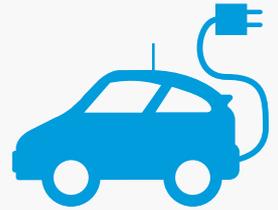
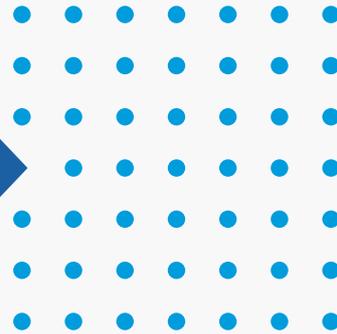


# FIPS

## Non-bank Financial Institutions Performance Survey – Review of 2017

Higher NPAT  
**10.2%**  
growth in NPAT

1



2

Weaker  
net interest margins  
**40bps**  
reduction in NIM

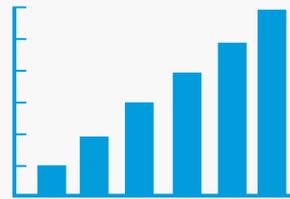


Higher  
net interest income

**4.6%**

rise in net interest income

3



Strong lending growth

**13.92%**

growth in gross lending

4

Steady provisioning

**1.67%**

increase in provisions



5

Greater write-offs  
**36.82%**  
increase in  
impairment expense



6



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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

## Welcome to Part One of the 2017 edition of the Financial Institutions Performance Survey.

Our survey of non-bank financial institutions captures the financial performance of entities with annual balance dates between 1 October 2016 and 30 September 2017. The threshold for inclusion in this year's survey has remained unchanged at total assets of \$75 million in one of the last two years.

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

The non-bank sector comprises a total of 25 survey participants this year following the inclusion of four new companies and the departure of EFN (New Zealand) Limited and Fisher & Paykel Finance Holdings Limited.

It was noted last year that the sale of Fisher & Paykel Finance Holdings Limited to Flexi Group (rebranded as Flexi Cards Limited) will have an impact going forward because of the effect of the unbundling, and, as a result, is no longer included in the survey. EFN (New Zealand) Limited has requested to be excluded from the survey this year after we welcomed them for the first time last year following the sale and disbanding of GE Capital.

Regarding the four new participants, we welcome Branded Financial Services (NZ) Limited, Christian Savings Incorporated, Turners Automotive Group and Geneva Finance Limited to this year's publication. We have included prior year figures for these entities in order to preserve consistency and comparability between reporting periods.

It should be noted that following the accounting restatements at Fuji Xerox Finance Limited, we have made an exception to our usual policy and have utilised the restated comparative figures in this year's publication so as to achieve better year-on-year consistency and comparability in the survey results.

The reader would do well to recall that the non-bank sector includes a diverse mix of credit unions, non-bank deposit takers ('NBDTs') and finance companies, with the latter operating in the motor vehicle, consumer, personal, commercial and mortgage sub-sectors.

**We must acknowledge and thank the survey participants (CEOs and CFOs) for their continued and valuable contributions, which included making the time to meet with us and discuss the various developments taking place within the industry.**

**TABLE 1: MOVEMENTS**

	Who's out	Who's in
<b>Non-banks: 25</b>	<ul style="list-style-type: none"> <li>— EFN (New Zealand) Limited</li> <li>— Fisher and Paykel Finance Holdings Limited</li> </ul>	<ul style="list-style-type: none"> <li>— Branded Financial Services (NZ) Limited</li> <li>— Christian Savings Incorporated</li> <li>— Turners Automotive Group</li> <li>— Geneva Finance Limited</li> </ul>



# Sector – Themes and Issues



**John Kensington**  
Partner – Audit  
Head of Banking and Finance  
KPMG

John has been with KPMG's Financial Services audit team for over 30 years, 19 of these as a partner working with a wide range of financial services audit clients, specialising in banks and finance companies.

John has a wealth of experience in auditing and accounting for banking products and services including treasury, retail offerings, corporate loans and loan provisioning. He is currently Head of KPMG's Banking and Finance team and editor of this publication. John is also Deputy Chairman of the New Zealand Auditing and Assurance Standards Board (NZAuASB) and serves as a board member of the XRB. John is also a member of CA ANZ and the Institute of Directors.

In 2017, the non-banks in the survey continued to perform well in their niche segments. Most survey participants have experienced stronger loan book growth in percentage terms than their banking competitors. It does appear as though the bank 'black box' has shrunk, which seems to have resulted in less competition from banks reaching into the non-banks' niche segments, and also some non-banks seeing business normally transacted by the banks.

A number of key themes were noted in the conversations we had with survey participants. These themes are discussed in detail below.

**The contraction of the banking 'black box' is likely due to banks focussing on several pressures within their own sector.**

## Lending growth and mix

Within the last 18-24 months, the non-bank sector has seen strong growth in its loan book. It appears non-banks have been capitalising on their banking counterparts' 'risk-off' attitudes. This has been observed in the Reserve Bank of New Zealand's ('RBNZ's') sector data on non-bank mortgage lending, which has increased from \$1.53 billion in September 2015 to \$2.05 billion in September 2017 as shown in [Figure 1](#). Personal lending continues to grow for the non-bank sector as the economic environment remains strong with low inflation, a low unemployment rate and a strong housing market helping bolster consumers' confidence. Business lending has remained relatively stable. A number of participants told us that they are seeing and declining more applications than ever before as there is no shortage of applications.

1

**SEE FIGURE 1 – PAGE 9**

## Smaller banking 'black box'

The aforementioned contraction of the banking 'black box' is likely due to banks focussing on several pressures within their own sector, which have led to banks lowering their risk appetites. Key pressures on the New Zealand banking sector are those that arise from the Loan-to-Value Ratio ('LVR') restrictions on mortgage lending and the knock-on pressure on funding availability as a result of higher regulatory capital requirements affecting the big four Australian-owned banks through the amendments to Australian Prudential Standard ('APS') 110 *Capital Adequacy*. Some participants noted that they have capitalised on the 'risk-off' attitude of the banks by lending on the perimeter of the smaller bank 'black-box' where traditionally the banks also have lent,

but are now saying 'no' to a large number of deals. Survey participants also made mention of the fact that some customers in this sector are just not 'bankable' due to not fitting all the elements of the 'black-box', or just have an 'anti-bank' view, so turn to the non-bank alternative instead. Sometimes this is a lifetime call, but for others it is just until they can make themselves bank attractive.

### Funding challenges

Many participants mentioned that the availability of low cost funding appears to be reducing. Participants noted that, in some instances, interest rates have increased or restrictive covenants have been included which dictate where the funds can and cannot be lent and whether funds can be lent to controlled securitisation vehicles or not. In addition, in some instances, a reduction in the facility size has been applied. A rise in interest rates probably does not come as a surprise given the inflationary pressures across the globe and in New Zealand. The combination of these cost pressures weighing down on wholesale funding and many participants' inability to access the wholesale sector directly makes it appear as though the liquid cash of retail depositors will be the kingmaker as far as funding is concerned, as it is easier to attract in the current low-yield environment. Nevertheless, a deposit war is unlikely to appeal to either the banks or NBDTs. Many participants noted that the historic love affair with looking after the borrower may be ending and it may be the depositors that now start to 'feel the love'.

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**Many participants mentioned that the availability of low cost funding appears to be reducing.**

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### Robust credit quality

In spite of the generally strong demand for loans and the empirical data which shows growth in gross loans and advances of 13.92% (2016: 13.70%) or \$1.08 billion (2016: \$1.06 billion) this year in the non-banks' sector, impairment losses and provisioning do not appear to have suffered; in fact, impairment losses and provisioning still appear to be close to cyclical lows. However, some survey participants have seen a slight uptick in past-due assets and an increase in the costs and time required to bring these loans under control; these factors may well be the lead indicators of an increase in impairment losses and provisioning approaching in the near future.

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**Impairment losses and provisioning still appear to be close to cyclical lows.**

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### Margins, fees and 'Peer-to-Peer' lending

Non-banks' margins seem to be pressed from both ends, with the funding-side interest rate pressures noted above, and a competitive lending market reducing the ability of lenders to pass on the funding rate increases to their customers. This is apparent in the reduction in the sector interest margin by 40 basis points ('bps') to 5.58 (see [Table 11](#) on page 31).

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**A few survey participants noted that they have detected an increase in the presence of brokers in the market.**

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A few survey participants noted that they have detected an increase in the presence of brokers in the market. Brokers seem to be bringing increasing number of borrowers to the door who have been declined by a previous lender. Some participants noted that a few of these brokers are charging fees which are high and if similar fees were charged by lenders as an establishment fee under the Credit Contracts and Consumer Finance Act ('CCCFA'), those lenders would fall foul of the CCCFA.

Although most of the P2P lenders operate tech savvy front-end platforms and appear to have the back-end support of robust credit risk analysis models, this does not appear to have translated into significant profits for most lenders. At present, the scale of wholesale funding received by some P2P lenders does appear to beg the question of whether these lenders are acting as *brokers*, albeit with a stylish shop front, rather than connecting retail peers. The P2P model was predicated on two things- a tech savvy speedy front-end, an area they have delivered on, and a sharing of the margin. The jury is still out on the second aspect and whether it is being achieved.

### Fintech, innovation and millennial minds

Fintech was, yet again, a topic of conversation this year and not only in conversations with P2P lenders. Many survey participants remarked on the effect of technology and the need to continue to innovate to keep up with changing customer expectations – or even just to remain *relevant*. It seems clear that the profile of the customer of tomorrow – one that might shun the tired and lengthy paper-based application process in favour of instant digital interactions – has to be kept top of mind.

Other participants felt that some participants have taken the “app interaction” too far and there is a group of customers that would use an app until they felt ignored or let down by a “bad” automated app. The rapid growth and evolution of the sharing economy, as reflected in Uber and Airbnb, will continue to test the traditional models and products offered by financial institutions. Fintech, innovation and the mind of the millennial are discussed in more detail later on in this publication.

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**Many survey participants remarked on the effect of technology and the need to continue to innovate to keep up.**

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## Economic uncertainty and confidence

Some survey participants noted with concern that some trends in the market, such as strong demand for loans, the overall level of indebtedness of borrowers and an early indicator of credit quality issues (an increase in past dues) around seemingly sub-prime lending, appear to be similar to those trends which were observed in 2007 – i.e. in the period immediately prior to the global financial crisis ('GFC').

If one was to look through a broader macroeconomic lens, the New Zealand economy does appear to be feeling somewhat gloomy in some areas. This (possibly temporary) gloominess is reflected in the recent negative reading on the business confidence index. The ANZ Business Confidence Index declined to -39 in November 2017, down from a reading of -10.1 in October 2017, 0.0 in September 2017 and +21 in November 2016.<sup>1,2,3</sup>

In some pockets such as construction, property development and residential property prices, it seems as though growth and/or prices seem to have either slowed down or reversed, nowhere more observed than in Auckland. However, export-led industries such as commodities remain relatively solid and are poised to benefit further from the recent NZD currency weakness.

The lead up to, and the outcome of the election has also led to a feeling of uncertainty. There are mixed views in the business sector around the various impacts the new coalition government may have, particularly around immigration, government spending and increases in lower decile incomes through changes to minimum wages and student allowances.

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**The lead up to, and the outcome of the election has also led to a feeling of uncertainty.**

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## Looking towards the future

The sector is gazing into its crystal ball and trying to determine what the customer of tomorrow expects and values in relation to financial products, tools and platforms. As discussed later in this publication, the infectious influence of millennial minds and preferences is being felt everywhere. Lexicon such as 'Crowd-funding', 'Artificial Intelligence', the 'sharing economy', 'cloud-computing' and the 'Internet of Things' has infiltrated our current daily lives through products and services such as Uber and Google Drive in a relatively short space of time. *How the next Fintech wave will come about and by whom the next buzz tool will be developed were other questions that survey participants pondered this year.*

Partnerships with tech-savvy specialists and the development of innovation centres may be a solution to the latter question, as entities individually lack the capabilities, time or expertise to develop these new ways of doing business on their own.

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***How the next Fintech wave will come about and by whom the next buzz tool will be developed were other questions.***

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## Digitisation and innovation

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***Digital interactions are de rigueur.***

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The ability of all firms in the finance and savings institutions space to innovate is crucial for their survival. Digital interactions are *de rigueur*. This trend and other themes, such as AI, machine learning and hyper-personalisation, are influenced, at least in part, by a customer-centric, millennial-serving approach which financial services companies are not-so-gently being urged to embrace to stay competitive. Further, one should recall that while the term 'millennial' is commonplace when describing current-day customer experience standards of 16 – 35 year olds, millennials' expectations and behaviours have been largely adopted by most other generations and is now seen more in a way of thinking.

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***Millennials' expectations and behaviours have been largely adopted by most other generations.***

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Non-bank financial institutions traditionally hold strong positions in the personal loans market and do benefit from Generation Y's 'You-Only-Live-Once' and 'Fear-of-Missing Out' mantras. Instant, uncomplicated finance (which equates to instant satisfaction) for discretionary goods and services (whether that means the next smartphone or a luxury trip to the other end of the world) provided to demanding, time-poor customers has a clear appeal.

**These companies often fill the gap just outside the banking 'black box' where would-be individual and business borrowers have been shunted.**

Non-bank financial institutions have also habitually been the places start-up entrepreneurs turn to for financing. These companies often fill the gap just outside the banking 'black box' where would-be individual and business borrowers have been shunted to due to poor credit history, a lack of, or volatile, financial history, low deposits or inadequate security. Banks' 'risk-off' attitudes, which are reflected in the focus on quality lending and the progressively more severe LVR restrictions, is clearly the space where non-bank finance companies have the ability to capitalise upon; however, in reality, we have only seen limited uptake in this area.

**A solid understanding of the customer of today – and the customer of the future – is unmistakably required to ensure that product and technological innovations which are developed or bought are *relevant*.**

## The Gen Y Ten Commandments

1. I want my day-to-day transactions to be seamless and effortless.
2. I'll only go to a branch for something big or to resolve a problem.
3. I would change banks if it was easier.
4. I want to be rewarded for being a loyal customer.
5. I want services that are tailored to my needs.
6. I want access to assets without the hassle of ownership.
7. I want my bank to support my entrepreneurial ambitions.
8. I want to manage my money better.
9. I want to believe that I have the best deal.
10. I would bank with tech giants if they provide better products.

SOURCE: 'BANKING ON THE FUTURE', KPMG AUSTRALIA<sup>4</sup>

Non-bank financial institutions would be well advised to keep customer centricity top of mind. A solid understanding of the customer of today – and the customer of the future – is unmistakably required to ensure that product and technological innovations which are developed or bought are *relevant*. The identity of the customer and customers' expectations and needs need to be understood and are likely to be quite different across the non-banking space and will depend on the financier's particular niche – whether that niche is vehicle, equipment or other asset-backed financing, personal loans, mortgage loans, or others.

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**When it comes to bigger financial decisions such as applying for a mortgage, many people still want to have face-to-face conversations.**

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When it comes to bigger financial decisions such as applying for a mortgage, buying insurance or dealing with complaints, many people still want to have face-to-face conversations. This is an area where an innovative tool or platform could step in and lower the perceived trade-off between the speed and impersonal nature of a fully digital application process and the reassurance and comfort that can be found in a good customer service relationship.

## Economic and Regulatory Environment

### House prices and the wealth effect

Housing affordability, especially in Auckland, is often a topic of debate as we saw in the recent election campaigns and coalition talks. In October, Stats NZ released an informative and insightful publication entitled *Household income and housing-cost statistics: Year ended June 2017*.<sup>5</sup>

This report revealed that average annual household income from all regular sources increased by 42% over the 10 year period to end June 2017, while average weekly housing costs surged ahead at a greater rate of 52% over the same period.

