FIPS

FINANCIAL INSTITUTIONS PERFORMANCE SURVEY

REVIEW OF 2015

THE CONTINUED STRENGTH OF THE BANKING SECTOR DRIVES THE REST OF THE NEW ZEALAND ECONOMY

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

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

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

The Survey

Our Financial Institutions Performance Survey (FIPS) of 2015 marks the 29th year we have provided industry commentary and an analysis on the performance of the New Zealand registered banks and non-bank financial institutions together with topical articles from the sector's participants.

The survey covers balance dates between 31 October 2014 and 30 September 2015. This has once again resulted in registered banks with the balance date of 31 December having their 31 December 2014 results included in this year's survey as their most recent results. The banks affected by this are Bank of China, China Construction Bank, Citibank, Deutsche Bank, Industrial and Commercial Bank of China, JPMorgan Chase Bank, Kookmin Bank, Rabobank and The Hongkong and Shanghai Banking Corporation.

We welcome two new registered banks to this year's survey, with China Construction Bank New Zealand Limited obtaining registration on 15 July 2014 and Bank of China New Zealand Limited obtaining registration on 21 November 2014. Both banks are subsidiaries of their much larger parents operating in China which are the second and fourth largest banks in the world, respectively, based on total assets in 2015.

For the non-bank sector participants, the threshold for inclusion in the survey has remained at total assets of $75 million.

First Mortgage Trust and Nissan Financial Services New Zealand Pty Limited are the latest entities to be welcomed into the non-bank sector survey this year.

Fisher & Paykel Finance Group changed their balance date in 2013 from 31 March to 31 December, which means the comparatives presented for Fisher & Paykel are for a 9 month period ended 31 December 2013. The sale of different businesses of GE Capital that have occurred during the 2015 year have not affected the way these entities are reported in this year's survey, as the financial statements used for GE Capital are as at 31 December 2014. At that time, the entity had not commenced its sell down. There will be a significant impact in next year's survey from these disposals. This year we continue to disclose the individual GE entities separately below our analysis of financial statements table for information purposes (see page 102). Hopefully next year we will welcome the results of the 'sold entities' in their new ownership.

As has been the case with previous surveys, all information used in compiling our analysis is extracted from publicly available annual reports and disclosure statements for each organisation, with the exception of certain information provided by the survey participants. A limited number of participants provide us with audited financial statements that might not otherwise be publicly available.

We wish to thank the survey participants for their valued contribution, both for the additional information they provide and for the time made available to meet with us to discuss industry issues.

Massey University continues to be a stakeholder in the survey, assisting with the data collection and analysis, as well as drafting the forecasting section of this survey. We thank them for their continued contribution.

Continuing the theme from last year, we are delighted to again have commentary from the Financial Markets Authority (FMA) and the New Zealand Bankers' Association (NZBA). In addition, we welcome contributions in this year's survey from the Financial Services Federation (FSF). We have supplemented their external thought leadership commentary with some of KPMG's own business line thought leadership. We trust you find the content of this survey of interest. If there are any issues or matters included in the document that you wish to discuss in further detail, please do not hesitate to contact us.

TABLE 1: Movements

	Who's out	Who's in
Banks: 25[1]	Nil	• Bank of China New Zealand Limited • China Construction Bank New Zealand Limited
Non-banks: 23	Nil	• First Mortgage Trust • Nissan Financial Services New Zealand Pty Limited

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A KPMG view from the editor

Each year when I review the performance of the banking sector, there is a recurring theme; banks have made a record profit, but there remains challenges ahead. And every year, the results get stronger.

Economic conditions continued to remain positive throughout most of 2015. Up until the final weeks of 2015, when volatility returned to global markets, the New Zealand economy had enjoyed a strong ride compared to the rest of the world. That is not to say that it had not faced some issues around dairy prices, challenges in Asian markets (in particular China), and the impact of Europe. Our economy's strong performance has been more than replicated by the banking sector. This year sees New Zealand banks record a net profit of $5.17 billion based on margin growth of four basis points, lending growth of 7.11%, and a reduction in the operating income to operating expense ratio to a low of 37.32%.

The banking sector has improved its overall capital adequacy ratio by 72 basis points (bps) to stand at 13.16%. The only slight blemish on the result has been an increase in the impairment provisioning, but that represents more of a return to normalisation.

Why have our banks performed so well in challenging global times? The answers are many and varied:

- The New Zealand economy never rose to the same dizzy heights as did some global economies in the mid-2000s; so when the global financial crisis (GFC) arrived, it didn't have so far to fall.
- Post-GFC, the New Zealand banks never found themselves in a position where they needed to be recapitalised or bailed out. This has meant that, as the New Zealand economy has recovered more quickly in comparison to foreign economies, the banks have been at the forefront of that recovery.
- The Auckland housing market (perhaps slightly artificially) has boosted the economy, as has the rebuild in Christchurch and new development in Auckland. Throughout this period, New Zealand employment levels have improved slightly.
- Our banks have been in a position to allow their customers to transact freely. Customers had been able to deposit and borrow from banks, and engage in trade activities or derivative products.
- During the period post-GFC, New Zealand's regulatory environment has moved or changed very quickly. The banks have proven very adept at implementing new regulations and ensuring their compliance with them.

So 'where to from here' for the New Zealand banking sector? At the risk of sounding a little like a stuck record, the New Zealand banking sector is well-poised to continue to grow. However it does face some headwinds:

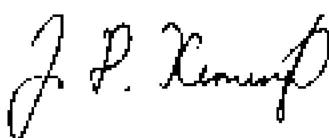
- The impact of a prolonged lower dairy pay-out is a significant challenge. There is still some concern around this, and the level of debt that the industry has to service.
- To date, there has been sufficient liquidity globally chasing yield to ensure adequate funding. While the New Zealand banks remain well above the Reserve Bank of New Zealand (RBNZ or Reserve Bank) core funding ratios, they still are exposed to the global markets they draw significant funding from.
- One of the major issues many banks will have to face in the current period is the potential regulatory impact from the Reserve Bank's proposed outsourcing rules. The Reserve Bank is clarifying its position on outsourcing, and requiring systemically important banks to bring key operations onshore. The Reserve Bank is looking to ensure that it can – if necessary, in the event of a global or regional issue – control a bank fully onshore. From the banks' perspective, they will argue that part of the reason they have been so efficient is that they have set up global centres of excellence where there are workforces capable of providing the labour and expertise required. This has allowed them to reduce the pricing that is passed on to consumers in the local economy.

No survey of the last five years would be complete without a comment on the Auckland property market. It has continued to rise at rates amongst the highest in the world, such that Auckland is now the 4th most unaffordable city in the world (hardly an achievement to be proud of). The basic structural problem is one of supply and demand. There is currently insufficient stock of dwellings, and net migration is such that more people are flooding to Auckland than houses are being built. The Reserve Bank has implemented various regulatory measures. These include the loan-to-value ratio (LVR) rules (the 80% rule, and the 70% rule for investors); the requirement to have a domestic bank account and an IRD number; and other tax rules around taxing profits on the sale of properties within two years. While the initial impact of these rules has been to slow down the level of settlements, they haven't really adjusted the prices downwards. Many commentators believe that it is only a matter of time until work-arounds to these rules emerge, or significant amounts of capital are released from Asia.

Looking to the future for banks, they are faced with many of the challenges that any global business faces. The six main strategic worries faced by bank Executives globally are all present in the New Zealand market.

1. Cybersecurity risks and cybercrime remain an ever-present threat. These risks evolve quickly, change radically, and threaten the profitability and reputation of any financial services business.
2. Conduct risk has an ever-increasing presence both globally and locally. Hopefully New Zealand businesses can learn from international episodes; and avoid some of the damage that is being done by the conduct itself, its remediation costs and social media's reporting of it.
3. The global economy continues to stumble along. The constant threats of deflation and various economies defaulting creates a very challenging environment. All Executives we spoke to are doing everything they can to avoid being a casualty in any future economic crisis.
4. As if that is not enough, the industry is facing unparalleled challenges from disruptors in the form of new fast-moving internet-based businesses. These businesses are most prevalent where there is a chance to expedite the interaction with the customer, and where there is sufficient margin that it can be shared between the disruptor and the customer. Financial institutions are increasingly aware that they need to join the disruption business if they are to survive.
5. Customers want to interact digitally, which is driving the need to constantly be making everything one click away.
6. When it comes to regulation, the biggest risk is the 'unknown' of the regulatory response to another event such as a GFC, and whether it will be an appropriate reaction or an over-reaction.

Finally, these risks have become increasingly interrelated. Where an entity suffers an impact from one of them, it is more than likely to suffer an impact from others at the same time. In summary, the New Zealand Financial Institutions can be incredibly proud of the 2015 result. Once again, the sector can look to its banks as the well-run businesses at the centre of New Zealand's economic engine.



John Kensington
Partner – Audit
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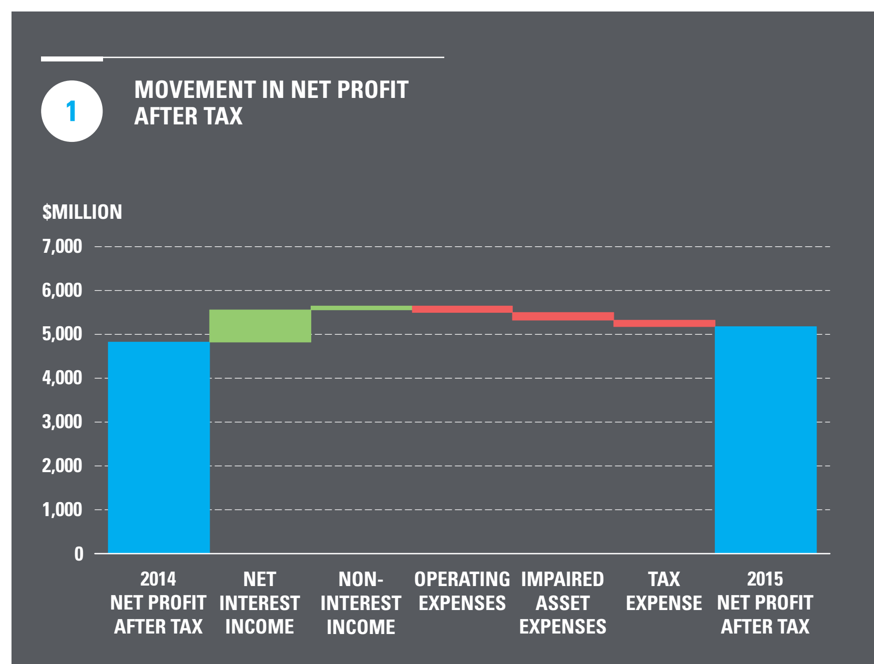
KPMG

BANKING INDUSTRY OVERVIEW

Registered banks – Industry overview

The banking sector has had another record year and navigated its way successfully through – dairy price volatility, Chinese market movements, and further regulatory impost. It stands as one of the strongest banking sectors in the world and one of the most successful.



Profitability continues on an upward trend underpinned by strong asset growth coupled with slight margin improvement

The New Zealand banking sector recorded another year of strong performance with profits up 6.94% to reach an all-time high of $5.17 billion (see Figure 1).

The banking sector has achieved steady year-on-year growth in profits, having increased net interest income on the back of growing lending books and improving cost efficiencies (see Figure 10). Lending has continued to grow at an increasing pace for the past five years. This was undermined by an increase in impaired asset expense of $173.08 million or 65.33% in the current survey period as the reversals of historical provisioning we had seen in the past came to an end. This is seen by many in the industry as being reflective of the slow return to a normalisation of impairment charges from the period post the GFC where higher levels of impairment were required. Lending growth was very much driven by the continued momentum in the housing market that saw the median house price in Auckland rise by 13.57%.

Continued cost discipline also drove significant operating efficiencies with operating expenses relative to operating income declining by 212 bps to 37.32% (see Table 3 – page 25). These factors in combination with a relatively stable New Zealand

economy have created a positive environment for banks to continue gaining momentum.

The New Zealand banking sector recorded another year of strong performance with profits up 6.94% to reach an all-time high of $5.17 billion.

Forecasts by our survey partner Massey University show that total industry lending is to continue growing at a reasonable pace over the next two years while net interest margin is expected to decline slightly due to higher competition. Credit loss rates are also forecast to increase slightly over the next two years, however will still be low due to the rigorous lending policies of the banks (see Tables 12 and 13 – page 74).

Competition for quality credit continues to be fierce and has not eased with the banks continuing to explore new avenues to maintain margins outside of their traditional lending segments. Despite the intense competitive pressures in the market, net interest margins have increased by 4 bps to 2.28% (see Table 4 – page 26), with return on assets (RoA) and return on equity (RoE) ratios slipping slightly by 1 bp and 17 bps respectively due to increasing capital requirements (see Table 5 – page 27).

The banks have consolidated their balance sheet positions further in the face of economic volatility in both global and local markets and additional regulatory requirements (see pages 40 and 41). Total Capital adequacy ratios and Tier 1 Capital ratios have risen to record highs of 13.16% and 11.86% respectively, well above the minimum requirement set out by the RBNZ. Furthermore, additional LVR restrictions introduced by the RBNZ strengthened the quality of bank loan books with the proportion of loans over 80% LVR declining from 15.72% to 13.17% for the five major banks in the 12 months to September 2015. Our non-bank sector survey participants noted this was an area where they had seen less intense bank competition.

This year has been another impressive year for the banks, achieving new records and improving several performance metrics. However, the future brings considerable uncertainty around just how prolonged the impacts of depressed dairy prices will be, the recent global market volatility impacting funding costs, and the ever-present threat of a sharp correction in Auckland house prices.

Normalisation of loan impairment charges

Improvements in asset quality metrics have been a key theme for the banks since the height of the GFC with the release of provisioning adding to the profitability of the banks each year. While asset quality has remained strong in the current survey period, the slight deterioration observed in some credit quality metrics indicates that the low levels of impairment charges may be coming to an end. This likely means that the bottom of the credit cycle has been reached and we are now seeing more normalised levels of impairment charges. In addition, the growth in loan books has and will continue to carry increases in collective provisioning while many industry participants also feel the implementation of NZ IFRS 9 *Financial Instruments* will lift provision levels even higher.

As the global supply of dairy products has continued to outstrip demand resulting in prices once again falling.

In the current survey period, impaired asset expense as a ratio of average gross loans and advances has risen from 0.08% to 0.12% (see Table 5 – page 27) on the back of a $173.08 million increase in impaired assets. Of the two major threats to credit quality that were mentioned in the prior year's survey, being the dairy industry and house price inflation, both still remain. However, dairy has probably become the more immediate concern with much uncertainty as to when dairy prices will recover and just exactly how the industry is placed to handle a more prolonged downturn.

As the global supply of dairy products has continued to outstrip demand resulting in prices once again falling at the Global Dairy Auctions in the first month of 2016, Fonterra has again re-forecast the Farm gate Milk Price downwards in late January to $4.15 per kgMS from the $4.60 per kgMS that was forecast in December. This will come as dire news for dairy farmers, with as many as 80% already estimated to generate negative cash flows before the cut to $4.15 per kgMS was announced, according to an RBNZ report[2]. Unfortunately for dairy farmers it appears prices are to remain depressed for the immediate future as supply of dairy products continues to grow from both Europe and the US. Additionally, the Chinese

economy, which is the world's largest consumer of dairy products, continues to slow down.

In an attempt to help mitigate the situation, Fonterra announced interest free loans to dairy farmers of 50 cents per KgMS produced during the period 1 June 2015–31 December 2015.

As of late last year specific and collective provisions relating to dairy loans based on data obtained by the RBNZ were sitting at 0.1% and 0.6% respectively of total dairy lending. Stress testing undertaken by the RBNZ indicates that in a situation where milk prices recover to the mid $5.00 per kgMS range in the 2016/2017 season and experience marginal growth in the years thereafter, non-performing loans are estimated to increase to around 7.8% of initial sector debt by 2018/19. This is compared to a scenario where the dairy price is not expected to recover in the 2016/2017 season and experience marginal growth in the years thereafter, where non-performing loans are estimated to increase up to 44% of initial sector debt. While provisioning relating to dairy loans currently remains below levels observed in the years immediately after the GFC, from the stress testing scenarios it can be seen that provisioning will begin to increase significantly should the price not recover for an extended period of time[2]. Comments by Executives indicate that many of the banks have already commenced reviews of their largest exposures in an attempt to identify and work with potential problematic loans.

Auckland is now considered to be the fourth most unaffordable city in the world.

Rapid house price inflation has been the subject of intense media coverage over the last few years as prices in Auckland have risen to the point where Auckland is now considered to be the fourth most unaffordable city in the world. The RBNZ has been actively trying to combat the rampant rise in house prices within the Auckland property market with the introduction of LVR ratio restrictions in October 2013. While the restrictions have had an impact particularly in reducing lending in the over 80% LVR bracket, these measures have not been strong enough to combat the market forces driving property prices, being a demand that outstrips supply caused by years of insufficient houses being built while immigration remained high. The risk of a sharp correction in house prices is therefore still a concern given the banking sector's significant exposure to the property market.

TABLE 2: Registered Banks – Non-performing Loans	2012	2013	2014	2015
Past Due Assets to Gross Loans and Advances	0.34%	0.27%	0.19%	0.19%
Gross Impaired Assets to Gross Loans and Advances	1.19%	0.87%	0.66%	0.48%
Total	**1.53%**	**1.14%**	**0.85%**	**0.67%**

As a result of the continued rise in prices), further measures were implemented late last year, most notably by the RBNZ and the New Zealand Government, which have been further covered in the 'Regulation' section (see page 13).

The Auckland housing market has had a relatively cool start to 2016 with falling auction clearance rates and reduced sales volumes. Whether the newly implemented measures, which aim to dampen demand, have an impact in the long term will be closely monitored by the banks and the RBNZ, particularly with many commentators predicting it is only a matter of time before a new wave of capital is released from Asia.

In addition, the implementation of NZ IFRS 9 may result in considerable changes to banks' impairment testing models, as the accounting standard replaces the existing 'incurred loss' model with the 'expected credit loss' model. Under the revised approach, it will no longer be necessary for a loss event to occur before an impairment loss is recognised. Expected credit losses would be measured as the present value of all cash shortfalls over a measurement period. The general consensus is that it will increase the provisioning levels.

Funding mix continues to improve

The banking sector has continued to improve its funding profiles in the current survey period, as local deposits have continued to experience growth (see Figure 22), albeit no longer exceeding the growth in lending based on RBNZ data. This has resulted in a further improvement in the RBNZ Core Funding Ratio which for the industry as a whole substantially exceeds the regulatory minimum of 75%.

Despite an improving funding profile, when compared against their overseas counterparts, the level of and reliance on short-term offshore funding still remains relatively high and exposes a vulnerability of the New Zealand economy which has not been missed by rating agencies in recent comments. The short-term nature of offshore debt exposes the New Zealand banks to volatility in global funding markets, which could threaten to reduce the supply of funds and push up borrowing costs, placing a strain on the banking sector.

In instances where the banks have needed to obtain wholesale funding, conditions earlier in the year have been generally favourable despite an increase in volatility and funding spreads. Global wholesale funding markets have remained relatively liquid and the cost of wholesale funds at levels close to that observed before the GFC in 2008, as global investors search for yield particularly in high interest markets such as New Zealand. Another driver of the favourable conditions has been the monetary easing policies introduced by some of the world's largest economies in an attempt to stimulate growth and combat deflationary pressures. Market conditions were echoed in remarks made by Executives who commented on their ability to obtain wholesale funding as and when required at reasonable rates in the early and middle parts of the year. We note however that market volatility in the last weeks of 2015 saw some of this favourable liquidity and pricing evaporate.

Looking at 2016, global equity markets have started by plunging into a state of apprehension.

Despite the favourable conditions in global wholesale markets and a combined 100 bps decrease in the RBNZ's Official Cash Rate (OCR) observed in the last half of 2015 as the RBNZ sought to combat deflationary pressures, the cost of funds marginally increased in the current survey period from 3.67% to 3.87% (see Figure 14). This is likely due to the fact that the reported results of the banks with December, March and June balance dates do not reflect the impact of decreases in the OCR which only commenced in June. Some banks also had funding at favourable rates roll off that could not be replaced with equivalent rates.

Looking at 2016, global equity markets have started by plunging into a state of apprehension. Until such time as confidence is restored, this could potentially be a benefit for any banks looking to raise funds in global wholesale markets if investors begin to move their money to what is seen as "safer" investments such as lending, but provided spreads do not increase significantly. Combined with the potential for further OCR cuts in the local market, the banks may see continued favourable conditions in which to source funding at least through the early part of 2016 if they can re-price quickly enough to take advantage of any rate reductions.

The environment continues to be highly competitive

The story around competition continues to show recurring themes from last year, with the addition of new market entrants in the banking sector contributing to an already highly competitive environment. For Executives, the challenge ahead is to be able to protect profit margins against the threats that greater competition brings.

Competition in the loan market is heating up.

With lending growth of 7.11% (which is the fastest pace observed in the last five years), we are seeing continually more aggressive loan writing practices taking place (see Table 5 – page 27). Executives have commented that deals are now being made which in usual situations would not be

economically justified. The rationale being that some banks are seeking to either grow their underweight loan books in a particular sector, maintain current market share, and/or establish client relationships to cross-sell additional products with higher margins. Competition in the loan market is heating up to the point that many participants mentioned they are starting to fall below RoA and RoE requirements for specific lending. Increasingly we are seeing debt consolidation style arrangements being offered, which are very attractive for borrowers due to their simplicity, with very low interest rates in an attempt to move customers from competitors.

Outside of retail lending where competitive pressures are well documented and reported on, the competition has been heating up in the corporate and commercial lending sectors with the entry of Bank of China and China Construction Bank at the end of 2014. They have since gone on to write over $366.06 million in loans as at 30 September 2015. Some Executives have commented on the noticeable impact of their presence in the market in terms of the number of deals and client relationships that they have been part of. However, their local incorporation status means they are subject to restrictions on related party exposures imposed by the RBNZ as part of their conditions of registration. This can be a disadvantage when compared to a branch structure that allows access to significant pools of related party funding, and could prove to be an impediment to growth if funding cannot be obtained from alternative sources.

In relation to P2P lenders, the banks do not currently see them as a major threat to their business as they have for the most part kept out of their traditional lending space. P2P lenders are more of a concern to the non-banks sector as they have continued to focus their operations mainly on small unsecured lending for vehicle, business or personal loans (see page 96). The banks have however acknowledged that future collaborations with P2P lenders may in fact be beneficial in gaining a competitive advantage. One aspect P2P lenders have been able to excel in is integrating interactive digital technologies into their front end platforms to enhance the user's experience. A partnership with a P2P lender could allow banks to strengthen their front end operations creating operational efficiencies, enhancing the customer experience and possibly changing the way mobile banking is understood and conducted today through innovative solutions. At present, P2P lenders are targeting areas that suit them, which is both where the process can take time in other traditional channels, so there is an ability to speed up the customer experience, and also where there is a sufficient margin to provide the service at a competitive price by sharing the margin. They will, in the near future, remain clear of areas where banks can drive real economies of scale, raising and lending large amounts of money at very competitive rates. For now the higher margin products will be where they target their high speed digital invasion.

In a response to the competitive environment, we have commented in the past that banks have been willing to enter non-traditional markets such as the non-bank sector, where the competitive pressures are not so high, to support growth and help alleviate margin pressure. Recently the banks have shown a willingness to provide wholesale or securitised funding to non-bank lenders, in effect indirectly lending to their customers through the entity while taking some comfort from the non-bank lender both in terms of the capital they contribute and their pre-existing relationships and processes they have already established. One such example is the securitisation programme between Westpac and Credit Union South implemented in November 2015. Another similar avenue for the banks is to provide wholesale funding to P2P lenders which could be viewed more as bringing new lending opportunities rather than being merely competitors or disruptors, as is the case between Harmoney and Heartland Bank. As the P2P market continues to gain traction with all four currently licensed P2P lenders now in operation, this could present significant opportunities for banks to grow their loan books in the non-traditional space.

Outside of lending there has also been significant competition in relation to banking service contracts this year, with several coming up for renewal or tender. Westpac retained the bulk of the 'All-of-Government' banking services contract after four years of negotiation, with the contract having been put out to tender for the first time in 25 years. Five other banks were also given parts of the 8 year contract including Citibank which will provide foreign exchange and card services. Westpac became Air New Zealand's Airpoints partner, signing a 10-year deal with Air New Zealand, with Airpoints to be

offered on four of their MasterCard credit cards.

Regulation continues to be a hot topic

The RBNZ continued to be proactive, having commenced a number of regulatory initiatives to ensure the New Zealand banking industry is well prepared for any large scale economic downturns. Although regulation is generally perceived with a mixture of support and reluctance by the banks, the pace of regulatory changes has posed significant strain on resources and has come at a high cost. There is a feeling among Executives that at times regulation is imposed without thorough consideration of potential impacts, or proper assessment of reasons prompting change. However, the banks remain well placed to cope with regulatory developments and Executives recognise that these are needed to help strengthen the banking sector.

The pace of regulatory changes has posed significant strain on resources and has come at a high cost.

This year the RBNZ has introduced new LVR speed limits, specifically targeting Auckland investment property loans. In its Financial Stability Report released in November 2015 the RBNZ has pointed to a growing risk of a correction to Auckland house prices and the significant impact this could have on financial stability. Thus, tighter restrictions have been introduced as of 1 November on lending to Auckland property investors in an effort to curb Auckland's rapid house price inflation and strengthen the credit quality of banks' loan books by reducing the proportion of riskier mortgage loans.

Impacts of tighter LVR restrictions were combined with new tax rules which came into effect on 1 October, aimed at helping to dampen the demand for Auckland property. The new tax rules encompassed the 'bright line' test which imposes capital gains tax on investment property sold within two years, and the new requirement for all property buyers and sellers to have a New Zealand IRD number and bank account. As could be expected, several Executives reported a notable influx in deals being done in the months before the new rules came into effect, with an easing in volumes seen afterwards.

If Asian capital is unlocked it will breach the dam.

The general consensus among Executives has been that the new LVR speed limits and new tax rules have had a positive impact, strengthening banking system stability, improving the credit quality of loans and making borrowers more responsible as they are now forced to consider foregoing discretionary spend in order to secure a property. Whether it has a prolonged impact on house prices remains to be seen, with many we spoke to saying a way around it will be found by various promoters, and if Asian capital is unlocked it will breach the dam.

Compliance with Anti-Money Laundering (AML) legislation has received much attention, with several Executives reporting having undergone AML audits or reviews, with no major non-compliance issues arising. Looking forward, AML is expected to continue to feature as one of the key compliance concerns in the banking sector and remains as such for banks globally. Interestingly, the RBNZ appears to have seen some unintended consequences of AML legislation, having issued a formal statement early this year about its concerns over widespread closures of accounts for money remitters as a means of potential 'de-risking' by New Zealand banks to comply with AML requirements.

Following a recently completed outsourcing stocktake, the RBNZ has commenced a review of the outsourcing policy applicable to 'large' banks (defined as locally incorporated banks with New Zealand liabilities of more than $10 billion). This review aims to enhance banks' ability to provide basic banking services in the event of separation from its parent or failure of a service provider, and to ensure clarity and consistency across banks in the application of the outsourcing policy interpretation of 'core' functions.

The proposal includes an express requirement for a separation plan for subsidiaries of overseas owned banking groups; a list of functions that cannot be outsourced; and considers whether the threshold used for the outsourcing policy should match that of the Open Bank Resolution (OBR) policy of $1 billion.

It would not be overstating the situation to say that the stance taken by the RBNZ is concerning to the industry, as there has been

considerable resource spent setting up the outsourcing operations with a view of achieving cost efficiencies, and centres of excellence in areas where knowledgeable resources are scarce, and has been perceived by some Executives surveyed as an apparent turnaround from their previous position. The worst case scenario of having to bring these functions back onshore would be very costly (estimated to be in the hundreds of millions according to an affected bank in the big four).

In addition, some Executives questioned as to whether this would actually produce better outcomes, as outsourcing enables banks to focus on core competencies and enjoy technology and practices that may not otherwise be locally available. In addition, the risks of complete supplier failure or bank failure aimed to be mitigated by potentially moving some functions back onshore were perceived as more remote than the risks that may be mitigated by outsourcing such as a natural disaster or technology failure that would have a greater adverse impact if all critical functions ended up in one place.

The potential flow-on impacts could create issues with capital movements within entity structures in the event of branch, subsidiary and parent failure, which could in turn lead to New Zealand banks being deprived of significant amounts of potential funding.

Some Executives interviewed have expressed concerns about uncertainty surrounding existing Trans-Tasman funding structures and the use of the branch networks to raise money due to recent developments across the ditch that will see Australian banks being subject to greater capital requirements. In July 2015, the APRA announced that the major Australian banks would be required to increase the capital requirements for residential mortgage loans in response to the Financial Stability Institute (FSI) recommendations effective from 1 July 2016. Late last year, APRA also moved to change the limits of the Australian bank non-equity exposures to their New Zealand banking subsidiaries to be below a limit of 5% of the bank's Tier 1 Capital ratio with a transition period of five years commencing from 1 January 2016. This limit does not apply to the New Zealand branch itself as it is within the Extended Licensed Entity (which comprises the parent and its subsidiary entities approved by the APRA for the purpose of measuring capital adequacy) but will have an impact on the New Zealand branch's non-equity exposures to other members of the New Zealand Banking Group. Further, another piece of regulation currently under consultation is the introduction of the proposed Basel III long-term liquidity reform (Net Stable Funding Ratio). This is intended to be introduced in January 2018, which will affect the funding profiles currently held by the banks, lengthening the banks' funding maturities and reducing reliance on short-term wholesale funding from offshore. Additional capital requirements may be introduced by APRA as they have yet not made any decision on other key recommendations by the FSI.

At present APRA has expressed the view that any strengthening should be done 'over a reasonable transition period' to minimise disruption to banking operations, and thus mitigating any potential risks of capital outflows from New Zealand.

Conduct risk at the forefront of Executives' minds

There has been an increased awareness of conduct risk management among Executives, as New Zealand continues to catch up with overseas trends. A lot of emphasis is being placed on changing the banking culture to ensure that customers are treated fairly due to increased operational and reputational risks that any slip ups may bring to the business.

There has been an increased awareness of conduct risk management among Executives.

Effective conduct risk management must be embedded in the workplace culture as people need to become accustomed to recognising situations that potentially give rise to conduct risk and making the right decisions. This can become challenging for organisations as it can be difficult to overcome set behaviours that have previously been considered acceptable. Views shared by the Executives have been that it is imperative to have more disciplined lending and sales processes and the right people. Some reported having simplified their product offering in response to conduct risk concerns and to avoid being seen as mis-selling products to customers. The alleged mis-selling of interest rate swaps to rural customers involving some of the major banks illustrates the importance of being seen as doing the right thing by the customer and treating the customer fairly.

Wealth products were seen as carrying greater conduct risk by many Executives due to the involvement of financial advisors who, albeit being very well qualified, may be lacking experience in investment management. They have been trained to sell and not necessarily assess if the product is the right fit for the customer, which potentially exposes the bank to being accused of mis-selling products. Some Executives expressed the view that managing conduct risk involves making a shift from a sales culture to more of a meeting customer needs culture.

Executives also commented that conduct risk has indirectly exposed the lack of financial literacy amongst many New Zealanders, with an increasing number of people not truly understanding the mix of products they have and how they work. For example, some people do not seem to understand the basic concepts of interest rates, certain types of products such as reverse mortgages or most importantly, risk involved when entering into deals. This lack of financial literacy leads to a lot of misunderstanding and misreporting. Further it creates a need for advisors to help these people, but they must be remunerated fairly and must act in the customers' best interests.

The continued evolution of technology and the threats and opportunities this brings

In a fast changing world of technology, data is increasingly perceived as carrying both enormous opportunities and significant threats. Competitive advantages could be gained by gathering customer insights to improve customer experiences and to identify business opportunities. At the same time, managing significant volumes of data poses real threats in terms of cybersecurity and highlights the need to keep customer data safe. In a recent survey performed by Unisys Corp, 50% of New Zealanders believe a data breach would occur in the banking and finance sector in the next 12 months. A previous 2011 survey highlighted the importance of public confidence in data security, revealing that 80% of New Zealanders would no longer choose to do business with an organisation that had a data breach occur.

Lessons have been learned from overseas with cyber hacking becoming a real threat to bankers globally.

While cybersecurity has long been a focus area for the banks, in recent times it has moved to the forefront and is seen as a major risk along with conduct risk by the Executives.

Although New Zealand banks have been somewhat sheltered thus far, lessons have been learned from overseas with cyber hacking becoming a real threat to bankers globally. Overseas experience has shown the considerable costs of cybercrime for banks, with an estimated US$1 billion having recently been reported as stolen from banks across the world by an international cybercrime group called 'Carnabak'.

Aside from monetary losses stemming from cybercrime, there are greater costs associated with reputational risks that are much harder to quantify. As banks grapple with managing massive volumes of transactions and sensitive data, against the backdrop of a continually evolving regulatory environment which requires system and process modifications, data security is expected to remain a major concern for the banks.

Opportunities exist to leverage off the technological capabilities within the wider global banking groups to strengthen data security for the New Zealand subsidiaries or branches. One example provided was having the ability to re-route settlements via Australian operations in an event of a significant cyberattack. In such cases, the short delay in processing settlements could provide the opportunity to look at transactions more closely using data analytics tools to identify any suspicious transactions. Implementing such measures was seen as a step towards not just responding to cyberattacks, but also as a measure towards alleviating conduct risk concerns.

Digital transformation is at the forefront of Executives' minds and banks continue to invest heavily in technology that keeps up with customer expectations.

Several Executives suggested the possibility of setting up an all-inclusive task force, comprising of individual representatives from the banks, the regulators and the Government Communications Security Bureau (GCSB). Such a task force would provide greater transparency and collaboration in tackling cybersecurity threats faced by the banking industry. One example provided by the Executives was in a case

where a bank discovered a security breach, it would be able to alert other members promptly and pool resources to develop an effective response. This would also provide an opportunity for the others to take measures in anticipation and avoid potential breaches.

One of the big challenges with utilising data analytics identified by Executives has been the cost versus benefit.

Larger banks tend to have significant resources devoted to developing more robust cybersecurity systems and potentially more experience in dealing with breaches given their global presence. Such a partnership would enable smaller banks to leverage off this, given their limited amount of resources. However, many Executives feel that the uphill challenge in establishing such a task force is to convince the larger banks to recognise their stake and get them to see how they could potentially benefit.

One of the big challenges with utilising data analytics identified by Executives has been the cost versus benefit, as the collection and cleansing of data needs to be performed in an efficient manner so it can be effectively turned into valuable information. Given the sheer volume of information, banks are finding that considerable resource needs to be employed in order to obtain useful insights.

Customer preferences are rapidly evolving with technological advancement challenging the traditional ways of doing banking. The digital and mobile revolution represents both threats and opportunities for banks. The traditional ways of doing business at the branch are now changing rapidly to digital platforms and devices. Digital transformation is at the forefront of Executives' minds and banks continue to invest heavily in technology that keeps up with customer expectations. An example would be branches where the front office is getting re-designed and digitised. The branch is perceived to be more efficient with front office personnel providing advice and education to customers about how to use digital services with their own devices or available self-service capabilities, while the back of the branch is where the detailed advice is given for more complex products.

Economic outlook looking a bit patchy

The New Zealand economy has fared relatively well amidst recent turbulence in international markets, with business and consumer confidence still up, low unemployment, record high net migration in 2015 and a continued pipeline of construction activity indicating strength in the domestic economy.

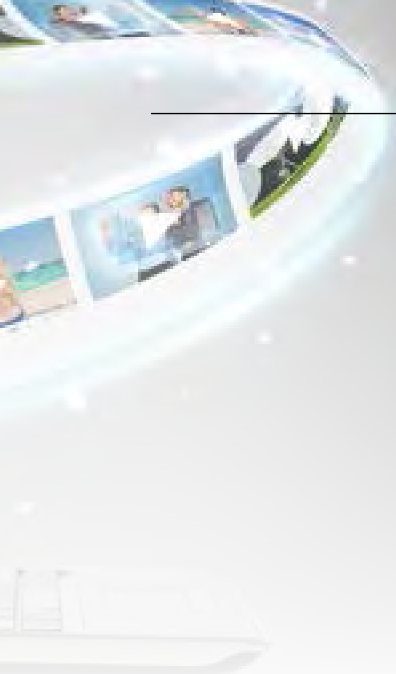
Over the second half of 2015 the RBNZ cut the OCR four times for a combined effect of 100 bps. This was a complete reversal of OCR hikes in 2014, when New Zealand became the first developed country to start raising interest rates as the RBNZ sought to dampen inflationary pressures. A year down the line and the environment now could not be any more different, with the RBNZ now combatting potential deflation. According to Statistics New Zealand overall inflation for 2015 was 0.1% which is the lowest level observed this century and well below the RBNZ policy target of 1–3%.

Borrowers have been the real winners from declining interest rates during 2015.

Looking back at 2014, we see that many of the factors that were ultimately driving the economy and inflation are still present today, such as rampant house price inflation, the Canterbury rebuild and business confidence. Given that the New Zealand economy continues to be relatively strong in comparison to global counterparts and still growing at a steady pace, it could be seen as unusual to observe deflation as a potential issue, as it is usually associated with a period of extended recession. Weak inflation appears to be primarily driven by lower oil prices, with global oversupply resulting from significant US oil production and the refusal of oil producing nations to cut back on supply. This ultimately shows the impact global factors can have on the New Zealand economy.

Borrowers have been the real winners from declining interest rates during 2015 with the floating rate and 2-year fixed rate falling by 60 bps and 90 bps respectively (see Figure 5), while deposit rates shifted downwards following OCR cuts (see Figure 3) according to RBNZ data.

Combined with intense competition within the banking industry and liquid wholesale funding markets, we have



seen record low mortgage rates being offered to the market, particularly in the fixed rate space of between 4 and 5%. With sub 4% rates appearing briefly in 2015 and in anticipation of further easing in the OCR, there is the potential that mortgage rates below 4% could feature again in 2016.

New Zealanders have continued to flock to fixed rate mortgages in the current survey period.

