KPMG

FIPS

Financial Institutions Performance Survey

June 2018 Quarterly Results

Overview

CEO Outlook Global

In May 2018, KPMG released its Global CEO Outlook report,[1] which summarises the views of 1,300 Chief Executive Officers (CEOs) of large companies from around the world on opportunities and challenges that they and their businesses face.

In the 2017 report, CEOs saw technology-driven change as a significant opportunity to disrupt their own respective sectors. The optimism of the future, as demonstrated by seeing change as an opportunity, continues in 2018. However, 2018 sees this optimism tempered, reflecting the ever-changing challenges businesses face, with growth forecasts lower than expected (55% predict less than 2%) and new hiring waiting until growth targets are achieved (52%).

CEOs saw technology-driven change as a significant opportunity to disrupt their own respective sectors.

Confidence in growth prospects remain stable from the 2017 report, in respect of the growth in the global economy, their respective industry and their respective country. 95% of CEOs see technological disruption as more of an opportunity than a threat, with 54% already actively disrupting in their sector rather than waiting to be disrupted by competitors. With disruption often comes the need to transform the business, both in what it does and how it does it, and 71% of CEOs believe they are personally ready to lead a radical organisational transformation. In gaining this change, CEOs say agility and intuition are key to turning disruption into opportunity, with 59% believing agility is the new currency of business; and, in the new world of big data, a surprising 67% have followed their own intuition instead of data-driven insights at some point in the past three years.

The number one threat to growth is considered to be "A return to territorialism".

The number one threat to growth is considered to be "A return to territorialism," a move reflecting heightened global tensions which are especially pronounced between the US and China / the EU, where protectionist policies are being implemented through tariffs on imports and subsidies on domestic exports.

The next biggest risk seen is cyber security.

The next biggest risk seen is cyber security, where 49% of CEOs said that they consider becoming a victim of a cyber-attack isn't a matter of 'if', but rather of 'when' – highest by American CEOs (68%). With high profile cyber-attacks in the last year on companies such as Equifax and Deloitte, and the infamous 'WannaCry' ransomware that infected more than 230,000 computers in over 150 countries,[2] and the impact that such an event can have on the company's reputation and share price, this concern is unsurprising. Only 51% of CEOs believe that they are well prepared for a cyber-attack, with the banking CEOs largely in line with this at 50%. This perception also aligns with 59% of CEOs seeing that protecting customer data is a critical personal responsibility. Given the significant amount of sensitive data that banks retain on their customers, in respect of the financial position of customers and of each individual customer's personal information, the potential impact of a data breach would be significant, both from a financial and a reputational perspective.

Millennials and those exhibiting millennial behaviours also are a high priority in CEOs minds, with 45% saying their organisation struggles to differentiate the needs of millennial thinkers and the older customers. While this report defines millennials as those born between 1980 and 2000, as discussed in previous editions of this publication, there also appears to be a trend that the characteristics that defined millennials is not confined to an age group, but a set of ideals that has spread across various age groups.

New Zealand

In June 2018, KPMG New Zealand released its 2018 NZ CEO Outlook report,[3] focusing on the views of the fifty New Zealand CEOs within the 1,300 CEOs from the KPMG Global CEO Outlook report.

Overall, NZ CEOs appear to be more cautious about growth prospects for New Zealand compared to last year. Some 64% expressed confidence in New Zealand's growth outlook, compared to 74% in last year's report; this result is compared to 92% having confidence of growth prospects in the global economy. Of this growth, 64% of NZ CEOs believe this growth will be harder earned than ever before (compared to 28% globally), and most of the NZ CEOs forecast less than 2% top line revenue growth over the next three years – a significant decrease from last year's report.

Overall, NZ CEOs appear to be more cautious about growth prospects for New Zealand compared to last year.

With this growth, 68% of NZ CEOs are struggling to link the growth strategy with a societal purpose, compared to 37% globally.

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While 98% of NZ CEO's viewing digital transformation as an opportunity rather than as a threat, only 28% were confident that they were disrupting their sector rather than waiting to be disrupted – a number that seems to have decreased significantly from 88% in last year's report. This trend may be driven by 96% of NZ CEOs seeing lead times for technology as overwhelming (compared to 65% globally), and 76% holding the view that the board has unreasonable expectations of return on investments (ROI) on digital transformation. These views may indicate that NZ CEOs are either struggling to get approval for their transformation; or, when it is approved, it is taking much longer than expected to get their transformation 'live'. These lead times may also be driving the view from 64% that their organisation is struggling to keep pace with technology innovation (compared to 36% globally).

NZ CEOs also have concerns around their capability to implement the transformation required to disrupt.

NZ CEOs also have concerns around their capability to implement the transformation required to disrupt, with only 26% confident that existing leadership is fully equipped to oversee radical transformation of their organisations (compared to 44% of their global counterparts).

Creating excellent customer experiences in financial services

As banks are increasingly seen as homogeneous in the eyes of the customer, customer experience serves as a critical differentiation point to drive brand loyalty and advocacy, which in turn, drives top and bottom line growth.

The leading financial institutions accomplish this with a customer first mind-set – evaluating every investment decision by considering how it contributes to the customer experience.

In KPMG's global research, we are seeing customer expectations rise year on year. What met customer expectations yesterday, no longer works today – and customers are voting with their wallets for the organisations to deliver their best experiences. Our research quantifies just how significant the value of customer experience excellence is – the top 50 global customer experience leaders realised 202% greater EBITDA growth than the bottom 50 brands and 54% greater revenue growth, at an aggregated level.

KPMG New Zealand's inaugural landmark report dives into the state of customer experience in New Zealand. It reveals what New Zealand consumers value most from their favourite brands and how New Zealand organisations perform in the eyes of New Zealanders.

The KPMG Customer Experience Excellence (CEE) report[4] has been undertaken globally for the last eight years – completing over two million individual consumer evaluations in 14 markets worldwide, and this year is the first time New Zealand consumers have participated. In the report, consumers evaluate brands based on the Six Pillars[5] of customer experience excellence, which global research has identified as the 'DNA' of every outstanding customer experience.

Brands represented cover nine distinct industries, with the financial services scoring the highest overall and having three organisations placed in the top 10. The most important pillars for financial services consumers were Integrity, and Time and Effort, where respondents recognised that many organisations stand for something beyond profits, and for the efforts these organisations go to make interacting and transacting a simplistic process.

See Customer experience excellence article

It is one thing to aim to and achieve providing better customer experience and place greater emphasis on conduct and culture – it is another to communicate this emphasis to the group of wider stakeholders. One way some companies are doing this is through integrated financial reporting, or Better Business reporting. Better Business reporting is a method where non-financial information is publically reported alongside financial information in the annual financial statements. One of KPMG's specialists in this area provides a high level overview of this in the article in this publication on page 15.

See Better Business Reporting Article

Global news

In the few months since the previous edition of our publication, there have been several headlines in respect of the global economy.

Turkey has made regular appearances in the headlines for the state of its economy, most recently for having its credit rating cut deeper into "junk" territory, downgraded from BB- to B+ by Standard and Poor's (S&P).

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This event took place on the back of a 40% drop in the value of its currency, with inflation expected to peak at 22% before the end of the year. With S&P predicting Turkey will enter recession next year[6] and Turkey's president Tayyip Erdogan continuing to fan the flames of a trade war with the US, this is a troubling trend when combined with countries like Venezuela having their own economic (hyperinflation) issues to deal with,[7] the overall impact of these directions on the global economy remains to be seen.

To further raise global risks, the tensions between the US and China continue with no resolution reached in their tit-for-tat trade war.

