



Finsec submission to banking inquiry

September 2009

1. Introduction and background

Finsec is the main union in the New Zealand financial sector representing over 5500 employees.

1.1 We are a close observer of developments in the banking sector and are advocates of reform to promote a sector that is sound, fair, ethical and socially responsible. These outcomes are regarded by Finsec as vital for our members and for the wider society.

1.2 Finsec supports the multi-party inquiry into locally registered banks. We note the lack of participation of parties that form the government and hope this lack of participation does not reflect a view that an inquiry into banks is not a good idea or that no changes in this area are required.

1.3 We note that Parliament's Finance and Expenditure select committee has identified in committee reports that interest rate charges appear to be too high and that the Reserve Bank has done some analysis that also indicates some interest rates may be too high.

1.4 We believe the New Zealand public needs to be satisfied that regulation and oversight of the financial system is sufficient to keep our financial system resilient and that fair outcomes are delivered to bank customers. We do not believe the current regulatory environment adequately addresses the issue of fair outcomes to customers.

1.5 We believe the global financial crisis has arisen, at least in part, from poor governance and risk management in financial institutions, imprudent lending, and an excessively short-term focus on profit by the boards and senior management, at the expense of longer term stewardship. For that reason we believe politicians need to become more active in altering the current regulatory framework.

1.6 This submission seeks to identify some practical ways that the banking system can be made to be more responsive to customer and concerns.

2. Profitability of banks in New Zealand

Registered banks have maintained a strong level of profitability¹ over the last decade or so, both by comparison to earlier periods and banks in other

¹ Profitability is measured by net operating profit after tax and expressed as a percentage return on either average total assets or average shareholders' funds for the year in question.

countries. This reflects the relatively buoyant economic conditions in which banks have been operating in New Zealand for most of the 1990s and 2000s and the measures taken in the 1990s and early 2000s by banks to reduce operating costs.

2.1 Most banks incorporated in New Zealand have maintained a level of profitability in excess of 1% of average total assets over the last decade or so. The average rate of profitability (measured against total assets) across the banking system in 2007 was around 1.1% - down from a peak of over 1.4% in 2003, but well up on the profitability levels in the early 1990s.² In 1992, for example, the average profitability of banks in New Zealand was just 0.4% of average total assets. This reflected the substantial loan losses and provisioning expenses being experience at the time.

2.2 In 2008 underlying profit of registered banks in New Zealand increased by 5.1% (according to KPMG) despite the economic downturn and higher provisioning for bad and doubtful debt. In the first 6 months of financial year 2009 all the banks have reported strong profits.

2.3 The profitability of the banking system in New Zealand compares well to other developed economies, such as Australia, the United Kingdom and much of the European Union. In many countries comparable to New Zealand, the profitability of banks, relative to total assets and shareholders is below that of New Zealand.

2.4 A major component of banks' profitability is their interest rate margin – the difference between the interest revenue they earn on their lending and interest paid on their liabilities. In 2007, the interest rate margin averaged around 2.2% for the banking system.

2.5 The distribution of profits by banks varies considerably across the banking sector, and varies from year to year. For example, in the period 2001 to 2006, the percentage of net profit after tax distributed by way of dividends or other distributions to shareholders across the New Zealand banking sector as a whole ranged from 32.2% in 2004 to 93.6% in 2006. The average percentage of net profit after tax distributed to shareholders over the period 2001 to 2006 inclusive, for the banking sector as a whole, was around 60%.³

2.6 Key points

- **The New Zealand banking system is profitable compared to both earlier periods and other countries.**
- **Interest margins are a key driver of bank profits.**
- **Banks have maintained good levels of dividend payments to shareholders.**

² Data on profitability and related data are derived from the Reserve Bank of New Zealand Financial Stability Reports and associated tables and graphs.

³ Data referred to in this paragraph is sourced from the Reserve Bank of New Zealand database on financial institution statistics, accessible via the Reserve Bank website.

3. Credit card interest rates

We have significant concerns about the level of credit card interest rates, and our analysis from February 2009 showed that the margins on this form of lending appear to have grown by more than 200% in the last year.

3.1 Based on the difference between the 90 day bill rate and what banks are charging on their standard credit cards, the banks' margins on credit card debt have ballooned from around 140% in February 2008 to 470% in February 2009.

Date	90 Day Bill Rate*	C/C Rates - Approx	Margin over OCR Rate - Approx	Margin Growth
08 February 2008	8.76%	21%	140%	
06 February 2009	3.50%	20%	472%	237%

NB: We used a straight 90 Bill Rate vs Interest Rate calculation as it is difficult to assess each bank's actual cost of providing credit card lending to customers.

