Reference: 20150371

23 September 2015

Thank you for your Official Information Act request, received on 26 August 2015. You requested the following:

> *"... the report Treasury did on competitiveness of the banking sector, further to the investigation it did in 2013 and 2014."*

The request was subsequently clarified with you to be in reference to a Treasury report from September 2013.

Information Being Released

Please find enclosed the following document:

Item	**Date**	**Document Description**	**Decision**
1.	06/09/2013	Treasury report: Competition in the New Zealand banking sector	Release in part

I have decided to release the document listed above, subject to information being withheld under one or more of the following sections of the Official Information Act, as applicable:

- personal contact details of officials, under section 9(2)(a) – to protect the privacy of natural persons, including deceased people, and

- names and contact details of junior officials and certain sensitive advice, under section 9(2)(g)(i) – to maintain the effective conduct of public affairs through the free and frank expression of opinions.

Please note that this report is over two years old and draws on data from 2013 or earlier. It therefore does not take into account subsequent data and developments in the banking sector.

This letter (with your personal details removed) and enclosed documents may be published on the Treasury website.

This fully covers the information you requested. You have the right to ask the Ombudsman to investigate and review my decision.

Yours sincerely

Jennie Kerr
Team Leader, Financial Markets

THE TREASURY
Kaitohutohu Kaupapa Rawa

Treasury Report: Competition in the New Zealand Banking Sector

Date:	6 September 2013	**Report No:**	T2013/1108

Action Sought

	Action Sought	**Deadline**
Minister of Finance (Hon Bill English)	**Note** the contents. **Indicate** if you would like to discuss matters further. **Refer** a copy to the Minister of Commerce.	None
Associate Minister of Finance (Hon Steven Joyce)	**Note** the contents.	None
Associate Minister of Finance (Hon Dr Jonathan Coleman)	**Note** the contents.	None

Contact for Telephone Discussion (if required)

Name	**Position**	**Telephone**		**1st Contact**
[Withheld under s9(2)(g)(i)]	Graduate Analyst, Financial Markets	[Withheld under s9(2)(g)(i)]	[Withheld under s9(2)(a)]	✓
Fiona Ross	Manager, Financial Markets	04 917 6165 (wk)		

Actions for the Minister's Office Staff (if required)

Return the signed report to Treasury. If agreed by the Minister of Finance, **refer** a copy to the Minister of Commerce.

Enclosure: No

6 September 2013 SH-11-4-3-1

Treasury Report: Competition in the New Zealand Banking Sector

Executive Summary

Anecdotally, there is recurring concern that New Zealand banks are excessively profitable, and that competition in the sector is lacking. We have therefore prepared this brief report, which assesses the overall level of competition in the New Zealand banking sector. Our aim is to inform you of whether or not there is a concerning lack of competition that should be further investigated or addressed.

Our overall judgement is that competition in the New Zealand banking sector is not severely lacking. The sector appears to be delivering outcomes that are generally consistent with those we would expect in a workably competitive market. This includes profit levels that are not obviously excessive. However, the area of bank fees may raise a concern, and the effect of the Credit Contracts and Financial Services Law Reform Bill (currently awaiting first reading) on bank fees should be monitored.

We make the following observations regarding the structure, conduct and performance of the banking sector:

	Characteristic	Likely case with high levels of competition	Case in New Zealand
Structure	*Market concentration*	*Low*. Many firms competing for market share	*High*. The big-four banks have around 88.5% market share, which is high by international standards.
	Barriers to entry	*Low*. The market is perfectly contestable.	*Some*. Low regulatory barriers, but there are likely to be some fixed costs for banks that run a traditional brick and mortar branch network. Internet only banks are unlikely to face significant entry barriers.
	Product differentiation	*Low*. Perfectly substitutable products.	*Low*. Generally uniform products, but banks try to differentiate their products and brands. Businesses may face lower substitutability.
	Market power[1]	*None*. Firms must sell products at or near marginal cost in order to compete.	*Low*, due to reasonably intense competition between four major banks for market share in retail banking and mortgage markets. Kiwibank and TSB also competing aggressively to gain scale in these markets. Competition for business banking likely to be lower due to different risk profile and specialisation among banks.
	Advertising	*High.* Indicates competition for market share.	*High*. Widespread advertising to gain market share. But New Zealand spend is not as high as in Australia.

[1] Market power is usually defined as the ability to raise prices above competitive levels on for a sustained period of time.