To further raise global risks, the tensions between the US and China continue with no resolution reached in their tit-for-tat trade war, with trade talks continuing while threats of more and more tariffs are announced, and the amounts of these tariffs continues to escalate – the latest being up to $50 billion of tariffs on US imports from China.[8]

In more positive news, Greece finally exited its eight-year bailout programme it entered into as a result of the 2008/09 Global Financial Crisis (GFC) where at one stage it had borrowed almost €300 billion – the world's largest ever financial rescue. While significant austerity measures, getting the economy back to where it was before the GFC will be extremely difficult because it needs to overcome almost 20% unemployment (a higher 43% youth unemployment), the highest debt to GDP ratio in the European Union of 177%, and achieve budget surpluses to continue to pay down the debt it has taken on.[9]

Back in the US, the yield curve continues to flatten, with the spread between the two year and ten year note at its tightest level since August 2007 on 24 August 2018[10] down to 19 basis points.[11] The prospects of an inversion in this treasury yield curve has prompted one federal reserve chief to dissent against further interest rate hikes, as an inversion in the treasury yield curve is widely viewed as a signal of a possible recession.[12] Research from some Federal Reserve economists highlight the correlation between an inverted yield curve and a recession, although recognising that such a correlation does not necessarily mean a causation.[13] However, opposing views abound on what an inversion of this curve would mean, with Goldman Sachs believing that investors should not "overly fear a flat yield curve, either a as signal or a cause of a recession".[14] Driving the increase in the shorter term yields are the rate rises from the Federal Reserve, and expectations of more to come. The Federal Reserve have raised their rate twice this year to date,[15] with an expectation for between one and two hikes this year (with the market pricing a higher probability of two hikes).[16]

Local news

In the local economy, the new Reserve Bank of New Zealand (RBNZ) Governor, Adrian Orr, continued to make an impact with his latest Official Cash Rate (OCR) announcement on 9 August 2018. While the OCR continues to be held at its record low 1.75, the tone of the announcement was remarkably more dovish than that of previous OCR releases, with more weighting placed on the chance of the next move in the OCR being down rather than up, and the OCR being held at expansionary levels for longer.

Markets were not expecting this language, with the NZ dollar being punished as a result, dropping 0.75 cents against the US dollar and 1 cent against the Australia dollar.[17] Another impact of this dovish tone was from the banks, with several announcing drops in both fixed mortgage and term deposit rates,[18] reflecting both the chance that local wholesale rates will remain lower for longer and possibly that these rates may even decrease before they rise again.

RBNZ Governor, Adrian Orr, continued to make an impact with his latest OCR announcement on 9 August 2018.

While the lull in the news continues on the RBNZ and the Financial Markets Authority's (FMA's) review into conduct in the New Zealand banking industry, with the RBNZ and FMA deep into the reviews before the public release of the results in October, ANZ has publically demonstrated it is taking action from one of the points coming out of the Royal Banking Commission in Australia, whereby it is no longer setting any sales targets as part of the incentive programme for frontline retail staff.

Where previously 25% of frontline retail staff's scorecards were based on sales, this element will be removed from 1 October 2018,[19] reflecting the tension that this sales incentive created between acting in the customers' best interests (a motive which is at the heart of good conduct) and meeting their incentive targets.

In July 2018, the RBNZ released the results of their review into capital requirements for registered banks.[20]

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The aim for these decisions is "to bolster how much capital banks need to hold, make it easier for investors to assess capital adequacy, and to minimise any unintended competitive advantages".[20] The main decision is to require the four largest banks – ANZ, ASB, BNZ and Westpac – to report their capital position using both their own internal capital models as well as the standardised capital frameworks that the other banks use. This approach will allow easier comparability of the capital position between the registered banks than was previously possible, and will allow the RBNZ to see "whether the big bank's risk estimates are appropriate".[20] The next phase of the review will assess the quantitative impact of the decisions made in the first phase, and the final phase will be to review the minimum capital ratios which it aims to complete by the end of 2018. Given the relatively high levels of capital currently held by the banks compared to current minimum ratios, it is unlikely that a modest increase in the minimum capital ratios will have a significant impact on the banks.

Analysis of results

We have presented our analysis of the results for the quarter ended 30 June 2018 on pages 6 to 14. The highlights from this analysis are that net profit has increased by 14.61% to $1,424 million, bouncing back up from last quarter's drop of 11.35%. This result has been driven by an increase in interest income of $48 million, an increase in non-interest income by $77 million, a decrease in impaired asset expense of $116 million and a slight dip in operating expenses of $7 million, with only an increase in tax expense offsetting the growth in profit.

Loan growth has continued its path of steady modest increases, with Heartland just slightly ahead of TSB's loan growth in the quarter. Both banks continue to lead the year-to-date growth with 12.28% and 13.61%, respectively. Some of the major banks also experienced an uptick in quarterly loan growth, with BNZ, ANZ and CBA all recording quarterly growth above 1.5%.

Asset quality seems to have stabilised in the quarter after a slight deterioration in the prior quarter, with a relatively low amount of impairment expense and fairly stable provisioning. Although this trend appears to show the prior quarter spike was more likely driven by a variability of results than by a clear signal of a turning point in the market cycle, and given provision levels have been held at these higher levels, this direction may still be an early indicator of coming change.

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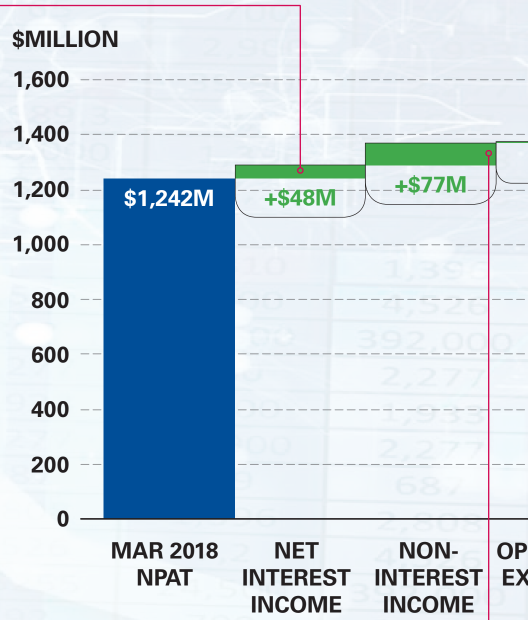
Net profit after tax

Movement in net profit



Net interest income

1.95%

to $2,505 million

Driven by

	Net interest margin
CBA (ASB)	10 bps
Kiwibank	10 bps
The Co-operative Bank	10 bps

TABLE 1: Movement in interest margin

	30 Jun 18 quarter ended (%)[23]	Mvmt. during the quarter (bps)	Mvmt. for the 6 months (bps)	Mvmt. for the 12 months (bps)
ANZ	2.2%	0	1	6
BNZ	2.1%	-10	0	4
CBA	2.1%	10	6	18
Heartland Bank	4.4%	-10	3	-14
Kiwibank	2.2%	10	15	25
SBS Bank	2.6%	0	-8	17
The Co-operative Bank	2.4%	10	11	18
TSB Bank	1.8%	0	0	-2
Westpac	2.1%	-10	14	7