Conversely, the picture was rosier for households over the year to end June 2017; in that period average annual personal income increased by 7.7%, while average annual housing costs declined by 3.0%. Housing costs as a percentage of household income also reduced from an average rate of 17.3% in the year ended June 2016 to an average rate of 16.4% in the year ended June 2017.

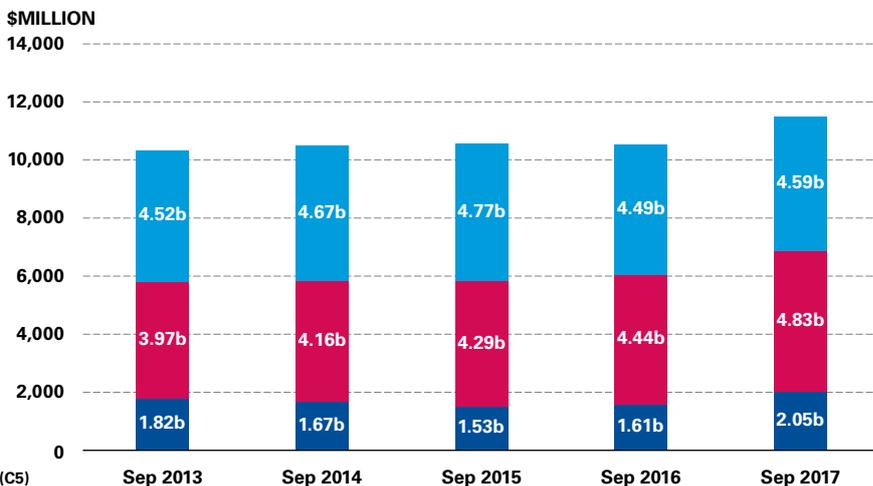
S&P, the global credit ratings firm, issued an update on New Zealand's banking sector in September. This report provided some pertinent reflections on the broader economy and also specifically addressed matters relevant to non-bank home lenders. In its report S&P focussed on the property market, and said, "Given the current environment, we're of the view that there still needs to be some cool down in these factors to take it to the next level."<sup>6</sup>

On 29 November 2017, the RBNZ released its semi-annual Financial Stability Report ('FSR'). In this report, the RBNZ stated that the financial system in New Zealand is still on a steady footing and that, although the financial system remains exposed to a number of risks, these risks have reduced over the past six months. The regulatory body noted that the key risks affecting the financial system are: housing market vulnerabilities, dairy sector indebtedness and the banking system's exposure to volatility in international funding markets. It also performed a 'Policy Assessment' in relation to the LVR restrictions imposed and opted to (with effect from 1 January 2018) loosen these restrictions somewhat by increasing the percentage of each bank's new mortgage lending to owner occupiers at LVRs in excess of 80% from 10% to 15% and allowing each bank to lend 5% of all new mortgage lending at a higher LVR of 65% (currently 60%) to investors. On this point, the FSR noted that "LVR restrictions will be adjusted gradually over time, provided that financial stability risks remain contained. Gradual adjustment to policy will reduce the risk of resurgence in the housing market and a deterioration in lending standards."<sup>9</sup>

House price inflation has predominately been Auckland-driven in the past few years, with other regions, especially Tauranga and Wellington, picking up in the last year or so, reflecting net migration inflow and demand that exceeds supply. Whether the high net migration figures we have observed over the past few years will continue is questionable given the policies discussed during the election of the parties in the Labour-led coalition government.

### 1 NON-BANK SECTOR LENDING

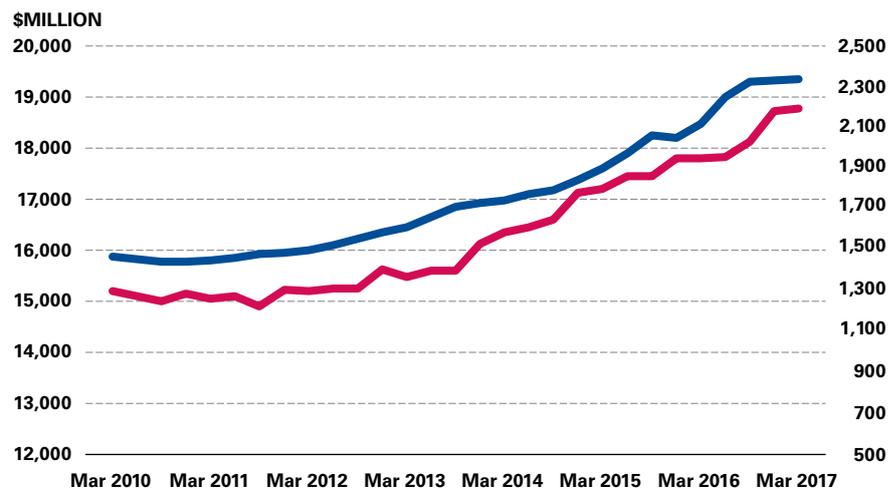
- HOUSING – NON-BANKS
- PERSONAL – NON-BANKS
- BUSINESS – NON-BANKS



SOURCE: RESERVE BANK OF NEW ZEALAND STATISTICS (C5)

### 2 PERSONAL LOANS VS HPI FOR HOUSES INDEX

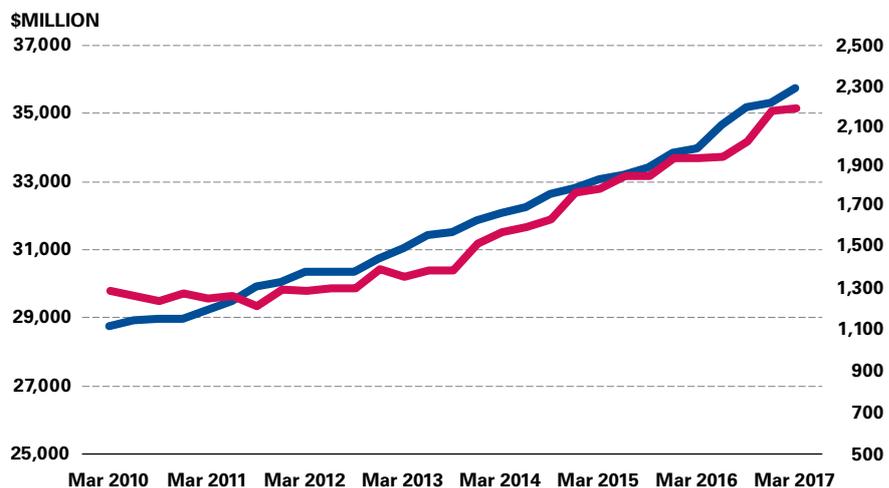
- PERSONAL CONSUMER LOANS + SEASONALLY ADJUSTED CREDIT CARD SPENDING (LHS)
- HPI FOR HOUSES, INDEX (RHS)



SOURCE: RESERVE BANK OF NEW ZEALAND STATISTICS (C5, C13 & KEY GRAPH DATA)

### 3 PRIVATE CONSUMPTION VS HPI FOR HOUSES INDEX

- PRIVATE CONSUMPTION (LHS)
- HPI FOR HOUSES, INDEX (RHS)



SOURCE: RESERVE BANK OF NEW ZEALAND STATISTICS (M5 & KEY GRAPH DATA)

In its published immigration policy statement, the Labour Party alludes to the fact that the party will continue to welcome migrants to the country, but has noted with concern that the apparent level of investment in housing, other infrastructure and public services has not kept pace with the migration level. The Labour Party stated that these changes have “contributed to the housing crisis, put pressure on hospitals and schools, and added to the congestion on roads.”<sup>7</sup>

It remains to be seen whether any future legislative change which curbs migration figures would result in a decrease in inflationary pressures in a market that already appears to be cooling somewhat due to various other reasons (based on sales volumes and days to sell).<sup>8</sup> Further reforms that directly affect the housing situation are likely if the Labour Party’s policies to increase supply and moderate demand-side price pressures from foreign and tax speculators’ activities are put in place.<sup>7</sup>

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### **Some economists support the idea that rising house prices influence private consumption through a mechanism called the ‘wealth effect’.**

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Economic studies often comment on the effect of rising house prices on private consumption. Some economists support the idea that rising house prices influence private consumption through a mechanism called the ‘wealth effect’. Economists that subscribe to this school of thought claim that there is a direct correlation between house prices and private consumption, i.e. rising house prices make homeowners *feel* wealthier which causes homeowners to spend more on private consumption.

Similarly, homeowners may be more inclined to borrow against the equity of their house in times of rising house prices. This additional credit could be used to fund renovations, a new car or discretionary spending on goods, services or experiences such as luxury holidays.<sup>10, 11</sup>

House prices may also have an impact on residential investment activity, provided, however, that house prices increase at a slower rate than the cost of constructing new homes. Further, these new homes would need to be furnished and equipped with durable goods, and, thus, there may also be an additional surge in private consumption.

The increases in private consumption and residential investment mentioned above would result in an increase in GDP because these two factors are key determinants of GDP. Increases in private consumption would need to be funded; funding could be in the form of homeowners’ liquid cash reserves, credit card spending or personal loans.

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### **It does appear as though the ‘wealth effect’ has been felt in New Zealand.**

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It does appear as though the ‘wealth effect’ has been felt in New Zealand. For example, as shown in [Figure 2](#), if the empirical data of personal loans plus seasonally adjusted credit card spending is plotted against the house price index (HPI), it does appear as if there is a positive correlation between house prices and personal loans (whether on credit cards or through personal loans).<sup>12</sup> The same is true when the private consumption component of GDP is plotted against the HPI.<sup>13</sup> This is shown in [Figure 3](#).

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### **3 SEE FIGURE 3 – PAGE 9**

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**The opposite effect is also potentially true – i.e. if house prices were to decrease by a substantial amount on a widespread basis, private consumption and residential investment (and, thus, GDP) would probably decrease too.**

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The opposite effect is also potentially true – i.e. if house prices were to decrease by a substantial amount on a widespread basis, private consumption and residential investment (and, thus, GDP) would probably decrease too. It remains to be seen whether this converse effect will actually be observed should the market slow down significantly and should prices start reversing.

### **NZ competitiveness in the global economy**

The *Global Competitiveness Report 2017–2018*, which is published annually by the World Economic Forum, was released in September 2017. New Zealand’s comparative advantages over other economies – and, arguably, the country’s ability to ‘punch above its weight’ – were clearly reflected in the country’s ranking at 13th of 137 countries.<sup>14</sup>

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**New Zealand’s comparative advantages over other economies – and, arguably, the country’s ability to ‘punch above its weight’ – were clearly reflected in the country’s ranking at 13<sup>th</sup> of 137 countries.**

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### **2 SEE FIGURE 2 – PAGE 9**

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Areas where New Zealand was praised through high rankings within the 'Top 10' of the surveyed countries were: 'Financial market development' (1<sup>st</sup> place), 'Institutions' (3<sup>rd</sup> place), 'Labour market efficiency' (5<sup>th</sup> place), 'Health and primary education' (6<sup>th</sup> place), 'Higher Education and training' (7<sup>th</sup> place) and 'Goods market efficiency' (9<sup>th</sup> place).

Within these broad 'pillars', the global organisation complimented the country on its particular areas of financial strength, being 'Ease of access to loans' and 'Soundness of banks'. The study put a feather in the Commerce Commission's cap by praising the 'Effectiveness of the anti-monopoly policy', and also appeared to approve of the certain government policies which are reflected in the high rankings of the ease of starting a business, the 'Diversion of public funds' and the 'Transparency of government policy making'.

Businesses' policies and structures, such as the 'Ethical behaviour of firms', the 'Efficacy of corporate boards' and 'Strength of investor protection' (which is likely due to a mix between regulation and business policy), were also lauded.

Nevertheless, key issues in what could be termed 'forward-looking' areas were also noted. Aside from the low ranking in the 'Market size' pillar (64<sup>th</sup>), which is not unexpected given the land area and population size of the country, additional pillars where New Zealand earned comparatively low rankings were: 'Infrastructure' (23<sup>rd</sup>), 'Business sophistication' (24<sup>th</sup>) and 'Innovation' (20<sup>th</sup>). It should be noted that these are still in the top 17%.

The survey also separately highlighted the 'Most problematic factors for doing business'. Of these concerns, at least two of the top five concerns (those two concerns being the 'Insufficient capacity to innovate' and the limitations on the 'Access to financing') might have a direct and discernible effect on, and be reflective of, amongst others, the non-bank sector. The remaining three matters in the top five of the list of concerns were: an 'Inadequate supply of infrastructure', the 'Inefficient government bureaucracy' and an 'Inadequately educated workforce'.

The ability of business leaders and the government to deal with these problems, which, admittedly, are not easily solved – and, moreover, the ability of the powers that be to deal with each of the issues separately without exacerbating the other issues – remains to be seen.

## Regulation

There has been very little movement in the regulatory arena for non-banks over the last twelve months.

Despite signalling at the conclusion of its regulatory stocktake on NBDT (in December 2015) that it would continue to work with the sector to address a number of prudential areas that required further work (for example, undertaking a capital review and clarifying aspects of the liquidity and risk management requirements), we are yet to see the RBNZ progress this. This is perhaps not surprising given the focus of RBNZ resource to the International Monetary Fund ('IMF') visit and reporting in 2016/17 and other large-scale projects in the registered banks arena.

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**There has been very little movement in the regulatory arena for non-banks over the last twelve months.**

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## — Capital Review

However, we understand that a review of the capital requirements for NBDTs is still on the cards. The RBNZ has previously stated that following the Capital Review for registered banks, which is currently underway, a review of capital requirements for NBDTs would also take place. The NBDT sector may welcome this review as there are concerns amongst the sector around the perceived arbitrary minimum capital requirements set for NBDTs. One area of review that will be of focus for NBDTs will be the potential changes to the standardised approach to credit risk for banks as globally the Basel Committee on Banking Supervision ('BCBS') is proposing a number of changes to this standard, for example removing the reliance on credit ratings. The RBNZ has not yet consulted on this area in its Capital Review, but it will be a point to watch for the non-bank sector given the similarities between the standardised approach and the NBDT capital requirements.

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**We understand that a review of the capital requirements for NBDTs is still on the cards.**

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## — Financial Services Legislation Amendment Bill

And on a positive note for the sector, the former Minister for Commerce and Consumer Affairs, Jacqui Dean, confirmed in August 2017 that the Financial Services Legislation Amendment Bill will be exempting consumer credit contract providers that already fall under the CCCFA from the legislation. The new Bill will require financial advisers to put the interests of their clients first, amongst other amendments. This is welcome news to providers as consumer protection requirements are already in place under the CCCFA.

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## The Financial Services Legislation Amendment Bill will be exempting consumer credit contract providers that already fall under the Credit Contracts and Consumer Finance Act.

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### — AML/CFT Compliance

Turning to Anti Money Laundering and Countering Financing Terrorism (AML/CFT) compliance, in April, the RBNZ issued a Sector Risk Assessment paper in which it noted that the overall inherent money laundering ('ML') risk rating for non-bank deposit-taking institutions was 'Medium', compared to the 'High' rating assigned to banks. Within the non-banks sector, the ratings assigned to building societies, co-operatives and credit unions was set at 'Medium', while the risk attached to non-bank deposit taking finance companies was assessed as 'Low'.<sup>15</sup>

The RBNZ attributed the disparity to the difference between banks and non-banks' business models. The regulator stated that "deposit taking finance companies recognises that they do not typically have the cash intensive products and services that other sub-sectors may have, but they do have a reasonable level of transactions by value and volume".

