transaction account service may currently find that they also need to vertically integrate to hold deposits. This can decrease a consumer's likelihood to switch to such a service (given the importance consumers place on safety and security of their money) and expose the fintech to additional deposit-taking regulations. This dynamic is currently making it more difficult for competition to emerge from innovative payment and money management services.

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377 In this section when we discuss to consumer switching their transaction accounts, we are referring to switching of the main banking relationship, that is, the consumers primary transaction account that is used day-to-day. As discussed in Chapter 8, many consumers may or may not close their previous transaction accounts when they switch to a new provider. This is sometimes referred to as a 'hard switch' or 'soft switch'. While a soft switch provides consumer more time to migrate their service to the new provider, the distinction is otherwise not relevant for this section of the report.

378 For example, Dolla provides a mobile app that is compatible with all large banks, and provides a range of services, without requiring funds to be transferred to a Dolla account.

Banks compete on price for savings accounts and term deposits

5.32 Price competition in the form of interest rates and/or fees appears to be the key driver of consumer choice for term deposits, and to a lesser extent for savings accounts. Aside from the interest rate, the range of term deposit products are relatively homogenous.

5.33 Consumers are more price sensitive for term deposits than for savings accounts and see term deposits as competing with other forms of interest bearing investments (eg, managed funds). However, price is not the only factor to consider when comparing products – a consumer's risk tolerance is also a key factor, and typically term deposits are viewed as a low-risk product (although, as discussed in paragraph 5.17, trust and security of a brand – rather than product – do play a role).[379]

5.34 While savings accounts are primarily used to earn an interest return, there are other features that may be important for consumers, such as the convenience of an account from the same provider as a main transaction account (ie, the main bank relationship).

5.35 As consumers are price sensitive for savings accounts and term deposits, banks are able to attract deposits to meet their funding needs through adjusting interest rates on these interest bearing products. By contrast, seeking to attract transaction deposits, appears more likely to require enhancements to non-price features (eg, a good app) which take longer to develop.

5.36 Engaged consumers appear to be able to get better term deposit rates by comparing and negotiating with providers.[380] We understand a bank's internal pricing discretion framework enables frontline staff to escalate pricing requests on term deposits, and in some cases gives frontline staff authority to immediately apply pricing discretion within set limits.[381]

5.37 Our review of bank pricing strategies found that key considerations when setting interest rates include current market conditions, competitor rate movement, core funding strategy, market share objectives, as well as other internal factors such as broader bank strategy.[382]

5.38 The major banks and Kiwibank tend to closely monitor each other's interest rates, with limited consideration of smaller banks or non-banks.[383] This suggests that they do not face strong competitive pressure from smaller providers on price.

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379 For example, see: https://www.moneyhub.co.nz/term-deposit-rates.html and https://www.fma.govt.nz/consumer/investing/types-of-investments/cash-investments/.

380 As we have observed discretionary discounting available for term deposits. Although this can depend on the sporadic intensity of competition.

381 [ ].

382 We have observed that a key role of a bank's Pricing Committee is to provide insights and information as to review and approve pricing for savings accounts and Term Deposits (across multiple terms). [ ].

383 [ ]; [ ]; [ ]; [ ]; [ ]; [ ].

5.39 Some banks have been moving to simplify their savings accounts to streamline products and provide greater value for customers. In some cases, this has meant a move away from base and bonus interest rates, towards one flat interest rate on savings products.[384]

5.40 Training is provided to frontline staff to support proactive and consistent application of discretions and to balance customer outcomes with customer retention. When considering a pricing escalation, bank staff consider factors including funds under management, and the length of time a customer has been with bank and current competitor rates.[385]

5.41 As we described in Chapter 4, the OCR is one important factor that providers have regard to when setting interest rates. However, we would not expect to see a one-for-one relationship between the OCR and savings or term deposit interest rates, because these interest rates are also influenced by other factors, such as the intensity in competition amongst banks to attract deposit funding.

Price comparison between banks

5.42 Figure 5.2 compares weekly deposit rates for savings and term deposit products, across selected banks.[386] Interest rates for term deposits offered tend to be similar across the most popular three-month, six month and 12-month terms.

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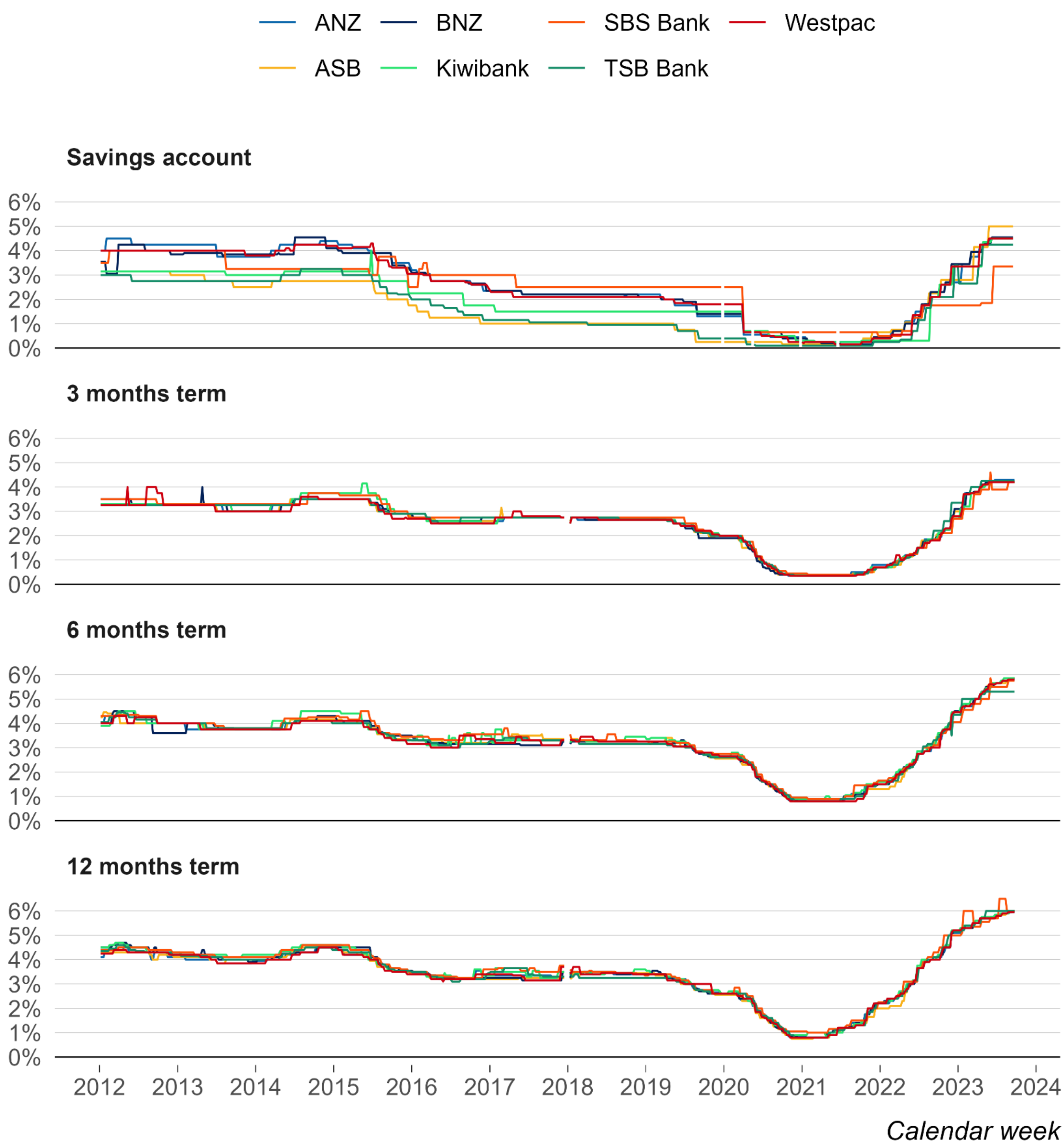
384 [ ].

385 [ ].

386 The banks included in Figure 5.2 are the main providers of personal deposit accounts for which the necessary pricing data is available.

Figure 5.2 Weekly deposit interest rates



Source: Our analysis of data provided by interest.co.nz.[387]

5.43 We have seen that the major banks and Kiwibank banks respond very closely to changes in interest rates for term deposits by their competitors. This may reflect that consumers are most sensitive on price for term deposits. We note in Chapter 2 there are features of retail deposits that suggest that, similar to home loans, the market could be prone to accommodating behaviour (or 'tacit coordination'). We cannot rule out that it could be occurring, though we note there may be less risk in deposits than for home loans.[388]

5.44 As observed in paragraph 5.6, savings deposits can have a 'two tier' base and bonus interest structure. Small banks, with a strategy to grow market share, seem to generally offer a low entry interest rate, and a higher 'bonus' interest rate if certain conditions are met (ie, minimum balance or maximum number of withdrawals in a period). Large banks, on the other hand, are more likely to offer one flat interest rate.[389]

5.45 It appears that consumers have a high tendency to access the bonus savings rates of the smaller banks.[390] This implies that small banks may be more likely to attract more price sensitive and engaged savings consumers.

Overdraft fees are required to be cost reflective under the CCCF Act

5.46 Overdraft services are provided via transaction accounts and can be arranged or unarranged. Overdraft services typically incur fees and interest expense on the overdraft balance.

5.47 The CCCF Act, which regulates credit and default fees charged on home loans and overdrafts, essentially requires that these fees are cost reflective.[391]

5.48 About a third of deposit account consumers were charged overdraft fees in the 2022/23 financial year. Most overdraft fees are charged by a consumer's main bank (the bank that consumers do most of their everyday banking with).[392]

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387 Chart includes the interest rates for savings account products where the minimum balance necessary is $2 or less. Savings accounts with a higher minimum balance are excluded from this analysis. Prices for term deposits are for products with a minimum deposit balance of $10,000 or less. Term deposits with a higher minimum balance requirement are excluded. [ ].

388 ACCC "Reasons for Determination - ANZ proposed acquisition of Suncorp Bank" (4 August 2023), at p. 9.

389 This may reflect large banks seeking to maintain their existing customer bases.

390 This is because our analysis has found that the major banks and Kiwibank pay a lower interest cost than small NZ banks for savings deposits.
[
].

391 CCCF Act sections 41-44.

392
[
].

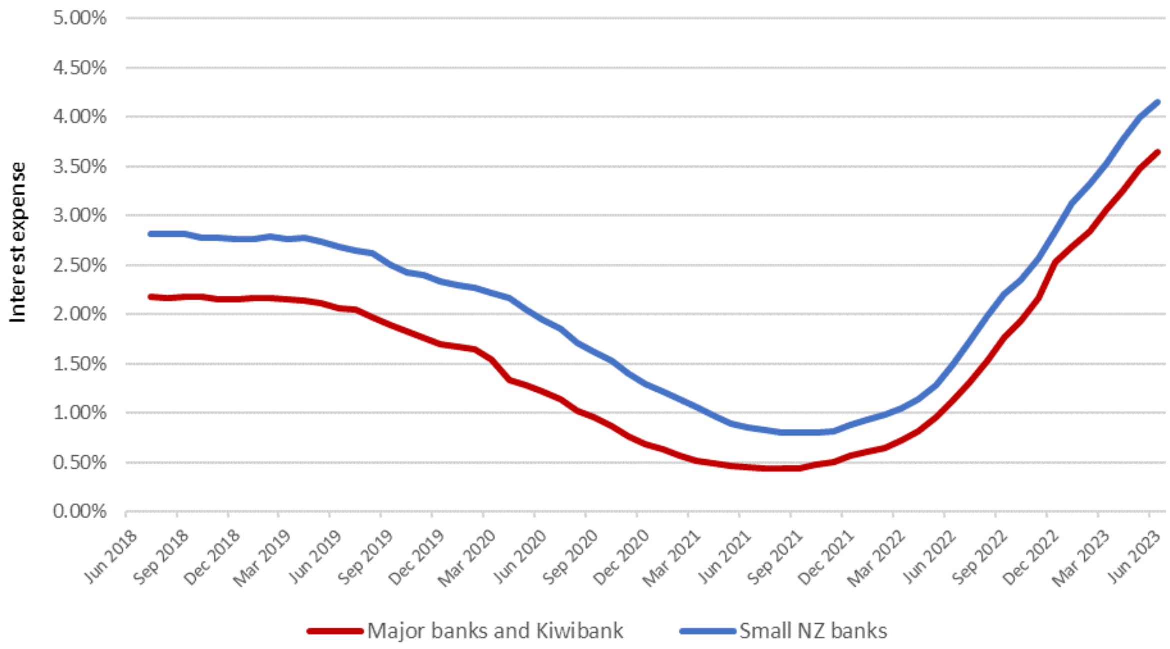
5.49 While we have not looked closely at the distribution of consumers paying fees, we consider that some consumers may be attracting unnecessary overdraft fees, particularly where they have money sitting in other accounts which could have been used to avoid the fees. Some also pay fees on an ongoing basis where another product might be more suitable.

5.50 Overdraft fees, while cost reflective, are somewhat widespread, however they can be harmful for some consumers. We discuss this further in Attachment D.

Retail deposits provide large banks with a significant funding advantage | *Ka whai huanga nui ngā pēke nui i ngā whakaputu hoko*

5.51 Retail deposits (funds stored in transaction, savings, and term deposit accounts) are generally a stable, secure, and relatively cheap source of bank funding.

Figure 5.3 Interest cost of total retail deposits



Source: Our analysis of data provided by Reserve Bank.[393]

393 Calculated as the monthly interest expense for retail deposits over the average monthly deposits balance. [ ].

5.52 As shown in Figure 5.3, the major banks and Kiwibank benefit from approximately a 50-60 basis points funding cost advantage over small NZ banks for the retail deposits they hold.[394] Across the total amount of retail deposits that major banks and Kiwibank hold (approximately $395b), this is a significant advantage for larger banks.

5.53 A bank's ability to attract retail deposits at competitive rates can have a significant impact on its overall cost of funding and profitability. We understand that it is very difficult for smaller banks or other challengers to attract a material amount of retail deposits, and particularly transaction deposits.[395] Overseas studies have also found that retail deposits are particularly sticky towards large incumbent banks.

5.54 Attracting deposits supports a provider's ability to expand. As noted in paragraph 5.18 above, the incoming DCS could reduce some challenges that smaller providers face for attracting retail deposits. Chapter 7 and Chapter 9 explains other challenges faced by small providers and fintechs for expanding their business.

Retail deposits are an important source of funding for a bank's lending activities

5.55 Banks seek retail deposits to fund lending activities. Other sources of funds include short- and long-term wholesale debt, and equity. Deposits are a high quality source of funding for meeting banks' core funding requirements.

5.56 Taking deposits is one side of a bank's core intermediation function.[396] A bank pays interest on deposits that it holds and earns interest revenue from lending those deposits (and other sources of funds), through loans such as home, personal, and business loans.

5.57 The cost of retail deposits, as well as cost of wholesale funding and cost of equity make up a bank's total cost of funding. In general, retail deposits are cheaper sources of funding than wholesale or equity funding.

5.58 Figure 5.4 below shows the funding mix of large and small New Zealand banks. It shows that retail deposits make up around 65% of larger banks total funding, and 80% of small NZ bank funding.

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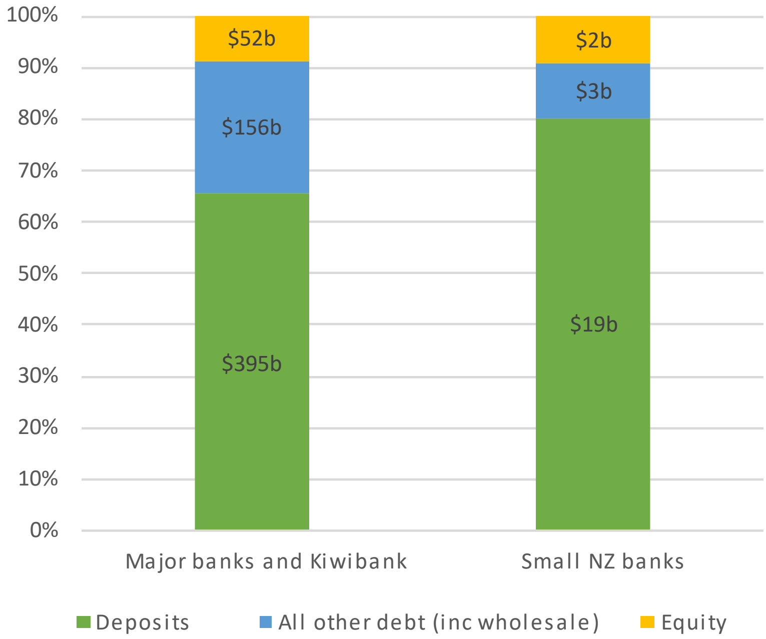
394 When rounded to the nearest 5 basis points, the average differential across June 2018 to June 2023 is 55bps, with a minimum of 30bps and a maximum of 80bps. [ ].

395 The ACCC finds that retail deposit market share has remained relatively stable for the past 20 years. ACCC "Retail Deposits Inquiry Final Report" (December 2023), at p. 26-27; The FCA found that while digital challengers are gaining market share for PCAs, this isn't the case for main bank relationships and retail deposit balances. FCA "Strategic Review of Retail Banking Business Models Final Report (2022), at p. 4, available at: https://www.fca.org.uk/publication/multi-firm-reviews/strategic-review-retail-banking-business-models-final-report-2022.pdf; [ ].

396 Commerce Commission "Preliminary Issues paper - Personal banking services market study" (10 August 2023) at footnote 20.

Figure 5.4 Total bank funding composition as at 30 June 2023



Source: Our analysis of data provided by Reserve Bank.[397]

5.59 While small NZ banks hold a higher proportion of retail deposits than the larger banks, the dollar balance of their retail deposits is considerably smaller. Larger banks also have better access to wholesale funding sources, while smaller banks rely more heavily on retail deposits.

5.60 Following the Global Financial Crisis (GFC), there has been a shift in focus from wholesale funding (particularly short-term wholesale) to retail deposits,[398] due to retail deposits being a more stable source of bank funding than securitised products.[399]

5.61 The Reserve Bank sets a core funding ratio (CFR), which requires banks to hold a minimum amount of its funding from stable sources.[400] Core funding includes deposits with a maturity of greater than one-year, and the CFR is currently set to 75%. The level of the CFR can influence banks' decisions regarding whether to seek retail deposits or wholesale funding.

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397 [ ].

398 This is also reflected by the ACCC for Australian Banks. ACCC "Retail Deposits Inquiry Final Report" (December 2023), at p. 57.

399 Jason Wong "Bank funding – the change in composition and pricing" (2012), at p. 15-17, available at: https://www.rbnz.govt.nz/-/media/ced9ce19786246819c727cefb6467bb7.ashx.

400 See https://www.rbnz.govt.nz/regulation-and-supervision/oversight-of-banks/standards-and-requirements-for-banks/liquidity-policy-for-banks.

5.62 We have heard that smaller providers such as NBDTs are disadvantaged as they are unable to access Exchange Settlement Account System (ESAS) accounts directly.[401] ESAS accounts (among other things) provide access to the OCR for on call deposits. NBDTs have stated that this gives the banks who can access ESAS:[402]

> "… 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."

5.63 We have heard that funding for lending (FLP) had a short-term impact on competition for deposits.[403] FLP was a low-cost source of funds available only to ESAS account holders, which contributed to reductions in the interest cost that ESAS account holders paid for all retail deposits.[404] While the FLP was a COVID-19 pandemic response measure, it was not evenly distributed, impacting competition.

Transaction deposits are particularly valuable for banks

5.64 Banks pay considerably less for transaction deposits than savings or term deposits, as most transaction account products are non-interest bearing.[405] Savings deposits are also a cheap funding source (though to a lesser extent than transaction deposits), while term deposits are generally the most expensive source of deposit funding.[406]

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401 As discussed in Chapter 9, currently, only a limited number of industry parties have direct access to ESAS. Current ESAS account holders include several registered banks, the Reserve Bank, CLS Bank and New Zealand Depository Limited, https://www.rbnz.govt.nz/payments-and-settlement-systems/exchange-settlements-account-system/esas-overview-governance-and-channels.

402 [ ].

403 FLP is a tool used by the Reserve Bank, designed to lower banks' funding costs during the COVID-19 pandemic in a context where the OCR may have reached its lowest practical level.

404 Figure 5.2 highlights the reduction in deposit rates for the December 2020 to December 2022 period that FLP was available. [ ].

405 [ ].

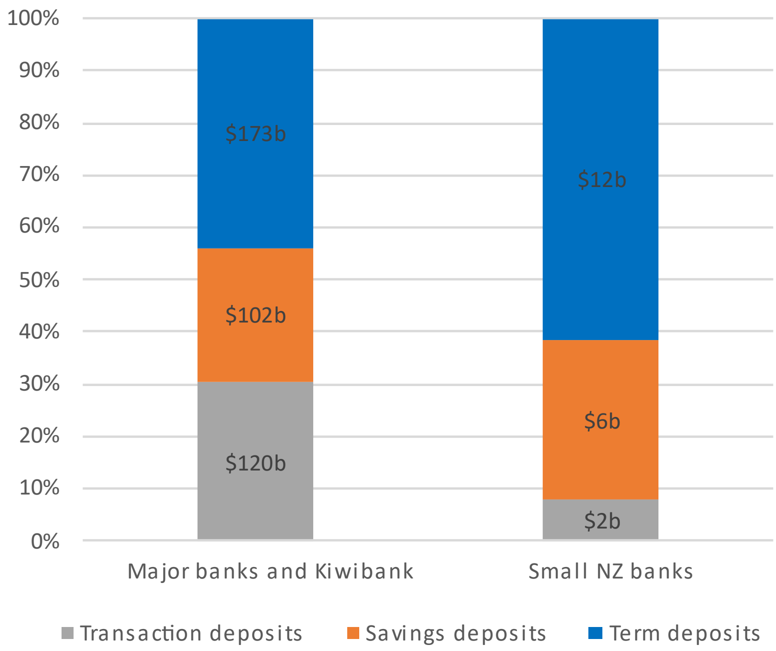
406 [ ]; [ ].

5.65 Combined, the major banks and Kiwibank hold in excess of $58b in deposits not bearing interest.[407] When contrasted with market lending rates, this contributes to overall profitability, particularly in a rising interest rate environment.[408]

5.66 As noted in paragraph 5.16, competition for deposits and home loans is sporadic, sometimes in an opposing way. For example, in a period of rising interest rates and weak housing demand, the higher interest margins generated by deposits can more than offset the impact to NIM of lower margins of a relatively competitive market for new mortgages.[409]

5.67 Figure 5.5 shows that the major banks and Kiwibank hold proportionally more transaction deposits than small NZ banks. This contributes to an overall funding advantage to the larger banks, because transaction deposits are typically the cheapest source of funding (followed by savings deposits, then term deposits).

Figure 5.5 Deposits mix as at 30 June 2023



Source: Our analysis of data provided by Reserve Bank.[410]

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407 Calculated using bank disclosure statements for 2023. This is an approximate calculation as the dates for disclosure statements do not align (ie, some are as of 30 June, while others 30 September). We acknowledge that deposits not bearing interest are not 'zero cost' for banks - for example, banks may hedge non-interest bearing call deposits to a 90-day rate (known as maturity transformation), at a cost to the bank.

408 New Zealand Treasury 'Windfall gains in the New Zealand banking sector, and responses' (10 February 2023), at para 81, available at: https://www.treasury.govt.nz/sites/default/files/2023-07/b23-tax-4791084.pdf.

409 Reserve Bank "Financial Stability Report" (May 2023), at p. 38.

410 [ ].

5.68 Transaction deposits are largely derived from the main bank relationship, where consumers do most of their everyday banking activity. The higher proportion of transaction deposits held by the larger banks reflects the strong position they have in main bank relationships, as discussed in Chapter 2 and 9.[411]

5.69 While a significant proportion of the deposits are on call, we have found that consumer switching rates are very low, and therefore these deposits are reasonably secure.[412] Although individual on call deposits may have a fluctuating balance for individual accounts, when aggregated across a large customer base, they provide a bank with stable funds that are often as sticky as the customer relationship.[413]

5.70 During the recent period of rising interest rates, consumers have shifted some deposits away from low (or no) interest call accounts towards higher return term deposits. Nevertheless, the balance of deposits not bearing interest remains high.[414] This is likely to reflect a high proportion of transaction deposits that consumers access for day-to-day banking, and therefore cannot easily be stored in an interest bearing account.

5.71 Where deposits are not bearing interest, and not used for day-to-day banking, there is an opportunity for consumers to engage in the market and earn an interest return, and an opportunity for services that can support this.

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411 [ ].

412 [ ].

413 [ ].

414 [ ].

Chapter 6 Profitability of New Zealand's banking sector | *Te whiwhinga huamoni a te rāngai pēke ki Aotearoa*

Summary of preliminary findings

- **The major banks make significant profits each year, however, they are among New Zealand's largest companies, so the dollar value of profits (on its own) tells us little about competition.** Measures of profitability (ie, returns in percentage terms), on the other hand, can provide an indication of the intensity of competition.
- **The profitability of the New Zealand banking sector is high relative to banking sectors in peer nations**. Between 2010 and 2021, New Zealand's banking sector profitability has, on average, performed in the upper quartile relative to peer nations on three important measures: ROA; ROE; and NIM.
- **New Zealand's major banks have also experienced high average returns on equity relative to other New Zealand banks.** The majority of the major banks (ASB, ANZ, and BNZ) have similarly performed well on ROA. This is consistent with the major banks being in tier one of a two tier structure as described in Chapter 2.
- Our findings support the conclusions reached recently by both the Reserve Bank and Treasury that the profitability of the New Zealand banking sector is high relative to peer banking sectors, and that the large New Zealand banks have been more profitable than the rest of the New Zealand banking sector.
- **We have been offered and considered a range of explanations for the New Zealand banking sector's recent levels of profitability.** We acknowledge that factors such as a relatively high-risk-free rate compared to other countries in our sample, the Australian ownership of New Zealand's major banks, and recent regulatory interventions in New Zealand may—at least partially—explain relatively high profitability in New Zealand.
- **The focus of New Zealand banks on lower risk activities means we would expect the sector to deliver lower returns relative to riskier banking sectors overseas.** This is because, all things being equal, a business that takes on higher risk can typically expect to earn higher profitability on average over time. The New Zealand banking sector is relatively low-risk in nature because it is more heavily weighted towards traditional ("vanilla") banking activities than many peer nations. On average over our analysis period, New Zealand's proportion of non-interest income to total income was the lowest of our peer country sample at 22%, indicating that New Zealand's banking sector has a greater focus on traditional interest bearing banking activities.
- **Based on our analysis of the evidence, we are not satisfied that the factors identified by the major banks fully explain the profitability of the New Zealand banking sector since 2010**. We therefore consider that, at least part of the profitability we observe is explained by the market power of the major banks and that New Zealand's banking sector profits are higher than what would be expected if they faced greater competition.
- Our preliminary findings on banking sector profitability corroborate and reinforce our findings elsewhere in this report that competition is sporadic and limited for personal banking services in New Zealand.

Introduction | *Whakatakinga*

6.1 This chapter assesses indicators of banking sector profitability to understand how the profitability of the New Zealand banking sector compares to the profitability of banking sectors in other jurisdictions, and to understand the relative profitability between banks operating in New Zealand. Although not determinative, an assessment of profitability over time can provide some insights into how a market is performing.

6.2 Attachment C describes our approach in more detail and contains a more detailed assessment of possible explanations for observed profitability trends.

Assessing banking sector profitability | *Te aromatawai i te whiwhinga huamoni a te rāngai pēke*

Persistently high profitability may indicate that competition is not working well

6.3 Outcomes of the competitive process that can be observed, including the prices charged by firms and their profitability, can serve as indicators of the intensity of competition.

6.4 In a well-functioning competitive market, firms are typically expected to earn profits that approximate their opportunity cost of capital (this is often referred to as a ‘normal’ rate of return). There are two main exceptions to this. Some firm(s) might have unusually productive assets and may therefore be able to sustain higher profits over time even in a competitive market. Similarly, profit levels across a competitive industry may vary over a business cycle. However, where firms that represent a substantial part of the market persistently derive returns that significantly exceed their opportunity cost of capital this could indicate that the competitive process is not working well.

6.5 That said, observing that profitability in a market appears high does not provide conclusive evidence that the market could be more competitive, and it is important to consider the underlying reasons for apparently high profits. Similarly, low profitability in a market is not necessarily evidence that competition is working well.

6.6 It is important that a banking sector remains well capitalised. This maintains confidence in the banking system which supports financial stability by improving banks' ability to access funding, by improving resilience to shocks throughout the business cycle, and by reducing the probability of bank runs.[415] Well capitalised banks can withstand fluctuations in profitability, though like any business a sequence of losses will pose challenges. On average across a sector and through time we would expect to observe 'normal' levels of profitability in the sector.

Bank profitability is best assessed using profitability ratios at the whole of bank level

We have focused on three profitability measures and place the greatest weight on ROE

6.7 Much of the recent media commentary on profitability in the banking sector has reported on the total dollar amounts of bank profits.[416] Given the large size of the major banks, we would expect these firms to earn relatively high dollar values of profit on average over time even in a competitive market. Profitability ratios on the other hand account for factors such as the scale of the firm. Consequently, ratios may be compared across firms.

6.8 We have focused on three measures of banking profitability: ROE, ROA, and NIM. Professor Margaritis and Dr Hasannasab have also examined the relationship between these measures and market power.[417] We have also, to a lesser extent, considered the CTI ratio. Each is defined in greater detail in Attachment C.

6.9 Each profitability ratio is only a partial measure of profitability and so our conclusions rely on the outcomes we observe across multiple ratios. Aligning with what we have heard from banks, supported by observations in the banks' key performance indicators, we place greater weight on ROE.[418, 419] However, we do not draw conclusions that are supported by ROE alone.

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415 The Reserve Bank "Financial stability report" (3 May 2023), at p. 22, available at: https://www.rbnz.govt.nz/hub/publications/financial-stability-report/2023/may-2023/financial-stability-report-may-2023; Andrea Enria "The many roads to return on equity and the profitability challenge facing euro area banks" (22 September 2021), available at: https://www.bankingsupervision.europa.eu/press/speeches/date/2021/html/ssm.sp210922~df2b18acb9.en.html.

416 For example, Tamsyn Parker "Record profits: Banks made $7 billion last year – a billion-dollar increase on 2021" (14 March 2023), available at: https://www.nzherald.co.nz/business/record-profits-banks-made-7-billion-last-year-a-billion-dollar-increase-on-2021/RNSQD7UTENHRZPCZEDDN5MSBTY/#:~:text=markets%20this%20week.-,Video%20%2F%20NZ%20Herald%20...,KPMG's%20Financial%20Institutions%20Performance%20Survey

417 Dimitris Margaritis and Maryam Hasannasab "Market power in banking: A study of New Zealand banks" (March 2024), at p. 20.

418 We have heard from multiple sources that return on equity is the most appropriate measure of bank profitability. ANZ "Market study into personal banking services Preliminary Issues paper: ANZ Bank New Zealand Limited submission" (September 2023), at para 8; [ ].

419 [ ].

We have assessed profitability at the whole of bank level

6.10 These profitability measures are at the whole of bank level and include activities that do not relate to personal banking services, including business banking.

6.11 Banks internally assess their own profitability at more granular levels. Margins are a common measure of the profitability of individual product categories or bank segments.[420] Often these margins are measured against a bank's internal transfer price or another interest rate benchmark. Other measures are used less frequently.[421] Margins allow a bank to understand the profitability of particular segments of the bank, particular product types, or even as granular as the profitability of particular product terms (eg, one-year vs two-year fixed rate home loan).

6.12 However, the nature of banking and limited consistency between internal approaches means a more granular assessment of profitability at a segment or product level is not feasible.

6.12.1 It is difficult to robustly allocate costs to a particular product given that banks pool a wide range of funds.[422]

6.12.2 It is difficult to construct a consistent cost benchmark at the product level given that each bank has a unique approach to transfer pricing.[423]

6.12.3 Bank products are not perfectly comparable, and banks may define segments in different ways so that similar products and segments may not be directly comparable.

6.12.4 Margins exclude non-interest income (such as fees) that may be relevant to the profitability of particular products.

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420 [ ].

421 [ ].

422 Deloitte Access Economics pointed to work by the CMA where they considered possible methods to assess the profitability of banks in more granular relevant markets. However, the CMA concluded that "there were inherent difficulties with such an exercise which would mean that such an analysis would not be sufficiently reliable to inform our assessment of competition." BNZ "Submission on Market study into personal banking services - Preliminary Issues paper - Attachment A - Deloitte Report" (7 September 2023), at para 207; and CMA "Retail banking market investigation: Final report" (9 August 2016), at para 32–33, available at: https://assets.publishing.service.gov.uk/media/57ac9667e5274a0f6c00007a/retail-banking-market-investigation-full-final-report.pdf.

423 [ ].

6.13 Given these limitations, we have elected to assess profitability at the whole of bank level. This aligns with the Cabinet Paper which envisaged that an assessment of financial performance as part of this market study would be conducted at a whole of bank level as opposed to just personal banking services.[424] Care must therefore be taken when interpreting our results, as conclusions cannot be interpreted with regard to personal banking services alone.

We have used publicly available datasets to assess the profitability of New Zealand banks and the New Zealand banking sector

6.14 We have used publicly available data from the Reserve Bank and World Bank to compare the profitability of banks operating in New Zealand and to compare New Zealand's banking sector internationally. As proposed in the Preliminary Issues paper, we have not estimated a weighted average cost of capital.[425] We describe both datasets and our approach to assessing profitability in Attachment C.

6.15 Submissions by Incenta (for ANZ), NERA (for ASB), and Deloitte Access Economics (for BNZ) critiqued our approach to assessing bank profitability in the Preliminary Issues paper.[426] Incenta conducted their own benchmarking exercise and submitted that a better approach is to compare profitability at a bank-by-bank level, rather than at a country level.[427]

6.16 Profitability can be assessed in a number of different ways. We do not regard Incenta's approach as likely to produce results that are any more objective than the approach that we have taken. Bank-by-bank comparisons still involve a level of subjectivity and choice with regards to the appropriate sample of comparator banks and the appropriate approach to control for factors that may influence relative profitability.

6.17 We disagree with certain aspects of Incenta's comparator bank approach. For example, we disagree with the exclusion of comparator banks from countries that have recently experienced a banking crisis or that have a price-to-book ratio greater than one, and we do not consider the inclusion of goodwill to be appropriate in this context. Incenta's "cross-check" of a price-to-book ratio that is greater than one is only likely to be satisfied by high performing banks (high ROE relative to cost of equity). Incenta's sampling method therefore does not, in our view, select a neutral sample of comparator banks with similar risk to New Zealand's banks.

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424 MBIE "Cabinet Paper – Initiating a market study into personal banking services" (28 June 2023), at para 23, available at: https://www.mbie.govt.nz/dmsdocument/26848-initiating-a-market-study-into-personal-bankingservices-proactiverelease-pdf.

425 Commerce Commission "Market study into personal banking services: Preliminary Issues paper" (August 2023), at para 117.

426 ANZ "Submission on Market study into personal banking services - Preliminary Issues paper - Annex 1 - Incenta Report" (7 September 2023); ASB "Submission on Market study into personal banking services - Preliminary Issues paper - Attachment A - NERA Report" (7 September 2023); BNZ "Submission on Market study into personal banking services - Preliminary Issues paper - Attachment A - Deloitte Report" (7 September 2023).

427 ANZ "Submission on Market study into personal banking services - Preliminary Issues paper - Annex 1 - Incenta Report" (7 September 2023), at para 27–28.

6.18 For these reasons, we do not think that comparing profitability, internationally, at a bank-by-bank level is going to improve materially our understanding of the factors affecting competition in personal banking in New Zealand or, ultimately, our recommendations for improving competition. We have instead based our analysis on the publicly available World Bank dataset, which we describe in Attachment C.

6.19 Our assessment of submissions relating to factors that affect relative profitability, including Incenta's approach, is included in Attachment C and we also summarise our findings later in this chapter.

New Zealand's banking sector profitability has been high relative to a range of peer nations over the past decade | *Ka nui te whiwhinga huamoni a te rāngai pēke o Aotearoa i tērā o ētahi atu whenua o te ao i te tekau tau kua hipa*

6.20 We have compared the profitability of New Zealand's banking sector against a sample of peer nations using World Bank data and several performance ratios. Attachment C describes the World Bank dataset and our approach in more detail. This section concludes that the New Zealand banking sector's profitability has been high relative to a range of peer nations over the past decade.

6.21 Recent work by the Reserve Bank and Treasury reached similar conclusions. The Reserve Bank stated that "the large New Zealand banks have been more profitable than the rest of the New Zealand banking sector and large banks in a number of comparable economies in recent years".[428, 429]

6.22 To compare levels of profitability requires a threshold at which, if New Zealand's profitability exceeded it, we would consider the level of profitability to be high. For the purpose of this analysis, we have considered the upper quartile of our sample of peer countries to be this threshold.[430] Our sample of peer countries mirrors that used by the Reserve Bank in their March 2023 Financial Stability Report.[431] We note that a lower CTI ratio reflects a more profitable bank; therefore, this analysis compares New Zealand's CTI ratio to the lower quartile of the sample.

428 Reserve Bank "Financial stability report" (3 May 2023), at p. 24, available at: https://www.rbnz.govt.nz/hub/publications/financial-stability-report/2023/may-2023/financial-stability-report-may-2023; and The Treasury "Budget 2023 Tax Initiatives Information Release" (July 2023), at para 5–6, available at: https://www.treasury.govt.nz/sites/default/files/2023-07/b23-tax-4791084.pdf.

429 We have previously discussed both the Reserve Bank and Treasury reports in more detail in our Preliminary Issues paper. Commerce Commission "Preliminary Issues paper - Personal banking services market study" (10 August 2023), at para 105–113.

430 Note that quartile and median values have been calculated from the sample of comparator countries, excluding New Zealand. The quartiles in this chapter have been calculated using the inclusive method, which returns the quartile of a data set based on percentile values from zero to one, inclusive.

431 Reserve Bank "Financial stability report" (3 May 2023), at Figure 2.12, available at: https://www.rbnz.govt.nz/hub/publications/financial-stability-report/2023/may-2023/financial-stability-report-may-2023.

Table 6.1 New Zealand's average annual banking sector profitability ratios between 2010 and 2021 relative to the upper quartile for the sample of comparator countries

Measure	New Zealand	Upper quartile
ROE	12.6%	10.5%
NIM	2.03%	1.65%
ROA	0.92%	0.76%

Source: Commerce Commission analysis of World Bank data.[432]

6.23 Table 6.1 shows that the average annual profitability of the New Zealand banking sector between 2010 and 2021 has been greater than the upper quartile of the comparator sample for post-tax ROE, post-tax ROA, and NIM.[433] New Zealand's annual trend for each measure relative to our sample of peer countries is discussed below and can be seen in Table 6.1 and Figure 6.3–6.5 below.

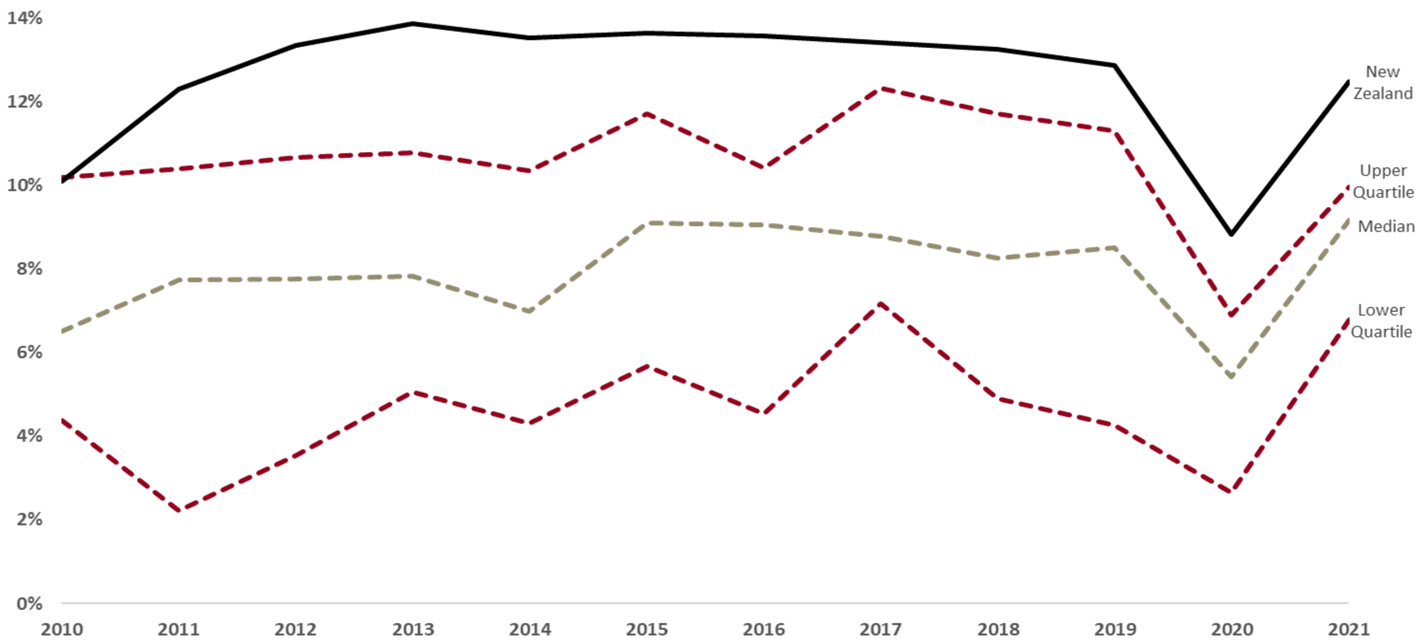
6.24 New Zealand has similarly outperformed the sample of peer countries on average CTI ratio over the period, with a ratio of 43% relative to the sample's lower quartile of 53%.[434] New Zealand's annual CTI ratio trend relative to our sample of peer countries is discussed below and can be seen in Figure 6.5.

432 World Bank "Global Financial Development Database" [ ].

433 The upper quartile values in Table 6.1 represent the upper quartile of country level averages between 2010 and 2021 for each profitability measure. Note that the upper quartile calculation excludes New Zealand.

434 The lower quartile cost to income ratio of peer countries represents the lower quartile of country level averages between 2010 and 2021. Note that the lower quartile calculation excludes New Zealand.

Figure 6.1 New Zealand's annual post-tax ROE relative to the quartile range and median of the sample peer countries between 2010 and 2021



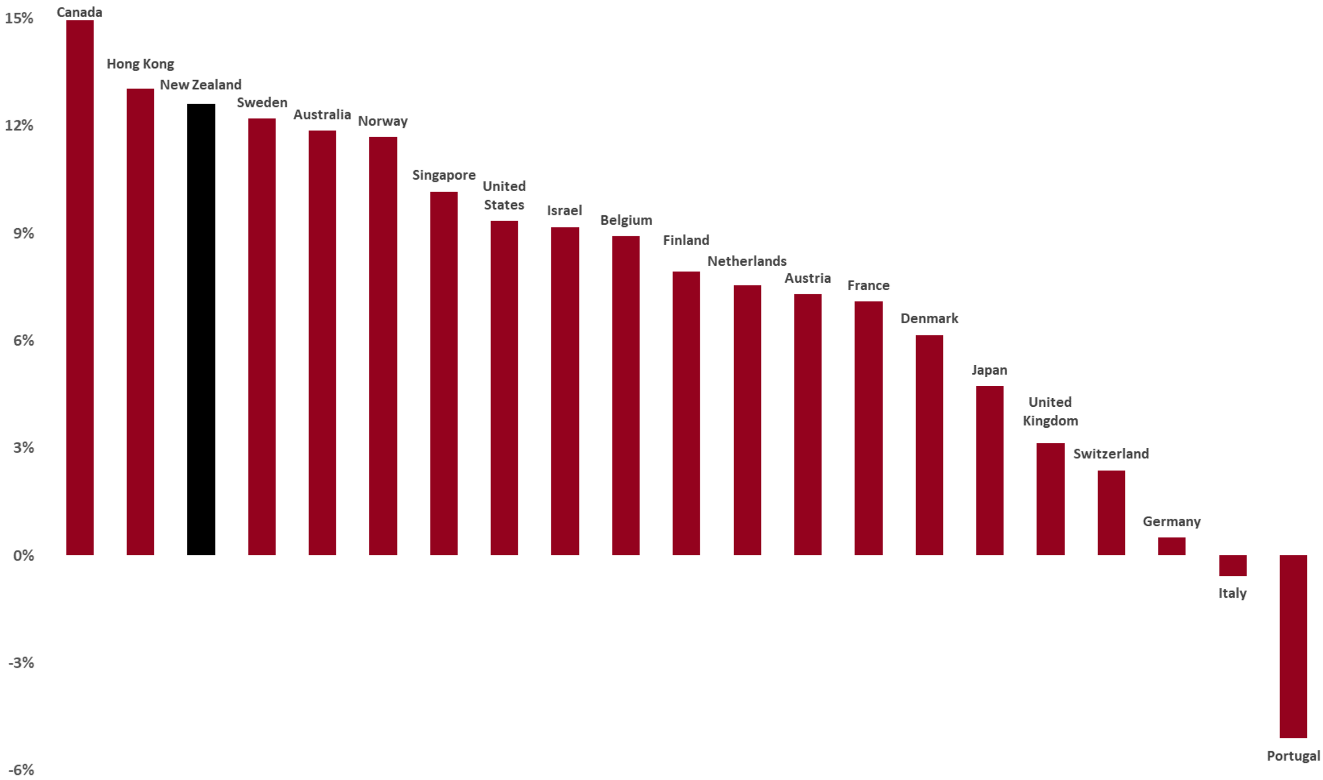
Source: Commerce Commission analysis of World Bank data.[435]

6.25 In relation to post-tax ROE, Figure 6.1 above shows that the New Zealand banking sector has consistently been in the upper quartile since 2011.

6.26 Looking at the average post-tax ROE of each country, Figure 6.2 shows that New Zealand had the third highest value relative to the 20 comparator countries in our sample. Only Canada and Hong Kong had higher average ROE over the same period.

435 World Bank "Global Financial Development Database" [ ].

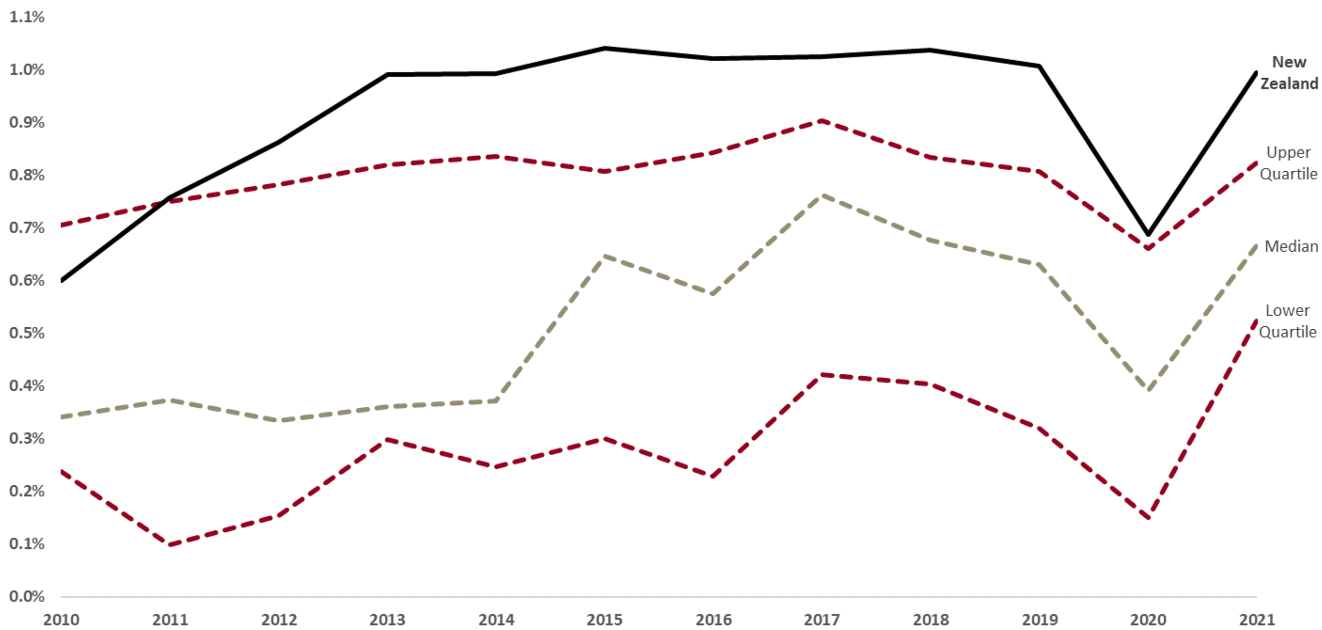
Figure 6.2 Country level average annual banking sector post-tax ROE between 2010 and 2021



Source: Commerce Commission analysis of World Bank data.[436]

436 World Bank “Global Financial Development Database” [ ].

Figure 6.3 New Zealand's annual post-tax ROA relative to the annual upper quartile of the peer country sample between 2010 and 2021

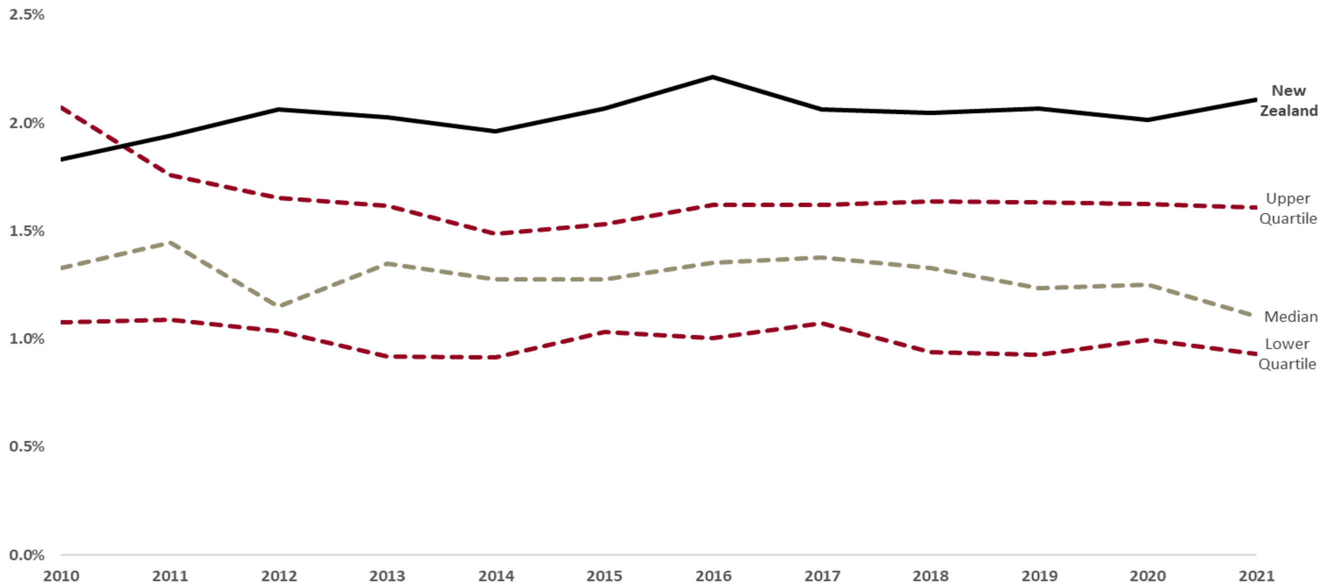


Source: Commerce Commission analysis of World Bank data.[437]

6.27 A similar picture emerges when considering the other three measures of profitability. As Figure 6.3–6.5 show, New Zealand's banking sector NIM and post-tax ROA have also been in the upper quartile since 2011. On CTI ratio, New Zealand has been in the lower quartile for the entire period which further points to New Zealand banking sector profits being high relative to other countries.

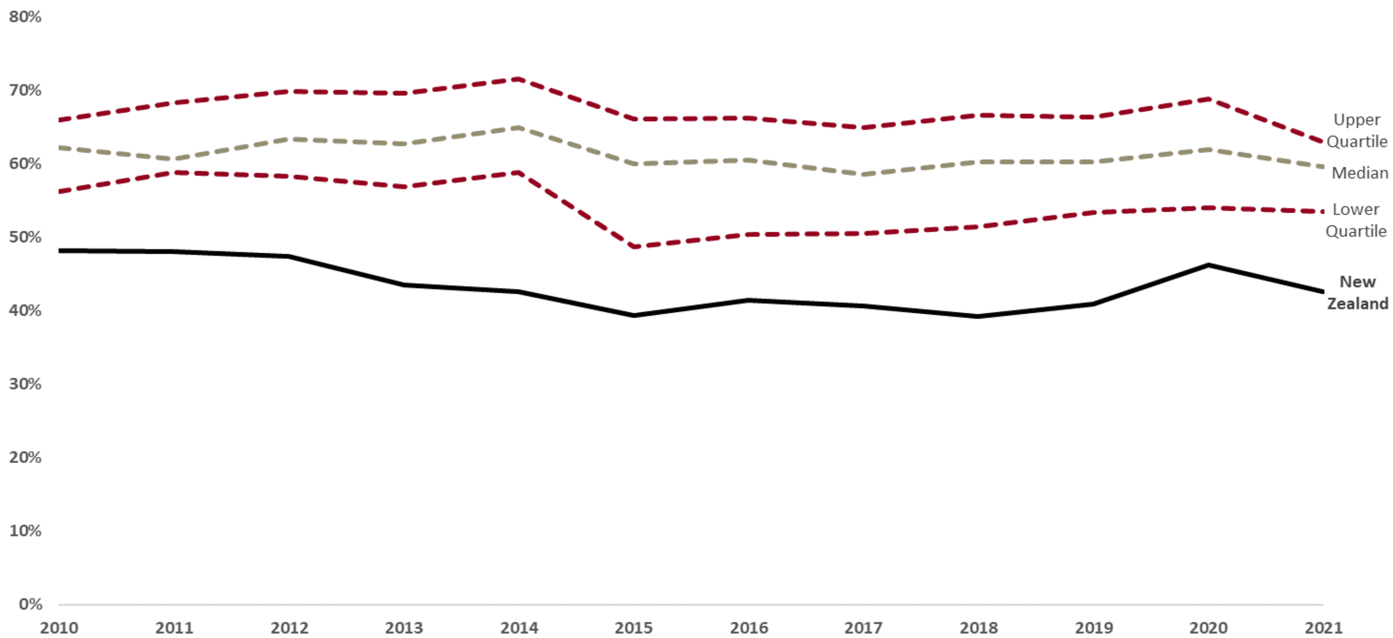
[437] World Bank "Global Financial Development Database" [ ].

Figure 6.4 New Zealand's annual NIM relative to the annual upper quartile of the peer country sample between 2010 and 2021



Source: Commerce Commission analysis of World Bank data.[438]

Figure 6.5 New Zealand's annual CTI ratio relative to the annual lower quartile of the peer country sample between 2010 and 2021



Source: Commerce Commission analysis of World Bank data.[439]

438 World Bank "Global Financial Development Database" [ ].
439 World Bank "Global Financial Development Database" [ ].

6.28 Table 6.2 shows the average annual NIM, ROA, and CTI ratio for New Zealand and for the peer countries in our sample. New Zealand had the fourth and fifth highest NIM and ROA, respectively. For both measures, New Zealand was not materially behind Canada.[440] On CTI ratio, New Zealand had the third lowest value over the period.

6.29 Given that New Zealand has ranked in the upper quartile (or lower quartile for CTI ratio) on each measure of profitability that we have considered, we conclude that the profitability of the New Zealand banking sector is high relative to peer countries. Our conclusions corroborate the findings of the Reserve Bank and Treasury that the New Zealand banking sector's profitability has been high relative to banking sectors in comparable economies in recent years.[441]

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440 Both New Zealand and Canada had an average annual post-tax ROA of 0.92 between 2010 and 2021 to two decimal places. New Zealand's average annual NIM of 2.03 over the same period was only 2 basis points behind Canada's; Canada's average NIM was materially increased by large values in 2010 and 2011.

441 Reserve Bank "Financial stability report" (3 May 2023), at p. 24, available at: https://www.rbnz.govt.nz/hub/publications/financial-stability-report/2023/may-2023/financial-stability-report-may-2023; and The Treasury "Budget 2023 Tax Initiatives Information Release" (July 2023), at para 5–6, available at: https://www.treasury.govt.nz/sites/default/files/2023-07/b23-tax-4791084.pdf.

