

Southland Building Society
Annual Report and Financial Summary



Highlights



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We're with you

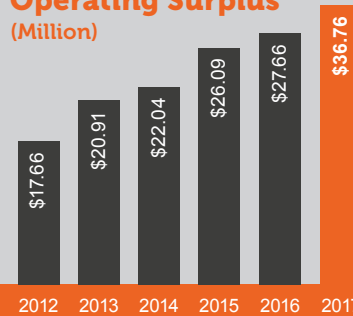
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Chairman's Report



John Ward
SBS Bank Chairman.

Operating Surplus (Million)



Welcome to the SBS Bank Annual Report for the financial year ended 31 March 2017.

Retail Deposits

\$3.0
billion

Loan Advances

\$3.4
billion



The SBS Group has performed most satisfactorily in an extremely competitive market but particularly in the residential lending sector. We've seen interest rates drop to historic lows and, like our competitors, we have been working hard to attract and retain customers.

Our strategic initiatives have positioned us to take advantage of prevailing market dynamics and we have recorded pleasing results on both the lending and funding aspects of our business. Retail deposits grew strongly, up 9% to \$3.0 billion. Advances to customers grew 19% on the previous year to \$3.4 billion. It is worth recording that this is the first time the Group has exceeded \$3 billion in lending. While a milestone, it is just part of a positive scene that includes better member engagement, enhanced membership numbers, improved technology and a series of competitive deposit rates too.

Our Operating Surplus of \$36.8 million exceeded the 2016 result of \$27.7 million by 33%. Contributing to this excellent Group outcome have been memorable results from our subsidiaries Finance Now, FANZ and Southsure.

These entities all exceeded budget. Your Directors are most grateful for the contributions of group executives and employees who have contributed to our successful financial outcome.

In August, we welcomed Shaun Drylie as Group CEO. With over 30 years' banking experience both in New Zealand and abroad, Shaun provides a balance of industry experience, strategic thinking and proven leadership to guide SBS into the future.

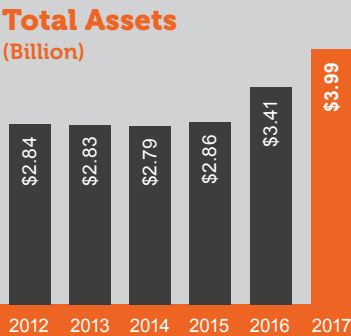
As we move into our 149th year we are experiencing interesting times in the economic cycle. There is a sense that the housing market has become 'too hot' in some regions to be sustainable. For SBS, our impairments are low and growth targets are realistic and manageable. Loan to Value ratios are being applied on a macro scale but we continue to live by the historic values of this entity and we are still enthusiastic about supporting first homeowners wherever possible.

During the year Deputy Chairman Jeff Walker retired as a Director. Jeff played a fundamental role within the

SBS Group and his commitment, experience and governance skills have been very much appreciated by those who have been on the Board over his time. Kathryn Ball has been appointed to the role of Deputy Chair.

I'd like to acknowledge the Directors for their contribution over the past 12 months. Each and every Board member is prudently focussed on strategy and outcomes. We look forward to a future of profitable growth, to taking advantage of opportunities as they arise and to providing enhanced membership benefits.

CEO's Report



Members' Equity

\$270
million

Lending Growth

\$539
million

“I’m passionate about progressing our organisation to provide you with enhanced ways of banking, while staying true to our traditions.”

Shaun Drylie, SBS Group CEO.

10 months ago I joined SBS Bank, an organisation with a strong history that I’m excited to lead into the future. As a mutual Bank we are owned by you, our Members, a responsibility that myself along with our Executive Leadership Team and the wider SBS Bank teams take seriously.

We are an organisation steeped in tradition with values that have centred on our Members, and have guided our people for almost 150 years. While we’re proud of both our history and our achievements to date, we are also looking firmly forward to a bright future.

