FIPS

Non-bank Financial Institutions Performance Survey – Review of 2019

1

Higher NPAT

16.49%

growth in NPAT

2

Higher net interest margins

19bps

increase in NIM

3

Higher net interest income

14.04%

rise in net interest income

4

Continued lending growth

9.32%

growth in gross lending

5

Greater write-offs

5.35%

increase in impairment expense

6

Growing provisioning

15.77%

increase in provisions

Contents

KPMG's Financial Services team provides focused and practical audit, tax and advisory services to the insurance, retail banking, corporate and investment banking, and investment management sectors.

Our professionals have an in-depth understanding of the key issues facing financial institutions.

Our team is led by senior partners with a wealth of client experience and relationships with many of the market players, regulators and leading industry bodies.

The Survey

Welcome to Part One of the 2019 edition of the Financial Institutions Performance Survey – the non-bank sector review.

Our survey of non-bank financial institutions captures the financial performance of entities with annual balance dates between 1 October 2018 and 30 September 2019. The threshold for inclusion in this year's survey continues to be based on total assets of $75 million in one of the last two years.

Most information used to compile this survey is extracted from publicly available annual reports for each financial institution. A limited number of participants provided us with audited financial statements that might not otherwise be publicly available.

The non-bank sector comprises a total of 24 survey participants this year following the amalgamation of Credit Union South with Credit Union Baywide, Avanti Finance's acquisition of Branded Financial Services, and the inclusion of a new survey participant, FlexiGroup (New Zealand) Limited.

This year's survey incorporates FlexiGroup (New Zealand) Limited, an entity that meets the threshold based on total assets and produces publicly available audited financial statements. Although these criteria were also met last year, the financial statements were not released in time for inclusion in the publication. We have however included 2018 statistics in this current year's publication to enable comparisons to the prior year. FlexiGroup (New Zealand) Limited offers a range of financial services including certain interest free lending, credit cards, long-term finance, leasing and vendor finance programmes.

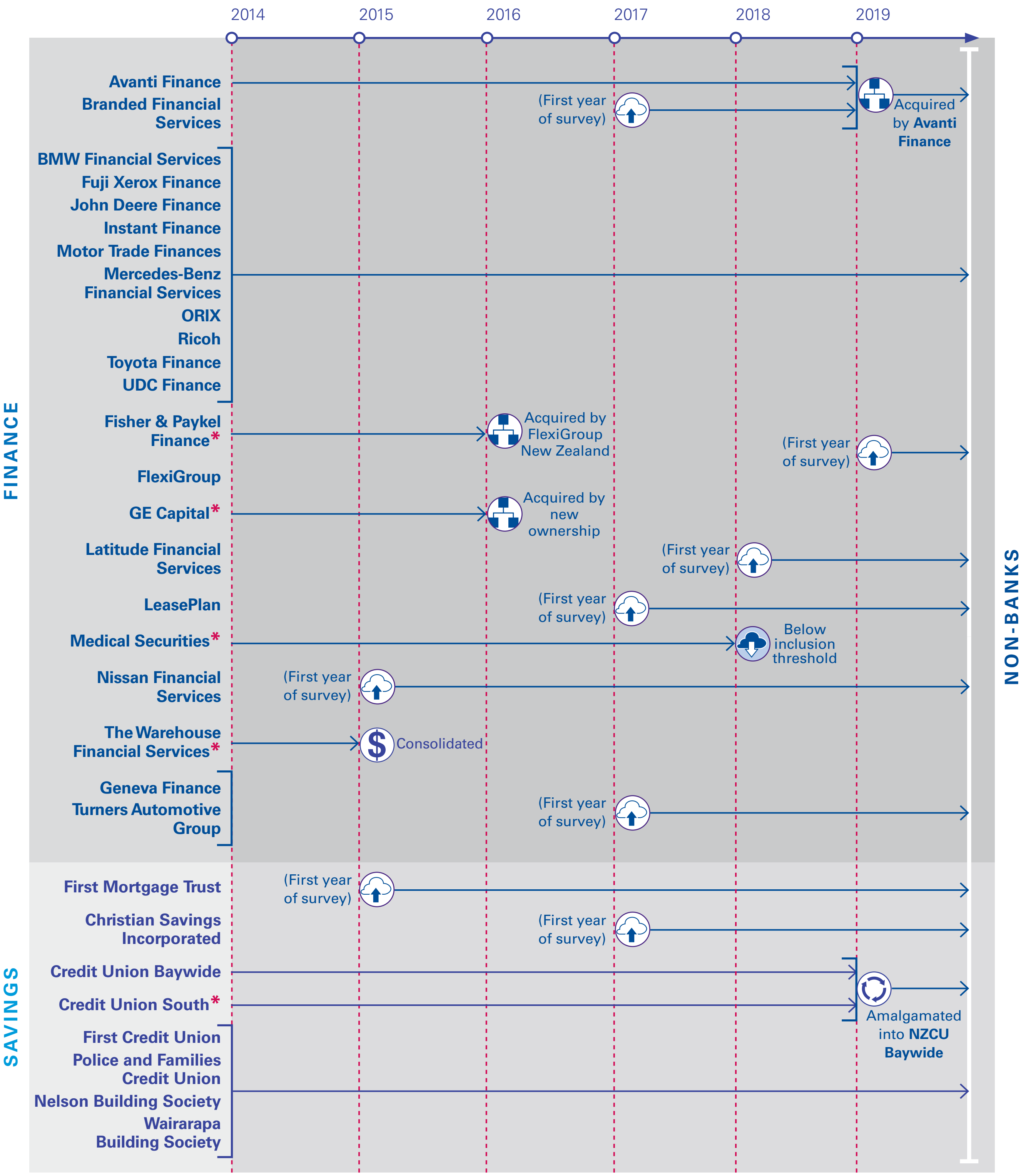
The non-bank sector, for the purposes of this survey, includes a range of credit unions, non-bank deposit takers (NBDTs), building societies and finance companies in the business of providing leasing opportunities for motor vehicles, consumers, personal, commercial and mortgage sub-sectors.

We would like to acknowledge and thank the survey participants (CEOs and CFOs) for their valuable contributions, which included making time to meet with us to discuss various developments taking place within the industry.

TABLE 1: ENTITY MOVEMENTS

	Who's out	Who's in
Non-banks: 24	Credit Union South (Merged with Credit Union Baywide) Branded Financial Services (Merged with Avanti Finance)	FlexiGroup (New Zealand) Limited

Looking back at the sector



* Entities are no longer participating in the survey for various reasons.

Sector - Themes and issues

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Head of Banking and Finance
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John has been with KPMG's Financial Services audit team for over 34 years, 22 of these as a partner working with a wide range of financial services audit clients, specialising in banks and finance companies.

John has a wealth of experience in auditing and accounting for banking products and services including treasury, retail offerings, corporate loans and loan provisioning. He is currently Head of KPMG's Banking and Finance team and editor of this publication. John is also Deputy Chairman of the New Zealand Auditing and Assurance Standards Board (NZAuASB) and serves as a board member of the XRB. John is also a fellow of CA ANZ, a member of the Institute of Directors and a Trustee of Breast Cancer Cure.

In 2019, non-banks participants in the survey generally continued the trend of strong growth that they have seen over the past few years. With record demand for lending and a surplus of funding looking for a home and yield, non-banks have not had to look outside of their sub-sector niche to find this growth. Coupled with solid economic conditions, this has allowed for the historically low level of impairment to remain, as many non-bank participants have 'stuck to their knitting' and are just doing more lending in areas they know and understand well. The desire for customers to have access to new products and an 'other significant financer' has also helped the growth. The sector has seen continued consolidation during the year; with increased regulation and competition on the horizon, and entities looking for scale and size to more effectively compete beyond natural growth, this may be something that continues further into 2020.

A number of key themes were noted in the conversations we had with survey participants. These themes are discussed in detail below.

Lending growth and mix

Our FIPS Non-banks 2018 publication discussed the observed shrinking of the banking 'black box', as registered banks appeared to lower their risk appetite and tighten up their lending following the Conduct and Culture review and ahead of the capital changes. This meant more people were told no and as a result came looking to the non-bank sector for financing. This gave the non-bank sector access to customers with higher credit quality and larger than average borrowing requirements, contributing to 14.24% growth in 2018.

The non-bank sector has continued to achieve strong lending growth, of 9.32% to $13.25 billion. This appears to be driven by both a continued tighter banking 'black box', as well as flat house prices restricting people's ability to put their new lending 'on the mortgage'. While the banking sector continues to adjust to a new normal for Conduct and Culture, the proposed capital changes for the banking sector have likely also impacted the banking sector's appetite for growth, leaving an opportunity for the non-bank sector, much as the loan-to-value ratio (LVR) restrictions did for the past several years (albeit less in the past year as the LVR restrictions loosened).

The non-bank sector saw housing lending again achieve the highest growth in type of lending at 16.87% to $2.94 billion (above personal and business lending), and it is likely that this area will continue to grow if banks are required to hold more capital against their same loans, effectively reducing their return on equity (all else remaining equal) (see figure 1).

1 SEE FIGURE 1 – PAGE 7

While we have said over the past few years that 'it can't keep getting better', many participants in the survey continued to observe an improvement in credit quality, albeit this trend has appeared to flatten out in the latter part of 2019. This is likely to be driven by a number of factors, including the banks continuing to tighten their lending causing higher quality lending to trickle through to the non-bank sector, falling interest rates and low unemployment levels. This is mirrored by finance industry leaders accrediting New Zealand's strengthening credit quality as a positive effect of both Gross Domestic Product (GDP) growth (2.1%) and more disposable income being available to workers (helped by lower interest rates decreasing the amount of income committed to paying off debt)[1].

Employment

As discussed above, unemployment rates are one of the key factors that influences credit quality, as it impacts the ability of customers to re-pay their loans through receiving salaries or wages. Unemployment levels dropped to an 11 year low of 3.9% in the second quarter of 2019, and has averaged 4.15% over the year[2].

Minimum wage is another factor that affects not only second and third tier lenders, but the wider New Zealand economy. The minimum wage was increased to $17.70 per hour in April 2019 following the Coalition Agreement commitment to increase the minimum wage to $20 per hour by April 2021. However, to preserve the real income of minimum wage workers; the Government noted that a meaningful minimum wage increase must occur annually in order to keep up with inflation[3]. Another challenging aspect of increasing the minimum wage is that staff become more expensive, which can negatively impact unemployment rates through businesses being able to afford fewer staff. Studies show that if the minimum wage had remained consistent, an estimated 8,000 more workers would be employed, although the unemployment rate is still at record lows[3].

Interest rates

The Reserve Bank of New Zealand (RBNZ) announced two reductions in the Official Cash Rate (OCR) during 2019, dropping it to a record low 1% after a three-year plateau at 1.75%, with one of these drops being a 'double drop' of 50 basis points (bps) – surprising the market. The RBNZ have determined the decrease is imperative to control inflation while GDP growth has slowed, and to help keep employment rates at their maximum sustainable level[4].

Unsurprisingly, interest rates have followed the falling trend of the OCR. Many survey participants have commented that the reduction in the OCR has helped reduced cost of funding, enabling second and third tier lenders to offer rates that are more competitive with banks while preserving margin. However, the pressure on margins has not really decreased due to the competition and fighting for market share. The latest OCR cut has appeared to spark another mortgage war among the banks, with interest rates reaching record lows in time for the spring seasonal high for the housing market.

Reduced funding rates have meant that term deposit rates are not as enticing to investors, especially those that rely on interest as their income in retirement. This has seen a continuation of the search for yield. One does not need to look to far back in history to see what a previous search for yield from investors caused, being the rise and fall of the property finance sector in New Zealand in 2007-2009, with many investors ending up putting their money with finance companies who offered high deposit rates, and either losing some or all of their money or being rescued through government guarantees. One would hope that the nation still remembers this lesson, and remains aware not just of the rewards, but also of the risks of higher yielding and less secure investments.

With interest rates falling, an increase in consumption would normally be expected to be observed. This is because theoretically there is less incentive for people to keep their money in the bank due to earning lower returns, and additionally the costs of borrowing are reduced which will in turn either give people more disposable income or encourage people to borrow to fund purchases.

However, this is not what appears to be actually happening. Instead of the OCR cuts stimulating spending and investment through the intended signal that borrowing costs would continue to remain low, many interpreted the cuts as a signal that things must be worse in the economy than they thought, if rates are being cut to similar levels as overseas countries; and as a result, a feeling of uncertainty and 'wait and see' has filtered across the economy. Consumers and businesses seem to have lost confidence and are currently in a holding pattern. This situation has been mirrored by the low business confidence numbers stalling many people from spending or investing in new capital. The phenomena when discussed prompted many survey participants to ask what are they waiting for and why?

Business confidence

There is still a lack of business confidence within New Zealand as shown by the ANZ Business Confidence Index[5]. This may be driven by a number of factors, such as continued low confidence in the Coalition Government by the business sector (who tend to prefer right of centre governments), or continued uncertainty in ultimate government policy, or indeed global uncertainties around Brexit or President Trump and China. However, this lack of confidence continues to remain starkly in contrast to the actual performance of the economy.

Unemployment has remained low despite increases to the minimum wage, GDP growth may have slowed, but it is still growing, and inflation has remained within the RBNZ's target of 1-3%[6]. A Moody's analyst has congratulated the Labour-led Coalition Government for their contribution to strengthening credit quality, suggesting it is the budgetary flexibility and increased spending on social projects that is helping to drive the somewhat surprising affirmative 2019 economic results[4].

The issue with a prolonged lack of business confidence from many industry leaders is that it can start becoming true by virtue of their inactivity. Continued low business sentiment combined with international and domestic headwinds slowing GDP growth has resulted in a reduction in investment; while house prices softening in some areas beyond Auckland and population growth decreasing due to lower net immigration has also caused the growth in household spending to slow[7].

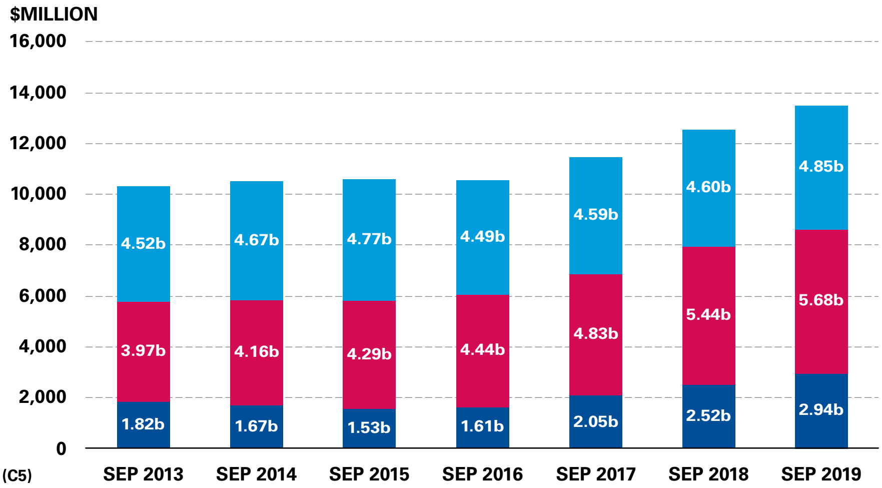
We have heard from various sector participants that there does appear to be a difference in confidence levels between the major cities and the regions. The cities seem to have talked themselves into a 'wait and see' holding pattern, possibly driven by flat house prices, while the regions seem to have good confidence levels, driven by strong housing and industrial growth. This is possibly fuelled by the inflow of wealth being brought in from those moving out from the cities, many for a better style of retirement while unlocking some of their capital wealth by selling their house in the city and buying a more affordable house in the regions.

The manufacturing sentiment has been the most pessimistic, possibly further impacted by global news such as the US-China trade wars and Brexit, but this sentiment has improved from the previous quarter[8]. If businesses cannot get the funds they need or are delaying making investments due to local or global uncertainties, they will be incapable of growing, or the growth will be delayed, which consequently in itself slows the economy.

While immigration is good for GDP growth, a lack of skilled workers has also been an issue that could be contributing to the slowing economy, as businesses are unable to find the employees they need to grow. This is something that many sector participants mentioned, not necessarily in their business, but in the businesses that they finance. The Government is making changes to temporary work visas to focus on encouraging higher skilled people, to help address work shortages[9], and introducing an employer-led work visa to aid in this. They want to reduce exploitation and improve working conditions by making the visa process less complex[10].

However, the increase to the minimum wage that must be paid to a migrant worker has led to many businesses questioning the need for the resolve.

