



FINANCIAL SERVICES FEDERATION

25 September 2024

Finance and Expenditure Committee

Inquiry into banking competition

The Financial Services Federation (FSF) is grateful for the opportunity to present this submission to the Finance and Expenditure Committee (the Committee) on behalf of our members.

By way of background, the FSF is the industry body representing alternative credit providers operating in New Zealand. We have 100 members (a list of which is attached as Appendix A) which include motor vehicle finance providers, non-bank housing lenders, Non-Bank Deposit Takers (NBDTs), the larger finance companies operating in New Zealand, fleet leasing providers, asset leasing and finance providers, credit-related insurers and Affiliate members which include internationally recognised legal and consulting partners. Our members provide their products and services to more than 1.7 million New Zealand consumers and businesses. Data relating to the extent to which FSF members (excluding Affiliate members) contribute to New Zealand consumers, society and business is attached as Appendix B.

The FSF made a comprehensive submission to the Commerce Commission in response to both their preliminary issues paper and their draft report on their market study into personal banking services. The FSF strongly agreed with the Commission's findings from their market study, particularly with respect to the following:

- **The major banks do not face strong competition when providing personal banking services.**

The FSF would go so far as to say the major banks do not face strong competition when providing any of their services largely because of their size and the ease with which they are able to access capital to fund their lending activities. However, the FSF contends that the non-banks represented by the FSF's membership play an extremely important role in providing necessary competition and innovation and alternative options for both consumers and businesses.

The problem for them is that they are unable to do this at scale because of access to and the cost of capital for them to fund their operations. Often, non-banks are forced to obtain wholesale funding lines provided by the very banks with whom they are in competition which is priced at a margin so the banks can derive a profit even from loans

made by a competitor. We will expand on the cost of capital issues as a barrier to competition further in this submission.

- **The “second tier” of providers does not exert significant competitive pressure on the larger banks due to lack of scale, higher cost of funding, weaker brand awareness and smaller shares of main bank customers.**

The FSF strongly disagrees with the terminology “second tier” as they imply a difference in quality or compliance or reputation that is not justifiable when all players are subject to the same regulatory obligations regardless of their size. Our preference would be that, if there is to be differentiation between the market players, the terminology should be “large” and “small”.

Having said that, the FSF does agree that smaller players cannot compete with the four major banks for all the reasons listed above.

- **Some consumer groups are not well served by competition alone.**

FSF’s credit union and building society members who provide transactional banking services believe that some individuals are excluded from being able to access a basic bank account – even with the competitive offerings credit unions and building societies provide. This is mainly due to the significant barrier created by the Anti-Money Laundering/Countering Financing of Terrorism requirement with respect to address verification. It is not possible to verify the address of a homeless person or one who has just been released from prison for example. Removing this requirement as soon as possible will allow easier access to people who are currently disenfranchised.

- **Competition for housing loans.**

In between the Commerce Commission issuing their draft report on their market study and the final report, one of the FSF’s non-bank housing lending members, Resimac, announced they were leaving the New Zealand market citing the fact that the competitive environment will continue to be restrictive for non-banks for the foreseeable future. Shortly thereafter, another non-bank housing lender, Bluestone, made the same decision. This is certainly not conducive to providing competitive options for New Zealand consumers, particularly those whose needs are more complex (for example those requiring loans to finance a house construction, bridging finance or a high LVR loan).

- **Regulatory factors affecting competition.**

The FSF is in complete agreement with the Commerce Commission’s findings that New Zealand’s regulatory settings for the financial services sector are the most significant barrier to entry into the New Zealand market. The government has worked swiftly to reverse the overly prescriptive affordability regulations within the Credit Contracts and Consumer Finance Act 2003 (CCCFA) that were implemented in December 2021, and which imposed a significant barrier to access to credit for many New Zealand consumers.

They have also signalled further work on the Act itself to remove the punitive penalty regime for senior managers and directors of consumer credit providers and to simplify disclosure requirements to make them more consumer-centric – all of which is very much welcomed by the FSF's consumer lending members.

The government is also looking at simplifying New Zealand's overly complex financial services sector licensing requirements that can result in financial services providers, including lenders, having to hold several licenses for what is essentially the same activity. This is all very helpful for existing players in the market and could help foster further competition by removing some of the barriers to entry, particularly as the Commission recognised that the regulatory burden disproportionately disadvantages the smaller players in the market.