Non-interest income

Driven by

Westpac

CBA

BNZ

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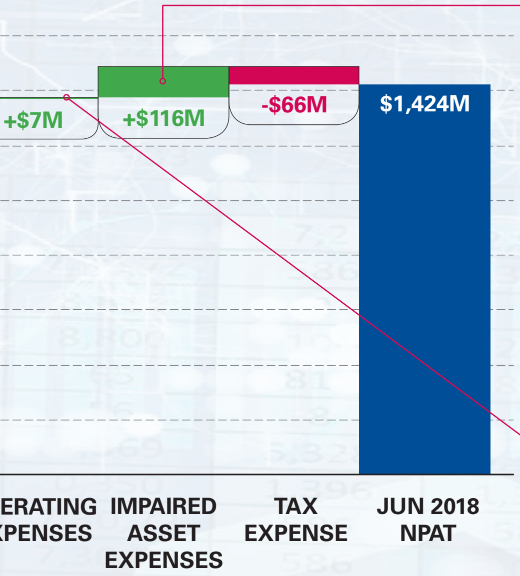
14.61%

to $1,424 million



Impaired asset expenses

68.66%

down $116 million

Driven by

ANZ	$53M
Westpac	$22M
CBA (ASB)	$22M

10.44%

up $77 million

$65M
$16M
-$16M

Operating expenses

0.51%

down $7 million

Driven by

BNZ	$46M
ANZ	-$13M
CBA (ASB)	-$13M

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Lending

Loans

1.58%

to $412,206 million

Quarterly

Heartland	2.69%
TSB	2.66%
BNZ	2.01%

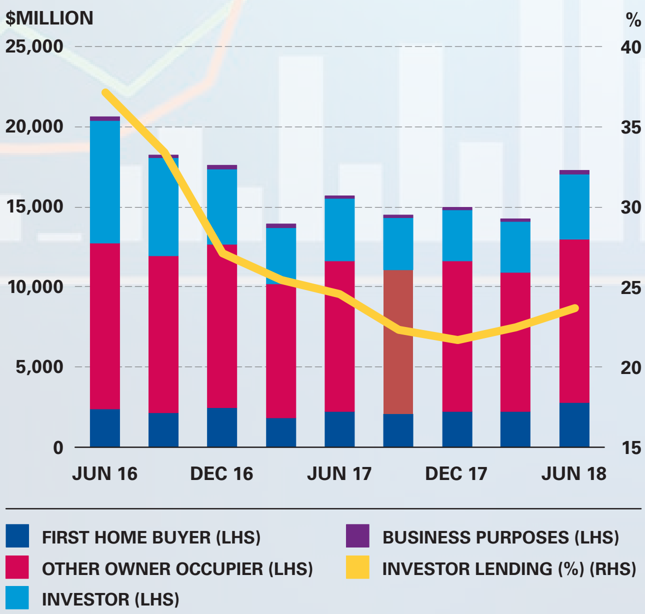
Year on year

TSB	13.61%
Heartland	12.28%
SBS Bank	8.98%

TABLE 2: Analysis of gross loans

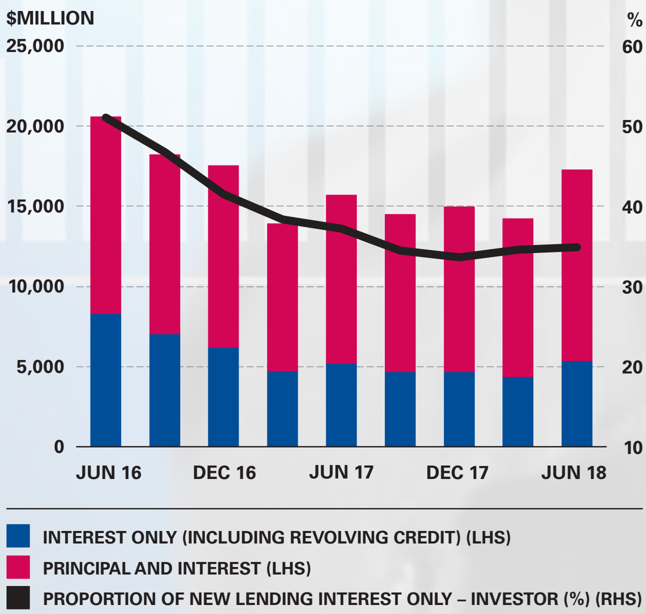
Quarterly analysis	30 Jun 18 quarter ended $Million	31 Mar 18 quarter ended $Million	% Increase
ANZ	128,976	126,834	1.69%
BNZ	82,449	80,821	2.01%
CBA	86,035	84,612	1.68%
Heartland Bank	4,015	3,909	2.69%
Kiwibank	18,416	18,247	0.93%
SBS Bank	3,863	3,824	1.02%
The Co-operative Bank	2,332	2,297	1.51%
TSB Bank	5,476	5,335	2.66%
Westpac	80,644	79,933	0.89%
Total	**412,206**	**405,811**	**1.58%**
Annual analysis	**30 Jun 18 quarter ended $Million**	**30 Jun 17 quarter ended $Million**	**% Increase**
ANZ	128,976	124,550	3.55%
BNZ	82,449	78,586	4.92%
CBA	86,035	81,549	5.50%
Heartland Bank	4,015	3,576	12.28%
Kiwibank	18,416	17,855	3.14%
SBS Bank	3,863	3,545	8.98%
The Co-operative Bank	2,332	2,176	7.16%
TSB Bank	5,476	4,820	13.61%
Westpac	80,644	77,877	3.55%
Total	**412,206**	**394,534**	**4.48%**

1 NEW MORTGAGE LENDING BY BORROWER TYPE



SOURCE: RESERVE BANK OF NEW ZEALAND STATISTICS

2 NEW MORTGAGE LENDING BY PAYMENT TYPE



SOURCE: RESERVE BANK OF NEW ZEALAND STATISTICS

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Asset quality

Individually assessed provisions

1.78%

down $7.4 million

Driven by

CBA $5.5M

Westpac $2.6M

Collectively assessed provisions

0.97%

down $15.5 million

Driven by

BNZ $11.3M

ANZ $10.6M

CBA $6.3M

3 MOVEMENT IN PROVISIONING

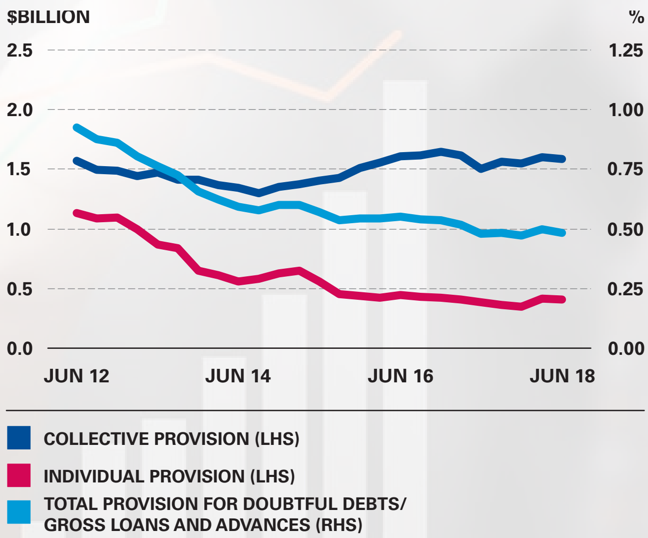
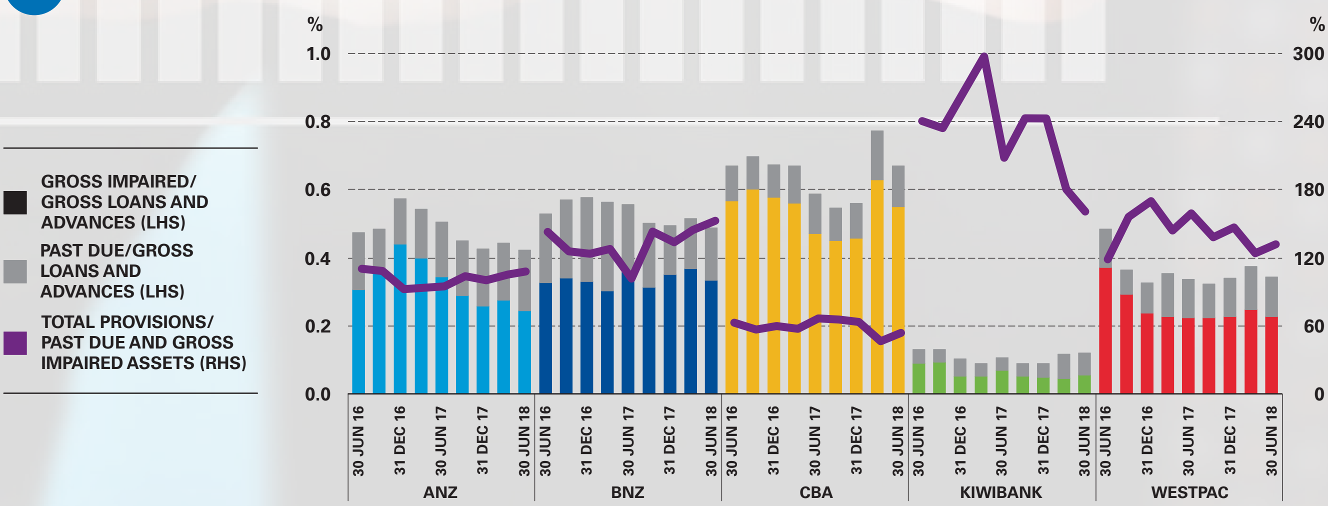