1 NON-BANK SECTOR LENDING



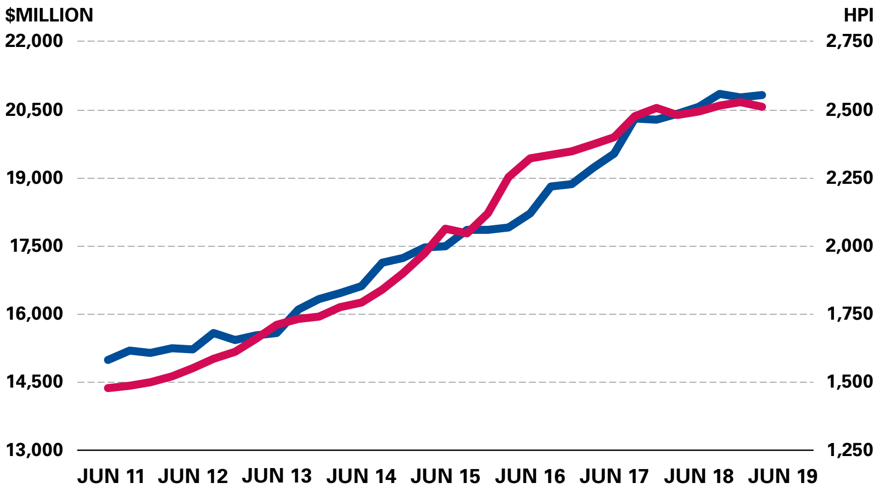
HOUSING – NON-BANKS

PERSONAL – NON-BANKS

BUSINESS – NON-BANKS

SOURCE: RESERVE BANK OF NEW ZEALAND STATISTICS (C5)

2 PERSONAL LOANS VS. HOUSE PRICE INDEX

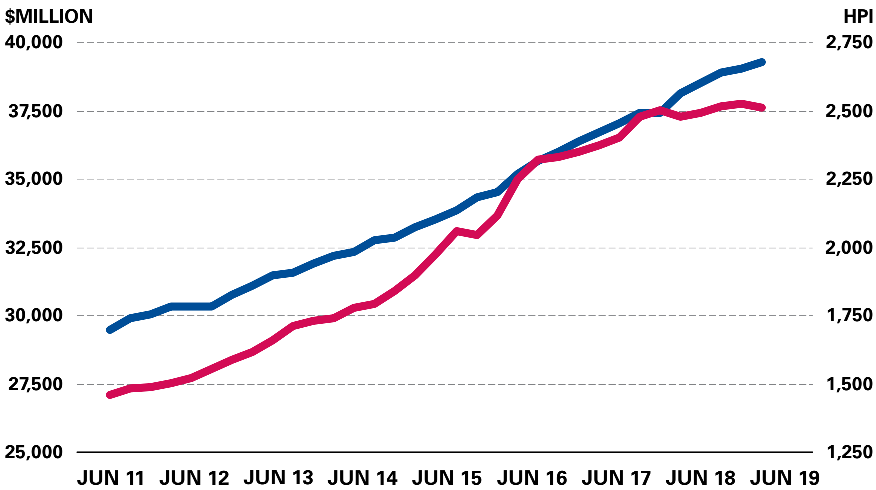


PERSONAL CONSUMER LOANS + SEASONALLY ADJUSTED CREDIT CARD SPENDING (LHS)

HOUSE PRICE INDEX (RHS)

SOURCE: RESERVE BANK OF NEW ZEALAND STATISTICS (M5 & KEY GRAPH DATA)

3 PRIVATE CONSUMPTION VS. HOUSE PRICE INDEX



PRIVATE CONSUMPTION (LHS)

HOUSE PRICE INDEX (RHS)

SOURCE: RESERVE BANK OF NEW ZEALAND STATISTICS (M5 & KEY GRAPH DATA)

Housing and immigration have been big issues Labour have tried to tackle during their first term in government. The foreign buyer ban was implemented to try an enable Kiwis to purchase homes without foreign buyers pushing up house prices, and it has worked to an extent. Median house prices in Auckland and the West Coast in the second quarter for 2019 have decreased compared to the second quarter for 2018, while every other region has increased. However, it has negatively impacted some developers who have not been able to get enough pre-sales to start development, and has also influenced a slowdown in delivery of new projects[11].

The reason behind house prices softening is interesting, because there are two very different viewpoints on it. On one hand, for home owners, it is likely concerning that the value of their property could decrease, which could also be aiding the feelings of economic uncertainty and hesitation to spend. Lenders also likely share this sentiment, as this will impact on both their ability to lend more against this good security, and also impact the value of security to cover the mortgage, if the loan goes bad.

On the other hand, for people looking to buy a house, a decrease in housing prices is probably a big relief. With homeownership rates at their lowest levels since 1951[12], being a homeowner in the city has become an unrealistic dream for many young Kiwis who can't get help from the bank of mum or dad.

Lower house prices combined with low interest rates, driven by the latest round of mortgage wars following the 50 bps OCR reduction, is resulting in consumers having more credit capacity through lower repayments on their existing debt. This situation is giving banks opportunity to be able to lend more to their customers while still lending responsibly. Some non-bank sector participants were starting to feel the impact of this in the latter part of 2019, with banks starting to again allow money lent to buy another asset to be put onto an existing mortgage rather than the customer going to a finance company, something that was previously more prevalent a couple of years ago during periods of very high house price growth.

Fintech

The word 'fintech' means different things to different people, with some just thinking it is another buzzword. When we have looked at the sector and met with sector participants, we have looked at fintech as anything that entities are doing, from digitalisation of their processes through to partnering with other parties to bring new innovation to the market, whether it be at the front end or back end of their business. Sector participants were varied in the work they have done to date in this regard, although almost all felt that they should be doing more. Many were working on better streamlining their back-end systems, to help improve the speed and efficiency of processes such as credit decisions through use of data and flow of data, particularly through developing tools to scrape customer bank data.

Others were looking at improving the front end, by allowing customers to have better and timelier access to information on their loans, such as their current balance, the ability to make changes quickly and easily, such as updating their address on an app rather than having to ring a call centre or visit a branch, and also making it easier for that customer to become a repeat customer. The theme of these changes is to reduce customer friction, at different points of the customer journey.

While these are good examples of current finance entities looking to effectively 'disrupt' themselves, it appears that the pace of change is fairly slow across the sector, with many reasons for this. It is a mix of the cost and time these changes take, as well as making sure that they only make changes which their customers will actually value.

From a whole of entity fintech perspective, the best example of this would be the Buy Now, Pay Later industry, which has entered the market with a fully digitised package, and is actively disrupting many sectors, directly through being an alternative credit provider, or indirectly through using people's repayment capacity, which in turn prevents responsible lenders from lending further. A number of survey participants offered a view that New Zealand companies are being left behind in the fintech space and need to catch up, or they will be overrun by foreign participants with newer products. There was also a view that a bit of the blame lands at the regulators' feet, with regulators feeling that they can improve the customer's outcome by better regulation as opposed to better innovation introduced to the market by new players.

Credit Union sub-sector

It has been a big, and sometimes difficult, couple of years for the Credit Union sub-sector, not helped by the continually increasing challenge of competing with larger and better cost optimised lenders, such as banks who also have lower funding costs, and having to continually respond to new regulation and legislation as it comes out.

There are two events that best define this time of change.

The first is the amalgamation of four Credit Unions, initially driven by the difficult situation that Aotearoa Credit Union (ACU) was in, caused partly by cost overruns in the implementation of the Oracle Flexcube system, as well as a deteriorating loan book. This led to ACU breaching minimum capital ratios and its trust deed, and needing about $2 million of capital to get back on track.

Fortunately for ACU customers, an opportunity to merge with NZCU Baywide, NZCU South, NZCU Central and NZCU Steelsands was proposed, with the Credit Unions loaning ACU $1.25 million to prop it up until the merger took place[13]. NZCU Steelsands' members voted against the takeover in the special resolution, despite being endorsed by its board[14]. However, the merger went ahead for the remaining four Credit Unions, enabling the merged Credit Unions to compete more effectively against mainstream banking.

As each of the Credit Unions are using the same underlying banking system, Oracle, the transfer of data was easier[15], and Co-op Money has endorsed the merger, despite the potential implications for its own operations[16]. Following the merger, NZCU Baywide provided a $3.9 million loan to Co-op Money to help it work through its issues as it continues to provide services for the remaining Credit Unions[17].

This brings us to the second defining event of change, being Co-op Money (officially the New Zealand Association of Credit Unions). Alongside implementation difficulties of the Oracle Flexcube system for its members, challenges in building out its customer base of this system to non-members, some members no longer using its services (or no longer being members) and some issues in its insurance business, it continued to get by (with the help of the loan from NZCU Baywide). The sale of its general and life insurance businesses to Provident Insurance and Pinnacle Life, respectively, have also helped it refocus on its core strategy. However, given the write-down in Co-op Money capital notes by member Credit Unions, reflecting that the Credit Unions did not believe they would get all of their money back, the future looked challenging. Another way of looking at this is that now all of the immediate challenges are behind it, Co-op Money and the Credit Unions can now move forward pursuing a new strategy.

While the Credit Union sub-sector is largely defined by the specific geographic regions or business sector that each serve, further consolidation of the sector feels like the way forward. Just as this document was being prepared the merger of Credit Union Baywide and Co-op Money was announced. Credit Union Baywide announced their primary focus post-acquisition includes rolling out a new banking app, while looking after Co-op Money customers and suppliers as they continue to service their customers[18]. Not much later the Council of Financial Regulation announced a piece of work led by the RBNZ to ensure the health and sustainability of Credit Unions. This probably represents a water shed moment and an acknowledgement of the independent role Credit Unions play and the importance of that sub-sector surviving.

Regulation

2019 has seen a continuation of increased regulatory and legislative change across the financial sector, and the non-bank lenders were not spared.

In our discussions with sector participants, there was generally wide support for strengthened regulation in the sector. This was driven by a mix of the belief that they were already doing the 'right' things for their customers and the recognition that some fringe parts of the sector or entities 'just' outside the sector were not always acting in the best interests of their customers and thus tainting the image of the wider sector.

Many in the sector raised several points about this wave of new and amended regulations. The first was that there was already a suite of legislation and accompanying regulations in place to protect customers (such as the Credit Contracts and Consumer Finance Act (CCCFA), and Responsible Lending). Since it was only a few sector entities that were currently not complying with existing regulation that became the main targets of the new legislation, some questioned whether more enforcement of current regulations rather than new regulations would be a more effective approach, given the ones paying the price for the new regulations were mainly the ones already complying with existing rules.

The second point many sector participants raised was the speed at which new regulations were being rolled out. While they recognised the good intention of the regulations or legislation, they felt there was limited time for consultation or implementation, which often led to some unintended consequences.

With these unintended consequences, either through interpretation issues or application of rules to products or processes that had not been considered, some felt they were not given either the guidance on how to best respond to this unintended consequence, nor any grace period to try and comply (i.e. they were instantly 'in breach'). Many sector participants praised the Financial Services Federation for their work helping the sector raise these potential issues through industry submissions, alongside other conduct and regulatory work they do for the sector.

A timely example that may impact the industry in the future is the proposed 'feebate' scheme for vehicles, being a rebate on electric vehicles and additional fees on non-electric vehicles. The application of this to vehicle lessors, such as who should receive the fee or rebate, how this is factored into lease payments, and how this impacts the return or resale of the vehicle, presents many questions, and one hopes that the industry receives sufficient time and guidance to be able to respond to the new rules in a timely manner. Another frequently heard comment was the concern that regulators and the legislature are too far removed in terms of socio-economic status from those that need protecting and don't understand what a true customer outcome is. Furthermore, we heard that they seem to be waiting on bringing good customer outcomes into force via regulation rather than innovation. The example given was to look at what innovation has brought to the telecommunications sector and the energy sector via number/account portability.

CCCFA

Flowing on from conduct, another area of regulatory impact on the sector is the recent proposed changes to the CCCFA, through the Credit Contracts Legislation Amendment Bill (CCLAB).

The current CCCFA requires lenders to act 'responsibly' at all times. This includes ensuring fees are reasonable and only recover costs to the extent that the expense incurred, by explicitly prohibiting lenders from making a profit from fees[19].

In April 2019, changes to the CCCFA were proposed through the CCLAB.

One of the changes that will likely have the biggest impact on the industry is for the lender to no longer be able to 'just' rely on information provided by the borrower. This will significantly increase the amount of verification that lenders will need to do on information provided by borrowers. On top of this, specific inquiries of borrowers will need to take place, and lenders will need to retain evidence of these inquiries taking place.

This is a fundamental change for the industry, and one that will likely result in additional cost, possibly slower credit decisions (which may possibly be offset by increased use of technology), and potentially increased frustration from both borrowers and lenders as a result.

Other changes in the CCLAB are that lenders will be limited to charging a maximum of 0.8% interest and fees per day as well as the cost of credit prohibited from being greater than 100% of the amount borrowed[20]. In an attempt to promote compliance with responsible lending requirements, the Commerce Commission has jurisdiction to force lenders to substantiate the reasonableness of their fees.

Similarly, affordability and suitability tests will be a requirement to simplify the procedure for lenders. The CCLAB will also establish increased financial penalties, statutory damages and banning orders to promote compliance, and a 'fit and proper person test' for lenders[21].

The latest version of the CCLAB proposed in November 2019 has a couple of further areas of note (amongst some other changes)[22], being:

1. Lenders will be required to not only assess the affordability and suitability of lending to borrowers at the inception of the loan, but also when there are any 'material' changes to the loan (such as increases to a credit limit).

   Many lenders currently perform 'bank statement' scraping at the start of a loan before money is lent as part of the current rules. Given the new rules, will this need to be done at each 'material' change? One consideration is whether to perform ongoing live bank statement scraping over the life of the loan, allowing customers more flexibility and timely responses to requests to change their loans, and providing more information to lenders in order to respond to changes in the borrower's situation from a conduct perspective. On the other side of the coin is the privacy considerations, and whether customers would have the appetite to give this information on an ongoing basis. This may be assisted by Open Banking once this becomes imbedded, and customers begin to use it and become comfortable with it.

2. Lenders will be required to reassess their fees when they know, or reasonably ought to know, that the costs underlying the fee or their business have changed, that would impact the reasonableness of this fee.

   There are many practicality issues that will need to be worked through for this change, including what is considered 'reasonable'. However, with a renewed focus on 'conduct' that should be taking place across the industry, this will likely just become part of the wider conduct plan.

   One other consideration for the CCCFA is how the rules apply to brokers. Fees charged by the lender to borrowers for lending can only cover costs to provide that particular service that the fee is covering (i.e. an establishment fee). However, in a situation where a broker introduces the customer and earns a fee, there are no rules for the amount a broker can charge for this (which the customer ends up paying for), and there are currently no rules around transparency of these payments. This is one area that may be a focus for regulators, across the various finance sectors that brokers operate in.

Conduct

In September 2019, it was announced that there would be a new licensing scheme for 'conduct', with the Financial Markets Authority as regulator, where non-bank deposit takers would be required to obtain a conduct license in order to be able to operate (alongside banks and insurers)[23]. While this only applies to deposit takers (i.e. it excludes those with wholesale funding), given the focus of conduct on how borrowers are treated by the market regulators (irrespective of where funding comes from), all non-bank lenders would be wise to consider conduct, and remember that conduct is not just giving a customer a good experience, but making sure the customer receives, and continues to receive, the right outcome.

One recent example of changes due to conduct for the finance industry elsewhere in the world is the recent ban of flex commissions in Australia and the UK[24]. Flex commissions are where the finance company sets a wholesale lending rate for a car dealer to lend out to customers at, but gives the car dealer the ability to negotiate with the customer the rate the customer actually pays – with the car dealer earning the difference between the wholesale rate and the rate paid as 'commission'. While this has not yet happened in New Zealand, given the adverse or unfair impact that flex commissions can have on the end consumer, it may only be a matter of time before this arrives here.

A recent situation highlighting the need for better conduct from particular New Zealand sector participants is the case brought by the Commerce Commission against Home Direct, for contract terms that take advantage of vulnerable customers. Home Direct offers in house credit to consumers to fund their purchases. However, their contract enables them to continue to debit their customers' bank accounts once the loan is repaid, converting the excess payments into vouchers; essentially requiring the consumer to spend the excess within one year[25]. These questionable trading practices has led the High Court to declare the loan contracts imposed by Home Direct 'unfair', and Home Direct has credited customers $133,000 and must refund any eligible vouchers[25].

Between 2009 and 2018, Home Direct earned $644,000 in forfeited vouchers, affecting 14,000 customers[24]. The High Court ruling has set an important precedent against this unacceptable conduct. Predatory loan-shark behaviour will no longer be accepted in the credit-providing industry and these changes to regulation will hopefully offer the much needed protection of vulnerable consumers.

One theme that did come out of discussion at the lower end of the sector was that customer outcomes are not new, with an often heard quote that "if we put someone into the wrong product, we get an immediate impact – a loss – so we are forced to, and do, manage their outcome". This highlighted an awareness of customer outcomes.

RBNZ Act Review

The Reserve Bank Act (RBA) Review is being undertaken by the Government. It is currently in its second phase with legislation expected in 2020, following the completion of the "Safeguarding the future of our financial system" phase[26]. Although the review is a comprehensive analysis of the legislative and governing policies of the RBNZ, the relevance to FIPS non-bank survey participants should not be underestimated. The first public consultation resulted in a decision to combine bank and non-bank deposit takers into a single category; 'licensed deposit takers'[27], implying that the non-bank deposit takers could be held to a higher standard than before. This also raises the questions of what the role of the 'trustee' or 'supervisor' will be in the future, and whether non-bank deposit takers will be directly regulated by the RBNZ.

The rise of Buy Now, Pay Later

Buy Now, Pay Later (BNPL) service providers such as Afterpay, Genoapay, Laybuy, Oxipay and PartPay, have been the catalysts for some serious disruption within the personal finance sector, with over 228,000 customers signed up for these services and over 1,200 merchants offering BNPL services as at June 2018[28]. Visa is also launching a BNPL service for its customers, after observing instalment payments volumes growing twice as fast as credit cards[29].

BNPL services are essentially short-term finance providers, but do not charge interest, and therefore, do not fall under the definition of a credit contract under the CCCFA[30]. Instead, in these arrangements, merchants receive the money (less the merchant fee, which is paid to the BNPL provider) for the sale up front and allow customers to take their purchase home before they pay back the BNPL provider in instalments.

The business model itself is not exactly new, as stores have been offering lay-buy options for years where the customer could pay off the item in instalments and take it home when they made the last payment, while mobile companies allow customers to get a new phone and pay for it as part of their monthly bill on a long-term plan. So why has BNPL become so popular now? It seems there are a few factors driving the demand for these services.

Firstly, it could be influenced by the effect of 'generation now' and high household debt. From student loans to car and home loans, debt is becoming a way of life and there are plenty of different options for financing. The desire to both have and do everything now, and the general acceptance of debt as a way of life, have created a very favourable environment for BNPL services to thrive in.

