Public Version
ISSN NO. 0114-2720
J6058

COMMERCE COMMISSION

Decision No. 507

Determination pursuant to the Commerce Act 1986 in the matter of an application for clearance of a business acquisition involving:

ANZ BANKING GROUP (NEW ZEALAND) LIMITED

and

NBNZ HOLDINGS LIMITED

The Commission:	Denese Bates QC Donal Curtin Shaan Stevens
Summary of Application:	The acquisition by ANZ Banking Group (New Zealand) Limited ("ANZ") or a related company nominated by ANZ of all the shares and assets of NBNZ Holdings, the New Zealand holding company of The National Bank of New Zealand Limited and its controlled subsidiaries ("National") from its parent, Lloyds TSB Bank plc.
Determination:	Pursuant to section 66(3) (a) of the Commerce Act 1986, the Commission determines to give clearance for the proposed acquisition.
Date of Determination:	25 September 2003

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EXECUTIVE SUMMARY

The Proposal

1. A notice pursuant to section 66(1) of the Commerce Act 1986 (“the Act”) was received on 14 August 2003. The notice sought clearance for the acquisition by ANZ Banking Group (New Zealand) Limited ("ANZ") or a related company nominated by ANZ of all the shares and assets of NBNZ Holdings, the New Zealand holding company of The National Bank of New Zealand Limited and its controlled subsidiaries ("National") from its parent, Lloyds TSB Bank plc.

Market Definition

2. In addition to the markets highlighted by the Applicant, the Commission considered the aggregation in insurance services, financial planning services and inter-bank trading. These areas of aggregation were considered first. The Commission therefore concludes that, for the purpose of analysing this application, the relevant markets are:

   - Interbank trading in the foreign exchange market;
   - Interbank trading in the money market;
   - Interbank trading in the bond market;
   - The national retail supply of financial planning services;
   - The national retail supply of managed funds;
   - The national supply of domestic house and contents insurance;
   - The national supply of domestic motor vehicle insurance;
   - The national supply of commercial motor vehicle insurance;
   - The national supply of commercial property insurance;
   - The national supply of commercial liability insurance;
   - The national retail supply of personal loans;
   - The national retail supply of corporate banking;
   - The national retail supply of transaction accounts;
   - The national retail supply of mortgages;
   - The national retail supply of SME banking;
   - The national retail supply of rural banking;
   - The national retail supply of savings accounts;
   - The national retail supply of credit cards; and
   - The national retail supply of merchant acquiring services.

Counterfactual

3. The Commission notes that National could be purchased by another business, either a bank that is not one of the five major banks in New Zealand, or another business not currently active in the banking industry. Alternatively, National may not be sold and may

remain as a major competitor in the New Zealand banking industry. These options all point to National remaining in the market as a major bank in the event that ANZ did not purchase National. Therefore the Commission considers the relevant counterfactual to be the status quo.

Market Shares

4. With the exception of managed funds, insurance and financial planning services (where the aggregation is minor), the combined entity would have a market share within the range of [ ] in the relevant markets. Post acquisition, the three-firm concentration ratio is outside the Commission's safe harbours in these markets.

Competition Analysis

5. The aggregation in the supply of insurance services, financial planning services and managed funds does not raise any competition issues. In the relevant markets for insurance, the aggregation was minor as insurance companies are the major providers of insurance. In the supply of financial planning services, there are numerous companies active throughout New Zealand. In the supply of managed funds, the combined entity would have a market share of [ ]. National has a small market share of [ ]. This aggregation is minor and, post merger, there will be sufficient competition provided from the major banks and from a wide range of other local and Australian independent providers.

6. The Commission's investigation found that the merger would not lead to a substantial lessening of competition in interbank trading in the foreign exchange market, domestic money market and the bond market in New Zealand. In the money market, the acquisition may affect the ability of the major banks to domestically fund their activities. However, the Commission found that banks can fund their activities offshore.

7. In the supply of personal loans, the merger is unlikely to result in a substantial lessening of competition because there are several other competitors in the market, including non-bank financial institutions. Further, barriers to entry into the supply of personal loans are not significant and the combined entity would be constrained by potential competition.

8. In the supply of corporate banking, the merger is unlikely to lead to a substantial lessening of competition. This is due to existing competition, competition from overseas banks and countervailing power from the larger corporate customers.

9. The Commission considers that compared to the counterfactual where National remains as a competitor, the proposed acquisition is likely to reduce choice and quality of service in the transaction accounts market. This is because National is considered to be a bank that customers would consider switching to due to its quality of service. Further, there are switching costs in changing banks, barriers to entry in the supply of transaction accounts are significant and there is limited countervailing power.

10. However, banks are trying to change customer perception on switching accounts, particularly with the current expectation that customers will switch post merger. It is considered that the combined market shares of the new entity are likely to be lower than

those provided by the Applicant. Also customers are avoiding switching costs by migrating, namely opening new accounts and not closing old accounts.

11. In addition, survey evidence suggests that competition between National and ANZ is not considered to be significant and post acquisition, there will be sufficient existing competition provided from BNZ, Westpac, Kiwibank and particularly from ASB from a quality of service perspective. Consequently, the Commission considers that there is a sufficient range of quality and price options from existing competition to prevent the combined entity from exercising any unilateral market power.

12. Also, the merger is unlikely to increase the likelihood of co-ordinated market power in the supply of transaction accounts because the fringe players are likely to provide some competition, the banks have different strengths and weaknesses and in particular ASB is unlikely to have the incentive to participate in co-ordinated power at the expense of its recent growth and customer satisfaction levels. This analysis of co-ordinated market power applies to each of the relevant markets. Therefore the Commission concludes that the merger is unlikely to result in a substantial lessening of competition in the supply of transaction accounts.

13. In the supply of mortgages, savings accounts and credit cards the merger is unlikely to lead to a substantial lessening of competition, as in each of these markets, ASB, Westpac and BNZ are likely to provide sufficient competition to the combined entity.

14. As with transaction accounts, the merger is likely to result in a reduction in choice and quality of service in the supply of SME banking. This is because National ranks highly in terms of customer satisfaction. In addition, there are switching costs in changing banks, barriers to entry in the SME market are significant and there is limited countervailing power.

15. However, the Commission does not consider the reduction in choice and quality of service in the supply of SME banking to be substantial given the presence of ASB, BNZ and Westpac in this market. In particular, ASB will provide competition to the combined entity because it ranks highly in customer satisfaction surveys, its market share has been increasing and it has been trying to reduce switching costs to SME customers. Generally, the banks are trying to make switching easier for customers and some industry participants stated that internet banking was popular with SME customers and was making switching accounts easier. [ ] The Commission therefore considers that existing competition in the supply of SME banking will be sufficient to prevent the combined entity from exercising unilateral market power. The merger is unlikely to result in substantial lessening of competition in the supply of SME banking.

16. In the supply of rural banking, the merger is unlikely to lead to a substantial lessening of competition because there is sufficient competition from existing competitors, particularly Rabobank. Rabobank is a nationwide specialist in rural banking and has recently expanded by acquiring AMP Bank's rural mortgage portfolio.

17. In the supply of credit card/debit card merchant acquiring services the main players are the banks. Entry into this market is unlikely as it is costly to set up a payment processing

system that will route all credit card and debit card transactions. A new entrant would need to negotiate access with an existing participant.

18. However, the Commission's investigation found that the banks actively competed for merchant acquiring business and some of the larger merchants had exercised their countervailing power to affect price, therefore removing any likelihood of a substantial lessening of competition.

OVERALL CONCLUSION

19. Overall the Commission's view is that the merger is unlikely to substantially lessen competition in: interbank trading in the foreign exchange market, domestic money market, bond market, and in the supply of financial planning services, managed funds, insurance services, personal loans, corporate banking, mortgages, rural banking, credit cards, merchant acquiring services and savings accounts. The merger will lead to reduction in choice and quality of service in the supply of transaction accounts and in the supply of SME banking. However, any loss of competition in these markets is not considered to be substantial because of competition provided from the three other main competitors, and in particular ASB.

THE PROPOSAL

20. A notice pursuant to section 66(1) of the Commerce Act 1986 ("the Act") was received on 14 August 2003. The notice sought clearance for the acquisition by ANZ Banking Group (New Zealand) Limited ("ANZ") or a related company nominated by ANZ of all the shares and assets of NBNZ Holdings, the New Zealand holding company of The National Bank of New Zealand Limited and its controlled subsidiaries ("National") from its parent, Lloyds TSB Bank plc.

THE PROCEDURES

21. Section 66(3) of the Act requires the Commission either to clear or to decline to clear a notice given under section 66(1) within 10 working days, unless the Commission and the person who gave notice agree to a longer period. An extension of time was sought by the Commission and agreed to by the Applicant. Accordingly, a decision on the application was required by 25 September 2003.

22. The Applicant sought confidentiality for specific aspects of the application. A confidentiality order was made in respect of the information for up to 20 working days from the Commission's determination notice. When that order expires, the provisions of the Official Information Act 1982 will apply.

23. The Commission's determination is based on an investigation conducted by staff.

24. The Commission's approach is based on the principles set out in the Commission's *Practice Note 4*.[1]

THE PARTIES

ANZ

25. The ultimate parent company of ANZ is Australia and New Zealand Banking Group Limited, which is incorporated in Australia. ANZ operates in New Zealand as a locally incorporated bank.

26. ANZ is the fourth largest banking group in New Zealand with total assets of $28 billion at 31 December 2002. ANZ acquired PostBank from the New Zealand Government in 1989 and operated it for five years as a separate registered bank before incorporating it into ANZ in December 1994.

27. As well as retail banking, ANZ has significant market share in business banking and funds management. In May 2002, a joint venture between ING and ANZ created the largest provider of retail funds management in New Zealand. ANZ also owns UDC Finance, New Zealand's largest finance company specialising in asset-backed financing.

[1] Commerce Commission, *Practice note 4: The Commission's Approach to Adjudicating on Business Acquisitions Under the Changed Threshold in section 47 – A Test of Substantially Lessening Competition*, May 2001.

28. In 2000, ANZ acquired EFTPOS New Zealand Limited, a provider of EFTPOS Terminal hire, merchant services (cards acquiring) along with service, support and payment processing.

National

29. National is a wholly owned subsidiary of Lloyds TSB Group plc, a banking group incorporated in the United Kingdom. National operates in New Zealand as a locally incorporated bank.

30. Following the acquisition of Countrywide Bank in September 1998, National became New Zealand's third largest bank. It bypassed BNZ to become the second largest bank in 2002 with total assets of $38.9 billion at 31 December 2002.

31. National has significant retail presence and historic strength in wholesale banking and rural lending. Significant asset growth during 2002 across all markets resulted in National gaining market share. National's strength in the rural market is largely attributed to its purchase of the Rural Bank from Fletcher Challenge in December 1992. National also provides a range of investment funds to its customer base, managed by a number of fund managers including AMP Henderson Global Investors, BT Funds Management, Lazard Asset Management and ABN AMRO Asset Management.

32. National also has a 25% interest in Electronic Transaction Services Limited ("ETSL"). ETSL is the alternative system for the interchange and clearance of EFTPOS and credit card transactions. ETSL is owned in equal shares by National, ASB, Westpac and BNZ.

OTHER RELEVANT PARTIES

Westpac Banking Corporation ("Westpac")

33. Westpac is a company incorporated in New South Wales, Australia and is listed on the Australian Stock Exchange. Westpac in New Zealand operates as a branch bank and is the only major bank in New Zealand not to incorporate domestically.

34. Westpac is New Zealand's largest bank with total assets of $38.9 billion at 31 December 2002 (just $27 million more in assets than National). Westpac owes its position as the largest bank to the acquisition of Trustbank in May 1996.

35. Westpac has a significant retail banking base with a large mortgage book, including approximately $1 billion of securitised mortgage receivables.

36. Westpac also applied for Commerce Commission clearance to acquire National. However, Westpac subsequently withdrew its clearance application.

Bank of New Zealand Limited ("BNZ")

37. BNZ is a wholly owned subsidiary of the National Australia Bank Limited, which is incorporated in Australia. BNZ operates in New Zealand as a locally incorporated bank.

38. BNZ is the third largest bank in New Zealand with total assets of $37 billion at 31 December 2002. BNZ has significant market shares in all areas, and in particular business banking, rural banking and credit cards. Since being sold to National Australia

Bank in November 1992, BNZ has experienced significant growth in both its wholesale and retail banking activities.

ASB Bank Limited ("ASB")

39. ASB is a wholly owned subsidiary of the Commonwealth Bank of Australia Limited, which is incorporated in Australia. ASB operates in New Zealand as a locally incorporated bank.

40. ASB is the fifth largest major bank operating in New Zealand with total assets of $26 billion at 31 December 2002[2], and forms part of the ASB Group of companies. The ASB Group is a broad based financial services provider, and provides life insurance and funds management operations as a result of its acquisition of Sovereign in December 1998 and Colonial New Zealand in June 2000. The Group also operates an advisory share trading service through its subsidiary, ASB Securities Limited.

41. ASB is particularly strong in the Auckland market, and has undertaken a programme of expansion throughout New Zealand since 1991. ASB's services include personal, business and rural banking, international, treasury and corporate banking, funds management and share broking services.

Kiwibank Limited ("Kiwibank")

42. Kiwibank is a wholly owned subsidiary of Government-owned New Zealand Post Limited. Government funding of $80 million was initially provided to establish the bank.

43. Since its registration under the Reserve Bank of New Zealand Act 1989 ("the Reserve Bank Act") on 1 February 2002, Kiwibank has opened more than 280 branches throughout New Zealand at existing New Zealand Post shops and franchise premises.

44. The original business plan relied on a take-up of between 100,000 and 150,000 customers in its first three years of operation (from February 2002 to February 2005). By September 2003 the bank had already signed up 170,000 customers.

Superbank Limited ("Superbank")

45. Superbank is the trading name of St. George Bank of New Zealand Limited. Superbank is a joint venture between Foodstuffs and St. George Bank Limited of Australia. Superbank was registered under the Reserve Bank Act 1989 on 3 February 2003, and commenced operations on 23 February 2003.

46. Superbank operates out of 474 New World, Pak'N Save, Write Price and Four Square stores throughout the country. Superbank's initial product offering was a "SuperSaver" account, and it has recently expanded its range to offer a "SuperAccess" transaction account. Customers can access their funds through phone and Internet banking facilities. The bank intends to introduce its own ATMs in the future.

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[2] Allens Consulting Group *State of Play of the Banking Industry in New Zealand* June 2003 page 3.

TSB Bank Limited ("TSB")

47. TSB is an independently owned New Zealand bank. At 31 December 2002 TSB had total assets of $1.8 billion[3].

48. TSB has a strong customer base in Taranaki and is building its asset base in other regions. Post Shops throughout New Zealand offer over the counter services for TSB customers. TSB opened TSB Bank Home Loan Centres in Christchurch and Auckland in 2001 and 2002 respectively. TSB also distributes branded insurance products underwritten by major insurance companies.

Hongkong and Shanghai Banking Corporation Limited ("HSBC")

49. HSBC operates in New Zealand as a branch of Hongkong and Shanghai Banking Corporation Limited. HSBC has total assets of $2.2 billion. It has five branches in Auckland and has corporate offices in Wellington and Christchurch

50. HSBC has been traditionally strong in the corporate sector, and in recent years has grown into the internationally focused commercial sector and the mid to upper end of the personal financial services sector.

Rabobank New Zealand Limited ("Rabobank")

51. Rabobank entered the New Zealand market in 1994 and transacts its business through two entities with their own banking licenses. Rabobank Nederland New Zealand Banking Group conducts corporate banking, food and agri-business banking, and structured finance activities, while Rabobank New Zealand Limited is responsible for the rural banking business. The combined New Zealand operations of the Rabobank Group offers finance to all members of the food production chain in New Zealand.

52. The Rabobank Group had total assets of $3.0 billion in 2002. The rural banking business had total assets of $2.52 billion at 31 December 2002[4].

53. Rabobank New Zealand is well represented in the sheep and beef, diary and horticulture sectors and essentially provides banking services for all primary production purposes.

PSIS Limited ("PSIS")

54. PSIS is a co-operative organisation which offers personal banking services (including transaction, deposit, lending and insurance products) to all New Zealanders through Nationwide branches, ATMs, EFTPOS, Telephone and Internet Banking.

55. PSIS is registered under both the Companies Act 1993 and Co-operative Companies Act 1996. PSIS is a member of the New Zealand Financial Services Federation (Inc) and the New Zealand Co-operatives Association (Inc). PSIS is not a registered bank.

56. As at 31 March 2003 PSIS had total assets of $662 million.

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[3] Allens Consulting Group *State of Play of the Banking Industry in New Zealand* June 2003 page 4-5.
[4] Allens Consulting Group *State of Play of the Banking Industry in New Zealand* June 2003 page 5.

New Zealand Association of Credit Unions ("NZACU")

57. The NZACU represents the interests of 44 member Credit Unions in New Zealand, which make up approximately 90% of all Credit Unions in New Zealand. The NZACU and all Credit Unions operate under the Friendly Societies and Credit Unions Act 1982.

58. The function of Credit Unions is to provide their members with savings and loans facilities. Through their membership with the NZACU, Credit Unions are able to offer a range of banking products and services to their Credit Union members.

59. As at 30 June 2003, the NZACU had total assets of $76 million.

New Zealand Bankers Association ("NZBA")

60. The NZBA acts as a forum for member banks to work together on a co-operative basis. It is a non-profit unincorporated association funded by member banks through subscriptions. Membership is open to any bank registered under the Reserve Bank Act 1989. Currently nine registered banks are members of the Association.

61. The governing body of the Association is the Council, comprising the Chief Executive of each member bank. Member banks undertake the bulk of the Association's work through committees supported by a small professional and administrative team in Wellington.

62. The NZBA provides services to its members which include:

    - Development of the self-regulatory Code of Banking Practice;
    - Development of co-operative inter-bank procedures and standards for retail payment methods such as direct debits and automatic payments;
    - Development of collective priority documents for securities over real and personal property;
    - Collective submissions on public policy and regulation which affect banks, in relation to, for example, taxation, consumer credit, privacy, terrorism and money laundering; and
    - Provision of payment statistics from data supplied by members.

