

1 **DAY 1 – PERSONAL BANKING SERVICES MARKET STUDY CONFERENCE**

2
3 **SESSION 1 – COMPETITION IN PERSONAL BANKING**

4
5 **13 MAY 2024**

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8 **9.01 am**

9 **SAM BISHARA:** Tuatahi rā ka tū ake tēnei te mihi ake ki a koe John, ki a koutou hoki ngā mea o
10 te Kōmihana nei, na koutou te karanga otira kua tae mai te katoa nei. Nō reira, kia ora rawa
11 atu.

12 Otira Whai korōria harirua ki a Ihoa o ngā mno, Matua, Tama, Wairua Tapu me
13 nga Anahera pono, me te Mangai hei tautoko mai aiane, ake nei, āe.

14 Kai aku nui kai aku rahi, rau rangatira ma nau mai, haere mai, whakatau mai.
15 Whakatau mai nei i mua te aroaro ēnei me ... ko taumehe mātou otira whakatau mai i raro i
16 te tuanui o tēnei piringa e whakakotahi ai tatou mai I tenei haora, tae atu ki te
17 whakamutunga o ta tātou nei hui. Nō reira tēnā koutou katoa.

18 Ka tuku whakaaro ki a rātou ma kua wehe atu ki te po. Nō reira me kii haere, haere,
19 haere atu rā. Otira ko tātou ngā waihotanga o rātou mā - e harikoa ana te mihi atu ki a
20 koutou.

21 Tēnei te reo mihi a te Kōmihana ki a koutou katoa, tēnā koutou, tēnā koutou, tēnā
22 koutou me ngā tini ahuatanga o te wā.

23 Ka mihi au ki ngā iwi o konei otirā ki Ngāti Whātua o Ōrākei, a, tae atu rā ki Tainui
24 me Waikato ki a Kīngi Tuheitia Pōtatau Te Wherowhero te tuawhitu, a rā ko Tūheitia tērā.
25 Otira ki ngā Maata Waka, ngā karangarangatanga maha katoa e noho mai nei i roto i tēnei
26 rohe. Ana ki ngā wai kanapanapa o te Waitemata, ngā wai ū, ngā waiora, era ahuatanga
27 katoa heke mai I a rātou mā. Nō reira, kaore e kumea te roa o te kōrero nei, kua tae pai mai
28 koutou ki tēnei hui i runga i te kaupapa te rā, me te karanga o te ra - kua tae pai mai hoki
29 mātou ngā mea o te Kōmihana ahakoa I tatu mai i Poneke etehi, no te Wai Pounamu etehi,
30 otira me ngā hau e whā. Nō reira aku rangatira tēnā koutou katoa.

31 Ko tēnei kōrero whakamutunga me pēnei. Ka mihi ake i ngā kapa haka o Tāmaki
32 Makauru, i tū i tera wikene - If there ever was the chance for regulation, there should have
33 been at the Matatini festival on the weekend here in Auckland. We three winners sharing
34 first place – incredible!

35 Heoi anō, ahakoa ... e kōrero whakakatatata tēnei otira he mea tūturu, he mea
36 motuhake kia tātou te iwi Māori.

1 Otira ehara i te mea ko te Kōmihana he rōpū Māori engari e mōhiotia nei te oritenga
2 o Te Tiriti o Waitangi . Me waiho ma Dr John te tino whakamārama, heoi anō kia tūpato, e
3 hara i te mea i whānau mai te Kōmihana i te Tiriti o Waitangi ki aan kōrero pea i whānau
4 mai i te “He Whakaputanga”. So Dr John might differ a little bit from me when I say we
5 were born of the Treaty. He might give us a lesson in how we were possibly born from the
6 Confederation of the Northern Tribes of New Zealand.

7 Heoi anō, kai āku rangatira tēnā koutou, tēnā koutou, tēnā koutou, kia ora mai tātou
8 katoa.

9 **JOHN SMALL:** Kia ora Sam, thank you very much indeed. Tēnā koutou, ngā mihi nui ki a
10 koutou katoa. Ko John Small tāku ingoa, ko te rangatira o te Kōmihana Tauhokohoko.
11 Good morning everybody, and thank you very much for joining us today. And Sam, thanks
12 again for that wonderful mihi.

13 So welcome to this conference on our Draft Report for the personal banking
14 services market study. We're all really looking forward to the discussion over the next few
15 days. For those I haven't met, my name is John Small. With me today and throughout this
16 conference are Deputy Chair Anne Callinan, Commissioner Bryan Chapple, Associate
17 Commissioner Rakihia Tau and the Telecommunications Commissioner Tristan Gilbertson,
18 who is unfortunately detained as a result of a dental emergency and will join us tomorrow.
19 I believe he's online currently, but not with us. So with us in spirit and has been working
20 on the project.

21 A number of the Commission staff will be assisting us throughout the conference,
22 many of them will be known to you from your interactions with them so far and they'll
23 contribute to the conference as they have to work on the study in the next few months.
24 With us today in particular we have Sam Bishara who you've met and Denise Trail from the
25 Te Ohu Māori team. We've got Grant Chamberlain, Acting GM Competition over the back
26 there, Oliver Meech, Head of Market Studies, Matthew Bailey and Tom Georg who are
27 Principal Advisors in the Market Studies team and most importantly, Marissa Cairncross
28 and Priya Gajadhar who are Senior Project Manager and Project Coordinator in the Market
29 Studies team. They are keeping the show running, so thank you Priya and Marissa.

30 So I want to reiterate at the outset our appreciation for the time and energy that
31 many of you have put into assisting us with the study so far, including your recent
32 submissions on our Draft Report. This is a hybrid conference, attendees having the option
33 to participate either in person or virtually through Zoom. To everyone online and with us
34 in the room, again, welcome. Thank you for making the time to be part of this discussion

1 and work through the issues that we consider are most important as we head to our Final
2 Report.

3 I want to briefly summarise the context of the matters we're looking to discuss over
4 the next few days and our process for after the conference finishes. Under the terms of
5 reference for this study, our Final Report to the Minister is to be published by 20 August
6 this year. The Commerce Act also requires us to publish a Draft Report which we did in
7 March and to have regard to comments and submissions on it, which is what we're giving
8 effect to here.

9 The purpose of a competition study, often referred to as a market study, is to
10 identify and assess any factors that may affect competition for the supply or acquisition of,
11 in this case, personal banking services. If we find that competition is not working
12 effectively, we may make recommendations to improve competition for the benefit of
13 New Zealand consumers over the long-term.

14 A competition study is not an investigation into whether aspects of the Commerce
15 Act has been breached, neither is it an exercise in industry regulation. We do undertake
16 both of those kinds of work in other parts of the Commission, but our role here in
17 competition studies is different and broader. We are looking for the factors that are
18 affecting competition to see whether it's working effectively, and if not, why not.

19 We can look into the structure of the market, barriers to entry and expansion, the
20 impact of regulation, the conduct of market participants, and the resulting performance of
21 the market itself. If we consider it merited, we can make recommendations on how
22 competition could be improved to benefit consumers.

23 Ultimately, the overriding aim is the same as the purpose of the Commerce Act
24 itself, which is to promote competition, in this case for personal banking services, for the
25 long-term benefit of consumers in New Zealand.

26 Our preliminary view expressed in the Draft Report is that the four major banks,
27 ANZ, ASB, BNZ and Westpac, do not face strong competition when providing personal
28 banking services, that competition between them is sporadic rather than strong and
29 sustained, and that smaller providers on a competitive fringe face severe impediments to
30 entry and sustainable expansion. So we've proposed some draft recommendations aimed at
31 improving competition.

32 It's important to note that those views in our Draft Report are preliminary and our
33 consultation process is integral to enabling us to reach our final conclusions and to refine
34 any recommendations that we may make. Not all of the recommendations that we have so

1 far identified will necessarily find their way into the Final Report, and neither will all of our
2 draft findings necessarily take the same form in our Final Report.

3 We've received over 30 submissions on our Draft Report from a range of submitters.
4 Thank you very much indeed. We, Commissioners, have, between us, read them all and we
5 appreciate the time, effort and thought that you've put into them. This conference provides
6 an opportunity for us to discuss aspects of those submissions with you and provides you
7 with the opportunity to hear a little more from one another and to better understand the
8 perspectives of others.

9 We encourage you to share your thoughts with us over the coming days and in any
10 submissions that you might want to make following the conference where issues arise that
11 you've not already addressed, or where you have additional information that may assist us.

12 Please use your best efforts to ensure the information you provide is accurate and
13 complete. If you do need to correct anything provided at the conference, please just reach
14 out to us afterwards, that's perfectly fine. We can only consider information we receive, so
15 if you have or are aware of others in the industry who have information that may be
16 relevant to our analysis, please do provide this and/or encourage others to contact us.