Table 6.2 Average banking sector NIM, ROA, and CTI ratio between 2010 and 2021

Country	Average NIM	Country	Average ROA	Country	Average CTI
United States	3.39%	Hong Kong	1.09%	Singapore	40.5%
Israel	2.43%	United States	1.03%	Norway	42.4%
Canada	2.05%	Singapore	1.01%	**New Zealand**	**43.3%**
New Zealand	**2.03%**	Canada	0.92%	Australia	46.6%
Australia	1.79%	**New Zealand**	**0.92%**	Hong Kong	52.0%
United Kingdom	1.74%	Norway	0.91%	Finland	52.2%
Norway	1.62%	Sweden	0.71%	Sweden	53.1%
Singapore	1.49%	Australia	0.70%	Canada	59.5%
Hong Kong	1.45%	Israel	0.66%	United States	59.8%
Sweden	1.31%	Austria	0.57%	Denmark	60.3%
Belgium	1.30%	Belgium	0.54%	Belgium	60.9%
Italy	1.28%	Denmark	0.51%	Netherlands	62.1%
Austria	1.27%	Netherlands	0.43%	Japan	62.7%
Netherlands	1.21%	Finland	0.39%	Portugal	63.6%
Portugal	1.21%	United Kingdom	0.28%	United Kingdom	65.1%
Denmark	1.02%	France	0.26%	Israel	65.4%
Germany	0.86%	Japan	0.23%	Austria	68.2%
Switzerland	0.82%	Switzerland	0.16%	France	69.3%
Japan	0.80%	Germany	0.00%	Italy	70.0%
France	0.66%	Italy	-0.07%	Germany	85.0%
Finland	0.61%	Portugal	-0.57%	Switzerland	89.3%

Source: Commerce Commission analysis of World Bank data.[442]

The four major banks have experienced high ROE relative to many other banks operating in New Zealand since 2018 | *He nui te whiwhi huanga a ngā pēke nui e whā tērā i te maha o ngā pēke e mahi ana i Aotearoa mai i 2018*

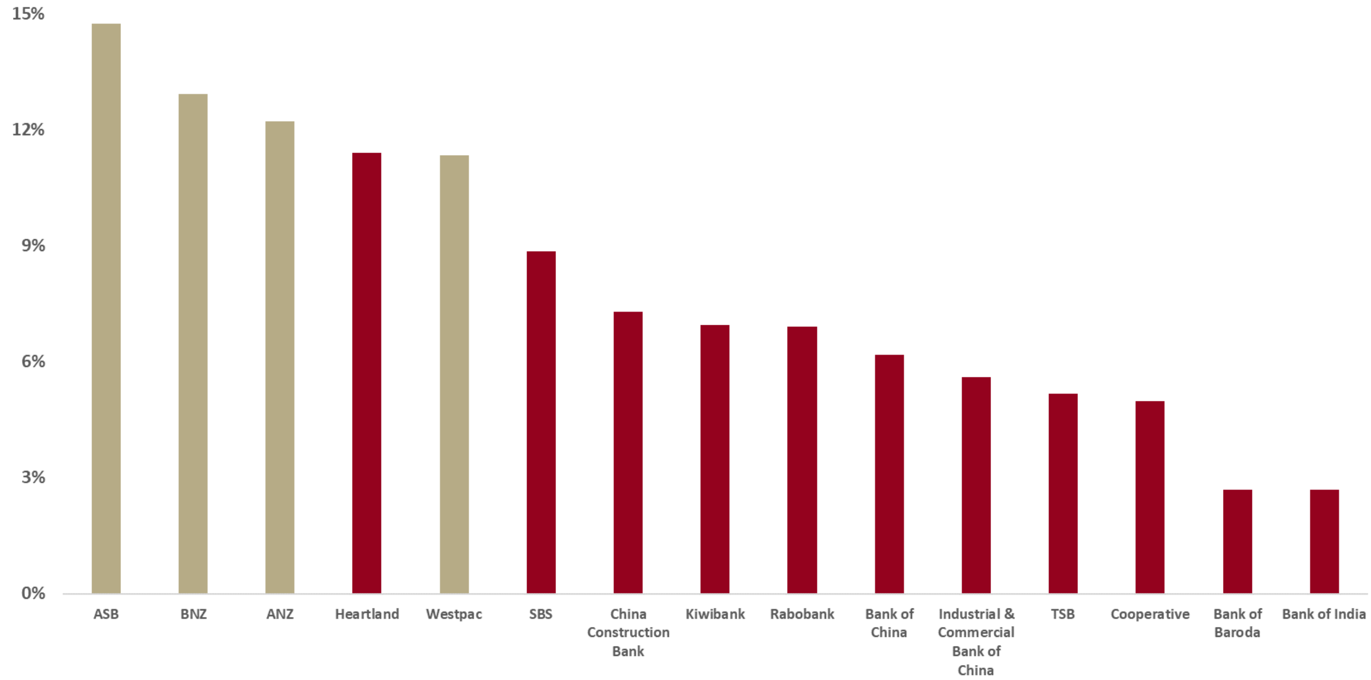
6.30 Using publicly available Reserve Bank data, we observe that New Zealand's major banks (ANZ, ASB, BNZ, and Westpac) have on some measures experienced high average returns relative to other New Zealand banks.

442 World Bank "Global Financial Development Database" [ ].

The major banks' ROE has been higher than most other New Zealand banks

6.31 Figure 6.6 below shows the average quarterly post-tax ROE for 15 banks operating in New Zealand.[443] It shows that the major banks had four of the top five levels of average ROE over the period.[444]

Figure 6.6 Average quarterly bank post-tax ROE between March 2018 and September 2023



Source: Commerce Commission analysis of Reserve Bank.[445]

443 This comprises all locally incorporated banks and the consolidated New Zealand-based activities of dual registered banking groups. See the Reserve Bank Dashboard's frequently asked questions page answer to the question "Does the Bank Financial Strength Dashboard include information on all banks in New Zealand?" available at: https://bankdashboard.rbnz.govt.nz/faqs.

444 Professor Margaritis and Dr Hasannasab plot aggregated ROE by four groups of banks in New Zealand. They identify that 'Group 4', which contains smaller foreign owned banks operating in New Zealand achieve the highest ROE. Figure 6.6 above is based on a Reserve Bank dataset that excludes several banks contained in Professor Margaritis and Dr Hassanasab's analysis. In particular, those that are not locally incorporated or a dual registered banking group. Dimitris Margaritis and Maryam Hasannasab "Market power in banking: A study of New Zealand banks" (March 2024), at p. 24-25.

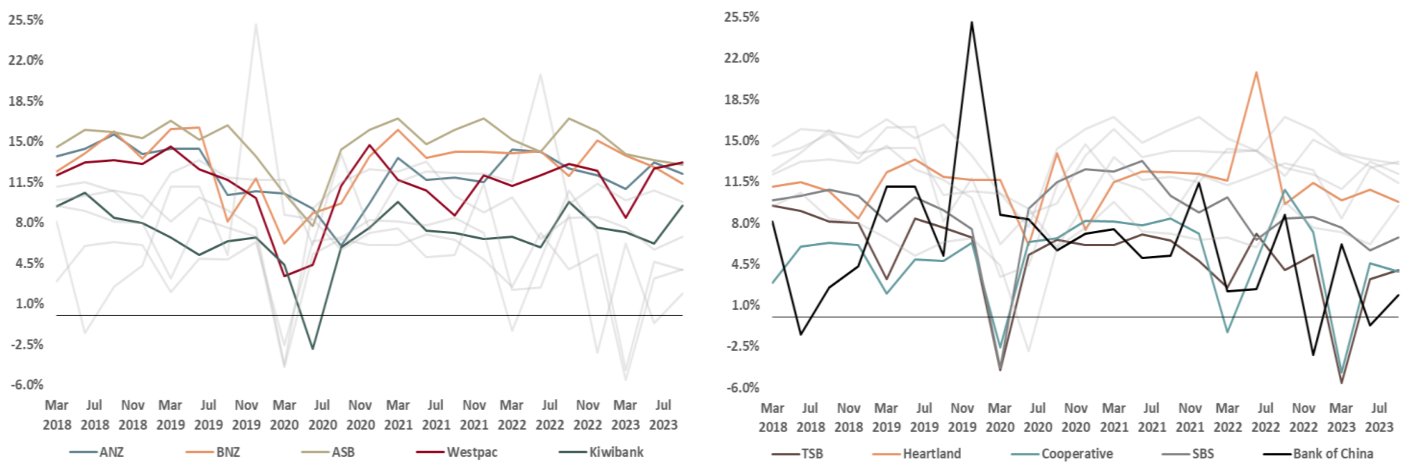
445 Reserve Bank "Bank Financial Strength Dashboard" [ ].

6.32 Heartland Bank is the only non-major bank that is in the top five, with an average ROE that is approximately six basis points above Westpac's. Heartland Bank's profitability is strong on all three profitability measures as seen in Figure 6.6–6.9. We understand that Heartland Bank's product mix is distinct from other providers, focusing on being the "best or only" provider of its products, and that it has a higher lending risk profile than the major banks. [446,447] These factors may mean that Heartland Bank's shareholders could reasonably expect to earn higher returns. Heartland Bank also refers to its automation and digitisation initiatives as allowing it to replicate a similar CTI ratio to that of the major banks.[448]

6.33 Kiwibank's ROE over this period was on average 440 basis points lower than Westpac, who had the lowest average ROE out of the major banks. As Figure 6.6 shows, this ranked Kiwibank as having the eighth highest average ROE between March 2018 and September 2023 out of the 15 banks we considered.

6.34 The strong performance on ROE of the major banks can also be observed in individual quarters. Figure 6.7 shows the quarterly post-tax ROE trend for the ten largest banks in the Reserve Bank dataset.[449] In particular, ANZ, ASB, and BNZ are in the top four performing banks in most quarters.

Figure 6.7 Quarterly bank level post-tax ROE between March 2018 and September 2023



Source: Commerce Commission analysis of Reserve Bank.[450]

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446 Heartland Group "Our Story", available at: https://www.heartlandgroup.info/about-heartland/our-brand-story; Kiwibank "Submission on Market study into personal banking services - Preliminary Issues paper" (7 September 2023), at p. 5; [ ].

447 We note that Heartland Bank claims it is transitioning towards higher quality and lower risk assets. Heartland "Heartland FY22 Results and Offer Announcement" (23 August 2022), at p. 5, available at: https://www.nzx.com/announcements/397408.

448 Heartland "Heartland FY23 - NZX/ASX Results Announcement" (29 August 2023) [ ], at p. 2, available at: https://www.nzx.com/announcements/417248.

449 "largest" refers to a banks average risk-adjusted assets (residential mortgages only) over the analysis period. Data is drawn from series DBB.QIB70 of the Reserve Bank, Bank Financial Strength Dashboard.

450 Reserve Bank "Bank Financial Strength Dashboard" [ ].

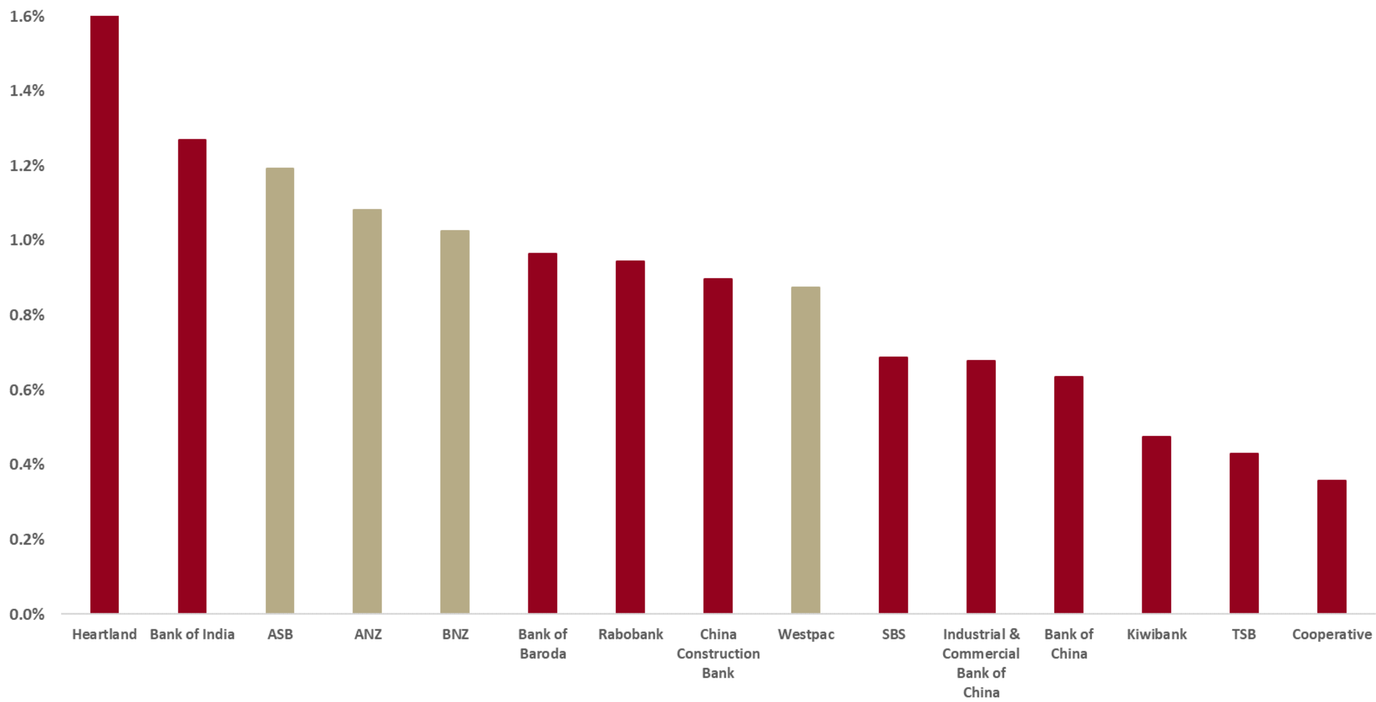
6.35 Some second tier banks performed stronger relative to the major banks in the middle of the sample period, with at least two in the top four between the December 2019 and the June 2021 quarters.[451]

While not the strongest performers, the major banks also perform well on ROA

6.36 A similar picture emerges when comparing the major banks' post-tax ROA over the period. However, the difference between the major banks and the second tier banks is less pronounced than for ROE.

6.37 Figure 6.8 shows the average quarterly post-tax ROA for banks operating in New Zealand. While Bank of India and Heartland Bank outperform all the major banks, ASB, ANZ, and BNZ are again in the top five banks.

Figure 6.8 Average quarterly bank ROA between March 2018 and September 2023



Source: Commerce Commission analysis of Reserve Bank.[452]

451 Commerce Commission analysis of Reserve Bank, Bank Financial Strength Dashboard data.
452 Reserve Bank "Bank Financial Strength Dashboard" [ ].

6.38 Westpac does not perform as well as the other major banks on ROA. It has the ninth highest average quarterly ROA of the 15 banks in the sample. Westpac's average profitability over this period has been the lowest of the major banks on all three measures we have considered.[453]

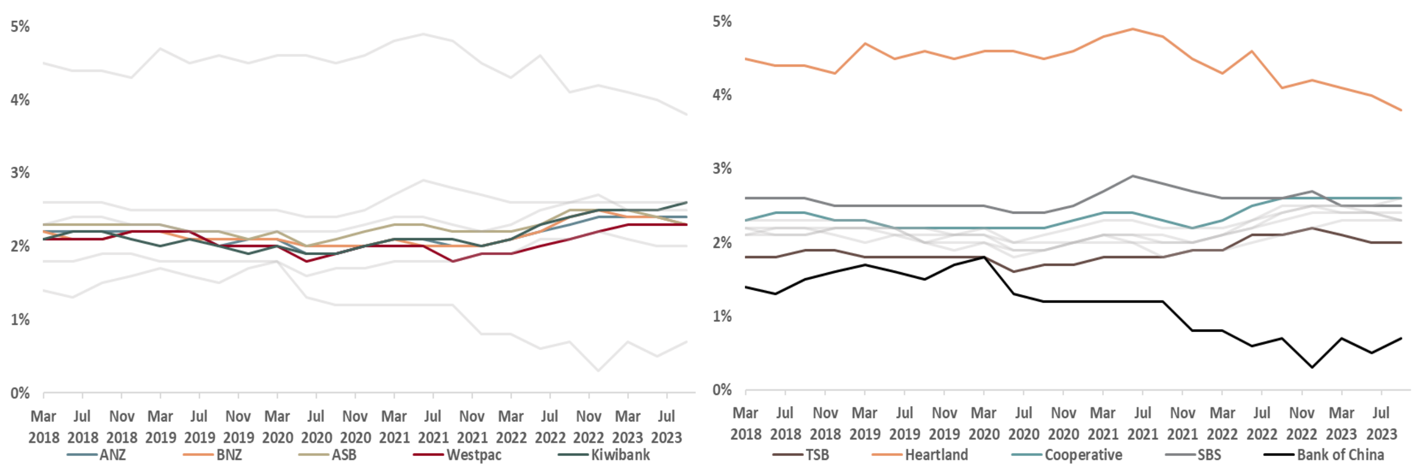
6.39 On ROA, Kiwibank had the third lowest profitability on average between March 2018 and September 2023. Kiwibank's average ROA of 0.47% is 40 basis points lower than Westpac and is between 55 to 72 basis points lower than the other three major banks. While Kiwibank is the fifth largest bank in New Zealand by total banking assets,[454] Kiwibank's greater scale relative to smaller banks does not appear to have led to higher profitability.

The major banks' NIMs are similar to other New Zealand banks

6.40 We have seen no evidence that the major banks' NIMs are especially high relative to other banks operating in New Zealand. Again, Westpac has the lower NIMs on average of the major banks.

6.41 Figure 6.9 shows that, over the analysis period, on NIM the major banks have remained near the middle of the ten largest banks in the Reserve Bank dataset.[455] Kiwibank has had a similar NIM to the major banks. NIMs vary considerably more when comparing the second tier banks.

Figure 6.9 Quarterly bank level NIM between March 2018 and September 2023



Source: Commerce Commission analysis of Reserve Bank.[456]

453 [

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454 See Figure 2.3 of this report.

455 "largest" refers to a banks average risk-adjusted assets (residential mortgages only) over the analysis period. Data is drawn from series DBB.QIB70 of the Reserve Bank, Bank Financial Strength Dashboard.

456 Reserve Bank "Bank Financial Strength Dashboard" [ ].

Recent bank profitability supports the conclusion that the New Zealand banking sector has a two tier dynamic

6.42 Looking at recent profitability data, there appears to be a clear distinction between the major banks' ROE and the ROE of Kiwibank and most of the smaller banks. Supporting this, on average ASB, ANZ, and BNZ outperformed many rival banks on ROA over our analysis period.

6.43 This aligns with the Reserve Bank and Treasury's finding that the major New Zealand banks have been more profitable than the rest of the New Zealand banking sector in recent years.[457]

6.44 As discussed elsewhere in this report, we have also identified barriers to smaller banks expanding to compete more effectively and we have identified that there are weak incentives for the major banks to compete strongly with each other.

6.45 The observations that the major banks' profitability is higher than other firms in the sector and that they appear to face limited constraint from smaller rivals indicates that providers of personal banking services can be split into two tiers. We discuss this two tier dynamic in greater detail in Chapter 2.

We are not satisfied that the explanations provided explain the high returns observed in the New Zealand banking sector | *Kāore i tau ō mātou whakaaro ki ngā kōrero hei whakamārama i te nui o te whiwhinga huamoni i kitea i te rāngai pēke o Aotearoa*

6.46 Profitability is affected by a range of factors beyond just competition. The appearance of high profitability relative to peer nations may instead indicate differences in factors such as relative risk, ownership structure, macroeconomic conditions, and the regulatory landscape.[458]

6.47 We sought submissions that explain the apparent high profitability of New Zealand's major banks and of the New Zealand banking sector relative to international peers.[459] We have considered a range of potential reasons, including those submitted to us, that might explain the relatively high-level of recent profitability observed in the New Zealand banking sector. We summarise our views here and include a more detailed discussion of each potential explanation in Attachment C**.**

457 Reserve Bank "Financial stability report" (3 May 2023), at p. 24, available at: https://www.rbnz.govt.nz/hub/publications/financial-stability-report/2023/may-2023/financial-stability-report-may-2023; and The Treasury "Budget 2023 Tax Initiatives Information Release" (July 2023), at para 5–6, available at: https://www.treasury.govt.nz/sites/default/files/2023-07/b23-tax-4791084.pdf.

458 Reserve Bank "Financial stability report" (3 May 2023), at p. 24, available at: https://www.rbnz.govt.nz/hub/publications/financial-stability-report/2023/may-2023/financial-stability-report-may-2023.

459 Commerce Commission "Preliminary Issues paper - Personal banking services market study" (10 August 2023), at para 122.

6.48 New Zealand's ten-year government bond yields have been higher than in many countries in our sample over the comparison period.[460] We have additionally heard that New Zealand banks may pay a premium in wholesale markets as a result of country level risk.[461] This indicates that across the whole economy, investors into New Zealand can reasonably expect to earn higher returns than investors in peer countries with lower risk-free rates.

6.49 However, this needs to be balanced against the nature of New Zealand's banking system which is relatively less risky compared to peer banking sectors.

6.49.1 the business mix of the New Zealand banking sector is more heavily weighted towards traditional (ie, "vanilla") banking activities than many peer nations.[462] These traditional banking activities include personal and business banking, as opposed to banking activities more prevalent overseas such as institutional and investment banking. Traditional banking activities are generally lower risk relative to these other types of banking.

6.49.2 there is little evidence that New Zealand banks are particularly highly leveraged.[463]

6.49.3 New Zealand's banking sector ROE have been relatively stable compared to other countries in our sample.[464]

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460 Commerce Commission analysis of Wall Street Journal data, See Attachment C, at Figure C5–C6.

461 [ ]; See Attachment C, at para C62.

462 Reserve Bank "Financial Stability Report" (3 May 2023), at p. 24, available at: https://www.rbnz.govt.nz/hub/publications/financial-stability-report/2023/may-2023/financial-stability-report-may-2023; Reserve Bank "Learnings from the global financial crisis" (September 2012) Bulletin, Vol. 75, No. 3, at p. 58; DBRS Morningstar "Australia and New Zealand Banking Gorup Limited" (December 2019), at p. 2 and 4, [ ]; JP Morgan "Rating report: Australian Banks: Key sector themes post FY22 results: Deposit competition and mix is key to the outlook from here" (December 2022), at p. 19, [ ]; JP Morgan "Westpac Banking Corporation: FY23 result: Valuation looks fair but multi-year tech simplification could unlock ROE upside if executed well" (November 2023), at p. 9, [ ].

463 See Attachment C, at para C41–C47.

464 See Attachment C, at Figure C4; The Reserve Bank conducted a similar analysis and reached similar conclusions in May 2023. Reserve Bank "Financial stability report" (3 May 2023), at Figure 2.12, available at: https://www.rbnz.govt.nz/hub/publications/financial-stability-report/2023/may-2023/financial-stability-report-may-2023.

6.50 The low-risk nature of New Zealand's banking sector implies that, other things being equal, it would be expected to derive lower returns relative to riskier banking sectors overseas.[465] Changes to the Reserve Bank's capital requirements, which are being implemented between now and 2028, are likely to further reduce the riskiness of New Zealand's banking sector into the future as banks will be more resilient to economic shocks and downturns.[466]

6.51 While we accept that banking crises will negatively impact bank profitability and the stability of returns in the short to medium run, we do not agree with Incenta's submission that we should exclude countries or banks that have experienced a banking crisis recently from our comparator set.[467] New Zealand has weathered the recent global banking crisis well relative to many other countries in our sample.[468] However, the emergence of a banking crisis is not on its own indicative of a higher risk banking sector and the exclusion of such comparators produces a sample comprising only the highest performing (most profitable) banking sectors. We do not consider sampling of this nature to be appropriate for constructing a comparator set.

6.52 We additionally do not accept that New Zealand faces a materially higher market risk premium relative to peer nations.

6.52.1 New Zealand banks may face a premium in wholesale markets, but the magnitude of this is not sufficiently material to explain the variation in returns we observe.[469]

6.52.2 The low-risk structure of New Zealand's banking sector and any funding advantage enjoyed by the major banks will at least partially offset this.[470]

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465 Similarly, the relatively low-risk, vanilla nature of the major banks suggests that caution also needs to be used in making returns comparisons with other listed companies (eg, on the NZX), which may have a different underlying risk profile.

466 The Reserve Bank "Capital Review: Go-to-Guide 2019" (December 2019), at p. 5, available at: https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/consultations/banks/review-capital-adequacy-framework-for-registered-banks/decisions/capital-review-guide.pdf; and The Reserve Bank "Capital Review: Decisions 2019" (December 2019), at p. 5–7.

467 ANZ "Submission on Market study into personal banking services - Preliminary Issues paper - Annex 1 - Incenta Report" (7 September 2023), at para 40–43.

468 Reserve Bank "Learnings from the global financial crisis" (September 2012) Bulletin, Vol. 75, No. 3, at p. 58; Reserve Bank "Financial Stability - risky, safe or just right?" (November 2018) available at: https://www.rbnz.govt.nz/hub/news/2018/11/financial-stability-risky-safe-or-just-right; and Chris Hunt "Banking crises in New Zealand – an historical perspective" (2009), at p. 26.

469 [ ]; See Attachment C, at para C62.

470 NERA point to work by the Treasury and later work by Professor Damodaran that indicates an upgrade to an AA- credit rating from an A or A- credit rating would reduce borrowing costs by around 10–60 basis points. [ ]; ASB "Submission on Market study into personal banking services - Preliminary Issues paper - Attachment A - NERA Report" (7 September 2023), at para 69–70; [ ]; [ ]; See Attachment C, at para C92–C94.

6.52.3 Recent estimates of New Zealand's tax adjusted market risk premium do not support the argument that New Zealand has higher systematic risk.[471]

6.53 Australian shareholders of New Zealand's major banks may require higher pre-tax returns because Australian resident shareholders cannot receive imputation credits from New Zealand profits.[472] However, we do not consider that this affects these shareholders' expected returns in practice. New Zealand bank profits only comprise a small proportion of total Australian Group profits,[473] and the vast majority of dividends over the past two decades have been fully franked.[474]

6.54 The low-cost structure of New Zealand's banking sector partly explains New Zealand's relative profitability. Relative to other countries in our sample, New Zealand has the third lowest CTI ratio and is below the median on overhead costs as a proportion of total assets.[475] This is partly driven by New Zealand's more vanilla banking structure, cost efficiencies derived through the Australian ownership of the major banks, and under-investment in core systems (as discussed in Chapter 9).[476, 477] Professor Margaritis and Dr Hasannasab found that New Zealand banks operate with high cost-efficiency, generally in the 80–90% range.[478]

6.55 However, we are not satisfied that in a workably competitive market this low-cost structure would reasonably explain the relatively high banking sector profitability we have observed relative to banking sectors in peer nations.

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471 Lally, M. "Estimation of the TAMRP" (10 April 2023), at p. 25, available at: https://comcom.govt.nz/__data/assets/pdf_file/0024/318462/Dr-Martin-Lally-Estimation-of-TAMRP-report-10-April-2023.pdf; and Fernández, P., Garcia de la Garza, D., & Fernández Acín, J. "Survey: Market Risk Premium and Risk-Free Rate used for 80 countries in 2023" (April 3, 2023), at Table 2, available at: SSRN: https://ssrn.com/abstract=4407839

472 ASB "Submission on Market study into personal banking services - Preliminary Issues paper - Attachment A - NERA Report" (7 September 2023), at para 76–78.

473 Commerce Commission analysis of each bank's full year 2023 New Zealand disclosure statements and each bank's Australian full year 2023 financial statements. See Attachment C, at para C103.

474 ANZ "Dividend information", available at: https://www.anz.com/shareholder/centre/your-shareholding/dividend-information/; NAB "NAB's dividend payment history", available at: https://www.nab.com.au/about-us/shareholder-centre/dividend-information/payment-history; CBA "Dividend information", available at: https://www.commbank.com.au/about-us/investors/dividend-information.html; Westpac "Dividend payment history", available at: https://www.westpac.com.au/about-westpac/investor-centre/dividend-information/dividend-payment-history/. See Attachment C, at para C104.

475 Commerce Commission analysis of World Bank data. See Table 6.2 and Figure C2.

476 For example, economies of scale and wholesale funding advantages through the strength of the Australian parent company. See Attachment C, at para C91–C94.

477 [

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478 Cost-efficiency is a measure of how effectively banks minimise costs given their level of outputs and input costs. Dimitris Margaritis and Maryam Hasannasab "Market power in banking: A study of New Zealand banks" (March 2024), at p. 7–10.

6.55.1 While in a workably competitive market, relatively efficient firms can have relatively high profitability, over time we would also expect that competitive pressure would at least partially erode this. We do not observe this in New Zealand.

6.55.1.1 The major banks possess approximately 90% of total banking assets in New Zealand and comprise the entirety of the first tier providers.[479] If that tier was workably competitive, we would expect that they would have competed away profits attributable to their low CTI ratio.

6.55.1.2 As discussed in this report, we observe barriers to smaller firms expanding to compete more effectively with the major banks and observe only weak incentives for the major banks to compete with each other. This is reflected in our observation that the major banks are generally more profitable than smaller banks.

6.55.2 The largest New Zealand banks are small by international standards, and so it is not clear that any benefits of scale economies would result in higher profitability than international peers.

6.55.3 As discussed above at paragraph 6.50, while the more vanilla nature of banking in New Zealand may be lower cost, it is also lower risk.

6.56 Recent Reserve Bank policy interventions have influenced the profitability of New Zealand's banking sector.[480]

6.56.1 The FLP and Large Scale Asset Purchase (LSAP) programme, both in response to Covid-19, weakened the need for banks to vigorously compete for deposits by increasing liquidity in the economy.[481] Simultaneously, the low interest rate environment saw customer deposits become more heavily weighted towards non or low interest bearing accounts. As a result, we saw New Zealand's NIM increase between 2020 and 2021, while the median for our sample declined.

479 Commerce Commission analysis of Reserve Bank, Bank Financial Strength Dashboard data, series DBB.QIG10.

480 We solely discuss these policies in the context of banking sector profitability with respect to competition and do not comment on the appropriateness of these policies with respect to wider policy objectives including financial stability and expansionary or contractionary monetary policy.

481 Both programmes are described in greater detail in Chapter 7 and in Attachment C at para C76.

6.56.2 In the rising interest rate environment that followed, we saw NIMs and revenues increase.[482] However, banks' internal documents suggest that at this time they experienced pressures on lending margins, customers reweighting their deposits to lower margin interest bearing deposits, and the ending of the FLP and LSAP programmes.[483] These factors mean that NIMs likely increased by less than they otherwise would have.

6.57 Factors such as a relatively higher risk-free rate than other countries in our sample, the Australian ownership structure of New Zealand's major banks, and recent regulatory intervention may partially explain elevated profits. However, for the reasons outlined above and in Attachment C, we are not sufficiently satisfied with the merits of many of these arguments and so place less weight on many of them.

6.58 These explanations must also be balanced against the relatively low-risk nature of the New Zealand banking sector which would, all else being equal, generate lower expected returns. On average over our analysis period, New Zealand's proportion of non-interest income to total inscome was 22%.[484] This was the lowest out of our peer country sample, indicating that New Zealand's banking sector has a higher focus on traditional interest bearing banking activities. Figure B1 further highlights New Zealand banks' focus on more traditional banking activities.[485]

6.59 Based on the evidence and our analysis of it, we are not satisfied that the explanations provided fully explain the profitability of the New Zealand banking sector since 2010. We therefore consider that at least part of the profitability is explained by the market power of some participants and that New Zealand's banking sector profits are higher than what would be expected if the major banks faced greater competition.

6.60 Professor Margaritis and Dr Hasannasab found evidence of what they described as 'moderate market power' in the market for loans, and across the banking sector more generally based on their estimates of the Lerner Index and the Panzar-Rosse H statistic respectively. They also found statistically significant and positive associations between ROE, ROA, and NIM and the Lerner Index of market power, although we note that their findings do not indicate a causal relationship.[486]

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482 See Figure 6.9 above showing trends in bank level NIM.

483 [ ].

484 Non-interest income refers to bank incomes that were generated through activities that do not bear interest. As many traditional banking activities are interest bearing, including loans and deposits, non-interest income can be used to assess whether banks focus more on traditional banking activities. Examples of non-interest incomes include fee income, commissions, other operating income, and net gains on trading, derivatives, and other securities. See World Bank Global Financial Development Database Metadata on series GFDD.EI.03.

485 Also see paragraph B6 of this report.

486 Dimitris Margaritis and Maryam Hasannasab "Market power in banking: A study of New Zealand banks" (March 2024), at p. 16–20.

6.61 This market study arose in the context of criticism regarding the level of profitability earned by New Zealand’s major banks. A more refined analysis may allow for more concrete conclusions to be reached on whether profitability exceeds what would be expected in a workably competitive market. However, such an analysis would still present a level of subjectivity and would not necessarily advance our understanding of the factors affecting competition. We have seen enough to be comfortable that our conclusions on profitability corroborate our preliminary findings, throughout this draft report, that competition is sporadic and limited in New Zealand’s banking sector.

Chapter 7 Regulatory factors affecting competition | *Ngā pānga ā-ture mai ki te whakataetaetanga*

Summary of preliminary findings

- **Competition amongst personal banking service providers has not been meaningfully affected by new entry or expansion of smaller providers since the establishment of Kiwibank in 2001.** No smaller provider has been able to grow to achieve the scale or scope needed to effectively compete with the major banks. Even Kiwibank has not been able to expand to match the scale of the major banks.
- **Personal banking services and providers (especially banks) are highly regulated in** the interests of financial system stability, consumer protection and other policy objectives.
- **Regulation is a condition of market entry**. It has been a universal theme of our engagement with providers that regulation shapes competition in personal banking, and is the single most important factor constraining new entry and the ability of existing providers to expand and compete.
- **Bank prudential capital requirements in particular have limited competition by constraining entry and expansion.** Since 2008, the Reserve Bank allowed major banks to hold significantly less capital than small banks for lending with a similar risk profile. Capital requirements reduce the level of retained earnings available to banks to fund growth and have had the unintended effect of constraining the growth of smaller banks relative to the major banks during a period of strong demand for lending.
- Together with less capital being available to smaller banks and their costs of capital being higher, the difference in capital requirements has given a material and entrenched competitive advantage to the major banks for the past 15 years or so.
- **Aside from capital requirements, the overall regulatory burden is very high and imposes a significant barrier to new entry**. For all existing providers, it has constrained growth and innovation due to resources being deployed to keeping up with regulatory change. Kiwibank and smaller providers have been affected by this change more than the major banks because they lack the same scale, meaning that proportionately more of their limited resources must be directed towards regulatory compliance. This has directly constrained their ability to expand.
- **Regulatory policy and design have not sufficiently taken into account the effect of regulation (in terms of both pace and extent) on providers' ability and incentives to compete.** The effect of regulation on competition for personal banking services should be explicitly and transparently considered. The Reserve Bank has a critical opportunity to consider competition impacts as it works to implement the bank capital and Depositor Insurance Scheme funding components of the Deposit Takers Act.

Introduction | *Whakatakinga*

7.1 This chapter discusses the most important conditions of entry and expansion in personal banking services, and how those conditions are affecting competition.

7.2 The terms of reference for our study require us to consider conditions for entry by potential competitors and the conditions for expansion in personal banking. Conditions for entry and expansion are important for competition because they affect the extent to which existing providers are constrained in their decision-making about prices, products, and service levels by:

7.2.1 the potential for their existing competitors to expand their sales; and/or;

7.2.2 the potential for new competitors to enter and effectively compete with them.

7.3 The conditions for entry and expansion that stakeholders have told us are the most important to competition, and which we therefore focus on in this chapter, are:

7.3.1 capital requirements;

7.3.2 the overall regulatory burden on providers; and

7.3.3 specific regulatory challenges.

7.4 These apply to personal banking services generally as well as both home loans and deposit accounts. They are also relevant to both entry and expansion because conditions affecting entry often remain relevant to expansion and ongoing competition after entry has occurred. Other conditions relevant to entry and expansion are discussed in Chapter 8 and Chapter 9.

Entry and expansion in personal banking services has been limited |*Kua herea te whakaurunga ki ngā ratonga pēke whaiaro me tōna whakawhānuitanga hoki*

7.5 As noted in Chapter 2, there has been a lack of noteworthy entry or expansion in personal banking since Kiwibank entered in 2001. In the past decade, less than a handful of banks have entered as registered banks, including Bank of China (New Zealand) Limited and China Construction Bank (New Zealand) Limited (both in 2014), whereas HSBC has ceased providing personal banking services in 2023.[487] No bank, including Kiwibank, has been able to expand sufficiently to provide an effective competitive constraint on the major banks.

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487 Reserve Bank "Registered banks in New Zealand." See: https://www.rbnz.govt.nz/regulation-and-supervision/cross-sector-oversight/registers-of-entities-we-regulate/registered-banks-in-new-zealand

Regulation shapes the competitive environment|*Mā te taha ture e hanga te taiao whakataetae*

7.6 It has been a universal theme of our engagement with providers that regulation shapes competition in personal banking and is the single most important constraint on enhancing competition.[488]

7.7 The regulatory factors most affecting entry and expansion in personal banking services are:

7.7.1 capital and other regulatory requirements for banks and NBDTs, and

7.7.2 the way these requirements can tilt the field of rivalry between large and smaller providers.

7.8 These factors have constrained the growth of smaller providers – that is, smaller banks and NBDTs, partly because they lack the scale to spread high fixed costs, meaning that regulation imposes proportionately higher costs on them than the major banks.[489]

7.9 Below we discuss what stakeholders have told us about how capital requirements, and the overall regulatory burden, are affecting competition.

Capital requirements are a key constraint on competition, particularly for smaller banks |*Kei ngā whakarite haupū rawa he herenga nui mō te whakataetaetanga, ina koa mō ngā pēke iti*

7.10 In the following paragraphs, we outline:

7.10.1 why there are minimum capital requirements;

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488 [ ]; [ ]; [ ]; [ ]; ANZ "Submission on Market study into personal banking services – Preliminary Issues paper" (7 September 2023), at para 23-24; ASB "Submission on Market study into personal banking services – Preliminary Issues paper (7 September 2023), at para 2.1, 2.5; BNZ "Submission on Market study into personal banking services – Preliminary Issues paper" (7 September 2023), at para 5.3; Westpac "Submission on Market study into personal banking services – Preliminary Issues paper" (7 September 2023), at para 2.2-2.5; Kiwibank "Submission on Market study into personal banking services – Preliminary Issues paper" (7 September 2023), at p. 12-13; Heartland Bank "Submission on Market study into personal banking services – Preliminary Issues paper" (7 September 2023), at para 11(d)-(f); TSB, Co-operative Bank, Kiwibank, SBS Joint Submission "Submission on Market study into personal banking services – Preliminary Issues paper" (7 September 2023), at p. 1-3.

489 [ ]; [ ]; [ ]; [ ]; [ ].

7.10.2 the past and current regulatory settings for banks' capital, including risk-weightings;

7.10.3 the advantage these settings have given the major banks and the negative impact they appear to have had on smaller banks' ability to compete to provide personal banking services; and

7.10.4 upcoming changes to the legal framework for capital requirements (and other prudential regulation).

Minimum capital requirements are a necessary prudential regulatory tool

7.11 Minimum capital requirements are one of the prudential requirements imposed on registered banks and NBDTs that underpin the stability of the financial system. NBDTs' current capital requirements are lower than banks.[490] For that reason we focus on bank capital in this part of our report.

7.12 In simple terms, banks are required to have a minimum percentage of their money come from their owners (shareholders) – known as "capital requirements". The rationale for imposing capital requirements on a bank is twofold:[491]

7.12.1 it ensures that the owners of a bank have a meaningful stake in the business. The more its owners are exposed to bank losses, the more carefully they will manage the bank; and

7.12.2 when the amount of a bank's capital gets too low and it is unable to obtain more capital, trading losses make the bank more likely to fail. Therefore, the more capital a bank has, the more money it can stand to lose (eg, in a string of negative profits) before it fails, and the safer depositors' funds are. In other words, more capital reduces the likelihood of bank failure.

7.13 Generally, more capital in the banking system reduces risk because it better enables banks to weather economic volatility that might temporarily limit or eliminate profits, and maintain good, long-term customer outcomes. That reduces the risk of the harmful economic and social effects of a banking crisis.[492]

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490 Part 3, Deposit Takers (Credit Ratings, Capital Ratios, and Related Party Exposures) Regulations 2010, available at: https://www.legislation.govt.nz/regulation/public/2010/0167/latest/DLM3032713.html.

491 Reserve Bank "Capital Review: Go-to-Guide 2019" (2019), at p. 2, available at: https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/consultations/banks/review-capital-adequacy-framework-for-registered-banks/decisions/capital-review-guide.pdf. Note that New Zealand's capital requirements are based on an international capital framework developed by the Basel Committee on Banking Supervision, the primary global standard setter for prudential regulation of banks. See https://www.rbnz.govt.nz/regulation-and-supervision/oversight-of-banks/how-we-regulate-and-supervise-banks/our-policy-work-for-bank-oversight/how-the-basel-framework-underpinned-our-bank-capital-requirements.

492 Reserve Bank "Higher bank capital means safer banking system for all New Zealanders" (5 December 2019), available at: https://www.rbnz.govt.nz/hub/news/2019/12/higher-bank-capital-means-safer-banking-system-for-all-new-zealanders.

7.14 The Reserve Bank has responsibility for the prudential regulation and oversight of registered banks and NBDTs, and views capital requirements as one of its key resilience levers.[493]

7.15 The Reserve Bank's powers to impose prudential regulation must be exercised for the purposes of:

7.15.1 promoting the maintenance of a sound and efficient financial system; and

7.15.2 avoiding significant damage to the financial system that could result from the failure of a registered bank.[494]

7.16 These purposes are also reflected in the Reserve Bank's Financial Policy Remit, to which the Reserve Bank must have regard when making prudential policy decisions.[495]

7.17 The regulatory framework for the setting of capital requirements is about to change. The potential impact of this change is discussed later in this chapter.

Current regulatory capital settings for banks

7.18 The Reserve Bank's current capital adequacy framework includes rules about:[496]

7.18.1 the minimum level of capital that each bank is required to hold, expressed as a capital ratio, ie, the amount of capital it needs to have as a percentage of its total risk-weighted assets (RWA);

493 Reserve Bank "Capital Review: Go-to-Guide 2019" (2019), at p. 4. The Reserve Bank describes bank capital as: "…in general terms, …the amount of money provided by the owners (shareholders) of a bank. Most banks get the vast majority of their money by borrowing it (usually over 90 percent), with the rest coming from owners (usually less than 10 percent). The money banks borrow includes deposits from ordinary New Zealanders." See: Reserve Bank "Capital Review: Go-to-Guide 2019" (2019), at p. 6. Available at: https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/consultations/banks/review-capital-adequacy-framework-for-registered-banks/decisions/capital-review-guide.pdf

494 Banking (Prudential Supervision) Act 1989, section 68. Reserve Bank Act 2021, section 9(1)(b). Note that the purpose of "promoting the maintenance of a sound and efficient financial system" mirrors one of the key responsibilities of the Reserve Bank as stated in its 1989 governing legislation (recently replaced by the Reserve Bank Act 2021, in which the purposes and principles that govern the Reserve Bank have been updated).

495 Reserve Bank "Our Financial Policy Remit", (01 July 2022), available at: https://www.rbnz.govt.nz/about-us/responsibility-and-accountability/our-financial-policy-remit. The Financial Policy Remit is issued by the Minister of Finance under the Reserve Bank Act 2021, section 203. It sets out matters that the Minster considers are desirable for the Reserve Bank to have regard to in relation to its financial stability objective, the objectives, or purposes of prudential legislation, and acting a prudential regulator and supervisor. The Remit has not been updated since 30 June 2022.

496 The capital adequacy framework comprises a range of Banking Prudential Regulation (BPR) documents published by the Reserve Bank, specifically BPR100-160. In addition, the Reserve Bank sets requirements for what each bank's internal capital adequacy assessment process is, and how information about each bank's capital position must be disclosed. Reserve Bank "Capital requirements for banks in New Zealand" (01 July 2022), available at: https://www.rbnz.govt.nz/regulation-and-supervision/oversight-of-banks/standards-and-requirements-for-banks/capital-requirements-for-banks-in-new-zealand.

7.18.2 what types of capital held by a bank qualify as capital for the purposes of the capital ratio. This is the numerator of the calculation of the capital ratio percentage;[497] and

7.18.3 how each bank must calculate its RWA (in other words, how it should value its assets for the purposes of capital requirements given the risk profile of each class of asset). This is the denominator of the calculation of the capital ratio percentage.

7.19 In order to be registered as a bank, the Reserve Bank has set a minimum absolute level of capital at $30 million.[498] It normally wants to see a significantly greater level of capital held by applicants for registration, so it can be satisfied that the level of capital appears adequate to cover the likely nature and mix of the proposed business and possible losses during the first few years of registration.[499]

7.20 Once a bank is registered, the minimum capital required to be held by locally incorporated New Zealand banks on an ongoing basis depends on whether they are a domestically systemically important bank (D-SIB) or not. D-SIBs are nominally required to hold more capital than other banks (on a RWA basis) to reflect the fact that the failure of any of them would have a significant impact on the economy and the rest of the financial system.[500]

7.21 Following the GFC, like many international regulators, the Reserve Bank undertook a Capital Review of the capital adequacy rules for locally incorporated, registered banks in New Zealand. [501,502] It determined that the overall level of capital held by New Zealand banks needed to be increased and developed new minimum capital requirements.

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497 The definition of 'capital' also changed with the Reserve Bank's new capital adequacy framework. From 1 October 2021, the rules for qualifying capital instruments are set out in BPR110. There are 2 tiers of qualifying capital:

a. Tier 1 – split into CET1, and Additional Tier 1 (AT1) capital; and
b. Tier 2, which is a form of subordinated debt.

The processes banks must follow for issuing AT1 and Tier 2 capital are set out in BPR120. Reserve Bank "BPR120 Capital Adequacy Process Requirements" (October 2023), available at: https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/consultations/banks/review-capital-adequacy-framework-for-registered-banks/bpr-documents/bpr120-capital-adequacy-process-req-oct-23.pdf.

498 Unlike banks, there is no 'entry level' requirement for the level of capital for NBDTs.

499 Reserve Bank "Bank registration information" (17 October 2013), at p. 12, available at: https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/regulation-and-supervision/banks/overview/2969066.pdf.

500 Reserve Bank "Capital Review: Go-to-Guide 2019" (2019), at p. 3

501 Reserve Bank "Higher bank capital means safer banking system for all New Zealanders" (05 December 2019).

502 Recent changes were set in motion following changes in international best practice and an International Monetary Fund (IMF) review of New Zealand's settings in 2016. See: https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/consultations/banks/fsap/fsap-review-financial-system-stability-assessment-report-2017.pdf

7.22 In explaining its rationale for the changes to capital settings, the Reserve Bank referred to its legislative responsibility to promote the soundness and efficiency of the financial system, and indicated that the "…level and quality of bank capital are key components of financial system soundness and efficiency".[503] The uplift in capital requirements effectively requires bank shareholders to increase their stake to absorb a greater share of losses, improving the quality of capital and ensuring banks more accurately measure their risk.[504]

7.23 Once the changes made in the Capital Review have been fully implemented, there will be an approximately 50% increase in high quality capital in the banking system. The level of increase for each bank's capital will depend on their current capital level, whether they choose to hold more than the required minimum, and whether the bank is a D-SIB or not.[505]

7.24 The first capital uplift was required in July 2022. Further increases in capital will be phased in between now and 2028. All registered banks must adhere to all of the new capital requirements by 1 July 2028.[506,507]

7.25 By the end of the transition to the new level of capital requirements in2028, the total capital ratios that New Zealand's banks must meet will be: [508]

7.25.1 for the D-SIBs (ANZ, ASB, Westpac and BNZ),[509] a minimum of 18%. This includes a 2% D-SIB buffer, which has been in effect since 1 July 2023, and was introduced to reflect the large cost of failure of a systemically important bank to the economy as opposed to a non-systemic one, and

7.25.2 for all other banks (ie, non-D-SIB banks), a minimum of 16%.

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503 Reserve Bank "Capital Review: Decisions 2019" (2019), at p. 59, available at: https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/consultations/banks/review-capital-adequacy-framework-for-registered-banks/decisions/capital-review-decisions.pdf

504 The Capital Review Go-To Guide sets out a simple explanation of what increasing capital requirements means. Reserve Bank "Capital Review: Go-to-Guide 2019" (2019).

505 Reserve Bank "Capital Review: Go-to-Guide 2019" (2019), at p. 3.

506 In addition, the Reserve Bank says that it is continuing to refine its capital adequacy framework. It recently published final documents on a new capital instrument for mutual banks and changes to the risk weights framework and is currently consulting on disclosure changes.

507 Reserve Bank "Updated Capital Review Implementation Timeline" (5 May 2021), available at: https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/consultations/banks/review-capital-adequacy-framework-for-registered-banks/updated-capital-review-implementation-timeline.pdf

508 Reserve Bank "Capital requirements for banks in New Zealand" (09 November 2023), available at: https://www.rbnz.govt.nz/regulation-and-supervision/oversight-of-banks/standards-and-requirements-for-banks/capital-requirements-for-banks-in-new-zealand.

509 In general, the classification of a bank as a D-SIB reflects the larger cost of failure of a systemic bank relative to that of a non-systemic one. Reserve Bank "Capital Review, Regulatory Impact Assessment and Cost-Benefit Analysis 2019" (19 December 2019), at p. 48, available at: https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/consultations/banks/review-capital-adequacy-framework-for-registered-banks/decisions/capital-review-cost-benefit-analysis.pdf

7.26 Several banks submitted that the level of capital that they have to hold is high relative to other countries (consistent with the Reserve Bank's view), which constrains their ability to grow.[510] The overall level of capital is likely to be important to the decision to register as a bank in New Zealand. In terms of expansion, however, it is how those requirements apply to different types of personal banking service providers that is most relevant to competition.

7.27 Based on the capital ratios set out above, it appears that the major banks have to hold a proportionately higher level of capital overall than other banks. However, submitters highlighted that the level of capital ultimately required to be held is affected by the requirements for how different classes of banks have to calculate their capital ratios.

Risk-weightings – how banks must calculate the capital they are required to hold

7.28 As mentioned, the Reserve Bank requires capital to be held at a level that is expressed as a proportion of RWA. RWA is an adjusted picture of a bank's financial position (eg, its loan portfolios, as well as its other assets) that takes account of the risk profile of that financial position.

7.29 The Reserve Bank sets detailed requirements for how RWA must be calculated under one of two approaches:

7.29.1 A standardised approach. This requires banks to apply risk weights specified by the Reserve Bank to each class of loans and other assets.[511] The risk weights are generally based on credit ratings from credit rating agencies. For residential home loans, the risk weighting categories also take account of the LVR for a particular loan at the time of origination and the borrower's mortgage insurance arrangements,[512] and

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510 ASB "Submission on Market study into personal banking services" (7 September 2023), at para 16.2b; BNZ "Submission on Market study into personal banking services – Deloitte Report" (7 September 2023), at para 118-122 and Figure 2; BNZ "Submission on Market study into personal banking services – Preliminary Issues paper" (7 September 2023), at para 2.14; Westpac "Submission on Market study into personal banking services – Preliminary Issues paper" (7 September 2023), at para 4.2(b).

511 Reserve Bank "Capital Review: Go-to-Guide 2019" (2019), at p. 5.

512 Reserve Bank "BPR131 Standardised Credit Risk RWAs" (July 2021), at para B1.1, Table 3.10, C3.1, and C3.4.1, available at: https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/consultations/banks/review-capital-adequacy-framework-for-registered-banks/bpr-documents/bpr131-standardised-credit-risk-rwas.pdf. For example, the Reserve Bank sets a risk weight of 35% for a standard residential mortgage loan where the following conditions are met:

- the loan is the first ranking mortgage over a residential property used primarily for residential purposes by the mortgagor or a related party of the mortgagor,
- lender's mortgage insurance is in place that meets certain requirements, and
- the loan-to-valuation ratio does not exceed 80%.

7.29.2 An internal ratings-based (IRB) approach, under which banks can use inputs from credit models that they have developed internally in a formula specified by the Reserve Bank. In other words, banks using the IRB approach (IRB banks) can use their own internal estimates in calculating credit risk, instead of using the standardised weights, based on their own modelling. In effect, that modelling must be such that they can robustly demonstrate the actual likely level of risk they face in relation to those assets to the Reserve Bank's satisfaction.[513]

7.30 A bank must use the standardised approach to calculate RWA unless it has been accredited by the Reserve Bank to use the IRB approach (and meet ongoing requirements to maintain that accreditation).

7.31 The IRB approach was introduced into the capital framework in 2008. The standardised and IRB approaches to determining RWA form part of the Basel international standards for capital frameworks. The Reserve Bank considered that introducing an IRB approach would support efficiency in that it would better align regulatory capital requirements with underlying risks, and incentivise banks to invest in their ability to assess risk by offering the potential for capital reduction.[514, 515]

7.32 To date, the only banks that have been able to meet the accreditation criteria set by the Reserve Bank to use the IRB approach are the major banks.[516] Any bank may apply to the Reserve Bank to become accredited, but the application and information requirements must be discussed with the Reserve Bank on a case-by-case basis. The Reserve Bank has however specified certain minimum requirements, including:[517]

7.32.1 general requirements: overall, a bank's risk rating system used for capital adequacy purposes must enable the bank to rank and quantify risk consistently and reliably. The systems and processes must be based on data and analysis that are rigorous, well-established, plausible, and appropriately conservative; and

7.32.2 other requirements: these relate to matters such as risk ratings system design and operations, corporate governance and oversight, risk quantification, and validation of internal estimates.

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513 Reserve Bank "Capital Review: Go-to-Guide 2019" (2019), at p. 4. For context, one of the parameters for the IRB approach set by the Reserve Bank is the "scalar", which adjusts the level of conservativism in the RIB approach's calibration.

514 Reserve Bank "Capital requirements for banks in New Zealand" (09 November 2023).

515 [ ].

516 Note that the accreditation to use the IRB approach does not flow automatically from being classified as D-SIB; separate accreditation is needed. It just so happens that the D-SIBs that have been able to meet the accreditation requirements for the IRB approach to date.

517 Reserve Bank "BPR134 IRB Minimum System Requirements"(July 2021), available at: https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/consultations/banks/review-capital-adequacy-framework-for-registered-banks/bpr-documents/bpr134-irb-minimum-system-requirements.pdf; Reserve Bank "BPR 151 AMA Operational Risk" (July 2021), available at: https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/consultations/banks/review-capital-adequacy-framework-for-registered-banks/exposure-drafts/bpr151-ama-operational-risk.pdf

7.33 The capacity, capability, and ongoing resourcing that the Reserve Bank has decided it requires for a bank to become accredited to use the IRB approach, and maintain that accreditation, is significant. This means that it is challenging for Kiwibank, and the smaller banks, to meet those requirements. We understand that there have been attempts by various banks other than the major banks over time to gain accreditation, which have not been successful.[518]

7.34 The key outcome of the standardised and IRB approaches to determining RWA for capital ratio calculations is that the same asset – for example, a loan – can be weighted differently in terms of the risk it poses to the bank that holds it. In other words, even if two banks hold a loan with exactly the same characteristics (the same borrower, deposit, interest rate, loan term, mortgage insurance, and LVR, and all other features of both the loan and the borrower are the same), an IRB bank can hold less capital for that loan than a standardised bank. This is what has transpired, as explained below.[519]

New 85% floor on the advantage conferred by the IRB approach

7.35 Prior to the Capital Review, the IRB banks were reporting decreasing levels of capital compared to other banks. The Reserve Bank indicated that this was an expected result of the use by IRB banks of their internal models over time provided it was explained by declining underlying risks. However, by the time of the Capital Review, the Reserve Bank had become concerned that the divergence in capital held by IRB banks compared to other banks had become wider than could be explained by the actual level of underlying risk.[520]

7.36 We understand that as a result of the Capital Review, the Reserve Bank therefore decided to limit the advantage that the IRB banks have had from using the IRB approach. Banks accredited to use the IRB approach cannot now have capital levels lower than 85% of the levels they would be required to hold under the Reserve Bank's standardised model. This change took effect on 1 January 2022.

7.37 The Reserve Bank also separately determined that the D-SIBs would need to hold an additional prudential capital buffer of 2% over and above the other banks. The 2% D-SIB buffer has been in place since 1 July 2023.

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518 [ ].

519 We have also heard that lending to entities involved in, for example, social housing construction or to fintechs whose business model involves bank (and other) finance supporting retail mortgage lending, is typically treated as business lending for prudential capital purposes. Housing developers and fintechs in this position consider that what is, from their perspective, equivalent to home loan lending carries a higher risk weighting and is priced to them accordingly. The increased cost of funding will be carried by the housing developer (and, ultimately, consumers) or the fintech, if looking to compete against banks on retail home loan interest rates, in reduced margin. The counter to this is that the lending is to an intermediary party that is not directly supervised by the Reserve Bank, and not directly secured by mortgagee rights, so an element of risk is introduced. While parties have raised these issues with us, and we have seen how the risk-weightings for prudential capital can impact on competition, these issues are outside the scope of this study into personal banking services.

520 [ ].

7.38 The D-SIBs were, and remain, the same subset of banks that are accredited to use the IRB approach. The 85% output floor and the 2% D-SIB buffer therefore both apply to the major banks and not others.

