Navigating tomorrow for Aotearoa's banking and finance sector

November 2024

Foreword

The banking and finance sector in Aotearoa New Zealand stands at the precipice of transformative change.

This landscape is being reshaped by an unprecedented fusion of technological innovation, evolving consumer expectation and regulatory change. The role of banks in our economy is multifaceted; they are not only financial intermediaries but also pillars of societal trust and innovation.

As customer behaviour evolves, driven by the digital revolution and increasing demand for seamless and personalised service, banking and finance institutions must pivot to meet these needs through agility and creativity.

We spoke with banking and finance sector leaders to understand what the next two years look like in Aotearoa New Zealand. In the following pages we present a summary of what we heard through these conversations, from our conversations with our banking and finance leads in the Asia-Pacific region, and some of our recommendations and challenges to the sector to ensure Aotearoa New Zealand's banking and finance system is set up for success.

Digital transformation has not only brought about enhanced operational efficiencies but also a paradigm shift in customer expectations. The demand for seamless, digital-first experiences is compelling banks to innovate and adapt at an unprecedented rate.

Risk management remains a cornerstone of banking, yet it is evolving. The proliferation of cyber threats, along with the financial uncertainties heightened by global events, necessitates a robust, forward-looking risk management framework.

Banking and finance institutions must be resilient and agile, capable of anticipating and mitigating risks in a highly interconnected world.

The regulatory landscape continues to evolve, with compliance becoming increasingly complex. Our institutions in Aotearoa New Zealand must navigate through a maze of local and international regulations, all while striving to maintain trust, integrity, and transparency.

And sustainability is emerging as a cornerstone of strategic priorities. The focus on environmental, social, and governance (ESG) criteria is becoming integral to banking and finance operations, not just from a regulatory standpoint but as a response to growing consumer awareness and demand.

This report serves as a guide for banking and finance professionals and stakeholders, offering insights that will help them anticipate and respond to the rapidly changing environment. It aims to illuminate the path forward, highlighting opportunities to transform and challenges to overcome in the journey toward a more robust, efficient, and customer-centric banking future.

Nicola Raynes-Pene

National Industry Leader — Financial Services

Digital & transformation:

Bringing Aotearoa forward to where we need to be

Time and again, we hear how the New Zealand banking and finance sector lags its peers across the globe for digital and technology advancements, a concern held by shareholders, regulators and customers alike.

There has been a systemic underinvestment in technology platforms and limited production use of contemporary core banking platforms across the local banking and finance sector. As a result, many institutions have core replacement initiatives high on their agenda, although most are still early in this journey. Core banking initiatives range from strategy and vendor selection, through to building towards delivery of initial banking products on a modern platform.

There is often a balance and tension between progressing platform modernisation while also needing to respond to both increasing regulatory pressure and the increasing complexity and sophistication of cyber threats. These both often require tactical investment and reallocation of key resources to uplift legacy technology platforms that are slated for decommission. A combination of funding pressures and scarcity of resource in the local market can make it difficult to increase delivery capacity and prioritisation calls need to be made which can impact core delivery timeframes.

We are behind globally, but KPMG's Asia-Pacific Head of Banking & Capital Markets, Chris Foster, states that investment in this area is only going to increase if the ASPAC region is anything to go by. Regulators are also focused on developments in this area, as any change in technology and consumer preferences carries through to financial stability, financial inclusion, and competition objectives.

"We know there hasn't been enough investment over the last two decades in technology and all organisations are staring at a tech cliff."

Aiming for an enhanced customer experience

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> "It's about an integrated transformation across the front, middle and back-office systems to create the most effective end-to-end structures, that bring the best customer experience, all whilst enabling growth."

Aiming for an enhanced customer experience

Enhanced customer experience is front and centre of these technology transformations. We all want institutions that make it easy to do business with them — technology that improves operating models and processes thus reducing friction and effort required. Banking and finance institutions are transforming to do just that, so that they can (a) gain a competitive advantage in speed to customer, (b) compete better with the digital startups who are already ahead of the industry and (c) drive compliant interactions which are simple and achieve the right customer outcomes.

The banking sector is evolving rapidly and the rate of change is increasing, driven by customer expectations, regulatory demand and the ever-increasing sophistication of cyber threat. The ability to respond effectively is further complicated by legacy technology stacks — the result of years of underinvestment, which poses significant challenges around data integration, platform interoperability and data accessibility and quality.

To respond effectively to this increasing demand, banks must embrace modern technologies such as artificial intelligence (AI), cloud, automation toolsets and advanced analytics capabilities, and the creation of application programming interfaces (APIs) to enable partnering opportunities.

