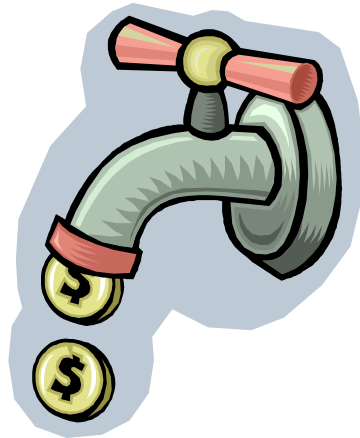


Credit losses and provisioning in New Zealand

Slides prepared by Kurt Hess,
University of Waikato Management
School

Credit Losses

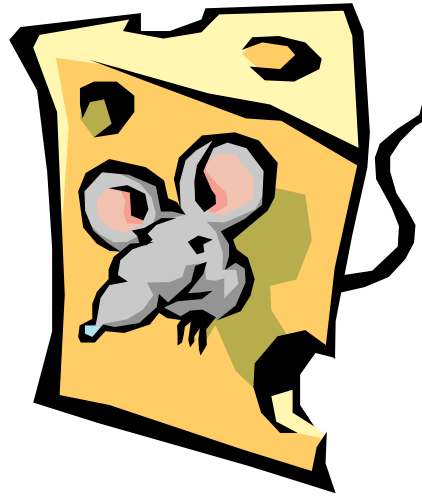


24-Mar-04

Kurt Hess, WMS
kurthess@waikato.ac.nz

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Credit Losses



24-Mar-04

Kurt Hess, WMS
kurthess@waikato.ac.nz

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AGENDA

- **Motivation:** Why study credit losses and provisioning of banks? How have researchers used these data?
- **Data:** Characteristics of data sample
- **Research Ideas:** results of first visual inspection of data

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Kurt Hess, WMS
kurthess@waikato.ac.nz

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Motivation

Why study credit losses and provisioning?

- Loan-loss provisions are a first quantitative indicator of deterioration in loan quality
- Subsequent loan write-offs give an ex-post measure of credit risk in a loan portfolio

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Kurt Hess, WMS
kurthess@waikato.ac.nz

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Motivation

Research that has studied loan loss and provisioning data

1. Research initiated and/or sponsored by banking regulators
2. Research with more academic perspective like exploration of motivations for provisioning, agency theory approaches to explain provisioning patterns.

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Kurt Hess, WMS
kurthess@waikato.ac.nz

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Motivation

Examples Regulatory Research (1)

- Pain (2003) of BOE explores factors affecting loan losses and provisions for a sample of 11 UK banks.
- Fernández de Lis et al. (2000) of Bank of Spain study credit growth and credit risk provisioning in Spain

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Kurt Hess, WMS
kurthess@waikato.ac.nz

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Motivation

Examples Regulatory Research (2)

- Borio & Lowe (2001) of BIS discuss the provisioning practices of banks and note differing perspectives between bank supervisors and accounting authorities.
- Borio, Furfine & Lowe (2001) in a major paper on the procyclicality of the financial system touch on the procyclical nature of credit provisions.

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Kurt Hess, WMS
kurthess@waikato.ac.nz

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Motivation

Development Basel II Capital Accord

- The Basel Committee fine tuning its latest proposals in CP 3.
- General provisions are relevant since they may qualify for inclusion in Tier II capital
- Most recent changes revise approach on capital requirement in relation to expected and unexpected (variance) of losses.

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Kurt Hess, WMS
kurthess@waikato.ac.nz

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Motivation

Examples “Academic” Research (1)

- Lobo & Yang (2001) explore motivations for discretionary behaviour of bank managers with respect to loan provisions:
 - Signaling
 - Income smoothing
 - Capital management
 - Tax incentive

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Kurt Hess, WMS
kurthess@waikato.ac.nz

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Motivation

Examples “Academic” Research (2)

- Cavallo & Majnoni (2001) looks at procyclical effects of capital regulation. They adopt agency approach to explain bank loan provisioning. Provisions are “in competition” with other stakeholder interests (shareholders, tax authorities). The authors call for a risk based regulation of bank provisions to mitigate these agency conflicts.