7.39 The Reserve Bank explicitly acknowledged these changes will "level the competitive playing field". They explained that large banks have been holding less capital than small banks for the same risks. The 2019 reforms will reduce this advantage and require the biggest banks to hold a higher level of capital because their failure would have greater costs for New Zealand.[521]

7.40 While the 85% floor and 2% D-SIB buffer led to major and other banks having similar total capital requirements, this was not a driver of the changes. That is, we understand that competition impacts did not factor into the Reserve Bank's decision-making.[522,523] In addition, these two requirements are for different purposes:

7.40.1 the 85% floor in IRB models is designed to approximately equalise riskiness of lending between IRB and other banks. That still gives major banks a capital discount of 15 percentage points, which is a significant competitive advantage;[524] but

7.40.2 the 2% buffer is designed to mitigate an additional risk that the major banks pose – ie, the risk that their failure leads to risks to the stability of the system as a whole.[525]

7.41 The Reserve Bank is also introducing a transparency requirement under which the IRB banks will be required to disclose their RWA calculations using both the IRB and standardised approaches, as well as the required level of capital resulting from any appreciation of the 85% floor.[526]

Impact of capital settings is that smaller banks have to hold relatively more capital

7.42 The overall effect of the regulatory capital settings discussed above is that:

7.42.1 between 2008 (when the IRB approach was introduced) and 1 January 2022 (when the 85% floor was introduced), the major banks using the IRB approach were permitted to hold materially less capital for the equivalent assets than a bank using the standardised approach, and

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521 Reserve Bank "Capital Review: Go-to-Guide 2019" (2019), at p. 7.

522 [ ].

523 [ ].

524 [ ].

525 Reserve Bank "Requirements for domestic systematically important banks" See: https://www.rbnz.govt.nz/regulation-and-supervision/oversight-of-banks/standards-and-requirements-for-banks/requirements-for-domestic-systemically-important-banks

526 Reserve Bank "Capital Review: Go-to-Guide 2019" (2019), at p. 7

7.42.2 since 1 July 2023 (when both the 85% floor and 2% D-SIB buffer were in place), the effect of the 85% output floor (and 2% D-SIB buffer) means that banks using the IRB approach are coincidentally required to hold a similar level of capital for equivalent assets than a bank using the standardised approach, but

7.42.3 putting the 2% D-SIB buffer aside (reflecting that that is targeted at systemic risk not equalising capital requirements across IRB and non-IRB banks), the D-SIBs – who are still the only banks accredited to use the IRB approach – are still able to hold significantly less capital than a standard approach.

7.43 To illustrate the impact on the level of capital held by the major banks compared to the smaller banks both before and after the introduction of the 85% floor, Table 7.1 and Table 7.1 below set out RWA calculations for a $1 million residential mortgage loan under the IRB approach and the standardised approach.

7.44 Before the imposition of the 85% output floor:

Table 7.1 Bank capital required for a $1 million home loan prior to Capital Review changes

	Value of home loan	Risk weighting required to be applied	Risk-weighted loan value	Required level of Common Equity Tier 1 (CET1) capital for that loan (7% CET1 ratio)
Bank using standardised approach	$1m	37%	$370,000	$25,900
Bank using the IRB approach	$1m	28%	$280,000	$19,600
			Difference	$6,300

Source: Commerce Commission.[527]

7.45 Table 7.1 shows that in this example, the difference between the CET1 capital required for a $1 million residential home loan between a standardised bank and an IRB bank was $6,300.

527 [ ].

7.46 The calculations in Table 7.1 are based on the following assumptions:

7.46.1 an average risk weight under the standardised approach of 37%. This is approximately the average risk weight observed among standardised banks in the years 2017 to 2022. The actual risk weight would depend on the LVR;

7.46.2 for IRB banks, the Reserve Bank assumed an average of 28% (prior to the Capital Review changes), which again is approximately the average figure observed during the period 2017 to 2022, taking into account overlays that the Reserve Bank applies to some banks' models;

7.46.3 minimum capital ratios apply to different types of capital, one of which is CET1. This is the highest quality type of capital and represents unrestricted and freely available funding, including retained earnings.[528] CET1 capital was selected for this example because it is the costliest form of capital. It is also the form of capital for which alternative uses would comprise investment for innovation and growth; and

7.46.4 for simplicity, the 85% floor is calculated as 85% of the average standardised outcome (37%). In practice, the floor is calculated across all lending portfolios in aggregate, rather than portfolio-by-portfolio.[529]

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528 Reserve Bank "Glossary", available at: https://www.rbnz.govt.nz/glossary#common-equity-tier-1

529 In other words, banks would add up all of the RWAs under the IRB approach (including with the new higher scalar) and compare this to 85% of the standardised RWA they would calculate for the same loan portfolios. It is possible for individual portfolios (eg housing, commercial property, agriculture etc) to be above or below the output floor on a standalone basis.

7.47 After the imposition of the 85% output floor (from 1 January 2022):

Table 7.2 Bank capital required for a $1 million home loan after full implementation of Capital Review changes

	Value of home loan	Risk weighting required to be applied	Risk-weighted loan value	Required level of CET1 capital for that loan (11.5% CET1 ratio)
Bank using standardised approach	$1m	37%	$370,000	$42,550
Bank using the IRB approach (without output floor, but including higher IRB scalar)	$1m	31.7%	$317,000	$36,455
Bank using the IRB approach (with output floor)	$1m	31.45%	$314,500	$36,175.50
			Difference*	$6,382.50

Source: Commerce Commission.[530]

7.48 Table 7.2 shows that in our example, once the 85% output floor is applied and taking into account the increase in the overall capital ratio for CET1 capital for all banks, the difference between the CET1 capital required for a $1 million residential home loan between a standardised bank and an IRB bank, is $6,382.

7.49 The basis of the calculations in Table 7.2 is the same as in Table 7.1.

7.50 This analysis shows that the difference in capital required to be held by a bank using the IRB approach and the standardised approach for a $1m home loan since 2008 remains significant despite the imposition of the 85% output floor.

530 Note that the difference in Table 7.2 has been calculated based on the results of the IRB approach with the output floor, since the IRB approach alone produces a value less than the floor. [ ].

7.51 The difference in capital may appear relatively small when compared to the value of the loan, but it is important to bear in mind that the difference in overall capital holdings for the smaller banks for home loans would have been multiplied across their portfolios, and it is the aggregate effect on smaller banks' capital holdings that must be considered. This is particularly the case given that this effect would be greater for the many smaller banks that have a focus on residential home loans.[531]

7.52 The effect of the imposition of the 2% buffer from 1 July 2023 is that, in our example, a D-SIB (noting that all of the D-SIBs are IRB banks) would need to hold an additional $6,300 in capital. Therefore, in our example, this coincidentally eliminates most of the difference in levels of capital required to be held between the IRB and non-IRB banks. But as noted above, the 2% buffer is aimed at systemic risk associated with the D-SIBs and was not intended to have the effect of bringing capital requirements for the IRB and non-IRB banks closer together.

The major banks have had a head start on growth since 2008 and the ability of small banks to compete has been restricted

7.53 Since 2008, the major banks have not had to hold as much capital as other banks for assets with a similar risk profile and have been able to use that additional funding to expand their businesses. Importantly, New Zealand has experienced significant growth in demand for home loans amid rising house prices in that same period, and lower capital requirements for the major banks meant that they were able to use relatively more funding for lending.[532] More generally, they were also able to choose where to invest funding in initiatives aimed at growth.[533]

7.54 In contrast, the smaller banks have had significantly less funding available for growth, innovation, and investment because they had to hold more as capital.

7.55 The aggregate effect of capital settings since 2008 was therefore to provide a material and entrenched competitive advantage to the major banks at a time when there was the potential for significant growth.

531 [ ].

532 [ ]; See also Link Economics "The nature of competition for personal banking services" prepared for Kiwibank (5 October 2023), at para 74.

533 [ ]; [ ].

7.56 The disadvantage experienced by the smaller banks has been exacerbated because of their lack of scale. They already have disproportionately higher costs (eg, regulatory costs) and lower profitability than the major banks, driven by having a smaller base over which to spread fixed costs. Smaller banks told us that higher capital requirements disproportionately restrict their ability to compete because less capital is available for expansion, and it costs them more:

7.56.1 capital can generally be raised by increasing shareholder funding or by retaining earnings (ie, reducing distributions to shareholders in the form of dividends);[534]

7.56.2 the costs of servicing equity capital are generally higher for smaller banks, because they tend to have lower credit ratings and the higher perceived risk means investors require higher return;[535]

7.56.3 due to the higher risk profile of smaller banks (because of their smaller scale) and less favourable access to wholesale markets, the pool of investors from which smaller banks can attract additional capital is smaller than for the major banks;[536]

7.56.4 some smaller banks are also constrained in the way that they can raise capital because of their structure.[537] Only certain capital instruments can be used to enable a bank to meet its regulatory capital requirements;[538]

7.56.5 taken together, the factors listed above mean that smaller banks have less retained earnings from which to build capital and are obliged to hold relatively more capital.[539]

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537 [ ]; [ ]; [ ]; [ ].

538 Reserve Bank "BPR120 Capital Adequacy Process Requirements" (July 2021), available at: https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/consultations/banks/review-capital-adequacy-framework-for-registered-banks/bpr-documents/bpr120-capital-adequacy-process-requirements.pdf

539 [ ]; [ ]; [ ]; [ ].

7.57 This has two key implications from a competition perspective:

7.57.1 smaller banks find it difficult to compete with the major banks on price (ie, interest rates) on home loans and deposits over a sustained period, which in part explains why smaller banks struggle to attract customers away from the major banks;[540]

7.57.2 smaller banks have higher cost structures and less funding for growth, whether that be through making funding available for lending, investment in innovations like mobile applications (to, for example, help attract customers away from major banks), and other initiatives to achieve growth such as marketing.[541]

7.58 Because the updated regulatory capital settings still enable the IRB banks to hold less capital than smaller banks, competition from smaller banks will continue to be constrained by capital requirements settings, amplified by the factors listed above.

7.59 The Reserve Bank should consider whether there is a sound justification for capital requirements settings resulting in IRB and non-IRB banks being able to hold materially different levels of capital for the lending of equivalent risk. In particular, the Reserve Bank should consider whether:

7.59.1 there is an ongoing justification for the output floor being set at 85%, allowing an ongoing differential between the level of capital that the IRB banks and smaller banks have to hold; and

7.59.2 in thinking about whether current capital settings continue to be justified, whether adjustments should be made in the interests of competition and proportionality. For example, whether:

7.59.2.1 some loan types (eg, first mortgages with LVRs below 80%) have sufficiently clear characteristics that there should be no difference in capital holdings between the standard and IRB approaches, reflecting that such loans are consistently low-risk irrespective of the lender;

7.59.2.2 the output floor should be set higher than 85% to more evenly apply capital requirements between IRB and non-IRB banks; and

7.59.2.3 the accreditation criteria for becoming an IRB bank should be relaxed in order to allow more smaller banks to be able to take advantage of the IRB approach.

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541 [ ]; [ ].

7.60 If the 2% D-SIB buffer is operating as intended – in other words, requiring D-SIBs to hold an additional capital buffer to reflect the higher systemic risk that a failure of any one of them presents to the system overall – that should be applied independently of any of the above changes.

7.61 There is an opportunity for the Reserve Bank to consider these aspects of the regime again now that its prudential regulatory role has been recast under the Deposit Takers Act 2023 (DT Act). In particular, the Reserve Bank now has a clear mandate to expressly consider the effects of these settings on competition, and take a proportionate approach to regulation, which are considerations that were not, at the time of the Capital Review, expressly part of its mandate. We discuss this further below.

With upcoming changes, it is unclear what capital requirements under the DT Act will be

7.62 The DT Act will bring in important changes to the Reserve Bank's prudential regulatory and supervision role for both banks and NBDTs. The DT Act is coming into effect progressively and will fully take effect in 2029.

7.63 First, the DT Act will bring in a range of changes to modernise and streamline prudential regulation. Capital, along with other prudential requirements, will be shifted into the DT Act framework over the coming years.[542]

7.64 In particular, the DT Act will combine the currently separate regimes for banks and NBDTs into one. One change will be that banks – along with other deposit takers – will need to be licensed by the Reserve Bank to operate as a bank (rather than simply being registered, as banks are currently) and the prudential requirements with which they must comply will be set out in standards made under the DT Act (rather than in conditions of registration).[543]

7.65 Second, the DT Act re-frames the purposes and principles that govern how the Reserve Bank must act as prudential regulator. Specifically, section 3 provides that:

7.65.1 the main purpose of the DT Act is "to promote the prosperity and well-being of New Zealanders and contribute to a sustainable and productive economy by protecting and promoting the stability of the financial system";

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542 Reserve Bank intends to consult on its proposed core standards (including capital) from May to June 2024, and July to August 2024 on non-core standards. This will be followed by consultation on exposure drafts of core and non-core standards in 2025 and 2026, and commencement of all standards in 2028. Reserve Bank "DTA DCS timeline" (27 February 2024), available at: https://www.rbnz.govt.nz/regulation-and-supervision/depositor-compensation-scheme/dta-dcs-timeline.

543 Reserve Bank "Questions and answers – Deposit Takers Act" (28 September 2023), available at: https://www.rbnz.govt.nz/about-us/responsibility-and-accountability/our-legislation/deposit-takers-act/dta-questions-and-answers.

7.65.2 the DT Act has the following additional purposes:

7.65.2.1 to promote the safety and soundness of each deposit-taker;

7.65.2.2 to promote public confidence in the financial system;

7.65.2.3 to avoid or mitigate the adverse effects of risks to the stability of the financial system, and risks from the financial system that may damage the broader economy; and

7.65.2.4 to the extent not inconsistent with the purposes outlined above, to support New Zealanders having reasonable access to financial products and services provided by the deposit-taking sector.

7.66 In achieving the purposes of the DT Act, the Reserve Bank must also take account of certain principles, including:

7.66.1 the desirability of taking a proportionate approach to regulation and supervision;[544]

7.66.2 the desirability of the deposit-taking sector comprising a diversity of institutions to provide access to financial products and services to a diverse range of New Zealanders;[545]

7.66.3 the need to maintain competition within the deposit-taking sector;[546]

7.66.4 the need to avoid unnecessary compliance costs;[547] amongst several others; and

7.66.5 the desirability of the deposit-taking sector comprising a diversity of institutions to provide access to financial products and services to a diverse range of New Zealanders.[548]

7.67 For the first time, the prudential regulatory framework gives explicit recognition to competition and the need for proportionality of regulation.

7.68 That said, in our view "maintaining" the current level of competition is not sufficient in light of our view that competition in personal banking is sporadic and limited.

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544 DT Act, section 4(a)(i).
545 DT Act, section 4(a)(iii).
546 DT Act, section 4(b).
547 DT Act, section 4(c).
548 DT Act, section 4(a)(iii)

7.69 Given the new purposes and principles governing the Reserve Bank's prudential functions:

7.69.1 we expect the Reserve Bank will now explicitly consider and articulate competition effects, and effects on different groups of deposit takers, when it is making decisions about prudential regulatory settings (including capital requirements). There will be more transparency about the role that competition plays in the way in which those settings are determined, and

7.69.2 we see an important role for competition to be factored into prudential regulatory settings, in this context to ensure that consumers of personal banking services can benefit from competition and note that financial stability and competition are not necessarily mutually exclusive objectives.[549]

DT Act sets a new Proportionality Framework for the creation of new prudential standards

7.70 The Reserve Bank has recently published a Proportionality Framework in accordance with the DT Act,[550,551] which sets out how the Reserve Bank will take into account the proportionality principle in the DT Act when developing standards.[552]

7.71 In preparing the framework, the Reserve Bank was required to have regard to:[553]

7.71.1 the size and nature of the businesses of different deposit takers;

7.71.2 the extent to which a range of different requirements are necessary or desirable to promote the safety and soundness of each deposit-taker; and

7.71.3 the relative importance of different deposit takers to the stability of the financial system.

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549 D. Anginer, A Demirguc-Kunt & M. Zhu "How does competition affect bank systemic risk?" *Journal of Financial Intermediation* 23 (2014), at p. 1–26; C. Silva-Buston "Systemic risk and competition revisited" *Journal of Banking and Finance* 101 (2019) 188–205, and Z. Fungácová, Shamshur & L. Weill "Does bank competition reduce cost of credit? Cross-country evidence from Europe" *Journal of Banking and Finance* 83 (2017), at p. 104–120.

550 DT Act, section 77.

551 See: The Reserve Bank "Proportionality Framework For Developing Standards Under the Deposit Takers Act" (March 2024), available at: https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/regulation-and-supervision/dta-and-dcs/the-proportionality-framework-under-the-dta.pdf

552 Reserve Bank "Deposit Takers Act 2023 – Proportionality Framework Consultation (31 July 2023), available at: https://www.rbnz.govt.nz/have-your-say/2023/deposit-takers-act-2023-proportionality-framework-consultation. Submissions closed on a draft version of the Framework on 25 September 2023.

553 DT Act, section 77(3).

7.72 Notably, the Reserve Bank was not explicitly required by the DT Act to take account of the competition principle in setting the Proportionality Framework. That said, competition – and the other principles in the DT Act – remain an overall guide to which the Reserve Bank's decision-making powers under the DT Act are subject. The Reserve Bank has confirmed that other principles in section 4 of the DT Act (including the need to maintain competition within the deposit-taking sector) will be taken into account when developing standards.[554]

7.73 In its 2023 consultation, the Reserve Bank stated that "[t]he proportionality framework will assist us to consistently and transparently balance the costs and benefits of regulation in relation to different types of deposit takers, when tailoring requirements in the standards." [555] It recognises in its Proportionality Framework that proportionality is important so that the public can benefit from a safe, sound and stable deposit-taking sector, but also one that can be diverse, innovative, and inclusive.[556]

7.74 However, the Reserve Bank states in the final Framework that "[i]t is important to note that the Framework does not necessarily mean reducing the strength of any particular standard. Taking a proportionate approach means balancing the costs and benefits of regulatory requirements in relation to different types of deposit takers."[557]

7.75 Many stakeholders supported the Proportionality Framework in the 2023 consultation, and were pleased to see the proportionality principle being applied to the prudential standards that will be eventually created under the DT Act.[558] However, stakeholders remained concerned that was unclear how the Proportionality Framework would apply in practice.[559]

7.76 During consultation, the Reserve Bank expressed the view that it interprets the DT Act as requiring an overall shift to a more intensive regulatory and supervisory regime in New Zealand. For the NBDTs, the Reserve Bank had said that prudential requirements may be about to increase substantially, even going so far as to suggest that some may need to reassess their viability in a more regulated environment.

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554 Reserve Bank "Proportionality Framework For Developing Standards Under the Deposit Takers Act" (March 2024), at p. 4.

555 Reserve Bank "Consultation Paper: Proportionality Framework, For Developing Standards Under the Deposit Takers Act" (31 July 2023), at p. 3.

556 Reserve Bank "Proportionality Framework For Developing Standards Under the Deposit Takers Act" (March 2024), at p. 3.

557 Reserve Bank "Proportionality Framework For Developing Standards Under the Deposit Takers Act" (March 2024), at p. 5.

558 [ ]; [ ]; [ ].

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7.77 That said, in the final Proportionality Framework, the Reserve Bank also states there may be some cases were standards are not needed for certain deposit takers or groups of deposit takers (for example, due to their size and/or business model).[560] The Reserve Bank also states that in some instances, it may take a principles-based approach to applying a standard rather than a rule-based approach, or a combination of the two. The Reserve Bank's view is that principles-based regulations can support proportionate requirements as deposit takers can then design systems that are appropriate for the nature and scale of their business.[561]

7.78 The Reserve Bank has set out its anticipated timeline for consulting on, and creating, the prudential standards with which banks (and other deposit takers) must comply. The first consultation for core standards will be undertaken from May to June 2024. The first consultation for the remaining, non-core standards will be undertaken from July to August 2024.[562]

7.79 This process for creating the standards will involve assessing each of the existing prudential requirements for their consistency with the purpose and principles of the DT Act, and then effectively transferring prudential requirements over to the new regulatory framework as appropriate.

7.80 In future, the prudential standards will be the primary tool for imposing prudential requirements on deposit takers, and will replace the current banking handbook, conditions of registration, Orders in Council and NBDT regulations.[563]

7.81 The Reserve Bank has stated that principles such as competition will be taken into account when developing standards.[564] As such, in its future consultations on the prudential standards, we expect the Reserve Bank to articulate clearly how it has considered the purposes and each principle of the DT Act – including competition and proportionality – to apply to each standard.

7.82 It will be important for consumers that the Reserve Bank follows through on its intention to carefully consider competition (alongside other factors) when making decisions about standards.

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560 Reserve Bank "Proportionality Framework For Developing Standards Under the Deposit Takers Act" (March 2024), at p. 6.

561 Reserve Bank "Proportionality Framework For Developing Standards Under the Deposit Takers Act" (March 2024), at p. 7.

562 See: https://www.rbnz.govt.nz/regulation-and-supervision/depositor-compensation-scheme/regulatory-environment-under-the-dta. Core standards are capital, liquidity, disclosure and the Depositor Compensation Scheme. Non-core standards are outsourcing, lending – LVR and DTI, related party exposures, general restrictions, governance, risk management, operational risk and branches.

563 See: https://www.rbnz.govt.nz/regulation-and-supervision/depositor-compensation-scheme/regulatory-environment-under-the-dta

564 Reserve Bank "Proportionality Framework For Developing Standards Under the Deposit Takers Act" (March 2024), at p. 4.

Regulatory burden is affecting all providers' ability to compete, but particularly smaller providers | *Ka pā mai ngā pīkaunga ā-ture ki ngā kaituku ratonga katoa, inarā ngā kaituku iti me te āhei ki te whakataetae*

7.83 Aside from capital requirements, there is a very high overall regulatory burden on personal banking service providers (both banks and other providers). In this section, we discuss:

7.83.1 the high regulatory burden on providers, exacerbated by the fast pace and broad-ranging nature of regulatory change;

7.83.2 how this has adversely affected competition and continues to do so because it necessarily diverts providers' resources away from initiatives directed at growth and innovation; and

7.83.3 how the greatest impact is being experienced by smaller banks and the NBDTs, because of their lack of scale.

The overall regulatory burden in personal banking services is high

7.84 Any provider that wishes to offer personal banking services must comply with the relevant regulation and meet their regulatory requirements.

7.85 The regulatory requirements in personal banking are many and complex. They reflect many important policy objectives, including the need for financial stability and the need to protect consumers. While we understand policymakers' objectives, the high volume of regulation associated with personal banking, as well as the high pace of significant regulatory change are specific factors affecting entry and – especially – expansion of providers in personal banking.

7.86 The overall regulatory burden (both the amount of regulation and pace of change) is also said to be detracting from innovation. We have heard that the cost of regulatory compliance consumes providers' physical (eg, IT), financial and human resources that may otherwise be available for spending on innovation and growth.[565] This is discussed further in Chapter 9.

7.87 Smaller providers are disproportionately affected by the overall regulatory burden, constraining their ability expand, innovate, grow, and ultimately compete harder against the major banks.

7.88 The Minister of Commerce and Consumer Affairs has announced an intention to review aspects of the regulatory regime for the financial sector. This provides an opportunity to ensure that any requirements on providers are as streamlined as possible and that competition is not unduly restricted. This would increase resource efficiency, assist productivity and lead to pro-competitive outcomes for all providers of personal banking services.

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565 [ ]; [ ]; [ ]; [ ]; [ ]; [ ]; [ ].

7.89 Where regulatory requirements can be proportionately tailored to the relative size, resources and/or risk of providers, this would especially assist smaller providers to compete more effectively with the major banks.

7.90 We have also observed some unintended consequences of some regulatory requirements, such changes to the CCCF Act and AML/CFT Act which have had the effect of deterring consumers from switching and therefore affecting competition. This is discussed further at Chapter 8.

7.91 In addition to the capital requirements mentioned in the previous section, there are other components of the regulatory regime that contribute to the overall regulatory burden and are affecting competition. These are:

7.91.1 Financial services licensing under the Financial Markets Conduct Act 2013 (FMC Act). Under this regime, providers need a licence from the FMA to provide certain services such as financial advice.

7.91.2 The new financial services licence that will be required under the Financial Markets (Conduct of Institutions) Amendment Act 2022 (CoFI Act) and administered by the FMA.[566]

7.91.3 The AML/CFT Act. That Act places obligations on a range of New Zealand organisations, including financial institutions, to detect and deter money laundering and terrorism financing.

7.91.4 Regulatory uncertainty created as result of the process of the DT Act coming into effect, including:

7.91.4.1 the Proportionality Framework and bringing deposit takers' current prudential requirements into the DT Act framework, discussed above; and

7.91.4.2 the establishment of funding arrangements for the new DCS, discussed in the next section.

566 The CoFI Act arose out of joint reviews by the Reserve Bank and the FMA into the conduct and culture of banks (and life insurers) in New Zealand in 2018 and 2019. These reforms are intended to address the issues identified in the reviews that banks and insurers were not putting in place systems and processes to ensure consumers were treated fairly. The new regime will fully come into effect on 31 March 2025. At that point, institutions subject to the CoFI Act, including personal banking service providers, will be required to obtain a market services licence and implement a fair conduct programme. Notably, CoFI has been applied to the NBDTs even though they were not subject to the investigation that the Reserve Bank and FMA were, and no NBDT conduct issues were identified.

7.91.5 For banks, open banking both in terms of the work being done by Payments NZ, and the development of the Customer Product and Data Bill (CPD Bill). To be able to use the standardised application programming interfaces (APIs) developed by Payments NZ, banks must meet minimum requirements.[567] The CPD Bill, if it goes ahead, will also add further burden on banks, although as discussed in Chapter 9 we see the CPD Bill as an important step towards open banking which will support increased competition. This is discussed further in Chapter 9.

7.91.6 The CCCF Act, for example, the costs to implement the prescriptive affordability and suitability requirements that were introduced in December 2021 as part of a significant reform to the CCCF Act and the costs to implement the subsequent amendments made to the CCCF Act to address the unintended consequences of the December 2021 changes, that were made in 2022 and 2023.[568]

7.91.7 In January 2024, the Government announced its intention to further reform the CCCF Act. We have heard that the constant changes to the CCCF Act, as well as the complexity of complying with the law, has placed a substantial cost burden on all providers of consumer credit (as explained in more detail below).

Specific regulatory challenges

7.92 Stakeholders have highlighted some specific regulatory challenges that contribute most significantly to the regulatory burden. In this section we discuss the relevant aspects of the CCCF Act and associated Regulations, proposed funding arrangements for the DCS under the DT Act, specific legislative provisions that advantage banks over other providers, and other areas of regulatory overlap.

CCCF Act

7.93 The CCCF Act and associated Regulations were commonly brought up by stakeholders as a good example of regulatory burden due to the prescriptive affordability and suitability assessment, the ongoing changes being made to the legislation (as described above), and the strict penalty regime (including the inability of lenders' directors and senior managers to obtain indemnities). While significant investment will be required by providers in order to meet consumer protection objectives of the regime (including the responsible lending principles), it is a question of degree. We consider that the regime overall has had unintended negative consequences for competition.

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567 Note that on 16 January 2024, the Commission received an application for authorisation by Payments NZ in connection with its APIs. See Chapter 9 for more information.

568 We acknowledge that there are other costs related to implementing CCCF Act obligations other than the prescriptive affordability and suitability requirements, however we are focusing on the costs associated with the prescriptive affordability and suitability requirements as stakeholders highlighted these costs to us.

7.94 Submitters told us that the CCCF Act and Regulations have restricted their ability to compete because:

7.94.1 the CCCF Act requirements to comply with the responsible lending principles are increasingly complex and costly. When a customer wants a home loan, ensuring compliance with the prescriptive affordability and suitability assessments in the Regulations consumes a large amount of bank staff time.[569] Smaller lenders appear to be disproportionately affected as their scale limits their ability to resource compliance with the CCCF Act;

7.94.2 particularly, NBDTs and non-bank lenders say the granular and intrusive nature of affordability and suitability requirements prohibit them from being able to provide timely and tailored support to customers, which is an important part of their offering.[570] We have also been told that CCCF Act requires lenders to take a “one size fits all” approach, regardless of the size of the loan or whether the lender has an existing relationship with the customer;[571]

7.94.3 each time the CCCF Act or associated Regulations and Responsible Lending Code have been amended, lenders have had to change their internal processes and systems. We heard that in one instance, costly changes to core technology were made in response to the December 2021 changes, but the subsequent July 2022 and May 2023 changes rendered those changes redundant – forcing the lender to go back to pen and paper processing of applications.[572] It appears that changes are being made faster than providers can keep up with;

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569 Westpac "Submission on Market study into personal banking services - Preliminary Issues paper" 7 September 2023), at para 1.7(c); ANZ "Submission on Market study into personal banking services - Preliminary Issues paper" (8 September 2023), at para 22.2(a)-(b); Kiwibank "Submission on Market study into personal banking services - Preliminary Issues paper" (8 September 2023), at Q3.

570 [ ].

571 NBDT "Cross submission on Market study into personal banking services - Preliminary Issues paper" (16 October 2023), at para 9; ASB "Submission on Market study into personal banking services - Preliminary Issues paper" (7 September 2023), at para 13.2; ANZ "Submission on Market study into personal banking services - Preliminary Issues paper" (7 September 2023), at para 152.11(b).

572 [ ].

7.94.4 some aspects of the penalties under the CCCF Act, and associated Regulations, mean that when lenders are interpreting their obligations, they are doing so conservatively to ensure compliance.[573] Under the CCCF Act, directors and senior managers may be personally liable for non-compliance with the CCCF Act obligations, with pecuniary penalties of up to $200,000 and/or court ordered damages and compensation. We understand that the consequences of even small initial and agreed variation disclosure breaches, as well as directors and senior management being unable to obtain indemnities for certain breaches of the Act (for example, through insurance) may be a driver of conservative business approaches which are arguably unduly costly;[574] and

7.94.5 an exemption (in regulation 4AH(3)) was introduced in May 2023 with the intention of making switching easier, providing an exception for lenders refinancing an existing home loan from the obligation to carry out a full affordability assessment on the borrower in accordance with the Regulations.[575] However, we heard that the conditions on the use of the refinancing exception means that lenders are generally unable to use it. For example, the loan must be refinanced for the same or lesser amount, and the new interest rate must be lower and/or the monthly repayments must be the same or lower. These conditions are very difficult to satisfy in a period of rising interest rates. As a result, the exception has had a limited impact on facilitating switching. Borrowers have ultimately continued to default to not switching and re-fixing with their existing home loan provider. This problem is discussed further in Chapter 8.

573 Heartland Bank "Submission on Market study into personal banking services - Preliminary Issues paper" (7 September 2023), at para 11(d)-(e).

574 NBDT "Cross submission on Market study into personal banking services - Preliminary Issues paper" (16 October 2023), at para 9(a).

575 New lenders are still required to comply with the responsible lending principle in section 9C(2)(a)(ii) of the CCCF Act and make reasonable inquiries to be satisfied that the borrower can make the loan payments without substantial hardship.

7.95 Major banks have provided us with levels of spend on CCCF Act compliance as a proportion of overall regulatory spend. Proportions have varied – for example, for one bank, the CCCF Act has contributed to 5% of overall regulatory spend over a seven-year period, however for others, the CCCF Act has contributed to over 20% of its regulatory spend over that same time period.[576]

7.96 Smaller banks and providers have been unable to provide us with levels of spend on CCCF Act compliance. We have been told that for smaller providers with fewer resource, delivery of regulatory change is not executed separately to business as usual (unlike large banks who can determine whether regulatory change should be delivered as business as usual or as a project, and if the latter, track the project through a separate budget with separate resource).[577] We also heard that for non-bank lenders and NBDTs, delivery of regulatory change may be done by staff who have other roles in the business.[578] The difficulty of estimating how much it costs in itself illustrates the amount of overall regulatory burden being imposed – including by the CCCF Act and Regulations – and that is being disproportionately faced by small providers.

7.97 Spending on compliance with the CCCF Act and Regulations is one example of a costly regulatory requirement, made worse by constant change, that may have had an impact on competition.

Depositor Compensation Scheme (DCS) funding arrangements

7.98 An issue that the NBDTs and smaller banks raised with us is the potential impact of the funding arrangements for the DCS, to be implemented under the DT Act.

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7.99 As mentioned, in Chapter 2, the DT Act introduces the DCS so depositors can have confidence in their deposits. In the event of a deposit-taker failure, depositors are eligible for compensation up to $100,000 per depositor, per institution. The DCS will be funded by levies on all licensed deposit takers. The Treasury's Statement of Funding Approach (SoFA) will set out the funding strategy for the DCS, including the overall size of the DCS fund. The DCS Levy Framework is being led by the Reserve Bank. The framework specifies the levy amount each deposit-taker will pay to build the DCS fund in line with the SoFA parameters.[579,580] The DCS is intended to come into effect in mid-2025.

7.100 From a competition perspective, the DCS has a cost for all providers which will be in addition to the already high regulatory burden faced. The cost of the DCS has the potential to fall disproportionately on smaller providers depending on how the levy is set, further burdening those providers. The Reserve Bank's first round of consultation on the Levy Framework closed in September 2023. This consultation set out three possible approaches to setting the levy, which had widely varying effects on smaller deposit takers: a flat rate, a risk-based approach (based on credit ratings), and a composite approach (based on a range of measures such as capital, asset quality, liquidity, business model and others).

7.101 The Reserve Bank announced on 11 March 2024 that its preferred option, on which it is now consulting, is that the levy is set based on a simplified risk-based composite approach.[581] Under the revised approach the levy would be set based on three risk indicators: capital, liquidity, and business model and management (proxied by profitability). The composite approach (as it was consulted on in 2023) had been favoured by large and medium sized deposit takers, whereas submissions from small deposit takers mostly favoured the flat rate approach.[582] Some small deposit takers cited proportionality or competitiveness reasons in support of that approach, for example, because the cost of a risk-based measure would drive operational costs up and reduce their ability to compete.[583]

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579 [ ].

580 Reserve Bank "Depositor Compensation Scheme Regulations Consultation Paper" (11 March 2024), at p. 8, available at: https://consultations.rbnz.govt.nz/dta-and-dcs/dcs-regulations/user_uploads/dcs-regulations-consultation-paper.pdf

581 Reserve Bank "Depositor Compensation Scheme Regulations Consultation Paper" (11 March 2024), at p. 8.

582 Reserve Bank "Depositor Compensation Scheme Regulations Consultation Paper" (11 March 2024), at p. 11.

583 Reserve Bank "Depositor Compensation Scheme Regulations Consultation Paper" (11 March 2024), at p. 11.

7.102 It remains to be seen precisely what the Reserve Bank's new formulation of the levy funding approach means for smaller deposit takers. From a competition perspective, however, it appears that smaller deposit takers may still be at a relative disadvantage under the latest composite risk-based approach. During our study, we heard:

7.102.1 Concerns expressed by the NBDTs (and to a lesser extent, the smaller banks) that the Reserve Bank's approach to how the levy for the DCS should be set do not take sufficient account of the effect that different approaches would have on competition.[584] We heard that that on the risk-based approach that the Reserve Bank consulted on in 2023, the DCS levy could represent up to 40% of an NBDT's profit, whereas that approach would represent up to only 2% of profit of the major banks.[585]

7.102.2 Small banks told us that although their preferred approach was the composite approach (as consulted on in 2023), they would still be disadvantaged due to the measures used to calculate that approach, which favour the major banks due to their scale.[586]

7.102.3 The NBDTs have told us that they are concerned about the Reserve Bank's interpretation of risk, rather than the systemic risk that the major banks carry due to their size.[587]

7.103 The Reserve Bank acknowledges that a risk-based approach is likely to result in, on average, smaller deposit takers having higher levies (as a proportion of their covered deposits) than larger deposit takers. We understand that the Reserve Bank's view is that smaller deposit takers bearing proportionality higher costs is appropriate because it is the smaller deposit takers that will benefit most from the DCS. This is because it will be easier for smaller, riskier providers (particularly NBDTs) to attract deposits following the introduction of the DCS as customers will have more confidence in them if their deposits are guaranteed up to $100,000. In turn, the Reserve Bank reasons that the NBDTs will not have to offer as high deposit interest rates to attract those deposits, and accordingly, there should be a net benefit to the NBDTs as a result of the DCS.

7.104 It is not clear the extent to which the Reserve Bank has considered the competition and proportionality principles (as part of the overall purpose and principles of the DT Act) to date when considering how the levy should be set. Imposing the greatest burden on those least able to bear that burden has the potential to sustain the two-tier oligopoly in personal banking rather than supporting smaller providers' ability to compete.

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587 [ ].

7.105 In addition, it is not clear to us the basis of the Reserve Bank's assessment about the costs and benefits of its proposed DCS levy funding approach on smaller deposit takers. We query the Reserve Bank's apparent view that under a risk-based approach, the smaller providers who are more heavily levied are likely to see a greater net benefit from the DCS. For example, in Australia, the ACCC recently concluded that there is a perception that large banks are perceived as safer even though all authorised deposit takers are covered by the same compensation scheme.[588] In addition, major bank failure is likely to lead to a greater risk of widespread failure and a disproportionately larger call on the scheme than the failure of a smaller deposit-taker. This would support a greater contribution to the scheme by major banks.

7.106 We encourage smaller deposit takers to consider how the latest proposed approach of the Reserve Bank to levy funding may affect their ability to compete, and to make submissions to the Reserve Bank about this. We expect the Reserve Bank to explicitly and transparently articulate how the competition and proportionality principles are being taken into account in making its decision given the role of NBDTs in the personal banking sector – particularly amongst smaller and regional communities – when it finalises its advice to the Minster about DCS funding. We also recommend that the Reserve Bank make clear the basis of its views around the costs and benefits of its proposed funding approach on smaller providers.

Other regulation that has advantaged banks over other types of providers

7.107 The NBDTs told us that there are certain pieces of legislation which require money to be held with a registered bank, consequently favouring banks.[589] We have been told, for example, that retention money in relation to a construction contract is required to be held at a registered bank.[590] This specific requirement has had a direct impact on one NBDT as a construction company previously happy to deposit its retention money with that NBDT no longer can.[591] Other examples of legislation that mandate the use of banks include:[592]

7.107.1 The AML/CFT Act: a reporting entity may conduct simplified customer due diligence if it meets 18(1)(a-c) with a registered bank. It does not include NBDTs;[593]

7.107.2 The Companies Act 1993: a liquidator must deposit money of a company under his or her administrated at a registered bank;[594]

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588 ACCC "Retail Deposits Inquiry" (December 2023), at p. 45.

589 [ ].

590 Section 18E, Construction Contracts (Retention Money) Amendment Act 2023.

591 [ ].

592 [ ].

593 Section 18, AML/CFT Act.

594 Section 256A, Companies Act 1993

7.107.3 The Education and Training Act 2020: a Vice Chancellors Committee may establish, maintain, and operate bank accounts at a registered bank;[595] and

7.107.4 The Biosecurity Act 1993, Burial and Cremation Act 1964, Business Payment Practices Regulation 2023, Chartered Professional Engineers of New Zealand Act 2002, Construction Contracts Act 2002, Gambling Act 2003, Infrastructure Funding and Financing Act 2020, Lawyers and Conveyancers Act 2006, Māori Television Service (Te Aratuku Whakaata Irirangi Māori) Act 2003, Masterton Trust Lands Act 2003, Maungaharuru-Tangitū Hapū Claims Settlement Act 2014, Pork Industry Board Act 1997; Prisoners' and Victims' Claims Act 2005; Public Finance Act 1989, and the Registered Architects Act 2005 all contain provisions reflecting a legislative preference for registered banks.

7.108 Additionally, while the Crown Entities Act 2004 specifies that a Crown entity's money can be paid into an account with a registered bank or registered building society (registered building societies are NBDTs), the Crown Entities (Financial Powers) Regulations 2005 sets out that the registered bank or building society must have a certain credit rating, generally only obtainable by a major bank due to their size and levels of capital held. [596,597,598]

7.109 All small bank and non-bank submitters also drew our attention to areas in which regulatory changes (either access to, or exemptions from, certain regimes) made in response to the COVID-19 pandemic and recent extreme weather events were applied to the major banks, but not other providers, such that competition – particularly the ability of smaller providers to expand – appears to have been negatively affected.

595 Schedule 12, Education and Training Act 2020.

596 Section 158, Crown Entities Act 2004.

597 Regulation 7, Crown Entities (Financial Powers) Regulations. Credit ratings must be A-/A-1 or higher (Standard & Poors Ratings Group) or A3/Prime 1 or higher (Moody's Investors Service, Inc). Only registered banks are able to meet these credit ratings.

598 [ ].

7.110 The examples provided were:

7.110.1 In relation to the CCCF Act, in March 2020, the Credit Contracts and Consumer Finance (Exemptions for COVID-19) Amendment Regulations 2020 were made and applied to registered banks. Under these regulations, registered banks were exempt from disclosure obligations and were permitted to waive the affordability assessment requirements of the CCCF Act for certain customers under certain circumstances. The same exemption from affordability obligations was not granted at the same time to NBDTs or non-bank lenders under the Credit Contracts and Consumer Finance (Exemptions for COVID-19) Amendment Regulations (No. 2), enacted in May 2020, which applied to non-bank lenders.[599]

7.110.2 Also during the COVID-19 pandemic, small banks and NBDTs were unable to access the Reserve Bank's FLP, that was introduced with the intention of lowering the cost of funding for banks and increasing lending by giving banks access to long-term funding at the OCR.[600]

7.110.3 A further exemption to undertaking the CCCF Act affordability assessment was made following the severe weather events of January/February 2023 (Upper North Island flooding and Cyclone Gabrielle), so that lenders could provide an up to $10,000 via an overdraft facility or extension of an existing home loan, to assist with replacing damaged household items. We have been told that restricting the exemption to this narrow product range meant that by default consumers went to their banks due to existing relationships, effectively limiting the benefit of the exemption to banks.[601]

7.111 We acknowledge that the changes above were made in emergency situations with the intention of effecting changes broadly and rapidly. But it is nevertheless important that when exemptions to regulation or access to certain regimes are considered as a policy measure, the competition effect of the exemption or regime on all providers is carefully considered. This is particularly important if the exemption would effectively improve the position of the major banks (whether because of their entity type, the nature of their products, or the fact they have more customers) who are already in a strong competitive position, even if this was not the intended outcome.

599 Financial Services Federation "Submission on Market study into personal banking services - Preliminary Issues paper" (7 September 2023), at p. 3, NBDT Joint Submission "Cross submission on Market study into personal banking services - Preliminary Issues paper" (5 October 2023), at p. 9-10.

600 Heartland Bank "Submission on Market study into personal banking services – Preliminary Issues paper" (7 September 2023), at para 11(f); Financial Services Federation "Submission on Market study into personal banking services – Preliminary Issues paper" (7 September 2023), at p. 5; NBDT Joint Submission "Cross submission on Market study into personal banking services – Preliminary Issues paper" (5 October 2023), at para 9(a).

601 Financial Services Federation "Submission on Market study into personal banking services - Preliminary Issues paper" (7 September 2023), at p. 3.

Overlaps in regulation and/or supervision

7.112 Submitters have pointed to overlaps in regulatory requirements or duplication in regulators' ambits. Unnecessary overlap in regulation creates inefficiencies and disproportionately impacts the smaller providers' resources which are already limited. Examples we have heard about include:

7.112.1 Banks must be registered as a bank with the Reserve Bank, licensed as a financial service provider with Ministry of Business, Innovation & Employment, Hīkina Whakatutuki and hold a financial advice provider licence with the FMA. Upcoming additional CoFI licensing requirements (with the FMA) and deposit takers' licence (with the Reserve Bank) will also be required;[602]

7.112.2 Annual reporting under the CCCF Act (administered by the Commission) and the FMC Act (administered by the FMA) both use the same database. We also understand that there is potential on occasion for the Commission and FMA to request information from banks on the same topic, albeit for different purposes, as part of business as usual (BAU) investigation activity, regulator stakeholder engagement and/or proactive monitoring;

7.112.3 The same or similar prudential information must be shared between the Reserve Bank and FMA;[603]

7.112.4 The same or similar cyber-reports and privacy incident reports must be made to the Reserve Bank, FMA and Privacy Commissioner; [604]

7.112.5 Same or similar reports on the impact of certain events (such as the COVID-19 pandemic and Cyclone Gabrielle) are required to be made to the Reserve Bank and FMA; [605] and

7.112.6 A provider who wishes to provide more than one product or service must obtain a different licence under the FMCA for each product they wish to provide.[606] For example, one provider may hold licences issued by the FMA for changing foreign currency, providing financial advice services, giving financial guarantees, issuing, or managing means of payment and managed investment schemes.

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7.113 There is a further potential area of overlap between the CCCF Act regime and CoFI in respect of banks and NBDTs (though there is no overlap for the majority of the consumer lenders, such as motor vehicle lenders, who are not subject to CoFI). This is because consumer credit contracts also fall within the new CoFI regime and lenders are subject to the CoFI obligation to treat consumers fairly.[607] There will also be an ongoing regulatory return requirement associated with the CoFI licence which has the potential to be duplicative with the annual return requirement under the CCCF Act.[608]

7.114 Regulators acknowledge that there is a degree of overlap in personal banking. CoFR, comprising MBIE, The Treasury, the Reserve Bank, the FMA and the Commission, has a work programme aimed at regulatory overlaps. CoFR has recognised that there are a number of areas of overlap between the Reserve Bank, FMA and Commission both in terms of remit overlaps (where different regulators oversee the same systems or regimes) and entity overlaps (where different regulators have oversight of the same financial institution but for different purposes).[609]

7.115 The recent announcement of the intention to review financial services regulations to simplify licensing requirements and remove areas of overlap and duplication by regulators also appears to have the potential to address some of the regulatory overlap that we have been told about and thereby reduce the regulatory burden on personal banking providers. In broad terms, the intention of the review is to move to a simplified model of a single prudential regulator (the Reserve Bank) and a single conduct regulator (the FMA) which would include the oversight of the CCCF Act transferring from the Commission to the FMA. [610]

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607 There is also a slight overlap in the information that will be required under the CCCF Act and CoFI regime. Under the CCCF Act annual return, lenders need to provide information including the number and value of consumer loans, the number and value of loan top-ups and the number of times exceptions in the Regulations have been relied upon. Under the CoFI application, lenders will have to provide information including number of consumers they advise for consumer loans.

608 FMA "Standards Conditions for financial institution licences" (November 2022), at p. 4, available at: https://www.fma.govt.nz/assets/Compliance/Standard-conditions-for-financial-institutions.pdf

609 Council of Financial Regulators "Regulatory effectiveness", available at: https://www.cofr.govt.nz/priority-themes/regulatory-effectiveness.html

610 Hon Andrew Bayly "Reducing barriers for financial services" (31 January 2024), available at: https://www.beehive.govt.nz/release/reducing-barriers-financial-services

Chapter 8 Consumer search and switching behaviour | *Te rangahau kaiwhakapeto me te panoni o te whanonga*

Summary of preliminary findings

- **There is a significant degree of customer inertia in personal banking**. Our survey found that customers have relatively low levels of confidence in their ability to access information in the market, assess that information to decide on a provider, and to act on that information by switching.
- **There are barriers for consumers in shopping around and in switching between providers. These barriers limit competition**. For transaction accounts, it is primarily the hassle factor associated with opening new accounts and re-organising the direction of salary and other regular payments. For home loan customers, there is a range of potential switching costs including the cost of instructing solicitors, bank fees to discharge a mortgage, the repayment of cash contributions, early repayment fees (if customers want to break a fixed-term home loan), and fees from mortgage advisors. Switching costs for savings accounts and term deposits are generally lower.
- **Compounding these barriers are two pieces of legislation** that create friction for customers seeking to switch home loan providers: (i) the AML/CFT Act, and (ii) the CCCF Act.
- **The industry-led switching service for transaction accounts is not working well.** None of the major banks actively recommend this Payments NZ service to their customers. Awareness and take-up of the switching service are low, and there are operational issues in practice such as inability to 'forward on'/redirect payments. Unlike other jurisdictions, such as the UK, no independent agency or body has the mandate to encourage, monitor or report on the performance of the switching service across the industry.
- **Smaller and newer providers face greater challenges with building customer bases.** Our survey found that the vast majority of people considered only the major banks and Kiwibank when taking out their home loan. Similarly, when prompted about which banks, they might consider in the future for their main banking provider, our survey found that nearly half (42%) of New Zealanders would only consider ANZ, ASB, BNZ, Westpac or Kiwibank.
- **Barriers to searching and switching reduces competitive pressure on the major banks.** These impediments to consumers switching exacerbate the difficulties faced by new entrants and smaller providers in expanding their operations organically and building their customer bases. This reduces the competitive pressure they can exert on the major banks in personal banking.

Introduction | *Whakatakinga*

8.1 When customers are well informed, engaged, and able to respond to the best offers in the market, suppliers are forced to compete on price and quality in order to win and retain customers. By contrast, if consumers are less engaged or there are significant barriers to shopping around and switching, competition is likely to suffer.

8.2 This chapter presents available evidence on the extent of customer engagement in personal banking services in New Zealand. It sets out the key barriers and impediments to shopping around or switching providers that are currently dampening competition.

8.3 In our assessment of engagement, we have considered a range of customer activities which drive competition between providers, including:

8.3.1 customers that switch to a new provider and close their old accounts (‘hard switching’);

8.3.2 customers that may open a new account with a new provider, while keeping their account with their old provider (‘soft switching’);

8.3.3 customers who actively negotiate with their existing provider for a better deal, for example by threatening to switch to another provider; and

8.3.4 customers who ‘multi-bank’ or ‘multi-home’ by having personal banking relationships with two or more providers, regardless of whether they have switched).

Customer inertia is a key feature of personal banking markets | *Ko te tūpuku kaiwhakapeto tētahi tino āhuatanga o ngā mākete pēke whaiaro*

8.4 We find that there is a significant degree of customer inertia in personal banking.[611] While some customers do shop around for the best deals, on average, a customer's existing banking relationship(s) is the strongest predictor of the provider they will choose in the future.[612,613,614]

8.5 Our consumer survey, undertaken by Verian, found that:[615]

8.5.1 the majority (62%) of personal banking customers neither switched nor considered switching over the last three years;[616]

8.5.2 around half of personal banking customers have never changed their main bank;[617]

8.5.3 only 15% of New Zealand adults have switched one or more personal banking products in the last three years.[618] If we also include customers who 'internally switched' by renegotiating a better deal with their existing provider, this number increases to 17%;[619]

8.5.4 23% of people considered switching at least one product in the last three years, but did not actually go through with it;[620]

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611 Inertia is the tendency of consumers to choose the same products or providers over time for reasons other than the fundamental attributes of those products or providers. It is a state of disengagement from making informed decisions which preferences their status quo or previous choice.

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615 These findings are consistent with the customer research undertaken by providers and internal documents provided to the Commission as part of this market study.

616 Verian "Personal banking services market study – Research report" (February 2024), at p. 31.

617 Verian "Personal banking services market study – Research report" (February 2024), at p. 31.

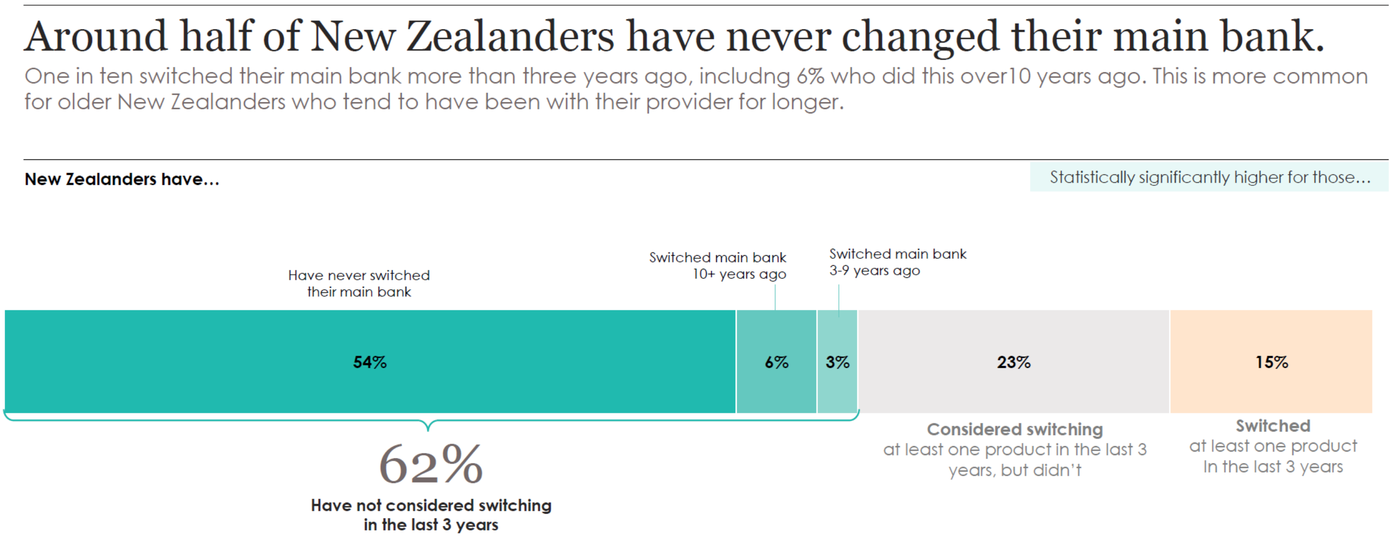
618 Verian "Personal banking services market study – Research report" (February 2024), at p. 31.

619 1.8% of New Zealand adults considered switching but didn't follow through because their provider offered a better deal. Information provided to the Commission by Verian, drawing on further analysis of survey data.

620 Verian "Personal banking services market study – Research report" (February 2024), at p. 31.

8.5.5 future switching intentions are also low - 11% of New Zealanders said they were likely to switch their main bank in the next 12 months.[621]

Figure 8.1 Customer inertia in New Zealand personal banking



Source: Verian.[622]

8.6 These survey findings are consistent with internal research undertaken by banks that we have reviewed during the study.[623]

8.7 Low levels of switching could partially reflect that many consumers are happy with the value they receive from their existing provider(s). However, it could also reflect a lack of willingness to consider alternatives or a lack of engagement. Internal bank documents often described customer decisions as 'inertia based'. For example, home lending customers were identified as making an 'automatic' decision to stick with their current provider, rather than on the basis of their product features or interest rates.[624,625]

621 Verian "Personal banking services market study – Research report" (February 2024), at p. 42.
622 Verian "Personal banking services market study – Research report" (February 2024), at p. 31.
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625 [ ].

8.8 There are a number of reasons why some customers do not shop around or actively engage in relation to their personal banking services, including:

8.8.1 the expectation that the time and effort in doing so will not be worth it;[626] and

8.8.2 relatedly, a perception that all the banks are broadly the same, offering the same products/services at more or less the same price.[627]

Engaged and non-engaged customers

8.9 Customers are most likely to review their personal banking needs and the suitability of their provider at key life moments or milestones that have implications for their income, or where a bank or another provider has a role to play. For example, starting a new job, new business, or university, buying a new home or vehicle, changes in family situation, unexpected loss of income and retirement.[628] Outside of these moments, customers may not have regular reasons to review their personal banking needs or provider.

8.10 More generally, there are two pools of customers (although a person can move between these pools over time):

8.10.1 engaged customers – who are willing and able to shop around and switch providers in order to obtain the best value from providers; and

8.10.2 non-engaged customers – these customers are 'sticky' in that they are unlikely to have switched or to consider switching providers in the future.

8.11 In Australia, the ACCC similarly has observed that a large proportion of retail deposit customers could be described as inert or non-engaged:

8.11.1 **In respect of retail deposits**: 'there is a high degree of consumer inertia when it comes to retail deposit products. In general, retail deposits customers are 'sticky', and the more established banks tend to retain a cohort of retail deposits customers who consider their bank to be their 'main financial institution' (MFI), and do not have a high propensity to switch'.[629]

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629 ACCC "Retail Deposits Inquiry Final Report" (December 2023), at p. 38, available at: https://www.accc.gov.au/system/files/Retail-deposits-inquiry-final-report.pdf.

8.11.2 **In respect of home loans:** 'there is widespread consumer inertia. Many existing residential mortgage borrowers do not regularly review their choice of lender.'[630]

8.12 Likewise, in the UK, the CMA, FCA, Social Market Foundation and Frontier Economics have presented reports describing a clear picture of these two groups of customers in banking markets: "switchers" and "non-switchers".[631]

Multi-banking is increasingly common

8.13 Multi-banking is common. Its use has increased over time as barriers have reduced, such as the move to zero fees on transaction accounts.

8.14 ANZ has submitted that approximately every second person has accounts with more than one bank.[632] Similarly, BNZ stated that customers frequently "multi-home" across a number of banks.[633] ASB and Westpac have made similar points. [634,635]

8.15 'Engaged' customers are more likely to multi-bank than non-engaged customers. Multi-bank customers are willing to move funds between existing or new accounts (either within the same provider, or between providers) to maximise interest returns on deposits or to take advantage of different product features.

8.16 Customers can multi-bank to achieve a range of outcomes such as: obtaining low interest rates on loans, or higher interest rates on deposits, to better managing their money and monitor spending; to create an extra sense of security, or to try out a smaller or new provider while still retaining their long-standing relationship with their main provider.[636]

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630 ACCC "Residential Mortgage Price Inquiry Final Report" (November 2018), at p. 66, available at: https://www.accc.gov.au/system/files/ACCC%20Residential%20mortgage%20price%20inquiry%20-%20Final%20report%20November%202018_1.pdf.

