FIPS

Non-bank Financial Institutions Performance Survey

Review of 2016

December 2016

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Contents

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

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

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

The Survey

Welcome to Part One of the 2016 edition of the Financial Institutions Performance Survey.

TABLE 1: MOVEMENTS		
	Who's out	**Who's in**
Non-banks: 23	— GE Capital — The Warehouse Financial Services	— EFN (New Zealand) Limited — LeasePlan (New Zealand) Limited

Part One of the Financial Institutions Performance Survey (FIPS) focuses on the non-bank financial institutions, while Part Two, to be published in February 2017, will focus on the registered banks. Our non-bank survey captures the financial performance of entities with annual balance dates between 1 October 2015 and 30 September 2016.

The threshold for inclusion in this year's survey has remained unchanged at total assets of $75 million.

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

This year, we have continued to meet and discuss various industry developments with the P2P lenders. One thing to note is that their filed financial statements disclose only the entity that manages the platform as opposed to disclosing the financial performance of the platform itself that houses the deposits and loans and the related profit or loss impacts. We had requested P2P lenders provide certain key information about their platform's financial performance, however due to the different in approach amongst P2P lenders in presenting this information, we have found the information not to be comparable enough for us to draw insightful conclusions about the performance of the P2P platforms. We hope that in the long term the platforms will publish comparable financial information disclosing the platforms' performance and we can then include P2P entities within the main analysis table.

The non-bank sector comprises a total of 23 survey participants this year, with two new additions and the departure of GE Capital and The Warehouse Financial Services Limited.

GE sold its different business divisions during the 2015 year, which resulted in the majority of its loan book being transferred to new owners. One of the entities that GE Capital was sold to is included by virtue of the fact that it was a company sale, and that the entity is large, and as such, we welcome EFN (New Zealand) Limited to this year's survey. EFN (New Zealand) Limited was incorporated on 27 July 2015, and as such, the first set of accounts available for the company are for the period 27 July 2015 to 31 December 2015.

The second sale was an asset sale and, as at the date of the survey, while large, the new entity into which the assets were transferred had not existed for two years and is therefore not required to publicly disclose its information. Hopefully, from next year onwards, we will be able to welcome the entity into the survey.

The final entity to which GE sold a part of its business to is also not required to file accounts for a similar reason, while it is large, it has not operated for two years and is therefore not required to file accounts. This is another entity we hope will join the survey next year.

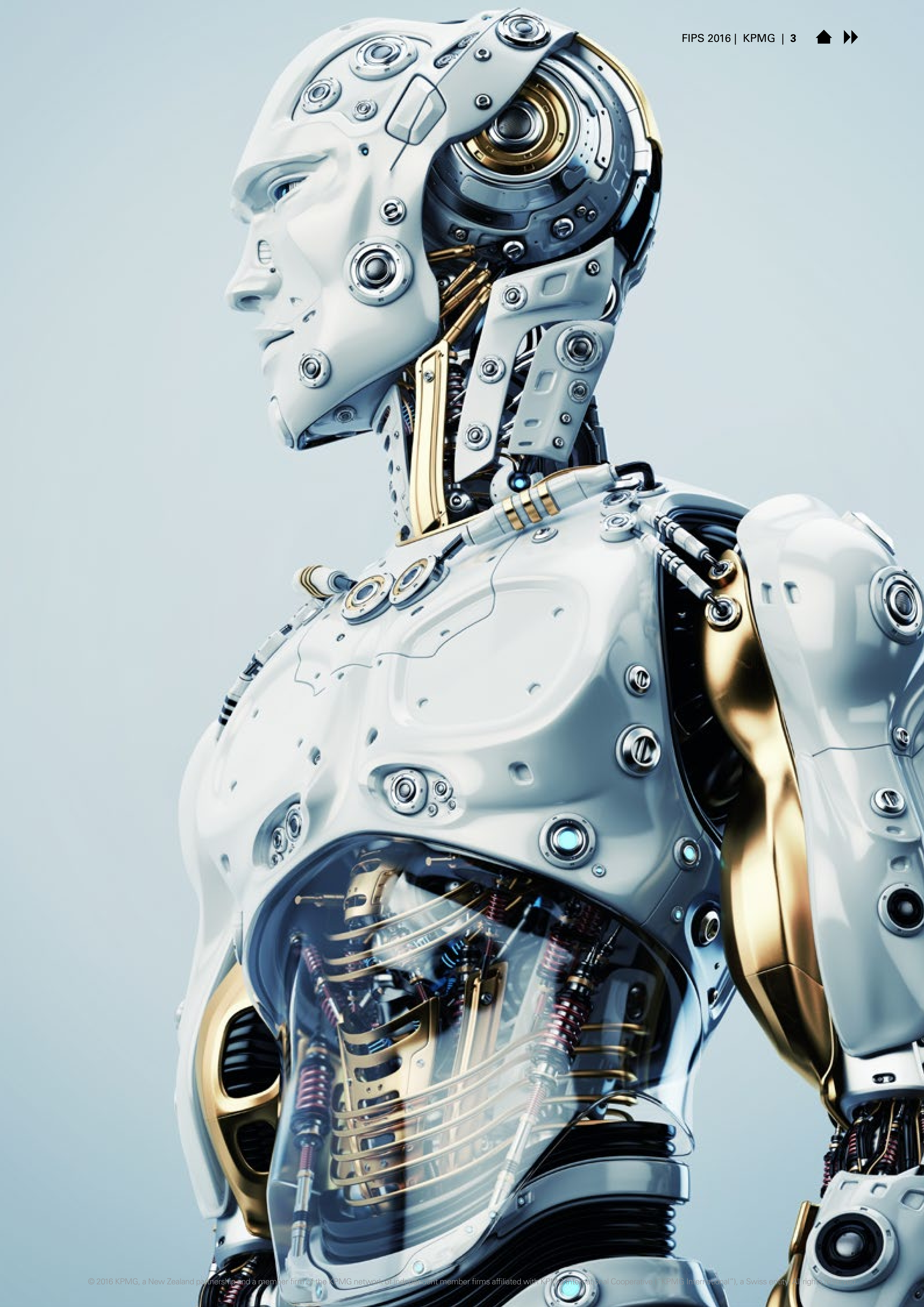
We note that late last year, Warehouse Group Limited acquired Westpac's 51% stake in The Warehouse Financial Services Limited. This means that Warehouse Group now has 100% ownership in the entity. The financial performance of Warehouse Financial Services is now reported as part of the 31 July 2016 year end consolidated figures for The Warehouse Group (parent company). Therefore there are no publicly available standalone financial statements for The Warehouse Financial Services Limited and as such the entity will no longer be part of the survey.

We welcome LeasePlan New Zealand Limited to this year's publication. We have also included all prior year comparatives for LeasePlan to ensure consistency and comparability between reporting periods.

It is also worth noting that the 31 December 2015 financial statements for Fisher & Paykel Finance Holdings Limited have been presented in this year's survey. The sale of Fisher & Paykel Finance to FlexiGroup (New Zealand) Limited in October of last year (rebranded as Flexi Cards Limited in September 2016) has not affected the way Fisher & Paykel Finance is presented in the survey this year, but it will have an impact next year.

What needs to be remembered is that the non-bank sector includes a diverse mix of Credit Unions, Non-Bank Deposit Takers (NBDTs) and Finance Companies, with the latter operating in the motor vehicle, consumer, personal commercial and mortgage sub-sectors.

We thank the survey participants (CEOs and CFOs) for their continued and valued contribution and for making the time to meet with us and discuss the various developments taking place within the industry.



Non-banks – Industry overview

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JOHN'S BIO

The non-bank sector has once again delivered a strong performance with current year net profit after tax (NPAT) increasing by 8.17% to $207.78 million.

However, if we were to exclude NPAT of $8.14 million for EFN (New Zealand) Limited due to the lack of comparative data (EFN purchased the equipment finance and fleet solutions business from GE Capital and was incorporated on 27 July 2015), normalised[1] NPAT showed a more modest growth of 3.93% or $7.55 million.

FOOTNOTE 1

Normalised NPAT growth was driven by an increase in net interest income and non-interest income of $19.67 million (3.68%) and $10.30 million (6.41%), respectively. Record high vehicle sales, on the back of strong momentum from the prior year, certainly had an impact on the increase in profitability for the sector as five out of the seven vehicle finance companies reported a combined NPAT growth of $9.98 million. Finance companies have also enjoyed an increase in profits on the back of strong loan growth. Credit union results were mixed, with half of them experiencing an increase in profits while the other half experienced a reduction.

Record high vehicle sales, on the back of momentum from the prior year, certainly had an impact on the increase in profitability for the sector.

Normalised net interest margin (NIM) for the sector continues to be under pressure in 2016 due to a prevailing competitive market caused by a mixture of continued low mortgage rates (particularly for credit unions and finance companies), the growth of peer-to-peer (P2P) lending, and tighter funding channels. Normalised NIM (excluding the results of EFN (New Zealand) Limited) fell by 24 basis points (bps) to 5.85% for the current year (5.68% for the whole sector including EFN). Lower funding costs were not sufficient to counteract the competitive pressures that were pushing lending rates down.

The sector's loan book has seen another year of strong growth and low impairment levels. Total gross loans and advances grew by 13.70% or $1.06 billion, for which EFN accounted for $0.42 billion. This result supports Executives' comments around the amount of good quality lending that is still very much available just outside the edge of the banking sector's 'blackbox'[2] and the perceived tightening of the size of the 'blackbox' as banks focussed more closely on their mortgage lending.

FOOTNOTE 2

Total gross loans and advances grew by 13.70% or $1.06 billion.

The sector's operating expense over operating income ratio has remained fairly consistent with last year's level, with a marginal improvement from 56.13% to 55.43%. Operating costs remained in line with operating income growth; however, the coming years could see a surge in operating costs as survey participants increase their spending in developing and investing more resources into their front-end technological capabilities to remain competitive and provide a better customer experience.

Many survey participants talked about the importance of a digital strategy to achieve this better customer experience by delivering loans and scoring and managing credit more quickly.

In many respects the non-bank sector continues to operate as it has in the past, focusing efforts on their area of speciality/niche where they are most comfortable. Participants do not feel that they have experienced as much in the way of competition from the banks or disruption, other than from the P2P lenders; however, all agree that the next wave of disruptors will come from the Fintech space.

Operating costs remained in line with operating income growth.

Executives have noticed a voluntary tightening of the credit market coming from the banking sector. The banking sector is expressing some level of anxiety over the property market and is taking a cautious approach in extending its exposure to the property market. The main question that is probably on everyone's mind right now is just how much longer can property prices in New Zealand grow at unsustainable rates? Lenders fear that sharply falling property prices could challenge the market and, if severe enough, result in mortgage's security values coming under pressure. The currently high employment rates, and low interest rates and confidence brought about by home balance sheet strengthening, have no doubt helped to minimise these issues to date.

This is a clear signal from the banking sector to expect tougher times ahead.

The Reserve Bank of New Zealand (RBNZ) has taken a more concerted approach to slow the property market together with IRD-imposed bank accounts, IRD number requirements, and increased lending restrictions. This, together with changes to capital requirements, inter-subsidiary lending guidelines, and voluntary impositions by the four banks on the use of offshore income might be finally starting to slow the market. To date this is just anecdotal evidence from the real estate industry. It will be interesting to see what Bank Executives will have to say in our bank survey in this regard when we meet them later this month and early next year.

Non-bank deposit takers (NBDTs) are experiencing strong competition coming from banks within the local deposit market.

The tightening of the credit market has, in turn, caused a flow-on effect onto some participants of the non-bank sector in recent months, as they have begun to find it more challenging to secure the necessary funds they require. Non-bank deposit takers (NBDTs) are experiencing strong competition coming from banks within the local deposit market and have found themselves challenged to match the special deposit interest rates being offered by banks.

Finance companies that are backed and funded by a bank are also being cautioned that they can no longer borrow the same level of funds at the same historically low interest rates that they have enjoyed. This is a clear signal from the banking sector to expect tougher times ahead as they shore up their capital balances and source additional deposits, while also trying to rein in lending growth.

Competition comes from all fronts and takes different forms

The finance company sector is an ever-changing landscape that never fails to bring about an engaging discussion on competition during the interviews with survey participants. The sale of Fisher & Paykel and GE Capital, the rise of the P2P lending sector, house price growth giving people a sense of home balance sheet improvement, growing use of Fintech applications, changing consumer behaviour and increased LVR restrictions are just some of the more obvious elements that are changing the landscape in which survey participants operate.

Competitive pressures are currently being felt by market participants on both ends of the spectrum.

Competitive pressures are currently being felt by market participants on both ends of the spectrum: the lending and the funding side. From the lending side, there is competition between the non-bank sector and the banking sector for high-quality loans that pay an appropriate yield. Although there is less competition from banks for newly originated mortgage loans, especially at the higher LVR's, Executives have pointed out that the non-bank sector is experiencing a higher than usual level of 'churn'. The majority of the Executives are of the opinion that the banks are being more aggressive this year in taking away loans from the sector participants, particularly in cases where that loan did not previously meet the banks' lending criteria, but now does because the customer has since paid down some of the loan balance and enjoyed a security valuation increase.

These loans initially started out with a non-bank entity as opposed to a bank, as the borrower might have had a minor credit issue (e.g. a late repayment history on a loan) and/or a high LVR. But after a year or two, the borrower has gone on to build up a strong credit history, and with house price inflation, the LVR on their mortgage now falls within the bank's lending criteria.

From the lending side, there is competition between the non-bank sector and the banking sector for high-quality loans that pay an appropriate yield.

In relation to the LVR restrictions that were put in place this year, the new set of rules presented the non-bank sector with an opportunity to capitalise on mortgage loans that were previously unavailable to them. In recent months, some Executives have seen a record number of mortgage loan enquiries being received where LVRs were higher than the applicable 60% or 80% for either investors or occupiers, respectively. Executives said that they have had to turn many enquiries away as they have not historically done any lending in this space. Despite having the ability to enter the LVR > 60% or 80% mortgage lending space, sector participants do not have an unlimited appetite to do so due to the risks involved. Survey participants do believe that there is still a generous amount of responsible lending that can be done just on the edge of the bank's 'blackbox', and that they should be focusing their resources and efforts in those areas.