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Kurt Hess, WMS
kurthess@waikato.ac.nz

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Kurt Hess, WMS
kurthess@waikato.ac.nz

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Data

- Loan losses and provisions collected for 8 NZ banks back to the early eighties
- Five institutions still operate today: ASB, ANZ, BNZ, NBNZ, Westpac
- Three have been absorbed into other institutions: Countrywide, Trustbank, Rural Bank
- History in appendix of paper (last page)

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Kurt Hess, WMS
kurthess@waikato.ac.nz

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Data

Data Issues (1)

- Westpac produced NZ disclosure statements only back to 1997
 - will expand sample with earlier data from security prospectuses
- Missing data for United Bank, Post Bank
 - to be added

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Kurt Hess, WMS
kurthess@waikato.ac.nz

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Data

Data Issues (2)

- Overseas banks (HSBC, Citibank, Barclays, Rabobank)
 - Typically wholesale lenders
- Kiwi Bank, “Superbank”
 - History too short
- Finance companies, building societies etc.
 - Some are offering virtually complete range of banking services (SBS, PSIS)

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Kurt Hess, WMS
kurthess@waikato.ac.nz

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Data

Data Issues (3)

- Early history for institutions with roots in cooperative banking is missing
- Reporting dates / periods
 - Reporting dates not standardized in NZ
 - Reporting periods have sometimes changed (ownership change)

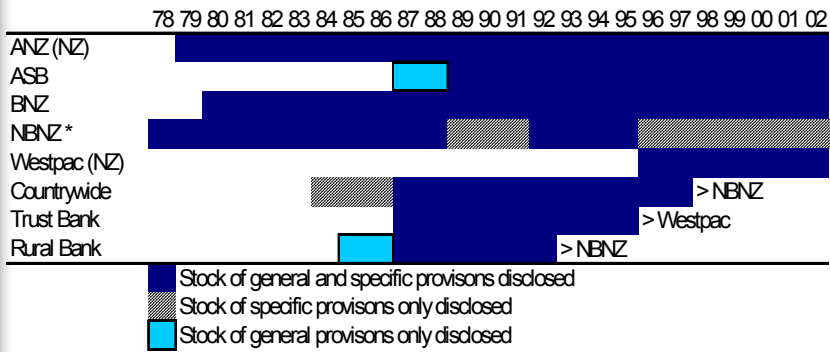
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Kurt Hess, WMS
kurthess@waikato.ac.nz

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Data

Data Availability



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kurthess@waikato.ac.nz

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Data

Disclosure of provision/credit losses

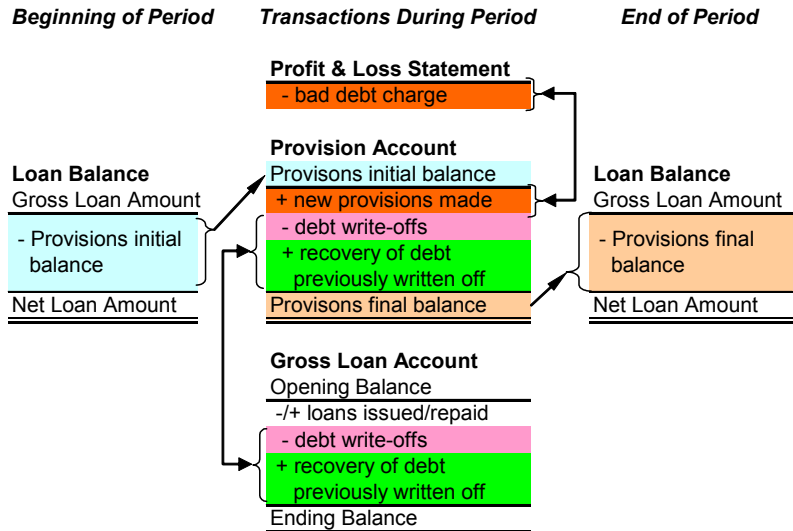
- Not uniform across
 - time
 - sample
- Earlier reports required some “forensic” work to extract the relevant data

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Kurt Hess, WMS
kurthess@waikato.ac.nz

