APRIL 2023

The banking industry: A look ahead

The future of banking – bumps but also some bounces

The global financial sector has been unsettled by three high profile shocks within the last six months – FTX in late 2022, and Silicon Valley Bank and Credit Suisse in March 2023 (see *A tale of three crises*, next page).

They came from different parts of the industry and are not directly linked, but they share a number of characteristics, and their proximity in time is no coincidence.

They landed in New Zealand in what was already a period of transformation. We have identified five key factors driving that change. They are not unique to New Zealand, in fact in many cases, New Zealand is behind the curve – deposit insurance, open banking and round-the-clock payments for example.

But New Zealand is facing these changes head on, all at once, at a time when technology is advancing into unknown territory and accepted 'truths' of modern banking are being re-examined.

The five change drivers are:

- The structural redesign of the domestic banking sector by the Reserve Bank of New Zealand (RBNZ) – discussed in **Winners and losers on the new RBNZ playing field.**
- Technological innovation – **Digitised, decentralised, disrupted.**
- A need for banks to reduce their reliance on deposits and reassess their asset base – **Changing balance sheet dynamics will require fancy footwork.**
- An increased focus on social licence – **Social licence: great expectations.**
- New obligations on banks, and new vulnerabilities – **Banks increasingly on the front line and under fire.**

The "three crises" each illustrate the economic factors that are currently weighing on the banking sector, offer insights into how catastrophic events can unfurl and provide lessons for New Zealand.

In particular, the 'bank runs' that have been associated with each failure have all been turbocharged by modern technology. Further fintech developments, already firmly in the pipeline for implementation in New Zealand, will accelerate the customer's ability to move funds – making the role of both bank and regulator more difficult.

Finding the right balance of financial regulation, market discipline and investor protection is a hard problem to solve. Unintended consequences – and complaints – arise regardless of approach. And where there are depositor/investor losses, litigation will follow.

Large static deposit bases – an important source of cheap funding – may become more volatile if consumers take up new fintech solutions promoting transparency, transferability and choice. While recent U.S. experience has shown a 'flight to quality', it also demonstrates the increasing speed at which deposits can move.

We expect banks to focus on building wider capability and incorporating new technologies to encourage customer loyalty – both to compete with new providers, and to meet their social licence and front line regulatory responsibilities.

Runs gathering speed

2008

US$16.7bn withdrawn over 10 days
Washington Mutual – the largest bank run in modern U.S. history

2022

US$6bn withdrawn in 72 hours
FTX – US$8bn was then withdrawn from other exchanges over a week

2023

US$42bn withdrawn in 24 hours
SVB – followed by Signature Bank shortly afterwards

A tale of three crises

FTX Trading Ltd.

At the unregulated end of the scale, cryptocurrency exchange FTX collapsed dramatically in late 2022 when it became the victim of a run following reported leverage and solvency concerns. As the chaos was confined to a small and relatively discrete segment of the economy, there was no incentive for the government to intervene and FTX was left to fail. However it will have damaged public confidence in private sector crypto and captured many retail customers who had turned to FTX for investment purposes or financial inclusion.

What does this mean for New Zealand?

Local uptake of cryptocurrencies has been slow, so the risk of a domestic crypto crisis is currently small. But it may not stay that way.

Interest in cryptocurrency options is growing rapidly in the Asia Pacific region – both in the sophisticated financial centres of Hong Kong, Singapore and Australia, and also in the smaller island economies, with Tonga and Fiji looking at making Bitcoin legal tender for reasons of financial inclusion.

More broadly, as the range of financial services in New Zealand expands, the FTX failure illustrates how rapidly the effects and contagion of a run can develop in a fast-growing unregulated market.

Silicon Valley Bank (SVB)

The chain of events that caused SVB to collapse will continue to be the subject of much media and expert analysis and commentary. Most at least agree SVB represented a unique set of circumstances, including:

- A large number of deposits over the deposit insurance limit;
- An unhedged over-exposure to fixed interest U.S. treasuries; and
- The inability of the lender-of-last-resort regime to respond in timely way to a modern tech-enabled depositor bank run.

But the contagion went beyond SVB with both Signature Bank and Silvergate experiencing runs after depositors took fright at their exposure to crypto and tech assets.