Conduct	*Customer satisfaction*	*High* (Customer satisfaction is 77% in Australia, 76% in the US and 63% in the UK).	*High*. 79.5% retail customer satisfaction in New Zealand. Smaller banks perform better than larger banks.
	Product innovation	*High*. Firms must take on latest innovations to retain customers.	*High*. New Zealanders quickly get access to latest banking products (e.g. internet banking, DebitPlus).
	Bank switching	*High*. Customers switch banks when they are not offered the best price/quality products.	*Relatively high*. 10% of New Zealanders switched banks in 2012. But some customers (especially businesses) may be less likely to switch banks. Banks may be able to charge these customers prices in excess of marginal cost.
	Interest rates	Bank lending rates as low and deposit rates as high as possible while covering costs.	On average, small banks offer more competitive rates than large banks, but large banks are also competitive. Headline interest rates may not reflect actual rates in all cases.
	Bank fees	*Low*, and in line with underlying costs.	*Mixed evidence*. Some fees have been subject to Commerce Commission and class action.
Performance	*Profitability*	Bank profits cover cost of capital but do not provide 'excess' returns (NB: bank profits may be desirable for financial stability reasons)	Healthy profits, but not excessive. Average ROE is 11.1% and average ROA is 0.89%. Profitability is: • Similar to estimated cost of equity. • Not discernibly higher for the four largest banks compared to smaller banks (Kiwibank, Rabobank, TSB). • Significantly lower than it was prior to the financial crisis. • Similar between the big-four banks and their Australian parents. • Higher than OECD average but similar to Australia, US, Canada. • Higher than the NZX50 average, but lower than for the most profitable industries (e.g. goods, services).

Recommended Action

We recommend that you:

a. **note** that based on the analysis in this report, competition in the New Zealand banking sector does not appear to be severely lacking, and appears to be delivering outcomes that are generally consistent with those we would expect in a workably competitive market.

b. **note** that the Credit Contracts and Financial Services Law Reform Bill (currently awaiting first reading) will amend the unreasonable fees provisions in the Credit Contracts and Consumer Finance Act to put downward pressure on bank fees (and fees charged by other lenders of consumer credit).

c. **note** that based on the work undertaken to date, there does not appear to be a need for further, more in depth investigation into competition in banking markets at this stage.

d. **indicate** if you would like a chew session or further discussion on any matters this report has raised, and

   Agree/disagree.

e. **refer** to the Minister of Commerce.

   Refer/not referred.

Fiona Ross
Manager, Financial Markets

Hon Bill English
Minister of Finance

Hon Steven Joyce
Associate Minister of Finance

Hon Dr Jonathan Coleman
Associate Minister of Finance

Treasury Report: Competition in the New Zealand Banking Sector

Purpose of Report

1. This report briefly examines the overall level of competition in the New Zealand banking sector. It aims to inform a judgement on whether or not there is need for further investigation in the area of banking competition.

2. Please note that this is not a full-blown investigation into banking competition. The report looks only at publically available information, such as banks' quarterly disclosure statements. Also, it focuses on banking overall, as opposed to delving into individual banking submarkets such as home loans, transaction accounts, and services for businesses. Any conclusions drawn in this report should be treated with an appropriate level of caution. The report has been prepared on a for-your-information basis, and is not intended to guide regulatory or enforcement action.

Analysis

Why banking competition matters

3. The profitability and competitiveness of New Zealand banks has received ongoing criticism in recent years. In August 2011, former Reserve Bank Governor Alan Bollard expressed concerns over a lack of competition, and the costs this was posing for New Zealand households and business[2]. Similar concerns in Australia and the United Kingdom have sparked reforms aimed at increasing banking competition.

4. Banking competition is not trivial. A lack of competition in the banking sector leads to inefficiencies in the economy. Weak competition can lead to excessive (supernormal) profits and reduced incentives to manage costs, resulting in more costly financial intermediation. The wedge this drives between savings and investment can result in lower savings, lower investment, and ultimately lower growth. It can also reduce the availability and quality of banking services to households and businesses.

5. That said, a lack of competition in the banking sector may not be entirely undesirable. If banks compete too fiercely, bank failures may become more frequent, potentially outweighing the benefits of cheaper financial intermediation. However, market power could also be harmful to financial stability if it reduces incentives to manage risk and costs. The international literature is not definitive on the relationship between competition and financial stability.

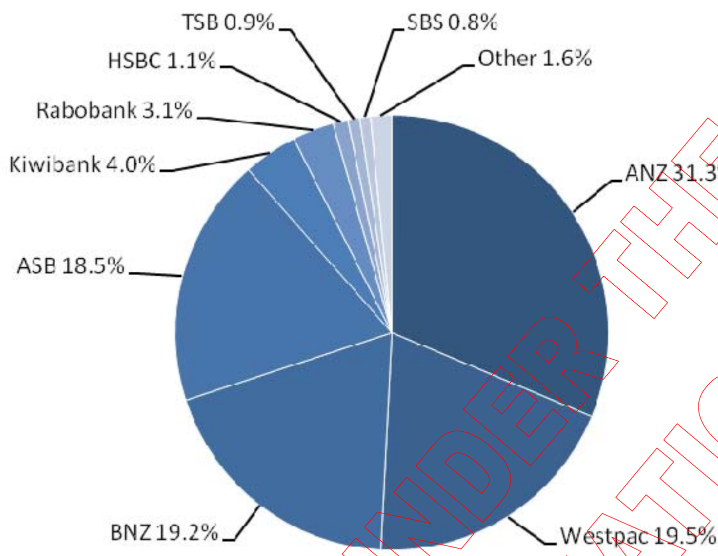
6. The remainder of this report assesses the level of competition in the New Zealand banking sector using the Structure-Conduct-Performance framework. This framework examines how market structure may allow for uncompetitive conduct which in turn determines whether or not firms make excessive (supernormal) profits.