However, with the move of enforcement of consumer credit from the Commerce Commission to the FMA, it is likely that consumer credit providers such as non-deposit-taking lenders (which is the majority of the FSF's consumer credit provider members) will be required to be licensed by the regulator. Currently the requirement is for their directors and senior managers to be certified by the Commerce Commission as being fit and proper persons to hold the roles they do.

The FSF is concerned to ensure that the cost of compliance is not increased due to a new licensing requirement. The key to ensuring appropriate levels of competition is to apply proportionality to any new compliance obligations so that the smaller players are not disproportionately disadvantaged compared to the larger ones.

One other regime that adds considerable complexity and expense to smaller players is the climate related disclosure regime under the Financial Markets Conduct Act 2013. This applies to listed issuers and large credit unions and building societies which are described in the Act as entities with assets of over \$1 billion. Several FSF members are therefore required to provide climate related disclosure and they report that the framework for disclosure is highly complex and therefore the cost to ensure they are reporting appropriately is significant.

- **Improve the capital position of smaller providers and Kiwibank.**

The Commission's report noted that the four major banks operating in New Zealand (ANZ, ASB, BNZ and Westpac) hold 90% of the market share for personal banking. Kiwibank holds a further 5%. This leaves a 5% share across all the remaining players – the smaller banks such as TSB, SBS, Heartland etc and the non-bank lenders operating in the transactional and housing sectors.

Access to capital, or the cost of capital, is one of the key inhibitors of smaller players being able to scale up sufficiently to be able to compete effectively with the four large banks. The FSF will have more to say about this and possible ways to improve this situation later in this submission.

- **Accelerate progress on open banking.**

The FSF has long advocated for a consumer data right to be implemented in New Zealand to allow for open banking and the options this would provide to consumers and businesses to access competitive offerings. It is a serious indictment on the large banks and previous governments that this has taken so long to come to pass.

Having said this, however, it should be noted that the experience overseas, for example in Australia, is that consumers do not embrace the opportunities open banking can provide to them because of a lack of understanding of the fact that it is their data they are accessing and that they own it – not the financial institution that holds it. The banks have done a very good job over the years of instilling in their customers that they must not share their data with anyone which makes it increasingly difficult for other providers to get access to the data they need to be able to make reasonable offers.

The FSF advocated strongly before the December 2021 prescriptive CCCFA affordability regulations were implemented, that open banking should be implemented first so that access to consumers' transactional data was easily available to all consumer credit providers not just to the banks holding the data.

Unfortunately, this recommendation was not taken up and non-bank lenders have since had to rely on third party software providers providing access to customers' transactional data through highly secure encrypted APIs which do not store any individual login identification information in order to satisfy the affordability assessment regulatory requirements. The banks have also been very critical of these apps and actively discouraging of their customers using them which is, in our view, anti-competitive.

We have brought up our concerns over recent comments by the Chair of the Commerce Commission, Dr John Small, directly with him where he has been quoted as saying that banking technology that involves handing over login details to a third-party provider is highly dangerous. Dr Small clarified to us that he meant apps like POLI payments which allow people to make payments directly from their bank account to a merchant without the need for a payment services provider, but which requires consumers to provide their internet banking log-in details – including their customer number and password – to allow the merchant to generate the payment.

This is not the same as the data extraction software that is used by non-bank lenders to access customers' transactional data to meet their lender responsibility principle obligations to determine income and expenditure in an affordability assessment. Care needs to be taken to distinguish between these apps so as not to limit the ability of non-banks to access vital information when assessing loan applications.

In Australia, open banking regulation is being extended to non-bank lenders with a minimum of a \$500 million loan book. This creates more expense for smaller lenders so it is important that data extraction software remains an option for lenders even with the

introduction of open banking as an easy and cheap way for them to access data to meet their responsible lending obligations.

The use of such software is also a key fraud protection measure for lenders as there is little risk of transactional information being altered. FSF members are reporting more frequently that they are seeing paper bank statements that have been altered and tampered with to provide a rosier picture of a person's transactional history than is actually the case. This along with the use of fake (but very plausible looking) drivers' licences to obtain fraudulent loans – which usually also means that someone's identity has been stolen – is one of the major means by which members are being defrauded and this is sadly becoming increasingly more prevalent.

The FSF will now turn our attention to addressing the specific issues raised in the terms of reference for this inquiry that have not already been covered in this submission.

The state of competition in banking:

One of the reasons the non-bank lending sector is thriving in New Zealand, as evidenced by the fact that 1.7 million New Zealand consumers and businesses have a relationship with an FSF member, is the viable alternatives such lenders offer when compared to the major banks.