What does this mean for New Zealand?

The principal relevance for New Zealand is that although SVB was not in the category of "systemically important" banks, and although the issues that undid it were specific to it, the U.S. Government stepped in immediately to guarantee all deposits, and put in place a lending facility to help minimise the risk to other similarly placed banks.

It will be interesting to see how the RBNZ reacts to this re-definition of moral hazard as we introduce deposit insurance across all deposit takers. The Deposit Takers Act would technically allow the Government to increase deposit insurance above its $100,000 cap for "financial stability" reasons (and levy the remaining banks afterwards to recover the cost).

Whether the RBNZ would want to give any impression of a possible total government guarantee is another story.

Credit Suisse (CS)

The solution in this case - rescue by UBS as part of a government-backed cut price deal - while very tidy and effective, may not be widely replicable and was not without controversy. One critic said Switzerland would now be regarded as "a financial banana republic", although the truth is somewhat less drastic.

Of more interest has been the treatment of Additional Tier 1 (AT1) bondholders. AT1 regulatory capital instruments are often called Contingent Convertibles or "CoCos", meaning bonds that convert into shares if certain triggers are hit to keep the bank afloat as a going concern.

But CS's AT1 bonds technically were not CoCos. They were designed to be written down to prevent CS from becoming insolvent, with no in-built equity conversion mechanics. The full write-down has panicked investors and prompted a reassessment of the asset class.

> "[In] practice, the majority of contingent debt issued globally has been write-off only - the debt will cease to exist but no new ordinary shares will be issued. [...] If a debt writes off, but no compensation is paid, debt holders absorb losses ahead of existing shareholders."
>
> **RBNZ – Capital Review Paper 2 (2017)**

What does this mean for New Zealand?

New Zealand's own regulatory capital instruments no longer include either conversion or write-down mechanics, which should provide some investor comfort. However, the RBNZ still retains a wide discretion in how it may structure a bank resolution or rescue.

We expect further investor focus on regulatory guidance (including the application of open bank resolution (OBR)), particularly as regulators in the European Union and England have made explicit statements in favour of respecting the expected creditor hierarchy.

01/

Winners and losers on new RBNZ playing field

The RBNZ is fundamentally redesigning the domestic banking sector, pursuing a dizzying rate and range of change, much of which simply brings New Zealand into line with international norms but some of which is disconcertingly original.

The latest volley is being delivered through the Deposit Takers Bill, in particular the depositor compensation scheme, to come into force in 2024, which will provide an explicit government guarantee over the first $100,000 in retail deposit accounts.

This will catch New Zealand up with other OECD countries[1] and is designed to create ballast against the risk of bank runs, but may trigger some other market responses, either neutral or negative depending on commercial positioning. These include:

- Large depositors splitting their banking relationships over a number of providers; and
- Providing a growth opportunity to existing non-bank deposit takers and to new entrants (especially in the "challenger bank" online space).

In practice, the effects of deposit insurance are often difficult to predict. At a retail level, opening and maintaining accounts at different banks is cumbersome, although the Customer Data Right and fintech solutions may serve to ameliorate that. And in a world of high inflation the incentives on customers to seek out better returns are higher.

The extent of change will likely depend on:

- How levies are imposed, and the level of regulation placed on deposit takers of different sizes (particularly in the wake of SVB's failure) – i.e. the cost of admission to the scheme for smaller non-banks.
- Public and investor confidence in the system:
  - Credibility with the public will depend on immediate (or almost immediate) pay-out, a function that will sit with the RBNZ and will be frustratingly complex to design. Deposit takers will have to devote significant resource to make the regime work well for users, in particular the systems changes needed to meet the new "single customer view" standards to identify eligible customers and their entitlements; and
  - The $100,000 limit, although twice the $50,000 amount initially proposed, is still significantly lower than other jurisdictions, such as the US$250,000 cap in the United States – and the SVB crisis has shown that even those limits may not be high enough.

The wholesale-funded non-bank residential mortgage sector continues to largely side-step regulation – apart from CCCFA and lending standards, such as loan-to-value and debt-to-income ratios as monetary policy butts against housing price controls. However the need for these has abated as the housing market has turned.