Interchange Settlement Limited ("ISL")

63. ISL operates the major retail payment processing system in New Zealand. The system is used to interchange cheques, direct debits, direct credits, automatic payments, ATM transactions, telephone banking transactions, and off-site electronic banking transactions. ISL has been in operation since the mid-1960s.

64. ISL is owned collectively by 9 registered banks in New Zealand. Respective shareholdings are:

Table 1: Shareholdings in ISL

Company	Shareholdings
ANZ	12.7%
BNZ	12.7%
National	12.7%
Westpac	12.7%
ASB	10.7%
Citibank	10.7%
HSBC	10.7%
TSB	10.0%
Deutsche Bank	7.3%
Total	**100%**

Note: Shareholdings do not add up to 100% due to rounding

65. Participation in ISL's system is governed by, but not limited to, ISL's owners. The owners set the rules governing the operation of the clearing house, including transaction pricing. At present, providers are required to be registered banks. However:

- Non-bank financial institutions have agency arrangements in place with participant banks; and
- Non-bank financial institutions could have a user licence agreement with ISL, which gives them the right to settle payments via the ISL system in return for the payment of a fee. NZ Post Financial Services Limited (on behalf of Kiwibank) is the only company at the present time with such an agreement.

Electronic Transaction Services Limited ("ETSL")

66. There are two systems available in New Zealand for the interchange and clearance of EFTPOS and credit card transactions: the Electronic Transaction Services Limited ("ETSL") system and EFTPOS New Zealand (ENZ), which is wholly owned and operated by ANZ.

67. EFTPOS was first introduced in New Zealand in 1984. At that time there were two separate bank networks offering terminals to retailers. In 1989 three banks came together in a joint venture to form ETSL. BNZ joined ETSL in 1994.

68. At present, the ETSL system for the interchange and clearance of EFTPOS and credit card transactions is owned in equal shares by National, ASB, Westpac and BNZ. Current shareholdings in ETSL are:

Table 2: Shareholdings in ETSL

Company	Shareholding
ASB	22,500 ordinary shares
National	22,500 ordinary shares
Westpac	22,500 ordinary shares
BNZ	22,500 ordinary shares
Total	90,000 ordinary shares

69. ETSL's constitution provides that each shareholder has the same rights and privileges and is subject to the same restrictions. The ETSL Participants' Agreement states that a shareholder's share may be transferred to its acquirer as long as following the registration of such transfers [ ].

70. National holds 22,500 ordinary shares. An acquisition by ANZ of National is unlikely to impact on the operations of ETSL.

Visa New Zealand Limited ("VNZL")

71. VNZL is a system which enables card holders to make payments and withdraw cash. Members of Visa International are entitled to solicit prospective cardholders and issue Visa and Bankcard credit cards, extend credit to cardholders through the use of those credit cards, solicit and sign up merchants who agree to honour those credit cards, and interchange drafts, contracts and other instruments arising from the use of the cards.

72. In 2002, Visa International reviewed the manner in which it granted access to the Visa network and payment system in New Zealand. Instead of granting membership to each card issuing agency, VNZL was incorporated as a joint venture vehicle to provide shareholders with access to the system.

73. VNZL's Board has discretion to issue shares to any applicant that agrees to accept the obligations of being a shareholder and would otherwise be eligible for direct membership in Visa International. The shares may be issued in any various classes, but the main share class is the principal share. Principal shareholders have full rights to solicit prospective cardholders and issue Visa cards bearing the name of the shareholder, and to extend credit to cardholders through the use of Visa cards, solicit and sign up merchants who agree to honour Visa cards, and interchange drafts, contracts and other instruments arising from the use of the cards.

74. Current shareholdings in VNZL are:

Table 3: Shareholdings in VNZL

Company	Shareholding
ANZ	1 Principal share 1 Plus share
BNZ	1 Principal share 1 Plus share 1 Cheque Issuing share
National	1 Principal share 1 Plus share
Westpac	1 Principal share 1 Plus share
ASB	1 Principal share 1 Plus share
HSBC	1 Plus share
TSB	1 Associate share
TOTAL	13 shares

75. The Constitution of VNZL provides that no shareholder may hold more than one share of any class of share. It further provides that upon a merger affecting a Shareholder the Board may approve the continuation of the shareholding, subject to the entity resulting after the merger holding no more than one share of any class of share.

76. Both ANZ and National hold 1 Principal share and 1 Plus share. As provided for the VNZL's Constitution, a combined entity of ANZ and National must terminate their surplus share so that the combined entity holds 1 Principal share and 1 Plus share.

MasterCard International

77. All the major banks are members of MasterCard International. Members of MasterCard International are entitled to solicit prospective cardholders and issue MasterCard credit cards, extend credit to cardholders through the use of MasterCard credit cards, solicit and sign up merchants who agree to honour MasterCard credit cards, and interchange drafts, contracts and other instruments arising from the use of the cards. In addition, members have access to the Maestro debit card, MasterCard Electronic and Cirrus ATM cash access programs.

INDUSTRY BACKGROUND

Structure

78. The banking sector is a critical part of the New Zealand economy. Total lending from registered banks reached $175 billion in 2002 (out of total assets of $204.5 billion) and most banks experienced strong asset and earnings growth.

79. The New Zealand banking market is made up of five major full service banks – all foreign owned – that control more than 84% of the total assets of all registered banks operating in New Zealand. The three largest banks by total assets- Westpac, National and BNZ -are all of a similar size, followed by ANZ and ASB.

80. The major banks in New Zealand generally provide a full range of financial services in addition to retail banking services via their branch networks and e-commerce initiatives. The range of financial services includes corporate and business lending, treasury services, trade finance and fund management.

81. In total, there are 18 registered banks in New Zealand: Kiwibank, Superbank and TSB are domestically incorporated banks, while nine banks are branch banks. Branch banks are banks that are branches of offshore incorporated banks. In addition to Westpac, the main branch banks in New Zealand are:

- HSBC;
- Rabobank;
- Deutsche Bank AG New Zealand Limited ("Deutsche");
- ABN AMRO Bank N.V. New Zealand Banking Group;
- Bank of Tokyo-Mitsubishi (Australia) Limited;
- Commonwealth Bank of Australia;
- Citibank; and
- Kookmin Bank;

82. These branch banks typically provide finance to corporate clients, although HSBC also targets high end personal clients. Rabobank targets the rural banking market. AMP Bank is currently a registered bank although it is no longer active in the banking sector after the sale of its asset portfolio to other industry participants. .

83. In order to use the word "bank" in its name, a company must be registered under the Reserve Bank Act 1989. This registration brings a company within the jurisdiction of the Reserve Bank and imposes quarterly disclosure requirements and regulatory standards in terms of minimum capital requirements and financial management.

84. There are a number of financial institutions that are not registered under the Reserve Bank Act as "banks" but provide similar products and services. These companies come within the jurisdiction of the Securities Act 1978 or the Friendly Societies and Credit Unions Act 1982. Non-bank financial institutions are typically strong in a particular market segment, for example mortgages or personal finance, and may operate on a non-national basis. Notable institutions of this type include the PSIS, the Southland Building Society and the NZACU.

Products and Customers

85. In considering the nature of the product and service supplied, it is possible to divide the banking industry by key financial products and customers. There are four types of customers:

- Personal customers - individual consumers;
- Business customers - consists of Small and Medium Enterprises ("SME") with less than $10m in turnover;
- Rural customers - consists of customers in the agricultural industry; and
- Corporate customers - corporate customers can be sub-divided into institutional customers with firms of more than $100m turnover and middle size enterprises between $10m and $100m turnover.

86. Both parties offer banking services to each of these customers. The types of financial products offered to these customers are:

- Insurance services (general insurance and life insurance);
- Financial planning services;
- Managed funds;
- Personal loans (secured and unsecured);
- Transaction accounts;
- Mortgages;
- Credit cards;
- Term deposits; and
- Savings accounts;

87. Personal customers are likely to purchase all the financial products listed above. Corporate customers mainly borrow money from the major banks and will purchase various types of financial services like foreign exchange services. SME customers and rural customers are likely to purchase the whole range of financial products that banks offer like transactional accounts, overdrafts and revolving credit lines, term debt financing, interest bearing facilities, trade finance, international payment services, EFTPOS facilities, treasury services and asset financing.

88. Financial planning is the process of establishing personal and financial goals and creating a way to reach them. Financial planners can assist people in establishing these goals by providing objective financial advice. The Financial Planners & Insurance Advisers Association ("FPIA") is the professional body that oversees around 1,300 financial advisers throughout New Zealand.

Merchant Acquiring Services

89. An SME or corporate customer that is a retailer ("merchant") is also likely to purchase credit card/debit card merchant acquiring services. This service involves the provision to merchants of credit/debit card payment processing services, namely, the routing of transactions through a switch.

90. Each switch is a physical and informational system that conveys financial information (on payments) from the merchant to the card issuer and back. It delivers real-time transactions from the point of sale to banks and card associations for authorisation. It also permits payment authorisation to be obtained from the bank issuer and delivered to the merchant (via its bank acquirer). The complexity of the switch comes from the fact that it has to link every merchant who is part of the network to every bank issuer which is part of the network.

91. All five major banks currently provide merchant acquiring services to merchants in relation to debit card and Visa and MasterCard credit card transactions.

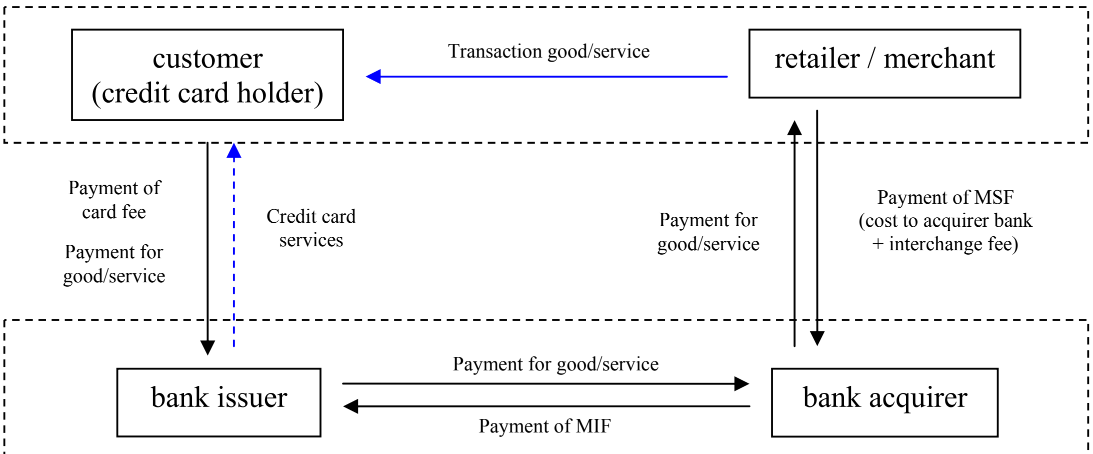
92. Transactions put through merchants who contract with Westpac, ASB, BNZ or National are processed via the ETSL switch. Transactions put through merchants who contract with ANZ are processed through the ANZ switch which is ENZ.

93. The routing of information in New Zealand is a mix of interchange (i.e. the encoded information going through both switches if necessary) and back-end switching (i.e. major banks are connected to both switches and thus do not need to have the transaction double

processed through both switches). The ETSL switch processes more than 85% of the market with around 1.4 million transactions per day.

94. The merchant acquirer receives the payment from the credit card issuer (minus the Merchant Interchange Fee ("MIF") and pays the merchant (minus the Merchant Service Fee ("MSF").

Figure 1: Participants in the Supply of Credit Card Issuing and Acquiring



95. Some merchant acquiring services will also provide the hardware (terminals) that links the merchant to the switch. ANZ provides EFTPOS equipment and support services to merchants. Merchants which acquire services from any of the other four of the major banks must contract with a third party for the provision of such equipment.

96. Merchant acquiring services are also provided by card issuing agencies such as American Express, Diners' Club and Farmers' Card. Any merchant who accepts these cards, must contract with the card issuing agency for merchant acquiring services. These services are limited solely to the processing of transactions on the relevant credit card. Each card issuing agency has an agreement with ANZ and ETSL that allows the card transactions to be switched through the ANZ and ETSL systems.

97. Depending on the activity of the bank, merchant acquiring services can be bundled with other products. ANZ, for instance, will provide merchant acquiring services to SME customers and corporate customers who hold business accounts with them.

Interbank Trading in Financial Markets

98. In New Zealand, each of the major banks is involved in trading in various financial instruments. Their choice of instrument will depend on their trading style, customer business and funding activities of the particular bank.

99. The major banks trade with each other in the following markets:

- Money markets;
- Government bonds; and
- Foreign exchange.

100. In the interbank trading market the major banks are price makers that agree to quote bid and offer prices for a typical transaction size for each asset traded. As price makers, they are obligated to deal at these quoted rates if the customer so wishes.

101. The money market involves the borrowing and lending of cash and the issuance and trading of short-term debt instruments with maturities of one year or less. Trading in the domestic money market consists of trading in physical instruments such as treasury bills, bank bills and commercial paper from banks and companies, as well as interest rate derivatives. The main purpose of trading between banks is to mitigate risks and to provide a funding tool to hold liquid assets which can be cashed easily as and when required. In the New Zealand money market, the price makers include ASB, ANZ, BNZ, Citibank, Deutsche Bank, National and Westpac.

102. The bond market involves the issuance and trading of bonds, namely, long term debt instruments with maturities of one year and more. In the domestic bond market, the main financial instruments traded are government bonds, which are issued by the government, and corporate bonds which are issued by corporates. The major banks act as brokers for customers trading in bonds, although they will also trade in bonds themselves. In New Zealand there are several price makers in the bond market, including AMP, ASB, ANZ, Deutsche Bank, Citibank, National and BNZ.

103. In the foreign exchange market, price makers quote a two way price (buy and sell) price for a specified volume of foreign exchange at a specified bid/offer spread. In New Zealand the price makers in the foreign exchange market include ASB, ANZ, BNZ, Citibank, Deutsche Bank, National Bank and Westpac. Citibank and HSBC have limited presence.

104. Westpac has the greatest volume of foreign exchange related contracts, followed by National and BNZ. ANZ has the lowest volume of contracts and is a fair way behind the others.

105. In 2002, National was by far the most active bank in currency options, followed by BNZ and ANZ. Westpac and BNZ have also been active in trading of interest rate swaps.

History of Entry and Exit

106. The structure of the market has recently been influenced to some degree by new entry. In terms of registered banks, St. George, which is the fifth largest bank in Australia, has recently entered the New Zealand banking market through the launch of Superbank – a joint venture with Foodstuffs-which introduced the British model of supermarket banking. The New Zealand government has also backed the entry of Kiwibank, which has more than 170,000 customers and reported a net loss after tax of $6.5 million for the six months until 31 December 2002.

107. 2002 also saw new entry in the finance sector, including Numeria Finance, Capital and Merchant Finance and Geneva Finance, targeted towards deposits and funding for non-conventional markets.

108. Another key development has been the exit from the banking and finance industry of AMP Bank, which has sold its credit card portfolio to American Express, its residential mortgages and property finance loan assets to HSBC and GE Finance respectively, and its rural banking business to Rabobank. The exit of AMP Banking was largely due to a re-orientation of the AMP Group as a result of the lack of success in its banking initiative

(purportedly due to high operating costs) and the commercial problems of AMP's UK operations.

Conduct

109. The introduction of new technology over recent years has led to significant changes in customer behaviour and preferences in the banking industry. Over the last five years the use of ATMs, EFTPOS, internet and telephone banking has increased rapidly. The corresponding reduction in over-the-counter transactions and cheque usage has led to a general trend of increasing functionality of electronic services and reducing the number of branches.

110. In general, banks and other financial institutions compete over a range of fronts. These include:

- Branding and advertising;
- Service and flexibility;
- Prices, bank fees and interest rates;
- The terms and conditions offered;
- The existence of added benefits and features (for example, links to loyalty schemes such as air points);
- The existence of added service propositions (for example, private banking offers individualised services to high level customers);
- The target audience (for example, products targeted to students or first home buyers);
- The risk/credit policies of each bank (for example, some banks may offer a maximum loan valuation ratio of 80% while others offer 90%);
- The security requirements;
- Volume concessions (where a customer purchases more than one product or service from the same bank); and
- Access options (for example, whether a product can be accessed through branches or by electronic means).

Performance

111. Last year saw a period of record profitability for each of the major five banks. As a sector the registered banks recorded a 16.9% improvement in underlying performance during the year. There were increases in most of the key drivers of profitability, namely, asset growth, non-interest income and cost control. In particular, National, Westpac and BNZ experienced significant increases of 20.5%, 11.0% and 11.2% respectively. ANZ had an increase of 6.5%[5].

112. With regards to the performance of the various financial products, mortgage growth was significant during 2002, in line with a strong housing market. The perceived risk free nature of term deposits continued to attract investors, whilst the more risky investments like managed funds invested in equities performed poorly due to the mixed performance of the NZ share market and the state of US share market.

[5] KPMG Financial Institutions Performance Survey 2003

113. Robust farm incomes over the past two years have allowed farmers to invest more and some banks have gained market share as a result. Also, stable economic conditions over the last year have resulted in an increase in business expenditure, although some of the major banks have experienced a reduction in the value of lending to the commercial sector during the year.

PREVIOUS DECISIONS

NZ Commerce Commission

114. Over the past five years there have been several mergers of relevance to the banking industry. In particular the Commission has investigated the following acquisitions:

- *The New Zealand Co-operative Dairy Co Limited and Waikato Valley Co-operative Dairies Limited*, Decision 264B, 7 June 1991 ("NZ Dairy/Waikato Dairy");
- *Westpac Holdings Limited and Trust Bank New Zealand Limited*, Decision 3 May 1996 ("Westpac/Trust Bank");
- *Commonwealth Bank of Australia Group and Colonial Limited*, Decision 392, 10 Aug 2000 ("CBA/Colonial");
- *PMI Mortgage Insurance Australia (Holdings) Pty Ltd and CGU Lenders Mortgage Limited,* Decision 439, 30 July 2001 ("PMI/CGU")
- *GE Capital Finance Australasia Pty Limited and Australian Guarantee Corporation (NZ) Limited,* Decision 461, 24 April 2002 ("GE/AGC").

