THE BANKING SECTOR IN NEW ZEALAND: AGGREGATE BANKING SUPERVISION DATA

This article publishes, for the first time, aggregate banking system data, collated from information provided by registered banks to the Banking Supervision Department.

Introduction

As part of the supervisory regime defined by the Reserve Bank of New Zealand Act 1989, registered banks are required to make regular reports to the Reserve Bank on matters prescribed by the Bank. These include requirements to provide information on the overall financial position and profitability of the bank, and other key areas of performance.

The information provided by individual banks and used as input into our supervision is subject to confidentiality provisions of the Act and cannot be published. However, we recognise that aggregate banking system data could be of interest. Now that three years of consistent data is available, we intend to publish aggregate information each year. A brief commentary on the banking system accompanies the data.

The aggregate data reported in this article covers the years 1989 to 1991. Balance sheet data is as at 31 December and income data has been annualised to a December year end. For banks with other than December balance dates, the data has been calculated on a 12 month running total basis and for banks not reporting to the Reserve Bank in December, annualised data from the previous reporting date has been used.[1]

Registered Banks

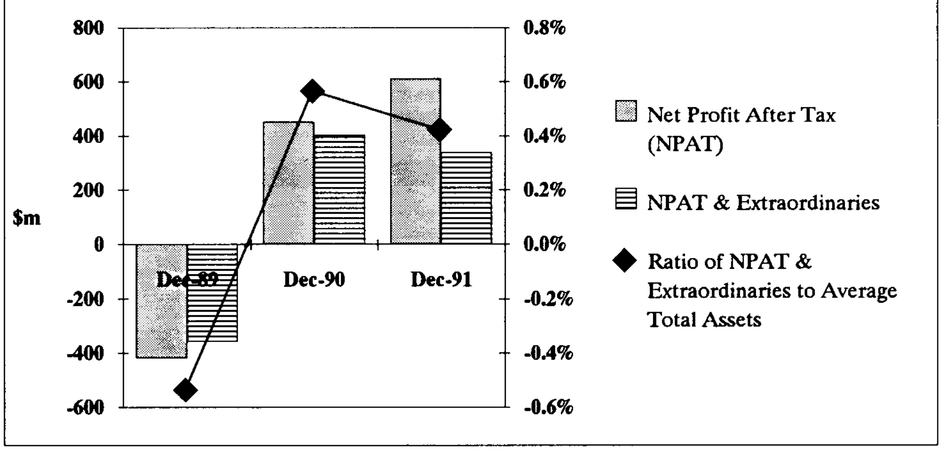
Since the introduction of bank registration in April 1987, 25 banks (counting the ASB Bank and Westland Bank as one) have been registered. As at December 1991, five banks had relinquished their registration: three withdrawing (CIBC New Zealand Limited, Elderbank Limited and Security Pacific Bank New Zealand Limited), one being merged with the operations of another bank (National Mutual Bank New Zealand), and one reverting to a non-bank financial institution (Macquarie Bank Limited).

1 Some banks are required to report on a half yearly basis, rather than a quarterly basis. For these banks, annualised September data has been used for the purposes of this article.

As at December 1991 there were 21 registered banks.[2] Of these banks, seven are registered as branches of overseas banks.

Profitability

Figure 1. Bank Profitability



At the beginning of the survey period, the overall profitability of the banking system was dominated by large losses being incurred by some banks. The data shows, however, that banking system profitability has improved over the period 1989 - 1991 (Table 1). Net profit after tax and extraordinaries as a proportion of average total assets has increased from -0.5 per cent for the year ended December 1989 to 0.4 per cent for the same period to December 1991.