Building societies and cooperatives however operate a similar model to registered banks hence were assigned a 'Medium' risk rating, although transactions are rated as a lower ML risk due to their domestic/regional focus. While credit unions are also domestically focussed, they are exposed to domestic ML/Financing Terrorism risks and high risk customers, and, in some instances, operate at similar or higher volumes of transactions like a small bank.

Even though this report was not particularly damning, AML/CFT compliance is clearly a space where constant vigilance is required. Another question that should be piquing interest is, with the digital revolution, is it really possible to perform effective so-called 'know-your-customer' ('KYC') procedures and jump through all the AML/CFT hoops if the customer is effectively embodied in a few taps and keystrokes and you never meet them in person?

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### Regulation is forcing those lenders who already lend 'responsibly' to document more, but is doing little to nothing to prevent the proliferation of seemingly irresponsible 'truck-stop'/'payday' lending.

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#### — 'Payday' lenders

A hot topic for survey participants this year was 'responsible' lending. Most participants take the view that the 'blanket' approach to regulation is forcing those lenders who already lend 'responsibly' to document how they do it, but is doing little to nothing to prevent the proliferation of seemingly irresponsible 'truck-shop'/'payday' lending at excessively high rates such as 2% a day or over 700% per annum. Many participants questioned how some lenders can truly understand and know their customers as envisaged under the responsible lending regulations when the timeframe from application to approval is as short as between 60 seconds and 20 minutes. The new Commerce and Consumer Affairs Minister, Hon. Kris Faafoi appears to be supportive of fee and interest rate caps similar to those that are currently in effect in Australia and the United Kingdom, where the former has capped the establishment fee at 20% and monthly interest at 4% and the latter has capped interest rates per day at 0.8%.<sup>16, 17</sup>

Another option could be to adopt a 'credit sense' model, as done in Australia, where a data base is maintained of all pay day loans and onus is then placed on the lender to enter all loans onto the system, and then for lenders to not provide a second or subsequent pay day loan to a borrower within 90 days.

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### Commerce and Consumer Affairs Minister, Hon. Kris Faafoi appears to be supportive of fee and interest rate caps.

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## Accounting changes just around the corner

### — NZ IFRS 9 *Financial Instruments*

One of the first impacts of the upcoming suite of accounting changes, with an effective date of years beginning on or after 1 January 2018, is NZ IFRS 9 *Financial Instruments* ('IFRS 9'), and it is approaching rapidly, being only a year away for some institutions. While at first glance one may think that the effects of IFRS 9 on non-bank financial institutions may be more muted given the non-banks' smaller loan books compared to the traditional banks, this is not necessarily the case. Even though smaller loan books may be seen as easier to control given the perceived closer relationship with borrowers, the technical complexities arising from implementing the forward-looking requirements around impairment will require a high level of management judgement. The impact of IFRS 9 is discussed in detail in an article by KPMG's technical accounting specialists which is found later on in this document.

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**The technical complexities arising from implementing the forward-looking requirements around impairment will require a high level of management judgement.**

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— **NZ IFRS 15 Revenue from Contracts with Customers and NZ IFRS 16 Leases**

The effective dates of the new revenue (NZ IFRS 15) and leasing (NZ IFRS 16) standards are fast approaching on 1 January 2018 and 1 January 2019, respectively. NZ IFRS 15 is expected to have minimal impact on non-bank financial institutions; however, they will still need to consider any special features in their standard loan and deposit transactions as the devil in the detail could create unforeseen complexity. NZ IFRS 16 may have a moderate to significant impact depending on the particular industry the financial institution is in, both on their financial statements and the products they offer.

**NZ IFRS 16**

NZ IFRS 16 requires lessees to account for almost all leases 'on-balance sheet'. This change will have a significant impact on businesses in particular industries, especially those operating in the aviation and retail industries. Exemptions are, however, allowed for short-term leases and leases of low value assets.

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**NZ IFRS 16 requires lessees to account for almost all leases 'on-balance sheet'.**

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While the potential impact on the primary statements of lessees may be substantial, on the face of it, financial reporting implications for lessors are less strenuous. As stated in par. IN14 of NZ IFRS 16, "NZ IFRS 16 substantially carries forward the lessor accounting requirements in NZ IAS 17. Accordingly, a lessor continues to classify its leases as operating leases or finance leases, and to account for those two types of leases differently." Whilst the impacts on lessor's are relatively minor, lessors should carefully consider the impact of the new standard to ensure they capture even the smaller impacts of NZ IFRS 16.

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**From a commercial perspective, however, the new standard may prompt some non-bank finance companies to innovate their products.**

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From a commercial perspective, however, the new standard may prompt some non-bank finance companies to innovate their products based on the response of lessees to this new standard, who perhaps may prefer to minimise or avoid the balance sheet effects (and resulting effects on key financial ratios and compliance with covenants as explained above), where possible. What forms these may take are yet to be seen; however, we expect those that are proactive in this innovation may benefit from being first to market with these new products.



# Sector – Timeline of events<sup>19</sup>

## Jan. 2017

11th

ANZ announces sale of UDC Finance to China's HNA Group for \$660 million, pending regulatory approval.

S&P downgrades UDC to BBB following its sale to the unrated HNA Group.

26th

Turners to sell \$150 million of its loans to investors.

## Feb. 2017

7th

RBNZ Governor Graeme Wheeler is not seeking another term, acting Governor appointed.

19th

Harmony launches in Australia with A\$200 million to lend.

## Apr. 2017

7th

The RBNZ updates its assessment of money laundering and terrorism financing risks.

## May. 2017

4th

Cabinet agrees to a new legislative framework that will improve regulation of payment systems and other Financial Market Infrastructures.

24th

Napier loan company Cash to You Loans Limited has been banned indefinitely from operating as a lender, after charging borrowers unreasonable fees and excess interest.

31st

New Zealand's financial system remains sound and the risks facing the system have reduced in the past six months, RBNZ Governor Graeme Wheeler said today when releasing the RBNZ's May Financial Stability Report.

## Jun. 2017

8th

The RBNZ releases consultation paper on debt to income limits.

21st

Latitude Financial Services announces Adrienne Duarte as its new Chief Financial Officer ('CFO').

30th

Commerce Commission releases its "Consumer Credit Fees Guidelines," to help provide guidance for lenders in setting credit fees.

## Jul. 2017

6th

Peer-to-peer lender LendMe changes its name to Zagga and launches in Australia.

19th

In a speech, the Head of Prudential Supervision at the RBNZ said, "In the long-term, digital disruption of the banking sector may improve the efficiency of the financial system."

24th

The Warehouse agrees to sell its financial services business to SBS Bank.

## Aug. 2017

7th

FlexiGroup launches new product aimed at millennials.

9th

Asset milestone of \$300 million for NZCU Baywide.

14th

Auckland truck shop Zee Shop Limited ('Zee Shop') is fined \$108,000 for providing contracts which included "incomprehensible" clauses.

**18th**

Truck shop operator Macful International Limited (trading as Ezitruck Shopping), is fined \$126,000 after failing to adequately disclose key information in consumer contracts and register as a financial services provider.

**26th**

Commerce Commission files High Court case against Harmony regarding the lender's platform fees.

**29th**

The RBNZ appoints Sean Mills as Assistant Governor and Head of Operations.

**Sep. 2017****11th**

PledgeMe announces plans of expansion into Australia as equity crowdfunding regulatory conditions improve.

**13th**

Turners Automotive Group announces its intention to raise \$30 million through new shares to fund future growth.

**Oct. 2017****25th**

Commerce Commission warns of industry wide implications that could arise from its suit against Harmony.

**Nov. 2017****2nd**

New passenger car sales peaked at an all-time high of 11,114 sold for the month of October.

**14th**

Geneva Finance debt collection subsidiary, Stellar Collections acquired software-based b2b debt collection operation MFL Services in an effort to enhance operations and introduce a point of difference in the market.

**20th**

Motor Trade Finance (rebranded as 'MTF') dropped the reference to vehicles in an effort to encourage broader asset lending.

**27th**

FMA publishes first peer-to-peer/crowdfunding statistical returns.

**29th**

S&P expect to lower UDC credit rating through its sale to China's HNA Group, affirming a negative outlook.

RBNZ set to ease LVR restrictions from 1 January 2018.

RBNZ releases the November Financial Stability Report as momentum in the global economy has continued to build over the past six months, reducing near-term risks to financial stability.

**Dec. 2017****5th**

The number of house sales in Auckland fell 20% on the year in November and prices remained subdued as inventory levels continue to push higher.

**6th**

New Zealand's burgeoning fintech sector is coming of age with the likes of the RBNZ thinking more deeply about the impact changing technology will have on the broader financial system.

# New Zealand declares war on multinational financing arrangements



## Bruce Bernacchi

Partner – Taxation  
KPMG

Bruce has over 20 years' experience as a taxation professional. He re-joined KPMG in 2016 (where he spent the first seven years of his career), having previously been a partner in one of NZ's major law firms and following a 10 year career as a senior tax executive with GE. Bruce's career at GE included seven years as treasury tax counsel for GE's operations across Asia Pacific, primarily focussed on GE's financial services arm, GE Capital.

Bruce is a member of KPMG's Deal Advisory Tax practice in New Zealand. He has undertaken tax due diligence and advised on acquisition structuring for a number of foreign entities (including both corporate and investment fund clients). Bruce is also a specialist in advising foreign multinationals on the pricing of their intercompany loans into New Zealand, to ensure that their loan pricing is undertaken on an arm's length basis.



## Jordan Taylor

Senior Manager – Taxation  
KPMG

Jordan is a member of KPMG's transfer pricing and international tax practice in New Zealand. He has undertaken structuring advice and dispute resolution projects for a number of foreign multinationals in relation to the pricing of interest rates in their inter-company loans.

Jordan previously worked as a credit analyst in the BNZ Institutional banking team assisting with the debt requirements for a number of New Zealand and foreign owned multinationals. Jordan has also spent time at KPMG London providing international tax and transfer pricing advice to multinationals in relation to their cross-border financing requirements.

## The winds of war

Those of us who thought the crackdown on multinationals was something viewed only on our laptops and iPhones involving belligerents in faraway jurisdictions like the US and Europe, will be interested to learn that New Zealand is now joining the fray. During the election campaign both Labour and National were clear on that they would be tightening up on the perceived avoidance of taxes by multinational companies operating in New Zealand. Now a Government has been formed, the time for talking has ended and implementation of these plans is proceeding.

Squarely in the firing line is the amount of interest that multinational can charge on intercompany loans to their NZ operations.

After the release of discussion papers in February and September this year and followed by a period of consultation, where a number of stakeholders raised a litany of concerns, a bipartisan proposal now sits on the cusp of significantly reducing the deductibility of interest payments made by New Zealand companies to related parties for offshore borrowing.

## Battle lines drawn

Now that we have a Government, a draft bill is set to be introduced in December, which establishes a "restricted transfer pricing rule" that will significantly impact the amount of interest that can be charged on related party debt for many multinationals.

Broadly, the new rules will:

- apply to inbound debt greater NZ\$10 million from a related party offshore;

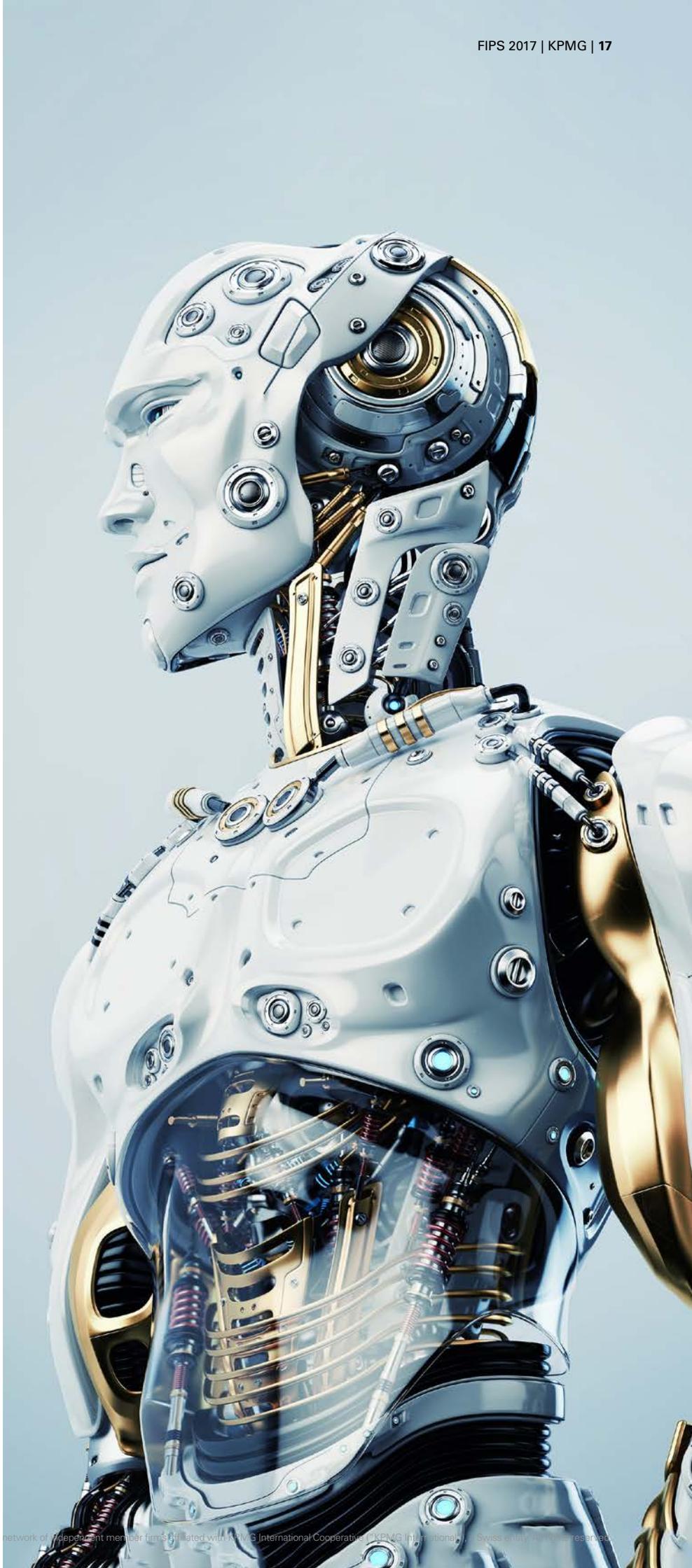
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- have a rebuttable presumption that a NZ borrower has the same credit rating as its foreign parent company if it is a financial institution, or a credit rating one notch lower than its foreign parent for all other industries; and
  - requires “exotic” terms and conditions (including subordination and loan terms greater than 5 years) to be ignored unless these are features evident in the borrower’s third party debt.

The effect of these measures will be to materially reduce the interest rate acceptable on such borrowing for many taxpayers. The new measures are intended to commence on income years beginning on or after 1 July 2018. Further, there will be no grand-parenting of existing loans – all cross border loans in place on or after the effective date will be impacted. The interest rate charged on every related party cross-border loan over \$10 million into NZ therefore needs to be re-evaluated to see whether the NZ borrower will risk having a portion of their interest deductions denied.

