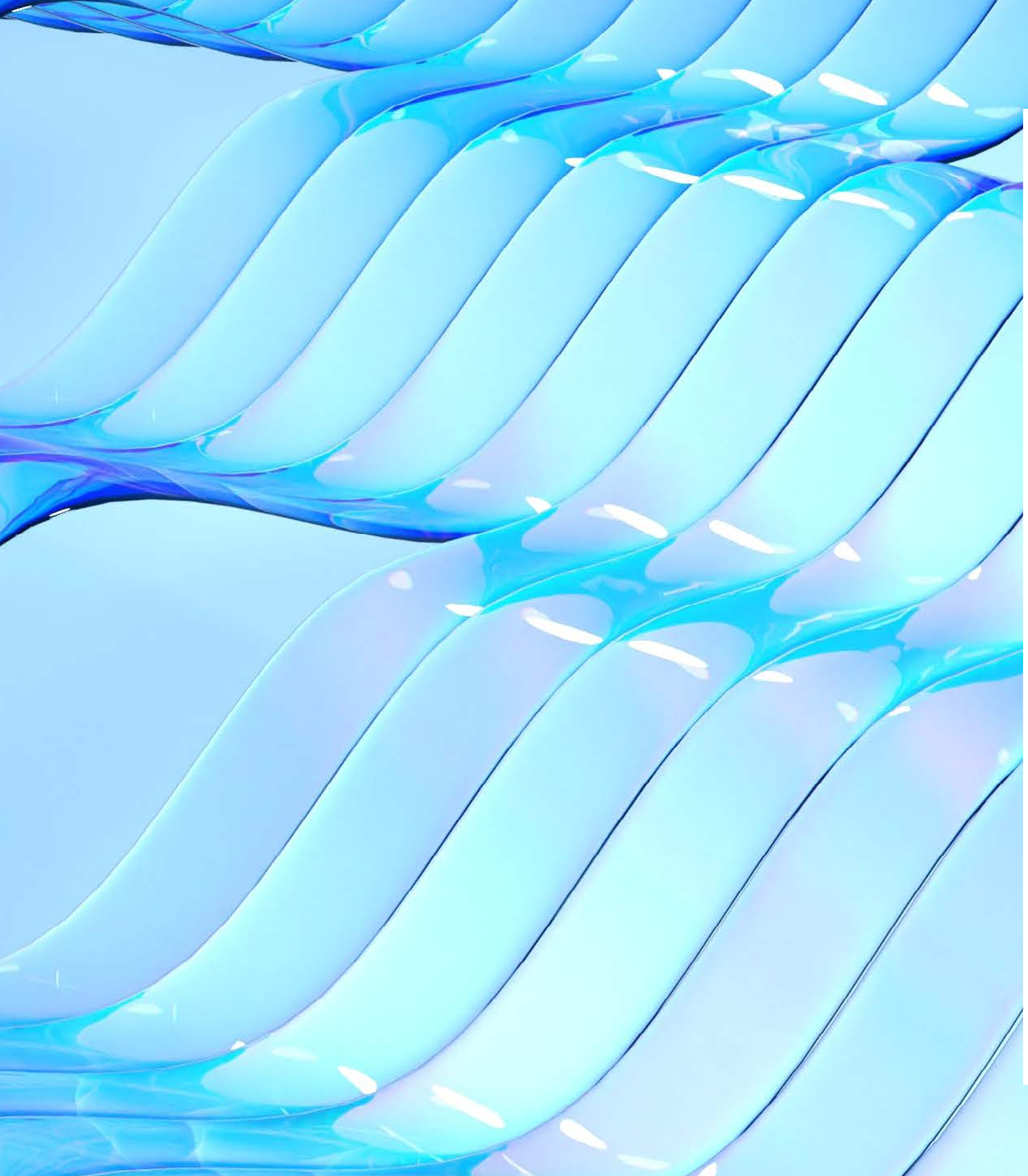
KPMG

FIPS

Financial Institutions Performance Survey

Non-Bank – Review of 2022



Contents

A snapshot of 2022

1. **56.82%** increase in NPAT
2. **11.43%** increase in operating expenses
3. **22.10%** rise in net interest income
4. **75 bps** rise in net interest margins
5. **13.22%** increase in gross lending
6. **14.26%** rise in average funding costs
7. **81.71%** increase in gross impaired assets
8. **19.10%** drop in provisions

The Survey

Welcome to Part One of the 2022 edition of the Financial Institutions Performance Survey – the non-bank sector review.

Our survey of non-bank financial institutions captures the financial performance of entities with annual balance dates between 1 October 2021 and 30 September 2022. The threshold for inclusion in this year's survey continues to be based on total assets of $75 million in one of the last two years.

Most information used to compile this survey is extracted from publicly available audited annual reports for each financial institution. A limited number of participants provided us with audited financial statements that might not otherwise be publicly available.

The non-bank sector comprises a total of 26 survey participants this year following the inclusion of a new participant, Midlands Funds Management Limited, which operates Midlands Income Fund, and the departure of FlexiGroup (New Zealand) Limited.

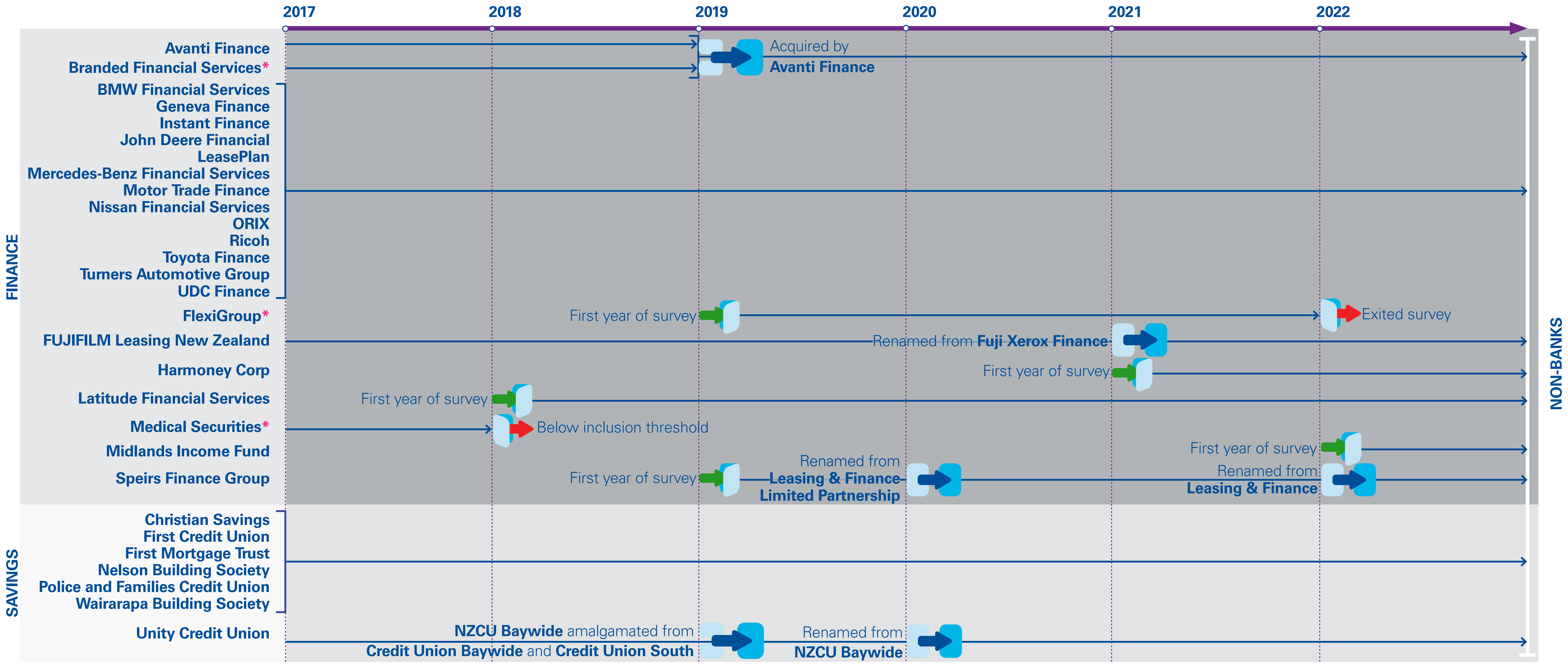
The 2022 survey incorporates Midlands Income Fund, as an entity that meets the threshold based on total assets and has publicly available audited financial statements. Midlands Income Fund is a managed investment scheme investing into mortgage securities over New Zealand land and buildings.

The non-bank sector for the purposes of this survey includes a range of credit unions, non-bank deposit takers (NBDTs), building societies and finance companies in the business of providing leasing opportunities for motor vehicles, consumers, personal, commercial and mortgage sub-sectors.

We would like to acknowledge and thank the survey participants (CEOs and CFOs) for their valuable contributions.

TABLE 1: Entity movements		
	Who's out	Who's in
Non-banks: 26	FlexiGroup (New Zealand) Limited	Midlands Income Fund

Looking back at the sector



* Entities are no longer participating in the survey for various reasons.

A KPMG view from the editor

John Kensington
Partner – Audit
Head of Banking and Finance
KPMG New Zealand

John has been with KPMG's Financial Services audit team for over 38 years, 25 of these as a partner working with a wide range of financial services audit clients, specialising in banks and finance companies.

John has a wealth of experience in auditing and accounting for banking products and services including treasury, retail offerings, corporate loans and loan provisioning. He is currently KPMG's Head of Banking and Finance and editor of this publication. John is also Deputy Chairman of the New Zealand Auditing and Assurance Standards Board (NZAuASB) and serves as a board member of the XRB. John is also a fellow of CA ANZ, a member of the Institute of Directors and a Trustee of Breast Cancer Cure.

Whenever I sit down to write the letter from the editor for the bank or non-bank FIPS, it is always with slight trepidation. I am always slightly anxious as to whether there will be a topic or topics that stand out from the vast array of issues and challenges that senior management of the entities have spoken about with us.

As I go through the process, it also reminds me how incredibly grateful we are for the time that the CEOs and CFOs spend with us talking about their businesses. I don't know why I worry to the extent I do because there is always a fantastic range of topics that stand out. Identifying the key topics is never difficult.

As part of drafting the letter from the editor, I looked back at the prior year's version for inspiration and this reinforced the fact that many of the topics that were at the forefront of this year's discussions were also there last year.

This year there are four key areas that have stood out from discussions with the non-bank sector.

1. The sector itself and the role that it plays

The non-bank sector plays an incredibly important part in New Zealand's financial and social fabric. While the sector may be significantly smaller than the bank sector, the role that it plays in providing alternative types of finance to 1.7 million New Zealanders is not to be underestimated. The bank sector is much larger, but the non-bank sector plays a vital role to a large number of New Zealand households and businesses, providing them access to financing that banks either won't or can't do. Yes, at the centrepiece of many households and businesses' funding is a bank, but there will always be some things that a bank will either not do or not do as well as a non-bank entity. Many New Zealanders financing portfolio is a mixture from these two sectors. For some it might be their only source of borrowing, ranging from core assets such as a motor vehicle to allow the family to get to and from work, school and enjoy a social life, through to some form of credit that allows access to entertainment and hospitality or a personal loan to finance that much needed and much enjoyed holiday/travel combination.

A lot of what the non-bank sector provides is critical for households and businesses in New Zealand to survive. Politicians and regulators need to appreciate the importance of non-bank lending. Often this lending is portrayed as high cost and predatory. There is probably nothing further from the truth for the entities in the survey and in fact those adjectives should only be used to describe the entities that are not strictly part of the sector, but are in a shady sector below this and engage in forms of lending that the sector members would not. While many politicians, regulators and budget advisors have criticised the sector, the fact that people keep coming back to it for valid credit needs they can't source elsewhere and that the sector loss ratios have been so low would indicate that a lot of concern around lending not being responsible is unfounded.

In many cases, the lending that is done is critical to people being able to live their normal life, carry on their daily business and be active participants in society.

2. The lack of Government support

The non-bank sector has not enjoyed the same degree of Government support that the bank sector has, particularly during the Covid-19 pandemic. A number of anomalies have arisen. Firstly, the banks had access to the Government's 'Funding For Lending Programme' aimed at providing them with access to cheaper lending so that they could lend to households and businesses to support them through the pandemic and stimulate the economy during and post the pandemic. Banks are also able to securitise certain assets and obtain further funding using that mechanism. A similar mechanism was not available to the non-bank sector. Thirdly, if an application was made for a deferral on a mortgage it had no impact on a person's credit rating. Again, the treatment in the non-bank sector was not symmetrical. While not suggesting that this was deliberate action against the sector as a whole, it certainly left entities within the sector at a disadvantage as they navigated through the lockdowns and other restrictions related to Covid-19.

3. The third area is related to the second resolution

Regulation is strangling the sector and needs to be both proportional or scalable. As discussed in last year's survey, the Credit Contracts and Consumer Finance Amendment (CCCFA) Act is an example of a piece of legislation that had lofty ('theoretical') aims, but was misguided and poorly executed and its impact was far from favourable. Originally designed to protect borrowers from unscrupulous lenders, this regulation probably achieved the opposite effect plus it had a number of other unintended consequences. It needs to be remembered that when you are lending to people at the lower end of the socio-economic spectrum, as the lender you will be more careful and assess their ability to repay more thoroughly. If you do not, you will suffer significant losses and the low loss ratio of the sector as a whole would indicate that lending was being conducted responsibly.

The CCCFA changes were put in place despite warnings from this sector and the banking sector of unintended consequences, and it achieved all of the negative outcomes that were warned against it. It slowed up and, in some instances, stopped lending. It made the time to complete a loan considerably longer and resulted in a significant number of applications being declined. When this happened, many borrowers had no option, but to go to a different type of lender and eventually ended up paying more. Those at the bottom of the credit spectrum would have been pushed back to pay-day lenders. The CCCFA was put in place to solve a problem, but the real issue was that the problem it sought to solve did not exist to the extent that many responsible for implementation the regulations thought that it did.

Further, when the inevitable happened and all of the problems became apparent, the Government was slow to accept responsibility for the issue and correct the problems and even tried to deflect criticism by implying that the reason lending rates had slowed or stopped was due to seasonal impact or was because the Act had curtailed previously unacceptable lending. In addition, when the CCCFA was launched there was supposed to be an information campaign explaining the impacts that it would have on customers – but that never occurred – leaving the industry to deal with confused and angry borrowers.

All in all, the CCCFA is symptomatic of regulation that is being applied to the industry. While none of the regulation is inappropriate, what needs to be taken into account is that these entities are small entities and simply do not have the workforce to rollout the full suite of controls, processes and procedures to a gold standard, and therefore, some form of proportionality or scalability needs to be applied. New Zealand's regulation doesn't need to be the best of the best if that brings unnecessary complexity with it. The perfect illustration of this is the fines that still remain in place under the CCCFA. A $500,000 fine could easily be absorbed by a bank – it would be unpalatable and unpleasant, but it could easily be absorbed, whereas a similar fine could be terminal for a smaller financier.

In other areas of regulation, concerns that we heard as we interviewed the non-bank sector were around the inability for some entities to raise capital due to having no capital instrument permitted by regulation. Other entities were concerned about the cost of maintaining their deposit-taker status while others were concerned around the ongoing impact of CCCFA and increased requirements around the Anti-Money Laundering and Countering Financing of Terrorism Act and the implementation of Financial Markets (Conduct of Financial Institutions) or 'CoFI'.

Another example of inconsistent regulation is around the recently announced Buy Now, Pay Later (BNPL) amendments. BNPL has long been outside of the responsible lending code due to the fact that the definition of lending includes interest and BNPL transactions did not under the definition have interest paid by the borrower. BNPL has now been pulled into the CCCFA regime, but the situation has been further complicated by having an exemption for transactions under $600. If we have a CCCFA that is considered by its designers to be a good piece of legislation, then why modify it for one type of transaction and create an artificial threshold by not implementing it 'as is'?

4. Uncertainty

The final area that had unanimous agreement amongst non-bank sector participants was the current level of uncertainty. Everybody spoke of rising costs and inflation, increasing interest rates and the impact that the Reserve Bank of New Zealand's (RBNZ's) strategy could have on the economy. It would appear that inflation is stronger than first thought and the Official Cash Rate (OCR) will need to be raised to a level higher than previously predicted.

The uncertainty will also be around once the rate raising cycle ends, with questions around how long interest rates and inflation will stay that high and eventually how quickly they will come down. The RBNZ's Governor has even indicated that they are looking to engineer a little bit of a 'recession'. While the RBNZ's Governor is speaking about a recession, the Government is still spending at a very high rate. This uncertainty was spoken about by everyone with all survey participants agreeing that the next six to nine months will be particularly challenging with businesses raising funds at higher rates and being forced to pass these extra costs onto borrowers. The real fear is that if interest rates keep rising, there will be a recession. All of the negative indicators combined with this uncertainty make for another challenging year in 2023.

Throughout our discussions with the senior executives in the non-bank sector, a number of other topics were commonly traversed. One further realisation was that this sector is diverse, ranging from captive car financiers through to personal loan lenders, mortgage lenders and other types of retail lenders. This year's sector performance more than ever has been affected by two factors. Firstly, the lockdowns that occurred during this current reporting period and how they fell within an entity's financial year. Secondly, those entities involved in mortgage lending enjoyed significant expansion as low interest rates made home ownership a viable option for many and banks pulled back on lending. However, those in the retail space suffered significant reductions in lending during the periods of lockdown.

In addition, as I noted last year, New Zealanders have shown themselves to be a very resilient bunch. It would appear that New Zealanders have continued to meet their debt obligations and repay as strongly as they have in the prior two periods with a combination of low interest rates, possible pay increases and Covid-19 restrictions reducing spending on discretionary items that all contributing to savings.

Once again, I would like to acknowledge the CEOs and CFOs that met with us during the process and the KPMG team who worked tirelessly on the project. Thank you all.

J. P. Kemp

Sector – Themes and issues

Information current as at 9 December 2022

> High inflation was a combination of domestic and international factors, with annual inflation up to 7.2% in the September quarter.

Over the past year we as a nation have returned to relative normality with regards to the relaxing or removal of lockdown measures that were in place throughout the Covid-19 pandemic. Throughout the last two and a half years, many businesses have had to operate through heightened uncertainty and for some financial hardship as New Zealand learned to live with the 'new normal'. The Covid-19 pandemic related impacts, in particular the money pumped into the economy to stimulate and support it, the restrictions on immigration and broken supply chains were key factors in driving up both inflation and uncertainty.

As we move into 2023, our survey participants highlighted the major concerns that they have, which have shifted towards uncertainty over the path the economy takes going into 2023 and beyond as it navigates its way through the unwind of the Government's stimulus packages and the other pandemic-related impacts. This time last year, the only certainty was uncertainty. However, while the road ahead seemingly holds challenges for many of our survey participants, they seem to have a clearer picture as to the direction the economy is heading, if not the exact road it might take and how long and bumpy that road might be.

Economic uncertainty

Inflation

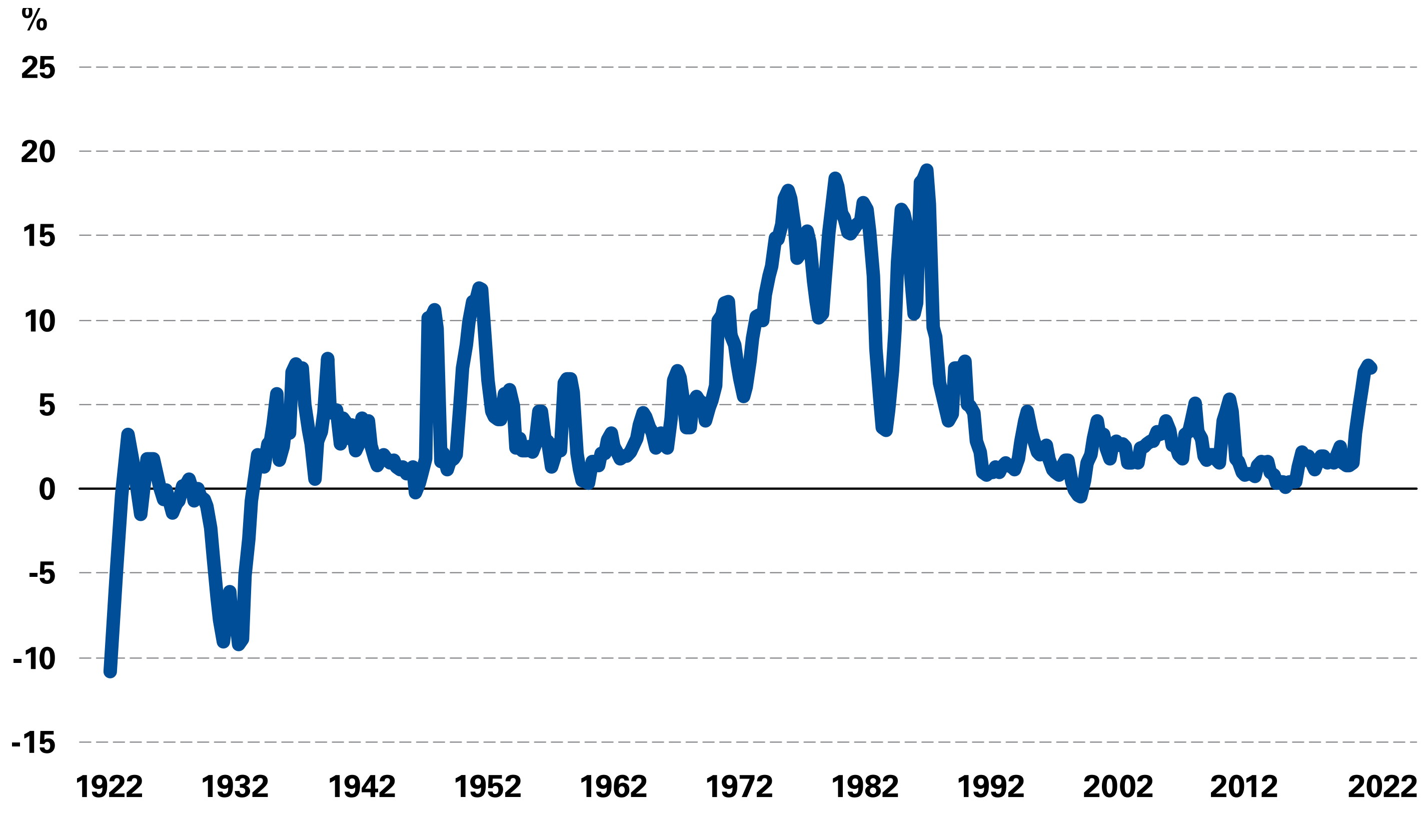
Inflation remains at the forefront of our survey participants' minds when discussing the economic uncertainty facing them. High inflation was a combination of domestic and international factors[1], with annual inflation up to 7.2% in the September quarter[2]. Many were surprised by the sharpness of the increase, the scale of the increase and how it has persisted throughout the year. Participants have experienced inflationary pressures to varying degrees. Others are more focused on the impact on their client base with their customers more hesitant and less likely to spend during such periods of low confidence leading to lower levels of surplus funds available for discretionary expenditure. The impact on our participants' younger clients was also a consideration and many noted that they are likely to have never experienced such a period of interest rates rises, inflation and the talk of a recession, so they will be uncomfortable with the prospect of further rising costs.

1 See Figure 1 – page 8

Cost pressures and operational efficiency were two consequences of high inflation that our survey participants reported that they were dealing with and trying to manage. For some, it sparked the debate – people vs. automation. While automation was noted as a tool against inflation to keep costs down, survey participants also stressed the importance of people in specific roles. There were fears that the cost-of-living crisis, brought upon by persistent inflation, could significantly impact the non-banking sector and its borrowers over the next five years as their loans re-price from historic lows and the quantum of that impact is fully felt.

One other key contributor to inflation is the continued high levels of Government expenditure and this is seemingly increasingly at odds with what the Reserve Bank of New Zealand's (RBNZ's) Governor is both trying to do and signal to the economy.