631 Pay.UK "Eight million switches: making changing bank accounts simple and stress-free", (October 2022), at p. 20-21, available at: https://newseventsinsights.wearepay.uk/media/pjna0pof/cass-banking-habits.pdf.

632 ANZ "Submission on Market study into personal banking services - Preliminary Issues paper" (7 September 2023), at para 112.

633 BNZ "Submission on Market study into personal banking services – Preliminary Issues paper" (7 September 2023), at para 2.23.

634 ASB "Response to the Commerce Commission's Preliminary Issues paper for the market study into personal banking services" (7 September 2023), at para 22.4.

635 Westpac "Response to the Preliminary Issues paper" (7 September 2023), at para 3.1 (c).

636 Pay.UK "Eight million switches: making changing bank accounts simple and stress-free", October 2022, Chapter 1: Research review, p 24, available at: https://newseventsinsights.wearepay.uk/media/pjna0pof/cass-banking-habits.pdf.

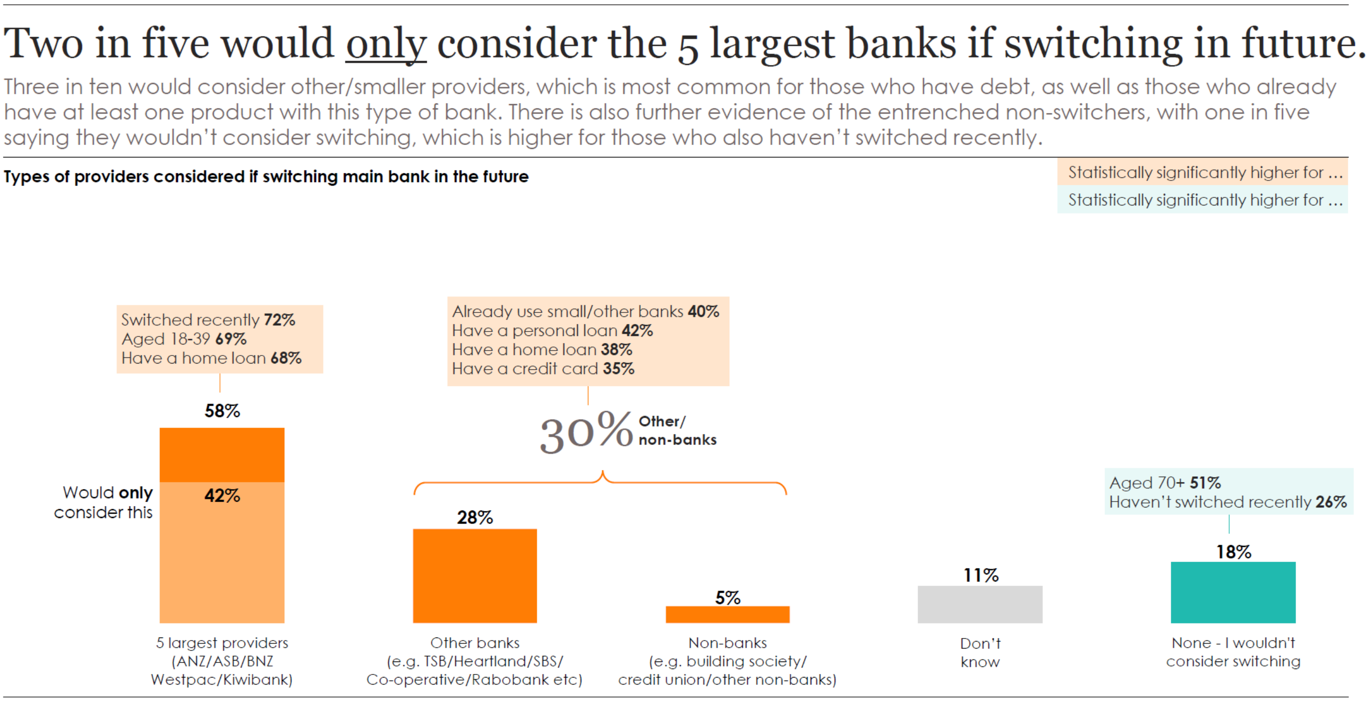
Smaller and newer providers face barriers to new customer acquisition | *Arā ngā tauārai ki ngā kaituku iti, kaituku hou hoki kia whiwhi kiritaki hou*

Many customers would only consider the largest five providers for their personal banking needs

8.17 Our survey found that the vast majority of people considered only the five largest banks when taking out their home loan. Only 17% considered other banks, of which the majority were already smaller bank users.[637]

8.18 Similarly, when prompted about which banks, they might consider in the future for their main banking provider, our survey found that 42% of people would only consider ANZ, ASB, BNZ, Westpac or Kiwibank (see Figure 8.2 below). A further 18% simply have no intention of switching.

Figure 8.2 Future switching intention by provider type



Source: Verian[638]

8.19 This leaves only a small minority of customers who would *consider* the smaller banks (28%, of which 40% are already customers of a small/other bank).[639]

637 Verian "Personal banking services market study – Research report" (February 2024), at p. 35.
638 Verian "Personal banking services market study – Research report" (February 2024), at p. 45.
639 [ ].

8.20 We understand that those most open to switching banks include those with fewer products (because it is less complicated to switch), and younger customers who tend to have less attachment to suppliers.[640] Younger customers are also most likely to have fewer products.[641] These customers reflect a long-term value proposition, but do not generate the highest value to banks in the present.

8.21 Taking the low rates of switching together with the large proportion of customers who would not consider smaller banks or non-bank providers, we find that the low customer engagement in personal banking constitutes an ongoing barrier to entry and expansion for small and newer providers. Consequently, this reduces the competitive pressure they can exert on the dominant players in the market.[642, 643]

8.22 This finding corresponds with what we've heard from smaller banks during this market study. For example, in their joint submission on the Preliminary Issues paper:[644]

> There are low levels of main bank switching in the market. Essentially, the larger and more established banks, which account for 85-90% of the market, enjoy the benefits of a large inert customer base that they have built up over many years making it harder for smaller and newer banks to attract customers.

8.23 We set out in Chapter 2 that this group of inert customers who have strong ties to their 'main bank' are particularly valuable because they provide more stable, lower cost funding and are likely to acquire a range of services from the bank (and go directly to their main bank when they have a new banking need).

8.24 Internal documents provided to the Commission by banks suggest that the extent of customer inertia varies across banking providers, with the largest banks having the greatest proportion of inert customers. [645,646]

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642 This was similarly observed by the CMA: see CMA "Retail Banking Market Investigation Final Report" (9 August 2016), at para 120 available at: https://assets.publishing.service.gov.uk/media/57ac9667e5274a0f6c00007a/retail-banking-market-investigation-full-final-report.pdf.

643 Moderate switching costs could also be conducive to entry, as they make incumbents less likely to react aggressively to new entry, and in cases where switching costs increase the profitability of markets, this can also encourage entry. See: NERA "Office of Fair Trading Economic Discussion Paper 5: Switching costs: Part one: Economic models and policy implications", (April 2003), at p. 2.

644 TSB, Co-op, Kiwibank, SBS (Joint Submission) "Submission on Market study into personal banking services –Preliminary Issues paper" (10 August 2023), at p. 3.

645 [ ].

646 [ ].

8.25 Consequently, new entrants and smaller banks are disproportionately vying for the engaged customer segment. By definition, this group is likely to be especially price sensitive and may be more likely to subsequently switch away if their provider does not continue to offer 'best in market' price and services.[647]

8.26 For example, there is evidence that home loan 'refinancers' are more likely to refinance again in the future and are price sensitive. [648,649] This affects smaller banks because these providers tend to obtain more new customers through refinancing than new home lending channels.[650]

There are some barriers preventing customers from making effective choices in personal banking services | *Tērā ētahi tauārai e aukati ana i te kiritaki ki te whakaoti whakatau tika mōna i roto i ngā ratonga pēke whaiaro*

8.27 There are barriers at each stage of the process of searching and switching:

8.27.1 search costs are high for some products, and are exacerbated by behavioural factors that limit customers' ability to engage with the market; and

8.27.2 switch costs can be high for some products, particularly home loans.

8.28 These barriers are reflected in our survey results, which found that customers have relatively low levels of confidence in their ability to access information in the market, assess that information to decide on a provider, and act on that information by actually switching (Figure 8.3 below).

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647 Kiwibank, The Co-operative Bank, TSB and SBS "Market Study into personal banking services – response to the Preliminary Issues paper dated 10 August 2023" (7 September 2023), at p. 4: "*the D-SIBs benefit from a much larger share of customer choice by being the default main bank for most of the market. This enables them to compete less than challengers on price or features and still gain a large market share while also gaining a large market share of new business*."

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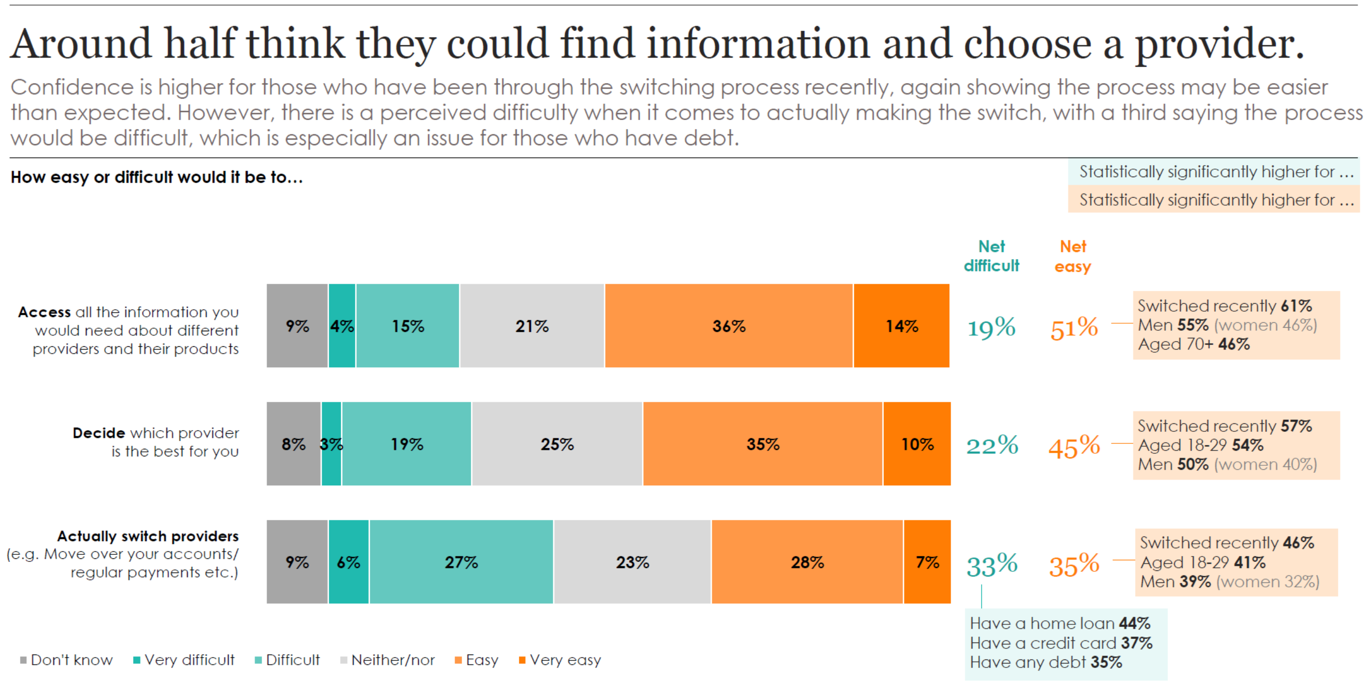
Figure 8.3 Confidence in shopping around and switching in personal banking markets



Source: Verian.[651]

Search costs are high for some banking products

8.29 For consumers to shop around effectively, there needs to be readily available information that is reliable and that covers all the relevant aspects of the banking providers and product(s) in question.

8.30 By "search costs" we mean how easy it is for consumers to access information about different providers, and the price and quality of the services they offer.[652]

8.31 Our survey found that:

8.31.1 19% reported it being difficult or very difficult to access information;

8.31.2 22% said it would be difficult or very difficult to decide which provider is best; and

8.31.3 33% said it would be difficult or very difficult to actually switch providers, increasing to 44% of those with a home loan.[653]

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651 Verian "Personal banking services market study – Research report" (February 2024), at p. 44.

652 Search costs may vary for different customers on the basis of the products/services they hold, and the relative importance placed on different features of those products and services.

653 Verian "Personal banking services market study – Research report" (February 2024), at p. 44.

8.32 There are several sources of information available to consumers that help to compare different banks and banking services, such as interest.co.nz, canstar.co.nz and sorted.org.nz. The banks submitted that these services allow consumers to easily compare rates, services, or returns on products.[654]

8.33 However, our survey found that only a minority of customers are using these services. We found that:[655]

8.33.1 for home loans, only 22% of those who switched or considered switching to another provider used an independent or other website for information;

8.33.2 for transaction accounts, this proportion is 18%;

8.33.3 for savings accounts – 23%; and

8.33.4 for term deposits – 44%.

8.34 The most commonly used sources of information on banking products are the bank websites themselves, with around 35-40% of customers seeking out information on a new provider's website.[656] It can be difficult for consumers to compare across multiple websites because it takes extra time and effort to visit multiple sites, and because there is no standardised way of presenting key terms and conditions to consumers to enable a 'like-for-like' comparison across banks.[657]

Search costs for particular personal banking products

8.35 In respect of home loans, search costs are significantly increased by opaque pricing / discretionary discounts and other "below the line" campaigns (such as cashbacks).[658] This means that a customer can only be certain of the terms and conditions of their deal with a particular provider (including interest rate and cashback offer) after going through a full application process. This results in much higher search costs overall, particularly if the customer wants to accurately compare multiple offers (requiring multiple application processes).

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654 BNZ "Submission on Market study into personal banking services – Preliminary Issues paper – Attachment A – Deloitte Report" (7 September 2023), at para 48.

655 Verian "Personal banking services market study – Research report" (February 2024), at p. 29.

656 Note that the survey allowed for multiple responses, so the different categories of information cannot be added together and may not add up to 100%. Verian "Personal banking services market study – Research report" (February 2024), at p. 29.

657 The ACCC also made this observation – ACCC "Retail deposits inquiry final report" (December 2023), at p. 124, available at: https://www.accc.gov.au/system/files/Retail-deposits-inquiry-final-report.pdf.

658 Once a home loan is drawn down a mortgage provider will pay an agreed amount to the borrower, usually a percentage of the initial home loan. Offers tend to range from 0.10% to 1.00% or be a fixed sum.

8.36 For transaction accounts, search costs primarily relate to making an assessment on aspects of service quality, noting that most providers offer transaction accounts that do not carry monthly account fees. Aspects of service quality include:[659]

8.36.1 quality of customer service;

8.36.2 the capability of digital channels such as mobile apps and internet banking;

8.36.3 other digital capabilities, technology, and innovation (including tools to support customers' budgeting and savings goals);

8.36.4 rewards such as Flybuys; and

8.36.5 perceptions of trust and security.

8.37 We have not identified any comprehensive tools that allow consumers to compare banks on their service quality. The most popular comparison websites (interest.co.nz, consumer.org.nz, sorted.org.nz, canstar.co.nz, and moneyhub.co.nz) focus on price but not service quality.[660] Canstar's website does include a 'most satisfied customers banking award' although, the criteria and survey results used to inform the judgement of this are not clearly set out.[661]

8.38 Because there is a lack of good information on service quality, consumers have to rely on doing their own research and word of mouth to effectively compare banks on the basis of service quality.

8.39 For **savings and term deposits**, search costs appear to be lower than for other products. Decisions about which provider to choose are more likely to be driven by interest rates, and this information is readily available on comparison websites and on banks' websites. Even so, there can be complexity in deciphering some aspects of these terms and conditions, including:

8.39.1 for **savings accounts -** the conditions for bonus interest rates, if any; and

8.39.2 for **term deposits** – whether interest is reinvested during the period, and whether interest is compounded monthly, quarterly, over a different term or at maturity. These features can make a significant difference to the overall interest associated with the deposit and their implications may not be immediately obvious.

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659 BNZ "submission on the Commerce Commission's Preliminary Issues paper regarding the market study into personal banking services" (7 September 2023), at para 2.8.

660 Interest.co.nz has a tool to compare *asset quality* by bank, which is related to trust and security (one aspect of quality) available at: https://www.interest.co.nz/saving/bank-financial-comparator.

661 Canstar "2023 Most Satisfied Customers Banking Award" available at: https://www.canstar.co.nz/star-rating-reports/msc-award-banking/#.

Switching costs can be high, deterring customers from acting on the best deals

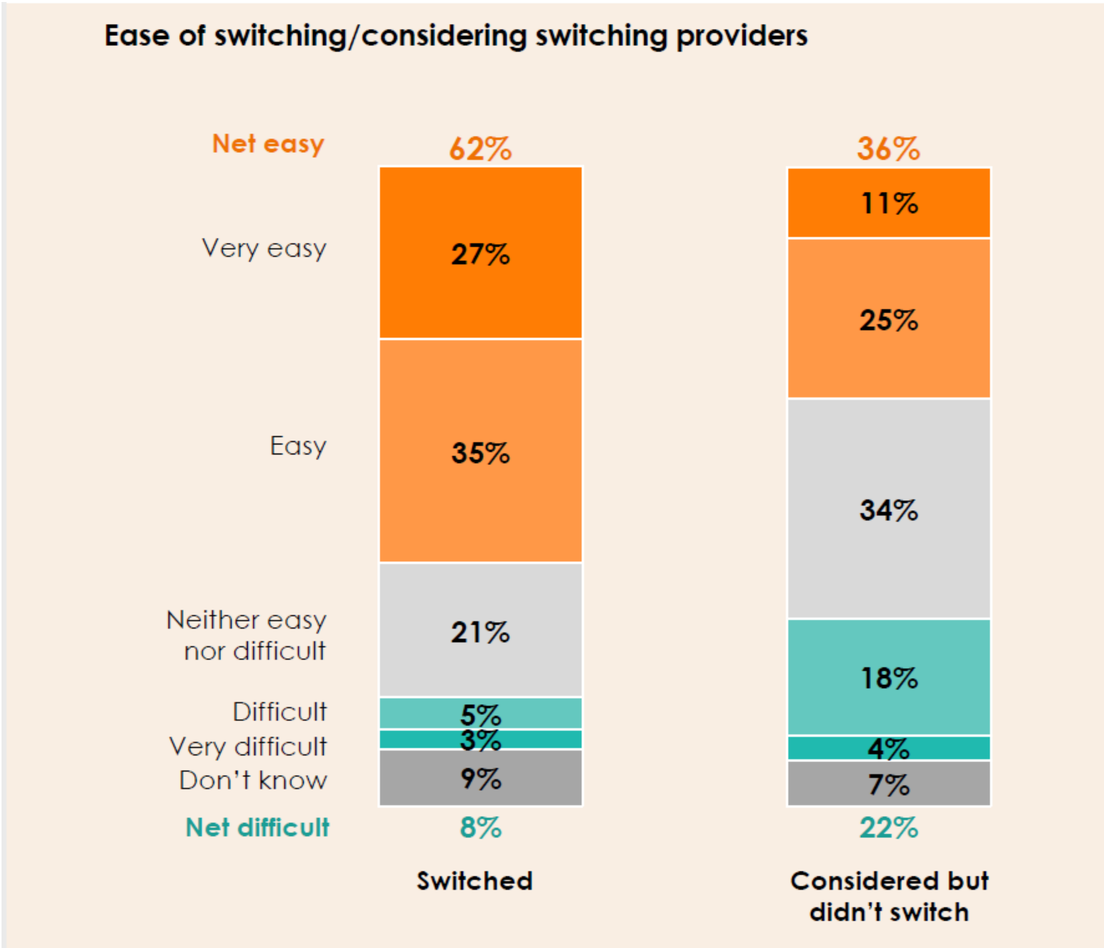
8.40 Switching costs are the real and/or perceived costs associated with changing a supplier (but which would not be incurred by remaining with the current supplier). Switching costs are difficult to quantify and will differ across customers and product types.

8.41 We heard from providers that switching is easy. For example, BNZ said that "BNZ's experience is that consumers can readily switch some or all of their banking between providers, and that switching between products / services (including switching between banks or switching to other non-bank competitors) is generally not complicated."[662]

8.42 Our survey found that 62% of customers who have actually switched provider in the last three years did report it to be easy or very easy. However, for those that only considered switching (but did not follow through) only 36% thought it would be easy or very easy to do so, as shown in Figure 8.4 below.

[662] BNZ "Submission on Market study into personal banking services – Preliminary Issues paper" (7 September 2023), at para 2.19.

Figure 8.4 Ease of switching / considering switching providers by those that (i) have switched and (ii) considered but didn't switch in the past three years



Source: Verian.[663]

8.43 These differences in survey responses across groups may reflect a combination of:

8.43.1 a 'perceptions gap' where the process is perceived to be more difficult than it is in practice, and/or

8.43.2 differences in the complexity of what was involved in the switch (eg the number/type of accounts/products).[664]

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663 Verian "Personal banking services market study – Research report" (February 2024), at p. 28.

664 [

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8.44 Behavioural theory suggests that the more consumers do something, the more familiar and confident they become, and the more likely they are to do it again. Once consumers have completed the process of switching, it lowers the perceived barrier to switching and they are more likely to switch again. Equally, a bad experience reinforces a reluctance to do it again. Suboptimal processes reinforce the status quo.

8.45 To the extent that there is a perceptions gap, competition in personal banking in New Zealand could be enhanced by ensuring that consumers have confidence in the switching process. We discuss this in more detail in Chapter 10.

8.46 In addition, we heard from many banks that aspects of the regulatory environment create friction for consumers seeking to switch, which we return to in detail later in this chapter.

8.47 We describe the key switching costs for home loans, transaction accounts and term deposit accounts below.

Switching costs for home loans

8.48 There are several potential switching costs in respect of home loan products, notably:

8.48.1 the cost of instructing solicitors to discharge their existing lender's mortgage and register a new mortgage. In addition, some lenders charge fees to discharge a mortgage or release other security;[665]

8.48.2 repayment of cash contribution, if the customer received a cash contribution and is leaving in advance of the specified commitment period;[666]

8.48.3 early repayment fees, if repaying a home loan during a fixed rate period.[667] In our focus on home loans, we found that a large proportion of home loan customers arrange their lending into 'tranches' to manage exposure to interest rate changes. One consequence of doing so is that a customer could face early repayment fees in respect of one or more tranches (although these are not always payable), or to face a long lead time to align these tranches to facilitate refinancing to another provider; and

8.48.4 fees from mortgage advisors if the refinancing activity triggers a commission clawback between provider and advisor. Commission clawbacks are discussed in more detail in Chapter 4.

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665 For example, ANZ's fee is $100, ANZ "Market study into personal banking services Preliminary Issues paper" (7 September 2023), at para 125; [ ].

666 ANZ "Market study into personal banking services Preliminary Issues paper" (7 September 2023), at para 127.

667 We understand that these fees compensate providers for the cost of hedging arrangements that were in place but are no longer required. See for example, ANZ "Market study into personal banking services Preliminary Issues paper" (7 September 2023), at para 126.

8.49 Sometimes these switching costs are reimbursed by a cash contribution from the new home loan provider.

8.50 Customers who have a home loan at a bank are required to also have a transaction account with their home loan provider. In addition, some banks have offered special home loan rates to customers on the condition that the customer's salary is direct credited to that transaction account.[668] Therefore, it is likely that some of the transaction account switching costs also apply when a customer switches their home loan, at least for some customers.

8.51 More generally, switching costs will tend to increase with the number of products a customer plans to switch across to a new provider.

Switching costs for term deposits

8.52 Actual and perceived switching costs for savings accounts and term deposits are generally low, which may partially reflect the more experienced nature of term deposit customers. [669,670] Qualitative research undertaken by Verian found that term deposits are the easiest to compare, and the switching process is seen to be straightforward.[671]

8.53 There are some considerations associated with switching a term deposit if a customer would like to 'break' a deposit before the fixed-term ends, such as requirements to give notice and pay break fees – reflective of the nature of term deposit products.

Switching costs for transaction accounts

8.54 For transaction accounts, switching costs primarily relate to the time and effort to fill out paperwork, cancel old accounts and open new accounts (the 'hassle factor'), and to notify employers or other regular payees.

8.55 We heard from many banks that switching is easy, and that all receiving banks offer support to new customers looking to switch their transaction accounts.[672] Many have dedicated teams that work with other banks to transfer funds, set up new payments and cancel old payments.[673] There is also an industry body (Payments NZ) which provides a switching service (discussed below).

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668 ANZ "Home loan rates, fees and agreements" available at: https://www.anz.co.nz/rates-fees-agreements/home-loans/.

669 Like transaction accounts, the main switching cost is the hassle factor associated with opening new accounts with new providers. This may include providing identification for AML requirements.

670 Based on Verian's observation that these customers are often 'quite financially experienced'. Verian "Personal banking services market study – Research report" (February 2024), at p. 53.

671 Verian "Personal banking services market study – Research report" (February 2024), at p. 49.

672 ANZ "Market study into personal banking services Preliminary Issues paper" (7 September 2023), at para 119, Appendix 1.

673 BNZ "Submission on Market study into personal banking services – Preliminary Issues paper" (7 September 2023), at para 2.20 (a) (ii).

8.56 Nonetheless, there are many perceived and actual switching costs associated with transaction accounts, eg:

8.56.1 the hassle factor associated with opening new accounts;[674]

8.56.2 customers may have concerns / lack confidence about whether direct payments will be transferred and the potential to incur additional fees if this does not occur smoothly, or to be left temporarily out of pocket if salary and other details are not updated correctly and in a timely manner;[675]

8.56.3 a customer will be required to manually update their payment card details in any service where their old card was on file.[676] This could include apps, websites, charitable donations, and shopping services.[677]

8.57 There may be material differences in perceived switching costs across customers. For example, in the UK the CMA found that customers with a higher number of transactions are less likely to both search and switch, suggesting that a more intensive use of one's personal current account may be associated with higher perceived costs of switching.[678]

There is limited uptake of the Payments NZ 'Easy Switch' service for transaction account switching

8.58 Customers generally have two options when seeking to move their transaction account(s) to a new provider, ie,:

8.58.1 they can 'do it yourself (DIY)' by opening new accounts with the new provider, manually move any reoccurring incoming and outgoing payments to their new provider (as required), and decide whether to keep their previous accounts open or not; or

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674 Verian "Personal banking services market study – Research report" (February 2024), at p. 43.

675 Verian "Personal banking services market study – Research report" (February 2024), at p. 43.

676 ANZ "Market study into personal banking services Preliminary Issues paper" (7 September 2023), at para 131, Appendix 1.

677 West Monroe "The State of Subscription Services Spending" (August 2021), at p. 3 and 8 at available at: https://www.westmonroe.com/perspectives/report/the-state-of-subscription-services-spending#:~:text=The%20average%20monthly%20spend%20on,how%20much%20they%20spend%20worsened.
For some consumers, the process of switching to a new everyday banking account and associated credit or debit card may also generate benefits, because it requires customers to review their ongoing payments. Many subscription service providers benefit from consumer inertia, which can result in continued subscription payments for services that customers may no longer value.

678 CMA "Searching and switching in retail banking: Economics working paper" (September 2018), at p. 12, available at: https://assets.publishing.service.gov.uk/media/5bc49dfe40f0b63873bce868/searching_and_switching_in_retail_banking.pdf.

8.58.2 the new provider can facilitate the switch for them through a free switching service (referred to here as the Easy Switch service). The new provider itself will arrange to move customers' recurring payments such as automatic payments and direct debits. Customers taking this option can complete a 'Switching Request Form' and present this to their new bank.

8.59 The Easy Switch service is supported by an industry-wide account switching arrangement established by Payments NZ, which sets industry standards and protocols for transferring accounts and reoccurring payment instructions from one bank to another. These protocols include:[679]

8.59.1 a timeframe of five business days to complete the switching process;

8.59.2 a standardised switching form and authority to re-establish customer payment instructions by the new bank'; and

8.59.3 a dedicated team at each bank for processing customer account switching requests.

8.60 Despite these industry arrangements, none of the major banks actively recommend the Payments NZ switching service to its customers.[680] Awareness and take-up of the service are low, and there are operational issues in practice: [681]

8.60.1 the service does not include arrangements to switch the customer's income payments with their employer, or to switch other direct credits such as payments from the Government;[682]

8.60.2 some companies that hold direct debit mandates do not confirm or make changes to their records for future payments, when requested by a bank on behalf of a customer – customers of these companies need to contact them directly to make the changes required;[683]

8.60.3 one provider told us that both frontline staff and consumers did not mention the service during recent branch visits;[684]

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679 Payments NZ "Switching banks" (on 5 March 2024) available at: https://www.paymentsnz.co.nz/resources/switching-banks/.

680 [ ].

681 [ ].

682 [ ].

683 [ ].

684 [ ].

8.60.4 although the switching service is advertised as taking five working days, in practice it can take-up to nine working days which can leave a customer in limbo for up to two weeks while payments are being shifted over;[685] and

8.60.5 there is no ability to forward on or 'redirect' payments from old to new accounts.

8.61 It appears there is a lack of information about how well the Payments NZ switching service is performing. For instance, there is no record of the number of consumers that use it each year, the average time it takes to execute a switch, the proportion of switches that are 'successful' in that they occur without raising any issues for customers, and whether there are differences across providers in terms of the timing and success. Payments NZ has no mandate or incentive to support or develop the switching service in New Zealand to ensure it is fit for purpose.

8.62 Overall, we find that in the current state the 'Easy Switch' service falls short of offering a meaningful contribution to the competitive process.

The sector lacks a 'switching champion' like in the UK

8.63 An effective switching service can stimulate competition in personal banking by making the process of switching providers quick and easy, thereby minimising any unnecessary barriers to switching.

8.64 For such a switching service to work effectively there are (at least) three essential elements:

8.64.1 awareness of the service;

8.64.2 confidence in the service; and

8.64.3 capability to deliver the service in a comprehensive and timely way.

8.65 New Zealand's industry-led arrangement sits in stark contrast with the United Kingdom's switching service - "Current Account Switching Service", or "CASS". CASS is overseen by Pay.UK. Pay.UK has a statutory mandate to encourage switching and produces annual reporting against CASS's key performance indicators (KPIs), including:[686]

8.65.1 awareness of the service (76% in 2022 against a KPI of 75%);

8.65.2 satisfaction with the service (91% in 2022 against a KPI of 90%); and

8.65.3 completion within a seven day period (99% in 2022 against a KPI of 99%).

685 [ ].

686 Pay.UK "Current Account Switch Service Annual Report 2022" at p. 5, available at: https://www.wearepay.uk/wp-content/uploads/2023/03/CASS-Annual-Report-2022.pdf.

8.66 Pay.UK delivers advertising campaigns designed to maximise awareness amongst consumers about how to switch, why to switch, and the guarantees of doing so through the service. It also holds an annual CASS strategy day with representatives from the banking sector to ensure that CASS remains representative of the marketplace and consumer markets.[687]

8.67 We consider that New Zealand's switching service could be improved through the adoption of a model similar to that in the UK, or at the very least, specific incentives being imposed on Payments NZ to improve its switching service and monitor its performance.

Payments NZ

8.68 Payments NZ is the governance body for the core payments system. It was established in 2010 by the banking industry. It is jointly owned by eight banks that contributed to the development of the payment system rules: ANZ, ASB, BNZ, Citibank, HSBC, Kiwibank, TSB and Westpac.[688] As we discuss in Chapter 9, Payments NZ has also established an API Centre that, to date, has been leading work on standards development for open banking.

8.69 Payments NZ acts as an industry association as well as payment system operator. Its core functions are to:[689]

8.69.1 develop and manage the rules and standards that govern the core payment clearing systems in New Zealand;

8.69.2 encourage and facilitate new participants to join the payment clearing systems;

8.69.3 facilitate the interoperability of payments between participants; and

8.69.4 promote interoperable, innovative, safe, open, and efficient payment systems.

8.70 Overseeing the switching process is not seen by Payments NZ as a core function, and is not mentioned in its forward work program, 'Payments Direction'.[690]

8.71 Payments NZ has no current mandate or incentive to support or develop the switching service in New Zealand to ensure it is fit for purpose. We understand that it does not have any requirement or incentive to track or report on awareness or satisfaction with the Easy Switch service, and it has not run any campaigns in relation to the switching service protocols.[691]

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687 Pay.UK "Current Account Switch Service Annual Report 2022" at p. 8, available at: https://www.wearepay.uk/wp-content/uploads/2023/03/CASS-Annual-Report-2022.pdf.

688 Payments NZ "About us" (as at 5 March 2024) available at: https://www.paymentsnz.co.nz/about-us/.

689 Payments NZ "About us" (as at 5 March 2024) available at: https://www.paymentsnz.co.nz/about-us/.

690 Payments NZ "Payments Direction" (as at 5 March 2024) available at: https://www.paymentsnz.co.nz/our-work/payments-direction/.

691 [ ].

Behavioural factors affect many consumers' ability to navigate personal banking

8.72 Faced with significant real or perceived search and/or switching costs, consumers may find it very difficult to navigate personal banking markets, in part because we have in-built behavioural responses that make it hard to be completely objective.

8.73 The most common and relevant behavioural biases for this market study are:[692]

8.73.1 status quo bias and loss aversion – these effectively involve consumers giving disproportionate weight to the benefits of their existing situation, which can exacerbate the real costs of switching providers and tend to result in customer stickiness;

8.73.2 present bias and hyperbolic discounting – which involve consumers giving disproportionate weight to the present, and insufficient weight to the future. In doing so, consumers may be expected to, for example, place large weighting on a cashback offer as part of a home loan deal with limited regard for the consequences of making a commitment not to switch providers for a certain period in exchange for the cashback deal, or to tend towards over-indebtedness; and

8.73.3 default bias, saliency bias and other forms of framing – these biases reflect certain shortcuts for simplifying decision-making which may involve adopting the 'default option', choosing a provider based on family and friends' recommendation or brand recognition, rather than on the value for money reflected in the personal banking offers.

8.74 Many of these biases (including status quo bias/loss aversion and default bias) increase customer stickiness and therefore favour the incumbent providers, ie, the major banks.

Regulation creates friction for customers seeking to switch home loan providers | *Ko tētahi hua o te ture ko te whakapōuaua i te āhei a te kiritaki ki whakawhitiwhiti kaituku moni tārewa ā-kāinga*

8.75 Banks identified two pieces of legislation that create friction for customers seeking to switch home loan providers:

8.75.1 the AML/CFT Act; and

8.75.2 the CCCF Act and associated Credit Contracts and Consumer Finance Regulations 2004 (Regulations).

692 Professor Amelia Fletcher, Centre for Competition Policy, University of East Anglia "The role of Demand Side Remedies in Driving Effective Competition: A review for Which?" (7 November 2016), at p. 17, available at: https://www.regulation.org.uk/library/2016-CCP-Demand_Side_Remedies.pdf.

Providing information to help providers meet their AML obligations can be time consuming and prohibitive for customers seeking to switch providers

8.76 The AML/CFT Act places obligations on New Zealand's financial institutions to detect and deter money laundering and terrorism financing. To carry out this purpose, the AML/CFT Act requires financial institutions to conduct a range of checks when onboarding new customers (such as opening a bank account with that institution for the first time), or when there is a material change in the business's relationship with the customer. These checks involve gathering information about a customer's identity, address and their source of funds and are known as "due diligence".

8.77 Due diligence requirements under the AML/CFT Act create impediments to switching, because of the customer identification and verification processes.[693] Put simply, they add to the overall hassle factor in signing up to a new banking service, which contributes to customer inertia.[694]

8.78 There are some regulatory processes recently implemented or are underway to address the overall burden caused by the AML/CFT Act. Some of these initiatives may ease the friction for customers seeking to switch personal banking providers.

8.79 The Ministry of Justice (MoJ) is currently undertaking a review of the AML/CFT Act and proposes to reduce address verification requirements by switching to a risk-based approach.[695] This would reduce some of the administrative burden for customers wishing to switch by reducing the amount of information that needs to be provided.

8.80 The Digital Identity Trust Services Framework Act 2023 (Digital Identity Act) aims to establish a legal framework for the use of digital identities and foster the growth of a digital identity network in New Zealand.[696]

8.81 The current proposed framework is an opt-in decentralised framework for the provision of safe, secure, and trusted digital identity services in New Zealand.[697]

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693 ANZ "Submission on Market study into personal banking services - Preliminary Issues paper" (7 September 2023), at para 22.2; ASB "Submission on Market study into personal banking services - Preliminary Issues paper" (7 September 2023), at para 22.7; BNZ "Submission on Market study into personal banking services - Preliminary Issues paper – Attachment A" (7 September 2023), at para 17.2.

694 [ ].

695 MoJ "AML/CFT 'Early' Regulatory Package: Exposure Draft" (February 2023), at p. 29, available at: https://www.justice.govt.nz/assets/Documents/Publications/Consultation-Document-AML-CFT-Early-Regulatory-Package-Exposure-Draft-February-2023.pdf.

696 Section 3, Digital Identity Services Trust Framework Act 2023.

697 New Zealand Government "Key concepts of the Trust Framework" (18 January 2022), available at: https://www.digital.govt.nz/digital-government/programmes-and-projects/digital-identity-programme/trust-framework/key-concepts/.

8.82 We understand that under the current proposed framework, an authority (to be established within Department of Internal Affairs, Te Tari Taiwhenua (DIA) and operating from 1 July 2024) will accredit digital identity services including potential credential providers such as RealMe (identity) and Waka Kotahi (drivers' licences). Users would then be able to provide a third party with their credentials – such as personal banking service providers.

8.83 This would allow customers to share their credentials (including identity) digitally, reducing the administrative burden on a customer to collate documents for providers' AML/CFT Act requirements, and enable customers to more easily satisfy AML/CFT Act requirements without physically visiting a branch.[698]

Unintended consequences of CCCF Act for switching

8.84 As discussed in Chapter 7, over the past decade numerous changes have been made to the CCCF Act and Regulations to improve consumer protection for vulnerable borrowers. However, some of these changes may have created barriers to customers switching home loans. The changes made to the CCCF Act in December 2021 added very prescriptive requirements for assessing the suitability and affordability of loans. This included investigating customers' discretionary spending and savings and investments when calculating their expenses.

8.85 Immediately after the December 2021 changes to the CCCF Act, some banks observed lower switching rates for home lending. It has been stated that this drop may have been because of an increase in the switching burden on customers caused by the new affordability rules, as well as the inability to pass those new affordability tests (eg, due to rising interest rates).[699]

8.86 In July 2022 and May 2023, the December 2021 prescriptive requirements were pulled back to an extent following an MBIE review concluding that they were resulting in a reduction in credit availability and overly intrusive questioning of borrower's personal expenditure.[700]

8.87 Banks have told us that, notwithstanding the July 2022 amendment, a widely-held and persisting consumer belief was created after the December 2021 changes that it is more difficult to obtain a home loan.[701]

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698 [ ].

699 ANZ "Submission on Market study into personal banking services – Preliminary Issues paper" (7 September 2023), at para 121, Appendix 1.

700 MBIE "Review of December 2021 credit law changes" (6 April 2023) available at: https://www.mbie.govt.nz/business-and-employment/consumer-protection/review-of-consumer-credit-law/review-of-december-2021-credit-law-changes/.

701 Westpac "Submission on Market study into personal banking services – Preliminary Issues paper" (7 September 2023), at para 1.7(c); ANZ "Submission on Market study into personal banking services – Preliminary Issues paper" (7 September 2023), at para 22.2(a)-(b); Kiwibank "Submission on Market study into personal banking services – Preliminary Issues paper" (7 September 2023); [ ]; [ ].

8.88 Submitting information about income and expenses to banks continues to be perceived as a challenging process for borrowers, although it is typically easier for a borrower if they are applying to their existing transactional bank because that bank will already hold some of the information required, and so may not have to conduct a full affordability assessment on the customer.[702]

8.89 Specifically, we have been told that when a customer is seeking to refinance to a new provider for a small service or interest rate benefit, there is a belief that they need to provide a large amount of information, with no leeway due to the prescriptive requirements of the CCCF Act.

8.90 We have also been told that publicity around the CCCF Act's prescription has reinforced the attitude among customers that the amount of information that is required to be provided is not worth the hassle of switching for an incremental benefit;[703]

8.91 In an environment with rising interest rates and costs of living, there may well be legitimate reasons why loan applicants do not meet an affordability assessment under the responsible lending principles of the CCCF Act. However, the reforms to the CCCF Act in 2021 may have unduly deterred some consumers from considering whether they should switch provider, and to this extent, there has been an unintended impact on competition.

Refinancing exemption to promote switching

8.92 In response to concerns about the 2021 CCCF Act amendments, in May 2023 a new regulation - Regulation 4AH(3) - was introduced to help facilitate switching and encourage competition in consumer credit markets. Regulation 4AH(3) creates an exception for new lenders from conducting a full affordability assessment under the CCCF Regulations when a borrower seeks to refinance or consolidate existing credit contract(s) (including home loans), subject to certain conditions being met.[704] Regulation 4AH(3) was introduced to mitigate one of the unintended consequences of the December 2021 amendments.[705]

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702 Kiwibank "Submission on Market study into personal banking services – Preliminary Issues paper" (7 September 2023), at p. 11-12.

703 [ ].

704 Where Regulation 4AH(3) applies, a new lender will still need to make reasonable inquiries to assess that the loan is affordable without substantial hardship under the general responsible lending principle under the CCCF Act (section 9C(3)(a)(ii)).

705 MBIE "Cabinet Paper - Impacts of Recent Changes to the Credit Contracts and Consider Finance Act 2003 – Findings and Options for Further Change" (2 August 2022), at para 70- 76, available at: https://www.mbie.govt.nz/dmsdocument/23283-regulatory-impact-statement-response-to-the-investigation-into-1-december-2021-credit-law-changes-proactiverelease-pdf.

8.93 However, we have heard that from a practical perspective Regulation 4AH(3) is not fit for purpose because the criteria for meeting the exception are drafted in a way that may unduly limit their usefulness when consumers are seeking to refinance with a new lender.[706]

8.93.1 The exception can only be used if the borrower's total credit limit does not increase,[707] and one or more of the following applies: the annual loan interest rate are lower than the existing loan(s) and/or monthly repayments are equal or lower on the existing loan(s);[708]

8.93.2 From a practical standpoint, lenders have told us that this means that Regulation 4AH(3) is not able to be used in the current rising interest rate environment, where annual loan interest rates and monthly repayments are typically increasing;[709]

8.93.3 Many customers will also want to increase their loan amount when they are refinancing. However, Regulation 4AH(3) can only be used if the borrower's credit limit does not increase. As such, lenders tell us that a large percentage of people cannot qualify for the streamlined process as it does not suit their financial needs.[710]

8.94 Lastly, lenders have told us that the penalties for breach of the CCCF Act and associated Regulations mean that they are interpreting the regulations relating to assessing affordability and suitability conservatively and this includes the application of Regulation 4AH(3).[711]

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706 ANZ "Submission on Market study into personal banking services – Preliminary Issues paper" (7 September 2023), at para 123, Appendix 1.

707 Unless the borrower is refinancing due to financial difficulty. Regulation 4AH(3)(a)(ii) allows an increase in credit limit only if, and to the extent, reasonably necessary to allow for the postponement or reduction of existing repayments to reduce financial difficulties that the borrower is experiencing or reasonably expects to experience.

708 Regulation 4AH, Credit Contracts and Consumer Finance Regulations 2004.

709 [ ]; [ ].

710 ANZ "Submission on Market study into personal banking services – Preliminary Issues paper" (7 September 2023), at para 121-123; [ ].

711 [ ].

8.95 A two-stage review of the CCCF Act is planned for 2024.As an initial change the Minister has announced an intention to disapply the prescriptive affordability regulations to lower risk lending. A second stage broader review of the CCCF Act is expected to look at disclosure obligations penalties amongst other things.[712] We consider that, as part of any review, changes can be made to the Regulation 4AH refinancing exemption, which would better achieve its pro-competitive objective, without compromising consumer protection.

Tying and bundling does not appear to be affecting competition | *Te āhua nei kāore he pānga mai o te paihere, te whakatōpū rānei ki te whakataetaetanga*

8.96 Tying and bundling can make it harder for consumers to switch individual products, potentially reducing competition. If the firm engaging in the tying or bundling strategy has market power, tying or bundling can also impede the ability of rival players to compete.

8.97 There is currently limited tying and bundling of personal banking services in New Zealand. Given tying and bundling is not a material feature of the market, it does not appear to be materially affecting consumers' ability to switch providers.

8.98 Services are 'tied' if the purchase of one service is conditional on also purchasing another service.[713] Bundling refers to the practice of selling two services together.[714]

8.99 In the past, tying and bundling of personal banking services by New Zealand banks was common – for example, offering customers package deals if they take out certain insurance policies together with their home loans. However, we found that there are few tied or bundled personal banking services in New Zealand at present.[715]

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712 MBIE "Proposals to review the Financial Markets (Conduct of Institutions) Amendment Act 2022 and the Credit Contracts and Consumer Finance Act 2003" (13 March 2024), available at: https://www.mbie.govt.nz/dmsdocument/28110-proposals-to-review-the-financial-markets-conduct-of-institutions-amendment-act-2022-and-the-credit-contracts-and-consumer-finance-act-2003-proactiverelease-pdf.

713 Jean Tirole "The Analysis of Tying Cases: A Primer" Competition Policy International (Spring 2005, Vol. 1, No. 1) at 8, available at: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=702641#:~:text=Jean%20Tirole,-University%20of%20Toulouse&text=This%20primer%20analyzes%20factors%20that,to%20total%20exclu sion%20of%20competitors.

714 Bundles can be 'pure', where the 2 services are only available together, or 'mixed' if the products are each available separately, as well as together in the bundle.

715 Some limited examples are observed in the combining of transaction and loan accounts, such as the requirement to have a transaction account with a home loan. [ ].

8.100 Following the conduct reviews undertaken by the FMA and Reserve Bank in 2018, banks have looked to simplify service offerings to customers including by removing the sale of bundled packages.[716] We have heard that banks' systems and controls are currently not suitable to reliably deliver tied or bundled packages to customers, and add operational risk to the banks.[717,718]

8.101 This simplification of banks' offerings following the conduct and culture review means that tying and bundling is no longer a prominent feature of the market.

Supply side factors are also relevant to an assessment of switching and engagement

8.102 Although this chapter focuses on the demand side of the market, the supply side is also relevant to a discussion on switching. Customers will only have the incentive to switch if suppliers are seen to offer them benefits from doing so, such as better interest rates, lower fees, better service, mobile applications, rewards of switching or innovative/new services offered.

8.103 However, qualitative research undertaken by Verian for the Commission found that customers often consider banks to be "*largely the same, with little to differentiate them, particularly the large banks*".[719] A lack of differentiation between providers - that is the perception that all the providers offer the same products with similar price/quality properties – can drive a lack of switching.

8.104 Our focus on home loans found that there are often benefits to shopping around, but that these benefits are not always clear. The hidden nature of discretionary discounts may be fuelling the perception that all banks are the same, and therefore a lack of switching.

716 [ ].
717 [ ].
718 [ ].
719 Verian "Personal banking services market study – Research report" (February 2024), at p. 49.

Chapter 9 Digital disruption and impediments to innovation | *Te tauwhatinga matihiko me ngā ārai ki te auahatanga*

Summary of preliminary findings

- **We have been surprised by the limited investment by the major banks and Kiwibank into core banking systems and the low prioritisation given to it**. Legacy systems constrain the ability of the major banks and Kiwibank, as well as fintechs, to innovate and compete. As a result, we have seen limited levels of innovation across the industry in personal banking services. Innovation has tended to occur “around the edges” of the customer experience rather than at the core of product and pricing structures.
- **We question whether the limited investment in core systems to date is explained by the need to keep pace with changing regulatory requirements.** Comparable change has also occurred in Australia, where there has been a higher level of innovation by the parents of the four large New Zealand banks. While we acknowledge the pace of regulatory change and the associated need for investment, fully depreciated core systems indicate sustained under-investment and, for the major banks, appear to indicate a lack of competitive pressure over an extended period.
- **Due in part to the disproportionate cost of regulatory change, smaller banks have faced comparatively higher constraints to innovate**. This enables the major banks’ service offering to stay ‘just ahead’ of smaller banks, countering the ability of the smaller banks to compete for main bank relationships.
- **We have not seen disruptive innovations observed overseas from fintechs** such as Revolut, Monzo, and Rocket Mortgage, as fintechs here face a range of impediments entering and expanding. Nor do we observe the sort of innovative responses seen in Australia by the parents of the major banks, for example with digital-only subsidiaries or “flanking brands” (like ubank by NAB and Unloan by CBA).
- **Impediments that fintechs face in entering or expanding in New Zealand limit the extent of competitive pressure they can exert on incumbent banks currently**. These impediments are a combination of structural, regulatory, and strategic in nature. Simply opening a business bank account, as well as an ongoing risk of being ‘de-banked’, are key risks that fintechs face.
- **Progress towards open banking has been too slow**. Open banking will help tip the scale for smaller challengers overseas and can be expected to boost innovation and competition for personal banking services. However, progress in New Zealand has been too slow, because the major banks have been left to set the nature and the pace of change. As a result, New Zealand is now falling behind the rest of the world. Progress towards open banking needs to be maintained and accelerated within a clear regulatory framework and with government-set deadlines.

Innovation is important for competition | *He mea whaitake te auahatanga mō te whakataetaetanga*

9.1 Workably competitive markets are characterised by levels of innovation that encourage firms to differentiate themselves, attract more customers and seek a competitive advantage over their rivals.

9.2 We have sought to assess levels of innovation in personal banking recognising that innovation is both a driver and an outcome of the competitive process.[720]

9.3 The terms of reference for this study require us to specifically consider any impediments to new or innovative banking products or services.

9.4 Overall, our preliminary view is that innovation is limited, reflecting the oligopolistic nature of competition between the major banks. Fintechs are an important potential source of more radical and disruptive innovation, but presently face a number of challenges entering and expanding. Open banking will increase competition and momentum towards it must be sustained.

The innovation we observe currently is incremental, and constrained by ageing core systems | *Ko te auahatanga e kitea ana he mea iti noa, he mea taparere hoki nā te kaumātuatanga o ngā pūnaha taketake*

9.5 The innovation we observe currently across the industry in personal banking is limited and occurring incrementally around the edges of the customer experience.

9.6 For the major banks and Kiwibank it is seen, for example, in simplification or streamlining of products, enhancements to cards and mobile app services, calculator tools, and digital onboarding processes.[721]

9.7 We have not seen disruptive innovations observed overseas from fintechs such as Revolut (in Europe), Monzo (in the UK), and Rocket Mortgage (in the USA), which have delivered new products, enhanced services, and low-cost digital personal banking services.

9.8 Although Revolut and other fintechs such as Dosh, Wise, and Squirrel have entered the market here, their potential to disrupt appears limited, as they face a range of impediments expanding. Nor do we observe the sort of innovative responses seen in Australia by the parents of the major banks, for example with digital-only subsidiaries or "flanking brands" (like ubank by NAB and Unloan by CBA).[722] Well-established innovations in Australia, such as offset accounts for home loan products, have not fully flowed through to New Zealand.

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720 OECD "Competition and innovation, a theoretical perspective" (2023), at p. 17, available at: https://www.oecd.org/daf/competition/competition-and-innovation-a-theoretical-perspective-2023.pdf.

721 [ ].

722 A flanking brand is a new brand introduced by an established provider, that can compete in a new category or customer group.

9.9 While incremental, many of the innovations of the major banks are aimed at maintaining main bank relationships and enabling them to stay ahead of the competition.

9.10 Due to their scale, smaller banks and non-banks face comparatively higher constraints on their ability to innovate, which is limiting their ability to compete with the major banks and Kiwibank for main bank relationships.

The major banks innovate enough to stay ahead, but significant investment in core systems is needed

9.11 A number of banks, including the major banks, Kiwibank, and some smaller banks have worked to simplify their product suites.[723]

9.12 In various ways, one of the key aims of those programmes has been to get back to core banking activities and to reduce business risk from more complex and legacy products and systems.

9.13 Simplification work stemmed from the joint Reserve Bank and FMA Culture & Conduct Review of retail banks in New Zealand,[724] which followed the review by the Australian Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry.[725]

9.14 Simplification efforts have, in part, helped the banks to position for digital transformation. Modern core systems, more capable of supporting and delivering digitised offerings, are needed for digital transformation. However, the major banks and Kiwibank still operate ageing core systems.

9.15 While the major banks and Kiwibank are planning or progressing transformation programmes, they have yet to complete core systems upgrades,[726] despite the resources available to them. Across the board there are ageing interconnected systems, many now fully depreciated.

723 BNZ "Submission on Market study into personal banking services - Preliminary Issues paper" (7 September 2023), at p. 38; Kiwibank "Submission on Market study into personal banking services - Preliminary Issues paper" (7 September 2023), at p. 16; ASB "Submission on Market study into personal banking services - Preliminary Issues paper" (7 September 2023), at para 10.7(f); [ ]; [ ].

724 FMA and Reserve Bank "Bank Conduct and Culture" (November 2018), available at: https://www.fma.govt.nz/assets/Reports/Bank-Conduct-and-Culture-Review.pdf. The review led to the introduction of the Financial Markets (Conduct of Institutions) Amendment Act 2022 (CoFI legislation). https://www.fma.govt.nz/business/legislation/conduct-of-financial-institutions-cofi-legislation/.

725 Australian Royal Commission "Misconduct in the Banking, Superannuation and Financial Services Industry - Final report" (1 February 2019) available at: https://www.royalcommission.gov.au/banking.

726 [ ]; [ ].

9.16 We have been surprised at the limited investment in core systems and the low prioritisation given to it. Fully depreciated systems indicate ongoing under-investment and an ability to 'sweat' legacy assets without fear of being competitively disadvantaged.

The lack of investment limits the banks and also constrains innovation and competition by others

9.17 Modern core banking systems would enable new innovation (as well as reducing operating costs and costs of regulatory change) and facilitate easier interoperability with third party systems.[727]

9.18 The major banks and Kiwibank have acknowledged the limitations of their legacy systems and the need to invest.[728] The major banks acknowledge that their legacy core systems can add additional time, cost, and complexity to work required for regulatory change and compliance.[729]

9.19 Aspects of the personal banking sector depend on interconnecting networks. Interoperability between industry participants is critical to doing this efficiently. Ageing core banking systems can therefore constrain, delay, or make more complex what are necessarily joint development efforts such as seven day payments,[730] standardised APIs, confirmation of payee, and real-time payments.[731]

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727 [ ];
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729 [ ]; [ ];
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730 Known as SBI365, 7-day payments was introduced in New Zealand on 26 May 2023. Payments NZ "Payments every day arrives in Aotearoa New Zealand" (22 May 2023) - available at: https://www.paymentsnz.co.nz/resources/articles/payments-every-day-arrives-in-aotearoa-new-zealand/.

731 New Zealand is one of 2 OECD countries without real-time payments. Payments NZ envisage that by 2030 consumers will be able to pay in real-time. Interest.co.nz "Ten NZ banks start offering 365-day a year electronic payments in 2023 but real-time payments still some way down the road" (15 June 2022) available at: https://www.interest.co.nz/personal-finance/116348/ten-nz-banks-start-offering-365-day-year-payments-2023-real-time-payments.

9.20 The interoperable nature of the sector means that one provider may not realise the full benefits of modernising their systems until other banks follow. Where one provider moves first (for example, BNZ has been an early adopter of APIs), that provider may not realise the full benefits of that investment until a critical mass of the other providers (particularly the major banks, with their extensive coverage) follow. This interdependence and delay also affects fintechs and other third party providers seeking to connect into the banks (and for whom coverage is important) or provide over-the-top services.[732]

The banks say that limited investment in core systems to date has been due to regulatory change, but we consider limited competition to be a contributing factor

9.21 The banks maintain that the limited investment in core systems to date is largely due to the need to keep pace with changing regulatory requirements.

9.22 They highlight the need to balance growth and innovation with regulatory change and compliance-driven work, with priority always given to the delivery of regulatory and compliance activity.[733]

9.23 While there has been significant and ongoing regulatory change, and an increase in regulatory spend,[734] for the major banks:

9.23.1 there have been similarly changing regulatory demands in Australia where their parent banks are based;

9.23.2 shareholder returns over the period have been consistently high; the availability of funding is not a constraining factor. The major banks have been able to maintain shareholder returns, keep pace with regulatory change, and innovate enough to keep up with one another; and

9.23.3 due to their size and scale, the major banks are the best placed, and have the greatest resources, to manage the demands of regulatory change while also upgrading core systems – and have not yet done so.

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732 In this context, over-the-top services refers to a service that is provided on top of an existing relationship that a customer has with their bank, often using APIs that enable a third party to perform actions on behalf of the customer. We understand that ageing systems limit the functionality that fintechs can tap into with regard to the products and services they can offer consumers, with respect to functionality and performance capacity. [ ].

