Southland Building Society

148th Annual Report

Disclosure Statement No.36 & Annual Financial Statements

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DIRECTORY

Chairman

Mr J F Ward
B Com FCA CFInstD
Chartered Accountant
Invercargill

Deputy Chair

Mrs K J Ball
B Com FCA CMInstD
Chartered Accountant
Invercargill

Directors

Mr G J Mulvey
B Com FCA FNZIM
General Manager
Invercargill

Mr J J Grant
Farmer/Company Director
Balfour

Mr F E Spencer
BBS (Val & Pty Mgt)
FNZIV FPINZ AREINZ
CMInstD
Registered Valuer
Hastings

Mr M J Skilling
B AgrSci PGDipBank
SFFINSIA CMInstD
Company Director
Auckland

Ms A L McLeod
B Com LLB MInstD
Barrister & Solicitor
Dunedin

All directors can be contacted through:
Southland Building Society
51 Don Street
Invercargill

Group Chief Executive Officer

Mr S R Drylie
MMgmt PGDipBank SF Fin

Secretary

Mr T D R Loan
B Com FCA DipBusStuds (IS)
(Chief Financial Officer)
Invercargill

Registered Office

51 Don Street
Invercargill

Solicitors

Buddle Findlay
83 Victoria Street
Christchurch

Auditors

KPMG
62 Worcester Boulevard
Christchurch

General Information

Southland Building Society (SBS) is registered as a bank under the Reserve Bank of New Zealand Act 1989, and is required to comply with the conditions of registration as laid down by the Reserve Bank of New Zealand. Southland Building Society operates under the brand "SBS Bank".

This Disclosure Statement has been issued by Southland Building Society in accordance with the Registered Bank Disclosure Statements (New Zealand Incorporated Registered Banks) Order 2014 (as amended) (the 'Order'). This Disclosure Statement is the consolidated accounts of the Banking Group comprising SBS and its subsidiaries.

Words and phrases defined by the Order have the same meanings when used in this Disclosure Statement.

Name and Address for Service of Registered Bank

The name of the registered bank is Southland Building Society (referred to either by its full name, as "SBS", or as the "Bank", or as the "Registered Bank") and the address for service is 51 Don Street, Invercargill. The "Banking Group" consists of the Bank and all of its controlled entities. All controlled entities are incorporated in New Zealand.

Details of Incorporation

Southland Building Society was established in 1869 and is incorporated under the Building Societies Act 1965. SBS's registration number is 1781001.

Ownership

Southland Building Society is a mutual building society and is owned by its members by virtue of their membership interests in Southland Building Society. Membership entitlements and voting rights are set out in the Rules of Southland Building Society.

Guarantee Arrangements

As at the signing date of this Disclosure Statement, the material obligations of the Bank are not guaranteed.

Pending Proceedings or Arbitration

There are no pending proceedings at the date of this Disclosure Statement that may have a material adverse effect on the Registered Bank or the Banking Group.

Other Material Matters

The Bank's Directors are of the opinion that there are no other matters relating to the business or affairs of the Registered Bank or the Banking Group which would, if disclosed in this Disclosure Statement, materially adversely affect the decision of a person to subscribe for debt securities of which the Registered Bank or any members of the Banking Group is the issuer.

Directorate

All directors of the Bank reside in New Zealand. All directors can be contacted at Southland Building Society, 51 Don Street, Invercargill.

Independent Non-Executive Directors

JF (John) Ward, BCom FCA CFInstD (Chairman - Board of Directors) Chartered Accountant	External Directorships: H&J Smith Holdings Ltd, H&J Smith Ltd, H&J Smith Corporate Ltd, H&J's Hardware Ltd, H&J's Electrical Ltd, H&J's Queenstown Properties Ltd, H&J Smith Parking Building Ltd, H&J Smith Finance Ltd, H&J's Carpet World Ltd, H&J's Properties Ltd, Outdoor World Ltd, Shotover Hardware Ltd, Symphony Retailing Ltd, Lorneville Discount Centre Ltd, South Island Retail Ltd, Outdoor Adventures Ltd, South Island Sports Ltd, Simner Investments Ltd, Cross Roads Properties Ltd, Southern Department Stores Ltd, SFI Properties Ltd, Corner Trading Ltd, Amtex Corporation Ltd, Hokonui Investments Ltd, Parthenon Investments Ltd, Trio Corporation Ltd, Tanknology (NZ) Ltd, Paddington Investments No 8 Ltd, Fun Innovators NZ Ltd, Southcom Ltd, Aviemore Corporation Ltd, University of Otago Holdings Ltd, Otago Innovation Ltd, Custos Securities Ltd
KJ (Kathryn) Ball, BCom FCA CMInstD (Deputy Chair - Board of Directors) Chartered Accountant	External Directorships: KJB Consulting Ltd
GJ (Greg) Mulvey, BCom FCA FNZIM General Manager	External Directorships: DB South Island Brewery Ltd
JJ (Jeff) Grant Farmer/Company Director	External Directorships: AgResearch Ltd, Mount Linton Station Ltd, Copper Valley Holdings Ltd, Ospri New Zealand Ltd, National Animal Identification and Tracing (NAIT) Ltd, Tbfree New Zealand Ltd, Milford Sound Tourism Ltd (previously Milford Sound Development Authority Ltd), Lakeland Adventures Wanaka Ltd, Predator Free 2050 Ltd

Directorate continued

FE (Frank) Spencer, BBS (Val & Pty Mgt) FNZIV FPINZ AREINZ CMInstD Registered Valuer	External Directorships: Verdure Ltd, Logan Stone Ltd
MJ Skilling, BAgrSci PGDipBank SFFINSIA CMInstD Company Director	External Directorships: Financial Synergy Ltd, Ruby Bay Estate Ltd, Hopkins Farming Group Ltd, Finance Investment Group Ltd, Hastings Street South Investment Ltd, Hastings Street South Ltd
AL McLeod, BCom LLB MInstD Barrister & Solicitor	External Directorships: Lust for Life Ltd, Raw Power Ltd, Anderson Lloyd Administration Ltd, ALC Trustees No 1 Ltd, Anderson Lloyd Trustee Company (No.2) Ltd, Anderson Lloyd Trustee (No.3) Ltd, Anderson Lloyd Trustee Company (2013) Ltd, Anderson Lloyd Trustee Company (2011) Ltd, Anderson Lloyd Trustee Company Ltd, AL Escrow 2014 Ltd

Audit & Risk Committee

Members of the Southland Building Society Audit & Risk Committee as at the date of this Disclosure Statement are as follows:

KJ Ball (Chairperson) - Independent Non-Executive Director

JF Ward - Independent Non-Executive Director

GJ Mulvey - Independent Non-Executive Director

MJ Skilling - Independent Non-Executive Director

Conflicts of Interest Policy

The policy and current practice of the board of directors (as set out in clause 16.6 of the Rules of Southland Building Society) for avoiding or dealing with conflicts of interest which may arise from personal, professional or business interests of the directors, are that, a director, after becoming aware of the fact that he or she is interested in a transaction or proposed transaction with the Society, shall disclose to the board and cause to be entered in the interests register:

(i) the nature and monetary value of the director's interest in a transaction if its monetary value is able to be quantified; or

(ii) the nature and extent of the director's interest in a transaction if its monetary value is not able to be quantified.

A director may not vote on a board resolution in respect of any matter in which that director is interested, nor shall the director be counted in the quorum for the purposes of consideration of that matter.

Interested Transactions

There have been no transactions between the Bank and any director or immediate relative or close business associate of any director which either, has been entered into on terms other than those which would in the ordinary course of business of the Bank be given to any other person of like circumstances or means or, which could be reasonably likely to influence materially the exercise of the director's duties.

Solicitors	Auditors
Buddle Findlay 83 Victoria Street Christchurch	KPMG Chartered Accountants 62 Worcester Boulevard Christchurch

Credit Rating

As at 31 March 2017, the credit rating assigned to Southland Building Society is BBB with a neutral outlook. This credit rating is applicable to long term unsecured obligations payable in New Zealand, in New Zealand dollars. The credit rating was issued by Fitch Ratings on 5 September 2016. The previous credit rating of BBB with a positive outlook was issued by Fitch Ratings on 9 September 2015. The rating is not subject to any qualifications.

The following is a summary of the descriptions of the major ratings categories of each rating agency for the rating of long-term senior unsecured obligations:

Fitch Ratings	Standard & Poor's	Moody's Investors Service	Description of Grade
AAA	AAA	Aaa	Ability to repay principal and interest is extremely strong. This is the highest investment category.
AA	AA	Aa	Very strong ability to repay principal and interest in a timely manner.
A	A	A	Strong ability to repay principal and interest although somewhat susceptible to adverse changes in economic, business or financial conditions.
BBB	BBB	Baa	Adequate ability to repay principal and interest. More vulnerable to adverse changes.
BB	BB	Ba	Significant uncertainties exist which could affect the payment of principal and interest on a timely basis.
B	B	B	Greater vulnerability and therefore greater likelihood of default.
CCC	CCC	Caa	Likelihood of default considered high. Timely repayment of principal and interest is dependent on favourable financial conditions.
CC - C	CC - C	Ca - C	Highest risk of default.
RD to D	D	-	Obligations currently in default.

Credit ratings from Fitch Ratings and Standard & Poor's may be modified by the addition of a plus or minus sign to show relative status within the major rating categories. Moody's Investors Service apply numerical modifiers 1, 2, and 3 to show relative standing within the major rating categories, with 1 indicating the higher end and 3 the lower end of the rating category.

Conditions of Registration

The conditions of registration imposed on Southland Building Society by the Reserve Bank of New Zealand pursuant to section 74 of the Reserve Bank of New Zealand Act 1989, and which apply as at the date of signing of this Disclosure Statement are as follows. These conditions of registration have applied from 1 October 2016.

The registration of Society Building Society ("the bank") as a registered bank is subject to the following conditions:

1. That -
   (a) the Total capital ratio of the banking group is not less than 8 percent;
   (b) the Tier 1 capital ratio of the banking group is not less than 6 percent;
   (c) the Common Equity Tier 1 capital ratio of the banking group is not less than 4.5 percent;
   (d) the Total capital of the banking group is not less than $30 million; and
   (e) the bank must not include the amount of an Additional Tier 1 capital instrument or Tier 2 capital instrument issued after 1 January 2013 in the calculation of its capital ratios unless it has received a notice of non-objection to the instrument from the Reserve Bank; and
   (f) the bank meets the requirements of Part 3 of the Reserve Bank of New Zealand document "Application requirements for capital recognition or repayment and notification requirements in respect of capital" (BS16) dated November 2015 in respect of regulatory capital instruments.

   For the purposes of this condition of registration, the Total capital ratio, the Tier 1 capital ratio, the Common Equity Tier 1 capital ratio and Total capital must be calculated in accordance with the Reserve Bank of New Zealand document: "Capital Adequacy Framework (Standardised Approach)" (BS2A) dated November 2015;

   an Additional Tier 1 capital instrument is an instrument that meets the requirements of subsection 8(2)(a) or (c) of the Reserve Bank of New Zealand document "Capital Adequacy Framework (Standardised Approach)" (BS2A) dated November 2015.

   a Tier 2 capital instrument is an instrument that meets the requirements of subsection 9(2)(a) or (c) of the Reserve Bank of New Zealand document "Capital Adequacy Framework (Standardised Approach)" (BS2A) dated November 2015.

1A. That -
   (a) the bank has an internal capital adequacy assessment process ("ICAAP") that accords with the requirements set out in the document "Guidelines on a Bank's Internal Capital Adequacy Assessment Process ("ICAAP")" (BS12) dated December 2007;
   (b) under its ICAAP, the bank identifies and measures its "other material risks" defined as all material risks of the banking group that are not explicitly captured in the calculation of the Common Equity Tier 1 capital ratio, the Tier 1 capital ratio and the Total capital ratio under the requirements set out in the document "Capital Adequacy Framework (Standardised Approach)" (BS2A) dated November 2015; and
   (c) the bank determines an internal capital allocation for each identified and measured "other material risk".

Conditions of Registration continued

1B. That, if the buffer ratio of the banking group is 2.5% or less, the bank must:

(a) according to the following table, limit the aggregate distributions of the bank's earnings to the percentage limit to distributions that corresponds to the banking group's buffer ratio:

Banking group's buffer ratio	Percentage limit to distributions of the bank's earnings
0% - 0.625%	0%
>0.625% - 1.25%	20%
>1.25% - 1.875%	40%
>1.875% - 2.5%	60%

(b) prepare a capital plan to restore the banking group's buffer ratio to above 2.5% within any timeframe determined by the Reserve Bank for restoring the buffer ratio; and

(c) have the capital plan approved by the Reserve Bank.

For the purposes of this condition of registration, -

"buffer ratio", "distributions", and "earnings" have the same meaning as in Part 3 of the Reserve Bank of New Zealand document: "Capital Adequacy Framework (Standardised Approach)" (BS2A) dated November 2015.

2. That the banking group does not conduct any non-financial activities that in aggregate are material relative to its total activities. In this condition of registration, the meaning of "material" is based on generally accepted accounting practice.

3. That the banking group's insurance business is not greater than 1% of its total consolidated assets. For the purposes of this condition of registration, the banking group's insurance business is the sum of the following amounts for entities in the banking group:

(a) if the business of an entity predominantly consists of insurance business and the entity is not a subsidiary of another entity in the banking group whose business predominantly consists of insurance business, the amount of the insurance business to sum is the total consolidated assets of the group headed by the entity and;

(b) if the entity conducts insurance business and its business does not predominantly consist of insurance business and the entity is not a subsidiary of another entity in the banking group whose business predominantly consists of insurance business, the amount of the insurance business to sum is the total liabilities relating to the entity's insurance business plus the equity retained by the entity to meet the solvency or financial soundness needs of its insurance business.

In determining the total amount of the banking group's insurance business -

(a) all amounts must relate to on balance sheet items only, and must comply with generally accepted accounting practice; and

(b) if products or assets of which an insurance business is comprised also contain a non-insurance component, the whole of such products or assets must be considered part of the insurance business.

For the purposes of this condition of registration, -

"insurance business" means the undertaking or assumption of liability as an insurer under a contract of insurance;

"insurer" and "contract of insurance" have the same meaning as provided in sections 6 and 7 of the Insurance (Prudential Supervision) Act 2010.

4. That the aggregate credit exposures (of a non-capital nature and net of any allowances for impairment) of the banking group to all connected persons do not exceed the rating-contingent limit outlined in the following matrix:

Credit rating of the Bank[1]	Connected exposure limit (% of the Banking Group's Tier 1 capital)
AA/Aa2 and above	75
AA-/Aa3	70
A+/A1	60
A/A2	40
A-/A3	30
BBB+/Baa1 and below	15

[1]This table uses the rating scales of Standard and Poors, Fitch Ratings and Moody's Investor Service. (Fitch Ratings' scale is identical to Standard and Poors).

Within the rating-contingent limit, credit exposures (of a non-capital nature and net of any allowances for impairment) to non-bank connected persons shall not exceed 15 percent of the banking group's tier 1 capital.

For the purposes of this condition of registration, compliance with the rating-contingent connected exposure limit is determined in accordance with the Reserve Bank of New Zealand document entitled "Connected Exposures Policy" (BS8) dated November 2015.

5. That exposures to connected persons are not on more favourable terms (e.g. as relates to such matters as credit assessment, tenor, interest rates, amortisation schedules and requirement for collateral) than corresponding exposures to non-connected persons.

Conditions of Registration continued

6. That the bank complies with the following corporate governance requirements:
   (a) the board of the bank must have at least five directors;
   (b) the majority of the board members must be non-executive directors;
   (c) at least half of the board members must be independent directors;
   (d) an alternate director,-
      (i) for a non-executive director must be non-executive; and
      (ii) for an independent director must be independent;
   (e) at least half of the independent directors of the bank must be ordinarily resident in New Zealand;
   (f) the chairperson of the board of the bank must be independent; and
   (g) the bank's rules must not include any provision permitting a director, when exercising powers or performing duties as a director, to act other than in what he or she believes is the best interests of the society (i.e. the bank).

   For the purposes of this condition of registration, "non-executive" and "independent" have the same meaning as in the Reserve Bank of New Zealand document entitled "Corporate Governance" (BS14) dated July 2014.
7. That no appointment of any director, chief executive officer, or executive who reports or is accountable directly to the chief executive officer, is made in respect of the bank unless:
   (a) the Reserve Bank has been supplied with a copy of the curriculum vitae of the proposed appointee; and
   (b) the Reserve Bank has advised that it has no objection to that appointment.
8. That a person must not be appointed as chairperson of the board of the bank unless:
   (a) the Reserve Bank has been supplied with a copy of the curriculum vitae of the proposed appointee; and
   (b) the Reserve Bank has advised that it has no objection to that appointment.
9. That the bank has a board audit committee, or other separate board committee covering audit matters, that meets the following requirements:
   (a) the mandate of the committee must include: ensuring the integrity of the bank's financial controls, reporting systems and internal audit standards;
   (b) the committee must have at least three members;
   (c) every member of the committee must be a non-executive director of the bank;
   (d) the majority of the members of the committee must be independent; and
   (e) the chairperson of the committee must be independent and must not be the chairperson of the bank.

   For the purposes of this condition of registration, "non-executive" and "independent" have the same meaning as in the Reserve Bank of New Zealand document entitled "Corporate Governance" (BS14) dated July 2014.
10. That a substantial proportion of the bank's business is conducted in and from New Zealand.
11. That the banking group complies with the following quantitative requirements for liquidity-risk management:
   (a) the one-week mismatch ratio of the banking group is not less than zero per cent at the end of each business day;
   (b) the one-month mismatch ratio of the banking group is not less than zero per cent at the end of each business day; and
   (c) the one-year core funding ratio of the banking group is not less than 75 per cent at the end of each business day;

   For the purposes of this condition of registration, the ratios identified must be calculated in accordance with the Reserve Bank of New Zealand documents entitled "Liquidity Policy" (BS13) dated July 2014 and "Liquidity Policy Annex: Liquid Assets" (BS13A) dated December 2011.
12. That the bank has an internal framework for liquidity risk management that is adequate in the bank's view for managing the bank's liquidity risk at a prudent level, and that, in particular:
   (a) is clearly documented and communicated to all those in the organisation with responsibility for managing liquidity and liquidity risk;
   (b) identifies responsibility for approval, oversight and implementation of the framework and policies for liquidity risk management;
   (c) identifies the principal methods that the bank will use for measuring, monitoring and controlling liquidity risk; and
   (d) considers the material sources of stress that the bank might face, and prepares the bank to manage stress through a contingency funding plan.
13. That no more than 10% of total assets may be beneficially owned by a SPV.

