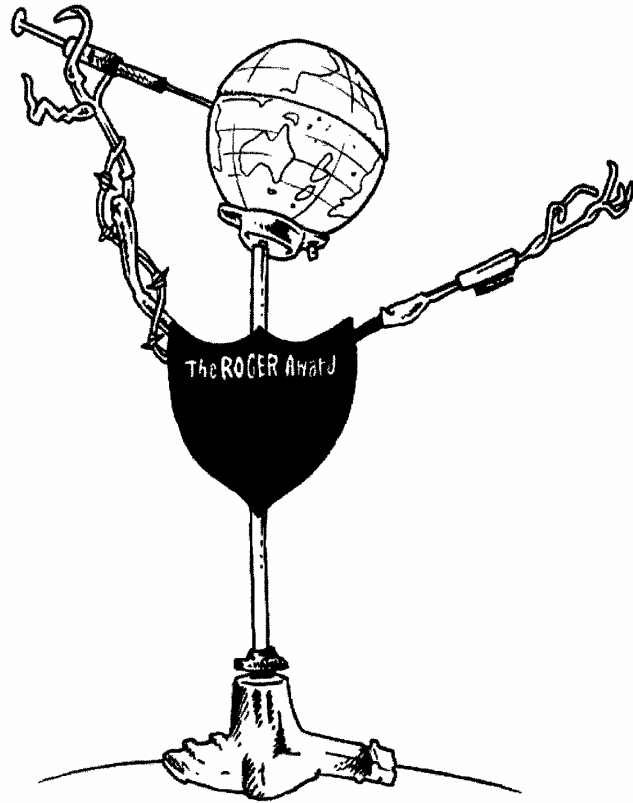


Roger



Award 2005

For the worst Transnational
Corporation operating in
Aotearoa in 2005

Winner

Bank of New Zealand & Westpac

Organised by

Campaign Against Foreign Control of Aotearoa (CAFCA)
GATT Watchdog

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STATEMENT FROM THE JUDGES

March 2006

John Minto
Maire Leadbeater
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Mary-Ellen O'Connor

Introduction

The Roger Award is presented each year to the worst transnational corporation operating in New Zealand and is organised by CAFCA (Campaign Against Foreign Control of Aotearoa) and GATT Watchdog.

The judges' task was to consider the activities of the finalists against the criteria for the Award which cover areas such as unemployment, abuse of workers, profiteering, political interference, cultural imperialism, and negative impacts on tangata whenua, women, children, animals and the environment.

For the 2005 year there were eight finalists, which in alphabetical order are: **Bank of New Zealand, British American Tobacco, Comalco, Guardian Healthcare, Merck Sharp and Dohme, Telecom, Toll Holdings and Westpac.**

Once again we would like to thank those New Zealanders who entered nominations and for the wealth of supporting material and background information provided in support of the nominations.

Unfortunately the competition this year was as strong as ever and the difficulty of the task was reflected in one of the judges commenting at the amount of "stomach-heaving" induced by so much of the material. In the judges' view each of the finalists exhibits policies and practices which are well outside the behaviour our community has a right to expect from any company operating in New Zealand.

Health Issues

Before proceeding to the judgment itself we were concerned that this year no less than three companies from the health sector were nominated. Each of the companies – Guardian Healthcare, British American Tobacco and Merck, Sharpe and Dohme – is involved in practices which exploit the most vulnerable in our community. It is clear these practices are the result of poor Government policy and lack of commitment to protect New Zealanders. For example -

- Poor funding for quality rest-home care with the elderly and rest-home workers left to the mercy of low pay, low quality, profit driven care in the private sector (**Guardian Healthcare**).
- Failure to adopt proven strategies to reduce smoking rates among young New Zealanders e.g. removing retail displays completely and putting larger warnings on packets (**British American Tobacco NZ**).
- Allowing the direct marketing of drugs (such as Vioxx) to consumers (**Merck, Sharp and Dohme**).

The judges therefore decided to issue a special award –

The **“Special Award for the Protection of Profit and Privilege at the Expense of Public Health”** to the **Minister of Health** on behalf of the Government.

The Judgement

Before going on to describe the “Top Four” finalists we wish to comment on those companies which although they did not reach the dizzying depths of the final four their practices nonetheless appalled the judges.

British American Tobacco New Zealand

BATNZ continues to be a rapacious predator on New Zealanders – the young in particular.

It is reliably estimated that 4,700 New Zealanders lost their lives last year from smoking related illnesses and that these people are predominantly from lower socio economic groups. Young Maori women are particularly at risk. For example only 18% of Maori girls have never been smokers compared to 48.2% of NZ European girls.

Reliable estimates also show that 101 New Zealanders die each year from exposure to smoke in the workplace and the health cost estimates go as high as \$8.7 million per year. The Government receives approximately \$884 million in tobacco tax each year.

BATNZ blames deaths and illnesses on individual choice despite nicotine’s addictive qualities. The company continues to lobby against health warning labels on cigarette packets.

The Government has passed smokefree legislation to ban smoking in hotels and bars etc and this is having a significant impact. However research conducted through Victoria University has found that the most effective reduction in smoking has been in regions where strong controls have been put in place (British Columbia, California, New York State and Australia) compared to NZ which has gone part way.

The social irresponsibility of BATNZ is becoming more sophisticated. Instead of tobacco companies being “banged” as they put it, they want to “work with government and researchers to minimise the harm that tobacco smoking causes”. This is a weasel way of saying they are still looking to find a way to make profits from their addictive products and sidestep the controversy.

The Napier cigarette plant is to close this year with the 170 jobs going to Australia.

Internationally 4.9 million die annually from smoking related illnesses – most in the global south – and by 2020 the figure will be seven million annually with aggressive promotion of smoking to youth in developing countries and the use of “free speech” arguments to defend their advertising.

The industry as a whole lobbied vigorously to water down or defeat a strong FCTC (Framework Convention on Tobacco Control) – this is a World Health Organisation treaty aimed to curb tobacco industry worldwide. It was unanimously adopted by 192 countries in 2003 and ratified by New Zealand in January 2004.

Comalco

Comalco continues to draw 15% of New Zealand’s electricity supply at a secret rate – believed to be one third of the rate domestic consumers pay. The result is that New Zealand subsidises Comalco on corporate welfare to the tune of several hundred million dollars per year. (Note: 90% of Comalco power is bought at the contract rate [1/3 below domestic price] with 10% bought on the “spot market”).

The company made estimated profits of \$80 to \$100 million in 2005 on \$1billion of sales.

In 2005 Comalco began negotiations with Meridian Energy for a long term power supply contract. Just prior to negotiations Comalco threatened to leave New Zealand because of the proposed carbon

tax it would be required to pay. "We could just flick off the switch and walk away," the company said. This is a familiar negotiating strategy of bullying arrogance from a large transnational corporation.

Guardian Healthcare

Guardian Healthcare runs a network of rest homes around NZ. It was purchased by Australian DCA Group in July 2005 for \$300 million but despite the huge capital gain made by the previous owner in selling and a predicted profit of \$28.7 million for the year ended June 2006 the staff employed by the company have been offered just a 2% pay rise.

Wages paid by Guardian Healthcare are already appalling. They pay the minimum adult wage (\$9.50 – rising to \$10.25 in March 2006) for many experienced workers and even after 23 years experience one worker is paid just \$11.36 per hour! On average the company pays \$1 per hour less than other similar employers in the rest home sector.

In their best "corporate speak" the company says: "We are attracted to the sector because of its stable revenues and predictable cash flows". Much of these cash flows come direct from the New Zealand taxpayer.

Guardian and other private sector aged care providers have been quick to profit from the July 2005 relaxation in the Government's asset testing rules. There are now a higher proportion of people in care whose fees are Government subsidised and there has been a related jump in the number of people entering residential care. Guardian's Managing Director recently boasted that the higher State financial support has increased the worth of the business more than 5%!

