FIPS

Financial Institutions Performance Survey
Banks – Review of 2021

MASSEY UNIVERSITY
TE KUNENGA KI PŪREHUROA
UNIVERSITY OF NEW ZEALAND

47.92%
increase in NPAT

0.80%
increase in operating expenses

15.20%
drop in total provisions

16.22%
decrease in interest income

1 bps
increase in net interest margins

6.58%
increase in gross lending

114.49%
decrease in impaired asset expense

89 bps
drop in average funding costs

Current and up to date as at 5 p.m. Wednesday 2 March 2022

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

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

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

The Survey

The KPMG Financial Institutions Performance Survey (FIPS) report of 2021 represents the 35th year that KPMG has provided in-depth insights into New Zealand's banking sector. In this 35th edition we will present industry commentary and analysis on the performance of the New Zealand registered banks, together with a range of topical articles from other key stakeholders such as industry experts, regulators and our own business leaders.

The survey covers registered bank entities with reporting dates between 1 October 2020 and 30 September 2021. As a result, registered banks with the reporting date of 31 December have had their 31 December 2020 financial results included in this year's survey as their most recent results. This includes Bank of China, China Construction Bank, Citibank, Industrial and Commercial Bank of China, JPMorgan Chase Bank, Kookmin Bank, Rabobank and The Hongkong and Shanghai Banking Corporation.

TABLE 1: ENTITY MOVEMENTS[1]

	Who's out	Who's in
Banks: 27	— Nil	— Industrial and Commercial Bank of China New Zealand Banking Group

FOOTNOTE 1

In May 2020, the Reserve Bank of New Zealand – Te Pūtea Matau (RBNZ) registered Industrial and Commercial Bank of China (ICBC) to operate in New Zealand as a branch in addition to the subsidiary which has been operating in New Zealand since 2013. ICBC has reported the branch entity's financial results within a consolidated disclosure statement, this has resulted in a change of top-level entity for ICBC to Industrial and Commercial Bank of China New Zealand Banking Group. As ICBC has a 31 December reporting date, the December 2020 results for the banking group are included in this year's survey.

As with previous FIPS, the information used in compiling our analysis is extracted from publicly available annual reports and disclosure statements for each organisation, with the exception of certain information which is provided directly from the survey participants.

We wish to thank the survey participants for their valued contribution, both for the additional information provided and for the time made available to meet and discuss the industry issues with us.

Massey University continues to be a partner and key contributor to the compilation of this publication, assisting with the data collection as well as drafting the banks' profit forecasting section of this survey. We thank them for their continued contribution.

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

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

In late 2021 we published and launched our *FIPS Non-bank – Review of 2021* publication. This publication can be accessed at the following link: https://home.kpmg/nz/en/home/insights/2021/12/fips-non-bank-2021.html

A KPMG view from the editor

John Kensington
Partner – Audit
Head of Banking and Finance
KPMG

JOHN'S BIO

Last year I opened the *Letter from the Editor* with a reflection on what an extraordinary year 2020 had been. The financial and health implications of the global Covid-19 pandemic on New Zealanders had been unprecedented. True, it was the first time we had experienced lockdowns, closed our borders and implemented a Managed Isolation and Quarantine (MIQ) system. It felt right at the time from a health perspective, even if it was uneasy from an economic perspective. It was also the first time we had enforced/encouraged working from home. These new phenomena all created a lot of uncertainty, but after each lockdown there was the strong bounce back and people got used to the new norms forced on us by Covid-19 and more confident in managing their way through and around it.

As 2020 ended and 2021 commenced, New Zealanders took comfort in the chance to have a summer, enjoyed the return to normal in many areas, and started to put Covid-19 behind them.

If we thought 2020 had some unprecedented impacts on New Zealanders, our economy and our health system, we really would have been shocked if we had foreseen what 2021 was about to bring.

2021 brought all of the experiences of 2020 plus a whole range of new ones leading into 2022:

- Delta, a more transmissible version of the virus;
- the arrival of vaccines and ultimately a booster;
- a very long lockdown to the Auckland region;
- vaccine passports and vaccine mandates;
- the arrival of Omicron, an even more transmissible version of the virus;
- the introduction of the 'traffic light' system; and
- probably most significantly, the Government decision to move to living with the virus as opposed to trying to eliminate it.

For all the challenges that 2020 brought, 2021 brought far more and did so on the backdrop of a country starting to get fatigued with Covid-19, the disruptions it caused and the task of navigating evolving guidelines.

What has been apparent throughout the last year is our resilience as a nation. However, in the latter months of the year, cracks began to appear, with the more vociferous opponents of the Government's approach starting to gain a more powerful voice. From our viewpoint on the other side of 2021, we now know that this culminated in an anti-mandate and anti-vaccine protest outside Parliament which developed into a much wider ranging 'anti' protest. Although the protestors' approach hasn't been popular with the majority of New Zealanders, what is becoming increasingly apparent is that *some* of their views are supported and understood by the general population, with certain rules being questioned for both fairness and logic.

Another significant development in 2021 was the interconnectivity of the issues and themes faced by the banking sector. In the past, these have been relatively siloed and could be approached as such. For example, the competition for talent. As New Zealand closed its borders and workers left it has become difficult to find replacements, leaving many industries, including the financial sector, increasingly short staffed. At the same time, the finance sector faced new regulations and enhanced cyber security requirements in the face of increasing threats. Both situations require not only additional people, but those with skills often found overseas. With employees increasingly working from home, and therefore, potentially experiencing less collaboration and office culture, some naturally have become less engaged. While we have yet to see the full effect here in New Zealand, internationally 'the Great Resignation' has been a result of many people changing or leaving jobs in part because they have missed the human aspects of working together.

The topic in this year's survey that has had the biggest impact and was most passionately talked about by bank CEO's and CFOs was the amendments to the Credit Contracts and Consumer Finance Act (CCCFA), implemented on 1 December 2021. When the changes were mooted, two things happened – commentators all agreed with the concept of promoting responsible lending and ensuring no one was harmed, but simultaneously issued warnings in advance about the impact this would have on processing times and decision making.

To add another level of complexity, the new regulations came into effect at a critical time for the economy, just as Auckland was exiting the lockdown it had been in for over four months. As businesses geared up for a shortened Christmas lead-up and as the nation readied for a well-earned and highly anticipated holiday (typically a period when debt can extend out a little) the foreshadowed impact of the regulations impacted the lending sector. The more prescriptive approach required more information to be gathered on all borrowing applications, which resulted in longer processing times and a reduction in approvals as lenders adopted a cautious line. No-one wanted to be the 'poster child' for a Commerce Commission investigation that could result in significant fines for Directors and senior managers and the potential for reputational damage.

The slow-down in loan processing times and the increase in declines meant at the very time many sectors of society needed funding it was turned down. At the same time, the cost of borrowing increased and some borrowers became 'un-bankable' due to the tightening of the affordability criteria.

Daily news feeds were littered with examples of people impacted by the new rules – many of whom were not the intended targets – who'd had their borrowing declined. The Commerce and Consumer Affairs Minister has launched an investigation into the reasons into why lending has slowed. However, when announcing this investigation there was a suggestion of shifting the blame away from poorly drafted legislation towards other factors such as new loan-to-value ratio (LVR) rules, debt-to-income (DTI) considerations, a seasonal slowdown and even poor lending decisions by the banking sector in the past now being stopped. An initial report was due mid-February with a final report in April. As yet, nothing has been made public. The hope is that a transparent and factual approach is adopted, leading to a balanced outcome.

As we continue into our third year of the pandemic, the country is starting to show signs of Covid-19 restrictions fatigue with some questioning whether the time gained by eliminating Covid-19 in the earlier stages and the opportunity to watch how events played out overseas, could have enabled us to be better prepared for where we are now.

That is not to say that we haven't done a good job. For a long time, the Government's actions kept the virus out of New Zealand and allowed us to live normal lives when compared to many overseas. They provided significant support to the economy through subsidies and support packages and managed the locking down/elimination phase particularly well when looking at global comparisons.

It's important, however, that they are able to put strong emphasis on the entrepreneurial aspect of the reopening phase.

Looking forward, as we move into the uncertainty of the Omicron outbreak, the Government will need to ensure it balances the health and economic impacts more evenly and tackles the challenge of bringing people with them on the journey.

One important factor which the Government would be prudent to consider is New Zealand's history of being very resilient in the initial stages of a crisis, and then suffering from a longer tail. If we look at what happened in the 1987 share market crash, Asian Crisis and Global Financial Crisis, New Zealand was remarkably resilient in the early stages of both of these events, but when the rest of the world was starting to recover two to three years later, New Zealand experienced some of its more difficult years and recovery stalled.

Finally, a word on the results of the banking sector. It might seem counter-intuitive that despite the various challenges the banking sector performed so strongly in 2021 and posted a record result. However, we need to bear in mind the following two key factors.

1. The Government provided support during the first two years of the pandemic by making a large amount of money available through various support mechanisms, which softened the economic impacts of the pandemic. Many New Zealanders, with their love of housing, have borrowed and binged on the housing market which has resulted in house prices increasing as much as 25% in some areas. The Government's policy and support for the economy has had the unintended consequence of contributing to a housing bubble.

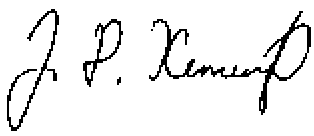
   The banks have seen phenomenal mortgage growth driven by the availability of cheap borrowing, allowing them to lend to home buyers at astonishingly low rates. Throughout the survey period, bank lending has grown 6% and the banks' margins have remained stable or increased slightly. This has resulted in more revenue for the banks.

2. The most significant factor in the record result for banks last year has been the reversing of provisions made in the prior year. When Covid-19 first struck New Zealand, banks were required to estimate the impact that it might have. As we look back now **with the benefit of hindsight**, it is apparent that nearly everyone overestimated the negative impact that the pandemic might have, resulting in provisioning levels that have subsequently not been required. A significant part of the banks' record performance is due to a portion of those provisions being reversed.

Throughout this period of Covid-19, the art of forecasting has been sorely tested. It would be a very brave person that tries to look forward in 2022 and 2023 and predict what is going to happen. Some things are certain though – there will be more uncertainty and we will all continue to encounter new experiences. It is highly likely that Omicron will make a greater incursion into society and more people will become unwell, albeit hopefully less seriously than with earlier variants. What is not clear is the impact that it will have on businesses as large waves of the workforce are unable to work for periods of time.

2022 will hold a new range of challenges in addition to the ones we have already endured during 2020 and 2021 including the impact from the Russia and Ukraine conflict which is still unclear.

One positive though is the fact that, to date, we have proven to be a particularly resilient group of people and our economy has, thus far, proven similarly resilient. If the Government and private sectors work together, we may be able to collaborate in a way that gets us through this next phase more efficiently from an economic point of view than we have historically, and without over-taxing the health system, all while keeping the 'team of 5 million' together and safe.



Industry overview

You will not be surprised that the banking sector themes are strongly aligned with those discussed in the *Non-bank FIPS Review of 2021*[2] released in December 2021. While the two sub-sectors have some differences the base services that they offer, the regulation that covers them both and the customers they deal with are strikingly similar and the most pervasive challenges facing the two sub-sectors and indeed the wider economy are the same.

FOOTNOTE 2

Our conversations with the CEOs and CFOs of New Zealand registered banks focused largely on the continuing impact of the Covid-19 pandemic including the evolving Government response and the associated economic impacts. As with the non-banks, the hottest and most passionately discussed topic was the implementation of the Credit Contracts and Consumer Finance Act (CCCFA) changes that took effect from 1 December 2021. In talking with the banking sector, we discussed the early onset of actual impacts as opposed to the predicted impacts and, unsurprisingly, they were not that different.

Impact of lockdowns

New Zealand was relatively Covid-19 free until mid-August 2021. There were 'short, sharp' lockdowns in both Auckland and Wellington, but these effectively and efficiently stopped transmission of the virus, allowing New Zealand to continue with the 'Zero-Covid' strategy and enjoy the greater freedoms that came with that, particularly when compared to many other countries.

This was changed by the community outbreak of the Delta strain of Covid-19 in August, following its earlier international debut, which proved to be more transmissible and not so easily contained. This resulted in Auckland spending over 100 days in either Alert Level 4 or 3[3] before transitioning to the Covid-19 Protection Framework (the Framework), colloquially referred to as the 'traffic light' system[4]. While those who endured this lockdown will attest to how long it felt – it was still relatively short compared to what has occurred in many places overseas.

FOOTNOTE 3

FOOTNOTE 4

Following a significant focus on getting people vaccinated against Covid-19, New Zealand achieved an overall national vaccination rate of over 90% of eligible people in December. This gave the Government the confidence to allow the country to enter the Orange light setting, with the exception of Auckland and Northland, and to drop the hard borders around Auckland in mid-December. Auckland joined the rest of the country on 30 December in the Orange setting of the traffic light system[5].

FOOTNOTE 5

The lower level of vaccination in Northland meant that it did not move to Orange until 20 January 2022[6]. Use of the vaccine pass meant that most New Zealanders were able to enjoy the summer break, albeit within New Zealand. The Government had already announced plans for the international border re-opening in November with a staged approach taking effect from January 2022 and it looked as if things were finally returning to 'normal'.

FOOTNOTE 6

However, this optimism did not last long. The new Omicron strain started dominating Covid-19 infections globally and was soon seen at the New Zealand border as the dominant strain and eventually made an unwelcome appearance into the community. As a result, the border re-opening plans were paused. An increase in cases at the border and confirmed community transmission led to the Government placing the entire country in the Red setting as of 11.59pm on 23 January 2022.

The Framework is designed to keep businesses operating while using vaccination passes and mask wearing to minimise risk. The new approach to Omicron includes a phased approach to the components of the Framework and these will change as case numbers increase. Although some are questioned the disconnect between the intention of keeping businesses operating with the isolation protocols for Phase 1 of the Omicron response, with some commentators feeling that when the duration of isolation is combined with the rules around defining close contacts, how they are defined and the required testing it all equates to a quasi-lockdown.

However, since the surge in Covid-19 cases increased, we quickly progressed through to Phase 3 of the Government's Omicron response where the definition of close contacts and the need to isolate are restricted to those in the same household, this point is now moot.

Working from home is 'encouraged' at the Red setting for those who can. This continues to have a flow on effect for many businesses in central business districts who were just getting going again after the summer break.

Our survey participants were generally of the opinion that working from home could be practical and efficient for transactional, process driven activities, but was not conducive to more complex problem-solving or relationship-based work such as onboarding, collaboration and mentoring staff. It was also not ideal for all employees and that there was going to be a continued need for a 'hybrid' model of working. Like a lot of organisations, this has resulted in many of the banks reviewing their physical footprint over the past 12 months and releasing office space, and therefore, some of the traditional overheads.

In addition, it has led to financial service sector looking to create multiple teams at multiple locations to avoid situations where one of their employees tests positive or is a close contact of a case resulting in their whole workforce having to isolate at once. New Zealand moved to Phase 2 of the Omicron response plan[7] when the daily number of positive cases reached 1,000+ and amendments were made to the guidelines so as to allow critical workers who are contacts to use Rapid Antigen Tests (RATs) and remain at work provided that these are negative[8].

FOOTNOTE 7

FOOTNOTE 8

Reports show that 1,261 businesses signed up to register under this scheme on the day that it was announced[9]. Phase 3 kicked in when daily positive cases surged over 5,000 and continued to climb.

FOOTNOTE 9

Once again, spending was severely curtailed while the country was in Level 4 during August 2021. However, this was not as dramatic as the original lockdown in March 2020 as more businesses were able to transact online this time around and more people were able to work from home effectively. The lockdown periods have normally been followed by a strong 'bounce back' in retail spending and, despite Auckland remaining under stronger restrictions for longer, this time was no different albeit with a sharper increase once Auckland entered the traffic light system at the Red setting in December 2021[10].

FOOTNOTE 10

In order to strengthen the immunity afforded by vaccination, the timeframe between receiving the second and third vaccination or 'booster' was reduced from six to four and then three months[11].

FOOTNOTE 11

This has been seen overseas as the best way to avoid becoming seriously ill from Covid-19 and has provided the Government with the confidence to plan for re-opening the borders.

As at 23 February, data from the Ministry of Health shows that 67.7% of eligible New Zealanders have received their booster shot tracking in right direction[12].

FOOTNOTE 12

The commitment from the Prime Minister that these border re-opening dates are 'very firm'[13] will come as some relief to individuals and businesses alike, but there are still some very real challenges in getting people, whether it be tourists and other visitors or new employees, approved and into the country.

FOOTNOTE 13

In addition, for a small percentage of the population, the lockdown, vaccine passes and mandates have proven not to their liking and as this has progressed we are seeing increased civil disobedience by a small minority – culminating with a lengthy and noisy protest at Parliament.

Volume and impact of regulation

Many of our survey participants highlighted that a key challenge for them was the increased volume of regulation, particularly citing the updates to the CCCFA and the Financial Services Legislation Amendment Bill (FSLAB). As discussed in the *Non-bank FIPS – Review of 2021*[14] and in countless media articles since the changes came into effect on 1 December 2021, the CCCFA changes are complex and onerous thus increasing the risks and compliance burden for banks.

FOOTNOTE 14

The update was designed to protect borrowers from taking on loans that they will not be able to repay. While all the survey participants agree with the principle of the CCCFA update, many believed it was going to have strong, unintended negative impacts, and unfortunately these seem to have been borne out in the first couple of months resulting in the Minister responsible asking for an enquiry into what is actually happening to ascertain whether the legislation and guidance is at fault or whether it is being mis-applied by the banking sector.

Directors and senior managers of lenders need to exercise due diligence and ensure that they comply with the procedures introduced in the CCCFA update. A breach of this duty can result in a personal fine of up to $200,000 per breach which is an uninsurable risk[15]. Understandably this has resulted in a more conservative approach being taken across the board by financial institutions. Stricter regulation and record keeping requirements around responsible lending involves more tests to determine if a loan is suitable for the borrower and whether the borrower can afford the repayments.

FOOTNOTE 15

Our survey participants emphasised the additional time and resource that it is taking to implement these changes. They expressed their concerns about the lack of guidance as to how the changes should be made which is causing the banks to take cautious approaches to implementing the new rules to avoid the financial and reputational damage that a breach would cause. This is resulting in slower processing times for loans and a substantially longer and more complex application process for borrowers.

In addition, the requirements are causing banks to reject more loans with Vittoria Shortt, ASB CEO, recently putting that figure at 7%[16] and Chris Flood, Heartland CEO saying that the vehicle lending decline rate has tripled[17].

FOOTNOTE 16

FOOTNOTE 17

This will have a downstream effect of causing some people to borrow funds from other entities who can offer the loan, but at a higher interest rate. Those at the lower end of the socio/economic ladder who can't get finance from the regulated market may be driven to the less regulated market. This is an unintended consequence as it is potentially putting borrowers under increased risk rather than the intended protection.

The Government has responded by bringing forward the planned review of the changes and is consulting with both regulators and the banks to investigate "the intended or unintended impacts, beyond those expected by the initial implementation" of the legislation "primarily in relation to mortgage, but also other lending, by banks and non-bank lenders in the current consumer credit market"[18]. The initial response from the Minister of Commerce and Consumer Affairs, David Clark, seemed to imply that the banks had previously been lending in a manner outside the legislation and implied other factors were responsible for the decrease in lending[18].

FOOTNOTE 18

The changes to the loan-to-value ratio (LVR)[19] restrictions and potential debt-to-income (DTI)[20] requirements from the Reserve Bank of New Zealand – Te Pūtea Matua (RBNZ) are also adding to the level of compliance required by the banks. These, along with the CCCFA changes and high house prices are combining to potentially make it harder for first-home buyers to get into the property market.

FOOTNOTE 19

FOOTNOTE 20

Another noteworthy update to regulation is the FSLAB. This Bill which contained amendments to the Financial Services Legislation Amendment Act 2019 was implemented on 15 March 2021[21]. This brings changes to disclosure requirements and conduct obligations with the intention of ensuring financial service providers are meeting their conduct and client care obligations.

FOOTNOTE 21

The regulators have been building up their monitoring and enforcement teams and we have seen an increase in the number of high-profile breaches or areas of concern highlighted demonstrating that it is an increasingly complex operating environment. These have included anti-money laundering, capital management, risk governance and consumer lending requirements.

You can read more specifically about the CCCFA changes in our articles *CCCFA: Where to now?* on page 46 and *Key industry challenges for remediation in 2021: A review* on page 52.

GOTO: CCCFA: Where to now?

GOTO: Key industry challenges for remediation in 2021: A review

Over-heated housing market

The housing market continue to be a key topic of discussion in 2022, especially the annual house price growth rate of 27%[22].

FOOTNOTE 22

According to figures released by Bloomberg in June 2021, New Zealand was the least affordable country in the Organisation Economic Co-operation Development (OECD) for housing[23] and the recent figures from CoreLogic putting the average national annual house price at over $1 million[24] will not be easing this situation. So far, these housing price increases haven't deterred buyers with annual banking sector lending increasing from $296 billion to $326 billion in 2021.

FOOTNOTE 23

FOOTNOTE 24

VIEW FIGURE 1

The Official Cash Rate (OCR) remained at 0.25% from March 2020 (reduced from 1.00% as part of the Covid-19 response) until October 2021 and November saw a further rise to 0.75%[25].

FOOTNOTE 25

FOOTNOTE 26

A further rise in February sees us back at 1.00%[26] with mortgage interest rates steadily rising. While banks already take the possibility of increased interest rates into consideration as part of their underwriting process, it is possible that borrowers have underestimated the impact. ANZ has predicted that the OCR will peak at 3%, while ASB believes it will be 2.25% by the end of this year[27].

FOOTNOTE 27

While the economic recovery from Covid-19 in 2021 kept the housing market strong, undoubtedly the large amounts of money that the RBNZ moved into the economy as it looked to protect it and New Zealanders from the initial impacts of Covid-19 has contributed to this situation. This has been an unintended consequence and one that some commentators feel should have been addressed quicker. However, 2021 could be the peak with many changes to lending and mortgage requirements now enforceable and some early signs of a cooling in the market are coming through in the data[28].

FOOTNOTE 28

VIEW FIGURE 2

For investors, changes in tax rules around interest deductions and the 40% deposit requirements will limit the property markets' appeal. The RBNZ data shows that lending to investors has decreased significantly in the second half of 2021 compared to the same period in 2020 (see Figure 3). This could be a result of investors looking elsewhere to put their money or could be related to the Covid-19 related restrictions making it harder to view and purchase property. When these changes are added to by the impact the new LVR and possible DTI restrictions being implanted the bull run of the housing market could slow.

VIEW FIGURE 3

There has been much talk of first-home buyers being priced out of the market and RBNZ figures show that has been a steady fall away in the amount of lending to first-home buyers over the course of 2021 (see Figure 4).

