KPMG

FIPS

Financial Institutions Performance Survey
December 2017 Quarterly Results

1

Higher NPAT

1.56%

increase in NPAT

2

Lower net interest margin

4bps

drop in NIM

3

Slow lending growth

0.90%

increase in gross lending

4

Slightly higher costs

4.50%

rise in operating expenses

5

Higher write-offs

70.02%

increase in loan impairments

6

Continued improvement in loan quality

1.67%

reduction in provisions

Industry update

This quarter's publication builds on a few of the key themes (namely innovation, digitisation and conduct risk) which were noted in the annual publication released in February 2018. In this edition, we have also provided a brief macroeconomic update.

Inventive innovators

In the last quarter of 2017, the results of the Efma-Accenture Banking Innovation awards programme were released.[1] This programme is an initiative which aims to identify and award the most innovative projects in the retail banking sector at a global level. This programme is in its fifth year and aims to share worldwide best practices in the retail banking distribution and marketing arenas. Innovations in ten categories are recognised, including two overarching awards for Global Innovator of the Year. A total of 183 financial institutions from 59 countries submitted 467 innovations. The three criteria used for evaluation included:

– originality;
– strategic capacity to generate long-term competitive edge and return on investment; and
– adaptability for use in other markets and countries.

Some notable awards winners and their ideas are discussed below:

Farming on tap through an app

The agricultural banking app from Turkey-based DenizBank won the award for the *Best New Product or Service*. The app was recognised for demonstrating how "banking can be at the centre of a lifestyle ecosystem, going far beyond a traditional banking application". Through the app, farmers can access insights from regional farming experts on crop rotation, planting, irrigation, and fertilisation; and can review and purchase machinery. In this case, the bank has clearly demonstrated the value it can source and bring to the table to create something that is truly customer-centric.

All aboard the banking train

Idea Bank, which is based in Poland, won an innovation award for its 'Idea Hub Express' train service. This service is geared towards its niche market of small to medium-sized entities (SME) business owners travelling cross-country on business trips and basically offers a fully-functional co-working space similar to that of a business class airport lounge – except that it is available *during* one's journey rather than *before* it. The train carriages are fitted out with desks, chairs, Wi-Fi connections, charging points, printers and scanners. There is even a coffee machine to give one's entrepreneurial flair a caffeinated kick-start.[2]

Empowered entrepreneurs

Another Polish bank received the *New Business Ecosystems* award for its "mPower Business Starter". This package of service offerings integrates government, bank and accounting services "to create an easy and intuitive new business customer (entrepreneur) user experience". This suite of services can dramatically reduce the time to establish a new business from ten days to ten minutes. Through using digital signatures and by bringing together separate "e-government" services into one suite, such an improvement eliminates the need for separate logins and portals, thus allowing entrepreneurs to focus on their innovative ideas rather than procedural tasks while not missing out on jumping through any of the necessary regulatory and operational hoops.

Accessible advertising

DBS Singapore won the *Digital Marketing* award for its DBS Sparks mini-series which was distributed through the YouTube platform. By using the real stories of actual customers and employees, "there was authenticity that was not possible in a traditional ad". The taglines used in promoting the content are "There are TV shows about lawyers, doctors and detectives. But there aren't any about bankers and banking. Inspired by true stories, SPARKS is a mini-series by DBS which follows a group of bankers as they navigate work and their personal lives. A smart and sassy portrayal of how the power of purpose and having the right banking partner enables everyone to get a lot more out of life – and a lot more joy from banking."

This marketing format may be just the thing to make inroads into unbanked and underbanked markets.

In analysing the viewing data, DBS realised that the format resonated with customers in the bank's developing markets (Indonesia, China and Taiwan), thus suggesting that this marketing format may be just what is needed to make inroads into unbanked and underbanked markets where banks are not necessarily seen as trustworthy yet.[3]

The pocket-sized porta-till

Barclaycard was the winner in the *Wallets and Payments* category with their 'Grab+Go' app. This innovative app turns the consumer's smartphone into a portable scanner and checkout till point, thus eliminating all the mindless tedium of waiting in a long queue and the requirement to make casual small talk with the cashier about the weather. In addition, this app also prevents the kids sneakily grabbing a couple of the strategically-placed chocolate bars.[4]

This innovative app turns the consumer's smartphone into a portable scanner and checkout till point.

The concept works as follows: The consumer browses around the store and scans the barcodes of the items they wish to purchase as they select the desired items from the shelves. Once done, they click on 'checkout'. This action initiates an 'invisible' and 'plastic-free' payment which is routed via the previously stored credit or debit card details which are housed in a secure database.

Challenger banks: Throwing down the digital gauntlet

So-called 'Challenger' and 'Neo' banks have recently made business headlines – usually connected with large swaths of venture capital (VC) funding[5] British banks Atom Bank and Monzo raised over US$120 million each in their 2017 rounds of financing. The VC financiers, who are intent on sniffing out profitable business strategies, can see the value that non-traditional banking models may be able to create. Even Sir Richard Branson, the well-known creator of the Virgin brand, is getting into the game with a Virgin Money digital bank that "will be underpinned by next generation technology and architecture."[6]

So, what is a 'Challenger' bank? And are 'Neo' banks simply fintech start-ups? A 'Challenger' bank is likely an established mid-sized or specialist bank that is seeking to compete with larger institutions. 'Neo' banks are purely digital and mobile-based. However, since both 'Challenger' and 'Neo' banks are unhindered by the burdens of legacy systems, they are more agile and adaptable than conventional banks – and can easily spell 'disruption' for traditional banking models.

Although most of these 'Challenger' and 'Neo' banks are based in the UK, where the market is not dominated by an oligopoly, unlike countries such as the US and New Zealand, there are other examples of these new-age disruptors in Asia. These disruptor Asian banks are often linked to or funded by well-known companies – for instance, MyBank and WeBank, which are both based in China and are backed by Alibaba Group and Tencent Holdings, respectively.

'Challenger' and 'Neo' banks are generally focused on servicing niche segments of the retail banking value chain rather than providing a full suite of services. An advantage of this model is that the regulatory yoke is less burdensome. Recent changes in legislation around open banking in the European region have also played well into the hands of those operating non-traditional banks. Furthermore, while those operating traditional banks have historically treated digital offerings as an afterthought, digital only banks have the advantage of being mobile app first and foremost.

On the other hand, traditional players not only have the advantage of economies of scale that comes with a large customer base but also tend to have well-known brands that are trusted by potential customers. More and more traditional banks are also seeking to zone in on the mind of the millennial by funding innovation labs and embarking on partnerships with fintech start-ups.

Nevertheless, regardless of how steady a traditional bank's position appears to be, those operating 'Challenger' and 'Neo' banks, with their solid fintech value propositions, will most likely continue to examine how to disrupt the industry and possibly drive a new wave of innovation in this age-old industry.

Considering the pool of registered banks in New Zealand and their operating models, we have not really seen any clear VC funded disruptors such as 'Challenger' or 'Neo' banks emerge. If we were to look more broadly at the lending and deposit taking sector, we may consider that some of the non-bank financial institutions fit the definitions. Certainly the peer-to-peer lenders may certainly be considered to fit the 'Neo' bank description quite well, due to their tech-savvy front ends and their use of the new-age concept of crowdfunding. Further, given that some non-bank financial institutions do hold stronger positions in niche financial markets such as vehicle and equipment finance than conventional banks, those financial institutions may fall into the 'Challenger' bank bill.

Dotting the 'i's and crossing the 't's

Recently, the Harvard Business Review Journal (HBR) released an article discussing the efficacy of companies' compliance efforts.[7] Banks who are subject to a plethora of rules, regulations and statutes are obliged to essentially comply or die.

The article scathingly states that, despite companies spending 'staggering' amounts on compliance efforts which include training programmes, hotlines, and other controls which are designed to prevent and detect non-compliance, the "ubiquity of corporate misconduct is especially surprising" and "malfeasance remains deeply entrenched in private enterprises today".

The HBR article emphasises that the causes of this inefficacy can be explained by, firstly, a lack of tangible metrics to measure compliance and, secondly, the approach to compliance as a 'check-the-box' exercise. Sure, you received the email and clicked through the web-based 'e-learning' course; the real question is whether you absorbed the message and *listened* rather than just *heard*.

The article advises that the first step to follow is to recognise that compliance programmes have multiple objectives and that the three main goals are to prevent misconduct; detect misconduct; and to align corporate policies with laws, rules and regulations. Each component of the proposed compliance programme should be clearly linked to one of these objectives. Clearly identifying the goals will assist in developing meaningful metrics.

The next step involves developing measurable and relevant metrics and actually measuring whether the goals have been achieved. The article provides an example of how to go about doing this in the case of a confidential whistle-blower hotline; that is to say, the company should test whether the hotline works, and determine based on usage data whether it is actually being used, what it is being used for, when and in what manner the allegations are investigated, and how the results of the investigations are reported and actioned.

