INQUIRY INTO BANKING COMPETITION

Submission from Westpac New Zealand Limited to the Finance and Expenditure Committee.

25 September 2024

TOGETHER GREATER

Executive summary

Introduction.

1. Thank you for the opportunity to submit to the Finance and Expenditure Committee's (**Committee**) inquiry into banking competition (**Inquiry**). Westpac New Zealand Limited (**Westpac**) looks forward to working constructively with the Committee to address the points raised in the Inquiry's terms of reference.

2. Westpac is committed to supporting our customers and the New Zealand economy to grow. We seek to compete and grow our business across all main banking segments, including business, agribusiness and personal banking services.

State of competition in banking.

3. In our experience, within the context of the existing regulatory framework and settings, the banking market is very competitive. Banks compete every day for customers on price, product features and service. This is illustrated by the following examples (which are discussed in more detail in the body of our submission):

   a. **Residential**: The volatility of Westpac's monthly home loan market share growth. From March 2023 to March 2024, our share of the total monthly growth in the home loan market ranged from 33% to negative 8%.

   b. **Agribusiness**: Competition is also shown by longer-term movements in market share in the agribusiness and business sectors. From 2018 to 2023, Rabobank saw its market share increase by 4.7 percentage points. Westpac has also grown its market share in agribusiness from 12.3% in 2015 to 14% in 2023.

   c. **Business and agribusiness**: We often see customers obtaining multiple offers from different banks via a tendering process, which reinforces transparent competition in the market.

4. Lending rates are set by a range of determinants, with the risk profile of a particular loan being a key factor. For example, home lending is relatively lower risk, due to home loan customers' income, costs and asset prices being more fixed and stable compared to business or agribusiness customers. Banks are required to hold more capital against business and agribusiness loans because they have a relatively higher risk. This is intended to act as a financial stability buffer in the event of unexpected losses. The reasons for this differential are set out in detail in Table 8.1 of this submission.

Profitability in banking.

5. Westpac is a stable and profitable bank. This provides stability to the New Zealand economy and allows us to take a long-term approach to supporting customers through economic cycles. Where customers experience financial distress, we work with them through a considered and careful process which aims to return them to financial stability. Mortgagee sales are only considered where all other options have been exhausted. In the agribusiness sector, Westpac has not initiated a mortgagee farm sale since 2017.

6. Westpac's profit as measured by return on equity (**ROE**) is similar to other major New Zealand corporates. Our ROE for the 2023 financial year was 11.8% compared with an average ROE of 11% for NZX50 companies.

7. We believe a key factor influencing profitability in the New Zealand banking sector is the strong relative performance of New Zealand's housing market. Approximately 64% of all registered bank lending is underpinned by the housing market which, over the past 15 years, has significantly outperformed most countries that New Zealand is typically compared to. This relatively stronger house price growth has resulted in strong credit growth over that period which has benefitted New Zealand banks and contributed to profitability.

8. Changes in the proportion of lending to the productive sector relative to residential mortgage lending comes from several factors but is primarily driven by customer demand for lending. This demand is influenced by economic conditions and global events, as well as customer preference for asset classes and earnings streams.

9. Westpac does not add additional lending costs to borrowers based on their emissions, nor do we restrict agribusiness lending based on borrowers' emissions. We set out at paragraph 21 detail about our Westpac Sustainable Farm Loan which offers discounted rates to agribusiness customers.

Barriers preventing competition.

10. Westpac has not seen evidence of barriers to meaningful competition. However, we recognise there are opportunities to address specific areas to strengthen the intensity of competition and to address friction and challenges for new entrants. This is consistent with the views Westpac submitted to the Commerce Commission (**Commission**) as part of the Commission's market study into personal banking services.

11. We are broadly supportive of the recommendations in the Commission's Personal Banking Service – Final Competition Report (**Final Report**). In particular, we expect the establishment of Open Banking will bring value to consumers and businesses.

12. Westpac is making significant investments to enable Open Banking and sees it as an effective means of lowering barriers to entry and bringing new value to our customers. This includes the potential to bring additional benefits to businesses beyond existing data integration between banks and large accounting platforms.

13. Westpac is actively working to support Fintechs and considers this to be an important growth opportunity for our business. We are also one of the main providers of Wholesale Transaction Banking services in New Zealand. This supports competition by allowing third party financial service providers to grow, while reducing the amount they need to invest in system infrastructure.

14. Westpac encourages the Committee to consider two other regulatory matters relating to Fintechs, which are discussed in more detail in paragraphs 41 to 44 of the body of this submission.

    a. Westpac supports the market study recommendation to consider changes to the AML/CFT Act to benefit Fintechs seeking to open bank accounts and considers this will likely reduce barriers for Fintechs.

    b. The Commission's proposal to lower the fee caps on interchange could impact smaller banks and discourage new entrants from entering the New Zealand market as the financial returns for those participants are unlikely to be sufficient to generate an appropriate return on investment and this could impact competition.

15. We also support greater collective government and industry focus on the introduction of centralised national digital identification technology. This would help to reduce friction in the switching process and reduce the risk of fraud and scams. It would also benefit the wider economy beyond banking given the broad applications of this technology.

Impact of the regulatory environment on competition and efficient access to lending.

16. Westpac supports the simplification and optimisation of regulation and sees the potential for regulatory initiatives to further enhance both innovation and competition. These still need to be balanced against financial stability and consumer protection. Unintended consequences should be front of mind throughout any attempt to adjust regulatory settings.

