KPMG

FIPS

Financial Institutions Performance Survey
June 2021 Quarterly Results

Overview

Information current as at 17 September 2021

Data for quarter ended June 2021

Well, here we are with a sense of unwanted déjà vu. We have all experienced the effects of being back in lockdown following an outbreak of the Delta variant of Covid-19, demonstrating all too clearly that we still have a considerable way to go before we see the health and economic impacts of the Covid-19 pandemic lessen or end.

At the time of writing, the whole of New Zealand had already completed two weeks of Level 4 lockdown. While the rest of the country stepped back down through the Levels to a 'Delta Level 2'[1], Auckland is still in the more restrictive Level 4 with hopes to move to Level 3 from 22 September 2021. The vaccine rollout has intensified and is seen as the key to avoiding harsh lockdowns in the future as well as eventually opening up the borders.

However, the banking results for the quarter ended June 2021 were unaffected by any lockdowns here in New Zealand. While Auckland experienced a couple of Level 3 lockdowns in February, the rest of the country experienced nothing more restrictive than Level 2 until this current outbreak necessitated the national Level 4 lockdown on 18 August 2021. The quarter saw unemployment fall (including underutilisation rates), job adverts rise, spending increase and house prices continue on their upward trajectory.

The banking sector had a strong quarter, reporting a combined Net Profit After Tax (NPAT) of $1,451.9 million. This was a slight dip (of 11.63%) when compared to the previous quarter ($1,642.9 million) which was a record result; however, it was still one of the strongest quarters ever and almost twice that of the same period last year.

The quarter ended June 2020 was, of course, the one most impacted by the arrival of Covid-19 in New Zealand and the subsequent lockdowns. Therefore, any year on year comparisons need to be viewed through this lens.

The June 2020 quarter was also when a large part of the provisioning for that year was made and we have seen some of this unwind over the past couple of quarters.

Mortgage growth

The strong result for this quarter has been largely driven by the continued growth in mortgage lending.

Lending overall increased by 2.20% compared to the previous quarter, but mortgage lending rose by 6%. While March 2021 retains the record for the largest amount of mortgage lending in one month, each month in the quarter ended June 2021 saw over $8 billion of new residential mortgage lending. The composition of the banking sector lending portfolio has seen a steady increase in housing lending and a decrease in consumer, business and agriculture lending.

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While house prices, and with them the levels of mortgage lending, overall continue to rise, the number of investors taking out new mortgages has dropped. The lending growth is largely driven by owner occupiers and first-time buyers (FTBs). This could be the beginning of the impact of the recently introduced tax changes deterring highly leveraged investors or the achievable yields from renting starting to look unattractive at such high purchase prices.

While the banking sector's mortgage lending is heavily weighted to owner occupiers, the quarter saw record numbers of FTBs (over 9,000) step onto the property ladder. This volume was second only to the quarter ended December 2020.

A third (34%) of FTBs this quarter borrowed over 80% of their loan-to-value ratio (LVR). This is down from about half of FTBs in the two previous quarters (54% in December 2020 and 46% in March 2021). This is a sign that the Reserve Bank of New Zealand's (RBNZ's) tightening of mortgage lending standards and the general feeling of discomfort with the heat in the residential property market could be having an impact on bank lending appetite for higher LVR loans.

The RBNZ is currently consulting on the further reduction of the amount of high LVR lending that banks can do, with the intention to implement any new settings from 1 October 2021[2]. Following this, the RBNZ intends to consult on potentially implementing Debt-to-Income (DTI) restrictions. The intention of this tool is to ensure that borrowers are resilient as interest rate rises become a possibility and house prices flatten or fall.

The expected Official Cash Rate (OCR) rise didn't occur, largely due to the Level 4 lockdown, but the RBNZ made it clear that this event simply postponed the rise. In addition, the RBNZ stated it believes the full impact of an OCR rise could take around six months to be felt due to the high proportion of borrowers currently on fixed term mortgage loans[3].

As in March/April 2020, the Level 4 lockdown period will naturally put a brake on the number of house sales and, therefore, slow the amount of mortgage lending. However, as both the industry and the general public have got better at switching to online options and, where possible, estate agents are conducting online auctions, the reduction may not be as stark as during the 2020 Level 4 lockdown. In fact, there have been reports of properties selling to buyers who have not physically inspected the property at all[4].

Employment and economy

In the quarter ended June 2021, the unemployment rate decreased further to just 4%, down from 4.7%, and the underutilisation rate reduced to 10.5% (down 1.6%). The most recent *SEEK NZ Employment Report* for July 2021 shows that there continues to be record high volume of job adverts across a broad range of sectors and levels, but record low numbers of people applying per vacancy[5].

In the quarter ended June 2021, the unemployment rate decreased further to just 4%, down from 4.7%.

Wage rates increased 0.7% in this quarter, which may be a reflection of those who had their wages reduced during last year's uncertainty about the impact of Covid-19 returning to pre-pandemic levels, as well as the increase to the minimum wage which came into effect on 1 April 2021.

Retail spending in the quarter ended June 2021 increased 3.30% compared to the previous quarter[6], but the next quarter's result will be heavily impacted by the current lockdown.

To date, there appears to be slightly less economic uncertainty during the current lockdown than the previous one in March/April 2020. Businesses are more prepared and adept at working within the Covid-19 restrictions, but there is still confusion about what is and isn't allowed[7] under Level 4 restrictions. Dependent on the length of the lockdown we could see these sentiments change. Either way, there are some sectors that will suffer considerable hardship in a Level 4 through Level 2/2.5 lockdown.

For many of the 63% of workers who are able to continue working in Level 4 (compared to 53% during the last Level 4 lockdown)[8], there is a familiarity in returning to the home office and video calls. In fact, as discussed in previous FIPS publications, many workers were already working from home up to two to three days per week.

More businesses continued operating this time around with overall economic activity reduced to 74% compared to 60% during the last Level 4 lockdown.

This is borne out by reports from Kiwibank that card spending only reduced by 20% in the first nine days of the national lockdown compared to 45% in the equivalent period in the 2020 Level 4 lockdown[9] – a clear sign that more businesses have a stronger online presence and that consumers are more comfortable transacting online. It is also an indicator that more people feel secure in their employment this time around and so are not cutting their spending so drastically.

The wage subsidy has been reintroduced to support business most impacted by the lockdown, which includes those offering face-to-face services that cannot be delivered in a contactless way such as hospitality, some retail, health and beauty services. The first two weeks of this national Level 4 lockdown saw more than $1 billion paid in wage subsidies and business support payments[10].

While we are used to seeing a spending 'bounceback' quickly following lockdown periods, this spending tends to be focused on goods rather than services so it may not be sufficient for many sectors to recoup lockdown losses.

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The recent *NZIER Quarterly Predictions*[11] report suggests that the New Zealand economy should remain resilient during this latest lockdown period, but acknowledges that the restrictions that are in place to contain the community outbreak of Covid-19 and the inability to open the border until vaccination rates are improved will exacerbate the supply chain issues and labour shortages that were already in place.

Banks are reporting less contact from customers than during the 2020 Level 4 lockdown[12] indicating that people are more used to dealing with uncertainty than in the first lockdown when there was a high influx of calls from customers concerned about their financial situation. This could also be a sign that the focus on encouraging their customers to use digital channels was successful.

What will determine the final impact of the lockdown on the economy is the length of it and time spent at each stage. New Zealand's apparent ability to handle the lockdown 'better' than the last one so far will be tested if it is extended significantly.

Regulation and reputation

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The implementation of the amendments to the Credit Contracts and Consumer Finance Act 2003 (CCCFA) is the next 'cab off the rank' and was due to come into effect from 1 October 2021; however, this has been delayed until 1 December 2021 as a result of this lockdown.

The overall focus on good customer outcomes of much of the recent and upcoming regulations means that compliance requirements have moved on from 'tick-box' frameworks to be added to processes to a focus on culture. This requires a principles-based approach to be woven into the banks' business, including product design and customer interactions.

The banks that are taking 'compliance by design' and customer centric views rather than a siloed regulation or product orientated approach are seeing the benefits of an efficient and consistent customer experience that also satisfies the regulators.

This quarter has unfortunately continued to see reports of regulatory breaches, some of which have necessitated remediation payments to customers and some have involved the payment of civil penalties[13]. The regulators have now created enforcement teams and this may be the beginning of a new approach to dealing with transgressions after allowing some tolerance to enable financial institutions to adjust their processes to these new requirements. This period of tolerance was extended during the 2020 lockdown to allow the organisations to focus on the impacts of the Covid-19 pandemic on their customers and staff, but it looks like the honeymoon period is starting to come to an end.

The quarter ended June 2021 showed a decline of 6% in the number of complaints made about banks to the Banking Ombudsman[14]. While the highest number of complaints are about 'service' which can encompass a broad range of issues, the second highest complaint was about fees and this increased by 61% over the previous quarter. This is an area that banks will be paying close attention to given the looming CCCFA deadline.

While two of the 'big 5' banks appear in the Corporate Reputation 2021 top 20[15], Consumer New Zealand found that only 32% of New Zealanders trust their bank and 47% strongly felt that their bank charged too much[16].

In order to support business customers, the 'big 5' banks have all waived contactless payment fees for merchants for at least Level 4 and Level 3 lockdowns[17].

The opportunities that banks have to rebuild customer trust through remediation are outlined in our article entitled 'How can we turn remediation into a strategic opportunity?' on page 22.

During the quarter ended June 2021, the RBNZ also finalised its bank capital rules[18] and issued cyber resilience guidance[19]. The latter is particularly relevant given the recent cyberattacks affecting ANZ and Kiwibank[20].

RBNZ thematic review highlights gaps in internal risk management frameworks.

KiwiSaver default changes

The Government announced changes to the KiwiSaver default fund providers in May 2021[21] which will come into effect from November 2021. While all of the 'big 5' banks are currently default fund providers, this will reduce to just three (BNZ, Westpac (BT Funds Management) and Kiwibank (Kiwi Wealth)). ANZ and ASB stand to lose a combined $5 billion of funds under management from their default funds if those customers do not make an active decision to stay with their current provider.

The Government announced changes to the KiwiSaver default fund providers in May 2021.

These changes will result in additional onboarding and offboarding for all of the providers as there is a reallocation of customers in the default funds.

While the Government's review focused on a broad range of criteria, there was a 60% weighting on fees continuing the sector's focus on customer outcomes and fair conduct.

With research from the Financial Services Council[22] showing that only 44% of New Zealanders feel that they are reasonably or very prepared for retirement, perhaps there is an opportunity to encourage New Zealanders to focus on robust financial plans to ensure a comfortable retirement.

The shift of the default fund from being 'Conservative' to 'Balanced' could have a positive impact for those default fund customers furthest away from retirement age.