Over the past year we have continued to strengthen SBS’ place in the market. Strong growth in our balance sheet and Member numbers, a highly engaged workforce and significant progress of key strategic initiatives are just a few of our accomplishments. We have invested in technology, looked beyond our traditional markets and have continued to challenge ourselves every day by developing our people to ensure you get the very best service.

As a Group, SBS Bank and our subsidiaries, Finance Now, Southsure and FANZ, have performed well. Our financial strength and profit result highlight how well we’ve worked together. We have built and maintained a strong organisation that protects your interests while making prudent decisions around how we continue to grow. There are some great synergies that provide even more opportunities for you to benefit from being part of the SBS Group and we’ll continue to explore how we can improve these.

I’m passionate about progressing our organisation to provide you with enhanced ways of banking, while staying true to our traditions. Over the past year we’ve enhanced the authentic service we provide through the introduction of a ‘virtual branch’, dedicated to serving and supporting our Members outside of our branch regions. Our Contact Centre is now open seven days a week and the launch of our Mobile Banking App has been extremely well received. We have also implemented a technology platform

that allows us to make future development and enhancements to both the App and our Internet Banking service, as well as providing you with new products and services in the future.

Looking forward, we’ll continue to build on our range of products and services through some exciting developments. We’re currently considering how to provide a Credit Card that’s a little different from our competitors and we’ll also bring the benefits of belonging to SBS to life. We have made positive steps forward in our Corporate Social Responsibility programme highlighting our commitment to a sustainable future.

Thank you for your continued support and entrusting us with your business. As a Member-owned bank we’re committed to providing you with the very best products, technology and service so that you are proud to not only bank with, but also belong to, SBS.

Shaun Drylie,
SBS Group CEO.



Strategy

Over the past 12 months, the Board, the Executive and the wider SBS team have continued to work hard on our strategy of 'bringing mutuality to life.' Our Members are at the heart of this strategy and remain central to our decision making and future planning.

Our key themes of **Simplicity**, **Benefit** and **Synergy** are the guiding foundations of how we continue to deliver a great banking experience. Simplicity focuses on our commitment to making banking easy to use, easy to understand and easy to do business with. Benefit is about giving value to you through our products and services and also providing tangible Member benefits. Our focus on Synergy also allows us to fully leverage the strength of the wider SBS Group by offering a full suite of banking services like insurance products, investment options and personal finance.

By focusing on several core elements, we will ensure our Members always receive the very best value from SBS.

Positioning and Relevance

We will continue to build on the investment we've made in our brand by providing benefits of belonging, to both existing Members and the communities we operate in.

Portfolio and Offer

We've given back rebates of \$1.4 million to our Members over the past year. We'll continue to invest in our products and services to ensure they remain valued, relevant and evolve with the rapidly changing landscape of modern day banking.

Distribution Reach and Access

We've strengthened our banking channels, allowing Members to bank with SBS where and when it suits them. The recent extension of our Contact Centre opening hours and launch of our Mobile Banking App, which was downloaded 3,500 times in the first 24 hours, are examples of this.

Process and Efficiency

By focusing on our internal and external processes and identifying ways that these can be simplified, we will improve our overall productivity and make everyday banking even easier for both Members and our staff.

Culture and Capability

Investing in our SBS Bank staff through technical training programmes and career development pathways has always formed part of our ethos, ensuring our teams can continue to deliver exceptional service back to our Members.

Across these areas we continue to look at opportunities where we can direct benefit to you, our Members, by bringing together the strength of our group of companies, Finance Now, Southsure and FANZ. As a group we are working more closely together to better understand Members' total financial needs and how we can tailor offers that best suit these needs.

As a mutual, our strategy and our priorities are firmly focused on delivering real outcomes and superior value to you. This is brought to life through interactions with our teams, by using our products and services and by experiencing the true benefits of belonging to SBS every single day.



Members

“We’re committed to putting you first by making banking simple, easy to understand and authentic.”