TABLE 3: Movement in impaired asset expense/ Average gross loans

	30 Jun 18 quarter ended (%)	Movement during the quarter (bps)	Movement for the 12 months (bps)
ANZ	0.02%	-17	-2
BNZ	0.14%	-6	15
CBA	0.06%	-10	0
Heartland Bank	0.60%	0	13
Kiwibank	-0.04%	-7	9
SBS Bank	0.40%	-15	10
The Co-operative Bank	0.17%	5	6
TSB Bank	-0.01%	-9	-9
Westpac	-0.01%	-11	6
Average	**0.05%**	**-12**	**4**

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



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Major banks - Quarterly analysis

Entity	Size & strength measures							
	30 Sep 16	31 Dec 16	31 Mar 17	30 Jun 17	30 Sep 17	31 Dec 17	31 Mar 18	30 Jun 18
	Total assets[22] ($Million)							
ANZ	166,706	163,155	161,007	164,071	158,185	160,583	159,719	164,588
BNZ	92,541	94,137	94,023	95,324	95,315	97,742	97,065	101,678
CBA	89,217	91,281	92,077	92,828	92,801	97,762	98,643	101,338
Heartland Bank	3,655	3,820	3,896	4,035	4,222	4,307	4,388	4,496
Kiwibank	19,540	20,008	20,428	20,616	20,449	20,381	20,498	20,715
SBS Bank	3,548	3,745	3,994	4,060	4,237	4,347	4,455	4,501
The Co-operative Bank	2,194	2,272	2,364	2,449	2,527	2,589	2,629	2,661
TSB Bank	6,522	6,629	6,803	6,958	7,072	7,278	7,416	7,454
Westpac	93,358	96,551	92,533	94,215	95,666	96,041	96,216	98,438
Total	**477,282**	**481,598**	**477,125**	**484,555**	**480,474**	**491,031**	**491,030**	**505,868**
	Increase in gross loans and advances (%)							
ANZ	0.43	0.99	0.90	0.93	0.64	0.36	0.82	1.69
BNZ	2.46	2.08	1.19	1.86	1.68	0.63	0.51	2.01
CBA	3.43	1.58	1.06	1.37	0.82	1.93	0.97	1.68
Heartland Bank	4.01	2.93	3.62	2.64	3.78	2.81	2.48	2.69
Kiwibank	1.74	2.59	2.25	-0.08	0.21	0.96	1.01	0.93
SBS Bank	3.15	6.06	5.10	3.45	4.53	2.07	1.11	1.02
The Co-operative Bank	4.97	3.69	3.00	3.25	2.00	2.26	1.21	1.51
TSB Bank	5.32	6.70	4.79	2.97	4.16	3.21	2.95	2.66
Westpac	1.86	0.71	1.03	0.69	0.20	0.64	1.79	0.89
Average	**1.91**	**1.48**	**1.19**	**1.18**	**0.89**	**0.90**	**1.04**	**1.58**
	Capital adequacy (%)							
ANZ[21]	14.30	14.00	14.50	14.20	14.80	15.10	14.40	14.80
BNZ	12.04	13.09	13.29	12.79	13.32	13.47	13.10	13.20
CBA[21]	12.70	13.70	13.80	14.20	14.10	14.80	13.60	13.90
Heartland Bank	12.71	12.96	13.19	13.56	13.04	14.76	14.10	14.10
Kiwibank	12.80	13.40	13.50	13.40	16.00	15.00	15.40	15.80
SBS Bank	13.63	13.27	12.56	11.91	11.35	11.80	12.80	13.00
The Co-operative Bank	16.10	17.50	16.90	16.60	16.60	16.70	16.80	16.70
TSB Bank	14.59	14.65	14.60	14.85	14.55	14.54	14.30	14.70
Westpac[21]	13.10	13.40	14.00	14.00	14.80	14.30	16.60	17.10
	Net profit ($Million)							
ANZ	349	403	466	406	505	520	444	492
BNZ	233	223	193	276	245	275	215	250
CBA	245	253	255	248	292	275	264	296
Heartland Bank	14	15	16	16	16	15	18	19
Kiwibank	28	35	22	-32	14	28	33	39
SBS Bank	7	6	6	7	6	7	7	8
The Co-operative Bank	3	3	2	3	3	3	1	3
TSB Bank	14	14	5	11	17	10	14	14
Westpac	224	285	237	255	282	268	246	305
Total	**1,117**	**1,237**	**1,202**	**1,190**	**1,380**	**1,401**	**1,242**	**1,424**

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Entity	Profitability measures							
	30 Sep 16	31 Dec 16	31 Mar 17	30 Jun 17	30 Sep 17	31 Dec 17	31 Mar 18	30 Jun 18
	Interest margin[23] (%)							
ANZ	2.17	2.18	2.14	2.14	2.18	2.19	2.20	2.20
BNZ	2.12	2.07	1.98	2.06	2.21	2.10	2.20	2.10
CBA	2.04	1.97	1.91	1.92	1.99	2.04	2.00	2.10
Heartland Bank	4.46	4.44	4.35	4.54	4.49	4.37	4.50	4.40
Kiwibank	1.96	1.92	1.82	1.95	1.95	2.05	2.10	2.20
SBS Bank	2.63	2.60	2.38	2.43	2.52	2.68	2.60	2.60
The Co-operative Bank	2.46	2.39	2.25	2.22	2.24	2.29	2.30	2.40
TSB Bank	2.12	2.18	1.80	1.82	1.84	1.80	1.80	1.80
Westpac	2.08	2.03	1.86	2.03	2.16	1.96	2.20	2.10
	Non-interest income/Total assets[22] (%)							
ANZ	0.36	0.47	0.62	0.45	0.72	0.82	0.62	0.64
BNZ	0.55	0.58	0.35	0.74	0.54	0.65	0.63	0.55
CBA	0.62	0.66	0.63	0.61	0.64	0.64	0.56	0.62
Heartland Bank	0.26	0.48	0.37	0.30	0.18	0.39	0.32	0.69
Kiwibank	0.56	0.79	0.51	0.66	0.58	0.69	0.99	1.14
SBS Bank	1.00	0.93	0.79	0.77	0.78	0.85	0.85	0.82
The Co-operative Bank	0.98	0.96	0.58	0.95	0.84	0.89	0.67	0.71
TSB Bank	0.35	0.27	0.21	0.25	0.79	0.29	0.71	0.28
Westpac	0.70	0.67	0.68	0.73	0.57	0.78	0.48	0.74
Average	**0.53**	**0.58**	**0.57**	**0.60**	**0.63**	**0.73**	**0.60**	**0.65**
	Impaired asset expense/Average gross loans and advances (%)							
ANZ	0.14	0.12	0.01	0.04	0.03	0.04	0.19	0.02
BNZ	0.08	0.11	0.12	-0.01	0.21	0.01	0.20	0.14
CBA	0.12	0.10	0.05	0.06	-0.08	0.12	0.16	0.06
Heartland Bank	0.49	0.36	0.46	0.47	0.56	0.57	0.60	0.60
Kiwibank	0.00	-0.05	0.05	-0.13	0.25	-0.22	0.03	-0.04
SBS Bank	0.44	0.40	0.33	0.30	0.32	0.45	0.55	0.40
The Co-operative Bank	0.16	0.10	0.11	0.11	0.10	0.11	0.12	0.17
TSB Bank	0.12	0.13	0.06	0.08	0.06	0.10	0.08	-0.01
Westpac	0.32	-0.19	0.01	-0.07	-0.14	0.03	0.10	-0.01
Average	**0.16**	**0.05**	**0.05**	**0.01**	**0.03**	**0.05**	**0.17**	**0.05**
	Operating expenses/Operating income (%)							
ANZ	43.98	38.24	35.67	39.28	34.30	34.46	35.08	35.28
BNZ	40.28	42.11	42.91	38.65	37.99	38.69	46.85	40.48
CBA	36.03	36.32	36.25	38.02	35.00	35.19	35.69	35.91
Heartland Bank	46.95	43.43	41.23	42.93	43.70	44.54	39.76	40.66
Kiwibank	67.80	64.62	73.04	138.17	78.74	79.41	69.43	69.20
SBS Bank	59.65	62.30	62.36	60.78	67.09	64.26	61.60	61.38
The Co-operative Bank	75.07	72.22	79.33	76.96	74.55	73.32	86.39	76.50
TSB Bank	47.36	48.60	77.37	55.00	47.54	59.48	53.44	50.77
Westpac	38.92	40.69	42.26	43.81	40.03	40.00	39.29	36.77
Average	**42.07**	**40.93**	**40.92**	**44.82**	**38.96**	**39.34**	**40.95**	**39.21**

