KPMG

FIPS

Financial Institutions Performance Survey
Banks – Review of 2019

MASSEY UNIVERSITY
TE KUNENGA KI PŪREHUROA
UNIVERSITY OF NEW ZEALAND

1

0.99%
decrease in NPAT

2

3.93%
escalation in operating expenses

3

4.79%
rise in net interest income

4

2 bps
decrease in net interest margins

5

5.37%
increase in gross lending

6

11 bps
drop in average funding costs

7

8.91%
rise in gross impaired assets

8

10.85%
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

The KPMG Financial Institutions Performance Survey (FIPS) report of 2019 represents the 33rd year that KPMG has provided in-depth insights into New Zealand's banking sector. In this 33rd edition we will be presenting industry commentary and analysis on the performance of the New Zealand registered banks, together with a range of topical articles from other key stakeholders such as industry experts, regulators and our own business leaders.

The FIPS publication covers registered bank entities with balance dates between 1 October 2018 and 30 September 2019. As a result, registered banks with the balance date of 31 December have had their 31 December 2018 financial results included in this year's survey as their most recent results. This includes Bank of China, China Construction Bank, Citibank, Industrial and Commercial Bank of China, JPMorgan Chase Bank, Kookmin Bank, Rabobank and The Hongkong and Shanghai Banking Corporation.

TABLE 1: ENTITY MOVEMENTS[1]

	Who's out	Who's in
Banks: 26	— Nil	— Bank of China (NZ) Banking Group — China Construction Bank (NZ) Banking Group

FOOTNOTE 1

In late 2019 we published and launched our *FIPS Non-bank – Review of 2019* publication. This publication can be accessed at the following link: https://home.kpmg/nz/en/home/insights/2019/12/fips-non-bank-2019.html

There have been two changes to the survey participants this year, with the inclusion of the Bank of China New Zealand Branch and the China Construction Bank New Zealand Branch, each with a 31 December 2018 balance date, each now dual-registered banks. As with other dual-registered banks, we will present the results of the New Zealand banking group for both Bank of China New Zealand and China Construction Bank New Zealand.

As with all previous FIPS publications, the information used in compiling our analysis is extracted from publicly available annual reports and disclosure statements for each organisation, with the exception of certain information provided by the survey participants. The results only include operations within the respective banks or banking groups, so any operations within the wider group, but outside of the registered bank or banking group, such as with Kiwibank and Heartland, will not be included.

We wish to thank the survey participants for their valued contribution, both for the additional information provided and for the time made available to meet and discuss the industry issues with us. Massey University continues to be a partner and key contributor to the compilation of this publication, assisting with the data collection, as well as drafting the banks' profit forecasting section of this survey. We thank them for their continued contribution.

External contributors continue to play a vital role in our publication, providing insight on key issues and developments that we might not otherwise have. We would like to acknowledge the contributors from the Financial Markets Authority (FMA), New Zealand Bankers' Association (NZBA) and CoreLogic for their exceptional contribution towards the compilation of this publication.

We have supplemented their external thought leadership commentary with some of KPMG's own business line thought leadership. We trust you find the content of this survey of interest.

A KPMG view from the editor

John Kensington
Partner – Audit
Head of Banking and Finance
KPMG

JOHN'S BIO

FIPS Banks – Review of 2018's key themes were summarised as the 3 C's: Capital, Conduct/Culture, and confidence. These continue to be some of the main themes in the *FIPS Banks – Review of 2019* publication. This year also sees more discussion regarding fintech/disruption, the changing customer, and a skill shortage in the banking sector and wider economy.

Bank capital was the most frequent headline during 2019, and main topic of discussion with survey participants. 2019 saw the consultation period end, continued discussion in the sector, external experts assess the proposed capital changes, and a final set of decisions released early December. The final decisions have been best received by the smaller banks, who are happy that their minimum requirements will be less than that of the big four banks, and that a cap has been set to limit the benefits the big banks get by using an internal ratings-based capital method. In effect they welcome this as a levelling of the playing field. However, both big and small banks are pleased that the Reserve Bank of New Zealand (RBNZ) took some submitter's concerns into consideration, in particular the RBNZ increased the implementation period and indicating they would allow a lower form of capital, Additional Tier 1 (AT1), to be used to meet minimum requirements (conditional on obtaining RBNZ approval).

Since the final decisions were released in December 2019, it has been fairly quiet from the banks – a stark contrast from the views being expressed by some banks and banking commentators during the consultation period. This is likely driven partly by an acceptance that these are now the rules and nothing can be done except to prepare for them to become effective, partly that banks don't need another reason to face a potential public backlash by appearing to care just about margins when the changes aim to make the banking system safer, and partly that no bank wants to attract the attention of the RBNZ in a time when many banks are being stung, publicly, both here and in Australia, by other control failures such as capital calculation issues and Anti-Money Laundering (AML) issues. In addition, banks are looking to rebuild the public trust.

One thing that will determine how successful these capital changes will be is how the banks, individually and as a sector, respond to these changes over the next few years. An outcome that is suggested by many is that to achieve the new capital requirements, the banks will, amongst other things, likely review their books, client by client, and reassess and reprice risk, with the possibility of credit rationing. For riskier clients in particular, rates will likely increase and loan covenants may become more restrictive, or in more severe cases the bank may discontinue funding. Deposit rates will likely reduce further; however, there is likely to be a floor in these rates as there will be certain levels of rates where term deposit investors will start looking for another home for their money in large droves, which will reduce available funding for the banks.

There will be limited scope for banks to reduce their operating expenses, given there have already been a few non-compliance issues (in New Zealand and across the Tasman) and each bank really doesn't want to be the one that has the next 'oops' moment and compliance costs money.

Eventually, if the banks go 'too far', with increases in lending rates, credit rationing, or reduction in deposit rates, the public will complain. This will lead to the both the regulator and public questioning of these changes, to which the banks will respond that these are just rationale responses to the capital changes. This further shows the importance of how banks manage these changes through the use of the seven-year transition period, to ensure there is no 'shock' to the economy – as a recessionary economy is not worth the 'I told you so' that it may elicit. The one concern that underlies all of this is if it does occur like this, there will be some reduction in credit availability, and therefore, there could be a group of people at the bottom of the economic ladder that become underbanked or unbanked as a result of the credit rationing. This would not only be an undesirable outcome, but an unintended consequence.

Conduct was thrust into the spotlight in 2018, with the RBNZ and FMA conducting their reviews of the banks, and several bank issues hitting the headlines. This was on the back of recent findings and individual customer stories coming out of the *Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry* (Australian Royal Commission) in Australia.

This year has been relatively benign in respect of headlines, with the life insurers bearing most of the brunt of regulator and media scrutiny in 2019 due to the release of the results of the RBNZ and FMA review into the industry in September 2019. As a result of 2019 seemingly calmer in this space for the banks and with other issues at the forefront of mind, many survey participants believed that they are through the worst of it, that things have gone more or less back to business as usual, with dedicated people/teams continuing to work in the conduct space.

However, conduct is not something that can be moved to the back of the mind, even though the specific issued raised by the conduct review may have been worked through. What is considered appropriate conduct today may be quite different to what is appropriate in a year's time, with changes in customer expectations, societal values, and technological changes. One worries that if these lessons are quickly forgotten with other current issues taking front of mind, the appearance of future customer conduct issues are only a matter of time.

Confidence is an interesting issue that continues to be a hot topic of discussion with survey participants, because despite market indicators being good and GDP still growing, general confidence is down, albeit slightly perked up near the end of 2019 compared to the rest of the year. One common view was that because things have been so good for so long, people are expecting things to come down soon because they surely can't keep getting better. It's undeniable that confidence has decreased since the Labour-led Coalition Government came into power. This has been attributed to both people not liking change, but also that business never seems to feel as confident under a Labour-led Coalition Government.

Part of the issue is when the business survey comes in, things like the increased fuel tax and minimum wage come to mind and both cause business expenses to rise. In addition, the government is also announcing that it is spending more but not a lot of it seems to be actually flowing through to action. In addition, the government has had some false starts (Kiwibuild), some failures (Tax Working Group), and some changes of mind (roading infrastructure).

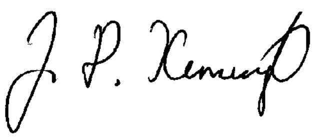
In contrast to the apparent lack of business confidence, many CEO's still remain confident in their company's ability to grow, and this is true for the banks too; again illustrating the disparity between business confidence and how the economy is actually performing. Despite the prolonged low confidence and worries of talking ourselves into a slowdown, the New Zealand economy is continuing to trundle along. Growth has slowed down a little, prompting the RBNZ to drop the OCR by 0.75% over 2019, but any significant change to economic conditions won't be domestic – it is going to come from big overseas events that cause uncertainty all over the globe, like the US/China trade war, Brexit, Coronavirus or a Gulf War.

New Zealand has also seen a bit of a slowdown in **Fintech** compared to what is happening globally. There has been some disruption from small Fintech firms that have been taking small bites out of banking market, but there hasn't been anything serious yet. **Open banking** should open the door to big change, but there are two different approaches that can be taken: pushed through by the government, or self-lead by the banks and industry driven.

In New Zealand it has mostly been left to the banks, who say that they consider data security the biggest hurdle to implementing open banking in New Zealand. However, the amount of time taken to produce any feasible progress brings to question how much time is actually being spent to ensure safe data and how much is being dragged out to preserve their dominance over many touchpoints in the financial services market. While achieving strong data security is essential for the safe sharing of data, and the banks will face public scrutiny if they are the reason for data breaches, a lack of progress will only be tolerated for so long before the government steps in and the minister to say "get on with it". Once open banking becomes public and gains popularity, there is no doubt there will be a whole range of new Fintech's looking to service consumer needs and look to disrupt the banking sector.

Another issue that was frequently brought up is the struggle to find and retain good staff, both in the banks themselves, but also in the companies that they are lending to. The war for talent seems to be stemming from two main issues. The first comes from the changes to immigration laws, making it harder and taking longer to secure migrant workers. Secondly there has been a shift in work habits, particularly among younger people / millennial thinkers. Less young people are wanting a career where they will work for years and years in order to save for a house deposit and then work for decades more while paying off the debt. Additionally, many Kiwis that are coming into the workforce from tertiary studies have significant student debt that also needs to be paid back but they cannot easily afford to repay the loan quickly on entry level salaries, adding yet another hurdle to home ownership.

Owning a home has become more of a dream than a reality for many young Kiwis, and there has been a shift to live in an 'Uber' environment. Consumers will rent or share what they need to spread their disposable income further and use the balance of it to get the experiences they want, and live more hand to mouth rather than commit to saving for a deposit in a time where they feel they will never 'catch up'. These people tend to have low loyalty to firms/brands, and are not interested in overtime as they want jobs that work with their 'living for the now' lifestyle. Low loyalty to firms may also be influenced by the seemingly continuous restructures, particularly in corporate entities, leading to people feeling like they have low job security and not valued by their employers. Employees that feel like just another number making up the workforce seek to find fulfilment outside of work and want the freedom to go out and do things after 5 pm. Traditionally, banks didn't tend to struggle with retaining staff, as staff that worked long, hard hours were rewarded with big bonuses, but now that the bonus is gone, the incentive has disappeared with it. In addition, the type of person they require to assist with the many regulatory impost are not readily available. The workforce attitude shift, combined with the removal of incentives and increased compliance roles, has made it more difficult for banks to adapt to this and keep the workforce full. This will be an area of challenge for the banks to create new working packages that appeal to what workers value in order to retain staff.



Industry overview

Capital

After the Reserve Bank of New Zealand (RBNZ) requested public submissions, there was significant public discussion during the consultation period up until the decision was made, and parallel to that several banks discovering areas of non-compliance with existing capital rules. The words 'bank' and 'capital' quite often came hand-in-hand in the final quarter of 2019, dominating the majority of the discussion around banking.

In December 2019, the RBNZ released its long awaited final decision from the consultation on bank capital. The final decision was to increase minimum capital requirements to 18% for the four major banks, and to 16% for the remaining smaller banks from the current 10.5% requirement for all banks. These capital levels are largely in line with the levels proposed by the RBNZ at the start of the consultation. However, some of the key adjustments made to the original proposal were:

- Eligibility of certain types of capital instruments (a softening from the initial RBNZ proposals), but still with some work to do to define what is compliant.
- Extended transition period of seven years compared to five years (to allow banks adequate time to prepare).

As noted above, getting to this final position involved many strong views being presented, with extensive analysis being presented by various industry participants and the RBNZ itself, and other independent experts and commentators. We have summarised the key dates over the period on page 9 – *RBNZ Capital Review Timeline*.

Rajesh Megchiani, a partner in our risk consulting practice, writes more about the key changes and the impact of the finalised decisions in his article *Capital adequacy: The bar is set higher* on page 42.

Looking back at the submissions that were raised, as released by the RBNZ in July 2019, there was broad support for the proposed higher capital requirements as a way of ensuring the financial system is safe; and for reducing the gap that arises from the use of internal models at the four major banks.

However, the submissions raised concerns about the cost versus the benefits of the safer system, whether the requirements could be met by non-equity capital, and the time to meet the proposed requirements, with many submissions requesting more time to implement the changes. Some survey participants, including the four major banks argued the proposals go too far, and will lessen incentives to measure risks accurately[2].

FOOTNOTE 2

These were discussed in our FIPS quarterly publications throughout 2019. Following this, in response to continued strong concerns being publicly presented, the RBNZ engaged three international independent experts to assess the RBNZ's capital review. On 1 October, the RBNZ released the results of these reviews, with each supporting the proposed direction of the review process. However, each expert did identify some areas to be considered that could be improved, for the RBNZ to work through[3].

FOOTNOTE 3

All of these were factored into the final decisions made by the RBNZ – probably not at the satisfaction of some of the stakeholders.

All in all, there has been a muted acceptance publicly by the banks and little negative comment since the announcement. The small and New Zealand based banks have largely been supportive of the changes, particularly around the levelling of the playing field through the internal based model caps. Most banks had already started considering the strategic impact of these changes since the original proposal was announced – primarily on how these new capital requirements will be met and changes in the business strategies. Now with the changes finalised, the focus will continue on these aspects and also on implementing changes to systems, data requirements, calculation engines, reporting and disclosure requirements.

Before the decision to increase capital requirements was announced, farmers were already starting to feel the pressure from banks, with many seeing a change in their loan structure, such as more information and security being required, needing to repay principal and interest, or switches between fixed and floating interest rates[4].

FOOTNOTE 4

VIEW FIGURE 1

VIEW FIGURE 2

Despite the concerns, when the announcement was made and the timeline increased, the banks seemed optimistic about their ability to reach the new requirements[5] in an acceptance of their new reality.

FOOTNOTE 5

New Zealand's largest bank, ANZ, has said that in order to meet the new capital requirements by 2027, it will need to grow its Common Equity Tier 1 (CET1) by a total of AUD$4.5 billion. BNZ and CBA are estimating an increase in CET1 of NZD$3–$4 billion and NZD$2.5 billion respectively, whilst Westpac is looking at a Tier 1 impact of between NZD$2.3–$2.9 billion[6].

FOOTNOTE 6

Conduct and culture review

One year on from the release of the results of the RBNZ's and Financial Market Authority (FMA)'s joint review of New Zealand registered banks, conduct and culture of banks has remained in the spotlight, with various incidents creating unfavourable press over the past year. A consumer survey found people are wary of banks, with 47% of respondents untrusting of banks and only 35% feeling that banks have their best interests at heart[7].

FOOTNOTE 7

The Council of Financial Regulators (CoFR) has set about to develop increased coordination and action around governance and conduct issues within the banking sphere as a priority for 2020, and the project will be led by the FMA[8].

FOOTNOTE 8

RBNZ Capital Review Timeline[9]

FOOTNOTE 9

1 Jul 2020	Key decisions will start to take effect (seven-year implementation period commences)
19 Dec 2019	Background materials and responses to submissions on *Consultation Paper 4* released
5 Dec 2019	Final decisions of the Capital Review announced, increasing minimum capital held from 10.5% to 18% for the big four banks and 16% for the remaining banks, with seven years for banks to implement the new rules
1 Oct 2019	Reports of three independent reviews of the proposed changes by experts and a summary report published
8 Aug 2019	Summary of submissions received on the proposed framework for implementing the capital surcharge for domestically systemically important banks published
1 Jul 2019	Summary of received submissions and individual submissions on capital required for locally incorporated banks published
28 May 2019	Three external experts commissioned to independently review the proposed changes
17 May 2019	Submission period for regulatory capital required for locally incorporated banks closes
8 Apr 2019	Consultation paper published on proposed framework for implementing the capital surcharge for domestically systemically important banks, and feedback requested
3 Apr 2019	A background paper outlining the analysis supporting the RBNZ's risk appetite framework published
26 Feb 2019	Geoff Bascand speaks about the proposals to increase bank capital requirements
22 Feb 2019	Summary of purpose of capital changes and its anticipated impacts published
25 Jan 2019	*Updated Capital Review Paper 4 – How much capital is enough?* published, proposing different requirements for local banks
14 Dec 2018	RBNZ publishes *Capital Review Paper 4* and requests feedback on regulatory capital required for locally incorporated banks
30 Nov 2018	Adrian Orr addresses higher capital at Business New Zealand CEO Forum
6 Jul 2018	Individual responses and RBNZ response to calculation of risk-weighted assets published
19 Mar 2018	Submission period for feedback on calculating risk-weighted assets closes
19 Dec 2017	RBNZ response to nature of financial instruments published, and seeks feedback on the options for calculating risk-weighted assets
7 Nov 2017	Individual responses on *Nature of Financial Instruments* published
19 Oct 2017	Individual responses on first consultation published
8 Sep 2017	Submission period for feedback on *Nature of Financial Instruments* closes
14 Jul 2017	Feedback about *Nature of Financial Instruments* requested
9 Jun 2017	Submission period for feedback on first consultation closes
1 May 2017	First consultation document issued, requesting feedback for views on capital adequacy for banks

With issues of weak conduct risk management systems also being highlighted by the RBNZ and FMA review, it is no surprise that changes to conduct and culture have moved from being 'findings from a review' to making its way into regulation.

In September 2019, Commerce and Consumer Affairs Minister, Hon. Kris Faafoi announced the new financial conduct regime aimed to make financial service providers treat their customers more fairly, with six new main features[10].

FOOTNOTE 10

1. Create a conduct licensing regime for banks, insurers and non-bank deposit takers regarding their general conduct. These institutions will be licensed by the FMA.
2. Require licensed institutions to meet a fair treatment standard (for example, to pay due regard to the needs and interests of customers and treat them fairly).

   Fair treatment means customers are provided with clear and transparent information that is not misleading, to be provided with products that are appropriate without facing unreasonable pressure[11].

   FOOTNOTE 11

   What 'fair treatment' means in practice is yet to be seen, and as with customer expectations over the past few years, this may be a definition that changes over time. Changes may also be driven by new products being developed that don't currently exist, new technology in ways customers interact, or changes to the use of customer data, or possibly all of the above.
3. Require licensed institutions to implement effective policies, processes, systems and controls to meet the fair treatment standard.

   As noted above, if the definition of 'fair treatment' changes over time, these policies, processes, systems and controls will need to be set up in a way to easily adapt to these changes.
4. Create obligations for financial institutions in relation to how they design their remuneration and any other sales incentives, and how they must manage the risks those incentives create.
5. Prohibit sales incentives based on volume or value targets (e.g. soft commissions such as overseas trips, bonuses for selling a certain number of financial products, leader boards, and performance management based on the volume of sales). This prohibition will apply to banks, insurers, non-bank deposit takers and their intermediaries.

   This is unlikely to have any material impacts for banks at this stage, given the RBNZ and FMA's report required banks to outline their plans to remove sales incentives.
6. Make licensed entities accountable for sales to consumers by the entities' contracted intermediaries who are not financial advice providers (non-adviser intermediaries include car dealers, retailers selling add-on finance and insurance, and travel agents or airlines selling travel insurance).

While the legislation is not yet in effect, a number of survey participants commented that banking institutions are already held to a strong code of conduct and that increased regulation may not produce the desired outcomes. Instead, some feel that focusing on better compliance and increased support over implementation would be most beneficial. This would better enable them to ensure that they are offering services that customer's value whilst keeping the customer's best financial interests at the core of all transactions.

From another angle, after a year of being told how and what to change, one good news story at the end of 2019 was BNZ announcing that it is granting its staff six weeks annual leave from 2020[12].

FOOTNOTE 12

They also announced they are also working to encourage more flexibility and increasing parental leave provisions, with the intention that these changes will improve wellbeing of staff and enable them to do their best work for BNZ customers[13].

FOOTNOTE 13

Regulation

Review of the Reserve Bank Act

In December 2019, the Government released some findings and in principle decisions as part of Phase 2 of the Reserve Bank Act Review (Phase 1 was completed in 2018 and was discussed in *FIPS Banks – Review of 2018*[14]).

FOOTNOTE 14

These findings and decisions are expected to be converted into legislative changes by the end of 2020 in a move to modernise New Zealand's monetary and financial stability policy frameworks. These were split into two areas:

- decisions on governance and accountability arrangements, to be progressed through an Institutional Act; and
- in-principle decisions for regulation of deposit takers and introduction of a deposit insurance scheme, covered by a Deposit Takers Act.

The Institutional Act will progress decisions related to the governance and accountability arrangements for the RBNZ[15].

FOOTNOTE 15

This will include the establishment of a governance board responsible for all of the functions of the RBNZ, with the Treasury as an external monitor of the RBNZ. The key objective of the Institutional Act has been defined as "protecting and promoting the stability of New Zealand's financial system"[16], with enhanced accountability; aided by reinforced coordination and cooperation with other regulatory agencies.

FOOTNOTE 16

Additionally, the Minister of Finance will also be able to issue a Financial Policy Remit for any matters relevant to the financial stability objective. Funding will remain unchanged, and will continue to be set by an agreement with some costs covered by levies paid.

The Deposit Takers Act will relate to the regulation of deposit takers and will introduce the deposit insurance scheme. Other key decisions include combining both banks and non-bank deposit takers and making them subject to a single prudential regulatory regime, using standards set by the RBNZ to impose regulatory requirements. Additionally, the accountability requirements for directors will be significant increased and the crisis resolution framework will be made both stronger and clearer[15]. New Zealand has typically had a relatively 'light' supervision model without onsite inspections and verifications of disclosure statements, compared to other financially advanced countries who changed their regulation following the 2008 global financial crisis. The deposit protection scheme could also be considered overdue, as New Zealand is the only Organisation for Economic Co-operation and Development (OECD) country without any sort of deposit protection. Stronger supervision and enforcement tools, including the ability to perform onsite inspections, will also be a useful new tool as regulators can independently verify compliance claims[17].

FOOTNOTE 15

FOOTNOTE 17

What is yet to be seen is how often onsite inspections will actually be performed, and whether they will be proactive or reactive. Given the number of entities that will be captured in the remit with the inclusion of non-bank deposit takers, the level of these greater supervision tools being used are likely to be heavily influenced by the resourcing available at the RBNZ.