Shaun Drylie, SBS Group CEO.

SBS is committed to putting our Members first and responding to your wants and needs. Through the products we provide, to the service you receive, our focus remains on ensuring your interactions with SBS are easy, effortless, and most importantly, enjoyable.

Advances in technology are happening at a rapid pace and are not only changing but also enhancing the banking landscape. It’s imperative that we anticipate and adapt to these changes in a smart and considered way.

The recent upgrade of our online banking platform and launch of our Mobile Banking App has seen SBS partner with a specialist digital banking services company. Its strengths and expertise have enabled us to provide a service to Members, which allows you to do your banking, where and when it suits you. It will also allow us to develop new solutions faster in the future.

Through our Mobile Banking App, Members can now easily perform everyday banking tasks in a safe and secure environment. While the technology may be new, the look and feel of it is still very much SBS. Members will still enjoy the same high level service they always have.

Our focus remains on making it easy and simple for Members to interact with SBS. We’ve extended the opening hours of our Member Contact Centre to include evenings and weekends and we’ve launched a ‘virtual branch’, dedicated to serve and support those Members who don’t live close to a branch.

We’re committed to making banking simple; simple to use, simple to understand and simple to do business with, because banking shouldn’t be hard.

SBS is committed to putting our Members first and responding to your wants and needs. Through the products we provide, to the service you receive, our focus remains on ensuring your interactions with SBS are easy, effortless and, most importantly, enjoyable.

Internet Banking

The recent upgrade to our Internet Banking is the first step on our digital journey that is focussed on delivering our products, services and transactions in a smarter way.



Mobile App

Our Mobile Banking App provides a safe and secure environment, where Members can do their banking where and when it suits them. Whether paying a bill, managing wealth, or transferring funds – members can now do it all, at home or on the go.

Virtual Branch

The establishment of a ‘virtual branch’, based in our Invercargill Contact Centre, allows Members who aren’t close to an SBS branch to experience the same great level of service and support.



Contact Centre

Following Member feedback our Contact Centre is now open longer hours and during the weekends, meaning Members will now be able to enjoy our great service at a time that suits them.



Your Team

“The calibre of our Executive can be seen in the results of our recent survey, which indicates high levels of staff engagement.”

Shaun Drylie, SBS Group CEO.

Over the past 12 months SBS has experienced strong growth in both lending and funding and Member numbers have continued to increase. Our team has been integral to this success.

As we continue towards becoming a modern financial services provider, SBS is committed to becoming a dynamic, exciting and relevant employer that attracts and retains the best talent.

Towards the end of last year, we introduced a new branch and retail banking structure that has streamlined and improved the way our teams perform their daily tasks, leading to a better experience for our Members. The enhancements have allowed staff to develop and grow their banking skill set.

To assist with this, each year our teams take part in an engagement survey carried out by an independent research company. The survey acts as a temperature check for SBS ensuring that what we’re doing at a strategic and business level is connecting with our people and that we’re providing them with the right level of support and development.

This year’s results are the strongest we’ve seen and further prove that our continued investment in our people and their development will drive performance, lift engagement and improve capability across our business.

However, our focus isn’t just on engaging our people inside our business but also ensuring our staff are engaged outside SBS. Being involved in the communities we operate in is key to who we are. As a mutual, we are owned by our Members and need to be involved in supporting those communities our Members belong to, to make them better places for us all to live and work in.

One practical way we are doing this is by observing ethical and sustainable corporate practices. We currently adhere to a Socially Responsible Investment Policy that ensures SBS never directly invests in socially questionable activities including the arms, tobacco and gaming industries. In our Corporate Social Responsibility programme we’ve introduced sustainable ways to manage our procurement activities particularly around supply chains, waste and the safety and wellbeing of our people.

We’ve been part of New Zealand for the past 148 years and our commitment to our people and the communities they live in will ensure we’re here for another 148.



Rebates of
\$1.4 million
have been given to our Members over the past year.