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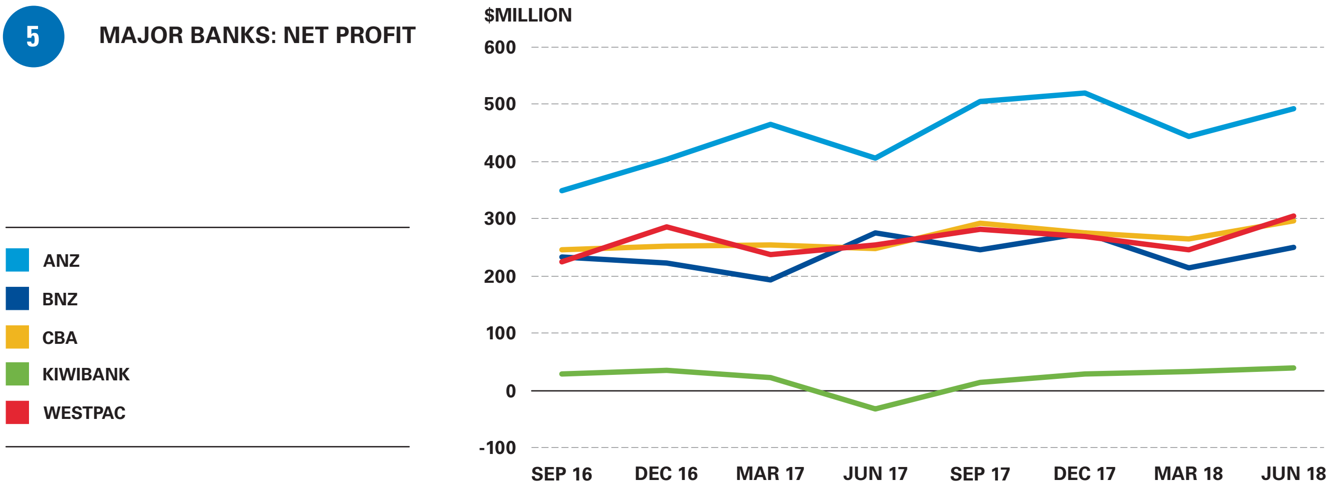
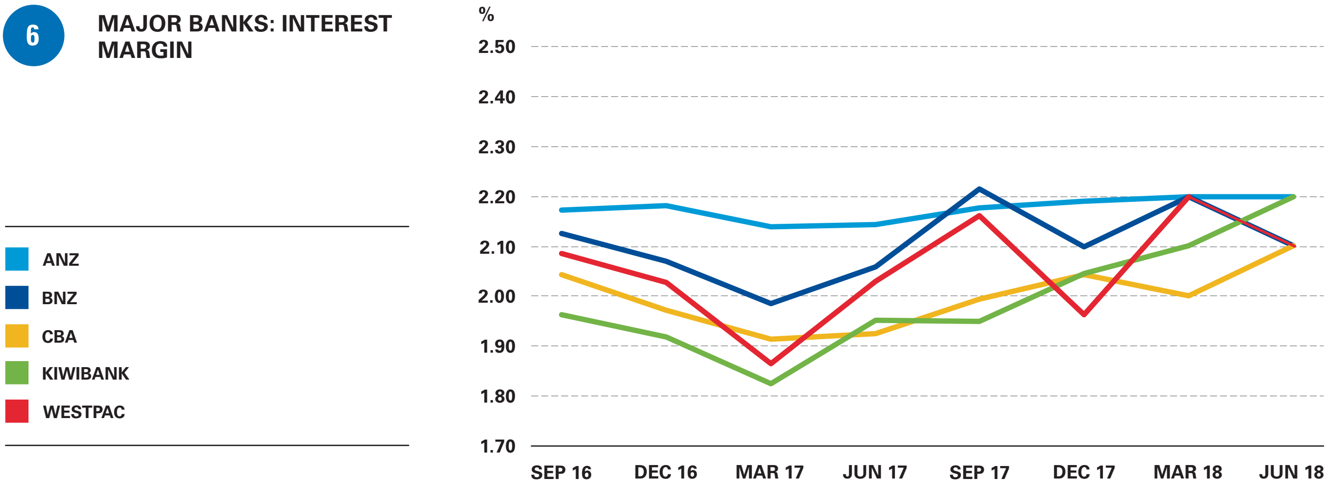
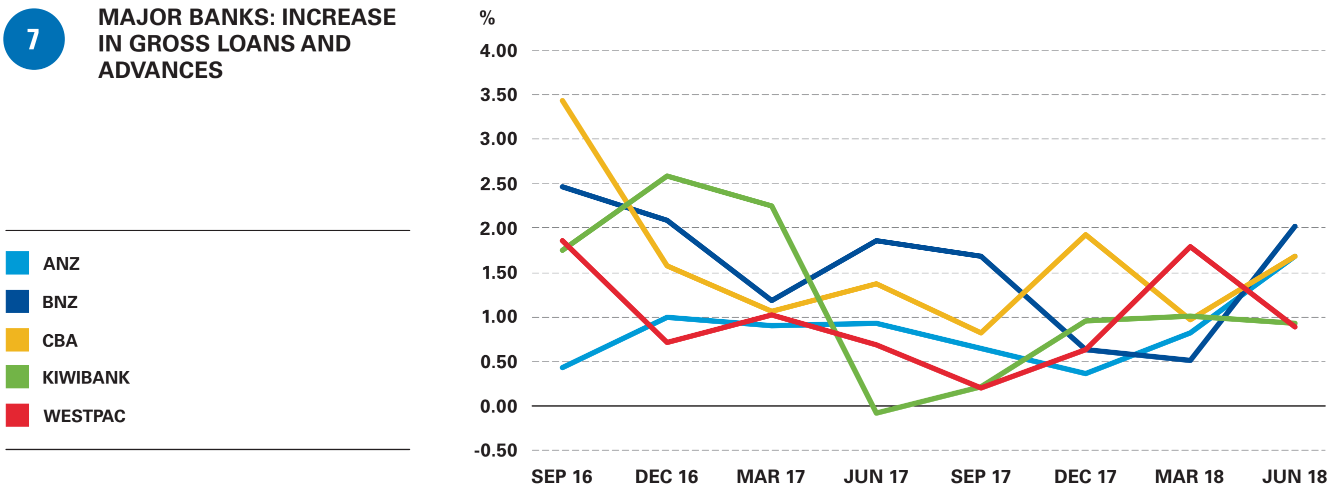
5 MAJOR BANKS: NET PROFIT