Focusing particularly on business and rural lending products, as the Committee's terms of reference for this inquiry does, the reason that businesses in commerce and the rural sectors choose to use non-bank lending products is because they offer more flexibility and choice than banking products tend to do.

For example, non-bank lenders will provide credit secured by the asset being purchased for the business such as a piece of machinery whereas the banks tend to want to take security over property including the family home of company directors alongside interlocking unlimited guarantees from all directors. Some FSF members also offer unsecured commercial cashflow lending products which is something banks tend not to do.

The downside to this flexible approach is that the lender has to price for the risk and the cost of funds and so such loans are often necessarily at higher interest rates than bank offerings. However, non-bank lenders also tend to be closer to their customers and therefore have a better understanding of how their businesses operate than do banks which means that they can better support their customers through the good times and the not so good times. It is a common criticism of banks in the commercial and rural markets that they are perceived to be "fair weather friends" – providing access to credit when times are good and then withdrawing from the markets when things start to turn down.

Access to capital for non-bank lenders is also a key reason why the cost of borrowing from such lenders is higher for the business and rural sectors than it is from the major banks. Many non-deposit-taking lenders are funded through securitisation arrangements provided by the major banks who profit from the funding lines they provide to non-bank lenders who then have to pass on the higher cost of funds to their customers whilst still trying to

maintain a profitable and sustainable business. So, it is not just a question of access to capital, it is a matter of the cost of capital particularly when banks are able to provide wholesale funding lines to non-bank lenders to fund their operations whilst clipping the ticket on the way through.

Ratings agencies such as Standard & Poors designate the amount of capital required to be held by lenders before they apply a credit rating to them. The lowest amount of capital required is for a lender's residential first mortgage portfolio and every other form of credit becomes more expensive after that depending on the type of asset by which it is secured. The Reserve Bank also applies similar capital ratings and higher levels of capital are therefore required to be held by a lender against commercial or rural loans.

An illustration of this is that the level of capital required to be held for a residential first mortgage loan is 0.8% versus a property development loan where the capital required is 260% - with everything, including commercial or rural loans, falling somewhere in between.

A similar mechanism is applied in the securitisation market, so this drives up the cost for the sector, particularly for asset lending rather than lending secured by property. There are significant downstream consequences from this such as for housing supply.

There is one area that is highly competitive and that is the funding of clean technology or green assets. These are the most well covered and overfunded assets in the market where there is no need for government participation (such as through New Zealand Green Investment Finance Limited and Carbn Group Holdings Limited) with banks offering loans to purchase electric vehicles at 1% interest per annum.

Barriers preventing competition in banking:

The inquiry's terms of reference asks about any limits on the growth of non-bank deposit takers (NBDTs). The Deposit Takers Act 2023 (DTA) which covers both banks and NBDTs comes fully into effect from July 2028, however entities in the scope of the Act will be required to pay levies into the Depositor Competition Scheme (DCS) which the Act brings about, from mid-2025.

In the meantime, NBDTs are exempt from the need to obtain a credit rating if their asset size is less than \$40 million. The cost to obtain a credit rating is excessive and the low exemption threshold is therefore a significant inhibitor to growth for small NBDTs.

The DTA will introduce new prudential liquidity requirements for NBDTs as well as introducing the DCS. The Reserve Bank has been working on the Core Standards under the DTA which will set the levels of capital required to be held by NBDTs and on the cost of the levies. The Act requires the Reserve Bank to develop a proportionality framework when setting DCS levies.

NBDT members of the FSF report that they have incurred significant cost in obtaining the professional advice they need to ensure they are ready and equipped for the requirements of the DTA and the DCS. On top of this, they have also been required to obtain a conduct

licence from the FMA that regulates their fair conduct programmes that are designed to ensure fair outcomes for consumers.

These layers of compliance are a considerable barrier to entry for new deposit takers, as well as being serious inhibitors of growth for existing players.

The FSF was not supportive of the suggestion in the Commerce Commission's market study report that scaling up KiwiBank with more capital is the silver bullet for increasing competition in the banking market in New Zealand. Our view is that all this would achieve is the creation of another large bank bringing the total from four in the market to five but not materially increasing choice for consumers or businesses when smaller players such as non-bank lenders do not have access to similar means to scale up their operations.

Any possible impact of the regulatory environment on competition and efficient access to lending:

The FSF has already commented extensively in this submission on the barriers to competition imposed on non-bank lenders by the regulatory environment including with respect to the capital requirements and credit risk models of both the RBNZ and credit ratings agencies and climate related disclosures.