One area that the banks continue to venture into is the personal financing space.

Sector participants perceived that the banking sector's 'blackbox' has not fundamentally changed from last year, but what they are seeing is that the banking sector is being more selective in its approval process for mortgage loans. Some Executives do foresee further voluntary credit tightening by the major banks in the upcoming months, amidst the risk of global uncertainty and pressure on the availability of funding.

One area that the banks continue to venture into is the personal financing space. The banks' behaviour in this space appears to be unusual as, according to some Executives, it appears that some banks are turning away mortgage loans that do not quite fit the 'blackbox', but are then providing credit card and debt consolidation loans, which could be considered a riskier lending space.

From the funding side, there is a pronounced dip in the level of wholesale offshore funding that is currently available to the sector's participants.

On the funding side, there is a pronounced dip in the level of wholesale offshore funding that is currently available to the sector's participants, when compared to the same period last year. Executives have noted that they are finding it increasingly difficult to compete with the banks in the local deposit market, especially when the banks carry out special six-to-nine-month deposit offers at a rate that is on par with what credit unions and building societies are offering their members. Executives within both the banking and non-bank sectors have been echoing their concerns over rising funding costs and the increased reliance on the offshore funding market. They put the blame on increased geopolitical and global economic instability over the past year.

This puts credit unions and building societies in a particularly challenging position, as their legal structure limits them as to where they are legally allowed to source funds. Credit unions and building societies are only allowed to source funds from mutual parties and, as such, attracting sufficient funds from the local deposit market is vital for their growth and profitability, and this is increasingly a challenge.

Finance companies are encountering more instances whereby potential borrowers think that having security on personal loan is neither necessary nor required.

The P2P sector has continued to have a significant impact on the way the non-bank sector operates. Some Executives have found that the growing presence and accessibility of the P2P sector to potential borrowers have begun to change the average borrower's behaviour and expectations in the market. Most noticeably, finance companies are encountering more instances whereby potential borrowers think that having security on a personal loan is neither necessary nor required. In this respect, the non-bank sector is finding it increasingly hard to compete with the P2P sector as borrowers seem to be more inclined to go with a lender that will not require any security to be held against the loan.

The digital offerings that these entities have are also mentioned as highlighting how important speed and ease of dealing is to the consumer. However, it is possible that this advantage might be short-lived as other non-bank entities acquire similar channels.

Regulation embedded in the culture

Several Executives have expressed a positive stance towards having a more rigorous regulatory environment. They believe that current regulation such as the Credit Contract and Consumer Finance Act 2003 (CCCFA), Anti-Money Laundering and Countering Financing of Terrorism Act 2009 (AML) and Financial Markets Conduct Act 2013 (FMC), while costly and time-consuming to implement, have become business as usual and are warranted in order to ensure that unscrupulous entities are kept out of the market and that a level playing field is maintained.

Other survey participants noted that in the current market, with deposit rates being at historically low levels, the ability to have access to the NBDT market may have some advantages. In the last few surveys, many Executives had commented that having the NBDT status was expensive and demanding to maintain, but now many see it as a good tool to have available in order to diversify its funding and tap into a very large sector of the market that is starting to become aware of just how low interest rates are and how long they have been at those levels. It will be interesting to see what messages are received from the banks when we interview them for the second half of the survey, as in recent weeks, following these comments by non-bank participants, a number of entities in both the bank and non-bank sector have indicated that deposit rates could be about to rise.

Conduct risk is in the front of Executives' minds, with many expressing that the sector is moving to be more conduct risk regulated.

Conduct risk is in the front of Executives' minds, with many expressing that the sector is moving to be more conduct risk regulated. The feeling expressed was that New Zealand has yet to be hit by quite the same wave of issues in this area as some overseas jurisdictions. One of the themes arising from the survey interviews was that most Executives were surprisingly confident that their organisation was not at risk in this area and that they had things fairly well covered. While they might think that their organisation would not do some of the things that have caused consternation in overseas jurisdictions, one thing to be aware of is that the landscape is changing rapidly in this area and behaviours that are accepted or even 'business as usual' today might not be appropriate tomorrow or in a digital world. A simple negative tweet or Facebook post from an unhappy customer could lead to local, national or even global exposure of the issue in such an explosive and viral manner that the resultant damage is difficult to contain.

There is an expectation among survey participants that regulations such as the CCCFA and FMC could be refined further to avoid unnecessary burdens on the lender. For instance, one of the Executives believed that it is unnecessary to establish a whole new AML process for a customer that has, at one point in time, had a loan with the entity, has paid it off and is now returning for another loan.

Regulatory pressures can also come from unexpected fronts and have unforeseen complications, as is the case with finance companies that have securitised vehicles funded by banks. These entities appear as though they are being pushed to comply with the same rules that banks do, as the bank lender is required to apply the same lending and capital requirements to loans that they are indirectly funding through finance companies.

In recent months, there has been much discussion in the media and between regulators and key stakeholders in the financial market about the implementation of Debt-to-Income (DTI) mortgage restrictions in New Zealand. This could be the next hurdle for the finance companies to implement and Executives are anxious about what form this would take and how it would be implemented. Their unease has since been alleviated momentarily as RBNZ Governor, Graeme Wheeler, recently announced in November that the RBNZ has no intention to introduce DTI measures as of yet[3].

FOOTNOTE 3

This remark was made based on recent data that showed that the housing market is beginning to demonstrate signs of relief from inflationary pressure. It is not clear if this is the result of the new LVR restrictions that went into effect in October, or whether it is the result of banks taking a proactive effort to rein in higher LVR lending. However, with that being said, the RBNZ is still continuing to seek permission from the Government to include DTI measures in its toolbox so as to be able to bring them to use in a timely manner when the right circumstance or situation calls for it[4].

FOOTNOTE 4

Motor Trade Finance's appeal of the recent ruling made against it was dismissed by the Supreme Court in May. The sector has been keeping a close eye on this case for a while, and this development has now established a precedence on how participants should be structuring their credit fee charges on consumer loan contracts. In response to this, the Commerce Commission in September of this year released a set of draft guidelines that outlines a set of principles which lenders could adopt to be compliant with the CCCFA. The guidelines stipulate that lenders, regardless of type or form, are only allowed to charge fees by way of recovering reasonable specific direct transaction costs incurred in instituting a consumer loan contract.

However, it is important to note that the guidelines from the Commission are not legally binding and it is ultimately the lender's responsibility to exercise professional judgement in determining a fee structure that is compliant with the CCCFA. The Commission is currently seeking feedback from the public and the industry, with the intention to finalise the guidelines by early 2017.

The P2P lending sector has also been under scrutiny by the Commission.

The P2P lending sector has also been under scrutiny by the Commission since the Commission decided to formally bring civil proceedings against Harmoney in August 2016. The Commission is doing this to formally seek a ruling from the Auckland High Court that will clear the confusion as to whether 'platform fees' charged to borrowers should be subjected to the CCCFA[5]. An unfavourable ruling could bring into question the sustainability of the current P2P model.

FOOTNOTE 5

The uncertainty has arisen as the platforms and the legislation under which they were licenced are new and untested. The initial concept of a P2P lender, and therefore the legislation under which they were licenced, is that the platform doesn't do the lending, and therefore they are not able to charge interest (only a lender is able to do that) and the extension is that as a result they are able to charge fees, but they should not be prescribed by the CCCFA as those fees relate to where lending interest is also earned. A potential worst case scenario would see the platform unable to earn interest and only charge fees in accordance with the CCCFA; this would mean they would have a business model under which they may not be able to recover their costs as the fee levels would be prescribed and there would be no interest earned to offset any other costs. Those subscribing to this view argue that such a model would never work and this cannot be what was envisaged and is not the way things work in other jurisdictions. The other view is that a consumer loan is a consumer loan no matter how it is executed and there should be the same protections and guidelines. Clearly, this is open to interpretation both ways, and this is why all lenders, P2P and others, and the regulators, are keen to see clarification.

Opportunities and challenges

A recurrent theme among survey participants this year was the sentiment towards the property market. Contrary to what many would think, most of the Executives do not see the new LVR restrictions on the banking sector as an opportunity to expand their market share and those that do acknowledge that it must be done carefully. While finance companies do sometimes operate in spaces that fall just outside of the banking sector's 'blackbox', the Executives emphasised that their focus in the property market has been responsible and not solely on loans with a high LVR. In regard to apartment projects, the non-bank sector as a whole is erring on the side of caution as they tread lightly into what is a relatively new lending market in Auckland.

A number of participants were considering how a partnership with a Fintech might bring some new product or service to market.

The use of partnerships was another theme that consistently emerged from comments made by Executives this year. Partnerships with other key members within a value chain, either horizontally or vertically, to come to a mutually beneficial arrangement that will help promote further sales and business growth for both parties were mentioned, possibly showing that the Executives do realise their business will have to change, but acknowledge that they do not know exactly how. In particular, a number of participants were considering how a partnership with a Fintech might bring some new product or service to the market. The challenge with this lies in ensuring that the right kind of partnership is established with organisations that share the same values and vision as themselves.

A good example of this concept is Flexi Card (formerly known as Fisher & Paykel Finance), who has partnered with MasterCard and Farmers to develop the Q MasterCard and Farmers Finance Card. The partnership has allowed Flexi Card to leverage on MasterCard's robust digital security programme to secure their credit cards, and give its customers access to a greater range of retailers throughout New Zealand and the rest of the world. In addition, the Farmers Finance Card entitles its members to exclusive offers that would not otherwise be available to them. MasterCard benefits by receiving increased transaction fee revenue when more transactions are processed through the use of the Q MasterCard. Farmers, on the other hand, will likely enjoy higher sales as its customers are now able to finance large purchases with greater ease.

Non-bank participants are also making a conscious effort to explore beyond their conventional operating model to find potential products that will complement the service/product offering for which their customer initially approached them. For the vehicle financing industry, this means identifying additional value-added services/products that they can add onto the purchase of a vehicle. This could range from providing extended warranties, liability insurance, maintenance service contracts, parts, accessories and finance. Turners' purchase of Autosure from Suncorp in November is a good illustration of this movement within the finance company market.

Executives from a range of organisations have identified the potential for a captive insurer market whereby the entity provides a loan, and some form of insurance is established with the individual.

With the future digitalisation of the industry, incumbent players also need to be prepared to change as the industry does.

While this strategy may have helped increase sales for the time being, if not managed appropriately it could divert much-needed resources and attention away from core activities. In addition, with the future digitalisation of the industry, incumbent players also need to be prepared to change to survive as the industry does.

Another area that Executives all commented on was the risk of a cyber attack and how important it was to have a coordinated approach to staying up with the latest intrusion techniques and sources due to the increasing frequency and complexity of cyber-attacks. All the Executives spoke of the need to spend more time and effort to protect against intrusion and, in particular, the need to stay abreast of where and how attacks were being launched. Many expressed a mix of nervous confidence and concern about their entity's defences, but all of them noted that it was an area where they would undoubtedly be tested in the future. The development of each new product or distribution channel, while necessary to enhance the customer experience, brings with it another area needing to be protected from cyber threats.

The relationship between Fintech and disruptors

In last year's publication, many of the Executives surveyed agreed that the growth of the P2P sector would be a disruptor to the non-bank sector. In just a year, significant changes have taken place within the personal/consumer lending space that have been brought about by the entry of P2P lenders into the market. Survey participants agree on the increasing importance of Fintech technologies to the non-bank sector. Executives expect Fintech innovations to give rise to disruption in the foreseeable future. In response to the likely threat, several Executives have gone on to mention how they are taking a proactive approach to seeking out collaborative opportunities with Fintech companies and even banks to assist them. The aim of the new partnerships is to assist them in developing sophisticated Fintech capabilities of their own, or to set themselves up to be ready for the next wave of disruptors that is expected to arrive from the Fintech industry.

Survey participants agree on the increasing importance of Fintech technologies to the non-bank sector.

The two major lessons to date from the P2P platform have been:

1. Building a faster and more streamlined 'know your customer' and deposit and loan processing system through the use of automation, starting from the submission of the application through to the disbursement/receipt of funds, right through to the process for collecting and allocating repayment and dealing with arrears and defaults. The one click away technology-driven front end that speeds things up was frequently mentioned.
2. Encouraging financial literacy by providing customers with interactive tools and data that will educate and enable them to make well-informed financial decisions.

It is crucial that before an entity embarks on a Fintech campaign, it properly considers whether the implementation would complement existing service/product offerings and support the sale of more business, or whether it would replace it.

Another judgement that needs to be considered is when to 'turn off' the old model and rely solely on the new model for doing business. In addition, it is important to recognise that the true power of the disruptor is not at the high-tech front end as a transaction enabler, but deeper where existing margins are reduced and/or shared by all participants together with the risk. To date, the disruptors have displayed the initial technologies well, but are only just starting to move into the risk and reward share space.

Companies that have yet to embrace data analytics might find themselves lagging behind, or even out of business, as they struggle to keep up with competitors.

The expansion of the use of data is a shift from solely using data analytics to identify new business opportunities through the analysis of transactions, to taking it to the next level by developing technological capabilities to predict and capitalise on those opportunities.

In the future, companies that have yet to embrace data analytics might find themselves lagging behind, or even out of business, as they struggle to keep up with competitors.

While having the entire lending process transitioned to an online platform may reduce processing time, it is not without its risks. The ability to capture generic information about the loan applicant through an online platform is one thing, but being able to meet the applicant face to face allows the decision maker to obtain the necessary depth of information specific to the individual's situation in order to make a responsible and properly informed lending decision. Lenders will need to consider the trade-off between the speed and ease of getting a loan out to a customer, and ensuring that the necessary and appropriate level of checks have been performed in accordance with the responsible lending code. For example, a non-English speaking person who does not truly understand the documentation may be quickly identified in a person-to-person application, but might not be picked up during an online application process.