3.2 This level of margin growth at the expense of customers seems excessive, and the banks have only made minor reductions to credit card interest rates despite the drop in the 90 day bill rate.

3.3 Even if the cost of providing this form of credit is much higher than the 90 Day Bill Rate, the margin growth over this last year might in fact be even larger. This example shows what happens if we assume the bank's cost of funding credit card lending is approximately 20% higher than the 90 Bill Rates stated above:-

Date	Cost of C/C Lending	C/C Rates - Approx	Margin Over Cost Rate - Approx	Approx Margin Growth
January 2008	10.50%	21%	100%	
January 2009	4.20%	20%	376%	276%

3.4 By our calculations, if the banks' margins remained the same as they were in January 2008, then standard credit card interest rates should have been about 8.4% at the beginning of this year. Even if the margin increases were acceptable, but the actual rates charged on credit cards dropped by the same drop in the 90 Day Bill Rate, interest rates on standard credit cards should have been about 15.75% at that time.

3.5 The margin has increased so much, while credit card interest rates have not reduced much at all and the customer appears to be paying significantly more than they ought to.

3.6 Many New Zealanders use credit cards to cover their basic costs, and can ill afford to pay inflated interest rates. People on low incomes can be particularly dependent on credit card debt. For example, the amount students owe on credit cards has increased by 32% since 2004, according to the

NZUSA Income and Expenditure Survey released last year. Credit card debt has increased at a higher rate than low to no interest overdrafts.

3.7 While banks now offer low interest credit cards the issue is that many people with existing debt don't or can't switch to a low interest card. In addition, the debt is still unsecured on these "low" interest cards therefore, why are there still "high" interest cards at all?

3.8 Key point

- **Credit card interest rates appear to be significantly higher than they need to be with interest margins increasing by around 200% in the last year.**

4. Regulation of lending practices

Finsec finds the current level of monitoring of lending practices, including the setting of interest rates, of both bank and non-bank lenders by government agencies to be inadequate.

4.1 Finsec sees a need to strengthen regulation of lending practices in New Zealand. There are too many examples of lenders indulging in practices that we and many others in society would regard as unacceptable. For example for some time now Finsec has been raising issues with the targets and sales culture of the banks that require staff to sell customers debt products.

4.2 Our view is that the Reserve Bank is not the best agency to monitor interest rate setting and other aspects of lending practices. As the central bank its primary role is to provide regulatory oversight to ensure the banking system is operating in a sound manner.

4.3 The Reserve Bank seems to hold the view that it needs to maintain a positive relationship with the banks in order to undertake its core role of prudential supervision of the banking system. This has the potential to lead to a situation where the Reserve Bank will be reluctant to question the banks on matters outside of core prudential supervision. Because of this we do not feel the Reserve Bank is in the best position to provide oversight on matters of lending and interest rate setting.

4.4 However we do think the Reserve Bank could require the banks to disclose their costs of borrowing and the interest rates they charge. The Reserve Bank could then publish this information in a publicly available comparative table. Customers could use this information to decide if their bank is being fair in what they charge and how this stacks up against other banks.

4.5 Finsec proposes the establishment of an independent Financial Consumer Agency, co-funded by the industry and government to oversee (from a consumer perspective) the workings of the financial sector. This perspective is lacking in the current regulation and supervision.

4.6 Canada has taken initiatives in this area. The Financial Consumer Agency of Canada (FCAC) established in 2001, is among other matters, responsible for administering consumer protection requirements, including: a requirement on banks to provide a minimum notice period before closing a retail branch; for large institutions to file Public Accountability Statements; and for all lenders and deposit-takers to adhere to the Code of Lending Practice.

4.7 There is no standard Code of Lending Practice applicable to all retail lenders in New Zealand that is publicly enforceable or independently overseen. Canada and Ireland have moved or are moving in this direction, and Australia's Code of Banking Practice now includes the commitment to an external monitoring body for investigation and reporting on breaches of the Code.

4.8 Finsec thinks the New Zealand government, consumer advocates, and managers and employees in the lending sector could work together to develop a binding, enforceable national code of lending practices, applicable to all retail lenders, that promotes responsible and ethical lending practices.