When the Reserve Bank and Treasury implemented the Business Finance Guarantee Scheme (BFGS) to provide a guarantee to approved lenders to allow them to provide finance to their customers during the Covid period, the FSF worked closely with RBNZ and Treasury to extend the scheme beyond the major banks to allow access to it for non-bank lenders and their customers. Eventually, shortly before the scheme closed, a handful of FSF members were able to access the guarantee.

It would be very helpful to non-bank lenders, particularly those lending to business and rural customers, if a scheme like the BFGS could be implemented permanently. Many countries around the world have economic development banks some of which are essentially a BFGS. The Business Development Bank of Canada has been operating since 1944 and similar organisations exist in countries like Germany, Italy, France, Japan, the USA and the UK.

If a lender is approved to be part of the "Bank's" guarantee scheme, they are then able to drive sustainable growth, back innovation, unlock potential growth and help build a modern, green economy. The development bank does not actually lend directly to customers but, rather where a lender is approved to be part of the guarantee, they are able to access capital at a lower interest rate because of the guarantee and therefore to on-lend it at lower rates using their normal credit criteria and terms and conditions.

The FSF believes this is an idea worth serious consideration if the government really wants to encourage competition in the business and rural lending markets.

Rural banking:

The terms of reference for this inquiry ask how and to what extent the RBNZ's capital requirements and credit risk models influence lending rates to agriculture and horticulture businesses. The FSF submits that these have far more influence for banks and NBDTs than they would for non-bank lenders who are not subject to the RBNZ's capital requirements.

However, as mentioned previously, the settings applied to a lender's portfolio by credit ratings agencies have a significant influence on the cost of capital the lender must pass on to the borrower and, because of the higher perceived risk inherent in lending to agriculture and horticulture businesses, these businesses are inevitably required to pay higher rates than they would for a loan secured by a residential first mortgage.

Lending to Māori asset-holders, organisations, businesses and individuals:

Whilst not actually resistant to lending to Māori asset-holders, FSF members report that the situation can become very complicated if payments stop and the lender needs to take recovery action. This does make lenders reluctant to lend to iwi or Māori organisations and asset holders.

Please do not hesitate to contact me if you wish to discuss any points in this submission further.



Lyn McMorran
EXECUTIVE DIRECTOR

Appendix A



FSF Membership List as at August 2024

Non-Bank Deposit Takers, Specialist Housing/Property Lenders, Credit-related Insurance Providers	Vehicle Lenders Finance Companies/Diversified Lenders	Finance Companies/ Diversified Lenders contd.	Finance Companies/ Diversified Lenders, Insurance Premium Funders	Affiliate Members	Affiliate Members contd., Leasing Providers and Social Impact Lenders
Finance Direct Limited ➤ Lending Crowd General Finance (BB) Gold Band Finance (B+) ➤ Loan Co Mutual Credit Finance (B) <u>Credit Unions/Building Societies</u> First Credit Union (BB) Nelson Building Society (BB+) Police and Families Credit Union (BB+) <u>Specialist Housing/Property Lenders</u> Basecorp Finance Limited First Mortgage Managers Ltd. Liberty Financial Limited Pepper NZ Limited Resimac NZ Limited <u>Credit-related Insurance Providers</u> Protecta Insurance Provident Insurance Corporation Ltd	Auto Finance Direct Limited BMW Financial Services ➤ Mini ➤ Alpera Financial Services Community Financial Services Go Car Finance Ltd Honda Financial Services Kubota New Zealand Ltd Mercedes-Benz Financial Motor Trade Finance Nissan Financial Services NZ Ltd ➤ Mitsubishi Motors Financial Services ➤ Skyline Car Finance Onyx Finance Limited Scania Finance NZ Limited Toyota Finance NZ ➤ Mazda Finance Yamaha Motor Finance <u>Finance Companies/Diversified Lenders</u> AfterPay Avanti Finance ➤ Branded Financial Basalt Group	Blackbird Finance Caterpillar Financial Services NZ Ltd Centracorp Finance 2000 DebtManagers Finance Now ➤ The Warehouse Financial Services ➤ SBS Insurance Future Finance Geneva Finance Harmony Humm Group Instant Finance ➤ Fair City ➤ My Finance John Deere Financial Latitude Financial Lifestyle Money NZ Ltd Limelight Group Mainland Finance Limited Metro Finance Nectar NZ Limited NZ Finance Ltd	Personal Loan Corporation Pioneer Finance Prosopa NZ Ltd Speirs Finance Group (L &F) ➤ Speirs Finance ➤ Speirs Corporate & Leasing ➤ Yoogo Fleet Turners Automotive Group ➤ Autosure ➤ East Coast Credit ➤ Oxford Finance UDC Finance Limited Yes Finance Limited Zip Co NZ Finance Limited <u>Insurance Premium Funders</u> Arteva Funding NZ Ltd Elantis Premium Funding NZ Ltd Financial Synergy Limited Hunter Premium Funding IQumulate Premium Funding Rothbury Instalment Services	Alfa Financial Software NZ Limited American Express AML Solutions Limited Buddle Findlay Chapman Tripp Credisense Ltd Deloitte EY FinTech NZ Finzsoft Happy Prime Limited KPMG Loansmart Ltd LexisNexis Match me Money Ltd Motor Trade Association Odessa Technology Inc. One Partner Limited PWC Sense Partners Simpson Western Summer Lawyers	<u>Credit Reporting, Debt Collection Agencies</u> Centrix Credit Corp ➤ Baycorp ➤ Collection House Debtworks (NZ) Limited Equipax Gravity Credit Management Limited IDCARE Ltd Illion Quadrant Group (NZ) Ltd Recoveries Corp NZ Ltd <u>Leasing Providers</u> Custom Fleet Euro Rate Leasing Limited Fleet Partners NZ Ltd ORIX New Zealand SG Fleet <u>Social Impact Lenders</u> Money Sweetspot Ltd. Total 99 members