With today's society being more consumer driven, the demand from borrowers for easier and quicker access to funds and from depositors for a different type of return, will only build. As the non-bank sector moves its lending and deposit processes online, it will be intriguing to see how the sector will address the trade-off between loan growth, socially responsible lending, and the sharing of risk.

The way finance is obtained and provided could change radically. Uber, Amazon and Netflix have all seen traditional customer views and models challenged. The same will happen in the finance space. People don't actually want a mortgage, they want a home that suits their needs, but the way that things currently work is that when they are young they struggle to afford a home; as the children grow they live in what they can afford (a smaller home than they would like); and they finally afford the family home they want just as the family has grown up. What if finance could change to enable intergenerational groups to leverage value in the parents' home to allow the second generation to enjoy a bigger home sooner?

At the consumer finance end of the market the day will come when, as you pass a retail store, your device will automatically know where you are and a financier will let you know the credit you have so that you enter the store with a pre-approved limit to purchase an item your device has guided you to, because a Fintech has used data about your past actions and preferences to select the product for you.

Organic growth vs. inorganic growth

The sales of GE Capital and Fisher & Paykel Finance were the key highlights in last year's publication. As at 30 September 2016, the sales of these respective entities have been completed, and the new entities are now in full operation under their new structure.

In contrast to last year, we have not seen much in the way of acquisitions or mergers. In the earlier part of the year, however, speculation about the sale of UDC Finance was floated in the media[6], and this prompted Macquarie Group and Heartland Bank to announce their interest in purchasing UDC should the finance company be put up for sale by its parent company, ANZ NZ Bank.

FOOTNOTE 6

In May, ANZ NZ CEO David Hisco firmly reiterated that ANZ's ownership in UDC is currently undergoing a strategic review and that no plans have been drawn up for its sale[7]. He did not, however, rule out the possibility of a sale following the conclusion of its review. Most recently, in August S&P's downgraded UDC's long-term issuer credit rating by three notches based on the expectation that UDC will be sold within the next year and Heartland's CEO reiterated that UDC would be a good fit within its business.

FOOTNOTE 7

The non-bank sector is truly a tough lending space.

The non-bank sector is truly a tough lending space, an area where not only is there a myriad of competitors, both old and new, but every so often the banks also have the tendency to enter into the sector if they spot an opportunity to do some quality lending or raise much-needed domestic deposits.

Despite the challenges they face, Executives have explained that they are perfectly comfortable with where they are currently sitting in the sector. They remain content with operating in the niche where they readily consider themselves as being good at what they do, in an area where there is still a potential for steady margin and lending growth. This year, the main focus has been on organic growth. This means growing the business in a way that is sustainable in the long term for all key stakeholders (i.e., both borrowers and lenders), being selective about where they invest their money or who they lend to, and nurturing lasting relationships with key stakeholders that will ultimately drive repeat business.

There is also a general consensus amongst Executives that increased regulation, significant operational issues or the lack of strategic resources will be the main catalysts that will drive the next big round of acquisitions or mergers within the non-bank sector in New Zealand.

The future

As a result of world events over the past year, many Executives have expressed some level of apprehension as to how New Zealand's financial market will be impacted in the upcoming months, largely due to:

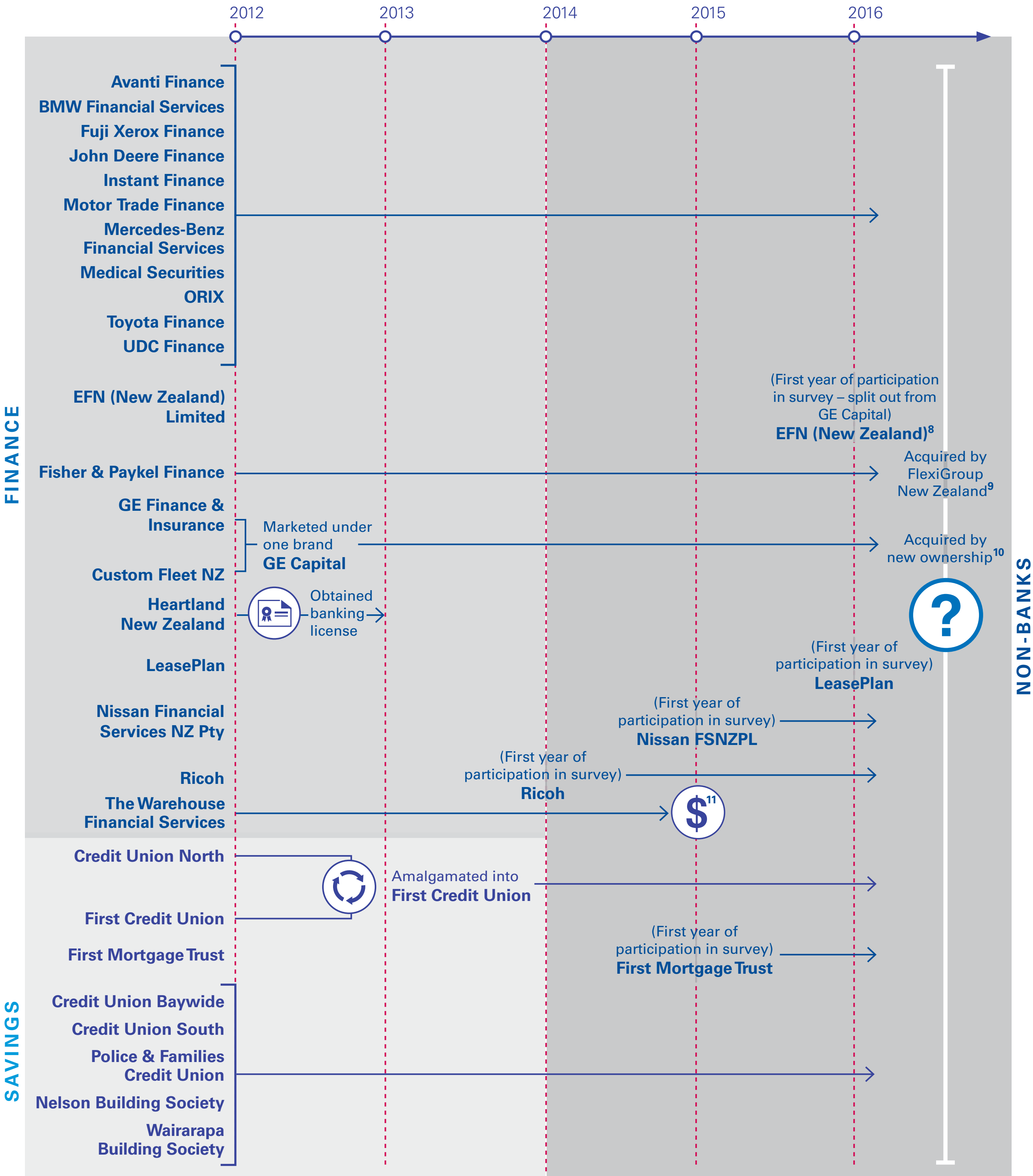
1. Ambiguity over how EU and global trade relations with the UK will look like following Brexit, and most recently;
2. U.S. president-elect, Donald Trump, and what his American protectionist policies could mean to both global economic and military stability, should he decide to follow through with them.

Increasing geopolitical and economic uncertainty has caused Executives to be certain of one thing: a continued rise in offshore funding costs during the foreseeable months. This could place further tension on the local deposit market as both the bank and non-bank sector continue to step up efforts to secure sufficient funding.

New Zealand continues to track well economically after another relatively benign year, with high employment levels and low interest rates for yet another year. However, this has left many Executives pondering whether the sector is adequately prepared to deal with another financial crisis such as the Global Financial Crisis (GFC), and just how much longer will these good times last. In short, they see the New Zealand economy as being in a good place locally and, if it is to be affected, they generally believe it will be as a result of the contagion effect of a global issue.

Lastly, the future will bring greater collaboration in the finance industry in order to remain competitive in an industry that continues to evolve. As a result, strategic partnerships are expected to develop between market participants as the nature of delivery of the customer experience changes and disruptors challenge existing models.

Looking back at the non-bank sector



FOOTNOTES 8–11

GE Capital New Zealand structure given the change in ownership

	Business Divisions Under GE Capital (Prior to Sale)	Branding Under New Ownership	Details of GE Capital's Sale	Public Disclosure of Financial Statements Under New Ownership
GE Capital (New Zealand)	Commercial Distribution Finance	Wells Fargo Commercial Distribution Finance (Ultimate Parent – Wells Fargo & Company)	On 31 October 2015, Wells Fargo & Company announced the purchase of GE Capital's Commercial Distribution Finance division for an undisclosed amount.	Not available
	Equipment Finance	EFN (New Zealand) Limited (Ultimate Parent – Element Financial Corporation)	On 29 June 2015, Element Financial Corporation purchased GE Capital's fleet management in the U.S., Mexico, Australia and New Zealand for US$6.9 billion. The sale also included a portion of GE Capital's New Zealand Equipment Finance division. On 10 November 2015, GE Capital sold the remaining portion of its Australian and New Zealand commercial lending and leasing portfolios to Sankaty Advisors for an undisclosed amount.	Available
	Fleet Solutions			
	Legacy Solutions (GE Money)	Latitude Financial Services (Ultimate Parent – KVD Singapore Pte Ltd)	On 15 March 2015, investment manager Varde Partners, private equity firm KKR, and Deutsche Bank purchased both the New Zealand and Australian consumer finance division of GE Capital (GE Money) for A$8.2 billion.	Not available

Non-banks – Timeline of events[12]

Jan. 2016

28th
The RBNZ leaves the Official Cash Rate (OCR) unchanged at 2.50%.

Feb. 2016

17th
The RBNZ approves Scorecard Pty Limited to be the fourth credit rating agency to provide credit ratings for NBDTs in New Zealand. The other three credit rating agencies include Standard & Poor's (S&P's), Moody's and Fitch Ratings.

29th
The sale of LeasePlan New Zealand Limited to LP Group BV receives approval from the Overseas Investment Office.

Mar. 2016

10th
The RBNZ cuts the OCR by 25 bps to 2.25%.

Apr. 2016

21st
S&P's places UDC Finance's 'AA-' long-term credit rating on a negative outlook.

28th
The RBNZ leaves the OCR unchanged at 2.25%.

PledgeMe becomes the fifth P2P lender in New Zealand after having its licence approved by the Financial Markets Authority (FMA).

May 2016

4th
ANZ NZ CEO, David Hisco, affirms that UDC Finance is not for sale.

6th
RBNZ statistics reports a record high of $1.7 billion of mortgage lending approved in a single week.

12th
Motor Trade Finance's appeal over the recent ruling made against it for charging unreasonable fees on loan contracts is dismissed by the Supreme Court.

Harmoney revises its fee structure, replacing the service fee on repayments with a lender fee that will only be charged on the interest earned by the lender.

Jun. 2016

9th
The RBNZ leaves the OCR unchanged at 2.25%.

Jul. 2016

6th
Ricoh announces a partnership with 2 Degrees as it seeks to expand its managed IT service business.

14th
Lending Crowd seeks to raise $5 million in capital for marketing and product development initiatives.

22nd
Former Wairarapa Building Society employee found to have been misappropriating funds; no member accounts were affected.

Aug. 2016

1st
The Commerce Commission formally files charges against Harmoney under the Fair Trading Act for misleading consumers into believing they had been pre-approved for a personal loan. Harmoney pleads guilty to those charges, for which it could potentially face a six-figure fine.

Wells Fargo completes acquisition of GE Capital's Commercial Distribution Finance business in Australia and New Zealand.

11th
The RBNZ cuts the OCR by 25 bps to 2.00%.

25th
S&P's expresses concern over the growing use of interest-only mortgage loans in New Zealand.

29th
The Commerce Commission formally files civil proceedings against Harmoney in a bid to get the Auckland High Court to clarify how the Credit Contract and Consumer Finance Act 2003 (CCCFA) applies to consumer loans offered through peer-to-peer lenders.

FOOTNOTE 12

Sep. 2016

6th
In response to the recent ruling against Motor Trade Finance in May, the Commerce Commission releases draft guidance outlining what amount of consumer credit fees may be constituted as reasonable.

13th
Fisher & Paykel Finance announces its new branding as Flexi Cards after having been acquired by Flexi Group last year, along with the announcement of its partnership with Mastercard to launch the Q Mastercard. Flexi Cards is the first non-bank to be granted a Mastercard issuing licence in New Zealand.

15th
Motor Trade Finance announces additional borrowings of $220 million from institutional investors, by way of securitising its finance receivables.

Warehouse Money's Visa cards receive A+ certification after having met Payment Card Industry Data Security Standards.

22nd
The RBNZ leaves the OCR unchanged at 2.00%.

30th
The RBNZ approves Medical Securities Limited's request to cancel its NBDT licence.

Oct. 2016

1st
New LVR rules come into effect, restricting mortgage lending to residential property investors across New Zealand with LVR greater than 60% to no more than 5%, and no more than 10% to owner-occupiers with LVR greater than 80%.

14th
Heartland invests $4 million into Harmoney to boost its stake to 13%.

17th
Fitch Ratings gives Credit Union Baywide its first credit rating at 'BB' for long-term debt issues.

25th
S&P's downgrades UDC Finance's long-term credit rating by three notches, from AA- to A-, due to its potential sale. No formal announcement has been made by its parent company, Australia & New Zealand Banking Group, as to the sale of UDC Finance.

The RBNZ announces its intention to release formal OCR projections from November onwards.

28th
Fitch Ratings re-establishes an 'A' long-term issuer rating for the Australian parent company of John Deere Financial Limited.

Nov. 2016

1st
The FMA approves Citizens Brokerage Limited's license to operate as a P2P lender in New Zealand.

2nd
New Zealand's unemployment rate falls to 4.9% for the three months ended 30 September 2016, a first since 2008.

3rd
New vehicle registrations in New Zealand for the month of October top the 14,000 mark to hit a 32-year high.