Referring to Figure 6, we see that New Zealanders have continued to flock to fixed rate mortgages in the current survey period, with the vast majority of mortgages fixed for the one to two year period (see Figure 9), which is likely driven not only by the fact that in most instances advertised fixed rates are now lower than floating but also by the belief that rates have now reached their lowest point. Whether this belief turns out to be true, or whether many borrowers have locked into a fixed rate too soon, will likely play out through 2016.

There are still some major risks faced by the economy in 2016, primarily coming from ongoing cash flow pressures in the dairy sector, Auckland house price inflation, deteriorating global market sentiment and volatility, slowing global growth and persisting deflationary pressures.

There are still some major risks faced by the economy in 2016.

Some interesting trends have emerged with close correlation reported between oil prices and equities. In the past, low oil prices were perceived to bring benefits and were seen as a form of tax cuts that increased discretionary income, encouraging consumers to spend more and propping up the economy. However, mounting concerns over global growth, and China in particular, appear to have taken the focus away from the supply side and more towards the demand side, where weak future growth prospects may be contributing to declines in stock markets.

The global stock sell-off in January marked the worst start to a year on record.

The global stock sell-off in January marked the worst start to a year on record with the Shanghai Composite Index entering bear-market territory in mid-January, having declined by over 20%.

For Australia, our other major trading partner, the minerals and mining sector has been hit hard by falling commodity prices, with the Australian economy slowing and facing similar concerns with house price inflation posing risks to financial stability.

At the December meeting, the US Federal Reserve raised its target range for the federal funds rate from 0% - 0.25% to 0.25% - 0.50% for the first time since the GFC, quoting strengthening employment data. However, in light of recent stock market events, the US Federal Reserve was reported to be closely monitoring global economic developments and assessing the potential impacts on the labour market and inflation.

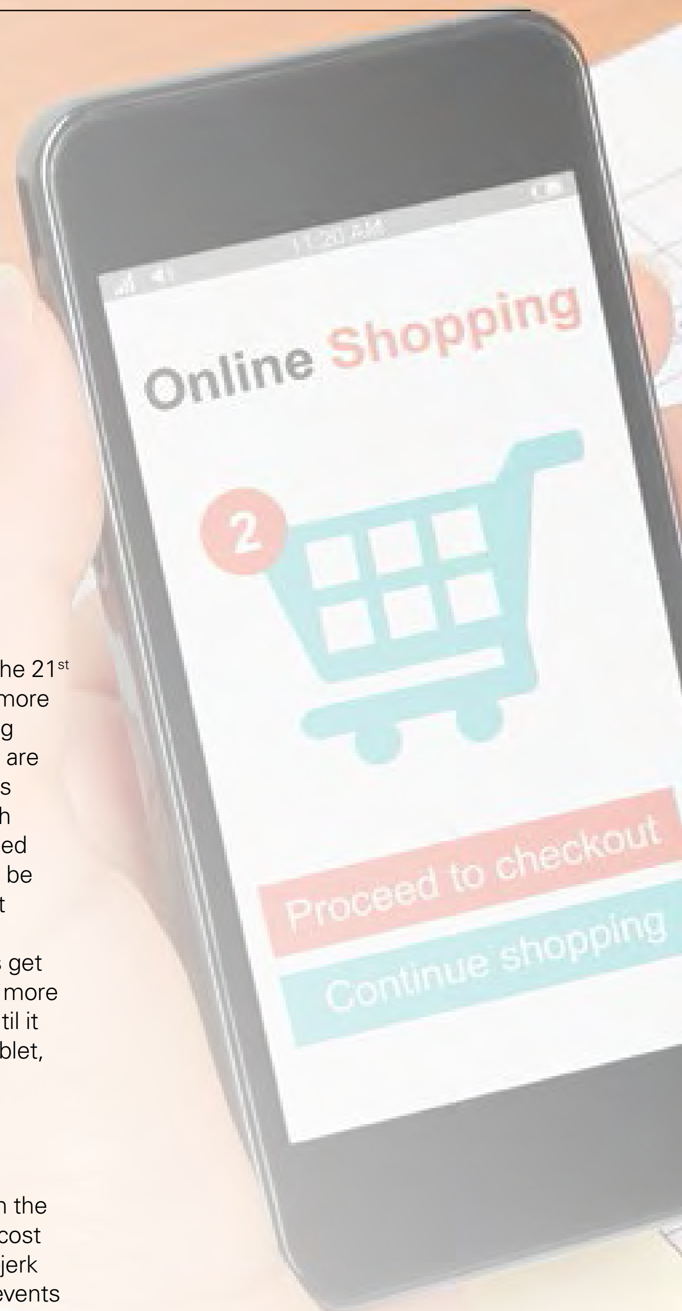
Bank Executives’ six main strategic worries

Cybersecurity

Security risks and cybercrime remain threats and while the New Zealand banks have not been the target of any significant cybercrime yet, we have seen a few of their overseas counterparts already become victims. It is likely to be only a matter of time before IT security at one of our major banks is put to the test. The challenge therefore remains for Executives to ensure their IT security teams stay one step ahead. While any breach is likely to result in significant financial loss, the greatest damage may well be to the reputation of the institution involved.

Conduct risk

Every interaction between bank staff and the general public is a display of the internal culture, controls and operations of the bank. Executives are therefore responsible for instilling the right culture and controls within an organisation so that harm is not brought upon the customer through inappropriate employee actions or non-suitable products being sold. Like cyber risk, while any issue is likely to result in significant financial loss, a greater loss might be the cost to rectify or make good and the greatest



damage may well be to the reputation of the institution involved, which is made all the more severe by the reach, speed and untamed nature of social media working alongside traditional outlets.

Global economy

With the global economy again in limbo, the spectre of whether another GFC will develop is increasingly unclear, just as we had seemed to be moving away from such an incident. Last year the focus was a potential meltdown in the European Union (EU) and the resulting fallout, compared to now when the worry is more around the continued slowdown of the Chinese economy and the impact of depressed oil prices. For Executives, this creates a very challenging environment to try to assess where threats are likely to come from, what form they will take and how to plan a response to them, given they are constantly changing. Executives do however know that it is not a matter of 'if' but a matter of 'when' another financial collapse will occur and the question is more about what its magnitude will be. While it is unlikely to originate here, New Zealand, being part of the global economy and society, will not escape its consequences.

Disruptors

Banks' existing business models continue to be challenged by the threat posed by digital disruptors. The threat they ultimately pose will depend on whether the banks are able to adapt fast enough to join them or form strategic partnerships to share in the rewards.

Digital

Digital interaction is the way of the 21st century as consumers become more tech savvy. Branches are evolving to now cater for customers who are increasingly using digital services and self-service capabilities. With greater costs involved in continued technology innovation, there will be further opportunities to gain cost efficiencies across the different business processes as branches get smaller and the front office gets more automated. It will not be long until it is all done from your phone, phablet, tablet or watch.

Regulation

While regulation is required, the speed at which it is pushed upon the banks has come at a significant cost and strain on resources. A knee-jerk reaction by regulators to global events could result in further regulation being imposed when it is not necessarily required in New Zealand just yet.

Summary

Possibly, the sudden realisation and the greatest concern is that these risks are no longer mutually exclusive, in fact quite the opposite – they are so interrelated that you can no longer assess the impact of any one risk in isolation. Now once you are afflicted by one of these risks, it can and will likely morph into a cross match, with several of the others being present or joining in the situation, making it all the more difficult to combat.

Registered banks – Timeline of events

Jan. 2015

13th
RBNZ receives 'Central Bank of the Year' award for 2015 from London-based central banking publications (the Central Banking Journal and CentralBanking.com).

14th
Fitch Report says New Zealand banks are among the most profitable banks in the developed world, and expects them to maintain strong net interest margins.

15th
Fitch upgrades Kiwibank's credit rating from AA stable to AA positive, a reflection of its backing by the Government and the rating agency's perceived "sound prospects for profitability" for New Zealand banks.

28th
RBNZ issues a formal statement raising its concerns over widespread closures of accounts for money remitters as a means of potential 'de-risking' by New Zealand banks to comply with AML requirements.

29th
RBNZ leaves the OCR unchanged at 3.50%.

Feb. 2015

17th
FMA reaches a $2.97 million settlement deal with Westpac over alleged mis-selling of interest rate swaps to rural customers. These allegations have not been tested in Court.

25th
Fitch affirms credit ratings of the four largest New Zealand banks; ANZ, ASB, BNZ, and Westpac as AA- stable, noting conservative risk appetite, strong profitability, sound asset quality and high likelihood of parent backing.

27th
Moody's affirms Kiwibank's credit rating of Aa3 stable.

Fitch affirms TSB's credit rating as A- stable, despite TSB Bank writing off its remaining $53.9 million debt exposure to Solid Energy.

Mar. 2015

2nd
Bank of China becomes the first Chinese bank to join the New Zealand Bankers' Association (NZBA).

3rd
Standard & Poor's (S&P) affirms TSB's credit rating of BBB+ stable.

4th
RBNZ issues a formal warning to JPMorgan New Zealand Branch (JPMNZ) after finding reasonable grounds to believe that risk assessment requirements of the Anti-Money Laundering and Countering Financing of Terrorism Act 2009 were not fully complied with for a period of approximately four months during 2013.

6th
Moody's reaffirms New Zealand's sovereign debt credit rating of Aaa stable.

RBNZ drops the proposed '5-plus' test for home loans, which would require borrowers with five or more residential properties to be classed as commercial borrowers.

12th
RBNZ leaves the OCR unchanged at 3.50%.

18th
MasterCard becomes the first affiliate member of the NZBA.

ASB Bank discontinues its Facebook payments app due to low usage and ahead of Facebook's announcement that a centralised app would soon be added.

20th
Westpac becomes Air New Zealand's airpoints partner. Westpac has signed a 10-year deal with Air New Zealand, offering airpoints with four MasterCard credit cards and giving customers the ability to earn additional airpoints on their mortgages, effective 1 May 2015.

24th
RBNZ Deputy Governor Grant Spencer is appointed as chair of the Organisation of Economic Co-operation and Development (OECD) Committee on Financial Markets.

Apr. 2015

20th
Kiwibank issues $150 million of perpetual capital notes with an S&P credit rating of BB-.

24th
Kiwibank pays its first dividend of $22 million, following pressure from the Government as the state-owned bank has been turning a profit for the last 10 years and accumulating over $500 million in capital.

30th
RBNZ leaves the OCR unchanged at 3.50%.

May. 2015

3rd
S&P downgrades Rabobank's credit rating from A+ to A.

26th
Bank of India announces the opening of its third New Zealand branch in Hamilton.

28th
High Court rules that ANZ has breached the Fair Trading Act in a case involving mis-selling of interest rate swaps to rural customers.

Jun. 2015

6th
Credit Contracts and Consumer Finance Amendment (CCCFA) Act 2014 and the Responsible Lending Code come into effect.

10th
S&P lowers Deutsche Bank's credit rating to BBB+.

11th
RBNZ reduces the OCR by 25 bps to 3.25%.

12th
ASB and the Inland Revenue Department (IRD) have settled a long running dispute involving $153 million plus interest and penalties that related to $499.4 million claimed in deductions for foreign exchange losses incurred during the GFC.

22nd
ASB agrees to pay $3.2 million in a settlement with the Commerce Commission over alleged mis-selling of interest rate swaps to rural customers between 2005–2009.

25th
Fitch reaffirms Kiwibank's credit rating of AA+.

29th
Bank for International Settlements (BIS) names the big four Australian banks, CBA, ANZ, Westpac and NAB, among the most profitable in the developed world when measured by return on assets.

Jul. 2015

1st
RBNZ Funding Agreement takes effect, providing five-year funding and prescribing how much of the Bank's income may be used to fund operating expenses.

15th
Australian Prudential Regulation Authority (APRA) indicates that the Australian banks would have to raise A$30 billion to be positioned within the top 25 banks in the world, which could have a flow on effect for their New Zealand operations.

23rd
RBNZ reduces the OCR by 25 bps to 3.00%.

Aug. 2015

4th
International dairy prices fall to a 13-year low at the Global Dairy Trade auction, with the weighted average price across all products down to US$1,815 per MT.

7th
Fonterra announces a reduction in the 2015/16 farmgate milk price forecast from $5.25 per kgMS to $3.85 per kgMS, which is reportedly well below breakeven point for most farmers.

14th
S&P downgrades standalone credit ratings by one notch for the four major New Zealand banks and a number of non-bank financial institutions, quoting increased risks and exposures posed by the Auckland property market.

28th
Moody's revises ICBC NZ's credit rating to A1, following the guarantee issued by its 'parent'.

Sep. 2015

1st
Applications open for Fonterra interest-free loans intended to help struggling dairy farmers amid low milk price payouts. Dairy farmers are eligible for an interest-free loan of 50 cents per kilogram of share-backed milk solids produced from 1 June to 31 December 2015. These loans will be interest-free until 31 May 2017, with applications closing on 25 September 2015.

2nd
Former mortgage broker convicted of fraud, having forged documents to facilitate sale of real estate to low income families. Charges were laid after BNZ launched an investigation into a fraudulent mortgage scheme in South Auckland in 2011.

10th
RBNZ reduces the OCR by 25 bps to 2.75%.

Fitch revises SBS Bank's credit rating of BBB stable to BBB positive.

15th
Kiwibank announces its intention to reduce deposit requirements for owner occupied apartment lending in the Auckland CBD area to as low as 15%, with a minimum apartment size of 40 sqm. This is compared to most other banks requiring 20% from owner occupiers.

ANZ seeks to raise $200 million through a five year unsecured unsubordinated bonds offer with an issue credit rating of AA- from S&P.

24th
Fonterra revises its 2015/2016 farmgate milk price forecast up by $0.75, from $3.85 per kgMS to $4.60 per kgMS.

Oct. 2015

1st
New tax rules come into effect, with capital gains tax on residential properties imposed by the 'bright line test'.

5th
Westpac retains the bulk of the 'all-of-Government' banking services contract after four years of negotiation, with the contract having been put out to tender for the first time in 25 years. Five other banks were also given parts of the eight-year contract.

28th
RBNZ issues a formal warning against Kiwibank for non-compliance with the Anti-Money Laundering and Countering Financing of Terrorism Act between the period of 30 June 2013 to 30 June 2014.

29th
RBNZ leaves the OCR unchanged at 2.75%.

30th
Deutsche Bank announces closure of its New Zealand operations as part of the wider global initiative to cut costs and improve capital levels, resulting in about 26,000 job cuts and closure of operations across 10 countries by 2018.

Nov. 2015

1st
RBNZ's new LVR restrictions relating to Auckland investment property come into force.

6th
Heartland Bank announces its restructuring plans, involving amalgamation with its 'parent' effective 31 December 2015, issuing of $75 million in Tier 2 capital securities, and returning up to $100 million to its shareholders.

11th
RBNZ Financial Stability Report is released, with the RBNZ pointing to increased risks to stability of New Zealand's financial system. The RBNZ notes growing dairy exposures for banks and asks the country's top five dairy lenders to carry out stress tests of potential dairy losses.

23rd
ASB and BNZ raise over $350 million and $550 million respectively, through oversubscribed bond issuances, with $500 million being through oversubscriptions collectively.

26th
High Court rules in BNZ's favour, finding that BNZ had not acted as a financial adviser when providing forecast analysis to support a farm property lending deal that ultimately lead to losses incurred by the borrower.

Dec. 2015

2nd
Chief Executive Officer (CEO) Ben Russell leaves Rabobank to join Heartland Bank as Head of Rural Banking.

3rd
ASB receives the New Zealand Bank of the Year award at the International Bank of the Year awards held in London for its 'Card Control' function offered to customers.

8th
New Zealand formally joins the Asian Infrastructure Investment Bank (AIIB), with the view to enhance economic, trade and investment links with the Asian region. The AIIB is expected to commence operations in January 2016 with around $150 billion of initial capital to invest in infrastructure development in the region.

10th
RBNZ reduces the OCR by 25 bps to 2.50%.

15th
RBNZ releases results of stress tests performed by the five largest diary lenders.

17th
US Federal Reserve announces its intention to raise its target interest rate range by 0.25% to 0.25% - 0.50%.

Jan. 2016

15th
BNZ's Enterprise Risk Management (ERM) model named "Initiative of the Year" at Central Banking Publications' annual award.

20th
Statistics New Zealand reports 0.5% deflation for the December 2015 quarter and annual inflation of 0.1%, well below the policy target of 1 to 3% per year.

26th
Westland Milk Products, New Zealand's second largest dairy co-op, reduces its forecast dairy payout to $4.15 to $4.45 per kgMS amid declining commodity prices.

27th
Fitch Ratings revises the outlook for the New Zealand economy from 'positive' to 'stable' and affirms its AA credit rating.

ANZ begins accepting China UnionPay credit and debit cards at selected EFTPOS terminals. Implementation of the programme will be completed over the next 12 to 18 months.

28th
RBNZ leaves the OCR unchanged at 2.50%.

Fonterra revises its forecast 2015/2016 farmgate milk price down by 45 cents to $4.15 per kgMS after prices at the Global Dairy Trade auctions declined again.

29th
Uber partners with ASB Bank, offering ASB card holders a 15% discount on Uber rides from 1 February to 31 July 2016.

Feb. 2016

1st
Synlait Milk reduces its farmgate milk price forecast for the 2015/2016 season from $5.00 per kgMS to $4.20 per kgMS.

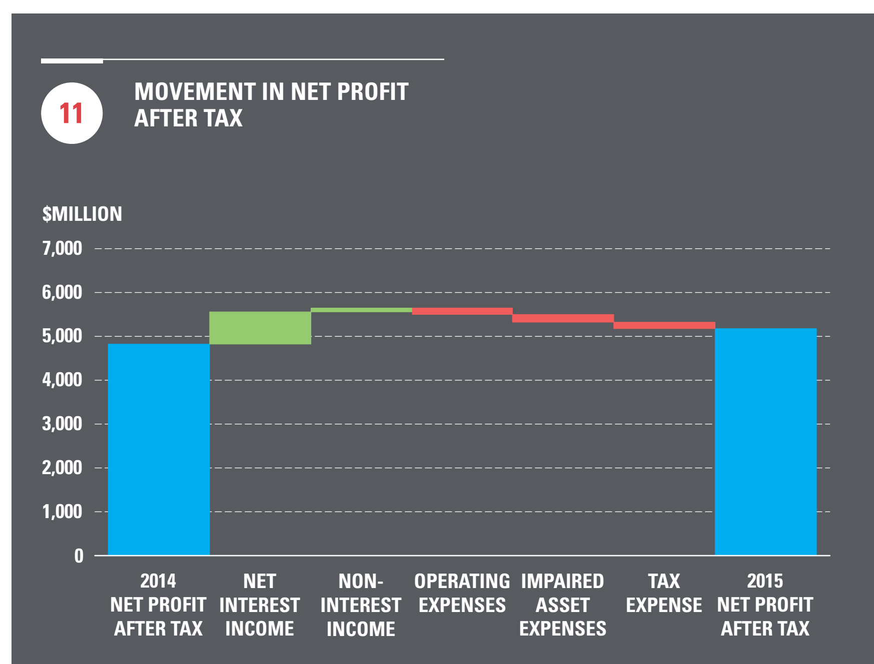
2nd
Paymark owners ANZ, ASB, BNZ and Westpac are reviewing their shareholding in the entity as an external party has indicated interest in purchasing the shares.

11th
Moody's affirms New Zealand's Aaa credit rating with a stable outlook.

Registered banks – Sector performance

The New Zealand banking sector continues to deliver strong results on the back of lending growth, margin growth and cost control. Capital ratios have been boosted.

The 2015 year has been generally positive for the New Zealand banks, with the sector achieving a further 6.94% increase in net profits to add to the 20.41% growth achieved last year (see Table 3 – page 25) and resulting in an all-time high overall net profit of $5.17 billion.



Profitability

13 of the 21 survey participants improved their profitability, including four of the five largest banks that contributed $301 million to the overall increase in net profits this year.

Non-interest income remained strong, contributing an additional $74.26 million to the bottom line for the banking sector (see Figure 11), and largely comprised of trading gains.

Returns on assets and equity eased slightly this year, with RoA marginally down from 1.17% to 1.16% and RoE reducing from 16.13% to 15.96% as earnings are spread over a growing asset and equity base (see Table 5 – page 27). However, returns remain strong with New Zealand banks continuing to outperform their Australian parents.

The following analysis of registered banks is from the view of the top geographic entity in New Zealand for each banking group, unless stipulated otherwise[3].

When looking at the main income statement categories, as shown in Figure 11, the following can be seen:

- Net interest income has improved by an impressive 8.45% on the back of strengthened interest margins up by 4 bps (see Table 4 – page 26) and solid lending growth of 7.11% (see Table 5 – page 27) contributing $729.19 million.
- Non-interest income has increased by 2.43%, on top of the 26.60% increase achieved last year, contributing $74.26 million.
- Asset quality showed some weakening, with the impaired

asset expense up by 65.33% or $173.08 million on historically low levels reported in the previous year.

- Banks have contributed $1.98 billion of tax to New Zealand, $161.42 million more than last year.

Deustche Bank achieved the largest percentage increase in net profit, lifting its bottom line six-fold from $4 million to $24 million, having significantly improved its net interest margin while also improving operating cost efficiencies, consistent with the parent's global strategy to reduce complexity and costs. Deutsche Bank's cost cutting resulted in the announcement of the closure of its New Zealand operations as part of a global restructure that will see the German bank exit from 10 countries. The restructure is expected to globally save Deutsche Bank about €3.8 billion by 2018, with associated restructuring and severance costs of around €3.0–3.5 billion, two-thirds of which is to be spent by 2016.

Of the other non-major banks Bank of India, Citibank, The Co-operative Bank, HSBC, JPMorgan, Bank of Tokyo and SBS Bank have all recorded significant uplifts in profits (more than 20%). HSBC has increased its profits by $41.39 million, mainly as a result of improved asset quality and stronger net interest margin, which improved by 16 bps to 1.82%.

Both SBS Bank and The Co-operative Bank look to differentiate themselves from other banks to achieve growth by focusing on the fact that they are owned by members rather than a group of shareholders, which seems to have had some effect as both managed to increase their profits by just over 24%.

Of the five major banks, Kiwibank has achieved the highest percentage growth in net profit, up by 27.00% to $127 million this year, having strengthened its net interest margin and having reduced its operating costs.

BNZ followed with a 22.12% improvement, increasing its bottom line by $188 million largely as a result of an additional $185 million in non-interest income and improved cost efficiencies mitigating some deterioration in asset quality. BNZ was the only major bank to implement NZ IFRS 9 and this may have had some impact on provisioning.

ANZ and CBA had another year of solid performance, having grown profits by a further 3.51% and 3.08% respectively. For ANZ the additional $94 million in non-interest income and better operating cost control compensated for a slightly weaker net interest margin. For CBA, its strengthened net interest margin mitigated impacts of weaker asset quality and lower non-interest income.

Westpac was the only major bank reporting a decrease in profitability. Net profit was marginally down showing a 1.28% or $13 million

TABLE 3: Registered Banks – Performance Trends

Year	Increase in Total Assets	Increase in Net Profit After Tax	Net Profit After Tax/Average Total Assets	Interest Margin	Operating Expenses/ Operating Income	Impaired Asset Expense/ Average Gross Loans and Advances
2015	10.20%	6.94%	1.16%	2.28%	37.32%	0.12%
2014	5.28%	20.41%	1.17%	2.24%	39.44%	0.08%
2013	1.15%	8.53%	1.00%	2.26%	42.05%	0.16%
2012	0.78%	14.12%	0.93%	2.26%	44.40%	0.22%
2011	4.51%	10.04%	0.84%	2.23%	43.62%	0.30%
2010	-0.05%	7,389.22%	0.78%	2.09%	44.02%	0.42%
2009	5.03%	-98.75%	0.08%	2.13%	43.66%	0.76%
2008	12.84%	-2.26%	0.91%	2.07%	44.64%	0.24%
2007	16.10%	9.70%	1.08%	2.15%	43.30%	0.10%
2006	15.01%	6.79%	1.14%	2.28%	44.56%	0.06%

decrease, attributable to an additional $21 million in impaired asset charges.

TSB reported a marked percentage decline in profits, down by 48.92% or $24.44 million, with an additional $53.87 million Solid Energy impairment charge being offset to some extent by stronger net interest margins.

Heartland Bank achieved 12.99% growth in net profit, attributable to a stronger net interest margin, up by 30 bps to 4.89% and improved operating costs.

Overall the banking sector continues to be in a strong position, with another record profit year fuelled by strengthened interest margins on the back of lending growth, well managed operating costs, low cost funding and plenty of liquidity all contributing to improved results (see Table 3 – page 25 and Table 5 – page 27). This is against the backdrop of a relatively stable domestic economy as the growing demand for funding facilitates lending growth and helps to alleviate some of the competitive pressures in the lending market.

Net interest margin

Net interest income has increased by $729.19 million or 8.45% which is reflective of the 7.11% growth in gross loans and advances (see Table 5 – page 27), mainly driven by an increase in property and agriculture lending (see Figure 8).

Strengthening interest margins, up from 2.24% to 2.28% over the survey period also contributed to an

TABLE 4: Movement In Interest Margin	2015	2014	Movement
	%	%	(bps)
Australia and New Zealand Banking Group Limited – New Zealand Banking Group	2.26%	2.33%	-7
Bank of Baroda (New Zealand) Limited	3.73%	3.84%	-10
Bank of China (New Zealand) Limited	n/a	n/a	n/a
Bank of India (New Zealand) Limited	4.21%	4.33%	-12
Bank of New Zealand	2.30%	2.30%	0
China Construction Bank (New Zealand) Limited	n/a	n/a	n/a
Citibank, N.A. New Zealand Branch	1.93%	1.61%	32
Commonwealth Bank of Australia New Zealand Banking Group	2.30%	2.27%	4
Deutsche Bank AG, New Zealand Group	1.66%	-0.33%	199
Heartland Bank Limited	4.89%	4.59%	30
Industrial and Commercial Bank of China (New Zealand) Limited	0.82%	0.78%	4
JPMorgan Chase Bank, N.A. New Zealand Branch	0.77%	1.15%	-39
Kiwibank Limited	2.12%	1.87%	25
Kookmin Bank Auckland Branch	1.66%	1.93%	-27
Rabobank Nederland New Zealand Banking Group	2.62%	2.74%	-13
Southland Building Society	2.91%	2.51%	40
The Bank of Tokyo-Mitsubishi UFJ Limited, Auckland Branch	0.47%	0.39%	8
The Co-operative Bank Limited	2.88%	2.76%	12
The Hongkong and Shanghai Banking Corporation Limited, New Zealand Branch	1.82%	1.65%	16
TSB Bank Limited	2.19%	2.00%	20
Westpac Banking Corporation – New Zealand Division	2.29%	2.18%	11
Sector Average	**2.28%**	**2.24%**	**4**

n/a = not available

improvement in interest income (see Figure 12 and Table 4 – page 26).

12 of the 21 participants showed improvements in interest margins this year with the overall margin achieved by the banking sector having more than recovered back to 2013 levels of 2.26%. Figure 14 shows the banking sector managed to maintain stable yields relative to fluctuating costs of funds, keeping spreads within a tight 12 bps range between 1.77%–1.89% for the past four years.

This is an impressive result given the low interest rate environment and competitive asset pricing across both the domestic and commercial lending books which continues to challenge survey participants. Per Figure 17 it can be seen that the banks managed to improve interest margins, while still achieving strong asset growth this survey period, after having maintained margins at stable levels for the past five years.

Bank margins on new customer mortgage lending peaked in January 2015, with margins over one and two-year swap rates improving to 2.84% and 2.52% respectively. During the period of June 2014 to January 2015 swap rates for both tenors began to gradually shift downwards due to changes in market sentiment, forecasting potential OCR cuts. Two-year swap rates decreased at a greater rate resulting in a wider margin observed for the two-year average mortgage rate.

Subsequently, as the OCR cuts in the second half of 2015 began to be priced into mortgage rates, margins returned to levels broadly similar to those observed in early 2014 (see Figure 16).

For a number of participants the year end reporting dates have not yet captured the OCR cuts and reflect the OCR rises imposed by the RBNZ in the first half of 2015, resulting in increased interest income and expenses for

TABLE 5: Registered Banks – Analysis of Performance of Banks	New Zealand Incorporated Banks		New Zealand Branch Banks		All Banks	
	2015	2014	2015	2014	2015	2014
Increase in Total Tangible Assets	10.91%	5.71%	-45.74%	2.48%	10.20%	5.28%
Increase in Operating Income	9.35%	8.64%	-45.40%	-8.75%	8.56%	7.31%
Increase in Net Profit After Tax	6.75%	22.88%	-36.83%	-16.70%	6.94%	20.41%
Increase in Gross Loans and Advances	7.91%	5.12%	-43.62%	1.78%	7.11%	4.85%
Net Profit After Tax/Average Total Tangible Assets	1.21%	1.22%	0.47%	0.58%	1.16%	1.17%
Net Profit After Tax/Average Equity	14.51%	14.27%	8.63%	9.85%	15.96%	16.13%
Net Interest Income/Average Total Tangible Assets	2.23%	2.24%	0.72%	0.85%	2.10%	2.09%
Non-interest Income/Average Total Tangible Assets	0.70%	0.66%	0.24%	0.53%	0.70%	0.69%
Operating Expenses/Average Total Tangible Assets	1.10%	1.15%	0.30%	0.39%	1.05%	1.11%
Operating Expenses/Operating Income	37.58%	39.83%	30.83%	27.83%	37.32%	39.44%
Impaired Asset Expense/Average Gross Loans and Advances	0.12%	0.06%	0.08%	0.52%	0.12%	0.08%
Collective Provision/Net Loans and Advances	0.41%	0.40%	0.12%	0.20%	0.39%	0.39%
Total Provision For Doubtful Debts/Gross Loans and Advances	0.55%	0.60%	0.87%	0.67%	0.56%	0.61%

the survey period. Overall interest expense rose a further $1.47 billion this year, after having increased by $567.77 million in the previous year. All of the five major banks reported higher funding costs, with interest expense rising relative to average interest bearing liabilities, with the highest basis point increase of 35 bps reported by CBA, followed closely by Kiwibank with 34 bps, while BNZ, ANZ and Westpac each reported increases of 16-17 bps. The big five incurred broadly similar funding costs at circa 4%, with the exception of BNZ at 3.79% and Westpac at 3.93% (see Figure 15).

During the survey period the banking sector has improved interest income generated over average interest earning assets by 19 bps, from 5.52% to 5.71%. When this is considered in conjunction with the 20 bps increase in interest expenses relative to average interest bearing liabilities, up from 3.67% to 3.87%, the resulting impact on net interest margin was still a positive one (see Figure 14).

Notably, four of the big five banks maintained a net interest margin of circa 2.30%, with ANZ at 2.26%, BNZ at 2.30%, CBA at 2.30%, and Westpac at 2.29%, while Kiwibank was not far behind at 2.12% (see Table 4 – page 26).

Notable gains in net interest margins were reported by SBS and Citibank, up by 40 bps and 32 bps, respectively. For both banks, this was attributable to stronger interest income yields over average interest earning assets. Of the five major banks, Kiwibank proved to be a clear outperformer, improving its net interest margin by 25 bps to 2.12%.

The more notable easing in net interest margins was shown by JPMorgan and Kookmin, down by 39 bps and 27 bps, respectively. JPMorgan's margin was negatively impacted by higher funding costs and reduced interest income, while for Kookmin funding costs were the main driver.

Heartland continues to lead the banking sector with an interest margin of 4.89%, a further 30 bps increase on last year. Heartland has established itself as a specialist financial services group not aiming to compete with mainstream banks, and has become one of the first banks globally to provide a funding line through the P2P online lending platform Harmoney.

According to the RBNZ, the proportion of fixed rate residential mortgage loans has increased by 367 bps over a 12 month period to 75.56% by November 2015. The proportion of fixed rate loans overtook floating loans during the first half of 2013 and have steadily risen since then (see Figure 6).

Term deposit rates followed OCR trends downward (see Figure 13), with the banking sector enjoying plenty of liquidity in the market both domestically and overseas, as domestic rates continue to attract strong overseas interest in a globally low yield environment. With prevailing competitive pressures to keep lending rates down and reduce funding costs, borrowers continue to benefit more than savers in this low interest rate environment. According to RBNZ statistics, 6 month term deposit rates have declined by 83 bps over a 12 month period to 3.36% by November 2015 (see Figure 3). This closely mirrors the 75 bps cut in OCR rates over the same period.

Positive trends around interest margins could continue through 2016 if the current economic climate prevails and banks continue to enjoy reduced funding costs. This is helped by OCR cuts in the latter half of 2015 and a further easing outlook for 2016 shared by most market commentators, persistently low global yields, and the borrowers' continued preference for fixed rate loans. One dark cloud on the horizon remains; the uncertainty in global markets and the potential impacts of this on spreads.

Return on assets/Return on equity

Both RoE and RoA eased slightly following strong improvements achieved in the previous survey period. RoE was down by 17 bps to 15.96%, while RoA remained consistent at 1.16%, down by only 1 bp from 1.17% last year (see Table 5 – page 27). Since 2009, RoE and RoA have steadily recovered to close to pre GFC levels, which were 16.68% and

1.08% respectively in 2007. However, the banks still have a little way to go before they are able to reach returns of 17.12% and 1.39% that were achieved in 2005. Certainly, returns to shareholders will continue to be challenged in the years ahead with the increased regulatory requirements for residential mortgages requiring banks to hold higher levels of capital for residential property loans from 1 November 2015.

Heartland continues to lead the way, generating the highest RoA of 1.59%, while Bank of Baroda lost its top position of 1.90%, having experienced a 78 bps decline this year. The four big banks have generated similar RoA levels, ranging between 1.14%–1.25% and continue to outperform their respective Australian parents. Performance continues to be fuelled by strong profitability generated from a growing asset base.

RoEs generated by the main banks remain strong compared to their Australian parents, with only CBA New Zealand being lower than CBA Australia. Westpac remained ahead at 17.21% despite a 258 bps decline on 19.79% reported last year. BNZ and Kiwibank improved their RoEs by 136 bps and 173 bps, respectively, while ANZ lost a bit of momentum with RoE easing by 35 bps.

Notably, BNZ outperformed its Australian parent with the greatest bps gap on both measures, reporting RoA of 1.25% and RoE of 16.24%, compared to RoA of 0.76% and RoE of 11.49% generated by its parent.

There was some reduction in the level of cash dividends paid by the five major banks this year, down by $83 million or 2.42% from $3.44 billion in 2014 to $3.35 billion in 2015. Substantial dividend payouts have been reflective of continued strong profitability in the banking sector. Kiwibank paid its first dividend of $22 million this year following pressure from the government, as the state-owned bank has been turning a profit for the last 10 years and accumulating over $500 million in capital.

Looking ahead we would expect further challenges to maintaining these levels of returns due to margin pressures coming from competition, higher capital requirements and global market volatility.

TABLE 6: Major Banks – Personnel Cost

Entity	2015			2014		
	Employee Numbers	Personnel Cost $Million	Cost/ Average Employees $000's	Employee Numbers	Personnel Cost $Million	Cost/ Average Employees $000's
ANZ	8,104	874	107.0	8,225	845	102.4
BNZ	4,841	449	93.4	4,769	454	95.5
CBA + ASB	4,469	487	108.3	4,521	473	102.4
Kiwibank	1,188	123	104.5	1,166	117	99.4
Westpac	4,497	468	104.4	4,469	447	98.4

Non-interest income

Overall the New Zealand banks continue to yield positive non-interest income results, showing an increase of $74.26 million (see Figure 11).

This increase was mainly a combination of a $253.26 million increase in other income, offset by a decrease of $179 million in abnormal income pertaining to one-off income items reported last year. Financial markets performance has been mixed across the survey participants with some large trading gains and losses reported for trading derivatives and securities, as well as foreign exchange revaluations.

BNZ and ANZ reported the largest increases in non-interest income at $185 million and $94 million, respectively. For BNZ the $185 million uplift was largely attributable to a $73 million increase in trading income and $151 million in favourable revaluations of financial assets and liabilities, offset by a $57 million reduction in other fees and commissions. ANZ benefitted from favourable trading activity and foreign exchange translation, reporting a $52 million increase in net trading income comprising mostly of a $44 million increase in foreign exchange gains. ANZ has had a successful year focusing on other lines of business, achieving a $60 million increase in funds management and insurance income.

The more notable decreases in non-interest income were reported by Rabobank, CBA and Deutsche Bank, showing declines of $62.83 million,

$28 million and $20 million, respectively. For Rabobank, the decrease was largely attributable to a $56.23 million unfavourable fair value movement on trading derivatives. For CBA, the $28 million decrease was mostly attributable to the $26 million unfavourable fair value movement on derivatives deemed as the ineffective portion of cash flow hedges. And for Deutsche Bank, the $20 million decrease in non-interest income was driven by $28 million in foreign exchange losses mitigated to some extent by a $12 million increase in net trading income.

Operating expense ratio

Cost efficiencies continue to improve as banks continue to focus on cost control and improve the efficiency of their processes. Operating expenses relative to operating income decreased further from 39.44% to 37.32% (see Figure 25) as the banking sector achieved an 8.56% increase in operating income, while operating expenses increased by only 2.72%. Improvements in operating expense levels were achieved by all major banks, with the exception of CBA keeping its ratio at 36.56%, up slightly from 36.54%. BNZ achieved the lowest operating costs ratio among the five major banks, down by 462 bps to 33.72% this year, having increased its operating income by 13.86% while keeping its cost base largely unchanged. Westpac followed with the next lowest operating expense ratio among the major banks at 35.77%, achieving a 139 bps reduction.

Among the major banks, Kiwibank achieved the largest bps reduction, albeit from a higher cost base with the ratio reducing by 569 bps to 55.81%. Kiwibank continues to incur greater levels of operating expenditure as it undergoes an upgrade to its core banking system that was estimated to cost over $100 million and run for up to five years. Citibank achieved the largest dollar value reduction in operating expenses, down by $7.43 million or 32.10%, while its operating income grew by 3.87%.

Personnel costs continued on an upward trend, with the banking sector having paid $2.63 billion to employees, up from $2.54 billion in the previous year. The additional $81.12 million in personnel costs contributed to 65.77% of the overall $123.35 million increase in operating expenses. Staff costs incurred by the five major banks remained within a tight range at circa 11% relative to revenues. CBA and ANZ were still at the higher end, with an average cost per employee at $108,300 and $107,000 respectively (see Table 6 – page 29).