Life for local branches of overseas banks, by contrast, is set to become harder as the RBNZ tightens its control on their activities in New Zealand and seeks to exclude them from the retail banking market.

This isolationist approach could be an own goal for the New Zealand economy if global banks retreat from the specialist services they now provide here - unless or until fintech and similar businesses fill the void.

Full compliance with the RBNZ's outsourcing requirements as transition periods expire later this year will require that New Zealand banks have the domestic capability to continue operations even in the event that an Australian parent bank collapses.

This will provide opportunities for third party providers as banks look beyond their parent entity for services.

02/

Digitised, decentralised, disrupted

Computerisation has worked largely in the mainstream banks' favour so far, enabling them to reduce their overheads by dismantling much of their physical customer infrastructure while maintaining market share.

But there are a number of initiatives in development which have the potential to transform the sector within the next 10 years, creating a more diverse, difficult and competitive trading environment.

Multiservice fintech providers Ant Group and Tencent have been able to create huge market scale in China within relatively short timeframes. China was more open to new entrants than New Zealand will be because much of the population was outside the formal banking system. But there will be demand here also for flexible, innovative financial products.

Central Bank Digital Currency (CBDC)
The RBNZ is putting a lot of resource into developing a local CBDC for wholesale and retail use, although New Zealand is late to the party as over 60 countries have either launched CBDCs or are in an advanced stage of development with over 20, including Japan, Brazil and Russia, running real world pilots.

A CBDC could create an existential challenge to traditional banking depending on the design – in particular whether there are no, or very high, caps on the amounts that can be held in CBDCs.

Among the possible effects are:

- Greater competition for bank deposits, requiring banks to pay higher rates on deposit or to offer other inducements (such as ESG mandates) and, to the extent their deposit base is reduced, a restricted ability to lend; and
- An increased risk of bank runs as depositors may be able to shift their funds to a government backed CBDC at the first sign of trouble, instantly and without any personal cost.

  The extreme speed of the SVB bank run (US$42 billion withdrawn in 24 hours) has been attributed to online banking and social network information sharing, both now rather dated technologies. Customers still needed to have an alternative bank account or fund into which to transfer their deposits.

  An ability to shift seamlessly into a CBDC would eliminate that remaining friction (particularly when combined with open banking, as discussed below).

Private crypto currencies
The use of crypto assets in New Zealand is comparatively low (particularly relative to emerging markets with low financial inclusion, but also to some larger, significant financial centres, including Australia).

This has allowed the RBNZ to be agnostic on crypto to date, taking a 'wait and see' approach to permit innovation. They have proposed a focus on monitoring and targeting of systemic areas only.

The regulatory path New Zealand eventually walks will likely be determined by whether the providers are able to demonstrate a clear consumer benefit or become mired in the 'crypto winters', scams, crashes and 51% attacks that have occurred elsewhere.

Internationally, banks are embracing cryptocurrencies – whether as tokenised deposits (such as JP Morgan's JPM Coin) or private stablecoins (such as the USDF in development). These projects provide the customer with greater control and speed of settlement. Because they are privately run, they can also encourage customers to keep their money with, or move their money to, the provider bank to take advantage of the product.

Closer to home, National Australia Bank (NAB) has created the AUDN stablecoin (backed one-for-one with the Australian dollar) and last month became the first mainstream financial institution to use stablecoins to complete an intra-bank cross-border transaction on a public blockchain.

Real-time payments technologies

Payments NZ, the industry-owned[1] body established with RBNZ support in 2010 to manage New Zealand's core payment systems, has suggested 2030 or later for creation of a real-time settlement system.

New Zealand is again playing catch-up, Australia got there in 2018, but with such a long project timeline existential questions remain. Will it be able to deliver promised benefits, or will regulatory concerns such as fraud prevention reintroduce delays? The UK House of Lords for example, released a report in November 2022 recommending a new corporate criminal offence of "failure to prevent fraud" which (among other things) calls for the introduction of a delay on real-time payments, potentially lasting several hours, to try to stop fraudsters cashing out stolen funds.

A more immediate goal in New Zealand is the launch of SBI365 in May this year. This does not promise 24/7 or real-time settlement, but will require banks to be able to make payments during normal hours over weekends.