FINANCIAL SERVICES FEDERATION (FSF)

THE NON-BANK FINANCE INDUSTRY SECTOR - 2024



49%

NON-BANK

BANK

of personal consumer loans are financed by the
non-bank sector represented by FSF members.

*Setting industry standards for responsible lending,
promoting compliance and consumer awareness.*

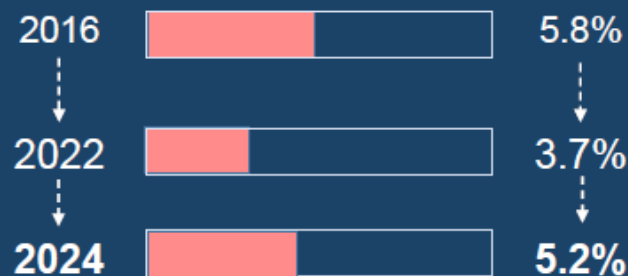
Only 6 dispute resolution complaints
upheld or partially upheld from
1 April 2023 to 31 March 2024

Percent of Loan Requests Approved

48%



Percent of Loan Book in Arrears



KEY FACTS: THE NON-BANK FINANCE INDUSTRY SECTOR

FSF Members (as at 31 Mar 2024)

Number of Members	97
Number of Employees	3,353
Applications Processed	1,102,266
Loan Requests Approved	527,382
Percent of Loan Book in Arrears	5.2%
Loan Disputes Upheld	6

Bank Sector (as at 31 Mar 2024)

Value of Mortgage Loans	\$352B
Value of Consumer Loans	\$7.7B
Value of Business Loans	\$125B

Non-Bank Sector Share (as at 31 Mar 2024)

% of Total Mortgage Loans	0.3%
% of Total Consumer Loans	48.5%
% of Total Business Loans	8.7%

Insurance Credit Related (as at 31 Mar 2024)

Number of Employees	250
Number of Policies	300,209
Gross Claims (annual)	\$22.1M

Consumer Loans (as at 31 Mar 2024)

Total Value of Loans	\$8.2B
Number of Customers	1,537,502
Number of Loans	1,735,718
Average Loan Size	\$4,746

Total Value of Loans:

Mortgage	\$979M
Vehicle Loan	\$4,036M
Unsecured	\$2,129M
Other Security	\$361M
Lease Finance	\$733M

Average Value of Loan:

Mortgage	\$134,675
Vehicle Loan	\$13,337
Unsecured	\$1,588
Other Security	\$4,245

Business Loans (as at 31 Mar 2024)

Total Value of Loans	\$11.9B
Number of Customers	131,161
Number of Loans	202,921
Average Loan Size	\$58,894

Total Value of Loans:

Mortgage	\$4,092M
Vehicle Loan	\$2,989M
Unsecured	\$262M
Other Security	\$2,846M
Lease Finance	\$1,763M

Average Value of Loan:

Mortgage	\$766,527
Vehicle Loan	\$37,362
Unsecured	\$48,107
Other Security	\$54,724
Lease Finance	\$29,308