KPMG

FIPS

Financial Institutions Performance Survey
March 2020 Quarterly Results

Overview

While the impact of the economic crisis caused by the COVID-19 health crisis was only just starting at the end of the March quarter, the results for the quarter demonstrate that its impact was also just starting to be felt by the banks.

The results published here are for the quarter ended 31 March 2020. The majority of the COVID-19 related impacts have happened since then.

The Prime Minister, Jacinda Ardern, announced an Alert System to manage and minimise the risk of COVID-19 in New Zealand and the country moved to Alert Level 4 on Wednesday, 25 March 2020. The lockdown was one of the most restrictive in the world and immediately reduced economic activity.

Financial services were largely deemed to be essential services so were able to continue operating even during this full lockdown. However, there were fundamental changes to how business was done. Branches were shut and the vast majority of staff were required to work from home. This caused initial challenges due to available bandwidth and hardware as well as working through compliance requirements data privacy aspects and the impact on personal lives.

Then came the influx of customer queries about mortgage deferrals and potential financial hardship once schemes to support borrowers were announced. While the initial flood of enquiries has passed, we expect the number of customers dealing with financial hardship as a result of the crisis to increase as the effects continue to impact customers for some time to come.

During this period, the Reserve Bank of New Zealand (RBNZ), the Government and the banks worked together on initiatives designed to assist the banks and their customers through the economic and financial impact.

In order to reduce pressure and allow resources to focus on customers, the RBNZ granted the banks extensions of between 6 and 12 months to comply with various regulatory and policy requirements[1] and delayed implementation of capital changes for a year.

This was quickly followed by a $9.3 billion business support package which included wage subsidies, a $6.25 billion Business Finance Guarantee Scheme for small to medium-sized businesses and a mortgage deferral scheme for those whose incomes had been affected by the economic disruption caused by COVID-19[2].

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Moving to Alert Level 3 on Monday, 27 April, enabled banks to open some of their branches for restricted hours and for some non-essential businesses to resume operations, subject to strict physical distancing and increased hygiene requirements.

In order to encourage the flow of credit, the RBNZ removed the loan-to-value ratio (LVR) restrictions for a 12-month period[5] and introduced term funding to banks at a very low interest rate to help them support the Government's Business Finance Guarantee Scheme and promote lending to businesses[6].

New Zealand moved to Alert Level 2 on Wednesday, 13 May, and to Alert Level 1 on Monday, 8 June.

At Alert Level 1, there are no restrictions on businesses, however, there is still considerable impact being felt. With tight border restrictions in place for the foreseeable future those in the tourism and hospitality sectors who rely heavily on international visitors are being particularly affected.

Strong banking system

Throughout this whole period, the RBNZ and individual banks have emphasised that New Zealand banks are in a strong financial position[7].

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Largely due to the changes made following the Global Financial Crisis (GFC), we entered this medical/economic crisis with our banking system in a strong position and capital adequacy remained stable in the quarter ended March 2020. The banks have been building up these capital buffers and are now being encouraged by the RBNZ to utilise these buffers in order to continue to lend since the RBNZ have extended the time allowed to meet the new minimum requirements.

While there is a lot of work currently being done by the banks to ensure compliance with the RBNZ's BS11 *Outsourcing Policy* regulation, which requires New Zealand banks to be able to operate completely onshore, the crisis triggered by the pandemic has clearly demonstrated a strong advantage to the New Zealand based banks having control of their own operations. Some banks found their business continuity plans were challenged when several offshore call centres and processing centres were out of action at the same time. As the local branches were closed, New Zealand staff were repurposed to answer customer queries.

The message is that the banks are not invincible, but they are well positioned to play a significant part in the support and then the recovery of New Zealand's economy.

The RBNZ has been stress testing the banks with several scenarios[8] ranging in severity and it feels that the banks are well placed to deal with this crisis which the RBNZ considers to be a one in a 200-year event. The message is that the banks are not invincible, but they are well positioned to play a significant part in the support and then the recovery of New Zealand's economy.

The strong financial position of the banks going into this economic crisis means that while profits were impacted in the quarter ended March 2020, the banks are currently able to absorb this. There is a long way to go before we will come to understand the full economic impact of COVID-19 in New Zealand and it will truly only be seen in future quarters.

Challenges to come

The challenges for a lot of people are still to come as the impacts of this economic crisis play out. This means that the banks will be facing some tough decisions as households and businesses are affected.

The definition of vulnerable customers is changing and there is likely to be an increasing number that fall into this new classification. Bank models, algorithms and guidelines used to assist banks in their decision making around these customers are increasingly at risk of being based on outdated and less relevant information so there is some work to be done on identifying where these assumptions are built into decision-making frameworks and how to reassess using appropriate data points.

The RBNZ has encouraged banks to be courageous in their lending.

The RBNZ has encouraged banks to be courageous in their lending[9]. The levels of lending are likely to ramp up over the next few months as the full implications of the economic crisis are felt for some individuals and businesses and their loans increase as a result of missed payments, while the low interest rates encourage others to borrow for home improvements or other investments.

The Government's wage subsidy has injected cash into a number of wage earners' bank accounts. For some, this will have been enough to cope with their immediate hardship, but for others it will only have delayed the need for further assistance. For many, borrowing will remain a last resort, as the banks, and responsible lending guidelines, will still require them to have the ability to repay the loan.

The banks will be challenged with valuing loan assets in sectors that have been most impacted by the economic crisis, such as retail, tourism and hospitality. The current level of provisioning indicates that there is a great level of uncertainty as to how this will play out. If we look at provisioning levels after the GFC, we can see how they emerged over time, but the big question is whether this crisis will be the same in the way it plays out.

The low interest rates we are seeing now are a result of the combination of the RBNZ's Official Cash Rate (OCR) reduction from 1.00% down to 0.25% in March (see Figure 1 on page 8) and global rates falling as the negative implications of COVID-19 started to become apparent. The RNBZ announced that it would remain at this level for at least 12 months. While the banks did cut their mortgage rates accordingly, they have continued to reduce their rates with a mini 'mortgage war' currently resulting in historic low fixed rates of 2.55% and floating rates of 3.40% available in the market (see Table 5 on page 9).

New mortgage lending was not impacted for the quarter, in part due to COVID-19 restrictions only impacting the last week of the quarter. In fact, there was an increase of 1.27% compared to the previous quarter and an increase of 4.64% compared to the same period in 2019. RBNZ data shows that April lending is much lower due to lockdown, but bounced back to 70% of March's level in May.

While the proportion of new lending below 80% LVR remained stable, this could be higher for the quarter ending June 2020 following the removal of the LVR restrictions by the RBNZ for 12 months from the end of April.

However, growth in >80% LVR lending will depend on the individual banks' risk appetite and we have already seen reports that some are reluctant to lend more than 80%[10]. What may drive an increase in this area is borrowers who have taken mortgage relief packages capitalising payments to the loan thus increasing their LVR.

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The net interest margin for the quarter ended March 2020 was stable with only two banks increasing by 10 basis points (bps), but where it goes over the next few quarters will be interesting to watch, especially whether it falls further or whether 2.0% will continue as an historic buffer level and we will see a rebound as it has done historically when it has hit this level.

Operating expenses increased by almost 9% overall in the quarter ended March 2020. This was largely driven by BNZ, which included a software capitalisation policy change that reduced BNZ's capitalised software balance.

The results for the next quarterly reporting period will include the lockdown period so it will reflect less expenses such as travel, but this may well be balanced by the increased expenditure on hardware to enable staff to work remotely.

Impairments have started to come through, but the situation is currently better than expected and probably does not reflect anywhere near the full impact. The global outlook is still challenging, and we expect it to take a while before the true impact is felt domestically too. While many individuals and businesses have already been affected, some of the impact will have been masked by the Government's stimulus package(s).

For a more detailed analysis, see pages 10–11.

With great power comes great responsibility

New Zealand banks currently occupy a privileged position. Unlike during the GFC, when the banks were seen as part of the problem, this time the banks are seen as integral to economic recovery. Our banks hold a unique position of trust, the 2020 Colmar Brunton Corporate Reputation Index[11] places two of our main banks in their top 20 most reputable New Zealand corporates, but they will need to work at maintaining this position.

According to figures published by the New Zealand Bankers' Association, the banks contributed $7.89 billion directly to the New Zealand economy in 2019.

According to figures published by the New Zealand Bankers' Association, the banks contributed $7.89 billion directly to the New Zealand economy in 2019 including $5.73 billion running their businesses and paying $2.19 billion in taxes. They employed over 25,000 people[12] so contributed significantly to sustaining New Zealand's economy.

The conduct and culture of New Zealand banks through this time will continue to be under greater scrutiny from both the regulators[13] and customers.

As we highlighted in the FIPS March 2019 Report, "a good customer experience does not always result in a good customer outcome. The challenge for banks will be to educate and communicate with customers where good customer outcomes can sometimes mean a 'no' (or 'not that way') and having strength in pillars such as Integrity and Empathy will assist in this process."[14] This was important pre-crisis and is especially true now. For example, allowing customers to continue deferring payments resulting in arrears eroding any potential capital recovery for the customer should repossession become necessary, or having open conversations about the benefits of fixed and floating rates will be important.

Consumers across the board are keen to reward businesses that they believe behaved responsibly through the lockdown period and banking customers are no exception. The importance of getting the basics right even while under immense pressure is viewed as critical.

Banks need to be seen to do the right thing by their customers and the economy as a whole while maintaining their own business viability.

It will not be enough just to do the right thing financially, banks need to be seen to do the right thing by their customers and the economy as a whole while maintaining their own business viability.

The economic crisis created by COVID-19 has highlighted that the level of financial resilience in New Zealand is lower than ideal.