17 Following the conference we've asked for any final submissions, including
18 cross-submissions, by Thursday 30 May. That will allow us enough time to consider that
19 material and those final submissions before our Final Report to the Minister is due. We
20 may also have some additional questions for parties arising out of the conference, or out of
21 the submissions that follow it, or any other information that we think might assist
22 preparation of our Final Report, in which case we will reach out to you. As I mentioned,
23 the Final Report is due to be published on 20 August.

24 So just a few minutes now explaining how we will run this conference. The
25 sessions have been divided up and the agenda has been circulated and posted on our
26 website, so I think you've probably all got that. So we're going to start today with sessions
27 focused on the nature of competition, and within that, indicators such as profitability; and
28 then we'll discuss prudential capital requirements and other regularly factors.

29 Tomorrow we'll discuss open banking and other enablers or barriers for fintechs.
30 We also have a session reserved for overrun in case there are additional topics or matters to
31 return to.

32 On Wednesday we have a session to consider promoting competition for lending on
33 Māori freehold land, a session on mortgage advisors and advice, and a session on consumer
34 experiences that will touch on switching, access to information, the CCCFA and AML

1 requirements, and access to basic bank accounts.

2 In each session the discussion will be chaired by one of us Commissioners. We will
3 introduce the session and topics, open the discussion and lead questioning. Other
4 Commissioners may also have questions as the session progresses. Some questions will be
5 directed to the room to invite comment from any interested parties, some may be directed to
6 particular parties who have raised particular perspectives.

7 In doing this we're going to be looking to continue to collect information and listen
8 to views, and focus the discussion on points of disagreements and/or areas where we feel
9 the need to better understand the relevant perspectives to test our positions, our problem
10 definitions and try and advance some of the possible solutions.

11 The session chairs will look to invite comments from any interested parties online
12 as well as in the room who wish to contribute based around our questions. We hope there'll
13 be ample opportunity for parties to contribute, but the time and the days are limited and we
14 do not wish to spend it on matters where there either is general agreement, or where
15 Commissioners do not need further information.

16 We do not see this as a forum for parties to re-present written submissions. Please
17 be assured that we have read them all. Instead, when discussing any issue, if you're
18 referring to a point that you've made in your submission, feel free to tell us where in that
19 submission we can find it for later reference. If it seems that a discussion is not advancing
20 matters in terms of the further consideration of our preliminary findings or draft
21 recommendations, Commissioners will move the discussion on.

22 When speaking, please identify yourself briefly by name and organisation for the
23 purpose of our transcription service and so that others attending the conference will know
24 who you are. We will be transcribing all of the public sessions.

25 We won't permit parties to question other attendees, but to the extent that we can,
26 we'll provide some time for people to comment on issues raised by others. We may also
27 round out the sessions with an opportunity for comments.

28 In this way, as time allows, we'll try to hear from everyone interested in
29 contributing to the discussion. If time does not allow, we'll note your interest in a topic and
30 follow-up with you after the session, or you should feel free to follow-up with us on final
31 submissions after the conference if that works best for you.

32 For those who have not seen the submissions we've received, there are public
33 versions available on our website. Given the objectives of the conference, the amount of
34 time spent on an issue at the conference does not necessarily reflect the importance of it as

1 an issue in our Final Report. Some of the issues are more complex than others and there
2 are some issues on which we understand your views already.

3 Just because we don't discuss an issue doesn't mean it's not important. It may just
4 mean that we don't have any questions to ask, or it's best addressed in another way;
5 particularly if it's best discussed in a confidential session to protect commercial sensitivity.
6 I'll say some more about that in a second, in fact right now.

7 While it's really important to us that our process is transparent and that parties have
8 the opportunity to hear from one another, some of the information you may wish to provide
9 to us may be commercially sensitive and confidential, and that could just arise in the
10 conversation. If there's something that you'd like to say in response to a discussion but it's
11 confidential, you do not wish to raise it in a public forum, feel free to say so if necessary to
12 curb the discussion at the conference, and/or follow-up with us separately. We're very
13 sensitive to these issues and Commission staff are in the room here today and contactable
14 obviously online as well.

15 The public sessions on every day will be recorded for the purpose of creating a
16 transcript of each session. Because the sessions will be transcribed, it's helpful to speak at a
17 normal but deliberate pace to enable our transcriber to pick up clearly what you're saying.
18 For those joining by Zoom, please use the raise hand function and we'll come to you for
19 your comments, unmute, then mute your microphone again after speaking please. We all
20 know that drill by now.

21 There are roving microphones in the room for those not sitting at this V table. We
22 request intending speakers to please just sub in and out from the V table for relevant
23 sessions. We'll try and keep things structured but flexible. We will not be publishing a
24 recording of the conference, but we will post the session transcripts on our website as soon
25 as practicable.

26 Media. We welcome any media members who are joining us to observe the
27 conference sessions. We do ask that if anyone is audio or video recording any part of the
28 conference that they do so for note-taking purposes only and not for publishing.
29 Commissioners and staff won't be available for further interview or discussion prior to the
30 release of our Final Report, but if you have any queries, I'd encourage you to email our
31 team.

32 There will be some breaks between the sessions. If matters arise during the
33 conference you'd like to discuss with a member of staff, use those breaks to do that.

34 And finally, some housekeeping information from the venue, evacuation and

1 housekeeping procedures. The public washrooms are outside to the left down the hall and
2 on the right just before the stairs. In case of emergency, please make your way out the
3 main doors to the right, out the doors by the spa and around the hotel to the front. That's
4 easy to remember, isn't it. In any evacuation the primary assembly point is directly in front
5 of the Pullman Hotel entrance, and the secondary assembly point is across the road in the
6 Auckland University grounds.

7 If there's a fire alarm sound, please remain calm, make your way to the nearest safe
8 exit following the exit signs to the exterior and proceed to the assembly point, use
9 emergency exits and stairwells, form one line quickly but carefully. Hotel staff will be at
10 strategic points to guide you, and you won't be allowed in until the chief fire warden gives
11 the all clear. Please do not attempt to use an elevator during an emergency. If stuck in an
12 elevator, do not attempt to force open the stalled elevator doors and use the emergency
13 phone to contact the communications centre.

14 Right, that's that part. Now let's get into session one directly. This is going to be
15 run by myself and Rakihia. And the purpose of this session is to discuss views on the
16 nature of competition for personal banking services; is it sporadic, or strong and sustained,
17 things like price matching, that kind of stuff, and also bank profitability.

18 **JOHN SMALL:** So as you know in our draft we described the market as a stable, two-tier
19 oligopoly with the first tier comprised of the big four major banks, and the second tier of all
20 other smaller providers and Kiwibank sitting in the middle.

21 Our preliminary view is that the four major banks do not face strong competition
22 and that competition between them is sporadic rather than strong and sustained. This was
23 evidenced, amongst other things, by high and stable shares of supply, and the difficulty that
24 smaller providers have experienced in exerting competitive pressure on the major banks,
25 largely due to high barriers to entry and expansion.

26 Some submissions supported that description of competition, others had differing
27 views, noting that competition is more dynamic and effective than suggested in the Draft
28 Report for a number of reasons, including price and non-price differentiation, the ability of
29 consumers to easily switch providers, plus the growth and potential entry of smaller
30 providers.

31 So here we really want to talk about the nature of competition. Is it as we've
32 described, or is it more dynamic and effective. We'll also be discussing profitability which
33 can be an indicator of the intensity of competition. Our analysis in the Draft Report sought
34 to build on existing work on banking sector profitability.

1 Using publicly available data, we compared New Zealand's banking sector
2 profitability to comparable banking sectors overseas and compared profitability across
3 New Zealand banks. That analysis identified the profitability of New Zealand banking
4 sector and New Zealand major banks appears relatively high. We did not undertake a cost
5 of capital exercise, but instead sought to understand the drivers of the observed level of
6 profitability.

7 We concluded that we were not satisfied that the explanations provided fully
8 explain the high level of observed profitability and that corroborated and reinforced our
9 findings that competition is sporadic and limited for personal banking services.

10 We have reviewed submissions on our profitability analysis and would like to thank
11 parties for those submissions. We're not interested in simply repeating these submissions,
12 rather in understanding what they mean for our analysis and our overall understanding of
13 competition in the sector.

14 So to the first part of that, the topic one, the nature of competition, is it sporadic or
15 strong and sustained. So some submissions suggested that competition is dynamic and
16 sustained and challenged our preliminary view that competition is sporadic. The
17 Commerce Act standard, as you may know, is workable competition, which the courts have
18 described as a situation where the market has a tendency towards strong competition. That
19 seems a little difficult for us to reconcile with the outbursts of more intense competition
20 that we've seen. It doesn't seem like a tendency, in other words.