Table 1. Profitability	**Dec-89**	**Dec-90**	**Dec-91**
Net Profit After Tax (NPAT)	($417.1m)	$453.5m	$612.4m
NPAT & Extraordinaries	($357.1m)	$406.0m	$340.1m
NPAT & Extras/Ave. Total Assets	(0.5%)	0.6%	0.4%
NPAT & Extras/Ave. S'holders Funds	(7.7%)	12.1%	8.3%

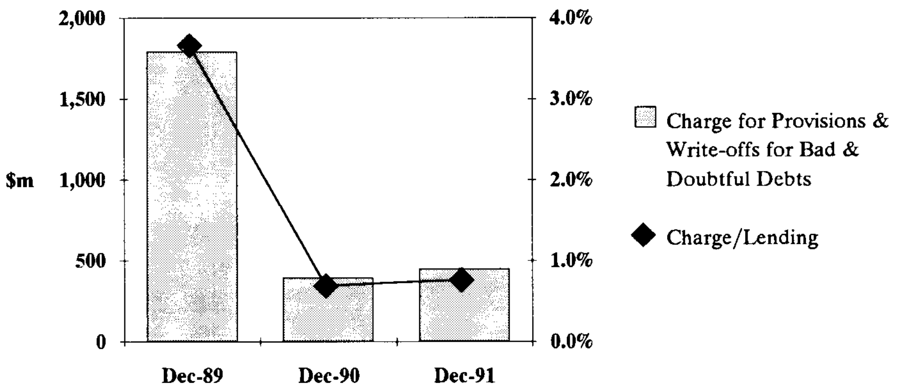
( ) denotes a negative figure

To an extent, the experiences of the New Zealand banking system during this period are similar to those of other OECD countries. The Bank of England has published figures showing that large British banks[3] recorded a return on total assets of 0.2 per cent in the year ended December 1989 and 0.6 per cent in the year ended December 1990. The Federal Reserve reported a return of 0.5 per cent for United States banks in both the year to December 1989 and the year to December 1990.

2 Since that time, NZI Bank Limited has relinquished its registration (February 1992). Refer to Appendix 1. for a list of registered banks as at December 1991.

3 Large British Banks are Barclays, Lloyds, Midland, National Westminster, Bank of Scotland, The Royal Bank of Scotland, Standard Chartered and the Trustee Savings Bank.

Figure 2. Charge for Provisions and Write-offs for Bad & Doubtful Debts



Contributing to the improved profit performance has been a decrease in the charge for provisioning and loan write-offs (Table 2). In dollar terms, the charge has declined from a substantial total of $1,793 million for the year to December 1989 to $448 million for the same period to December 1991, a reduction of 75 per cent. The extent of the reduction in the charge for provisioning and loan write-offs is reflected in the decline of the ratio of the charge to lending.[4]

Table 2. Charges for Provisions & Write-offs	Dec-89	Dec-90	Dec-91
Charge for Provisions and Write-offs	$1,792.9m	$393.2m	$447.8m
Charge/Lending	3.7%	0.7%	0.8%

Banks have continued to seek efficiencies in the way they operate, partly by internal restructuring and partly through the implementation of new technology. The impact of these strategies can be seen in the improvement in the ratio of operating expenses to average total assets (Table 3). This ratio has declined from 3.8 per cent for the year to December 1989 to 3.4 per cent for the year to December 1991.

Table 3. Operating Expenses	Dec-89	Dec-90	Dec-91
Operating Expenses/Ave. Total Assets	3.8%	3.6%	3.4%

4 The term lending is used in this article to refer to banks' non-government and non-bank loans.

Bank Assets

Table 4, below, shows that there has been a slowdown in the growth of banking system total assets. While total bank assets have continued to grow in dollar terms, the growth rate has declined significantly. From a growth rate of 20.1 per cent in the year to December 1989, the rate had declined to just 3.1 per cent in the year to December 1991.[5]

Table 4. Assets	Dec-89	Dec-90	Dec-91
Total Assets for Registered Banks	$66,915.1m	$78,005.1m	$80,441.4m
Percentage increase in Assets from previous yr	20.1%	16.6%	3.1%
Residential Mortgages	na	$15,943.1m	$19,850.7m
Residential Mortgages/ Total Assets	na	20.4%	24.7%
Lending	$54,581.0m	$57,819.1m	$58,582.2m

The slowdown in growth of total assets is due to a number of factors. The banking system has seen a period of consolidation, with some banks instigating a reassessment of their loan criteria, resulting in a more cautious approach to lending. Some banks were faced with large write-off expenses, limiting their asset growth. The absence of sound lending opportunities, in the face of a corporate and commercial sector downturn, has also been a factor.