Research published last year forecast that New Zealanders would save -1.23% of their disposal income. New Zealanders are among the world's worst savers, ranking 26th out of 29 countries based on data from the Organisation for Economic Co-operation and Development (OECD)[15], and this was before the impact of an economic crisis hit. How do we encourage more New Zealanders to have the traditional three months' worth of salary saved as a financial cushion?

A recent report released by the Commission for Financial Capability (CFFC)[16], showed that just 26% of New Zealand households could be considered financially secure when the survey was carried out in April 2020.

The high number of KiwiSaver withdrawals and fund switches indicates that Kiwis are unfamiliar with long-term investing in equities and could benefit from more education. The initial surge in request for mortgage payment deferrals receded when people realised that interest still accrued on the loan and it was not in fact a mortgage 'holiday'.

This crisis has clearly demonstrated the need for people to invest time and energy in financial planning for their future.

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Like many other businesses, banks are facing operational challenges as they transition back to business as usual whilst retaining some of the changes that occurred during the lockdown period. The increase in digital and contactless transactions will have regulatory implications and banks will be reviewing how to incorporate the positive streamlining of processes while ensuring legal and business compliance requirements are met.

As a nation, those that can afford to are being encouraged to spend locally and thereby help the economic recovery. This also applies to large organisations such as the banks. The implications of some cost saving measures have wider consequences to smaller businesses throughout the supply chain and consideration of the broader community needs to be considered.

Another area where the banks are being encouraged to use their power and influence for good is climate change.

Adrian Orr, RBNZ Governor, spoke about "incorporating the impact of climate change right into our core functions and monetary policy and also assessment of financial stability" and recently hosted a virtual roundtable, 'A Near Horizon'[17] which included Mark Carney, (United Nations Special Envoy for Climate Action and Finance and former Governor of the Bank of England) and James Shaw (Minister for Climate Change).

Signalling that the financial services sector as a whole can expect more reporting and disclosure requirements, it was clear that the RBNZ sees climate change as a material risk that banks need to consider.

You can read more in the article on page 19.

More to come

While the results from the quarter ended March 2020 are largely in line with previous quarters, due in part to the most significant COVID-19 related impacts only commencing in the last week of the quarter. We expect some more significant shift in banking key performance indicators in the quarters ending June and September 2020. This will be an evolving situation and one to watch.

This has been a time of unprecedented change and has provided an opportunity to reflect and examine what and how we want to reset our personal and business lives and wider values.

Results for the quarter

The overall profit has dropped by 20.41% ($229.6 million) which is driven largely by the significant increase in impaired asset expenses. For more details see pages 10–12.

Non-interest income increased by $401.9 million which has helped offset the dip in profits. This is likely to have been impacted by the volatility in the market due to the increasing uncertainty of the COVID-19 pandemic.

Operating expenses were up by almost 9%, but this varied across the banks. ASB recorded a significant reduction while BNZ's increase would have been heavily impacted by its software capitalisation policy.

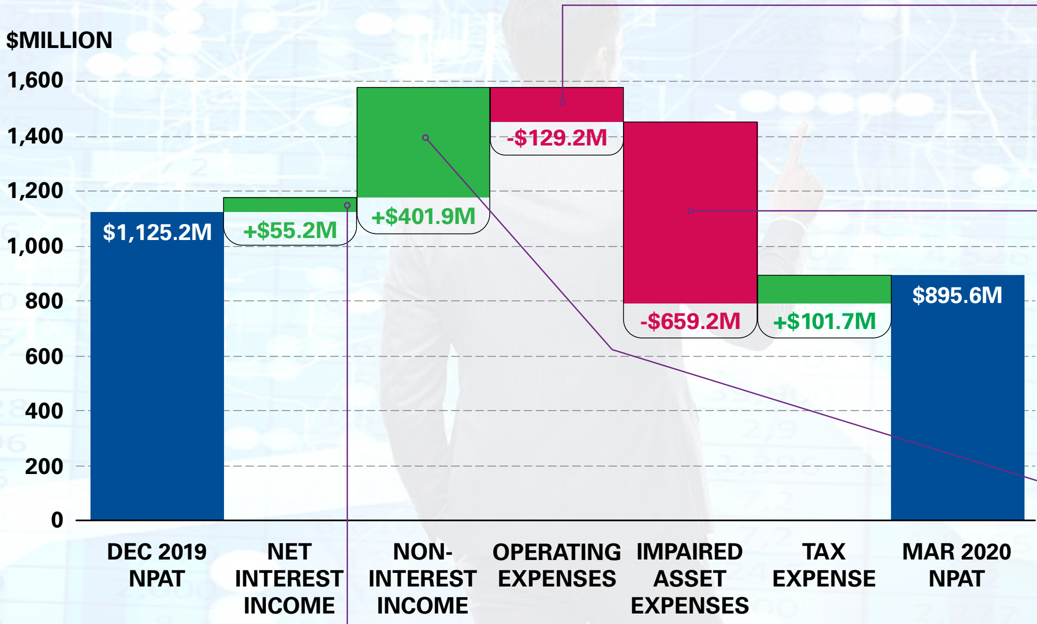
Net interest income increased slightly from the last quarter to $2,619.7 million (increase of 2.15%).

Net profit after tax

Movement in net profit

20.41%

to $895.6 million



Net interest income

2.15%

to $2,619.7 million

Driven by

Net interest margin

ASB/Kiwibank — 10 bps

Others — 0 bps

TABLE 3: Movement in interest margin

	31 Mar 20 quarter ended (%)[19]	Mvmt. during the quarter (bps)	Mvmt. for the 6 months (bps)	Mvmt. for the 12 months (bps)
ANZ	2.10	0	10	-10
ASB	2.00	10	10	0
BNZ	2.10	0	0	-10
Heartland Bank	4.50	0	-10	-20
Kiwibank	2.00	10	0	0
SBS Bank	2.50	0	0	0
TSB Bank	1.80	0	0	0
The Co-operative Bank	2.20	0	0	-10
Westpac	1.90	0	10	-20

Operating expenses

8.90%

up $129.2 million

Driven by

BNZ	$166M
ASB	-$27M

Non-interest income

72.86%

up $401.9 million

Driven by

ANZ	$241M
BNZ	$101M
Westpac	$69M

Impaired asset expenses

731.63%

up $659.2 million

Driven by

ANZ	$200M
Westpac	$168M
ASB	$142M

Lending

Loans

1.27%

to $446,922 million

The RBNZ cut the OCR on 16 March

0.75%

to 0.25%

Quarterly

Kiwibank 1.91%

Westpac 1.80%

BNZ 1.41%

Year on year

Kiwibank 10.36%

Heartland 7.03%

TSB 6.16%

1 CHANGES IN OCR – MARCH 2015 TO MARCH 2020

SOURCE: RESERVE BANK OF NEW ZEALAND STATISTICS

TABLE 4: Analysis of gross loans

Quarterly analysis	31 Mar 20 quarter ended $Million	31 Dec 19 quarter ended $Million	% Increase (Quarterly)	Annual analysis	31 Mar 20 quarter ended $Million	31 Mar 19 quarter ended $Million	% Increase (Annual)
ANZ	136,324	134,999	0.98%	ANZ	136,324	132,275	3.06%
ASB	93,819	92,865	1.03%	ASB	93,819	90,012	4.23%
BNZ	90,068	88,814	1.41%	BNZ	90,068	86,174	4.52%
Heartland Bank	3,794	3,748	1.23%	Heartland Bank	3,794	3,545	7.03%
Kiwibank	22,052	21,639	1.91%	Kiwibank	22,052	19,981	10.36%
SBS Bank	4,190	4,166	0.58%	SBS Bank	4,190	4,007	4.57%
TSB Bank	6,174	6,184	-0.16%	TSB Bank	6,174	5,821	6.07%
The Co-operative Bank	2,571	2,537	1.32%	The Co-operative Bank	2,571	2,467	4.22%
Westpac	87,931	86,378	1.80%	Westpac	87,931	82,829	6.16%
Total	**446,922**	**441,329**	**1.27%**	**Total**	**446,922**	**427,109**	**4.64%**

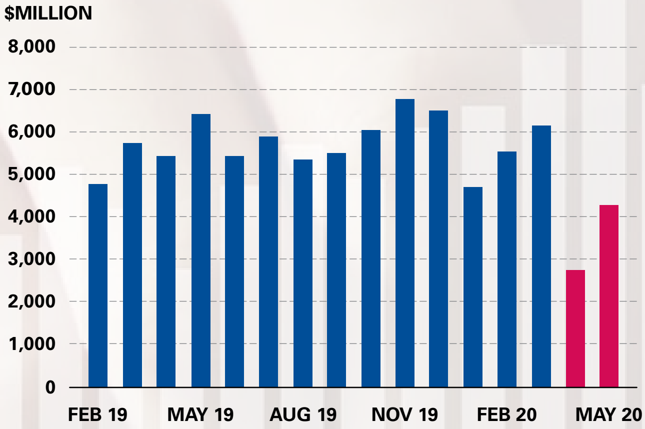
Lending was relatively stable during the quarter ended 31 March 2020 and rose 1.27%.

We know already that mortgage lending for April 2020 was a lot lower due to lockdown, but rebounded in May (see Figure 2 below). Residential lending (First-time buyers, other owner occupiers and investors) was less than half of the volume experienced in March 2020 (44%) and 50% of that in April 2019. Figures for May show that residential lending has recovered to 70% of March's level.

We expect some the bounce back to continue through to the end of the quarter as those who have been negatively impacted and have exhausted other credit options may look to borrow and those who are in stable financial positions may take advantage of the historically low interest rates (see Table 5 below) to borrow funds for home improvements or other investment opportunities.