Given that conduct risk should be front and centre for banks, banks should be thinking critically about how they currently approach compliance and whether the mindless check-the-box exercises really fit the bill or not.

The HBR's guidelines for best practice, as explained above, could be useful for directors in demonstrating their adherence to the tenets espoused in the recent review of the directors' attestation regime which was conducted by the Reserve Bank of New Zealand (RBNZ).[8] In its review, the sector's regulator suggested certain enhancements to the current governance processes such as "formally embedding a positive assurance process for attestation sign-off". Per the RBNZ, the review "highlighted that most banks adopt a limited or 'negative' assurance process whereby management states to directors that they are not aware of any compliance or risk appetite breaches. The Reserve Bank would prefer to see senior management actively demonstrating or providing evidence of compliance to directors".

TABLE 1: Recent real estate metrics (Changes year-on-year for February 2017 to February 2018)

	National	National excl. AKL	Auckland (AKL)
Seasonally adjusted median price	Up 7.1%	Up 8.5%	Up 3.9%
Median days to sell	4 days longer	3 days longer	6 days longer
REINZ house price index	Up 3.9%	Up 6.9%	Up 1.1%

Some key economic metrics

From the December 2016 quarter to the December 2017 quarter, the Consumer Price Index (CPI) inflation rate was 1.6 percent.[9] Some notable changes impacting this were as follows:

- housing and household utilities increased 3.0%, with construction up 5.3%, and rentals for housing up 2.3%;
- food prices increased 2.3%, with grocery food prices up 2.5%, and restaurant meals and ready-to-eat food up 2.3%; and
- telecommunication services prices fell 6.3%, due to better-value data plans.

In September 2017, the year-on-year percentage change in real Gross Domestic Product (GDP) was 3.0%.[10] Some notable matters arising during the September quarter were as follows:

- the construction industry led economic growth;
- there was steady growth in the service industries;
- there were mixed results across other industries; and
- New Zealanders spent more in the quarter on audio-visual equipment, clothing, and cars.

Per the ANZ Business Outlook survey, business confidence metrics indicated that a net 19% of business owners are pessimistic about the year ahead.[11] According to ANZ, "a slower housing market, a small dip in net migration, difficulty finding credit and already stretched construction and tourism sectors are making acceleration hard work from here. But strong terms of trade and a positive outlook for wage growth are providing a push".

Recent real estate metrics are shown in Table 1 (changes year-on-year for February 2017 to February 2018).[12]

Quarterly analysis

Our review of the banking sector's performance for the December quarter shows net profit after tax continued to grow, setting an all-time quarterly record of $1.40 billion, off the back of strong growth in non-interest income.

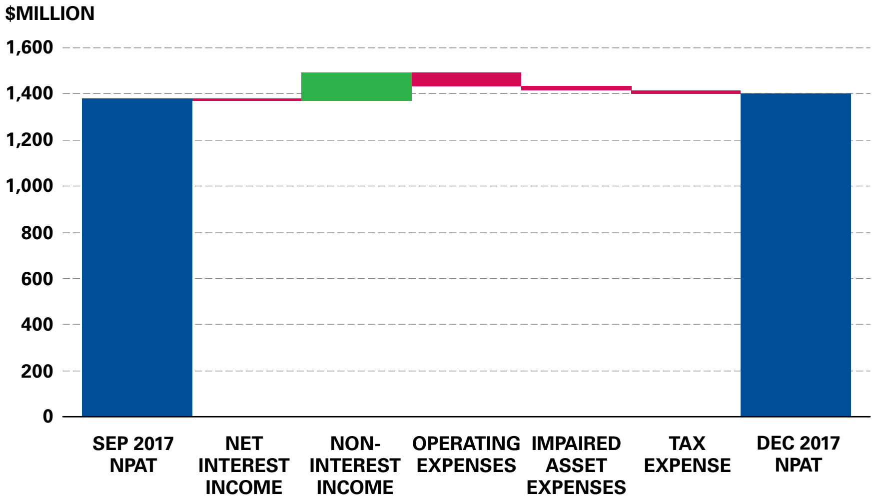
Net profit after tax (NPAT)

NPAT rose slightly by 1.56% ($21.56 million) in the quarter, up from $1.38 billion to $1.40 billion. BNZ ($30.00 million), ANZ ($15.00 million) and Kiwibank ($14.00 million) were the drivers of this movement, together contributing an increase of $59.00 million which was offset somewhat by NPAT decreases reported by ASB ($17.00 million), Westpac ($14.00 million) and TSB ($6.76 million).

1 SEE FIGURE 1 – PAGE 6

BNZ was the only major bank that achieved an increase in NPAT while experiencing a decrease in net interest income. BNZ's increase in NPAT was mostly attributable to both a significant decrease in impairment asset expense, decreasing by $38.00 million (92.68%), to $3.00 million, and a considerable increase in non-interest income of $27.00 million (20.93%) to $156 million.

1 MOVEMENT IN NET PROFIT AFTER TAX



This movement was partly offset by a $15.00 million (-3.08%) decrease in net interest income and an increase in operating expenses of $9.00 million (3.85%).

ANZ's increase of 2.97% in NPAT resulted from an increase in both net interest income of $13.00 million (1.67%) to $793.00 million and non-interest income of $37.00 million (12.76%) to $327 million. However, this movement was offset by a $19.00 million rise in operating expenses to $386.00 million (5.18%).

ASB was the only major bank to achieve a higher increase in net interest income ($23.00 million; 5.09%) than non-interest income ($5.00 million; 3.38%). However, a large increase in impaired asset expense of $41 million (256.26%) meant their NPAT declined this quarter.

SBS's NPAT rose by $0.95 million to $6.65 million and The Co-operative Bank's NPAT increased by $0.33 million to $3.41 million. Heartland experienced a small decrease in NPAT, dropping by $0.96 million to $15.06 million, while TSB suffered a large 40.33% decrease of $6.76 million to $10.00 million. TSB's result was mostly due to a significant decrease in non-interest income of $8.72 million, a 62.58% reduction, to $5.21 million.

The main drivers for the total increase in NPAT for all banks in the survey are detailed below:

- Net interest income decreased slightly by $9.62 million (0.40%) to $2.40 billion.
- Non-interest income increased by 15.76%, or $120.07 million, to $882.16 million. All banks except TSB reported increases in non-interest income.

TABLE 2: Movement in interest margin	31 Dec 17 quarter ended (%)	Movement during the quarter (bps)	Movement for the 6 months (bps)	Movement for the 12 months (bps)
ANZ	2.19%	1	5	1
BNZ	2.10%	-11	4	3
CBA	2.04%	5	12	7
Heartland Bank	4.37%	-12	-17	-7
Kiwibank	2.05%	10	10	13
SBS Bank	2.68%	16	25	8
The Co-operative Bank	2.29%	5	7	-10
TSB Bank	1.80%	-4	-2	-38
Westpac	1.96%	-20	-7	-7
Average	**2.11%**	**-4**	**4**	**1**

- Operating expenses increased by 4.50% ($55.71 million). Every survey participant experienced a growth in operating expenses.
- Loan book growth continued the trend over the past year of slower sustained growth, showing a 0.90% ($3.60 billion) rise.
- Impaired asset expense increased by $19.10 million (70.02%) to $46.38 million, and varied largely from the prior quarter for most of the banks.

Asset quality

Impaired asset expense increased by 70.02%, from $27.28 million in the previous quarter to $46.38 million this quarter. Seven of the nine banks surveyed experienced increases, with ASB ($41.00 million) and Westpac ($33.00 million) being the driving forces for the substantial rise. However, substantial decreases were also reported by BNZ ($38.00 million) and Kiwibank ($21.00 million), which partially offset the large increases.

As gross loans have remained relatively stable, the ratio of impaired asset expense to average gross loans and advances increased by 2 bps to 0.05%; historically speaking, this number is still a relatively low one. Although all banks increased the value of their gross loan books, the mixed experience with respect to impaired asset expense meant that no clear trend was observable in this ratio across the survey participants.

Past due assets decreased slightly this quarter by 2.10% ($12.01 million), to $561.37 million. However, only three of the nine banks actually achieved reductions in this metric. BNZ achieved the largest reduction in past due assets at $34.00 million (22.67%) to $116.00 million, while SBS reduced past due assets by 17.37% ($0.79 million) and followed closely by The Co-operative Bank at 17.31% ($0.84 million). TSB had the largest percentage increase in past due assets in the quarter of 23.78% ($2.03 million), increasing past due assets to $10.54 million.

