Southland Building Society

Disclosure Statement

For the six months ended 30 September 2020

Number 45 Issued November 2020

Contents

Abbreviations

The following abbreviations are used throughout the report:

AT1	Additional tier 1
CET1	Common equity tier 1
CVA	Credit valuation adjustment
ECL	Expected credit losses
FVTPL	Fair value through profit or loss
FVOCI	Fair value through other comprehensive income
ICAAP	Internal capital adequacy assessment process
LVR	Loan-to-valuation ratio
NZ GAAP	New Zealand Generally Accepted Accounting Practice
NZ IAS	New Zealand equivalents to International Accounting Standards
NZ IFRS	New Zealand equivalents to International Financial Reporting Standards
RBNZ	Reserve Bank of New Zealand
REM	Reverse equity mortgage
RMBS	Residential mortgage backed security
ROU	Right-of-use

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 Registered 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

There have been no changes in the composition of the Bank's Board of Directors since the publication date of the previous full year Disclosure Statement.

Credit Rating

As at 30 September 2020, the credit rating assigned to Southland Building Society is BBB with a negative 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 rating is not subject to any qualifications.

Auditors

KPMG Chartered Accountants
79 Cashel Street
Christchurch

Conditions of Registration

There have been no changes in the Bank's conditions of registration during the period since the signing 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 six months ended 30 September 2020:
   (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.

JF Ward
(Chairman)

AL McLeod

KJ Ball
(Deputy Chair)

AJ O'Connell

GJ Mulvey

MP O'Connor

MJ Skilling

KJ Murphy

Southland Building Society

Income Statement for the six months ended 30 September 2020

All in $000's

	Note	Unaudited 6 Months 30/09/2020	Unaudited 6 Months 30/09/2019	Audited 12 Months 31/03/2020
Interest income		104,076	123,878	242,267
Interest expense		7,820	13,344	24,881
Dividends on redeemable shares		39,267	51,279	98,249
		47,087	64,623	123,130
Net interest income		**56,989**	**59,255**	**119,137**
Net fee and commission income		**11,961**	**12,362**	**24,844**
Other income		4,008	4,928	10,406
Total operating income		**72,958**	**76,545**	**154,387**
Operating expenses		43,898	48,689	96,092
Provision for credit impairment	(6(g))	5,021	6,496	36,973
Operating surplus		**24,039**	**21,360**	**21,322**
Net gain/(loss) from financial instruments at FVTPL		263	133	(269)
Share of associates profit net of tax		591	554	1,274
Surplus before income tax		**24,893**	**22,047**	**22,327**
Less income tax expense		7,004	6,028	3,576
Net surplus		**17,889**	**16,019**	**18,751**
Attributable to:				
Members' interests		17,889	15,894	18,626
Non-controlling interests		-	125	125
		17,889	**16,019**	**18,751**

Southland Building Society

Statement of Comprehensive Income for the six months ended 30 September 2020

All in $000's

	Unaudited 6 Months 30/09/2020	Unaudited 6 Months 30/09/2019	Audited 12 Months 31/03/2020
Net surplus for the period	17,889	16,019	18,751
Items that may not be reclassified subsequently to profit or loss			
Net change in property, plant and equipment reserve, net of tax	-	-	(181)
Items that may be reclassified subsequently to profit or loss			
Net change in FVOCI reserve, net of tax	7,114	2,670	(1,171)
Net change in cash flow hedging reserve, net of tax	2,059	(5,737)	(5,919)
Other comprehensive income for the period, net of tax	9,173	(3,067)	(7,271)
Total comprehensive income for the period	**27,062**	**12,952**	**11,480**
Attributable to:			
Members' interests	27,062	12,827	11,355
Non-controlling interests	-	125	125
	27,062	**12,952**	**11,480**

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

Southland Building Society

Statement of Changes in Equity for the six months ended 30 September 2020

All in $000's

As at 30 September 2020 (Unaudited)	Retained earnings	Reserves: Property, plant and equipment	Reserves: FVOCI	Reserves: Cash flow hedging	Total equity attributable to members' interests	Non-controlling interests	Total equity
Balance as at 31 March 2020	344,735	2,057	5,749	(21,253)	331,288	-	**331,288**
Net surplus for the period	17,889	-	-	-	17,889	-	**17,889**
Other comprehensive income for the period							
Revaluation/change in fair value	-	-	9,880	2,635	12,515	-	**12,515**
Current/deferred tax impact	-	-	(2,766)	(576)	(3,342)	-	**(3,342)**
Total comprehensive income for the period	17,889	-	7,114	2,059	27,062	-	**27,062**
Dividends paid	-	-	-	-	-	-	**-**
Balance as at 30 September 2020	**362,624**	**2,057**	**12,863**	**(19,194)**	**358,350**	**-**	**358,350**

