Kiwibank's Submission in response to the Commerce Commission's draft report into Personal banking services market study – 18 April 2024

Executive Summary

Kiwibank Limited (**Kiwibank**) thanks the Commerce Commission (**Commission**) for the draft report into Personal banking services market study released on 21 March 2024 (**Draft Report**) and the substantial amount of work that has gone into preparing it. Overall, Kiwibank supports most of the analysis contained in the Draft Report: noting that many of the findings are consistent with our submissions and those contained in Kiwibank's joint submission with The Co-operative Bank Limited (**Co-op**), SBS Bank (**SBS**) and TSB Bank Limited (**TSB**) (**First Joint Submission**). The critical point of difference at this stage between Kiwibank and the Draft Report is the recommendation relating to expanding the types of open banking solutions required and expediting their delivery by Kiwibank in particular. That recommendation cuts across the macro theme of the Draft Report, being to encourage competition in the market in part through Kiwibank better fulfilling its current "maverick" role at scale.

Kiwibank sets out below the Commission's 16 draft recommendations and provides commentary on each recommendation.

Kiwibank has also participated in a further joint submission on selected topics with Co-op, SBS and TSB (**Second Joint Submission**). We have noted this in the response where appropriate.

Improve the capital position of smaller providers and Kiwibank

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

   Kiwibank supports this recommendation.

   Kiwibank welcomes the Commission's findings around the capital settings in New Zealand and is supportive of the draft recommendations that the Reserve Bank of New Zealand (**Reserve Bank**) consider whether the same level of capital should be held where the risk on home lending is likely to be identical regardless of IRB accreditation. The Second Joint Submission addresses this point. The capital advantage enjoyed by the major banks has had a material impact on the competitive ability of the smaller banks for a number of years. It is critical to a levelling of the playing field that the Reserve Bank consider our views and those of the Commission on this topic.

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

   Kiwibank supports this recommendation.

   Kiwibank notes the Commission's finding that there is currently no "maverick" in the banking sector in New Zealand. Kiwibank is up for the challenge of fulfilling that role with our focus on being the best bank we can for New Zealand, aligned to our purpose of Kiwi Making Kiwi Better Off. Kiwibank has been successfully growing market share for some time now, supported in part by $225m of additional capital injected in July 2023 by its parent Kiwi Group Capital Limited (KGCL), and would welcome more access to capital to deliver on its purpose. Kiwibank is currently focussed on a multi-year transformation that will deliver more scalable systems to enable it to further accelerate its current growth rate to compete as the "maverick". Any capital injection would need to take timing of the transformation into account in order to maximise value. Ultimately, any decision around access to more capital sits with our shareholder, KGCL, and ultimate parent the Crown.

Accelerate progress on open banking

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

   Kiwibank does not support this recommendation. Much of the Draft Report focusses on the potential accommodating behaviour and lack of competition between the four Australian-owned banks (classified by the Reserve Bank as Domestic Systemically Important Banks (**D-SIBs**)). However, for reasons that are not made clear in the Draft Report, its recommendation as to open banking's adoption extends beyond the D-SIBs to include Kiwibank. Kiwibank considers that the Commission should reassess this recommendation on the basis that:

   - The recommendation has an outsized impact on Kiwibank compared to the D-SIBs without any empirical analysis as to why the recommendation is required. This is contrary to the overall focus of the Draft Report.
   - The staged adoption of open banking is a well-trodden path in overseas jurisdictions and is even more relevant in a small market like Aotearoa. The current phasing adopted by the API Centre should be retained.
   - The Draft Report (illustratively, at para 9.11) notes the historic underinvestment from banks in their core banking systems. Kiwibank has already commenced a multi-year transformation and has a dedicated roadmap to achieve this. However, adopting the current draft recommendation will delay that transformation, requiring Kiwibank to dedicate resources away from that important goal.
   - The draft recommendation also requires Kiwibank to establish open banking solutions that have not even been adopted overseas in more mature (and deeper) financial services markets. The basis for both expediting and extending open banking in a small jurisdiction is not apparent on the face of the Draft Report.

   As the Draft Report notes, regulatory change has a disproportionate impact on smaller banks, like Kiwibank, and constrains their ability to compete. Payments New Zealand has agreed to a staged approach to delivering open APIs, with the D-SIBs due to deliver them in 2024, and Kiwibank to follow in 2026. This is a proportionate approach that recognises the different sizes of industry participants and the fact that smaller banks, like Kiwibank, do not have the resources to build and

deliver open APIs within the same timeframes as the D-SIBs. It also reflects the approach taken in other jurisdictions like the UK and Australia. The Draft Report suggests that Kiwibank should meet the same delivery timeline as the D-SIBs, without providing any empirical analysis displaying a reason for this that would outweigh the anti-competitive effects.