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Data

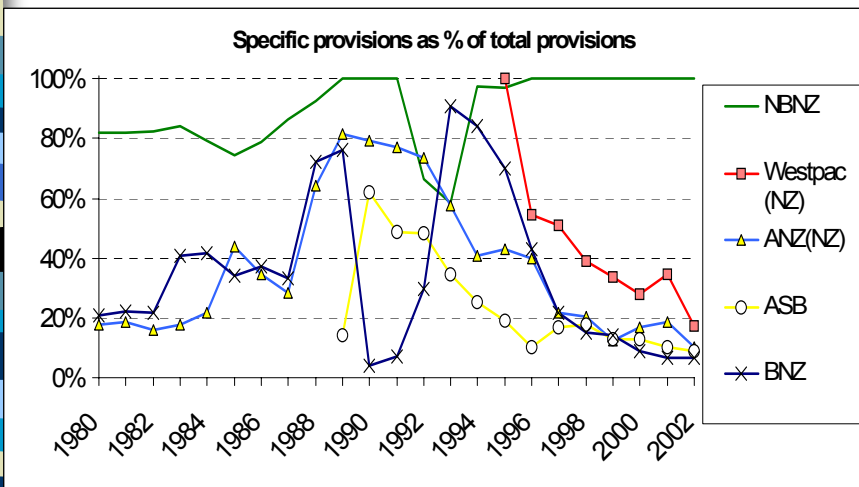


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kurthess@waikato.ac.nz

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Data

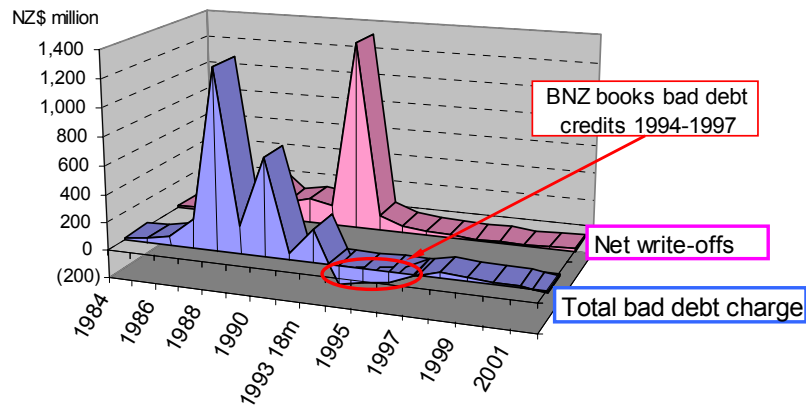


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Kurt Hess, WMS
kurthess@waikato.ac.nz

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Data



BNZ debt provisioning and net write-offs

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Kurt Hess, WMS
kurthess@waikato.ac.nz

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AGENDA

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Kurt Hess, WMS
kurthess@waikato.ac.nz

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Research Ideas

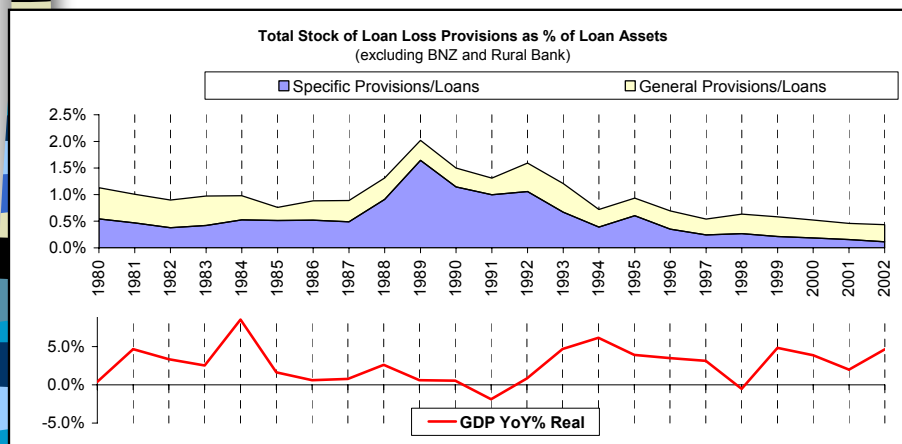
- Correlation provisions / write-offs with ...
 - economic activity (e.g. GDP growth, output gap)
 - credit expansion (growth loan portfolio)
 - bank profit performance
- Accuracy of provisioning

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Kurt Hess, WMS
kurthess@waikato.ac.nz