Insurance

Following the announcement that Westpac NZ would remain as part of the Westpac Group, it became the latest bank to sell its New Zealand insurance arm[23]. This followed ANZ's announcement in February 2021 that it was selling its distribution interests to Tower[24]. Both banks cite simplification of their business continuing the pressure on costs discussed in the last FIPS publication[25].

Movers and shakers

There has been a noteworthy amount of change at the Chief Executive Officer (CEO) and Board level of our New Zealand banks over the past few months.

David McLean announced his retirement from **Westpac NZ** in May 2021 and left in June 2021 having been CEO for seven years. Simon Power is currently acting CEO.

Jan Dawson has retired from the Westpac NZ Board and will be replaced as Chair by Pip Greenwood. Malcolm Bailey is also retiring and there are three new directors with effect from August 2021 (David Havercroft, Christine Parker and Michael Rowland).

In August 2021 Angela Mentis announced that she was returning to National Australia Bank as Group Chief Digital, Data and Analytics Officer. Dan Huggins has been appointed as the new **BNZ** Managing Director and CEO with effect from October 2021.

Barbara Chapman (formerly CEO of ASB and Sovereign) will join the BNZ Board from October 2021.

Tony Carter retired from the **ANZ New Zealand** Board in August 2021 and has been replaced by Scott St John.

David Cunningham left **The Co-operative Bank** in July 2021. Bevan Miller is currently the Interim CEO.

Quarterly analysis of the results

While not a record profit this quarter, the NPAT of $1,451.9 million was certainly a strong result, benefitting from being a quarter free of lockdowns with all of New Zealand at Level 1.

The strong result was largely driven by continued strong mortgage growth and the margin stability or slight strengthening which has continued for two consecutive quarters.

One of the reasons NPAT was lower (by 11.63%) for this quarter compared to the previous quarter was a reduction in non-interest income (of 21.47%) which is always a volatile component.

Operating expenses have increased this quarter by 11.11% to $1,531.6 million, partly as a reflection that the banks are hiring more people. While the uptake of digital channels has been significant over the past 12 months there is still a large proportion of customers who prefer to deal with their bank face to face. There are also a number of large-scale technology transformation programmes and regulatory change programmes in the banking sector which require specialist skills.

This resulted in an increase in the operating expenses/operating income ratio, up from 38.53% to 43.97%. However, this is still one of the lowest even pre-pandemic.

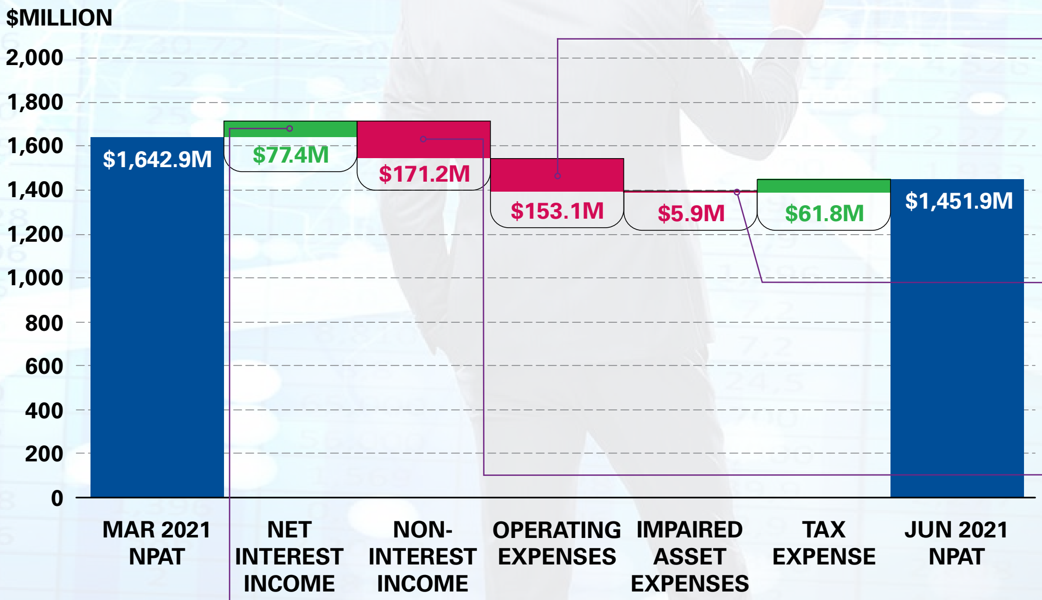
There was an overall reduction in the level of collective provisioning, but a slight increase in individual provisioning. This is possibly a reflection of the relatively stable economic outlook (pre-current lockdown) and a focus on particular sectors or customers who are negatively impacted.

Net profit after tax

Movement in net profit

11.63%

to $1,451.9 million



Net interest income

2.78%

to $2,857.2 million

TABLE 1: Movement in interest margin

Entity[26]	30 Jun 21 quarter ended (%)	Mvmt. during the quarter (bps)	Mvmt. for the 6 months (bps)	Mvmt. for the 12 months (bps)
ANZ	0.02	0	20	20
ASB	0.02	-10	10	20
BNZ	0.02	-10	0	0
Heartland	0.05	10	30	30
Kiwibank	0.02	0	10	20
SBS	0.03	20	40	50
TSB	0.02	0	10	20
Co-op	0.02	0	10	20
Westpac	0.02	0	0	30

Operating expenses

11.11%

up $153.1 million

Driven by

ASB	$57.2M
ANZ	$36.5M
Kiwibank	$27.6M

Non-interest income

21.47%

down $171.2 million

Driven by

BNZ	$62.3M
ANZ	$59.2M
Westpac	$44.6M

Impaired asset expenses (writebacks)

7.70%

reduced by $5.9 million

Driven by

ANZ	$36.5M
Westpac	$13.5M

Lending

Gross loans 2.20% to $473,671 million

Quarterly

Heartland	3.11%
ASB	2.79%
BNZ	2.78%

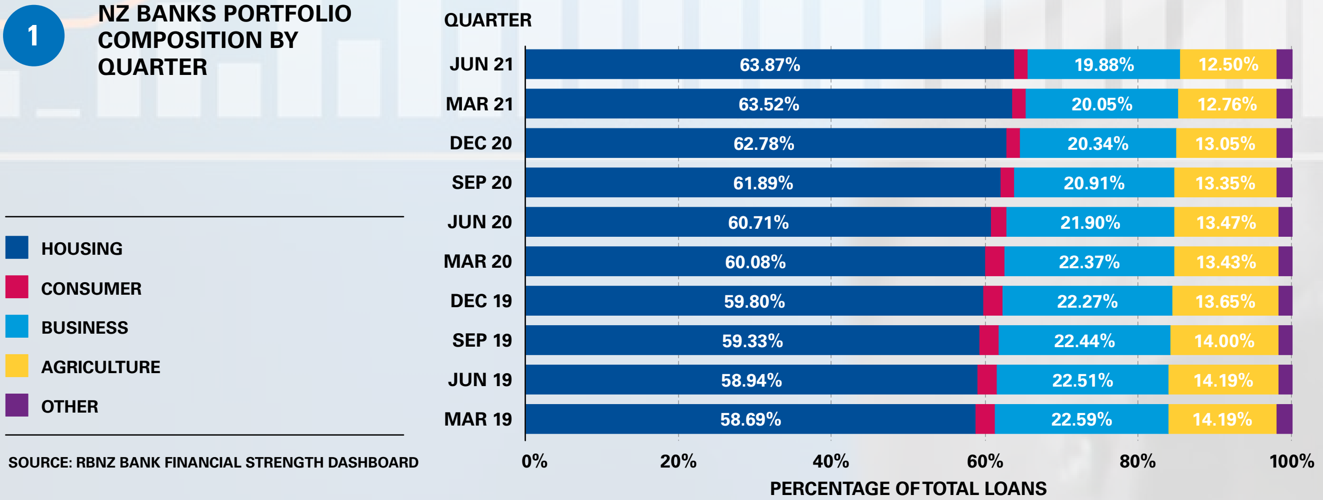
Year on year

Kiwibank	13.20%
ASB	9.82%
Co-op	7.83%

TABLE 2: Analysis of gross loans

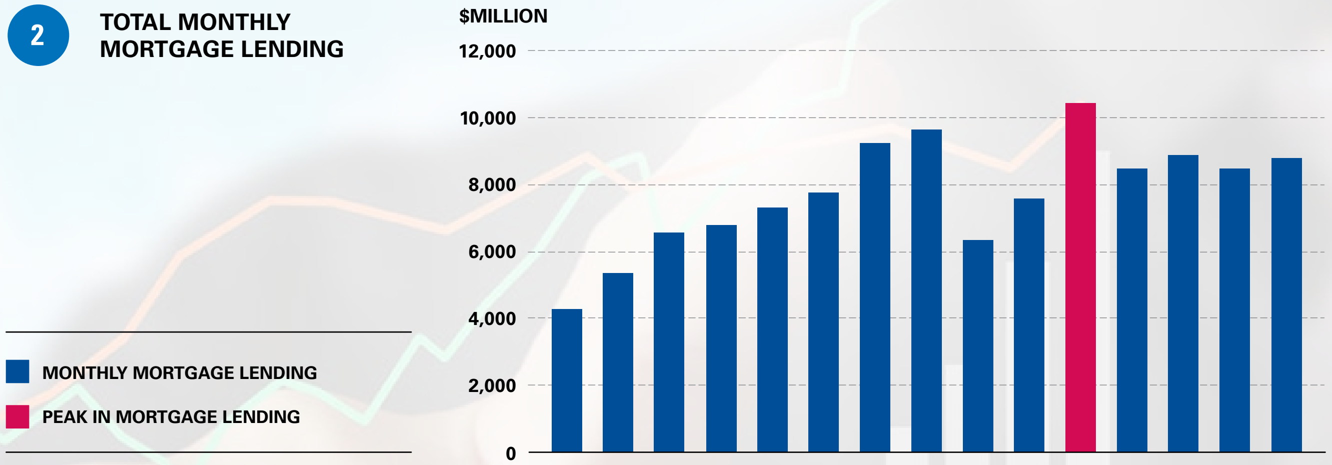
Entity[26] Quarterly analysis	30 Jun 21 quarter ended $Million	31 Mar 21 quarter ended $Million	% Increase (Quarterly)
ANZ	140,358	138,403	1.41%
ASB	103,130	100,329	2.79%
BNZ	94,250	91,704	2.78%
Heartland	3,866	3,749	3.11%
Kiwibank	25,337	24,716	2.51%
SBS	4,082	4,073	0.23%
TSB	6,521	6,373	2.32%
Co-op	2,763	2,708	2.05%
Westpac	93,364	91,419	2.13%
Total	**473,671**	**463,475**	**2.20%**
Entity[26] Annual analysis	**30 Jun 21 quarter ended $Million**	**30 Jun 20 quarter ended $Million**	**% Increase (Annual)**
ANZ	140,358	136,292	2.98%
ASB	103,130	93,906	9.82%
BNZ	94,250	88,842	6.09%
Heartland	3,866	3,717	4.01%
Kiwibank	25,337	22,384	13.20%
SBS	4,082	4,133	-1.23%
TSB	6,521	6,157	5.91%
Co-op	2,763	2,563	7.83%
Westpac	93,364	87,675	6.49%
Total	**473,671**	**445,668**	**6.28%**