As at 30 September 2019 (Unaudited)	Retained earnings	Reserves: Property, plant and equipment	Reserves: FVOCI	Reserves: Cash flow hedging	Total equity attributable to members' interests	Non-controlling interests	Total equity
Balance as at 31 March 2019	330,536	2,238	6,920	(15,334)	324,360	973	**325,333**
Net surplus for the period	15,894	-	-	-	15,894	125	**16,019**
Other comprehensive income for the period							
Revaluation/change in fair value	-	-	3,709	(7,715)	(4,006)	-	**(4,006)**
Current/deferred tax impact	-	-	(1,039)	1,978	939	-	**939**
Total comprehensive income for the period	15,894	-	2,670	(5,737)	12,827	125	**12,952**
Acquisition of non-controlling interests	(4,427)	-	-	-	(4,427)	(973)	**(5,400)**
Dividends paid	-	-	-	-	-	(125)	**(125)**
Balance as at 30 September 2019	342,003	2,238	9,590	(21,071)	332,760	-	**332,760**

As at 31 March 2020 (Audited)	Retained earnings	Reserves: Property, plant and equipment	Reserves: FVOCI	Reserves: Cash flow hedging	Total equity attributable to members' interests	Non-controlling interests	Total equity
Balance as at 31 March 2019	330,536	2,238	6,920	(15,334)	324,360	973	**325,333**
Net surplus for the year	18,626	-	-	-	18,626	125	**18,751**
Other comprehensive income for the year							
Revaluation/change in fair value	-	(251)	(1,626)	(8,136)	(10,013)	-	**(10,013)**
Current/deferred tax impact	-	70	455	2,217	2,742	-	**2,742**
Total comprehensive income for the year	18,626	(181)	(1,171)	(5,919)	11,355	125	**11,480**
Acquisition of non-controlling interests	(4,427)	-	-	-	(4,427)	(973)	**(5,400)**
Dividends paid	-	-	-	-	-	(125)	**(125)**
Balance as at 31 March 2020	344,735	2,057	5,749	(21,253)	331,288	-	**331,288**

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

Southland Building Society
Statement of Financial Position as at 30 September 2020
All in $000's

	Note	Unaudited 30/09/2020	Unaudited 30/09/2019	Audited 31/03/2020
Assets				
Cash on hand and at bank		52,225	50,778	60,120
Funds with financial institutions		45,219	53,882	82,804
Investment securities	(4)	551,388	569,039	532,654
Derivative financial instruments		8,331	8,168	8,587
Advances to customers	(5)	4,070,566	4,070,073	4,138,394
Investments in associates		7,596	6,925	7,274
Other assets		31,478	33,448	33,314
Property, plant and equipment		19,424	20,281	19,848
Right-of-use assets		24,208	23,888	24,469
Assets held for sale		653	661	657
Goodwill and intangible assets		11,097	12,523	11,741
Net deferred tax assets		20,034	13,306	21,666
		4,842,219	**4,862,972**	**4,941,528**
Liabilities				
Redeemable shares		3,376,926	3,295,627	3,378,387
Deposits from customers		173,044	148,527	134,655
Commercial paper		334,522	334,623	336,592
Due to other financial institutions		384,089	536,180	540,517
Derivative financial instruments		39,785	41,238	43,682
Current tax liabilities		4,209	3,033	3,828
Other liabilities		65,856	65,856	68,714
Subordinated redeemable shares		105,438	105,128	103,865
		4,483,869	**4,530,212**	**4,610,240**
Net assets		**358,350**	**332,760**	**331,288**
Equity				
Reserves		(4,274)	(9,243)	(13,447)
Retained earnings		362,624	342,003	344,735
Attributable to members of the society		358,350	332,760	331,288
Attributable to non-controlling interests		-	-	-
		358,350	**332,760**	**331,288**
Total interest earning and discount bearing assets		4,719,398	4,743,772	4,813,972
Total interest and discount bearing liabilities		4,073,821	4,199,821	4,229,675

For and on behalf of the Board of Directors:

Chairman
JF Ward

Deputy Chair
KJ Ball

18 November 2020

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

Southland Building Society

Statement of Cash Flows for the six months ended 30 September 2020

All in $000's

	Unaudited 6 Months 30/09/2020	Unaudited 6 Months 30/09/2019	Audited 12 Months 31/03/2020
Cash flows from operating activities			
Interest and dividends received	105,696	124,998	243,069
Interest and dividends paid	(53,759)	(66,347)	(129,140)
Other cash inflows provided by operating activities	21,299	25,835	52,102
Other cash outflows used in operating activities	(54,364)	(62,332)	(113,552)
Net cash flows from operating activities before changes in operating assets and liabilities	18,872	22,154	52,479
Net changes in operating assets and liabilities	(52,446)	(29,264)	(47,536)
Net cash flows provided by/(used in) operating activities	**(33,574)**	**(7,110)**	**4,943**
Cash flows from investing activities			
Cash inflows provided by investing activities	279	579	12,151
Cash outflows used in investing activities	(11,577)	(26,096)	(9,583)
Net cash flows provided by/(used in) investing activities	**(11,298)**	**(25,517)**	**2,568**
Cash flows from financing activities			
Cash inflows provided by financing activities	-	-	-
Cash outflows used in financing activities	(1,733)	(7,101)	(8,775)
Net cash flows provided by/(used in) financing activities	**(1,733)**	**(7,101)**	**(8,775)**
Net increase/(decrease) in cash held	(46,605)	(39,728)	(1,264)
Add opening cash and cash equivalents	138,040	139,304	139,304
Closing cash and cash equivalents	**91,435**	**99,576**	**138,040**
Reconciliation of cash and cash equivalents			
Cash on hand and at bank	52,225	50,778	60,120
Funds with financial institutions	39,249	48,847	77,980
Interest accrued	(39)	(49)	(60)
	91,435	**99,576**	**138,040**
Reconciliation of net surplus to net operating cash flows			
Net surplus for period	17,889	16,019	18,751
Non-cash items	5,803	11,172	39,911
Deferral or accruals of past or future operating cash receipts or payments	(57,286)	(34,314)	(53,721)
Items classified as cash	20	13	2
Net cash flows from operating activities	**(33,574)**	**(7,110)**	**4,943**

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

1. Significant Accounting Policies

(a) Basis of Preparation

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.

These financial statements were authorised for issue by the Board of Directors on 18 November 2020.

These financial statements have been prepared in accordance with New Zealand Generally Accepted Accounting Practice ("NZ GAAP"), NZ IAS 34 Interim Financial Reporting, Financial Markets Conduct Act 2013 and the Registered Bank Disclosure Statement (New Zealand Incorporated Registered Banks) Order 2014 (as amended) and should be read in conjunction with the Banking Group's financial statements for the year ended 31 March 2020.

(b) Changes in Accounting Policies

There have been no changes in accounting policies and all accounting policies adopted are consistent with those used in the financial year ended 31 March 2020.

2. Risk Management Policies

There has been no material change in the Banking Group's policies for managing risk, or material exposures to any new types of risk since the authorisation date of the previous Disclosure Statement on 26 May 2020.

3. Management Judgement, Estimates and Assumptions

The impact of Covid-19 remains a significant area of judgment. Management and risk management continue to monitor measures taken by government, the macro economic scenarios and accessing the impact on the Banking Group and industry. Refer to Note 6(f) for further information on impact on ECL and related sensitivity analysis on assumptions made.

4. Financial Assets Pledged as Collateral

As at 30 September 2020, no investments were encumbered through repurchase agreements (31 March 2020 $26.4 million). These investment securities have not been derecognised from the Banking Group's Statement of Financial Position as the Banking Group retains substantially all the risks and rewards of ownership. Counterparties have the right to sell or repledge these encumbered securities. The Bank's obligation to repurchase investment securities is classified under due to other financial institutions.

All in $000's

5. Advances to Customers

	Note	Unaudited 30/09/2020	Unaudited 30/09/2019	Audited 31/03/2020
Residential		3,227,993	3,156,754	3,218,777
Agricultural		200,506	228,840	217,371
Commercial		108,366	133,172	130,296
Consumer		580,343	579,736	623,040
Gross advances		**4,117,208**	**4,098,502**	**4,189,484**
Provisions for credit impairment	(6(d))	(47,602)	(28,779)	(51,412)
Deferred fee revenue and expenses		960	350	322
Total net advances		**4,070,566**	**4,070,073**	**4,138,394**

Included in advances to customers are $74.0 million (30 September 2019 $72.6 million 31 March 2020 $73.4 million) of reverse equity mortgages which are valued at fair value through profit or loss rather than at amortised cost.

6. Asset Quality and Provisions for Credit Impairment

(a) Asset quality - advances to customers

As at 30 September 2020	Residential Mortgages	Retail Exposures	Corporate Exposures	Total
Neither past due or impaired	3,201,355	544,212	302,635	**4,048,202**
Individually impaired	905	-	620	**1,525**
Past due	30,783	33,855	3,803	**68,441**
Provision for credit impairment	(13,206)	(28,387)	(6,009)	**(47,602)**
Carrying amount	**3,219,837**	**549,680**	**301,049**	**4,070,566**

- **Residential mortgages** comprise advances to individuals and corporates that are secured against residential properties. The securitiy against these loans include investments in residential property as well as owner-occupied housing.