115. In NZ Dairy/Waikato Dairy, the Commission defined a regional market for farm finance services. The Commission found that a number of finance companies would provide financial services to farmers post-acquisition and the merger would not result in the combined entity acquiring a dominant position in this market.

116. In Westpac/Trust Bank, the relevant market was defined as:

- The provision of banking services and related financial services throughout New Zealand.

117. The Commission found that competition would remain vigorous post-acquisition, there were low entry barriers and the acquisition would not result in Westpac gaining a dominant position in the market.

118. In CBA/Colonial, the markets were defined as:

- The market for life insurance;
- The market for managed funds including superannuation; and
- The market for investment administration services.

119. The Commission found that competition would remain vigorous post-acquisition, there were low entry barriers and the acquisition would not result in CBA gaining a dominant position in the relevant markets.

120. In the PMI/CGU merger the Commission defined a relevant market for:

- The national market for the wholesale supply of lenders' mortgage insurance to lenders of residential mortgages.

121. The Commission believed that new entry would not provide constraint on the combined entity, and that the constraint provided by existing competition would not in itself be sufficient to constrain the combined entity. However the Commission considered that the strong countervailing power of the purchasers of lenders' mortgage insurance, together with the potential for expansion would be sufficient to constrain the combined entity.

122. In GE/AGC the Commission defined markets for:

- The market for consumer finance products (not including motor vehicles);
- The market for retail merchant finance; and
- The market for business finance.

123. The Commission found that existing competition from other finance companies, banks and credit card issuers in the consumer, retail and business finance markets was sufficiently robust to constrain the combined entity. The Commission also found that barriers to entry were low in the markets considered.

Australian Competition and Consumers Commission ("ACCC")

124. Following the Wallis Inquiry[6] into the state of the Australian Financial Sector, the ACCC has abandoned the cluster product approach to market definition in favour of an assessment of individual product markets. This was reflected in the Westpac/Bank of Melbourne[7] merger, where the ACCC adopted the following markets:
    - home loans (moving to a national market);
    - personal loans (state based);
    - deposits/term saving products (state based);
    - small business banking products (probably more local than state based, but state figures were used as no reliable regional statistics were available);
    - credit cards (state based);
    - transaction accounts (state based); and
    - corporate banking (national).

125. The ACCC formed the preliminary view that competition was likely to be substantially lessened only in the transaction accounts market in Victoria. However, after taking into account the enhanced access to electronic networks arising from the undertakings given, it considered that damage to competition in that market was likely to be minimised.

126. In May 2002, the ACCC reiterated the multi-product approach to market definition in Commonwealth Bank/Colonial and adopted the following market definitions:
    - Non-Banking Financial Services:
        - Retail investment (funds management products); and
        - Wholesale funds management.

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[6] Financial System Inquiry into the Australian Financial System, 31 March 1997, Chairman: Stan Wallis, http://fsi.treasury.gov.au/content/default.asp
[7] Westpac/Bank of Melbourne 25 July1997

- Large Corporate Banking; and
- Retail Banking Services, including:
    - Home lending;
    - Personal loans;
    - Hybrid personal lending products;
    - Credit card issuing;
    - Credit card - merchant servicing;
    - Deposits/term deposits;
    - Transaction accounts;
    - Small and medium enterprise banking; and
    - Agri-business banking.

127. Notably, the ACCC took the view that SME banking was still a cluster product market consisting of the provision of credit cards, transaction/cash facilities, banking advice/relationship, and credit card merchant services.

128. Overall, the ACCC concluded that a merger between the Commonwealth Bank and Colonial would be likely to result in a substantial lessening of competition in the supply of transaction accounts and in the supply of SME banking in both Tasmania and New South Wales.

129. In Tasmania, the combined entity had a market share of 50% in SME banking. The ACCC found that [ ]. As a result the ACCC imposed behavioural undertakings which consisted of providing access to ATM and EFTPOS networks to new and small financial institutions, vacating banking sites, providing IT support to new and small players and various other undertakings regarding price, quality of service and product range. The merger was approved on the basis of these undertakings.

MARKET DEFINITION

130. The Act defines a **market** as:

> *. . . a market in New Zealand for goods or services as well as other goods or services that, as a matter of fact and commercial common sense, are substitutable for them.*

131. For the purpose of competition analysis, a relevant market is the smallest space within which a hypothetical, profit-maximising, sole supplier of a good or service, not constrained by the threat of entry, could impose at least a small yet significant and non-transitory increase in price, assuming all other terms of sale remain constant (the '*ssnip* test'). For the purpose of determining relevant markets, the Commission will generally consider a *ssnip* to involve a five percent increase in price for a period of one year.

132. The Commission defines relevant markets in terms of four characteristics or dimensions:

- the goods or services supplied and purchased (the product dimension);

- the level in the production or distribution chain (the functional level);
- the geographic area from which the goods or services are obtained, or within which the goods or services are supplied (the geographic extent); and
- the temporal dimension of the market, if relevant (the timeframe).

133. The Commission aims to define the markets in a way that best assists the analysis of the competitive impact of the acquisition under consideration. A relevant market will ultimately be determined, in the words of the Act, as a matter of fact and commercial common sense.

Relevant Markets

Product Market

134. The delineation of relevant markets as a basis for assessing the competitive effects of a business acquisition begins with an examination of the goods or services offered by each of the parties to the acquisition. Both demand-side and supply-side factors are generally considered in defining market boundaries. Broadly speaking, a market includes products that are close substitutes in buyers' eyes on the demand-side, and suppliers who produce, or are able easily to substitute to produce, those products on the supply-side.

135. The Commission takes the view that the appropriate time period for assessing substitution possibilities is the longer term, but within the foreseeable future.[8] The Commission considers this to be a period of one year, which is the period customarily used internationally in applying the 'ssnip' test (see below) to determine market boundaries. The Commission will take into account recent, and likely future, changes in products, relative prices and production technology in the process of market definition.

136. The Applicant has taken the ACCC's[10] approach and has considered the relevant product markets to be following:

  - Managed funds;
  - Personal Loans;
  - Institutional corporate market;
  - Middle corporate market;
  - Transaction accounts;
  - Mortgages;
  - SME market;
  - Rural banking;
  - Credit card issuers;
  - Credit card acquirers; and

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[8] In *Tru Tone Ltd v Festival Records Retail Marketing Ltd* [ ] 2 NZLR 351 Smellie J and the Court of Appeal on appeal approvingly quoted an earlier decision of the Commerce Commission in *Edmonds Food Ind Ltd v W F Tucker & Co Ltd* (Decision 21, June 1984) where the Commission had ruled: "A market has been defined as a field of actual or potential transactions between buyers and sellers amongst whom there can be strong substitution, at least in the long run, if given a sufficient price incentive".

[10] In Westpac/Bank of Melbourne (25 July1997), Commonwealth Bank/Colonial (30 May 2000)

- Term deposits/Savings accounts;

137. The demand side and supply side factors in each of the markets described above are considered in further detail below.

138. The Applicant did not consider interbank trading between the major banks in New Zealand, nor did it consider the supply of financial planning services and the supply of insurance services. The Commission has considered these areas of aggregation first, in the following sections.

Demand Side Substitutability

139. In the past the European Commission[11] has considered separate markets for trading in:

- Equities;
- Bonds;
- Derivatives;
- Foreign exchange; and
- Money markets.

140. In this merger a similar approach can be adopted, although the competition analysis is not affected by a broader market definition.

141. The Commission's investigations found that financial instruments traded in the money market are not substitutes for financial instruments traded in the bond market, as the former involves trading in short term debt with a maturity of one year or less and the latter consists of trading in long term debt with maturity of one year or more.

142. However, there is likely to be some demand side substitutability between the financial instruments traded in the money market and financial instruments traded within the bond market. The choice of instrument would depend on what the bank wants to achieve and the liquidity and risk associated with trading that particular instrument.

143. Interbank trading in the foreign exchange market is different to the money market and bond market as it involves trading in foreign currency, namely the NZ dollar cross rate against other currencies, and certain other cross rates not involving the NZ dollar, such as the Australian dollar/US dollar rate.

144. In this merger there is likely to be an aggregation in the supply of financial planning. This is a distinct activity that involves the provision of financial planning services predominately to individuals (including their family trusts) but also to institutions (such as charities and not-for-profit organisations) and companies.

145. In the CBA/Colonial merger, the Commissioned defined one of the relevant markets to be for managed funds (including retail and wholesale funds management, namely, superannuation). The Commission has no reason to believe that this market definition has changed.

146. In this merger there is likely to be an aggregation in the supply of insurance. In the CGU/Norwich Union Plc merger and the IAG/NZI merger the Commission considered narrow product markets for the different types of insurance. The same approach can be adopted in this acquisition. Therefore separate markets can be defined for:

[11] COMP/M.1910 Meritanordbanken/Unidanmark

- The national supply of domestic house and contents insurance;
- The national supply of domestic motor vehicle insurance;
- The national supply of commercial motor vehicle insurance;
- The national supply of commercial property insurance; and
- The national supply of commercial liability insurance.

147. On the demand side, rural, SME and corporate customers each have different banking needs. Further, each type of business customer generally shops with one bank and thus the products offered are bundled. For example, an Auckland University Customer[12] survey found that around 60% of businesses used one bank. However, corporate clients can have more than one bank, as syndicates of banks often group together in the corporate loan market.

148. The Applicant makes a distinction between institutional and middle corporate customers. The Commission's investigation found that some of the other banks describe the corporate market as being made of two segments. However, it is not clear to the Commission that there is a real distinction as similar products are being offered to both middle and large corporate customers.

149. Transaction accounts are differentiated in the sense that banks offer different levels of fees to different types of personal and business customers. Transaction accounts provide deposit-holding services, like savings accounts, but the fact that they offer individuals with basic banking services like access to means of payment, namely, cheques, charge cards, automated transfers and direct debits, suggest that they probably have no close substitutes[13]. A survey[14] found that last year the proportion of consumers obtaining transaction accounts was 93%.

150. A mortgage is a loan secured on a property. This product is different to a personal loan. Personal loans include unsecured loans but also loans secured on personal assets other than property. Unsecured loans are usually sold directly to the customer either at bank branches or by telephone. Personal loans can be a substitute for an overdraft facility on a transaction account or a credit card. There are thus many ways to obtain consumer finance. Banks that are not present in this market can still compete by offering related products.

151. The credit card market can be divided into two activities: issuing and merchant acquiring. There is no demand side substitutability between these two activities. Merchant acquiring services consists of providing the merchant access to a payment processing system, namely a switch that transmits data and authorises payment. The issuing of credit cards provides individual customers with a source of finance.

152. Banks can either be issuers, or acquirers, or both. There are more risks on the issuer side than on the acquirer side, as bank issuers need to provide payment to the merchant and bear the risk of default from the customer.

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[12] The Business Customer Survey, by B. Lang, M. Colgate and A. Parsons, Marketing Department, University of Auckland. July and August 2002

[13] See "Lloyds TSB Group Plc and Abbey National Plc: A report on the proposed merger" p. 89.

[14] The Residential Customer Survey, by B. Lang, M. Colgate and A. Parsons, Marketing Department, University of Auckland. July and August 2002

153. Credit cards to some extent are a substitute for debit cards, charge cards, and store cards. However, credit cards offer greater flexibility and functionality, as store cards can only be used in that particular store and debit cards have limited use for internet and telephone purchases. Further, the majority of credit cards offer an interest-free period and charge interest after that period has expired. Thus credit cards differ from other cards in that they provide an interest free loan for a short period (of up to 55 days). The fact that credit cards offer general payment and finance facilities in the same product suggest that it is a product quite distinct from other banking products.

154. Savings accounts are deposit-holding accounts which tend to have limited facilities to access cash. Term deposits may be considered to be a substitute for "on call" savings accounts. This is especially true when money can be invested for a short period of time (e.g. 3 months) on term deposits. This was confirmed by the Commission's market investigation. To some extent managed funds could be a substitute for term deposits. Managed funds, such as cash management funds like the Macquarie Gilt Edge Access accounts can be considered to be a substitute for term deposits and savings accounts. However, managed funds invested in equities do not often guarantee a return, their risk profile is different and can be considered to be a form of long term investment.

Supply Side Substitutability

155. There are economies of scope in producing most of the financial products that full-service banks offer. Thus, it might be expected that banks would offer bundled products to their customers so that they can provide one stop-shop services to their customers. For instance, transaction accounts are often the gateway to selling other financial services, as customers usually anchor their relationship with a bank around the existence of a transaction account. Further, banks or non-bank financial institutions that have traditionally been active in the supply of savings accounts also try to offer a transaction account to attract more business from their customers[15]. There is also some indication that the key relationship to have with customers is in the supply of mortgages or credit cards.

156. On the other hand, an increasing trend is for individuals and businesses to use a second bank to complement the services of their main bank. A survey[16] found that around 19% of customers had a relationship with two banks.

157. Despite the economies of scale, there will be specialisation taking place and not all the banks offer all services to consumers. For instance, many do not offer personal financial services to their personal clients, while others specialise more in certain types of mortgages. Some banks are more present in the credit card issuing business, like BNZ, than others.

158. The various degrees of specialisation are changing all the time as banks and non-bank financial institutions tailor their supply and try to gain market share. However in the short run, there are limitations because of the set of capabilities and the experience that banks possess in different markets. For example, SME, rural and corporate customers are offered products that are similar, although selling them may require a good understanding

[15] For instance the case of Credit Unions and also Superbank.

[16] The Residential Customer Survey, by B. Lang, M. Colgate and A. Parsons, Marketing Department, University of Auckland. July and August 2002

of the issues and needs of the customer. For instance, in the supply of rural banking, National and Rabobank require their lending managers to be trained in the rural industry. Also in the corporate and SME markets a bank would need to possess knowledge of the business customers' requirements.

159. With regards to credit card issuing and merchant acquiring services, there is likely to be limited supply side substitutability. The banks operate the issuing and acquiring activities as separate businesses with separate accounts. Also a player considering expanding into merchant acquiring services may need to offer a bundle of other SME banking services. For example, Kiwibank is a credit card issuer only [

].

160. In the supply of merchant acquiring services, no distinction is made between credit card merchant acquiring services and debit card acquiring services. This is because the services provided are similar and both transactions are routed through the same payment processing systems.

161. Overall there is high degree of supply substitutability between the majority of financial products and customers.

Conclusion on product market

162. Due to the limited demand side substitutability between the financial products and customers supplied, narrow product markets will be adopted by the Commission. This approach is consistent with the ACCC and UK Competition Commission's approach in recent banking mergers[17].

Functional Market

163. The production, distribution and sale of a product typically occur through a series of functional levels – for example, the manufacturing/import level, the wholesale/distribution level and the retail level. It is often useful to identify the relevant functional level in describing a market, as a proposed business acquisition may affect one horizontal level, but not others.[18] Alternatively, some acquisitions, such as those involving businesses at different vertical levels, may raise issues related to vertical integration. Generally, the Commission will seek to identify separate relevant markets at each functional level affected by an acquisition and assess the impact of the acquisition on each.

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[17] Commonwealth Bank of Australia/Colonial merger 30 May 2000, Lloyds TSB Group plc and Abbey National plc July 2001.

[18] *Telecom Corporation of New Zealand Ltd v Commerce Commission* (1991) 4 TCLR 473, 502 The High Court (Greig J, Shaw WJ, Prof M Brunt) noted: "If we ask what functional divisions are appropriate in any market definition exercise, the answer, …, must be whatever will best expose the play of market forces, actual and potential, upon buyers and sellers. Wherever successive stages of production and distribution can be co-ordinated by market transactions, there is no difficulty: there will be a series of markets linking actual and potential buyers and sellers at each stage. And again, where pronounced efficiencies of vertical integration dictate that successive stages of production and distribution must be co-ordinated by internal managerial processes, there can be no market."

164. In this merger, both parties are involved in wholesale activities, namely interbank trading in financial markets. Both parties are also active in the provision of retail banking services, namely services provided from the bank to the customer.

165. The wholesale and retail activities are different and will be considered to be separate functional levels.

Geographic Market

166. The Commission seeks to define the geographical extent of a market to include all of the relevant, spatially dispersed, sources of supply to which buyers can turn should the prices of local sources of supply be raised. For each good or service combination, the overlapping geographic areas in which the parties operate are identified. These form initial markets to which a ssnip is applied. Additional geographic regions are added until the smallest area is determined within which the hypothetical monopolist could profitably impose a ssnip.

167. Although buyers and sellers of a particular good or service may interact in markets that are apparently local or regional in extent, those markets may themselves overlap and interrelate so as to form a market covering a larger geographical area. In these situations, the larger market is likely to be the appropriate one for analysing the competitive effects of a business acquisition.

168. Whilst the geographic location of branches may determine the customer's choice of a bank, each branch offers core banking services at the same price. Also, other forms of remote account access such as internet banking and telephone banking make the geographic location of branches less important than they were a few years ago.

169. On the whole, the Commission has found that the relevant geographic market is national, with the banks competing at a national level. Each bank has a national pricing strategy and engages in national advertising.

Conclusion on the Relevant Market

170. The Commission concludes that, for the purpose of analysing this application, the relevant markets are:

- Interbank trading in the foreign exchange market;
- Interbank trading in the money market;
- Interbank trading in the bond market;
- The national retail supply of financial planning services;
- The national retail supply of managed funds;
- The national supply of domestic house and contents insurance;
- The national supply of domestic motor vehicle insurance;
- The national supply of commercial motor vehicle insurance;
- The national supply of commercial property insurance;
- The national supply of commercial liability insurance;
- The national retail supply of personal loans;

- The national retail supply of corporate banking;
- The national retail supply of transaction accounts;
- The national retail supply of mortgages;
- The national retail supply of SME banking;
- The national retail supply of rural banking;
- The national retail supply of savings accounts;
- The national retail supply of credit cards; and
- The national retail supply of merchant acquiring services.

COUNTERFACTUAL

171. The Commission uses a forward-looking, counterfactual type of analysis in its assessment of business acquisitions, in which two future scenarios are postulated: that with the acquisition in question (the factual), and that in the absence of the acquisition (the counterfactual). The impact of the acquisition on competition can then be viewed as the difference between those two scenarios. It should be noted that the status quo cannot necessarily be assumed to continue in the absence of the acquisition, although that may often be the case. For example, in some instances a clearly developing trend may be evident in the market, in which case the appropriate counterfactual may be based on an extrapolation of that trend.

