

# 2018

## Southland Building Society Annual Report & Financial Summary



# Highlights



# Contents



We're with you

- 2 Chairman & CEO Report
- 4 Values-Based Banking
- 6 Your Board of Directors
- 8 Subsidiaries
- 10 Summary Financial Statements
- 12 Notes to the Summary Financial Statements

# Chairman & CEO Report

Welcome to the SBS Bank Annual Report for the financial year ending 31 March 2018. As we enter our 150<sup>th</sup> year, it's pleasing to report that the organisation is in good financial health and continues to perform well.

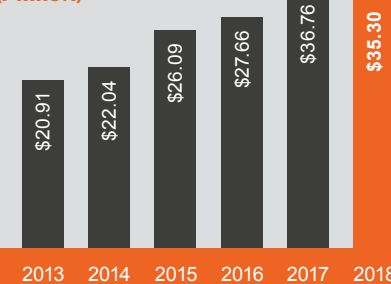


John Ward, Chairman



Shaun Drylie, Group CEO

## Operating Surplus (Million)



## Retail Deposits

up  
**11%**

## Loan Advances

up  
**11%**

## Members' Equity

up  
**9%**



SBS Bank's strategic focus on balanced, quality growth has positioned us appropriately and we have achieved positive results in both lending and funding in a competitive and complex market. Loan advances have increased 11% on the previous year, up \$388 million, while retail deposits have also grown strongly, up \$337 million, an increase of 11%.

The Operating Surplus of \$35.3 million is a strong result. While this is marginally down on the previous year, it reflects the acquisition costs of the Warehouse Group Financial Services, which will assist in positioning the bank and Group for the future.

SBS Bank has been a key contributor to this result with subsidiary companies (Finance Now, FANZ and Southsure) continuing to make meaningful contributions to the group outcome.

We're pleased to report that Members' Equity has increased \$25 million on the previous year, to \$295 million. We provided further benefits to Members through several key developments such as the removal of bank ATM fees as well as enhanced service improvements through our team member training and technology.

As the digital world continues to evolve, so too are SBS' offerings to our Members. As people become more comfortable conducting their lives on a mobile device, the way SBS shapes its products, services and operating channels must also appeal to the needs of a diverse population.

Over the next 12 months we will continue to expand our digital and product offering making banking with SBS easier, more accessible and more appealing. Examples of this include the launch of a credit card and the ability for Members to apply for and open term deposits online.

SBS' primary focus is about delivering value to our Members, who also participate as owners. This is an important distinction to other banking ownership models. We do this by reinvesting the profits we make in building a stronger mutual organisation. By operating with integrity and transparency we will continue assisting our Members to achieve their aspirations and goals.

Our appreciation is extended to our team members who have made a meaningful impact across the SBS Group. In the past 149 years, the essence of banking has not changed and our teams' commitment and dedication to providing Members and customers with authentic service is testament to our people and this organisation.

We also acknowledge the significant contributions of all board members to the various committees, subsidiary boards and the parent organisation.

The year under review has been a demanding one from a governance perspective and we acknowledge, with gratitude and appreciation, the commitment and expertise that board members bring to this entity.

Thank you for your continued support of SBS. We have been in existence now for 149 years and we look forward to working with you for many more to come.

**“Over the next 12 months we will continue to expand our digital and product offering making banking with SBS easier, more accessible and more appealing.”**

John Ward  
Chairman

Shaun Drylie  
Group CEO



# Values-Based Banking

“We’re all about working together to make things better. A better banking experience for our Members, a better workplace for our team and a better community for us all to live and work in.”

Sue Bingham, Cromwell Branch Manager

Almost 150 years ago, the Southland Building, Land and Investment Society was formed. In its most basic role the aim of a Building Society was to build a society, and through the formation of SBS, James Walker Bain saw an opportunity to help the people of Invercargill into their own homes and onto their own land.

For almost a century and a half, SBS has weathered the country’s highs and lows. While banking and the way in which people communicate and interact with their bank has changed, SBS’ focus on values-based banking and helping people within our communities hasn’t.

Mutuality, honesty, trust and integrity are the values on which we were founded and are the values which guide our team members in their daily interactions with Members.

“People want to deal with people they know, like and trust and that’s what SBS provides,” Hastings Branch Manager Grant Brodie says.

“All Members are on a financial journey and they often turn to us at key times in their lives, like purchasing their first home or eyeing retirement. At these crucial life moments people want to feel valued and that they’re dealing with real people who believe in doing what’s right. We work closely with Members to get to know them better, because the better we know what matters most, the more we can do to help them reach their goals.”

It’s a similar sentiment echoed by Cromwell Branch Manager Sue Bingham.

“We’re all about working together to make things better. A better banking experience for our Members, a better workplace for our team and a better community for us all to live and work in. Our profits don’t go offshore, instead they go back to our Members and into their communities, so we can support the causes that are important to our Members.”

SBS has been looking after the interests of our Members for the past 149 years and we will continue to do this into the future.

SBS Bank at the Southern Field Days. SBS Group CEO Shaun Drylie with 2017 Tour of Southland winner James Piccoli.



Above: Blenheim Branch celebrate 149 years.  
Right: Cromwell Branch Manager Sue Bingham.



Above: Hastings Branch Manager Grant Brodie delivering Christmas hampers to Women's Refuge.



SBS Bank team members at the ISPS Handa NZ Golf Open. SBS Bank Ambassador Eddie Dawkins at Otatara School.



# Your Board of Directors



**John Ward, Chairman**  
BCom Hon LLD (Otago) FCA CFInstD

John is a Chartered Accountant who stepped aside from public practice after being a partner and Board Member of KPMG and its ancillary practice Ward Wilson for many years. He is a Fellow of the Institute of Chartered Accountants of Australia and New Zealand and a Chartered Fellow of the Institute of Directors.