7th
Trade Me purchases an additional $670,000 in shares to maintain a 14.4% shareholding in Harmoney.

10th
The RBNZ cuts the OCR by 25 bps to 1.75%.

11th
SCFL Management Limited, wholly owned by Southern Cross Financial Holdings Limited, receives its license from the FMA to operate in New Zealand as a P2P lender.

22nd
Tuners purchases Autosure insurance business from Suncorp Group for $34 million.

More legislation? Success is all about customer centricity

Adele Wallace
Associate Director – Advisory
KPMG

ADELE'S BIO

In our previous publications, we highlighted the raft of emerging legislation that was heading in the direction of the financial services industry. That legislation is now in force, so what does it mean for the non-bank sector and, most importantly, how is the regulatory environment changing? We may find the future could bring less 'black letter' legislation replaced with a shifting focus towards overarching principles based on customer outcomes with a strong ethical culture at the heart of business. We discuss how you can go beyond the 'legislative burden' and instead, by harnessing the many drivers for improving consumer outcomes, you can create innovation and opportunity in the market.

The financial services industry has recently seen a significant increase in both legislation and regulation and the non-bank sector, often considered to be at the light end of this legislative burden, is increasingly feeling the pressure. Both 2015 and 2016 have been busy years for legal, risk and compliance departments, so what legislative changes have the non-bank sector had to consider over the past year?

Arguably, non-banks have been most impacted by the Credit Contracts and Consumer Finance Amendment Act 2014 (CCCFA) that came into effect in June 2015. It strengthens consumer protection by defining lender responsibility principles (Responsible Lending Code) around affordability, providing customers with clear information and acting ethically. In addition, the sector has had to reconsider their fees in light of new requirements around how fees are calculated and charged and the requirement that these are 'reasonable'.

Amendments to the Fair Trading Act 1986 (FTA) came into effect in March 2015. These amendments represent the implementation of new unfair contract provisions, providing new rights for consumers and obligations for businesses. The requirements have triggered a number of organisations to launch extensive reviews of contractual terms and conditions across all products and drafting of new standardised terms and conditions.

Additionally, November 2016 signalled the end of the licensing process that began two years ago, as part of wider financial services reforms to regulate the industry further. All fund managers, discretionary investment management service providers and derivatives issuers must meet new governance and capability standards under the Financial Markets Conduct Act 2014 (FMCA).

Now we have emerged from this flurry of legislative change, we can reflect on the drivers behind their inception. It isn't hard to see that this legislative activity signalled a championing of the consumer and a concerted effort by regulators to improve the behaviours and interactions that companies have with their customers.

But regulatory reflections have revealed an interesting contradiction. Despite global increases in consumer-based legislation and regulation aimed at improving consumer experience, instances of misconduct continue. Arguably, instances have actually increased, which has driven a deterioration in trust and customers' perception of the value they get from their financial services provider.

Moving towards change in culture and conduct

Increasing the extent and coverage of legislation and regulation has failed to stem the tide of poor customer outcomes. The inherent culture in firms and focus on profit and shareholder value rather than customer outcomes are being seen as potential root causes. As a result, we are now seeing regulatory approaches take a more holistic view of the entire organisation and a renewed focus on improving organisational culture and individual conduct.

There has been a groundswell of discussion and interest surrounding 'conduct and culture' around the globe with the UK's Financial Conduct Authority taking the lead. Closer to home, the FMA have recently released their consultation paper on their view of conduct and how they will consider conduct in their supervision of providers. The consultation states that "*Good conduct is vital to fair, efficient and transparent markets, and ensures the confident and informed participation of businesses, investors and consumers*". In Australia, APRA have released their insights into Risk Culture and ASIC's rhetoric is strongly levelled at firms' culture and tone from the top. As the international landscape continues to evolve and mature, we can expect further changes to the domestic landscape, but this is unlikely to be driven by the 'black-letter' legislation that we have seen in recent years.

Instead, organisations will be asked to demonstrate how their culture and conduct consistently delivers good customer outcomes. They will need to provide evidence-based positive assurance that they are achieving good customer outcomes – rather than relying on simple negative assurance.

To many organisations and their risk advisors, the departure from the simple interpretation of black-letter legislation and reasonably fluid regulatory expectations has caused some discomfort and uncertainty. How should you go about understanding your organisation's culture and changing it? Who should take responsibility and where in the business should the change be driven? Are there instances of misconduct that you simply don't know about and what is driving this?

Success is all about customer centricity and good customer outcomes

To succeed during this period, organisations will need to change their view of 'compliance' from a burden that simply needs to be ticked off or perfunctory adherence to regulation, and instead, consider good conduct and positive customer outcomes as the 'way things are done in this business'.

Organisations that are succeeding are taking a holistic view and really examining their strategies and business models. The world is changing fast, and customer expectations are increasing, so these businesses are harnessing the drive for change and taking a wider view by focusing on their longer-term strategies and strengthening relationships with customers rather than simply on short-term profit increase.

Conduct risk

The risk that strategic business decisions negatively impact on the ultimate customer. Usually, these are decisions that are made quite early in the value chain, for example, in strategy setting and product design. Conduct is all about balancing the financial interests of the company with the needs of the customer and driving trust and sustainable income by being more customer centric and focusing on consistently delivering good customer outcomes.

Culture

Culture is what drives day-to-day behaviour. The accumulation of years of corporate history and the messages that senior leadership drive through the business, either through their own behaviours or expectations, form part of the attitudes and beliefs around the organisation as to what constitutes expected performance. Organisations may believe that they have a strong system of controls to prevent inappropriate behaviour but culture has a huge influence on an employee's course of action when faced with competing priorities.

Risk culture

The way the firm identifies and deals with risks. Risk culture is all about creating an environment whereby risks can be identified and called out. The right people taking responsibility for risk, monitoring and managing those that are emerging, and dealing with issues that have crystallised.

These are organisations who have realised that being customer-centric not only makes good business sense, it is absolutely at the core of their business model and the source of future growth. They have identified that good culture and conduct is a differentiator in an industry where products and pricing are very similar, and they are starting to stand out for all the best reasons. We see the focus on good conduct as a key driver of innovation, which supports a sustainable long-term business model which is less at risk of regulatory enforcement, remediation and fines. This not only 'future proofs' a business where new 'Fintech' players, digital disruptors and peer-to-peer entities are starting to take market share by focusing on ethical behaviour and delivering to customer needs, but supports the strength of the overall market and increases perceptions of integrity. The focus is on building integrity, increasing employee satisfaction and creating brand advocates in their customers who trust them to manage their core financial interests.

Change is driven from the top

Successful businesses are reviewing and re-evaluating their strategic priorities and their core business model to identify the potential risks to customer outcomes; they are looking at a broad blend of data and inputs to give them real insight. They are talking to their employees and their customers, looking at complaints and social media to see where those moments of truth are, and where they aren't delivering, they are identifying the root causes and defining what needs to change. They are ensuring that customer centricity is at the heart of everything they do, starting at the very top of the organisation and embedded into their business models, training, product design and performance management. At the same time, they are starting programmes which change the overall culture and measuring whether customers are getting real value from their core business offerings.

Organisations may be missing a significant opportunity for improvement by innocently believing that they have a positive culture and conduct environment. Clearly, no business overtly decides that their strategy will be to mislead customers; however, our experience is that sometimes poor customer outcomes are inadvertent or an unintended consequence of a decision made much higher up the value chain, and usually this is because there has failed to be a clear analysis or understanding of the potential risks to customers as a result of a decision.

It is clear that this absolutely starts at the top and the drive for change has to come from senior leadership and has to permeate through their decisions, behaviours and expectations and continually set an example for the whole of the organisation.

Regulation is certainly one aspect of the pressure to improve customer outcomes, but it's clear that failing to move at pace to harness the myriad other drivers: changing customer expectations; employee satisfaction; digital disruption; and increasing competition from Fintech entrants, could mean that traditional providers get left behind by failing to balance the divergent interests of the customer, employees, the company and the wider market. Now is the time to turn those risks into opportunity.

Turn risk into opportunity by harnessing customer centricity and the drivers of change

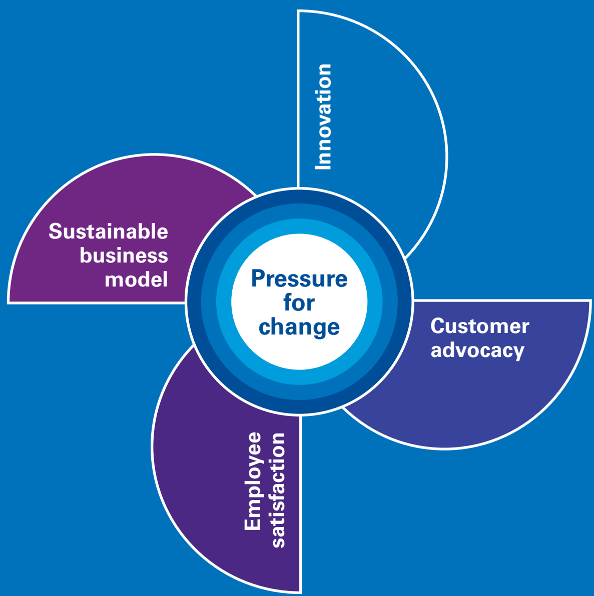
Digital disruption
Competition from new market entrants and Fintech are changing traditional distribution models.

Social media
Level of customer advocacy becomes more visible. Increased opportunities for client interaction.

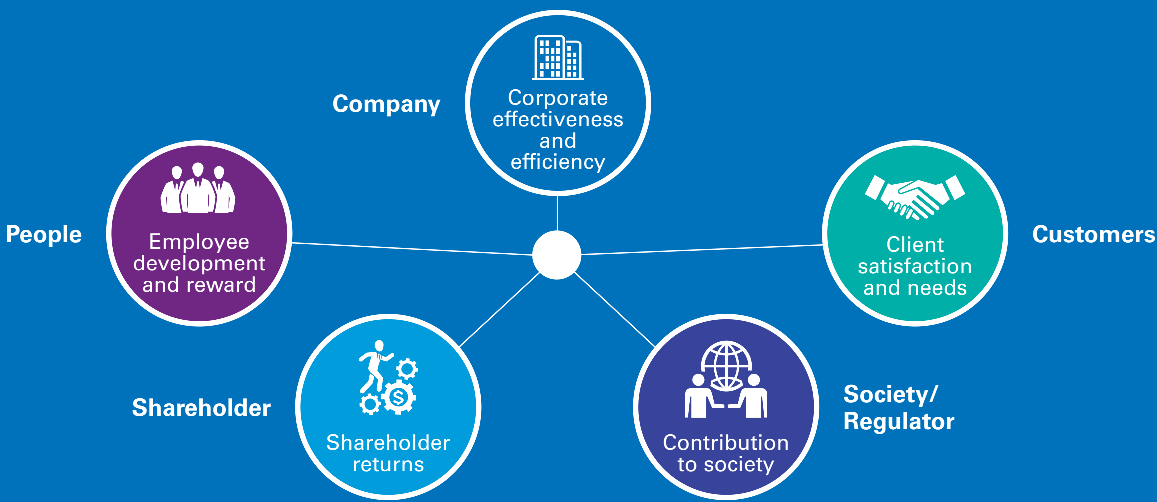
Customer expectations
Customers desire transparency and simple products that perform as expected. Trust in banks is at a low.

Regulatory intervention
Sustained regular and government investigation increases the risk of fines and unsustainable strategies.

EXTERNAL DRIVERS



DIVERGENT INTERESTS



Financial Services Federation

Lyn McMorran
Executive Director
Financial Services Federation Inc.

FINANCIAL SERVICES FEDERATION

LYN'S BIO

Last year, I wrote an article for inclusion in the KPMG Financial Institutions Performance Survey which largely reflected on what Financial Services Federation (FSF) members had been doing. This seemed appropriate at the time, particularly as in 2015 the FSF celebrated the 50th anniversary of our founding. Also, because we felt we were coming to the end of the 'once-in-a-lifetime' regulatory reform of the financial services sector forced upon us by the events of the Global Financial Crisis.

At that time, we were hopeful that in 2016 we would be able to let our compliance obligations take care of themselves because systems and processes were largely in place and that we would be able to turn our attention to innovation and business growth.

How that has actually panned out has been interesting, and it's fair to say the results have been mixed.

It certainly has not been the case that the need to respond to regulatory matters has diminished, with the FSF having provided more than a dozen submissions on behalf of members this year to date. These have included responses to the Options Paper on possible changes to the Financial Advisers Act, Phase 2 of the Anti-Money Laundering and Countering Financing of Terrorism regime, the Consumer Guarantees (Removal of Unrelated Lender Liability) Amendment Bill and the Commerce Commission's draft guidance on consumer credit fees – among others.

With exposure drafts of amended Financial Advisers and Anti-Money Laundering legislation expected to be consulted on and enacted in 2017 (again, among others), I'm not prepared this year to tempt fate by saying that our regulatory reform days are behind us, or even that they are tapering off.

In regard to the former of these, in particular, we still remain hopeful that common sense will prevail and that the provision of consumer credit will be removed from the scope of an amended Financial Advisers Act. Under the current Act, consumer credit is a category two product and any 'advice' provided in relation to this, such as the suitability of a loan for the borrower's purposes, how it might be structured to suit their needs, or helping them to understand their obligations under a loan agreement, is covered by both the Financial Advisers Act (FAA) and the Credit Contracts and Consumer Finance Act (CCCFA). We believe this overlapping regulation is an anomaly that the amended FAA could take the opportunity to fix.

Realistically, we believe the reforms to the CCCFA and the introduction of the Responsible Lending Code provide the necessary consumer protections around the provision of consumer credit, and this Act would always take precedence over the FAA if any concerns arose from the regulator as to the provision of credit 'advice'.

One area of particular concern to some of them has been the increase and greater sophistication of identity and other types of fraud that they have been subjected to.

The upside, however, is that it has not at all been about compliance for our members this year and certainly the mood among them is that 2016 has been a good year for lending with volumes high and arrears low.