   For the purposes of this condition -

   "total assets" means all assets of the banking group plus any assets held by any SPV that are not included in the banking group's assets

   "SPV" means a person -
   (a) to whom any member of the banking group has sold, assigned, or otherwise transferred any asset;
   (b) who has granted, or may grant, a security interest in its assets for the benefit of any holder of any covered bond; and
   (c) who carries on no other business except for that necessary or incidental to guarantee the obligations of any member of the banking group under a covered bond:

Conditions of Registration continued

"covered bond" means a debt security issued by any member of the banking group, for which repayment to holders is guaranteed by a SPV, and investors retain an unsecured claim on the issuer.

14. That -
    (a) no member of the banking group may give effect to a qualifying acquisition or business combination that meets the notification threshold, and does not meet the non-objection threshold, unless:
        (i) the bank has notified the Reserve Bank in writing of the intended acquisition or business combination and at least 10 working days have passed; and
        (ii) at the time of notifying the Reserve Bank of the intended acquisition or business combination, the bank provided the Reserve Bank with the information required under the Reserve Bank of New Zealand Banking Supervision Handbook document "Significant Acquisitions Policy" (BS15) dated December 2011; and
    (b) no member of the banking group may give effect to a qualifying acquisition or business combination that meets the non-objection threshold unless:
        (i) the bank has notified the Reserve Bank in writing of the intended acquisition or business combination;
        (ii) at the time of notifying the Reserve Bank of the intended acquisition or business combination, the bank provided the Reserve Bank with the information required under the Reserve Bank of New Zealand Banking Supervision Handbook document "Significant Acquisitions Policy" (BS15) dated December 2011; and
        (iii) the Reserve Bank has given the bank a notice of non-objection to the significant acquisition or business combination.

    For the purposes of this condition of registration, "qualifying acquisition or business combination", "notification threshold" and "non-objection threshold" have the same meaning as in the Reserve Bank of New Zealand Banking Supervision Handbook document "Significant Acquisitions Policy" (BS15) dated December 2011.

15. That the bank is pre-positioned for Open Bank Resolution and in accordance with a direction from the Reserve Bank, the bank can-
    (a) close promptly at any time of the day and on any day of the week and that effective upon the appointment of the statutory manager-
        (i) all liabilities are frozen in full; and
        (ii) no further access by customers and counterparties to their accounts (deposits, liabilities or other obligations) is possible;
    (b) apply a *de minimis* to relevant customer liability accounts;
    (c) apply a partial freeze to the customer liability account balances;
    (d) reopen by no later than 9am the next business day following the appointment of a statutory manager and provide customers access to their unfrozen funds;
    (e) maintain a full freeze on liabilities not pre-positioned for open bank resolution; and
    (f) reinstate customers' access to some or all of their residual frozen funds.

    For the purposes of this condition of registration, "*de minimis*", "partial freeze", "customer liability account", "frozen and unfrozen funds" have the same meaning as in the Reserve Bank of New Zealand document "Open Bank Resolution (OBR) Pre-positioning Requirements Policy" (BS 17) dated September 2013.

16. That the bank has an Implementation Plan that-
    (a) is up-to-date; and
    (b) demonstrates that the bank's prepositioning for Open Bank Resolution meets the requirements set out in the Reserve Bank document: "Open Bank Resolution Pre-positioning Requirements Policy" (BS 17) dated September 2013.

    For the purposes of this condition of registration, "Implementation Plan" has the same meaning as in the Reserve Bank of New Zealand document "Open Bank Resolution (OBR) Pre-positioning Requirements Policy" (BS 17) dated September 2013.

17. That the bank has a compendium of liabilities that-
    (a) at the product-class level lists all liabilities, indicating which are-
        (i) pre-positioned for Open Bank Resolution; and
        (ii) not pre-positioned for Open Bank Resolution;
    (b) is agreed to by the Reserve Bank; and
    (c) if the Reserve Bank's agreement is conditional, meets the Reserve Bank's conditions.

    For the purposes of this condition of registration, "compendium of liabilities", and "pre-positioned and non pre-positioned liabilities" have the same meaning as in the Reserve Bank of New Zealand document "Open Bank Resolution (OBR) Pre-positioning Requirements Policy" (BS17) dated September 2013.

18. That on an annual basis the bank tests all the component parts of its Open Bank Resolution solution that demonstrates the bank's prepositioning for Open Bank Resolution as specified in the bank's Implementation Plan.

    For the purposes of this condition of registration, "Implementation Plan" has the same meaning as in the Reserve Bank of New Zealand document "Open Bank Resolution (OBR) Pre-positioning Requirements Policy" (BS 17) dated September 2013.

19. That, for a loan-to-valuation measurement period, the total of the bank's qualifying new mortgage lending amount in respect of property-investment residential mortgage loans with a loan-to-valuation ratio of more than 60%, must not exceed 5% of the total of the qualifying new mortgage lending amount in respect of property-investment residential mortgage loans arising in the loan-to-valuation measurement period.

Conditions of Registration continued

20. That, for a loan-to-valuation measurement period, the total of the bank's qualifying new mortgage lending amount in respect of non property-investment residential mortgage loans with a loan-to-valuation ratio of more than 80%, must not exceed 10% of the total of the qualifying new mortgage lending amount in respect of non property-investment residential mortgage loans arising in the loan-to-valuation measurement period.
21. That the bank must not make a residential mortgage loan unless the terms and conditions of the loan contract or the terms and conditions for an associated mortgage require that a borrower obtain the registered bank's agreement before the borrower can grant to another person a charge over the residential property used as security for the loan.

In these conditions of registration,-

"banking group" means Southland Building Society (as reporting entity) and all other entities included in the group as defined in section 6(1) of the Financial Markets Conduct Act 2013 for the purposes of Part 7 of that Act.

"generally accepted accounting practice" has the same meaning as in section 8 of the Financial Reporting Act 2013.

In conditions of registration 19 to 21, -

"loan-to-valuation ratio", "non property-investment residential mortgage loan", "property-investment residential mortgage loan", "qualifying new mortgage lending amount in respect of non property-investment residential mortgage loans", "qualifying new mortgage lending amount in respect of non property-investment residential mortgage loans", and "residential mortgage loan" have the same meaning as in the Reserve Bank of New Zealand document entitled "Framework for Restrictions on High-LVR Residential Mortgage Lending" (BS19) dated October 2016:

"loan-to-valuation measurement period" means a period of six calendar months ending on the last day of the sixth calendar month, the first of which ends on the last day of March 2017.

Changes in Conditions of Registration

There have been no changes in the Bank's conditions of registration during the period since the reporting date of the previous disclosure statement.

Directors' Statement

The directors of Southland Building Society (the "Bank") state that each director of the Bank believes, after due enquiry, that:

1. As at the date on which the Disclosure Statement is signed:
   (a) the Disclosure Statement contains all the information that is required by the Registered Bank Disclosure Statements (New Zealand Incorporated Registered Banks) Order 2014 (as amended); and
   (b) the Disclosure Statement is not false or misleading;
2. Each director of the Bank believes, after due enquiry, that during the year ending 31 March 2017:
   (a) the Bank has complied with all conditions of registration applicable during the period; and
   (b) credit exposures to connected persons were not contrary to the interests of the Banking Group; and
   (c) the Bank had systems in place to monitor and control adequately the Banking Group's material risks, including credit risk, concentration of credit risk, interest rate risk, currency risk, equity risk, liquidity risk, operational risk, and other business risks, and that those systems were being properly applied.

This Disclosure Statement is dated 30 May 2017 and has been signed by or on behalf of all the directors.

JF Ward (Chairman)

FE Spencer

KJ Ball (Deputy Chair)

MJ Skilling

GJ Mulvey

AL McLeod

JJ Grant

All in $000's

Income Statements

	Year ended 31 Mar 2017	Year ended 31 Mar 2016	Year ended 31 Mar 2015	Year ended 31 Mar 2014	Year ended 31 Mar 2013
Interest income	194,822	195,112	183,307	169,936	176,928
Interest expense	19,375	16,721	11,142	11,524	11,497
Dividends on redeemable shares	84,967	94,458	91,100	88,970	93,991
	104,342	111,179	102,242	100,494	105,488
Net interest income	**90,480**	**83,933**	**81,065**	**69,442**	**71,440**
Other income	32,918	30,484	25,525	21,368	20,114
Total operating income	**123,398**	**114,417**	**106,590**	**90,810**	**91,554**
Operating expenses	75,879	73,542	68,331	58,237	53,343
Provision for credit impairment	10,764	13,212	12,173	10,529	17,304
Operating surplus	**36,755**	**27,663**	**26,086**	**22,044**	**20,907**
Net gain/(loss) from financial instruments designated at fair value	(113)	7	(46)	(706)	(1,078)
Share of associates and joint ventures profit net of tax	802	657	515	-	-
Revaluation of property	-	-	-	46	(46)
Revaluation of investment properties	-	-	-	(200)	(61)
Surplus before income tax	**37,444**	**28,327**	**26,555**	**21,184**	**19,722**
Less income taxation expense	9,996	8,354	7,118	5,545	5,383
Net surplus	**27,448**	**19,973**	**19,437**	**15,639**	**14,339**
Attributable to:					
Members' interests	25,654	18,603	18,009	13,915	11,733
Non-controlling interests	1,794	1,370	1,428	1,724	2,606
	27,448	**19,973**	**19,437**	**15,639**	**14,339**

Significant Statement of Financial Position Items

	As at 31 Mar 2017	As at 31 Mar 2016	As at 31 Mar 2015	As at 31 Mar 2014	As at 31 Mar 2013
Total assets	3,994,412	3,412,175	2,862,657	2,787,776	2,829,669
Individually impaired assets	7,523	9,159	12,921	20,247	23,758
Total liabilities	3,719,494	3,172,215	2,618,981	2,553,563	2,598,079
Equity	274,918	239,960	243,676	234,213	231,590
Regulatory capital					
Tier one capital	264,186	245,303	235,721	218,418	221,981
Total capital	282,709	270,075	265,645	223,367	238,724
Tier one capital expressed as a percentage of total risk weighted assets	11.74%	12.50%	13.85%	13.39%	13.34%
Total capital expressed as a percentage of total risk weighted assets	12.56%	13.76%	15.61%	13.69%	14.34%

The amounts included in this summary have been extracted from the audited consolidated financial statements of the Banking Group.

Contents

Symbols used within the financial statements represent:

Specific accounting policy

Accounting estimates and areas of judgement

Southland Building Society

Income Statement for the year ended 31 March 2017

All in $000's

	Note	31/03/2017	31/03/2016
Interest income		194,822	195,112
Interest expense		19,375	16,721
Dividends on redeemable shares		84,967	94,458
		104,342	111,179
Net interest income	(2)	**90,480**	**83,933**
Other income	(3)	32,918	30,484
Total operating income		**123,398**	**114,417**
Operating expenses	(4)	75,879	73,542
Provision for credit impairment	(11)	10,764	13,212
Operating surplus		**36,755**	**27,663**
Net gain/(loss) from financial instruments designated at fair value	(5)	(113)	7
Share of associates and joint ventures profit net of tax		802	657
Surplus before income tax		**37,444**	**28,327**
Less income tax expense	(6)	9,996	8,354
Net surplus		**27,448**	**19,973**
Attributable to:			
Members' interests		25,654	18,603
Non-controlling interests		1,794	1,370
		27,448	**19,973**

Southland Building Society

Statement of Comprehensive Income for the year ended 31 March 2017

	Note	31/03/2017	31/03/2016
Net surplus for the year		27,448	19,973
Items that may not be reclassified subsequently to profit or loss			
Net change in property, plant and equipment reserve, net of tax		600	825
Items that may be reclassified subsequently to profit or loss			
Net change in available for sale asset reserve, net of tax		(1,921)	1,965
Net change in cash flow hedging reserve, net of tax		12,513	(21,119)
Other comprehensive income for the year, net of tax		11,192	(18,329)
Total comprehensive income for the year		**38,640**	**1,644**
Attributable to:			
Members' interests		36,832	320
Non-controlling interests		1,808	1,324
		38,640	**1,644**

The accounting policies and other notes form part of, and should be read in conjunction with, these financial statements.

Statement of Changes in Equity for the year ended 31 March 2017

All in $000's

As at 31 March 2017	Retained earnings	Revaluation reserves: Property, plant and equipment	Revaluation reserves: Available for sale assets	Revaluation reserves: Cash flow hedging	Total equity attributable to members' interests	Non-controlling interests	Total equity
Balance as at 31 March 2016	253,313	2,384	5,768	(25,242)	236,223	3,737	**239,960**
Net surplus for the year	25,654	-	-	-	25,654	1,794	**27,448**
Other comprehensive income for the year							
Revaluation/change in fair value	-	337	(2,634)	17,373	15,076	-	**15,076**
Current/deferred tax impact	-	263	713	(4,860)	(3,884)	-	**(3,884)**
Total comprehensive income for the year	25,654	600	(1,921)	12,513	36,846	1,794	**38,640**
Non-controlling share of change in reserve	-	-	9	(23)	(14)	14	**-**
Non-controlling interests present value adjustment	(3,083)	-	-	-	(3,083)	-	**(3,083)**
Transfer from revaluation reserve	1,252	(1,252)	-	-	-	-	**-**
Dividends paid	-	-	-	-	-	(599)	**(599)**
As at 31 March 2017	**277,136**	**1,732**	**3,856**	**(12,752)**	**269,972**	**4,946**	**274,918**

As at 31 March 2016	Retained earnings	Revaluation reserves: Property, plant and equipment	Revaluation reserves: Available for sale assets	Revaluation reserves: Cash flow hedging	Total equity attributable to members' interests	Non-controlling interests	Total equity
Balance as at 31 March 2015	238,221	1,559	3,799	(4,161)	239,418	4,258	**243,676**
Net surplus for the year	18,603	-	-	-	18,603	1,370	**19,973**
Other comprehensive income for the year							
Revaluation/change in fair value	-	1,144	2,729	(29,332)	(25,459)	-	**(25,459)**
Current/deferred tax impact	-	(319)	(764)	8,213	7,130	-	**7,130**
Total comprehensive income for the year	18,603	825	1,965	(21,119)	274	1,370	**1,644**
Non-controlling share of change in reserve	-	-	4	42	46	(46)	**-**
Acquisition of non-controlling interests	(3,748)	-	-	(4)	(3,752)	-	**(3,752)**
Non-controlling interests present value adjustment	237	-	-	-	237	-	**237**
Change in capital of non-controlling interests	-	-	-	-	-	(1,247)	**(1,247)**
Dividends paid	-	-	-	-	-	(598)	**(598)**
As at 31 March 2016	253,313	2,384	5,768	(25,242)	236,223	3,737	**239,960**

The accounting policies and other notes form part of, and should be read in conjunction with, these financial statements.

Statement of Financial Position as at 31 March 2017

All in $000's

	Note	31/03/2017	31/03/2016
Assets			
Cash on hand and at bank		50,823	31,948
Funds with financial institutions	(7)	49,938	44,826
Investment securities	(8)	417,540	401,074
Derivative financial instruments	(9)	4,501	3,526
Advances to customers	(10)	3,408,075	2,868,850
Investments in associates and joint ventures	(13)	6,771	6,001
Other assets		22,467	16,764
Property, plant and equipment		20,713	23,670
Goodwill and intangible assets		6,918	4,618
Net deferred tax assets	(6)	6,666	10,898
		3,994,412	**3,412,175**
Liabilities			
Redeemable shares	(15)	2,732,581	2,487,345
Deposits from customers	(15)	212,733	215,650
Commercial paper	(15)	259,017	198,692
Due to other financial institutions	(15)	400,521	150,471
Derivative financial instruments	(9)	26,512	42,419
Current tax liabilities		1,719	34
Other liabilities		47,287	38,475
Subordinated redeemable shares	(15)	39,124	39,129
		3,719,494	**3,172,215**
Net assets		**274,918**	**239,960**
Equity			
Reserves		(7,164)	(17,090)
Retained earnings		277,136	253,313
Attributable to members of the society		269,972	236,223
Attributable to non-controlling interests		4,946	3,737
		274,918	**239,960**
Total interest earning and discount bearing assets		3,926,376	3,346,698
Total interest and discount bearing liabilities		3,643,976	3,091,287

For and on behalf of the Board of Directors:

Chairman
JF Ward

Deputy Chair
KJ Ball

30 May 2017

The accounting policies and other notes form part of, and should be read in conjunction with, these financial statements.

Statement of Cash Flows for the year ended 31 March 2017

All in $000's

	Note	31/03/2017	31/03/2016
Cash flows from operating activities			
Interest received		190,681	191,372
Fees and other income		46,829	42,418
Dividends received		106	104
Interest paid		(19,591)	(16,468)
Dividends paid on redeemable shares		(84,552)	(93,304)
Operating expenses		(84,512)	(80,911)
Income taxes received/(paid)		(7,929)	(8,676)
Net cash flows from operating activities before changes in operating assets and liabilities		41,032	34,535
Net changes in operating assets and liabilities			
Change in advances		(547,104)	(488,377)
Change in shares and deposits from customers		241,868	226,814
Change in commercial paper		60,325	134,053
Change in amounts due to other financial institutions		250,297	150,000
Change in subordinated redeemable shares		-	(1,901)
Net cash flows provided by/(used in) operating activities	(18)	**46,418**	**55,124**
Cash flows from investing activities			
Change in investment securities		(18,967)	(91,503)
Proceeds of property, plant and equipment		3,139	173
Purchase of property, plant and equipment		(2,331)	(6,629)
Purchase of intangible assets		(3,677)	(1,420)
Investment in associates and joint ventures		32	(359)
Net cash flows provided by/(used in) investing activities		**(21,804)**	**(99,738)**
Cash flows from financing activities			
Dividends paid to non-controlling interests		(599)	(598)
Acquisition of non-controlling interests		-	(5,000)
Net cash flows provided by/(used in) financing activities		**(599)**	**(5,598)**
Net increase/(decrease) in cash held		24,015	(50,212)
Add opening cash and cash equivalents		76,685	126,897
Closing cash and cash equivalents		**100,700**	**76,685**
Reconciliation of cash and cash equivalents			
Cash on hand and at bank		50,823	31,948
Funds with financial institutions	(7)	49,938	44,826
Interest accrued on available for sale assets		(61)	(89)
		100,700	**76,685**

The accounting policies and other notes form part of, and should be read in conjunction with, these financial statements.