He has served on the Board of SBS Bank since 2002 and has been Chairman since 2014. He chairs the Board's Appointment Committee and is a member of both the Audit and Risk and

Remuneration Committees. He also Chairs Finance Now Limited and is a Director of Southsure Assurance Limited, both wholly owned subsidiaries of SBS Bank. John is involved with various charitable trusts and he has recently stepped aside as the Chancellor of the University of Otago (2009 – 2017).

He currently chairs H&J Smith Holdings Limited, Otago Innovation Limited and the University of Otago Foundation Trust.



**Kathryn Ball, Deputy Chair**  
B Com, FCA, CMInstD

Kathryn is a chartered accountant with over 30 years' experience in public practice. She is currently a self-employed consultant, principally to McIntyre Dick & Partners Ltd (MDP), Chartered Accountants and Business Advisors, based in Invercargill. Kathryn was a partner/principal in MDP for many years, and prior to that a partner in PricewaterhouseCoopers and Coopers and Lybrand. She remains part of the MDP tax specialist team and provides business advice to a wide range of clients.

Kathryn Chairs the bank's Audit and Risk Committee. She is also a Director of Stadium Southland Ltd. Kathryn served for a number of years as a Southern Institute of Technology (SIT) Councillor, Chairing the Audit and Finance Committee and serving a period as Deputy Chair. She was involved with SIT at the time the innovative "Zero Fees" scheme was introduced.

Kathryn is a fellow of Chartered Accountants Australia and New Zealand, and a Chartered Member of the Institute of Directors.



**Frank Spencer**  
BBS, FPinZ, FNZIV, AREINZ, CMInstD

Frank is a Registered Valuer and Managing Director of Logan Stone Limited. Frank was appointed to the Hastings Building Society as a Director in 2001 and became Chair in 2009, joining the SBS Board following its merger with HBS in 2010.

Frank is a Director of Finance Now Ltd. He was Chairman of the Bank's insurance subsidiary Southsure Assurance (2011 – 2017) and was a Director of Abbott Group (2014 – 2017).

Frank's Governance experience includes the Hastings Tourism Facilities Trust, Chair of the Water Testing Hawke's Bay Limited Advisory Board and a number of closely held company roles.

He is a Fellow of the New Zealand Institute of Valuers and the Property Institute of New Zealand, a Chartered Member of the Institute of Directors and an Associate Member of the Real Estate Institute of New Zealand.



**Jeff Grant**

Jeff is a sheep and beef farmer in Balfour, Southland. Since joining the SBS Bank Board in 2007, Jeff has been on the Finance Now Board and is a Member of the Remuneration and Board Appointment Committees.

Prior to this Jeff served two terms as a Member of Parliament from 1987 to 1993 and then became involved in Governance roles within the Agribusiness sector nationally. He has been on the Boards of NZ Meat, Meat and Wool NZ, Wrightsons, Landcorp, Animal Health Board and Ovita.

Jeff has also Chaired a range of Boards since 1994 including Meat Research and Development Council, AGMARDT, Milford Sound Tourism, Primary Industry Council, Meat Board and Meat and Wool NZ. He currently is the Chair of OSPRI, AgResearch and Mt Linton. He is a Director of Predator Free 2050 Ltd, a Board Member of the Southern Institute of Technology and a Trustee of Mid Dome Wilding Pines Trust.



**Greg Mulvey**  
BCom, FCA, FNZIM

Greg is a qualified accountant with 40 years' experience in the corporate sector. Up until 1 January 2018, he was the General Manager of Invercargill Licensing Trust, a position he held for 30 years.

Appointed to the Board of SBS Bank in 2004, he is Chair of both the Remuneration and IT Committees and is a member of the Audit and Risk Committee as well as a Trustee of SBS Charitable Trust.

Greg is also a Director of Funds Administration New Zealand Ltd.

He is a Trustee of the Southland Indoor Leisure Centre Charitable Trust, the entity that developed and owns ILT Stadium Southland. He is also a long-serving Director of DB South Island Brewery Ltd.



**Anne McLeod**  
LLB, BCom

Anne is a partner in the corporate commercial team at Anderson Lloyd in Dunedin. Her legal expertise includes banking law, mergers and acquisitions and structuring advice. Anne also advises Anderson Lloyd's clients who are listed on NZX and regularly advises on the offer of financial products. Given this experience, she is a member of SBS Board's Due Diligence Committee in relation to Capital instrument issues.

Anne was appointed to the SBS Board in 2015 and also Chairs the Bank's subsidiary, Southsure Assurance Limited. She is a Member of the Institute of Directors, RITANZ (Restructuring Insolvency and Turnaround Association New Zealand) and the Banking and Financial Services Law Association.



**Mike Skilling**  
BAgrSci, PGDipBank, SFFINSIA, CMInstD

Mike joined the SBS Board in August 2014. He has in-depth experience in retail, private, rural and business banking together with insurance, managed funds and finance companies.

In previous roles Mike has led both the Agribusiness and Business Banking arms of BNZ including Small Business, Medium/Large Business, International Trade, Property, Plant and Machinery Finance and Private Banking. During this time he also deputised for the CEO when required.

He is an independent Director of various companies spanning funds management, insurance, electronic transactions, mortgage broking, wool, dairy/sheep/beef/crop farming, consumer finance, rural banking, business banking, retail banking and motor vehicle importing, selling, servicing and finance.

He is a Senior Fellow of Financial Services Institute of Australasia (FINSIA) and a member of the NZ Institute of Directors.