172. Lloyds TSB Group, the parent company of National [ ].

173. [ ].

174. [ ], the Commission has considered three possible counterfactuals:

- National is purchased by another business that is not currently active in the banking industry;

- National is purchased by another bank which is not one of major five banks in NZ; or

- National is not sold and remains as major competitor in NZ banking industry.

175. These scenarios all point to National remaining in the market as a major bank in the event that ANZ did not purchase National. Therefore, the Commission considers the most appropriate counterfactual to be the status quo.

COMPETITION ANALYSIS

176. Having defined the counterfactual, the Commission will assess the following for each of the relevant markets:

- the probable nature and extent of competition that would exist in a significant section of the market, but for the acquisition (the counterfactual);
- the nature and extent of the contemplated lessening by considering market concentration, existing competition and potential competition and other competition factors such as countervailing power; and
- whether the contemplated lessening is substantial.[19]

177. The first step in assessing competition is to look at market shares. Market shares can be measured in terms of revenues, volumes of goods sold, production capacities or inputs (such as labour or capital) used. All measures may yield similar results in some cases. Where they do not, the Commission may, for the purposes of its assessment, adopt the measure which yields the highest level of market share for the combined entity. The Commission considers that this will lead to an appropriately conservative assessment of concentration, and that the factors which lead to the other different market share results are more appropriately considered elsewhere during the assessment of the acquisition.[20]

178. In determining market shares, the Commission will take into account the existing participants (including 'near entrants'), inter-firm relationships, and the level of imports. This is followed by an application of the Commission's 'safe harbours'.

179. A business acquisition is considered unlikely to substantially lessen competition in a market where, after the proposed acquisition, either of the following situations exist:

- where the three-firm concentration ratio (with individual firms' market shares including any interconnected or associated persons) in the relevant market is below 70%, the combined entity (including any interconnected or associated persons) has less than in the order of a 40% share; or

- where the three-firm concentration ratio (with individual firms' market shares including any interconnected or associated persons) in the relevant market is above 70%, the market share of the combined entity is less than in the order of 20%.

180. In this merger, market shares are measured by Funds Under Management ("FUM"). Market shares could also be measured by number of customers. The Applicant provided market shares by share of customers, which is how much business a customer does with each bank in the supply of rural banking services and SME banking services. It appears

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[19] See *Dandy*, supra n 5, pp 43–887 to 43-888 and adopted in New Zealand: *ARA v Mutual Rental Cars* (1987) 2 NZLR 647; *Tru Tone Ltd v Festival Records Retail Marketing Ltd* (1988) 2 NZLR 352; *Fisher & Paykel Ltd v Commerce Commission* (1990) 2 NZLR 731; *Commerce Commission v Carter Holt Harvey*, unreported, High Court, Auckland, CL 27/95, 18/4/00.

[20] See the Commission's Practice Note 4 for further explanation of the Commission's approach to market share.

that markets by share of customers or FUM do not differ significantly and at the most there is a [ ] difference.

181. However, market shares are insufficient in themselves to establish whether competition in a market has been lessened. Additional factors must also be considered before a conclusion is reached. These factors are:

- Existing competition;
- Potential competition; and
- Other competition factors such as countervailing power.

182. These factors, along with market concentration, are considered in subsequent sections for each of the relevant markets.

183. After considering the additional factors outlined above, the Commission will assess whether the merger is likely to result in a substantial lessening of competition ("SLC").

184. Section 2(1A) of the Act provides that substantial means real or of substance. Substantial was considered by McGechan J in *Commerce Commission v Port Nelson Ltd* (1995) 6 TCLR 406, 434. He observed:

> "substantially lessening competition " is taken as meaning "lessening competition in a way which is more than insubstantial or nominal". The merely ephemeral and minimal will not suffice. Inevitably, that will involve some attention to relativity; and in the end be a question of judgment on a matter of degree."

185. The Commission considers that it is necessary to identify a real lessening of competition that is not nominal, rather than a quantifiable measure of lessening. The lessening needs to be of such a size, character and importance that it is worthy of consideration.[21] Overall, the Commission considers that substantially lessening competition concerns a real or substantial impact on a market in a way of a lessening, hindering and preventing the process of workable and effective competition.

Interbank Trading in Foreign Exchange Market

186. The Commission's investigation found no competition issues in interbank trading in the foreign exchange market. [ ].

187. In addition, [ ] said the foreign exchange market was over-banked. [ ] said that, post acquisition, it was content with the choice of providers of foreign exchange services.

Interbank Trading in Money Market

188. This acquisition is likely to have an impact on interbank trading in the money market. The Commission's investigations found that National has a strong presence in this market and there would be a reduction in the number of players the major banks could

[21] *Dandy Power Equipment Pty Ltd v Mercury Marina Pty Ltd* (1982) ATPR 40-315, 43-888.

trade with, reducing each bank's liquidity base and its ability to clear risk within the money market. This could raise a bank's costs, which could ultimately be passed on to its retail customers.

189. For instance, [ ] said that, the merger may affect the money market by reducing the investment options available to the major banks. [ ] said that in the money market, the major banks issued bank bills for funding purposes. The main purchasers of [ ] bank bills are the major banks. Consequently, the acquisition would result in the loss of one purchaser. [

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190. [

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191. The Commission found that the Reserve Bank's registration process requires that a banking group's credit exposure to connected persons must be no more than 75% of capital. ANZ stated that its registration conditions required that its aggregate credit exposures to connected persons did not exceed the applicable rating contingent limit set out below. Within this rating contingent limit, ANZ's credit exposures to non-bank connected persons must not exceed 15% of the banking group's tier 1 capital.

	Connected Exposure Limit (% of the banking group's tier 1 capital)
AA/Aa2 and above	75
AA-/Aa3	70
A+/A1	60
A/A2	40
A-/A3	30
BBB+/Baa1 and below	15

192. It appears that, post acquisition, each bank's ability to issue bank bills will be affected, including the new combined entity's. The major banks are interdependent. For instance, it is likely that [ ]

193. Despite the fact that the money market is currently illiquid, and the merger could exacerbate the current problem, it should be noted that the Reserve Bank is currently carrying out policy work on the New Zealand financial system. In particular, the Reserve Bank Amendment Act 2003 has recently come into force, requiring parties who wish to acquire or increase significant influence over a registered bank to obtain the Reserve Bank's consent. One of matters that will be assessed under this new law is the proposed risk management of the combined entity. Risk management is also part of the Reserve Bank's financial stability work programme. Currently minimum capital requirements are the same for all banks, however in the future the Reserve Bank may consider varying capital requirements for particular classes of banks.

194. In addition, it seems as if the banks can obtain funding from other sources. [

] also highlighted that with only three banks to choose from it could lead to greater investment in money markets offshore. [

] did not provide a view on whether the merger would affect them in the interbank trading market.

195. The table below shows that some banks are more dependent on funding from the interbank market than others, but for the major banks the majority of funding is from retail deposits.

Table 4: NZ Dollar Funding-Wholesale and retail. Includes Wholesale Interbank Funding

[

]

196. Most industry participants stated that many banks have entered and exited the wholesale New Zealand financial market. [ ] stated that some of the offshore banks that tried to enter failed because of their lack of presence in the domestic market. On the other hand, [ ] said that there are low regulatory barriers for banks wanting to participate in the New Zealand financial markets. It stated that the decision on whether to enter depended on the bank's objectives, namely whether it wanted to invest or simply obtain funding, although some banks chose not to enter or chose to exit the market not because it was not profitable but because it was not interested in the New Zealand market.

197. [ ] said that it traded in bank bills with ten of the registered banks in New Zealand, including HSBC, Deutsche Bank and Citibank. It stated that it may reduce its investment in bank bills in the portfolios held by some of its managed funds, but that would not affect them as it could easily invest in other assets.

198. Some industry participants also said that any increase in costs from raising funds through the money market, were unlikely to be substantial.

199. The Commission is of the view that the merger is unlikely to lead to a substantial lessening of competition in the money market as the major banks could seek other funding options, and there is unlikely to be a 5% increase in costs in raising funds through the money market.

Interbank Trading in Bond Market

200. The Commission considers that the merger is unlikely to have a substantial affect in interbank trading in the bond market.

201. There are currently seven price makers in the bond market. Post acquisition, corporates and institutional investors will continue to have sufficient choice of banks to deal with when buying and selling corporate bonds.

202. [ ] said that National had a strong presence in the corporate bond market and in the government bond market, although [ ] had recently increased its activity in government bonds.

203. [ ].

204. The Commission concludes that the proposed acquisition is unlikely to lead to a substantial lessening of competition in the bond market as there are several other banks active in this market.

Financial Planning

205. In this acquisition, both parties provide financial planning services to individuals and companies. Formal market share data was not available. However, the Commission found this aggregation to raise no competition concerns, as there are numerous competitors, including the major banks, entities associated with sharebrokers, life offices, and wholesale fund managers, and specialist standalone financial planning firms, throughout New Zealand. Also (as noted previously) the Financial Planner & Insurance Advisers Association ("FPIA") represents 1,300 financial advisers nationwide, confirming the wide availability of credible alternatives.

Managed Funds

206. The combined entity estimates that it would have a market share of [ ] by Funds Under Management ("FUM"), in the supply of managed funds. National has a very small market share of [ ] and ANZ has a market share of [ ]. Post acquisition, the three-firm concentration ratio is [ ], which is within the Commission's safe harbours.

207. The aggregation is minor and post acquisition, there will sufficient competition provided from an extensive range of sources. The major local banks have significant funds management operations; there is competition from the funds management arms of the local life offices (as well as offering locally managed funds, AMP for example offers a range of funds from its Henderson operations in the UK) and sharebrokers (such as the range of funds offered by Goldman Sachs JB Were) as well as from specialist fund managers (such as Fisher Funds Management); and there is further competition from Australian fund managers (such as Perpetual and Platinum) and from UK managed funds and listed investment trusts. This aggregation is not considered further.

Insurance

208. There is some aggregation in the supply of insurance services. Banks offer a range of insurance products, which are sold as an adjunct to other financial services. They primarily offer domestic house and contents insurance and domestic motor vehicle insurance. Banks brand their own insurance products and use established general

insurance companies to underwrite them. The banks tender their requirement for insurance packages every two to three years. The table below shows the market shares for each of the relevant product markets in the IAG/NZI merger that was considered by the Commission earlier this year.

Table 5: Market Shares in Insurance Services

Supplier	Domestic House and Contents	Domestic Motor Vehicle	Commercial Motor Vehicle	Commercial Property Segment	Commercial Liability Segment
IAG NZ	[ ]	[ ]	[ ]	[ ]	[ ]
NZI	[ ]	[ ]	[ ]	[ ]	[ ]
RSA	[ ]	[ ]	[ ]	[ ]	[ ]
AMI	[ ]	[ ]			
Tower	[ ]	[ ]	[ ]	[ ]	
Lumley	[ ]	[ ]	[ ]	[ ]	[ ]
AHA	[ ]	[ ]	[ ]	[ ]	[ ]
QBE	[ ]	[ ]	[ ]	[ ]	[ ]
Overseas Insurers				[ ]	[ ]
Other	[ ]	[ ]	[ ]	[ ]	[ ]

Source: estimates by IAG NZ.

209. The insurance companies have the most significant market shares. The banks are not major players in the different types of insurance and so this aggregation is not considered further.

Personal Loans

210. In the supply of personal loans, the Applicant estimates that it will have a market share of [ ] by FUM. National has a market share of [ ] and ANZ is estimated to have [ ]. Post acquisition, the three-firm concentration ratio is [ ], which is within the Commission's safe harbours.

211. In the market for personal loans, post merger, there is sufficient competition provided from the remaining three full-service banks, namely Westpac, with a market share of [ ], and BNZ, with [ ] market share. The combined entity is also likely to have some competition from competitors in the "Others" category that makes up [ ] of the market. This "Others" category includes non-bank financial institutions. For example GE Finance stated that it competed with the major banks for secured and unsecured loans. [

]. Therefore, for customers who meet the lending criteria of both banks and non-bank financial institutions, there appear to be plenty of providers of personal loans.

212. There is also likely to be sufficient potential competition in the supply of personal loans post merger. This is largely because there are few regulatory requirements for non-

bank financial institutions to provide lending facilities. In addition, as highlighted in paragraph 107, last year there was entry from Numeria Finance, Capital and Merchant Finance and Geneva Finance.

213. In conclusion, the merger is unlikely to lead to a substantial lessening of competition in the supply of personal loans.

Corporate Banking

214. The Commission has considered the relevant market to be the supply of corporate banking, although, the Applicant has provided market share information for institutional corporate banking and middle corporate banking.

215. In the supply of institutional corporate banking, the Applicant estimates that the combined entity would have a market share of [ ]. National estimated its market share to be [ ] in 2002. [
]. However, such market shares may not provide an accurate representation of each banks' activity. Consequently the Commission has not been able to obtain meaningful market shares in the supply of institutional corporate banking.

216. In the middle corporate market, the Applicant estimated that the combined entity would have a market share of [ ]. Post acquisition, the three-firm concentration ratio would be [ ], which is outside the Commission's safe harbours.

Table 6: Market Shares in the Supply of Middle Corporate Customers by Share of Primary Relationships

Company	Market Share
ANZ	[ ]
National	[ ]
Combined	**[ ]**
BNZ	[ ]
Westpac	[ ]
ASB	[ ]
Others	[ ]
Post acquisition three firm concentration ratio	[ ]

Source: Roberts Research

217. The combined market share is significant, although there are other competitors providing this service including the three remaining major banks. HSBC New Zealand is also strong in this sector particularly in trade-related and other key international services such as Treasury and Global Cash management.

218. Further, customers spread their business over a number of banks, including overseas banks. The Commission considers that there is sufficient competition from domestic and international competitors in the supply of corporate banking.

219. In addition, corporate customers are sophisticated customers and are likely to have some countervailing power. There is evidence that shows customers switching between banks. For instance, [ ].

220. [ ]. The most cited reason for middle corporate customers switching banks was as a result of a banking review or better service elsewhere.

221. In conclusion, in the supply of corporate banking, the Commission considers that post acquisition there is sufficient existing competition provided by the other major banks, competition from overseas competitors and countervailing power from larger corporate customers.

Transaction Accounts

Existing Competition

222. In the supply of transaction accounts, the combined entity would have a combined market share of [ ] by FUM. National has a higher market share of [ ], whilst ANZ has [ ]. ANZ has a slightly higher market share if measured by the number of transaction account holders, namely, [ ] in 2002.

223. Post acquisition, the three-firm concentration ratio is [ ], which is outside the Commission's safe harbours.

Table 7: Market Shares in the Supply of Transaction Accounts by Funds Under Management

Company	Market Share
ANZ	[ ]
National	[ ]
Combined	**[ ]**
BNZ	[ ]
Westpac	[ ]
ASB	[ ]
Others	[ ]
Post acquisition three firm concentration ratio	[ ]

Source: ANZ based on ACNielsen Consumer Finance Monitor 2002

224. The analysis of existing competition in the supply of transaction accounts involves assessing the loss of competition between ANZ and National and the competition provided by the three remaining full-service banks, other registered banks and from non-bank financial institutions.

225. In order to assess the competition provided by the other banks, the switching behaviour of customers is analysed.

<u>Switching Behaviour</u>

226. In 2002, an Auckland University Consumer Survey[23] found that between 15-20% of New Zealand residential customers were currently considering switching banks. However, only 3-5% actually switched banks. Similar estimates for the rate of switching were provided by [ ], who also said that the switching rate had remained stable for the past few years.

227. The actual rate of transaction account holders switching is low compared to those considering switching and suggests that consumers may get stuck somewhere in the switching process. The presence of switching costs and the reasons for switching could explain why fewer consumers actually complete the switching process.

228. Switching costs can affect the ease at which customers can switch banks. The Auckland University Consumer survey estimated that up to 40% of a bank's residential customer base would be at stake if switching barriers did not exist.

229. The main switching costs highlighted to the Commission were the delays and financial costs associated with switching accounts, in particular transferring direct debits and other automated transactions to the new account. In some cases, the consumer has to contact

[23] The Residential Customer Survey by B. Lang, M. Colgate and A. Parsons, Marketing Department, University of Auckland. July and August 2002

each company that it has a direct debit with and arrange automatic payments with the new banks either through the telephone or a branch.

230. The Applicant stated that new customers opening a transaction account are charged $5 for establishing automatic payments and a minimum of $8 for each new Automatic Payment and Direct Credit Schedules. Also fees for staff-assisted automatic payment schedules increased this year from $3.50 to $6. [ ].

231. The Commission also found that many times when consumers were switching banks the old bank was very slow in processing the changeover. This is particularly the case when the new bank requests the old bank for the appropriate customer information, namely account numbers and automatic payments. The old bank has no incentive to process the change quickly and may seek to offer a better deal to prevent a customer from switching.

232. On the other hand, the banks have tried to reduce switching costs to customers by offering to pay some of the fees or waive them if the customer purchases more banking services. This prospective merger has encouraged existing banks to try and reduce switching costs even further, as there is an expectation that the combined entity will experience customer attrition. There is some indication that competing banks are keen on acquiring a greater share of those customers leaving post acquisition. In particular, ASB and Kiwibank have recently been advertising that it is easy to switch to their banks.

233. Also customers have been reducing the effect of switching costs by migrating rather than switching between banks. The Commission found that customers are opting to open new accounts without closing the old account. This has resulted in a number of inactive accounts, which can be costly for the banks.

234. The Commission found that the banks view switching as easy but considered that customer perception and habit affected switching. The main reasons for transaction account holders switching banks were found to be:

- Cost of charges;
- Quality of service;
- Product features;
- Change in personal circumstances; and
- Changes in bank ownership.

235. A survey[24] found that approximately [ ] who had switched their entire banking relationship had switched because of high account/transaction charges. [ ].

236. The Auckland University Consumer Survey[25] found that older customers were less likely to switch than younger ones, and of the 15-20% that considered switching, the

[24] ACNielsen Consumer Finance Monitor 2000-2002

[25] The Residential and Business Customer Survey by B. Lang, M. Colgate and A. Parsons, Marketing Department, University of Auckland. July and August 2002

majority came from ANZ (23%), followed by BNZ (19%), Westpac (19%), ASB (11%), and National (10%). This seems consistent with satisfaction levels as TSB ranks the highest, followed by National and ASB. ANZ, BNZ and Westpac all rank third.