6 MAJOR BANKS: INTEREST MARGIN



7 MAJOR BANKS: INCREASE IN GROSS LOANS AND ADVANCES



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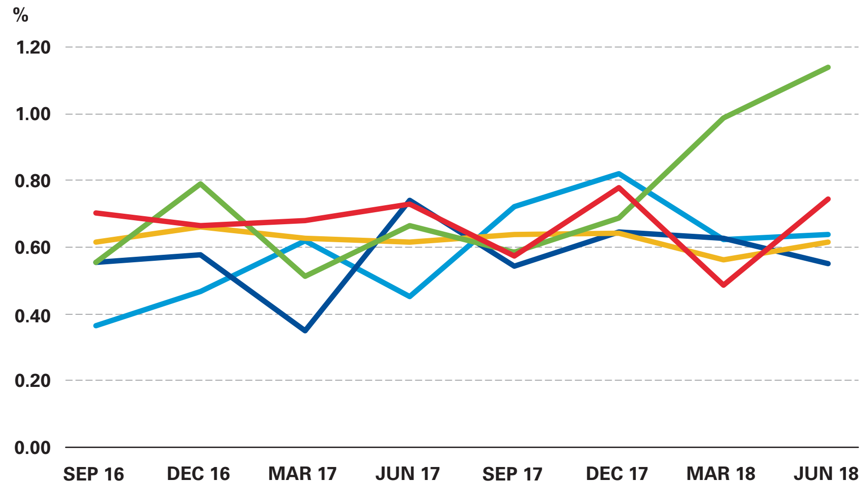
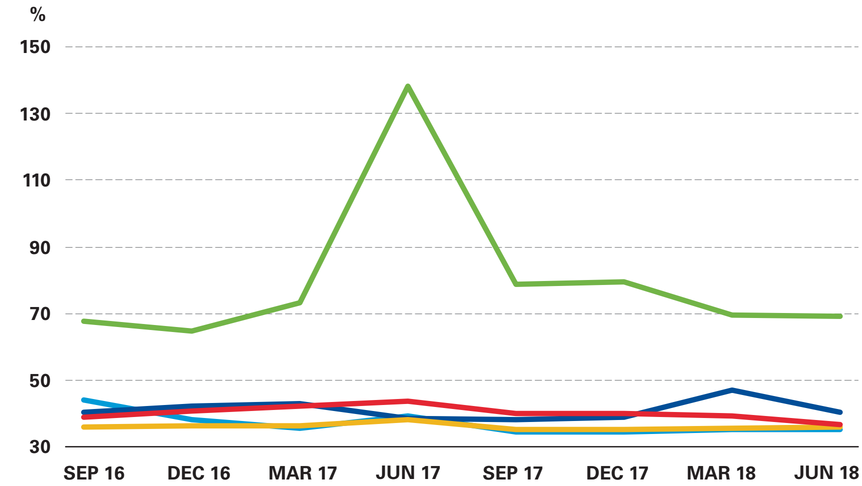
8 MAJOR BANKS: NON-INTEREST INCOME/ TOTAL ASSETS

- ANZ
- BNZ
- CBA
- KIWIBANK
- WESTPAC



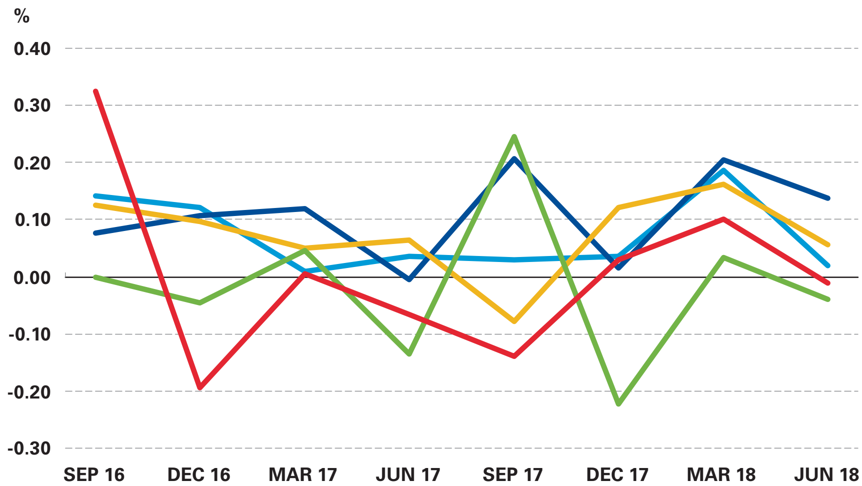
9 MAJOR BANKS: OPERATING EXPENSES/ OPERATING INCOME

- ANZ
- BNZ
- CBA
- KIWIBANK
- WESTPAC



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

- ANZ
- BNZ
- CBA
- KIWIBANK
- WESTPAC



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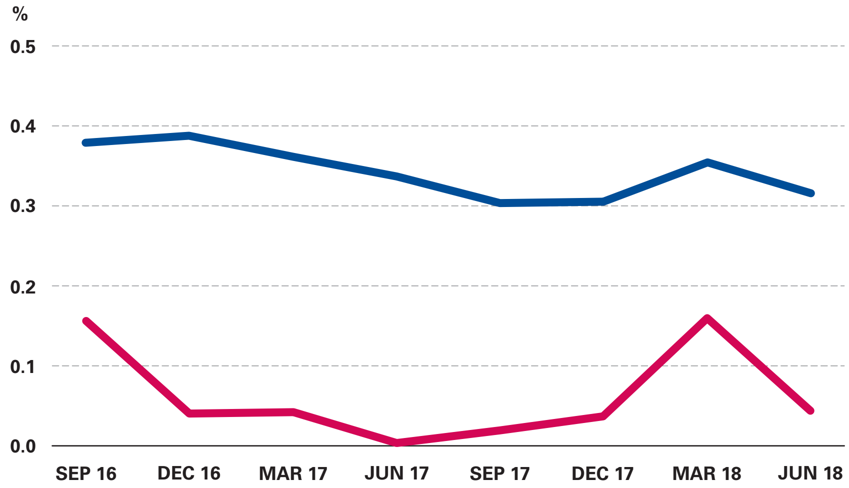
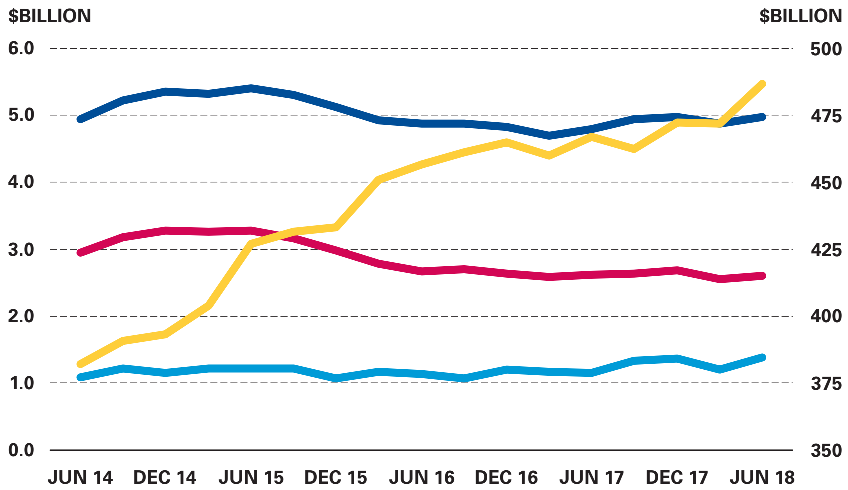
11 MAJOR BANKS: GROSS IMPAIRED VS. IMPAIRED ASSET EXPENSE