1. Statement of General Accounting Policies

Reporting entity

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 consolidated financial statements presented here are for the reporting entity of the Banking Group comprising SBS and its subsidiaries.

Basis of preparation

The financial statements have been prepared in accordance with the requirements of the Financial Reporting Act 2013 and under New Zealand Generally Accepted Accounting Practice ("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 Statement (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).

These financial statements were authorised for issue by the Board of Directors on 30 May 2017.

Measurement base

The financial statements have been prepared on a going concern basis in accordance with historical cost concepts except that the following assets and liabilities are stated at their fair value: derivative financial instruments, certain financial assets and liabilities designated at fair value through profit or loss or as available for sale, and the revaluation of certain non-current assets.

Accounting estimates

The preparation of the financial statements requires the use of management judgement, estimates and assumptions that affect reported amounts and the application of policies. The estimates and associated assumptions are based on historical experience and various other factors that are believed to be reasonable. Actual results may differ from these estimates. For further discussion on judgements and estimates made by the Banking Group, in the process of applying its accounting policies, that have the most effect on the amounts recognised in the financial statements, refer to the relevant note within in the financial statements.

Judgement areas include:

Note 9 - Derivative financial instruments - Hedge accounting of derivatives

Note 11 - Provision for credit impairment - Estimation of credit provisions

Recognition and derecognition of financial assets and financial liabilities

The Banking Group recognises, on its statement of financial position, loans and receivables, deposits and redeemable shares at origination date and all other financial assets and liabilities at trade date.

The Banking Group derecognises a financial asset from its statement of financial position when, and only when, (i) the contractual rights to the cash flows from the financial asset expire, or (ii) the Banking Group has transferred all or substantially all of the risks and rewards of ownership of the financial asset and no longer controls the asset. The Banking Group derecognises a financial liability from its statement of financial position, when and only when, it is extinguished.

Offsetting

Income and expenses are not offset unless required or permitted by an accounting standard. This generally arises in the following circumstances:

- where amounts are collected on behalf of third parties where the Banking Group is, in substance, acting as an agent only; or
- where costs are incurred on behalf of customers from whom the Banking Group is reimbursed.

Assets and liabilities are offset and the net amount reported in the statement of financial position only where:

- there is a current enforceable legal right to offset the asset and liability; and
- there is an intention to settle on a net basis, or to realise the asset and settle the liability simultaneously.

Goods and services tax

Revenues, expenses and assets are recognised net of the amount of goods and services tax (GST) except where the amount of GST incurred is not recoverable from Inland Revenue. In these circumstances, the GST is recognised as part of the cost of acquisition of the asset or as part of the expense.

Receivables and payables are stated with the amount of GST included. The net amount of GST recoverable from, or payable to, Inland Revenue is included as 'other assets' or 'other liabilities' in the statement of financial position.

Cash flows are included in the cash flow statement on a net basis. The GST components of cash flows arising from investing and financing activities, which are recoverable from, or payable to, Inland Revenue are classified as operating cash flows.

1. Statement of General Accounting Policies continued

Presentation currency and rounding

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

Comparative data

To ensure consistency with the current period, comparative figures have been restated where appropriate.

Changes in accounting policies

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

Standards issued but not yet effective

The following new standards and amendments to standards relevant to the Banking Group are not yet effective and have not yet been applied in preparing the financial statements. The Banking Group does not currently intend to apply any of these pronouncements until their effective date and is still assessing their impact on its financial statements.

- NZ IFRS 9 Financial Instruments - was issued in September 2014 and will become effective from 1 January 2018. This final version of NZ IFRS 9 Financial instruments reflects all phases of the financial instruments project and replaces NZ IAS 39 Financial Instruments: Recognition and Measurement. The standard includes revised guidance on the classification and measurement of financial assets, including a forward-looking impairment model for expected credit losses, and supplements hedge accounting on a more principles-based approach to assessing hedge effectiveness. For the classification and measurement of financial liabilities, the standard retains most of the existing requirements from NZ IAS 39. The main change is that, in cases where the fair value option is taken for financial liabilities, the part of the fair value change due to an entity's own credit risk is recorded in other comprehensive income rather than the income statement, unless this creates an accounting mismatch. NZ IFRS 9 will apply to the Banking Group from 1 April 2018.
- NZ IFRS 15 Revenue from Contracts with Customers - was issued in July 2014 and will become effective from 1 January 2018. The standard establishes a five-step model framework specifying the accounting treatment for all revenue arising from contracts with customers. NZ IFRS 15 will apply to the Banking Group from 1 April 2018.
- NZ IFRS 16 Leases - was issued in February 2016 and will become effective from 1 January 2019. The standard will bring leases on-balance sheet for lessees, with a resulted increase in reported assets and liabilities. This standard also eliminates the current operating/finance lease due accounting model for lessees. NZ IFRS 16 will apply to the Banking Group from 1 April 2019.

Notes to the Financial Statements for the year ended 31 March 2017 All in $000's

2. Net Interest Income

	31/03/2017	31/03/2016
Interest income		
Cash at bank	832	975
Funds with financial institutions - available for sale	718	2,334
Investment securities - available for sale	12,796	13,300
Derivative financial instruments	(15,944)	(8,140)
Advances to customers - at amortised cost	195,843	185,894
Advances to customers - impaired	577	749
Total interest income	**194,822**	**195,112**
Interest expense		
Redeemable shares	82,383	91,851
Deposits from customers	12,650	12,004
Other financial institutions	280	155
Other borrowings	6,444	4,562
Subordinated redeemable shares	2,585	2,607
Total interest expense	**104,342**	**111,179**
Net interest income	**90,480**	**83,933**

Interest income

Interest income for all instruments measured at amortised cost is recognised in the income statement as it accrues, using the effective interest method. Interest income for all instruments measured at fair value is recognised in the income statement on a daily accrual basis.

The effective interest method calculates the amortised cost of a financial asset and allocates the interest income, including any fees and directly related transaction costs that are an integral part of the effective interest rate over the expected life of the financial asset. The application of the method has the effect of recognising income evenly in proportion to the amount outstanding over the expected life of the financial asset.

Loan commitment fees are deferred and recognised as an adjustment to the effective interest on the loan once drawn or immediately to the income statement for expired commitments.

Fees and commissions payable to brokers in respect of originating lending business, where these are direct and incremental costs related to the issue of a financial instrument, are included in interest income as part of the effective interest rate.

Interest expense

Interest expense (including dividends on redeemable shares and subordinated redeemable shares) for all instruments measured at amortised cost is recognised in the income statement as they accrue, using the effective interest method. Interest expense for all instruments measured at fair value is recognised in the income statement on a daily accrual basis.

The effective interest method calculates the amortised cost of a financial liability and allocates the interest expense, including any fees and directly related transaction costs that are an integral part of the effective interest rate over the expected life of the financial liability. The application of the method has the effect of recognising expense evenly in proportion to the amount outstanding over the expected life of the financial liability.

Notes to the Financial Statements for the year ended 31 March 2017 All in $000's

3. Other Income

	31/03/2017	31/03/2016
Loan fees	2,351	2,612
Management fees	8,021	7,149
Other fee and commission income	12,210	10,353
Net insurance income	8,835	9,063
Dividends	106	104
Gain on sale of shares	255	100
Sundry income	1,140	1,103
	32,918	**30,484**

Revenue is recognised to the extent that it is probable that economic benefits will flow to the Banking Group and that revenue can be reliably measured.

Other fee and commission income

Other fee and commission income integral to the effective yield of a financial asset or liability for all instruments measured at amortised cost is recognised as an adjustment to the effective interest calculation and included in net interest income.

Fee and commission income which relates to the execution of a significant act, for example maintaining and administering existing facilities is recognised at the time the services are provided and is recognised as income no later than when the loan is disbursed or the commitment to lend expires.

Fees and commissions payable to brokers in respect of originating lending business, where these are direct and incremental costs related to the issue of a financial instrument, are included in interest income as part of the effective interest rate.

Net insurance income

Insurance premium revenue is recognised from the inception date as soon as there is a basis on which it can reliably be estimated. Insurance premium revenue is recognised as income when it is earned in accordance with the pattern of incidence of risk expected under the insurance contract. Reinsurance premiums are set off against insurance premium revenue within the income statement.

Notes to the Financial Statements for the year ended 31 March 2017 All in $000's 19

4. Operating Expenses

	31/03/2017	31/03/2016
Auditors remuneration - audit and statutory	311	286
Auditors remuneration - other services	121	731
Computer expenses	4,685	3,873
Fees and commissions	805	902
Fees to directors	642	672
Marketing	7,786	7,681
Personnel	40,868	38,374
Actuarial life adjustment	28	697
Amortisation and depreciation	3,740	3,982
Rent and leases	2,603	2,660
Write off of property, plant and equipment	123	631
Bank charges and funding line fees	4,331	3,749
Other expenses	9,836	9,304
	75,879	**73,542**
Amounts received, or due and receivable by the auditors, KPMG:		
Year end audit of financial statements	267	237
Half year review of financial statements	44	49
Secondment of resources	32	593
Regulatory and other assurance	89	67
Staff training and facilitation	-	71
	432	**1,017**
Amounts received, or due and receivable by directors:		
JF Ward (Chairman)	132	133
JB Walker (resigned 19 October 2016) *	187	85
KJ Ball (Deputy Chair)	71	70
GJ Mulvey	71	64
JJ Grant	65	64
FE Spencer	70	70
AG Neill (retired July 2015)	-	21
MJ Skilling	65	64
AL Mcleod (appointed July 2015)	65	42
	726	**613**
Provision for directors retiring allowance	(94)	53
GST on directors fees	10	6
	642	**672**

* Includes a retirement allowance.

	31/03/2017	31/03/2016
Personnel expenses includes key management personnel compensation which comprised:		
Salaries and short-term employee benefits	5,237	4,998
Post-employment benefits	125	107
Other long term benefits	10	9
	5,372	**5,114**

Notes to the Financial Statements for the year ended 31 March 2017 All in $000's

4. Operating Expenses continued

Expenses are recognised in the income statement on an accruals basis.

Personnel expenses

Personnel expenses are recognised over the period the employee renders the service to receive the benefit.

Amortisation and depreciation

Depreciation is provided on all property, plant and equipment other than land, and amortisation is provided on intangible assets, on a basis which will write down the net cost or revalued amount of each item over its expected useful life on a straight line basis, as follows:

Buildings	30 - 50 years
Building Alterations	1 - 33 years
Computer Equipment	1 - 16 years
Other Assets	1 - 16 years
Software	1 - 3 years
Management Rights - Staples Rodway KiwiSaver Scheme	15 years

At each reporting date, the carrying amounts of property, plant and equipment, goodwill and intangible assets are reviewed for indications of impairment in light of commercial and technological developments. If any such indication exists, the recoverable amount of the assets are estimated and compared against the existing carrying value. Where the asset's existing carrying value exceeds its recoverable amount the difference is charged to the income statement. An impairment loss recognised in prior periods may be reversed if there has been a change in the estimates used to determine the asset's recoverable amount.

5. Net Gain/(Loss) from Financial Instruments Designated at Fair Value

	31/03/2017	31/03/2016
Net gain/(loss) arising on:		
Investment securities	(11)	9
Derivative financial instruments	(94)	1
Hedge ineffectiveness on cash flow hedging	(8)	(3)
	(113)	**7**

Interest income and interest expense on all financial instruments designated at fair value through profit or loss is reported within interest income or interest expense and not included in the fair value of these instruments.

Provision for credit impairment on all financial instruments designated at fair value through profit or loss is reported within provision for credit impairment and not included in the fair value of these instruments.

Notes to the Financial Statements for the year ended 31 March 2017 All in $000's 21

6. Taxation

	31/03/2017	31/03/2016
The major components of the income tax expense comprise:		
Current tax expense		
Current income tax charge	10,121	8,107
Adjustments recognised in the current period in relation to current tax of prior periods	85	1
Deferred taxation expense		
Deferred tax expenses relating to the origination and reversal of temporary differences	(210)	246
Total income tax expense recognised in the income statement	**9,996**	**8,354**
The following amounts were charged/(credited) direct to equity:		
Current income tax	(730)	367
Deferred income tax	4,614	(7,497)
Total income tax expense recognised directly in equity	**3,884**	**(7,130)**
Reconciliation of the prima facie income tax payable on profit with income tax expense in the income statement:		
Surplus before income tax	37,444	28,327
Prima facie income tax at 28%	10,484	7,931
Adjust for the tax effect of:		
Imputed dividends	(22)	(30)
Other permanent items	(551)	452
Prior period adjustments	85	1
	(488)	423
Taxation expense/(benefit)	**9,996**	**8,354**

Income tax expense

Income tax expense for the year comprises current and deferred tax. It is recognised in the income statement as tax expense, except when it relates to items credited directly to equity, in which case it is recorded in equity.

	31/03/2017	31/03/2016
Provision for deferred tax:		
Balance at beginning of the year	10,898	3,433
Prior period adjustment	172	214
(Charged)/credited to equity	(4,614)	7,497
(Charged)/credited to income statement	210	(246)
Balance at end of the year	**6,666**	**10,898**

Notes to the Financial Statements for the year ended 31 March 2017 All in $000's

6. Taxation continued

Movement in deferred taxation assets/liabilities are as follows:

	Provision for credit impairment	Derivative financial instruments	Property, plant and equipment	Provisions	Other	Total
As at 31 March 2017						
Balance at beginning of the year	5,050	9,835	(3,125)	716	(1,578)	10,898
Prior period adjustment	-	-	(22)	216	(22)	172
Amounts recognised in equity	-	(4,860)	263	-	(17)	(4,614)
Amounts recognised in income statement	536	-	306	(250)	(382)	210
Balance at end of the year	**5,586**	**4,975**	**(2,578)**	**682**	**(1,999)**	**6,666**
As at 31 March 2016						
Balance at beginning of the year	4,743	1,622	(2,656)	541	(817)	3,433
Prior period adjustment	-	-	(1)	189	26	214
Amounts recognised in equity	-	8,213	(319)	-	(397)	7,497
Amounts recognised in income statement	307	-	(149)	(14)	(390)	(246)
Balance at end of the year	**5,050**	**9,835**	**(3,125)**	**716**	**(1,578)**	**10,898**

There are no unrecognised deferred tax assets as at 31 March 2017 (31 March 2016 $nil).

Current income tax

Current income tax is the expected tax payable or receivable on taxable income for the year, based on tax rates (and tax laws) which are enacted or substantively enacted by the reporting date and including any adjustment for tax payable in previous periods. Current tax for current and prior periods is recognised as a liability (or asset) to the extent that it is unpaid (or refundable).

Current tax assets and liabilities are only offset to the extent that they relate to income taxes imposed by the same taxation authority and there is a legal right and intention to settle on a net basis and it is allowed under tax law.

Deferred income tax

Deferred tax is accounted for using the balance sheet method. Deferred tax arises by providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for tax purposes.

Deferred income tax assets and liabilities are measured at the tax rates that are expected to apply to the period(s) when the asset or liability giving rise to them are realised or settled, based on tax rates (and tax laws) that have been enacted or substantively enacted by the reporting date. The measurement reflects the tax consequences that would follow from the manner in which the Banking Group, at the reporting date, recovers or settles the carrying amount of its assets and liabilities.

Deferred tax assets, including those related to the tax effects of income tax losses and credits available to be carried forward, are recognised only to the extent that it is probable that future taxable profits will be available against which the deductible temporary differences or unused tax losses and credits can be utilised. Deferred tax assets are reviewed each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realised.

Deferred tax assets and liabilities are offset only to the extent that they relate to income taxes imposed by the same taxation authority and there is a legal right and intention to settle on a net basis and it is allowed under tax law.

7. Funds with Financial Institutions

	31/03/2017	31/03/2016
Call funds	45,920	40,031
Term deposits	4,018	4,795
Designated as available for sale	**49,938**	**44,826**

Funds with financial institutions are recognised in the financial statements as available for sale therefore carrying amount equals fair value. The fair values are based on market prices.

Refer to Note 20 - Fair Value of Financial Instruments for more information on fair value of financial instruments.

Notes to the Financial Statements for the year ended 31 March 2017 All in $000's

8. Investment Securities

	31/03/2017	31/03/2016
Equity securities	1,652	2,120
Commercial paper	33,756	-
Local authority bonds	58,500	38,568
Bank securities	194,471	209,715
Other bonds	129,161	150,671
	417,540	**401,074**

Investment securities are recognised in the financial statements as either fair value through profit or loss or available for sale, therefore carrying amount equals fair value. The fair values are based on quoted market prices.

Refer to Note 20 - Fair Value of Financial Instruments for more information on fair value of financial instruments.

9. Derivative Financial Instruments

	As at 31 March 2017			As at 31 March 2016		
	Notional principal	Fair value assets	Fair value liabilities	Notional principal	Fair value assets	Fair value liabilities
Held for risk management - at fair value						
Interest rate related contracts						
Swaps	289,176	2,380	2,571	182,790	1,556	1,652
Options	-	-	-	-	-	-
Total held for risk management at fair value	**289,176**	**2,380**	**2,571**	**182,790**	**1,556**	**1,652**
Held for hedging - cash flow hedges						
Interest rate related contracts						
Swaps	2,035,700	2,121	23,941	1,722,950	1,970	40,767
Options	-	-	-	-	-	-
Total held for hedging	**2,035,700**	**2,121**	**23,941**	**1,722,950**	**1,970**	**40,767**
Total derivative financial instruments	**2,324,876**	**4,501**	**26,512**	**1,905,740**	**3,526**	**42,419**

The Banking Group uses the following derivative instruments for economic or risk management purposes:

Interest rate swaps are commitments to exchange one set of cash flows for another. Swaps result in an economic exchange of interest rates (for example, fixed rate for floating rate). No exchange of principal takes place. The Banking Group's credit risk represents the potential cost to replace the swap contracts if counterparties fail to fulfil their obligation. This risk is monitored on an ongoing basis within treasury policy guidelines, and with reference to a proportion of the notional amount of the contracts and the term to expiry of the contracts. To control the level of credit risk taken, the Banking Group assesses counterparties based on their published credit rating compared with treasury policy limits.

Interest rate options are contractual agreements under which the seller (writer) grants the purchaser (holder) the right, but not the obligation, either to buy (a call option) or sell (a put option) at or by a set date or during a set period, a specific amount of a financial instrument at a predetermined price. The seller receives a premium from the purchaser in consideration for the assumption of interest rate risk. The Banking Group is exposed to credit risk on purchased options only, and only to the extent of their carrying amount, which is their fair value.