17. Current prudential settings require more capital to be held against business and agribusiness loans compared to home loans. In the case of agribusiness loans, the credit capital requirement is proportionally 2.5 times higher than home lending. Capital for other business segments varies but is also higher than home lending. Despite this differential, Westpac is actively seeking to grow our lending across the business and agribusiness segments.

18. The prudential settings described above are one of several factors that impact the price of agribusiness and business loans. Other factors are the OCR and wholesale rates, lending type and individual customer risk. We also note that the introduction of new capital requirements up until 2028 will increase the price of all lending. Relaxing prudential settings may reduce the price of lending for some customers, but this needs to be balanced against financial stability considerations. The role of regulators and policy makers is to decide on the trade-offs between access to capital and financial stability. We believe New Zealand regulators should regularly compare themselves with international best practice to ensure the best balance.

Rural banking.

19. Westpac is committed to investing in the rural sector. We operate the largest branch network of any of the agribusiness banks in New Zealand, with 105 branches across New Zealand (approximately half of which are in the regions). We have a team of 121 dedicated agribusiness staff that support customers around the country and have $9 billion in lending to the agribusiness sector, with an ambition to grow our market share.

20. We acknowledge the tough circumstances that many farmers are currently experiencing, caused by high costs, falling commodity prices and high relative interest rates. We have supported our rural borrowers during this period by working with them to ensure their businesses are financially sustainable. As stated previously, this approach has delivered measurable results and, since 2017, we have not initiated any farm customer mortgagee sales.

21. In addition, 39% of our agribusiness term lending is now on a Westpac Sustainable Farm Loan, which is proving to be popular with farmers and growers. The loan offers discounted rates to customers who make on-farm decisions to reduce emissions and improve their environmental impact. We are currently providing over $3 billion in discounted lending through this product.

22. The higher overall pricing for agribusiness loans, compared with home lending, is commensurate with the higher risk of agricultural assets compared to other asset types. This is reflected in our impairment figures. For example, at 31 March 2024, 0.29% of our agribusiness portfolio was impaired, compared with 0.13% for business lending (excluding agribusiness) and 0.07% of home lending.

23. Approximately 80% of our agribusiness lending portfolio and 65% of our business (corporate and small business) portfolio is on variable/rolling rates, compared to just 10% for residential lending. This preference for variable/rolling rates meant that our business and agribusiness customers were more exposed than residential customers to rapidly rising interest rates through the most recent cycle of increasing rates. On the other hand, these customers will experience interest rate relief much sooner than residential customers on predominantly fixed rates.

Lending to Māori.

24. Westpac has a long history of supporting and partnering with iwi, Māori businesses, land incorporations and trusts, organisations, communities and individuals to provide access to finance and additional services such as advisory and financial capability support.

25. A focus of our work has been working alongside iwi Māori organisations to support their home ownership aspirations for their people. Through innovative home ownership programmes, we have utilised shared equity and leasing models. Examples include partnerships with Ngāti Koroki Kahukura, Ngā Pōtiki, and Ngāti Whātua Ōrākei. These partnerships have supported whānau to be homeowners in their community of choice, on land they are connected to.

26. In addition, Westpac's work with housing providers to customise our housing models has allowed us to provide over $246 million in home loans to more than 645 borrowers, many of whom are Māori whānau, to facilitate the building of homes under shared equity and leasehold pathways.

The state of competition in banking

1. The New Zealand banking market is competitive within the context of the existing regulatory frameworks and settings. Banks compete strongly for customers on price, product features and service. Westpac puts extensive efforts into trying to retain existing customers, win new customers and improve our position in the market.

2. This can be seen in changes in market shares between the banks, which move materially based on pricing decisions and other factors across all products and services. For example, Westpac's monthly market share in home lending changes significantly each month. From March 2023 to March 2024, our share of the total monthly growth ranged from 33% to negative 8%. This is a clear indication of banks competing for home loan market share. In addition, data from the Reserve Bank of New Zealand (**RBNZ**) shows that 26% of all new home lending in July 2024 was from customers switching banks. This highlights the level of customer engagement and active behaviour by customers to secure the best offering for their needs.

3. Competition is also shown by longer-term movements in market share in the agribusiness and business sectors. For example, from 2018 to 2023, Rabobank has seen its market share increase 4.7 percentage points. From 2015 to 2023, Westpac grew our market share in agribusiness from 12.3% to 14%, in line with our ambition to grow in this sector. Despite these growth aspirations, in 2024 Westpac has lost some market share in agribusiness due to the highly competitive environment. In relation to business banking, Kiwibank recently announced that it has grown its business lending more than three times faster than the market.

4. In the business and agribusiness sectors we often tender for business against multiple banks and pricing offers can be strongly differentiated. We provide our best offer in order to ensure we are competitive both in terms of price and product offering. Customers can and do compare our prices against other offers they have obtained.

The price of banking services, with a particular focus on business and rural lending products.

5. Westpac seeks to ensure that our products and services are matched to customer needs and priced competitively. There are several factors that we consider when pricing our different loan products:

    a. **Cost of funds**: The cost of funds is the cost to a bank to acquire the funds it uses to lend to borrowers. This includes customer deposits, interbank borrowing and wholesale funding.

    b. **Capital**: To support financial stability, the RBNZ requires Westpac to hold credit capital for its loan exposures. As at the end of March 2024, compared to our residential lending exposures, Westpac is proportionately required to hold 2.4 times the amount of credit capital for our business (excluding agribusiness) lending exposures. This is aggregated across multiple business segments with some significant variation. We are required to hold proportionally 2.5 times the amount of credit capital for our agribusiness lending exposures. The RBNZ is currently partway through the phased implementation of its Capital Review which will see total capital requirements increase from 10.5% to 18% of risk weighted assets for the major banks by 2028.

    c. **Operational costs**: Costs to support the operation of Westpac's business, such as customer service costs, technology, fraud management and other operating expenses.