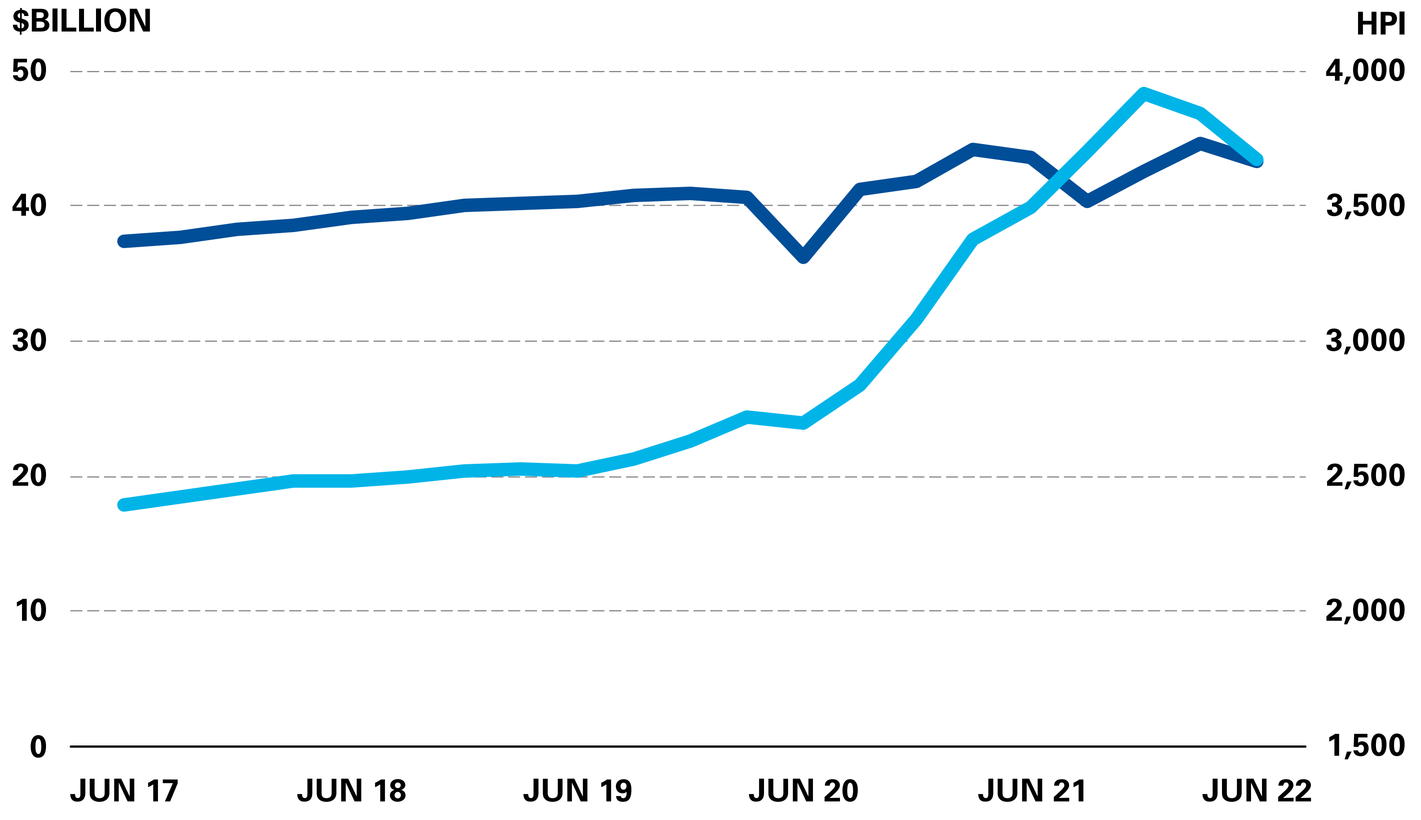
1 CONSUMER PRICE INDEX (CPI) (ANNUAL % CHANGE) 1922 TO 2022



CONSUMER PRICE INDEX

SOURCE: RESERVE BANK OF NEW ZEALAND

3 PRIVATE CONSUMPTION VS. HOUSE PRICE INDEX

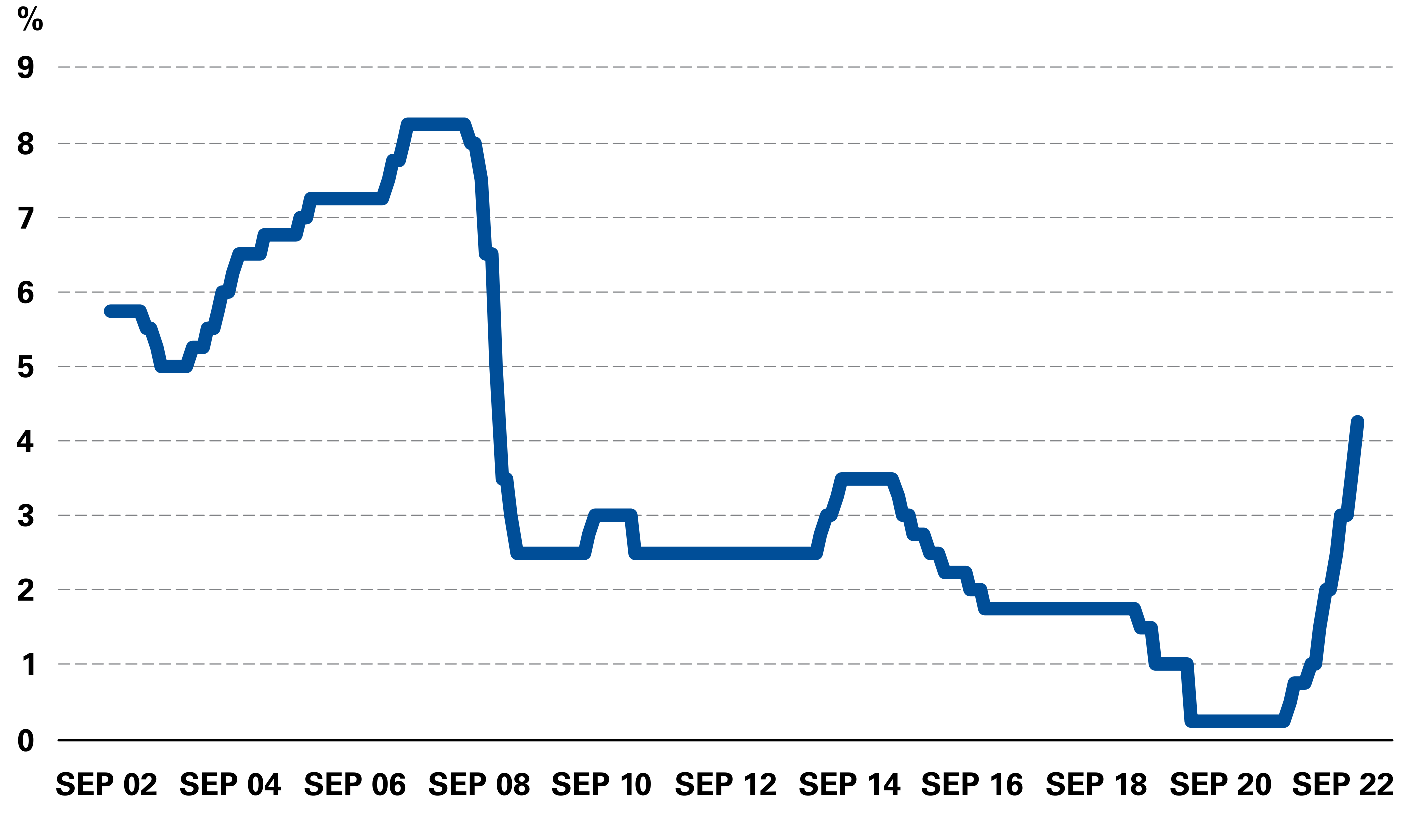


PRIVATE CONSUMPTION (LHS)

HOUSE PRICE INDEX (HPI) (RHS)

SOURCE: RESERVE BANK OF NEW ZEALAND

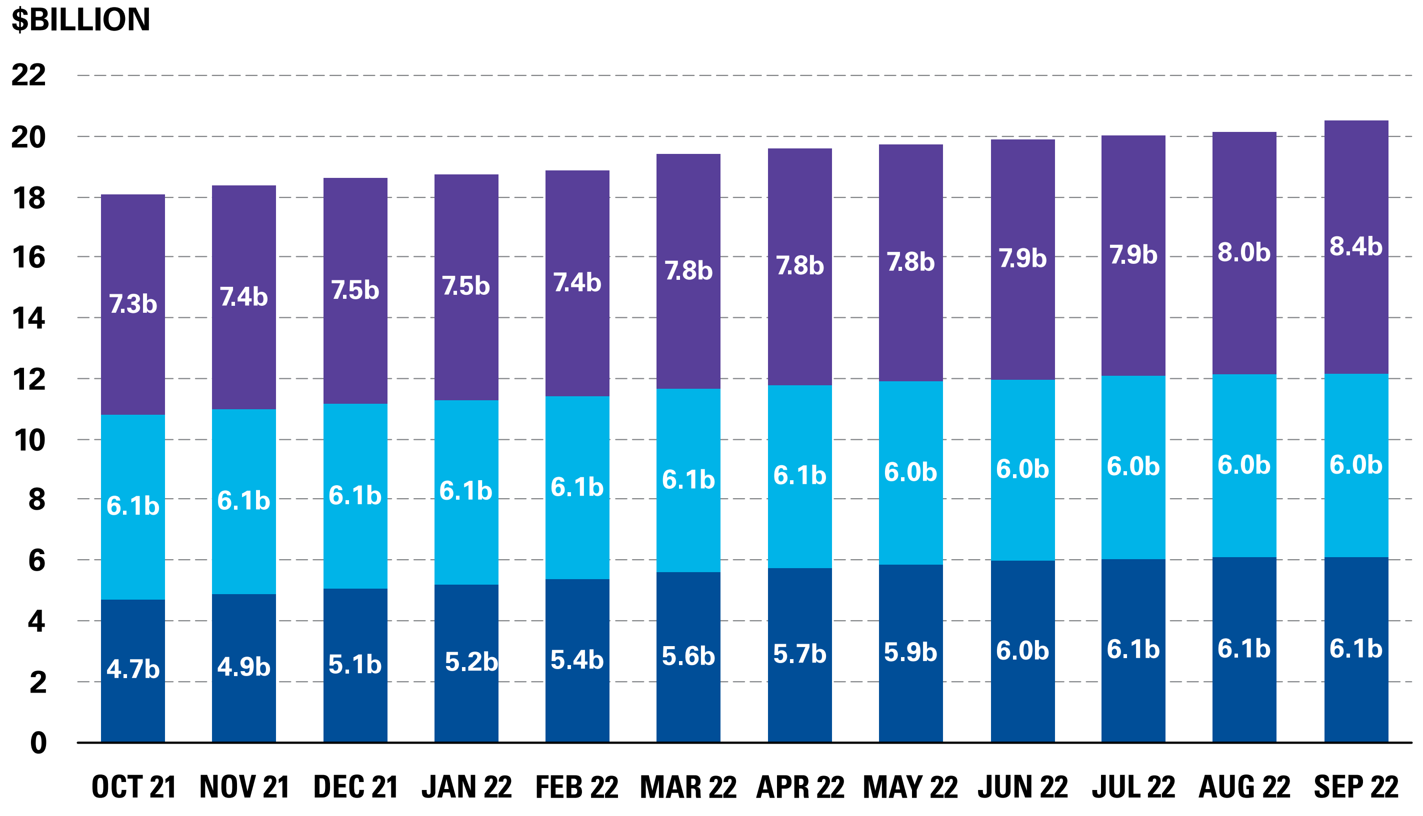
2 OFFICIAL CASH RATE (OCR) (END OF MONTH) 2002 TO 2022



OFFICIAL CASH RATE

SOURCE: RESERVE BANK OF NEW ZEALAND

4 NON-BANK SECTOR LENDING



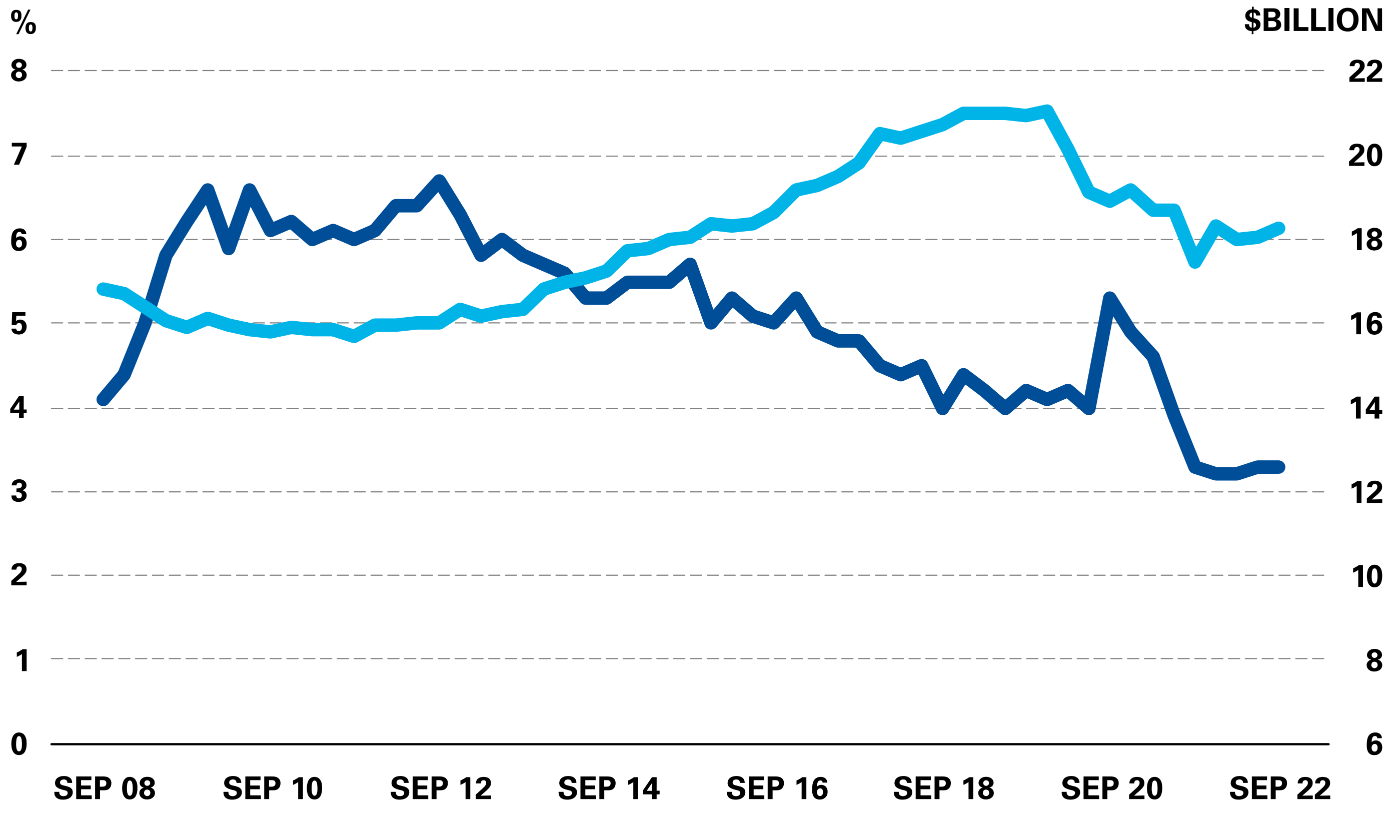
HOUSING – NON-BANKS

PERSONAL – NON-BANKS

BUSINESS – NON-BANKS

SOURCE: RESERVE BANK OF NEW ZEALAND

5 UNEMPLOYMENT RATE VS. PERSONAL LOANS AND CREDIT CARD SPENDING

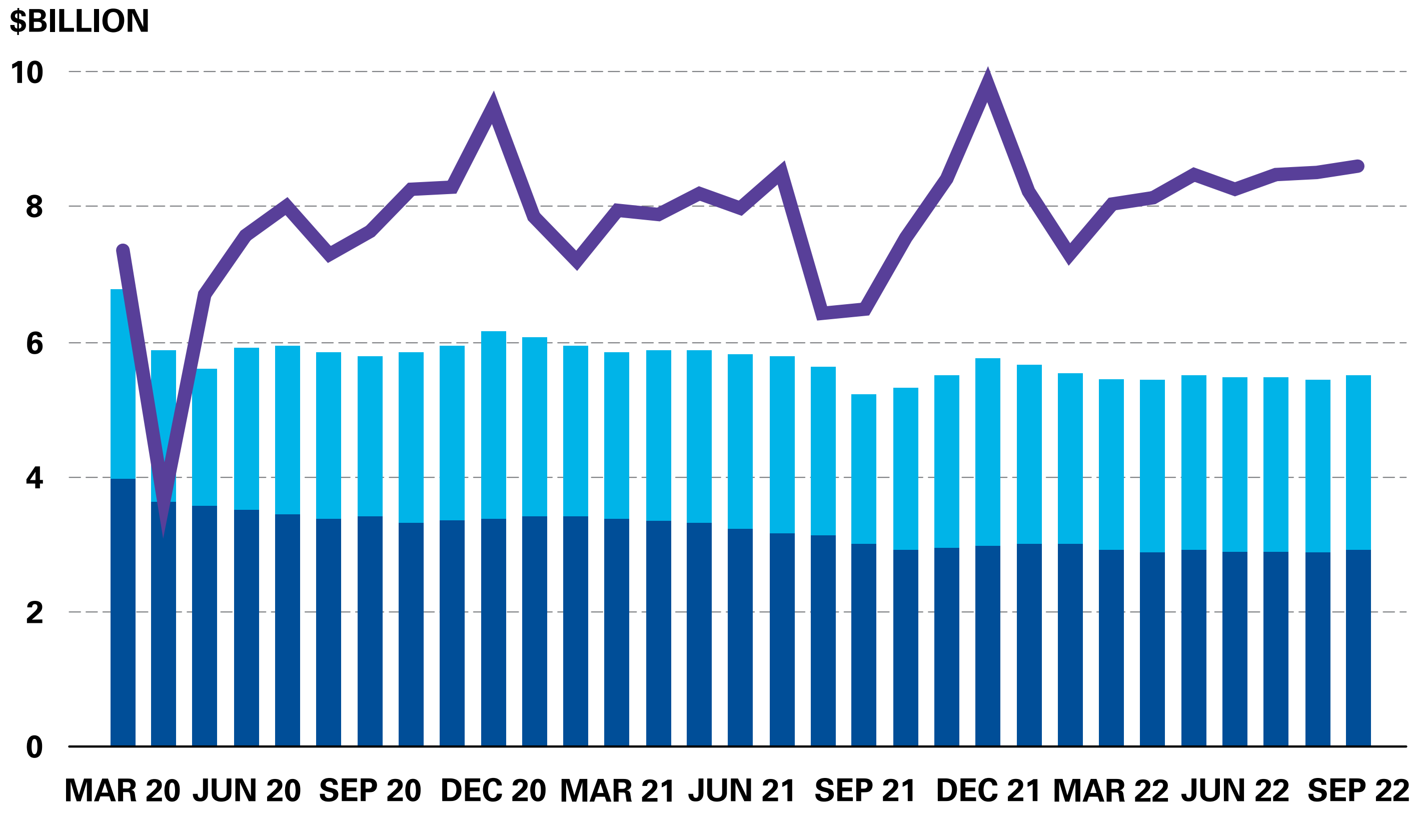


UNEMPLOYMENT RATE (LHS)

PERSONAL CONSUMER LOANS + SEASONALLY ADJUSTED CREDIT CARD SPENDING (RHS)

SOURCE: STATISTICS NEW ZEALAND

7 CREDIT CARD BALANCES VS. ELECTRONIC CARD TRANSACTION



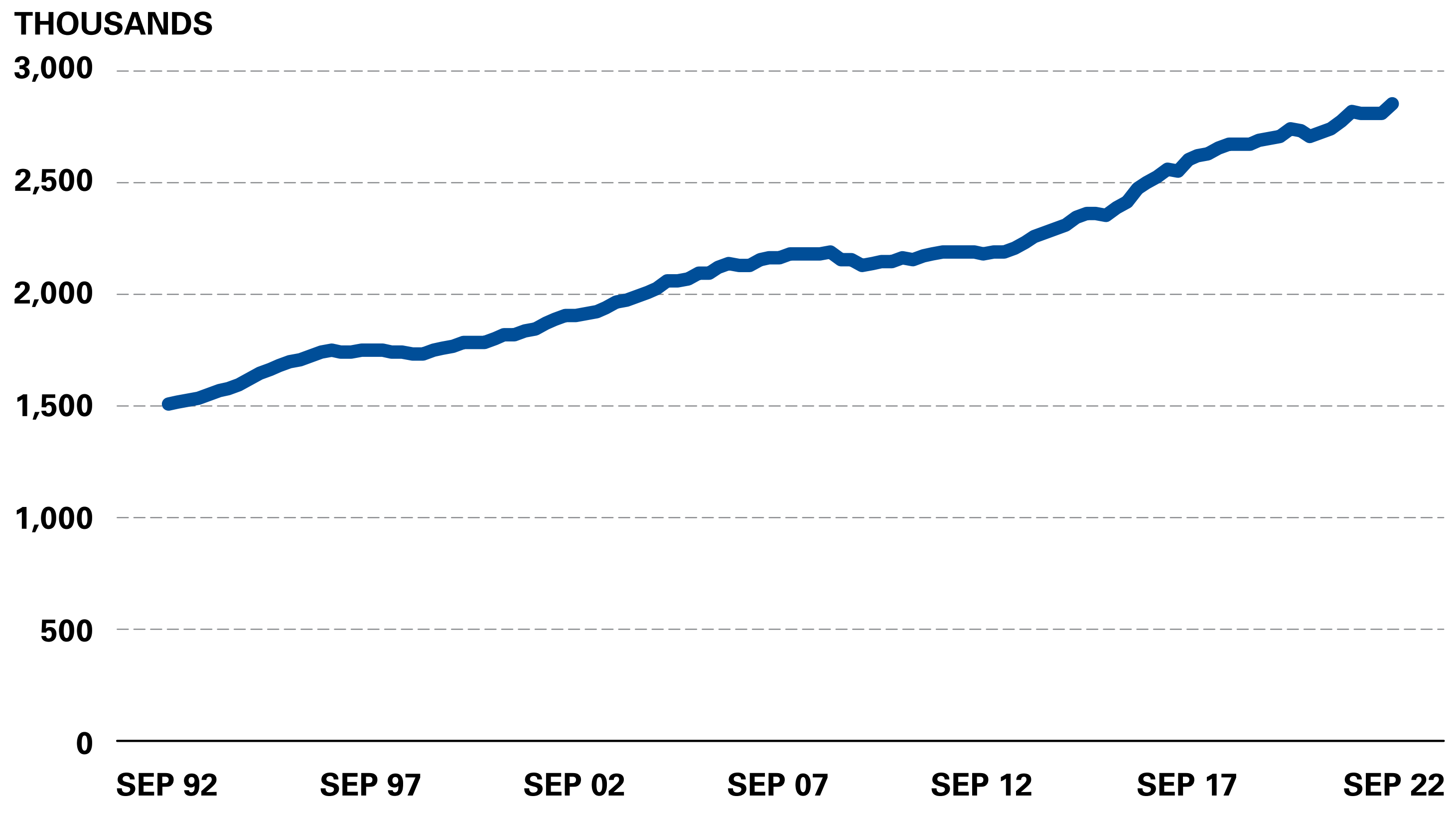
INTEREST BEARING CREDIT CARD BALANCES

NON-INTEREST BEARING CREDIT CARD BALANCES

ELECTRONIC CARD TRANSACTIONS

SOURCE: RESERVE BANK OF NEW ZEALAND

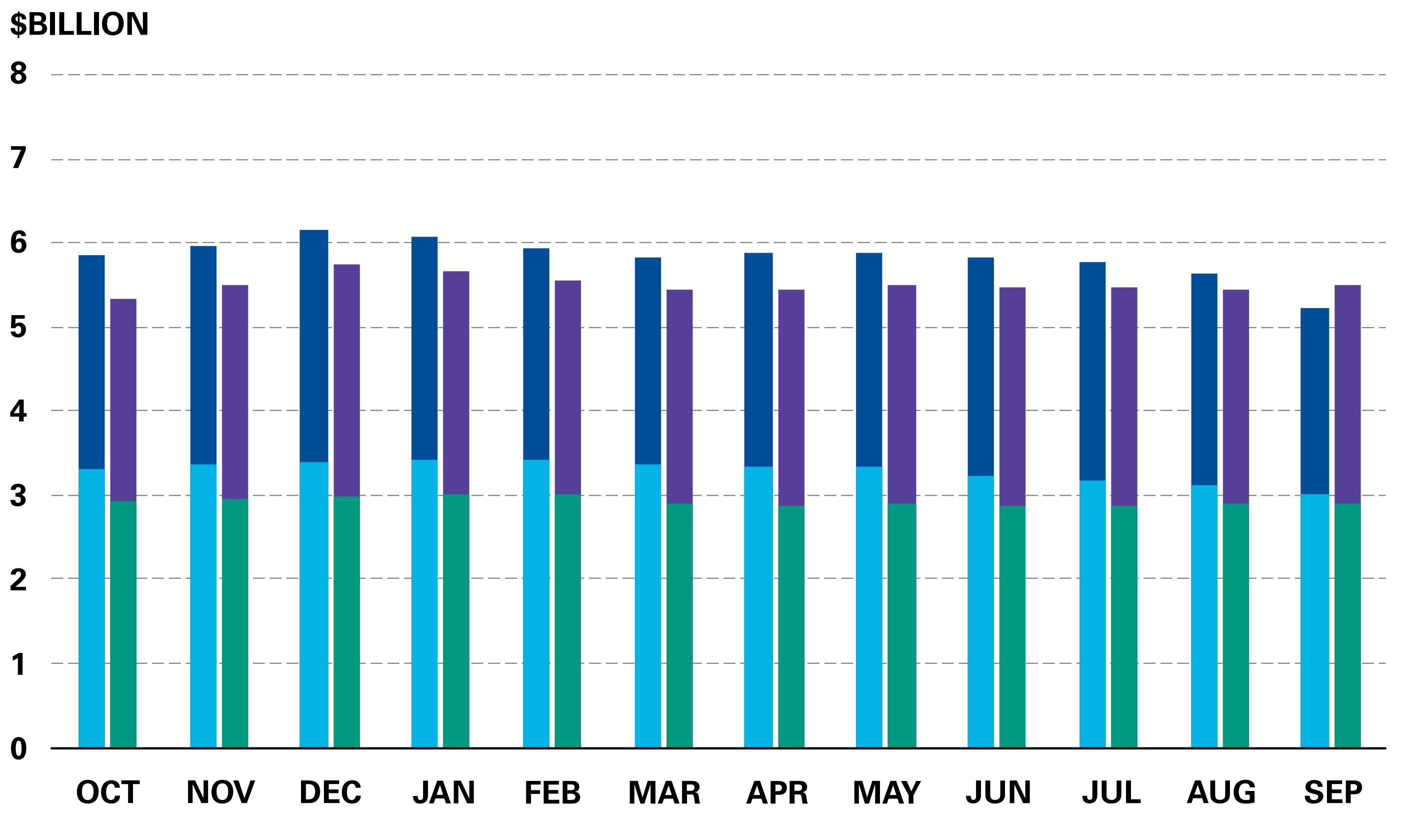
6 NUMBER EMPLOYED (SEASONALLY ADJUSTED) 1992 TO 2022



NUMBER EMPLOYED

SOURCE: RESERVE BANK OF NEW ZEALAND

8 2020/21 VS. 2021/22 CREDIT CARD BALANCES



2021 CREDIT CARD BALANCES (LHS)

2021 INTEREST BEARING CREDIT CARD BALANCES (LHS)

2022 CREDIT CARD BALANCES (RHS)

2021 INTEREST BEARING CREDIT CARD BALANCES (RHS)

SOURCE: RESERVE BANK OF NEW ZEALAND

The Governor is saying we need to limit expenditure and implement austerity measures, with interest rates being pushed up to try to achieve this. All the while one of the biggest players in the economy (the Government) is continuing to spend up large and probably will continue to do so in the lead up to next year's election.