Structure: high concentration doesn't appear to give rise to market power

7. The New Zealand banking sector is dominated by the four Australian-owned banks that collectively hold 88.5% of the country's net bank loans. This degree of concentration is high by international standards, but it is by no means unique to New Zealand.

[2] Alan Bollard, *"The role of banks in the economy - improving the performance of the New Zealand banking system after the global financial crisis."* Delivered on 6 August 2011.

Chart 1: Market share of New Zealand bank loans, 2012



Source: KPMG: Financial Institutions Performance Survey

8. Technical measures indicate a relatively high level of concentration. The Herfindahl-Hirschman Index (HHI) – a technical measure of concentration - is around 2100 for bank loans in New Zealand, compared to 1620 in Australia, and 1736 for current accounts in the UK[3]. In competition analysis, a lower HHI indicates lower concentration, whilst a higher HHI indicates higher concentration. However, the HHI does not capture the effect of market contestability on an industry's competitiveness.

9. High concentration does not appear to translate into market power due to healthy competition between the four major banks in key sub markets. The Commerce Commission investigated this surrounding ANZ's acquisition of National Bank in 2003. Looking at all common classes of banking services the Commission found that the competition between the remaining four major banks is strong enough to prevent market power. Since 2003, the sector's structure has not changed as to make market power significantly more likely. In fact, the growth of Kiwibank and other small banks such as Rabobank and TSB may have had the opposite effect.

10. The New Zealand banking market seems reasonably contestable. Contestability reduces market power because the threat of new entrants deters incumbents from overcharging. Regulatory barriers to entry are low by international standards[4].The recent registration of the Cooperative Bank and Heartland Bank is evidence of this. However, non-regulatory barriers such as advertising and a branch network may limit the degree of contestability to some extent. Internet only banking services are likely to face lower barriers to entry, but may only be able to provide limited services.

11. Empirical evidence suggests that the New Zealand banking market is characterised by monopolistic competition where firms have some degree of choice over prices (Chan et al., 2007[5]; NZIER, 2004[6]). While this differs from perfect competition, it is the case for most workably competitive New Zealand industries.

---

[3] APRA (2013); Independent Commission on Banking (2010)
[4] OECD (2006) ''*Competition and regulation in retail banking"* Policy Roundtables.
[5] Donald Chan, Christoph Schumacher and David Tripe (2007): *"Bank Competition in Australia and New Zealand."* Massey University working paper.
[6] NZIER (2004): *"The performance of the New Zealand banking sector: Report to the Reserve Bank of New Zealand."*

12. Banking products offered by different institutions do appear reasonably uniform or substitutable in most cases. Customers almost always have a choice between multiple banks for a given product. This is an important characteristic of a competitive market. Despite this, banks go to a lot of effort to differentiate their brands and products in order to compete effectively for market share. For businesses, product differences may be meaningful for more complex products (eg, products related to international trade).

Conduct: mainly good, but some areas may raise concerns

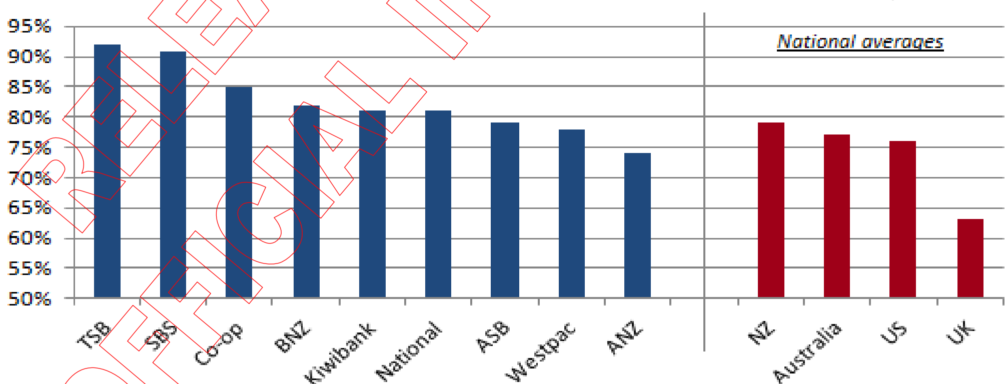
Banks appear to compete fiercely for market share

13. Strong competition for market share is a reasonable indicator for the overall level of competitiveness of a market. Recent years have seen banks invest heavily in rebranding, and in upgrading their branch networks. In 2012, banks spent $104million on advertising (0.03% of total assets), although this amount is not remarkably high internationally. In Australia, the big-four banks spent over A$1billion in 2012 (0.04% of total assets). Bank of America spent US$1.9billion (0.08% of total assets). In 2009, the bank with the largest advertising budget (Westpac) was the 26th largest advertiser in New Zealand, with Kiwibank, ANZ and ASB also appearing in the top 50[7].

Customer satisfaction is high for New Zealand banks

14. Banks in a competitive market will face greater incentives to avoid customer dissatisfaction. The latest RoyMorgan customer satisfaction surveys show that 79.5% of New Zealand bank customers are satisfied or very satisfied with their banks. This rate of satisfaction is high on international standards: average customer satisfaction is around 77% in Australia, 76% in the US, and 63% in the UK.