Historically, the loan loss rate for mortgage lending has been low. This, combined with the lack of sound lending opportunities has resulted in an increase in the volume of mortgage lending.[6] The ratio of mortgage lending to total assets has increased from 20.4 percent as at December 1990 to 24.6 per cent as at December 1991.

Sub and Non-Performing Debt

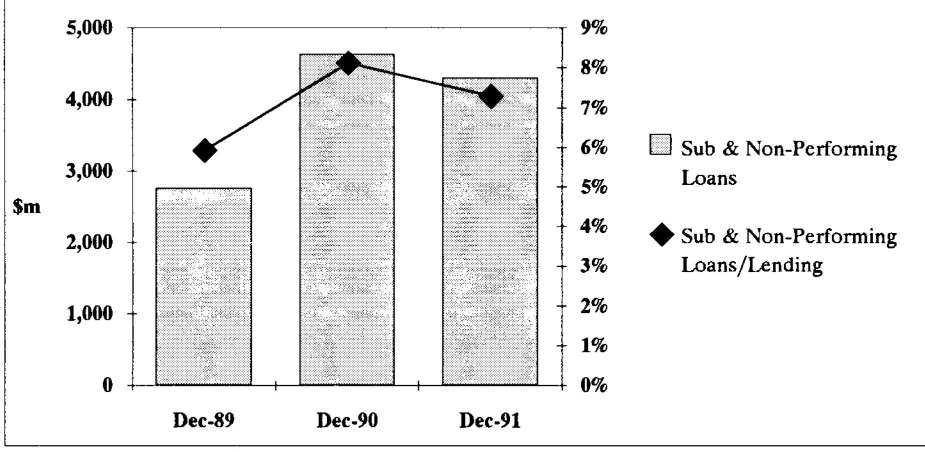
Banks report sub-and non-performing debt to the Reserve Bank in four categories:

- loans 3-6 months in arrears
- loans in arrears greater than 6 months
- restructured or reduced rate loans
- other sub and non-performing loans.

Sub-and non-performing loans, for the purposes of this article, are represented by the sum of these categories. Banks differ in the methodology they use to identify sub-and non-performing debt. Over the period covered by this article, some banks have adopted a more conservative approach to the assessment of asset quality. Thus, in addition to actual changes in asset quality, changes in methodology may have affected the level of sub-and non-performing debt, reported in this article.

5 Banking system total assets refers to the sum of the total assets for banks registered as at December 31 of the relevant year. Thus the figure does not represent a change in the total assets of a constant list of banks but rather a change in total assets of the banking system as a whole. For example, as at December 1988 there were 14 registered banks. By 1989 the number of registered banks had increased to 20. Therefore, part of the 20.1 per cent increase, referred to in table 4, could be attributed to an increase in the number of banks. The number of registered banks has remained reasonably constant since December 1989.

6 Note that the data available for December 1989 was incomplete and therefore has not been included in this report.



The data reveals a substantial increase in the volume of sub and non-performing loans, from $2,760 million as at December 1989 increasing to $4,635 million as at December 1990 but declining slightly to $4,305 million as at December 1991 (Table 5). The increase, in part, indicates an improvement in banks' identification of doubtful loans.

Table 5. Sub and Non-Performing Loans	Dec-89	Dec-90	Dec-91
Sub and Non-Performing Loans	$2,760.0m	$4,634.6m	$4,304.5m
Sub and Non-Performing Loans/Lending	6.0%	8.2%	7.3%

The ratio of sub-and non-performing loans to lending reflects this trend. While encouraging, the decline in this ratio to 7.3 per cent as at December 1991 is due, in part, to loan write-offs and debt reclassification by a number of the registered banks.