The RBNZ removed the LVR restrictions in April 2020 with the intention of encouraging more first-time buyers to enter the housing market.

2 TOTAL MONTHLY MORTGAGE LENDING



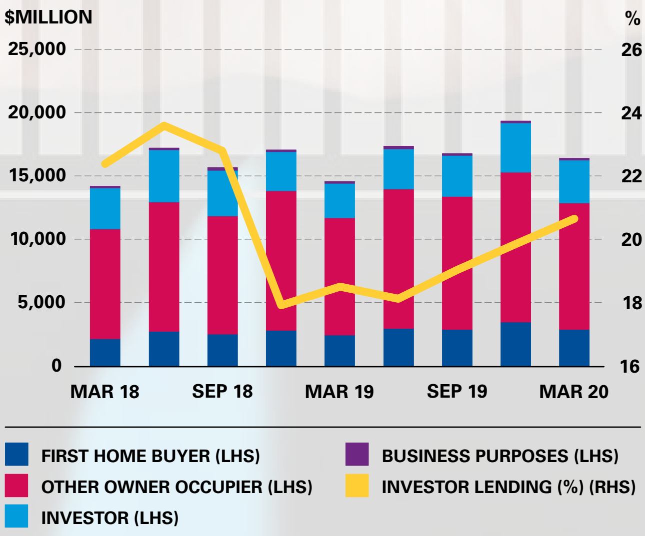
SOURCE: RESERVE BANK OF NEW ZEALAND STATISTICS

TABLE 5: Lowest advertised mortgage rates – June 2020

Term	Rate (%)
Floating	3.40
1 year	2.55
2 year	2.65
3 year	2.75
4 year	2.85
5 year	2.95

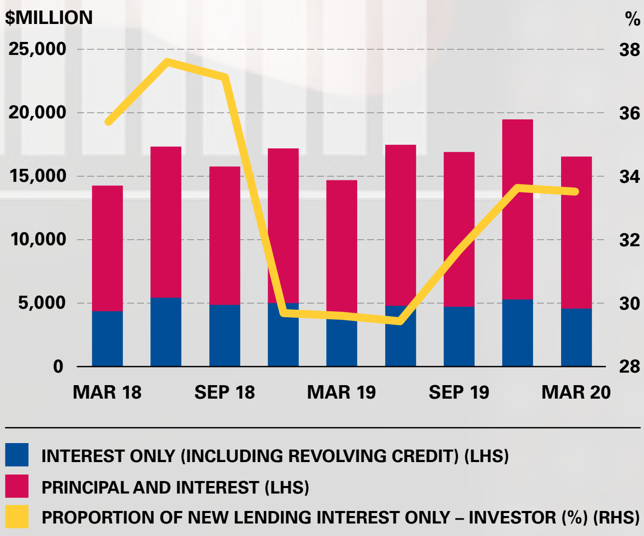
SOURCE: INTEREST.CO.NZ

3 NEW MORTGAGE LENDING BY BORROWER TYPE



SOURCE: RESERVE BANK OF NEW ZEALAND STATISTICS

4 NEW MORTGAGE LENDING BY PAYMENT TYPE



SOURCE: RESERVE BANK OF NEW ZEALAND STATISTICS

Asset quality

Individually assessed provisions

16.36%

up $59 million

Driven by

BNZ	$29M
Westpac	$33M
ANZ	-$16M

Collectively assessed provisions

32.54%

up $552 million

Driven by

ANZ	$157M
Westpac	$136M
ASB	$127M

As expected, the 31 March 2020 results start to reflect the onset of the COVID-19 crisis through a marked increase in the level of impairment provisions across the banking sector which rose by $611 million for the three months ended 31 March 2020.

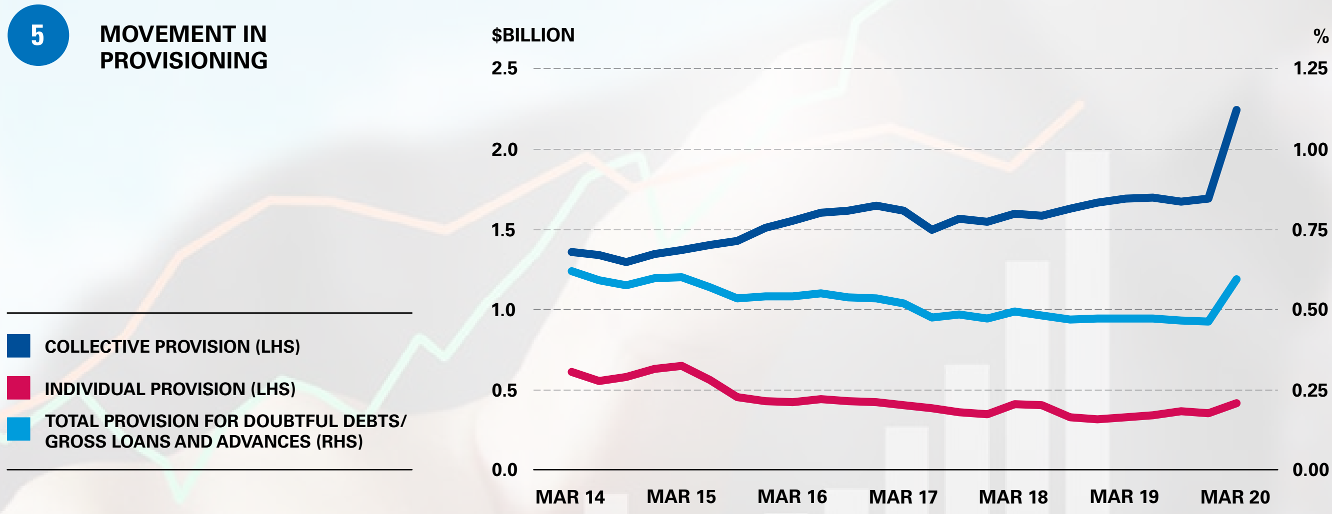
Although banks have gone into this crisis holding a strong level of capital and liquidity, asset quality and provisioning will be a key consideration for the banking sector in the short to medium term.

Loan provisioning remains a challenge due to the forward-looking requirements of accounting standards and the unpredictability of the current situation. This is reflected in the wide range of provisioning results reported across the banking sector.

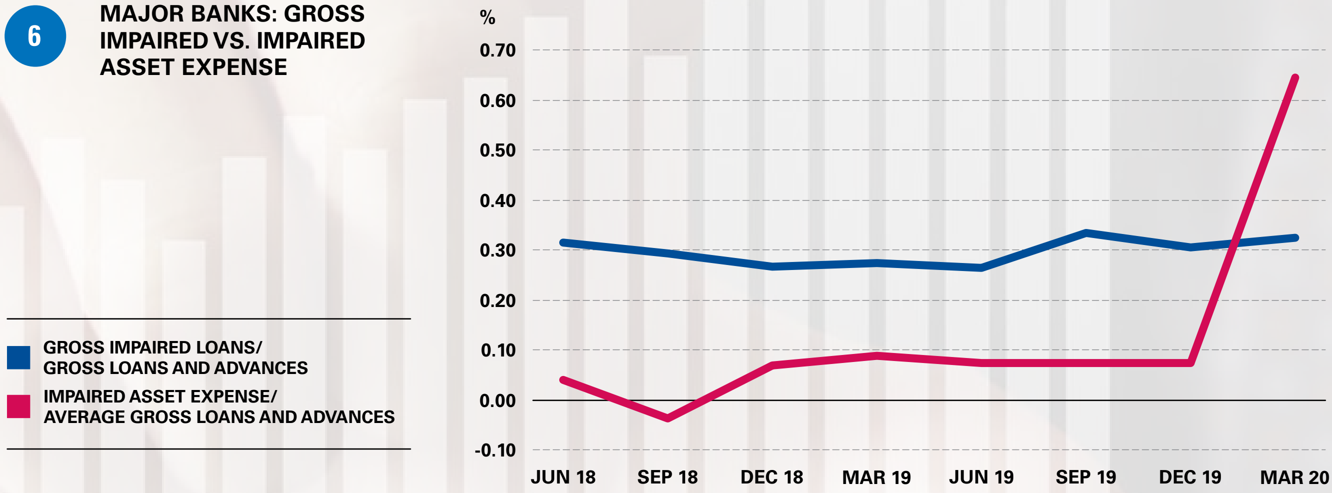
TABLE 6: Movement in impaired asset expense/ Average gross loans

	31 Mar 20 quarter ended (%)	Movement during the quarter (bps)	Movement for the 12 months (bps)
ANZ	0.64%	59	58
ASB	0.65%	61	51
BNZ	0.53%	39	40
Heartland Bank	0.69%	22	24
Kiwibank	0.28%	22	20
SBS Bank	2.44%	196	204
TSB Bank	1.29%	126	93
The Co-operative Bank	1.03%	93	87
Westpac	0.87%	77	83
Average	**0.67%**	**59**	**57**