**Joe O'Connell**  
B.Com, CA

Joe is a Chartered Accountant and a Member of the Institute of Directors. Joe is an experienced Director with a financial background which spans transportation, ready-mix concrete, timber processing, exploration piling and drilling, commercial property, fuel distribution, growing media, airports and electrical distribution networks.

Joe was the Chairman of the Invercargill Airport Ltd. and serves as a member of SBS Board's Due Diligence Committee in relation to Capital instrument issues.

Joe spent six years as General Manager of Finance for H W Richardson Group Ltd. Over the last 10 years he has focused on Directorships and Management Consulting work with a large amount of time being spent with the K G Richardson Limited Group of Companies,02 which has extensive interests in timber processing, property, drilling and transportation.

He currently sits on several Boards, including Electricity Invercargill Limited, PowerNet Limited and Southfuels Limited, among others.

# Subsidiaries

Over the past 12 months SBS' subsidiary companies, Finance Now, FANZ and Southsure have continued to perform well, recording solid contributions for the SBS Group.

These subsidiary companies have increased in value significantly over the last 15 years with a combined enterprise value now in excess of \$180 million, based on our internal valuation models.



**Phil Ellison** BMS  
Finance Now CEO

Founded in 2000, Finance Now is a consumer finance business offering customers retail, personal, business and car finance.

The 2017/2018 year was yet another busy and successful period for the Finance Now Group which included a number of strategic acquisitions along with continued customer and receivable growth in our established lines of business.

In February, Farmlands and Finance Now announced the purchase of Farmlands Finance and the continued provision of finance products to Farmlands on an exclusive basis. Following the announcement two products were launched; FarmFlexi (Revolving product) and FarmFixed (Term loans).

In September, Finance Now acquired the Warehouse Group Financial Services which included the Warehouse Money Credit Card

We believe that these models provide a fair reflection of market value but note that they are not independently verified or audited.

We are pleased with the value generated within each of these businesses, representing more than \$130 million over the net assets of these entities. Over 95% of this value is attributable to Members of SBS Bank. The \$295 million of equity attributable to Members as disclosed in the financial statements, excludes the revaluation of our subsidiaries.

portfolio (The Warehouse Red Card and the Purple Card) and a term of exclusive retail finance provision to the entire Warehouse Group. This involved the transition of all team members and technologies into the current Auckland office.

These initiatives see Finance Now extending finance distribution channels into different markets and setting a robust foundation for further growth opportunities within the

Finance Now Group. The focus for the next 12 months will include the consolidation of technologies and processes and driving more volume from existing channels while developing new ones with our new product ranges.



**Graham Duston**  
NCFS, B.Com, PG Dip, AFA  
FANZ CEO

Established in 2002, Funds Administration New Zealand (FANZ) is a managed funds and investment advisory business focussed on providing investment solutions that take a stable, long-term view.

Funds Administration New Zealand (FANZ) has again recorded another strong performance for the financial year ending 31 March 2018. Total funds under management increased more than 8% and now exceed \$1.3 billion and revenues

have also grown by more than 11%. Investors will also be pleased to have received strong returns in both portfolios and KiwiSaver accounts.

These results have been achieved by a number of key strategic initiatives and while they are favourable, FANZ will continue to adapt to an ever-changing landscape.

Over the next three years the FANZ business will undergo a transformational period to ensure

we are ready to meet these challenges. We will look to invest in a number of key business programmes which will include the creation of a series of digital and investor-centric tools that will assist investors to plan, design and manage their own financial plan alongside their FANZ adviser.

We will also look to provide additional benefits to our investors by reducing fees in the Lifestages KiwiSaver scheme and developing

an investment offering which will benefit different investor segments.

While the way in which we conduct business may change, our commitment to provide investors with reliable returns over the long term, by offering a carefully considered, 'no surprises' investment management approach, will not.



**David Newman** BCom, DipBank  
Southsure Assurance CEO

Founded in 1987, Southsure is a personal insurance business offering a range of insurance options including life, funeral, house, contents and income protection insurance.

The year ended 31 March 2018 was another successful year for Southsure. Operationally, record claim payments were made to

customers and Members, solid increases in premium income were achieved and a third significant retail distribution partnership was established.

Overall premium income has grown. This growth has been driven by continued strong performance from our wholesale distribution partners Finance Now and the Smith City Group in the consumer insurance market.

Our new retail, guaranteed acceptance "Fastprotect" product, which was piloted through SBS Bank, has also been successful. The product's attractive pricing and flexible protection options resulted in demand which far exceeded our expectations.

We have also increased investment in our associate commercial insurance broker – Abbotts Insurance. Abbotts has effected

a merger with IC Frith NZ Ltd, giving the new, larger merged entity national coverage.

Looking ahead we expect the further release of new products to provide the backbone of growth in the next 12 months. Southsure management are currently working on several exciting business opportunities which should result in significant additional growth in premium income and distribution reach.



