

Rural bank lending: ANZ's briefing submission



9 May 2024

To: Primary Production Committee, Komiti Whiriwhiri Ahumatua

From: ANZ Bank New Zealand Limited

Introduction

1. ANZ has been a major supporter of the agriculture sector for over 180 years and recognises the critical role that the sector plays in supporting the New Zealand economy.
2. A sustainable agriculture sector is vital to New Zealand's economic well-being, and it is crucial that the agriculture sector benefits from working with a strong and competitive banking sector. ANZ is New Zealand's largest lender to the sector and is committed to helping the New Zealand rural community thrive.
3. ANZ acknowledges that the agriculture sector, like many New Zealanders, is experiencing the adverse effects of inflation and higher lending interest rates.
4. ANZ supports the work that the Primary Production Committee, Komiti Whiriwhiri Ahumatua, is undertaking, including to examine rural banking practices. ANZ welcomes the invitation to provide a written submission on rural bank lending practices and answer any questions the Committee may have.
5. ANZ defines the rural sector to encompass land-based primary producers such as dairy, beef, sheep, and horticulture. ANZ refers to this as the agriculture sector in this submission. ANZ does not include fisheries or other businesses in the supply chain such as milk processors, pack houses and distributors in the agriculture sector.
6. ANZ acknowledges that greater clarity on how the agriculture banking system operates, including ANZ's approach to supporting the sector, is helpful. ANZ welcomes this opportunity to contribute to providing that clarity.
7. ANZ's submission focuses on the following:
 - ANZ innovation and other support for the agriculture sector,
 - The agriculture banking sector,
 - Interest rates, in particular:
 - Capital requirements,
 - Monetary policy,
 - Wholesale funding markets,
 - Shareholder return, and
 - Impact on agriculture borrowers
 - ANZ support for agriculture customers in financial distress, and
 - ANZ support for the agriculture sector towards a sustainable and climate resilient future.

Executive Summary

8. ANZ has supported the agriculture sector for nearly two centuries and is the largest lender to the sector. ANZ understands the sector, the challenges it faces, and offers products and support that respond to the sector's present and future needs. ANZ has been awarded the Canstar bank of the year – Agribusiness award for the last 10 years. This award is given to the financial institution that, according to Canstar, provides "an outstanding value combination of products to agribusiness customers, as well as excelling in a range of institutional factors"¹.
9. The agriculture banking sector is large and competitive. Lending is ~\$62b and deposits are significantly lower at ~\$8b.
10. Agriculture lending interest rates are influenced by factors such as economic conditions, regulatory settings (such as capital requirements), monetary policy, wholesale funding markets and shareholder returns.
11. The infographic appended to this submission "*Why all interest rates aren't the same*" provides a helpful overview of the factors influencing banks' interest rates and explains why lending interest rates and their impact can be different for agriculture borrowers than for home lending borrowers. Please see the Appendix. The key factors impacting interest rates are set out below.
 - 11.1. The main regulator of banks in New Zealand, the Reserve Bank of New Zealand (RBNZ), provides a capital framework that sets out how much capital banks must hold. It determines how much capital a bank needs to hold based on the risk associated with the lending they have provided their customers. ANZ is required to hold two times more capital against lending to the agriculture sector than against home lending. This is due to the respective level of risk of loss to the bank. It increases the cost of those loans to ANZ.
 - 11.2. Interest rates are also impacted by wholesale market interest rates and the RBNZ's monetary policy (including the Official Cash Rate (OCR)). Changes in the OCR, including expected changes, influence wholesale market interest rates. The OCR and wholesale market interest rates have increased since 2021 and increased the cost of funding to banks.
 - 11.3. Like any organisation, banks must provide a return to shareholders. Shareholders expect appropriate returns for riskier investments that require more capital than other investments. ANZ's post-tax return on equity after tax is materially the same as its global peers.²
 - 11.4. Agriculture borrowers are more likely than home lending borrowers to have variable lending interest rates. This means they are more likely to feel the impact of higher lending interest rates sooner than home lending borrowers with fixed rates, who do not feel that impact until the fixed rate period ends.
12. ANZ works collaboratively with agriculture customers in financial distress and takes the time needed to find viable solutions. ANZ harnesses the skill and care of its specialist advisory team, provides support for specialist advice, and refers customers to the Rural Support Trust when appropriate. At the date of this submission, ANZ has had only two receiverships for agriculture customers in the last ten years.