The notional amounts of certain types of financial instruments provide a basis for comparison with instruments recognised on the statement of financial position but do not necessarily indicate the amounts of future cash flows involved or the current fair value of the instruments and, therefore, do not indicate the Banking Group's exposure to credit or price risks. The derivative instruments become favourable (assets) or unfavourable (liabilities) as a result of fluctuations in market interest rates relative to their terms. The aggregate contractual or notional amount of derivative financial instruments on hand, the extent to which instruments are favourable or unfavourable, and thus the aggregate fair values of derivative financial assets and liabilities, can fluctuate significantly from time to time.

Cash Flow Hedges

The Banking Group hedges the forecasted interest cash flows from floating rate loans and deposits using interest rate swaps and interest rate options. There were no transactions where cash flow hedge accounting ceased in the year ended 31 March 2017 as a result of highly probable cash flows no longer expected to occur (31 March 2016 $nil).

9. Derivative Financial Instruments continued

Derivative financial instruments are contracts whose value is derived from changes in one or more underlying financial instruments or indices. They include swaps, options and combinations of these instruments.

Derivatives are initially recognised at fair value on the date on which a derivative contract is entered into and are subsequently measured at their fair value. All derivatives are carried as assets when fair value is positive and as liabilities when fair value is negative. Fair values are obtained from quoted market prices in active markets, including recent market transactions, and valuation techniques, including discounted cash flow models and options pricing models, as appropriate. Fair values include adjustment for counterparty credit risk.

The method of recognising the resulting fair value gain or loss depends on whether the derivative is designated as a hedging instrument, and if so, the nature of the item being hedged. A hedge instrument is a designated derivative, the changes in fair values or cash flows of which are expected to offset changes in the fair value of cash flows of a designated hedged item. A hedged item is an asset, liability, firm commitment or highly probable forecast transaction that exposes the Banking Group to risk of changes in fair value or cash flows, and that is designated as being hedged. The Banking Group hedges a portion of the floating rate risk in the funding and lending books. Hedge accounting is used for derivatives designated in this way, provided certain criteria are met.

Cash flow hedge accounting

The criteria that must be met for a relationship to qualify for hedge accounting include:

- the hedging relationship must be formally designated and documented at inception of the hedge;
- effectiveness testing must be carried out to ensure the hedge is effective, consistent with the originally documented risk management strategy; and
- the instruments must involve a party external to the Banking Group.

The Banking Group documents, at the inception of the transaction, the relationship between hedged items and hedging instruments, as well as its risk management objective and strategy for undertaking various hedge transactions. The Banking Group also documents its assessment, both at hedge inception and on an ongoing basis, of whether the derivatives that are used in hedging transactions are highly effective on offsetting changes in cash flows of hedged items.

A fair value gain or loss associated with the effective portion of a derivative designated as a cash flow hedge is recognised initially in the cash flow hedging reserve. The ineffective portion of a fair value gain or loss is recognised immediately in the income statement. When the transaction or item that the derivative is hedging (including cash flows from the transaction that were forecast when the derivative was effected) affects the income or expense then the associated gain or loss on the hedging derivative is simultaneously transferred from the cash flow hedging reserve to the corresponding income or expenses item in the income statement.

When a hedging derivative expires or is sold, the hedge no longer meets the criteria for hedge accounting, or the Banking Group elects to revoke the hedge designation, the cumulative gain or loss on the hedging derivative remains in the cash flow hedging reserve until the forecast transaction occurs and affects income, at which point it is transferred to the corresponding income or expense line. If a forecast transaction is no longer expected to occur, the cumulative gain or loss on the hedging derivative previously reported in the cash flow hedging reserve is immediately transferred to the income statement.

Derivative financial instruments at fair value through profit or loss

Certain derivative financial instruments that do not meet the criteria for hedge accounting under NZ IAS 39 are classified at fair value through profit or loss. Changes in the fair value are reflected in the income statement immediately.

The movement in the fair value of derivative financial instruments is included in the income statement as 'Net gain/(loss) from financial instruments designated at fair value'.

Hedge accounting

Judgement is required by management in selecting and designating hedging relationships and assessing hedge effectiveness. NZ IAS 39 does not specify a single method for assessing hedge effectiveness. The Banking Group adopts the hypothetical derivative approach to determine hedge effectiveness. Hedge ineffectiveness can arise for a number of reasons, and whilst a hedge may pass the effectiveness tests it may not be perfectly effective, thus creating volatility within the income statement through recognition of this ineffectiveness.

Notes to the Financial Statements for the year ended 31 March 2017 All in $000's 25

10. Advances to Customers

	Note	31/03/2017	31/03/2016
Residential		2,682,415	2,212,665
Agricultural		241,436	257,735
Commercial		147,773	150,223
Consumer		355,064	267,257
Gross advances		**3,426,688**	**2,887,880**
Provisions for credit impairment	(11)	(21,138)	(19,224)
Deferred fee revenue and expenses		2,525	194
Total net advances		**3,408,075**	**2,868,850**

Advances are recognised in the financial statements as loans and receivables at amortised cost. For variable rate advances the carrying amount is a reasonable estimate of fair value as they can be settled the following day at balance outstanding. For fixed rate advances fair values are estimated using the discounted cash flow approach by reference to relative wholesale rates adjusted with a retail lending margin for the term at original fixing and the wholesale rate for the remaining term at balance date.

Refer to Note 20 - Fair Value of Financial Instruments for more information on fair value of financial instruments.

11. Provision for Credit Impairment

	As at 31 March 2017			
	Residential Mortgages	Retail Exposures	Corporate Exposures	Total
Individual provisions against advances and loans				
Balance at beginning of the year	374	-	2,406	2,780
New provisions during the year	535	-	225	760
Balances written off during the year	(158)	-	(85)	(243)
Recoveries/reversals of previously recognised provision	-	-	(456)	(456)
Balance at end of the year	**751**	**-**	**2,090**	**2,841**
Collective provisions against advances and loans				
Balance at beginning of the year	5,380	8,212	2,852	16,444
Charged to income statement	1,750	(45)	148	1,853
Balance at end of the year	**7,130**	**8,167**	**3,000**	**18,297**
Total provisions for credit impairment	**7,881**	**8,167**	**5,090**	**21,138**
Reconciliation of provision movements				
Bad debts written off during the year	(869)	9,139	(119)	8,151
Individual provisions	535	-	225	760
Collective provision	1,750	(45)	148	1,853
Provision for credit impairment to income statement	**1,416**	**9,094**	**254**	**10,764**

- Residential mortgages comprise advances to individuals and corporates that are secured against residential properties. They include investments in residential property as well as owner-occupied housing.
- Retail exposures comprise consumer personal, consumer finance and motor vehicle lending.
- Corporate exposures comprise primarily advances to individuals, corporates or small to medium enterprises that are secured against commercial or agricultural properties.

Notes to the Financial Statements for the year ended 31 March 2017 All in $000's

11. Provision for Credit Impairment continued

	As at 31 March 2016			
	Residential Mortgages	Retail Exposures	Corporate Exposures	Total
Individual provisions against advances and loans				
Balance at beginning of the year	946	-	4,880	5,826
New provisions during the year	235	-	2,181	2,416
Balances written off during the year	(807)	-	(4,655)	(5,462)
Balance at end of the year	**374**	**-**	**2,406**	**2,780**
Collective provisions against advances and loans				
Balance at beginning of the year	5,380	5,201	1,574	12,155
Charged to income statement	-	3,011	1,278	4,289
Balance at end of the year	**5,380**	**8,212**	**2,852**	**16,444**
Total provisions for credit impairment	**5,754**	**8,212**	**5,258**	**19,224**
Reconciliation of provision movements				
Bad debts written off during the year	106	6,321	80	6,507
Individual provisions	235	-	2,181	2,416
Collective provision	-	3,011	1,278	4,289
Provision for credit impairment to income statement	**341**	**9,332**	**3,539**	**13,212**

At 31 March 2017 the Banking Group's total provision for credit impairment was $21.1 million (31 March 2016 $19.2 million) representing 0.6% of total net loans and advances (31 March 2016 0.7%). The provisions represent provisions against individual loans and collective provisions.

Advances and loans are regularly reviewed for impairment loss. Credit impairment provisions are raised for exposures that are known to be impaired. Advances and loans are impaired and impairment losses incurred if there is objective evidence of impairment as a result of one or more loss events that occurred after the initial recognition of the advance or loan and that loss event (or events) has had a reliably measurable impact on the estimated future cash flows of the individual advance or loan or the collective portfolio of advances and loans.

Impairment is assessed initially for assets that are individually significant (or on a portfolio basis for small value loans), and then on a collective basis for those exposures not individually known to be impaired.

For those exposures that are assessed collectively, these are placed in pools of similar assets with similar risk characteristics. The required provision is estimated on the basis of historical loss experience for assets with credit risk characteristics similar to those in the collective pool. The historical loss experience is adjusted based on current observable data.

The estimated individual impairment loss is measured as the difference between the asset's carrying amount and the estimated future cash flows discounted to their present value at the original effective interest rate. As this discount unwinds during the period between recognition of impairment and recovery of the written down amount, it is recognised in the income statement.

The provision for credit impairment (individual and collective) is deducted from advances and loans in the statement of financial position and the movement in the provision for the reporting period is reflected in the income statement as 'provision for credit impairment'.

When an advance or loan is uncollectible, it is written-off against the related provision for impairment. Subsequent recoveries of amounts previously written-off are taken to the income statement.

Where impairment losses recognised in previous periods are subsequently decreased or no longer exist, such impairments are reversed in the income statement.

11. Provision for Credit Impairment continued

Estimation of credit provisions

Provisions are raised for losses on exposures that are known to be impaired by measuring the difference between an asset's carrying amount and future cash flows. The process of estimating the amount and timing of cash flows involves considerable management judgement. These judgements are reviewed regularly to reduce any differences between loss estimates and actual loss experience.

Exposures found not to be impaired are placed into pools of similar assets with similar risk characteristics to be collectively assessed for losses that have been incurred, but not yet identified. The required provision is estimated on the basis of historical loss experience for assets with credit risk characteristics similar to those in the collective pool. The historical loss experience is adjusted based on current observable data. This may include data indicating that there has been an adverse change in the payment status of borrowers in a group, or national or local economic conditions that correlate with defaults on assets in the Banking Group. Management regularly reviews and adjusts the estimates and methodologies for collective provisions as improved analysis becomes available. Changes in these assumptions and methodologies could have a direct impact on the level of credit provision and credit impairment charge recorded in the financial statements.

Notes to the Financial Statements for the year ended 31 March 2017 All in $000's

12. Asset Quality

As at 31 March 2017	Residential Mortgages	Retail Exposures	Corporate Exposures	Total
(a) Asset quality - advances to customers				
Neither past due or impaired	2,666,659	327,676	377,177	3,371,512
Individually impaired	1,284	-	6,239	7,523
Past due	21,047	25,526	3,605	50,178
Provision for credit impairment	(7,881)	(8,167)	(5,090)	(21,138)
Carrying amount	**2,681,109**	**345,035**	**381,931**	**3,408,075**
(b) Ageing of past due but not impaired assets				
Past due 0-29 days	18,694	19,485	779	38,958
Past due 30-59 days	897	3,870	2,632	7,399
Past due 60-89 days	290	1,211	29	1,530
Past due 90 days +	1,166	960	165	2,291
Carrying amount	**21,047**	**25,526**	**3,605**	**50,178**
(c) Impaired assets				
Balance at beginning of the year	545	-	8,614	9,159
Additions to individually impaired assets	920	-	359	1,279
Reductions to individually impaired assets	(181)	-	(1,907)	(2,088)
Transfers back to productive ledger	-	-	(827)	(827)
Balance at end of the year	1,284	-	6,239	7,523
Provision at end of the year	(751)	-	(2,090)	(2,841)
Net carrying amount at end of the year	**533**	**-**	**4,149**	**4,682**
Undrawn balances on individually impaired lending commitments	-	-	-	-

(d) Other assets under administration

There are no other assets under administration as at 31 March 2017.

As at 31 March 2016	Residential Mortgages	Retail Exposures	Corporate Exposures	Total
(a) Asset quality - advances to customers				
Neither past due or impaired	2,194,178	246,032	386,902	2,827,112
Individually impaired	545	-	8,614	9,159
Past due	21,605	18,864	11,334	51,803
Provision for credit impairment	(5,754)	(8,212)	(5,258)	(19,224)
Carrying amount	**2,210,574**	**256,684**	**401,592**	**2,868,850**
(b) Ageing of past due but not impaired assets				
Past due 0-29 days	15,722	13,074	10,354	39,150
Past due 30-59 days	3,263	2,985	160	6,408
Past due 60-89 days	1,451	1,570	79	3,100
Past due 90 days +	1,169	1,235	741	3,145
Carrying amount	**21,605**	**18,864**	**11,334**	**51,803**
(c) Impaired assets				
Balance at beginning of the year	1,724	-	11,197	12,921
Additions to individually impaired assets	113	-	7,055	7,168
Reductions to individually impaired assets	(1,292)	-	(9,638)	(10,930)
Balance at end of the year	545	-	8,614	9,159
Provision at end of the year	(374)	-	(2,406)	(2,780)
Net carrying amount at end of the year	**171**	**-**	**6,208**	**6,379**
Undrawn balances on individually impaired lending commitments	-	-	-	-

(d) Other assets under administration

There are no other assets under administration as at 31 March 2016.

Notes to the Financial Statements for the year ended 31 March 2017 All in $000's

12. Asset Quality continued

Credit assessment

All advances and loans are subject to regular scrutiny of credit risk.

The Banking Group has classified its non-performing assets into the following categories:

Impaired assets

Impaired assets are credit exposures where a credit event has occurred and for which it is probable the Banking Group will not be able to collect all amounts owing in terms of the contract and includes:

- advances and loans that are not contractually past due but where there is insufficient security to cover principal outstanding and where recovery is doubtful;
- advances and loans which are past due with insufficient security to cover principal and arrears of interest;
- restructured advances and loans where the interest rate charged is below that of the Banking Group's average cost of funds.

An individual provision is raised to cover the expected loss, where full recovery is doubtful.

Restructured assets

Restructured assets are defined as advances and loans on which the original contractual terms have been concessionally modified due to the financial difficulties of borrowers, and on which interest continues to be accrued at a rate which is equal to or greater than the Banking Group's average cost of funds at the date of restructuring.

Real estate or other assets acquired through security enforcement

Real estate or other assets acquired through security enforcement are those assets which are legally owned by the Banking Group as a result of enforcing security.

Past due assets

Advances and loans are designated as past due assets where a counterparty has failed to make a payment when contractually due and which are not impaired assets.

13. Investments in Subsidiaries, Associates and Joint Ventures

	Percentage Held		Balance	
	31/03/2017	31/03/2016	Date	Nature of Business
Subsidiaries:				
Fraser Properties Limited	100.0%	100.0%	31 March	Property Holding
Southsure Assurance Limited	80.0%	80.0%	31 March	Insurance Company
Finance Now Limited	95.0%	95.0%	31 March	Finance Company
Funds Administration New Zealand Limited ("FANZ")	85.0%	85.0%	31 March	Funds Administration
In-substance Subsidiaries:				
SBS Invercargill W Trust	-	-	31 March	Mortgage Securitisation
SBS Oreti Trust No. 2	-	-	31 March	Mortgage Securitisation
Finance Now Warehouse Trust	-		31 March	Loan Securitisation
Associates:				
Abbott Insurance Brokers Limited	32.5%	31.0%	31 March	Insurance Brokers
Joint Ventures:				
Staples Rodway Asset Management Limited	50.0%	50.0%	31 March	Investment Advisory

All subsidiaries and in-substance subsidiaries are incorporated in New Zealand. For all subsidiaries, the ownership percentage equates to the voting power held.

13. Investments in Subsidiaries, Associates and Joint Ventures continued

On 31 March 2016, the Bank increased its shareholding in Finance Now Ltd (FNL) from 90% to 95%. 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 a transaction amongst shareholders. No adjustment has been made to the fair value of the assets and liabilities of FNL in the consolidated accounts of the Bank in accordance with IFRS, and the associated premium (reflecting the future earnings potential of the entities) is recorded as an adjustment to equity. The put and call options have been adjusted in the financial statements to reflect the new present value of the estimated exercise price of the options. The unwind of the discounted present value is reflected in the statement of changes in equity as 'Non-controlling interests present value adjustment'.

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. Refer to note 14 - Loan securitisation for more information on securitisation.

Basis of consolidation

The consolidated financial statements include those of SBS and its subsidiaries and special purpose entities which it controls, accounted for using the acquisition method, and the results of its associates and joint ventures, accounted for using the equity method.

The acquisition method of accounting involves recognising at acquisition date, separately from goodwill, the identifiable assets acquired, the liabilities assumed and any non-controlling interest in the acquiree. The identifiable assets acquired and the liabilities assumed are measured at their acquisition date fair values.

The equity method of accounting involves initial recognition at cost, which includes transaction costs. Subsequent to initial recognition the consolidated financial statements include the Banking Group's share of profit or loss and other comprehensive income of the associates or joint ventures until the date significant influence or joint control ceases.

On consolidation, all significant inter-company transactions, balances and unrealised gains on transactions have been eliminated. Unrealised losses are also eliminated unless the transaction provides evidence of an impairment of the asset transferred. The accounting policies of the subsidiaries have been changed where necessary to ensure consistency with the policies adopted by the Parent, SBS.

Where subsidiaries have been sold or acquired during the year, their operating results have been included to the date control ceases or from the date control is transferred to the Banking Group.

Changes in a parent's ownership interest in a subsidiary that do not result in the parent losing control of the subsidiary are recorded through equity to reflect a transaction amongst shareholders.

Subsidiaries

Subsidiaries are those entities over which the Banking Group has the power, exposure or rights to variable returns from its involvement with the investee and has the ability to affect those returns through its power.

In-substance subsidiaries

In-substance subsidiaries are special purpose entities that the Banking Group may invest in or establish to enable it to undertake specific types of transactions such as securitisation. Where SBS or a subsidiary control such vehicles, they are consolidated into the Banking Group's financial results.

Associates

Associates are entities over which the Banking Group exerts significant influence but does not exercise control, or joint control over the financial and operating policies.

Joint ventures

Joint ventures are entities over which the Banking Group exerts joint control over the financial and operating policies, but does not have outright control.

Notes to the Financial Statements for the year ended 31 March 2017 All in $000's

14. Loan Securitisation

	31/03/2017	31/03/2016
Securitised loan balances		
SBS Invercargill W Trust	276,088	235,879
SBS Oreti Trust No 2	183,910	125,942
Finance Now Warehouse Trust	251,050	-
	711,048	**361,821**

Mortgages assigned by SBS to the SBS Invercargill W Trust during the year ended 31 March 2017 amounted to $258.46 million (31 March 2016 $198.11 million).