(Note: Churches and charity groups are leaving the elderly healthcare sector because Government funding [around \$650 a week per resident] is not enough to maintain high standards of care. Private owners are moving in rapidly now and because they have on average 15% less staff they can make handsome profits by providing lower cost–lower quality care. This is a familiar pattern to those in the early childhood and tertiary education sectors)

Merck, Sharp and Dohme New Zealand

MSD manufactures and distributes the pain relief drug Vioxx with more than 20 million worldwide taking it up till September 2004 when it was withdrawn.

However MSD continued to promote and market Vioxx for four years after evidence that it increased the likelihood of heart attacks by four to five times compared to other drugs. It was only withdrawn in September 2004 after highly critical US Federal Drug Administration reports.

One legal firm in the US is reported as saying that more than 100 New Zealanders are part of a class action lawsuit against MSD. (Note that these people can't take legal action here because of our ACC regulations).

Vioxx was not funded by Pharmac in New Zealand – saving between 330 and 1900 deaths induced by Vioxx and several thousand more from heart attacks.

However Vioxx was able to be marketed direct to consumers in NZ because our law allows this. The Green Party has called for this loophole to be closed.

Confronted with the evidence MSD engaged in a "consistent pattern of intimidation" of investigators in universities and trained its sales consultants in dodging the hard questions. For example the recommended response to the increase in heart attacks was to say "Vioxx would not be expected to show reductions in heart attacks in patients" or to suggest that the drug Vioxx was being compared with showed a reduction in heart attacks – rather than Vioxx showing an increase!

Although this appalling behaviour came to light in 2004 the judges considered that because the full extent of the impact on New Zealanders only came to light last year that this nomination was justified for the 2005 awards.

The Final Four

The final four companies are now listed from fourth to the winner.

The judges noted that these four prizewinners are all part of the essential infrastructure of New Zealand and because of this their behaviour impacts hugely on the general public. This emphasises the shameful nature of their anti-social practices.

In 4th Place – Telecom

Telecom made a \$1.3 billion pre-tax profit in 2005 which was up from \$1.1 billion in 2004. This represents \$325 profit for each man, woman, child and baby in NZ!

During 2005 Telecom was convicted of breaching the Fair Trading Act and paid \$54,000 in compensation when customers were charged at the peak phone rate instead of the off-peak rate.

The cost of Telecom services is very high compared to other Organisation for Economic Cooperation and Development (OECD) countries. For example, the cost of business access is the highest in the OECD while low data users pay 80% above average and medium users pay 160% more than average. Telecom cellphone charges would need to drop 45% to be in line with other OECD countries!

Ernie Newman of the Telecommunications Users Association of NZ called on Government once more to “unbundle the loop” to allow other competitors to use Telecom’s lines and force down prices. Another failed appeal. In the meantime the most highly paid executive in New Zealand - Theresa Gattung of Telecom – received a 10% increase in her base salary in 2005.

2005 was another year of desperate pleading from many people for the Government to act to curb Telecom’s appalling monopoly greed but to little effect. For 15 years now this private monopoly has run amok with New Zealanders and has made more than \$15 billion in profits – most going to wealthy shareholders overseas.

The judges are appalled that this national scandal continues. It seems that the Government is terrified of effectively regulating Telecom because it is the largest player on our sharemarket and the health of the sharemarket depends on Telecom’s health! In the judges’ view this is feeble leadership.

3rd Place - Toll Holdings

Toll Holdings operates our rail network and the Cook Strait ferries.

It has continued to operate the fast ferry Kaitaki in Marlborough Sounds at 20 knots despite the Marlborough District Council setting 15 knots as acceptable because the wake of the ferry is causing significant environmental damage. However the Council has failed to enforce this through issuing an abatement notice for fear that Toll would relocate its ferry terminal away from Picton!

This is a recurring theme in the 2005 awards – heavy bullying of authorities by big companies determined to get their own way.

Toll also operates the Cook Strait ferries with the ferry Awatere (nicknamed “El Lemon”) which has had 43 investigations, including 19 full investigations, since 1999. In one incident the ferry was just five seconds away from going aground.

Toll pleaded poverty to excuse lack of maintenance on the tracks (although it was still able to purchase Singapore Rail!) so the New Zealand government agreed to pay \$200 million to upgrade our rail tracks for Toll after ten years of disastrous private sector ownership and management of our rail network. The Government has also agreed to pay for additional “special projects” once the \$200 million runs out.

The Minister of Finance, Michael Cullen, agrees the Government would not earn an economic return on its \$200 million upgrade. In other words the company takes all the profits while the people of New Zealand take the losses!

The Government agreed also to allow no new rail passenger services to use the rail network (which is now owned by the Government) for three years. This means that even if another operator wanted to continue a rail service dumped by Toll it is prevented from doing so. Cullen describes Toll as a tough group of people – “archetypal Australians” but this is a feeble response.

In 2005 Toll financial records contained a blackout on salaries paid to senior executives and it has been openly hostile to trade unions representing workers.

Toll made a \$41.41 million profit in 2005 which its Australian parent company describes as an “unacceptable return on assets”.

The Winners - 1st Equal - Bank Of New Zealand And Westpac

(Judges Note: BNZ and Westpac were both nominated for the 2005 Roger Award although it became clear from the material gathered in support of these nominations that many of the practices they have adopted also apply to the other two large Australian-owned banks – ASB and ANZ – and had they also been nominated then the likelihood is that all four would have been joint winners of the 2005 Roger Award).

Over the past six years the big banks have used tax avoidance strategies to borrow overseas, channel the money through NZ and re-lend it overseas.

Through this scam these banks are paying as little as 6.7% tax instead of the official company rate of 33% (according to leaked Reserve Bank documents, as reported in the media). The Inland Revenue Department (IRD) has noted that tax payments by the banks have fallen well behind profit figures. Reliable estimates have put the tax owed by the “gang of four” at NZ\$1.63 billion! The judges were pleased to note that the IRD are taking on the banks and insisting on recouping tax from previous years. (During the 2005 election campaign Michael Cullen announced an unexpected windfall of \$500 million in taxation received and pledged it to roading. It is almost certain this money came from the Australian banks).

Through 2005 the banks tried to force the New Zealand government to agree to a “trans-Tasman regulator” for banking and to remove them from New Zealand Reserve Bank oversight, as the Reserve Bank insists they remain stand alone in NZ instead of operating as branch operations of Australian banks. Again the judges noted it was pleasing to see the Government and Reserve Bank refusing to buckle to this pressure and protecting New Zealand account holders in the case of a bank collapse.

Our Australian owned banks have an annual combined profit of \$2 billion from their New Zealand operations but they still suggested they might leave New Zealand if they didn’t get their way – familiar bullying tactics again.

It is interesting to note that Australia expressly prohibits foreign ownership of its banks but New Zealand has no such laws which mean all our large banks are now Australian owned. We have been a bunch of mugs – ripe for a rip-off – and our banking profits flow back across the Tasman instead of supporting our community here.

It is also interesting to note that New Zealand has the highest degree of foreign bank ownership in the world – 99% of assets are in foreign owned banks with 85% of that in Australian banks.

Australian banks have been reported to say “the Australian system is highly interventionist, New Zealand is highly market-based” – no surprises here!

Material Relating Specifically To The BNZ

The BNZ sent credit cards with \$3,000 to \$5,000 limits to prospective customers just three weeks before Xmas 2005. This was a cynical move to exploit families under pressure. It encourages indebtedness at usurious interest rates and was described as “ethically reprehensible” by David Russell of Consumers Institute. The judges agree!

The BNZ made a net profit \$471 million to September 2005 with the IRD claiming up to \$300 million in unpaid tax by BNZ.

The BNZ has required its employees to “sell debt” to its customers to increase productivity with unrealistic targets. This has resulted in huge stress on employees who are asked to fleece BNZ customers, which resulted in the employees publicly speaking out in opposition. It is rare for employees to take action on anything other than wages and conditions and the judges congratulate the bank employees and their union FINSEC for drawing these appalling practices to public attention.

The BNZ has displayed appalling anti-union/anti-worker attitudes and practices.

Material Relating Specifically To Westpac

Westpac made a pre-tax profit of \$708 million – up from \$661 million in the previous year but still has \$711 million of unpaid tax dating back as far as 1999. Recovery of this money is being sought by the IRD.

