FIPS

Financial Institutions Performance Survey

March 2022 Quarterly Results

Overview

Information current as at 20 June 2022

Covid-19 has taken a back seat in the media headlines, with rising inflation, interest rates and cost of living taking the spotlight. As a result of these factors, along with a tighter credit environment, the country's housing market has continued to slow down after significant increases over the past years.

Meanwhile, the banking sector has posted yet another record quarterly profit of $1.74 billion for March 2022, driven by increases to net interest income and tightly managed expenses. The sector has also ceased the releasing of loan provisions, with an impairment expense being posted for the first time since September 2020.

Inflation and interest rates increase

The Consumer Price Index (CPI) experienced its largest annual increase since 1990, as annual inflation hit 6.9% for the year to 31 March 2022[1]. The year-on-year surge was predominantly driven by rising housing construction and rental costs, while a 32% increase in petrol prices was the largest influence on the 1.3% quarter-to-quarter rise[1,2].

> "The OCR is now expected to peak at 3.9% during 2023.

Other commentators also noted the inflationary impact arising from the Government's domestic spending decisions[3].

Globally, inflationary pressures resemble what we are experiencing domestically. The ongoing conflict in Eastern Europe continues to heighten economic instability as sanctions and trade restrictions have culminated in climbing energy and oil prices[4]. Stronger demand for goods has reinforced existing supply chain disruptions, with tightening labour markets in some economies enhancing the severity[4].

The Reserve Bank of New Zealand (RBNZ) remains confident of inflation rates returning to the 1-3% band within two years, with wage growth and strong export commodity prices helping to cushion the impacts of high inflation and rising interest rates[5]. Some retail banks pick CPI to remain above 5% for 2022, with a dip below 3% only arriving in 2024[3].

Interest rates rose as the RBNZ increased the Official Cash Rate (OCR) from 1.5% to 2.0% on 25 May 2022[6]. This was the second 50 basis point (bp) increase in succession. The monetary policy response was deemed necessary by the RBNZ due to the inability of New Zealand's productive capacity to match

rising inflationary pressures[7]. The RBNZ adjusted its forecast in its May monetary policy statement, with the OCR now expected to peak at 3.9% during 2023, rather than 3.5% as predicted in its February statement[7]. Banks are forecasting OCR increases of 50 bps at each of the July and August reviews, followed by 25 bp increases to take us to the peak[3].

> **Major New Zealand banks have forecasted significant housing market corrections.**

The RBNZ's 'least regrets' framework drove their decision to implement strong monetary policy tightening, noting the risk of tightening the policy 'too little, too late' versus 'too much, too soon'[8].

Cost of living crisis

In response to New Zealand's growing cost of living crisis, the Government announced measures in 'Budget 2022' to help alleviate the pressure on households. An $814 million package would provide $350 each to low and middle-income earners who earned less than $70,000 in the last tax year and did not receive the Winter Energy Payment. This equated to $27 a week for those eligible across a three-month period[9].

In addition, the Government extended the 25 cents per litre reduction in fuel excise duty, the cut to road user charges and half price public transport for a further two months in response to the ongoing global energy crisis. Finance Minister Grant Robertson noted that cutting the fuel tax was the quickest and most efficient way to provide relief to households. As at 1 June 2022, crude oil prices had pushed up the average price of 91 grade petrol by 10 cents on the previous high (achieved one week prior) and 90 cents higher than the same time in 2021[10].

> **The Government announced measures in 'Budget 2022' to help alleviate the pressure on households.**

Prime Minister Jacinda Ardern noted that these measures were on top of the significant lifts to main benefits, student allowances, family tax credits and the Winter Energy Payment.

The impact of the increasing cost of living on households is beginning to become evident with an 8.9% increase in arrears on Buy Now, Pay Later (BNPL) products in April 2022 along with a 12% increase in the number of borrowers struggling to make repayments across all types of loans[11].

Homeowners are also facing increasing mortgage interest payments as major banks continue to increase home loan interest rates in response to their increased cost of funding. Kiwibank, the first to respond to the increase in the OCR, lifted their two-year fixed mortgage rate to 5.19% per annum[12].

Commentators argue that the impact of rising mortgage rates has yet to be felt across the economy, as a large portion of borrowers are yet to refix their mortgages at the higher rates[12]. Latest RBNZ data reveals the average mortgage rate across the country's stock of fixed lending only amounted to 3.0% as at 31 March 2022. The RBNZ noted it typically took over 18 months for monetary policy decisions to take full effect within the economy. Furthermore, the RBNZ added that the stress testing of mortgage applicants at approximately 6% during the Covid-19 pandemic provided a buffer to ensure debt serviceability could continue despite the rising mortgage interest rates.

Finance Minister Grant Robertson acknowledged the challenging strain placed on household budgets through higher mortgage interest rates[13]. Some commentators have emphasised the impact of inflation on low-income households given wage inflation is currently less than half of the CPI. Others have called for a 'minimum wage floor' for a number of industries to ensure low-income households aren't being left behind[6].

Housing market correction

'Budget 2022' brought greater support for first-home buyers. The Government announced that house price caps would be omitted from the first-home-loan application process, first-home grant house price caps would be increased, and a Covid-19 industry support package to fund affordable housing would be set up. These changes are expected to provide enough

> It was lending to investors which fell the most during this period, down **46%.**

funding for approximately 7,000 extra first-home grants and make 2,500 more home loans available every year[14].

Major New Zealand banks have forecasted significant housing market corrections. ASB expects a 9% decrease in national house prices this year, while Westpac forecasts an inflation-adjusted drop of just over 20% for house prices to the end of 2023. House values have already experienced a 4.7% drop in the past four months, with the number of unsold homes hitting a three-year high[15]. See CoreLogic's article, *Early 2022 marked a turning point for property and lending activity*, on page 17.

Auckland's housing market has experienced a downturn in the form of auction cancellations due to the absence of registered bidders[16]. OneRoof reported just 23.4% of auctioned homes ending in a sale in the month of March 2022[16]. There are also concerns for those who purchased real estate during the market peak, and whether the property is now worth as much as when it was purchased. Economic commentators have pointed to the replacement of 'fear of missing out' with the 'fear of over-paying' as the primary culprit to the dwindling competition amongst home buyers.

Lending slows

Rising interest rates and a tighter credit market driven by the continued effects of the Credit Contracts and Consumer Finance Act (CCCFA) saw the level of new residential lending in the March 2022 quarter fall to the lowest it has been since the onset of the pandemic in the June 2020 quarter. The lower level of new residential lending has continued since the March 2022 quarter, with Centrix data showing a 27% decrease in demand for new mortgages in May 2022 compared to May 2021[17].

Total new mortgage lending by banks fell to $17,646 million in the March 2022 quarter, down from $24,686 million in the December 2021 quarter and $24,448 in the corresponding prior March quarter. The fall in lending was felt across all buyer types from March 2021 to March 2022, with a 25% decrease in first-home buyer lending and a 21% decrease in other owner-occupied lending. However, it was lending to investors which fell the most during this period, down 46% from $5,832 million to $3,147 million compared to the December 2021 quarter[18].

Despite the lower levels of new lending, gross loans and advances in the March 2022 quarter still increased by 1.25% on the previous quarter. This suggests either lower principal repayments made by borrowers as interest rates rise, fewer borrowers switching between lenders, or a combination of both[18].

Uncertainty within the housing market has also resulted in the banking sector being less willing to provide credit to borrowers with lower levels of equity, with lending to those with less than 20% equity falling from 9.2% in the December 2021 quarter to just 5.3% in the March 2022 quarter[18].

One reason for positivity amongst potential home buyers is confirmation of the changes the Government is making to the CCCFA. The changes remove some of the controversial aspects of the CCCFA which have gained media attention since being introduced on 1 December 2021. Lenders would no longer need to base borrowers' living expenses on a detailed assessment of their recent bank statements, and a 'reasonable surplus' would no longer be required if a lender applied adequate buffers and adjustments to income and outgoings. Commentators said that the tweaks to the CCCFA amounted to an admission that there were unintended consequences from the lending law reforms, and that it was disappointing it had taken so long for them to be corrected[19]. There remains

> One reason for positivity amongst potential home buyers is confirmation of the changes the Government is making to the CCCFA.

concern that they still aren't enough to provide the certainty to banks to lend as easily as would be ideal.

Business failures

The impact of increasing costs, along with a number of other factors, have started to take its toll on the construction industry with a reported 92 construction companies having entered liquidation in the past year alone. Commentators cited increased construction costs, the unavailability of building materials, the lack of experienced trade staff and rising interest rates as the key drivers for difficulties in the sector. Those who have entered liquidation noted cash flow issues caused by these factors as the tipping point[20].

Industry leaders explained that it was possible that the sector was experiencing a short spike in liquidations, but it was likely to be part of a broader trend towards the later part of another boom-bust cycle.

More recently, a total of 122 properties across four Auckland projects were with receivers of an Ormiston developer at Flat Bush after the business faced financial difficulties[21].

Quarterly analysis of results

The March 2022 quarter set yet another record for the banking sector with an 8.08% increase in net profit after tax (NPAT) to $1.74 billion. However, not all banks experienced such an increase with The Co-operative Bank posting a loss, the first one from amongst the larger banks since June 2020[18].

The overall strong result was driven by increases to net interest income and non-interest income, along with a continued reduction in operating expenses.

Net interest income rose by 2.11% from $2.93 billion in the December 2021 quarter to $2.99 billion in the March 2022 quarter. This was driven by a 1.25% increase in gross loans and advances to record levels along with an expansion of the net interest margin across the majority of banks to approximately 2.1%[18] (see Table 1 on page 6).

The decrease in operating expenses illustrates a continued focus on cost control from banks as they look to maintain profits despite the economic headwinds. The operating expenses/operating income ratio decreased to its lowest level in over five years, reflecting growth in operating income outpacing the increase in operating expenses over the longer term.

There was a 1.2% increase in total loan provisioning to $2.47 billion in the March 2022 quarter, consisting of a 1.9% increase in collective provisioning partially offset by a 3.3% increase to individual provisioning. This was the first increase in the total provisioning level since September 2020 after five consecutive quarters of the sector unwinding the provisions taken at the beginning of the pandemic[18]. Despite the increase in provisioning level, there has been an equal increase in total gross loans and advances, and therefore, the coverage ratio has remained flat.

Concluding remarks

In summary, the March 2022 quarter's results don't show the direct impact of the 'dark clouds' that were hovering and threatening from the horizon arriving on the scene late in this quarter.

The result seems immune at this stage to the combined impact of inflation, rising interest rates, supply chain issues, intended and unintended regulatory impacts on lending volumes, and a decrease in confidence. However, it is hard to believe these impacts will be short lived and will not result in a weakening of the banking sector results in the second and third quarters.

Over the remainder of the year, it will be interesting to see how the wider economy fares and whether the impact of rising interest rates and the rising cost of living leads to an increase in arrears. Coupled with a fall in business confidence and the falling housing market, this would likely result in two impacts – firstly it would require the banks to consider higher levels of provisioning once again and secondly we might see reduced discretionary spending as household budgets come under pressure from rising costs and their sense of wealth is battered by falling house prices.

> **"92 construction companies have entered liquidation in the past year alone.**

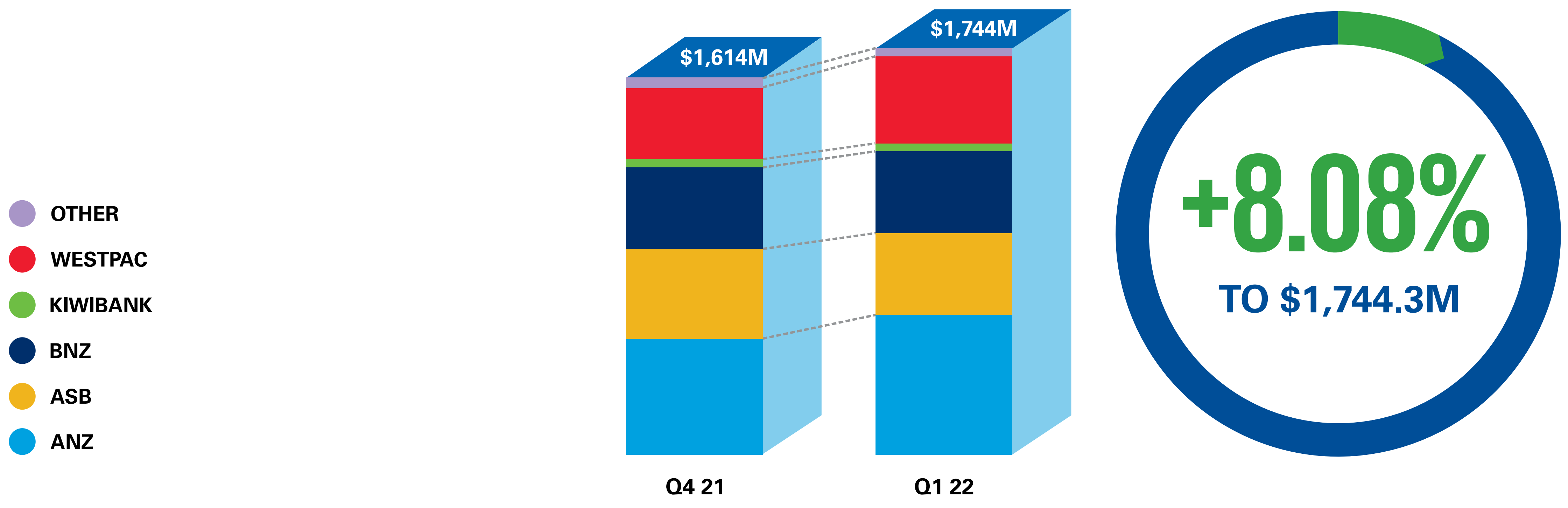
Once again this illustrates that while our economy came through the first two years of the pandemic comparatively well, the delayed impacts might be more pronounced. We haven't yet really seen the full impact of the combination of inflationary pressures, increased interest rates, supply chain and labour shortage issues. We are just starting to see the first signs of business failures. The one very large silver lining is that our banking sector is well capitalised, has been conservatively managed, and is well placed to deal with the challenges ahead.