6. There are other elements we consider in our pricing, for example product features that best meet customer needs such as accessibility and flexibility.

7. As noted above, lending to a business or agribusiness is very different from providing a home loan to a residential customer. There is additional risk and complexity when lending to business or agribusiness customers, which impacts the pricing of products for these customers.

8. Table 8.1 below sets out differences in risk between lending for home loans and lending to business or agribusiness customers.

8.1: Differences in Risk between Home Lending and Business/Agribusiness Lending

	Home Loans	Business (including agribusiness) Loans
Income	**Fixed and stable**: The income of home loan customers is generally fixed and the income sources are from across the entire economy which makes the home loan portfolio more resilient to industry specific shocks.	**Income is more variable**: Business and agribusiness revenue fluctuates from month to month, which makes cashflow management more challenging. **Income is impacted by international commodity markets**: Commodity markets (e.g. dairy, forestry and aluminium) are highly competitive and volatile, which can impact cash flow. Customers are also exposed to movement in foreign exchange rates. **High concentration of income sources**: The New Zealand economy is reliant on a small number of key markets such as dairy, meat, forestry and tourism, which increases the likelihood that industry shocks will have a greater impact across the sector (and, therefore, the loan book).
Expenses	**Predictable costs**: Personal living costs are largely predictable and fixed, however they can be impacted by inflation.	**Variable expenses**: Businesses and agribusinesses face greater variability in their costs. Examples of this include changes in the costs of inputs, or the impacts of scaling production up or down to meet seasonal demand. This can make it difficult to predict cost fluctuations for different businesses.
Security value	**Stable housing market**: Residential property is generally stable and secure over the long term and there is a relatively constant level of demand for residential housing.	**Value of the secured asset is based on its income potential**: Investment decisions for a business or agribusiness need to be justified by a return. If the secured asset is less productive (for example, for an agribusiness customer where crop yield decreases due to adverse weather conditions) the value of that asset is likely to be impacted. **Higher risk to loan recovery**: The pool of potential buyers for distressed business assets (such as machinery, commercial property or agricultural assets) is typically much smaller than the residential market. **Income and the asset that we take security over are often tied together**: The property a business or agribusiness customer uses to earn income is often the same property that secured the loan. If the property is impacted (for example, by a flood), both the income and the value of the security can be impacted.
Capital requirements	**Lower capital requirements**: The lower risk associated with lending to home buyers is reflected in the lower level of capital the RBNZ requires lenders to hold.	**Higher risk reflected in higher capital requirements**: Reflecting the higher risk of business and agribusiness loans, the RBNZ requires banks to hold a much higher level of capital for this type of lending to support the stability of the financial system as a whole. For example, capital requirements for agribusiness loans are 2.5 times the level that is required for a residential loan.

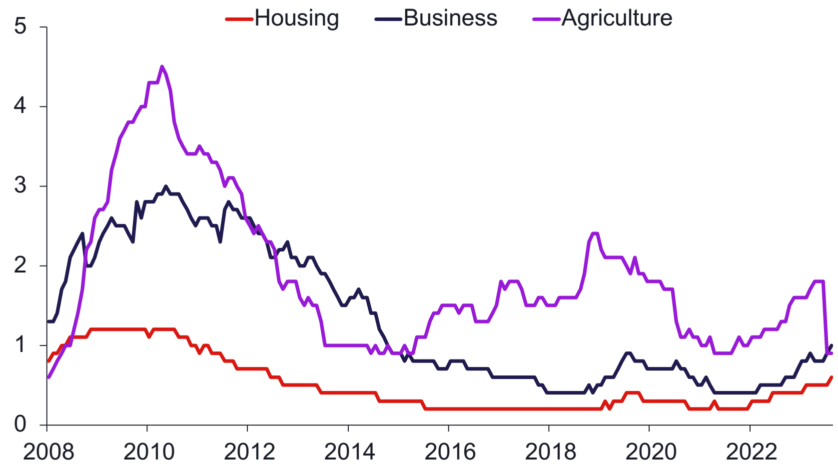
	Home Loans	Business (including agribusiness) Loans
Risk assessments	**Standardised risk assessments**: The similar risk profile of home loans allows lenders to use standardised risk assessments.	**Risk assessments are individualised for more complex customers**: Many business and agribusiness customers are assessed on an individualised basis rather than under a standardised risk assessment. Businesses vary widely both in terms of how they are set up (including product offering, ownership, structure, location, scale) and the environments in which they operate (volatile environments/weather events, customer demand, international markets, commodity prices etc). This is true within the agribusiness sector too with significant variation across farming businesses. Conducting individualised risk assessments requires the bank to dedicate additional resources to understanding the specific circumstances of each customer.

9. Table 8.1 highlights some of the key areas in which residential and agribusiness or business lending are different. In particular, the differences in risk and the additional complexities involved in lending to business and agribusiness customers mean there are different pricing considerations and outcomes for different customers.

10. Business and agribusiness loans are higher risk. There is greater potential for something to go wrong that affects the security for the loan and/or many customers at once (for example, flooding or commodity price movements) and where this happens there is also a much higher likelihood of losses (where customers are unable to pay back their loan). The likelihood of incurring losses in our business and agribusiness books is much higher than residential and the total losses that have been incurred historically are proportionately much higher than residential. Where a customer uses residential land or housing as security, the relatively low risk profile of that security allows them more attractive pricing. In many instances, small and medium sized businesses will choose to use their home as security to get better pricing.