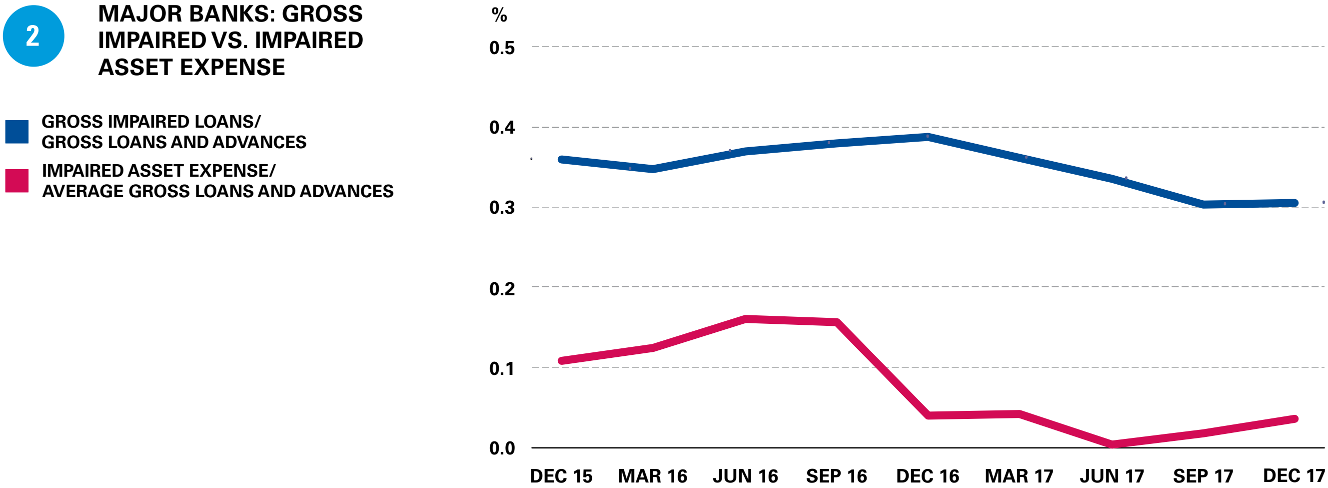
The ratio of total provisions to gross loans and advances for the majority of survey participants declined, thus resulting in a collective decrease of 1 bps, with ASB, Heartland, The Co-operative Bank, TSB and Westpac all reporting slight decreases in the ratio. This reduction is mostly due to the decrease in the level of specific provisions of 4.09% ($14.92 million). ANZ was the key driver of this movement, with a 22.22% decrease (of $28.00 million) in their specific provision. This decrease was only partly offset by ASB's 16.98% increase of $9.00 million and BNZ's 3.77% increase of $4.00 million.

Lending

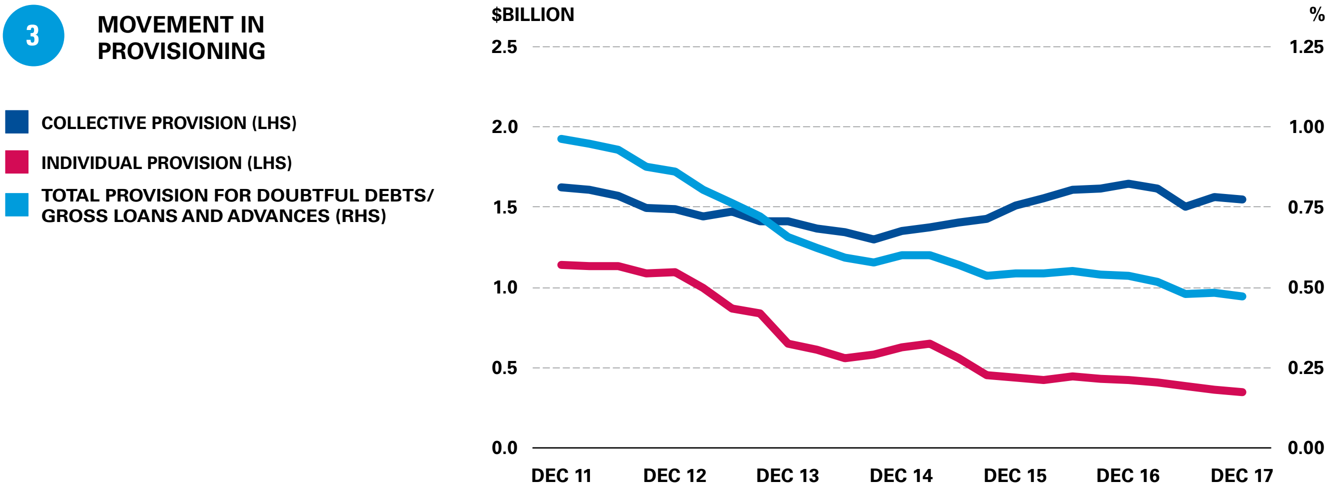
Overall, the bank's lending continued its trend of slow growth over the quarter, growing by a slight 0.90% to $401.65 billion, largely consistent with the prior quarter's growth of 0.89% (to $398.05 billion), compared to 1.48% growth in the December 2016 quarter. Every bank surveyed reported increases in their loan books, with TSB having the fastest growth rate of 3.21% ($160.97 million), while ANZ had the lowest percentage-based increase at 0.36% ($451.00 million), although this is off the highest base figure in the industry.

All major banks displayed low loan book growth rates in percentage terms, ranging between 0.96% (Kiwibank) and 0.36% (ANZ), with the exception of ASB which grew its loan book at a relatively high rate of 1.93% ($1.58 billion) despite its focus on balanced lending.

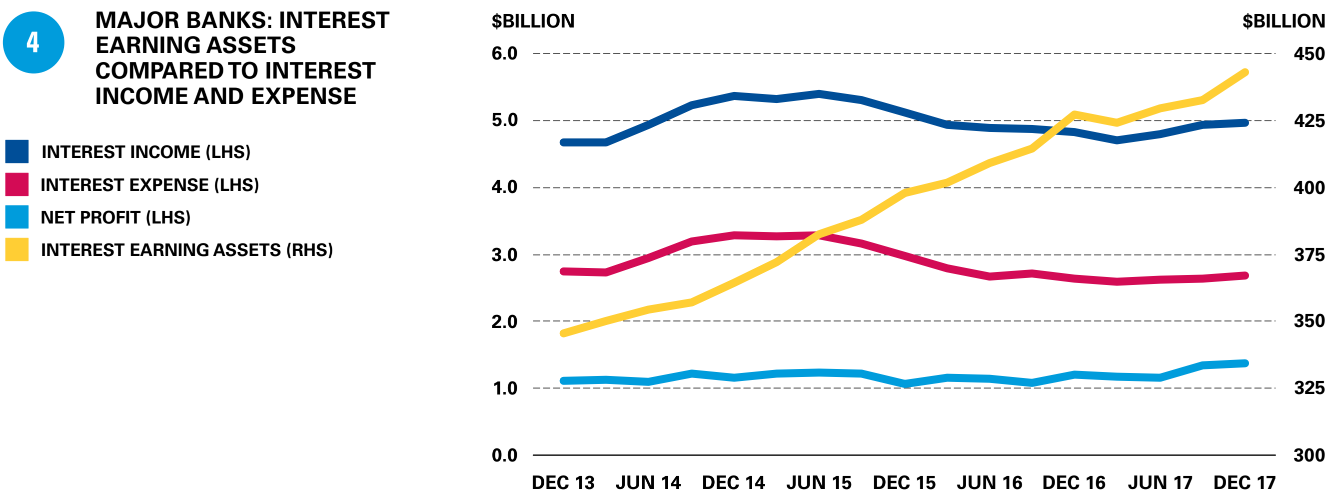
2 MAJOR BANKS: GROSS IMPAIRED VS. IMPAIRED ASSET EXPENSE