Operational cost efficiency will continue to be at the forefront of focus for the banks. However, with an industry that continues to evolve, the banks continue to invest in technology and innovation to digitise their processes especially at the front office to meet customer needs and also to stay ahead of the game when potential disruptors threaten to enter the banks' traditional markets. Regulatory changes continue to put pressure on compliance costs as banks need to spend on risk and compliance programmes to meet new regulatory obligations such as the new LVR speed limits and outsourcing reviews announced later in 2015. The Executives interviewed have reported heightened awareness around managing conduct risk, the importance of digital transformation and ensuring data security, which could put further pressure on operating costs in the near future. Continued investment in technology and digital channels will remain critical for the banks in order to remain competitive and protect their customer base.

Impaired assets

The banking sector has experienced some softening in asset quality during this survey period with the impaired asset expense up by $173.08 million or 65.33%. As mentioned in our last survey, the reduction in impaired assets seen in recent years has reached the bottom of the credit cycle and current year's charges reflect a more normalised credit performance. The overall impaired asset expense for the banking sector has increased relative to both revenues and gross loans, up by 62 bps to 1.87%, and up by 4 bps to 0.12%, respectively (see Figure 18 and Table 5 – page 27).

Notably, all of the five major banks experienced these increases to varying degrees.

BNZ who was the only major bank to early adopt the new NZ IFRS 9 reported the highest impaired asset expense ratio among major banks at 0.19% of average gross loans, closely followed by CBA at 0.15%, with ANZ, Westpac and Kiwibank in the lower range of 0.7%–0.9%.

The increase in impaired asset expense was mainly attributable to

fewer write-backs this year. There was also some reduction in specific provisioning relative to gross loans, down from 0.22% to 0.16%, with 11 of 21 entities reporting lower specific provisions. Meanwhile, levels of collective provisioning moved in line with new lending growth, remaining at 0.39% of gross loans (see Table 5 – page 27).

For ANZ, the $85 million increase in asset impairment charges was mainly due to a $92 million write-back in collective provisioning last year compared to a $3 million charge this year. CBA reported a similar story with an unfavourable movement in impaired asset expense mostly arising due to a $13 million increase in collective provisioning.

BNZ recorded a $52 million collective provision charge, offset by a $28 million reduction in specific provisioning mostly reflecting write-offs during the year. Meanwhile, TSB's current year impaired asset expense was negatively impacted by a further $53.87 million Solid Energy impairment charge. Bank of Tokyo also had significant exposures to Solid Energy, recording a $29.56 million impairment charge this year, in addition to a $50.44 million charge the previous year.

HSBC and Rabobank bucked the trend and showed significant improvements in asset quality, releasing $14.47 million and $14.41 million in specific provisions, respectively.

According to RBNZ statistics, agriculture and mortgage lending contributed to 62.33% of the total $48.58 billion in lending growth for the 2015 year.

In June 2015, dairy loans totalled $37.87 billion and comprised 66.72% of all agricultural lending by the banks. Amid dairy payouts remaining below breakeven point, and the RBNZ and Dairy NZ estimating 80% of dairy farmers to have negative cash flow in the 2015/16 dairy season, the banks are keeping a close eye on these exposures. In September 2015 Fonterra moved to provide some financial relief to struggling dairy farmers, offering interest-free loans at 50 cents per kilogram of share-backed milk solids produced from 1 June to 31 December 2015. Fonterra estimated that this will cost them $390 million. With the recent cut of Fonterra's payout for the 2015/16 season to just $4.15 per kgMS, the dairy sector will continue to be under extreme pressure.

In June 2015 the country's biggest dairy lender, ANZ, reported having reduced its dairy exposures by approximately 16% or $11.3 billion since 2010, having estimated that 5% of its dairy book would be stressed in the upcoming 12 months.

In November the RBNZ reported that although non-performing dairy loans were still low at 1%, up from 0.6% the previous year, the watchlist loans increased to 5.8% and were considered a leading indicator of non-performing loans.

Mortgage exposures continue to dominate the banks' loan books, forming 51.75% or $208.76 billion of total banking sector lending (see Figure 4). This lending continues to be supported by a buoyant property market, with the recently implemented LVR speed limits perceived by the Executives as strengthening the credit quality of new lending. December property data released by REINZ showed some signs of slowing, with December median prices stagnant and sales volumes falling.

However, the outlook for property in 2016 is expected to remain unclear for a few more months as the December month is typically a low season for real estate. The RBNZ has said that house price inflation in Auckland remains a financial stability risk suggesting that it will continue to monitor developments in house prices and introduce further lending restrictions if house inflation persists and extends to other regions.

The banking sector achieved a marked reduction in gross impaired assets, down by $495.17 million or 21.97% (see Figure 19), led by ANZ having reduced its gross impaired assets by $264 million while also growing its lending book.

Reductions were also achieved by the other major banks, with the exception of CBA which reported a $116 million

increase in gross impaired assets this year.

The potential risks to asset quality mainly arising from dairy, property and global uncertainties are mitigated to an extent by the relative stability in the local economy with reported strong employment, tourism, consumer and business confidence.

Analysis of lending

Lending has continued to grow at a steady pace for the past five years (see Figure 20), with banking sector lending rising by 7.11% this year, up on the 4.85% growth the year before (see Table 5 – page 27).

Total gross loans and advances increased from $341.76 billion to $366.05 billion in 2015.

As seen in Figure 23 growth rates in agriculture lending outpaced growth rates in lending to all other sectors by the end of 2015, with a lot of the growth coming from dairy (see Figure 21). An RBNZ report indicated that only a small proportion of this related to new dairy lending, with the majority being working capital debt loans to existing customers.

Overall, only five banks experienced a reduction in their loan books with the most notable declines reported by Citibank, Kookmin and Bank of Tokyo at 13.69%, 36.42% and 10.78%, respectively.

Citibank's loan books declined by $90.81 million, mostly attributable to run-off of existing corporate loans with limited new lending. Bank of Tokyo's loan book declined by over $324.87 million, comprising of corporate loans. Kookmin reported a $71.92 million reduction, representing a reduction in residential and corporate loans of $31.29 million and $40.70 million, respectively.

The five major banks accounted for 96.57% of total new lending this year, contributing $23.45 billion of the total $24.29 billion increase for the banking sector, with ANZ achieving the highest growth rates amongst the major banks at 8.32%, closely followed by CBA at 8.26%, Westpac at 6.91%, Kiwibank at 6.55% and BNZ at 5.93%.

ANZ continues to enjoy the largest market share at 31.42%, measured by gross loans and advances, having gained an additional 0.35% market share this year. BNZ appears to have lost 0.21% market share down to 18.76% this year, while CBA gained 0.20% to reach 18.94%. Meanwhile, Westpac and Kiwibank maintained their market share at broadly consistent levels with 19.12% and 4.28%, respectively.

Amongst the four major banks, home lending continues to increase driven by the continued momentum in the property market and was the biggest driver of loan growth with an additional $11.22 billion in lending, followed by $9.85 billion in corporate and other non-housing term loans. As can be seen in Figure 24 the banks continued to grow their business lending books at a steady pace of approximately 6% per annum.

Deutsche Bank and Bank of India achieved the most notable growth in loan books, up by 48.37% and 28.07%, respectively; however, both of these were from relatively small bases.

LVR restrictions imposed by the RBNZ continue to have a positive impact on the quality of housing loans, with the big five banks reporting reductions in higher LVR loans. Loans with LVRs < 80% have increased from 84.28% to 86.83%. Loans with LVRs > 80% have decreased from 15.72% to 13.17%. Executives surveyed viewed the new introduced LVR restrictions on investor lending positively, commenting that these should help enhance the credit quality of loan books.

Analysis of funding

New Zealand banks were able to enjoy a good supply of funds during 2015, with total funding increasing by 5.26% to $298.56 billion for the banking sector by November 2015 (see Figure 22).

Increased volatility in global financial markets poses risks to New Zealand's financial system due to continued reliance on offshore funding by New Zealand banks. RBNZ data released in November 2015 shows positive trends, with banks continuing to move away from offshore funding and more towards local term deposits to mitigate these risks (see Figure 22). Further, the Core Funding Ratio (CFR) introduced by the RBNZ as a measure of reliance on offshore funding and designed to ensure that New Zealand banks are better positioned to withstand any major shocks in global financial markets, has strengthened this year up from 85.50% to 87.06%, and is well above the regulator minimum CFR of 75%. This is consistent with an increase in customer deposit growth over the survey period to 8.53%, up from 6.84% the year before.

Despite OCR cuts by the RBNZ during the second part of 2015 with the OCR now down from 3.50% to 2.50% (see Figure 5), New Zealand continues to have some of the highest interest rates among developed countries and continues to be appealing to offshore investors chasing higher yields, thus providing a steady pipeline of overseas funding. However, as New Zealand faces deflationary pressures, with inflation in negative territory in the last quarter, many economists are pointing to the possibility of further OCR cuts.

Most banks reported an increase in funding costs over the survey period with interest expense over average interest bearing liabilities for the banking sector increasing from 3.67% to 3.87% and likely to be reflective of the OCR hikes that were in effect earlier in the 2015 year which is reflected in Figure 15.

However, global market liquidity has declined in early 2016 affecting the availability of funds. Up until the end of 2015 Executives commented that there was plenty of liquidity chasing yield, with a range of funding types and range of rates, products and tenors on offer. Following considerable declines in commodity and equity prices in January 2016, global financial markets have become more volatile, starting to impact availability of funds. Impacts of this, if current developments continue, will not be seen until next year's survey.

TABLE 7: Major Banks – Funds Management Activities			
Entity	2015 $Million	2014–2015 Movement %	2014 $Million
ANZ	22,740	14.1%	19,923
BNZ	3,900	17.0%	3,334
CBA + ASB	7,523	24.3%	6,050
Kiwibank	3,735	-3.9%	3,885
Westpac	9,448	19.2%	7,924
Total	**47,346**	**15.2%**	**41,116**

Capital adequacy remains strong

For the first time since the inception of Basel III in 2013, registered banks have reversed the declining trends in their capital adequacy ratios. They have since built their capital up to all-time highs post the GFC. The average capital adequacy ratio for locally incorporated banks in New Zealand improved by 72 bps from 12.44% to 13.16%, while the Tier 1 Capital adequacy ratio increased by 48 bps from 11.38% to 11.86% which reflects the banks' continued focus on meeting capital requirements as well as protecting themselves against future financial shocks. On top of the RBNZ minimum capital ratios of 8% and 6% for Total Capital and Tier 1 capital, all of the banks were able to cover the 2.5% common equity buffer requirement.

ANZ, BNZ and Rabobank showed marked improvements in their Tier 1 Capital ratios, increasing by 160 bps, 105 bps and 97 bps respectively. For these banks, the growth in risk weighted exposures arising from growing loan books was mitigated by increased capital in the form of earnings retained and issuance of new subordinated debt.

Among the major banks, only ASB and Westpac reported declines in their Tier 1 Capital ratios, down by 90 bps to 10.80% and down by 80 bps to 11.10%, respectively. As for Total Capital ratios, ASB saw a

decline of 90 bps, however, Westpac managed to increase their Total Capital ratio by 150 bps. The primary driver behind the decrease in Tier 1 Capital ratios was the growth in gross loans of $4.75 billion and $4.55 billion, respectively, which resulted in increased risk weighted exposures for both banks. Westpac was however able to increase its Tier 2 Capital through the issuance of $1.14 billion in subordinated debt, which resulted in its Total Capital ratio increasing to 13.40%.

Strengthened capital adequacy in the New Zealand banking sector provides much welcomed news amid concerns around dairy exposures, slowing growth in China and uncertainties in global financial markets, and provides greater assurance of the banks' ability to withstand any significant downturn in the financial markets.

Funds Under Management (FUM)

The registered banks reported strong growth in Funds Under Management (FUM) during the survey period, with the five major banks reporting an increase of $6.23 billion or 15.15% growth with total FUM reaching $47.35 billion (see Table 7 – page 33). Among the big five banks, Kiwibank was the only one reporting a contraction in FUM, down by 3.86% or $150 million. Meanwhile all of the other major banks reported double-digit growth, with CBA and Westpac FUM increasing by 24.35% and 19.23%, respectively. Westpac recorded this growth on the back of a $680 million increase in retirement plan funds, along with its retail unit trusts growing by $240 million.

With $22.74 billion in FUM, ANZ continues to be the largest market player in this space and leads the sector in growth with a $2.82 billion increase in FUM. This alone accounts for 45.22% of total growth and is almost equivalent to that of CBA and Westpac combined. For ANZ much of this growth was driven by an increase in its KiwiSaver and other managed funds increasing from $7.21 billion to $9.15 billion, along with their investment portfolios managed on behalf of customers increasing by another $715 million.

Since its inception in 2007, the KiwiSaver scheme continues to play a pivotal role in fuelling FUM growth and will continue to do so as more people opt into the scheme. Fund management fees continue to present opportunities for banks to expand their revenue base and diversify their revenue streams.

TABLE 8: Registered Banks – Derivative Contracts

Entity	Year	Interest Rate Contracts					Exchange Rate Contracts			
		Forwards	Swaps	Futures	Options	Total	Forwards	Swaps	Options	Total
ANZ	2015	24,633	1,130,414	45,407	2,045	1,202,499	75,930	130,093	3,690	209,713
	2014	*8,899*	*680,503*	*17,930*	*2,447*	*709,779*	*63,800*	*155,303*	*4,909*	*224,012*
BNZ	2015	3,560	442,045	242,715	183	688,503	81,395	47,818	6,456	135,669
	2014	*3,308*	*339,406*	*132,593*	*134*	*475,441*	*69,646*	*47,632*	*4,132*	*121,410*
CBA + ASB	2015	14,477	33,574	1,250	82	49,383	7,365	2,713	315	10,393
	2014	*3,007*	*27,500*	*93*	*148*	*30,748*	*4,312*	*2,983*	*134*	*7,429*
Kiwibank	2015	1,800	37,506	1,075	0	40,381	978	36	37	1,051
	2014	*550*	*25,080*	*1,010*	*0*	*26,640*	*1,153*	*303*	*112*	*1,569*
Westpac	2015	8,821	350,798	112	215	359,946	27,540	46,538	0	74,078
	2014	*6,813*	*327,365*	*2,772*	*209*	*337,159*	*31,454*	*35,652*	*0*	*67,106*
Total	**2015**	**53,291**	**1,994,337**	**290,559**	**2,525**	**2,340,712**	**193,208**	**227,198**	**10,498**	**430,904**
	2014	***22,577***	***1,399,854***	***154,398***	***2,938***	***1,579,767***	***170,365***	***241,873***	***9,287***	***421,526***

Treasury and trading income

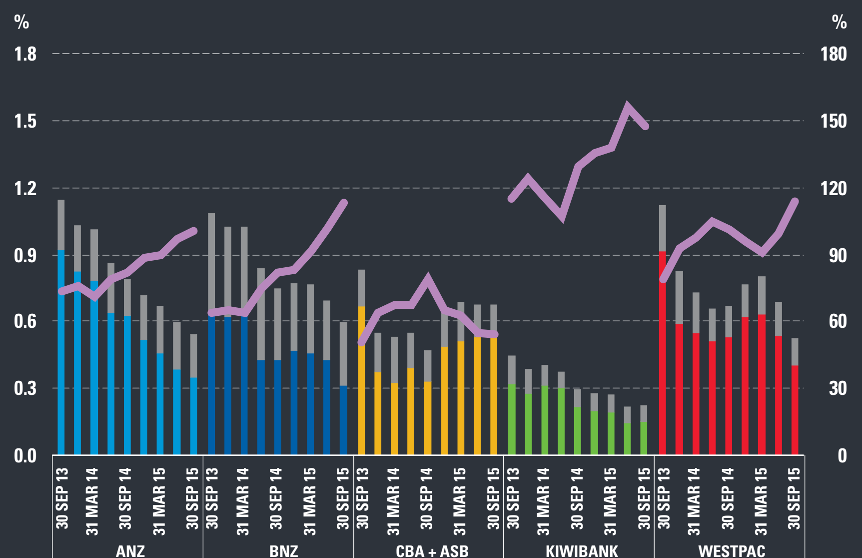
Foreign exchange and trading income were the main drivers behind movements in non-interest income for the major banks this year. Volatility in both interest rates and foreign exchange rates led to larger revaluation movements for trading derivatives recorded in the income statements (see Table 8 – page 34 for positions at year end)

Notably, ANZ's foreign exchange trading income increased by $44 million or 28.03%, while for BNZ the increase was $30 million or 40.00%. BNZ reported the highest dollar value increase in trading income at $43 million, while Westpac recorded a decrease of $15 million or 51.72% for the year.

The sharp decline in swap curves that occurred in January 2016 will likely trigger further revaluation gains or losses in early 2016. Meanwhile, after having reached their lowest levels since the GFC, credit spreads have begun to creep up and are expected to continue widening in the upcoming 2016 year which could push up term lending margins.

26 **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)



Registered banks – Analysis of annual results

Analysis of Financial Statements							
Entity	Location of Head Office	Balance Date	Survey Year	Rank by Total Assets	Total Assets* $Million	Net Assets $Million	Total Capital Adequacy Ratio %
Australia and New Zealand Banking Group Limited – New Zealand Banking Group	Wellington	30-Sep-2015	2015	1	152,177	7,507	13.30
		30-Sep-2014	*2014*	*1*	*135,170*	*6,723*	*12.70*
Bank of Baroda (New Zealand) Limited	Auckland	31-Mar-2015	2015	20	77	44	112.00
		31-Mar-2014	*2014*	*17*	*70*	*43*	*118.80*
Bank of China (New Zealand) Limited	Auckland	31-Dec-2014	2015	21	68	62	424.78
		31-Dec-2013	*2014*	*n/a*	*n/a*	*n/a*	*n/a*
Bank of India (New Zealand) Limited	Auckland	31-Mar-2015	2015	19	86	52	81.00
		31-Mar-2014	*2014*	*18*	*69*	*51*	*94.00*
Bank of New Zealand	Auckland	30-Sep-2015	2015	3	86,629	6,884	12.67
		30-Sep-2014	*2014*	*3*	*79,522*	*5,578*	*12.04*
China Construction Bank (New Zealand) Limited	Auckland	31-Dec-2014	2015	18	92	58	133.43
		31-Dec-2013	*2014*	*n/a*	*n/a*	*n/a*	*n/a*
Citibank, N.A. New Zealand Branch	Auckland	31-Dec-2014	2015	13	1,980	196	14.81
		31-Dec-2013	*2014*	*13*	*2,191*	*188*	*15.60*
Commonwealth Bank of Australia New Zealand Banking Group	Auckland	30-Jun-2015	2015	4	80,262	4,997	12.70
		30-Jun-2014	*2014*	*4*	*72,190*	*5,386*	*12.00*
Deutsche Bank AG, New Zealand Group	Auckland	31-Dec-2014	2015	12	2,132	152	16.00
		31-Dec-2013	*2014*	*11*	*2,575*	*128*	*18.50*
Heartland Bank Limited	Auckland	30-Jun-2015	2015	11	2,778	353	12.86
		30-Jun-2014	*2014*	*12*	*2,371*	*344*	*14.39*
Industrial and Commercial Bank of China (New Zealand) Limited	Auckland	31-Dec-2014	2015	16	670	57	36.33
		31-Dec-2013	*2014*	*19*	*61*	*60*	*394.79*
JPMorgan Chase Bank, N.A. New Zealand Branch	Wellington	31-Dec-2014	2015	15	1,016	-1	12.53
		31-Dec-2013	*2014*	*15*	*969*	*-1*	*14.13*
Kiwibank Limited	Wellington	30-Jun-2015	2015	5	18,344	1,033	13.40
		30-Jun-2014	*2014*	*5*	*16,676*	*1,003*	*13.00*
Kookmin Bank Auckland Branch	Auckland	31-Dec-2014	2015	17	374	4	15.97
		31-Dec-2013	*2014*	*16*	*419*	*6*	*15.42*
Rabobank Nederland New Zealand Banking Group	Wellington	31-Dec-2014	2015	6	13,555	1,340	21.30
		31-Dec-2013	*2014*	*6*	*12,191*	*1,192*	*19.80*
Southland Building Society	Invercargill	31-Mar-2015	2015	10	2,860	241	15.61
		31-Mar-2014	*2014*	*10*	*2,787*	*233*	*13.69*
The Bank of Tokyo-Mitsubishi UFJ Limited, Auckland Branch	Auckland	31-Mar-2015	2015	9	3,019	98	15.61
		31-Mar-2014	*2014*	*9*	*3,450*	*97*	*15.57*
The Co-operative Bank Limited	Wellington	31-Mar-2015	2015	14	1,806	150	16.50
		31-Mar-2014	*2014*	*14*	*1,624*	*143*	*16.80*
The Hongkong and Shanghai Banking Corporation Limited, New Zealand Branch	Auckland	31-Dec-2014	2015	8	5,292	28	15.70
		31-Dec-2013	*2014*	*8*	*5,036*	*-17*	*15.20*
TSB Bank Limited	New Plymouth	31-Mar-2015	2015	7	5,912	498	13.85
		31-Mar-2014	*2014*	*7*	*5,682*	*477*	*14.21*
Westpac Banking Corporation – New Zealand Division	Auckland	30-Sep-2015	2015	2	88,336	5,668	13.30
		30-Sep-2014	*2014*	*2*	*81,153*	*4,974*	*12.30*
Bank Sector Total			**2015**		**467,467**	**29,421**	**n/a**
			2014		***424,205***	***26,610***	***n/a***

* Total Assets = Total Assets - Goodwill - Other Intangibles

Size & Strength Measures						Growth Measures		
Tier 1 Capital Adequacy Ratio %	Net Loans and Advances $Million	Customer Deposits $Million	Number of Employees	Number of Branches	Number of Owned ATMs	Increase in Net Profit After Tax %	Increase In Underlying Profit %	Increase in Total Assets %
11.30	114,843	83,134	8,104	225	684	3.51	8.62	12.58
10.70	*105,949*	*74,520*	*8,225*	*232*	*663*	*24.98*	*20.76*	*6.86*
112.00	49	32	20	3	3	-34.60	-20.93	10.94
118.80	*43*	*25*	*18*	*3*	*3*	*83.04*	*240.70*	*9.78*
424.78	-	-	n/d	-	-	n/a	n/a	n/a
n/a	*n/a*	*n/a*	*n/a*	*n/a*	*n/a*	*n/a*	*n/a*	*n/a*
81.00	62	12	12	3	-	32.62	31.06	24.12
94.00	*49*	*6*	*11*	*2*	-	*72.59*	*76.00*	*6.37*
11.69	68,590	46,729	4,841	173	474	22.12	19.39	8.94
10.64	*64,715*	*45,379*	*4,769*	*177*	*470*	*22.30*	*25.05*	*5.85*
133.43	4	1	n/d	-	-	n/a	n/a	n/a
n/a	*n/a*	*n/a*	*n/a*	*n/a*	*n/a*	*n/a*	*n/a*	*n/a*
13.65	572	923	27	1	-	53.58	45.69	-9.61
13.52	*663*	*970*	*27*	*1*	-	*7.10*	*12.11*	*0.50*
11.20	69,288	49,138	4,469	134	462	3.08	0.73	11.18
11.10	*63,994*	*42,884*	*4,521*	*140*	*470*	*16.87*	*16.14*	*1.30*
12.90	273	83	29	-	-	500.00	650.00	-17.20
16.90	*184*	*66*	*23*	-	-	*-69.23*	*-77.78*	*-6.67*
12.79	2,323	2,085	352	7	-	12.99	17.84	17.20
14.29	*1,992*	*1,732*	*334*	*9*	-	*386.98*	*649.46*	*-4.41*
36.33	86	9	23	1	-	-4,777.05	-4,701.64	999.21
394.79	-	-	*10*	*1*	-	*51.59*	*51.59*	*0.44*
11.82	47	169	13	-	-	400.09	468.89	4.83
11.93	*52*	*231*	*14*	-	-	*-189.51*	*-151.85*	*30.06*
11.00	15,639	13,724	1,188	265	243	27.00	24.05	10.00
10.40	*14,667*	*12,676*	*1,166*	*276*	*244*	*3.09*	*3.95*	*9.65*
13.38	126	151	n/d	-	-	-25.27	-23.74	-10.60
12.61	*197*	*178*	*n/d*	-	-	*-7.07*	*-7.83*	*7.15*
16.00	10,001	4,696	305	32	-	-14.45	-12.64	11.18
16.60	*10,006*	*4,333*	*310*	*32*	-	*66.73*	*68.33*	*6.58*
13.85	2,407	2,436	428	17	-	24.29	25.64	2.64
13.39	*2,289*	*2,446*	*413*	*17*	-	*9.07*	*8.66*	*-1.48*
12.33	2,625	201	17	1	-	96.93	82.44	-12.50
12.21	*2,979*	*125*	*16*	*1*	-	*-184.13*	*-204.84*	*21.53*
16.40	1,565	1,575	305	34	-	24.41	26.97	11.24
16.60	*1,412*	*1,405*	*295*	*34*	-	*23.96*	*27.57*	*6.72*
14.40	3,780	3,181	213	1	-	165.11	156.73	5.08
14.10	*3,381*	*3,136*	*224*	*3*	-	*-38.26*	*-37.03*	*0.16*
13.53	3,290	5,366	328	27	47	-48.92	-50.08	4.05
13.91	*3,102*	*5,156*	*306*	*25*	*43*	*-5.95*	*-7.70*	*4.66*
11.40	69,873	51,916	4,497	189	639	-1.28	9.82	8.85
10.60	*65,325*	*49,416*	*4,469*	*195*	*629*	*19.18*	*10.34*	*5.35*
n/a	**365,444**	**265,561**	**25,171**	**1,113**	**2,552**	**6.94**	**10.27**	**10.20**
n/a	***341,000***	***244,684***	***25,151***	***1,148***	***2,522***	***20.41***	***17.41***	***5.28***

Registered banks – Analysis of annual results

Analysis of Financial Statements		Credit Quality Measures						
Entity	Survey Year	Impaired Asset Expense $Million	Past Due Assets $Million	Gross Impaired Assets $Million	Individual Provision For Doubtful Debts/ Gross Impaired Assets %	Collective Provision/ Net Loans and Advances %	Total Provision For Doubtful Debts/ Gross Loans and Advances %	Impaired Asset Expense/ Average Gross Loans and Advances %
Australia and New Zealand Banking Group Limited – New Zealand Banking Group	2015	76	222	404	40.10	0.41	0.55	0.07
	2014	*-9*	*172*	*668*	*33.53*	*0.44*	*0.65*	*-0.01*
Bank of Baroda (New Zealand) Limited	2015	0	0	0	100.00	0.41	0.63	0.11
	2014	*0*	*0*	*0*	*100.00*	*0.40*	*0.61*	*0.08*
Bank of China (New Zealand) Limited	2015	0	0	0	0.00	0.00	0.00	0.00
	2014	*n/a*	*n/a*	*n/a*	*n/a*	*n/a*	*n/a*	*n/a*
Bank of India (New Zealand) Limited	2015	0	0	0	0.00	0.41	0.41	0.04
	2014	*0*	*0*	*0*	*0.00*	*0.48*	*0.48*	*0.24*
Bank of New Zealand	2015	128	196	215	42.79	0.55	0.68	0.19
	2014	*74*	*208*	*277*	*43.32*	*0.43*	*0.61*	*0.12*
China Construction Bank (New Zealand) Limited	2015	0	0	0	0.00	0.08	0.08	0.00
	2014	*n/a*	*n/a*	*n/a*	*n/a*	*n/a*	*n/a*	*n/a*
Citibank, N.A. New Zealand Branch	2015	0	0	0	0.00	0.00	0.00	0.00
	2014	*0*	*0*	*0*	*0.00*	*0.00*	*0.00*	*0.00*
Commonwealth Bank of Australia New Zealand Banking Group	2015	101	100	365	14.79	0.29	0.37	0.15
	2014	*54*	*101*	*249*	*23.29*	*0.28*	*0.37*	*0.09*
Deutsche Bank AG, New Zealand Group	2015	0	0	0	0.00	0.00	0.00	0.00
	2014	*0*	*0*	*0*	*0.00*	*0.00*	*0.00*	*0.00*
Heartland Bank Limited	2015	11	35	30	51.56	0.40	1.05	0.52
	2014	*6*	*34*	*32*	*29.55*	*0.35*	*0.82*	*0.29*
Industrial and Commercial Bank of China (New Zealand) Limited	2015	0	0	0	0.00	0.56	0.56	1.12
	2014	*0*	*0*	*0*	*0.00*	*0.00*	*0.00*	*0.00*
JPMorgan Chase Bank, N.A. New Zealand Branch	2015	0	0	0	0.00	0.00	0.00	0.00
	2014	*0*	*0*	*0*	*0.00*	*0.00*	*0.00*	*0.00*
Kiwibank Limited	2015	13	11	23	52.17	0.26	0.34	0.09
	2014	*-4*	*11*	*44*	*50.00*	*0.25*	*0.40*	*-0.03*
Kookmin Bank Auckland Branch	2015	0	0	0	0.00	0.44	0.44	-0.06
	2014	*0*	*0*	*0*	*63.35*	*0.33*	*0.37*	*0.13*
Rabobank Nederland New Zealand Banking Group	2015	-19	22	239	23.50	0.12	0.68	-0.19
	2014	*1*	*29*	*404*	*23.31*	*0.17*	*1.10*	*0.01*
Southland Building Society	2015	12	5	13	45.09	0.51	0.75	0.52
	2014	*11*	*8*	*20*	*49.43*	*0.47*	*0.90*	*0.46*
The Bank of Tokyo-Mitsubishi UFJ Limited, Auckland Branch	2015	30	0	64	100.00	0.00	2.37	1.04
	2014	*50*	*0*	*64*	*53.00*	*0.00*	*1.13*	*1.83*
The Co-operative Bank Limited	2015	1	7	1	61.74	0.20	0.26	0.07
	2014	*1*	*3*	*3*	*31.54*	*0.25*	*0.30*	*0.11*
The Hongkong and Shanghai Banking Corporation Limited, New Zealand Branch	2015	-18	0	122	17.00	0.14	0.68	-0.50
	2014	*43*	*0*	*142*	*28.40*	*0.25*	*1.42*	*1.26*
TSB Bank Limited	2015	56	2	1	61.42	0.45	0.46	1.75
	2014	*11*	*7*	*4*	*47.22*	*0.43*	*0.49*	*0.38*
Westpac Banking Corporation – New Zealand Division	2015	47	83	282	41.84	0.43	0.59	0.07
	2014	*26*	*90*	*346*	*41.62*	*0.46*	*0.68*	*0.04*
Bank Sector Total	**2015**	**438**	**683**	**1,758**	**34.18**	**0.39**	**0.56**	**0.12**
	2014	***265***	***663***	***2,253***	***33.68***	***0.39***	***0.61***	***0.08***

** Operating Expenses = Total Expenses - Interest Expense - Loan Write Offs and Bad Debts - Abnormal Expenses.

Profitability Measures										Efficiency Measures	
Total Operating Income $Million	Net Interest Income/ Average Total Assets %	Interest Margin %	Interest Spread %	Non-interest Income/ Average Total Assets %	Net Profit After Tax $Million	Net Profit After Tax/ Average Equity %	Net Profit After Tax/ Average Total Assets %	Underlying Profit $Million	Underlying Profit/ Average Total Assets %	Operating Expenses** /Average Total Assets %	Operating Expenses/ Operating Income %
4,037	2.00	2.26	1.83	0.81	1,771	16.91	1.23	2,483	1.73	1.03	36.61
3,737	*2.11*	*2.33*	*1.90*	*0.74*	*1,711*	*17.26*	*1.31*	*2,286*	*1.75*	*1.12*	*39.07*
4	3.51	3.73	1.99	1.81	1	1.91	1.12	1	0.95	4.31	81.00
4	*3.53*	*3.84*	*1.94*	*2.04*	*1*	*2.99*	*1.90*	*1*	*1.32*	*4.21*	*75.58*
1	n/a	n/a	n/a	n/a	-1	n/a	n/a	-1	n/a	n/a	236.17
n/a	*n/a*	*n/a*	*n/a*	*n/a*	*n/a*	*n/a*	*n/a*	*n/a*	*n/a*	*n/a*	*n/a*
4	4.12	4.21	1.57	0.46	1	1.21	0.80	1	1.12	3.43	74.94
3	*4.22*	*4.33*	*1.80*	*0.56*	*0*	*0.92*	*0.70*	*1*	*0.98*	*3.65*	*76.43*
2,432	2.09	2.30	1.85	0.84	1,038	16.24	1.25	1,484	1.79	0.99	33.72
2,136	*2.10*	*2.30*	*1.94*	*0.66*	*850*	*14.88*	*1.10*	*1,243*	*1.61*	*1.06*	*38.34*
1	n/a	n/a	n/a	n/a	-1	n/a	n/a	-1	n/a	n/a	149.33
n/a	*n/a*	*n/a*	*n/a*	*n/a*	*n/a*	*n/a*	*n/a*	*n/a*	*n/a*	*n/a*	*n/a*
45	1.91	1.93	1.71	0.23	21	11.02	1.01	29	1.39	0.75	35.14
43	*1.58*	*1.61*	*1.47*	*0.38*	*14*	*7.53*	*0.63*	*20*	*0.91*	*1.06*	*53.76*
2,125	2.22	2.30	1.85	0.57	871	15.79	1.14	1,247	1.64	1.02	36.56
2,036	*2.20*	*2.27*	*1.84*	*0.64*	*845*	*15.65*	*1.18*	*1,238*	*1.73*	*1.04*	*36.54*
56	1.40	1.66	1.76	0.98	24	17.14	1.02	30	1.27	1.10	46.43
35	*-0.30*	*-0.33*	*-0.36*	*1.61*	*4*	*3.19*	*0.15*	*4*	*0.15*	*1.16*	*88.57*
128	4.73	4.89	4.34	0.25	41	11.11	1.59	55	2.13	2.41	48.47
114	*4.39*	*4.59*	*4.05*	*0.31*	*36*	*9.94*	*1.49*	*47*	*1.92*	*2.54*	*53.97*
4	0.81	0.82	0.78	0.17	-3	-5.07	-0.81	-3	-0.80	1.65	168.02
0	*0.76*	*0.78*	*0.15*	*-0.01*	*0*	*-0.10*	*-0.10*	*0*	*-0.10*	*0.85*	*113.35*
19	0.58	0.77	0.71	1.36	6	0.00	0.64	9	0.95	0.99	50.94
9	*0.70*	*1.15*	*1.09*	*0.39*	*-2*	*0.00*	*-0.25*	*-3*	*-0.30*	*1.39*	*127.29*
473	2.06	2.12	1.60	0.64	127	12.48	0.73	196	1.12	1.51	55.81
400	*1.84*	*1.87*	*1.40*	*0.67*	*100*	*10.75*	*0.63*	*158*	*0.99*	*1.54*	*61.50*
8	1.65	1.66	1.64	0.47	4	74.25	0.96	5	1.36	0.78	36.89
10	*1.92*	*1.93*	*1.90*	*0.57*	*5*	*91.13*	*1.25*	*7*	*1.75*	*0.69*	*27.55*
295	2.57	2.62	2.28	-0.28	148	11.66	1.15	211	1.64	0.81	35.18
343	*2.68*	*2.74*	*2.43*	*0.23*	*173*	*15.61*	*1.46*	*241*	*2.04*	*0.86*	*29.42*
107	2.87	2.91	2.57	0.90	19	8.13	0.69	28	1.00	2.34	62.09
91	*2.47*	*2.51*	*2.19*	*0.76*	*16*	*6.71*	*0.56*	*22*	*0.80*	*2.06*	*63.66*
29	0.46	0.47	0.40	0.45	0	-0.51	-0.02	-4	-0.14	0.13	14.61
30	*0.38*	*0.39*	*0.31*	*0.57*	*-16*	*-15.34*	*-0.52*	*-25*	*-0.79*	*0.14*	*14.54*
66	2.85	2.88	2.35	1.02	9	6.06	0.52	13	0.78	3.02	78.23
62	*2.73*	*2.76*	*2.34*	*1.23*	*7*	*5.14*	*0.45*	*11*	*0.67*	*3.19*	*80.66*
133	1.74	1.82	1.71	0.84	66	300.37	1.29	94	1.82	1.11	42.89
136	*1.57*	*1.65*	*1.56*	*1.14*	*25*	*320.37*	*0.50*	*37*	*0.73*	*1.13*	*41.70*
147	2.17	2.19	1.74	0.36	26	5.23	0.44	34	0.59	0.98	38.62
130	*1.97*	*2.00*	*1.55*	*0.37*	*50*	*10.92*	*0.90*	*68*	*1.23*	*0.91*	*38.85*
2,371	2.10	2.29	1.79	0.70	1,006	17.21	1.19	1,476	1.74	1.00	35.77
2,180	*2.01*	*2.18*	*1.76*	*0.75*	*1,019*	*19.79*	*1.29*	*1,344*	*1.70*	*1.02*	*37.16*
12,485	**2.10**	**2.28**	**1.84**	**0.70**	**5,174**	**15.96**	**1.16**	**7,388**	**1.66**	**1.05**	**37.32**
11,501	***2.09***	***2.24***	***1.85***	***0.69***	***4,838***	***16.13***	***1.17***	***6,700***	***1.62***	***1.10***	***39.44***