Southland Building Society Summary Financial Statements  
Summary Income Statement – Banking Group for the year ended 31 March 2018

|   | 31/03/18<br>\$000 | 31/03/17<br>\$000 |
|---|-------------------|-------------------|
| Interest income   | 225,417           | 194,822           |
| Interest expense  | 25,761            | 19,375            |
| Dividends on redeemable shares                                      | 93,631            | 84,967            |
|   | 119,392           | 104,342           |
| <b>Net interest income</b>  | <b>106,025</b>    | <b>90,480</b>     |
| Other income  | 33,428            | 32,918            |
| <b>Total operating income</b>                                       | <b>139,453</b>    | <b>123,398</b>    |
| Operating expenses  | 89,235            | 75,879            |
| Provision for credit impairment                                     | 14,920            | 10,764            |
| <b>Operating surplus</b>  | <b>35,298</b>     | <b>36,755</b>     |
| Net gain/(loss) from financial instruments designated at fair value | 76                | (113)             |
| Share of associates and joint ventures profit net of tax            | 1,066             | 802               |
| <b>Surplus before income tax</b>                                    | <b>36,440</b>     | <b>37,444</b>     |
| Less income tax expense   | 9,777             | 9,996             |
| <b>Net surplus</b>  | <b>26,663</b>     | <b>27,448</b>     |
| <b>Attributable to:</b>   |                   |                   |
| Members' interests  | 25,801            | 25,654            |
| Non-controlling interests   | 862               | 1,794             |
|   | <b>26,663</b>     | <b>27,448</b>     |

Summary Statement of Comprehensive Income – Banking Group for the year ended 31 March 2018

|  |               |               |
|--|---------------|---------------|
| Net surplus for the year                       | 26,663        | 27,448        |
| <b>Other comprehensive income</b>              |               |               |
| Net change in reserves, net of tax             | 2,464         | 11,192        |
| <b>Total comprehensive income for the year</b> | <b>29,127</b> | <b>38,640</b> |
| <b>Attributable to:</b>                        |               |               |
| Members' interests                             | 28,281        | 36,832        |
| Non-controlling interests                      | 846           | 1,808         |
|  | <b>29,127</b> | <b>38,640</b> |

Summary Statement of Changes in Equity – Banking Group for the year ended 31 March 2018

|   |                |                |
|---|----------------|----------------|
| Equity at beginning of the year                 | 274,918        | 239,960        |
| Net surplus for the year                        | 26,663         | 27,448         |
| Other comprehensive income for the year         | 2,464          | 11,192         |
| <b>Total comprehensive income for the year</b>  | <b>29,127</b>  | <b>38,640</b>  |
| Dividends                                       | (357)          | (599)          |
| Acquisition of non-controlling interests        | (10,824)       | -              |
| Change in capital of non-controlling interests  | 4,133          | (3,083)        |
| <b>Total equity at end of the year</b>          | <b>296,997</b> | <b>274,918</b> |
| <b>Equity represented by:</b>                   |                |                |
| Revaluation reserves                            | (4,708)        | (7,164)        |
| Retained earnings                               | 299,707        | 277,136        |
| Total equity attributable to members' interests | 294,999        | 269,972        |
| Non-controlling interests                       | 1,998          | 4,946          |
| Total equity at end of the year                 | <b>296,997</b> | <b>274,918</b> |

Southland Building Society Summary Financial Statements  
Summary Statement of Financial Position – Banking Group as at 31 March 2018

|   | 31/03/18<br>\$000 | 31/03/17<br>\$000 |
|---|-------------------|-------------------|
| <b>Assets</b>                             |                   |                   |
| Liquid assets and securities              | 573,557           | 518,301           |
| Advances to customers                     | 3,796,045         | 3,408,075         |
| Other assets                              | 85,608            | 68,036            |
|   | <b>4,455,210</b>  | <b>3,994,412</b>  |
| <b>Liabilities</b>                        |                   |                   |
| Redeemable shares                         | 3,087,614         | 2,732,581         |
| Deposits from customers                   | 145,716           | 212,733           |
| Commercial paper                          | 278,521           | 259,017           |
| Due to other financial institutions       | 486,538           | 400,521           |
| Subordinated redeemable shares            | 88,345            | 39,124            |
| Other liabilities                         | 71,479            | 75,518            |
|   | <b>4,158,213</b>  | <b>3,719,494</b>  |
| <b>Equity</b>                             |                   |                   |
| Attributable to members of the society    | 294,999           | 269,972           |
| Attributable to non-controlling interests | 1,998             | 4,946             |
|   | <b>296,997</b>    | <b>274,918</b>    |

Summary Statement of Cash Flows – Banking Group for the year ended 31 March 2018

|   |                |                |
|---|----------------|----------------|
| Net cash flows provided by/(used in) operating activities | 88,632         | 46,418         |
| Net cash flows provided by/(used in) investing activities | (80,402)       | (21,804)       |
| Net cash flows provided by/(used in) financing activities | (11,181)       | (599)          |
| <b>Net increase/(decrease) in cash held</b>               | <b>(2,951)</b> | <b>24,015</b>  |
| Add opening cash and cash equivalents                     | 100,700        | 76,685         |
| <b>Closing cash and cash equivalents</b>                  | <b>97,749</b>  | <b>100,700</b> |



Chairman  
J F Ward



Deputy Chair  
K J Ball

23 May 2018



1. Accounting Policies

Southland Building Society (SBS) was established in 1869, is incorporated under the Building Societies Act 1965, and is registered as a bank under the Reserve Bank of New Zealand Act 1989. The summary financial statements presented here are consolidated statements for the reporting entity of the Banking Group comprising SBS and its subsidiaries.

These summary financial statements have been prepared in compliance with FRS-43: Summary Financial Statements and comply with New Zealand Generally Accepted Accounting Practice (NZ GAAP) as it relates to summary financial statements. The specific disclosures included in the summary financial statements have been extracted from the full financial statements dated 23 May 2018. The full financial statements from which the summary financial statements have been produced have been audited by KPMG, who expressed an unmodified opinion in relation to those financial statements as at 25 May 2018. These summary financial statements have been examined by KPMG for consistency with the full financial statements.

Users of the summary financial statements should note that the information contained therein cannot be expected to provide as complete an understanding as provided by the full financial statements of the Banking Group.