### Rebuttable presumption – a bridge too far?

The presumed credit rating of NZ borrower can be rebutted, but only if three criteria are met, which the Government views as being indicative of whether or not “tax structuring elements” exist with the lending into NZ. If the presumption can be rebutted then a taxpayer is allowed to determine the interest rate under a more traditional transfer pricing analysis (which allows taxpayers to make interest deductions based on their standalone credit rating, and not the usually stronger parent rating). The three criteria are:

- the interest income on the loan must be subject to tax in the lender’s jurisdiction at a rate greater than 15% (unless the lender is the global parent entity);



- there must be a reasonable expectation that the NZ borrower's interest coverage ratio (i.e. EBIT-to-interest expense) will be above 3.3x; and
- there must be a reasonable expectation that the NZ borrower's thin capitalisation ratio will be less than 110 percent of its parent's worldwide group's ratio.

You would be right to view this presumption as hardly "rebuttable." While the 15% tax requirement is reasonable, for many organisations, particularly financial institutions, the second and third criteria will be difficult to meet. This will particularly be the case if a NZ financial institution is owned by a parent company that is not itself wholly engaged in providing financial services – in such a fact pattern the NZ borrower will always have gearing levels greater than 110% of the worldwide group. In our view these strict criteria simply go too far.

### See no evil

The other significant area of concern is that once a credit rating for the NZ borrower has been established (i.e. using the presumed rating or via orthodox transfer pricing analysis if the presumption can be rebutted), certain "exotic" terms of an intercompany loan must be ignored in pricing it. These will include:

- ignoring the effect of any subordination of the intercompany loan to third party senior debt;
- ignoring any loan terms in excess of five years (i.e. a loan must be priced assuming that it only has a five year term even though legally it may be in place for longer); and

- ignoring any other unusual terms, such as deferral of interest payments, options which give rise to premiums on interest rates and convertibility into equity.

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**"The supreme art of war is to subdue the enemy without fighting."**

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All of this begs the question as to why these rules are being introduced. Fundamentally it all boils down to the fact that the Government believes that in the majority of cases multinationals should not be able to charge more than their global cost of funds to the New Zealand operations. The restricted transfer pricing rule will achieve this for many taxpayers. New Zealand believes this is the way most of the world is headed and that the restricted transfer pricing rule is therefore consistent with global trends.

We disagree. Our primary concern is that this has the potential to be a blunt instrument, for what will no doubt be widely varying circumstances across taxpayers. It assumes that NZ operations have the same assets, risk and functions as their parent. Transfer pricing analysis is complicated and time consuming, as the Government has acknowledged itself. But it does eventually produce outcomes which Governments should be happy with, as demonstrated by the Full Federal Court of Australia in the recent *Chevron* decision. By introducing this rule, the New Zealand Government is seeking to legislate the view they maintain in many transfer pricing disputes, without giving taxpayers a chance to argue back.

Also of concern is that the rules will leave New Zealand out of step with international consensus. While the New Zealand side of the transaction will mandate a much lower interest rate, the lender jurisdiction will still (reasonably might we add) expect their taxpayer to return an arm's length level of interest income based on a traditional transfer pricing principles. This of course raises the spectre of double taxation and trying to resolve the issue via the multi-jurisdictional vortex that is Mutual Agreement Procedure.

### Getting ready for action

Times are changing, and New Zealand's reputation as an easy place to do business will be impacted by the complexity these rules create.

While the planned December tax bill that will contain the precise wording of the new laws is yet to be seen, we expect that the key principles outlined above will remain. As a result, the most important thing taxpayers can do at the moment is to ready themselves by conducting an initial gap analysis, comparing their interest rates under the current and proposed rules to determine any potential exposure. Not only will this quantify the size of the problem, but it can kick-start the process of putting in place a revised financing arrangement to ensure taxpayers are in compliance with the rules when they commence.



# FSF: An interesting year ahead follows an interesting year just gone



## Lyn McMorran

Executive Director  
Financial Services Federation Inc.



## FINANCIAL SERVICES FEDERATION

Lyn McMorran is the Executive Director of the Financial Services Federation Inc., which is the industry body representing responsible finance and leasing providers in New Zealand ([www.fsf.org.nz](http://www.fsf.org.nz)). Prior to joining the FSF in 2012, Lyn was Area Manager for Westpac's Private Bank in the Lower North and South Islands.

A Certified Financial Planner, Lyn is a past President of the Institute of Financial Advisers of New Zealand.

Lyn holds a Graduate Certificate in Management and a Post-Graduate Diploma in Business Studies (Personal Financial Planning) and is a Fellow of both the Institute of Financial Advisers and the Financial Services Institute of Australasia. She is also a Trustee of the Skylight Trust and a Commissioner for the Insurance and Savings Ombudsman disputes resolution scheme.

It could hardly be said that 2017 has proved not to be an interesting year. Who would have said even as recently as six months ago that we would have the Government we do and would be seeing the changes we are as a result?

The change in Government does mean that we are yet again dealing with a new Minister for Commerce and Consumer Affairs. The Hon. Kris Faafoi will be the 8<sup>th</sup> in the role since I came to FSF five and a half years ago.

The process of the General Election has also held up the progress of the Financial Services Legislation Amendment Bill through the House. This was introduced to the House by then Minister the Hon. Jacqui Dean in August but had yet to be referred to Select Committee when the House rose for the Election.

The key aspect to this legislation for consumer credit providers is that it includes the exemption from financial advice legislation that we were seeking. It recognises that the "advice" provided by a consumer credit contract and credit-related insurance provider is already covered by the Credit Contracts and Consumer Finance Act. So, if the Bill passes in its current form, the regulatory overlap to which we referred in our FIPS article last year will be removed for these providers.

I am yet to meet with Minister Faafoi to discuss our mutual areas of concern – at the time of writing he has only been in the portfolio for a fortnight – but reports indicate that he is keen to explore the concept of an interest rate cap for second and third tier lenders (among other things). No indication

yet as to how these lenders will be defined but he has spoken of a similar cap for New Zealand payday lenders as that of their Australian counterparts – i.e. 20% upfront with 4% per month thereafter until the loan is repaid.

While this is clearly likely to protect the more vulnerable users of payday lenders, who currently charge rates of 10% per week or beyond, the danger with an interest cap is that it becomes a target for those lenders that play on the fringes of being responsible. The important thing with this type of lending (as with any other) is in ensuring that the loan can be repaid in the agreed term without causing substantial hardship.

It's when the payday loan in particular is rolled over (and over again) because it couldn't be repaid that the borrower ends up in the most vulnerable position as the interest compounds. The practices of these types of lenders have been a key enforcement focus of the Commerce Commission over this past year to ensure that the Lender Responsibility Principles are being adhered to, and particularly the need to ensure that the loan can be repaid without causing substantial hardship.

The Commission has also had some success in their enforcement efforts against irresponsible and unethical mobile traders or "truck shops". Again, these are lenders that can cause considerable harm to the more vulnerable sectors of society, so we applaud the Commission's efforts in closing the more unscrupulous of these down.

Provided responsibly, however, mobile traders offer a valuable community service to those who are housebound, have mobility or transport issues, work unsociable hours or otherwise prefer to shop from the comfort of their own home. On that basis the FSF recently launched its *Responsible Mobile Trader Code* to describe to consumers how a responsible trader should treat them,

what their rights and obligations are, how they might complain about a trader, etc.

This is part of the FSF's work to continually raise standards of responsible lending in New Zealand and consumer awareness of how they should be treated by responsible providers. This also saw the launch of our *Responsible Credit-Related Insurance Code* (presided over by Minister Dean) earlier in the year. This outlined the value to consumers of having some form of protection to ensure their loan is repaid should something go wrong during its term, the key features of this type of insurance, how a responsible provider operates and what they need to know in order to ensure they meet their obligations to the insurer. (Copies of FSF's Codes can be accessed via the website: [www.fsf.org.nz](http://www.fsf.org.nz)).

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**This is part of the FSF's work to continually raise standards of responsible lending in New Zealand and consumer awareness of how they should be treated by responsible providers.**

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Apart from the obvious consumer benefits of having appropriate credit-related insurance protection when they take on debt, the release of this Code was in part a response to the actions of regulators in other jurisdictions with regard to these products. As a reaction to some serious mis-selling practices, the UK regulator has introduced a delayed sales model which means that credit-related insurance products cannot be discussed with a borrower until five working days after the loan has drawn down. This was introduced over there about a year ago.

The Australian regulator informs me that they too are looking at adopting a similar model for the same reasons. To FSF, this would seem to be counter-

intuitive – the issue surely must be in enforcing existing regulation to protect consumers from being sold products they will never be able to claim against, rather than to prevent consumers from being able to obtain legitimate protection when they need it.

We will be working with our international counterparts to gather data as to the inevitable increased bad debt and occurrences of repossession that will happen as a result of this.

Another enforcement focus for the Commerce Commission in the coming year is expected to be that of on-line lending to ensure that the Lender Responsibility Principles are being observed when the borrower and lender do not meet face-to-face. On-line lending is not the way of the future, it's the way of now – it's how consumers want to interact with us and we need to be prepared for this.

It is of concern that, through no fault of their own, a lender with the best will in the world to comply with all their obligations could fall foul of the responsible lending obligations as a result of not being able to determine in a digital setting that the borrower at the other end of the transaction might have been vulnerable (as per the Responsible Lending Code definition as being someone for whom their command of English or understanding of financial matters is limited or who is under pressure – either because of existing hardship or being under duress from someone else).

Whilst there is little appetite from the regulator to assist industry with providing guidance as to what would constitute responsible behaviour in this space, we believe the FSF and other industry players could fill that void so our next piece of work will be some form of such guidance that will provide a clearer path for responsible lenders than they have at present.

In the meantime, we await with interest the Court judgment in the case of the Commerce Commission versus peer-to-peer lender Harmoney and whether that decision makes it clear that the CCCFA applies to them as platform provider – this is certainly the outcome that FSF would hope to see to ensure the level playing field remains for all lenders regardless of the way in which they transact.

Our members reported to us – and this is borne out in the results of this Financial Institutions Performance Survey – that they are still enjoying excellent levels of lending growth. Our monthly MotorFax publication for members which tracks all new and used imported motor vehicle registrations (including commercial), changes of ownership, securities registered etc right back to 2007 would also reflect this. On top of this we hear from members that they are experiencing low levels of arrears.

As an industry body the FSF has continued to grow with the right kind of responsible lenders and affiliated organisations still showing interest in being a member so we are now at nearly sixty members overall. The first ever FSF conference – themed "Financial Services Future-Proofing" is being held in Auckland in the second week of November with speakers including Mitchell Pham from FinTech NZ; Helen Gordon from the Australian Financial Institutions Association; Karen Stevens, the Insurance and Financial Services Ombudsman and Susan Taylor, CEO of Financial Services Complaints Limited (among others) providing their view of the future of responsible lending.

Based on the inevitable success of this one-day event, we are already planning a two-day extravaganza for 2018 so, this together with the inevitable regulatory agenda of a new Government, will see us keeping as busy as ever in the year to come.

# Focus on peer-to-peer lending

We had considered extending our focus on and highlighting the growth and performance of Peer-to-Peer ('P2P') lenders in this non-bank FIPS report. We were fortunate that in November 2017, the Financial Markets Authority ('FMA') released a set of aggregated statistics that provides a snapshot of P2P activity in New Zealand for the year ended 30 June 2017. The statistics are based on data provided to the FMA by the seven licensed providers of these services in their annual regulatory returns.<sup>18</sup>

This is the first such publication issued for this sector. Going forward, comparative information will be published by the FMA so that the performance of this sub-sector can be tracked over time.

P2P investors provide funding to borrowers through their various P2P platforms. Based on the FMA's report, there are 20,744 investors that are registered with P2P services, however only 7,991 investors have open accounts as at the end of June 2017. Considered together, this appears to indicate that the loans provided through these platforms have a high churn rate. Given that a total of 2,880 new investors (i.e. 13.88% of all registered investors) were registered in the year ended 30 June 2017, it does appear that P2P platforms are growing their investor base quite quickly.

**TABLE 2: SUMMARY**

Number of service providers	7
Total number of investors registered with P2P services	20,744
Total number of new investors	2,880
Total number of investors with open investments	7,991
Providers operating a secondary market	2
Total value of trades on secondary markets	\$2,385,676
Total value of loans written off	\$8,529,177

SOURCE: FMA, PEER-TO-PEER LENDING AND CROWDFUNDING: SECTOR SNAPSHOT REPORT

This sub-sector is dominated by a P2P lender whose loan book size is \$238.67 million as at 30 June 2017 (i.e. 82.71% of total outstanding loans of \$289.10 million). The second biggest P2P lender at \$30.26 million holds a substantially lower market share at 10.49%. If one was to compare these figures to the banks and other segments of the non-bank sector, it is apparent that the lending performed through these platforms is a drop in the ocean; total net loans and advances by banks and non-banks as at 30 June 2017 amounts to \$670.93 billion.

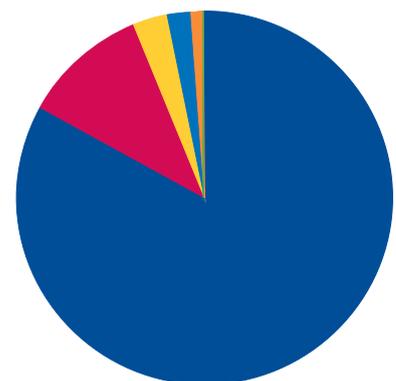
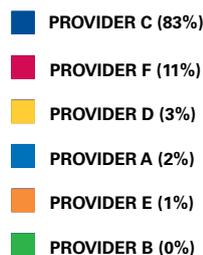
Turning to the stratified data, the number of individual investors is concentrated in the range of \$0 - \$4,999 (collectively 5,689 investors), rather than in higher value loan buckets such as \$50,000 - \$500,000+ (collectively 514 investors). This picture is in line with general expectations based on the nature of P2P – i.e. many investors funding small loans and may also be a reflection of investors' cautious curiosity around these services given that P2P was only introduced in New Zealand in the last couple of years.