Registered banks – Analysis of annual results

Balance Sheet Breakdown		Assets ($Million)								
Entity	Balance Date	Cash On Hand, Money At Call and Balances With Other Banks	Trading, Investment Securities, Investments in Subsidiaries and Investment Properties	Derivative Financial Instruments	Loans and Advances (Less Provisions)	Balances With Related Parties	Fixed Assets	Intangibles	Other Assets	Total Assets
2015										
Australia and New Zealand Banking Group Limited – New Zealand Banking Group	30-Sep	4,532	13,718	13,650	114,376	4,179	388	3,492	1,195	**155,530**
Bank of Baroda (New Zealand) Limited	31-Mar	23	0	0	49	3	1	0	1	**77**
Bank of China (New Zealand) Limited	31-Dec	67	0	0	0	0	1	0	0	**68**
Bank of India (New Zealand) Limited	31-Mar	18	0	0	62	4	1	0	0	**86**
Bank of New Zealand	30-Sep	3,643	4,918	7,895	68,216	1,259	176	158	522	**86,787**
China Construction Bank (New Zealand) Limited	31-Dec	76	0	0	4	12	1	0	0	**92**
Citibank, N.A. New Zealand Branch	31-Dec	450	751	0	572	143	1	0	62	**1,980**
Commonwealth Bank of Australia New Zealand Banking Group	30-Jun	3,174	4,675	1,759	69,087	641	189	438	622	**80,585**
Deutsche Bank AG, New Zealand Group	31-Dec	48	353	0	273	1,444	1	0	13	**2,132**
Heartland Bank Limited	30-Jun	32	323	0	2,314	29	5	26	70	**2,799**
Industrial and Commercial Bank of China (New Zealand) Limited	31-Dec	582	0	0	86	0	2	0	1	**670**
JPMorgan Chase Bank, N.A. New Zealand Branch	31-Dec	321	448	0	47	19	0	1	180	**1,016**
Kiwibank Limited	30-Jun	686	1,318	480	15,598	77	20	116	49	**18,344**
Kookmin Bank Auckland Branch	31-Dec	3	0	0	125	246	0	0	0	**374**
Rabobank Nederland New Zealand Banking Group	31-Dec	320	687	16	9,989	2,472	6	0	65	**13,555**
Southland Building Society	31-Mar	128	306	2	2,395	2	19	5	6	**2,863**
The Bank of Tokyo-Mitsubishi UFJ Limited, Auckland Branch	31-Mar	77	223	5	2,625	68	1	0	21	**3,019**
The Co-operative Bank Limited	31-Mar	209	10	2	1,562	0	8	11	5	**1,806**
The Hongkong and Shanghai Banking Corporation Limited, New Zealand Branch	31-Dec	426	495	116	3,775	448	1	18	30	**5,309**
TSB Bank Limited	31-Mar	107	2,450	1	3,275	0	16	4	59	**5,912**
Westpac Banking Corporation – New Zealand Division	30-Sep	1,107	7,636	5,459	69,576	3,451	164	658	810	**88,861**
Bank Sector Total		**16,028**	**38,311**	**29,384**	**364,006**	**14,498**	**1,000**	**4,927**	**3,712**	**471,866**
2014										
Australia and New Zealand Banking Group Limited – New Zealand Banking Group	30-Sep	3,262	13,182	7,657	105,485	4,539	380	3,454	569	**138,528**
Bank of Baroda (New Zealand) Limited	31-Mar	22	0	0	43	3	1	0	1	**70**
Bank of India (New Zealand) Limited	31-Mar	16	0	0	49	3	1	0	0	**69**
Bank of New Zealand	30-Sep	4,601	4,396	4,644	64,437	743	189	163	512	**79,685**
Citibank, N.A. New Zealand Branch	31-Dec	633	594	0	663	220	1	0	79	**2,191**
Commonwealth Bank of Australia New Zealand Banking Group	30-Jun	2,027	4,197	744	63,815	348	201	436	745	**72,513**
Deutsche Bank AG, New Zealand Group	31-Dec	100	616	0	184	1,638	2	0	35	**2,575**
Heartland Bank Limited	30-Jun	35	239	2	1,985	29	10	22	69	**2,391**
Industrial and Commercial Bank of China (New Zealand) Limited	31-Dec	58	0	0	0	0	2	0	1	**61**
JPMorgan Chase Bank, N.A. New Zealand Branch	31-Dec	305	333	0	52	28	0	1	251	**970**
Kiwibank Limited	30-Jun	582	1,137	130	14,630	77	13	86	21	**16,676**
Kookmin Bank Auckland Branch	31-Dec	2	0	0	197	219	0	0	0	**419**
Rabobank Nederland New Zealand Banking Group	31-Dec	37	586	21	9,989	1,483	5	0	70	**12,191**
Southland Building Society	31-Mar	110	359	10	2,278	0	22	4	4	**2,788**
The Bank of Tokyo-Mitsubishi UFJ Limited, Auckland Branch	31-Mar	135	284	4	2,979	34	1	0	13	**3,450**
The Co-operative Bank Limited	31-Mar	47	148	3	1,408	0	7	8	3	**1,624**
The Hongkong and Shanghai Banking Corporation Limited, New Zealand Branch	31-Dec	778	400	117	3,373	338	1	20	27	**5,054**
TSB Bank Limited	31-Mar	86	2,444	2	3,088	0	14	0	47	**5,682**
Westpac Banking Corporation – New Zealand Division	30-Sep	2,518	6,572	4,180	65,027	1,770	178	715	718	**81,678**
Bank Sector Total		**15,355**	**35,485**	**17,512**	**339,683**	**11,473**	**1,030**	**4,909**	**3,166**	**428,613**

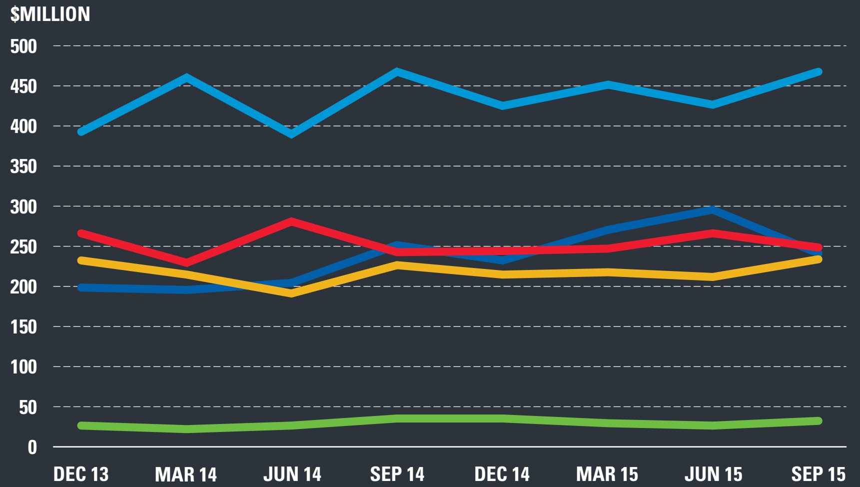
Liabilities ($Million)								Equity ($Million)					
Customer Deposits	Balances With Other Banks And Money Market Deposits	Debt Securities	Derivative Financial Instruments	Balances With Related Parties	Subordinated Debt	Other Liabilities	Total Liabilities	Share Capital – Ordinary Shares	Head Office Account	Convertible Debentures/ Perpetual Preference Shares	Other Equity/Cash Flow Hedge Reserves	Retained Earnings	Total Equity
83,134	2,417	26,848	13,926	14,093	2,381	1,871	**144,670**	8,047	11	0	-10	2,812	**10,860**
32	0	0	0	1	0	0	**34**	40	0	0	0	4	**44**
0	0	0	0	5	0	0	**6**	63	0	0	0	-1	**62**
12	0	0	0	21	0	0	**34**	50	0	0	0	2	**52**
46,729	1,439	21,183	8,310	1,095	0	989	**79,745**	2,351	0	650	96	3,945	**7,042**
1	33	0	0	1	0	0	**34**	59	0	0	0	-1	**58**
923	15	0	0	837	0	9	**1,785**	29	34	0	0	134	**196**
49,138	1,003	13,759	1,193	5,774	3,784	614	**75,265**	704	462	1,480	496	2,178	**5,320**
83	210	71	0	1,608	0	8	**1,980**	20	0	0	3	129	**152**
2,085	0	262	3	32	0	44	**2,426**	341	0	0	0	32	**373**
9	4	50	0	547	0	3	**613**	60	0	0	-3	0	**57**
169	0	397	0	259	0	192	**1,016**	0	0	0	0	0	**0**
13,724	325	2,397	475	22	255	113	**17,311**	400	0	0	101	532	**1,033**
151	189	0	0	30	0	1	**370**	0	4	0	0	0	**4**
4,696	0	2,787	35	4,624	0	72	**12,215**	551	169	0	0	620	**1,340**
2,436	0	65	10	39	41	28	**2,619**	0	0	0	5	238	**244**
201	0	0	8	2,710	0	1	**2,921**	0	83	0	1	15	**98**
1,575	0	61	6	0	0	15	**1,656**	0	0	0	-1	151	**150**
3,181	182	740	72	1,040	0	50	**5,265**	0	42	0	2	0	**44**
5,366	0	0	1	0	0	47	**5,414**	10	0	0	0	488	**498**
51,916	837	15,755	6,717	4,288	1,984	1,171	**82,668**	143	1,824	0	-102	4,328	**6,193**
265,561	**6,654**	**84,374**	**30,756**	**37,026**	**8,445**	**5,229**	**438,046**	**12,868**	**2,629**	**2,130**	**587**	**15,606**	**33,820**
74,520	2,898	26,044	6,385	16,137	835	1,628	**128,447**	7,393	0	0	-7	2,695	**10,081**
25	0	0	0	1	0	0	**27**	40	0	0	0	3	**43**
6	0	0	0	12	0	0	**18**	50	0	0	0	1	**51**
45,379	2,147	19,614	4,438	1,265	0	1,101	**73,944**	1,851	0	650	-17	3,257	**5,741**
970	36	0	0	990	0	8	**2,003**	29	33	0	0	126	**188**
42,884	353	12,368	899	7,182	2,539	579	**66,804**	704	462	1,482	587	2,474	**5,709**
66	334	385	0	1,438	208	16	**2,447**	20	0	0	3	105	**128**
1,732	0	232	0	28	0	34	**2,026**	340	0	0	1	23	**364**
0	0	0	0	0	0	1	**1**	60	0	0	0	0	**60**
231	0	303	0	189	0	247	**970**	0	0	0	0	0	**0**
12,676	185	2,143	236	102	247	84	**15,673**	400	0	149	18	436	**1,003**
178	189	0	0	45	0	1	**413**	0	6	0	0	0	**6**
4,333	0	3,029	38	3,531	0	68	**10,999**	551	128	0	-1	513	**1,192**
2,446	50	0	1	12	19	25	**2,554**	0	0	0	13	221	**234**
125	0	0	10	3,215	0	2	**3,353**	0	83	0	-1	15	**97**
1,405	0	58	1	0	0	16	**1,481**	0	0	0	1	143	**143**
3,136	158	792	120	810	0	37	**5,053**	0	-4	0	4	0	**0**
5,156	0	0	1	0	0	47	**5,205**	10	0	0	0	467	**477**
49,416	1,141	13,746	4,123	5,157	710	1,886	**76,179**	143	1,750	0	51	3,555	**5,499**
244,684	**7,491**	**78,715**	**16,254**	**40,113**	**4,558**	**5,781**	**397,595**	**11,591**	**2,459**	**2,281**	**652**	**14,035**	**31,018**

Major banks – Quarterly analysis

Entity	Size & Strength Measures							
	31 Dec 13	31 Mar 14	30 Jun 14	30 Sep 14	31 Dec 14	31 Mar 15	30 Jun 15	30 Sep 15
	Total Assets[6] ($Million)							
ANZ[4]	128,109	129,529	132,422	135,074	135,290	140,253	150,664	152,038
BNZ	75,481	76,740	75,845	79,522	79,658	81,926	85,657	86,629
CBA + ASB[4]	71,950	72,586	72,077	73,483	74,149	76,994	80,147	81,321
Heartland Bank	2,462	2,423	2,368	2,431	2,543	2,623	2,772	2,825
Kiwibank	16,032	16,344	16,590	16,882	17,064	17,948	18,228	18,686
Southland Building Society	2,806	2,784	2,786	2,825	2,826	2,858	3,094	3,163
The Co-operative Bank Limited	1,595	1,616	1,664	1,704	1,770	1,795	1,838	1,896
TSB Bank Limited	5,684	5,682	5,655	5,736	5,908	5,908	5,991	6,208
Westpac[4]	76,807	78,857	80,392	80,963	82,442	82,087	87,455	88,203
Total	**380,926**	**386,561**	**389,799**	**398,619**	**401,649**	**412,392**	**435,846**	**440,968**
	Increase in Gross Loans and Advances (%)							
ANZ[4]	1.81	0.99	1.30	1.31	1.53	1.75	3.60	0.86
BNZ	0.69	0.42	1.45	0.93	1.16	1.57	1.01	1.72
CBA + ASB[4]	0.92	0.49	0.96	1.87	1.19	2.75	2.04	2.29
Heartland Bank	-2.96	-0.49	3.77	3.15	4.50	4.10	4.11	3.21
Kiwibank	3.73	2.87	1.85	0.66	2.20	2.04	1.50	2.24
Southland Building Society	0.62	0.03	-0.53	-0.10	2.88	2.50	11.34	2.71
The Co-operative Bank Limited	3.83	3.02	2.58	2.74	2.93	2.19	3.24	4.28
TSB Bank Limited	1.31	0.26	0.94	0.20	3.04	1.73	5.27	3.39
Westpac[4]	1.17	1.16	0.95	1.24	1.67	1.51	1.57	1.99
Average	**1.32**	**0.88**	**1.22**	**1.30**	**1.50**	**1.90**	**2.34**	**1.67**
	Capital Adequacy (%)							
ANZ[4, 5]	11.20	12.10	12.10	12.70	11.80	12.60	12.50	13.30
BNZ	12.06	12.13	11.82	12.04	12.28	12.90	12.59	12.67
CBA + ASB[4]	11.20	11.20	12.00	11.10	12.70	12.10	12.70	13.30
Heartland Bank	14.73	14.71	14.39	14.09	13.76	13.36	12.86	12.85
Kiwibank	11.50	11.60	13.00	13.20	13.30	12.40	13.40	12.80
Southland Building Society	13.69	13.69	15.64	16.02	16.07	15.61	14.59	14.21
The Co-operative Bank Limited	16.60	16.80	16.80	16.80	16.50	16.50	16.30	16.20
TSB Bank Limited	14.00	14.21	14.77	14.98	13.48	13.85	13.71	15.77
Westpac[4, 5]	11.30	12.10	11.70	12.30	11.60	12.10	12.40	13.30
	Net Profit ($Million)							
ANZ[4]	393	460	390	468	425	452	427	467
BNZ	198	195	205	252	232	270	295	241
CBA + ASB[4]	232	214	191	227	214	218	212	234
Heartland Bank	9	9	10	10	10	11	10	10
Kiwibank	26	22	26	35	36	29	27	33
Southland Building Society	4	5	4	6	5	4	6	4
The Co-operative Bank Limited	2	2	2	2	3	2	2	3
TSB Bank Limited	14	13	16	12	-18	16	13	25
Westpac[4]	266	230	281	242	244	247	266	249
Total	**1,144**	**1,150**	**1,125**	**1,254**	**1,151**	**1,249**	**1,259**	**1,266**

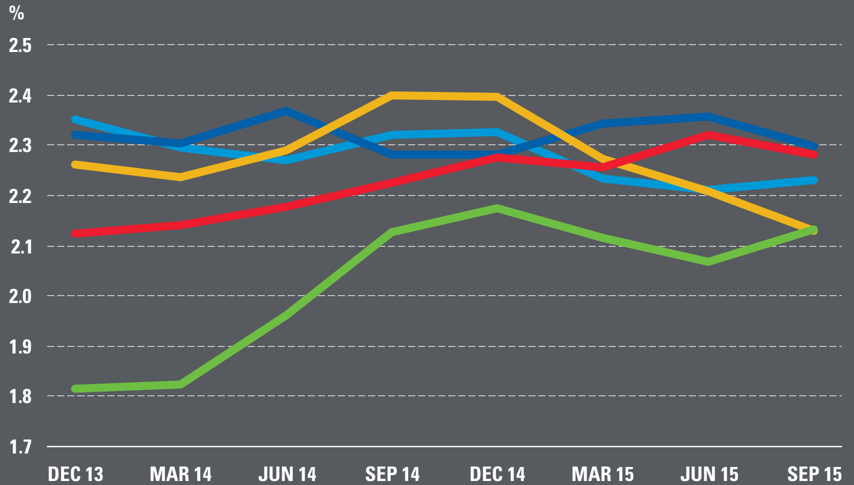
Entity	Profitability Measures							
	31 Dec 13	31 Mar 14	30 Jun 14	30 Sep 14	31 Dec 14	31 Mar 15	30 Jun 15	30 Sep 15
	Interest Margin (%)							
ANZ[4]	2.35	2.30	2.27	2.32	2.33	2.23	2.21	2.23
BNZ	2.32	2.30	2.37	2.28	2.28	2.34	2.36	2.30
CBA + ASB[4]	2.26	2.24	2.29	2.40	2.40	2.27	2.21	2.13
Heartland Bank	4.61	4.45	4.94	4.99	5.06	4.91	4.83	4.81
Kiwibank	1.82	1.82	1.96	2.13	2.17	2.12	2.07	2.13
Southland Building Society	2.53	2.58	2.81	2.97	2.97	2.93	2.86	2.67
The Co-operative Bank Limited	2.78	2.78	2.85	2.95	2.90	2.80	2.81	2.77
TSB Bank Limited	2.01	1.99	2.17	2.30	2.15	2.20	2.12	2.14
Westpac[4]	2.12	2.14	2.18	2.23	2.28	2.26	2.32	2.28
Average	**2.27**	**2.25**	**2.28**	**2.32**	**2.34**	**2.29**	**2.28**	**2.25**
	Non-interest Income/Total Tangible Assets (%)							
ANZ[4]	0.65	0.31	0.73	1.00	0.79	0.90	0.76	0.80
BNZ	0.61	0.47	0.53	1.06	0.63	0.94	0.97	0.83
CBA + ASB[4]	0.64	0.59	0.64	0.58	0.63	0.56	0.52	0.66
Heartland Bank	0.52	0.63	0.45	0.33	0.41	0.41	0.36	0.39
Kiwibank	0.66	0.77	0.58	0.72	0.73	0.57	0.57	0.59
Southland Building Society	0.74	0.71	0.77	0.93	0.96	1.03	0.98	0.95
The Co-operative Bank Limited	1.30	0.90	1.17	1.14	1.13	0.24	1.00	0.99
TSB Bank Limited	0.32	0.33	0.33	0.38	0.35	0.40	0.24	0.38
Westpac[4]	0.80	0.69	0.73	0.78	0.73	0.66	0.73	0.69
Average	**0.67**	**0.50**	**0.66**	**0.86**	**0.71**	**0.77**	**0.74**	**0.74**
	Impaired Asset Expense/Average Gross Loans and Advances (%)							
ANZ[4]	-0.07	-0.08	0.07	0.04	0.05	0.07	0.10	0.06
BNZ	0.11	0.13	0.11	0.12	0.02	0.26	0.10	0.38
CBA + ASB[4]	-0.06	0.09	0.16	0.10	0.29	0.14	0.08	0.09
Heartland Bank	0.33	0.31	0.46	0.36	0.52	0.44	0.74	0.56
Kiwibank	0.03	0.03	-0.11	0.08	0.16	0.08	0.03	0.08
Southland Building Society	0.38	0.43	0.51	0.35	0.43	0.79	0.31	0.62
The Co-operative Bank Limited	0.14	0.07	0.07	0.08	0.07	0.05	0.16	0.04
TSB Bank Limited	0.08	0.05	0.11	0.85	6.06	0.04	0.07	-1.47
Westpac[4]	0.08	-0.06	0.01	0.13	0.12	0.07	0.08	0.01
Average	**0.01**	**0.01**	**0.08**	**0.10**	**0.17**	**0.13**	**0.09**	**0.11**
	Operating Expenses/Operating Income (%)							
ANZ[4]	41.52	45.40	39.85	37.81	39.02	36.61	38.03	36.34
BNZ	42.91	40.85	41.67	43.07	39.67	32.91	34.47	35.81
CBA + ASB[4]	38.78	37.52	38.15	37.66	37.04	37.60	41.19	37.73
Heartland Bank[7]	53.93	51.35	47.98	49.15	48.13	47.14	48.45	49.94
Kiwibank	61.86	68.27	70.19	56.78	54.10	62.07	67.52	59.84
Southland Building Society	64.55	61.20	63.33	62.83	66.27	62.82	60.39	67.73
The Co-operative Bank Limited	77.63	83.96	81.97	82.85	77.95	78.63	80.40	77.65
TSB Bank Limited	39.39	42.26	36.91	38.20	37.95	42.72	44.68	42.50
Westpac[4]	41.57	40.54	39.64	37.70	38.97	37.89	38.95	43.11
Average	**42.55**	**43.26**	**41.51**	**40.20**	**39.98**	**37.89**	**39.80**	**39.52**

27 MAJOR BANKS: NET PROFIT



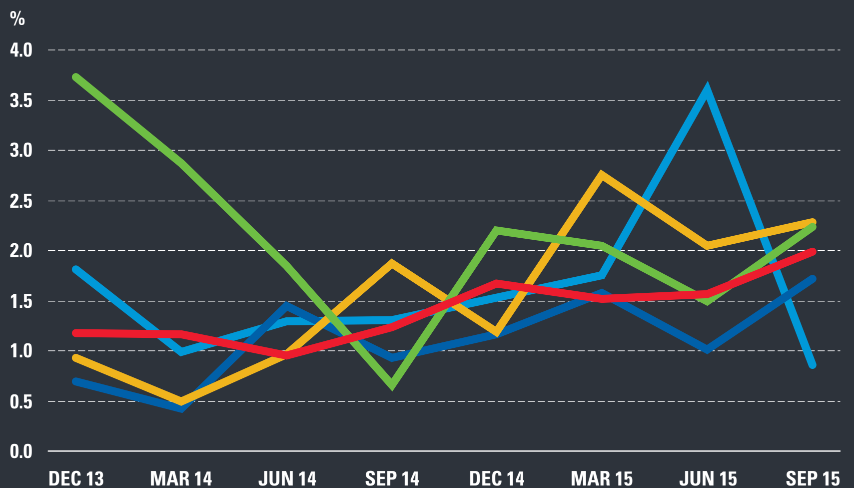
- ANZ
- BNZ
- CBA + ASB
- KIWIBANK
- WESTPAC

28 MAJOR BANKS: INTEREST MARGIN



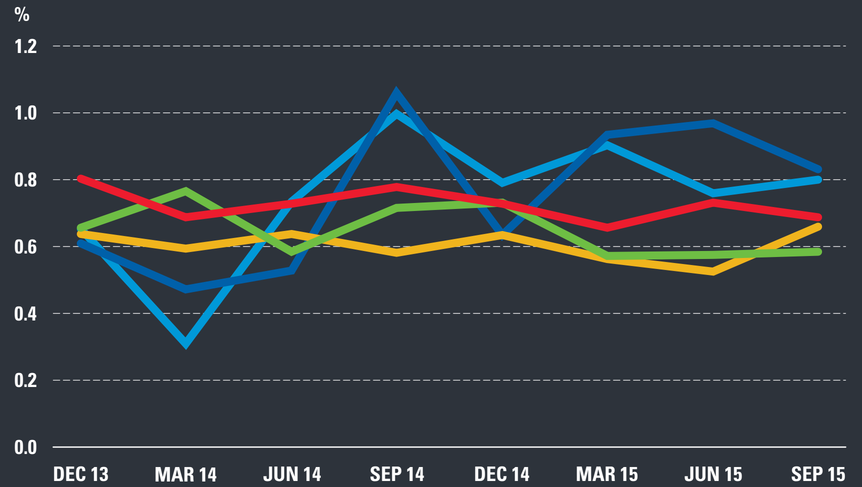
- ANZ
- BNZ
- CBA + ASB
- KIWIBANK
- WESTPAC

29 MAJOR BANKS: INCREASE IN GROSS LOANS AND ADVANCES

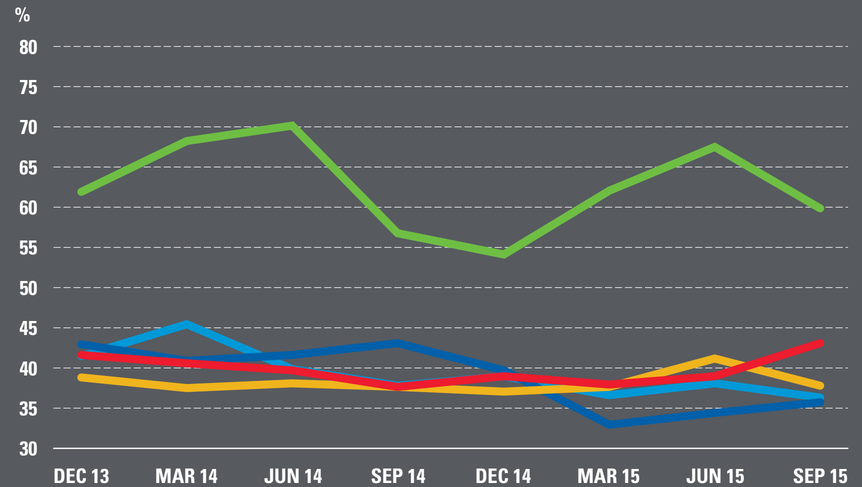


- ANZ
- BNZ
- CBA + ASB
- KIWIBANK
- WESTPAC

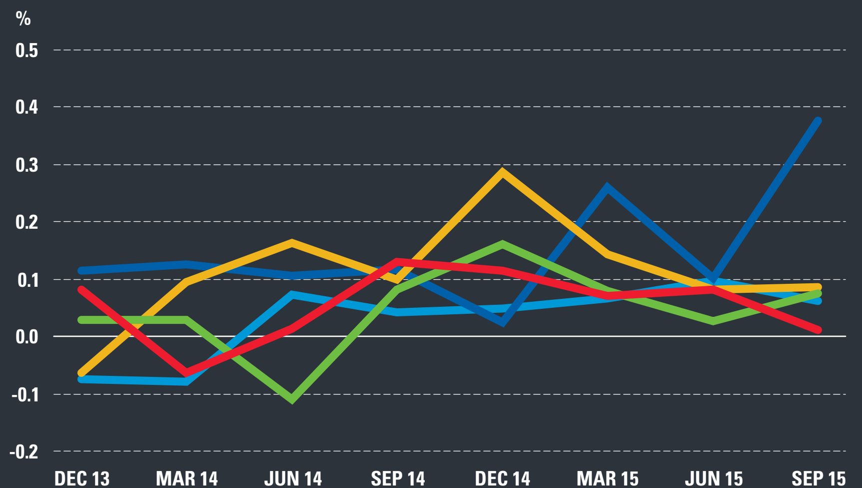
30 MAJOR BANKS: NON-INTEREST INCOME/AVERAGE TOTAL ASSETS



31 MAJOR BANKS: OPERATING EXPENSES/OPERATING INCOME



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



Moving beyond disclosure to put conduct at the top of your priorities

Liam Mason
Director of Regulation
Financial Markets Authority

The implementation of the Financial Markets Conduct (FMC) Act has given the financial services industry an opportunity to up its game, and to focus on conduct that has good customer outcomes as its objective.

New Zealand has come a long way in the regulation of financial services in a relatively short space of time. Previously the focus in the regulation of financial product offers was on disclosure, with an underlying assumption that if all information was made available then 'we'd be alright'. On the basis of exhaustive disclosure, firms felt they were doing what they needed to do to comply, and investors had what they needed to make an informed decision. It proved not to be the case.

The old Securities Act regime ignored the way in which behaviour – conduct – is critical to the way financial services are delivered. It didn't recognise how, or even whether, investors use 'disclose it all' documents. More importantly it didn't recognise how the broader behaviour of firms can influence and affect investor decisions and outcomes.

The FMC Act quite rightly sets a clear direction for improving the accessibility and readability of financial product disclosures, but it's only part of the battle. Learning the lessons from the past – from here and from overseas – the new regime focuses on the conduct of firms. The new FMC Act is about clear, concise and effective disclosure *plus* conduct.

As well as bringing a new focus for the regulator, the new regime gives us new tools such as licensing, to ensure we can effectively raise standards and increase consumer confidence in the conduct of providers. The biggest group of newly-licensed firms will include members of almost all banking groups – investment scheme managers. These new licences come with specific duties – to act honestly, not to misuse information and to act in the interests of customers or investors.

We initially assess whether firms meet minimum standards, which often leads to improvements in many firms. More importantly, licensing gives us a closer, continuous relationship with you as financial providers and the ability to set our expectations early and work with you to fix issues before problems become serious. That's how we want to raise standards – working collaboratively with the industry.

In our Strategic Risk Outlook (SRO)[8] we gave very clear guidance as to what we believe are the main risks to fair, efficient and transparent financial markets. As a risk-based regulator, we published the SRO to show where we'll focus our resources through the transition to the FMC Act– and why.

Put simply, this is about having systems and processes that look for actual incidents of – and the potential for – poor customer outcomes and identify and address the causes.

That means providers must be able to demonstrate how they go about identifying and managing conduct risk within their business and how they know that their conduct is appropriate. Put simply, this is about having systems and processes that look for actual incidents of – and the potential for – poor customer outcomes and identify and address the causes. If customers are treated unfairly, or if products or services produce poor outcomes for customers, that can damage the reputation of a firm, and have the potential for significant regulatory intervention.

But while systems and processes are necessary for good conduct, they are not sufficient. Good conduct is also strongly influenced by organisational culture. However robust, processes and controls can be exploited by behaviour if the culture is wrong. So, rules and controls plus conduct drive what actually happens and what the customer experiences.

But culture is hard to define and even harder to regulate.

For a regulator, a risk management tool or a governance structure is visible and can be tested and benchmarked. But culture is hard to define and even harder to regulate. As such we do not presume to 'dictate' a required culture. We do know, however, that example and consequence are critical influences on culture. People need to see examples from their colleagues and their leaders for a sense of whether conduct expectations are real, or just rhetoric. Good conduct is taken seriously when there are clear consequences if expectations are not met.

From the insights we've gained through supervising and monitoring in the last few years we know that if we are going to see real emphasis on achieving good customer outcomes, then good conduct needs to be embedded in the DNA of the firm.

That is why we have made it clear that setting the right 'tone at the top' is crucial and that directors and senior management are responsible for assessing conduct against business and customer outcomes. The FMA will also be assessing whether a firm's board and senior management are 'walking the talk', and can show how business practices have customer interests at their core.

At the coalface, our thematic review of KiwiSaver sales and advice practices last year pointed to a willingness to grasp the spirit of the new regime from most players. However, in practice many were also struggling with how to make the changes needed to bring this about. We found a lack of comprehensive governance systems enforcing the right culture in sales and advice practices. More importantly, given the strong behavioural aspect of the new regime, there was a disappointing lack of reporting to senior management on sales and advice practices and outcomes, and inconsistent attention to managing conflicts of interest.

We accept there are challenges for firms to meet our expectations and the intentions of the FMC Act, and that good conduct varies enormously depending on the circumstances, and we will do our part to enable firms to meet the new licensing requirements, which become effective 1 December. To get every licence application through, it is up to the industry to engage with us to ensure we can work through any particular questions or issues with individual firms.

The licensing of the managed investment schemes in particular is a key priority for the FMA this year and it is a substantial part of the functional operation of the new regime. High standards of conduct are critical to the reputation and success of our financial markets, and we believe will build a stronger industry and deliver better outcomes for customers.

Conduct and culture: at home and away

Off the back of the huge focus by global regulators over the last ten years on restoring trust in banking, consumer protection and market integrity, the term conduct risk finally arrived in New Zealand in 2015. New Zealand regulators are in the throes of looking at higher risk areas and most New Zealand financial institutions are kicking off programmes of work around conduct risks and culture assessments.

At the same time as these programmes of work are getting underway, the ground is moving beneath our feet; the thinking of global regulators and global financial institutions is evolving and changing as fast as New Zealand works hard to catch up. In this article we highlight some of the topical areas that you should be thinking about both globally and closer to home.

Away: What's topical up there?

Practically at banks

At a risk conference in Europe in December 2015, conduct issues were still at the very top of the Chief Risk Officer's (CRO's) and CEO's agenda. But the discussion has evolved from being purely focused on the external conduct agenda and outcomes for consumers and markets, to being more internally focused on cultural change at banks. There was a lot of discussion in particular around the market studies focusing on bank culture. Post the GFC a huge amount of literature was published by think tanks, global regulatory bodies and individual banks to understand what happened in the GFC, looking for ways to protect both the market and consumer in the future. The most recent of these is a report published in July 2015 by the Group of Thirty (G30) called 'Banking Conduct and Culture'. The report calls for a sustained focus on conduct and culture. In their view, "culture and repairing trust go hand in hand and are a prerequisite for sustainable economic returns and – in the medium term – a source of competitive advantage".

Day to day, it is increasingly challenging for banks to balance execution and remain current with these ever-changing publications; banks are responding to regulators, market and media demands and actually driving cultural change, while at the same time actively trying to be on top of every new piece of theory or thematic analysis published. For example, several banks had project teams reviewing the G30 report, while at the same time looking at the findings of the Financial Conduct Authority's (FCA's) latest market study on credit cards, while also managing risks in chat forums post the publication of chat room transcripts as part of LIBOR manipulation investigations.

This emphasis on conduct being at the heart of the business has refocused attention on the conduct aspects of the bank's overall strategy.

Longer term however, there seems to be an increasing realisation that driving appropriate conduct in banking needs to be a long-term sustainable process led from the top and involving all parts of the bank, not a siloed piece of work led by Risk. Naturally this emphasis on conduct being at the heart of the business has refocused attention on the conduct aspects of the bank's overall strategy. It is also driving banks and regulators to look at the foundations of who and how strategy is executed in the bank through its core values and culture. The bank's growth strategy needs to be aligned with the conduct agenda and ultimately the customers' interests. For example:

- where one aspect of strategy could be a focus on fintech (see page 62) and innovation to drive agility and speed of execution, the complex and unexpected customer impacts which could materialise as a result of implementation must be treated with the same importance;
- another example is balancing the need to improve ROE and take cost out whilst ensuring the customer experience is improved at the same time; or

- when pursuing digital strategies ensuring that as much emphasis is placed on middle and back office systems such as payments, which support overall delivery to a customer, as on as glossy front end customer interfaces.

Overall it's about rebalancing the historic focus on rewarding employees and increasing shareholder value with an equal focus on value to customers and impact on society.

And at the regulators...

The regulators' approach to conduct risk has also evolved and is following a similar journey of refocusing on evaluating the culture and governance at banks. Recognising that they form the foundation for the success, or failure, of conduct initiatives as well as market integrity.

For example, the Dutch Central Bank has been reviewing and investigating behaviour at banks and the effectiveness of a bank's board using a team of specialists with psychology, governance and change backgrounds. Similarly, other governments are using these types of skills to inform policy. The UK Government's programme of using Nudge theory and behavioural economics has been so successful that it has been spun off into a commercial venture in its own right. The FCA is employing similar techniques; for example, the payday lending market where they are highlighting borrowers "present bias" or the propensity for optimism about their future behaviour. Even institutions such as the International Monetary Fund (IMF) have a view on banking culture with Managing Director, Christine Lagarde calling for a "culture of greater virtue and integrity at the individual level in the financial industry" at a conference in November 2015.

There seems to have been a noticeable shift with EU regulators towards thematic reviews of specific industry concerns e.g. credit cards and payday lenders, as well as looking at conduct risks to market integrity as a whole rather than consumer protection in isolation. The FCA has also recently introduced the Senior Managers Regime which, for the first time, formally introduces accountability at the CEO level for leading, implementing and challenging cultural change and has therefore given regulators a remit to review the bank's governance and cultural values.

However, although the FCA is emphasising the importance of culture in the banking industry, over Christmas it was decided not to complete a thematic review of culture over UK banks as a whole. Instead to work with each of the banks individually to promote cultural change in banking, rather than complete an industry-wide review. The FCA is also looking at some new and innovative approaches to regulation as part of their objective to promote "competition in the interests of consumers". By adopting this strategy the objective is to "shape [our] approach to competition around the benefits for consumers, which includes better value, genuine choice, quality products and services, and useful innovation in financial services". One part of this strategy is to look at ways of supporting the development of new innovations and disruptors in the market which might be beneficial to consumers and making sure those businesses have access to the regulator, essentially providing safe environments or 'regulatory sandboxes' in which to test new ideas.

Ceri Horwill
Partner – Advisory
KPMG

At the same time as European market regulators are shifting towards the importance of culture, prudential regulators are catching up on conduct risk and considering whether a bank should be holding capital against conduct risk as a separate category within operational risk. This has led to consultation papers around the measurement of conduct risk as a Pillar 2 risk and a refocus of the Pillar 2 supervisory review and evaluation process (SREP) to include conduct and culture within the qualitative assessments regulators are making. The European Banking Authority (EBA) has also announced plans for its 2016 EU-wide stress test and for the first time conduct risk will be included using banks own estimates of profit or loss impacts of conduct related fines.

Home: What's going on down closer to home?

Practically at banks

New Zealand banks have started their conduct risk and culture projects several years later than global banks. In the early stages these reviews have tended to be piecemeal across all three lines of defence and often not joined up. The findings were also hard connect to wider conduct risk strategies or programmes and were often restricted to "mis-selling risk" rather than thinking about conduct risk more holistically across the whole of the product lifecycle.

New Zealand banks however do have to start somewhere in what will likely be a long journey to changing conduct and embedding cultural change. It will be important for Bank's that have started a conduct risk programme not to lose the learnings from those early reviews and to join up all findings into wider themes and programmes of work. It will be important to also think laterally about the findings from those reviews. Where conduct risks have been identified in a specific area of the bank, taking the time to identify where similar conditions, approaches or risks might exist in other parts of the bank. Similarly on routine second or third line reviews, ensuring that conduct risks are being considered and the findings from those reviews are being fed up into the overall programme.

Australian banks, by contrast, have been working on conduct risk agendas for several years now and over the last couple of years have been starting to migrate into cultural reviews and cultural change programmes. Typically the conduct risk projects would start with a review of risk areas which had been raised by regulators overseas and how they applied to their local business. These gave them a sound starting point for assessing the conduct risks in the business, however over the last year regulators have also started to voice wider concern over culture in Australian banks. This has been coupled with research published by Macquarie University, based on employee surveys, which also raised concerns about the risk culture in Australian banks. These have prompted significant debate about the interaction of conduct risk, risk culture and overall banking culture in Australian banks, whether culture can be "regulated" and how culture can be measured and changed.

And at the regulators...

The Australian Securities and Investments Commission (ASIC), as the Australian conduct regulator, has called out poor culture as a key factor that can undermine trust and confidence in the financial system and "is a key driver of conduct within the financial services industry". They stated in their Enforcement Outcomes report for the six months to June 2015 that they "are planning to incorporate examinations of culture into their reviews focussing on (a) incorporating an examination of culture into our risk-based surveillance reviews; (b) using the surveillance findings to better understand how culture is driving conduct among our regulated population; and (c) addressing the issue directly with entities when we see a problem with their culture and conduct".