One area of particular concern to some of them has been the increase and greater sophistication of identity and other types of fraud that they have been subjected to. Greater vigilance has been required to spot these instances because the documentation being provided is of such high quality that this has not been easy.

The FSF as a body is now looking at ways in which we can facilitate more information sharing amongst our members to try to prevent instances of identity fraud or the use of fraudulent account information to verify loan affordability.

The future is certainly in digitally providing consumers with access to credit. The demand is most certainly there for borrowers to be able to access credit through their online devices without having to use a branch network. They want money when they want it and fast.

The difficulty for lenders is in being able to meet the consumer demand while still satisfying the regulator that they are meeting their responsibilities as responsible lenders. The Commerce Commission rightly feels that consumers deserve the same protections no matter what channel they use to access products and services.

There are many technology providers who can help lenders meet their Lender Responsibility Principle obligations when transacting with their customers digitally. For example, there are ways to satisfactorily achieve electronic identity verification, to access borrowers' bank account data to verify income and expenditure and determine whether the loan is affordable, and for the borrower to electronically sign loan agreements.

The gap is in providing lenders with the certainty that borrowers are making an informed decision and that they do in fact understand the terms and conditions of the lending agreement they are entering into, when the lender is not able to assess that understanding face-to-face. We all know how easy it is when accessing products and services on-line to tick the box that says that we have read the terms and conditions without having read them at all – it's a question of wanting to buy the product and move on.

We understand that the tick-box approach will not be good enough in the lending situation, particularly when it comes to the protection of those customers who might be regarded as being vulnerable, for example, when they are people for whom English is a second language. So, as a Federation, we are looking to help members to formulate the means to meet their responsible lending obligations and still be able to innovate and offer their customers access to products via a variety of channels.

We understand that the tick-box approach will not be good enough in the lending situation.

This is important to our members because we, like the regulators, believe that consumers are entitled to the same protections regardless of the channel they use to interact with lenders, and for that reason we have also been reasonably vocal about the fact that care needs to be taken not to be seduced by the idea of 'disruptors' in the industry that then allows them an easier ride in respect to compliance. In our view, a loan is a loan whether it's provided by a lender in a branch, via a platform by an intermediary such as a peer-to-peer lender, via on-line means, or whatever. The only difference is the channel by which the loan is accessed.

There is clearly plenty to occupy us and, like many, particularly after the events of recent days in North Canterbury and Wellington, we will be pleased to welcome in 2017 with whatever that has in store for us.

Non-banks – Sector performance

The non-bank sector showed an 8.17% growth in overall reported net profit, up by $15.70 million to $207.78 million.

Out of the 23 participants, 15 reported higher profit levels, and 10 of those achieved double-digit growth. Despite tighter margins due to a decrease in lending rates and market volatility creating cost of funds pressure, the non-bank sector demonstrated steady growth in net interest income and non-interest income that led to the increase in profitability.

Non-banks' profitability increases on the back of strong loan growth

Non-bank survey participants had a strong year in 2016 with the sector achieving an increase in net profit of $15.70 million to $207.78 million compared to the previous year. If we ignore the impact of EFN (New Zealand) Limited, which is included in the survey for the first time since it started operations on 27 July 2015, the sector showed a normalised[13] growth of 3.93% to $199.64 million.

FOOTNOTE 13

Out of the 23 participants, 15 reported positive increases to NPAT levels. Nissan Financial Services and Wairarapa Building Society were the standout performers this year with triple-digit NPAT growth of 201.90% (from $1.26 million to $3.81 million) and 467.92% (from $106k to $602k), respectively.

Nissan Financial Services, in its second full year of operation, is continuing to show significant growth as it continues to establish its footing within the local vehicle financing sector in New Zealand, supporting the sale of its vehicle brand and the Nissan dealership network. Nissan Financial Services' NPAT growth of 201.90% was driven by increased net interest income of $4.98 million or 98.17%, alongside net interest margin (NIM) growth of 45 bps to 4.04%. Similarly, Wairarapa Building Society had a $317k or 13.32% increase in net interest income this year.

Other notable mentions are Avanti Finance, First Mortgage Trust, Medical Securities, Mercedes-Benz Financial Services, Ricoh and Toyota Finance, all of whom achieved NPAT growth ranging from 23.11% to 44.51%. The top three performers, in terms of dollar value increases ranging from $3.15 million to $3.75 million, were Avanti, Mercedes-Benz Financial Services and Toyota Finance.

In contrast, Fuji Xerox Finance reported a $10.66 million reduction in net profit for the year, dropping from a $3.95 million net profit in 2015 to a $6.71 million net loss in 2016. Fuji Xerox Finance is the only participant that reported a loss this year. The contraction in NPAT was

1 MOVEMENT IN NET PROFIT AFTER TAX

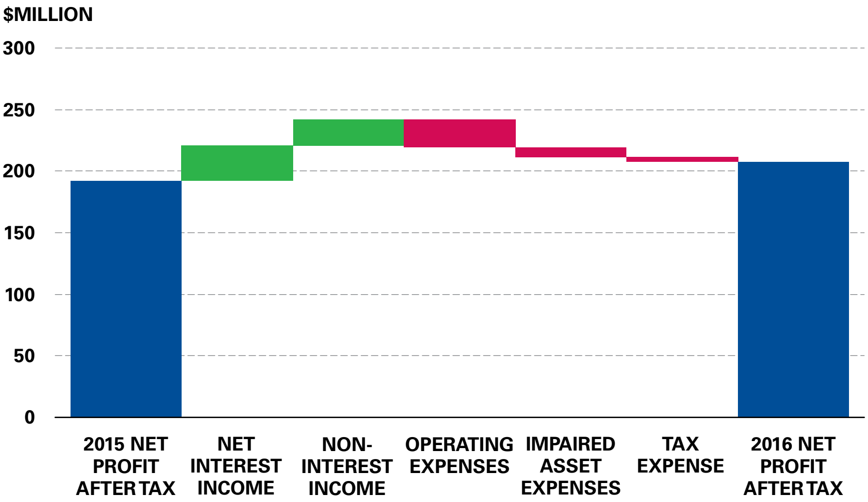


TABLE 2: PERFORMANCE METRICS		Total
Increase in Total Assets		17.40%
Increase in Net Profit After Tax (NPAT)		8.17%
Movement of Impaired Asset Expense (As a Percentage of Average Gross Loans and Advances)	bps	4
Decrease in Interest Margin	bps	-41
Decrease in NPAT/Average Total Assets	bps	-9
Decrease in NPAT/Average Equity	bps	-23

driven by several factors, including a $2.57 million (10.66%) reduction in interest income, a contraction of 138 bps in NIM to 2.79%, a further $1.05 million reduction in non-interest income, and lastly, a steep increase of $10.25 million (from $635k) in impairment expense. Positively, Fuji Xerox Finance reported a 7.72% or $441k reduction in operating expenses.

With reports of record vehicle sales in the media over the past couple months, a closer look at this segment of the sector revealed that five of the seven vehicle financing companies contributed a total of $9.98 million towards normalised (excluding EFN) NPAT growth for the non-bank sector. BMW Financial Services and ORIX were the only ones that reported reductions in profits from last year of 24.57% ($2.32 million) and 0.84% ($132k), respectively. Weaker performance from BMW Financial Services stemmed from a decrease of $1.43 million in net interest income, the majority of which came from a decline in interest income as interest expense remained flat. Worsening credit quality also had a significant impact on the deterioration of its NPAT as impairment expenses rose $952k for the year, followed by a marginal reduction in non-interest income of $259k as well.

In relation to non-interest income, we continue to see the same theme from previous years, with vehicle financing companies contributing over $12.57 million to the overall $10.30 million (6.41%) growth in normalised non-interest income. The largest increase in non-interest income came from Toyota Finance, Nissan Financial Services and LeasePlan, which reported increases of $5.66 million, $3.40 million and $2.95 million, respectively.

Overall, the non-bank sector delivered plenty of positives this year as over half of our survey participants improved their profitability, despite new challenges that arose and tougher competitive pressures from P2P lenders and the banking sector.

Summary of non-bank sector profitability measurements (see figure 1 – page 22):

— NPAT grew by $15.70 million or 8.17%, to achieve $207.78 million (normalised growth of 3.93%).

— Net interest income went up by $29.78 million, to reach $563.72 million (normalised increase of $19.67 million or 3.68%).

— Non-interest income increased by $20.92 million, to reach $181.53 million (normalised gain of $10.30 million).

— Impairment asset expense increased by $7.83 million, climbing to a total of $47.80 million (normalised of $7.47 million or an 18.70% hike in impaired asset expense).

— Operating expenses increased by $23.20 million.

— Tax expense went up by $3.98 million.

Net interest margin continues to contract

Participants in the sector are finding it increasingly difficult to maintain their NIMs. This year, only 7 out of the 23 survey participants were able to increase their NIM levels, with one participant's NIM staying flat. Normalised NIM contracted by 24 bps, declining from 6.09% to 5.85%. Margin pressures primarily stemmed from lower lending rates as a result of ever-increasing competition within the sector, without sufficient relief from the lending side of the equation.

Normalised interest income for the sector is up $20.82 million or 2.43%, while normalised interest earning assets increased to $9.78 billion, a growth rate of 6.93% or $633.34 million.

Of the seven survey participants that saw NIM growth, Ricoh and Instant Finance were the top performers, with increases of 121 bps and 105 bps, respectively. The remaining five competitors recorded improvements in the range of 2 to 45 bps. These two, along with Nissan Financial Services who had the 3rd highest NIM gain of 45 bps, were the only participants who were able to benefit from both favourable lending and funding conditions (i.e. achieving a higher interest income over interest earning asset ratio, while simultaneously driving down its interest expense over interest bearing liability ratio).

On the other hand, Avanti Finance and Fuji Xerox Finance had the largest NIM declines of 96 bps to 9.98% and 138 bps to 2.79%, respectively.

Instant Finance continues to have the highest NIM at 22.30%, followed by ORIX at 12.22% and Fisher & Paykel Finance at 11.30%. On the other end, Wairarapa Building Society, Nelson Building Society, and Fuji Xerox Finance held the weakest NIMs at 2.25%, 2.30% and 2.79%, respectively.

VIEW FIGURE 2

Despite normalised NIM levels reducing this year, normalised interest income grew by 2.43% for the year, compared to an impressive 12.73% growth last year. Nissan Financial Services and Avanti Finance once again saw impressive results this year with increases in interest income of $8.66 million and $8.57 million, up from last year by 84.18% and 37.13%, respectively. Of the 23 participants surveyed, 15 saw increases in interest income for the year.

Going forward, the sector will no longer be able to rely on lower funding costs to alleviate the pressures felt on the lending side, as the cost of funds will likely come under further pressure. Non-banks' Executives have commented on the expected rise of offshore wholesale funding costs as investors demand higher returns during these increasingly uncertain times. The competition for funds within the local deposit market will drive up funding costs, as the major banks are no longer able to rely on their Australian parents to provide as much funding as they have previously. Regulatory developments across the Tasman over the past year have meant that Australian banks have reduced funding levels to their New Zealand subsidiaries. This was to ensure that they remained compliant with rules that restricted the bank's non-equity exposure to 5%, and for them to shore up funds to meet the capital requirements as set out by APS 110 and APS 120.

Total assets continue to grow

The sector continues to achieve strong asset growth as total assets climbed a further $1.63 billion to $11.01 billion, a rise of 17.40% over last year. It should be noted that $982.25 million relates to the inclusion of EFN in this year's survey, for which no comparatives are available since this is its first year of operation. Asset growth continues to be fuelled by the increase in the sector's loan book as gross loans and advances increased from $7.72 billion to $8.77 billion.

VIEW FIGURE 3

TABLE 3: GROSS LOANS Entity	2016 $'000	2015 $'000	Movement $'000	Movement %
Avanti Finance Limited	239,940	152,977	86,963	56.85%
BMW Financial Services New Zealand Limited	353,714	369,427	-15,713	-4.25%
Credit Union Baywide	213,276	215,041	-1,765	-0.82%
Credit Union South	107,894	93,867	14,027	14.94%
EFN (New Zealand) Limited	424,684	n/a	n/a	n/a
First Credit Union	181,295	183,340	-2,045	-1.12%
First Mortgage Trust	284,282	219,436	64,846	29.55%
Fisher & Paykel Finance Holdings Limited	694,193	656,469	37,724	5.75%
Fuji Xerox Finance Limited	427,213	438,111	-10,898	-2.49%
Instant Finance Limited	95,722	92,210	3,512	3.81%
John Deere Financial Limited	151,550	144,503	7,047	4.88%
LeasePlan New Zealand Limited	8,588	5,491	3,097	56.40%
Medical Securities Limited	134,618	159,464	-24,846	-15.58%
Mercedes-Benz Financial Services	545,557	513,722	31,835	6.20%
Motor Trade Finance Limited	540,565	517,250	23,315	4.51%
Nelson Building Society	402,168	361,228	40,940	11.33%
Nissan Financial Services NZ Pty Limited	297,572	202,437	95,135	46.99%
ORIX New Zealand Limited	37,504	35,614	1,890	5.31%
Police & Families Credit Union	60,701	64,400	-3,699	-5.74%
Ricoh New Zealand Limited	86,239	88,651	-2,412	-2.72%
Toyota Finance New Zealand Limited	776,512	720,654	55,858	7.75%
UDC Finance Limited	2,601,939	2,378,692	223,247	9.39%
Wairarapa Building Society	108,787	104,013	4,774	4.59%
Sector Total	**8,774,513**	**7,716,997**	**1,057,516**	**13.70%**

n/a = not available

Avanti Finance, First Mortgage Trust, Nelson Building Society, Nissan Financial Services and UDC Finance registered the largest growth in interest earning assets in the range of $75.55 million to $224.17 million. Collectively, these five participants account for over 91.24% of the $633.34 million increase in interest earning assets (excluding EFN).