11. The difference in risk is illustrated by the RBNZ graph below, which shows the much higher proportion of non-performing loans within business and agribusiness portfolios:

Bank Assets – Non-performing loan ratios (%)



Source: RBNZ Bank Balance Sheet Survey

12. Given the higher risk profile of business and agribusiness customers, the RBNZ requires that the bank holds additional capital when lending to them. However, even if capital requirements were set at the same level for residential, business and agribusiness loans, we would still need to price business and agribusiness loans higher than residential lending to reflect the increased likelihood of Westpac incurring losses at both an individual and portfolio level.

13. There are also variations in how different customers choose to structure their loans. For example, over 80% of our agribusiness lending and around 65% of our business lending is on variable/rolling rates. By contrast, only 10% of the residential portfolio is variable. Those on variable/rolling rates feel the impact of rising interest rates relatively quickly. Agribusiness customers in particular have been significantly impacted in recent years due to their preference for variable/rolling rates. The upside for these customers is that as interest rates drop, they will benefit quickly from rate relief. Customers who are on fixed rates are less exposed to volatility in the market.

14. The individualised nature of business and agribusiness pricing also makes it harder to give customers immediate visibility of potential pricing (in the form of publicly advertised headline rates). More variability in risk between different customers results in a greater range of potential interest rates at which lending can be offered to customers. This limits the extent to which banks can give meaningful general pricing guidance to both business and agribusiness customers ahead of completing a lending assessment, as the individual risk profile of each customer will have a significant influence on their interest rate. Our bankers are adept at discussing the risk profile of businesses and agribusinesses with their customers and encouraging them to manage risk effectively to benefit from better pricing.

15. Despite the individualised nature, as noted above, we consider there is strong price competition in the market, with business and agribusiness customers often obtaining multiple offers from different banks and presenting them to us to encourage even more competition for their business. We provide our best individualised offer to ensure we are competitive both in terms of price and product offering. Customers can and do compare our prices (and other product features) against other offers they have obtained.

Profitability in banking, how it has changed over time, and how it compares to other OECD economies.

16. For our last full financial year (FY2023), Westpac reported an after tax net profit of $963 million. This number needs to be considered in the context of our scale. We recognise that the profit number we report is large, but the scale of our business is significant and the amount of capital we employ is also significant. Our size provides benefit to all New Zealanders in terms of access to capital globally.

17. Westpac holds over $120 billion in assets and lends over $100 billion to customers around New Zealand to help them achieve their financial goals. We have over 5,000 employees in New Zealand.

18. ROE is a common way to compare profitability across businesses and better accounts for differences in scale. Westpac's ROE in our most recent full year result was 11.8%. This is the lowest of the four Australian-owned banks and compares with the average ROE of 11% for NZX50 companies.

19. Between 2018 and 2023, for every dollar of revenue that was earned, 77 cents was spent in New Zealand. For example, in the 2023 financial year $2.2 billion of revenue was spent in New Zealand. This includes payments to employees, paying New Zealand tax and payments to New Zealand suppliers of various goods and services needed to run the bank in New Zealand.

20. Furthermore, approximately 21,000 of the shareholders in Westpac Group, our parent company, are New Zealand-based and benefit from dividend payments.

21. A key factor influencing profitability in the New Zealand banking sector is the strong relative performance of New Zealand's housing market. Approximately 64% of all registered bank lending is underpinned by the housing market which, over the past 15 years, has significantly outperformed countries that New Zealand is typically compared to. This relatively stronger house price growth has resulted in strong credit growth over that period which has benefitted New Zealand banks and contributed to profitability.

22. The financial stability of banks is critical to New Zealand's economy. The long-term financial success of the banks gives New Zealanders confidence that their money is safe and enables banks to support customers through economic cycles. Globally, we have seen the impact of bank failures and how this affects a financial system as well as individual customers who trusted their money would be safe. Financial stability is particularly important for New Zealand, given our small size and geographical distance to other markets. Having a strong, stable financial system ensures that New Zealand banks can access overseas funding (which can reduce the overall rate customers pay on their lending).

23. Having stable and profitable banks also ensures that during difficult economic periods, banks can withstand shocks and protect customers' money. An example of this was during the COVID-19 pandemic, when bank profitability significantly reduced, but banks were able to withstand this period given responsible fiscal management in prior years.

Bank profitability – Return on Equity (%)

Source: RBNZ Income Statement Survey

The return on capital from business, rural, and residential mortgage lending.

24. In addition to the information provided about the difference in risk and allocated capital between segments, there are many factors that impact returns, such as how costs are distributed within our business, and the costs, composition and allocation of funding. Therefore, it is hard to compare these returns between banks. Westpac does not typically publicly report on individual portfolio returns, however a review of overall business returns across each of our business units for the 2023 financial year shows that our Institutional & Business Banking returns (excluding agribusiness) are slightly higher than our Consumer Banking returns, with agribusiness providing the lowest overall returns out of the three.

The level of interest rates charged to each sector.

25. Please refer to paragraphs 5 to 15 of this submission which explain the differences in interest rates and pricing for different sectors.

An assessment as to whether there has been a change in the proportion of lending to the productive sector relative to residential mortgage lending.