Users who require additional information are encouraged to access the SBS Disclosure Statement and Annual Financial Statements on the SBS website at [www.sbsbank.co.nz](http://www.sbsbank.co.nz). Alternatively a hard copy of the SBS Disclosure Statement and Annual Financial Statements can be requested by any person and will be dispatched within two working days after the day on which the request is made at no charge.

The full financial statements have been prepared in accordance with the requirements of the Financial Reporting Act 2013 and under NZ GAAP. They comply with New Zealand equivalents to International Financial Reporting Standards (NZ IFRS) and other applicable Financial Reporting Standards, as appropriate for profit-oriented entities and the Registered Bank Disclosure Statements (New Zealand Incorporated Registered Banks) Order 2014 (as amended). The financial statements also comply with International Financial Reporting Standards as issued by the International Accounting Standards Board (IASB).

The functional and presentation currency of the Banking Group is New Zealand dollars. All amounts contained in the summary financial statements are presented in thousands of New Zealand dollars, unless otherwise stated.

All accounting policies are consistent with those used in previous periods.

2. Critical Estimates and Judgements Used in Applying Accounting Policies

The full financial statements upon which the summary financial statements are based have been prepared in accordance with stated accounting policies which are based on New Zealand equivalents of International Financial Reporting Standards (NZ IFRS) and other authoritative accounting pronouncements. Notwithstanding the existence of relevant accounting standards, there are a number of critical accounting treatments which include complex or subjective judgements and estimates that may affect the reported amounts of assets and liabilities. Estimates and judgements are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

An explanation of the judgements and estimates made by the Banking Group in the process of applying its accounting policies, that have the most significant effect on the amounts recognised in the financial statements are set out in the full financial statements.

3. Risk Management Policies

SBS's objective is to appropriately manage all the risks that arise from its activities. SBS does not naturally seek treasury and financial risk from its involvement in the financial markets and consequently minimises risks wherever possible. Reviews of risk management policies, systems and reporting are conducted on a regular basis.

Risk Governance Structure

The Board has responsibility for reviewing all aspects of risk management. The Board receives comprehensive monthly reporting covering each area of risk management. In addition SBS has specific policies in relation to liquidity and capital management which contain trigger points at which Board involvement is required. The following committees also report into the Board.

**Audit and Risk Committee** - responsible for overseeing the effectiveness and integrity of the internal control environment and the quality of financial information presented to the Board;

**Lending Committee** - responsible for reviewing and approving all lending proposals in excess of \$5 million;

**IT Committee** - responsible for monitoring and reviewing risks associated with IT and for formulating and developing SBS's IT strategy;

**Asset and Liability Committee (ALCO)** - responsible for all aspects of balance sheet risk management and strategy including interest rate, liquidity, funding, credit and margin;

**Credit Risk Committee (CRC)** - responsible for monitoring and reviewing exposure to credit risks in SBS's lending portfolios;

**Operational Risk Committee (ORC)** - responsible for monitoring and reviewing exposure to operational risks arising from SBS's day to day activities;

**Internal Audit** - SBS's internal audit function conducts independent reviews that assist the board of directors and management to meet their statutory and other obligations. The internal audit function has been carried out by the Dunedin based firm of Chartered Accountants, Deloitte.

Liquidity risk management

Liquidity risk is the risk that, under certain conditions, cash outflows can exceed cash inflows in a given period. Liquidity risk is managed on a cash flow mismatch and also core funding basis. To meet both expected and unexpected patterns in operating cash flows, SBS maintains a stock of core liquid assets to adequately meet day to day operational requirements. This includes committed wholesale funding facilities and utilisation of securitisation vehicles. The Banking Group's liquidity risks are governed by a Board approved liquid-ity strategy that defines policy, systems and procedures for measuring, assessing, reporting and managing liquidity. This also includes a formal contingency plan for dealing with a liquidity crisis. This also meets the RBNZ liquidity policy requirements.

Credit risk management

Credit risk is the risk of loss arising from the non-performance of a counterparty to an instrument or facility. Credit risk arises when funds are extended, committed, invested or otherwise exposed through contractual arrangements, and encompasses both on and off-balance sheet instruments. Credit risk is controlled through a combination of approvals, limits, reviews and monitoring procedures that are carried out on a regular basis, the frequency of which is dependent on the level of risk. Credit risk management involves a thorough evaluation of the credit risk associated with potential borrowers, the taking of security against the loan and close ongoing monitoring of account performance. Loans which show signs of adverse performance are managed by the credit risk management function, which is responsible for the collections and recovery process. For wholesale arrangements, credit risk is managed with reference to specific limits as outlined in detailed treasury management policies and reported to the Board on a monthly basis.

Interest rate risk management

Interest rate risk is the risk of loss arising from adverse changes in interest rates. Management's objective is to produce strong and stable net interest income over time. Interest rate risk management focuses on mismatches between the repricing dates of interest bearing assets and liabilities. Interest rate risk is managed using financial instruments to manage the risks within set limits as defined by SBS treasury policy. Regular reporting of interest rate risk against limits is provided to the Board.

Operational risk management

Operational risk is the risk arising from day to day operational activities which may result in direct or indirect loss. These losses may result from failure to comply with policies, procedures, laws and regulations, from fraud or forgery, from a breakdown in the availability or integrity of services, systems and information, or damage to SBS's reputation. Examples include failure to comply with policy and legislation, human error, natural disasters, fraud and other malicious acts. SBS aims to minimise the impact of operational risks by ensuring the appropriate risk management policies, controls, systems, staff and processes are in place. Where appropriate, risks are mitigated by insurance.