Of the 15 participants that had larger loan books this year, Avanti Finance and Nissan Financial Services stood out as having the highest growth rates in terms of both dollar and percentage increases to their loan books. After a triple-digit percentage growth of 150.28% last year, Nissan Financial Services went on to add a further $95.14 million to its loan book, up by more than 46.99%. Similarly, Avanti Finance grew its loan book to $239.94 million, an increase of $86.96 million. The bulk of Avanti's growth was derived from an increase in its mortgage book, a space in which it has only established a presence in the last two years.

UDC Finance reported the highest dollar growth of $223.25 million to total gross loans of $2.60 billion, the largest among our survey participants. LeasePlan had a growth rate of 56.40% to a loan book of $8.59 million; this was the second fastest growth rate when compared to Avanti Finance who achieved a growth rate of 56.85%.

EFN (New Zealand), who was previously known as part of the fleet solutions and equipment finance division of GE Capital, has the third largest total asset holdings of $982.25 million, but only the seventh-highest gross loans and advances balance at $424.68 million.

TABLE 4: MOVEMENT IN INTEREST MARGIN **Entity**	**2016** **%**	**2015** **%**	**Movement** **(bps)**
Avanti Finance Limited	9.98	10.94	-96
BMW Financial Services New Zealand Limited	6.82	7.20	-38
Credit Union Baywide	4.73	5.16	-43
Credit Union South	7.69	8.08	-39
EFN (New Zealand) Limited	n/a	n/a	n/a
First Credit Union	4.01	4.57	-56
First Mortgage Trust	7.17	7.69	-52
Fisher & Paykel Finance Holdings Limited	11.30	11.01	29
Fuji Xerox Finance Limited	2.79	4.17	-138
Instant Finance Limited	22.30	21.25	105
John Deere Financial Limited	3.63	3.63	0
LeasePlan New Zealand Limited	9.67	9.91	-24
Medical Securities Limited	4.03	3.68	35
Mercedes-Benz Financial Services	4.13	4.23	-10
Motor Trade Finance Limited	8.61	9.06	-45
Nelson Building Society	2.30	2.57	-27
Nissan Financial Services NZ Pty Limited	4.04	3.59	45
ORIX New Zealand Limited	12.22	12.35	-12
Police & Families Credit Union	4.58	4.78	-20
Ricoh New Zealand Limited	9.52	8.30	122
Toyota Finance New Zealand Limited	4.50	4.43	7
UDC Finance Limited	4.50	4.87	-37
Wairarapa Building Society	2.25	2.22	3
Sector Average	**5.68**	**6.09**	**-41**

n/a = not available

In terms of market share for gross loans and advances (excluding EFN), UDC Finance continues to the hold the lead at 31.16% with a 34 bps increase this year. Avanti Finance and Nissan Financial Services had the largest gains of 89 bps and 94 bps, respectively, as would be expected given the magnitude of their increase as mentioned above. Overall, 15 of our 23 survey participants had a shrinking market share for gross loans and advances.

VIEW FIGURE 4

The ongoing expansion of the sector's gross loans and advances balance is a testament to the strong consumer confidence levels in New Zealand at the moment. Consumer confidence levels in the New Zealand market are impacted by record low interest rates, high employment levels and general confidence from the strengthening of the household balance sheet.

Asset quality

Although competition in the lending market continues to be intense, non-banks' Executives have stressed that they will not compromise on asset quality in order to write more loans. The current focus on market discipline and responsible lending is not just a talking point resulting from recent legislation. Executives do remember the pattern from the post-GFC era, and not fondly.

Asset quality for the sector softened with a slight deterioration coming through from credit quality measurements. Although impairment expense and total bad debt provision levels for the sector rose in the current year, the increase is not large in the context of the size and growth of the sector's loan book. Impaired asset expense increased by $7.83 million (19.60%) to $47.80 million from last year, while total impairment provision increased for the year by 10.53% to $122.70 million. The increase in impairment provision was the result of specific provisions rising from $35.54 million in 2015 to $45.77 million in 2016, for which an increase of $10.25 million by Fuji Xerox Finance was the main cause. The collective provision for the year increased to $76.94 million, a $1.46 million (or 1.94%) increase from the previous year.

VIEW FIGURE 5

As in previous years, credit quality has improved year on year. The percentage of gross loans and advances over impairment provision improved slightly for the year at 1.40%, a movement of -4 bps from last year. Of those surveyed, 15 out of 23 showed an impairment provision to gross loans and advances ratio that was unchanged or lower by an amount in the range of 0 to 127 bps. ORIX had the largest improvement in terms of basis points and percentage change, decreasing its impairment provision to gross loans and advances ratio by 127 bps, from 1.37% to 0.10%.

VIEW FIGURE 6

Impaired asset expense as a percentage of gross loans and advances rose by 2 bps over the current year, from 0.52% to 0.54%. However, excluding Fuji Xerox Finance, which had an abnormal increase in impaired asset expense of $10.25 million (or 1,613.39%), impairment expense for the sector would have decreased by $2.41 million (or 6.13%). At that level, impaired asset expense as a percentage of gross loans and advances would have improved by 10 bps, decreasing from 0.52% to 0.42%. Mercedes-Benz Financial Services and UDC Finance had the largest decreases in impaired asset expense of $4.06 million and $3.01 million, respectively. Overall, 15 out of 23 participants had an impaired asset expense over gross loans and advances ratio in the range of 0% to 0.91%.

While the sector continues to report positive recurring trends in asset quality year after year, the Executives all explained that this was an area that they will continue to monitor carefully: the adequacy of provisions held in light of a growing loan book.

Improved operating efficiency ratio despite higher operating costs

Operating expense for the sector rose by 5.95% to $413.08 million, and of the $23.20 million increase, EFN accounted for $10.48 million. On the other hand, the non-bank sector also reported higher operating income levels of 7.30% or $50.71 million, to reach $745.26 million. The inclusion of EFN had an impact on this result as EFN contributed $20.74 million in additional operating income, more than 40% of the total increase.

Despite higher operating costs, the sector achieved better than expected operating efficiencies, as the operating expense over operating income ratio decreased by 70 bps, from 56.13% to 55.43%. In isolating the effect of EFN on our calculation of this year's operating efficiency ratio, it was noted that exclusion of EFN only had a minor impact, as the sector still delivered 56 bps in efficiency savings as normalised operating expense to operating income fell from 56.13% to 55.57%.

VIEW FIGURE 7

Operating costs often tend to be highly fixed in nature, comprising of items such as employee remuneration costs and administration expenses (e.g. overhead and rent). Whereas operating income can be considered to be more variable/volatile in nature due to its susceptibility to interest rate changes, fair value adjustments, and a myriad of other factors that can drastically change an entity's operating income level from year to year, despite having no fundamental change to its operations.

At an individual level, the results were a bit mixed, with 12 out of 23 participants showing an improved operating efficiency ratio. Nelson Building Society, Motor Trade Finance, ORIX and UDC Finance were the only entities whose operating efficiency ratio remained largely consistent with last year, with changes of just 2 bps, 20 bps, 9 bps and 20 bps, respectively. Looking into the detail, 10 entities had an operating ratio that was better than the industry average of 55.43%. Of those, First Mortgage Trust, Nissan Financial Services and UDC Finance had the best operating ratios at 24.06%, 18.26% and 26.25%, respectively. Given that the ultimate objective of a credit union is not to make a profit, but rather to maximise interest paid to its members (i.e. interest expense), it is reasonable that they would have the highest operating expense over operating income ratio within the sector.

In light of comments from Executives about investing more in the way of Fintech to further develop their front end technological capabilities, it is expected that operating costs will continue to increase in the future.

Partnerships with Fintech companies and/or banks will be on the agenda of non-banks' Executives in order to leverage the IT capabilities and resources that they already have in place, in exchange for a small fee for the use of its innovation. Non-bank entities are aware that the banking sector has made significant headway in this area as Fintech entities are becoming an increasing threat to them in the markets where they traditionally operate. Therefore, it is likely to see partnerships with these types of entities as beneficial to combat disruptors and protect their customer base.

Where is P2P lending at today?

In the previous year, we profiled P2P lending explaining what it is, how it works, where it is going, and its potential place in New Zealand's financial market.

At this stage, it is still too early to comment on the financial performance of P2P lenders as a segment of the non-bank sector, as the platforms are not required to report their performance. The conditions of their license require them to report the results of the entity that manages the platform. Although Harmoney is not required to disclose any information relating to its platform, it has taken the initiative to do so. However, the figures disclosed have not been audited.

In the current year, the FMA has granted PledgeMe Limited, Citizens Brokerage Limited and SCFL Management Limited licenses to operate in New Zealand as P2P lenders. The P2P subsector also includes Lend Me, Lending Crowd and Squirrel Money, all of whom received their license from the FMA last year and have since begun operations.

As P2P lending begins to establish a foothold in New Zealand, it is becoming evident that there is no hard and fast rule to dictate how a P2P lender ought to operate or what it should look like. This flexibility works in favour of P2P lenders as it allows them to exercise creativity in differentiating themselves from the competition and in developing a competitive advantage. Several of our survey participants have noted an impact from the growing presence and influence of P2P lenders in the market, particularly around:

1. the speed with which they are able to process and complete a client loan or deposit application; and
2. borrowers expecting to be able to borrow without providing security.

The increase in P2P lending is largely attributable to Harmoney's growing presence with over $357 million in lending done through its platform to date. This is considerably higher than the combined lending of its competitors. Despite Executives being impressed with the technological capabilities of P2P lenders in developing a sophisticated and impressive front-end technologies, they continue to express reservations as to the quality of lending that is taking place given that lending decisions are being made in minutes and the reliance on credit scoring models.

On the regulatory side, legal actions that have been brought against Harmoney during the year could have significant implications for the P2P market. The most significant of these are the civil proceedings brought against Harmoney by the Commerce Commission in a bid to get the Auckland High Court to clarify how the Credit Contract and Consumer Finance Act 2003 (CCCFA) applies to personal loans offered through P2P lenders. The draft consumer credit fee guideline that was recently published in September states that under the CCCFA, the fees charged by lenders under a consumer credit contract 'can not generate profit or recover more than the costs permitted by the Act'.[14]

FOOTNOTE 14

Harmoney's position has been that the whole premise of a P2P lender is that, in providing a platform where borrowers are matched to potential investors for a fixed fee, the CCCFA does not apply to the platform as it is not the party undertaking the lending. An unfavourable ruling for Harmoney – that the CCCFA does apply – could have a significant impact on the structure and compliance regimes of its business. The developments in this area will be something to watch.

In the previous year, we asked questions about how P2P lenders would provide visibility into loan performances and the extent to which credit losses are being recognised. Harmoney has made significant headway in this area by presenting key performance metrics such as loan performance by credit grade (i.e., default and arrears rate), realised annual return by investor type and distribution of loans by grade.[15]

FOOTNOTE 15

Squirrel Money has done this to a more limited extent by providing investors with information about the current lending book size, the amount in arrears, the value of write-offs, and the size of the reserve fund. Harmoney has had the benefit of a larger pool of transactional data from which they can leverage, whereas newer companies will require a little more time to obtain more transactional data before they can provide meaningful and insightful information disclosures of a similar nature.

P2P lenders could have an incentive to provide such disclosures as it promotes investor confidence and encourages them to provide the funds that are needed to meet the demands of the platform's borrowers. Such disclosures will help give investors insight as to the accuracy of the P2P lender's credit rating model and the potential level of returns they can expect. P2P lenders that do not make such voluntary disclosures as part of their business model may stand to lose out in this respect. One question that will be asked is whether this information is reliable and presented in a consistent manner (i.e., all P2P lenders use commonly understood forms of accounting principles such as NZ GAAP and NZ IFRS). When we talk about presenting reliable figures, we may also mean figures that have been audited. To date, the only accounts that the P2P lenders are required to present and have audited are those of the company that manages the lending platform. From those early accounts, we will notice losses typically incurred by new companies as they incur setup costs.

On 10 October 2016, the FMA released a consultation paper 'Regulatory Returns for Prescribed Intermediary Services'. Submission closed on 28 October 2016. The paper proposes what information P2P and Crowdfunding providers should provide to the FMA in their regulatory returns. This information is designed to help the FMA access the platform's performance and to consider whether its license requires any additional terms. It is however, unlikely that the information will be made public.

Several Executives have questioned whether P2P lending in New Zealand is sustainable. The main reasons for this are the:

1. low business margins due to fees being their only source of revenue;
2. high churn rate of 30–40% with borrowers being able to either obtain cheaper refinancing options or electing to pay off the loan quicker; and
3. difficulty in achieving economies of scale at a level required to turn a healthy profit due to low business margins and the limited size of New Zealand's financial market.

One P2P Executive we spoke to holds the opinion that P2P lending can only survive in the near term as an add-on to the back of another business to support its growth. In addition to its core business offering, the lender might offer a P2P complementary service until it is at a point where it is profitable enough to stand alone. This was also supported by the view that to survive in the P2P industry the lender must move beyond just being a faster, one-click front end customer touch point and reporting platform. The P2P lender must also provide an enhanced overall customer experience by regularly incorporating new and sophisticated technological innovations, and by sharing with its customers the rewards (and risks) that come from being a disruptor of the finance industry. This will mean providing faster access to becoming a customer, faster completion of loans and deposits, rates that are more suitable, access to different risk-return profiles, finance when and for things the consumer wants, and all that right now, and done more fairly vis a vis risk and reward. In its early phase of growth, the focus of the P2P market has been to integrate state of the art technologies into their lending platform to provide an enhanced customer experience based around automation and speed of interaction.

Going forward, the next phase for the industry will be to focus its efforts on leveraging the technologies that it has in place to support a more meaningful total customer experience and a sharing of the risks and rewards.

It therefore still remains to be seen whether the comment made by Neil Roberts, CEO of Harmoney, is still valid, namely that the New Zealand market has the potential to develop into a $10 billion per year lending industry if the P2P market gets the right support from business leaders, regulators and investors[16]. Only time will tell who holds the right view.