1 NZ BANKS PORTFOLIO COMPOSITION BY QUARTER



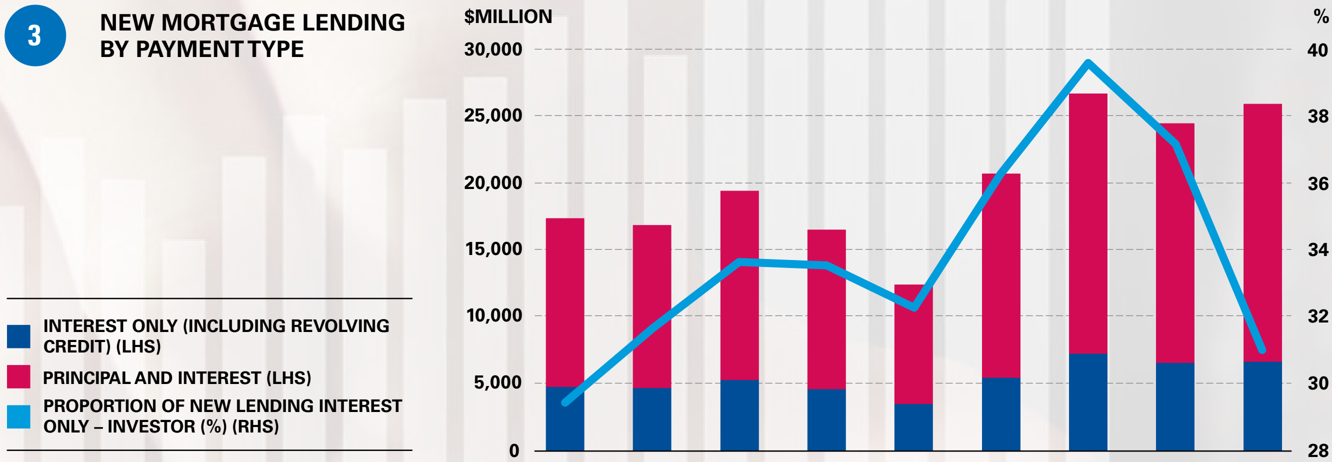
SOURCE: RBNZ BANK FINANCIAL STRENGTH DASHBOARD

2 TOTAL MONTHLY MORTGAGE LENDING



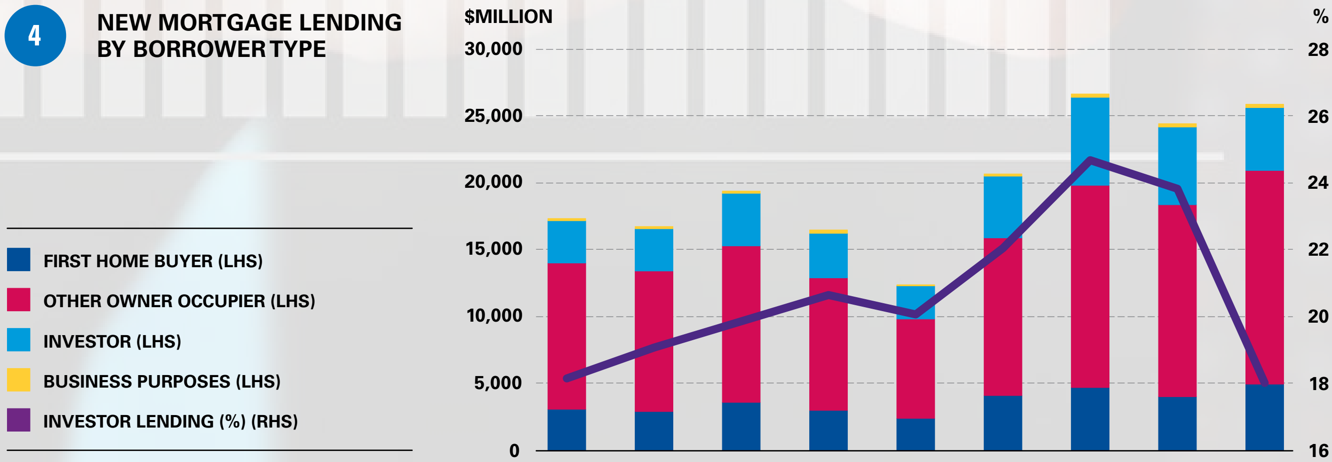
SOURCE: KPMG FIPS QUARTERLY MARCH 2021
DATA: RBNZ BANK FINANCIAL STRENGTH DASHBOARD

3 NEW MORTGAGE LENDING BY PAYMENT TYPE



SOURCE: RESERVE BANK OF NEW ZEALAND STATISTICS

4 NEW MORTGAGE LENDING BY BORROWER TYPE



SOURCE: RESERVE BANK OF NEW ZEALAND STATISTICS

Asset quality

Individually assessed provisions

7.05%

up $30.9 million

Driven by

Westpac	$42.8M
ASB	$15.8M

Collectively assessed provisions

5.39%

down $126.0 million

Driven by

ASB	$43.4M
Westpac	$31.2M
Kiwibank	$19.5M

TABLE 3: Impaired asset expenses	$Million
June 2021	-$70.7
March 2021	-$76.6
December 2020	-$126.0
September 2020	$188.6
June 2020	$478.0
March 2020	$749.3
December 2019	$90.1

As observed from the previous quarterly dashboard data, the June 2021 results maintained the downward trend of the coverage ratio to potentially return to pre-Covid levels. This was in line with how the financial institutions perceived the economic conditions since the start of the year. Although at an aggregated level, financial institutions seem to be writing back provisions, there are some that are still recording impairment expenses instead. This shows that there is still a degree of uncertainty with potential losses and management taking a more measured approach with their loan loss provision estimations.

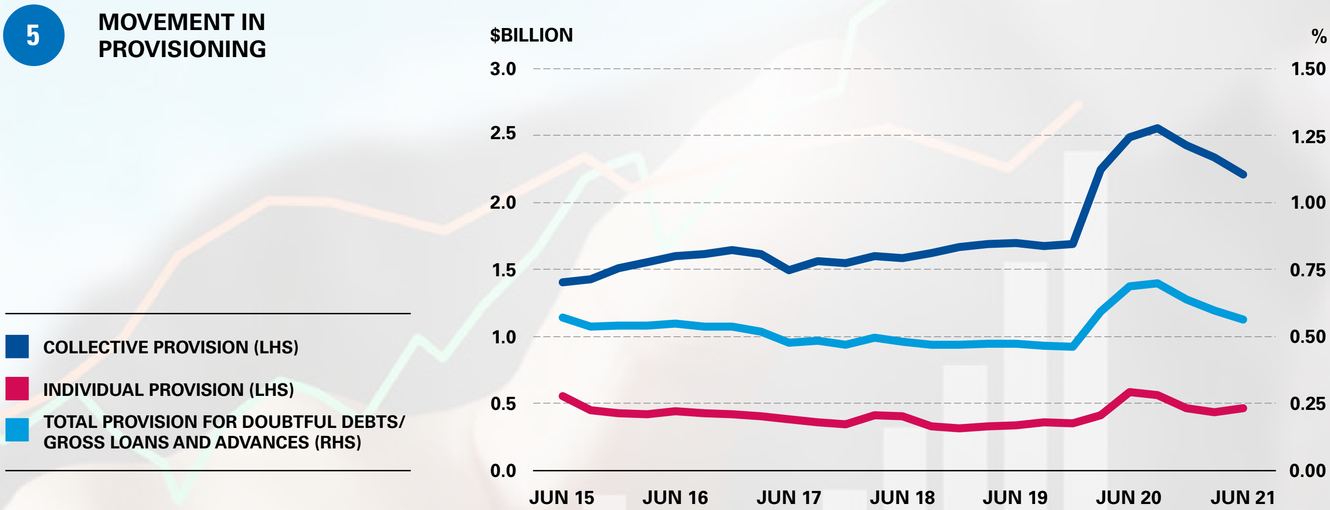
It also shows that while some sectors of the economy have performed better than expected over the period of the initial lockdown and the rebound in 2020, there are still some sectors that are really struggling due to the deeper impact of closed borders and lockdowns.

However, the recent Delta outbreak in New Zealand might alter the recovery path that we have been observing with the loan loss provisions. One must wonder if the hard and early approach taken with this outbreak may minimise the impact this might have on our recovery path to provisions levels seen prior to the pandemic or whether it would be a bitter blow to the recovery. Again, the length of the lockdown and time will tell.

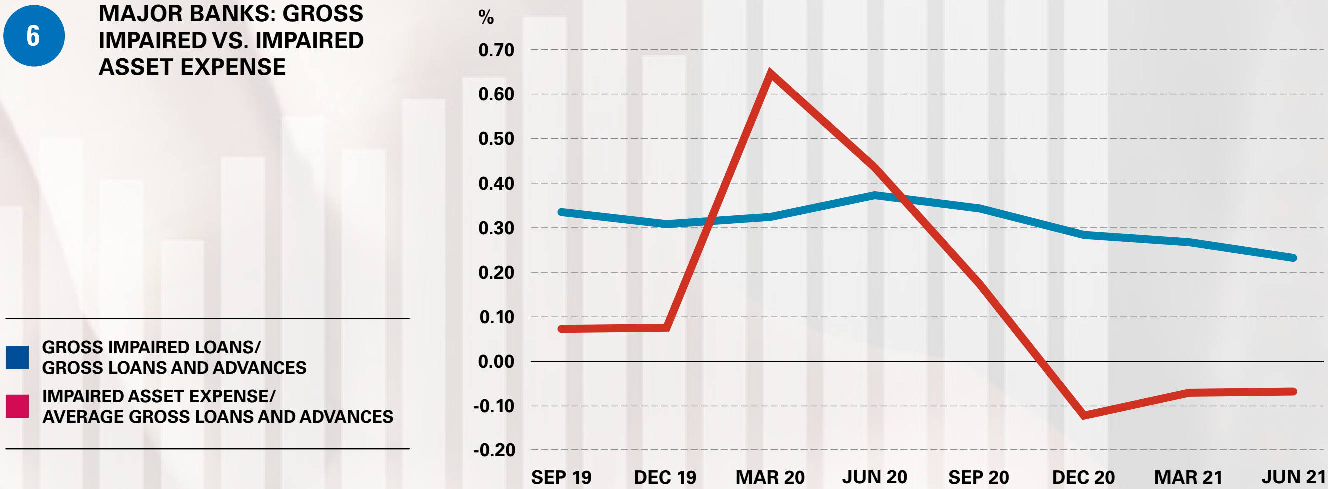
TABLE 4: Movement in impaired asset expense/ Average gross loans