This message has subsequently been frequently reinforced in their publications and speeches including a speech by Greg Medcraft in November 2015 which discussed what culture is and why it matters, what good culture looks like and how they plan to address poor culture. Particularly relevant for New Zealand banks is his encouragement to banks to not wait for the regulator to look over their shoulder, but to initiate taking action to address culture themselves. He also warned of the dangers of complacency on the risks that haven't happened yet and thinking once about culture and then "ticking that box as 'done'".

APRA, Australia's prudential regulator, has also warned that it is monitoring culture. In their view "strengthening culture, like strengthening capital, is critical to long-run stability". Although they acknowledge that you can not regulate culture, they have emphasised that culture is particularly important to risk through the introduction of CPS 220 'Risk Management' and its requirement for "a sound risk management culture to be established and maintained throughout an organisation". New Zealand banks forming part of an Australian group will also need to meet these requirements.

Closer to home, conduct risk and culture has also firmly arrived on the FMA's agenda. In its Strategic Risk Outlook document for 2015 it states that "for financial services firms, embedding a strong culture that puts customer interests at the heart of the business is crucial to ensuring conduct that benefits both the business and consumers". They have also actively started reviews of sales incentives, marketing and distribution of certain products, commission structures and switching practices amongst others.

More pervasively however, the new Financial Markets Conduct regime has come into force and going forward will be a key tool for the FMA to assess the conduct and culture at banks. The headlines around the regime have primarily focussed on the hard deadlines, the licensing requirements and the new disclosure requirements. However, much more important in our view are the clear messages around the FMA's expectations of firms' culture and conduct and how critical those are to the robustness of our

financial markets. The emphasis has shifted from 'buyer beware' to 'seller beware'. The FMA is not only expecting good behaviour, culture and conduct at firms, but is also increasingly expecting firms to be able to actively demonstrate how they achieve those. Their messages are not just around identifying pockets of poor behaviour or rogue incidents, but are recognising that a culture of protecting consumer and market outcomes is critical across the bank: from top to bottom, from strategy to underlying processes, systems and infrastructure. It's not just the front office getting it right, but the tone from the top resonating through the way the whole firm goes about doing business.

New Zealand banks are starting to face into the challenges of conduct risk and setting a firm foundation for trust in our financial markets, but we also need to be conscious of the extraordinary impact of change driven by conduct and cultural focus that is going on in the rest of the world and prepare ourselves for those changes in New Zealand. New Zealand has got a lot to learn from the rest of the world in this space, but we are also actively facing the challenges of getting it right and seizing the opportunity to serve customer outcomes better.

Resilient banks, a resilient economy

Antony Buick-Constable
Acting Chief Executive, Policy Director and Legal Counsel
New Zealand Bankers' Association

Over the past year New Zealand's economy has faced numerous challenges – dairy prices fell, commodity prices decreased, growth in China slowed, and the housing market remained constrained as demand continued to outstrip supply – yet New Zealand's banking sector remains stable. How have our banks remained resilient while facing risk in global and local environments?

A world-class banking system

New Zealand has established a well-capitalised, world-class banking system, and is known to be one of the most competitive globally. As outlined in the RBNZ's Financial Stability Report (November 2015), our banks are well-funded with capital and liquid assets well above regulatory requirements.

While the IMF in its November 2015 report noted a challenging outlook for New Zealand's economy, it acknowledged New Zealand remains resilient due in part to banks being well-capitalised and employing stress tests to help ensure the sector can withstand volatility in housing, trade and economic markets, and that banks continue supporting the agricultural sector as it faces lowering prices.

New Zealand's banks have remained stable and self-sufficient against the stresses or fluctuations in the global environment. This was evident during the GFC, and more recently the Greek debt crisis and slowdown in China's economy.

The competitiveness of our market has been noted by the World Economic Forum, which ranked New Zealand first in financial market development in its Global Competitive Report 2015–16. This ranking recognises that our financial markets can make capital available to private sector investment from sources such as bank loans and well-regulated securities exchanges in order to contribute to business investment, which is critical to broader economic productivity. The soundness of New Zealand's banks continues to rank highly (fourth out of 140 countries), and New Zealand leads the world in terms of trustworthiness and confidence in the banking sector – an

enviable reputation. The strength of our banks means they can access funding at good rates, and the benefits of this can be passed onto New Zealanders.

Managing risk with a long-term view

Since the GFC there has been a renewed focus on ensuring risks are minimised within our banking industry. Our banks invest significantly in best practice governance, risk management, portfolio management, business continuity planning and infrastructure. Ongoing investment in technology and cybersecurity helps ensure our bank systems and customers are well-protected against potential threats of cybercrime. This long-term view and investment is also a commitment to maintaining a sustainable and successful banking sector in New Zealand.

Banks understand the importance of long term thinking and are focused on striking the right balance between lending and growth on the one hand, and prudence on the other. For many New Zealanders this presents the opportunity to save for a more secure future through personal saving and investment in KiwiSaver, with banks being able to offer a range of investment options, competitive fees and investment capability.

Playing our part for a stable economy

New Zealand's regulated banking system supports a flexible economy and is respected globally. Its effectiveness is contributed to by government and the banking sector working in a coordinated and consultative way to achieve a balance of policy and prudence through quality regulation. The banking sector is committed to working constructively with government and regulators to help ensure the best outcomes can be achieved. As an industry we are very focused on playing our part toward maintaining a stable banking environment.

The challenges that banks have faced following the GFC have not been insignificant. The wholesale funding markets remain volatile and there have been numerous legislative and regulatory changes. Our banks are committed to complying with their domestic and international obligations as registered banks. Doing so has required substantial investment and resources to be expended on implementing these changes, which have included the Anti-Money Laundering and Countering Financing of Terrorism Act 2009, United States Foreign Account Tax Compliance Act (FATCA), and the RBNZ's requirements for banks to hold increased capital and restrictions on LVRs.

A key benefit of a stable banking environment is that banks can continue to invest in New Zealand.

In 2015, banks directly contributed $6.9 billion to the New Zealand economy. That's made up of the $4.9 billion cost of running their businesses here, which includes employing around 25,000 people and purchasing goods and services from businesses across New Zealand. In addition to that operational expenditure, banks paid $2 billion in tax.

A stable banking sector contributes to a stable and sustainable economy. On a personal level banks allow us to finance our homes, buy products, and grow our savings. They also support domestic businesses and export businesses to grow.

Banks thinking global, acting local

At a local level the banking sector recognises it's as much about working with customers as it is working for customers. Managing relationships is very much a part of managing risk. Contributing to and building relationships with communities and customers is important.

It is critical for banks to understand their customers' industries to assist with responding effectively to their needs and issues. Some industries are more vulnerable to fluctuations than others. This means banks focus on continuing close working relationships with their customers. For example, in recognising the importance of agribusiness to the economy, banks are committed to supporting and working with farmers during the good times and bad times.

Banks are an essential part of local communities. This is evident through being a significant employer, purchasing a range of local goods and services, and playing an active role in communities through sponsorship and volunteer projects.

Our banks have weathered the last few years of global financial turmoil well. They are among the best capitalised and reputed banks in the world – that's good for us and the economy. This also means our banks are well placed to meet the global and local challenges ahead.

A stable and resilient banking system helps underpin a resilient economy. Mitigating and managing risk to maintain its resilience is a banking sector responsibility, one that is not taken lightly.

Godfrey Boyce
National Managing Partner – Advisory
KPMG

LOW INTEREST RATE ENVIRONMENT – AN EARNINGS CHALLENGE FOR BANKS IN 2016

An inherent part of the asset liability management challenge faced by all banks is the decisions they make in terms of investing free funds – that is non-interest bearing (NIB) liabilities and their equity. The decisions made by New Zealand's registered banks will come into focus in 2016 in a period of historically low interest rates. The current easing cycle initiated by the RBNZ began in June 2015 when the OCR was reduced from 3.5% to 3.25%. The most recent OCR change was on 10 December 2015 when the OCR was reduced to its previous lowest level of 2.5%.

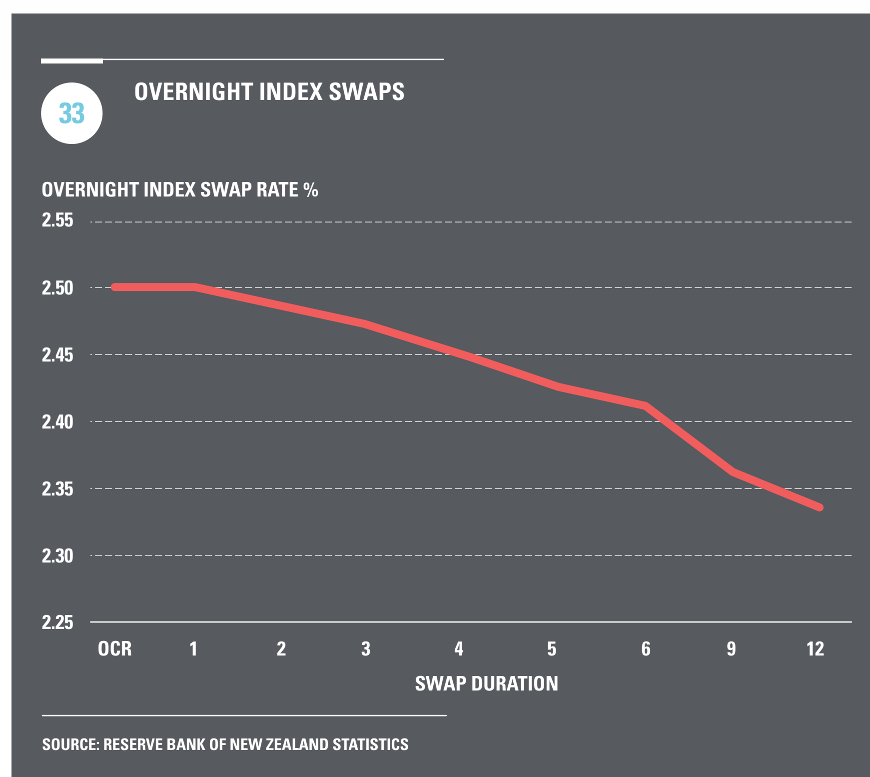
The market has been expecting further cuts in the OCR potentially down to as low as 2%. The current pricing in the Overnight Indexed Swap (OIS) rate market supports this view (see Figure 33). However in a recent speech the RBNZ Governor hosed down expectations for further OCR cuts.

In a recent speech the RBNZ Governor hosed down expectations for further OCR cuts.

The RBNZ sees downside risks to the OCR outlook, but mainly from downside global risks, rather than perceived downside risks to domestic inflation pressures. The market is still expecting the RBNZ to eventually cut the OCR, but the speech makes it clear the hurdle for a cut in the near term is high (see Figure 33).

Nonetheless the OCR has fallen a full 1% over the last six months of 2015 with a similar impact on the pricing of the banks' assets and liabilities. This might imply no net impact on the banks' earnings, but non-interest bearing liabilities and equity do not re-price and so the return on those funds is reduced to the extent the related assets they have been invested in do re-price.

The free funds of the four largest banking groups was $48.7 billion.



The interest rate re-pricing information presented by each of the nine banks we report on each quarter enables us to estimate each bank's free funds and therefore the potential impact on earnings were all the free funds invested to immediately earn 1% less return. We estimated (using the most recent annual financial statements available) that the non-interest bearing liability for the nine banks was $20.8 billion and the equity was $31.7 billion. The impact of a 1% decrease in the return on these free funds would be $525 million.

The free funds of the four largest banking groups were $48.7 billion and therefore the potential impact on income of a 1% reduction on those funds would be $487 million (or $508 million for the registered banks on a stand-alone basis). This would have been a significant amount in the context of each bank's reported earnings in 2015 (an average of 8% of pre-tax profit).

However, this high level analysis ignores the fact that the assets in which each bank's free funds are invested will not re-price immediately. This is because most banks have policies that determine a benchmark or target duration over which free funds are invested. A representative

TABLE 9: Interest Rate Risk Sensitivity Analysis				
$Million	Profit Before Tax	1% Reduction in Interest Rates Over a One-Year Horizon		
		Potential Impact on Free Funds (Fully re-prices)	Potential Impact on Free Funds (1/3 re-prices)	Disclosed Sensitivity (Parallel Shift)
ANZ Bank New Zealand Limited	2,464	-201	-67	-49
ASB Bank Limited	1,192	-96	-32	-36
Bank of New Zealand	1,439	-107	-36	n/a
Westpac New Zealand Limited	1,254	-104	-35	n/a

n/a = not available

assumption might be that free funds are invested so that they re-price evenly over a three-year horizon. If we apply this assumption, then the potential impact in 2016 of a 1% decrease on free funds reduces to $170 million.

Of course the interest rate risk on each bank's free funds is not managed in isolation. Rather it is managed as part of each bank's structural interest rate risk exposure (non-traded market risk) with a normal objective being to help ensure the reasonable stability of net interest income over time. The Treasury unit of each bank manages the structural interest rate mismatch associated with a transfer-priced balance sheet, including managing the bank's capital to its agreed benchmark duration. Banks provide a range of disclosures in relation to this activity.

If the reported interest rate sensitivity gaps of the four largest registered banks are aggregated the re-pricing picture is seen in Table 10 – page 57.

As expected this confirms that the largest percentage of the balance sheet re-prices within the 12 months following the respective balance dates of these banks. While this position is likely to have changed to some degree since each of the banks' balance dates, and interest rate risk management actions will have been taken, there will still be a significant re-pricing impact in 2016.

TABLE 10: Big 4 Aggregated Interest Rate Sensitivity Gap			
Re-pricing Period	0 to 1 Year	1 to 2 Years	Greater Than 2 Years
% of Total Net Gap (including derivatives and excluding NIB)	47%	27%	26%

Two questions for each bank's ALCO Committee to address over the coming months are:

1. What assumptions do we make regarding the period in which the current low interest rates will remain in place?
2. Do we change our benchmark duration for the investment of free funds?

Regardless of the conclusions reached, banks will be faced with a lower earnings contribution on their free funds in 2016 which will slow the earnings growth the industry might have otherwise expected from their anticipated balance sheet growth. Taken with the other potential impacts on earnings over the next 12 months, including the amortisation of mortgage acquisition costs and increased credit provisioning, there are some clear earnings challenges for New Zealand's banks in 2016.

THERE IS NO OTHER CHOICE BUT TO INVEST IN THE FUTURE

Ian Proudfoot
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Global Head of Agribusiness
KPMG

The media have adopted the dairy industry, or more specifically, the Global Dairy Trade (GDT) auction results, as their proxy for the success or otherwise of the New Zealand primary sector. The last year has seen journalists increasingly hone in on the bi-weekly price movements of the limited range of dairy commodity products sold through the GDT platform (often in declining quantities) as a key bellweather for the economic wellbeing of farmers and the wider New Zealand economy. As a consequence they have largely painted an increasingly black picture during the year.

There is no doubt dairy farmers are facing strong headwinds that have proved more persistent than many commentators expected, but if you are prepared to look beyond dairy the primary sector trends are significantly more optimistic. The kiwifruit industry has continued its rapid recovery from the decimation of the Psa disease, beef farmers have seen demand and prices hold up during the year, the wine sector has recorded yet another record for the value of exports and there are positive growth stories in the honey, pipfruit and fishing sectors amongst others.

The dairy sector is in part a victim of its own success.

The beauty of New Zealand's primary sector is its diversity; we provide a basket of premium food and beverage, fibre and timber products to the world, yet the wider community has been conditioned to largely measure the sector's contribution to the economy on the basis of a single metric, dairy prices. Depressed prices over the last two years have raised questions over the economic viability of some dairy farmers, and resulting media commentary has raised concerns for many that intense financial pressure will impact the decisions farmers make surrounding their natural environment, their livestock and their own health and safety.

The dairy sector is in part a victim of its own success; the apparently endless demand for milk from emerging Asian economies accelerated farm conversions to dairy and boosted New Zealand's production volumes. This occurred at the same time as Europe was unleashing itself from thirty years of quota management, corn prices were falling reducing the cost of US production, political disputes saw Russia close its borders to exports and China in particular focused on building its domestic industry. Many of the conversions, funded by easily accessible and historically cheap debt, were undertaken on the premise of a new normal for dairy prices and did not have the ability to break even at a milk price over $8 per kg/MS. At current price levels there is no question that many of these high cost systems will struggle to survive.

It is likely that current lower prices may be prove to be a long-term benefit.

Given the commodity nature of the market, when supply exceeds demand prices must fall and they have, leaving producing regions staring each other down over who will cut their production to rebalance the market. However, the news is not entirely bad; indicators suggest that consumer demand for dairy has continued its growth trajectory over the last couple of years suggesting the long-term protein demand story remains relevant.

It is likely that current lower prices may prove to be a long-term benefit; cheaper milk now enables more people to afford to try dairy products, building a deeper base of potential consumers to sell to in the future. However, their ongoing purchasing cannot be guaranteed as prices recover (as they undoubtedly will; supply will be curtailed if farmers are losing money) and the dairy sector will need to earn their loyalty. There is hard work to be done to get to know these consumers and to enable us to deliver the dairy products and solutions they need to fit within their modern lifestyles. This requires the industry to think carefully about the products it supplies the market and invest, not only in the stainless steel needed to process the milk, but the branding, innovation and consumer experiences that differentiate our products and secure a premium.

To me, the key development over the last year has not been the shifts in dairy pricing, but the clear emergence of some really disruptive thinking and technology into agriculture across the world and the dairy sector is not immune from this disruption.

Two examples standout as providing strong indicators that we need to take heed of; we have seen Coca-Cola enter the dairy sector through an investment in Fairlife, a dairy company based in the Midwest of the USA, with a message from Coke that they see the high protein, low lactose, low sugar dairy beverages Fairlife produces as significant future source of growth for their business as it refocuses towards health and nutrition. This move highlights a trend we are observing globally that consumers will pay a premium for formulated beverages that deliver proven health benefits. It also highlights that consumer innovation and premium pricing is being attached to liquid dairy products rather than powders, a particularly strong trend in Asian markets as fresh water supplies become ever more constrained.

We have seen also venture capital investment being directed into companies looking to create alternatives to animal protein; companies like Mufri, which is focused

on developing an alternative dairy protein; Hampton Creek Foods, who are looking to synthesise eggs; and Impossible Foods and Beyond Meat, who are creating alternative forms of meat protein. All these entities highlight their comparatively small environmental footprint, their ability to eliminate animal welfare issues and the health attributes of their products as competitive advantages over natural protein.

We have seen also venture capital investment being directed into companies looking to create alternatives to animal protein.

While many of these alternative products remain some years away from commercialisation, we cannot ignore the disruption that is coming to the global agri-food system or underestimate the pace at which the change is going to be adopted. The wool sector choose inaction when faced with the competitive threat posed by synthetically produced carpets. The industry was ultimately left with an immaterial share of the global carpet market and decades of low returns, as consumers voted with their wallets for cheaper synthetic products. We need to learn from wool farmers' experience and invest today to build and protect a market position as the world's leading producer of innovative, natural products.

A further clear global trend we are observing is the arrival of new investors and entrepreneurs into the primary sector; people that have previously invested in communications, IT or healthcare but recognise that agriculture, due to its traditional nature and slow adoption of digital technology, is ripe for disruption. It is interesting that many of these investors are coming to agriculture with a view of not only making money but improving environmental and social outcomes from agriculture; they are looking to bring innovation to the market that enables farmers around the world to produce more (in response to malnutrition and poverty) while having a reduced environmental impact.

In the long-term the cost of doing nothing is likely to be immeasurably greater.

Innovation is arriving on many fronts; sensors and data analysis are being integrated into farming systems, drones are being utilised to collect data and manage wide acre properties, water is being managed through precision irrigation, biological gain is being derived through genetic enhancement and the adoption of biological control technologies, as well as farmers having the opportunity to connect directly with their customers. Innovation will transform the global agri-food system as we have historically known it; adopting these technologies will come with a cost, however in the long-term the cost of doing nothing is likely to be immeasurably greater.

New Zealand will only ever be a small player in a global agri-food system gearing up to feed nine billion people by 2050. Our aspiration cannot be to feed the world. Our goal should be to provide the most affluent consumers in the world with the ultra-premium part of their diet, the food and beverage they purchase to mark special occasions. As a consequence, our products need to stand out in a crowded marketplace to command a premium. Our products need to be the food, fibre and timber equivalents of a Louis Vuitton handbag or an Apple iPhone. It is the provenance, innovation, branding and experience that we deliver that will determine whether the primary sector prospers.

There is no other choice but to invest in the future.

New Zealand has benefited significantly over the decades from having an innovative primary sector and strong recognition as a 'clean, green' country which has generated export earnings and wealth to support the standard of living expected in a developed country. However, what has delivered success in the past will not be sufficient to secure future success in our dynamic and rapidly changing world, making it critical that the primary sector invests in innovation and technology to secure its future.

Many of the good news stories from the primary sector are a result of companies responding to rapidly changing markets, moving swiftly, innovating with their products and the solutions they deliver to consumers around the world. Despite the headwinds, now is the time to boldly invest in the innovation that will differentiate our products in the minds of consumers and preserve the premiums we have enjoyed in the past. There is no other choice but to invest in the future.

New Zealand banks must embrace the Fintechs

If they do not, the Fintechs will arrive in any case. The evidence from overseas and in particular Australia is compelling. Digital disruption is challenging existing business models, with estimates that in Australia around 25–30% of current banking industry revenue is at risk.

The marrying of technology with core financial services has been termed 'Fintech' and is seeing exponential growth globally.

The agglomeration of technology and financial services is 'Fintech' – we have defined it broadly to include the emergence of new business ventures; the activities and investments in technology innovation from established financial services firms; as well as from ICT/technology providers – collaboration between these parties or 'disruptive innovation' by any of them individually (see Figure 34).

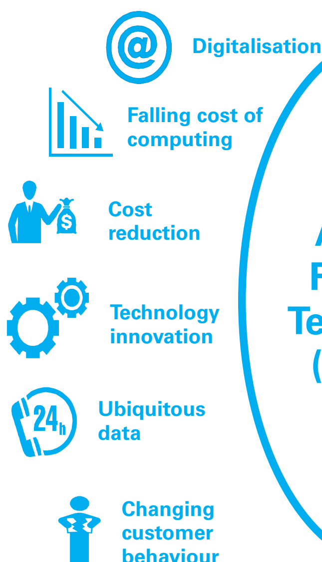
It is impacting all sectors of the industry: banking, payments, insurance, wealth management and real estate.

The agglomeration of technology and financial services is 'Fintech'.

There are three clear trends that are colliding to create an environment conducive to the Fintechs disrupting the New Zealand banking industry:

- customer experience expectations;
- technology developments; and
- removal of barriers to entry.

34 **IMPACT ON THE INDUSTRY**



Areas of Financial Technology (Fintech)

Personal Finance – Tools to help individuals manage their wealth, including stock portfolios, personal budgets and taxes.

Big Data and Analytics – Application of big data and advanced algorithmic techniques to risk management, fraud detection, credit scoring, calculation of insurance premiums, etc.

Payments – Technology and tools to facilitate transactions of virtual currencies and mobile payments to eliminate processing costs.

Front Office – Tools and platforms that drive efficiencies into traditional banking operations and practices such as loan origination, fundraising and sales etc.

Capital Markets Technology – Tools and platforms that enable buying and selling of securities such as foreign exchange.

Godfrey Boyce
National Managing Partner – Advisory
KPMG

Customer experience expectations

An increasingly universal theme in the industry is the elimination of friction from the user experience as traditional institutions and emerging disruptors compete for customers. The drive is to make transactions as simple and streamlined as possible. The less time needed to complete a transaction and the fewer 'clicks' are the key metrics.

The banking industry will need to proactively respond to growing customer expectations. One way to describe the shift that will need to occur is from excellence in product to excellence in customer experience.

The 'new world' game is all about how do we create a frictionless, easy and simple value proposition around the entire customer need.

As an example, customers don't get up on any given day and say they want a mortgage product from a bank — instead they desire what the mortgage can provide, that is, the benefit of home ownership. So new players and banks that need to compete for their business in the future, will need to look at the end-to-end customer experience around obtaining a home.

So, it is no longer a product development process, whereby, strategic focus and investment is directed towards simply providing a better mortgage loan/product. That is the 'old world' game.

The 'new world' game is all about how do we create a frictionless, easy and simple value proposition around the entire customer need, including research, property search, bidding/ negotiation/settlement, obtaining a loan, and so on. Those that are doing this most successfully are providing a highly personalised experience informed by the data available on the individual customer. There are some noteworthy examples of this including risk- based insurance (modelled at an individual level rather than portfolio level).

It is about identifying and understanding this value chain and collaborating with a range of partners to deliver the ultimate customer outcome in a seamless way.

The 'payments space' has historically been dominated by the banks, but is one of the areas where the Fintechs are having the most impact. Payments have always been a derived demand and now the technology exists to remove them from the customer experience entirely. It is an opportunity for merchants to create a new dialogue with consumers, but a fundamental challenge for the issuers and their networks.

Technology developments

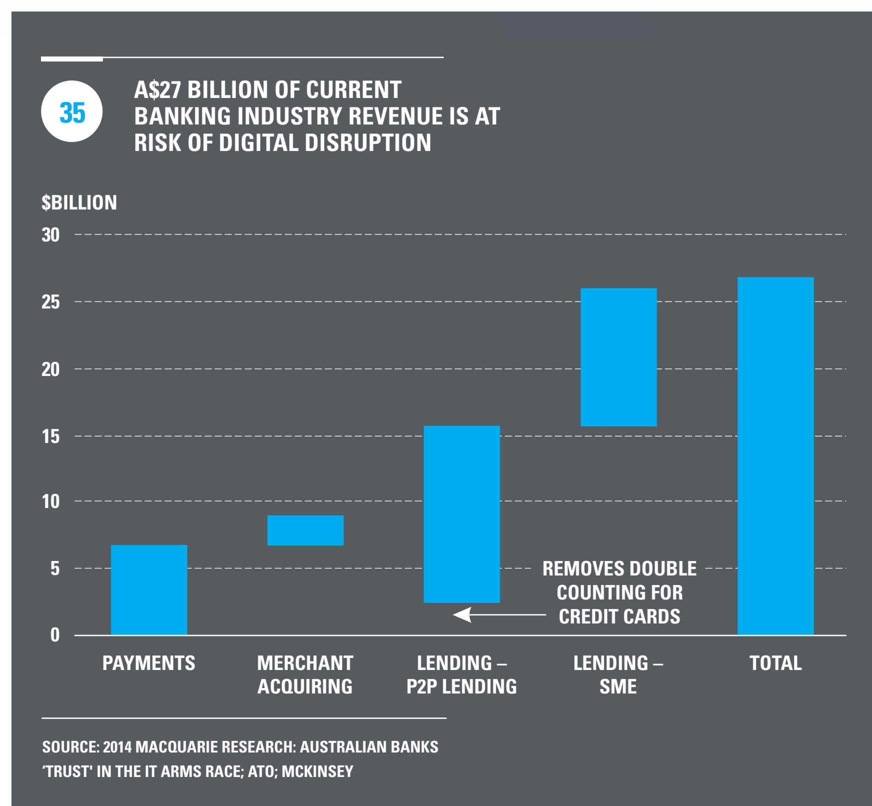
The technology is now in place to substantially transform financial services (e.g. cheap IT, widespread mobile penetration, and the progressive move to real time payments). While the Fintechs generally set up in competition with the banks using this new technology we are now seeing some of the UK Fintechs selling their algorithms and data back to the banks.

The technology is now in place to substantially transform financial services.

One of the key developments has been the new blockchain technology. Blockchain represents a shift in financial services from centralised, proprietary systems to more standardised, distributed yet secure systems off a 'trust but verify' model. This has the potential to transform and disrupt many areas of financial services by lowering costs, reducing barriers to entry and disintermediating players that have been central for many years.

There is an emerging view that blockchain will become the default global standard distributed ledger for financial transactions.

Many of the world's global banks have initiated blockchain-related projects. There is an emerging view that blockchain will become the default global standard distributed ledger for financial transactions.



SOURCE: 2014 MACQUARIE RESEARCH: AUSTRALIAN BANKS 'TRUST' IN THE IT ARMS RACE; ATO; MCKINSEY

Removal of barriers to entry

It has become easier for the Fintechs to be successful. They have captured the attention of the investment community and are able to access reasonably priced capital. This together with the substantially reduced costs for launching a start-up (technology costs and other costs) has enabled those with viable new ideas to go to market. The other important factor has been the regulators growing sensitivity to consumer rights and competition post-GFC which has seen willingness, and in some countries encouragement, from the regulators for the Fintechs to enter established banking markets.

In New Zealand the FMA has granted licences to Harmoney, LendMe, Lending Crowd and Squirrel Money.

What's at stake?

In Australia it is estimated that there is A$27 billion of current revenue at risk, with the areas of financial services most at risk of digital disruption being lending, payments and merchant acquiring (generally higher turnover areas of the banks operations).

This analysis is corroborated by looking at Fintechs operating in the Australian market (see Figure 35).

In our recently released joint report with H2 Ventures – 'Fintech 100 – the leading global Fintech innovators ' – there were two of the 50 leading companies from Australia and one from New Zealand (Xero).

Name	Located	Company Description
Prospa	Sydney	An online small business lender – they provide unsecured business loans and finance for small business (loans for under A$20,000 are approved in less than a day).
SocietyOne	Sydney	Australia's leading P2P lending platform – they pioneered marketplace lending in Australia to creditworthy borrowers directly with investors.

There are 50 'emerging stars' which include the following Australian companies:

Name	Located	Company Description
Avoka	Sydney	Avoka delivers frictionless digital sales and service transactions for financial institutions, government agencies and many other industries where traditional 'shopping cart' e-Commerce is not a good fit.
Equitise	Sydney	The Equitise Investment Platform removes traditional barriers to investing and sourcing capital by making the process quick, easy and safe.
Metamako	Sydney	Design and manufacture enterprise grade network devices with the goal of simplifying networks, reducing latency and increasing flexibility.
Moula	Melbourne	Moula is one of Australia's leading providers of unsecured business loans (up to A$100,000).
PromisePay	Melbourne	A fully managed payments platform built just for online marketplaces, which is up and running for customers in a single day with no extra operational overheads or costs.
Simply Wall Street	Sydney	The company visualises stocks, portfolios and Exchange Traded Funds using infographics to help casual investors understand the stock market and become better investors.
Stockspot	Sydney	Helps clients invest in a professionally managed portfolio of global investments (low fee Exchange Traded Funds) for a fraction of the fees charged by traditional financial advisers and fund managers.

The same opportunities exist in the New Zealand market. We have seen Harmoney establish itself in the New Zealand market as a P2P lender with others also entering the market.

Our expectations for the New Zealand banking industry based on what we are observing overseas are that:

- the banks will retain their dominance in areas where there are significant barriers to entry such as accessing central exchange settlement, holding a banking licence and accessing liquidity from the RBNZ; but
- areas which are open to change will be targeted including the creation of proprietary payment networks, the front end relationship with consumers, risk assessment and processing capabilities, monitoring Internet Protocol (IP) and risk transfer IP.

New Zealand Banks should be looking to collaborate with the Fintechs.

BEPS – latest developments for financial institutions

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Partner – Tax
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Darshana Elwela
National Director – Tax
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In an increasingly interconnected world, tax laws have not always kept pace with global corporations, the cross-border movement of capital and the rise of the digital economy. This has led to gaps and mismatches that some multinationals have exploited to minimise their tax bills. Over the last two years the OECD and G20 countries have been working together to address concerns over tax base erosion and profit shifting (BEPS) by multinationals, culminating in a series of OECD recommendations that were presented in October 2015.

The ultimate success of BEPS will be dependent on each country implementing the recommendations. Each country's tax rules will need to change to align. While there has been a degree of consensus to date, achieving accord on implementation will be much harder. This is because countries will have different domestic political considerations, which may affect their ability to implement some or all of the OECD's recommendations.

The BEPS actions most relevant to the banking sector and the particular consequences for financial institutions are outlined below. Although the final recommendations were presented in October 2015, detailed design on a number of these will carry on into 2016 and beyond.

Action item:	Summary	Impact on financial institutions
Action 2: Hybrid mismatch arrangements The aim of Action 2 is to develop domestic rules to neutralise mismatches arising from the use of hybrid financial instruments and entities. These arise where the tax treatment of an instrument or entity differs between countries.	The OECD is recommending rules to address different hybrid mismatch arrangements. The main recommendation is to include in domestic legislation a primary rule that will deny a deduction for a payment from a hybrid instrument, with a secondary rule to tax the payment if the payer's jurisdiction allows a deduction (i.e. if the primary rule does not apply). Similar rules are proposed to deal with hybrid entities. A new model tax treaty provision dealing with hybrids is also recommended.	Instruments issued by financial institutions for regulatory capital purposes often have characteristics of a hybrid instrument. Although externally issued instruments will generally not be caught, where there has been an intra-group push down of an externally issued instrument, there may be unintended adverse tax consequences. The OECD recommendations leave individual countries with a policy choice on whether the hybrid mismatch rules should apply to intra-group regulatory capital. There is a risk that this will result in counter-parties being required to adopt inconsistent tax positions for the same instrument.
Action 4: Interest deductions and other financial payments Action 4 seeks to develop rules limiting the deductibility of interest and other financial payments.	The OECD has made best practice recommendations to prevent tax base erosion through the use of excessive interest deductions. The main recommendation is a primary rule to limit interest deductibility based on an Interest/EBITDA ratio, with a corridor of ratios between 10% and 30% suggested. If the primary rule is exceeded, a higher interest deduction can be allowed if the group interest expense is higher. This group-wide ratio rule will be further developed by the OECD in 2016. If implemented, these recommendations are likely to replace the current thin capitalisation rules in New Zealand.	The Action 4 final recommendations are a significant change for many countries, including New Zealand, which has interest limitation rules based on debt/asset ratios. The OECD acknowledges that the particular features of banking and insurance groups need to be taken into account when developing appropriate interest limitation rules for financial institutions. However, the OECD does not go as far as proposing an industry based exclusion. The OECD has however highlighted the importance of ensuring that any interest limitation rules do not conflict with or reduce the effectiveness of capital regulation that is intended to reduce the risk of a future financial crisis. Further work will be done by the OECD in 2016 to identify best practice rules to deal with potential BEPS risks relating to banks and insurance companies.

Action item:	Summary	Impact on financial institutions
Action 7: Permanent establishments The aim of Action 7 is to strengthen the permanent establishment (PE) concept for establishing taxable presence in a country.	The OECD recommends expanding what constitutes a PE, by focusing on the substantial negotiation and conclusion of contracts. The PE definition will be widened beyond the traditional authority to conclude contracts to include situations where "a person habitually plays the principal role leading to conclusion of contracts that are routinely concluded without material modification". The OECD is also undertaking further work in 2016 to provide guidance on attribution of profits to the PEs that will result from the proposed changes.	Banks with cross border business models will need to review their procedures to ensure that personnel in one country are not playing the principal role leading to the conclusion of contracts in other countries. Specifically, banks with global booking models will need to determine whether such models give rise to incremental PE risks. The OECD's PE recommendations will also raise additional questions regarding the appropriate profits to allocate across jurisdictions. Banks with an international client base may find that they have a PE in certain countries, because of senior sales or relationship managers servicing clients.
Actions 8–10: Risk and re-characterisation/transfer pricing Actions 8–10 aim to better align taxation rights and the attribution of profit with where economic activity is undertaken.	The OECD work has resulted in an increased focus on economic substance – where the actual functions, assets and risks of an enterprise reside as compared to legal ownership and contracts – to justify the allocation of returns. The recommendations will be achieved through modification of the OECD's Transfer Pricing Guidelines.	Despite consultation with the banking industry, a carve-out for financial services from the OECD work on risks and capital has not materialised. The impact of these reforms on the financial services sector could be significant if the rules apply as proposed. However, banks can take some comfort from the acknowledgement by the OECD that further work will be undertaken on profit splits and financial transactions.

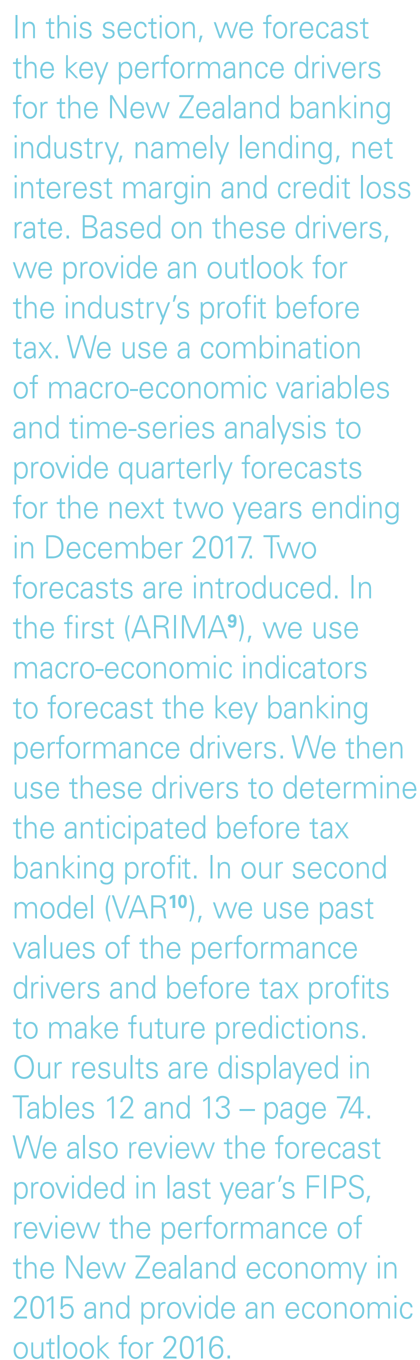
The release of the final OECD recommendations marks a crucial shift from the consultation and thinking about the problem and solutions. It is now time for action.

The New Zealand Government's response to the BEPS recommendations is expected in 2016 and 2017, with consultation to follow.

The OECD is also undertaking further detailed work which will impact on the banking industry and we can expect to see further recommendations on these areas. New Zealand banks, particularly those with a cross-border presence, should carefully monitor progress on BEPS.