We will continue to see collaboration and integration with fintechs and digital startups to help deliver this, with gaps in technology or customer experience already being met through acquisitions and partnerships with fintechs. Globally, we've seen it's not a 'one or the other' approach anymore — it's an ecosystem design of how to bring the best capabilities to the fore. Regulatory bodies will be watching this space with interest, supportive of enhanced competition (following the Commerce Commission market study recommendations) and financial market accessibility, balanced with the risks around conduct and personal data protection.

> "Start piloting now, start testing now, build AI opportunities into technology change programmes."

Accelerating with AI

Banks have already been using data and analytics to drive enhanced customer experiences. Determining what products or services are most appropriate to customer groups is critical to ensure the in-person moments, which are still highly in demand, are well constructed and of value to the customer. But what will enhance this even further? As mentioned, AI is going to be central to helping banking and finance institutions achieve enhanced customer experience and wider strategic objectives, through both personal and digital interactions.

We are seeing AI used in Aotearoa New Zealand in biometrics for financial crime and pilots are starting in other bespoke areas. Globally, use-cases are being developed for the streamlining of processes across the value chain of the organisation, driving better employee and customer experience. We see examples of making lending credit assessments, creating regulatory and legal obligations registers (with risks and controls identified), or performing quality assurance for fraud operations.

Market participants want to understand the real impacts of AI before going full steam ahead, working internally to set up appropriate guardrails and governance practices, in line with regulatory expectations as well. In the Asia-Pacific region, we are seeing a reluctance to dive into using AI direct with customers until there is certainty about the quality of information that can be provided to them through these tools. Trust is hard won, but quickly lost. That said, digital banks and startups are using these tools within their platforms and can already create employee and customer experiences incumbent banks and lenders are dreaming of.

Talent and skill development

With all the new technologies and digital tools, there is a real need to have the right talent and skillsets. The workforce challenges are not to be underestimated. KPMG has been highlighting for many years the need to ensure there is budget and investment for the retraining of employees across the organisation to take advantage of new technologies and enable digitisation.

The pool of talent within Aotearoa New Zealand is limited, so retraining is an imperative. Additionally, technical build and support roles have often sat outside the institution in the past, particularly for smaller organisations or bespoke product sets within larger organisations, and many are seeing the need to bring those skills inhouse to retain intellectual property and to build sustainable models going forward. In Aotearoa New Zealand, this is coming to the fore as technology transformations get underway.

This culminates in the need to focus on strategically designing a workforce of the future. How can investment in technology be complemented by a well-led, brave and empathetic culture, with a workforce that is enabled through good tooling to do meaningful and customer centric work? Organisations need to look at:

1. What can be automated;
2. What skills can be taught;
3. How to ensure critical thinking is embedded in training;
4. What expertise needs to be bought in either fractional or as full-time equivalent (FTE);
5. What partnerships need to supplement the skills; and
6. What skills/roles are no longer needed.

This is essential for future success.

Managing the tensions of transformation

Having the right technology, digital assets and workforce structures are crucial for successful transformation programmes, but they aren't the only determinants of success. In Aotearoa New Zealand and across Asia-Pacific, we see tension and/or sub-optimal outcomes appearing in the following areas:

1. The misalignment between business/commercial requirements and technical requirements;
2. Poor training of front-line staff compromising effective uptake of new processes or technology;
3. Lead times being significantly long, bringing transformation fatigue;
4. Lack of operational resilience across the organisation, with tension between operational business-as-usual (BAU) responsibilities and the significant demands of transformation programmes;
5. A lack of enterprise-wide governance for change programmes, leading to poor prioritisation and integration across the organisation, as well as within programme streams;
6. Poor benefit realisation methodologies both at business case stage, and also post implementation;
7. A lack of talent for technology-enabled business transformation; and
8. Poor change management and leadership practices.

Additionally, lessons from the Asia-Pacific region tell us that change programmes need to be designed and run in such a way that they are nimble enough to take advantage of technological improvements and advancements that arise throughout the programme lifetime, and changes in scope. This is a crucial lesson for us here in Aotearoa New Zealand — if we fail to do this, we will fail to keep pace again with change in other jurisdictions.

Our recommendation for banking and finance institutions is to ensure transformation programmes are robust enough and integrated to manage key risks within the following pillars:

- Project governance
- Project management
- Change management
- Performance management
- People
- Process
- Technology

KPMG has identified risk factors within each of these pillars based on our experience across diverse transformations, ensuring the programme design and execution programmes are optimised, and the tensions outlined are addressed at the outset and continually throughout the programme.

