Time for another look at non-bank deposit takers

Goldband chief executive Martin Brennan says it is time investors and advisers took a new look at non-bank deposit takers.

BY MARTIN BRENNAN

In the 15 years since the Global Financial Crisis, New Zealand's non-bank deposit taker (NBDT) sector has been transformed, with new levels of oversight, a tightening of rules and consolidation of participants.

Many of these changes have gone largely unnoticed in the wider sector, as new products and technology compete for investors' attention. But with increased pressure on capital, Gold Band Finance (GBF) chief executive Martin Brennan says it might be a good time to pay attention to the opportunities the sector offers as part of a diversified portfolio.

When inflation hit 7.3% in July this year, it marked the largest annual rise in the cost of living since 1990. With one year term deposits across the major banks having just reached 4%, after the latest 50 basis point increase in the OCR, and five-year rates barely adding another half a percent, for many Kiwi investors that represents a significant erosion in capital.

As readers will be all-too aware, investment propositions across the board in 2022 have been increasingly fraught. The share market closed the first half of the year down 18% – following overseas trends, which saw Wall Street have its worst half since 1970. The high-profile collapse of crypto investments, with marquee currency Bitcoin losing half of its value over the last six months, have also shaved millions from the local market. Even our 'forever increasing' property market has come off the boil quickly, with local house prices seeing the largest drop in over a decade.

While the establishment of KiwiSaver has greatly increased the investor savvy of New Zealanders, it has also made fluctuations in those investments much more obvious, and the impacts of a falling market more widespread. By their nature, Mum and Dad Kiwi investors tend to be conservative. In this environment – confronted by bad news at seemingly every turn – they will be seeking advice on how to protect their assets.

A well-governed sector

For anyone who experienced the GFC, it might seem counterintuitive to be recommending the non-bank sector as the sensible option for diversification in a market where negative sentiment dominates. But that would ignore the enormous changes that have taken place across the industry and the regulation and oversight which now controls the sector.

Chief among those is the Non-bank Deposit Takers Act of 2013. This legislation governs a small number of organisations that, like registered banks, offer debt securities and borrow and lend money. It's a small group of local businesses – around 15 in total – and includes building societies like the Nelson Building Society, credit unions, such as those operated for the Police and the NZ Firefighters, and established businesses like GBF.

The Act was introduced with the aim of raising standards and improving the sector's overall resilience to adverse market conditions. With benefits of the lessons learned from the GFC, this level of oversight has been established in recognition that, as the Reserve Bank itself states, "The NBDT sector is an important component of the broader financial system because it assists with providing funding to wider sectors of the economy, and provides alternative investment options for individuals and organisations."

As further outlined by the Reserve Bank, the sector is subject to the Financial Markets Conduct Act 2013 (the FMC Act), which requires them to have a trust deed (and therefore be supervised by a trustee) and a product disclosure statement. They are also required to comply with prudential requirements outlined in the relevant Act and associated regulations, which include twice-yearly independent audits in almost all cases.

In reality, this means regular contact with their supervisors, and clear and transparent processes for investors to see how the business is acting and operating. It also means strict penalties for businesses, and their Boards and management, if they fail to comply with the requirements of the Act.

Protecting investment value

In a market like the current one, having an alternative option that provides higher interest rates than the banks (in the case of GBF, between 4.90% for one year fixed and 6.15% over five years) can make a major difference. This is particularly true for those on fixed incomes – still a major class of local investor – for whom the rise in inflation has put real pressure on their supplementary earnings.

Of course, like any investment, the sector is not without risk. However, with careful oversight by a prudential regulator (RBNZ) and conduct regulator (FMA) these risks have been substantially reduced over the last decade, and the sector should now be viewed in this context.

If we look at GBF as an example, we have a track record of prudent operation over more than 35 years. During that time, we have never failed to pay back the full value of an investment on maturity. In fact, we have consistently provided good returns for every month over the past three and a half decades.

Perhaps as a measure of how much things have changed in the sector, my latest update to investors was a discussion on why – in comparison to the more 'exciting' investments in cryptocurrency, app-driven share trading or even NFTs – an investment in our company was so boring. And why in the current market, boring was good, if it meant investors still had the full value of their capital, while receiving a fair market return through robust, licensed non-bank funders meeting requirements set by the Reserve Bank.

Even our own investment portfolio is one that would hardly stir the heart rate. The vast majority of our loan book is focused on investments in residential property – something the average Kiwi investor understands very well. But that conservative approach is one that has continued to serve our local investors well – allowing them to achieve higher interest than offered by the banks, without erosion of their capital.

At a time when there are growing concerns about the use of wholesale investment schemes to secure investment funding for property development, the option of a prudent and well-regulated option that still pays higher than bank interest may well be a good path for local investors.

A changing market

With the lingering impacts of the COVID-19 pandemic, a disrupted supply chain and uncertainty in the world's major economies, it is unlikely that markets will become any less volatile in the near future. At the same time inflation is proving a particularly intractable problem. New Zealand is certainly not getting the worst of it, with the UK predicted to see inflation top 18% this year off the back of high energy prices. But our increasingly connected world will continue to see those impacts spread around the globe.

In this kind of market, finding the right balance between risk and return is extremely important. The NBDT sector has a role to play in that as part of a diversified portfolio, especially as they offer returns which can reduce the impact of inflation on local Mums' and Dads' investment principal.

The fact that the Government has chosen to create a framework of legislation for the sector reinforces that they see value in the role it plays. There is even discussion at present about including NBDTs within the deposit compensation scheme, offering still-further protection to local investors, and potentially completing the transformation of the sector.

With all this in mind, it would be prudent for investment advisors and local investors to take another look at the options available within the Non-bank Deposit Takers sector, especially established local organisations with a considerable track record, like GBF.

For further information on NBDTs and the role of the Reserve Bank, visit their website. Or if you'd like to further discuss the sector, please feel free to contact me at: martin@goldbandfinance.co.nz