Time right for big banks to list NZ assets

We've rightly started to debate the merits of foreign ownership of land and houses but what's clear is that no other advanced economy in the world would allow almost all of its banking system to be owned overseas.

It's no fault of the Australians that they were smart enough to understand how good the long-term returns were from banking and either bought or built their banking businesses in NZ.
The big four banks in NZ, which are all Australian owned, have a combined market share of about 90 per cent and will make combined after tax profits out of NZ of more than $4.5 billion in 2015.

To put that in context, if you add up the profits of all the companies listed on the NZ Stock Exchange you get to a similar number. The big four banking oligopoly is so profitable that in NZ in 2014 they generated a pre-tax ROE (return on equity) of more than 22 per cent for their Australian shareholders. Given the banks are effectively NZ Government guaranteed, this represents an exceptionally attractive return, particularly relative to the current risk-free rate of about 3.5 per cent. The NZ taxpayer (represented by the Government) effectively guaranteed the foreign-owned banks - interesting, isn't it?

Australia, like Singapore, takes a much more planned approach to looking after its long-term sovereign interests. For many years Australia has operated a four pillars policy which primarily prevents mergers between the big four banks, but also means it's most unlikely that the Australian government would allow foreign ownership of any of the big banks. Specifically, government approval needs to be given before any party can acquire more than 15 per cent of a large Australian financial institution. It is widely believed the Australian government would never give this approval.

So, is the situation in NZ a problem and does it matter? My view is yes.

Some people see the banks as an Australian-based tax on the NZ economy but that's a bit harsh. However, it is true that NZ's current account, which measures what a country saves minus what it spends, has been in deficit since 1973 - partly due to the poor investments many of our companies have made overseas compared to the smarter investments that foreigners have made here. Banks are a big contributor to that deficit. All other developed sovereign nations have taken the view that it's important to have domestic ownership of the majority of the banking system, particularly in the event of a severe financial crisis.

What can we do about it?

Here's a bold idea that I'd like to see debated - let's require the big four banks to list 25 per cent of just their NZ operations on the NZ Stock Exchange over the next 10 years.
The amount of capital needed would be about $20 billion, but spread over 10 years would be manageable.

The timing is right:

- We now have a solid regulatory regime under the RBNZ and the FMA.

- KiwiSaver is transforming our savings base. NZ now has more than $27 billion in KiwiSaver and growing strongly. This money is looking for attractive investment opportunities.

- Our total equity market has grown substantially and is now capitalised at about $100 billion. Consequently the new listed bank stocks would comprise a manageable 20 per cent of the market, compared to about 30 per cent of the Australian Index.

- The NZ equity market is now trading at a price to earnings (PE) multiple premium to the Australian market and so Australian shareholders in the banks would not have to take a hit on valuation. Historically, we've traded at a discount so the timing is good.

- Transparency is increasingly important and a stock exchange listing helps provide this. Stakeholders will have a much clearer idea about leverage, taxation and transfer pricing issues following partial listing.

- If, as a possible consequence of the economic cycle or new capital regulation rules, the banks needed to raise more equity, this is now possible through the NZ Stock Exchange given our improved liquid savings pool.

- The banks are a big part of our economy and NZ-based investors should be able to access their NZ businesses, particularly through KiwiSaver.

- NZ shareholders could benefit from the imputation credits generated from tax paid in NZ. Currently, if a New Zealander buys shares in an Australian bank the franking credits have no value.

The NZ market is hungry for yield and banks generate great dividends. Investing directly into Australian banks is a different risk exposure to buying shares in their NZ operations, which typically account for less than 15 per cent of overall group profits.

I think it is in the banks' long-term interest to be listed here and be part of KiwiSaver schemes, as it will reduce the risk of their high profits becoming more regulated.

We should not bash the banks. They are typically well run, high integrity businesses and are an integral part of the social and economic fabric of NZ. It's vital to the stability of our financial system that they remain profitable and strong. But as New Zealanders, wouldn't it be great if we could directly share in the growth of their NZ operations?