¹ See <https://www.canstar.co.nz/star-rating-reports/agribusiness-award/>

² ANZ Bank New Zealand Limited submission to the New Zealand Commerce Commission Draft report for its market study into personal banking services. Page 27 paragraph 122

13. ANZ aims to support its agriculture customers transition to lower emission, climate resilient operations. This transition will help the sector compete against the backdrop of growing global demand for sustainable food supply chains. ANZ has advocated for support for the agriculture sector to undertake this transition.³ It has designed products and invested in AgriZero^{NZ} to support the innovation in technology that will be needed.⁴
-

ANZ innovation and other support for the agriculture sector

14. ANZ has provided sustained support to agriculture customers for nearly two centuries. ANZ understands the needs of farmers, the challenges and risks the sector faces and the importance of the lifestyle and enjoyment farming brings. This section describes some of the ways that ANZ supports the sector.
15. *Products and services* – ANZ has transaction accounts and lending products fit for agriculture businesses. It also provides products and services that respond to the unique needs of the agriculture sector:
- 15.1. Farm start up packages and succession planning. Many of ANZ's farming customer relationships are intergenerational. It is important that there is a healthy pipeline of new farmers coming through. ANZ is one of the few banks to offer a dedicated farm start-up package to support those starting their farming journey, such as contract milkers, share milkers, and farm lessees. This package includes access to unsecured limits, and subsidised access to business planning tools that support financial resilience. ANZ has local managers across the country who specialise in supporting start-up farmers. For the mature end of the farming sector, ANZ provides people and capital to support their transition – whether to the next generation, or out of farming entirely. Our farmers also work with our Private Banking specialists on wealth generation.
- 15.2. Products to support customers facing climate change and weather events. For example:
- The ANZ Business Green Loan – discounted interest rates for loans for projects with clear environmental benefits.
 - The ANZ Business Regrowth Loan – lending with a discounted interest rate for customers' recovery and rebuild following adverse weather events such as the cyclone and flooding in 2023.
 - The North Island Weather Events Loan Guarantee Scheme – for customers (predominantly agriculture customers) who were adversely impacted by the North Island weather events of 2023.
16. *Flexible ways to bank* – Like many New Zealanders, our agriculture customers have preferences as to how and when they interact with their bank. ANZ's agriculture customers can bank through ANZ Direct Online (an online platform with enhanced functionality for business banking needs), internet banking, GoMoney (ANZ's mobile banking application), and the ANZ branch network. ANZ has 71 physical branches in the North Island, and another 30 branches in the South Island. Across the country, ANZ has ~209 relationship bankers who specialise in agriculture lending located at 23 regional sites. ANZ's free phone line is available to all customers 13.5 hours a day, recognising the extended hours that many agriculture customers operate. ANZ and six other banks are testing a new way to offer banking in seven small communities. The regional hubs provide basic banking

³ See for example, Submission on Action for Healthy Waterways – ANZ Bank New Zealand Limited dated 21 October 2019 at page 4.

⁴ <https://news.anz.com/new-zealand/posts/2024/04/AgriZeroNZ-investment-boosts-farm-emissions-reduction-research>
ANZ Bank New Zealand Limited

services, a Smart ATM, staff, and technology support.

17. *Digital Solutions* – ANZ has responded to the demands of changing customer needs by innovating to provide digital solutions that make interactions easier, for example supporting financial information to be shared between accounting and farm software providers such as Xero and Farm Focus.
18. *Industry Insights* – ANZ has a dedicated insights team and an ESG (Environment, Social & Governance) specialist who work closely with our agriculture sector bankers and industry to understand the environment our customers operate in and the challenges they face. This team regularly hosts events and produces industry insights, financial benchmarking reports and a range of performance analyses for the dairy, red meat, and horticulture sectors.
19. *Investment* – ANZ has a history of supporting work on scientific developments to support its agriculture customers through the challenges they face (for example, to address PSA disease affecting the kiwifruit industry). Most recently, ANZ announced a \$4 million investment in AgriZero^{NZ} which invests in tools and technologies that will help pasture-based farmers reduce their biogenic methane and nitrous oxide emissions.⁵
20. *Partnerships, donations, and sponsorships* – ANZ supports causes, events, and programmes that support or enhance the health of rural communities. Some examples include Agri-Women's Development Trust, Field Days, and Century Farms. ANZ was the largest private contributor to the Red Meat Profit Partnership. ANZ proudly supports its staff who personally invest many volunteer days to support local community events. In 2023 ANZ pledged \$3 million to support communities impacted by Cyclone Gabrielle.
21. *Customer well-being* – ANZ recognises the pressure that financial stress can have on customers, so it has partnered with the Rural Support Trust to provide mental health support to rural communities. Refer further to the section *ANZ support for agricultural customers in financial distress* below.
22. *Canstar Bank of the Year – Agribusiness* – ANZ has been granted this award for ten consecutive years. This award is given to the financial institution that, based on the analysis of Canstar's expert research team, provides "an outstanding value combination of products to agribusiness customers, as well as excelling in a range of institutional factors".⁶ In assessing its 2023 award Canstar stated that "ANZ introduced an assistance package to provide impacted customers with immediate liquidity, including \$9.5 million in interest-free overdrafts to Agri customers".⁷