520
staff across the
SBS Group.



More than
200,000
Members/customers
of the SBS Group.



Members are
twice as likely
to refer SBS
to family or
friends.
(Net Promoter Score
by Research First.)

1. Shaun Drylie, SBS Group CEO. 2. Phil Ellison, Finance Now CEO. 3. David Newman, Southsure Assurance CEO.
4. Graham Duston, FANZ CEO. 5. Tim Loan, Chief Financial Officer. 6. Phil Jamieson, General Manager Development.
7. Martine Milcich, General Manager Member Banking. 8. Mark McLean, Chief Risk Officer. 9. Richard Hutton, Chief Digital and IT Officer.
10. Hamish McKenzie, General Manager People and Support. 11. Grant Dermody, Head of Rural and Commercial Banking.



Staff are happy,
committed and
proud to work
at SBS.
(Independent survey
December 2016.)



More than
16,000
people have engaged with the
SBS Bank Facebook page over
the past year.



Your Board of Directors



John Ward B Com, FCA, CFInstD
(Chairman)
Chairman: SBS, Finance Now Ltd, Southsure Assurance Ltd and Board Appointment Committee.
Member: Audit and Risk Committee and Remuneration Committee.
Trustee: SBS Charitable Trust.

Mr Ward is a Fellow of the Institute of Chartered Accountants Australia and New Zealand, and a Chartered Fellow of the Institute of Directors. He chairs H&J Smith Holdings Ltd, the Transport for Disabled Trust (Southland) and is President of the Otago Cricket Association. He is the Chancellor of the University of Otago, chairs the University of Otago Foundation Trust and Otago Innovation Ltd.



Kathryn Ball B Com, FCA, CMInstD
(Deputy Chair)
Chairperson: Audit and Risk Committee.
Member: Board Apointment Committee, IT Committee.
Trustee: SBS Charitable Trust.

Mrs Ball, a practising chartered accountant and taxation specialist, was appointed to the Board of SBS Bank in April 2006. She is a consultant in Invercargill accounting firm McIntyre Dick & Partners Ltd and a Fellow of the Institute of Chartered Accountants Australia and New Zealand. Mrs Ball is a Chartered Member of the Institute of Directors and a member of the Otago Southland Branch Committee of the IOD. Prior to becoming a Director of SBS, Mrs Ball had been the independent representative on SBS Bank's audit committee.



Jeff Grant
Director: Finance Now Ltd.
Member: Board Appointment Committee, and Remuneration Committee.
Trustee: SBS Charitable Trust.

Mr Grant, in partnership with his wife Julia, farms sheep and deer at Balfour. He joined the Board of SBS Bank in 2007. Formerly a Member of Parliament from 1987 to 1993, Mr Grant has since been involved in agribusiness directorships with a range of companies and organisations. Mr Grant is chairman of the Milford Development Authority and is a Director of Agresearch.



Frank Spencer BBS (Val & Pty Mgt), FNZIV, FPINZ, AREINZ, CMInstD

A Registered Valuer, Mr Spencer joined the Board of SBS Bank in November 2010, following the merger of HBS with SBS Bank. The managing director of Logan Stone Ltd, Mr Spencer has expertise in property and commerce and provides property advice to a broad range of clients. He is active in the Hawke's Bay business community and is a Fellow of both the New Zealand Institute of Valuers and the Property Institute of New Zealand, a Chartered Member of the Institute of Directors and is an Associate of the Real Estate Institute of New Zealand.



Greg Mulvey B Com, FCA, FNZIM
Chairman: Remuneration Committee and IT Committee.
Director: Funds Administration New Zealand Ltd.
Member: Audit and Risk Committee.
Trustee: SBS Charitable Trust.

The Invercargill Licensing Trust's general manager for more than two decades, Mr Mulvey joined the Board of SBS Bank in 2004. He is a Fellow of the Institute of Chartered Accountants Australia and New Zealand, and a Fellow of the New Zealand Institute of Management. A director of DB South Island Brewery Ltd, Mr Mulvey is also a trustee of the Stadium Southland Charitable Trust.