- **Retail exposures** comprise consumer personal, consumer finance, consumer credit card 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.

(b) Ageing of past due but not impaired assets

As at 30 September 2020	Residential Mortgages	Retail Exposures	Corporate Exposures	Total
Past due 0-9 days	11,435	16,859	791	**29,085**
Past due 10-29 days	6,630	8,963	1,797	**17,390**
Past due 0-29 days	18,065	25,822	2,588	**46,475**
Past due 30-59 days	3,317	3,932	116	**7,365**
Past due 60-89 days	908	1,735	624	**3,267**
Past due 90+ days	8,493	2,366	475	**11,334**
Carrying amount	**30,783**	**33,855**	**3,803**	**68,441**

(c) Impaired assets

As at 30 September 2020	Residential Mortgages	Retail Exposures	Corporate Exposures	Total
Balance at beginning of the period	889	-	667	**1,556**
Additions to individually impaired assets	16	-	62	**78**
Reductions to individually impaired assets	-	-	(109)	**(109)**
Balance at end of the period	**905**	**-**	**620**	**1,525**
Specific provision at end of the period	(493)	-	(350)	**(843)**
Net carrying amount at end of the period	**412**	**-**	**270**	**682**
Undrawn balances on individually impaired lending commitments	-	-	-	-

All in $000's

6. Asset Quality and Provisions for Credit Impairment (continued)

(d) Provision for credit impairment

The Banking Group applies a three stage collective approach to measuring expected credit losses ("ECL") on financial assets accounted for at amortised cost and FVOCI. The key inputs into the measurement of ECL include variables such as probability of default ("PD"), exposure at default ("EAD") and loss given default ("LGD").

The following summarises the three stage model:

Stage 1 - Not deteriorated - the ECL is based on 12-month expected credit losses using a combination of historical losses and vintage analysis over the entire loan book;

Stage 2 - Deteriorated (accounts more than 30 days past due, as well as payment deferred hardship loans) - determined on reasonable and supportable forward looking data or if data not available use 30 days past due;

Stage 3 - Impaired - based on lifetime expected credit losses.

	Expected Credit Losses			Specific Provision	
As at 30 September 2020	Stage 1	Stage 2	Stage 3	Stage 3	Total
Residential Mortgages					
Balance at beginning of period	6,373	6,007	1,171	493	14,044
Changes to the opening balance due to transfer between stages:					
Transferred to Stage 1	3,215	(3,109)	(106)	-	-
Transferred to Stage 2	(236)	395	(159)	-	-
Transferred to Stage 3	(2)	(547)	549	-	-
New provisions	685	170	104	-	959
Charge/(credit) to income statement excluding transfers	(3,022)	1,143	82	-	(1,797)
Balance at end of period - Residential Mortgages	**7,013**	**4,059**	**1,641**	**493**	**13,206**
Retail Exposures					
Balance at beginning of period	18,756	7,226	4,975	-	30,957
Changes to the opening balance due to transfer between stages:					
Transferred to Stage 1	3,922	(2,897)	(1,025)	-	-
Transferred to Stage 2	(383)	508	(125)	-	-
Transferred to Stage 3	(176)	(215)	391	-	-
New provisions	3,649	5,735	4,334	-	13,718
Reversal of previously recognised provision	(8,548)	(3,773)	(3,967)	-	(16,288)
Balance at end of period - Retail Exposures	**17,220**	**6,584**	**4,583**	**-**	**28,387**
Corporate Exposures					
Balance at beginning of period	3,264	2,028	769	350	6,411
Changes to the opening balance due to transfer between stages:					
Transferred to Stage 1	808	(776)	(32)	-	-
Transferred to Stage 2	(189)	189	-	-	-
Transferred to Stage 3	(14)	(39)	53	-	-
New provisions	262	586	179	-	1,027
Charge/(credit) to income statement excluding transfers	(738)	466	(364)	-	(636)
Reversal of previously recognised provision	(410)	(115)	(268)	-	(793)
Balance at end of period - Corporate Exposures	**2,983**	**2,339**	**337**	**350**	**6,009**
Total					
Balance at beginning of period	28,393	15,261	6,915	843	51,412
Changes to the opening balance due to transfer between stages:					
Transferred to Stage 1	7,945	(6,782)	(1,163)	-	-
Transferred to Stage 2	(808)	1,092	(284)	-	-
Transferred to Stage 3	(192)	(801)	993	-	-
New provisions	4,596	6,491	4,617	-	15,704
Charge/(credit) to income statement excluding transfers	(3,760)	1,609	(282)	-	(2,433)
Reversal of previously recognised provision	(8,958)	(3,888)	(4,235)	-	(17,081)
Balance at end of period - Total	**27,216**	**12,982**	**6,561**	**843**	**47,602**