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SEE FIGURE 4 – PAGE 22

4

P2P MARKET SHARE BY TOTAL VALUE OF OUTSTANDING LOANS

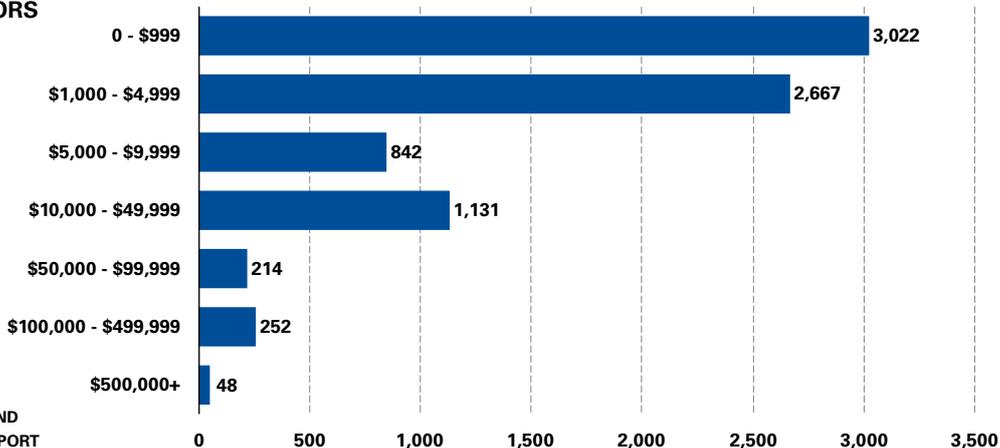


SOURCE: FMA, PEER-TO-PEER LENDING AND CROWDFUNDING: SECTOR SNAPSHOT REPORT

5

**TOTAL NUMBER OF INDIVIDUAL INVESTORS ACROSS RANGES**

NUMBER OF INVESTORS

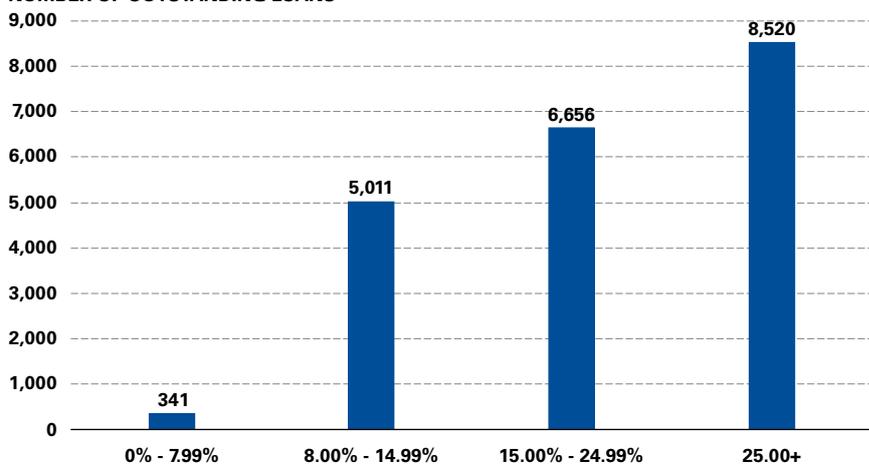


SOURCE: FMA, PEER-TO-PEER LENDING AND CROWDFUNDING: SECTOR SNAPSHOT REPORT

6

**NUMBER OF OUTSTANDING LOANS ACROSS INTEREST RATE RANGES**

NUMBER OF OUTSTANDING LOANS

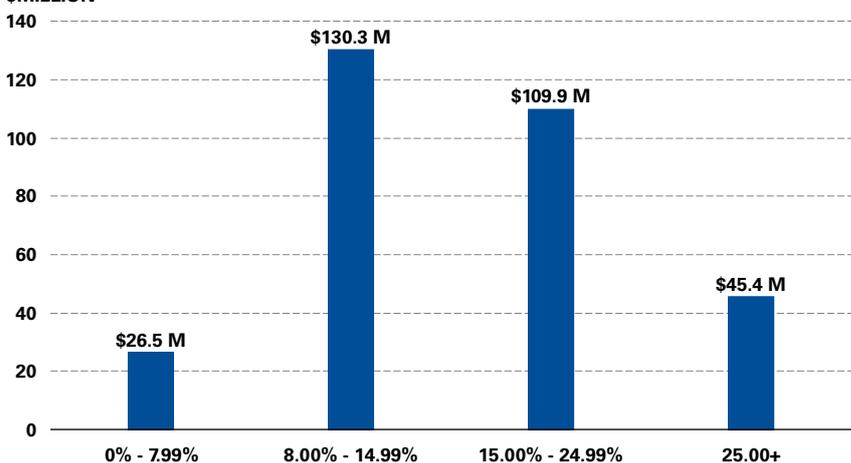


SOURCE: FMA, PEER-TO-PEER LENDING AND CROWDFUNDING: SECTOR SNAPSHOT REPORT

7

**VALUE OF OUTSTANDING LOANS ACROSS INTEREST RATE RANGES**

\$MILLION



SOURCE: FMA, PEER-TO-PEER LENDING AND CROWDFUNDING: SECTOR SNAPSHOT REPORT

At the high value end of the spectrum (\$500,000+ segment), where the average amount invested by an individual investor is \$1,538,268, this shows the impact of the wholesale investors such as Heartland Bank and TSB Bank who have lent funds through Harmoney's platform.

## 5 SEE FIGURE 5 – PAGE 23

On the flip side of the coin are the borrowers who borrow money from the lenders via the platform. Based on the FMA's report, there are 207,230 borrowers that are registered with P2P services, however there are only 17,069 loans outstanding from individuals and businesses as at the end of June 2017. The relationship between the number of borrowers with loans outstanding (17,069) and the number of investors with open accounts (7,991) where the former exceeds the latter makes sense in the context of the P2P model where one investor diversifies by investing portions of their total investment in various different loans thereby reducing the concentration of credit risk.

While this sub-sector of the market is dominated, in value terms, by unsecured lending, secured lending still forms a large piece of the pie at 24.87% of the loans outstanding from individuals. Also, although the percentage of loans to individuals (at 99.46%) towers above the percentage of loans to businesses (at 0.54%), business loans are still a sizeable chunk in dollar value terms at 10.23% of the market.

## 8 SEE FIGURE 8 – PAGE 24

**TABLE 3: AVERAGE AMOUNT INVESTED BY INDIVIDUAL INVESTORS ACROSS RANGES**

Range	Average
0 - \$999	\$308
\$1,000 - \$4,999	\$2,096
\$5,000 - \$9,999	\$6,912
\$10,000 - \$49,999	\$19,835
\$50,000 - \$99,999	\$66,108
\$100,000 - \$499,999	\$205,408
\$500,000+	\$1,538,268

**TABLE 4: BORROWER INFORMATION**

Total number of borrowers registered with P2P services	207,230
Number of first time borrowers	7,840
Number of repeat borrowers	843
Total value of loans taken out by repeat borrowers	\$26,388,604
Total number of secured loans	612
Total value of secured loans	\$64,554,338
Number of borrowers borrowing the \$2 million maximum	0
Total value of loans written off	\$8,529,177

**TABLE 5: INDIVIDUAL BORROWERS**

Total number of outstanding loans to individuals*	16,977
Total value of outstanding loans to individuals	\$259,524,275

**TABLE 6: BUSINESS BORROWERS**

Total number of outstanding loans to businesses*	92
Total value of outstanding loans to businesses	\$29,574,542

## 8 TOTAL VALUE OF NEW LOANS



## 9 TOTAL VALUE OF OUTSTANDING NEW LOANS



SOURCE: FMA, PEER-TO-PEER LENDING AND CROWDFUNDING: SECTOR SNAPSHOT REPORT

## 9 SEE FIGURE 9 – PAGE 24

Turning to look at interest rates, the majority of loans by *number* attract an interest rate of 25.00% or more (8,520 loans). Given that the majority of loans are unsecured, interest rates as high as this are not unexpected. Only 341 of outstanding loans fall within the lowest bracket of interest rates being 0.00% - 7.99%. However, when the data is split by value per interest rate bracket, the majority of outstanding loans are concentrated in the range of 8.00% to 24.99%. This range is somewhat comparable to the interest rates levied by Instant Finance of 19.95% to 29.95%, which is used as a comparison as it also concentrates on personal loans.

## 6 SEE FIGURE 6 – PAGE 23

## 7 SEE FIGURE 7 – PAGE 23

On the subject of asset quality, 8.61% of outstanding loans (by value) are past due, 2.87% of gross outstanding loans before write-offs were written off during the year and 5,208 outstanding loans were refinanced in the year. Details of specific and collective provisions are not disclosed in the report. Comparatively speaking, non-banks surveyed this year collectively reported a ratio of 0.36% of impaired asset expense to gross loans and advances. Whilst many survey participants do not report past due assets, if one was to compare the ratio past due assets to gross loans and advances for a company that provides a number of unsecured loans and discloses past due assets such as Instant Finance (being 6.28%), the ratio reported by P2P lenders (being 8.61%) is over 235 bps higher.

**TABLE 7: LOANS IN ARREARS OR WRITTEN OFF**

Total number of loans in arrears	1,469
Total value of loans in arrears	\$20,446,190
Percentage of outstanding loans in arrears	8.61%
Total number of loans written off	833
Total value of loans written off	\$8,529,177

**TABLE 8: REFINANCED LOANS**

Number of loans refinanced by individuals	5,197
Total value of loans repaid by individuals before refinancing	\$80,168,433
Number of loans refinanced by businesses	11
Total value of loans repaid by businesses before refinancing	\$1,196,945
Total value of loans written off	\$8,529,177

SOURCE: FMA, PEER-TO-PEER LENDING AND CROWDFUNDING: SECTOR SNAPSHOT REPORT

# Sector performance

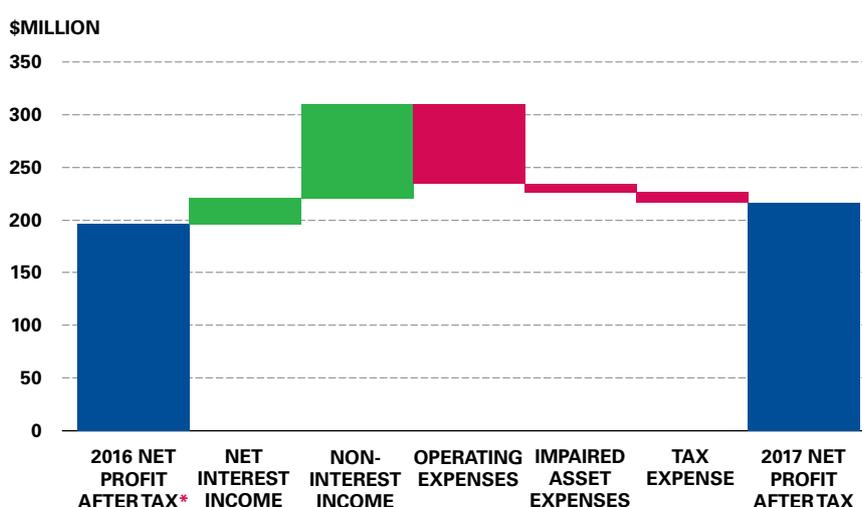
Non-bank survey participants had another strong year in 2017 with the sector achieving an increase in net profit after tax of \$20.05 million (10.20%) to \$216.67 million as demand and lending continues to soar.

## Net Profit After Tax ('NPAT')

Non-bank survey participants had another strong year in 2017 with the sector achieving an increase in net profit after tax of \$20.05 million (10.20%) to \$216.67 million as demand and lending continues to soar. Out of the 25 participants, 18 participants reported positive increases to NPAT levels. Branded Financial Services, Nissan Financial Services and Geneva Finance Limited were the top performers for the year with NPAT growth of 105.59% (from \$0.50 million to \$1.03 million), 46.23% (from \$3.81 million to \$5.57 million) and 45.45% (from \$3.53 million to \$5.13 million), respectively, while Fuji Xerox Finance Limited, Medical Securities Limited, First Mortgage Trust, Credit Union South and Nelson Building Society all reported strong growth of between 31.13% and 44.84%. One notable mention is new survey participant, Branded Financial Services, who have only been in the New Zealand market for three years and reported strong results, as noted above, as they continue to gain a sound position in the market.

Nissan Financial Services has once again reported a strong performance in its third full year of operations with the second largest percentage increase in NPAT of 46.23% (\$1.76 million) to \$5.57 million as it continues to gain a footing in the local vehicle finance sector through its dealership network.

## 10 MOVEMENT IN NET PROFIT AFTER TAX



\* Note this balance has been adjusted for the Fuji Xerox restatements and comparatives for the new participants

Nissan Financial Services' continued strong performance is attributable to increases in both net interest income and non-interest income of \$2.97 million (29.53%) and \$1.58 million (24.46%), respectively; similarly Geneva Finance's net interest income rose by \$2.06 million (35.27%). Geneva Finance Limited (who is new in this year's survey) credited the strong growth to robust demand for all types of loans.

The top three performers, in terms of dollar-value increases, were: First Mortgage Trust (an increase of \$6.05 million to \$22.72 million), UDC Finance (an increase of \$3.11 million to \$61.65 million) and Avanti Finance (\$2.89 million increase to \$14.12 million).

In contrast, LeasePlan New Zealand Limited and Mercedes-Benz Financial Services experienced reductions in NPAT of \$1.52 million (22.24%) and \$0.83 million (7.37%), respectively. These two decreases were due to reductions in interest income of \$2.31 million and \$1.38 million, respectively as well as a rise in operating expenses.

As vehicle sales continue to stretch to reach record heights,<sup>20</sup> a closer look at this segment of the sector revealed six of the nine vehicle financing companies contributed a total of \$5.08 million towards the increase in the sector's NPAT.

TABLE 9: PERFORMANCE METRICS

	Total
Increase in Total Assets	12.19%
Increase in Net Profit After Tax (NPAT)	10.20%
Movement of Impaired Asset Expense (As a Percentage of Average Gross Loans and Advances)	bps 6
Decrease in Interest Margin	bps -40
Decrease in NPAT/Average Total Assets	bps -5
Decrease in NPAT/Average Equity	bps -91

LeasePlan New Zealand Limited saw the largest reduction of \$1.52 million (22.24%) as net interest income and net interest margin contracted by \$2.31 million (7.24%) and 209 bps, while operating expenses rose by \$2.14 million (6.90%). BMW Financial Services continued its recent trend with a reduction in NPAT of \$0.69 million (9.64%) to \$6.44 million as net interest income reduced by \$2.43 million, even though this company recorded an impressive 31.74% (\$4.17 million) reduction in operating expenses. A number of non-vehicle specialised survey participants noted increased growth in the car lending books, contributing lower returns compared with last year as quality customers have the option to look around for the best deals and market competition puts downwards pressure on lending rates.

The personal finance sector including Avanti Finance, Instant Finance and Geneva Finance has seen the most stable result of all participants with increases ranging from \$0.83 million to \$2.89 million as the bank competition softens in this space and loan books continue rise through record demand while quality lending remains in the forefront.

Overall, the non-bank sector delivered plenty of positives this year as most of survey participants improved profitability despite economic conditions slowing down slightly, tougher funding pressures and increased competition from P2P lenders and within the sector.

Overall, as shown in [Figure 10](#).

- NPAT grew by \$20.05 million or 10.20%, to arrive at \$216.67 million
- Net interest income went up by \$24.61 million, to reach \$560.10 million
- Non-interest income increased by \$89.09 million to \$377.36 million. With the exclusion of Turners

Automotive Group non-interest income rose by \$10.08 million to \$158.89 million.

- Impaired asset expense increased by \$8.43 million reaching \$31.34 million for the year
- Operating expenses increased by \$75.46 million. Excluding Turners Automotive Group, operating expenses reduced by \$1.28 million to \$394.30 million.
- Tax expense went up by \$9.75 million.

## 10 SEE FIGURE 10 – PAGE 26

### Total Assets

The sector continues to achieve strong asset growth as total assets climbed a further \$1.19 billion to \$10.96 billion, a rise of 12.19% over last year. It should be noted we have included four new participants (Branded Financial Services, Christian Savings Incorporated, Geneva Finance and Turners Automotive Group) this year. Comparatives for these companies are also included. As expected, asset growth continues to be fuelled by the increase in the sector's loan book as gross loans and advances increased from \$7.72 billion to \$8.80 billion. For the second consecutive year Avanti Finance, First Mortgage Trust and UDC Finance registered the largest growth in interest-earning assets contributing an increase of \$608.24 million.

Of the 20 participants who reported larger loan books during the year, Avanti Finance and First Mortgage Trust stood out with the highest percentage growth of 62.37% to \$389.60 million and 48.63% to \$422.54 million. Avanti's impressive performance is attributable to it entering the mortgage lending space.

UDC Finance continued its steady performance from last year with the largest dollar increase of \$338.93 million while maintaining the largest loan book and market share of \$2.94 billion and 33.43% with the next closest being Toyota Finance with a loan book of \$854.21 million and market share of 9.71%.

On the other end of the spectrum, Medical Securities Limited reported a contraction in total assets of \$85.93 million (60.86%) driven by a \$79.51 million (59.06%) reduction in gross loans and advances to \$55.11 million.

As [Table 10](#) shows, whilst the sector saw strong growth, the growth rates differed significantly between sector participants.