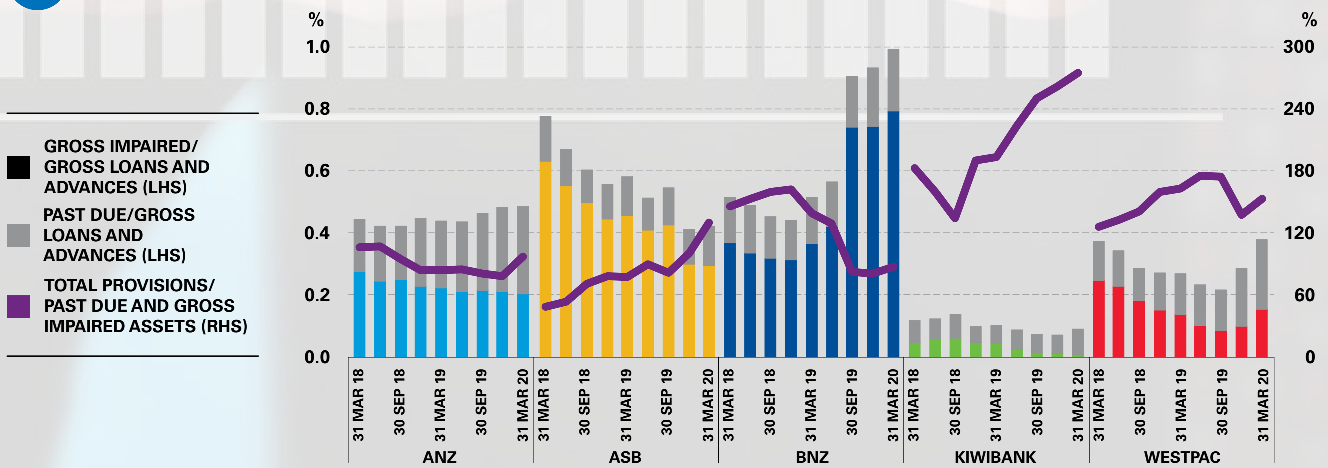
5 MOVEMENT IN PROVISIONING



6 MAJOR BANKS: GROSS IMPAIRED VS. IMPAIRED ASSET EXPENSE



7 MAJOR BANKS: PAST DUE AND GROSS IMPAIRED ASSETS VS. GROSS LOANS AND ADVANCES

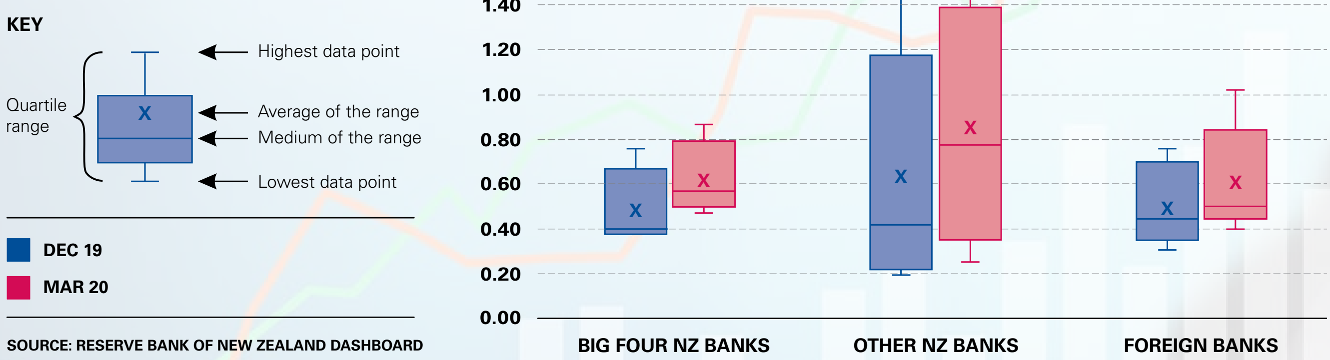


Provisions

The economic outlook is changing rapidly, as the global impacts of the COVID-19 pandemic and the resulting impacts on New Zealand continues to unfold. Much of the longer-term impacts of loan repayment deferrals and hardship requests will not be known for another 6 to 12 months, as normal payment terms resume, wage subsidies end and the impacts of the COVID-19 crisis continue to be felt.

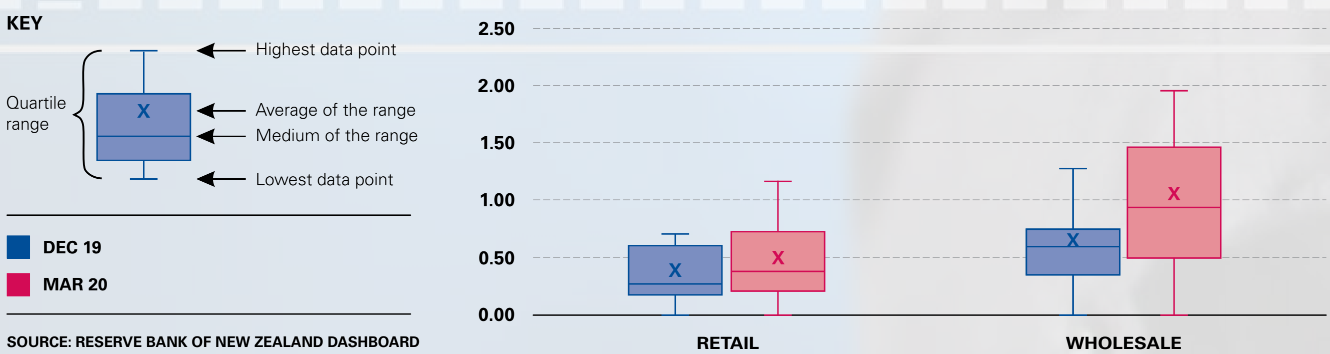
These results reflect that the average coverage ratio (i.e. Total provisions as a percentage of Total loans) for the banking sector increased by 10 bps from an average of 0.54% to 0.69% across all portfolios. However, the impact has been varied across the banks and also across portfolios, the driver for which might also be because some of these banks may still be in the process of working through incorporating the COVID-19 impact on their provisions.

8 INCREASE IN COVERAGE RATIO ACROSS ALL BANKS



SOURCE: RESERVE BANK OF NEW ZEALAND DASHBOARD

9 INCREASE IN COVERAGE RATIO FOR RETAIL AND WHOLESALE LOAN PORTFOLIO



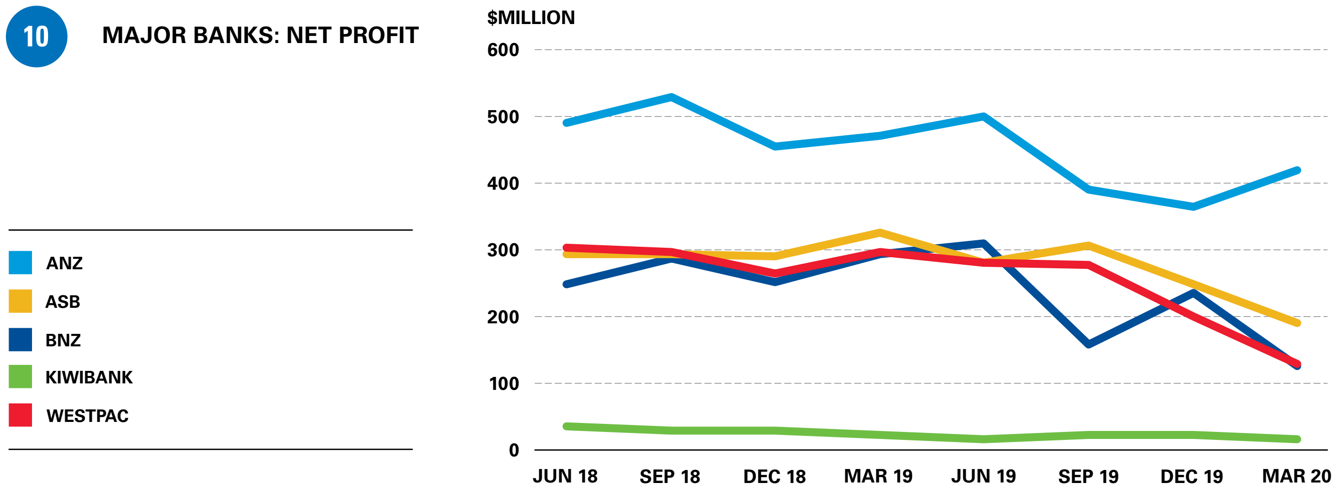
SOURCE: RESERVE BANK OF NEW ZEALAND DASHBOARD