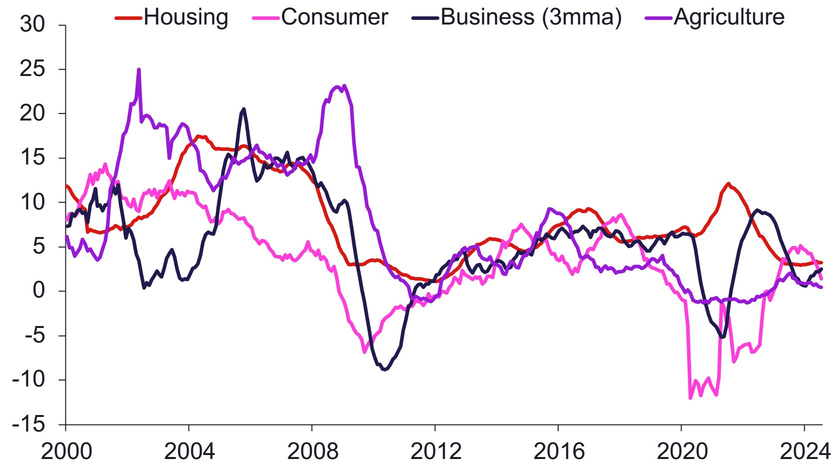
26. Westpac actively lends to customers in multiple sectors and benefits from a balanced and diversified loan portfolio. We want to ensure that we are lending responsibly to customers with profitable business models so we can support these customers through economic cycles.

27. Changes in the proportion of lending to the productive sector relative to residential mortgage lending comes from several factors but is primarily driven by customer demand for lending. Customer demand will be influenced by economic conditions both in New Zealand and globally, which includes asset prices and commodity prices. The impact of global events will also affect lending demand for different sectors. For example, during the COVID-19 pandemic interest rates were low, driving an increase in prices for assets such as residential housing, which were less impacted by COVID-19. Conversely, demand for business lending was low due to the impact of lockdowns on business trading.

28. Another factor that impacts demand for lending is the investment decisions our customers make. This can be particularly apparent in the agribusiness sector where there may be increased demand to convert land to support different types of production, such as during the dairy boom in the 2000s.

29. The graph below shows the variation in credit growth rates by sector in New Zealand since 2000. This illustrates that at times the credit growth across the different sectors follows similar trends, while there are also periods of disparity.

Annual Credit Growth by Secor (%)



Source: RBNZ Bank Balance Sheet Survey

30. Housing credit growth between 2000 and 2010 reflected the trends in house sales. There was strong growth in the early part of the decade which gave way to weaker activity following the Global Financial Crisis (**GFC**) as economic activity reduced and access to credit tightened. Consumer credit followed a similar trend in line with the slowdown in household spending. For business credit, strong economic growth supported increased investment spending and demand for credit in the early part of the decade. However, this declined following the GFC, as credit conditions tightened and economic activity slowed. In agribusiness, credit demand in the early part of the decade was boosted by land being converted to dairy farms and related investment spending.

The effect of any bank lending policies relating to borrowers' emissions that result in additional lending costs and/or lending restrictions.

31. We recognise that climate change is a complex problem that requires a carefully balanced approach of mitigation and adaptation to its impacts. For our agribusiness customers, Westpac does not charge customers more based on their emissions, nor do we restrict lending based on borrowers' emissions.

32. Our Sustainable Farm Loan offers discounted rates to support customers who make on-farm decisions to reduce emissions and improve their environmental impact. This is proving popular with our customers and we are proud of the fact that 39% of agribusiness term lending is now on a Westpac Sustainable Farm Loan.

33. This loan is based on the Westpac Sustainable Farm Standard, which recognises and complements other farm assurance programmes, reducing duplication and reporting commitments on-farm. This standard takes a whole-of-farm approach to sustainability and can help customers position their farm to be more resilient in the face of adverse weather events arising from climate change.

The level of customer "switching", how this has changed over time, and how this compares to other countries.

34. Westpac regards further increasing switching rates in the market as an opportunity to attract new business and is supportive of the Commission's recommendations to reduce real and perceived friction in the switching process.

35. Switching is readily available to the two thirds of our customers that have customer relationships with more than one bank. This 'silent' switching by customers with existing multi-bank relationships is difficult to account for in overall switching data.

36. We have recently observed higher customer engagement with banking services and an increased level of switching activity. As noted above, in July 2024, the number of customers switching in the market for residential mortgages climbed to a record high with the value of mortgages refinanced by another bank reaching $1.75 billion.[1] This made up 26% of all new home lending. Switching in the market translates to significant variations in market share month on month as a result of customers taking advantage of the best offers in the market.

37. Westpac considers there is still more that can be done to support higher levels of switching in the market. Westpac supports the measures recommended by the Commission in its Final Report such as increasing the promotion of the existing switching service to customers, the pro-rating of cash back clawbacks when switching home loans and the reduction of barriers to onboarding new customers to banks.

1 It was reported that the value of mortgages refinanced by a new bank climbed to $1.75 billion in July 2024– the largest amount since the RBNZ started publishing this data. Sourced from the New Zealand Herald, *High interest rates see bank-switching among those with mortgages hit record high* (29 August 2024).

Reducing barriers to competition in banking

38. Westpac welcomes competition and supports any initiatives that further enhance competition. In this section we discuss the Commission's recommendations in the Final Report that we consider will be the most impactful in terms of reducing barriers to competition for the industry (including for non-bank deposit takers (**NBDTs**), Fintechs and smaller banks). We also comment on further opportunities including e-Money regulations for Fintechs and the introduction of centralised secure national digital identification technology. As stated above, we have concerns with the proposal to potentially lower interchange fee caps and the barriers this could create for smaller players who may be early use cases for Open Banking.