- GROSS IMPAIRED LOANS/ GROSS LOANS AND ADVANCES
- IMPAIRED ASSET EXPENSE/ AVERAGE GROSS LOANS AND ADVANCES



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

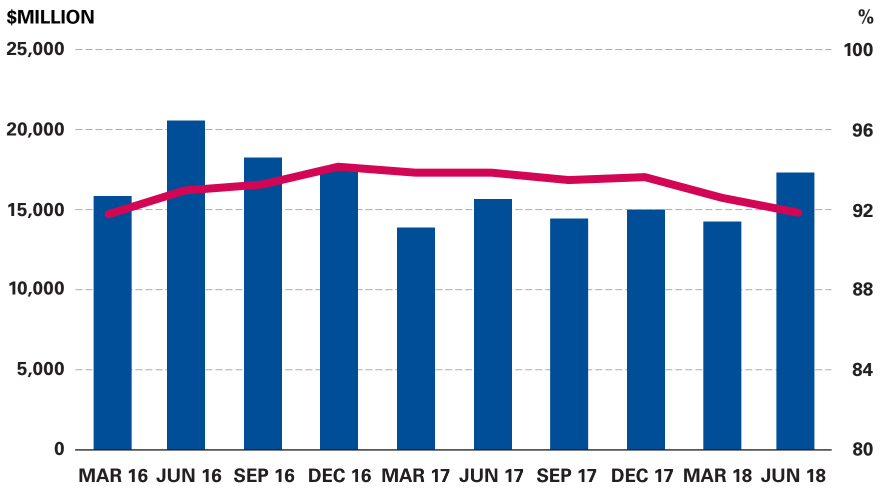
- INTEREST INCOME (LHS)
- INTEREST EXPENSE (LHS)
- NET PROFIT (LHS)
- TOTAL ASSETS (RHS)



13 LVR ANALYSIS OF RESIDENTIAL MORTGAGES

- NEW MORTGAGES (LHS)
- PROPORTION OF NEW MORTGAGES WITH LVR OF 80% OR BELOW (RHS)

SOURCE: RESERVE BANK OF NEW ZEALAND STATISTICS



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Reporting towards sustainable value

Ian Jameson
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Ian is an Associate Director in KPMG's Sustainable Value practice and specialises in better business reporting solutions. Ian was previously the programme lead for the Corporate Reporting Dialogue, an initiative convened by the International Integrated Reporting Council (IIRC) designed to respond to market calls for greater coherence, consistency and comparability between corporate reporting frameworks, standards and related requirements.

The reporting landscape is dynamic

The need to have clarity and purposeful reporting is evident. The likes of Larry Fink, in his 2018 letter to the world's business CEO's, confirmed the need for organisations to demonstrate leadership and clarity to not only drive their own investment returns, but also the prosperity and security of their fellow citizens. This implies a broader level of accountability, stewardship and reporting within business – and a greater emphasis on societal purpose.

The need to have clarity and purposeful reporting is evident.

Financial institutions are part of the societal fabric, and therefore, their ability to navigate the reporting and disclosure landscape in a meaningful way will impact upon the level of trust held for that organisation. We only have to reflect on recent misconduct incidents within the financial services industry to understand the impact on trust.

The 2018 Edelman Trust Barometer found that 64% of CEO believed they should take the lead on change.

The 2018 Edelman Trust Barometer found that 64% of CEO believed they should take the lead on change, rather than waiting for government to impose any regulation. Worryingly, the same report has the financial services sector branded in the 'least trusted' category at 54% – this needs to change. The response by the sector needs to manifest into how the business operates a more customer centric model – not just a seasonal marketing tactic.

In addition to an expected level of business conduct, there is a reduced tolerance towards unethical investments and lending to unethical industries and demand for fairer corporate behaviours. This again drives the sector to review and amend their traditional suite of products and service offerings to meet the expectations of their customers. Furthermore, communicating and reporting on this to investors (who want better quality information) and key stakeholders is paramount.

In New Zealand, the release of the NZX governance code, as well as an update to the Financial Markets Authority governance guideline has catalysed a response to improve reporting. We should not see reporting as a compliance exercise. Unfortunately, the majority of organisations tend to view the code as a compliance exercise and do not see it as an opportunity to drive better disclosure to support transparency and build trust with investors and key stakeholders.

It is about the integrated thinking NOT the reporting

Organisations that look to try and shoe-horn their reporting into a pre-defined framework or standard in an effort to 'comply' are often those same organisations that struggle to connect with their investors and key stakeholders. We have observed that the leading practice in reporting is when there is alignment of internal reporting (organisation's own 'management reporting') and external reporting – applying better business reporting frameworks like the International Integrated Reporting Framework. This particular framework allows organisations to own their reporting – tell their unique value creation story to the market.

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The framework seeks to help organisations inform their own thinking and strategy development process, to the extent that if it is applied correctly, it will help unlock value (beyond financial returns) for the organisation. The focus on developing a more integrated and responsive strategy (especially when considering broader issues such as responsible investing and climate change) is far more valuable than attempting to produce a report that will be a static account of the organisation and of very little use to investors and key stakeholders. Integrated thinking is a new lens being applied to demonstrate management quality and capture the organisation's ability to communicate its long-term value proposition. We are starting to see a positive response by the financial services sector, with some companies like Heartland Bank including a value creation model in their 2018 report.

In New Zealand, we see that there are some key broad themes for financial institutions to consider in their application of integrated thinking.

Transitioning business to be future-resilient

Business that are transitioning to a low carbon economy requires a fundamental shift in thinking. The financial services sector can facilitate businesses to respond on their progress toward a low-carbon economy. This shift is not just about being 'responsive' – the fact is that those organisations who are more resilient to issues affecting their business are likely to outperform their peers. Better resilience – better returns.

Business that are transitioning to a low carbon economy requires a fundamental shift in thinking.

Climate change is something that all organisations in New Zealand should have on their radar. The recent establishment of the Climate Leaders Coalition (who collectively represent more than 50% of New Zealand's gross emissions) includes financial services organisations such as Westpac and IAG (among other leading organisations).[24] The goal of the new group is to help organisations and New Zealand transition towards to a low emissions economy. The resilience of the financial system and the risk of the loan portfolio exposure are important areas of concern to support this transition. The opportunity for the financial sector to drive innovative products, like green mortgages (energy efficient mortgages for conventional households) are good catalysts to support organisations and currently expanding in Europe and Australia.

The reporting world and investors are also responding through the Task force on Climate-related financial disclosures, which will support companies in providing consistent and relevant information to investors, lenders, insurers and other stakeholders.

Financing for the future

The focus on responsible investing and (more recently) impact investing has put a spotlight on how organisations account for their investments and allocate capital in the market. Investors, as highlighted in the recent Responsible Investment Benchmark Report, confirmed that a systematic approach to environmental, social and governance (ESG) and/or ethical factors across the entire portfolio – is now the expected minimum standard of good investment practice in New Zealand.[25] Interesting, at the launch of this report, there was a strong message from institutional investors that the demand for ethical investments is outstripping the supply.

So what does this mean – practically speaking? We need to consider how we innovate to support the uptake of initiatives and /or companies that support long-term value creation. The green bonds and access to 'green finance' is something that is welcomed by the broader market. However, this needs to be directed in a way that is legitimately in the interest of long-term societal benefit – not only short-term gains.

Sustainable land stewardship

We are an island with limited natural resources and yet we tend to look at ourselves as living in abundance. The impact of climate change is being felt already and we cannot stand idle and suggest that it is purely a government responsibility. This is not a 'doom-slayer' view – but rather the fact that New Zealand has a reliance on primary industry exports, and therefore, to support our long-term prosperity we need to ensure we manage our land sustainably. Understanding the material risks and opportunities within the primary sector is relevant to all sectors. However, the financial services sector can play a pivotal role to support sustainable agricultural practices and investment.

Where to from here?

This approach and thinking is fast becoming the norm. The new generation of investors and providers of financial capital need new thinking and reporting – a more holistic approach to understanding risks and opportunities. The financial services sector is uniquely positioned to respond to these developments and will have to embed this thinking to be a catalyst for positive change and also be relevant and viable over the long term.

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Customer experience excellence

Baxter McConnell
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Baxter leads Customer Experience in KPMG's performance team. His focus lies at the intersection of business and psychology, helping clients to create economic value through customer-centric solutions. Internationally and in New Zealand, Baxter has worked with global leading brands to gain insights into how customers feel, what they expect and what they want in the future to drive top and bottom growth.

