The Treasury

Reserve Bank Act Review Phase 2 Submission Information Release

October 2019

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[1] 9(2)(a) - to protect the privacy of natural persons, including deceased people

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HEARTLAND BANK

30 August 2019

Phase 2 of the Reserve Bank Act Review
The Treasury
PO Box 3724
Wellington 6140
Via email: rbnzactreview@treasury.govt.nz

Submission to the Treasury on the Second Consultation for Phase 2 of the Reserve Bank Act Review

Introduction

1. Heartland Bank Limited (**Heartland**) welcomes the opportunity to submit on the second consultation for Phase 2 of the Reserve Bank Act Review (**Phase 2 Review**).

2. Heartland refers to its submission on the first consultation of the Phase 2 Review submitted to you on 4 February 2019 (**First Submission**) and attached to this submission for your reference.

RBNZ's financial policy objectives

3. Heartland supports the Minister of Finance's in-principle decision to replace the Reserve Bank of New Zealand's (**RBNZ**) existing 'soundness' and 'efficiency' objectives with the objective to "Protect and enhance the stability of New Zealand's financial system".

4. In Heartland's First Submission, it submitted that "efficiency", and in particular, competitive efficiency, should be an objective of the RBNZ. Heartland reiterates that point now, and submits that "efficiency" (including competitive efficiency) should be included as a lower-tier objective of the RBNZ.

RBNZ's regulatory perimeter

5. Heartland also supports RBNZ's in-principle decision to align bank and NBDT regulatory regimes into a single 'licensed deposit taker' framework.

6. However, we also submit that it is important to ensure that the regulatory regime has minimal regulatory leakage and does not lessen competition in the market, by providing some participants (e.g. wholesale funded lenders) with a more favorable regulatory or supervisory regime than others such as Heartland Bank which has a substantial depositor base.

7. This could be taken into account when determining the definition of 'NBDT' (i.e. by including wholesale funded lenders within that definition). A more bespoke option could be the use of tools such as designation and exemption powers to ensure that the regulatory system adequately addresses risks whilst also providing flexibility where required. This could enable RBNZ's macro-prudential tools to be applied more broadly to entities outside of the single deposit-taking framework if those entities were subject to less onerous standards than entities within the single deposit-taking framework.

Depositor protection scheme

8. Heartland supports regulation that protects the New Zealand public and provides confidence in the New Zealand financial system.

9. However, the introduction of a depositor protection scheme must necessarily be considered in the context of the wider regulatory regime. At the present time, significant changes to New Zealand's regulatory regime are being consulted on – most crucially, the Reserve Bank's review on capital adequacy, which will impose significant extra costs on banks. Enacting further changes at present, when the changes to the capital adequacy regime have not yet been determined, is premature and, in Heartland's view, banks should not have to pay for both extra capital and a depositor protection scheme.

10. Were the costs of a depositor protection scheme to be passed on to banks, Heartland submits that using a 'fund' is a problematic model. The proposed changes to capital adequacy requirements are designed to reduce the chance of bank failure in New Zealand – and, in turn, to reduce the chance of depositors losing their deposits. A depositor protection scheme seeks to provide depositors with recourse in the event of such a risk eventuating. Heartland considers that some other financial product (such as insurance, the cost of which would take into account a lower chance of bank failure) could be more appropriate and efficient. In any event, the use of a fund would appear to raise a number of complexities (which would not be the case with insurance).

11. Heartland also notes that a levy on profits would make it more difficult for banks (particularly small banks) to meet any future increased capital requirements (which, in the case of most small banks, will only be able to be met through retained earnings / profits). In the case of the other banks, it remains to be seen whether the increased capital requirements will be absorbed by the banks or passed on to customers, but adding a levy on profits would clearly increase the cost of capital, and the prospect of increased costs being passed on to consumers.

12. Notwithstanding the issues set out above, if a premium on deposits was the preferred model of seeding a fund, Heartland suggests that, rather than a premium being charged on *all* deposits, customers could be given the opportunity of opting into the guarantee scheme in return for a reduced interest rate (with the differential being used to pay for the guarantee). This would provide customers with an ability to select whether they want their deposits to be protected by the scheme or not.