733 ASB "Submission on personal banking Market study – Preliminary Issues paper" (7 September 2023), at para 2.2; ANZ "Submission on personal banking Market study – Preliminary Issues paper" (7 September 2023), at para 26; [ ]; [ ].

734 [ ]; [ ]; [ ]; [ ].

9.24 Kiwibank is in a similar position to the major banks as regards its core systems. It has not had the capital backing to accelerate its transformation programme and, we were told, is often out-bid by the major banks when it comes to engaging consultants and contractors.[735]

9.25 Smaller banks have faced comparatively higher constraints to innovate, which they have characterised as 'running to stand still'. Chapter 7 finds that, due to their smaller scale, the overall regulatory burden disproportionately affects smaller banks.

9.26 Some smaller banks have told us that, for example, they have had to delay exploring options like adopting Apple Pay or Google Pay because they must prioritise spend on regulatory compliance.[736] Others have made a decision to provide only basic functionality on their mobile phone application pending further development.[737]

9.27 Despite significant and ongoing regulatory change, and an increase in regulatory spend for the major banks, we consider that limited competition is a contributing factor to the lack of investment in core systems and the lack of more extensive innovation in the industry.

Fintechs are a potential source of more radical, disruptive, innovation but face challenges in entering and expanding | *Ko ngā Fintech pea te ara e kaha ai te auahatanga tauwhati, heoi he uaua te whakauru me te whakawhānui*

9.28 Fintechs (or financial technology firms) are firms that use digital information and technology in providing innovative financial services.[738]

9.29 While some fintechs offer services that are complementary to banks (such as credit assessment), they also compete more directly with banks.

Fintechs have potential to innovate and disrupt the market

9.30 Fintechs are often described as 'digital native' firms, meaning their services are provided primarily over digital channels and from modern software and technology, contributing to lower cost and more personalised consumer experiences.

9.31 Further advantages can potentially flow from a fintech's more targeted (or 'narrow') service offer, where it may specialise in a specific service rather than the broad range of services provided by traditional banks.

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735 Kiwibank "Submission on Market study into personal banking services - Preliminary Issues paper" (7 September 2023) at Q29; TSB, Co-op, Kiwibank, SBS (Joint Submission) "Submission on Market study into personal banking services - Preliminary Issues paper" (7 September 2023), at p. 2-3.

736 [ ].

737 [ ].

738 While there are a broad range of fintechs offering a similarly broad range of services, we have generally focused on fintechs that seek to provide personal banking services. We have not closely considered digital currency providers, which can face similar, but also unique challenges in competition for personal banking services.

9.32 Internationally, we have seen fintechs emerge as a potential source of significant disruption in markets for personal banking services. In the UK, for example, digital challengers have been able to rapidly gain share in certain markets, even though they face scale challenges after a certain point.[739]

9.33 Examples of fintechs that have disrupted markets overseas include Revolut (in Europe), Monzo (in the UK) and Rocket Mortgages (in USA).[740] These disruptive fintechs have rapidly gained significant market share from incumbent providers, which can prompt a competitive response from the incumbent banks, catalysing innovation in financial services that can benefit many consumers.[741]

9.34 Currently, however, in New Zealand, fintechs are not yet seen as, and do not yet impose, a strong competitive constraint on banks.

Fintechs face a number of challenges entering and expanding

9.35 While there is an established fintech community in New Zealand we have been told that they face significant impediments to both entering and expanding in the personal banking sector, limiting their contribution to competition.[742]

9.36 While all firms can face structural, regulatory, and/or strategic challenges seeking to enter or expand, we have identified a range of impediments specific to fintechs seeking to provide personal banking services:

9.36.1 opening and maintaining a business bank account;

9.36.2 access to ESAS and agency banking arrangements;

9.36.3 cost and complexity of the regulatory environment;

9.36.4 adoption by customers;

9.36.5 access to capital and wholesale funding; and

9.36.6 access to data.

9.37 We expand on each of these impediments that fintechs face below.

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739 In the UK, fintech challengers rapidly gained 8% of the personal current and business current (personal and business deposit) accounts market. UK FCA "Strategic Review of Retail Banking Business Models – Final Report" (January 2022).

740 Disruption could also come from large tech firms such as Apple and Google, however prospects of entry have been speculative, for example, in Australia. ACCC "Retail deposits inquiry - Final report" (December 2023), at p. 43.

741 UK FCA "The potential competition impacts of Big Tech entry and expansion in retail financial services" (October 2022), available at: https://www.fca.org.uk/publication/discussion/dp22-5.pdf.

742 Commerce Commission "Summary of views expressed - FinTechNZ/Commerce Commission workshop" (14 February 2024), at p. 4-7.

Opening and maintaining a business bank account

9.38 A key concern that fintechs raised with us is the difficulty in opening a business bank account with a bank.[743] For those who are successful in getting "banked" there is an ongoing risk that a bank may close a fintech's bank account (known as "de-banking"), which would have clearly detrimental consequences for the fintech's business.

9.39 As with most other businesses, a business bank account is a fundamental operating need. Aside from the typical use of a business banking transaction account, fintechs may seek agency banking services, which involves the on-selling or provision of banking services to an end-user.[744]

9.40 Only a limited number of banks in New Zealand can meet the banking needs of fintechs, particularly for agency banking services. This can increase the dependency that a fintech has on their bank and limit their ability to negotiate terms.[745] If a bank declines or de-banks a fintech, that fintech may not have another viable option it can approach.

9.41 There is a perception that banks have both the incentive and the opportunity to restrict fintechs' ability to compete with them, through limiting fintechs' access to business bank accounts, and some suggestion that this may occur from time to time.[746]

9.42 The internal bank processes and guidance we reviewed are appropriately competitively neutral and do not lend support to the perception,[747] although the reasons behind a bank's decision to decline a fintech's (or other customer's) application for services are not always made clear.

AML/CFT compliance risk is commonly identified as a reason for declining business bank account services

9.43 AML/CFT compliance risk is commonly identified as a reason, or the reason, for a cautious approach to providing services to fintechs.

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743 Commerce Commission "Summary of views expressed - FinTechNZ/Commerce Commission workshop" (14 February 2024), at p. 4; [ ]; [ ].

744 For example, agency services can include access to payments infrastructure such as ESAS or holding consumer deposits. [ ].

745 [ ]; [ ].

746 We have heard anecdotally that banks are asking fintechs whether they are in competition to, or complementary of, the banks' service. Commerce Commission "Summary of views expressed - FinTechNZ/Commerce Commission workshop" (14 February 2024), at p. 4; [ ].

747 [ ]; [ ]; [ ]; [ ]; [ ].

9.44 Under the AML/CFT Act, a fintech needs to develop a risk-based AML/CFT programme, conduct customer due diligence (CDD), conduct audits, and submit annual reports, and report suspicious activity to the New Zealand Police Financial Intelligence Unit.

9.45 When a bank onboards a fintech it also accepts the compliance risk of the fintech not meeting AML/CFT requirements. Therefore banks can be concerned about the compliance, credit, and reputational risk of providing bank account services to a fintech.[748]

9.46 Due to the nature of their business, fintechs are almost always considered high-risk entities under the AML, and therefore the bank must undertake ECDD of the fintech.[749] Enhanced due diligence requires more processes and assurances that fintechs need to provide. It also requires banks to conduct ongoing monitoring and assessments of its customers.

9.47 We heard criticism from various parties that the rapid implementation of AML/CFT in New Zealand has resulted in 'blunt' requirements, which can unnecessarily shift cost to industry and that clear guidance on how banks and fintech can meet requirements is limited.[750]

9.48 The expectations that fintechs face can be different for each different bank, and expectations may not be transparent. Each bank interprets its requirements under AML to determine its own necessary checks and processes to undertake in considering providing services to a fintech. This creates challenges for fintechs seeking to 'shop around' or establish accounts at multiple banks.

9.49 We have also heard that banks may be uncomfortable providing clear direction to a fintech on how it can meet a banks expectation, as this may shift the legal burden and potentially responsibility onto banks.

9.50 Sometimes the overall cost of initial and ongoing due diligence can outweigh the commercial benefits to a bank of a fintech customer.[751]

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748 This can include risk that the fintech may breach international sanctions. [ ].

749 This can be a blanket categorisation for a diverse set of fintechs that can include providers of personal banking services, money remittance, and digital currency (eg cryptocurrency) service providers. Each firm can present a different AML/CFT risk to a bank. In this section we are concerned with fintechs that are not seeking to provide a digital currency service.

750 [ ]; [ ].

751 [ ].

9.51 We have heard that banks may prefer not to provide reasons for declining services to avoid reputational risks that can flow from fintech reliance of the reasoning, and case law supports banks right to decline service without needing to provide reasoning.[752] There are also circumstances in which the AML/CFT regime restricts a bank from providing a reason for 'de-banking' or declining to provide further services if that could disclose information relating to a suspicious activity report.[753]

9.52 Some banks are more active and receptive to onboarding fintechs, while other banks appear to have engaged less.[754] This can significantly increase the bargaining position of the bank when a fintech has only one or two prospective banks it can approach for services.

9.53 In its review of the AML/CFT Act, the MoJ has recommended a licensing framework for high-risk sectors, where licensing would be undertaken by the AML/CFT supervisor or another appropriate body.[755]

9.54 This has the potential to:

9.54.1 provide fintechs with greater certainty of expectations for meeting AML/CFT requirements, by shifting assessments from individual banks, which each have potentially bespoke requirements, to a single agency. A single agency may also be more willing to provide guidance for fintechs;

9.54.2 reduce the perception that AML/CFT compliance risk might be being used as a reason for declining services to a competing business; and

9.54.3 having been licensed for AML/CFT, make it easier for fintechs to 'shop around' for business banking services.

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752 [ ].

753 AML/CFT Act section 94; [ ].

754 We have heard that some banks are much better than others at working with a fintech to support an onboarding request. [ ].

755 MoJ "Report on the review of the Anti-Money Laundering and Countering Financing of Terrorism Act 2009" (July 2022), recommendation #92, available at: https://www.justice.govt.nz/assets/AMLCFT-Statutory-Review-Final-Report.pdf; [ ].

Access to ESAS and agency banking

9.55 ESAS is the system used for processing and settling payments between banks and other financial institutions in New Zealand. It is a key input into the provision of personal banking services through its function as a settlement system (enabling payments between banks),[756] and an account system (that pays interest at OCR on overnight balances).

9.56 Providers can either access ESAS directly through the Reserve Bank, or indirectly through a bank that has an ESAS account through what is known as an "agency banking" arrangement. Many providers of personal banking services do not have direct access to an ESAS account, and some instead connect to ESAS through 'agency banking'.

9.57 Currently, only a limited number of industry parties have direct access to ESAS.[757] A lack of access, or indirect access (ie, through an agency banking arrangement) to ESAS is likely to be limiting some fintech's and other providers' ability to provide innovative services and compete more generally for personal banking services.[758]

9.58 Agency banking arrangements can create dependency of smaller banks and non-banks on the large incumbents (with which they compete). This can also provide major banks with an inside view of their competitors' business.[759]

9.59 Currently the Reserve Bank only grants direct ESAS access to financial institutions that "meet requirements regarding the soundness and efficiency of the financial system, that have legitimate business interest, and demonstrate a lack of reputation risks to the Reserve Bank".[760]

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756 Access to ESAS is also a key requirement for participation in Payments NZ's clearing systems, including BECS, HVCS, and CECS. Payments NZ submission "ESAS Access Review: Risk Assessment Framework for ESAS" (27 July 2023), at p. 2. Available at: https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/consultations/esas/esas-access-review-consultation-submissions.pdf.

757 [ ].

758 Commission "Summary of views expressed - FinTechNZ/Commerce Commission workshop" (14 February 2024), at p. 6; [ ]; [ ].

759 For example, agent banks having visibility of firms' payment flows through this arrangement. Reserve Bank "Summary of Submissions and Next Steps on the ESAS Access Review (Risk Assessment Framework) Consultation Paper" (October 2023), at p. 4, available at: https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/consultations/esas/esas-access-review-consultation-summary-of-submissions.pdf

760 Reserve Bank "ESAS Access Review: Risk Assessment Framework for ESAS – Consultation Paper (15 June 2023), at p. 9, available at: https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/consultations/esas/esas-risk-assessment-framework-consultation.pdf.

9.60 From 1 March 2023 regulation of ESAS transferred from under the Reserve Bank of New Zealand Act 1989 to the Financial Market Infrastructures Act 2021 (FMI Act). The Financial Market Infrastructures Act 2021 includes Access and Participation Requirements, which require the Reserve Bank as operator of ESAS to, amongst other things, ensure that access requirements are justified in terms of the safety and efficiency of the FMI and the markets that the FMI serves.[761]

9.61 The Reserve Bank is reviewing the current ESAS access policy and criteria, in light of the FMI Act, to contemplate allowing new participants to enter.[762]

9.62 In its review consultation document, the Reserve Bank identified what it saw as the potential benefits and risks of wider direct ESAS access. It notes that, while it is substantially concerned with understanding the relevant risks, wider direct access has the potential to remove firms' reliance on the agency arrangements with the incumbent banks, and that new firms may be able to offer a wider range of services.[763]

9.63 Submissions to the review have commented that the innovation and competition objectives of ESAS have not been met. The Reserve Bank have reported stakeholder concerns relating to agency arrangements, and that fewer ESAS members had led to there being less innovation and less competition in the New Zealand payments market.[764]

9.64 Our discussions with fintechs and others with an interest in ESAS indicate significant demand for ESAS access. While some fintechs have stated that direct access is not viable for a startup, other more established firms seeking direct access have noted that seeking access can take a very long time, while also expressing frustration with agency banking arrangements.[765]

9.65 We think there are likely to be benefits to both innovation and competition of allowing wider ESAS access – both in its use as an input into payment services, as well as an account that provides access to OCR returns (as described in Chapter 5). With the FMI Act in force, the Reserve Bank will need to consider the efficiency of the market for personal banking service, which ESAS serves.

9.66 In its consultation paper, the Reserve Bank noted potential risks of opening up access including credit and liquidity risks, legal enforceability risks, and operational risks. We question if these risks are already present in the system, indirectly under agency banking arrangements, but with less Reserve Bank visibility.

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761 Reserve Bank "FML Standard 1: Legal Basis" (1 March 2024), at p. 72. Available at: https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/regulation-and-supervision/financial-market-infrastructure-oversight/fmi-standards/fmi-standards.pdf.

762 Reserve Bank "Exchange Settlement Account System (ESAS) access review" (15 June 2023), available at: https://www.rbnz.govt.nz/have-your-say/2023/esas.

763 Reserve Bank "Exchange Settlement Account System (ESAS) access review" (15 June 2023), at p. 12-14.

764 Reserve Bank "Summary of Submissions and Next Steps on the ESAS Access Review (Risk Assessment Framework) Consultation Paper" (October 2023), at p. 3-4.

765 [ ].

Cost and complexity of regulatory environment

9.67 We have heard that the overall cost and complexity of regulatory compliance contributes to high fixed startup costs for fintechs which are often resource constrained during this phase of their business. We have also heard it can be difficult to innovate within a strict regulatory framework.

9.68 Other jurisdictions provide support for innovators though operating environments such as regulatory sandboxes,[766] or regulatory guidance through innovation hubs,[767] that help fintechs test products or concepts and/or to become familiar with regulatory requirements.

9.69 The design of, in particular, regulatory sandboxes can be difficult to get right, and, in our view, what matters most is that fintechs are more likely to develop and provide additional competition in the market when regulators are actively supportive.

9.70 We therefore support the work of CoFR's Fintech Forum work, coordinated by the FMA.[768] [769]

9.71 The Fintech Forum operates in a similar way to an innovation hub and provides coordinated information and guidelines to help fintechs navigate New Zealand's financial regulatory system. It also helps identify elements of the system that may hinder fintechs' innovation, and it can provide input into appropriate operational and regulatory solutions.

Adoption by customers

9.72 As discussed in Chapter 8, personal banking is characterised by a significant degree of customer inertia and limited switching away from, in particular, the major banks. Internationally, it is common for challengers to struggle to gain significant market share from large incumbent banks.

9.73 Consumer willingness to consider switching to alternative providers is an important driver of competition, particularly for new organisations seeking to grow.

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766 A regulatory sandbox is a separate regulatory framework where there is some relaxation of the application of an existing regulatory framework that would otherwise apply to the business. There is close monitoring of the development of the product in sandbox testing. https://documents1.worldbank.org/curated/en/912001605241080935/pdf/Global-Experiences-from-Regulatory-Sandboxes.pdf.

767 An innovation hub operates within the existing regulatory framework and involves regulators providing the business informal guidance and knowledge. https://www.europarl.europa.eu/RegData/etudes/STUD/2020/652752/IPOL_STU(2020)652752_EN.pdf

768 New Zealand CoFR Fintech Forum. See https://fintech.govt.nz/.

769 We've heard positive feedback of FMAs support and guidance to support innovation. [ ].

Access to capital and wholesale funding

9.74 We have heard that fintechs are facing challenges accessing capital and wholesale funding necessary to launch a product or grow their business. Requirements for capital or wholesale funding depends on the fintechs' business model.

9.75 Some fintechs seeking to providing banking services have trouble meeting the minimum prudential capital requirements necessary to register as a bank (which include capital of $30m).[770]

9.76 We have heard that there is a lack of stepping stones towards banking licences in New Zealand to support growth and the pathway towards full bank registration. Stakeholders have pointed to overseas jurisdictions that offer alternative banking licences that better support growth and expansion, such as a small banking licence or digital banking licence.[771]

9.77 There are many non-bank fintech business models and, in general, they can struggle to secure capital or other wholesale funding.[772] This can be, in part, because the various challenges this chapter points to, which can increase the risk (or perception of risk) of a business failing.

Access to data

9.78 Fintechs seek access to customer banking data in order to develop new innovations and services, to provide services over-the-top of incumbent services, and to leverage valuable consumer data held by the incumbent banks.

9.79 Open banking would enable, among other things, access to customer banking data, but New Zealand does not yet have a developed open banking framework. Some fintechs (such as Akahu) are finding workarounds, which can include solutions that are suboptimal,[773] and appear to have gained limited consumer traction.

9.80 The following section describes the benefits of open banking for competition and innovation more broadly, and its development in New Zealand to date.

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770 Registering as a bank, among other things, allows a firm to refer to itself as a bank, and its services as banking services. The trust and credibility that comes with referring to services as 'banking services' is important for those fintechs seeking to compete with the major bank for traditional banking services. [ ]; [ ]; [ ].

771 [ ]; [ ].

772 Including access to funding for lending. Commission "Summary of views expressed - FinTechNZ/Commerce Commission workshop" (14 February 2024), at p. 7; [ ]; [ ].

773 Commerce Commission "Payments Between Bank Accounts - Request for Views (31 July 2023), at para 2.22.

Open banking will increase competition and progress towards it needs to be accelerated | *Mā te pēke tuwhera noa e nui ake te whakataetaetanga, ā, kia kaha te whakatere ake i tōna putanga mai*

9.81 Open banking refers to a system in which consumers can make payments and instruct their banks to share their financial data, such as account information and transaction data, with third party providers such as fintechs.[774] It has the potential to be an ongoing disruptor to competition in personal banking amongst both existing providers and through the entry of fintechs.

9.82 To date New Zealand has lagged other countries in developing open banking, and ongoing effort by both industry and government will be needed to ensure that the potential benefits to New Zealand businesses and consumers can be realised in a reasonable period of time.

Open banking drives competition and innovation

The potential benefits of open banking include products and services for consumers, from both existing providers and new entrants, which can:

9.82.1 facilitate consumers' ability to search and compare personal banking services. Third parties could, potentially, present offers from several providers simultaneously and use a consumer's data to compare (in, for example, a budgeting tool) how different products might best suit their needs;

9.82.2 leverage consumers data held by the incumbent banks. This can support digital challengers in overcoming the advantages of consumer data held with the incumbent providers; and

9.82.3 facilitate fintechs in providing over-the-top services (for example transaction services) that are not dependent on, or are less dependent on, also winning over main bank relationships. This reduces the link between where money is held and who provides transactions and other services, overcoming some of the switching inertia of consumers that prefer to have their funds with a bank.

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774 API Centre "Open banking implementation timeline set for largest banks" (30 May 2023), available at: https://www.apicentre.paymentsnz.co.nz/news/articles/open-banking-implementation-timeline-set-for-largest-banks/.

New Zealand lags other countries in developing open banking

9.83 There are four key minimum requirements for the successful establishment of open banking:[775]

9.83.1 **Standardised application programming interfaces (APIs).** In open banking, APIs specify the software interface requirements that enable systems to communicate to facilitate requests for, and the secure exchange of, data.[776]

9.83.2 **Partnering**. Banks entering into agreements with third parties for the use of APIs. This can include an accreditation framework or similar which ensures that third party providers are able to enter into agreements for the use of APIs.

9.83.3 **Participation**. Third party providers partnering with banks (which could include smaller and larger banks partnering with other banks) and developing products and services that leverage open banking APIs and customer banking data. Third parties will only participate under the right commercial settings.

9.83.4 **Confidence**. Consumers and banks need to trust that the ecosystem is operating safely and securely. This is particularly important as open banking requires consumers to be confident in authorising third parties to access and use their data, and confident using new products and services for the full benefits to be realised.

9.84 There are other important initiatives that will complement open banking, including a digital identity framework and an efficient and competitive payments system. Policy design and implementation work across these three critically important and complementary areas need to be aligned and progressed in parallel. It requires both coordination across government-led initiatives and the active and constructive involvement of industry.

9.85 Work to date on the development of open banking in New Zealand has been largely industry-led and payments-driven, although government has been progressively becoming more involved in ensuring progress is made.

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775 See for example Commerce Commission "Retail Payment System – Update on our Payments Between Bank Accounts work" (22 February 2024) at Annex A, available at: https://comcom.govt.nz/__data/assets/pdf_file/0017/344132/Retail-Payment-System-Update-on-our-Payments-Between-Bank-Accounts-work-22-February-2024.pdf. The minimum requirements are essentially the same as the requirements for a thriving API-enabled payments system, which is a specific aspect of open banking.

776 An API is a set of routines, protocols, and tools for building software applications. An API specifies how software components should interact.

9.86 Initial work began around 2017, motivated by moves toward open banking in Australia and the UK after the UK CMA required the major banks in the UK to facilitate data sharing and to adopt common and open API standards.[777]

9.87 The bank-owned industry body (Payments NZ) established an API Centre in May 2019 to develop and publish API standards and pave the way for banks and third parties to form partnerships to deliver open banking innovation.[778]

9.88 In December 2019, the then Minister of Commerce and Consumer Affairs published an open letter to API providers expressing concern at the slow pace of progress. That letter stated that the Minister had asked officials to work on the possibility of a consumer data right (CDR) to the development of New Zealand's digital economy.[779] MBIE has since published a discussion document on options for establishing CDR and a draft Bill.[780] The intention is that the first industry where CDR would apply is banking.

9.89 In May 2023, the API Centre published a Minimum Open Banking Implementation Plan setting out milestone delivery dates for payment initiation and account information APIs for participating banks.[781] This plan stipulates the delivery dates for new versions of the API standards as 30 May 2024 for ANZ, ASB, BNZ and Westpac and 30 May 2026 for Kiwibank.

9.90 On 16 January 2024, the Commission received an application for authorisation by Payments NZ to work with API providers and third parties to develop arrangements that, according to Payments NZ, will facilitate a more well-utilised, secure, and innovative open banking framework.[782]

9.91 The proposed partnering framework involves the joint development of:

9.91.1 an accreditation scheme (including accreditation criteria) for third parties; and

777 CMA "Retail banking market investigation" (August 2016); CMA "CMA paves the way for Open Banking revolution" (9 August 2016), available at: https://www.gov.uk/government/news/cma-paves-the-way-for-open-banking-revolution.

778 https://www.apicentre.paymentsnz.co.nz/about/.

779 Hon Kris Faafoi, Minister of Commerce and Consumer Affairs "Open letter to API Providers regarding industry progress on API-enabled data sharing and open banking" (December 2019) available at: https://www.mbie.govt.nz/assets/open-letter-to-api-providers-regarding-industry-progress-on-api-enabled-data-sharing-and-open-banking.pdf. A legislative CDR would allow consumers to request that their personal data, including product data, be shared securely with trusted third parties.

780 MBIE "Options for establishing a consumer data right in New Zealand – Discussion Document" (August 2020), available at: https://www.mbie.govt.nz/dmsdocument/11625-discussion-document-options-for-establishing-a-consumer-data-right-in-new-zealand.

781 API Centre "Minimum Open Banking Implementation Plan" (30 May 2023) available at: https://www.apicentre.paymentsnz.co.nz/standards/implementation/minimum-open-banking-implementation-plan/.

782 Commerce Commission case register "Payments NZ Limited", available at: https://comcom.govt.nz/case-register/case-register-entries/payments-nz-limited.

9.91.2 default standard terms and conditions on which API providers would contract with third parties who meet the accreditation criteria.[783]

9.92 At the time of publishing this draft report a determination on Payments NZ's authorisation application is due by 10 July 2024.

9.93 In the absence of completing work on agreed standards, banks are at different stages of API development and deployment. BNZ has built some APIs and partnered with some third parties, while other banks have indicated that they are not yet at that point.

9.94 Internationally, New Zealand lags other countries in progress toward open banking. For example, Australia, through its CDR legislation, has had partial open banking in operation since 2020, while open banking has been operational in the UK for five years.

9.95 The UK and Australia have taken different approaches to implementing open banking, particularly with respect to their 'breadth versus depth' scope. The Australian CDR is a broad cross-sector framework for data exchange but has been implemented with less core functionality than open banking in the UK (which is more narrowly focused on banking, but with both 'read' and 'write' functionality.)[784]

9.96 There are benefits to each approach. The depth of the UK approach has driven greater innovations and uptake, while the broad approach of Australia's CDR has greater potential for economy-wide benefits.[785]

A digital identity is critical for trust and confidence in open banking

9.97 The verification of a consumer's identity in a digital context will be fundamental to open banking.

9.98 The Digital Identity Act provides a legal framework to assist the development of trusted, people-centred digital identity services.[786]

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783 Payments NZ Limited "Authorisation application" (16 January 2024), available at: https://comcom.govt.nz/__data/assets/pdf_file/0026/340586/Payments-NZ-Limited-Authorisation-application-16-January-2024.pdf.

784 Read access is where a third party can only read and display consumer data, and write access is where a third party can change consumer data with the consumer's consent. At its introduction, the Australian CDR incorporates a 'read access' function, but not a 'write access' function (which is also referred to as 'action initiation').

785 NatWest "Lessons Learned from Australia and the United Kingdom The Consumer Data Right and Open Banking" (2023), available at: https://news.nab.com.au/wp-content/uploads/2023/02/NAB-and-NatWest-Open-Banking-Whitepaper-2023.pdf.

786 https://www.digital.govt.nz/digital-government/programmes-and-projects/digital-identity-programme/trust-framework/.

9.99 Holders of identity information, such as DIA (birth certificates, passports), Waka Kotahi New Zealand Transport Agency (drivers' licences), universities (qualifications), or banks (bank account numbers) will be able to issue digital credentials. The Digital Identity Act adds a regulatory framework for participating providers, enabling better trust and confidence in the service.

9.100 Users will then provide their credentials to third parties (known as "relying parties") who are the consumers of this identity information.[787]

9.101 This would allow, for example, an agency such as DIA to issue a digital identification and customers to share this identity digitally with a bank. There is the potential here for this to help address some of the pain points we have discussed with customer switching, such as the need to verify identification for AML/CFT requirements, sometimes multiple times, and the need for consumers to physically visit bank branches to open accounts.

9.102 DIA is engaging with MBIE, Payments NZ, and other industry players to ensure alignment between the Digital Identity Act and the API Centre work, a CDR and potential banking sector designation.

9.103 Participation in the scheme is voluntary and may not have sufficiently strong commercial incentives for individual banks to participate, as the benefit of the framework will be shared across the sector (and wider economy) rather than any given operator.[788]

Supporting a reliable and efficient payments system

9.104 We have heard a consistent theme that real-time payments are important for an efficient and competitive payments network and that the richer payments data that this would result in will be key to unlocking yet further innovation.[789]

9.105 Payments NZ, as part of its Next Generation payments work,[790] has plans to modernise the payments system in New Zealand. This may include, for example real-time payment capabilities, simple verification, payee identifiers, rich data, improved fraud solutions, greater payment choices and cross-border payment corridors.

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787 [ ].

788 [ ]; [ ].

789 Consumer NZ "Submission on Market study into personal banking services - Preliminary Issues paper" (7 September 2023), at p. 12; ASB "Submission on Market study into personal banking services - Preliminary Issues paper" (7 September 2023), at para 3.6;
[ ]; [ ];
[ ].

790 Payments NZ "Next generation payments", available at: https://www.paymentsnz.co.nz/our-work/next-generation-payments/. While decisions for specific plans are yet to be made, Payments NZ are working to the assumption that building blocks will need to be in place by 2030. Payments NZ "Payments Modernisation Plan" (September 2020), at p. 10. Available at: https://www.paymentsnz.co.nz/documents/309/Payments_NZ_Payments_Modernisation_Plan.pdf.

9.106 The Reserve Bank has set clear expectations that the private sector should lead this work alongside other expectations in a July 2023 letter.[791]

9.107 We understand that, related to its Next generation payments work, Payments NZ has initiated a governance review to consider, in part, whether the governance of the organisation is fit for its Next Generation work.[792] The Reserve Bank and the Commission have written to Payments NZ requesting to be engaged through this governance review.[793]

Accelerating progress is possible but will require government working with industry to create regulatory frameworks and set deadlines

9.108 A common feature of open banking in other countries is that widespread take-up has required government involvement. A key reason why a purely industry-led approach is unlikely to succeed is that open banking depends on banks to build APIs and partner with fintechs, who in some cases will be competing to take some of their business. Strong network effects also mean that if a single major bank were to delay development or implementation, the benefits of open banking to customers (and fintech providers) diminish considerably.

9.109 The Commission has a role in promoting competition and efficiency within the retail payments system. We recently issued an open letter to participants in the retail payments system noting that while there is currently good momentum in developing APIs to support open payments, progress has tended to stall in the past.[794] We see the same risk in open banking more generally, given the mixed incentives banks have in this area.

9.110 Accordingly, we signalled in our open letter that we intend to consult on whether the interbank payments network should be designated under the Retail Payments Systems Act 2022, allowing us the ability to set rules and standards for the network. If progressed, the designation would act as a regulatory backstop, reducing the ability for industry to continue to delay the implementation of APIs for payments.

Payments NZ governance and oversight of the API Centre

9.111 Standards work on APIs to date has, as we have noted, been led by Payments NZ's API Centre. Stakeholders have expressed concerns with the incentives and governance of Payments NZ and the API Centre.

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791 Reserve Bank letter to Payments NZ "Reserve Bank position on Aotearoa New Zealand's need for real-time payment capability" (10 July 2023), available at: https://www. .govt.nz/-/media/project/sites/rbnz/files/publications/information-releases/2023/letter-to-payments-nz-on-nzs-need-for-real-time-payments-10-july-2023.pdf

792 [ ].

793 Reserve Bank letter to Payments NZ "Reserve Bank position on Aotearoa New Zealand's need for real-time payment capability" (10 July 2023); Commerce Commission "Retail Payment System – Update on our Payments Between Bank Accounts work" (22 February 2024), expectation 4.

794 Commerce Commission "Retail Payment System – Update on our Payments Between Bank Accounts work" (22 February 2024).

9.112 As noted in Chapter 8, Payments NZ is the governance body for the core payments system. It was established in 2010 by the banking industry. It is jointly owned by eight banks that contribute to the development of the payment system rules: ANZ, ASB, BNZ, Citibank, HSBC, Kiwibank, TSB and Westpac.[795]

9.113 The Board of Payments NZ is comprised of 11 directors, which includes a director appointed by each of its shareholder organisations (the eight banks), and three independent directors (including the Chair).

9.114 While an API Council is delegated authority by the Board for day-to-day operations and other responsibilities, the Payments NZ Board oversees the functions of the API Centre.[796]

9.115 Despite some separation, the API Centre is ultimately overseen by the Board of Payments NZ. There is, in our preliminary view, at least the perception of the potential for conflicting interests on the part of the banks that govern Payments NZ to inhibit confidence in, or neutral delivery of, the API Centre's work. This is similar to our concerns expressed in Chapter 8 regarding the incentives on Payments NZ to promote an effective switching service.

9.116 Some parties, for example, have voiced concern that there is no incentive for Payments NZ's API Centre to quickly progress the development of open banking due to the governance and effective control of the Payments NZ being with the major banks.[797]

9.117 Similar concerns have also been expressed to the Commission through Payments NZs authorisation application.[798] Public submissions to us in response to the authorisation application highlighted the conflict of Payments NZ ownership and governance, and advocate for an independent body to oversee the roll out and governance of open banking. Some submitters are concerned that the Payments NZ's Board continues to have a role in setting the mandate and funding for the API Centre.

9.118 We invite comments from parties on whether the present governance arrangements of the API Centre, and Payments NZ's Board oversight, are fit for purpose to deliver open banking.

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795 Payments NZ "Who we are & What we do". https://www.paymentsnz.co.nz/about-us/.

796 The API Council includes up to 6 registered API Providers (ie, banks), up to 6 registered Third Parties, and 3 independent members (including the Chair).

797 Commission "Summary of views expressed - FinTechNZ/Commerce Commission workshop" (14 February 2024), at p. 6.

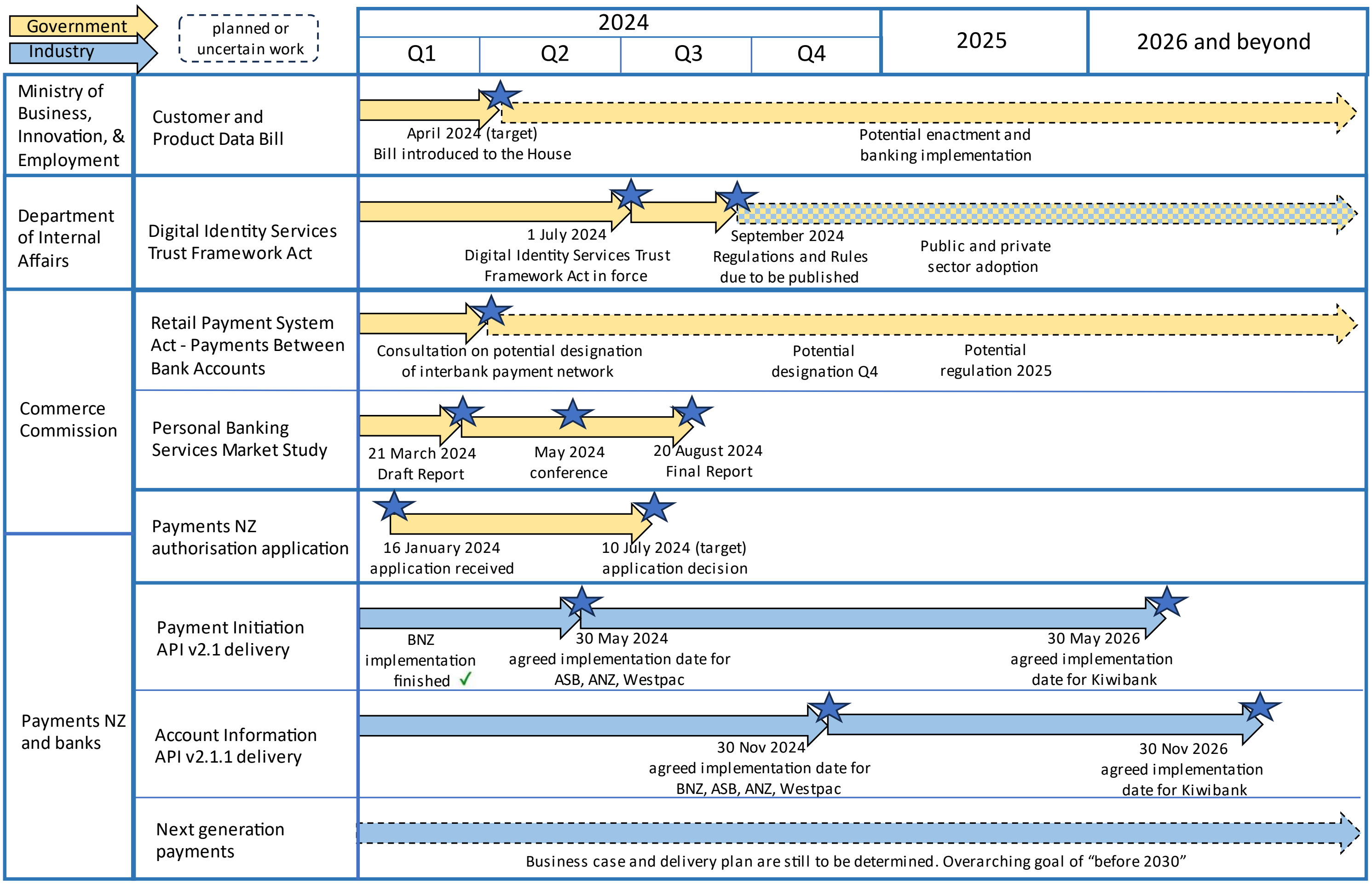
798 Akahu "Submission in response to Payments NZ Authorisation Statement of Preliminary Issues (26 February 2024); Dosh "Submission in response to Payments NZ Authorisation Statement of Preliminary Issues (22 February 2024); PaySauce "Submission in response to Payments NZ Authorisation Statement of Preliminary Issues (23 February 2024); Squirrel "Submission in response to Payments NZ Authorisation Statement of Preliminary Issues (26 February 2024)". Available at: https://comcom.govt.nz/case-register/case-register-entries/payments-nz-limited.

Maintaining momentum on industry work, and prioritising regulatory frameworks

9.119 There are, as we have noted, complementarities between initiatives for open banking, a digital identity framework and an efficient and competitive payments system. Policy design and implementation work across these three critically important areas should be prioritised and aligned by progressing them simultaneously, not sequentially. This will require both coordination across government-led initiatives and the active and constructive involvement of industry.

9.120 Figure 9.1 below sets out timing of the initiatives that will support the delivery of open banking.

Figure 9.1 Timeline of initiatives related to open banking



Source: Commerce Commission.[799]

9.121 To further sustain momentum and accelerate progress, policy work on banking sector designation under a CDR should also continue and be prioritised. This will provide an important backstop, should momentum by the banks stall and the minimum requirements of open banking not be met in a timely manner.

799 [ ].

9.122 The timing of a banking designation under the CPD Bill is presently uncertain,[800] and potentially in the longer term. Maintaining momentum of the more immediate work of the API Centre and the banks may need other regulatory interventions, to support open banking ahead of the CDR being fully operational.

9.123 The Commission has oversight of industry progress. Our open letter on Payments Between Bank Accounts summarises of our assessment of the current state of work, and how the industry and other government work programmes potentially address some of the minimum requirements. The letter includes our expectations for industry aimed at supporting the development of a thriving API-enabled payments ecosystem.

9.124 There is opportunity here for the banking sector to deliver frameworks and outcomes that will benefit consumers, merchants, small businesses, fintechs, and promote competition in personal banking services. There is, for example, the opportunity that the industry's work could be adopted and applied through designation of the banking sector under a CDR (or, possibly, that designation of the banking sector is not ultimately needed). There is also opportunity for the industry's work to inform frameworks and outcomes for other industries under a CDR and so to have wider benefits beyond banking.

9.125 We invite comments from industry stakeholders and interested parties on:

9.125.1 What is needed to achieve alignment and maintain and accelerate momentum toward open banking.

9.125.2 Whether there may be additional open banking functionality that falls outside of the API Centre's focus. This could include, for example, additional action initiation functionality such as "open or close an account", or "change plan" (though the latter may be more relevant to other sectors such as energy or telecommunications), other functionality that would support home loan customers, or product information APIs that would support search and switch.[801]

9.125.3 In Chapter 10, we include a recommendation open banking is fully operational, including APIs that enable a range of personal banking products and services be available, by June 2026.

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800 The CPD Bill is anticipated to be introduced to the House in the first half of 2024. NZ Advisor "How is open banking progressing in New Zealand?" (25 Jan 2024), available at: https://www.mpamag.com/nz/news/general/how-is-open-banking-progressing-in-new-zealand/474310.

801 We acknowledge that some functionality (such as "change plan") may have greater benefits to consumers in subsequent sectors that the CDR is introduced, such as energy or telco sectors.

Chapter 10 Draft recommendations | *Ngā tūtohinga hukihuki*

List of draft recommendations

Improve the capital position of smaller providers and Kiwibank

1. The Reserve Bank should review its prudential capital settings to ensure they are competitively neutral and smaller players are better able to compete.
2. Kiwibank's owner should consider what is necessary to make it a disruptive competitor, including how to provide it with access to more capital.

Accelerate progress on open banking

3. The Government should set clear deadlines and work with industry to ensure opening banking is fully operational by June 2026.
4. The Government should reduce the barriers imposed by the AML/CFT regime on banks working with fintechs.

Ensure the regulatory environment better supports competition

5. The Reserve Bank should use its new decision-making framework under the DT Act to explicitly and transparently consider competitive effects.
6. The Reserve Bank should explicitly and transparently articulate how it is applying the purposes and principles of the DT Act to its Deposit Compensation Scheme levy advice.
7. The Reserve Bank should consider broadening access to ESAS accounts.
8. The Government should amend the DT Act to allow the Reserve Bank to promote competition, rather than maintain competition.
9. The Government and policy makers should seek competitive neutrality across banks and other providers in their decision-making wherever possible.
10. The CCCF Act should be competitively neutral with respect to home loan refinancing to make it easier for consumers to switch providers.

Empower consumers

11. Industry should create an enhanced switching service with appropriate Government oversight.
12. Home loan providers should present offers in a readily comparable manner.
13. Mortgage lenders should pro-rate all clawbacks for broker commissions and cash incentives.
14. The FMA should produce guidance and monitor mortgage advisors' compliance with their duties under the Financial Markets Conduct Act.
15. Industry and Government should prioritise work to reduce the barriers to lending on Māori freehold land.
16. Industry and Government should prioritise ensuring widespread availability of basic bank accounts.

Introduction | *Whakatakinga*

10.1 Our preliminary view is that New Zealand's four largest banks – ANZ, ASB, BNZ and Westpac (the major banks) – do not face strong competition when providing personal banking services. There are limited constraints from outside the four major banks, and competition between the majors is sporadic. This chapter describes opportunities we have identified to disrupt the status quo and promote competition for personal banking services for the long-term benefit of consumers in New Zealand. Our recommendations are arranged into four themes.

Improve the capital position of smaller providers and Kiwibank | *Kia whakapai ake te tū haupū rawa o ngā kaituku iti me Kiwibank*

Draft recommendation 1 – the Reserve Bank should review its prudential capital settings to ensure they are competitively neutral and smaller players are better able to compete

10.2 We have explained in our draft report how important the Reserve Bank's prudential capital settings are to the ability of all other banks to compete with the major banks. It is helpful that the Reserve Bank has a new decision-making framework for prudential regulation under the 2023 DT Act that allows it to take account of competitive effects and the desirability of a proportionate approach to regulation and supervision. However, the implementation of this framework will determine how effectively it promotes competition.

10.3 We have identified two opportunities in the near term for the Reserve Bank to adopt prudential capital settings that are more competitively neutral than the current requirements. The first relates to the impact of the IRB regime on the ability of all other banks to compete effectively with the major banks, the second relates to the impact on NBDTs of bringing their prudential regulation under the DT Act.

10.4 Our preliminary view is that these opportunities have the potential to improve competition from many of the smaller providers of personal banking services without compromising the financial stability of New Zealand's financial system. We invite the Reserve Bank to give these options serious consideration and transparently and explicitly work through the competition impacts.

10.5 As noted in Chapter 7, the Reserve Bank has acknowledged that the effect of its IRB regime since 2008 has been that IRB accredited banks (which are the major banks) have held less prudential capital than non-IRB accredited banks, for assets with similar risk.[802] This differential has given a material and entrenched competitive advantage to the major banks, and limited all other banks' ability to compete and grow, in particular smaller banks that focus on providing home loans.

802 Reserve Bank "Capital Review: Go-to-Guide 2019" (2019), at p. 7, available at: https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/consultations/banks/review-capital-adequacy-framework-for-registered-banks/decisions/capital-review-guide.pdf.

10.6 Following its 2019 Capital Review, the Reserve Bank introduced a ‘floor’ in 2022 to require IRB banks hold at least 85% of the amount of capital that banks using the standardised approach must hold, for assets with an equivalent risk profile. We are concerned the ongoing 15% differential may not be justified in terms of financial stability and will continue to limit smaller banks’ ability to compete.

10.7 The IRB regime allows accredited banks to model the risks associated with their lending portfolio. We understand the rationale for this approach when the category of lending has diverse risks, such as for business lending. However, we have not seen a compelling reason to suggest there are material differences in risks between banks for some well-defined categories of home loans (such as first mortgage-backed loans in specific LVR bands), or that the IRB approach results in improved risk management for these assets.

10.8 From a competition perspective, unless a different approach is clearly justified, we think all banks should be required hold the same level of prudential capital for loans that have equivalent risks (which we consider includes major categories of home loans).

10.9 This draft recommendation includes that the Reserve Bank should review the role and operation of the IRB regime for home loans as part of its upcoming consultation on a new capital standard later this year to ensure that the same level of capital is held where risk is likely to be equivalent. In particular, the Reserve Bank should:

10.9.1 **Consider whether the same level of capital should be held where risk is likely to be identical (regardless of whether the lender is IRB accredited):** For example, whether some home loan types should have no difference in capital holdings between the standard and IRB approaches, because such loans are similarly risky irrespective of the lender.

10.9.2 **Consider making it easier to acquire IRB accreditation:** Relaxing the criteria for IRB accreditation to allow more smaller banks to take advantage of the IRB approach.

10.10 The Reserve Bank has signalled NBDTs will likely have an ‘overall uplift’ in prudential requirements as those entities’ prudential regulation is brought under the DT Act, and that they may need to ‘assess their viability in line with operating in a well-regulated competitive marketplace’.[803] We are not aware the Reserve Bank has articulated what it means by ‘overall uplift’ in requirements, what its concerns are with NBDTs’ current prudential requirements such that an ‘overall uplift’ is necessary, or why this would impact the viability of NBDTs. These issues are discussed in more detail in Chapter 7.

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[803] Reserve Bank “Proportionality Framework Consultation Paper” (31 July 2023), at p. 6 and 11, available at: https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/consultations/deposit-takers-act/proportionality-framework-consultation-paper.pdf.

10.11 Competition could be promoted by the Reserve Bank reducing the uncertainty created by its comments, and increasing transparency around how it will consolidate and apply prudential regulation for all deposit takers that will be subject to the DT Act.

10.12 This draft recommendation includes that the Reserve Bank provide further information about its views on the prudential requirements that NBDTs may have under the DT Act, including the policy reasons for any proposed changes to the status quo. In doing so, we recommend the Reserve Bank explicitly and transparently articulate how it is thinking about its role in setting prudential requirements with reference to the purposes and principles set out in the DT Act.

Draft recommendation 2 – Kiwibank's owner should consider what is necessary to make it a disruptive competitor, including how to provide it with access to more capital

10.13 In Chapter 2 we explained how the four major banks do not currently face strong competition from smaller providers. The market for personal banking services is split into two tiers. The first tier comprises the four Australian-owned major banks. The second tier comprises the smaller registered banks and non-banks. Kiwibank is "stuck in the middle" of these two tiers; being larger than the smaller providers but having less capital and assets than the Australian-owned banks.

10.14 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.

10.15 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.

10.16 Kiwibank, which we know is being watched by the four major banks as their next closest rival, appears to have the greatest potential to constrain the major banks in the near term and disrupt a market that is otherwise stable due to lack of competition. However, Kiwibank does not yet have the necessary access to capital backing, or the systems, required to continuously challenge the major banks aggressively. Access to equity is a constraint on how fast Kiwibank can continue to grow.[804]

10.17 To change this, Kiwibank's owner should consider increasing its access to capital and support a strategic refocus of Kiwibank's efforts to compete more strongly with the major banks (which could involve significant systems development).

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804 [ ].

10.18 Accordingly, our draft recommendation is that Kiwibank's owner explores what changes are necessary to maximise its potential as a disruptive competitor.

10.19 We see this as the best near term prospect for more robust competition. However, there is also an opportunity to accelerate open banking to increase competition from smaller providers over the medium term and ensure ongoing disruption can drive better consumer outcomes.

Accelerate progress on open banking | *Whakatere ake i te kauneke o te pēke tuwhera*

10.20 We think it is important to take a multi-faceted approach to improving competition. Open banking has the potential to revolutionise banking by driving ongoing innovation and competition in personal banking. Fintechs are a potential source of more radical and disruptive innovation and competition over the medium to long-term, and are important to realising the full benefits of open banking.

Draft recommendation 3 – the Government should set clear deadlines and work with industry to ensure opening banking is fully operational by June 2026

10.21 Implementing open banking as soon as possible, and in a competitively neutral way, is critical to allowing consumers and businesses to access new and innovative ways to manage their money and make payments. We've identified the minimum requirements for open banking in Chapter 9 and noted that competition will be promoted by its continued development and evolution: greater participation by business and consumers, and enhanced functionality.

10.22 Work is underway on the Customer and Product Data Bill, initiatives under the Retail Payment System Act, and various other important complementary initiatives including developing a digital identity system.

10.23 We see an opportunity to bring forward the benefits of open banking for both consumers and businesses by accelerating these initiatives and ensuring that they occur simultaneously. If done sequentially, open banking will take much longer to be implemented and there is a risk that the various components do not fit well together. For example, if the digital identity framework is developed without close links to how it could be used in open banking, it may need to be adapted later on, causing further delays and cost.

10.24 Industry involvement is critical to ensure the solutions developed can be implemented and the technical standards work for both fintechs and existing banks. However, we have heard concerns that banks and Payments NZ do not have the right incentives to develop and deploy functional APIs,[805] and concerns that governance arrangements for the API Centre (which ultimately reports to Payments NZ) are affecting the timeliness and neutrality of industry-led work.

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805 An API (application programming interface) is a set of routines, protocols, and tools for building software applications. An API specifies how software components should interact.

10.25 Progress by the sector has been too slow, despite repeated undertakings by the sector to advance this work. In particular, we are yet to see all the major banks and Kiwibank partnering with fintechs. Accordingly, government involvement (eg, via regulatory frameworks and backstops) appears necessary if we are to achieve the potential of open banking.

10.26 While work on the various initiatives related to open banking is underway, setting clear milestones for progress will help drive momentum. Up until now, it has been too easy for target dates to be missed and New Zealand is falling behind other countries.

10.27 Our draft recommendation is that industry and the Government work together to ensure, by June 2026, open banking is fully operational. Setting a clear deadline and having regulatory backstops available will support the acceleration of open banking. Our preliminary view is that meeting this milestone of being fully operational by June 2026 means, at a minimum:

10.27.1 **APIs enable a range of products and services**: The design of APIs (both functional and non-functional aspects) should continue to advance, and each of the five largest banks should have deployed the most recent versions. The APIs that are designed and implemented should address use cases that promote competition and include payment initiation, confirmation of payee, account information, product information, and 'other actions' initiation such as opening and closing accounts.

10.27.2 **Widespread fintech use of APIs**: the five largest banks should each be meeting the minimum requirements we have set with regard to partnering between banks and third party providers.[806] Beyond minimum requirements, we would expect to see widespread partnering between banks and fintechs, including individual fintechs who have agreed commercial terms to partner with each of major banks and Kiwibank.

10.27.3 **Active participation in the digital identity market**: the five largest banks should be actively participating in the digital identity market, through both providing verified digital identity credentials and accepting digital identity credentials from a wide range of third parties accredited under the trust framework. Key Government agencies that hold identifying information, like DIA which holds birth certificates and passports, should prioritise providing verified digital identity credentials.

806 These include standardised and reasonable minimum onboarding criteria, a standardised process across banks for agreeing API use, and pricing that enables commercially viable business models. See: Commerce Commission "Retail Payment System – Update on our Payments Between Bank Accounts work" (22 February 2024), paras A10 – A13.

10.27.4 **Early adoption by Government**: The Government should take an all-of-government approach to accepting payments enabled by open banking functionality. This will help build confidence in open banking and assist in developing a market for open banking enabled products and services.

Draft recommendation 4 – the Government should reduce the barriers imposed by the AML/CFT regime on banks working with fintechs

10.28 We have heard from fintechs that one of the biggest barriers and ongoing risks they face is accessing a bank account. Banks' willingness to provide fintechs with bank accounts is influenced by legal risks associated with the AML/CFT regime and with broader reputational risks. Fintechs have a heightened risk profile under the AML/CFT regime, which impacts banks' obligations (ie, enhanced due diligence requirements).

10.29 Our draft recommendation is that the Government should explore ways to reduce the actual and perceived risks to banks under the AML/CFT regime when providing banks accounts to fintechs. This could include prioritising AML/CFT reforms that seek to address banks' perception of fintechs as being high-risk.

10.30 The MoJ's 2022 AML/CFT review has already recommended that AML/CFT supervisors develop a code of practice for businesses (especially banks) to on-board high-risk businesses and that there should be a licensing framework applied to high-risk sectors.[807] These recommendations have not been implemented yet, and we think there is merit in expediting consideration of whether there are appropriate ways to reduce this regulatory entry barrier for fintechs.

Ensure the regulatory environment better supports competition | *Me whakarite kia pai ake i tā te taha ture tautoko i te whakataetaetanga*

10.31 Regulation shapes the environment within which competition for personal banking services takes place. Regulation might promote competition, be competitively neutral in effect, or cut across competition to achieve other policy objectives. It can also have unintended consequences.

10.32 This section sets out draft recommendations and observations that seek to ensure the regulatory environment promotes competition where possible, limits the negative impact on competition where it is not, and that unintended consequences are minimised.

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807 MoJ "Report on the review of the Anti-Money Laundering and Countering Financing of Terrorism Act 2009" (2022), recommendations 48 and 92.

Draft recommendation 5 – the Reserve Bank should use its new decision-making framework under the DT Act to explicitly and transparently consider competitive effects

10.33 We explained in draft recommendation 1 our suggestion the Reserve Bank apply a competition lens in the near term to specific aspects of the prudential capital settings it imposes on deposit takers. More generally however our preliminary view is that competition in personal banking would be better supported if the Reserve Bank applied the ‘competition’ principle in the DT Act to its decision-making explicitly and transparently. In terms of process, what this could look like in practice includes:

10.33.1 articulating the potential effects on competition in different parts of the sector (eg, amongst banks, NBDTs and others) in each of its decisions about prudential regulatory settings;

10.33.2 seeking pro-competitive outcomes where this is not inconsistent with its financial stability mandate;

10.33.3 when consulting stakeholders on its decisions, including how it sees the role that competition plays in those decisions, to minimise the risk of unintended consequences; and

10.33.4 where it considers it must prioritise considerations that cut across competitive outcomes, having regard to the purposes of the DT Act, doing so explicitly so that the trade-offs between policy objectives are clear.

10.34 Applying this process would help ensure prudential regulation promotes competition to the greatest extent possible and cuts across competitive outcomes only to the extent necessary. It would also help reduce the risk of unintended impacts on competition. As the competition regulator, we will continue to work with the Reserve Bank and to advocate for competition policy issues to be given adequate weight.

10.35 In addition to the points we made concerning capital requirements, we set out below some more specific examples of upcoming opportunities where we think competition in personal banking would be better supported if the Reserve Bank applied the ‘competition’ and ‘proportionality’ principles in the DT Act to its decision-making explicitly and transparently.

Draft recommendation 6 – the Reserve Bank should explicitly and transparently articulate how it is applying the purposes and principles of the DT Act to its Deposit Compensation Scheme levy advice

10.36 The Reserve Bank is preparing advice to the Minister on what approach to take in setting an industry levy to fund the DCS. Different approaches to imposing the levy could impose a disproportionate cost on smaller providers, potentially significantly adversely affecting their ability to compete for personal banking customers. This issue is discussed in more detail in Chapter 7.

10.37 In the publicly available material, it is not clear the extent to which the Reserve Bank is considering competition in preparing its advice to the Minister on how the levy should be set. This is important, given that the Reserve Bank has itself acknowledged that a risk-based approach is likely to result in, on average, smaller deposit takers having higher levies, as a proportion of their covered deposits, than larger deposit takers.[808] We query the Reserve Bank's apparent view that under a risk-based approach, the smaller providers who are more heavily levied are likely to see a greater net benefit from the DCS. It is also possible that the major banks (who are systemically important) will impose a greater cost on the DCS because of the higher risk of contagion if they fail.

10.38 Our draft recommendation is that the Reserve Bank explicitly and transparently articulates how it has applied the purpose and principles under the DT Act to its levy advice. This should include how different levy approaches may impact competition (under the competition principle), the proportionality principle, and how those considerations sit within the overall legal framework for the Reserve Bank's levy advice.

Draft recommendation 7 – the Reserve Bank should consider broadening access to ESAS accounts

10.39 In Chapter 9, we discussed how current arrangements for accessing ESAS accounts may be detrimental to competition. Access to an ESAS account conveys a competitive advantage to those providers that have it, and significant disadvantages to those who do not. We think there are benefits to both innovation and competition of broadening access to ESAS accounts, including because it will allow smaller, innovative providers to reduce their reliance on larger bank competitors.