21 So perhaps I'll start with BNZ on this, and Deloitte Access Economics. And with
22 respect to market shares, both for home loans and total assets, these have been fairly stable
23 for an extended period. Could you give us a kind of, I guess, a -- we're trying to reconcile
24 that against your comments that competition is more dynamic and effective than we
25 suggested. So how do you think about stability of market shares against that sort of
26 observation?

27 **DAN HUGGINS:** Sure, I'll start and then maybe hand to Liza for the Deloitte view, which is
28 obviously, as you mention, the analysis that we provided on why we believe that
29 competition is more dynamic. So our experience is that competition is strong and
30 sustained, that the sector is dynamic and intensely competitive. And we see that every day
31 with our bankers fighting every day to both win and retain customers.

32 We also encourage the Commission -- as we mention in our submissions, I won't go
33 into it in detail -- to review the impact of Kiwibank, but also of smaller players, which,
34 again, I'll get Liza to talk to. Because whilst at a national level, some of the observations

1 may hold true that smaller competitors at a national level may exert less competitive
2 pressure, that is not true from our experience at a regional level, where, for example, TSB is
3 larger than us and many of the larger competitors, and therefore acts as a major and direct
4 competitor in those markets and it is dynamic.

5 So that's our broad experience, but Liza, perhaps I'll hand to you to talk about the
6 analysis on pricing in particular and why banks compete in a dynamic way.

7 **LIZA VAN DER MERWE:** Great, thank you. So I think the first comment that I want to make
8 is on sporadic competition. So our point there, and our interpretation of the evidence, is
9 that the period in the Draft Report is really from 2018-2023, and in this respect I would like
10 to refer you to figure 8 of the Draft Report.

11 If you look at that report, is that during this period was a period of Covid. Covid
12 really in New Zealand extended from lockdowns early 2020 and our borders only opened in
13 July 2022. So if you look at figure 8, during that period you can see a stable period, but
14 directly prior and after, we see really strong, sustained competition.

15 Then, secondly, in terms of market shares, we want to emphasise that context is
16 really important. So banks are of systematic importance to the economy and a degree of
17 stability is really a key consideration for regulations imposed in this market. So for this
18 reason we would not expect significant volatility in market share and also balance sheet
19 size.

20 Then we want to refer you to key statistics and data in terms of underlying evidence.
21 So again, for example, if we look at Kiwibank and its system growth, and also referring to
22 figure 1 on the ANZ submission, system growth was 1.48. Again, it's closest competitor to
23 BNZ is 1.22. So that's really significant growth.

24 Further, a key consideration is, if we look at Kiwibank's main bank share, it's main
25 bank share is 12%. So it took about 22 years for Kiwibank to gain 12%, whereas BNZ is
26 14%. So again, very close to BNZ.

27 Then if we look at regional players. So regional players really provide a significant
28 constraint. And if we look at their regional success, so again, TSB in Taranaki, second
29 largest player, 15% market share. SBS, for example, again in Southland, 11%, third largest
30 player.

31 So they're really providing significant constraint. And also if we refer you to the
32 econometrics paper commissioned by the Commission to figure 10, what we see there is
33 that both TSB and SBS is as efficient as the larger banks, and this in itself is potentially
34 undermining the theory of a two-tier nature of competition.

1 **JOHN SMALL:** Thanks very much for that, Dan and Liza, that's really helpful. Could I just go
2 to figure 8 which you referred to. So I think this kind of is interesting, because it shows the
3 short-run dynamics. This is about annual home lending growth, so it's about percentage
4 changes in a short period of time.

5 And so what we found, I think, as a general point, was that whilst there's quite a lot
6 of variability in the short-run dynamics of market shares in new lending, because there's
7 such a huge established base and new lending's just a tiny part of that, that doesn't really
8 change market shares very much, even though you can see quite a lot of variability in the
9 shares of new lending growth. Would you like to comment on that, or Dan?

10 **DAN HUGGINS:** I think that observation's obviously correct in the data. However, when we
11 think about competition, what is happening is that the impact of that competition on the
12 flow that's available in the market is influencing what's happening in the back books as
13 well, because the pricing that we're seeing on front and back books, at least in the BNZ's
14 case, is equivalent. So actually, the competition that you see here, which plays out on the
15 front book, is also flowing through to the benefit of all customers, including in the back
16 book, because they are on a fixed rate mortgage which is rolling intermittently.

17 **JOHN SMALL:** Right, so the pricing flows through in due course, depending on the length of the
18 mortgage and so on, yeah, I agree. I was really thinking about the market shares, though,
19 which do seem quite stable.

20 **DAN HUGGINS:** Sure, but I think what you're seeing there is also a reflection of the fact that
21 customers are happy and are provided good service. So in the research which the
22 Commission did, I think you saw that nearly 50% of customers are happy at an aggregate
23 level, and those that aren't find it easy to switch and they're in these numbers.

24 **JOHN SMALL:** Okay, we'll get to consumer switching later on. Thanks for that, that's a helpful
25 contribution. Just back to you, though Liza, if you wouldn't mind. This point about the fact
26 that market shares differ by region; are you suggesting that that means that this is not a
27 stable market structure or not?

28 **LIZA VAN DER MERWE:** Again, our interpretation of the evidence and analysing the data is
29 really suggesting that the regional competition is important to consider, and the regional
30 constraints varies. And even, again, if we consider Kiwibank, across all the regions, its
31 market share is pretty close to the largest competitor from the larger banks.

32 And again, what we would like to emphasise is that when we were analysing the
33 regions, 60% of the regions do follow a different pattern to a national stable, competitive
34 pattern if we only look at the market shares, as you indicated, on a national level.

1 **JOHN SMALL:** So they're unstable, is that what you're saying?

2 **LIZA VAN DER MERWE:** If we look at a regional level, there's regional competitive
3 constraints. In that perspective, our interpretation is it's not a stable market and it's a
4 competitive market.

5 **JOHN SMALL:** Okay. Yeah, I think we would -- I certainly wouldn't challenge the proposition
6 that TSB is strong in Taranaki, obviously it is. But there's a difference between that and the
7 time dimension, which is about stability of shares. So have you got anything on that in
8 particular at the regional level?

9 **LIZA VAN DER MERWE:** So in terms of our report, we analyse it for 2023.

10 **JOHN SMALL:** Yeah, which is just one period, yeah. Okay. Alright, thank you for that.
11 Perhaps turning to ANZ and CRA who reported for them. The CRA report suggested that
12 the pricing of home loans in '22 and the first half of '23 was financially unsustainable and
13 therefore not indicative of effective competition but rather of untenable or maybe excessive
14 competition. In what sense was this pricing unsustainable and therefore not a good guide
15 for what effective competition might look like on an ongoing basis?

16 **ANTONIA WATSON:** I will refer that to CRA who are online.

17 **JOHN SMALL:** Great. Can we get them unmuted please. Is that Geoff Edwards? Early test of
18 the hybrid format coming up.

19 **RAKIHIA TAU:** I do have one question. Not everything would make it into your report for
20 whatever reason, but was there any themes that came through when you were looking at
21 other years? I assume you went through a process to identify that Covid period around
22 regional shares. Was there anything else that popped out in your analysis outside those
23 years to confirm stable markets, or movement in regional competition?

24 **LIZA VAN DER MERWE:** I think one thing that I want to emphasise is that the evidence, even
25 if it's for 2023, emphasised that there's variability in leadership across regions. What's also
26 captured in our report is our empirical analysis around price responses from banks. What
27 we see is that all banks, and that was over a very long period as well, what we see is that all
28 banks are responding to each other's pricing, irrespective of whether it's home loans, across
29 all the products, whether it's a 1 year, 2 year, 3 year, 5 year product; and the same for term
30 deposits as well.

31 And then in particular for home loans, what we've seen over that period is that your
32 smaller banks do have quite a significant constraint on ANZ, BNZ, Westpac, Kiwibank and
33 ASB. And that is capturing a long period, even prior to Covid, including the GFC period as
34 well.

1 **JOHN SMALL:** Thank you. How are we going with CRA? Yes, welcome.

2 **GEOFF EDWARDS:** Good morning everyone. Dr Geoff Edwards from Charles River
3 Associates.

4 **JOHN SMALL:** Welcome Geoff, thanks for joining us. Did you catch the question or shall
5 I repeat it?

6 **GEOFF EDWARDS:** I caught the question, thank you.

7 **JOHN SMALL:** Oh cool.