It was the Westpac Bank Chief Executive Officer who led the charge to get a “trans-Tasman regulator” for NZ banks as described earlier and Westpac has the lowest level of customer satisfaction of all the banks at just 64%.

Westpac keeps its monthly credit card repayments as low as 3% of the total owed. This practice has been criticised by the Consumers Institute – “It’s about keeping people in hock for longer!” The judges agree!

Westpac has indulged in appalling anti-worker and anti-union practices in relation to its employees through 2005 and this resulted in strike action by bank employees before Xmas.

Closing Comments

These bank practices described above are in direct and serious conflict with New Zealand government policy to reduce spending and encourage private saving.

These practices must be effectively challenged by the Government.

Together these banks constitute a “gang of four” wielding huge power and influence over the New Zealand economy and operating solely in their own interests rather than that of their account holders, employees and the wider community.

BNZ and Westpac are deserving winners of the 2005 Roger Award.

ROGER AWARD REPORT 2005

- Joe Hendren

The Bank of New Zealand (BNZ) and Westpac Banking Corporation are the joint winners of the 2005 Roger Award for the Worst Transnational Corporation Operating in Aotearoa/New Zealand.

While the BNZ and Westpac richly deserve to receive the dubious honour in 2005, the other two major trading banks should not be too disappointed as they are also guilty of much of the skulduggery outlined below. Had the ASB and the ANZ also been nominated it is likely that all four would have shared the jeers as joint winners.

It is an irony that the Auckland businessmen who launched the BNZ in 1861 complained about the inability of foreign banks to act in New Zealand's interests¹. Since being privatised by a Labour government in the late 1980s the BNZ was bailed out of financial trouble by the Government in 1989 and again in 1990, before being sold to the National Australia Bank in 1992. Westpac began in 1982 as an amalgamation of the Bank of New South Wales (which had been in NZ since the 19th Century) and the Commerical Bank of Australia. In 1996, Australian-owned Westpac took over Trust Bank, then the last major bank still in New Zealand ownership, leaving branch closures and redundancies in its wake.

The four Australian owned banks have a huge influence on the economic and political life of the country. Peter Thodey, the Managing Director of the BNZ is a member of the Business Round Table. Westpac Chief Executive Ann Sherry, as well as being the chairwoman of the Government's Innovation Advisory Group, formed part of a group of select business leaders who were invited by Prime Minister Helen Clark into her office for a chat - in the middle of the 2005 coalition negotiations. According to business sources speaking on background, Clark sought confidential advice on Cabinet appointments and a more pro-business direction for her third term in office². The Chief Executive of the 2004 Roger Award winner, Telecom, was also present.

The news media are encouraged to contact the banks' "chief economists" for public comment on the banking sector and the overall state of the economy. While economists employed by the banks are regularly cited by the news media, this has not always been the case. Prior to the mid 1980s, journalists were more likely to approach academic economists in the universities for comment on economic issues. While the banks may claim their economic commentary is, as Westpac put it, "independent of any other bank interest"³ this is precisely the point on which their credibility depends. It is also useful free advertising. Yet it is hard to imagine any of the chief economists issuing any sort of criticism of the actions of their employer or the banking industry as a whole. This would be the true test of "independence". As the *Roger Award Judges' Report* will show, the economic commentary issued by the banks is often self-serving, particularly when the interests of the foreign-owned banks appear to be at stake. Westpac provided a particularly galling example in 2005 when its Chief Economist, Brendan O'Donovan, prepared some highly politically loaded costings of a key Labour Party election pledge and released these at a critical time in the campaign.

Despite the appalling actions of the BNZ and Westpac in 2005, the situation is not all doom and gloom. As the Roger Judges note in their *Judges' Statement*, a recurring theme of the 2005 awards was the way that the big companies, determined to get their own way, mounted a heavy bullying campaign against legitimate government authorities. It was particularly encouraging to see the

¹ Jesson, Bruce (1999), "Only Their Purpose Is Mad", Dunmore Press, Palmerston North, p108.

² *NZ Herald*, 20/10/05, "Clark seeks 'A-list' advice on direction to take", Fran O'Sullivan.

³ Westpac Press Statement, 2/8/05, "Westpac responds to Education Minister's comments", <http://www.scoop.co.nz/stories/BU0508/S00027.htm>

appropriate regulatory authorities take action against the banks in 2005. The Commerce Commission brought criminal charges against the banks for failing to inform their customers of hidden currency conversion fees when using credit cards. The Reserve Bank sought to protect New Zealander's savings in the event of a banking collapse of one of the foreign-owned banks, tightening the rules around capital resources and the outsourcing of key bank functions. It also insisted that Westpac incorporate in New Zealand and issued strong advice to the Government on the dangers of transferring the supervision of banking to a single trans-Tasman regulator. The Inland Revenue Department (IRD) presented the banks with a large tax bill for (what it believes to be) tax obligations unpaid in previous years. This year our public servants did their job – it's a pity our politicians have not been as resolute.

The Indignity Of Having To Pay Tax

In 2004 the Inland Revenue Department issued the ASB, ANZ National Bank, Westpac and the BNZ with bills for more than \$1 billion in back tax based on a ruling by the IRD on the structured finance deals the banks operated with their parent companies in Australia⁴. All of them are disputing the tax claims.

A windfall in tax revenue from the financial sector helped Dr Michael Cullen fund a \$500 million cash injection for the transport network. The tax take for the 11 months to the end of May 2005 ran \$544 million ahead of forecasts, with corporate tax accounting for \$368m of the difference. "A significant portion of it is due to some large, unexpected payments from the financial sector relating to previous tax years," Cullen said⁵. While Cullen was bound by tax law not to reveal who had made the payments, officials said it would be "safe to speculate" that the tax windfall relate to the long running dispute between the Inland Revenue Department and the four main banks over their tax arrangements. In October 2004 Michael Cullen predicted new tax rules would see the foreign-owned banks pay up to \$360m more a year in New Zealand tax⁶.

For an indepth commentary on the information the BNZ and Westpac have provided to the public on their tax, and on how they might structure their financial arrangements to avoid tax, please see Sue Newberry's *Financial Analysis*, which follows the *Judges' Report*.

Political Interference And Lobbying

Westpac Attempts To Interfere In Our Election

A mere month and a half prior to the 2005 election, Westpac's Chief Economist, Brendan O'Donovan, released some highly inflated costings of Labour's flagship policy of interest-free student loans.

"Our position is not to comment on election issues; that's a strong preference. This one, I think, carries just such large fiscal risks and potential long-term impact on the economy, I felt beholden as an economist ... to try and get sanity into the debate. In our view, this election lolly would result in a chronic case of tooth decay. We implore that the 'free interest' proposal is not made an election pledge"⁷ (Westpac Chief Economist Brendan O'Donovan).

This was simply blatant political interference in an election campaign by an overseas-owned bank. Given the lobbying experience of Mr O'Donovan and Westpac, it would seem far too charitable to put down Westpac's actions to idyllic political naivety. O'Donovan predicted the annual bill for Labour's election pledge would far exceed Education Minister Trevor Mallard's estimate of \$300 million, and claimed the cost could be as high as \$1.1 billion a year. He then took a mid-point between the figures to estimate the cost of the policy as \$700 million a year.

While he conceded that his figures were "extreme", the call for sanity did not stop Mr O'Donovan from making some wild assumptions. He assumed interest free loans would give students an incentive to borrow as much as they were entitled to, and every student would do so. It is worth noting that similar claims were made in 1999 when Labour introduced the interest-free-while-studying policy, but these fears simply did not eventuate, as the percentage of students with student loans only increased from 50% to 55% between 1999 and 2004. More critically, O'Donovan failed to take

⁴ *Press*, 24/6/05, "\$500m tax windfall to fund transport".

⁵ *Press* 24/6/05, "\$500m tax windfall to fund transport".

⁶ *Press*, 1/10/05, "Westpac says tax was paid".