Secondly, it's cheap. Recently, credit cards have been targeted for high interest rates and payday loans are generally seen as an expensive last resort. In contrast, BNPL services are considered a substitute for the high margins. Assuming you pay on time, there's no interest or fees, and payment is spread over a number of short-term instalments, usually weekly or fortnightly. Being able to spread a payment over a number of weeks instead of taking a big hit up front, without having to pay more than the original purchase cost, is appealing, especially to Kiwis who have a weekly or fortnightly budget or pay cycle.

Thirdly, it's convenient. The BNPL arrangement doesn't take long to sign up and requires significantly less paper work for the customer than obtaining a credit card or small personal loan. The BPNL service provider also sets up an automatic payment to be deducted from the customer's bank account, which takes away the hassle of having to manually transfer funds to pay a credit card bill.

There appears to be two different perspectives on BNPL. On one hand, it is seen as a great tool to assist with affordability and budgeting when making a purchase. On the other hand, there are concerns about credit capacity and being able to provide finance without having to apply responsible lending, given it is not captured by the CCCFA.

There's a strong demand for BNPL services from customers. Consumers are choosing to use BNPL over credit cards to buy necessary or luxury items they could not normally afford, stagger spending, avoid increasing credit card debt, and managing budget surprises[31]. Latitude Financial Services has demonstrated that it sees the value of the BNPL business model through its purchase of Genoapay, a 2016 Kiwi start-up, in December 2018 for $6 million, six times the original investment[32].

The main risk with BNPL services from a consumer perspective is that a payment will be missed and the customer will incur a late payment fee, alongside additional fees depending on how long the payment is outstanding. This can be costly, especially if a customer has missed a payment because they cannot afford it, while additionally non-payment will also damage their credit score. However, it is not in the interest of the BNPL provider for a customer to miss payments, so the providers will not let the customer make another purchase if a payment is outstanding[33]. This is influencing consumers to reprioritise their repayment orders, as customers don't want to miss payments as they want to continue to use BNPL services. This is becoming an issue for credit card providers where customers are using credit cards to make these BNPL payments if needed. In some scenarios, this is causing some customers to no longer be able to make their minimum credit card repayments, and therefore, making it harder for credit card providers/banks to comply with their own responsible lending requirements, even though it was not directly their debt repayments which caused the issue.

While the BNPL provider might be able to stop the customer from purchasing again through their service if they have payments outstanding, the customer is still able to go to another BNPL provider. This allows the consumer to potentially over-commit and spend more than they should. The behaviour of using these services is rewarded by the instant gratification of receiving the item before the consumer can afford to pay for it[34].

Across the ditch, Australia has also seen significant growth with BNPL services. In April 2016 there were approximately 50,000 transactions, which increased to 1.9 million in June 2018[35]. The Australian Securities & Investments Commission (ASIC) reviewed the new industry and agrees that many customers can benefit from the service, but there are risks involved.

The review found that some customers became financially overcommitted from using these services and one in six customers had either needed to delay bill payments, had become overdrawn or had to borrow additional money[35]. BNPL will remain an area of focus for ASIC who say that they will take regulatory action to address misconduct that results in significant consumer detriment. We are yet to hear from our local New Zealand regulators on how they will respond.

A number of survey participants have expressed their concerns about BNPL services taking up more and more of a consumer's credit capacity, especially as BNPL services are not covered by responsible lending. That is not to say some participants, particularly those with other credit products do choose to apply responsible lending behaviours to their product. Credit card and personal loan providers are required to ensure that the credit provided will meet the borrower's needs and objectives and additionally that they are able to make the payments without suffering substantial hardship[36]. Because of this, missing payments not only affects credit score, but can also make it more difficult to obtain credit due to the strain BNPL puts on credit capacity. For example, if a customer requests a loan and the lender's due diligence discovered that the customer has outstanding BNPL payments, but no feasible way of repaying anything extra, then the application would be declined.

In the 2018 review of New Zealand's consumer credit law, BNPL services were noted to fall outside the current definition of the CCCFA, but despite concerns being raised the review claimed there was limited evidence of harm and the products are covered by the Fair Trading Act so they have not been brought into the CCCFA scope yet.

However, a new power has been introduced in the CCCFA which gives the Government the ability to decide whether or not a particular agreement is a credit contract, in order to future proof the CCCFA. This means that while BNPL services do not currently fall under the CCCFA, they could in the future[37].

While BNPL's do not have to legally practice responsible lending currently, they do need to comply with Anti-Money Laundering and Countering Financing of Terrorism (AML/CFT) laws. This is an area the industry needs to be careful with. As the sign-up process is so quick, there are concerns about the various obligations being met. In Australia, Afterpay has been ordered to appoint an external auditor by AUSTRAC to examine its compliance with the AML/CFT Act after identifying concerns relating to Afterpay's compliance[38]. An audit found that incorrect legal advice resulted in a historic breach of the AML/CFT Act, however, Afterpay has since been in compliance with this regulation[39]. This investigation serves as a good reminder to BNPL service providers to ensure their compliance.

Ultimately, as with all financing, it is clear that there are both pros and cons for BNPL. BNPL is most appropriate for consumers that have a regular income and are able to make all payments, and possibly a replacement or legitimate disrupter for the credit card industry. However, currently the responsibility is on the consumers to be careful to make sure their purchase is within their credit capacity, rather than the onus being on the lender such as in the case with CCCFA. Due to its popularity it doesn't seem to be leaving any time soon, and will remain a space to continue to watch.

One of the other things that BNPL, and P2P before it, have shown is that the business model was accepted as new and allowed to set up differently from existing players with innovation, but then it becomes the focus of regulators and regulation. While regulation seeks to protect customers, the big question is whether it stifles innovation.

Sector - Timeline of events[40]

Nov. 2018

19th
Credit Union members of Co-op Money started working to get step-in rights for delivery of key services.

23rd
Fitch Ratings downgraded Co-op Money two notches from BB to B+ to reflect tight liquidity, weakening capitalisation and unprofitable core operations.

28th
Claire Matthews stepped down as chairperson for Co-op Money and was replaced by Richard Westlake.

Dec. 2018

4th
Latitude purchased Genoapay, a BNPL service provider, to offer customers an additional way to pay for purchases.

5th
The RBNZ confirmed the licence for First Credit Union's insurance company allowing it to act as a full insurer and provide life insurance for other New Zealand Credit Unions.

NZCU Baywide won Canstar awards for the third year in a row, for the 'outstanding value' of both their personal loans and car loans.

18th
NZCU Baywide, NZCU South, NZCU Central, NZCU Steelsands and Aotearoa Credit Union announced intentions of a merger to create a single Credit Union with more than $600 million in assets, and serving 75,000 Kiwis.

Jan. 2019

16th
NZCU Baywide, NZCU South, NZCU Central and Steelsands Credit Union loaned Aotearoa Credit Union $1.25 million until the merger takes place in March.

30th
David Gelbak appointed as Chief Country Officer for Latitude Financial Services.

Feb. 2019

1st
Campbell Smith appointed Country Manager of LeasePlan NZ.

4th
CapitalGroup purchased First Mortgages Trust's manager.

Mar. 2019

12th
Commerce and Consumer Affairs Minister Hon. Kris Faafoi announced plans to cap total amount of interest and fees that can be charged on loans at 100%.

15th
NZCU Baywide and three others finalised merger to create New Zealand's largest Credit Union with $560 million in assets, serving 64,000 Kiwis.

Apr. 2019

9th
The RBNZ announced the appointment of Vanessa Rayner and Yuong Ha as Head of Financial Markets and Head of Economics respectively.

May. 2019

8th
The RBNZ's OCR reduced to 1.5%.

21st
Harmoney's platform fee found to be caught by the Credit Contracts and Consumer Finance Act 2003 (CCCFA) 'credit fee' regulation.

Jun. 2019

13th
Questions raised on whether New Zealand will follow Australia's lead on Anti-Money-Laundering compliance for Buy Now, Pay Later Services.

18th
Avanti launched a $200 million residential-mortgage backed securities issue to be priced around 400 bps above the one-month bank bill rate.

27th
NZCU Baywide loaned almost $4 million to Co-op Money.

Jul. 2019

8th
Moola purported to have breached lender responsibility principles contained in the CCCFA.

17th
Aotea Finance forced to return $2.8 million to borrowers for failing to include all necessary information on credit contracts under the CCCFA.

25th
The Financial Markets Authority (FMA) announced the release of the Financial Advice Provider Transitional Licenses from November onwards, allowing a window of seven months for financial advisors to register.

Aug. 2019

7th
The RBNZ shocked the economy with an unexpected 50 bps drop in the OCR, down to 1%.

8th
Australian small business lender Prospa expanded into the New Zealand market.

14th
David Stevens appointed as the new CEO for Harmoney.

Sep. 2019

3rd
Hon. Kris Faafoi declared action against predatory lending.

6th
UDC Finance faced court proceedings for alleged charging of unreasonable default fees.

Oct. 2019

16th
Latitude withdrew its initial public offer to be listed on the ASX after the business was repriced below its original initial public offer range.

30th
The US Federal Reserve cut its interest rates to a range of 1.5% to 1.75%, reversing the trend of increases over the past couple of years.

31st
Harmoney raised $47 million to expand into the Australian market.

Nov. 2019

12th
Australian Payright entered the New Zealand market offering a pay later service of up to $20,000.

13th
The RBNZ's OCR remained at 1%.

Dec. 2019

10th
WeCare Finance was warned by the Commerce Commission of their likely breach of the CCCFA for failing to make reasonable inquiries about the borrower's ability to repay the loan.

The more things change, the more they stay the same

Lyn McMorran
Executive Director
Financial Services Federation Inc.

FS
FINANCIAL SERVICES FEDERATION

Lyn McMorran is the Executive Director of the Financial Services Federation Inc., which is the industry body representing responsible finance and leasing providers in New Zealand (www.fsf.org.nz). Prior to joining the Financial Services Federation (FSF) in 2012, Lyn was Area Manager for Westpac's Private Bank in the Lower North and South Islands.

A Certified Financial Planner, Lyn is a past President of the Institute of Financial Advisers of New Zealand.

Lyn holds a Graduate Certificate in Management and a Post-Graduate Diploma in Business Studies (Personal Financial Planning) and is a Fellow of both the Institute of Financial Advisers and the Financial Services Institute of Australasia. She is also a Trustee of the Skylight Trust and a Commissioner for the Insurance and Savings Ombudsman disputes resolution scheme.

As the French aptly say: "plus ça change, plus c'est le même chose" (the more things change, the more they stay the same).

Previously, the pace of regulatory change has been a challenge to keep up with at times.

It came so thick and fast there was concern for the sector's ability to innovate and improve, when all its attention and resources focussed on meeting changing compliance obligations.

The pace of regulatory change has been a challenge to keep up with at times... Yet that pace was practically glacial compared to what we have seen in the last 12 months.

Yet that pace was practically glacial compared to what we have seen in the last 12 months.

Last year I wrote that Commerce and Consumer Affairs Minister, Hon. Kris Faafoi, had recently announced another review of the Credit Contracts and Consumer Finance Act (CCCFA) and some proposed changes such as a cap on interest and fees of 100% of the loan amount for high cost loans, that he wished to see written into the legislation to provide better consumer protection.

As I write, the Credit Contracts Legislation Amendment Bill has just been reported back to the House by the Finance and Expenditure Select Committee following the most part of the year in consultation.

This has included late changes to the Bill announced by Minister Faafoi while the Select Committee was still considering submissions. These changes included implementation of a rate cap of 0.8% per day, per annum (292% per annum) and a requirement for lenders to provide details of financial mentoring and disputes resolution services to borrowers applying for hardship or being declined a loan.

In both cases, consultation on these changes was 'targeted' – meaning that it did not go out for wider public consultation. Instead, some interested parties were asked for their views and given about a week to respond.

This 'legislation on the run' is of significant concern to FSF members – particularly when it relates to something as important as a rate cap. In particular, our concerns also include whether a rate cap means a pure interest rate cap or a cap which includes both interest and fees, the latter of which looks like a return to the old finance rate as the means to calculate the cost of credit. It presently appears that it is the intention of the Bill that this rate cap is meant to be a rate (or finance rate) cap.

We also await accompanying regulations that will provide more prescription in the way that lenders assess the suitability and affordability of a loan, how they advertise credit, and how debt collection activity should proceed.

Once lenders assess where the Bill has landed and the scope of the changes in regulations, they will have to assess how these changes will affect their processes and technical systems, and implement necessary changes and staff training in order to comply.

Anyone who has had any dealing with systems changes knows this is not like changing your relationship status on Facebook, but a complex undertaking for which the length of even pressurised timeframes cannot be underestimated. Fortunately, our submission that the timeframe of 1 March 2020 is plainly unrealistic, appears to have been listened to and we now have a deadline of 1 April 2021 by which to meet all of these new requirements.

The regulatory rollercoaster that we might have thought was reaching the end of the track, keeps hurtling along at a pace I have never seen before.

In addition to all this, the regulatory rollercoaster that we might have thought was reaching the end of the track, keeps hurtling along at a pace I have never seen before.

Off the back of the Australian Royal Commission and the RBNZ/FMA's reviews into banks and life insurers closer to home, the Government – in its year of delivery – is looking to fast-track and implement a range of other reforms admirably aimed at providing further consumer protection.

We can now expect to see draft legislation to introduce a new conduct regime for financial institutions, which will create a new licensing requirement for already-licensed entities such as banks, insurers and non-bank deposit takers in respect of their general conduct. It includes aspects of how they design and offer sales incentives and will prohibit sales incentives based on volume or value targets – supposedly before the House rises for the summer recess only a handful of sitting days away.

Whilst non-bank deposit taking lending institutions (i.e. finance companies), are not specifically included in the scope of this proposed regime, it would be a very brave company indeed that did not seriously consider how the proposed licensing requirements might apply to their own business.

Then we have the Clean Car Discount (Feebate) proposals to encourage the purchase of electric vehicles over fossil-fuel powered ones. Consideration for our motor vehicle finance provider members of how this will impact re-sale values of vehicles attracting a rebate (electric vehicles) or a fee (fossil-fuel powered vehicles), after it has been paid or imposed at the time of first registration in New Zealand, has only just begun. There is also the question of what the insured value of the vehicle should be, not to mention how misuse of the scheme – or outright fraud – can be prevented, and there are many other issues that we are only just getting our heads around.

We can also expect legislation to extend the current protections in the Fair Trading Act 1986 against unfair contract terms in standard form consumer contracts to also apply to some standard form business contracts. This will also introduce a prohibition against unconscionable conduct in connection with the supply and acquisition of goods or services.

Then of course there are the reviews of the Reserve Bank Act and Insurance Contract Law, and the introduction of a Farm Debt Mediation scheme.

But what is clearly staying the same is the Government's appetite for greater scrutiny and control around how that is done.

All of which imply significant changes for most lenders in the way in which they run their businesses, but what is clearly staying the same is the Government's appetite for greater scrutiny and control around how that is done.

Good times in the non-bank sector

Ben Speedy
Country Manager, New Zealand
CoreLogic

Ben is the New Zealand Country Manager, with accountability for the business performance of the New Zealand Division of CoreLogic International, the world's largest property data and insight company.

Immediately prior to joining CoreLogic, Ben spent 12 years in senior leadership roles, including responsibilities for shared services as Chief Operating Officer, Business Transformation, Business Banking and Agribusiness. Ben also worked in the UK, providing him with valuable international experience.

Ben's formal qualifications include a bachelor of applied science, majoring in rural valuation and a post graduate diploma in marketing. Outside of CoreLogic, Ben is a keen sportsman with an incredible goal of achieving a half Iron Man later this year.

Driven by demand from owner-occupiers, New Zealand's banks have generally been increasing their residential lending activity over the past 12-18 months, with the loosening of the loan-to-value ratio (LVR) speed limits back in January helping to boost the market. But what about the non-bank sector? This broadly includes credit unions and building societies, and although the sector has had its challenges in the past (e.g. during the Global Financial Crisis (GFC)), the most recent few years have been better.

Indeed, the stock of mortgages (by value) held by non-banks has been growing at consistent annual rates of 20% or more since late 2016, significantly above the equivalent figure for the trading banks of about 5-6% p.a. Even after such a strong period of growth, however, it's important to point out that non-banks still only hold about 1% of all mortgages across New Zealand.

The recovery for non-banks has been solid.

Switching to the *number* of new mortgage registrations that the non-banks have been processing lately, our internal figures at CoreLogic show that easily the most per month (about 160) have been for standard residential dwellings (i.e. homes), with lifestyle properties, flats, and apartments much less significant (fewer than 20 per month for each type of property).

As figure 4 shows, the last time that non-banks were writing this many mortgages for residential dwellings was more than a decade ago in 2008. The recovery for non-banks has been solid, after the tough times endured in the sector during the GFC and for a number of years after it too.

4 **SEE FIGURE 4 – PAGE 19**

The biggest non-bank players for residential property lending in recent years have been Nelson Building Society (NBS), Liberty Financial, Wairarapa Building Society (WBS), and Finance Direct. Given the geographically-based histories for these institutions, especially NBS and WBS, it's no surprise that key regions for the non-bank sector as a whole include Nelson/Tasman, and the West Coast. But it's not tightly limited to those areas – non-bank mortgage registrations have risen pretty steadily in the past few years in Auckland, Canterbury, and Wellington too.

Non-bank mortgage registrations have risen pretty steadily in the past few years.

There are also some really interesting insights we can glean from a breakdown of non-banks' mortgage registrations by type of borrower. In the third quarter of 2019, 40% of non-bank registrations went to first-home buyers (FHBs), while 23% were for existing borrowers who were refinancing, and 22% to multiple property owners (i.e. investors). This concentration of non-bank activity in the FHB segment is much stronger than the overall market. For example, when you look at FHBs across the country as a whole and switch to property purchases (rather than mortgage registrations), they accounted for only 24% of activity in the third quarter of 2019.