"Transformation programmes must be nimble enough to take advantage of technological improvements and advancements and changes in scope."

> "Given the scale of change and the financial and resource investment over the coming years, banking and finance institutions need to get better at quantifying ROI to demonstrate the value-add and sustainability of these investments."

Measuring return on investment

We know the financial cost of these transformations is substantial. Organisations need to ensure the strategic objectives being pursued by the bank or lender are enabled by the new structures, processes, technology and digital tools. This will ensure there is an uplift in employee and customer experience, and a return on investment (RoI) achieved.

But how do you measure that return on investment? It's not an easy thing to do and both here and across Asia-Pacific, we have seen that organisations have not spent enough time challenging themselves on this.

Organisations need to be able to articulate what they are trying to achieve and how they will measure that at each level — breaking it down into the customer journeys and considering how it comes to life through the operating model layers. This means that organisations need to develop more robust business case processes for business transformation programmes; i.e. a business case should be able to clearly articulate measurable financial and operational key performance indicators (KPIs) that will provide the RoI on the individual components of a programme as they are gradually executed.

Risk & regulation:

The cornerstone of stakeholder trust

All institutions know that strong risk management is central to maintaining their banking licence, as well as the trust of stakeholders (both internal and external) and ensuring a sustainable future. It goes without saying that robust governance, processes, data, and reporting systems are central to this, but the leaders we spoke with all agreed that it is an institution's risk culture that really drives effective risk management. So what helps drive a strong, risk-aware culture? It's fostering a 'speak up' culture, embedding an enterprise-wide principle of 'no surprises', ensuring there is strong communication around expectations, and embedding strong risk management into people processes. Ultimately, a proactive culture is needed, with a constant lens on emerging trends and risks, and this begins from the top at Board and Executive levels.

Equally important to risk culture is the structural operation of risk management across an organisation. We are witnessing increasing tension around the traditional Three Lines of Defence (3LOD) model employed by banking and finance institutions, a trend that is likely to persist over the coming years. A range of factors have been at the heart of this trend including a long history of failings in the 3LOD model, resulting from either unclear accountabilities between the first or second line team, or the challenge of finding appropriate capabilities to fill both first and second line teams among others. A range of hybrid models are emerging such as line 1.5 structures or centres of excellence being utilised for specialised risk functions.

Organisations, regardless of size, must find a structure that suits their needs, budgets, and ability to recruit appropriate expertise. Crucially, roles and responsibilities within the risk management framework need to be well defined, with clear accountabilities assigned, and robust governance practices established. This isn't going to happen by chance but if the Chief Risk Officer (CRO) can clarify accountabilities, including broadening the risk ownership across the business then we might see a real strengthening of risk management and sustainable futures.

"Market players are actively challenging the traditional first-line risk ownership and second-line compliance and advisory structure, striving for more effective collaboration with front-line teams, and addressing areas of specialist knowledge (e.g. cyber, or market risk) to improve risk outcomes."

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"The C-suite must evolve into the R-suite, with each executive championing enterprise-wide risk management."

The role of the c-suite in risk management

In KPMG's Future of Risk report, we advocate that risk is the responsibility of every member of the C-Suite and that CROs should be spreading risk ownership across the business. The increased importance of external risks — not least given the state of the economy, emerging frauds and scams, the ever prevalent risk of cyber threats to name just a few — demands closer collaboration with business leaders to build risk into their strategy and business-as-usual (vs. risk just being the responsibility of the CRO).

When we move to the C-suite (rather than just the CRO) addressing the external and internal drivers of risk and developing and implementing a comprehensive risk management strategy, we will see real progress. In other words, the C-suite must evolve into the R-suite. This increases organisational awareness of, and responsiveness to, complex and evolving risks.

We have observed a handful of banking and finance institutions here in Aotearoa New Zealand stepping into this and we expect this to become a broader and more common focus for the sector.

Top risks for banking and finance CEOs

Globally, banking and finance CEOs continue to cite cyber, fraud and regulatory risks as the risks dominating their focus, which is consistent with the top risks identified by our local CEOs.

KPMG's Global CEO Outlook report found that 81 percent of banking CEOs believe that cyber crime and cyber insecurity will have an impact on their organisation's growth in the next three years. That said, they have become marginally more confident in their readiness to respond to this threat.

