PositiveMoneyNZ

Follow up submission to Commerce Commission

Followup response to the Draft Report, Personal banking services market study

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[redacted]

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Introduction

Thank you for the opportunity to provide further input to our submission following the Auckland conference earlier this month and with the benefit of feedback from its wide range of attendees.

1. We left the conference with a mixture of hope and concern. Hope popped up in many places among the attendees, including from the big banks whose ideas on occasion were surprisingly constructive. Concern came as we saw that the Reserve Bank was not representedn.

2. This market study is a generational opportunity to fix a market largely created from faulty regulation from the 1980s that remains fundamentally unchanged.

3. We believe the Commerce Commission must work directly with the Reserve Bank to develop a new, high-level regulatory framework that better balances the needs of stability and competition. This should include the separation of retail banking from other activities of the oligopoly banks. We have no confidence that RBNZ can do this alone, nor that the current approach with minor tweaks will fix the market failures. We felt from the mood of the conference that we were not alone in our frustrations.

4. Stability and competition are not opposed. To a large extent, it is the Reserve Bank's failure to properly consider competition that has led to the problems we see today. Endless debates about profit margins and returns on capital and equity play into the hands of incumbents and distract us from the actual causes and cures.

5. Our concern is exacerbated by public comments from RBNZ regarding the planned regulation of the new deposit insurance scheme. Many saw this as the main hope for RBNZ to take a more pro-competition approach. Unfortunately, it appears to be leaning in the opposite direction (see below).

6. It will be difficult to change the competitive landscape while we continue to operate under the same regulatory framework and Reserve Bank culture that created our current market problems.

7. Open banking alone will not produce the diversity of banking options we need, and technology's tendency to concentrate markets is just as likely to create its own dominant players and competition issues.

8. In its final recommendations, we ask the Commerce Commission to shift the narrative to the bigger picture and open the door to an overhaul of the regulatory framework, one that is fit for the next thirty years rather than entrenching the mistakes of the last thirty.

Banking Regulation 3.0

9. The Reserve Bank rates its own performance on financial stability very highly. But it has clearly failed in *both* financial stability and competition, having produced an unstable and anti-competitive oligopoly.

10. Prior to the banking reforms of the 1980s, New Zealand had a diverse retail banking market where no institution or sector was dominant. There had never been a banking failure and if a bank had failed, none would have been big enough to bring the system down.

11. The Reserve Bank took this sound and diverse retail banking market and turned it into an unsound and uncompetitive market in which four entrenched banks face little competition and are now too big to fail, effectively commanding a government guarantee. Loose credit inflated the property market in tandem with bank balance

sheets, stressing households and supercharging a housing affordability crisis along the way.

12. **We submit that the Reserve Bank's failures on both stability and competition fronts happened *precisely because* it did not properly consider competition when making its regulatory decisions.**

13. These mistakes should not be repeated, but the signs from RBNZ are that they will. Little has been learned on the competition front, and it seems the same failings are being carried into the arena of deposit insurance (see below).

14. Tellingly, RBNZ was the only major party to avoid the Auckland conference. Its refusal to engage in this public forum is emblematic of a culture problem.

15. We hope its unhelpful stance might prompt soul-searching within RBNZ's ranks and among the wider expert community that too often shelters the Bank from robust debate and analysis.

Recommendation: A joint Commerce Commossion and RBNZ process to review regulation, with retail separation among the options

16. Our key recommendation in this follow-up submission is to address Reserve Bank shortcomings and develop a more pro-competition regulatory framework suited to the future retail banking and monetary environments.

17. **Recommendation: That a joint Commerce Commission and Reserve Bank group develop a new, pro-competition regulatory framework for retail banking.**

    - This should take a "first principles" approach, looking forward to the regulatory framework needed for the next 30 years rather than reviewing the current 30-year-old settings

    - The Commerce Commission will add greater expertise and input into competition and economic outcomes than the Reserve Bank's current culture and skillset allows

    - We strongly recommend that it consider the separation of retail banking from the other operations of the four Domestic Systemically Important Banks (D-SIBs). This has proved effective in the UK.

    - We recommend including the Bank of England's ring-fencing approach as well as other options for separation. We proposed this in our earlier submission and have reproduced our reasons for it below. The BoE recently completed a ten-year review which found a positive outcome from separation.

      Ring-fencing happened in conjunction with the acceleration of open banking.

- Separating retail from other banking activities would allow retail regulation that is more appropriate to the needs of the domestic market and might improve the focus on the remaining institutional and corporate banking.
- Separation can improve financial stability by reducing the too-big-to-fail problem, provide better economic outcomes by linking deposit and lending rates more closely to the domestic economy, and create a better environment for competition.
- It would potentially benefit the big banks by simplifying any future divestment decisions if retail competition or changing business priorities make it less attractive to hold these assets
- We suggest that Commerce Commission and RBNZ should formally advise banks to consider operational separation in any upgrade plans for their legacy systems
- The review should be conducted openly and widely consulted with regular public feedback. Where RBNZ and The Commerce Commission disagree, the public consultation will benefit if differences and their reasons are highlighted in order to allow a more nuanced and informed public discussion
- We suggest the joint review should report back by June 2026, the proposed date for open banking readiness.

Deposit Takers’ Act (DTA) and Depositor Compensation Scheme (DCS)

18. Concerns about the Reserve Bank’s plans for the new Deposit Takers’ Act provide another reason for proposing direct The Commerce Commission input into the regulatory framework.
19. Several speakers at the conference expressed hope that a more pro-competition approach with the DCS will moderate the Reserve Bank’s “anti-competition” stance in the current market. However, recent comments suggest the Reserve Bank plans the opposite.