Net profit after tax

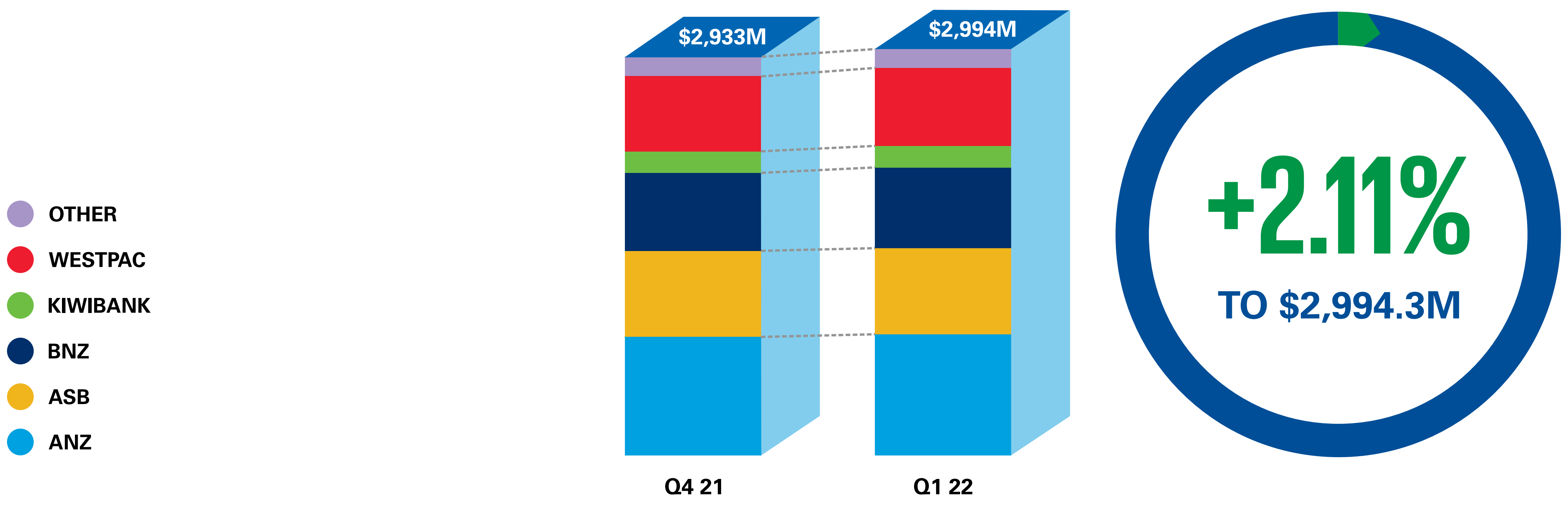
Q4 21–Q1 22 | Q1 21–Q1 22 | Q1 20–Q1 22 | Q1 17–Q1 22

HOVER over button to see the movement over time

Movement in net profit: Breakdown

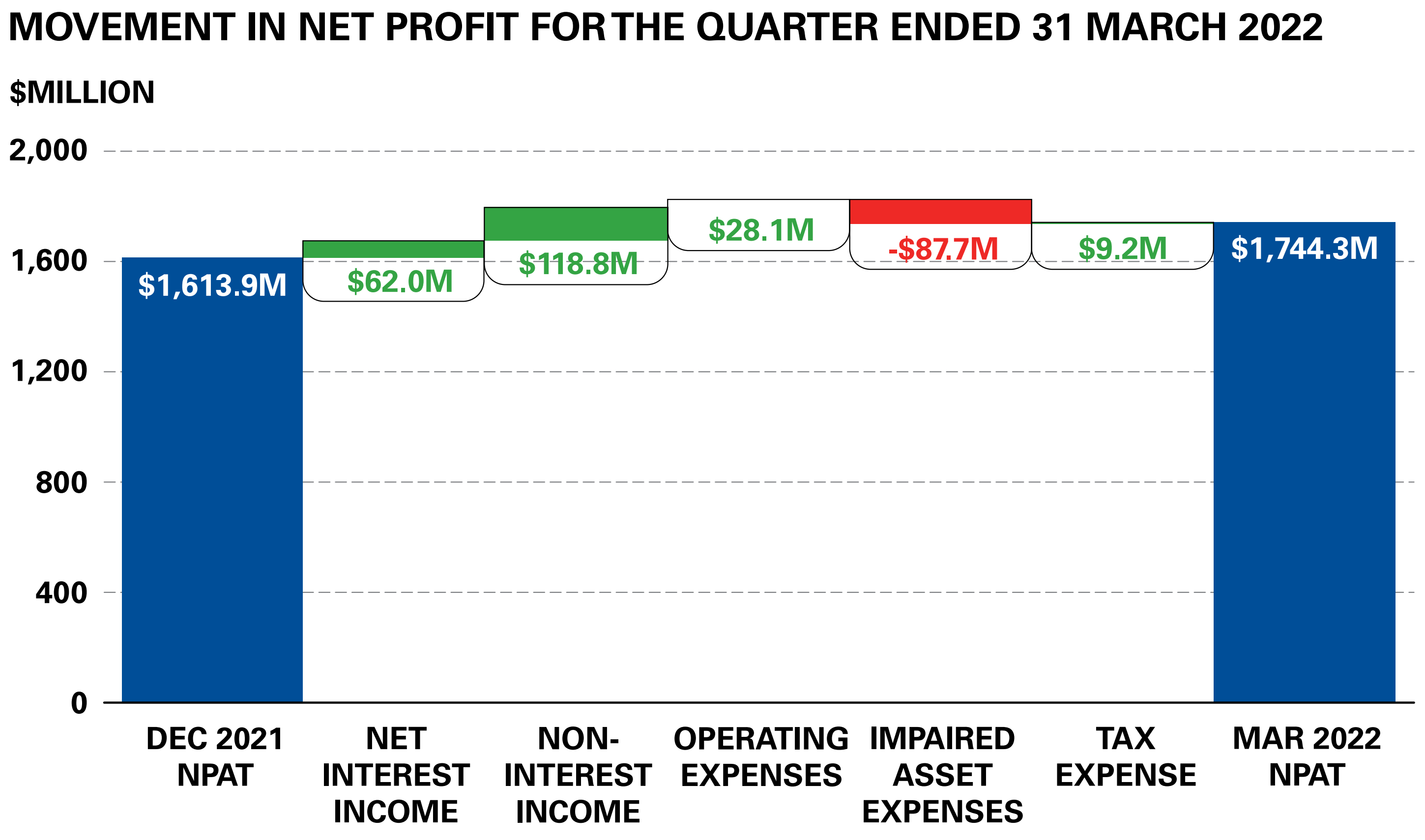


Net interest income

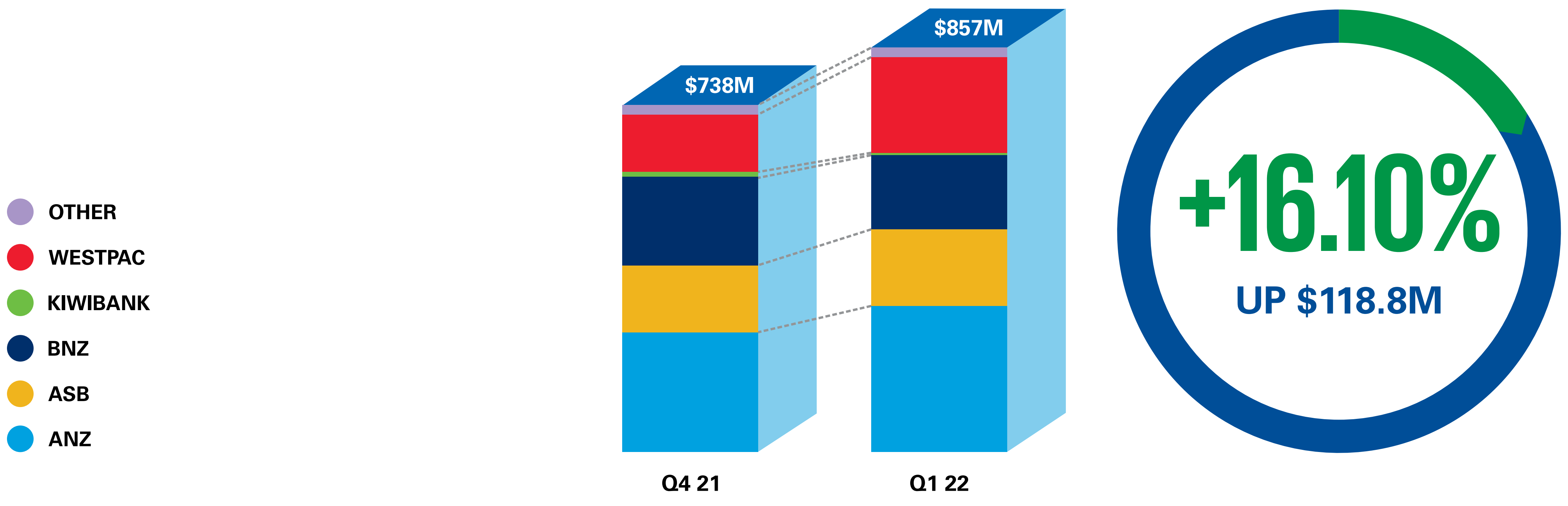


Hover over button to see historic quarterly results

Q1 22 | Q1 21
Q4 21 | Q4 20
Q3 21 | Q3 20
Q2 21 | Q2 20



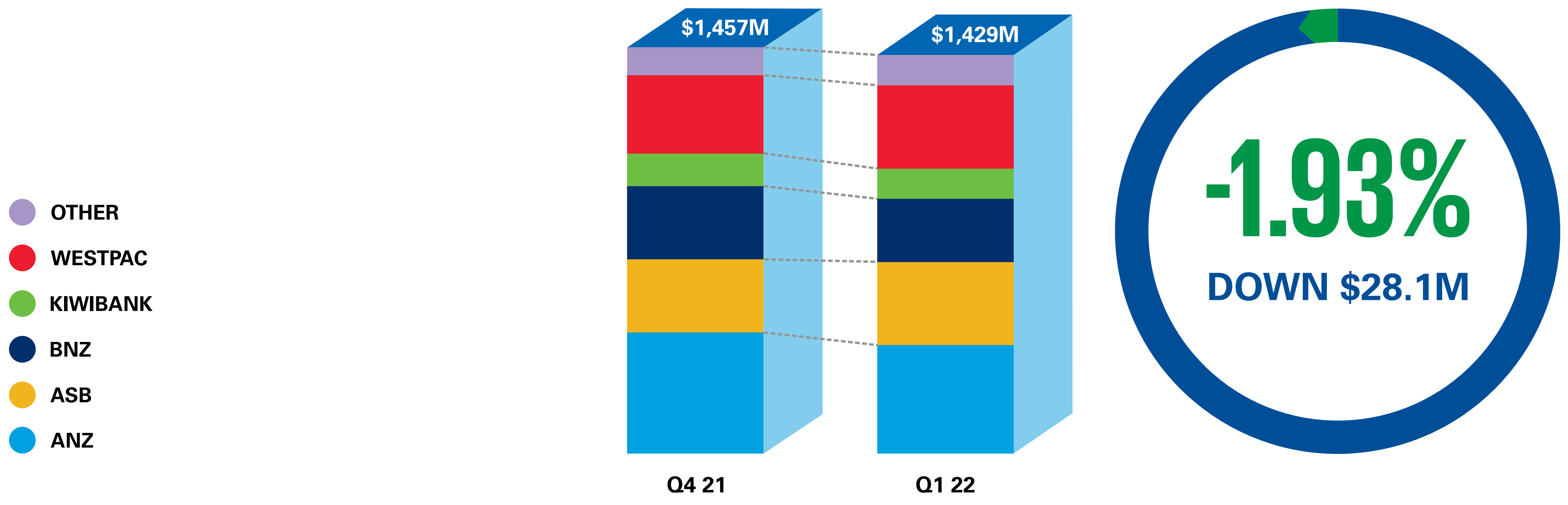
Non-interest income



KPMG

Net profit after tax

Operating expenses



Impaired asset expenses (writebacks)

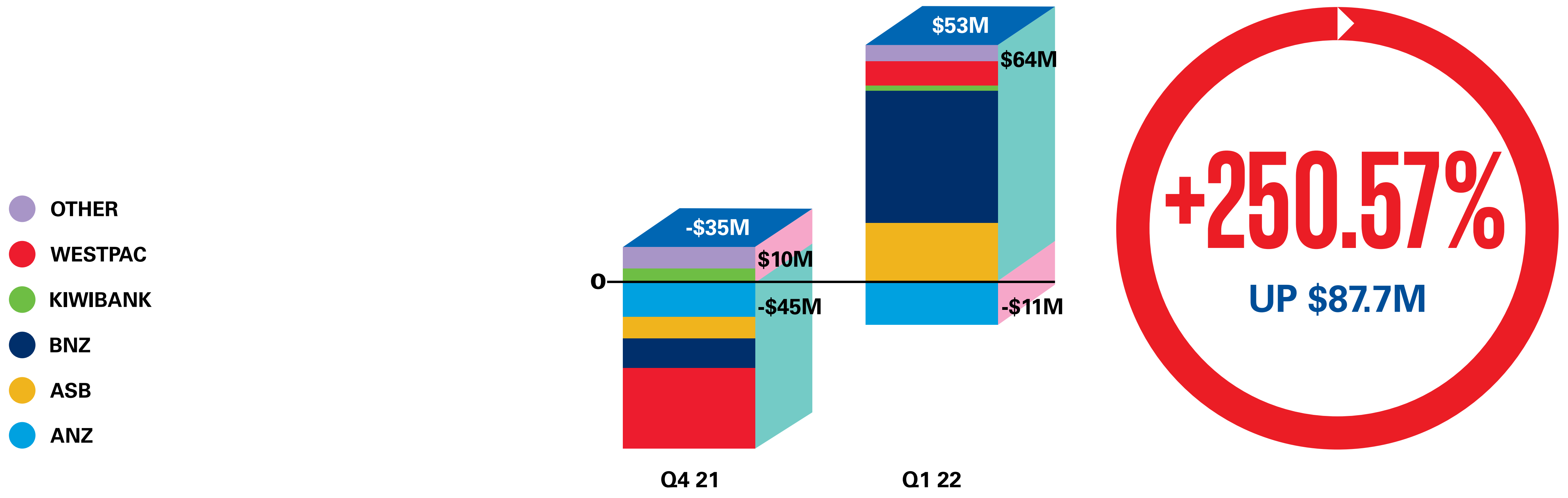


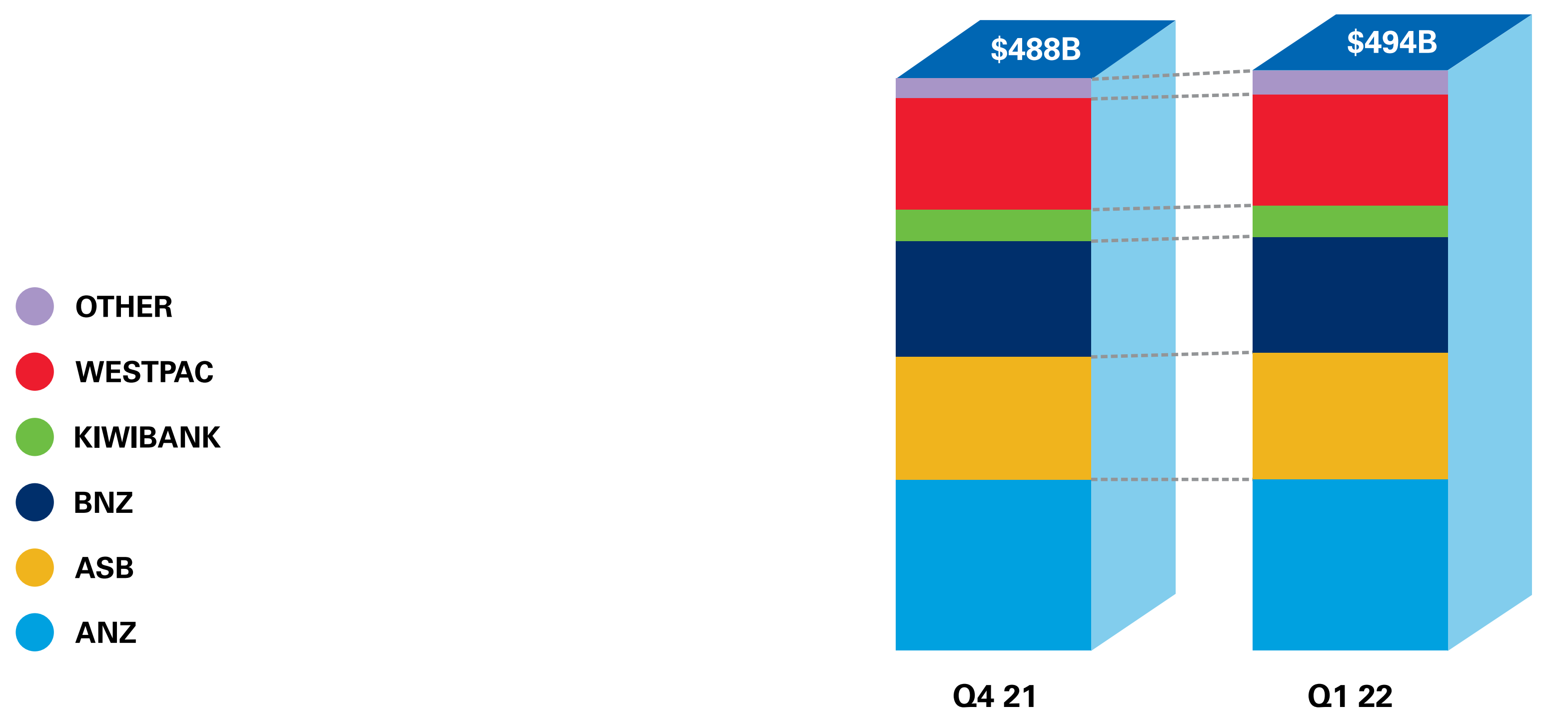
TABLE 1: Movement in interest margin			
Entity[22]	31 Dec 21 quarter ended (%)	Mvmt. during the quarter (bps)	Mvmt. for the 12 months (bps)
ANZ	2.1	10	0
ASB	2.1	0	0
bnz	2.1	10	0
HEARTLAND BANK	4.3	-20	-50
Kiwi bank.	2.1	10	0
sbs	2.6	-10	-10
TSB	1.9	0	10
The Co-operative Bank	2.3	10	-10
Westpac	2.0	0	0