Additionally, Kiwibank is part way through a significant multi-year transformation to upgrade its core banking system (**Transformation**). These changes will enable Kiwibank to be more agile, innovative, and responsive to customer demand. Ultimately, they will help Kiwibank to compete with the D-SIBs, foster innovation and achieve its purpose of Kiwi Making Kiwi Better Off.

Our Transformation includes the modernisation of key platforms and technology infrastructure which underpin our ability to expose data to third parties in a safe, resilient and reliable way. We are currently unable to do this using our existing technology stack. Accordingly, Kiwibank is planning to deliver open banking as part of our Transformation.

If Kiwibank is required to deliver open banking earlier than planned, this would mean delaying the Transformation and the competitive benefits it will give rise to. Additionally, Kiwibank would need to deliver open banking using its existing core systems, necessitating the utilisation of sub-optimal tactical solutions which come with significant limitations, including concerns regarding security and user experience (for both customers and third parties).

The Draft Report also recommends an expansion to the scope of the proposed open banking regime to include APIS relating to product information, and 'other actions' initiation such as opening and closing accounts. To deliver these, Kiwibank would need to complete its Transformation, because the current technology stack and system of record cannot cater for them. 'Other action' initiation capabilities, such as opening and closing accounts, are not features enabled in countries that are well advanced in their open banking journeys, such as the UK and Australia. We believe that the current Implementation Plan (relating to payment initiation and account information services) provides solid ground to foster competition and innovation.

The Draft Report also states that the five largest banks (which includes Kiwibank) should provide and accept digital identity credentials by June 2026. If participation in the digital identity ecosystem was mandated as suggested by the Commission, this would delay the implementation of our Transformation and our open banking work programme.

Finally, keeping customers safe is a key priority for Kiwibank and any changes to the scope and delivery timeframes for open banking and digital identity services need to also be carefully considered from the perspective of fraud risk and other unintended consequences, particularly when considering introducing new services such as opening and closing accounts which could be harnessed as a tool for fraud.

4. The Government should reduce the barriers imposed by the AML/CFT regime on banks working with fintechs.

Kiwibank is generally supportive of this recommendation. However, the draft recommendation needs to recognise that fintechs, as with any financial services provider, lie across a continuum of risk in terms of AML/CFT. So there may not be a single solution for the issue.

Kiwibank is aware of the recommendations put forward under the AML/CFT Statutory Review with regards to reducing friction for fintechs wanting to obtain and retain a bank account and is supportive of any further work in this regard.

While Kiwibank is supportive of the AML/CFT supervisors releasing a code of practice to on-board higher risk businesses (and thereby providing a safe harbour for banks), and also a licensing framework for higher-risk sectors (such as virtual asset service providers), Kiwibank will always consider its own internal risk appetite and its purpose in determining who to offer banking services to, as it does with any customer type.

In addition to the recommendations under the AML/CFT Statutory Review, we note the Commission's comment at paragraph 9.54.1, *"A single agency may also be more willing to provide guidance for fintechs"*. Kiwibank submits that detailed, bespoke guidance for fintechs on what their AML/CFT Risk Assessment and Programme should include would be beneficial and should be considered regardless of the other recommendations. Kiwibank notes that some fintechs may not fully understand what their obligations are or what is required to evidence they have adequate policies, processes, and controls in place to manage their AML/CFT risks.

Kiwibank would encourage consultation on the idea of a higher-risk sector licence to understand any unintended consequences. One risk we foresee is that, by creating a licensing regime, only those who pay to get licensed will be able to get a bank account, with anyone else potentially missing out. It could have the unintended consequence of creating a divide in the market and stifling competition and innovation. Smaller players could be shut out on the basis of compliance cost (for a license) and therefore unable to get a bank account because they are not licensed.

Kiwibank does not have a policy of 'de-risking' or 'de-banking' and does not have a prohibition on banking fintechs or businesses in higher-risk sectors such as virtual assets. Each prospective customer is assessed on a case-by-case basis.

Ensure the regulatory environment better supports competition

5. The Reserve Bank should use its new decision-making framework under the DT Act to explicitly and transparently consider competitive effects.

Kiwibank supports this recommendation.