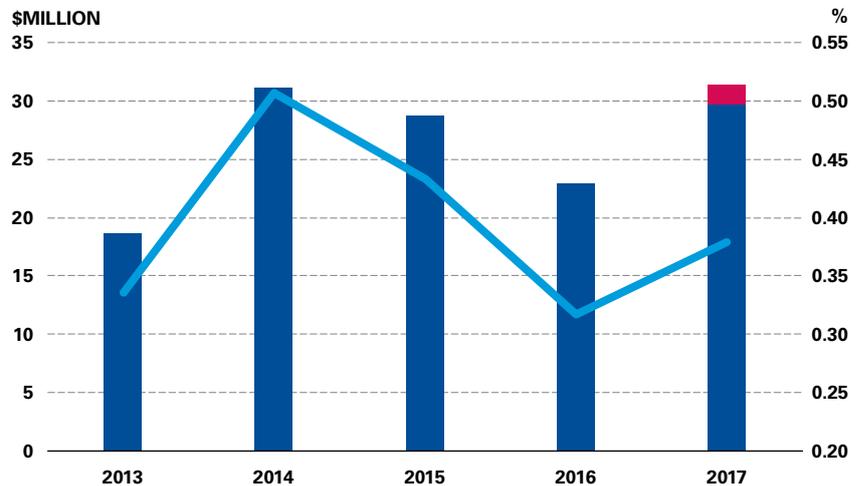
### Asset Quality

The non-bank sector has seen strong growth and limitless demand, but Executives have stressed that asset quality will not be compromised to simply fill demand. Comments from Executives who were interviewed ran in a similar vein to last year. Topics of conversation included market discipline and responsible lending, as well as concerns that the market is currently exhibiting some trends which are similar to the period immediately before the GFC.

Asset quality for the sector declined somewhat this year, as evidenced by the rise in impaired asset expense of \$8.43 million to \$31.34 million and by 15 out of the 25 participants reporting increases. Viewed in the context of the substantial lending growth that was observed during the year, the increase in impairment losses is not as significant as evidenced by the ratio of impaired asset expense to gross loans and advances showing a 6 bps increase to 0.36%.

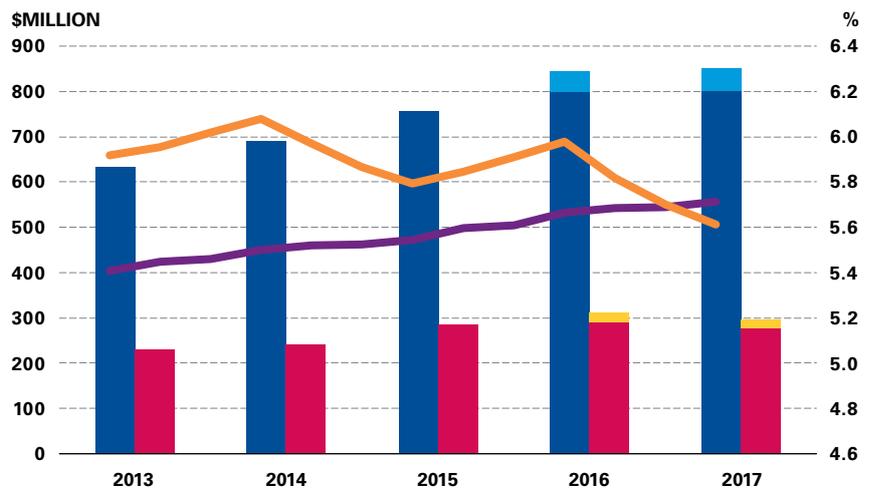
### 11 IMPAIRED ASSET ANALYSIS\*

- IMPAIRED ASSET EXPENSE (LHS)
- NEW PARTICIPANTS' IMPAIRED ASSET EXPENSE (LHS)
- IMPAIRED ASSET EXPENSE/AVERAGE LOANS AND ADVANCES (RHS)



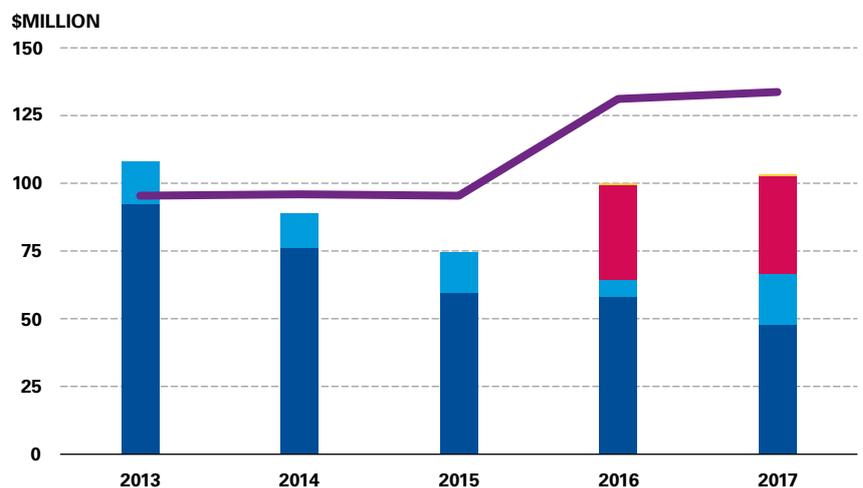
### 12 NET INTEREST INCOME ANALYSIS\*

- INTEREST INCOME (LHS)
- INTEREST EXPENSE (LHS)
- NEW PARTICIPANTS' INTEREST INCOME (LHS)
- NEW PARTICIPANTS' INTEREST EXPENSE (LHS)
- NET INTEREST INCOME (LHS)
- NET INTEREST MARGIN (RHS)



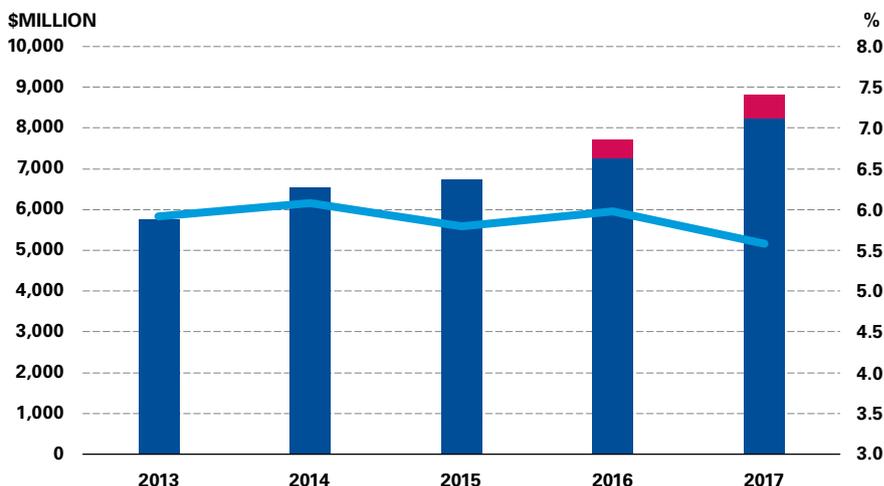
### 13 GROSS IMPAIRED AND PAST DUE ASSETS\*

- GROSS IMPAIRED ASSETS
- NEW PARTICIPANTS' GROSS IMPAIRED ASSETS
- PAST DUE ASSETS
- NEW PARTICIPANTS' PAST DUE ASSETS
- TOTAL PROVISION



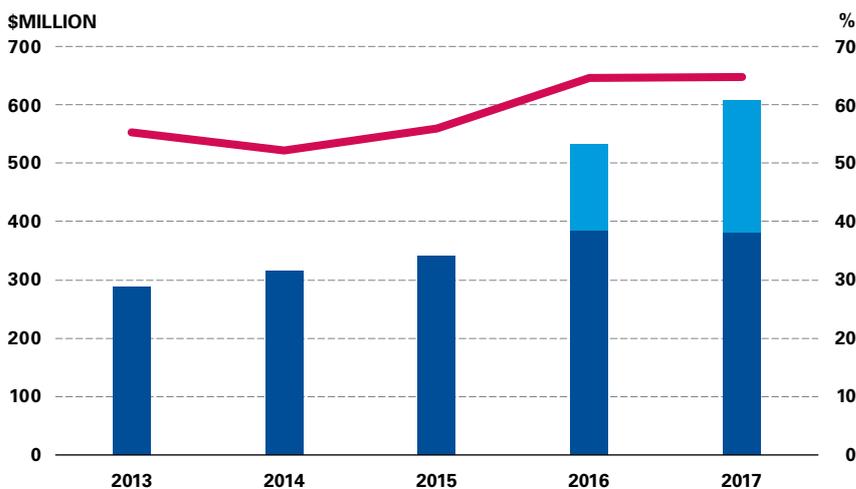
**14 GROSS LOANS AND ADVANCES VS. NET INTEREST MARGIN\***

- GROSS LOANS AND ADVANCES (LHS)
- NEW PARTICIPANTS' GROSS LOANS AND ADVANCES (LHS)
- NET INTEREST MARGIN (RHS)



**15 OPERATING EXPENSES VS. OPERATING EXPENSES/ OPERATING INCOME\***

- OPERATING EXPENSES (LHS)
- OPERATING EXPENSES/ OPERATING INCOME (RHS)
- NEW PARTICIPANTS' OPERATING EXPENSES (LHS)



\* Note that data for 2013–2015 does not include:

- Branded Financial Services
- Christian Savings Incorporated
- Geneva Finance Limited
- Turners Automotive Group

Additionally, it is adjusted for Fuji Xerox 2016 restatements

As shown in Figure 11, Avanti Finance and BMW Financial Services reported the largest dollar value increases of \$2.69 million and \$2.76 million. However if one was to calculate the ratios of impaired asset expense to gross loans and advances Avanti Finance only actually reported an 11 bps increase to 1.62% as its loan book grew by a substantial sum of \$149.66 million. BMW Financial Services saw an 82 bps increase as its gross loans and advances figure reduced by \$7.85 million.

11

SEE FIGURE 11 – PAGE 28

While Executives seemed cautious about the immediate future, total impairment provisions remain close to a cyclical low with a small increase of \$2.20 million (1.67%) to \$133.56 million driven by an increase in collective provisions of \$8.50 million to \$99.93 million. The ratio of impairment provision over gross loans and advances improved by 18 bps to reduce to 1.52%. A notable outlier is Geneva Finance who has the greatest ratio of provisions to gross loans of 31.81%. This is due to this company recording a collective provision of \$28.59 million on its \$93.97 million loan book. The next largest percentage is Fuji Xerox at 5.66%. Of those surveyed, 17 of the 25 surveyed entities registered an increase in their ratios of impairment provisions to gross loans and advances. Specific provisions for the sector increased by \$6.31 million (15.79%) to \$33.64 million as Nissan Financial Services reported the largest dollar increase of \$1.62 million while BMW Financial Services and UDC Finance reported the largest dollar value decreases of \$3.86 million and \$2.49 million respectively.

TABLE 10: GROSS LOANS AND ADVANCES Entity	2017 \$'000	2016 \$'000	Movement \$'000	Movement %
Avanti Finance Limited	389,598	239,940	149,658	62.37%
BMW Financial Services New Zealand Limited	345,863	353,714	-7,851	-2.22%
Branded Financial Services (NZ) Limited	144,890	106,611	38,279	35.91%
Christian Savings Incorporated	99,317	75,055	24,262	32.33%
Credit Union Baywide	267,501	213,276	54,225	25.42%
Credit Union South	113,864	107,894	5,970	5.53%
First Credit Union	198,383	181,295	17,088	9.43%
First Mortgage Trust	422,538	284,282	138,256	48.63%
Fuji Xerox Finance Limited	53,032	44,439	8,593	19.34%
Geneva Finance Limited	93,966	84,024	9,942	11.83%
Instant Finance Limited	104,863	95,722	9,141	9.55%
John Deere Financial Limited	138,089	151,550	-13,461	-8.88%
LeasePlan New Zealand Limited	10,938	8,588	2,350	27.36%
Medical Securities Limited	55,111	134,618	-79,507	-59.06%
Mercedes-Benz Financial Services New Zealand Limited	608,698	545,557	63,141	11.57%
Motor Trade Finance Ltd	607,029	540,565	66,464	12.30%
Nelson Building Society	489,512	402,168	87,344	21.72%
Nissan Financial Services New Zealand Pty Limited	336,787	297,572	39,215	13.18%
ORIX New Zealand Limited	40,841	37,504	3,337	8.90%
Police and Families Credit Union	57,628	60,701	-3,073	-5.06%
Ricoh New Zealand Limited	85,142	86,239	-1,097	-1.27%
Toyota Finance New Zealand Limited	854,209	776,512	77,697	10.01%
Turners Automotive Group	222,393	184,108	38,285	20.79%
UDC Finance Limited	2,940,872	2,601,939	338,933	13.03%
Wairarapa Building Society	116,667	108,787	7,880	7.24%
<b>Sector Total</b>	<b>8,797,731</b>	<b>7,722,660</b>	<b>1,075,071</b>	<b>13.92%</b>

While the sector continues to report positive recurring trends as impairment still remains relatively flat, Executives have noted there are some indications asset quality is set to decrease as past due assets over 90 days rose from \$6.92 million to \$19.15 million for those who disclosed these figures. This will be an area many participants will continue to monitor carefully as loan books continue to grow.

### Operating Expenses

Operating expenses for the sector rose by 14.19% (\$75.46 million) to \$607.30 million as Turners Automotive Group reported a \$76.74 million increase in expenses as cost of sales increased by 49.60%. If Turners Automotive Group were excluded, the overall movement would have a reduction of \$1.28 million (32 bps) as participants saw mixed results.

The operating efficiency ratio (operating expense over operating income) remained relatively flat with an increase of 22 bps to 64.78% as operating income rose by 13.80% (\$113.69), proportionally less than operating expenses. Turners Automotive Group once again was the key driver to the increasing operating efficiency ratio as operating income rose by 51.34% to \$238.60 million while operating expenses increased by 56.31% primarily due to an increase in cost of goods sold. If Turners Automotive Group were isolated and excluded, the remaining participants in the sector would have delivered 297 bps in efficiency savings.

At an individual level, the results were mixed, with 16 of the 25 participants showing a decreased operating efficiency ratio. Notable reductions included Medical Securities Limited, BMW Financial Services, Branded Financial Services and Geneva Finance whom reported reductions of 2727 bps to 48.28%, 1261 bps to 38.01%, 1151 bps to 60.59% and 1061 bps to 65.18%.

TABLE 11: MOVEMENT IN INTEREST MARGIN Entity	2017 %	2016 %	Movement (bps)
Avanti Finance Limited	8.99	9.98	-99
BMW Financial Services New Zealand Limited	6.32	6.82	-50
Branded Financial Services (NZ) Limited	3.05	2.72	33
Christian Savings Incorporated	1.70	1.22	48
Credit Union Baywide	4.30	4.73	-43
Credit Union South	8.22	7.69	53
First Credit Union	4.03	4.01	2
First Mortgage Trust	7.15	7.17	-2
Fuji Xerox Finance Limited	8.68	11.33	-266
Geneva Finance Limited	10.89	8.82	208
Instant Finance Limited	22.67	22.30	37
John Deere Financial Limited	3.83	3.63	20
LeasePlan New Zealand Limited	9.79	11.88	-209
Medical Securities Limited	4.26	4.03	23
Mercedes-Benz Financial Services New Zealand Limited	4.05	4.13	-8
Motor Trade Finance Ltd	8.52	8.61	-9
Nelson Building Society	2.25	2.30	-5
Nissan Financial Services New Zealand Pty Limited	4.14	4.04	10
ORIX New Zealand Limited	12.17	12.22	-5
Police and Families Credit Union	4.25	4.58	-32
Ricoh New Zealand Limited	9.95	9.52	44
Toyota Finance New Zealand Limited	4.49	4.50	-2
Turners Automotive Group	7.97	8.68	-71
UDC Finance Limited	4.26	4.50	-24
Wairarapa Building Society	2.18	2.25	-7
<b>Sector Average</b>	<b>5.58</b>	<b>5.98</b>	<b>-40</b>

Medical Securities Limited and BMW Financial Services' performance was attributable to substantial reductions in operating expenses of 57.01% (\$3.11 million) and 31.74% (\$4.17 million) through cost control and reductions in interest expense which were proportionally greater than the reductions in operating income in the year. Geneva Finance reported an increase in operating expenses of 16.15% (\$1.08 million) while operating income rose by a greater margin of 35.05% (\$3.11 million) as net interest income rose from by 35.27% (\$2.06 million) to \$790 million.