Interest rates

Rising interest rates was another area of specific focus for our survey participants. Some were concerned about the ability of borrowers to repay loans with interest rates higher than they have been for many years. Interest rates for housing have risen to above 6% annually (average bank two-year fixed rate)[3]. Many participants were worried that they would be unable to pass on additional interest rate rises while at the same time acknowledging that it must be necessary to protect both margin and profits.

Focus from investors on remaining profitable among this period of uncertainty

There was a consensus among survey participants that the focus from investors during this period has shifted slightly and while Climate/Environmental, Social and Governance (ESG) are still hot topics there is a slight move away from areas considered less pressing to focus on short term financial performance in a challenging economy. There was a consistent message from our participants that a large area of focus for them was how they will remain profitable and continue to deliver their services to the market competitively during this period of uncertainty.

Monitoring of Official Cash Rate (OCR) changes and bracing for upcoming recession

In November 2022, the RBNZ raised the OCR by 75 basis points (bps) to a 14-year high of 4.25%[4] with the expectation that it will peak at 5.5%. There was agreement from participants across the board that the RBNZ will need to act carefully in how they continue to tackle inflation. Many believe the RBNZ is at risk of inducing a recession with their record rises in the OCR over the last year (something the Governor of the RBNZ has since agreed with) and so are cautiously looking ahead to the future as movements in inflation and interest rates continue into 2023.

2 See Figure 2 – page 8

While survey participants believe inflation needs to be tackled, the fear many hold is that due to a delay of another three to six months before all mortgage rates reset, there could be continued OCR rises to combat inflation. Due to this lag effect, there is a concern that interest rates could rise faster than is required to combat inflation, resulting in unnecessarily high rates for borrowers to deal with. Some participants worry that we may push past the tipping point of a soft landing and create a crash before the impact of rate rises can be reversed.

Cooling housing market

The housing market continues to be an ever-present feature in the media with the national house price continuing to decline since the beginning of the year. In October 2022, the average national house value was $951,040, signalling a 5.1% reduction in average national house values over the last 12 months[5]. This is a return to an average national house price below $1 million. Therefore, it is no surprise that survey participants describe the housing market as faltering.

3 See Figure 3 – page 8

The decreasing house prices can be attributed to several factors including affordability and inflation. Inflation is having a significant impact on interest rates with the RBNZ raising the OCR by 75 basis points to a 14-year high of 4.25%[6] on 23 November 2022. Increasing interest rates and tougher lending criteria, has had a significant impact on many of the home buyers in the market, especially first-home buyers. Mortgage interest rates have increased from 4.2% (average bank two-year fixed rate) in early 2022 to over 6% in November[7].

> “In October 2022, the average national house value was $951,040 signalling a **5.1%** reduction in average national house values over the last 12 months.

This increased cost of finance is driving both uncertainty and affordability issues and with it slowing demand, which is at the same time shifting house prices down. Many borrowers would not have factored in such steep increases of interest rates throughout the year and may struggle when it comes time to either refix or float their mortgage, as the cost of living continues to soar.

Consequently, buyers are taking a wait and see approach, which is contributing to the slowing of the housing market. More buyers are seeking finance through non-bank lenders with some survey participants reporting that this period of declining house prices has been perversely good for them and their business as they have received an increase in application for loans. This is evidenced through non-bank sector lending for housing increasing by 24.81% between September 2021 and 2022[8]. As buyers no longer meet criteria set by banks, more non-bank lenders are picking up this slack.

4 See Figure 4 – page 8

A significant consequence of a slowing market is a reduction of the property development market, especially in main centres where developers are having to drop prices to meet the market. Some survey participants noted that developers are holding on to property where they would usually sell or are slower to sell, and therefore, are slower to commence the next project. Our participants noted that the regions were performing well compared to main centres with developers still having good profit margins for developments in regional areas, despite potentially taking a little longer to sell at a slightly lower price.

2021 home buyers are significantly impacted by the cooling of the housing market. The impact on this group is venturing into negative equity and impacting their ability to service mortgage rates at higher interest rates[9]. This continues to play a part in the declining house prices and overall, the flow on effects to the economy. It is predicted that the housing market will continue to decline into 2023 and the rising cost of living along with financing will continue to play a major role in house prices heading into the next year.

Competition for talent

Once again, one of the most significant risks many survey participants identified was the shortage in skilled labour. The October 2022 *Seek Employment Report*[10] reports that job adverts increased by 16% compared to October 2021 from an already high level.

The shortage of talent has also driven up salaries, with many survey participants experiencing inflationary pressures in employee costs (due to both the competition for talent and increased regulation requiring a larger workforce. Statistics New Zealand[11] indicates that the private sector average ordinary time hourly earnings increased by 8.6% to $36.09 in the year to September 2022.

Most survey participants noted they were experiencing difficulties in attracting or retaining talent, leaving them to ask, 'where have all the people gone?'.

5 See Figure 5 – page 9

6 See Figure 6 – page 9

Some survey participants suggested this was primarily due to the lack of international workers, with New Zealand border restrictions still in place, resulting in a less favourable perception of the country. They believe this has restricted businesses from acquiring the skilled staff they require to operate at full capacity. Immigration was also noted as a key issue, one which the Government needed to address in order to create a more efficient economy and prevent wage costs from spiralling even further. Many survey participants believed our border restrictions were in place only for tourists, but open for workers; however, the administrative requirements related to immigrant workers were deemed significant. Relaxing the administrative requirements was identified as a lever that the Government could pull to assist businesses.

> One of the most significant risks many survey participants identified was the shortage in skilled labour.

> Many survey participants indicated a key challenge that they were facing was regulation, which primarily favoured the banking sector over the non-bank sector.

With little progress towards changes leading many to think that the Government is holding onto the ideological idea that immigration restrictions will improve New Zealand's low wage economy. Many pointed out the problem with this approach is the unintended consequences along the way, and that this is also a contributor to inflation.

Another answer to where all the people have gone is likely to be back to their home countries, with a number of employees returning back to family overseas after the Covid-19 pandemic. There is also a build up of younger employees seeking to go on their overseas experience (OE), with many now deciding that it is safe enough to do so. New Zealand for many, is still not seen as a desirable destination, indicating that we might not see as many young people arriving as departing.

There were also concerns by survey participants over staff retention without consistently increasing salaries by significant amounts. A number of participants noted that their staff were being poached by the banking sector as they were attracted by higher salaries or large signing bonuses.

The Covid-19 pandemic led to a greater acceptance of employees working from home, and this hybrid working environment is now being offered as the new normal for most entities as they attempt to recruit and retain staff. However, many survey participants noted that a balance is required between offering flexibility and maintaining both company culture and a collaborative workplace. This newly accepted hybrid form of working has also seen employees' value more of a work-life balance, and this has resulted in participants noticing that fewer hours are getting worked.

A number of survey participants noted the low unemployment rate and questioned whether there could be more transparency in these figures as currently they did not include those on 'job seeker', which would paint quite a different picture. Others questioned whether it was the right measure to look at given the challenges the country was facing, or whether a better measure could be used to consider the capacity at which an entity's workforce could operate.

Competition from banks

Many survey participants indicated a key challenge that they were facing was regulation, which primarily favoured the banking sector over the non-bank sector. Increased and new regulations seem to assume that an entity has significant resources to implement it with little or no scalability being applied. The Financial Services Federation is calling for more 'proportionality' (see Non-bank lenders weather the storm – but is there worse yet to come? on **page 19**). Participants on the whole did not have high hopes of these concerns being addressed in part because of what they have seen happen around the Credit Contracts and Consumer Finance Act (CCCFA) and in part because of a lack of understanding of the non-bank sector and its role.

Many survey participants expressed concern around the lack of support provided by the RBNZ and the Government, with many noting issues of inequitable treatment between the two sectors, particularly through the pandemic, with assistance being provided to the banking sector, but not the non-banks sector. Key areas mentioned were preferential funding programs and the ability to securitise assets.

Comments were made by survey participants about the challenges for credit unions and building societies, in particular, around raising capital and the use of capital instruments with the RBNZ seemingly being slow to allow them to raise capital in order to be a real competitor to the banks.

Some noted that the non-banks sector had not benefited as much from Government initiatives such as the funding for lending programme. Other survey participants were more focused on the support that they required in order to improve their credit rating to allow them to participate fully under the Deposit Takers Bill. Without this, they would face more pressure obtaining sufficient funding at a competitive rate.

CCCFA

The CCCFA remained a hot topic among survey participants. Almost a year since the legislative changes were introduced and nine months on from being modified, the consequences and impacts of the new regulations have started to become clearer. For many, this is a beacon of how poor regulations causes layers of damage. The unintended consequences were partially due to the mistaken belief that a one size fits all approach would be appropriate, combined with an oversight of the practical market-based implementation. Unsurprisingly, the areas of concern were similar to last year. Our survey participants reinforced the negative outcomes the CCCFA is having on borrowers. They felt that the legislation was poorly constructed and there was an overwhelming consensus that the legislation was looking to solve a problem, that did not exist. This in turn has caused widespread disruptions to lending.

> The [CCCFA] legislation was poorly constructed and there was an overwhelming consensus that the legislation was looking to solve a problem, that did not exist.

None of the survey participants felt that it is good business to lend money to those who are unable to repay borrowed money. However, they emphasised that the legislation was restricting finance from the people that really needed it. The CCCFA was constructed to provide protections against predatory lending. However, due to its untested nature, lack of guidance and lack of public announcement of its impacts, it has had widespread unintended consequences.

There are a couple of main areas of concern for our survey participants:

Firstly, loans are still taking longer to process with greater documentation requirements for consumers and greater disclosure requirements for lenders. Some survey participants indicated a 50% increase in processing time. The increased processing time resulted in fewer loans being written together with a significant negative impact on customer experience. Together, this has cost implications for lenders as they have fewer loans to spread the cost of administration over, which ultimately falls on the consumer through higher interest rates as lenders are unable to charge higher administration and establishment fees to cover this extra cost.

Secondly, the slowing of the market at a time where the economy was re-opening after a record long lockdown was a concern that was shared by many of the survey participants. Increased regulation via the CCCFA has made it harder for both borrowers and lenders to be paired. Participants made it clear that there was a non-back sector view that those who needed credit the most are being negatively impacted by the very Act designed to protect them.

Major lending institutions remain uncertain and cautious about the interpretation of the regulations and liability under it, which has meant that their policies surrounding lending have shifted to a highly conservative approach. This has resulted in more rejections of applications as major lending institutions' appetite for risk has decreased. This has benefited a few survey participants who operate in near-bank lending. For these participants, they have largely been unaffected by the legislative changes as their processes relating to documentation and credit assessment have remained largely unchanged and as such are still able to process applications at a similar rate to pre-legislative change. However, as these entities are seeing more sizeable deals, they are now finding that they have to spend more administrative time ensuring their processes remain complaint.

> Major lending institutions remain uncertain and cautious about the interpretation of the regulations and liability under it, which has meant that their policies surrounding lending have shifted to a highly conservative approach.

Many participants commented that customers who really needed credit from lower tier lenders have been faced with one of two outcomes, being declined and needing to move to a lower tier (higher cost) lender or move back to an unregulated lender. The risk is that many vulnerable borrowers will now be dealing with more exploitative lenders.

To conclude, while the Government has made changes to the legislation, they have never really apologised or admitted the shortfalls of the legislation. Instead, the Government pointed towards seasonality for the lower volume of lending and noted that the CCCFA enforces responsible lending across the sector. However, data does not support the assumption that historical lending was inappropriate and led to higher levels of borrowers defaulting.

While the opposition political parties have criticised the CCCFA, they also have failed to grasp the importance of the non-bank sector, suggesting that if they form the next government they will limit the impact and requirement for banks to comply with the CCCFA. This shows that there is a lack of realisation that the non-bank sector actually provides credit and products that banks do not (and likely won't) to customers that banks don't usually service.

Credit quality and provisioning

This past survey year has seen the continuation of the benign credit environment with many survey participants highlighting the fact that their defaults and past dues have been reducing and are at all-time lows. The big question that they are all asking themselves is 'will this continue?' While many are watching their arrears and past dues nervously for the first signs of an increase, others have already experienced some of these early signs.

There are three main theories to explain the improvement in credit quality: the low interest rate environment at the beginning of the 2022 year, low unemployment rates and wage inflation.

> **In the recent past, the non-bank sector has felt no issues in terms of repayments with survey participants observing borrowers are moving up the credit quality curve.**

During the Covid-19 pandemic, when interest rates were low the cost of financing for consumers was affordable with survey participants seeing some borrowers reducing their debt. With less opportunity for discretionary spending during lockdowns, consumers had funds available and many opted to either repay ahead of schedule, or keep payments the same and get ahead of schedule as rates fell. In addition to paying more, many borrowers may have retained loans with older, lower rates. As discussed above in 'Competition for talent', some borrowers may have received an increase in income due to wage inflation assisting with their repayments. However, inflation and interest rates continue to bite and will continue to put pressure on borrowers.

In the recent past, the non-bank sector has felt no issues in terms of repayments with survey participants observing borrowers are moving up the credit quality curve.

Looking at the numbers for the 2022 year, we are seeing the release of provisions and low impaired asset expenses reported (see Figure 17). While across the board the survey participants voiced what a good year it had been in terms of credit quality, the challenge remains as to what the next year will bring.

17 See Figure 17 – page 32

However, as we see the impact of rising cost of living and inflationary cost on essential goods there could be a shift in credit quality going forward. Some survey participants acknowledged that their borrowers are borrowing more as for some, times are getting tougher. Participants predicted that they will see more demand for lending at the lower end of the market. Entities will need to remain aware of the quality of their loan book and how these macroeconomic factors will impact credit provisioning models. There was a collective view that entities will need to focus on how credit quality moves going forward, ensuring that they maintain or increase the quality of their loan book.

Climate and ESG reporting

Mandatory climate and ESG reporting has finally arrived at the doorstep for some of the larger industry participants in our survey. The External Reporting Board (XRB) is set to release Aotearoa New Zealand Climate Standard 1: *Climate-related Disclosures* (NZ CS1) in December 2022, with it coming into effect for accounting periods starting on 1 January 2023 or thereafter.

With the release of NZ CS1, those survey participants with greater than $1 billion in assets or a listed entity with market capitalisation of more than $60 million will be required to adopt the standard alongside existing financial disclosures.

> **Mandatory climate and ESG reporting has finally arrived at the doorstep for some of the larger industry participants in our survey.**

Those mandated to the reporting requirements have indicated that preparations are underway in getting assistance with ESG reporting. Some have sought out consultants to better understand the requirements of NZ CS1 and how the requirements of the standard integrates with their current systems, while others are building their in-house teams to be able to cope with the new requirements.

Entities captured by the standard highlighted Scope 3 emissions as a challenging area of focus for them and noted that there was a possible risk that they did not currently have the processes to capture the required information.

Most of our survey participants were not mandated to the reporting requirements as they did not meet the thresholds. Among this group there was a consensus that while many hadn't received any pressure from stakeholders relating to climate and ESG reporting, it was on the horizon.

“Most acknowledge the EV revolution is coming, but it will also come with some issues.

Two of the key stakeholders which participants saw as requiring further climate reporting from them in the near future was their funders and insurers as those entities would likely be required to report their Scope 3 emissions.

Most survey participants were positive about the changes, with some saying this is long overdue.

Future of electric vehicles (EV)

With a number of survey participants financing motor vehicles, the future of EVs is a key matter being considered by some. Most acknowledge the EV revolution is coming, but it will also come with some issues. The number of EVs in New Zealand has doubled in the past two years, from 18,526 in 2019 to 35,256 in 2021 and seems to be continuing to grow. However, this still represents less than 1% of the total number of licensed cars in New Zealand.

With the Clean Car Discount offering a rebate of up to $8,625 for a zero-emission imported car, the Clean Car Standard coming into effect in mid-2023 could swing the pendulum in favour of EVs. The Clean Car Standard's implementation will mean that car importers will be penalised or rebated depending on the level of emissions of the cars that they import. This will further increase the relative cost of internal combustion cars compared to EVs. However, the future of the Clean Car Standard doesn't currently seem particularly clear as the Government has delayed the start date of the programme from January until June 2023, and there haven't been many details of what the standard will include. This is another example of government regulation being less then well organised.

One of the main issues with EVs is their high upfront cost, which may act as a large deterrent to those people with less disposable income. Despite the ongoing costs associated with EVs being far lower than those with internal combustion engines, many people do not view it as a worthwhile investment. Approximately 80% of cars in New Zealand are worth less than $20,000, making electric vehicles inaccessible to the majority of the public.

Additionally, survey participants noted that New Zealand currently lacked the infrastructure required to deal with a large increase in the number of EVs on our roads given the difficulties in adding further charging stations in suburbs that are already near their power capacity. Some survey participants suggested that we need to clean up our energy sources before we invest too heavily in the EV revolution.

In many people's minds, the mining of the battery material and its disposal after its useful life has still not been satisfactorily resolved from an environmental perspective. Some survey participants mentioned that hydrogen engines may be an alternative to EVs; however, it was not yet feasible due to both the high costs and safety concerns.

Cyber security

The importance of cybersecurity in the ever changing digital world continues to grow, especially with the expectation for most services to now be digital and instant. With the digitisation of the non-bank lending sector continuing to expand, nearly all survey participants recognised that the threat of a cyber-attack is ever-present and is one of the most significant daily risks.

Cybersecurity is a constantly evolving issue and one that is at the top of all survey participants minds, as cyber-criminals are as resourceful as ever and will attempt to strike within a moment's notice. The money spent on making sure their cybersecurity is up to date is continuing to become a larger expense for the majority of survey participants, but the cost of not adequately focusing on security enough can be far higher than taking the time to do it right. Most participants were placing a greater focus on penetration testing.

Many of the survey participants with a parent company operating overseas have seen consequences of a cyber-hack and thus have invested heavily in protection. Others have been victims of small cybersecurity attacks themselves.

> **“The importance of cybersecurity in the ever changing digital world continues to grow, especially with the expectation for most services to now be digital and instant.**

It appears that no company is immune from a cyber-attack and companies are focused on always being one step ahead of the cyber-criminals.

Many survey participants outlined that the low unemployment level was not helpful to them seeking to improve their cybersecurity, as IT staff were now extremely in demand and able to fetch much higher wages than they were beforehand. As more and more companies begin to recognise the risk cybersecurity poses, IT talent will continue to be hot property.

Cyber-criminals operating in New Zealand just had their most successful quarter on record, stealing $8.9 million via online attacks, which is a large spike on the previous quarter ($3.9 million)[12]. New Zealand businesses must remain aware of the international cyber trends that could impact them.

Funding

The component that powers the lending and sector growth, is ultimately funding. Survey participants were fairly unanimous in their comments on this topic. While it wasn't high on the agenda of issues that they currently face, the thoughts of participants were consistent:

- funding is still available; however, it is not quite as plentiful or as sticky as a year ago;
- funding is getting more expensive across the board and costs associated with it continue to rise;
- the need to be prepared to pass this increased cost on to the customer in order to maintain margins; and
- diversification is probably recommended and a number of new entrants to the non-bank sector are appearing in the market place.

> **“Cyber-criminals operating in New Zealand just had their most successful quarter on record, stealing $8.9 million via online attacks.**

Sector – Timeline of events[13]

OCT 2021

6th
The Reserve Bank of New Zealand's (RBNZ's) Monetary Policy Committee raises the Official Cash Rate (OCR) to 0.50%

NOV 2021

17th
Geneva Finance fined $65,000 after breaching New Zealand's Exchange's (NZX's) share market listing rules

24th
The RBNZ's Monetary Policy Committee raises the OCR to 0.75%

DEC 2021

17th
Squirrel is handed a formal warning after its Trust failed to obtain assurance engagements in each year from 2016 to 2020

JAN 2022

19th
Financial Services Federation writes an open letter to Commerce and Consumer Affairs Minister Hon Dr David Clark and officials outlining what they believe needs to be done to improve the Credit Contract and Consumer Finance Act (CCCFA) regime

FEB 2022

1st
Ricoh Company Ltd announces the acquisition of Axon Ivy and their renowned digital process automation platform

21st
Process intelligence and automation software developer Nintex adds Ricoh NZ to its local reseller stable

23rd
The RBNZ's Monetary Policy Committee raises the OCR to 1.0%

24th
Russia invades Ukraine

MAR 2022

11th
The Government proposes initial changes to lending requirements that will help New Zealanders acquire credit safely and responsibly

David Clark announces that the Government will make practical changes to responsible lending curbs for any unintended consequences caused by the CCCFA

31st
Commerce Amendment Bill passes its third reading, which introduces a package to better regulate anti-competitive packages

APR 2022

10th
BMW Group New Zealand Managing Director Karol Abrasowicz-Madej steps down

13th
The RBNZ's Monetary Policy Committee raises the OCR to 1.5%

MAY 2022

19th
The Government agrees to increase the annual operational funding to the Financial Markets Authority (FMA) for 2025/26

25th
The RBNZ's Monetary Policy Committee raises the OCR to 2.0%

JUN 2022

9th
Government confirms it will loosen CCCFA rules after unintended consequences

JUL 2022

13th
The RBNZ's Monetary Policy Committee raises the OCR to 2.5%

28th
FMA report reveals ethical investment funds are not providing enough details for customers to make an informed decision on where to invest their money

AUG 2022

- **2nd**
  The Commerce and Consumer Affairs Minister David Clark announces three changes to further loosen the new consumer lending regulations
- **12th**
  Turners Automotive Group has partnered with Sharesies to launch an employee share scheme
- **17th**
  The RBNZ's Monetary Policy Committee raises the OCR to 3.0%
- **22nd**
  After five years of legal proceedings Auditors settle with Fuji Xerox NZ out of court

SEP 2022

- **12th**
  The Government abolishes the Covid-19 traffic light system
- **23rd**
  Harmoney announces they are delisting from the NZX to move solely to the Australian Securities Exchange (ASX)

OCT 2022

- **5th**
  The RBNZ's Monetary Policy Committee raises the OCR to 3.5%
- **11th**
  The Serious Fraud Office closes its investigation into Fuji Xerox's accounting scandal
- **14th**
  Unity Credit Union is the target of an online scam attack where customers' money is transferred out of their accounts
- **18th**
  Inflation increases annually by 7.2% in the September 2022 quarter
- **27th**
  FMA releases a document aimed at the 200 climate reporting entities and as well as all financial reporting entities regarding its expectations on the impact of climate risks in financial reporting

NOV 2022

- **1st**
  Parliament Select Committee seeks feedback on Deposit Takers Bill which intends on helping to protect society from the damage to New Zealand's financial system and wider economy from unexpected external factors, excessive risk taking and unmanaged failures
- **2nd**
  The Government announces the next steps to protect consumers from potential financial harm when using Buy Now, Pay Later
- **22nd**
  Payments associated with the Clean Car Standard will be deferred until July of 2023 to ensure smooth implementation
- **23rd**
  The RBNZ's Monetary Policy Committee raises the OCR to 4.25%

DEC 2022

- **6th**
  Payday lender Moola goes into liquidation after its parent company was placed into receivership

  RBNZ's Funding for Lending Programme for banks comes to an end
- **TBD**
  XRB to release New Zealand's first Climate-related Disclosure Standard

Non-bank lenders weather the storm – but is there worse yet to come?