⁷ *NZ Herald*, 2/8/05, "War of words heats up on student loans".

into account the fact that part time students can not access as much money as full time students. This could affect the accuracy of any estimate quite considerably, as most students without a student loan are part-time, and part time students do not qualify for the living cost component of a student loan.

Education Minister Trevor Mallard dismissed Westpac's figures as "inflammatory, self-motivated garbage", and said the bank had its own "very selfish reasons" for issuing its analysis. Westpac offered a service to graduates, refinancing up to \$10,000 of student loans at a discounted rate in an attempt to gain valuable follow-on mortgage business, and stood to lose millions of dollars of loans business from Labour's policy. "It is disappointing that this international company did not declare its conflict of interest"⁸.

Looking a little wider, there are also other possible conflicts of interest. Papers released under the Official Information Act in October 1999 revealed that the then Tertiary Education Minister Max Bradford looked at proposals to sell the student loan scheme to Westpac. Removing the interest on student loans means that the scheme is unlikely to ever be a commercial prospect for the private sector.

Westpac said it was disappointed with Mallard's comments and claimed its economists possessed "editorial independence" to "preserve the integrity" of their analysis⁹. "In the case of the proposed student loans policy the cost analysis was positioned to calculate the extreme worst-case fiscal costs". But only calculating the "worst case" scenario is hardly an objective economic analysis aiming for accuracy. It is what you might expect from an opposition political party. Ironically, Westpac's flawed costings of the student loan policy were considerably higher than the initial estimates issued by National MPs.

The final, more detailed Treasury costings of interest free student loans, released by Finance Minister Michael Cullen in December 2005, estimated the policy would cost \$218 million in 2006-7, rising to \$269 million in 2009-10. "This is in line with, although a little lower, than the Labour Party's costings and significantly lower than the Treasury scenario released during the election campaign,"¹⁰ Dr Cullen said. This demonstrates that Westpac's figures had even less credibility.

On An Ideological Crusade

Other comments made by the bank economists suggest they are fronting a Rightwing ideological crusade on behalf of their owners. Westpac Chief Economist Brendan O'Donovan has criticised Government spending plans such as Working for Families and advocated for tax cuts funded through greater Government borrowing. His comment about "a chronic case of tooth decay" in regards to the student loan policy suggests his objection is more "moral" than economic. BNZ Chief Economist Tony Alexander has lobbied in favour of tax cuts and moving the bulk of resources to the hands of the private sector. Perhaps Mr Alexander deserves some credit for his attempt to appear more even-handed during the election campaign. However the most effective way to avoid perceptions of political interference may be not to comment on party policy proposals at all.

If It Was Up To Westpac And The BNZ There Would Be No Pension

Westpac economist Andrew Fung and Tony Alexander of the BNZ have both attempted to blame the existence of New Zealand Superannuation for our low rates of savings, and claim New Zealanders are not given enough "incentives" to set up private superannuation funds. "The problem is, you're not giving people the incentive to save, when you're sort of saying: 'We're going to give you an income'"¹¹. Mr Fung claims it is a problem that Super is "viewed by people as a retirement income", as they pay for it via taxation. Most Kiwis would argue that isn't so much a problem, but precisely the point of publicly funded superannuation. For most Kiwis "super" will be their primary "income" once they turn 65. Mr Fung's advice that New Zealanders should regard superannuation as "a safety net rather than a pension", suggests the banks would prefer a system where superannuation was no

⁸ Mallard, Trevor, 1/8/05, "Westpac's dodgy analysis driven by selfishness", <http://www.scoop.co.nz/stories/PA0508/S00021.htm>, Press Release

⁹ Westpac Press Statement, 2/8/05, "Westpac responds to Education Minister's comments", <http://www.scoop.co.nz/stories/BU0508/S00027.htm>

¹⁰ Cullen, Michael, 19/12/05, "Interest free student loan costings", Press Release <http://www.scoop.co.nz/stories/PA0512/S00277.htm>

¹¹ *Dominion Post*, 27/9/05, "Few kiwis saving for future"

longer a universal entitlement and the Government put its money into providing “incentives” for people to start private savings schemes. It just so happens that the banks already sell such products. Thankfully, the banks do not have any great hopes of this ever coming to pass. Tony Alexander says that New Zealand Super will remain because of political pressure. “That’s where the voting power is going to be, end of story”.

Regulatory Supervision: The Banks Bully; Cullen Folds

All four banks have applied sustained political pressure on the Government to transfer the regulatory authority powers of the Reserve Bank over to the Australian Prudential and Review Authority (APRA) or a single trans-Tasman regulator run on Australian lines¹². They enlisted the help of Australian Treasurer Peter Costello, who pressed strongly for a single regulator. Cullen is thought to be sympathetic to the idea, and he concedes it could be a potential outcome of moves towards a single economic market.

Westpac Chief Executive Ann Sherry wrote to all New Zealand MPs and warned that the Australian banks could pull out of New Zealand if there was no agreement on a single trans-Tasman regulator. This thinly veiled threat was dismissed as a “joke” by Tim Brown of investment firm Infratil, who doubted the banks would turn their backs on the combined profit of \$2 billion a year they gain from the New Zealand market. The Director of Banking Studies at Massey University, David Tripe warned that “the Australians appear to be waving around some conditions which are pretty extreme and making some comments which are of doubtful veracity.”¹³. In this context, the words “doubtful veracity” means that Tripe believed the comments made by the banks did not conform to facts and were of doubtful accuracy.

In a joint 36 page report the Reserve Bank, Treasury and the Ministry of Economic Development warned Cullen that the push for a single regulator could undermine New Zealand’s tax base, lead to an exodus of foreign investors in the event of a banking crisis and restrict the decision-making ability of the Government during such a crisis. Reserve Bank Governor Allan Bollard warned Cullen that an inevitably Australian-dominated regulator “could impose significant economic costs on New Zealand”¹⁴.

In a speech to a conference at the Federal Reserve Bank of Chicago, Bollard explained some of the difficulties faced by the Reserve Bank attempting to act as a regulatory authority in an economy dominated by foreign owned banks.

“There can also be conflicts of interest between the home and host authorities in the allocation of capital and risks across a multinational banking group. The home authorities have an interest in retaining as much capital within the home jurisdiction, and particularly within the parent bank, as possible. Conversely, the host authority would like to see a reasonable portion of the group’s capital vested in the local subsidiary. A similar dichotomy of interest applies in respect of the spread of risk across the banking group. In times of stress, the allocation of capital and risk within the group can be crucial. Tensions between home and host authorities can quickly become apparent in those circumstances. This is especially so when the bank subsidiary is under-capitalised and the host authorities are requesting the parent bank to inject more capital. The situation is even more complicated when the bank in distress is a branch of a foreign bank. The home and host authorities may also have different interests in deciding the response to a banking crisis.

“The home authorities’ primary interest and (generally) their primary statutory duty is the maintenance of stability in the home financial system”¹⁵.

Costello has already met with some success, convincing Cullen to agree to a joint trans-Tasman Council on Banking Supervision to allow “seamless regulation” of banks between Australia and New Zealand. At the conclusion of their annual bilateral meeting in February 2006 Cullen and Costello announced both governments would legislate to ensure the APRA and the Reserve Bank collaborate on regulatory issues and avoid actions that could affect the financial stability of either country. While

¹² *Press* (27/9/04), “BNZ backs Aust-NZ watchdog”.

¹³ *Press*, 16/4/05, “Bank debate heats up”.

¹⁴ *Press* 24/2/05, “Cullen warned of bank regulator costs”.

¹⁵ Bollard, Dr Alan, 2/10/05, “An Address to the Federal Reserve Bank of Chicago Conference: Systemic Financial Crises - Resolving Large Bank Insolvencies”, <http://www.rbnz.govt.nz/speeches/0158779.html#TopOfPage>

this stops short of a trans-Tasman regulator for now, both these moves are likely to increase the lobbying power of the Australian banks.