Christoph Schumacher
Professor for Innovation and Economics
Massey University

BANKING INDUSTRY FORECASTS



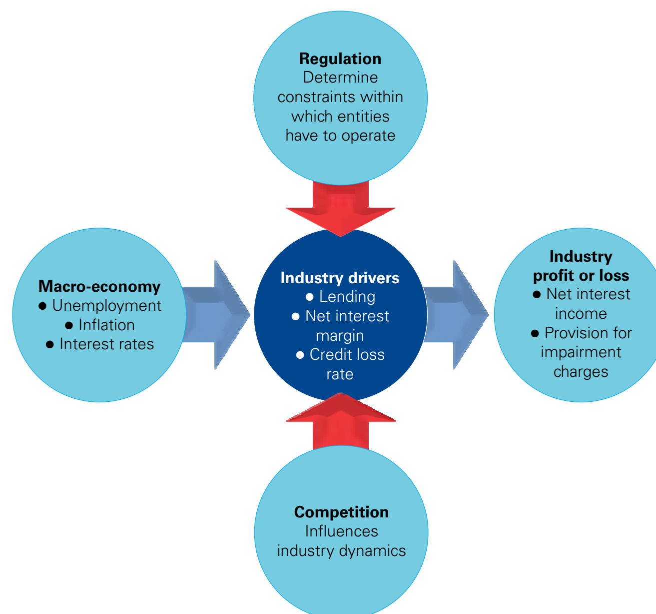
In this section, we forecast the key performance drivers for the New Zealand banking industry, namely lending, net interest margin and credit loss rate. Based on these drivers, we provide an outlook for the industry's profit before tax. We use a combination of macro-economic variables and time-series analysis to provide quarterly forecasts for the next two years ending in December 2017. Two forecasts are introduced. In the first (ARIMA[9]), we use macro-economic indicators to forecast the key banking performance drivers. We then use these drivers to determine the anticipated before tax banking profit. In our second model (VAR[10]), we use past values of the performance drivers and before tax profits to make future predictions. Our results are displayed in Tables 12 and 13 – page 74. We also review the forecast provided in last year's FIPS, review the performance of the New Zealand economy in 2015 and provide an economic outlook for 2016.

Before explaining our forecast in more detail, it is pertinent to highlight the two forecasting models we have used. In the ARIMA model, the forecast variable is influenced by the predictor variables, but not vice versa. This is the model we have used in previous years. It is plausible however, that our key performance indicators affect each other. This year the VAR model has been introduced to see how interaction between our variables changes the forecast. We also want to point out that although macro-economic indicators are not used in the VAR model, the impact of these indicators is already factored into past values of the performance drivers.

We expect before tax banking profits to dip slightly in the fourth quarter of 2015 (actual data not available yet). The dip is more pronounced in our VAR model and is caused by an increase in the Credit Loss Rate (CLR) and tighter Net Interest Margins (NIM). The small reduction in NIM could be due to increased competition in the industry. The increase in CLR could be caused by the more volatile commodity prices that we have experienced in the second half of 2015. The ARIMA[11] model indicates that after the slight dip in Q4 of 2015, banking profits are expected to increase steadily for 2016 from $1.79 billion to $1.92 billion per quarter in 2017. The growth rate is modest and is similar to the growth experienced during 2014 and 2015. When we allow for interaction between the performance drivers, as in the VAR model, the expected growth for 2016 and 2017 is almost stagnant rising only from $1.67 billion in Q1 of 2016 to $1.71 billion in Q4 of 2017. The outlook is similar to the growth forecast of the New Zealand economy, very modest and almost stagnant. The fact that profits show growth at all is driven by an increase in lending volume which offsets the continued decrease in NIM.

Let's now take a closer look at the industry performance drivers. In the ARIMA model, we have used historical data of 10 macro-economic variables, such as inflation, interest rates and unemployment rates (see Table 11 – page 73), as well as third-party forecasts to predict the three core industry performance drivers: lending, net interest margin, and credit loss rate. The resulting forecasts of the three industry drivers are subsequently used in a model predicting the profitability of the banking industry. The profit model has also incorporated time series elements to account for the effect of past values of profit and further improve the quality of the predictions (see Figure 37). In our VAR model, we use the collection of past values of our drivers and before tax profits; that is, a vector of time series, in order to predict future values (see Figure 38).

36 **FORECASTING APPROACH**



The definition of industry drivers are:

- **Lending** – the total volume of lending broadly defined, that is, all interest-earning assets.
- **Net interest margin** – the difference between interest income and interest expense, expressed as a percentage of lending.
- **Credit loss rate** – provision for credit impairment, expressed as a percentage of lending.

Total industry lending is expected to increase at a reasonable pace for the next two years. Both our ARIMA and VAR models make similar predictions. ARIMA predicts an increase from $446 billion in Q1 of 2016 to $503 billion in Q4 of 2017 while the VAR model sees

TABLE 11: Macro-economic Variables

Macro variable	Description	Units	Source
gdp	Gross Domestic Product (expenditure based)	$mn, nominal index	RBNZ
bankbill90	90-day bank bills rate	%, annualised	RBNZ
govbond10y	10-year government bond yield	%, annualised	RBNZ
unemployed	Number of registered unemployed	Number	RBNZ
avgqhouseloancount	Average number of home loans approved	Number	RBNZ
estpop	Estimated population of New Zealand	Thousands	Statistics NZ
cpindx	Consumer Price Index	Index level	RBNZ
housepricendx	REINZ house price index	Index level	REINZ
weeklyearnings	Weekly earnings	$, nominal	Statistics NZ
nzstocksndx	New Zealand all stocks index	Index level	NZSE

lending volume to increase from $445 billion to $496 billion. Low levels of unemployment and a growing population base are contributing factors. Growth is steady, although a slightly slower pace is expected than in the past two years. This could be caused by an anticipated slowing of housing sales as well as a more modest outlook of GDP growth in New Zealand. The anticipated lending growth is slightly lower when we consider the impact of other industry drivers.

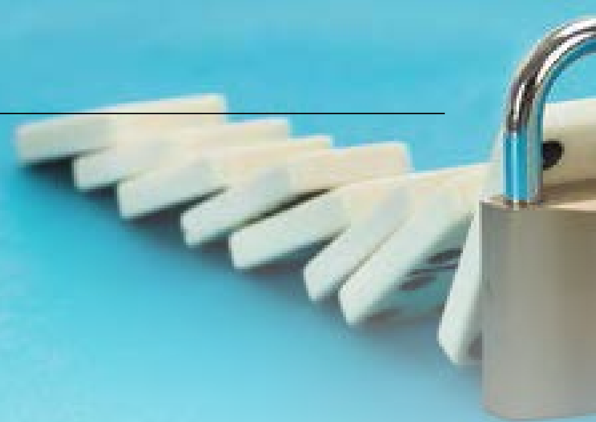
NIMs are expected to decrease ever so slightly over the next two years. As already mentioned, this is due to greater competition (e.g. the Bank of China and the China Construction Bank entered the market in 2014) as well as a relatively low-risk business environment and a low OCR. ARIMA predictions are a decrease from 2.14% in Q1 of 2016 to 2.06% in Q4 of 2017 while the VAR model sees NIMs fall from 2.17% to 2.13%.

The CLR increased slightly in 2014 and was stagnant in 2015. We expect this trend to continue in 2016. Our ARIMA model predicts an initial increase of the CLR from 0.1% to 0.12% and this rate is expected to stay this way for 2016 and 2017. Our VAR model provides a slightly more pessimistic outlook with a steady increase of the CLR from 0.1% to 0.20% by the end of 2017. The increase, however, is marginal and overall the CLR is low due to the stringent lending policies of New Zealand's banks.

Changes in our macro-economic indicators may impact the industry drivers used in our model. The regression results suggest that changes in lending volume are inversely related with changes in unemployment. New Zealand's unemployment rate is expected to stabilise or decrease slightly in the coming years providing a stable platform for lending by banks. Furthermore, with the OCR back at record lows, borrowing will be cheaper which contributes to the anticipated increase in lending volume. Another factor that will likely exert a positive influence on the lending volumes of banks is growth in New Zealand's population. Over 2015, New Zealand's population grew at its fastest rate in over a decade. Overall the country's population increased by 86,900 people or 1.9%, in the year to June 2015. Especially the net migration of 58,300 will contribute to the anticipated increase in lending volumes as more people will deposit their capital into New Zealand and utilise the lending facilities of our banks (natural increase of 28,700; all figures from Statistics New Zealand).

Inflation is a key factor that is positively associated with the NIMs of banks. While inflation results in an increase in both bank lending and deposit rates, it tends to be the case that lending rates increase at a faster pace. This is because environments of higher inflation often entail greater credit risk which banks need to offset with greater margins. New Zealand's inflation rate in 2015 remained at around 1% and with the recent sharp drop in oil prices inflation may decline further over 2016, possibly to levels just above 0% (see last paragraph of article for further explanation). Indeed, if this occurs and the positive relationship between NIMs and inflation continues, then it is expected that NIMs will continue to tighten. In addition to this, increased competition in the banking industry is also likely to play a role in the forecasted declines in NIMs over the next two years. This is due to a combination of competition between existing banks and the addition of new banks to the New Zealand banking industry. The forecasted contraction in NIMs is the key factor that, we believe, will moderate the growth of banking industry profits over the next two years.

Interest rates are expected to fall even further which historically leads to a drop of the CLR (a drop in interest rates puts less pressure on borrowers resulting in a lower number of defaults). However, this trend may be dominated by an increase in household debt in 2015. In September 2014, household debt as a percentage of disposable income was 156.2%, up from 154.2% in the year earlier. By the same time in 2015 the figure reached 160%. Although the present levels of household debt are not particularly alarming compared with other countries, the rate at which households become increasingly leveraged is a factor to watch. This is possibly reflected in the slight increase in the CLR. Another related factor that deserves consideration is rural debt-to-income ratios. Over the past few years, high commodity prices



have helped to offset any deterioration of asset quality in the rural sector. However, weak commodity prices of late have resulted in decreasing dairy exports. If commodity prices continue to remain low, this will place strain on rural borrowers and may increase credit losses.

Despite their obvious importance, we do not attempt to take into account regulatory changes in this analysis. This is a limitation since regulatory changes can clearly have a large impact on lending volume, margins, and CLRs. Preventative measures taken by the RBNZ, such as more stringent capital requirements on high LVR lending, which were intended to slow the increase in house prices, have surely impacted overall lending and credit losses within the banking industry over the past few years. Although, there are indications that these restrictions may start to be relaxed in the near future, it is difficult to ascertain when exactly changes will be implemented, and as a result, they have not been considered in our analysis.

Comparing our 2015 forecast of industry drivers and industry profit before tax (see Financial Institutions Performance Survey 2014) with how these drivers actually fared in 2015, we find that all our predictions are well within the 95% confidence interval. At a closer glance, both lending volume and the CLR over 2015 were marginally higher than anticipated while the NIM was very close to our

TABLE 12: ARIMA Industry Driver		2015 Q1	2015 Q2	2015 Q3	2015 Q4	2016 Q1	2016 Q2	2016 Q3	2016 Q4	2017 Q1	2017 Q2	2017 Q3	2017 Q4
		Actual	Actual	Actual	Forecast	Forecast	Forecast	Forecast	Forecast	Forecast	Forecast	Forecast	Forecast
Lending ($Billion)	Upper CI				452	467	482	496	511	526	541	556	572
	Forecast	413	425	430	438	446	454	462	470	478	486	494	503
	Lower CI				425	426	428	430	432	434	437	439	442
Net Interest Margin (%)	Upper CI				2.3%	2.4%	2.4%	2.4%	2.4%	2.5%	2.5%	2.5%	2.5%
	Forecast	2.32%	2.12%	2.17%	2.14%	2.14%	2.12%	2.11%	2.10%	2.09%	2.08%	2.07%	2.06%
	Lower CI				2.0%	1.9%	1.9%	1.8%	1.8%	1.8%	1.8%	1.7%	1.7%
Credit Loss Rate (%)	Upper CI				0.2%	0.3%	0.3%	0.4%	0.4%	0.5%	0.5%	0.5%	0.6%
	Forecast	0.10%	0.10%	0.10%	0.13%	0.12%	0.12%	0.12%	0.12%	0.12%	0.12%	0.12%	0.12%
	Lower CI				0.0%	0.0%	-0.1%	-0.1%	-0.2%	-0.2%	-0.3%	-0.3%	-0.3%
Profit Before Tax ($Billion)*	Forecast	1.79	1.81	1.82	1.76	1.79	1.81	1.83	1.84	1.86	1.88	1.90	1.92

TABLE 13: VAR Industry Driver		2015 Q1	2015 Q2	2015 Q3	2015 Q4	2016 Q1	2016 Q2	2016 Q3	2016 Q4	2017 Q1	2017 Q2	2017 Q3	2017 Q4
		Actual	Actual	Actual	Forecast	Forecast	Forecast	Forecast	Forecast	Forecast	Forecast	Forecast	Forecast
Lending ($Billion)	Upper CI				450	464	477	489	501	514	526	538	550
	Forecast	413	425	430	437	445	453	460	468	475	482	489	496
	Lower CI				424	427	430	433	437	440	443	446	448
Net Interest Margin (%)	Upper CI				2.4%	2.4%	2.4%	2.4%	2.4%	2.4%	2.4%	2.4%	2.4%
	Forecast	2.32%	2.12%	2.17%	2.2%	2.17%	2.16%	2.15%	2.15%	2.14%	2.14%	2.13%	2.13%
	Lower CI				2.0%	2.0%	1.9%	1.9%	1.9%	1.9%	1.9%	1.9%	1.9%
Credit Loss Rate (%)	Upper CI				0.2%	0.3%	0.3%	0.3%	0.4%	0.4%	0.4%	0.4%	0.4%
	Forecast	0.10%	0.10%	0.10%	0.11%	0.12%	0.14%	0.15%	0.16%	0.17%	0.18%	0.19%	0.20%
	Lower CI				0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Profit Before Tax ($Billion)*	Forecast	1.79	1.81	1.82	1.68	1.67	1.67	1.67	1.68	1.68	1.69	1.70	1.71

* Note: Forecasts for profit before-tax will seem less than in the forecasts of previous publications due to the fact that the figures are not annualised.

prediction. Overall this had a slightly negative impact on the profit before tax prediction with actual values being marginally lower than anticipated.

We now take a closer look at the performance of the New Zealand economy. In 2015, the New Zealand economy could not quite replicate the strong performance from 2014. GDP growth fell from around 2.8% in 2014 (Q3, 2014) to 0.4% in 2015 (Q2, 2015), but increased slightly to 0.6% by the end of the year, driven by private consumption, tourism and residential investments. While business confidence was still high, the unemployment rate increased slightly from 5.4% in September 2014 to 6.0% a year later. However, despite a decrease in employment, private consumption increased which boosted household spending.

2015 saw a drop in housing construction activity. After a seven-year high construction GDP at the end of 2014, real GDP construction growth fell from around 3.5% to 1%. Housing demand also slowed sharply in the last quarter of 2015 as the market responded to regulatory changes. Especially in Auckland, both house sales and house prices fell as tighter government property taxation rules came into effect. In the rest of New Zealand, however, demand for houses stabilised as buyers were looking for more affordable housing outside the Auckland area. In terms of dwelling consent volumes, numbers for areas outside Auckland and the greater Christchurch area are largely flat. In Auckland, however, the number of consents is still growing, but not as fast as in 2014.

The New Zealand dollar continued to depreciate in the second half of 2015 which resulted in higher business prices. Especially in the September quarter, business input and output prices increased faster than in the first half of the year, driven by agriculture, petrol and imported capital. The flow through of the lower exchange rate increased tradable inflation and consumer prices increased by around 0.4% over the year. Inflation decreased from around 1.2% in 2014 to below 1% in 2015. Overall, the depreciation of the New Zealand dollar had a positive effect on the economy due to benefits for exporters and the tourism industry.

Due to falling dairy prices in the second half of 2015, the terms of trade decreased by 3.7%. While overall exports increased due to the weaker New Zealand dollar, dairy export values decreased due to lower dairy prices. Although we saw a slight recovery starting in October, it may take some time for prices to recover from their low.

Globally, we saw a sustained recovery of the US economy, however, slower growth in the other major advanced economies. Of international concern is the slowdown of the Chinese economy with anticipated further drops in 2016. This could negatively impact the New Zealand economy if this trend continues.

2016 is expected to follow a similar trend to 2015. Overall, the New Zealand economy is in good shape with modest GDP growth expectations, a stabilising unemployment rate, low inflation (especially if oil prices continue to fall) and a low OCR. Potential risk factors to the New Zealand economic performance are developments in China as well as poor commodity prices. Furthermore, the continued strengthening of the NZD-AUD exchange rate may hurt export volumes to Australia, one of our largest trading partners. Volatile commodity prices, especially the falling dairy price, may also slow down economic growth as already experienced in the second half of 2015.

On a more positive note, there are global macro-economic factors that may have a beneficial impact on the New Zealand economy. Improvements in the US economy provide confidence that the world economy is progressing on the right track. Europe's financial woes also seem to be under control for now. Germany's economic growth is projected to strengthen further in 2016 and the outlook for the United Kingdom and France is also positive. With Europe's powerhouses in reasonably good shape, the risk of a collapse of Europe's economies is lower than in past years. While the recent decline in oil prices will surely hurt oil producing countries, it will offer benefits to New Zealand. That is, New Zealand oil prices have quite a strong cost-push effect on consumer prices, largely driven by higher transport services costs. If oil prices continue to decline, consumers should not only expect cheaper petrol prices, but also cheaper prices for consumer goods that undergo substantial transportation.

To conclude, the banking industry and the New Zealand economy are in good shape. The industry outlook closely follows the economic performance of New Zealand: our banks continue to generate healthy profits while also maintaining strong capital ratios, however, profit growth is expected to be very modest or stagnant similar to the anticipated GDP growth.

NON-BANKING INDUSTRY OVERVIEW

Non-banks – Industry overview

2015 – A solid year for the non-bank sector helped by the momentum from prior years despite some competitive challenges.

The non-bank sector achieved profits of $254.62 million. Compared to the 2014 year, the overall result was a decrease in net profit after tax by 6.67% or $18.20 million. This was mainly the result of an increase in operating expenses of $48.49 million that more than offset the strong increases in interest income and other income. The non-bank sector has also experienced some contraction in margins, decreasing 32 basis points (bps) despite the underlying net interest income increasing by $23.36 million. This increase was driven mainly by the combination of an increase in interest income due to asset growth and flat funding rates. This increase is a remarkable achievement considering the current low interest rate environment and the intense competition coming from both existing market players, new entrants, banks and peer-to-peer (P2P) lenders.

The non-bank sector achieved profits of $254.62 million.

The sector has also continued to show significant asset growth, increasing by $487.64 million over the prior year. Asset quality has remained strong and is not showing significant signs of deterioration with impaired asset expense only increasing by $2.30 million compared to the previous year.

Executives interviewed commented that recent softening conditions prevailing in the economic environment have not yet resulted in an increase in impaired assets; however, some commented that they remain mindful of credit quality when writing new deals as they are aware they are in 'the very best part of the impairment cycle'. A number of Executives are keeping a keen eye for early indicators of impairment growth. Another comment made by Executives was that the low level of impairment experienced this year also has a lot to do with the asset values held as securities, especially when these asset values need to be tested through a quick sale. Executives commented that as interest rates continue to be low with plenty of liquidity and a stable market, it is a good time to dispose of any problematic exposures, with the accompanying argument that if a loan "can't wash its face" in the current market it will never be able to "and therefore it would be best exited as plenty of participants are looking for volume". Operating expenses have increased significantly which has undone all the improvements seen in the net interest income and non-interest income.

The sector has also continued to show significant asset growth, increasing by $487.64 million over the prior year.

Margins continue to contract

Net interest income has increased by $23.36 million, a 3.26% increase on the previous year, driven by strong lending growth. A dominant theme this year was entities achieving growth in their loan portfolios through securitisation vehicles established with the help of investor or bank funding or renewed growth via increased bank facilities.

The investment opportunities provided by securitisation will continue to be attractive to investors abroad who are chasing yield in a globally low yield environment with local entities benefiting from securitisation via both the mix of funding they achieve and the way these structures assist in maximising their returns and allowing growth.

Operating expenses have increased significantly which has undone all the improvements seen in the net interest income and non-interest income.

Despite the good news about lending, net interest margin (NIM) for the sector contracted 32 bps from 6.94% to 6.62%. This was mainly driven by an increase in interest expense by 17.87% attributable to an increase in interest bearing liabilities and also due to the fact that some financial institutions still have funding priced around the time of the 2014 Reserve Bank of New Zealand (RBNZ) Official Cash Rate (OCR) rises, and the re-pricing impact of the current year falls in the OCR has been delayed.

The increase in interest bearing liabilities is reflective of comments made by Executives in relation to the high levels of liquidity prevailing in the market, with some entities being approached by investors with large deposits who have an appetite for higher yields offered by non-bank entities. Some Executives commented that they had to adjust deposit rates downwards when they had large amounts of investors' dollars flooding in the door. Another common comment we heard was that this surplus of liquidity occurs when bank deposit rates drop below a certain point and investors chase yield.

Another interesting comment made by the survey participants was that banks are very willing to fund non-bank participants at very competitive rates or support the establishment of a securitisation vehicle. This is because they have an established relationship with the non-bank entity and they know the entity's lending practices, but most importantly, these non-bank entities also have their own capital at stake in the ultimate lending equation.

Despite the good news about lending, NIM for the sector contracted 32 bps from 6.94% to 6.62%.

Banks are also reviewing their lending practices with the onset of conduct risk and they are less prepared to lend to some borrowers directly, or customers who represent a significantly different credit risk to their normal customer or to other entities who then on-lend with less rigorous lending practices.

Competition continues to be fierce

Clearly competition has not eased and continues to be tight. Executives commented that competition continues to be aggressive and it does not seem to take a breath. New market entrants, emergence of P2P lenders and banks still trying to entice away clients have been the common theme amongst Executives surveyed. Having said that, participants also perceive new growth opportunities arising from the M&A activity in the sector, as new buyers digest their new acquisitions and see favourable market conditions for certain lending products such as those that do not fit the banks' "black box" lending criteria.

Non-bank lenders repeatedly tell us the banks have a pre-set criteria for lending based around security percentages and type, repayment ability, credit history, cash flows. If these criteria are met (i.e. the loan fits inside the parameters of the box), a loan is concluded to be of good quality and quickly settled. But just outside the parameters of the box there is still a lot of good lending to be done for those prepared to analyse, take on and manage the different risk.

This year, it was perceived by survey participants that the banks' "black box" has been more consistent in its size meaning that there is a more stable, but still very good market around the perimeter of that black box. Some participants said that they have managed to successfully grow their loan books and establish their position in the market place by operating at the periphery of the banks' "black box", targeting customers that are still of a good quality but just not quite fitting within the banks' "black box". An example might be a customer who needs bridging finance, but does not have regular cash flows from income; non-bank sector participants are happy to provide this type of finance as long as they have a mortgage registered on all securities held.

Executives commented that competition continues to be aggressive and it does not seem to take a breath.

Surveyed participants also commented that competition from banks has not been consistent during the period

with the banks sometimes having a presence in the non-bank market and sometimes not. Some Executives said that on balance they have not perceived as much competition from banks in the personal loan market but when they do it will be at very competitive rates. Other Executives perceived that the banks will get into other areas, such as personal or vehicle lending when they are struggling to fill their mortgage volume targets and they appear to successfully take some business away from certain non-bank sector participants offering more competitive rates, but this doesn't last for a prolonged period.

Disruptors – Peer to peer lending

The number of licensed P2P lenders has now reached four and they have definitely arrived in the market. Executives surveyed agreed that P2P lenders are the biggest disruptor in the personal/consumer market space at the moment. With more P2P lenders planning to venture into other markets such as property lending, vehicle and equipment finance, competition will certainly not ease over the coming years. The real impact is not from the amount lent (some claimed $150 million to date), but more from the efficiency and sharpness of their distribution models and the entities' agility and the fact they provide yet another option to borrowers.

The number of licensed P2P lenders has now reached four and they have definitely arrived in the market.

As mentioned above, P2P lenders have emerged over the past year, with four now licenced by the Financial Markets Authority (FMA) – Harmoney, Squirrel Money, LendMe and LendingCrowd.

Harmoney has the largest presence with its loan book having reached about $106 million this year per media reports. Harmoney has reportedly secured $200 million of institutional funding from the UK based Global Investments plc; however, the bulk of this is anticipated to be used in its soon to be launched Australian online platform. Harmoney is 80% funded by institutional investors, including Heartland Bank which also provides funding via the online platform. Harmoney's default rate for the year was reported at 4.5%.

One of two methods is used by P2P Lenders: "fractionalisation" or "Reserve Fund". The 'fractionalisation' method is used by P2P lenders to spread borrower risks, and thus far they have been operating at the edges, lending out smaller sized unsecured loans. The Reserve Fund model reduces the return slightly to each investor, but uses it to create a reserve fund to help with any credit event.

P2P lenders are utilising online platforms in an attempt to reduce borrowing costs, create efficiencies and obtain national reach.

P2P lenders are now also eyeing potential opportunities in the Small to Medium Enterprise (SME) space. LendMe is aiming to focus on secured loans up to $2 million, however is still in the process of negotiating a funding deal with an un-named New Zealand trading bank.

P2P lenders are utilising online platforms in an attempt to reduce borrowing costs, create efficiencies and obtain national reach, together with speed of delivery. Many sector participants felt it is becoming critical to better utilise technology to remain competitive in the non-bank sector of the market. While the front offices of P2P lenders appear to be technologically impressive, there remain questions as to how mature the back office functions are.

Many surveyed felt that these entities and their strengths would not be tested until they have been through the full economic cycle.

Some of the concerns around P2P lenders voiced by the Executives surveyed include the perceived limited regulatory oversight (exemptions that have been granted) with P2P lenders for example not being subject to responsible lending guidelines, the reduced visibility of potential losses as the asset book and performance are not reported in the traditional way, in a set of financial statements. These P2P entities have been set up in very benign times (full employment, low interest rates) and are yet to be tested in a downturn. Many surveyed felt that these entities and their strengths would not be tested until they have been through the full economic cycle. Lessons have been learned abroad with Quakle in UK going under in 2011 and a number of P2P lending websites closing in China as borrowers defaulted. There is no doubt this is an interesting development and something which we have explained in a little more detail on page 96.

Regulation becoming business as usual

Regulation is now embedded in the non-bank lenders' culture, and although compliance is costly and has posed a significant constraint on resource, it is generally perceived more positively in this survey as it has taken a role in strengthening the sector and creating some form of barrier to entry.

Regulation is now embedded in the non-bank lenders' culture

From 1 November 2015 all registered banks are required to distinguish loans for residential property investment from other residential property loans, with loans written for investment property in Auckland now requiring at least 30% deposit. This will push more deals outside the banks' "black box", providing further opportunities for non-banks to fund.

The Credit Contracts and Consumer Finance Amendments (CCCFA) Act 2014 which came into effect in June 2015 is back in the spotlight as the Commerce Commission is considering whether the P2P lenders fees are covered by the fees provisions of the CCCFA. The CCCFA fee provisions permit fees that only recover the cost of the service they relate to, with the expectation that the lenders should earn their return from interest rates. There is uncertainty as to whether P2P lender fees are caught by the CCCFA. A ruling in this area could have a material impact on the growth of this sub sector.

In March 2015 the Court of Appeal rejected claims by Motor Trade Finance in the long running credit fees case brought by the Commerce Commission regarding alleged unreasonable establishment and other credit fees on 39 finance contracts between 2005 and 2008 under the CCCFA. The Supreme Court has since granted leave to MTF to appeal this decision.

The "Responsible Lending Code" and the provisions regarding reasonable credit fees came into effect on 6 June 2015.

The "Responsible Lending Code" and the provisions regarding reasonable credit fees came into effect on 6 June 2015. This places greater onus on the participants to determine the appropriateness of lending, based on factors such as the borrowers' ability to repay and the suitability of the financial products. The Code will not be binding; however, it will form evidence of compliance with the binding lender responsibility principles set out in the CCCFA Act. Some of the feedback received from the Executives surveyed was that the Code really only makes already responsible lenders document why they are responsible lenders and does not reach the right people in the sense it has had little impact on payday, car boot, and truck shop lenders. Another comment made was it seems to help to regulate people who need to help themselves, in other words, it is perceived as a piece of regulation looking to have the finance companies 'save' the borrowers from themselves.

Challenges and opportunities of the business model for particular sectors

Finance companies associated with and supporting particular manufacturing brands (whether it be motor vehicle or business equipment) have their own set of unique opportunities and challenges. Their competitive advantage lies in their association to a well-known and respected brand and the ongoing pipeline of business coming from their brand retailers, or indeed the way they can assist the retailer to make a sale. However, for some they appear to be experiencing restrictions in terms of deals they are allowed to do, either in the form of a requirement any deal should have a nexus to the brand or the group, or restrictions on local product development due to conduct risk concerns.

Some of the Executives interviewed remarked that these restrictions have evolved mostly in response to reputational and conduct risk. New found global caution is taken to ensure that the customer is not only sold the right product, but treating customers fairly has become very important due to the risk of miss-selling of financial products and any inappropriate culture around the sale.

In relation to the motor vehicles finance and leasing industry, some Executives commented that the manufacturers are placing very high expectations on dealers and set high targets before any rebate can be achieved. This has a number of flow on effects: it has forced dealers to pre-register vehicles, building inventory which will be funded by the non-bank lenders, but a consequence

is depressed sales margins as the last few "target" vehicles are sold. Dealers are starting to see low margins become even lower and an increased need to sell vehicles to get rebates drives down the price of second hand vehicles. As a result, finance income, insurance, warranties, and servicing play an increased role for the dealers' overall margin. This combined with much of the sales growth in vehicle numbers going to the rental sector, only further depresses margins.

Groups which manufacture and finance their products have their own competitive advantage. Maintaining and strengthening customer relationships has become a critical factor in entities that manufacture and finance their products, as one supplier instead of several, can be positioned to provide not just an individual product, but a total business solution in the business equipment market. These entities are now assessing the profitability and performance of the operating and financing entities collectively as they operate under a joint strategy with less concern for the apportionment of profit margins between the operating and finance arm.

Major acquisition activity

During the past survey period we have seen two large transactions take place. Firstly, GE Capital has signed agreements to sell its New Zealand consumer and commercial financing businesses. The first one to be sold, was consumer finance company GE Money as part of the wider A$8.2 billion deal to a consortium of global investors, Varde Partners, private equity group KKR, and Deustche Bank.

Then, Canada's Element Financial Corporation bought Custom Fleet NZ from GE Capital for $590 million. The last deal done by GE in November, was the sale of the GE Capital Australian and New Zealand commercial lending and leasing portfolios to Sankaty Advisors, and affiliate of US private equity group Bain Capital for an undisclosed amount.

During the past survey period we have seen two large transactions take place.

These deals will complete the sale of all of GE Capital's businesses in Australia and New Zealand. This move was part of the wider global strategy by GE to focus on its core industrial businesses.

GE Money, New Zealand's biggest consumer finance company, is estimated to have about 450,000 customers and provides a range of financial services such as personal loans, credit cards and interest free retail finance. It has strategic partnerships with Kiwibank and many of the major retailers such as Harvey Norman and Michael Hill. It includes the GEM Visa card with 158,000 cardholders, and the Countdown OneCard Visa credit card with 10,000 customers. The sales process provides for some of these products or relationships to be re-designed/re-branded.

Some of the Executives surveyed felt this transaction could bring valuable opportunities as the ex-GE business potentially undergoes major changes in terms of its funding structure, business partnership arrangements, some of which are coming up for renewal, and while its new owners settle into the role.

The other significant transaction in the market has been the sale of Fisher & Paykel (F&P) Finance to ASX-listed FlexiGroup for $315 million, with purchase price paid $250 million in cash and $65 million deferred consideration. This transaction is subject to approval by the Overseas Investment Office and the RBNZ.

F&P Finance has undergone major changes this year, having been restructured and having established a securitisation programme under which it sold $275 million of receivables from its Q card to its immediate parent F&P Finance Holdings. Q Card is F&P main product with a consumer card service and network comprising over 10,000 retail outlets and more than 148,000 customers. This was followed by the sale of its Consumer Insurance Services unit that offers insurance and product protection policies to retailers and consumers for $20.1 million in December 2014, and the transfer of software and intangible assets for $7.3 million to its parent.

Motor Trade Finance (MTF) continues to excite interest from parties interested in acquiring a stake in or all of the company. Heartland, in a statement released in September 2015, said that it was still interested in acquiring MTF if the company's shareholders were receptive of the offer and MTF's loan fees dispute with the Commerce Commission is resolved. This followed a move made by Turners Finance, which was seeking up to 20% of MTF's shares in an unsolicited offer. On 29th of October, Turners Finance announced that it had received valid acceptances approved by the MTF Board taking its

shareholding to 7.6% of the ordinary shares of MTF.

Executives commented that in order to achieve growth, they focus on quality sustainable customer relationships.

Other survey participants have experienced good growth during the year which has been largely organic. Executives commented that in order to achieve growth, they focus on quality sustainable customer relationships. Some entities have offered a wide range of new products in order to have a wider reach and increase their customer base.

Many of the Executives surveyed continue to be on the lookout for potential acquisition targets to achieve growth and scale to maintain competitiveness.

The Future – A non-bank sector which continues to change

Over the course of this year the RBNZ has reversed almost all the OCR hikes it imposed last year, with the OCR now back to 2.75% compared to its lowest point in over a decade of 2.50%. The RBNZ commented in its September 2015 statement that a further easing in OCR seems likely. Some economists are predicting further cuts in 2016 with some saying that it could go as low as 2.0%. Persistently low inflation, softening global economic outlook, concerns over slowing growth in China and East Asia, increased volatility in financial markets and falls in commodity prices have been downside risks noted in the RBNZ November 2015 Financial Stability Report, however the RBNZ has remained of the view that the New Zealand financial system continues to perform well despite these concerns.

Global interest rates are expected to remain low for a prolonged period. The relatively higher yields offered by sector participants remain very attractive to overseas institutions in a globally low yield environment, with participants continuing to enjoy a strong pipeline of liquidity helping support asset growth.

Global interest rates are expected to remain low for a prolonged period.

The recent tightening of LVR requirements by RBNZ, such as new rules for property investors, will provide further growth opportunities for the non-bank sector. Additionally, the non-banks have been able to accommodate good quality borrowers wishing to diversify from their current banking relationships, and post the Global Financial Crisis (GFC) many customers are opting for a multi provider finance solution to avoid depending on one party, and in some cases, prevent financiers from seeing the whole picture of their wealth.

Credit quality remains strong, however, survey participants acknowledge that they feel they are in as good a part of the cycle as they can get.

Regulation seems now to be embedded in the entities' culture and while being viewed as necessary and strengthening the sector's behaviour, the compliance is costly and onerous. There has been a slight decrease in the negative sentiment on regulatory requirements, which have become 'business as usual'.

With competition continuing to be aggressive from the traditional banks and P2P lenders, Executives commented that continued investment in technology and online platforms will be crucial to remain competitive and meet clients' needs.

As the sector continues to change and evolve, sector participants are very clear about their individual strategies in order to remain competitive. Sector participants agreed that there is no lack of business opportunities in the current environment, but the difference between them is that some companies are restricted by the overall 'Parent' strategy and business models which means that they are not allowed to venture into new products not developed by the 'Parent' or products which do not have a nexus with the 'Parent' company. In the past, it appears that some of these entities had been able to do non-core lending activities with a 'blessing' from the 'Parent', but due to concerns around conduct risk, this now appears to be decreasing, making it more difficult to do some deals and leaving a gap in the market which can be taken by other entities who do not have restrictions to do such type of deals.

Sector participants are optimistic about business opportunities over the next year. With a stable economy, rising business and consumer confidence, low interest rates and plenty of liquidity, considerable pipeline of construction activity and strong net migration being all positive factors to put the non-bank sector in a strong position for next year.

Non-banks – Timeline of events

Jan. 2015

12th
NZCU Baywide is issued its Non-bank Deposit Takers (NBDT) Licence by the RBNZ.

Trade Me purchases a 15% shareholding in Harmoney, New Zealand's first fully licensed peer-to-peer (P2P) lender.

28th
The FMA and NZX sign a memorandum of understanding, to co-operate in the regulation of New Zealand's capital markets.

29th
The RBNZ leaves the OCR unchanged at 3.50%.

Feb. 2015

13th
Credit Union South is issued its NBDT Licence by the RBNZ.

Mar. 2015

2nd
UDC Finance is issued its NBDT Licence by the RBNZ.

5th
First Credit Union is issued its NBDT Licence by the RBNZ.

12th
The RBNZ leaves the OCR unchanged at 3.50%.

16th
General Electric sells their Australian and New Zealand consumer finance divisions to a consortium of investors – Varde Partners, KKR & Co, and Deutsche Bank for a total of $A8.2 billion.

19th
FMA removes at least 23 companies to date from its Financial Services Provider Register (FSPR), and denies registration of another 20 companies for misrepresenting the limited extent to which they are operating in New Zealand.

23rd
Nelson Building Society is issued its NBDT Licence by the RBNZ.

31st
Court of Appeal rejects Motor Trade Finance Ltd's (MTF) appeal in the long running credit fees case brought by the Commerce Commission regarding alleged unreasonable establishment and other credit fees on 39 finance contracts between 2005 and 2008.

Apr. 2015

2nd
Two of the largest logging companies in Northland – HarvestPro and Smith and Davies (NZ) Ltd are faced with bankruptcy, owing $24.9 million to GE Finance, Mercedes Benz Financial Services Ltd, and Itochu Corporation. GE Finance and Mercedes Benz Financial Services Ltd repossessed the financed equipment.

8th
Wairarapa Building Society is issued its NBDT Licence by the RBNZ.

30th
The RBNZ leaves OCR unchanged at 3.50%.

May. 2015

1st
The RBNZ announces they have completed the NBDT licencing of 31 entities.

7th
Fisher & Paykel Finance Ltd is offered for sale by its ultimate parent Haier Group.

11th
LendMe is issued its licence by the RBNZ to become New Zealand's second P2P lender, with focus on offering secured loans up to $2 million.

12th
Unsecured creditors of Smith & Davies (NZ) Ltd agreed on a compromise payment of an average amount of 26.46 cents in the dollar, which allowed the company to avoid liquidation. Estimated values of the unsatisfied debt to GE Finance and Mercedes-Benz Financial Services Ltd are $11.2 million and $12.5 million respectively.

28th
Harmoney reaches a milestone, having lent out over $50 million in loans to date.

Jun. 2015

2nd
The RBNZ seeks expressions of interest for the acquisition of the NZClear security settlement and depository business.