Unfortunately, there is no hard data on the proportions of non-bank lending that are done at high and low LVRs, but we do know from the RBNZ's figures that high LVR (>80%) FHBs have played a key role in the overall growth in mortgage lending flows for the banks.

Indeed, growth in this segment has been running at an annual pace of about 40% in recent months, versus a rise in lending flows across all types of borrowers and LVRs of less than 10%.

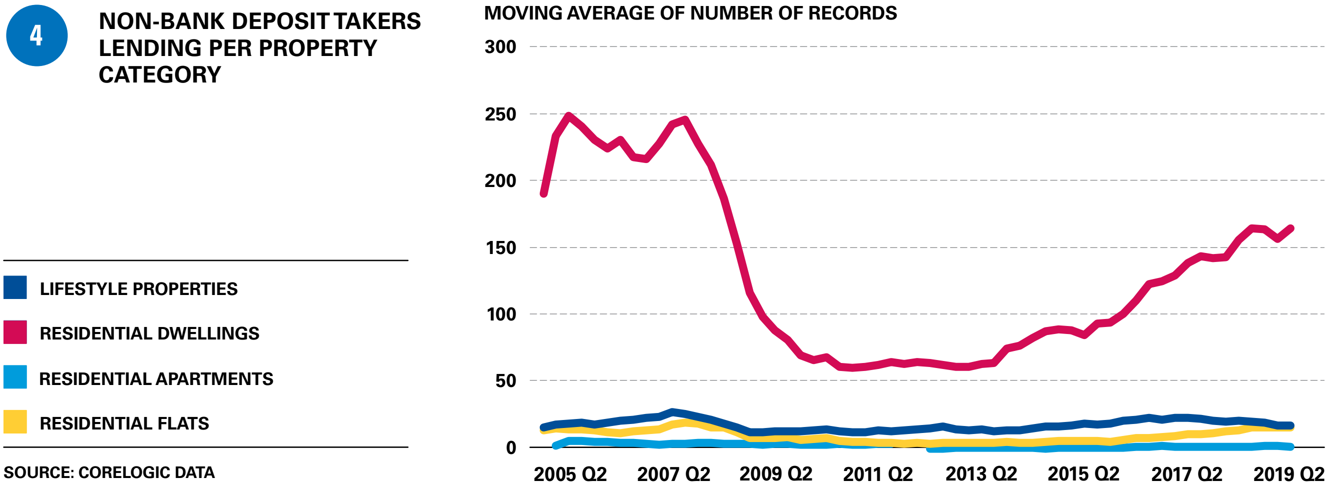
Accordingly, for the non-banks to have increased their lending activity over the past few years to such a strong extent as shown by the figures above, it doesn't seem too much of a stretch to suggest that they must also have been ramping up their presence in the high LVR FHB segment. Of course, those FHBs who have taken loans with the non-banks may have faced a slightly higher mortgage rate – a typical two-year fixed mortgage with the registered banks is currently around the 4% mark, compared to 4.5-5% with the non-banks.

It's been a solid few years for the non-banking sector.

Overall, it's been a solid few years for the non-banking sector (especially in their traditional heartlands such as the upper South Island), and the data suggests that they have been sharing in the 'purple patch' that we have seen for FHBs in 2018 and 2019 – buoyed by access to their KiwiSaver funds for a deposit (or at least part of it), and often a willingness to compromise on location and/or the type of property (especially in the bigger cities).

However, there are signs now that, as term deposit rates fall, 'mum and dad' investors are looking to get back into property more strongly, especially now that the possibility of a broad-based capital gains tax is off the table. FHBs will clearly remain an important target for all lenders, but property investors may also start to present more opportunities as we move into 2020.

4 NON-BANK DEPOSIT TAKERS LENDING PER PROPERTY CATEGORY



SOURCE: CORELOGIC DATA

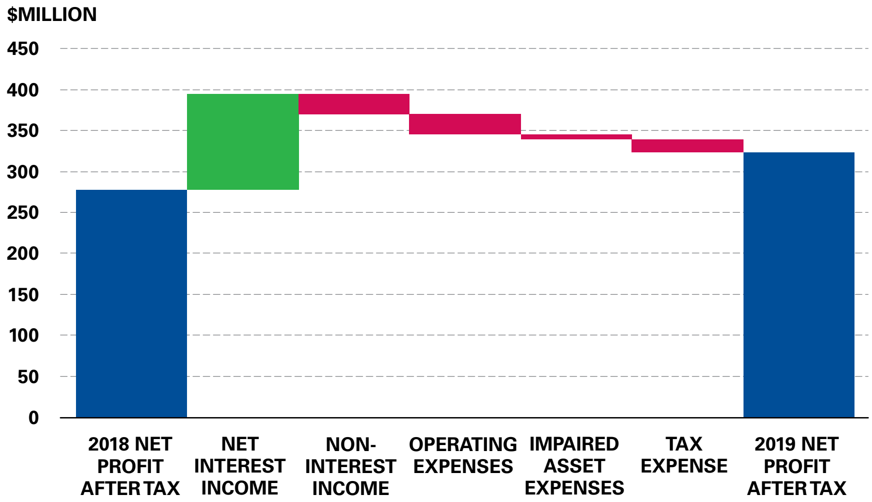
Sector performance

The non-bank survey participants have managed to grow their combined net profit after tax by $45.87 million (or 16.49%) over the year. This continues the trend of the large profit increase in 2018 (of 22.97%), albeit at a slightly reduced rate.

Changes in the sector

There have been some interesting changes among sector participants over the year with an addition, and an amalgamation and acquisition occurring between participants. We welcome FlexiGroup (New Zealand) Limited to the survey in 2019. FlexiGroup offers a range of financial services including; certain interest free lending, credit cards, long-term finance, leasing and vendor finance programmes and meets the threshold in size and public availability of audited financial statements to be included in the survey. We have touched on the Credit Union merger in our sector themes article, where Credit Union Baywide amalgamated with Credit Union South (and two other non-participants in the FIPS Non-Banks sector due to size, being Credit Union Central and Aotearoa Credit Union). The other change is the acquisition of Branded Financial Services by Avanti Finance. The amalgamation and acquisition have impacted the financial results of these participants during the year. We have described below the impact on the financial results, and what we have done to adjust for this, where applicable.

5 MOVEMENT IN NET PROFIT AFTER TAX



Starting with the Credit Unions, the amalgamation occurred on 1 May 2019 and Credit Union Baywide's balance date is 30 June 2019. Credit Union Baywide's financial statements represent the full balance sheet of all entities at 30 June 2019, but only two months of income statement of Credit Union South and the other two Credit Unions included in the amalgamation. As part of the amalgamation process, Credit Union South produced financial statements as at and for the 10 months ended 30 April 2019. As such, to try and more accurately reflect the true financial result and balance sheet for the amalgamated entity for the year ended 30 June 2019, we have combined the income statement of Credit Union South for the 10 months ended 30 April 2019 with Credit Union Baywide's financial statements. The combination of these accounts is presented as Credit Union Baywide's 2019 results. For metrics that use average balance sheet amounts between years, we have used the combined balance sheet of Credit Union Baywide and Credit Union South for the 2018 value. These have been done seeking to minimise the distortion on ratios and metrics calculated for the year. We continue to present 2018 results for Credit Union Baywide and Credit Union South separately and unchanged.

TABLE 2: PERFORMANCE METRICS		Total
Increase in Total Assets		7.66%
Increase in Net Profit After Tax (NPAT)		16.49%
Movement of Impaired Asset Expense (As a Percentage of Average Gross Loans and Advances)	bps	-8
Increase in Interest Margin	bps	19
Increase in NPAT/Average Total Assets	bps	4
Increase in NPAT/Average Equity	bps	-29

For the acquisition of Branded Financial Services by Avanti Finance, we have not made any adjustments as there are no other publicly available results for Branded Financial Services during the period to use for this adjustment. As such, while the full balance sheet of Branded Financial Services has been incorporated, only a portion of the income statement was included. Also, Avanti Finance changed their balance date from 31 March to 30 June during the period, resulting in their income statement being for a 15-month period. Both of these points impact the ratios and metrics calculated for Avanti Finance for 2019. Again, we continue to present the 2018 results for Avanti Finance and Branded Financial Services unchanged.

In regards to FlexiGroup; financial statement information has been included for 2018 and 2019 to enable comparisons of the data to be made.

Net profit after tax (NPAT)

The finance companies, Credit Unions and building societies who constitute the non-bank survey participants have accomplished another year of strong growth in NPAT of 16.49% to $324.02 million.

This increase in NPAT was mainly driven by a very strong increase in net interest income, up $116.78 million (14.04%) to $948.41 million. However, this was partially offset by a decrease in non-interest income of $24.34 million, increase in operating expenses of $24.68 million, a slight increase in impaired asset expense of $5.82 million, and on the back of strong profits an increase in tax expense of $15.83 million.

A solid increase in net interest income may not come as a surprise for the non-bank sector, especially with the sector participants seeing a collective increase in gross loans and advances of 9.32%.

It is clear that the survey participants are making the most of a market that is seeing more and more traditional bank customers shifting to non-bank lenders, as many borrowers don't quite fit the banking 'black box' or want to fund something through a different method or route. Despite the arguably low business confidence within the economy, a strong economic environment, especially in the regions, is contributing to consumers continuing to spend, and low interest rates are encouraging them to borrow.

Latitude Financial Services managed to turn their loss of $5.98 million in 2018 around to a $12.90 million profit in the 2019 financial year, the largest movement in NPAT of all the survey participants at $18.88 million (315.81%). Latitude has managed this turn around by increasing net interest income by $70.31 million (67.89%), whilst simultaneously decreasing operating expenses by $8.69 million (6.91%).

The second best performer was First Mortgage Trust recording a NPAT increase of $8.82 million (28.83%), who have undoubtedly benefited from a combination of banks declining mortgages to customers on the lending criteria fringes and strong customer growth through their own channels. Fuji Xerox was a close third increasing their NPAT by $8.60 million (176.96%), achieving a net profit of $3.74 million, reversing their 2018 net loss after tax.

First Credit Union reported the second highest percentage increase in NPAT of 295.19% (from $0.75 million to $2.96 million), aided by a $1.11 million surplus from its insurance underwriting business. Avanti Finance has also experienced an unsurprisingly strong NPAT increase of 42.91% (from $18.60 million to $26.58 million) after acquiring Branded Financial Services, who has performed well over its short five years prior to its acquisition.

However, as mentioned above, Avanti Finance's increase in NPAT is also distorted due to the comparison of its 15-months' period profit in 2019 compared to its 12-months' period profit in 2018.

Credit Union Baywide was the only survey participant reporting a loss in this year's survey, with a loss of $5.11 million (including Credit Union South's 10-month loss). A large portion of this loss relates to costs related to the amalgamation, and also the write-down of capital notes held in Co-op Money.

The decrease in non-interest income, even on the back of strong loan growth, could be driven by an increased focus on compliance with CCCFA, with an ever increasing focus by regulators on ensuring fees charged to customers are fair and in line with regulations.

5 **SEE FIGURE 5 – PAGE 20**

As shown in figure 5, NPAT has increased by $45.87 million (16.49%) to $324.02 million. This grown is driven by:

— Net interest income boost of $116.78 million to $948.41 million.

— Non-interest income reduced by $24.34 million to $501.76 million. This is despite non-interest income of Turners Automotive Group, who contribute a large amount to non-interest income, staying relatively stable year on year.

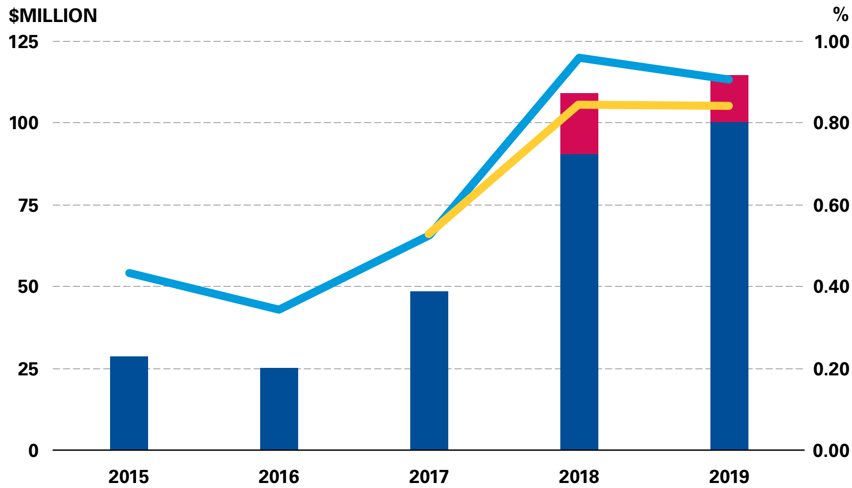
— Operating expenses have increased by a mere 2.84% to $894.78 million.

— Impaired asset expense has increased by 5.35% to $114.69 million.

— On the back of stronger profits, tax expense increased by $15.83 million or 17.22%.

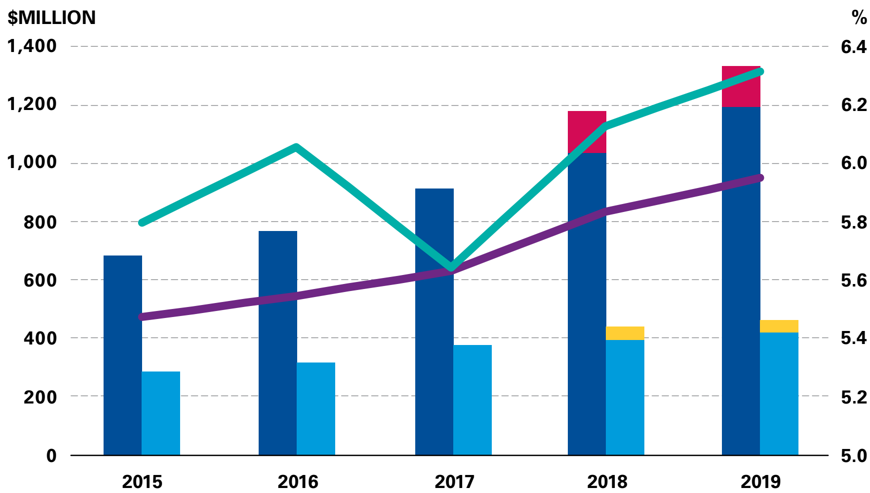
6 IMPAIRED ASSET ANALYSIS

- IMPAIRED ASSET EXPENSE (LHS)
- NEW PARTICIPANTS' IMPAIRED ASSET EXPENSE (LHS)
- IMPAIRED ASSET EXPENSE/AVERAGE LOANS AND ADVANCES (RHS)
- IMPAIRED ASSET EXPENSE/AVERAGE LOANS AND ADVANCES (EXCLUDING NEW PARTICIPANTS) (RHS)



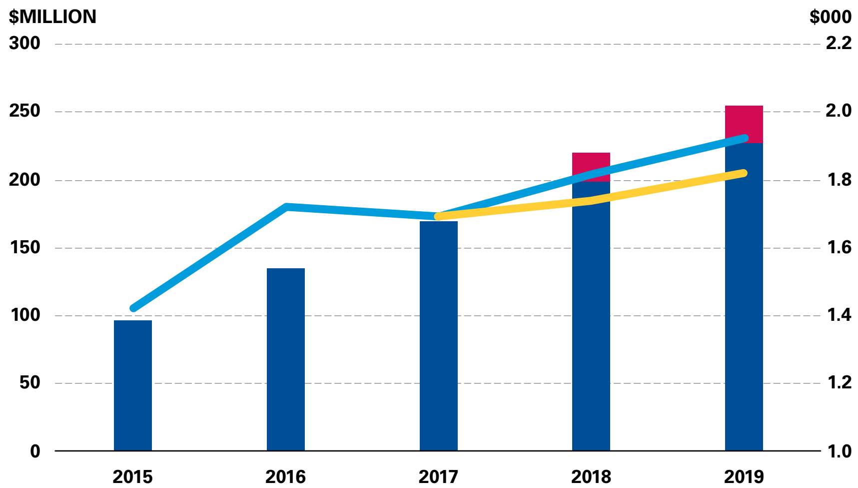
7 NET INTEREST INCOME ANALYSIS

- INTEREST INCOME (LHS)
- NEW PARTICIPANTS' INTEREST INCOME (LHS)
- INTEREST EXPENSE (LHS)
- NEW PARTICIPANTS' INTEREST EXPENSE (LHS)
- NET INTEREST INCOME (LHS)
- NET INTEREST MARGIN (RHS)



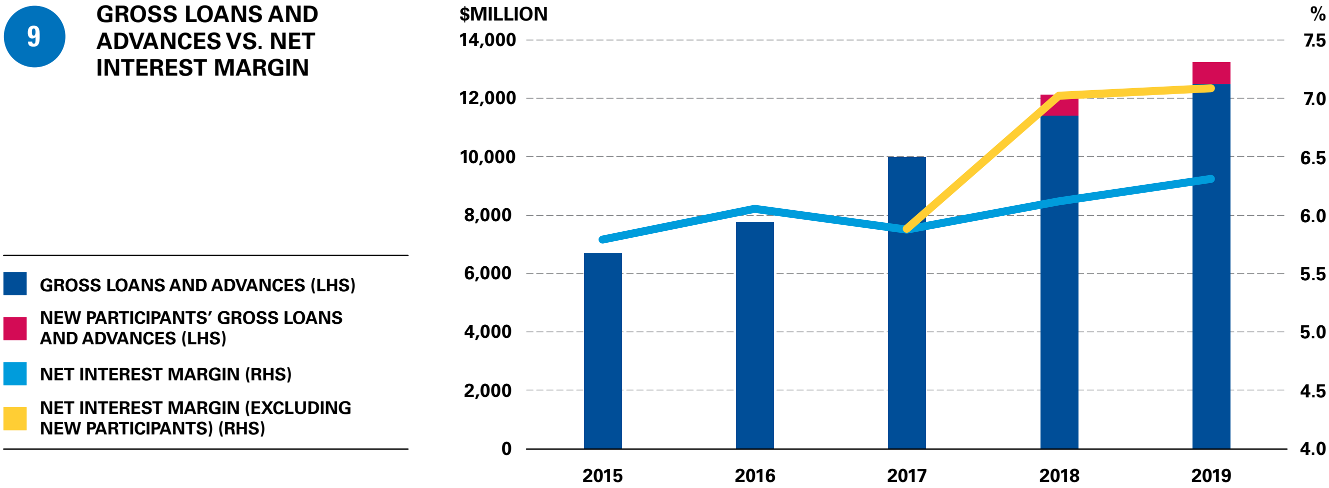
8 PROVISIONS AS A PROPORTION OF GROSS LOANS AND ADVANCES

- TOTAL PROVISIONS (LHS)
- NEW PARTICIPANTS' TOTAL PROVISIONS (LHS)
- PROVISIONS/GROSS LOANS & ADVANCES (%) (RHS)
- PROVISIONS/GROSS LOANS & ADVANCES (%) (EXCLUDING NEW PARTICIPANTS) (RHS)