Entity[26]	30 Jun 21 quarter ended (%)	Movement during the quarter (bps)	Movement for the 12 months (bps)
ANZ	-0.10%	7	-33
ASB	-0.07%	-1	-66
BNZ	-0.06%	-10	-52
Heartland	0.54%	2	-94
Kiwibank	-0.31%	-32	-87
SBS	0.06%	19	-33
TSB	-0.12%	-1	-11
Co-op	0.06%	36	-6
Westpac	0.04%	9	-50
Average	**-0.06%**	**1**	**-50**

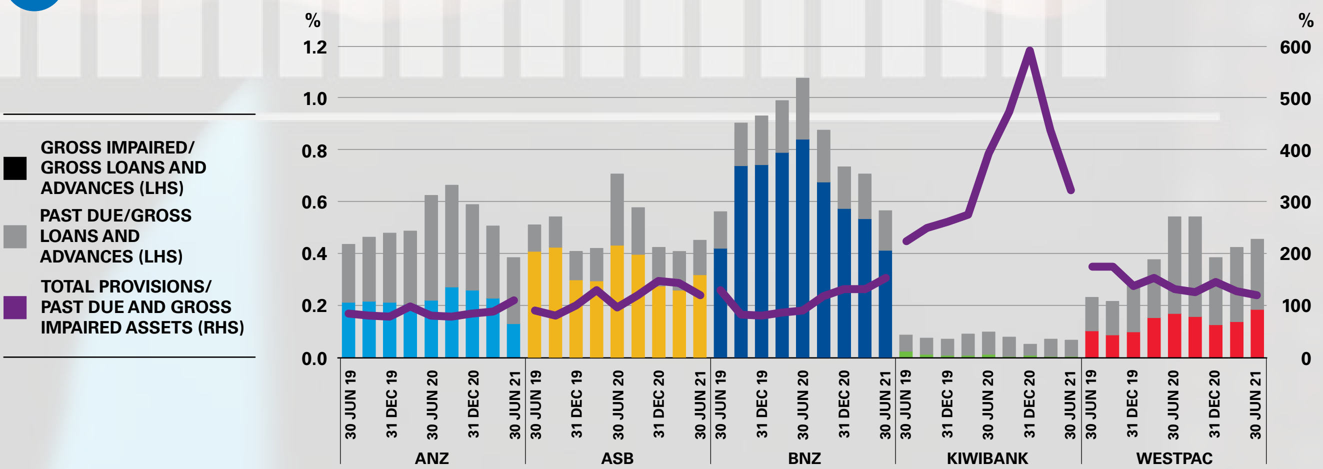
5 MOVEMENT IN PROVISIONING



6 MAJOR BANKS: GROSS IMPAIRED VS. IMPAIRED ASSET EXPENSE



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

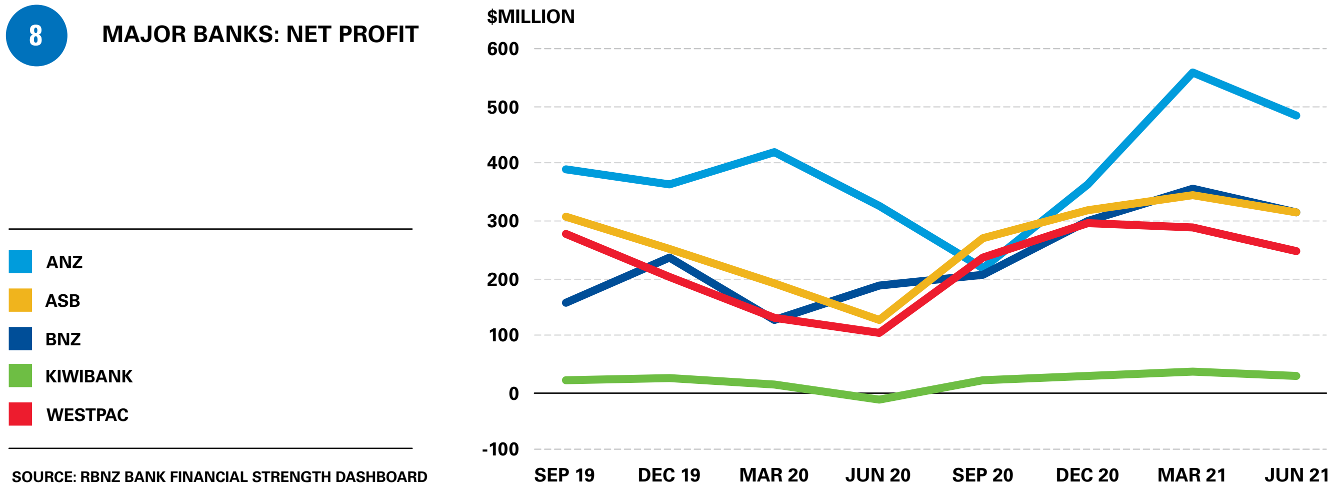


Major banks - Quarterly analysis

Entity[26]	Size & strength measures							
	30 Sep 19	31 Dec 19	31 Mar 20	30 Jun 20	30 Sep 20	31 Dec 20	31 Mar 21	30 Jun 21
	Total assets[27] ($Million)							
ANZ	170,492	170,385	183,424	181,688	180,087	186,404	183,811	187,064
ASB	111,167	109,464	116,042	113,464	115,064	117,967	121,115	120,810
BNZ	109,111	108,289	118,501	114,452	112,310	117,287	114,314	118,549
Heartland	4,206	4,262	4,315	4,315	4,288	4,358	4,297	4,419
Kiwibank	23,584	24,086	25,249	25,510	26,645	27,283	27,546	28,230
SBS	4,863	4,948	4,942	4,836	4,842	4,839	4,832	4,789
TSB	8,075	8,130	8,179	8,332	8,575	8,761	8,789	8,725
Co-op	2,927	2,948	2,980	3,008	3,048	3,064	3,122	3,171
Westpac	106,762	107,111	120,525	114,223	113,187	117,160	114,726	116,786
Total	**541,187**	**539,622**	**584,157**	**569,827**	**568,047**	**587,123**	**582,552**	**592,543**
	Increase in gross loans and advances (%)							
ANZ	0.35	0.92	0.98	-0.02	-1.92	1.51	2.00	1.41
ASB	1.40	0.83	1.03	0.09	2.41	2.58	1.70	2.79
BNZ	1.07	0.41	1.41	-1.36	-0.30	1.43	2.07	2.78
Heartland	0.88	1.82	1.23	-2.03	-0.62	0.72	0.78	3.11
Kiwibank	1.63	3.57	1.91	1.51	3.06	3.86	3.16	2.51
SBS	1.05	1.63	0.58	-1.36	-0.36	-1.10	0.01	0.23
TSB	2.72	-0.33	-0.16	-0.28	0.58	0.81	2.09	2.32
Co-op	0.98	1.08	1.32	-0.31	1.14	2.83	1.61	2.05
Westpac	1.75	1.68	1.80	-0.29	1.47	1.34	1.40	2.13
Average	**1.10**	**1.07**	**1.27**	**-0.28**	**0.31**	**1.78**	**1.86**	**2.20**
	Capital adequacy (%)							
ANZ[28]	13.60	13.60	13.90	14.00	14.40	15.00	15.90	15.50
ASB[28]	13.50	14.20	13.60	14.00	14.20	13.90	14.80	15.10
BNZ	13.90	14.40	14.10	14.60	14.90	15.50	16.00	16.50
Heartland	12.90	12.60	12.90	12.70	13.40	14.00	14.40	13.90
Kiwibank	13.50	13.20	13.00	12.60	12.30	13.30	13.20	13.20
SBS	14.20	14.20	13.80	14.30	14.90	15.20	15.70	16.20
TSB	14.60	14.60	14.30	14.90	15.10	15.10	15.00	14.20
Co-op	16.70	16.40	16.30	16.90	16.90	17.00	16.90	16.80
Westpac[28]	15.90	15.90	15.90	16.60	17.10	17.60	18.20	18.80
	Net profit ($Million)							
ANZ	392	367	422	327	220	367	563	487
ASB	310	252	192	130	270	321	348	317
BNZ	160	238	129	187	209	303	357	318
Heartland	18	17	17	9	21	12	18	20
Kiwibank	25	27	17	-12	24	31	40	31
SBS	8	6	-4	8	10	12	12	13
TSB	13	12	-8	9	12	11	11	13
Co-op	2	3	-1	3	4	5	4	4
Westpac	280	203	132	107	238	300	290	249
Total	**1,207**	**1,125**	**896**	**770**	**1,008**	**1,361**	**1,643**	**1,452**