Chart 2: Customer satisfaction rates for selected banks and national averages, 2012



Source: Roy Morgan, J.D. Power and Associates, Which? Market Research

15. Larger banks tend to have lower customer satisfaction than smaller banks. This could reflect differences in branding, customer biases, and size-related difficulties in maintaining high customer satisfaction. Large banks may also face weaker incentives to satisfy customers given their larger existing customer bases and potential limitations to bank switching.

Product innovation appears to be rapid

16. The swift introduction of a range of banking innovations indicates competition for market share between banks. In their 2004 report on the performance of the New Zealand banking sector, NZIER found that banking customer in New Zealand were not missing out on banking innovations that are available overseas, noting the early

[7] Neilsen (2010)

adoption of innovations such as EFTPOS, internet banking, mobile mortgage managers, revolving credit loans and pre-approved finance.

17. Anecdotal evidence suggests that the sector continues to be innovative. For example, recent years have seen the introduction of innovations such as banking apps for smartphones, Debitplus Visa cards, offset home loans, and secure high-interest online savings accounts. These innovations suggest that banks are competing actively to maintain and gain market share.

Bank switching rates are relatively high

18. A high rate of account switching has a strongly pro-competitive effect. It means that banks are unable to charge existing retail customer above-market prices, as there is a strong likelihood that customers will change banks in retaliation.

19. New Zealand currently has a relatively high level of bank switching. In 2012, 415,000 retail customers (roughly 10%) changed their main bank[8], compared to 357,000 who changed power companies that year[9]. However this rate may not reflect actual switching propensities as many customers passively switched during the de-branding of National Bank. In 2011 only 6.3% switched banks. By comparison, current account switching rates were 9.6% in the US, 10% in the EU and 6% in the UK in 2011[10].

20. In December 2010, a new bank switching system was introduced by bank-owned Payments NZ. The system allows customers to change banks by filling in a simple form, with direct debits being transferred automatically to their new bank. However, switching costs still exist. Additional measures could be taken to further reduce switching costs. For example, direct *credits* (e.g. salary payments) could be changed automatically, as is now the case in Australia. Full bank account number portability (like cell phone numbers) is also an option; however, the high costs of establishing this are unlikely to be justified in the New Zealand context.

21. High overall switching rates do not necessarily indicate a high propensity to switch for all customers at all times. Bank switching tends to be strongest at key life points, such as starting university, marriage, or buying a first home. While banks compete fiercely for market share at these life points, switching levels at other stages of a customer's life may be lower. Customer inertia may lead to market power if banks can charge above-market prices knowing that most customers are unlikely to switch banks as a result.

Competition in the business banking submarket may be less fierce

22. Business banking is generally thought to be a more specialist market because of the higher risks that it often involves, and because an assessment of these risks requires an understanding of the underlying business. Business banking is also more relationship-based, and products in these markets can be more bespoke and complex.

23. These factors may result in greater customer inertia in business banking. In a study of New Zealand small businesses, Perry and Coetzer (2009)[11] find that while dissatisfaction with banks is frequent, bank switching is infrequent. In concentrated markets, customer inertia can lead to less competitive pressure. While we acknowledge that competition could be weaker in the business banking submarket, this report does not attempt to further investigate this possibility.

[8] RoyMorgan Single Source (New Zealand)
[9] Electricity Authority
[10] J.D. Power and Associates (US), Europena Commission (EU), Accenture 2011 UKI FS Customer Survey (US)
[11] Perry, M., and Coetzer, A. (2009) *"Small enterprise relations with banks and accountants",* Journal of Small Business and Enterprise Development, 16 (2), pp. 306-321

Smaller banks offer more competitive headline interest rates than larger banks

24. On average, the big-four banks advertise higher mortgage rates and roughly the same deposit rates as smaller banks. Note though that the interest rates customers are able to negotiate can differ significantly from advertised rates. Also, differences in headline rates may be offset by lower lending fees and promotional offers that tend to be offered by the larger banks. It is therefore difficult to draw firm conclusions about the competitiveness of large and small banks from this data.

Chart 3a: Average headline mortgage rates 2009-2013

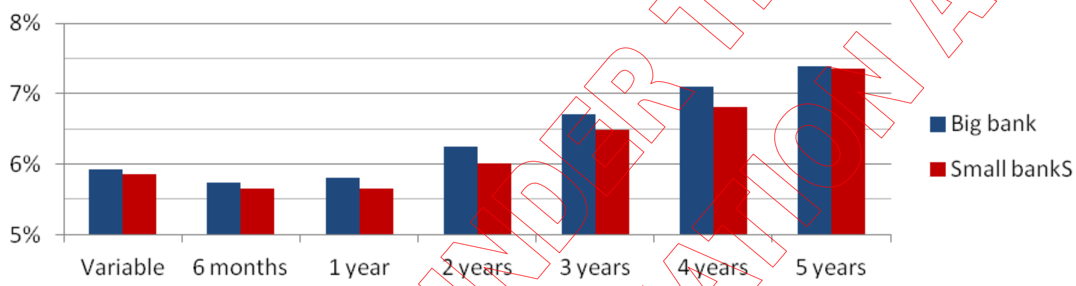
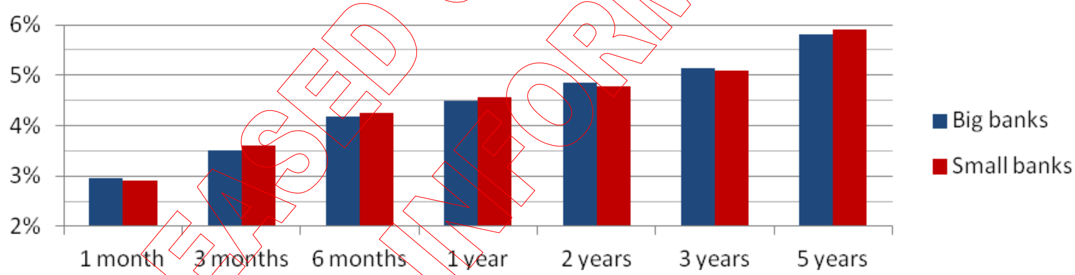