8 **GEOFF EDWARDS:** Just quickly on the issue around stable market shares before I answer the
9 question. I don't think it should be assumed that because market shares have been stable for
10 a period of time the market is not effectively competitive. That's just a first point. That's
11 not necessarily the case, you don't necessarily see dynamic movement even if they're
12 competing aggressively to maintain their shares.

13 In terms of your question, we were making the observation there that, from reading
14 the evidence in the Draft Report, some banks have reported, we understand, that their
15 margins on home lending fell well below their cost of capital and the observations of the
16 CEO of the Commonwealth Bank, parent of ASB, that the mortgage rates at that time
17 through 2022 early 2023 were difficult to reconcile and offered unsustainable returns.

18 So we're making the observation there that it wasn't clear that that period should be
19 regarded as a period of competition, and that the periods either side of that should be
20 regarded as not strong competition. And so that the conclusion should not be that
21 competition is necessarily sporadic. It's possible that competition is continually sustained
22 and strong in a sustained way, and that there was a period when there was a rather
23 unsustainable degree of competition that has now resolved.

24 **JOHN SMALL:** Thank you. Would you care to comment on how that happened, how could it be
25 that the world ended up like that? Orr maybe Antonia would like to --

26 **ANTONIA WATSON:** I'll let Geoff comment first, but I can add to that.

27 **GEOFF EDWARDS:** I can only speculate, so take that for what it's worth. It was a period
28 following Covid, it was a period when there was inflation and changes in interest rates, and
29 it may be that people struggled to set their expectations correctly and found themselves in
30 an unsustainable position.

31 **ANTONIA WATSON:** And I think also it was a period of intense competition in a rapidly rising
32 interest rate environment. I think we could take some comments about actual price setting
33 and things like that to the sessions on Thursday.

34 **JOHN SMALL:** Yeah, certainly there was a lot of growth, right, in lending at that time. That

1 might be what you're getting at.

2 **ANTONIA WATSON:** I think it also points to some of the comments around price matching and
3 if prices are being matched that's not a form of competition. But if you're not matching and
4 constantly going lower and going lower and going lower, you are going to erode the
5 sustainability of the margins on a particular product.

6 So there is sort of a natural floor that's also driven by things like availability of
7 funding. Funding is a very, very key thing for banking in terms of how much we're able to
8 lend. And there's points in time where you see individual players in the market who might
9 be constrained at a point in time, whether it be from a prudential requirement or a funding
10 requirement.

11 **JOHN SMALL:** Right, yeah. So can I just clarify, though, is it that those loans were expected to
12 be unprofitable overall at those prices? I mean, for example, once future interest rate
13 changes were factored in and margins on sales of other products and so on; bearing in mind
14 the interdependence between loans and other things, which you've referred to, and also over
15 time as interest rate changes.

16 **ANTONIA WATSON:** So over time they may become more or less unprofitable, depending on
17 what happens to interest rate changes, depending on what happens in competition in the
18 market, and depending on the ability to reprice loans and the customer's ability to -- in that
19 period of rapid rising interest rates, you're also looking at repayment ability. There's a lot
20 of things that go into pricing that aren't just simply the OCR rate, for example.

21 **JOHN SMALL:** Sure. Yeah. Okay. Anyone else want to jump in on that point? Okay, thank
22 you. Thank you. There's some smaller banks and non-bank deposit takers here, and I'm
23 kind of interested to take their temperature on this question as well.

24 So I guess the question is, what do you think about the intensity of competition over
25 time and have you observed sporadic outbursts? Would you characterise the current state
26 of competition as dynamic, strong and sustained? Who have we got here from the smaller
27 banks and NBDTs. Yes, thank you. I've forgotten to remind people to say their names.

28 **MIKE HENDRIKSEN:** Kia ora, Mike Hendriksen, Kiwibank. Obviously Kiwibank is humbled
29 at the suggestion from the four banks that we are a competitive constraint on them. We'd
30 like to think we're a competitive threat in the sense that we were established as a challenger
31 bank and have been growing market share in the recent times. But I think when we step
32 back we say we're a quarter of the size of the smallest of the big four banks, we have 7%
33 market share, so we don't see ourselves as a competitive constraint on the other four.
34 Emma Ihaia is from Link Economics and she can perhaps speak to some of the

1 observations that she made.

2 **EMMA IHAIA:** Thank you. Emma Ihaia, Link Economics. Look, I guess I have a couple of
3 comments, firstly on the extent of competitive constraint by Kiwibank on the larger banks,
4 and then also some observations as to sort of other factors that influence mortgage rates
5 aside from the cost of funds. So firstly, we had prepared a report, I'm not sure if you've
6 soon it because it wasn't a submission on the Draft Report, but it was a cross-submission on
7 the preliminary issues paper.

8 **JOHN SMALL:** Yeah, we saw that.

9 **EMMA IHAIA:** In that, one of the examples we highlighted was where Kiwibank had reduced
10 the variable rate, variable mortgage rate by 100 basis points and that was sustained over the
11 period of more than a year, but yet there didn't appear to be a competitive response to that,
12 certainly not on variable rates in the same way that we often see rates moving together on
13 each type of mortgage interest rate. So that was something of interest, and I highlight that
14 because I'm not sure that it was mentioned in the Draft Report.

15 But what's really interesting when you're looking into price matching, because
16 obviously there's the issue of well, is price matching simply a result of strong competition
17 or not. And so there's two types of price movements you can observe. One is where a price
18 movement is actually associated with the change in some sort of a reference rate, or cost of
19 funds, and you can see that even in the, for example, in the Draft Report I think there's a
20 series of charts where you can look at the OCR and the changes in variable rates and then
21 the swap rates and so on.

22 But what's interesting is to think about the two types of interest rate changes,
23 mortgage rate changes. One is where we've got this change that's driven by the cost of
24 funds, and then the question is, is the change simply reflecting that cost of fund, or is there
25 an increase in margin or reduction in margin.

26 But then there's another set of mortgage rate changes which is particularly
27 interesting to look at in terms of competition, which is where it was purely a strategic
28 move; and the Kiwibank example seems to be that category. So we have a change in the
29 variable interest rate, variable mortgage rate offered by Kiwibank that wasn't driven by
30 OCR. So look, I'd highlight that to the Commission.

31 And then the other thing is just sort of a general observation around other factors
32 that might drive pricing, or in this case mortgage rates. For example, there might be
33 responses to concerns about social licence when high profits are announced and of concern
34 to the public, or also even regulatory risk, so perhaps a risk of a market study and

1 intervention.

2 Regulatory risk is, I think, pretty commonly recognised and often appears on
3 company's risk registers. For example, we've seen, you know, there'll be people in the
4 room who are familiar with the telco sector and there were some clear examples there of
5 how heightened regulatory risk changed the behaviour of market participants, whether that
6 was negotiating deals for termination, or roaming or whatever. So just a comment, really,
7 that in looking at changes in interest rates over time and how competition has worked, that
8 that could be another factor that the Commerce Commission could consider.

9 **JOHN SMALL:** Yes, thank you Emma and Mike. While you've still got the mic there, Emma,
10 your comments really have gone to the extent to which Kiwibank constrains or doesn't
11 constrain the majors, and that's an important part of our analysis obviously, so thanks for
12 that. But what about our characterisation of competition generally between the majors as
13 being of a sporadic nature rather than strong and sustained? Would you like to comment on
14 that?

15 **EMMA IHAIA:** Well, you know, I agree with the comments that the Commerce Commission has
16 made around the conditions for accommodating behaviour, for example. In terms of the,
17 you know, I think you've mentioned some comments about time limited pricing and so on, I
18 don't have visibility of that.

19 But my thoughts on the sporadic nature was really related to that period from, I
20 think, late 2022/early 2023 where we saw, for example -- it's on page 93 of the Commerce
21 Commission's Draft Report, figure 4.7. There's some really interesting things happening
22 there, because we see, for example, if you just look at the floating rate, we've got the OCR
23 increasing and rates increasing. Again, the OCR increases, the rates increase.

24 But then we have this interesting outcome in March or February 2023 where the
25 OCR increases and we don't see any increase in rates. So there's something happening
26 there where the rates aren't adjusting for the OCR, and the question is what's happening in
27 this period. And I throw into the mix, as I said, that there could be other factors, yeah.

28 **JOHN SMALL:** Yeah, other funding costs and so on.

29 **EMMA IHAIA:** Or also sort of a threat of regulation perhaps.

30 **JOHN SMALL:** I see.

31 **EMMA IHAIA:** You know, there was a lot of commentary in the media and so on and discussion
32 about whether there would be a market study at that point.

33 **JOHN SMALL:** Yeah, that's true, there was.

34 **EMMA IHAIA:** So just something else to consider.