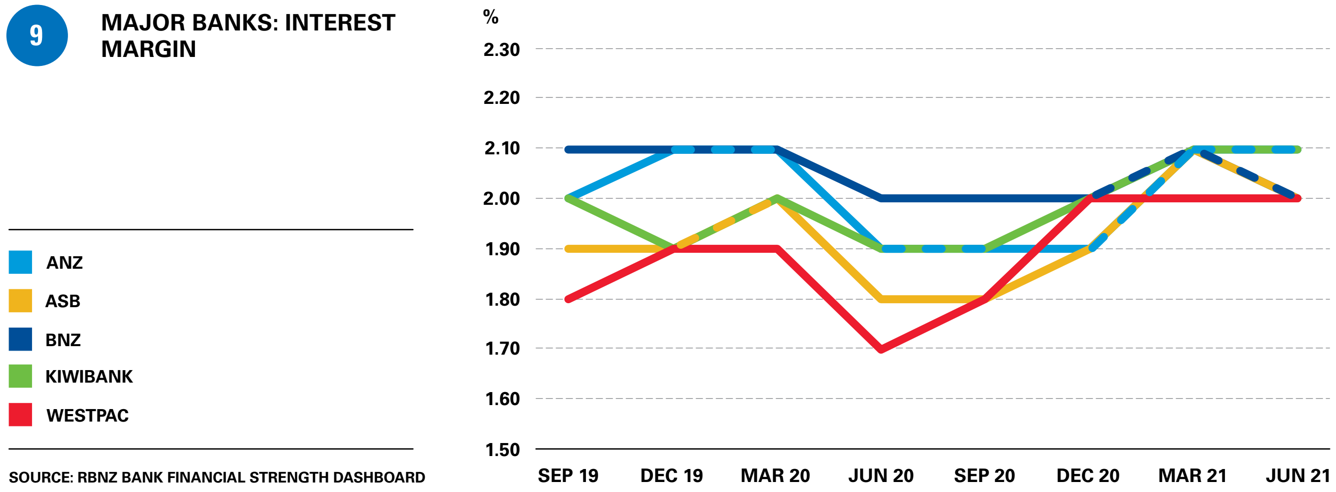
Entity	Profitability measures							
	30 Sep 19	31 Dec 19	31 Mar 20	30 Jun 20	30 Sep 20	31 Dec 20	31 Mar 21	30 Jun 21
	Interest margin[29] (%)							
ANZ	2.00	2.10	2.10	1.90	1.90	1.90	2.10	2.10
ASB	1.90	1.90	2.00	1.80	1.80	1.90	2.10	2.00
BNZ	2.10	2.10	2.10	2.00	2.00	2.00	2.10	2.00
Heartland	4.60	4.50	4.60	4.60	4.50	4.60	4.80	4.90
Kiwibank	2.00	1.90	2.00	1.90	1.90	2.00	2.10	2.10
SBS	2.50	2.50	2.50	2.40	2.40	2.50	2.70	2.90
TSB	1.80	1.80	1.80	1.60	1.70	1.70	1.80	1.80
Co-op	2.20	2.20	2.20	2.20	2.20	2.30	2.40	2.40
Westpac	1.80	1.90	1.90	1.70	1.80	2.00	2.00	2.00
	Non-interest income/Total assets[27] (%)							
ANZ	0.68	0.31	0.85	0.33	0.29	0.18	0.53	0.40
ASB	0.67	0.57	0.53	0.51	0.58	0.54	0.56	0.55
BNZ	0.45	0.30	0.65	0.40	0.35	0.42	0.72	0.50
Heartland	0.42	0.38	0.32	0.38	0.28	0.42	0.32	0.39
Kiwibank	0.86	0.90	0.92	0.53	0.63	0.27	0.26	0.15
SBS	0.78	0.82	0.70	0.68	0.74	0.82	0.65	0.74
TSB	0.29	0.29	0.25	0.22	0.22	0.22	0.20	0.22
Co-op	0.66	0.71	0.50	0.67	0.69	0.60	0.58	0.62
Westpac	0.70	0.37	0.59	0.32	0.35	0.28	0.48	0.33
Average	**0.63**	**0.41**	**0.68**	**0.39**	**0.39**	**0.34**	**0.55**	**0.43**
	Impaired asset expense/Average gross loans and advances (%)							
ANZ	0.13	0.05	0.64	0.23	0.27	-0.03	-0.17	-0.10
ASB	0.05	0.04	0.65	0.59	0.15	-0.01	-0.06	-0.07
BNZ	0.18	0.14	0.53	0.46	0.31	-0.13	0.04	-0.06
Heartland	0.50	0.47	0.69	1.48	0.05	0.44	0.52	0.54
Kiwibank	0.03	0.06	0.28	0.56	0.03	-0.03	0.01	-0.31
SBS	0.35	0.48	2.44	0.39	0.09	0.09	-0.13	0.06
TSB	0.05	0.03	1.29	-0.01	-0.05	0.03	-0.11	-0.12
Co-op	0.03	0.10	1.03	0.12	0.09	0.05	-0.30	0.06
Westpac	-0.08	0.10	0.87	0.54	-0.04	-0.39	-0.05	0.04
Average	**0.08**	**0.08**	**0.67**	**0.44**	**0.17**	**-0.11**	**-0.07**	**-0.06**
	Operating expenses/Operating income (%)							
ANZ	45.63	44.88	33.93	43.97	54.60	44.39	34.29	38.88
ASB	35.89	43.48	38.09	49.46	38.55	36.97	37.66	44.62
BNZ	61.11	40.38	58.00	41.97	41.65	39.83	32.75	38.23
Heartland	42.77	45.02	40.78	48.39	40.28	61.61	43.47	42.93
Kiwibank	78.13	79.01	75.76	91.00	78.94	70.89	65.25	84.38
SBS	64.21	65.58	56.07	59.78	59.36	58.31	61.87	56.21
TSB	54.46	60.00	80.68	66.31	60.76	62.80	68.38	65.02
Co-op	82.09	75.48	75.77	74.52	74.65	70.59	81.61	71.86
Westpac	41.82	47.07	42.68	50.79	44.14	45.34	41.67	44.98
Average	**47.89**	**46.61**	**44.25**	**48.95**	**47.85**	**44.13**	**38.53**	**43.97**

8 MAJOR BANKS: NET PROFIT



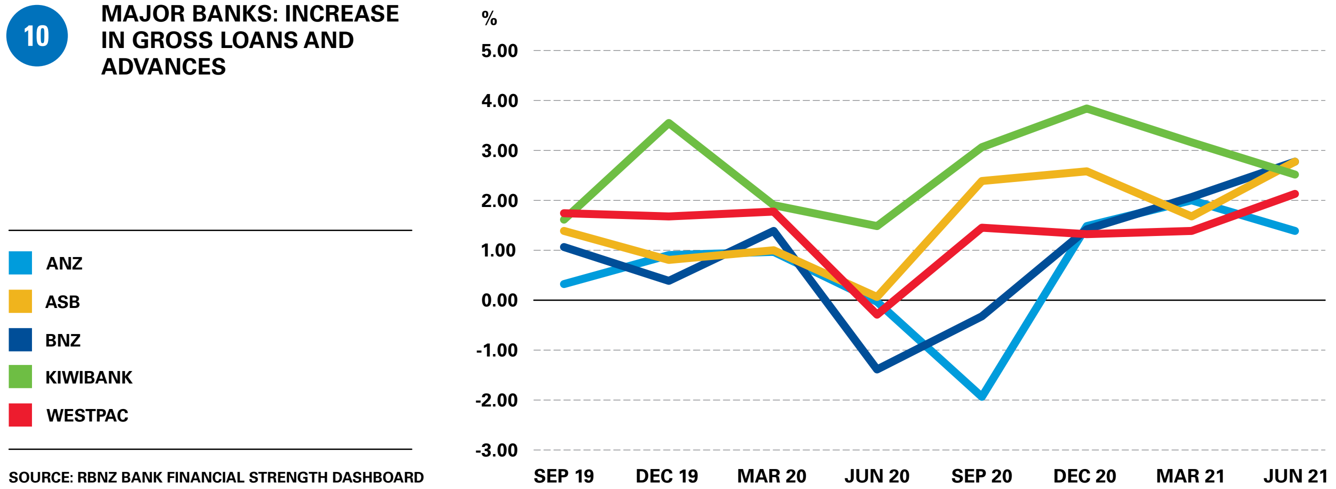
SOURCE: RBNZ BANK FINANCIAL STRENGTH DASHBOARD

9 MAJOR BANKS: INTEREST MARGIN



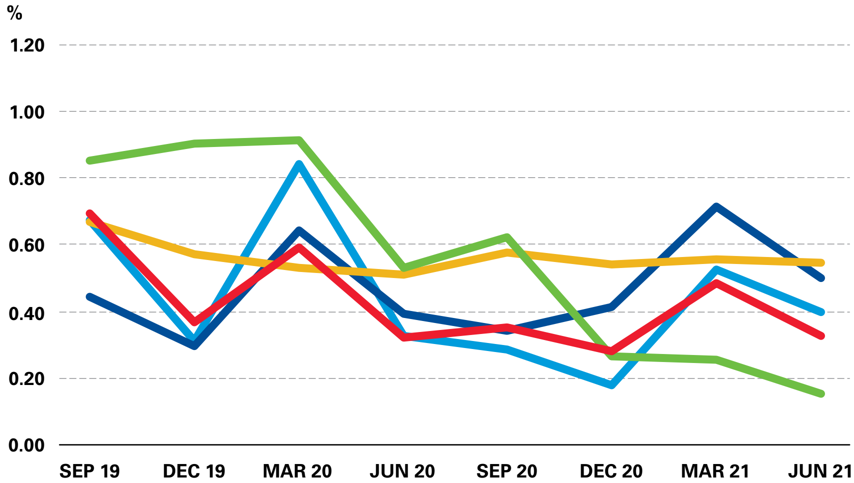
SOURCE: RBNZ BANK FINANCIAL STRENGTH DASHBOARD

10 MAJOR BANKS: INCREASE IN GROSS LOANS AND ADVANCES



SOURCE: RBNZ BANK FINANCIAL STRENGTH DASHBOARD

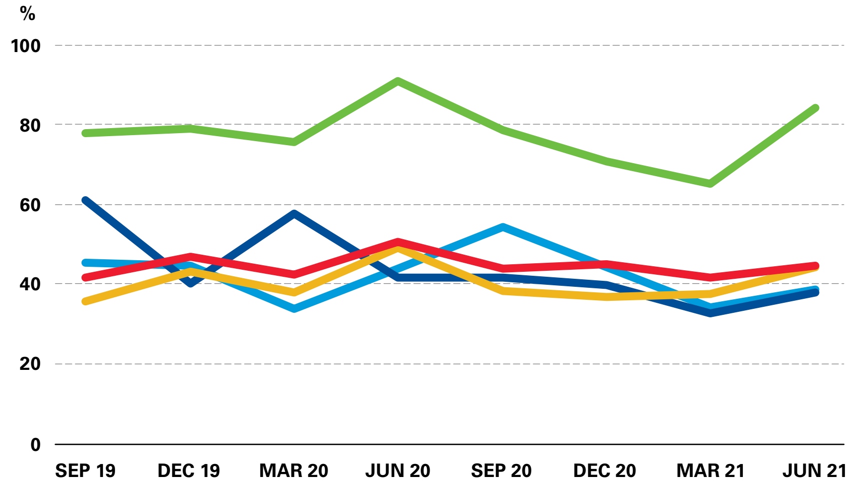
11 MAJOR BANKS: NON-INTEREST INCOME/ TOTAL ASSETS