However, as with many new legislative requirements, implementation will likely be the biggest roadblock to compliance. Banks are questioning what implementation support and guidance will be available in order to reach compliance in a timely and efficient manner, in order to avoid being in breach of the proposed decisions. In addition, the timeline for implementation could be some way off with an election due this year and the necessarily legislation taking time to complete, be consulted on and be passed into law.

Credit Contracts and Consumer Finance

The Government introduced the Credit Contracts Legislation Amendment Bill (CCLAB) to Parliament in April 2019 amending the Contracts and Consumer Finance Act (CCCFA) after the Ministry of Business, Innovation and Employment (MBIE) identified issues with the CCCFA in its review[18]. The Bill has now been passed and came into force from December 2019[19], with most of the significant changes taking effect from 1 March 2020.

FOOTNOTE 18

FOOTNOTE 19

One of the largest areas of change is responsible lending. Lenders will have greater responsibility for ensuring that products are suitable and affordable for individual customers, not just at the inception of the loan, but when a lender makes certain 'material changes' as defined by the CCLAB[20], and they will have to perform specific inquiries to consider the impacts of the lending on the borrower.

FOOTNOTE 20

Additionally, lenders will no longer be allowed to rely on information provided by borrowers and will need to perform more extensive verification of information; keeping record of the borrower assessment. As part of responsible lending, advertising will need to comply with regulated standards, and lenders must ensure key information is available in the advertised language if necessary[18].

FOOTNOTE 18

Meeting the 'fit and proper person' test is required for directors and executives of lenders, and they will need to be certified under the CCCFA. They will also have to ensure that lending complies with the CCCFA as part of their new duties, including exercising due diligence. This due diligence covers following compliance procedures, having processes for identifying deficiencies and remedying any deficiencies in a timely manner.

Under the CCLAB, there will be restrictions on fees, lenders will be required to keep records about the calculation and reasonableness of fees and will be required to reassess fees if there has been a change in the lender's business that may indicate that the previous fees may no longer be reasonable. Interest and fees over the life of a loan will be capped at 100% of the principal borrowed for loans with annualised interest rate of 50% or more, meaning the borrower's repayments cannot be more than double what they borrowed.

The consequences of non-compliance have been strengthened, with damages able to be charged on a wider range of breaches. Statutory damages and civil pecuniary penalties of up to $600,000 can be charged and are enforceable by the Courts. Additionally, the Courts will be able to determine the 'affordable repayment' amount of outstanding debt for breaching responsible lending principles.

In September 2019, additional measures of protection against 'loan sharks' and pay-day lenders were added, including a 0.8% per day cap on interest rates, and making all mobile traders subject to the same level of disclosure and responsible lending requirements before credit can be granted[21].

FOOTNOTE 21

While the CCLAB was primarily targeted at loan sharks and the extreme hardship that can be caused by the cycle of debt caused by interest, fees and the inability to keep up with repayments, the introduction of new regulations are likely to affect other lenders, in both expected and unexpected ways. The expected consequences of increased regulation are inflated costs, to what extent is yet to be seen in a competitive market, and slower credit decisions, which can be frustrating for both lenders and borrowers. However, most survey participants consider this a small price to pay to enable better consumer outcomes.

One concerning potential unintended consequence of this legislation is that tightened restrictive criteria may lead to some existing lending that is currently considered 'responsible lending' being deemed as 'non-responsible lending'. This could make lenders more cautious in lending to marginal borrowers and may result in those at the lower end of the economy no longer being able to access credit, creating a larger 'unbanked' portion of the economy, making it even harder for these people to get by. There is a fear that as the new, complicated rules take effect one of the unintended by-products is that more people will be forced into the unbanked or underbanked sector if credit rationing occurs.

There is also an element of future proofing within the changes, which allows regulators to declare certain types of credit arrangements a 'consumer credit contract' even if they are not captured by the current definition, but act in a similar way[18].

FOOTNOTE 18

The implications of the changes and the potential to regulate previously uncaptured credit contracts will be interesting to watch, to see how it effects lenders all across the system, especially with the Buy Now, Pay Later (BNPL) schemes that are currently not captured as a consumer credit contract.

There are still some in the industry that say this regulatory reform is still primarily aimed at existing or older business models and some newer players are exempt as they argue they are not lending despite offering effectively the same service albeit structured in a different way.

Another matter raised was the tension between a lender that scrapes bank statement data at the start of the loan potentially using that technique during the loan to identify possible issues and whether the ongoing use is a privacy breach.

Anti-Money Laundering and Countering Financing of Terrorism Act (AML/CFT)

While Anti-Money Laundering (AML) rules came into effect in 2013, and even earlier in Australia, significant issues are still being identified. Westpac (Australia) is the latest bank to be caught up in non-compliance with AML, with AUSTRAC having found more than 23 million alleged breaches. AUSTRAC has performed an in-depth investigation of Westpac's non-compliance and believes their oversight of banking and services provided through correspondent banking relationships was not sufficient to comply with the law. In addition, Westpac's programme to assess AML/CFT risks was also found to be deficient in the investigation. These deficiencies resulted in serious and systematic non-compliance stemming from issues with its corresponding banking relationships and International Fund Transfers[22].

FOOTNOTE 22

The RBNZ has been in contact with its Australian counterparts regarding Westpac's alleged breaches and will be looking closely at the findings to determine if there will be any relevance for Westpac New Zealand and indeed the whole industry here. However, in New Zealand, Westpac has stated the proceedings in Australia do not relate to its operations in New Zealand, which it states comply with New Zealand AML/CFT laws, and it will continue to engage with the RBNZ about their AML/CFT obligations[23].

FOOTNOTE 23

This situation follows on from issues found in CBA in 2018, where CBA was ultimately fined AUD$700 million, following serious breaches of AML/CFT laws uncovered last year.

The amount CBA was fined represents the largest ever civil penalty in Australian corporate history, to reflect the magnitude and seriousness of non-compliance; and to ensure the industry takes note that non-compliance with AML/CFT will not be tolerated[24].

FOOTNOTE 24

CBA was found to have breached the Australian AML/CFT on 53,750 separate occasions, primarily arising from issues related to Intelligent Deposit Machines and monitoring transactions for AML/CFT risks. Comparing the 53,750 breaches for CBA to the 23 million breaches for Westpac, and the resulting AUD$700 million fine for CBA, one does wonder what Westpac Australia's fine will end up being.

AUSTRAC undoubtedly sent out a strong message about the importance of AML, and consequences of poor compliance when they issued this fine. However, they also noted that they were pleased with the way that CBA handled the situation and worked collaboratively together to progress through these issues[25].

CBA's breaches prompted the RBNZ to question New Zealand banks over the use of smart ATMs, as part of regular ongoing work with the institutions it supervises. However, all of the New Zealand banks were confident that they were appropriately addressing money laundering risks, and ASB confirmed that they operate a different model of smart ATMs with different software to their parent, CBA[25].

FOOTNOTE 25

In addition, National Australia Bank, parent of BNZ, has stated in its annual report that it also has reported several compliance breaches relating to AML/CFT laws, and is working through them with the regulator. The issues identified included: specific weaknesses with the implementation of 'Know Your Customer', other financial crime risks, and system and process issues impacting certain aspects of transaction monitoring and reporting[26].

FOOTNOTE 26

Again, the RBNZ has also contacted all of the main banks in New Zealand with follow-up questions around detection and international payment systems and actions, as well as considering whether to take a closer look across the sector and be provided with additional assurance regarding compliance with AML/CFT laws[27]. The RBNZ is sending a clear message that breaches of AML/CFT laws is not acceptable and will not be tolerated here.

FOOTNOTE 27

Fintech

Fintech is seen in two quite different lights as either a vital piece of the banking puzzle, with most players in New Zealand acknowledging that not only is innovation important, but it is the key to providing meaningful services that consumers appreciate and value. Or alternatively, as challengers that will gradually erode the banks' dominance, attacking small parts of the banks' business and looking to take away a few clients at a time. One of the trends to emerge recently is that the customer mind set has a big impact and part to play in the space.

A 'traditional'/'Boomer' bank customer will have a 'main bank' with whom they have a transaction account, and they are cross sold into a debit or credit card, a mortgage and potentially sold investments and life insurance. These are all built around three things, brand recognition, customer loyalty and the difficulty to move accounts to another provider. Whereas a 'millennial thinking customer' will just use an app for each service they need, having little loyalty to any one provider and using the product that they see as best; with 'best' being defined by speed, ease of use and functionality.

The CoFR, made up of the RBNZ, FMA, Commerce Commission, MBIE and the Treasury, has announced that they will be focusing on improving legal parameters in 2020 to ensure the regulatory system facilitates innovation that is focused on positive consumer outcomes, as opposed to avoiding technological advancements[28].

FOOTNOTE 28

For a while, the main disruption in the banking industries were from the banks themselves, disrupting their own businesses and staying ahead of the game. This has been largely helped by strong barriers to entry into the industry, through both regulation, but also the public trust that the established banking sector has – trust being less about 'doing what is right for the customer' but trust that their information and money is secure. We are now beginning to see the signs of disruption from non-banking Fintech companies impacting the conventional layout of the banking system, albeit that it is yet early days[29]. The concept behind 'unbundling' has gained some momentum within the Fintech space in 2019. Unbundling allows consumers to spread their financial service needs across multiple players operating in the market rather than having a traditional bank servicing all of their financial needs[29].

FOOTNOTE 29

The ability to share data through technology has enabled unbundling to grow with new Fintech companies operating and serving a niche rather than providing a whole range of financial services. This is yet to have an impact on the 'mainstream' banking customers of New Zealand, especially compared to countries such as the UK which are quite progressed in the sense of 'challenger banks' and similar banking fintech apps. However, given we tend to lag the UK on many aspects of recent banking trends (such as conduct and culture), it is likely only a matter of time before we are impacted, especially given the likely ease at which a global disrupter could enter the New Zealand market with their overseas offerings, much like Uber did.

An example of one of these new Fintech companies is Transferwise. In the age of international travel, foreign exchange transactions are often made by many New Zealanders, with the fees and hidden charges associated with the international transfer of money coming more into the limelight. Transferwise's research found that Kiwis paid $5 billion in foreign exchange fees from 2013–2017[30], although there is a lack of education in regards to these charges for the average Kiwi due to New Zealand's generally low level of financial literacy, and there is a common acceptance that these types of fees are just the price to pay for transacting globally.

FOOTNOTE 30

However, with the number of foreign exchange transactions increasing and a rise in demand for quick and more affordable products, it would not be surprising to see growth in Fintech companies that are able to compete in the fee margins.

Globally, and to some but a lesser extent locally, banks are already encountering new competition from 'technology-centric banks', lenders, digital financial providers, electronic platforms and peer-to-peer lenders, each bringing a different offering of services through innovation to New Zealanders.

As noted above, the CoFR has set Fintech as a work priority for 2020[31], as it can assist in bringing about better outcomes for customers by offering new products and modern adaptions of current products that customers find value in, and we will see whether this work priority eventuates in a passive manner, such as not putting in new regulation to hamper Fintech, or in an active manner that actually puts regulations or frameworks in place to help foster and grow new Fintech innovations within the industry.

FOOTNOTE 31

Innovation and regulation

During 2019 Facebook announced its intention to release its own digital currency, Libra. With the concerns of other blockchain digital currencies in mind, Libra aims to minimise the volatility of price, which many other digital currencies experienced, by behaving like a currency rather than a commodity, without big transaction fees. Facebook throwing its considerable resources into cryptocurrency and blockchain is a strong indicator that they are expecting it to be an important part of the future financial system. One roadblock to Libra being fully embraced by the public is that a number of users do not trust Facebook with their data, and with data privacy becoming increasingly more important, this is an important hurdle they will have to overcome for it to be fully embraced as a currency and store of value for the mainstream public. However, if Facebook is able to establish trust through its onboarding of 27 founding members for Libra, including Visa, MasterCard, PayPal and eBay, it seems that there may be considerable corporate control over the global financial system[32].

FOOTNOTE 32

This is interesting in two different aspects. The first is that one of the criticisms of the current financial system is that there is centralised control of the system by a few people, being central banks. Is keeping the centralised control by a few people, but just shifting it from central banks to large corporates, really any better? The second is that the main attractiveness of blockchain digital currencies was the aspect of a decentralised ledger, that was not 'owned' or 'managed' by any party – a concept which may differ significantly for Libra.

One may ask whether Libra is just Facebook's version of 'Bitcoin'. While Libra is reliant on blockchain just like Bitcoin, it is different in that Libra has counterparty risk, as it is backed by stable investments (which act to minimise volatility of price and be a more solid proof towards the currency being a store of value), possibly making it a competitor to banks rather than other cryptocurrencies. If the launch of Libra is successful, a number of other big corporates will likely follow suit which could lead to mass adoption. Facebook will have a number of regulatory hurdles to jump through to bring Libra to the market, including overcoming several lobby groups which are trying to stop it, but it will undoubtedly be a space to watch[32].

FOOTNOTE 32

Looking closer to home, Trackback is a blockchain-based company which acts to allow customers to have trust in the authenticity of their purchases. In April the company successfully recorded all events along a manuka honey supply chain, right to its destination in China on the blockchain ledger. This enabled the Chinese consumer to have confidence over the authenticity, integrity and origin of the New Zealand manuka honey offered for sale[33]. Fintech has enabled Trackback to increase transparency and accountability in the supply chain, and it seems as though New Zealander's would welcome this type of accessibility to their banking.

FOOTNOTE 33

While innovation in relation to Fintech is undoubtedly an area of great opportunity, it is not without its threats and risks. Fintechs can fail for a number of reasons including underinvestment, system constraints, poor implementation and cyber-threats; and each of these vulnerabilities plays a role in reducing the potential benefit of technological innovation[34].

FOOTNOTE 34

One only has to look at Cryptopia, a Christchurch-based cryptocurrency exchange that was hacked, lost significant amounts of their own and customer money, and was subsequently placed into liquidation[35].

FOOTNOTE 35

In order for Fintech to be most impactful, consumers need to be at the heart of fast-moving technological advances to ensure that the best customer experience is the key outcome. With growing and evolving customer expectations, and ever-changing definitions of what a 'good customer outcome' is, the use and embracing of Fintech will likely be at the heart of not just staying relevant, but being at the forefront.

There is somewhat of a risk reward trade-off with a number of Fintech offerings, as the new products tend to be quick and easy to use, but they may not offer the same level of security as a traditional bank, and this includes the distributor ledger system. Whilst the system enables 'Mum and Dad' investors to trade in items such as Bitcoin it does not have a central point of control, so if things go wrong it is hard to correct. The finance industry is not used to having nowhere for the blame to land, and determining how to regulate this type of system is a difficult task[36].

FOOTNOTE 36

A common theme discussed amongst survey participants was the need for balance between innovation and regulation, BNPL being the most common example cited.

Many agree that innovation is the key to increasing efficiency and better consumer outcomes; however, it is vital to ensure that technology is appropriately regulated in order to protect both consumers and banks. A challenge for banks is regulation halting potential innovation, especially when compliance hurdles slow down customer service, causing customers to look elsewhere to fulfil their finance needs. However, more often than not these 'new business model' entities are not bound by the same level of regulation as the banks; and are able to offer a quicker, more streamline service, but one that does not involve the same level of protection for the consumer. It is probable that regulation will come as Fintech advances, but implementation of this regulation is time critical. Currently, the RBNZ has identified that protection of data and inadequate testing of Fintech apps will be key risks to Fintech development, but it does recognise that the benefits, such as customers being matched with the best interest rates available and all at their fingertips, is an enticing opportunity[37].

FOOTNOTE 37

BNPL

In last year's *FIPS Banks – Review of 2018*[38] publication, we considered high interest rates charged on credit cards could be an opportunity for disruption, and in 2019 we have seen the boom of the BNPL.

FOOTNOTE 38

BNPL seems to be directly competing mostly with credit cards and small personal loans, by offering consumers the ability to take home a product and pay for it in interest free instalments over a set period. The pressure of these digital disrupters is being felt by both the non-banks and banks, and we looked into the new trend as part of our *FIPS Non-banks – Review of 2019*. It's clear that customers love BNPL as a form of payment as it's cheap and convenient; and as it is not considered lending, responsible lending guidelines do not have to be applied.

BNPL avoids meeting the definition of a consumer credit contract due to the fact that no interest is being charged, and this is becoming somewhat of a point of contention.

There is motivation for service providers to apply caution when 'lending', as they do not want customers to default due to the relatively low returns earned from merchant fees if consumers make all required instalments. Defaults cost the company money in the lost principal lent. However, it is no secret that applying responsible lending criteria is expensive, and if they are forced to comply, the cost of doing this will need to be picked up by someone. Performing costly background checks means the providers will need to achieve high volumes in order to make a profit from the product offering and may also slow down the credit assessment process – one of the attractive aspects of the current iteration, although, if this isn't realistic, it's likely that the costs will be pushed onto the merchants or consumer. In this case, the merchant may determine that the costs outweigh the benefits and cease to offer BNPL, or if they are unable to absorb the cost and want to continue to offer BNPL the consumer may end up paying a premium for using the BNPL product – such as a monthly 'service' fee, similar to a credit card. It should be noted that some BNPL scheme operations do apply a responsible lending lens to their decision making.

BNPL is causing some grief for lenders who do need to comply with responsible lending principles, as customers seem to be prioritising BNPL payments so they can continue to use the service (as a default of a BNPL purchase may mean that the customer may not be able to use it for the next purchase). A typical issue seems to be occurring when a customer has a credit card with an acceptable limit within their credit capacity, but then they purchase goods using several BNPL products and paying off the BNPL instalments using their credit cards. When the customer is unable to keep up with their credit card payments, it starts to look like the credit card provider has been the one that hasn't lent responsibly.

While it is a difficult situation to manage, it is clear that the impacts of any regulation would need to be well thought through in order to preserve the value to the consumer and competition as an alternative financing option. If there are no regulatory changes on the horizon, then banks may be tempted to join the competition. ASB has already made a move by partnering with Klarna, Europe's biggest private Fintech firm and a BNPL provider[39]. The partnership is both an offensive and defensive move to become Klarna's exclusive partner in Australia and New Zealand.

FOOTNOTE 39

Open banking

Open banking, being a secure framework which gives consumers the ability to share their banking information with trusted third parties, has continued to gain momentum in 2019 in New Zealand, albeit at a slower rate than expected considering the potential benefits for consumers.

In May 2019, Payments NZ launched a collaborative Application Programming Interface (API) where banks can share resources and provide better products and services for their customers. Under the API Centre, the bank and a third party are required to set out their terms under a bilateral contract. One concern in this arrangement of a bilateral contract, as expressed by the Hon. Kris Faafoi, is that this could leave the banks with too much control due to their stronger bargaining position, with relatively fewer large banks compared to the number of third parties that will be looking to enter into these agreements[40].

FOOTNOTE 40

Whilst API development is a step in the right direction, there appears to be a lack of motivation for the banks to rush into implementing open banking. One obvious reason is that given the fact that they currently dominate the market, and effective and trusted open banking will reduce the friction of switching to competitors by empowering and enabling consumers to switch to other financial service providers more seamlessly, there is little incentive to push hard.

In New Zealand, there is currently no legislation or regulation for governing open banking, with open banking being industry led by the banking and payment industries, although encouraged by the Government[41].

FOOTNOTE 41

However, this has shown early signs of changing. In an open letter in December 2019, Hon. Kris Faafoi, confirmed his support of the open banking movement, but let the industry know that he would like it to progress more quickly, requesting that API Providers make open banking a priority. In this letter, he has also given them a timeline to be in a position to enter bilateral agreements with third parties within six months of the v2.0 *Payments Initiation and Account Information* standards release[42].

FOOTNOTE 42

Creating a 'Consumer Data Right' to enable consumers to have better control over their own data and to generally assist in the development of New Zealand's data economy is also a focus for Faafoi. This will be achieved by creating a legislative data sharing framework available to assist particular designated sectors that will not be forcibly implemented as UK and Australia have done, unless necessary and appropriate[43].

FOOTNOTE 43

As with other areas of Fintech, one of the areas that is critically important to it being effective long term, and being accepted by the public, is the on-going issue of data security. Consumer trust in the open banking system is critical as Kiwis tend to be cautious with their financial data in particular, and if there is considerable concern in this area, mainstream adoption may not be as near as some may think. Although it can be a time-consuming process, a quality functioning product with strong data security is essential to allow consumers to feel comfortable with their own financial data being used. Ensuring this data security may likely be one of the issues that is causing the current slow pace of change, on top of all of the other current issues that banks are facing.

Another key issue possibly impeding timely implementation is the importance of keeping customers at the centre of decisions especially in regard to letting the customer choose to end data sharing and the disposal of data at the end of a contract. To address these concerns, Payments NZ has issued a set of standards detailing how the API Centre should be used to ensure that data is secure and how those risks are managed[44].

FOOTNOTE 44

Looking overseas, the open banking movement in Europe, the UK and Australia was pushed through by governments rather than being industry driven; with Europe implementing open banking earliest, back in 2016. Since then, open banking has enabled three main functionalities for consumers: money management, lending and payments[45]. Consumers have been able to enjoy the simplicity and ease of dashboards containing all their bank accounts, investments and loan facilitates, allowing them to manage their money more conveniently[45].

FOOTNOTE 45

In regard to lending; open banking provides the consumer the ability to share their credit worthiness with lenders which both speeds up the process and assists in determining whether to provide finance. The payments process is also faster and cheaper, as customers are able to pay directly from their bank account, eliminating the need for a payment retailer. Open banking has allowed UK's largest online bank, Monzo, to flourish with over 3.5 million people that have open accounts with Monzo[46], while one in four UK citizens under 37 years of age are now using online-only banks.

FOOTNOTE 46

This again, highlights how customer action, by particular age or other sector groups could be the key driver of innovation. Incumbents could see their customer base change its behaviour to the new products that erode some of their dominance. With the popularity and demand for this type of banking increasing it is no surprise that Westpac Australia has recently announced plans to launch a similar bank[47]. However, there are currently no plans to expand it into New Zealand any-time soon, due to the smaller customer base and the apparent sense of customers being sufficiently content with current banking practices[47].

FOOTNOTE 47

Yolt, created by ING Bank, is a different kind of financial service provider enabled by open banking, which earns commission from banking partners when a customer swaps to their services[48]. Yolt's app offers customers a 'one view' approach to their banking and features a tracking and budgeting tool, which provides great value to customers. The app also takes the hassle out of transferring money to friends and family, essentially taking care of some of the more headache-inducing aspects of banking. Since launching in the UK less than 18 months ago, Yolt already has registered over 500,000 users[48], and is a fantastic example of what open banking could eventually look like in New Zealand.

FOOTNOTE 48

Confidence and interest rates

Business confidence seems to have increased towards the end of 2019 after a prolonged period of low levels, along with the global outlook also improving as the US China trade war appears to progress closer to agreement, after months of rhetoric[49].