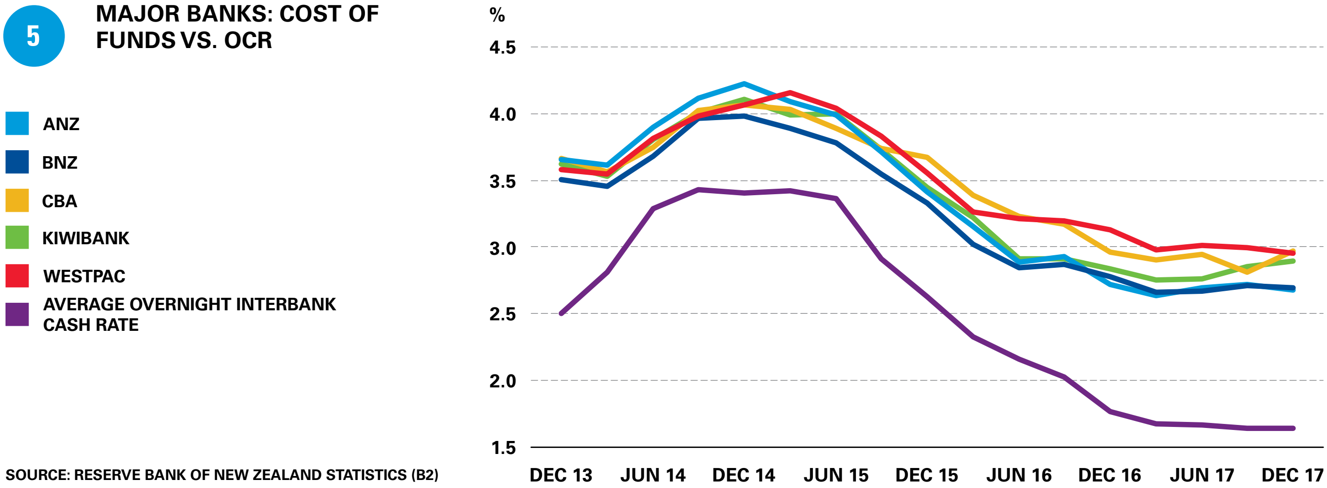
3 MOVEMENT IN PROVISIONING



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

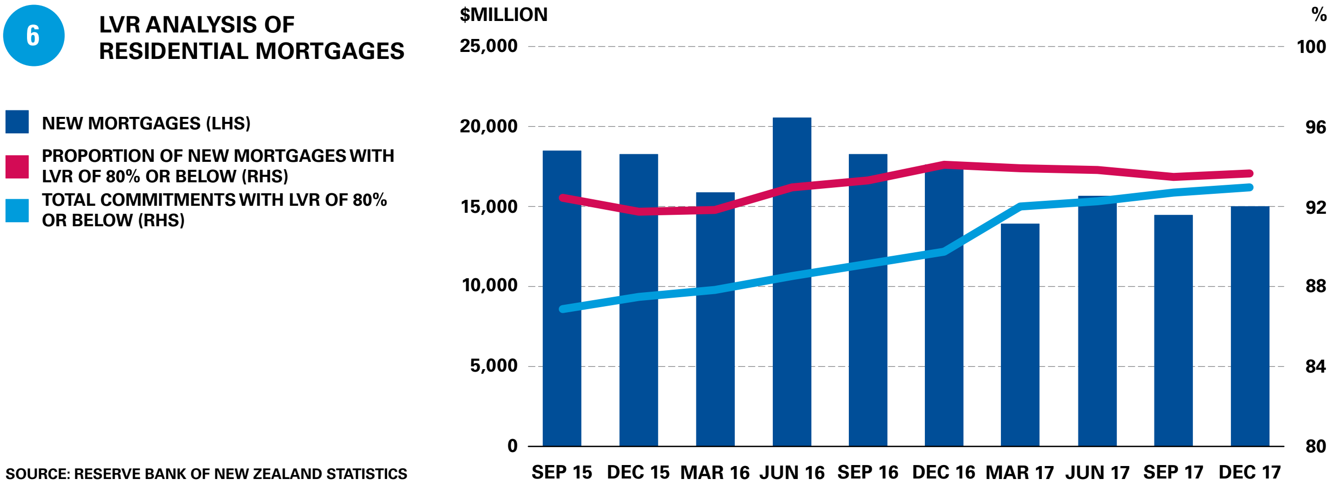


5 MAJOR BANKS: COST OF FUNDS VS. OCR



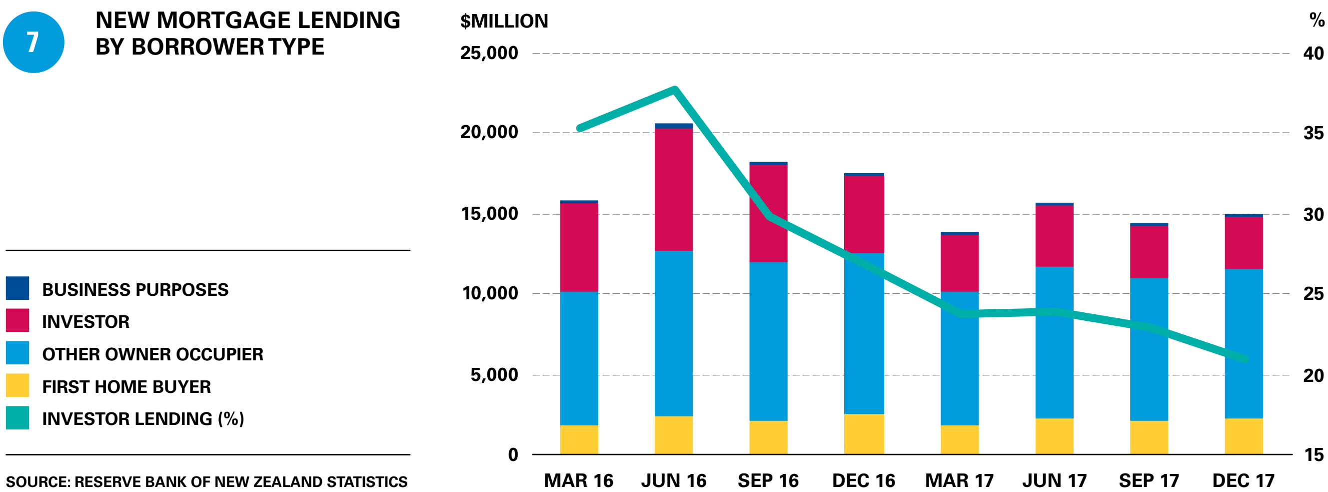
SOURCE: RESERVE BANK OF NEW ZEALAND STATISTICS (B2)

6 LVR ANALYSIS OF RESIDENTIAL MORTGAGES



SOURCE: RESERVE BANK OF NEW ZEALAND STATISTICS

7 NEW MORTGAGE LENDING BY BORROWER TYPE



SOURCE: RESERVE BANK OF NEW ZEALAND STATISTICS

All non-major banks (Heartland, SBS, The Co-operative Bank and TSB) again increased their lending at higher growth rates than those experienced by the major banks, with increases ranging between 3.21% (TSB) and 2.07% (SBS). Despite Heartland reporting the second largest growth rate in its loan book (at 2.81% or $104.28 million), the bank still experienced a decrease in NPAT (of 6.02%). In their preliminary results announcement, they stated that "the strong growth in net receivables was not reflected in net operating income due to a large proportion of the new business coming from lower risk, lower margin loans."[13]

Based on RBNZ statistics, residential housing loans again accounted for 56% of total loans in the December quarter, remaining consistent with the prior quarter.[14] Total sector loans in the quarter increased by 1.46% ($6.19 billion), while residential housing loans increased at a slightly lower rate of 1.34% ($3.20 billion) and business loans increased at a slightly faster rate of 1.54% ($1.56 billion), with business loans accounting for 25% of the total increase. Amongst the subcategories, 'loans to financial institutions' grew by a notable 15% ($1.29 billion), whereas the 'other loans' category registered the largest fall, dropping 4.90% ($134.00 million).

In terms of market share for survey participants, ANZ still accounts for the highest percentage of total loans at 31.32% but this has decreased by 17 bps from the prior quarter. ASB remains in second and achieved a 21 basis points (bps) increase to 20.86% of total gross loans and advances, followed closely by BNZ at 20.02% and Westpac at 19.55%, which both had, had reductions of 5 bps each. Kiwibank's market share remained steady at 4.5%.

TABLE 3: Movement in impaired asset expense/ Average gross loans	31 Dec 17 quarter ended (%)	Movement during the quarter (bps)	Movement for the 6 months (bps)	Movement for the 12 months (bps)
ANZ	0.04%	1	0	-8
BNZ	0.01%	-20	2	-10
CBA	0.12%	20	6	2
Heartland Bank	0.57%	1	10	21
Kiwibank	-0.22%	-47	-9	-17
SBS Bank	0.45%	13	15	5
The Co-operative Bank	0.11%	1	0	1
TSB Bank	0.10%	4	2	-3
Westpac	0.03%	17	10	22
Average	**0.05%**	**2**	**4**	**0**

Operating expenses

All survey participants reported increases in operating expenses for the quarter, resulting in an aggregated rise of in operating expenses of 4.50% ($55.71 million), partly off-setting the prior quarter's decrease of 8.66% ($117.24 million). The largest increase in operating expenses originated from Kiwibank, which saw an 8.00% increase (to $108.00 million). At the other end of the spectrum, TSB experienced a very small increase in operating expenses at 1.17% ($0.26 million); however, their operating income decreased by a notable 19.14%.