Lending

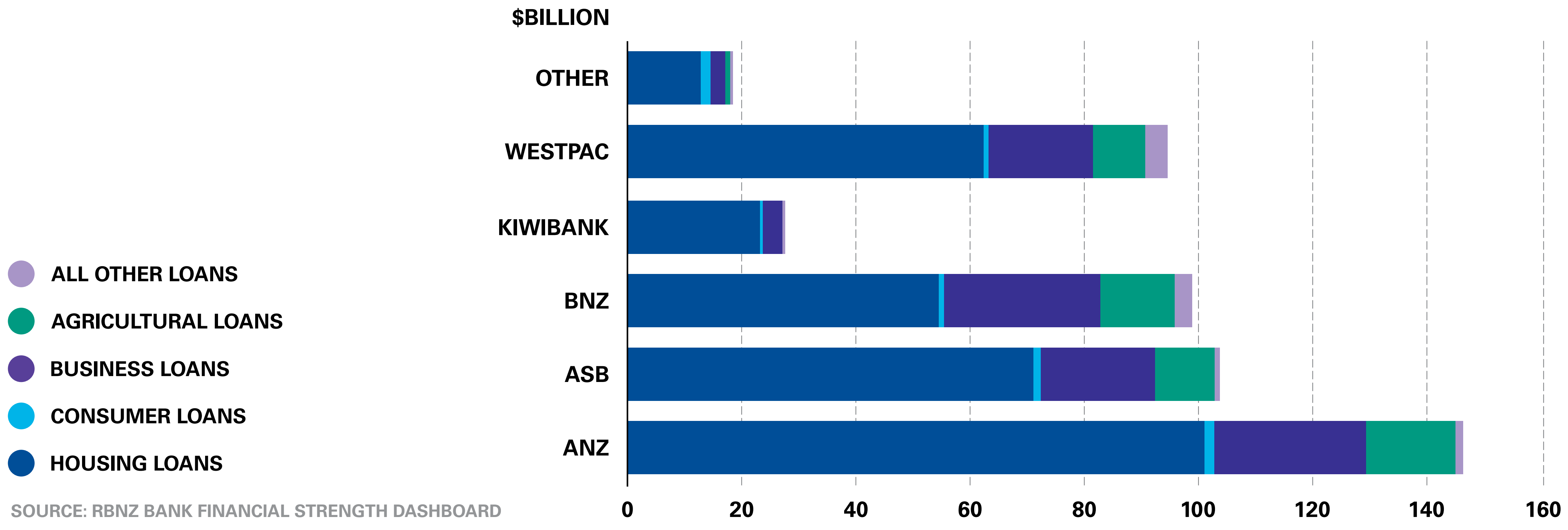
Q4 21–Q1 22 | Q3 21–Q1 22 | Q2 21–Q1 22 | Q1 21–Q1 22

HOVER over the button to see the movement in each quarter

Gross loans



Breakdown by bank for 31 March 2022



SOURCE: RBNZ BANK FINANCIAL STRENGTH DASHBOARD

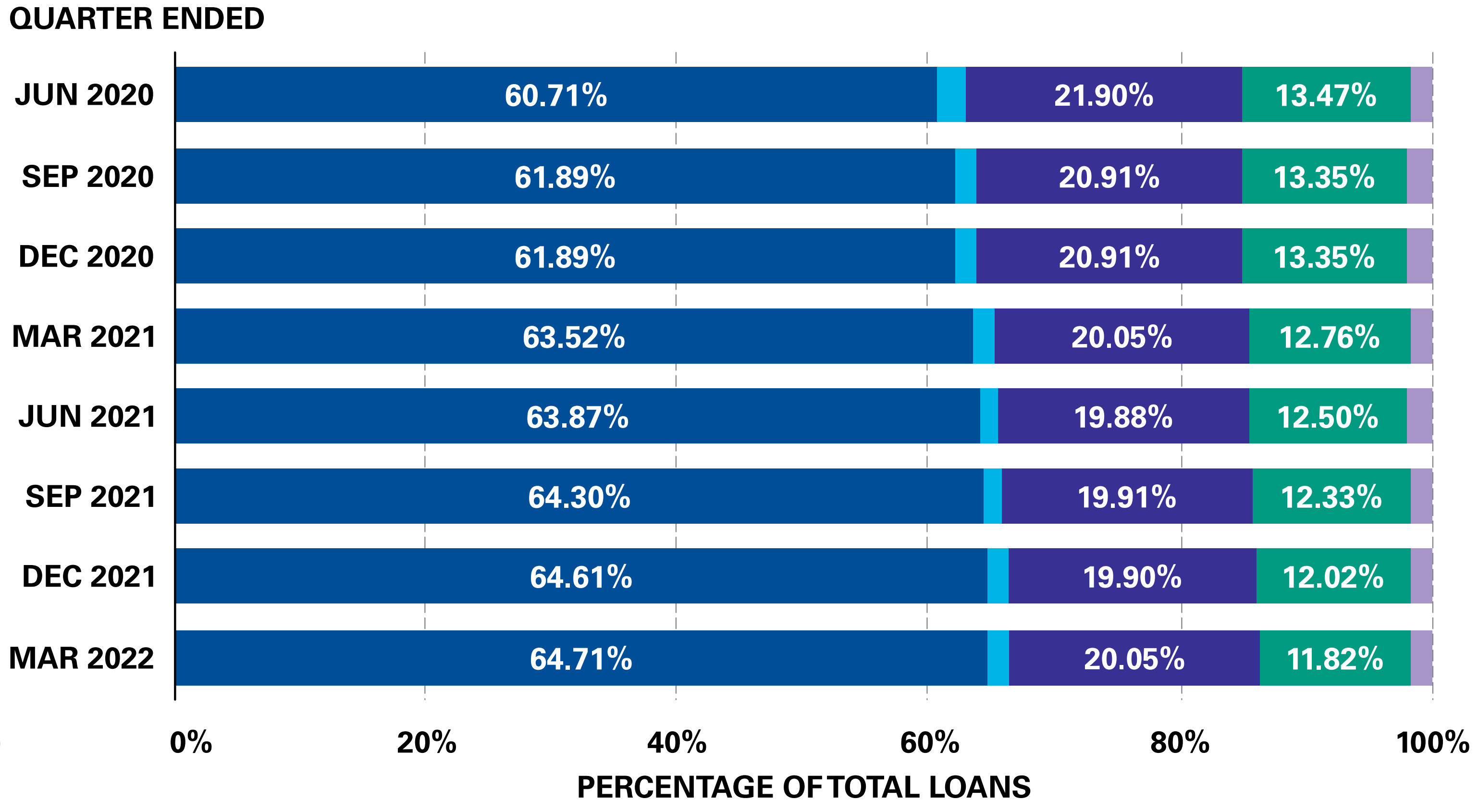
TABLE 2: Analysis of gross loans

Entity[22] Quarterly analysis	31 Mar 22 quarter ended $Million	31 Dec 21 quarter ended $Million	% Increase (Quarterly)
ANZ	146,971	144,219	1.91%
ASB	107,456	106,062	1.31%
bnz	98,791	97,895	0.92%
HEARTLAND BANK	4,310	4,170	3.35%
Kiwi bank.	27,468	27,237	0.85%
sbs	4,433	4,321	2.59%
TSB	6,700	6,734	-0.49%
The Co-operative Bank	2,704	2,722	-0.65%
Westpac	94,872	94,261	0.65%
Total	493,705	487,620	1.25%

Entity[22] Annual analysis	31 Mar 22 quarter ended $Million	31 Mar 21 quarter ended $Million	% Increase (Annual)
ANZ	146,971	138,403	6.19%
ASB	107,456	100,329	7.10%
bnz	98,791	91,704	7.73%
HEARTLAND BANK	4,310	3,749	14.95%
Kiwi bank.	27,468	24,716	11.14%
sbs	4,433	4,073	8.83%
TSB	6,700	6,373	5.13%
The Co-operative Bank	2,704	2,708	-0.13%
Westpac	94,872	91,419	3.78%
Total	493,705	463,475	6.52%

Lending

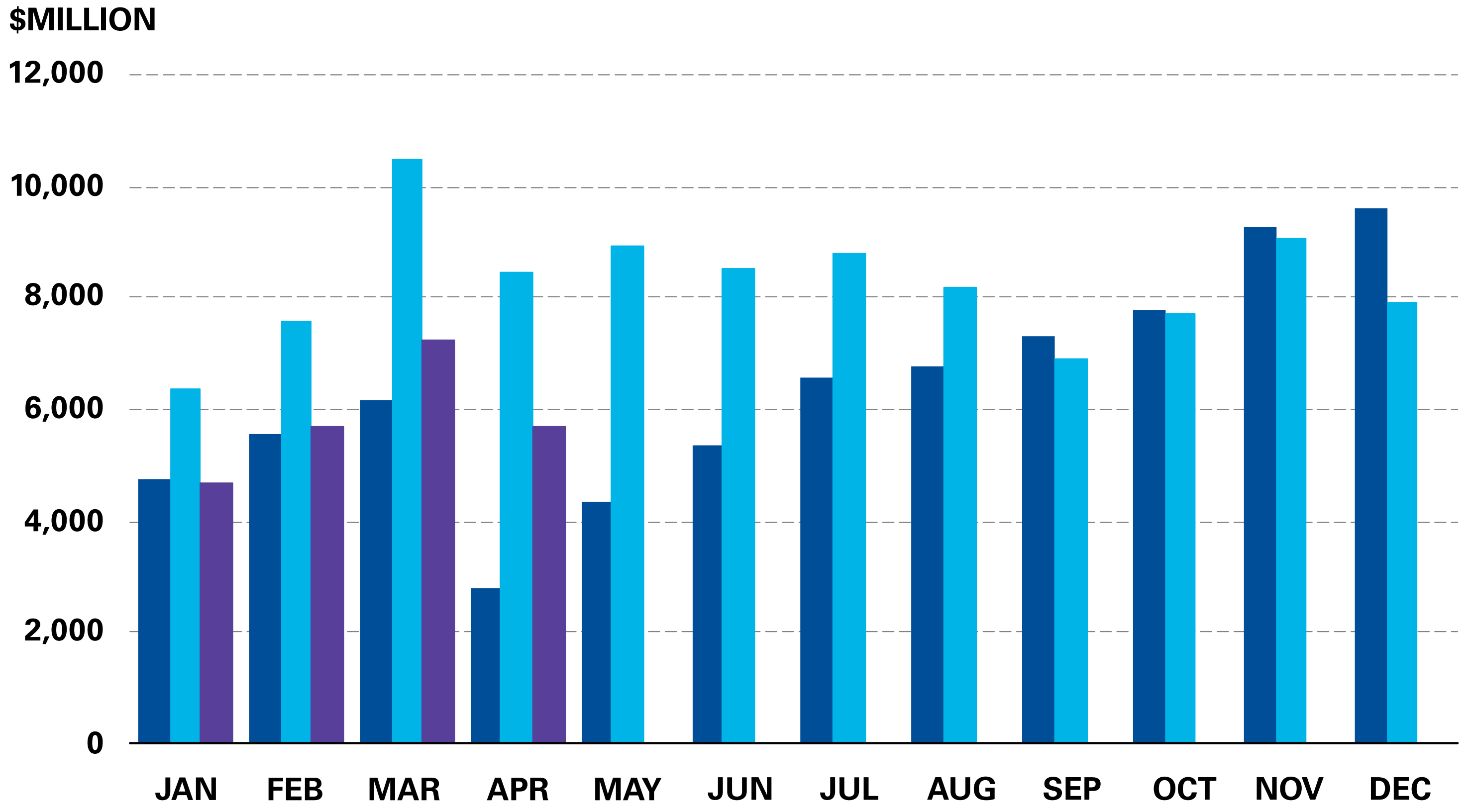
1 NZ BANKS PORTFOLIO COMPOSITION BY QUARTER