Chart 3b: Average headline deposit rates 2009-2013



Source: Interest.co.nz. Small banks include Kiwibank, TSB and the Co-operative Bank.

The level of bank fees may raise some questions

25. Bank fees are often a less visible cost to customers. While banks compete relatively fiercely on headline interest rates, it is possible that they use the lower level of scrutiny surrounding fees to extract uncompetitive profits.

26. Current class action (the "Fair Play on Fees" case) has argued that New Zealand customers are paying excessively high fees, emphasising fees for unexpected overdrafts, exceeding credit card limits, and late payments. These fees are notably higher for New Zealand's big-four banks than for their Australian parents. Litigators are relying on common law relating to default fees and penalties.

27. It appears that fees do account for a relatively high proportion of bank profits in New Zealand. In 2012, Westpac New Zealand's fee income accounted for 38.9% of pre-tax profits, compared to 29.4% for the banking group overall. Similarly, ASB's fee income accounted for 36.7% of pre-tax profits compared to 30.0% for Commonwealth Bank overall. Comparisons of fees as a percentage of net interest margins yield similar results. However, the available data does not distinguish between consumer, commercial or corporate fees. Differences in bank business models limit our ability to conclude that New Zealand banks charge excessive fees relative to their parents.

28. The Commerce Commission can, and has, intervened when bank fees become unreasonable. For example, in 2009, they found credit card late payment fees and to be in breach of the provisions prohibiting unreasonable fees in the Credit Contracts and Consumer Finance Act (CCCFA). Pre-emptive fee reductions and enforcement action

subsequently have arguably aligned these fees to more reasonable levels. However, the Commerce Commission has submitted that the unreasonable fees provisions in the CCCFA are too vague and difficult to enforce. A bill addressing these issues is currently awaiting its first reading.

29. Interchange fees charged to merchants for credit card transactions have also raised concerns. In 2009 the Commerce Commission found the fees in breach of the Commerce Act and reached settlements with Visa, MasterCard, and several financial institutions. However, the Commission's powers under the Act are somewhat limited. The current RBNZ payments systems review is considering the extent to which the RBNZ should have a role in this area.

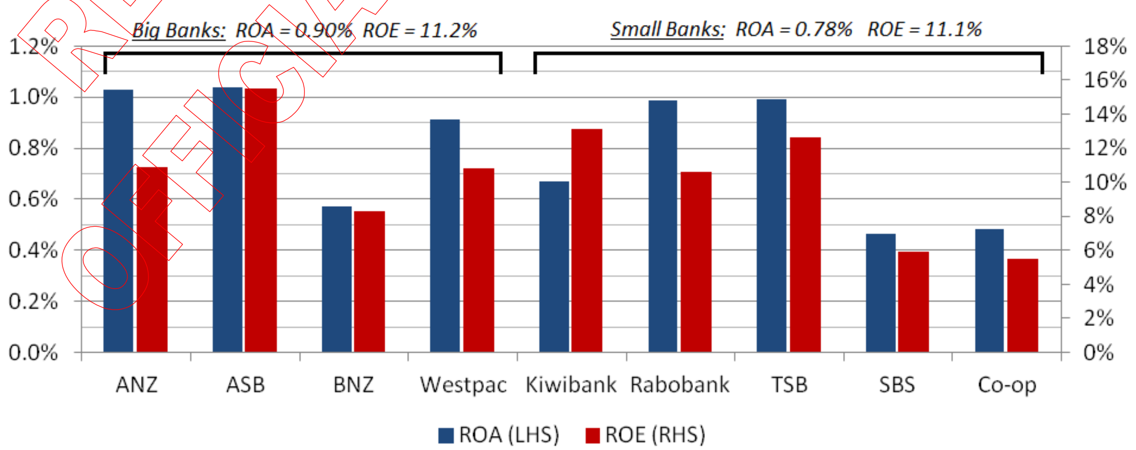
30. Overall, some fees charged by banks may be consistent with a lack of competition. But this conduct does not go unopposed by regulators and customers. Regulatory oversight positively contributes to competition, although regulatory powers are limited in some cases. The threat of customer retaliation (by switching banks) has a similar disciplinary and pro-competitive effect, as is currently evident in the US market, where high fees are the main reason behind abnormally high switching rates. However, this discipline may be limited by customer inertia.