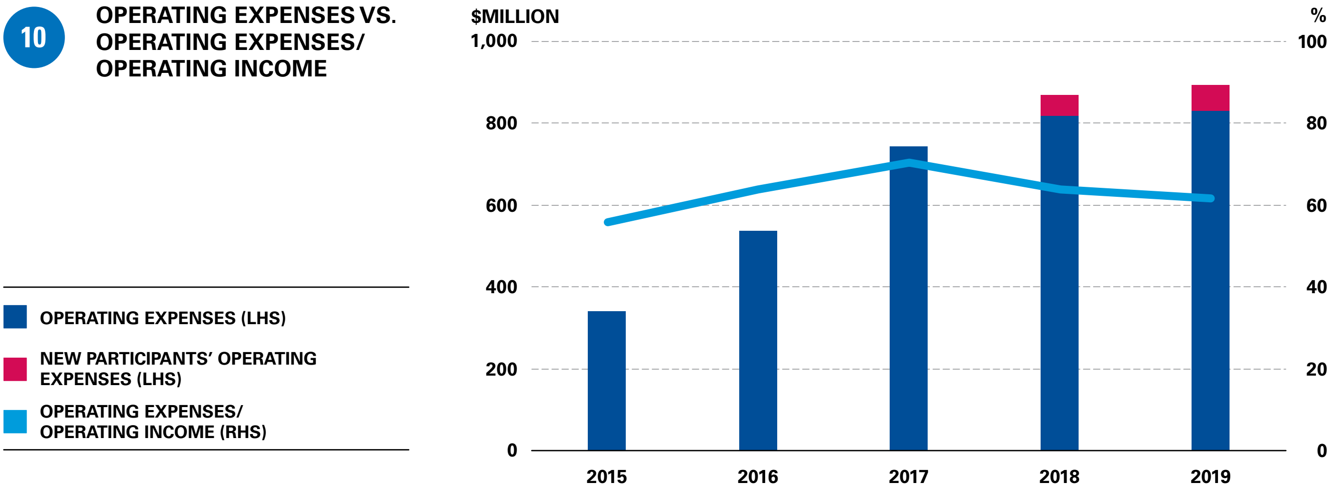
9

GROSS LOANS AND ADVANCES VS. NET INTEREST MARGIN



10

OPERATING EXPENSES VS. OPERATING EXPENSES/ OPERATING INCOME



Total assets

The non-bank sector has continued its trend of strong growth, achieving an increase of 7.66% ($1.15 billion) to $16.17 billion, with 20 out of 24 survey participants increasing their total assets. Similarly, gross loans and advances have increased by 9.32% ($1.13 billion) to $13.25 billion, with 20 of the 24 survey participants increasing their loan books.

Avanti Finance saw the largest asset growth within the sector with an increase of 91.20% ($517.43 million) to $1.08 billion, mostly driven by the increase in their loan book, up from $0.55 billion to $1.05 billion, reaching the milestone of $1 billion. Avanti Finance is a story of remarkable growth over the past few years, having grown over 700% from a $153 million loan book in 2015 to $1 billion today. The growth in 2019 was partially driven by their acquisition of Branded Financial Services, who held $177.09 million of assets with a loan book of $168.87 million at their last period end, but also driven by continued strong organic growth.

UDC Finance, Latitude Financial Services and First Mortgage Trust also had significant asset growth of $187.95 million (5.70%), $163.35 million (10.74%) and $162.48 million (25.15%), respectively.

Just four of the survey participants saw decreases in total assets, with Fuji Xerox and Toyota Finance dropping the most, by 26.87% ($98.22 million) and 6.08% ($85.46 million), respectively.

UDC Finance remains the largest lender of the participants in the non-bank sector by a considerable margin, holding 26.00% of the market share in gross loans and advances, followed by Latitude Financial Services who holds 12.38%, and Avanti Finance who holds 7.96%. Together, they comprise 46.34% of the total lending by the survey participants.

TABLE 3: GROSS LOANS AND ADVANCES Entity	2019 $'000	2018 $'000	Movement $'000	Movement %
Avanti Finance Limited	1,054,831	553,633	501,198	90.53%
BMW Financial Services New Zealand Limited	361,197	382,281	-21,084	-5.52%
Branded Financial Services (NZ) Limited	N/A	168,868	-168,868	N/A
Christian Savings Incorporated	128,639	103,356	25,283	24.46%
Credit Union Baywide	394,146	275,110	119,036	43.27%
Credit Union South	N/A	106,743	-106,743	N/A
First Credit Union	205,065	199,897	5,168	2.59%
First Mortgage Trust	632,373	525,463	106,910	20.35%
FlexiGroup (New Zealand) Limited	761,770	686,806	74,964	10.91%
Fuji Xerox Finance Limited	66,542	65,443	1,099	1.68%
Geneva Finance Limited	98,734	93,307	5,427	5.82%
Instant Finance Limited	112,119	110,126	1,993	1.81%
John Deere Financial Limited	181,882	143,285	38,597	26.94%
Latitude Financial Services Limited	1,641,074	1,473,478	167,596	11.37%
LeasePlan New Zealand Limited	12,350	12,052	298	2.47%
Mercedes-Benz Financial Services New Zealand Limited	657,120	643,771	13,349	2.07%
Motor Trade Finances Ltd	694,011	684,345	9,666	1.41%
Nelson Building Society	641,833	558,356	83,477	14.95%
Nissan Financial Services New Zealand Pty Limited	531,256	437,750	93,506	21.36%
ORIX New Zealand Limited	77,846	60,166	17,680	29.39%
Police and Families Credit Union	48,437	53,817	-5,380	-10.00%
Ricoh New Zealand Limited	89,529	85,544	3,985	4.66%
Toyota Finance New Zealand Limited	972,188	999,445	-27,257	-2.73%
Turners Automotive Group	317,906	311,090	6,816	2.19%
UDC Finance Limited	3,446,261	3,256,998	189,263	5.81%
Wairarapa Building Society	126,613	132,397	-5,784	-4.37%
Sector Total	**13,253,722**	**12,123,527**	**1,130,195**	**9.32%**

For the second consecutive year, Avanti Finance has shown the largest growth in market share of 3.39%, while Toyota Finance saw the largest decrease, losing 0.91% to hold 7.34%.

Net interest margin (NIM)

There has been a 19 bps increase in NIM to 6.32%, partly reflecting the lower cost of funding being utilised by survey participants. However, only 9 of 24 survey participants have managed to achieve an improvement in NIM, with the majority seeing decreases due to competition remaining strong, keeping pressure on margins. Latitude Financial Services saw the largest increase in NIM, increasing by 367 bps to 11.27% from 7.60% in the prior year. This increase is driven by the 345 bps growth of their interest income over their average interest earning assets, effectively bringing their lending rate to 16.70% while also decreasing their interest expense over average interest bearing liabilities, their funding rate, by 14 bps to 5.10%. Credit Union Baywide saw the next largest increase in NIM of 110 bps to 5.16% following the merger of the Credit Unions, benefiting from Credit Union South's historically higher NIM.

7 SEE FIGURE 7 – PAGE 22

Net interest income increased by $116.78 million (14.04%) from the previous year with 16 survey participants seeing increases in net interest income. This increase was driven by a proportionately larger growth in interest income at 13.01% ($165.27 million), than interest expense at 5.78% ($25.36 million), as loan books continue to increase, better utilisation of existing funding, and cheaper access to funding.

TABLE 4: MOVEMENT IN INTEREST MARGIN Entity	2019 %	2018 %	Movement (bps)
Avanti Finance Limited	7.65	8.00	-35
BMW Financial Services New Zealand Limited	6.28	6.74	-47
Branded Financial Services (NZ) Limited	n/a	3.33	n/a
Christian Savings Incorporated	1.60	1.89	-29
Credit Union Baywide	5.16	4.06	110
Credit Union South	n/a	7.39	n/a
First Credit Union	3.73	3.92	-19
First Mortgage Trust	7.13	7.14	-1
FlexiGroup (New Zealand) Limited	10.85	11.14	-29
Fuji Xerox Finance Limited	3.89	7.22	-332
Geneva Finance Limited	11.25	10.51	74
Instant Finance Limited	22.33	22.32	1
John Deere Financial Limited	3.92	3.94	-2
Latitude Financial Services Limited	11.27	7.60	367
LeasePlan New Zealand Limited	9.59	9.37	21
Mercedes-Benz Financial Services New Zealand Limited	3.76	4.04	-28
Motor Trade Finances Ltd	8.20	8.51	-31
Nelson Building Society	2.34	2.24	10
Nissan Financial Services New Zealand Pty Limited	3.45	4.13	-68
ORIX New Zealand Limited	10.00	12.65	-265
Police and Families Credit Union	3.93	4.21	-28
Ricoh New Zealand Limited	10.30	10.24	6
Toyota Finance New Zealand Limited	3.95	4.24	-29
Turners Automotive Group	9.02	9.12	-10
UDC Finance Limited	4.33	4.21	12
Wairarapa Building Society	2.42	2.26	16
Sector Average	**6.32**	**6.13**	**19**

Interest income over average interest earning assets remained relatively flat over the period, increasing by just 5 bps to 9.40%, with Fuji Xerox reporting the largest decrease of 363 bps to 6.91%. Interest expense over average interest-bearing liabilities actually decreased by 13 bps to 3.69%, reflecting the cost of funding decreasing over the period.

63% of survey participants reported decreases in their NIM. Fuji Xerox saw the largest decrease in NIM of 332 bps as net interest income reduced by 50.16% ($12.34 million). The next largest drop in NIM was seen by Orix, with a 265 bps decrease to 10.00%. This was due to Orix's interest earning assets growing at 20.41% ($59.88 million), whilst their net interest income fell by 447 bps to $32.33 million.

9 SEE FIGURE 9 – PAGE 23

Asset quality

The area of impairment has gone through some significant changes over the past year, with the new impairment accounting standard becoming effective for all survey participants. This has resulted in changes in measurement of impairment, terminology and required disclosures. Given these significant changes, this has affected some comparability in metrics between 2018 and 2019. For this transition year, we have purely focused on impairment provisions and impaired asset expense, rather than looking specifically at gross impaired or past due assets, in our graphs and analysis. Also, given these changes, we only looked at provisions overall rather than splitting our analysis between individual and collective provisions, as this split is not always clear from the new disclosures.

6 SEE FIGURE 6 – PAGE 22

Impaired asset expense has increased by 5.35% in 2019, a movement of $5.82 million to $114.69 million. This increase can mainly be attributed to the strong growth in loans over the year, which result in a corresponding increase in provisions. We have heard mixed messages on the impact that the new impairment accounting standard has, with some survey participants seeing an increase in provisions and some seeing decreases in provisions following its implementation.

The sector has also seen a slight uptick in the ratio of provisions for impairment over gross loans and advances, up from 1.81% to 1.92%. However, these still remain at historically very low levels. Looking at its components, total provisions have increased by 15.77% ($34.68 million), while gross loans and advances have increased at a proportionally lower rate of 9.32% ($1.13 billion).

8 SEE FIGURE 8 – PAGE 22

Turners Automotive Group saw the largest increase of 253 bps to 6.16% in their impairment provision to gross loan and advances ratio, while at the other end of the scale Geneva Finance achieved the greatest decrease of 946 bps to 18.02%. Geneva Finance's ratio of 18.02% remains significantly higher than any other participant in the survey, followed by Fuji Xerox who has a 7.23% impairment provision to gross loan and advances ratio. Fuji Xerox also achieved the second highest decrease in this ratio, dropping 285 bps from 10.08% in the previous period.

Credit Union Baywide saw the largest deterioration in asset quality based on the impairment provision over gross loans and advances ratio, rising by 172 bps from 0.22% last year to 1.94%. This will largely be caused by the amalgamation with Credit Unions who had lower quality loan books. They are followed by ORIX, who saw a 6 bps increase to 0.10%, although even with this increase, ORIX still retained the lowest ratio of sector participants with impairment provisions.

Digging into impairment provisions, both Avanti Finance and Credit Union Baywide have had large increases in their provisions of $10.35 million (109.53%) and $7.05 million (1,144.16%), respectively. This has flowed through to an increase in impairment provisions as a ratio of their gross loans and advances, raising by 17 bps to 1.88% for Avanti Finance and by 172 bps to 1.94% for Credit Union Baywide. However, these increases are somewhat expected following the acquisition of Branded Financial Services and the merger of the Credit Unions respectively, as both Branded Financial Services and the Credit Unions that Credit Union Baywide amalgamated with had relatively higher levels of provisioning due to a different loan portfolio composition.

Toyota Finance had the largest decrease in provisions, decreasing by 7.94 million (29.19%), followed by Geneva Finance who saw their provisions drop by $7.85 million (30.61%).

Operating expenses

Operating expenses have appeared to reach a plateau in 2019, increasing by a mere 2.84% ($24.68 million) to $894.78 million, following a sizable increase of 10.26% in the previous year. Operating expenses as a proportion of operating income decreased by 238 bps to 61.70%, reflecting the increase in profits achieved this year, and the non-bank sector realising more economies of scale as their loan books continue to grow.

Unsurprisingly, Credit Union Baywide and Avanti Finance showed the largest increases in operating expenses. Credit Union Baywide's operating expenses grew 133.50% ($19.97 million) to $34.93 million, partially driven by a merger with Credit Union South ($12.11 million attributable), Aotearoa Credit Union, and Credit Union Central. Meanwhile, Avanti Finance saw a 97.22% ($15.72 million) increase in operating expenses to $31.90 million, following their acquisition of Branded Financial Services who reported $3.51 million in their pre-acquisition financial statements. In addition, Avanti Finance's financial statements are for a 15-month period due to the change of reporting date, both impacting this increase and leaving us unable to see what the true increase is.

On the other hand, Fuji Xerox more than halved their operating expenses as they reported the largest decrease of 51.11% ($11.59 million) to $11.09 million, which enabled them to generate a profit this period. LeasePlan, Ricoh and Latitude Financial Services also achieved decreases in their operating expenses by 19.69% ($6.37 million), 14.69% ($8.13 million) and 6.91% ($8.69 million), respectively.

While the majority of survey participants saw increases in operating expenses, they were largely offset by the six that managed to achieve decreases, as the increases on average were relatively small compared to the fewer relatively large decreases, which resulted in the small overall movement.

10 SEE FIGURE 10 – PAGE 23

The operating efficiency ratio (operating expenses over operating income) for the non-bank sector as a whole has decreased to 61.70% from 64.09%, a reduction of 238 bps. This is a result of overall operating income increasing by 6.81% ($92.44 million), proportionally larger than the 2.84% ($24.68 million) increase in overall operating expenses.

Avanti Finance achieved the largest increase in operating income, contributing a $33.66 million (68.30%) rise to the non-bank sector increase of $92.44 million, likely influenced by both their purchase of Branded Financial Services and their 15-month results. However, the increase was offset by their significant increase in operating expenses, causing their operating efficiency ratio to increase by 564 bps to 38.46%, likely to reflect a combination of Branded Financial Services' higher operating efficiency ratio, which was 60.20% in 2018, and the transactional costs involved in the acquisition.

Latitude Financial Services also contributed a large portion of the increase in operating income, increasing $24.39 million (15.29%). They also achieved a decrease of $8.69 million (27.90%) in operating expenses, causing their operating efficiency ratio to drop 1,518 bps to 63.63%, which is largely driven by a decrease in administrative and professional expenses and distribution to trust beneficiaries. This was the largest decrease of the survey participants. LeasePlan saw the next best improvement in their operating efficiency ratio, dropping 1,048 bps to 71.28%, driven by a sizable 19.69% ($6.37 million) decrease in operating expenses, being a reduction in restructure costs compared to the prior period.

Nissan Financial Services again had the lowest operating efficiency ratio of the survey participants at just 18.36% after a small decrease of 184 bps. They were followed by First Mortgage Trust with an operating efficiency ratio of 23.06% after a slight dip of 36 bps since last year. At the other end of the scale, Credit Union Baywide had the highest operating efficiency ratio, with a 1,600 bps jump to 107.02%, pushing them into a loss position for the period. This will again likely be impacted by some of the other Credit Unions in the amalgamation who were not as profitable previously (e.g. Credit Union South's large 10-month loss that was included in these results), and some one-off costs incurred as part of the amalgamation, such as significant advisory costs. Turners Automotive Group saw a slight increase of 38 bps to 88.76%, giving them the second highest ratio of the survey participants.

Both Turners Automotive Group and Latitude Financial Services' results have a significant influence over the ratio, as they make up 34.40% of operating income and 44.90% of operating expenses. If these two entities were excluded, then the operating efficiency ratio would drop to just 52.15%, a 60 bps decrease from the previous period.