Anne McLeod B Com, LLB, MInstD
Director: Southsure Assurance Ltd.

Ms McLeod is a practicing barrister and solicitor being a Partner of Anderson Lloyd, based in Dunedin. She was elected to the Board of SBS Bank in 2015. She has considerable experience in banking and corporate law. She is a Fellow of the Te Rangi Hiroa College, a Member of the Institute of Directors, RITANZ (Restructuring Insolvency and Turnaround Association New Zealand) and the Banking and Financial Services Law Association.



Mike Skilling BAgSci, PGDipBank, SF FINSIA, CMInstD
Director: Funds Administration New Zealand Ltd.
Member: Audit and Risk Committee.

Mr Skilling joined the Board of SBS Bank in August 2014. He has indepth experience in retail, private, rural and business banking together with insurance, managed funds and finance companies. Mr Skilling is a director of six boards – three large scale farming enterprises, a pre-school business and two finance companies. He was a founding director of The ICEHOUSE and Board Member and Trustee for eight years. He has been a judge of the Auckland Business Awards and the Indian Business Awards. He is a Senior Fellow of Financial Services Institute of Australasia (FINSIA) and a Chartered Member of the Institute of Directors.

Southland Building Society Summary Financial Statements
Summary Income Statement – Banking Group for the year ended 31 March 2017

	31/03/17 \$000	31/03/16 \$000
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	90,480	83,933
Other income	32,918	30,484
Total operating income	123,398	114,417
Operating expenses	75,879	73,542
Provision for credit impairment	10,764	13,212
Operating surplus	36,755	27,663
Net gain/(loss) from financial instruments designated at fair value	(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	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

Summary Statement of Comprehensive Income – Banking Group for the year ended 31 March 2017

Net surplus for the year	27,448	19,973
Other comprehensive income		
Net change in reserves, net of tax	11,192	(18,329)
Total comprehensive income for the year	38,640	1,644
Attributable to:		
Members' interests	36,833	320
Non-controlling interests	1,807	1,324
	38,640	1,644

Summary Statement of Changes in Equity – Banking Group for the year ended 31 March 2017

Equity at beginning of the year	239,960	243,676
Net surplus for the year	27,448	19,973
Other comprehensive income for the year	11,192	(18,329)
Total comprehensive income for the year	38,640	1,644
Dividends	(599)	(598)
Change in capital of non-controlling interests	(3,083)	(4,762)
Total equity at end of the year	274,918	239,960
Equity represented by:		
Revaluation reserves	(7,164)	(17,090)
Retained earnings	277,136	253,313
Total equity attributable to member's interests	269,972	236,223
Non-controlling interests	4,946	3,737
Total equity at end of the year	274,918	239,960

Southland Building Society Summary Financial Statements
Summary Statement of Financial Position – Banking Group as at 31 March 2017

	31/03/17 \$000	31/03/16 \$000
Assets		
Liquid assets and securities	518,301	477,848
Advances to customers	3,408,075	2,868,850
Other assets	68,036	65,477
	3,994,412	3,412,175
Liabilities		
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
Other liabilities	75,518	80,928
	3,719,494	3,172,215
Equity		
Attributable to members of the society	269,972	236,223
Attributable to non-controlling interests	4,946	3,737
	274,918	239,960

Summary Statement of Cash Flows – Banking Group for the year ended 31 March 2017

Net cash flows provided by/(used in) operating activities	46,418	55,124
Net cash flows provided by/(used in) investing activities	(21,804)	(99,738)
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

Chairman
J F Ward

Deputy Chair
K J Ball

30 May 2017

Southland Building Society

Notes to the Summary Financial Statements for the year ended 31 March 2017

1. Accounting Policies

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

These summary financial statements have been prepared in compliance with FRS-43: Summary Financial Statements and comply with New Zealand Generally Accepted Accounting Practice (NZ GAAP) as it relates to summary financial statements. The specific disclosures included in the summary financial statements have been extracted from the full financial statements dated 30 May 2017. The full financial statements from which the summary financial statements have been produced have been audited by KPMG, who expressed an unmodified opinion in relation to those financial statements as at 30 May 2017. These summary financial statements have been examined by KPMG for consistency with the full financial statements.