ALL OTHER LOANS
AGRICULTURAL LOANS
BUSINESS LOANS
CONSUMER LOANS
HOUSING LOANS

SOURCE: RBNZ BANK FINANCIAL STRENGTH DASHBOARD

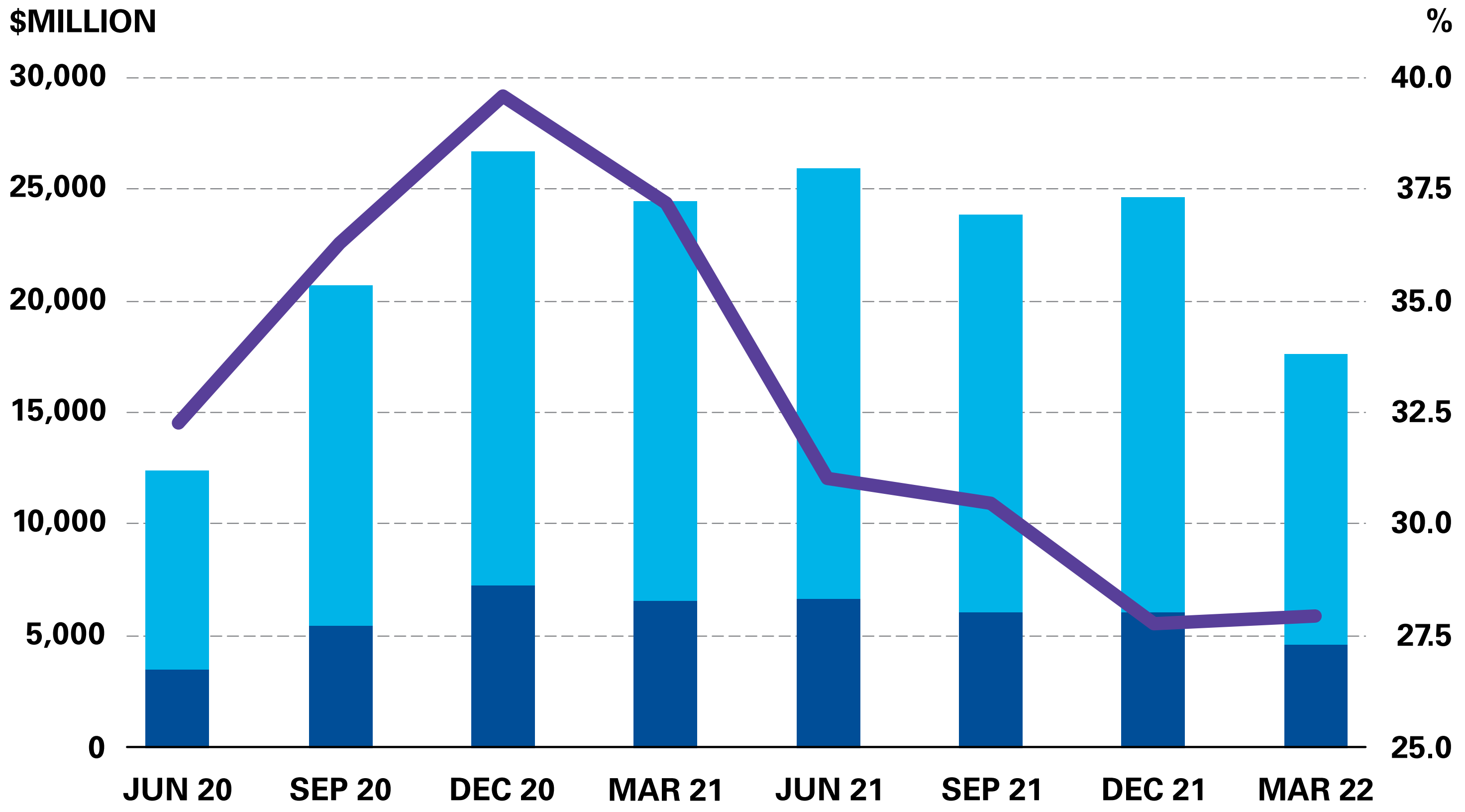
2 TOTAL MONTHLY MORTGAGE LENDING



2020
2021
2022

SOURCE: RESERVE BANK OF NEW ZEALAND STATISTICS

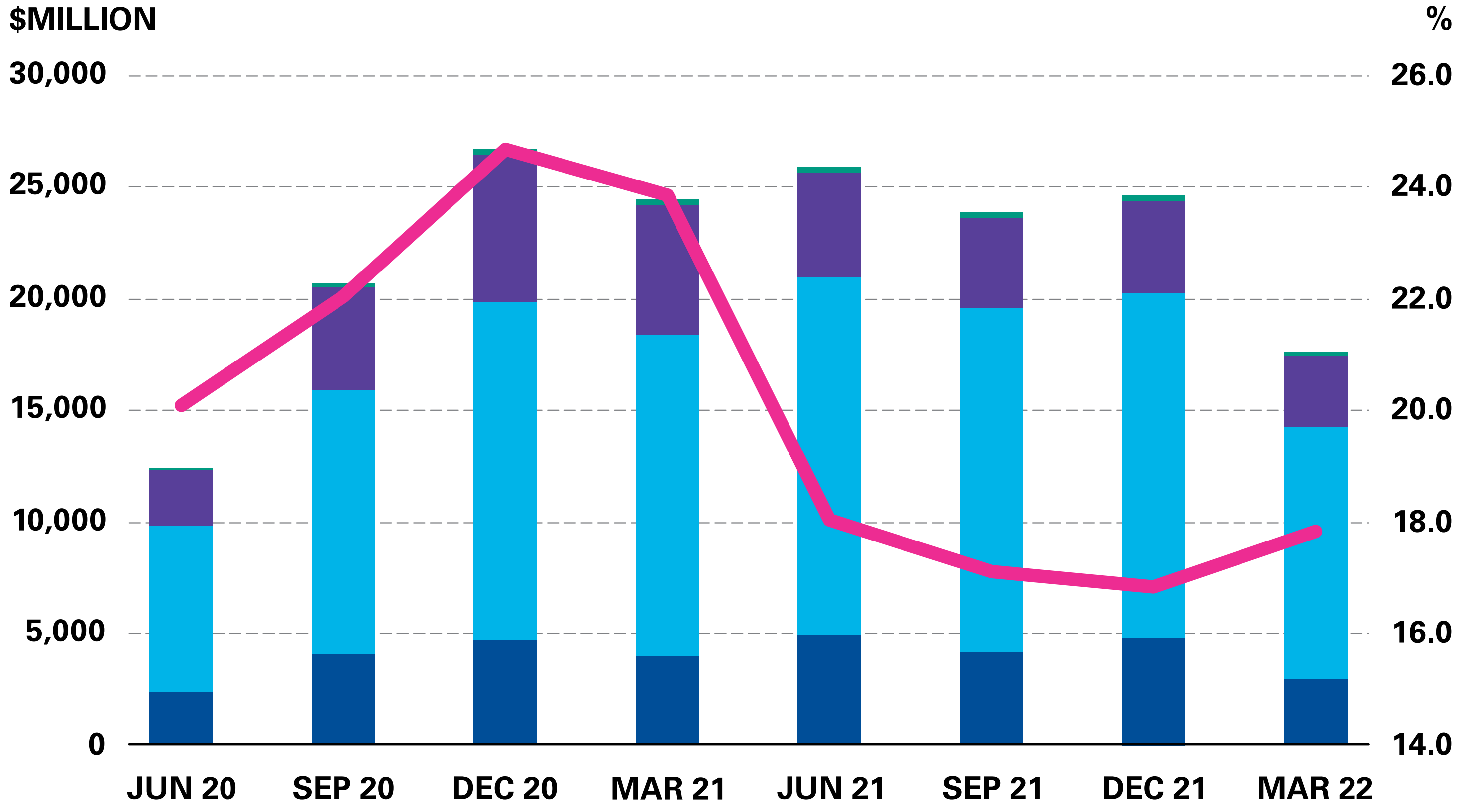
3 NEW MORTGAGE LENDING BY PAYMENT TYPE



INTEREST ONLY (INCLUDING REVOLVING CREDIT) (LHS)
PRINCIPAL AND INTEREST (LHS)
PROPORTION OF NEW LENDING INTEREST ONLY – INVESTOR (%) (RHS)

SOURCE: RESERVE BANK OF NEW ZEALAND STATISTICS

4 NEW MORTGAGE LENDING BY BORROWER TYPE



FIRST-HOME BUYER (LHS)
OTHER OWNER OCCUPIER (LHS)
INVESTOR (LHS)
BUSINESS PURPOSES (LHS)
INVESTOR LENDING (%) (RHS)

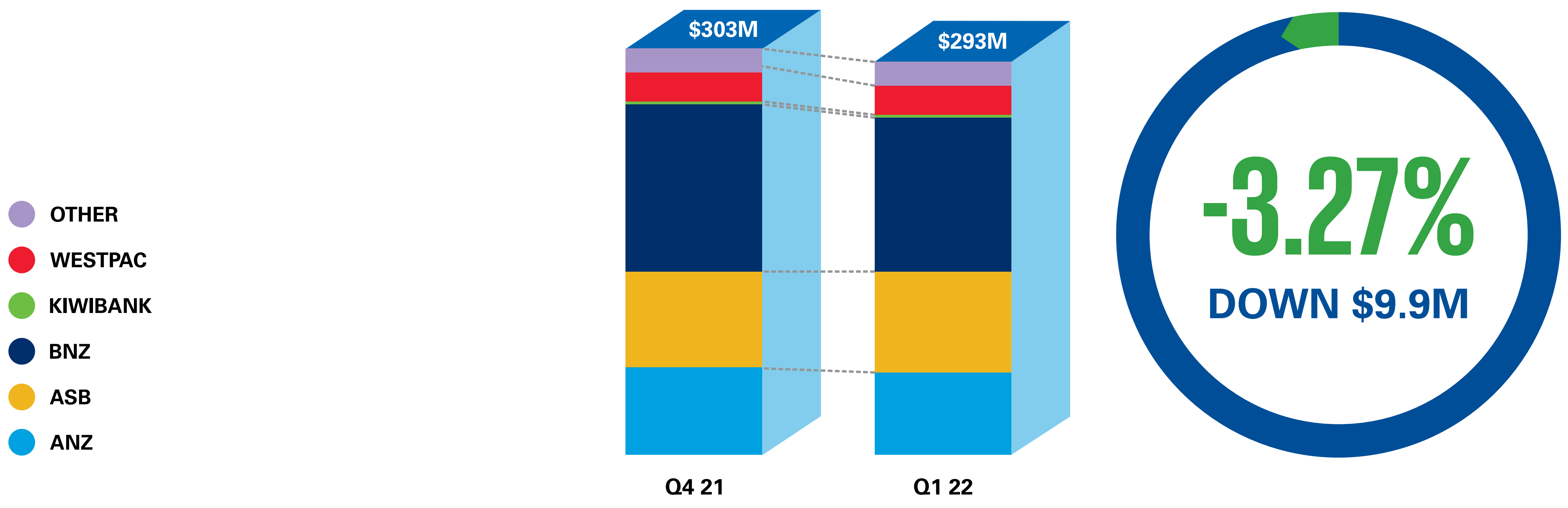
SOURCE: RESERVE BANK OF NEW ZEALAND STATISTICS

Asset quality

Q4 21–Q1 22 | Q3 21–Q1 22 | Q2 21–Q1 22 | Q1 21–Q1 22

HOVER over the button to see the movement in each quarter

Individually assessed provisions



Collectively assessed provisions

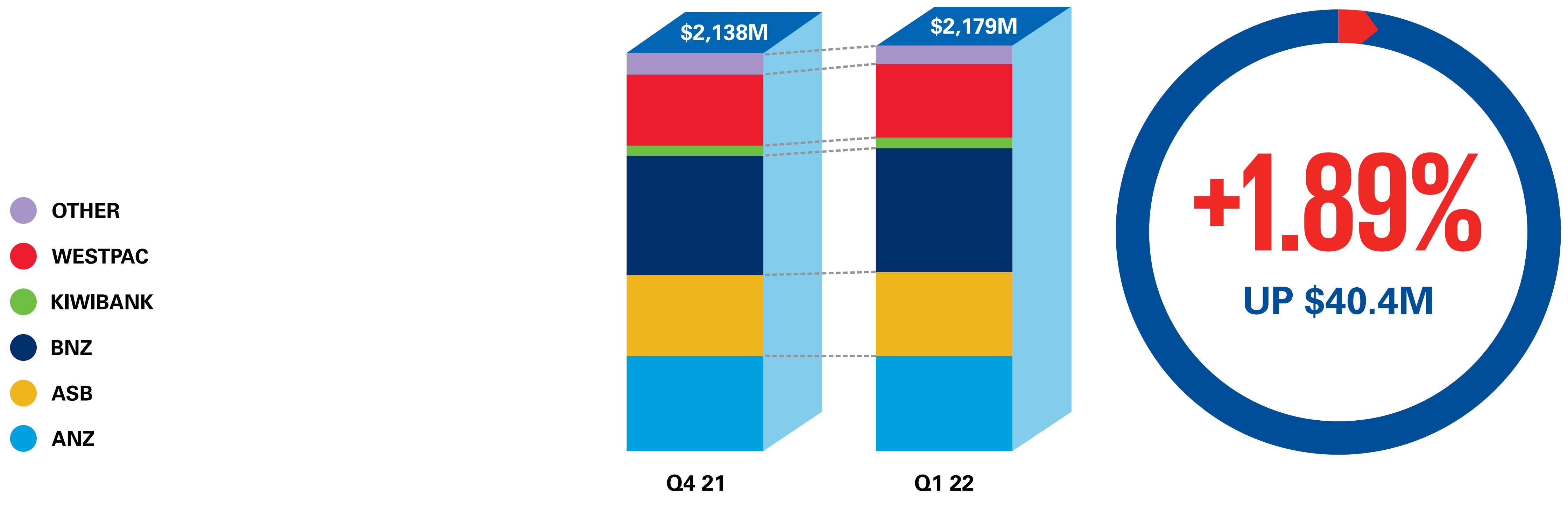


TABLE 3: Impaired asset expenses			
	$Million		$Million
March 2022	$52.7	March 2021	-$76.6
December 2021	-$35.0	December 2020	-$126.0
September 2021	-$29.2	September 2020	$188.6
June 2021	-$70.7	June 2020	$478.0

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

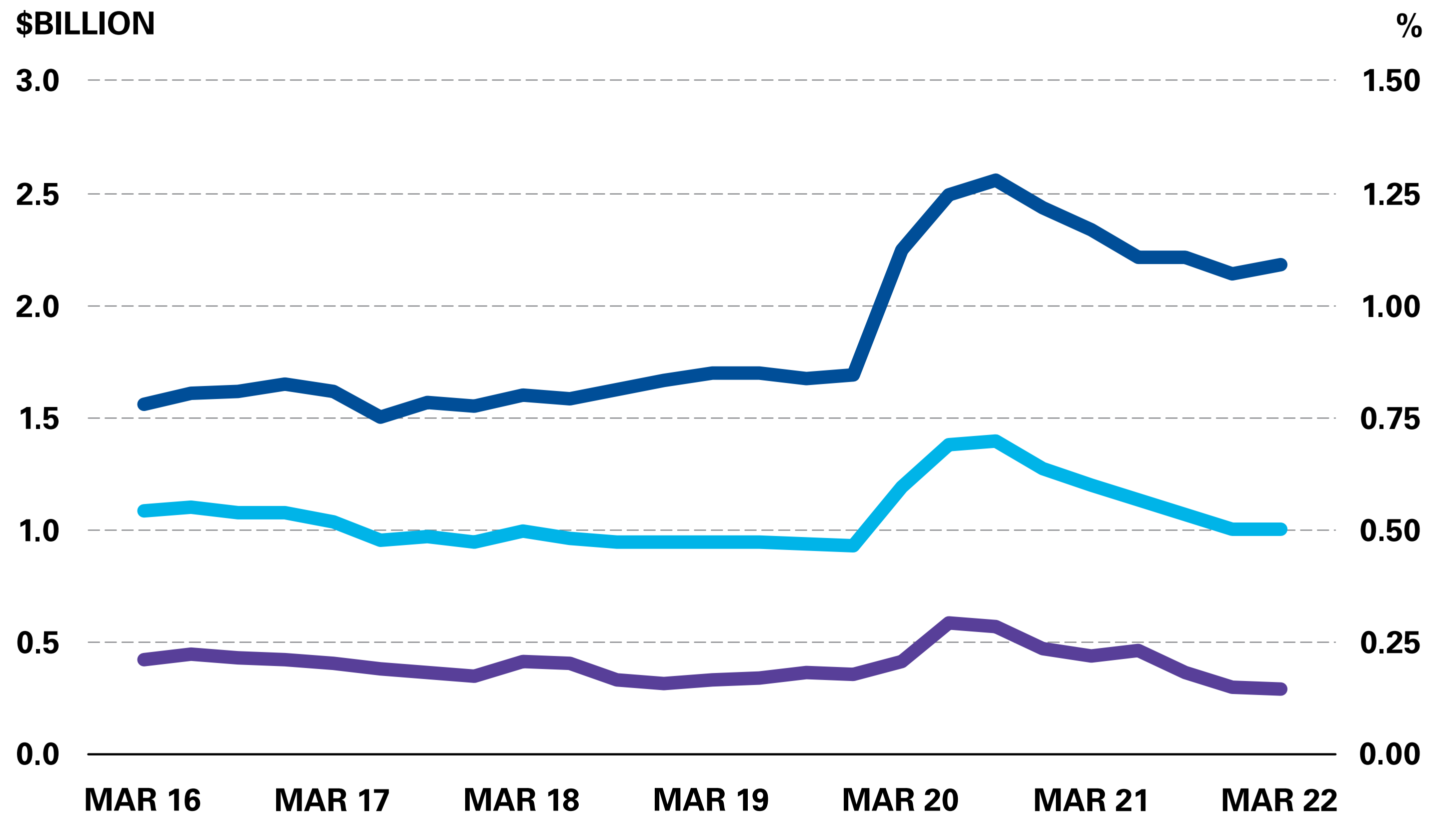
Entity[22]	31 Dec 21 quarter ended (%)	Mvmt. during the quarter (bps)	Mvmt. for the 12 months (bps)
ANZ	-0.03%	0	14
ASB	0.06%	8	12
bnz	0.14%	17	10
Heartland Bank	0.36%	-4	-16
Kiwibank	0.02%	-4	1
SBS	0.03%	-19	16
TSB	-0.02%	2	9
The Co-operative Bank	0.00%	-1	30
Westpac	0.03%	12	8
Average	0.04%	7	11

The results for the quarter ended March 2022 showed the first increase in the total provisioning level since September 2020. This followed declines in provisions held by the banking sector since the onset of the Covid-19 pandemic in June 2020. Despite the increase in the total provisioning level, the increase in total gross loans and advances meant the coverage ratio (provisions held compared to total gross loans and advances) remained flat. This ratio rose from 0.47% in December 2019 to a peak of 0.70% in September 2020, and had since fallen in each consecutive quarter to 0.50% in December 2022 before remaining flat for the first quarter of 2022.

Provisioning levels still remain above those seen before the pandemic, likely driven by the economic uncertainty with high inflation and interest rates driving the cost of living difficulties for many households. It will be interesting to see whether continued inflation, rising interest rates and the conflict in Eastern Europe will place further pressure on borrowers and lead to an increase in missed repayments and arrears. Once this flows through the banking sector's provisioning models, it may lead to an increase in collective provisions and reduce profits.