A common theme continuing from last year's survey was Executives reporting that they are investing in Fintech in order to keep pace with slick P2P lenders and other competitors in the sector whom can process customer applications quickly and electronically. An example of this is Geneva Finance who are committed to building on core process through organic growth or by acquisition. Non-bank entities are aware of the threat of disruption and the need to increase their online presence and Fintech development in the near future and are expected to see more partnerships with Fintech entities to combat and protect their customer base.

### Net Interest Margin ('NIM')

Participants in the sector reported mixed results in maintaining their NIMs, as 10 out of the 25 survey participants were able to increase their NIM levels.<sup>21</sup> NIM contracted by 40 bps to 5.58% as interest earning assets rose by a proportionally greater rate of 11.50% (\$1.09 billion) than net interest income of 4.60% (\$24.61 million). Similar to last year, margin pressures primarily stemmed from lower lending rates as a result of increased competition, with continued upwards pressure on the funding side.

Of the 10 participants that reported increases in NIM levels, Geneva Finance was the standout with an increase of 208 bps as net interest income rose by 35.27% (\$2.06 million) due to higher interest income and flat interest expense remained, and slower growth in interest-earning assets of 18.94% (12.55 million).

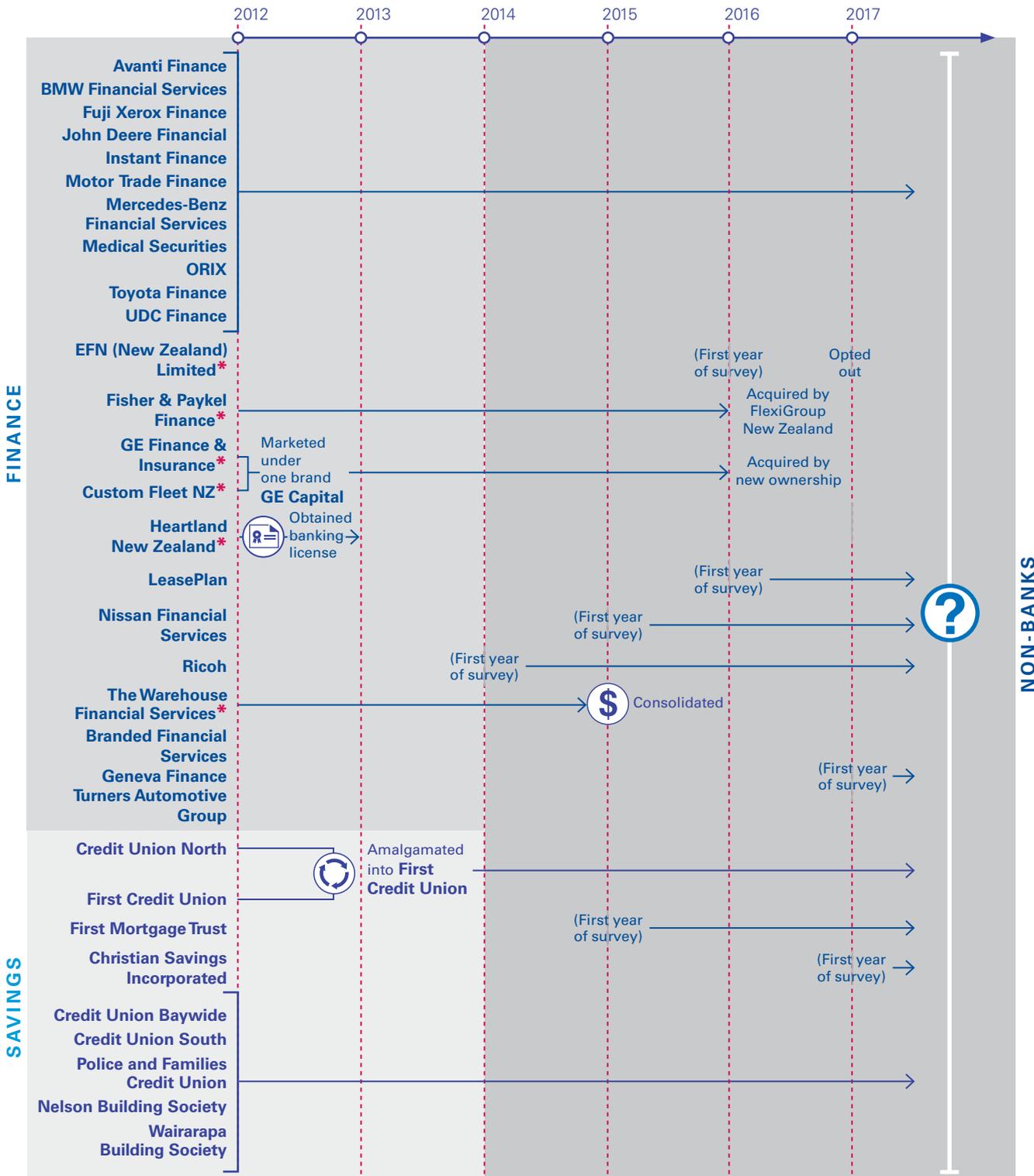
Interest income remained relatively flat with a \$10.24 million (1.20%) increase to \$860.32 million while the key driver behind the increase in net interest income was the \$14.37 million (4.57%) reduction in interest expense. 17 of the 25 survey participants reported strong decreases in interest expense with Toyota Finance, Mercedes-Benz Financial Services and Medical Securities leading the way with decreases of \$3.84 million, \$3.38 million and \$2.81 million respectively.

Instant Finance and ORIX continue to have the highest NIM of 22.67% and 12.17%, while Christian Savings, Wairarapa Building Society and Nelson Building Society have the lowest NIMs at 1.70%, 2.18% and 2.25% respectively.

While some Executives have commented on the funding shortages which has resulted in them not being able to meet the demand for loans, the cost of funding remained relatively flat in reality with a decrease in interest expense over average interest-bearing liabilities of 61 bps, reflecting this pressure was not being seen by all entities, especially those with alternative sources of funding. This result was primarily driven by the decrease in interest expense for the year which was discussed earlier.

The competition for funds within the non-bank sector continues to intensify as participants can no longer rely on the banks to extend funding to meet demand as the Australian banks have reduced funding levels to their New Zealand subsidiaries due to the changes to capital requirements as set out in the amended standards APS 110 *Capital Adequacy* and APS 120 *Securitisation*.

# Looking back at the sector



\* Entities are no longer participating in the survey for various reasons.

# Analysis of annual results

Entity	Rank by Total Assets	Balance Date	Year	Size
				Total Assets \$000
Avanti Finance Limited	8	31-Mar	2017	394,070
			2016	245,398
BMW Financial Services New Zealand Limited	9	31-Dec	2016	358,992
			2015	358,164
Branded Financial Services (NZ) Limited	16	30-Jun	2017	154,635
			2016	113,971
Christian Savings Incorporated	17	31-Aug	2017	145,886
			2016	146,876
Credit Union Baywide	14	30-Jun	2017	312,296
			2016	293,580
Credit Union South	21	30-Jun	2017	136,682
			2016	129,857
First Credit Union	11	30-Jun	2017	348,118
			2016	334,421
First Mortgage Trust	6	31-Mar	2017	497,150
			2016	353,831
Fuji Xerox Finance Limited	13	31-Mar	2017	318,193
			2016	340,592
Geneva Finance Limited	24	31-Mar	2017	84,177
			2016	69,628
Instant Finance Limited	23	31-Mar	2017	109,438
			2016	99,415
John Deere Financial Limited	19	31-Oct	2016	143,362
			2015	157,905
LeasePlan New Zealand Limited	10	31-Dec	2016	349,076
			2015	300,359
Medical Securities Limited	25	31-Mar	2017	55,267
			2016	141,199
Mercedes-Benz Financial Services New Zealand Limited	4	31-Dec	2016	639,282
			2015	567,045
Motor Trade Finance Ltd	3	30-Sep	2017	670,157
			2016	596,520
Nelson Building Society	5	31-Mar	2017	638,482
			2016	558,666
Nissan Financial Services New Zealand Pty Limited	12	31-Mar	2017	343,277
			2016	302,254
ORIX New Zealand Limited	15	31-Mar	2017	242,025
			2016	229,862
Police and Families Credit Union	22	30-Jun	2017	122,701
			2016	118,835
Ricoh New Zealand Limited	18	31-Mar	2017	144,804
			2016	136,592
Toyota Finance New Zealand Limited	2	31-Mar	2017	1,159,685
			2016	1,069,499
Turners Automotive Group	7	31-Mar	2017	464,124
			2016	297,219
UDC Finance Limited	1	30-Sep	2017	2,984,653
			2016	2,665,019
Wairarapa Building Society	20	31-Mar	2017	139,683
			2016	139,189
<b>Sector Total</b>			<b>2017</b>	<b>10,956,215</b>
			<b>2016</b>	<b>9,765,897</b>

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

and Strength Measures		Growth Measures			
Net Assets \$000	Net Loans and Advances \$000	Increase in Net Profit After Tax %	Increase in Total Assets %	Impaired Asset Expense \$000	Provision for Doubtful Debts/ Gross Loans & Advances %
53,654	382,902	25.73	60.58	6,296	1.72
33,664	235,526	44.51	54.71	3,607	1.84
32,213	340,110	-9.64	0.23	5,686	1.66
25,772	344,100	-24.57	-4.80	2,922	2.72
1,552	144,040	105.59	35.68	379	0.59
314	105,895	n/a	n/a	354	0.67
14,059	99,317	18.66	-0.67	-59	0.00
12,371	75,024	n/a	n/a	0	0.04
39,884	266,946	-39.57	6.38	156	0.21
38,674	212,550	16.17	10.36	202	0.34
21,584	113,280	36.00	5.00	1,236	0.51
21,132	107,250	-47.43	4.09	983	0.60
55,759	195,993	11.67	4.10	852	1.20
53,683	178,836	-23.34	13.36	395	1.36
494,106	421,558	36.26	40.50	-30	0.23
351,567	283,332	23.11	27.30	225	0.33
-18,785	50,032	44.84	-6.58	1,178	5.66
-15,364	41,839	-256.97	-0.70	993	5.85
24,862	64,077	45.45	20.90	351	31.81
20,256	54,576	n/a	n/a	-234	35.05
28,573	100,668	9.85	10.08	2,462	4.00
27,487	91,894	18.13	2.87	2,380	4.00
2,600	138,089	-0.26	-9.21	n/d	0.00
17,066	151,550	6.43	4.76	n/d	0.00
94,167	10,938	-22.24	16.22	0	n/d
88,851	8,588	4.61	7.50	51	n/d
11,972	54,970	35.43	-60.86	-29	0.26
26,140	134,465	32.81	-28.62	-111	0.11
43,213	601,538	-7.37	12.74	726	1.18
47,011	538,436	38.86	8.65	-845	1.31
88,199	600,961	5.01	12.34	112	1.00
85,174	535,237	3.27	5.30	95	0.99
41,832	488,800	31.13	14.29	269	0.15
36,323	401,258	6.83	21.53	287	0.23
11,595	332,542	46.23	13.57	2,058	1.26
6,202	294,946	201.90	46.13	1,765	0.88
177,382	40,804	2.27	5.29	-2	0.09
162,666	37,465	-0.84	-2.97	-406	0.10
22,780	57,517	-9.16	3.25	4	0.19
21,133	60,591	-10.95	9.19	8	0.18
71,792	84,180	-1.56	6.01	197	1.13
65,557	84,578	26.18	-10.97	1,679	1.93
146,374	830,509	0.64	8.43	2,549	2.77
146,272	754,412	29.45	-5.32	1,183	2.85
79,207	216,365	12.64	56.16	968	2.71
59,924	177,332	n/a	n/a	-158	3.68
485,645	2,911,594	5.31	11.99	5,929	1.00
423,999	2,573,030	2.61	9.19	7,418	1.11
17,384	116,441	3.32	0.35	50	0.19
16,746	108,587	467.92	11.77	112	0.18
<b>2,041,604</b>	<b>8,664,171</b>	<b>10.20</b>	<b>12.19</b>	<b>31,338</b>	<b>1.52</b>
<b>1,772,620</b>	<b>7,591,297</b>	<b>12.90</b>	<b>13.63</b>	<b>22,905</b>	<b>1.70</b>

# Analysis of annual results

Entity	Year	Credit Quality Measures			
		Past Due Assets \$000	Gross Impaired Assets \$000	Impaired Asset Expense/ Average Loans & Advances %	Net Interest Margin %
Avanti Finance Limited	2017	6,855	13,287	2.00	8.99
	2016	1,345	14,205	1.84	9.98
BMW Financial Services New Zealand Limited	2016	n/d	n/d	1.63	6.32
	2015	n/d	n/d	0.81	6.82
Branded Financial Services (NZ) Limited	2017	n/d	n/d	0.30	3.05
	2016	n/d	n/d	n/a	2.72
Christian Savings Incorporated	2017	7	0	-0.07	1.70
	2016	0	0	n/a	1.22
Credit Union Baywide	2017	n/d	943	0.06	4.30
	2016	n/d	1,189	0.09	4.73
Credit Union South	2017	0	1,638	1.11	8.22
	2016	0	3,320	0.97	7.69
First Credit Union	2017	1,612	5,841	0.45	4.03
	2016	786	5,155	0.22	4.01
First Mortgage Trust	2017	4,862	0	-0.01	7.15
	2016	1,600	0	0.09	7.17
Fuji Xerox Finance Limited	2017	n/d	n/d	2.42	8.68
	2016	n/d	n/d	2.21	11.33
Geneva Finance Limited	2017	0	35,181	0.39	10.89
	2016	0	35,003	n/a	8.82
Instant Finance Limited	2017	0	6,582	2.45	22.67
	2016	0	5,787	2.53	22.30
John Deere Financial Limited	2016	n/d	n/d	0.00	3.83
	2015	n/d	n/d	0.00	3.63
LeasePlan New Zealand Limited	2016	n/d	n/d	0.00	9.79
	2015	n/d	n/d	0.72	11.88
Medical Securities Limited	2017	9	n/d	-0.03	4.26
	2016	12	n/d	-0.08	4.03
Mercedes-Benz Financial Services New Zealand Limited	2016	n/d	n/d	0.13	4.05
	2015	n/d	n/d	-0.16	4.13
Motor Trade Finance Ltd	2017	391	13	0.02	8.52
	2016	45	216	0.02	8.61
Nelson Building Society	2017	59	0	0.06	2.25
	2016	4	150	0.08	2.30
Nissan Financial Services New Zealand Pty Limited	2017	n/d	n/d	0.65	4.14
	2016	n/d	n/d	0.71	4.04
ORIX New Zealand Limited	2017	n/d	0	-0.01	12.17
	2016	n/d	0	-1.11	12.22
Police and Families Credit Union	2017	0	29	0.01	4.25
	2016	0	20	0.01	4.58
Ricoh New Zealand Limited	2017	n/d	2,213	0.23	9.95
	2016	n/d	3,645	1.92	9.52
Toyota Finance New Zealand Limited	2017	164	2,080	0.31	4.49
	2016	64	2,794	0.16	4.50
Turners Automotive Group	2017	822	203	0.48	7.97
	2016	553	204	n/a	8.68
UDC Finance Limited	2017	2,428	11,243	0.21	4.26
	2016	1,230	17,657	0.30	4.50
Wairarapa Building Society	2017	1,942	3,978	0.04	2.18
	2016	1,279	3,845	0.11	2.25
<b>Sector Total</b>	<b>2017</b>	<b>19,151</b>	<b>83,231</b>	<b>0.38</b>	<b>5.58</b>
	<b>2016</b>	<b>6,918</b>	<b>93,190</b>	<b>0.32</b>	<b>5.98</b>