Once in effect and reflected in bank terms and conditions, SBI365 should open the door a little wider for fintech products. Wallet providers that allow round-the-clock payments among users are already taking off and the ability to withdraw and pay between wallets on Saturdays and Sundays will go a long way towards a proxy real-time settlement system.

Open banking

The Government committed in November last year to establishing open banking protocols in New Zealand within the next two years. The precursor step is to create a Consumer Data Right, which will require legislation.

A Bill was to have been introduced before the 2023 general elections but Commerce and Consumer Affairs Minister Duncan Webb has acknowledged that this may be "a bit tight"[2] . However, as National supports the initiative, it will likely be progressed next term whatever the election result.

Open banking will encourage further innovation and integration between banks and third parties, but it will also expose the banks to more competition, remove their data advantages, and require them to invest more in data protection mechanisms to address the increased privacy risks.

Defensive manoeuvres

To maintain their position, incumbents are likely to invest in new payment product developments, develop coordinated ways of working with fintechs and encourage a large, contained user-base through other services and incentives.

1. Shareholders are ANZ, Westpac, BNZ, ASB, Kiwibank, TSB, HSBC and Citibank.
2. Stuff article, 19 March 2023

03/

Changing balance sheet dynamics will require fancy footwork

Every element of bank balance sheets – from the deposit base through wholesale funding to liquidity requirements and asset management – is about to become more contestable or more uncertain, requiring a strategic response.

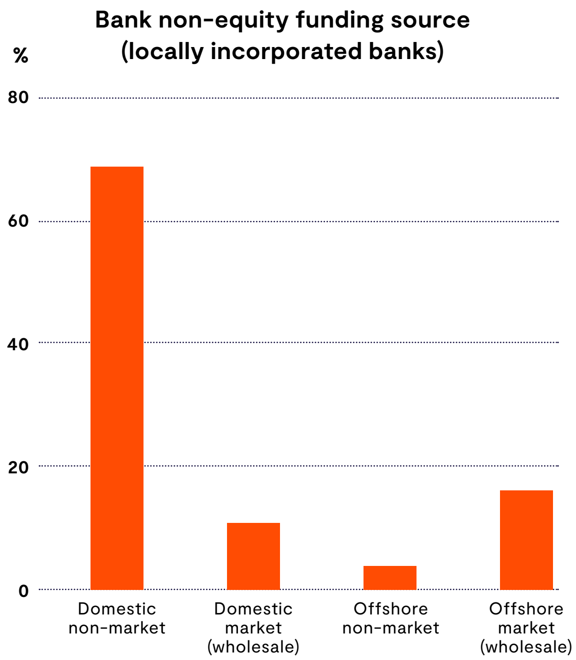
Customer deposits

Customer deposits are the bedrock of bank funding in New Zealand, accounting for almost 65% of bank lending as at March 2022 and providing a traditionally static source of revenue.

Depositor compensation should reduce the risk of mass capital flight but, as discussed earlier, we expect deposit bases will become much more dynamic and competitive on a day-to-day basis due to a more supportive regulatory environment for consumer led technological developments.

The current inflationary environment will incentivise customers to seek out higher returns just as new technologies and regulations make it easier for them to switch funds among banks, or to exit the banking system entirely. And younger generations, accustomed to making and changing investments at the push of a button, are unlikely to bring much loyalty to their banking relationships.

New bank products that can keep deposits within the bank ecosystem will become vital.



Wholesale funding

To the extent that deposits become more volatile, and as the RBNZ-mandated capital requirements ratchet up to 16-18% by 2028, wholesale funding sources (both domestic and international) will become increasingly important.

These markets are typically a deep source of capital but an increased reliance on them will make New Zealand banks more susceptible to downturns in overseas markets and the lessons of the Global Financial Crisis, reinforced by very recent experience, will be front of mind.

In addition:

- Some of the biggest unknowns and divergences from international practice in the Deposit Takers Bill relate to the treatment of creditors - from the absence of statutory bail-in, to the interplay between the depositor compensation scheme and bank resolution, and the lack of clarity around the framework for the RBNZ's preferred open bank resolution (OBR) process; and
- The RBNZ has indicated that it will be making further changes to the design of regulatory capital, potentially brought forward by the recent international bank crises, adding further uncertainty.