Analysis of annual results

				Size
Entity	**Rank by Total Assets**	**Balance Date**	**Year**	**Total Assets $000**
Avanti Finance Limited	4	30-Jun 31-Mar	2019 *2018*	1,084,764 *567,336*
BMW Financial Services New Zealand Limited	14	31-Dec	2018 *2017*	378,079 *405,602*
Branded Financial Services (NZ) Limited		30-Jun	2018	177,092
Christian Savings Incorporated	19	31-Aug	2019 *2018*	183,529 *155,652*
Credit Union Baywide	12	30-Jun	2019 *2018*	521,030 *380,998*
Credit Union South		30-Jun	2018	130,612
First Credit Union	13	30-Jun	2019 *2018*	382,979 *358,023*
First Mortgage Trust	7	31-Mar	2019 *2018*	808,561 *646,083*
FlexiGroup (New Zealand) Limited	5	30-Jun	2019 *2018*	1,033,843 *983,093*
Fuji Xerox Finance Limited	17	31-Mar	2019 *2018*	267,378 *365,601*
Geneva Finance Limited	24	31-Mar	2019 *2018*	117,742 *99,321*
Instant Finance Limited	23	31-Mar	2019 *2018*	118,008 *116,780*
John Deere Financial Limited	18	31-Oct	2018 *2017*	187,405 *149,386*
Latitude Financial Services Limited	2	31-Dec	2019 *2018*	1,684,909 *1,521,555*
LeasePlan New Zealand Limited	16	31-Dec	2018 *2017*	367,532 *371,733*
Mercedes-Benz Financial Services New Zealand Limited	9	31-Dec	2018 *2017*	687,005 *662,848*
Motor Trade Finances Ltd	8	30-Sep	2019 *2018*	784,017 *748,036*
Nelson Building Society	6	31-Mar	2019 *2018*	828,818 *723,029*
Nissan Financial Services New Zealand Pty Limited	11	31-Mar	2019 *2018*	538,272 *443,364*
ORIX New Zealand Limited	15	31-Mar	2019 *2018*	374,054 *311,233*
Police and Families Credit Union	22	30-Jun	2019 *2018*	131,929 *128,015*
Ricoh New Zealand Limited	20	31-Mar	2019 *2018*	160,960 *150,690*
Toyota Finance New Zealand Limited	3	31-Mar	2019 *2018*	1,320,837 *1,406,299*
Turners Automotive Group	10	31-Mar	2019 *2018*	561,648 *559,208*
UDC Finance Limited	1	30-Sep	2019 *2018*	3,483,859 *3,295,905*
Wairarapa Building Society	21	31-Mar	2019 *2018*	160,013 *159,809*
Sector Total			**2019** ***2018***	**16,167,171** ***15,017,303***

n/d = not disclosed; n/a = not available. * Does not include FlexiGroup (New Zealand) Limited.

and Strength Measures		Growth Measures			
Net Assets[41] $000	Net Loans and Advances $000	Increase in Net Profit After Tax %	Increase in Total Assets %	Increase in Gross Loans and Advances %	Increase in Net Interest Income %
118,822	1,035,026	42.91	91.20	90.53	64.29
67,294	*544,181*	*31.73*	*43.97*	*42.10*	*33.98*
28,227	356,237	-17.40	-6.79	-5.52	-5.97
23,528	*376,469*	*-17.48*	*12.98*	*10.53*	*11.65*
2,765	167,858	46.25	14.52	16.55	34.93
19,192	128,639	-31.18	17.91	24.46	-5.02
17,745	*103,356*	*78.64*	*6.69*	*4.07*	*14.62*
57,909	386,482	-6,038.37	1.84	3.22	11.25
40,893	*274,494*	*-16.68*	*22.00*	*2.84*	*7.64*
20,709	105,963	-300.22	-4.44	-6.25	-10.54
59,558	202,295	295.19	6.97	2.59	-0.62
56,507	*197,227*	*-63.97*	*2.85*	*0.76*	*-0.40*
799,702	631,153	28.83	25.15	20.35	27.12
637,083	*524,323*	*34.61*	*29.96*	*24.36*	*34.25*
80,382	734,067	-7.84	5.16	10.91	0.32
54,372	*665,152*	*n/a*	*0.50*	*10.78*	*n/a*
-19,905	61,729	176.96	-26.87	1.68	-50.16
-23,647	*58,844*	*-42.12*	*14.90*	*23.40*	*-13.42*
29,590	80,941	-28.24	18.55	5.82	22.81
29,168	*67,664*	*19.29*	*17.99*	*-0.70*	*9.58*
31,646	107,522	-2.00	1.05	1.81	3.03
30,574	*105,731*	*-2.85*	*6.71*	*5.02*	*6.64*
7,324	181,882	4.41	25.45	26.94	14.62
4,911	*143,285*	*0.70*	*4.20*	*3.76*	*-0.07*
-91,958	1,581,995	315.81	10.74	11.37	67.89
-97,966	*1,428,281*	*76.72*	*14.30*	*16.12*	*43.33*
106,383	12,350	43.99	-1.13	2.47	4.04
99,177	*12,052*	*-5.76*	*6.49*	*10.18*	*6.85*
56,416	651,526	1.06	3.64	2.07	-3.48
54,753	*636,604*	*14.34*	*3.69*	*5.76*	*7.81*
95,929	692,194	35.48	4.81	1.41	4.30
92,067	*677,549*	*9.26*	*11.62*	*12.74*	*12.12*
58,467	640,502	42.18	14.63	14.95	19.30
49,072	*557,025*	*10.06*	*13.24*	*14.06*	*13.52*
26,024	525,060	20.39	21.41	21.36	4.49
17,942	*432,519*	*19.04*	*29.16*	*29.98*	*21.50*
173,456	77,767	-19.21	20.18	29.39	-1.36
192,244	*60,140*	*-6.56*	*28.60*	*47.32*	*22.35*
25,577	48,333	-24.70	3.06	-10.00	-3.47
24,375	*53,706*	*-3.16*	*4.33*	*-6.61*	*2.60*
81,444	87,610	-2.17	6.82	4.66	2.96
80,727	*84,632*	*43.32*	*4.06*	*0.47*	*4.40*
178,952	952,927	18.10	-6.08	-2.73	-0.87
147,090	*972,245*	*4.32*	*21.27*	*17.00*	*9.45*
133,840	298,311	-2.74	0.44	2.19	11.31
121,799	*299,796*	*32.92*	*20.49*	*39.88*	*52.72*
612,422	3,398,375	6.72	5.70	5.81	10.93
550,944	*3,222,430*	*5.93*	*10.43*	*10.75*	*9.88*
19,894	126,169	158.64	0.13	-4.37	14.61
18,049	*132,047*	*8.84*	*14.41*	*13.48*	*12.12*
2,689,293	**12,999,092**	**16.49**	**7.66**	**9.32**	**14.04**
2,312,175	***11,903,573***	***22.97****	***13.68***	***21.10***	***16.38****

Analysis of annual results

Entity	Year	Credit Quality Measures			
		Impaired Asset Expense $000	Provision for Doubtful Debts/ Gross Loans & Advances %	Impaired Asset Expense/ Average Loans & Advances %	Net Interest Margin %
Avanti Finance Limited	2019	14,123	1.88	1.76	7.65
	2018	*7,223*	*1.71*	*1.53*	*8.00*
BMW Financial Services New Zealand Limited	2018	5,357	1.37	1.44	6.28
	2017	*3,785*	*1.52*	*1.04*	*6.74*
Branded Financial Services (NZ) Limited	2018	241	0.60	0.15	3.33
Christian Savings Incorporated	2019	0	0.00	0.00	1.60
	2018	*0*	*0.00*	*0.00*	*1.89*
Credit Union Baywide	2019	2,817	1.94	0.73	5.16
	2018	*468*	*0.22*	*0.17*	*4.06*
Credit Union South	2018	1,940	0.73	1.76	7.39
First Credit Union	2019	667	1.35	0.33	3.73
	2018	*819*	*1.34*	*0.41*	*3.92*
First Mortgage Trust	2019	-196	0.19	-0.03	7.13
	2018	*188*	*0.22*	*0.04*	*7.14*
FlexiGroup (New Zealand) Limited	2019	14,386	3.64	1.99	10.85
	2018	*18,418*	*3.15*	*2.82*	*11.14*
Fuji Xerox Finance Limited	2019	-1,408	7.23	-2.13	3.89
	2018	*7,270*	*10.08*	*12.27*	*7.22*
Geneva Finance Limited	2019	1,697	18.02	1.77	11.25
	2018	*363*	*27.48*	*0.39*	*10.51*
Instant Finance Limited	2019	3,246	4.10	2.92	22.33
	2018	*2,765*	*3.99*	*2.57*	*22.32*
John Deere Financial Limited	2018	0	0.00	0.00	3.92
	2017	*0*	*0.00*	*0.00*	*3.94*
Latitude Financial Services Limited	2019	48,288	3.60	3.10	11.27
	2018	*39,905*	*3.07*	*2.91*	*7.60*
LeasePlan New Zealand Limited	2018	280	0.00	2.29	9.59
	2017	*247*	*0.00*	*2.15*	*9.37*
Mercedes-Benz Financial Services New Zealand Limited	2018	-43	0.85	-0.01	3.76
	2017	*735*	*1.11*	*0.12*	*4.04*
Motor Trade Finances Ltd	2019	305	0.26	0.04	8.20
	2018	*181*	*0.99*	*0.03*	*8.51*
Nelson Building Society	2019	783	0.21	0.13	2.34
	2018	*878*	0.24	*0.17*	*2.24*
Nissan Financial Services New Zealand Pty Limited	2019	2,834	1.17	0.58	3.45
	2018	*1,860*	*1.19*	*0.48*	*4.13*
ORIX New Zealand Limited	2019	76	0.10	0.11	10.00
	2018	*11*	*0.04*	*0.02*	*12.65*
Police and Families Credit Union	2019	7	0.21	0.01	3.93
	2018	*-6*	*0.21*	*-0.01*	*4.21*
Ricoh New Zealand Limited	2019	211	2.14	0.24	10.30
	2018	*599*	*1.07*	*0.70*	*10.24*
Toyota Finance New Zealand Limited	2019	1,222	1.98	0.12	3.95
	2018	*4,477*	*2.72*	*0.48*	*4.24*
Turners Automotive Group	2019	6,995	6.16	2.22	9.02
	2018	*5,493*	*3.63*	*2.06*	*9.12*
UDC Finance Limited	2019	13,172	1.39	0.39	4.33
	2018	*10,885*	*1.06*	*0.35*	*4.21*
Wairarapa Building Society	2019	-126	0.35	-0.10	2.42
	2018	*124*	*0.26*	*0.10*	*2.26*
Sector Total	**2019**	**114,693**	**1.92**	**0.90**	**6.32**
	2018	***108,869***	***1.81***	***0.98***	***6.13***

n/d = not disclosed; n/a = not available

Profitability Measures					Efficiency Measures	
Interest Spread %	**Net Profit After Tax $000**	**Underlying Profit $000**	**NPAT/Average Total Assets %**	**NPAT/Average Equity %**	**Operating Expenses/Gross Revenues %**	**Operating Expenses/ Operating Income %**
6.95	26,584	36,918	3.22	28.29	26.19	38.46
7.32	*18,602*	*25,883*	*3.87*	*30.76*	*23.43*	*32.82*
6.15	4,390	6,173	1.12	16.96	36.13	52.71
6.49	*5,315*	*7,384*	*1.39*	*19.07*	*39.95*	*57.12*
3.24	1,506	2,078	0.91	69.74	31.18	60.20
1.20	852	852	0.50	4.61	25.40	70.86
1.50	*1,238*	*1,238*	*0.82*	*7.79*	*23.04*	*57.95*
4.84	-5,107	-5,107	-0.99	-8.55	77.35	107.02
3.66	*1,009*	*1,009*	*0.29*	*2.50*	*55.72*	*91.01*
7.02	-923	-923	-0.69	-4.36	76.75	92.25
3.36	2,956	2,985	0.80	5.09	58.92	83.80
3.53	*748*	*748*	*0.21*	*1.33*	*62.40*	*91.98*
7.13	39,396	39,899	5.42	5.48	23.06	23.06
7.14	*30,581*	*30,898*	*5.35*	*5.41*	*23.43*	*23.43*
10.68	41,972	57,830	4.16	15.48	35.50	46.31
11.12	*45,543*	*63,384*	*4.64*	*19.31*	*29.24*	*38.46*
4.06	3,742	3,742	1.18	-17.18	48.37	82.61
7.36	*-4,862*	*-4,862*	*-1.42*	*22.92*	*62.31*	*90.40*
9.35	4,394	5,434	4.05	14.96	58.24	68.97
8.57	*6,123*	*4,524*	*6.67*	*22.67*	*55.40*	*68.28*
20.43	8,851	11,893	7.54	24.63	55.31	63.14
20.47	*9,032*	*12,220*	*7.99*	*26.25*	*55.53*	*63.01*
3.84	2,413	3,350	1.43	39.44	30.27	48.89
3.89	*2,311*	*3,213*	*1.58*	*61.54*	*27.57*	*43.81*
11.60	12,901	18,618	0.80	53.65	43.73	63.63
8.01	*-5,978*	*-6,085*	*-0.42*	*-24.85*	*53.17*	*78.80*
9.59	7,214	10,188	1.95	7.02	29.15	71.28
9.37	*5,010*	*6,971*	*1.39*	*5.18*	*34.04*	*81.76*
3.45	12,056	16,389	1.79	21.69	20.88	35.31
3.74	*11,930*	*16,361*	*1.83*	*24.36*	*20.85*	*34.76*
7.59	11,143	15,701	1.45	11.85	59.07	79.81
7.84	*8,225*	*11,645*	*1.16*	*9.13*	*60.20*	*83.80*
2.10	5,649	7,897	0.73	10.51	23.70	55.24
2.00	*3,973*	*5,540*	*0.58*	*8.74*	*25.15*	*60.85*
3.24	7,978	20,161	1.63	36.29	16.33	18.36
3.92	*6,627*	*17,856*	*1.68*	*44.87*	*18.92*	*20.19*
8.41	12,092	16,818	3.53	6.61	24.71	55.95
9.99	*14,968*	*20,801*	*5.41*	*8.10*	*24.00*	*47.68*
3.52	1,201	1,200	0.92	4.81	53.85	76.95
3.80	*1,595*	*1,595*	*1.27*	*6.77*	*50.40*	*70.93*
9.20	8,742	13,100	5.61	10.78	75.75	78.00
8.66	*8,936*	*10,082*	*6.05*	*11.72*	*81.16*	*83.82*
3.54	20,437	28,321	1.50	12.54	21.16	52.25
3.82	*17,305*	*24,212*	*1.35*	*11.79*	*19.99*	*50.61*
8.22	22,719	29,049	4.05	10.31	84.81	88.76
8.46	*23,360*	*31,133*	*4.57*	*12.10*	*84.54*	*88.38*
3.71	69,690	97,057	2.06	11.98	16.38	26.67
3.57	*65,299*	*90,779*	*2.08*	*12.60*	*15.11*	*25.52*
2.19	1,751	2,228	1.09	9.23	30.60	58.35
2.02	*677*	*1,075*	*0.45*	*3.82*	*30.68*	*68.33*
5.71	**324,016**	**440,696**	**2.08**	**11.09**	**43.42**	**61.70**
5.70	***278,150***	***378,759***	***2.04***	***11.38***	***44.95***	***64.09***

Focus on peer-to-peer lending

In December 2019, the FMA released its annual peer-to-peer (P2P) and crowdfunding data, the third of this series. P2P lenders have achieved solid growth during the year, with their total value of outstanding loans increasing by 12% to $547 million, although this is considerably less than the previous year's growth of 63% (to $489 million). The number of investors with open investments has continued to increase with growth of 19% to 12,121, while the total number of investors registered also grew by 22% to 31,846.

During the year one P2P provider had their lending service license cancelled, bringing the number of licensed providers back down to 7. ChangeFund was likely the lender that had their license cancelled as they are no longer included with the other licenced P2P lenders on the FMA's website, and as with last year, their metrics were not included. See table 5.

Harmoney remains the dominant player in the sector, gaining 7% market share to 72% of the total value of lending within the sector; with their outstanding loans increasing by 23.38% to $392 million, well above market growth of 12%. On the funding side, Harmoney gets a good portion of their funding from institutions rather than from 'mum and dad' investors, and during the year Harmoney raised $47 million from two investors in Australia[42], helping to secure more market share in the P2P sector.

11 SEE FIGURE 11 – PAGE 32

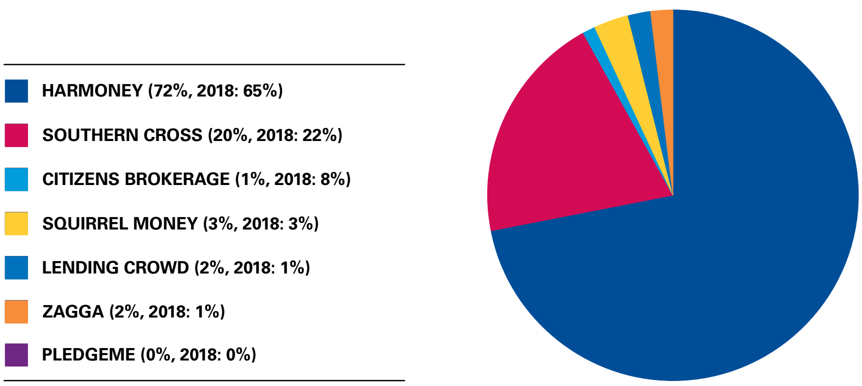
Southern Cross has slightly dropped back in market share as a result of Harmoney's strong growth, sliding from 22% to 20%, although it did still see good growth of 6.43% in outstanding loans to $112.0 million; while Zagga saw the largest growth of the group, more than doubling their loans from $4.5 million to $12.0 million, a rise of 166.65%. Conversely Citizens Brokerage actually experienced a sizable decrease, with their outstanding loans dropping by 84.86% to $6.0 million, and Pledgeme also saw a decline, decreasing by 17.64% to just $0.8 million.