Performance: profits are high but not obviously excessive

31. In general, New Zealand banks make healthy profits. In 2012, average return on assets (ROA) was 0.89%, and average return on equity (ROE) was 11.1%[12]. In the years following the financial crisis, the sector has made ROAs just below one percent and ROEs around 12% on average.

32. The big-four banks appear to be making their cost of equity on average. Estimated cost of equity is currently around 10.7% for the big-four banks[13] compared to an average post-tax ROE of 11.2% in 2012. Average ROE over the last three years has been 11.9% compared to an estimated cost of equity of 11.4% due to a higher risk-free rate.

Chart 4: Profitability of selected New Zealand banks, 2012



Source: December 2012 Disclosure Statements

33. Overall, larger banks appear to be slightly more profitable than smaller banks, especially the smallest banks (SBS and the Cooperative Bank). Larger banks make

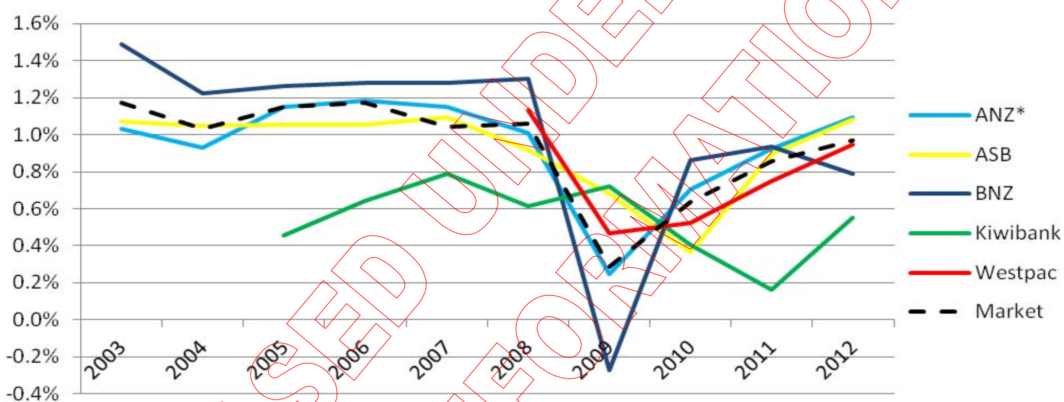
[12] ROE is calculated using total equity, including goodwill. ANZ has about $3.3billion in goodwill from its acquisition of National Bank, which may understate ROE if the goodwill resulted from expected supernormal profits. ANZ's 2012 ROE excluding goodwill was 15.4%, pushing average ROE to 12.6%.

[13] Cost of equity estimate using an average equity beta of 1.0 (the average equity beta for parent-bank shares listed on the ASX), a long-run risk-free rate of 4.5%, a post-tax market risk premium of 7.5% (based on PWC's 2013 estimates), and a corporate/investor tax rate of 28%.

notable higher ROAs on average, although average ROEs are very similar[14]. This suggests that large banks do not enjoy significant market power, as this would likely result in the large banks making significantly higher profits. Smaller banks actually have larger net interest margins than large banks, but also have higher costs.

34. Profitability has reduced significantly over the last decade. Before the crisis ROA was around 1.1%, and ROE was over 17%. ROA fell to 0.3% in the height of the crisis, but has since recovered to just below 1%. The reduction in profitability may reflect improvements in competition over the last decade, but could also be symptomatic of relative economic and market conditions, such as lower interest rates. ROE has fallen more so than ROA, largely because banks hold more equity as a percentage of assets now than they did before the crisis (largely due to increased capital requirements).

Chart 5: Time series of annual return-on-assets for selected NZ banks

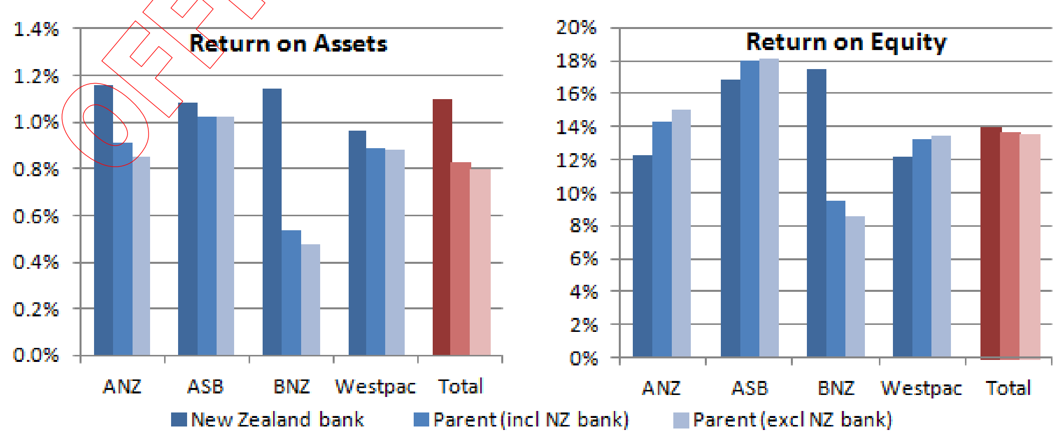


Source: S&P Capital IQ (data for June financial year ends)[15]

Profitability is roughly in line with Australia

35. New Zealand banks make around the same returns as their Australian parents. ROE is lower than for parent banks in all cases but that of BNZ[16]. While ROA is higher in all cases, this may reflect that the underlying risk of the New Zealand subsidiaries is higher than that of the parent banks. This suggests that Australian banks' New Zealand business does not provide them noticeably higher returns than their domestic business.