Reserve Bank’s plans for DCS likely to make competition from smaller players tougher

20. Instead of the deposit insurance fund giving the regulator latitude to be more pro-competition, RBNZ is planning to tighten regulation for smaller entities, making compliance more onerous and further discouraging diversity and competition from smaller players.
21. Recent comments to the Finance & Expenditure Select Committee (Video: 31:50) show its intention to tighten regulation for smaller entities. In answer to a question

from Finance and Expenditure Select Committee Chair Stuart Smith on how it will balance risk with competition among smaller banks, the Reserve Bank's Senior Manager Prudential Policy, Jess Rowe, said:

> "Because we now have the Depositor Compensation Scheme, this is one of the reasons the new legislation moves us from just focusing on systemic impact, so the big end of town, to also focusing on the safety and soundness of each individual entity because the costs of failure are socialised through the fund. So this is actually a subtle but a step change in the framework because once you do that and you socialise the cost of failure through the DCS, you do need to focus on not just systemic and contagion and the big end of town but each individual entity and their soundness which is why we've got that minimum level **and why we might be sort of saying in the past maybe it didn't matter much if an entity didn't succeed, you have entities coming in and out, that's OK, we'll sort of step back a bit. When the cost of that is borne by the fund, you do need to put more checks and balances in to make sure there's a minimum level of soundness for each entity**. [Emphasis ours.]

22. Along with the DCS's leisurely, five-year implementation timeframe, it seems that far from contributing to competition, this new RBNZ job will serve as another brake on it

23. We believe this offers a further reason for the Commerce Commission to be directly involved with the Reserve Bank in developing a high-level regulatory framework that better balances stability and competition needs going forward.

Public investment: bottlenecks and accelerators

24. Positive Money did not support the Commission's recommendation for the Crown to invest to boost Kiwibank's competitiveness because we believe it would be a poor use of public funds – it would not significantly improve competition since it would just mean the oligopoly would consist of five "business as usual" banks instead of four.

25. However, Positive Money does support the limited use of public funding where there is a case to address externalities, limit monopoly control of essential infrastructure or accelerate economic benefits

26. In this respect, we suggest that the Commission consider some targeted public funding in its recommendations. Three potential areas stand out for us.

Payment system: supporting a free option

27. A widely-accepted and accessible payment system, including a fee-free option, is essential public infrastructure. The ageing EFTPOS system is the only current option and is vulnerable to closing after years of neglect.

28. There is a case for EFTPOS, or a network like it, to be under public control to guarantee a free payment option and to put downward pressure on fees for premium payment services
29. The future need to ensure access to CBDC (Central Bank Digital Currency), including its cash-like digital forms, should also inform the thinking of both The Commerce Commission and the Reserve Bank in this area.

API Centre

30. We believe there is a case for the API Centre to move from an industry group to a new group with some public funding and a governance structure that takes it away from its current D-SIB dominance
31. Decisions over the development, standards, operation and lifecycle of API creation and expiry are critical to open banking success, with the API Centre at the heart of it. This is a potential “bottleneck” area that can slow or accelerate open banking and requires strong governance in the public interest. We support the addition of some public funding to ensure this.
32. The API Centre could also serve as a valuable “anchor tenant” for a Banking Innovation Hub.

Banking Innovation Hub

33. In our earlier submission, we proposed that if Kiwibank were to be a disruptor it would be better to do this by supporting an “innovation hub” for banking, making it easier, safer and more successful for small banks to grow and new banks to enter the market. More banks, not bigger banks is the best way to encourage competition in both price and services.
34. Kiwibank (or more likely a spinoff unit) could play a key part in getting an innovation hub started, with its retail banking and regulatory expertise, and possible provision of banking services and products to fintechs and new entrants
35. While Kiwibank’s technology credentials are modest (and it needs to bring forward its own open banking timetable), it can also provide branch banking expertise to help grow regional, cooperative and other forms of community banking services
36. We were surprised to hear that private fintech investment in NZ was just $20M last year. For an industry that can both spur domestic banking competition and sell its products and services internationally, this shows an urgent need to kickstart investment in what could be a new billion-dollar technology export sector.
37. Early-stage public investment could enter the industry through government innovation funds. A successful hub will quickly draw in private investment.

38. An innovation hub approach could also make the banking system safer by helping new entrants—often with technology rather than banking backgrounds—upskill and adopt banking best practices.

CBDC and future changes to public money

39. The development of central bank digital currencies (CBDC) should inform any future-facing regulatory framework. Several conference attendees raised this.
40. Positive Money fully supports the development of digital forms of public money including both tokenised and non-tokenised forms
41. The distribution needs of retail CBDCs—including permanent free payment options—should be key considerations in any regulatory design
42. Based on the Reserve Bank's own timetable, the introduction of retail CBDC will be in progress by the end of the decade. For perspective, this is a similar timetable to the introduction of deposit insurance.

Appendix: Retail banking separation for D-SIBs

The following is an extract from our earlier submission on the draft report in response to the question: ***What recommendations would you add that we may not have considered?***

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

6. At the same time, it can potentially improve economic efficiency by sharpening corporate focus and reducing regulations that impede business investment.

7. There are precedents for this approach. In the UK, which has a highly-concentrated banking market like ours, the Bank of England has required the big banks to separate retail operations from their other banking through a process it calls ring-fencing. This is an operational separation rather than a full breakup but can provide a foundation for separate regulatory treatment.

8. In New Zealand, there are precedents. Our dominant telecommunications provider, Telecom, was broken up into a wholesale operation, Chorus, and a retail business, Spark, leading to greater competition and improved services.

9. The Commission's own recent inquiry into supermarkets included breakup options among its considerations, including possible separation of wholesale and retail operations to support a more competitive market.

10. We believe the lack of consideration of separation is a notable absence which the Commission should remedy in its final report.