The agriculture banking sector

23. The agriculture banking sector is highly competitive. It is served by five larger lending banks, several smaller market participants, and agriculture lending specialists. ANZ must compete hard to maintain and grow its market share.
24. Total lending to the agriculture sector is ~\$62b while deposits are significantly lower at ~\$8b. Dairy lending accounts for around 60% of the agriculture lending market; sheep and beef accounts for ~25%, and horticulture and others comprise ~15%.
25. Banking is fundamentally about managing risk. Banks have many tools (including sophisticated models) for managing risks.
26. To lend money to customers, banks rely on funding. This funding comes from

⁵ See <https://news.anz.com/new-zealand/posts/2024/04/AgriZeroNZ-investment-boosts-farm-emissions-reduction-research>.

⁶ See <https://www.canstar.co.nz/star-rating-reports/agribusiness-award/>

⁷ See <https://www.canstar.co.nz/agribusiness/anz-canstars-bank-of-the-year-agribusiness-award-2023/>.

shareholders, deposits, or wholesale markets. Banks manage the risks around their funding by having multiple sources of funding and by having different timeframes to pay them back.

27. Banks must also manage the risks around who they lend to, what they charge and for how long. A bank's ability to manage its interest rate risk will impact its financial performance. For example, loans and deposits have different tenures (loans are typically longer tenure on average than deposits) and that generates interest rate risk to be managed.
28. Banking operates under a prudential regulatory framework designed to minimise systemic risks to New Zealand, reflecting its critical importance to the healthy functioning of New Zealand's economy.

Interest Rates

29. Agriculture lending interest rates are influenced by a similar set of factors as other lending products in the finance industry including economic conditions, regulatory settings (such as capital requirements), monetary policy, wholesale funding markets, and shareholder return.

Capital requirements

30. The RBNZ has an important role in managing New Zealand's monetary and financial system. The RBNZ requires banks to meet minimum capital ratios; these are calculated as the amount of capital that each bank must hold in relation to its risk-weighted assets. Capital requirements are a key element of New Zealand's prudential framework and a core part of maintaining financial stability.
31. Risk-weighted assets are the loans and other assets of a bank weighted to reflect their respective level of risk of loss to the bank. The greater the amount of higher risk assets and loans, the greater a bank's risk-weighted assets, and the higher the amount of capital it must hold.
32. Banks in New Zealand calculate their risk-weighted assets according to either standardised models (determined by the RBNZ) or to internal ratings-based (IRB) models. IRB models must be approved by the RBNZ and provide a more dynamic, sensitive, and granular risk assessment of the risks held by an individual bank. ANZ uses an IRB model approach approved by the RBNZ.
33. Agriculture is a vitally important sector in New Zealand. History shows its performance can fluctuate, which presents risks from a lending perspective. The sector is highly competitive and is impacted by many factors outside the sector's control like the weather, input costs, access to markets, diseases, a changeable New Zealand dollar, and prices received. This agriculture sector risk is reflected in the amount of capital banks must hold.
34. The capital ANZ is required to hold against agriculture lending is two times higher than home lending due to the respective level of risk of loss to the bank. Capital requirements increase the cost to ANZ to provide agriculture lending and may impact the interest rates for its customers.
35. While ANZ acknowledges that it is appropriate that the amount of capital that must be held for a particular type of lending should reflect the risk of loss, ANZ highlighted during the RBNZ's recent capital review that this approach to capital requirements would directly impact both pricing and availability of lending in the agriculture sector:

"In summary, we believe the Reserve Bank proposals would have a material impact on both the pricing and availability of lending to the agriculture sector, one of the economy's productive sectors and one which, in parts, may not be well placed to

absorb the potential impact.”⁸

Monetary policy

36. Monetary policy refers to the actions the RBNZ takes to influence monetary conditions in the economy. It impacts money supply, interest rates and credit availability. The RBNZ can influence these factors through changes in the OCR.
37. Monetary policy and the expected level and direction of the OCR influence interest rates, money supply, and credit availability. Changing the OCR is one of the key levers available to the RBNZ, but other monetary policy tools, such as quantitative tightening, may be used by the RBNZ to influence market outcomes.
38. The OCR increased 5.25% from a low of 0.25% as of October 2021 to 5.50% as of April 2024.

Wholesale funding markets

39. Generally, because lending amounts exceed the amount of deposits that banks hold, banks must obtain funding via other segments or wholesale markets in order to lend.
40. Changes in the OCR, including expected future changes, influence wholesale market interest rates and therefore impact the interest rate environment banks operate in and banks' cost of capital.
41. Changes in wholesale market interest rates, whether driven by the OCR or other external economic factors, impact the interest rates banks offer to borrowers and depositors.
42. Since June 2021 wholesale market interest rates have increased materially, in part due to the OCR, expected movements in the OCR, and disruptions in global financial markets.

Shareholder return

43. Banks, like other organisations, are expected to deliver an appropriate return to shareholders against capital deployed. Banks' revenue is predominantly earned through net interest income which is the earnings generated by a company's interest-bearing assets e.g. customer lending, less the cost of its interest-bearing liabilities e.g. deposits.
44. The higher level of capital and risk associated with lending to the agriculture sector means that it is expected that lending interest rates would be higher than lower-risk lending such as home loans in competitive markets. This is similar in financial markets overseas.
45. ANZ's post-tax return on equity after tax is materially the same as its global peers. The current Commerce Commission market study, which is currently at the draft stage and is ongoing, is looking at the New Zealand banking sector's profitability. As described in ANZ's response to the Commerce Commission Draft report: "ANZ's average post-tax return on equity (ROE) over the 2010 to 2021 period – 12.3% – was materially the same as the average post-tax returns of a valid peer group of international banks – 12.2% – when compared on a like-for-like basis, and an estimated cost of equity for ANZ of 12.1%-12.8%. ANZ's actual post-tax ROE of 12.3% was within the range of normal returns.”⁹

⁸ ANZ Bank New Zealand Limited submission on the Capital Review Paper 4: How much capital is enough? 17 May 2019 page 9 at paragraph 23

⁹ ANZ Bank New Zealand Limited submission to the New Zealand Commerce Commission Draft report for its market study into personal banking services. Page 27 paragraph 122

Impact on agriculture sector

46. Agriculture borrowers may have felt lending interest rate increases faster than others due to the nature of their borrowing (see below) and the volatile impact of the current economic environment on their costs and markets:
 - 46.1. Most home loans are provided on a fixed rate in New Zealand, so most home loan borrowers do not feel the impact of increasing lending interest rates until their fixed rate term ends.
 - 46.2. By contrast, most agriculture borrowers choose variable rates that move up and down with market conditions. Most agriculture borrowers will therefore take the benefits and disadvantages of a fluctuating lending interest rate more immediately. The level of variable borrowing to agriculture customers reflects the customer need for flexibility; this is particularly relevant where cashflow is seasonal.
47. Over the six months preceding the date of this submission, customer interest lending rates have been steady to declining. This reflects a less volatile wholesale market interest rate environment, and a stable OCR since May 2023. Weather events have contributed to lower lending interest rates for some impacted agriculture borrowers, noted in paragraph 15.2.