ANZ
ASB
BNZ
KIWIBANK
WESTPAC

SOURCE: RBNZ BANK FINANCIAL STRENGTH DASHBOARD

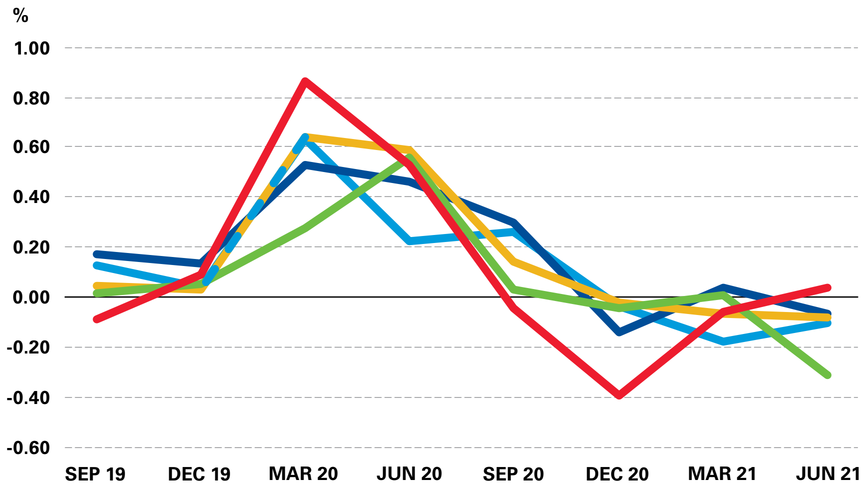
12 MAJOR BANKS: OPERATING EXPENSES/ OPERATING INCOME



ANZ
ASB
BNZ
KIWIBANK
WESTPAC

SOURCE: RBNZ BANK FINANCIAL STRENGTH DASHBOARD

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

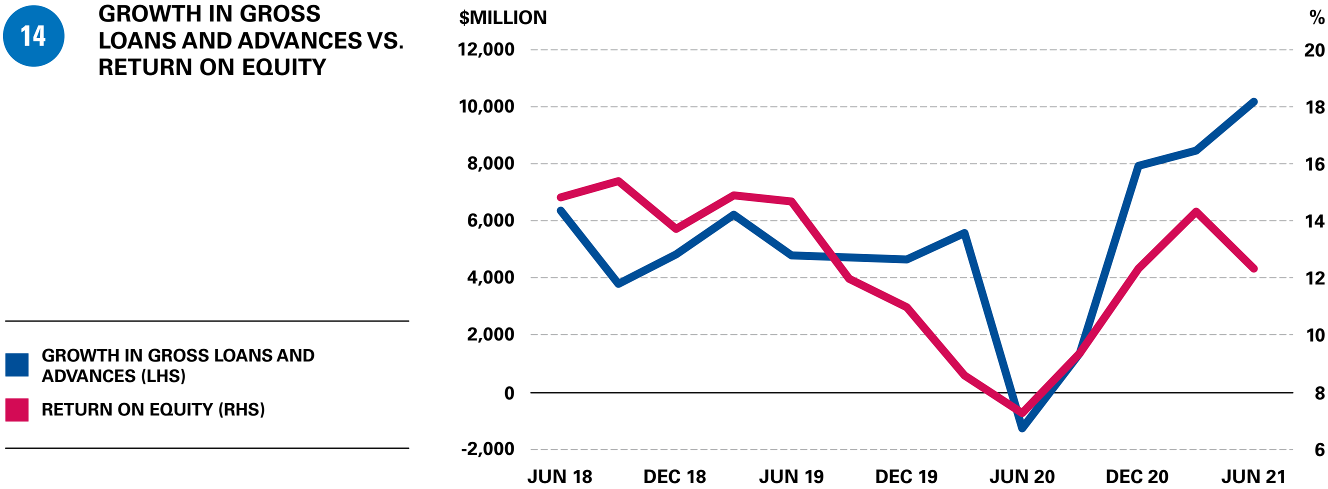


ANZ
ASB
BNZ
KIWIBANK
WESTPAC

SOURCE: RBNZ BANK FINANCIAL STRENGTH DASHBOARD

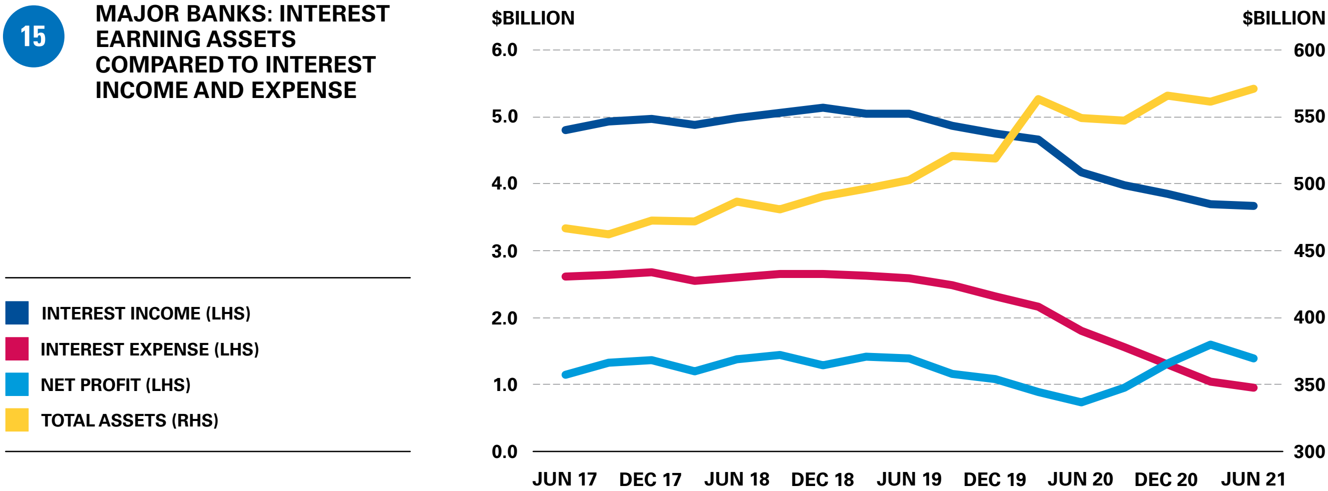
14

GROWTH IN GROSS LOANS AND ADVANCES VS. RETURN ON EQUITY



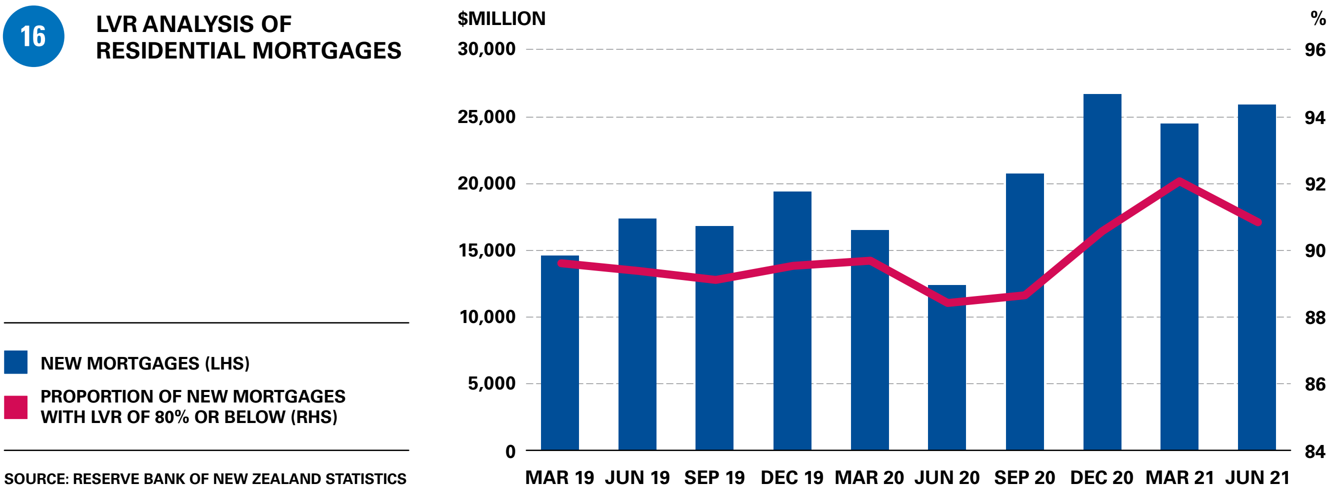
15

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



16

LVR ANALYSIS OF RESIDENTIAL MORTGAGES



SOURCE: RESERVE BANK OF NEW ZEALAND STATISTICS

Buy Now, Pay Later

Buy Now, Pay Later (BNPL) products have increased rapidly over the past few years in New Zealand. While there has been a decline in the number of credit cards issued, Reserve Bank of New Zealand (RBNZ) data shows that credit card spending has steadily increased over the past four years (albeit with a noticeable dip during the 2020 lockdown). However, as the Centrix data on page 21 shows, those aged 18–24 years are more likely to have BNPL than a credit card. While BNPL is being led by non-bank providers, the banks are now starting to venture into the market sub-sector.

The discussion around this product is a good example of the tension between innovation and regulation. To date, BNPL providers have been allowed to innovate (in part due to a lower regulatory threshold) and create products particularly attractive to those under 35 years[30]. A recent report from price comparison website Finder found that 50% of those aged 35 years and under had used BNPL and that 52% of Gen Z'ers (18–24 years) use BNPL compared to 39% who use a credit card[31].

When customers flock to a new product because of its attractiveness, the question will be asked: do they fully understand the detail about how it works or have they just latched onto the convenience of it?

The financial services sector generally is subject to increasing levels of oversight and regulation. At the same time there is some concern being expressed about the level of 'debt' that consumers have accessed under these schemes and the fact they are subject to little or no formal requirement to ensure they are lending responsibly. There is a debate unfolding around whether BNPL is an innovative new payment method or a financial product that has escaped regulation.

There is a debate unfolding around whether BNPL is an innovative new payment method or a financial product that has escaped regulation.

Questions are now being asked about whether BNPL has the potential to do, or is already doing, harm, with some groups starting to point to anecdotal evidence that it already is.

This is where the role of regulation comes in – to provide some protection when a product or service is doing harm. The critical questions will be: how much harm is being done, and therefore, how much regulation is needed; who decides that; and based on what data? An overreaction could potentially stifle innovation and damage a very popular product; however, insufficient guidance will not fix any harm that is being done.

What is BNPL and how does it work?