Any limits on the growth of non-bank deposit takers and any restrictions on overseas investment/new entrants, including Fintechs.

39. Westpac supports the growth of NBDTs and Fintechs and welcomes new entrants to the market. We consider that ongoing improvements in innovation, technology and Open Banking will further assist this growth.

Wholesale Transaction Banking and funding of smaller financial institutions

40. Westpac is proud to have been a leader in providing Wholesale Transaction Banking services since 1997 and funding smaller financial institutions. Through this service and our funding, Westpac provides 33 smaller banks, NBDTs and financial institutions with funding and/or transactional services, as well as access to 'ESAS accounts' (a payments and settlement processing system that is necessary for clearing customers' payments) and shared technology platforms. Wholesale transactional and funding services significantly lower the costs, complexity and timeframe of entering and participating in the New Zealand market. By supporting smaller providers in the market, Westpac is encouraging competition and greater access to capital for customers. This enables these providers to more readily compete with the main banks in New Zealand and they can be market leaders in certain products or regions (for example, Heartland with its market leading reverse mortgage offering).

Other factors that impact competition.

41. The market study recommendation to consider changes to the AML/CFT Act to benefit Fintechs seeking to open bank accounts will likely reduce barriers for Fintechs. By having a simpler regime or an exemption from the AML/CFT Act for Fintechs, banks would have greater confidence that banking Fintech customers would not expose the bank to material risk and liability. This may also give consumers greater confidence when using their services.

42. The Government should consider the UK e-Money regulations to further reduce barriers to banks onboarding Fintechs in New Zealand. Under the United Kingdom regime, e-Money institutions (EMI) are required to be registered and comply with capital, safeguarding, outsourcing, record-keeping, and audit requirements for money held in bank accounts maintained by the EMI. The regulations also provide rules for issuing and redeeming e-Money, meaning funds held by the EMI are not held on trust. This allows banks to deal only with the EMI. These regulations make it easier to onboard Fintechs offering certain types of payments, such as digital wallet or other payment system providers.

43. Fintechs can be riskier and significantly more difficult for banks to onboard and monitor as customers as they often hold bank accounts in the name of the Fintech but which contain funds owned by the Fintech's underlying customers. This model puts significant transaction monitoring obligations on banks and can result in reputational and legal risks to the bank if an underlying customer suffers a

loss. For example, Westpac could be subjected to claims from an underlying customer who suffers a loss because a Fintech fails to deal with the customer's money in accordance with the terms of the underlying customer's account (which the bank cannot monitor). We consider that Fintech customers should be responsible for AML/CFT obligations rather than the bank working with the Fintech. e-Money regulations in New Zealand would give banks more confidence that Fintechs meet capital, safeguarding, outsourcing, record keeping and audit requirements and make banks more confident to onboard certain Fintechs. This would promote greater competition and innovation in the market.

44. Separately, Westpac is concerned that the Commission's recent proposal to lower interchange fee caps is likely to discourage new entrants (including Fintechs) and impact their ability to compete in the payments space. All card issuers rely on interchange fees to fund their operating costs and to enhance their debit and credit card propositions. Under the proposal, credit card interchange would be reduced to below the levels in Australia, the UK and the EU. Reducing the fee caps to the proposed levels is likely to restrict innovation, and competition across the payments market, particularly from smaller bank competitors. Lower interchange fees will also disincentivise new entrants (both smaller bank competitors and Fintechs such as Revolut and Wise) into the market given the relatively small size of the New Zealand market and the limited financial returns available under the proposed lower pricing caps.

Any outstanding constraints on the use of technology and Open Banking.

45. Westpac is committed to the successful establishment of Open Banking by June 2026 and supports the recommendations made in the market study. Open Banking represents an opportunity to reduce barriers to entry for Fintechs and to promote innovation that brings value to our customers, especially in personal banking. While businesses already benefit from our existing data integrations with accounting platforms, we consider the value of Open Banking for businesses will increase as APIs develop and modernise. For businesses, we expect over time that Open Banking should increase efficiencies, payment conversion rates, data quality, access to customers and cashflow due to intra-day settlements.

46. To maximise the uptake of Open Banking initiatives, it is important that customers have confidence their data will remain secure. Industry and Government must continue to work together (alongside other stakeholders, including social media companies and telcos) to counter the increasing prevalence of sophisticated fraud. This is crucial to maintaining New Zealand's reputation as having a stable and safe financial system.

47. Westpac also supports the introduction of centralised secure national digital identification technology. This has the potential to drive forward the use of Open Banking and technology in the sector. The benefits for consumers would include increased fraud protection, additional payments innovation, easier switching and enhanced financial insights. This would have a large impact beyond the banking industry with wide reaching social and economic benefits for New Zealand. To ensure that this is as effective as possible it requires:

    a. clear ownership within government;

    b. support from a strong technology provider; and

    c. transferable verification across all sectors (not just banks).

The role of Kiwibank as a competitor.

48. We consider Kiwibank to be an effective competitor with continuing growth in market share. In the most recent financial year, Kiwibank grew its lending book by 9.3% and home lending 2.7 times faster than market. In business lending, Kiwibank grew over three times faster than market.

Impact of the regulatory environment on competition and efficient access to lending

49. Westpac is broadly supportive of the Commission's recommendations to optimise regulation and sees the potential for these initiatives to further enhance innovation and competition. Financial stability and unintended consequences should remain front of mind throughout any attempt to adjust regulatory settings.