The overall operating cost ratio (operating expense/operating income) increased by 390 bps, a trend which was largely due to the 1194 bps movement from the outlier, TSB, who saw a significant drop in non-interest income. While six of the nine banks experienced increases, the second largest increase in this ratio was reported by Heartland at 84 bps to 44.54%, followed by BNZ at 71 bps to 38.69%. Heartland's rise in operating expenses "was partly due to depreciation of the new core banking system as well as additional expenditure incurred in relation to the implementation of this system."[15]

The largest reduction in the operating cost ratio was reported by SBS with a 283 bps decline to 64.26%; this reduction was due to a 10.50% ($3.54 million) increase in operating income from the prior quarter, whereas their operating expenses only increased by 5.83% ($1.32 million).

TABLE 4: Analysis of gross loans	Quarterly analysis			Annual analysis		
	31 Dec 17 quarter ended $Million	30 Sep 17 quarter ended $Million	% Increase	31 Dec 17 quarter ended $Million	31 Dec 16 quarter ended $Million	% Increase
ANZ	125,803	125,352	0.36%	125,803	122,305	2.86%
BNZ	80,408	79,904	0.63%	80,408	76,248	5.46%
CBA	83,801	82,217	1.93%	83,801	79,601	5.28%
Heartland Bank	3,815	3,711	2.81%	3,815	3,362	13.48%
Kiwibank	18,065	17,893	0.96%	18,065	17,477	3.36%
SBS Bank	3,782	3,705	2.07%	3,782	3,260	16.01%
The Co-operative Bank	2,270	2,219	2.26%	2,270	2,046	10.93%
TSB Bank	5,181	5,020	3.21%	5,181	4,467	15.99%
Westpac	78,527	78,031	0.64%	78,527	76,560	2.57%
Total	**401,652**	**398,053**	**0.90%**	**401,652**	**385,326**	**4.24%**

The other notable decrease was from The Co-operative Bank which dropped 123 bps, from 74.55% to 73.32% followed along the same trend as SBS.

Westpac's operating cost ratio remained relatively consistent with that of the previous quarter and only decreased slightly by 3 bps (to 40%), while both ANZ and ASB reported small increases of 17 bps (to 34.46%) and 19 bps (to 35.19%), respectively. ASB attributed this trend to "a continued focus on cost management, despite some significant regulatory compliance costs, and higher technology expenses."[16] Kiwibank continued to have the highest operating cost ratio at 79.41%, up 67 bps from the prior quarter.

Net interest margin (NIM)

Movements in NIM in the quarter were mixed, with just five banks seeing increases in their NIM. Kiwibank had the largest increase of the major banks, and the second largest increase of survey participants, with a 10 bps rise to 2.05%, which they credited to reduced funding costs and opportunities with market pricing.

SBS's NIM grew the most, increasing by 16 bps to 2.68%, while The Co-operative Bank and ASB both achieved increases of 5 bps from the prior quarter. ANZ's NIM was relatively stable, only increasing by 1 bps to 2.19%. Westpac saw the largest drop in NIM in the quarter, dropping by 20 bps to 1.96%. This decline caused Westpac to fall to the lowest NIM of all the major banks. Heartland had the next largest decrease at 12 bps to 4.37%; however, despite this quarter's reduction in NIM, Heartland continued to have the highest margin of all the banks surveyed.

Only three of the banks (Kiwibank, SBS and The Co-operative Bank) managed to increase their interest income to average interest earning assets ratios for the quarter, as interest income remained relatively stable and interest earning assets increased for all banks except Kiwibank. The lack of change in interest income over the quarter appears to be due to the current low interest rate environment and slowdown in lending, as mentioned by ASB and Kiwibank in their press releases.[17, 18]

The Co-operative Bank saw the largest rise in the ratio of interest income to average interest-earning assets, gaining 31 bps to 5.53%. BNZ saw the largest decrease of the major banks, falling 10 bps to 4.50%, while Heartland saw the largest drop at 11 bps (to 7.44%), but retained the highest percentage of those surveyed.

TABLE 5: Movement in over 80% LVR lending (On and off balance sheet)								
	Quarterly analysis				Six month analysis			
Quarterly analysis	31 Dec 17 $Million	30 Sep 17 $Million	Movement during the quarter $Million	% Change	31 Dec 17 $Million	30 Jun 17 $Million	Movement during the 6 month period $Million	% Change
ANZ	4,561	4,846	-285	-5.88%	4,561	5,120	-559	-10.92%
BNZ	2,784	2,878	-94	-3.27%	2,784	2,948	-164	-5.56%
CBA	4,566	4,637	-71	-1.53%	4,566	4,844	-278	-5.74%
Heartland Bank	24	17	7	41.07%	24	21	3	13.16%
Kiwibank	1,631	1,661	-30	-1.81%	1,631	1,848	-217	-11.74%
SBS Bank	409	373	37	9.82%	409	345	65	18.77%
The Co-operative Bank	229	228	1	0.24%	229	225	4	1.98%
TSB Bank	413	401	12	2.89%	413	388	25	6.50%
Westpac	4,294	4,398	-104	-2.36%	4,294	4,586	-292	-6.37%
Total	**18,911**	**19,439**	**-528**	**-2.72%**	**18,911**	**20,324**	**-1,413**	**-6.95%**

Funding

Funding costs have remained flat from prior quarters, with a small increase in the ratio of interest expense to average interest bearing liabilities of 1 bps to 2.82%. This relative stability is partly due to the RBNZ's Official Cash Rate remaining steady at 1.75% p.a. since November 2016, and the wholesale funding costs remaining relatively flat over the period.

The slight increase in funding costs was due to interest expense increasing at a slightly higher rate of 1.88% ($51.88 million) to $2.81 billion than interest-bearing liabilities (which rose by 1.26%).

ANZ was the only bank that reduced their interest expense, dropping 0.59% ($5.00 million), despite a 0.97% ($1.21 billion) increase in interest-bearing liabilities. Kiwibank and ASB both managed to keep their interest expense figures the same as the previous quarter; however, Kiwibank reduced its interest-bearing liabilities by 1.38% ($231.00 million), while ASB's interest-bearing liabilities ticked up by 2.46% ($2.01 billion) following its increase in lending over the quarter.

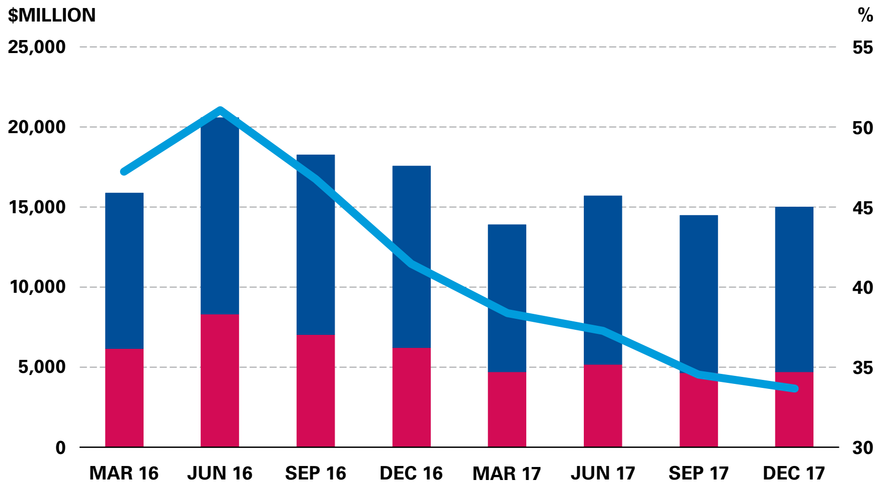
BNZ had the largest increase in interest-bearing liabilities of the major banks at 2.98% ($2.35 million) to reach $81.38 billion. However, ANZ had the largest interest-bearing liabilities balance at $126.77 billion (0.97% growth), with ASB in second place with interest-bearing liabilities of $83.65 billion (2.46% growth), in line with their respective market share rankings of gross loans.

Of the major banks, ANZ, BNZ and ASB all had reductions in finance costs of 4 bps (to 2.68%), 2 bps (to 2.69%) and 4 bps (2.95%), respectively. Westpac and Kiwibank experienced increases in funding costs, with Westpac's metric rising by 16 bps off the back of a 7.10% increase in interest expense together with a reduction of interest-bearing liabilities of 0.90%, while Kiwibank's metric rose by 4 bps. However, of all the banks surveyed, The Co-operative Bank's funding costs rose the most by 31 bps to 3.69%, with an increase in interest expense of 11.87% ($2.18 million).