6th
The Responsible Lending Code comes into effect.

8th
The FMA reached a $10.24 million settlement with failed finance company Dominion Finance.

11th
The RBNZ cuts the OCR by 25 bps to 3.25%.

16th
NXT, a NZX licenced market for SME's, welcomes its first listing.

30th
General Electric announces agreement to sell the bulk of GE Capital Fleet Services for US$6.9 billion to Element Financial Corporation, including fleet-financing businesses in Australia, Mexico, New Zealand and United States.

Jul. 2015

7th
The FMA reach an out of court settlement agreement with failed

finance company Hanover Finance for a sum of $18 million.

2 Cheap Cars move its $30 million per annum finance business from UDC Finance to Finance Now, a subsidiary of the SBS Bank.

11th
Wayne Percival is appointed CEO of UDC Finance, having previously headed the Specialist Distribution team for ANZ's Retail and Business Banking division.

23rd
The RBNZ cuts the OCR by 25 bps to 3.00%.

27th
The FMA issues a Stop Order against Green Gardens Finance Trust Ltd due to non-compliant investment offerings and cautions the public about depositing money with them.

30th
Turners Finance Ltd announce they have entered into an unconditional agreement to purchase Christchurch based Southern Finance Ltd for $5 million with a settlement date of 31 July 2015.

Aug. 2015

5th
The Commerce Commission begin inquiry as to whether P2P lender's fees are covered by the Credit Contracts and Consumer Finance Amendment Act (CCCFA).

9th
Squirrel Money is issued its licence by the FMA to operate as New Zealand's third P2P lender, with focus on offering both secured and unsecured personal loans of up to $70,000.

13th
Standard & Poor's downgrades credit ratings for a number of NBDTs, including Credit Union Baywide, Credit Union South, First Credit Union, Avanti Finance Ltd and Fisher & Paykel Finance Ltd.

Sep. 2015

10th
The RBNZ cuts the OCR by 25 bps to 2.75%.

Fitch Ratings affirmed the long-term and short-term credit ratings of Nelson Building Society and Wairarapa Building Society.

15th
Turners Finance Ltd has made an unsolicited offer to MTF shareholders to buy ordinary shares at $1.15 per share in a bid to acquire 20% of MTF.

17th
NZCU South announces establishment of a securitisation programme with Westpac, providing it access to $50 million funding.

18th
In response to Turners' offer, Heartland New Zealand expresses an interest in making an offer for a full takeover of MTF.

26th
Harmoney reaches a milestone, having lent out over $100 million in loans, and announces that an international P2P funder, P2P Global Investments, is to provide $200 million in additional funding and acquire a 4.5% stake in the business.

Oct. 2015

1st
The Warehouse Group buys out Westpac's 51% stake in The Warehouse Financial Services Ltd to obtain 100% ownership of the business.

12th
Another P2P lender, LendingCrowd, is issued its licence by the FMA.

14th
MTF confirmed that Heartland New Zealand would likely make an offer of more than $1.50 per share to complete the takeover deal.

27th
Fisher & Paykel Finance are bought by FlexiGroup for $315 million.

29th
Turners Finance Ltd receives shareholder acceptances approved by MTF's Board to acquire shares and increase its shareholding in MTF to 7.6%.

The RBNZ leaves the OCR unchanged at 2.75%.

Nov. 2015

1st
The RBNZ's new LVR restrictions relating to investment property come into force.

2nd
Squirrel Money commences operations in New Zealand.

6th
The Warehouse launches two new credit cards (Warehouse Money Visa Card and The Purple Credit Card Visa) through its new subsidiary trading as 'Warehouse Money'.

10th
The Supreme Court grants leave to MTF and Sportzone Motorcycles to appeal a decision by the Court of Appeal over breaches to the CCCFA.

GE Capital agrees to the sale of its remaining commercial lending and leasing portfolios in Australia and New Zealand to Sankaty Advisors, and affiliate of US private equity group Bain Capital for an undisclosed amount.

Dec. 2015

1st
LendMe commences operations in New Zealand.

Lyn McMorran
Executive Director
Financial Services Federation Inc.

FINANCIAL SERVICES FEDERATION

This year the Financial Services Federation (FSF), originally known as the Finance Houses Association (FHA), celebrated its 50th anniversary. A look through the archive at the driving force behind the organisation's formation shows just how much the New Zealand economy has changed. But it also gives pause for thought about where the industry can usefully put its efforts now that the recent raft of regulation arising from the Global Financial Crisis, is largely in place.

Fundamentally the FHA's establishment was a response to government regulatory intervention. The Finance Minister at the time, one Robert Muldoon, believed that consumers' easy access to credit was fuelling inflation. The Government's response was to require finance houses to freeze a portion of their funds in Government Stock to effectively control the amount they were able to lend.

The FHA was initially able to negotiate on members' behalf for a voluntary lump sum payment rather than a compulsory one which equated to just over 5% of their assets. It also encouraged members to look for opportunities to lend elsewhere away from the financing of consumer goods to the provision of funding for industrial, farming and commercial operations.

Fundamentally the FHA's establishment was a response to government regulatory intervention.

This was the first time finance houses were recognised as being important to New Zealand's money and capital markets. The high sense of responsibility shared by FHA members was also evident. At the same time the FHA successfully represented to the Government and the Reserve Bank that the term "Non-Banking Financial Institutions" should be used to describe their members rather than more negative term "fringe institutions".

The lending restrictions remained in place for most of the next 20 years and by 1984, when the Labour Government was elected, financial institutions were required to invest a whopping 30% in Government Stock. This meant that they were borrowing money at 14% then lending a quarter of their asset book to the Government for a return of 11%.

Throughout this period the sector continued to look for ways to innovate and help support growth in New Zealand's economy. By the end of the 1960s members were lending not just for the purchase of home appliances but also for home improvements, purchase of motor vehicles, overseas travel, education fees and medical expenses. They had also become the most important providers of risk loan capital to small and medium businesses.

By the end of the 1960s members ... had also become the most important providers of risk loan capital to small and medium businesses.

In the early 1970s it became possible for New Zealanders to buy a new car without having to go on very long waiting lists (except for one or two particularly popular models) and members became interested in supporting New Zealand's burgeoning wine industry.

By the early 1980s a Credit Contracts Bill was proposed to replace the Moneylenders Act of 1908 which, until that time, had regulated consumer lending in New Zealand. The FHA and the FSF have continued to be involved in ensuring that the various iterations of the Credit Contracts legislation since then achieve the aims of providing appropriate levels of consumer protection without inhibiting access to credit.

FSF members have continued to innovate in order to provide New Zealand consumers and businesses with finance and leasing products that meet their changing needs. They are generally smaller than banks and are therefore more nimble in terms of product and channel development in order to more quickly anticipate changing requirements.

In the Business-to-business space, finance companies have and will continue to play a vital role in fuelling New Zealand's economic growth through having a greater appetite for risk than traditional funding sources. This is because they are able to specialise and get closer to the business and the sector into which they are lending. This in turn allows finance companies to take a less conservative approach when businesses are looking to expand and also to understand the cyclical nature of business so that they can work together for the long haul.

FSF members have continued to innovate in order to provide New Zealand consumers and businesses with finance and leasing products that meet their changing needs.

Many FSF members provide motor vehicle finance or leasing products to consumers and/or business. One obvious characteristic is their passion for vehicles – they all love motor vehicles whether they help customers to get into prestige, top-of-the range vehicles, the second hand family

car market or provide fleet leasing opportunities to major corporates. This passion translates into a sincere desire to help people and businesses get into the most appropriate vehicle or vehicles for their needs and financial situation.

Since the GFC, FSF members have been substantially focused on meeting their compliance obligations arising from the "once in a generation" regulatory reform that necessitated.

Even before the changes to the Credit Contracts and Consumer Finance Amendment Act 2014 and the introduction of the Responsible Lending Code that came into force at the beginning of June this year, our members estimated that legislation such as the Financial Advisers Act 2008, Financial Services Providers (Registration & Disputes Resolution) Act 2008, Anti-Money Laundering & Countering Financing of Terrorism Act 2009, Non-Bank Deposit Takers Act 2013 and the Financial Markets Conduct Act 2013 (to mention only a few) had cost them $30–$40 million in systems and process changes and professional advice. This estimate does not include the human resource and lost opportunity cost which would require that amount to be multiplied many times over.

The FSF and its members fully support the need to provide appropriate levels of consumer protection.

The FSF and its members fully support the need to provide appropriate levels of consumer protection and sincerely hope that these regulations are effective for all consumers but particularly those who are in more vulnerable circumstances. We believe that we have an important community service role in reporting to the regulators situations where lenders are less concerned with responsible and ethical behaviour. We look forward to effective enforcement action as a result.

We also look forward to turning our attention once again to innovation as opposed to compliance. Many of our members give customers the choice of accessing their products on-line and increasing consumer demand is driving more advances in these lending platforms. Such platforms not only ensure that credit is easily accessible but have the potential to improve compliance with responsible lending and other regulatory obligations as more and better quality information about borrowers becomes available.

Clearly one recent innovation that has caught everyone's attention is the introduction of Peer to Peer lending which is already enjoying strong uptake and which can only be expected to continue to grow.

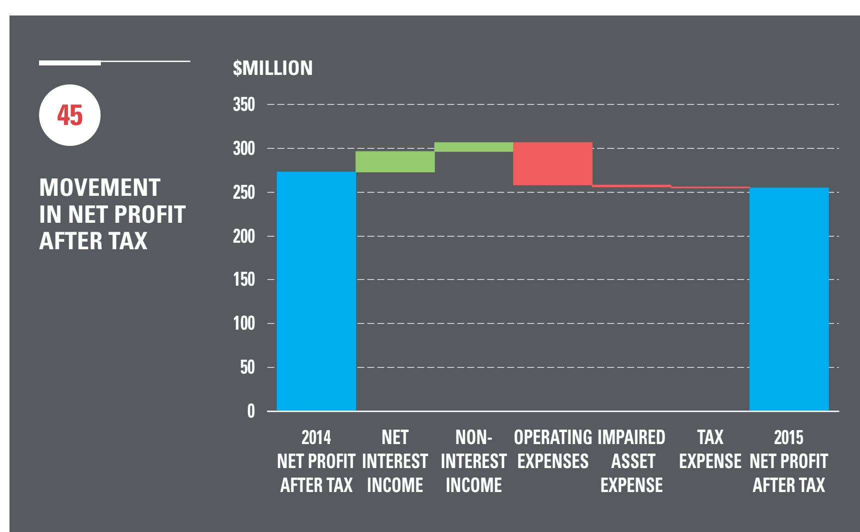
One of the ways in which the FSF marked its 50 year milestone this year was by releasing a Code of Responsible Borrowing.

One of the ways in which the FSF marked its 50 year milestone this year was by releasing a Code of Responsible Borrowing which was written in collaboration with the NZ Federation of Family Budgeting Services. The timing of this release also coincided with the introduction of the changes to the CCCFA and the Responsible Lending Code. This Code suggests that borrowers consider all the alternatives available to them including taking budget advice before entering into a new loan contract. It also sets out the reasons why responsible lenders need to ask so many questions of borrowers to enable them to make responsible lending decisions and why it is important for borrowers to fully disclose their current situation as well as what to do if a loan application is declined.

The FSF plans to continue to set the standards for responsible lending behaviour. One way is through development of additional codes, regardless of how credit is accessed or what platform is used. Although these codes might only be adhered to by those finance providers who voluntarily subscribe to them by being FSF members, we believe that we have an important role to play in establishing what responsible behaviour is so that consumers can have certainty that the lender they are dealing with will treat them ethically.

Non-banks – Sector performance

The non-bank sector experienced a 6.67% contraction in overall reported net profit (see Table 14 – page 90), down by $18.20 million to $254.62 million this year. However, upon a closer look at the financial results, the performance of the entities is mixed, with half of the participants having actually improved their bottom line. Notably all but one of the deposit takers enjoyed better profit results this year.



Easing in profitability

Over half the participants improved their profitability. Notably, Fisher & Paykel Finance contributed with a reported 42.06% or $7.13 million increase in net profit. However, due to change in reporting dates of Fisher & Paykel Finance the comparatives used for this analysis cover a nine month period thus distorting results. Fisher & Paykel Finance has undergone significant changes this year before being sold to ASX-listed FlexiGroup. UDC Finance also reported a 10.68% increase in net profit, contributing $5.51 million to overall results, driven by 8.79% revenue growth and reduced operating expenses compensating for the slightly weaker interest margin. First Mortgage Trust, whom we welcome to the survey, achieved a 32.10% or $3.29 million increase in net profit this year, attributable to 22.30% revenue growth.

Declines in profitability were led by Toyota Finance, Fuji Xerox and GE Capital with reported profits down by 55.47%, 73.30% and 9.95% respectively, accounting for a combined decrease in profits of $33.66 million. Toyota Finance was negatively impacted by a $13.38 million unfavourable fair value movement arising due to changes in interest rates. For Fuji Xerox the decline in net profit was in part due to the prior year

TABLE 14		Total
Increase in Total Assets		4.32%
Decrease in Net Profit After Tax		-6.67%
Movement of Impaired Asset Expense (Percentage of Loans and Advances)	bps	-5
Decrease in Interest Margin	bps	-32

result having a $3.61 million fair value gain on derivatives. Margin pressures were felt by most participants, with 14 of the 23 participants experiencing declining margins, this was despite the majority of participants growing their revenues by 6.07% or $98.08 million this year.

Over half the participants improved their profitability.

Non-interest income showed a 3.04% improvement, contributing an additional $10.26 million for the sector. This was again attributable to Ricoh generating $12.23 million from its non-financing business selling equipment and services. Fisher & Paykel reported $6.75 million more in fee income and premium revenue mostly due to comparatives being for nine months. This was offset by a $13.38 million unfavourable fair value movement on derivatives for Toyota Finance.

Overall the non-bank sector has still delivered plenty of positives this year. Increased competition has done little to impact continued momentum in asset growth supported by abundant liquidity. While improving consumer and business confidence, further restrictions on banks' ability to lend, and recent market activity have all been perceived as promising of more growth opportunities in this sector.

When looking at the main income statement categories the following can be seen:

- net interest income has increased by $23.36 million despite interest margins decreasing by 32 bps (see profitability measures on page 105), with balance sheet growth being the driver;
- non-interest income was up by $10.26 million;
- asset impairment expense was up by $2.30 million (see Figure 46);
- operating expenses increased by $48.49 million (see Figure 51); and
- tax expenses increased by $1.09 million.

Asset quality continues to be strong

Impairment was one of the good news stories shared by the Executives surveyed, all of whom felt that impairment continues to be at historic lows with no significant concerns experienced this year. However, Executives surveyed are all aware that they are "in the very best part of the cycle" and that they need to be mindful of this when writing new deals and many are watching keenly for any early indicators of a downturn.

Survey participants in the motor vehicle financing segment continue to show good improvements in impairment asset expenses.

Although the impairment expense has gone up by 2.61% to reach $90.74 million for the non-bank sector (see Figure 46), largely driven by "collective" provision increases, this has been in line with revenue and asset growth, with levels of impairment charges actually improving from 5.48% in 2014 to 5.30% in 2015 relative to revenue.

Deposit takers within the survey appear to have had a good year, each having managed to reduce their impairment charges and having collectively achieved an overall reduction of $1.74 million in asset impairment expense. Most other participants maintained their impairment charges at levels broadly consistent with the prior year. The largest increases in impairment charges were reported by Fisher & Paykel Finance of $4.95 million, followed by a $2.27 million increase reported by Mercedes Benz Financial Services. As far as improvements, BMW Financial Services led the way with a $1.84 million reduction, followed by UDC Finance down by $1.31 million and Fuji Xerox Finance down by $1.02 million. The relatively small movements in impairment charges are testament of an industry that has enjoyed a generally positive year in terms of asset quality, and a vehicle market where residual values remain strong.

Survey participants in the motor vehicle financing segment continue to show good improvements in impairment asset expenses, as three of the six motor vehicle financing companies managed to reduce their impairment charges, with the $2.95 million reduction in impairment across these three companies accounting for over a third of the total reduction in impairment

charges achieved this year. Comments from Executives surveyed suggest these improvements are stemming from strong motor vehicle residual values and better quality borrowers in the new car market space where they operate.

Trends in gross impaired assets continued to show improvement and have now reduced for the sixth consecutive year. The $21.83 million reduction in the gross impaired assets (see Figure 47) has been mostly attributable to First Mortgage Trust reducing their gross impaired assets by $13.17 million and Fisher & Paykel Finance by $8.38 million.

Impairment provisioning showed a similar improvement, with the level of impairment provisions relative to gross loans and advances reducing from 1.87% in 2014 to 1.74% in 2015, close to the 1.64% seen in 2013. Impaired asset expense over gross loans and advances also improved from 1.01% in 2014 to 0.96% in 2015, down by 5 bps per Table 14 – see page 90 and Figure 46.

Total assets continue to grow

The sector continues to achieve good asset growth with total assets up a further 4.32% (see Table 14 – page 90), being an additional incremental increase on 11.48% growth in the previous year. Total sector assets now total $11.78 billion. Asset growth was underpinned by growth in loans and advances that has been prevalent across the sector, with 19 of the 23 participants surveyed having grown their loan books. Latest RBNZ data shows growth in non-bank sector lending for two consecutive years, with loans reaching $10.98 billion in September 2015, up from $10.52 billion in the previous year (see Figure 48).

Most notable were Nissan Financial Services, whom we welcome to the survey this year, with a 150.28% increase. Nissan Financial Services has been newly established and is still building its loan books with lending related to the Nissan dealerships and their sales and other needs. Avanti Finance achieved 43.86% growth and Fuji Xerox grew 24.24%. Among these entities, total gross loans and advances grew an accumulated $253.68 million.

The ongoing expansion and growth in loan books coincides with the general sense of optimism coming from both participants in the sector and their clients. This is confirmed by recently reported increases in business and consumer confidence with firms' expectations of their own activity, profits, intentions of investment, employment, export and residential investments all on the rise, and then continues to be reflective of a domestic economy performing comparatively well when compared to the uncertainties persisting in global economies. Confidence and sentiment are as important drivers for the sector as business fundamentals.

Strengthening competition and new entrants chasing market share led to some marginal loss in market share of gross loans and advances observed for the three largest entities, namely GE Capital, UDC Finance and Toyota Finance experiencing declines by 1.42%, 0.80% and 0.97% respectively. The combined market share of gross loans and advances for these entities fell from 55.37% to 52.17% of the total group surveyed. Most other participants managed to maintain their market share at broadly consistent levels, while Nissan Financial Services stood out gaining 1.19% of the market in this survey year.

In an industry that continues to present good growth opportunities, the risks of margin pressure and overcrowding poses ongoing concerns as participants all commented on the importance of positioning themselves in their area of expertise in order to strategically stay ahead of the competition.

Net interest margin

The non-bank sector has achieved an impressive 8.09% growth in interest income for the year (see Figure 49).

However, when excluding the impact of Fisher & Paykel Finance's 37.25% increase in interest income due to comparatives being for a nine month reporting period, the overall uplift in interest income was 5.71%, which largely corresponds to 6.63% growth in loan books (see Table 15 – page 93) offset by the effects of falling interest rates. The non-bank sector has experienced a decline in interest margins for the second consecutive year, with a 32 bps decrease down to 6.62% (see Table 16 – page 95 and Figure 50). This has been reflective of comments made by Executives surveyed.

Wholesale debt funding costs continued on a downward trend and the OCR is close to historic lows at 2.75% after three consecutive rate cuts this year. The RBNZ is indicating the possibility of further cuts. Due to the timing of OCR rises in 2014 followed by reversals of the same in 2015 and the differing reporting periods amongst participants, there were mixed trends in interest costs in the current survey period. Overall interest expenses showed an increase of 17.87% (see Figure 49), attributable in

TABLE 15: Gross Loans Entity	2015 $'000	2014 $'000	Movement $'000	Movement %
Avanti Finance Limited	152,977	106,340	46,637	43.86%
BMW Financial Services New Zealand Limited	369,427	349,725	19,702	5.63%
Credit Union Baywide	215,041	197,262	17,779	9.01%
Credit Union South	93,867	82,709	11,158	13.49%
First Credit Union	183,340	143,726	39,614	27.56%
First Mortgage Trust	219,436	187,223	32,213	17.21%
Fisher & Paykel Finance Group	656,469	615,921	40,548	6.58%
Fuji Xerox Finance Limited	438,111	352,620	85,491	24.24%
GE Capital	2,008,749	2,014,279	-5,530	-0.27%
Instant Finance Limited	92,210	83,777	8,433	10.07%
John Deere Financial Limited	144,510	129,246	15,264	11.81%
Medical Securities Limited	159,464	169,537	-10,073	-5.94%
Mercedes-Benz Financial Services New Zealand Limited	513,722	448,497	65,225	14.54%
Motor Trade Finance Limited	517,250	489,293	27,957	5.71%
Nelson Building Society	361,227	318,826	42,401	13.30%
Nissan Financial Services NZ Pty Limited	202,437	80,885	121,552	150.28%
ORIX New Zealand Limited	35,614	33,046	2,568	7.77%
Police & Families Credit Union	64,400	63,746	654	1.03%
Ricoh New Zealand Limited	94,060	88,487	5,573	6.30%
The Warehouse Financial Services Limited	64,664	67,945	-3,281	-4.83%
Toyota Finance New Zealand Limited	720,654	765,330	-44,676	-5.84%
UDC Finance Limited	2,378,692	2,303,886	74,806	3.25%
Wairarapa Building Society	104,013	88,936	15,077	16.95%
Total	**9,790,334**	**9,181,242**	**609,092**	**6.63%**

part to a 3.26% increase in interest bearing liabilities and in part to some financials still reflecting 2014 OCR rises. Commenting on these interest rate movements Executives raised the importance of timely adjustments of deposit rates to protect margins, being balanced with manageable sources and tenors of funding.

On the interest income side of the equation, the Executives commented on considerable competitive pressures on lending rates with new entrants, growing presence of disruptors and banks intermittently dipping into this space offering very competitive rates all having an impact. The largest decreases observed in interest margins were experienced by Avanti Finance, John Deere Financial and Fuji Xerox Finance with movements of 307 bps, 147 bps and 136 bps respectively (see Table 16 – page 95). For Avanti Finance the interest margin was impacted by the timing of new lending (a percentage of which was mortgage based) that contributed to 43.86% growth in its lending book this year. Fuji Xerox Finance experienced its interest margin impacted by its 24.24% growth in its loan book.

Competitive pressures continue to be evident in the yield (interest income to average interest earning assets ratio), which eased by 2 bps from the previous year to 10.35%, which is the lowest it has been since 2010 at 10.27%.

Many Executives commented that the earlier loan-to-value (LVR) rules had created opportunities for the non-bank lenders around the periphery of the banks' "black box", as banks were prevented or chose not to do all > 80% LVR deals. Comments from Executives surveyed also indicated there has been some degree of relief in terms of banks being less flexible with the black box lending criteria and focusing on the < 80% LVR and corporate and commercial space. Banks have however been noted as having a willingness to provide wholesale or securitised funding to non-bank lenders, in effect indirectly lending to their customers through the entity while taking some comfort from the capital in the non-bank lender as opposed to lending to the sector directly. One example being Credit Union South having entered into a securitisation programme with Westpac to be implemented in November 2015 that will provide access to $50 million in additional funding, and another being Avanti Finance's growth of its mortgage book through similar mechanisms.

Operating expenses on the rise

The non-bank sector has experienced an overall 8.14% or $ 48.49 million increase in operating expenses (see Figure 51). The operating expenses to operating income ratio also increased from 56.53% in 2014 to 59.23% in 2015 (see Figure 51).

The levels of operating expenses relative to gross revenues have remained broadly consistent overall at 37.60% compared to 36.88% last year. For Fuji Xerox Finance, operating expense levels were adversely impacted by a $4.51 million loss on derivatives. While Nissan Financial Services reported operating expenses at 19.80% of gross revenues which appears to be well below the average across the group of 38.98%. However, the current level of operating expenses may not be indicative of longer term trends as Nissan Financial Services is still in the process of establishing its operations.

Overall, the sector appears to be running at an efficient rate with increases in operational costs supported to a large extent by rises in operating income. This has been encouraging to see given the challenges in managing operating costs down posed not only by rising competitive pressures to attract and maintain business, but also the significant ongoing costs associated with regulatory compliance. From discussions held with participants, there continues to be a clear and consistent message that regulatory requirements are posing substantial costs and remain the key driver behind operating cost increases. Despite this the view of regulation and its impact has softened now that its implementation is behind many entities and it is absorbed into the business as usual, as much as possible. Some commented it may have cleaned the industry up, raised the bar and is seen to be an extra hurdle for new entrants.

TABLE 16: Movements in Interest Margin	2015 %	2014 %	Movement (bps)
Avanti Finance Limited	10.94	14.01	-307
BMW Financial Services New Zealand Limited	7.29	7.52	-23
Credit Union Baywide	5.16	5.29	-13
Credit Union South	8.08	8.56	-47
First Credit Union	4.57	4.15	42
First Mortgage Trust	n/a	n/a	n/a
Fisher & Paykel Finance Group	11.01	8.76	225
Fuji Xerox Finance Limited	4.17	5.53	-136
GE Capital	8.52	9.07	-55
Instant Finance Limited	21.25	20.83	42
John Deere Financial Limited	3.57	5.04	-147
Medical Securities Limited	3.70	3.51	19
Mercedes-Benz Financial Services New Zealand Limited	4.23	4.56	-33
Motor Trade Finance Limited	9.06	9.41	-35
Nelson Building Society	2.57	2.50	7
Nissan Financial Services NZ Pty Limited	3.59	n/a	n/a
ORIX New Zealand Limited	12.35	12.59	-24
Police & Families Credit Union	4.78	4.58	19
Ricoh New Zealand Limited	8.30	8.76	-46
The Warehouse Financial Services Limited	11.99	12.02	-3
Toyota Finance New Zealand Limited	4.43	5.17	-74
UDC Finance Limited	4.87	4.90	-2
Wairarapa Building Society	2.22	2.22	1
Sector Average	**6.62**	**6.94**	**-32**

n/a = not available

P2P lending

In recent times there has been increased press about the growth and impact of peer-to-peer (P2P) lending in the New Zealand Financial Services market.

Two P2P platforms Harmoney and Squirrel Money have launched and two more, LendingCrowd and LendMe are shortly to launch. But Why all this activity now, and What is a P2P lender, and Where do they fit within our survey?

The P2P lenders business model is different from that of current market participants captured by our survey. Historically we have looked at the financial statements of entities that have interest income, interest expense, fee income, other costs, capital, deposits and various types of lending together with the inherent levels of impairment in the market. P2P lenders are significantly different as they are a platform that brings together willing investors and willing borrowers, but the business itself (platform) does not take on the credit risk, and therefore, neither the funding or the advances are recorded on the P2P lender's balance sheet. Unlike Finance Companies and Credit Unions, investors are unable to see the overall picture of the income and expenditure, debt and advances, capital and liquidity of the entire platform via a set of financial statements. P2P lending is a true social interaction between independent investors and borrowers with the platform simply facilitating their getting together, but not taking a principal position or standing any credit risk and so not recording the transaction in the traditional way.

So the question is, Why is this happening now? Two things have made P2P lending possible in its new form, but before we look at why this is possible now, P2P lending is not new.

In many ways Credit Unions, Building Societies and Mutuals were similar. People from a similar community, company or workforce who had money, would invest it to allow those from the same community, company or workforce to borrow. The theory was those investing would earn a slightly better rate than the banks could offer and those borrowing would borrow at a slightly more favourable rate and the holistic societal view would ensure that there was performance across the board and credit issues were minimised. All involved had the common bond of the community, company or workforce. In some ways a P2P lender is the modern version (60+ years newer) of those older entities with more technology, more immediacy, but just like the Credit Union, Building Society or Mutual, when they launched, the P2P offer a different platform. The reasons this has occurred now is the massive leap forward in technology, in particular the ability to analyse, compare and use large quantities of data, the ability to host the platform on a website all can access such that it can instantly achieve national reach and to a lesser degree, some frustration and dissatisfaction with existing financial institutions and the willingness of people to adopt a new and different business model. Just like Uber in the taxi market and Amazon in the retail market, P2P lenders have offered a newer faster more agile and technologically savvy way of achieving the same goals that are both time saving and with potentially better outcomes for the consumers.

How the models work

Broadly, the technology platforms run over the web introduce people with excess funds who wish to invest and earn a higher return than a current market participant would offer, an opportunity to be matched with borrowers who wish to borrow. It may be that those borrowers want access to a simple and fast loan without having to go through all of the perceived hurdles of a bank or a finance company loan. Alternatively, over the longer term they may wish to have a slightly lower borrowing rate or just wish to spread their dealings with financial institutions. The platform

basically matches the parties across a range of criteria such as interest rates, maturity and payment amounts. There are many models, two of the more common are the ones based around the idea of fractionalisation and the idea of a reserve balance.

There are many models, two of the more common are the ones based around the idea of fractionalisation and the idea of a reserve balance.

In the fractionalisation model investors invest an amount, say $5,000, and this amount is matched to say 10 loans where each contribution to those loans will be, say $500. In this example, the investors' risk in relation to the return of the $5,000 is spread across 10 different borrowers and each of those borrowers in turn is funded by (potentially) 10 different investors. This is the principle of fractionalisation. The platform might be remunerated by some form of upfront fee (say a percentage of the amount lent) and may take some slice of the total interest paid, i.e. the total interest paid by the borrower might consist of a return to the investor and a margin for the platform. In this model, fractionalisation is one of the two ways in which the credit risk is managed.

The first way that the credit risk is managed (in both models) is that each loan is graded and investors, by selecting the rate of the return they want, effectively accept the credit risk relative to that grading. If the investor chooses a loan with a 12.5% interest rate they might receive that interest rate less any fee or share for the platform (assume 2.0%) and thus receive 10.5%. The platform may receive remuneration either as a share of funds as they are repaid or a share of the interest rate received. Under the fractionalisation model, in the event of default by a borrower, the investor will suffer some (fraction) of the loss.

The other model commonly referred to as the reserve model is similar in the sense that investors are matched to borrowers but this may occur on more of a one to one or one to a few basis as opposed to forced fractionalisation in terms of investors to loans. In this example, the investor will receive a return based on the level of risk say 12.5% they wish to accept, e.g. they might receive a return of 8.0%. The platform may charge a portion of interest say another 2.0% for the service/access to the platform (as with the fractionalisation model) with another portion going to the reserve, say 2.5%. In the reserve model situation, the full amount of any payment (principal and interest) is split firstly to the investor, secondly to the platform and thirdly to a reserve. The reserve is built up such that it is able to absorb potential losses. In some situations, an amount is seeded into the reserve by the platform owner to create an underlying reserve greater than the current potential credit loss. In these situations where a loan stops making payment, the reserve fund is available to make that good until such time as the borrower starts paying again in which case the payments will be diverted back to the reserve fund to top it up again. In the event of a severe credit downturn, and the reserve being drawn on heavily there is often a facility for the return component to the investor to be reduced across the board, such that all borrowers wear a reduced return and effectively share in the credit loss until borrowers can return to normal.

John Kensington
Partner – Audit
Head of Financial Services
KPMG

Target areas

What areas will P2P lending target? Those that have launched in New Zealand appear to be targeting a range of areas, but they are typically areas where the P2P lender does not have to compete with the banks' or finance companies' main strength areas or where those entities tend to be less dominant in the market. These are also typically areas where incumbent entities enjoy a higher margin and there is some ability to reduce the cost to the borrower and increase the return to the investor because of the wider margins. Banks and finance companies in particular, are well suited to large economies of scale and access to significant amounts of cheap funds. This makes them able to compete strongly in low yield sectors of the market such as corporate lending, SME lending and retail mortgages. The types of sectors that will come under increasing pressure from P2P lenders will be the higher margin areas such as credit cards and personal loans and potentially higher LVR mortgages.

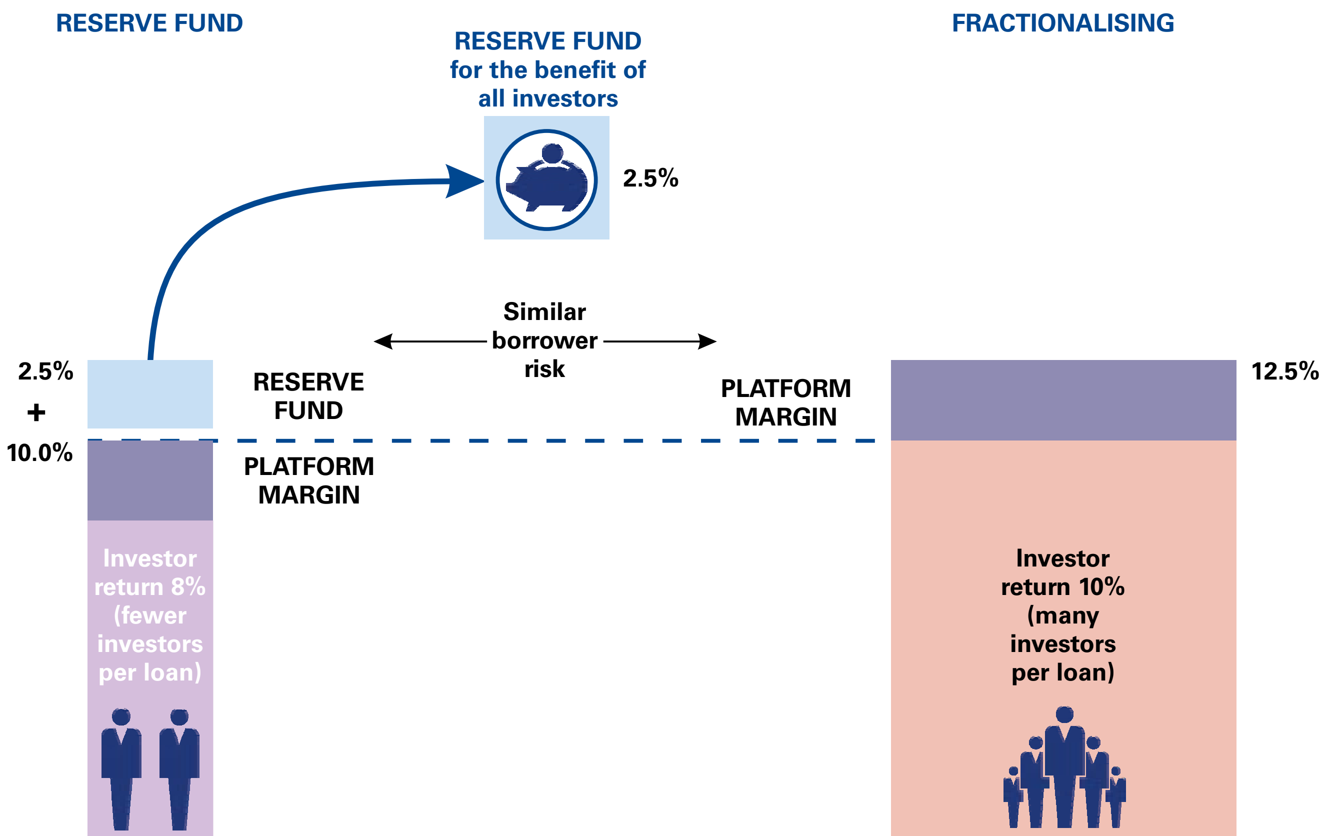
Regulation

What regulation are the P2P funders bound by?

The FMA website clearly sets out the requirements for a P2P lender and market participants feel they are bound by all the regulation of other borrowers and lenders, but already questions have arisen, as they do with any new regulation, as to whether other Acts apply, questions have been raised as to whether CCCFA and the Responsible Lending Code are applicable in this space.

The future

The P2P lenders that have launched so far in New Zealand are quite different. Harmoney have targeted a strong growth launch and has been assisted by having some cornerstone shareholders and wholesale money available to support its fast launch.



Squirrel Money has gone for a slower approach matching its lending to its funding and is looking to be the true mum and dad P2P lender. LendingCrowd and LendMe have yet to launch or have just launched as this goes to press and it will be interesting to see how they approach the market in due course.

P2P lending is here in the New Zealand market and operating. How we capture its impact in the survey long term, will be both interesting and challenging and a little dependant on what and how they report the results of the platform. Currently P2P platforms are not required to report the traditional financial information in the sense of a set of financial statements that show interest income, expenses, other expenses, deposits, advances and impairment that this survey has traditionally covered. As more P2P lenders come to the market, we will look to see what metrics are available to provide a useful and meaningful comparison of their performance. At the same time, we will need to be mindful that information included in the survey will need to be of a robust and audited nature.

So what are the lessons learnt and what does the future hold for P2P lending?

From the discussion that we have had with the P2P lenders which have set up, a number of interesting myths have been debunked and a number of competitive advantages and also 'watch this space' opportunities have been identified.

Firstly, it is very clear that the borrower demographic is probably quite different from what you would expect and then the investor demographic similarly is quite different. Many looking in from the outside might assume that the investor demographic would typically be those who are a bit older, have a little bit of excess cash and want to have another provider; and perhaps put into the platform a small amount of their accumulated wealth until such time as the platform proves itself. While there may be many investors of this nature, this is not typically the person involved as an investor. Similarly, on the borrower's side, many might have felt that the borrowers will be young, restless and looking for some funding they can't achieve from the bank, again this is not necessarily a correct assessment.

So what is different about these operations?

Firstly, the use of data. These enterprises are data hungry and what they do is based around automation of processes without human intervention (to some extent this still remains). They look to use the data and the information within the data to make decisions based on where a person is at, what a person likes and what a person needs while considering what a person has just done and is likely to do. One of the key drivers of these platforms is the ability to use data effectively and efficiently.

So what is the typical P2P lending platform?

It is a technology offering that offers a cost advantage and speed advantage to those that are willing to try out new technology just like those who tried Amazon and those who have tried Uber. This is a new way of doing an old thing.

So are there any other elements that are different from a normal financial institution?