237. The table in Appendix One shows that in 2002,[26] out of those considering switching banks, 12.8% of ANZ customers considered switching to National, whereas only 5.3% of National customers considered ANZ. The fact that National is one of the top five banks customers want to switch to, suggests that customers may face a loss of choice when deciding which bank to switch to as a result of the acquisition. The survey found that Westpac, BNZ and ANZ and some niche players have less appeal to switchers.

238. However, the same survey found that out of those considering switching, 33% of ANZ customers considered Kiwibank, 17.9% considered ASB, 12.8% considered Westpac and 10.3% considered PSIS[27] (See Appendix One). This suggests that if ANZ were to acquire National, then customers would have other banks offering a good quality of service to switch to.

239. The fact that the majority of customers are considering switching to another major bank rather than other registered banks and non-bank financial institutions suggests that these institutions provide only a small degree of constraint. However, individuals are more likely to consider non-bank financial institutions when choosing a second bank in addition to their main bank.

240. As noted before, most industry participants expect that the combined entity would experience attrition of customers post acquisition. A banking analyst estimated, based on bank mergers in Australia, that the combined entity would experience an attrition rate of 7-10%. Some commentators suggested that it could be as high as 15%. On the whole, it appears that different types of customers, depending on whether they value quality of service or price, will switch to different banks as a result of the acquisition. Therefore, the remaining banks offer transaction account customers a sufficient range of price and quality of service.

Conclusion on Existing Competition in Transaction Accounts

241. Compared to the counterfactual where National remains as a competitor, the Commission considers that the proposed acquisition is likely to reduce choice and quality of service in the transaction accounts market. This is because National is considered to be a bank that customers would consider switching to due to its quality of service. Further, there are switching costs in changing banks.

242. However, banks are trying to change customer perception on switching accounts, particularly with the current expectation that customers will switch post merger. It is

[26] The Residential and Business Customer Survey by B. Lang, M. Colgate and A. Parsons, Marketing Department, University of Auckland. July and August 2002

[27] The Residential and Business Customer Survey by B.Lang, M. Colgate and A. Parsons, Marketing Department, University of Auckland. July and August 2002

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considered that the combined market shares of the combined entity are likely to be lower than those provided by the Applicant. Also customers are avoiding switching costs by migrating, namely opening new accounts and not closing old accounts.

243. In addition, survey evidence suggests that competition in the supply of transaction accounts between National and ANZ is not considered to be significant.

244. However, in order to assess fully the impact of the reduction in the number of major banks from five to four, the Commission has gone onto consider potential competition and the constraint provided by buyers in the supply of transaction accounts.

Potential Competition in Transaction Accounts

245. A business acquisition is unlikely to result in a substantial lessening of competition in a market if behaviour in that market continues to be subject to real constraints from the threat of market entry.

246. The likely effectiveness of the threat of new entry in constraining the conduct of market participants, following a business acquisition that might otherwise lead to a substantial lessening of competition in a market, is determined by the nature and height of barriers to entry into that market.

247. The Commission considers that, for the purpose of considering this issue, a barrier to entry is best defined as an additional or significantly increased cost or other disadvantage that a new entrant must bear as a condition of entry.

248. Entry barriers into the supply of transaction accounts can be considered to be:

- Capital requirements;
- Regulatory requirements;
- Branding and advertising;
- Access to branch networks;
- Access to ATMs; and
- Access to a payment processing.

249. Each of these entry barriers are discussed in further detail below.

<u>Capital Requirements</u>

250. A new entrant wanting to be a registered bank would need to meet the Reserve Bank's minimum capital requirements. These are:

- Minimum capital of $15 million.
- Minimum capital of 8% of risk weighted assets
- Minimum tier 1 capital of 4% of risk weighted assets.

251. Non-bank financial institutions that choose not be registered would face lower capital costs, although the Commission found that these financial institutions could meet these requirements adequately.

252. The Commission is of the view that the capital requirements in the supply of transaction accounts market can be considered to be a moderate barrier to entry.

Regulatory Barriers

253. Regulatory barriers are considered to be low, [ ]. Finance companies, savings institutions and fund managers operate in a lightly regulated market and are subject to Securities Act 1978 and Credit Contracts Act 1981 and Codes of Practice specific to the product market.

Branding and Advertising

254. The Commission considers that the major banks have strong brand names that have been developed over an extended period of advertising, and reinforced through the branding of ATMs and branches. Therefore any new entrant would have to invest significantly on advertising in order to promote the brand and/or to advertise new products. A new entrant would also need to invest in advertising to develop a reputation for being a credible supplier of transaction accounts.

255. The Commission found that advertising strategies will be affected by seasonal changes. For instance, student accounts tend to be promoted during February, which is the start of the tertiary year and many banks have a spring mortgage campaign.

256. The table below indicates the advertising spend by banks involves significant investment.

Table 8: Advertising Spend by the Major Banks in 2002

Bank	Advertising Spend in 2002
ANZ	[ ]
National	[ ]
Westpac	[ ]
ASB	[ ]
BNZ	[ ]

Source: Commission's investigations

257. ANZ stated that its advertising spend had been [ ], National's advertising expenditure has [ ]. National said that its strategy was to [ ]. Further, the Commission's investigations found that National had a strong brand and the "black horse" played a significant role in promoting that brand.

258. Kiwibank has been actively advertising its products through the mail. In terms of the overall brand, the Commission considers that Kiwibank had a particular advantage in terms of credibility due to its backing by the Government and therefore is not entirely indicative of the true cost of establishing a brand presence in the New Zealand market.

259. Although the need for marketing expenditure appears to create a barrier to entry, existing suppliers have launched separately branded banks for non-branch based supply. A notable example of this is ASB's introduction of Bank Direct. This suggests that there may be advantages to a new brand that a new entrant could potentially take advantage of.

260. On the whole, the Commission considers that branding and advertising is a significant barrier to entry in the supply of transaction accounts.

Access to Branch Network

261. A new entrant into the supply of transaction accounts would need to have some means of delivering products to customers. This could be in the form of branches, telephone or internet banking. The estimated capital cost of setting up a branch is [ ] for a small branch and [ ] for a large branch. The capital costs for internet banking were estimated to be [ ] and [ ] for telephone banking.

262. The Financial System Inquiry conducted on behalf of the Australian Treasury made the following comments with respect to the importance of branch networks:

> "The need for a widespread branch network has traditionally been considered to be a major barrier to entry into retail banking…New technologies and alternative distribution mechanisms are likely to reduce the significance of this barrier. The increased potential for outsourcing functions and entering into joint ventures and agency arrangements will also reduce some of the barriers resulting form sunk costs and economies of scale and scope".[28]

263. The Commission considers that it is important for a new entrant to have access to a branch network. This is because consumers like to have face-to face contact, particularly when dealing with complaints. Customers that tend to use branches are small business customers, older people, low-income earners and low-skilled workers. Approximately [ ] of ANZ customers visit their main branch at least quarterly. It has also been suggested that branches play an important part in promoting the bank's brand.

264. However, the advent of telephone and internet banking, as well as ATMs, has provided new ways for customers to access their transaction accounts. Most banks and financial institutions are now offering telephone and internet access. Internet banking in New Zealand is still growing with more than one million subscribers[29]. ANZ estimates that [ ] of its transaction account holders only use the internet. Westpac estimated that [ ] of their transaction account holders used the internet, while [ ] used their branches every three months. The Commission considers that establishing internet and telephone banking services would appear to pose no special problem for new entrants, although some investment would be required to establish these services.

265. Internet and telephone banking has changed the way customers use their branches, although most banks still see branches as a core aspect of their business as it is the foundation of the relationship between the bank and its customer.[30] Consequently the Commission is of the view that the non-branch sales channels are complementary rather than substitutes for branches.

266. The New Zealand market has recently seen the entry of Superbank via a joint venture agreement with Foodstuffs, which potentially creates 474 branches for Superbank customers. Kiwibank provides branch services via an agency agreement with New Zealand Post that allows Kiwibank customers to access their accounts through 300 Post Shops. TSB also has an agency agreement with New Zealand Post which allows TSB

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[28] Financial System Inquiry, Chapter 10, p 454, http://fsi.treasury.gov.au/content/FinalReport.asp

[29] Source KPMG, Financial Institutions Performance Survey 2003.

[30] See KPMG report.

customers outside of Taranaki to make deposits via Post Shops. [

].

267. The Commission considers that the existing joint venture and agency arrangements are evidence that there has been a reduction in the barriers to entry resulting from the sunk costs associated with establishing a branch network. Given that Kiwibank has gained 170,000 customers since entering the market in February 2002 the Commission considers that this barrier may no longer be as high as traditionally perceived.

268. However, the Commission considers that the sunk costs of establishing a traditional branch network are still high and would therefore represent a barrier to entry. Even though it is possible to lease premises to reduce the cost of establishing a branch, there is still a need to invest in infrastructure and the training of skilled staff. Economies of scale also represent a barrier to new entrants, as it would be difficult to match the branch networks of the major banks since the costs of establishing a branch network would initially have to be spread over a smaller number of customers.

269. The degree to which a bank utilises an alternative branch network is discussed in the LET test in paragraphs 299-310.

270. Overall, the Commission's view is that access to a branch network is a significant barrier to entry in the supply of transaction accounts.

<u>Access to ATMs</u>

271. A new entrant into the supply of transaction accounts would need to provide cash withdrawal facilities. Access to ATMs can be seen as an essential way of providing this facility. A new entrant could roll out its own ATM network or it could access the existing ATM network by obtaining agreements with one or more of existing ATM owners.

272. Rolling out an ATM network involves large sunk costs. The approximate cost of installing an ATM wall machine is estimated to be [ ], and [ ] for a free-standing machine. The annual average operating expense for an ATM was estimated to be [ ] per annum. [

]

273. In this proposed merger, access to ATMs could be an issue for a new entrant or a current market player which does not possess its own ATM network. Some industry participants, namely [

]

274. [

]

275. The table below shows that ANZ owns about 21% of the current ATM network and National Bank owns 13%. Together they would represent 34% of the market. The next largest player would be Westpac with a market share of 27%.

Table 9: Market Shares of Owned ATM

Bank	**Owned ATMs**	**Market Share**
ANZ	386	21%
National	240	13%
Combined	**626**	**34%**
Westpac	493	27%
ASB	315	17%
BNZ	374	21%
Total	**1808**	**100%**

Source: Merrill Lynch Report: New Zealand Banking (April 2003)

276. At present, the industry consists of a number of bilateral agreements among ATM owners and between ATM owners and non-ATM owners. Fees are generally received on a per transaction basis. [

] These fees are shown in the tables below:

Table 10: ATM Fees Between Banks For Cash Withdrawal Transactions

[

]

Table 11: ATM Fees Between Banks for Non-Cash Transactions

[

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277. [

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278. [

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279. It could be argued that access to ATMs is required to provide consumers with convenience in accessing their cash 24 hours and to manage their account through balance enquiries. However, there has been a mixed response on ATM usage. For instance, [ ] said that ATM transactions had gone down and EFTPOS transactions had increased. On the other hand, [ ] said that ATM transactions had gone up. However, the table below shows that ATM usage and EFTPOS are equally popular.

Table 12: ATM and EFTPOS Usage

Bank	**ATM**	**EFTPOS**
	March 2003	**March 2003**
ANZ	67%	77%
National	73%	86%
Westpac	71%	81%
ASB	76%	85%
BNZ	63%	82%
Kiwibank	76%	82%

Source: ACNielsen
Notes: Use of any bank's ATMs, use of EFTPOS at any location

280. Alternatively, it could be argued that an ATM network is an infrastructure that would be more efficient if shared by all the banks rather than a private investment that is made by each owner. ATM owners could benefit by obtaining network economies of scale, which ultimately lowers the fees for consumers.

281. However, as stated by [ ]. ATMs also develop brand awareness. Investing in ATMs therefore is not akin to an investment in public infrastructure but rather is an investment in a private asset that is limited in its capacity. From this perspective allowing any bank to use one's own ATMs may change the economics of the initial investment in ways that could endanger future rollouts.

282. If the combined entity denied access or raised prices to non-ATM owners, non-ATM owners would still have access to 66% of ATMs in New Zealand, as well as all the EFTPOS terminals to offer cash withdrawal services. According to data from the New Zealand Bankers' Association, there are just under 100,000 EFTPOS terminals in New Zealand. In addition, [

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283. Although consumers want to have as much convenience as possible, access to all ATMs does not seem necessary to compete effectively. [

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284. As stated above, TSB currently does not have access to ANZ's ATMs. However, it has access to 75% of the ATMs in New Zealand, including its own network in Taranaki. [

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285. Moreover, the fact that a major player in the market could foreclose access to its ATM network means that the relative price of setting up an ATM network would change and thus it may make sense to rollout one's own network instead of negotiating access to the existing network. [ ] the New Zealand Association of Credit Unions ("NZACU") has informed the Commission that it plans to roll out [ ] ATMs, [ ]. The NZACU is using American technology [

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286. Overall, the Commission is of the opinion that the strategic barriers in accessing existing ATMs are likely to be increased and this may lead to some loss of competition in the transaction account market. However, the other 66% of the ATM market is available through negotiations with the ATM owners and there remains the option of rolling out a new ATM network.

<u>Payment Processing Systems</u>

287. A new entrant into the transaction accounts market would need access to a debit card payment processing system. The choice is either to join an existing switch or to set up one's own.

288. It is theoretically possible to set up a new switch in New Zealand. There are currently two switches in New Zealand that run on different platforms and are independent systems. Moreover, most banks that are part of ETSL [

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289. There are network economies of scale in centralising all the transactions in one or few switches. With New Zealand being a small market, there are good reasons to believe that only a small number of switches would be optimal. This being said, technology evolves all the time and this may change the economics of switches in the future.

290. Network effects probably limit the development of a new switch, but do not necessarily preclude it. A new switch, however, would have to establish links with the existing switches if it wants to be economically viable. There are many technical issues to solve in doing so, but probably the main issue is to obtain the agreement of the existing switches to connect to them. If agreement is not obtained, the new switch would have to

connect with all the parties either front-end or back-end, which is costly and creates additional technical, operational and business process complexities.

291. The Commission considers that because of the network effects, the uncertainty that exists with regard to future technology and the size of the New Zealand market, it is likely that the economics of a third switch would not allow it to exist.

292. If a new switch were established and linked to the existing switches, the new entrant would probably have to pay a relatively high interchange fee. Indeed, it makes sense for incumbents who have borne the capital expenditure to ask for a price that provides a return on their past investments. This is because to bring a network to commercial viability, years of investments in business processes are necessary and a critical mass must be achieved. The interchange fee allows the new entrant to share the development costs of the incumbents and it protects the latter from free-riding problems.

293. [ ].

294. [ ].

295. The actual prices are shown in Table 3 in Appendix One. [ ].

296. Therefore, the Commission considers that there are no real competition concerns in the payment system area in New Zealand, as one or two switches are probably optimal and the cost of new entrants accessing ANZ systems is unlikely to be affected by this acquisition. Moreover, the situation where ANZ were to acquire the National could lead to two scenarios:

- ANZ could transfer all of National's merchant acquiring business onto its own switch. This would in fact balance the amount of transactions between the two switches more evenly and is thus of no concern from a competition perspective. This is probably the most likely scenario if the past position of ANZ were considered. ANZ chose not to join the other banks in ETSL when it was created (following the sale of Databank assets) and ran its own operation by buying ENZ.

- Alternatively ANZ could keep National's 25% share in ETSL. In this scenario, ANZ would have a limited affect on ETSL's future. ANZ would not be in a situation to direct the decisions taken, as every member has an equal share in the organisation. ETSL's constitution provides that each shareholder has the same rights and privileges and is subject to the same restrictions. The ETSL Participants' Agreement states that a shareholder's share may be transferred to its acquirer as long as following the registration of such transfers [ ]. National holds 22,500 ordinary shares.

297. The Commission's view is that access to a payment processing system is a barrier to entry in the transaction accounts market, although this barrier is unlikely to increase, as a result of the proposed acquisition.

The LET Test

298. Having considered the various barriers to entry in the supply of transaction accounts, the LET test is now applied and is discussed in the paragraphs below.

299. In order for the threat of market entry to be such a constraint on the exercise of market power as to alleviate concerns that a business acquisition could lead to a substantial lessening of competition, entry of new participants in response to the exercise of market power must be likely, sufficient in extent and timely (the *let* test).

Likelihood of Entry

300. The Commission considers that the extensive branch networks of the five major banks represent a significant sunk investment that it is difficult for new entrants to replicate. In addition, the major banks have an advantage over new entrants because they have already secured the majority of the best locations in most regions. There will also be a significant period of time before a new branch could be expected to break even. The Commission considers that it is unlikely there would be significant new entry into branch banking other than by acquisition in the two year time frame considered by the Commission when assessing the likelihood of entry to prevent the combined entity from attempting to exercise its unilateral market power.

301. It appears that entry is most likely to occur with joint venture arrangements made with existing companies, through agency arrangements or through acquisition. Recent examples are Superbank, which is a joint venture with St George and Foodstuffs, and Kiwibank, which provides banking services via an agency agreement with New Zealand Post.

302. The Commission considers it is more likely that a new entrant could enter the market via a similar means to Superbank or Kiwibank. In the event of a new market participant entering the market via a joint venture or agency arrangement, the crucial question is the extent to which they could constrain the combined entity in the event that it attempted to exercise unilateral market power.

303. Therefore the Commission concludes that entry in the supply of transaction accounts is likely.

Extent of Entry

304. A new entrant that entered the market via a branch network would need to make significant investments in time and resources. The Commission considers that it is unlikely that entry of this kind would be achieved within the two year time frame to be of sufficient extent to prevent the combined entity from exercising unilateral market power.

305. With respect to joint venture or agency arrangements, a new entrant could gain sufficient geographic coverage to enter the market with a national presence as Kiwibank and Superbank have done. A new entrant would be required to invest in infrastructure and marketing in order to build up a customer perception of security.