8 NEW MORTGAGE LENDING BY PAYMENT TYPE

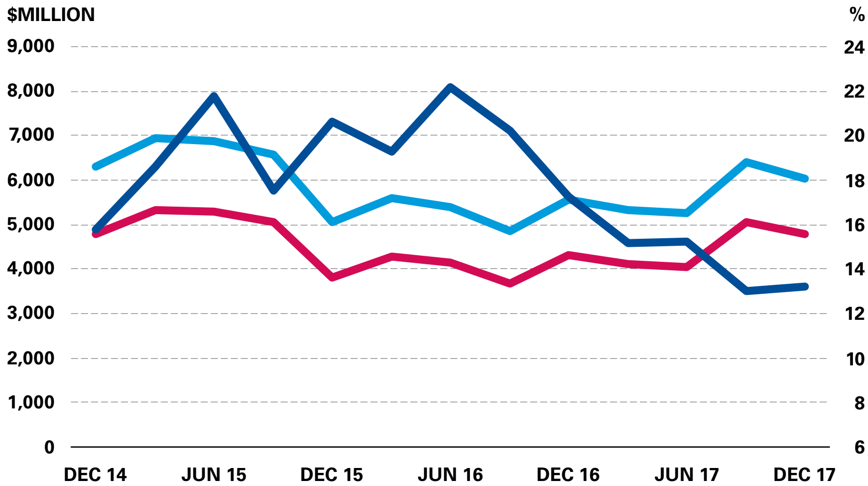
- PRINCIPAL AND INTEREST
- INTEREST ONLY (INCLUDING REVOLVING CREDIT)
- PROPORTION OF NEW LENDING INTEREST ONLY – INVESTOR

SOURCE: RESERVE BANK OF NEW ZEALAND STATISTICS



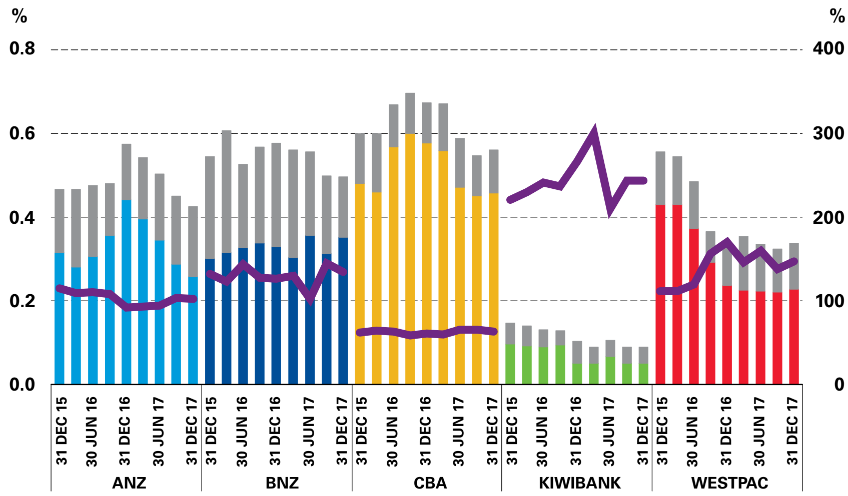
9 GROWTH IN GROSS LOANS & ADVANCES VS. RETURN ON ASSETS & RETURN ON EQUITY

- GROWTH IN GROSS LOANS & ADVANCES (LHS)
- RETURN ON EQUITY (RHS)
- RETURN ON ASSETS (RHS)



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

- GROSS IMPAIRED/GROSS LOANS AND ADVANCES (LHS)
- PAST DUE/GROSS LOANS AND ADVANCES (LHS)
- TOTAL PROVISIONS/PAST DUE AND GROSS IMPAIRED ASSETS (RHS)



Major banks - Quarterly analysis

Entity	Size & strength measures							
	31 Mar 16	30 Jun 16	30 Sep 16	31 Dec 16	31 Mar 17	30 Jun 17	30 Sep 17	31 Dec 17
	Total assets[23] ($Million)							
ANZ	160,801	163,538	163,282	159,861	157,717	160,788	154,910	157,178
BNZ[19]	89,913	91,906	92,325	93,906	93,775	95,063	95,038	97,445
CBA[20]	86,012	85,678	88,764	90,827	91,625	92,375	92,344	97,302
Heartland Bank	3,334	3,489	3,595	3,755	3,829	3,963	4,151	4,236
Kiwibank	19,227	19,199	19,372	19,834	20,247	20,519	20,364	20,297
SBS Bank	3,408	3,506	3,543	3,740	3,987	4,053	4,229	4,340
The Co-operative Bank	2,029	2,109	2,179	2,257	2,349	2,434	2,512	2,575
TSB Bank[21]	6,424	6,475	6,522	6,621	6,794	6,949	7,062	7,269
Westpac	90,309	91,518	92,708	95,903	91,883	93,564	95,001	95,373
Total	**461,455**	**467,418**	**472,291**	**476,703**	**472,206**	**479,709**	**475,612**	**486,015**
	Increase in gross loans and advances (%)							
ANZ	1.47	1.94	0.43	0.99	0.90	0.93	0.64	0.36
BNZ[19]	2.24	1.80	2.46	2.08	1.19	1.86	1.68	0.63
CBA[20]	1.87	2.38	3.43	1.58	1.06	1.37	0.82	1.93
Heartland Bank	3.02	3.29	4.01	2.93	3.62	2.64	3.78	2.81
Kiwibank	0.53	1.55	1.74	2.59	2.25	-0.08	0.21	0.96
SBS Bank	2.67	3.19	3.15	6.06	5.10	3.45	4.53	2.07
The Co-operative Bank	2.87	4.01	4.97	3.69	3.00	3.25	2.00	2.26
TSB Bank[21]	2.80	3.26	5.32	6.70	4.79	2.97	4.16	3.21
Westpac	2.22	2.88	1.86	0.71	1.03	0.69	0.20	0.64
Average	**1.85**	**2.22**	**1.91**	**1.48**	**1.19**	**1.18**	**0.89**	**0.90**
	Capital adequacy (%)							
ANZ[22]	13.70	14.40	14.30	14.00	14.50	14.20	14.80	15.10
BNZ[19]	12.58	12.48	12.04	13.09	13.29	12.79	13.32	13.47
CBA[20, 22]	13.70	14.30	12.70	13.70	13.80	14.20	14.10	14.80
Heartland Bank	14.01	13.78	12.71	12.96	13.19	13.56	13.04	14.76
Kiwibank	12.90	12.90	12.80	13.40	13.50	13.40	16.00	15.00
SBS Bank	13.76	13.50	13.63	13.27	12.56	11.91	11.35	11.80
The Co-operative Bank	15.80	15.50	16.10	17.50	16.90	16.60	16.60	16.70
TSB Bank[21]	14.52	14.62	14.59	14.65	14.60	14.85	14.55	14.54
Westpac[22]	14.00	14.00	13.10	13.40	14.00	14.00	14.80	14.30
	Net profit ($Million)							
ANZ	416	430	349	403	466	406	505	520
BNZ[19]	259	229	233	223	193	276	245	275
CBA[20]	220	211	245	253	255	248	292	275
Heartland Bank	14	15	14	15	16	16	16	15
Kiwibank	29	24	28	35	22	-32	14	28
SBS Bank	6	7	7	6	6	7	6	7
The Co-operative Bank	2	2	3	3	2	3	3	3
TSB Bank[21]	10	14	14	14	5	11	17	10
Westpac	239	249	224	285	237	255	282	268
Total	**1,195**	**1,181**	**1,117**	**1,237**	**1,202**	**1,190**	**1,380**	**1,401**