VIEW FIGURE 4

You can read more about the housing market over 2021 in the CoreLogic article *Was 2021 a peak for mortgages lasting several years?* on page 62.

GOTO: Was 2021 a peak for mortgages lasting several years?

Competition for talent

Despite the uncertainty and restrictions of the second half of 2021, the latest unemployment rate is an historic low of 3.2%[29], a level at which it is generally assumed that everyone who wants a job has one.

FOOTNOTE 29

However, there has not been a shift in the underutilisation rate which indicates that there is still a significant proportion of people who are employed, but not with the number of hours that they would like. This is possibly due to industries such as hospitality, travel and tourism which are still heavily affected by the impacts of Covid-19.

The *Seek NZ Employment Dashboard for January 2022*[30] shows that job adverts on the site are up 9% compared to December 2021 and a huge 42% compared to January 2021. While wages were up 2.6% for the quarter ended December 2021 compared to December 2020[31], inflation has risen by 5.9% so people are still finding that they are possibly worse-off in real terms. Many survey participants expressed concerns about the recent inflation figures and the direction of food and fuel prices.

FOOTNOTE 30

FOOTNOTE 31

Our survey participants are not alone in finding it increasingly difficult to attract and retain good employees, but restricted international mobility and the closed border due to the pandemic has resulted in a smaller talent pool for the New Zealand banking sector in particular. The 'Great Resignation' has seen the number of people quitting their jobs hit historic rates around the world, as people demand more flexibility in the way that they work[32]. Survey participants mentioned that it is very challenging to replace people that leave, and they are having to tailor their offering to remain competitive in the fast-moving job market.

FOOTNOTE 32

Employers are going to great lengths to acquire skilled talent. Banks are seeing a lot of staff being poached by competitors which hasn't previously been seen as the "New Zealand way of doing things"[33]. Survey participants have also commented that they are seeing junior staff being promoted into higher roles at other organisations faster than usual. This potentially brings risk to these organisations since it is a highly regulated sector where it is important to have staff with the right expertise and experience needed to keep up with regulations and not doing so poses a financial and reputational risk. Cyber and environmental, social, and governance (ESG) are also areas where skilled people are in high demand, with one bank CEO 'joking' that these people could currently name their price.

FOOTNOTE 33

The prolonged lockdown, particularly in Auckland could have reduced employee loyalty to the point where people felt that there were no differentiating factors in workplace culture as they were working from home anyway so they might as well work for the highest paying employer. This is seeing staff move to other higher paying sectors such as government roles. This is not unique to New Zealand and we are also hearing about a shortage of skills in Australia and other parts of the world. However, with Australia opening its borders to international travel earlier than New Zealand we might gain some insight into what we can expect for the New Zealand banking sector in terms of gaining overseas talent or losing talent to overseas markets.

The New Zealand Government announced plans to open the border in stages[34] and has amended these as the Omicron outbreak continues[35]. Ironically, this may actually cause the problem to get worse before it gets better as many young New Zealanders, having delayed their Overseas Experience (OE) until there was certainty that they would be able to get home, will now be able to leave the country knowing they can easily return to New Zealand without having to stay in Managed Isolation and Quarantine facilities (MIQ). As restrictions are lifted overseas there are fewer barriers to travel. However, the overseas skilled workers that the New Zealand workforce needs might not be able to come into the country until the Government fully opens the borders to non-New Zealand citizens. Currently, the Government has set the date for opening the border to these people as October 2022[34], so the positive effects won't be felt for some time.

FOOTNOTE 34

FOOTNOTE 35

Supply chain issues

Supply chain pressures continue to be one of the biggest problems faced here in New Zealand and globally, with widespread disruption to production, transport and shipping, leading to empty shelves and rising prices. The Government plans investment in ports, rail, and road over the next 15 to 30 years; however, this won't solve the issues we are currently facing in the short term[36].

FOOTNOTE 36

Late last year, the Government announced an extension to the International Airfreight Capacity (IAFC) scheme until March 2022, which has been subsidising airfreight to keep critical imports and exports flowing[37]. In pre-Covid-19 times, airlines would rely on both passenger revenue and revenue from airfreight to make flying overseas justifiable. Now with most international passenger flights into and out of New Zealand grounded, airlines without the Government subsidy would be unlikely to find value in flying. The IAFC package has already amounted to $176 million for phase 1 (from March 2021 to November 2021), with another $196 million forecast for phase 2 of the scheme (December 2021 to March 2022).

FOOTNOTE 37

The next pressing issue our supply chain is going to face will be due to the spread of the more transmissible Omicron variant of Covid-19. The thought of widespread illness and close contact isolation requirements has left the Government having to decide between stopping the virus and keeping our supply chain going. The initial Covid-19 exemption scheme enables some essential workers to not follow the standard isolation policy if they are close contacts and was aimed at keeping critical supply chains running[38]. The timing of the emergence of the Omicron variant in New Zealand has allowed us to watch and learn from other countries' responses to the variant of the virus, in particular our Australian neighbour.

FOOTNOTE 38

We can see how the supply chain has been impacted and what measures the Australian Government has been prepared to use to maintain the flow of important goods and critical services required to keep the supply chain intact. This exemption policy, which includes self-testing with RATs, is a clear example of the New Zealand Government's move away from a 'Zero-Covid' strategy to one of 'learning to live with Covid'. As we have progressed through the three phases of the Government's Omicron response, the definition of a 'close contact' has become limited to a household contact and there is a higher reliance on rapid antigen testing.

There are many who feel the Government hasn't done enough considering the lead time gained through the success of the 'Zero-Covid' strategy, in particular the initial banning of RATs for general use and stockpiling and then the slow release of them to the general public can be seen as a failure to plan ahead.

The Russian invasion of Ukraine and subsequent international condemnation and sanctions are bound to have flow-on effects to our supply chain with the most immediate being the impact on petrol prices.

Cyber security

In last year's *Banks FIPS – Review of 2020*[39], Phillip Whitmore, KPMG Cyber Security Partner in his article *What will 2021 bring amid the fierce battle against cyber crime?*, wrote of the need for businesses to ensure that they have effective people, processes, and technology to successfully respond to cyber-attacks.

FOOTNOTE 39

2021 has seen a rise in cyber-crime activities and some businesses have proven to be less cyber-resilient than others. The banking sector has experienced some of New Zealand's biggest cyber-attacks of the year including the data breach of a third-party file sharing software application that the RBNZ itself experienced in January 2021[40].

FOOTNOTE 40

September 2021 saw several 'distributed denial of service' (DDoS) attacks on Kiwibank and ANZ among other large New Zealand organisations[41]. These DDoS attacks, like those targeted at the NZX in late 2020, overwhelmed the banks' online services with requests which resulted in service outages.

FOOTNOTE 41

In July 2021 the Financial Markets Authority – Te Mana Tatai Hokohoko (FMA) released cyber resilience guidance for financial advice providers[42] and confirms that cyber resilience of all market participants will be a key focus for the FMA going forward. The advice includes a requirement to have and maintain a business continuity plan that includes procedures to respond and recover from events that impact on cyber security. Licensees will need to demonstrate not only that they have the appropriate cyber protection policies and systems in place, but also that these policies are widely understood and integrated into their businesses.

FOOTNOTE 42

As Philip Whitmore pointed out in his *Eight cyber security priorities for 2022 article in our Non-bank FIPS – Review of 2021*[43], no financial institution can ever be too prepared for an attack. Our survey participants have told us that cyber security has become one of their biggest costs and an area in which there is enormous focus.

FOOTNOTE 43

There needs to be continual improvements to cyber security as technology continues to evolve and the people that are out to steal and disrupt data become more sophisticated. Gone are the days of robberies with masks and guns, today's thief is more likely to be seated in-front of a computer 'working' from the comfort of their own home.

Innovation

There is no longer a need for bank branches like there used to be. Technology advances along with managed customer transitions due to Covid-19 lockdowns have allowed banks to either shut down many of their branches and or reduce their opening hours, while re-deploying staff to other areas and also at the same time focusing on their online offering[44] with one bank finding that, "The average customer visits a branch one to two times a year and uses online, mobile or phone banking at least five times a week"[45]. Product innovation has been needed to keep up with changing customer demand.

FOOTNOTE 44

FOOTNOTE 45

The RBNZ have released an article about the importance of utilising digital technology to modernise central bank money. They are commencing Central Bank Digital Currency (CBDC) which will take a lot of design and development to meet New Zealand's use, privacy and trust needs[46]. The CBDC supports New Zealand's financial innovation and will allow for easier cross-border transfers as well as financial tools to support inclusion and capability.

FOOTNOTE 46

Continued uncertainty

As with all our publications since March 2020, we end with a feeling of uncertainty when looking forward. It is unclear how widespread the impact of the Omicron variant is going to be, how the isolation requirements will impact jobs, supply chains and critical services and what impact the border re-opening will have on the New Zealand economy.

Further afield, the Russia and Ukraine conflict has had a predictably unsettling impact on financial markets. Several New Zealand banks have already started to divest their interests in Russia[47].

FOOTNOTE 47

What we can be certain of is that there will always be new challenges on the horizon, some known and some as yet unknown.

Provisioning

In our *FIPS Banks – Review of 2020*[48], we alluded to the possibility of provision writebacks in 2021 due to New Zealand's economic strong post-lockdown 'bounce back', partly due to the prominent Government support. Fast forward a year and that forecast has eventuated with over $200 million of impairment write-backs realised across the banking sector.

FOOTNOTE 48

As discussed in previous FIPS publications, the provisioning models used by the banks were built during calmer economic times with a concise approach to variable moves and moves of a smaller nature. They were not built for sharp shocks in multiple directions. Through 2020 and 2021 there were some specific factors that could have contributed to the challenges in using forward-looking provisioning models.

Firstly, there was the wage subsidy. Many loan holders require income to make repayments on their loans and although we saw a reduction in business being conducted during the March 2020 and June 2020 quarters due to the initial lockdown, the $13 billion printed by the Government and dispersed in the form of the wage subsidy meant that income remained more stable than many predictions. Provisioning models were not built to factor in the impact of this support which enabled people to service their loans despite not being able to work.

VIEW FIGURE 5

Secondly, the banks lowered their interest rates following the decrease in the OCR to 0.25% in March 2020. However, lending to personal consumers slowed for a number of reasons including the lack of opportunity for consumer discretionary spending with travel off the agenda and the preference of banks to lend against housing to ensure some security on their loans. This spike in housing lending led to big increases in house prices resulting in increased equity while debt levels remained the same. This increases the loan holder's net worth on paper as well as their loan-to-value ratio (LVR) which provides the opportunity to extend their mortgage lending to service their other loans if they needed to.

VIEW FIGURE 6

Thirdly, for those that were still not able to service their loans, the Government announced the mortgage deferral scheme. You can't default on your home loan if you don't have to pay it[49].

FOOTNOTE 49

VIEW FIGURE 7

What we have learned from the spike in impairment in 2020 and the subsequent release in 2021 is that provisioning models are not perfect.

In 2020 modellers were trying to predict the unknown, and in hindsight it is easy to wonder how they got it so wrong. Looking into 2022, things seemingly look steady, but with inflation and fuel prices increasing and still significant uncertainty particularly around the impact Omicron could have on the workforce and supply chains, impairment modellers will continue to have an unenviable job.

In 2020 modellers were trying to predict the unknown, and in hindsight it is easy to wonder how they got it so wrong.

Many of the survey participants mentioned that the provisioning models have not worked as they would like, but that they are not designed to do what they have had to over the past two years and it is time that this was understood. Survey participants also noted that they were not prepared to release all the provisions written down until the long-tailed effects of Covid-19 are realised. Against this background, it is understood that many entities have retained a certain level of additional overlay for this unknown impact in the future rather than release all of the current indicated provisioning.

Many of the survey participants mentioned that the provisioning models have not worked as they would like.

Timeline of events[50]

FOOTNOTE 50

Events in blue relate to Covid announcements from the New Zealand Government.

Feb. 2021

2nd
ASB will start offering discounted lending initiatives to customers to minimise emissions. These options will include transitioning to electric vehicles, using renewable energy and targeting projects with a regional growth and climate focus.

14th
Auckland moves to Alert Level 3. Rest of New Zealand moves to Alert Level 2.

17th
Auckland moves to Alert Level 2. Rest of New Zealand moves to Alert Level 1.

22nd
Auckland moves to Alert Level 1.

25th
Kiwibank announces likely closure of seven branches in response to customers moving to online banking.

28th
Auckland moves to Alert Level 3. Rest of New Zealand moves to Alert Level 2.

Mar. 2021

7th
Auckland moves to Alert Level 2. Rest of New Zealand moves to Alert Level 1.

11th
ANZ receives penalty of $280,000 for misleading representations over credit card insurance charges which breached the Financial Markets Conduct Act 2013.

12th
Auckland moves to Alert Level 1.

17th
The Commonwealth Bank Australia has announced its new Buy Now, Pay Later (BNPL) offering. The offering can be used anywhere debit or credit cards are accepted.

24th
Concerns are raised around Westpac New Zealand's risk governance processes. The RBNZ instructs Westpac to commission two independent reports to address them.

Westpac considers sale of New Zealand banking business.

31st
The RBNZ eases its ban on New Zealand banks being allowed to pay dividends.

Apr. 2021

13th
The RBNZ establishes an Enforcement Department to enhance the compliance of regulated sectors.

14th
The Financial Markets Authority (FMA) publishes the 'Final guidance on fund manager fees and value for money'.

16th
Kiwibank wins Canstar Bank of the Year for Home Loans.

23rd
The Government announces a new deposit guarantee scheme which the RBNZ will implement.

28th
The RBNZ releases its guidance on cyber resilience for regulated entities.

May 2021

4th
ASB begins making payments totalling $8.1 million in compensation to borrowers following an agreement with the Commerce Commission regarding breaches under the Credit Contracts and Consumer Finance Act (CCCFA).

14th
The Government announces the result of its KiwiSaver default provider tender, ANZ and ASB lose their default status from 30 November 2021.

18th
ASB is offering 1.79% floating interest rate for home and land packages and new builds in an effort to boost New Zealand housing supply.

23rd
BNZ highlights misuse of bank transfers to send abusive messages and announces monitoring to prevent it.

27th
The RBNZ has filed a statement of claim in the High Court against TSB Bank Limited for 'acknowledged breaches' under the Anti-Money Laundering and Countering Financing of Terrorism Act 2009 (AML CFT).

Jun. 2021

16th
The RBNZ adds debt-to-income lending restrictions as a tool to support financial stability and house-price sustainability.

17th
ASB agrees to pay $8.9 million to borrowers who were overcharged for Early Repayment Adjustment fees.

23rd
Wellington moves to Alert Level 2. The rest of New Zealand remains at Alert Level 1.

24th
Westpac commits to retaining New Zealand banking business.

29th
Wellington moves to Alert Level 1.

The FMA releases a guide for discussing financial services products online aimed at 'finfluencers'.

Jul. 2021

6th
Fidelity Life buys Westpac's life insurance company.

15th
Westpac customers will be able to utilise BNPL with no minimum requirement of spending and a credit limit of $1,000 with bundll.

16th
As major banks increase home loan interest rates, Kiwibank lowers its two-year home loan interest rates.

20th
Westpac drops the annual administration fee and will also lower the fund fees on its KiwiSaver.

Aug. 2021

11th
Reserve Bank issues a formal warning to Westpac NZ for its failure to report transactions as required under the AML CFT Act.

17th
The whole of New Zealand moves to Alert Level 4.

18th
The RBNZ's Monetary Policy Committee decides to retain the Official Cash Rate (OCR) at 0.25%.

24th
Agreement reached with ANZ by investors in Ross Asset Management case.

25th
BNZ names Dan Huggins as new CEO replacing Angela Mentis who returns to National Australia Bank.

31st
The whole of New Zealand south of Auckland moves to Alert Level 3.

Sep. 2021

2nd
BNZ is the first bank to remove contactless debit transaction fees for small to medium-sized businesses.

Northland moves to Alert Level 3.

7th
The whole of New Zealand except Auckland moves to Alert Level 2.

8th
Cyber attacks affect Kiwibank and ANZ among others.

10th
The Government proposes that Visa and Mastercard's debit and credit retail payment networks be authorised under legislation, with the Commerce Commission regulating merchant surcharging.

21st
Auckland moves to Alert Level 3.

23rd
The RBNZ announces the tightening of its loan-to-value ratio (LVR) restrictions from 1 November 2021 to reduce high-risk mortgage lending.

24th
Westpac names Catherine McGrath as new CEO, filling the position left vacant by David McLean's departure in June.

29th
Both ANZ and ASB face class action law suits under the CCCFA for failing to refund 150,000 customers for interest and fees.

30th
The RBNZ issues a consultation document on the development of a digital currency.

Oct. 2021

3rd
Parts of Waikato move to Alert Level 3.

5th
Auckland moves to Alert Level 3, Step 1.

6th
The RBNZ raises OCR from 0.25% to 0.5% as expected.

8th
Westpac provides staff with an additional five days 'wellbeing leave'.

Kiwibank launches $250 million preference share issue.

11th
The Co-operative Bank names Mark Wilkshire as new CEO, filling the position left vacant by David Cunningham's departure in July.

27th
Parts of Waikato move to Alert Level 3, Step 1.

Westpac and Pamū sign the largest sustainability linked loan in the agricultural sector to date, $85 million over three years.

Nov. 2021

2nd
Parts of Waikato move to Alert Level 3, Step 1.

3rd
Kiwibank reveals that 1.2% of its house lending portfolio is at risk of coastal flooding and this is expected to increase to 1.8% by 2050.

5th
SBS Bank names Mark McLean as new CEO, replacing departing Shaun Drylie.

8th
Kiwi Group Holdings sells Kiwi Insurance to NIB New Zealand Holdings.

9th
Auckland moves to Alert Level 3, Step 2.

Westpac launches money app from BNPL giant Afterpay, the first product utilising Westpac's banking as a service model.

12th
The Government announces intention to issue Green Bonds to deliver low-carbon projects in late 2022.

23rd
The RBNZ consults on its debt servicing restrictions framework.

24th
The RBNZ raises the OCR to 0.75%.

Dec. 2021

3rd
New Zealand enters the Covid-19 Protection Framework traffic light setting. Auckland, Northland, Taupō and Rotorua Lakes Districts, Kawerau, Whakatane, Ōpōtiki Districts, Gisborne District, Wairoa District, Rangitikei, Whanganui and Ruapehu Districts move in at Red. The rest of the North Island and the whole of the South Island move in at Orange.

7th
The RBNZ releases the outcomes of their liquidity stress test.

9th
The FMA files court proceedings against Kiwibank for making false or misleading representations under the Financial Markets Conduct Act 2014.

15th
Auckland border lifts and Aucklanders can leave the city for first time in over 100 days.

Concerns are raised about the new lending regime under the CCCFA.

30th
Auckland and other areas in the Red setting of the Covid-19 Protection Framework (except for Northland) move to orange.

Jan. 2022

8th
Politicians call for an inquiry into the 'unintended consequences' of the CCCFA changes.

19th
ANZ predicts OCR will hit 3% next year.

20th
The RBNZ and FMA released their findings on the systematic importance of Financial Market Infrastructures.

21st
Northland joins the rest of New Zealand in the Orange Setting of the Covid-19 Protection Framework.

23rd
The whole of New Zealand moves into the Red setting of the Covid-19 Protection Framework after Omicron cases detected in the community.

26th
Government announced three step public health response to Omicron variant and New Zealand entered Phase One.

Feb. 2022

8th
RBNZ released article about the need for innovation for money and cash, announcing it is commencing Central Bank Digital Currency (CBDC).

11th
There is media speculation that the ownership of Kiwibank could be under review.

15th
New Zealand moved to Phase Two of the Omicron response.

23rd
Monetary policy committee raise OCR to 1%.

24th
New Zealand moved to Phase Three of the Omicron response.

Sector performance

Consistent with previous surveys, our analysis of bank performance is performed over the top-level entity's consolidated results. For dual registered banks with a local bank and branch structure, the New Zealand banking group level results are used. Results only include operations within the banking group, any operations within wider groups, but outside the registered banking group, such as the Kiwibank and Heartland structures, have not been included.

In the 2020 survey, we welcomed the branch entity of Industrial and Commercial Bank of China (ICBC). Due to ICBC's 31 December reporting date, the 2021 survey represents the first year of inclusion of the ICBC branch results. With the introduction of this new entity, ICBC reported at a consolidated level, this means there has been a change to the top-level entity within this year's survey, as such, ICBC results included herein represent those of the Industrial and Commercial Bank of China New Zealand Banking Group.

Adjustments have been made to a few comparative figures for Bank of China (BOC) and BNZ where the change was considered necessary; these changes are abnormalities[51].

FOOTNOTE 51

Net profit after tax

The New Zealand banking sector has shown strong performance during the 2021 year, with an increase in net profit after tax (NPAT) of 47.92% ($1.99 billion) to reach $6.13 billion for the year. This marks the first year in the history of the survey that we have reported a NPAT of over $6 billion, see Figure 8. This sharp increase is a bounce back from 2020 which saw a decrease in NPAT of 27.57%, the largest decrease captured by the survey in the past ten years and highlights the sectors' recovery from the initial shock of the Covid-19 pandemic.

VIEW FIGURE 8

Overall, 14 of the 20 survey participants saw an increase in their NPAT. None of the 12 participants with March to September reporting dates reported a decrease in NPAT, achieving combined growth of 52.28% ($2.02 billion). Conversely, six of the eight banks with December 2020 reporting dates saw decreases in NPAT, resulting in a combined decrease of 13.68% ($37.46 million). The difference in these results reflects the effect of the first year of Covid-19 on December reporting entities, similar to the results we reported in our 2020 survey for entities with reporting dates in March to September. An entity's reporting date and which lockdowns and rebounds were included within its results had a significant impact on those results, see Figure 9.

VIEW FIGURE 9

One could be forgiven for asking why, in continued pandemic conditions amid lockdowns where other businesses struggled, the banks have done seemingly well – the answer is straight forward.

The largest determinant of the increase in NPAT was a $1.69 billion (114.49%) movement in the survey participants' impaired asset expense from a $1.47 billion impairment expense in 2020 to a $213.43 million impairment release in 2021. In addition, all the other stars aligned at the same time with net interest income rising by 7.07% ($765.62 million) and non-interest income contributing a 5.94% ($159.08 million) increase. The net interest income increase was driven by a 1 basis point (bp) margin increase for the banking sector and a 6.58% increase in lending across the sector. This lending increase was fuelled by a strong property/mortgage market.

VIEW FIGURE 10

The increase was further influenced by operating expenses (excluding amortisation) only increasing by a marginal $47.21 million (0.80%).