Asset quality

5 MOVEMENT IN PROVISIONING

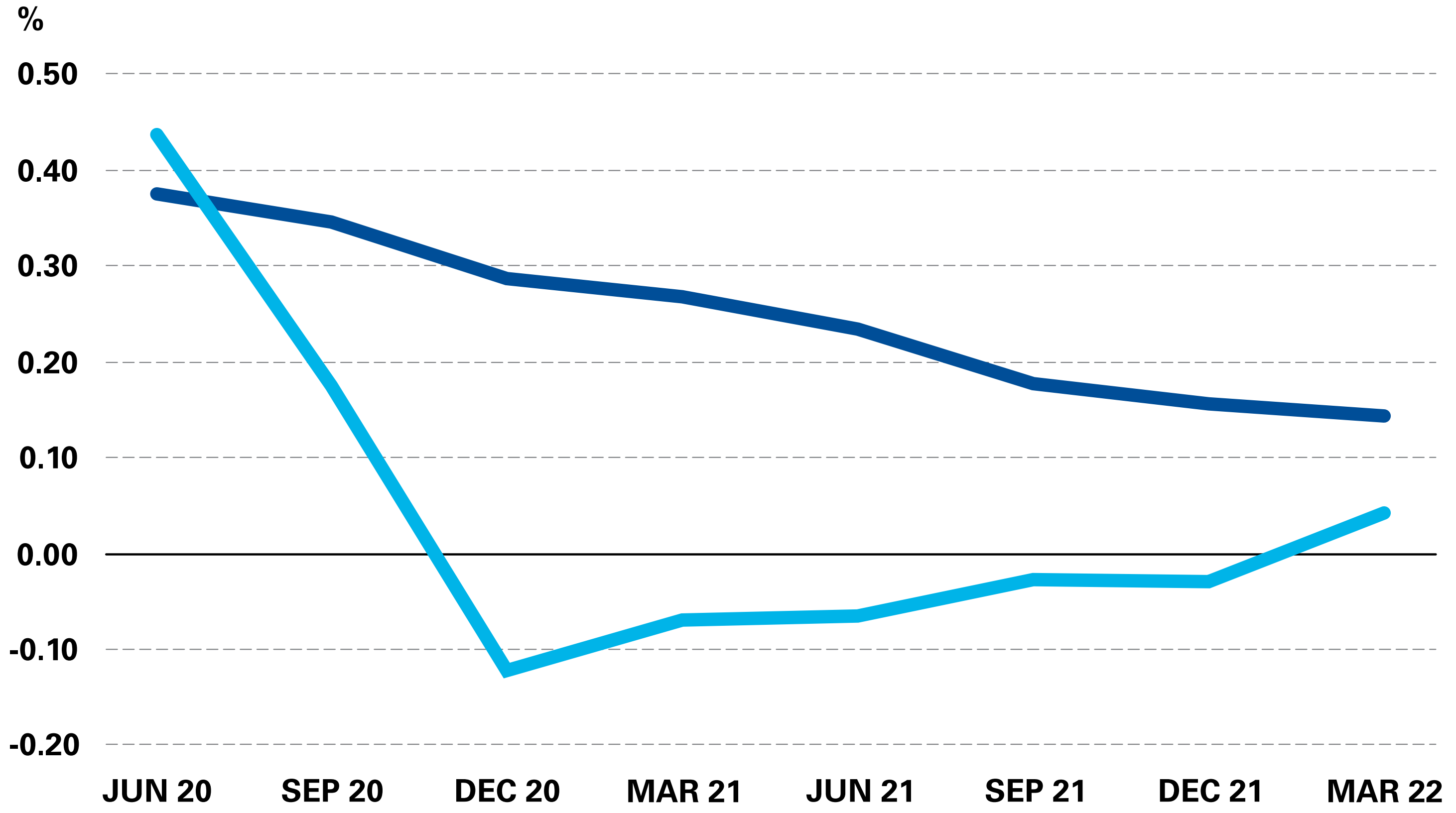


COLLECTIVE PROVISION (LHS)

INDIVIDUAL PROVISION (LHS)

TOTAL PROVISION FOR DOUBTFUL DEBTS/ GROSS LOANS AND ADVANCES (RHS)

6 MAJOR BANKS: GROSS IMPAIRED VS. IMPAIRED ASSET EXPENSE



GROSS IMPAIRED LOANS/ GROSS LOANS AND ADVANCES

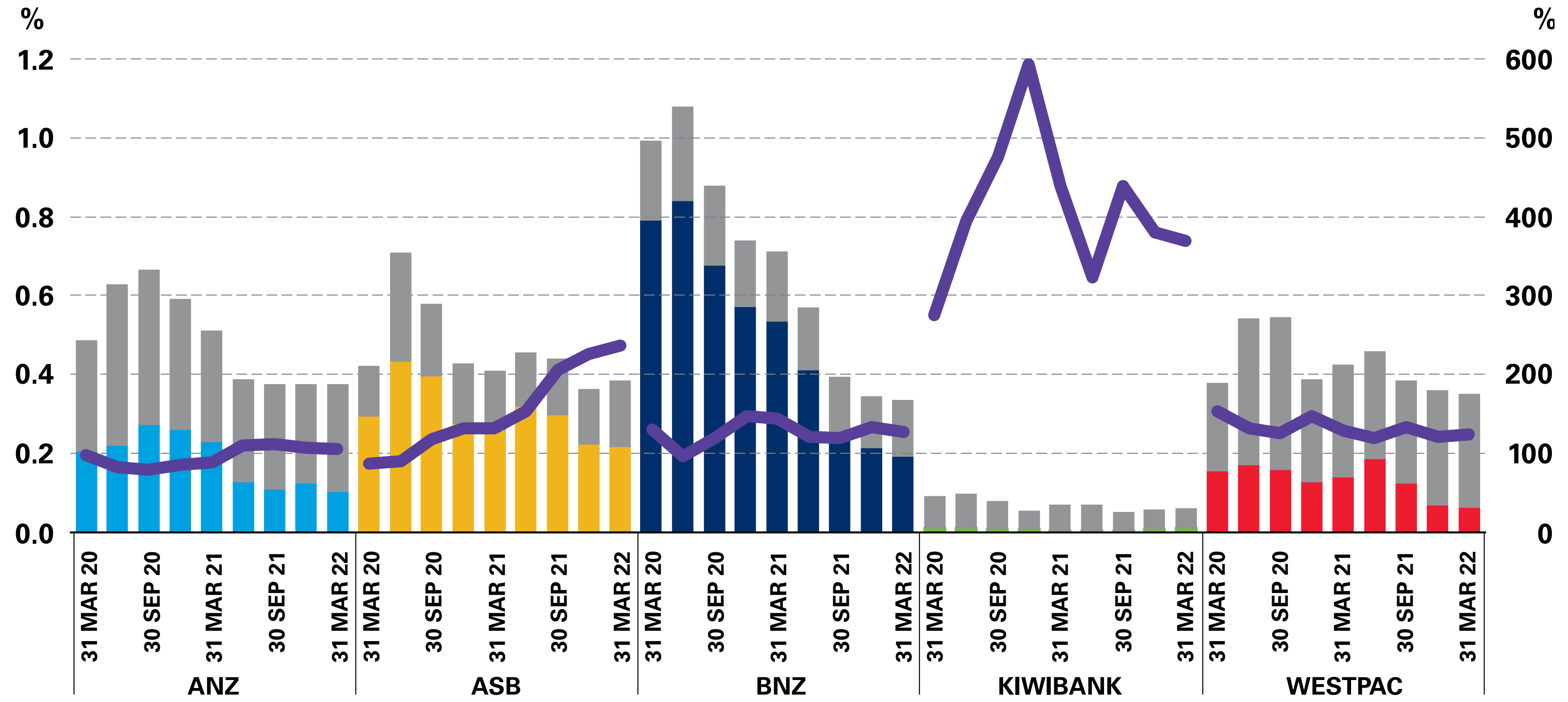
IMPAIRED ASSET EXPENSE/ AVERAGE GROSS LOANS AND ADVANCES

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

GROSS IMPAIRED/ GROSS LOANS AND ADVANCES (LHS)

PAST DUE/GROSS LOANS AND ADVANCES (LHS)

TOTAL PROVISIONS/ PAST DUE AND GROSS IMPAIRED ASSETS (RHS)



Major banks – Quarterly analysis

Size & strength measures

Entity[22]	30 Jun 20	30 Sep 20	31 Dec 20	31 Mar 21	30 Jun 21	30 Sep 21	31 Dec 21	31 Mar 22
Total assets ($Million)								
ANZ	181,688	180,087	186,404	183,811	187,064	185,072	190,636	190,720
ASB	113,464	115,064	117,967	121,115	120,810	120,230	121,030	123,365
BNZ	114,452	112,310	117,287	114,314	118,549	119,122	123,038	124,060
Heartland Bank	4,315	4,288	4,358	4,297	4,419	4,484	4,703	4,857
Kiwibank	25,510	26,645	27,283	27,546	28,230	29,379	30,970	30,589
SBS	4,836	4,842	4,839	4,832	4,789	4,889	5,024	5,220
TSB	8,332	8,575	8,761	8,789	8,725	8,780	8,934	8,961
The Co-operative Bank	3,008	3,048	3,064	3,122	3,171	3,194	3,239	3,194
Westpac	114,223	113,187	117,160	114,726	116,786	119,848	122,382	125,026
Total	569,827	568,047	587,123	582,552	592,543	594,998	609,954	615,991
Increase in gross loans and advances (%)								
ANZ	-0.02	-1.92	1.51	2.00	1.41	0.93	1.81	1.91
ASB	0.09	2.41	2.58	1.70	2.79	1.94	0.88	1.31
BNZ	-1.36	-0.30	1.43	2.07	2.78	1.64	2.19	0.92
Heartland Bank	-2.03	-0.62	0.72	0.78	3.11	2.54	5.19	3.35
Kiwibank	1.51	3.06	3.86	3.16	2.51	3.49	3.87	0.85
SBS	-1.36	-0.36	-1.10	0.01	0.23	2.00	3.78	2.59
TSB	-0.28	0.58	0.81	2.09	2.32	1.53	1.70	-0.49
The Co-operative Bank	-0.31	1.14	2.83	1.61	2.05	-0.13	-1.36	-0.65
Westpac	-0.29	1.47	1.34	1.40	2.13	0.15	0.81	0.65
Average	-0.28	0.31	1.78	1.86	2.20	1.30	1.63	1.25

Entity[22]	30 Jun 20	30 Sep 20	31 Dec 20	31 Mar 21	30 Jun 21	30 Sep 21	31 Dec 21	31 Mar 22
Capital adequacy (%)								
ANZ[23]	14.00	14.40	15.00	15.90	15.50	16.90	16.40	15.10
ASB[23]	14.00	14.20	13.90	14.80	15.10	14.50	14.60	13.40
BNZ	14.60	14.90	15.50	16.00	16.50	16.90	16.40	15.30
Heartland Bank	12.70	13.40	14.00	14.40	13.90	14.00	14.00	13.10
Kiwibank	12.60	12.30	13.30	13.20	13.20	12.80	13.70	13.80
SBS	14.30	14.90	15.20	15.70	16.20	16.30	16.00	15.40
TSB	14.90	15.10	15.10	15.00	14.20	14.10	13.70	13.50
The Co-operative Bank	16.90	16.90	17.00	16.90	16.80	16.10	16.90	16.90
Westpac[23]	16.60	17.10	17.60	18.20	18.80	18.60	19.00	14.50
Net profit ($Million)								
ANZ	327	220	367	563	487	503	496	600
ASB	130	270	321	348	317	367	382	349
BNZ	187	209	303	357	318	344	356	353
Heartland Bank	9	21	12	18	20	20	21	19
Kiwibank	-12	24	31	40	31	32	32	36
SBS	8	10	12	12	13	11	10	11
TSB	9	12	11	11	13	12	9	5
The Co-operative Bank	3	4	5	4	4	5	4	-1
Westpac	107	238	300	290	249	219	305	373
Total	770	1,008	1,361	1,643	1,452	1,512	1,614	1,744

Major banks – Quarterly analysis

Profitability measures

Entity[22]	30 Jun 20	30 Sep 20	31 Dec 20	31 Mar 21	30 Jun 21	30 Sep 21	31 Dec 21	31 Mar 22
Interest margin (%)								
ANZ	1.90	1.90	1.90	2.10	2.10	2.00	2.00	2.10
ASB	1.80	1.80	1.90	2.10	2.00	2.00	2.10	2.10
bnz	2.00	2.00	2.00	2.10	2.00	2.00	2.00	2.10
Heartland Bank	4.60	4.50	4.60	4.80	4.90	4.80	4.50	4.30
Kiwibank	1.90	1.90	2.00	2.10	2.10	2.10	2.00	2.10
sbs	2.40	2.40	2.50	2.70	2.90	2.80	2.70	2.60
TSB	1.60	1.70	1.70	1.80	1.80	1.80	1.90	1.90
The Co-operative Bank	2.20	2.20	2.30	2.40	2.40	2.30	2.20	2.30
Westpac	1.70	1.80	2.00	2.00	2.00	1.90	2.00	2.00

Entity[22]	30 Jun 20	30 Sep 20	31 Dec 20	31 Mar 21	30 Jun 21	30 Sep 21	31 Dec 21	31 Mar 22
Non-interest income/Total assets (%)								
ANZ	0.33	0.29	0.18	0.53	0.40	0.53	0.54	0.65
ASB	0.51	0.58	0.54	0.56	0.55	0.67	0.48	0.53
bnz	0.40	0.35	0.42	0.72	0.50	0.66	0.61	0.51
Heartland Bank	0.38	0.28	0.42	0.32	0.39	0.39	0.33	0.29
Kiwibank	0.53	0.63	0.27	0.26	0.15	0.22	0.19	0.09
sbs	0.68	0.74	0.82	0.65	0.74	0.71	0.66	0.49
TSB	0.22	0.22	0.22	0.20	0.22	0.28	0.19	0.21
The Co-operative Bank	0.67	0.69	0.60	0.58	0.62	0.65	0.57	0.60
Westpac	0.32	0.35	0.28	0.48	0.33	0.42	0.40	0.65
Average	0.39	0.39	0.34	0.55	0.43	0.54	0.49	0.56

Entity[22]	30 Jun 20	30 Sep 20	31 Dec 20	31 Mar 21	30 Jun 21	30 Sep 21	31 Dec 21	31 Mar 22
Impaired asset expense/Average gross loans and advances (%)								
ANZ	0.23	0.27	-0.03	-0.17	-0.10	-0.03	-0.03	-0.03
ASB	0.59	0.15	-0.01	-0.06	-0.07	-0.04	-0.02	0.06
bnz	0.46	0.31	-0.13	0.04	-0.06	-0.07	-0.03	0.14
Heartland Bank	1.48	0.05	0.44	0.52	0.54	0.46	0.40	0.36
Kiwibank	0.56	0.03	-0.03	0.01	-0.31	0.05	0.06	0.02
sbs	0.39	0.09	0.09	-0.13	0.06	0.28	0.22	0.03
TSB	-0.01	-0.05	0.03	-0.11	-0.12	-0.31	-0.04	-0.02
The Co-operative Bank	0.12	0.09	0.05	-0.30	0.06	-0.06	0.01	0.00
Westpac	0.54	-0.04	-0.39	-0.05	0.04	0.02	-0.09	0.03
Average	0.44	0.17	-0.11	-0.07	-0.06	-0.02	-0.03	0.04

