FinSec submission to the Inquiry Into The Australian Financial System

Attachments to the submission include:

The Changes Banks Face, Peter Harris 1996

FinSec submission on Reserve Bank's proposed revisions to banking supervision arrangements

Towards Better Banking Regulation and Supervision, FIET

Section 1 Introduction

The issues raised by the Inquiry and the possible outcomes have enormous and far reaching effects on this side of the Tasman.

1.1 FinSec is the union representing finance sector employees in New Zealand. It was formed by the amalgamation of the Bank Officers' Union and the Insurance Workers Union in 1990. Since that time it has merged with the Stock and Station Workers Union, the Reserve Bank Union and various smaller staff associations. It has also taken over coverage of those finance sector employees who were previously covered by the Clerical Workers Union.

1.2 FinSec has over 16,000 members. We have collective contracts with the four major banks - BNZ, ANZ, National and WestpacTrust. We also have a collective contract with Countrywide Bank. There are no collective contracts with ASB Bank or the smaller non retail registered banks. The union also has members in the insurance sector and collective contracts with the major insurers, both life and general. We also have membership and collective contracts among non bank financial institutions.

1.3 FinSec views the deliberations and conclusions of the Financial System Inquiry as the single most important event in our sector since deregulation in the mid 80s. We believe that the issues raised by the Inquiry and the possible outcomes have enormous and far reaching effects on this side of the Tasman.

1.4 We believe that the necessary debate within New Zealand around the implications of the work of the Inquiry has not taken place and we view this with some concern. We therefore see it as entirely appropriate that the Inquiry visits New Zealand to look at the effects of the reforms in this country and to investigate the possible implications in this country of their work.

1.5 We appreciate the opportunity to provide the Inquiry with the views of finance sector staff in New Zealand.

Section 2 FinSec’s interest in the Inquiry

The New Zealand finance sector is dominated by Australian owned institutions. Any effects on those institutions in their domestic base will inevitably impact on their New Zealand operations.

2.1 FinSec’s interest in the work of the Inquiry comes out of a number of factors.

i **Australian penetration of the New Zealand finance sector.**
Put briefly, the New Zealand finance sector is dominated by Australian owned institutions. Any effects on those institutions in their domestic base will inevitably impact on their New Zealand operations. Section three explores this further.

ii **Closer economic relations**
The moves to increasingly link the two economies are well documented and provide an international model for closer economic linkages between two sovereign states. The finance sector mediates the relationship in a special way. Changes in one country cannot help but impact on the other and this must affect the finance sector of that other country.

iii **Globalisation**
A key component of Australian economic policy is globalisation; that is the recognition that an economy cannot exist independent of developments elsewhere in the world and of the opportunities that this creates. Associated with this must come, in FinSec’s view, a recognition that the effects of any internal changes will impact to a greater or lesser degree, on other countries. It is the responsibility of the ‘host’ country to understand these effects and take them into account.

2.2 **New Zealand experiences with reform**
New Zealand has already experienced many of the finance sector reforms under consideration by the Inquiry. Our wish is to have the experience of finance sector employees heard in an examination of those reforms.

Section 3 The New Zealand Finance Sector

In the event of a modest increase in bad debts eroding trading profits and imperilling capital adequacy the stability of the New Zealand system falls back entirely on the soundness of the Australian parent banks.

3.1 This section describes the New Zealand finance sector with a particular emphasis on the penetration of Australian owned institutions.

3.2 The points that we wish to make in this section ares follows:

- banks dominate the finance sector in New Zealand.
- there is a heavy concentration (by international standards) in banking in New Zealand.
- Australian owned bank dominate the finance sector.
- trends in the changes in banking in New Zealand are similar to overseas trends.

TABLE 1: Profile of New Zealand banking

Registered banks	Date	Total assets $'000	Branch numbers	Employee numbers
Westpac/Trust Bank (total combined)	30 Sept 1995	24,056,850	412	6,813
Bank of New Zealand	30 Sept 1995	21,962,700	267	5,549
ANZ Banking Group	30 Sept 1995	17,932,635	280	5,953
National Bank of New Zealand Ltd	31 Dec 1995	15,548,000	180	3,821
ASB Bank	30 Jun 1996	9,092,819	126	2,319
Countrywide Banking Corporation	29 Feb 1996	6,483,022	72	1,189
The Hongkong & Shanghai Banking Corp	31 Dec 1995	3,564,979	2	172
Bankers Trust NZ Ltd	31 Dec 1995	2,163,716	1	104
Citibank, N.A. (New Zealand operations)	30 Jun 1996	1,478,329	n/a	109
Barclays Bank PLC (New Zealand operations)	31 Dec 1995	1,088,985	1	n/a
BNZ Finance	30 Sept 1995	1,016,202	6	79
TSB Bank Limited	31 Mar 1996	614,793	16	211
Primary Industry Bank of Australia Ltd (New Zealand operations)	31 Dec 1995	232,085	4	15
Banque Indosuez (New Zealand operations)	31 Dec 1995	211,481	n/a	n/a

Australian "four pillar" banks Source: KPMG 1996 New Zealand Financial Institutions Performance Survey, October 1996

3.3 The seven registered banks which offer national retail banking networks are the four Australian owned foreign banks (ANZ, BNZ, ASB and WestpacTrust). The remaining two banks are wholly owned by UK banks - Bank of Scotland owns Countrywide and Lloyds owns National Bank.