Entity	Profitability measures							
	31 Mar 16	30 Jun 16	30 Sep 16	31 Dec 16	31 Mar 17	30 Jun 17	30 Sep 17	31 Dec 17
	Interest margin (%)							
ANZ	2.18	2.24	2.17	2.18	2.14	2.14	2.18	2.19
BNZ[19]	2.21	2.15	2.12	2.07	1.98	2.06	2.21	2.10
CBA[20]	2.09	2.22	2.04	1.97	1.91	1.92	1.99	2.04
Heartland Bank	4.58	4.53	4.46	4.44	4.35	4.54	4.49	4.37
Kiwibank	1.98	2.02	1.96	1.92	1.82	1.95	1.95	2.05
SBS Bank	2.61	2.57	2.63	2.60	2.38	2.43	2.52	2.68
The Co-operative Bank	2.61	2.51	2.46	2.39	2.25	2.22	2.24	2.29
TSB Bank[21]	2.03	2.02	2.12	2.18	1.80	1.82	1.84	1.80
Westpac	2.11	2.12	2.08	2.03	1.86	2.03	2.16	1.96
Average	**2.17**	**2.20**	**2.13**	**2.10**	**2.01**	**2.07**	**2.15**	**2.11**
	Non-interest income/Total tangible assets (%)							
ANZ	0.77	0.62	0.37	0.48	0.63	0.46	0.73	0.84
BNZ[19]	0.71	0.59	0.56	0.58	0.35	0.74	0.54	0.65
CBA[20]	0.57	0.47	0.62	0.66	0.63	0.62	0.64	0.65
Heartland Bank	0.45	0.45	0.26	0.49	0.37	0.31	0.18	0.39
Kiwibank	0.55	0.46	0.56	0.80	0.52	0.67	0.59	0.69
SBS Bank	0.97	1.00	1.00	0.93	0.79	0.77	0.78	0.85
The Co-operative Bank	0.64	0.94	0.98	0.97	0.58	0.96	0.85	0.90
TSB Bank[21]	0.21	0.21	0.35	0.27	0.21	0.25	0.80	0.29
Westpac	0.62	0.65	0.71	0.67	0.69	0.73	0.58	0.79
Average	**0.67**	**0.58**	**0.53**	**0.59**	**0.58**	**0.61**	**0.64**	**0.73**
	Impaired asset expense/Average gross loans and advances (%)							
ANZ	0.08	0.18	0.14	0.12	0.01	0.04	0.03	0.04
BNZ[19]	0.23	0.15	0.08	0.11	0.12	-0.01	0.21	0.01
CBA[20]	0.17	0.31	0.12	0.10	0.05	0.06	-0.08	0.12
Heartland Bank	0.41	0.63	0.49	0.36	0.46	0.47	0.56	0.57
Kiwibank	0.10	0.02	0.00	-0.05	0.05	-0.13	0.25	-0.22
SBS Bank	0.67	0.21	0.44	0.40	0.33	0.30	0.32	0.45
The Co-operative Bank	0.05	0.08	0.16	0.10	0.11	0.11	0.10	0.11
TSB Bank[21]	0.31	0.07	0.12	0.13	0.06	0.08	0.06	0.10
Westpac	0.06	0.02	0.32	-0.19	0.01	-0.07	-0.14	0.03
Average	**0.13**	**0.16**	**0.16**	**0.05**	**0.05**	**0.01**	**0.03**	**0.05**
	Operating expenses/Operating income (%)							
ANZ	42.41	36.61	43.98	38.24	35.67	39.28	34.30	34.46
BNZ[19]	34.94	39.69	40.28	42.11	42.91	38.65	37.99	38.69
CBA[20]	37.98	37.66	36.03	36.32	36.25	38.02	35.00	35.19
Heartland Bank	43.96	42.55	46.95	43.43	41.23	42.93	43.70	44.54
Kiwibank	62.39	71.30	67.80	64.62	73.04	138.17	78.74	79.41
SBS Bank	57.43	60.30	59.65	62.30	62.36	60.78	67.09	64.26
The Co-operative Bank	81.41	80.27	75.07	72.22	79.33	76.96	74.55	73.32
TSB Bank[21]	51.65	45.26	47.36	48.60	77.37	55.00	47.54	59.48
Westpac	40.80	41.25	38.92	40.69	42.26	43.81	40.03	40.00
Average	**41.07**	**40.33**	**42.07**	**40.93**	**40.92**	**44.82**	**38.96**	**39.34**

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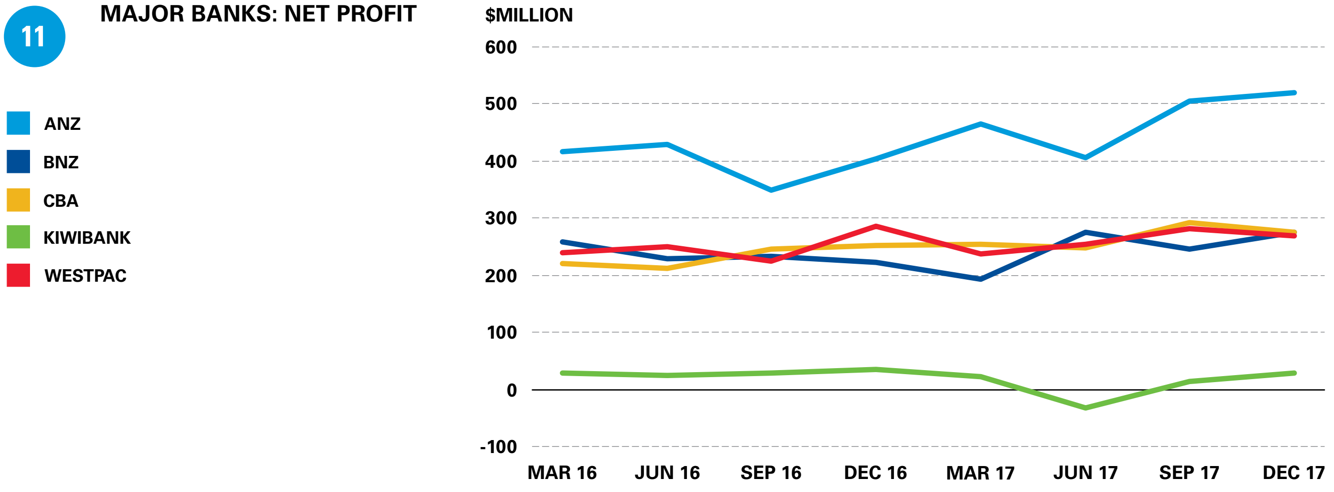
MAJOR BANKS: NET PROFIT



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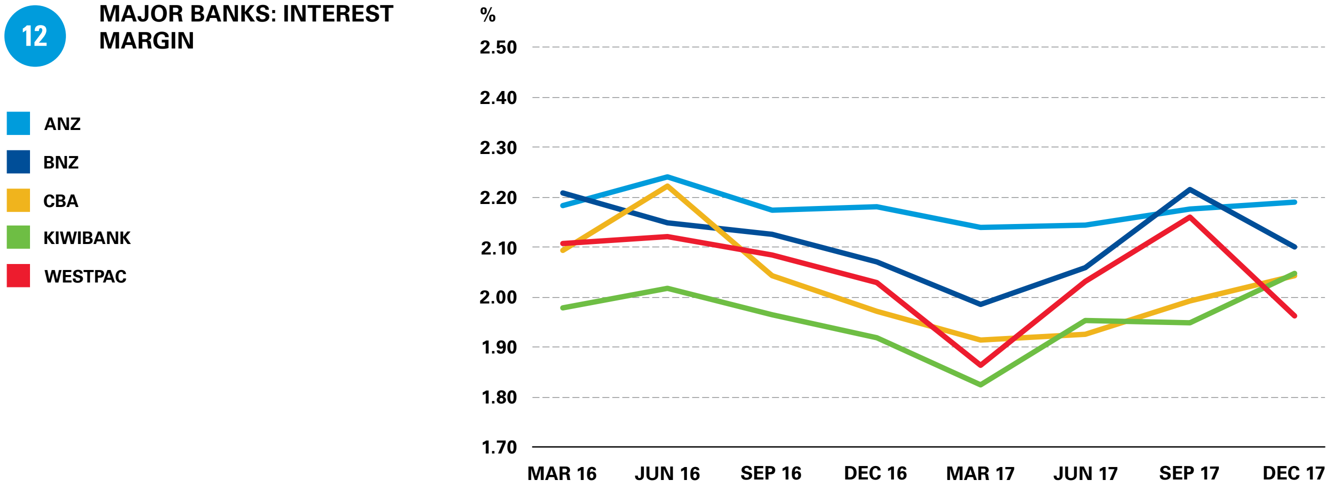
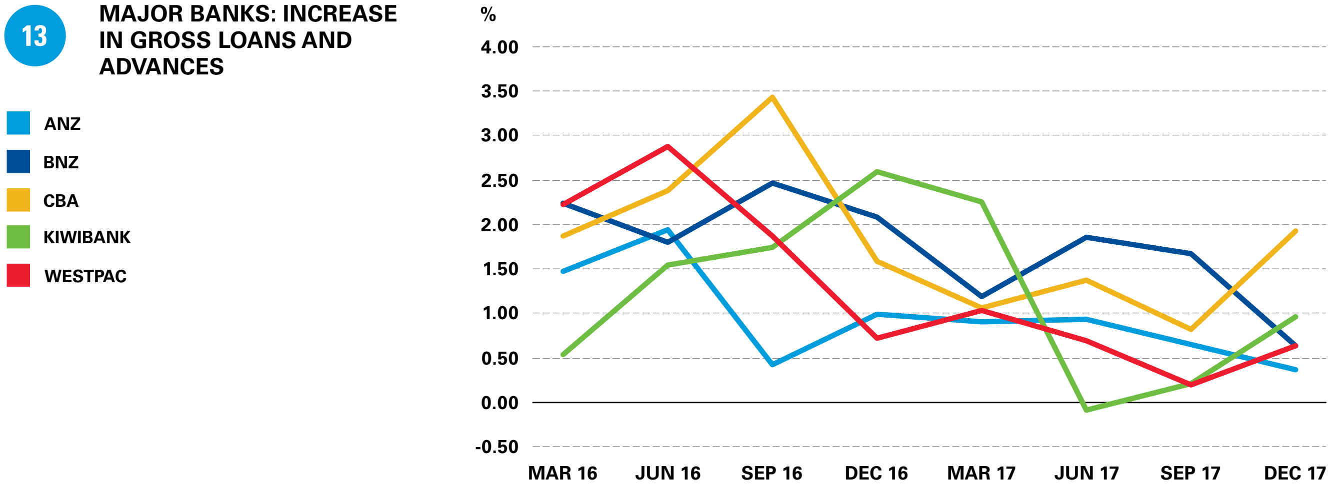
MAJOR BANKS: INTEREST MARGIN