Any impact on the allocation of bank lending by sector, such as business, rural, and residential mortgage.

50. As noted at paragraphs 27 and 28 of this submission, allocation of bank lending by sector changes over time and is driven by a number of factors, but primarily customer demand.

The role of prudential regulation and any impacts on risk allocation, smaller banks, and non-bank deposit takers (NBDTs).

51. Prudential capital requirements should be as competitively neutral as possible, but not at the expense of financial stability.

52. Westpac supports exploring additional measures to enhance competitively neutral outcomes while ensuring consideration of the potential for unintended consequences or avoidable inefficiencies in the financial system. Once the Capital Review decisions are fully implemented in 2028, New Zealand will have the most conservative capital settings in the world relative to comparable countries. We note that in the US and UK, prudential regulators are considering moderating requirements for banks to increase their capital buffers under the Basel III rules due to concerns that higher capital holding requirements would raise lending costs and reduce economic activity.

The role of bank regulators (FMA, MBIE, RBNZ) and whether the regulatory environment can be simplified.

53. There is further scope to optimise regulatory settings to support competition and simplify the regulatory environment. Opportunities include:

    a. **Introducing a regulatory sandbox**. Several overseas jurisdictions have introduced a regulatory sandbox, which allows businesses to test certain innovative financial products and services without first obtaining full licencing or regulatory approvals. This would provide new entrants and incumbents with greater confidence to develop and launch new products and services by reducing the regulatory risks associated with their introduction.

    b. **Developing a long-term regulatory roadmap**. The current uncertainty as to the long-term "rules of the road" makes it difficult to invest in the development of new and innovative products. A long-term regulatory roadmap outlining the timing, sequencing and coordination of planned regulatory changes would enable strategic delivery of those changes in a way that supports greater investment in innovation.

    c. **Streamlining regulator oversight**. Banks are regulated by the RBNZ, Financial Markets Authority (**FMA**) and the Commission. Reducing existing overlap between roles and responsibilities would allow some resources that are currently spent on compliance to be reallocated to delivering innovative projects. Westpac supports the ongoing work by the Government to streamline how banks are regulated in New Zealand.

Determine how and to what extent the RBNZ's capital requirements and credit risk models influence lending rates (see emphasis in Rural Banking section).

54. The RBNZ's capital requirements have a direct impact on the bank's returns and, therefore, have an influence on the lending rates offered to customers. The RBNZ modelled that the increase in capital requirements would increase lending rates by 20-40bps on average across all lending. We note that this is an average and more capital-intensive portfolios would be higher.

55. As previously noted, capital settings are one of several factors that impact lending rates. Other factors are the OCR and wholesale rates, lending type and individual customer risk.

Climate related disclosures.

56. As a country, and across successive governments, New Zealand has committed to achieving Net Zero Emissions by 2050. Action is required across the public and private sector to achieve this goal. Westpac supports this goal, which is important to help manage climate-related financial risks, including the risk of reduced access to capital should we fail to adequately manage these climate risks. Westpac supports climate disclosures as they are important to help understand and manage these risks. We are supporting our customers by providing discounted products, such as our Sustainable Farm Loan, Sustainable Business Loan and Greater Choices Home Loan to incentivise and help our customers to take action to help manage their climate-related risks and meet these climate goals.

Whether the RBNZ's focus on "financial stability" impeding the development of competitiveness, particularly amongst NBDTs and existing / potential Fintechs.

57. While we are supportive of further enhancing competition, the RNBZ's focus on financial stability is important and any changes would need to be carefully considered. For consumers to fully engage in the financial sector, they need to trust the stability and security of financial service providers and the sector as a whole. Retaining trust through any regulatory change is crucial.

Rural Banking

58. Westpac has been supporting rural communities and agribusiness customers in New Zealand for over 150 years. Rural and agribusiness customers are a fundamental part of New Zealand's economy and it is clearly in the bank's commercial interest to support these customers to thrive and grow. Westpac has over $33 billion in business lending including over $9 billion in lending to our agribusiness customers. We want to continue to support the sector and grow our lending further. We welcome competition in this sector.

Determine how and to what extent the RBNZ's capital requirements and credit risk models influence lending rates to agriculture and horticulture businesses.

59. We refer to our response at paragraphs 5 to 15 of the body of this submission.

Ascertain whether the RBNZ's approach to greenhouse gas emissions risk, including risk of government policy, has and is likely to result in further increases in lending rates to the agriculture and horticulture sectors.

60. There are no prudential requirements that specifically relate to greenhouse gas emissions. The purpose of the RBNZ's capital adequacy requirements is not to encourage nor discourage lending to specific sectors and they do not penalise lending to the primary industries. Instead, these requirements are designed to ensure that banks hold enough capital against a loan to reflect its risk profile, including by taking into account climate-related risks, for the purpose of supporting overall financial stability.

61. Climate-related risks can be incorporated into the existing capital adequacy framework. There is no need for the RBNZ to deal with these risks separately as there is no fundamental difference between climate-related risks and any other risk faced by the banking sector.

Ascertain whether bank environmental and sustainability policies have or are likely to result in further increases in lending rates to the agriculture and horticulture sectors.

62. Our environmental and sustainability policies do not increase lending rates to the agriculture or horticulture sectors.

63. Westpac is proud to support some of the world's most emissions-efficient farmers. New Zealand is a global leader in agricultural management and technology. Most New Zealand farmers have made changes or improvements to their farm and this trend is set to continue as sustainability becomes increasingly important for end-consumers in high-value markets. Most of New Zealand's leading food manufacturers have set emissions reduction targets for their suppliers.