The fallout from Credit Suisse's merger with UBS, beyond the direct losses suffered by AT1 bond holders, is a general loss of confidence in regulatory capital investments.

Credit Suisse's AT1 products were designed to be written-off in exactly the circumstances that ultimately occurred, and appear to have functioned as intended - but they were valued similarly to 'contingent convertible' instruments.

We expect a very strong investor focus in future on how products will shake out in a crisis.

This can be partially addressed by issuers in disclosure, but clear legislation, definitive central bank guidance, and approaches comparable to international norms, are likely to be highly valued. At this stage it is too early to tell how the RBNZ and other central banks will view these considerations.

Liquidity and assets

The RBNZ is considering imposing limits on banks' ability to use mortgage loans (securitised as Residential Mortgage Backed Securities, or RMBS) and other highly rated bonds to meet the RBNZ's liquidity requirements.

Banks would instead be required to hold significant additional government bonds which, in the New Zealand market, could substantially increase demand for such securities, may reduce the ability for other issuers to fund through the bond market (shifting reliance back to bank funding), and effectively tying bank credit quality even closer to New Zealand's country credit.

Whether the Silicon Valley Bank collapse will give the RBNZ pause for thought is yet to be seen - SVB's failure provided an extreme scenario of the risks that can be created by over-investment in a single fixed interest asset class.

The effect of the above trends in combination will be to bring into sharper focus the need for efficient asset use generally – including who to lend to (borrower risk) techniques such as netting, central clearing and credit default swaps.

Banks will continue to seek out new and alternative income-producing assets that do not require deposits or regulatory capital to sit behind them, such as fintech investments.

There are inherent difficulties attached to fitting new business lines into the highly regulated New Zealand bank model (often leading to divestments). But the various change factors at play or in prospect for the industry will require new approaches that improve the customer experience, so that they are not motivated to seek out alternative providers.

04/
Social licence: great expectations

Social licence is a delicate commodity – hard to balance, hard to maintain and once lost, hard to regain.

Where substantial economic power is involved, a failure to meet the public's expectations of reasonable behaviour, as mediated through the government, will result in coercion.

The banking sector is already one of the most tightly regulated sectors in the economy and more regulation is coming down the line, most immediately:

- Climate risk reporting, in effect from the 2023 Financial Year (possibly to be followed within the next few years by nature-related and biodiversity reporting[1]); and
- Implementation of the Conduct of Financial Institutions (CoFI) licensing regime, expected in early 2025.

There are also other initiatives in play from the RBNZ which have the potential to promote a stronger sustainability and social inclusion focus among the banks. These include an issues paper[2] to improve Māori access to capital and a proposal[3] to entrench climate risk into the RBNZ's supervisory framework (which could go so far as requiring that banks assign a greater risk weighting to non-green financing).

The banks are already active in the sustainable financing area and had the opportunity through the lockdown phases of the COVID strategy to demonstrate forbearance toward firms under pressure (assisted by the Business Finance Guarantee Scheme and the payment arrangements around tax debt offered by IRD).

However, a recessionary environment with rising interest rates and constrained government support is increasing customer distress.

As commercial enterprises with responsibilities toward their shareholders, their depositors, and the stability of the financial system, the banks will find it increasingly difficult to be lenient, particularly if their funding base is jeopardised – e.g. defaulting mortgage loans generally cannot be used to back securitisation or covered bond lending, and a worsening loan book will disadvantage depositor holders.

The banks are well aware that these commercial realities require a more nuanced stakeholder approach than previous cycles, with no abatement in the political response to news of record bank profits and negative customer experiences.

After the 2022 corporate financial reporting season, then Prime Minister Jacinda Ardern invited the banks to engage in some "self-reflection" about their profit-taking – a call that Finance Minister Grant Robertson and Prime Minister Chris Hipkins have thus far conspicuously failed to echo.

But the RBNZ Monetary Policy Committee and RBNZ Governor Adrian Orr have publicly called for the banks to lift their deposit rates to bring them in line with increases in wholesale and mortgage rates so that the benefits of the higher OCR flow through to savers, and incentivise saving.

And in early March National Deputy Leader and finance spokesperson Nicola Willis asked the finance and expenditure committee, of which she is a member, to open a "short, sharp" inquiry into retail banking regulation and competition. The idea was voted down by Labour, as she knew it would be.