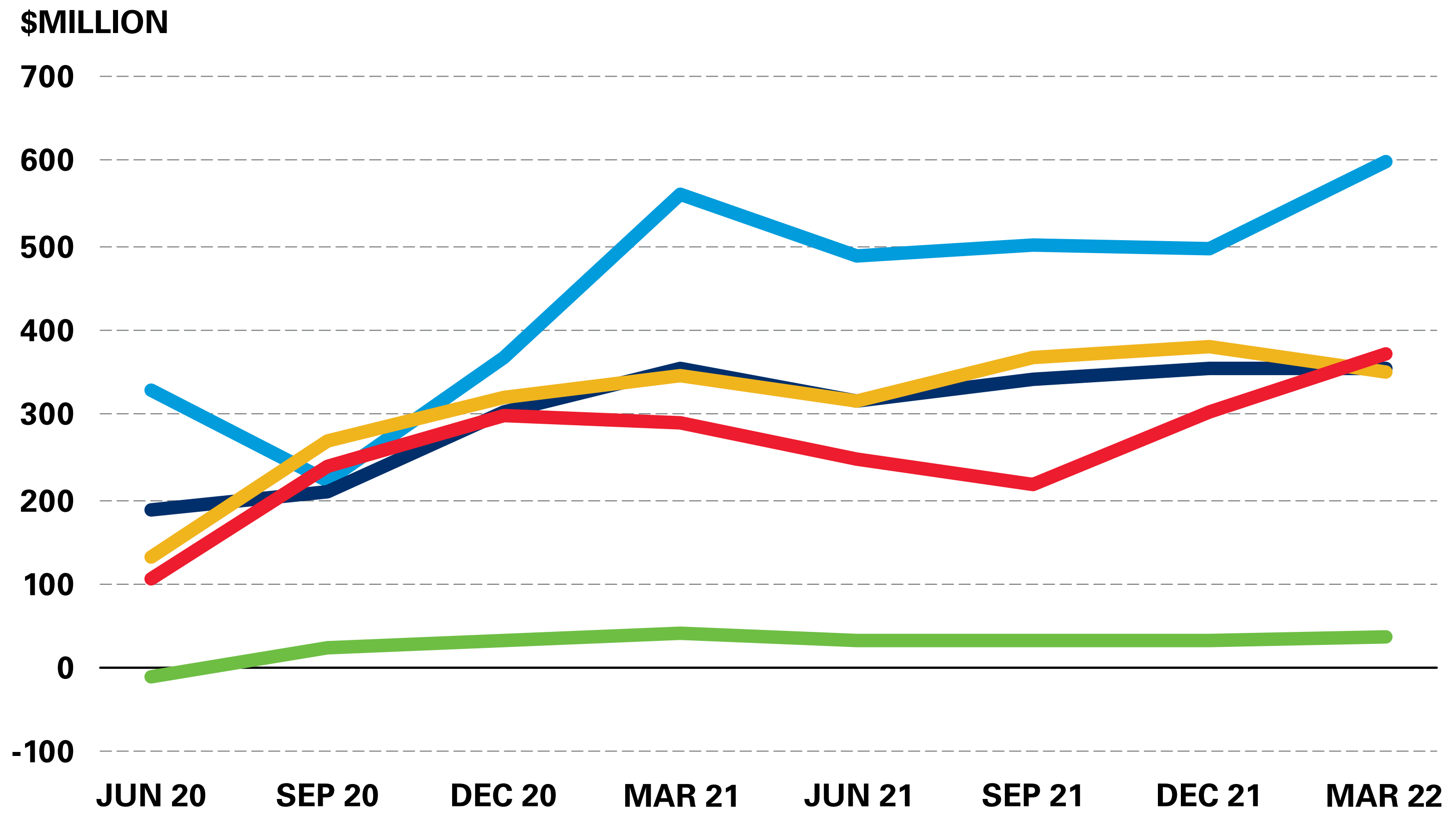
Entity[22]	30 Jun 20	30 Sep 20	31 Dec 20	31 Mar 21	30 Jun 21	30 Sep 21	31 Dec 21	31 Mar 22
Operating expenses/Operating income (%)								
ANZ	43.97	54.60	44.39	34.29	38.88	39.25	39.19	32.19
ASB	49.46	38.55	36.97	37.66	44.62	37.77	32.43	37.51
bnz	41.97	41.65	39.83	32.75	38.23	39.02	35.31	29.70
Heartland Bank	48.39	40.28	61.61	43.47	42.93	42.53	43.40	42.00
Kiwibank	91.00	78.94	70.89	65.25	84.38	70.88	70.67	68.78
sbs	59.78	59.36	58.31	61.87	56.21	57.51	62.23	59.74
TSB	66.31	60.76	62.80	68.38	65.02	74.84	74.23	85.71
The Co-operative Bank	74.52	74.65	70.59	81.61	71.86	72.41	72.65	105.26
Westpac	50.79	44.14	45.34	41.67	44.98	49.95	41.15	38.40
Average	48.95	47.85	44.13	38.53	43.97	43.07	39.69	37.10

Major banks – Quarterly analysis

Q1 22 | Q1 21 | Q1 20 | Q1 19

HOVER over the button to see the results for each quarter

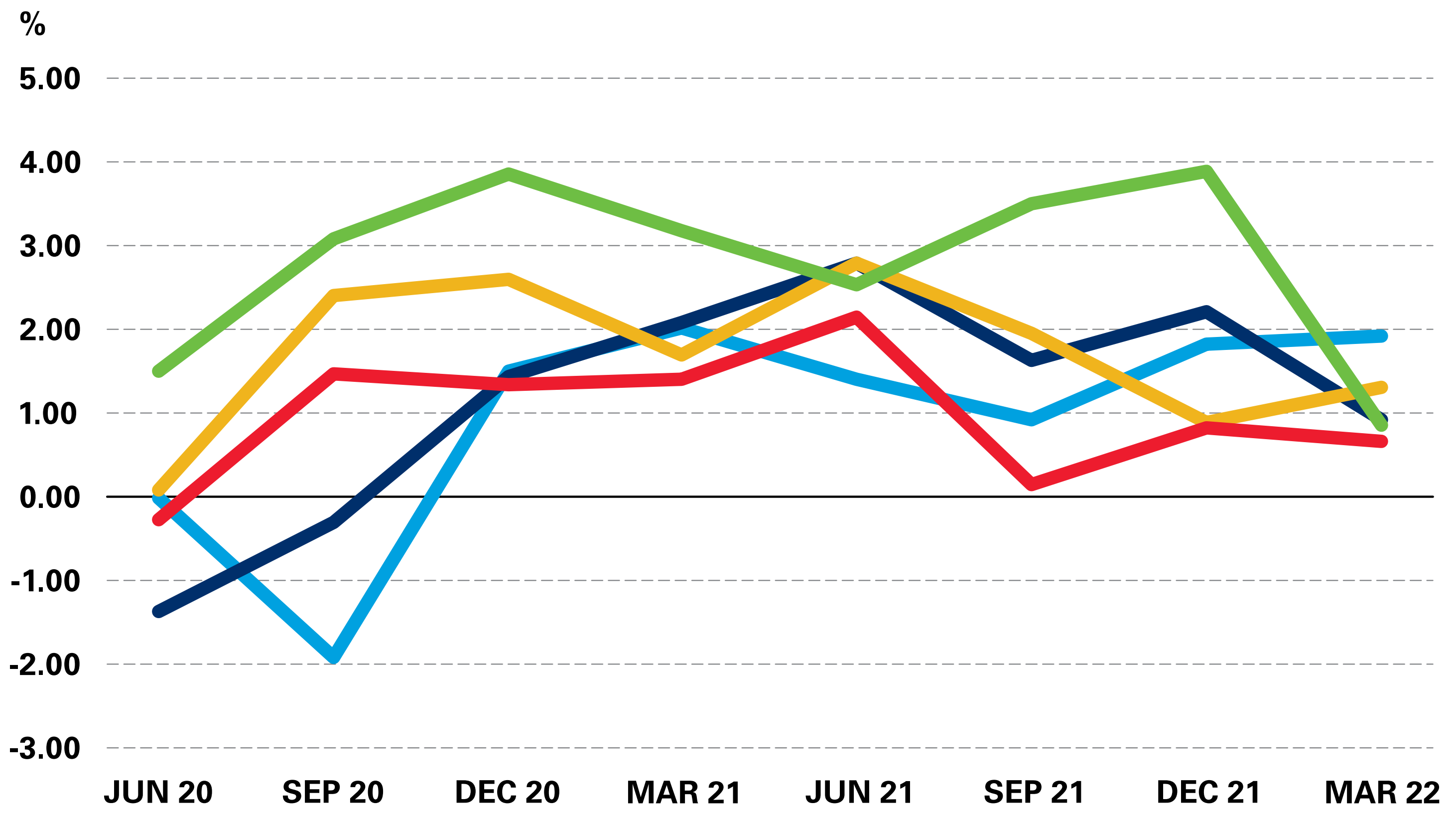
8 MAJOR BANKS: NET PROFIT



- ANZ
- ASB
- BNZ
- KIWIBANK
- WESTPAC

SOURCE: RBNZ BANK FINANCIAL STRENGTH DASHBOARD

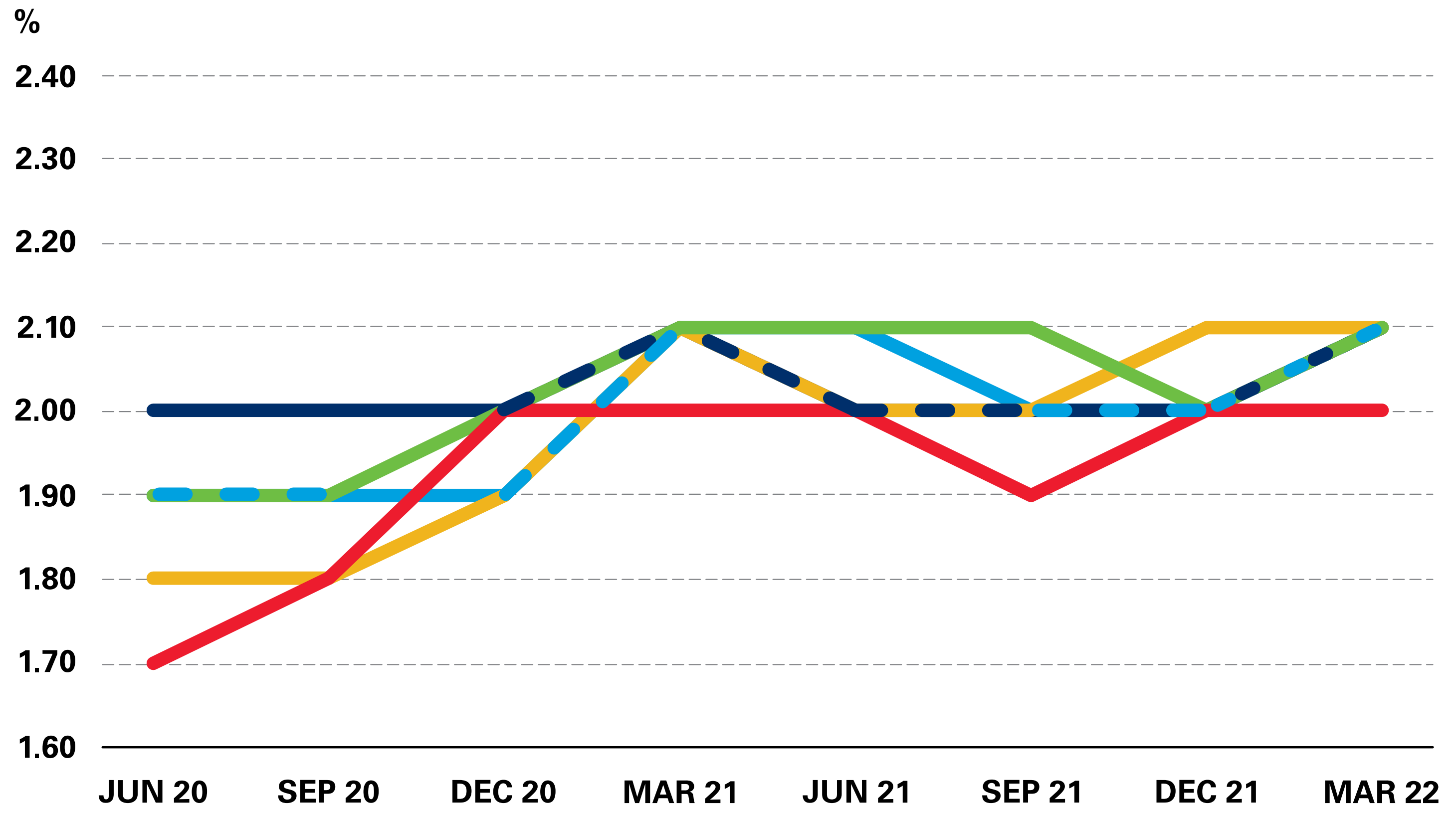
10 MAJOR BANKS: INCREASE IN GROSS LOANS AND ADVANCES



- ANZ
- ASB
- BNZ
- KIWIBANK
- WESTPAC

SOURCE: RBNZ BANK FINANCIAL STRENGTH DASHBOARD

9 MAJOR BANKS: INTEREST MARGIN



- ANZ
- ASB
- BNZ
- KIWIBANK
- WESTPAC

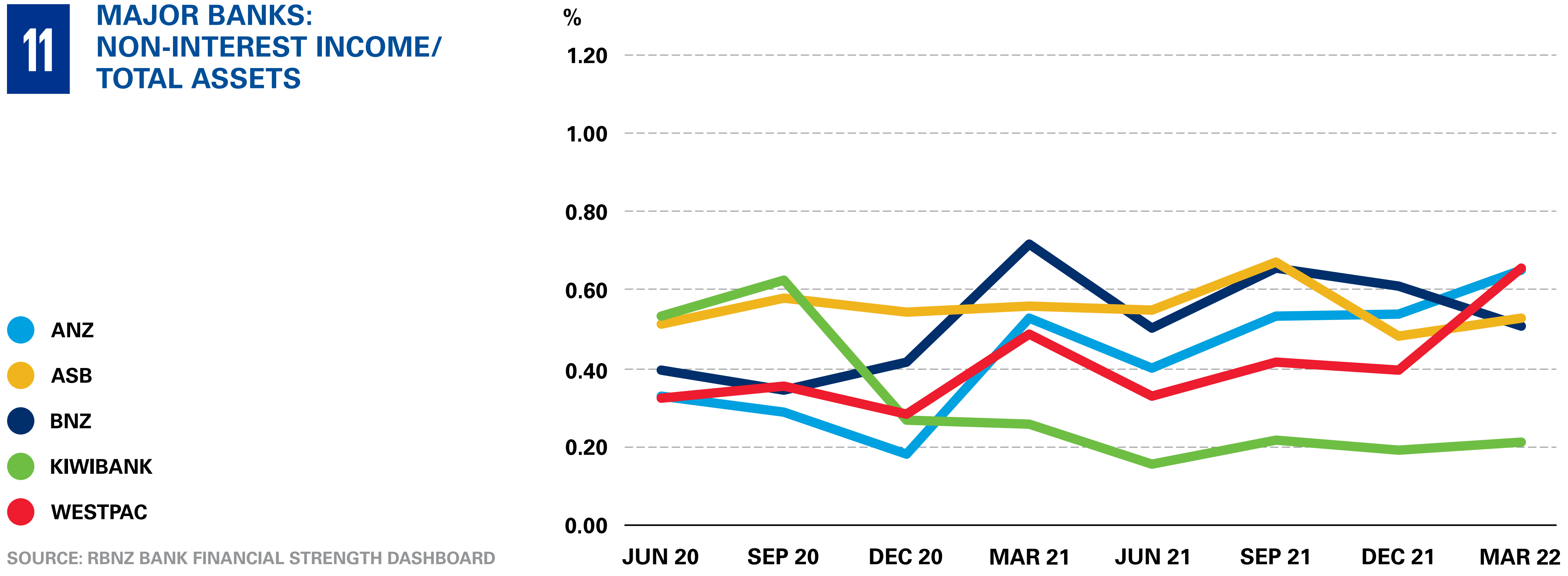
SOURCE: RBNZ BANK FINANCIAL STRENGTH DASHBOARD

Major banks – Quarterly analysis

Q1 22 | Q1 21 | Q1 20 | Q1 19

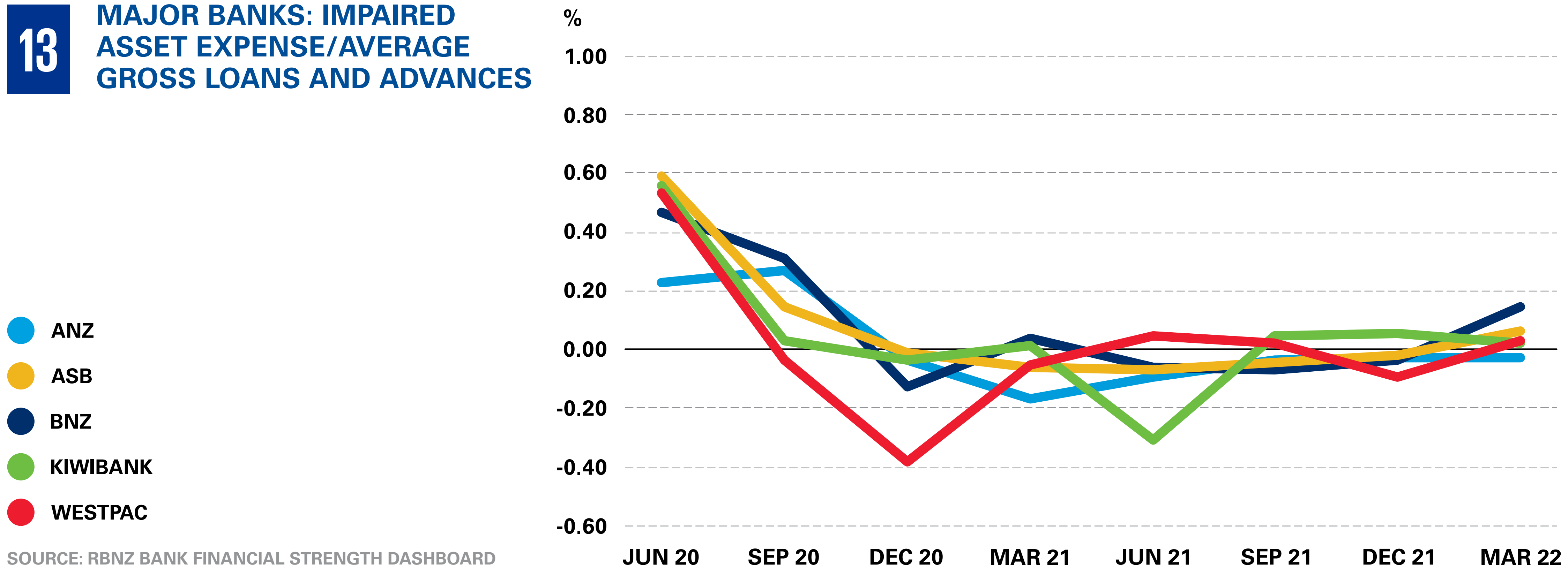
HOVER over the button to see the results for each quarter