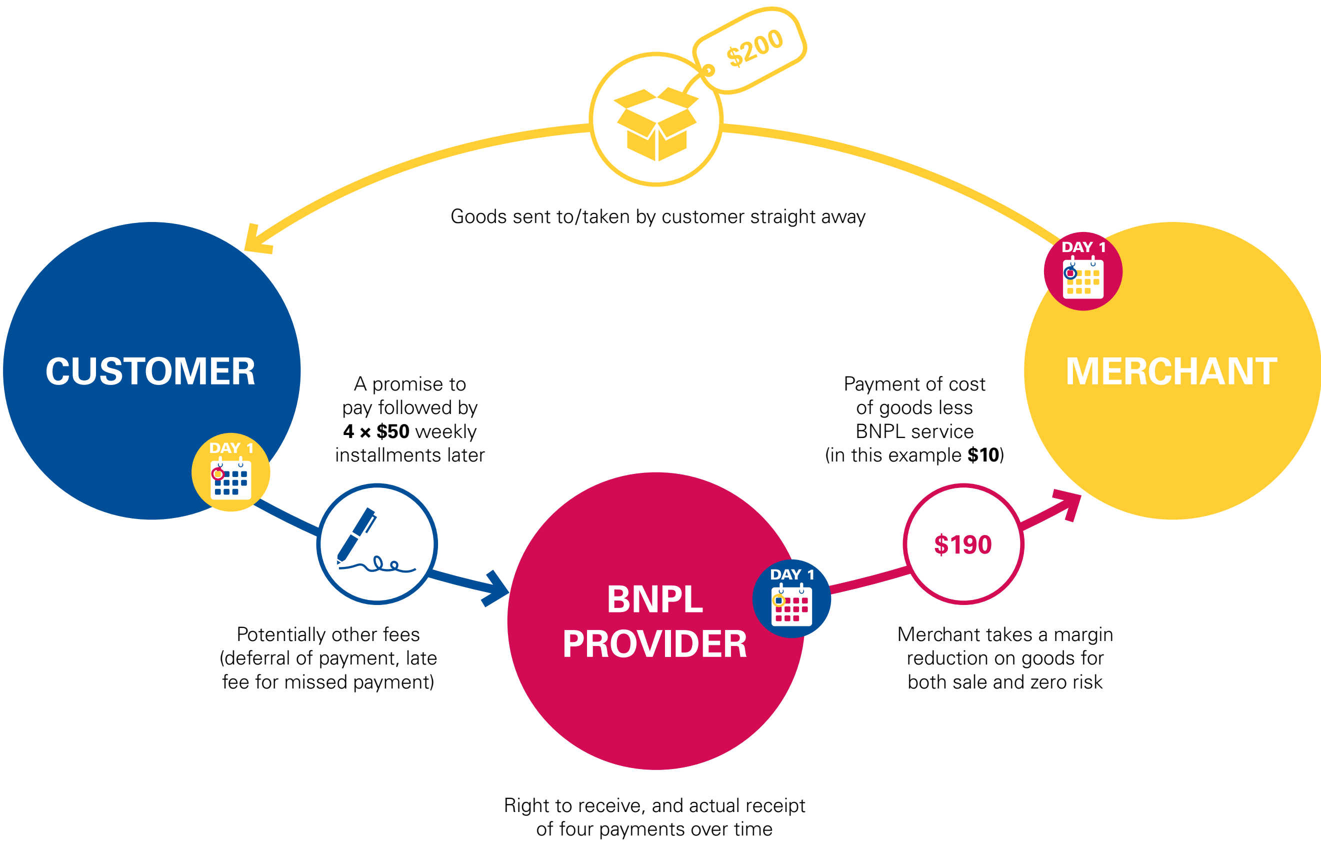
BNPL does exactly what its name says: it allows consumers to obtain goods immediately, but pay for them in future installments. It is another tool in a suite of financial products including personal loans (both interest paying and interest free), credit cards, store cards and layby that enable consumers to get the goods that they want without having to save the money upfront. BNPL allows consumers to pay for goods in pre-arranged installments, usually between four and six, scheduled to suit them and their cash flow. To many it has the best of all worlds – it allows the consumer to get the goods or services now but pay later with no interest charges and control their outgoings by modifying payment terms for a fee. It is not recognised as debt in the traditional sense and the consumer can do this all easily from their smartphone.

In an era of instant gratification, the sense of immediacy is the draw.

In an era of instant gratification, the sense of immediacy is the draw.

The merchant achieves the sale and, usually, receives the money for the products upfront, albeit minus a margin. This lost margin is, in effect, the interest that is paid by the merchant on the customer's behalf. Unlike layby, where the consumer would not get the goods until the final payment had been made, there is no need for the merchant to store the product.

While cash used to be considered king, methods of payment have continued to evolve to include debit and credit cards. Now BNPL can be accessed from smartphones or watches, there is much less need to carry a wallet at all. One lasting impact of the Covid-19 pandemic has been the increase in the use of contactless payment options, so you are just as likely to be able to use PayWave in smaller dairies and cafes as supermarkets and other large retail stores.



BNPL is simply another tool to enable quick, easy payments both in store and online. As it currently stands, it is designed in a way that doesn't bring it under the regulatory definition of lending and, therefore, is not covered by the regulation that traditional consumer lending is.

While the banks were initially slow to realise the appeal of BNPL and continued to focus on their own credit card products, the recent partnerships between Westpac NZ and Bundll, Westpac Banking Corporation and Afterpay, and Commonwealth Bank of Australia and Klarna demonstrate that this method of payment is now part of the established financial services sector. Visa, Mastercard and PayPal all have their own versions further illustrating that it is a product that is here to stay.

So, why all the fuss?

BNPL certainly has a place in the suite of financial tools available to people and has seen rapid growth since it landed in New Zealand in 2016. Today, nearly a third of New Zealanders have used BNPL services with the average customer using it eight times in a six-month period[32]. As always with financial products, the problem comes when people don't fully understand how the product works or the consequences of not using it as intended (e.g. not making payments on time). This is where the potential for harm emerges and it is key that there is transparent disclosure around the product use and any potential pitfalls. In addition, consumer financial literacy, or the lack of, also plays a part.

Nearly a third of New Zealanders have used BNPL services with the average customer using it eight times in a six-month period.

Now, who should be responsible for consumers' financial awareness – the product provider, the customer, the regulator? The answer is probably all of them to a certain degree.

While the product is interest-free (as currently defined), convenient and isn't considered lending under the Credit Contract and Consumer Finance Act (CCCFA), its cost advantage depends on the consumer sticking to the payment schedule.

The costs can rack up quickly if customers incur deferral fees or late fees and this can end up on customers' credit records. The fact that the product does not involve interest means that it falls outside of the current responsible lending regime and this is causing concern to both traditional financial services players and to consumer groups.

Some more traditional financial services providers claim that BNPL creates an uneven playing field as they cannot compete on speed when they have to conduct anti-money laundering and affordability checks.

For consumer groups, there are concerns that people are using BNPL without fully understanding the implications.

Ngā Tāngata Finance, a non-profit organisation backed by Kiwibank which offers loans for people on low incomes, says that 60% of the people aged 26 to 30 years that are seeking help from them have one or more BNPL loans[33]. The Ministry of Business, Innovation and Employment (MBIE) says that missed payment rates for BNPL loans are between 9% and 15%[34]. Consumer NZ is concerned that people are actually incurring debt as a result of these late payment fees[35].

Should it be regulated?

The UK Government has announced that it will include BNPL products under the Financial Conduct Authority's regulatory regime[36] and the Australian Financial Industry Association has launched a code of practice which has 95% of the market participants signed up[37].

There is always a healthy tension between innovation and regulation and perhaps part of the answer is industry self-regulation.

There is always a healthy tension between innovation and regulation and perhaps part of the answer is industry self-regulation. Considering that regulation could potentially stifle the growth and sustainability of this popular product, we need to ensure that:

1. Customers understand financial products and exercise good judgement.
2. BNPL providers ensure that their product is being used as intended. If their products are creating financial hardship, they will attract 'heavy-handed' regulation.
3. Regulation is considered only if it is required and is targeted to dealing with an actual issue(s).

A combination of market participant self-regulation, transparent explanation around the product, its intended uses and potential pitfalls, and greater consumer awareness might result in best outcomes.

How are different generations using credit?

Keith McLaughlin
Managing Director,
Centrix Group Limited

Keith McLaughlin is the Managing Director of Centrix Group Limited, New Zealand's only locally owned credit bureau. A highly experienced senior executive and director, Keith started Centrix with a vision to offer New Zealand businesses a superior and cost-efficient credit offering, with a focus on long-term relationships. Previously the founder and Managing Director of Baycorp Holdings Limited, his strengths include strong leadership skills with an emphasis on empowerment, and a proven ability to forge and sustain high performance teams. Keith has a wealth of finance experience in business process, requirements analysis, banking, IT strategy and professional services and holds a number of major awards, including Deloitte / Management Magazine NZ Executive of the Year.

With advances in technology, the financial services sector is looking very different than it was only a decade ago. So how has the arrival of app-based credit services such as Buy Now Pay Later (BNPL) impacted the consumer credit market?

We analysed the credit records of over 4 million Kiwi consumers, to see how different generations are using credit in 2021. Our results highlight emerging gaps in the ways different generations are accessing credit, and how they are managing their finances, based on average credit scores.

Younger generations choose non-bank lending

Younger generations aged under 40 are now more likely to access non-bank lending products such as BNPL, with 24% of 25–40-year-olds and 43% of 18–24-year-olds accessing these forms of credit.

Older generations are still using more traditional sources of credit from their banks, with two-thirds of those aged 40+ holding a credit card, compared to only 15% of under 25-year-olds.

Mortgage holdings strongest in Gen X

There's a significant variance in the uptake of mortgages between different generations. Almost half of Generation X (aged 41–56) have a mortgage, while not surprisingly, the youngest and oldest generations are less likely to have a mortgage.

Uptake may not be a direct reflection of home ownership, as many people aged over 57 may have paid their mortgage off, leading to lower numbers of active mortgage holders in this demographic bracket.

Lack of affordable housing for first home buyers is reflected in the low levels of mortgage holders in Generations Y and Z, the age brackets 18–24 (3%) and 25–40 (29%).

Youngest generations not as credit savvy

Kiwis aged under 40 are much more likely to have adverse credit or be in arrears, leading to these generations having lower credit scores than older generations.

This may be due to younger generations having lower levels of disposable income to service credit in general, compared with older, more financially settled generations.

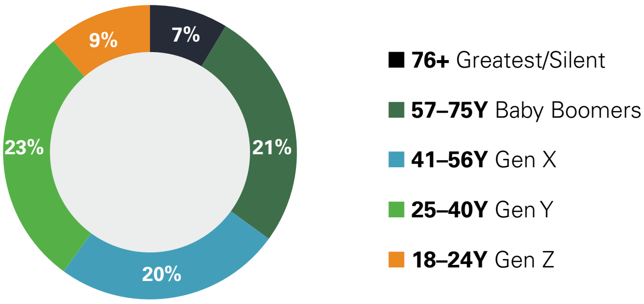
Most young people also need more education about financial capability, in particular the importance of paying bills on time, to build up a positive credit history.

Find out more about Centrix and get NZ consumer and business insights at www.centrix.co.nz.