But she has identified National with the case for reform so it seems likely, whatever the election result, that the retail banking sector will be subjected to a market study by the Commerce Commission.

Indeed, it has been on the candidate list from the outset but the retail fuel, supermarkets and building supplies industries were given priority because, in a low interest rate environment, they were bigger targets in terms of household budgets. Now that has changed with the RBNZ in tightening mode.

Market studies, although rarely a welcome event to the specimens under the microscope, notwithstanding the banks' largely supportive response, offer the virtue of being disciplined, well-resourced processes where industry participants can make their arguments and have that evidence considered by an expert body.

1. Chapman Tripp commentary: Top ESG risks for boards and management in 2023
2. Reserve Bank Issues Paper: Improving Māori Access to Capital
3. Reserve Bank Issues Paper: Climate Changed 2021 and Beyond

05/

Banks increasingly on the front line and under fire

Banks are increasingly being co-opted to front line roles in the fight against crime, unscrupulous investment schemes and climate change, and have become natural targets for climate activists and other forms of litigation.

In the last decade, the banking sector has had new regulatory obligations placed upon it in the service of a range of government policy objectives and been party to several cases looking to expand banks' duties at common law, including:

- The prevention of money laundering (the Anti-Money Laundering and Countering the Financing of Terrorism Act);
- Protecting borrowers against taking on loans they can't afford (the Responsible Lending Code and the Credit Contracts and Consumer Finance Act (CCCFA));
- Protecting customers against scams – the UK courts have considered several cases to expand the Quincecare duty to require banks to protect customers from the consequences of their own misguided payment instructions; and
- The imposition of sanctions in relation to the Russian war on Ukraine.

These policies rely on banks to act as an arm of the regulator, monitoring transactions and protecting consumers, in the course of which they must often interpret principles-based laws and guidelines - and do so quickly and, potentially, many times a day.

Strengthening regulation

Banks – and their directors – will be expected to devote increasing resource to meeting their regulatory and other responsibilities, with the potential threat of enforcement action for any breaches.

They are facing a progressively stronger enforcement regime, through the expanded remit and resources of their regulators – the RBNZ, the Financial Markets Authority (FMA), and the Commerce Commission – and the new regulator' powers conferred under the Financial Markets Conduct Act, the Fair Trading Act, the Commerce Act, and the CCCFA, and proposed in the Deposit Takers Bill.

The Quincecare duty

The Quincecare duty directs that financial institutions must not implement a customer's instructions where they have reasonable grounds to believe that this might facilitate a fraud against that customer. It has often arisen in cases where it is alleged that the bank should have been on notice that an agent, such as an employee, of a corporate customer has misdirected company funds for their own benefit.

In New Zealand, the courts have been more reserved, requiring a claimant to show that the bank dishonestly assisted the fraud. However the topic is open to fresh debate in light of developing UK case law.

The UK Supreme Court is soon to rule on whether the duty also extends to individual customers that have been deceived. *Philipp vs Barclays Bank UK PLC* concerns a claim by Mrs Philipp, who was tricked by a fraudster into transferring £700,000 from her Barclays account to two accounts in the United Arab Emirates, that Barclays should:

- Not have executed her instructions until satisfied that there was no attempt to misappropriate funds; and
- Taken steps to recover the money once the fraud was discovered.

Should the Court uphold the appeal, the scope of Quincecare will be substantially expanded and substantially slow payments. While an expanded Quincecare duty may reduce the impact of fraud, it also reduces the efficiency of the payments system and impinges on the autonomy of banking customers. As the New Zealand courts have recognised, requiring banks to investigate the bases on which payments are made can result in significant financial loss where legitimate transactions are delayed.

1. Case details, Supreme Court website

Climate activism

Climate activism against banks can take the form of regulatory enforcement by the FMA, advertising standards claims brought by NGOs or competitors, shareholder activism preliminary to private law action, or litigation brought by NGOs or investors alleging misleading or unsubstantiated statements. So far no legal challenges have been made by climate activists against banks in New Zealand but it can only be a matter of time, judging from the Australian and UK experience.