1 **JOHN SMALL:** Okay, thank you. That might lead us nicely into this question about price
2 matching, which has also come up in submissions, and we mentioned it obviously in our
3 draft. And I think perhaps the strongest challenge to what we said in the draft was probably
4 from CRA, so this might be another question for Geoff.

5 So CRA challenges our view that there are established patterns of price matching
6 behaviour. It says that there's no predictable patterns in price movements. Different banks
7 lead the market on different products at different times and there's no reason to expect, or
8 wish, for there to be a consistent best-in-market lowest player, lowest price player. Also
9 says our analysis of movements in home loan rates, for example the green home loan
10 top-up offers in the Draft Report is incomplete when additional material is considered. It
11 suggested that this shows a period of price beating that eventually settles into a stable
12 equilibrium.

13 So assuming Geoff's heard that, I guess my question is, should we expect to see
14 firms reaching settled or stable equilibria in workably competitive markets, or I guess
15 conversely, should competition be an ongoing struggle, you know, rather than something
16 that begins and ends? Could you dial in CRA to address that? And it may be something
17 that other people may want to comment on because this price matching thing has been a
18 matter of some discussion. We can see you but we can't hear you.

19 **GEOFF EDWARDS:** Thank you John. Can you hear me?

20 **JOHN SMALL:** Yes we can, thank you.

21 **GEOFF EDWARDS:** Yeah, so we looked at the evidence that was in the Draft Report, and
22 I suppose it could be interpreted in different ways. Our interpretation of that evidence was
23 that there was actually no evidence of established kinds of price matching as it was put in
24 the Draft Report. So you can see variation in terms of -- you can see leadership and some
25 sustained periods of differences in prices, if you look at home loan rates and deposit rates.

26 But in terms of that green home loans example, our interpretation of that example is
27 actually one in which there was a period of iteration between the banks with a number of
28 different types of offers; differences both in terms of price, but also non-price terms on
29 those offers, arriving at a, I'm not sure we'd call an equilibrium, but a position where the
30 offers are similar but they are still differentiating; which seemed to us not price matching,
31 but rather iteration towards a new competitive position.

32 I think it's possible to have an effectively competitive market where, I wouldn't say
33 things are perfectly stable, but where there is a reaction by competitors; in fact I think it's
34 quite likely a reaction of competitors to the pricing of others. And that would be expected

1 to be -- if somebody lowers their price you'd expect to see some reaction in terms of lower
2 prices from others. How far they lower prices will depend on many factors. They may
3 price match, they may not quite price match, particularly if they've got some differentiated
4 products and some non-price terms and conditions that differ.

5 So those are observations that, you know, first of all it wasn't clear to us that there
6 are established patterns of price matching; and secondly, you would expect some degree of
7 movement together of prices in a competitive market.

8 **JOHN SMALL:** Headline prices, though, for loans are pretty similar across the big banks, you'd
9 agree I'm sure?

10 **GEOFF EDWARDS:** They are pretty similar, yeah. And that will be driven by similar funding
11 costs, I would imagine. And there will be movement, as has just been observed, when the
12 OCR moves banks will move. But there is often some delay in movement and they don't
13 all necessarily move at the same time.

14 **JOHN SMALL:** I think yours was the submission that had the vector autoregressive model, was
15 that right?

16 **GEOFF EDWARDS:** No, sorry.

17 **JOHN SMALL:** No, it wasn't? Sorry, I'm getting confused. It was yours (Liza Van der Merwe),
18 I'll ask you about that later, thanks.

19 Okay, so perhaps I'd just ask any of the major banks whether there's been any sort
20 of -- whether with these green loan top-ups have reached a kind of equilibrium and whether
21 we've missed any kind of subsequent developments in that area? Has anybody got new
22 information to add in respect of that example?

23 **ADAM BOYD:** Adam Boyd from ASB. A couple of points, one more broadly. Obviously we're
24 talking a lot about price in the sense of competition, but there are a number of other factors
25 that we, and our observations of competitors, use to be competing on a day-to-day basis,
26 whether that be credit settings, marketing, lending capability, turnaround time, marketing
27 spend etc. So all of those dimensions are getting looked at on a day-by-day basis, and we
28 certainly are changing settings regularly on each of those dimensions in order to try and
29 compete. On that point we kind of see Kiwibank as no different to any of the other majors
30 on that point.

31 I think on the green home loans, the only point I'd make is, I think, I mean it appears
32 that we've reached equilibrium, but that is an equilibrium at well below cost of capital,
33 which I think is another indicator of how fierce the competition is out there.

34 **JOHN SMALL:** Which means that the loans themselves are kind of rationed, or constrained in a

1 sense. That's the green part of it, isn't it, that's how you'd limit your exposure to something
2 that's a bit underpriced?

3 **ADAM BOYD:** Correct.

4 **ANTONIA WATSON:** Antonia Watson, ANZ. I'd just add they're probably not a bit under price,
5 they're very, very good offers in market. And I'm not sure about, you know, equilibrium,
6 we're all at slightly different prices. But the other thing that's really important, and we talk
7 about non-price competition quite a lot because it is an important factor. I think the sorts of
8 things that you've seen over time is changes in loan purpose. So it might be expanded to
9 electric bikes instead of solar panels or those sorts of things.

10 So you've seen over time as well as the prices remaining very, very low, which I see
11 as an indicator of competition because they are extremely low compared to every day
12 prices, is also the changes in the purposes that you're able to use those loans for.

13 **JOHN SMALL:** Yeah, that makes sense.

14 **KENT DUSTON:** Kent Duston, Habilis New Zealand. We have a slightly different take on this
15 to Geoff and the four banks obviously; in the sense that to us the green loans look like a
16 textbook example of sporadic competition in the sense that the loan arrives in the
17 marketplace, there is some competition occur, it looks a lot like coordination effects
18 between the four banks then take over. And the important thing is it does settle into a
19 stable equilibrium because innovation at that point vanishes.

20 So if there was external pressure from the smaller banks, or outside the four banks
21 themselves, then we would expect innovation in product to continue. But as we see, this
22 hasn't occurred. So this, we think, is a textbook example of exactly what the Commission
23 has highlighted of sporadic competition rather than sustained competition.

24 **CATHERINE McGRATH:** Just a couple of observations -- sorry, Catherine McGrath from
25 Westpac. I think you can't distinguish green loan products from strategy and banks
26 choosing to differentiate and choosing to do things with social purpose. Because actually
27 when you look at the pricing on those products, they're not ones that in their core that the
28 banks make money.

29 From an innovation perspective, certainly from our perspective ours has evolved
30 and changed in the last two and a half years and it's probably changed on at least two
31 occasions. So it's certainly not static from our perspective.

32 **JOHN SMALL:** Okay. Excellent. Look I think then that might bring us to probably the last of
33 the main topics in this area before we go to talk about profitability. And this is really on
34 customer inertia, particularly the role of discretionary discounting in customer inertia. So

1 we've already agreed, and I think it's probably, you know, pretty well widely accepted that
2 most of the headline rates are very, very similar. But many customers don't pay the
3 headline rates, and so they're just the starting point for various discretionary discounts that
4 can be negotiated.

5 And I guess we're wondering whether this practice might lead to customer inertia.
6 So it may well be, for example, that people don't know that this is happening, they look at
7 all the rates and think they're all the same, it doesn't really matter, not much point in
8 switching, or it may be that there are differences in the discretionary discounts but you
9 don't find that out until you go right through the process with at least two banks. So I'm
10 just interested in views about whether that sort of hypothesis stacks up from your point of
11 view and pretty open to whoever wants to tackle that.

12 **ANTONIA WATSON:** Antonia Watson, ANZ. I think it's a sign of competition. It's our ability
13 to react to competitors' offers and to continue to compete in a really dynamic way and
14 discretionary pricing allows us to do that. We are conscious of fairness, we build that into
15 how we think about discretionary pricing, but it is a really important part of attracting new
16 customers.

17 **JOHN SMALL:** So you know what you're reacting to?

18 **ANTONIA WATSON:** Yeah, yeah, we have a good sense of what it will take to retain a
19 customer, what it will take to bring on a new customer. Mortgage brokers play an
20 enormous part in that, they're really good advocates for Kiwis to get a sense of what's on
21 offer around the market and I think that's why you see more and more use of mortgage
22 brokers by consumers.

23 **JOHN SMALL:** Is that the channel by which you find out what other people are offering by way
24 of discretionary discounts?

25 **ANTONIA WATSON:** That's one way, another way is shopping around. And we see people
26 coming to us and saying "I just got this offer from so and so, what can you do?"

27 **JOHN SMALL:** Thank you. Vittoria.

28 **VITTORIA SHORTT:** Thanks, so just to reinforce, a lot of home loan customers do use brokers,
29 that's one way of price discovery. But at ASB we don't make our customers who are with
30 us already go around and do that, we offer up a discount in our digital experiences anyway.
31 So there's many ways of customers accessing that benefit, not just making the customer do
32 the shopping.