Chart 6: Profitability of the big-four NZ banks and their parents (year to June 2012)



Source: Bank Annual Reports

[14] This is largely because Kiwibank is leverage at 18:1, compared to 12:1 for the big four banks. This means that ROA translates into a relatively higher ROE.

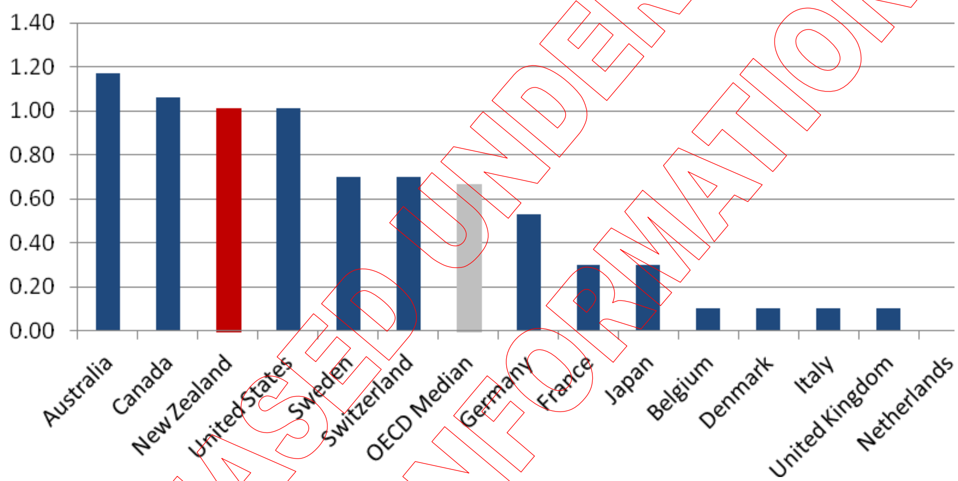
[15] BNZ's sharp drop in ROA was due $542million in provisions relating to a High Court tax dispute.

[16] BNZ's parent National Australia Bank had a large write off from its UK business in 2012

Wider international comparisons also show modestly strong performance

36. The latest IMF data shows that banks in New Zealand are profitable, but not exceptionally so. Pre-tax ROA is well above the OECD median, largely because of the poor performance of most European banking sectors. However, the profitability of New Zealand banks is no greater than the likes of Australia, Canada and the US. In fact, the latest data puts the New Zealand banking sector at 10th most profitable in the OECD. Note though that international profitability comparisons are limited by differences in business models and discount rates, and the extent to which overseas banks may themselves be making supernormal profits.

Chart 7: National averages of bank ROAs (latest IMF cross-country data)

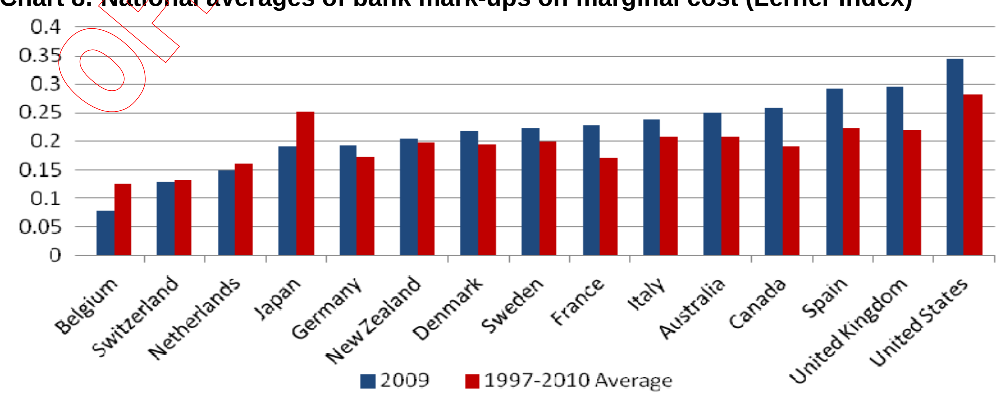


Source: IMF Financial Stability Indicators (April 2013)

37. Recent profitability is notably lower than during the years prior to the global financial crisis. For the period 2002-2007, New Zealand had the second highest ROE in the OECD, behind Slovakia, at 18%. While this may have resulted from a lack of competition, relatively high domestic interest rates would have also been a factor.

38. Other measures of market power and supernormal profit also show modest performance by New Zealand banks. For example, the Lerner Index, which measures the mark-up of prices over marginal cost, is relatively low in New Zealand.