FOOTNOTE 49

Our *2019 KPMG New Zealand CEO Outlook Report* (the Report) showed that over 90% of CEOs are confident in their organisation's ability to grow, but the majority expect revenue growth of less than 2% over the next three years. In the Report, participants agreed that a pessimistic mind-set must be questioned in order to avoid talking ourselves into a slowdown[50].

FOOTNOTE 50

The ANZ Business Confidence Index also reflects that confidence has improved, especially in recent months, rising to 13.2 in December 2019; a level not seen since 2017. This is up from 26.4 in the previous month, which is a large increase, but still means a net 13.2% of respondents expect general economic conditions to deteriorate in the year ahead[51].

FOOTNOTE 51

Sharon Zollner, ANZ Chief Economist, acknowledges that lower interest rates are affecting New Zealand in a positive way, and our strong commodity prices are enabling the economy to grow in a world of political turmoil[52].

FOOTNOTE 52

However, 2019 started with low confidence and there has actually been a slowdown within the domestic economy. Some indicators estimate that GDP growth may only be about 1%[49], while inflation has remained between the RBNZ's target of 1-3%[53].

FOOTNOTE 49

FOOTNOTE 53

In an effort to aid GDP growth, RBNZ Governor, Adrian Orr, announced Official Cash Rate (OCR) cuts during the year. For the first time after almost three years of a stable OCR, a 25 basis points (bps) cut in the OCR was announced in May 2019. Consequently, this resulted in falling interest rates as banks had access to cheaper funding and passed this on to customers through lower lending rates.

VIEW FIGURE 3

In August 2019, the RBNZ caught almost everyone off guard when it put through a 'double' drop in OCR of 50 bps to 1.00%, driven by slower economy growth and headwinds emerging[54]. In theory, lower interest rates should stimulate spending as there is less incentives for consumers to save whilst borrowing is cheaper.

FOOTNOTE 54

However, this doesn't appear to be what the market took from this cut, at least initially. What many read from this cut was that things must be worse than they thought it was, as rates were being cut so much. This put people on notice and cause them to act with caution, with many appearing to adopt a 'wait and see' mentality to see what would happen with the economy. It also seemed to unintentionally start a mortgage war, just after house prices had stabilised. Of late, there has been some signs of a more positive outlook.

One common theme noted among survey participants is that while full employment and low interest rates all help the economy there is a very real need for Government leadership in the growth area. Many survey participants felt that the Government has a large infrastructure programme, but it has been very slow to get it underway. The recent infrastructure announcement by the Coalition government showed the nature of work that needs doing in the medium to long term.

Mortgage wars

The RBNZ cutting the OCR in August 2019 by 50 bps appears to have given the banks more wiggle room in their margins to again drop mortgage rates and compete on price to seek volume. This resulted in sparking a mini 'mortgage war', which must have surely been an unintended consequence of the drop.

Banks have acknowledged that customers are price conscious and in a time when consumer loyalty is low, an attractively priced mortgage rate is often what is required to grow mortgage books[55]. Some of the benefits will also flow to existing home loan customers with floating loans who can now pay off their debt faster[56] and customers with other debts, such as car loans, that are added to the mortgage as lower interest rates mean they can now borrow more money, but keep their repayments the same.

FOOTNOTE 55

FOOTNOTE 56

ASB was the first bank to slash interest rates; passing the full 50 bps OCR drop on to customers[57]. Kiwibank offered the most remarkable rate of 3.55% for a one-year fixed rate and 3.65% for a two-year fixed rate[58]. This was a cut of 24 bps and 14 bps respectively, effectively becoming the most competitive rate for both one and two-year fixed-term mortgage rates amongst the major banks. But they didn't stop there, dropping their rates once again to a record low of 3.39% for a one-year fixed rate in November[59].

FOOTNOTE 57

FOOTNOTE 58

FOOTNOTE 59

The historically low interest rates mean that it is an undeniably good time to have a mortgage, but it is unclear how long these rates will stay so low. Mortgage holders need to be prepared to adjust to higher repayments values when interest rates rise[60]. Additionally, there is the general expectation that the increased capital requirements will put upwards pressure on interest rates as banks look to increase capital reserves[60]. In a time when the housing market is still elevated, a small increase in mortgage rates may just be the right sized stone to crack the ice, although the intense mortgage wars do provide a slight buffer in preventing increasing interest rates slowing the housing market. It will also be interesting to see what tools the RBNZ might choose to look at if house prices and the market heat up again.

FOOTNOTE 60

Timeline of events[61]

FOOTNOTE 61

Jan. 2019

17th
Paymark's shareholders, ANZ, ASB, BNZ and Westpac, agreed to sell the electronic payments processor to Ingenico Group for $190 million.

18th
Westpac became a platinum sponsor for the Rainbow Excellence Awards which helps acknowledge employers who value inclusion and welcome diversity of LGBTQI+ people in the workplace.

Feb. 2019

1st
BNZ announced plans to create a new division bringing together Business and Consumer banking in a move to build on their strengths and offer better customer service.

BNZ announced the appointment of Paul Carter as new Chief Customer Officer (CCO) – Partners and Consumer, Christine Yates as new CCO – Private, Wealth and Insurance and Penny Ford as new CCO – Corporate and Institutional.

Westpac became the first bank in New Zealand to be accredited as a Living Wage Employer by the Living Wage Movement Aotearoa NZ.

Mar. 2019

4th
Dame Jenny Shipley stepped down from the board of China Construction Bank New Zealand after she and other directors were found liable for reckless behaviour under the Mainzeal court case.

14th
Westpac introduced a home loan option called Westpac Prebuilt which encourages Kiwis to get into prefabricated homes. The product aims to address the housing shortage and lack of affordable construction options in New Zealand.

25th
Westpac announced the appointment of Pip Greenwood to the board as an independent non-executive director.

Apr. 2019

10th
The Government announced it will give the Commerce Commission more resources to help with regulating lenders.

12th
Supreme Court authorised the disclosure of ANZ Banking information to liquidators of Ross Asset Management.

13th
New Zealand blockchain company, TrackBack, developed a system which fights back against counterfeiting by verifying that products received by a customer were the same ones shipped out by the warehouse.

May 2019

10th
ASB announced that Scott Bartlett is to join ASB's board from 3 June but will remain CEO for Kordia Group.

23rd
Kiwibank, The Co-operative Bank, SBS Bank and TSB Bank question whether the change in capital requirements will result in the unintended consequence of widening the gap between large and small banks, as opposed to flattening the 'playing field'.

25th
Hon. Kris Faafoi, revealed that he wants to see all major banks working with third parties to give industry-led open banking a chance to succeed.

29th
The RBNZ publishes *Financial Stability Report* dealing with the effects of capital buffers, high levels of debt for households and farms, and conduct and culture being critical to success.

Jun. 2019

17th
ANZ announced the departure of their CEO, David Hisco, following internal procedures uncovering his use of company funds for chauffeur-driven cars and wine storage.

The RBNZ announced that ANZ will no longer be allowed to calculate their own capital requirements for operational risk due to the bank's failure of appropriate controls.

19th
Westpac issued green bonds and raised $860 million from European investors for reinvesting into sustainable projects and climate change solutions in New Zealand.

Jul. 2019

21st
Hon. Kris Faafoi, Minister of Commerce and Consumer Affairs, announced that KiwiSaver will allow people with shortened life expectancy to withdraw their savings at the time of their retirement.

Aug. 2019

6th
Westpac refunds $7 million to customers after self-reported misapplications of discounts and relationship awards.

7th
The RBNZ cuts its Official Cash Rate (OCR) from 1.5% to 1.0%.

29th
Bruce Weir was appointed as Rabobank's new General Manager – Country Banking.

Sep. 2019

18th
Westpac's 2019 Gender Pay Analysis reveals that the bank had an overall pay gap of 30.3%.

19th
ANZ, ASB, BNZ, Kiwibank and Westpac announced that they will be involved in a 2020 trial for regional bank hubs in Nelson. The hubs facilitate functions such as basic transactional services, online banking and Smart ATM.

25th
Hon. Kris Faafoi announced that new laws and large fines will be introduced to make sure banks and insurers treat their customers fairly.

27th
Tony Alexander announced his resignation after 26 years serving as BNZ's Chief Economist.

Oct. 2019

30th
An RBNZ survey found that nine out of ten New Zealanders prefer to pay without using cash, as part of their review into the role of cash in the New Zealand economy.

31st
Ministry of Business Innovation and Employment and the Ministry for the Environment proposed a new law requiring annual reports by financial firms and major listed companies to discuss climate-related financial risks.

Nov. 2019

4th
Westpac retains their accreditation as an internal models bank after being required by the RBNZ to remedy their concerns regarding compliance and internal models obligations.

7th
BNZ increased annual leave for 5,000 staff from the minimum term of four weeks to six weeks, designed to boost staff wellbeing.

8th
After three years as Kiwibank chair, Dr Susan Macken announced that she will not seek reappointment. Former deputy chair of ASB Bank, Jon Hartley, was announced as the incoming chairman.

14th
The RBNZ announced that Assistant Governor, Lindsay Jenkin, will be leaving after one year in the role.

18th
Dr Murray Horn was appointed to chair the China Construction Bank (New Zealand) Limited after six years of experience on the board of China Construction Bank Corporation (Beijing).

19th
The RBNZ increased BNZ's operational risk capital requirements as a result of BNZ identifying errors in their capital calculations, but were not in breach at any time.

26th
Westpac NZ advised that it is not associated to its Australian parents anti-money laundering issues that resulted in Westpac Group's CEO stepping down.

Dec. 2019

5th
Final decisions regarding new capital requirements were made by the RBNZ; banks were given seven years to implement the changes, instead of the expected five years.

12th
The Credit Contracts Legislation Amendment Bill, which targets loan sharks, passed its third reading in Parliament.

18th
The Government announced that it will introduce deposit insurance of a maximum of $50,000 per financial institution for each bank depositor.

Antonia Watson was appointed CEO of ANZ.

20th
Hon. Kris Faafoi gives banks a timeline to speed up the introduction of open banking.

Jan. 2020

7th
ANZ removed international transfer fees for Kiwis making donations to support the victims of the Australian bushfires.

15th
Westpac NZ agreed to issue a $50 million loan to Contact Energy at a discounted interest rate if it meets agreed targets for a range of environmental, social and governance (ESG) targets.

Sector performance

As in previous years, our analysis of bank performance is at the top level entity's consolidated results. For banks that are dual registered with a local bank and branch structure, the results analysed are at a New Zealand banking group level. The results only include operations within the banking group, so any operations within the wider group, but outside of the registered banking group, such as with Kiwibank and Heartland, have not been included.

Now that Bank of China New Zealand (BoC) Branch and China Construction Bank New Zealand (CCB) Branch are included in this year's survey, we will be presenting the top level entity's consolidated results – the New Zealand banking group – for both. As the first set of financial statements for these banking groups (with a significant period of operations included in the results) was for the period ended 31 December 2018, which are the results included in this survey, the respective New Zealand locally incorporated bank's figures will be used as comparatives for each.

The total net profit after tax (NPAT) for the New Zealand banking sector has remained relatively unchanged in 2019.

Net profit after tax

The total net profit after tax (NPAT) for the New Zealand banking sector has remained relatively unchanged in 2019, seeing a drop of just 0.99% from $5.77 billion in 2018 to $5.71 billion in 2019. This is, however, a significant change of pace to the growth experienced in 2017 and 2018 where NPAT increased by 7.35% and 11.21% respectively. Despite a relatively strong economy and reasonable growth in net interest income, a decrease in non-interest income, an increase in operating expenses and impaired asset expenses have overshadowed the top line increases and prevented them from positively impacting the bottom line.

VIEW FIGURE 4

Net interest income increased by 4.79% ($497.04 million) whilst non-interest income decreased by 3.99% ($129.89 million).

Operating expenses (including amortisation) have increased by $359.93 million; a significant movement of 6.70% which is more than double 2018's increase of 3.02%. On top of this, there was a significant increase in impaired asset expense, rising 51.48% ($132.80 million) to reach $390.75 million, with four major banks except Westpac experiencing increases in impairment losses in 2019. This is still off a relatively low base, but continuing the trend seen in 2018 which had an increase of 45.19% ($80.28) from 2017.

From the five major banks, only ASB and Westpac were able to end the financial year with an increase in NPAT, seeing increases of $75 million (6.65%) and $12 million (1.07%) respectively, while ANZ had the largest decrease in NPAT with a decrease of $161 million (8.11%).

Of the other major five, BNZ and Kiwibank both saw decreases of $7 million each, a relatively stable 0.68% for BNZ, and a 6.09% movement for Kiwibank due to their smaller base of NPAT.

Looking at the overall banking sector, the largest increases in NPAT in percentage terms were from BoC and Industrial and Commercial Bank of China (ICBC), who both reported losses last year, but managed to increase their profits by 1,000% ($6.93 million) and 714.26% ($8.56 million), respectively. The prior result for both including a significant credit provision in relation to CBL Insurance Limited.

A snapshot of the financial performance of the banking sector was as follows:

- net interest income increased by $497.04 million (4.79%) to $10.87 billion;
- non-interest income dropped by $129.89 million (3.99%) to $3.12 billion;
- operating expenses (including amortisation expenses) rose by $359.93 million (6.70%) to $5.73 billion;
- impaired asset expense increased by $132.80 million (51.48%) to $390.75 million; and
- tax expense declined by 3.08% ($0.68 million) to $2.16 billion.

See Tables 2 and 3 on page 23.

There was a slight dip in net interest margin for the banking sector.

TABLE 2: REGISTERED BANKS – PERFORMANCE TRENDS						
Year	**Increase in total assets**	**Increase in net profit after tax**	**Net profit after tax/Average total assets**	**Interest margin**	**Operating expenses/ Operating income**	**Impaired asset expense/ Average gross loans & advances**
2019	7.67%	-0.99%	1.04%	2.10%	38.41%	0.09%
2018	5.07%	11.21%	1.12%	2.12%	37.95%	0.06%
2017	1.42%	7.35%	1.04%	2.08%	39.61%	0.04%
2016	6.35%	-6.58%	1.00%	2.17%	39.25%	0.12%
2015	10.20%	6.94%	1.16%	2.28%	37.32%	0.12%
2014	5.28%	20.41%	1.17%	2.24%	39.44%	0.08%

TABLE 3: REGISTERED BANKS – ANALYSIS OF PERFORMANCE OF BANKS	New Zealand incorporated banks		New Zealand branch banks		All banks	
	2019	2018	2019	2018	2019	2018
Increase in total tangible assets	6.71%	4.72%	9.07%	21.41%	7.67%	5.07%
Increase in operating income	2.66%	7.92%	10.45%	6.01%	2.69%	8.13%
Increase in net profit after tax	-0.24%	10.35%	11.84%	4.73%	-0.99%	11.21%
Increase in gross loans and advances	5.46%	6.40%	7.55%	20.85%	5.37%	6.03%
Net profit after tax/Average total tangible assets	1.07%	1.13%	0.71%	0.73%	1.04%	1.12%
Net profit after tax/Average equity	12.99%	13.74%	27.34%	25.75%	13.52%	14.88%
Net interest income/Average total tangible assets	2.08%	2.10%	0.95%	1.11%	1.98%	2.01%
Non-interest income/Average total tangible assets	0.54%	0.60%	0.77%	0.68%	0.57%	0.63%
Operating expenses/Average total tangible assets	1.01%	1.03%	0.74%	0.76%	0.98%	1.00%
Operating expenses/Operating income	38.63%	38.23%	43.05%	42.48%	38.41%	37.95%
Impaired asset expense/Average gross loans and advances	0.09%	0.07%	0.00%	0.04%	0.09%	0.06%
Collective provision/Net loans and advances	0.39%	0.37%	0.04%	0.02%	0.38%	0.36%
Total provision for doubtful debts/Gross loans and advances	0.48%	0.46%	0.05%	0.07%	0.47%	0.44%

Net interest margin

There was a slight dip in net interest margin (NIM) for the banking sector, dropping 2 basis points (bps) from 2.12% to 2.10% in 2019, despite the Reserve Bank of New Zealand (RBNZ)'s Official Cash Rate (OCR) cuts. Net interest income increased by 4.79% ($497.04 million), while interest earning assets grew at a proportionately higher rate of 6.31% ($31.71 billion), leading to the small decrease in NIM. Almost half of the survey participants saw decreases in their NIM, with flat or relatively smaller increases in NIM, these were offset by larger average decreases in NIM, leading to an overall small dip in NIM for the sector.

See Table 4 on page 24.

Among the major banks, NIM was fairly flat, with NIM in 2019 ranging between 2.16% (BNZ) and 2.01% (ASB). Kiwibank experienced the largest change, increasing by 6 bps to 2.11%, while ANZ saw the next largest change, decreasing by 4 bps to 2.14%.

The major banks all saw an increase in interest earning assets.

The major banks all saw an increase in interest earning assets, with Kiwibank again taking the lead on a percentage basis, increasing by 10.00% to $22.08 billion. The majority of the smaller banks also saw increases in interest earning assets, but JPMorgan and Bank of India saw the largest decreases of the non-major banks on a percentage basis, declining by 13.58% ($163.76 million) and 12.73% ($12.81 million), respectively.

TABLE 4: MOVEMENT IN INTEREST MARGIN	2019	2018	Movement
Entity	**%**	**%**	**(bps)**
Australia and New Zealand Banking Group Limited – New Zealand Banking Group	2.14%	2.18%	-4
Bank of Baroda (New Zealand) Limited	2.66%	2.89%	-23
Bank of China (New Zealand) Banking Group	1.57%	n/a	49
Bank of China (New Zealand) Limited	n/a	1.08%	
Bank of India (New Zealand) Limited	3.83%	2.96%	87
Bank of New Zealand	2.16%	2.15%	1
China Construction Bank (New Zealand) Banking Group	1.52%	n/a	-31
China Construction Bank (New Zealand) Limited	n/a	1.83%	
Citibank, N.A. New Zealand Branch	0.92%	1.39%	-47
Commonwealth Bank of Australia New Zealand Banking Group	2.01%	2.02%	-1
Heartland Bank Limited	4.20%	4.44%	-24
Industrial and Commercial Bank of China (New Zealand) Limited	1.93%	1.81%	12
JPMorgan Chase Bank, N.A. New Zealand Branch	0.80%	0.89%	-9
Kiwibank Limited	2.11%	2.05%	6
Kookmin Bank Auckland Branch	1.79%	1.52%	27
MUFG Bank, Ltd. Auckland Branch	0.51%	0.46%	5
Rabobank Nederland New Zealand Banking Group	2.25%	2.25%	0
SBS Bank	2.56%	2.56%	0
The Co-operative Bank	2.35%	2.27%	8
The Hongkong and Shanghai Banking Corporation Limited – New Zealand Branch	1.38%	1.57%	-19
TSB Bank Limited	1.83%	1.80%	3
Westpac Banking Corporation – New Zealand Division	2.12%	2.11%	1
Sector average	**2.10%**	**2.12%**	**-2**

n/a = not available

To support asset growth, 17 of the survey participants experienced increases in interest bearing liabilities, with an overall increase of 5.65% ($24.84 billion), reflecting the large influx of cash that the banks have had, enabling them to lower deposit rates in order to retain NIM while in the process of lowering lending rates.

Of the non-major banks, Citibank saw the largest decrease in NIM down 47 bps (to 0.92%), with growth in their loan books outstripping their growth in net interest income; however, Citibank's NIM and loan movements will partly be affected by Citibank's core business being less of a traditional lending bank compared to others in the sector.

Bank of India saw the largest increase in their NIM during the period, up 87 bps. Part of their large drop in interest earning assets may be driven by the timing of this decrease in NIM during the period. Bank of China also had a strong increase in NIM, up 49 bps to 1.57%.

Heartland remained at the top of the pack with the highest NIM of 4.20% despite a 24 bps decline when compared to 2018; and they are clearly continuing to leverage their market niche, albeit at a slightly reduced rate. Bank of India now sits second in NIM after their large increase.

On the other end of the scale MUFG remains the lowest at just 0.51% after a 5 bps rise in 2019, followed by JPMorgan on 0.80%, after a 9 bps decrease from 2018, together they are the only banks with a NIM under 1%, other than Citibank.

Over the year, there was a 3.99% ($129.89 million) drop in non-interest income to $3.12 billion.

TABLE 5: REGISTERED BANKS: NON-PERFORMING LOANS[62]	2016	2017	2018	2019
Past due assets/Gross loans and advances	0.13%	0.14%	0.13%	0.17%
Gross impaired assets/Gross loans and advances	0.37%	0.33%	0.37%	0.38%
Total	**0.50%**	**0.47%**	**0.50%**	**0.55%**

FOOTNOTE 62

Non-interest income

Over the year, there was a 3.99% ($129.89 million) drop in non-interest income to $3.12 billion, with 12 out of 20 survey participants reporting decreases. This is always a volatile area as it includes a wide range of factors that impact it, such as derivatives trading, fee and commission income, and other sources such as insurance receipts and gains on sales of associates. ANZ primarily drove this decline, reporting the largest dollar decrease of $177 million (15.49%) down to $966 million, but Kiwibank saw the largest decrease in percentage terms, dropping by 27.34% ($35 million), after reductions in fee and transaction income. Some of the decline was offset by ASB's increase in non-interest income of 20.78%, or $123 million, being the only major bank to grow their non-interest income, partially driven by a gain on the sale of Paymark. This sale of Paymark will have increased non-interest income of all four of the major banks, being ANZ, ASB, BNZ and Westpac.

CCB and TSB recorded the largest percentage decreases in non-interest income of 57.55% ($1.59 million) and 34.97% ($12.77 million) respectively. The disclosure statements showed CCB's decrease was partially due to a rise in loss on derivatives and losses on financial assets, whilst TSB's decrease was primarily due to a reduction in gains from fair value movements. In contrast, ICBC saw another year of strong growth in non-interest income, with the largest percentage increase of all the survey participants, rising by 68.54% ($0.71 million) to $1.74 million.

Total assets for the banking sector saw another year of growth, rising from $529.76 billion in 2018 to $570.39 billion in 2019.

Total assets and gross loans and advances

Total assets for the banking sector saw another year of growth, rising from $529.76 billion in 2018 to $570.39 billion in 2019. The 7.67% increase is up from last year's 5.07% growth, reflecting a strong economy that has enabled the banking industry to continue to grow lending, and lower lending rates allowing borrowers to service more debt. Many of the banks were able to utilise these factors to grow their assets, with 17 reporting increases.

See Table 5 on page 25.

VIEW FIGURE 5

While the major five banks account for 90% of total assets within the sector, and make up $36.12 billion of the overall growth in total assets, CCB and BoC saw the largest percentage increases in total assets, up 41.10% to $2.58 billion and 37.26% to $2.29 billion respectively. Natural growth will have driven some of this movement, but it may also be influenced by the introduction of the new banking groups in 2019, as opposed to purely their New Zealand subsidiaries used in 2018, with the lower capital constraints on lending in the branch compared to the locally registered bank. MUFG Bank and ICBC also saw significant growth in their total assets, with increases of 32.69% ($1.33 billion), and 28.51% ($473.78 million) respectively.