306. Superbank has access to 474 supermarket stores to provide customers with access to their cash. Supermarket banking is a new concept in New Zealand and it is not clear how well it will succeed. [ ]. Supermarket banking has been successful in the UK but only in the market for savings products. In Australia, the Commonwealth Bank of Australia teamed up with the supermarket chain Woolworths, three years ago. It attracted 550,000 customers to the venture branded EZi Banking. However, a banking analyst in Australia stated that while EZi Banking still exists it has not been very successful, and is used primarily to provide low value customers with low cost service. The analyst also stated that ANZ had opened five branches in Coles supermarket in Australia as a pilot, but closed them in 2001.

307. Switching costs can also affect the extent of entry into the transaction account market. For instance, PSIS has approximately [ ] members and this customer base has [ ]

308. Kiwibank has secured 170,000 customers since entry in February 2002 and [ ]. Kiwibank also stated that it had high levels of customer satisfaction. [ ]

309. The Commission is of the opinion that the presence of switching costs and customer loyalty indicates that entry is unlikely to be sufficient in extent within the two year time period considered by the Commission when assessing the extent of entry required to prevent the combined entity from exercising unilateral market power.

<u>Timeliness of Entry</u>

310. The entry of Superbank and Kiwibank suggests that potential entry could be timely in the supply of transaction accounts.

Conclusion on Potential Competition in Transaction Accounts

311. The Commission concludes that, on the whole, barriers to entry in the supply of transaction accounts, mainly branding and advertising, access to branch networks, access to ATMs and access to payment processing system, are significant and that while entry may be likely and timely, it would not be sufficient in extent.

Constraint from Buyers in Transaction Accounts

312. The potential for a firm to wield market power may be constrained by countervailing power in the hands of its customers, or alternatively, when considering buyer (oligopsony or monopsony) market power, its suppliers. In some circumstances, it is possible that this constraint may be sufficient to eliminate concerns that a business acquisition may lead to a substantial lessening of competition.

313. Where a combined entity would face a purchaser or supplier with a substantial degree of market power in a market affected by the acquisition, the Commission therefore considers whether that situation is such as to constrain market participants to such an extent that competition is not substantially lessened.

314. The Commission considers that given that transaction account holders are individuals and are unlikely to be able to negotiate prices and better terms and conditions for their transaction accounts, they are unlikely to have countervailing power.

315. The analysis of countervailing power in the supply of transaction accounts applies to all the other relevant markets considered in this acquisition, with the exception of corporate banking and merchant acquiring services.

Unilateral Market Power in Transaction Accounts

316. The Commission considers that compared to the counterfactual where National remains as a competitor, the proposed acquisition is likely to reduce choice and quality of service in the transaction accounts market. This is because there are switching costs in changing transaction accounts between banks and National is considered to be a bank that customers would consider switching to due to its quality of service. Further, barriers to entry in the supply of transaction accounts are significant and there is limited countervailing power.

317. However, banks are trying to change customer perceptions on switching accounts, particularly with the current expectation by banks that customers will switch post merger. It is considered that the combined market shares of the combined entity are likely to be lower than those provided by the Applicant. Also customers are avoiding switching costs by migrating, namely opening new accounts and not closing old accounts.

318. In addition, survey evidence suggests that competition in the supply of transaction accounts between National and ANZ is not considered to be significant and post acquisition, there will be sufficient existing competition provided from BNZ, Westpac, Kiwibank and particularly from ASB from a quality perspective. Consequently, the Commission considers that there is a sufficient range of quality and price options from existing competition to prevent the combined entity from exercising any unilateral market power. The merger is unlikely to result in a substantial lessening of competition in the supply of transaction accounts.

Co-ordinated Market Power in Transaction Accounts

319. A business acquisition may lead to a change in market circumstances such that coordination between the remaining firms either is made more likely, or the effectiveness of pre-acquisition coordination is enhanced. Business that would otherwise compete may attempt to coordinate their behaviour in order to exercise market power by restricting their joint output and raising price. In extreme cases, where all businesses in the market are involved and coordination is particularly effective, they may be able to behave like a collective monopolist. Where not all firms are involved, and market share in the hands of the collaborators is reduced, coordinated market power becomes more difficult to exercise because of competition from the independent firms in the market.

320. Co-ordination covers both explicit agreements and tacit forms of behaviour. Tacit co-ordination involves the use of facilitating devices such as price signalling, conscious parallelism and price leadership.

321. In broad terms, successful coordination can be thought of as requiring three ingredients:

- Collusion;
- Detection; and
- Retaliation.

322. 'Collusion' involves the firms individually coming to a mutually profitable expectation or agreement over coordination.

323. 'Detection' requires that firms that deviate from the understanding or collusive agreement are able to be detected.

324. 'Retaliation' refers to the fact that deviations from the terms of coordination need to be not only quickly detected by other suppliers, but also the deviating firm would need to be faced with a credible threat of swiftly being punished thereby eliminating the short-term profit to be gained by the firm from deviating. The threat of retaliation increases the cost of deviating and thus helps preserve the coordination.

325. When assessing the scope for coordination in the market during the consideration of a business acquisition, the Commission will evaluate the likely post acquisition structural and behavioural characteristics of the relevant market or markets to test whether the potential for coordination would be materially enhanced by the acquisition. The intention is to assess the likelihood of certain types of behaviour occurring, and whether these would be likely to lead to a substantial lessening of competition.

326. Some industry participants raised concerns that the creation of the combined entity would facilitate tacit collusion. This was largely because the merger would result in four Australian owned banks in New Zealand that would have a common objective to collude. The Commission notes that the nationality of companies per se is not considered to be a characteristic required for collusion.

327. There are some structural and behavioural characteristics of the transaction account market that may facilitate collusion. For instance, the banks have around 80% of the market and the reduction in major banks from five to four leads to higher concentration in the market. In addition, prices are transparent as banks regularly advertise their offerings, the product offered is homogenous despite the fact that banks will try to differentiate themselves, individuals are unlikely to have any countervailing power and barriers to entry into the supply of transaction accounts are considered to be significant.

328. The banking industry also consists of a trade association, namely NZ Bankers Association as well as a number of organisations where the major banks are the main shareholders. These organisations are ISL, ETSL and VNZL. Therefore, the banks regularly meet to discuss matters that come into the remit of the trade association or organisation.

329. Further, in the transaction account market, deviations from collusion in prices would be detectable.

330. However, the remaining [ ] of the transaction accounts market consists of fringe players like Kiwibank and TSB. The fringe players are likely to provide some customers,

namely price sensitive customers, with a viable alternative. For instance, Kiwibank has marketed itself to be an alternative to non-competitive fees imposed by the major banks. An example of this is its recent launch of a low interest credit card. Therefore, the fringe players may deter tacit collusion between the major banks.

331. It should also be noted that each of the banks have different strengths and weakness. For instance BNZ has a strong presence in the credit card and corporate market, whilst National has a strong presence in the rural market. These different strengths may mean that banks have different costs making it difficult for the banks to closely align their prices.

332. However it is not clear whether the banks would have a credible punishment strategy. For instance, over the past few years, ASB has been growing successfully and was considered by one market participant as a maverick player. ASB was the first to introduce internet banking. Given ASB's growth and high customer satisfaction levels, it is unlikely that it would have an incentive to participate in co-ordinated market power to maximise profits, at the expense of its expansion.

Conclusion of Co-ordinated Market Power in Transaction Accounts

333. The Commission is of the view that the merger is unlikely to increase the likelihood of co-ordinated market power in the supply of transaction accounts because the fringe players are likely to provide some competition, the banks have different strengths and weaknesses and in particular ASB is unlikely to have the incentive to participate in co-ordinated power at the expense of its recent growth and customer satisfaction levels.

334. The analysis of co-ordinated market power applies to all of the other relevant markets considered in this acquisition.

Conclusion on SLC in Transaction Accounts

335. In conclusion, in the supply of transaction accounts, the proposed acquisition is unlikely to lead to a substantial lessening of competition. There is sufficient existing competition from the three major banks to prevent the combined entity from exercising unilateral market power. The merger is unlikely to increase the likelihood of co-ordinated market power in the supply of transaction accounts because the fringe players are likely provide some competition, the banks have different strengths and weaknesses and in particular ASB is unlikely to have the incentive to participate in co-ordinated power at the expense of its recent growth and customer satisfaction levels.

Mortgages

Existing Competition

336. In the supply of mortgages, the proposed acquisition would lead to a combined market share of [ ]. The next largest player is Westpac with [ ]. Post acquisition, the three firm concentration ratio is [ ], which is slightly outside the Commission's safe harbours.

Table 13: Market Shares in the Supply of Mortgages by FUM

Company	Market Share
ANZ	[ ]
National	[ ]
Combined	**[ ]**
BNZ	[ ]
Westpac	[ ]
ASB	[ ]
Others	[ ]
Post acquisition three firm concentration ratio	[ ]

Source: ANZ based on ACNielsen Consumer Finance Monitor 2002

337. The Applicant states that the combined entity would face sufficient competition through the presence of mortgage brokers. Mortgage brokers can be considered to be intermediaries that add value by providing a service, but some can be considered to act as sales agents for the banks. There are around 26 lenders in the NZ Mortgage Brokers Association. Advice from mortgage brokers is free, although only around 25% (compared to 40% in Australia) of all mortgage business is placed through mortgage brokers. Indications are that this figure will continue to increase, although the Commission is of the view that mortgage brokers provide limited competition as they are not the main providers of mortgages.

338. The Commission found that most customers purchased fixed rate loans. After the term expires, customers tend to review their options. The Applicant stated that a customer wishing to switch finance providers may face all, or a combination, of the following costs:

- Legal costs associated with discharging an existing security and registering a new security. ANZ estimated that customers will pay a security discharge fee of $40 per security to transfer security for lending to another bank;
- Legal costs of preparing new loan documentation;
- Application fees for a new loan; and
- For a fixed rate loan, break costs of early termination.

339. Some banks offer a service whereby they will arrange the switch for customers by dealing with the old bank and resolving legal issues, and possibly paying some of the financial costs. Kiwibank has no establishment fees. Some of the banks stated that the gains from switching mortgages outweigh any switching costs. The Consumer Online website[31] provides information on switching and suggests that customers negotiate on the establishment fee which can be around $200-$600, on day-to-day banking fees and possibly on matching lower interest rates offered from old bank. However, it is not clear

[31] www.consumer.org.nz

how often customers attempt to negotiate these fees and whether they are successful. This could be where a mortgage broker could assist in negotiations with banks.

340. Data on customers switching mortgages has not been available, although changes in market share over a time period can provide some evidence. A report from the Centre of Banking Studies, Massey University[32] shows that during the past five years National has been the strongest player in the mortgage market and BNZ has been the weakest (see Graph 1 in Appendix One). National has maintained a high market share since 1998, while BNZ remained the weakest. Between 1996 and 2002, Westpac's market share in mortgages has been steadily declining, despite the acquisition of Trust Bank. During that period, ASB's market share has risen and ANZ has been declining in the past three years, despite it stating that it had reduced some of its loan fees. This could suggest that customers are switching to ASB and switching away from ANZ.

341. Another indication of customers switching can be the proportion of customers re-mortgaging. Re-mortgaging is currently a large component of the mortgage market and this has increased the banks' opportunities to compete for new customers at the end of their fixed terms (average 2-3 years) compared to previously where the opportunity to compete came only every 5-7 years when people changed houses. National stated that over the past year, existing home loan customers switching between providers has accounted for approximately [ ] of total new mortgage registrations. ANZ stated that [ ] of their mortgage activity in any year relates to customers re-mortgaging with ANZ and the remaining [ ] are new mortgages. Westpac stated that [ ] of their mortgage customers are re-mortgaging and [ ] are first home buyers. On the other hand, those that are remortgaging may be existing customers renewing their fixed terms with the same bank rather than customers switching banks.

342. With regards to price competition, it appears that Kiwibank currently has a mortgage rate that clearly leads the market. Consumer Online said that on 11 July 2003 Kiwibank offered a floating rate of 6.65% compared to ASB and National at 7.3% and ANZ, BNZ, Westpac at 7.35%.

Conclusion on Existing Competition in Mortgages

343. The Commission considers that post merger, there is likely to be sufficient competition provided from the other three major banks. In particular, competition would be provided by ASB because it has been successful in increasing its market share in this market and there is no reason to believe this will change as a result of the acquisition.

Potential Competition in Mortgages

344. A new entrant into the supply of mortgages would face similar barriers as those identified in the transaction account market, although a branch network would be less important.

345. Entry into the mortgage market is likely either by acquisition or through organic growth. For example, in April 2003, HSBC acquired AMP Bank's residential mortgage book. The acquisition will transfer loan assets and deposits of [ ].

[32] New Zealand Banks in the March Quarter 2003, David Tripe, Centre for Banking Studies, Massey University.

346. In September 2002, Kiwibank launched a mortgage with a low cost guarantee. A consumer survey[33] found that last year, 22% of those customers that were seriously considering switching to Kiwibank, showed an interest in mortgages. Kiwibank's mortgage portfolio is valued at [ ].

347. As with transaction accounts, the Commission considers that the presence of switching costs indicates that entry is unlikely to be sufficient in extent within the two year time frame.

348. Entry in the mortgage market can be considered to be timely due to entry of Kiwibank last year.

Conclusion on SLC in Mortgages

349. Compared to the counterfactual, the Commission considers that although potential competition is likely and timely but not sufficient in extent, there is sufficient existing competition from the three major banks to prevent a substantial lessening of competition in the supply of mortgages.

SME Banking

Existing Competition

350. The table below shows that the main players in the SME banking market are the major banks. In the supply of SME banking, the combined entity has a combined market share of [ ]. National Bank has a strong presence with a market share of [ ]. ANZ has lower market share of [ ].

351. Post acquisition, the three firm concentration ratio is [ ], which is outside the Commission's safe harbours.

[33] The Residential and Business Customer Survey by B.Lang, M.Colgate and A.Parsons, Marketing Department, University of Auckland. July and August 2002

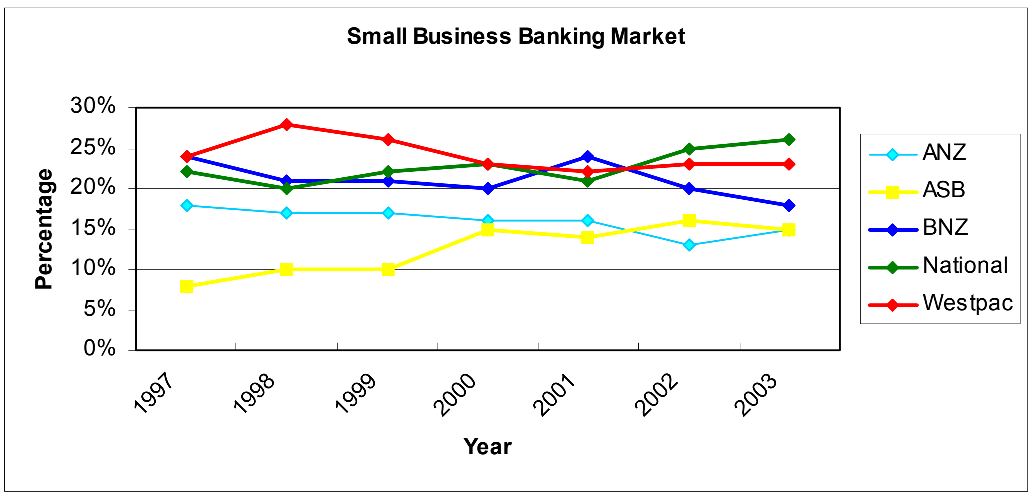
Table 14: Market Shares in SME Banking by FUM

Company	Market Share
ANZ	[ ]
National	[ ]
Combined	**[ ]**
BNZ	[ ]
Westpac	[ ]
ASB	[ ]
Others	[ ]
Post acquisition three firm concentration ratio is	[ ]

Source: ANZ based on ACNielsen Small Business Finance Monitor 2002

352. Market shares by SME customers[34] from 1997-2003 are shown in the graph below. ANZ's share of SME customers was 13% in 2002 and 16% in 2001. The graph also shows that National's market share has been relatively stable whilst ASB's market share has been continuously growing.

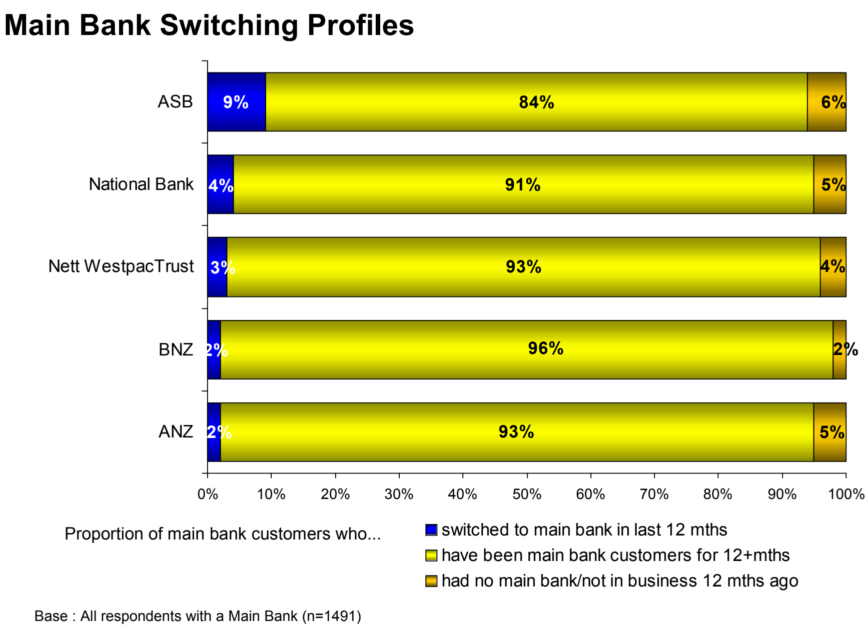
Graph 1: Market Shares by Customers in SME Banking



Source: ACNielsen Small Business Banking Monitor

[34] Small Business Banking definition: 1997-1999: Assets should not exceed $5 million: 2000-2003 Business Turnover should not exceed $5million. Data refers to percentage of small businesses, naming each bank as their main bank.