Chart 8: National averages of bank mark-ups on marginal cost (Lerner Index)

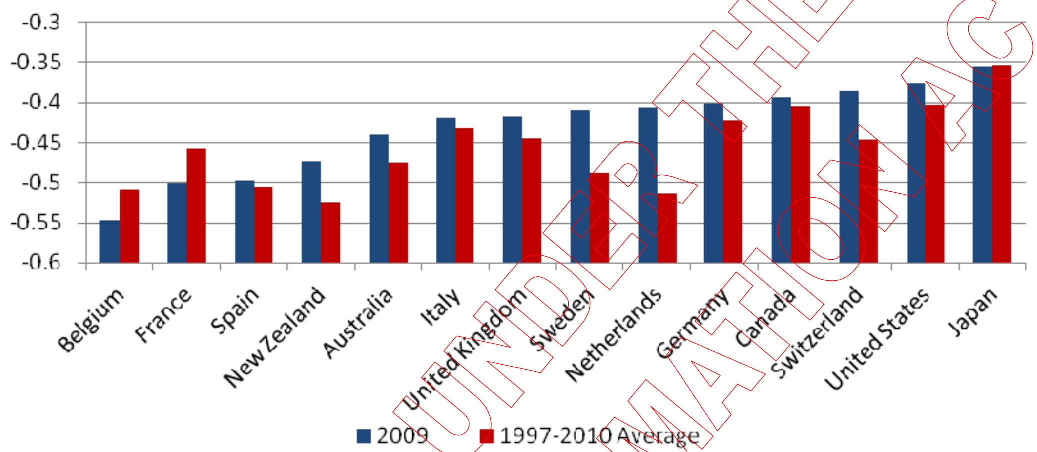


Source: Clerides, et al. (2013)[17]

[17] Clerides, S., Delis, M., and Kokas, S. (2013) *"A new data set on competition in national banking markets",* University of Cyprus working paper 08-2013.

39. The profit elasticity of New Zealand banks is also relatively high (in absolute value). This means that, for New Zealand banks, changes in costs have a relatively strong impact on profits. This could indicate lower market power, as banks are less able to pass cost increases onto customers, or retain cost reductions as profits.

Chart 9: National average of bank profit elasticity (Boone measure)

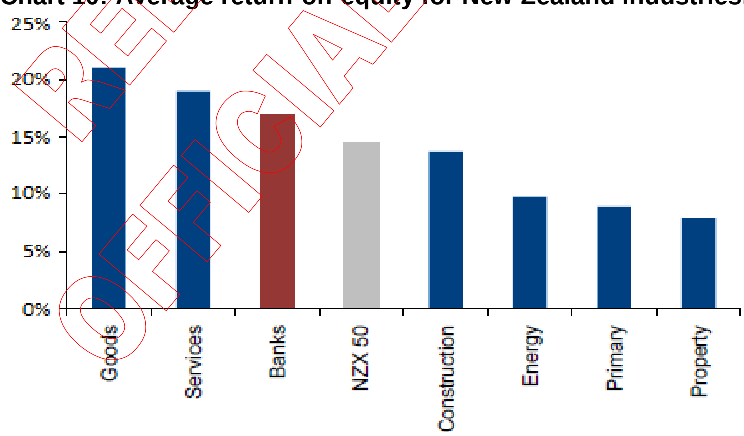


Source: Clerides, et al. (2013)

Banks do not substantially outperform other New Zealand companies

40. Comparisons with other New Zealand industries support the notion that banks make profits that are healthy, but not excessive. Although the banking industry makes higher returns than the NZX average, it is outperformed by the goods industry and the services industry in the period 2000-2009. In recent years, banks have continued to be significantly less profitable than the most profitable publically listed firms.

Chart 10: Average return-on-equity for New Zealand industries, 2000-2009



Source: RBNZ

41. Finally, please note that this section has only looked at banks' overall profitability. Banks operate in numerous submarkets. Reasonable *overall* profits do not preclude that banks' profits are excessive in certain submarkets. The previous section identified business banking or payments interchange as areas of potential concern. However, due to data limitation, this report does not attempt to further investigate profitability in individual submarkets.

Conclusion: No Major Concern Over Banking Competition

42. There does not appear to be a severe lack of competition in the New Zealand banking sector. While the sector is dominated by four large players, market contestability and competition between banks appears to be resulting in outcomes consistent with a workably competitive market in a small open economy. On this basis, the level of competition in the banking sector is not likely to be a significant impediment to efficiency and productivity in the economy.

43. For the large part, bank conduct is consistent with a highly competitive market. Some bank fees are concerning, and while regulators and third parties appear to actively confront unreasonable fees, powers may be limited in some cases (e.g. interchange fees). Overall, bank switching rates are relatively high, but some customers (including businesses) may be less willing to switch banks or negotiate interest rates to get the best deals. There may therefore be some areas of banking, such as business banking, that are less competitive than others.

44. Overall though, bank performance suggests that the major banks are not making supernormal profits. Profitability appears to be healthy and more-or-less consistent with that of smaller banks, other New Zealand firms, overseas banks, and cost of capital.

Next Steps:

45. We intend to maintain a watching brief on competition in the banking sector - particularly given improving macroeconomic conditions and growth in the housing market. These conditions coincided with high bank profitability between 2002-2007.

46. If you deem necessary, we can further investigate particular areas of banking which did raise concern, such as bank fees and business banking. At this stage we do not deem additional investigation to be necessary, noting that the Credit Contracts and Financial Services Law Reform Bill and payments system oversight review are currently underway.