4. Advances – Banking Group

|                                   | 31/03/18<br>\$000 | 31/03/17<br>\$000 |
|-----------------------------------|-------------------|-------------------|
| Gross advances                    | 3,822,147         | 3,426,688         |
| Provisions for credit impairment  | (28,261)          | (21,138)          |
| Deferred fee revenue and expenses | 2,159             | 2,525             |
| <b>Total net advances</b>         | <b>3,796,045</b>  | <b>3,408,075</b>  |

5. Provision for Credit Impairment – Banking Group

|   | 31/03/18<br>\$000 | 31/03/17<br>\$000 |
|---|-------------------|-------------------|
| <b>Individual provisions against advances and loans</b>   |                   |                   |
| Balance at beginning of the year                          | 2,841             | 2,780             |
| New provisions during the year                            | 1,090             | 760               |
| Balances written off during the year                      | (1,371)           | (243)             |
| Recoveries / reversals of previously recognised provision | (140)             | (456)             |
| Balance at end of the year                                | 2,420             | 2,841             |
| <b>Collective provisions against advances and loans</b>   |                   |                   |
| Balance at beginning of the year                          | 18,297            | 16,444            |
| Charged to income statement                               | 1,504             | 1,853             |
| Acquired in business acquisition                          | 6,040             | -                 |
| Balance at end of the year                                | 25,841            | 18,297            |
| <b>Total provisions for credit impairment</b>             | <b>28,261</b>     | <b>21,138</b>     |
| <b>Reconciliation of provision movements</b>              |                   |                   |
| Bad debts written off during the year                     | 12,466            | 8,151             |
| Individual provisions                                     | 950               | 760               |
| Collective provision                                      | 1,504             | 1,853             |
| Provision for credit impairment to income statement       | <b>14,920</b>     | <b>10,764</b>     |

6. Asset Quality – Banking Group

|                                 | 31/03/18<br>\$000 | 31/03/17<br>\$000 |
|---------------------------------|-------------------|-------------------|
| <b>Advances to customers</b>    |                   |                   |
| Neither past due or impaired    | 3,741,269         | 3,371,512         |
| Individually impaired           | 6,638             | 7,523             |
| Past due                        | 76,399            | 50,178            |
| Provision for credit impairment | (28,261)          | (21,138)          |
| Total carrying amount           | <b>3,796,045</b>  | <b>3,408,075</b>  |

7. Liquidity Risk – Banking Group

Liquidity risk is the risk that the Banking Group will encounter difficulty in meeting commitments associated with its financial liabilities. The Banking Group manages its exposure to liquidity risk on a cash flow mismatch and also core funding basis and maintains sufficient liquid funds to meet its commitments. The following maturity profile of liabilities, derivatives and commitments show cash flows prepared on a contractual maturity basis as at balance date. These have been created using a run-off scenario which assumes no further origination of liabilities. Further detail on this maturity profile and the contractual undiscounted maturity profile, including the assumptions underlying them, can be obtained from the full financial statements. Note that the contractual maturity profile is not indicative of future cash flows.

7. Liquidity Risk – Banking Group (continued)

| Contractual maturity profile   | 31/03/18                     |                                  |                  | 31/03/17                     |                                  |                  |
|--------------------------------|------------------------------|----------------------------------|------------------|------------------------------|----------------------------------|------------------|
|                                | Current Liabilities<br>\$000 | Non-current Liabilities<br>\$000 | Total<br>\$000   | Current Liabilities<br>\$000 | Non-current Liabilities<br>\$000 | Total<br>\$000   |
| <b>Liabilities</b>             |                              |                                  |                  |                              |                                  |                  |
| Redeemable shares              | 2,858,082                    | 229,532                          | <b>3,087,614</b> | 2,589,454                    | 143,127                          | <b>2,732,581</b> |
| Other deposits                 | 435,427                      | 475,348                          | <b>910,775</b>   | 463,808                      | 408,463                          | <b>872,271</b>   |
| Subordinated redeemable shares | -                            | 88,345                           | <b>88,345</b>    | -                            | 39,124                           | <b>39,124</b>    |
| Other monetary liabilities     | 34,425                       | -                                | <b>34,425</b>    | 34,933                       | -                                | <b>34,933</b>    |
|                                | <b>3,327,934</b>             | <b>793,225</b>                   | <b>4,121,159</b> | <b>3,088,195</b>             | <b>590,714</b>                   | <b>3,678,909</b> |
| Net derivative cash flows      | (8,298)                      | 2,599                            | <b>(5,699)</b>   | (14,539)                     | (10,137)                         | <b>(24,676)</b>  |
| Unrecognised loan commitments  | 30,727                       | -                                | <b>30,727</b>    | 37,344                       | -                                | <b>37,344</b>    |

The following table outlines the liquid investments and committed funding lines that are available to SBS to meet both expected and unexpected fluctuations in operating cash flows. Included within total liquidity are residential mortgage backed securities ('RMBS') that are eligible under the Reserve Bank of New Zealand liquidity management arrangements.

|   | 31/03/18<br>\$000 | 31/03/17<br>\$000 |
|---|-------------------|-------------------|
| Asset liquidity <sup>2</sup>                          | 530,216           | 518,301           |
| Committed and undrawn funding lines                   | 180,198           | 30,000            |
| Eligible RMBS collateral (less haircut <sup>1</sup> ) | 114,516           | 151,077           |
| <b>Total liquidity</b>                                | <b>824,930</b>    | <b>699,378</b>    |

<sup>1</sup>A haircut is a percentage that is subtracted from the par value of the assets that are being used as collateral. The size of the haircut reflects the perceived risk associated with holding the assets.

<sup>2</sup>As at 31 March 2018 investment securities of \$43.3 million (31 March 2017: \$nil) that are encumbered through repurchase agreements have been excluded in the above table as they are not held for liquidity management purposes.