Cyber resilience

Cyber risk is ever-present, and institutions need to continue to enhance their processes and systems to address the constant changes across the threat landscape and in emerging technology, along with ensuring their organisational risk appetite directly addresses this critical risk. We challenge the sector to ensure every financial services organisation has a clearly articulated and up-to-date cyber security roadmap that demonstrates what they are doing to mitigate cyber risk over a two-to-four-year period. This roadmap should reflect current organisational priorities, planned changes, shifts in the threat and risk landscape, and target security maturity. Alongside that, we expect to see improved maturity in the following areas:

1. Data governance and management
2. Identity and access management
3. Cyber event resiliency
4. Quantum-safe cryptography
5. Supply chain protection.

Focusing on these areas will also enhance customer experience, reduce fraud, increase process efficiency, and improve business continuity. As many institutions aim to leverage AI, areas like data and identity will be critical to ensuring the AI journey is successful and valuable.

Spotlight on fraud and scams

Frauds and scams in Aotearoa New Zealand's banking and finance sector have become increasingly sophisticated, posing significant risks to both financial institutions and their customers. The result is both a financial loss and a loss of customer trust and confidence in the system.

To combat this growing threat, institutions are investing heavily in advanced security technologies, enhancing their monitoring and detection systems, removing key vulnerabilities (e.g. hyperlinks in texts to customers) and conducting regular risk assessments. Additionally, there is a heightened emphasis on educating customers about recognising and preventing scams, thereby empowering them to protect their assets.

Collaboratively, banks are sharing information with one another, particularly in relation to mule accounts, to help target perpetrators. We have seen the establishment of GetVerified which is the organisation that provides confirmation of payee services to the sector, which will begin to be phased in from the end of November 2024. Additionally, the Minister of Commerce and Consumer Affairs, Andrew Bayly, requested an investigation be undertaken on voluntary reimbursement schemes to understand the merits of such schemes and thus informing whether this could be an option for Aotearoa New Zealand, akin to the United Kingdom. We eagerly await to see the outcomes of both these initiatives.

But what we collectively need to see is a more robust eco-system response. Banking and finance institutions are only one part of the puzzle here — enforcement agencies, telecommunication companies and social media giants also need to be part of the response. We, along with many stakeholders, support the banking sector's call for an Anti-Scam Centre (ASC) to be established, bringing agencies and organisations together to combat fraud and scams at a national level. It is fantastic to see that this call has been heard, with Minister Bayly announcing the government will lead efforts to establish a more seamless and efficient response system, commencing with a meeting with key industry providers in December 2024. This will also involve collaboration with Australia and Singapore - two nations that have already established ASCs.

Regulatory change

When it comes to regulatory risk, the changing regulatory landscape for banking and financial institutions shows no sign of abating, irrespective of whether it is prudential (Reserve Bank of New Zealand (RBNZ)) or consumer protection (Financial Markets Authority (FMA)/Ministry of Business, Innovation & Employment (MBIE)) focused. Institutions need to have robust change management processes and programmes to ensure they not only deliver what is expected from a regulatory or legislative perspective (managing the regulatory risk), but that they can deliver additional value to the organisation and customers alike.

This is our challenge to the sector. Too often the technical business requirements are the sole focus — organisations need to bring operational excellence, customer experience and benefits realisation analysis to the fore, in the planning stages through to execution. We know that institutions in this sector have felt the investment burden for regulatory change, overshadowing their technology transformation needs. This approach needs to change, as Boards and shareholders will no longer accept this disparity.

"We have not seen enough additional organisational value creation through regulatory change programmes across the sector — this needs to change or we will continue to see sunk costs."

Collaboration and consultation

However, the focus isn't just on how these organisations internally respond to regulatory change, but how the regulatory supervisory bodies drive their change agendas forward. The Deposit Takers Act (DTA) and everything it contains (deposit compensation scheme, core and non-core standards, crisis management) is the number one priority for the RBNZ, and we know the FMA will be focused on the Conduct of Financial Institutions regime (CoFI) implementation and fair outcomes supervision, which aims to streamline conduct regulation. These are large pieces of change and are / will be time consuming for the sector.

Consequently, we need to see enhanced collaboration by the Council of Financial Regulators on their regulatory initiatives calendar and it's necessary for greater collaboration to be fostered with the sector. We have seen a change in approach from both the RBNZ and FMA who are using one-to-one meetings, reference groups, and industry and online workshops to consult with sector participants on upcoming regulatory change and this has been well received — long may this continue.

We must learn from the past consultation flaws and the implementation of the Credit Contracts & Consumer Finance Act (CCCFA). Sector submissions need to be thoroughly considered to ensure regulations and legislation are truly fit for purpose.