Mortgages assigned by the SBS Invercargill W Trust to the SBS Oreti Trust No. 2 during the year ended 31 March 2017 amounted to $102.16 million (31 March 2016 $nil).

Loans assigned by FNL to the Finance Now Warehouse Trust during the period ended 31 March 2017 amounted to $286.75 million (31 March 2016 $nil).

SBS sells its interest in certain loans (principally housing mortgage loans) to a trust known as the SBS Invercargill W Trust by way of an equitable assignment. At the time of the sale all legal, equitable and beneficial interests in the mortgages are transferred to the purchaser. SBS consolidates the financial statements of SBS Invercargill W Trust within the Parent on the basis that SBS retains some of the risks and rewards of ownership through the provision of a subordinated loan.

The SBS Invercargill W Trust also sells its interest in certain loans (principally housing mortgage loans) to a trust known as the SBS Oreti Trust No. 2 by way of an equitable assignment. At the time of the sale all legal, equitable and beneficial interests in the mortgages are transferred to the purchaser. The SBS Oreti Trust No. 2 issues residential mortgage backed securities that qualify as acceptable collateral under the RBNZ liquidity management arrangements. SBS consolidates the financial statements of the SBS Oreti Trust No. 2 within the Parent on the basis that SBS retains a continuing involvement in the transferred assets by holding the securities issued by the trust.

FNL sells its interest in certain loans (mixture of consumer and business loans) to a trust known as the Finance Now Warehouse Trust by way of an equitable assignment. At the time of the sale all legal, equitable and beneficial interest in the loans are transferred to the purchaser. The financial statements of the Finance Now Warehouse Trust are consolidated within the Group on the basis that FNL retains a continuining involvement in the transferred assets.

SBS is the manager and servicer of mortgages assigned to the SBS Invercargill W Trust and the SBS Oreti Trust No. 2. SBS receives a fee for providing these management services. This fee is recognised when earned.

FNL is the manager and servicer of loans assigned to the Finance Now Warehouse Trust. FNL receives a fee for providing these management services. This fee is recognised when earned.

Notes to the Financial Statements for the year ended 31 March 2017 All in $000's

15. Funding

	31/03/2017	31/03/2016
(a) Concentrations of funding:		
Concentrations of funding by geographical location		
North Island other	499,848	481,908
Auckland	733,274	399,862
Canterbury	637,360	591,031
Otago	536,241	487,380
Southland	907,677	864,226
South Island other	266,235	209,363
Overseas	63,341	57,517
Total concentrations of funding by geographical location	**3,643,976**	**3,091,287**
Concentrations of funding by product		
Redeemable shares	2,732,581	2,487,345
Deposits from customers	212,733	215,650
Commercial paper	259,017	198,692
Due to other financial institutions	400,521	150,471
Subordinated redeemable shares	39,124	39,129
Total concentrations of funding by product	**3,643,976**	**3,091,287**
(b) Subordinated redeemable shares		
SBS Premier Bond	**39,124**	**39,129**

The SBS Premier Bond are five-year fixed rate bonds issued continuously as subordinated redeemable shares. These rank behind redeemable shareholders, depositors (including commercial paper) and other unsecured creditors of SBS and are subject to loss absorption provisions.

At 31 March 2017 $16.79 million of subordinated redeemable shares qualify as lower tier 2 capital for Reserve Bank of New Zealand capital adequacy purposes (31 March 2016 $22.39 million). This is after adjustments for potential tax and other offsets.

Notes to the Financial Statements for the year ended 31 March 2017 All in $000's

15. Funding continued

Funding sources consist of redeemable shares, deposits from customers, commercial paper, amounts due to other financial institutions and subordinated redeemable shares.

Redeemable shares and subordinated redeemable shares are recorded in the statement of financial position inclusive of accrued interest. Redeemable shares and subordinated redeemable shares are considered to be compound instruments. Dividends on redeemable shares and subordinated redeemable shares are recorded in the income statement on an accruals basis using the effective interest method.

Deposits from customers, commercial paper and amounts due to other financial institutions are recorded in the statement of financial position inclusive of accrued interest. Interest expense on deposits from customers, commercial paper and amounts due to other financial institutions are recorded in the income statement on an accruals basis using the effective interest method.

The fair value of demand deposits and shares is the amount payable on demand at the reporting date. For other liabilities with maturities of less than three months, the carrying amount is a reasonable estimate of fair value. For liabilities with maturities of three months or longer, fair values are based on quoted market prices, where such process exist. Otherwise, fair values are estimated using the discounted cash flow approach by reference to rates currently offered for similar liabilities of similar remaining maturities.

Amounts due to other financial institutions are either short term in nature or reprice frequently and therefore the carrying amount is equivalent to fair value.

Refer to Note 20 - Fair Value of Financial Instruments for more information on fair value of financial instruments.

Repurchase agreements

Securities sold under repurchase agreements are retained in the financial statements when substantially all the risks and rewards of ownership remain with the Banking Group, and counterparty liability is disclosed under the classification of 'Due to other financial institutions' or 'Other liabilities', depending on the term of the agreement and the counterparty.

The difference between the sale price and the repurchase price is amortised over the life of the repurchase agreement and charged to interest expense in the income statement.

Ranking of securities

Redeemable shares, deposits (including commercial paper and amounts due to other financial institutions) and subordinated redeemable shares are unsecured. Deposits (including commercial paper and amounts due to other financial institutions) rank equally amongst themselves and equally with other unsecured creditors and behind creditors given priority by law. Redeemable shares rank equally amongst themselves and behind deposits (including commercial paper and amounts due to other financial institutions), unsecured creditors and those creditors given priority by law. Subordinated redeemable shares rank equally amongst themselves and behind redeemable shares, deposits (including commercial paper and amounts due to other financial institutions), unsecured creditors and those creditors given priority by law.

16. Contingent Liabilities and Credit Related Commitments

	Contract or notional amount	Credit equivalent	Contract or notional amount	Credit equivalent
	31/03/2017	31/03/2017	31/03/2016	31/03/2016
Commitments				
Commitments with uncertain drawdown	37,344	18,672	40,592	20,296
Commitments to extend credit which can be unconditionally cancelled	266,248	-	247,790	-
Total credit related commitments	**303,592**	**18,672**	**288,382**	**20,296**

There are no material contingent liabilities as at 31 March 2017.

Contingent liabilities are disclosed where there is a possible obligation that is higher than remote but where requirements for recognition as a liability are not met.

Liabilities are no longer contingent, and are recognised on the statement of financial position, when the following requirements are met:

- The transaction is probable in that a contingency is likely to occur; and
- The contingency can be reasonably estimated.

Notes to the Financial Statements for the year ended 31 March 2017 All in $000's

17. Lease Commitments

	31/03/2017	31/03/2016
Lease commitments payable after balance date:		
0-12 Months	2,529	2,290
12-24 Months	2,198	1,931
24-60 Months	3,634	3,231
>60 Months	2,482	528
	10,843	**7,980**

The Banking Group leases land and buildings under operating leases expiring from one to ten years. Leases generally provide the Banking Group with a right of renewal at which time all terms are renegotiated. There are no restrictions placed upon the lessee by entering into these leases.

Leases as lessee

The leases entered in to by the Banking Group are primarily operating leases. Operating leases are recognised as an expense on a systematic basis over the lease term.

Leases as lessor

Operating lease rentals are included in the income statement on a systematic basis over the lease term. Gross operating lease income comprises amounts received under the lease contracts. Operating lease assets are stated at market value and are included as property, plant and equipment.

18. Reconciliation of Net Surplus to Net Operating Cash Flows

	31/03/2017	31/03/2016
Net surplus for year	27,448	19,973
Add/(deduct) non cash items		
Depreciation and amortisation	3,740	3,982
Provision for credit impairment	10,764	13,212
Share of associates and joint ventures profit net of tax	(802)	(657)
Write off of property, plant and equipment	123	429
Actuarial life adjustment	28	697
Deferred fee revenue and expenses	(2,332)	(987)
Derivatives fair value adjustment	102	2
Investment securities fair value adjustment	11	(9)
Net deferred tax assets	382	(335)
	12,016	**16,334**
Deferral or accruals of past or future operating cash receipts or payments		
Change in income tax payable/receivable	1,685	13
Change in sundry debtors	(5,703)	(14,001)
Change in sundry creditors	5,702	9,958
Change in accruals relating to interest receivable	(343)	67
Change in accruals relating to accrued interest and dividends payable to customers	446	936
Change in accruals relating to accrued interest payable to financial institutions	(247)	471
Change in net advances	(547,104)	(488,377)
Change in shares and deposits	241,868	226,814
Change in commercial paper	60,325	134,053
Change in amounts due to other financial institutions	250,297	150,000
Change in subordinated redeemable shares	-	(1,901)
	6,926	**18,033**
Items classified as cash		
Change in accruals relating to funds with financial institutions	28	784
Net cash flows from operating activities	**46,418**	**55,124**

Notes to the Financial Statements for the year ended 31 March 2017 All in $000's

18. Reconciliation of Net Surplus to Net Operating Cash Flows continued

The statement of cash flows has been prepared using the direct approach modified by the netting of certain items as disclosed below.

Cash and cash equivalents

Cash and cash equivalents reflect the balance of cash and liquid assets used in the day to day cash management of the Banking Group, which are unconditionally convertible at the Banking Group's option within three months. These assets are short term in nature and the related carrying amount is equivalent to their fair value.

Netting of cash flows

Certain cash flows have been netted in order to provide more meaningful disclosure, as many of the cash flows are received and disbursed on behalf of customers and reflect the activities of the customers rather than those of the Banking Group. These include customer loans and advances, customer shares and deposits and parent company funding.

19. Accounting Classifications

The table below sets out the Banking Group's classification of each class of financial assets and liabilities.

As at 31 March 2017	Designated at Fair Value	Available for Sale	Loans and Receivables	Held to Maturity	Other Amortised Cost	Total Carrying Amount
Assets						
Cash on hand and at bank	-	-	50,823	-	-	**50,823**
Funds with financial institutions	-	49,938	-	-	-	**49,938**
Investment securities	1,197	416,343	-	-	-	**417,540**
Derivative financial instruments	4,501	-	-	-	-	**4,501**
Advances to customers	-	-	3,408,075	-	-	**3,408,075**
	5,698	466,281	3,458,898	-	-	**3,930,877**
Liabilities						
Redeemable shares	-	-	-	-	2,732,581	**2,732,581**
Deposits from customers	-	-	-	-	212,733	**212,733**
Commercial paper	-	-	-	-	259,017	**259,017**
Due to other financial institutions	-	-	-	-	400,521	**400,521**
Derivative financial instruments	26,512	-	-	-	-	**26,512**
Subordinated redeemable shares	-	-	-	-	39,124	**39,124**
	26,512	-	-	-	3,643,976	**3,670,488**

As at 31 March 2016	Designated at Fair Value	Available for Sale	Loans and Receivables	Held to Maturity	Other Amortised Cost	Total Carrying Amount
Assets						
Cash on hand and at bank	-	-	31,948	-	-	**31,948**
Funds with financial institutions	-	44,826	-	-	-	**44,826**
Investment securities	1,210	399,864	-	-	-	**401,074**
Derivative financial instruments	3,526	-	-	-	-	**3,526**
Advances to customers	-	-	2,868,850	-	-	**2,868,850**
	4,736	444,690	2,900,798	-	-	**3,350,224**
Liabilities						
Redeemable shares	-	-	-	-	2,487,345	**2,487,345**
Deposits from customers	-	-	-	-	215,650	**215,650**
Commercial paper	-	-	-	-	198,692	**198,692**
Due to other financial institutions	-	-	-	-	150,471	**150,471**
Derivative financial instruments	42,419	-	-	-	-	**42,419**
Subordinated redeemable shares	-	-	-	-	39,129	**39,129**
	42,419	-	-	-	3,091,287	**3,133,706**

19. Accounting Classifications continued

Financial instruments

The Banking Group classifies its financial instruments into the following categories at initial recognition: financial assets at fair value through profit or loss, available for sale financial assets, loans and receivables, held to maturity financial assets, financial liabilities at fair value through profit or loss, and other financial liabilities. Designation of financial assets and liabilities into instrument categories is determined by the business purpose of the financial instruments, policies and practices for their management, their relationship with other instruments and the reporting costs and benefits associated with each designation.

Financial assets at fair value through profit or loss

Financial assets at fair value through profit or loss are financial assets acquired principally for the purpose of selling in the short term (held for trading), financial assets designated as fair value through profit or loss, and derivative financial instruments which are not designated as a cash flow hedge.

The Banking Group may designate financial assets at fair value through profit or loss when doing so significantly reduces measurement or recognition inconsistencies (accounting mismatch) that would arise from measuring assets and liabilities or recognising the gains and losses on them on different bases.

Other financial assets may be classified at fair value through profit or loss where they are part of a group of financial assets that are managed and evaluated on a fair value basis in accordance with a documented risk management or investment strategy and reported to key management personnel on that basis.

Once a financial asset has been designated at fair value through profit or loss upon initial recognition, the Banking Group cannot subsequently change the designation. Financial assets at fair value through profit or loss are measured at fair value with realised and unrealised gains and losses included in the income statement. Assets classified in this category include certain investment securities and derivative financial assets.

Directly attributable transaction costs are recognised in profit or loss as incurred. Financial assets at fair value through profit or loss are measured at fair value and changes therein, including any interest or dividend income, are recognised in profit or loss.

Available for sale financial assets

Available for sale financial assets are non-derivative financial assets that are designated as available for sale. The Banking Group may designate financial assets as available for sale when they may be sold prior to maturity in response to needs for liquidity or due to changes in interest rates.

Available for sale financial assets are initially recognised at fair value plus transaction costs that are directly attributable to acquisition and are subsequently carried at fair value. Gains and losses (not attributable to accrued interest) arising from changes in the fair value of available-for-sale financial assets are recognised directly in equity, until the financial asset is derecognised or impaired. At this time, the cumulative gain or loss previously recognised in equity is recognised in the income statement. Assets classified in this category include certain funds with financial institutions and investment securities.

Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market, not available for sale, and not designated as fair value through profit or loss. Loans and receivables are initially recognised at fair value including direct and incremental transaction costs and are subsequently measured at amortised cost using the effective interest method, less any impairment loss.

Assets classified in this category include cash on hand and at bank, investment securities which are not managed on a fair value basis, advances to customers other than those classified at fair value through profit or loss, and loans to subsidiaries.

Held to maturity financial assets

Held to maturity financial assets are non-derivative financial assets where management has the intention and ability to hold to maturity. Held to maturity financial assets are initially recognised at fair value including direct and incremental transaction costs, and subsequently measured at amortised cost using the effective interest rate method. The Banking Group has not classified any financial assets as held to maturity.

Other financial liabilities

Other financial liabilities includes all financial liabilities other than those classified at fair value through profit or loss. Other financial liabilities are initially recognised at fair value including direct and incremental transaction costs, and subsequently measured at amortised cost. Liabilities classified in this category include redeemable shares, deposits from customers, commercial paper, due to other financial institutions and subordinated redeemable shares.

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20. Fair Value of Financial Instruments

Comparison of fair values and carrying amounts:

Carrying values and the fair values of those assets and liabilities that are not presented at fair value in the statement of financial position or where carrying value is not a reasonable approximation of fair value are outlined below:

	31/03/2017		31/03/2016	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Financial assets				
Advances to customers	3,408,075	3,391,025	2,868,850	2,878,715
Total financial assets	**3,408,075**	**3,391,025**	**2,868,850**	**2,878,715**
Financial liabilities				
Redeemable shares	2,732,581	2,737,331	2,487,345	2,504,672
Deposits from customers	212,733	213,059	215,650	217,080
Subordinated redeemable shares	39,124	43,393	39,129	45,600
Total financial liabilities	**2,984,438**	**2,993,783**	**2,742,124**	**2,767,352**

Fair value measurement

The determination of fair values of financial assets and financial liabilities are based on quoted market prices or dealer price quotations for financial instruments traded in active markets, or by using valuation techniques. When entering into a transaction, the financial instrument is recognised initially at the transaction price, which is the best indicator of fair value and subsequently at valuation.

Valuation techniques include the discounted cash flow method and comparison to similar instruments for which market observable prices exist. The Banking Group uses widely recognised valuation models however some or all of the inputs into these models may not be market observable, and are derived from market prices or rates or are estimated based on assumptions.

The value produced by a model or other valuation technique is adjusted to allow for a number of factors as appropriate, because valuation techniques may not appropriately reflect all factors market participants take into account when entering a transaction. Valuation adjustments are recorded to allow for liquidity and credit risks as well as other factors. Management believes that these valuation adjustments are necessary and appropriate to fairly state financial instruments at fair value on the statement of financial position.

Financial assets and liabilities that are recognised and measured at fair value on a recurring basis are categorised below:

As at 31 March 2017	Level 1	Level 2	Level 3	Total
Financial assets				
Derivative financial instruments	-	4,501	-	4,501
Funds with financial institutions	45,920	4,018	-	49,938
Investment securities	1,652	415,888	-	417,540
Total financial assets	**47,572**	**424,407**	**-**	**471,979**
Financial liabilities				
Derivative financial instruments	-	26,512	-	26,512
Total financial liabilities	**-**	**26,512**	**-**	**26,512**

As at 31 March 2016	Level 1	Level 2	Level 3	Total
Financial assets				
Derivative financial instruments	-	3,526	-	3,526
Funds with financial institutions	40,031	4,795	-	44,826
Investment securities	2,120	398,954	-	401,074
Total financial assets	**42,151**	**407,275**	**-**	**449,426**
Financial liabilities				
Derivative financial instruments	-	42,419	-	42,419
Total financial liabilities	**-**	**42,419**	**-**	**42,419**

There were no transfers in or out of level 3, or between levels 1 and 2 during the year.

20. Fair Value of Financial Instruments continued

Valuation hierarchy for financial instruments held at fair value:

The Banking Group uses valuation techniques within the following hierarchy for determining the fair value of financial instruments:

Level 1: Fair values are determined using quoted (unadjusted) prices in active markets for identical assets and liabilities;

Level 2: Fair values are determined using other techniques where all inputs which have a significant effect on the recorded fair value are observable, either directly or indirectly; and

Level 3: Fair values are determined using techniques that use inputs which have a significant effect on the recorded fair value and are not based on observable market data.

21. 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 as outlined below. In addition SBS has specific policies in relation to liquidity and capital management which contain trigger points at which Board involvement is required.