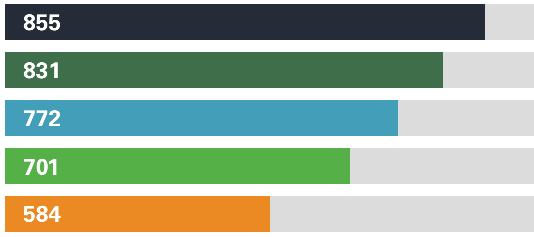
How different generations use credit

CENTRIX

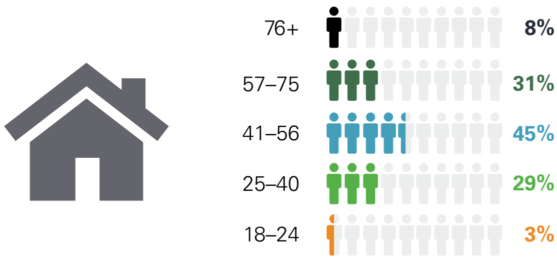
Percentage of population age in 2021



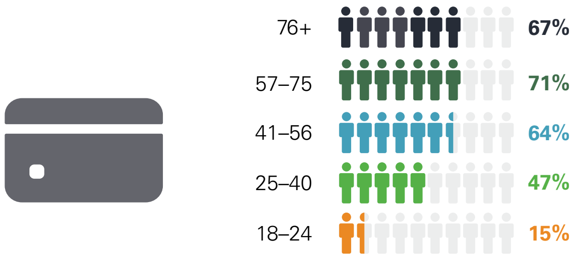
Average credit score



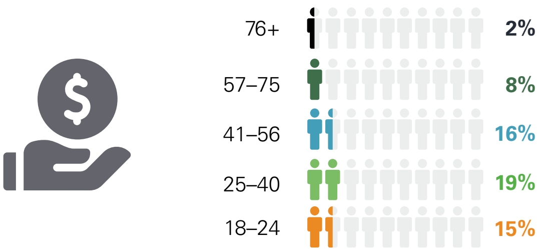
Percentage with mortgages



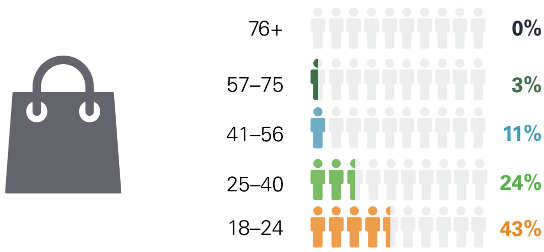
Percentage with credit cards



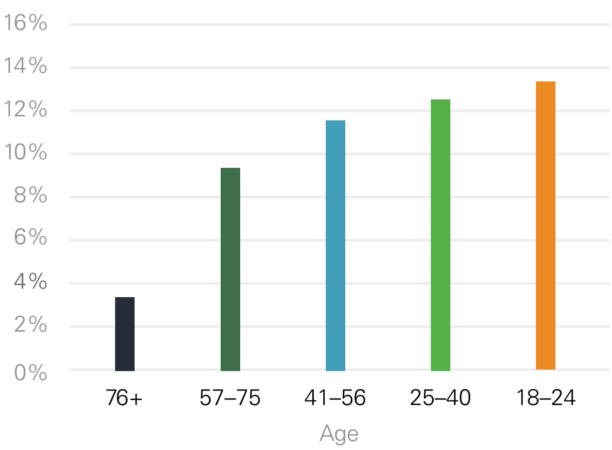
Percentage with personal loans



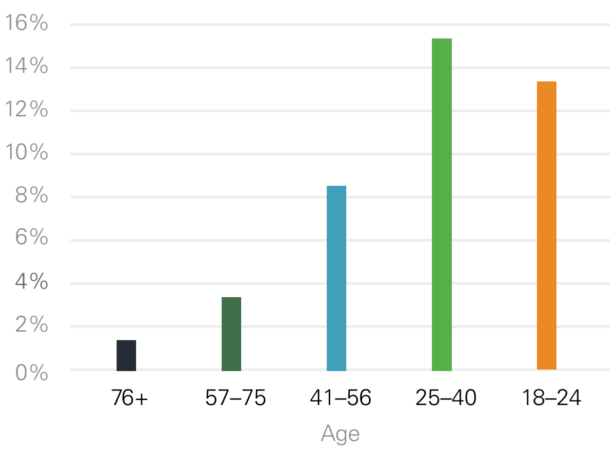
Percentage with buy now pay later



Arrears



Adverse credit



How can we turn remediation into a strategic opportunity?

Malcolm Bruce
Principal – Risk Consulting
KPMG

Malcolm leads KPMG's Risk Consulting team and specialises in financial services risk and regulatory advisory work. The KPMG Risk Consulting team supports clients across a broad range of areas from operational risks to non-financial risk management issues including conduct and culture, anti-money laundering, controls, and compliance.

Laura Iddles
Senior Manager – Risk Consulting
KPMG

Laura Iddles is a Senior Manager within our Risk Consulting practice. Laura transferred from KPMG UK over two years ago, bringing with her a wealth of remediation experience from complex banking remediation programmes. During her time in New Zealand, Laura has supported Big Four Banks and Insurance providers by providing advice on the design of remediation policies and processes, and support on the operational execution of remediation activities.

KPMG's experience working on remediation programmes in New Zealand, the UK and Australia has shown us that remediation is a strategic opportunity that the New Zealand market is not yet taking advantage of.

In order to understand the opportunity, businesses must first accept that remediation is part of delivering good customer outcomes.

The financial services industry needs to rebuild trust

The foundation of any good relationship is honesty and trust. Once gold standard risk practices are implemented, the reduction in mistakes will help to increase customer trust, but until that point, how organisations respond to problems will define their reputations.

The foundation of any good relationship is honesty and trust.

As organisations are seen to take ownership of their mistakes, it will be increasingly easy to rebuild customer relationships and maintain trust.

Remediation is an opportunity to demonstrate care, as well as integrity.

When a customer trusts that their financial institution will proactively and competently rectify issues, while putting its customers first, then remediation can actually improve relationships.

Get ahead of the ball

Remediation is sometimes rushed and hidden away, bundled into a quiet dark corner with a countdown to completion. KPMG encourages clients to open the door, shed the light, bring in the product managers/ process owners and consider; "If we need to spend money fixing something, how can we make it better than it was before?" Rather than only fixing your root cause problem, take the opportunity to align products and processes with strategic objectives and develop internal capabilities too.

Remediation is sometimes rushed and hidden away, bundled into a quiet dark corner with a countdown to completion.

Not only does looking at your root causes inform you of the biggest weaknesses your organisation faces, it also presents opportunities to improve and solve problems now, before they cost you in the future.

There are a number of common risk factors KPMG is seeing increasing the volume of remediation in the New Zealand market, resulting from:

- **legacy systems:** that may no longer be able to support the business, products or customers, leading to increasing manual fixes and work-arounds to deal with system limitations;
- **manual processes:** exposing organisations to human error and lack of oversight;
- **key person risk:** a reliance on a single or few employees who understand the systems and processes without adequate documentation to ensure continuity; and
- **immature risk management protocols:** or over-reliance on lag indicators to identify issues (e.g. complaints processes).

The financial services sector is inherently prone to risk and operates in an increasingly regulated environment that is demanding higher standards. Instead of responding with sticking plasters, market leaders will be proactive in adopting higher standards and using them to drive their organisation. We believe that remediation is a function that organisations should embrace to help deliver on those strategic objectives.

Product and process optimisation

Given proper attention, remediation presents opportunities to improve systems, processes, controls, and products. Once again, it requires the sector to not just review the intended and original specifications of a product. We should take it further, and consider how we can optimise systems and processes and increase the potential for products and services to truly meet customer needs.

This includes establishing processes to regularly review and update product design, incorporating feedback from a breadth of sources with the help of connected systems, and investing in documenting processes.

Basic remediation helps identify where these processes fall-down, but good remediation has a role in developing review processes that ensures products are optimised continually.

A real-life example was a bank having issues with the application of fees and charges on personal loan accounts, where these were manually applied. The remediation dealt with issues caused by the historical application, but, more significantly, looked to automate a scenario-based application of the fees to eliminate manual intervention.

Remediation can act as a valuable catalyst to address past problems *and* fix the process for the future.

Foster remediation talent

Remediation also gives you an opportunity to develop your employees. It requires a broad skill base, requiring an understanding of almost every area of an organisation, as well as senior stakeholder management.

We often see remediation being outsourced to contractors whose main priorities are progressing the remediation to customer contact quickly, rather than identifying the root cause, documenting findings and embedding frameworks.

At KPMG, we're passionate about remediation as a blend of complex problem-solving, stakeholder management and prioritising customer outcomes. We see it as a lifecycle, from the root cause fixes to the considerable opportunity conversations around remediation bring to the table.

Building internal remediation skills presents a unique opportunity for your people to:

- understand systems and processes;
- build data skills;
- uplift risk management capabilities;
- fix complex problems; and
- develop prioritisation skills.

An established remediation process requires us to go beyond identifying and remediating issues, with a focus on strengthening processes and controls to detect and manage ongoing conduct risks. International experience and local expertise tells us that New Zealand is underutilising remediation as it stands, but we're excited to help the market change and evolve.

Endnotes

1. https://www.rnz.co.nz/news/national/450890/delta-2-what-s-changed-with-alert-level-2
2. https://www.rbnz.govt.nz/news/2021/09/tighter-lvrs-proposed-to-reduce-risky-mortgage-lending
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22. https://www.fsc.org.nz/site/fsc1/Financial%20Services%20Council%20-%20%20Financial%20Resilience%20Index%20-%20April%202021.pdf
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25. https://assets.kpmg/content/dam/kpmg/nz/pdf/2021/06/fips-march-2021-quarterly.pdf
26. This data represents the top New Zealand level banking-licenced entity and is referred to using the brand in common usage, and as per the RBNZ Bank Financial Strength Dashboard. ANZ represents Australia and New Zealand Banking Group Limited – ANZ New Zealand; ASB represents Commonwealth Bank of Australia New Zealand Operations; Heartland represents Heartland Bank Limited; SBS represents Southland Building Society (trading as 'SBS Bank'); TSB represents TSB Bank Limited; Co-op represents The Co-operative Bank Limited; and Westpac represents Westpac Banking Corporation – New Zealand Banking Group.
27. 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. Total Assets = Total Assets - Intangible Assets.
28. The capital adequacy ratios reported are for the local bank.
29. 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.
30. https://www.rnz.co.nz/news/business/445450/buy-now-pay-later-scheme-use-increased-by-49-percent-money-specialist
31. https://www.interest.co.nz/sites/default/files/embedded_images/Buy-Now-Pay-Later-Report_NZ-2021.pdf
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34. https://www.newshub.co.nz/home/money/2021/07/shoppers-forgoing-food-for-buy-now-pay-later-purchases-officials-warn.html
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