All the major banks (ANZ, BNZ, ASB, Kiwibank and Westpac) reported increases in NPAT. Together, they accounted for 98.79% of the $1.99 billion increase in NPAT, with a combined increase of $1.96 billion. Of the major banks, Kiwibank saw the largest increase in NPAT year-on-year, increasing 121.05% ($69.00 million) to $126.00 million.

Of the remaining banks, Bank of India (BOI) reported the largest increase in NPAT of 348.40% ($0.87 million) to $1.12 million. This was followed by The Co-operative Bank with an increase of 133.22% ($8.94 million) to $15.65 million. The non-major bank with the largest reduction in NPAT was ICBC with a reduction of 48.23% ($11.08 million) to $11.89 million followed by The Hongkong and Shanghai Banking Corporation (HSBC) which reported a decrease of 28.60% ($11.49 million) to $28.68 million.

TABLE 2: REGISTERED BANKS – PERFORMANCE TRENDS						
Year	Increase in total assets	Increase in net profit after tax	Net profit after tax/Average total assets	Interest margin	Operating expenses/ Operating income	Impaired asset expense/ Average gross loans and advances
2021	5.46%	47.92%	0.99%	1.97%	40.98%	-0.04%
2020	5.90%	-27.57%	0.71%	1.96%	43.44%	0.31%
2019	7.73%	-0.88%	1.04%	2.10%	38.41%	0.09%
2018	5.07%	11.21%	1.12%	2.12%	37.95%	0.06%
2017	1.42%	7.35%	1.04%	2.08%	39.61%	0.04%
2016	6.35%	-6.58%	1.00%	2.17%	39.25%	0.12%

TABLE 3: REGISTERED BANKS – ANALYSIS OF PERFORMANCE OF BANKS	New Zealand incorporated banks		New Zealand branch banks		All banks	
	2021	2020	2021	2020	2021	2020
Increase in total tangible assets	5.81%	5.99%	7.85%	9.84%	5.46%	5.90%
Increase in operating income	6.97%	-3.11%	-3.01%	-0.67%	6.85%	-3.59%
Increase in net profit after tax	49.91%	-27.39%	-4.51%	-6.79%	47.92%	-27.57%
Increase in gross loans and advances	7.06%	2.48%	-18.49%	10.45%	6.58%	2.90%
Net profit after tax/Average total tangible assets	1.03%	0.73%	0.53%	0.61%	0.99%	0.71%
Net profit after tax/Average equity	12.32%	8.90%	20.99%	23.91%	12.49%	9.21%
Net interest income/Average total tangible assets	1.98%	1.96%	0.68%	0.87%	1.87%	1.84%
Non-interest income/Average total tangible assets	0.42%	0.43%	0.72%	0.70%	0.46%	0.46%
Operating expenses/Average total tangible assets	0.98%	1.04%	0.67%	0.73%	0.95%	1.00%
Operating expenses/Operating income	40.87%	43.68%	47.76%	46.34%	40.98%	43.44%
Impaired asset expense/Average gross loans and advances	-0.05%	0.32%	0.01%	0.00%	-0.04%	0.31%
Collective provision/Net loans and advances	0.46%	0.56%	0.05%	0.02%	0.46%	0.55%
Total provision for doubtful debts/Gross loans and advances	0.54%	0.69%	0.08%	0.04%	0.53%	0.67%

The financial performance of the survey participants can be summarised as follows:

— net interest income increased by $765.62 million (7.07%) to $11.60 billion;

— non-interest income rose by $159.08 million (5.94%) to $2.83 billion;

— operating expenses (including amortisation) fell $88.60 million (1.43%) to $6.12 billion;

— impaired asset expense plummeted by $1.69 billion (114.49%) to a $213.43 million recovery;

— tax expense increased by $742.67 million (44.94%) to $2.40 billion.

It is worth remembering that the effect of the four-month lockdown of Auckland (and lesser impact for the rest of the country), that occurred from August 2021 would have had less than a one-month impact on these results due to their respective reporting dates and any impact from the arrival of Omicron on our shores will have had no impact on these numbers. These impacts will be reflected in next year's survey results.

Net interest margin

The net interest margin (NIM) remained stable with a movement of only 1 bp from 1.96% to 1.97% across the banking sector in 2021. This was due to the increase of net interest income moving in line with the increase in interest earning assets. Net interest income saw an increase of 7.07% ($765.62 million) to $11.60 billion; a result of interest income falling 16.22% ($3.28 billion) offset by interest expense falling by a greater amount of $4.04 billion (43.12%);

TABLE 4: MOVEMENT IN INTEREST MARGIN	2021	2020	Movement
Entity[52]	**%**	**%**	**(bps)**
Australia and New Zealand Banking Group Limited – ANZ New Zealand	2.02%	2.02%	0
Bank of Baroda (New Zealand) Limited	2.56%	2.69%	-13
Bank of China New Zealand Banking Group	1.23%	1.39%	-16
Bank of India (New Zealand) Limited	3.94%	3.31%	63
Bank of New Zealand	2.04%	2.07%	-3
China Construction Bank Corporation New Zealand Banking Group	1.54%	1.30%	24
Citibank, N.A. New Zealand Branch and Associated Banking Group	0.62%	0.69%	-7
Commonwealth Bank of Australia New Zealand Operations	1.97%	1.90%	7
Coöperatieve Rabobank U.A. New Zealand Banking Group	2.22%	2.14%	8
Heartland Bank Limited	4.76%	4.66%	10
Industrial and Commercial Bank of China New Zealand Banking Group	1.32%	1.57%	-25
JPMorgan Chase Bank, N.A., New Zealand Banking Group	0.36%	0.85%	-49
Kiwibank Limited	2.02%	1.94%	8
Kookmin Bank Auckland Branch	1.86%	1.86%	0
MUFG Bank, Ltd. Auckland Branch	0.41%	0.50%	-9
Southland Building Society	2.50%	2.51%	-1
The Co-operative Bank Limited	2.26%	2.19%	7
The Hongkong and Shanghai Banking Corporation Limited, New Zealand Banking Group	1.02%	1.28%	-26
TSB Bank Limited	1.71%	1.80%	-9
Westpac Banking Corporation – New Zealand Banking Group	1.90%	1.88%	2
Sector average	**1.97%**	**1.96%**	**1**

FOOTNOTE 52

while interest earning assets saw an increase of 6.44% ($36.75 billion) to $607.27 billion, resulting in the minimal movement of NIM. Eight of the 20 survey participants reported increases in NIM and two participants remained unchanged from 2020.

Of the eight banks reporting an increase in NIM, BOI had the largest upward movement, rising 63 bps to 3.94%. This increase was a result of a 25.03% ($0.72 million) increase in net interest income against a 13.61% ($11.57 million) increase in interest earning assets. BOI maintains the second highest NIM of all survey participants behind Heartland, who maintained the highest NIM in 2021, after increasing their margin 10 bps to 4.76%.

Meanwhile, JPMorgan Chase Bank (JPMorgan) suffered the largest deterioration in NIM with a reduction of 49 bps to 0.36% from 0.85% in 2020, falling to the lowest NIM out of all the participants. This was driven by a 43.43% ($5.93 million) reduction in net interest income, against an increase in interest earning assets of 17.74% ($347.00 million).

Three of the major banks reported increases in NIM, with Kiwibank seeing the largest increase in NIM of 8 bps to 2.02%. ANZ's NIM remained stable at 2.02% and BNZ was the only major bank to see a decrease in NIM with a drop of 3 bps to 2.04%.

However, BNZ maintained the highest NIM of the major banks in 2021. All of the major banks reported increases in net interest income, with Kiwibank having the largest percentage movement of 16.04% ($73.00 million). This resulted in a combined movement for the major banks of 7.46% ($724.00 million), while interest-earning assets saw slightly slower growth of 6.47% ($32.86 billion) causing the slight overall increase in NIM for the major banks.

Only two survey participants saw decreases in interest earning assets, being Southland Building Society (SBS) and MUFG Bank (MUFG), down by 2.12% ($102.04 million) and 6.71% ($418.15 million), respectively.

TABLE 5: REGISTERED BANKS – NON-PERFORMING LOANS	2018	2019	2020	2021
Past due assets/Gross loans and advances	0.13%	0.17%	0.29%	0.19%
Gross impaired assets/Gross loans and advances	0.37%	0.38%	0.45%	0.28%
Total	**0.50%**	**0.54%**	**0.74%**	**0.47%**

Meanwhile, BOC once again reported the largest increase in interest earning assets of all the banks, increasing 31.30% ($1.18 billion) to $4.94 billion. Citibank also saw significant growth in interest earning assets, with an increase of 28.87% ($493.45 million) to reach $2.20 billion of interest earning assets. However, its net interest income didn't increase in line with its assets, resulting in a NIM decrease of 7 bps to 0.62% which could be the result of both banks having 31 December 2020 reporting dates.

Non-interest income

Non-interest income has increased by 5.94% ($159.08 million), with eight of the 20 survey participants seeing increases in their non-interest income. ICBC saw the largest increase of all banks, growing their non-interest income by 303.13% ($4.06 million), driven by a large gain on fair value financial instruments. JPMorgan achieved the next largest rise in non-interest income, rising 59.33% ($9.42 million) to $25.30 million, driven by increased fee and commissions income and higher trading income.

The non-major bank with the largest reduction in non-interest income was Rabobank which had a significant drop of 759.89% ($33.31 million) from $4.38 million in 2020 to a $28.92 million loss in 2021, caused by a drop in net operating lease income and a net trading loss on derivatives. This was by far the biggest decline with the next largest reduction being China Construction Bank (CCB) with an 81.77% ($9.06 million) reduction.

The major banks reported combined growth in non-interest income of 7.90% ($193.00 million). BNZ drove most of the increase in the non-interest income of the major banks with an increase in non-interest income of 48.36% ($221.00 million). This was driven by the gains on financial instruments more than doubling since 2020 and an increase in fee income.

Of the major banks, Kiwibank suffered the biggest decline in their non-interest income, halving their non-interest income from $98.00 million in 2020 to $49.00 million in 2021, caused by a reduced net gain on financial instruments and drop in fee revenue. ANZ also had reduced non-interest income with a drop of 3.68% ($29.00 million). However, ANZ still had the highest non-interest income of all the survey participants of $760.00 million.

Total assets and gross loan and advances

The banking sector saw continued growth in total tangible assets of 5.46% ($32.98 billion) to $637.34 billion in 2021. The growth was at a slightly slower rate than the 5.95% increase in 2020. This demonstrates:

— the resilience of banks in the changing economic environment that they've faced over the last year;

— the possibly unintentional impact resulting from the Government's support policies affecting markets in a counterintuitive way and providing conditions that fuelled the property markets; and

— the large amounts of money pumped into the economy along with the reduction of interest rates to stimulate the economy have been able to ensure lower lending rates for more affordable debt servicing.

VIEW FIGURE 11

18 of the 20 banks surveyed reported an increase in total assets. The two survey participants facing declines in total assets this year were SBS and MUFG, both saw relatively small declines of 2.18% and 0.86%, respectively in 2021. Interestingly the two banks that faced declines in total assets last year, BOI and Citibank, have seen some of the largest rates of growth out of all the participants this year of 17.68% and 28.47%, respectively.

VIEW FIGURE 12

The five major banks contributed $28.51 billion (86.47%) to the overall growth of total tangible assets of the banking sector, with their share of the total assets across the industry remaining stable at 89.30% (compared with 89.46% reported in 2020). Kiwibank experienced the largest percentage growth of the major banks of 10.66% ($2.72 billion) to $28.23 billion, significantly higher than the proportion of the next largest increase made by ASB which was up 6.49% ($7.35 billion) to $120.53 billion. BOC reported the largest percentage increase in total assets of the non-major banks up 36.00% ($1.31 billion) to $4.97 billion, continuing its strong growth of 37.26% in 2019 and 59.70% in 2020.

Citibank reported the next highest growth, rising 28.47% ($489.35 million) to $2.21 billion.

Gross loans and advances (GLA) for the overall banking sector grew by 6.58% ($31.35 billion), which is more than double the previous years' growth rate of 2.90% ($13.65 billion). All five major banks increased their loan books, resulting in a combined growth rate of 7.28% ($31.14 billion), while the non-major banks collectively grew by only 0.43% ($208.95 million).

VIEW FIGURE 13

The major bank which saw the greatest increase in its GLA was Kiwibank which achieved an increase of 13.24% ($2.95 billion). ASB and BNZ reported the next highest growth, achieving 9.82% ($9.22 billion) and 7.23% ($6.44 billion), respectively. Westpac's growth of 5.10% ($4.54 billion) was the lowest of the major banks. The major banks' overall GLA increase of 7.28% ($31.14 billion) is significantly higher than the 2020 increase of 2.20% ($9.19 billion) possibly highlighting the banks' willingness to lend in 2021 due to the low cost of funding due to the record low Official Cash Rate (OCR) for most of the year.

VIEW FIGURE 14

It has been interesting to observe how the introduction of the Credit Contracts and Consumer Finance Act (CCCFA) has impacted this lending growth in just one or two months.

VIEW FIGURE 15

Of the non-major banks, BOI saw the largest rate of growth in its loan book of 54.62% ($32.10 million), followed by BOC and Kookmin Bank (Kookmin), which achieved increases of 33.98% and 26.73%, respectively. BOI's growth arose as it re-entered the lending market after its parent decided to retain it as opposed to considering disposal options. During the sale process it had slowed lending. Meanwhile, five banks saw decreases in their GLA, with the largest declines of the non-major banks being from JPMorgan which reduced its loan book by 99.71% ($348.27 million) and MUFG which saw a reduction of 21.91% ($1.14 billion).

The major banks have continued to dominate the banking sector and have experienced an increase in their collective market share up to 90.39% in 2021 from 89.80% in 2020. This has resulted in the smaller banks experiencing a decrease in their collective share of the sector's GLA from 10.20% in 2020 to 9.61% in 2021.

ASB experienced the greatest growth in market share for the major banks, increasing by 60 bps to 20.31%. Followed by Kiwibank which also reported a considerable increase, gaining 29 bps to 4.97%. Westpac experienced the biggest decrease of the major banks dropping 26 bps to 18.41%. Despite a decrease of 16 bps, ANZ remains the largest bank by a considerable margin with a 27.89% market share.

Despite seeing an 11 bps decline in market share to 2.80%, Rabobank has maintained its leading market share position as the largest non-major bank. BOC experienced the largest growth of all non-major banks, increasing by 16 bps to 0.78%, while MUFG had the largest decline in market share decreasing by 29 bps to 0.80%.

Looking ahead to 2022, it will be interesting to see what the impact of increased regulations such as the CCCFA, loan-to-value ratio (LVR) restrictions and the debt-to-income requirements will continue to have on the levels of lending across the banking sector. One other point to note when considering the loan growth in the banking sector, is that nearly all the growth has come in the mortgage books of the banks with other forms of lending – personal, credit cards, corporate, commercial or institutional lending all static or going backwards.

Funding costs

For the fifth year in a row, funding costs (interest expense as a ratio of average interest-bearing liabilities) for the banking sector have declined, this time a whopping 89 bps from 1.98% in 2020 to 1.09% in 2021. This is a result of the OCR being at the record low of 0.25% for most of 2021, resulting in a 43.12% ($4.04 billion) decrease in interest expense. These savings on interest expenses for the banks have been passed on to the consumers who relished in some of the lowest retail loan rates in recent history and have then taken the opportunity to move into the housing market fuelling a housing boom.

VIEW FIGURE 16

All 20 of the survey participants recorded a decrease in their funding costs in 2021. Among the big five banks, Kiwibank drove the decrease in funding costs the most, decreasing 117 bps from 2.30% in 2020 to 1.13% in 2021. This was a result of Kiwibank's decrease in interest expenses of 46.92% ($206.00 million) and increase in interest-bearing liabilities of 7.84% ($1.56 billion). Kiwibank was closely followed by ASB and Westpac who both reported decreases of 94 bps and 90 bps, respectively.

Both ANZ and BNZ recorded the lowest funding costs of the major banks for 2021 of 0.87%.

Outside of the major banks, BOI experienced the largest decrease in funding costs, down 171 bps from 3.46% in 2020 to 1.75% in 2021. However, it was Citibank who recorded the lowest funding costs of 0.18% down 105 bps. On the other hand, SBS recorded the highest funding costs out of all the survey participants of 2.37% in 2021, which was still down 51 bps from 2020.

The banks have kept their interest-bearing liabilities relatively flat with a banking sector increase of only 3.46% ($16.73 billion), this shows that the decline in funding costs can be directly attributable to the decrease in interest expense across the sector. This decline in interest expense is largely attributable to the major banks whose combined decrease was $3.66 billion, 90.43% of the total $4.04 billion decrease.

With the OCR increases in both October and November 2021, it is hard to see a publication of FIPS next year in which the funding costs slip for a sixth time or below the levels we have seen in 2021. With the end to the access of cheap capital for the banks in sight, it will be interesting to see what the effect will be on consumer rates and asset prices looking into 2022.

Asset quality

After the 2020 survey saw one of the biggest write down of bad debts, 2021 has led to the largest impairment recovery in survey history. Asset quality has rebounded positively in 2021, with a net impairment recovery of $213.43 million across the banking sector.

This indicates the considerable rise in provisioning reported by the sector in 2020 due to the concerns surrounding Covid-19 were, **with the benefit of hindsight**, perhaps overcautious and largely unwarranted.

One does have to remember the circumstances in early 2020 when financial institutions considered 'black hat' predictions across the board in their provisioning models and then applied well-reasoned overlays amid commentators talking about house prices dropping 15-20% and unemployment reaching double figures (10%). Now, with hindsight, we all know that this didn't happen and while a lockdown will slow the economy down to a quarterly low point, there will be a bounce back that largely compensates this contraction in the following quarter.

The $1.47 billion impaired asset expense in 2020 decreased by 114.49%, to a net release of $213.43 million across the banking sector; with 13 of the 18 survey participants who report on asset impairment realising a decrease in their impairment expense. Four of the five participants which did not realise a decrease in their impairment expense have December reporting dates and, as such, their results in this year's survey reflect the continued uncertainty present in late 2020 that eased away as we moved into the early months of 2021 and continue to do so.

VIEW FIGURE 17

The major banks were responsible for a large amount of the impairment expense release with a combined release of $258.00 million. ANZ had the most substantial release of $115.00 million in 2021 after recording $401.00 million of impairment expense in 2020.

ASB saw the smallest impaired asset recovery of only $3.00 million in 2021, coming after it realised its largest impairment expense in 2020 since the beginning of the survey of $310.00 million. ASB's releases reflected in this survey will only account for the period to 30 June 2020 (its reporting date) whereas the other big Australian banks' reporting dates are a quarter later, falling in September. Quarterly reporting to the RBNZ indicates a further $10.6 million was released by the CBA banking group in the September quarter.

Impaired asset expense as a percentage of GLA decreased by 35.68 bps from 0.31% in 2020 to -0.04% in 2021. Total provisions as a proportion of GLA also decreased, albeit not as sharply, decreasing 14 bps from 0.67% in 2020 to 0.53% in 2021. This overall improvement in total provision as a proportion of GLA is attributable to the reduction of both the specific and collective provisioning. The specific provision decreased by 32.73% ($195.24 million) across the banking sector from $596.55 million in 2020 to $401.31 million in 2021, while the collective provision decreased 11.19% ($291.71 million) from $2.61 billion in 2020 to $2.31 billion in 2021.

All five of the major banks saw a decrease in both the specific and collective provision amounts from 2020 to 2021. BNZ achieved the largest dollar decrease in specific provisioning from 2020 to 2021 of $103.00 million, although it still held the largest amount of specific provisioning in 2021, with $134.00 million.

On the other hand, Westpac saw the largest dollar decrease in collective provisioning of $127.00 million (23.78%) down from $534.00 million in 2020 to $407.00 million in 2021. Outside of the major banks, SBS saw the largest decrease in total provisions, down 20.30% ($10.44 million) from $51.41 million in 2020 to $40.98 million in 2021, which was driven by decreases to both specific and collective provisioning.

Past due but not impaired assets decreased by 30.82% ($431.64 million) to $968.71 million, a sharp decline after the 81.70% ($639.66 million) increase in 2020 after nine of the 11 survey participants who report past due assets reported decreases. All five of the major banks also reported decreases in their past due assets, with ASB recording the largest decrease of 45.95% ($119.00 million). This, interestingly, comes after ASB recorded the smallest decreases in both total provisions and impairment expense of the major banks. For the non-major banks, SBS realised the largest decrease in past due assets of 42.14% ($4.89 million), closely followed by Heartland who dropped 38.26% ($22.68 million). Of the two increases in past due assets, HSBC had the highest percentage change, climbing 264.13% ($0.24 million), followed by Rabobank, increasing 21.27% ($0.13 million). It is worth noting that both banks have a December reporting date.

VIEW FIGURE 18

What is clear from the levels of provisioning in 2021 is that New Zealand has fared much better through Covid-19 than any provisioning models in 2020 could have predicted. As a result, asset quality has shifted to more reasonable levels in 2021 reflecting an improvement in asset quality across the banking sector. However, with the emergence of new strains of the virus and the potential for further disruptions particularly form the impact of Omicron, determining the level of provisioning in 2022 is an unenviable job especially as early indicators are that without lockdown scenarios some of the toll (in particular, the wage subsidy which was hugely effective) may not apply.

Already financial institutions are seeing a slight tick up in arrears and past dues post the end of lockdown in November/December 2021 and following the Christmas break according to some of the December numbers published by Centrix[53].

FOOTNOTE 53

Operating expenses

This year, the cost to income ratio (CIR) for the banking sector has fallen by 246 bps to 40.98%. This decrease comes after a significant increase of 503 bps to 43.44% in 2020. The decrease is largely due to a flattening in operating expenses, rising only by 0.80% to $5.91 billion, and a significant increase in operating income increasing by 6.85% ($924.72 million) to $14.43 billion.

Of the major banks, ANZ experienced the most significant decrease, with their CIR falling by 397 bps to 38.97%. ANZ's result was due to its operating income increasing by 3.61% ($145.00 million) to $4.17 billion and a decrease in operating expenses of 5.97% ($103.00 million) to $1.62 billion. ANZ was closely followed by Kiwibank and BNZ who reported decreases of 389 bps to 68.80% and 344 bps to 35.71%, respectively.

BOI saw the largest drop in its CIR, a significant 3,673 bps decrease from 99.49% to 62.76%. This was driven by a 19.04% ($0.63 million) increase in operating income whilst also managing to decrease operating expenses by 24.91% ($0.82 million). In contrast, HSBC saw the largest increase in its CIR, raising to 835 bps from 55.85% to 64.20%, an increase significantly larger than any other survey participants. The increase was driven by significant reductions in operating income of 11.23% ($14.33 million) and together with a smaller 2.05% ($1.46 million) increase in operating expenses.