VIEW FIGURE 6

Gross loans and advances for the banking sector grew by 5.37% ($23.57 billion) in 2019, with 16 of the 20 top level consolidated entities seeing increases in their loan books, including all the five major banks. Excluding the major banks, the other banks saw greater percentage growth in their loan books, achieving a combined increase of 7.43% ($3.25 billion). Despite the proportionately larger loan book growth, the non-major banks have only been able to slightly chip into more of the overall market share; growing their collective share of the gross loans in the sector to 9.47% (from 9.23%), with the major banks seeing a corresponding slight dip in the significant market share, from 90.77% in 2018 to 90.53% in 2019.

VIEW FIGURE 7

Of the five major banks, who dominate the market share of gross loans and advances, Kiwibank had the strongest rate of growth at 11.68% (up $2.14 billion), up from relatively modest growth of 2.72% ($485 million) in 2018. On the other side, ANZ had the lowest growth of the five major banks in percentage terms, up 3.54%.

Looking at absolute growth, BNZ saw the biggest increase of $5.04 billion, followed by ASB ($4.79 billion), ANZ ($4.57 billion), Westpac ($3.76 billion) and then Kiwibank ($2.14 billion).

Of the non-major banks, JPMorgan saw the largest rate of growth in their loan book of 65.14% ($84.73 million) to $214.80 million, while Citibank reported the largest rate of decrease of 32.63% ($292.26 million) to $603.36 million. Kookmin, BoC, ICBC, and MUFG also achieved notable expansions in their loan books, reporting increases of 35.84% ($77.97 million), 35.18% ($501.94 million), 33.80% ($434.66 million), and 32.41% ($1.15 billion), respectively.

ANZ saw the largest change in market share of gross loans and advances of all the survey participants, decreasing by 51 bps to 28.92%, although remaining the largest of the banks by market share. Some of this market share was picked up by Kiwibank, who achieved the largest growth in market share of 25 bps to 4.43%. Westpac also lost some market share dropping 13 bps to 18.37%, while BNZ grew theirs by 12 bps to 19.18%.

Rabobank maintained its leading position as the largest non-major bank, gaining an additional 6 bps to reach a market share of 2.63% in 2019. MUFG achieved the largest growth of the non-major banks, increasing by 21 bps to 1.01%, while Heartland lost the most market share of the non-major banks, decreasing by 13 bps to 0.79%.

The banking sector has again reported their lowest ever funding costs.

Funding costs

For the third consecutive year, the banking sector has again reported their lowest ever funding costs (interest expense as a ratio of average interest-bearing liabilities). In 2019, funding costs dropped to 2.59%, a decrease of 11 bps from the previous year, to a new record low for the banks. The overall movement was partially due to interest expenses increasing by 0.96% ($110.93 million), which was significantly less than the 5.65% ($24.84 billion) increase in interest bearing liabilities. The reduced funding costs are likely assisted by both a lower OCR as well as lower yields globally as a significant amount of cash looking for yield worldwide continues to allow rates to decrease.

VIEW FIGURE 8

Four of the five major banks saw decreases in funding costs, while Kiwibank's rate remained unchanged at 2.78%, now the highest of the major banks, following ASB's 11 bps decline to 2.76% (who previously had the highest of the five major banks). ANZ and Westpac both reported the largest decrease out of the major banks, a 14 bps drop in funding costs for each bank to 2.51% and 2.65%, respectively. This gives ANZ the lowest funding costs among the major banks for 2019, edging out BNZ by just 1 bps, who saw a 10 bps decrease to 2.52%.

Looking at all of the non-major banks, Bank of India reported the largest decrease in funding costs this period, dropping by 122 bps to 3.53%. Despite the large decrease they still have the second highest rate behind BoC, who has the largest increase in funding costs rising 184 bps to 3.60%. On the other hand, JPMorgan has maintained the lowest funding costs of the banking sector, despite having a 33 bps increase in their rate, up from 1.14% to 1.48% in 2019.

Impaired asset expense saw a significant increase in 2019.

Asset quality

Impaired asset expense saw a significant increase in 2019, rising $132.80 million (51.48%) to $390.75 million. Unsurprisingly, the increase was mainly driven by the five major banks, with four of the major banks seeing large increases. On a percentage increase basis, Kiwibank saw the largest increase of 1,100.00%, from $1.00 million to $12.00 million, while ASB had the largest dollar value movement of $52.00 million (96.30%). Westpac was the only major bank to reduce their impaired asset expense, decreasing by $7.00 million (233.33%) off the back of a $3.00 million recovery in 2018, to bring their impaired asset expense further into a net recovery position.

Impaired asset expense as a percentage of gross loans and advances (GLA) increased by 3 bps to 0.09%, albeit still remaining at a low level compared to historical figures. Total provisions as a percentage of GLA has also seen a small increase, rising 3 bps to 0.47%, while specific and collective provisioning have seen larger increases at $43.80 million (10.57%) and $167.21 million (10.62%), respectively – showing that a lot of the growth in provisions are driven by the growth in loans and advances of 5.37%. The increases in both collective and specific provisions resulted in total provisions increasing by 10.85% ($211 million). The slight worsening of asset quality amongst the banking sector is partly due to the adoption of NZ IFRS 9 *Financial Instruments*, coupled with an arguable peak in the credit cycle within New Zealand.

Looking at specific provisions, BNZ increased their specific provision by the largest dollar amount of the banking sector and saw the largest percentage increase among the major banks, rising $52 million (33.12%) to $157 million. ASB also saw a large increase of $20 million (28.99%), while the remaining major banks each achieved considerable decreases. HSBC achieved a significant decrease in their specific provisions, dropping 377.75% from $4.51 million to $0.94 million, but interestingly saw the largest increase in collective provision of the non-major banks, rising 176.47% ($2.26 million) – but with a net decrease in provisions as a proportion of GLA from 0.13% to 0.11%.

Looking at collective provisions, the two Indian Banks, were the only two banks to decrease their collective provisions, seeing decreases of 40.73% for Bank of Baroda (to $0.15 million) and 16.42% for Bank of India (to $0.05 million). While Bank of India also saw a decrease in GLA, it still managed to maintain its provision as a proportion of GLA, remaining at 0.37%. Of the five major banks, ASB increased their collective provision by 34.50% ($89 million), the largest contributor to the overall upward movement in this provision, and largest movement in both percentage and absolute dollar terms of the major banks. Of the non-major banks, several banks saw significant increases in their collective provision, led by CCB (up $4.41 million: 268.39%), HSBC (up $2.26 million: 176.47%), Heartland Bank (up $30.02 million: 145.71%), BoC (up $4.43 million: 145.44%). Much of this is likely to be driven by both strong growth in underlying loans and advances, and the impact of the adoption of NZ IFRS 9 – possibly masking some true deterioration in the experience within the loan books.

Gross impaired assets followed the same trend as provisions, increasing by 8.91% ($143.19 million), with BNZ seeing the largest increase of all the registered banks, rising by a massive 146.4% ($388 million). Past due but not impaired assets for the banking sector increased by 31.51% from $585.97 million to $770.63 million; a significant increase and off the back of a 1.97% drop in 2018 and 14.15% increase in 2017. Some banks do not disclose this information in their disclosure statements, but given the fact that the five major banks disclose this, in addition to various other banks, this still gives a good overall view for the sector. Four of the major banks recorded increases in their past due but not impaired assets, with ASB being the exception, decreasing by $7 million to $95 million. ANZ's past due but not impaired assets was the largest of the banking sector increasing by a significant 51.13%, or $113 million, to $334 million and Heartland saw a similar level of increase, rising 55.06% ($15.79 million) to $44.45 million.

VIEW FIGURE 9

Last year's FIPS publication considered the sentiment that the credit cycle was as good as it could get, and this year it appears we may have seen this materialise through a slight decline in credit quality. It will be interesting to see if much of this decrease is due to the implementation of new accounting standards in 2019, or early indications of a more fundamental turn in the credit cycle.

Over the year, the cost to income ratio increased by 46 bps.

Operating expenses

Over the year, the cost to income ratio increased by 46 bps from 37.95% to 38.41%. The banking sector saw a slight increase in operating income of 2.69% ($366.99 million), partly driven by the increase in net interest income of 4.79% ($497.04 million). However, the sector also faced an overall decrease in non-interest income of 3.99% ($129.90 million), and coupled with the increase in operating expenses (excluding amortisation) of 3.93% (to $5.37 billion), drives the increase in the cost to income ratio.

VIEW FIGURE 10

BNZ reduced their cost to income ratio by 335 bps (from 38.18% to 34.83%), driven by operating income growing by $100 million (3.91%) compared to operating expenses (excluding amortisation) decreasing by $51 million (5.23%). Conversely, ANZ saw the largest increase in its cost to income ratio of 321 bps (to 38.33%), due to a 2.82% ($122 million) decrease in operating income and an increase of 6.06% ($92 million) in operating expenses (excluding amortisation). A large increase in expenses was observed in the last quarter of ANZ's financial year, rising by 29.34%, with the overall increase in expenses being attributed to remediation costs and the increased regulatory requirements introduced in 2019[63].

FOOTNOTE 63

Of the non-major banks, ICBC experienced the largest decrease in the cost to income ratio, dropping a massive 1,821 bps (to 44.93%), as they were able to achieve a 65.33% ($15.03 million) rise in operating income, while only increasing operating expenses (excluding amortisation) by 17.65% ($2.56 million).

TABLE 6: MAJOR BANKS – PERSONNEL COST

Entity	2019			2018		
	Employee numbers	Personnel cost $Million	Cost/ average employees $000's	Employee numbers	Personnel cost $Million	Cost/ average employees $000's
ANZ	7,114	922	127	7,374	891	119
BNZ	4,503	521	113	4,703	537	113
CBA	5,229	552	111	4,961	537	110
Kiwibank	1,449	161	110	1,491	153	103
Westpac	4,105	523	127	4,124	484	114

Only two of the major banks achieved decreases in their operating expenses (excluding amortisation), being BNZ and Kiwibank, decreasing by 5.23% ($51 million) and 2.51% ($9 million), respectively. Interestingly, BNZ's decrease was not coupled with a decrease in operating income, but they did report a significant amortisation of goodwill and other intangibles of $141 million (204.35%). This increase was a result of a change in their software capitalisation policies, applied on both current and future software balances, and explains why BNZ saw such a large increase in operating expenses (including amortisation) in the last quarter of their financial year, rising by 53.55% from the previous quarter.

ASB saw the largest increase in operating expenses (excluding amortisation) in percentage terms of the major banks, rising by 10.41% over the period, while MUFG saw the largest increase of the banking sector, almost doubling from their 2018 result of $5.40 million to $10.70 million.

Personnel expenses rose by 3.01% ($86.64 million), a key contributor to the increase in operating expenses. BoC and CCB saw the largest increases in personnel expenses this year at an increase of 27.17% ($2.54 million) and 40.26% ($2.83 million), respectively, while JPMorgan saw the largest decrease in staff costs, decreasing by 31.06% to $1.35 million.

See Table 6 on page 28.

Of the major banks, BNZ was the only bank that decreased their personnel expenses from $537 million to $521 million (2.98%), while Westpac had the largest increase of 8.06% ($39 million), followed by Kiwibank with a 5.23% increase ($8 million).

Return on equity/Return on assets

The Return on Equity ratio (ROE) for the banking sector dipped in 2019, down 136 bps to 13.52%; due to NPAT remaining flat after many years of growth while total equity has continued to grow. Following impressive movements in profit, HSBC, ICBC and BoC all recorded large increases in their ROE of 1,404 bps (to 200.88%), 480 bps (to 3.95%) and 340 bps (to 2.88%), respectively, although HSBC's results are influenced by it being a branch, so less capital is required to be held.

The ROE of all five major banks fell in 2019, and as with profits ANZ experienced the largest decrease in ROE of 230 bps (to 15.31%), albeit still retaining the highest amongst the banking sector. The reductions in ROE do not really come as a surprise as the discussion around increasing capital requirements likely led the banks to start to retain more capital in anticipation of the final decision. Even after these falls, the five major banks achieved a ROE of 14.07% for the period, compared to 9.57% for the rest of the banking sector.

While the majority of banks experienced decreases, Kookmin's ROE saw the largest decline of 301 bps; however, the bank retained the second highest ratio of 95.50% amongst the 20 top level banks, following HSBC's 200.88% ROE – both helped by their branch structures.

The banking sector's return on assets ratio (ROA) has decreased, down by 8 bps to 1.04%, the same ROA as 2017, reversing the gain seen in the prior year. Similar to ROE, this reduction was driven by the small fall in NPAT, combined with the increase in total assets of 7.67% ($40.63 million). As with ROE, none of the major banks saw increases in ROA; with ASB remaining flat at 1.16%, while ANZ saw the largest decline of 15 bps to 1.12%.

Heartland still holds the highest ROA of 1.60% of all survey participants, remaining unchanged from 2018; while The Co-operative Bank became the lowest after their drop from 0.42% to 0.35%.

VIEW FIGURE 11

TABLE 7: MAJOR BANKS – FUNDS MANAGEMENT ACTIVITIES			
Entity	**2019 $Million**	**2018 $Million**	**Movement**
ANZ	34,145	30,665	11.35%
BNZ	7,785	7,058	10.30%
CBA	16,452	14,234	15.58%
Kiwibank[64]	4,438	3,856	15.09%
Westpac	14,668	13,468	8.91%
Total	**77,488**	**69,281**	**11.85%**

FOOTNOTE 64

Funds under management

It has been another good year for the major banks as they continue to achieve strong growth for funds under management (FUM), rising by 11.85% ($8.21 billion) to $77.49 billion. ASB achieved the highest percentage growth of the major banks, rising 15.58% ($2.22 billion) over the period, although this is considerably lower than its 32.66% ($3.50 billion) increase in 2018.

Kiwibank saw the next largest percentage increase in FUM at 15.09% ($0.58 billion), but their total FUM remains the lowest of the major banks due to KiwiWealth managing a sizable proportion of the total FUM within the Kiwi Group Holdings, which is outside of Kiwibank's financial results. ANZ remains dominant in the FUM sub-sector, with its managed funds reaching $34.15 billion (up 11.35%) in 2019, with a significant portion, $1.86 billion, of this rise attributable to the growth in their KiwiSaver fund, with the next largest bank's FUM being $16.45 billion of ASB.

See Table 7 on page 29.

Capital adequacy ratio

Only five of the 20 incorporated banks included in the survey reported a decrease in their capital adequacy ratio (CAR). The increase in CAR experienced by most banks was likely driven by proactive responses to the RBNZ's *Review of the capital adequacy framework for registered banks*. Despite the final decisions only being announced in December 2019, the major banks were not underestimating the likelihood that the review would bring significant changes to be implemented, even if the exact final decisions were still to be determined. As discussed in the *Capital adequacy: The bar is set higher* article on page 42, the four major banks will be required to have Tier 1 capital equal to 16% of risk-weighted assets (RWA) and total capital of 18% of RWA, whilst the other banks will face a minimum Tier 1 capital requirement of 14% of RWA and total capital of 16% of RWA[65].

FOOTNOTE 65

Twelve of the survey participants reported increases in their Tier 1 capital ratio, but of the major banks, only two had increases, with one being flat. Kiwibank saw the largest Tier 1 capital ratio decrease of the major banks, dropping 110 bps to 13.70%, after last year's massive increase of 250 bps, and ANZ also saw a slight decrease to 13.20% (20 bps) meaning their overall increase in CAR of 10 bps has come from lower Tier 1 capital. ASB recorded the largest increase in their Tier 1 capital ratio with a 40 bps increase (to 12.70%), followed by BNZ's increase of 35 bps to 12.30% (which is still the lowest of the five major banks), while Westpac has remained flat at 12.80%.

The effects of the new capital regulation are clearly flowing through to capital adequacy ratios already for some banks. These ratios will be an area to watch over the next seven years as the banks work to increase their capital holdings in order to be compliant by the end of the implementation period. Two areas for future interest will be how early banks react to increase their capital requirements compared to the increasing levels in the transition period, and secondly, where bank capital levels ultimately end up; this will depend on how much of an internal buffer each bank holds above these new minimum capital level requirements.

Analysis of annual results

Analysis of financial statements							
Entity	**Location of head office**	**Balance date**	**Survey year**	**Rank by total assets**	**Total assets* $Million**	**Net assets $Million**	**Total capital adequacy ratio %**
Australia and New Zealand Banking Group Limited – New Zealand Banking Group	Wellington	30-Sep-2019	2019	1	167,256	9,363	15.30
		30-Sep-2018	*2018*	*1*	*158,180*	*8,000*	*15.20*
Bank of Baroda (New Zealand) Limited	Auckland	31-Mar-2019	2019	19	125	48	72.53
		31-Mar-2018	*2018*	*19*	*116*	*47*	*78.06*
Bank of China (New Zealand) Banking Group Bank of China (New Zealand) Limited	Auckland	31-Dec-2018	2019	13	2,286	218	14.16
		31-Dec-2017	*2018*	*15*	*1,666*	*214*	*14.13*
Bank of India (New Zealand) Limited	Auckland	31-Mar-2019	2019	20	89	55	71.00
		31-Mar-2018	*2018*	*20*	*103*	*54*	*57.00*
Bank of New Zealand	Auckland	30-Sep-2019	2019	2	108,819	7,640	13.90
		30-Sep-2018	*2018*	*3*	*99,639*	*7,027*	*13.59*
China Construction Bank (NZ) Banking Group China Construction Bank (New Zealand) Limited	Auckland	31-Dec-2018	2019	13	2,577	216	16.23
		31-Dec-2017	*2018*	*16*	*1,826*	*206*	*13.09*
Citibank, N.A. New Zealand Branch	Auckland	31-Dec-2018	2019	14	2,151	186	15.59
		31-Dec-2017	*2018*	*14*	*2,045*	*193*	*14.60*
Commonwealth Bank of Australia New Zealand Banking Group	Auckland	30-Jun-2019	2019	3	106,752	7,609	15.50
		30-Jun-2018	*2018*	*2*	*101,016*	*7,674*	*15.00*
Heartland Bank Limited	Auckland	30-Jun-2019	2019	11	4,109	574	13.49
		30-Jun-2018	*2018*	*9*	*4,451*	*619*	*14.12*
Industrial and Commercial Bank of China (New Zealand) Limited	Auckland	31-Dec-2018	2019	15	2,136	234	18.19
		31-Dec-2017	*2018*	*16*	*1,662*	*139*	*11.74*
JPMorgan Chase Bank, N.A. New Zealand Branch	Wellington	31-Dec-2018	2019	17	1,806	0	15.90
		31-Dec-2017	*2018*	*17*	*1,573*	*0*	*15.44*
Kiwibank Limited	Wellington	30-Jun-2019	2019	5	22,734	1,549	14.50
		30-Jun-2018	*2018*	*5*	*20,715*	*1,487*	*15.80*
Kookmin Bank Auckland Branch	Auckland	31-Dec-2018	2019	18	448	5	15.52
		31-Dec-2017	*2018*	*18*	*425*	*4*	*16.01*
MUFG Bank, Ltd. Auckland Branch	Auckland	31-Mar-2019	2019	9	5,383	189	14.42
		31-Mar-2018	*2018*	*11*	*4,057*	*164*	*15.90*
Rabobank Nederland New Zealand Banking Group	Wellington	31-Dec-2018	2019	6	16,122	1,869	26.60
		31-Dec-2017	*2018*	*6*	*15,271*	*1,731*	*26.20*
SBS Bank	Invercargill	31-Mar-2019	2019	10	4,742	313	14.18
		31-Mar-2018	*2018*	*10*	*4,447*	*289*	*12.84*
The Co-operative Bank	Wellington	31-Mar-2019	2019	12	2,786	198	17.10
		31-Mar-2018	*2018*	*12*	*2,629*	*182*	*16.80*
The Hongkong and Shanghai Banking Corporation Limited – New Zealand Branch	Auckland	31-Dec-2018	2019	8	6,016	12	19.80
		31-Dec-2017	*2018*	*8*	*6,391*	*11*	*18.90*
TSB Bank Limited	New Plymouth	31-Mar-2019	2019	7	7,819	653	14.57
		31-Mar-2018	*2018*	*7*	*7,416*	*613*	*14.28*
Westpac Banking Corporation – New Zealand Division	Auckland	30-Sep-2019	2019	4	106,237	8,132	15.60
		30-Sep-2018	*2018*	*4*	*96,131*	*7,861*	*14.70*
Bank sector total			**2019**		**570,394**	**39,063**	**n/a**
			2018		***529,759***	***36,516***	***n/a***

* Total Assets = Total Assets - Goodwill - Other Intangibles

n/a = not available

Size & strength measures						Growth measures		
Tier 1 capital adequacy ratio %	Net loans and advances $Million	Customer deposits $Million	Number of employees	Number of branches	Number of owned ATMs	Increase in net profit after tax %	Increase in underlying profit %	Increase in total assets %
13.20	133,665	109,107	7,114	164	576	-8.11	-9.45	5.74
13.40	*129,061*	*103,124*	*7,374*	*179*	*591*	*11.57*	*9.43*	*2.07*
72.53	101	75	20	3	3	-20.73	-13.24	8.09
78.06	*86*	*67*	*20*	*3*	*3*	*25.05*	*21.22*	*12.48*
11.99	1,909	355	66	0	0	1,000.00	407.22	37.26
14.13	*1,417*	*393*	*0*	*0*	*0*	*57.41*	*-53.60*	*223.72*
71.00	75	13	11	3	0	15.54	15.39	-13.40
57.00	*91*	*21*	*12*	*3*	*0*	*-11.00*	*-11.93*	*-14.80*
12.30	88,541	63,065	4,503	153	657	-0.68	7.94	9.21
11.95	*83,549*	*59,776*	*4,703*	*153*	*633*	*9.82*	*10.72*	*4.84*
13.92	1,937	235	0	0	0	10.08	10.56	37.26
12.43	*1,648*	*459*	*41*	*0*	*0*	*480.50*	*3,273.44*	*105.75*
14.17	603	1,083	27	1	0	-9.31	-9.75	5.20
13.23	*896*	*919*	*28*	*1*	*0*	*-7.65*	*-7.10*	*-0.99*
12.70	90,760	61,908	5,229	120	456	6.65	6.87	5.68
12.30	*85,986*	*58,772*	*4,961*	*122*	*458*	*12.59*	*12.69*	*9.20*
13.49	3,641	3,154	439	4	0	1.16	-0.79	-7.68
13.71	*4,006*	*2,882*	*428*	*4*	*0*	*11.03*	*14.45*	*11.56*
14.21	1,701	636	62	1	0	714.26	352.47	28.51
9.30	*1,276*	*420*	*57*	*1*	*0*	*-204.08*	*-322.44*	*83.95*
15.50	215	201	9	0	0	63.83	63.61	14.82
15.03	*130*	*188*	*12*	*0*	*0*	*21.94*	*22.16*	*86.10*
13.70	20,480	18,230	1,449	219	221	-6.09	-1.68	9.75
14.80	*18,335*	*16,152*	*1,491*	*244*	*250*	*116.98*	*88.42*	*0.48*
14.33	296	212	13	1	0	15.08	14.17	5.29
14.86	*218*	*207*	*13*	*1*	*0*	*10.15*	*10.71*	*8.05*
12.46	4,691	705	17	1	0	18.78	21.08	32.69
13.59	*3,543*	*346*	*17*	*1*	*0*	*19.65*	*38.37*	*13.95*
19.50	12,140	4,706	343	32	0	4.38	4.26	5.57
18.80	*11,281*	*4,520*	*327*	*32*	*0*	*12.25*	*10.36*	*6.75*
11.41	4,006	3,381	524	16	2	15.58	15.90	6.63
10.92	*3,824*	*3,233*	*535*	*16*	*0*	*-2.86*	*-2.68*	*11.53*
14.60	2,466	2,321	324	33	0	-8.67	-3.65	5.98
14.10	*2,297*	*2,200*	*327*	*33*	*0*	*1.34*	*5.34*	*11.22*
17.80	4,128	3,059	227	1	0	9.15	8.75	-5.86
17.00	*4,445*	*3,154*	*207*	*1*	*0*	*1.73*	*0.90*	*26.02*
14.57	5,820	7,093	483	26	40	-13.17	-11.83	5.43
14.28	*5,334*	*6,741*	*464*	*25*	*40*	*11.94*	*12.39*	*9.02*
12.80	84,919	64,464	4,105	155	513	1.07	1.07	10.51
12.80	*81,148*	*61,884*	*4,124*	*161*	*538*	*5.48*	*4.05*	*1.04*
n/a	**462,095**	**344,001**	**25,141**	**980**	**2,513**	**-0.99**	**0.38**	**7.67**
n/a	***438,570***	***325,459***	***25,365***	***1,024***	***2,535***	***11.21***	***10.28***	***5.07***