Major banks - Quarterly analysis

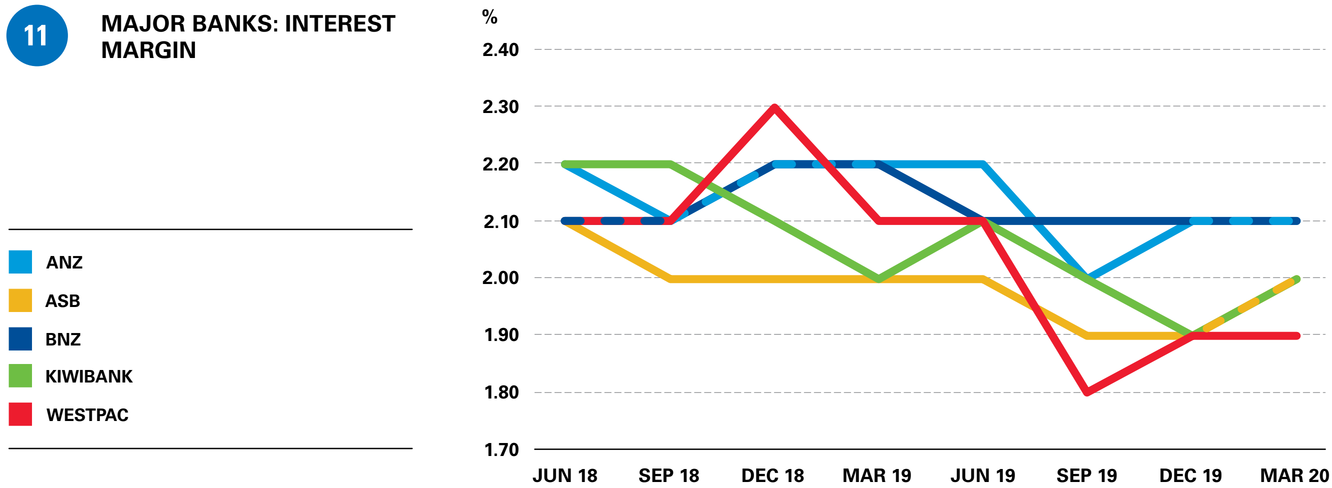
Entity	Size & strength measures							
	30 Jun 18	30 Sep 18	31 Dec 18	31 Mar 19	30 Jun 19	30 Sep 19	31 Dec 19	31 Mar 20
	Total assets[18] ($Million)							
ANZ	164,588	161,416	164,698	164,952	166,292	170,492	170,385	183,424
ASB	101,338	101,906	103,157	105,388	107,075	111,167	109,464	116,042
BNZ	101,678	99,991	102,536	103,758	105,313	109,111	108,289	118,501
Heartland Bank	4,496	4,596	4,018	4,054	4,139	4,206	4,262	4,315
Kiwibank	20,715	20,935	22,040	22,514	22,734	23,584	24,086	25,249
SBS Bank	4,501	4,574	4,660	4,755	4,791	4,863	4,948	4,942
TSB Bank	7,454	7,527	7,733	7,819	7,920	8,076	8,130	8,179
The Co-operative Bank	2,661	2,697	2,786	2,786	2,855	2,927	2,948	2,980
Westpac	98,438	96,656	98,537	100,180	101,464	106,762	107,111	120,525
Total	**505,868**	**500,298**	**510,164**	**516,204**	**522,582**	**541,188**	**539,622**	**584,157**
	Increase in gross loans and advances (%)							
ANZ	1.69	0.17	1.04	1.33	0.77	0.35	0.92	0.98
ASB	1.68	1.11	1.76	1.68	0.91	1.40	0.83	1.03
BNZ	2.01	1.64	1.46	1.35	1.56	1.07	0.41	1.41
Heartland Bank	2.69	3.12	-14.95	0.68	2.94	0.88	1.82	1.23
Kiwibank	0.93	2.49	2.93	2.85	2.89	1.63	3.57	1.91
SBS Bank	1.02	0.37	2.20	1.11	1.24	1.05	1.63	0.58
TSB Bank	2.66	1.88	1.88	2.40	3.77	2.72	-0.33	-0.16
The Co-operative Bank	1.51	2.48	2.17	1.04	0.77	0.98	1.08	1.32
Westpac	0.89	0.67	0.68	1.34	0.79	1.75	1.68	1.80
Average	**1.58**	**0.93**	**1.16**	**1.48**	**1.13**	**1.10**	**1.07**	**1.27**
	Capital adequacy (%)							
ANZ	14.80	14.40	15.20	14.60	13.50	13.60	13.60	13.90
ASB	13.90	13.90	14.80	14.30	14.00	13.50	14.20	13.60
BNZ	13.20	13.60	13.30	13.60	13.70	13.90	14.40	14.10
Heartland Bank	14.10	13.40	13.30	13.10	13.50	12.90	12.80	12.90
Kiwibank	15.80	15.70	15.30	14.90	14.50	13.50	13.20	13.00
SBS Bank	13.00	13.10	14.10	14.20	14.30	14.20	14.20	13.80
TSB Bank	14.70	14.50	14.80	14.60	14.50	14.60	14.60	14.30
The Co-operative Bank	16.70	17.20	17.20	17.10	16.60	16.70	16.40	16.30
Westpac	17.10	16.60	16.90	16.50	16.70	15.90	15.90	15.90
	Net profit ($Million)							
ANZ	492	530	456	473	504	392	367	422
ASB	296	297	292	329	282	310	252	192
BNZ	250	289	253	296	313	160	238	129
Heartland Bank	19	17	13	18	20	18	18	17
Kiwibank	39	32	30	25	20	25	27	17
SBS Bank	8	8	8	6	8	8	6	-4
TSB Bank	14	13	13	5	14	14	12	-8
The Co-operative Bank	3	3	3	1	2	2	3	-1
Westpac	305	299	266	300	284	280	203	132
Total	**1,423**	**1,489**	**1,335**	**1,455**	**1,447**	**1,208**	**1,125**	**896**

Entity	Profitability measures							
	30 Jun 18	30 Sep 18	31 Dec 18	31 Mar 19	30 Jun 19	30 Sep 19	31 Dec 19	31 Mar 20
	Interest margin[19] (%)							
ANZ	2.20	2.10	2.20	2.20	2.20	2.00	2.10	2.10
ASB	2.10	2.00	2.00	2.00	2.00	1.90	1.90	2.00
BNZ	2.10	2.10	2.20	2.20	2.10	2.10	2.10	2.10
Heartland Bank	4.40	4.40	4.30	4.70	4.50	4.60	4.50	4.50
Kiwibank	2.20	2.20	2.10	2.00	2.10	2.00	1.90	2.00
SBS Bank	2.60	2.60	2.50	2.50	2.50	2.50	2.50	2.50
TSB Bank	1.80	1.90	1.90	1.80	1.80	1.80	1.80	1.80
The Co-operative Bank	2.40	2.40	2.30	2.30	2.20	2.20	2.20	2.20
Westpac	2.10	2.10	2.30	2.10	2.10	1.80	1.90	1.90
	Non-interest income/Total assets[18] (%)							
ANZ	0.64	0.76	0.46	0.52	0.67	0.68	0.31	0.85
ASB	0.67	0.63	0.71	0.78	0.64	0.67	0.57	0.53
BNZ	0.55	0.64	0.36	0.67	0.79	0.45	0.30	0.65
Heartland Bank	0.67	0.27	0.23	0.32	0.44	0.42	0.46	0.32
Kiwibank	1.14	0.98	0.91	0.74	0.83	0.86	0.90	0.92
SBS Bank	0.82	0.88	0.92	0.81	0.75	0.78	0.82	0.70
TSB Bank	0.28	0.35	0.33	0.30	0.27	0.29	0.29	0.25
The Co-operative Bank	0.71	0.63	0.69	0.56	0.71	0.66	0.71	0.50
Westpac	0.74	0.60	0.43	0.69	0.59	0.70	0.37	0.59
Average	**0.66**	**0.68**	**0.50**	**0.64**	**0.67**	**0.63**	**0.41**	**0.68**
	Impaired asset expense/Average gross loans and advances (%)							
ANZ	0.02	-0.07	0.04	0.06	0.07	0.13	0.05	0.64
ASB	0.06	0.05	0.16	0.14	0.14	0.05	0.04	0.65
BNZ	0.14	0.03	0.06	0.13	0.12	0.18	0.14	0.53
Heartland Bank	0.60	0.61	0.79	0.45	0.38	0.50	0.47	0.69
Kiwibank	-0.04	0.01	0.07	0.08	0.08	0.03	0.06	0.28
SBS Bank	0.40	0.40	0.38	0.40	0.29	0.35	0.48	2.44
TSB Bank	-0.01	0.10	-0.16	0.36	-0.06	-0.02	0.03	1.29
The Co-operative Bank	0.17	0.15	0.13	0.16	0.13	0.03	0.10	1.03
Westpac	-0.01	-0.14	0.03	0.04	-0.03	-0.08	0.10	0.87
Average	**0.05**	**-0.02**	**0.08**	**0.10**	**0.08**	**0.08**	**0.08**	**0.67**
	Operating expenses/Operating income (%)							
ANZ	35.28	35.64	38.14	35.23	34.29	45.63	44.88	33.93
ASB	37.20	35.39	35.22	33.58	37.72	35.89	43.48	38.09
BNZ	40.48	37.85	40.42	35.66	35.47	61.11	40.38	58.00
Heartland Bank	41.07	41.60	47.60	39.96	40.16	42.77	44.23	40.78
Kiwibank	69.20	72.87	71.71	74.33	78.57	78.13	79.01	75.76
SBS Bank	61.38	60.91	62.97	65.97	62.14	64.21	65.58	56.07
TSB Bank	50.77	53.75	60.63	69.31	54.14	54.46	60.00	80.68
The Co-operative Bank	76.50	75.00	76.33	87.88	80.00	82.09	75.48	75.77
Westpac	36.77	38.26	39.89	37.45	39.91	41.82	47.07	42.68
Average	**39.46**	**39.15**	**40.91**	**38.27**	**39.21**	**47.89**	**46.59**	**44.25**