FOOTNOTE 16

Non-banks – Analysis of annual results[17]

				Size
Entity	**Rank by Total Assets**	**Balance Date**	**Year**	**Total Assets $000**
Avanti Finance Limited	15	31-Mar	2016	245,398
			2015	*158,614*
BMW Financial Services New Zealand Limited	9	31-Dec	2015	358,164
			2014	*376,204*
Credit Union Baywide	14	30-Jun	2016	293,580
			2015	*266,031*
Credit Union South	21	30-Jun	2016	129,857
			2015	*124,749*
EFN (New Zealand) Limited	3	31-Dec	2015	982,253
First Credit Union	11	30-Jun	2016	334,421
			2015	*295,007*
First Mortgage Trust	10	31-Mar	2016	353,831
			2015	*277,951*
Fisher & Paykel Finance Holdings Limited	4	31-Dec	2015	786,224
			2014	*753,399*
Fuji Xerox Finance Limited	8	31-Mar	2016	443,537
			2015	*452,025*
Instant Finance Limited	23	31-Mar	2016	99,415
			2015	*96,643*
John Deere Financial Limited	17	31-Oct	2015	157,905
			2014	*150,733*
LeasePlan New Zealand Limited	13	31-Dec	2015	300,359
			2014	*279,400*
Medical Securities Limited	18	31-Mar	2016	141,199
			2015	*197,815*
Mercedes-Benz Financial Services	6	31-Dec	2015	567,045
			2014	*521,923*
Motor Trade Finance Limited	5	30-Sep	2016	596,520
			2015	*566,501*
Nelson Building Society	7	31-Mar	2016	558,666
			2015	*459,706*
Nissan Financial Services NZ Pty Limited	12	31-Mar	2016	302,254
			2015	*206,839*
ORIX New Zealand Limited	16	31-Mar	2016	229,862
			2015	*236,893*
Police & Families Credit Union	22	30-Jun	2016	118,835
			2015	*108,829*
Ricoh New Zealand Limited[18]	20	31-Mar	2016	136,592
			2015	*153,421*
Toyota Finance New Zealand Limited	2	31-Mar	2016	1,069,499
			2015	*1,129,650*
UDC Finance Limited	1	30-Sep	2016	2,665,019
			2015	*2,440,613*
Wairarapa Building Society	19	31-Mar	2016	139,189
			2015	*124,537*
Sector Total			**2016**	**11,009,624**
			2015	***9,377,483***

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

FOOTNOTES 17–18

and Strength Measures		Growth Measures			
Net Assets $000	Net Loans and Advances $000	Increase in Net Profit After Tax %	Increase in Total Assets %	Impaired Asset Expense $000	Provision for Doubtful Debts/ Gross Loans & Advances %
33,664	235,526	44.51	54.71	3,607	1.84
25,633	*148,874*	*-15.87*	*45.61*	*2,525*	*2.68*
25,772	344,100	-24.57	-4.80	2,922	2.72
18,645	*361,500*	*17.65*	*4.59*	*1,970*	*2.15*
38,674	212,550	16.17	10.36	202	0.34
36,669	*213,588*	*0.23*	*5.56*	*412*	*0.68*
21,132	107,250	-47.43	4.09	983	0.60
20,748	*92,945*	*130.47*	*10.51*	*559*	*0.98*
8,234	424,248	n/a	n/a	361	0.10
53,683	178,836	-23.34	13.36	395	1.36
49,955	*180,613*	*57.98*	*18.37*	*661*	*1.49*
351,567	283,332	23.11	27.30	225	0.33
276,174	*218,586*	*32.10*	*24.84*	*514*	*0.39*
79,246	674,598	-1.37	4.36	14,608	2.82
80,000	*639,236*	*42.06*	*6.89*	*13,340*	*2.63*
34,256	416,333	-269.81	-1.88	10,880	2.55
40,965	*437,476*	*-73.30*	*25.10*	*635*	*0.14*
27,487	91,894	18.13	2.87	2,380	4.00
25,771	*88,490*	*11.48*	*9.17*	*2,365*	*4.03*
17,066	151,550	6.43	4.76	0	0.00
14,765	*144,503*	*-28.17*	*11.17*	*0*	*0.00*
88,851	8,588	4.61	7.50	51	n/d
76,015	*5,491*	*-14.81*	*10.06*	*22*	*n/d*
26,140	134,465	32.81	-28.62	-111	0.11
38,188	*159,161*	*-39.15*	*-2.49*	*-129*	*0.19*
47,011	538,436	38.86	8.65	-845	1.31
35,841	*504,549*	*-10.03*	*12.42*	*3,217*	*1.79*
85,174	535,237	3.27	5.30	95	0.99
82,621	*512,151*	*13.01*	*4.73*	*105*	*0.99*
36,323	401,258	6.83	21.53	287	0.23
30,724	*360,478*	*17.51*	*10.98*	*354*	*0.21*
6,202	294,946	201.90	46.13	1,765	0.88
2,395	*201,212*	*2,435.19*	*134.75*	*1,294*	*0.61*
162,666	37,465	-0.84	-2.97	-406	0.10
147,342	*35,126*	*-5.33*	*3.19*	*-245*	*1.37*
21,133	60,591	-10.95	9.19	8	0.18
19,319	*64,284*	*26.30*	*10.56*	*-30*	*0.18*
65,557	84,578	26.18	-10.97	1,679	1.93
56,542	*87,732*	*-23.49*	*12.50*	*640*	*1.04*
146,272	754,412	29.45	-5.32	1,183	2.85
142,521	*698,954*	*-55.47*	*-0.81*	*1,273*	*3.01*
423,999	2,573,030	2.61	9.19	7,418	1.11
365,462	*2,347,163*	*10.68*	*3.66*	*10,427*	*1.33*
16,746	108,587	467.92	11.77	112	0.18
16,128	*103,870*	*-62.54*	*9.09*	*56*	*0.14*
1,816,855	**8,651,810**	**8.17**	**17.40**	**47,799**	**1.40**
1,602,423	***7,605,982***	***-5.91***	***8.64***	***39,965***	***1.44***

Non-banks – Analysis of annual results[17]

Entity	Year	Credit Quality Measures			
		Past Due Assets $000	Gross Impaired Assets $000	Impaired Asset Expense/ Average Loans & Advances %	Net Interest Margin %
Avanti Finance Limited	2016	1,345	14,205	1.84	9.98
	2015	*1,193*	*13,481*	*1.95*	*10.94*
BMW Financial Services New Zealand Limited	2015	n/d	n/d	0.81	6.82
	2014	*n/d*	*n/d*	*0.55*	*7.20*
Credit Union Baywide	2016	n/d	1,189	0.09	4.73
	2015	*n/d*	*4,414*	*0.20*	*5.16*
Credit Union South	2016	n/d	3,320	0.97	7.69
	2015	*n/d*	*1,858*	*0.63*	*8.08*
EFN (New Zealand) Limited	2015	4,388	n/d	n/a	n/a
First Credit Union	2016	786	5,155	0.22	4.01
	2015	*1,628*	*4,437*	*0.40*	*4.57*
First Mortgage Trust	2016	1,600	0	0.09	7.17
	2015	*4,388*	*0*	*0.25*	*7.69*
Fisher & Paykel Finance Holdings Limited	2015	n/d	25,502	2.16	11.30
	2014	*n/d*	*21,645*	*2.10*	*11.01*
Fuji Xerox Finance Limited	2016	n/d	n/d	2.51	2.79
	2015	*n/d*	*n/d*	*0.16*	*4.17*
Instant Finance Limited	2016	0	5,787	2.53	22.30
	2015	*0*	*5,739*	*2.69*	*21.25*
John Deere Financial Limited	2015	n/d	n/d	0.00	3.63
	2014	*n/d*	*n/d*	*0.00*	*3.63*
LeasePlan New Zealand Limited	2015	n/d	n/d	0.72	9.67
	2014	*n/d*	*n/d*	*0.35*	*9.91*
Medical Securities Limited	2016	12	n/d	-0.08	4.03
	2015	*183*	*n/d*	*-0.08*	*3.68*
Mercedes-Benz Financial Services	2015	n/d	n/d	-0.16	4.13
	2014	*n/d*	*n/d*	*0.67*	*4.23*
Motor Trade Finance Limited	2016	45	216	0.02	8.61
	2015	*77*	*55*	*0.02*	*9.06*
Nelson Building Society	2016	4	150	0.08	2.30
	2015	*112*	*0*	*0.10*	*2.57*
Nissan Financial Services NZ Pty Limited	2016	n/d	n/d	0.71	4.04
	2015	*n/d*	*n/d*	*0.91*	*3.59*
ORIX New Zealand Limited	2016	n/d	0	-1.11	12.22
	2015	*n/d*	*26*	*-0.71*	*12.35*
Police & Families Credit Union	2016	0	20	0.01	4.58
	2015	*110*	*35*	*-0.05*	*4.78*
Ricoh New Zealand Limited[18]	2016	n/d	3,645	1.92	9.52
	2015	*n/d*	*3,285*	*0.75*	*8.30*
Toyota Finance New Zealand Limited	2016	64	2,794	0.16	4.50
	2015	*87*	*3,234*	*0.17*	*4.43*
UDC Finance Limited	2016	1,230	17,657	0.30	4.50
	2015	*6,369*	*18,919*	*0.45*	*4.87*
Wairarapa Building Society	2016	1,279	3,845	0.11	2.25
	2015	*462*	*4,173*	*0.06*	*2.22*
Sector Total	**2016**	**10,753**	**83,485**	**0.58**	**5.68**
	2015	***14,609***	***81,301***	***0.54***	***6.09***

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

FOOTNOTES 17–19

	Profitability Measures				Efficiency Measures	
Interest Spread %	**Net Profit After Tax $000**	**Underlying Profit $000**	**NPAT/Average Total Assets %**	**NPAT/Average Equity %**	**Operating Expenses/Gross Revenues[19] %**	**Operating Expenses/ Operating Income %**
8.86	11,231	15,603	5.56	37.88	27.35	37.78
9.39	*7,772*	*10,764*	*5.81*	*33.52*	*32.40*	*44.24*
6.37	7,128	9,900	1.94	32.10	31.30	50.62
6.74	*9,450*	*13,139*	*2.57*	*47.44*	*28.35*	*45.37*
4.22	2,004	2,004	0.72	5.32	55.95	86.46
4.63	*1,725*	*1,725*	*0.67*	*4.82*	*58.08*	*87.10*
7.15	338	338	0.27	1.61	74.37	91.41
7.56	*643*	*643*	*0.54*	*3.16*	*76.49*	*91.97*
n/a	8,143	9,898	n/a	n/a	20.55	50.53
3.44	1,859	1,859	0.59	3.59	57.18	87.77
3.98	*2,425*	*2,425*	*0.89*	*5.39*	*55.49*	*82.69*
7.17	16,672	16,861	5.28	5.31	24.06	24.06
7.69	*13,542*	*14,134*	*5.41*	*5.45*	*23.06*	*23.06*
10.99	23,739	33,143	3.08	20.94	39.95	54.59
10.59	*24,068*	*33,522*	*3.30*	*20.33*	*38.43*	*53.24*
2.55	-6,709	-8,680	-1.50	-17.84	31.67	70.55
3.97	*3,951*	*6,631*	*0.97*	*10.13*	*28.19*	*44.01*
19.80	8,463	11,930	8.63	27.43	52.24	60.73
18.53	*7,164*	*10,298*	*7.74*	*24.44*	*53.01*	*62.55*
3.28	2,301	3,191	1.49	14.46	22.34	42.58
3.34	*2,162*	*3,008*	*1.51*	*15.80*	*22.85*	*41.48*
9.67	6,836	9,528	2.36	8.29	34.10	76.01
9.91	*6,535*	*9,160*	*2.45*	*8.98*	*31.79*	*74.04*
3.17	1,352	1,878	0.80	4.20	40.63	75.55
2.83	*1,018*	*1,415*	*0.51*	*2.70*	*42.48*	*83.21*
3.72	11,264	15,687	2.07	27.19	17.32	33.45
3.83	*8,112*	*11,128*	*1.65*	*22.13*	*16.23*	*30.88*
7.71	7,169	10,109	1.23	8.54	57.55	83.14
8.07	*6,942*	*9,999*	*1.25*	*8.50*	*55.61*	*82.94*
2.06	2,753	3,841	0.54	8.21	26.59	67.50
2.32	*2,577*	*3,587*	*0.59*	*9.06*	*28.34*	*67.52*
3.83	3,807	11,736	1.50	88.57	15.89	18.26
3.42	*1,261*	*4,806*	*0.86*	*71.47*	*19.80*	*25.08*
9.20	15,663	21,764	6.71	10.10	18.03	41.82
9.25	*15,795*	*21,950*	*6.77*	*11.32*	*17.26*	*41.91*
4.08	1,813	1,813	1.59	8.96	44.70	66.27
4.21	*2,036*	*2,035*	*1.96*	*11.13*	*40.18*	*61.29*
8.73	6,334	8,482	4.37	10.33	81.14	83.57
7.44	*5,020*	*7,538*	*3.46*	*9.19*	*83.67*	*87.13*
3.87	16,483	21,298	1.50	11.42	22.08	57.83
3.77	*12,733*	*17,112*	*1.12*	*8.46*	*20.61*	*61.99*
3.83	58,537	81,417	2.29	14.83	15.25	26.25
4.14	*57,050*	*79,323*	*2.38*	*16.14*	*14.89*	*26.45*
2.00	602	773	0.46	3.66	32.69	74.96
1.99	*106*	*359*	*0.09*	*0.66*	*33.90*	*84.81*
4.97	**207,782**	**284,373**	**2.04**	**11.89**	**33.32**	**55.43**
5.29	***192,087***	***264,701***	***2.13***	***12.12***	***33.27***	***56.13***

Cyber security: It's not just about technology

Philip Whitmore
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PHILIP'S BIO

Cyber security is an important concern for every financial services organisation. Daily occurrences demonstrate the risk posed by cyber attackers — from individual, opportunistic hackers, to professional and organised groups of cyber criminals with strategies for systematically stealing monies and intellectual property.