Analysis of annual results

Analysis of financial statements		Credit quality measures						
Entity	Survey year	Impaired asset expense $Million	Past due assets $Million	Gross impaired assets $Million	Individual provision for doubtful debts/ Gross impaired assets %	Collective provision/ Net loans and advances %	Total provision for doubtful debts/ Gross loans and advances %	Impaired asset expense/ Average gross loans and advances %
Australia and New Zealand Banking Group Limited – New Zealand Banking Group	2019	99	334	287	34.15	0.30	0.37	0.08
	2018	53	221	323	40.87	0.30	0.40	0.04
Bank of Baroda (New Zealand) Limited	2019	0	0	0	0.00	0.21	0.21	0.01
	2018	0	0	0	0.00	0.41	0.41	0.09
Bank of China (New Zealand) Banking Group	2019	13	0	33	59.81	0.39	1.40	0.76
Bank of China (New Zealand) Limited	2018	12	0	33	30.00	0.21	0.91	1.36
Bank of India (New Zealand) Limited	2019	0	0	0	0.00	0.37	0.37	-0.14
	2018	0	0	0	0.00	0.37	0.37	0.01
Bank of New Zealand	2019	114	146	653	24.04	0.56	0.74	0.13
	2018	82	113	265	39.62	0.60	0.72	0.10
China Construction Bank (NZ) Banking Group	2019	2	0	0	0.00	0.31	0.31	0.10
China Construction Bank (New Zealand) Limited	2018	1	0	0	0.00	0.10	0.10	0.08
Citibank, N.A. New Zealand Branch	2019	0	0	0	0.00	0.00	0.00	0.03
	2018	0	0	0	0.00	0.00	0.00	0.00
Commonwealth Bank of Australia New Zealand Banking Group	2019	106	95	370	18.65	0.38	0.46	0.12
	2018	54	102	474	10.34	0.30	0.36	0.06
Heartland Bank Limited	2019	21	44	26	29.77	1.39	1.60	0.54
	2018	22	29	42	21.40	0.51	0.74	0.58
Industrial and Commercial Bank of China (New Zealand) Limited	2019	11	0	35	56.49	0.39	1.55	0.71
	2018	13	0	0	0.00	0.50	1.29	1.26
JPMorgan Chase Bank, N.A. New Zealand Branch	2019	0	1	0	0.00	0.00	0.00	0.00
	2018	0	0	0	0.00	0.00	0.00	0.00
Kiwibank Limited	2019	12	13	5	60.00	0.18	0.20	0.06
	2018	1	12	10	50.00	0.17	0.20	0.01
Kookmin Bank Auckland Branch	2019	-1	0	0	0.00	0.12	0.12	-0.01
	2018	-1	0	0	0.00	0.15	0.15	0.00
MUFG Bank, Ltd. Auckland Branch	2019	0	0	0	0.00	0.00	0.00	0.00
	2018	0	0	0	0.00	0.00	0.00	0.00
Rabobank Nederland New Zealand Banking Group	2019	1	1	257	3.15	0.23	0.29	0.01
	2018	-1	0	293	2.21	0.24	0.30	-0.01
SBS Bank	2019	15	11	4	53.94	0.68	0.73	0.39
	2018	15	7	7	36.46	0.68	0.74	0.41
The Co-operative Bank	2019	4	6	3	18.62	0.23	0.25	0.15
	2018	3	7	2	33.30	0.18	0.21	0.12
The Hongkong and Shanghai Banking Corporation Limited – New Zealand Branch	2019	0	0	5	18.41	0.09	0.11	0.00
	2018	3	0	9	48.06	0.03	0.13	0.08
TSB Bank Limited	2019	4	6	4	10.62	0.48	0.49	0.08
	2018	4	9	4	6.93	0.46	0.47	0.08
Westpac Banking Corporation – New Zealand Division	2019	-10	113	69	40.58	0.35	0.38	-0.01
	2018	-3	86	145	24.83	0.35	0.40	0.00
Bank sector total	**2019**	**391**	**771**	**1,751**	**23.66**	**0.38**	**0.47**	**0.09**
	2018	**258**	**586**	**1,608**	**23.05**	**0.36**	**0.44**	**0.06**

* Operating Expenses = Total Expenses - Interest Expense - Loan Write Offs and Bad Debts - Abnormal Expenses.

Profitability measures										Efficiency measures	
Total operating income $Million	Net interest income/ Average total assets %	Interest margin %	Interest spread %	Non-interest income/ Average total assets %	Net profit after tax $Million	Net profit after tax/ Average equity %	Net profit after tax/ Average total assets %	Underlying profit $Million	Underlying profit/ Average total assets %	Operating expenses*/ Average total assets %	Operating expenses*/ Operating income %
4,198	1.99	2.14	1.80	0.59	1,825	15.31	1.12	2,490	1.53	0.99	38.33
4,320	*2.03*	*2.18*	*1.85*	*0.73*	*1,986*	*17.61*	*1.27*	*2,750*	*1.76*	*0.97*	*35.12*
4	2.60	2.66	1.47	1.02	1	1.90	0.75	1	1.13	2.49	68.68
5	*2.82*	*2.89*	*1.67*	*1.35*	*1*	*2.45*	*1.04*	*2*	*1.44*	*2.68*	*64.15*
39	1.55	1.57	1.10	0.42	6	2.88	0.32	9	0.44	0.88	44.72
22	*1.08*	*1.08*	*0.85*	*0.90*	*-1*	*-0.52*	*-0.06*	*-3*	*-0.26*	*1.14*	*57.49*
4	3.76	3.83	1.75	0.56	1	1.73	0.98	1	1.37	3.08	71.21
4	*2.89*	*2.96*	*0.61*	*0.54*	*1*	*1.52*	*0.73*	*1*	*1.02*	*2.41*	*70.13*
2,656	1.98	2.16	1.88	0.57	1,022	13.35	0.98	1,617	1.55	0.89	34.83
2,556	*2.00*	*2.15*	*1.86*	*0.63*	*1,029*	*14.37*	*1.06*	*1,498*	*1.54*	*1.00*	*38.18*
34	1.48	1.52	1.29	0.05	12	5.45	0.52	16	0.73	0.72	47.10
27	*1.81*	*1.83*	*1.40*	*0.20*	*10*	*5.20*	*0.77*	*15*	*1.08*	*0.87*	*43.15*
43	0.92	0.92	0.77	1.14	16	8.60	0.78	23	1.08	0.97	47.03
46	*1.38*	*1.39*	*1.26*	*0.85*	*18*	*9.28*	*0.88*	*25*	*1.22*	*1.01*	*45.13*
2,756	1.96	2.01	1.67	0.69	1,202	15.09	1.16	1,727	1.66	0.89	33.49
2,506	*1.98*	*2.02*	*1.70*	*0.61*	*1,127*	*17.34*	*1.16*	*1,616*	*1.67*	*0.86*	*33.36*
190	4.11	4.20	3.80	0.33	68	10.78	1.60	95	2.22	1.74	39.12
195	*4.36*	*4.44*	*4.00*	*0.27*	*68*	*10.94*	*1.60*	*96*	*2.27*	*1.83*	*39.55*
38	1.91	1.93	1.57	0.09	7	3.95	0.39	10	0.54	0.90	44.93
23	*1.71*	*1.81*	*1.50*	*0.08*	*-1*	*-0.86*	*-0.09*	*-4*	*-0.32*	*1.13*	*63.14*
28	0.53	0.80	0.93	1.15	11	0.00	0.65	16	0.93	0.75	44.50
21	*0.62*	*0.89*	*0.85*	*1.09*	*7*	*0.00*	*0.55*	*10*	*0.80*	*0.91*	*53.26*
538	2.05	2.11	1.64	0.43	108	7.11	0.50	176	0.81	1.61	65.06
539	*1.99*	*2.05*	*1.60*	*0.62*	*115*	*8.02*	*0.56*	*179*	*0.87*	*1.74*	*66.60*
9	1.78	1.79	1.77	0.34	4	95.50	0.92	6	1.30	0.82	38.85
8	*1.51*	*1.52*	*1.51*	*0.47*	*4*	*98.51*	*0.86*	*5*	*1.22*	*0.76*	*38.43*
43	0.50	0.51	0.45	0.42	26	14.51	0.54	33	0.69	0.23	24.68
32	*0.45*	*0.46*	*0.40*	*0.40*	*22*	*14.07*	*0.57*	*27*	*0.71*	*0.14*	*16.69*
318	2.22	2.25	2.00	-0.20	138	7.66	0.88	199	1.27	0.75	37.29
297	*2.22*	*2.25*	*1.98*	*-0.21*	*132*	*7.94*	*0.89*	*191*	*1.29*	*0.73*	*36.39*
153	2.52	2.56	2.35	0.80	31	9.90	0.67	42	0.92	2.07	62.20
139	*2.51*	*2.56*	*2.35*	*0.79*	*27*	*9.32*	*0.63*	*36*	*0.86*	*2.09*	*63.17*
81	2.33	2.35	1.97	0.65	10	5.05	0.35	18	0.67	2.17	72.94
77	*2.25*	*2.27*	*1.86*	*0.84*	*10*	*5.95*	*0.42*	*19*	*0.76*	*2.24*	*72.27*
138	1.37	1.38	1.31	0.85	51	200.88	0.83	72	1.16	1.05	47.57
130	*1.53*	*1.57*	*1.50*	*0.74*	*47*	*186.84*	*0.82*	*66*	*1.16*	*1.06*	*46.51*
162	1.81	1.83	1.48	0.31	45	7.11	0.59	65	0.85	1.22	57.22
163	*1.78*	*1.80*	*1.44*	*0.51*	*52*	*8.64*	*0.73*	*74*	*1.04*	*1.21*	*52.49*
2,560	1.97	2.12	1.71	0.56	1,129	13.25	1.12	1,611	1.59	0.95	37.46
2,514	*2.00*	*2.11*	*1.70*	*0.63*	*1,117*	*13.78*	*1.17*	*1,594*	*1.67*	*0.97*	*36.71*
13,992	**1.98**	**2.10**	**1.76**	**0.57**	**5,713**	**13.52**	**1.04**	**8,227**	**1.50**	**0.98**	**38.41**
13,625	***2.01***	***2.12***	***1.78***	***0.63***	***5,770***	***14.88***	***1.12***	***8,196***	***1.59***	***1.00***	***37.95***

Analysis of annual results

Balance sheet breakdown		Assets ($Million)								
Entity	Balance date	Cash on hand, money at call and balances with other banks	Trading, investment securities, investments in subsidiaries and investment properties	Derivative financial instruments	Loans and advances (less provisions)	Balances with related parties	Fixed assets	Intangibles	Other assets	Total assets
2019										
Australia and New Zealand Banking Group Limited – New Zealand Banking Group	30-Sep	3,992	15,969	7,733	133,264	5,212	335	3,276	711	**170,492**
Bank of Baroda (New Zealand) Limited	31-Mar	19	0	0	101	5	0	0	0	**125**
Bank of China (New Zealand) Banking Group	31-Dec	221	135	2	1,902	0	3	0	24	**2,286**
Bank of India (New Zealand) Limited	31-Mar	17	0	0	75	-4	1	0	0	**89**
Bank of New Zealand	30-Sep	4,174	7,267	7,616	88,041	615	177	293	929	**109,112**
China Construction Bank (NZ) Banking Group	31-Dec	352	188	68	1,931	35	1	0	2	**2,577**
Citibank, N.A. New Zealand Branch	31-Dec	792	0	0	603	140	0	0	616	**2,151**
Commonwealth Bank of Australia New Zealand Banking Group	30-Jun	2,933	8,685	1,005	90,413	2,853	197	478	511	**107,075**
Heartland Bank Limited	30-Jun	45	355	13	3,590	21	9	57	48	**4,139**
Industrial and Commercial Bank of China (New Zealand) Limited	31-Dec	302	111	1	1,694	10	0	0	17	**2,136**
JPMorgan Chase Bank, N.A. New Zealand Branch	31-Dec	179	867	0	215	251	0	1	293	**1,806**
Kiwibank Limited	30-Jun	492	1,176	358	20,443	85	51	74	55	**22,734**
Kookmin Bank Auckland Branch	31-Dec	7	0	0	295	146	0	0	0	**448**
MUFG Bank, Ltd. Auckland Branch	31-Mar	419	154	29	4,691	78	0	0	12	**5,383**
Rabobank Nederland New Zealand Banking Group	31-Dec	421	647	19	12,113	2,896	3	0	23	**16,122**
SBS Bank	31-Mar	139	547	5	3,979	5	21	12	46	**4,755**
The Co-operative Bank	31-Mar	277	8	6	2,461	0	9	12	13	**2,786**
The Hongkong and Shanghai Banking Corporation Limited – New Zealand Branch	31-Dec	537	422	13	4,124	892	1	15	26	**6,030**
TSB Bank Limited	31-Mar	149	1,828	7	5,792	0	28	9	7	**7,819**
Westpac Banking Corporation – New Zealand Division	30-Sep	2,419	9,340	6,257	84,626	2,367	137	685	931	**106,762**
Bank sector total		**17,886**	**47,699**	**23,132**	**460,353**	**15,607**	**973**	**4,912**	**4,264**	**574,827**

Liabilities ($Million)								Equity ($Million)					
Customer deposits	Balances with other banks and money market deposits	Debt securities	Derivative financial instruments	Balances with related parties	Subordinated debt	Other liabilities	Total liabilities	Share capital – ordinary shares	Head office account	Convertible debentures/ perpetual preference shares	Other equity/cash flow hedge reserves	Retained earnings	Total equity
109,107	2,736	27,840	6,266	8,725	1,525	1,694	157,893	11,044	11	0	21	1,523	12,599
75	0	0	0	1	0	1	77	40	0	0	0	8	48
355	518	580	2	591	0	23	2,068	223	-1	0	-0	-4	218
13	0	0	0	20	0	0	34	50	0	0	0	5	55
63,065	1,833	26,024	6,106	2,238	548	1,365	101,179	4,056	0	0	99	3,778	7,933
235	337	690	7	1,084	0	7	2,361	199	0	0	-0	17	216
1,083	6	0	0	866	0	10	1,965	0	34	0	0	152	186
61,908	788	24,133	358	4,307	6,836	813	99,143	667	2,887	0	-108	4,486	7,932
3,154	0	345	10	0	0	26	3,535	553	0	0	-1	51	603
636	1	598	1	640	0	27	1,902	234	0	0	1	0	234
201	0	723	0	358	0	524	1,806	0	0	0	0	0	0
18,230	126	2,078	343	19	253	136	21,185	737	0	0	-11	823	1,549
212	30	0	0	200	0	1	443	0	5	0	0	0	5
705	0	0	14	4,457	0	19	5,194	0	83	0	0	106	189
4,706	0	3,105	15	6,408	0	19	14,253	551	290	0	2	1,026	1,869
3,381	539	298	30	0	132	49	4,429	0	0	0	-5	331	325
2,321	0	234	16	0	0	18	2,588	0	0	0	-0	198	198
3,059	229	690	35	1,938	0	54	6,004	0	23	0	3	0	26
7,093	0	0	12	0	0	61	7,166	10	0	0	11	632	653
64,464	623	18,988	5,825	2,892	3,185	2,128	98,105	143	2,289	0	-69	6,294	8,657
344,001	**7,763**	**106,326**	**19,041**	**34,745**	**12,479**	**6,975**	**531,331**	**18,507**	**5,621**	**0**	**-58**	**19,426**	**43,496**

Analysis of annual results

Balance sheet breakdown		Assets ($Million)								
Entity	Balance date	Cash on hand, money at call and balances with other banks	Trading, investment securities, investments in subsidiaries and investment properties	Derivative financial instruments	Loans and advances (less provisions)	Balances with related parties	Fixed assets	Intangibles	Other assets	Total assets
2018										
Australia and New Zealand Banking Group Limited – New Zealand Banking Group	30-Sep	4,742	14,526	5,656	128,677	2,701	325	3,289	1,500	**161,416**
Bank of Baroda (New Zealand) Limited	31-Mar	24	0	0	86	5	0	0	1	**116**
Bank of China (New Zealand) Banking Group	31-Dec	239	0	1	1,414	0	1	0	12	**1,666**
Bank of India (New Zealand) Limited	31-Mar	14	0	0	91	-3	1	0	0	**103**
Bank of New Zealand	30-Sep	3,232	6,842	4,336	83,051	1,253	172	352	753	**99,991**
China Construction Bank (NZ) Banking Group	31-Dec	155	0	21	1,646	2	1	0	1	**1,826**
Citibank, N.A. New Zealand Branch	31-Dec	402	0	0	896	213	1	0	534	**2,045**
Commonwealth Bank of Australia New Zealand Banking Group	30-Jun	2,885	9,193	1,527	85,728	914	184	467	441	**101,339**
Heartland Bank Limited	30-Jun	50	341	0	3,985	0	9	74	37	**4,496**
Industrial and Commercial Bank of China (New Zealand) Limited	31-Dec	328	40	0	1,270	13	0	0	11	**1,662**
JPMorgan Chase Bank, N.A. New Zealand Branch	31-Dec	198	877	0	130	100	0	1	267	**1,573**
Kiwibank Limited	30-Jun	579	1,220	344	18,304	87	45	78	58	**20,715**
Kookmin Bank Auckland Branch	31-Dec	4	0	0	217	203	0	0	0	**425**
MUFG Bank, Ltd. Auckland Branch	31-Mar	286	129	12	3,543	67	0	0	20	**4,057**
Rabobank Nederland New Zealand Banking Group	31-Dec	488	604	17	11,254	2,885	4	0	19	**15,272**
SBS Bank	31-Mar	98	476	3	3,799	6	22	8	44	**4,455**
The Co-operative Bank	31-Mar	302	5	4	2,292	0	7	14	5	**2,629**
The Hongkong and Shanghai Banking Corporation Limited – New Zealand Branch	31-Dec	777	244	12	4,444	889	1	14	23	**6,405**
TSB Bank Limited	31-Mar	138	1,933	1	5,309	0	20	8	7	**7,416**
Westpac Banking Corporation – New Zealand Division	30-Sep	1,709	6,826	3,509	80,860	2,023	144	683	902	**96,656**
Bank sector total		**16,651**	**43,256**	**15,442**	**436,995**	**11,358**	**937**	**4,989**	**4,634**	**534,263**

Liabilities ($Million)								Equity ($Million)					
Customer deposits	Balances with other banks and money market deposits	Debt securities	Derivative financial instruments	Balances with related parties	Subordinated debt	Other liabilities	Total liabilities	Share capital – ordinary shares	Head office account	Convertible debentures/ perpetual preference shares	Other equity/cash flow hedge reserves	Retained earnings	Total equity
103,124	3,141	27,023	5,848	7,851	1,549	1,644	**150,180**	11,044	11	0	33	148	**11,236**
67	0	0	0	1	0	1	**69**	40	0	0	0	7	**47**
393	302	150	0	595	0	12	**1,452**	223	0	0	0	-9	**214**
21	0	0	0	27	0	0	**49**	50	0	0	0	4	**54**
59,776	1,944	23,421	3,053	2,313	546	1,559	**92,612**	3,456	0	0	38	3,885	**7,379**
459	0	454	6	696	0	5	**1,621**	199	0	0	-0	7	**206**
919	1	0	0	923	0	8	**1,852**	29	34	0	0	131	**193**
58,772	1,000	23,049	918	1,418	7,430	755	**93,342**	667	2,887	0	478	3,965	**7,997**
2,882	0	914	2	0	0	34	**3,832**	542	0	0	5	117	**664**
420	0	366	0	720	0	17	**1,523**	145	0	0	-6	0	**139**
188	0	622	0	402	0	361	**1,573**	0	0	0	0	0	**0**
16,152	128	2,265	293	29	254	107	**19,228**	737	0	0	-5	755	**1,487**
207	64	0	0	149	0	1	**421**	0	4	0	0	0	**4**
346	0	0	13	3,519	0	15	**3,893**	0	83	0	0	81	**164**
4,520	0	3,781	28	5,185	0	26	**13,540**	551	256	0	2	923	**1,731**
3,233	487	279	23	0	88	49	**4,158**	0	0	0	-3	300	**297**
2,200	0	219	9	0	0	19	**2,447**	0	0	0	-1	183	**182**
3,154	275	389	20	2,495	0	46	**6,379**	0	23	0	3	0	**25**
6,741	0	0	8	0	0	54	**6,803**	10	0	0	5	598	**613**
61,884	1,253	14,943	3,569	2,440	2,866	1,315	**88,270**	143	2,169	0	-55	6,126	**8,383**
325,459	**8,595**	**97,873**	**13,790**	**28,764**	**12,733**	**6,028**	**493,243**	**17,837**	**5,466**	**0**	**494**	**17,220**	**41,016**