Lyn McMorran
Executive Director
Financial Services Federation Inc.

Financial Services Federation

Lyn McMorran is the Executive Director of the Financial Services Federation Inc., which is the industry body representing responsible finance and leasing providers in New Zealand (www.fsf.org.nz). Prior to joining the Financial Services Federation (FSF) in 2012, Lyn was Area Manager for Westpac's Private Bank in the Lower North and South Islands.

A Certified Financial Planner, Lyn is a past President of the Institute of Financial Advisers of New Zealand. She is also a Trustee of the Skylight Trust and a Commissioner for the Insurance and Savings Ombudsman disputes resolution scheme.

The new Credit Contracts and Consumer Finance Act (CCCFA) regime has just had its first birthday, Covid-19 is on its third, and each of these matters could be described as 'the gifts that keep on giving'.

Whilst we might have lived through 2022 without any lockdowns, the arrival of the Omicron variant into Aotearoa has seen those New Zealanders who have not yet had Covid-19 become the minority, and businesses scrambling to cover staffing gaps while staff and their whanau self-isolate. It's not over yet – and we face the reality that it may not be for a long time.

And then there's the CCCFA.

I have to admit I struggle to think of anything positive to say about this fiasco. There is no nice way to spin the fact that any legislation that requires review within weeks of implementation was poorly written legislation.

What is most disappointing of course is that this should not have happened.

It is difficult to believe that what have been described as the 'unintended consequences' of the new regime were 'unintended'. Throughout the long consultation process, lenders including ourselves and the banks repeatedly warned that the legislation would result in inhibiting access to credit for all New Zealanders, not just those in the most vulnerable of situations. We just weren't being listened to.

It became obvious within days of 1 December 2021, that the new prescriptive requirements were resulting in intrusive and unwarranted micro questioning of borrowers and that access to credit was having to be declined for spurious reasons. Minister of Commerce and Consumer Affairs, Hon Dr David Clark, had several theories as to why this might be – all of which the FSF disagreed with.

It was not the case that lenders were misinterpreting the new regulations and taking them to extremes. These are so prescriptive as to leave no room for interpretation.

> **"FSF member companies account for 48% of personal lending in New Zealand, with a combined loan book just 4.4% in arrears, down from 5.8% in 2016.**

What's more, the highly punitive personal liability for directors and senior managers of credit providers if they are found to be in breach of them provided such a strong incentive to do nothing, but interpret them to the letter.

Nor did we agree that the difficulties borrowers were experiencing in getting loans approved came down to 'external factors' as cited by the Minister, such as global inflation, increasing interest rates, war in Ukraine, increased fuel costs, etc. At that point, these issues were yet to test the New Zealand market.

And it was absolutely not the case, as was also suggested from the top, that lenders (including the banks) had been lending irresponsibly prior to the new regime. While there is no denying the compelling anecdotal experiences of individuals who have been harmed by irresponsible lending by lenders who should indeed be put out of business, to this day we are yet to see any data to show that irresponsible lending was widespread in New Zealand. FSF member companies account for 48% of personal lending in New Zealand, with a combined loan book just 4.4% in arrears, down from 5.8% in 2016.

So, as a result of a review we have had a first tranche of minor tweaks to the regulations which came into force from 7 July 2022, that deleted the requirement for lenders to include any regular savings declared by the borrower from their expense calculations.

A second tranche of tweaks was announced by the Minister in August to come into force in March 2023, that will make some changes to the way in which lenders can treat discretionary expenses when making their affordability assessments. However, these will still require lenders to make intrusive enquiries of borrowers to determine what to them is their 'discretionary' expenditure and what is fixed.

This will improve the situation slightly, but is still a far cry from the principles-based approach used pre-1 December that allowed lenders and borrowers to have some discretion over their lending and borrowing decisions. Discretion that meant lenders could draw on their expertise to work with individuals to reach a good outcome, and that empowered customers to feel trusted.

The National Party's suggestion of a change to the CCCFA that would allow registered banks to go back to the principles-based approach, but not other lenders, was naturally not greeted with unqualified support from FSF members.

Indeed, the suggestion seemed indicative of an overall lack of comprehension from politicians of all stripes of the significance and importance of non-bank lenders and their contribution to New Zealand's communities, society, and the economy. Despite our best efforts, obsolescent views that anything that isn't a bank is 'lower than' (i.e. 'second tier') or inferior to a bank is proving very hard to shake. It's a view that will leave New Zealand behind in the world when it comes to empowering people with personalised, innovative, and competitive opportunities in the world of personal finance.

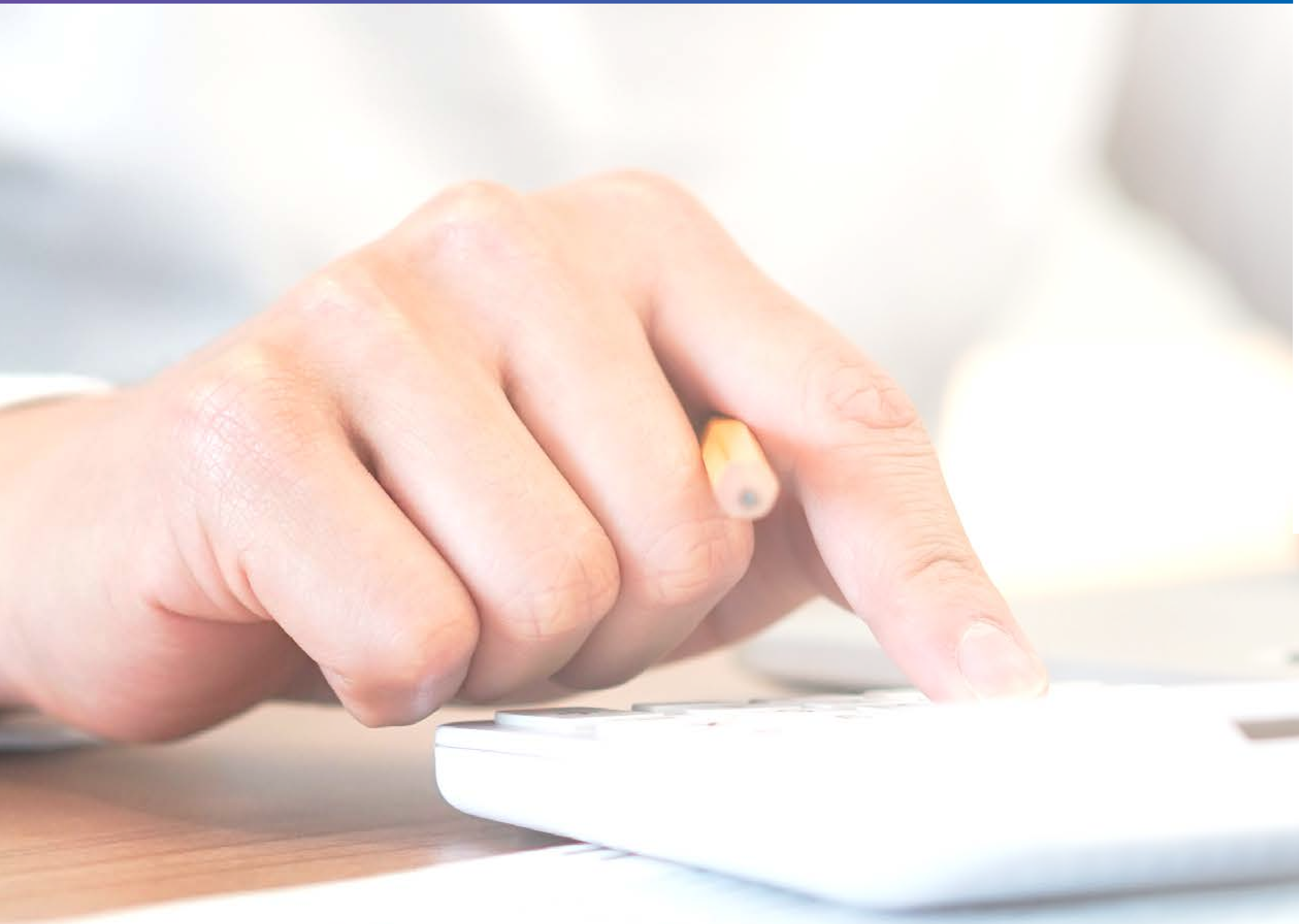
This is something of increasing concern to FSF and our members. Yes, overall, the non-bank sector is small when compared to the banks. Our members represent $15.4 billion of total lending to New Zealand consumers and businesses (as at our annual data collection date of 28 February), compared to $538 billion across the registered banks. However, our members have relationships with 1.7 million consumers and businesses, and there are reasons why these relationships exist.

Key among these reasons is that non-bank lenders provide services and products that banks do not. For example, our credit union and building society members provide transactional account services to individuals that the banks will not, and access to branch services in places where the banks no longer operate. Our business lending members provide access to specialist lending products such as asset financing or leasing that the banks will not provide, unless it comes with a mortgage over personal property and interlocking directors' guarantees.

But, while it is important that Government and regulators recognise the vital role played by the non-bank lending sector, the FSF is also consistently urging that a common-sense approach be taken when introducing further legislation or regulation of the sector to ensure their value is not lost by regulating them out of existence.

> "Our members represent **$15.4 billion** of total lending to New Zealand consumers and businesses … compared to **$538 billion** across the registered banks. However, our members have relationships with **1.7 million** consumers and businesses, and there are reasons why these relationships exist.

> “A fine of $500,000 for a breach of legislation may be something that none of the banks or large insurers would welcome, but it would not materially affect their ability to operate. However, it would likely wipe out any one of our non-bank members.



It is essential that regimes like the Financial Markets (Conduct of Financial Institutions) or ‘CoFI’ and the new deposit-takers legislation adequately provide for appropriate levels of proportionality to protect the competition and innovation that the non-bank lending sector provides, but also to recognise the fact that, unlike the registered banks, non-bank lenders are not systemically critical to New Zealand’s overall financial system, and therefore, a lighter touch approach should be taken.

This proportionality is required not just in the way that non-banks are supervised and the application and enforcement of regimes such as CoFI, but also to the penalties that these pieces of legislation carry. A fine of $500,000 for a breach of legislation may be something that none of the banks or large insurers would welcome, but it would not materially affect their ability to operate. However, it would likely wipe out any one of our non-bank members.

It is likely therefore that ‘proportionality’ will become the word of the year for the FSF in our submissions and government relations work during 2023.

Although it’s also likely that, when we get to this point next year and reflect on what 2023 has thrown at us, there may be several other words we might use to describe our experiences.

Judging from the economic forecasts, these are likely to include words like ‘tough’ and ‘recession’ and other words equally as gloomy. It seems that it has been a long time coming, but the financial effects of Covid-19 look certain to finally be felt in higher interest rates, even higher inflation, and higher unemployment. The only thing certain at this point is uncertainty. We are pleased to say that FSF members are in a good space to weather the storm and to help their customers to get through to the other side.

Non-bank lending review

Keith McLaughlin
Managing Director,
Centrix Group Limited

Keith McLaughlin is the Managing Director of Centrix Group Limited, New Zealand's only locally owned credit bureau. A highly experienced senior executive and director, Keith started Centrix with a vision to offer New Zealand businesses a superior and cost-efficient credit offering, with a focus on long-term relationships. Previously the founder and Managing Director of Baycorp Holdings Limited, his strengths include strong leadership skills with an emphasis on empowerment, and a proven ability to forge and sustain high performance teams.

At the end of 2021, we talked about the potential for clouds on the economic horizon. It seems we weren't too far off the mark.

For many consumers, 2022 has been a year of unprecedented challenge, with consistent increases to the Official Cash Rate (OCR) deployed to try to combat record high inflation.

As the year went on, cracks began to emerge for consumer and business confidence, resulting in credit demand contracting and arrears rising.

Early lending ripples due to CCCFA

The dominant story at the beginning of the year was the long-anticipated changes to the Credit Contracts and Consumer Finance Act (CCCFA).

Introduced in December 2021, changes made to the CCCFA were designed to protect New Zealanders from predatory lenders.

This was through requiring lenders – like banks – to make sure the people they were lending to are able to comfortably make their repayments.

The unforeseen consequences of these changes were felt immediately, with successful credit applications for both mortgages and consumer finance plummeting in December 2021.

9 **See Figure 9 – page 23**

In January 2022, the proportion of mortgage loan applications successfully converted into new home loans fell from 39% in October 2021 to just 27% – a drop of nearly a third – while consumer finance conversions reduced

“The proportion of mortgage loan applications successfully converted into new home loans fell from **39%** in October 2021 to just **27%** – a drop of nearly a third.

> The downward trend in BNPL demand throughout 2022 is a good indicator of declining consumer confidence, as discretionary spending falls to the wayside in lieu of meeting financial demands.

from 35% in October 2021 to 25% over the same period.

While these impacts have started to even out as lenders come to terms with the nuances of the new lending landscape, both mortgage and consumer loan conversions remain below levels seen at the end of 2021.

Cost of living up, consumer confidence dwindles

For the majority of 2022, consumer credit demand tracked below the previous year as Kiwis grappled with both the introduction and impacts of the CCCFA changes followed by the rising cost of living.

This was driven largely by a fall in mortgage demand, while personal loan and Buy Now, Pay Later (BNPL) demand also fell during the first six months of the year.

10 See Figure 10 – page 23

BNPL demand was a cornerstone of 2021, as more and more Kiwis began to shop online following the Covid-19 pandemic forcing more businesses to focus on their e-commerce offering.

The downward trend in BNPL demand throughout 2022 is a good indicator of declining consumer confidence, as discretionary spending falls to the wayside in lieu of meeting financial demands.

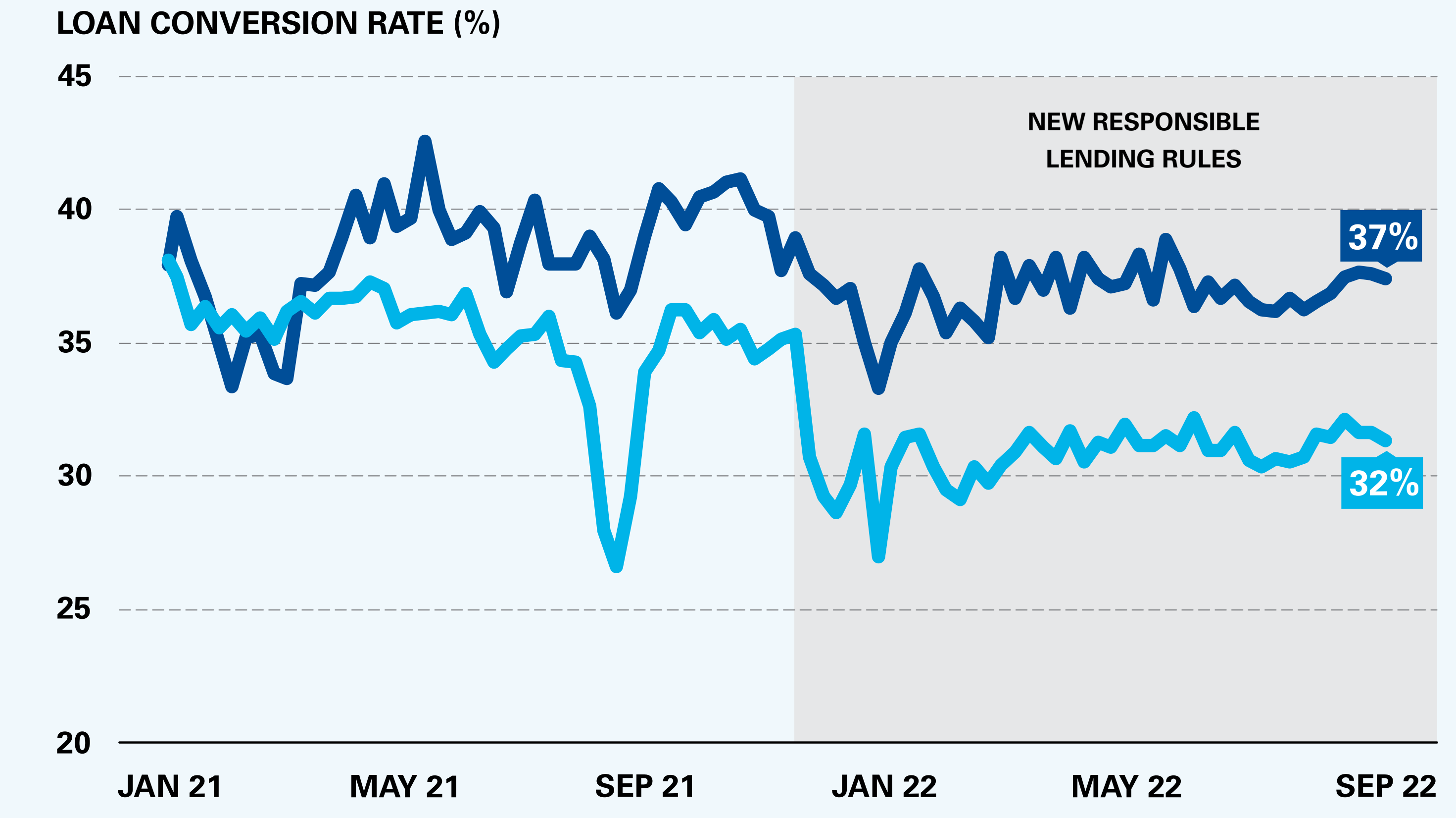
However, in September 2022 consumer credit demand returned to pre-pandemic levels, driven by an increased volume of personal loan applications reflecting the expectation that Kiwis are increasingly turning to credit to fund spending.

Cooled housing market

After dominating the headlines in 2021, the record-high lending and spending seen in Aotearoa's property market dwindled throughout 2022.

11 See Figure 11 – page 24

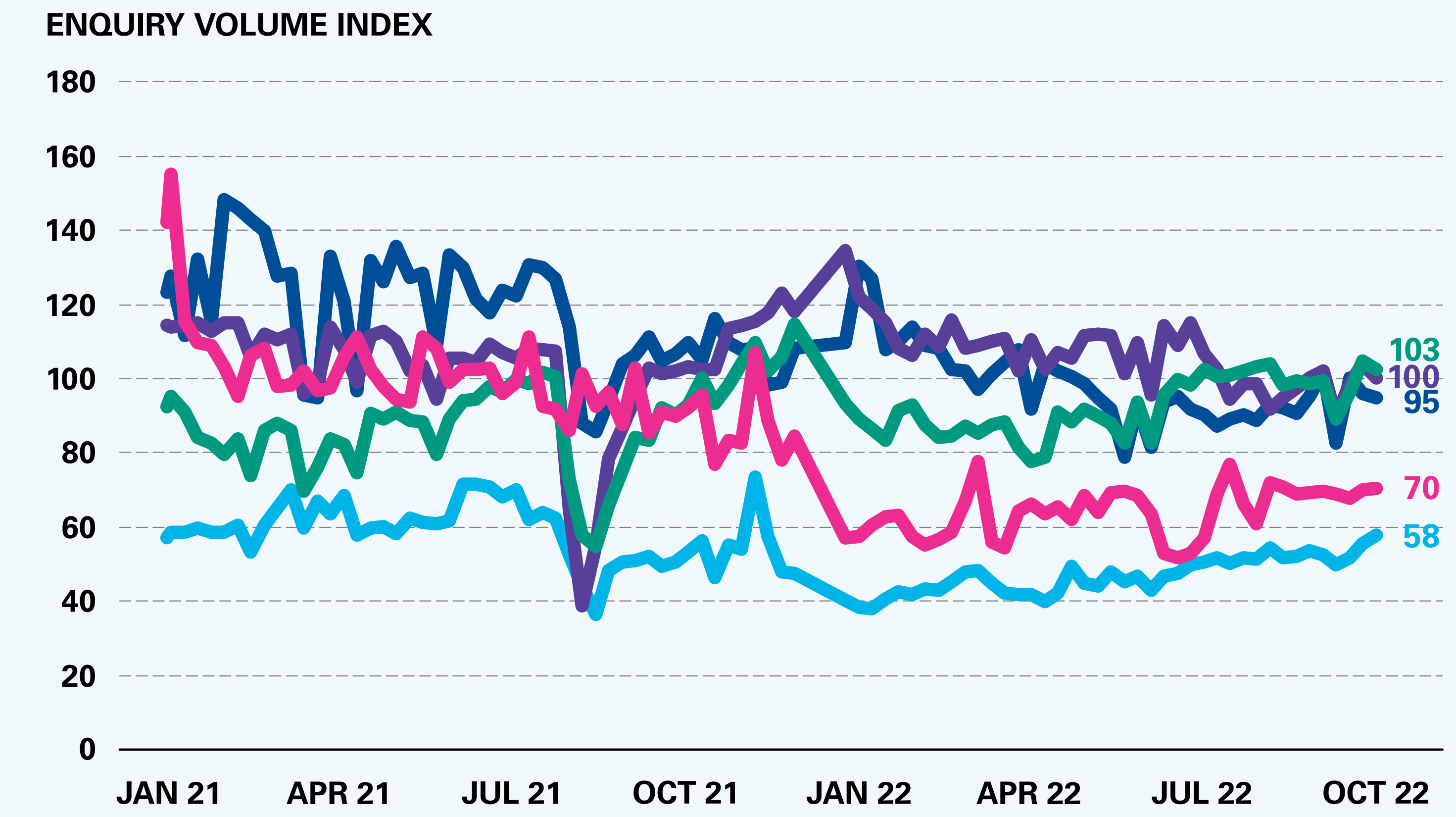
9 CONSUMER LOAN CONVERSION RATES: CREDIT APPROVALS AS A PROPORTION OF APPLICATION ENQUIRIES MADE