33 **JOHN SMALL:** Does anyone -- Mr Duston.

34 **KENT DUSTON:** Kent Duston, Habilis New Zealand. While some of this, you know, is

1 undoubtedly correct in terms of bank retention of customers, it de-emphasises the switching
2 costs associated with going through that process if you're an individual. In the sense that
3 none of the pricing or the preferential pricing, all of it is opaque, it is difficult to price
4 compare, and the switching costs associated with doing the research to figure out what the
5 rate is that I will obtain from each of the large banks, let alone the small banks, is a very
6 significant barrier to switching.

7 So if there is no transparency in pricing in the market other than the headline rates,
8 it's very difficult for any individual customer to make an informed decision to switch or not
9 to switch at the point of a home loan roll-over.

10 So while, you know, from the point of view of competitive activity, the preferential
11 rates may well be competitive, it steps away from the core problem, which is the nature of
12 the opaque market means the switching costs for individual customers and the research
13 costs and the time cost of that is very high indeed.

14 **JOHN SMALL:** To Mike Hendriksen first.

15 **MIKE HENDRIKSEN:** Thanks, Mike Hendriksen, Kiwibank. The only thing I'd add to that
16 conversation is it's a matter for, I think, Wednesday, but the grind of the CCCFA
17 obligations on a new bank versus an existing bank is another factor that you'd consider
18 when you're determining customer inertia.

19 **JOHN SMALL:** Yeah, yeah. And Antonia.

20 **ANTONIA WATSON:** Antonia Watson, ANZ. I was just going to add, we see, and I think we've
21 referred to it in our response, 20% of switching in a month of new home loans, new and
22 re-fixing home loans. So I think that's pretty good evidence that switching behaviours are
23 pretty strong.

24 **JOHN SMALL:** We did say, and I think there's been quite a bit of discussion about the customer
25 research that we did and reported in our Draft Report. And that showed fairly, I mean I
26 guess to stylise back from that, was that the difficulties with switching were perhaps more a
27 matter of perception than reality, in the sense that people perceived it to be difficult but
28 those that actually did go through with it found it wasn't all that difficult.

29 And some of your submissions have touched on this and said well, you know, it's
30 clear that it's not difficult. But is that the point? Isn't it the point that if it's perceived to be
31 difficult, people will tend not to do it? So do we still have an issue here about getting over
32 that perception barrier?

33 **ANTONIA WATSON:** Antonia Watson, ANZ. I think it's a point out of this market study, I
34 think you're absolutely right. We have a faster switching service in New Zealand than the

1 one that was referenced in the market study in the UK. And if that's an outcome for this
2 that we make that clearer to consumers, I'd be happy to be part of that.

3 **ADAM BOYD:** Adam Boyd, ASB. I think I'd agree with that point on perception of switching. I
4 think the other really important dimension when we talk about switching is, I guess, the
5 number of customers that are now multi-banked; which my hypothesis would be that's
6 actually more important to competition than switching, because it really enables customers
7 to be able to move products very quickly, like within the day, depending on the particular
8 attributes or whatever the value is that they are seeking. So I think when we're having a
9 conversation in the context of competition and talking about switching, I think this
10 multi-bank is a really important, I would say more powerful, driver of competition.

11 **JOHN SMALL:** Thank you. Alright, let's -- sorry, Tex.

12 **TEX EDWARDS:** Two points -- Tex Edwards, Monopoly Watch. Multi-bank versus switching
13 is an important differential because multi-bank doesn't facilitate innovation. And
14 multi-bank turbocharges the claim that the rating agencies would have us all believe that
15 there's an oligopoly, so you're not getting a break-in of new behaviours or innovation.

16 **BRYAN CHAPPLE:** Sorry, can you just unpack that a bit more? I don't follow you.

17 **TEX EDWARDS:** So unpacking, the issue is that my industry colleague from ASB is suggesting
18 that multi-banking, that customers having multi-bank is more important than switching.
19 And we put it to the Commission that we need switching to innovative new banks at lower
20 margins and that switching in the clubhouse is not competition.

21 And when we reference the hairy gorilla in the room here, which is Standard &
22 Poors, Moody's and Fitch ratings, they conflict with what we've heard from the CEOs of the
23 banks this morning. Because the rating agencies are telling us we've got an oligopoly, it's a
24 cosy club. And we just had the head prefect from the ASB suggest that multi-banking is
25 actually competition. We don't think it is.

26 **JOHN SMALL:** Okay, thank you. Alright, I'm going to close that one off there and move to
27 profitability for the rest of this session. And there's a few questions here. I might start with
28 ANZ and Incenta who have submitted that ANZ's returns are materially the same as its peer
29 group of international groups and towards the lower end of the estimates of ANZ's cost of
30 equity, so it's returns are normal. So I guess my first question is, do you think we should
31 interpret those results any more broadly than just ANZ?

32 **JEFF BALCHIN:** Jeff Balchin, Incenta Economic Consulting. I think that would be reasonable
33 to extend them to the four big banks, that was part of our reason for focusing on ANZ. The
34 second part was we didn't have a full history back to 2010 of the returns of the other three

1 New Zealand banks. So the alternative would be to do that and to compare that, because
2 we're talking about the same basis of comparison. There would need to be some
3 adjustments made because the leverage of the four New Zealand banks won't be identical.
4 But that's a fairly easy task, and I recall we handed our models over to you prior to the draft
5 so you could do that yourself.

6 **JOHN SMALL:** Yeah, thanks. So why would you just extend that to the four big banks?

7 **JEFF BALCHIN:** Why would I?

8 **JOHN SMALL:** Yeah, I said should we interpret this as saying anything more generally, and you
9 said it's probably representative of the big four; why just them?

10 **JEFF BALCHIN:** So in relation to the four, in relation to the larger banks, they're fairly similar
11 organisations that compete in the same market, so I thought you could extend it to them.
12 I haven't thought about the issues of the large versus small banks, that wasn't part of my
13 work.

14 **JOHN SMALL:** Okay, thank you, that's helpful. So Deloitte submitted that -- just trying to get
15 an idea of what's normal here. Deloitte submitted that prices in the competitive market are
16 set by a marginal producer who earns normal returns at the market prices.

17 So would you agree, I suppose as a starting point, would you agree that that
18 happens, in probably the obvious way? The analogy I've got in my mind is the wholesale
19 electricity market where it's really very, very transparent that, you know, we often need
20 high cost thermal generation and that sets the market price, but if you've got hydro or wind
21 with low marginal costs then, you know, that's not your cost.

22 Is that the kind of idea you're getting at, and would you agree that in that world the
23 reason that the marginal producer's a higher cost is because the others can't supply the
24 whole market? Is that a fair way into this?

25 **LIZA VAN DER MERWE:** So I think the first point that I want to make is more with a focus on
26 the fact that regulation is impacting entry and expansion. So even if competition is
27 otherwise working well, we would expect more efficient firms to continue to earn higher
28 returns. And the reason for this is that these conditions may impede the ability of less
29 efficient firms to compete away the returns through expansion. So our key point here is
30 more on efficiency.

31 **JOHN SMALL:** So essentially you're saying that the smaller banks have higher regulatory costs
32 and so they're relatively inefficient, and so they don't earn as much money and they set the
33 marginal prices? Is that sort of what you're saying? They're the marginal producer in the
34 system and so it's their pricing that sets the market price and they've got high costs because

1 of various regulation? Am I getting this right?

2 **LIZA VAN DER MERWE:** I can perhaps just rephrase it and then Mayuresh is also online, he
3 may want to contribute. But I think the key point, again, what we want to emphasise is that
4 we note the Commission's view is that levels of profitability attributable to enhanced levels
5 of efficiency should be competed away. So that's our interpretation of the Draft Report.
6 But then based on our assessment of the features of the market, there are regulation
7 impediments impacting entry and expansion.

8 **JOHN SMALL:** Yeah.

9 **LIZA VAN DER MERWE:** So that's meaning that the Commission's expectations for a smaller
10 firm to compete away profitability associated with enhanced efficiencies may be
11 unreasonable in this situation.

12 **JOHN SMALL:** Yeah, I think we'd absolutely agree with you in terms of the difficulties of
13 smaller banks in competing with the bigger banks. But this notion that the smaller banks
14 are the marginal producer and therefore kind of setting the price is a little difficult to
15 reconcile with the fact that the majors don't really look at the pricing of the smaller banks,
16 with the exception of our friends at Kiwibank. So how can that be? If they're not even
17 looking, it's a little difficult to characterise that as setting the price, isn't it?