We agree that greater transparency around how s 4(b) of the DTA (and the other purposes and principles of the Act) is being applied would aid understanding of the rationale for, and policy trade-offs influencing, the Reserve Bank's decision making. It would also enable deposit takers to give more targeted and constructive feedback to the Reserve Bank on those decisions. In particular, we support greater transparency in relation to the competitive effects of decisions regarding the DCS levy, as explained below in response to recommendation 6. However, we note that we do not support the Reserve Bank's mandate being expanded to seeking "pro-competitive" outcomes for the reasons explained below in response to recommendation 8.

6. The Reserve Bank should explicitly and transparently articulate how it is applying the purposes and principles of the DT Act to its Deposit Compensation Scheme levy advice.

Kiwibank supports this recommendation.

Kiwibank supports the Reserve Bank's preference to adopt a risk-based approach to setting the DCS levy. However, we agree that the Reserve Bank should clearly articulate its reasons for that decision, including how it applied s 4(b) of the DTA, when giving advice to the Minister.

As explained in our submission to the Reserve Bank on its consultation Levy Framework for the Depositor Compensation Scheme,[1] Kiwibank's view is that a risk-based model is necessary to incentivise deposit takers to ensure that they have appropriate policies and processes in place to effectively manage risk. Without this, there is an unacceptably high risk of moral hazard. We consider that this approach to setting the DCS levy can be justified if deposit takers are grouped in risk buckets along with their key competitors. That way, there is a level playing field as between competitors, but not necessarily as between deposit takers operating and competing in different parts of the market.

However, both Kiwibank's submission and a joint submission with Co-op, TSB and SBS on the Reserve Bank's consultation[2] raised concerns with the 'strength' risk indicator proposed by the Reserve Bank on the basis that it unfairly advantages the D-SIBs. This risk indicator would treat the D-SIBs, which are permitted to use IRB modelling, as 'safer' than standardised banks when the underlying risk exposure and the amount of loss absorbing capital held is the same. To take reported IRB capital ratios at face value and treat them as equivalent to standardised ones is, in our view, inconsistent with s 4(b) of the DTA. This is because it fails to account for regulatory advantages that the IRB banks enjoy in the calculation of their capital ratios. We submitted that the capital adequacy risk indicator should be based on the standardised capital ratio for all banks to enable an apples-with-apples comparison (this is possible as a result of the implementation of dual reporting).

Based on the preferred options set out in the Reserve Bank's subsequent consultation Depositor Compensation Scheme Regulations, our submission does not appear to have been taken on board, nor has the Reserve Bank explained why. For this reason, we welcome the Reserve Bank's advice to the Minister explaining the policy justification and competition implications of this choice when, on its face, it appears to bake-in the D-SIB capital advantage therefore undermining competition.

7. The Reserve Bank should consider broadening access to ESAS accounts.

Kiwibank does not have any substantive feedback on this recommendation, beyond noting that the risk assessment framework that applies to entities seeking access to an ESAS account must be properly considered.

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

Kiwibank supports the spirit of this recommendation.

However, in our view, if s 4(b) of the DT Act is amended, it should be done so in a way that is consistent with the twin peaks model of financial services supervision. As explained below, we consider that s 4(b) should instead be amended to provide that, when exercising its powers, functions, and duties under the Act, the Reserve Bank "should not undermine competition in the deposit taking sector". This is discussed further in the Second Joint Submission.

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[1] Available on the Reserve Bank's website here, at page 63: https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/consultations/deposit-takers-act/dcs-levy-submissions.pdf

[2] Available on the Reserve Bank's website here, at page 55: https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/consultations/deposit-takers-act/dcs-levy-submissions.pdf

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

   Kiwibank supports this recommendation.

   In particular, we support the recommendation that Government and regulators transparently consider the effects on competition when making decisions, and undertaking a review of existing regulation and legislation to ensure competitive neutrality.

   Regarding the examples listed at paragraph 7.110 of the Draft Report, we acknowledge that these legislative and regulatory responses may have unintentionally caused disadvantage to some smaller entities. However, we consider that the policy reasons for the differential treatment of registered banks in those circumstances were justified. We agree that it may be beneficial to prepare a playbook to help guide decision makers working under urgency and in emergency situations. In particular, guidance could provide for a non-exhaustive list of policy reasons which may justify a departure from the principle of competitive neutrality. This would improve transparency and accountability for decisions, and of decision makers. Given the vast majority of those decisions are driven by MBIE, they would seem to be the most appropriate agency to lead that initiative.

10. **The CCCFA Act should be competitively neutral with respect to home loan refinancing to make it easier for consumers to switch providers.**

    Kiwibank supports this recommendation.