11 MAJOR BANKS: NON-INTEREST INCOME/ TOTAL ASSETS



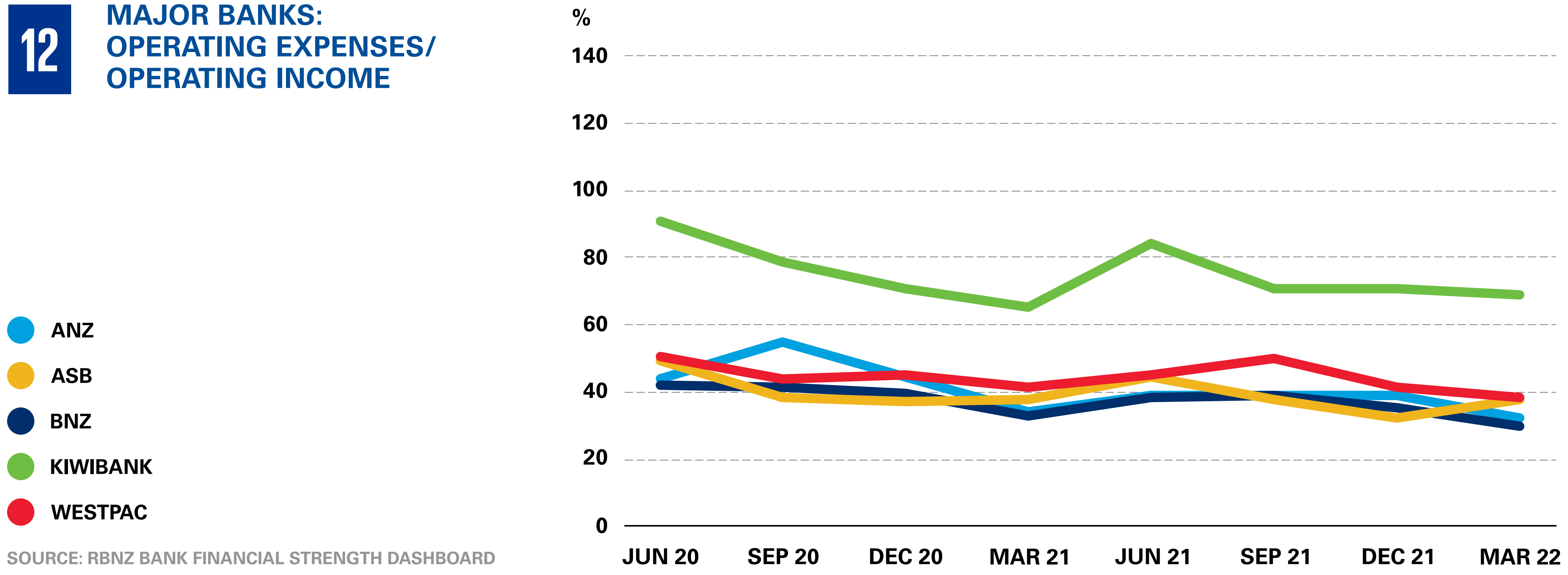
SOURCE: RBNZ BANK FINANCIAL STRENGTH DASHBOARD

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



SOURCE: RBNZ BANK FINANCIAL STRENGTH DASHBOARD

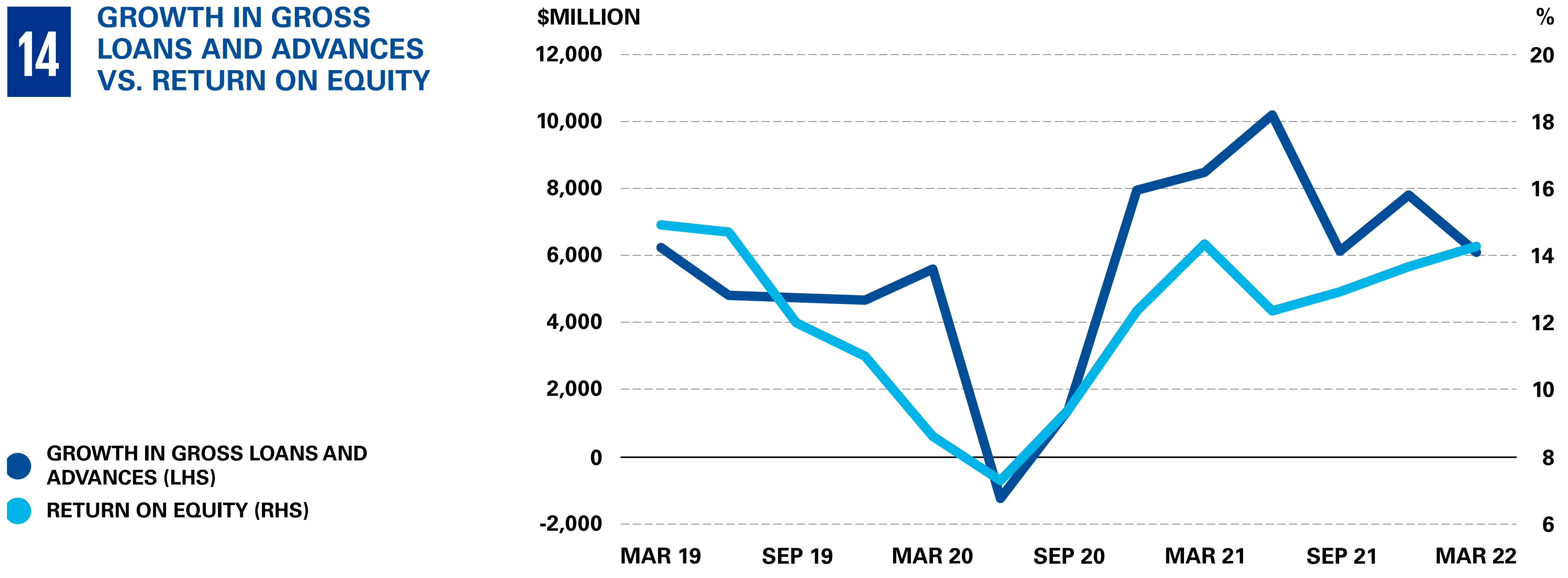
12 MAJOR BANKS: OPERATING EXPENSES/ OPERATING INCOME



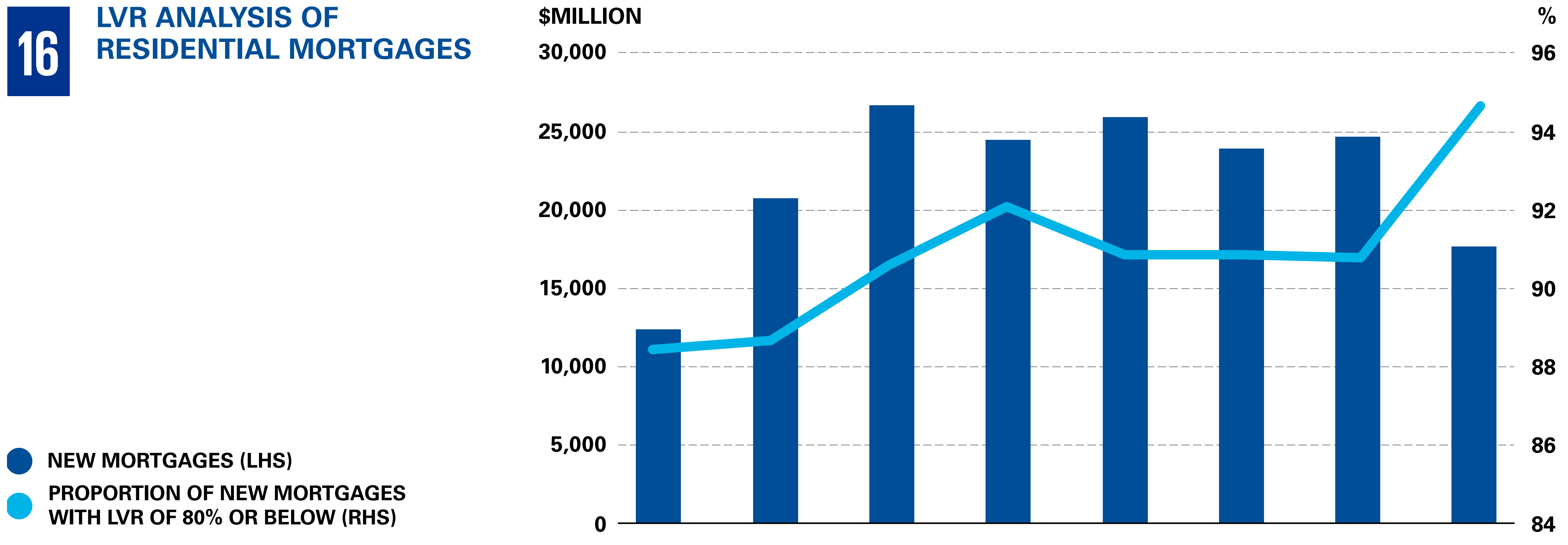
SOURCE: RBNZ BANK FINANCIAL STRENGTH DASHBOARD

Quarterly analysis

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

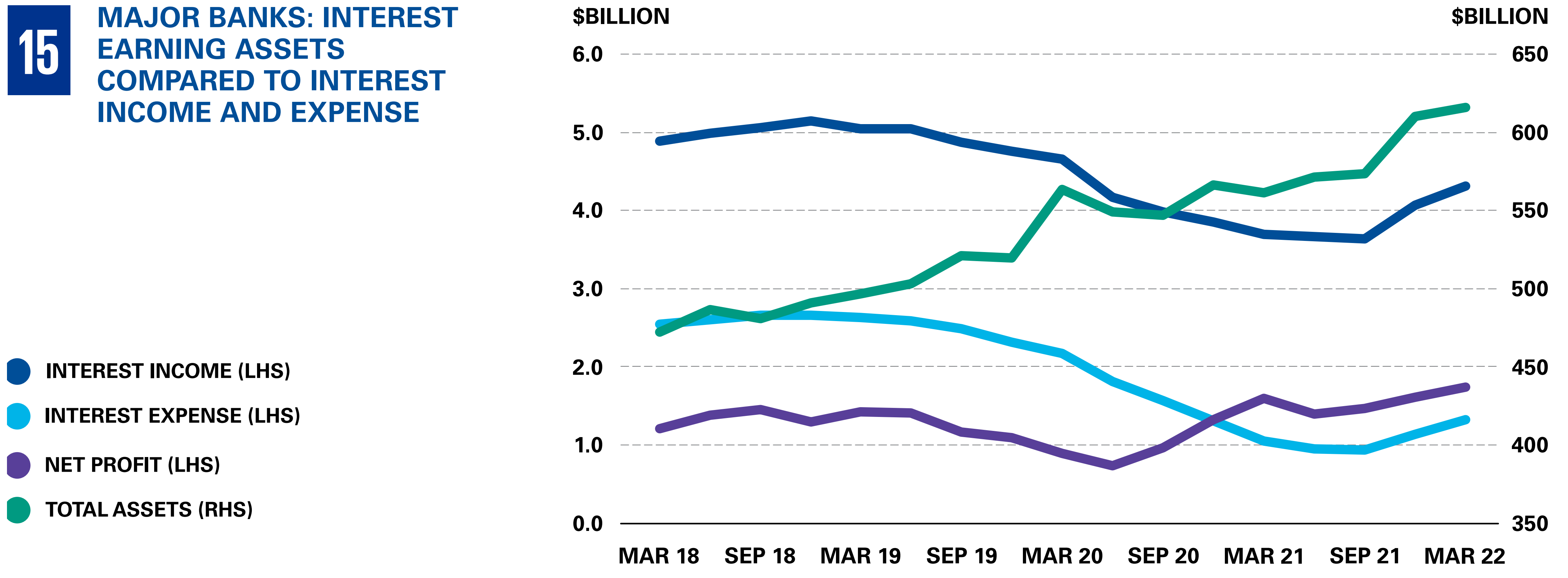


16 LVR ANALYSIS OF RESIDENTIAL MORTGAGES



SOURCE: RESERVE BANK OF NEW ZEALAND STATISTICS

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



Early 2022 marked a turning point for property and lending activity

Kelvin Davidson
Chief Property Economist
CoreLogic

CoreLogic

Kelvin is a Chief Property Economist at CoreLogic and has a wealth of experience after spending more than 15 years working largely in private sector economic consultancies in both New Zealand and the UK. Kelvin applies macroeconomic trends and data to the property market, both residential and commercial, to provide key insights and tell a compelling story.

After a very strong run through 2020-21 for the economy, property market, and mortgage lending activity, conditions have certainly taken an abrupt turn so far in 2022 – both due to regulatory changes, but also just due to simple market forces. The rest of the year also looks set to be much tougher for the economy and the housing/ mortgage sector.

Starting with some key housing market indicators, sales activity has now been under downwards pressure for several months. Indeed, volumes in April were down by 34% from a year earlier, marking the 11th consecutive fall. That has allowed the amount of stock/ listings on the market to be replenished, and has quickly shifted pricing power in favour of buyers in most parts of the country.

Accordingly, it's been no surprise to see property values declining too. The CoreLogic House Price Index recorded a 0.8% drop in April, and given how stretched housing affordability has become (mortgage payments are now about 50% of gross average household income, and its taking more than 11 years to save a typical deposit for a home), those declines in property values aren't set to end anytime soon either.

Our Buyer Classification data has also been recording some really interesting trends. Mortgaged investors remain relatively subdued, with a market share sitting at around 23-25% of purchases – well down on the figure of 29% in early 2021, which was prior to deposit requirements being increased and also before the Government announced the phased removal of tax deductibility of interest expenses. First-home buyers have also been starting to struggle, with market share dropping to 21-22% recently, after record highs of 26% in late 2021. By contrast, movers (or relocating owner-occupiers) – who typically have a greater equity base – have become more prominent.

Of course, these patterns shouldn't be too much of a surprise – after all, the reduction in the loan-to-value ratio (LVR) speed limit for owner occupiers kicked in on 1 November 2021, while the CCCFA rules were tightened from 1 December 2021. These changes have certainly affected credit availability, which has impacted first-home buyers and mortgaged investors, and dampened overall lending flows too. And meanwhile, higher mortgage rates have also played a key role in impacting credit availability.

Two splits of the Reserve Bank of New Zealand (RBNZ's) mortgage lending stats really stand out. First, when you look at the number of loans being written (which strips out the upwards influence of rising house prices over time), the combined total for January to March 2022 was significantly (-37%) below the average for that comparative three-month period over 2015-21. Second, just 3% of owner occupier loans in March 2022 were approved with a low deposit – well below the allowable cap of 10%.

Clearly, some borrowers could have pulled back from low-deposit lending of their own accord. But more likely, banks have taken a much more cautious attitude, especially now that the 'V' part of that LVR equation is also under downwards pressure. Indeed, even without official rules from the RBNZ (delayed until mid-2023 at the earliest, if required), the share of lending being done at a high debt to income ratio has also been declining in recent months.

In terms of mortgage interest rates, sure, we're probably closer to the end for this cycle of increases than the start. But with inflation still high, the Official Cash Rate (OCR) certainly has further to increase, and that will keep a degree of pressure on mortgage rates. And then you've also got to keep in mind that about 50% of mortgages in New Zealand are fixed, but will be due to refinance in the next 12 months – so even if many borrowers have been 'protected' so far, this grace period is set to end pretty shortly.