Audit and Risk Committee

The Audit and Risk Committee is a sub committee of the Board and has the responsibility of:

- overseeing the quality of financial information presented to the Board;
- the effectiveness and integrity of the internal control environment;
- SBS's compliance with regulatory requirements that impact on the business; and
- the external and internal audit functions.

The committee consists of four directors. In addition the Chief Executive Officer, Chief Financial Officer and Chief Risk Officer are in attendance at meetings. The Audit and Risk Committee meets at least four times a year, and reports directly to the Board.

Lending Committee

The Lending Committee is a sub committee of the Board and has the responsibility of reviewing and approving all lending proposals in excess of $5 million. The committee is made up of the full Board with senior management in attendance as requested.

IT Committee

The IT Committee has responsibility for monitoring and reviewing exposure to the risks associated with IT, including data security, disaster recovery and business continuity. It also has responsibility for formulating and developing the Banking Group's IT strategy including monitoring and reviewing the impacts resulting from change in the regulatory, business and economic environment and evaluating business cases for technology projects requiring significant investment.

The IT Committee consists of two directors. In addition the Chief Executive Officer, Chief Risk Officer and the Chief Digital & IT Officer are in attendance at meetings. The IT Committee meets quarterly and reports directly to the Board.

Asset and Liability Committee (ALCO)

The ALCO has responsibility for the assessment of exposure to treasury counterparty, credit, market, liquidity and interest rate risk. This includes:

- reviewing SBS past performance with respect to asset and liability growth, yields, cost of funds, interest rate risk management and net interest margin;
- monitoring the interest rate risk position, liquidity, maturity, funding and credit position, financial investments portfolio, and financial performance;
- reviewing the current and recommended future hedging positions and risk profiles within risk control limits;
- monitoring interest rate pricing levels and interest margin levels for all assets and funding products;
- considering and evaluating the sensitivity of particular asset and liability classes to changes in market interest rates and yield curve shape;
- reviewing the liquidity position, investment and funding activity and making recommendations on future action;
- reviewing the funding strategy and funding risk mitigation;
- considering the level of capital employed, capital adequacy levels and the risk weighting of statement of financial position items;
- reviewing wholesale counterparty credit exposures; and
- monitoring SBS's credit risk position and trends.

21. Risk Management Policies continued

The ALCO is made up of members of the senior management team and treasury function. The ALCO usually meets at least twice a month and reports directly to the Board.

Credit Risk Committee (CRC)

The CRC has responsibility for monitoring and reviewing exposure to credit risks in SBS's lending portfolios. This includes:

- monitoring maximum exposure to individual counterparties;
- reviewing the analysis and reporting of individual watch list and impaired loans;
- review and approval of specific provisioning against impaired loans; and
- monitoring the performance of lending portfolios in relation to excesses and past dues, industry and geographic concentrations.

The CRC is made up of members of the senior management team and credit risk management function. The CRC usually meets quarterly and reports to the Board.

Operational Risk Committee (ORC)

The ORC has responsibility for monitoring and reviewing exposure to operational risks arising from SBS's day to day activities. This includes:

- regular measurement, monitoring and reporting of operational risk;
- ensuring appropriate strategies are in place to manage and mitigate operational risks; and
- monitoring compliance with legislative and regulatory obligations.

The ORC is made up of members of the senior management team and the risk and compliance functions. The ORC usually meets quarterly and reports to the Board.

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 no reporting line to SBS management. The function reports directly to the chairperson of the Audit and Risk Committee. The internal audit function has been carried out by the Dunedin based firm of Chartered Accountants, Deloitte. In performing this role, the internal audit function adopts a risk-based approach, encompassing reviews of the major risks that could impact upon SBS. Significant findings are reported quarterly to the Audit and Risk Committee.

An audit plan is prepared annually covering each business area of SBS, with greater emphasis placed on those areas with perceived higher risk. The plan is endorsed by the Audit and Risk Committee.

Specialist Support Functions

Primary responsibility for the identification, control and mitigation of risk rests with each business unit. Oversight and governance are provided through specialist support functions including Risk, Support, Finance and Treasury. The role of these functional specialists is to maintain and review policies, establish limits which are consistent with the Board's risk appetite, monitor and report on compliance with those limits and generally to provide an oversight role in relation to the management of risk.

Specific areas of risk management

Liquidity Risk Management

Liquidity risk is the risk that under certain conditions, cash outflows can exceed cash inflows in a given period. Further information on the Banking Group's liquidity risk management is set out in Note 22 - Liquidity Risk.

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. Further information on the Banking Group's credit risk management is set out in Note 23 - Credit Risk.

Interest Rate Risk Management

Interest rate risk is the risk of loss arising from adverse changes in interest rates. Further information on the Banking Group's interest rate risk management is set out in Note 24 - Market Risk.

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.

Notes to the Financial Statements for the year ended 31 March 2017 All in $000's

22. Liquidity Risk

Liquidity risk is the risk that the Banking Group will encounter difficulty in meeting commitments associated with its financial liabilities, e.g. overnight deposits, current accounts, maturing deposits, and future commitments such as loan draw-downs and guarantees.

The Banking Group has a Board approved liquidity 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.

The Banking Group is subject to the RBNZ's liquidity requirements as set out in the RBNZ's "Liquidity Policy" (BS13/BS13A).

Consistent with the requirements of the RBNZ's Liquidity Policy, liquidity risk is managed in the Banking Group on a cash flow mismatch and also core funding basis to ensure that the Banking Group exceeds RBNZ specified minimum standards for those metrics. This information is measured daily and reported to the Board monthly.

To meet both expected and unexpected patterns in operating cash flows the Banking Group maintains a stock of core liquid assets to adequately meet day-to-day operational requirements, a potential crisis, or 'funding stress' scenario.

Total liquidity includes committed but undrawn funding lines. As at 31 March 2017, the Banking Group had total committed funding lines with other registered banks of $430.0 million (31 March 2016 $230.0 million). Of these facilities, $400.0 million were drawn down at 31 March 2017 (31 March 2016 $150.0 million).

The Banking Group also has an in-house residential mortgage backed security (RMBS) facility (the SBS Oreti Trust No. 2) that issues securities which can be used as collateral for borrowing from the RBNZ under its liquidity management arrangements. Whilst not intended to be used for standard daily liquidity requirements, this facility is available as contingent funding and accordingly core liquid assets includes this RMBS. The eligible RMBS collateral is discounted for the 'haircut'[1] that applies to those securities under the RBNZ's Domestic Operations for the purposes of those operations.

	31/03/2017	31/03/2016
Core liquid assets		
Cash on hand and at bank	50,823	31,948
Funds with financial institutions	49,938	44,826
Investment securities	417,540	401,074
Committed and undrawn funding lines	30,000	80,000
Eligible RMBS collateral (less haircut[1])	151,077	99,312
Total liquidity	**699,378**	**657,160**

[1] 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.

The maturity profiles of assets and liabilities and loan commitments show the cash flows and have been prepared on both a contractual and undiscounted maturity basis as at balance date. These have been created using a run-off scenario which assumes no further origination of assets or liabilities.

The maturity profiles reflect the remaining period to contractual maturity of assets and liabilities as at balance date. This is not considered by the Banking Group to be in any way indicative of future cash flows. This is primarily because a significant proportion of the Banking Group's redeemable shares and deposits are renewed at maturity and therefore do not have a cash flow impact. Historical experience has shown that such balances are a stable source of funding for the Banking Group. The maturity profile has also been prepared on the basis of the agreed terms of the advance with the customer. However, some SBS mortgages include a term giving SBS the ability to call mortgage advances which are repayable on demand, or repayable on three months notice of demand, at the Banking Group's discretion. While the Banking Group is not likely to call advances on demand the contractual maturity date is not indicative of future cash flows due to early repayments, further drawdowns and principal reductions.

The maturity profiles include interest cash flows expected to maturity. Note that the resulting undiscounted financial assets and liabilities do not reflect how the Banking Group manages its liquidity risk. As set out above, the Banking Group manages liquidity through the maintenance of a portfolio of liquid assets and committed funding lines and as such no expected maturity profile is presented.

Notes to the Financial Statements for the year ended 31 March 2017 All in $000's

22. Liquidity Risk continued

Monetary assets receivable matched against liabilities payable (contractual cash flows including expected interest to maturity)

As at 31 March 2017	On demand	0-6 Months	6-12 Months	12-24 Months	24-60 Months	> 60 Months	Total
Assets							
Cash on hand and at bank	50,823	-	-	-	-	-	**50,823**
Funds with financial institutions	2,918	45,791	250	727	252	-	**49,938**
Investment securities	1,652	64,993	48,819	59,236	204,011	38,829	**417,540**
Advances to customers	68,641	89,388	60,062	122,998	403,595	2,663,391	**3,408,075**
Other assets	22,467	-	-	-	-	-	**22,467**
Total assets	**146,501**	**200,172**	**109,131**	**182,961**	**607,858**	**2,702,220**	**3,948,843**
Interest	2,052	125,711	118,767	230,175	599,375	1,030,958	**2,107,038**
Total assets (inclusive of interest)	**148,553**	**325,883**	**227,898**	**413,136**	**1,207,233**	**3,733,178**	**6,055,881**
Liabilities							
Redeemable shares	464,612	1,384,074	740,768	118,692	24,435	-	**2,732,581**
Deposits from customers	18,236	105,001	81,554	6,891	1,051	-	**212,733**
Commercial paper	-	259,017	-	-	-	-	**259,017**
Due to other financial institutions	-	-	-	400,521	-	-	**400,521**
Current tax liabilities	1,719	-	-	-	-	-	**1,719**
Other liabilities	33,214	-	-	-	-	-	**33,214**
Subordinated redeemable shares	-	-	-	-	39,124	-	**39,124**
Total liabilities	**517,781**	**1,748,092**	**822,322**	**526,104**	**64,610**	**-**	**3,678,909**
Interest	137	20,580	26,140	15,562	8,979	-	**71,398**
Total liabilities (inclusive of interest)	**517,918**	**1,768,672**	**848,462**	**541,666**	**73,589**	**-**	**3,750,307**
Derivatives							
Net derivative cash flows	-	(9,059)	(5,479)	(6,074)	(3,912)	(152)	**(24,676)**
Unrecognised loan commitments	37,344	-	-	-	-	-	**37,344**

Notes to the Financial Statements for the year ended 31 March 2017 All in $000's

22. Liquidity Risk continued

As at 31 March 2016	On demand	0-6 Months	6-12 Months	12-24 Months	24-60 Months	> 60 Months	Total
Assets							
Cash on hand and at bank	31,948	-	-	-	-	-	**31,948**
Funds with financial institutions	40,032	3,296	518	257	723	-	**44,826**
Investment securities	2,120	34,538	38,121	84,129	208,131	34,035	**401,074**
Advances to customers	65,507	52,198	70,230	101,240	334,276	2,245,399	**2,868,850**
Other assets	16,764	-	-	-	-	-	**16,764**
Total assets	**156,371**	**90,032**	**108,869**	**185,626**	**543,130**	**2,279,434**	**3,363,462**
Interest	1,655	110,804	95,154	211,863	542,444	867,068	**1,828,988**
Total assets (inclusive of interest)	**158,026**	**200,836**	**204,023**	**397,489**	**1,085,574**	**3,146,502**	**5,192,450**
Liabilities							
Redeemable shares	482,450	1,120,821	675,454	163,178	45,442	-	**2,487,345**
Deposits from customers	23,285	114,548	67,763	5,560	4,494	-	**215,650**
Commercial paper	-	198,692	-	-	-	-	**198,692**
Due to other financial institutions	-	-	-	-	150,471	-	**150,471**
Current tax liabilities	34	-	-	-	-	-	**34**
Other liabilities	34,193	-	-	-	-	-	**34,193**
Subordinated redeemable shares	-	-	-	-	39,129	-	**39,129**
Total liabilities	**539,962**	**1,434,061**	**743,217**	**168,738**	**239,536**	**-**	**3,125,514**
Interest	44	16,009	12,915	25,052	19,718	-	**73,738**
Total liabilities (inclusive of interest)	**540,006**	**1,450,070**	**756,132**	**193,790**	**259,254**	**-**	**3,199,252**
Derivatives							
Net derivative cash flows	-	(8,871)	(9,811)	(12,669)	(9,456)	(233)	**(41,040)**
Unrecognised loan commitments	40,592	-	-	-	-	-	**40,592**

Notes to the Financial Statements for the year ended 31 March 2017 All in $000's

23. Credit Risk

The nature of SBS's activities as a financial intermediary necessitates SBS dealing in financial instruments that contain an inherent element of credit risk. Credit exposure means the amount of the maximum loss that SBS could incur as a result of the counterparty to a contract failing to discharge its obligations, without taking into account the value of collateral, guarantees, indemnities, other support arrangements and any potential recoveries. SBS's activities are conducted within the bounds of prudent and conservative banking practice.

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.

The Banking Group's dominant activity is the provision of residential mortgage finance which comprises 79% (31 March 2016 77%) of the Banking Group's loan portfolio and is undertaken throughout New Zealand. Rural loans which comprise 7% (31 March 2016 9%) of the Banking Group's loan portfolio are predominantly concentrated in the Southland/Otago region.

	31/03/2017	31/03/2016
(a) The maximum exposures to credit risk at the relevant reporting dates are:		
Cash on hand and at bank	50,823	31,948
Funds with financial institutions	49,938	44,826
Investment securities	417,540	401,074
Derivative financial instruments	4,501	3,526
Advances to customers	3,408,075	2,868,850
Other assets	22,467	16,764
Total on-balance sheet credit exposures	**3,953,344**	**3,366,988**
(b) Concentrations of credit risk by sector		
Residential	1,965,320	1,676,314
Residential investing	715,789	534,260
Agricultural	239,716	255,699
Commercial finance	12,092	5,773
Commercial other	130,123	140,120
Consumer lending	345,035	256,684
Local authority	58,500	38,568
Corporate investments	464,302	442,806
Other	22,467	16,764
Total concentrations of credit risk by sector	**3,953,344**	**3,366,988**
(c) Concentrations of credit risk by geographical location		
North Island other	775,069	670,169
Auckland	1,128,856	821,365
Canterbury	703,713	617,559
Otago	549,103	507,437
Southland	535,636	519,688
South Island other	240,636	230,770
Overseas	20,331	-
Total concentrations of credit risk by geographical location	**3,953,344**	**3,366,988**

Notes to the Financial Statements for the year ended 31 March 2017 All in $000's

23. Credit Risk continued

(d) Credit exposures to individual counterparties and groups of closely related counterparties

The Banking Group's disclosure of concentrations of credit exposure to individual counterparties and groups of closely related counterparties, which equalled or exceeded 10% of the Banking Group's equity, is based on actual credit exposures and calculated on a gross basis (net of specific provisions). Credit exposures to the central government of any country with a long term credit rating of A- or A3 or above, or its equivalent, banks with a long term credit rating of A- or A3 or above, or its equivalent, and connected persons are excluded. Peak end of day credit exposures to individual counterparties are calculated over the last quarter using the Banking Group's end of period equity.

	As at 31 March 2017			As at 31 March 2016		
End of Period Exposure	**Number of Non Bank Counterparties**			**Number of Non Bank Counterparties**		
Percentage of equity	"A" Rated	"B" Rated	Total	"A" Rated	"B" Rated	Total
10%-14%	2	-	**2**	3	-	**3**
15%-19%	-	-	**-**	-	-	**-**
20%-24%	-	-	**-**	-	-	**-**
Total	**2**	**-**	**2**	**3**	**-**	**3**

Peak Exposure						
Percentage of equity	"A" Rated	"B" Rated	Total	"A" Rated	"B" Rated	Total
10%-14%	2	-	**2**	4	-	**4**
15%-19%	-	-	**-**	-	-	**-**
20%-24%	-	-	**-**	-	-	**-**
Total	**2**	**-**	**2**	**4**	**-**	**4**

Note:

"A" Rated - those counterparties that have a long term credit rating of A- or A3 or above

"B" Rated - those counterparties that have a long term credit rating of at least BBB- or Baa3, or its equivalent, and at most BBB+ or Baa1, or its equivalent

There were no peak or balance date credit exposures to bank counterparties with a credit rating below A- or A3, or its equivalent, which exceeded 10% of the Banking Group's equity for the three months ended 31 March 2017.

(e) Credit exposures to connected persons

Credit exposure concentrations are disclosed on the basis of actual credit exposures and calculated on a gross basis (net of individual credit impairment allowances and excluding advances of a capital nature) in accordance with the bank's conditions of registration and the RBNZ's "Connected Exposure Policy" (BS8). The Banking Group does not have credit exposures to connected persons other than non-bank connected persons. Peak end of day credit exposures to non-bank connected persons have been calculated using the Banking Group's tier 1 capital at the end of the period. The rating-contingent limit, which is applicable to the Banking Group, based on the conditions of registration imposed by the RBNZ is 15%. There have been no rating-contingent limit changes during the last year. Within the rating-contingent limit there is a sub-limit of 15%, which applies to non-bank connected persons. All limits on aggregate credit exposure to all connected persons and non-bank connected persons in the Banking Group's conditions of registration have been complied with at all times over the last year. There are no individual credit impairment allowances against credit exposures to non-bank connected persons as at 31 March 2017 (31 March 2016 $nil).

	31/03/2017	**31/03/2016**
Credit exposures to non-bank connected persons at year end	1,170	2,921
Credit exposures to non-bank connected persons at period end expressed as a % of total tier 1 capital	0.44%	1.19%
Peak credit exposures to non-bank connected persons during the quarter	1,423	2,924
Peak credit exposures to non-bank connected persons during the quarter expressed as a % of total tier 1 capital	0.54%	1.19%

Notes to the Financial Statements for the year ended 31 March 2017 All in $000's

23. Credit Risk continued

(f) Collateral held

SBS takes collateral where it is considered necessary to support credit risk on financial instruments including both recognised and unrecognised financial instruments. An evaluation is undertaken of the customer's credit risk on a case by case basis and the amount of collateral taken if deemed necessary, is based on management's credit evaluation of the counterparty. The collateral taken varies but could include cash deposits, mortgages, debentures, investments and financial covenants.

In terms of SBS retail lending activity, credit is extended within predetermined loan to security valuation ratios, which vary depending on the class of an advance, and within established and proven repayment to income ratios. Independent credit evaluations are undertaken where this is deemed necessary. Additionally some advances are insured with an independent third party mortgage insurer. In excess of 90% of SBS advances are secured by first mortgage over real property as a minimum. Once established, loan performance is monitored regularly. The debt management team monitor exposures to non-performing loans on a daily basis and provide monthly reports to senior management and the Board.