Half of the banks surveyed achieved decreases in their operating expenses (excluding amortisation), a significant increase from only 2 of the 20 banks in 2020.

VIEW FIGURE 19

Of the non-major banks, Rabobank experienced the greatest increase of operating expenses, rising 8.78% ($12.95 million) to $160.36 million, followed by CCB with a rise of 6.60% ($1.13 million) to $18.23 million. Three of the five major banks experienced increases in operating expenses (excluding amortisation) with Westpac having the largest increase of 8.17% ($83.00 million). ANZ and Kiwibank both reduced their operating expenses (excluding amortisation) by 5.97% ($103.00 million) and 1.24% ($5.00 million), respectively.

Personnel expenses grew by 4.03% ($130.25 million) and is a key driver for the increase in operating expenses (excluding amortisation).

TABLE 6: MAJOR BANKS – PERSONNEL COST						
	2021			2020		
Entity[54]	Employee numbers	Personnel cost $Million	Cost/ average employees $000's	Employee numbers	Personnel cost $Million	Cost/ average employees $000's
ANZ	7,473	935	130	6,937	989	141
ASB	5,883	662	118	5,320	630	119
BNZ	4,785	612	129	4,720	574	124
Kiwibank	1,781	213	122	1,720	187	114
Westpac	5,152	600	126	4,355	544	129

FOOTNOTE 54

Four of the five major banks saw increases in personnel expenses with ANZ being the only one to see a reduction despite an increase in personnel levels. ANZ's decrease in operating expenses could, in part, be attributed to the closure of 17 branches during 2021. Regardless of ANZ's decrease, the personnel expenses of the major banks still rose by a combined 3.35% ($98.00 million).

Some of this cost can likely be attributable to additional paid leave, increased staffing within compliance teams, with amendments to the CCCFA that came into force in December 2021, and many banks implementing the requirements of the new guidance prior to that. From all the survey participants, Rabobank, Heartland and BOC saw the largest increases in personnel expenses, rising by 27.79% ($15.09 million), 24.64% ($11.28 million) and 15.47% ($2.02 million), respectively. BOI saw the largest decrease in personnel expense, decreasing by 15.58% ($0.16 million) to $0.88 million.

Return on equity/Return on assets

The banking sector has experienced an increase in its return on equity (ROE) ratio of 328 bps to 12.49%. This is a recovery from the sharp decline last year which saw the lowest ROE the survey had seen in over a decade of 9.21%. The increase is due to a combination of the large increase in NPAT of 47.92% ($1.99 billion) and the marginally lower increase in total equity of 11.48% ($5.32 billion).

HSBC again saw the largest reduction in ROE of all survey participants, with a 5,712 bps decline to 103.98%, but still has the highest ROE of the banks by a significant margin.

ICBC and Kookmin reported the next largest reductions of 546 bps to 3.90% and by Kookmin 388 bps to 72.75%, respectively. SBS, on the other hand, saw a significant increase in ROE of 572 bps to 11.43%, driven by a 119.40% increase in NPAT from $18.75 million in 2020 to $41.14 million in 2021.

All five of the major banks experienced increases in ROE. BNZ experienced the largest increase of 507 bps to a ROE of 14.26% in 2021, followed by Kiwibank's increase of 399 bps to 7.65%. ASB continues to hold the highest ROE among the major banks at 14.59% after an increase of 349 bps.

18 of the 19 survey participants that report an equity balance saw an increase in their total equity in 2021. This could be in part due to the restriction on the distribution of earnings during most of the survey period (due to Covid-19) and the recent allowance to dividend payments restricted to only 50% of their latest audited profit. ICBC saw the largest percentage increase in total equity, increasing 37.43% ($96.21 million) to $353.26 million largely caused by an $84 million capital injection. Citibank was the only bank to see a decrease in total equity of 1.35% ($2.51 million) to a total equity of $184.01 million in 2021.

Of the major banks, ASB saw both the largest percentage increase and dollar increase in total equity, rising 15.59% ($1.25 billion) to $9.24 billion.

The increase in total equity in 2020 and 2021 shows the amplified level of caution the banks have taken to ensure that they are prepared in the case of a major economic downturn coupled with the recent changes to the RBNZ's capital adequacy requirements.

The return on assets (ROA) ratio for the banking sector increased by 28 bps in 2021 to 0.99%. This year, total tangible assets have increased by 5.46% ($32.98 billion), marginally less than the rise in NPAT which has led to the increase in ROA. 14 of the 20 survey participants achieved increases in their ROA, with BOI seeing the largest increase of 90 bps to 1.19%, followed by BNZ and SBS who both saw a 45 bps increase to 1.14% and 0.84%, respectively. Meanwhile, ICBC recorded the largest decrease, with a 52 bps decline to 0.52%.

All five of the major banks saw increases in their ROA, with the aforementioned BNZ increase of 45 bps meaning they now have the highest ROA of the major banks at 1.14%.

Funds under management

The combined funds under management (FUM) for the major banks has increased from 2020 by 8.24% ($6.68 billion) to $87.72 billion. This is an increased rate of growth from 4.58% ($3.55 billion) reported in 2020. During 2020 New Zealand investors moved money away from managed funds into low risk KiwiSaver funds due to the impacts of Covid-19. It is likely that the growth in 2021 is primarily due to New Zealanders moving more money into managed funds as the market recovered or having a greater level of disposable income available to invest which may have otherwise been spent on overseas travel.

TABLE 7: MAJOR BANKS – FUND MANAGEMENT ACTIVITIES

Entity[54]	2021 $Million	2020 $Million	Movement
ANZ	39,043	35,223	10.85%
ASB	21,750	18,500	17.57%
BNZ	7,563	7,359	2.77%
Kiwibank[55]	4,436	4,707	-5.76%
Westpac	14,923	15,246	-2.12%
Total	**87,715**	**81,035**	**8.24%**

FOOTNOTE 54

FOOTNOTE 55

ASB reported the largest increase in FUM for the year of 17.57% ($3.25 billion) to $21.75 billion, ANZ reported the second largest increase of 10.85% ($3.82 billion) to $39.04 billion; remaining the largest holder of FUM and accounting for 44.51% of FUM reported by the major banks. Kiwibank reported the largest decrease in FUM of the major banks with a decrease of 5.76% ($0.27 billion). See Table 7.

Capital adequacy ratio

15 of the 20 survey participants reported improvements in their capital adequacy ratios in 2021, largely attributable to banks holding more capital because of the 50% dividend restriction, which has been put in place until 1 July 2022. The RBNZ has stated that, although the New Zealand economy has rebounded much better than predicted, given the uncertainties ahead it is appropriate that some restrictions around dividends remain. All the major banks reported increases in their ratios, to levels well above what is required of them by the RBNZ.

15 of the 20 survey participants also noted an increase in their tier 1 capital ratio. All the major banks reported improvements to their tier 1 capital ratio with the exception of Kiwibank who saw a decline of 70 bps, from 12.60% to 11.90%.

The largest improvement of tier 1 capital ratio was recorded by BNZ who increased their ratio by 193 bps from 13.17% to 15.10%. BNZ was closely followed by SBS and ASB who both reported increases of 180 bps to 12.90% and 15.70%, respectively. BOI saw the largest reduction in their tier 1 capital ratio by 1,700 bps from 79.00% to 62.00%, however they still maintain the highest ratio out of all survey participants. Followed closely by the other Indian bank in the survey, Bank of Baroda, who experienced a decline of 470 bps to a ratio of 60.00%.

The most recent RBNZ stress test of the banks late in 2021 included, along with the regular solvency stress test, a liquidity stress test to assess the liquidity and funding resilience of the banks. The findings of the solvency stress test was that banks have a stronger level of resilience compared with previous years' testing. The liquidity stress test, however, highlighted that many of the banks were not resilient to liquidity shocks. These findings will provide the banks with areas for improvement in their own internal stress testing capability. The next focus for banks is going to be working towards meeting the requirements of the full implementation of the new Capital Review standards in 2028.

Analysis of annual results

FOOTNOTE 52

Analysis of financial statements							
Entity[52]	**Location of head office**	**Reporting date**	**Survey year**	**Rank by total assets**	**Total assets* $Million**	**Net assets $Million**	**Total capital adequacy ratio %**
Australia and New Zealand Banking Group Limited – ANZ New Zealand	Wellington	30-Sep-2021	2021	1	181,990	11,994	18.40
		30-Sep-2020	*2020*	*1*	*177,005*	*10,928*	*16.40*
Bank of Baroda (New Zealand) Limited	Auckland	31-Mar-2021	2021	19	148	50	59.99
		31-Mar-2020	*2020*	*19*	*132*	*49*	*64.70*
Bank of China New Zealand Banking Group	Auckland	31-Dec-2020	2021	10	4,966	276	16.22
		31-Dec-2019	*2020*	*12*	*3,651*	*249*	*15.51*
Bank of India (New Zealand) Limited	Auckland	31-Mar-2021	2021	20	102	56	62.00
		31-Mar-2020	*2020*	*20*	*86*	*55*	*79.00*
Bank of New Zealand	Auckland	30-Sep-2021	2021	4	119,107	9,866	16.90
		30-Sep-2020	*2020*	*4*	*112,295*	*8,642*	*14.91*
China Construction Bank Corporation New Zealand Banking Group	Auckland	31-Dec-2020	2021	13	3,311	252	16.88
		31-Dec-2019	*2020*	*13*	*3,066*	*234*	*17.30*
Citibank, N.A. New Zealand Branch and Associated Banking Group	Auckland	31-Dec-2020	2021	17	2,208	184	15.94
		31-Dec-2019	*2020*	*17*	*1,719*	*187*	*15.66*
Commonwealth Bank of Australia New Zealand Operations	Auckland	30-Jun-2021	2021	2	120,525	8,951	19.80
		30-Jun-2020	*2020*	*2*	*113,179*	*7,705*	*17.50*
Coöperatieve Rabobank U.A. New Zealand Banking Group	Wellington	31-Dec-2020	2021	6	17,494	2,142	24.20
		31-Dec-2019	*2020*	*6*	*16,756*	*2,020*	*25.20*
Heartland Bank Limited	Auckland	30-Jun-2021	2021	12	4,390	612	13.88
		30-Jun-2020	*2020*	*11*	*4,285*	*567*	*12.67*
Industrial and Commercial Bank of China New Zealand Banking Group	Auckland	31-Dec-2020	2021	16	2,302	353	16.88
		31-Dec-2019	*2020*	*15*	*2,282*	*257*	*16.77*
JPMorgan Chase Bank, N.A., New Zealand Banking Group	Wellington	31-Dec-2020	2021	15	2,385	-	17.80
		31-Dec-2019	*2020*	*16*	*2,004*	*-*	*16.90*
Kiwibank Limited	Wellington	30-Jun-2021	2021	5	28,229	1,724	13.20
		30-Jun-2020	*2020*	*5*	*25,510*	*1,570*	*12.60*
Kookmin Bank Auckland Branch	Auckland	31-Dec-2020	2021	18	597	7	17.78
		31-Dec-2019	*2020*	*18*	*493*	*6*	*15.85*
MUFG Bank, Ltd. Auckland Branch	Auckland	31-Mar-2021	2021	9	6,460	258	15.04
		31-Mar-2020	*2020*	*9*	*6,516*	*222*	*14.43*
Southland Building Society	Invercargill	31-Mar-2021	2021	11	4,822	379	15.70
		31-Mar-2020	*2020*	*10*	*4,930*	*320*	*13.80*
The Co-operative Bank Limited	Wellington	31-Mar-2021	2021	14	3,122	223	16.90
		31-Mar-2020	*2020*	*14*	*2,980*	*202*	*16.30*
The Hongkong and Shanghai Banking Corporation Limited, New Zealand Banking Group	Auckland	31-Dec-2020	2021	8	7,072	17	20.80
		31-Dec-2019	*2020*	*8*	*6,628*	*10*	*21.00*
TSB Bank Limited	New Plymouth	31-Mar-2021	2021	7	8,789	726	14.47
		31-Mar-2020	*2020*	*7*	*8,179*	*680*	*14.32*
Westpac Banking Corporation – New Zealand Banking Group	Auckland	30-Sep-2021	2021	3	119,323	9,679	18.90
		30-Sep-2020	*2020*	*3*	*112,671*	*8,520*	*16.40*
Banking sector total			**2021**		**637,343**	**47,750**	**n/a**
			2020		***604,367***	***42,424***	***n/a***

* Total Assets = Total Assets - Goodwill - Other Intangibles

n/a = not applicable

Size & strength measures						Growth measures		
Tier 1 capital adequacy ratio %	Net loans and advances $Million	Customer deposits $Million	Number of employees	Number of branches	Number of owned ATMs	Increase in net profit after tax %	Increase in underlying profit %	Increase in total assets %
14.30	141,599	125,129	7,473	124	504	43.64	40.36	2.82
13.20	*133,572*	*120,863*	*6,937*	*141*	*548*	*(26.79)*	*(23.98)*	*5.83*
59.99	126	95	18	3	3	24.22	24.81	12.40
64.70	*100*	*80*	*20*	*3*	*3*	*(1.55)*	*(11.01)*	*5.28*
13.19	3,935	862	93	1	-	(15.62)	(17.50)	36.00
13.02	*2,935*	*529*	*92*	*1*	-	*392.24*	*394.52*	*59.70*
62.00	91	16	9	2	-	348.40	353.31	17.68
79.00	*59*	*13*	*9*	*2*	-	*(73.52)*	*(73.55)*	*(2.95)*
15.10	95,365	71,244	4,785	108	592	73.49	50.60	6.07
13.17	*88,822*	*67,580*	*4,720*	*145*	*639*	*(25.44)*	*(23.01)*	*2.93*
13.86	2,729	420	69	-	-	(11.53)	(11.61)	7.99
14.50	*2,312*	*312*	*65*	-	-	*72.37*	*71.85*	*18.98*
14.33	394	1,306	28	1	-	(20.03)	(20.71)	28.47
14.26	*462*	*1,058*	*27*	*1*	-	*4.16*	*4.63*	*(20.09)*
15.70	103,037	69,748	5,883	86	401	42.19	39.09	6.49
13.90	*93,771*	*67,554*	*5,320*	*109*	*267*	*(26.46)*	*(23.86)*	*6.02*
19.00	14,199	5,732	483	33	-	(6.58)	(7.39)	4.40
18.80	*13,843*	*5,475*	*385*	*32*	-	*(10.04)*	*(12.23)*	*3.70*
13.88	3,859	3,220	404	4	-	17.81	21.60	2.45
12.67	*3,712*	*3,269*	*402*	*4*	-	*(11.13)*	*(7.52)*	*4.15*
14.28	1,758	651	72	1	-	(48.23)	(48.06)	0.91
14.27	*1,726*	*815*	*65*	*1*	-	*211.93*	*210.27*	*6.82*
17.40	1	250	9	-	-	37.37	27.20	19.01
16.30	*349*	*234*	*9*	-	-	*(15.89)*	*(8.58)*	*10.99*
11.90	25,260	22,121	1,781	161	221	121.05	99.00	10.66
12.60	*22,306*	*20,433*	*1,720*	*193*	*221*	*(47.22)*	*(43.18)*	*12.21*
15.42	402	259	18	1	-	16.45	17.33	21.16
14.68	*317*	*229*	*14*	*1*	-	*5.30*	*4.05*	*10.12*
12.76	4,047	2,270	17	1	-	20.47	18.50	(0.86)
12.29	*5,182*	*1,063*	*17*	*1*	-	*18.52*	*19.94*	*21.03*
12.90	4,076	3,552	498	14	-	119.40	155.86	(2.18)
11.10	*4,191*	*3,513*	*540*	*16*	-	*(39.16)*	*(47.13)*	*3.95*
14.70	2,707	2,591	306	26	-	133.22	83.78	4.79
14.00	*2,570*	*2,405*	*331*	*31*	-	*(29.91)*	*(18.38)*	*6.95*
18.80	4,096	4,451	227	1	-	(28.60)	(28.02)	6.70
18.80	*4,659*	*3,538*	*226*	*1*	-	*(21.89)*	*(21.84)*	*10.17*
14.47	6,371	7,999	539	22	43	39.19	43.63	7.45
14.32	*6,165*	*7,421*	*486*	*25*	*43*	*(31.58)*	*(31.22)*	*4.61*
14.60	93,432	75,917	5,152	117	464	55.21	50.93	5.90
13.20	*88,888*	*70,974*	*4,355*	*143*	*495*	*(39.68)*	*(36.87)*	*6.06*
n/a	**507,482**	**397,831**	**27,864**	**706**	**2,228**	**47.92**	**41.59**	**5.46**
n/a	***475,940***	***377,355***	***25,740***	***850***	***2,216***	***(27.57)***	***(25.13)***	***5.90***

Analysis of annual results

FOOTNOTE 52

Analysis of financial statements		Credit quality measures						
Entity[52]	Survey year	Impaired asset expense $Million	Past due assets $Million	Gross impaired assets $Million	Individual provision for doubtful debts/ Gross impaired assets %	Collective provision/ Net loans and advances %	Total provision for doubtful debts/ Gross loans and advances %	Impaired asset expense/ Average gross loans and advances %
Australia and New Zealand Banking Group Limited – ANZ New Zealand	2021	(115)	374	155	38.71	0.37	0.41	(0.08)
	2020	*401*	*525*	*363*	*29.48*	*0.44*	*0.52*	*0.30*
Bank of Baroda (New Zealand) Limited	2021	(0)	-	-	n/a	0.33	0.33	(0.04)
	2020	*0*	*-*	*-*	*n/a*	*0.43*	*0.43*	*0.22*
Bank of China New Zealand Banking Group	2021	3	-	5	59.08	0.30	0.38	0.09
	2020	*(14)*	*-*	*8*	*46.37*	*0.30*	*0.43*	*(0.57)*
Bank of India (New Zealand) Limited	2021	(0)	-	-	n/a	0.79	0.79	(0.14)
	2020	*(0)*	*-*	*2*	*-*	*1.04*	*1.04*	*(0.49)*
Bank of New Zealand	2021	(37)	146	231	58.01	0.68	0.81	(0.04)
	2020	*300*	*175*	*600*	*39.50*	*0.76*	*1.02*	*0.34*
China Construction Bank Corporation New Zealand Banking Group	2021	8	-	-	n/a	0.59	0.59	0.31
	2020	*2*	*-*	*-*	*n/a*	*0.36*	*0.36*	*0.10*
Citibank, N.A. New Zealand Branch and Associated Banking Group	2021	(0)	-	-	n/a	-	-	(0.01)
	2020	*0*	*-*	*-*	*n/a*	*-*	*-*	*0.02*
Commonwealth Bank of Australia New Zealand Operations	2021	(3)	140	329	28.27	0.46	0.55	(0.00)
	2020	*310*	*259*	*406*	*33.25*	*0.54*	*0.68*	*0.34*
Coöperatieve Rabobank U.A. New Zealand Banking Group	2021	16	1	499	3.59	0.29	0.42	0.11
	2020	*23*	*1*	*534*	*3.05*	*0.27*	*0.38*	*0.17*
Heartland Bank Limited	2021	15	37	38	20.00	1.13	1.32	0.38
	2020	*29*	*59*	*25*	*21.49*	*1.55*	*1.69*	*0.80*
Industrial and Commercial Bank of China New Zealand Banking Group	2021	1	-	6	67.65	0.56	0.78	0.05
	2020	*(15)*	*-*	*8*	*47.04*	*0.48*	*0.71*	*(0.86)*
JPMorgan Chase Bank, N.A., New Zealand Banking Group	2021	-	-	-	n/a	-	-	-
	2020	*-*	*-*	*-*	*n/a*	*-*	*-*	*-*
Kiwibank Limited	2021	(19)	16	1	100.00	0.21	0.21	(0.08)
	2020	*51*	*19*	*2*	*100.00*	*0.38*	*0.39*	*0.24*
Kookmin Bank Auckland Branch	2021	0	-	-	n/a	0.19	0.19	0.12
	2020	*(0)*	*-*	*-*	*n/a*	*0.10*	*0.10*	*(0.02)*
MUFG Bank, Ltd. Auckland Branch	2021	0	-	-	n/a	0.03	0.03	0.01
	2020	*(0)*	*-*	*-*	*n/a*	*-*	*-*	*(0.00)*
Southland Building Society	2021	5	7	1	40.72	0.99	1.01	0.11
	2020	*37*	*12*	*2*	*54.18*	*1.21*	*1.23*	*0.90*
The Co-operative Bank Limited	2021	(0)	5	7	11.79	0.35	0.38	(0.01)
	2020	*8*	*6*	*7*	*16.62*	*0.43*	*0.47*	*0.32*
The Hongkong and Shanghai Banking Corporation Limited, New Zealand Banking Group	2021	-	0	20	14.50	0.06	0.13	-
	2020	*-*	*0*	*16*	*10.60*	*0.04*	*0.08*	*-*
TSB Bank Limited	2021	(2)	1	23	31.44	0.58	0.69	(0.04)
	2020	*20*	*2*	*18*	*54.56*	*0.62*	*0.77*	*0.34*
Westpac Banking Corporation – New Zealand Banking Group	2021	(84)	242	109	63.30	0.44	0.51	(0.09)
	2020	*320*	*343*	*137*	*53.28*	*0.60*	*0.68*	*0.37*
Banking sector total	**2021**	**(213)**	**969**	**1,425**	**28.16**	**0.46**	**0.53**	**(0.04)**
	2020	***1,473***	***1,400***	***2,127***	***28.05***	***0.55***	***0.67***	***0.31***

* Operating Expenses = Total Expenses - Interest Expense - Loan Write Offs and Bad Debts - Abnormal Expenses.
n/a = not applicable