4.9 The Code of Lending Practice could include requirements for lenders to:

- a) establish fair and transparent mechanisms for interest rate setting;
- b) disclose the terms and conditions of a credit proposal, in plain English, and take all reasonable steps to ensure that the customer understands the proposals and the full costs of them and if there are alternatives, what they are and the full costs of them;
- c) take all reasonable steps to ascertain whether a borrower understands the implications of a credit proposal and has sought independent advice where this may be the prudent course of action;
- d) take all reasonable steps to evaluate whether a customer has the current capability to service the proposed borrowing under a range of plausible circumstances, taking into account all their other commitments;
- e) act honestly, fairly and professionally in the best interests of its customers and the integrity of the market;
- f) not recklessly, negligently or deliberately mislead a customer as to the real or perceived advantages or disadvantages of any product or service;
- g) not exert undue pressure or undue influence on a customer, and;
- h) ensure the lending product offered best suits the need of the customer.

4.10 The Code would be supported by regulation and signed off by the appropriate Minister, such as the Minister of Commerce.

5. Establishing greater oversight of banks

We are of the view that even improved prudential supervision and other forms of government oversight will be insufficient to inject greater fairness and social responsibility into the banking sector that makes it act more in the interests of the societies in which they operate.

5.1 The current financial crisis has demonstrated that left to their own devices, the banks will act against even their own long term interests in pursuit of short terms profits.

5.2 The days of light handed intervention and the primacy of the “invisible hand” must end. Noam Chomsky points out that Adam Smith, the father of modern economics, is often misrepresented on this point.

“Throughout history, Adam Smith observed, we find the workings of “the vile maxim of the masters of mankind”: “All for ourselves, and nothing for other People.” Smith had few illusions about the consequences. The invisible hand, he wrote, will destroy the possibility of a decent human existence “unless government takes pains to prevent” this outcome, as must be assured in “every improved and civilized society.” It will destroy community, the environment and human values generally – and even the masters themselves.”

5.3 We believe that a range of interventions are required to actively correct the banking industry. In this regard we see measures that increase workplace democracy in banks, strengthen trade unions and put in place requirements for stronger community engagement as part of a wider solution.

5.4 A practical example of how workers can assist is one put forward by bank workers internationally through our global union federation UNI. In short the proposal is to create a mechanism within regulatory programmes for workers to directly report on the implementation of regulation and to report on abuses and unethical lending arrangements.

5.5 Actively utilising workers on the shop floor as watchdogs of corporations is a useful and practical step that could be taken to ensure regulations are implemented and to provide an early warning signal if things get out of hand.

5.6 New decision making and consultative frameworks that require banks to bring workers and customers into the decision making fold can also make a difference, but will require legislative change that actively assists unions to rebuild in order to be an equal social partner.

5.7 The current crisis is evidence that we should not shy away from such a project that will eliminate the current power imbalance.

Recommendation 1

Require the Reserve Bank to collect information on actual costs of bank funding and regularly publish a comparative table of actual costs and interest rates charged to improve competitiveness in the market and increase the amount of information available to customers.

Recommendation 2

Establish a Financial Consumer Agency (FCA) that acts as an industry watchdog that implements and monitors consumer protection rules and forces greater accountability and transparency in the market.

Recommendation 3

Establish a Code of Lending Practice that would be enforced by the FCA and among other things establishes rules for fair and transparent interest rate setting in banks.

Recommendation 4

Consider other forms of government intervention that permit a stronger voice for workers and customers in the banking sector such as legislation that strengthens unions so workers can better act as an industry watchdog.



ANZ National & BNZ Results - Nine Months to 30th June

	ANZ National			BNZ		
		2009	2008		2009	2008
	Difference	\$m	\$m	Difference	\$m	\$m
Net Interest Income	8.53%	\$1,857	\$1,711	3.19%	\$1,035	\$1,003
Provision for Impairment	222%	\$538	\$167	184%	\$142	\$50
	ANZ National			BNZ		
		2009	2008		2009	2008
	Difference	\$m	\$m	Difference	\$m	\$m
Profit Before Tax & Impairments	-13.16%	\$1,326	\$1,527	-8.04%	\$823	\$895
Income tax	-40.75%	\$237	\$400	-18.14%	\$203	\$248
NPAT	-3.37%	\$1,089	\$1,127	-4.17%	\$620	\$647
Cr Impairment	216%	\$528	\$167	184%	\$142	\$50
Income Tax Expense (Liability)		0	0		\$416	0
Income Tax Expense Interest (Liability)		0	0		\$245	0
Profit After Income Tax & Impairments		\$561	\$960		-\$183	\$587