In our view, the unemployment rate remains a key variable to watch. If it stays relatively low, as most commentators are currently expecting, then this weaker phase for the property market and lending sector is likely to be a correction rather than the dreaded 'crash'. But if job losses started to appear more significantly later in 2022, then property pessimism would only increase. Of course, the silver lining there would probably be a lower OCR peak and less mortgage interest rate pressure.

In a nutshell, then, the first three months of 2022 marked a clear change in direction for the property market and mortgage lending patterns. These pressures are unlikely to abate to any significant degree in the short term, but there are always opportunities. Low-equity buyers may be quiet this year, but relocating owner occupiers are coming out of the woodwork, and may well need to secure some mortgage finance to supplement their equity and allow them to trade up.

> **"The first three months of 2022 marked a clear change in direction for the property market and mortgage lending patterns.**

Uncover the potential of data

Alistair Evans
Director – Lighthouse
KPMG

Alistair leads the advanced analytics practice in Auckland for KPMG Lighthouse. Alistair has over 15 years' experience in the data analytics field and has led projects in financial services and insurance in the United Kingdom and New Zealand. These projects include data strategy, data engineering, business intelligence and advanced analytics/data science and cloud platforms.

The modern connected bank is a data-driven business. At a time when customers are increasingly empowered, connected and demanding, banks that are insight-led can equip themselves to better understand their customers' needs and wants as well as the health of their business.

By harnessing data from multiple sources, such as social media, online surveys and transactions, banks are able to create a real-time understanding of their customers. However, it takes a truly connected bank to be able to develop the right insights and use them to drive forward new opportunities.

Data leadership

There are more organisations appointing executive level roles such as Chief Data Officer (CDO) who are responsible for the organisation's data management and governance, and for establishing and integrating data and information policies into their company.

These roles are helping to drive more strategic conversations around the use of data and artificial intelligence (AI). Having data leaders as part of the senior leadership team lifts the conversation from how data supports operational activities to how it supports strategy. Strong insights-driven cultures typically start at the top with roles like the CDO encouraging their C-suite peers to demonstrate data literacy and encourage the use of insights.

Data leaders at the executive level are better able to implement enterprise data strategies and hold the organisation to account in ensuring data is used appropriately and ethically. As such, the CDO is the pivotal figure in aligning an organisation's data and information strategy with its overall business strategy.

Data mesh

Data mesh is an architecture that allows for different data domains – think of these as business units – to directly connect with various data sources that an organisation has.

Whilst the 'cloud' has lowered the barrier to driving value from data, the journey to being insights-driven remains elusive and challenging for many organisations. Research suggests some of the factors are non-technical. New Zealand organisations are

Key considerations for banks

- Are you gathering and evaluating the wealth of insights available, internally and externally, to improve how you understand and serve individual customers?
- Is your data and analytics strategy foundational to your business growth?
- Is there sufficient knowledge in your leadership team to ensure your organisation's data is being used to its full potential?
- Do your data practices help you to provide a real-time, 360-degree view of your customers, supporting effective relationship development and an efficient customer service?
- Do you use integrated data sources to support the measurement of customer lifetime value management and create/manage customer-level segmentation?
- Are you able to use integrated real-time customer and operational data to prompt business decisions, strategy and next best actions across the bank? Is this augmented with AI?

starting to explore the use of data mesh – a relatively new decentralised approach to architecting and ownership of data.

These organisations are starting to strategise around data as a product, with dedicated data teams for these products. This enables data product ownership to be aligned to the domains or business units who have the most interest in collecting and leveraging the data, but with support from the dedicated teams to ensure strong management of it. These data domains are responsible for the creation and maintenance of data products – outputs that can be consumed by an external or internal audience. The main benefit is reduced reliance on the centralised data team, freeing them up to work on more innovative or strategic projects, as it becomes faster and easier for teams to access the data they need.

Data mesh is set up to be a flexible, innovative architecture, and as technologies are purpose-built to help facilitate a data mesh framework, and skills in the New Zealand market develop, the architecture will be easier to implement within organisations. Consideration must be given to all the changes needed to existing data governance and management approaches, as well as the technical architecture. For businesses that are not yet far enough along the maturity curve to fully embrace data mesh, steps can still be taken towards preparing for a future state data mesh.

You can read more about data mesh in our recent publication: Data mesh: laying the foundations – KPMG New Zealand (home.kpmg).

AI governance

Financial services organisations are increasingly relying on algorithm-based applications to make critical business decisions. While this unlocks opportunities, it also raises questions about trustworthiness.

The adoption of AI and advanced analytics capabilities are creating evolving regulatory and compliance challenges in more advanced markets like those in the US, UK and Europe. New policy initiatives and regulations in these countries around data and AI signal the end of self-regulation and the rise of a new oversight model.

Because of this, New Zealand organisations are anticipating the arrival of greater regulation around the use of AI and data. In 2020 the New Zealand Government Chief Data Steward released the Algorithm Charter[24] and a number of Government agencies became founding signatories, making a public commitment to the transparent and accountable use of algorithms.

Even financial services organisations who are new to AI development are considering the development of governance and control frameworks in parallel to be ready for the anticipated explosion in use once they reach a greater maturity in both AI and advanced analytics development. Critical business decisions made by AI affect their brand – and consumer trust in their brand – and they can have an enormous impact on the well-being or safety of consumers and citizens.

An effective framework will help organisations gain confidence in their AI technology. It should continuously assess and maintain control over sophisticated, evolving algorithms by putting in place methods, controls, and tooling. It should also provide clear guidance for the organisations' stakeholders across various management and oversight functions.

We believe that the governance of AI is just as important as the governance of people, so KPMG has developed the AI in Control framework to help organisations drive greater confidence and transparency through tested AI governance constructs, as well as methods and tooling along the AI lifecycle, from strategy through to evolution.

As the financial services landscape continues to evolve in response to the shifts in customer demand and use of emerging technology, the need to optimise the use of data and the governance around it becomes more critical than ever.

KPMG has experience working with banking clients to develop data governance frameworks. If you would like to speak to our KPMG Lighthouse team about how to successfully leverage your data to drive better business and customer outcomes then, please reach out to Alistair.

The remediation framework and governance in managing complexity

Malcolm Bruce
Partner –
Consulting
KPMG

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

Catherine Spencer
Director –
Consulting
KPMG

Catherine is a Director in our Financial Risk Management team. She comes from a data and analytics background and brings her remediation and modelling expertise to clients in the financial services sector.

Jun Yoo
Manager–
Consulting
KPMG

Jun is a Manager in our Financial Risk Management team. He comes from an audit background, specialising in risk management and remediation in the financial services sector.

> "The pressure on financial institutions to ensure products are **accurate, transparent**, administered correctly and handled with the utmost care whilst **protecting customer outcomes** has never been higher.

In the third article in our series[25] about remediation, we explore the role of governance.

Have you ever considered how your organisation deciphers remediation complexity and if you are doing the right thing for your customers? Remediation is complex. Solving a remediation incident is like a ball of threads; there are historical knots that you must untangle which leads into another larger knot and can sometimes seem like there is no end in sight. Without the right foundations of a remediation framework, the complexity is seldom understood and therefore challenging to unravel.

A key pillar of any remediation framework is good governance. Governance exists in all shapes and forms, but can fall short of addressing remediation incidents if it is driven without purpose and remediation principles. Here, we will discuss the role of a remediation framework and how good governance serves to support the efficient and robust delivery of complex remediations.

> “A key pillar of any remediation framework is good governance.

In our view, senior leaders with responsibilities for remediation should consider within their own organisation the following questions:

- How remediations are governed and whether this is effective?
- Is stakeholder consultation and analysis robust?
- Is there a forum and is this forum focussed and timely?
- Is the forum well documented and is it supported by remediation principles or your organisation’s risk framework?

Role of a remediation framework within an overarching risk framework

The first line of defence for stopping customer harm is designing products and processes that adequately understand customer needs before they are offered to the public. When this fails, a proactive principle-based risk framework that prompts an honest self-reflection of the potential shortfalls across the organisation is important in order to stop customer harm.

Remediation is a tool to address shortfalls in the business decisions previously made, generally in relation to either products or legacy system implementation, and its delivery should be viewed holistically as part of the overarching risk framework. When product or process failures are not adequately detected and addressed through the risk framework, remediation sits as the last line of defence for customers who have potentially experienced harm. A key question to ask is this. If this goes wrong, and our customers experience further harm, are we willing to accept a level of negligence?

In our experience where remediation incidents are managed within a dedicated remediation framework, it gives structure and eliminates the confusion on how incidents should be managed.

Eliminating the element of confusion drives consistency and efficiency of delivery. It means that every time a new thread of knots presents itself, we have a systematic and proven delivery method to untangle the knot at hand.

Effective governance delivers better remediation and builds trust

A dedicated remediation governance forum guided by a remediation framework supports quality of delivery, consistency in approach, and quick decision making. With a dedicated governance forum, there is purpose and impetus to remediation incidents that, if not given their own attention, can risk falling short of either regulatory scrutiny or (even worse) customer expectations.

By having one forum responsible for remediation decision making, the line of accountability is clear for rectifying any identified issues, both internally and for the regulator. Multiple thematic reviews in both Australia and New Zealand exposed the industry-wide challenges for financial institutions to meet the expectations of the regulator in relation to remediation activity, and imminent Financial Markets Authority remediation principles or ‘Conduct of financial institutions’ (COFI) regulation only increases expectations further.

The pressure on financial institutions to ensure products are accurate, transparent, administered correctly, and handled with the utmost care whilst protecting customer outcomes has never been higher. Undeniably there can be an element of inherent conflict when the responsibility to expose your bad practices is on the financial institution, especially when you want to protect your brand and reputation, do the right thing, and meet growth or strategy targets for the organisation. On the flip side, good governance can be an opportunity to build a positive relationship with the regulator by acknowledging past shortfalls, demonstrating the diligence to understand the complexity of the issue, and finding out what is being done

> **“ Good documentation practices are linked with good governance.**

to ensure customer harm is not ongoing, and making sure that all this is driven with structure, consistency, and quality.

The litmus test for all remediation decisions should be the following three questions.

- Would this meet regulatory scrutiny as a conduct issue?
- Would our customers trust that we have proactively and completely rectified the issues?
- Would we be comfortable if a customer was sitting here?

A dedicated governance forum can be the place to both challenge decisions and apply this litmus test, and it also ultimately ensures that remediation activity is completed in line with remediation principles and any overarching risk frameworks.

Governance and stakeholder engagement go hand in hand

A singular decision-maker is unlikely to be able to untangle the complexity on their own. Hence this is why consultation is important. Major stakeholders should be represented or consulted with before a governance forum, as good consultation work will expedite the pathway to remediation, untangle the complexity prior to the decisions required, and demonstrate the value of the group. Regarding the principle that “if it’s not documented, it’s not done,” an organisation must understand that even with proper consultation and deliberation that without supporting evidence, the efforts of the organisation will fall short of any regulatory scrutiny.

Every remediation incident requires a high degree of problem-solving for historical and future issues. Our experience is that remediation is made more challenging by trying to decipher the unique complexity of historical rules when there is limited documentation on system implementation, product design and sales practices. The lack of historically documented evidence to identify what should have happened and what went wrong is part of the remediation complexity. Without discipline and intervention, this mistake can repeat itself.

Good documentation practices are linked with good governance. Even though every organisation is different in its approach to documentation, the underlying needs are to document:

- the understanding of the issue;
- the unique challenges analysed that add complexity;
- who was involved;
- recommended approaches;
- the thought process underlying decisions; and
- a timeline of past event and milestones.

We find decision papers are a key tool for remediation governance forums, especially where they demonstrate understanding of the underlying complexity that you have been trying to resolve. When regulators become engaged and start examining decisions like how all impacted customers have been identified, or why a certain approach was taken, decision papers demonstrate the effort and care taken, and the underlying analysis will provide an audit trail of the thinking that has occurred.

Conclusion

The foundations of a remediation framework that effectively mitigates customer harm are supported by a pillar of good governance. Good governance is purpose-driven, forces discipline, challenges the status quo, includes a diverse view from wide consultation, builds trust with stakeholders, and addresses the root cause of the issue and not just the symptom.

At KPMG we understand the unique challenges remediation can present. Remediation complexity doesn’t have to be overwhelming. No matter the complexity with the right governance action and expertise, remediation issues can be managed efficiently and robustly, to ensure good customer outcomes and allow the business to get on with doing business.

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, Catherine or Jun.

End notes

1. Reserve Bank raises New Zealand inflation hits 30-year high of 6.9pc – The Market Herald
2. Consumers price index | Stats NZ
3. OCR will keep rising thanks to inflation, economists say (nbr.co.nz)
4. Financial Stability Report May 2022 (rbnz.govt.nz)
5. Reserve Bank confident it will tame inflation (nbr.co.nz)
6. Reserve Bank raises OCR to 2 per cent as it seeks to smack down inflation – NZ Herald
7. Reserve Bank lifts OCR as it grapples with inflation (nbr.co.nz)
8. Monetary Policy Statement May 2022 (rbnz.govt.nz)
9. Budget 2022: Surprise cost of living payment into Kiwis' wallets, fuel tax and public transport fare cuts extended | Newshub
10. Cost of importing petrol hits record high (newstalkzb.co.nz)
11. Sharp rise in people missing repayments on buy now, pay later consumer loans | Stuff.co.nz
12. Banks begin hiking mortgage rates post OCR – NZ Herald
13. Effects of rising mortgage rates yet to be felt across the economy – NZ Herald
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15. Homeowners warned to brace for 20% downwards correction in property market (nbr.co.nz)
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19. Government walks back some of its tougher loan rule changes, but banks say it's not enough | Stuff.co.nz
20. Construction 'probably entering bust cycle' with 92 companies liquidated this year | Stuff.co.nz
21. https://www.nzherald.co.nz/business/ormiston-house-developer-receivership-122-properties-105-homes-under-construction/VP4GDZ5FBMJYQ2DF2PO7MLE3PE/
22. This data represents the top New Zealand level banking-licenced entity and is referred to using the brand in common usage, and as per the RBNZ Bank Financial Strength Dashboard. ANZ represents Australia and New Zealand Banking Group Limited – ANZ New Zealand; ASB represents Commonwealth Bank of Australia New Zealand Operations; Heartland represents Heartland Bank Limited; SBS represents Southland Building Society (trading as 'SBS Bank'); TSB represents TSB Bank Limited; Co-op represents The Co-operative Bank Limited; and Westpac represents Westpac Banking Corporation – New Zealand Banking Group.
23. The capital adequacy ratios reported are for the local bank.
24. https://data.govt.nz/toolkit/data-ethics/government-algorithm-transparency-and-accountability/algorithm-charter/
25. Previous articles: How can we turn remediation into a strategic opportunity? FIPS June 2021 and Good customer outcomes in remediation: Redressing the impact FIPS December 2021.

KPMG's Financial Services Team

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

Matthew Prichard
Executive Chair
+64 (09) 367 5846
matthewprichard@kpmg.co.nz

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

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

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

Dinesh Naik
National Managing Partner – Tax
+64 (09) 367 5867
dnaik@kpmg.co.nz

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

Jamie Munro
National Industry Leader – Financial Services
+64 (09) 367 5829
jamiemunro@kpmg.co.nz

Bineeta Nand
Partner – Consulting
+64 (09) 367 5945
bineetanand@kpmg.co.nz

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

Malcolm Bruce
Partner – Consulting
+64 (09) 367 5990
malcolmbruce@kpmg.co.nz

Ceri Horwill
Head of Financial Services – Consulting
+64 (09) 367 5348
cerihorwill@kpmg.co.nz

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

Simon Wilkins
Partner – KPMG IMPACT
+64 (09) 363 3480
swilkins1@kpmg.co.nz

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

Leon Bowker
Partner – Deal Advisory
+64 (09) 367 5333
lbowker@kpmg.co.nz

Additional thanks to the team that makes this publication possible:

Matt Brak, Financial Services Audit Manager
Charlotte Burgess, Financial Services Sector Driver
Elliot Brown, Financial Services Audit Intern

Contact us

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

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

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

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

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

Timaru
24 The Terrace
PO Box 526
Tel: (03) 683 1870

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

kpmg.com/nz

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