Estimates of fair value are based on the value of collateral assessed at the time of borrowing, and generally are not updated except when a loan is individually assessed as impaired.

An estimate of the fair value of collateral and other security enhancements held against financial assets that are individually impaired or past due are shown below:

	31/03/2017	31/03/2016
Against individually impaired property	8,095	9,415
Against past due but not impaired property	66,091	101,958
	74,186	**111,373**

24. Market Risk

Market risk is the risk that changes in market prices, such as interest rate, and credit spreads will affect the Banking Group's income or the value of its holdings of financial instruments. The objective of market risk management is to manage and control market risk exposures within acceptable parameters, while optimising the return on risk.

The Banking Group's exposure to market risk is governed by a policy approved by the Audit and Risk Committee and managed by the Asset and Liability Committee (ALCO). This policy sets out the nature of risk which may be taken and aggregate risk limits, and the ALCO must conform with this. The objective of the ALCO is to derive the most appropriate strategy for the Banking Group in terms of the mix of assets and liabilities given its expectations of the future and the potential consequences of interest rate movements, liquidity constraints and capital adequacy.

The Banking Group's exposure to market risk is managed operationally by Treasury. Treasury manages market risk by using appropriate risk management instruments. Market risk is managed within a clearly defined framework of policy limits. Treasury reports to and is represented on the ALCO.

Market risk is measured and reported using a variety of techniques, according to the appropriateness of the technique to the exposure concerned. The techniques used include interest rate gap analysis, scenario analysis and Value at Risk (VaR).

The Banking Group is not exposed to currency risk as it does not hold any financial instruments whose value is directly linked to changes in foreign exchange rates.

Policies for managing interest rate risk

Interest rate risk is the risk of loss to the Banking Group arising from adverse changes in interest rates. The Banking Group is exposed to interest rate risk in respect of the following activities: borrowing from and lending to customers, investing in physical money market instruments as well as derivatives such as interest rate contracts used for risk management purposes. Changes in interest rates can impact the Banking Group's financial results by affecting the spread earned on interest earning assets and interest paying liabilities and impacting on the market value of other financial instruments held.

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. The Banking Group undertakes 100% of its transactions in interest rate contracts with other financial institutions. Management has established limits such that, at any time, less than 60% of equity is at risk with any individual counterparty.

Exposure to interest rate risk is measured primarily through the analysis of repricing maturities of the Banking Group's assets, liabilities and unrecognised financial instruments. Exposure to interest rate risk is also measured, managed and monitored using VaR, scenario analysis (to a 1% shock) and interest rate sensitivity gap. Exposures are monitored continuously and reported to the Board on a monthly basis.

Effective interest rates on risk management transactions within classes of financial assets or liabilities are disclosed exclusive of the impact of the derivative transaction. The financial assets or liabilities carrying values do not incorporate the values of the derivative transactions.

The interest rate repricing schedule reflects statement of financial position financial assets and liabilities and has been prepared on the basis of the next repricing date.

Notes to the Financial Statements for the year ended 31 March 2017 All in $000's

24. Market Risk continued

The following schedule details the Banking Group's interest rate repricing profile:

As at 31 March 2017	Less than 3 Months	3-6 Months	6-12 Months	12-24 Months	>24 Months	Non-Interest Sensitive	Total
Assets							
Cash on hand and at bank	50,823	-	-	-	-	-	**50,823**
Funds with financial institutions	47,187	1,522	250	727	252	-	**49,938**
Investment securities	115,057	27,134	43,810	44,665	186,874	-	**417,540**
Derivative financial instruments	-	-	-	-	-	4,501	**4,501**
Advances to customers	962,783	217,465	497,179	909,950	820,698	-	**3,408,075**
Other assets	-	-	-	-	-	63,535	**63,535**
	1,175,850	**246,121**	**541,239**	**955,342**	**1,007,824**	**68,036**	**3,994,412**
Liabilities and equity							
Redeemable shares	1,068,036	780,650	740,768	118,692	24,435	-	**2,732,581**
Deposits from customers	89,847	33,390	81,554	6,891	1,051	-	**212,733**
Commercial paper	229,215	29,802	-	-	-	-	**259,017**
Due to other financial institutions	400,521	-	-	-	-	-	**400,521**
Derivative financial instruments	-	-	-	-	-	26,512	**26,512**
Current tax liabilities	-	-	-	-	-	1,719	**1,719**
Other liabilities	-	-	-	-	-	47,287	**47,287**
Subordinated redeemable shares	-	-	-	-	39,124	-	**39,124**
Equity	-	-	-	-	-	274,918	**274,918**
	1,787,619	**843,842**	**822,322**	**125,583**	**64,610**	**350,436**	**3,994,412**
On-balance sheet interest sensitivity gap	(611,769)	(597,721)	(281,083)	829,759	943,214	(282,400)	**-**
Net balance of derivative financial instruments	1,418,200	278,000	(287,200)	(802,900)	(606,100)	-	**-**
Total interest rate sensitivity gap	**806,431**	**(319,721)**	**(568,283)**	**26,859**	**337,114**	**(282,400)**	**-**

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24. Market Risk continued

As at 31 March 2016	Less than 3 Months	3-6 Months	6-12 Months	12-24 Months	>24 Months	Non-Interest Sensitive	Total
Assets							
Cash on hand and at bank	31,948	-	-	-	-	-	**31,948**
Funds with financial institutions	42,568	760	518	257	723	-	**44,826**
Investment securities	110,492	15,328	38,121	60,744	176,389	-	**401,074**
Derivative financial instruments	-	-	-	-	-	3,526	**3,526**
Advances to customers	810,189	133,354	497,503	648,378	779,426	-	**2,868,850**
Other assets	-	-	-	-	-	61,951	**61,951**
	995,197	**149,442**	**536,142**	**709,379**	**956,538**	**65,477**	**3,412,175**
Liabilities and equity							
Redeemable shares	1,042,979	560,291	675,454	163,178	45,443	-	**2,487,345**
Deposits from customers	58,741	79,092	67,763	5,560	4,494	-	**215,650**
Commercial paper	149,228	49,464	-	-	-	-	**198,692**
Due to other financial institutions	150,471	-	-	-	-	-	**150,471**
Derivative financial instruments	-	-	-	-	-	42,419	**42,419**
Current tax liabilities	-	-	-	-	-	34	**34**
Other liabilities	-	-	-	-	-	38,475	**38,475**
Subordinated redeemable shares	-	-	-	-	39,129	-	**39,129**
Equity	-	-	-	-	-	239,960	**239,960**
	1,401,419	**688,847**	**743,217**	**168,738**	**89,066**	**320,888**	**3,412,175**
On-balance sheet interest sensitivity gap	(406,222)	(539,405)	(207,075)	540,641	867,472	(255,411)	**-**
Net balance of derivative financial instruments	1,526,700	(63,750)	(296,750)	(553,700)	(612,500)	-	**-**
Total interest rate sensitivity gap	**1,120,478**	**(603,155)**	**(503,825)**	**(13,059)**	**254,972**	**(255,411)**	**-**

The management of interest rate risk against interest rate gap limits is supplemented by monitoring the sensitivity of the Banking Group's financial assets and liabilities to various standard interest rate scenarios. The Banking Group's market risk model determines the mismatch between assets and liabilities after taking derivatives into account. The present value of the mismatched cash flows are discounted using the current yield curve at period end and the assessed most probable scenarios as well as a 100 basis point (bp) parallel rise or fall in the New Zealand yield curve. The difference in the present value of the scenario and the present value of the current yield curve are identified for each of the scenarios. Differences between equity and profit and loss are a result of interest rate derivatives designated in cash flow relationships which have most of the fair value movements in the derivatives taken directly to the cash flow hedge reserve in equity. An analysis of the Banking Group's sensitivity to an increase or decrease in market interest rates is as follows:

	31/03/2017	31/03/2016
Impact on equity of increase or decrease to market interest rates		
100 bp parallel increase	22,220	20,735
100 bp parallel decrease	(23,054)	(22,256)
Impact on profit and loss of increase or decrease to market interest rates		
100 bp parallel increase	(7)	(1)
100 bp parallel decrease	7	2

25. 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.

For regulatory purposes, capital comprises two elements, eligible tier 1 and tier 2 capital, from which certain deductions are made to arrive at regulatory tier 1 and tier 2 capital as documented in the RBNZ's "Capital Adequacy Framework (Standardised Approach)" document (BS2A). Tier 1 capital is divided into two levels. Common equity tier 1 capital consists of retained profits, revenue and similar reserves, less intangible assets, deferred tax assets, cash flow hedge reserve and certain other deductions. Additional tier 1 capital consists of eligible non-controlling interests net of certain deductions. Tier 2 capital includes term subordinated debt and the property, plant and equipment revaluation reserve. The tangible element of investments in subsidiaries that are not wholly owned or funded is deducted from the sum of tier one and tier two capital to arrive at total regulatory capital.

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 "standardised approach" as per BS2A 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.

The Board of Directors has ultimate responsibility for capital adequacy, approves capital policy and establishes minimum internal capital levels and limits. These are typically higher than the regulatory minimum.

The capital adequacy calculations summarise the composition of regulatory capital and capital adequacy ratios. For the purposes of calculating the capital adequacy ratios for the Registered Bank, wholly-owned and wholly-funded subsidiaries of the Banking Group are consolidated with the Registered Bank. In this context, wholly funded by the Registered Bank means that there are no liabilities (including off-balance sheet obligations) to anyone other than the Registered Bank, Inland Revenue, and trade creditors, where aggregate exposure to trade creditors does not exceed 5% of the subsidiary's equity. Wholly owned means that all the equity issued by the subsidiary is held by the Registered Bank.

During the periods shown the Banking Group fully complied with all RBNZ capital requirements as set out in the relevant Banking Group's Conditions of Registration.

Notes to the Financial Statements for the year ended 31 March 2017 All in $000's 49

25. Capital Adequacy continued

Regulatory capital ratios (unaudited)	Minimum ratio required	BANKING GROUP 31/03/2017	BANKING GROUP 31/03/2016	REGISTERED BANK 31/03/2017	REGISTERED BANK 31/03/2016
Common equity tier 1 capital ratio	4.50%	11.58%	12.41%	10.74%	12.37%
Tier 1 capital ratio	6.00%	11.74%	12.50%	10.74%	12.37%
Total capital ratio	8.00%	12.56%	13.76%	11.64%	12.20%
Buffer ratio	2.50%	4.56%	5.76%		

(i) Qualifying capital (unaudited)	BANKING GROUP 31/03/2017	BANKING GROUP 31/03/2016
Tier 1 capital		
Common equity tier 1 (CET1) capital		
Retained earnings	253,313	238,221
Current year's retained earnings	26,906	18,603
Acquisition of non-controlling interests	-	(3,748)
Non-controlling interests present value adjustment	(3,083)	237
Available for sale assets reserve	3,856	5,768
Cash flow hedging reserve	(12,752)	(25,242)
Less deductions from CET1 capital		
Goodwill & intangible assets	(6,918)	(4,618)
Deferred tax assets	(6,666)	(10,898)
Cash flow hedging reserve	12,752	25,242
Investments in associates and joint ventures	(6,771)	-
Total CET1 capital	**260,637**	**243,565**
Additional tier 1 (AT1) capital		
Non-controlling interests (net of deductions and surplus AT1 capital)	3,549	1,738
Total AT1 capital	3,549	1,738
Total tier 1 capital	**264,186**	**245,303**
Tier 2 capital		
Revaluation reserves	1,732	2,384
Subordinated redeemable shares	16,791	22,388
Total tier 2 capital	**18,523**	**24,772**
Total capital	**282,709**	**270,075**

At 31 March 2017 the balance of subordinated redeemable shares issued was $38.9 million. After adjustments for potential tax or other offsets, $16.79 million (31 March 2016 $22.39 million) has been recognised as tier 2 capital for RBNZ capital adequacy purposes.

Notes to the Financial Statements for the year ended 31 March 2017 All in $000's

25. Capital Adequacy continued

(ii) Total risk weighted assets

As at 31 March 2017 (unaudited)	Total exposure after credit risk mitigation	Risk weighting	Risk weighted exposure	Minimum pillar one capital requirement
On balance sheet credit exposures				
Cash	477	0%	-	-
Multilateral development banks	20,130	0%	-	-
Public sector entities	58,500	20%	11,700	936
Banks	278,616	20%	55,723	4,458
Banks	16,249	50%	8,125	650
Corporates				
Rating grade 1	42,127	20%	8,425	674
Rating grade 2	86,860	50%	43,430	3,474
Rating grade 3 - 4	13,691	100%	13,691	1,095
Rating grade 5	316	150%	474	38
Residential mortgages				
<= 80% loan to value ratio (LVR)	1,420,223	35%	497,078	39,766
80 <= 90% LVR	52,398	50%	26,199	2,096
90 <= 100% LVR	2,187	75%	1,640	131
Past due	990	100%	990	79
Impaired	533	100%	533	43
Property investment residential mortgage				
< = 80% LVR	842,011	40%	336,804	26,944
80 <= 90% LVR	11,609	70%	8,126	650
90 <= 100% LVR	977	90%	879	70
Residential mortgages welcome home loans				
<= 90% LVR	222,038	35%	77,713	6,217
90 <= 100% LVR	62,352	50%	31,176	2,494
Reverse residential mortgage loans				
<= 60%	55,166	50%	27,583	2,207
60 <= 80%	9,815	80%	7,852	628
80 <= 100%	810	100%	810	65
Equity holdings	1,336	300%	4,008	321
Other assets	770,146	100%	770,146	61,612
Non-risk weighted assets	24,855	0%	-	-
Total on balance sheet credit exposures	3,994,412		1,933,105	154,648

As at 31 March 2017 (unaudited)	Total exposure after credit risk mitigation	Credit conversion factor	Credit equivalent amount	Average risk weighting	Risk weighted exposure / implied risk weighted exposure	Minimum pillar one capital requirement
Off balance sheet credit exposures						
Commitments with uncertain drawdown	37,344	50%	18,672	59%	10,967	877
Commitments to extend credit which can be unconditionally cancelled	266,248	0%	-	0%	-	-
Market related contracts[1]						
Interest rate contracts	2,324,876	n/a	13,468	22%	2,962	237
Credit valuation adjustment (CVA)					364	29
Total off balance sheet credit exposures	2,628,468		32,140		14,293	1,143
Total credit risk	6,622,880		32,140		1,947,398	155,791
Operational risk	n/a				203,439	16,275
Market risk	n/a				99,950	7,996
Total risk weighted assets	**6,622,880**				**2,250,787**	**180,062**

[1] The credit equivalent amount for market related contracts was calculated using the current exposure method.

Notes to the Financial Statements for the year ended 31 March 2017 All in $000's

25. Capital Adequacy continued

As at 31 March 2016 (unaudited)	Total exposure after credit risk mitigation	Risk weighting	Risk weighted exposure	Minimum pillar one capital requirement
On balance sheet credit exposures				
Cash	610	0%	-	-
Public sector entities	38,568	20%	7,714	617
Banks	286,194	20%	57,239	4,579
Corporates				
Rating grade 1	33,532	20%	6,706	536
Rating grade 2	90,528	50%	45,264	3,621
Rating grade 3 - 4	26,396	100%	26,396	2,112
Rating grade 5	215	150%	323	26
Residential mortgages				
<= 80% loan to value ratio (LVR)	1,759,645	35%	615,876	49,270
80 <= 90% LVR	62,175	50%	31,088	2,487
90 <= 100% LVR	7,961	75%	5,971	478
Past due	629	100%	629	50
Impaired	171	100%	171	14
Property investment residential mortgage				
<= 80% LVR	108,226	40%	43,290	3,463
80 <= 90% LVR	2,226	70%	1,558	125
90 <= 100% LVR	345	90%	311	25
Residential mortgages welcome home loans				
<= 90% LVR	203,454	35%	71,209	5,697
90 <= 100% LVR	65,005	50%	32,503	2,600
Past due	737	100%	737	59
Equity holdings	1,806	300%	5,418	433
Other assets	721,154	100%	721,154	57,692
Non-risk weighted assets	2,598	0%	-	-
Total on balance sheet credit exposures	3,412,175		1,673,557	133,884

As at 31 March 2016 (unaudited)	Total exposure after credit risk mitigation	Credit conversion factor	Credit equivalent amount	Average risk weighting	Risk weighted exposure / implied risk weighted exposure	Minimum pillar one capital requirement
Off balance sheet credit exposures						
Commitments with uncertain drawdown	40,592	50%	20,296	61%	12,480	998
Commitments to extend credit which can be unconditionally cancelled	247,790	0%	-	0%	-	-
Market related contracts[1]						
Interest rate contracts	1,905,740	n/a	10,650	20%	2,130	170
Credit valuation adjustment (CVA)					283	23
Total off balance sheet credit exposures	2,194,122		30,946		14,893	1,191
Total credit risk	5,606,297		30,946		1,688,450	135,075
Operational risk	n/a				180,708	14,457
Market risk	n/a				93,546	7,484
Total risk weighted assets	**5,606,297**				**1,962,704**	**157,016**

[1] The credit equivalent amount for market related contracts was calculated using the current exposure method.

[2] The calculation of total risk weighted assets as at 31 March 2016 is based on the transitional requirements of BS2A. A standard residential mortgage loan originated on or after 1 November 2015, has been further sub-classified into either a residential mortgage loan or a property investment residential mortgage loan. From 1 November 2016, all loans originated before 1 November 2015 have been sub-classified.

Notes to the Financial Statements for the year ended 31 March 2017 All in $000's

25. Capital Adequacy continued

(iii) Residential mortgages by loan-to-valuation ratio

	On balance sheet Unaudited 31/03/2017	Off balance sheet Unaudited 31/03/2017	On balance sheet Unaudited 31/03/2016	Off balance sheet Unaudited 31/03/2016
LVR range				
0 - 80%	2,363,008	222,771	1,902,748	194,520
80 - 90%	252,997	5,080	234,298	5,250
90% +	65,104	2,494	73,528	2,553
Total residential mortgages	**2,681,109**	**230,345**	**2,210,574**	**202,323**

Welcome Home Loans make up 96% of the residential mortgages in the 90% + loan to valuation grouping as at 31 March 2017 (31 March 2016 89%) and 74% of the 80-90% loan to valuation grouping (31 March 2016 73%). The Welcome Home Loan product is fully insured by Housing New Zealand Corporation.