8. Capital Adequacy

The Banking Group's objectives in relation to the management of capital adequacy are to comply at all times with the regulatory capital requirements set out by the Reserve Bank of New Zealand (RBNZ); to maintain a strong capital base to cover the inherent risks of the business and maintain a targeted credit rating; and to support future business development and growth.

The Banking Group is subject to regulation by the RBNZ. The RBNZ has set minimum regulatory capital requirements for banks that are consistent with the internationally agreed framework developed by the Basel Committee on Banking Supervision. These requirements define what is acceptable as capital and provide for methods of measuring the risks incurred by the Banking Group. The Banking Group must comply with RBNZ minimum capital adequacy ratios as determined in its Conditions of Registration which are as follows:

- Total capital ratio of the banking group is not less than 8%
- Tier 1 capital ratio of the banking group is not less than 6%
- Common equity tier 1 capital ratio of the banking group is not less than 4.5%
- Total capital of the banking group is not less than NZ \$30 million

Regulatory capital adequacy ratios are calculated by expressing capital as a percentage of risk weighted assets. Risk weighted assets are derived by assigning risk weight percentages to certain material risk categories of exposures. These exposures are measured or estimated from selected balance sheet assets and off balance sheet exposures and market contracts. It should be noted that the regulatory risk weightings may not necessarily be consistent with the loss experience of the Banking Group.

The Banking Group has adopted the Basel III methodology as per the RBNZ's "Capital Adequacy Framework (Standardised Approach)" (BS2A) document to calculate regulatory capital requirements. Basel III consists of 3 pillars - Pillar One covers the capital requirements for banks for credit, operational, and market risks. Pillar Two covers all other material risks not already included in Pillar One, and Pillar Three relates to market disclosure.

8. Capital Adequacy (continued)

|                                    | Mininimum ratio requirement | 31/03/18<br>Unaudited | 31/03/17<br>Unaudited |
|------------------------------------|-----------------------------|-----------------------|-----------------------|
| <b>Regulatory Capital Ratios</b>   |                             |                       |                       |
| Common equity tier 1 capital ratio | 4.50%                       | 10.87%                | 11.58%                |
| Tier 1 capital ratio               | 6.00%                       | 10.92%                | 11.74%                |
| Total capital ratio                | 8.00%                       | 12.84%                | 12.56%                |
| Buffer ratio                       | 2.50%                       | 4.84%                 | 4.56%                 |

9. Directors' Fees

|   | 31/03/18<br>\$000 | 31/03/17<br>\$000 |
|---|-------------------|-------------------|
| Amounts received, or due and receivable by directors: |                   |                   |
| JF Ward (Chairman)                                    | 144               | 132               |
| KJ Ball (Deputy Chair)                                | 73                | 71                |
| JB Walker (resigned 19 October 2016)*                 | -                 | 187               |
| GJ Mulvey   | 77                | 71                |
| JJ Grant  | 67                | 65                |
| FE Spencer  | 67                | 70                |
| MJ Skilling   | 72                | 65                |
| AL McLeod   | 69                | 65                |
| AJ O'Connell (appointed 1 June 2017)                  | 56                | -                 |
|   | <b>625</b>        | <b>726</b>        |
| Provision for directors' retiring allowance           | 10                | (94)              |
| GST on directors' fees                                | 10                | 10                |
|   | <b>645</b>        | <b>642</b>        |

\* Includes a retirement allowance.

10. Investments in Subsidiaries, Associates and Joint Ventures

During the year ended 31 March 2017, the Banking Group established the Finance Now Warehouse Trust, a special purpose vehicle holding securitised loans assigned from Finance Now Limited and funded through wholesale funding lines.

On 30 June 2017, the Bank increased its shareholding in its subsidiary Southsure Assurance Limited from 80% to 90%. On 11 September 2017, the Bank increased its shareholding in its subsidiary Finance Now Limited from 95% to 100%. In accordance with International Financial Reporting Standards, as the Bank has had no change in effective control, the acquisition price was recorded through equity to reflect transactions amongst shareholders. No adjustments have been made to the fair value of the assets and liabilities of Southsure Assurance Limited or Finance Now Limited in the consolidated accounts of the Bank in accordance with IFRS, and the associated premiums (reflecting the future earnings potential of the entities) are recorded as an adjustment to equity.

Effective 11 September 2017, the Banking Group via its subsidiary Finance Now Limited, purchased 100% of the shares in The Warehouse Group Financial Services (TWGFS) for \$17.1 million. The purchase of TWGFS creates a stronger business for Finance Now Limited and allows the wider Group to access new capabilities, including credit cards. The group consists of the following entities:

|  | % Obtained | Nature of Business          |
|--|------------|-----------------------------|
| The Warehouse Financial Services Limited | 100%       | Credit Card Finance Company |
| TW Financial Services Operations Limited | 100%       | Finance Operating Company   |
| TW Money Limited                         | 100%       | Credit Card Finance Company |
| TWGFS Warehouse A Trust                  | 100%       | Loan Securitisation         |

On 31 October 2017, the Bank increased its indirect interest in Abbott Insurance Brokers Limited by 5% to 37.5%. During January 2018, the Abbott group restructured, with a new entity established as holding entity, named Abbott NZ Holdings Limited. Abbott NZ Holdings Limited is the 100% shareholder of Abbott Insurance Brokers Limited. Southsure's shareholding diluted from 37.5% to 22.99% due to this restructure. This investment is still being accounted for as an associate company under the equity method of accounting as the Banking Group does not have control over the financial and operating policies.

During March 2018, the Banking Group established the SBS Warehouse Trust No.2, a special purpose vehicle holding securitised loans assigned from SBS and funded through wholesale funding lines.