MORTGAGE LOANS
CONSUMER FINANCE

SOURCE: CENTRIX

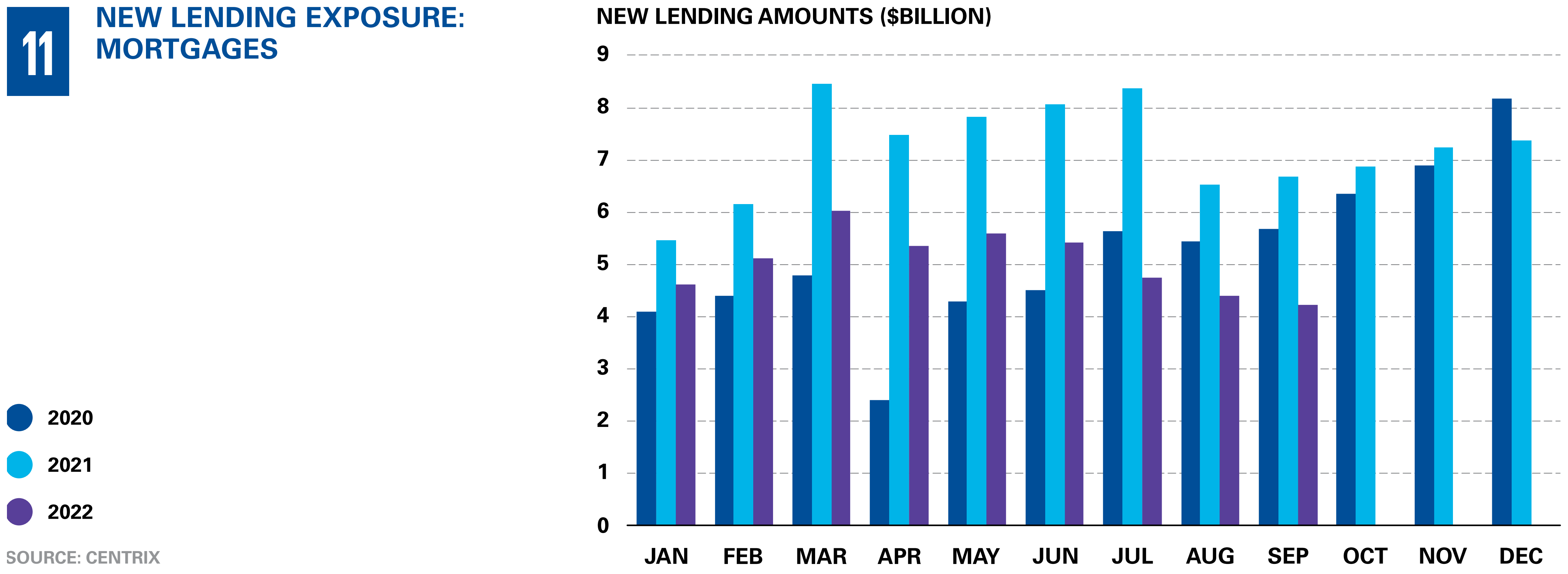
10 CREDIT DEMAND BY PRODUCT TYPE



MORTGAGES
CREDIT CARDS
AUTO LOANS
PERSONAL LOANS
BNPL

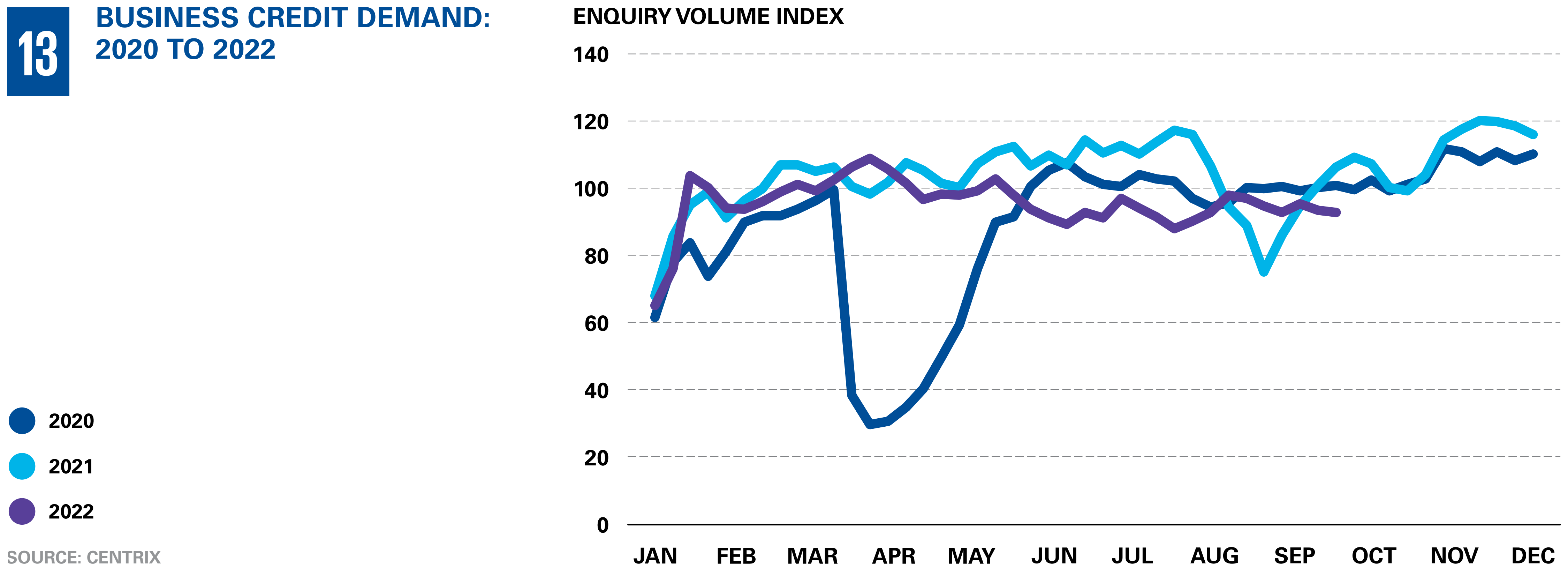
SOURCE: CENTRIX

11 NEW LENDING EXPOSURE: MORTGAGES



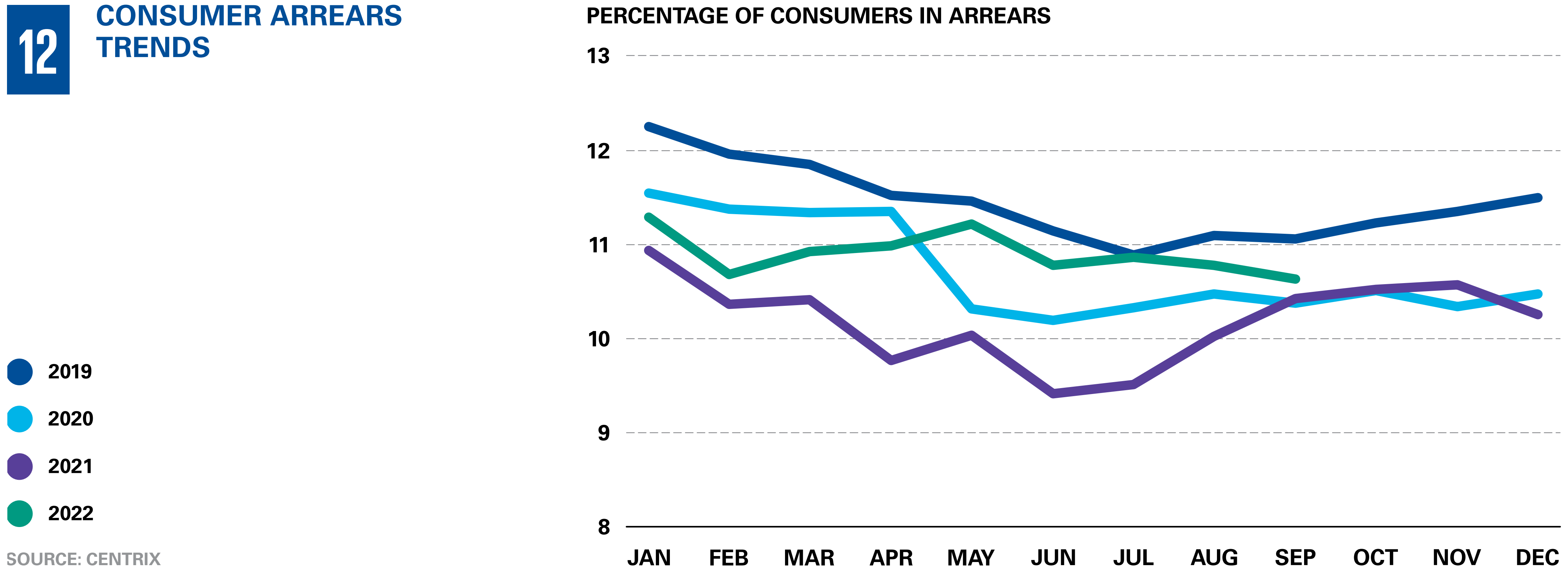
SOURCE: CENTRIX

13 BUSINESS CREDIT DEMAND: 2020 TO 2022



SOURCE: CENTRIX

12 CONSUMER ARREARS TRENDS



SOURCE: CENTRIX

The tightening of monetary policy in response to rising global inflation has seen interest rates rise consistently throughout 2022.

While it's encouraging to see home loan arrears remain near record lows, the overall economic climate suggests real estate may be becoming a backseat consideration for cash-strapped Kiwis.

Kiwis in arrears up year-on-year

Alongside slower credit demand, the rise in arrears throughout 2022 contributed to the strain facing many Kiwi households.

The uncertainty of the pandemic spurred many to settle outstanding debts in order to feel financially comfortable in what was a period of anxiety for households and businesses alike.

12 See Figure 12 – page 24

This trend continued throughout 2021, but by March 2022 the ripples of global inflation began to reach our shores.

The number of Kiwis in arrears rose steadily throughout 2022 as Kiwis prioritised making home loan and vehicle repayments over discretionary debts. These arrears rates still track below pre-pandemic figures recorded in 2019.

Furthermore, the number of households behind on repayments has slowly declined over the last three months, edging down to 10.6% of the active credit population in September 2022 – a mere 2% increase year-on-year despite recent mortgage interest rate increases.

Global circumstances, local business challenges

It's been a challenging year for Kiwi businesses. In addition, to impacts from the war in Ukraine, and the flow-on effects of the Covid-19 pandemic, Kiwi businesses have seen surging inflation and supply chain issues.

Due to these circumstances, business credit demand is materially down across the country, with several sectors including retail trade, property and healthcare particularly affected.

> "The number of households behind on repayments has slowly declined over the last three months, edging down to 10.6%.

Additionally, the average business credit score for new applications was 756 in October 2022, down from 760 in September and the annual high of 779 in April, as we observe a shift in profile towards a slightly higher credit risk.

13 See Figure 13 – page 24

The construction industry is one sector in particular significantly impacted by these circumstances.

Throughout the year, local construction companies faced material shortages, rising costs and the downturned housing market, which placed significant pressure on the sector.

In May 2022, 25% of all company liquidations were from the construction sector and we've seen company credit defaults begin to rise, reaching the highest default rates since the final quarter of 2019.

2023 and beyond

Presently, there appears to be no silver bullet in sight to end the cost-of-living crisis many Kiwis are experiencing. Despite record low unemployment, Kiwi households continue to feel the squeeze of an uncertain economic landscape.

While there is no material sign of mortgage repayment stress, we see Kiwis are beginning to borrow in order to maintain their lifestyles while grappling with rising interest rates.

> "25% of all company liquidations were from the construction sector and we've seen company credit defaults begin to rise.

With the Reserve Bank of New Zealand (RBNZ) increasing the OCR by 75 bps to 4.25% in November 2022 in an attempt to rein in inflation, it seems an engineered recession is on the cards for New Zealand.

Only time will tell how effective the RBNZ's actions will be, but one thing seems clear – Kiwis can expect challenging economic conditions well into 2023.

Appreciating values

> Christian Savings marked its 60th anniversary in December 2022, and it is New Zealand's only charitable licensed non-bank deposit taker.

Dan Mazengarb
Chief Executive
Christian Savings
Incorporated

Dan started at Christian Savings Incorporated (Christian Savings) in March 2017 as our in-house lawyer before taking over as Christian Savings Senior Lender in 2018 and became the CEO in 2021. He works alongside new and existing borrowers, from construction projects to social housing building purchases, to coordinating the closure of major and complex loans with Christian Savings. Previously Dan worked as a commercial lawyer in Tauranga and at Z Energy head office in Wellington. He is passionate about our vision and purpose to help finance not-for-profit organisations doing good in our communities, throughout Aotearoa.

Following on from our focus piece on Community Finance last year, we now take a look at another values-based organisation being Christian Savings.

What is the secret to the success of a small charitable financial organisation located in the corner of Penrose?

Christian Savings marked its 60th anniversary in December 2022, and it is New Zealand's only charitable licensed non-bank deposit taker. It was originally called New Zealand Baptist Savings and Development Society until it was rebranded as Christian Savings in 2016. Over the last 60 years, the entity has journeyed through various trials, changes, and significant growth.

The years 2020 and 2021 were no exception to Christian Savings where challenges were posed in ways that disrupted business conduct, social events and everyday lives. Contrary to the economic downturn many businesses experienced, our financial results proved strong and continued to improve over 2021 and 2022. Our lending in 2021 was $184.3 million which increased to $211.2 million in 2022 which equated to an 11.4% growth, and our deposits grew from $207.4 million in 2021 to $248.6 million in 2022 which was a 19.9% rise. We also experienced a record-breaking increase of 106.3% in our surplus in 2022. One can argue that this significant growth was simply because the need to borrow naturally expanded the lending landscape, but the overall amount of deposits for Christian Savings also increased despite the low interest rates period. We, therefore, view that other fundamental factors contributed to our longevity and recent achievements. These underpinning values have always been embraced and practised consistently within our organisation.

One of our values is 'integrity'. Being good stewards and custodians of people's funds has always been a strong emphasis for Christian Savings since its inception. We recognise the privilege to serve on behalf of the depositors to lend to various not-for-profit organisations. The loans-to-deposits ratio being around 90% is a testament to how we are committed to maximising the funds on deposit for the benefit of the greater good. Serious measures against more recent issues such as the Anti-Money Laundering and Countering Financing of Terrorism Act and cybersecurity are also being implemented, and the importance of vigilance is regularly communicated to staff.

The second value which has been long-standing for Christian Savings is 'rapport'. There has always been a strong importance placed on establishing relationships with our shareholders, borrowers, depositors, and staff. Amidst the trend that is shifting towards the digitalised world, Christian Savings invests in maintaining personal relationships with its customers by being available over the phone and sending personal messages on birthdays and Christmas cards at Christmas time. Building bespoke and personal connections is our default way of completing transactions with our borrowers. Our dedication is apparent when our team travels long distances to fully engage with the borrowers' plans and visions, not just to inspect the site.

> There has always been a strong importance placed on establishing relationships with our shareholders, borrowers, depositors, and staff.

The third value is our 'purpose'. We are a small faith-based entity positioned in a niche market, but we believe that the key component to our ability to punch above our weight is that all the involved stakeholders share a common altruistic motive of wanting something greater and longer-term than just financial profits. Although the scale we operate in may be limited, the depth of rewards for the people is palpable, and we are fortuitous to be able to operate with clients whose values are aligned. Seeing the outcome when people find hope in life or gain stability in living situations continues to remind us of the reason for the work that we undertake, namely to enrich the lives of the people around us.

In this economic climate faced with volatility and adversity, it may be worthwhile to reflect and explore options of what should be invested in. As cliched as it may sound, there are things money can never buy that will never depreciate. Perhaps, it's worth considering investing in values that endure for generations and benefit the wider community.

Photo: Liberton Christian School – one of the many projects funded by Christian Savings

> Seeing the outcome when people find hope in life or gain stability in living situations continues to remind us of the reason for the work we undertake is to enrich the lives of people around us.

Sector performance

The non-bank survey participants have reported a combined increase in net profit after tax of $143.24 million (or 56.82%) over the year.

Changes in the sector

There have been a number of changes during the year, including the introduction of a new participant to the survey, a previous entity departing the survey and a name change.

We welcome Midlands Funds Management Limited (Midlands) to the survey in 2022 after it met the size thresholds to be included in the survey. Midlands invest in a portfolio of floating rate loans secured by first ranking mortgages over residential, commercial and rural land and buildings throughout New Zealand. Midlands has a 31 March balance date and enters as the smallest participant in terms of total assets when compared to the other survey participants.

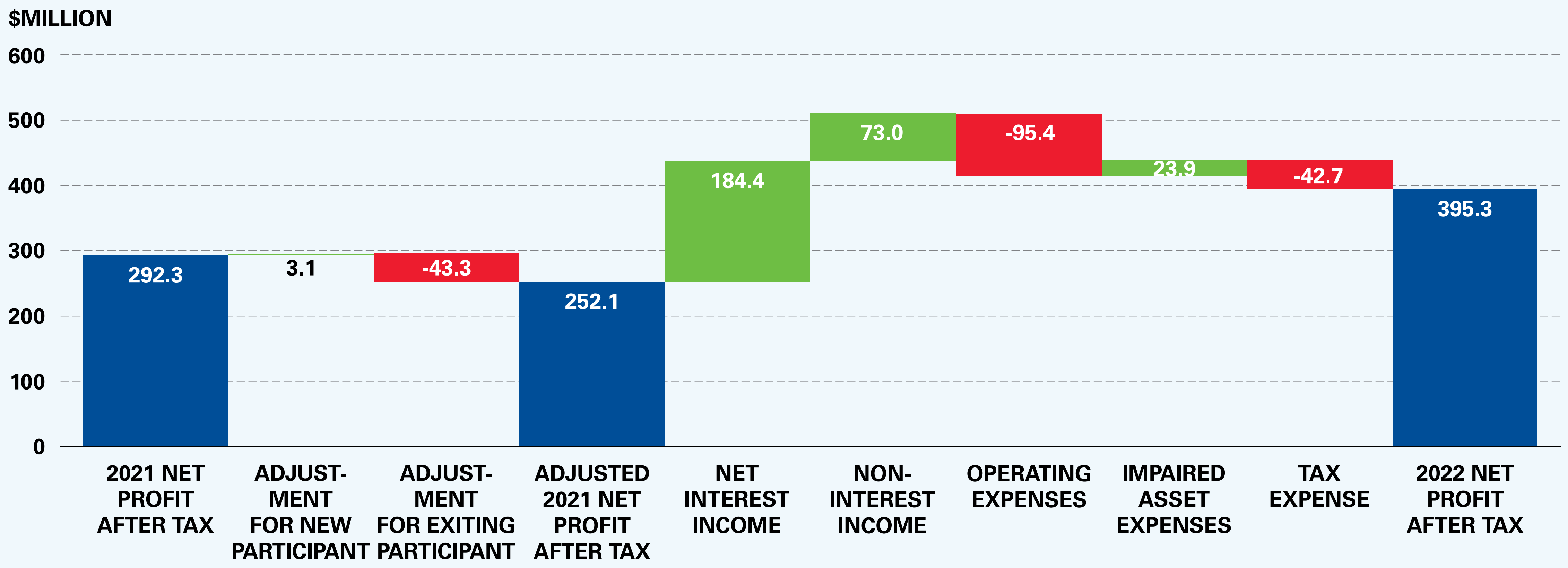
FlexiGroup (New Zealand) Limited has departed the survey this year after being included in the last four annual non-banks FIPS publications.

Due to the inclusion of a new entity and the departure of another, some comparative totals may have been restated from the 2021 edition of non-bank FIPS impacting graphs (Figures 14–19) and tables.

After transferring almost all of its assets to a new funding warehouse in December 2020 as an effective replacement of Leasing & Finance Limited Partnership, a second Warehouse was established during the 2022 year. The second warehouse trust has been in operation for 10 months within the 2022 year. The group of entities has also undergone a branding change within the survey to Speirs Finance Group Limited (Speirs) and this has been reflected throughout the document.

The data for UDC Finance Limited (UDC) represents 12 months of financials in 2022, compared to just three months in 2021 due to a change in balance date in the prior year. We draw special attention to the fact that the 2021 profitability measures for UDC represent only

14 MOVEMENT IN NET PROFIT



Hover over the button to see historic results

2022

2021

2020

2019

2018

MOVEMENT IN NET PROFIT FOR 2022

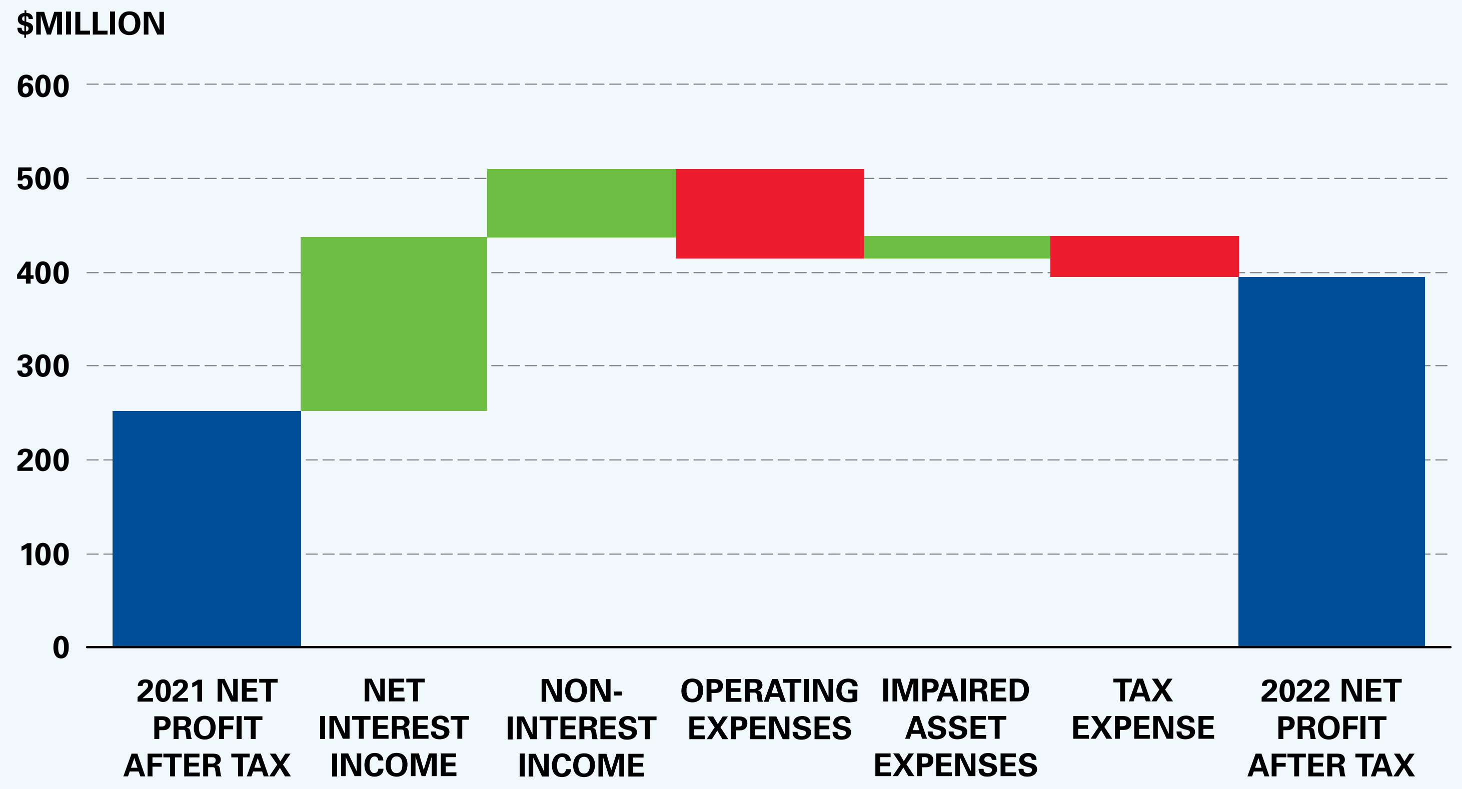


TABLE 2: Performance metrics		Total
Increase in total assets		12.62%
Increase in net profit after tax (NPAT)		56.82%
Movement of impaired asset expense (As a percentage of average gross loans and advances)	bps	-22
Increase in interest margin	bps	75
Increase in NPAT/Average total assets	bps	72
Increase in NPAT/Average equity	bps	269

one quarter.
This should be kept in mind when comparing movements in UDC's performance against other entities in the survey and when comparing movements in total sector performance between 2021 and 2022.

We would also like to draw special attention once again to the differing balance dates of our survey participants. While our survey covers the 2022 year, our respondents have a range of balance dates, with the earliest being the 52 weeks to 31 October 2022 and the most recent reporting representing the year ended 30 September 2022. It is important to recognise that the results of each entity will reflect the different state of the economy at their various balance dates, with the results of those entities with later balance dates reflecting the rapidly rising Official Cash Rate (OCR) and high inflation. The timing of an entity's balance date would also affect the amount of lockdown impacts included in its financial year. When reading the industry analysis text and comparing the performance of any entities in the survey, these factors should be taken into consideration.