Profitability measures										Efficiency measures	
Total operating income $Million	Net interest income/ Average total assets %	Interest margin %	Interest spread %	Non-interest income/ Average total assets %	Net profit after tax $Million	Net profit after tax/ Average equity %	Net profit after tax/ Average total assets %	Underlying profit $Million	Underlying profit/ Average total assets %	Operating expenses*/ Average total assets %	Operating expenses*/ Operating income %
4,165	1.90	2.02	1.87	0.42	1,919	13.20	1.07	2,657	1.48	0.90	38.97
4,020	*1.88*	*2.02*	*1.75*	*0.46*	*1,336*	*10.04*	*0.78*	*1,893*	*1.10*	*1.00*	*42.94*
4	2.39	2.56	1.78	0.81	1	2.24	0.79	2	1.08	2.14	67.07
4	*2.56*	*2.69*	*1.51*	*0.89*	*1*	*1.84*	*0.69*	*1*	*0.94*	*2.34*	*67.73*
59	1.24	1.23	1.05	0.14	26	9.86	0.60	36	0.83	0.48	35.03
49	*1.40*	*1.39*	*1.01*	*0.26*	*31*	*13.13*	*1.03*	*43*	*1.45*	*0.68*	*40.94*
4	3.80	3.94	2.87	0.39	1	2.00	1.19	2	1.67	2.63	62.76
3	*3.26*	*3.31*	*1.07*	*0.51*	*0*	*0.45*	*0.29*	*0*	*0.40*	*3.76*	*99.49*
2,859	1.89	2.04	1.91	0.59	1,322	14.26	1.14	1,875	1.62	0.88	35.71
2,539	*1.88*	*2.07*	*1.85*	*0.41*	*762*	*9.19*	*0.69*	*1,245*	*1.12*	*0.90*	*39.15*
51	1.53	1.54	1.38	0.06	18	7.21	0.55	25	0.77	0.57	35.98
47	*1.27*	*1.30*	*1.12*	*0.39*	*20*	*8.81*	*0.70*	*28*	*0.98*	*0.61*	*36.45*
37	0.61	0.62	0.60	1.29	14	7.33	0.69	19	0.96	0.95	49.94
43	*0.69*	*0.69*	*0.57*	*1.52*	*17*	*9.12*	*0.88*	*24*	*1.23*	*0.98*	*44.25*
2,916	1.93	1.97	1.76	0.56	1,257	14.59	1.08	1,829	1.57	0.93	37.38
2,685	*1.86*	*1.90*	*1.59*	*0.58*	*884*	*11.10*	*0.80*	*1,315*	*1.20*	*0.96*	*39.48*
345	2.18	2.22	2.04	(0.17)	121	5.82	0.71	169	0.99	0.94	46.50
353	*2.12*	*2.14*	*1.88*	*0.03*	*130*	*6.64*	*0.79*	*182*	*1.11*	*0.90*	*41.77*
212	4.58	4.76	4.51	0.31	72	11.54	1.65	106	2.44	2.11	43.16
203	*4.50*	*4.66*	*4.28*	*0.33*	*61*	*10.11*	*1.45*	*87*	*2.08*	*2.06*	*42.55*
35	1.31	1.32	1.01	0.24	12	3.90	0.52	17	0.73	0.78	50.53
36	*1.56*	*1.57*	*1.20*	*0.06*	*23*	*9.36*	*1.04*	*32*	*1.45*	*0.85*	*52.35*
33	0.35	0.36	0.36	1.15	13	n/a	0.57	18	0.84	0.67	44.45
30	*0.72*	*0.85*	*0.83*	*0.83*	*9*	*n/a*	*0.48*	*14*	*0.76*	*0.79*	*51.16*
577	1.97	2.02	1.78	0.18	126	7.65	0.47	199	0.74	1.48	68.80
553	*1.89*	*1.94*	*1.53*	*0.41*	*57*	*3.66*	*0.24*	*100*	*0.41*	*1.67*	*72.69*
11	1.83	1.86	1.86	0.24	5	72.75	0.91	7	1.27	0.72	34.76
10	*1.84*	*1.86*	*1.86*	*0.26*	*4*	*76.63*	*0.90*	*6*	*1.26*	*0.86*	*40.73*
57	0.38	0.41	0.41	0.50	37	15.27	0.56	46	0.72	0.16	18.14
50	*0.48*	*0.50*	*0.46*	*0.36*	*30*	*14.79*	*0.51*	*39*	*0.66*	*0.19*	*22.13*
151	2.44	2.50	2.17	0.66	41	11.43	0.84	57	1.17	1.84	59.16
154	*2.46*	*2.51*	*2.23*	*0.73*	*19*	*5.71*	*0.39*	*22*	*0.46*	*1.97*	*61.59*
87	2.22	2.26	1.96	0.63	16	7.36	0.51	27	0.89	1.96	69.01
81	*2.15*	*2.19*	*1.82*	*0.65*	*7*	*3.35*	*0.23*	*15*	*0.51*	*2.00*	*71.52*
113	1.00	1.02	0.99	0.65	29	103.98	0.42	41	0.59	1.06	64.20
128	*1.26*	*1.28*	*1.22*	*0.76*	*40*	*161.10*	*0.64*	*56*	*0.89*	*1.13*	*55.85*
162	1.69	1.71	1.48	0.22	43	6.10	0.51	64	0.76	1.18	61.72
164	*1.78*	*1.80*	*1.48*	*0.27*	*31*	*4.62*	*0.39*	*45*	*0.56*	*1.24*	*60.46*
2,550	1.77	1.90	1.68	0.42	1,057	10.98	0.91	1,535	1.32	0.95	43.10
2,353	*1.73*	*1.88*	*1.53*	*0.42*	*681*	*7.69*	*0.62*	*1,017*	*0.93*	*0.93*	*43.18*
14,430	**1.87**	**1.97**	**1.79**	**0.46**	**6,127**	**12.49**	**0.99**	**8,729**	**1.41**	**0.95**	**40.98**
13,505	***1.84***	***1.96***	***1.68***	***0.46***	***4,142***	***9.21***	***0.71***	***6,165***	***1.05***	***1.00***	***43.44***

Analysis of annual results

FOOTNOTE 52

Balance sheet breakdown		Assets ($Million)								
Entity[52]	Reporting date	Cash on hand, money at call and balances with other banks	Trading, investment securities, investments in subsidiaries and investment properties	Derivative financial instruments	Loans and advances (less provisions)	Balances with related parties	Fixed assets	Intangibles	Other assets	Total assets
2021										
Australia and New Zealand Banking Group Limited – ANZ New Zealand	30-Sep	8,466	21,511	3,952	141,074	5,524	509	3,091	945	**185,072**
Bank of Baroda (New Zealand) Limited	31-Mar	20	-	-	125	0	2	-	1	**148**
Bank of China New Zealand Banking Group	31-Dec	772	162	8	3,923	71	6	0	25	**4,966**
Bank of India (New Zealand) Limited	31-Mar	9	-	-	90	2	1	-	0	**102**
Bank of New Zealand	30-Sep	10,531	7,348	2,691	94,721	1,892	466	293	1,180	**119,122**
China Construction Bank Corporation New Zealand Banking Group	31-Dec	531	33	26	2,713	1	2	0	6	**3,311**
Citibank, N.A. New Zealand Branch and Associated Banking Group	31-Dec	1,232	542	-	394	35	1	-	5	**2,208**
Commonwealth Bank of Australia New Zealand Operations	30-Jun	2,972	10,973	567	102,566	2,292	413	453	574	**120,810**
Coöperatieve Rabobank U.A. New Zealand Banking Group	31-Dec	531	676	21	14,157	1,992	9	2	104	**17,494**
Heartland Bank Limited	30-Jun	113	359	14	3,815	0	24	53	41	**4,419**
Industrial and Commercial Bank of China New Zealand Banking Group	31-Dec	211	197	8	1,748	118	9	0	11	**2,302**
JPMorgan Chase Bank, N.A., New Zealand Banking Group	31-Dec	428	1,882	-	1	(7)	0	-	81	**2,385**
Kiwibank Limited	30-Jun	741	1,704	228	25,207	77	161	50	61	**28,229**
Kookmin Bank Auckland Branch	31-Dec	22	-	-	401	169	5	-	0	**597**
MUFG Bank, Ltd. Auckland Branch	31-Mar	1,210	456	78	4,046	652	1	-	17	**6,460**
Southland Building Society	31-Mar	118	562	13	4,036	5	43	10	45	**4,832**
The Co-operative Bank Limited	31-Mar	347	8	8	2,698	-	35	11	16	**3,122**
The Hongkong and Shanghai Banking Corporation Limited, New Zealand Banking Group	31-Dec	1,428	529	10	4,094	959	28	19	19	**7,086**
TSB Bank Limited	31-Mar	438	1,939	11	6,334	-	33	22	12	**8,789**
Westpac Banking Corporation – New Zealand Banking Group	30-Sep	8,811	9,215	3,852	93,025	1,739	410	721	2,075	**119,848**
Banking sector total		**38,930**	**58,096**	**11,487**	**505,167**	**15,521**	**2,159**	**4,725**	**5,217**	**641,303**

Liabilities ($Million)								Equity ($Million)				
Customer deposits	Balances with other banks and money market deposits	Debt securities	Derivative financial instruments	Balances with related parties	Subordinated debt	Other liabilities	Total liabilities	Share capital – ordinary shares	Head office account	Other equity/Cash flow hedge reserves	Retained earnings	Total equity
125,129	4,990	24,776	2,708	8,262	2,105	2,026	**169,996**	11,044	11	70	3,951	**15,076**
95	-	-	-	1	-	3	**98**	40	-	-	10	**50**
862	877	530	15	2,377	-	30	**4,690**	223	6	1	46	**277**
16	-	-	-	29	-	1	**45**	50	-	-	6	**56**
71,244	5,388	24,382	1,837	4,608	-	1,782	**109,241**	4,056	-	20	5,805	**9,881**
420	503	1,074	126	925	-	10	**3,059**	199	11	0	42	**252**
1,306	3	-	-	707	-	8	**2,024**	-	34	0	150	**184**
69,748	3,560	25,990	151	4,252	6,987	886	**111,574**	3,167	2,887	(36)	3,218	**9,236**
5,732	-	3,267	45	6,278	-	30	**15,352**	551	330	3	1,257	**2,142**
3,220	40	463	5	3	-	47	**3,778**	553	-	1	88	**642**
651	0	603	3	667	-	25	**1,949**	234	83	36	-	**353**
250	-	267	-	1,791	-	77	**2,385**	-	-	-	-	**-**
22,121	718	2,544	195	284	415	228	**26,505**	737	-	20	967	**1,724**
259	70	-	-	257	-	5	**590**	-	7	-	-	**7**
2,270	-	-	45	3,853	-	33	**6,202**	-	83	2	172	**258**
3,552	341	344	22	-	106	78	**4,444**	-	-	3	386	**389**
2,591	-	245	13	-	-	50	**2,899**	-	-	4	219	**223**
4,451	374	900	65	1,213	-	52	**7,054**	-	22	9	-	**31**
7,999	-	-	10	-	-	55	**8,063**	10	-	12	703	**726**
75,917	320	19,754	2,620	2,410	2,988	5,635	**109,644**	488	2,487	3	7,226	**10,204**
397,831	**17,184**	**105,139**	**7,860**	**37,917**	**12,601**	**11,061**	**589,593**	**21,352**	**5,962**	**149**	**24,247**	**51,710**

Analysis of annual results

FOOTNOTE 52

Balance sheet breakdown		Assets ($Million)								
Entity[52]	Reporting date	Cash on hand, money at call and balances with other banks	Trading, investment securities, investments in subsidiaries and investment properties	Derivative financial instruments	Loans and advances (less provisions)	Balances with related parties	Fixed assets	Intangibles	Other assets	Total assets
2020										
Australia and New Zealand Banking Group Limited – ANZ New Zealand	30-Sep	9,854	22,690	6,849	132,984	3,121	590	3,092	907	**180,087**
Bank of Baroda (New Zealand) Limited	31-Mar	29	-	-	100	0	2	-	1	**132**
Bank of China New Zealand Banking Group	31-Dec	366	119	7	2,926	203	7	0	22	**3,651**
Bank of India (New Zealand) Limited	31-Mar	27	-	-	58	0	1	-	0	**86**
Bank of New Zealand	30-Sep	4,715	10,814	3,844	88,149	3,349	423	229	787	**112,310**
China Construction Bank Corporation New Zealand Banking Group	31-Dec	385	202	54	2,304	117	2	0	3	**3,066**
Citibank, N.A. New Zealand Branch and Associated Banking Group	31-Dec	778	427	-	462	40	0	-	12	**1,719**
Commonwealth Bank of Australia New Zealand Operations	30-Jun	4,101	10,703	1,221	93,266	2,634	452	463	624	**113,464**
Coöperatieve Rabobank U.A. New Zealand Banking Group	31-Dec	421	757	19	13,806	1,652	12	1	88	**16,756**
Heartland Bank Limited	30-Jun	105	399	17	3,654	1	28	57	52	**4,315**
Industrial and Commercial Bank of China New Zealand Banking Group	31-Dec	334	183	4	1,718	23	8	0	12	**2,282**
JPMorgan Chase Bank, N.A., New Zealand Banking Group	31-Dec	140	1,423	-	349	44	0	-	47	**2,004**
Kiwibank Limited	30-Jun	597	1,895	434	22,222	77	144	60	81	**25,510**
Kookmin Bank Auckland Branch	31-Dec	7	-	-	317	164	5	-	0	**493**
MUFG Bank, Ltd. Auckland Branch	31-Mar	453	597	78	5,182	184	2	-	20	**6,516**
Southland Building Society	31-Mar	143	533	9	4,140	6	44	12	56	**4,942**
The Co-operative Bank Limited	31-Mar	341	9	9	2,559	-	36	12	15	**2,980**
The Hongkong and Shanghai Banking Corporation Limited, New Zealand Banking Group	31-Dec	686	542	2	4,657	714	3	16	22	**6,642**
TSB Bank Limited	31-Mar	233	1,742	14	6,127	-	34	15	15	**8,179**
Westpac Banking Corporation – New Zealand Banking Group	30-Sep	4,885	9,245	5,660	88,354	2,713	398	696	1,245	**113,196**
Banking sector total		**28,598**	**62,278**	**18,221**	**473,334**	**15,043**	**2,192**	**4,653**	**4,009**	**608,329**

Liabilities ($Million)								Equity ($Million)				
Customer deposits	Balances with other banks and money market deposits	Debt securities	Derivative financial instruments	Balances with related parties	Subordinated debt	Other liabilities	Total liabilities	Share capital – ordinary shares	Head office account	Other equity/Cash flow hedge reserves	Retained earnings	Total equity
120,863	4,785	25,528	5,375	6,159	1,512	1,855	**166,077**	11,044	11	118	2,837	**14,010**
80	-	-	-	1	-	3	**83**	40	-	-	9	**49**
529	688	604	12	1,534	-	35	**3,402**	223	(1)	0	27	**249**
13	-	-	-	17	-	1	**31**	50	-	-	5	**55**
67,580	2,820	23,773	2,722	5,292	549	917	**103,653**	4,056	-	108	4,493	**8,657**
312	432	976	35	1,067	-	10	**2,832**	199	7	(0)	29	**234**
1,058	16	-	-	450	-	9	**1,533**	-	34	(0)	153	**187**
67,554	2,725	22,631	244	4,163	7,009	1,148	**105,474**	3,167	2,887	(72)	2,008	**7,990**
5,475	-	2,205	26	7,000	-	30	**14,736**	551	319	2	1,147	**2,020**
3,269	-	359	17	8	-	65	**3,718**	553	-	(3)	46	**597**
815	0	709	4	466	-	31	**2,024**	234	-	24	-	**257**
234	-	479	0	1,235	-	57	**2,004**	-	-	-	-	**-**
20,433	317	2,229	400	171	150	240	**23,940**	737	-	(20)	853	**1,570**
229	89	-	-	164	-	4	**487**	-	6	-	-	**6**
1,063	-	-	68	5,127	-	36	**6,294**	-	83	3	136	**222**
3,513	541	337	44	-	104	73	**4,610**	-	-	(13)	345	**331**
2,405	-	305	23	-	-	44	**2,777**	-	-	(1)	204	**202**
3,538	348	925	82	1,680	-	44	**6,618**	-	21	3	-	**24**
7,421	-	-	18	-	-	61	**7,499**	10	-	10	660	**680**
70,974	508	18,795	5,417	2,560	3,220	2,677	**104,151**	143	2,378	(12)	6,536	**9,045**
377,355	**13,269**	**99,855**	**14,488**	**37,095**	**12,544**	**7,338**	**561,943**	**21,007**	**5,746**	**145**	**19,488**	**46,386**

Major banks: Quarterly analysis

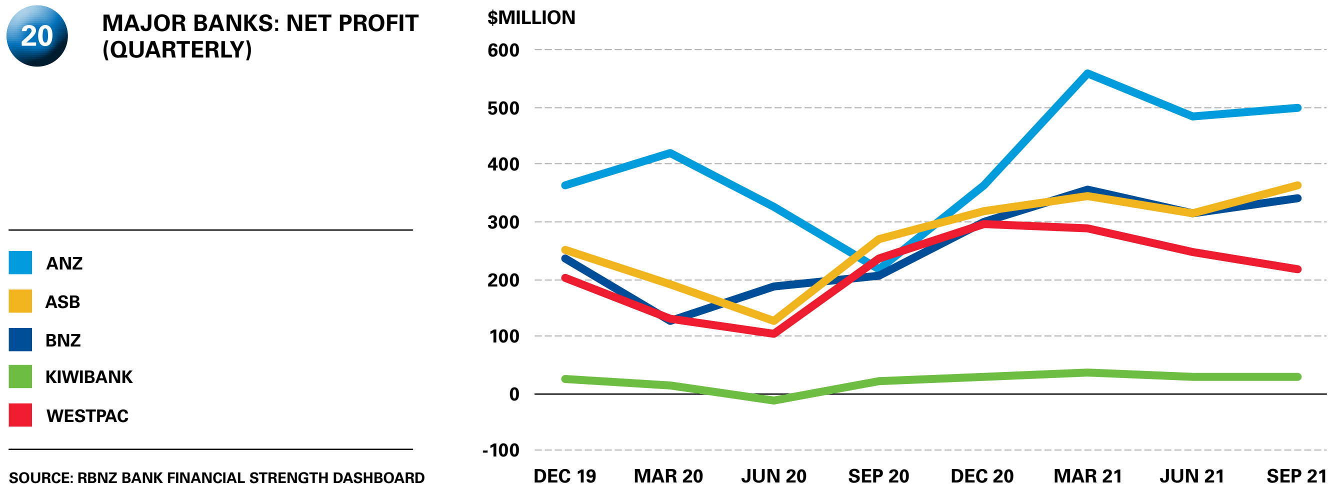
FOOTNOTE 54

Entity[54]	Size & strength measures							
	31 Dec 19	31 Mar 20	30 Jun 20	30 Sep 20	31 Dec 20	31 Mar 21	30 Jun 21	30 Sep 21
	Total assets[56] ($Million)							
ANZ	170,385	183,424	181,688	180,087	186,404	183,811	187,064	185,072
ASB	109,464	116,042	113,464	115,064	117,967	121,115	120,810	120,230
BNZ	108,289	118,501	114,452	112,310	117,287	114,314	118,549	119,122
Heartland	4,262	4,315	4,315	4,288	4,358	4,297	4,419	4,484
Kiwibank	24,086	25,249	25,510	26,645	27,283	27,546	28,230	29,379
SBS	4,948	4,942	4,836	4,842	4,839	4,832	4,789	4,889
TSB	8,130	8,179	8,332	8,575	8,761	8,789	8,725	8,780
Co-op	2,948	2,980	3,008	3,048	3,064	3,122	3,171	3,194
Westpac	107,111	120,525	114,223	113,187	117,160	114,726	116,786	119,848
Total	**539,622**	**584,157**	**569,827**	**568,047**	**587,123**	**582,552**	**592,543**	**594,998**
	Increase in gross loans and advances (%)							
ANZ	0.92	0.98	-0.02	-1.92	1.51	2.00	1.41	0.93
ASB	0.83	1.03	0.09	2.41	2.58	1.70	2.79	1.94
BNZ	0.41	1.41	-1.36	-0.30	1.43	2.07	2.78	1.64
Heartland	1.82	1.23	-2.03	-0.62	0.72	0.78	3.11	2.54
Kiwibank	3.57	1.91	1.51	3.06	3.86	3.16	2.51	3.49
SBS	1.63	0.58	-1.36	-0.36	-1.10	0.01	0.23	2.00
TSB	-0.33	-0.16	-0.28	0.58	0.81	2.09	2.32	1.53
Co-op	1.08	1.32	-0.31	1.14	2.83	1.61	2.05	-0.13
Westpac	1.68	1.80	-0.29	1.47	1.34	1.40	2.13	0.15
Average	**1.07**	**1.27**	**-0.28**	**0.31**	**1.78**	**1.86**	**2.20**	**1.30**
	Capital adequacy (%)							
ANZ[57]	13.60	13.90	14.00	14.40	15.00	15.90	15.50	16.90
ASB[57]	14.20	13.60	14.00	14.20	13.90	14.80	15.10	14.50
BNZ	14.40	14.10	14.60	14.90	15.50	16.00	16.50	16.90
Heartland	12.60	12.90	12.70	13.40	14.00	14.40	13.90	14.00
Kiwibank	13.20	13.00	12.60	12.30	13.30	13.20	13.20	12.80
SBS	14.20	13.80	14.30	14.90	15.20	15.70	16.20	16.30
TSB	14.60	14.30	14.90	15.10	15.10	15.00	14.20	14.10
Co-op	16.40	16.30	16.90	16.90	17.00	16.90	16.80	16.10
Westpac[57]	15.90	15.90	16.60	17.10	17.60	18.20	18.80	18.60
	Net profit ($Million)							
ANZ	367	422	327	220	367	563	487	503
ASB	252	192	130	270	321	348	317	367
BNZ	238	129	187	209	303	357	318	344
Heartland	17	17	9	21	12	18	20	20
Kiwibank	27	17	-12	24	31	40	31	32
SBS	6	-4	8	10	12	12	13	11
TSB	12	-8	9	12	11	11	13	12
Co-op	3	-1	3	4	5	4	4	5
Westpac	203	132	107	238	300	290	249	219
Total	**1,125**	**896**	**770**	**1,008**	**1,361**	**1,643**	**1,452**	**1,512**