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Research Ideas

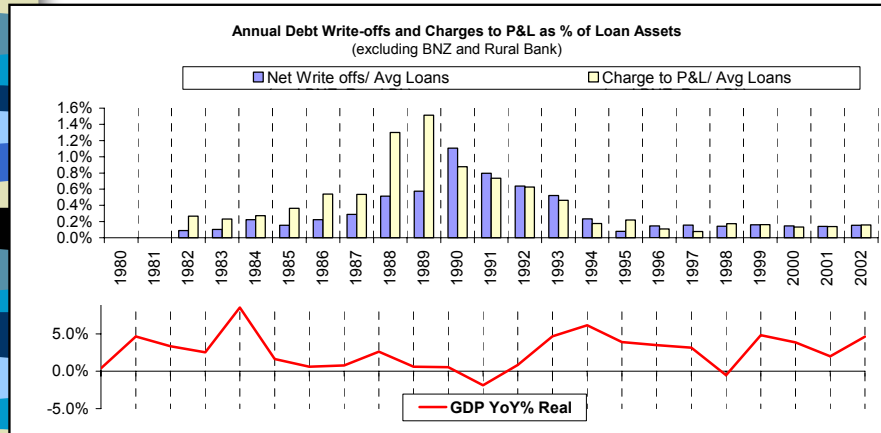


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kurthess@waikato.ac.nz

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Research Ideas

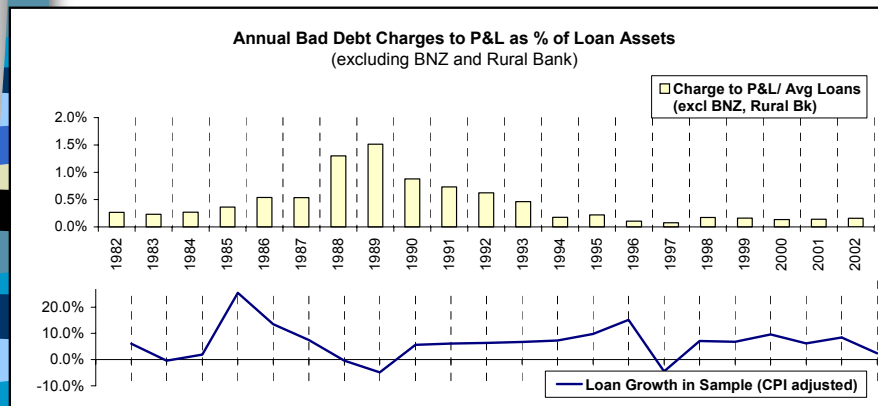


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Kurt Hess, WMS
kurthess@waikato.ac.nz

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Research Ideas



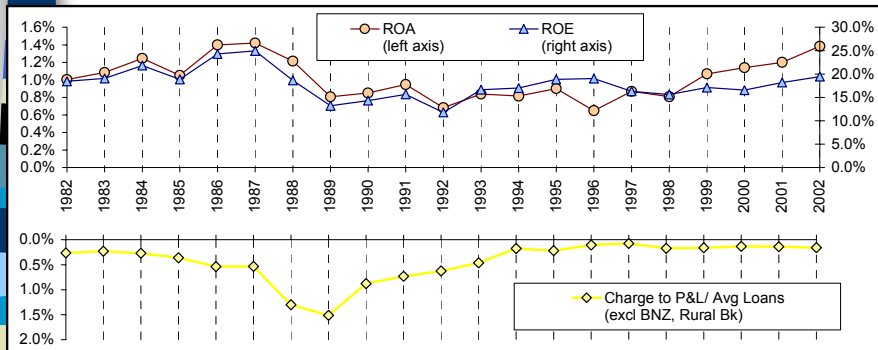
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kurthess@waikato.ac.nz

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Research Ideas

Annual debt write-offs (inverse) vs. ROA and ROE of NZ Banks



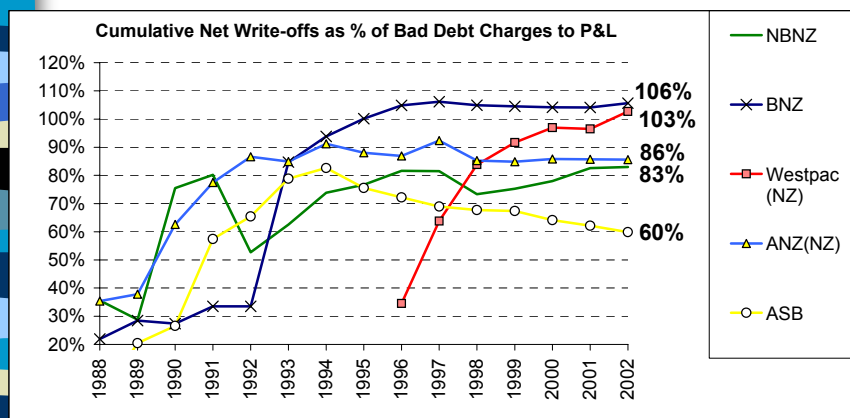
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Kurt Hess, WMS
kurthess@waikato.ac.nz

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Research Ideas

How accurate are estimates of loan losses?