Major banks: Quarterly analysis

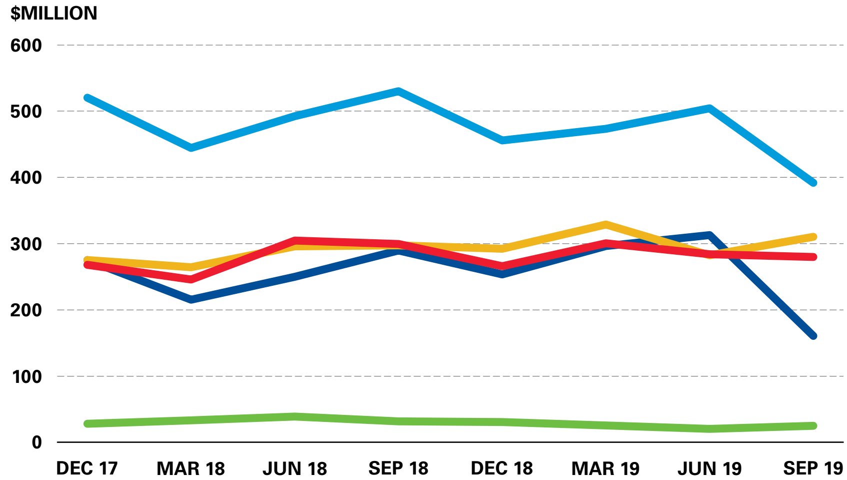
Entity	Size & strength measures							
	31 Dec 17	31 Mar 18	30 Jun 18	30 Sep 18	31 Dec 18	31 Mar 19	30 Jun 19	30 Sep 19
	Total assets[67] ($Million)							
ANZ	160,583	159,719	164,588	161,416	164,698	164,952	166,292	170,492
BNZ	97,742	97,065	101,678	99,991	102,536	103,758	105,313	109,111
CBA	97,762	98,643	101,338	101,906	103,157	105,388	107,075	111,167
Heartland Bank	4,307	4,388	4,496	4,596	4,018	4,054	4,139	4,206
Kiwibank	20,381	20,498	20,715	20,935	22,040	22,514	22,734	23,584
SBS Bank	4,347	4,455	4,501	4,574	4,660	4,755	4,791	4,863
The Co-operative Bank	2,589	2,629	2,661	2,697	2,786	2,786	2,855	2,927
TSB Bank	7,278	7,416	7,454	7,527	7,733	7,819	7,920	8,076
Westpac	96,041	96,216	98,438	96,656	98,537	100,180	101,464	106,762
Total	**491,031**	**491,030**	**505,868**	**500,298**	**510,164**	**516,204**	**522,582**	**541,188**
	Increase in gross loans and advances (%)							
ANZ	0.36	0.82	1.69	0.17	1.04	1.33	0.77	0.35
BNZ	0.63	0.51	2.01	1.64	1.46	1.35	1.56	1.07
CBA	1.93	0.97	1.68	1.11	1.76	1.68	0.91	1.40
Heartland Bank	2.81	2.48	2.69	3.12	-14.95	0.68	2.94	0.88
Kiwibank	0.96	1.01	0.93	2.49	2.93	2.85	2.89	1.63
SBS Bank	2.07	1.11	1.02	0.37	2.20	1.11	1.24	1.05
The Co-operative Bank	2.26	1.21	1.51	2.48	2.17	1.04	0.77	0.98
TSB Bank	3.21	2.95	2.66	1.88	1.88	2.40	3.77	2.72
Westpac	0.64	1.79	0.89	0.67	0.68	1.34	0.79	1.75
Average	**0.90**	**1.04**	**1.58**	**0.93**	**1.16**	**1.48**	**1.13**	**1.10**
	Capital adequacy (%)							
ANZ[66]	15.10	14.40	14.80	14.40	15.20	14.60	13.50	13.60
BNZ	13.47	13.10	13.20	13.60	13.30	13.60	13.70	13.90
CBA[66]	14.80	13.60	13.90	13.90	14.80	14.30	14.00	13.50
Heartland Bank	14.76	14.10	14.10	13.40	13.30	13.10	13.50	12.90
Kiwibank	15.00	15.40	15.80	15.70	15.30	14.90	14.50	13.50
SBS Bank	11.80	12.80	13.00	13.10	14.10	14.20	14.30	14.20
The Co-operative Bank	16.70	16.80	16.70	17.20	17.20	17.10	16.60	16.70
TSB Bank	14.54	14.30	14.70	14.50	14.80	14.60	14.50	14.60
Westpac[66]	14.30	16.60	17.10	16.60	16.90	16.50	16.70	15.90
	Net profit ($Million)							
ANZ	520	444	492	530	456	473	504	392
BNZ	275	215	250	289	253	296	313	160
CBA	275	264	296	297	292	329	282	310
Heartland Bank	15	18	19	17	13	18	20	18
Kiwibank	28	33	39	32	30	25	20	25
SBS Bank	7	7	8	8	8	6	8	8
The Co-operative Bank	3	1	3	3	3	1	2	2
TSB Bank	10	14	14	13	13	5	14	14
Westpac	268	246	305	299	266	300	284	280
Total	**1,401**	**1,242**	**1,423**	**1,489**	**1,335**	**1,455**	**1,447**	**1,208**

FOOTNOTES 66–67

Entity	Profitability measures							
	31 Dec 17	31 Mar 18	30 Jun 18	30 Sep 18	31 Dec 18	31 Mar 19	30 Jun 19	30 Sep 19
	Interest margin (%)							
ANZ	2.19	2.20	2.20	2.10	2.20	2.20	2.20	2.00
BNZ	2.10	2.20	2.10	2.10	2.20	2.20	2.10	2.10
CBA	2.04	2.00	2.10	2.00	2.00	2.00	2.00	1.90
Heartland Bank	4.37	4.50	4.40	4.40	4.30	4.70	4.50	4.60
Kiwibank	2.05	2.10	2.20	2.20	2.10	2.00	2.10	2.00
SBS Bank	2.68	2.60	2.60	2.60	2.50	2.50	2.50	2.50
The Co-operative Bank	2.29	2.30	2.40	2.40	2.30	2.30	2.20	2.20
TSB Bank	1.80	1.80	1.80	1.90	1.90	1.80	1.80	1.80
Westpac	1.96	2.20	2.10	2.10	2.30	2.10	2.10	1.80
	Non-interest income/Total tangible assets (%)							
ANZ	0.82	0.62	0.64	0.76	0.46	0.52	0.67	0.68
BNZ	0.65	0.63	0.55	0.64	0.36	0.67	0.79	0.45
CBA	0.64	0.62	0.67	0.63	0.71	0.78	0.64	0.67
Heartland Bank	0.39	0.32	0.67	0.27	0.23	0.32	0.44	0.42
Kiwibank	0.69	0.99	1.14	0.98	0.91	0.74	0.83	0.86
SBS Bank	0.85	0.85	0.82	0.88	0.92	0.81	0.75	0.78
The Co-operative Bank	0.89	0.67	0.71	0.63	0.69	0.56	0.71	0.66
TSB Bank	0.29	0.71	0.28	0.35	0.33	0.30	0.27	0.29
Westpac	0.78	0.48	0.74	0.60	0.43	0.69	0.59	0.70
Average	**0.73**	**0.61**	**0.66**	**0.68**	**0.50**	**0.64**	**0.67**	**0.63**
	Impaired asset expense/Average gross loans and advances (%)							
ANZ	0.04	0.19	0.02	-0.07	0.04	0.06	0.07	0.13
BNZ	0.02	0.20	0.14	0.03	0.06	0.13	0.12	0.18
CBA	0.12	0.16	0.06	0.05	0.16	0.14	0.14	0.05
Heartland Bank	0.57	0.60	0.60	0.61	0.79	0.45	0.38	0.50
Kiwibank	-0.22	0.03	-0.04	0.01	0.07	0.08	0.08	0.03
SBS Bank	0.45	0.55	0.40	0.40	0.38	0.40	0.29	0.35
The Co-operative Bank	0.11	0.12	0.17	0.15	0.13	0.16	0.13	0.03
TSB Bank	0.10	0.08	-0.01	0.10	-0.16	0.36	-0.06	-0.02
Westpac	0.03	0.10	-0.01	-0.14	0.03	0.04	-0.03	-0.08
Average	**0.05**	**0.17**	**0.05**	**-0.02**	**0.08**	**0.10**	**0.08**	**0.08**
	Operating expenses/Operating income (%)							
ANZ	34.46	35.08	35.28	35.64	38.14	35.23	34.29	45.63
BNZ	38.69	46.85	40.48	37.85	40.42	35.66	35.47	61.11
CBA	35.19	37.05	37.20	35.39	35.22	33.58	37.72	35.89
Heartland Bank	44.54	39.76	41.07	41.60	47.60	39.96	40.16	42.77
Kiwibank	79.41	69.43	69.20	72.87	71.71	74.33	78.57	78.13
SBS Bank	64.26	61.60	61.38	60.91	62.97	65.97	62.14	64.21
The Co-operative Bank	73.32	86.39	76.50	75.00	76.33	87.88	80.00	82.09
TSB Bank	59.48	53.44	50.77	53.75	60.63	69.31	54.14	54.46
Westpac	40.00	39.29	36.77	38.26	39.89	37.45	39.91	41.82
Average	**39.34**	**41.20**	**39.46**	**39.15**	**40.91**	**38.27**	**39.21**	**47.89**

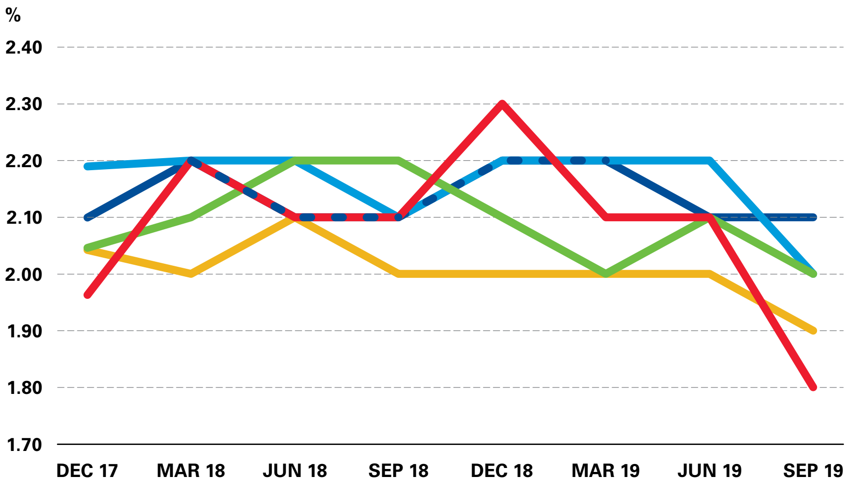
12 MAJOR BANKS: NET PROFIT (QUARTERLY)

- ANZ
- BNZ
- CBA
- KIWIBANK
- WESTPAC



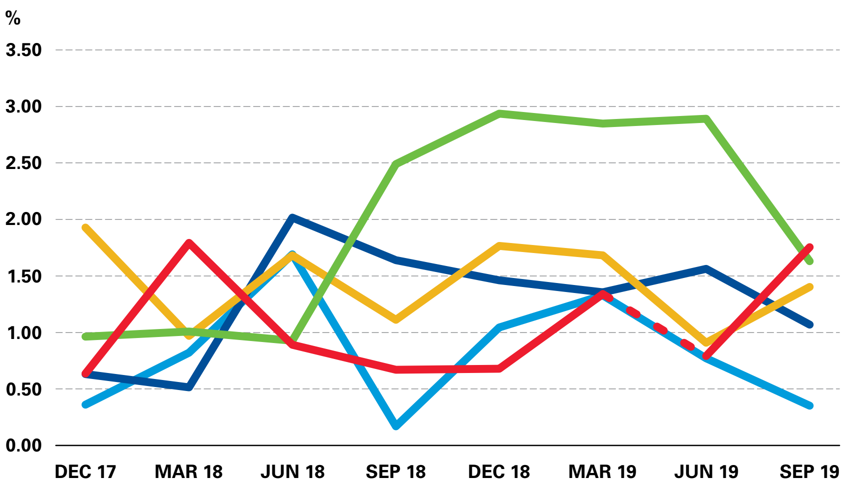
13 MAJOR BANKS: INTEREST MARGIN (QUARTERLY)

- ANZ
- BNZ
- CBA
- KIWIBANK
- WESTPAC



14 MAJOR BANKS: INCREASE IN GROSS LOANS AND ADVANCES (QUARTERLY)

- ANZ
- BNZ
- CBA
- KIWIBANK
- WESTPAC



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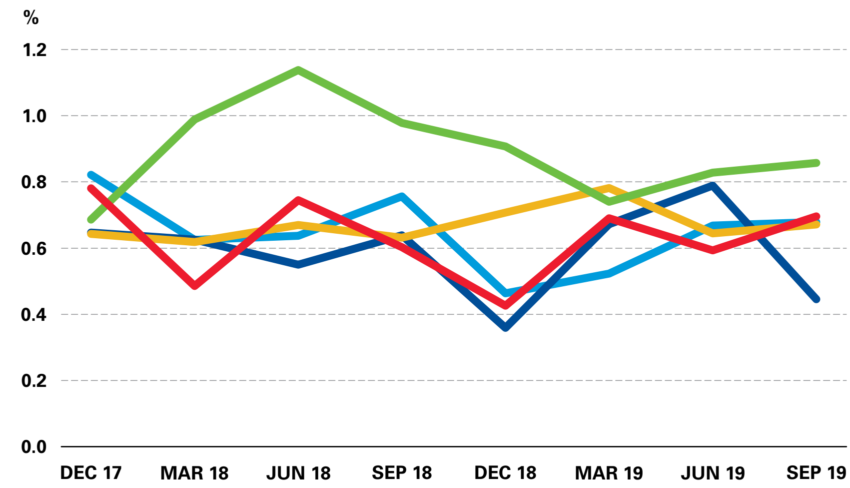
MAJOR BANKS: NON-INTEREST INCOME/ TOTAL ASSETS (QUARTERLY)

- ANZ
- BNZ
- CBA
- KIWIBANK
- WESTPAC



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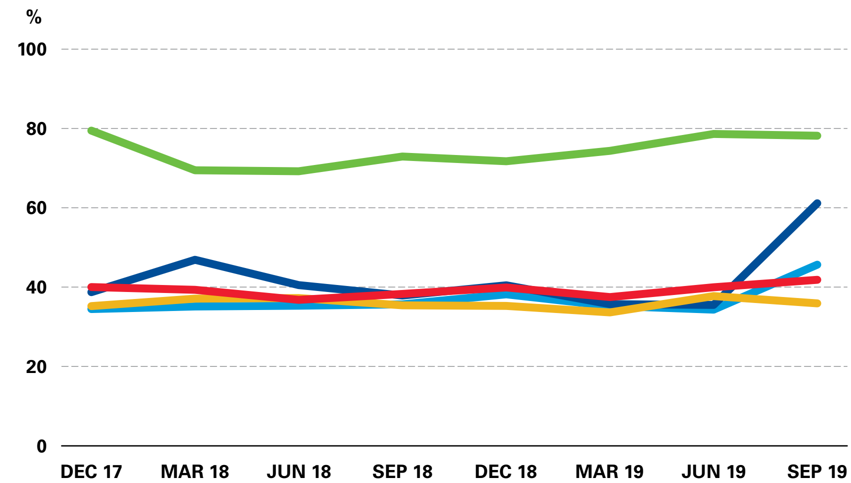
MAJOR BANKS: OPERATING EXPENSES/ OPERATING INCOME (QUARTERLY)

- ANZ
- BNZ
- CBA
- KIWIBANK
- WESTPAC



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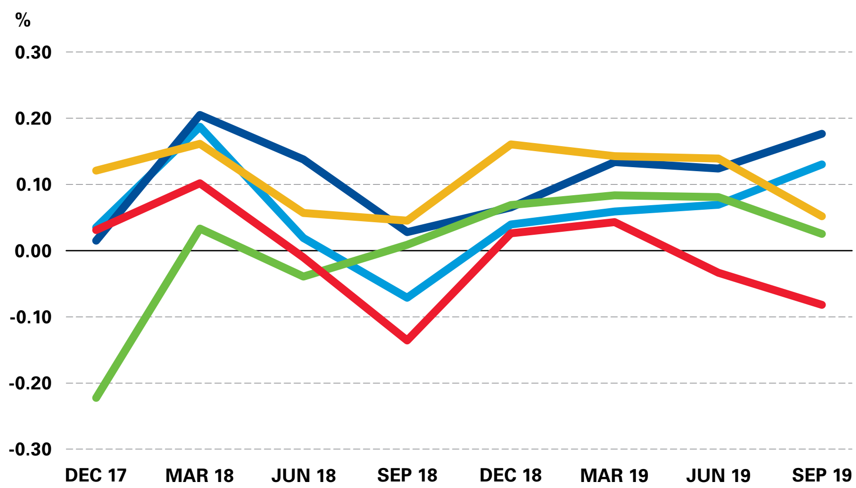
MAJOR BANKS: IMPAIRED ASSET EXPENSE/AVERAGE GROSS LOANS AND ADVANCES (QUARTERLY)

- ANZ
- BNZ
- CBA
- KIWIBANK
- WESTPAC



Capital adequacy: The bar is set higher

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RAJESH'S BIO

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Whether you agree with the RBNZ or not is now irrelevant. 2019 saw extensive discussion, workshops, consultations and debate about what the right level of capital for our banking system is.

The RBNZ is the ultimate arbiter on this question, and having shared its thinking, analysis, Quarterly Insurer Surveys and Regulatory Impact Assessments, it believes that the financial stability benefits of carrying the additional capital outweighs the potential costs that might arise from higher cost of credit or lower returns to depositors and shareholders together with any impact from credit rationing.

Whether this assessment is right or not has been thoroughly debated, but what is now certain is that on a global landscape, New Zealand banks will be well capitalised, substantially reducing the risk at a societal level of having to deal with the consequences of a bank failure or is it more correct to say a 1:200 year shock.

While there were some changes from the earlier consultations, the final decisions are substantially and directionally consistent with the earlier proposals, namely:

- a material uplift in overall capital levels – lifting total capital requirements to 18% (and 16%) for Domestic Systemically Important Banks (D-SIB) (and other banks) from the current 10.5% requirement after inclusion of countercyclical buffers and D-SIB buffers;
- a substantial constraining of the advantage 'Advanced' banks have had over their 'Standardised' colleagues;
- introduced a dual reporting requirement of both Advanced capital levels and the equivalent Standardised levels;
- an acceptance of Redeemable Preference Shares as Additional Tier 1 (AT1) and the retention of the Tier 2 capital requirements;
- no requirements for a leverage ratio (although given the high capital levels this was not a surprise); and
- a seven-year transition period.

In any change there will be winners and losers, and the final capital decisions certainly deliver a material capital demand upon the four large 'Advanced' banks. This comes in the form of substantially constraining their capital advantages over the Standardised banks (lifting the capital requirements), but also in the phasing of the new requirements. While the overall capital levels (from 10.5% to 18%) lift in a linear fashion from 2020 to 2027, the phasing out of existing Tier 1 instruments, and the introduction of the new floors sees some heavy capital raising will be required in the early phases of the transition period. A number of banks had been running up capital levels in advance of the announcements meaning the increases will not be as severe.

TABLE 8: UPCOMING CHANGES TO CAPITAL REQUIREMENTS

Capital

CET1
- No change

AT1
- Redeemable, perpetual, preference shares with no contractual contingent features
- Max. 2.5% of RWA

Tier 2
- Long term subordinated debt with no contractual conversion features
- Max. 2% of RWA

RWA

Credit Risk
- RWA output floor of 85% for IRB banks (from 1 January 2021)
- Increase of scaler from 1.06 to 1.2 for IRB banks (from 1 October 2020)
- Adoption of standardised approach for bank and sovereign exposures (1 January 2021)

Market Risk
- No change

Operational Risk
- Planned consultation on use of standardised approach to operational risk for all banks (Consultation in 2020/21)

=

Prudential capital buffer

D-SIB buffer
- Applies to large banks only
- Increases from 0% to 2% in phrases to 2027

Conservation buffer
- Increases from 2.5% to 5.5% in phrases to 2027

Counter Cyclical buffer (CCyB)
- Increases from 0% to 1.5% in phrases to 2027

DUAL REPORTING FOR IRB BANKS (1 JANUARY 2021)

The other factor at play in the capital domain during 2019 was the acknowledgement by a number of banks, of errors within their capital calculations. During 2019 several banks were subject to capital overlays while they worked through reviewing their capital models. More broadly the RBNZ has made it clear that the expectations on banks to accurately report their compliance obligations is lifting and the level of supervision the sector can expect going forward will be substantially higher.

There are still elements to be finalised such as the Operational Risk framework and the revisions to the RBNZ's *Banking Supervision Handbook*, which we expect in 2020, but materially we now have clarity on the future requirements.

Key changes and their implications

The upcoming revisions of the capital requirements (see Table 8 on page 43) are primarily driven by increases in the prudential capital buffers, changes in the calculation of the risk-weighted assets (RWA) and the change in the types of funding that qualify as capital.

Prudential capital buffers – more buffers

One of the key changes is the different minimum thresholds of capital required to be held by (D-SIB) – ANZ, ASB, BNZ and Westpac, which use internal models and the other banks that use the Standardised approach.

Overall, the expectation is that by 2027 the minimum total capital ratio for D-SIB's should be 18% of RWA compared to 16% for the other banks. The current minimum threshold for the total capital ratio is 10.5% of RWA for all banks. This increase is driven by the increase in the level of prudential capital buffers.

The requirements for the conservation buffer has increased from 2.5% to 5.5% and two additional prudential buffers have been introduced:

— *'Early-set' countercyclical buffer of 1.5%:* A countercyclical buffer (CCyB) is additional capital over the regulatory minimum which may be increased or decreased by the regulator over a financial cycle. Most regulators globally have adopted a 'late-set' CCyB which means that it is initially set at 0% and the regulator will continuously monitor the risks in the financial system to assess whether an increase in the CCyB is required. Although, RBNZ currently has the option to use CCyB, it has never used it – compared to some of the other global jurisdiction where this has been used. RBNZ's 'Early-set' CCyB strategy, where the buffer is built up initially to a certain level and then removed during a severe down-turn, differs with most of global regulators. The RBNZ is still to carry out a detailed consultation on the operational framework for the CCyB, particularly the indicators of when the buffer will be released and re-instated.

— *D-SIB buffer (applicable to ANZ, ASB, BNZ and Westpac) of 2%:* A D-SIB buffer is additional capital held over the regulatory minimum and applies to banks that are deemed systemically important whose failure would have significant impact on the economy. RBNZ has determined ANZ, ASB, BNZ and Westpac to be D-SIBs to which this prudential buffer would apply. Again, most regulators globally have adopted this buffer. However, the size of the buffer of 2% is higher than most jurisdictions, but consistent with International Monetary Fund's recommendation due to the high level of concentration of the banking sector in New Zealand.

These increases will be introduced in a phased manner over the seven-year transition period which should give banks adequate time to implement the new requirements and reduce any potential economic impact of the changes on credit availability and lending rates.

Based on RBNZ's analysis, the benefit of these changes is that it will increase the financial stability and resilience of the New Zealand financial system which is greater than the cost of the potential increase in the average lending rates by approximately 20 basis points by the end of the transition period (as banks look to recoup the additional costs of capital). The caveat to this is that increase in the lending rate may have a disproportionate impact across portfolios and banks will be looking at their portfolio composition and strategies in the sectors they operate or identify new sectors they would like to operate in.