10.40 The Reserve Bank is currently reviewing its ESAS access policy and criteria, and contemplating allowing new participants to enter. In response to feedback, it has revised its approach and aims to balance its initial risk-based approach with considering the benefits ESAS access brings, particularly around innovation and competition.

10.41 Our draft recommendation is that the Reserve Bank, in its review of ESAS access policy and criteria:

10.41.1 place significant weight on the benefits to competition and innovation in the personal banking sector that would result from broadening access to ESAS accounts; and

10.41.2 consider whether the risks it has identified are already present in the system, indirectly under agency banking arrangements, but with less Reserve Bank visibility.

808 Reserve Bank "Depositor Compensation Scheme Regulations – Consultation Paper" (11 March 2024), p 12, available at: https://consultations.rbnz.govt.nz/dta-and-dcs/dcs-regulations/user_uploads/dcs-regulations-consultation-paper.pdf.

Draft recommendation 8 – the Government should amend the DT Act to allow the Reserve Bank to promote competition, rather than maintain competition

10.42 Our draft findings include that competition is sporadic and limited and that the major banks represent a stable oligopoly with no meaningful competitive constraint apart from Kiwibank, which is not currently a disruptive force. Given that, we consider it insufficient for the Reserve Bank to be limited in the DT Act to taking account of the need to 'maintain' competition within the deposit-taking sector.

10.43 Our draft recommendation is that the Government should amend the DT Act to enable the Reserve Bank to take account of the need to 'promote' competition within the deposit-taking sector.

10.44 Amending the Act in this way would send a strong signal about the desirability of improving the competitive status quo, to ensure consumers enjoy the value and choice that competition can bring.

Draft recommendation 9 – the Government and policy makers should seek competitive neutrality across banks and other providers in their decision-making wherever possible

10.45 In Chapter 7 we outline a number of small but pervasive examples where legislation, regulation, and Government decision-making appears to have unintentionally favoured major banks (and disadvantaged other banks and non-bank providers) or ignored the existence of non-bank providers entirely. These include where requirements in legislation are described with respect to the form or regulatory status of an entity, without apparent consideration of the underlying outcomes sought, and where decisions are made under urgency.

10.46 These laws and decisions have limited, or are limiting, the ability of smaller providers to compete. Although most of the examples are relatively narrow in scope and it appears the negative effect on competition is unintended, they have had the effect of helping to sustain the current two-tier oligopoly and limiting smaller providers' ability to compete.

10.47 Competition would be promoted by the Government and regulators:

10.47.1 considering the effect on competition of all future decisions;

10.47.2 reviewing existing regulation to ensure it is competitively neutral, unless justified by other policy considerations; and

10.47.3 preparing guidance ahead of time for considering the competitive effect of decisions made under urgency.

There are opportunities for the Credit Contracts and Consumer Finance Act 2003 to better promote competition for personal banking services

10.48 As noted in Chapter 7, a prominent example we have heard of regulatory burden leading to unintended consequences for competition is the CCCF Act – specifically the costs associated with implementing the prescriptive affordability assessment, the ongoing changes being made to the legislation, and the strict penalty regime. These views appear to be widely held, and the Minister for Commerce and Consumer Affairs has signalled an intention to review the CCCF Act as part of upcoming financial services reforms.[809] We support this review and note the potential benefits to competition of reviewing aspects of the CCCF Act we discuss in our report.

Draft recommendation 10 – the CCCF Act should be competitively neutral with respect to home loan refinancing to make it easier for consumers to switch providers

10.49 One opportunity we have identified to increase competition for home loans is to encourage consumers to critically assess if they remain on the best deal for them or would benefit from changing providers during the term of their loan. Currently, consumers refinancing a home loan with a new provider may trigger an affordability assessment under the CCCF Act that would not arise if they stayed with their original loan provider.

10.50 Any new lender is required to make reasonable inquiries to be satisfied that it is likely that the borrower can afford the home loan repayments without suffering substantial hardship.[810] The need to go through this process may deter some consumers from considering their options.

10.51 In addition, the prescriptive affordability assessment obligations under the CCCF Regulations are triggered unless an exception applies. An exception to this requirement, when a new lender refinances existing debt, only applies if the credit limit does not increase and that either the interest rate is lower or that monthly repayments are lower or the same.[811] In practice, these conditions are difficult to meet, particularly in a rising interest environment.

10.52 Neither the general responsible lending affordability assessment obligation, nor the additional prescriptive affordability assessment obligations, are triggered where a consumer remains with their existing home loan provider (eg, where they refix interest rates at the end of a fixed rate period).[812]

10.53 Our preliminary view is that these aspects of the CCCF Act regime appear to create an unnecessary barrier to consumers switching providers of home loans, potentially impacting competition. This problem is discussed in more detail in Chapter 8.

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809 See: https://www.beehive.govt.nz/release/reducing-barriers-financial-services.

810 Credit Contracts and Consumer Finance Act 2003, section 9C(3)(a)(ii).

811 The exception is set out in regulation 4AH(3) of the Credit Contracts and Consumer Finance Regulations 2004.

812 Unless a "material change" is being made to the home loan agreement. Under section 9C(8) of the CCCF Act, a material change means an additional amount is being advanced (ie, home loan top-up) or an increase to a revolving loan credit limit.

10.54 Competition would be promoted if lenders refinancing a home loan are not subject to additional obligations (in the form of affordability assessments) in comparison to obligations on existing home loan providers in similar circumstances.

10.55 Our draft recommendation is that the Government consider amending the CCCF Act to achieve competitive neutrality between existing home loan providers and potential alternative providers in the context of a consumer refinancing a home loan.

10.56 Our draft recommendation focuses on refinancing home loans because home loans are important to competition in the personal banking sector, and this is the context in which we have heard the CCCF Act creates a competitive disadvantage for growing providers. We also consider that an amendment to the CCCF Act dealing with home loans has reduced risk of unintended consumer harm because of the lower risk nature of home loans compared to other types of personal lending.

There are other opportunities to promote competition by reducing the regulatory burden of the CCCF Act

10.57 We have identified other opportunities to promote competition by reducing the regulatory burden of the CCCF Act, while preserving its consumer protection function. We recommend MBIE explore these as part of its review of the CCCF Act.

10.58 As discussed in Chapter 7, the penalty regime in the CCCF Act may be incentivising conservative and costly approaches to compliance that are disproportionate to the consumer harm that the Act protects against. Aspects of the penalty regime we think could be explored include restrictions on indemnities and insurance for directors and senior management, and the consequences of failing to fully comply with the disclosure requirements (which can include requiring a lender to refund interest and fees paid by the borrower).

10.59 A ‘safe harbour’ benchmark for expenses, that applies to responsible lending affordability assessments, could reducing lenders’ regulatory burden and promote competition. Such a benchmark could reduce the cost and risk to lenders of undertaking an affordability assessment under the CCCF Act.

Empower consumers | *Te whakakaha kaiwhakapeto*

10.60 We observed in Chapter 8 that barriers to consumers shopping around and switching between providers limits competition. This section identifies opportunities to empower consumers to seek out and switch to providers that best meet their needs, and to benefit from the value and choice that competition can bring.

Improve consumer search and switch

Draft recommendation 11 – Industry should create an enhanced switching service with appropriate Government oversight

10.61 The ease which consumers can compare and switch transaction accounts impacts the competitive process.

10.62 Costs to consumers associated with switching transaction accounts include the "hassle" associated with opening a new account and moving financial activities to it, as well as perceived risks and lack of confidence around the process. These issues arise independently of the costs associated with opening an account. That is, they arise regardless of whether the customer is 'multi-banked' (and is simply transferring financial activities to an existing account) or whether they are also opening a new account. These costs are further discussed in Chapter 8.

10.63 Some banks in New Zealand participate in an account switching arrangement established by Payments New Zealand, "Easy Switch", but we have some reservations about how well this service is working in practice, including that it is not overseen by an independent body with an appropriate mandate.

10.64 Our draft recommendation is that industry explore ways to create an enhanced transaction account switching service with the following features:

10.64.1 **Better functionality**: The service should enable a comprehensive move from one provider to another including, at a minimum, recurring outgoing payments, incoming payments (including redirection service of at least three years), overdrafts, transaction history, and payment recipients. This would address the major "hassles" we have heard about. Customers should also be able to choose whether to close their old accounts or not.

10.64.2 **Guaranteed minimum standards**. This includes guaranteed minimum standards for the timeliness and quality of the switch, backed by an undertaking to provide compensation in the event of loss caused by a failure to meet the guarantee. This would be consistent with the standard of service offered in the UK by the CASS.

10.65 The success of any new service will depend on it having a mandate to promote consumer awareness of switching, supported by the appropriate governance structures and accountabilities, including Government oversight. The aim should be to continually improve the service, including through setting KPIs and publishing annual reports. The service will also need sufficient funding to carry out its functions.

10.66 Industry and the Government could consider an option similar to that in the UK. This would involve setting up a subsidiary of Payments NZ, similar to the API Centre, with appropriate governance, mandate and resourcing, including Government oversight.

Draft recommendation 12 - home loan providers should present offers in a readily comparable manner

10.67 In Chapter 4 we explained that the search costs for home loans are significantly increased by opaque pricing, discretionary discounts and other below the line campaigns (such as cashbacks). This means that a customer can only be certain of the terms and conditions of their deal with a particular provider (including interest rate and cashback offer) after going through a full application process. This results in much higher search costs overall, particularly to compare multiple offers (requiring multiple application processes).

10.68 Even once an offer is received, it may not be presented in an easily comparable way. For example, cashbacks may make it more difficult to compare offers between providers. If one provider is offering a slightly higher interest rate but a more generous cashback offer, it may not be obvious how to weigh these two factors against one another.

10.69 Competition would be promoted by home loan providers giving customers all the relevant information they require to choose the product and provider that best meets their needs.

10.70 Our draft recommendation is that home loan providers should present their offers in a way that is easily understood and makes it easy for consumers to compare products and offers across different providers. The information that is presented should be standardised across all providers, and the specific information that must be presented should be informed by consumer testing to ensure it is effective and relevant to consumer switching decisions.

10.71 We are sceptical that industry has the right incentives to do this quickly, or in a way that maximises the ability of consumers to compare and switch providers, so regulatory oversight may be necessary.

Better align mortgage broker incentives with the interests of consumers

Draft recommendation 13 – mortgage lenders should pro-rate all clawbacks for broker commissions and cash incentives

10.72 We are concerned that some of the financial costs imposed (directly and indirectly) by lenders when home loan customers switch away ‘early’ may be unjustified and create a barrier to switching to a more suitable lender. These costs relate to ‘clawbacks’ that are common for broker commissions and cashbacks paid by lenders, discussed in Chapter 4.

10.73 Our preliminary view is that industry practices around commission clawbacks may be imposing an unjustifiably high financial disincentive on consumers switching home loan providers within the first several years of the loan. Competition would be promoted if consumers faced more certain and lower costs when switching home loan providers. We have similar concerns about industry practices around cash incentive clawbacks.

10.74 Our draft recommendation is that industry changes its practices around clawback of commissions and cash incentives so that the clawback amounts recovered from advisors or consumers are pro-rated, diminishing on a linear basis and calculated monthly.

10.75 This recommendation will likely require changes to the contractual relationships between the relevant parties (ie, lenders, aggregators, mortgage brokers, and borrowers).

10.76 As part of this recommendation, it will be important to benchmark current practices and monitor and confirm whether industry practices are changing, and whether these changes are flowing through to consumers.

10.77 If a voluntary approach does not result in the issue being addressed, then we recommend the Government consider ways to intervene directly to ensure these changes are made, so that customers face more certain and lower costs when switching home loan providers.

Draft recommendation 14 – the Financial Markets Authority should produce guidance and monitor mortgage advisors' compliance with their duties under the Financial Markets Conduct Act

10.78 We explained in Chapter 4, that mortgage advisors may face a conflict of interest with their clients because they are incentivised to recommend a lender that pays them the best commissions, even if that lender is not the best fit for the borrower.

10.79 The Financial Markets Conduct Act 2013 imposes duties on financial advisors, including mortgage advisors, including to prioritise the client's interests,[813] and to disclose conflicts of interest and how they are being managed.[814]

10.80 However, we think that the high level requirements the FMC Act places on mortgage advisors are uncertain and there remains a risk that they are unduly influenced by their own financial interests in receiving commission payments when providing advice. This is a significant concern because taking out a home loan is likely to be the most substantial, long-term, financial decision many consumers make.

10.81 Our draft recommendation is that the FMA issues specific guidance on mortgage advisor duties, and monitors the mortgage advisor sector, engaging with advisors and their clients. The particular factors that we recommend the FMA should consider are:

10.81.1 Ensuring mortgage advisors disclose the different amounts and structures of commissions offered to them by different providers (eg up-front only or up-front and trail);

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813 Financial Markets Conduct Act 2013, section 431K.

814 Financial Markets Conduct Act 2013, section 431O and Financial Markets Conduct Regulations 2014.

10.81.2 The strong interest the customer has in securing the lowest interest rate, as compared to other considerations (eg familiarity with the provider);

10.81.3 Ensuring that mortgage advisors adequately alert their clients to how tranche lending, commission clawbacks, and cash incentive clawbacks can impact their subsequent ability to switch providers;

10.81.4 Ensuring that mortgage advisors are accredited with a sufficient breadth and depth of providers to meet their customers' needs; and

10.81.5 How mortgage advisors should act if they are aware the most suitable product for a customer is not provided by a member of their panel.

10.82 Guidance issued by the FMA would assist mortgage advisors to interpret their duties in the context of home loans and support better outcomes for consumers. We consider the FMA is best placed to monitor and to test whether the FMC Act duties are having the intended effect of ensuring quality financial advice and public confidence in advisors.

Improve competition to meet Māori demand for home loans on Māori freehold land

Draft recommendation 15 – industry and Government should prioritise work to reduce the barriers to lending on Māori freehold land

10.83 In Chapter 3 we discuss some of the barriers to providers supplying home loans secured by Māori freehold land. Those barriers increase the cost for providers to supply these loans, reducing competition to supply them and limiting the choice of providers available to Māori.

10.84 Our preliminary view is that competition would be promoted by the continued collaboration of home loan providers with Māori, iwi and/or Government to overcome or reduce the barriers to lending on Māori freehold land. We are aware of several recent and current examples, including:

10.84.1 Kiwibank, Te Puni Kōkiri, and Kāinga Ora collaborating on the Kāinga Whenua loan scheme. That scheme supports Māori to build, purchase or relocate a house on multiply-owned whenua Māori.

10.84.2 BNZ's collaboration with Ngāti Whātua Ōrākei to build papakāinga housing on whenua Māori.[815]

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[815] See: https://blog.bnz.co.nz/2024/01/unlocking-home-ownership-aspirations-for-iwi-housing-bnz-and-ngati-whatua-orakei-collaborate-on-papakainga-development.

10.84.3 Westpac's collaboration with several iwi including Ngāti Koroki Kahukura[816] and Waikato-Tainui,[817] to provide shared equity home loans on multiply-owned land.[818]

10.85 These examples are described in more detail in Chapter 3.

10.86 Our draft recommendation is that industry, Māori, iwi and Government continue to explore ways to replicate and build on the success of these initiatives by expanding their scope, scale and participation.

10.87 There is also scope for successful frameworks and models to be shared and used by other providers. BNZ has shared the framework it developed when collaboration with Ngāti Whātua Ōrākei 'with other banks in the hopes that it will help expand access to finance for development on Māori land across New Zealand'.[819] We are not aware of any restrictions preventing more providers from collaborating with Kāinga Ora on its Kāinga Whenua loan scheme, in which currently only Kiwibank participates.

10.88 We appreciate that competition law is sometimes perceived as a barrier to greater cooperation between competing providers on these types of initiatives.[820] On the face of it, we think there is greater scope for cooperation of this nature within the bounds of competition law and the recent collaboration guidelines we have published.[821] For example, publishing high level information about funding frameworks or lending models, or publishing aggregated or high level data and information on the success or otherwise of an initiative.

10.89 The MoJ's 2022 AML/CFT Act review report considered the extent to which the AML/CFT Act supported or undermined the ability of Māori trusts and other Māori governance bodies to operate effectively.[822] A large portion of multiply-owned land is held in a Māori land trust.[823]

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816 See: https://www.westpac.co.nz/rednews/relationship-with-iwi-leads-to-innovative-papakainga-shared-equity-model-for-whanau/.

817 See: https://www.westpac.co.nz/rednews/waikato-tainui-sign-shared-equity-agreement-to-build-50-homes-for-whanau/.

818 [ ].

819 See: https://blog.bnz.co.nz/2024/01/unlocking-home-ownership-aspirations-for-iwi-housing-bnz-and-ngati-whatua-orakei-collaborate-on-papakainga-development.

820 [ ].

821 Commerce Commission "Collaboration and Sustainability Guidelines" (November 2023), available at: https://comcom.govt.nz/__data/assets/pdf_file/0033/335985/Collaboration-and-Sustainability-Guidelines-30-November-2023.pdf.

822 MoJ "Report on the review of the Anti-Money Laundering and Countering Financing of Terrorism Act 2009" (2022), at p. 101.

823 See: https://www.xn--morilandcourt-wqb.govt.nz/assets/Documents/Guides-Templates-Factsheets/MOJ0217.1E-OCT21-Maori-Land-Trusts.pdf.

10.90 The report noted that the level of scrutiny on Māori land trusts imposed by the AML/CFT Act was unlikely to be justified with respect to the money laundering or financing terrorism risks they posed, and that enhanced scrutiny made it hard for such trusts to deal with interests in land and to satisfy banks' AML/CFT requirements.[824]

10.91 Our preliminary view is that competition would be promoted by reducing the regulatory burden imposed on Māori land trusts under the AML/CFT Act, to the extent that the current level burden is unjustified with respect to the purposes of the AML/CFT regime.

10.92 The 2022 MoJ report makes several recommendations in the context of the unjustified level of scrutiny on Māori land trusts imposed by the AML/CFT regime.[825] Progress on those recommendations is mixed. Some have been implemented, but more impactful ones are yet to be prioritised by Government and require coordination and alignment across Government.[826]

10.93 There is a perception amongst some Māori that the recommendations in MoJ's 2022 report didn't go far enough to address the issues, and in any event have yet to make a material change.[827]

10.94 Our draft recommendation is that the Government explore ways to reduce the unjustified level of scrutiny on Māori land trusts imposed by the AML/CFT regime, including by:

10.94.1 engaging with Māori stakeholders to understand their outstanding concerns and priorities;

10.94.2 considering whether there are other means to address the issue of unjustified scrutiny on Māori land trusts that result in faster and better outcomes for affected Māori; and

10.94.3 prioritising the recommendations in the 2022 MoJ report that seek to address these issues, if that is still considered the most appropriate response. This would include prioritising the necessary policy work and legislative changes to address the issues and ensuring coordination and alignment between the MoJ, MBIE, and AML/CFT supervisors to ensure the recommendations have their intended effect.

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824 MoJ "Report on the review of the Anti-Money Laundering and Countering Financing of Terrorism Act 2009" (2022), at p. 101.

825 In particular recommendations 115, 116-120, and 125-126 are identified as protecting the interest Māori have in the effective and efficient operation of Māori trusts.

826 [ ].

827 [ ].

Improve vulnerable consumers access to basic bank accounts

Draft recommendation 16 – industry and Government should prioritise ensuring widespread availability of basic bank accounts

10.95 We discuss in Chapters 2, 3 and Attachment D the barriers some consumers face in accessing bank accounts. Although being 'unbanked' is not common in New Zealand, its negative impacts are significant. Not having or using a bank account can have far reaching consequences for people's lives including difficulty receiving wages, salary and benefits, reduced access to credit, and being vulnerable to exploitation.[828] Lack of access, or reduced access, to personal banking services reduces the choice and value consumers can gain from competition.

10.96 Access issues can arise from barriers to opening an account (for example, being unable to provide adequate identification), deterrents to opening an account (for example, distrust of banks), and from underutilisation of existing accounts (for example, if there is poor rural banking infrastructure such as a lack of bank branches and ATMs).[829]

10.97 Key drivers of banking access issues in New Zealand include limited competition for vulnerable consumers, supply side issues such as capability of frontline staff and onboarding requirements, as well as demand side issues such as affordability, trust and financial capability.[830]

10.98 Our draft recommendation is that industry work to ensure widespread availability and awareness of basic bank accounts. This would include promoting their availability to suitable customers, and ensuring frontline staff are appropriately trained and supported.

10.99 We expect this recommendation could be implemented by each provider on a unilateral basis, but also acknowledge there may be benefits to consumers from having minimum standards across industry. This is the approach taken by the Australian Bankers Association, which was granted an authorisation by the ACCC to set minimum standards for basic bank accounts.[831] We have published guidance on the clearance regime for collaborative activities in New Zealand and would welcome a discussion with interested parties.[832]

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828 Westpac New Zealand "Westpac NZ Access to Banking in Aotearoa Report" (April 2023), at p. 2, available at: https://www.westpac.co.nz/assets/Personal/life-money/documents/Westpac-NZ-Access-to-Banking-in-Aotearoa-Report.pdf;
[ ].

829 [ ].

830 [ ].

831 See: https://www.accc.gov.au/public-registers/authorisations-and-notifications-registers/authorisations-register/australian-banking-association-basic-bank-accounts-minor-variation.

832 Commerce Commission "Competitor Collaboration Guidelines" (January 2018), available at: https://comcom.govt.nz/__data/assets/pdf_file/0036/89856/Competitor-Collaboration-guidelines.pdf.

10.100 As part of this draft recommendation we think it is important that progress by industry is closely monitored by the Government, and that it is prepared to step in and regulate if required.

Improving competition will require multi-faceted solutions | *Mā ngā rongoā maha e pai ake ai te whakataetaetanga*

10.101 Our draft recommendations seek to promote competition by addressing the factors we have identified as affecting competition for personal banking services in New Zealand.

10.102 It is important our draft recommendations are considered as a whole. The current state of competition is being reinforced by several interrelated factors, some of which have been operating for many years. Our draft recommendations are similarly interrelated. Some will have an impact in the shorter term, while others will likely take several years to come into effect. Taken together, we expect them to promote competition in personal banking services, for the long-term benefit of consumers.

10.103 We would also expect our recommendations, if implemented, to reduce the potential for accommodating behaviour (or 'tacit coordination') occurring. The most effective way of reducing this risk and disrupting any coordination that is occurring, is to introduce a stronger challenger or challengers, reduce switching barriers, and encourage more consumers to engage and be prepared to change providers. This is what our suite of recommendations is aimed at achieving.

10.104 We are New Zealand's competition agency, and the focus of our study has been identifying and addressing factors affecting competition. We acknowledge that competition is rarely the only relevant factor when policy decisions are being made. The regulatory environment for the personal banking sector has strong and sometimes conflicting policy goals. We have sought to identify opportunities to promote competition without compromising other policy goals.

10.105 Our suite of draft recommendations is preliminary and subject to consultation through the submissions we are inviting, the consultation conference, and further analysis and deliberation. We may also identify areas where we (or others) could undertake further work in the future. Our recommendations may therefore change in the final report.

Attachment A Next steps and how you can have your say | *Ngā mahi āmuri me te are kōrero mai māu*

A1 This attachment provides information on how stakeholders can submit on the draft report, and details about our consultation conference.

A2 Written submissions on this draft report are due by **4pm, Thursday 18 April 2024**.

A3 We also invite written submissions on the econometric analysis by Professor Dimitris Margaritis and Dr Maryam Hasannasab of the University of Auckland, published alongside our draft report. Written submissions on that analysis are due by **4pm, Thursday 2 May 2024**.

A4 We intend to hold a consultation conference in central Auckland and online in the week commencing **Monday 13 May 2024,** and provide further details on this below.

A5 Further submissions, including cross-submissions on matters raised at the conference and in published submissions made by others, are due by **4pm, Thursday 30 May 2024**.

A6 The remaining sections in this attachment cover:

A6.1 making written submissions;

A6.2 confidential information – disclosure of your submission;

A6.3 invitation to attend the consultation conference; and

A6.4 questions on material included in this attachment.

Making written submissions | *Te tuhi tāpaetanga mai mō tēnei pūrongo*

A7 Please provide your views to us by emailing us at: marketstudies@comcom.govt.nz.

A8 We encourage you to provide submissions that are supported by evidence. Less weight may be given to a statement or submission that cannot be supported by evidence.

A9 Please provide submissions in both a format suitable for word processing (such as a Microsoft Word document), and a 'locked' format (such as a PDF) for publication on our website.

Confidential information – disclosure of your submission | *Pārongo matatapu – te puakanga o tō tāpaetanga mai*

A10 As part of running a transparent process, we will publish all submissions that we receive at different points in the process to the website landing page for this study.

A11 We do, however, understand that it is important to parties that confidential, commercially sensitive, or personal information (confidential information) is not disclosed because this could harm the provider of the information or a third party.

A12 We recognise the need to ensure that you can have confidence in our use and retention of information, and we are committed to respecting any privacy, confidentiality, and/or commercial sensitivity attached to your information where possible.

A13 Anyone who has information relevant to the study can ask the Commission to keep their identity and/or the information provided confidential. If confidentiality is a concern, it should be raised when you first contact the Commission so we can discuss your concerns and any available protections as soon as possible.

A14 If your submission includes confidential information, we request that you provide us with a confidential and a public version of your submission. We intend to publish the public versions of submissions on our website. It is the responsibility of submitters to ensure that no confidential information is included in the public versions of submissions.

A15 Where confidential information is included in submissions:

A15.1 the information should be clearly marked with brackets and highlighted in yellow [like this, for example]; and

A15.2 both confidential and public versions of submissions should be provided by 4pm on the due date.

A16 If your submission contains information which is considered confidential, a schedule must be provided which identifies each piece of information over which confidentiality is claimed and the reason why the information is confidential (preferably with reference to the Official Information Act 1982 (OIA)).

A17 We will not disclose any confidential or commercially sensitive information in a media statement, public report, or in response to a request, unless there is a countervailing public interest in doing so in a particular case. Such cases are likely to be rare and would be discussed with you in advance of any publication.

Invitation to attend consultation conference | *He tono kia tae mai ki ngā hui whakawhiti kōrero*

A18 We intend to hold a consultation conference in the week commencing **Monday 13 May 2024**.

A19 This conference is intended to inform our final report by allowing us to test our preliminary findings with stakeholders, and to clarify and test comments received on our draft report.

A20 We intend to hold the conference at a venue in central Auckland. There will be opportunities to attend either in person, or online. Registration details and a registration link for those wanting to attend the conference will be sent out in due course, and further details on the conference venue and agenda will be provided closer to the time.

Consultation conference format

A21 The conference is likely to include open sessions as well as some confidential sessions with stakeholders on specific topics.

A22 During the conference, each topic will be introduced by us. Members of the Commission and Commission staff will ask specific questions of parties and experts. We may choose to direct some questions to experts without reference to the parties. Parties may only ask questions of us for the purpose of clarifying a question. No party will have the right to cross-examine us or any other party during the conference. We do not intend to update stakeholders with our views on matters addressed in our draft report prior to, or during, the conference.

A23 Although there may not be an opportunity for participants to speak to their comments in general, we may allow for statements from participants on specific topics. Where this is the case, we will inform participants prior to the conference.

Attendance of experts at the conference

A24 We expect that all experts that have been advising parties will be available at the conference to respond to our questions and that experts attending the conference appear as experts in their fields rather than as an advocate for any particular party. We also expect experts to follow the guidance provided in the code of conduct for expert witnesses in the High Court Rules.[833]

Confidentiality

A25 Our expectation is that confidential material should be kept to a minimum during the conference in order to maintain as transparent a process as possible. Attendance at any closed confidential session would be limited to Commission members, Commission staff, and the party presenting the confidential information.

A26 We understand that some information you may want to discuss with us could be commercially sensitive and highly confidential. If stakeholders wish to attend the conference but have concerns or questions regarding confidentiality, please contact us at: marketstudies@comcom.govt.nz.

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[833] Schedule 4 of the High Court Rules 2016: https://www.legislation.govt.nz/regulation/public/2016/0225/latest/DLM6953324.html.

Other administrative matters

A27 The conference will be recorded, and a stenographer will also provide a transcript of the conference. A transcript of each day's discussion (excluding any closed confidential sessions) will be made available on our website as soon as practicable.

A28 Interested media may be in attendance at public sessions.

A29 Please note that limited seating is available so the number of attendees at the conference may have to be restricted. Time constraints may also mean that we cannot accommodate all requests to speak at the conference.

A30 We will confirm conference attendees and speakers one week prior to the conference, at the latest.

A31 We will also confirm topics and publish an agenda for the conference prior to the conference date.

Questions on material included in this attachment | *He pātai mō ngā kōrero kei roto i tēnei tāpiritanga*

A32 If you want to register your intention to attend the conference or have any questions or comments regarding material covered by this attachment, please contact us at: marketstudies@comcom.govt.nz.

Attachment B Overview of the personal banking services industry| *Tirohanga whānui ki te ahumahi ratonga pēke whaiaro*

The financial system plays a fundamental role in the functioning of our economy

B1 The financial system and its participants contribute to economic development by providing services necessary for economic activity, such as clearing and settlement systems to facilitate trade, channelling financial resources between savers and borrowers, and providing methods of payment.

B2 The financial system is constituted by institutions, markets and infrastructures which interact between them and with their customers to facilitate New Zealanders in their work, the set up and running of a business, saving, spending, obtaining insurance, and investing.

B3 The interaction between the financial entities and their customers is what creates a financial system which facilitates the distribution of financial resources and supports economic development.

B4 The financial system is a large ecosystem which includes not only banks and other non-bank lending institutions, but also financial market infrastructures,[834] investment platforms (such as managed funds, KiwiSaver, shares), financial markets (such as foreign exchange, swaps, bonds) and insurance.

B5 Within this more complex ecosystem, banks, non-bank lending institutions and finance companies are the major providers of personal banking services. The range of personal banking services is discussed in Chapter 1.

The New Zealand banking system is relatively simple

B6 The New Zealand banking system has been described as 'plain vanilla' due to the fact that a large proportion of the bank assets are loans to households and businesses and their funding is mainly sourced, as shown in Figure B1, from deposits and equity rather than other securitisation channels.[835,836]

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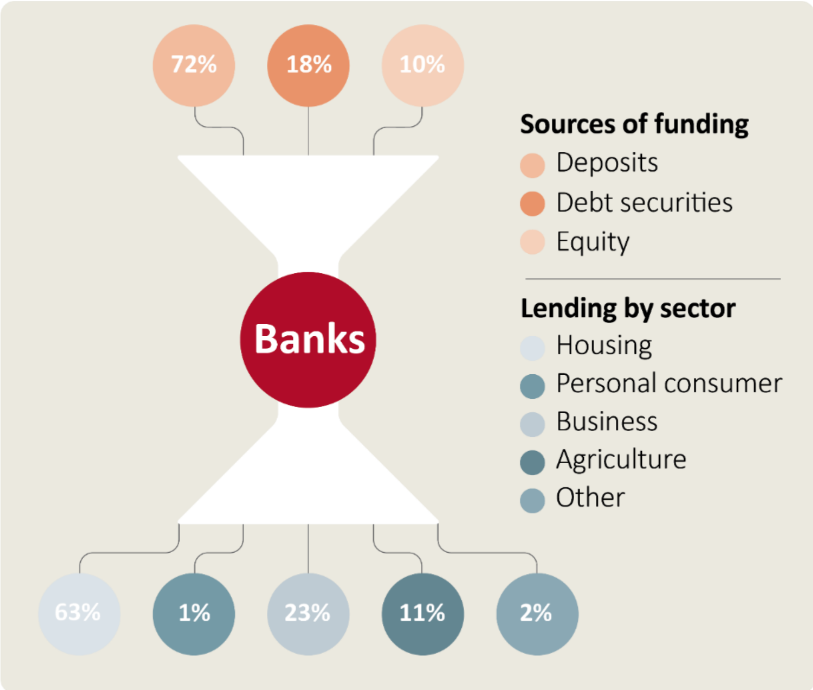
834 Financial market infrastructures are systems or arrangements that facilitate the clearing, settlement and recording of payments, security, derivatives, and other financial transactions. See: https://www.rbnz.govt.nz/financial-stability/about-the-new-zealand-financial-system/financial-market-infrastructures.

836 Reserve Bank "The Role of Banks in the economy – improving the performance of the New Zealand banking system after the Global Financial Crisis" (06 August 2011). See: https://www.rbnz.govt.nz/hub/publications/speech/2011/speech2011-08-06.

836 Securitisation is a process through which a pool of assets (typically home loans, which are an illiquid asset) are packaged and sold as marketable securities. This transforms long-term illiquid assets into tradeable liquid assets. These assets are sold to other financial institutions or investors, freeing up capital for the original lender to expand its lending operation.

B7 Figure B1 shows the different sources of funding that registered banks in New Zealand use, their relative size, as well as the sectors that registered banks lend to. The numbers used in Figure B1 are illustrative only and are intended to provide a sense of the relative significance of each source of funding and each lending sector.

Figure B1 Sources of registered bank funding and sector lending



Source: Commerce Commission with data from Reserve Bank.[837]

B8 Registered banks are prudentially supervised by the Reserve Bank and are allowed to refer to themselves as a 'bank' (the term is otherwise restricted). Registered banks' business activities primarily consist of the borrowing and lending of money, or the provision of other financial services. There is also a range of non-bank businesses (such as NBDT, non-bank lending institutions and fintechs) that offer personal banking services. Registered banks are the primary providers of deposit accounts and home loans, which are the personal banking services of primary interest in this study.

B9 Banks also offer services in other areas such as insurance, financial advice, wealth management (including KiwiSaver), and other financial services provided to corporate, business, and personal customers.

Banks dominate the New Zealand financial system and a few, overseas owned entities, dominate the banking sector

B10 The New Zealand financial system is dominated by banks which do most of the lending to the non-financial, private sector in New Zealand. Lending by non-bank lending institutions (NBLIs) accounts for only 4% of lending to this sector (Figure B2).

837 Reserve Bank "Balance Sheet (S10) & Bank: Assets – total loans" [ ].

B11 Despite banks’ dominance of the financial system, New Zealand’s banking sector is quite small by international standards. In March 2022, banks had total assets of just over $667 billion NZD. This is around 188% of our Gross Domestic Product (GDP) and is at the lower end of the range for OECD countries.[838]

Figure B2 Lending by financial institution type (bank and non-bank) and by bank ownership type (December 2023)

Source: Commerce Commission with data from Reserve Bank.[839]

B12 ANZ, BNZ, ASB, and Westpac represent 87% of the total assets as shown in Figure B2. All four are overseas owned and are each subsidiaries of Australian banks.[840] Their parent entities ANZ Group Holdings, NAB, CBA, and Westpac Banking Corporation are the four largest banks operating in Australia. Figure B3 provides a breakdown of the total assets of the major banks by asset type.

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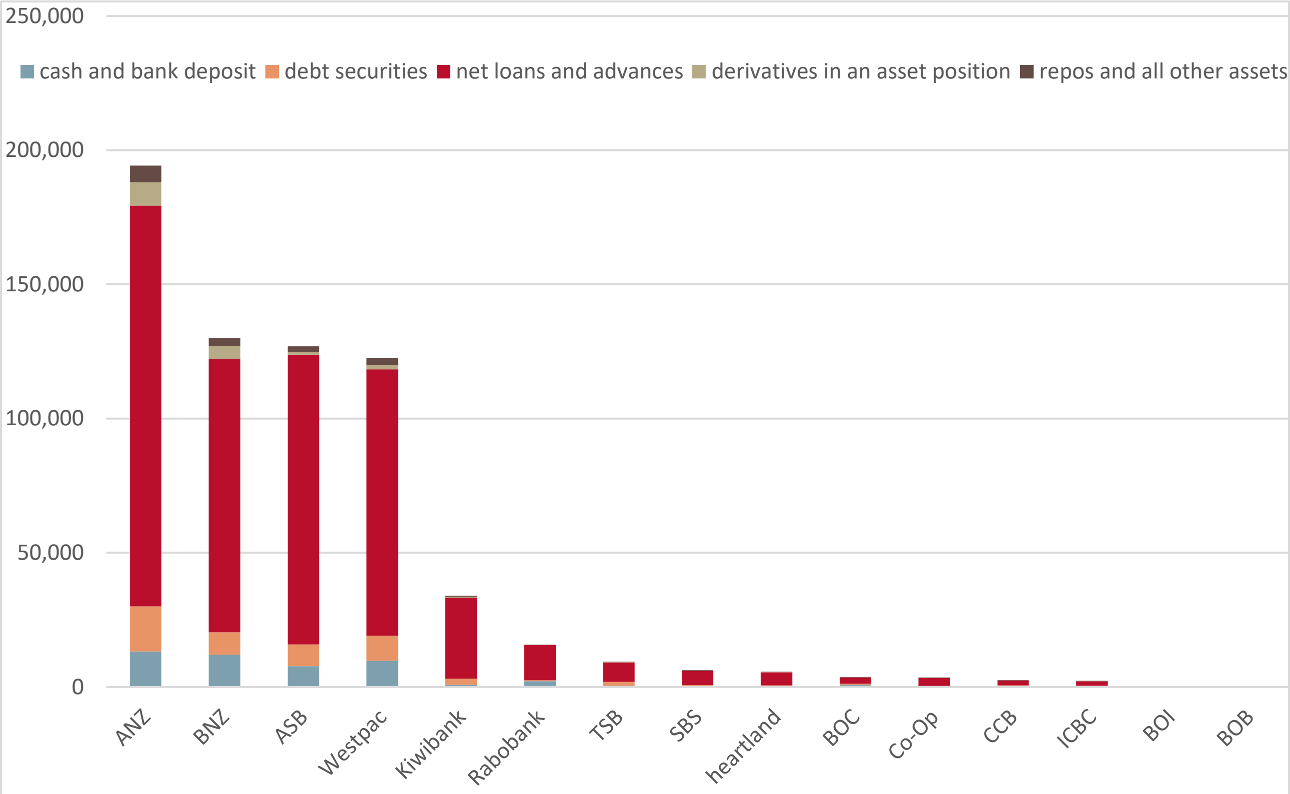
838 See: https://www.rbnz.govt.nz/financial-stability/about-the-new-zealand-financial-system/the-banking-sector .

839 Reserve Bank "Bank Financial Strength Dashboard" and Reserve Bank "Registered banks and non-bank lending institutions: Sector lending (C5)" [ ].

840 See Companies Office for each of: ANZ Bank New Zealand Limited, see: https://app.companiesoffice.govt.nz/companies/app/ui/pages/companies/35976 ; Bank of New Zealand, see: https://app.companiesoffice.govt.nz/companies/app/ui/pages/companies/428849 ; ASB Bank Limited, see: https://app.companiesoffice.govt.nz/companies/app/ui/pages/companies/398445 ; and Westpac New Zealand Group Limited, see: https://app.companiesoffice.govt.nz/companies/app/ui/pages/companies/1856466.

Figure B3 Breakdown of bank assets ($mil)



Source: Commerce Commission with data from Reserve Bank.[841]

Banks offer a variety of personal banking services but increasingly focus on housing loans

B13 Housing loan and household deposits constitute the most significant personal banking products offered by the banks (by value), as highlighted in Figure B4.

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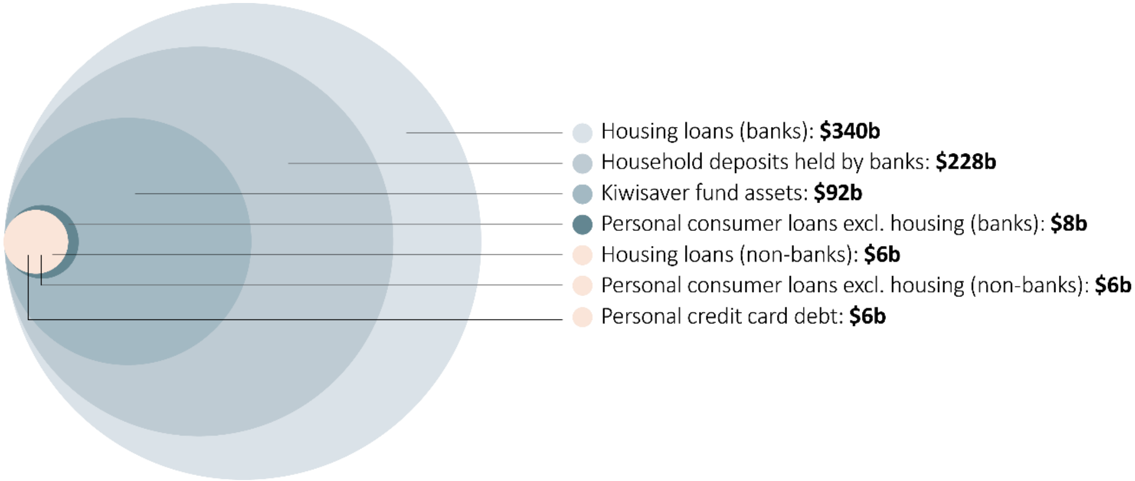
841 Reserve Bank "Bank Financial Strength Dashboard" [ ].

Figure B4 Relative size of selected personal banking services, December 2022



Source: Commerce Commission with data from Reserve Bank.[842]

B14 Increasingly, banks in New Zealand appear to be focused on core business products, particularly home loan and deposits, and have reduced their exposure to other types of financial services. Examples of this include the ANZ's sale of UDC Finance to Shinsei Bank in 2020, Kiwibank's sale of Kiwi Wealth to Fisher Funds in 2022, divestment from life insurance, and unsecured personal lending products by several banks.[843,844] Banks may still offer these products as intermediaries.

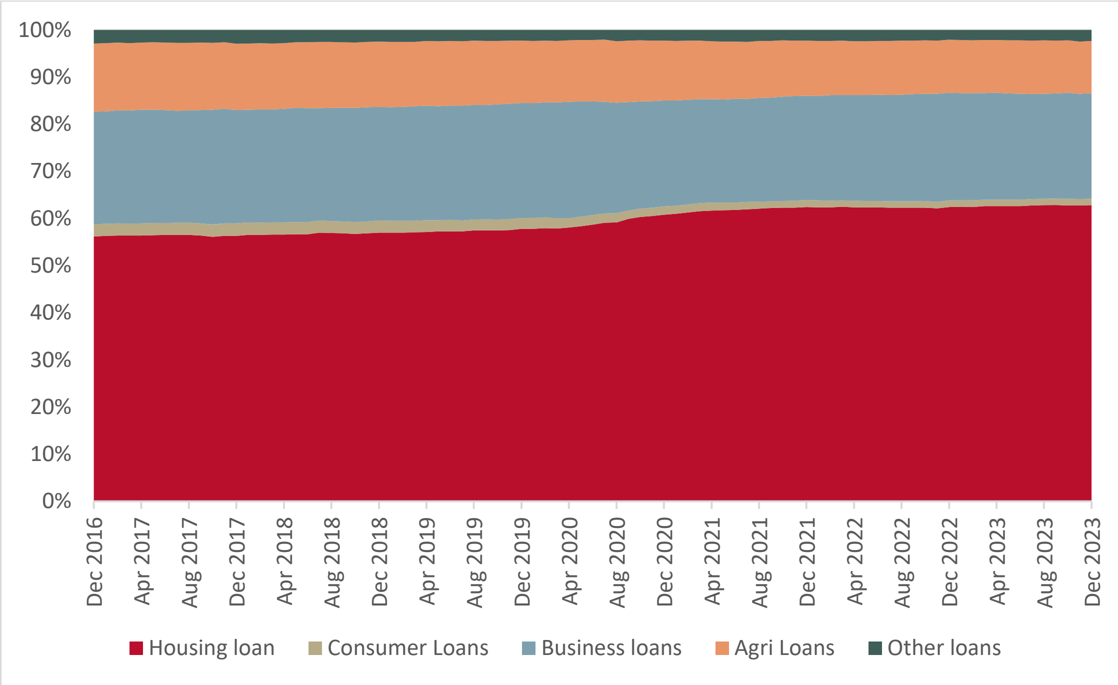
B15 It is also apparent that over the past few years housing loans have acquired an increasing importance for the banks' lending portfolio. Figure B5 reflects how, between December 2016 and December 2023, the share of housing lending has increased from 56.19% to 62.82%. This is likely due to a number of factors, including sharp increases in housing prices over the reference period, changing risk appetite, changes in the regulatory environment or other market forces.

B16 Over the 7-year period in the sample there has been a marked drop in business and agricultural lending from 38.33% in December 2016 to 33.45% in December 2023. Consumer lending has remained comparatively small, with a decreasing percentage of the portfolio composition in the period.

B17 Between December 2016 and December 2023, the total dollar value of housing lending has increased 53%, whereas business lending increased by 28%, agricultural lending growth held at 4% and consumer lending decreased by 35%.[845]

842 Reserve Bank "Balance Sheet (S10) & Bank: Assets – total loans" [ ].
843 MinterEllisonRuddWatts Non-Insurers retreat from the insurance market - MinterEllisonRuddWatts – ANZ, BNZ, Westpac and Kiwibank have sold their insurance business over the past 5 years.
844 As an example, both Kiwibank and TSB stopped offering personal consumer lending to their customers.
845 See: https://www.rbnz.govt.nz/statistics/series/registered-banks/banks-assets-loans-by-purpose

Figure B5 NZ banks loan composition by sector as percentage of total December 2016 December 2023



Source: Commerce Commission with data from Reserve Bank.[846]

Lending by non-bank providers caters for different groups of consumers and is growing

B18 Personal banking services are provided by a diverse group of entities. These include lenders who also take customer deposits - banks and NBDTs (such as CUBS) and non-deposit-taking lending institutions such as finance companies, buy-now-pay later (BNPL) platforms, peer-to-peer lenders, and digital wallet providers.

B19 The distinction between lenders who take deposits and those who do not is important to the level of regulatory oversight, and ultimately relevant to entry and expansion.

B20 The non-bank lending sector is highly diverse, with a range of operating structures, geographic distribution, ownership, and strategies.[847] Some lenders focus on personal loans (including car finance), others on mortgage lending, or property development.

B21 The sector can service borrowers who may otherwise have difficulty accessing personal banking services through a bank, due to a range of factors including having an adverse credit history, the bank's credit and risk policy, and lack of physical access to banks.

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846 Reserve Bank "Banks: Assets – Loans by purpose (S31)" [ ].

847 The non-bank lending sector comprises non-bank deposit takers and non-deposit takers finance companies.

B22 As they typically assume higher levels of risk compared to banks and have different sources of capital, NBLIs are likely to charge higher interest rates compared to banks.[848] Customers may look to shift to bank lending when they can.

B23 The non-bank lending sector grew rapidly in the lead up to the GFC in 2008. The GFC resulted in the failure of nearly 70 finance companies and 170,000 depositors were adversely affected.[849,850] This resulted in the Reserve Bank assuming supervision of NBDTs as a means to improve resilience of the sector and restore confidence in the sector. [851]

B24 Over the past few years, lending by companies that do not also take a customer's deposits has grown significantly faster compared to lending by NBDTs.

B25 The Reserve Bank points out that the value of mortgage lending by non-deposit-taking lending companies has more than doubled in the period between 2019 and 2022, compared to a growth of 25% for banks and NBDTs.[852] This is shown in Figure B6.

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848 Not having access to deposit or wholesale rates may mean that the access and cost of capital to finance lending is more restricted and therefore expensive.

849 https://www.interest.co.nz/saving/deep-freeze-list lists the companies which had failed as a result of the financial crisis.

850 Reserve Bank: "A tale of small branches: NBDT sector performance under increased regulatory scrutiny" Bulletin, Vol. 82, No. 5 (May 2019). Available at: https://www.rbnz.govt.nz/-/media/40e4ae45a189452ebefb3ca632ae9bd3.ashx?sc_lang=en.

851 A list of non-bank deposit takers can be found at https://www.rbnz.govt.nz/regulation-and-supervision/cross-sector-oversight/registers-of-entities-we-regulate/register-of-non-bank-deposit-takers-in-new-zealand.

852 Reserve Bank "Lending by non-deposit-taking institutions" (02 November 2022), available at: https://www.rbnz.govt.nz/hub/publications/financial-stability-report/2022/nov-2022/fsr-nov-22-box-d.

Figure B6 Residential mortgage lending by banks, NBDTs, and non-deposit lenders

	Total Mortgage lending ($mil)			% Growth over the previous 12 months		
Period	Banks	NBDTs	Non-deposit lenders	Banks	NBDTs	non-deposit lenders
Aug-19	267,200	980	1,910	6.3	0.5	31.3
Aug-20	284,400	1,030	2,350	6.4	4.3	22.9
Aug-21	317,000	1,150	3,320	11.5	12.4	41.3
Aug-22	335,200	1,280	4,820	5.7	10.7	45

Source: Reserve Bank.[853]

B26 The Reserve Bank suggests that the lending growth by non-deposit takers may be linked to several factors, including more flexible access to funding, supportive monetary conditions, flexible credit policies (for instance the absence of an LVR test) and lower costs of regulatory compliance.[854]

B27 Whether the growth is ongoing will likely be tested by the current economic environment. A KPMG sector review in 2023, suggested that profitability for the sampled group had decreased, however asset growth had continued.[855]

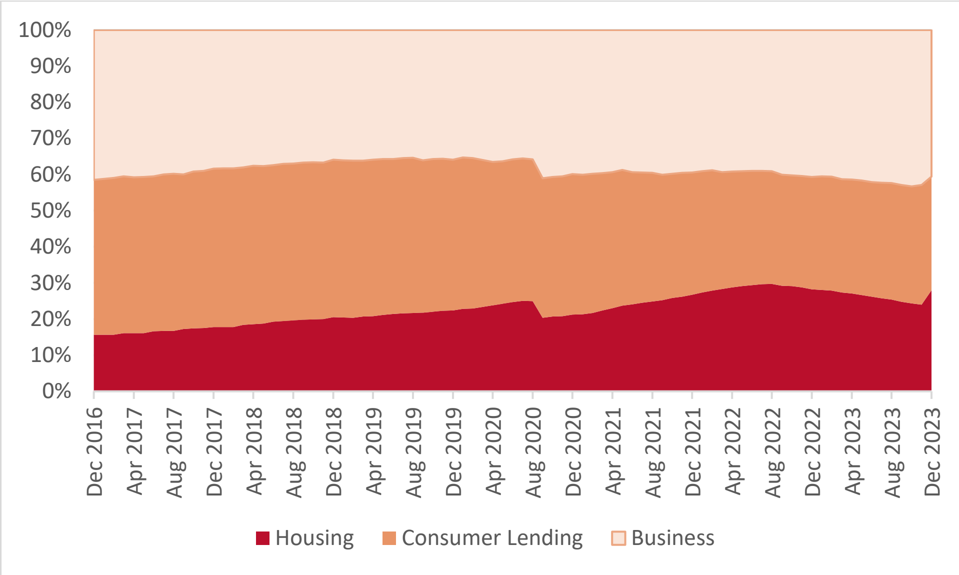
B28 The distribution of products on offer by non-bank lenders is shown in Figure B7. The table shows that lending is distributed fairly evenly between mortgage lending, personal and business lending. This differs from the product distribution for banks, which was shown in Figure B5, which showed a preference by banks for housing lending.

853 Reserve Bank "Lending by non-deposit-taking institutions: An article from the November 2022 Financial Stability Report." (2 November 2022), at Table D.1, available at: https://www.rbnz.govt.nz/hub/publications/financial-stability-report/2022/nov-2022/fsr-nov-22-box-d

854 ibid

855 KPMG "FIPS Non-Bank: Review of 2023" available at: https://assets.kpmg.com/content/dam/kpmg/nz/pdf/2023/12/fips-non-banks-2023-v3.pdf . The review notes that only 4 of the 28 companies experienced a loss.

Figure B7 Non-bank lending by sector as percentage of total – December 2016 to December 2023



Source: Commerce Commission with data from Reserve Bank.[856]

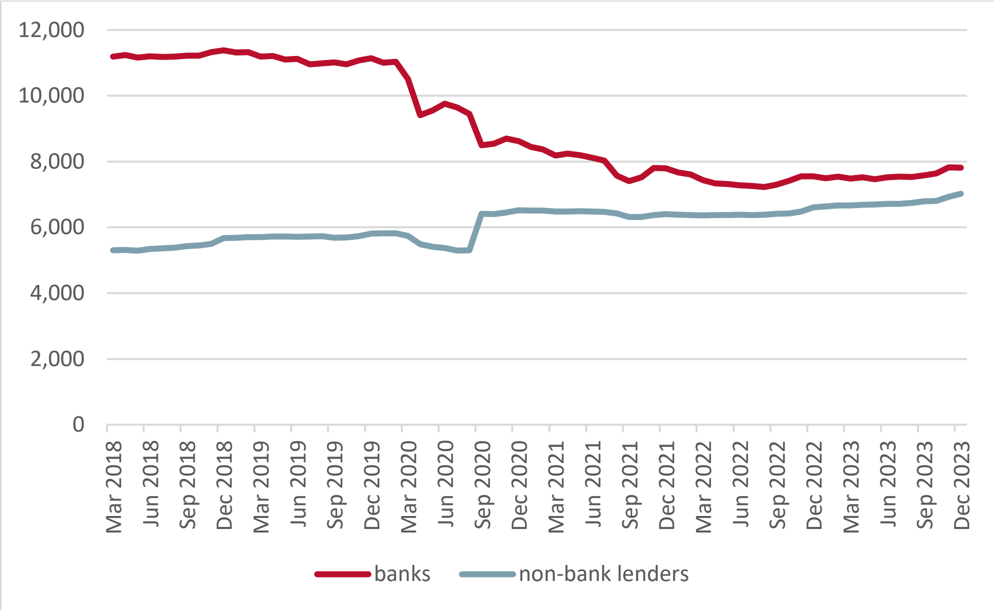
B29 While non-deposit-taking lenders are not prudentially regulated by the Reserve Bank, they still must be prudent with their lending practices, including compliance with the CCCF Act and any capital covenants or risk restrictions which may be imposed by the funding parties.

B30 Despite their growth, non-bank lenders still only represent a small portion of the lending sector, as shown in Figure B2. However, while their mortgage lending figure is still small, the progressive reduction of consumer lending offered by banks, as shown in Figure B8, has increased the significance of these companies as an alternative source of funding for consumer borrowing purposes.

B31 Figure B8 shows that, while the non-bank lender value of consumer lending has remained relatively steady, banks have decreased their consumer lending.

856 Reserve Bank "Registered banks and non-bank lending institutions: Sector lending (C5)" [ ].

Figure B8 **Value of personal consumer loans by registered banks and non-bank lenders December 2016 – December 2023 ($mil)**



Source: Commerce Commission with data from Reserve Bank.[857]

Non-Bank finance providers play a significant role in responding to evolving customer needs

B32 There is an evolving landscape of bank and non-bank providers offering personal banking sector products. The change reflects the fact that both banks and financial providers, such as fintechs, have become increasingly attuned to how to address customers' needs and expectations and with the aim of being a central touchpoint.

B33 Data and data analysis is becoming increasingly important in understanding and anticipating customer needs, and this gives banks and fintechs the opportunity to proactively develop and offer services which are tailored to specific needs. Understanding customer needs and delivering good customer experience can facilitate customer retention and increase sales.

B34 BNPL products, which allow consumers to split and defer payment upon purchase, are considered a disruptor for credit card services and personal loans due to the ease of access and lack credit check or affordability requirements and an interest free structure. [858]

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857 Reserve Bank "Registered banks and non-bank lending institutions: Sector lending (C5)" [ ].

858 Although this is set to change in September 2024 following the introduction of consumer protection regulations. Relevant information can be found at https://www.mbie.govt.nz/business-and-employment/consumer-protection/buy-now-pay-later/

B35 Fintechs vary in their product and service offering. Some, such as Revolut and Wise focus on money transfer and foreign account options, but also assist with budgeting and payments. [859,860] Other companies, like Sharesies, Dosh and Aera, have started offering interest bearing accounts. [861,862,863] The payment industry is increasingly being disrupted by digital wallet options, such as Apple Pay and Google Pay.

B36 While some of the fintechs (or neobanks) tend to specialise in specific personal banking services or customer's needs, some (like Revolut) have ambitions around diversifying the range of products on offer, to become a money hub and attract customers in the process.[864]

859 See: https://www.revolut.com/en-NZ/.
860 See: https://wise.com/nz/.
861 See: https://www.sharesies.nz/save.
862 See: https://www.dosh.nz/
863 See: https://www.aera.nz/deposit-accelerator.
864 Revolut being the clearest example: https://www.revolut.com/en-NZ/about/.

Attachment C Further details on bank profitability | *He taipitopito anō mō te whai huamonitanga a te pēke*

Introduction | *Whakatakinga*

C1 This attachment supplements our analysis on bank profitability contained in Chapter 6 of this report, by setting out more detail on:

C1.1 our approach to assessing bank profitability; and

C1.2 our assessment of potential explanations for the observed level of profitability in New Zealand's banking sector.

Our approach to assessing bank profitability | *Tā mātou hei aromatawai i te whai huamonitanga ā-pēke*

C2 This section defines the profitability measures we have considered, details our approach to assessing profitability, and discusses the key datasets we have used in our analysis in Chapter 6 of this report.