All in $000's

6. Asset Quality and Provisions for Credit Impairment (continued)

(e) Asset quality - movement in gross exposures

Movement in gross exposures/nominal amount of advances to customers, including loan commitments and financial guarantees by ECL allowance stage are as follows:

As at 30 September 2020

Residential Mortgages	**Stage 1**	**Stage 2**	**Stage 3**	**Total**
Balance at beginning of period	3,362,137	64,410	6,765	3,433,312
Changes to the opening balance due to transfer between stages:				
Transferred to Stage 1	34,620	(33,732)	(888)	-
Transferred to Stage 2	(120,556)	121,634	(1,078)	-
Transferred to Stage 3	(646)	(5,556)	6,202	-
New loans	363,049	6,824	35	369,908
Assets derecognised and payments made	(304,907)	(10,158)	(1,509)	(316,574)
Other movements	(84,290)	1,172	(35)	(83,153)
Balance at end of period - Residential Mortgages	**3,249,407**	**144,594**	**9,492**	**3,403,493**
Retail Exposures				
Balance at beginning of period	722,216	10,858	4,558	737,632
Changes to the opening balance due to transfer between stages:				
Transferred to Stage 1	4,958	(4,055)	(903)	-
Transferred to Stage 2	(4,791)	4,917	(126)	-
Transferred to Stage 3	(2,074)	(332)	2,406	-
New loans	148,423	409	13	148,845
Assets derecognised and payments made	(179,103)	(1,443)	(1,498)	(182,044)
Balance at end of period - Retail Exposures	**689,629**	**10,354**	**4,450**	**704,433**
Corporate Exposures				
Balance at beginning of period	312,367	40,543	2,270	355,180
Changes to the opening balance due to transfer between stages:				
Transferred to Stage 1	3,386	(3,361)	(25)	-
Transferred to Stage 2	(16,024)	16,024	-	-
Transferred to Stage 3	(182)	(44)	226	-
New loans	19,327	18,993	-	38,320
Assets derecognised and payments made	(48,439)	(18,531)	(1,353)	(68,323)
Other movements	29,931	2,192	(28)	32,095
Balance at end of period - Corporate Exposures	**300,366**	**55,816**	**1,090**	**357,272**
Total				
Balance at beginning of period	4,396,720	115,811	13,593	4,526,124
Changes to the opening balance due to transfer between stages:				
Transferred to Stage 1	42,964	(41,148)	(1,816)	-
Transferred to Stage 2	(141,371)	142,575	(1,204)	-
Transferred to Stage 3	(2,902)	(5,932)	8,834	-
New loans	530,799	26,226	48	557,073
Assets derecognised and payments made	(532,449)	(30,132)	(4,360)	(566,941)
Other movements	(54,359)	3,364	(63)	(51,058)
Balance at end of period - Total	**4,239,402**	**210,764**	**15,032**	**4,465,198**

All in $000's

6. Asset Quality and Provisions for Credit Impairment (continued)

(f) Covid-19 impact on credit performance

Our approach to incorporating the effect of Covid-19 on our ECL calculations was guided by a recognition that uncertainty has increased significantly since Covid-19, with unemployment and GDP both expected to deteriorate. However, there is significant uncertainty in the timing and quantum of this deterioration. Although the approach to ECL calculations remains the same as previous quarters, SBS has built in Covid-19 related adjustments to account for this uncertainty.

SBS have used probability weighted unemployment and GDP scenarios (base, optimistic and pessimistic) to calculate the ECL by risk-weighting these scenarios. In addition, sensitivity analysis has been performed to quantify the impact on the ECL of forecasts being incorrect.

Many SBS customers have taken up the SBS offer, which is in line with industry practice, to switch lending to interest only, or defer payments completely for up to six months as part of the Covid-19 response. For ECL calculation, SBS reviewed the lending to assess whether there had been a significant increase in credit risk that would require the loans to be placed in Stage 2 or Stage 3. SBS concluded that full payment deferred could indicate a credit risk increase, while moving to interest only did not. SBS has taken a prudent approach and placed all loans fully deferring payment into Stage 2, but keeping interest only loans in Stage 1. As at 30 September 2020, the Bank has provided mortgage repayment holidays to $107.7 million loans, with another $149.2 million loans moving to interest only.