FOOTNOTES 56–57

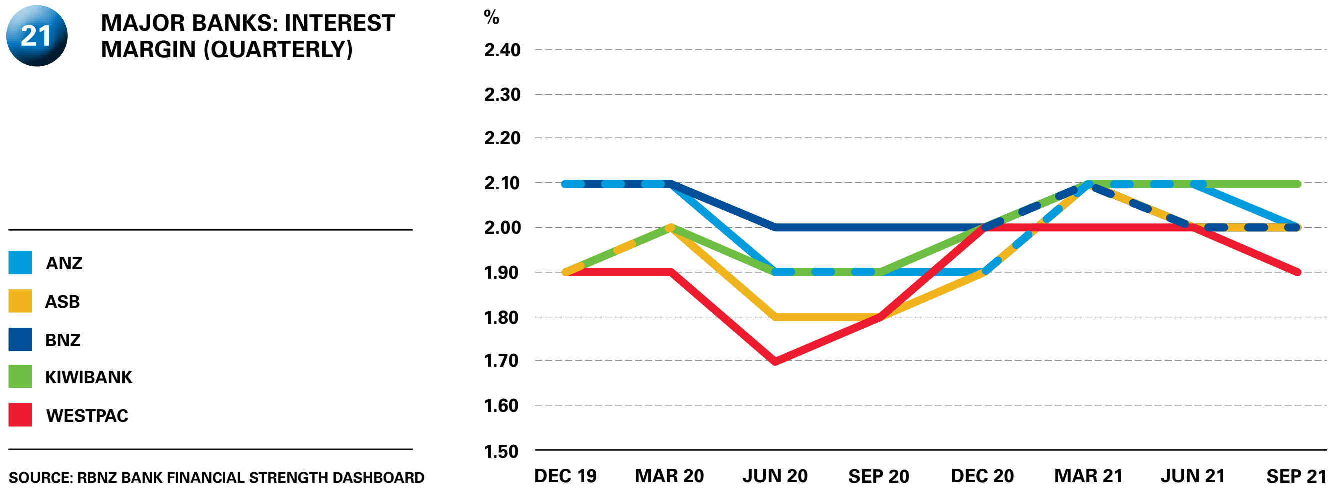
Entity	Profitability measures							
	31 Dec 19	31 Mar 20	30 Jun 20	30 Sep 20	31 Dec 20	31 Mar 21	30 Jun 21	30 Sep 21
	Interest margin (%)							
ANZ	2.10	2.10	1.90	1.90	1.90	2.10	2.10	2.00
ASB	1.90	2.00	1.80	1.80	1.90	2.10	2.00	2.00
BNZ	2.10	2.10	2.00	2.00	2.00	2.10	2.00	2.00
Heartland	4.50	4.60	4.60	4.50	4.60	4.80	4.90	4.80
Kiwibank	1.90	2.00	1.90	1.90	2.00	2.10	2.10	2.10
SBS	2.50	2.50	2.40	2.40	2.50	2.70	2.90	2.80
TSB	1.80	1.80	1.60	1.70	1.70	1.80	1.80	1.80
Co-op	2.20	2.20	2.20	2.20	2.30	2.40	2.40	2.30
Westpac	1.90	1.90	1.70	1.80	2.00	2.00	2.00	1.90
	Non-interest income/Total tangible assets (%)							
ANZ	0.31	0.85	0.33	0.29	0.18	0.53	0.40	0.53
ASB	0.57	0.53	0.51	0.58	0.54	0.56	0.55	0.67
BNZ	0.30	0.65	0.40	0.35	0.42	0.72	0.50	0.66
Heartland	0.38	0.32	0.38	0.28	0.42	0.32	0.39	0.39
Kiwibank	0.90	0.92	0.53	0.63	0.27	0.26	0.15	0.22
SBS	0.82	0.70	0.68	0.74	0.82	0.65	0.74	0.71
TSB	0.29	0.25	0.22	0.22	0.22	0.20	0.22	0.28
Co-op	0.71	0.50	0.67	0.69	0.60	0.58	0.62	0.65
Westpac	0.37	0.59	0.32	0.35	0.28	0.48	0.33	0.42
Average	**0.41**	**0.68**	**0.39**	**0.39**	**0.34**	**0.55**	**0.43**	**0.54**
	Impaired asset expense/Average gross loans and advances (%)							
ANZ	0.05	0.64	0.23	0.27	-0.03	-0.17	-0.10	-0.03
ASB	0.04	0.65	0.59	0.15	-0.01	-0.06	-0.07	-0.04
BNZ	0.14	0.53	0.46	0.31	-0.13	0.04	-0.06	-0.07
Heartland	0.47	0.69	1.48	0.05	0.44	0.52	0.54	0.46
Kiwibank	0.06	0.28	0.56	0.03	-0.03	0.01	-0.31	0.05
SBS	0.48	2.44	0.39	0.09	0.09	-0.13	0.06	0.28
TSB	0.03	1.29	-0.01	-0.05	0.03	-0.11	-0.12	-0.31
Co-op	0.10	1.03	0.12	0.09	0.05	-0.30	0.06	-0.06
Westpac	0.10	0.87	0.54	-0.04	-0.39	-0.05	0.04	0.02
Average	**0.08**	**0.67**	**0.44**	**0.17**	**-0.11**	**-0.07**	**-0.06**	**-0.02**
	Operating expenses/Operating income (%)							
ANZ	44.88	33.93	43.97	54.60	44.39	34.29	38.88	39.25
ASB	43.48	38.09	49.46	38.55	36.97	37.66	44.62	37.77
BNZ	40.38	58.00	41.97	41.65	39.83	32.75	38.23	39.02
Heartland	45.02	40.78	48.39	40.28	61.61	43.47	42.93	42.53
Kiwibank	79.01	75.76	91.00	78.94	70.89	65.25	84.38	70.88
SBS	65.58	56.07	59.78	59.36	58.31	61.87	56.21	57.51
TSB	60.00	80.68	66.31	60.76	62.80	68.38	65.02	74.84
Co-op	75.48	75.77	74.52	74.65	70.59	81.61	71.86	72.41
Westpac	47.07	42.68	50.79	44.14	45.34	41.67	44.98	49.95
Average	**46.61**	**44.25**	**48.95**	**47.85**	**44.13**	**38.53**	**43.97**	**43.07**

20 MAJOR BANKS: NET PROFIT (QUARTERLY)



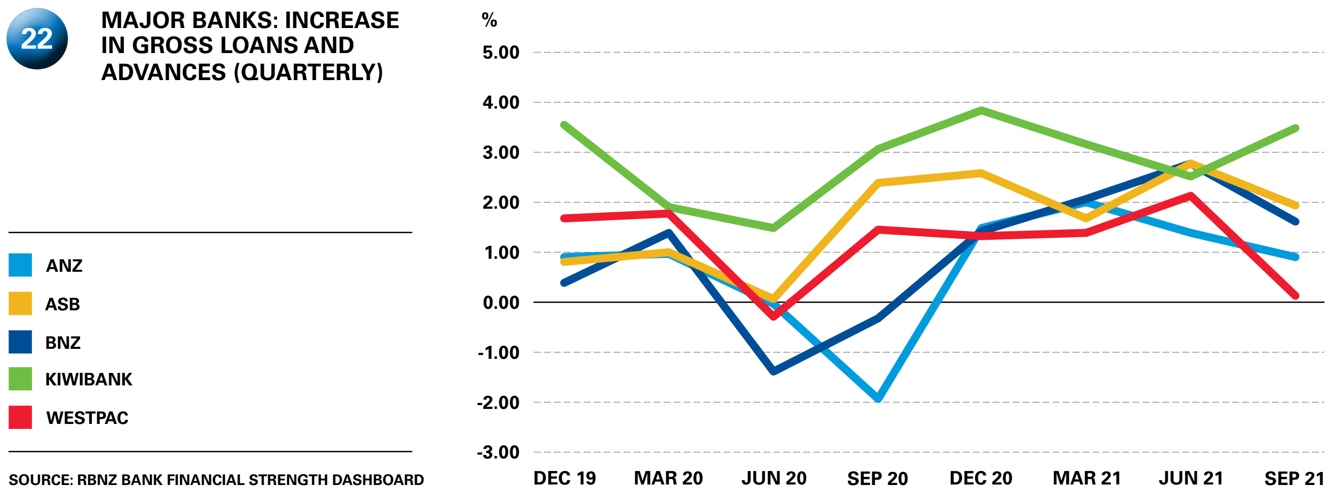
SOURCE: RBNZ BANK FINANCIAL STRENGTH DASHBOARD

21 MAJOR BANKS: INTEREST MARGIN (QUARTERLY)



SOURCE: RBNZ BANK FINANCIAL STRENGTH DASHBOARD

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

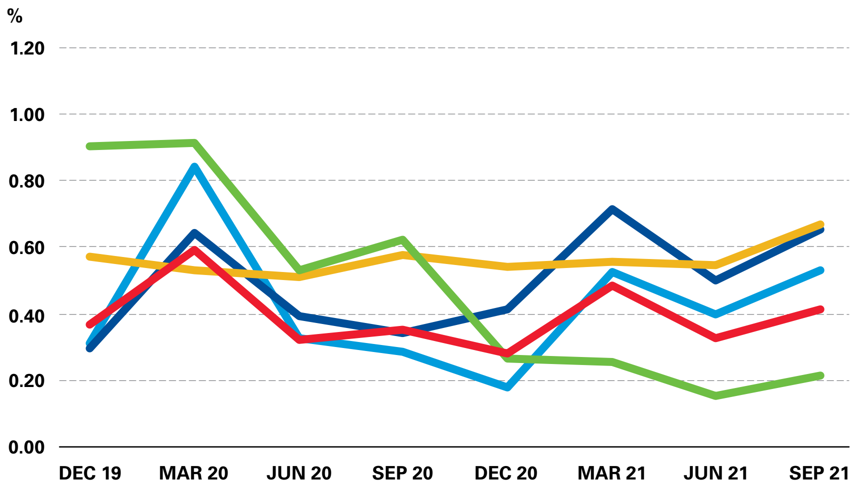


SOURCE: RBNZ BANK FINANCIAL STRENGTH DASHBOARD

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

ANZ
ASB
BNZ
KIWIBANK
WESTPAC

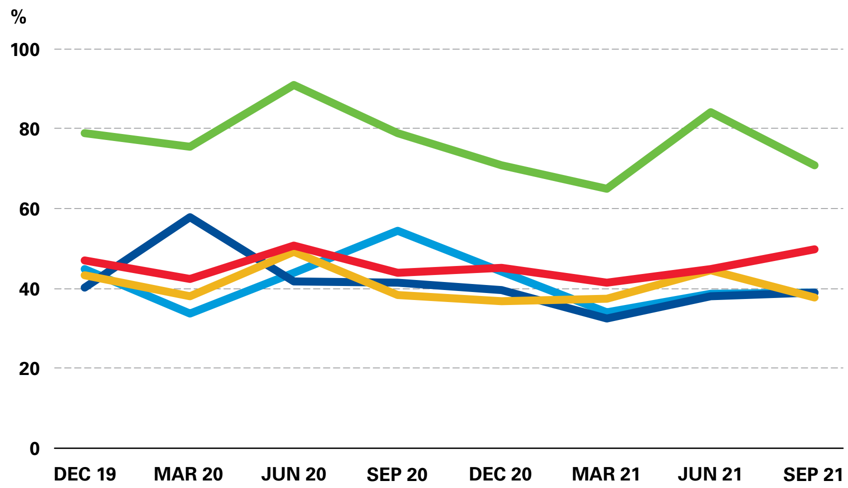
SOURCE: RBNZ BANK FINANCIAL STRENGTH DASHBOARD



24 MAJOR BANKS: OPERATING EXPENSES/ OPERATING INCOME (QUARTERLY)

ANZ
ASB
BNZ
KIWIBANK
WESTPAC

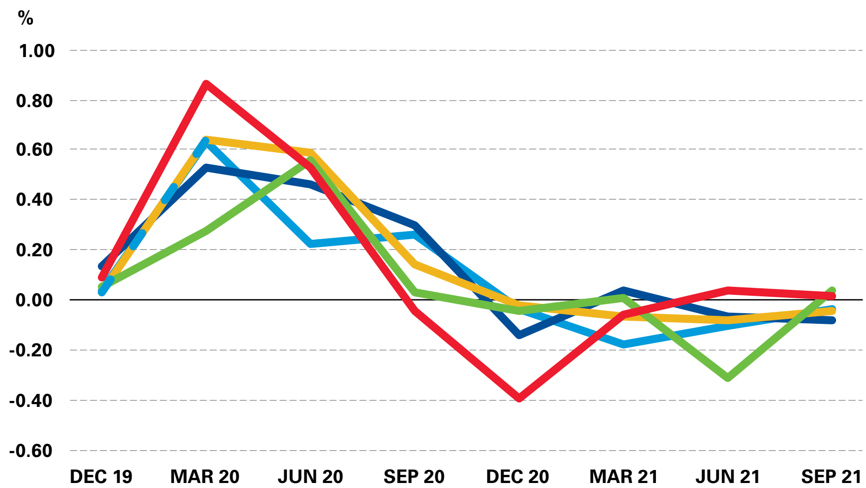
SOURCE: RBNZ BANK FINANCIAL STRENGTH DASHBOARD



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

ANZ
ASB
BNZ
KIWIBANK
WESTPAC

SOURCE: RBNZ BANK FINANCIAL STRENGTH DASHBOARD



Confidence in your model risk management practices

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The growing reliance on models in the financial services sector

In recent times, the financial services sector has been experiencing heightened regulatory scrutiny with increasing complexity of regulatory requirements and associated periodic reporting. The use of tools, models or automated systems have become common for the purpose of customer decisioning, monitoring customer behaviours, complying with regulatory requirements, evaluating entities' risks, dashboarding and supporting senior management decisions.

Entities in the financial services sector have always been relying on models for various purposes. Recently it has been uncovered that a number of these models are not performing as intended after being scrutinised by the banks themselves or the regulators. This has resulted in entities increasing their model validation activities and some entities setting up model risk management (MRM) functions; however, there is still a need to focus on MRM more holistically.

Undeniably, the usage of models is only set to thrive as these entities join the upswing trend of using artificial intelligence, machine learning and big data as part of their business processes more and more. The illustration in Figure 26 provides an overview of some of the areas where models are used within a financial services entity.

VIEW FIGURE 26

In essence, there can be difference in the model definition employed by financial services entities. However, the definition that the entity chooses to adopt establishes the consistent means in identifying models across the entity and consequently the appropriate model risk governance applied to it. Generally, a model is a system, approach or quantitative method that applies statistical, financial or mathematical theories and assumptions to process input data into quantitative estimates or valuable outputs used for decision making or reporting.

A model is a system, approach or quantitative method that applies statistical, financial or mathematical theories and assumptions to process input data into quantitative estimates or valuable outputs used for decision making or reporting.

The intensifying expectation on MRM

As some of these models can be defined as high risk (i.e. they have a material impact on complying with regulatory requirements or the entity's financial performance), regulators across the globe are introducing or in some cases are intensifying their expectation on these entities' MRM practices. In the past, model validation was seen to be the anchor of MRM. However, there is greater belief and understanding that MRM practices should extend to the entire model lifecycle. Over the past decade we have started observing an increased attention amongst regulators globally who have started introducing some form of guidance or regulation in relation to model risk.

Globally

Organisations such as the Federal Reserve (FED) and the Office of the Comptroller of the Currency (OCC) have raised the expectations emphasising the need for a management framework in financial institutions (FIs) through the issuance of the Supervisory Guidance on MRM (OCC 2011-12/SR11-7). They require the implementation of frameworks which establishes guiding principles for various components of the model lifecycle for a successful MRM. In essence, MRM should also encompass governance and control mechanisms such as board and senior management oversight, policies and procedures, controls, and an appropriate organisational structure.

VIEW FIGURE 27

In addition, the European Central Bank's (ECB) Target Review of Internal Models (TRIM), and the guidance from the Bank of England (BOE) Prudential Regulation Authority (PRA) also seek to provide direction and expectations as to the MRM practices that should be adopted.

Australia and New Zealand

Here in Australasia, the momentum on MRM has yet to become more prominent or even become a regulatory requirement. Nonetheless, considering the elevated regulatory environment in recent years, one can expect that it is only a matter of time before model risk becomes a highly observed requirement or framework.

Moreover, in a recent thematic review[58] (with respect to liquidity policy) conducted by the Reserve Bank of New Zealand (RBNZ), it found significant weakness across the industry in model governance and MRM.

Whilst the thematic review focused only on liquidity management, the RBNZ however, felt that the underinvestment in systems and frameworks may extend beyond liquidity management. The report goes on to say that "banks should review and enhance model risk governance frameworks and associated risk management processes and procedures"[58].

FOOTNOTE 58

Increasing focus on model lifecycle

One of the focal issues with yesteryear approaches in relation to MRM is the disconnection with the model post-implementation. Only in specific instances, where the model is rated 'high risk', these models are revisited during the periodic validation as per internal model validation frameworks.

While model validation is designed to identify problems with the model and issue a stamp of approval before implementation, it would be rather reckless to assume that this process is fool proof. Model validation alone cannot be treated as a sole control as validation is often performed over a selected period and cannot ensure that all permutations of the model would have been tested.

This is why MRM focuses on the entire model lifecycle. One way is ensuring that appropriate governance and oversight has occurred during the model build period. This ensures that the right forum has been consulted to seek the appropriate decisions around model methodology or implementation decisions.

Another important aspect would relate to model performance monitoring. Some of the larger FIs tend to have model performance monitoring as part of its MRM. However, it would seem these practices are more apparent in more technical or quantitative models (which are usually rated as high risk), but more of an afterthought for other types of model. As trivial as it may seem, performance monitoring oftentimes helps detect issues early on which in turn gives model owners sufficient time to deliberate on the suitable rectifications.

In short, the increasing reliance on models across an entity could stand to benefit from a sound model governance and MRM framework overlaid on top of the FI's model lifecycle process. We feel that a good MRM framework should consider the following overarching components throughout the model lifecycle component.

VIEW FIGURE 28

CCCFA: Where to now?

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You would have seen them. And perhaps tired of reading them. Almost daily since December 2021, New Zealand news media have published a plethora of stories about the negative impact that the new Credit Contracts and Consumer Finance Act (CCCFA) changes have had on banks and particularly borrowers. There have been stories of disconsolate first-home buyers now with no hope of entering the housing market, and life-long bank customers being told that they are being refused credit for spending too much on their dog, or at Kmart. While a portion of these stories slightly misrepresent the banks' examination of discretionary expenses for the sake of a headline, the substance is accurate.

Equally, some comments from the Minister of Commerce and Consumer Affairs justifying the new code and hypothesising about banks' historic lending conduct and the application of the new rules have also contained some inaccuracies – the recent loss levels in the banking sector point to the vast majority of regulated lenders actually lending responsibly.

A figure of 18% of borrowers getting into debt that they can't afford was used in the original research for the CCCFA changes, while the banks' default rates for home loans are stable at around 0.02-0.05%. These figures suggest that the banks may not be the issue here.

It is not likely to come as a shock to anyone in the banking sector that the implementation of these changes has caused uproar and upset among the industry and to customers. The industry has been quick to point out that they warned the Government during the consultation phase of the legislation changes that the proposed amendments would have the effect of slowing lending processes, increasing administration time, and lead to the banks not being able to lend to some who they could previously lend responsibly to.

The implementation of these changes has caused uproar and upset among the industry and to customers.

The intention of the original Act, to protect vulnerable customers from lending that was unsuitable or unaffordable and to promote responsible lending has undeniably been lost in the prescriptive changes to the CCCFA, which also mandate comprehensive due diligence obligations with the threat of fines for Directors and senior managers for any breaches.

While the Government claims that there are multiple other factors affecting lending concurrently – including the Official Cash Rate, loan-to-value ratio changes, increase in mortgage interest rates and housing prices, and the lingering uncertainty of a global pandemic – the timing points to the CCCFA amendments being a strong contender for the abrupt onset of aggrieved borrowers and frustrated lenders, particularly when you consider that those other factors haven't historically caused such outcry. Something had to give.

The result? In mid-January 2022, just six weeks after the changes came into effect, the Government announced that it will undertake an investigation to review both the intended and unintended impacts of the changes, beyond those that were expected by the initial implementation[59].

FOOTNOTE 59

Just six weeks after the changes came into effect, the Government announced that it will undertake an investigation to review both the intended and unintended impacts of the changes.

The investigation was welcomed by many, but its independence has already been questioned given that the Council of Financial Regulators (CoFR) agencies[60] who will conduct it were heavily involved in the changes already made[61].

FOOTNOTE 60

FOOTNOTE 61

At the time of writing the Minister had just completed a round of meetings with the bank executives and interim findings were due to be published in mid-February, with a more comprehensive report being delivered in April. However, as yet, nothing has been made public.

Lessons from the UK and Australia

Like many other legislative changes that have occurred in New Zealand, countries with similar jurisdictions have made similar changes in previous years. The CCCFA changes to consumer lending laws are no different.

After the 2008 Global Financial Crisis, the UK Government set up an investigation known as the Mortgage Market Review (MMR) to address the finding that there was too much high-risk lending which could become unaffordable for borrowers. As a result of this review, mortgage lending rules were tightened, and some homeowners found themselves with the unintended consequence of being rejected for new mortgages because the affordability rules had changed. Borrowers who had mortgages under the old rules and were managing to keep up on their repayments suddenly found that they were being turned down when trying to switch to cheaper deals. As a result, some homeowners were stuck on uncompetitive mortgage interest rates, effectively being told they could not afford the deal even though it was a lower rate.

Early assumptions by the UK regulator, the Financial Conduct Authority (FCA), of the number of people caught out were quite low, but further reviews have identified that there are many more affected than first thought.

This has led to many years of high repayments for borrowers who could not meet the new, stricter, lending criteria as they were unable to switch provider to cheaper deals under these lending rules.

Fast forward to 2019, the FCA issued a Consultation paper: *Mortgage customers: proposed changes to responsible lending rules and guidance* (CP19/14)[62]. The aim of this paper was to consult on changes to the responsible lending rules which would enable mortgage lenders to make more proportionate affordability assessments, in other words to remove the barriers. This consultation led to the policy statement (PS19/27)[63] where the FCA proposed an amendment to the responsible lending rules and guidance.

FOOTNOTE 62

FOOTNOTE 63

This provided mortgage lenders with the option to choose a modified affordability assessment ('modified assessment') where the borrower:

- has a current mortgage;
- is up to date with their mortgage payments;
- does not want to borrow more, other than to finance any relevant product, arrangement or intermediary fee for that mortgage; and
- is looking to switch to a new mortgage deal on their current property.

Lenders that use the modified assessment must tell the borrower the basis on which their affordability is assessed and provide additional disclosures about potential risks.

Whilst this may free-up lenders to relax the rules slightly, it does not remove the need to ensure suitability of products for borrowers.

This serves to highlight that new regulations brought in with the intention to protect borrowers can have unintended consequences that prevent a good outcome being achieved. It is still in its early stages, but the changes to the CCCFA are reportedly already having unintended consequences for those borrowers that it is meant to protect. What is important going forward is for the Government to acknowledge this and be prepared to make amendments where necessary.

The changes to the CCCFA are reportedly already having unintended consequences for those borrowers that it is meant to protect.

Australia followed suit and revised consumer lending laws with the enforcement of the National Consumer Credit Protection Act 2009 in April 2010. This introduced responsible lending obligations (RLO) to ensure lenders did not provide unsuitable loans to consumers, with the guidance extending to approximately 100 pages. Similar to New Zealand's CCCFA changes (but much less than the UK's 586 pages of Mortgage conduct of business (MCOB) rules), the RLO guidance, and the internal systems lenders developed to enable compliance with the legislation and guidance resulted in a shift to:

1. placing the onus/responsibility on the lender to verify information provided by borrowers; and
2. a one-size-fits-all approach to lending.