    Kiwibank agrees that the CCCFA should enable positive competition between banks – particularly when customers might consider switching (or refinancing) their mortgages. The risk of hardship resulting from refinancing is very low – if appropriate affordability checks were undertaken at the time the lending was approved, it shouldn't matter that the customer later decides to refinance with another lender. The Minister of Commerce and Consumer Affairs is currently undertaking a review of the operation and efficacy of the CCCFA which we expect will address this recommendation. The Commission's support of amendments to the CCCFA which serve to ensure competitive neutrality will assist with that.

Empower consumers

11. **Industry should create an enhanced switching service with appropriate Government oversight.**

    Kiwibank supports this recommendation.

    In line with the Draft Report's finding that there is a lack of information about how the Payments NZ switching service is performing, Kiwibank also supports establishing greater industry transparency on current levels of market switching via the current switching process (or otherwise) ahead of more enhanced recommendations. This will enable the setting of clearer industry objectives to guide the prioritisation of those enhancements to the current switching service.

    We note the Draft Report has identified a range of issues with the way switching works today that go beyond the core switching service itself. As such we anticipate there being a range of potential initiatives that could be delivered to achieve defined customer and industry outcomes such as

growing awareness and consideration for switching banks, or ensuring switching process is seen as being more trust-worthy and reliable.

Kiwibank is supportive of working with industry banks and Payments NZ to investigate ways to improve or replace Easy Switch, using the UK CASS system as a benchmark, as referred to in the Draft Report.

12. Home loan providers should present offers in a readily comparable manner.

Kiwibank supports the spirit of this recommendation.

In creating a framework reflecting that recommendation, it will be important to consider whether and how a home loan offer incorporating a cash contribution element can be presented in a manner that is both readily comparable and easily comprehensible.

In its Draft Report, the Commission suggests that the cash contribution element could be converted to an effective interest rate. To do this, providers would need to make a number of decisions and assumptions, such as:

(a) The clawback term for a cash contribution will often be different to the proposed fixed interest rate term for the relevant loan. To calculate an effective interest rate where the fixed interest rate period is shorter than the clawback term, the provider will need to decide whether to pro-rate the cash contribution.

(b) Where a loan is divided into tranches, there may be a different interest rate and fixed rate term for each tranche. In contrast, the cash contribution will not be connected to any particular tranche. To calculate an effective interest rate, the provider will need to decide how to split the cash contribution across the tranches.

(c) A cash contribution is a lump sum, often based on the initial principal amount of the loan. On the other hand, an interest rate is applied to the (reducing) principal amount of the loan at regular intervals. To calculate an effective interest rate, the provider will need to make assumptions about the future repayment profile of the loan.

For offers to be readily comparable, all providers would need to adopt the same decisions and assumptions. Additionally, the decisions and assumptions required could mean that readily comparable offers are not easily comprehensible for customers.

13. Mortgage lenders should pro-rate all clawbacks for broker commissions and cash incentives.

Kiwibank generally supports this recommendation.

Kiwibank requires repayment of all or a portion of broker commissions and cash contributions if a loan is repaid within a certain time period.

For cash contributions, the percentage of the cash contribution required to be repaid reduces annually. No amount is required to be repaid if the loan is repaid more than four years after it was advanced.

For broker commissions, the percentage of the commission required to be repaid reduces 6 months after the loan is advanced, then again 12 months after the loan is advanced. No amount is required to be repaid if the loan is repaid more than 24 months after it was advanced.

To calculate pro-rated clawback amounts on a monthly basis, Kiwibank would need to make technical changes to its systems. We submit that the benefits of calculating pro-rated clawback amounts more frequently should be weighed against the anti-competitive effects that come with adding to the costs of smaller banks aiming to compete with the D-SIBs.

14. The FMA should produce guidance and monitor mortgage advisors' compliance with their duties under the Financial Markets Conduct Act.

Kiwibank does not have any comment on this recommendation. We expect it will be addressed directly by the mortgage advisor industry.

15. Industry and Government should prioritise work to reduce the barriers to lending on Māori freehold land.

Kiwibank support this recommendation.

As set out in our previous submission, Kiwibank is actively engaged in tackling this issue both internally via the products and services that we offer and by being an active member of Tāwhia. Kiwibank acknowledges that progress has been slow and needs more dedicated investment support and engagement from all stakeholders.

We also note the following points:

- At paragraph 3.3, of the Draft Report, the Commission notes, *"Further, it is important to recognise that Māori are a diverse group, and many Māori may be satisfied with their personal banking products and services*." However, the Commission does not provide any evidence to support this statement and the views expressed during the Māori wānanga would seem to suggest that is not the case for the majority.