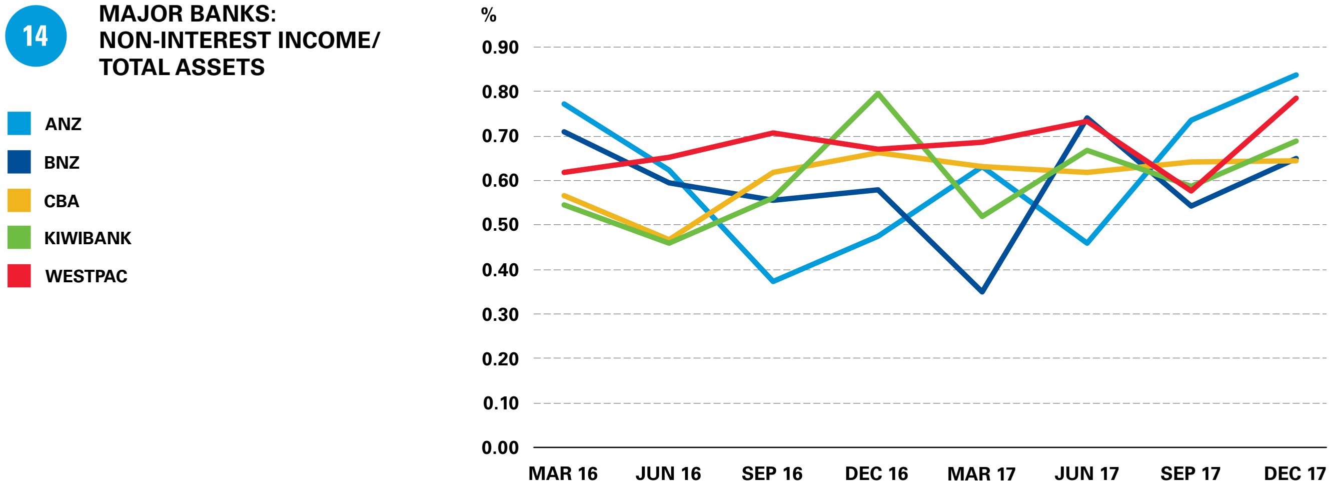


13

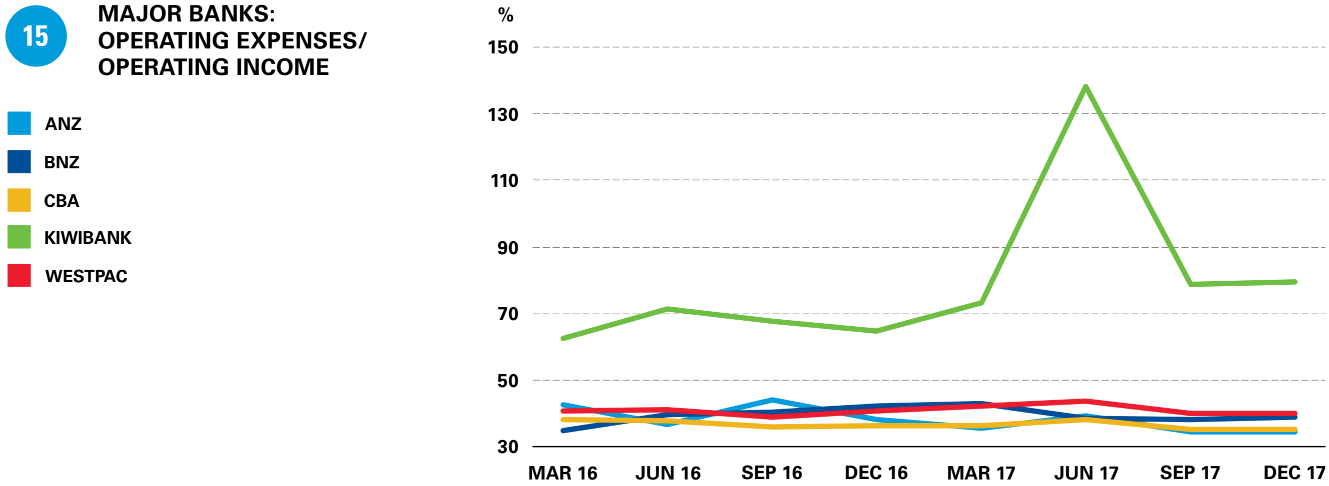
MAJOR BANKS: INCREASE IN GROSS LOANS AND ADVANCES



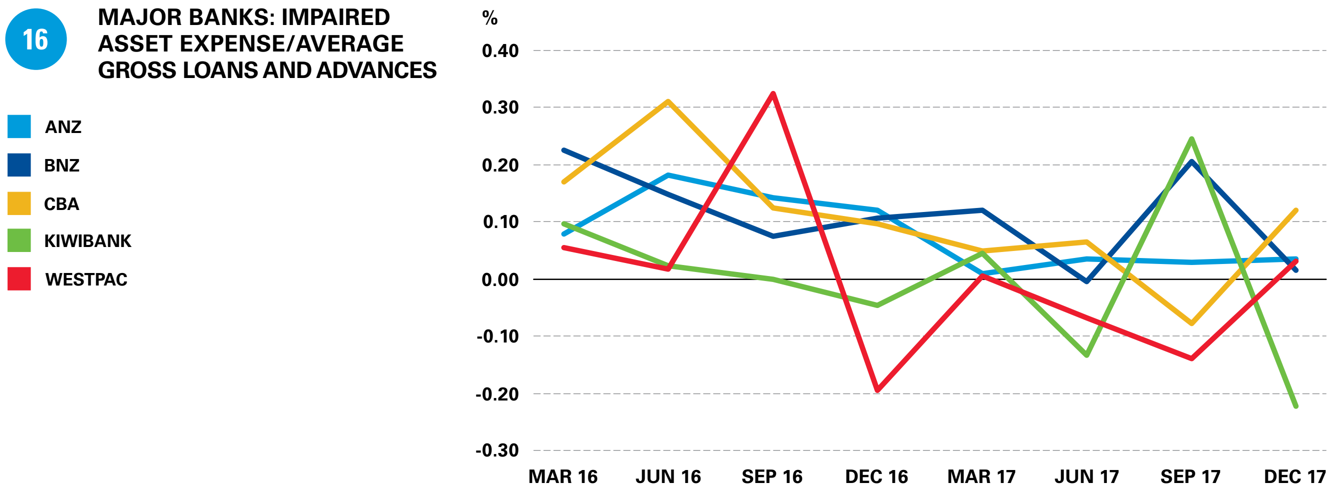
14 MAJOR BANKS: NON-INTEREST INCOME/ TOTAL ASSETS



15 MAJOR BANKS: OPERATING EXPENSES/ OPERATING INCOME



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



Endnotes

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19 Effective from 30 September 2016 onwards, Bank of New Zealand changed its methodology for the calculation of interest earning assets (to exclude mortgage offset account). Prior period comparatives (data and ratios) do not reflect the change in methodology and as such, ratios calculated in this survey may differ if restated 30 June 2016 figures and its prior period comparatives had been used for the purpose of analysis.

20 As at 1 July 2015, interest from certain derivatives (transacted as economic hedges) are recorded as part of net interest earnings instead of other income. In addition, fixed rate prepayment cost recoveries have been reclassified from other income to interest income in order to align with industry practice, effective for the period ended 30 June 2016 onwards. Prior period comparatives (data and ratios) do not reflect the change in methodology and as such, ratios calculated in this survey may differ if restated 31 March 2016 figures and its prior period comparatives had been used for the purpose of analysis.

21 On 1 April 2015, 'Investment in associates – held for sale' was transferred to a new group structure under TSB Community Trust. In addition to this, certain comparatives in relation to interest income, interest expense, other operating income and other operating expenses have been restated on numerous occasions in the last few periods. Prior period comparatives (data and ratios) do not reflect these changes and as such, ratios calculated in this survey may differ if restated 31 March 2016 figures had been used for the purpose of analysis.

22 The capital adequacy ratio's reported are for the overseas banking group.

23 Total Assets = Total Assets - Intangible Assets.

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