Net profit after tax (NPAT)

The survey participants have accomplished another year of strong growth in NPAT of 56.82% to $395.3 million. This significant increase demonstrates the non-bank sector's recovery from the impacts caused by Covid-19 in prior years. Note that a portion of the sector's increase in NPAT can be attributed to UDC's 2021 figures only reflecting three months of the year due to a change in balance date. UDC's NPAT for the three months included in the 2021 survey was $21.7 million, while its NPAT for the 12 months included in the 2022 survey was $80.4 million, reflecting a $58.7 million increase of which is likely attributable to the differing period used. Excluding UDC, the survey participants still accomplished growth

TABLE 3: Gross loans and advances Entity	2022 $'000	2021 $'000	Movement $'000	Movement %
Avanti Finance Limited	2,068,230	1,543,200	525,030	34.02%
BMW Financial Services New Zealand Limited	238,912	253,772	-14,860	-5.86%
Christian Savings Incorporated	211,169	184,550	26,619	14.42%
First Credit Union	301,057	276,441	24,616	8.90%
First Mortgage Trust	1,170,727	869,009	301,718	34.72%
FUJIFILM Leasing New Zealand Limited	85,772	71,510	14,262	19.94%
Geneva Finance Limited	112,769	112,446	323	0.29%
Harmoney Corp Limited	637,696	308,145	329,551	106.95%
Instant Finance Limited	97,140	103,054	-5,914	-5.74%
John Deere Financial Limited	183,588	172,170	11,418	6.63%
Latitude Financial Services Limited	1,407,000	1,484,552	-77,552	-5.22%
LeasePlan New Zealand Limited	9,884	10,486	-602	-5.74%
Mercedes-Benz Financial Services New Zealand Limited	611,896	579,215	32,681	5.64%
Midlands Income Fund	91,953	69,279	22,674	32.73%
Motor Trade Finance Limited	740,527	676,921	63,606	9.40%
Nelson Building Society	865,907	719,624	146,283	20.33%
Nissan Financial Services New Zealand Pty Limited	510,931	487,300	23,631	4.85%
ORIX New Zealand Limited	105,182	97,785	7,397	7.56%
Police and Families Credit Union	31,195	37,793	-6,598	-17.46%
Ricoh New Zealand Limited	92,914	98,207	-5,293	-5.39%
Speirs Finance Group Limited	292,066	258,254	33,812	13.09%
Toyota Finance New Zealand Limited	1,024,815	1,021,255	3,560	0.35%
Turners Automotive Group	437,132	351,507	85,625	24.36%
UDC Finance Limited	3,540,979	3,308,429	232,550	7.03%
Unity Credit Union	320,038	322,811	-2,773	-0.86%
Wairarapa Building Society	124,979	108,046	16,933	15.67%
Sector total	**15,314,459**	**13,525,761**	**1,788,697**	**13.22%**

of 36.7% in NPAT between 2021 and 2022. The other largest contributors to the increase in the sector's NPAT are Latitude Financial Services Limited (Latitude) with a $29.6 million increase and First Mortgage Trust with a $22.6 million increase.

Of the 26 survey participants, 18 reported increases to NPAT. The participants who achieved the largest percentage growth in NPAT were Speirs which saw a 1,892% increase ($10.1 million), Latitude with a 144% increase ($29.6 million), FUJIFILM Leasing New Zealand Limited (FUJIFILM) with a 109% increase ($2.2 million), and Christian Savings Incorporated (Christian Savings) which experienced a 106% increase ($2.0 million). Note that this excludes the increase seen by UDC due to prior year results being reported for a three-month period. Speirs' result is partially due to a prior period of just six months.

Of the eight participants reporting a decrease in NPAT, Unity Credit Union (Unity), formerly known as Credit Union Baywide, reported the largest decrease of $3.56 million (103.46%) resulting in it being one of two participants to report a loss for the reporting period. Harmoney Corp Limited (Harmoney) reported a loss of $20.18 million; however, this was an improvement on its prior year loss of $25.30 million. The second largest reduction in NPAT was recorded by Instant Finance Limited (Instant Finance) with a $2.73 million (28.60%) reduction to $6.80 million.

Looking at the motor vehicle financing sector, each of the nine participants saw an increase in NPAT apart from Toyota Finance New Zealand Limited (Toyota Finance) which experienced a modest 2.51% decrease ($0.65 million). The overall result is an improvement for this sector which was hit particularly hard in 2021 with four of the nine motor vehicle financing participants reporting reductions in NPAT. This turnaround likely reflects an improvement of supply chains which were disrupted in 2021 due to the Covid-19 pandemic.

14 See Figure 14 – page 28

As shown in Figure 14, NPAT increased by $143.2 million (56.82%) to $395.34 million. This is driven by the following factors (noting the impact of UDC's reporting period increasing from three months to twelve months as explained above):

- net interest income increased $184.4 million (22.10%) to $1.02 billion, reflective of both the growing loan books and increasing margins in an increasing interest rate environment;
- non-interest income increased $73.0 million (16.71%) to $510.0 million with only seven participants reporting decreases;
- operating expenses increased by $95.4 million (11.43%) to $930.2 million;
- impaired asset expense reduced by $23.9 million (25.16%) to $71.2 million; and
- tax expense increased $42.7 million (53.64%) to $127.8 million.

Total assets

After a couple of years of minimal movement in total assets, this year has seen a return to more normal growth levels within the non-bank sector with total assets increasing by 12.62% ($2.08 billion) to $18.56 billion. Through our survey of participants, most entities pointed to a particularly strong year in terms of asset growth. This can be compared to the lower growth rates seen during the Covid-19 pandemic, which saw increases in total assets of 1.03% ($168 million) in 2021 and 3.95% ($0.65 billion) in 2020. It is also larger than the growth rate of 7.66% ($1.15 billion) seen in 2019 just before the pandemic hit.

The lift in the growth trajectory of total assets has meant that 19 of the 26 survey participants reported an increase in their total assets, while the other seven saw a contraction.

Growth of gross loans and advances (GLA) during the year mirrored the growth seen in the total assets, increasing by 13.22% ($1.79 billion). In line with total assets, this was a return to a higher growth rate compared to previous years, which saw growth of 1.03% ($0.09 billion) in 2021, 3.19% ($0.43 billion) in 2020 and 12.54% ($1.52 billion) in 2019.

Much like total assets, 19 of the 26 survey participants experienced growth in their loan books during 2022 with the remaining seven saw a contraction. See Table 3 on **page 29**.

Of the seven survey participants reporting a contraction in total assets, Ricoh New Zealand Limited (Ricoh) and BMW Financial Services New Zealand Limited (BMW) saw the largest percentage-based contractions at 12.03% ($23.0 million) and 9.36% ($25.1 million) respectively. For Ricoh and BMW this was reflected in a drop in GLA of 5.39% and 5.86% respectively. The largest dollar value drop in total assets was seen by Latitude, with a drop of $48.4 million (3.03%).

For the fourth consecutive year, Avanti Finance Limited (Avanti) reported the largest dollar growth of total assets in the non-bank sector, with an increase of $542.5 million (33.59%), which has almost entirely come from an increase in their loan book of 34.02% ($525 million). Last year Avanti achieved an equally impressive $363.96 million (29.09%) increase in total assets, which indicates that they are capitalising on the growth they have had in the last few years and are looking to cement their place as the industry leader when it comes to asset growth. Looking back longer term, Avanti is a story of remarkable growth having grown from a $153 million loan book in 2015 to $2.07 billion in 2022.

Harmoney has claimed the largest percentage increase in GLA for a second consecutive year. Strong loan book growth of $329.6 million (106.95%) has resulted in them increasing their market share from 2.28% in 2021 to 4.16% in 2022. Harmoney have now had back-to-back years of approximately doubling their market share, which has seen them grow from the 12th largest non-bank lender in 2021 to 8th largest in 2022. Avanti gained the most market share this year, increasing by 210 basis points (bps) to reach 13.51%.

UDC has remained the largest participant in the survey with its loan book passing $3.5 billion this year, despite their market share decreasing by 134 bps to 23.12%. Avanti has now cemented their place as the second largest entity based upon market share, with its loan book passing $2 billion this year, after only cracking the $1 billion mark in 2019. Latitude's loan book has dropped again this year, with their GLA being reported at $1.41 billion. Despite this, they still have the third largest loan book in the survey.

First Mortgage Trust reached a milestone of $1 billion in GLA following a 34.72% increase ($301.7 million) over the previous year.

Net interest margin (NIM)

The non-bank sector has been able to increase its average NIM slightly over the period. When those entities which did not have 12 months of net interest included in their prior year results are excluded, the sector saw a 3 bps increase from 6.59% to 6.62%. This shows that survey participants have maintained their NIM through the current interest rate environment which has seen the OCR rapidly increase from 0.25% at the start of October 2021 to 4.25% at the end of 2022.

15 See Figure 15 – page 32

For all entities including those with less than 12 months included within their prior reporting period, NIM across the non-bank sector increased by 75 bps from 5.32% to 6.07%; however, this is primarily due to the skewed results from both UDC and Speirs.

The non-bank sector had mixed results when looking at NIM compared to the prior year, with half of the 26 participants experiencing an increase in their NIM while the other half seeing decreases.

See Table 4 on page 31.

16 See Figure 16 – page 32

When looking at the entities in the survey that reported full 12-month results in both 2021 and 2022, the two largest increases in NIM were experienced by Unity with an increase of 132 bps from 6.83% to 8.15% and Toyota Finance with an increase of 94 bps from 4.51% to 5.45%.

TABLE 4: Movement in net interest margin

Entity	2022 %	2021 %	Movement (bps)
Avanti Finance Limited	4.22	5.05	-83
BMW Financial Services New Zealand Limited	6.49	6.69	-20
Christian Savings Incorporated	2.25	1.94	31
First Credit Union	3.67	3.27	40
First Mortgage Trust	6.90	6.12	78
FUJIFILM Leasing New Zealand Limited	12.05	16.32	-427
Geneva Finance Limited	9.21	9.94	-73
Harmoney Corp Limited	10.45	10.52	-7
Instant Finance Limited	22.59	22.45	14
John Deere Financial Limited	4.84	4.75	9
Latitude Financial Services Limited	12.25	11.86	39
LeasePlan New Zealand Limited	5.75	8.01	-226
Mercedes-Benz Financial Services New Zealand Limited	3.08	3.11	-3
Midlands Income Fund	6.46	6.31	15
Motor Trade Finance Limited	8.58	8.73	-15
Nelson Building Society	2.80	2.70	10
Nissan Financial Services New Zealand Pty Limited	3.64	3.90	-26
ORIX New Zealand Limited	9.59	9.04	55
Police and Families Credit Union	2.61	3.25	-64
Ricoh New Zealand Limited	9.53	10.71	-118
Speirs Finance Group Limited	4.22	2.88	134
Toyota Finance New Zealand Limited	5.45	4.51	94
Turners Automotive Group	7.57	7.89	-32
UDC Finance Limited	4.27	1.16	311
Unity Credit Union	8.15	6.83	132
Wairarapa Building Society	3.19	2.49	70
Sector average	**6.07**	**5.32**	**75**

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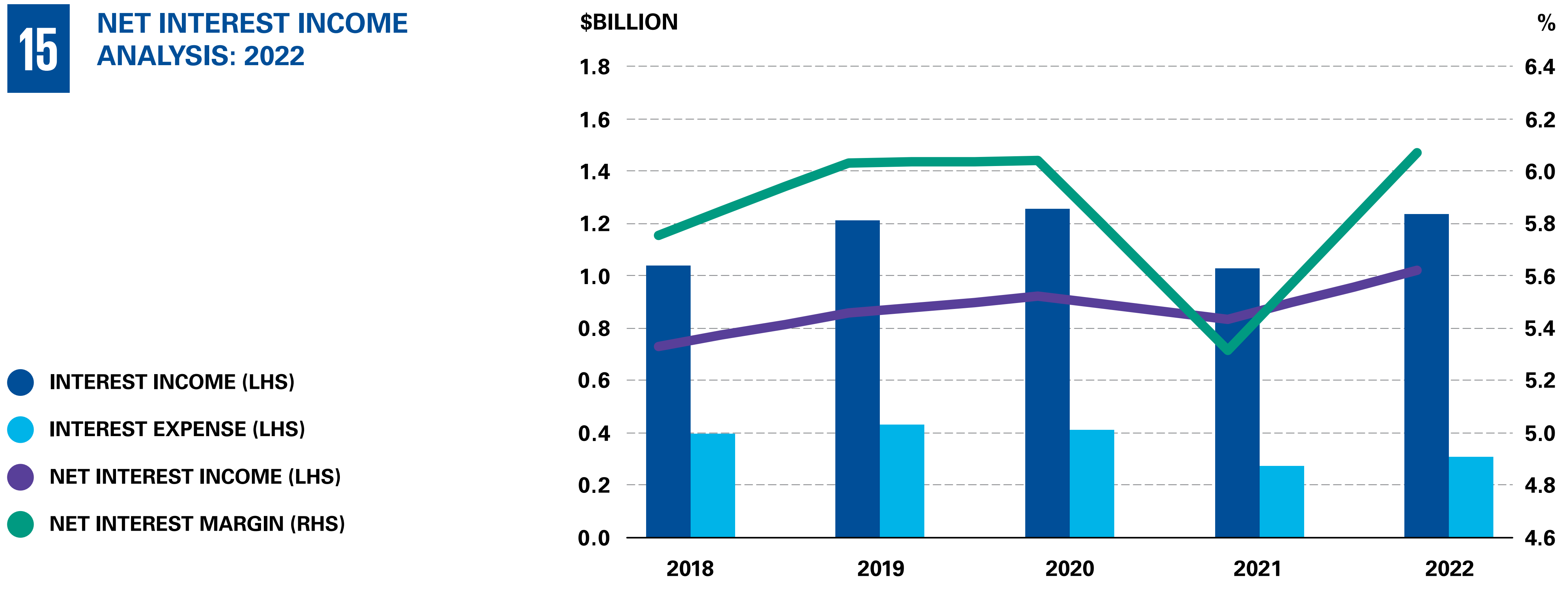
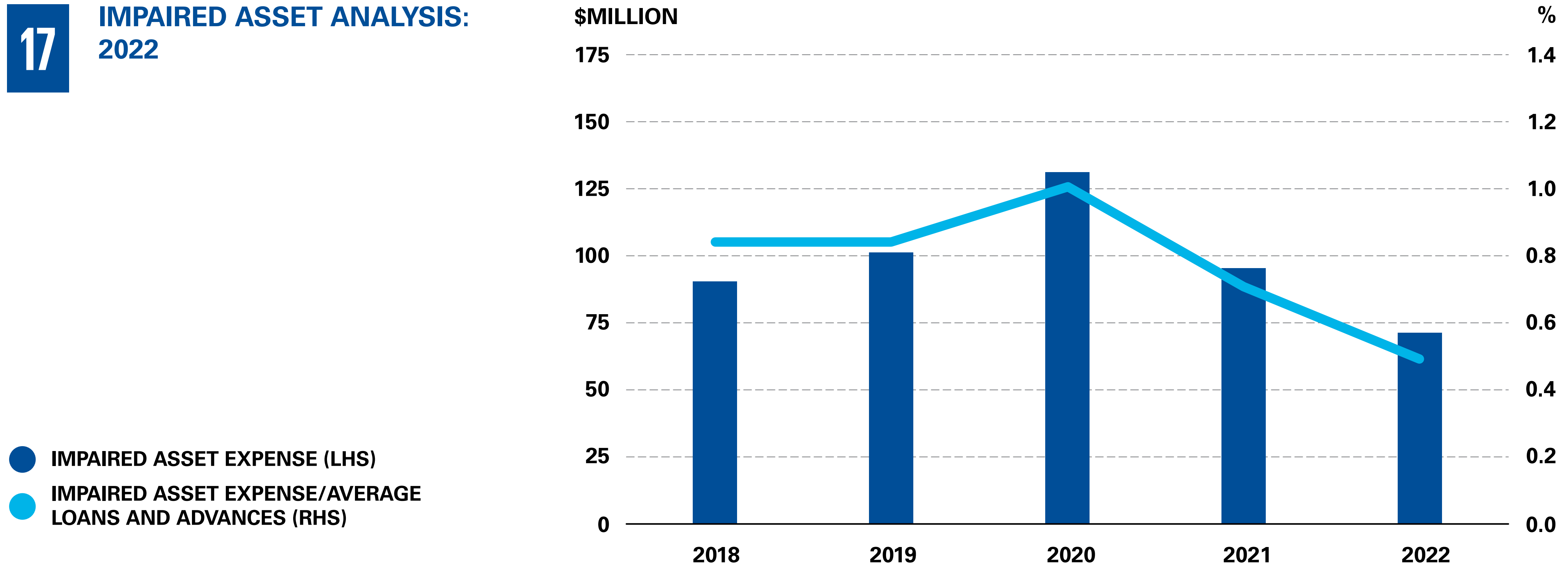
2022 2021 2020 2019 2018

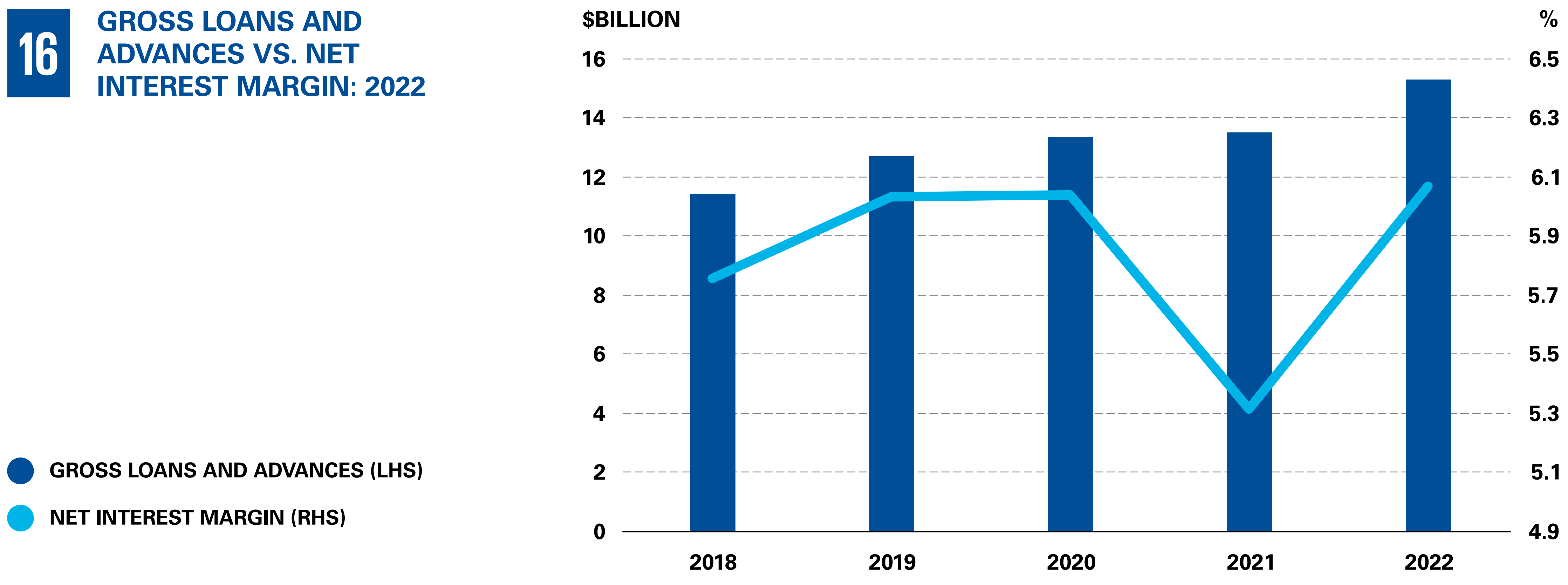
15 NET INTEREST INCOME ANALYSIS: 2022



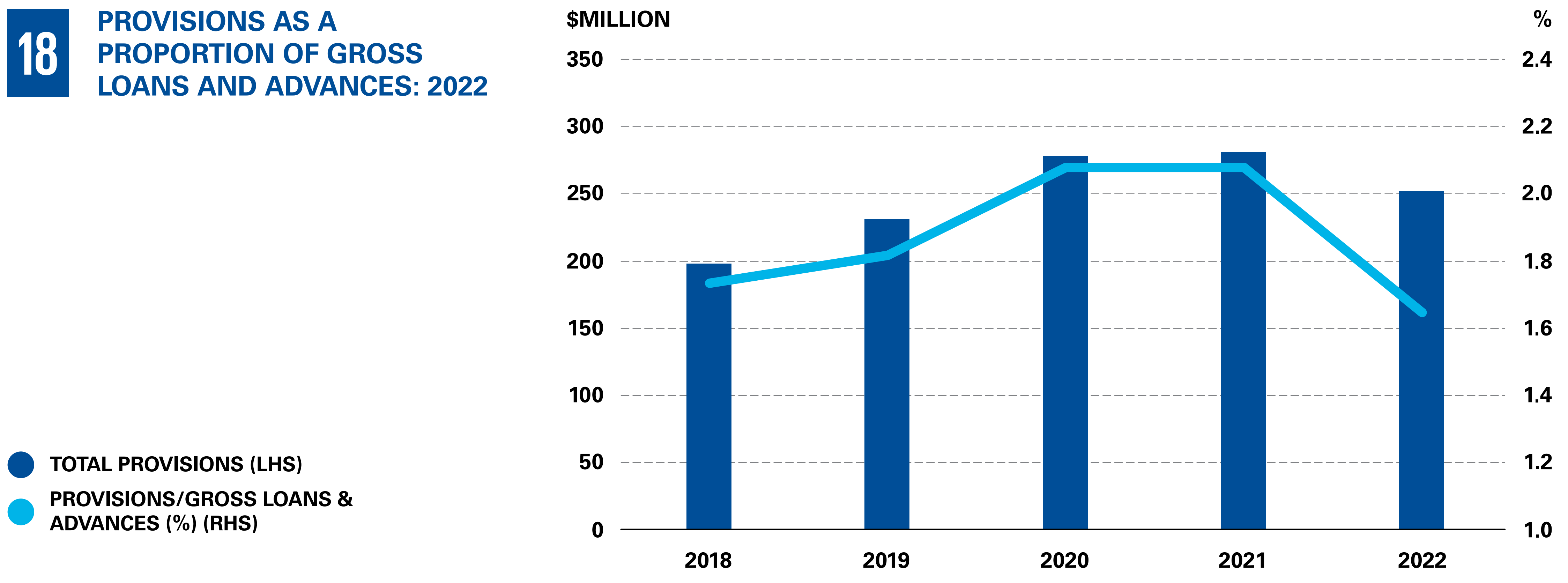
17 IMPAIRED ASSET ANALYSIS: 2022



16 GROSS LOANS AND ADVANCES VS. NET INTEREST MARGIN: 2022



18 PROVISIONS AS A PROPORTION OF GROSS LOANS AND ADVANCES: 2022



FUJIFILM saw the largest decrease in NIM as it dropped by 427 bps from 16.32% to 12.05%. This was closely followed by LeasePlan New Zealand Limited with a decrease of 226 bps from 8.01% to 5.75%.

Looking at interest income as a percentage of average interest-bearing assets and excluding those entities without a 12-month prior reporting period comparison, Unity led the non-bank sector when comparing 2022 results to 2021 results with a 81 bps increase to 8.95%, followed by Toyota Finance and First Mortgage Trust which both had 78 bps increases to 7.02% and 6.90% respectively.

On the flip side, the largest improvements in interest expense as a percentage of average interest-bearing liabilities were experienced by Wairarapa Building Society with a decrease of 109 bps to 1.06%, John Deere Financial Limited with a decrease of 89 bps to 0.67%, and Latitude with a decrease of 88 bps to 3.17%. Overall, 18 survey participants improved their interest expense as a percentage of average interest-bearing liabilities, while five participants saw increases (the other three participants do not have interest-bearing liabilities).

As we continue to navigate through the highest level of inflation New Zealand has seen since the 1990s and the resulting response from the Reserve Bank of New Zealand (RBNZ) to raise the OCR including a record-breaking 75 bps increase on 23 November 2022, it will be interesting to see how NIM shapes up for the non-bank sector as we head into 2023.

Asset quality

The 2022 survey has seen the release of a large amount of provisioning within the non-bank sector (see Figure 17). This is consistent with what has been seen in the banking sector, however the release of provisions has brought the level of provisions down to the lowest level since 2015, a much larger movement than seen in the banking sector.

17 See Figure 17 – page 32

It is important to recognise that the differing balance dates of the participants in the survey means the provisioning balances and impairment expense reflect different stages of the past year. As such, the provisioning and impairment numbers we see in Figure 18 may not fully reflect the persistently high inflation, the cost-of-living crisis and rapidly rising interest rates. It will be interesting to see whether the level of provisioning moves back up over the next few months to reflect these factors.

18 See Figure 18 – page 32

Nevertheless, based on the data captured by the survey, asset quality has improved with impaired asset expense decreasing by 25.16% from $95.1 million in 2021 to $71.2 million in 2022. This reflected 18 of the 26 survey participants experiencing a decrease in impaired asset expense.

The largest decrease in impaired asset expense was recorded by Latitude, with a decrease from $48.7 million in 2021 to $16.6 million in 2022, a decrease of 65.86%. This was the lowest impaired asset expense recorded by Latitude during their participation in the survey since 2016.

The largest rise in impaired asset expense was experienced by Harmoney with an increase of 109.43% from $13.1 million in 2021 to $27.4 million in 2022. However, this can be attributed primarily to the 106.95% growth seen in its loan book from $308.1 million in 2021 to $637.7 in 2022 (with all new loans attracting an expected credit loss).