This isn't about weakening policies or creating loopholes; it's about ensuring that standards, principles, and guidelines are crafted with a commercial perspective. Similarly, the RBNZ is introducing a Proportionality Framework in their prudential supervision under the new Deposit Takers Act. This will be a significant test to see if the RBNZ's policies and supervision can deliver proportionate compliance costs for smaller organisations. We await the results with keen interest.

"The challenge is to ensure regulations are designed with a commercial lens, without compromising on the robustness of standards."

Sustainability:

Moving towards the new future

With no regulatory requirements or other incentives to report beyond climate impacts, the short-term focus of the majority of institutions is on ensuring compliance with the Aotearoa New Zealand Climate Standards (climate reporting standards). Very few have considered long term sustainability goals or how sustainability principles could (potentially) shape the future of the banking and finance industry.

With the first year of climate reporting out of the way, the focus for 2025 is on implementing processes to deliver the necessary information to report on those aspects that were not included in the first reports. These generally include financed emissions, anticipated financial impacts and transition planning. Looking beyond 2025/6 the goal is to ensure these reporting duties are being embedded within BAU reporting teams; to drive continuous improvement in processes and data sets to lift the useability of the data and outcomes from this reporting; and to embed climate and ESG transformation across other organisational transformation programmes.

Despite the significant drain on human and financial resources to deliver this reporting, amid several other regulatory and transformation programmes of change across the sector, institutions recognise the role they must play in supporting the transition of New Zealand's economy to a lower carbon economy. It is a matter for course that climate considerations will start becoming embedded in all lending and investment decisions over the long term. However, in the interim, bankers and credit risk officers need to upskill to capture transition finance opportunities across the market; e.g. from emissions reduction efforts across hard-to-abate sectors, or green lending products for the consumer segment. We are seeing this right across the Asia-Pacific region.

"The desire is there to step into more strategic, data-led decision making around risk appetite settings, product development and pricing to name a few areas, but robust and comparable data and investment appetite remains a challenge."

Challenges in data quality

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A dynamic, strategic approach is needed

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Effective lending products for transition

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> “There is a concern that the lack of comparability across the sector will render poor customer outcomes. Collaboration is key, but who is going to drive this?”

Challenges in data quality

We hear time and again from the sector about the issues surrounding quality and pricing across different data sets — and there is concern from both preparers and users of these climate statements that the lack of comparability across the sector may render poor customer outcomes. Take the example of a borrower seeking to access a mortgage on a house and land that has been prone to flooding in severe weather events. If individual banks are using incomparable data sets to underpin decisions around whether to provide that lending and the pricing attached to it, that will create uncertainty and noise for customers — who do I trust and why are they treating me differently? Collaboration is key, but an important question is who is going to drive this?

While some specialist lenders are collaborating across their value chains, more extensive collaboration is needed across all industrial value chains. How will we see this evolve? Central data repositories are needed and it would be helpful for the Government to step into this.

This feedback on data has been heard loud and clear by the External Reporting Board (XRB), as they seek to review the climate reporting standards and ascertain whether an extension to the transitional provisions is needed to ease disclosure and assurance requirements, while data providers are working to improve data availability and quality.

"Through a structured approach of identifying, prioritising, evaluating, and disclosing these impacts, the banking and finance sector can comprehend and act upon the potential value implications of climate change."

A dynamic, strategic approach is needed

A transition to a lower carbon economy is imperative, however this must be a dynamic approach that balances the strategic focus of these organisations.

A crucial challenge is testing the resilience of current business models and envisioning enhanced resilience for the future. Operational and financial resilience must now withstand a broader range and higher frequency of shocks.

Quantifying these impacts is essential for effective capital allocation towards low-emission, climate-resilient activities.

Effective lending products for transition

Whilst reporting is one side of the coin, supporting the transition to a lower carbon economy through effective lending is the other. We are noticing a divide across the sector when it comes to the provision of specific transition-focussed products.

Green loans, social loans and sustainability linked loans are more common across the marketplace, but there are concerns about the assurance requirements and related costs that come with some of those lending products, with pricing benefits not seen to be material for the added costs of compliance. Some institutions have chosen to develop bespoke products with customers instead.

What is clear in any event is that pricing should not be the primary factor motivating customers — social and market driven demands need to be the driving force — there needs to be a mindset shift from customers as we go on this journey together and the banking and finance sector needs to continue to help drive that.

Contacts

We hope you enjoyed this report and would be delighted to discuss its content and insights in further detail. Please do not hesitate to get in touch if you have any questions or would like to schedule a conversation.

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