Sensitivity of the collective provision ECL

The critical accounting assumptions in determining the provision relating to ECL, are the determination whether there has been a significant increase in credit risk and the use of probability weighted forward looking macroeconomic scenarios. Due to the current Covid-19 environment, there is a lot of uncertainty around macroeconomic forecasting. To provide a better understanding on the sensitivity of the credit impairment calculation based on the assumptions made, the Banking Group performed sensitivity analysis on the ECL. The sensitivity primarily reflects the impact on parent ECL (mainly relating to residential and corporate exposures), while historical loss experience for retail exposures has not shown a correlation to specific individual macro-economic indicators. The impact of Covid-19 for retail exposures has been incorporated by increasing the historical loss experience rates by a total of approximately 45%.

	Base	% change	Increase	Decrease
- Unemployment	as high as 9.8%	+/- 1%	1,450	(1,429)
- GDP	as low as -5.7%	+/- 1%	(528)	551
- House price	-25%	+/- 10%	(740)	639

(g) Credit impairment income statement reconciliation

The following provides a reconciliation of the movements in provisions for credit impairment reported in the income statement:

	Residential Mortgages	Retail Exposures	Corporate Exposures	Investment Securities	Total
Bad debts written off/recovered during the period	(21)	8,397	490	-	**8,866**
Individual provisions	-	-	-	-	**-**
Collective provision	(838)	(2,570)	(402)	-	**(3,810)**
Other credit provisions	-	-	-	(35)	**(35)**
Provision for credit impairment to income statement	**(859)**	**5,827**	**88**	**(35)**	**5,021**

(h) Other assets under administration

There are no other assets under administration as at 30 September 2020.

All in $000's

7. Contingent Liabilities and Credit Related Commitments

	Unaudited Contract or Notional Amt 30/09/2020	Unaudited Credit Equivalent 30/09/2020	Unaudited Contract or Notional Amt 30/09/2019	Unaudited Credit Equivalent 30/09/2019	Audited Contract or Notional Amt 31/03/2020	Audited Credit Equivalent 31/03/2020
Credit related commitments						
Commitments with uncertain drawdown	63,981	31,991	39,677	19,839	37,089	18,545
Commitments to extend credit which can be unconditionally cancelled	354,931	-	333,414	-	352,983	-
Total credit related commitments	**418,912**	**31,991**	**373,091**	**19,839**	**390,072**	**18,545**

The Banking Group has no material contingent liabilities.

The Banking Group has contingent liabilities in relation to actual and potential claims and proceedings. Where relevant, expert legal advice has been obtained and, in light of such advice, provisions and/or disclosures as deemed appropriate have been made. The outcome and total costs attributable to such claims and proceedings and possible exposures and potential remediation remain uncertain.

8. Related Parties

The Banking Group is controlled by SBS who is also the ultimate parent.

Effective 30 September 2019, the Banking Group increased its shareholding in Southsure Assurance Ltd ("Southsure") from 90% to 100%. In accordance with International Financial Reporting Standards, as the Bank has had no change in effective control, the acquisition price was recorded through equity to reflect transactions amongst shareholders. No adjustments have been made to the fair value of the assets and liabilities of Southsure in the consolidated accounts of the Bank in accordance with IFRS, and the associated premiums (reflecting the future earnings potential of the entities) are recorded as an adjustment to equity.

During September 2019, the Bank's indirect interest in Abbott NZ Holdings Ltd increased from 23.0% to 23.7% due to a reduction in the total shares on issue. This investment is still being accounted for as an associate company under the equity method of accounting as the Banking Group does not have control over the financial and operating policies.

At 30 September 2020 there are no amounts due from, or due to any related entities that are outside of the Banking Group.

All in $000's

9. Liquidity Risk

To meet both expected and unexpected fluctuations 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 with other registered banks.

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.

Core liquid assets	**Unaudited 30/09/2020**
Cash on hand and at bank	52,225
Funds with financial institutions	45,219
Investment securities	551,388
Committed and undrawn funding lines[2]	300,171
Eligible RMBS collateral (less haircut[1])	106,625
Total liquidity	**1,055,628**

[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.

[2] The Group also has another $66.0 million available funding, not included as core liquid assets, in two of the securitisation vehicles. This is subject to having sufficient assets available to be securitised and has therefore not been included.

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 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 profiles include interest cash flows expected to maturity. Note that the resulting undiscounted financial 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.