Hooray, A Regulator That Actually Does Some Regulating

In the last couple of years the Reserve Bank has moved to a tougher regulatory stance towards the foreign banks, placing greater restrictions on core bank work being “outsourced” and insisting Westpac change from being a branch of its Australian parent to become a wholly-owned subsidiary. Westpac, the only Australian bank not to be incorporated in New Zealand, spent most of 2004 arguing with the Reserve Bank over this, dismissing the possibility of a collapse as a “one in 900 year” likelihood. But regulatory bodies do and ought to have a responsibility to prepare as much as possible for all eventualities – if the health authorities dismissed the possibility of a bird flu outbreak and did nothing they would be justly criticised. Westpac put up a counter-proposal to its regulator to run its New Zealand operation as a “buttressed branch”. Thankfully the Reserve Bank held its nerve and forced Westpac to take moves to incorporate in New Zealand, a process that could take two years. Dr Alan Bollard told a Sydney business audience he aimed to give the New Zealand banking system “more resilience in times of financial stress....Banks on occasion do get into trouble, and probably more than is commonly thought”¹⁶ pointing to the recent \$A360m foreign exchange trading scandal at National Australia Bank, the owners of the BNZ.

The incorporation of Westpac is expected to provide New Zealand depositors with greater protection in the event of an Australian bank failure, as current Australian law gives priority to Australian customers having first call on the funds and places restrictions on the claims of overseas customers. While Westpac claims that a piece of New Zealand legislation, the Westpac Banking Corporation Act of 1982, offers protection for customers, it is not clear whether New Zealand or Australian law would take precedence in the event of a bank finding itself in financial trouble. As an incorporated company in New Zealand Westpac will have its own board of directors which must act in the best interests of the local operation. The Reserve Bank also has the right to veto the appointment of directors and the chief executive of the local bank.

The Reserve Bank also wants to tighten the rules regarding the outsourcing of the information technology (IT) systems of the banks. These changes are designed to make it harder for the banks to outsource their IT systems to third parties, and make it virtually impossible for them to merge them with their parent businesses in Australia. This is also motivated to provide another “buttress” in the event of a collapse, as a New Zealand operation is more likely to be affected if it is overly dependent on the IT systems of its Australian parent.

In November 2004 the Reserve Bank vetoed a proposal by Westpac to physically move its mainframe computers to Australia. Westpac’s Chief Information Officer, Ross Hughson, said that the Reserve Bank had sent a “clear message it wants Westpac to keep its infrastructure in New Zealand. We can’t argue with the regulator though, clearly, people have the right to lobby....If you read the policy dictates given to ANZ and likely to be given to BNZ, then that is what is going to happen”. ANZ National Bank has already agreed to move the processing of ANZ bank accounts back to New Zealand from Melbourne, and the BNZ is expected to follow suit.

In submissions to the Reserve Bank, released under the Official Information Act, the Australian banks voiced strong protest at Bollard’s outsourcing proposals and attempted to argue that the new rules would make it harder to rescue their NZ subsidiaries, should they ever run into financial trouble. In April 2005 BNZ, Westpac and the Australian Bankers’ association called on the Reserve Bank to stop work on a new outsourcing policy and give the issue to the Trans-Tasman Council on Banking Supervision¹⁷. The Reserve Bank rejected this call, reminding the banks the Council is “not a policy-making body” and that the submissions were “out of kilter with what the Council has been set up to do”¹⁸.

Yet Cullen appears to have disregarded Bollard’s advice yet again, as Cullen and Costello also agreed during the 2006 bilateral to implement the legislative changes recommended by the Council on Banking Supervision. The Reserve Bank recognised the proposed changes would have immediate relevance to its current debate with the Australian banks “because intervention in outsourcing arrangements is explicitly defined as an action which is detrimental to financial stability in

¹⁶ *Press*, 13/9/04, “Push on for tighter controls on banks”.

¹⁷ *Press*, 2/4/05, “Banks buck policy view”

¹⁸ *Press*, 7/4/05, “Bank outsourcing policy stays put”.

the other country”¹⁹. While the Reserve Bank maintains that there still needs to be some restrictions on the outsourcing of key functions, the proposed legislative changes will give the banks “greater flexibility about the trans-Tasman location of some of their functions”. With the help of our own Finance Minister Michael Cullen, the Australian banks appear to have won the outsourcing war.

Banks Damage New Zealand Economy In Greedy Pursuit Of Short Term Profits

Banks Stoke Inflation

Total household debt is now about \$128 billion, up a staggering \$32b in just two years²⁰. Rising debt and rampant spending are cited by the Reserve Bank as reasons to raise interest rates. In November 2005 the Reserve Bank Governor, Alan Bollard, accused the banks of pressuring inflation through their lending practices, and urged them to look beyond short term profits and market share²¹. He also warned that the interests of the shareholders of the larger banks would not be served by the banks promoting loans to people who could not afford them. In response, Westpac and the BNZ claimed they were only responding to customer demand and rejected Bollard’s view they were playing a role in fuelling inflation. Peter Thodey said the “very competitive mortgage market” in New Zealand was “healthy for consumers and providers alike”.

Finsec general secretary Andrew Casidy said the banks could not be blamed for the entire inflation problem, but their actions played a part. He highlighted how performance pay targets can place greater pressure on interest rates. Such targets provide a greater incentive for bank employees to sell mortgages, credit cards and other forms of lending, as such “sales” are rewarded more highly than savings products. “The banks consistently raise the targets on their employees as they seek to take market share off each other. This means a customer walking into BNZ will be meeting staff who will be under pressure from their employer to encourage them into debt. The economic effect of such large growth can be inflationary pressure....Finsec believes that these customer debt targets have now reached crisis point”²². Finsec is the union of finance sector employees.

BNZ sales staff are set a target of 10,320 points each per year. They get 12 points for every \$10,000 of home loans on a variable interest rate that they sell but only three points for every \$10,000 of term investments. Westpac customer service workers get ten points towards their annual target of 8575 for opening a new account and an extra 25 points for selling a credit card. They get five points for every \$10,000 of home loans they sell and five points for every \$1,000 of personal lending. As the banks often compel staff to focus on up-selling products to customers, these targets stand in clear contradiction to the claims of Peter Thodey and Ann Sherry that the banks are merely responding to customer demand, as Finsec Campaigns Director Karen Skinner explains. “The major banks are driving inflation and attempting to grow their market share by imposing ever increasing sales targets on their staff,”²³.

BNZ Santa Gives Debt For Christmas

During the 2005 Christmas shopping season, the BNZ sent out an offer of a pre-approved credit card to non-bank customers using a Fly-Buys database. Many people who received the letters would not normally be able to get a credit card. Recipients included bankrupts, beneficiaries and people with mental impairments. With many families struggling to make it through the expensive Christmas season, an offer of \$3,000 to \$5,000 would be hard to turn down. Consumers Institute head David Russell called this practice of the BNZ “ethically reprehensible...particularly if they are sending it to people who are going to struggle to meet the debt they are likely to run up on the pre-approved card”²⁴.

Banks Encourage Their Customers To Get Into Debt

¹⁹ Reserve Bank, 23/2/06, “Legislative changes proposed by the trans-Tasman Council on Banking Supervision”, <http://www.rbnz.govt.nz/finstab/banking/supervision/2420258.html>

²⁰ *Press*, 3/12/05, “Pulled up for pushing credit”, James Weir

²¹ Dr Alan Bollard, 2/11/05, “Housing debt, inflation and the exchange rate”, speech to EMA AGM, <http://www.rbnz.govt.nz/speeches/2157629.html#TopOfPage>

²² Finsec, December 2005, “Submission to Reserve Bank on the effect of bank sales targets and performance management systems upon consumers and the economy”.

²³ *Press*, 10/11/05, “BNZ profits grow 15%”.

²⁴ *Press*, 2/12/05, “BNZ rejects accusation over credit cards”.