353. The Auckland University Customer survey[35] found that 10-15% of business bank customers consider switching every year, although only 3-5% actually switch banks. ANZ and National provided similar estimates of switching rates. ACNielsen data found that in 2002, around 90% of small businesses had been with the same main bank for the last twelve months while 4% had switched main bank. Of National Bank's main bank customers, 91% had been with them for twelve months or more, while 84% of ASB's customers had been with them twelve months or more.



Source: ACNielsen Small Business Banking Monitor 2002

354. As with transaction accounts, the presence of switching costs or customer satisfaction levels are likely to be the cause for a low level of switching. Most banks stated that switching was easy, although possibly not as easy for SME banking as for transaction accounts. The main switching cost identified for SME customers was the hassle and time involved in switching accounts, rather than the financial cost.

355. Switching SME banking between banks was considered to be time-consuming because customers have complex requirements and have multiple automatic payments and bill payments set up. There was also a fear that errors may be made in the switching process. For instance, an SME customer can miss crucial payments/receipts if the switching process is not well managed. Some banks handle errors better than others. [ ].

356. Some banks issue SME customers with a PC software package that allows them to manage their business banking needs electronically. This could make it more difficult for SME customers to switch accounts. SME clients that transact larger volumes and have more complex management structures may require a tailored software package such as ANZ Direct, which has a set up cost of $250. ANZ Direct is a computer based banking package that allows customers to perform cash management, funds transfers and

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[35] Business Customer Survey by B.Lang, M.Colgate and A.Parsons, Marketing Department, University of Auckland. July and August 2002

payments, account reporting and reconciliations from their office computer. Currently there are [ ] SME customers registered to ANZ's service.

357. On the other hand, one industry participant said that they had switched their business account from Westpac to National, with National managing the whole switching process for the company, and felt the process went quite smoothly. Some industry participants stated that internet banking amongst business customers was growing and this was making it easier for SME customers to switch banks.

358. The ACNielsen data provides some of the reasons for SME customers switching. It found that a third of main bank switchers had switched banks due to poor service. The Commission's investigations have also confirmed that poor service was often the trigger for switching banks. The ACNielsen data also found that a fifth of switchers had switched due to being offered a better package. Around 10% had shifted due to the bank not being interested in small businesses, a change in business/company policy, staff being difficult to relate to or the bank being inflexible.

359. Amongst small businesses that had changed their main bank in the last twelve months, over a third had gone to ASB, with National Bank and Westpac providing two thirds of the new customers. Nearly another 30% of switchers had gone to National, with half having come from BNZ.

360. A survey[36] found that of out of those considering switching, 25% of ANZ's customers would consider switching to National, while 19.4% of National customers would consider switching to ANZ. This suggests that there is likely to be some competition between National and ANZ in SME banking.

361. The same survey also found that some business customers of the major banks would consider switching to HSBC indicating that it could be credible alternative.

362. The choice of bank may also be affected by an individual's main personal bank. For example, around [ ] of ANZ and National SME customers have a personal account with the same bank. This choice factor was raised by the [

].

363. Despite the presence of switching costs, some SME customers are price sensitive and will shop around for the best deals. Some industry participants stated that the choice of bank was determined by who offered the lowest fees. An accountancy firm in Auckland stated that they had recommended ASB to their clients because it had low banking fees. ASB have a flat rate whereas Westpac has different fees for different transactions. For instance Westpac charges 0.35% of the cash amount deposited at the cashier and 0.25% for deposit boxes. [ ].

364. In the event that a major bank raised its fees, a survey found that some banks were more likely to lose SME customers than others depending on how well the quality of service provided by the bank was. The table below shows a lower percentage of National and ASB customers, suggesting that these customers were likely to pay a fee increase if it was satisfied with the quality of service provided by the bank.

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[36] Business Customer Survey by B.Lang, M.Colgate and A.Parsons, Marketing Department, University of Auckland. July and August 2002

Table 15: Business Customers That Would Switch If Its Bank Raised Its Fees

Bank	% of business customers that would switch
ANZ	40%
National	30%
ASB	20%
BNZ	30%
Westpac	30-40%

Source: Business Customer Survey by B.Lang, M.Colgate and A.Parsons, Marketing Department, University of Auckland. July and August 2002

Conclusion on Existing Competition in SME Banking

365. The Commission considers that the merger is likely to result in a reduction of choice and quality of service in the supply of SME banking. This is because National ranks highly in terms of customer satisfaction. Further there are switching costs in changing banks.

366. However, there are three other banks that SME customers could switch to, all of which would continue to compete on quality of service. Also banks are trying to make switching easier for SME customers and some industry participants stated that internet banking was popular with SME customers and was making switching accounts easier.

Potential Competition in SME Banking

367. A new entrant into the supply of SME banking will face the same barriers as a new entrant into the supply of transaction accounts, although the SME banking market appears to be more branch dependent than transaction accounts due to the need for deposit, cash and coin functions.

368. The main barrier an entrant would face is switching barriers. As with transaction accounts, SME customers do not switch accounts very often, which may make it more difficult for new entrants to establish market share. The Commission considers that switching costs for SME customers are larger than for transaction account customers due to the additional complexity of a SME customer's banking needs.

369. Existing competitors such as ASB, BNZ and Westpac do not face the same levels of barriers that a new entrant would face. However, expansion may be impeded by the difficulty in switching new customers. Despite this, the Commission considers that the remaining major banks have the capacity to expand and may have a window of opportunity in which to do so due to the expected attrition rate from the proposed merger.

<u>Likelihood of Entry</u>

370. [ ]. However, [ ].

371. [

].

372. [ ], the Commission considers that entry into the SME market is likely.

373. The Applicant has argued that GE Finance could easily enter the SME banking market. [

].

374. The Commission considers that entry is likely in the supply of SME banking.

Extent of Entry

375. [ ] considers the main impediment to extensive entry into the SME market is the reluctance of SME customers to switch. In order to overcome this, [

]. Also some industry participants stated that if [ ].

376. It is not clear how successful [ ] will be in the SME market, as evidence indicates that the rate of switching of SME customers is low. However the Commission is of the opinion that [ ] entry may provide customers with a credible alternative.

Timeliness of Entry

377. [ ] The Commission therefore considers that entry is likely to occur within the two year time period considered when assessing whether entry is likely to constrain the combined entity should it attempt to exercise unilateral market power.

Conclusion on Potential Competition in SME Banking

378. The Commission, therefore, considers entry into the supply of SME banking is likely and timely but not sufficient in extent.

Conclusion on SLC in SME Banking

379. Compared to the counterfactual, the Commission considers that the proposed acquisition is likely to result in a reduction of choice and quality of service in the SME market. This is because switching costs act as a barrier to customers switching business accounts and National ranks highly in terms of customer satisfaction. In addition, barriers to entry in the SME market are significant and there is limited countervailing power.

380. However, the Commission does not consider the reduction in choice and quality of service in the SME market to be substantial given the presence of ASB, BNZ and Westpac in this market. In particular, ASB will provide competition to the combined entity because it ranks highly in customer satisfaction surveys, its market share has been increasing and it has been trying to reduce switching costs to SME customers. Also, the

banks are trying to make switching easier for customers and some industry participants stated that internet banking was popular with SME customers and was making switching accounts easier. [ ] The Commission therefore considers that existing competition in the supply of SME banking will be sufficient to prevent the combined entity from exercising unilateral market power.

381. The Commission concludes that the merger is unlikely to increase the likelihood of co-ordinated market power in the supply of SME banking for the same reasons highlighted in the supply of transaction accounts.

Rural Banking

Existing Competition

382. In this market, the combined market share for the combined entity would be [ ] by FUM. Post acquisition, the three firm concentration ratio is [ ], which is outside the Commission's safe harbours.

Table 16: Market Shares in Rural Banking by FUM

Company	Market Share
ANZ	[ ]
National	[ ]
Combined	**[ ]**
BNZ	[ ]
Westpac	[ ]
ASB	[ ]
Rabobank	[ ]
Others	[ ]
Post acquisition three firm concentration ratio	[ ]

Source: ANZ based on ACNielsen Rural Finance Monitor 2002

383. National has a strong market share in the rural banking market. This is attributed to its acquisition of the Rural Bank from Fletcher Challenge in December 1992 and its subsequent growth. [ ] said that at present National was the market leader in the rural banking market because it was innovative, it offered a good finance package and it had a good quality of service and was considered to be the "farmer's friend".

384. The other 3 major banks are active in this market as is Rabobank, which is a specialist in rural banking. Rabobank provide services through an alliance with Wrightson which lets them operate through the 26 Wrightson branches. It has focused on the non-dairy side of

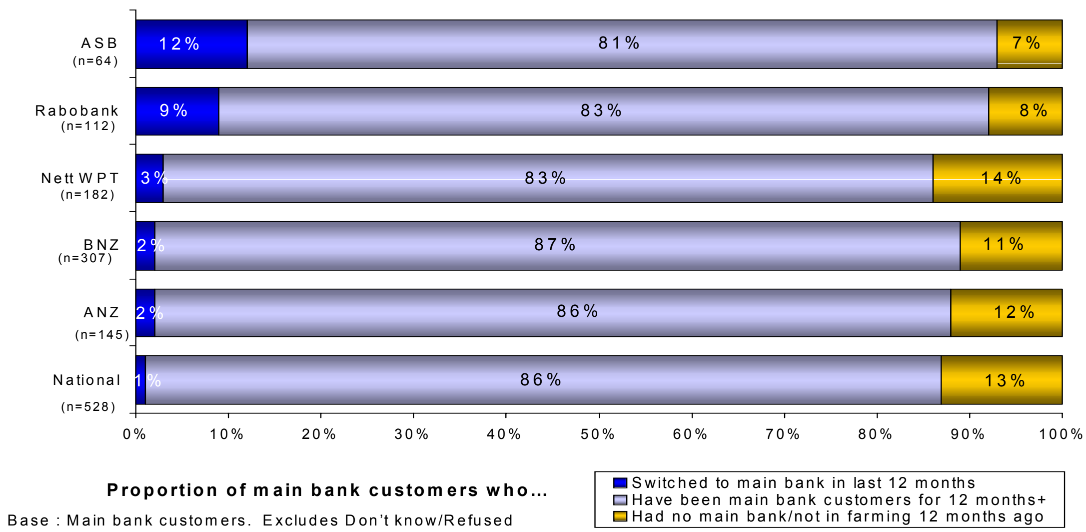
rural business (e.g. cropping and horticulture) because it considered there to be low margins in the dairy sector due to vigorous competition.

385. [ ] said that Rabobank provided tailor-made services and tended to supply the larger rural customers. It also said that ASB were strong providers in the rural banking market with a good financial package whilst ANZ and BNZ were not so strong.

386. The Commission found that each of the banks have mobile lenders that operate in different regions. These mobile lenders can be considered to be sales representatives that actively look for new customers as well as serve their existing customer base.

387. National estimated that around [ ] of rural customers a year switch banks and it had remained at this level for 6 years. The ACNielsen data also showed that 85% of respondents had been with their main bank for the last twelve months while 3% had switched main banks during that period.

Switching Profiles



Source ACNielsen Rural Banking Finance Monitor 2002[37]

388. The most common reason for farmers switching was being offered a better package (31%), rather than poor service (23%). "Poor performance/too many errors" was however another common reason for rural customer switching (15%). [

].

389. ASB and Rabobank's portfolios had the largest proportions of "switchers", 12% and 9% respectively. The "switchers" to Rabobank equated to 25% of all switchers.

390. Rabobank and ASB have been particularly competitive in the rural market and both have been achieving high growth. ASB has made a significant impact by focusing on price competition and driving down profitability margins.

[37] 2002 Rural Business Banking Definition: Gross Farm Income must exceed $100,000

391. [ ] considered there to be a reasonable amount of competition in the supply of rural banking. This was also noted by [ ] who said that each bank's mobile managers were actively seeking new customers. The [ ] said that post acquisition, it hoped it was business as usual and the new combined entity continued to have a commitment to providing banking services to the rural community. Post acquisition, if farmers were not happy with their rural banking service they would consider switching to Rabobank or ASB.

392. [ ].

393. In terms of price competition, [ ] both stated that there have been no fee changes during the period 2001-2003. [ ] said that some rural customers were loyal although they did shop around for the best deals.

Conclusion on Existing Competition in Rural Banking

394. The Commission considers that, post acquisition, the combined entity is likely to face sufficient existing competition in the rural market, particularly from ASB and Rabobank.

Potential Competition in Rural Banking

395. A new entrant into the supply of rural banking would face the same barriers as a new entrant into the SME banking. A new entrant will need to obtain branch managers and mobile lenders that have the knowledge and skills to deal with the banking needs of customers from the farming industry. For example National and Rabobank's mobile lender must have a degree from Lincoln or Massey University.

396. A new entrant would need to build customer relationships and access to a branch network is likely to be more important. For instance, TSB provides rural banking only in Taranaki.

<u>The LET Test</u>

397. Entry into the rural banking market has previously predominantly been through acquisition. For example, National has been strong in the rural sector due to its acquisition of the Rural Bank in December 1992.

398. Also, Rabobank entered the market in 1994 by entering into an alliance with Wrightson Limited in 1998 by purchasing Wrightson Farmers Finance Limited. In May 2003, Rabobank acquired AMP Bank's rural portfolio for [ ] which consisted primarily of rural mortgages coupled with a small amount of commercial lending

399. The extent of entry in the rural banking market could be limited due to the need to be a credible and knowledgeable supplier. [ ].

400. The Commission is not aware of any new entrants into the rural banking market in the last two years. However given that entry is likely through acquisition such acquisitions could be considered to be timely if the combined entity exercised unilateral market power.

401. As in SME banking, the Commission considers that new entry would be likely and timely but would be insufficient in extent in the supply of rural banking.

Conclusion on SLC in Rural Banking

402. Compared to the counterfactual, the Commission considers that existing competition, particularly from Rabobank which has just expanded and ASB, is sufficient to prevent the combined entity from exercising unilateral market power in the rural banking market.

403. The Commission concludes that the acquisition is unlikely to increase the likelihood of co-ordinated market power in the supply of rural banking for the same reasons highlighted in the supply of transaction accounts.

Credit Card Issuing

Existing Competition

404. In the issuing of credit cards, the combined entity would have a combined market share of [ ] by FUM. ANZ and National have similar market shares, namely [ ]. Post acquisition the three-firm concentration ratio is [ ]. This is outside the Commission's safe harbours.

Table 17: Markets Share in Credit Cards FUM

Company	Market Share
ANZ	[ ]
National	[ ]
Combined	**[ ]**
BNZ	[ ]
Westpac	[ ]
ASB	[ ]
Others	[ ]
Post acquisition three firm concentration ratio	[ ]

405. The Applicant states that there are in excess of 18 credit card issuers. However the major four banks represent [ ] of the market. BNZ has the highest market share in the issuing of credit cards, followed by Westpac.

406. Each major bank offers several credit cards with different offerings such as reward schemes to suit different customer needs. For example, BNZ has an agreement with Fly Buys. The banks stated that it is important to differentiate product. [

].

407. [ ] stated that the loyalty aspect of credit cards was becoming increasingly important for higher socio-economic cardholders and this could make the credit card business generally less profitable. On the other hand, [ ] stated that the issuing of credit cards is not competitive and highlighted the stable interest fees as being evidence. It stated that the major banks were making super profits on interest rates and loyalty schemes which did not really compensate cardholders for the high interest rates paid. [
].

408. However, a customer will take into account numerous factors when deciding which credit card to subscribe to. Such factors will depend on purchasing habits, whether the credit card balance is paid every month and whether there are gains from a particular type of reward scheme. If a customer values the ability to obtain credit, then a credit card with lower interest rates would be more attractive.

409. Kiwibank are currently offering a low interest credit card at 12.9% aimed at people using the credit card facility, rather than paying off the balance every month. Its rivals currently have an interest rate of about 19%, with an annual fee at $38.

410. The most notable fee increases in ANZ credit cards have been:

- [

].

Conclusion on Existing Competition in Credit Cards

411. In conclusion, post acquisition, there is likely to be sufficient existing competition provided by the major banks, in particular, BNZ, in the supply of credit cards..

Potential Competition in Credit Cards

412. In the supply of credit cards a new entrant would need to have access to credit card payments systems (ETSL or ENZ) and access to ATMs. To provide a credit card for international use a new entrant would need to negotiate with Visa New Zealand or Mastercard. For instance NZ Credit Unions have a credit card but it is for New Zealand use only. [
].

413. The Commission found that a new entrant would need to have a different product offering either in the form of a low interest rate, or a rewards scheme in order to be competitive.

<u>The LET Test</u>

414. The Commission considers entry is likely and timely. For example, in July 2003, Kiwibank introduced a low interest credit card at 12.9%. [

].

415. However entry in the supply of credit cards may not be sufficient in extent. [

]

416. The Commission is of the view that entry into the supply of credit cards is likely, timely but not sufficient in extent as customers may prefer the reward schemes from existing credit card providers.

Conclusion on SLC in Credit Cards

417. In conclusion, the Commission considers that there is unlikely to be a substantial lessening of competition in the supply of credit cards because there is sufficient existing competition from the other three major banks.

418. The Commission concludes that the merger is unlikely to increase the likelihood of co-ordinated market power in the supply of credit cards for the same reasons highlighted in the supply of transaction accounts.

Merchant Acquiring Services

Existing Competition

419. In the supply of merchant acquiring services the Applicant provided market share for credit card and debit card transactions. Market shares are measured by the value of transactions routed by each bank.

420. The table below shows that the combined entity would have similar market shares in the supply of credit card and debit card transactions, namely [ ]. However, Westpac has the largest market share with [ ] for debit card transactions and [ ] for credit card transactions.

421. The post acquisition three firm concentration ratio is around [ ] for debit card transactions and [ ] for credit card transactions. These market shares are well outside the Commission's safe harbours.

Table 18: Market Share of Credit Card and Debit Card Merchant Acquiring Services

Bank	Debit Card in $	%	Credit Card in $	%
ANZ	[ ]	[ ]	[ ]	[ ]
National	[ ]	[ ]	[ ]	[ ]
Combined	**[ ]**	**[ ]**	**[ ]**	**[ ]**
Westpac	[ ]	[ ]	[ ]	[ ]
ASB	[ ]	[ ]	[ ]	[ ]
BNZ	[ ]	[ ]	[ ]	[ ]
Post acquisition three firm concentration ratio		[ ]		[ ]

Source ANZ estimates

422. The Commissions has found that banks actively compete to provide merchant acquiring services. However, some industry participants have stated that banks will cherry pick the merchant. It was highlighted that banks will target high value, low risk merchants rather than low value and high volume merchants like supermarkets.