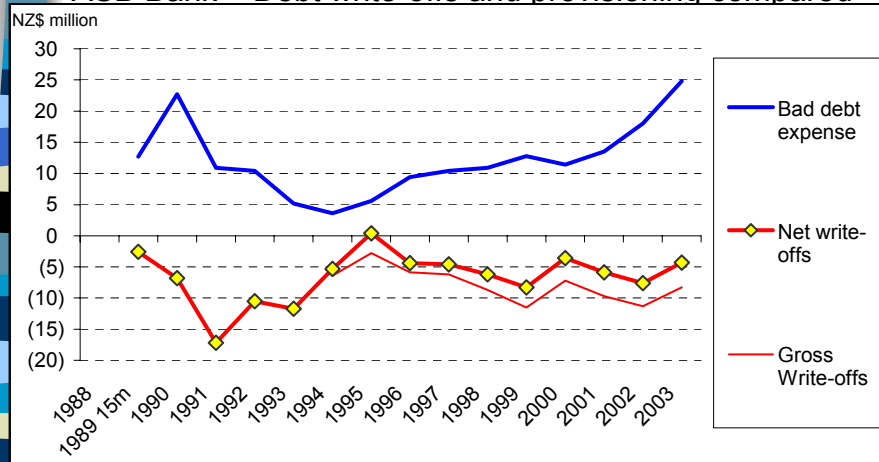
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Kurt Hess, WMS
kurthess@waikato.ac.nz

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Research Ideas

ASB Bank – Debt write-offs and provisioning compared



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Kurt Hess, WMS
kurthess@waikato.ac.nz

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Conclusion

- The data set raises a number of interesting research questions
- Intend to explore long-term loss rates in NZ market in view of new Basel II capital requirements
- Expansion of sample
 - Australian banks
 - Much longer time series for selected banks

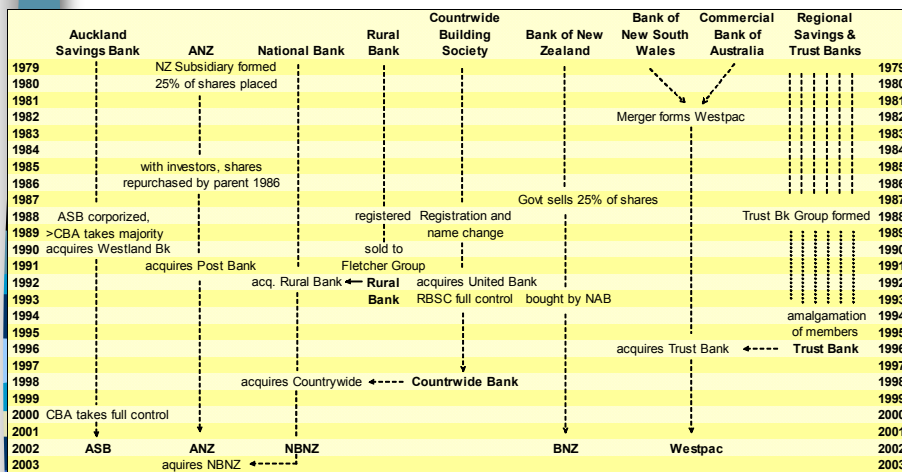
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kurthess@waikato.ac.nz

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Back-up Charts

New Zealand Banking Institutions: Major Events During Observation Period

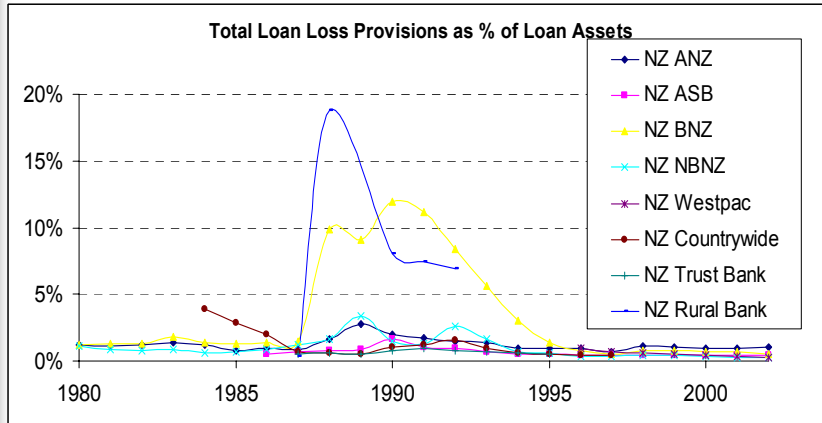


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Kurt Hess, WMS
kurthess@waikato.ac.nz