The Banking Ombudsman has criticised the practice of “inertia selling” where the banks unilaterally raise the credit card limits of their customers, relying on the target not to take steps to decline the offer. Chief investigator Susan Taylor says the Ombudsman’s Office found that “often the only criteria the banks consider is whether the customer has met the minimum monthly repayment. But meeting the repayment on a \$2,000 credit limit is quite different from meeting it on a \$5,000 limit”. The Consumers Institute also criticised Westpac when it heralded its decision to lower minimum monthly payments from 5% to 3% as “good news” for customers. “Of course it’s not good news,” said Russell. “It’s about keeping people in hock for longer”²⁵. Research by Massey University’s Centre of Finance and Banking found that higher credit card limits encourage people to spend more and results in higher outstanding balances²⁶.

Banks Face Criminal Charges Over Hidden Credit Card Fees Ripoff

Anyone who has made use of a credit card overseas or to make a purchase over the Internet may have been hit with a hidden currency conversion fee that banks and finance institutions have conveniently forgotten to inform their customers about. In November 2004 the Commerce Commission announced it was pursuing legal action against five major banks and two credit card transnationals for not disclosing their international currency conversion fees. Westpac, BNZ, ASB Bank, TSB Bank and ANZ National, are set to face criminal prosecution for breaching the Fair Trading Act, alongside credit card companies American Express International (NZ) and Diners Club (NZ). Warehouse Financial Services (where everyone gets a billing?), a partnership of Westpac and the Warehouse, is also facing charges. Commerce Commission Chairwoman, Paula Rebstock, said the amount of undisclosed fees run into “at least the tens of millions”.

In April 2004 the California Superior Court ordered Visa and Mastercard to repay up to \$US800 million in undisclosed conversion fees, setting a helpful precedent for the Commerce Commission action. The US judgement is still under appeal and no American consumers have received any fee refunds yet. Ms Rebstock expects the legal action in New Zealand to take up to two years, so Kiwis will also have to wait for their refunds. The banks and the financial institutions made their first appearance in the dock in April 2005. Let us hope there are some hidden court costs.

Low Wages, Bullying, Stress And Sales Targets

The Banks Love Low Wages

According to Statistics New Zealand, labour costs for the finance and insurance sector (which is dominated by the four big banks) have lagged behind the average pay increases gained by the general population²⁷ over the past four years. As the majority of bank employees are women this demonstrates that finance sector employers are contributing to the growing gender pay gap.

Westpac, in a clear demonstration that management are not averse to exploiting their underpaid New Zealand workforce, announced in September 2004 that it might return some more back office processing to New Zealand. “Westpac...is keen to take advantage of New Zealand’s low wages as part of a programme to reduce the \$1.6 million in costs incurred each year in the business, technology and services divisions”²⁸. According to Finsec, the remuneration offered to Westpac workers continues to lag behind what is offered by the other banks.

This also suggests the push for a “single economic market” by the banks is primarily a cost saving measure. Harmonisation is fine when it is protecting the profits and the interests of the bankers, but it is an entirely different story when it comes to looking after the interests of their trans-Tasman workers. A real “single market” ought to include trans-Tasman standards on wages and conditions, so perhaps our Government should be told in no uncertain terms to stop pushing the so called “single market” in harmony with the corporates, unless the corporates make some concessions themselves. ANZ National continues to refuse to pay its New Zealand workers the double time penal rates it offers Australian staff for working in the weekends.

Call Centres: 21st Century Sweatshops?

²⁵ *Press*, 8/10/05, “Danger of debt”

²⁶ *Press*, 8/10/05, “Danger of debt”.

²⁷ Between 2002 and 2005 labour costs for the finance and insurance sector increased by an average of 1.725% (c.f. average of 2.125% for the whole population)

²⁸ *Press* (20/9/05), “Westpac plans to shift some processing functions to NZ”.

At BNZ all telephone conversations made by call centre staff are taped and randomly chosen for pay assessments, where workers can be marked down for using the wrong words or scripts. In one instance a call including an error was played in front of the whole team while the person who took the call was asked to leave the room while the rest of the team critiqued the call. Call centre operators have been disciplined for being as little as half a minute late signing on to their phones. All of these factors affect their Performance Management Framework (PMF) rating which affects their take home pay.

In a clear cut case of bullying, a pregnant woman working at a Westpac call centre was told she would have to make up time after work if she went to a specialist appointment. A Finsec organiser informed the team leader of the bank's responsibilities under the Parental Leave Employment Act. The team leader then demanded a doctor's certificate from a 20 weeks pregnant woman to prove she was pregnant and that the specialist appointment was related to the pregnancy.

Call centre staff at Westpac are closely monitored. An employee making a three minute call to their union was threatened with having to make up the time at the end of the day. Staff have been spoken to for taking more than three toilet breaks during the day, and if they spend more than 17 minutes not ready on the phone over an eight hour shift.

Not Family Friendly

Some of the employment practices at the BNZ and Westpac make them far from family friendly workplaces. Workers are regularly unable to take holidays at the same time as their children, and are sometimes asked to return from holidays due to their workplace being understaffed. A Samoan worker at the BNZ was refused leave to visit her son over Christmas, despite asking nine months in advance and being the only one in her team to ask for leave on those dates. The bank refused because the period included December 16, the busiest banking day of the year, despite assurances from her team that they would cope. Westpac staff in Takaka are almost never allowed leave over the Christmas period, as it is the busiest time of the year for the branch. Bank staff are forced to find a way to look after their children and work at the same time, as the only childcare facility in Takaka is closed during the Christmas period. Westpac refuses to send temporary replacement staff to Takaka from other areas to allow their workers to have a holiday.

Stress And Sales Targets

Stress is widespread among workers at the BNZ because of serious understaffing and unreasonable demands placed on staff in the form of ever increasing sales targets. Entire offices have been known to work late or miss morning and afternoon tea (without compensation) and workload pressure has forced some workers to come to work despite being sick. Stress and pressure also affects their families. Westpac staff reported similar experiences.

One BNZ manager insisted that staff put their hands on their head and answer questions about their sales targets for the week. They could not lower their hands until they had given the answer.

A BNZ branch in Taihape won an award in 2005 for being the best branch in the whole country. Sadly, BNZ does not appear to give the staff adequate recognition for their effort, as workers there have been handed a PMF rating of "Needs Improvement" because they cannot meet the unrealistic targets set by the bank, meaning they will not receive the negotiated increase in their base salaries.

To make matters worse, under a new aspect to the PMF system BNZ staff are expected to promote mortgages and home loans in their own time. Under the title of "community responsibility" staff members are expected to promote the bank outside of work such as at social gatherings.

As a sponsor of the 2006 Commonwealth Games team, the BNZ asked back office staff to adopt an athlete and fundraise money through cake stalls and the like. The bank makes an after tax profit of \$541 million and still asks its staff to run a cake stall?

In December 2005, Westpac staff who are members of Finsec, voted to issue a public statement to the community:

"Westpac sets staff targets to sell large amounts of lending and other products to customers each year. As Westpac staff we are concerned about these targets, and how they are managed. If staff don't reach these arbitrary targets, they miss out on pay. And our jobs might even be threatened. For us these targets cause stress, frustration and lost pay. For you, our customers, they can also cause

stress and frustration. Westpac staff don't like doing that to you. We want to be paid for giving good service and quality advice".

In order to demonstrate their resolve on the issue, Westpac staff held a strike on December 19, 2005 – the last banking day before Christmas. In a provocative move, on January 5, 2006, Westpac gave all non-union employees a pay rise prior to the conclusion of negotiations with the union. This meant that non-union staff were being paid more than union staff.

Following a four month dispute, union members on February 10 voted to accept a 5.2% pay offer and a commitment from Westpac to develop a new pay progression system that will not be based solely on targets. Westpac staff and Finsec ought to be congratulated for this small but significant step towards resolving the issue. One hopes the bank will develop a pay progression scale that rewards service and not just sales.

Westpac and the Bank of New Zealand are the worthy winners of the 2005 Roger Award.

FINANCIAL ANALYSIS: BNZ AND WESTPAC

- Sue Newberry

The judges' decision that the Roger Award should go to the BNZ and Westpac cites their tax practices as a key reason for the award. Both banks are under investigation by the Inland Revenue Department (IRD) in relation to particular structured finance transactions. Evidently, the IRD regards these transactions as tax abusive and is seeking payment of additional tax. The two banks acknowledge a combined total potential tax obligation of NZ\$1.23 billion (including penalty interest) from these transactions, all of which occurred between 1999 and 2005. This analysis reviews the banks' tax disclosures in their financial reports back to 1999.