There is an expectation that the RBNZ would monitor the impacts of these rules particularly with respect to lending spreads, credit availability and activities pushed outside the banking sectors, which are not similarly regulated as there could be unintended consequences due to the implementation of these changes by the banks. RBNZ is committed to carry out annual reviews to cover these aspects and also assess the extent to which the policy is achieving the intended objectives.

Figures 18 and 19 summarise the phased approach to the increase in the minimum capital requirements for D-SIBs and the other banks.

VIEW FIGURE 18

VIEW FIGURE 19

RWA – reduced variability between Internal Ratings Based (IRB) and Standardised banks

These changes are primarily driven by credit risk weight calculations so as to reduce the variability of the capital requirements between IRB and Standardised banks.

The key changes implemented to achieve this are:

— Similar to the Basel III reforms, RBNZ has adopted the output floor which sets the floor for capital requirements calculated under internal models at 85% of the RWA calculations.

  The 85% floor is higher than those recommended in December 2017 by the Basel reforms of 72.5% (which under Basel is being implemented in a phased manner over five years). RBNZ has not adopted the phased approach and the output floor is effective from 1 January 2021. RBNZ is not the only regulator that is not following the phased approach for the output floors as Canada's Office of the Superintendent of Financial Institutions is also taking a similar approach.

— Increase in the scalar applied to RWA for IRB banks from 1.06 to 1.2. The objective of the scalar for RBNZ is similar to the output floor (i.e. narrow the difference in capital outcomes between IRB and Standardised approaches). Although, Basel has removed the requirement of scalar due to the introduction of the output floor, RBNZ (similar to Australian Prudential Regulation Authority (APRA)) has retained this requirement. Albeit, the RBNZ scalar is higher than that required by APRA. Implementation will be a consultation with each bank on its Conditions of Registration, but could be expected as early as 1 July 2020.

— Similar to the Basel III reforms, which allow only the Standardised approach for sovereign and bank exposures, as internal models are not considered very useful in calculating risk weights for these exposures due to the lack of appropriate level of default data.

— In addition to the above, IRB banks would be expected to calculate and report on its capital requirements under both the IRB and the Standardised approach (Dual Reporting) from 1 January 2021.

These changes will impact only the IRB banks which would require operationalising the bank's existing capital reporting engines.

These changes will impact only the IRB banks which would require operationalising the bank's existing capital reporting engines.

For Standardised bank's this creates a more level playing field and will be a welcome change as it is expected to reduce the variability in risk weights and resulting capital requirements between IRB and Standardised banks.

There are still decisions to be made with respect to operational risk, it is likely the RBNZ will remove the advanced approach option for banks which will result in these models no longer requiring RBNZ approval, but may require IRB banks to hold additional capital than what is currently being held for operational risk. RBNZ is still to consult on this change.

No changes have been made to the market risk capital calculations and the current Standardised approach will continue to apply. However, the detail of how this will work in practice in the New Zealand environment needs to be worked through.

Capital composition

The most significant and welcome change for the banks (and departure from the 2018 RBNZ proposal) is the eligibility of redeemable preference shares as additional Tier 1 capital, which is largely consistent with similar instruments being eligible under Basel. In addition, long-term subordinated debt would continue to be eligible as Tier 2 capital.

Other implications

Board oversight

Bank internal targets on the level of capital will have to be revised upwards both in this transition phase and by 2027, and capital held against the level of Pillar 2 risk would need to be reassessed. This is crucial as current practice is to set capital levels above the prudential capital buffer to absorb stress without the risk of regulatory breach. The phased supervisory response to banks entering the CCyB buffers means that there may be an opportunity to reassess the level of buffers above regulatory minimums.

The directors of the banks are expected to have adequate oversight to ensure these changes are appropriately implemented.

Cultural takeaways: Lessons from financial services in China

James Dowle
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JAMES' BIO

A Silicon Valley study tour has become a rite of passage for the modern business executive. Spending a week touring businesses in Palo Alto, and being wowed by passionate technologists, showcasing incredible innovation on fabulous digitally-enabled campuses is now fairly common. And it often results in an executive returning home from the Golden State brimming with ideas and full of energy and inspiration.

So, when I decided to take myself off on a trip to discover 'the art of the possible' in modern banking, California was immediately top of my shortlist of destinations. But, after a bit of reflection and some consultation with my global KPMG banking colleagues, I was convinced to head in a different direction: I set off for China.

In a whistle-stop tour of Beijing, Shanghai and Shenzhen, I was fortunate enough to go behind the scenes at some new entrants to the Chinese financial services industry including Tencent, WeBank, Ant Financial, AiBank, Baidu and CreditEase.

Without waxing lyrical for too long, it was an amazing experience. I highly recommend anyone with a passion for the future of banking to take a similar trip. Much of what I saw was very impressive, but didn't really come as much of a surprise: the ability to scale, test and change at high speed, and at a marginal cost by using privately built clouds; mind-blowing real-time wall-sized dashboards giving executives and planners insights you can only dream of; and the use of artificial intelligence (AI) and mobile device features to enhance security and the customer experience. But the thing that did catch me on the hop had nothing to do with these expected technological advances: it was the sophistication and insight these businesses had in the softer sider of operations, the way they worked together and the people they invested in.

So here are my key cultural 'takeaways' from Chinese financial services start-ups that I hope are insightful for New Zealand financial institutions as they shape their future:

1. Moving faster is not just about automation – it's about having the right people in the right place at the right time

When I first worked in financial services, new system features were introduced quarterly and products were refreshed every six months. That now seems a million miles away from the fast-paced cadence required to respond to current market demands.

The pace of change is greater than ever.

The pace of change is greater than ever. And banks are actively seeking ways to automate so that they can improve the customer experience, and to reduce the time to develop new products and services. Unsurprisingly, all of the banks visited in China had fully embraced Agile methodologies to respond to the need for pace. What did surprise me was two specific facets that they brought to their Agile squads.

The first was the way that squads were fully resourced for every necessary business function required in the development cycle. This meant that in addition to the usual technology, product and marketing people on every squad, there were also dedicated legal and compliance staff. While this means that they might have many more compliance staff than an equivalent New Zealand bank. However, we were assured, that the benefits of reduced bottlenecks and reduced rework, because compliance was designed in from day one, were of greater value than the increased cost of staff.

The second facet was the passion for continuous improvement in all staff. If you could find a way of making the process run faster, you should make it happen. If you improve the customer experience, build it into your next release. In some ways, there was a constant sense of crisis with people encouraged to constantly re-think how existing activities could be better performed and how technology can be applied to customer problems in new ways. All banks need to become comfortable with constant change as a way of doing business.

2. Technologists need to be at the heart of the business

After spending just a couple of minutes in any of these Chinese start-up banks, it was obvious how critical technology was to their success. How else could one bank scale to servicing almost one million customers after one week of operation and seven million after just one month? But this techno-centricity was perhaps most graphically illustrated by AiBank whose logo is a line of Javascript written to represent how winning at banking will result from combining AI with big data and leveraging the cloud.

While most New Zealand banking executives I've spoken to echo the sentiment of valuing technology, the major thing I noticed that was dramatically distinctive in China was how banks valued their technologists. It was clear that they were authentically seen by their colleagues as real assets who had so much to contribute. There was no 'them' and 'us' mentality on display.

It was obvious by the number of technologists in senior positions of leadership how important they are to the vision, journey and operations of these banks. We observed technologists not being seen as executors of the fine thoughts of product and marketing specialists, but as respected peers, consulted from the start of any new process.

While many New Zealand banks are embracing digital, it seems to me that the winners in the future will be those who can really understand how to exploit technology at pace. And while a 'DevOps' approach is the obvious start in creating the necessary speed-to-market and to increase rate of change, having technologists at the leadership table will be vital to ensure this potential competitive advantage is exploited. This will be especially true as banks venture into the possibilities of AI, natural language and neural networks in order to stay ahead of customer expectation.

3. Leadership is critical to win the fight for talent

With a population of over 1.3 billion people and a renowned education system, you might think that finding talent in China might not be a challenge. But Chinese banks have already identified how important it is to be able to attract and retain the very best staff. The question they all ask is why should talent come and work for us?

Each bank we visited had very flexible workspaces that suited an Agile working culture, work cultures that suited modern sensibilities (including at desk napping!), and reward structures that recognised success. But all of these features just seemed to be table stakes. To truly differentiate as an employer, Chinese banks identified that they needed two distinctive qualities: firstly, a very clear vision of success provided by leadership to ensure everyone was aligned around what was important and what was not; and, secondly, the ability for people to feel empowered because they know what is important for their customers.

Without focused and consistent leadership, it's really not possible to unleash the power of your people.

Without focused and consistent leadership, it's really not possible to unleash the power of your people. Only when the objectives and goals are clear can staff be freed up to innovate and improve the customer experience. Every bank we visited had very visible passionate leaders who left you in little doubt what they wanted to achieve.

My final observation was that every individual I met in China was a life-long learner. Nobody seemed satisfied with where they were, and everyone was curious how they and their business could improve. This is one of the lessons I've taken from my trip. The others are: Keep looking over the fence at what others are doing. Stay inspired. Keep stretching.

Tax governance and compliance: The new certainty

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BRUCE'S BIO

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ALEXANDRA'S BIO

We all know the famous phrase about the only two certainties in life being death and taxes. For the financial services sector it's probably fair to say that these days there is a third certainty – regulation. The industry continues to face a seemingly endless barrage of more and more regulation across a range of operational areas.

Tax is not immune from this wave of regulatory change. The message for the financial services sector, and in particular those that are multinationals, is that they are clearly in the Government's firing line, as it seeks to address on-going concerns about whether multinationals are paying their 'fair share' of tax.

Tax is not immune from this wave of regulatory change.

This was made abundantly clear in November 2019 when Inland Revenue released its Multinational Enterprises Compliance Focus document (the Multinational Document). The Multinational Document is an update and extension of the 2016 release and is focussed on making tax compliance more transparent. The document states that Inland Revenue hopes to make tax more 'simple, open and certain' and yet its content highlights that recent developments in the tax world have only led to increased legislation, board-down expectations and consequent increases in the costs of compliance.

While the title of the Multinational Document suggests that the recommended actions are intended for multinationals, there is no doubt that this document also represents a shift that will cascade down to domestically owned banks and other large corporates in New Zealand, particularly with respect to expectations around tax governance.

Very clearly Inland Revenue now expects that tax governance begins with the right 'tone from the top'. Boards and senior management are expected to have a documented tax strategy, supported by appropriate controls and systems to ensure tax obligations are accurately complied with. Tax can no longer be relegated to the concern of those specifically charged with undertaking an organisation's tax compliance.

Although the 'tone at the top' and governance more generally are perhaps the most important messages in the Multinational Document, it also outlines some key developments in the multinational compliance space in recent years, including:

- Inland Revenue's **increased powers to collect information and assess tax on 'large multinational groups**. The major banks operating in New Zealand all meet the definition of a large multinational group as their consolidated group income exceeds the €750 million threshold.
- **Base erosion and profit shifting minimum reporting standards** have been introduced enabling country-by-country reporting on the high-level activities of a group's global activities and the ease of exchange for tax authorities regarding international tax rulings.
- New Zealand's tax laws have been amended to **strengthen our transfer pricing rules so that they better align with the rules in Australia and the OECD**. The onus of proof now resides with the taxpayer rather than Inland Revenue. This increases the importance of maintaining up-to-date transfer pricing documentation as a lack of adequate documentation would make it difficult for a group to rebut alternate arm's length conditions proposed by Inland Revenue.

The Multinational Document also lays out a range of quantitative measures that will likely attract increased Inland Revenue scrutiny. These include having two or more consecutive years of tax losses, higher than 40% leverage, interest payments in excess of 20% of EBITDA and paying margins of more than 5% on cross-border services charges. If nothing else this provides multinationals with a chance to review their financial and tax positions and if failing any of these metrics, presents an opportunity to be ready to explain why.

This must be understood against the backdrop of Inland Revenue's multi-billion-dollar Business Transformation project which has resulted in a major step change in their ability to compile and analyse taxpayer data. Inland Revenue's ability to undertake more comprehensive data analytics will mean that taxpayers failing the sorts of metrics noted above and who are outliers in their industry, will now be able to be more quickly identified. Inland Revenue's messaging to boards and senior management regarding governance is therefore, no idle threat or some theoretical point being made. Inland Revenue's ability to monitor and enforce compliance has been enhanced. Accordingly, its expectations have lifted also.

FMA: Looking forward to a year of consolidation and change

Liam Mason
Director of Regulation
Financial Markets Authority

FINANCIAL MARKETS AUTHORITY
TE MANA TATAI HOKOHOKO - NEW ZEALAND

LIAM'S BIO

In the past twelve months the FMA concluded the joint reviews with the Reserve Bank of New Zealand into the conduct and culture of banks and life insurers. This has been a major piece of work for both the prudential and conduct regulators. We will continue to focus on ensuring all financial services providers take the lessons from the review, investing in the appropriate systems and controls to provide strong governance for their business and better outcomes for customers.

The next twelve months will also see further evolution in the regulation of financial services. One result of the conduct and culture reviews has been the introduction of the Conduct of Financial Institutions Bill. This legislation is working its way through Parliament and, if passed, will give the FMA a greater remit to regulate the conduct of banks, insurers and non-bank deposit takers.

The Government announced the FMA would be given extended powers to monitor and enforce compliance with changes to insurance contract law.

In addition, the Government announced the FMA would be given extended powers to monitor and enforce compliance with changes to insurance contract law.

While we look to normalise the focus on good conduct and heighten attention on the fair treatment of customers, we recognise that this is a long game. This is why governance and culture remains one of our core strategic priorities,as outlined in our Strategic Risk Outlook.

Coordinated regulation developments

The financial services sector has coped well with legislative changes over the last few years but nothing in this industry stands still for long and we are entering a time of dynamic change.

Nothing in this industry stands still for long and we are entering a time of dynamic change.

This includes changes to financial adviser regulation, the Reserve Bank Act review, the Insurance Prudential Supervision Act review, the consumer credit law review and the Financial Market Infrastructures Bill.

We recognise that many of these initiatives overlap or impact the same sectors. We also understand that the respective regulators will need to collaborate and provide clarity for the market to ensure these changes are managed effectively. The Council of Financial Regulators (CoFR) will play an important and more visible role in coordinating the implementation of these legislative reforms.

CoFR includes the FMA, RBNZ, MBIE, the Treasury and the Commerce Commission.

Late last year, CoFR laid out a more comprehensive vision: to maximise New Zealand's sustainable economic well-being through responsive and coordinated financial system regulation.

While the agencies continue to operate within the framework of their statutory responsibilities and the preferences and priorities set by the Government, the need for a coherent framework and consistent system view of the regulation of financial services sector is clear.

Financial advice regime

Many of the upcoming changes are long-term, however the new financial advice regime takes effect in the next six months. Today's advisers need to get a transitional licence by the end of June. Then the transitional period for full licensing lasts until June 2022, at which time Financial Advice Providers will need to have a full licence and to have met all the relevant qualifications and standards.

Our initial focus is to help support advisers through the transitional period; working with the industry and other agencies to ensure advisers have appropriate access to training ahead of the new competency standards.

The objective of the regime is to ensure New Zealanders have access to quality financial advice and that there's a level playing field for all Financial Advice Providers.

It's important to remember the objective of the regime is to ensure New Zealanders have access to quality financial advice and that there's a level playing field for all Financial Advice Providers.

This change touches other areas of financial services, particularly insurance, because of the wide use of advisers as a distribution channel.

Value for money

KiwiSaver reached a significant milestone in November – three million New Zealanders are now part of the scheme.

As signalled in our KiwiSaver Report, this year we will be asking providers how they are delivering value for money to members.

We have said we were surprised that the level of KiwiSaver fees were not coming down faster, considering the inevitable economies of scale providers were enjoying. Over the last financial year to March 2019, KiwiSaver providers took in nearly half a billion dollars in fees, equivalent to an average of $163 per member. We want to see what providers are offering their members to earn those fees.

We want to ensure KiwiSaver members are getting what they pay for.

In line with our value for money focus, research prepared for the FMA by Melville Jessup Weaver last year suggested that fees charged by KiwiSaver providers are high when compared to broadly similar funds in the UK.

Continuing this work, we will soon release the findings of an analysis of active and passive fund management by MyFiduciary.

We want to ensure KiwiSaver members are getting what they pay for. Where a manager is charging a premium for an active management style we want to be sure that members know how the manager is adding value.

Equally, that the fees charged for low cost passive investments are fair and represent good value.

ESG investments

In a similar vein to our focus on active and passive managers in KiwiSaver, we will be taking a closer look at their environmental, social and governance (ESG) investments. Again this is where managers can position their funds as having a point of difference due to the responsible or ethical nature of the funds. Our initial focus here will primarily be on the labelling and disclosure of the funds so that people can be sure they are getting what's on the tin.

Outside KiwiSaver there is increasing demand for these products and the FMA has a role to facilitate innovation in New Zealand's capital markets.

While we are supportive of their development, ESG products add a layer of complexity to the investing landscape.

While we are supportive of their development, ESG products add a layer of complexity to the investing landscape and there are issues to consider, chief among these issues is the potential for greenwashing.

We will also be watching with interest the types of hybrid products, and the way they are labelled, which are being targeted at retail investors to support banks' Tier 1 capital requirements.

We look forward to a year of consolidation and collaboration with the industry. It is important to recognise we share a common goal in promoting a healthy, resilient financial service sector where the interests of customers are placed at the heart of every business. Doing the right thing and keeping these principles top of mind through a period of change and evolution will ensure we can succeed.

NZBA: Conduct, culture and capital

Roger Beaumont
Chief Executive,
New Zealand Bankers' Association

NEW ZEALAND BANKERS ASSOCIATION

ROGER'S BIO

The New Zealand banking industry is living in interesting times. In 2019 the three C's – conduct, culture and capital – dominated our landscape. Where have we got to and what's coming up?

Good conduct and customer outcomes

Conduct and culture continued to be in the spotlight following the Reserve Bank of New Zealand (RBNZ) and Financial Markets Authority 2018 review. It found no evidence of widespread misconduct, but did require banks to tighten their systems to more effectively identify, manage and remediate conduct risks.

Conduct and culture continued to be in the spotlight.

Banks have continued to work closely with the regulators on their own board-endorsed action plans to respond to the review's recommendations. That importantly included all affected banks removing sales incentives for front line staff and their managers. This move avoids potential or perceived conflicts for staff and helps ensure banks are serving customer needs.

In addition to the work individual banks are doing to support good conduct and culture outcomes, the NZBA has been working with the industry on guidance to help banks serve customer needs.

The guidelines will flow from the *Code of Banking Practice* in which banks commit to treating customers fairly and reasonably. They will aim to help bank staff understand what it means to serve the needs of customers and deliver good outcomes. The guidelines are intended to meet evolving customer and community expectations of banks.

Vulnerable customers

As a subset of ensuring they meet their customers' needs, banks are also looking at how they are working with customers in vulnerable circumstances. That includes reviewing their systems, processes, products and services to ensure that they are inclusive of the diverse needs of customers. Vulnerability comes in many forms, and may be related to certain timeframes or life events. For example, it covers customers who may be experiencing financial stress, mental and physical issues, or grief.

Banks are also looking at how they are working with customers in vulnerable circumstances.

In April last year the NZBA also launched revised guidelines, written in plain language, that sets out what banks will do to meet the needs of older and disabled customers. In particular, banks will train staff to help and understand, and they'll consider older and disabled customer needs in providing customer information, products and services, in physical banking spaces, and for ATMs and electronic banking services.

As with the proposed guidelines to help banks serve customer needs, these revised guidelines flow from the *Code of Banking Practice*. They were previously voluntary for our retail member banks. As of January this year, those banks have all committed to follow the guidelines.

New consumer-focused regulation

During the year the Government announced that it would fast-track new regulation so financial service providers put their customers first. As well as banning sales incentives, which the banks have already done, the Financial Markets (Conduct of Institutions) Amendment Bill introduces a licensing regime for financial institutions and will require them to ensure products sold to customers are fit for purpose and meet their needs. The Bill is currently before Parliament.

During the year the Government also announced it would fast-track new regulation so financial service providers put their customers first.

In addition, other major regulatory changes in the pipeline include the Credit Contracts Legislation Amendment Act to target irresponsible lending, alongside the Financial Services Legislation Amendment Act to ensure financial advisers meet their clients' interests.

So there's a bit going on.

The RBNZ's consultation on banks' capital adequacy attracted a lot of attention.

Capital

At the same time, the RBNZ's consultation on banks' capital adequacy attracted a lot of attention, both in the media and among business and consumer groups. This is perhaps surprising for an issue that might otherwise have gone under the radar. It reflects the RBNZ's desire to engage a broader cross-section of stakeholders on banking stability matters than it might have previously.

Following the consultation the RBNZ retained its proposal to raise the minimum total capital requirement for systemically important banks to 18%. There was movement for non-systemically important banks that will now have a total capital minimum of 16%. The implementation period has also been moved from five to seven years.

The final decision also usefully recognises the difference between the larger systemic and smaller non-systemic banks. That's reflected in the lower total capital requirements for smaller banks. There was also a levelling of the playing field between the two whereby the larger banks that use their own internal risk models will now be closer to the standardised model used by other banks. That means banks will need to hold similar levels of capital for similar types of risk, which promotes competition within the banking sector.

We support a strong and stable banking system that can withstand significant shocks. The fact remains that the RBNZ's decision will have a cost for our economy. The new requirements will impact each of our banks differently because of their exposure to different types of lending, how much capital they currently hold, and their ability to raise new capital.

We support a strong and stable banking system that can withstand significant shocks.

Each of the banks is considering the implications for their business and is developing its own commercial response. Depending on each bank's position, managing the new capital requirements may be met by a mix of responses including retained earnings and less lending in certain sectors. The RBNZ also expects some of the costs to fall on customers.

What's coming up

We expect conduct, culture and capital to continue to be major focuses for the banking industry in 2020 as we continue to implement changes in those areas.

At the same we'll be pushing ahead on some new proactive initiatives. They include the regional banking hubs pilot that we announced last September[68].

FOOTNOTE 68

Banking hubs will be trialled in Martinborough, Opunake, Stoke and Twizel. The hubs will feature a Smart ATM, support staff and online and technology support. The idea is to test demand for an innovative banking service in small towns where individual bank branches have become unsustainable because customers prefer other ways of banking.

Among other initiatives, we'll continue to work with the Banking Ombudsman to develop a complaints dashboard that aims to make customer issues more transparent. At the moment the Banking Ombudsman, as the free and independent dispute resolution service, largely only sees unresolved issues between banks and their customers. Through the complaints dashboard, banks will also share information about customer complaints they resolve themselves, which is the vast majority.

We'll also be looking at ways to further support financial capability, particularly for people in vulnerable circumstances.

In 2020 the banking industry is still likely to be living in interesting times, but our focus will be more on bedding in previously announced changes and developing new initiatives to enhance our social licence to operate.