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Stock of provisions to loans NZ banks

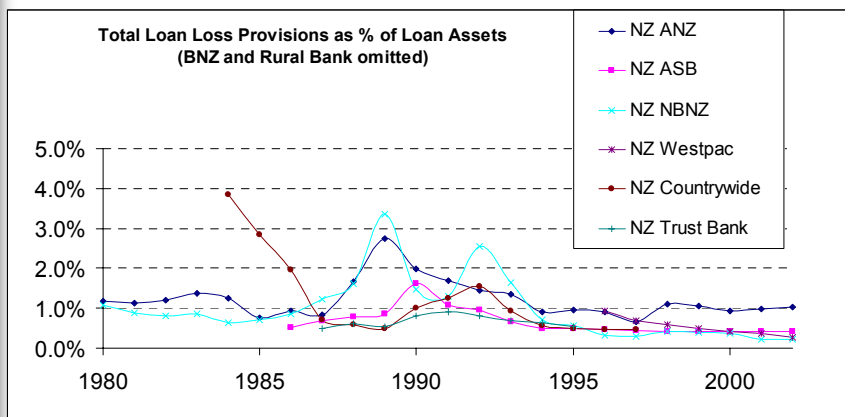


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Kurt Hess, WMS
kurthess@waikato.ac.nz

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Stock of provisions to loans NZ banks (BNZ and Rural Bank omitted)

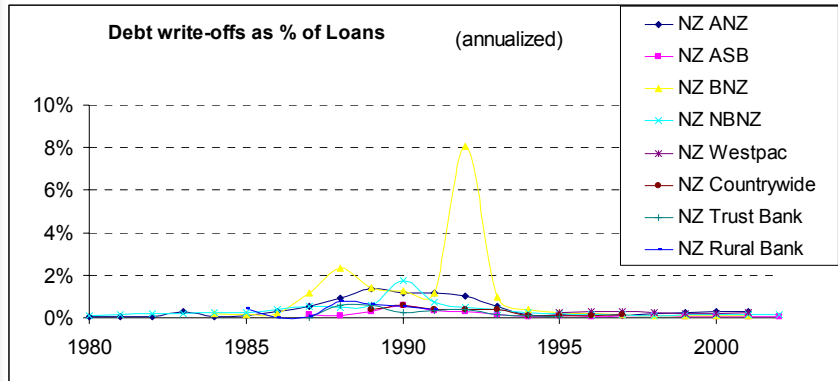


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Kurt Hess, WMS
kurthess@waikato.ac.nz

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Debt write-offs as % of loans NZ banks

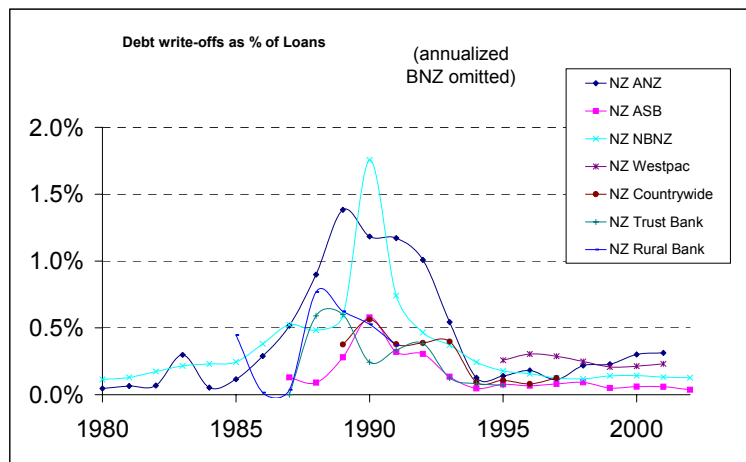


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Kurt Hess, WMS
kurthess@waikato.ac.nz

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Debt write-offs as % of loans NZ banks (BNZ omitted)



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Kurt Hess, WMS
kurthess@waikato.ac.nz

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