The level of problem loans has a significant impact on bank profitability, particularly in terms of write-offs, lost interest and the cost of human resources required to manage the loans. The data indicates that the impact of sub and non-performing debt is beginning to decline and this should facilitate an improvement in bank profitability. The dramatic reduction in interest rates during the later part of the survey period may assist this trend as some businesses regain viability with lower interest rate costs.

The level of provisioning for sub-and non-performing loans has increased (Table 6). As at December 1991, specific provisions totalled $2,296 million, compared to $1,499 million reported in December 1989. The extent to which changes in asset quality will impact on future profitability depends partly on how adequately problem loans have been provided for. As at December 1991, the ratio of specific provisioning to sub and non-performing loans was 53.3 per cent. This ratio, by providing a measure of the proportion of doubtful loans provisioned for by banks, gives some indication of the adequacy of provisioning.

Table 6. Provisioning	Dec-89	Dec-90	Dec-91
Specific Provisions	$1,499.3m	$1,506.6m	$2,295.7m
General Provisions	$466.3m	$471.7m	$301.2m
Total Provisions	$1,965.6m	$1,978.3m	$2,596.9m
General Provisions/Lending	0.9%	0.8%	0.5%
Total Provisions/Lending	4.0%	3.4%	4.4%
Specific Provs/Sub & Non-Performing Loans	59.7%	32.5%	53.3%

Capital Adequacy

The Reserve Bank adopted the Basle Committee[7] capital framework and introduced capital ratio reporting on this basis in June 1989.[8] Registered non-branch[9] banks were required to have a capital ratio of at least 7.25 per cent by the end of 1990 and 8 per cent by the end of 1992. Tier one or core capital must be at least 4 per cent of risk adjusted exposures.

Aggregate banking system capital adequacy has been above minimum requirements since the introduction of the Basle based reporting (Table 7). The tier one capital ratio, in particular, has been well in excess of the 4 per cent minimum level.

Table 7. Capital Ratios - Non Branch Banks	Dec-89	Dec-90	Dec-91
Tier One Capital	$3,265.8m	$3,842.1m	$3,891.5m
Tier One Capital Ratio	7.5%	8.1%	8.4%
Total Capital	$4,065.3m	$5,204.0m	$5,156.4m
Overall Capital Ratio	9.3%	11.0%	11.1%

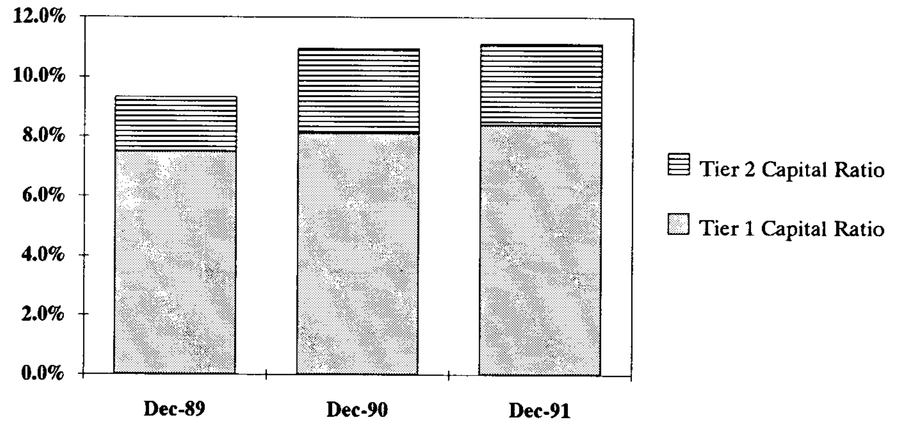
Capital adequacy levels in the banking system have increased over the reported period, from 9.3 per cent as at December 1989 to 11.1 per cent as at December 1991. Capital adequacy of New Zealand banks is comparable with that of other countries. For example, the Reserve Bank of Australia reported that, as at December 1991, the consolidated capital ratio for Australian banks was 10.4 per cent.