We have focused on three measures of profitability

C3 We have focused on three profitability ratios.

C3.1 **ROE** is calculated as net income divided by shareholders' equity. ROE provides a direct assessment of financial return to shareholders. The measure is only a partial measure of profitability. It depends upon a firm's leverage, such that a high ROE may simply reflect limited equity capital, and it is not risk sensitive.[865, 866] As we discuss in Chapter 6, we have placed greater weight on ROE. However, as each profitability ratio is only a partial measure of profitability, our conclusions rely on the outcomes we observe across multiple ratios.

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865 For example, in 2022 all 4 of the largest Australian banks completed share buy-backs (in Australia), increasing their ROE without a change in prices or costs.

866 European Central Bank "Beyond ROE – how to measure bank performance, appendix to the report on EU banking structures" (September 2010), at p. 5, available at: https://www.ecb.europa.eu/pub/pdf/other/beyondroehowtomeasurebankperformance201009en.pdf.

C3.2 **ROA** is calculated as net income divided by total assets. ROA is a measure of how efficiently a bank uses its assets to generate returns. A core benefit of ROA is, because of the long-term nature of many assets, it is less sensitive to short-term 'gaming' than other measures.[867] However, it is not suitable for cross-sector comparisons because it is sensitive to the total quantum of assets which may be affected by varying levels of capital intensity in each sector.

C3.3 **NIM** refers to the difference between what banks earn on their lending assets and their borrowing costs (net interest income), divided by their interest earning assets to account for scale. NIM is particularly useful in the New Zealand context given that net interest income is a primary driver of New Zealand banks' earnings.[868] However, NIMs do not account for all revenues and costs. Importantly, as NERA submit, NIMs exclude the cost of equity funding and can be skewed by greater non-interest bearing deposits.[869] It is therefore only a partial indicator of profitability.

C4 To a lesser extent, we have considered the CTI ratio. This measure reflects a bank's costs divided by revenues. The World Bank dataset we use for our analysis defines CTI as operating expenses as a share of the sum of net interest revenue and other operating income.[870] We included the CTI ratio because costs are relevant to profits and this measure frequently appears in bank's internal reporting and KPIs.[871]

C5 We agree with submissions that post-tax returns on equity and assets are better for international comparisons than pre-tax measures because investors target post-tax returns.[872] We have changed our approach to international comparisons from the Preliminary Issues paper and now use post-tax returns.

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867 Deloitte "Success or Struggle: ROA as a true measure of business performance" (31 October 2013), available at: https://www2.deloitte.com/us/en/insights/topics/operations/success-or-struggle-roa-as-a-true-measure-of-business-performance.html.

868 Reserve Bank "Financial stability report" (3 May 2023), at footnote 11, available at: https://www.rbnz.govt.nz/hub/publications/financial-stability-report/2023/may-2023/financial-stability-report-may-2023; ANZ "Submission on Market study into personal banking services - Preliminary Issues paper" (7 September 2023), at Appendix 1 para 25.4.

869 ASB "Submission on Market study into personal banking services - Preliminary Issues paper - Attachment A - NERA Report" (7 September 2023), at para 20; [ ].

870 World Bank "Global Financial Development Database" (September 2022) metadata for the series GFDD.EI.07, available at: https://databank.worldbank.org/source/global-financial-development.

871 [ ].

872 ANZ "Submission on Market study into personal banking services - Preliminary Issues paper - Annex 1 - Incenta Report" (7 September 2023), at para 29–30; ASB "Cross submission on Market study into personal banking services - Preliminary Issues paper" (5 October 2023), at para 5.1a; and David Tripe "Submission on Market study into personal banking services - Preliminary Issues paper" (6 September 2023), at p. 1.

Our methodology to assess bank level profitability

C6 To assess the level of profitability of New Zealand banks and the New Zealand banking sector, we have compared publicly available profitability data.

C7 We have sought to understand:

C7.1 how New Zealand's banking sector profitability compares on average and over time against peer countries; and

C7.2 the relative profitability of banks operating in New Zealand including differences between the four major banks (ANZ, ASB, BNZ, and Westpac) and other providers.

C8 Competition is a long run process, and profits can vary through the business cycle, so we have considered average profitability ratios over the longest reasonable periods available in our datasets.

C9 For the purpose of international comparisons, we have considered exceeding the upper quartile as the threshold for profitability being "high" compared to the sample of peer nations. For the CTI ratio, a low value represents a higher performing bank, and so we consider the lower quartile as the threshold for high profitability.

C10 We lastly consider a range of potential explanations for the observed levels of profitability in New Zealand's banking sector relative to those in other jurisdictions. Profitability is affected by a range of factors beyond competition that may explain higher returns relative to other firms or other banking sectors. We discuss each potential explanation in detail in this attachment, while we summarise our conclusions in Chapter 6.

C11 Incenta and Deloitte Access Economics submitted that a better approach to international comparisons is to compare profitability at a bank-by-bank level, rather than at a country level.[873] Incenta conducted their own bank level international benchmarking exercise.

C12 Profitability can be assessed in a number of different ways. We do not regard Incenta's approach as likely to produce results that are any more objective than the approach that we have taken. Bank-by-bank comparisons still involve a level of subjectivity and choice with regards to the appropriate sample of comparator banks and the appropriate approach to control for factors that may influence relative profitability.

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[873] ANZ "Submission on Market study into personal banking services - Preliminary Issues paper - Annex 1 - Incenta Report" (7 September 2023), at para 27–28; BNZ "Submission on Market study into personal banking services - Preliminary Issues paper - Attachment A - Deloitte Report" (7 September 2023), at para 156.

C13 We disagree with certain aspects of Incenta's comparator bank approach. For example, we disagree with the exclusion of comparator banks from countries that have recently experienced a banking crisis or that have a price-to-book ratio greater than one, and we do not consider the inclusion of goodwill to be appropriate in this context. Incenta's 'cross-check' of a price-to-book ratio that is greater than one is only likely to be satisfied by high performing banks (high ROE relative to cost of equity). Incenta's sampling method therefore does not, in our view, select a neutral sample of comparator banks with similar risk to New Zealand's banks.

C14 For these reasons, we do not think that comparing profitability, internationally, at a bank-by-bank level is going to improve materially our understanding of the factors affecting competition in personal banking in New Zealand or, ultimately, our recommendations for improving competition. We have instead based our analysis on the publicly available World Bank dataset, which we describe below.

We have used two publicly available datasets

C15 We sought out publicly available datasets on bank profitability from established, reputable sources. We identified two robust data sources. These are:

C15.1 Reserve Bank of New Zealand Bank Financial Strength Dashboard: Quarterly bank level data for New Zealand banks; and

C15.2 World Bank Global Financial Development Database: Annual country level data, including data on banking sector profitability.

Reserve Bank dataset

C16 The Reserve Bank publishes a dashboard that presents measures of bank financial strength.[874] This includes measures of profitability, liquidity, and asset quality among others.

C17 The data is reported quarterly at a bank level for up to 22 'banks' and 'groups' operating in New Zealand.[875] We present only the data relating to the 15 locally incorporated banks contained within the dataset, excluding groups.[876] The dataset does not include data on branches of overseas incorporated banks such as HSBC and Kookmin Bank.

874 The dataset can be found at https://bankdashboard.rbnz.govt.nz/profitability.

875 We use the Reserve Bank's definitions for these terms and refer to locally incorporated banks as 'banks', and the consolidated New Zealand-based activities of dual registered banking groups as 'groups', Reserve Bank "Frequently asked questions", available at: https://bankdashboard.rbnz.govt.nz/faqs.

876 The banking group data includes both the activities of the New Zealand incorporated company and the activities of any New Zealand branches of affiliated overseas companies. We understand that the provision of personal banking services occurs through the New Zealand incorporated companies, rather than through the New Zealand branches of overseas companies, so we have removed the banking groups from our dataset.

C18 The data covers the period from 1 January 2018 to 30 September 2023 at the time of our analysis. The raw data has been supplied to the Reserve Bank by each individual bank.

C19 The Reserve Bank, database contains the following profitability measures:[877]

C19.1 ROE (after tax); [878]

C19.2 ROA (after tax); [879] and

C19.3 NIM.[880]

C20 The key benefits of the Reserve Bank's database are that:

C20.1 it allows for the assessment of each individual bank's performance over time;

C20.2 quarterly data allows us to understand intra-year variation; and

C20.3 it is complete, and the Reserve Bank's compulsory reporting ensures that a system is in place to minimise inconsistencies across banks.

C21 The key limitations of this dataset are that data is only available from 2018 and the dataset does not include data on the CTI ratio of banks in New Zealand.

World Bank dataset

C22 The World Bank publishes annual country level data on measures of financial development and financial system characteristics for 214 economies.[881]

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877 Reserve Bank "Bank Financial Strength Dashboard Data" Series: DBB.QIE13, DBB.QIE10, and DBB.QIE15, available at: https://bankdashboard.rbnz.govt.nz/profitability.

878 The Reserve Bank defines ROE (after tax) as the ratio of profit after tax to average equity over the quarter.

879 The Reserve Bank defines ROA (after tax) as profit after tax as a percentage of average total assets over the quarter.

880 The Reserve Bank defines NIM as the ratio of net interest income to average interest bearing assets, where net interest income is interest received less interest paid.

881 For more detail on the dataset see https://www.worldbank.org/en/publication/gfdr/data/global-financial-development-database#:~:text=The%20Global%20Financial%20Development%20Database,annual%20data%2C%20starting%20from%201960.

C23 For each indicator we use, data for the numerator and the denominator is aggregated from a bank level to a national level before the value is calculated.[882] The profitability measures we use in our analysis are:[883]

C23.1 ROE (post-tax);[884]

C23.2 ROA (post-tax);[885]

C23.3 NIM;[886] and

C23.4 CTI ratio.[887]

C24 Data on these indicators are available for many countries over the period from 2000 to 2021. However, New Zealand's data is only available from 2007. We have limited our analysis of the World Bank database to the period from 2010 to 2021 to account for the availability of New Zealand data, to limit the number of missing or excluded values for other countries, and to remove the years relating to the GFC.

C25 The key benefits of the World Bank's data are the comprehensive list of countries data is available for, the wide range of variables included, and the fact that the data covers a longer period than the Reserve Bank's data.

C26 The key limitation of the World Bank data relates to its aggregate nature. It is not clear which banks are included for each country and it is not possible to disaggregate the data to construct a sample at the bank level.[888]

C27 The countries included in our analysis are summarised in Table C1. We have mirrored the sample of peer nations used by the Reserve Bank in their March 2023 Financial Stability Report.[889]

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882 The World Bank notes that the banks included may vary between indicators for the same country. Data is also calculated from underlying bank-by-bank unconsolidated data from Bankscope and Orbis. Consequently, there may be some inter- and intra-country inconsistencies that may affect the interpretation of results.

883 The World Bank "DataBank – World Development Indicators" , available at: https://databank.worldbank.org/reports.aspx?source=2&series=FR.INR.LNDP&country=.

884 Defined by World Bank as the ratio of commercial banks' after-tax income to yearly averaged equity. Series: GFDD.EI.06.

885 Defined by World Bank as the ratio of commercial banks' after-tax income to yearly averaged total assets. Series: GFDD.EI.05.

886 Defined by World Bank as accounting value of banks' net interest revenue as a share of its average interest bearing assets. Series: GFDD.EI.01.

887 Defined by World Bank as operating expenses of a bank as a share of sum of net interest revenue and other operating income. Series: GFDD.EI.07.

888 ANZ "Submission on Market study into personal banking services - Preliminary Issues paper - Annex 1 - Incenta Report" (7 September 2023), at para 7(a) and 27(a).

889 Reserve Bank "Financial stability report" (3 May 2023), at Figure 2.12, available at: https://www.rbnz.govt.nz/hub/publications/financial-stability-report/2023/may-2023/financial-stability-report-may-2023.

C28 As discussed later in this attachment, we do not agree with Incenta's submission that we should exclude countries that have recently experienced a banking crisis and so we continue to include the United Kingdom, Japan, and countries in the European Union in our sample.[890]

Table C1 List of countries used in this attachment to assess trends in bank financial performance

Australia (AUS)	Germany (DEU)	Norway (NOR)
Austria (AUT)	Hong Kong (HKG)	Portugal (PRT)
Belgium (BEL)	Israel (ISR)	Singapore (SGP)
Canada (CAN)	Italy (ITA)	Sweden (SWE)
Denmark (DNK)	Japan (JPN)	Switzerland (CHE)
Finland (FIN)	Netherlands (NLD)	United Kingdom (GBR)
France (FRA)	New Zealand (NZL)	United States (USA)

Source: Reserve Bank.[891]

We have assessed a wide range of potential explanations for higher levels of profitability in New Zealand | *Kua oti i a mātou te aromatawai i ngā momo take hei whakamārama i te nui ake o te whai huamoni i Aotearoa*

We sought submissions that explain the observed level of profitability

C29 Profitability can be affected by a range of factors beyond just competition. For example, high profitability relative to peer nations may indicate differences in factors such as relative risk, ownership structure, macroeconomic conditions, and the regulatory landscape.[892]

C30 Even if the level of bank profitability in New Zealand is higher than in peer nations (as shown in Chapter 6), such factors may reasonably explain earning relatively higher returns. We sought submissions that explain the high profitability we observe in New Zealand's banking sector.[893]

890 ANZ "Submission on Market study into personal banking services - Preliminary Issues paper - Annex 1 - Incenta Report" (7 September 2023), at para 43; [ ].

891 Reserve Bank "Financial stability report" (3 May 2023), at Figure 2.12.

892 Reserve Bank "Financial stability report" (3 May 2023), at p. 24, available at: https://www.rbnz.govt.nz/hub/publications/financial-stability-report/2023/may-2023/financial-stability-report-may-2023.

893 Commerce Commission "Preliminary Issues paper - Personal banking services market study" (10 August 2023), at para 122.

C31 We have considered a range of potential explanations, to assess the extent to which each potential explanation may explain the observed levels of profitability in New Zealand. For example:

C31.1 Incenta, NERA, and Deloitte submit that we should consider differences in the risk-free rate between peer countries;[894]

C31.2 Incenta, NERA, and Deloitte submit that we should adjust for differences in leverage;[895]

C31.3 Incenta, NERA, and Deloitte submit that we should consider the effect of macroeconomic conditions and banking crisis in different jurisdictions;[896]

C31.4 Incenta and Deloitte submit that we should include adjustments for the level of intangible assets such as goodwill;[897]

C31.5 Incenta and NERA submit that we should use the market risk premium, rather than total market return and submit on other issues with the Damodaran data we used in the Preliminary Issues paper;[898]

C31.6 NERA submit that we have understated the comparative riskiness of Australian banks investing in New Zealand banks.[899]

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894 ANZ "Submission on Market study into personal banking services - Preliminary Issues paper - Annex 1 - Incenta Report" (7 September 2023), at para 54(b); ASB "Submission on Market study into personal banking services - Preliminary Issues paper - Attachment A - NERA Report" (7 September 2023), at para 23, 59–61; BNZ "Submission on Market study into personal banking services - Preliminary Issues paper - Attachment A - Deloitte Report" (7 September 2023), at para 144–145.

895 ANZ "Submission on Market study into personal banking services - Preliminary Issues paper - Annex 1 - Incenta Report" (7 September 2023), at para 31–32 and 54(c); ASB "Submission on Market study into personal banking services - Preliminary Issues paper - Attachment A - NERA Report" (7 September 2023), at para 6, 15, 27–32; BNZ "Submission on Market study into personal banking services - Preliminary Issues paper - Attachment A - Deloitte Report" (7 September 2023), at para 146

896 ANZ "Submission on Market study into personal banking services - Preliminary Issues paper - Annex 1 - Incenta Report" (7 September 2023), at para 83–89; ASB "Submission on Market study into personal banking services - Preliminary Issues paper - Attachment A - NERA Report" (7 September 2023), at para 39 and 63; BNZ "Submission on Market study into personal banking services - Preliminary Issues paper - Attachment A - Deloitte Report" (7 September 2023), at para 168–183.

897 ANZ "Submission on Market study into personal banking services - Preliminary Issues paper - Annex 1 - Incenta Report" (7 September 2023), at para 54(a), 70–71, Appendix C; BNZ "Submission on Market study into personal banking services - Preliminary Issues paper - Attachment A - Deloitte Report" (7 September 2023), at para 161–166.

898 ANZ "Submission on Market study into personal banking services - Preliminary Issues paper - Annex 1 - Incenta Report" (7 September 2023), at para 33–35; ASB "Submission on Market study into personal banking services - Preliminary Issues paper - Attachment A - NERA Report" (7 September 2023), at para 44–58.

899 ASB "Submission on Market study into personal banking services - Preliminary Issues paper - Attachment A - NERA Report" (7 September 2023), at para 62–72.

C31.7 NERA submit that Australian investors require higher pre-tax returns to compensate for their inability to access imputation credits on New Zealand profits.[900]

C31.8 Deloitte submit that profitability differences between the largest and smallest banks are explainable by cost efficiencies such as economies of scale and wholesale funding advantages.[901]

C31.9 Deloitte submit that we should control for differences between the banking sectors in each country.[902]

The low-risk nature of New Zealand's banking system should result in lower returns relative to peer countries

C32 Risk and return finance principles state that risk averse investors ask for compensation, or a risk premium, for taking on higher risk investments.[903] Consequently, riskier activities can earn higher long run returns, though they will be more volatile.

C33 This section explains why we consider New Zealand's banking system to be less risky than peer countries. Consequently, we would usually expect banking sector profitability in New Zealand to be lower, rather than higher, relative to other countries over time.

New Zealand's business mix focusses on more vanilla banking activities

C34 Business mix affects the relative risk of a bank due to differences in risk and cost across banking activities.

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900 ASB "Submission on Market study into personal banking services - Preliminary Issues paper - Attachment A - NERA Report" (7 September 2023), at para 73–78.

901 BNZ "Submission on Market study into personal banking services - Preliminary Issues paper - Attachment A - Deloitte Report" (7 September 2023), at para 184–198.

902 BNZ "Submission on Market study into personal banking services - Preliminary Issues paper - Attachment A - Deloitte Report" (7 September 2023), at para 147–151.

903 Schoenmaker, D., Schramade, W "Corporate finance for long-term value" (September 2023), at p. 325, available at: https://doi.org/10.1007/978-3-031-35009-2.

C35 New Zealand banks and their Australian parent companies are more heavily weighted towards more traditional (ie, ‘vanilla’) banking activities including personal and business banking and have been simplifying their offerings in recent years.[904] Overseas banks are more heavily weighted towards institutional, insurance, and investment type activities.

C36 Traditional banking activities carry less risk than other forms of banking and are often lower cost. For example, the more vanilla nature of New Zealand and Australia’s banking systems resulted in both economies’ banking sectors only facing relatively mild effects during the GFC.[905] Additionally, diversification into wider forms of banking and into a larger geographic scope increases complexity and cost.[906]

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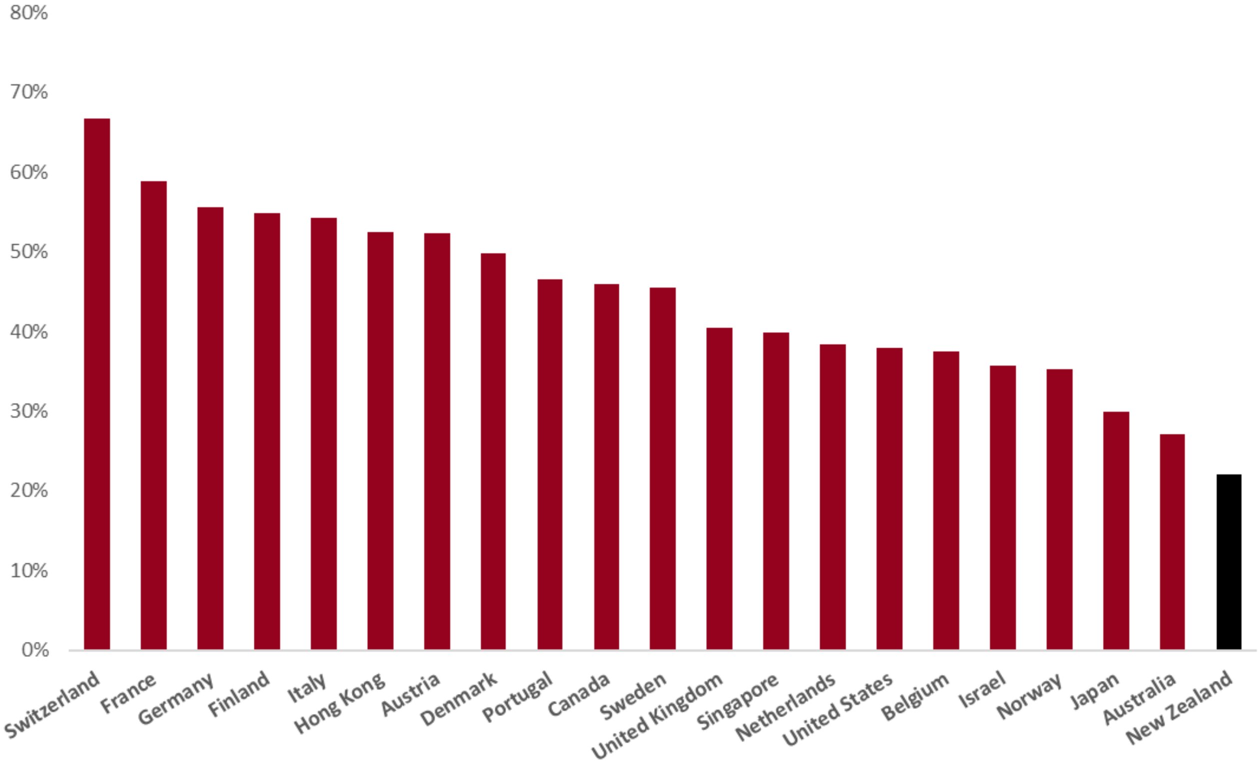
904 Reserve Bank “Financial Stability Report” (3 May 2023), at p. 24, available at: https://www.rbnz.govt.nz/hub/publications/financial-stability-report/2023/may-2023/financial-stability-report-may-2023; Reserve Bank “Learnings from the global financial crisis” (September 2012) Bulletin, Vol. 75, No. 3, at p. 58; DBRS Morningstar “Australia and New Zealand Banking Gorup Limited” (December 2019), at p. 2 and 4 [ ]; JP Morgan “Rating report: Australian Banks: Key sector themes post FY22 results: Deposit competition and mix is key to the outlook from here” (December 2022), at p. 19 [ ]; JP Morgan “Westpac Banking Corporation: FY23 result: Valuation looks fair but multi-year tech simplification could unlock ROE upside if executed well” (November 2023), at p. 9 [ ].

905 Reserve Bank “Learnings from the global financial crisis” (September 2012) Bulletin, Vol. 75, No. 3, at p. 58.

906 Reserve Bank “Learnings from the global financial crisis” (September 2012) Bulletin, Vol. 75, No. 3, at p. 58; [ ].

Figure C1 New Zealand's banking sector's average non-interest income to total income between 2010 and 2021 relative to peer nations



Source: Commerce Commission analysis of World Bank data.[907]

C37 The more traditional nature of New Zealand's banking system can be seen in Figure C1, which shows, that on average, New Zealand had the lowest non-interest income as a proportion of total income relative to peer nations over the comparison period (with Australia second to lowest).[908] While we acknowledge this also reflects the reduction in fees in the New Zealand banking sector in recent years, the low proportion of non-interest income is indicative of New Zealand and Australia's focus on more traditional interest earning banking activities.[909]

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907 World Bank "Global Financial Development Dsatabase" [ ].

908 Non-interest income refers to bank incomes that were generated through activities that do not bear interest. As many traditional banking activities are interest bearing, including loans and deposits, non-interest income can be used to assess whether banks focus more on traditional banking activities. Examples of non-interest incomes include fee income, commissions, other operating income, and net gains on trading, derivatives, and other securities. See World Bank Global Financial Development Database Metadata on series GFDD.EI.03.

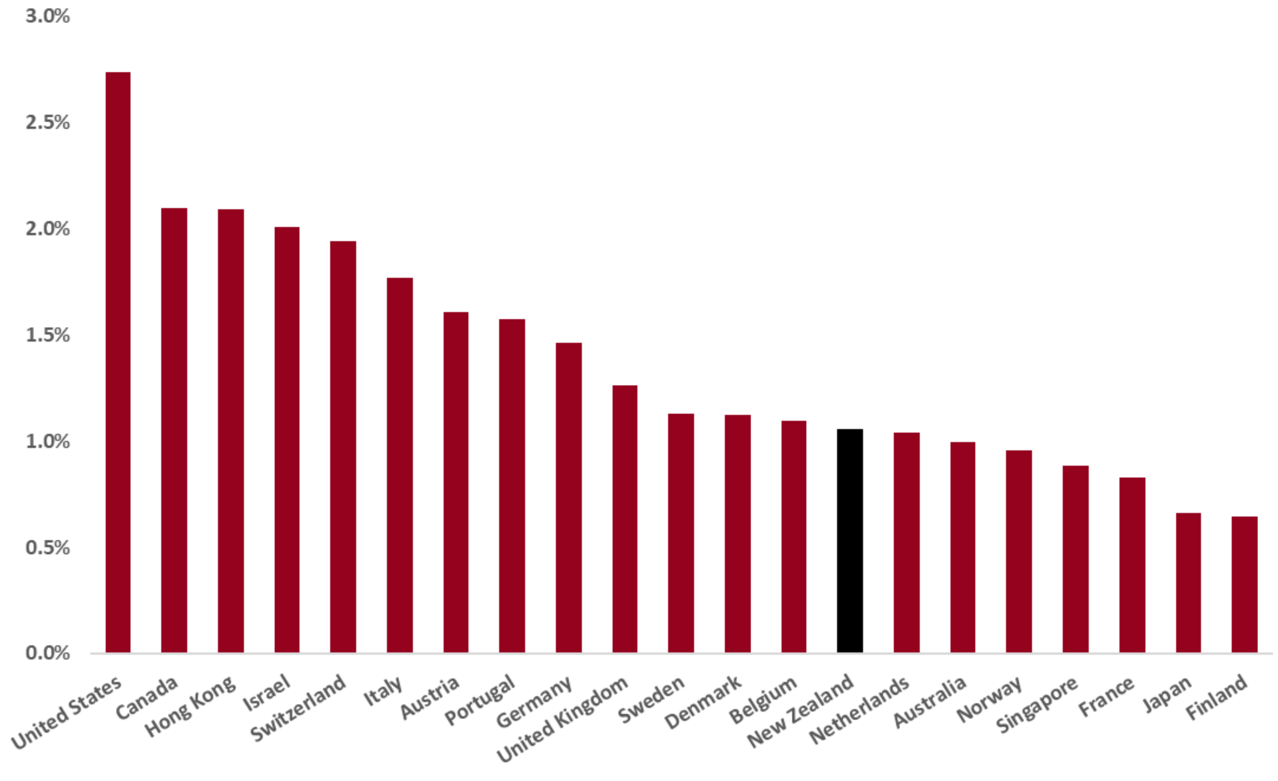
909 BNZ "Submission on Market study into personal banking services - Preliminary Issues paper - Attachment A - Deloitte Report" (7 September 2023), at para 112; [ ].

C38 Figure C2 and Figure 6.5 also demonstrate the lower cost structure of the New Zealand banking sector in terms of average overhead costs to total assets and CTI ratio, respectively, which is partially driven by New Zealand's more vanilla business mix. Professor Margaritis and Dr Hasannasab found that New Zealand banks operate with high cost-efficiency, generally in the 80–90% range.[910] Low CTI ratios in New Zealand may also, in part, reflect under-investment in core systems, which is discussed further in Chapter 9.

C39 Figure B1 further highlights New Zealand banks' focus on more traditional banking activities with a large proportion of bank assets being loans to households and businesses and their funding being mainly sourced from deposits and equity rather than other securitisation.[911]

C40 We would expect that the lower risk nature of New Zealand's core banking activities would, other things equal, result in lower long run returns than the banking sectors of economies that have a riskier business mix.[912]

Figure C2 New Zealand's banking sector's average overhead costs to total assets between 2010 and 2021 relative to peer nations



Source: Commerce Commission analysis of World Bank data.[913]

910 Cost-efficiency is a measure of how effectively banks minimise costs given their level of outputs and input costs. Dimitris Margaritis and Maryam Hasannasab "Market power in banking: A study of New Zealand banks" (March 2024), at p. 7–10.

911 Also see paragraph B6 of this report.

912 [ ].

913 World Bank "Global Financial Development Database" [ ].

There is little evidence that New Zealand banks are particularly more leveraged than peers

C41 The degree of leverage can affect bank profitability. A more leveraged bank may expect to earn a higher ROE largely due to the higher associated risk of greater liability funding.[914] Incenta adjust their estimation of peer group returns under the assumption that New Zealand banks are more highly leveraged than international peers.[915] The Modigliani-Miller theorem concludes that, in theory, a leveraged firm cannot command a premium over an unleveraged firm; however, we note that in practice higher leverage can increase expected returns at certain levels of leverage.[916]

C42 One measure of leverage is the equity ratio, which shows total equity as a proportion of total assets. A more leveraged bank would have a higher proportion of debt funding and so a lower equity ratio.

C43 Because the World Bank dataset does not include data that would allow for the assessment of leverage at the national level, we have compared the average equity ratio for ANZ, BNZ, ASB, and Westpac to the average equity ratio of banks in Incenta's wider, non-diversified sample between 2018 to 2022.[917]

C44 Care must be taken when interpreting these results. New Zealand banks' data is captured from the Reserve Bank dataset, while international banks' data is captured through Bloomberg. Different datasets may not be directly comparable. Additionally, Bloomberg data is annual while Reserve Bank data is quarterly.[918]

C45 While not determinative due to these data limitations, Figure C3 shows that the major New Zealand banks' equity ratios have on average been near the middle of Incenta's sample. This does not support the view that New Zealand's major banks' profits are explainable by higher leverage.

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914 European Central Bank "Beyond ROE – how to measure bank performance, appendix to the report on EU banking structures" (September 2010), at p. 5 and 18, available at: https://www.ecb.europa.eu/pub/pdf/other/beyondroehowtomeasurebankperformance201009en.pdf.

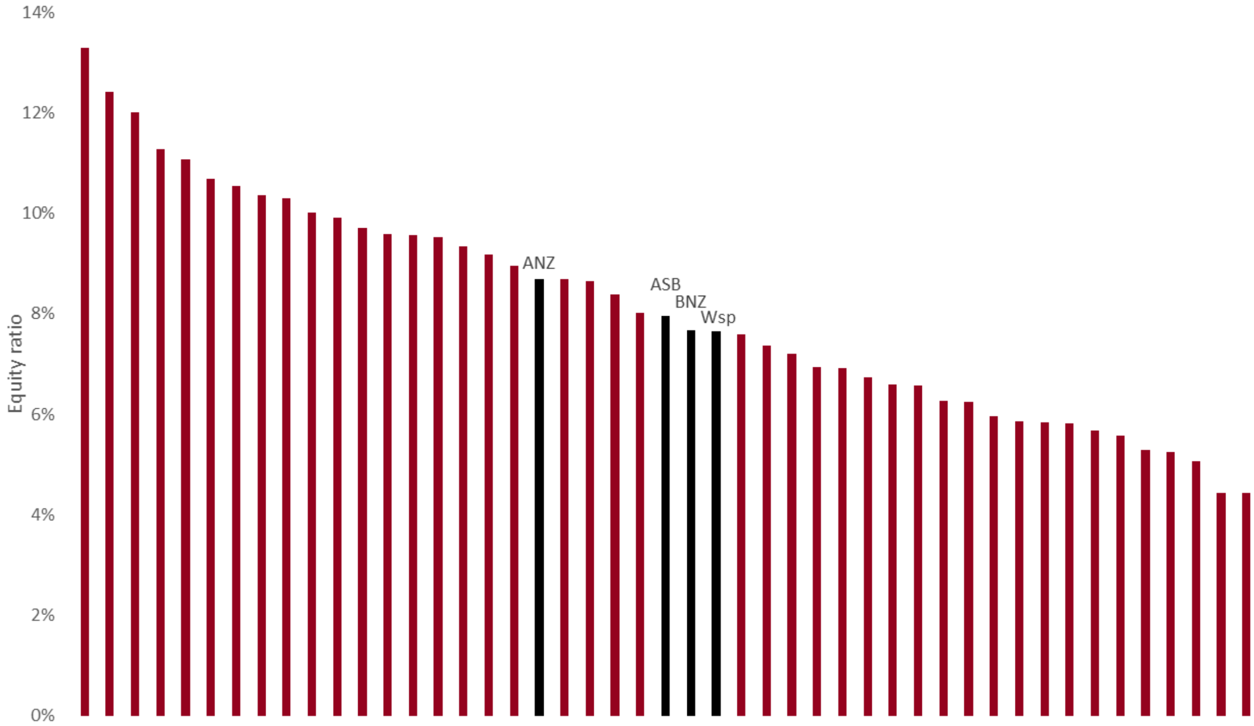
915 ANZ "Submission on Market study into personal banking services - Preliminary Issues paper - Annex 1 - Incenta Report" (7 September 2023), para 54 (c).

916 Modigliani, F. & Miller, M. "The cost of capital, corporation finance and the theory of investment" (June 1958), at p. 270.

917 The list of comparator banks match those in Table 5 and Table 7 of ANZ "Submission on Market study into personal banking services - Preliminary Issues paper - Annex 1 - Incenta Report" (7 September 2023), at Appendix A. As Incenta uses financial year data, we have used Reserve Bank data for New Zealand banks between June 2018 and June 2022.

918 The use of averages will partly mitigate the effect of quarterly fluctuations, including seasonality.

Figure C3 Average bank level equity ratio for ANZ, ASB, BNZ, and Westpac relative to overseas banks between 2018 to 2022



Source: Commerce Commission analysis of Reserve Bank and Bloomberg data.[919]

C46 In a submission to the Reserve Bank in May 2019, the New Zealand Banking Association points to work by PWC which claims that the capital ratios of New Zealand's major banks are in the top quartile of large international banks and are above what Australian Prudential Regulation Authority (APRA) would consider to be "unquestionably strong".[920] A higher proportion of capital implies that the major New Zealand banks are less leveraged than international peers.

C47 Additionally, our analysis in Chapter 6 shows that the profitability of New Zealand's banking sector has also been high over the past decade on ROA, which adjusts for the effect of leverage.[921]

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919 Reserve Bank "Bank Financial Strength Dashboard" [ ].

920 New Zealand Bankers Association "Submission to the Reserve Bank of New Zealand on the Consultation Paper: How much capital is enough? (17 May 2019), at para 18; and PWC "International comparability of the capital ratios of New Zealand's major banks – update paper" (17 May 2019), at p. 4, 6, and 14.

921 European Central Bank "Beyond ROE – how to measure bank performance, appendix to the report on EU banking structures" (September 2010), at p. 19.

We do not consider it appropriate to make adjustments for goodwill

C48 Incenta and Deloitte submit that intangible assets such as goodwill should be included in the assessment of profitability.[922] Both submit that excluding intangible assets may overstate the level of profitability of a firm with significant intangible assets, by excluding an asset that investors purchased with the intention of yielding a future return.

C49 We do not consider that adjustments for goodwill should be made. This is consistent with our approach to goodwill in the market study into the retail grocery sector, where we excluded goodwill on the basis that it is not an asset employed to generate earnings, rather, it reflects future expected earnings, which may capture the expectation of excessive profits in the future.[923]

Shareholders of New Zealand banks have experienced relatively stable returns on equity

C50 Volatility of earnings can provide a further indication of relative risk. All else equal, a higher risk firm would expect to experience more volatile returns. We have considered the standard deviation of ROE for countries in our sample between 2010 and 2021 as an indicator of volatility.[924]

C51 As Figure C4 shows, New Zealand's banking sector has experienced near to the least volatile ROE over the period, while having the third highest average ROE. Both countries that had a higher average post-tax ROE (Canada and Hong Kong) experienced noticeably greater volatility in their returns than New Zealand has.

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922 ANZ "Submission on Market study into personal banking services - Preliminary Issues paper - Annex 1 - Incenta Report" (7 September 2023), at para 54(a) and 70–71(c)ii; BNZ "Submission on Market study into personal banking services - Preliminary Issues paper - Attachment A - Deloitte Report" (7 September 2023), at para 161–166.

923 Commerce Commission "Market study into the retail grocery sector: Final report" (8 March 2022), at para 3.33, B85.5, B98–B100.

924 We have used the sample standard deviation formula for the purposes of Figure C4.

Figure C4 Country level standard deviation of ROE against mean ROE between 2010 and 2021

Source: Commerce Commission analysis of World Bank data.[925]

C52 This stability is partly explainable by New Zealand's comparably limited experience of banking crisis over this period, as discussed below. We acknowledge NERA's submission, that a longer time series would better reflect this by capturing the effects of a full business cycle.[926] However, we note that Figure C4 largely supports the Reserve Bank's similar chart in its Financial Stability Report that shows a similar picture over a longer period, between 2000 to 2021.[927] Over the Reserve Bank's longer sample period, New Zealand had the highest average ROE relative to the same country sample, combined with relatively modest volatility.

A higher risk-free rate in New Zealand and New Zealand banks paying a premium in wholesale markets at least partly explain higher profitability

C53 The prevailing risk-free rate and the market risk premium both affect investor's expected level of return.

925 World Bank "Global Financial Development Database" [ ].

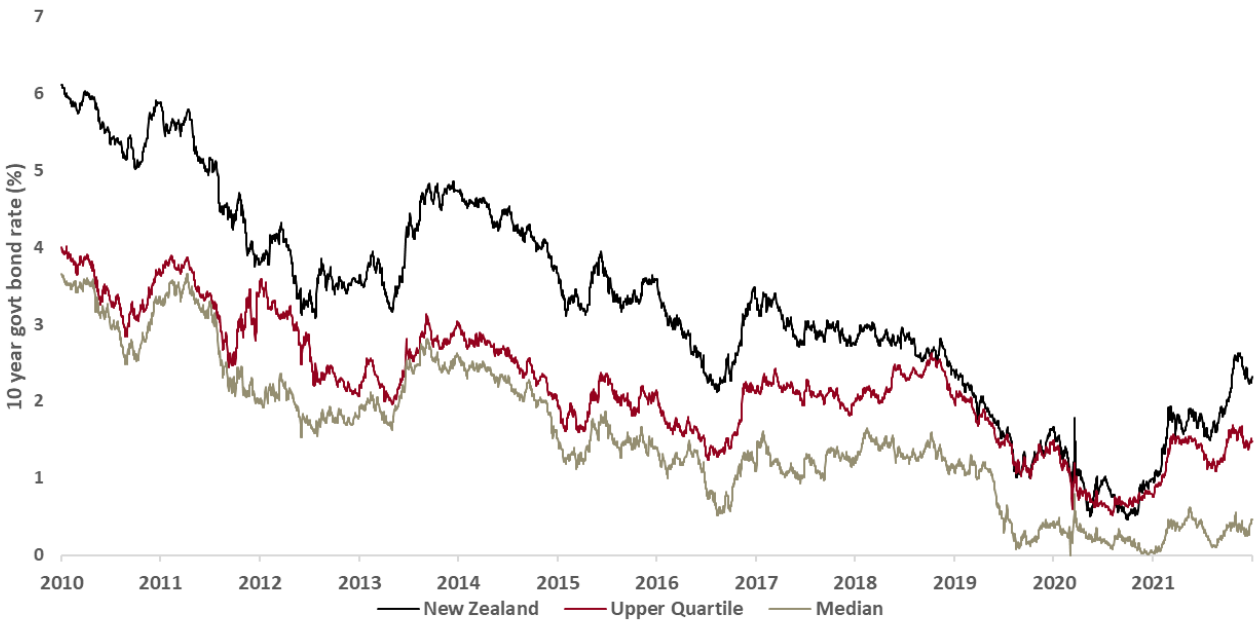
926 ASB "Submission on Market study into personal banking services - Preliminary Issues paper - Attachment A - NERA Report" (7 September 2023), at para 42–43.

927 Reserve Bank "Financial stability report" (3 May 2023), Figure 2.12, available at: https://www.rbnz.govt.nz/hub/publications/financial-stability-report/2023/may-2023/financial-stability-report-may-2023.

C54 The risk-free rate is the rate of return expected when there is no risk of default. When estimating the cost of capital as the benchmark for assessing profitability, the risk-free rate is explicitly relevant to the calculation of the cost of debt and cost of equity.[928] All else equal, if the risk-free rate increases, an investor would expect a higher rate of return.

C55 Debt issued by the New Zealand Government and denominated in New Zealand dollars is considered to be free of default risk and we have considered 10-year government bond yields in previous market studies.[929] In this case, we have compared New Zealand's daily 10-year government bond yields between 1 January 2010 to 31 December 2021 to the 10-year government bond yields of countries in our sample for which data was available.[930]

Figure C5 New Zealand's 10-year government bond rate between 1 January 2010 and 31 December 2021 relative to the upper quartile of comparator countries



Source: Commerce Commission analysis of Wall Street Journal data.[931]

928 Commerce Commission "Part 4 Input Methodologies Review 2023: Final decision – Cost of capital topic paper" (December 2023), at para 4.357.

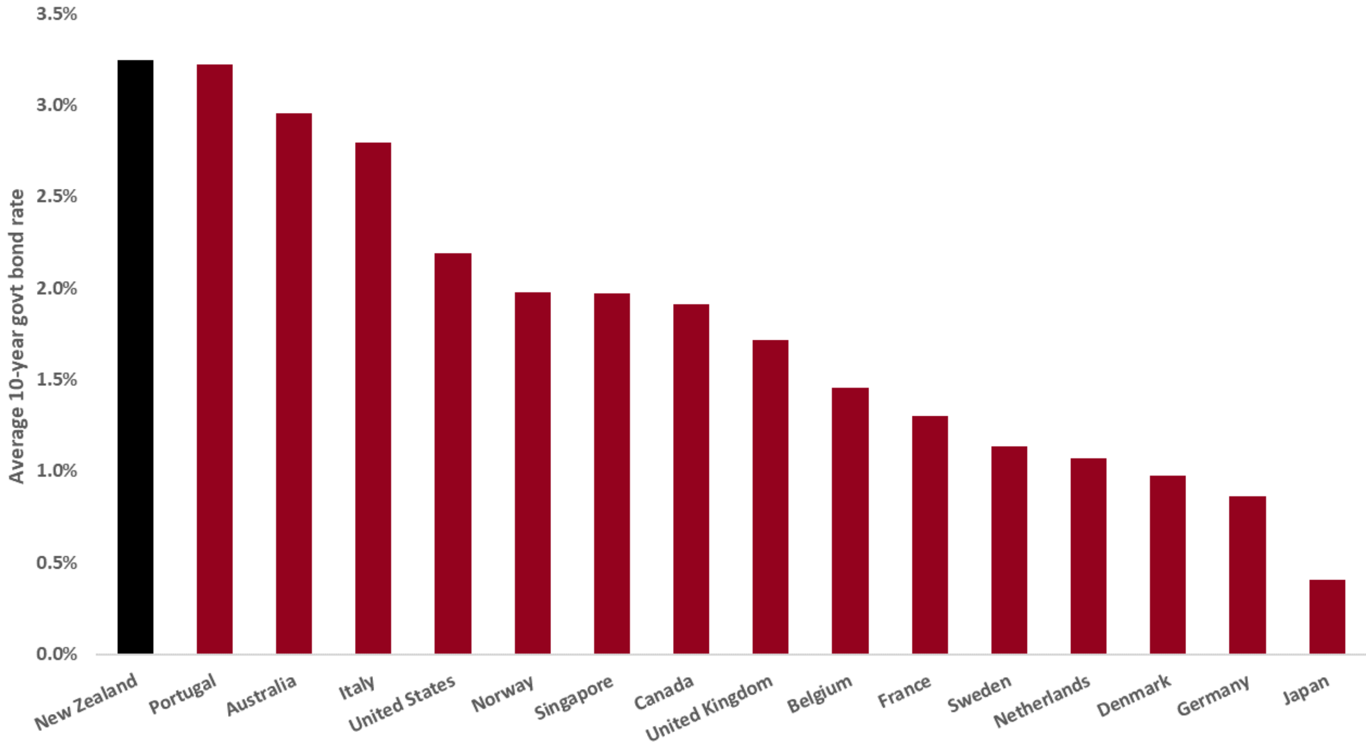
929 Commerce Commission "Market study into the retail grocery sector: Final report" (8 March 2022), at para B13–B14.

930 Data was available for all countries in our sample except Austria, Finland, Hong Kong, Israel, and Switzerland. We have used the daily day close value for each country. Where data was unavailable for a particular day, we have used the previous day close value as a proxy.

931 Wall Street Journal 10-year government bond yield data for each country in our sample except Austria, Finland, Hong Kong, Israel, and Switzerland [ ].

C56 As can be seen in Figure C5, New Zealand is in the upper quartile of this sample for much of the period. Figure C6 shows that in fact New Zealand had the highest average risk-free rate over this period out of the 16 countries in our sample for which data was available.[932]

Figure C6 New Zealand's average 10-year government bond rate between 1 January 2010 and 31 December 2021 relative to comparator countries



Source: Commerce Commission analysis of Wall Street Journal data.[933]

C57 All else equal, this would suggest that New Zealand firms would expect a higher level of profitability over this period relative to the countries in the sample.

C58 However, the magnitude of this effect is not clear. Figure C5 shows, that in recent years New Zealand's risk-free rate has aligned more closely with other countries in our peer sample. However, we have not observed a corresponding decline in banking sector ROE in New Zealand over the same period relative to countries in our sample (as shown in Figure 6.1). It is therefore not obvious that there is a clear link between the risk-free rate and bank returns.

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932 Average risk-free rates are appropriate when assessing the profitability of an unregulated firm over time. Commerce Commission "Market study into the retail grocery sector: Final report" (8 March 2022), at para B15–B15.3.

933 Wall Street Journal 10-year government bond yield data for each country in our sample except Austria, Finland, Hong Kong, Israel, and Switzerland [ ].

C59 The market risk premium is also relevant to shareholders’ expected returns and reflects investors’ expected return above the risk-free rate for bearing systematic (market) risk.[934]

C60 As we have not conducted a full cost of capital exercise, we have not endeavoured to estimate New Zealand’s market risk premium relative to other countries in our sample.

C61 We understand that investing in New Zealand could carry higher risk than other developed economies, which could translate into New Zealand banks needing to pay a premium to debt and equity investors.[935, 936]

C62 In respect of debt, we have sector-specific information that New Zealand banks pay a premium in wholesale markets because of country-specific risk.[937] This is significant given that New Zealand faces a mismatch between deposits and credit demand, so that there is a reliance on wholesale funding at the margin.[938] However the evidence suggests that this risk premium is very low.[939]

C63 The equity premium is not known for New Zealand banks, but we do have recent country level estimates that challenge the view that equity investment in New Zealand carries more systematic risk than investing in comparator countries.

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934 Commerce Commission “Part 4 Input Methodologies Review 2023: Final decision – Cost of capital topic paper” (13 December 2023), at para 4.337.

935 [ ]; [ ];
[ ].

936 [ ]; [ ].

937 [ ];
[ ]; [ ].

938 BNZ "Submission on Market study into personal banking services - Preliminary Issues paper - Attachment A - Deloitte Report" (7 September 2023), at para 124–125;
[ ]; [ ].

939 [ ];
[ ].

C64 Dr Martin Lally estimated the tax adjusted market risk premium (TAMRP) for New Zealand in April 2023; these estimates are used in the Commission's regulatory work.[940] He concludes that New Zealand's median TAMRP across various methodologies is the same as for comparator countries when rounded to the nearest 0.5%, as is the Commission's standard practice.[941] This is consistent with results provided by Fernández et al., which shows that New Zealand's TAMRP is not in the upper quartile of our peer sample countries, based on survey data.[942]

C65 We note that there are country-specific risks for international investors in all countries. New Zealand's risks are assessed as being broadly similar to those of other developed countries, so we do not consider country-specific risk to be an explanation for high bank profits in New Zealand relative to comparator countries.

The macroeconomic and regulatory environment can affect profitability

C66 The macroeconomic and regulatory environment can materially influence actual and expected shareholder returns relative to international peers.

C67 New Zealand's banking sector is experiencing a period of significant regulatory change. For example, the recent implementation of BS11, the ongoing implementation of the uplift in capital requirements to 2028, the upcoming potential changes of other prudential requirements as they are shifted under the Deposit Takers Act, and a host of other concurrent regulatory changes, require investment from banks not only to implement the changes, but to ensure ongoing compliance.[943]

C68 The cost of complying with these changes is asymmetric and affects smaller and less well-resourced banks more substantially than larger ones, as they lack the ability to deal with the ongoing and upcoming regulatory burden (in terms of both pace and substance).[944]

940 Lally, M. "Estimation of the TAMRP" (10 April 2023), available at: https://comcom.govt.nz/__data/assets/pdf_file/0024/318462/Dr-Martin-Lally-Estimation-of-TAMRP-report-10-April-2023.pdf.

941 Lally, M. "Estimation of the TAMRP" (10 April 2023), at p. 25, available at: https://comcom.govt.nz/__data/assets/pdf_file/0024/318462/Dr-Martin-Lally-Estimation-of-TAMRP-report-10-April-2023.pdf.

942 Fernández, P., Garcia de la Garza, D., & Fernández Acín, J. "Survey: Market Risk Premium and Risk-Free Rate used for 80 countries in 2023" (April 3, 2023), at Table 2, available at: SSRN: https://ssrn.com/abstract=4407839.

943 Kiwibank "Submission on Market study into personal banking services - Preliminary Issues paper" (7 September 2023), at p. 3; [ ].

944 Heartland Bank "Submission on Market study into personal banking services - Preliminary Issues paper" (7 September 2023), at para 11(e); Kiwibank "Submission on Market study into personal banking services - Preliminary Issues paper" (7 September 2023), at p. 6–7, 13–14, 18; and TSB, Co-op, Kiwibank, SBS (Joint Submission) "Submission on Market study into personal banking services - Preliminary Issues paper" (7 September 2023), at p. 1–2; [ ].

Changes to prudential regulation are requiring greater capital be held by New Zealand banks

C69 Changes to New Zealand's prudential requirements require New Zealand banks to increase the amount of capital they hold resulting in some of the most stringent CET1 capital requirements in the world.[945] CET1 capital is one type of capital that a bank can use to meet its capital requirements but is the highest quality and highest cost form of capital.[946]

C70 By 2028, the domestic systemically important banks (D-SIBs) will be required to hold capital based on a total ratio of 18%, relative to 16% for non-D-SIB. However, all D-SIBs also happen to be accredited to use IRB models to calculate their capital requirements. This allows the D-SIBs to calculate their capital based off a lower RWA calculation relative to non-DIBs (subject to the 85% floor).[947, 948]

C71 All else equal, higher capital holdings (and therefore higher equity) will reduce ROE by increasing the denominator of the equation.[949, 950]

C72 Higher capital requirements aim to promote the soundness and efficiency of the financial system by ensuring banks are better able to weather banking crisis and other macroeconomic shocks.[951] Increasing the required level of capital will reduce risk in the New Zealand banking system and therefore will, all else equal, lower shareholders' expected return, though that lower return will be earned on more capital.[952]

C73 Consequently, if competition were working well, we would expect that ROE should decline for New Zealand banks relative to international peers as these new requirements are implemented by the 2028 deadline.

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945 S&P Global "World's toughest capital requirements in New Zealand may squeeze credit" (August 2021), available at: https://www.spglobal.com/marketintelligence/en/news-insights/latest-news-headlines/world-s-toughest-capital-requirements-in-new-zealand-may-squeeze-credit-65720981; [ ]; [ ].

946 Reserve Bank "BPR110: Capital definitions" (October 2023), at p. 8; ASB "Submission on Market study into personal banking services - Preliminary Issues paper - Attachment A - NERA Report" (7 September 2023), at para 10 and New Zealand Bankers Association "Submission to the Reserve Bank of New Zealand on the Consultation Paper: How much capital is enough?" (17 May 2019), at para 42.

947 The Reserve Bank "Capital Review: Decisions 2019" (December 2019), at p. 3 and 6–7, available at: https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/consultations/banks/review-capital-adequacy-framework-for-registered-banks/decisions/capital-review-decisions.pdf

948 For more detail, see Chapter 7.

949 Return on equity is calculated as net income divided by shareholders' equity.

950 [ ].

951 The Reserve Bank "Capital Review: Decisions 2019" (December 2019), at p. 5–7; The Reserve Bank "Capital Review: Go-to-Guide 2019" (December 2019), at p. 5, available at: https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/consultations/banks/review-capital-adequacy-framework-for-registered-banks/decisions/capital-review-guide.pdf.

952 Schoenmaker, D., Schramade, W "Corporate finance for long-term value" (September 2023), at p. 325, available at: https://doi.org/10.1007/978-3-031-35009-2.

Recent monetary policy responses have supported banking sector profitability during a period of heightened macroeconomic uncertainty

C74 Banking sector profitability has been affected in recent years by the Covid-19 pandemic and the Reserve Bank's resulting monetary policy measures including the FLP, the LSAP, and the reduction and subsequent raising of the OCR.

C75 This section solely discusses these policies in the context of banking sector profitability with respect to competition and does not comment on the appropriateness of these policies with respect to wider policy objectives including financial stability and expansionary or contractionary monetary policy.

C76 FLP aimed to lower interest rates to encourage household and business spending by allowing banks to borrow from the Reserve Bank at the OCR.[953] LSAP aimed to lower borrowing costs to households and businesses by injecting money into the economy through the purchase of various government bonds.[954]

C77 FLP may have distorted competition to an extent as access to funding was limited to particular banks, so that providers who could not access the programme were unable to access cheap funding.[955] Consequently those smaller banks would have faced a funding disadvantage.

C78 Both programmes were expansionary and resulted in an injection of liquidity into the economy.[956] This weakened bank competition for deposits as banks could access cheap funding through the FLP programme and faced increased deposit supply through LSAP.[957] We note that this effect may have been partly offset by banks taking more conservative approaches (due to macroeconomic uncertainty) by maintaining high levels of liquidity.[958]

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953 Reserve Bank "Funding for Lending Programme Terms" (December 2020), at p. 1, available at: https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/markets/domestic-markets/flp-term-sheet-december-2020.pdf.

954 Reserve Bank "Large scale asset purchase programme", available at: https://www.rbnz.govt.nz/monetary-policy/monetary-policy-tools/large-scale-asset-purchase-programme.

955 Heartland Bank "Submission on Market study into personal banking services Preliminary Issues paper" (7 September 2023), at para 11(f).

956 Reserve Bank "Funding for Lending Programme Terms" (December 2020), at p. 1; New Zealand Parliament "Library research brief - LSAP programme" (28 October 2020), available at: https://www.parliament.nz/mi/pb/library-research-papers/research-papers/library-research-brief-large-scale-asset-purchase-lsap-programme/.

957 [ ].

958 [ ].

C79 Simultaneously, customers had weighted their deposits towards on call transaction accounts or savings accounts (often bearing little to no interest) due to the low interest rate environment at the time.[959] Greater non-interest bearing deposits bolster NIMs by essentially providing banks with "free" funding as these deposits bear no or low interest expense.[960]

C80 All together this supported NIM stability with New Zealand's banking sector's NIM increasing by ten basis points between 2020 to 2021, while the upper quartile NIM of peer countries declined by one basis point and the median declined by 14 basis points.[961]

C81 We note that the effect of FLP was partly offset by banks largely focusing this funding into discounted lending products.[962] Some banks indicated that they ringfenced the funding to offer discounted rates on a range of targeted lending products.[963] This may have reduced the magnitude by which the programme increased bank profitability.

C82 In the rising interest rate environment that followed, we saw NIMs increase largely due to non-interest bearing deposits, while certain interest rate spreads decreased.[964,965] This was partly offset by pressures on lending margins, customers shifting to interest bearing deposits as interest rates increased, and the ending of the FLP and LSAP programmes.[966]

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959 [ ].

960 The Treasury "Budget 2023 Tax Initiatives Information Release" (July 2023), at para 81, available at: https://www.treasury.govt.nz/sites/default/files/2023-07/b23-tax-4791084.pdf.

961 Based on Commerce Commission analysis of World Bank data.

962 We asked the major banks for information on whether the FLP funding was all completely passed through into lower interest rates, or whether it also contributed to higher profits. The major banks stated that they did not directly profit from the FLP programme, but not all had records which could demonstrate directly how the lower cost funding was completely passed through to customers, and at this stage we have not confirmed the accuracy of the banks' claims; [ ].

963 These targeted products often focused on loans to build new housing or for environmental purposes. [ ].

964 See Figure 6.9 showing trends in New Zealand banks' net interest margins.

965 Based on Commerce Commission analysis of interest.co.nz data on LVR special headline 1-year fixed mortgage rate vs highest available 1-year term deposit rate for each bank. [ ].

966 [ ].

