Competition study into personal banking services

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*(**Note -** This is the text of the speech as drafted and may differ from the delivered version)*

Nō reira, tēnā koutou, tēnā koutou, tēnā koutou katoa // Good afternoon to you all.

It's a pleasure to be here with you today. My name is Anne Callinan, and I am the Deputy Chair of the Commerce Commission.

Before joining the Commission in 2023, I spent 30 years as a commercial litigator in a large law firm, often working on the other side of regulators like the Commission and the FMA. So I am a poacher turned gamekeeper.

Having been on both sides of the fence, I appreciate how important it is to have a good understanding of the regulatory environment within which you need to do business.

One of my first jobs when I joined the Commission was to work on the competition study into personal banking services and I have been asked to speak to you today about our findings.

That's a bit of a challenge in 20 minutes as our report ran to over 300 pages, but you will be pleased to know you will be getting the edited highlights today:

- I will set the scene by outlining the main functions of the Commerce Commission.

- I will then explain the overall assessment of competition from the study and outline our main recommendations.

- Next I will drill into the questions most relevant to this audience:
    - What influences competition for home loans?
    - What impacts the behaviour of consumers when selecting a banking service?
    - What role do mortgage advisers play in this?

  - And what can be done to better empower consumers and drive stronger competition in the home lending market.

While the recommendations we made are most directly relevant to the mortgage advisers in the audience, my message of competition being a driver of choice and good outcomes for consumers is a universal one. I would challenge everyone here today to reflect on how they can be better champions for consumers.

Commerce Commission's Functions

But before we dive in, a quick refresh on the Commission and what we do.

The Commerce Commission is responsible for enforcing laws related to competition, fair trading, and consumer protection. Some of our key functions include:

- **Promoting Competition:** Ensuring markets operate competitively by preventing anti-competitive behaviour and mergers that could harm competition.
- **Fair Trading:** Enforcing laws that prohibit misleading and deceptive conduct by traders.
- **Consumer Credit Contracts:** Protecting consumers when they borrow money or buy goods on credit.
- **Regulatory responsibilities:** Overseeing sectors where:
  - there is little or no competition, such as electricity lines and gas pipelines; or
  - competition could be improved, such as telecommunications, grocery, retail payment systems and fuel.

Competition is the catalyst that propels sectors to innovate, enhance efficiency, and provide New Zealanders with better value and more options.

This government has identified competition as a tool that can boost productivity in New Zealand. As New Zealand's competition agency, we have a unique vantage point to monitor market dynamics and foster greater competition.

Competition Study into Personal Banking – August 2024

A market (or competition study) is a tool the Commission has to look at markets or sectors to find out how well competition is working, and whether it could be improved. They are independent and in-depth assessments. We've completed four to date – you may be familiar with our previous studies into groceries, fuel, and building supplies.

We delivered our final report into personal banking services in August last year.

In it we observed that the country's four largest banks – ANZ, ASB, BNZ, and Westpac, alongside Kiwibank, dominated the provision of personal banking services, especially in the areas we focussed on, such as home loans and deposit accounts.

The major banks (ANZ, ASB, BNZ, and Westpac) hold 85-90% of the assets of all registered banks

We also found that New Zealand's banking sector has been consistently more profitable than its international peers.

Kiwibank is positioned between the major banks and smaller providers. It imposes some constraints but lacks the scale to drive significant competition.

Smaller banks and fintechs compete at the margins, and do not constrain the big players.

Open banking represented an opportunity to drive new competition, but New Zealand is lagging behind its international peers in establishing open banking rules.

We looked at the competitive dynamics. When it comes to home loans and deposit accounts, the competition among the major banks can be hit or miss. Sometimes they compete fiercely, but other times, they ease off and focus more on keeping their profit margins rather than fighting for market share.

We also found that the big banks and Kiwibank hadn't really put much effort into updating their core systems, which meant there wasn't a lot of innovation happening.

In a competitive market we would expect to see greater investment in innovation from banks trying stay ahead of their rivals.

Drawing all of these factors together, our assessment was that the four largest banks faced limited competitive pressure in the personal banking sector.

As Minister Willis phrased it, New Zealand's banking market is characterised by, a ‘cosy oligopoly’.

Having made our assessment of the state of competition, perhaps the harder question is what can we do to improve things?

We made 14 headline recommendations, and I am pleased to say that the government has said it will act on all of them.

Our recommendations fell into four broad categories:

- Capitalise Kiwibank to help create a ‘maverick’ to disrupt the current market in the shorter term.
- Accelerate and co-ordinate progress on open banking, to promote ongoing disruptive competition in the medium to longer term.
- Ensure the regulatory environment, including Reserve Bank policies, better supports competition.