CoreLogic: Review of property banking in 2019

Ben Speedy
Country Manager, New Zealand
CoreLogic

BEN'S BIO

Arguably the best description for the banking sector in terms of residential mortgage lending activity in 2019 was a 'year of two halves'. Activity was relatively restrained earlier in the year, as potential borrowers (especially investors) remained cautious, but this gave way to stronger performance in the second half of 2019, partly as internal serviceability rates were eased, and, for other reasons (e.g. low returns on alternative assets), buyer demand for property also improved.

So to start at the start, based on the Reserve Bank of New Zealand (RBNZ)'s aggregated mortgage lending data, the soft patch for activity really kicked in around from March through to May. For example, in March, overall lending flows were about $80 million lower than a year earlier, while the drop in May was more than $120 million. Throughout 2019, owner-occupiers (especially first home buyers at high loan-to-value ratios (LVRs), i.e. >80%) retained a decent appetite to borrow, so the weakness earlier in the year reflected subdued investor flows. Of course, the lending speed limits remain pretty tight for investors (in other words, a supply-side restraint), but it would seem that soft demand was the real cause – at least partly reflecting fears at the time that a capital gains tax (CGT) was going to be introduced.

However, once the CGT proposals were surprisingly scrapped in April, confidence started to return, alongside a decline in the returns available on other assets, such as term deposits. That laid the foundation for investors to return to property, and helped to give overall mortgage lending activity another leg up. In addition, the internal serviceability tests began to ease in late August, and the combined effect was pretty immediate. September saw investor lending flows begin to recover, and in each of the following three months, overall activity was up by at least $550 million on a year-on-year basis (see Figure 20). This has been driven mostly by larger average loans sizes rather than more loans.

VIEW FIGURE 20

It's important to point out that the rise in lending towards the end of 2019 did not come about because of lax credit policies – in fact, quite the opposite. For a start, the RBNZ has kept the LVR speed limits unchanged at 20% for high LVR owner-occupiers (less than a 20% deposit) and 5% for investors (less than a 30% deposit). Not only that, but the banks themselves have been sticking steadfastly below those limits, with a self-imposed buffer of 5%, while interest-only lending remains contained too. Higher debt-to-income loans have also been reined in, while income and expense testing has remained pretty stringent. The upshot is that non-performing loan ratios and mortgagee sales are very low.

The CoreLogic Buyer Classification series re-emphasises all of these trends. First home buyers (FHBs) held their ground well in 2019, retaining a market share of purchases in the vicinity of 24% – as high as it's been for at least 15 years.

TABLE 9: SHARE OF LENDING			
By number of mortgage registrations	**2017**	**2018**	**2019**
Lifestyle	8.3%	8.1%	7.6%
Apartment	2.6%	2.8%	3.1%
House	79.0%	78.8%	78.7%
Flat	10.1%	10.2%	10.6%

Meanwhile, after a quiet start to 2019, mortgaged multiple owners (or investors) came back strongly in the second half of the year, raising their share of purchases from 23% in Q2 to 25% in Q4. That was the highest figure since late 2016, which was when the third round of LVR changes was made, requiring investors to have a 40% deposit. Meanwhile, movers (i.e. existing owner occupiers who are relocating) are pretty quiet, in many cases staying where they are because of a lack of listings (and fear they won't find the next house they really want).

What about by property type? The past 12 months have seen a continuation of the patterns from 2018, whereby lifestyle property lending has fallen as a share of the total (as has house lending, albeit by a smaller amount), but apartments and flats have taken a bigger slice of the pie (see Table 9 on page 55). This fits with other evidence, such as building consents data, which shows that smaller dwellings are becoming increasingly popular.

What about by payment type? Reflecting the dominant pricing structure, with fixed rates often cheaper for borrowers than variable or floating, fixed lending has continued its rise as a share of the total. Indeed, it currently comprises 84% of the value of outstanding mortgage debt in New Zealand, up from 82% at the end of 2018, and the highest level since late 2008. More than 35% of total mortgage debt is fixed for at least one year. This gives households and the financial system certainty and stability.

So in that general environment (i.e. strong/high LVR FHBs, strong investors, subdued movers), which banks have enjoyed the limelight? The CoreLogic mortgage market share stats show that both ANZ and Westpac had a rise in market share for FHBs in 2019 (based on the number of mortgage registrations), a segment that saw some fierce competition last year. Westpac also saw its market share rise in the investor segment, as did ASB.

Overall, 2019 turned out to be a pretty good year for mortgage lending activity in New Zealand. Conditions look to be set fair for at least the first half of 2020 as well, and probably for the whole year. The key issue looming is the beginning of the new capital requirements regime on 1 July, but given that the adjustment phase is seven years, it's hard to see a clear material effect on mortgage rates or credit supply coming through this year. By buyer type, it wouldn't be a surprise to see investors remain active, so banks with solid offerings in this segment may well fare the best in 2020.

Massey: Banking industry review and forecasts

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CHRISTOPH'S BIO

"An economist is an expert who will know tomorrow why the things he predicted yesterday didn't happen today. "

Evan Esar

In this section, we forecast the key performance drivers for the New Zealand banking industry, namely lending, net interest margin, and credit loss rate.

2019 was an eventful year for the banking sector. In August, the Reserve Bank of New Zealand (RBNZ) surprisingly cut the OCR by half a percentage point to 1.0% and in December it announced the outcomes of the broadest ever review of regulatory capital requirements for registered banks. Throw in talks about a negative interest rate environment, and you understand why 2019 was out of the ordinary.

In this article, I assess the impact of the 2019 events on the banking sector. Specifically, I analyse and forecast the key performance measures of the sector, namely before-tax profit, lending volume, net interest margin, and the credit loss rate. The review covers the period from Q4 2018 to Q3 2019 (last available information) and, the forecast, the period from Q4 2019 to Q4 2021.

VIEW FIGURE 21

For the forecast, I use a combination of macroeconomic variables and time-series analysis (see Table 10 on page 57).

Specifically, I employ a vector autoregressive (VAR) model as it enables me to investigate how interaction between the variables changes the forecast. The results of my analysis are displayed in Table 11 on page 58. I also revisit the forecast supplied in last year's survey to see how accurate it was, review the performance of the New Zealand economy in 2019 and provide an economic outlook for 2020. On a personal note, the economist in me likes 'out of the ordinary' events as changes in the economic environment allow for interesting research projects. As a forecaster, however, I feel very differently: we use the past to predict the future so extra-ordinary events make for poor forecasts. Please keep this in mind when reading the remainder of this article.

2018/19 was a mixed year for banks in terms of before-tax profit. After a record high in Q3, 2018 of $2.18 billion, quarterly profits fell by 9% to $1.94 billion in Q4, 2018. There was a slight recovery in Q1 and Q2 of 2019 ($2.08 billion and $2.10 billion respectively) but profits fell again in Q3, 2019 to $1.77 billion. Overall, the rolling annual total from Q4, 2018 – Q3, 2019 was $7.89 billion, down by $190 million compared to the same period in the previous year. Net interest margins fell on average during this period, however, the larger lending volume ensured that total interest income increased during the 2019 calendar year by around $700 million. A closer look at the balance sheets reveals that while income rose, expenses grew marginally faster. I am sure this is something the major banks will bring to the attention of the RBNZ in light of the required capital increase.

Profits are expected to recover and slightly rise again during 2020, driven by a continuous growth in lending volume. The impact of the capital increase on profits during this year is a bit of an unknown.

The four major banks need to source $11 billion from equity and $9 billion through issuing preference shares but the implementation period has been extended to seven years and the start date pushed back to July 2020.

Profits are expected to recover and slightly rise again during 2020, driven by a continuous growth in lending volume. The impact of the capital increase on profits during this year is a bit of an unknown. The major four banks need to source $11 billion from equity and $9 billion through issuing preference shares but the implementation period has been extended to seven years and the start date pushed back to July 2020.

VIEW FIGURE 22

I now take a closer look at the industry performance drivers. The model uses a collection of past values of our drivers and before-tax profits; that is, a vector of time series, in order to predict future values. The key benefit of the VAR model is its ability to rely not only on previous values of past drivers, but also on previous values of profit, thus providing a two-way interaction within the model.

The definitions of industry drivers are:

- **Lending** – the total volume of lending broadly defined, that is, all interest-earning assets.
- **Net interest margin** – the difference between interest income and interest expense, expressed as a percentage of lending.
- **Credit loss rate** – provision for credit impairment, expressed as a percentage of lending.

Lending in 2019 was higher than anticipated, with a total lending volume of just under $212 billion for the Q4, 2018 to Q3, 2019 period. Lending growth was over 5% which is higher than the growth rates over the past years. Looking at our forecast for the period, quarterly lending volumes were at the top end or slightly above the predicted values. Banks passed on the low OCR to their customers, and reduced interest and mortgage rates provided substantial borrowing incentives. Our forecast suggests that lending volume continues to grow this year, however, at a slower rate. The anticipated total lending volume for 2020 is $226.8 billion up from $214.6 billion for the 2019 calendar year. Migration numbers are still strong and a key contributor to economic growth.

There is an expectation for numbers to stagnate or decrease. If this materialises then lending volumes could be affected especially if economic growth fails to re-ignite.

VIEW FIGURE 23

Net Interest Margins (NIM) were slightly lower than estimated (actual annual average of 2.03% with a forecast of 2.07%). This was caused by a drop from 2.07% to 1.97% in Q3, 2019. Expect NIM to remain at this value over the next few quarters with a possible marginal decline towards the end of the year. The new capital requirements will start to kick in during the second part of 2020, potentially increasing lending expenses. Also, low interest rates might discourage customers to make deposits. As banks in New Zealand are reliant on customer deposits to serve lending needs, a lower deposit volume might require banks to borrow internationally at higher rates.

As anticipated, the Credit Loss Rate (CLR) remained very low during 2019 and hovered around the 0.06% mark. Concerns about a potential increase due to the economic slow-down didn't materialise. Expectations are that the rate will remain around this value for 2020 and 2021.

TABLE 10: LIST OF MACRO-ECONOMIC INDICATORS

Macro variable	Description	Units	Source
gdp	Gross Domestic Product (expenditure based)	$mn, nominal index	RBNZ
bankbill90	90-day bank bills rate	%, annualised	RBNZ
govbond10y	10-year government bond yield	%, annualised	RBNZ
unemployed	Number of registered unemployed	Number	RBNZ
avgqhouseloancount	Average number of home loans approved	Number	RBNZ
estpop	Estimated population of New Zealand	Thousands	Statistics NZ
cpindx	Consumer Price Index	Index level	RBNZ
housepricendx	REINZ house price index	Index level	REINZ
weeklyearnings	Weekly earnings	$, nominal	Statistics NZ
nzstocksndx	New Zealand all stocks index	Index level	NZSE

This low rate shows that lending regulations seem to work and that banks are conservative in credit risk assessments. There are expectations that loan-to-value ratio (LVR) restrictions might be loosened but it is unlikely that any change would be substantial enough to impact on the CLR. What could have an impact on the CLR is the lower deposit rate due to falling interest rates. Banks might struggle more to grow their lending and might be inclined to take more risks particularly if the OCR falls further or, becomes negative.

VIEW FIGURE 24

VIEW FIGURE 25

Changes in our macroeconomic indicators can impact the industry drivers used in our model. The regression results suggest that changes in lending volume are inversely related to changes in unemployment. Looking back at 2019, the unemployment rate remained low at around the 4% mark. We saw a slight increase of unemployment towards the end of the year to 4.2% and this trend is expected to continue with anticipated values to be around 4.5%. However, in an international context, our employment levels are strong which provides a stable platform for lending and a positive impact on lending volume and profits.

In August, the OCR dropped to a record low of 1% with many economists expecting further cuts in 2020. With economic growth still slow and inflation very low, the RBNZ might cut the OCR to possibly 0.25% over the course of 2020 to stimulate the economy.

As suggested earlier, population growth has slowed down over the past year. Using Statistics New Zealand's figures, our population has grown by around 80,000 people in 2019 to a total of 4,942,500 (annual growth rate of 1.6% compared to 1.95% during 2018). Population growth is a major driver of our economy. If the slowdown continues then the economy might struggle to kick into gear.

Inflation can have an impact on NIMs as environments of higher inflation often entail greater credit risk, which banks need to offset with higher margins. The Consumer Price Index (CPI) is a measure of inflation for New Zealand households and currently sits around 1.6 annual percentage change. This is in line with the majority of OECD countries. During 2018, the CPI rose to just under 2% but has fallen gradually during the second half of 2019. We anticipate the CPI to stay around the 1.6% mark during 2020. At this level, the impact on NIMs should be minimal, as possible increases in profit margins to compensate banks for increased risks, could be offset by the competition within the industry.

Record low interest rates are still reducing pressure on borrowers, which contributes to the low number of loan defaults and CLR. In addition, the housing market has cooled down in 2019 and expectations are that this trend continues during 2020 with possibly a mild pick-up towards the end of the year. Housing affordability, however, is still an issue and not just in Auckland, and household debt in relation to income remains high (around 165%). New Zealanders have also reduced their level of saving due to the very low OCR to a gross annual rate of around 20% (down by around 3% compared to the same period last year). Overall, none of these values are particularly alarming compared with other countries, however, the rate at which households become increasingly leveraged is a factor to watch.

TABLE 11: FORECASTING RESULTS VAR

VAR industry driver		2019 Q1	2019 Q2	2019 Q3	2019 Q4	2020 Q1	2020 Q2	2020 Q3	2020 Q4	2021 Q1	2021 Q2	2021 Q3	2021 Q4
		Actual	Actual	Actual	Forecast	Forecast	Forecast	Forecast	Forecast	Forecast	Forecast	Forecast	Forecast
Lending ($Billion)	Upper CI				560	571	582	593	604	614	625	636	647
	Forecast	524	530	543	549	556	563	571	578	586	594	602	610
	Lower CI				539	541	545	549	554	558	564	569	574
Net Interest Margin (%)	Upper CI				2.09%	2.10%	2.10%	2.10%	2.09%	2.09%	2.08%	2.07%	2.06%
	Forecast	2.09%	2.07%	1.97%	1.97%	1.98%	1.97%	1.97%	1.96%	1.95%	1.94%	1.93%	1.92%
	Lower CI				1.86%	1.86%	1.85%	1.84%	1.83%	1.82%	1.81%	1.80%	1.80%
Credit Loss Rate (%)	Upper CI				0.09%	0.10%	0.10%	0.10%	0.09%	0.09%	0.09%	0.09%	0.08%
	Forecast	0.05%	0.05%	0.07%	0.06%	0.05%	0.05%	0.04%	0.04%	0.04%	0.03%	0.03%	0.03%
	Lower CI				0.03%	0.01%	0.00%	-0.01%	-0.01%	-0.02%	-0.02%	-0.02%	-0.03%
Profit Before Tax ($Billion)*	Upper CI				2.20	2.25	2.30	2.34	2.37	2.40	2.42	2.44	2.46
	Forecast	2.08	2.10	1.77	1.97	2.00	2.04	2.06	2.09	2.11	2.13	2.15	2.17
	Lower CI				1.74	1.75	1.77	1.78	1.80	1.82	1.84	1.86	1.88

* Forecasts for profit before-tax will seem less than in the forecasts of previous publications due to the fact that the figures are not annualised.

See Table 10 on page 57.

Before looking at the economy, a few notes need to be stated about our model and data. First, although macroeconomic indicators are not explicitly used in the VAR model, the impact of these indicators is already factored into past values of the performance drivers. Second, we did not attempt to take the current regulatory changes into account. This is a limitation of our analysis as clearly, the increase in capital requirement and the speculation about negative interest rates could have an impact on our performance drivers. However, nobody really knows how the banks will respond and how immediate the impact might be. Capital change requirements will kick-off in July and will be phased in over seven years and it's hard to believe that interest rates will drop below zero by the end of the year. Rather than to speculate, we made no special adjustments to our model. If the changes do have an impact in 2020 then this will be captured in next year's forecast by the actual 2020 values.

We now take a closer look at the performance of the New Zealand economy in 2019 and identify challenges that lie ahead. The economy grew by around 2.2%, which is about half of the 2016 value but above expectations, given the significant slowdown at the beginning of 2019. Quarterly growth had dropped from 1% in Q4, 2018 to just 0.1% in Q2, 2019 but recovered towards the end of the year with a Q3 value of 0.7% (Statistics New Zealand's figures). Factors that have contributed to the slowdown are essentially the same that caused the slowdown in the previous year: a slight decline in net immigration numbers as well as a cooling down of the housing market, resulting in lower consumption and residential investment. The expectation is that our economy will stabilise during 2020 with GDP growth of around 2%.

Construction activity has slightly fallen during the first half of 2019 but has picked up since. Future growth is expected to be stagnant due to capacity constraints. The situation in the tourism sector is not too dissimilar. While demand to visit New Zealand is strong, future growth is constrained by infrastructure and other capacity issues such as staffing.

Expectations of a softer New Zealand dollar became a reality in 2019. After an initial rise during the first three months of the year, the New Zealand dollar eventually hit a four-year low against the US dollar in October. This was a response to the falling OCR and a slowdown of the economy. Since then the New Zealand dollar strengthened again to reach July levels but overall performed weaker during the year. This trend is expected to continue as the interest differential to other major economies is getting smaller.

There was hope that the weaker New Zealand dollar would boost exports in 2019 and reduce our trade deficit. Total exports did rise but our overall annual trade deficit remained at around $4.8 billion. While we saw a seasonally-driven positive monthly trade balance in the first part of 2019, it hit an all-time record low in August of minus $1.64 billion.

Our terms of trade (relative price ratio of exports versus imports) remained positive due to strong global prices of our trading goods. The forecast for 2020 is for the overall trade balance to remain at current levels and the terms of trade to marginally increase.

Economic growth of our main trading partners has continued to slow down. The Chinese annual GDP growth rate is still solid, but has dropped to around 6% and Australia, Japan, and the UK are only growing in the low to mid 1%.

The USA has grown at a similar pace to New Zealand in 2019, however, US economic expansion has slowed down from an annual growth rate of around 3% in 2018 to around 2% in 2019. This trend might continue given the uncertainty about the Iran crises. Overall, the outlook for the world's main economies for 2020 is not as positive as in the past years and the real possibility of war in the Middle East and a 'hard Brexit' might upset things further. However, global demand for New Zealand products remains strong and given the robustness of the New Zealand economy, one would hope that it can cope with potential international shocks.

To conclude, by banking standards 2019 was a turbulent year. Despite the ever-growing lending volume, annual profits fell slightly due to lower interest margins and increased costs. Overall, however, the industry is in good shape and this is unlikely to change despite the current regulatory changes and the possibility of unconventional monetary policies. For the New Zealand economy, 2019 was similarly turbulent with a substantial drop of quarterly growth followed by a recovery. Like the banking sector, our economy is also in good shape. All this might change however, if immigration numbers continue to drop, household debt continues to rise and interest rates become negative.

Ownership and credit ratings

as at 30 January 2020

			Long-term credit rating					
Registered banks	**Ultimate shareholding**	**%**	**Standard & Poor's**		**Moody's**		**Fitch Ratings**	
ANZ Bank New Zealand Limited	Australia and New Zealand Banking Group Limited	100	AA-	Stable	A1	Stable	AA-	Negative
ASB Bank Limited	Commonwealth Bank of Australia	100	AA-	Stable	A1	Stable	AA-	Negative
Australia and New Zealand Banking Group Limited – New Zealand Branch[69]	Australia and New Zealand Banking Group Limited	100	AA-	Stable	Aa3	Stable	AA-	Negative
Bank of Baroda (New Zealand) Limited[70]*	Bank of Baroda (India)	100			Baa3	Stable	BBB-	Stable
Bank of China (New Zealand) Limited	Bank of China Limited (China)	100	A	Stable	A1	Stable		
Bank of China Limited – New Zealand Branch[71]*	Bank of China Limited (China)	100	A	Stable	A1	Stable	A	Stable
Bank of India (New Zealand) Limited[72]*	Bank of India (India)	100	BB+	Stable	Baa3	Stable	BBB-	Stable
Bank of New Zealand	National Australia Bank Limited	100	AA-	Stable	A1	Stable	AA-	Negative
China Construction Bank (New Zealand) Limited	China Construction Bank Corporation	100	A	Stable	A1	Stable	A	Stable
China Construction Bank Corporation – New Zealand Branch[73]*	China Construction Bank Corporation	100	A	Stable	A1	Stable	A	Stable
Citibank, N.A. New Zealand Branch and Associated Banking Group[74]	Citigroup Inc.	100	A+	Stable	Aa3	Stable	A+	Stable
Commonwealth Bank of Australia – New Zealand Branch[75]	Commonwealth Bank of Australia	100	AA-	Stable	Aa3	Stable	AA-	Negative
Heartland Bank Limited	Various investment/nominee companies; various private shareholders	100					BBB	Stable
Industrial and Commercial Bank of China (New Zealand) Limited[76]	Industrial and Commercial Bank of China Limited (ICBC)	100	A	Stable	A1	Stable	A	Stable
JPMorgan Chase Bank, N.A. New Zealand Branch[77]	JPMorgan Chase & Co.	100	A+	Stable	Aa2	Stable	AA-	Stable
Kiwibank Limited	Various[78]		A	Positive	A1	Stable	AA-	Stable
Kookmin Bank Auckland Branch[79]	KB Financial Group Inc.	100	A+	Stable	Aa3	Stable	A	Stable
MUFG Bank, Ltd. Auckland Branch[80]	Mitsubishi UFJ Financial Group, Inc.	100	A	Positive	A1	Stable	A	Negative
Rabobank Nederland New Zealand Banking Group[81]	Coöperatieve Rabobank U.A.	100	A+	Stable	Aa3	Stable	AA-	Negative
Rabobank New Zealand Limited	Coöperatieve Rabobank U.A.	100	A	Stable	Aa3	Stable		
SBS Bank	Mutual	100					BBB	Stable
The Co-operative Bank	Mutual	100					BBB	Stable
The Hongkong and Shanghai Banking Corporation Limited – New Zealand Branch[82]	HSBC Holdings plc	100	AA-	Stable	Aa3	Negative	AA-	Stable
TSB Bank Limited	TSB Community Trust	100					A-	Stable
Westpac Banking Corporation – New Zealand Division[83]	Westpac Banking Corporation	100	AA-	Stable	Aa3	Stable	AA-	Negative
Westpac New Zealand Limited	Westpac Banking Corporation	100	AA-	Stable	A1	Stable	AA-	Negative

* No Long-term credit rating, or no outlook for the rating, Long-term deposit has been used in place of Long-term debt.

FOOTNOTES 69–83

Descriptions of the credit rating grades

Long-term credit rating grades assigned by Standard & Poor's (S&P's)	Description of the steps in the S&P'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 and economic conditions.
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 to meet its financial commitments.
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 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 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.

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 in relation to gross loans and advances. This 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), depreciation of leased assets where a lessor, and amortisation of goodwill and other intangibles (including software)).
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.

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