An overview on the New Zealand CEE report

The KPMG Customer Experience Excellence (CEE) report has been undertaken globally for the last eight years – completing over two million individual consumer evaluations in 14 markets worldwide, and this year is the first time New Zealand consumers have participated.

Based on a survey of almost 55,000 consumers across 14 markets, the report identifies which brands consumers ranked highest for customer experience excellence. 2,504 Kiwi consumers evaluated 124 New Zealand brands.

To be able to answer questions about a brand, consumers were required to have interacted with that brand within the past six months. At least 100 consumers per brand were required for that brand to be included in the final KPMG research results. In total 62 brands made the cut, with the top ten featured in the report to highlight the actions they are taking to deliver exceptional customer experiences.

These brands were ranked across the KPMG 'Six Pillars of Customer Experience Excellence':

- **Personalisation:** Using individualised attention to drive an emotional connection.
- **Integrity:** Being trustworthy and engendering trust.
- **Expectations:** Managing, meeting and exceeding customer expectations.
- **Resolution:** Turning a poor experience into a great one.
- **Time & Effort:** Minimising customer effort and creating frictionless processes.
- **Empathy:** Achieving an understanding of the customer's circumstances to drive deep rapport.

In this year's CEE report, companies from the financial services sector made up three of the New Zealand top ten, Kiwibank (3rd), ASB (5th) and Southern Cross Healthcare (9th). On a whole the Financial Services sector scored highest in Integrity, and Time and Effort. Respondents recognised that many organisations stand for something beyond profit, and acknowledge the efforts they make to create a simplistic process for interactions and transactions.

Consumers rated Kiwibank most highly in Personalisation, Empathy and Integrity, which is largely a result of their focus on culture and personal connections. Kiwibank's commitment to creating exceptional customer experiences is visible across the organisation. This includes investment in everything from digital innovation to transforming the company's operating model to be completely centred on the customer.

"Kiwibank makes a conscious effort to give their people a licence to bring their personality to work and customers appreciate that. It is an intangible quality, but often captured in customer comments such as 'the Kiwibank person spoke like a normal person'."

Mark Stephen
Kiwibank CEO

ASB's strongest pillars were Time and Effort, and Personalisation. Consumers commented on the Bank's great 'personal service' and easy to use digital channels, which is a testament to ASB's continued dedication to technological advances and innovation.

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"Our mortgage is currently with ASB and the entire process was easy and seamless with them. Excellent customer service and we were hand held through the process extremely well."

2018 CEE respondent

Southern Cross Healthcare scored highest in Empathy, being praised for its understanding of the lifestyle challenges of modern Kiwi's lives, while also being discrete and compassionate around the sensitivities of health care. This attention to the individual was also recognised in their above industry average score in Personalisation, where Southern Cross was recognised for providing support unique to each member's situation.

Top trends in financial services from our global research

For the financial services sector globally, greater levels of customer churn is showing that brand loyalty is steadily decreasing. As new technologies make switching between service providers increasingly fluid, customer experience is becoming the key differentiator. Being able to provide exceptional experiences requires organisations to continuously strive to understand their target customers' and their ever changing needs. Top financial institutions are leading the way with seamless omni-channel experiences and by leveraging data and insights to empathise with customers and deliver unique experiences.

One of the global exemplars in customer experience excellence is the UK-based bank first direct. first direct describes itself as "the bank that never closes." As it explains on its website, it's "the bank with real people answering the phone 24 hours a day, seven days a week.

We're the bank that changed what being a bank means – we're not over there, on the high street, we're right here, on your mobile or laptop… We love coming to work every day – even Christmas Days and New Year's Days. Even Mondays – oh yes… And it's all for you."

first direct accomplishes this by putting the customer first and balancing digital and human touchpoints to provide a personal, yet efficient experience.

"Our customers' experience is everything to first direct. Everything we do starts and ends with the customer. When we are talking about new products or systems changes it always comes back to the customer journey, what will the impact be on customers, and how can we make it better for customers? We are always making changes to the business to make sure we're delivering what customers want and need."

first direct, CEO

The financial services landscape is changing

New entrants are entering the financial services space and changing the way customers view the banking industry. Disruptive fintech organisations and non-traditional players are focusing on different aspects of the financial services value-chain and customer experience, such as payment processing and product selection. They are challenging the benchmarks that have been slow moving for many years, forcing the incumbents to assess not only their operating models, but also whether particular aspects of the value-chain can be outsourced through partnering where they are most at threat.

Alipay is a non-traditional brand who has redefined the financial services landscape in China, which is reflected in their number one overall ranking in KPMG China's CEE Report. Evolving beyond financial services, it is a central platform for assisting in day-to-day activities such as booking travel and hotels, hailing rides, ordering food and scheduling doctors' appointments. Their "your security, our responsibility" value has helped develop a reputation as a trusted platform, where their risk monitoring and management system conducts real-time big data analysis to identify suspicious transactions and users.

Conduct and social responsibility

It is one thing to aim to achieve better customer experience and place greater emphasis on conduct and culture – it is another to communicate this emphasis to the group of wider stakeholders. The successful brands in our study have mastered the art of trust-based brand building. They have moved from an era where trust can be bought with advertising and product quality to an era where trust is built slowly over time, interaction after interaction. In financial services, organisations are re-evaluating their controls and risk management focuses, while setting clearer expectations for senior management staff. Organisations have begun setting 'conduct goals' centred around the customer and creating performance metrics that align with desired customer outcomes.

The sector is also responding to new customer expectations concerning the environment and social responsibility. There is a reduced tolerance towards unethical investments and lending to unethical industries along with increased demand for sustainable and fairer corporate behaviours.

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This again drives the sector to review and amend their traditional suite of products and service offerings to meet the expectations of their customers.

Delivering through employee experience

The employee experience and the resulting customer experience are inextricably linked. Firms are recognising that success is found when employees are enabled and supported to deliver great customer service experiences. Ensuring employees have access to the right tools and techniques, along with delegated discretion, enables those that are closest to customer problems to make sensible decisions. This is leading to a move from hierarchies to cross-functional teams, greater personal control over how employees perform their role and greater accountability for the outcomes.

Consistently ranked as one of the best companies in the world to work for, Google strives to treat its customers and its employees well. It makes the connection between the employee experience and the target customer experience they are seeking to create every day. At the centre of Google's approach is its hiring process. By choosing the right people and giving them the freedom to express themselves, Google encourages these people to be excited and energised by Google's purpose of making information available to everyone.

Fragmented customer journeys

Customers are increasingly 'mixing and matching' as they unbundle and then reconfigure their buying experience to suit their individual needs. Organisations that react to the connected consumer and enable customers to re-bundle in unique and personalised ways are beginning to achieve a market advantage. By following customer journeys and listening to their voice as they move through this process, organisations can uncover opportunities to improve their customer's experience across a greater number of touchpoints.

The financial sector is responding to the challenge. Banks have the attitude for improvement, responding to the new imperative of enhanced customer experience, getting closer to the customer. Success will be achieved by those who make an investment to closely integrate the management of all their customer touchpoints and deliver enriched and seamless interactions that feel unique to each and every individual.

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Endnotes

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21 The capital adequacy ratio's reported are for the overseas banking group for quarters ended up to and including 31 December 2017. From 31 March 2018, the capital adequacy ratio reported reflects the ratio of the local registered banking group in line with the information disclosed in the RBNZ Dashboard.

22 For quarters ended 31 December 2017 and earlier, total assets excluded intangible assets. From 31 March 2018, intangible assets are no longer deducted as this information is not available in the RBNZ Dashboard.

23 In line with the information disclosed in the RBNZ Dashboard, the net interest margin is disclosed to 1 decimal place from 31 March 2018 onwards. As interest earning assets is not disclosed in the RBNZ Dashboard, average net interest margin cannot be calculated from 31 March 2018 onwards.

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