- Empower consumers, allowing them to have more freedom and choice within the market.

Today I want to talk about the importance of this last recommendation - how to empower consumers and drive better competition from the demand side. This is where your sector can really make a difference.

How do consumers behave?

To better empower consumers, it's important to understand what makes them tick.

We know that when consumers are well-informed, and engaged, suppliers have to compete on harder on price and quality to win and retain customer business.

Conversely, if consumers are less engaged or face significant barriers to shopping around and switching, competition is likely to diminish.

So we tested these issues, by commissioning an independent research company, Verian, to conduct a survey of over 2000 consumers on their personal banking choices. Unfortunately - but perhaps not surprisingly - we found that banking consumers are best described as "very sticky" and often unwilling or unable to switch providers.

The Verian Survey on switching behaviour

The Verian survey revealed some concerning findings:

- *the majority (62%) of personal banking customers neither switched nor considered switching over the last 3 years.*
- *around half of personal banking customers have never changed their main bank.*
- *a third with home loans have thought about switching but haven't followed through*
- *only 12% of all home loan customers had switched bank in the last 3 years.*

Mortgage holders face added roadblocks to switching. Changing your mortgage provider typically incurs legal costs, may incur early repayment fees, and involves the hassle factor of moving your main transaction accounts, or repaying a cashback. These factors can all contribute to the low switching rates.

Having said that, I do want to acknowledge that Interest.co.nz has recently reported that switching for home loan providers was popular at the moment, with banks "strongly competing" to retain existing customers who are coming off fixed rates.

This is a trend the Commission would very much like to see continue.

Our findings on Competition for Home Lending

We put these insights on consumer behaviour together with our analysis of competition for home lending.

We made some specific findings on homa loan competition:

- *Home lending is the most important personal banking product for those with mortgages or looking to buy a first home.*
- *It is difficult and time consuming for consumers to compare products between lenders*.
- *Mortgage advisers are increasingly being used by customers to navigate the complexity.*
- *Manual bank processes make it time consuming to shop around despite the time sensitive nature of home loan applications.*

The second bullet is important. Consumers can easily see and compare the headline interest rates offered by different banks. But the final cost of a mortgage can be significantly improved if a customer shops around to find "below the line" discretionary discounts and cashback offers. These are not easy to find out unless a consumer makes a formal loan application.

This lack of pricing transparency makes it hard for a consumer to make informed choices.

And we saw mortgage advisers increasingly playing an important role.

In view of these findings, we made some specific recommendations to promote price competition and choice for home loans.

Some of our recommendations were directed at the banks and some directed to mortgage advisers. I'll start with the banks, but before that I want to talk a little about how the Commission and FMA are working together.

Our findings and recommendations in this area are clearly of interest to the Financial Markets Authority.

As Samantha Barass mentioned, the FMA has been considering what levers it has to address the findings in our report – and it's great to hear from Sam about opportunities CoFI presents to work on these important issues. We'll continue to work with the FMA to ensure we have a joined-up approach to carrying out our complementary mandates.

Recommendations to banks

Cashbacks

Banks are increasingly seeking to win customers, not just on interest rates, but on the level of cashbacks they give their customers.

Banks are offering up to $5,000 or more for first home buyers with a loan of $200k more. This is frequently a deciding factor for consumers about who they bank with.

But there is a catch. If a customer decides to change their mortgage provider, the banks may claw back a cashback payment (or part of it). This acts as a dis-incentive to switch mortgage providers. We therefore recommended that any cashback clawbacks should be pro-rated, reducing each month.

Commission Clawbacks

We all know that mortgage advisers are paid commissions by the banks, not by the borrower.

Where the customer decides to switch mortgage providers early in the term of the loan, this can entitle the bank to claw back some of the commission the mortgage adviser was paid. This means the adviser may then (in turn) seek to claw back that money from the customer.

This additional cost can act as a dis-incentive to switching for the customer.

We understand why some clawback of commissions is justified when a customer leaves very early in the term of a mortgage. But we recommended that any claw back of commissions was pro-rated, reducing monthly and there would be no claw back of commissions after 2 years.

I am pleased to say that all four major banks have committed to acting on our recommendations on cashbacks and commissions.

Conversion rates.

We saw that some banks impose implicit and explicit disincentives for advisers to shop around on behalf of their clients. This includes tracking and reporting on the percentage of loan applications that result in settlement, with negative consequences if targets are not met. At the extreme end, this might result in losing accreditation with a lender.