3.4 Since deregulation we have seen the classic rapid expansion in the number of registered banks (four in April 1986 to a peak of 23 in 1990). This rationalisation has been a result of strong competition and difficult economic conditions. As a result we have seen banks completely withdrawing from New Zealand over a steady process of mergers.

3.5 A casual glance at *table 1* would suggest that given the market dominance of the four major banks (ANZ, BNZ, National and WestpacTrust) we have actually gone back to the conditions that existed prior to deregulation.

3.6 The concentration (total assets) of these four largest banks among registered banks is 77%. Among all financial instituitions as measured by the KPMG survey the concentration of these four major banks is 71%. In 1985 the concentration (total assets of all financial institutions) was 50%. (Peat Marwick 1986). It is suggested that through the seventies and the early eighties the concentration of the four trading banks would have been higher as by the mid eighties some elements of deregulation or at least attempts to avoid the effects of regulation had already the taken place.

3.7 ***Conclusion: Deregulation has actually tended to concentrate the industry and ironically taken it back to the situation that existed prior to deregulation.***

TABLE 2: Payment types by volume 1993-95

TABLE 3: Access to banking services - international comparisons

Country	ATMs	Population per ATM	EFTPOS terminals	Population per terminal
Australia (1995)	8,700	2,022	49,000	359
Canada	16,927	1,725	119,733	244
France	20,533	2,810	437,000	132
Germany	29,400	2,768	62,500	1,302
Japan	122,250	1,022	28,320	4,413
New Zealand (1995)	1,419	2,466	28,719	122
United Kingdom	19,500	2,994	350,000	167
United States	109,080	2,390	375,500	694
AVERAGE		**2,275**		**929**

Source: New Zealand Bankers' Association Annual Review 1995

3.8 *Tables 2 and 3* illustrate that the new banking system follows (or even possibly leads) overseas trends in the move away from paper based transactions to electronic forms of banking. The high uptake of EFTPOS is illustrative of that fact.

3.9 The aggressive use of pricing strategies by the banks also has a lot to do with the migration of customers away from branches and paper based transactions.

TABLE 4: Bank branches and ATMs as at end of December 1995

3.10 The number of branches in New Zealand has also declined, albeit rather slowly. In some cases (for example ASB), there has been an aggressive move to open more branches. In other cases branches have been closed through the process of merger (Countrywide and United or ANZ and PostBank).

3.11 In all cases branch numbers are constantly under review and all banks have moved to close down non profitable branches as a normal part of business. This will go on regardless of the impact of further mergers.

3.12 We are aware that there is some divergence of thinking in the industry about the role of branches as part of an integrated distribution strategy and the dangers that a branch closure plays to that strategy. It seems agreed however that what goes on inside bank branches (or more correctly - points of representation) is changing.

TABLE 5: Bank employee numbers (full time equivalent)

Source: KPMG 1996 New Zealand Financial Institutions Performance Surveys

3.13 While there has been a slow decrease these numbers in our view are remarkable by their consistency. It is hard to argue that mergers or other changes in banking have resulted in significant job losses in the industry. Our argument (in section) is that the nature and character of any further mergers will be quite different and will significantly impact on these numbers.

Concentration of Australian finance institutions in New Zealand

FIGURE 1: Total assets in finance institutions (banks, finance companies and savings institutions) $000

FIGURE 2: Total assets in banking ($000)

FIGURE 3: Full time equivalent employees

FIGURE 4: Banking branch numbers

3.14 These pie charts clearly show the concentration of the Australian owned banks in New Zealand. In our view they clearly signal the importance of the Australian financial system and any changes in it to this country and to those who work in this industry.

3.15 The Regulation of New Zealand finance institutions

i The New Zealand system may be described as light self regulation. It relies heavily on transparency as the transmission mechanism that ensures the solvency of the individual institution and individual solvency as the building block of the stability of the banking system as a whole.

ii Systemic stability has been assured in the past by two factors - a regime of reserve asset ratio requirements and the fact of extensive government ownership of financial institutions.

iii Previously the government owned such significant institutions as the BNZ, Rural Bank, DFC, PostBank, State Insurance and Government Life. Only the latter is still in the government's hands.

iv The ownership of these institutions carried with it an implicit guarantee by government of deposits and investments. In the case of the various Trust Banks which were also publicly owned the guarantee was explicit.

v Actions such as the successive bailouts of the BNZ were part of that system and a recognition of the importance of systemic stability. With the sale of these institutions has gone the implicit guarantee or even the option to chose an institution with a government guarantee.

vi The Reserve Bank does require banks to maintain adequate capital bases. There is a constant suspicion that this has more to do with international acceptability to the financial community than with a view as to the necessity of such a requirement to maintain solvency and stability.

vii What are the capital requirements? Leaving aside the technical definitions, the concept of Tier One capital is that it is part of the liabilities of the bank that are the 'owners risk' and eventually 'residual risk'. All other liabilities are 'customer risk'.

viii Tier Two is a cushion. It includes items of 'quasi capital' like capital notes with a maturity of greater than five years, building revaluations and other reserves. These are liabilities that the bank does not have to find the cash to pay out immediately in the event that there is a run on the bank.

viv The Reserve Bank requires both tiers to amount to at least 8 % of assets, but Tier Two can not be more than half of the total.

x New Zealand banks, including those that are Australian owned, are not exactly capital rich. The relevant capital adequacy ratios are presented below.