(iv) Reconciliation of mortgage related amounts

	31/03/2017	31/03/2016
Gross residential mortgage loans (Note 10)	2,682,415	2,212,665
Provision for credit impairment relating to residential mortgages (Note 11)	(7,881)	(5,754)
Deferred fee revenue and expenses relating to residential mortgages	6,575	3,663
Residential mortgage loans net of provision for impairment	2,681,109	2,210,574
Off balance sheet exposures - undrawn commitments (Note 25(iii))	230,345	202,323
Total on and off balance sheet residential mortgage loans	**2,911,454**	**2,412,897**

(v) Market risk exposures

Market risk exposures have been calculated in accordance with the methodology detailed in Part 10 of the RBNZ's BS2A Capital Adequacy Framework, and Schedule 9 of the Registered Bank Disclosure Statement (New Zealand Incorporated Registered Banks) Order 2014 (as amended). Peak exposures are calculated using the Banking Group's equity at the end of the period.

	End of Period		Peak End of Day	
	Unaudited 31/03/2017	Unaudited 31/03/2016	Unaudited 31/03/2017	Unaudited 31/03/2016
Interest rate exposures				
Implied risk weighted exposure	99,950	93,546	102,361	93,550
Aggregate capital charge	7,996	7,484	8,189	7,484

(vi) Capital for other material risks

Basel III is intended to ensure that banks have adequate capital to support all material risks inherent in their business activities and includes the requirement on banks to have an "Internal Capital Adequacy Assessment Process (ICAAP)" for assessing their overall capital adequacy in relation to their risk profile and a strategy for maintaining adequate capital to support risk. Southland Building Society's ICAAP has identified other areas of risk and requires it to hold capital against them. These risks include but are not limited to:

(i) Earnings risk - The risk due to uncertainty in future reported earnings arising from adverse changes in the business environment and from adverse business decisions.

(ii) Liquidity risk - The risk that the Bank cannot meet or generate sufficient cash resources to meet its cash out goings as they fall due. Capital is not held for day to day liquidity. Instead a portfolio of cash, highly liquid instruments and committed funding lines is held. This largely mitigates the requirement to hold additional capital for liquidity risk, however capital is held to allow for excessive costs of raising suitable funds in adverse market conditions.

(iii) Access to capital - The risk that the Bank may not be able to raise additional capital as required in a timely manner, particularly arising from the mutual status of SBS.

(iv) Reputational risk - The potential that negative publicity regarding the bank's business practices or financial position, whether true or not, will cause a decline in the customer base, costly litigation or impact future earnings and funding.

The Bank has made an internal capital allocation of $25 million to cover these identified risks (31 March 2016 $25 million).

Notes to the Financial Statements for the year ended 31 March 2017 All in $000's

26. Related Parties

The Banking Group is controlled by SBS who is also the ultimate parent. A number of transactions are entered into with related parties (including key management personnel)[1] in the normal course of business. Details of these transactions are outlined below.

[1]Key management personnel are defined as being directors and senior management of the Banking Group. The information relating to key management personnel disclosed below includes transactions with those individuals, their close family members and their controlled entities.

(a) Loans and advances to related parties

	31/03/2017	31/03/2016
Directors and other key management personnel		
Loans and advances outstanding at beginning of year	3,830	2,746
Net loans issued/(repaid) during the year	(1,338)	1,084
Loans and advances outstanding at end of year	**2,492**	**3,830**
Interest income earned on amounts due from related parties	**183**	**190**

Loans and advances with directors and key management personnel of the Banking Group are made either:

- on normal terms and conditions; or
- on terms and conditions which apply to other employees in the Banking Group.

All loans made to directors and key management personnel have been made in accordance with the Banking Group's lending policies.

No provisions have been recognised in respect of loans given to related parties. There were no debts with any of the above parties written off or forgiven during the year ended 31 March 2017 (31 March 2016 $nil).

(b) Deposits from related parties

	31/03/2017	31/03/2016
Directors and other key management personnel		
Deposits at beginning of year	39,693	38,814
Net deposits received during the year	(9,675)	879
Deposits at end of year	**30,018**	**39,693**
Interest expense on amounts due to related parties	**880**	**1,513**

(c) Other transactions with related parties

During the year ended 31 March 2017, the Banking Group paid $0.60 million of dividends to non-controlling interests whom were key management personnel (31 March 2016 $0.45 million).

All other transactions with key management personnel are conducted on an arm's length basis in the ordinary course of business and on normal terms and conditions.

Lifestages Portfolio Funds

FANZ has entered into a trust deed made between FANZ and Trustee Executors Limited as Trustee of six unit trusts registered under the Unit Trusts Act 1960, known as Lifestages Corporate Bond Portfolio (previously known as the Lifestages Mortgage Distributing Portfolio), Lifestages Income Portfolio (previously known as the Lifestages Mortgage Non-Distributing Portfolio), Lifestages Australasian Portfolio, Lifestages World Equity Portfolio, Lifestages World Bond Portfolio and the Lifestages Deposit Portfolio. FANZ is the issuer and manager of the above Portfolios.

The cash of the Lifestages Deposit Portfolio fund is invested with SBS.

The Lifestages Portfolio funds that are invested with SBS are included in the statements of financial position as deposits from customers.

Lifestages KiwiSaver Scheme

The Lifestages KiwiSaver Scheme was established by trust deed on 30 April 2007 and is a registered KiwiSaver scheme under the KiwiSaver Act 2006. FANZ and SBS are the "Promoter" of the scheme. FANZ is also the investment and administration manager.

A portion of the fixed interest allocation of the investments of this scheme are invested with or managed by SBS. The Lifestages KiwiSaver Scheme funds that are invested with SBS are included in the statements of financial position as deposits from customers.

(d) Key management compensation

Details of remuneration paid or payable to the directors and other key management personnel are outlined in Note 4 - Operating Expenses.

Notes to the Financial Statements for the year ended 31 March 2017 All in $000's

27. Fiduciary Activities

Funds management

The Banking Group markets and manages unit trusts, investment and superannuation funds through its subsidiary Funds Administration New Zealand Limited (FANZ). FANZ is a registered unit trust manager, an approved KiwiSaver provider and also operates a financial advisory business providing custodial services, investment advice and portfolio management called SBS Financial Advisers. The Banking Group derives fee and commission income from these activities but is not responsible for any decline in performance of the underlying assets of the investors due to market forces.

The outstanding value of assets related to funds management activities is set out in the table below. These assets are not owned by the Banking Group and are therefore not included on the Banking Group's statement of financial position.

	31/03/2017	31/03/2016
Funds under management on behalf of customers	750,100	699,000

Securitised assets

As at 31 March 2017, the Banking Group had securitised assets amounting to $711 million (31 March 2016 $362 million). These assets have been sold to the SBS Invercargill W Trust (a special purpose vehicle established for the purpose of purchasing residential mortgages from the Bank and funded through wholesale funding lines), the SBS Oreti Trust No. 2 (a special purpose vehicle investing in residential mortgages originated and funded by the Bank through issue of residential mortgage backed securities) and Finance Now Warehouse Trust (a special purpose vehicle investing in a mixture of consumer and business loans and funded through wholesale funding lines). Note 14 - Loan Securitisation provides further information on securitised assets. The Banking Group receives fees for various services provided to the securitisation vehicles on an arm's length basis, including servicing fees. These fees are recognised as earned. All securitisation vehicles form part of the Banking Group.

The SBS Oreti Trust No. 2 is an in-house residential mortgage backed securities (RMBS) facility that can issue securities that meet the RBNZ criteria to use as collateral in repurchase transactions with the RBNZ. The facility provides the Bank with additional contingent funding from the RBNZ. Further information on liquidity is provided in Note 22 - Liquidity Risk.

Insurance business

The Banking Group markets and distributes insurance products through its subsidiary company Southsure Assurance Limited. The Banking Group derives premium income from the sale of insurance products.

The total assets of Southsure Assurance Limited as at 31 March 2017 are $16.7 million (31 March 2016 $15.6 million) which is 0.4% of the total assets of the Banking Group (31 March 2016 0.5%). This complies with the Conditions of Registration of Southland Building Society, which allows a maximum of 1% of the total consolidated assets of the Banking Group to be represented by insurance business assets.

Policies and procedures exist to ensure that the insurance activities of the Banking Group are conducted in an appropriate manner. These include regular reviews of the operations of the insurance business by management. Should adverse conditions arise, these policies and procedures are expected to mitigate the impact of the conditions on the Banking Group.

Risk management

The Banking Group has in place policies and procedures to ensure that the fiduciary activities identified above are conducted in an appropriate manner. It is considered that these policies and procedures will ensure that any difficulties arising from these activities will not impact adversely on the Banking Group. The policies and procedures include comprehensive and prominent disclosure of information regarding products, and formal and regular review of operations and policies by management and internal auditors. Further information on SBS risk management policies and practices are included in Notes 21 to 24.

Provision of financial services

Financial services provided by the Banking Group to entities which are involved in trust, custodial, funds management and other fiduciary activities, are provided on arm's length terms and conditions and at fair value. Any assets purchased from such entities have been purchased on an arm's length basis and at fair value.

The Banking Group has not provided any funding to individual unit trusts which the Banking Group distributes on behalf of third parties. All entities involved in securitisation and insurance activities are members of the Banking Group.

28. Subsequent Events

There have been no material subsequent events after 31 March 2017.

KPMG

Independent Auditor's Report

To the Members of Southland Building Society

Report on the Banking Group disclosure statement

Opinion

Opinion on financial statements

In our opinion, the accompanying consolidated financial statements (excluding supplementary information relating to Capital Adequacy) of Southland Building Society (the Bank) and its subsidiaries (the Banking Group) on pages 11 to 54:

i. give a true and fair view of the Banking Group's financial position as at 31 March 2017 and its financial performance and cash flows for the year ended on that date; and

ii. comply with New Zealand Generally Accepted Accounting Practice, which in this instance means New Zealand Equivalents to International Financial Reporting Standards ("NZIFRS") and International Financial Reporting Standards.

Opinion on supplementary information (excluding supplementary information relating to Capital Adequacy)

In our opinion, the supplementary information (excluding supplementary information relating to Capital Adequacy) that is required to be disclosed in accordance with Schedules 4, 7, 13, 14, 15 and 17 of the Registered Bank Disclosure Statements (New Zealand Incorporated Registered Banks) Order 2014 (as amended) (the "Order") and is included within notes 11, 12, 21, 22, 23, 24, and 27 of the disclosure statement:

i. has been prepared, in all material respects, in accordance with the guidelines issued pursuant to section 78(3) of the Reserve Bank of New Zealand Act 1989 and any conditions of registration;

ii. is in accordance with the books and records of the Banking Group in all material respects; and

iii. fairly states the matters to which it relates in accordance with those Schedules

We have audited the accompanying consolidated financial statements and supplementary information (excluding supplementary information relating to Capital Adequacy) which comprise:

— the consolidated statement of financial position as at 31 March 2017;

— the consolidated income statement, statement of comprehensive income, statement of changes in equity and statement of cash flows for the year then ended;

— notes, including a summary of significant accounting policies and other explanatory information; and

— the information that is required to be disclosed in accordance with Schedules 4, 7, 13, 14, 15 and 17 of the Order.

KPMG

Basis for Opinion on the financial statements and supplementary information (excluding supplementary information relating to Capital Adequacy)

We conducted our Audit in accordance with International Standards on Auditing (New Zealand) (ISA's (NZ)). We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

We are independent of the Banking Group in accordance with Professional and Ethical Standard 1 (Revised) Code of Ethics for Assurance Practitioners issued by the New Zealand Auditing and Assurance Standards Board and the International Ethics Standards Board for Accountants' Code of Ethics for Professional Accountants (IESBA Code), and we have fulfilled our other ethical responsibilities in accordance with these requirements and the IESBA Code.

Our responsibilities under ISA (NZ) are further described in the Auditor's Responsibilities for the Audit of the consolidated financial statements (excluding supplementary information relating to Capital Adequacy) section of our report.

Our firm has also provided other services to the Banking Group in relation to secondment of resources, regulatory and other assurance, limited assurance engagements, and tax compliance. 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.

Other Information

The Directors, on behalf of the Banking Group, are responsible for the other information included in the Banking Group's Disclosure Statement. Other information includes the information required to be included in the Disclosure Statement in accordance with Schedule 2 of the Order and is included on pages 3 to 10. Our opinion on the consolidated financial statements does not cover any other information and we do not express any form of assurance conclusion thereon.

In connection with our audit of the consolidated financial statements our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the consolidated financial statements or our knowledge obtained in the audit or otherwise appears materially misstated. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

Report on other legal and regulatory requirements

In accordance with the requirements of clauses 2(1)(d) and 2(1)(e) of Schedule 1 of the Order, we report that:

- we have obtained all the information and explanations we have required; and
- in our opinion, proper accounting records have been kept by the Banking Group, as far as appears from our examination of those records.

Responsibilities of Directors for the consolidated financial statements and supplementary information (excluding supplementary information relating to Capital Adequacy)

The Directors, on behalf of the Banking Group, are responsible for:

- the preparation and fair presentation of the consolidated financial statements in accordance with Clause 24 of the Order, NZIFRS and International Financial Reporting Standards;
- the preparation and fair presentation of supplementary information (excluding the supplementary information relating to Capital Adequacy), in accordance with Schedules 2, 4, 7, 13, 14, 15 and 17 of the Order;
- implementing necessary internal control to enable the preparation of consolidated financial statements that are fairly presented and free from material misstatement, whether due to fraud or error; and
- assessing the ability to continue as a going concern. This includes disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless they either intend to liquidate or to cease operations, or have no realistic alternative but to do so.

Auditor's Responsibilities for the Audit of the consolidated financial statements and supplementary information (excluding supplementary information relating to Capital Adequacy)

Our objective is:

- to obtain reasonable assurance about whether the consolidated disclosure statement, including the financial statements prepared in accordance with Clause 24 of the Order, and supplementary information (excluding the supplementary information relating to Capital Adequacy), in accordance with Schedules 4, 7, 13, 14, 15 and 17 of the Order as a whole is free from material misstatement, whether due to fraud or error; and
- to issue an Auditor's Report that includes our opinion.

Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with International Standards on Auditing (New Zealand) will always detect a material misstatement when it exists.

Misstatements can arise from fraud or error. They are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of this consolidated financial statements.

A further description of our responsibilities for the Audit of these consolidated financial statements is located at the External Reporting Board (XRB) website at:

https://www.xrb.govt.nz/Site/Auditing_Assurance_Standards/Current_Standards/Page5.aspx

This description forms part of our Auditor's Report.

KPMG

Review conclusion on the supplementary information relating to Capital Adequacy

Based on our review, nothing has come to our attention that causes us to believe that the supplementary information relating to Capital Adequacy, disclosed in note 25 to the disclosure statement, is not, in all material respects:

i. prepared in accordance with the Banking Group's conditions of registration; and

ii. disclosed in accordance with Schedule 9 of the Order.

We have reviewed the supplementary information relating to Capital Adequacy, as disclosed in note 25 of the disclosure statement for the year ended 31 March 2017. The supplementary information relating to Capital Adequacy comprises the information that is required to be disclosed in accordance with Schedule 9 of the Order.

Basis for conclusion on the supplementary information relating to Capital Adequacy

A review of the supplementary information relating to Capital Adequacy in accordance with NZ SRE 2410 *Review of Financial Statements Performed by the Independent Auditor of the Entity* ("NZ SRE 2410") is a limited assurance engagement. The auditor performs procedures, primarily consisting of making enquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. Our responsibilities under that standard are further described in the Auditor's Responsibilities for the Review of the supplementary information relating to capital adequacy section of our report.

As the auditor of Southland Building Society, NZ SRE 2410 requires that we comply with the ethical requirements relevant to the audit of the annual financial statements.

Responsibilities of Directors for the supplementary information relating to capital adequacy

The directors are responsible for the preparation of supplementary information relating to Capital Adequacy that is required to be disclosed under Schedule 9 of the Order and prepared in accordance with the Capital Adequacy Framework (Standardised Approach) (BS2A) and described in note 25 to the disclosure statement.

Auditor's Responsibilities for the Review of the supplementary information relating to capital adequacy

Our responsibility is to express a conclusion on the Capital Adequacy information based on our review. We conducted our review in accordance with NZ SRE 2410 Review of Financial Statements Performed by the Independent Auditor of the Entity ("NZ SRE 2410") issued by the New Zealand External Reporting Board. As the auditor of Southland Building Society, NZ SRE 2410 requires that we comply with the ethical requirements relevant to the audit of the annual financial statements, and plan and perform the review to obtain limited assurance about whether the capital adequacy information is, in all material respects:

— prepared in accordance with the Banking Group's conditions of registration; and

— disclosed in accordance with Schedule 9 of the Order.

A review of the Capital Adequacy information in accordance with NZ SRE 2410 is a limited assurance engagement. The auditor performs procedures, primarily consisting of making enquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures.

The procedures performed in a review are substantially less than those performed in an audit conducted in accordance with International Standards on Auditing (New Zealand). Accordingly we do not express an audit opinion on the supplementary information relating to Capital Adequacy disclosures.

Use of this Auditor's Report

This report is made solely to the Members as a body. Our work has been undertaken so that we might state to the Members those matters we are required to state to them in the 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 work, this report, or any of the opinions or conclusions we have formed.

KPMG

Peter Taylor

For and on behalf of

KPMG
Christchurch

30 May 2017

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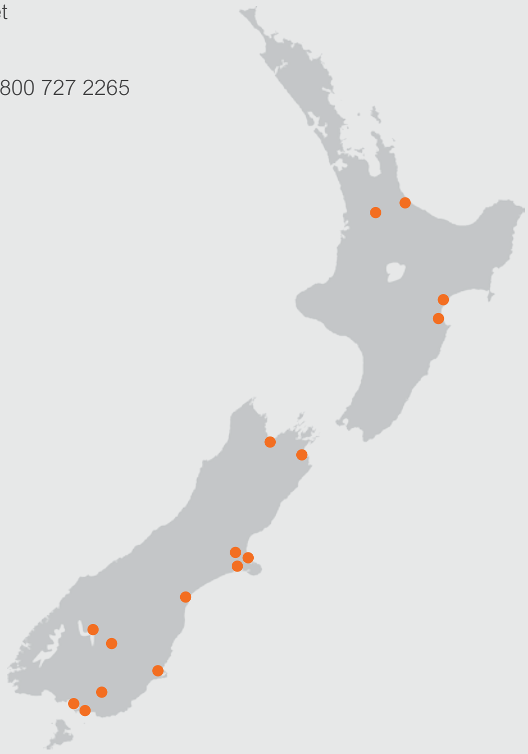

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