We accept that it is legitimate to track the quality of applications. However, we think conversion rates are a poor way to do this and create a significant dis-incentive on mortgage advisers to test the market for their clients by submitting multiple applications. This in turn reduces competitive tensions on the banks, transparency of competing loan offers, and consumer choice.

We therefore recommended that lenders stop using conversion rate targets or other performance targets that might dissuade mortgage advisers submitting multiple qualifying home loan offers.

Again, we have already seen progress on this. All four majors have told us they either don't, or are on track to stop, tracking conversion rates and setting performance targets based on them. Banks will still track approval rates (cf sale rates), which speaks to the quality of the application – and this seems fair to us.

Switching Services: New Zealand has a bank account switching service, set up by Payments NZ. In our view Payment's NZ was not meeting its potential to assist consumers to easily switch. We recommended that they take steps to minimise the remaining pain points we could see in the switching process, and they have a plan in place to make improvements this year.

The Role of Mortgage Advisers

Throughout our study we could see that mortgage advisers added significant value to consumers.

We heard that consumers turned to mortgage advisers for their expertise and in-depth knowledge of the market. Advisers help to navigate the complexities of different mortgage products and lenders.

Advisers save consumers time by researching and comparing mortgage deals, handling the application process, and providing personalised advice based on the consumer's financial situation and goals. They help borrowers structure their loans. They also assist with the paperwork to ensure applications meet lender criteria, reducing the risk of rejection.
Consumers are increasingly turning to advisers for advice. You'll be well aware that advisers are now the dominant distribution channel for new home lending and this trend looks set to continue.

But as with any industry, we think there is room for improvement, and steps that can drive stronger consumer choice and competition. Hence our recommendations.

Recommendations to Mortgage Advisers

Panel Gaps

Not all mortgage advisers deal with all banks, which is perfectly reasonable.

We understand that the advisers' disclosure statement does identify the lenders they deal with. Nevertheless, an ordinary client approaching an adviser may expect an adviser to deal with all of the major banks.

We therefore recommended that advisers should highlight if there are any registered banks offering home loans that are not on their panel. We also recommended that advisers identify if any lender outside their panel is offering a superior headline interest rate.

We think a reasonable consumer would be rightfully concerned if their adviser knew of a better option outside their panel and didn't share this opportunity with their client.

Three Offers

We also recommended that "where possible advisers should present at least three actual offers to their clients to ensure that clients were making informed choices".

This proved to be a remarkably controversial recommendation!

Our recommendation was qualified ("where possible") because we appreciate it isn't always possible to present three options. The characteristics of the borrower or time constraints may mean three isn't feasible. So, to be clear we aren't suggesting that advisers should be forced to present three offers, full stop.

We also appreciate that there are currently practical issues with getting loan application systems up to a standard, and a level of standardisation, where it is more feasible to process multiple offers for clients. We understand that tight time constraints that are often at play when people are seeking to buy a home and understandably anxious about getting their application accepted.

So we are not expecting an over-night turn around on this. But we are setting expectations.

We are placing expectations on the banks to improve processes at their end to make it easier for mortgage advisers to submit multiple applications on behalf of their clients and to make it more efficient for lenders to quickly process loan applications.
One of the overarching problems we identified with the banking sector was the lack of investment in systems and processes of this kind. This needs to improve.

We anticipate that the NZBA and its members will engage with the financial adviser industry, and work with you, to address our recommendation to increase standardisation of data exchange, and increase standardisation of home loan applications, with greater automation.

We think it is entirely reasonable for consumers who are often making the single biggest financial commitment of their lives to be presented with a few detailed options, and for their independent adviser to explain which option is best for them and why.

Those mortgage advisers who come to the party will be taking a significant step forward in improving the service they offer to their clients and placing stronger pressure on the banks to compete harder.

We addressed our recommendation to industry in the first instance, and said we'd report back to the government on progress after 12 months. We've been having constructive discussions with stakeholders across the sector about how our recommendations can be implemented.

I have confidence that the wider industry can come up with a means of addressing our concerns. An industry-led solution will be far preferable to having more regulation. That is the challenge our study poses for you.

My message to mortgage advisers is that you are uniquely placed to give your clients real choice and to play a major role in driving stronger competition between the banks.

Let's build on the good work you have already done and make you indispensable to consumers who want a mortgage.

My message to the broader audience today is that being client focussed, in a way that goes above and beyond the status quo, will give you a competitive edge and help to promote competition in your respective sectors.

The collective benefits of competition in any sector contributes to a healthier economy and a better overall experience for consumers. Together, we can foster a fairer, more dynamic market that benefits everyone.