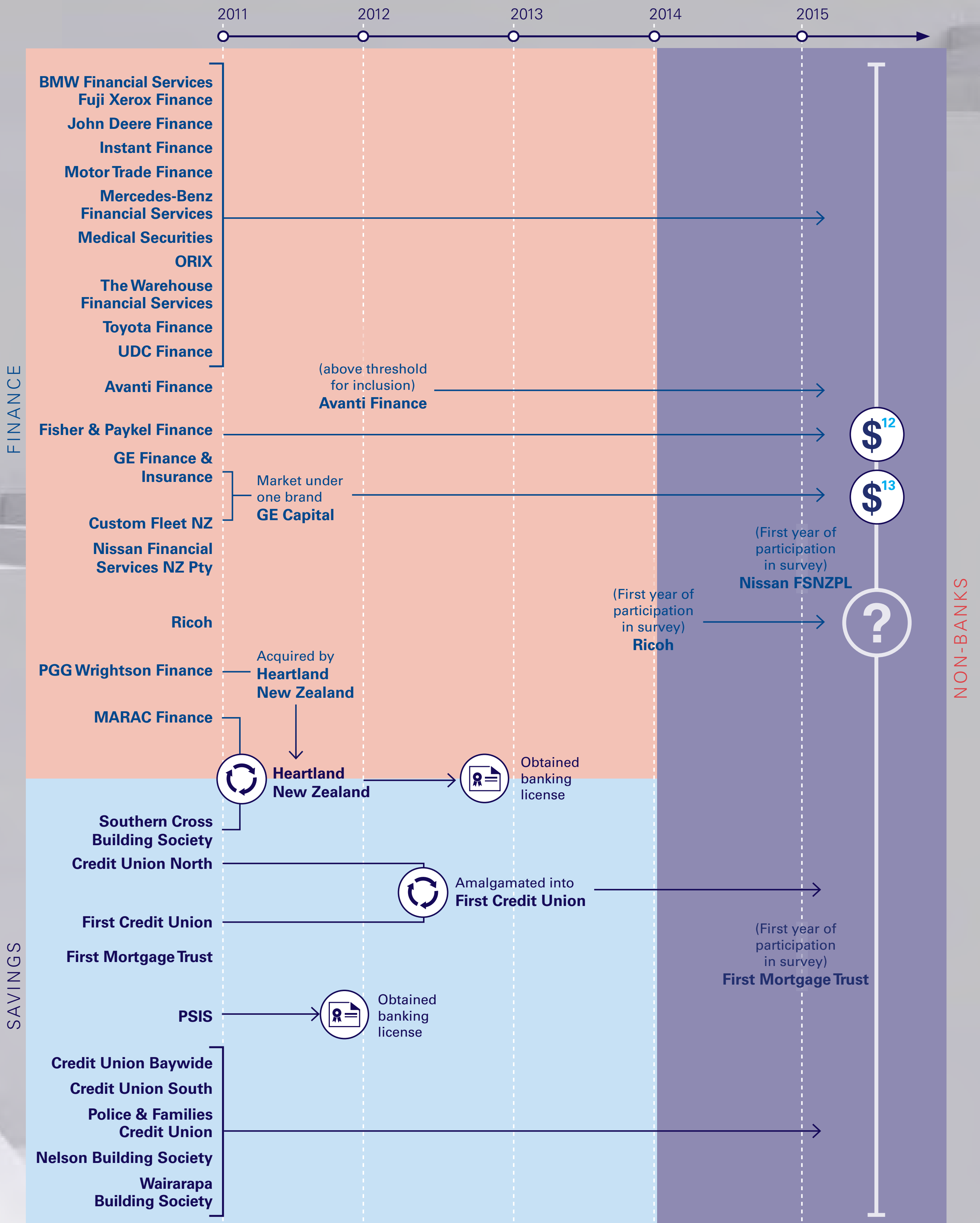
One is the element of buyer beware. These platforms match investors and borrowers but don't take the risk. They clearly disclose the level of risk involved and to some extent there is an element of buyer beware for the investor. An investor needs to understand that by investing in a loan that will return them 12.5% they have a significantly greater risk of loss than a loan or deposit with a bank at 3.0%. There is an assumption that those dealing with this understand the risk reward relationship.

Another matter that has yet to be tested is the secondary market. Should investors want to exit their investment, is there a secondary market that allows them to be taken out? To date this has not formed but again it is only a matter of time before something occurs in this space.

So P2P lending is an exciting new addition to the financial services industry and it is something that we will no doubt follow up on in the second part of the survey when we talk to the banks.

One of the comments made by sector participants is that the P2P lenders have launched at a relatively benign time. Interest rates are at an all time low, employment numbers are strong and NZ's economy is as good as any in the world. Many feel the real test for the P2P lenders will be when they go through a down part of the cycle and pressure comes on the accuracy of their credit modelling and/or a liquidity event occurs. This will be a very real test of the P2P sub-sector, and whether its investors understand the risk reward equation and whether the credit modelling is correct.

Looking back at the non-bank sector



Non-banks – Analysis of annual results

Entity	Rank by Total Assets	Balance Date	Survey Year	Total Assets $000	Net Assets $000
Avanti Finance Limited	16	31-Mar	2015 *2014*	158,614 *108,927*	25,633 *20,741*
BMW Financial Services New Zealand Limited	9	31-Dec	2014 *2013*	376,204 *359,711*	18,645 *21,195*
Credit Union Baywide	12	30-Jun	2015 *2014*	266,031 *252,021*	36,669 *34,943*
Credit Union South	19	30-Jun	2015 *2014*	124,749 *112,885*	20,748 *19,877*
First Credit Union	10	30-Jun	2015 *2014*	295,007 *249,216*	49,955 *39,994*
First Mortgage Trust	11	31-Mar	2015 *2014*	277,951 *222,654*	276,174 *221,189*
Fisher & Paykel Finance Group	4	31-Dec	2014 *2013*	753,399 *704,808*	80,000 *89,346*
Fuji Xerox Finance Limited	8	31-Mar	2015 *2014*	452,025 *361,341*	40,965 *37,014*
GE Capital	1	31-Dec	2014 *2013*	2,599,989 *2,829,296*	435,340 *372,410*
Instant Finance Limited	22	31-Mar	2015 *2014*	96,643 *88,529*	25,771 *24,415*
John Deere Financial Limited	18	31-Oct	2014 *2013*	150,733 *135,584*	14,765 *12,603*
Medical Securities Limited	15	31-Mar	2015 *2014*	197,815 *202,860*	38,188 *37,170*
Mercedes-Benz Financial Services New Zealand Limited	6	31-Dec	2014 *2013*	521,923 *464,252*	35,841 *37,481*
Motor Trade Finance Limited	5	30-Sep	2015 *2014*	566,501 *540,910*	82,621 *80,676*
Nissan Financial Services NZ Pty Limited	14	31-Jul	2015 *2014*	206,839 *88,111*	2,395 *1,134*
Nelson Building Society	7	31-Mar	2015 *2014*	459,705 *414,210*	30,723 *26,155*
ORIX New Zealand Limited	13	31-Mar	2015 *2014*	236,893 *229,576*	147,342 *131,810*
Police & Families Credit Union	21	30-Jun	2015 *2014*	108,829 *98,434*	19,320 *17,284*
Ricoh New Zealand Limited	17	31-Mar	2015 *2014*	153,421 *136,379*	56,542 *49,532*
The Warehouse Financial Services Limited	23	30-Sep	2014 *2013*	79,306 *82,543*	12,358 *12,621*
Toyota Finance New Zealand Limited	3	31-Mar	2015 *2014*	1,129,650 *1,138,884*	142,521 *158,378*
UDC Finance Limited	2	30-Sep	2015 *2014*	2,440,613 *2,354,448*	365,462 *341,412*
Wairarapa Building Society	20	31-Mar	2015 *2014*	124,537 *114,160*	16,128 *16,006*
Sector Total			**2015** ***2014***	**11,777,377** ***11,289,739***	**1,974,105** ***1,803,386***
GE Commercial Finance NZ		31-Dec	2014 *2013*	107,738 *134,247*	45,534 *45,003*
GE Commercial Finance US (NZD)		31-Dec	2014 *2013*	17,873 *17,546*	63 *612*
GE Finance and Insurance		31-Dec	2014 *2013*	2,474,378 *2,677,503*	389,743 *326,795*

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

Size and Strength Measures			Growth Measures		
Gearing %	Net Loans and Advances $000	Number of Employees	Increase in Net Profit After Tax %	Increase in Underlying Profit %	Increase in Total Assets %
16.16	148,874	75	-15.87	-16.16	45.61
19.04	*102,622*	*63*	*10.49*	*10.42*	*17.90*
4.96	361,500	18	17.65	18.32	4.59
5.89	*342,572*	*17*	*5.99*	*5.57*	*17.03*
13.78	213,588	106	0.23	0.23	5.56
13.87	*195,776*	*103*	*41.41*	*41.41*	*10.19*
16.63	92,945	94	130.47	130.47	10.51
17.61	*81,526*	*93*	*111.36*	*111.36*	*4.45*
16.93	180,613	108	57.98	57.98	18.37
16.05	*141,419*	*93*	*-11.53*	*-11.53*	*7.68*
99.36	218,586	n/d	32.10	34.66	24.84
99.34	*183,703*	*n/d*	*n/a*	*n/a*	*n/a*
10.62	639,236	230	42.06	42.05	6.89
12.68	*598,262*	*239*	*-31.89*	*-31.70*	*-4.52*
9.06	437,476	n/d	-73.30	-59.80	25.10
10.24	*350,969*	*n/d*	*138.23*	*27.55*	*22.02*
16.74	1,951,341	764	-9.95	-10.03	-8.10
13.16	*1,955,746*	*785*	*809.65*	*1,569.07*	*6.96*
26.67	88,490	140	11.48	10.99	9.17
27.58	*80,622*	*140*	*1.28*	*0.29*	*2.77*
9.80	144,510	n/d	-28.17	-28.06	11.17
9.30	*129,246*	*n/d*	*42.52*	*42.60*	*13.32*
19.30	159,161	27	-39.22	-39.17	-2.49
18.32	*169,016*	*31*	*-10.24*	*-8.75*	*-7.46*
6.87	504,549	n/d	-10.03	-11.01	12.42
8.07	*441,943*	*26*	*-1.85*	*-4.53*	*17.56*
14.58	512,151	52	13.01	11.16	4.73
14.91	*484,421*	*51*	*-24.82*	*-22.67*	*22.94*
1.16	201,212	n/d	2,435.19	1,894.19	134.75
1.29	*80,885*	*n/d*	*n/a*	*n/a*	*n/a*
6.68	360,477	37	17.51	16.95	10.98
6.31	*317,966*	*36*	*42.96*	*43.18*	*10.10*
62.20	35,126	64	-5.33	-5.27	3.19
57.41	*32,316*	*63*	*0.81*	*0.66*	*2.10*
17.75	64,284	13	26.30	26.25	10.56
17.56	*63,598*	*13*	*33.44*	*33.55*	*9.70*
36.85	94,060	370	-23.49	-26.61	12.50
36.32	*88,487*	*369*	*0.58*	*13.38*	*17.85*
15.58	62,152	3	-4.88	-4.90	-3.92
15.29	*65,377*	*3*	*-5.37*	*-5.35*	*-9.14*
12.62	698,954	89	-55.47	-53.15	-0.81
13.91	*742,441*	*84*	*114.73*	*92.94*	*8.72*
14.97	2,347,163	145	10.68	10.53	3.66
14.50	*2,272,081*	*144*	*19.94*	*20.29*	*8.42*
12.95	103,870	9	-62.54	8.79	9.09
14.02	*88,849*	*9*	*133.88*	*11.11*	*10.38*
16.76	**9,620,318**	**2,344**	**-6.67**	**-4.63**	**4.32**
15.97	***9,009,843***	***2,361***	***110.50***	***52.86***	***11.48***

Gearing %	Net Loans and Advances $000	Number of Employees	Increase in Net Profit After Tax %	Increase in Underlying Profit %	Increase in Total Assets %
42.26	83,013	n/d	-71.06	-64.90	-19.75
33.52	*42,270*	*n/d*	*111.89*	*37.81*	*-4.55*
0.35	10,153	n/d	70.15	103.31	1.86
3.49	*13,416*	*n/d*	*-1,846.02*	*-4,429.54*	*8.79*
15.75	1,858,175	n/d	-9.92	-10.95	-7.59
12.21	*1,900,060*	*n/d*	*307.61*	*300.67*	*91.21*

Non-banks – Analysis of annual results

Entity	Credit Quality Measures				
	Impaired Asset Expense $000	Provision for Doubtful Debts/ Gross Loans & Advances %	Past Due Assets $000	Gross Impaired Assets $000	Impaired Asset Expense/ Average Loans and Advances %
Avanti Finance Limited	2,525 *1,920*	2.68 *3.50*	1,193 *628*	13,481 *11,817*	1.95 *1.92*
BMW Financial Services New Zealand Limited	1,970 *3,808*	2.15 *2.05*	n/d *n/d*	n/d *n/d*	0.55 *1.17*
Credit Union Baywide	412 *498*	0.68 *0.75*	0 *0*	3,896 *3,985*	0.20 *0.28*
Credit Union South	559 *1,118*	0.98 *1.43*	0 *0*	1,858 *2,828*	0.63 *1.45*
First Credit Union	661 *835*	1.49 *1.61*	1,628 *1,430*	4,437 *5,065*	0.40 *0.60*
First Mortgage Trust	514 *1,308*	0.39 *1.88*	4,325 *4,993*	0 *13,165*	0.25 *n/a*
Fisher & Paykel Finance Group	13,340 *8,388*	2.63 *2.87*	11,413 *9,268*	21,645 *30,028*	2.10 *1.35*
Fuji Xerox Finance Limited	635 *1,651*	0.14 *0.47*	n/d *n/d*	n/d *n/d*	0.16 *0.51*
GE Capital	48,678 *49,155*	2.86 *2.91*	n/d *n/d*	n/d *n/d*	2.42 *2.43*
Instant Finance Limited	2,365 *1,539*	4.03 *3.77*	0 *0*	5,739 *6,087*	2.69 *1.85*
John Deere Financial Limited	0 *0*	0.00 *0.00*	n/d *n/d*	n/d *n/d*	0.00 *0.00*
Medical Securities Limited	-129 *247*	0.19 *0.31*	n/d *n/d*	n/d *n/d*	-0.08 *0.14*
Mercedes-Benz Financial Services New Zealand Limited	3,217 *951*	1.79 *1.46*	n/d *n/d*	n/d *n/d*	0.67 *0.23*
Motor Trade Finance Limited	105 *-180*	0.99 *1.00*	77 *68*	55 *243*	0.02 *-0.04*
Nissan Financial Services NZ Pty Limited	1,294 *0*	0.61 *0.00*	n/d *n/d*	n/d *n/d*	0.91 *n/a*
Nelson Building Society	354 *455*	0.21 *0.27*	112 *0*	0 *1,424*	0.10 *0.15*
ORIX New Zealand Limited	-245 *-35*	1.37 *2.21*	n/d *n/d*	26 *0*	-0.71 *-0.10*
Police & Families Credit Union	-30 *-22*	0.18 *0.23*	110 *3*	35 *17*	-0.05 *-0.04*
Ricoh New Zealand Limited	640 *368*	0.00 *0.00*	n/d *n/d*	919 *939*	0.70 *0.46*
The Warehouse Financial Services Limited	2,116 *2,447*	3.88 *3.78*	n/d *n/d*	n/d *n/d*	3.19 *3.53*
Toyota Finance New Zealand Limited	1,273 *2,176*	3.01 *2.99*	87 *23*	3,234 *2,986*	0.17 *0.29*
UDC Finance Limited	10,427 *11,733*	1.33 *1.38*	6,369 *5,172*	18,919 *19,436*	0.45 *0.53*
Wairarapa Building Society	56 *72*	0.14 *0.10*	462 *598*	2,471 *526*	0.06 *0.08*
Sector Total	**90,736** ***88,432***	**1.74** ***1.87***	**25,776** ***22,183***	**76,715** ***98,546***	**0.96** ***1.01***
GE Commercial Finance NZ	318 *-87*	0.49 *0.21*	n/d *n/d*	n/d *n/d*	0.51 *-0.12*
GE Commercial Finance US (NZD)	-84 *-349*	0.61 *2.53*	n/d *n/d*	n/d *n/d*	-0.70 *-2.42*
GE Finance and Insurance	48,444 *49,591*	2.97 *2.97*	n/d *n/d*	n/d *n/d*	2.50 *3.05*

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

Profitability Measures						Efficiency Measures	
Interest Margin %	Interest Spread %	Non-Interest Income/ Average Total Assets %	Net Profit After Tax $000	Net Profit After/ Average Net Total Assets %	Underlying Profit $000	Operating Expenses/ Average Total Assets %	Operating Expenses/ Operating Income %
10.94	9.39	7.08	7,772	33.52	10,764	7.88	44.24
14.01	*11.66*	*9.83*	*9,238*	*32.88*	*12,838*	*8.90*	*37.78*
7.29	6.82	0.50	9,450	47.44	13,139	3.62	46.83
7.52	*7.14*	*0.32*	*8,032*	*46.75*	*11,105*	*3.29*	*42.39*
5.16	4.63	1.29	1,725	4.82	1,725	5.57	87.10
5.29	*4.78*	*1.36*	*1,721*	*5.08*	*1,721*	*5.67*	*86.00*
8.08	7.56	4.77	643	3.17	643	11.59	91.97
8.56	*8.01*	*5.15*	*279*	*1.45*	*279*	*12.23*	*90.63*
4.57	3.98	2.11	2,425	5.39	2,425	5.42	82.69
4.15	*3.51*	*2.18*	*1,535*	*3.91*	*1,535*	*5.24*	*84.17*
n/a	n/a	0.00	13,542	5.45	14,134	1.75	23.06
n/a	*n/a*	*n/a*	*10,251*	*n/a*	*10,496*	*n/a*	*24.17*
11.01	10.59	3.83	24,068	28.42	33,522	7.32	53.24
8.76	*8.41*	*2.79*	*16,942*	*18.08*	*23,599*	*6.14*	*58.07*
4.17	3.97	0.16	3,951	10.13	6,631	2.51	58.46
5.53	*5.37*	*1.51*	*14,796*	*49.96*	*16,495*	*1.47*	*21.06*
8.52	7.89	2.54	62,934	15.58	88,541	5.61	52.59
9.07	*8.62*	*2.61*	*69,891*	*24.20*	*98,413*	*5.75*	*51.59*
21.25	18.53	19.79	7,164	28.55	10,298	26.02	65.55
20.83	*17.84*	*18.85*	*6,426*	*27.02*	*9,278*	*26.03*	*67.76*
3.57	3.28	0.06	2,162	15.80	3,008	1.49	41.48
5.04	*4.89*	*0.01*	*3,010*	*27.12*	*4,181*	*1.71*	*34.33*
3.70	2.88	0.37	1,018	2.70	1,415	3.38	84.04
3.51	*2.62*	*0.42*	*1,675*	*3.82*	*2,326*	*2.69*	*68.78*
4.23	3.83	0.00	8,112	22.13	11,128	1.29	30.67
4.56	*4.18*	*0.00*	*9,016*	*27.39*	*12,505*	*1.39*	*30.70*
9.06	8.07	2.15	6,942	8.50	9,999	9.20	83.45
9.41	*8.46*	*2.56*	*6,143*	*7.79*	*8,995*	*9.91*	*84.64*
3.59	3.42	2.08	1,261	71.47	4,806	1.38	25.08
n/a	*n/a*	*n/a*	*-54*	*n/a*	*241*	*n/a*	*72.86*
2.57	2.32	0.24	2,577	9.06	3,587	1.87	67.52
2.50	*2.27*	*0.25*	*2,193*	*9.11*	*3,067*	*1.83*	*67.22*
12.35	9.25	16.48	15,795	11.32	21,950	18.75	66.83
12.59	*9.74*	*18.42*	*16,684*	*13.55*	*23,170*	*20.04*	*66.31*
4.78	4.21	0.24	2,036	11.12	2,035	3.06	61.29
4.58	*4.07*	*0.29*	*1,612*	*9.78*	*1,612*	*3.16*	*65.16*
8.30	7.44	91.18	5,020	9.47	7,538	91.77	94.21
8.76	*8.06*	*94.62*	*6,561*	*16.47*	*10,271*	*92.67*	*91.65*
11.99	11.46	6.13	6,137	49.14	8,525	4.72	26.42
12.02	*11.56*	*6.10*	*6,452*	*47.28*	*8,964*	*4.70*	*26.31*
4.43	3.77	0.63	12,733	8.46	17,111	3.39	67.63
5.17	*4.55*	*1.17*	*28,591*	*18.97*	*36,525*	*2.72*	*43.49*
4.87	4.14	0.24	57,050	16.14	79,323	1.35	26.45
4.90	*4.23*	*0.20*	*51,543*	*15.71*	*71,768*	*1.38*	*27.27*
2.22	1.99	0.30	106	0.66	359	1.94	84.81
2.22	*1.95*	*0.56*	*283*	*1.78*	*330*	*2.18*	*85.49*
6.62	**5.86**	**3.02**	**254,623**	**13.48**	**352,606**	**5.59**	**59.23**
6.94	***6.32***	***3.15***	***272,820***	***17.45***	***369,714***	***5.56***	***56.53***
2.37	1.53	0.67	531	1.17	875	1.97	66.63
2.87	*1.81*	*2.00*	*1,835*	*4.16*	*2,493*	*2.88*	*62.21*
1.89	1.87	0.04	-545	-161.40	81	1.92	101.08
2.65	*2.63*	*1.20*	*-1,824*	*-599.69*	*-2,435*	*20.32*	*536.52*
8.86	8.26	2.64	62,948	17.57	87,585	5.80	52.36
12.07	*11.48*	*3.36*	*69,880*	*32.45*	*98,355*	*7.35*	*50.33*

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TACKLING CYBER THREATS – THREE KEY PRIORITIES FOR FINANCIAL INSTITUTIONS

Media reports on cyber incidents are everywhere these days. It seems as if all organisations – both public and private – are extremely fragile compared to the invincible strength of their attackers – varying from script kiddies to organised crime. Recent incidents once again signalled that reputations are at stake when private data comes out into the public arena. It goes without saying that organisations must protect their digital assets properly and that failing to do so may result in serious problems. Cybersecurity clearly deserves a prominent place on the management agenda of all financial institutions.

It has often been stated that in a world where everything is interconnected, data is the new oil. The pace of technological progress is astounding and the world has become a village when it comes to communication and interaction. The classic boundaries of financial institutions – and their information systems – are blurred, while in all markets they can pursue success only through working in agile coalitions with partners. In the light of these developments, one fact is very clear: control of your data and systems is essential to achieve strategic goals.

It is easier than ever before to buy do-it-yourself malicious software; the strong mutual dependencies in a network- based society bring along new vulnerabilities. Cyber crime shifts from amateurs to resourceful organised crime groups, which perform focused attacks for espionage or massive disruptions of systems. And hacktivists have discovered cyber crime is an effective means to make their views heard by bringing sensitive information into the public domain.

Whilst cybersecurity is on top of many financial institutions agendas, organisations struggle to properly assess, measure and communicate to what extent their business is resilient against cyberattacks. This understanding is paramount in order to tackle cyber risk effectively. To effectively tackle the growing cyber threat, there are three key priorities for financial institutions:

1. Gaining insights

Our experience shows that many New Zealand financial institutions struggle to grasp what cyber risk really means for their organisation. This constitutes a gap between an intuitive and operational knowledge of the assets.

You can't manage what you don't know.

Moreover, the information processes about threats, risks and solutions tend to be dominated by technological buzz words. This further contributes to the sense of mystery that surrounds cybersecurity for management and it blurs their perception of the subject. Many Executives struggle to grasp what is really going on and debunking the lingo of the security industry is essential in making them understand what is and what can be at stake.

All in all, it seems fair to say that many financial institutions lack the necessary insights to be able to take informed decisions when it comes to cybersecurity. This is a serious issue and IT leadership should simply not accept this. They need to be able to make well-informed investment decisions that address cybersecurity risks. By doing so, they can engage business sponsors and build understanding, confidence and credibility. In practice, this is largely done in a rather reactive way.

This is in stark contrast to other management areas – such as commercial information – where relevant insights are often just a few clicks away to justify strategic decisions such as entry into new market segments. There's no reason why insights into cybersecurity should not be available at a comparable level. Moreover, such insights are highly significant: a lack of effective cybersecurity may have serious consequences and may even hamper financial institutions in reaching their strategic goals.

A professionalisation of insights is the foundation for applying a risk management approach to dealing with cybersecurity. In essence, cybersecurity means performing a risk assessment from the perspective of the organisation (prevention), identifying and analysing critical assets (detection), and implementing a standby incident response process (response). The success of such an approach, however, is dependent on solid insights.

2. Shifting security from a technological approach to a balanced approach

Most Executives currently consider cybersecurity a technical issue. This clearly implies a lack of attention to the other two pillars of a complete and balanced strategy: people and processes.

Put the user experience – not the technology – at the centre of the cybersecurity approach.

This view is closely interlinked with the fact that cybersecurity is a relatively young issue. In a short period of time, the industry has evolved and introduced a series of concepts, tools and techniques. It may be tempting for Executives to embrace these solutions in order to feel comfortable about the security of their organisation and its digital assets. Everyone can buy security tools, while it is much more challenging to build up a holistic approach.

The reality is that technology is just one part of the equation in the domain of cybersecurity and an isolated technological approach will lead to a false sense of security. In other words, a fool with a tool is still a fool.

Organisations should adopt a more balanced approach. A cybersecurity strategy should be a cost-effective control of the cyber environment, addressing the coherent domains of people, processes and technology. The best way to do so is to put the user experience – not the technology – at the centre of the cybersecurity approach. Cybersecurity is not about tools and technologies; it is about people using those tools and technologies in a user-friendly, natural way. Professionals working in the security domain have a responsibility here: they should not focus solely on the technology. They also need the skills to communicate about the issue in a broader sense in terms of people, processes and technology.

Related to this is the fact that cybersecurity cannot just be the focus of a specialist team. Cyber criminals may use advanced technologies to penetrate an organisation, but may also try social engineering or benefit from careless employees. The level of security depends on the weakest link in the organisation. Therefore, cybersecurity concerns all employees in an organisation. Cybersecurity is an attitude, not a department. To create awareness, the right tone at the top is an effective driver to get more focus on this issue. Executives that "walk the talk" – for instance, by demanding that their mobiles and tablets are secure – have a stronger impact on the rest of the organisation. Executives that do not lead by example might run the risk that the rest of the organisation lowers its security standards.

3. From reactive to predictive – Cybersecurity capabilities must be developed

The main driver for improving cybersecurity is too often unfortunately, the occurrence of an incident. It is a clear sign that for many financial institutions, the cyber strategies are largely reactive. This immaturity may also mean that the organisations focus on the wrong areas: they probably miss upcoming issues and will almost inevitably be overwhelmed by a continuously changing technological landscape.

Closely related to this is that compliance seems to be a dominant factor when it comes to investing in cybersecurity. For many financial institutions, organisations are driven more by compliance than security.

Incidents are unfortunately still the main driver for investment in cybersecurity.

At the same time, most of them leverage compliance to achieve security targets. In practice, the differences between various organisations are huge in this respect. Some organisations are driven solely by a response to incidents. Their reactive investments in the cybersecurity domain are driven by fear. On the other side of the spectrum are organisations that have a lot more self-confidence. By continuously scanning threats and analysing data patterns, they have developed capabilities to predict the character and nature of future events.

The maturity level of financial institutions can roughly be divided into four stages of cyber strategies, ranging from reactive, structured, and integrated to predictive.

To achieve the highest level of maturity – which is key, because the stakes are high – financial institutions must find new ways. They should of course focus on being well informed of possible threats and invest in a proper defence. However, they should not do this in an isolated way, but rather use the knowledge and experience of peers. A joint effort is essential to the maintenance of a high level of intelligence.

Another important aspect is better knowledge management. Insights can be enriched by smart combinations of data from different sources and by combining data with issues from the past. A multidisciplinary approach helps to avoid specialist blindness and brings in the necessary new perspectives to improve predictions of risk areas.

Registered banks – ownership & credit ratings[14]

Registered Banks	Ultimate Shareholding	%	Long-term Credit Rating: Standard & Poor's		Moody's		Fitch Ratings	
ANZ Bank New Zealand Limited	Australia and New Zealand Banking Group Limited	100	AA-	Stable	Aa3	Stable	AA-	Stable
ASB Bank Limited	Commonwealth Bank of Australia	100	AA-	Stable	Aa3	Stable	AA-	Stable
Australia and New Zealand Banking Group Limited – New Zealand Branch[15]	Australia and New Zealand Banking Group Limited	100	AA-	Stable	Aa2	Stable	AA-	Stable
Bank of Baroda (New Zealand) Limited	Bank of Baroda (India)	100					BBB-	Stable
Bank of China (New Zealand) Limited	Bank of China Limited (China)	100			A1	Stable		
Bank of India (New Zealand) Limited	Bank of India (India)	100	BBB-	Stable				
Bank of New Zealand	National Australia Bank Limited	100	AA-	Stable	Aa3	Stable	AA-	Stable
China Construction Bank (New Zealand) Limited	China Construction Bank Corporation	100	A	Stable	A1	Stable		
Citibank, N.A. New Zealand Branch and Associated Banking Group[16]	Citigroup Inc.	100	A	Watch Pos	A1	Stable	A+	Stable
Commonwealth Bank of Australia – New Zealand Branch[17]	Commonwealth Bank of Australia	100	AA-	Stable	Aa2	Stable	AA-	Stable
Deutsche Bank AG, New Zealand Branch[18]	Deutsche Bank AG	100	BBB+	Stable	A2	Negative	A-	Stable
Heartland Bank Limited	Heartland New Zealand Limited	100					BBB	Stable
Industrial and Commercial Bank of China (New Zealand) Limited	Industrial and Commercial Bank of China Limited (ICBC)	100			A1	Stable		
JPMorgan Chase Bank, N.A. New Zealand Branch[19]	JPMorgan Chase & Co.	100	A+	Stable	Aa2	Stable	AA-	Stable
Kiwibank Limited	New Zealand Post Limited/ New Zealand Government	100	A+	Stable	Aa3	Stable	AA	Stable
Kookmin Bank Auckland Branch[20]	KB Financial Group Inc.	100	A	Stable	A1	Stable	A	Stable
Rabobank Nederland New Zealand Banking Group[21, 22]	Coöperatieve Centrale Raiffeisen-Boerenleenbank B.A.	100	A+	Stable	Aa2	Stable	AA-	Stable
Rabobank New Zealand Limited	Coöperatieve Centrale Raiffeisen-Boerenleenbank B.A.	100	A	Stable				
Southland Building Society	Mutual	100					BBB	Positive
The Bank of Tokyo-Mitsubishi UFJ Limited, Auckland Branch[23]	The Bank of Tokyo-Mitsubishi UFJ, Ltd	100	A+	Negative	A1	Stable	A	Stable
The Co-operative Bank Limited	Mutual	100					BBB-	Positive
The Hongkong and Shanghai Banking Corporation Limited, New Zealand Branch[24]	HSBC Holdings plc	100	AA-	Stable	Aa2	Stable	AA-	Stable
TSB Bank Limited	TSB Community Trust	100					A-	Stable
Westpac Banking Corporation – New Zealand Division	Westpac Banking Corporation	100	AA-	Stable	Aa2	Stable	AA-	Stable
Westpac New Zealand Limited	Westpac Banking Corporation	100	AA-	Stable	Aa3	Stable	AA-	Stable

Non-banks credit ratings[14]

	Long-term Credit Rating							
	Standard & Poor's		Fitch Ratings		Moody's		Rating and Investment	
	Rating	Outlook	Rating	Outlook	Rating	Outlook	Rating	Outlook
Avanti Finance Limited	BB	Stable						
BMW Financial Services New Zealand Limited[25]	A+	Stable			A2	Positive		
Credit Union Baywide	BB-	Positive						
Credit Union South	BB-	Stable						
First Credit Union	BB-	Stable						
First Mortgage Trust								
Fisher & Paykel Finance Limited	BB	Watch Dev						
Fuji Xerox Finance Limited[26]							AA	Stable
GE Capital[27]	AA+	Negative			A1	Stable		
Instant Finance Limited								
John Deere Financial Limited[28]					A2	Stable		
Medical Securities Limited	BBB+	Stable						
Mercedes-Benz Financial Services New Zealand Limited[29]	A-	Stable	A-	Stable	A3	Positive		
Motor Trade Finance Limited								
Nelson Building Society			BB+	Stable				
Nissan Financial Services NZ Pty Limited[30]	A-	Stable	BBB+	Stable	A3	Stable	A+	Stable
ORIX New Zealand Limited[31]	A-	Negative	A-	Stable	Baa1	Stable	A+	Stable
Police & Families Credit Union	BB+	Stable						
Ricoh New Zealand Limited[32]	A	Stable					AA-	Stable
The Warehouse Financial Services Limited								
Toyota Finance New Zealand Limited	AA-	Stable			Aa3	Stable		
UDC Finance Limited	AA-	Stable						
Wairarapa Building Society			BB+	Stable				

Non-banks ownership[14]

Non-bank Entity	Ultimate Shareholding	%
Avanti Finance Limited	Various investment/nominee companies	100
BMW Financial Services New Zealand Limited	BMW AG	100
Credit Union Baywide	Various depositors	100
Credit Union South	Various depositors	100
First Credit Union	Various depositors	100
First Mortgage Trust	Various unitholders	100
Fisher & Paykel Finance Group Limited	Haier Group Corporation	100
Fuji Xerox Finance Limited	Fuji Xerox Co. Ltd (Japan)	100
GE Finance and Insurance	IGE USA Investments (UK)	100
GE Commercial Finance NZ	Topaz Holdings LLC (USA)	100
GE Commercial Finance (USD) NZ	Various private shareholders (USA)	100
Instant Finance Limited	Various Private Shareholders	100
John Deere Financial Limited	Deere & Company (USA)	100
Medical Securities Limited	Medical Assurance Society New Zealand Limited	100

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

Descriptions of the credit rating grades

Long-term credit rating grades assigned by Standard & Poor's	Description of the steps in the Standard & Poor's credit rating grades for the rating of the long-term senior unsecured obligations payable in New Zealand, in New Zealand dollars.
AAA	Extremely strong capacity to meet financial commitments. Highest rating.
AA	Very strong capacity to meet financial commitments.
A	Strong capacity to meet financial commitments, but somewhat susceptible to adverse economic conditions and changes in circumstances.
BBB	Adequate capacity to meet financial commitments, but more subject to adverse economic conditions.
BB	Less vulnerable in the near term, but faces major ongoing uncertainties to adverse business, financial and economic conditions.
B	More vulnerable to adverse business, financial and economic conditions, but currently has the capacity to meet financial commitments.
CCC	Currently vulnerable and dependent on favourable business, financial and economic conditions to meet financial commitments.
CC	Currently highly vulnerable. Default has not yet occurred but is expected to be a virtual certainty.
Plus (+) or Minus (-)	The ratings AA to CCC may be modified by the addition of a plus (+) or minus (-) sign to show relative standing with the major rating categories.
BB, B, CCC, and CC	Borrowers rated BB, B, CCC and CC are regarded as having significant speculative characteristics. BB indicates the least degree of speculation and CC the highest. While such borrowers will likely have some quality and protective characteristics, these maybe outweighed by large uncertainties or major exposures to adverse conditions.
Assigned by Moody's Investors Service	Moody's Investors Service appends numerical modifiers 1, 2 and 3 in each generic rating classification from Aa through Caa. The modifier 1 indicates the obligation ranks in the higher end of its generic category; the modifier 2 indicates a mid range ranking; and the modifier 3 indicates the lower end of that generic category.
Assigned by Fitch Ratings	Fitch Ratings applies 'investment grade' rates 'AAA' to 'BBB' to indicate relatively low to moderate credit risk, while those in the 'speculative' or 'non-investment grade' categories which have either signalled a higher level of credit risk or that a default has already occurred, Fitch Ratings applies a 'BB' to 'D' rating. The modifiers '+' or '-' may be appended to a rating to denote relative status within the major rating categories. Credit ratings express risk in relative rank order, which to say they are ordinal measures of credit risk and not predictive of a specific frequency of default or loss.

Definitions

Terms and ratios used in this survey	Definitions used in this survey
Gearing	Net assets divided by total assets.
Gross impaired assets	Includes all impaired assets, restructured assets, assets acquired through the enforcement of security, but excludes past due assets.
Impaired asset expense	The charge to the Profit and Loss Account for bad debts and provisions for doubtful debts, which is net of recoveries (where identifiable).
Interest bearing liabilities	Customer deposits (including accrued interest payable where identifiable), balances with banks, debt securities, subordinated debt and balances with related parties.
Interest earning assets	Cash on hand, money on call and balances with banks, trading and investment securities, net loans and advances (including accrued interest receivable where identifiable), leased assets net of depreciation and balances with related parties.
Interest expense	Includes all forms of interest or returns paid on debt instruments.
Interest margin	Net interest income divided by average interest earning assets.
Interest spread	Difference between the average interest rate on average interest earning assets, and the average interest rate on average interest bearing liabilities.
Loans and advances	Includes loans and advances, lease receivables (net of unearned income) and accrued interest receivable (where identifiable), but excludes amounts due from banks, marketable securities, loans to related parties, sundry debtors and prepayments.
Net assets	Total assets less total liabilities.
Net interest income	Interest income (including net income from acting as a lessor) less interest expense.
Net loans and advances	Loans and advances, net of provision for doubtful debts.
Net profit after tax	After minority interests, adjusting for the impact of subvention payments.
Operating expense	Includes all expenses charged to arrive at net profit before tax (excluding interest expense, impaired asset expense, subvention payments and depreciation of leased assets where a lessor).
Operating income	Net interest income and income from all other sources net of depreciation of leased assets, but excludes subvention receipts.
Past due assets	Includes any asset which has not been operated by the counterparty within its key terms for 90 days and which is not an impaired or restructured asset.
Provision for doubtful debts	Includes both collective and individual provisions for bad and doubtful debts.
Total assets	Excludes goodwill assets (unless specifically defined).
Total liabilities	Includes subordinated debt, but excludes minority interest.
Ultimate shareholding	Identifies the ultimate holding company rather than any intermediate holding companies.
Underlying profit	Operating income less operating expense and impaired asset expense. Items of a non-recurring nature, unrelated to the ongoing operations of the entity, are excluded.

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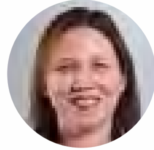

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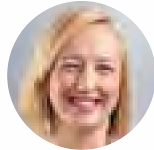

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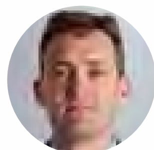

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ISSN 0113-4655

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