A now-famous legal case dubbed in 2019 'wagyu and shiraz'[64] was brought by the Australian Securities and Investments Commission (ASIC) against Westpac, in which Westpac successfully defended allegations that it had breached responsible lending laws by using a benchmark, rather than looking at declared expenses[64]. The judge made the point that a customer's current lifestyle and comforts assessed by the bank cannot always be taken as being the way that the customer will live when they also have a mortgage to pay and they should not be denied lending for previously living a certain way.

FOOTNOTE 64

By 2020, it was clear the legislation and guidance were being implemented in a way that no longer fit the purpose for which they were created. The Government drafted reforms with the aim to improve the flow of credit and streamlining a consumer's interaction with lenders. The National Consumer Credit Protection Amendment (Supporting Economic Recovery) Bill 2020 (the NCCP Bill) aims to do that by:

1. Removing RLO from the National Consumer Credit Protection Act 2009, with the exception of small amount credit contracts (SACCs) and consumer leases where heightened obligations will be introduced.
2. Ensuring that authorised deposit-taking institutions (ADIs) will continue to comply with the Australian Prudential Regulation Authority's (APRA's) lending standards requiring sound credit assessment and approval criteria.
3. Adopting key elements of the APRA's ADIs lending standards and applying them to non-ADIs.

4. Protecting consumers from the predatory practices of debt management firms by requiring them to hold an Australian Credit Licence when they are paid to represent consumers in disputes with financial institutions.
5. Allowing lenders to rely on the information provided by borrowers, replacing the current practice of 'lender beware' with a 'borrower responsibility' principle.
6. Clarifying the application of consumer lending laws to small business lending.

While the changes seem sensible, there has been opposition to the Bill and it is yet to become law.

The situation in New Zealand

The initial feedback from CoFR's investigation was due early to mid-February, with further, and more detailed advice expected in April 2022. However, as yet, nothing has been made public.

It will be interesting to note what, if any, changes come about following this investigation, or whether it will take a similar situation to Australia in that a legal case was the catalyst for change.

In terms of the output of the review, there are some aspects of the CCCFA and Responsible Lending Code (RLC) that could be clarified, redefined, or slightly reinterpreted to lessen the impact of the legislation in the short to medium term.

We believe the following 'levers' could be pulled to relieve some of the tension that has arisen since the changes came into force in the short to medium term:

1. There are areas where some of the language used in the Act could be clarified. For example, terms such as 'substantial hardship' and 'reasonable surplus' are not clearly defined. Definitions and examples that more clearly illustrate the intention of the regulators in these areas might enable these terms (and others) to be interpreted less strictly and might enable lending to occur to a wider group of people, as it was intended to.
2. The Government could look to provide a higher volume of, and better-detailed, examples of the CCCFA in practice as amendments to the RLC. More examples and further guidance on how the Government intends the legislation to work will assist lenders to make the correct decisions on lending and will provide confidence that they will not breach the Act in making such decisions.
3. Lenders could make more use of the 'Obviously Affordable' carve-out in the determination of whether a full income and expenditure review is necessary due to the borrower's income or the assets that the borrower holds. The high bar of the example in the RLC, of the use of the clause deterred many banks from even using it, preferring to subject all customers to the new changes and a full income and expenditure assessment. A lesser definition of 'Obviously Affordable' might relieve some pressure where households have significant budget surpluses and a good record of repayment.
4. The regulators could consider offering 'breathing space' or relaxation of enforcement action and Directors' liability rules for a short period to allow nuances to policy and encourage banks to consider how they can amend their processes. Just as the regulators asked banks to consider and relax their default and hardship policies during Covid-19 to avoid a similar potentially poor outcome for customers.

We believe it would be helpful if the regulators consider a transitional period, or enforcement moratorium on the full application of the new rules, while the interpretation and application of these issues are being discussed at Ministerial levels.

Whether the levers for change to the CCCFA are operated by the Government, jointly with the banks to uplift and modify moving parts that they can control, or results from a court case that will provide a legal judgement that clarifies the direction that should be taken remains to be seen.

The flood of negative publicity regarding the Act and the resulting political pressure mean that inaction is not an option.

One complicating factor in all of this is the need for banks in New Zealand to operate within the law. It is one matter to clarify or modify the intent of the Act, but the banks are not compelled to follow the intent of the Act (even if they support it), they must follow the 'letter of the law'. In order for substantive changes to lending behaviour by banks, large parts of the legislation will need to be re-written. This will take time and there are only so many of these levers that can be operated in the short-term.

The problems with the Act such as those that lead to the focus on discretionary expenses are enshrined in law and cannot easily be discarded.

The National Party have already drafted proposed changes to the Act and sent them to Minister Clark, urging him to take up the bill and promising support for it[65]. Their proposed changes would mean regulations issued under the CCCFA could differ depending on the type of financial institution being regulated.

FOOTNOTE 65

What about other longer terms changes? The CCCFA compels lenders to examine future changes to income that customers might experience when considering lending. It is an interesting asymmetry of the Act that future changes to expenses are not taken into account in the same way. If a forward-looking view of changes to household expenses was incorporated, lenders could take into account proposed reductions in expenditure when credit decisioning (as was the result of the Australian court case).

There is a raft of other potential changes that could be applied. Changes could be made to the way discretionary expenses are categorised, calculated and benchmarked. New Zealand could adopt the 'borrower responsibility' approach from Australia and adopt a more 'principles-based' approach to the calculation of a household budget.

Further to this is the problem of implementation. There seems to be a collective expectation from consumers, regulators, and the Minister that the banks can easily and immediately implement changes to the operation of the CCCFA. This is patently not the case. Banks' CCCFA programmes took several years to implement and incorporated very significant changes to systems, processes, and people.

While the mooted CCCFA changes and how they will be managed long-term is uncertain, one thing is certain: it cannot continue the way it is currently. The only undetermined factor is, who will lead the change and how?

While the mooted CCCFA changes and how they will be managed long-term is uncertain, one thing is certain: it cannot continue the way it is currently. The only undetermined factor is, who will lead the change and how?

What is abundantly clear is that the current legislation is causing disruption in areas where lending could, and should, reasonably occur at a time when the economy needs all the support in the form of access to funding that it can get.

KPMG has significant experience supporting clients with their CCCFA compliance. If you would like to speak to us about any aspect of the CCCFA, then please reach out to Malcolm, Gordon, Brett or Annabel.

Key industry challenges for remediation in 2021: A review

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KPMG

MALCOLM'S BIO

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CATHERINE'S BIO

Alongside the challenges of ongoing management of Covid-19 including an extended lockdown, 2021 was a seminal year for remediations in the financial services sector.

Reflecting on key challenges or themes for remediation for the banks in 2021 can provide valuable insight in looking forward into 2022 and planning for better customer outcomes and more efficient remediation programmes.

Regulatory activity is increasing

New Zealand regulators invested in growing their enforcement teams in 2021, and made clear public statements about their intent to make good on regulatory promises such as holding banks and insurers to account on good customer outcomes. The Financial Markets Authority **(FMA) are setting 'visible expectations'**[66] on how they intend to implement the law, good conduct and their enforcement strategy. They are increasingly active in supervision response, including stating publicly that self-reporting of issues to the FMA will not mitigate potential regulatory outcomes – they encourage a focus on putting customers right, and on timely and accurate customer remediations as well as good governance of any remediation activity.

FOOTNOTE 66

New Zealand regulators invested in growing their enforcement teams in 2021.

The FMA also released a **thematic review** on credit card related insurances, finding that they are poor value products. In its media release, the FMA encouraged customers to consider the value of these products – these kinds of public statements show the focus of the FMA on good customer outcomes, which banks should pay close attention to when balancing priorities and resourcing of remediation projects.

In 2022, the FMA is anticipated to release much-awaited **remediation principles** – the banks often run ahead of the rest of the financial services sector in relation to setting remediation policy, principles and frameworks, but these will form useful context and expectations for remediation. The Reserve Bank of New Zealand (RBNZ) and FMA are also expected to complete a thematic review of **governance**, which has relevance to remediation for how issues are escalated, including determination of whether a problem for a customer is systemic, and whether or not a customer should be recompensed as a result of an error – complex questions leading to remediations.

The RBNZ and FMA are also expected to complete a thematic review of governance.

CCCFA remediations are industry-wide

2021 saw several Credit Contracts and Consumer Finance Act **(CCCFA) related remediations** hit headlines across the country. While we have seen a number of high-profile cases from the larger trading banks, KPMG's experience across the industry suggests that almost every bank and financial institution will have elements or similar issues with CCCFA compliance that they are yet to fully face into.

Both bank and non-bank lenders continue to be challenged by historical disclosure issues, with the class action launched against ANZ and ASB high on the watchlist for 2022. In addition, 2021 saw fee justification and early repayment fee issues be remediated and settled with warnings or enforceable undertakings from the regulator.

Both bank and non-bank lenders continue to be challenged by historical disclosure issues.

KPMG has seen CCCFA remediations challenged by historic data collection and legacy systems that can make it difficult to evidence key elements of historical loans such as what disclosure was provided and when. This also makes a remediation strategy **complex** to design and implement, and almost always require a 'corrective' action, such as issuing of the relevant documentation.

Time will tell in terms of the impact of the 1 December 2021 CCCFA changes on potential future remediations, we note the industry was given a two-month extension to the original deadline as a number were struggling with the timetable. Given the need to evidence compliance to the Act and the increased focus on responsible lending, it seems likely that there is **potential for further CCCFA remediations** in 2022 and beyond.

It seems likely that there is potential for further CCCFA remediations in 2022 and beyond.

Remediations are resource intensive projects

The continued extension of closed borders and a resulting competitive domestic labour market further challenged banks in 2021, and remediation resources were not immune. Remediations drew heavily from **skills across the bank**, from technical skillsets such as technology expertise related to legacy systems, and data engineering and analytics skills, to product subject matter expertise, and marketing and communications capability required to deliver remediations at scale.

All banks are working on more than one remediation at a time (some are working on large programmes of remediations), which means prioritising of time and effort across both people and remediations, and challenges to expectations of **timely delivery** by regulators. Every day longer a remediation takes to deliver increases the cost of remediation, both in terms of operational delivery, and also in the amount of time that a customer is in error, where compensatory 'lost use of monies' payments may be required.

This results in a complex and high-pressure working environment, with the added challenge of a limited pool of remediation specialists in the New Zealand market to guide the banks through the process.
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Every day longer a remediation takes to deliver increases the cost of remediation.

Borders opening later in 2022 may help to supplement **this resource pool**, but banks should be wary of ongoing resource competition, and the need to carefully plan and execute remediations to balance impacts on people.
Due to the length of delivery (more often in the years than months for more complex cases), remediations must be treated as marathons not sprints. Development of good institutional practices, frameworks, policies and guidelines for remediations will support the growth of remediation delivery at scale – this is particularly critical where remediation requires a new set of skills for those technical experts who land in the project.
Banks may also consider implementing of RegTech or data analytics tools to support analysis required for timely and accurate remediations, to more efficiently manage particularly labour-intensive remediations, such as those requiring repeatable reviews of documents or data.

Remediations must be treated as marathons not sprints.

Learning from the Australian experience

The Australian Securities and Investment Commission (ASIC) continued to pursue regulatory action related to remediation in the Australian market in 2021. The fallout from the Hayne Royal Commission continued, and cases were brought covering banking fees, loan referral programmes, advice and superannuation activities. Each case, as they are made publicly available, provides interesting insight into the direction of regulatory expectations and the nature of remediable errors, which generally informs the direction of the New Zealand regulators too.

In 2022, ASIC will finalise updated **remediation guidance**, which is often referred to by New Zealand-based organisations, especially those with an Australian connection. We expect that the revised ASIC remediation guidance will also be helpful for New Zealand banks running remediation programmes, as Australia lifts expectations for remediation practices, and broadens from advice-specific remediation into guidance covering a broader range of remediation activity, including more quantitative remediations like we see in New Zealand.

We expect that the revised ASIC remediation guidance will also be helpful for New Zealand banks running remediation programmes.

We will also continue to watch We will also continue to watch closely for remediation trends in Australia and the UK that may arrive in New Zealand, such as advice related remediations – these have resulted in large scale file-based reviews (including of recorded conversations and customer interactions), management of loan affordability and bad debt management, or loan repayment insurance remediations. Given the changes to the New Zealand financial advice regime, we anticipate that it's only a matter of time until we see more advice-related remediations here.

Whether banks are seasoned remediators or the programme is new or changing, it's clear that 2022 will continue to bring remediation challenges and that the regulators are paying close attention. Banks should consider now more than ever, investment in banking systems and processes that protect good customer outcomes and could also benefit from investing in remediation to make it efficient and sustainable, in order to complete each case quickly and accurately.

KPMG has experience working with banking clients across multiples types of remediations. If you would like to speak to us about remediation then please reach out to Malcolm or Catherine.

How sustainable is New Zealand's finance?

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ALTON'S BIO

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JESSICA'S BIO

New Zealand banks are increasingly integrating environmental, social, and governance (ESG) criteria into credit policies and lending activities. In fact, the total value of the sustainable finance market in New Zealand now exceeds $13 billion and sustainability linked loans have been the biggest growing lending product, with over $3 billion of loans announced during 2021[67].

FOOTNOTE 67

VIEW FIGURE 29

VIEW FIGURE 30

This activity is not unique to New Zealand; significant evolution occurred in sustainable finance markets internationally during 2021, with the global sustainable debt market now valued at over US$4 trillion. Over US$1.6 trillion of sustainable debt instruments were issued during the year[68], which is more than double the amount issued in 2020.

FOOTNOTE 68

VIEW FIGURE 31

We have also seen a diversification in the types of borrowers accessing sustainable lending products. Corporate borrowers of sustainable debt instruments have historically been concentrated in the energy and construction sectors; however, activity became more diversified in 2021 with borrowers from agriculture, retail, telecommunications and aged care industries.

Public sector activity

Sustainable finance activity has also not been limited to private markets. In the public sector, the New Zealand Government announced plans to issue sovereign green bonds in 2022, with proceeds being applied to finance low-emission or environmental projects to help New Zealand reach the Government's net zero carbon target[69]. Another example comes from the Local Government Funding Agency (LGFA) announcing plans in 2021 to lend funds to Councils and Council controlled organisations (CCOs) at a discounted margin to enable them to undertake green, social or sustainability projects. The aim is for this to help drive forward ambitious climate, environmental and social projects in the New Zealand local government sector, so it is possible to see agencies using funding to amplify priorities and encourage meaningful results.

FOOTNOTE 69

Sustainable finance activity has also not been limited to private markets.

This rise of our domestic sustainable finance market across sectors has helped encourage attention from overseas. International funding organisations are increasingly viewing New Zealand as a favourable jurisdiction for raising sustainable debt. The Asian Development Bank issued its first New Zealand dollar gender bond in May 2021, with the NZ$475 million bond proceeds being applied to finance projects that promote gender equality and women's empowerment, while the World Bank issued NZ$1 billion of New Zealand dollar denominated bonds in April 2021.

International funding organisations are increasingly viewing New Zealand as a favourable jurisdiction for raising sustainable debt.

Outlook and trends

In looking ahead to 2022, we expect to see a strong focus on regulation of sustainable finance activities, as already seen in offshore markets. The Financial Markets Authority has signalled its intent to help investors have confidence in the integrated product being offered by the sustainable finance market through regulation and education[70]. The regulator's focus will be to target false, misleading, deceptive or confusing behaviour and activities by financial market participants. There is hope that this will drive an education piece both for the consumers and businesses looking to access 'green' or sustainable finance as well as the financial providers who will need to be fully aware of the broad implications around ESG. Moving away from lip service to thorough, informed details of sustainable finance products will be a competitive advantage.

FOOTNOTE 70

The regulator's focus will be to target false, misleading, deceptive or confusing behaviour and activities by financial market participants.

We have already seen that New Zealand banks are evolving to better understand and disclose climate-related risks. Lending requirements typically now include seeking ESG-related information from prospective borrowings. Some banks are now publicly reporting against each of the four major categories of the Task Force on Climate-related Financial Disclosures (TCFD) framework, in advance of the Financial Sector (Climate-related Disclosures and Other Matters) Amendment Act coming into play. Once the External Reporting Board (XRB)'s climate standards are published, around 200 large financial institutions will be required to publish climate-related disclosures.

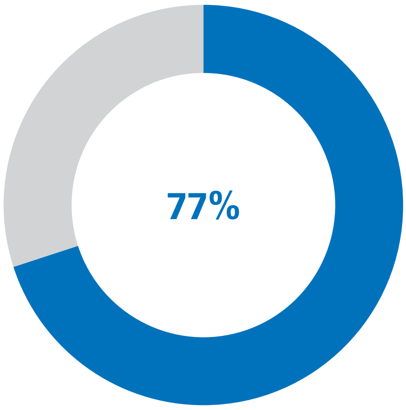
Once the External Reporting Board (XRB)'s climate standards are published, around 200 large financial institutions will be required to publish climate-related disclosures.

Similar requirements are starting to take hold across other countries and jurisdictions too, so it is no surprise that ESG-related matters featured prominently in KPMG's 2021 Global Banking CEO Outlook, which includes the views of over 1,300 CEOs in 11 countries. Bank CEOs are focusing on employee well-being and are looking to devote significant capital to becoming more sustainable, with 37% planning to invest more than 10% of their revenues in their efforts.

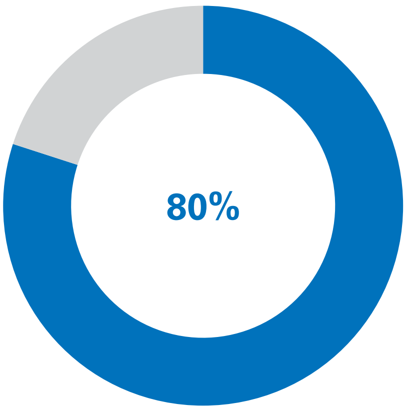
While the focus has been predominantly on environmental factors, the social component has become increasingly important, with some banks reviewing global human rights and modern slavery policies across their operations, supply chains and lending practices.

Many bank CEOs surveyed also saw an opportunity to capitalise on sustainability gains arising from the global Covid-19 pandemic.

Focus on ESG during the pandemic



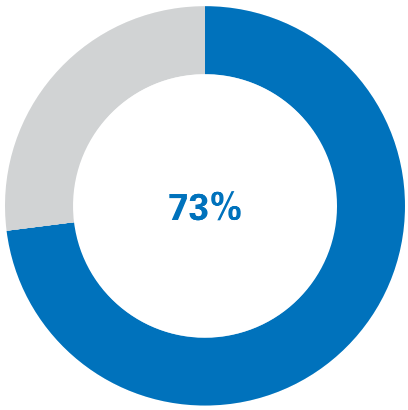
Bank CEOs want to lock in the sustainability and climate change gains that they have made as a result of the pandemic.



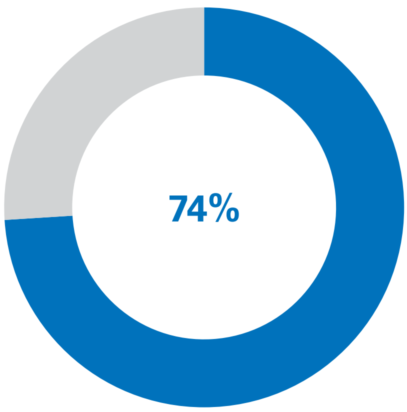
Bank CEOs are confident that the response to the pandemic has caused their focus to shift towards the social component of their ESG programme.

More than half (58%) of bank CEOs surveyed saw significant demand from stakeholders to provide reporting and transparency on ESG issues compared with 2020. However, they also highlighted challenges in communicating their efforts to stakeholders, with 44% saying that they struggle to articulate their ESG story.

With respect to pay structure, only 19% of bank CEOs expressed interest in having pay based on performance against ESG goals, in addition to traditional financial-performance goals; however, most felt that they will be held personal responsible for their bank's performance in addressing social issues.



of CEOs said they will be increasingly held personally responsible for driving progress in addressing social issues.



of CEOs believe they have responses to help fight global challenges.

From their own disclosures, to transparency around their products and services, banks and other financial providers are increasingly acknowledging ESG and sustainability as a critical strategic pillar. They have a vital role to play in supporting a sustainable, resilient and inclusive New Zealand economy, holding a unique position of influence within the financial markets. Our Sustainable Finance team is passionate about supporting this relationship between finance and positive impact, connecting capital to what matters and contributing to the evolution of the sustainable finance market.

Banks and other financial providers are increasingly acknowledging ESG and sustainability as a critical strategic pillar.

NZBA: Riding the Covid rollercoaster

Roger Beaumont
Chief Executive
New Zealand Bankers' Association

NEW ZEALAND BANKERS ASSOCIATION

ROGER'S BIO

Two years since Covid-19 hit New Zealand it's still dominating the headlines. In 2021 the global pandemic continued to have an extraordinary impact on households and businesses. Plans to re-open our borders have been a moveable feast and the emotional rollercoaster ride continues for many.

2021 was tougher than 2020 for some, especially for those in areas that experienced an extended lockdown. At the same time, the vaccination rollout provided greater protection and we had a better idea of what we were dealing with.

Same, same but different

What did this mean for banking in New Zealand? We learnt a great deal very quickly in 2020, when Covid-19 first hit. We learnt to work remotely and deliver relief for customers financially impacted by the pandemic. With help from the Government, the Reserve Bank of New Zealand (RBNZ) and credit reporting agencies, banks deferred or reduced repayments on around $70 billion in household and business loans.

The good news in 2021 was that we didn't need to reintroduce the mortgage deferral scheme. While some sectors continue to be affected by the pandemic, many households and businesses are doing well, which is reflected in the economy's solid performance and historically low unemployment. As was the case before Covid-19, banks continued to assist customers facing financial hardship.

While the Government adapted its Covid-19 response from lockdowns and Alert Levels to the new 'traffic light' protection framework, banks and their customers also continued to evolve in the new reality. From September 2020 to September 2021, over-the-counter transactions in branches decreased on average by 49% across the five major banks. The decrease was 86% in Auckland due to the lockdown, which saw banks opening fewer branches with reduced hours. This shows that Covid-19 has dramatically influenced changes in the way customers do their banking. While a significant majority of customers already preferred to bank anytime online or on their smart phone banking app, the pandemic has encouraged others to go digital out of necessity.

From September 2020 to September 2021, over the counter transactions in branches decreased on average by 49% across the five major banks.

Customers in vulnerable circumstances

Banks recognise that not all customers have the capacity or resources to access general banking services in the same way others can. That may be because those customers are experiencing vulnerability. The Financial Markets Authority has identified four key drivers of vulnerability:

- **health and physical factors** – health conditions or illnesses that affect the ability to carry out day-to-day tasks;
- **life events** – major life events such as bereavement or relationship breakdown;
- **resilience** – low ability to withstand financial or emotional shocks; and

- **capability** – low knowledge of financial matters or low confidence in managing money.