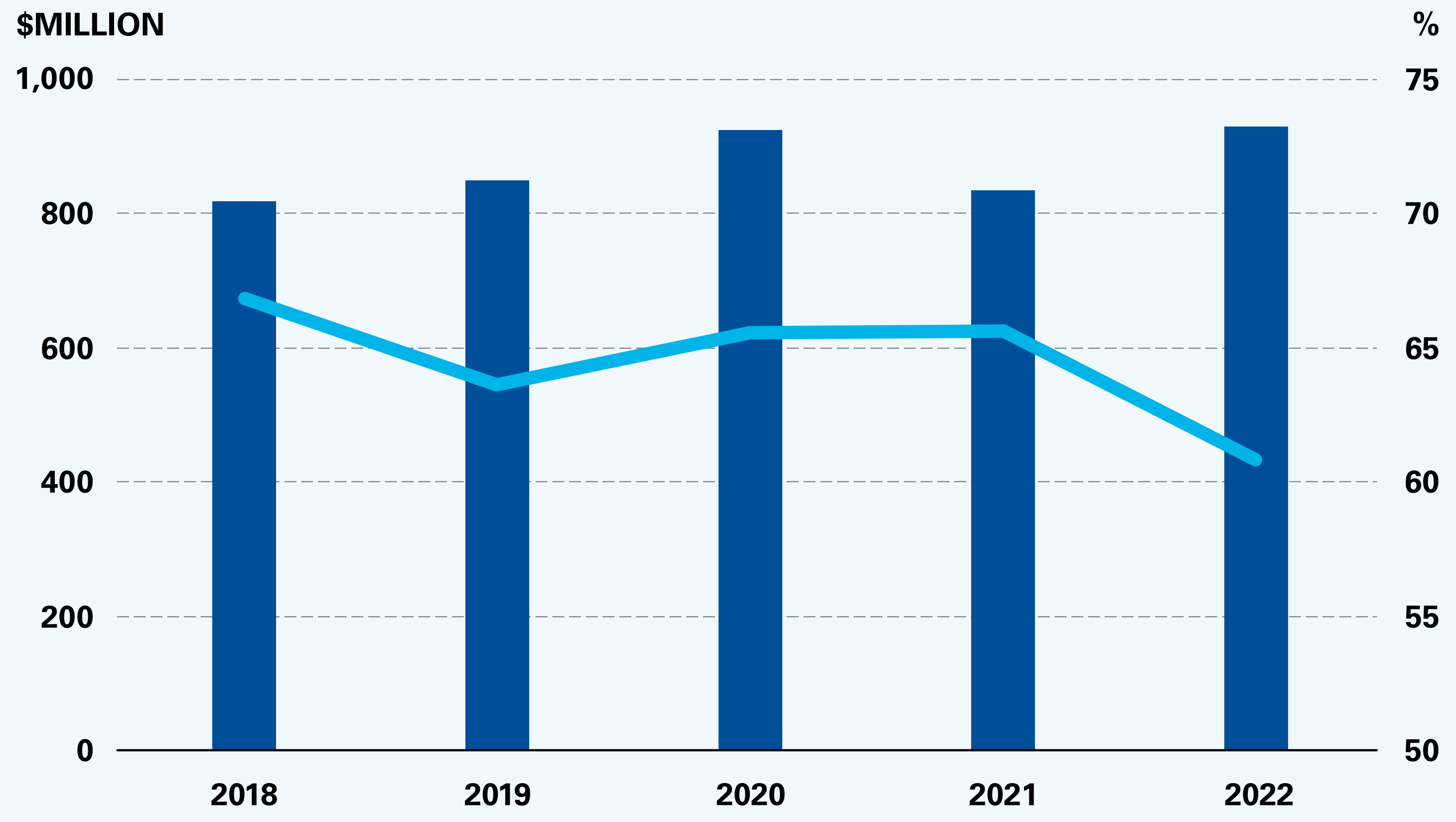
Five of the entities surveyed reported an impaired asset recovery rather than an expense in 2022, the largest of which was experienced by UDC at $3.9 million. This was the second year in a row that UDC saw an impaired asset recovery.

Total provisioning for the non-bank sector decreased by 19.10% from $311.9 million to $252.4 million reflecting an improved credit environment compared to the prior year based off a record low unemployment rate and rising wages. The largest decrease in impairment provision was by Latitude, who decreased provisions by $18.3 million or 31.92% on 2021. However, the trend of a decrease in provisioning numbers doesn't appear likely to continue given current economic forecasts of high inflation and increasing interest rates, which will likely prompt survey participants to relook at their models.

Of the 23 survey participants who disclosed provisioning numbers, only four recorded an increase in their provisioning numbers. Harmoney had the largest increase in credit provisions, increasing it by 107.36% from $15.4 million in 2021 to $31.9 million in 2022. Unity had the second largest increase, a rise of 65.25% from $4.3 million in 2021 to $7.1 million in 2022. However, this may be partially explained by both of these entity's financial year ends being 30 June 2022, which is later than most other survey participants and is also impacted by the level of unsecured lending in their books. By this time of the year, the economic environment had started to deteriorate. Both Unity and Harmoney were also two of the four entities to increase their provisions to GLA ratios, with a change of 89 bps and 1 bp respectively.

Of the companies to decrease their impairment provision to GLA ratios, both Turners Automotive Group (Turners) and Ricoh decreased provisions by 237 bps. Turners impairment provision to GLA ratio decreased from 4.89% in 2021 to 2.52% in 2022, while Ricoh decreased their ratio from 4.24% in 2021 to 1.87% in 2022.

19 OPERATING EXPENSES VS. OPERATING EXPENSES/ OPERATING INCOME: 2022



Hover over the button to see historic results

2022 2019 2021 2018 2020

These large decreases in the impairment provision to GLA ratio is driven by decreasing provisions rather than a large increase in GLA.

Operating expenses

Operating expenses increased by 11.43% ($95.4 million) across the non-bank sector to $930.2 million in the 2022 survey. This movement is in contrast to the decrease of 9.87% ($97.6 million) seen in 2021 and represents the cost and inflationary pressures the economy has experienced during this year. As noted earlier in the survey, increasing costs and wage inflation have been seen across the board. However, the operating efficiency ratio (operating expenses as a proportion of operating income) decreased 481 bps to 60.84% from 65.65%, as operating income increased at a comparatively higher rate of 20.25% ($257.4 million).

19 See Figure 19 – page 34

Turners saw the largest value increase in operating expenses of the survey participants with $36.54 million (14.56%); however, this is more a reflection of the non-finance side of the business with a large portion of the operating expenses related to sales and cost of goods sold. Other entities with large increases in operating expenses are Geneva Finance Limited (32.77%), Midlands (31.01%) and First Mortgage Trust (26.98%). Each of these entities also recorded increases in operating income.

Latitude experienced the largest value decrease in operating expenses with a reduction of $17.2 million (15.01%). Other entities which also reported large percentage decreases in operating expenses were BMW (43.55%), Nelson Building Society (10.23%) and Christian Savings (9.11%). Latitude and BMW also experienced decreases in operating income of 4.27% and 24.77% respectively, while Nelson Building Society and Christian Savings saw increases in operating income of 15.52% and 32.71% respectively.

In another turbulent year for survey participants, operating effectively and efficiently proved challenging, illustrated by the mixed results drawn from the data collected. Twelve of the 26 participants noted an improvement in their operating efficiency ratio. Nissan Financial Services New Zealand Pty Limited again had the best operating efficiency ratio of the survey participants at 21.89% despite an increase of 293 bps. At the other end of the scale, Harmoney reported an 87.66% ratio (down from 146.45%) and Turners experienced a ratio of 86.46% (up from 86.12%).

Wairarapa Building Society and Instant Finance experienced the greatest deterioration in their operating efficiency ratios during the year, increasing by 8.83% to 62.77% and 8.26% to 69.77% respectively.

The most notable improvement in operating efficiency ratio was reported by Harmoney with a decrease from 146.45% to 87.66% primarily due to an 86.74% ($27.10 million) increase in operating income. Another notable increase in operating efficiency was seen by Speirs, who improved from 91.87% to 59.93%, driven by the strong increase of 183.93% ($17.90 million) in operating income.

Analysis of annual results

				Size and strength measures			Growth measures			
Non-bank entity	**Rank by total assets**	**Balance date**	**Year**	**Total assets $000**	**Net assets[14] $000**	**Net loans and advances $000**	**Increase in net profit after tax %**	**Increase in total assets %**	**Increase in gross loans and advances %**	**Increase in net interest income %**
Avanti Finance Limited	2	30-Jun	2022	2,157,515	236,178	2,041,474	16.33	33.59	34.02	9.91
			2021	*1,615,033*	*209,103*	*1,515,099*	*42.16*	*29.09*	*26.65*	*11.73*
BMW Financial Services New Zealand Limited	18	31-Dec	2021	243,164	21,697	236,346	36.68	-9.36	-5.86	-15.87
			2020	*268,288*	*21,204*	*249,012*	*-26.36*	*-16.23*	*-18.96*	*-11.25*
Christian Savings Incorporated	17	31-Aug	2022	285,749	34,971	211,113	106.33	19.18	14.42	32.55
			2021	*239,760*	*31,231*	*184,349*	*39.50*	*8.26*	*11.42*	*26.14*
First Credit Union	13	30-Jun	2022	442,356	63,967	298,282	63.85	6.51	8.90	18.54
			2021	*415,313*	*59,495*	*273,561*	*138.14*	*3.59*	*22.22*	*-3.87*
First Mortgage Trust	4	31-Mar	2022	1,459,923	1,455,002	1,167,684	51.97	32.79	34.72	41.96
			2021	*1,099,438*	*1,096,305*	*865,746*	*-2.08*	*17.58*	*9.83*	*3.09*
FUJIFILM Leasing New Zealand Limited	23	31-Mar	2022	153,226	71,123	82,438	109.25	91.14	19.94	14.89
			2021	*80,165*	*66,848*	*67,752*	*3.44*	*11.14*	*7.41*	*15.82*
Geneva Finance Limited	21	31-Mar	2022	155,651	37,760	93,203	-10.21	9.23	0.29	2.73
			2021	*142,499*	*34,220*	*92,152*	*60.87*	*13.57*	*9.68*	*5.95*
Harmoney Corp Limited	9	30-Jun	2022	701,326	65,311	605,815	20.23	80.40	106.95	93.66
			2021	*388,766*	*75,694*	*292,770*	*-53.86*	*115.72*	*128.04*	*76.59*
Instant Finance Limited	25	31-Mar	2022	109,404	33,573	92,769	-28.60	-4.37	-5.74	-6.92
			2021	*114,406*	*35,359*	*98,418*	*9.23*	*-8.42*	*-9.23*	*-4.61*
John Deere Financial Limited	19	31-Oct	2021	188,321	19,461	183,588	-5.80	6.15	6.63	0.02
			2020	*177,411*	*15,350*	*172,170*	*19.17*	*-8.95*	*-10.12*	*8.24*
Latitude Financial Services Limited	3	31-Dec	2021	1,549,182	-24,185	1,367,919	143.61	-3.03	-5.22	-3.07
			2020	*1,597,546*	*-57,098*	*1,427,150*	*29.01*	*-9.92*	*-12.24*	*-0.08*
LeasePlan New Zealand Limited	16	31-Dec	2021	309,400	126,382	9,884	0.24	-6.47	-5.74	-33.17
			2020	*330,793*	*119,374*	*10,486*	*-22.32*	*-7.23*	*12.56*	*-12.67*
Mercedes-Benz Financial Services New Zealand Limited	10	31-Dec	2021	629,454	35,610	606,452	13.23	6.20	5.64	-6.84
			2020	*592,684*	*34,607*	*572,387*	*-32.17*	*-16.20*	*-15.77*	*-9.56*
Midlands Income Fund	26	31-Mar	2022	104,205	103,470	91,460	34.86	22.69	32.73	33.21
			2021	*84,937*	*84,724*	*68,805*	*5.52*	*40.66*	*25.99*	*6.21*

Analysis of annual results

				Size and strength measures			Growth measures			
Non-bank entity	**Rank by total assets**	**Balance date**	**Year**	**Total assets $000**	**Net assets[14] $000**	**Net loans and advances $000**	**Increase in net profit after tax %**	**Increase in total assets %**	**Increase in gross loans and advances %**	**Increase in net interest income %**
Motor Trade Finance Limited	7	30-Sep	2022	845,198	99,628	736,628	4.56	11.01	9.40	3.06
			2021	*761,355*	*93,852*	*672,478*	*61.31*	*1.00*	*0.19*	*3.99*
Nelson Building Society	6	31-Mar	2022	1,088,058	102,838	862,099	40.84	14.76	20.33	16.29
			2021	*948,155*	*92,462*	*714,458*	*44.67*	*9.55*	*5.82*	*12.54*
Nissan Financial Services New Zealand Pty Limited	11	31-Mar	2022	525,634	62,057	500,551	0.12	6.30	4.85	-10.23
			2021	*494,459*	*46,527*	*476,201*	*23.30*	*-12.60*	*-12.22*	*7.31*
ORIX New Zealand Limited	12	31-Mar	2022	459,859	172,262	105,151	35.38	7.74	7.56	8.96
			2021	*426,808*	*150,132*	*97,447*	*32.23*	*-1.09*	*6.52*	*8.36*
Police and Families Credit Union	22	30-Jun	2022	155,357	27,673	31,066	-34.25	2.14	-17.46	-17.54
			2021	*152,103*	*27,001*	*37,664*	*28.72*	*5.39*	*-11.11*	*-4.45*
Ricoh New Zealand Limited	20	31-Mar	2022	168,201	73,151	91,177	-20.87	-12.03	-5.39	-17.36
			2021	*191,200*	*74,187*	*94,046*	*493.80*	*-0.68*	*-2.59*	*25.99*
Speirs Finance Group Limited	15	30-Jun	2022	390,864	3,732	284,944	1,892.68	15.69	13.09	63.43
			2021	*337,849*	*-1,661*	*252,832*	*-72.33*	*9.92*	*11.55*	*-48.69*
Toyota Finance New Zealand Limited	5	31-Mar	2022	1,359,700	229,879	1,009,072	-2.51	5.17	0.35	15.58
			2021	*1,292,834*	*230,525*	*1,001,161*	*0.25*	*-12.06*	*-4.81*	*6.54*
Turners Automotive Group	8	31-Mar	2022	733,176	159,880	426,112	16.44	17.13	24.36	9.36
			2021	*625,942*	*141,061*	*334,317*	*28.21*	*1.64*	*9.96*	*0.73*
UDC Finance Limited	1	31-Dec	2021	3,750,418	663,560	3,489,454	270.10	8.23	7.03	276.19
			2020	*3,465,293*	*564,206*	*3,248,219*	*-65.20*	*-2.61*	*-1.25*	*-73.16*
Unity Credit Union	14	30-Jun	2022	439,993	60,836	312,906	-103.46	-7.74	-0.86	10.04
			2021	*476,880*	*60,954*	*318,495*	*969.19*	*-7.19*	*-7.62*	*3.00*
Wairarapa Building Society	24	31-Mar	2022	152,190	24,525	124,499	-24.71	-4.11	15.67	22.32
			2021	*158,714*	*23,188*	*107,471*	*-3.02*	*-5.41*	*-15.03*	*9.11*
Sector total			**2022**	**18,557,524**	**3,960,341**	**15,062,086**	**56.82**	**12.62**	**13.22**	**22.10**
			2021	***16,478,631***	***3,328,850***	***13,244,646***	***-4.09***	***1.03***	***1.21***	***-9.38***

n/d = not disclosed; n/a = not available.

Analysis of annual results

		Credit quality measures			Profitability measures						Efficiency measures	
Non-bank entity	Year	Impaired asset expense $000	Provision for doubtful debts/ Gross loans & advances %	Impaired asset expense/ Average loans & advances %	Net interest margin %	Interest spread %	Net profit after tax $000	Underlying profit $000	NPAT/ Average total assets %	NPAT/ Average equity %	Operating expenses/ Gross revenues %	Operating expenses/ Operating income %
Avanti Finance Limited	2022	8,395	1.29	0.46	4.22	3.84	35,086	50,160	1.86	15.63	24.59	38.46
	2021	11,675	1.82	0.85	5.05	4.65	30,162	41,972	2.10	17.26	25.98	37.90
BMW Financial Services New Zealand Limited	2021	1,365	1.07	0.55	6.49	6.35	5,493	7,770	2.15	25.61	43.96	52.78
	2020	2,046	1.88	0.72	6.69	6.50	4,019	5,583	1.37	17.22	57.20	70.33
Christian Savings Incorporated	2022	-146	0.03	-0.07	2.25	2.03	3,811	3,811	1.45	11.51	24.87	40.88
	2021	36	0.11	0.02	1.94	1.71	1,847	1,847	0.80	6.22	33.76	59.69
First Credit Union	2022	1,099	0.92	0.38	3.67	3.55	3,059	3,060	0.71	4.96	68.76	81.60
	2021	1,150	1.04	0.46	3.27	3.11	1,867	1,867	0.46	3.12	67.45	84.92
First Mortgage Trust	2022	9	0.26	0.00	6.90	6.90	66,130	67,051	5.17	5.18	23.73	23.73
	2021	1,450	0.38	0.17	6.12	6.12	43,516	44,053	4.28	4.29	26.53	26.53
FUJIFILM Leasing New Zealand Limited	2022	323	3.89	0.41	12.05	12.05	4,275	4,275	3.66	6.20	70.44	70.46
	2021	1,088	5.26	1.58	16.32	15.80	2,043	2,043	2.68	3.10	76.50	76.82
Geneva Finance Limited	2022	-430	17.35	-0.38	9.21	7.52	5,944	8,238	3.99	16.52	72.28	79.82
	2021	825	18.05	0.77	9.94	8.37	6,620	6,766	4.94	20.19	66.79	75.39
Harmoney Corp Limited	2022	27,377	5.00	5.79	10.45	9.95	-20,179	-20,179	-3.70	-28.62	65.78	87.66
	2021	13,072	4.99	5.90	10.52	9.63	-25,295	-27,581	-8.89	-48.37	111.89	146.45
Instant Finance Limited	2022	2,303	4.50	2.30	22.59	20.46	6,803	8,783	6.08	17.31	61.83	69.77
	2021	1,842	4.50	1.70	22.45	20.71	9,528	12,920	7.96	24.38	54.93	61.51
John Deere Financial Limited	2021	0	0.00	0.00	4.84	4.77	4,111	5,710	2.25	23.62	31.20	35.09
	2020	0	0.00	0.00	4.75	4.63	4,364	6,061	2.34	33.14	24.38	31.75
Latitude Financial Services Limited	2021	16,617	2.78	1.15	12.25	12.39	50,240	71,519	3.19	64.11	41.45	52.50
	2020	48,678	3.87	3.07	11.86	12.13	20,623	30,541	1.22	39.61	43.63	59.13
LeasePlan New Zealand Limited	2021	2,267	0.00	22.26	5.75	5.75	7,008	8,313	2.19	5.70	27.89	70.32
	2020	19	0.00	0.19	8.01	8.01	6,991	9,725	2.03	6.03	26.85	71.67
Mercedes-Benz Financial Services New Zealand Limited	2021	-1,354	0.89	-0.23	3.08	2.97	10,045	13,918	1.64	28.61	31.13	42.68
	2020	1,609	1.18	0.25	3.11	2.94	8,871	12,619	1.36	20.78	24.14	37.16
Midlands Income Fund	2022	19	0.54	0.02	6.46	6.46	4,126	4,126	4.36	4.38	32.21	32.21
	2021	24	0.69	0.04	6.31	6.31	3,059	3,059	4.21	4.22	32.78	32.78

Analysis of annual results

Non-bank entity	Year	Credit quality measures			Profitability measures						Efficiency measures	
		Impaired asset expense $000	Provision for doubtful debts/ Gross loans & advances %	Impaired asset expense/ Average loans & advances %	Net interest margin %	Interest spread %	Net profit after tax $000	Underlying profit $000	NPAT/ Average total assets %	NPAT/ Average equity %	Operating expenses/ Gross revenues %	Operating expenses/ Operating income %
Motor Trade Finance Limited	2022	204	0.53	0.03	8.58	8.27	8,366	11,863	1.04	8.65	69.10	85.08
	2021	*127*	*0.66*	*0.02*	*8.73*	*8.34*	*8,001*	*11,390*	*1.06*	*8.36*	*69.05*	*85.09*
Nelson Building Society	2022	1,276	0.44	0.16	2.80	2.67	12,571	17,525	1.23	12.87	25.93	36.83
	2021	*1,354*	*0.72*	*0.19*	*2.70*	*2.52*	*8,926*	*12,201*	*0.98*	*10.76*	*28.41*	*47.39*
Nissan Financial Services New Zealand Pty Limited	2022	334	2.03	0.07	3.64	3.42	11,231	20,121	2.20	20.69	19.66	21.89
	2021	*2,884*	*2.28*	*0.55*	*3.90*	*3.75*	*11,218*	*21,990*	*2.12*	*27.40*	*17.94*	*18.96*
ORIX New Zealand Limited	2022	12	0.03	0.01	9.59	8.71	20,293	28,188	4.58	12.59	22.74	48.68
	2021	*304*	*0.35*	*0.32*	*9.04*	*8.16*	*14,990*	*20,851*	*3.49*	*9.84*	*23.22*	*53.57*
Police and Families Credit Union	2022	3	0.41	0.01	2.61	2.53	672	673	0.44	2.46	73.00	85.27
	2021	*15*	*0.34*	*0.04*	*3.25*	*3.13*	*1,022*	*1,022*	*0.69*	*3.83*	*65.98*	*79.35*
Ricoh New Zealand Limited	2022	126	1.87	0.13	9.53	9.08	7,429	10,463	4.13	10.08	75.91	79.22
	2021	*147*	*4.24*	*0.15*	*10.71*	*10.49*	*9,388*	*12,583*	*4.89*	*12.69*	*71.46*	*73.98*
Speirs Finance Group Limited	2022	448	2.44	0.16	4.22	4.28	10,621	10,621	2.92	1,025.69	26.40	59.93
	2021	*258*	*2.10*	*0.11*	*2.88*	*2.85*	*533*	*533*	*0.17*	*25.78*	*36.08*	*91.87*
Toyota Finance New Zealand Limited	2022	3,778	1.54	0.37	5.45	5.10	25,172	34,758	1.90	10.93	29.60	51.39
	2021	*1,912*	*1.97*	*0.18*	*4.51*	*4.16*	*25,819*	*36,151*	*1.87*	*11.86*	*24.61*	*46.80*
Turners Automotive Group	2022	1,877	2.52	0.48	7.57	7.23	31,281	43,120	4.60	12.87	83.71	86.46
	2021	*3,049*	*4.89*	*0.91*	*7.89*	*7.67*	*26,864*	*37,375*	*4.33*	*11.77*	*82.92*	*86.12*
UDC Finance Limited	2021	-3,850	1.46	-0.11	4.27	3.94	80,396	111,787	2.23	13.10	22.13	30.32
	2020	*-777*	*1.82*	*-0.02*	*1.16*	*1.09*	*21,723*	*30,199*	*0.62*	*3.94*	*21.42*	*28.59*
Unity Credit Union	2022	9,248	2.23	2.88	8.15	8.05	-119	-119	-0.03	-0.20	73.19	79.08
	2021	*2,400*	*1.34*	*0.71*	*6.83*	*6.68*	*3,442*	*3,444*	*0.69*	*5.81*	*75.17*	*86.17*
Wairarapa Building Society	2022	-94	0.38	-0.08	3.19	3.07	1,475	2,070	0.95	6.18	49.78	62.77
	2021	*-45*	*0.53*	*-0.04*	*2.49*	*2.30*	*1,959*	*2,474*	*1.20*	*8.70*	*34.45*	*53.94*
Sector total	**2022**	**71,207**	**1.65**	**0.49**	**6.07**	**5.59**	**395,340**	**527,625**	**2.26**	**10.23**	**46.46**	**60.84**
	2021	***95,142***	***2.08***	***0.71***	***5.32***	***4.92***	***252,100***	***341,689***	***1.54***	***7.54***	***49.15***	***65.65***

n/d = not disclosed; n/a = not available

Climate reporting: ready, steady go ... but only if we have to?

Sanel Tomlinson
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KPMG

Sanel is a Principal in KPMG's Impact team, supporting clients in navigating the various financial and broader corporate performance reporting requirements.

If you want more information on the topics discussed in this article or related to your broader climate reporting journey, then please reach out to Sanel.