The corporate tax rate in New Zealand is 33%. For simplicity, the tax information shown below draws on the amounts reported as tax expense in the banks' financial reports even though that is not the actual amount paid. As many people know, the information reported to the IRD in tax returns typically differs from the information reported in published financial reports. The tax returns are not publicly accessible, and so there is no choice but to use the information provided in the companies' audited annual reports in the hope that it provides a reasonable approximation.

The audited financial reports of companies like these are required by law to comply with financial reporting standards. The required practice for accounting for income tax is known as tax effect accounting. It emerged in the United States in the late 1960s after companies had been criticised for paying very little tax. Tax effect accounting is dubious and controversial, and it tends to confuse rather than inform. With variations, tax effect accounting is now part of financial reporting standards in many countries, including Australia and New Zealand. The move to a single set of international financial reporting standards will not bring relief from the confusion caused by tax effect accounting. In late 2003, Sir David Tweedie, the chairman of the International Accounting Standards Board which has now produced the first financial reporting standards for application globally, denounced tax effect accounting as stupid but admitted that the international financial reporting standards would continue to require it. According to Tweedie, requiring tax effect accounting in the international financial reporting standards will at least mean all countries apply the same stupid standard tax accounting practice.

Under tax effect accounting, the amount reported in audited financial reports as operating profit before tax is not the same as assessable income as reported to the IRD, and neither is the amount of tax expense reported the same as the actual amount of tax assessed for the year. The actual tax information is not publicly available. The tax information reported below is drawn from the tax figures shown in the banks' audited financial reports in the hope that it might provide a reasonable approximation, but it most likely overstates the actual amounts of tax.

Bank Of New Zealand

The BNZ reports in its 2005 *Annual Report* on the Inland Revenue Department's "industry-wide review of structured finance transactions." At that time, the IRD had issued the BNZ with amended assessments relating to structured finance transactions relating to the 1999 income year. The amended assessments were for \$47 million, on top of which would be interest and any penalties. According to the BNZ, if the IRD were to reassess income tax for all structured finance transactions of that type up to 30 September 2005, the total tax liability would be \$416 million plus interest of \$117 million, giving a combined total of \$533 million. All transactions of the type under investigation had matured or terminated by 30 June 2005.

The BNZ reports its confidence that it had correctly applied the law and that it had "obtained legal opinions that confirm that the transactions complied with New Zealand tax law." The BNZ argues that it should not, therefore, have to pay further tax.

The table below shows the figures reported in the BNZ's audited financial reports for the last seven years and the reported tax expense.

Table 1.**Bank of New Zealand: Tax expense compared with operating profit before tax**

	Total	2005	2004	2003	2002	2001	2000	1999
\$NZ	\$mill	\$mill	\$mill	\$mill	\$mill	\$mill	\$mill	\$mill
Operating profit before tax	4,375	710	625	752	750	587	513	438
Tax expense	1,046	169	154	204	168	147	124	80
Tax expense as % of profit	24%	24%	25%	27%	22%	25%	24%	18%

The BNZ reports total operating profits before tax of \$4,375 million, and total tax expense of \$1,046 million. Over the seven years, tax expense averages 24% of reported operating profits. If the BNZ's acknowledged potential tax liability of \$416 million is added to the total reported tax expense of those seven years, that would give a total tax expense of \$1,462 million, raising the proportion of tax expense to 33% which is the level of the corporate tax rate.

Westpac

Westpac's 2005 *Annual Report* also explains that the Inland Revenue Department in New Zealand is taking action against Westpac in respect of some of its structured financing transactions between 1999 and 2005. The total potential tax liability is NZ\$611 million. With penalty interest included the amount rises to approximately NZ\$750 million.

Like the BNZ, Westpac reports it is defending this effort by the IRD. It states that in 1999 the IRD issued a binding ruling on the first of that type of structured finance transaction and confirmed that binding ruling in 2001. Westpac further states that the tax principles underlying all of the subsequent transactions were the same, and that it has obtained independent tax and legal opinions which confirm its tax treatment was "consistent with New Zealand law." It has already paid NZ\$110 million to the IRD, that amount including interest, but regards the amount paid as still in dispute and therefore has not recorded it as a tax expense. Westpac reports confidence that payment of additional income tax is unlikely.

Identifying Westpac's profits and income taxes in New Zealand is not straightforward. Westpac is registered in Australia and all of its financial activities in New Zealand are included in its Australian financial reports. Westpac does provide financial reports in New Zealand for its New Zealand Banking Group, but it is not clear that the New Zealand reports cover all of Westpac's financial activities in New Zealand. A comparison of the tax information reported in New Zealand against that reported in the Australian financial reports for Westpac reveals anomalies. For this reason, I have provided both New Zealand and Australian information. All of the information below is taken from Westpac's published financial reports as audited by Price WaterhouseCoopers.

Table 2**Westpac's New Zealand Banking Group: Tax expense compared with operating profit before tax**

As reported in NZ	Total	2005	2004	2003	2002	2001	2000	1999
	NZ\$m	NZ\$m	NZ\$m	NZ\$m	NZ\$m	NZ\$m	NZ\$m	NZ\$m
Operating profit before tax	4,972	917	918	667	786	610	579	495
Tax expense	1,398	292	297	203	168	131	144	163
Tax expense as % of profit	28%	32%	33%	30%	22%	22%	25%	33%

Table 2 shows that its New Zealand Banking Group financial reports published in New Zealand, Westpac reports total operating profits before tax of NZ\$4,972 million, and total tax expense of

NZ\$1,398 million. Over the seven years, tax expense averages 28% of reported operating profits. If the potential tax liability of NZ\$611 million is added to the total tax expense of those seven years, that would give a total tax expense of NZ\$2,009 million, raising the proportion of tax expense to 40% which is higher than of the corporate tax rate, the difference being about NZ\$369 million. That seems odd.

Westpac's Australian financial reports cover the whole Westpac group whereas the New Zealand reports relate only to the New Zealand Banking Group. For comparison I extracted from Westpac's financial reports issued in Australia information about Westpac's financial activities in New Zealand. Because all of the figures below are taken from the Australian financial report, they are in Australian dollars.

Every large company is required to provide detailed financial information about its different lines of business and the different geographical locations where it operates. To do this it must re-present and analyse key figures from the financial reports twice. This disclosure, found in the notes to the financial statements, is known as group segment information. In Westpac's Australian financial reports it may be found at Note 29.

Table 3

Westpac: Segment profits from ordinary operations before tax; and tax expense (from Note 29)

Reported in Australia	Total	2005	2004	2003	2002	2001	2000	1999
Business segs: NZ Banking	A\$mill	A\$mill	A\$mill	A\$mill	A\$mill	A\$Mill	A\$Mill	A\$Mill
Operating profit before tax	3,296	579	551	450	503	427	374	412
Tax expense	1,078	192	185	146	140	144	123	148
Tax expense as % of profit	33%	33%	34%	32%	28%	34%	33%	36%
Geographical segs: NZ		A\$mill	A\$mill	A\$mill	A\$mill	A\$Mill	A\$Mill	A\$Mill
Operating profit before tax	3,454	749	718	430	662	336	329	230
Tax expense		Not shown	Not shown	Not shown	Not shown	Not shown	Not shown	Not shown

Table 3 shows the information from Note 29 in the Australian financial reports. In the segment information by business segments, Westpac identifies five segments, one of which is New Zealand Banking. For that segment, operating profits before tax total A\$3,296 million and tax expense reported totals A\$1,078 million, an average of 33% which is exactly the corporate tax rate. In the segment information by geographical segment, Westpac identifies three segments, Australia, New Zealand and other. The operating profit before tax for the New Zealand geographical segment (A\$3,454 million) is A\$158 million higher than that for the New Zealand Banking segment. Clearly the Westpac Group has activities in New Zealand other than those shown in the New Zealand Banking segment information. For example, another of the business segments shown in the Australian report is called Westpac Institutional Bank which "services the financial needs of corporations, institutions and government customers that are based in or have interests in Australia and New Zealand." Because there are additional activities and additional profits in New Zealand it would seem logical for there to be additional tax but the information disclosed for New Zealand as a geographical segment does not show tax expense (and is not required to show it).