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

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

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

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

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

2. Critical Estimates and Judgements Used in Applying Accounting Policies

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

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

Southland Building Society

Notes to the Summary Financial Statements for the year ended 31 March 2017

3. Risk Management Policies

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

Risk Governance Structure

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

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

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

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

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

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

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

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

Liquidity risk management

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

Credit risk management

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

Interest rate risk management

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

Operational risk management

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

4. Advances – Banking Group

	31/03/17 \$000	31/03/16 \$000
Gross advances	3,426,688	2,887,880
Provisions for credit impairment	(21,138)	(19,224)
Deferred fee revenue and expenses	2,525	194
Total net advances	3,408,075	2,868,850

5. Provision for Credit Impairment – Banking Group

	31/03/17 \$000	31/03/16 \$000
Individual provisions against advances and loans		
Balance at beginning of the year	2,780	5,826
New provisions during the year	760	2,416
Balances written off during the year	(243)	(5,462)
Recoveries / reversals of previously recognised provision	(456)	-
Balance at end of the year	2,841	2,780
Collective provisions against advances and loans		
Balance at beginning of the year	16,444	12,155
Charged to income statement	1,853	4,289
Balance at end of the year	18,297	16,444
Total provisions for credit impairment	21,138	19,224
Reconciliation of provision movements		
Bad debts written off during the year	8,151	6,507
Individual provisions	760	2,416
Collective provision	1,853	4,289
Provision for credit impairment to income statement	10,764	13,212

6. Asset Quality – Banking Group

	31/03/17 \$000	31/03/16 \$000
Advances to customers		
Neither past due or impaired	3,371,512	2,827,112
Individually impaired	7,523	9,159
Past due	50,178	51,803
Provision for credit impairment	(21,138)	(19,224)
Total carrying amount	3,408,075	2,868,850

7. Liquidity Risk – Banking Group

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

Contractual maturity profile	31/03/17			31/03/16		
	Current Assets \$000	Non-current Assets \$000	Total \$000	Current Assets \$000	Non-current Assets \$000	Total \$000
Assets						
Advances	218,091	3,189,984	3,408,075	187,935	2,680,915	2,868,850
Liquid assets and securities	215,246	303,055	518,301	150,573	327,275	477,848
Other monetary assets	22,467	-	22,467	16,764	-	16,764
	455,804	3,493,039	3,948,843	355,272	3,008,190	3,363,462
	Current Liabilities \$000	Non-current Liabilities \$000	Total \$000	Current Liabilities \$000	Non-current Liabilities \$000	Total \$000
Liabilities						
Redeemable shares	2,589,454	143,127	2,732,581	2,278,725	208,620	2,487,345
Other deposits	463,808	408,463	872,271	404,288	160,525	564,813
Subordinated redeemable shares	-	39,124	39,124	-	39,129	39,129
Other monetary liabilities	34,933	-	34,933	34,227	-	34,227
	3,088,195	590,714	3,678,909	2,717,240	408,274	3,125,514
Net derivative cash flows	(14,539)	(10,137)	(24,676)	(18,682)	(22,358)	(41,040)
Unrecognised loan commitments	37,344	-	37,344	40,592	-	40,592

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

	31/03/17 \$000	31/03/16 \$000
Asset liquidity	518,301	477,848
Committed and undrawn funding lines	30,000	80,000
Eligible RMBS collateral (less haircut*)	151,077	99,312
Total liquidity	699,378	657,160

* 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.