13. Finally, any depositor preference scheme implemented in conjunction with a depositor protection scheme would impose further substantial costs by increasing wholesale funding costs. In Heartland's view, the imposition of a depositor preference scheme would be yet another further financial and regulatory burden and is not warranted in the circumstances.

Questions

14. If you would like to discuss any aspect of the submission further, please do not hesitate to contact me via the sender of this submission.

Yours faithfully

[1]

Bruce Irvine
Chairman of Heartland Bank

HEARTLAND BANK

4 February 2019

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Submission to the Treasury on the Phase 2 of the Reserve Bank Act Review

Introduction

1. Heartland Bank Limited (**Heartland**) welcomes the opportunity to submit on Phase 2 of the Reserve Bank Act Review (**Phase 2 Review**).

2. Heartland supports the submission made by the New Zealand Bankers' Association (**NZBA**). However, as noted in the NZBA's submission, there are some areas where the NZBA members' interests diverge. Heartland wishes to submit separately on one of those areas of importance to Heartland, and its submission is set out below.

RBNZ's high-level financial policy objectives

3. The NZBA's submission notes that individual members will provide more detail on the issue of whether "efficiency" should remain a high-level objective.

4. Heartland agrees that it should, and that it is a critical moderator of the stability objective. However, as The Reserve Bank notes in its consultation document, "efficiency" is a broad term and can encompass a number of different things. In Heartland's view, it ought to include (but not necessarily be limited to) competitive efficiency for the reasons set out below.

5. As the Reserve Bank acknowledges, New Zealand's financial system is dominated by the large Australian-owned banks, which has implications for the competitive landscape. In Heartland's view, increased competition in New Zealand's financial system would result in better customer outcomes by providing customers with more choice of credit providers, promoting innovation in financial markets and allowing customers greater access to a broader range of more affordable products.

6. Were the Reserve Bank's mandate to include promotion of competitive efficiency, it could empower the Reserve Bank to focus on ensuring customers have frictionless access to a broader range of competitive credit and depositor products. It would also empower the Reserve Bank to reconsider whether the barriers for entry into, and remaining in, the banking market were set at appropriate levels (including taking into account business models which diverge from those of the Australian-owned banks), which may help to facilitate new entrants into the banking market.

7. In addition to the above, competition considerations ought to be taken into account when imposing more onerous obligations on banks than those imposed on non-banks. It is imperative that banks are not required to meet onerous standards that can be ignored by the non-bank sector; however, in Heartland's view, one of the consequences of the Australian

Royal Commission and the subsequent Reserve Bank and FMA review could be the restriction of customers' access to bank credit. Recent media commentary suggests that this is already occurring in Australia. Were this to occur in New Zealand, it would only further reduce competition.

8. Finally, whilst Heartland supports the need for anti-money laundering and consumer credit legislation, it is important to recognise that overly onerous requirements (including on-boarding requirements) can act both as an impediment to customers' initial access to credit, and also as an impediment to customers movement between financial institutions. We expect there to be considerable developments in the use of technology to simplify the process of obtaining bank finance in the near future (including in Australia, where Volt bank has recently obtained a full ADI licence and appears to have used technology to simplify it processes). We also expect that customer demand will follow swiftly, and that it will be imperative for financiers to be able to meet that demand. Although this is something that is clearly not isolated to banks, Heartland considers that the Reserve Bank should at least be cognisant of this issue – particularly in its role as AML supervisor of registered banks – when exercising its powers.

How to increase competition?

9. There are various areas where the Reserve Bank could act to increase competition in the banking sector.

10. Regulatory action in other industries, such as telephone number portability in the telecommunications industry, has had significant positive impact on those other industries. Bank account portability would be an initial example of something which could help to promote competition in the banking industry, by removing impediments to customers transferring their business between banks. Open banking (i.e. 'open data') is another way of facilitating competition. The Reserve Bank would have key roles in relation to the implementation of both.

Conflict

11. Heartland does not believe that fostering and promoting competition in the New Zealand financial markets is inconsistent with the Reserve Bank's other fundamental financial policy objectives. Indeed, one of the dynamics of a market dominated by a small number of larger participants could be a 'too big to fail' attitude, which brings with it certain risks. However, a more competitive market with a greater number of smaller participants could help to effectively mitigate those risks.

Questions

12. If you would like to discuss any aspect of the submission further, please do not hesitate to contact me on the details below.

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