- Paragraph 3.51.1 of the Draft Report states: *"In the event of default, the Te Ture Whenua Māori would generally prevent a lender from being able to take possession of and sell the land to recover borrowed amounts. This means that lenders cannot take security over Māori freehold land."* Kiwibank makes the following points:

    - This sentence should be revisited in light of the Māori Land Court's Practice Note for Lending on Whenua Māori and the subsequent information released by the Reserve Bank in early April 2024.
    - Kiwibank and other banks do already take Māori land as security. Kiwibank treats Māori land offered as security just like a general title in our credit policy. The customer's lawyer is responsible for following the Māori Land Court process and security cannot be taken without this being undertaken to protect Kiwibank's position.
    - Māori land owners often do not want to provide the land as security. For example, five of 300 beneficiaries of the land may want to build and live on the land. It is understandable that the other 295 beneficiaries may not want to put their asset at risk. This is why the Kāinga Whenua product does not take security over the land.

Kiwibank and Kāinga Ora welcome any other banks wanting to join the Kāinga Whenua scheme – there are no contractual or product restrictions preventing other banks from joining and participating in the scheme.

- Paragraph 3.57 of the Draft Report states *"BNZ has told us that there has been low uptake for home lending over Māori freehold land".* This statement does not hold true for Kiwibank. Due to process and delivery improvements in February 2022, we have seen an increase in the amount of lending and houses built using the Kāinga Whenua loan (noting in this case the loan is secured against the house and not the land).

- Kiwibank supports a review of the AML/CFT Act with a view to removing trusts established by the Māori Land Court from being subject to enhanced customer due diligence (**ECDD**). The administration and oversight of Māori land trusts by the Māori Land Court reduces some of the risks associated with other 'regular' trusts, and the current ECDD requirements are challenging and not 'fit for purpose' for Māori land trusts.

- ECDD is currently mandatory for all trusts. We note that recommendation 125 of the AML/CFT Statutory Review acknowledged that not all trusts are inherently high risk and yet they are all subject to the same requirements.[3] Recommendation 126 proposes that certain trusts are categorised as low risk, and therefore a different set of requirements should apply. Recommendation 126 did progress to the drafting of a Regulation. However, it was determined by the Ministry of Justice that this could not be implemented via Regulation and a change to the primary legislation, the AML/CFT Act is required. Kiwibank is supportive of Recommendation 125 and 126.

- Kiwibank would support the Commission making a recommendation on data collection and reporting of demographic customer information including Māori to promote competition and support the removal of barriers in this space.

16. Industry and Government should prioritise ensuring widespread availability of basic bank accounts.

Kiwibank supports this recommendation.

Most banks currently provide no-fee transaction accounts as an offering to customers. However, these may be difficult for certain customers to access if they are unable to meet regulatory requirements (especially AML/CFT) or have a credit history that makes them high risk.

It would be far simpler for banks and customers if the Ministry of Justice (**MoJ**) were able to simplify the sections of the AML/CFT Act and regulations that complicate opening an account for certain customers. Regulatory change is essential to ensure basic bank accounts are widely available. For example, the current obligation to verify address information under AML requirements can have a disproportionate impact on vulnerable customers. This is one of a number of submissions that the banking industry has made in responses to the MoJ on the AML/CFT Act Review Consultation Document and the AML/CFT 'Early' Regulatory Package: Exposure Draft.[4] We note that the MoJ tried to introduce a regulation (effective July 2023) that

[3] https://www.justice.govt.nz/assets/Documents/Publications/AMLCFT-Statutory-Review-Final-Report-v2.pdf p.30, 199-200. Regulation 12C was proposed however, it was determined that this change could not be made via Regulations. https://www.justice.govt.nz/justice-sector-policy/key-initiatives/aml-cft/aml-cft-review/

[4] The NZBA industry submissions on these two consultations are available here and here.

would remove the need to verify a customer's address. However, it was determined that this change could not be made via regulations and required a change to the primary legislation, the AML/CFT Act. We understand that this is being pursued and we would welcome any assistance in expediting this process.

It's important to note that banks in New Zealand have historically been wary of the 'right' to a bank account as some customers use accounts for nefarious means such as using payment transfer fields for domestic abuse, or as mule accounts to transfer the money of scammed New Zealanders offshore. Protecting the right to suspend or cancel an account for criminal or abusive activity is an important part of any basic bank account initiative. Banks must also take the safety of their staff into account if a customer is perceived as a safety risk.