TABLE 6: Capital adequacy ratios in New Zealand banks

Bank	*Total Capital Adequacy Ratio (%)*	*Tier One CAR (%)*
ANZ	10.3	7.8
ASB	10.2	8.6
BNZ	10.8	6.6
Countrywide	12.0	6.6
National	9.12	7.2
Westpac(pre merger)	13.9	9.5
Trust Bank	11.7	9.4

Source: KPMG 1996 New Zealand Financial Institutions Performance Survey, May 1996. (As at 31December 1995)

xi There is always a degree of discretion about how different categories of capital and reserves are classified and how assets are risk weighted. It always prudent to regard published ratios as an optimistic assessment of capital adequacy.

xii The margins of satisfaction are around 2.5% of assets. That compares with returns - net profit after tax- (for the New Zealand banks as a whole and not only the Australian owned banks) of 1.13% of average total assets. Provision for bad and doubtful debts are 1.18% of those assets.

xiii A modest (by 1987 standards) increase in bad debts would rapidly erode trading profits and imperil capital adequacy. In that event the stability of the New Zealand system falls back entirely on the soundness of the Australian parent banks which will in turn be reflected (in part) in the prudential requirements that the Australian system imposes on them.

3.16 Banking Supervision

i Arising out of a policy review commenced in late 1991, the Reserve Bank radically changed its banking supervision arrangements. The new arrangements were introduced in late 1995. (For a good summary of the changes and the policy issues driving the changes see *Review of banking supervision: Reserve Bank's policy conclusions* Reserve Bank Bulletin, Vol 58 No.2,1995.)

ii Prior to the introduction of the new arrangements, New Zealand maintained a relatively orthodox supervisory regime. The only unorthodox feature was in the objectives the regime sought to achieve. Rather than protection of depositors' interests *per se* it focussed on protection and stability of the financial system as a whole.

iii Another feature of the New Zealand system was (and still is) the Reserve Bank’s approach to the registration of banks. The Reserve Bank does not licence the function of banking or of deposit taking. There is little or no distinction between bank and non bank financial institutions in what they can or cannot do.

iv Registration as a bank confers the advantage of being able to be called a bank and certain disclosure requirements. A registered bank is not required to conduct banking business or take in deposits.

v The review has resulted in New Zealand moving from this somewhat light handed regime to one best compared to a featherweight.

vi Reliance is now placed on market disciplines to strengthen the financial soundness of banks. Through a process of open public disclosure of all significant risk dimensions of a bank and an increased focus on the responsibility of bank directors, it is expected that systemic risk will be reduced.

vii These changes have been accompanied by a reduction in the prudential regulation of banks.

viii A key driver of this change has been the perceived need to reduce or remove any perception that the government, in some way, underwrites the soundness of individual banks - a de facto deposit insurance scheme.

viv The key to the new system will be the ability of the person or institution considering dealing with the bank, to determine from the disclosure statement the soundness of the bank.

x This somewhat heroic belief in the sophistication of the market and its disciplines provides the basis of this new system of banking supervision.

Conclusion: the NZ financial sector will be greatly impacted on by changes to policy resulting from the deliberations of the Inquiry. This is particularly so with respect to any changes to the ‘Six Pillars’ policy.

Section 4 Impact of any change to the Six Pillar policy

The scale of job loss from future mergers will be severe and is likely to reflect that resulting from the Westpac / Trust Bank merger.

4.1 This section will examine from the New Zealand perspective a number of issues raised by the Inquiry in its review of mergers and acquisitions. It will look at the effects on competition, employment, potential benefits and prudential considerations.

4.2 Employment effects

It is FinSec's submission that any change to the Six Pillar policy in Australia that allows mergers between the pillars, particularly the banks, will have a severe effect on employment in New Zealand's finance sector.

4.3 As *figure 4* shows, the four Australian bank pillars employ 78 % of the workforce in banking - over 20,630 staff.

4.4 It requires little imagination to predict the effects on employment of any merger between any of the four banks.

4.5 It is illustrative to look at some of the effects on employment following mergers between banks in New Zealand.

4.6 Employment levels in (registered) banking have shown very little change over the past few years. This is despite a considerable reduction in the number of registered banks and a number of mergers of national institutions.

4.7 Examples of some of the decreases in employment following mergers are set out below.

TABLE 7: Staff numbers in ANZ/PostBank (1989 merger)

	ANZ	**PostBank**
Pre merger (1991)	4238	2638
Post merger(1995)	5953	

TABLE 8: Staff numbers Countrywide/United (1992 merger)

	Countrywide	**United**
Pre merger (1991)	819	806
Post merger (1995)	1189	

TABLE 9: Staff numbers in National/Rural bank. (1992 merger)

	National	Rural Bank.
Pre merger (1991)	3541	411
Post merger (1995)	3821	

TABLE 10: Staff numbers in BNZ/NAB. (1993 merger)

	BNZ	NAB
Pre merger (1991)	6051	647
Post merger (1995)	5549	

Source: KPMG Financial Institutions Performance Surveys 1991 - 1996

4.8 In the face of the statistics presented in the tables above, how does FinSec maintain the argument that the removal of the Six Pillar policy will have severe effects on employment in this country?

4.9 The answer lies in an analysis of the nature of mergers to date and, more importantly, the likely nature of future mergers. This analysis produces a number of factors which, in our submission, lead to the conclusion that any relaxation of policy will have severe effects on employment.