Regulatory enforcement

The FMA has greenwashing clearly in its sights, with updated guidance and wide sweeps of advertising claims on a sector by sector basis. We expect the FMA to take more formal enforcement action this year.

Advertising standards claims

Climate-focused NGOs are increasingly active pursuing greenwashing claims. Lawyers for Climate Action NZ Incorporated (LCANZI) has already made greenwashing complaints against New Zealand corporates to the Commerce Commission and Advertising Standards Agency and we anticipate further complaints being brought by LCANZI and other climate-focussed NGOs based on overseas experience.

In the UK, two HSBC advertisements promoting the bank's investments in sustainable finance and tree-planting were banned last year by the UK Advertising Standards Authority. While the advertisements were factually true, they were held to give a misleading impression of HSBC's climate impact because they did not disclose HSBC's continued financing of fossil fuel exploitation and links to deforestation. The HSBC may represent a high-water mark, but New Zealand regulators are also keen to emphasise that it is the overall impression of the advertising that counts.

Shareholder activism

In Australia, there are increasing examples of shareholders using corporate governance processes to demand environmental accountability. For example:

- Shareholders may seek to exercise their right to inspect company records for the purpose of assessing greenwashing (such as whether internal company documents align with public environmental commitments and claims). In Abrahams v CBA, Federal Court of Australia made orders by consent requiring the Commonwealth Bank of Australia to permit a shareholder to inspect documents detailing decisions to finance oil and gas developments and relating to the bank's emissions reductions target; and
- Market Forces, the Australian shareholder activist group, filed multiple ordinary resolutions at the December 2022 AGMs of Australian banks, requesting that they disclose how their financing would not be used for the purposes of new or expanded fossil fuel projects. Although the resolutions were voted down by shareholders, they dominated the discussion at the respective meetings and the accompanying press coverage.

Class actions

New Zealand's informal class action regime continues to develop. While the proposed statutory class action scheme recommended by the Law Commission may now have been put on the Government's back-burner, the existing de facto regime gives sufficient basis for claims against banks when used effectively. Both ANZ and ASB are currently defending a class action alleging breaches of the CCCFA and litigation funders are actively looking for further claims to support.

Timeline

The banking sector is facing a multi-faceted regulatory reform programme which will require substantial adjustment and will change the dynamics of the market, encouraging technological innovation and creating opportunities for new entrants.

Near term certainties

Next 12 months

- Deposit takers and regulators will continue to watch global developments, and whether recent bank failures will spread.
- Domestically, the depositor compensation scheme is scheduled for early 2024, potentially increasing the attractiveness of non-bank deposit takers offering higher yields.
- The scale of impending regulatory change is massive, including climate risk reporting and full outsourcing restrictions within 12 months. Conduct licensing will come into effect shortly afterwards. The time and resources required for core system development and troubleshooting cannot be underestimated.
- Banks will also need to continue to position themselves for the next growth areas – from sustainability products and financial inclusion, to payments changes and open banking (made more likely by the expected introduction of a Consumer Data Right).
- The ability to make payments 365 days a year is expected in May 2023, providing a key milestone for fintech payment providers.

Medium term probabilities

Next 5 years

- Conduct licensing is expected to be required by early 2025 – although in the wake of the conduct and culture reviews, banks are already focused on identifying and ensuring good customer outcomes. Products related to sustainability and financial inclusion will multiply.
- We are likely to see significant central bank digital currency (CBDC) testing, given the pace at which other countries are proceeding.
- Competition for deposit bases will increase, and capital requirements will ratchet towards the new 16-18% maximums.
- More specialised providers of new fintech solutions, diversifying the industry. To compete, larger players will continue to develop their own products or acquire start-ups.

Long term possibilities

Next 10 or more years

- Completion of key modernisation projects, including introduction of a CBDC, open banking and potential for open source 24/7 real time payments.
- Deposit bases may become considerably less static, compounding the need for banks to obtain wholesale funding and develop products that keep money within the bank ecosystem.
- A long term consolidation may occur as scale and breadth of product offering widen (beyond traditional banking services) to attract customers. A possible by-product of this may be that participants beyond the traditional banks (e.g., financial market infrastructures) become “too big to fail”, increasing the moral hazard attached to the sector.

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Our thanks to Patricia Herbert for helping us write this publication.

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