Monetary liabilities payable as at 30 September 2020 (contractual cash flows including expected interest to maturity)

	On demand	0-6 Months	6-12 Months	12-24 Months	24-60 Months	> 60 Months	Total
Liabilities							
Redeemable shares	650,829	1,751,396	787,184	147,087	40,430	-	**3,376,926**
Deposits from customers	7,040	66,443	86,671	9,063	3,827	-	**173,044**
Commercial paper	-	334,522	-	-	-	-	**334,522**
Due to other financial institutions	-	334,086	-	50,003	-	-	**384,089**
Current tax liabilities	4,209	-	-	-	-	-	**4,209**
Other liabilities	51,774	-	-	-	-	-	**51,774**
Subordinated redeemable shares	-	-	-	-	-	105,438	**105,438**
Total liabilities	**713,852**	**2,486,447**	**873,855**	**206,153**	**44,257**	**105,438**	**4,430,002**
Interest	(8)	7,655	3,207	645	1,062	56,010	**68,571**
Total liabilities (inclusive of interest)	**713,844**	**2,494,102**	**877,062**	**206,798**	**45,319**	**161,448**	**4,498,573**
Derivatives							
Net derivative cash flows	(8)	(11,261)	(5,630)	(3,817)	(1,844)	4	**(22,556)**
Unrecognised loan commitments	63,981	-	-	-	-	-	**63,981**

All in $000's

9. Liquidity Risk (continued)

Average liquidity ratios (unaudited)

The following ratios have been calculated in accordance with the Registered Bank Disclosure Statements (New Zealand Incorporated Registered Bank) Order 2014 (as amended) Schedule 9, and reflects the average daily ratio for each of the latest two quarters.

	Unaudited 30/09/2020	Unaudited 30/06/2020
One-week mismatch ratio	11.7%	11.9%
One-month mismatch ratio	16.6%	16.9%
Core funding ratio	97.2%	96.2%

10. 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.

The Banking Group's dominant activity is the provision of residential mortgage finance which comprises 79% (30 September 2019 77%; 31 March 2020 78%) of the Banking Group's loan portfolio and is undertaken throughout New Zealand. Agricultural loans which comprise 5% (30 September 2019 6%; 31 March 2020 5%) of the Banking Group's loan portfolio are predominantly concentrated in the Southland/Otago region.

(a) The maximum exposures to credit risk

	Unaudited 30/09/2020
Cash on hand and at bank	52,225
Funds with financial institutions	45,219
Investment securities	551,388
Derivative financial instruments	8,331
Advances to customers	4,070,566
Other assets	31,478
Total on-balance sheet credit exposures	**4,759,207**

(b) Concentrations of credit risk by sector

	Unaudited 30/09/2020
Residential	2,481,803
Residential investing	738,034
Agricultural	196,689
Commercial finance	15,354
Commercial other	89,007
Consumer lending	473,393
Consumer credit card	76,286
Local authority	85,047
Corporate investments	572,116
Other	31,478
Total concentrations of credit risk by sector	**4,759,207**

All in $000's

10. Credit Risk (continued)

(c) Concentrations of credit risk by geographical location

	Unaudited 30/09/2020
Auckland	1,193,479
North Island other	1,084,223
Canterbury	887,447
Otago	594,120
Southland	666,833
South Island other	227,122
Overseas	105,983
Total concentrations of credit risk by geographical location	**4,759,207**

(d) Concentration of credit exposures to individual 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 Common Equity Tier 1 capital, 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, supranational or quasisovereign agency 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 since the last disclosure statement using the Banking Group's end of period Common Equity Tier 1 capital.

	Number of non-bank counterparties			Number of bank counterparties		
End of period exposure	Unaudited	Unaudited	Audited	Unaudited	Unaudited	Audited
Percentage of common equity tier 1	30/09/2020	30/09/2019	31/03/2020	30/09/2020	30/09/2019	31/03/2020
10-14%	1	1	-	2	-	-
15-19%	-	-	-	1	-	1
20-24%	-	-	-	1	2	1
25-29%	-	-	-	-	1	1
30-34%	-	-	-	-	-	-
35-39%	-	-	-	-	-	-
40-44%	-	-	-	-	-	-
45-49%	-	-	-	1	1	-
50-54%	-	-	-	-	-	-
55-59%	-	-	-	-	-	-
60-64%	-	-	-	-	-	1

	Number of non-bank counterparties			Number of bank counterparties		
Peak exposure	Unaudited	Unaudited	Audited	Unaudited	Unaudited	Audited
Percentage of common equity tier 1	30/09/2020	30/09/2019	31/03/2020	30/09/2020	30/09/2019	31/03/2020
10-14%	1	1	1	1	-	-
15-19%	-	-	-	-	-	-
20-24%	-	-	-	3	2	1
25-29%	-	-	-	-	1	2
30-34%	-	-	-	-	-	-
45-49%	-	-	-	-	1	-
50-54%	-	-	-	1	-	-
55-59%	-	-	-	-	-	-
60-64%	-	-	-	-	-	1

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 or non-bank counterparties with a credit rating below A- or A3, or its equivalent, which exceeded 10% of the Banking Group's equity for the six months ended 30 September 2020.