4.10 Our analysis of the effects of mergers on employment in banking in New Zealand has identified the following factors as crucial in determining employment effects. The list is not exhaustive nor is it in any particular order. To attempt to prioritise the factors would be to ignore the shifting nature of the reasons for bank mergers and the interactions of these factors.

i) Parent bank policy

In our experience the attitude of the parent bank towards redundancies is crucial. This largely goes towards the parent bank's general attitude to their staff. In some cases banks have had no difficulty in attempting to manage down staff numbers through natural attrition so leavening the effect on staff. In other cases the 'get the numbers right' approach is predominant and inevitably there is very quickly a large job loss. The Countrywide approach is an example of the latter.

ii) Nature of the business

This factor examines who the bank's customers are, where they are, and what is needed to service and sell to them. If the business is largely retail and oriented around personal customers and small to medium size business then it is predictable that the bank will have an extensive branch network. To the degree the business overlaps there will be significant job loss in any merger. Again the merger of the two ex building societies (Countrywide and United) can be cited as an example. In the obverse, the dissimilarities in the business of National Bank (a large retail bank) and Rural Bank (a rural funder with very few branches and little in the way of support functions) meant relatively low job loss resulting directly from the merger.

iii) Inefficiencies in one of the parties

To the extent that there are gross inefficiencies (or at least perceived inefficiencies) in one or other or even both of the merging parties then obviously to the degree that staff are part of those inefficiencies, the purchasing bank will quickly move to reduce those inefficiencies as a quick way to begin realising savings. Job losses will inevitably occur. Westpac Trust is a good example.

iv) Comparative size

Where one bank is considerably larger than the other it appears easier to reduce job losses. A good example is the BNZ and NAB merger. Another is the National and Rural merger.

v**) Technology**

The effects of technology are a little more indistinct. However this factor may operate in two ways. Firstly, the purchasing bank may use the opportunity provided by the merger to upgrade the technology in both institutions with a resulting job loss. Alternatively the technology in one institution is so lacking that there is considerable job loss as a result of introducing the purchaser's technology.

vi**) Short term focus**

This approach to bank management is captured in the inordinate focus on the cost-income ratio. This is criticised elsewhere (*The Changes Banks Face*, Harris 1996) for, amongst a number of reasons, its short termism. Cost reduction is a fixation. Growing the income side, particularly if it looks costly in the short term, is penalised. We agree with the ACCC conclusion[1] that moves to achieve cost savings flowing out of mergers by closing branches and reducing staff numbers say nothing about the improvements in internal efficiency in the merging banks. This is the 'easy way out'. If the purchasing bank has this focus, large scale job losses seem to follow. Again the Countrywide and United merger is a good example.

It follows further from this fixation with the short term that where a bank has paid a premium to buy another bank (as seems to be the case at present), the management of the purchasing bank will put considerable pressure on their local management to quickly get value out of the merger. Translated this means quickly reducing staff numbers. Again WestpacTrust is a good example.

4.11 This list is not exhaustive by any means. It also does not take into account the nature of one of this country's most significant mergers, that of ANZ and PostBank. The reason for the omission is that this merger cannot be seen as

[1] FSI discussion paper, p.178

typical. For a long time the two institutions were run separately. Many observers believed that the ANZ did not quite know what to do with PostBank once they had acquired it. Only comparatively recently have the two networks been brought together in any significant way. Internal restructuring and job loss seems to be more driven by a focus on reducing costs generally rather than getting benefits out of the merger.

4.12 On the other hand, we argue (below) that an analysis of the recent merger of Westpac and Trust Bank in the light of the factors outlined in 4.10 provides an illustration of the shape of any future mergers should the Six Pillar policy go.

i) Parent bank policy

This factor interacts with the short term focus factor. Staff in either bank did not believe that their bank had any commitment to jobs. At least Westpac was honest to the extent that at no stage has it attempted to conceal the fact that there would be significant job loss. The pressure from Sydney has been continually on the New Zealand management to reduce costs as quickly as possible in order to get the numbers right. Layoffs have been underway for some time through the head office and regional offices. Support and ancillary areas are next and then in mid year the branch network will be focussed on.

ii**) Nature of the business**

Both banks are retail banks with extensive branch networks. The only differentiation lies in the far more extensive business and corporate banking of Westpac. On the retail side both banks were basically dealing with the same sort of customer base. There is extensive overlap of branches and support areas.

iii) Inefficiencies in one of the parties

The dispersed regional nature of Trust Bank which is a result of its regional origins had always been seen as a significant area of inefficiency. A significant number of jobs in Trust Bank were involved in these roles. It became an easy place for Westpac to focus in achieving cost cutting at the expense of jobs.

iv) Comparative size

Both banks were of similar size. Prior to the merger in terms of total assets they were the third (Westpac) and the fifth(Trust Bank) biggest banks in New Zealand. They employed similar numbers of staff (3600 in Westpac and 3213 in Trust Bank). Westpac had 174 branches and Trust Bank had 238. In these circumstances any flexibility to absorb jobs resulting from a disparity of size is gone.

v**) Technology**

In this case, while the technology platform that has been adopted is largely Westpac's, at least in the short term this was not seen as a significant factor in accounting for job loss. In the long term, bringing together two separate information technology units will result in job loss.

vi**)** **Short term focus**

See the above discussion on parent bank policy.

4.13 Although it is hard to accurately predict the scale of job losses as a result of the merger, our estimate is that, at the completion of the exercise of merging, there will be at least 2000 fewer positions (that is: around 30 % of total staff numbers pre-merger). One difficulty we readily acknowledge in estimating job losses arising out of mergers is how many jobs would have gone anyway as a result of a program of branch closures, technology and constant internal restructuring.