Investor numbers continue to grow presumably driven by a combination of people looking for yield as bank interest rates drop and increased familiarity with the market. The composition of investors remains relatively in line with last year; with small investors such as 'mum and dad' that invest less than $5,000, making up 69.90% of total investors by number. However, these investments from the small investors only account for 0.98% of total lending, while the top 1.01% of investors (by number), who invest more than $500,000 each, account for 57.09% of the total funding from investors.

12 SEE FIGURE 12 – PAGE 33

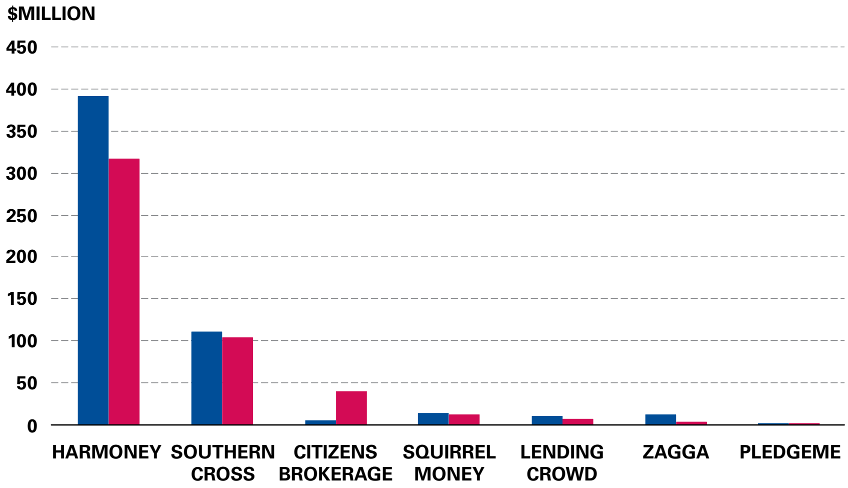
TABLE 5: SUMMARY	2019	2018
Number of service providers	7	8
Total value of outstanding loans	$547,000,000	$489,000,000
Total number of investors registered with P2P services	31,846	26,123
Total number of new investors	1,578	1,937
Total number of investors with open investments	12,121	10,176
Providers operating a secondary market	2	2
Total value of trades on secondary markets	$4,100,000	$6,570,394
Total value of loans written off	$14,000,000	$13,937,938

11 P2P MARKET SHARE BY TOTAL VALUE OF OUTSTANDING LOANS IN 2019



SOURCE: FMA, PEER-TO-PEER LENDING AND CROWDFUNDING: SECTOR SNAPSHOT REPORT

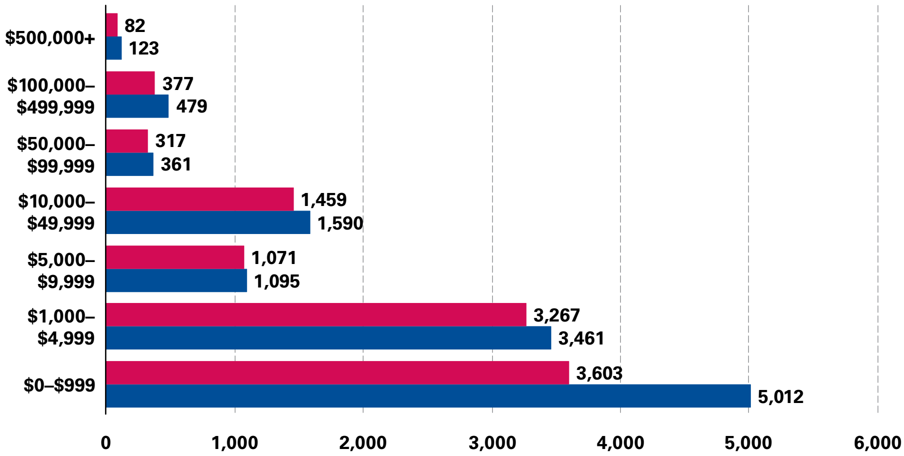
12 TOTAL VALUE OF OUTSTANDING LOANS



2019
2018

SOURCE: FMA, PEER-TO-PEER LENDING AND CROWDFUNDING: SECTOR SNAPSHOT REPORT

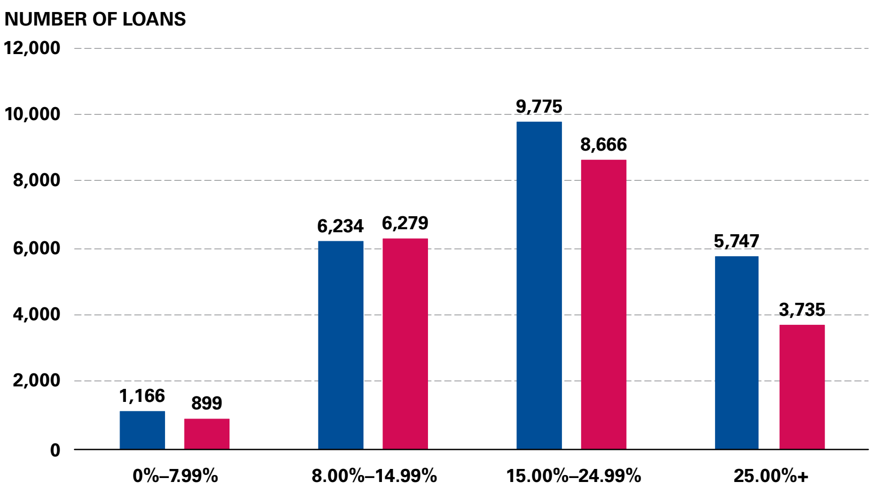
13 TOTAL NUMBER OF INDIVIDUAL INVESTORS ACROSS RANGES



2019
2018

SOURCE: FMA, PEER-TO-PEER LENDING AND CROWDFUNDING: SECTOR SNAPSHOT REPORT

14 NUMBER OF OUTSTANDING LOANS ACROSS INTEREST RATE RANGES



2019
2018

SOURCE: FMA, PEER-TO-PEER LENDING AND CROWDFUNDING: SECTOR SNAPSHOT REPORT

13 SEE FIGURE 13 – PAGE 33

The number of registered borrowers has had significant growth, up 73% to 484,635, with the number of first-time borrowers increasing by 36% to 9,158. It is likely that the number of borrowers are also influenced by the banks saying no, and the customers on the margins trickling through the lending hierarchy, as the need for funding doesn't go away even if a second tier lender says no. It could also be influenced by the frustrations of people and small businesses who are finding it harder and slower dealing with the banks in the current market due to responsible lending, CCCFA and AML type requirements. The number of repeat borrowers have also increased, rising 47.70% to 1,474, implying many customers have enjoyed using a P2P lender for a specific purpose and are willing to do so again. See table 6.

The proportion of the number of investors to number of borrowers has decreased to 6.57% from 9.34% last year, showing the continuing trend of more and more funding by dollars coming from large investors, while the percentage of investors with open investments compared to total registered dipped to 38.06% from 38.95% in the previous year. The number of loans (22,607) remains slightly below double the number of investors with open investments (12,121), despite the average amount invested within each bucket decreasing or remaining flat.

The percentage of secured loans has remained relatively flat from the previous year, decreasing slightly from 24.33% to 23.95%, showing there is still a similar proportion of secured and unsecured lending.

TABLE 6: BORROWER INFORMATION	2019	2018
Total number of borrowers registered with P2P services	484,635	279,750
Number of first time borrowers	9,158	6,737
Number of repeat borrowers	1,474	998
Total value of loans taken out by repeat borrowers	$35,000,000	$32,413,388
Total number of secured loans	1,470	1,133
Total value of secured loans	$131,000,000	$119,057,159
Number of borrowers borrowing the $2 million maximum	1	2
Total value of loans written off	$14,000,000	$13,937,938

SOURCE: FMA, PEER-TO-PEER LENDING AND CROWDFUNDING: SECTOR SNAPSHOT REPORT

TABLE 7: INDIVIDUAL BORROWERS	2019	2018
Total number of outstanding loans to individuals	22,607	19,359
Total value of outstanding loans to individuals	$443,000,000	$388,242,315
Total value of new loans to individuals	$165,000,000	$143,830,883

SOURCE: FMA, PEER-TO-PEER LENDING AND CROWDFUNDING: SECTOR SNAPSHOT REPORT

TABLE 8: BUSINESS BORROWERS	2019	2018
Total number of outstanding loans to businesses	315	220
Total value of outstanding loans to businesses	$105,000,000	$101,026,404
Total value of new loans to businesses	$76,000,000	$64,487,470

SOURCE: FMA, PEER-TO-PEER LENDING AND CROWDFUNDING: SECTOR SNAPSHOT REPORT

TABLE 9: LOANS IN ARREARS OR WRITTEN OFF	2019	2018
Total number of outstanding loans in arrears	1,426	949
Total value of outstanding loans in arrears	$39,000,000	$26,241,611
Percentage of outstanding loans in arrears	6.20%	4.80%
Total number of loans written off	845	1,197
Total value of loans written off	$14,000,000	$13,937,938

SOURCE: FMA, PEER-TO-PEER LENDING AND CROWDFUNDING: SECTOR SNAPSHOT REPORT

TABLE 10: REFINANCED* LOANS	2019	2018
Number of loans refinanced by individuals	8,106	6,129
Total value of loans repaid by individuals before refinancing	$181,000,000	$111,550,988
Number of loans refinanced by business	19	42
Total value of loans repaid by businesses before refinancing	$1,000,000	$5,079,292

* Refinancing refers to when a borrower replaces an outstanding loan with a new larger loan.

SOURCE: FMA, PEER-TO-PEER LENDING AND CROWDFUNDING: SECTOR SNAPSHOT REPORT

15 SEE FIGURE 15 – PAGE 35

Again the majority of loans by number have interest rates in the 15% to 24.99% bracket (42.64% of the number of loans), which is in line with 2018 with 44.26%. Interestingly, the value of loans in this category as a proportion of total loans has decreased to 49.26% from 54.35%, while loans with an interest rate of over 25% increased from 6.12% to 11.11%. This change could be partly driven by the desire for yield, where investors may be more willing to spread some of their funds to riskier borrowers due to the low interest paid by the banks, provided they are rewarded with a higher return. This could also be driven by investors getting more experience with how their previous loans have performed, with their first investments being fairly 'safe', and are now willing to take more risks.

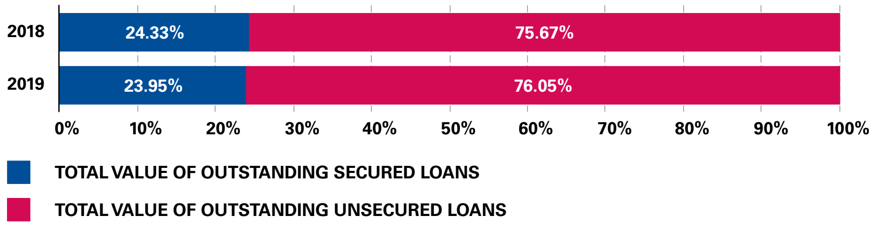
This idea that investors could be willing to take on more risk is shown in the increase of number of loans in arrears from 949 in 2018 to 1,426, similar to the number in 2017, and outstanding loans in arrears as a proportion of total outstanding loans has increased to 6.20% from 4.80% in 2018. While asset quality may appear to have slipped, the total number of loans written off remains flat from last year at $14 million, with loan write offs compared to outstanding loans actually decreasing from 2.85% to 2.55%. This suggests that although the number of loans in arrears has increased, either these arrears are ultimately caught up, or the average size of loans in arrears are smaller. Comparing the ratio of loan write offs to gross loans and advances to a non-bank lender, Instant Finance, who also offers unsecured loans, has a ratio of 2.90%, which is actually 5 bps higher than the P2P average of 2.85%, showing that their overall loan quality may not be much more risky than other unsecured financers.

TABLE 11: AVERAGE VALUE OF OUTSTANDING LOANS IN INTEREST RANGES

	0%–7.99%	8%–14.99%	15%–24.99%	25%+
2019	40.691	43.255	17.342	10.584
2018	53.609	42.347	16.760	8.015

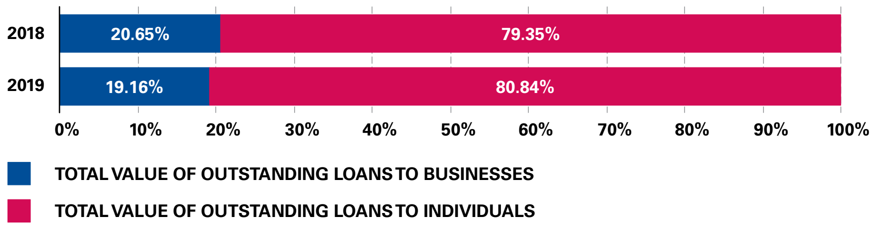
SOURCE: FMA, PEER-TO-PEER LENDING AND CROWDFUNDING: SECTOR SNAPSHOT REPORT

15 PROPORTION OF SECURED LOANS OF TOTAL OUTSTANDING LOANS BY VALUE



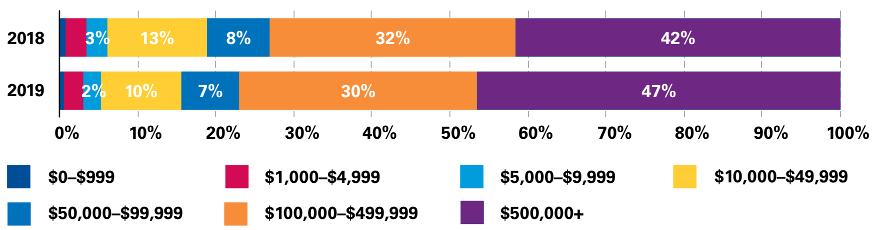
SOURCE: FMA, PEER-TO-PEER LENDING AND CROWDFUNDING: SECTOR SNAPSHOT REPORT

16 TOTAL VALUE OF OUTSTANDING LOANS – INDIVIDUAL AND BUSINESS SPLIT



SOURCE: FMA, PEER-TO-PEER LENDING AND CROWDFUNDING: SECTOR SNAPSHOT REPORT

17 PROPORTION INVESTED BY INVESTORS ACROSS RANGES



SOURCE: FMA, PEER-TO-PEER LENDING AND CROWDFUNDING: SECTOR SNAPSHOT REPORT

Conduct becoming - a new conduct licensing regime

Kate Stewart
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Kate is a Senior Manager specialising in conduct and regulation. She joined the team from the Financial Markets Authority and brings with her valuable experience in conduct regulation from both the UK and New Zealand.

Kate previously worked for a major New Zealand life insurer in marketing and product development roles.

Quinn Ooi
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Quinn is a Manager in Risk Consulting specialising in conduct and credit risk management. Prior to joining KPMG she has undertaken complex remediation projects in Australia relating to responsible lending and vulnerable customers. Most recently, Quinn has undertaken work in supporting New Zealand's financial institutions with conduct and culture uplift programmes.

The Government has proposed a bold new conduct licensing regime that encompasses banks, insurers and non-bank deposit takers. Most banks and insurers have already moved forward with their conduct and culture review, and action plans in response to the FMA and the RBNZ's recent Conduct and Culture review (the Reviews). The non-bank sector that was untouched by the Reviews may find themselves exposed to greater scrutiny in relation to their conduct, more than ever before, as they grapple with the work that will be required to meet the expectations of the regime.

With the new regulatory regime on the horizon we discuss how non-bank participants can reframe their thinking on conduct and pose questions to kickstart a conduct strategy from what may be a standing start.

The conduct of financial institutions continues to receive considerable regulatory and media attention and has been for some time now. The Reviews into banks and life insurers have shone light on issues in New Zealand's financial sector.

New Zealand banks and insurers have long maintained that they are not affected by the same issues as their Australian counterparts. The Reviews challenged this assumption, finding:

- there are weaknesses in systems and controls to identify and manage conduct issues;
- 'Good Customer Outcomes' are not prioritised; and
- there is currently a gap where the general conduct of financial institutions is not captured under any explicit legislative mandate.

Unsurprisingly, the Government has responded with the proposal of a new conduct licensing regime to address these issues and to 'lift the bar' on customer treatment. The new regime will be introduced for banks, insurers and non-bank deposit takers (licenced entities) in relation to their general conduct. The Government has proposed to introduce this new legislation to the House before the end of 2019, however, it has not indicated precisely when the changes will come into effect[43].

Fair treatment standard and limiting volume-based incentives

The intention of the regime is to set a conduct standard for licensed entities to place customer needs and treating customers fairly at the heart of their businesses. To meet this expectation, the licenced entities will be required to have effective policies, processes, systems and controls to monitor whether they are delivering good customer outcomes.

In particular, volume-based incentives will be prohibited because of the heightened risk of mis-selling they create. This means that licensed entities will have to consider the potential harms created by their incentive structures for staff and intermediaries and design them in the way that minimises the risk of misconduct. We have observed some banks 'pulling the plug' on incentives linked directly to sales for front-line staff and re-designing remuneration scorecards with a focus on customer outcomes and no direct link to sales. Similar approaches could be used for the design of incentives for intermediaries such as brokerages and car dealers, with incentives designed holistically, with a customer lens, and not principally weighted on sales or loan size. However, this change requires a well-thought-out approach and shouldn't be undertaken as a knee-jerk reaction in order to avoid unforeseen consequences being borne out such as customers not being offered or provided with products they need. Organisations should move to investigate and advance their thinking sooner, rather than later, taking into account not only incentives, but any other elements of oversight of distributors that may be required, for a smooth and well-thought through transition, as new frameworks will take time to embed and may require 'trial and error' to fine tune.