18 **LIZA VAN DER MERWE:** I think I will hand over to BNZ maybe just to comment on a point
19 that they are looking at prices for smaller banks as well and responding to that, and then
20 hand over to Mayuresh.

21 **JOHN SMALL:** Okay.

22 **DAN HUGGINS:** I think our observation of pricing and where we're starting to see is certainly
23 regional. So where we see some markets where a smaller bank will be a major player in
24 that bank, whether that's SBS in Southland or TSB in Taranaki, then certainly they're going
25 to have a material impact on the pricing and the competition in that particular market. So
26 it's not going to be necessarily that there is a single player in the market which is the
27 marginal producer setting the price, it's going to be dynamic by region as per who is the
28 participant in that market, who is the marginal player.

29 **BRYAN CHAPPLE:** So you have different prices in the regions as a result of that in different
30 regions?

31 **DAN HUGGINS:** We have pricing which is impacted, which is national pricing at a headline
32 level, but it's certainly the case that you will see different participants in different regional
33 areas at different times be more or less competitive, as is expected in a dynamically
34 competitive market, and we'll need to match that pricing. So sometimes TSB in Taranaki

1 will have a very competitive offer and to participate in that market we need to match that
2 pricing, and that's from time-to-time what we seek to do.

3 **BRYAN CHAPPLE:** At a regional level?

4 **DAN HUGGINS:** If there is a regional offer, yes.

5 **LARISSA VAUGHAN:** Larissa Vaughan, TSB. I do feel this piece around regional competition
6 has been somewhat overstated and that regional loyalty does not equate to sustained
7 national competition. We have around 2% market share I think on a good day and around
8 500 staff. We're proud of the service and the pricing we offer to our customers, particularly
9 our Taranaki customers. But I think if you look at the volume of loans by region, loan
10 amount and loan volume, particularly in Taranaki and I think Southland was the other
11 example given earlier by BNZ, you know, that's a relatively small share of the
12 New Zealand market overall.

13 So while we're pleased to look after our customers -- and I actually can't think of
14 any recent examples of offering regional discounts, that's generally not how we price -- I
15 don't think that adds up to sustained national competition, I think you could characterise it
16 as sporadic geographical loyalty, perhaps. Thank you.

17 **JOHN SMALL:** Thank you. Alright, so just to pursue this line a bit further, perhaps we'll come
18 back to you, Jeff Balchin. So if ANZ is earning a normal return, does that mean essentially
19 that smaller and less efficient banks are operating below normal returns? Is that a fair kind
20 of inference from your analysis, given what we know that the big banks are more profitable
21 than the smaller banks?

22 **JEFF BALCHIN:** I think you'd need more information than that, because ordinarily it's the case
23 that small firms operate in niches and can survive specialising in what they're good at, so
24 we don't know whether there's a like-for-like comparison. But as I said, I haven't looked
25 at -- it wasn't part of my work to look at the nature of the small firms in New Zealand in
26 any detail. My focus was squarely on the profitability of ANZ and whether you could infer
27 from that it had been exercising market power.

28 **JOHN SMALL:** So it's not an unreasonable hypothesis, though is it, based on your information,
29 that that would be the case; if ANZ is the biggest bank in the country and definitely more
30 profitable than a lot of the smaller banks, you know, there or thereabouts in terms of a
31 normal return, it really does invite one to wonder about how the smaller and less profitable
32 banks are surviving.

33 **ANTONIA WATSON:** Antonia Watson, ANZ. I'd agree with that. I think that you probably
34 could conclude that the smaller banks make a lower than normal return. I think that scale

1 plays a very large part in banking. We are very, very large technology shops, we have
2 to -- and as the report has pointed out, we have to -- we're in a highly regulated
3 environment. And I think if I look at our cost of capital and our overall returns, which, as
4 Jeff says, are there or thereabouts in an international comparison basis, they're very
5 modestly above our cost of capital.

6 But we have a capital market discipline on us, so our shareholders would be pretty
7 upset and wouldn't provide the \$17 billion that they provide, I think we'd be the largest
8 importer of foreign capital in New Zealand. Our shareholders wouldn't do that if we were
9 showing returns at the level of some of the smaller banks. So there's a difference in that
10 capital market discipline compared to if you're owned by a community, or if you're owned
11 by the tax payers, for example.

12 **JOHN SMALL:** Great thank you. I believe Mayuresh is online. Welcome Mayuresh. You've
13 got some comments on this?

14 **MAYURESH PRASAD:** Hi, can you hear me?

15 **JOHN SMALL:** Yeah, we can.

16 **MAYURESH PRASAD:** Kia ora, Mayuresh Prasad, Deloitte Access Economics. I guess I'll
17 make two points. The first, John, was whether -- I think you noted whether the larger banks
18 respond to the pricing of the smaller banks and the smaller banks are price setters. I guess
19 the point I'd make there is that we've undertaken some analysis that does suggest that, you
20 know, the larger banks do respond to the likes of Kiwibanks and other smaller banks, and
21 this ranges across a variety of mortgage and term deposit products, at least as it relates to
22 advertised rates. These are consistent with what you see in the LINZ data; acknowledge
23 that it is a 2023 snapshot, but with the regional variations you see and the fact that, you
24 know, TSB, for example, is particularly strong in the Taranaki region, SBS in the Southland
25 region.

26 The second point I would make is that I think we'd have to be careful, or carefully
27 consider how regulatory conditions of entry and expansion interact also with the scale and
28 scope. And so we have seen that larger banks probably have scale and scope. As they
29 interact with regulatory conditions of entry and expansion, they do mean that they are
30 potentially more efficient than the smaller banks that, and it might explain a lot of the
31 observations seen in the Draft Report. So yeah, those are the two key points that I wanted
32 to emphasise in relation to the discussion that's just been.

33 **JOHN SMALL:** Thank you. Can I just pick up on that first one, which was in part about banks
34 reacting to each other's pricing. Are you referring to your modelling when you say that?

1 **MAYURESH PRASAD:** Yes, in part, but I think that is consistent with a wider body of evidence.

2 So I think in the Draft Report, you know, that the larger banks do respond to Kiwibank's
3 pricing and our analysis of the LINZ data as well. The pricing in those regions must reflect
4 some sort of pricing constraint -- sorry, the regions, I mean where, you know, the shares are
5 different to the national average, or where, for example, TSB is strong and SBS is strong.

6 **JOHN SMALL:** Just on that temporal analysis, one question I did have for you about that was
7 whether -- I believe you used weekly data in that modelling, and I guess I'm struggling to
8 understand how that would be capable of picking up price leadership and interactions,
9 responses to pricing given that, you know, it's weekly data essentially. For example, if
10 ASB makes a move at 11 o'clock on a Monday and everyone else has followed it by 4
11 o'clock on a Monday, that's just going to show up in your data as they all changed together,
12 right?

13 **MAYURESH PRASAD:** Yes, I do acknowledge that. I guess, you know, weekly data was as
14 frequent as we could get, so we had to work with what we had. I know the Draft Report
15 noted that, you know, pricing can be met quite frequently, weekly. So to the extent that
16 certain changes occurred the week prior, then the pricing committee would meet in the next
17 week, then those changes would be reflected in the data that we were working on.

18 So, you know, a combination of the fact that we had to use what was available, and
19 also our view that, in a lot of respects, it is reasonably high-frequency and it would
20 potentially pick up some of the dynamics in the market.

21 **JOHN SMALL:** Okay, thank you. Alright. I think we may have exhausted what we need to do
22 here. Any closing comments on this topic? Yes, Tex.

23 **TEX EDWARDS:** Commissioner Small, can I just comment on the scale playing to the
24 advantage? We don't think it's -- there's no pass-through on the scale creating an
25 advantage. We urge the Commission to read the SEC bond filings from ANZ. And we put
26 to the Commission that further work is needed on the "too big to fail" guarantee, the
27 implied "too big to fail" guarantee that the large four Australian banks have in
28 New Zealand. And we urge the Commission to do some empirical research on the value of
29 that guarantee and the fact that there is scale, as my colleague at ANZ says, there is
30 advantage in scale in bond issuance.

31 The problem we've got here today, Commissioners, is there's no pass-through of
32 these benefits of scale, and the value of the "too big to fail" guarantee is not being valued
33 correctly by the taxpayer who's being asked to fix up at Kiwibank. Thank you.

34 **JOHN SMALL:** Thank you. Any other final thoughts? One from here and one over there, then

1 we'll close off.

2 **LIZA VAN DER MERWE:** Just quickly as a final comment; in the Draft Report there is quite a
3 lot of emphasis on cross-country comparisons to inform a view on profitability and the
4 nature of competition. So the key point that I just want to make is that we understand it is
5 inherently difficult to do cross-country comparisons.