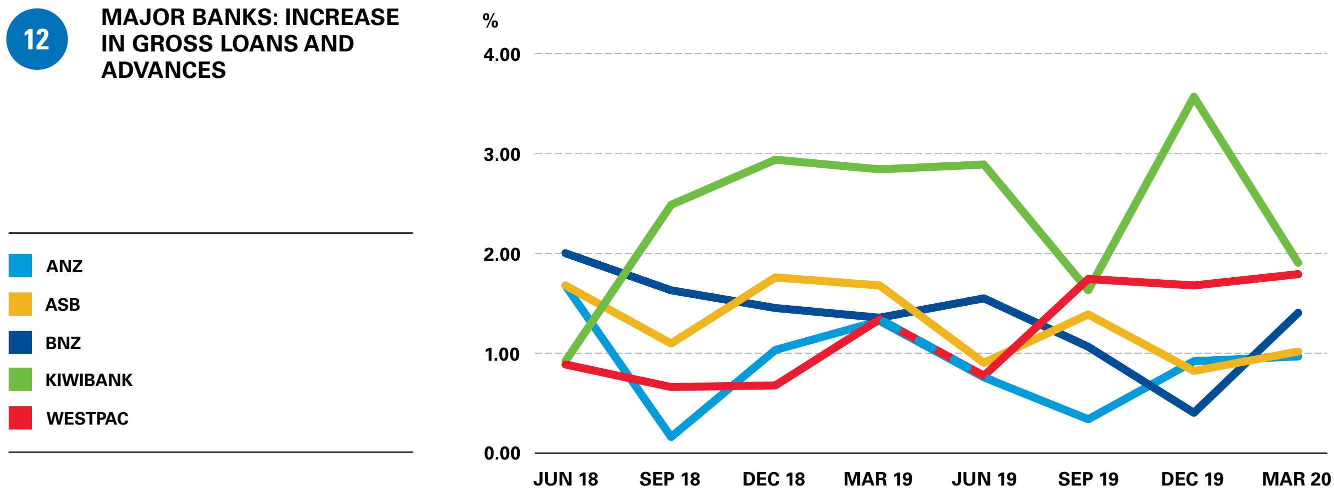
10 MAJOR BANKS: NET PROFIT



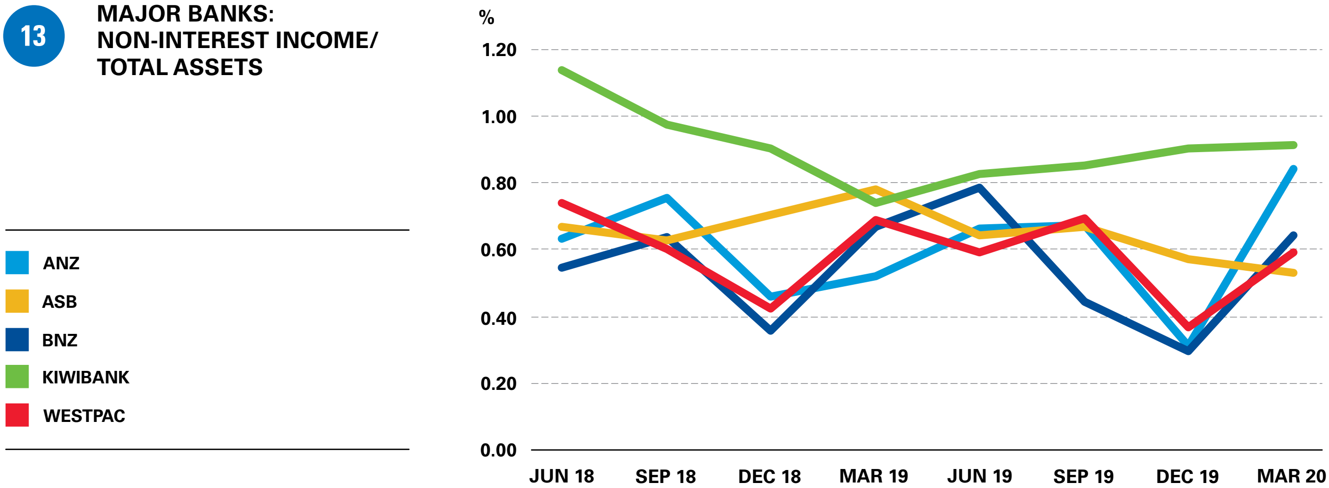
11 MAJOR BANKS: INTEREST MARGIN



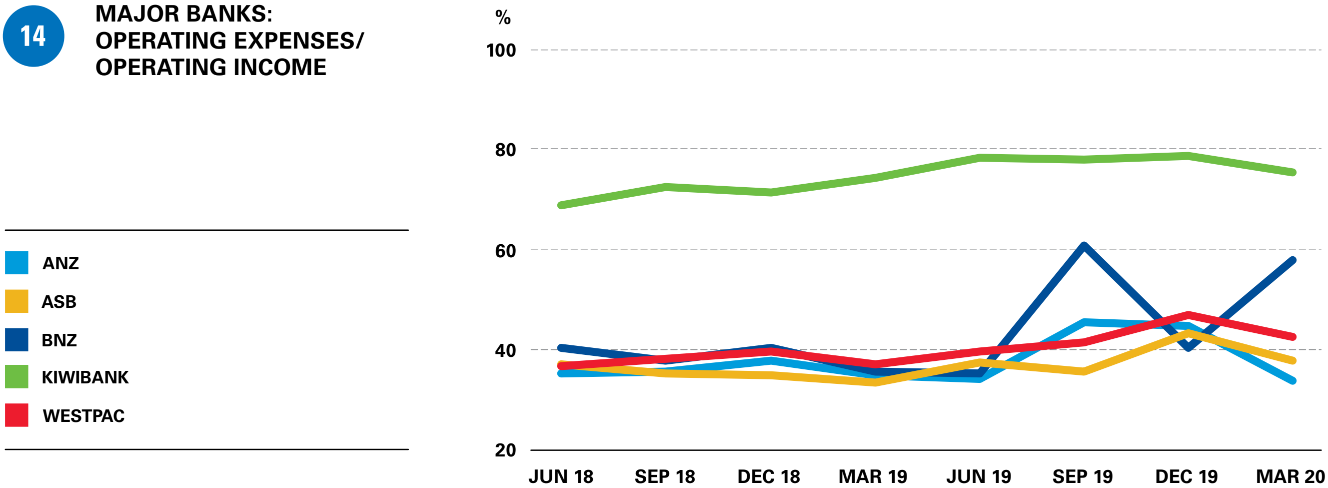
12 MAJOR BANKS: INCREASE IN GROSS LOANS AND ADVANCES



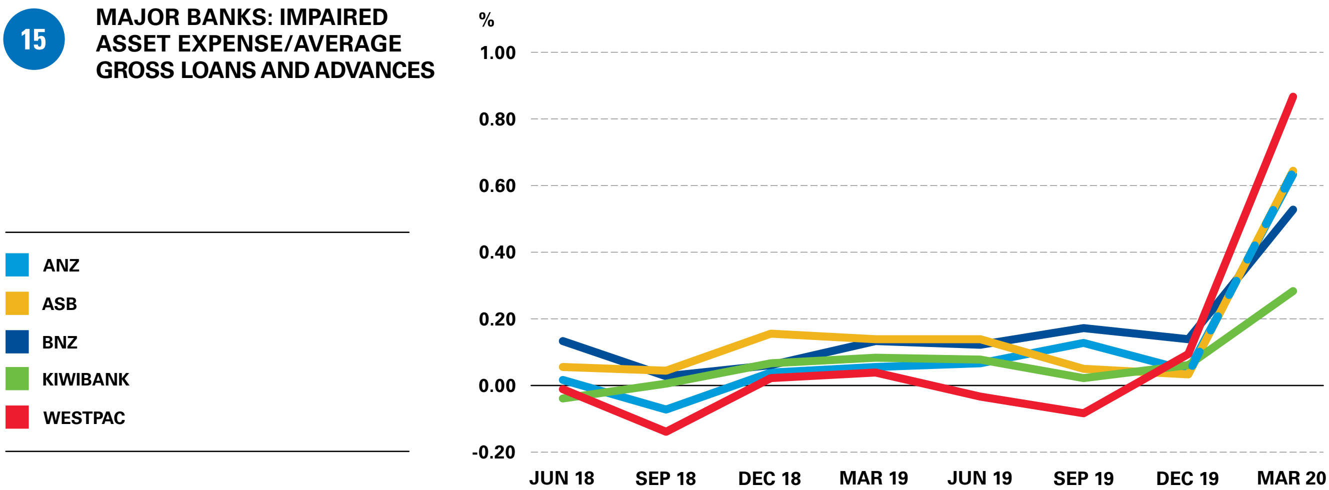
13 MAJOR BANKS: NON-INTEREST INCOME/ TOTAL ASSETS



14 MAJOR BANKS: OPERATING EXPENSES/ OPERATING INCOME

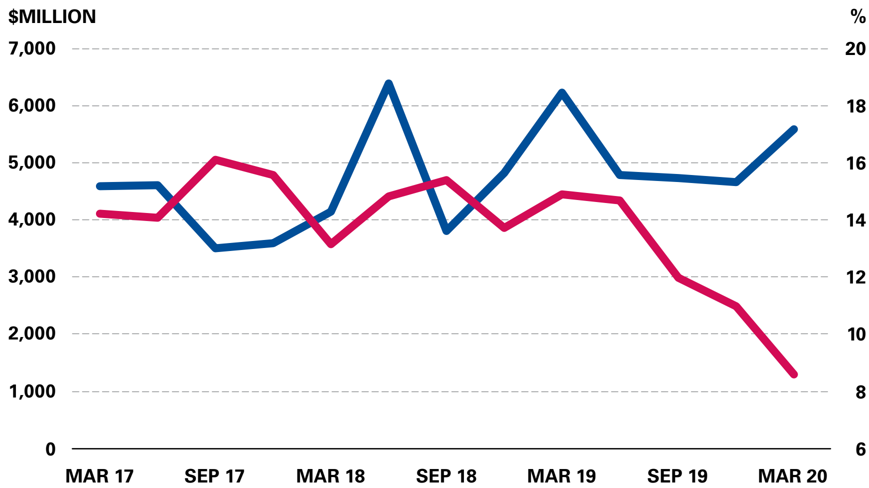


15 MAJOR BANKS: IMPAIRED ASSET EXPENSE/AVERAGE GROSS LOANS AND ADVANCES



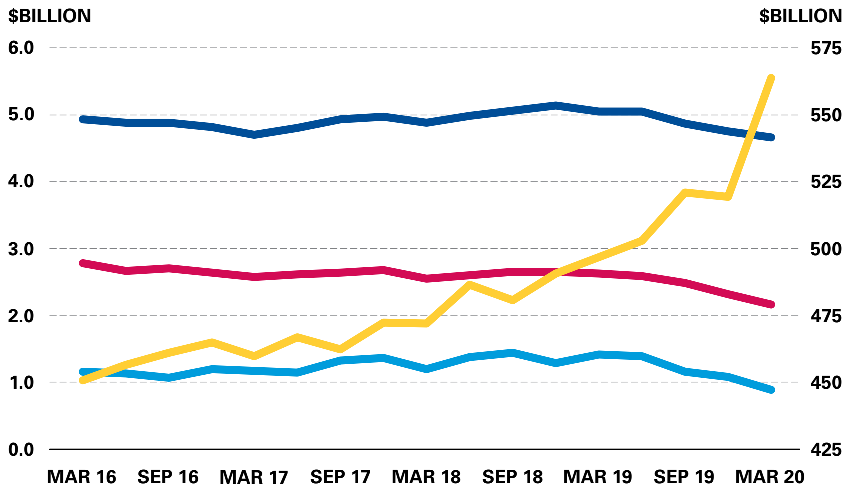
16 GROWTH IN GROSS LOANS AND ADVANCES VS. RETURN ON EQUITY

GROWTH IN GROSS LOANS AND ADVANCES (LHS)
RETURN ON EQUITY (RHS)