64. We realise that customers themselves best understand what works for their business. This is why we work alongside our customers on their goals to become more sustainable businesses and to more proactively manage their climate risk.

Ascertain whether there is adequate transparency on lending rates for rural, residential, and business lending.

65. Customers receive clear information setting out their interest rates, lending conditions and any fees. At paragraph 14 of the body of this submission we set out the factors that make it more difficult to provide agribusiness and business customers with immediate visibility of pricing across the market (in the form of headline rates) than for residential customers. As noted, customers frequently get offers from other banks during the tendering process and market testing, so are able to compare lending rates on that basis.

Access to banking services, including access to cash services, especially in rural areas.

66. Westpac has the largest branch network of any of the agribusiness banks in New Zealand, with 105 branches across New Zealand (approximately half of which are in the regions). We recognise that access to banking through a range of channels is critical to the communities we serve and we want to ensure we support our customers in the way that suits them best. While there has been a significant shift towards digital service, we are committed to maintaining our presence in rural communities.

67. Westpac's team of 121 agribusiness staff are based around the country and visit customers on their farms so they can better understand their businesses. Our frontline staff have financial qualifications

and many have backgrounds in the primary sector making them well placed to understand our customers' needs.

68. Our staff work with customers to ensure their financial planning and management is appropriate for now and the future and they assist customers with managing any financial challenges. We encourage staff to identify customers in financial difficulty as early as possible to ensure we can provide any additional support required to get them back on track. We actively analyse customer data to identify customers most at risk of financial distress and endeavour to contact them proactively so we can work with them to mitigate risk of further stress. As noted, since 2017, we have not initiated any farm customer mortgagee sales.

69. Westpac has strong local relationships with the Rural Support Trust which provides support to farmers in New Zealand to help rural people through financial, health and wellbeing challenges. We also provide financial support for its Business Support Fund to fund external advisors (such as farm consultants, accountants and business advisers) for customers as required.

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

70. Westpac has a long history of supporting and partnering with iwi, Māori businesses, land incorporations and trusts, organisations, communities and individuals to provide access to finance and additional services like advisory and financial capability support.

71. Many of these partnerships have led to positive financial outcomes for Māori and iwi over an extended period of time.

Ascertain what is the experience of Iwi (organisations and asset holders) and Māori (asset-holders and businesses) accessing banking products and services.

72. We consider this question is best answered by iwi and Māori submitters to provide independent views.

Investigate whether banks are unreasonably resistant to accepting Māori land as collateral for borrowing.

73. Westpac has many Māori and iwi customers that we have provided lending to using Māori land as security. The ability to service any lending is our top priority and security is another consideration. We have many products that can be used for lending to Māori and iwi, and some of these do not require us using land as security.

74. Westpac has long relationships with large Māori land incorporations such as Wakatū and Mangatu, who we have supported since their inception.

75. In relation to our more recent partnerships with iwi and Māori entities, we have been using a model known as 'Public Iwi Private Investment'. This model has been very successful, including where there has been government investment, which has stimulated regional economic growth. More recently this has been used in the recovery of businesses in flood-affected areas.

76. Through our innovative home ownership programmes, we have utilised shared equity and leasing solutions. These have been effective partnerships that support whānau to be homeowners in their community of choice, on land that they are connected to. Some of the most publicised examples are:

a. our work with Ngāti Koroki Kahukura on a contemporary papakāinga;

b. a shared home ownership partnership between Ngā Potiki, Te Puni Kōkiri and Westpac;

c. the Ngāti Whātua Ōrākei Iwi housing initiative which is a partnership with government, iwi and Westpac that will support whānau into homes on their ancestral land; and

d. Te Karearea – Waikato Tainui home ownership programme, also in partnership with government, iwi and Westpac.

77. Through these projects, as well as others, we have adapted our processes, including the requirements for standard lending criteria and credit risk, to suit these models. We continue to support growth in this area, including by having funding underway for further provision of affordable housing.

78. We have also supported lending to Māori land incorporation customers that we have a long history with. Some of these are large agribusiness customers who have diversified and now include housing as part of their operations.

79. Lending in this way, where we look at alternative options, work in partnerships and lend where there is leasehold land, has required a change in our mindset and approach. We are proud of the work we have completed in this space and the work we continue to do to grow and support lending to iwi Māori.

80. We acknowledge there is more to be done, in particular:

a. growing the cultural confidence of our bankers so that we can develop deeper relationships with our iwi and Māori customers;

b. increasing the representation of Māori employees in the financial services sector; and

c. ensuring we have tools and processes so that we are easily accessible for iwi Māori customers, from lending through to advice.

81. Westpac is committed to uplifting knowledge and understanding in this area and continuing to find ways to improve the experiences of Māori accessing banking products and services.

Investigate whether banks' processes and procedures contribute to the Māori individuals and households having a disproportionately low rate of home ownership.

82. As noted above, we have developed successful programmes in partnership with iwi Māori to help whānau own their own homes in their communities and on land that they have a connection to.

83. We have worked in partnership with government entities such as Kāinga Ora and helped to create a shared equity home ownership product to assist all New Zealanders to access finance. In particular, this has assisted Māori whānau, given it was developed in partnership with the New Zealand Housing Foundation, who work closely with iwi to provide shared home ownership support to their members.

84. By working closely with housing providers to customise our housing models, Westpac has been able to provide over $246 million in home loans to more than 645 borrowers, many of whom are Māori whānau, to facilitate the building of homes through shared equity and leasehold pathways.

TOGETHER GREATER

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