Financial services organisations are a prime target for cyber attacks and management faces the task of ensuring that their organisation understands the risks and sets the right priorities. This is no easy task in light of the technical jargon involved and the pace of change.

Focusing on technology alone to address these issues is not enough. Effectively managing cyber risk means putting in place the right governance and the right supporting processes, along with the right enabling technology.

This complexity, however, cannot be an excuse for management to divest responsibility to technical 'experts'. It is essential that leaders take control of allocating resources to deal with cyber security, actively manage governance and decision-making over cyber security, and build an informed and knowledgeable organisational culture.

Outlined below are the essential insights for management to get the basics right: the world of cyber crime today, the five common cyber security mistakes and the critical dimensions of a strong cyber security model.

Understanding the cyber risk

The amount of data continues to grow exponentially, as does the rate at which organisations share data through online networks. Billions of machines – tablets, smartphones, ATMs, environmental control systems, and other Internet of Things – are all linked together, increasing inter-dependencies exponentially. Organisations increasingly open their information technology (IT) systems to a range of machines and lose direct control of data security. Furthermore, business continuity, both in society and within companies, is increasingly dependent on IT. Disruption to these core processes can have a major impact on service availability.

Not all organisations are necessarily easy targets for cyber criminals.

Cyber criminals are very aware of these vulnerabilities. Driven by a wide range of motivations – from pure financial gain, to raising the profile of an ideology, to espionage or terrorism – individual hackers, activists, organised criminals and governments are attacking government networks with increasing volume and severity.

What is true for any financial services organisation is that cyber crime risks can be controlled.

But while the cyber threat is very real and its impact can be debilitating, the media often sketches an alarmist picture of cyber security, creating a culture of disproportionate fear. Not all organisations are necessarily easy targets for cyber criminals. For example, a small or mid-sized company has a very different risk profile than that of a multinational organisation.


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Organisations can reduce the risks to their business by building up capabilities in three critical areas – prevention, detection and response

Prevention

Prevention begins with governance and organisation. It is about installing fundamental measures, including placing responsibility for dealing with cyber security within the organisation and developing awareness training for key staff.

Detection

Through monitoring of critical events and incidents, an organisation can strengthen its technological detection measures. Monitoring and data mining together form an excellent instrument to detect strange patterns in data traffic, to find the location on which the attacks focus and to observe system performance.

Response

Response refers to activating a well-rehearsed plan as soon as evidence of a possible attack occurs. During an attack, the organisation should be able to directly deactivate all technology affected. When developing a response and recovery plan, an organisation should perceive cyber security as a continuous process and not as a one-off solution.

What is true for any financial services organisation is that cyber crime risks can be controlled. Cyber criminals are not invincible geniuses and, while they can cause real damage to your business, you can take steps to protect yourself against them. You may not be able to achieve 100 percent security, but by treating cyber security as 'business as usual' and balancing investment between risks and potential impacts, your organisation will be well prepared to combat cyber crime.

The five most common cyber security mistakes

To many financial services organisations, cyber security is a bit of a mystery. This lack of understanding has created many misconceptions among management about how to approach cyber security. From our years of experience, we have seen the following five cyber security mistakes repeated over and over – often with drastic results.

Mistake #1: 'We have to achieve 100 percent security'

Reality: 100 percent security is neither feasible nor the appropriate goal

Almost every airline company claims that flight safety is its highest priority while recognising that there is an inherent risk in flying. The same applies to cyber security. Whether it remains private or is made public, almost every financial services organisation will, unfortunately, be impacted by cyber crime.

Almost every financial services organisation will unfortunately be impacted by cyber crime.

Developing the awareness that 100 percent protection against cyber crime is neither a feasible nor an appropriate goal is already an important step towards a more effective strategy, because it allows you to make choices about your defensive posture. A good defensive posture is based on understanding the threat (i.e., the criminal) relative to organisational vulnerability (prevention), establishing mechanisms to detect an imminent or actual breach (detection) and establishing a capability that immediately deals with incidents (response) to minimise loss.

The emphasis at most New Zealand financial services organisations is often skewed towards prevention – the equivalent to building impenetrable walls to keep the intruders out. Once you understand that perfect security is an illusion and that cyber security is 'business as usual', you also understand that just as much emphasis needs to be placed on detection and response. After a cyber crime incident, which may vary from the theft of information to a disruptive attack on core systems, an organisation must be able to minimise losses and resolve vulnerabilities.

Mistake #2: 'When we invest in best-of-class technical tools, we are safe'

Reality: Effective cyber security is less dependent on technology than you think

The world of cyber security is dominated by IT companies that sell technical products. These tools are essential for basic security and must be integrated into the technology architecture, but they are not the basis of a holistic and robust cyber security strategy. The investment in technical tools should be the output, not the driver, of cyber security strategy.

Good security starts with developing a robust cyber defence capability. Although this is generally led by the IT department, the knowledge and awareness of the end user is critical. The human factor is and remains, for both IT professionals and the end user, the weakest link in relation to security. Investment in the best tools will only deliver a return when people understand their responsibilities to keep the systems safe. Social engineering, in which hackers manipulate employees to gain access to systems, is still one of the main risks that financial services organisations face.

The world of cyber security is dominated by IT companies that sell technical products.

Technology cannot help in this regard, and it is essential that management takes ownership of dealing with this challenge. They have to show genuine interest and be willing to study how best to engage with the workforce to educate staff and build awareness of the threat of cyber attacks. This is often about changing the culture so that employees are alert to the risks and are proactive in raising concerns.

Mistake #3: 'Our weapons have to be better than those of the hackers'

Reality: Your security strategy should primarily be determined by your goals, not those of your attackers

The fight against cyber crime is an example of an unwinnable race. The attackers keep developing new methods and technology, and the defence is always one step behind.

So, is it useful to keep investing in increasingly sophisticated tools to prevent an attack? So is it useful to keep investing in increasingly sophisticated tools to prevent attack?

It is critical for management to adopt a flexible, proactive and strategic approach to cyber security.

While it is important to keep up-to-date and to obtain insights into the intention of attackers and their methods, it is critical for management to adopt a flexible, proactive and strategic approach to cyber security. Given the immeasurable value of a financial services organisation's information assets and the severe implication of any loss to the core business, cyber security strategy needs to prioritise investment into critical asset protection, rather than the latest technology or system to detect every niche threat.

First and foremost, management needs to understand what kinds of attackers their business attracts and why. An organisation may perceive the value of its assets differently than a criminal. How willing are you to accept risks to certain assets over others? Which systems and people store your key assets, keeping in mind that business and technology have developed together and are therefore co-dependent on each other's security?

Mistake #4: 'Cyber security compliance is all about effective monitoring'

Reality: The ability to learn is just as important as the ability to monitor

Reality shows that cyber security is very much driven by compliance. This is understandable because financial services organisations have to accommodate a growing range of regulations. However, it is counterproductive to view compliance as the ultimate goal of cyber security policy.

Only a financial services organisation that is capable of understanding external developments and incident trends, and using this insight to inform policy and strategy, will be successful in combating cyber crime in the long term. Therefore, effective cyber security strategy should be based on continuous learning and improvement.

Effective cyber security strategy should be based on continuous learning and improvement.

Financial service organisations need to understand how threats evolve and how to anticipate them. This approach is ultimately more cost-effective in the long term than developing ever-higher security 'walls'. This goes beyond the monitoring of infrastructure; it is about smart analysis of external and internal patterns in order to understand the reality of the threat and the short, medium and long-term risk implications. This insight should enable organisations to make sensible security investment choices. Unfortunately, most organisations do not take a strategic approach and do not collect and use the internal data available to them.

Financial services organisations need to ensure that incidents are evaluated in such a way that lessons can be learned. In practice, however, actions are driven by real-time incidents and often are not recorded or evaluated. This destroys the ability of the organisation to learn and put better security arrangements in place in the future.

The same applies to monitoring attacks. In many cases, financial services organisations have certain monitoring capabilities, but the findings are not always shared with the wider organisation. No lessons, or insufficient lessons, are learned from the information received. Furthermore, monitoring needs to be underpinned by an intelligence requirement. Only if you understand what you want to monitor does monitoring become an effective tool to detect attacks.

Financial services organisations also need to develop an enterprise-wide method for assessing and reporting cyber security risks. This requires protocols to determine risk levels and escalations, and methods for equipping the board with insight into strategic cyber risks and the impacts to core business.

Mistake #5: 'We need to recruit the best professionals to defend ourselves against cyber crime'

Reality: Cyber security is not a department, but an attitude

Cyber security is often seen as the responsibility of a team of specialists in the IT department. This mindset may result in a false sense of security and lead to the wider organisation not taking responsibility.

The real challenge is to make cyber security a mainstream approach. This means, for example, that cyber security should become part of the boardroom agenda. It also means, that cyber security should have a central place when developing new IT systems, and not, as is often the case with most organisations, be given attention only at the end of such projects.

The six dimensions of cyber security

As management, you want to know whether your organisation has an adequate approach to cyber security. This involves considering six key dimensions that together provide a comprehensive and in-depth view of an organisation's cyber maturity.

1. Leadership and Governance

Is the organisation's leadership demonstrating due diligence, ownership and effective management of risk?

2. Human Factors

What is the level and integration of a security culture that empowers and ensures the right people, skills, culture and knowledge?

3. Information Risk Management

How robust is the approach to achieve comprehensive and effective risk management of information throughout the organisation and its delivery and supply partners?

4. Business Continuity

Have we made preparations for a security event and do we have the ability to prevent or minimise the impact through successful crisis and stakeholder management?

5. Operations and Technology

What is the level of control measures implemented to address identified risks and minimise the impact of compromise?

6. Legal and Compliance

Are we complying with relevant regulatory standards and guidance?

Addressing all six of these key dimensions can lead to a holistic cyber security model, providing the following advantages to any organisation:

– Minimising the risk of an attack on an organisation by an outside cyber criminal, as well as limiting the impact of successful attacks.
– Better information on cyber crime trends and incidents to facilitate decision making.
– Clearer communication on the theme of cyber security, enabling everyone to know his or her responsibilities and what needs to be done when an incident has occurred or is suspected.
– Improved reputation, as an organisation that is well prepared and has given careful consideration to its cyber security is better placed to reassure its stakeholders.
– Increased knowledge of competence in relation to cyber security.


Legal and
Compliance
Leadership
and Governance
Operations
and Technology
Human Factors
Business
Continuity
Information
Risk Management

Non-banks - Credit ratings

as at 9 December 2016

	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[20]	A+	Stable			A2	Positive		
Credit Union Baywide			BB	Stable				
Credit Union South	BB-	Stable						
EFN (New Zealand) Limited[21]								
First Credit Union	BB-	Positive						
First Mortgage Trust								
Fisher & Paykel Finance Holdings Limited[22]								
Fuji Xerox Finance Limited[23]							AA	Stable
Instant Finance Limited								
John Deere Financial Limited[24]			A	Stable	A2	Negative		
Leaseplan New Zealand Limited[25]	BBB-	Stable	BBB+	Stable	Baa1	Stable		
Medical Securities Limited								
Mercedes-Benz Financial Services[26]	A	Stable	A-	Stable	A3	Positive		
Motor Trade Finance Limited								
Nelson Building Society			BB+	Stable				
Nissan Financial Services NZ Pty Limited[27]	A-	Positive	BBB+	Stable	A3	Stable	A+	Stable
ORIX New Zealand Limited[28]	A-	Negative	A-	Stable	Baa1	Stable	A+	Stable
Police & Families Credit Union	BB+	Stable						
Ricoh New Zealand Limited[29]	A-	Negative					AA-	Negative
Toyota Finance New Zealand Limited[30]	AA-	Stable	A	Stable	Aa3	Stable	AA+	Stable
UDC Finance Limited	A-	Watch Neg						
Wairarapa Building Society			BB+	Stable				

FOOTNOTES 20–30

Non-banks - Ownership

as at 9 December 2016

Non-bank Entity	Ultimate Shareholding	%
Avanti Finance Limited	Various investment/ nominee companies	100
BMW Financial Services New Zealand Limited	BMW AG (Germany)	100
Credit Union Baywide	Various depositors	100
Credit Union South	Various depositors	100
EFN (New Zealand) Limited	EFN (Netherlands) Cooperatief U.A.	100
First Credit Union	Various depositors	100
First Mortgage Trust	Various unitholders	100
Fisher & Paykel Finance Holdings Limited	FlexiGroup Limited (Australia)	100
Fuji Xerox Finance Limited	Fuji Xerox Co. Ltd (Japan)	100
Instant Finance Limited	Various Private Shareholders	100
John Deere Financial Limited	Deere & Company (USA)	100
LeasePlan New Zealand Limited	LeasePlan Corporation (Netherlands)	100
Medical Securities Limited	Medical Assurance Society New Zealand Limited	100

Non-bank Entity	Ultimate Shareholding	%
Mercedes-Benz Financial Services New Zealand Limited	Daimler AG (Germany)	100
Motor Trade Finance Limited	Various Licensed Motor Vehicle Dealers	100
Nelson Building Society	Various depositors	100
Nissan Financial Services NZ Pty Limited	Nissan Motor Co. Ltd (Japan)	100
ORIX New Zealand Limited	ORIX Corporation (Japan)	100
Police & Families Credit Union	Various depositors	100
Ricoh New Zealand Limited	Ricoh Co. Ltd (Japan)	100
Toyota Finance New Zealand Limited	Toyota Motor Corporation (Japan)	100
UDC Finance Limited	Australia and New Zealand Banking Group (Australia)	100
Wairarapa Building Society	Various depositors	100

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.
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 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.

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 and 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.
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.
Definitions for operating income and operating expense have been adjusted in the current year to provide further clarity as to the calculation of these figures. In certain circumstances, direct expenses relating to other income have been reallocated from operating expense to operating income to ensure consistent presentation of income comparatives between entities. This would subsequently affect the calculation and analysis of performance ratios that are being driven by these figures.	

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