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

Interest Spread %	Profitability Measures				Efficiency Measures	
	Net Profit After Tax \$000	Underlying Profit \$000	NPAT/Average Total Assets %	NPAT/Average Equity %	Operating Expenses/Gross Revenues %	Operating Expenses/Operating Income %
8.18	14,121	19,607	4.42	32.34	26.46	35.91
8.86	11,231	15,603	5.56	37.88	27.35	37.78
5.82	6,441	8,947	1.80	22.22	23.13	38.01
6.37	7,128	9,900	1.94	32.10	31.30	50.62
2.98	1,030	1,431	0.77	110.34	31.33	60.59
2.70	501	696	n/a	n/a	34.98	72.10
1.37	693	693	0.47	5.24	29.35	76.36
0.92	584	584	n/a	n/a	21.45	70.34
3.93	1,211	1,211	0.40	3.08	62.21	91.34
4.22	2,004	2,004	0.72	5.32	55.95	86.46
7.87	461	461	0.35	2.16	77.04	89.27
7.15	338	338	0.27	1.61	74.37	91.41
3.59	2,076	2,076	0.61	3.79	58.33	84.84
3.44	1,859	1,859	0.59	3.59	57.18	87.77
7.15	22,718	23,019	5.34	5.37	23.97	23.97
7.17	16,672	16,861	5.28	5.31	24.06	24.06
8.81	-3,421	-3,421	-1.04	20.04	70.65	107.83
11.38	-6,202	-6,202	-1.81	50.57	81.25	113.38
8.70	5,133	3,815	6.67	22.75	50.57	65.18
6.45	3,529	2,379	n/a	n/a	54.89	75.78
20.44	9,297	12,926	8.90	28.56	52.81	60.56
19.80	8,463	11,930	8.63	27.43	52.24	60.73
3.64	2,295	3,187	1.52	23.34	25.32	44.30
3.28	2,301	3,191	1.49	14.46	22.34	42.58
9.79	5,316	7,428	1.64	5.81	36.25	81.72
11.88	6,836	9,528	2.36	8.29	34.61	76.43
3.42	1,831	2,543	1.86	9.61	28.41	48.28
3.17	1,352	1,878	0.80	4.20	40.63	75.55
3.75	10,434	14,509	1.73	23.13	21.73	37.29
3.72	11,264	15,687	2.07	27.19	17.32	33.45
7.75	7,528	10,745	1.19	8.68	59.40	83.50
7.71	7,169	10,109	1.23	8.54	57.55	83.14
2.03	3,610	5,035	0.60	9.24	26.88	63.38
2.06	2,753	3,841	0.54	8.21	26.59	67.50
3.95	5,567	15,516	1.72	62.56	15.45	16.58
3.83	3,807	11,736	1.50	88.57	15.89	18.26
9.19	16,019	22,267	6.79	9.42	19.49	40.57
9.20	15,663	21,764	6.71	10.10	18.03	41.82
3.83	1,647	1,648	1.36	7.50	48.27	68.97
4.08	1,813	1,813	1.59	8.96	44.70	66.27
8.55	6,235	10,894	4.43	9.08	79.89	82.51
8.73	6,334	8,482	4.37	10.33	81.14	83.57
3.93	16,589	23,141	1.49	11.34	21.74	54.11
3.87	16,483	21,298	1.50	11.42	22.08	57.83
7.31	17,574	24,631	4.62	11.66	85.22	89.27
7.60	15,602	21,551	n/a	n/a	80.59	86.43
3.62	61,646	85,709	2.18	13.55	15.37	26.14
3.83	58,537	81,417	2.29	14.83	15.25	26.25
1.95	622	801	0.45	3.64	36.42	76.99
2.00	602	773	0.46	3.66	32.69	74.96
<b>4.86</b>	<b>216,673</b>	<b>298,819</b>	<b>2.09</b>	<b>10.87</b>	<b>44.23</b>	<b>64.78</b>
<b>5.16</b>	<b>196,623</b>	<b>269,020</b>	<b>2.14</b>	<b>11.79</b>	<b>41.58</b>	<b>64.56</b>

# IFRS 9 – Road to compliance



## Rajesh Megchiani

Director – Advisory  
KPMG

Rajesh is a financial risk management specialist with an in-depth understanding of the practical implications on organisations adopting NZ IFRS 9. Rajesh has led a wide variety of financial risk and financial instruments accounting implementation related projects for a number of financial institutions and corporates. He has extensive experience advising businesses on complex financial instruments accounting and the application of hedge accounting.

Rajesh has presented on the application of financial instruments accounting standards to major entities in New Zealand and sits on KPMG's financial instruments Asia Pacific topic team which discusses financial instruments accounting standard implementation issues in the region.

IFRS 9 is the new financial instruments accounting standards that replaces NZ IAS 39 *Financial Instruments: Recognition and Measurement* ('IAS 39'). It is effective for annual periods beginning on or after 1 January 2018 which is just around the corner. The impairment aspects of IFRS 9 are expected to have the most significant impact on provisioning practices of entities in the non-bank sector and the related disclosure requirements.

## Challenges for the non-bank sector

The implementation of IFRS 9 presents a different set of challenges for the non-bank sector when compared to the registered banks. Many of the registered banks are more advanced in the implementation of IFRS 9 compared to the non-bank sector.

Also, the non-bank sector entities part of a larger overseas group are in a better position as they are able to rely on models and approaches established by their parent. However, care should be taken to ensure that the impairment models developed for the New Zealand entities adequately reflect the impact on the specific characteristics of their portfolio in the context of the New Zealand economic environment.

A primary source of concern for the non-bank sector is the potential lack of credit risk modelling resources for implementing the impairment aspects of IFRS 9, which is the most complex part of the new standard.

Credit risk is at the heart of the non-bank sector's business and accordingly, the standard is likely to have a significant impact on its existing provisioning practices.

The size of the finance and risk teams at most of the registered banks is much larger than the non-bank sector entities and hence better equipped to tackle the implementation requirements of the new standard.

Given the time frames for compliance, important aspects of the implementation such as embedding IFRS 9 into the business as usual reporting and in the control framework are not receiving the same amount of attention and a number of non-bank sector entities are currently striving to achieve at least minimum compliance by the time the adoption of accounting standard becomes mandatory.

The new model inherently requires expected credit losses (ECLs) to be calculated based on probabilities of default (PDs), losses given default (LGDs) and exposures at the time default (EADs) to estimate expected credit loss provisioning amounts.

Alternatively, entities may consider using a loss rate approach, where PDs and LGDs are assessed as a single combined measure. However, further consideration needs to be given on stage allocation and forward looking adjustments when using this approach. These concepts are either new to most of the entities in the non-bank sector or conceptually different from the existing IAS 39 'incurred loss' approaches currently used by these entities as part of the provisioning practices or credit risk management process.

Complicating matters is the fact that not all the IFRS 9 changes affect non-bank sector entities equally. For example, classification and measurement guidelines, which are now driven by cash flow characteristics and the business models in which the assets are held, should usually be more straightforward to implement for non-bank sector entities that have narrow client bases. However, there are certain aspects that should not be overlooked which could result in loan portfolios that were previously measured at amortised cost to be measured at fair value and hence introduce volatility in the income statement. These include securitisation arrangements, prepayment options, interest rate rebate elements or insurance bundled loan products.

### Meeting the compliance challenge – Four step process

In order for non-banks to meet the compliance requirements of the impairment aspects of IFRS 9, we suggest a four step process for entities to consider as part of their implementation strategies if they have not already done so.

#### — Identify accounting and credit risk modelling resources

IFRS 9 is a principles based standard which does not prescribe specific details on methods of application. Risk modelling has always been an integral part of the IFRS 9 implementation programme. Hence, non-bank entities will also need to identify credit risk modelling resources within the organisation in order to develop and implement the IFRS 9 impairment models.

There are also a number of areas of interpretation which will require organisations to make accounting judgments and demonstrate why those judgments are appropriate.

A collaborative approach between finance and credit risk teams is essential to make these judgments.

#### — Determine areas that require judgment in the modelling approach

There are a number of new concepts introduced in IFRS 9 that require judgment to be applied to the impairment modelling approach. Non-banks should identify these areas and document the rationale for making these judgments. Some of these areas are discussed below:

##### Significant increase in credit risk

IFRS 9 introduces a new concept of “significant increase in credit risk” which will drive the level of expected credit losses and potential volatility in the income statement. If an exposure’s credit risk has not increased significantly since initial recognition, then the bank recognises credit losses expected over the next 12 months of the life of the exposure as a loss allowance. However, if the exposure has suffered a significant increase in credit risk, then the bank recognises credit losses expected over the lifetime of the loan as a loss allowance. Therefore, the assessment — especially for longer dated portfolios — can have a significant impact on reported earnings and equity.

This staging assessment will be a critical area for non-bank entities and one requiring use of significant management judgment in establishing the staging policy, criteria and thresholds and then ensuring the continued relevance post implementation.

##### Forward looking estimates

Entities will be required to incorporate different forward-looking information into its estimates of ECLs. Forward-looking information inherently involves management judgment in determining key inputs such as macroeconomic factors that affect PDs and LGDs or loss rates of portfolios including their forecasted values in one, two or more years forward (depending on the expected life of the portfolio).

Management is tasked with determining these attributes and forecasts to model management’s view of how the business and credit cycles will develop over the lifetime of the loans.

#### — Assess data quality and availability

Data quality and availability continues to be a challenge for some of the non-banks and will continue to be so well beyond IFRS 9 has gone live in 2018. Data requirements for the models should be determined as soon as possible to agree on the data that will be used in the model build. This will ensure any data gaps are identified as early as possible and addressed accordingly.

#### — Embed a robust governance process

Finally, strong governance and controls would be expected over the way the IFRS 9 model is designed and the judgement exercised during model development. In addition, governance over the assumptions and forecasts used on an ongoing basis would also be expected to ensure that expected credit losses properly incorporate an un-biased forward-looking view.

# Credit ratings

as at 6 December 2017

	Standard & Poor's		Fitch Ratings		Moody's		Rating and Investment		AM Best	
	Rating	Outlook	Rating	Outlook	Rating	Outlook	Rating	Outlook	Rating	Outlook
Avanti Finance Limited	BB	Stable								
BMW Financial Services New Zealand Limited <sup>22</sup>	A+	Stable			A1	Stable				
Branded Financial Services (NZ) Limited										
Christian Savings Incorporated			B+	Positive						
Credit Union Baywide			BB	Stable						
Credit Union South	BB-	Stable	BB	Stable						
First Credit Union			BB	Stable						
First Mortgage Trust <sup>23</sup>										
Fuji Xerox Finance Limited <sup>24</sup>							AA	Stable		
Geneva Finance Limited <sup>23</sup>										
Instant Finance Limited <sup>23</sup>										
John Deere Financial Limited <sup>25</sup>			A	Stable						
Leaseplan New Zealand Limited <sup>26</sup>	BBB-	Positive	BBB+	Stable	Baa1	Stable				
Medical Securities Limited <sup>23</sup>										
Mercedes-Benz Financial Services New Zealand Limited <sup>27</sup>	A	Stable	A-	Stable	A2	Stable				
Motor Trade Finance Ltd <sup>23</sup>										
Nelson Building Society			BB+	Stable						
Nissan Financial Services New Zealand Pty Limited <sup>28</sup>	A	Stable	BBB+	Stable	A2	Stable	A+	Positive		
ORIX New Zealand Limited <sup>29</sup>	A-	Negative	A-	Stable	Baa1	Positive	A+	Stable		
Police and Families Credit Union <sup>23</sup>										
Ricoh New Zealand Limited <sup>30</sup>	A-	Negative					A+	Stable		
Toyota Finance New Zealand Limited <sup>31</sup>	AA-	Stable	A	Stable	Aa3	Stable	AA+	Stable		
Turners Automotive Group									B+	Good
UDC Finance Limited	BBB	Watch Neg								
Wairapa Building Society			BB+	Stable						

# Ownership

as at 6 December 2017

Non-bank Entity	Ultimate Shareholding	%
Avanti Finance Limited	Various investment/ nominee companies	100
BMW Financial Services New Zealand Limited	BMW AG (Germany)	100
Branded Financial Services (NZ) Limited	Balverona Pty Limited	100
Christian Savings Incorporated	Various private shareholding entities	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
Fuji Xerox Finance Limited	Fuji Xerox Co. Ltd (Japan)	100
Geneva Finance Limited	Various investment/ nominee companies; various private shareholders	100
Instant Finance Limited	Various private shareholders	100
John Deere Financial Limited	Deere & Company (USA)	100
LeasePlan New Zealand Limited	LeasePlan Corporation (Netherlands)	100

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

# Descriptions of the credit rating grades

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

# Definitions

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

# Endnotes

1. ANZ, ANZ Business Outlook Survey: The boardwalk, ANZ, November 2016. Web. 6 December 2017. [https://www.anz.co.nz/resources/1/3/1396912e-3c3c-431a-9b40-a4c9f339dfab/ANZ\\_Business\\_Outlook\\_20161130.pdf?MOD=AJPERES](https://www.anz.co.nz/resources/1/3/1396912e-3c3c-431a-9b40-a4c9f339dfab/ANZ_Business_Outlook_20161130.pdf?MOD=AJPERES)
2. ANZ, ANZ Business Outlook Survey: The prevailing breeze, ANZ, September 2017. Web. 6 December 2017. [https://www.anz.co.nz/resources/5/c/5c459276-656c-492f-8694-3a6dae7f037c/ANZ\\_Business\\_Outlook\\_20170926.pdf?MOD=AJPERES](https://www.anz.co.nz/resources/5/c/5c459276-656c-492f-8694-3a6dae7f037c/ANZ_Business_Outlook_20170926.pdf?MOD=AJPERES)
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21. Please note that the prior year comparable figures for the new survey participants have been calculated using the 2016 denominator rather than the 2015/2016 average value of interest-earning assets.
22. Rating of parent company BMW AG (Germany).
23. Credit rating is not available for this entity.
24. Rating of parent company Fuji Xerox Co. Ltd (Japan).
25. Rating of parent company John Deere Financial Limited Australia.
26. Rating of parent company LeasePlan Corporation N.V. (Netherlands).
27. Rating of parent company Daimler AG (Germany).
28. Rating of parent company Nissan Motor Co. Limited (Japan).
29. Rating of parent company ORIX Corporation (Japan).
30. Rating of parent company Ricoh Co. Limited (Japan).
31. Rating of parent company Toyota Motor Corporation (Japan).

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