6 But in order to provide insights on the nature of competition it's really important to
7 control for differences between countries to make an accurate assessment around it. And
8 so, for example, in our submission on the process and issues paper last year, we've made
9 some suggestions, which included the risk-free rate, control for leverages across countries,
10 business models, also control for the fact of a competitive benchmark, and intangible assets.
11 And we've noticed that in Incenta's submission now they've made similar suggestions,
12 including but also controlling for crisis countries, risk levels, also again the need for
13 competitive benchmark, risk-free rates, leverages and intangible assets.

14 So we do think it's really important to control for those factors. And one example is
15 in the Commission's preliminary issues paper we've noticed that the Commission there used
16 pre-tax measures. In the Draft Report, the Commission changed from pre-tax to post-tax
17 measures. And the implication of that is that it really moved New Zealand almost from an
18 outlier back into the cluster of other countries by only making one change.

19 So we do think it's important to consider the suggestions and then to ultimately
20 inform a view on the nature of competition with profitability as the indicator.

21 **JOHN SMALL:** Thank you. So Jeff and then over here for the final.

22 **JEFF BALCHIN:** When you say you're closing off, you're closing off this part of --

23 **JOHN SMALL:** Yeah, this session.

24 **JEFF BALCHIN:** Profitability altogether?

25 **JOHN SMALL:** Yeah.

26 **JEFF BALCHIN:** Oh okay. What I just wanted to make a final comment on is about the big
27 bank versus small bank discussion we're just having then. We didn't get into the issue of
28 the different returns between small and large banks, because I don't think there's a lot you
29 can take from that. We know there are a lot of differences in the way the banks operate,
30 including who their shareholders are, so there's probably some less discipline on returns.

31 And the other issue is they both operate in the same market. So if I came to you
32 saying that different firms in the same market make different levels of profit and try to draw
33 implication from that, you might just say, well how do I know that they're not all making
34 monopoly returns, you haven't managed to show anything to me that's actually subject to a

1 true exogenous test.

2 Which is why in our analysis we focused on what, in all honesty, we thought you
3 guys would do after the previous market studies, which is to benchmark, assemble a careful
4 set of firms from international comparators and adjust for all of the things that should cause
5 differences in the cost of capital between firms and come up with a fair comparison there.
6 And we also thought, we also expected, which is why we front-ended this, that you'll do a
7 bottom-up estimate of the cost of capital. It's only really from those exogenous sort of
8 external checks that you can actually test whether returns are fair or not in a market.

9 One thing I'd just like to close with, is that your conclusions in your draft paper are
10 essentially that the profit levels from major banks in New Zealand have been persistently
11 high compared to international peers. And in a sense it's hard to challenge that, because
12 that's exactly what comes out of your data.

13 But that's actually really not what we're on about here. We're on about whether the
14 returns of the New Zealand banks are above and have been persistently above the returns
15 that would be earned in a competitive market. And forming a view on that is a much more
16 difficult question. You need to make sure you're comparing against firms that are
17 comparable in the activities they do, you need to adjust for all the things, of course,
18 differences in the cost of capital, including interest rates and leverage is very important in
19 this area.

20 And you also need to make sure you're comparing against firms that have been
21 making competitive market returns themselves, and that's a central part of our thesis, was
22 that a lot of those countries that you're comparing against have just been subject to a series
23 of negative shocks over the last decade, two decades and it makes them inappropriate
24 comparators.

25 And we also think, and we'd urge you to think again about doing a comparison
26 against a bottom-up estimate of the cost of capital, as you've done with previous market
27 studies, because that does add information to the process; and it would tell you some things,
28 yield some fairly clearer insights into how comparable some of the countries around the
29 world are to the New Zealand banking sector. So I'd just like to finish there.

30 **JOHN SMALL:** Thank you. Thanks for that.

31 **KENT DUSTON:** Kent Duston, Habilis New Zealand. Just wanting to build on that last point.

32 Of course, that comparison has been done, it's just been done by the OECD. And as the
33 OECD market report out from -- the economy report out last week indicated the
34 New Zealand banks, the four Australian banks have an ROE of about 15%, the European

1 banks have an ROE of about 7%.

2 The OECD report also points out, of course, that the risk reward ratio is quite
3 different in the sense that, to put it in Cameron Bagrie's words, the Australian banks are
4 making alpha returns without taking alpha risks, and that's all contained in the OECD
5 report. Of course, the OECD is not notable for being a hot bed of left-wing revolutionary
6 thought, so I would encourage the Commission to take a look at those findings, because
7 they may be material to the very points just raised by ANZ.

8 **JOHN SMALL:** Thank you. There's two other people who have signalled they want to make a
9 comment, so we'll take them, one here, and was it you, Mike, and Antonia.

10 **MARTIN TAYLOR:** Thank you. Hello, Martin Taylor from Positive Money New Zealand. On
11 this issue of bank profitability, I'd just like to pull us back a little bit, because if you look at
12 the profitability as in the profit, the absolute dollar profit of the big four banks, you'd have
13 to go kind of down the next 50 New Zealand businesses, non-bank businesses, to aggregate
14 that level of profit.

15 If you look at the profit of smaller banks, such as TSB, or Cooperative Bank, or
16 indeed Kiwibank, you know, you could have a dozen Kiwibank's profit for the profit of
17 one, one of the four big banks. You could have 100 cooperative banks' profit for the profit
18 of one bank. And those 100 banks, if they follow the cooperative model, will be delivering
19 the best service, according to Consumer New Zealand, in the country.

20 So I think, you know, while we can talk about cost of capital and the finer points of
21 this and that, we need to recognise the dead weight of profit that is contained in those four
22 banks, and we need to think more clearly about if that profit was distributed more widely in
23 the marketplace, could we have a more diverse marketplace. And of course, the only
24 acknowledgment of real competition that we've heard from the big four banks' comments
25 today have been in regions where there has been a physical presence with regional loyalty
26 and a long-time bank.

27 So our belief is that we need more banks and that if a challenger bank like Kiwibank
28 is going to help the banking market, we should be looking at them as an enabler of more
29 small banks of various sorts, not just fintechs but also physical, as a much better way to use
30 that profitability, or dead weight, whichever way you look at it, than we are currently using
31 it for. Thanks.

32 **JOHN SMALL:** Thank you. Okay, look we'll carry on for just these two and we'll see how that
33 goes.

34 **MIKE HENDRIKSEN:** I'll only take a short moment, John. I just wanted to take mild umbrage

1 at the suggestion from ANZ's economist, which I understood was we may be less focused
2 on returns because we have less discipline in relation to the market. We obviously have
3 debt instruments listed on the New Zealand Exchange and we're owned by all of Aotearoa,
4 so we don't take any return discipline any more seriously than the other four. So if that was
5 what was suggested, we will refute that.

6 **JOHN SMALL:** Thank you.

7 **ANTONIA WATSON:** It's Antonia Watson here again. I was talking about a comparison with
8 cost of capital there specifically. But just back to the profitability question, because I think
9 it's a really important part of this. And I agree, the large banks make a very large dollar
10 profit when you add it up. But the large banks have attracted, between us, over \$50 billion
11 of investment, some of which is from New Zealanders. We have a vast array of
12 shareholders, some of whom are New Zealanders. Not enough of them are New
13 Zealanders, I would love to be more owned in New Zealand. But the reality is that that \$50
14 billion is around about half of our overall Kiwisaver balances.

15 So we need to be in a position to attract that capital to New Zealand to provide the
16 banking system that we've got, and in order to do that we actually need to make a return to
17 our shareholders, which I would suggest is very modestly above our cost of capital. It's
18 certainly not -- our last half year was 11%, it was nowhere near 15%. I think the OECD
19 report that's been referred to is a bit, as my colleague from Incenta has talked about, it's
20 been a bit blunt, it hasn't done a proper, true apples for apples comparison with banks that
21 look like us in countries like us.

22 And then the last thing I would just refer to is that I think from where I sit
23 New Zealand is a risky country. We're at the very end of the world, we're small, we are
24 reliant on exports, we're subject to natural disasters, we've had an earthquake, we've had
25 floods. We're reliant on a couple of large trading partners, we're reliant on the commodity
26 price cycle. There are an enormous number of things that actually bring a risk into the
27 New Zealand economy which I also think we have to account for here.

28 **JOHN SMALL:** Thank you. Alright, I am going to stop it there and if there's anything burning
29 that you desperately feel like I've cut off you from saying, come and attack me in the break.
30 We'll have a -- not attack, I didn't mean that. Come and talk nicely to me, see if you can
31 persuade. So let's take a half hour break now and then we'll come back at 10 past.

32 **Adjournment from 10.41 am to 11.10 am**