***Conclusion**: It is FinSec's submission that all of the above factors are present in any merger in New Zealand that involves the four pillar banks. For that reason we predict the scale of job loss will be severe and is likely to reflect the scale of job loss resulting from the Westpac/Trust Bank merger.*

4.15 This is compounded when we consider the comparative thinness of the New Zealand finance sector. As *figure 1* shows, the industry is dominated by the registered banks and in particular the Australian owned registered banks. This also has important implications for competition which we will consider in a further section.

4.16 We submit that the relatively constant employment levels in banking to date can be explained by other factors, including the nature of the mergers that have occurred to date. What we will see with the next round of mergers will be quite different, in our view because of the greater preponderance of those factors listed above. The WestpacTrust merger is merely the start.

Effects in the South West Pacific

A relaxation of the Six Pillar policy would have significant effects in these countries if there were to be a link up with Westpac and ANZ.

4.17 FinSec also submits that the Inquiry consider the effects of any changes to the current merger policy on banking in the South West Pacific.

4.18 By South West Pacific we mean Fiji, Western Samoa, Cook Islands, Tonga, Solomon Islands and Vanuatu. While the record of the banks in some of these places is somewhat chequered, they all maintain fully fledged banking systems.

4.19 The predominant banking feature in most of these countries is the extensive Australian interest. Typically the banking system consists of a local government owned bank, usually with development responsibilities and then one or two banks that are either Australian owned or in which there is extensive Australian investment.

4.20 Westpac and ANZ are the two Australian banks concerned. They either operate in their own name (as in the Cook Islands) or through differently branded banks which they own (as with the Bank of Western Samoa, which is owned by the ANZ) or banks in which they have an extensive interest and often management control (for example the Pacific Commercial Bank in Western Samoa in which Westpac has a 40% interest and the management contract).

4.21 In these countries the Australian owned banks provide what we know as retail banking services and any corporate or international work that may be required. They occupy important roles in the economy and are important employers. Often they are the major private sector employer of skilled white collar employees.

4.22 They provide an important source of skills to the population and some stability and credibility to the financial system.

4.23 A relaxation of the Six Pillar policy would have significant effects in these countries if there were to be a link up with the two owner banks. We would suggest that this needs to be considered in any consideration of changing that policy.

4.24 Just as in the case of New Zealand, it is our submission that arising out of a policy of globalisation and the other factors mentioned in section two, the effects of changes in Australian policy on countries outside of Australia where Australian owned institutions are dominant must be considered.

Section 5 Prudential regulation

Realistically, a failure of an Australian owned bank in New Zealand will be as a result of a decision made in Melbourne or Sydney, rather than any intervention by the New Zealand Reserve Bank.

5.1 Due to the extensive dissimilarities between the two countries in the nature of prudential regulation and the number and type of market participants, this submission raises only two points. The first relates to the implications for the New Zealand banking system of any changes to prudential regulation in Australia. The second relates to any move to introduce a more market based regulatory regime, as exists in New Zealand.

5.2 Australian Prudential Regulation and the New Zealand Finance System

i Because of the Australian ownership of the New Zealand financial system and the deregulation of our own regulatory regime, effectively the safety in New Zealand of individual banks and through individual banks, systemic stability, now depends on their parent banks in Australia and the stability of the Australian financial system. In short our banking system is dependent on Australia. As a result any changes to the Australian system should be of intense concern to New Zealand.

ii The Reserve Bank seems to accept that as primarily a 'host' banking supervisor it has a limited capacity to influence the risk profile of the banking system. It recognises that the stability of the New Zealand banking system is influenced more by the stability of the banking system of the parent (in this case Australian) banks than by local considerations. The bank then goes on to say the local system still has a role to play.

iii Realistically a failure of an Australian owned bank in New Zealand will be as a result of a decision made in Melbourne or Sydney, rather than any intervention by the New Zealand Reserve Bank. Such a decision will, in FinSec's view, be made more with an eye to the stability of the parent in Australia than any particular concerns for New Zealand depositors or the New Zealand banking system.

iv Likewise any instability of the Australian banking system will inevitably have a dramatic impact on New Zealand. This is due to the realities of the linkages between major international corporates and their overseas subsidiaries and the view of the person on the street that if for example ANZ in Australia are in trouble, then it must mean trouble for ANZ in New Zealand.

v In our submission the Australian financial system and its regulation now acts as a de facto parent of the New Zealand system. Any decisions for change in the Australian system must in our view take this into consideration.

5.3 **Market Based Regulation**

i FinSec has strongly opposed the move by the Reserve Bank to a more market based supervisory regime. We believe that any such moves, to the extent that they are possible in Australia, should also be resisted.

ii Our primary concern is that such moves are based on a naive view of the market and its participants. The bank has outlined six reasons why it moved to this regime. It is our submission that such moves had more to do with ideology than reality and that subsequently our banking system is placed at the less credible end of international banking supervisory practice.

iii The reasons given by the bank appear in some of the submissions made to the Inquiry. To the extent that there is any overlap between the two financial systems it may be valuable to the Inquiry to review our response to these reasons provided by the bank.

iv The primary problem with the bank's position is that it is based on two fictions. The first is that customers have the expertise to effectively evaluate a bank's financial performance and to make financial decisions accordingly. The second is that, by moving to a more market based regime, those actions will destroy the public's belief that the government will provide support to the bank in distress.

v The first fiction is easily dealt with by the sight of a customer trying to come to grips with a disclosure statement. While there will always be a proportion of customers, especially corporates, who have that ability to analyse, general retail customers have no such ability.

vi It becomes a matter of market dogma to say that is the customer's fault and that they should take just as much care with their money as they do to buying a car. But as the Inquiry discussion paper points out, this problem of information asymmetry is crucial to the debate[2].