The New Zealand banking sector was not significantly affected by the GFC and other recent banking crises

C83 New Zealand's banking sector profitability has been affected by crises over time. As Figure C7 shows, New Zealand's banking sector experienced reductions in ROA and ROE that align with banking crises in the late 1980's, the GFC and European Sovereign Debt Crisis between 2008 to 2010, and the Covid-19 pandemic throughout 2020. During the Covid-19 downturn and recent weather events banks significantly increased their provisioning for expected credit losses, reducing returns.[967]

C84 In any event, New Zealand has weathered recent global banking crisis, including the GFC and European Sovereign Debt Crisis, well relative to many other countries.[968]

C85 Incenta argue that we should therefore remove the United Kingdom, European Union countries, and Japanese banking systems from our sample on the basis that they are incomparable to New Zealand because each experienced recent banking crises.[969] Incenta additionally submit that our sample should exclude banks where the price-to-book ratio is below unity over the assessment period.[970]

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967 ANZ "Annual report and registered bank disclosure statement" (30 September 2020), at p. 28; ASB "ASB disclosure statement and annual report" (30 June 2020), at p. 4; BNZ "Disclosure statement" (30 September 2020", at p. 24 and 29 [ ].

968 Reserve Bank "Learnings from the global financial crisis" (September 2012) Bulletin, Vol. 75, No. 3, at p. 58; Reserve Bank "Financial Stability - risky, safe or just right?" (November 2018) available at: https://www.rbnz.govt.nz/hub/news/2018/11/financial-stability-risky-safe-or-just-right; and Chris Hunt "Banking crises in New Zealand – an historical perspective" (2009), at p. 26.

969 ANZ "Submission on Market study into personal banking services - Preliminary Issues paper - Annex 1 - Incenta Report" (7 September 2023), at para 43; [ ].

970 ANZ "Submission on Market study into personal banking services - Preliminary Issues paper - Annex 1 - Incenta Report" (7 September 2023), at para 50.

Figure C7 New Zealand banking sector quarterly ROE, ROA, and NIM between June 1991 and September 2023

Source: Commerce Commission analysis of Reserve Bank data.[971]

C86 The existence of a recent banking crisis does not on its own indicate that a particular banking sector was inherently more risky than New Zealand. Even if conclusions on relative risk could be drawn from the presence of recent banking crisis, this would imply that these other economies had higher risk banking sectors, and we would expect to observe higher long run returns in these countries than in New Zealand.

C87 In the short to medium run, limited experience with recent crises could result in New Zealand banking sector returns being on average higher than other countries in the sample. However, as Chapter 6 shows, New Zealand's annual banking sector profitability has been in the upper quartile in each year since 2011. If the presence of banking crises were a material driver, then you would expect there to be periods where New Zealand's profitability was not especially higher than other nations.

C88 A price-to-book ratio of greater than unity implies that a stock is trading at a premium to the book value. A bank with a price-to-book ratio of greater than unity will by construction have a ROE that is above its cost of equity, indicating a higher ROE.

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971 Reserve Bank "Banks: Summary income statement and related ratios (S20)" [ ].

C89 Both of Incenta's proposed sampling constraints therefore exclude from the comparator set banks which have experienced low profitability leaving only the most profitable comparators in the sample. These constraints are proposed without a genuine justification that the risk profile of the banking sector differed from that of New Zealand. It is inappropriate to remove from the comparator set countries and banks which have experienced recent banking crises or that have a price-to-book ratio below unity.

The major banks' Australian ownership may provide cost advantages over domestic banks, but is unlikely to explain international variation

C90 New Zealand's four major banks are subsidiaries of Australian parent companies. ANZ and Westpac are owned by the Australian firms by the same name, while BNZ is owned by NAB and ASB by CBA.

Cost efficiencies derived from the foreign ownership of New Zealand's major banks

C91 We have observed that New Zealand banks have a relatively low-cost structure in comparison to overseas banks. As shown above at Figure C2, New Zealand banks have relatively low overhead costs compared to other countries and, as Figure 6.5 in Chapter 6 shows, New Zealand has a relatively low CTI ratio.

C92 The relatively vanilla banking operations of New Zealand's banking sector, the major banks possessing a higher proportion of transaction deposits (which includes non-interest bearing deposits) relative to smaller banks, and under-investment in core systems (as discussed in Chapter 9) likely drive some of these differences.[972, 973] However, the Australian ownership of New Zealand's major banks appears to drive additional cost efficiencies. For example, these banks' average operating expenses as a share of total assets has on average been lower than the average for other banks operating in New Zealand between March 2018 to September 2023.[974]

C93 The major banks also benefit from scale efficiencies as a result of being subsidiaries of their Australian parent company. This includes savings relating to group strategy and investor relations generated from the Australian business.[975] The banks may also benefit from group wide investment and funding when access to wholesale markets is disrupted.[976]

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972 Relative proportions of transaction deposits can be seen at Figure 5.5 of this report.

973 [ ].

974 Based on Commerce Commission analysis of Reserve Bank, Bank Financial Strength Dashboard data. Only ICBC, China Construction Banks, and Bank of China had lower average values over the period.

975 BNZ "Submission on Market study into personal banking services - Preliminary Issues paper" (7 September 2023), at para 4.29–4.29(b); [ ].

976 [ ].

C94 The Australian-owned banks also generally have the highest credit ratings of the banks operating in New Zealand (as shown in Table C2) and the strength of the Australian parent companies appear to partly drive this difference.[977] Smaller banks' organisational structures may instead constrain their ability to raise capital, for example if they have a co-operative or mutual membership structure.[978] This provides the major banks with a funding advantage in wholesale markets over smaller banks operating in New Zealand.[979]

Table C2 Credit rating for banks opperating in New Zealand in the September 2023 quarter

Bank name	Fitch	Moody's	S&P Global
Kiwibank	AA	A1	
ANZ	A+	A1	AA-
ASB	A+	A1	AA-
BNZ	A+	A1	AA-
Westpac	A+	A1	AA-
China Construction Bank	A	A1	
TSB	A-		
Heartland Bank	BBB		
SBS	BBB		
Co-operative	BBB		
Bank of India	BBB-		
Bank of Baroda	BBB-		
Rabobank			A
Industrial and Commercial Bank of China		A1	A
Bank of China		A1	A

Source: Commerce Commission analysis of Reserve Bank.[980]

977 ASB "Submission on Market study into personal banking services - Preliminary Issues paper - Attachment A - NERA Report" (7 September 2023), at para 66–70. [ ].

978 TSB, Co-op, Kiwibank, SBS (Joint Submission) "Submission on Market study into personal banking services - Preliminary Issues paper" (7 September 2023), at p. 4; and New Zealand Bankers Association "Submission to the Reserve Bank of New Zealand on the Consultation Paper: How much capital is enough? (17 May 2019), at para 46.

979 ASB "Submission on Market study into personal banking services - Preliminary Issues paper - Attachment A - NERA Report" (7 September 2023), at para 69–70; ASB "Submission on Market study into personal banking services - Preliminary Issues paper" (7 September 2023), at para 31.3; BNZ "Submission on Market study into personal banking services – Preliminary Issues paper – Attachment A – Deloitte Report" (7 September 2023), at para 126–127; [ ].

980 Reserve Bank "Bank Financial Strength Dashboard" [ ].

C95 We acknowledge that in a workably competitive market, more efficient firms can extract greater returns. However, in a workably competitive market we would also expect that competitive pressure would at least partially erode this. We do not observe this in New Zealand.

C96 The major banks possess approximately 90% of total banking assets in New Zealand and comprise the entirety of the first-tier providers.[981] As discussed in this section, they also enjoy cost advantages over second tier banks. If this tier was workably competitive, we would expect that the first tier banks would have competed away profits attributable to their relatively lower CTI ratio. We have not seen evidence of this occurring.

C97 In a workably competitive market, we would also expect to see less efficient firms seeking to capture, and compete away, some of those higher returns by expanding. The more efficient firms would consequently need to seek out additional efficiencies to maintain their superior returns. As we discuss in Chapter 2, however, we do not observe this competitive dynamic in New Zealand because smaller providers face various barriers to expansion. Shielded from the threat of significant competition and disruption from smaller providers, the oligopolistic large providers, who have similar cost structures, have weak incentives to compete strongly to achieve additional cost advantages.[982]

C98 We are not persuaded that, as NERA submit, Australian investors take on materially more risk investing into New Zealand by bearing the cost of insulating their subsidiaries from shocks.[983] We have seen no evidence that the risk borne by shareholders of New Zealand's major banks is larger than that borne by any other investor in a bank operating in New Zealand. Even if Australian shareholders did bear additional risk, the above-mentioned wholesale funding advantage as a result of the strength of the Australian parent company would negate some of this effect.

C99 While Australian ownership and any related cost efficiencies may drive differences between New Zealand's major banks and the smaller domestic banks, the largest New Zealand banks are small by international standards.[984] It therefore does not follow that foreign ownership would provide a funding advantage or an economies of scale benefit relative to banks in larger banking sectors.

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981 Commerce Commission analysis of Reserve Bank, Bank Financial Strength Dashboard data, series DBB.QIG10.

982 See Chapter 2 of this report.

983 ASB "Submission on Market study into personal banking services - Preliminary Issues paper - Attachment A - NERA Report" (7 September 2023), at para 62–72.

984 Reserve Bank "The banking sector" (18 May 2022), available at: https://www.rbnz.govt.nz/financial-stability/about-the-new-zealand-financial-system/the-banking-sector; BNZ "Submission on Market study into personal banking services - Preliminary Issues paper - Attachment A - Deloitte Report" (7 September 2023), at Figure 17 and para 85; [ ].

We do not currently accept that shareholder expectations are affected by the transferability of imputation credits

C100 Australian resident shareholders, including those of New Zealand's major banks, cannot access imputation credits on the profits of the New Zealand subsidiary.[985] Imputation credits (franking credits in Australia's tax system) allow shareholders receiving a dividend to benefit from the income tax paid by the company on its profits, by claiming the credit against their income tax liability.[986]

C101 NERA submit that an Australian-owned bank would require a higher pre-tax return to ensure the same post-tax profitability because the New Zealand shareholders can receive imputation credits on these profits.[987]

C102 It is not clear to us whether this is a material issue in practice given that the dollar value of profits stemming from the New Zealand businesses are only small relative to the profits of each banking group.

C103 On average, ANZ, Westpac, ASB, and BNZ's 2023 financial year profit in New Zealand comprised approximately 20% of the whole group's profits.[988] Simultaneously, the banks tend to target a dividend payout ratio of only between 60%–80%.[989] Consequently, the Australian dividend may be entirely comprised of Australian profits, while New Zealand profits are held as retained earnings. These Australian profits could be fully franked in the Australian tax system.

985 Australian Taxation Office "Trans-Tasman imputation special rules", available at: https://www.ato.gov.au/businesses-and-organisations/corporate-tax-measures-and-assurance/imputation/in-detail/trans-tasman-imputation-special-rules.

986 Inland Revenue Department "Imputation: A guide for New Zealand companies" (July 2022) p 4, available at: https://www.ird.govt.nz/-/media/project/ir/home/documents/forms-and-guides/ir200---ir299/ir274/ir274-jul-2022.pdf?modified=20230330231847&modified=20230330231847.

987 ASB "Submission on Market study into personal banking services - Preliminary Issues paper - Attachment A - NERA Report" (7 September 2023), at para 76–78.

988 Calculated by comparing net profit in each bank's full year 2023 New Zealand disclosure statements converted to Australian dollars using the average exchange rate for the year ended 30 September 2023, against the net profit attributable to shareholders/owners in each bank's Australian full year 2023 financial statements. This figure is the average of all 4 banks values.

989 See Westpac "2023 Annual report" (November 2023), at p. 4; CBA "2023 Annual report", at p. 51; NAB "Full year results 2023" (November 2023), at p. 11; ANZ "2023 Annual report" (November 2023), at p. 14.

C104 If it were the case that the non-transferability of imputation credits materially affected the cost of equity of the major banks, one would expect Australian dividends to consistently be only partially franked. However, over the past two decades, ANZ, CBA, NAB, and Westpac have fully franked their Australian dividends at most payments.[990] The only examples of partially franked dividends over this period are NAB between 2005 and 2007, and ANZ in both December 2019 and December 2023.

C105 We are therefore not persuaded that Australian resident shareholders face a tax disadvantage through not having access to New Zealand imputation credits.

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990 ANZ "Dividend information", available at: https://www.anz.com/shareholder/centre/your-shareholding/dividend-information/; NAB "NAB's dividend payment history", available at: https://www.nab.com.au/about-us/shareholder-centre/dividend-information/payment-history; CBA "Dividend information", available at: https://www.commbank.com.au/about-us/investors/dividend-information.html; Westpac "Dividend payment history", available at: https://www.westpac.com.au/about-westpac/investor-centre/dividend-information/dividend-payment-history/.

Attachment D Competition for different consumer groups | *Te whakataetae mō ngā rōpū kaiwhakapeto*

D1 In considering the factors affecting competition in personal banking, we have asked whether competition is delivering good outcomes for all consumers. Our overall conclusion is that certain consumer groups are not well-served by competition alone and, for certain pockets of the population, the outcomes are worse. There are some individuals in New Zealand who experience financial exclusion more than others. This segment of consumers, referred to as vulnerable consumers, can be unduly affected by lack of competition.[991]

D2 Although not an exhaustive list, vulnerable consumers in New Zealand, can be consumers living rurally, elderly, disabled, recent migrants, those with no fixed abode, experiencing a relationship breakdown, going through insolvency, have an undesirable credit rating, experiencing digital exclusion, have financial literacy barriers, people coming out of prison and people who rely on government support as main line of income.[992]

D3 To understand this issue better, we sought feedback from a diverse range of consumers groups, charitable trusts, and other relevant stakeholders. We spoke with Consumer NZ, Christians Against Poverty New Zealand (CAP), FinCap, and Community Law centres. The wānanga we conducted with Māori representatives also contributed to this workstream.[993]

D4 Other relevant research included a consumer feedback form hosted on our website, submissions on the Preliminary Issues paper, related reports, online articles, and the consumer research undertaken Verian on our behalf.[994]

D5 Our analysis of the information provided by stakeholders revealed that competition alone is not providing the products and service quality standards that meet the needs of vulnerable consumers. A consumer's financial situation can change quickly, and even short periods of financial vulnerability have potential to cause greater harm if not carefully navigated and supported by the consumer’s bank.[995] Continued research and engagement with individuals and community groups is important to better understand this issue.

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991 CoFR “Consumer Vulnerability Framework”, available at: https://www.cofr.govt.nz/files/consumer-vulnerability-framework.pdf.

992 FinCap “Voices - Indicators of financial well-being for whānau supported by financial mentors in 2021 and 2022 – final report” (September 2023), part 3 of report, available at: https://www.fincap.org.nz/wp-content/uploads/2023/09/230915-Final-Voices-report.pdf

993 Commerce Commission “Summary of views expressed from Te Komihana Tauhokohoko wānanga” (14 February 2024).

994 Verian “Personal banking services market study – Research report” (February 2024).

995 [ ].

D6 We identified five areas where vulnerable consumers are not being served by competition alone or where enhanced consumer protection would be strongly advisable. These are:

D6.1 access to bank accounts;

D6.2 consumers with overdrafts may face difficulties in switching;

D6.3 unintended consequences of regulation;

D6.4 access to face-to-face banking; and

D6.5 financial literacy.

D7 Possible solutions to these issues can be shared with New Zealand policy makers, regulators, and industry for collective social impact and increased financial inclusion.

Access to bank accounts | *Te uru ki ngā pēke putea*

D8 Access to a bank account is of primary importance to raising levels of financial inclusion in New Zealand.[996] In some circumstances vulnerable consumers find it difficult to obtain or retain a bank account or access credit.[997]

D9 Access to a bank account is especially important to allow vulnerable consumers to access lower cost credit and relevant services when facing financial hardship.[998] Financial inclusion allows a pathway forward, by facilitating day-to-day transactions, as well as the ability to plan towards future goals.

D10 Marginalised consumers, such as new migrants and ex-prisoners, can struggle to obtain access to a bank account. Reasons for this may be that the consumer is unable to meet AML/CFT identity documentation requirements, has negative or no credit history, or is deemed high-risk by a bank.[999]

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996 A 2012 report by World Bank, which included New Zealand in the data set, 'The foundations of financial inclusion: understanding ownership and use of formal accounts', observed that *'Overall, the results suggest that policies to reduce barriers to financial inclusion may expand the pool of eligible account users and encourage existing account holders to use their accounts with greater frequency and for the purpose of saving.'* available at: https://documents.worldbank.org/en/publication/documents-reports/documentdetail/348241468329061640/the-foundations-of-financial-inclusion-understanding-ownership-and-use-of-formal-accounts.

997 Reserve Bank "Financial Inclusion – our approach at RBNZ – final report" (September 2023), at p. 9.

998 The World Bank "Financial inclusion - Financial inclusion is a key enabler to reducing poverty and boosting prosperity" available at: https://www.worldbank.org/en/topic/financialinclusion/overview.

999 [ ]; Lisa Cowe "Submission on Market study into personal banking services - Preliminary Issues paper" (6 September 2023).

D11 Lack of access to a bank account (being unbanked) disproportionately affects vulnerable consumers.[1000] The World Bank estimates that 1.25% of the population, more than 50,000 people, over the age of 15 in New Zealand are unbanked.[1001]

D12 We have heard that access to banking services can be removed, often with only seven - 14 days' notice, by having access to a bank account suspended or terminated.[1002] This action commonly affects those going through insolvency and bankruptcy.[1003] Being de-banked can also affect consumers whom banks may view as undesirable.[1004] Often there is no other viable alternatives to safely access financial services. The consequences of this can leave some susceptible to exploitation.[1005]

D13 We have heard that to improve financial inclusion, a basic bank account should be treated as an essential service that all New Zealanders have access to.[1006] A basic bank account allows the account owner to receive payments, like wages, benefits, and pensions and to pay for things or take out cash with a debit card, transfer money to pay bills or other people.[1007]

D14 Some of the key drivers of banking access issues in New Zealand include:[1008]

D14.1 limited competition in affordable products and services designed for vulnerable consumers (who are perceived by banks as commercially unattractive) the risk checks;

D14.2 legal requirements in the customer onboarding process;

1000 Westpac "Westpac NZ Access to Banking in Aotearoa Report" (April 2023), at p. 5, available at: https://www.westpac.co.nz/assets/Personal/life-money/documents/Westpac-NZ-Access-to-Banking-in-Aotearoa-Report.pdf.

1001 Westpac "Westpac NZ Access to Banking in Aotearoa Report" (April 2023), p5, available at: https://www.westpac.co.nz/assets/Personal/life-money/documents/Westpac-NZ-Access-to-Banking-in-Aotearoa-Report.pdf; The World Bank, available at: https://data.worldbank.org/indicator/FX.OWN.TOTL.ZS?locations=NZ-AS. The figure comes from a calc with Stats NZ data - In June 2021, NZ had 5,122,600, with 81% being over the age of 15. So, 4,149,306 x1.25% = 51,866 approx. available at: https://www.stats.govt.nz/information-releases/national-population-estimates-at-30-june-2021; To cross reference this: https://www.1news.co.nz/2023/04/10/vulnerable-communities-struggling-to-set-up-bank-accounts/.

1002 [ ].

1003 [ ].

1004 Gloriavale Christian Community "Submission on Market study into personal banking services - Preliminary Issues paper" (7 September 2023).

1005 For example, those who are on benefits sometimes don't have access to their own account and so must nominate another person to receive their benefit, at times this power imbalance can have negative outcomes for the vulnerable consumer, such as relationship strain, lack of dignity, and risk of financial harm. [ ].

1006 Westpac "Westpac NZ Access to Banking in Aotearoa Report" (April 2023), at p. 7, available at: https://www.westpac.co.nz/assets/Personal/life-money/documents/Westpac-NZ-Access-to-Banking-in-Aotearoa-Report.pdf; [ ].

1007 Money Helper "Fee-free basic bank accounts" available at: https://www.moneyhelper.org.uk/en/everyday-money/banking/basic-bank-accounts.

1008 [ ].

D14.3 affordability of, and trust in, products and providers;

D14.4 the availability of infrastructure and support (such as extra-care units and cultural capability among frontline staff); and

D14.5 financial capability and awareness of available products and services.

D15 Widespread availability and awareness of 'basic' bank accounts could address many of these drivers. The definition of a basic bank account varies between jurisdictions, but at its core is a transaction account which customers are entitled to (customers are unable to be de-banked arbitrarily) that can perform basic banking functionality (sending and receiving payments), has no account keeping fees (and no or low other fees), and is unable to go into debt (no overdraft facility, arranged or unarranged).[1009]

D16 Westpac's 2023 report on access to banking noted that accounts meeting these criteria (particularly the inability to go into debt) are not widely available in New Zealand.[1010] This aligns with what we were told in a submission to our Preliminary Issues paper.[1011]

D17 Policy measures can support financial participation, especially policy initiatives designed to improve financial inclusion outcomes in New Zealand.[1012] Notably, there is work underway by the CoFR and the Reserve Bank on the topic of financial inclusion.[1013]

1009 Australian Banking Association "Banking Code of Practice" (5 October 2021), at chapter 16, available at: https://www.ausbanking.org.au/wp-content/uploads/2021/10/2021-5-Oct-Banking-Code-WEB.pdf; https://www.moneyhelper.org.uk/en/everyday-money/banking/basic-bank-accounts; [ ].

1010 Westpac New Zealand "Access to Banking in Aotearoa Report" (April 2023), p 9, available at: https://www.westpac.co.nz/assets/Personal/life-money/documents/Westpac-NZ-Access-to-Banking-in-Aotearoa-Report.pdf.

1011 Lisa Cowe "Submission on Market study into personal banking services - Preliminary Issues paper" (6 September 2023)

1012 NZBA "Submission to the Ministry of Business, Innovation and Employment on the Conduct of Financial Institutions – Discussion Documents" (June 2021), available at: https://www.mbie.govt.nz/dmsdocument/17415-nzba-conduct-of-financial-institutions-regulations-submission-pdf.

1013 CoFR "Priority themes – Financial Inclusion", available at: https://www.cofr.govt.nz/priority-themes/inclusion.html, Reserve Bank "Financial Inclusion – our approach at RBNZ – final report" (September 2023).

Consumers with overdrafts may face difficulties in switching | *Ko ngā kaiwhakapeto kua tango moni tarepa ka raru pea ki te whakawhiti*

D18 Once a bank account has been acquired, the ability to shop around for suitable banking products and services, and the potential to switch banks, is an important competition factor. There is a perception among some consumers that it is hard to switch banks.[1014] Vulnerable consumers appear less likely to change banks once a main bank relationship has been established. This may be due to barriers, such as having unsecured debt or lower credit scores, which can make moving banks more complex.

D19 An overdraft is a common form of unsecured debt. There are two key types of overdrafts with different associated fee structures: arranged overdrafts and unarranged overdrafts. We have heard arranged overdrafts are often marketed for flexibility and designed to be short-term.[1015] However, some vulnerable consumers may not be able to manage this type of product as it is intended.[1016]

D20 Our review of the broader evidence base has shown the average fee cost for an arranged overdraft to be fairly low, with the major banks having low or no overdraft management fee (OMF). Data we have seen shows that an unarranged overdraft fee (UOF), can range anywhere from $3 - $10 per month. We found that the applicable interest charges for both products appear to be similar.[1017] Vulnerable consumers are more at risk of sliding into unarranged overdraft.

D21 The fixed nature of banks fees and charges means they have a more significant impact on consumers with smaller account balances.[1018] Unsecured lending that is unmanageable can create a debt trap for a consumer, especially when compounded with avoidable fees and charges.[1019]

1014 [ ].

1015 [ ].

1016 [ ].

1017 [ ]; [ ]; [ ]; [ ]; [ ]; For example, as at 5 March 2023, ASB's website shows it charges 19.5% pa for an unsecured OD and 22.5% for an unarranged OD. Westpac charges 19.95% for both arranged and unarranged personal ODs.

1018 ACCC "Retail deposits inquiry – Final report" (December 2023), p8, available at: https://www.accc.gov.au/system/files/Retail-deposits-inquiry-final-report.pdf

1019 [ ].

D22 We have observed that overdraft issues are being addressed by banks, with initiatives and mitigation measures designed to ensure consumers are aware of avoidable fees that they may have recently incurred. Some banks contact a subset of these consumers every month, to provide information to help them avoid such fees in the future.[1020] Several banks have established business units aimed at supporting financial literacy, financial capability, and financial well-being.[1021] Banks also provide frontline staff with awareness training to enable broader conversations with consumers.[1022]

D23 The primary purpose of the Credit Contracts and Consumer Finance Act 2003 (CCCF Act) is to protect the interests of consumers entering into consumer credit agreements. The CCCF Act contains responsible lending principles requiring lenders to exercise care, diligence, and skill in their dealing with consumers. The obligations on lenders include:

D23.1 making reasonable inquiries before entering into a loan to be satisfied that the loan is suitable and affordable for the borrower and to assist the borrower to make an informed decision to enter the loan; and

D23.2 treating the borrower reasonably and in an ethical manner when problems arise (eg, payment difficulties).

D24 While the requirement to assess credit affordability can limit the ability of consumers with overdrafts to switch banks the CCCF Act does provide important protections for vulnerable consumers having debt.[1023] This reinforces the need for strong regulatory oversight.

Unintended consequences of regulation | *Ngā hua ohorere o te ture*

D25 AML/CFT regulation and the application of the KYC identification process, and CDD risk assessment process, can adversely impact some vulnerable consumers. We have heard that supplying the required identification can be the most challenging factor. Without access to key documents, such as proof of address or a driver's licence, this creates an unintended barrier to enter or stay in the banking system.[1024]

1020 [ ].

1021 [ ].

1022 [ ].

1023 Unarranged overdrafts are not consumer credit for the purposes of the CCCF Act and are excluded from the consumer protections (section 15(1)(b)).

1024 Australian Government AUSTRAC "Assisting customers who don't have standard forms of identification" available at: https://www.austrac.gov.au/business/core-guidance/customer-identification-and-verification/assisting-customers-who-dont-have-standard-forms-identification.

D26 The Reserve Bank has been engaging with banks on the topic of financial inclusion, in line with their role as one of the supervisors of the AML/CFT legislation.[1025] The AML/CFT regime requires banks to have appropriate exception handling procedures for identity verification for low to medium risk consumers.[1026] Our findings indicate that there is more work to be done by policy makers, regulators, and industry to ensure consumers understand how to meet the identification requirements.

D27 The MoJ has recently reviewed the AML/CFT Act, the accompanying regulations and guidance. Recommended changes include expanded application of AML exemptions and alternative pathways to meeting AML documentation requirements.[1027] Although no timeframe has been given on the implementation of these measures, this work could support identification procedures that more low to medium risk consumers are able to meet.

Face-to-face banking | *Pēke kanohi ki te kanohi*

D28 We have heard that face-to-face banking is a crucial factor to maintain consumer relationships and support consumer confidence. Nevertheless, this is becoming ever more challenging to deliver, and receive, due to branch closures and increased digitisation of personal banking services.[1028] Reduced access to face-to-face services can particularly affect older consumers (who may be less familiar with digital services),[1029] consumers living with disability (eg, hearing or eyesight impaired, or living with mobility issues), or rural consumers (who need to travel further to visit a branch).

D29 Our evidence indicates New Zealand currently has just under 500 branches and bricks-and-mortar stores, excluding bank hubs.[1030] Reduction in the physical branch network can lead to greater financial exclusion due to time and travel costs to get to the nearest bank branch, lack of reliable internet and mobile coverage in some rural areas, and the requirement for sound digital literacy.[1031]

1025 The Reserve Bank supervises banks, life insurers and non-bank deposit takers,
The FMA supervises issuers of securities, trustee companies, futures dealers, collective investment schemes, brokers, and financial advisors,
The DIA supervises casinos, non-deposit-taking lenders, money changers and any other financial institutions not supervised by the Reserve Bank or the FMA, as well as designated, non-financial businesses or professions and high-value dealers.

1026 Reserve Bank "AML/CFT guidance and resources" available at: https://www.rbnz.govt.nz/regulation-and-supervision/anti-money-laundering-and-countering-terrorism-financing/aml-cft-guidance-and-resources

1027 MoJ "Changes to AML/CFT Act regulations", July 2022, at p. 145-146, available at: https://www.justice.govt.nz/justice-sector-policy/key-initiatives/aml-cft/aml-cft-review/.

1028 [ ]

1029 [ ].

1030 [ ]; [ ]; [ ]; [ ]; [ ]; [ ].

1031 Westpac New Zealand "Access to Banking in Aotearoa Report" (April 2023), p 7 and 15, available at: https://www.westpac.co.nz/assets/Personal/life-money/documents/Westpac-NZ-Access-to-Banking-in-Aotearoa-Report.pdf.

D30 To potentially mitigate barriers faced by vulnerable consumers, the major banks in New Zealand have voluntarily signed up to a banking hub pilot run by New Zealand Banking Association, Te Rangapū Pēke (NZBA).[1032] The NZBA regional banking hub initiative has a pilot currently underway, in partnership with six New Zealand banks.[1033] This new approach aims to provide and maintain banking services in small regional communities.[1034]

D31 There are multiple methods in which the consumer can contact their bank, or their bank can contact them, for example via a call centre, internet banking, mobile app, postal, and by visiting a physical branch.[1035] Service quality, service time, consumer well-being, bank staff capacity and consistency across all service channels remains key.[1036]

D32 Smaller providers deliver additional physical access to banking services in regional areas, such as NBDTs, CUBS and smaller banks (TSB, Co-operative Bank and Heartland Bank). We have heard that NBDTs and CUBS often provide services, such as transaction accounts, to consumers refused service by banks and serve a higher proportion of low-income customers.[1037]

D33 Demand remains high for vulnerable consumers to have straightforward access face-to-face banking. While it is encouraging to see initiatives underway, there is more work to be done by industry to overcome barriers of meaningful participation across all available service channels, whether that be digital or physical.[1038]

Financial literacy | *Te matatau ki te penapena pūtea*

D34 Financial inclusion can be a leading factor in reducing financial hardship, growing innovation in financial services, and fostering opportunities for economic growth.[1039] Reserve Bank's broadly defines financial inclusion as a system in "which all Aotearoa have reasonable access to financial products and services that meet their needs."[1040]

[1032] Consumer NZ "Bank branch closures: are banking hubs the answer?", 5 July 2021, available at: https://www.consumer.org.nz/articles/bank-branch-closures-are-banking-hubs-the-answer.

[1033] ANZ, ASB, BNZ, Kiwibank, TSB and Westpac.

[1034] [ ].

[1035] [ ].

[1036] [ ]; [ ].

[1037] The Financial Services Federation submission to Reserve Bank on the exposure draft of the Deposit Takers Bill, (February 2022), available at: https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/proactive-releases/submissions/financial-services-federation-fsf-submission-on-dt-billpdf.pdf; [ ].

[1038] [ ].

[1039] The World Bank "UFA2020 Overview: Universal Financial Access by 2020 – brief" (October 2018), available at: https://www.worldbank.org/en/topic/financialinclusion/brief/achieving-universal-financial-access-by-2020.

[1040] Reserve Bank "Financial Inclusion – our approach at RBNZ – final report" (September 2023), at p. 2.

D35 We heard that vulnerable consumers often need additional support, for instance budgeting advice and guidance on navigating financial matters.[1041] Low financial literacy capabilities across New Zealand can mean consumers often face difficulties in understanding banks' terms and conditions, interest rates, fees, and comparing products and services.[1042] To support financial literacy consumers need clearer and more transparent information to enable them to better understand banks' decision-making, and compare bank services and product offerings, especially when experiencing hardship.

D36 We observed that banks are aware of this issue and act to provide in-house support, as well as encouragement of community-based avenues, to improve financial capabilities. Other ways that banks can assist to increase financial literacy and capabilities across New Zealand are clearer reporting, targeted training courses for frontline staff, additional in-house support services, assess to budgeting mentors, and increased preventative action around scams and fraud.[1043]

D37 The incoming CoFI legislation includes a "fair conduct principle" which requires financial institutions to ensure that services and products are likely to meet the requirements and objectives of the consumers expected to use them.[1044]

D38 The Retirement Commission, Te Ara Ahunga Ora has also undertaken research and evaluation projects aimed to give a deeper understanding of the level of financial capability in New Zealand, and how it compares internationally.[1045] Education programs that are run in New Zealand secondary schools also support raising financial capability.[1046]

1041 [ ].

1042 [ ].

1043 Community Networks Aotearoa "Better Banking – Final report" (2023), available at: https://irp.cdn-website.com/96a27c73/files/uploaded/Community%20Networks%20Aotearoa%20_%20Better%20Banking%202023%20Report.pdf.

1044 Available at: https://www.mbie.govt.nz/business-and-employment/business/financial-markets-regulation/conduct-of-financial-institutions-regime/.

1045 Retirement Commission "Financial Capability Research" available at: https://retirement.govt.nz/financial-capability/research/.

1046 Sorted, available at: https://sortedinschools.org.nz/about/support/faqs/ .

Attachment E International money transfers | *Whakawhitinga Moni ā-Ao*

E1 During the initial stages of our study we received stakeholder feedback suggesting we expand our focus to include remittances, international payments, and foreign exchange.[1047] We have not expanded the scope of our study in this way because these services do not appear to be relevant to understanding the wider competitive dynamics for personal banking services, and focusing on them would take away from resources available to the rest of the study.

E2 However, during our exploratory research we identified features of these services that suggest there may be room to improve competition, particularly around international money transfers. This attachment sets out the findings of our research on international money transfers, which may be of interest to stakeholders. We use the term 'international money transfer' interchangeably with 'remittances' throughout this note.

E3 The information we have analysed includes submissions received during the study, various reports, and reviews, as well as information readily available online and to the public. Some of this information is several years old or may not be directly applicable to the New Zealand context, so our exploratory research set out in this attachment should be treated accordingly.

E4 We identified two issues that may impact competition:

E4.1 difficulty in opening or maintaining a bank account for smaller remittance providers; and

E4.2 a lack of transparency on pricing of international money transfer (IMT) services.

E5 Difficulties in opening and maintaining a bank account for smaller remittance providers is a complex and ongoing issue related to AML/CFT regimes globally, including in New Zealand. This issue appears to have the greatest impact on New Zealanders who send remittances to the Pacific Islands. There are strong and important policy considerations that underpin New Zealand's AML/CFT regime. A recent MoJ report appears to support the view that more could be done to address this issue without undermining AML/CFT policy goals.[1048]

1047 Wise "Submission on Market study into personal banking services – Preliminary Issues paper" (7 September 2023), at p. 4-5; [ ]; [ ]; [ ].

1048 MoJ "Report on the review of the Anti-Money Laundering and Countering Financing of Terrorism Act 2009" (July 2022).

E6 The magnitude of the issues around IMT pricing transparency is unclear. This issue would benefit from further investigation to understand the nature and size of the problem in New Zealand. If pricing transparency problems are found to be material and impacting competition, there are interventions that appear to have been successful in Australia that could be considered.

We have focused on IMTs and no other types of remittances

E7 Remittances are the transfer of funds between parties in the form of a bill, invoice, or gift. More commonly, remittances are referred to when workers or migrants send home part of their earnings to support their families.[1049]

E8 An IMT is an electronic transfer of funds in a specific currency to an overseas recipient.[1050] Our exploratory review has focused on international money transfers and no other types of remittances (for example, transfer of gifts or physical items of value).

E9 The ACCC conducted an inquiry into the supply of foreign currency conversion services in Australia in 2019.[1051] The inquiry covered four related services: IMT services, foreign cash services, payment card foreign exchange (FX) services and travel card services. The ACCC observed that IMTs were significant because the other services it reviewed were not generally substitutable for IMTs, and that they had larger transaction sizes than the other services.[1052]

Remittances are significant to Pacific Island countries

E10 In 2022, New Zealand received over $677m USD and paid (transferred out) over $889m USD in personal remittances.[1053,1054] Although small in value compared to other personal banking services, they are important for Pacific countries and the people involved. The magnitude of remittances to Pacific countries has grown significantly over the past 20 years.

1049 International Monetary Fund "What Are Remittances?", at p. 1, available at: https://www.imf.org/external/pubs/ft/fandd/basics/pdf/ratha-remittances.pdf

1050 Banking Ombudsman Scheme "International Money Transfers" (January 2024), available at: https://bankomb.org.nz/guides-and-cases/quick-guides/payment-systems/telegraphic-transfers

1051 ACCC "Foreign currency conversion services inquiry" (July 2019), available at: https://www.accc.gov.au/system/files/Foreign%20currency%20conversion%20services%20inquiry%20-%20final%20report_0.PDF.

1052 ACCC "Foreign currency conversion services inquiry" (July 2019), p18-19.

1053 The World Bank "Personal Remittances, received, (current US$) – New Zealand", available at: https://data.worldbank.org/indicator/BX.TRF.PWKR.CD.DT?locations=NZ&year=2022

1054 The World Bank "Personal Remittances, paid, (current US$) – New Zealand" available at: https://data.worldbank.org/indicator/BM.TRF.PWKR.CD.DT?end=2022&locations=NZ&start=1972&view=chart.

E11 In 2022, over $1.16 billion USD of remittances were received by the small island states in the Pacific.[1055] Remittances make up a large portion of some Pacific countries' national economy, averaging 12.5% of GDP in smaller states in 2021, and as high as 46.5% of GDP in Tonga.[1056] Remittances from New Zealand are a vital source of income for many families in these countries.[1057]

Remittance providers can be grouped into three categories

E12 A 2016 report prepared by Deloitte, for Treasury, identified three main types of money remittance providers that operate between New Zealand and the Pacific Islands.[1058] Many of these remittance providers also operate in other parts of the world. They are:

E12.1 banks;

E12.2 global Money Transfer Operators (MTO); and

E12.3 corridor specialists.[1059]

E13 Banks that offer remittance services have the support of their reputation as an established financial institution. They have history with customers and will have access to most currencies globally through their international banking networks.[1060] Although they are the most reliable, they tend to be more costly.[1061]

1055 The World Bank "Pacific Island Small States" defined by the World Bank to include Fiji, Kiribati, Marshal Islands, Federated States of Micronesia, Nauru, Palau, Samoa, Solomon Islands, Tonga, Tuvalu, and Vanuatu, available at: https://data.worldbank.org/region/pacific-island-small-states

1056 Department of Foreign Affairs "Empowering Migrants through Pacific Remittances (EMPR), (June 2023), at p. 4, available at: https://www.dfat.gov.au/sites/default/files/empr-mid-term-review.pdf.

1057 Reserve Bank "Pacific Remittances Project" (28 February 2022), available at: https://www.rbnz.govt.nz/regulation-and-supervision/cross-sector-oversight/our-relationship-with-other-financial-regulators/pacific-remittances-project.

1058 The Treasury "Review of the Money Remittance Market in New Zealand: A report on the problems affecting the remittance services between New Zealand and the Pacific, prepared by Deloitte for The Treasury" (March 2017), at p. 5, available at: https://www.treas ury.govt.nz/sites/default/files/2013-06/remittance-review.pdf.

1059 Corridor specialists are MTOs that operate in a specific region or 'corridor'. The World Bank "De-risking and remittances: the myth of the "underlying transaction" debunked (13 June 2018), available at: https://blogs.worldbank.org/psd/de-risking-and-remittances-myth-underlying-transaction-debunked

1060 International Monetary Fund "Understanding Remittances: Demography, Transaction Channels, and Regulatory Aspects" (October 2009), at p. 8, available at: https://www.imf.org/external/np/sta/bop/2008/rcg/pdf/ch2.pdf.

1061 World Bank "Remittances Remain Resilient but Likely to Slow" (June 13 2023), available at: https://www.worldbank.org/en/news/press-release/2023/06/13/remittances-remain-resilient-likely-to-slow.

E14 Global MTOs are financial businesses that use internal systems or access to cross-border banking networks to transfer funds across borders. MTOs have access to their own outlets or various transfer agents such as exchange bureaus, post offices, and other intermediaries to deliver their remittances in the destination countries.[1062]

E15 The 2016, Deloitte report found that corridor specialists have a large share of the remittance market in a number of Pacific Island countries. This is largely due to them offering lower prices and being more accessible than other remitters.[1063]

Issues potentially affecting competition for IMTs | *Ngā take ka tūpono pā ki te whakataetae mō ngā IMT*

There is an ongoing issue of smaller remittance providers being de-banked

E16 Smaller providers maintain that they have been de-banked and that banks are restricting services to them, and this has a significant impact on the ability of smaller providers to compete.[1064]

E17 This appears to be an unintended and complex issue associated with New Zealand's AML/CFT regime, as well as international AML/CFT regimes New Zealand banks interact with.[1065]

E18 There are recent government reports that discuss this issue in New Zealand, and one by the ACCC in Australia.

E19 The 2016 report Deloitte prepared for The Treasury, Te Tai Ōhanga identified three key concerns New Zealand banks have in relation to AML/CFT regulation and maintaining banking services for MTOs:[1066]

E19.1 Under the AML/CFT Act, banks are liable for all transactions processed by them. This includes transactions submitted by MTOs that are non-compliant with AML/CFT requirements. There is also a risk where although MTO's are compliant in New Zealand, they may not be compliant with corresponding banking partners who may have access to a wider range of data.

1062 International Monetary Fund "Understanding Remittances: Demography, Transaction Channels, and Regulatory Aspects" (October 2009), at p. 9, available at: https://www.imf.org/external/np/sta/bop/2008/rcg/pdf/ch2.pdf.

1063 The Treasury "Review of the Money Remittance Market in New Zealand: A report on the problems affecting the remittance services between New Zealand and the Pacific, prepared by Deloitte for The Treasury" (August 2016), at p. 5, available at: https://www.treasury.govt.nz/sites/default/files/2013-06/remittance-review.pdf.

1064 [ ]; [ ].

1065 Reserve Bank "Statement about banks closing accounts of money remitters" (28 January 2015), available at: https://www.rbnz.govt.nz/hub/news/2015/01/statement-about-banks-closing-accounts-of-money-remitters.

1066 The Treasury "Review of the Money Remittance Market in New Zealand: A report on the problems affecting the remittance services between New Zealand and the Pacific, prepared by Deloitte for The Treasury" (March 2017), at p. 6, available at: https://www.treasury.govt.nz/sites/default/files/2013-06/remittance-review.pdf.

E19.2 The AML/CFT compliance costs are high for wire transfer services. These costs mean that MTOs are usually not profitable enough for banks to justify providing accounts.

E19.3 Globally, correspondent banks have been heavily fined for breaches of AML/CFT regulations.[1067] This has resulted in banks strengthening their AML/CFT requirements and increasing the level of evidence required for foreign currency conversion transactions. Failure of New Zealand banks to comply with correspondent banks requirements could see services limited or even terminated. Services terminated from a United States banking partner for example could lead to New Zealand banks being shut out from global currency conversion markets.[1068]

E20 In 2022, MoJ released a report on its review of the AML/CFT Act. That report found that the AML/CFT regime had unintentionally made it harder for remittance providers to open or maintain a bank account. If banks prefer to avoid rather than manage the risk associated with IMT providers they may de-bank remittance providers, negatively impacting communities in New Zealand and overseas (and increasing risk).[1069]

E21 The 2019 ACCC report addresses consumer issues in the foreign exchange market and focuses on the importance of competition. One of the key findings of the inquiry was that 'de-banking' is a significant threat to competition in the IMT market. De-banking or the risk of de-banking results in costs being raised in order to comply and maintain access to banking services. This becomes a barrier for entry in the market and therefore lessens competition.[1070]

E22 Global MTOs provide a cheaper service than that offered by banks.[1071] With these providers being unable to operate, consumers have fewer options to choose from.

1067 Corresponding bank defined by Reserve Bank of Australia as 'a financial institution (the 'correspondent') providing a deposit account and related payment services to another financial institution (the 'respondent') for the purposes of currency exchange, the execution of third party payments, trade finance and cross-border money transfers' Reserve Bank of Australia "Correspondent Banking in the South Pacific" (15 June 2023), at p. 83, available at: https://www.rba.gov.au/publications/bulletin/2023/jun/pdf/correspondent-banking-in-the-south-pacific.pdf

1068 The Treasury "Review of the Money Remittance Market in New Zealand: A report on the problems affecting the remittance services between New Zealand and the Pacific, prepared by Deloitte for The Treasury" (March 2017), at p. 6, available at: https://www.treasury.govt.nz/sites/default/files/2013-06/remittance-review.pdf.

1069 MoJ "Report on the review of the Anti-Money Laundering and Countering Financing of Terrorism Act 2009" (July 2022), at p. 144.

1070 ACCC "Foreign currency conversion services inquiry" (July 2019), at p. 14.

1071 The Treasury "Review of the Money Remittance Market in New Zealand: A report on the problems affecting the remittance services between New Zealand and the Pacific, prepared by Deloitte for The Treasury" (March 2017), at p. 19, available at: https://www.treasury.govt.nz/sites/default/files/2013-06/remittance-review.pdf.

E23 We discuss the issue of 'de-banking' in Chapter 9 of our report, in the context of fintechs being able to open and maintain bank accounts. Based on our exploratory research, and our understanding of de-banking with respect to fintechs, we think denial of service to smaller remittance providers (ie, corridor specialists) could be impacting competition for remittance services. This is particularly the case as these providers may have lower fees or have better service.[1072] These providers are also likely to have greater penetration in some communities due to them using agents that operate out of dairies and small shops.[1073]

Various government agencies have made recommendations or are undertaking initiatives to address these issues, but progress is slow

E24 We identified a range of options being considered and implemented by various government agencies in New Zealand, as well as in Australia. These options are in line with the importance of AML/CFT policy considerations, including New Zealand's alignment with international partners.

E25 The Reserve Bank set up the Pacific Remittances Project in 2022 to analyse the challenges that affect Pacific nations in the remittance market. These challenges include banks in Pacific nations struggling to access global financial services and international regulations and associated de-risking. The goals of the project were to increase operational efficiency, reduce cost, reduce the likelihood of de-risking, improve the standards of culture and compliance, better detect, and deter financial crime and improve financial inclusion. [1074]

E26 The Reserve Bank has stated that they expect banks to manage and mitigate risk rather than avoid, arguing anti-money laundering laws are not an excuse to de-bank or de-risk from the Pacific Islands.[1075]

E27 The Pacific Remittances Project explored unintended consequences of AML standards, made recommendations to inform the review of New Zealand's AML/CFT legislation, increased collaboration with banks across the Pacific, and developed a business case regarding potential development of a regional electronic KYC (eKYC) facility.[1076]

1072 ACCC "Foreign currency conversion services inquiry" (July 2019), at p. 51, available at: https://www.accc.gov.au/system/files/Foreign%20currency%20conversion%20services%20inquiry%20-%20final%20report_0.PDF.

1073 The Treasury "Review of the Money Remittance Market in New Zealand: A report on the problems affecting the remittance services between New Zealand and the Pacific, prepared by Deloitte for The Treasury" (March 2017), at p. 4, available at: https://www.treasury.govt.nz/sites/default/files/2013-06/remittance-review.pdf.

1074 Reserve Bank "Pacific Remittances Project" (28 February 2022), available at: https://www.rbnz.govt.nz/regulation-and-supervision/cross-sector-oversight/our-relationship-with-other-financial-regulators/pacific-remittances-project.

1075 Reserve Bank "Keeping the bank door open for Pacific Peoples" (27 April 2021), available at: https://www.rbnz.govt.nz/hub/news/2021/04/keeping-the-bank-door-open-for-pacific-peoples.

1076 Reserve Bank "Pacific Remittances Project" (28 February 2022), available at: https://www.rbnz.govt.nz/regulation-and-supervision/cross-sector-oversight/our-relationship-with-other-financial-regulators/pacific-remittances-project.

E28 The 2016 Deloitte report outlined a number of recommendations relevant to the de-banking of smaller MTO's. These included: [1077]

E28.1 Having industry specific regulations in order to increase bank's confidence when applying AML/CFT compliance to MTOs.

E28.2 Granting limited licences to banks in the Pacific, enabling them to bank MTOs in send and receive markets.

E28.3 Encouraging competition from government owned banks or credit card companies, with the use of incentives when appropriate.

E28.4 Influencing US bank positions in international forums.

E28.5 Using a common regulatory approach within a single reporting agency.

E29 The 2022 MoJ report made recommendations relevant to this issue, including: [1078]

E29.1 AML/CFT supervisors develop a code of practice or guidance for businesses (particularly banks) to refer to when onboarding or reviewing high-risk businesses and customers, including remittance providers.[1079]

E29.2 Amend the AML/CFT Act to include a licensing framework for high-risk sectors (that are not licensed under other legislations). Licensing should be undertaken by AML/CFT supervisor and be a pre-requisite for registration on the Financial Services Providers Register (FSPR) to provide the relevant service.

E30 We understand that neither of these two recommendations has been actioned to date.[1080]

E31 The 2019 ACCC report recommended the formation of a working group tasked with consulting on the development of a scheme where IMT providers can address the AML/CFT compliance requirements.[1081]

1077 The Treasury "Review of the Money Remittance Market in New Zealand: A report on the problems affecting the remittance services between New Zealand and the Pacific, prepared by Deloitte for The Treasury" (March 2017), at p. 44, available at: https://www.treasury.govt.nz/sites/default/files/2013-06/remittance-review.pdf.

1078 MoJ "Report on the review of the Anti-Money Laundering and Countering Financing of Terrorism Act 2009" (July 2022), at p. 22, 27.

1079 The 3 AML/CFT supervisors are Reserve Bank, FMA and DIA. The Reserve Bank "Supervising agencies for anti-money laundering and countering terrorism financing" (28 February 2022), available at: https://www.rbnz.govt.nz/regulation-and-supervision/anti-money-laundering-and-countering-terrorism-financing/supervising-agencies-for-anti-money-laundering-and-countering-terrorism-financing

1080 [ ]

1081 ACCC "Foreign currency conversion services inquiry" (July 2019), at p. 11.

We have heard that opaque pricing of IMTs may limit consumers' ability to shop around and find the best value provider

E32 We understand pricing of money transfer services are complex and depend on various factors. The 'price' of a money transfer can include:[1082]

E32.1 **A fee charged by the provider.** This fee is charged by the sending bank and may change depending on the amount customers are sending. It may also have a minimum or maximum value. Factors banks could take into consideration when setting these fees could include the currency, speed of transfer, and payment method.

E32.2 **An exchange rate spread.** Many providers make a margin (or place a mark-up) on the exchange rate offered as part of the transfer service. That is, they offer more (or less) than the mid-market wholesale exchange rate when selling (or buying) currency.

E32.3 **Other fees** may include fees charged by intermediary banks that facilitate money transfers between the sending bank and the receiving bank. Receiving banks may also charge a fee for their customers to withdraw the sent funds.

E33 The existence of some of these price components, and their significance, may not be readily apparent without further work by the customer. For example, we've heard that many banks advertise headline exchange rates with a significant margin.[1083] Customers may be able to secure a more favourable exchange rate if they ask for one, but this can take time and effort.

E34 Time limited quotes may also make it difficult for consumers to compare prices between providers. With the quotes constantly changing on each individual site, it becomes harder to accurately compare rates. We do not know how widespread this practice is, but it could further reduce the ability of consumers to effectively compare providers.

E35 There are various comparison sites available to customers looking to compare international money transfer providers. These include:

E35.1 Interest.co.nz;[1084]

E35.2 RemitFinder;[1085]

E35.3 Monito;[1086]

1082 ACCC "Foreign currency conversion services inquiry" (July 2019), at p. 9.

1083 Wise "Submission on Market study into personal banking services - Preliminary Issues paper" (7 September 2023), at p. 6.

1084 See: https://www.interest.co.nz/currencies/buying-foreign-currency.

1085 See: https://www.remitfinder.com/.

1086 See: https://www.monito.com/.

E35.4 The Currency Shop;[1087]

E35.5 Wise;[1088] and

E35.6 SendMoneyPacific.[1089]

E36 However, it is not clear these websites offer a complete solution to the issue of opaque prices. For example, some only compare a limited number of providers, or appear to only compare 'headline' rates.

E37 A submission to our Preliminary Issues paper referred to a report from the United Kingdom (UK) governments' Behavioural Insights Team (BIT). One of the findings was that when individuals are given more transparency on pricing, they make better decisions. They also found that the positive effect of price information is notably stronger for individuals without foreign exchange experience.[1090]

E38 The 2019 ACCC study on foreign currency conversion services in Australia, found that consumers need to be able to compare total 'price' of services to get the best deal, but this can be difficult for three reasons: [1091]

E38.1 prices are complex;

E38.2 prices are presented in different ways by different suppliers; and

E38.3 prices lack transparency.

E39 The World Bank has stated that "one of the most important factors leading to high remittance prices is a lack of transparency in the market".[1092]

E40 The ACCC found that the difficulties in comparing prices, as well as customer inertia, appeared to be limiting the growth of smaller providers, even if they offered cheaper services. The ACCC also found that the big four banks in Australia were consistently more expensive than some other providers, and that there were significant savings from shopping around.[1093]

1087 See: https://www.thecurrencyshop.co.nz/international-money-transfers/send-money-to-new-zealand

1088 See: https://wise.com/gb/compare/.

1089 See: https://sendmoneypacific.org/.

1090 The Behavioural Insights Team "The impact of improved transparency of foreign money transfers for consumers and SMEs: Final Report" (March 2018), at p. 25-26, available at: https://www.bi.team/wp-content/uploads/2018/03/The-impact-of-improved-transparency-on-foreign-money-transfers-for-consumers-and-SMEs_WEB.pdf.

1091 ACCC "Foreign currency conversion services inquiry" (July 2019), at p. 10.

1092 The World Bank "Remittance Prices Worldwide", available at: https://remittanceprices.worldbank.org/about-remittance-prices-worldwide.

1093 ACCC "Foreign currency conversion services inquiry" (July 2019), at p. 10-11.

E41 Empowering Migrants through Pacific Remittances (EMPR) is a programme jointly funded by the New Zealand Ministry of Foreign Affairs and Trade, Manatū Aorere (MFAT) and the Australian Department of Foreign Affairs and Trade (DFAT). The programme was designed to allow people living in Australia and New Zealand remitting to the Pacific to engage with the remittance provider market, select the right providers and get the most value when sending remittances to Pacific households.[1094]

E42 The programme saw the development of the Send Money Pacific (SMP) website which has since become the main tool for EMPR.[1095] SMP operates as a remittance price comparison site where it returns rates based on the user's selected country of destination.

E43 The programme is still running and has seen a significant decrease in the cost of sending money in the past decade. Remittance costs to Fiji have decreased by 43% since 2011, Vanuatu, Samoa and Tonga have seen a decrease in cost of 17-21% over the 10-year period.[1096]

E44 There appears to be merit in undertaking further research to understand the size and nature of pricing issues, particularly around transparency, and how they may be affecting competition for IMTs and other foreign exchange services.

Potential policy options

E45 In response to findings about opaque prices and customer inertia in its 2019 foreign currency inquiry, the ACCC:

E45.1 Made four recommendations to providers, aimed at improving how prices are presented to customers. These included providing certainty of correspondent banking fees, digital tools to calculate the total price of a service, better information for in-store customers, and better disclosure of international transaction fees.[1097]

E45.2 Published guidance for consumers focusing on assisting consumers to find and use foreign exchange services that best meet their needs.[1098]

1094 Department of Foreign Affairs "Empowering Migrants through Pacific Remittances (EMPR), (June 2023), at p. 6, available at: https://www.dfat.gov.au/sites/default/files/empr-mid-term-review.pdf

1095 Department of Foreign Affairs "Empowering Migrants through Pacific Remittances (EMPR), (June 2023), at p. 4, available at: https://www.dfat.gov.au/sites/default/files/empr-mid-term-review.pdf.

1096 Department of Foreign Affairs "Empowering Migrants through Pacific Remittances (EMPR), (June 2023), at p. 4, available at: https://www.dfat.gov.au/sites/default/files/empr-mid-term-review.pdf.

1097 ACCC "Foreign currency conversion services inquiry" (July 2019), at p. 12.

1098 ACCC "Transparent pricing of foreign currency conversion services", (December 2019), available at: https://www.accc.gov.au/system/files/1651FAC_FX%20busines%20guide%20Transparent%20pricing%20D02.pdf.

E46 Since the publishing of the report on foreign currency conversion services, the ACCC has conducted further reviews into price transparency. In 2021 it found that the majority of remittance providers it reviewed were giving consumers the correct tools they need to readily compare the total price of IMTs.[1099]

E47 Deloitte's 2016 report also included recommendations relevant to the issue of opaque prices impacting the ability of consumers to shop around, including options to require greater disclosure of costs by remittance providers at the point of purchase of the service to their customers, and to require greater disclosure of transaction data to a regulatory agency.[1100]

E48 A submission to our Preliminary Issues paper suggested requiring providers of IMTs and payments to provide the total cost of their transactions inclusive of all fees and rates, up-front. They also suggested a currency calculator be integrated into their services to enable consumers to compare prices with other providers.[1101]

1099 ACCC "Money remitters improve price transparency after ACCC inquiry" (10 August 2021), available at: https://www.accc.gov.au/media-release/money-remitters-improve-price-transparency-after-accc-inquiry.

1100 The Treasury "Review of the Money Remittance Market in New Zealand: A report on the problems affecting the remittance services between New Zealand and the Pacific, prepared by Deloitte for The Treasury" (March 2017), at p. 59, available at: https://www.treasury.govt.nz/sites/default/files/2013-06/remittance-review.pdf.

1101 Wise "Submission on Market study into personal banking services - Preliminary Issues paper" (7 September 2023), at p. 10.