ANZ support for agriculture customers in financial distress

48. ANZ works with customers to avoid financial distress. For example, ANZ encourages principal repayments to help agriculture customers reduce debt levels during periods of stronger performance. This increases financial buffers and reduces the likelihood of distress. As a result, the higher proportion of agriculture borrowers repaying principal debt contributes to a more financially resilient sector. However, these buffers will not always be sufficient.
49. When financial distress arises, ANZ has a specialist advisory team to support customers. This team is comprised of some of ANZ's more experienced bankers who are carefully chosen; they have managed customers through economic cycles and have experience dealing with difficult financial situations.
50. ANZ takes a collaborative approach with its agriculture customers in financial distress. ANZ aims to work with its customers to find viable solutions; providing time to see whether proposed solutions might be successful.
51. ANZ pro-actively supports agriculture customers in distress needing independent operational or financial advice. This support existed before the Farm Business Advice Fund was established in 2020. The Farm Business Advice Fund, managed by the Rural Support Trust, offers financial assistance to farmers experiencing financial difficulties so they can obtain independent advice. ANZ also actively introduces the Rural Support Trust to customers in need of its services.
52. ANZ is proactive in encouraging farm debt mediation where it cannot agree an appropriate way forward with a customer.
53. At the date of this submission, ANZ has had only two receiverships for agriculture customers in the last ten years.
54. Recognising the pressure that financial stress can have on customers, ANZ partners with the Rural Support Trust to provide mental health support to rural communities through its Time-Out Tours. Over 2022 and 2023, 25 events were held throughout New Zealand with over 3,800 registered attendees. A further 14 events will be held over the 2023 to 2024 financial year.

ANZ support for the agriculture sector towards a sustainable and climate resilient future

55. In line with New Zealand's national climate change commitments and legislation, ANZ aims to support customers' transition to a lower emission and climate resilient future.
56. ANZ acknowledges the critical role agriculture plays in New Zealand's economy, and the specific climate challenges that customers in the sector face. Customers and trading partners' demand for sustainable food supply is increasing. Demonstrating reduced climate impact may be needed to compete globally and secure the long-term future of many of our export categories including both the agriculture sector and export earnings.
57. Technologies and practices to effectively reduce emissions in the sector are still evolving. ANZ has made submissions about needing to support the agriculture sector to transition, and the investment needed in technology to enable this.¹⁰ As noted above, ANZ has a history of supporting scientific developments and has committed to support advancing technologies to reduce emissions through ANZ's recent investment in AgriZero^{NZ, 11}
58. ANZ's work with its agriculture customers includes engaging with industry and other stakeholders to better understand potential solutions. ANZ develops innovative, tailored financial products to help customers invest in projects that reduce emissions or improve sustainability (such as the ANZ Business Green Loan and ANZ Business Regrowth Loan). ANZ is also focused on improving its data capability to gain a more accurate view of its customers' climate exposure and opportunities.

Conclusion

ANZ welcomes the opportunity to provide clarity on rural banking practices to the Primary Production Committee through this submission. A sustainable primary sector is vital to New Zealand's economic well-being and ANZ is committed to helping it thrive.

About ANZ

ANZ is the largest financial institution in New Zealand. The ANZ group comprises brands such as ANZ and ANZ Investments. ANZ offers a full range of financial products and services including a significant range of financial advisory and wealth management services, personal, business, agriculture, and institutional banking.

Contact for submission

For any questions or further engagement about this submission, please contact Jessica Mutch McKay Jessica.MutchMcKay@anz.com.

Yours sincerely,



Lorraine Mapu, Managing Director – Business & Agri
ANZ Bank New Zealand Limited

¹⁰ Submission on Action for Healthy Waterways – ANZ Bank New Zealand Limited, see footnote 3.

¹¹ See <https://news.anz.com/new-zealand/posts/2024/04/AgriZeroNZ-investment-boosts-farm-emissions-reduction-research>.

WHY ALL INTEREST RATES AREN'T THE SAME

The risks around those doing the borrowing impacts the interest they pay.

1



CALCULATING RISK

Banking is fundamentally about managing risk. In order to lend money to our customers, we rely on funding. This funding comes from shareholders, deposits, or wholesale markets. Banks manage the risks around their funding by having multiple sources of funding and different timeframes to pay them back.

2



RESERVE BANK

Our main regulator, the Reserve Bank of New Zealand (RBNZ), provides us with a capital framework that sets out how much capital we must hold. It determines how much capital a bank needs to hold based on the risk associated with the lending they have provided their customers. The higher risk a bank's loans are the more capital it must hold.

3



Weather



Input costs



Diseases

AGRICULTURE - INCREASED RISK



Prices received



Markets



Changing dollar

4



AGRI LENDING

We're required to hold twice as much capital against agriculture lending as home lending. This capital is there in case there are unexpected levels of loan defaults – where borrowers can't repay their lending - and serves as a safeguard to shield the financial system from economic turbulence.

5



HOME LENDING

Most home loans are on a fixed rate in New Zealand and borrowers don't feel the impact until their fixed term ends.

6



FIXED V VARIABLE INTEREST RATES

Most loans in the agriculture sector are on variable rates so changes in interest rates hit them sooner.