The buck stops here – addressing the conduct of intermediaries

Linked to incentives, another key development is the requirement on licensed entities who manufacture products, to take ownership and have greater oversight over the sale of their products; and ensuring that distributors of their products (i.e. intermediaries who are not licensed Financial Advice Providers) are doing so with the end customer in mind.

This means that when previously, product manufacturers could sell products through an intermediary (e.g. car dealer or brokerages) and pay a commission without a large degree of oversight over the quality of the sale, the manufacturers will now be accountable for those sales made by intermediaries that are not licensed Financial Advice Providers – a major uplift in oversight processes and distribution contracts will be required in many cases. To adapt to such change, licensed entities will have to consider reviewing and changing contractual agreements with their intermediaries to ensure that the customer's best interest is considered and adequately met by their intermediaries. But more importantly they will need to develop third party assurance and oversight frameworks.

This solution complements the Financial Services Legislation Amendment Act to ensure that all customers are protected, regardless of the channel through which they choose to purchase financial services.

What does this mean for non-banks?

The Cabinet paper has left room for the possibility of the conduct licensing regime to be applied more widely over time, where further entities (e.g. wholesale funded lenders) may be drawn in as needed[44]. Although some of these entities may already be regulated under other legislation (e.g. Consumer Credit Contracts Finance Act (CCCFA)), this conduct licensing regime will be governing these entities more explicitly in terms of customer treatment and sales.

The fact that some financial services entities[45] are not immediately caught by the regime presents an opportunity for these organisations to make the most of this time to assess what 'conduct risk' and the 'good customer outcomes' means to them, and whether they have placed adequate focus on these topics and what they need to improve on.

The 'wait and see' approach, we know, is a risky one. As we noted in the 2018 non-bank FIPS, non-banks should not assume that they are free of conduct issues on the basis that they believe they already have good conduct. This assertion was made by the New Zealand banks and insurers, at the outset, and was later challenged by the findings uncovered by the Review. In light of this, non-banks should profit from this learning by being proactive in placing conduct front of mind in everything they do[46].

"Good conduct is up to you – the industry – providers and advisers. Given what we've seen in other countries, I have to ask why you are waiting for us to come knocking – look at what we are saying and think about how it applies to your business."

Robert Everett, CEO
Financial Market Authority

Most banks and insurers should already be well advanced with their conduct and culture review and action plans to uplift their practices. Late adopters will be measured against the standards already being set, and if they don't act now, it will be a more difficult transition once they're caught by a regulator with increased regulatory tools and scrutiny.

Looking ahead

The introduction of the new regime will add to an already complex regulatory environment. Non-banks will need to be forward thinking and agile to navigate the future regulatory changes.

Through our experience in supporting clients in the conduct and culture space, we see that it is increasingly vital to have clear direction from boards and senior management to meet the expectations the conduct licensing regime will bring.

We set out below some questions boards and senior management should be asking themselves as a starting point for thinking about how businesses need to adapt and plan for change. We have also provided a road map for help guide non-banks in their conduct and culture journey.

Questions we should be asking about our conduct:

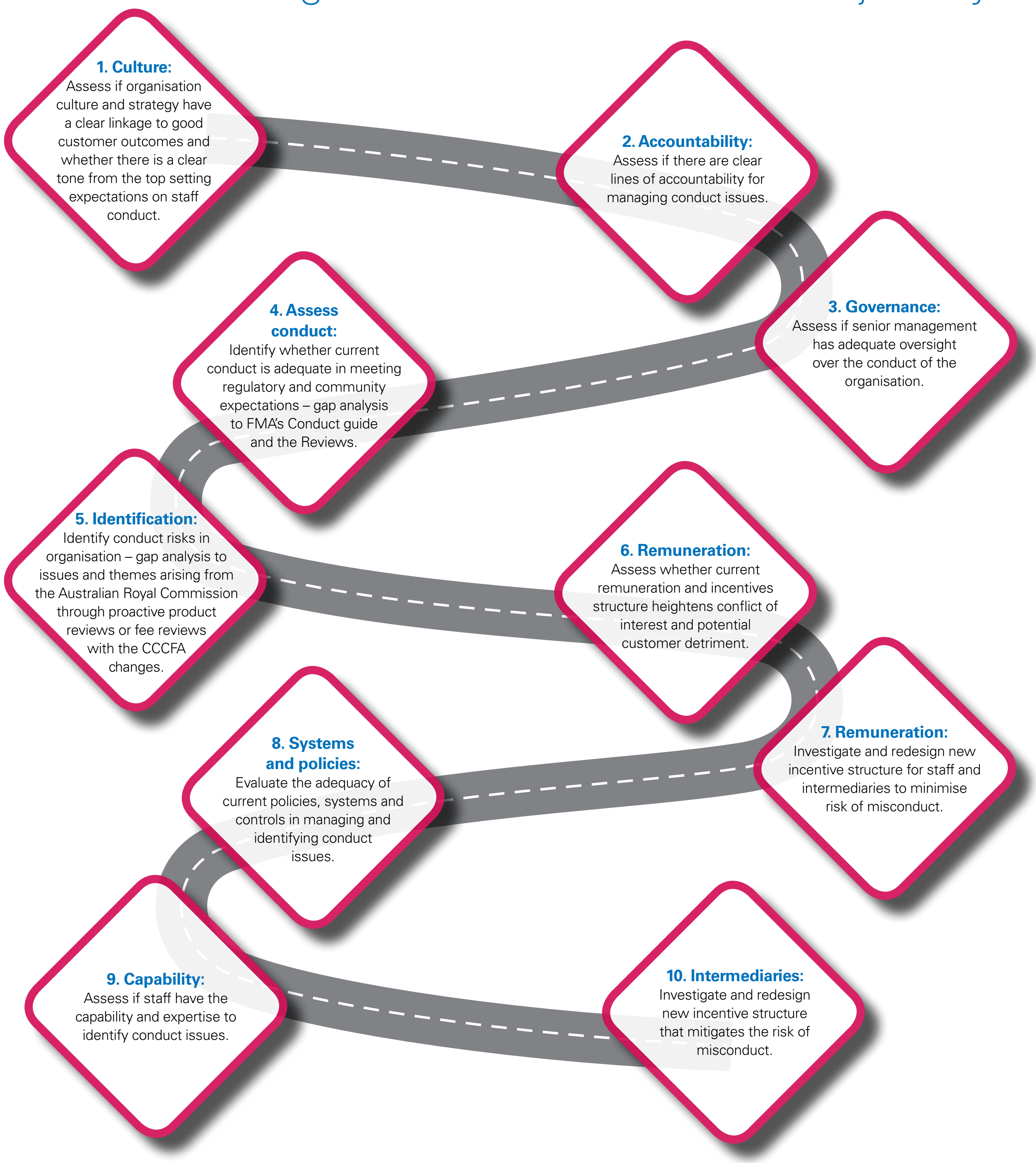
1. How are our Board and senior management setting a clear tone from the top on conduct and is this embedded in our strategy?
2. What does conduct mean to us?
3. How are conduct risk and customer outcomes embedded in our organisational culture?
4. What will be the impact to our reputation and brand if we fail to meet the expectations set out in the regime?
5. Can we demonstrate an effective management of conduct risks?
6. What actions have we taken to identify and address poor customer outcomes?
7. Do we design products and services that meet our customers' needs?
8. Have we completed a gap analysis against the FMA's *Guide to Good Conduct* and the findings from the Australian *Royal Commission into Misconduct into Banking, Superannuation and Financial Services*[47]?
9. Are our incentive structures set up to support Good Customer Outcomes?
10. How are we managing the conduct of our intermediaries?

Where do we begin on the conduct and culture journey?

(See Road map journey on page 39)

1. **Culture:** Assess if organisation culture and strategy have a clear linkage to good customer outcomes.
2. **Accountability:** Assess if there are clear lines of accountability for managing conduct issues, and whether there is a clear tone from the top setting expectations on staff conduct.
3. **Governance:** Assess if senior management has adequate oversight over the conduct of the organisation.
4. **Assess conduct:** Assess whether current conduct is adequate in meeting regulatory and community expectations – gap analysis to FMA's *Guide to Good Conduct* and the Reviews[48].
5. **Identification:** Identify conduct risks in organisation – gap analysis to issues and themes arising from the Australian Royal Commission through proactive product reviews or fee reviews with the CCCFA changes.
6. **Remuneration:** Assess whether current remuneration and incentives structure heightens conflict of interest and potential customer detriment.
7. **Remuneration:** Investigate and redesign new incentive structure for staff and intermediaries to minimise risk of misconduct.
8. **Systems and policies:** Evaluate the adequacy of current policies, systems and controls in managing and identifying conduct issues.
9. **Capability:** Assess if staff have the capability and expertise to identify conduct issues.
10. **Intermediaries:** Identify if there is adequate oversight over the conduct of intermediaries.

Where do we begin on the conduct and culture journey?



Credit ratings

as at 3 December 2019

	Standard & Poor's		Fitch Ratings		Moody's		Rating and Investment		Other	
	Rating	Outlook	Rating	Outlook	Rating	Outlook	Rating	Outlook	Rating	Outlook
Avanti Finance Limited	BB	Stable								
BMW Financial Services New Zealand Limited[49]	A+	Negative			A1	Stable				
Christian Savings Incorporated			BB	Stable						
Credit Union Baywide			BB	Stable						
First Credit Union			BB	Stable						
First Mortgage Trust										
FlexiGroup (New Zealand) Limited										
Fuji Xerox Finance Limited[50]							AA	Stable		
Geneva Finance Limited										
Instant Finance Limited										
John Deere Financial Limited[51]			A	Stable	A2	Stable				
Latitude Financial Services Limited[52]										
LeasePlan New Zealand Limited[53]	BBB-	Stable	BBB+	Stable	Baa1	Stable				
Mercedes-Benz Financial Services New Zealand Limited[54]	A	Watch Neg	A-	Stable	A2	Negative				
Motor Trade Finances Ltd										
Nelson Building Society			BB+	Negative						
Nissan Financial Services New Zealand Pty Limited[55]	A-	Watch Neg			A3	Negative	A+	Negative		
ORIX New Zealand Limited[56]	A-	Negative	A-	Stable	A3	Stable	A+	Positive		
Police and Families Credit Union										
Ricoh New Zealand Limited[57]	BBB+	Stable					A+	Stable		
Toyota Finance New Zealand Limited[58]	AA-	Stable	A+	Stable	Aa3	Stable	AA+	Stable	BBB	Stable
Turners Automotive Group										
UDC Finance Limited	BBB+	Stable								
Wairarapa Building Society			BB+	Stable					B+	Good

Ownership
as at 3 December 2019

Non-bank Entity	Ultimate Shareholding	%
Avanti Finance Limited	Various investment/ nominee companies	100
BMW Financial Services New Zealand Limited	BMW AG (Germany)	100
Christian Savings Incorporated	Various private shareholders	100
Credit Union Baywide	Various depositors	100
First Credit Union	Various depositors	100
First Mortgage Trust	Various unitholders	100
FlexiGroup (New Zealand) Limited	FlexiGroup Limited	100
Fuji Xerox Finance Limited	Fuji Xerox Co. Ltd (Japan)	100
Geneva Finance Limited	Various investment/ nominee companies; various private shareholders	100
Instant Finance Limited	Various private shareholders	100
John Deere Financial Limited	Deere & Company (USA)	100
Latitude Financial Services Limited	KVD Singapore Pte. Ltd	100
LeasePlan New Zealand Limited	LeasePlan Corporation N.V. (Netherlands)	100

Non-bank Entity	Ultimate Shareholding	%
Mercedes-Benz Financial Services New Zealand Limited	Daimler AG (Germany)	100
Motor Trade Finances Ltd	Various Licensed Motor Vehicle Dealers	100
Nelson Building Society	Various depositors	100
Nissan Financial Services New Zealand Pty Limited	Nissan Motor Co. Ltd. (Japan)	100
ORIX New Zealand Limited	ORIX Corporation (Japan)	100
Police and Families Credit Union	Various Depositors	100
Ricoh New Zealand Limited	Ricoh Company Ltd. (Japan)	100
Toyota Finance New Zealand Limited	Toyota Motor Corporation (Japan)	100
Turners Automotive Group	Various Investment/ Nominee companies	100
UDC Finance Limited	Australia and New Zealand Banking Group (Australia)	100
Wairarapa Building Society	Various depositors	100

Descriptions of the credit rating grades

Long-term credit rating grades assigned by Standard & Poor's	Description of the steps in the Standard & Poor's credit rating grades for the rating of the long-term senior unsecured obligations payable in New Zealand, in New Zealand dollars.
AAA	Extremely strong capacity to meet financial commitments. Highest rating.
AA	Very strong capacity to meet financial commitments.
A	Strong capacity to meet financial commitments, but somewhat susceptible to adverse economic conditions and changes in circumstances.
BBB	Adequate capacity to meet financial commitments, but more subject to adverse economic conditions.
BB	Less vulnerable in the near-term, but faces major ongoing uncertainties to adverse business, financial and economic conditions.
B	More vulnerable to adverse business, financial and economic conditions, but currently has the capacity to meet financial commitments.
CCC	Currently vulnerable and dependent on favourable business, financial and economic conditions to meet financial commitments.
CC	Currently highly vulnerable. Default has not yet occurred but is expected to be a virtual certainty.
Plus (+) or Minus (-)	The ratings AA to CCC may be modified by the addition of a plus (+) or minus (-) sign to show relative standing within the major rating categories.
BB, B, CCC, and CC	Borrowers rated BB, B, CCC and CC are regarded as having significant speculative characteristics. BB indicates the least degree of speculation and CC the highest. While such borrowers will likely have some quality and protective characteristics, these may be outweighed by large uncertainties or major exposures to adverse conditions.
Assigned by AM Best	AM Best applies 'Long-Term Issuer Credit Rating (ICR) Scale' rates 'aaa' to 'b' to indicate exceptional to marginal credit risk, for entities exhibiting greater credit risk, ratings are assigned from 'ccc' to 'c', indicating weak to poor credit risk, where credit quality is vulnerable to extremely vulnerable to adverse changes to industry and economic conditions. AM Best applies 'Rating Notches' to ratings in categories 'aa' to 'ccc' to reflect a graduation within the category, indicating whether credit quality is nearer the top or bottom of a particular rating bracket.
Assigned by Fitch Ratings	Fitch Ratings applies 'investment grade' rates 'AAA' to 'BBB' to indicate relatively low to moderate credit risk, while for those in the 'speculative' or 'non-investment grade' categories which have either signalled a higher level of credit risk or that a default has already occurred, Fitch Ratings applies a 'BB' to 'D' rating. The modifiers '+' or '-' may be appended to a rating to denote relative status within the major rating categories. Credit ratings express risk in relative rank order, which is to say they are ordinal measures of credit risk and not predictive of a specific frequency of default or loss.
Assigned by Moody's Investors Service	Moody's Investors Service appends numerical modifiers 1, 2 and 3 in each generic rating classification from Aa through Caa. The modifier 1 indicates that the obligation ranks in the higher end of its generic category, the modifier 2 indicates a mid-range ranking and the modifier 3 indicates the lower end of that generic category.
Assigned by Rating and Investment Information, Inc.	Rating and Investment Information Inc. applies a rating scale where the grades of "AAA" to "BB" indicate the highest level of creditworthiness supported by excellent factors, to a sufficient level of creditworthiness where some factors require attention at times. Grades of "B" to "C" are applied where creditworthiness is questionable and some factors require constant attention, to cases where an obligation is in default. Rating and Investment Information Inc. include the use of modifiers, such as "+" or "-" to the categories of "AA" to "CCC" to indicate the relative standing within each rating category.

Definitions

Terms and ratios used in this survey	Definitions used in this survey
Gross impaired assets	Includes all impaired assets, restructured assets, and assets acquired through the enforcement of security, but excludes past due assets.
Gross loans and advances	Includes loans and advances, lease receivables (net of unearned income) and accrued interest receivable (where identifiable), but excludes amounts due from banks, marketable securities, loans to related parties, sundry debtors and prepayments.
Gross revenue	Includes gross interest income, gross operating lease and net other income.
Impaired asset expense	The charge to the Profit and Loss Account for bad debts and provisions for doubtful debts, which is net of recoveries (where identifiable).
Interest bearing liabilities	Customer deposits (including accrued interest payable where identifiable), balances with banks, debt securities, subordinated debt and balances with related parties.
Interest earning assets	Cash on hand, money on call and balances with banks, trading and investment securities, net loans and advances (including accrued interest receivable where identifiable), leased assets net of depreciation and balances with related parties.
Interest expense	Includes all forms of interest or returns paid on debt instruments.
Interest spread	Difference between the average interest rate on average interest earning assets, and the average interest rate on average interest bearing liabilities.
Net assets	Total assets less total liabilities.
Net interest income	Interest income (including net income from acting as a lessor) less interest expense.
Net interest margin	Net interest income divided by average interest earning assets.
Net loans and advances	Loans and advances, net of provision for doubtful debts.
Operating expense	Includes all expenses charged to arrive at net profit before tax (excluding interest expense, impaired asset expense, subvention payments, direct expense related to other income (where identifiable) and depreciation of leased assets where a lessor.
Operating income	Net interest income, net operating lease income and net other income (where direct expense related to other income is identifiable).
Past due assets	Includes any asset which has not been operated by the counterparty within its key terms for 90 days and which is not an impaired or restructured asset.
Provision for doubtful debts	Includes both collective and individual provisions for bad and doubtful debts.
Total assets	Excludes goodwill assets (unless specifically defined).
Ultimate shareholding	Identifies the ultimate holding company rather than any intermediate holding companies.
Underlying profit	Operating income less operating expense and impaired asset expense. Items of a non-recurring nature, unrelated to the ongoing operations of the entity, are excluded.

Endnotes

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54 Rating of parent company Daimler AG (Germany).
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56 Rating of parent company ORIX Corporation (Japan).
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