Southland Building Society

Notes to the Summary Financial Statements for the year ended 31 March 2017

8. Capital Adequacy

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

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

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

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

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

	Mininimum ratio requirement	31/03/17 Unaudited	31/03/16 Unaudited
Regulatory Capital Ratios			
Common equity tier 1 capital ratio	4.50%	11.58%	12.41%
Tier 1 capital ratio	6.00%	11.74%	12.50%
Total capital ratio	8.00%	12.56%	13.76%
Buffer ratio	2.50%	4.56%	5.76%

9. Directors Fees

	31/03/17 \$000	31/03/16 \$000
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.

10. Investments in Subsidiaries, Associates and Joint Ventures

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

As at 31 March 2017, total investments in associates and joint ventures recognised by the Banking Group was \$6.8 million. Further information on investments in subsidiaries, associates and joint ventures is set out in the full financial statements.

Southland Building Society

Notes to the Summary Financial Statements for the year ended 31 March 2017

11. Subsequent Events

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

Independent Auditor's Report



To the Members of Southland Building Society

Report on the summary consolidated financial statements

Opinion

In our opinion, the accompanying summary consolidated financial statements on pages 14 to 21:

- have been correctly derived from the audited consolidated financial statements of Southland Building Society and its subsidiaries (the "Banking Group"); and
- are a fair summary of the consolidated financial statements, in accordance with FRS-43 Summary Financial Statements.

The accompanying summary consolidated financial statements comprises:

- the summary consolidated statement of financial position as at 31 March 2017;
- the summary consolidated income statement, statements of comprehensive income, changes in equity and cash flows for the year then ended; and
- notes, including a summary of significant accounting policies and other explanatory information.

Basis for opinion

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

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 during the year ended 31 March 2017. Subject to certain restrictions, partners and employees of our firm may also deal with the Banking Group on normal terms within the ordinary course of trading activities of the business of the Banking Group. These matters have not impaired our independence as auditor of the Banking Group. The firm has no other relationship with, or interest in, the Banking Group.

Use of this Independent Auditor's Report

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

Responsibilities of the Directors for the summary consolidated financial statements

The Directors are responsible for the preparation of a summary of the audited consolidated financial statements, in accordance with FRS-43 Summary Financial Statements.

Auditor's Responsibilities for the Audit of the summary consolidated financial statements

Our responsibility is to express an opinion on the summary consolidated financial statements based on our procedures.

We expressed an unmodified audit opinion on the consolidated financial statements in our audit report dated 30 May 2017.

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



Christchurch
30 May 2017

Branches

Invercargill – Head Office

51 Don Street
PO Box 835
Telephone: 0800 727 2265

Invercargill – Windsor

54 Windsor Street
Telephone: 0800 727 2265

Gore

80 Main Street
PO Box 212
Telephone: 0800 727 2265

Dunedin

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

Queenstown

7 Shotover Street
PO Box 710
Telephone: 0800 727 2265

Cromwell

21 The Mall
PO Box 226
Telephone: 0800 727 2265

Timaru

248 Stafford Street
PO Box 844
Telephone: 0800 727 2265

Christchurch – Ferrymead

23 Humphreys Drive
PO Box 19835
Telephone: 0800 727 2265

Christchurch – Riccarton

48 Rotherham Street
PO Box 80058
Telephone: 0800 727 2265

Christchurch – Papanui

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

Nelson

126 Trafalgar Street
PO Box 211
Telephone: 0800 727 2265

Blenheim

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

Hastings

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

Napier

97 Dalton Street
PO Box 1041
Telephone: 0800 727 2265

Hamilton

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

Tauranga

36 Spring Street
PO Box 13020
Telephone: 0800 727 2265

SBS Bank Rural – Invercargill

66 Don Street
PO Box 835
Telephone: 0800 727 2265

Subsidiaries

Southsure Assurance

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

Finance Now

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

FANZ

PO Box 835
Invercargill
Telephone: 0800 727 2265



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