vii There are certain features about financial products that '...*are perhaps unique in the nature and intensity of these characteristics* (eg complexity, difficult to compare etc)'.

viii The report outlines two possible responses to the problem of information asymmetry. The first option of further and better disclosure is the path taken

[2] FSI discussion paper 4.29-4.34

by the Reserve Bank. In our view it does not work - simply because customers do not have the ability or time to analyse that information.

ix The Reserve Bank path ignores the fact that people bank with banks because they are banks. While historically banks have had a chequered career they have certainly been more stable and safer than other operations. Part of that stability is built on the government's prudential regulatory role.

x While it may be laudable for ideological reasons to unbundle the government underpinning of the banking system, the problem remains that the public at large need to have a financial system in which they have confidence. Given recent experiences with the market and the historical performance of banks operating outside of a regulatory framework the public have little confidence in a system of market regulation.

xi The bank makes the point in their discussion on the effectiveness of banking supervision that their recognition of the emerging financial distress on the late 1980s and early 1990s came too late to avoid the subsequent deteriorations in bank's capital positions.

xii The bank states that it is doubtful that supervisors are any better placed than bank management to recognise early signs of financial distress. If the Reserve Bank was unable to pick it up, what ability would the customer in the street have faced with the same information?

xiii If the bank cannot handle the information or it gets it too late then it is hardly possible for the standard personal customer to make the evaluation.

xiv The Reserve Bank points to the fact that management are best placed to evaluate risk through their better access to information. The track record of bank management in many institutions, particularly in the past ten years, does not create much confidence that this better access will be used in ways that protect the capital position of the bank and its depositors.

xv No doubt the issue then for the Reserve Bank is one of incentives. By putting the correct package of incentives - both negative and positive - together, management will respond in the best interests of the bank. Hence the emphasis on increased director liability, market ratings and the like.

xvi It is FinSec's view that this displays a faith in bank's management and other principals that is somewhat misplaced.

xvii Secondly, the Reserve Bank has worked assiduously to remove any notion of government underwriting of a bank in distress. This problem of moral hazard is as much a political problem as any problem with banking supervision.

xviii In the bank's view the way to resist this pressure, which inevitably arises when there is any form of bank registration and supervision, is to reduce the intensity of supervision. Increase the intensity and there is a corresponding increase in the perception of government liability and the harder it becomes to resist pressures to support a bank in distress. But how do bank customers have any idea of the intensity (an issue of relativity) of regulation?

xviv We see this attempt by the Reserve Bank to somehow distance government from the banking system as misplaced. It ignores the political reality of a country where a few banks occupy a dominant position in the finance system. It ignores the needs of ordinary customers to have a 'safe haven' for their finances.

xx On this issue there is a constant tension between the requirement for transparency of regulation and what customers really believe the government's role in banking is. The problem is continually compounded by the behaviour of politicians.

xxi This does raise the question of why it should be the responsibility of any authority to assure systemic stability - especially in another country.

xxii Is it not, after all, simply a normal commercial relationship with all of its attendant risks? No one compels bank customers to buy bank products so why should that customer be protected from the results of their economic decisions.

xxiii The fact is that the banking system of any country is given a degree of protection within which to make profits. There are sound reasons for that - a recognisable currency with a stable value and a robust system of financial intermediation and credit creation are all vital for the functioning of a modern diverse market economy.

xxiv All service providers obtain 'privileges'. The market, for example, is a construct of the government. Without a system that defines property rights and prescribes process for exchange of property rights and penalties for breach of that process, there is simply anarchy.

xxv Limited liability encourages the accumulation of equity capital but also puts creditors at greater risk in the event of insolvency. Product safety standards recognise that the right to trade carries obligations on sellers as well as rights.

xxvi With financial systems relatively little owner's equity is at risk. The industry has high levels of gearing. This means a greater risk to depositors in the event of system failure. Bank customers expect their governments to provide them with acceptable levels of confidence as the quid pro quo of their governments allowing banks and other financial service providers to operate with the degree of risk that is necessary for the efficient function of a financial system.

Conclusions: Due to the changes to New Zealand banking resulting from changes in ownership and deregulation, the impact of any changes on this country needs to be considered as part of the Inquiry's deliberations.

Any move to a more market based regulatory regime should be viewed with caution and a full understanding of the realities of political behaviour and customer perceptions.

6 Foreign acquisition and ownership

> ***It is certainly somewhat ironic to see Australian financial institutions with significant interests in New Zealand arguing Australian interests as a reason for retention of ownership of financial institutions operating in Australia.***

6.1 The Inquiry raises the question of foreign acquisition and ownership. It identifies two issues at 6.111. : justification for or against foreign participation and special considerations relevant to the finance sector.

6.2 Leaving aside the xenophobic side of the debate about foreign ownership, it is FinSec's view that real question is one of sovereignty. While this issue may be strictly outside the terms of reference, in our view this question is a key underpinning of the whole debate about the future of the financial system.

6.3 Therefore we have devoted a short separate section to this issue.

6.4 The logic of free markets and globalisation must say that there can be little reason for barriers against foreign participation in the financial system. The whole framework of world and regional trade agreements is predicated on that premise.

6.5 The only argument against it seems to lie with a questioning of the principles and practice of the free markets and globalisation. Built into that argument is the question of sovereignty and whether there is a need for domestic reasons to have control over your domestic financial system. This may be as much a political question as it is an economic question.