17 MAJOR BANKS: INTEREST EARNING ASSETS COMPARED TO INTEREST INCOME AND EXPENSE

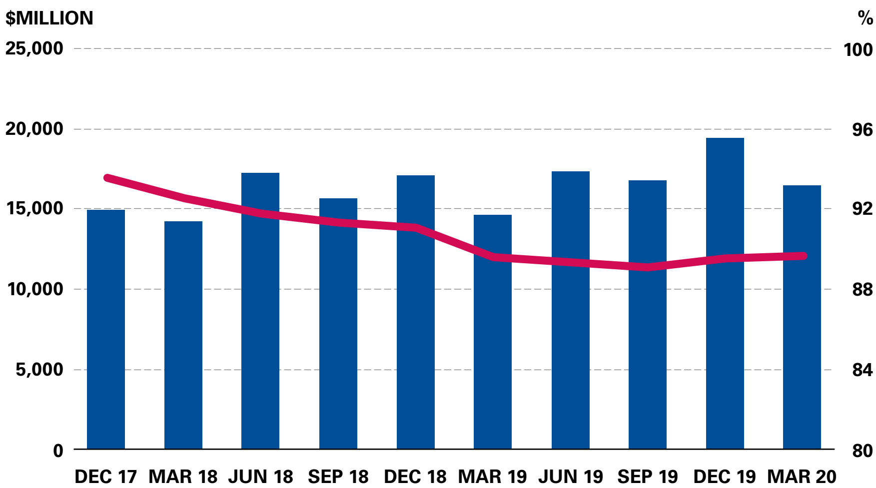
INTEREST INCOME (LHS)
INTEREST EXPENSE (LHS)
NET PROFIT (LHS)
TOTAL ASSETS (RHS)



18 LVR ANALYSIS OF RESIDENTIAL MORTGAGES

NEW MORTGAGES (LHS)
PROPORTION OF NEW MORTGAGES WITH LVR OF 80% OR BELOW (RHS)

SOURCE: RESERVE BANK OF NEW ZEALAND STATISTICS



Sustainable value

Justine Sefton
Associate Director – Sustainable Value
KPMG

Justine is a climate change and sustainability specialist with 20 years' experience across public and private sectors, in New Zealand and internationally – as a lawyer, policy and regulatory adviser, United Nations Framework Convention on Climate Change (UNFCCC) negotiator, consultant and responsible investment/Environmental, social, and governance (ESG) senior analyst. Justine's experience working on these issues from multiple stakeholder perspectives and interests enables her to genuinely bridge policy and investment worlds.

A fundamental transformation of the financial services sector is on the horizon. Prior to the COVID-19 pandemic, there was already considerable momentum underway, in New Zealand and internationally, on transitioning to a sustainable economy and financial system.

Far from driving this down the agenda, the COVID-19 pandemic has only reinforced the sustainability imperative, and revealed the need to build much greater resilience to natural and man-made shocks, including climate change. It has also prompted an increased focus on social issues (such as health and inequality) and pushed biodiversity high up the agenda.

Far from driving this down the agenda, the COVID-19 pandemic has only reinforced the sustainability imperative.

New Zealand's response to COVID-19 has set a precedent for putting people and planet first, making the tough decisions and taking the bold action necessary to achieve that, and demonstrated what is possible when we collectively mobilise, with urgency, around a common goal.

For financial institutions, sustainability is now central to their future value proposition and strategic positioning, and potentially also their ongoing legal and social licence to operate.

They will need to understand, manage and account for their climate and other sustainability-related risks, opportunities and impacts, as part of core business, and grow their 'green' asset base.

For financial institutions, sustainability is now central to their future value proposition and strategic positioning, and potentially also their ongoing legal and social licence to operate.

Designing a sustainable financial system for New Zealand

Drawing upon lessons from similar international initiatives, the industry-led 'Sustainable Finance Forum' (SFF)[20] is developing recommendations for a sustainable, resilient and inclusive financial system in New Zealand.

The SFF calls for a long-term and multi-stakeholder (financial and non-financial) value creation model, anchored in Te Ao Māori. A system "where business and finance are understood to operate within natural, human and social constraints and dependencies. The economy serves the needs and long-term wellbeing of society, while protecting and enhancing natural and human capital. Financial wealth creation is not the overriding goal of business and finance, but an outcome of, and wholly contingent upon, the creation of whole system prosperity."[20]

Specific measures identified in the *SFF's Interim Report*[21], for further consideration and stakeholder consultation, include:

- Aligning public finance and investment with New Zealand's climate and sustainability related goals and inter-generational wellbeing agenda.

- Adoption of long-term, purpose-based business models; incorporating sustainability outcomes into executive performance metrics and incentives and industry codes of conduct; developing a *Stewardship Code* for investment managers and service providers.
- Making consideration and management of ESG factors explicitly part of fiduciary/governance duties of directors, trustees and financial advisers; considering the future evolution of legal duties, noting international work on 'sustainability impact' duties (beyond financial implications)[22].

Financial wealth creation is not the overriding goal of business and finance, but an outcome of, and wholly contingent upon, the creation of whole system prosperity.

- Requiring climate change stress testing by banks and insurers; applying sustainability criteria to capital adequacy requirements for banks; monitoring progress towards risk-based pricing in the insurance sector; removing barriers to and incentivising positive impact investments.
- Defining and setting minimum standards and labelling requirements for 'sustainable' finance approaches, products and services; promoting measurement and pricing of social and environmental impacts, and integration into financial accounts plus risk and asset valuation models and credit ratings; promoting open/shared data models; introducing mandatory disclosure requirements for corporates, financial institutions and product providers.

COVID-19 and the opportunity to hit re-set

COVID-19 is having catastrophic effects globally on societies and world economies. The response of the New Zealand Government and RBNZ, to date, has been focussed on public health and short-term economic stabilisation and stimulus.

The banking sector is playing a key role in providing financial support to households and businesses.

The banking sector is playing a key role in providing financial support to households and businesses, with Government (and in turn, RBNZ) backing. However, there have been comments that they should be doing more to support customers and communities, which some banks have refuted[23]. Concerns have also been raised about protections for vulnerable customers, prompting the Council of Financial Regulators to issue guidance on responsible behaviour[24].

The managed funds sector has been hit hard by volatility in financial markets. KiwiSaver managers have sought to reassure members as balances plummeted. There is some evidence[25] of out-performance of ESG funds relative to market benchmarks over the COVID-19 crisis period. Commentators have pointed to the inadequacy of current risk indicators provided to retail investors[26], which fail to capture a range of different, and forward-looking, risks that can impact returns and are not based on the fundamentals of portfolio investments. They have also called for the same kind of oversight and (climate and other) stress testing that applies to banks.

All financial institutions are already under heightened scrutiny from stakeholders in terms of their conduct and operations (including treatment of customers and employees and contribution to community wellbeing) as well as their investment portfolios or loan books. There is a growing expectation to demonstrate social purpose across all levers, integrate and manage risk and be transparent. In addition, there is a growing demand for new financial products and services that deliver positive societal impact.

There is a growing expectation to demonstrate social purpose across all levers, integrate and manage risk and be transparent. In addition, there is a growing demand for new financial products and services that deliver positive societal impact.

As the country moves into an economic recovery and renewal phase, there is a collective desire to reimagine the current model and 'build back better'. To seize this once-in-a-generation opportunity to build a society and economy that truly serves both people and planet. Stakeholders are calling upon the Government to apply climate/sustainability related conditions and criteria to business support and infrastructure spending, and at a minimum, to proceed on a 'no regrets' basis, avoiding long-term structural lock-in of an unsustainable pathway. Here and overseas, there are calls to embrace 'stakeholder capitalism' – notably, the theme of the 2020 World Economic Forum meeting[27] – redefining purpose and performance metrics across public and private sectors and transforming our understanding of value[28].

Spotlight on climate change

Speaking at the recent *A Near Horizon* event, RBNZ Governor, Adrian Orr, drew the parallels with, and linkages between, the COVID-19 pandemic and climate change, citing a quote from *The Economist* that "following the pandemic is like watching climate change with your finger on the fast-forward button."[29] At the same time, he said, New Zealand has shown its ability to rally together to tackle a common threat.