If all goes according to plan, by the time you read this, New Zealand's own Climate Standards have, or should be, about to hit the streets. For some entities this is not news and they have started their climate reporting journey already because they see the value to this exercise that goes beyond mere compliance. For other entities this is not news, but they are waiting for certainty with regards to the requirements. And then we have a group of entities who feel fortunate to not have been caught by the legislative requirements – thank goodness?

Unfortunately not.

Do you have to prepare financial statements that comply with New Zealand accounting standards?

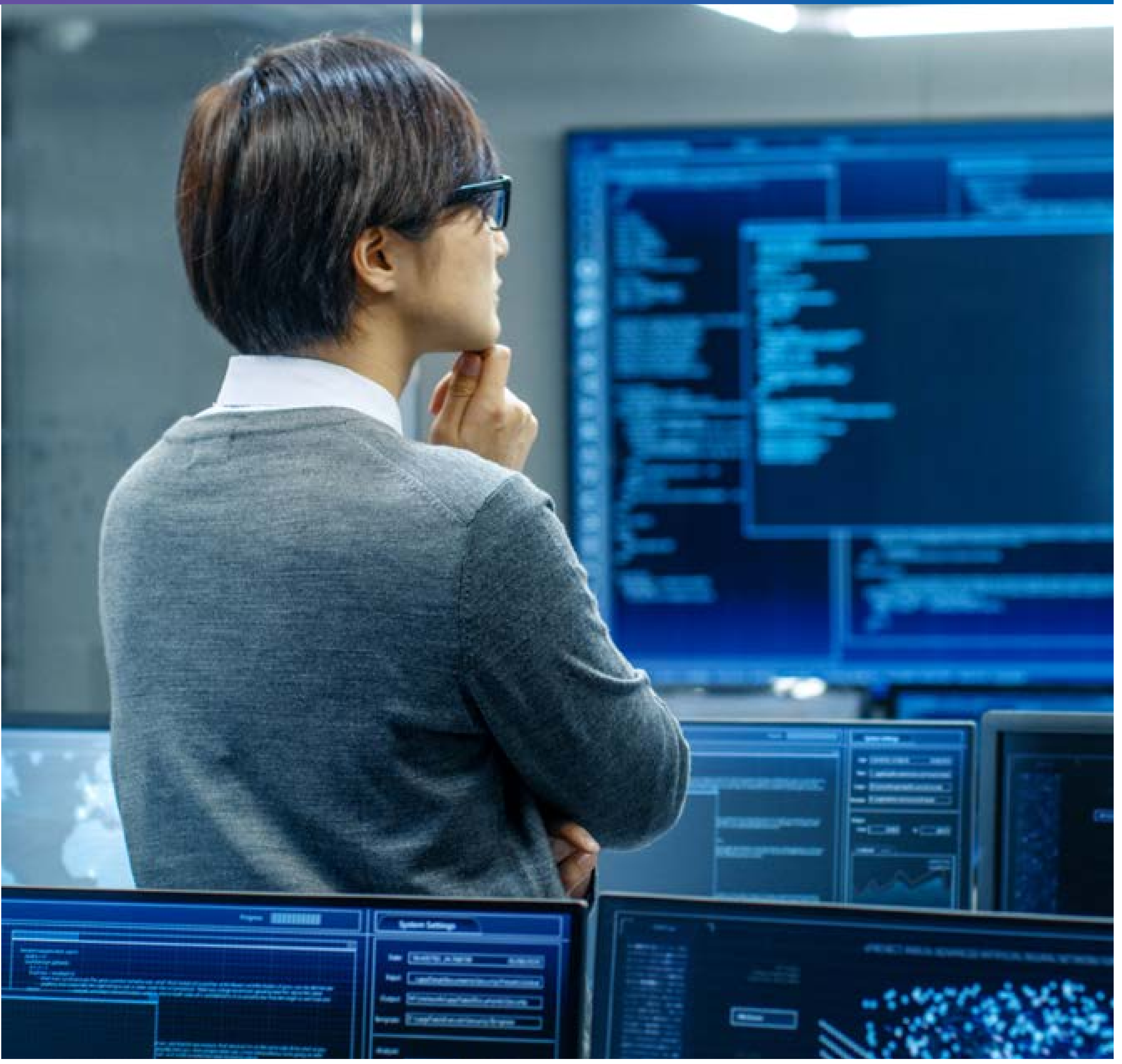
For most entities, climate reporting under the new Climate Standards will remain voluntary. However, all entities are required to comply with New Zealand generally accepted accounting practice (NZ GAAP). To argue that the accounting standards do not specifically deal with climate-related issues and therefore these need not be considered, is a misapplication of GAAP.

New Zealand International Accounting Standard (NZ IAS) 1 *Presentation of Financial Statements* contains some overarching requirements that could be relevant when considering climate-related matters. For example, it requires disclosure of information not specifically required by an accounting standard and not presented elsewhere in the financial statements, but that is relevant to an understanding of any of the financial statements. Another paragraph requires an entity to consider whether any material information is missing from its financial statements – i.e. an entity is required to consider whether to provide additional disclosures when compliance with the specific requirements in the accounting standards is insufficient to enable users to understand the impact of particular transactions, other events and conditions on the entity's financial position and financial performance.

Even if it is determined that these overarching requirements do not apply, any standard that requires measurement using future cashflows will necessarily require the entity to consider the impacts of climate change on the entity's future business model and activities. Think here about impairment testing, deferred tax asset recognition, provision for doubtful debts and potentially your lease accounting.

> "For most entities, climate reporting under the new Climate Standards will remain voluntary. However, all entities are required to comply with NZ GAAP.

> You are putting your organisation at a distinct disadvantage if you are not able to provide information about your GHG emissions footprint and your plans for reducing that footprint.



You may decide not to prepare formal climate statements that comply with the Climate Standards. However, using the Climate Standards as a guide to consider the risks, opportunities and impacts of climate change will also be useful in determining what information to include in your financial statements.

Are your customers asking for green finance options?

Your customer may already be working on determining its greenhouse gas (GHG) emissions and looking for ways in which it could reduce its emissions. Every entity is part of the value chain of another entity and GHG emissions are measured across an entity's complete value chain. We are already seeing in practice that entities are starting to be more selective with whom they do business. And this is not limited to corporates, prospective employees are also interested to know what the entity is doing about reducing their impact on the environment.

You are putting your organisation at a distinct disadvantage if you are not able to provide information about your GHG emissions footprint and your plans for reducing that footprint. It is also worthwhile to note that users of this information are becoming more sophisticated in discerning whether a green statement or product is just coloured that way or the 'real deal'. Maybe this is because of the spotlight on 'greenwashing' – so one can expect some naming and shaming on the topic.

Once again, this isn't to say the entity should produce formal climate statements or comply fully with the new Climate Standards. But the guidance included in the standards will be useful in ensuring that your approach to calculating GHG emissions is robust.

What is the word on the street?

We have spoken to many entities in the non-banks financial institutions sector in preparation for this publication. Many entities in this sector are not caught by the mandatory legislative requirements, and therefore, haven't done much work from a reporting perspective. However, while not required, many entities have gone beyond climate considerations and are starting to work on broader environmental, social and governance (ESG)/sustainability strategies. Many are also working with their customers to help them become more sustainable or to find solutions to their green financing needs.

However, we have also heard that concerns about the economy and future profitability may cause entities to slow down or even pause some of their initiatives. Hopefully this is just a short detour and will not derail the good work that is happening in the non-banking sector. Steady progress on your sustainability initiatives can materially help the situation by increasing short and long-term resilience and confidence in your business.

For those entities that are caught by the requirements and that have started their projects, their main concerns are around the ability of both systems and processes to capture the information that they need for the reporting, and the availability of data that is not entity specific. This is consistent with what we hear from other sectors.

It shouldn't be about 'have to'

Whether it is climate reporting or broader ESG/sustainability reporting, many entities that have started this journey have realised (and have commented publicly on) the extent of benefits that could be achieved by doing this right and making the most of this opportunity.

The Climate Standards provide a good framework to help you through the reporting process, while at the same time make you think about the opportunities presented as New Zealand transitions to a sustainable, low-emissions economy. The requirements cover every aspect of the business: from the top of the entity (the Board), through risk management and strategy down to operational targets and metrics.

It makes good business sense to be prepared.

Tax governance – an update and where to from here?

> Those selected for the questionnaire in 2021 and 2022 were from the business population (totalling around 1,000 taxpayers) comprised of 'significant enterprises'– those with an annual turnover greater than NZ$30 million.

Darshana Elwela
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Darshana is a Partner in KPMG's tax team. Darshana has over 20 years' tax experience. He specialises in funds management and international taxation issues and leads KPMG's wealth management sector focus. Darshana is heavily involved in working with both tax policy and government officials on various tax policy changes, including on behalf of a range of clients.

KPMG has experience working with financial services clients across a range of tax matters. If you would like to speak to us about tax, then please reach out to Darshana.

Late last year, Inland Revenue sent almost 150 businesses a questionnaire about their tax governance arrangements. In late October this year, Inland Revenue repeated this exercise.

In this article, we explore the 2021 questionnaire findings, Inland Revenue's expectations around tax governance and what businesses should be doing to prepare.

The tax governance questionnaire

At a high-level, the questionnaire asks whether businesses have documented their tax strategy and tax control framework, have policies and procedures in place for tax compliance requirements, undertake regular independent testing of tax controls, and the extent of Board level reporting on tax and tax risk in the business.

Businesses selected

Those selected for the questionnaire in 2021 and 2022 were from the business population (totalling around 1,000 taxpayers) comprised of 'significant enterprises'– those with an annual turnover greater than NZ$30 million.

Inland Revenue has indicated that the almost 300 businesses selected across the two years represent a cross-section of both foreign and New Zealand-owned business and are across different industry sectors, including the financial services sector. (Separately, the top 50 taxpayers who are 'compliance managed' are subject to special governance reviews, including Inland Revenue reviews of systems to understand and evaluate their tax controls.)

2021 findings

According to Inland Revenue, the 2021 questionnaire responses painted a mixed picture:

- Slightly less than half of respondents had a documented tax strategy.
- While over 80% of respondents indicated that they had tax controls:
  - — Around one-third were not willing to make these available to Inland Revenue for examination, if requested; and
  - — Less than half of respondents had their controls regularly tested and updated.
- On a more positive note, more than 90% respondents said they were regularly assessing their tax risks and there was some tax risk reporting to the Board.

Based on these finding, the three key 'work-ons' identified by Inland Revenue are:

- fit-for-purpose documentation;
- testing and regular updating of controls; and
- board reporting on tax matters.

Inland Revenue's tax governance maturity model

Inland Revenue has developed a tax governance maturity model to evaluate where respondents sit on the spectrum, ranging from:

1. ***Emerging*** – some tax governance capability but ad hoc with room for significant improvement.
2. ***Progressing*** – some tax process improvements have been initiated but not systematically implemented or institutionalised within the business. *This is where the majority of 2021 questionnaire respondents were found to be at.*
3. ***Established*** – there are robust tax processes resulting in a high degree of governance capability. *This is where Inland Revenue would like the majority of taxpayers to be at.*
4. ***Aspirational*** – tax processes have been optimised and there is full and transparent reporting of tax risks.

Inland Revenue's expectation this year is for an improvement from the 2021 results.

Tax governance in practice

Inland Revenue's 2021 findings are broadly consistent with the themes we are seeing when talking to clients about tax governance:

- Most, if not all, businesses have a genuine desire to get tax right. But there can often be a lack of clarity as to what the business's tax objectives are. This is because the Board's tax risk tolerance and tax risk focus areas are generally not explicitly stated or communicated, which can make it difficult for those involved in managing the business to know what tax risks they should be focussing on.
- Similarly, tax policies and procedures are often not documented, which (combined with the absence of testing of tax controls) runs the risk that errors accumulate over time, while knowledge about key processes may be lost if the person responsible for the particular compliance activity is incapacitated or leaves the business.
- We sometimes hear that testing of tax controls occurs as part of the annual financial statements audit. Whether this provides sufficient assurance will be fact and circumstance specific – e.g. are tax processes also being tested and is the scope sufficiently broad (does the testing cover just income tax or other tax types as well)? If not, such testing will not be fit-for-purpose.

> **"Most, if not all, businesses have a genuine desire to get tax right. But there can often be a lack of clarity as to what the business's tax objectives are.**

What should business be focussing on?

As a starting point, a clear statement of the Board's tax risk preference for the business is critical. The purpose of a tax strategy is to make this risk preference explicit to the business and to those responsible for its day-to-day management. The tax control framework should then demonstrate how tax risk will be practically managed, in accordance with that preference, to ensure that reasonable care has been taken.

> **"A clear statement of the Board's tax risk preference for the business is critical.**

Inland Revenue's expectation is that tax governance documentation should be proportionate to the size and complexity of your business. It has warned against generic (or so-called 'cookie cutter') governance policies. Care should also be taken if looking to replicate tax risk management policies from other jurisdictions for New Zealand. Does the documentation accurately reflect the New Zealand business's specific tax risks and tax risk profile and the controls that are in place (if any) to manage those risks?

> **"Inland Revenue's expectation is that tax governance documentation should be proportionate to the size and complexity of your business.**

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> Having documented tax compliance policies and procedures is an important starting point for understanding what tax controls are in place and to enable them to be independently and regularly tested.

Having documented tax compliance policies and procedures is an important starting point for understanding what tax controls are in place and to enable them to be independently and regularly tested (a key deficiency identified by Inland Revenue from the 2021 questionnaire results).

Polices, including controls, should not be limited to income tax. GST, employer tax obligations (including Fringe Benefit Tax), and withholding taxes, should not be overlooked. As these processes tend to be largely systems driven, their settings, once implemented, can easily be forgotten about. These should be regularly reviewed for changes in both tax law and the business.

Having clear roles and responsibilities for tax compliance processes, including review and sign-off steps, is also critical in managing the day-to-day tax risk. Some of the considerations here include:

- Are those performing the tax-related duties suitably qualified, particularly, if there is no specialist in-house tax resource, and/or the finance or tax function for the New Zealand business is based offshore?
- Are the review and sign-off procedures sufficiently robust – for example, is the same person preparing, reviewing and signing-off returns?

Who is responsible for tax risk identification in the business – is it the tax manager, the CFO, or others in the business, including the Board? Is there regular engagement with the wider business to identify tax risks (e.g. in relation to major transactions)?

Is there a clear system for considering tax risk and its escalation and mitigation, including through use of external advisors or engaging with Inland Revenue (e.g. through the Binding Rulings process)?

What is the governance structure of your business? Does senior management also sit on the Board (which is not uncommon for New Zealand subsidiaries of foreign businesses and some privately owned New Zealand businesses)? If it is a New Zealand branch, what is the effective governance structure?

What information is the Board receiving in relation to tax? Is tax a standing agenda item, or only reported when a material tax risk arises (e.g. when an Inland Revenue audit or investigation is notified)?

Is the tax strategy and tax control framework endorsed by the Board (e.g. as a Board-level responsibility)? Is there a requirement for those with responsibility for tax to confirm compliance with tax governance policies, including regular testing?

Where to from here?

Those selected for the 2021 questionnaire who did not have appropriate documentation in place last year were placed on a 'watch list' and have been followed up in 2022 to check their progress in remedying this.

Inland Revenue's approach has generally been to encourage compliance – for example, by allowing additional time for tax governance polices to be developed, if not already. However, we understand non-responses have also received additional scrutiny, including in the form of risk reviews. So, this is not an issue that can or should be ignored.

Some concluding thoughts:

For financial services businesses, the compliance requirements may not just be 'tax as usual'

In addition to traditional tax types, such as income tax and GST, your business may

> Those selected for the 2021 questionnaire who did not have appropriate documentation in place last year were placed on a 'watch list' and have been followed up in 2022 to check their progress in remedying this.

> “While there is no ‘one size fits all approach‘, Inland Revenue has emphasised the need for all businesses to have at least some documentation on tax risks.

also have additional information reporting requirements to Inland Revenue. Examples of these include:

- investment income reporting (e.g. for dividends and interest) and associated withholding tax obligations;
- financial account information for Foreign Account Tax Compliance Act (FATCA) and the Common Reporting Standard (CRS) reporting purposes; and
- new bulk information reporting requirements for payment services providers (from 1 April 2023).

Your governance and tax risk management framework also need to cover these reporting requirements, to ensure the information being reported (and withholding obligations, if any) on behalf of customers is accurate, because Inland Revenue is relying on information from intermediaries to populate individuals’ year-end tax returns. As a result, getting any of this wrong not only creates a risk with the regulator, but can also adversely impact customer relationships.

Don’t assume your business is immune from having to consider tax governance…

Either due to its size or complexity, or because you think the odds are in your favour. In our experience, the coverage of Inland Revenue compliance campaigns tends to expand over time. And with a ‘SMART‘ new IT system, and its enhanced data analysis capabilities, Inland Revenue’s tool kit has expanded considerably.

While there is no ‘one size fits all approach‘, Inland Revenue has emphasised the need for all businesses to have at least some documentation on tax risks. Whether this is ‘on a page‘ or a more detailed tax procedures manual will depend on the nature and complexity of your business.

Are you managing tax (and risk) in the most efficient manner?

Setting aside the regulatory, financial and reputational risk from getting tax wrong, have you thought about the business impact of how your tax function is currently operating?

In addition to effective tax risk management, there may be sound business reasons for looking at how your tax function is currently structured and whether this can be optimised. Do your current arrangements accurately reflect the complexity of operating in New Zealand’s business environment? Are there time and cost savings to be had from outsourcing some, or all, of the tax function to tax specialists or from automating certain processes and activities?

Ownership

as at 1 December 2022

Non-bank entity	Ultimate shareholding	%
Avanti Finance Limited	Various investment/nominee companies	100
BMW Financial Services New Zealand Limited	BMW AG (Germany)	100
Christian Savings Incorporated	Various private shareholders	100
First Credit Union Incorporated	Various depositors	100
First Mortgage Trust	Various unitholders	100
FUJIFILM Leasing New Zealand Limited	FUJIFILM Business Innovate Asia Pacific Pte. Ltd	100
Geneva Finance Limited	Various investment/nominee companies; various private shareholders	100
Harmoney Corp Limited	Various shareholders, listed on ASX[15]	100
Instant Finance Limited	Various private shareholders	100
John Deere Financial Limited	Deere & Company (USA)	100
Latitude Financial Services Limited	KVD Singapore Pte. Ltd	100
LeasePlan New Zealand Limited[16]	SG Fleet Group Limited (Australia)	100
Mercedes-Benz Financial Services New Zealand Limited	Daimler AG (Germany)	100

Non-bank entity	Ultimate shareholding	%
Midlands Funds Management Limited	Various unitholders	100
Motor Trade Finance Limited	Various Licensed Motor Vehicle Dealers	100
Nelson Building Society	Various depositors	100
Nissan Financial Services New Zealand Pty Limited	Nissan Financial Services Australia Pty Ltd	100
ORIX New Zealand Limited	Orix Australia (International) Pty Ltd	100
Police and Families Credit Union	Various depositors	100
Ricoh New Zealand Limited	Ricoh Company, Ltd (Japan)	100
Speirs Finance Group Limited	Equipment, Leasing & Finance Holdings Limited	100
Toyota Finance New Zealand Limited	Toyota Motor Corporation (Japan)	100
Turners Automotive Group	Various investment/nominee companies	100
UDC Finance Limited	Shinsei Bank, Limited (Japan)	100
Unity Credit Union	Various depositors	100
Wairarapa Building Society	Various depositors	100

Credit ratings

as at 1 December 2022

Non-bank entity	Standard & Poor's		Fitch Ratings		Moody's		Rating and Investment	
	Rating	Outlook	Rating	Outlook	Rating	Outlook	Rating	Outlook
Avanti Finance Limited	BB	Stable						
BMW Financial Services New Zealand Limited[17]	A	Stable			A2	Stable		
Christian Savings Incorporated			BB+	Stable				
First Credit Union			BB	Stable				
First Mortgage Trust								
FUJIFILM Leasing New Zealand Limited[18]	AA-	Stable			A2	Stable	AA	Stable
Geneva Finance Limited								
Harmoney Corp Limited								
Instant Finance Limited								
John Deere Financial Limited[19]			A	Stable	A2	Positive		
Latitude Financial Services Limited[20]								
LeasePlan New Zealand Limited[21]								
Mercedes-Benz Financial Services New Zealand Limited[22]	A-	Positive	A-	Positive	A3	Stable		

Non-bank entity	Standard & Poor's		Fitch Ratings		Moody's		Rating and Investment	
	Rating	Outlook	Rating	Outlook	Rating	Outlook	Rating	Outlook
Midlands Funds Management Limited								
Motor Trade Finance Limited								
Nelson Building Society			BB+	Stable				
Nissan Financial Services New Zealand Pty Limited[23]	BBB-	Negative			Baa3	Stable	A	Negative
ORIX New Zealand Limited[24]	A-	Stable	A-	Stable	A3	Stable	AA-	Stable
Police and Families Credit Union								
Ricoh New Zealand Limited[25]	BBB+	Negative					A+	Stable
Speirs Finance Group Limited								
Toyota Finance New Zealand Limited[26]	A+	Stable	A+	Stable	A1	Stable	AAA	Stable
Turners Automotive Group								
UDC Finance Limited[27]	BBB	Stable			Baa1	Stable	A-	Positive
Unity Credit Union			BB	Stable				
Wairarapa Building Society			BB+	Stable				

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Descriptions of the credit rating grades

Long-term credit rating grades assigned by Standard & Poor's	Description of the steps in the Standard & Poor'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.
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.
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.

Long-term credit rating grades assigned by Standard & Poor's	Description of the steps in the Standard & Poor's credit rating grades for the rating of the long-term senior unsecured obligations payable in New Zealand, in New Zealand dollars.
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.
Assigned by Rating and Investment Information, Inc.	Rating and Investment Information, Inc. applies a rating scale where the grades of 'AAA' to 'BB' indicate the highest level of creditworthiness supported by excellent factors, to a sufficient level of creditworthiness where some factors require attention at times. Grades of 'B' to 'C' are applied where creditworthiness is questionable and some factors require constant attention, to cases where an obligation is in default. Rating and Investment Information, Inc. include the use of modifiers, such as '+' or '-' to the categories of 'AA' to 'CCC' to indicate the relative standing within each rating 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, which 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.

Terms and ratios used in this survey	Definitions used in this survey
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) and depreciation of leased assets where a lessor.
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.

End notes

1. https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/publications/monetary-policy-statements/2022/mps-nov-22/monetary-policy-statement-snapshots-nov-2022.pdf
2. https://www.stats.govt.nz/news/annual-inflation-at-7-2-percent/
3. https://www.interest.co.nz/charts/interest-rates/mortgage-rates
4. https://www.1news.co.nz/2022/11/23/ocr-tipped-for-record-rise-recession-still-possible-economist/
5. https://qv.co.nz/price-index/
6. https://www.1news.co.nz/2022/11/23/ocr-tipped-for-record-rise-recession-still-possible-economist/
7. https://www.interest.co.nz/charts/interest-rates/mortgage-rates
8. https://www.rbnz.govt.nz/statistics/series/lending-and-monetary/registered-banks-and-non-bank-lending-institutions-sector-lending
9. https://www.newshub.co.nz/home/money/2022/08/declining-house-prices-putting-some-homeowners-into-negative-equity.html
10. https://www.seek.co.nz/about/news/seek-nz-employment-report-applications-per-job-ad-continued-to-rise-in-october
11. https://www.stats.govt.nz/news/hourly-earnings-rise-7-4-percent/
12. https://www.nzherald.co.nz/nz/scammers-siphon-millions-from-kiwi-victims-in-elaborate-cyber-attacks/NY6THLPNUJDHRO6VC6WSEJJAIE/
13. The related articles are hyperlinked to provide the reader with the ability to access the respective news releases
14. Net tangible assets
15. No longer dual listed on NZX/ASX as at 31 October 2022
16. Completed amalgamation with SG Fleet Group NZ Limited on 11 November 2022 which resulted in removal from companies register
17. Rating of parent company BMW AG (Germany)
18. Rating of parent company FUJIFILM Holdings Corporation (Japan)
19. Rating of parent company John Deere Financial Limited Australia
20. Rating of parent company KVD Singapore Pte. Ltd (Singapore)
21. Rating of parent company SG Fleet Group Limited (Australia)
22. Rating of parent company Daimler AG (Germany)
23. Rating of parent company Nissan Motor Co. Limited (Japan)
24. Rating of parent company ORIX Corporation (Japan)
25. Rating of parent company Ricoh Co. Limited (Japan)
26. Rating of parent company Toyota Motor Corporation (Japan), Moody's and Fitch. Rating of Toyota Finance NZ Limited, S&P
27. Rating of parent company Shinsei Bank Ltd

About KPMG's Financial Services Team

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.

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