7 The Basle Committee on Banking Supervision comprises representatives of the Governors of the central banks of the G10 countries (plus Switzerland and Luxembourg) and is based at the Bank for International Settlements, Basle, Switzerland. The objective of the committee is to develop guidelines to: (1) close gaps in the supervision of the global banking industry; and (2) improve the quality of banking supervision worldwide.

8 Prior to that time, banks were required to meet individual capital ratio requirements, but these were not based on the Basle framework

9 Branches of overseas banks operating in New Zealand are subject to the capital requirements of their parent supervisors.

Figure 4. Capital Ratios



Most banks are comfortably in excess of requirements. However, the spread of capital adequacy ratios (Table 8)[10] demonstrates that some individual banks were required to increase their capital levels to bring them up to the level required by Reserve Bank guidelines by the end of 1992.

Table 8. Capital Ratio Spreads	Dec-89	Dec-90	Dec-91
Tier One Capital Ratio	5.2% - 20.4%	5.6% - 23.5%	6.3% - 19.4%
Overall Capital Ratio	6.4% - 21.1%	5.8% - 23.5%	8.9% - 19.6%

Conclusions

The period covered by the banking supervision data, 1989-1991, has been a difficult one for the banking system. However, data reported by banks indicates that they are starting to recover from some of the difficulties experienced over the last three years.

Assisted by a significant decrease in the charges for provisioning and loan write-offs, system profitability is slowly improving. December 1991 data reveals a decline in the ratio of sub and non-performing loans to lending indicating a strengthening in banks' asset quality. This was due, in part, to reductions in property sector exposures. Declining interest rates also contributed to the improvement.

New Zealand incorporated banks have capital ratios generally well above minimum levels, with a continued steady growth in tier one capital.

10 Adjustments have been made to this table for banks who had abnormal ratios due to the winding down of their operations.

Glossary of Terms

Risk Adjusted Exposures
Assets and off balance sheet exposures are weighted according to broad categories of credit risk as determined by the risk weighting framework. For example, Government exposures of less than one year areweighted at zero, while commercial lending is weighted at 100 per cent. Banks are required to hold capital against their risk adjusted credit exposures.

Capital
The residual claims of owners on the assets of the bank once all claims of depositors and other commitments have been satisfied. Under the Basle framework capital is divided into Tier One and Tier Two capital.

Tier One Capital
Tier One Capital is shareholders' funds or net worth (primarily issued share capital and retained earnings). It represents that part of a bank's funding which is available to absorb unanticipated losses without the bank being obliged to cease trading and which is free from any fixed servicing obligations.

Tier Two Capital
Tier Two Capital comprises items which are not equity but which have some of the same characteristics as equity, for example, revaluation reserves, hybrid capital instruments such as subordinated debt and general provisions.

Capital Adequacy Ratio
The Capital Ratio is total capital (the sum of Tier One and Tier Two) divided by total risk adjusted exposures.

Appendix 1

Registered Banks as at December 1991	Registration Date
ANZ Banking Group (New Zealand) Limited	1 April 1987
ASB Bank Limited	11 May 1989
Bank of New Zealand	1 April 1987
Bankers Trust New Zealand Limited	21 June 1988
Banque Indosuez	28 March 1991
Barclays Bank Plc	7 December 1988
BNZ Finance Limited	23 January 1991
Citibank NA	22 July 1987
Countrywide Banking Corporation	3 December 1987
National Australia Bank (NZ) Limited	22 July 1987
NZI Bank Limited [11]	22 July 1987
Post Office Bank	11 August 1989
Primary Industry Bank of Australia Limited	11 May 1989
State Bank of South Australia	7 December 1988
The Hongkong and Shanghai Banking Corporation	22 July 1987
The National Bank of New Zealand Limited	1 April 1987
The Rural Bank Limited	13 August 1990
Trust Bank New Zealand Limited	21 December 1989
TSB Bank Limited	8 June 1989
United Bank Limited	29 June 1990
Westpac Banking Corporation	1 April 1987

11 NZI relinquished its registration in February 1992.