423. [

].

424. [

].

425. [

].

426. [ ] stated that it is very easy to switch acquiring banks. For example, [

].

427. Merchants may incur penalties for switching if they do so before their contract with the merchant acquirer is up. However, some banks will pay these penalty clauses to encourage merchants to switch. Also the term of these contracts has been decreasing due

to an increase in competition. Contracts for merchant acquiring services can range from a week to about 3 years.

428. Some of the larger merchants are also likely to have countervailing power. [

].

Conclusion on Existing Competition in Merchant Acquiring Services

429. The Commission's view is that post acquisition, there is sufficient existing competition provided from the other major banks, in the supply of merchant acquiring services. This is because the combined entity will provide merchant acquiring services that routes through its own payment processing system and will compete actively with the other banks to gain economies of scale.

Potential Competition in Merchant Acquiring Services

430. Entry into merchant acquiring is unlikely for the same reason that development of a new payment processing system for credit card and debit card transactions are unlikely. This was considered in paragraphs 278-288.

Conclusion on SLC in Merchant Acquiring Services

431. In the supply of merchant acquiring services, there will be sufficient existing competition provided by the major banks despite there being insufficient potential competition. It is the Commission's view that the acquisition is unlikely to substantially lessen competition in the supply of merchant acquiring services. This is because there is evidence of the banks actively competing and larger merchants exercising countervailing power. It should be noted that the Commission is currently investigating the setting of interchange fees in credit card transactions in New Zealand. This is a separate investigation and does not affect the Commission's analysis of the proposed acquisition.

Savings Accounts

Existing Competition

432. The Applicant provided separate market shares for term deposits and call accounts. In the supply of term deposits the combined entity would have a market share of [ ] and in the supply of call accounts the combined entity would have [ ]. Post acquisition, the three firm concentration ratio for term deposits and call accounts would be [ ] and [ ] respectively, both of which are outside the Commission's safe harbours.

Table 19: Share of Term Deposit Balance and Share of Savings Call Account Balance

Company	Term Deposits	Call accounts
ANZ	[ ]	[ ]
National	[ ]	[ ]
Combined	**[ ]**	**[ ]**
ASB	[ ]	[ ]
Westpac	[ ]	[ ]
BNZ	[ ]	[ ]
Others	[ ]	[ ]
Post acquisition three-firm concentration ratio	[ ]	[ ]

Source: ACNielsen Financial Monitor

433. ANZ has a slightly higher market share if measured by customers. [ ]. Further the Auckland University survey[38] in 2002, found that out of the five major banks and TSB, ANZ had the highest take up of savings accounts.

434. However, Westpac and National also have a strong presence in the savings market.

435. In the supply of savings accounts, switching banks is less of an issue than in transaction accounts. [ ].

436. Given that savings accounts do not require frequent access to cash, customers are likely to consider banks with different distribution channels. Further, customers are likely to choose a second bank for a saving account if their main bank offered a lower interest rate on their savings products.

437. In the supply of savings accounts, the "others" category is made up of Kiwibank, TSB as well as non-bank financial institution that specialise in savings accounts. Non-bank financial institutions like building societies could provide alternatives to consumers. Customers of non- bank financial institutions are likely to be loyal as some customers have held accounts since an early age.

Potential Competition in Saving Accounts

438. The barriers to entry in the supply of savings accounts are the same as those for the supply of transactions accounts. The most notable barrier is brand recognition. [ ].

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[38] The Residential and Business Customer Survey by B.Lang, M.Colgate and A.Parsons, Marketing Department, University of Auckland. July and August 2002

439. However, entry into the savings market is easier than entry into the supply of transaction account. With a savings account there is less of a need to provide frequent access to money, like automatic payments and direct debits, and there is less need for access to payment systems and branch networks. For example TSB offers customers outside of Taranaki a savings product which can be accessed through the internet, telephone and post. HSBC also offers an online savings account.

440. On the other hand, consumer purchasing behaviour is affected by inertia and consumers tend to purchase savings products from the same bank they have their transaction accounts with.

<u>The LET Test</u>

441. The Commission is of the view that entry into the savings market is likely and timely. For example, in February 2003, Superbank entered the banking industry with a savings product. Superbank said that it chose to enter with a savings account because [

].

442. However, as in the transaction accounts market, the extent of entry into the supply of savings accounts may be limited. This is because consumer purchasing behaviour is affected by inertia, and some customers may be reluctant to move their money to accounts offering better interests.

Conclusion of SLC in Savings Market

443. The Commission considers that, post acquisition, there is likely to be sufficient existing competition and some potential competition in the supply of savings accounts.

444. The Commission concludes that the merger is unlikely to increase the likelihood of co-ordinated market power in the supply of savings accounts for the same reasons highlighted in the supply of transaction accounts.

OVERALL CONCLUSION

445. The Commission has considered the probable nature and extent of competition that would exist in the following relevant markets:

- Interbank trading in the foreign exchange market;
- Interbank trading in the money market;
- Interbank trading in the bond market;
- The national retail supply of financial planning services;
- The national retail supply of managed funds;
- The national supply of domestic house and contents insurance;
- The national supply of domestic motor vehicle insurance;
- The national supply of commercial motor vehicle insurance;
- The national supply of commercial property insurance;

- The national supply of commercial liability insurance;
- The national retail supply of personal loans;
- The national retail supply of corporate banking;
- The national retail supply of transaction accounts;
- The national retail supply of mortgages;
- The national retail supply of SME banking;
- The national retail supply of rural banking;
- The national retail supply of savings accounts;
- The national retail supply of credit cards; and
- The national retail supply of merchant acquiring services.

446. The Commission notes that National could be purchased by another business, either a bank that is not one of the five major banks in New Zealand, or another business not currently active in the banking industry. Alternatively National may not be sold and may remain as a major competitor in the New Zealand banking industry. These options all point to National remaining in the market as a major bank in the event that ANZ did not purchase National. Therefore the Commission considers the relevant counterfactual to be the status quo.

447. The Commission has considered the nature and extent of the contemplated lessening of competition in each of the relevant markets.

448. With the exception of managed funds, insurance, financial planning services (where the aggregation is minor), the combined entity would have a market share of [ ] in the relevant markets. Post acquisition, the three firm concentration ratio is outside the Commission's safe harbours in these relevant markets.

449. The Commission has also considered the nature and extent of the contemplated lessening, in terms of the competitive constraints that would exist following the merger from:

- Constraint posed by existing competition;
- Ease of entry by potential competitors; and
- Countervailing power by large purchasers.

450. The Commission considered the aggregation in managed funds, insurance services, financial planning services and inter-bank trading in foreign exchange market, money market and bond market. None of these activities raised any competition issues. In the relevant markets for insurance, the aggregation was minor as insurance companies are the major providers of insurance. In the supply of financial planning services, there are numerous companies active throughout New Zealand. In the supply of managed funds, the combined entity would have a market share of [ ]. National has a small market share of [ ]. This aggregation is minor and, post merger, there will be sufficient competition provided from the major banks and from a wide range of other local and Australian independent providers.

451. The Commission's investigation found that the merger would not lead to a substantial lessening of competition in interbank trading in the foreign exchange market, domestic money market and in the bond market in New Zealand. In the money market, the acquisition may affect the ability of the major banks to domestically fund their activities. However, the Commission found that banks can fund their activities offshore.

452. In the supply of personal loans, the merger is unlikely to result in a substantial lessening of competition because there are several other competitors in the market, including non-financial institutions. Further, barriers to entry into the supply of personal loans are not significant and the combined entity would be constrained by potential competition.

453. In the supply of corporate banking, the merger is unlikely to lead to a substantial lessening of competition. This is due to existing competition, competition from overseas banks and countervailing power from the larger corporate customers.

454. The Commission considers that compared to the counterfactual where National remains as a competitor, the proposed acquisition is likely to reduce choice and quality of service in the supply of transaction accounts. This is because National is considered to be a bank that customers would consider switching to due to its quality of service. Further, there are switching costs in changing banks, barriers to entry in the supply of transaction accounts are significant and there is limited countervailing power.

455. However, banks are trying to change customer perceptions on switching accounts, particularly with the current expectation by banks that customers will switch post merger. It is considered that the combined market shares of the new entity are likely to be lower than those provided by the Applicant. Also customers are avoiding switching costs by migrating, namely opening new accounts and not closing old accounts.

456. In addition, survey evidence suggests that competition in the supply of transaction accounts between National and ANZ is not considered to be significant and post acquisition, there will be sufficient existing competition provided from BNZ, Westpac, Kiwibank and particularly from ASB from a quality of service perspective. Consequently, the Commission considers that there is a sufficient range of quality and price options from existing competition to prevent the combined entity from exercising any unilateral market power.

457. Also, the merger is unlikely to increase the likelihood of co-ordinated market power in the supply of transaction accounts because the fringe players are likely to provide some competition, the banks have different strengths and weaknesses and in particular ASB is unlikely to have the incentive to participate in co-ordinated power at the expense of its recent growth and customer satisfaction levels. This analysis of co-ordinated market power applies to each of the relevant markets. Therefore the acquisition is unlikely to lead to a substantial lessening of competition in the supply of transaction accounts.

458. In the supply of mortgages, savings accounts and credit cards, the merger is unlikely to lead to a substantial lessening of competition, as in each of these markets, ASB, Westpac and BNZ are likely to provide sufficient competition to the combined entity.

459. As with transaction accounts, the merger is likely to result in a reduction in choice and quality of service in the supply of SME banking . This is because National ranks highly

in terms of customer satisfaction. In addition, there are switching costs in changing banks, barriers to entry in the SME market are significant and there is limited countervailing power.

460. However, the Commission does not consider the reduction in choice and quality of service in the supply of SME banking to be substantial given the presence of ASB, BNZ and Westpac in this market. In particular, ASB will provide competition to the combined entity because it ranks highly in customer satisfaction surveys, its market share has been increasing and it has been trying to reduce switching costs to SME customers. Generally, the banks are trying to make switching easier for customers and some industry participants stated that internet banking was popular with SME customers and was making switching accounts easier. [ ] The Commission therefore considers that existing competition in the supply of SME banking will be sufficient to prevent the combined entity from exercising unilateral market power. The merger is unlikely to lead to a substantial lessening of competition in the supply of transaction accounts.

461. In the supply of rural banking, the merger is unlikely to lead to a substantial lessening of competition because there is sufficient competition from existing competitors, particularly Rabobank. Rabobank is a nationwide specialist in rural banking and has recently expanded by acquiring AMP Bank's rural mortgage portfolio.

462. In the supply of credit card/debit card merchant acquiring services the main players are the banks. Entry into this market is unlikely as it is costly to set up a payment processing system that will route all credit card and debit card transactions. A new entrant would need to negotiate access with an existing participant.

463. However, the Commission's investigation found that the banks actively competed for merchant acquiring business and some of the larger merchants had exercised their countervailing power to affect price, therefore removing any likelihood of a substantial lessening of competition.

464. The Commission is satisfied that the proposed acquisition would not have, nor would be likely to have, the effect of substantially lessening competition, in the following markets.

- Interbank trading in the foreign exchange market;
- Interbank trading in the money market;
- Interbank trading in the bond market;
- The national retail supply of financial planning services;
- The national retail supply of managed funds;
- The national supply of domestic house and contents insurance;
- The national supply of domestic motor vehicle insurance;
- The national supply of commercial motor vehicle insurance;
- The national supply of commercial property insurance;
- The national supply of commercial liability insurance;
- The national retail supply of personal loans;
- The national retail supply of corporate banking;

- The national retail supply of transaction accounts;
- The national retail supply of mortgages;
- The national retail supply of SME banking;
- The national retail supply of rural banking;
- The national retail supply of savings accounts;
- The national retail supply of credit cards; and
- The national retail supply of merchant acquiring services.

DETERMINATION ON NOTICE OF CLEARANCE

465. Accordingly, pursuant to section 66(3) (a) of the Commerce Act 1986, the Commission determines to give clearance for the proposed acquisition of

Dated this 25th day of September 2003

Denese Bates QC
Division Chair
Commerce Commission

APPENDIX ONE

Table 1: Personal Customers switching behaviour – from where to where?

			FROM Main Banks					
			ANZ	ASB	BNZ	National Bank	Westpac Trust	Total
TO MAIN BANK	**ANZ**	% within Main Banks		*4.8%*		*5.3%*	*4.4%*	*2.5%*
	ASB	% within Main Banks	*17.9%*		*23.5%*	*5.3%*	*15.6%*	*14.6%*
	BNZ	% within Main Banks	*2.6%*	*4.8%*		*5.3%*	*8.9%*	*4.4%*
	Kiwibank	% within Main Banks	*33.3%*	*38.1%*	*29.4%*	*36.8%*	*26.7%*	*31.6%*
	National Bank	% within Main Banks	*12.8%*	*19.0%*	*14.7%*		*13.3%*	*12.7%*
	PSIS	% within Main Banks	*10.3%*	*4.8%*	*5.9%*	*10.5%*	*15.6%*	*10.1%*
	TSB	% within Main Banks	*10.3%*	*9.5%*	*17.6%*	*15.8%*	*11.1%*	*12.7%*
	Westpac Trust	% within Main Banks	*12.8%*	*14.3%*	*5.9%*	*5.3%*		*7.0%*
	BankDirect	% within Main Banks		*4.8%*		*5.3%*		*1.3%*
	Building Society	% within Main Banks					*2.2%*	*.6%*
	Credit Union	% within Main Banks				*5.3%*		*.6%*
	AMP	% within Main Banks					*2.2%*	*.6%*
	Cutknife Credit Union	% within Main Banks			*2.9%*	*5.3%*		*1.3%*
	Total	% within Main Banks	*100.0%*	*100.0%*	*100.0%*	*100.0%*	*100.0%*	*100.0%*

Source: Residential Customer Survey by B.Lang, M.Colgate and A.Parsons, Marketing Department, University of Auckland. July and August 2002

Note: The proportion of switches from ASB Bank and Nationals Bank needs to be interpreted with caution due to their small numbers (21 and 19 respectively).

Table 2: Business Customers switching behaviour – from where to where?

% within new main		Current					Total
		ANZ	**ASB**	**BNZ**	**National Bank**	**Westpac Trust**	
New Bank	**ANZ**		*11.1%*	*11.1%*	*19.4%*	*11.1%*	*10.9%*
	ASB	*25.0%*		*35.6%*	*19.4%*	*26.7%*	*25.9%*
	BNZ	*18.2%*	*22.2%*		*25.8%*	*17.8%*	*14.9%*
	National	*25.0%*	*33.3%*	*24.4%*		*26.7%*	*21.8%*
	WestpacTrust	*11.4%*	*11.1%*	*17.8%*	*9.7%*		*9.8%*
	BankDirect	*2.3%*		*2.2%*	*12.9%*	*2.2%*	*4.0%*
	TSB	*2.3%*			*6.5%*	*6.7%*	*3.4%*
	AMP	*4.5%*	*11.1%*	*2.2%*			*2.3%*
	Building Society					*2.2%*	*.6%*
	HSBC	*6.8%*	*11.1%*	*6.7%*			*4.0%*
	Citibank				*3.2%*	*4.4%*	*1.7%*
	Other					*2.2%*	*.6%*
	Total	*100.0%*	*100.0%*	*100.0%*	*100.0%*	*100.0%*	*100.0%*

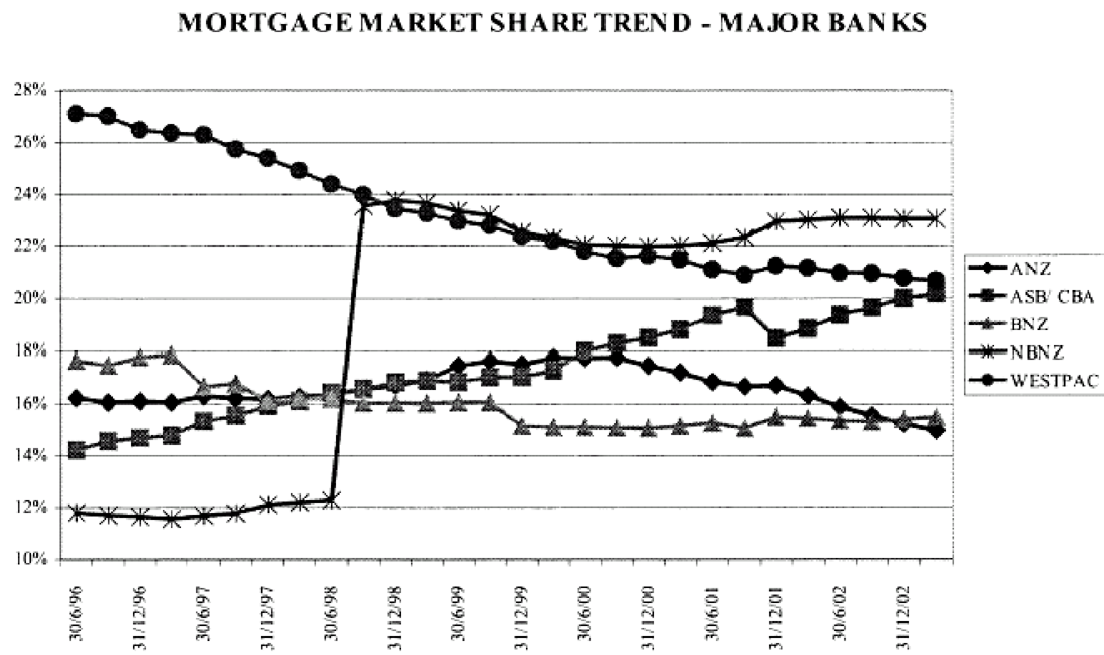
Source: Business Customer Survey by B.Lang, M.Colgate and A.Parsons, Marketing Department, University of Auckland. July and August 2002

Table 3: ANZ Interchange Agreements With Non-ETSL Card Providers

[

]

Graph 1: Market Shares in the Supply of Mortgages During 1996-2002



Source: New Zealand Banks in the March Quarter 2003, David Tripe, Centre for Banking Studies, Massey University.