Although the figures above are in Australian dollars, neither set seems to compare with the New Zealand Banking Group information as reported in New Zealand. For example, the New Zealand Banking segment information reported in the Australian reports (Table 3) shows total tax expense of A\$1,078 million but this is less than the tax expense as reported in New Zealand (NZ\$1,398 million)

(Table 2), even after allowing for translation of the NZ\$ figures to Australian dollars. The NZ\$292 million tax expense reported in the New Zealand financial report for 2005 (Table 2) would translate to the A\$192 million tax expense shown for the NZ Banking segment in the Australian reports (Table 3) only if the exchange rate were 65 cents. But the exchange rate in September 2005 was closer to 90 cents. Further analysis seems to be required.

The amount of tax reported on all of Westpac's activities outside Australia is disclosed in the Australian financial reports at Note 6. For this reason, Table 4 adds together the profits from Westpac's New Zealand and "Other" geographical segments as shown in the Australian financial reports at Note 29, and then compares those profits with the tax expense reported in Note 6 as incurred outside Australia. As may be seen from these figures, over the last seven years, Westpac's total reported profits from outside Australia amount to A\$4,881 million, and the reported tax expense on those profits to A\$744 million, an average of 15%. It has ranged from a high of 38% in 1999 to a low of 6% in 2004.

Table 4

Westpac: Segment profits from ordinary operations before tax; and tax expense

Reported in	Total	2005	2004	2003	2002	2001	2000	1999
Australia	A\$mill	A\$mill	A\$mill	A\$mill	A\$mill	A\$Mill	A\$Mill	A\$Mill
Profits NZ geog segment	3,454	749	718	430	662	336	329	230
Profits "Other" geog segment	1,427	366	310	222	-107	266	225	145
Total profits outside Australia	4,881	1,115	1,028	652	555	602	554	375
Tax expense on profits outside Australia	744	182	60	81	111	83	86	141
Tax as % of profits	15%	16%	6%	12%	20%	14%	16%	38%

These Table 4 figures raise a puzzling question. In its Australian financial reports Westpac's reported total activities outside Australia include its activities in New Zealand. The profits reported on all of activities outside Australia (A\$4,881 million) are greater than the profits reported on its New Zealand activities A\$3,454 million). But the tax expense on all activities conducted outside Australia (A\$744 million) is less than the tax expense reported in the Australian report as incurred in relation to Westpac's New Zealand Banking segment's activities (A\$1,078 million) (see Table 3, Tax expense business segments NZ Banking). And yet the total tax expense on all Westpac's activities outside Australia must include all of the tax expense on Westpac's New Zealand activities.

An interesting aspect of the difference reported in Westpac's Australian financial reports between the income tax expense relating to the New Zealand Banking Group segment activities (A\$1,078 million) and that reported as relating to all of the Westpac's financial activities outside Australia (A\$744 million) is that the figures suggest Westpac incurs lower taxes from higher profits. The implication is that the higher profits earned outside Australia somehow generate tax gains to Westpac. Structured finance transactions frequently flow through international tax havens (activities outside Australia), and they tend to make little commercial sense other than to conceal, and to exploit a tax base or tax bases. Possibly, signs of the basis for the tax dispute between Westpac and the IRD are buried in these tax figures on all of Westpac's financial activities outside Australia.

Why the three sets of audited tax figures Westpac publishes are so different and which is correct is, perhaps, something Westpac and/or its auditors might like to explain. Even then though, tax effect accounting means that identification of the "correct" amount will not help with identification of the actual tax for the year. I can only agree with Sir David Tweedie's views on tax effect accounting and wonder why the financial reporting standard requiring it has not been dumped. At the very least, corporate financial reports should be required to show the amount declared as assessable income for the year and the actual amount of income tax.

In summary, at the 2005 financial year end, both Westpac and the BNZ reported that they were under investigation by the IRD in relation to certain structured finance transactions which they were defending. The combined total of the potential obligation they faced (including interest) was \$1.23

billion. Both banks are required by law to observe financial reporting standards, but those standards do not allow clear identification of actual tax assessed, and tax records filed with the IRD are not publicly accessible. There is little in their financial reports to help with assessing the banks' tax activities other than the disclosures provided by both banks of the amount of tax under dispute. The outcome of the IRD's action against both banks will be interesting to see.

And What Will Come Next?

There are many variations of structured finance transactions and the potential tax liability reported by the BNZ and Westpac relates to a particular set of such deals. Both the BNZ and Westpac seem to have stopped engaging in those particular transactions. Recent permissions issued to Westpac by the Overseas Investment Commission (OIC)²⁹, however, suggest the need to remain alert for the effects of other structured finance arrangements. Details from the OIC approvals reveal that the amounts involved are around \$2 billion.

On 19 July 2005, the OIC issued approval for Westpac to sell for an undisclosed amount "up to 100 percent of certain specified securities" in a company called Pacific Funding to Linvest LP an organisation with its beneficial ownership in Germany. The rationale stated that "entities associated with Linvest LP undertake nationally and internationally, the business of financing and investment banking. The financing of Pacific Funding is a continuation of those activities."

On 12 August 2005, the OIC issued approval for Westpac to purchase from Linvest LP for an undisclosed amount "up to 100% of the specified securities" in Pacific Funding. The rationale stated that Westpac would "provide finance to Pacific Funding, a New Zealand incorporated unlimited liability company, which it partly owns. In order to protect its position, in certain circumstances it may wish to ensure that it has full control of Pacific Funding by exercising the option to acquire specified securities in Pacific Funding from Linvest LP."

On 1 November 2005, a company called Pacific Funding was registered in New Zealand, with 20,294,118 shares. Company register documents reveal that 98.8% of Pacific Funding's shares are owned by Linvest LP, which is registered in the Cayman Islands, a tax haven. The remaining 250,000 shares are owned half each by two companies, Tasman Funding No 1 and Tasman Funding No 2 which are included in the NZ Banking Group financial reports published in New Zealand. Both Tasman Funding No 1 and Tasman Funding No 2 are owned by Infrastructure Australia (No 1) Limited. Westpac's 2005 Australian annual report reveals that it controls Infrastructure Australia (No 1) Ltd and all of the New Zealand operations, including Tasman Funding No 1 and Tasman Funding No 2.³⁰

Westpac has not issued financial reports since September 2005 so whether anything about sale of securities in Pacific Funding will be apparent in such reports is not known. The structuring of what is disclosed so far makes it seem likely that most of the arrangement will be "off-balance sheet", that is, it either will not show in any of Westpac's published financial reports or will be barely visible. Even from what is disclosed, it seems reasonable to suggest that any funding Westpac received by "selling" the securities in Pacific Funding could be regarded as a loan secured over those securities rather than the sale of those securities. This is because of Westpac's desire to protect its "full control" of Pacific Funding through the options arrangement. Given that the OIC's permission is for around \$2 billion, the amount is sufficiently large that Westpac and its auditors should regard themselves as obliged to ensure sufficient explanation is provided to allow the public to understand this arrangement. Westpac's next financial reports will be interesting to see.

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²⁹ Note that these were among the last approvals given by the OIC. From August 25, 2005, it was replaced by the Overseas Investment Office, part of Land Information New Zealand.

³⁰ Tasman Funding No 1 and Tasman Funding No 2 are owned by Infrastructure Australia (No 1) Ltd, but that company does not seem to be included in the NZ Banking Group financial reports published in New Zealand. Consequently, it is difficult to see why the two Tasman Funding entities would be included. The NZ Banking Group financial report suggests this is part of a messy resolution to the debate with the Reserve Bank over what must be included in the New Zealand Banking Group's financial reports. The banking group is reported as "including those entities whose business is required to be reported in financial statements for the Overseas Banking Group's New Zealand business".