6.6 Probably the pragmatic answer (admittedly from the perspective of a country that lost that control a while ago!) is that it is no longer possible to maintain domestic control of the finance system and its institutions.

6.7 Apart from the significant pressure from such sources as GATS the new forms of technology will increasingly make the question irrelevant. Certainly if Australian financial institutions see themselves as a force in international banking they can be little or no argument against protection of their domestic base from international ownership.

6.8 It is certainly somewhat ironic to see Australian financial institutions with significant interests in New Zealand arguing Australian interests as a reason for retention of ownership of financial institutions operating in Australia (Colonial

Mutual) or community sensitivity which is apparently shared throughout OECD countries (Westpac). Obviously the same concerns do not motivate their behaviour internationally.

6.9 Looked at more narrowly in terms of employment practices our experience has been that there is no differentiation between banks that are owned locally or are foreign owned. While the directions may come from outside the country, they all have a certain sameness.

6.10 However we fully support the ANZ concerns about foreign takeovers leading to the shifting of head offices (or the actual decision centre) and a consequent brain drain of the best managers and most skilled staff [3]. The extension of the argument is that the senior and highly skilled positions are picked up by managers from the parent country.

6.11 Ironically the bank cites its experience in New Zealand in support of this argument. For that bank there is a constant flow of Australian executives through the senior management group of the bank in New Zealand.

6.12 At a recent seminar of unions in the South Pacific who organise in the ANZ it was commonly cited that senior management positions always seemed to go to Australian or New Zealand ex patriate managers and that there was little or no training of locals to pick up these positions.

6.13 The diminishing employment opportunities as a result of the development of technology was also cited by the ANZ. NAB have recently announced an initiative that will centralise all of their work in the area of information technology development into Sydney.

6.14 ***Conclusion: It is difficult economically to maintain any argument for restrictions on foreign acquisitions particularly when the very same institutions benefit internationally from no restrictions. The real question in our view is the political question of sovereignty.***

[3] FSI discussion paper 6.110

Section 7 Competition

A reduction in the number of banks operating in New Zealand due to a merger resulting from any changes to the Australian merger policy will undoubtably effect detrimentally competition in New Zealand.

7.1 New Zealand provides an interesting case study of competition. There is very little in the way of barriers to competition in any part of the sector. As table (?) shows there is a very high level of concentration in the sector.

7.2 Despite the low number of participants in the market, there is intense competition at least in the area of home lending. New Zealand is commonly cited as one of the most competitive banking systems in the world.

7.3 While non bank financial institutions such as mortgage securitisers have recently emerged, the competitiveness of the market in New Zealand will mean that their ability to undercut the banks on price is considerably less than elsewhere.

7.4 For two of the banks to merge under these circumstances, the conclusion can only mean a lessening of competition.

7.5 This situation is compounded by the low number and size of other non bank finance sector participants. Basically, since deregulation, the number of non bank participants has reduced dramatically. In contrast to Australia, there is no second tier (regional banks and large credit unions/building societies) which can act to '... *prevent a return to the competitive hibernation that existed prior to deregulation*[4].

7.6 It is our concern that any reduction in the number of retail banks in New Zealand will lead to exactly that situation.

7.5 The New Zealand Commerce Commission also plays a role in this area.

i In FinSec's view it is very unlikely that the commission would disapprove any proposed merger on those grounds. The New Zealand Commerce Commission assesses merger proposals.

ii The criteria set out in the Commerce Act, which governs these matters, is that no merger will receive a clearance from the commission if as result of the acquisition, the acquirer would achieve a '... a dominant position in the market' or if the acquirer already had a dominant position in the market then that

[4] St. George Bank, Submission No.212 to the Financial System Inquiry

position would likely to be strengthened. The latest application considered by the commission was the Westpac/Trust bank merger[5]

iii Much of the discussion focuses on a definition of the 'market' and as such parallels the discussion in the Inquiry document. Westpac defined the market as 'the provision of banking services and related financial services throughout New Zealand'. The commission saw this as a relatively narrow definition, as other financial intermediaries offer many of the services provided by registered banks. They went on to say that the services offered by the major banks is more comprehensive than those offered by any other financial intermediary.

iv The commission rejected the view that the market should be defined as either retail banking or wholesale banking or even narrower definitions. They said that major banks target a broad spectrum of users, the corollary of which is they offer a broad range of products and services.

v Westpac's submission to the Commerce Commission on the definition of market contrasts that reported by the Inquiry as being the predominant view of the major banks - that is the market is one of financial services rather than retail banking products.

vi In determining dominance in respect of the market the commission used the net loans and advances figure as a useful comparison and the measure that should be used.

vii Due to the strong competition in New Zealand among competitor banks and the ease of entry into banking, the marketing power of the new merged bank would be appreciably below the level of dominance which would raise concerns.

viii The position taken by the commission may be simply a recognition of the market dominance of the major banks in New Zealand and the lack of alternative financial service providers.

viv The question of an extended definition along the lines canvassed by the various submissions to the Inquiry probably never needed to be considered.

x In terms of future merger activity then we do not see the commission providing any significant hurdle. 'Dominance' appears to have a high threshold - certainly more than 25%.

xi In the commission's view competition between the banks is vigorous, there are no regulations limiting flexibility in such areas as controlling branch opening and closing and the range of services offered. Likewise the ease of entry into banking also acts to create or potentially create competition.