We see vulnerability as being based on circumstances rather than types of people. Vulnerability may also be short-term or longer term.

At NZBA we've been working with our members to develop a set of principles to help banks design and implement policies and processes to meet the needs of customers in vulnerable circumstances. Banks can't agree on how they will collectively deliver services to customers experiencing vulnerability because they work in a commercial and competitive environment. The principles will provide them with a framework to help focus their response to those customers. Ultimately, each bank needs to develop and implement its own way of meeting these customers' needs.

Regional banking hubs trial

In addition to responding to vulnerability issues, we have also been trialling practical solutions to banking in regional centres where branches are no longer sustainable due to lack of customer demand.

To date we have trialled regional banking hubs in Twizel, Stoke, Martinborough and Opunake. Each banking hub has a Smart ATM that allows for coin and note deposits, along with the usual ATM functions. There's also a tablet for online banking and a phone with dedicated lines to the six participating banks' contact centres. There are also staff available to help people access these services.

To date we have trialled regional banking hubs in Twizel, Stoke, Martinborough and Opunake.

We are currently considering the performance of the banking hubs so far. That includes assessing customer and community feedback as well as usage metrics. We'd like to know how well the hubs have been received in the communities they serve, and whether locals find them useful. We'd also like to know if they can be improved to meet community needs and expectations.

The banking hubs' trial is an example of industry innovation within a competitive environment. We hope to build on the work we've done to date.

FinCap partnership

We also have a partnership agreement with FinCap that helps people in small towns access banking services. We are in our second year of funding FinCap $5 million over five years. The funding is provided by our member banks.

We also have a partnership agreement with FinCap that helps people in small towns access banking services.

As part of a suite of projects funded through the partnership, six budgeting services are currently providing banking support to people in small towns where there are no longer branches.

Each service is tailored to, and has been created in consultation with, the relevant community. They mostly involve a computer, a private space, and a financial mentor to help clients build financial capability and digital confidence. Some budgeting services also drive clients to a nearby branch.

FinCap expects to fund more services like this in the coming year through the partnership.

Tightened lending

Looking to the year ahead, there is already a high-profile issue that is likely to attract further public attention.

Changes to the Credit Contracts and Consumer Finance Act 2003, which came into force late last year, have created a stir. All lenders, including banks, need to collect more information from customers seeking credit and then check the information is correct. This means it takes longer to get a loan, and more applications may be declined because the deeper dive into your finances might show that you're less able to repay the loan.

Changes to the Credit Contracts and Consumer Finance Act 2003, which came into force late last year, have created a stir.

We agree with the aim of the law change to help vulnerable consumers avoid unaffordable debt. It's also affecting people seeking loans from banks, where there are traditionally very low rates of borrowers being unable to make repayments. That's still the case, but the law change has tightened banks' ability to lend.

Banks are responsible lenders and take their obligations under the law very seriously. The new rules are prescriptive and there's less flexibility or room for lender discretion than was previously the case.

There's currently an investigation into the unintended consequences of the law change. We look forward to working collaboratively with the Government to find solutions to these issues.

All this is happening in the context of an ever-changing global pandemic which will make for another interesting year in banking.

CoreLogic: Was 2021 a peak for mortgages lasting several years?

Kelvin Davidson
Senior Property Economist
CoreLogic

KELVIN'S BIO

With the economy holding up relatively well in the face of Covid-19-related disruptions last year – especially the unemployment rate hitting multi-year lows and the construction sector going from strength to strength – there was plenty of optimism and momentum in the property market and the mortgage lending sector. But there are reasons to think that 2021 could prove to be a high-water mark that won't be seen again for a few years yet.

Taken across 2021 as a whole, the value of new mortgages written by banks was around the $100 billion mark, significantly above the next busiest year in recent history – which was $76 billion in 2020. Clearly a buoyant property market in terms of sales volumes boosted that total in 2021, but there also appears to have a been a fair degree of 'other' lending occurring too, including bank switches and top-up loans (given ever-rising equity from the value upswing).

The value of new mortgages written by banks was around the $100 billion mark.

Not surprisingly, the share of lending going to investors was more sluggish last year, as the 40% deposit requirement and changed tax rules reduced the appeal of the property market.

Owner-occupier lending held on much better, while interest-only flows were fairly steady too (even though investors were less active; or in other words, owner occupiers also took interest-only facilities).

However, a key change for owner occupiers towards the end of last year was of course the reduction in the low deposit lending speed limit from 20% to 10% – and in practice, the banks may actually choose to only lend about 5% of the total to owner occupiers with less than a 20% deposit, or perhaps even close to zero. First-home buyers were the dominant users of the low deposit allowance in 2021, so they stand to now be hardest hit by the tightening.

Another interesting aspect of the mortgage market last year was the changing mix of loan terms, with the rising interest rate environment prompting borrowers to start fixing for longer periods of time. In the early stages of last year, only about 5% of existing mortgages needed to be refinanced within a two-year horizon. But by the end of the year, that had jumped to about 15%. On the flipside, the share of mortgages due to roll over within a 12-month horizon fell from a peak of 65% earlier in 2021 to less than 55% now. At the same time, the share of debt on a floating rate remains at historical lows of only about 11%.

Meanwhile, with unemployment still low, mortgage repayment problems are almost non-existent. For example, the share of mortgages that are either 90 days' overdue or fully impaired as a share of the total is only 0.2% at present. And given the willingness of both the banks and borrower to avoid 'forced sales', mortgagee transactions are at rock-bottom too.

However, there are forces building which suggest that 2021 could be prove to be a cyclical high point for mortgage lenders, or in other words a peak that might not be seen again for a while.

For a start, we all know that mortgage rates have risen sharply and with inflation high, the Reserve Bank of New Zealand's (RBNZ's) Official Cash Rate also has significantly further to rise yet. Granted, further mortgage rate increases in 2022 could be either slower or smaller than in 2021, but they'll still rise.

2021 could be prove to be a cyclical high point for mortgage lenders.

And not only is credit getting more expensive, but there's less available too, in light of the loan-to-value ratio (LVR) tightening, but also the widely publicised changes to the Credit Contracts and Consumer Finance Act 2003, and potentially even formal caps on debt-to-income (DTI) ratios from the RBNZ later in 2022 (unless of course we're right and that market will have slowed significantly by then, in which case the RBNZ may hold fire on the introduction of DTI ratios).

Given that housing affordability is also significantly stretched, we think these factors will combine to see the number of property sales ease down over the next two years, to end 2023 about 10% lower than the 2021 total. That will directly lower the amount of mortgage through-put at the banks, while a generally softer housing market in terms of value growth may also make borrowers more reluctant and/or less able to get top-ups.

In terms of possible fertile areas that might be targeted, we wonder about 'movers', or existing owner occupiers who are looking to relocate. Sure, the rise in property values has made it more difficult for some households to 'trade up', if the ideal next property has risen faster than their own. But in a market where buyers are a little less urgent and the supply of available listings has risen, there may be a growing number of 'movers' looking to trade this year and secure finance to do so.

Massey University: Banking industry review and forecasts

Dr Christoph Schumacher
Professor of Innovation and Economics
Massey University

MASSEY UNIVERSITY
TE KUNENGA KI PŪREHUROA
UNIVERSITY OF NEW ZEALAND

CHRISTOPH'S BIO

"I don't know where I'm going from here, but I promise it won't be boring."

David Bowie

Two thousand and twenty-one was a bit of a rollercoaster ride for the New Zealand economy with a slow first-quarter GDP growth rate (1.5%) followed by a stronger second quarter (2.4%) and a steep drop in the third (-3.7%) due to a prolonged Auckland lockdown. But the news isn't all bad. Expectations are that we will see a positive quarterly growth rate in Q4, 2021 and overall, the New Zealand economy recovered strongly, supported by significant policy stimulus.

The banking sector had a fantastic 2021 with its highest-ever quarterly net profit before tax of $2.4 billion in Q1, 2021. Profits dropped slightly in Q2 and Q3, but overall, annualised profits (Q4, 2020 to Q3, 2021) reached an all-time high of $8.83 billion, up 55% on last year's values.

Before looking ahead to what we expect to happen in 2022, let's look at the 2021 values of the banking industry's key performance measures: lending volume, net interest margins (NIM, the difference between interest income and interest expense, expressed as a percentage of lending), and the credit loss rate (CLR, provision for credit impairment, expressed as a percentage of lending).

Quarterly lending increased steadily from Q4, 2020 to Q3, 2021 from $591 billion to $609 billion, driving the high-profit results. NIMs increased slightly and averaged around 2% for the year. The credit loss rate decreased even further from an already low 0.23% (Q4, 2020) to 0% (Q3, 2021). This suggests two things: firstly, banks continue to be very conservative with their lending; and secondly, the Government's Covid-19 pay-outs seem to be working.

The economic recovery in the first half of 2021 was remarkable, but the Delta outbreak threw a spanner in the works. It looks like the economy is now back on track, and with the promise of borders gradually opening again, we might be on a path back to a new normal (unless of course Omicron requires another lockdown). Key economic indicators are a mixed bag. Unemployment is at a record low (3.2% in Q4, 2021), but the Consumer Price Index (CPI) inflation is reaching a 20-year high (5.9% in Q4, 2021); retail and construction have experienced record growth, but without international visitors, the tourist and hospitality sectors are struggling; business confidence dipped further in December to -23.2, but consumer confidence edged marginally higher after its declines in the middle of 2021.

The falling levels of business confidence are easy to understand with business owners struggling with labour shortages, supply chain blockages, rising non-wage cost pressures and freight disruptions. On the positive side, without overseas holidays, New Zealanders have been spending big domestically. Due to some supply constraints, companies have also been able to move harder-to-sell top-of-the-line items. The hospitality sector, however, is recovering slower than expected as restaurants struggle to survive under the red traffic light setting. With the current Omicron threat, people are more cautious about eating out or spending time in cafés, negatively impacting business confidence. But what is fuelling the lacklustre consumer confidence? Although workers are in a position to negotiate higher wages due to record high labour market participation rates, real wages have fallen due to high inflation. There are also concerns that prices might rise further. Substantial Government Covid-19-related spending of over $62 billion (around 18% of our annual nominal GDP) has created inflationary pressure, which is intensified by rising wages and international and domestic supply chain constraints. In addition, house prices are still at record highs, and the Reserve Bank of New Zealand's (RBNZ's) Official Cash Rate (OCR) has increased from 0.25% in August to 0.75% in November, and again to 1.00% in February, with more increases on the cards.

Let's look at the road ahead now. GDP growth is expected to be slow in the first two quarters of 2022, but with no further lockdowns, we could see an annual growth rate of around 4%. Unemployment is expected to fall even further to a low of 3% by the end of 2022, while CPI inflation is projected to continue its rise. Capacity constraints and increased transport costs will remain, putting additional pressure on our inflation rate. The response of the RBNZ is likely to be a further tightening of monetary policy with an increase of the OCR to around 2%. Given New Zealand's clear interest rate advantage, projections are that the NZ dollar remains strong during 2022 at around NZD/USD 0.7.

Overall, conditions during 2022 will be similar to what we saw in 2021. While this is good for most industry sectors (unlike tourism which will continue to struggle due to the continued lack of international travellers), the household sector is in a difficult situation: Prices and interest rates are going up while real income is going down, which could lead to a significant increase in household debt.

Another area to watch is net migration values, which generally drive GDP growth. We currently don't know if or how the Government will determine migration numbers or how many Kiwis will want to leave once the borders are open again. We also know that the housing market has relaxed a bit in recent months, and expectations are that the cool-down will continue, but all this could change quickly if net migration numbers increase suddenly.

For the banking industry forecast (Q4, 2021 to Q4, 2022), I use a combination of macroeconomic variables and time-series analysis. The model uses a collection of past values of our drivers, that is, a vector of time series, to predict future values. Specifically, I employ a vector autoregressive model (VAR) as it enables me to investigate how the interaction between the variables changes the forecast. Macroeconomic indicators are not explicitly used in the VAR model as the impact of these indicators is already factored into past values of the performance drivers. The results of my analysis are displayed in Table 8.

TABLE 8: FORECASTING RESULTS VAR

VAR industry driver		2020 Q1	2020 Q2	2020 Q3	2020 Q4	2021 Q1	2021 Q2	2021 Q3	2021 Q4	2022 Q1	2022 Q2	2022 Q3	2022 Q4
		Actual	Actual	Actual	Forecast	Forecast	Forecast	Forecast	Forecast	Forecast	Forecast	Forecast	Forecast
Lending ($Billion)	Upper CI								629	640	651	662	673
	Forecast	580	580	577	591	591	603	609	604	605	611	616	624
	Lower CI								579	584	590	595	600
Net Interest Margin (%)	Upper CI								2.09%	2.10%	2.10%	2.10%	2.09%
	Forecast	1.98%	1.82%	1.85%	1.94%	2.03%	2.04%	1.97%	1.97%	1.98%	1.97%	1.95%	1.93%
	Lower CI								1.86%	1.86%	1.85%	1.84%	1.83%
Credit Loss Rate (%)	Upper CI								0.09%	0.09%	0.09%	0.09%	0.09%
	Forecast	0.18%	0.25%	0.27%	0.23%	0.08%	0.00%	0.00%	0.06%	0.05%	0.05%	0.05%	0.04%
	Lower CI								0.03%	0.01%	0.00%	0.00%	0.00%
Profit Before Tax ($Billion)*	Upper CI								2.20	2.25	2.30	2.34	2.37
	Forecast	1.31	1.13	1.56	2.01	2.40	2.15	2.27	1.97	2.00	2.04	2.06	2.09
	Lower CI								1.74	1.75	1.77	1.78	1.80

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

If you are a FIPS follower, you would have noticed that this year's forecast is only for one year rather than the usual two years. Given the ongoing uncertainty surrounding the current environment, forecasting over a longer-term period leads to a high degree of unpredictability as the models are highly susceptible to shocks caused by the likes of another lockdown. To increase confidence in the forecasts, I use an autoregressive integrated moving average (ARIMA) and machine-learning model in addition to the VAR model. This year, the models started to diverge after 12 months, so I restricted the current forecast to one year.

VIEW FIGURE 32

Lending

The quarterly lending volume increased from $591 billion in Q1, 2021 to $609 billion in Q3, 2021. We expect a slight drop in Q4, 2021 followed by a below-average growth throughout 2022 to a quarterly balance of around $624 billion. As mentioned, the great unknown is net migration and the opening of our borders, which impacts lending.

VIEW FIGURE 33

NIM

Interest margins dropped slightly during 2021 from 2.03% in Q1, 2021 to 1.97% in Q3, 2021 due to increased interest expense. We expect this trend to continue with the start of the RBNZ's strict new capital rules in July 2022. We don't anticipate that the new capital adequacy framework will substantially increase the banking sector's interest expense and foresee interest margins of around 1.9%.

VIEW FIGURE 34

Credit loss rate

CLR increased after the lockdown from 0.07% (Q3, 2019) to 0.27% (Q3, 2020) as businesses and households struggled to meet repayments. The RBNZ also decided in Q2, 2021 to suspend loan-to-value ratio (LVR) restrictions for 12 months. Overall loan defaults seem to be lower than anticipated and I expect CLR to fall again during 2022.

VIEW FIGURE 35

Profit

Banking profits reached record highs during 2021, but we don't expect this trend to continue. The low consumer confidence might slow down lending, and the combination of increasing interest expenses and loan defaults could reduce profits. However, the banking sector's profit expectations are still very healthy, with an anticipated annual value of around $8.19 billion (down 7%). Specifically, we foresee a drop of quarterly profits in Q4, 2021 to approximately $1.97 billion followed by a gradual increase throughout 2022 to $2.09 billion in Q4, 2022.

VIEW FIGURE 36

The current uncertainty about new variations of Covid-19, lockdowns, Government actions and global conditions make forecasting difficult. The values presented in this article take a 'most likely scenario' approach, assuming that New Zealand, and the world, is learning to live and cope with Covid-19.

To conclude, New Zealand's economic recovery was remarkable until Delta reached our shores and slowed progress. We are back on track with optimistic forecasts for Q1, 2022, but now the Omicron wave has started.

TABLE 9: LIST OF MACRO-ECONOMIC INDICATORS

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

So far, there is no indication that the Government will lock down the economy again, so we hope that the recovery will continue. For some industries such as tourism, education, and hospitality, 2022 will still be difficult, and the threat of rising inflation and supply shortages might also slow down the growth of other sectors. The banking sector will remain healthy and strong even if profits drop slightly. We haven't reached normality yet, but we are heading in the right direction.

Ownership and credit ratings

As at 31 January 2022

			Long-term credit rating					
Registered banks	**Ultimate shareholding**	**%**	**Standard & Poor's**		**Fitch Ratings**		**Moody's**	
ANZ Bank New Zealand Limited	Australia and New Zealand Banking Group Limited	100	AA-	Stable	A+	Stable	A1	Stable
ASB Bank Limited	Commonwealth Bank of Australia	100	AA-	Stable	A+	Stable	A1	Stable
Australia and New Zealand Banking Group Limited – New Zealand Banking Group[71]	Australia and New Zealand Banking Group Limited	100	AA-	Stable	A+	Stable	Aa3	Stable
Bank of Baroda (New Zealand) Limited[72]	Bank of Baroda (India)	100	-	-	BBB-	Negative	Ba1	Stable
Bank of China (New Zealand) Limited	Bank of China Limited (China)	100	A	Stable	-	-	A1	Stable
Bank of China New Zealand Banking Group[73]	Bank of China Limited (China)	100	A	Stable	A	Stable	A1	Stable
Bank of India (New Zealand) Limited[74]	Bank of India (India)	100	BB+	Stable	BBB-	Negative	-	-
Bank of New Zealand	National Australia Bank Limited	100	AA-	Stable	A+	Stable	A1	Stable
China Construction Bank (New Zealand) Limited	China Construction Bank Corporation	100	-	-	A	Stable	A1	Stable
China Construction Bank Corporation New Zealand Banking Group[75]	China Construction Bank Corporation	100	A	Stable	A	Stable	A1	Stable
Citibank, N.A. New Zealand Branch[76]	Citigroup Inc.	100	A+	Stable	A+	Stable	Aa3	Stable
Commonwealth Bank of Australia New Zealand Operations[77]	Commonwealth Bank of Australia	100	AA-	Stable	A+	Stable	Aa3	Stable
Coöperatieve Rabobank U.A. New Zealand Banking Group[78]	Coöperatieve Rabobank U.A.	100	A+	Stable	A+	Stable	Aa2	Stable
Heartland Bank Limited	Various investment/nominee companies; various private shareholders	100	-	-	BBB	Stable	-	-
Industrial and Commercial Bank of China New Zealand Banking Group[79]	Industrial and Commercial Bank of China Limited (China)	100	A	Stable	A	Stable	A1	Stable
Industrial and Commercial Bank of China (New Zealand) Limited[80]	Industrial and Commercial Bank of China Limited (China)	100	A	Stable	A	Stable	A1	Stable
JPMorgan Chase Bank, N.A., New Zealand Banking Group[81]	JPMorgan Chase & Co.	100	A+	Stable	AA-	Stable	Aa1	Positive
Kiwibank Limited	Various[82]		-	-	AA-	Positive	A1	Stable
Kookmin Bank Auckland Branch[83]	KB Financial Group Inc.	100	A+	Stable	A	Stable	Aa3	Stable
MUFG Bank, Ltd. Auckland Branch[84]	Mitsubishi UFJ Financial Group, Inc.	100	A	Stable	A-	Stable	A1	Stable
Rabobank New Zealand Limited	Coöperatieve Rabobank U.A.	100	A	Stable	-	-	Aa2	Stable
Southland Building Society	Mutual	100	-	-	BBB	Positive	-	-
The Co-operative Bank Limited	Mutual	100	-	-	BBB	Positive	-	-
The Hongkong and Shanghai Banking Corporation Limited, New Zealand Banking Group[85]	HSBC Holdings plc	100	AA-	Stable	AA-	Negative	Aa3	Stable
TSB Bank Limited	TSB Community Trust	100	-	-	A-	Stable	-	-
Westpac Banking Corporation – New Zealand Banking Group[86]	Westpac Banking Corporation	100	AA-	Stable	A+	Stable	Aa3	Stable
Westpac New Zealand Limited	Westpac Banking Corporation	100	AA-	Stable	A+	Stable	A1	Stable

FOOTNOTES 71–86

Descriptions of the credit rating grades

Long-term credit rating grades assigned by Standard & Poor's (S&P's)	Description of the steps in the S&P's credit rating grades for the rating of the long-term senior unsecured obligations payable in New Zealand, in New Zealand dollars.
AAA	Extremely strong capacity to meet financial commitments. Highest rating.
AA	Very strong capacity to meet financial commitments.
A	Strong capacity to meet financial commitments, but somewhat susceptible to adverse economic conditions and changes in circumstances and economic conditions.
BBB	Adequate capacity to meet financial commitments, but more subject to adverse economic conditions.
BB	Less vulnerable in the near-term, but faces major ongoing uncertainties to adverse business, financial and economic conditions to meet its financial commitments.
B	More vulnerable to adverse business, financial and economic conditions, but currently has the capacity to meet financial commitments.
CCC	Currently vulnerable and dependent on favourable business, financial and economic conditions to meet financial commitments.
CC	Currently highly vulnerable. Default has not yet occurred but is expected to be a virtual certainty.
Plus (+) or Minus (-)	The ratings AA to CCC may be modified by the addition of a plus (+) or minus (-) sign to show relative standing within the major rating categories.
BB, B, CCC, and CC	Borrowers rated BB, B, CCC and CC are regarded as having significant speculative characteristics. BB indicates the least degree of speculation and CC the highest. While such borrowers will likely have some quality and protective characteristics, these may be outweighed by large uncertainties or major exposures to adverse conditions.
Assigned by Fitch Ratings	Fitch Ratings applies 'investment grade' rates 'AAA' to 'BBB' to indicate relatively low to moderate credit risk, while for those in the 'speculative' or 'non-investment grade' categories which have either signalled a higher level of credit risk or that a default has already occurred, Fitch Ratings applies a 'BB' to 'D' rating. The modifiers '+' or '-' may be appended to a rating to denote relative status within the major rating categories. Credit ratings express risk in relative rank order, which is to say they are ordinal measures of credit risk and not predictive of a specific frequency of default or loss.
Assigned by Moody's Investors Service	Moody's Investors Service appends numerical modifiers 1, 2 and 3 in each generic rating classification from Aa through Caa. The modifier 1 indicates that the obligation ranks in the higher end of its generic category, the modifier 2 indicates a mid-range ranking and the modifier 3 indicates the lower end of that generic category.

Definitions

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

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