As at 31 March 2018, total investments in associates and joint ventures recognised by the Banking Group was \$8.5 million. Further information on investments in subsidiaries, associates and joint ventures is set out in the full financial statements.

11. Subsequent Events

There have been no material subsequent events after 31 March 2018.

Independent Auditor's Report



To the Members of Southland Building Society

Report on the summary consolidated financial statements

|   |  |
|---|--|
| <b>Opinion</b>  |  |
| In our opinion, the accompanying summary consolidated financial statements of Southland Building Society and its subsidiaries (the "Banking Group") on pages 10 to 17:                                | The accompanying summary consolidated financial statements comprises:  |
| i. Have been correctly derived from the audited consolidated financial statements for the year ended on that date; and  | - the summary consolidated statement of financial position as at 31 March 2018;  |
| ii. Are a fair summary of the consolidated financial statements, in accordance with FRS 43 Summary Financial Statements.  | - the summary consolidated income statement, statements of comprehensive income, changes in equity and cash flows for the year then ended; and |
| iii. Disclose in accordance with schedule 9 of the Order, in all material respects, the registered bank disclosures relating to Capital Adequacy and Regulatory Liquidity Requirements in section B4. | - notes, including a summary of significant accounting policies and other explanatory information.   |

Basis for opinion

We conducted our audit in accordance with International Standard on Auditing (New Zealand) (ISA (NZ)) 810 (Revised), *Engagements to Report on Summary Financial Statements*.

Our firm has also provided other services to the Banking Group in relation to regulatory and other assurance, limited assurance engagements, and tax compliance in the year ended 31 March 2018. Subject to certain restrictions, partners and employees of our firm may also deal with the Banking Group on normal terms within the ordinary course of trading activities of the business of the Banking Group. These matters have not impaired our independence as auditor of the Banking Group. The firm has no other relationship with, or interest in, the Banking Group.

Use of this Independent Auditor's Report

This report is made solely to the Members as a body. Our audit work has been undertaken so that we might state to the Members those matters we are required to state to them in the Independent Auditor's Report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the members as a body for our audit work, this report, or any of the opinions we have formed.

Responsibilities of the Directors for the summary consolidated financial statements

The Trustees, on behalf of the incorporated society, are responsible for:

- the preparation and fair presentation of the summary consolidated financial statements in accordance with FRS 43 Summary Financial Statements;
- the preparation and fair presentation of the registered bank disclosures in regards to Capital Adequacy and Regulatory Liquidity Requirements in accordance with Schedule 9 of the Order.

Auditor's Responsibilities for the summary consolidated financial statements

Our responsibility is to express an opinion on whether the summary consolidated financial statements are consistent, in all material respects, with (or are a fair summary of) the audited consolidated financial statements based on our procedures, which were conducted in accordance with International Standard on Auditing (New Zealand) (ISA (NZ)) 810 (Revised), *Engagements to Report on Summary Financial Statements*.

It is also our responsibility to obtain reasonable assurance that the registered bank disclosures relating to Capital Adequacy and Regulatory Liquidity Requirements in section B4 is not, in all material respects, disclosed in accordance with schedule 9 of the Order.

We expressed an unmodified audit opinion on the consolidated financial statements in our audit report dated 25 May 2018.

The summary consolidated financial statements do not contain all the disclosures required for a full set of consolidated financial statements under generally accepted accounting practice in New Zealand. Reading the summary consolidated financial statements, therefore, is not a substitute for reading the audited consolidated financial statements of the Banking Group.



Christchurch  
25 May 2018



## Branches

### Invercargill – Head Office

51 Don Street  
PO Box 835  
Telephone: 0800 727 2265

### Invercargill – Windsor

54 Windsor Street  
Telephone: 0800 727 2265

### Gore

80 Main Street  
PO Box 212  
Telephone: 0800 727 2265

### Dunedin

Cnr George & Hanover Streets  
PO Box 5492  
Telephone: 0800 727 2265

### Queenstown

7 Shotover Street  
PO Box 710  
Telephone: 0800 727 2265

### Cromwell

21 The Mall  
PO Box 226  
Telephone: 0800 727 2265

### Timaru

248 Stafford Street  
PO Box 844  
Telephone: 0800 727 2265

### Christchurch – Riccarton

48 Rotherham Street  
PO Box 80058  
Telephone: 0800 727 2265

### Christchurch – Papanui

2-6 Main North Road  
PO Box 5038  
Telephone: 0800 727 2265

### Nelson

126 Trafalgar Street  
PO Box 211  
Telephone: 0800 727 2265

### Blenheim

Cnr Market & Main Streets  
PO Box 1188  
Telephone: 0800 727 2265

### Hastings

Cnr Queen & Market Streets  
PO Box 10  
Telephone: 0800 727 2265

### Napier

97 Dalton Street  
PO Box 1041  
Telephone: 0800 727 2265

### Hamilton

Cnr Victoria & Bryce Streets  
PO Box 19222  
Telephone: 0800 727 2265

### Tauranga

36 Spring Street  
PO Box 13020  
Telephone: 0800 727 2265

### SBS Bank Rural – Invercargill

66 Don Street  
PO Box 835  
Telephone: 0800 727 2265

## Subsidiaries

### Southsure Assurance

40 Don Street  
PO Box 1404  
Invercargill  
Telephone: 0800 002 002

### Finance Now

81 Yarrow Street  
PO Box 1204  
Invercargill  
Telephone: 0800 299 399

### FANZ

PO Box 835  
Invercargill  
Telephone: 0800 727 2265



To view this Annual Report online go to **sbsbank.co.nz**