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[5] Memo: Commerce Act 1986: Business Acquisition Westpac Holdings NZ Ltd/Trust Bank NZ Ltd. AUT/BA- W11/1 M2295

xii It is therefore Finsec’s view that the commission is very unlikely to disapprove any proposed further merger on those grounds.

xiii Our submission is that a reduction in the number of banks operating in New Zealand due to a merger resulting from any changes to the Australian merger policy will undoubtably detrimentally affect competition in New Zealand.

Section 8 The future face of finance

> ***The banks seem captured by a single set of responses to what is seen by many as a crisis. They are like possums caught in the headlights.***

8.1 Essential to the analysis of the appropriate regulatory framework for the finance industry is a consideration of a view of what the industry will look like in the next few years and into the next century.

8.2 We have little disagreement with much of the analysis contained in the discussion with a lot of it being directly transferable to the New Zealand situation.

8.3 We do, however, contest the view typified by Deloitte Touche Tohmatsu International in their scenario for the future[6], which is reflective of a lot of thinking in the industry.

8.4 Our critique is contained in the report we published entitled *The Changes Banks Face (attachment).*

8.5 In FinSec's view, the response by banks in New Zealand to the challenges they face has been totally formulaic. At the most simplistic level a cynic would say that whatever NAB does, the others will do the same.

8.6 At a more realistic level, the banks seem captured by a single set of responses to what is seen by many as a crisis. They are like possums caught in the headlights.

8.7 A fixation with cost reduction rather than income growing marks out the responses of all of the banks. Segmentation is seen as the answer. Branches are seen as liabilities. All banks (and other financial providers) chase the high net worth customers (the 20% of the 80/20 rule). The skills of the finance sector workforce are continually downgraded and staff are seen as disposable.

8.8 It is FinSec's view that the future is about *integration.* Properly integrated the very factors that banks now see as liabilities would in fact be their strengths.

8.9 Part of the integration strategy is a role for the branch as part of a fully integrated distribution strategy. Luckily some of the banks are now waking up to that possibility.

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6 Deloitte Touche Tohmatsu International *The Future of Retail Banking: a global perspective*

8.10 ***Conclusion: In future banks should:***

- ***accept there is no single solution to the problems of profitability***
- ***radically change both the delivery of and the use of information technology***
- ***move the banking culture to a balance between selling, service, cost control and risk management***
- ***improve management systems and base staffing around higher skills and appropriate rewards***
- ***develop strategies for profitable exploitation of money transmission systems***

Section 9 Sovereignty

> ***Whatever the reason, this country has lost control of its financial system and the control now largely resides in Australia.***

9.1 It is FinSec's view that no discussion of the future of the regulatory structure of the finance system is complete without the inclusion of a discussion of the issue of sovereignty.

9.2 Loss of control of a country's financial system through loss of ownership (either public or private) and the opening up of the system goes right to the heart of a country's ability to independently manage its own affairs. This is the issue of sovereignty.

9.3 Any discussion about the regulatory framework for the finance system is as much as anything a political discussion. It is political as it is about the direction and control of the country. The finance system is such an integral part of the economic system that changes to the way that it operates will change the way that system operates.

9.4 It is FinSec's submission that this point is little appreciated (or often considered irrelevant). The danger in opening up this debate is that it can open up the ugly side of society and develop into a xenophobic diatribe. This is unfortunate, as it inevitably obscures the real issues.

9.5 The debate in New Zealand, to the extent that it existed, is largely over. This may be due to the historically high level of overseas ownership of financial institutions in New Zealand. It may also be due to the behaviour of those New Zealand owned institutions as they became increasingly unrecognisable from their foreign owned sisters.

9.6 It may also be due to exhaustion amongst those opposing the deregulation of the late 80s and early 90s.

9.7 Whatever the reason, this country has lost control of its financial system and the control now largely resides in Australia. Regardless of any criticisms of the agenda of the Inquiry, from a New Zealand perspective at least there is an opportunity for Australians to have their say on this matter and attempt to carry the day with their view.

9.8 That opportunity was denied in this country. It remains for New Zealand to raise with this inquiry the issues outlined in this submission.

Section 10 Conclusion

10.1 In conclusion, FinSec welcomes the opportunity to make this submission to the Financial Systems Inquiry.

10.2 FinSec’s contribution to the debate is consistent with this union’s commitment to a finance industry which is highly skilled, motivated and focussed - well-positioned to respond to the challenges facing the sector globally.

10.3 It is this union’s view that those challenges cannot be faced with the short term approach too often seen in the industry, but one which is long term and integrated.

10.4 It is FinSec’s view that the perspectives of New Zealand and South West Pacific finance workers need to be part of the discussion of this Inquiry.

10.5 It is also our view that the offshore impact should be one of the factors the Inquiry takes into account in its deliberations.

10.6 This is appropriate because of the Australian domination of the finance sectors of these countries and the responsibilities that accompany globalisation.

10.7 It is further appropriate for the Inquiry to examine the experience of employees in the New Zealand finance sector because New Zealand has experienced much of the deregulation currently being considered by the Inquiry.

10.8 Because of the Australian domination of New Zealand's finance sector, it is, to a very large extent, the Australian regulatory system which underpins the systemic stability of the deregulated New Zealand financial system.

10.9 It is also the existence of the Six Pillar policy which determines, to a large extent, the present financial competitive environment in New Zealand.

10.10 There can be little doubt that deregulation of the Australian regulatory system would strongly impact in this country.

10.11 In the same way, should the Six Pillar policy be removed, the current competitive finance environment would be threatened.

10.12 Further, the impact on employment in the finance sector would be severe.

10.13 It is FinSec’s submission that the Inquiry seriously consider the above in its deliberations.