Fellow panellist, Minister for Climate Change, James Shaw, referred to the trillions of dollars of unquantified, undisclosed and unmanaged climate risks sitting on corporate balance sheets around the world, including New Zealand. This being the impetus for the Government's proposal to introduce mandatory climate-related financial risk disclosures for NZX listed issuers, banks, insurers, asset owners and asset managers by 2022 (and potentially also large unlisted companies and Crown entities). Part of a package of measures including the Climate Change Response (Zero Carbon) Amendment Act 2019 and proposed changes to the New Zealand Emissions Trading Scheme to align with national emissions budgets set under that legislation. James Shaw also spoke of the moral imperative of a green recovery, to avoid "borrowing twice from future generations."[30]

Adrian Orr called for long-term horizons and endorsed the need for better climate risk reporting to assess financial implications (at entity, portfolio and system levels). He signalled that the RBNZ will be stepping up its oversight of climate-related stress testing and disclosures by regulated entities, and engagement with senior executives – referring to a 2019 RBNZ survey of banks[31] which indicated broad awareness of climate risks, but there is scant evidence of this changing business decisions.

He also signalled that the RBNZ will be looking at its own balance sheet. This could mean applying climate-related criteria to the RBNZ's own asset purchasing and to the collateral framework for liquidity lending to commercial banks.

The RBNZ is a member of the Network for Greening the Financial System (NGFS) which is a group of Central Banks and Supervisors who voluntarily share best practice, contribute to the development of environment and climate risk management in the financial sector and mobilise mainstream finance to support the transition toward a sustainable economy[32].

A new model of financial services

Financial institutions need to care about, and be seen to care about, their impacts and dependencies upon society and the environment, for two reasons.

Financial institutions need to care about, and be seen to care about, their impacts and dependencies upon society and the environment.

Firstly, these can translate into investment or credit risks and opportunities, plus have direct reputational, legal and capital raising implications. As well as individualised implications, there is also shared exposure to – and shared interest in managing – systemic risk.

Secondly, we are moving to a new model of investment and finance, which values social and environmental capital in its own right, and measures performance in terms of both financial and non-financial outcomes. Recognising that economic and financial systems operate within social and environmental system boundaries and dependencies.

In relation to both the entities they are investing in, and their own corporate conduct, operations and capital raising, financial services organisations need to:

- Apply a long-term horizon and broad stakeholder lens; seek to avoid harm and ideally make a positive contribution to a sustainable, inclusive and resilient economy.
- Consider both their impacts on people and planet – are they aligned with a zero-carbon, sustainable and inclusive economy – and their resilience under different economic transition and climate change impact scenarios as well as other potential system shocks. Taking into account the potential legacy effects of COVID-19 in terms of structural changes to the economy as well as what stakeholders expect and care about.
- Be transparent about their progress and adopt a partnership mindset.

Please feel free to contact either the author or your regular KPMG contact if you would like any further information.

Endnotes

1. https://www.rbnz.govt.nz/news/2020/03/regulatory-relief-to-provide-headroom-for-customer-focus-and-risk-management
2. https://www.rbnz.govt.nz/news/2020/03/mortgage-holiday-and-business-finance-support-schemes-to-cushion-covid-impacts
3. https://www.rbnz.govt.nz/news/2020/03/rbnz-to-implement-30bn-large-scale-asset-purchase-programme-of-nz-govt-bonds
4. https://www.rbnz.govt.nz/news/2020/05/large-scale-asset-purchases-expanded
5. https://www.rbnz.govt.nz/news/2020/04/reserve-bank-removes-lvr-restrictions-for-12-months
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7. https://www.rbnz.govt.nz/news/2020/03/new-zealand-banks-strong-cashed-up-and-ready-to-support-customers
8. https://www.rbnz.govt.nz/-/media/ReserveBank/Files/Publications/Financial%20stability%20reports/2020/fsr-may-20.pdf?revision=5e407e63-0ed6-409d-8a84-fdf62b65526e
9. https://www.rnz.co.nz/news/business/415838/banks-defend-covid-19-response-after-criticism-they-aren-t-doing-enough
10. https://www.goodreturns.co.nz/article/976517016/new-to-bank-lending-freeze.html
11. https://static.colmarbrunton.co.nz/wp-content/uploads/2019/05/2020-Corporate-Reputation.pdf
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13. https://www.rbnz.govt.nz/news/2020/04/the-financial-sector-and-responsible-behaviour
14. https://home.kpmg/nz/en/home/insights/2019/07/fips-quarterly-march-2019.html
15. https://www.nzherald.co.nz/personal-finance/news/article.cfm?c_id=12&objectid=12223031
16. https://cffc-assets-prod.s3.ap-southeast-2.amazonaws.com/public/Uploads/Research-2020%2B/COVID-19/CFFC-COVID-19-Research-Report-May-2020.pdf
17. https://www.youtube.com/watch?v=Nim4MBZ-mw4&t=2964s
18. For quarters ended 31 December 2017 and earlier, total assets excluded intangible assets. From 31 March 2018, intangible assets are no longer deducted as this information is not available in the RBNZ Dashboard.
19. In line with the information disclosed in the RBNZ Dashboard, the net interest margin is disclosed to 1 decimal place from 31 March 2018 onwards. As interest earning assets are not disclosed in the RBNZ Dashboard, average net interest margins cannot be calculated from 31 March 2018 onwards.
20. The SFF is an initiative of The Aotearoa Circle, chaired by Matt Whineray (New Zealand Superannuation Fund) and Karen Silk (Westpac). It comprises leaders from across New Zealand's business and financial sectors as well as other stakeholders. KPMG is participating in the SFF and Justine Sefton was a co-author of the SFF Interim Report. Work is underway on final recommendations, involving consultation workshops with industry leaders over the coming months.
21. https://static1.squarespace.com/static/5bb6cb19c2ff61422a0d7b17/t/5dd3b114d0279f0fb06e00f3/1574154539204/1013241_Sustainable+Finance+Report_FINAL_NEW+%28002%29.pdf
22. https://www.unpri.org/sustainable-markets/a-legal-framework-for-impact
23. https://www.rnz.co.nz/news/business/415838/banks-defend-covid-19-response-after-criticism-they-aren-t-doing-enough
24. https://www.rbnz.govt.nz/news/2020/04/the-financial-sector-and-responsible-behaviour
25. https://www.theguardian.com/money/2020/jun/13/ethical-investments-are-outperforming-traditional-funds
26. https://www.newsroom.co.nz/2020/06/10/1218972/draft-article-on-risk-in-kiwisaver-funds
27. https://www.weforum.org/press/2019/10/world-economic-forum-50th-annual-meeting-in-davos-defining-stakeholder-capitalism; https://www.weforum.org/agenda/2019/12/davos-manifesto-2020-the-universal-purpose-of-a-company-in-the-fourth-industrial-revolution/
28. This kind of 'multi-capitals thinking' approach has long been championed, for example, by the Natural Capital Coalition and Social Capital Coalition – https://capitalscoalition.org/.
29. https://www.rbnz.govt.nz/research-and-publications/speeches/2020/speech2020-05-28
30. https://www.youtube.com/watch?v=Nim4MBZ-mw4
31. https://www.rbnz.govt.nz/financial-stability/financial-stability-report/fsr-may-2019/industry-survey-on-the-potential-impacts-of-climate-change
32. https://www.ngfs.net/en

KPMG's Financial Services Team

John Kensington
Head of Banking and Finance
+64 (09) 367 5866
jkensington@kpmg.co.nz

Ross Buckley
Executive Chairman
+64 (09) 367 5344
rjbuckley@kpmg.co.nz

Godfrey Boyce
Chief Executive Officer
+64 (04) 816 4514
gboyce@kpmg.co.nz

Graeme Edwards
National Managing Partner – Audit
+64 (04) 816 4522
gdedwards@kpmg.co.nz

Jack Carroll
National Managing Partner – Advisory
+64 (04) 816 4516
jackcarroll@kpmg.co.nz

Ross McKinley
National Managing Partner – Tax
+64 (09) 367 5904
rdmckinley@kpmg.co.nz

Kay Baldock
National Managing Partner – Brand & Growth
+64 (09) 367 5316
kbaldock@kpmg.co.nz

Matthew Prichard
Partner – Head of Funds Management
+64 (09) 367 5846
matthewprichard@kpmg.co.nz

Jamie Munro
Partner – Head of Insurance
+64 (09) 367 5829
jamiemunro@kpmg.co.nz

Brent Manning
Partner – Audit
+64 (04) 816 4513
bwmanning@kpmg.co.nz

Malcolm Bruce
Principal – Risk Advisory
+64 (09) 367 5990
malcolmbruce@kpmg.co.nz

Gary Ivory
Partner – Corporate Finance
+64 (09) 367 5943
givory@kpmg.co.nz

Mike Clarke
Partner – Head of IT Advisory
+64 (09) 363 3507
mikeclarke@kpmg.co.nz

Ceri Horwill
Partner – Advisory
+64 (09) 367 5348
cerihorwill@kpmg.co.nz

Rajesh S Megchiani
Partner – Risk Advisory
+64 (09) 363 3581
rmegchiani@kpmg.co.nz

Simon Wilkins
Partner – Sustainable Value
+64 (09) 363 3480
SWilkins1@kpmg.co.nz

Contact us

Auckland

KPMG Centre
18 Viaduct Harbour Avenue
PO Box 1584
Tel: (09) 367 5800
Fax: (09) 367 5875

Hamilton

KPMG Centre
85 Alexandra Street
PO Box 929
Tel: (07) 858 6500
Fax: (07) 858 6501

Tauranga

Level 2
247 Cameron Road
PO Box 110
Tel: (07) 578 5179
Fax: (07) 578 2555

Wellington

10 Customhouse Quay
PO Box 996
Tel: (04) 816 4500
Fax: (04) 816 4600

Christchurch

The Terrace, Level 5
79 Cashel Street
PO Box 1739
Tel: (03) 363 5600
Fax: (03) 363 5629

Timaru

24 The Terrace
PO Box 526
Tel: (03) 683 1870
Fax: (03) 686 9062

Ashburton

151 Burnett Street
PO Box 564
Tel: (03) 307 6355
Fax: (03) 307 6358

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