All in $000's

11. 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.

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 its 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.

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

As at 30 September 2020 (Unaudited)	Less than 3 Months	3-6 Months	6-12 Months	12-24 Months	>24 Months	Non-Interest Bearing	Total
Assets							
Cash on hand and at bank	52,225	-	-	-	-	-	**52,225**
Funds with financial institutions	39,249	1,658	3,461	851	-	-	**45,219**
Investment securities	132,531	8,139	28,792	81,997	299,929	-	**551,388**
Derivative financial instruments	-	-	-	-	-	8,331	**8,331**
Advances to customers	1,250,326	434,712	962,193	964,893	458,442	-	**4,070,566**
Other assets	-	-	-	-	-	114,490	**114,490**
	1,474,331	444,509	994,446	1,047,741	758,371	122,821	**4,842,219**
Liabilities and equity							
Redeemable shares	1,260,136	843,402	787,184	147,087	40,430	298,687	**3,376,926**
Deposits from customers	40,919	31,053	86,671	9,062	3,828	1,511	**173,044**
Commercial paper	334,522	-	-	-	-	-	**334,522**
Due to other financial institutions	384,089	-	-	-	-	-	**384,089**
Derivative financial instruments	-	-	-	-	-	39,785	**39,785**
Current tax liabilities	-	-	-	-	-	4,209	**4,209**
Other liabilities	-	-	-	-	-	65,856	**65,856**
Subordinated redeemable shares	-	-	-	-	105,438	-	**105,438**
Equity	-	-	-	-	-	358,350	**358,350**
	2,019,666	874,455	873,855	156,149	149,696	768,398	**4,842,219**
On-balance sheet interest sensitivity gap	(545,335)	(429,946)	120,591	891,592	608,675	(645,577)	**-**
Net balance of derivative financial instruments	1,042,401	32,000	(130,400)	(706,000)	(238,001)	-	**-**
Total interest rate sensitivity gap	**497,066**	**(397,946)**	**(9,809)**	**185,592**	**370,674**	**(645,577)**	**-**

12. Capital Adequacy - Unaudited

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 qualifying capital is not less than 8%;
- Tier 1 capital 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 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, the Inland Revenue Department, 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.

Hardship loans

As at 30 September 2020, there have been $107.1 million of loans where the bank has approved mortgage repayment holidays under Covid-19 related hardship that have been classified as 'performing loans' in line with RBNZ guidance.

For the purposes of BS2A 43(h), any mortgage repayment holidays related to Covid-19 hardship loans are able to be treated as performing (non-defaulted) loans for capital adequacy purposes, provided they were not otherwise recorded as in arrears, on a watchlist or impaired in any way as at 29 February 2020. The standard regulatory treatment of such loans will resume for any loans restructured after 31 March 2021.

All in $000's

12. Capital Adequacy - Unaudited (continued)

		BANKING GROUP			REGISTERED BANK		
Regulatory capital ratios	Minimum ratio requirement	30/09/2020	30/09/2019	31/03/2020	30/09/2020	30/09/2019	31/03/2020
Common equity tier 1 capital ratio	4.5%	12.1%	11.4%	11.1%	10.4%	10.1%	9.8%
Tier 1 capital ratio	6.0%	12.1%	11.4%	11.1%	10.4%	10.1%	9.8%
Total capital ratio	8.0%	14.9%	14.2%	13.8%	13.8%	13.5%	13.2%
Buffer ratio	2.5%	6.1%	5.4%	5.1%			

(a) Qualifying capital

	BANKING GROUP 30/09/2020
Tier one capital	
Common equity tier 1 (CET1) capital	
Retained earnings	344,735
Current period's retained earnings	17,889
FVOCI reserve	12,863
Cash flow hedging reserve	(19,194)
Less deductions from CET1 capital	
Goodwill and intangible assets	(11,097)
Deferred tax assets	(20,034)
Cash flow hedging reserve	19,194
Investments in associates	(7,596)
Total CET1 capital	336,760
Additional tier 1 (AT1) capital	
Non-controlling interests (net of deductions and surplus AT1 capital) (Capital in nature)	-
Total AT1 capital	-
Total tier 1 capital	**336,760**
Tier 2 capital	
Revaluation reserves	2,057
Subordinated redeemable shares	75,578
Total tier 2 capital	**77,635**
Total capital	**414,395**

At 30 September 2020, the balance of all subordinated redeemable shares issued was $104.9 million. After adjustments for potential tax or other offsets, $75.6 million has been recognised as tier 2 capital for RBNZ capital adequacy purposes.

All in $000's

12. Capital Adequacy - Unaudited (continued)

(b) Total risk weighted assets

BANKING GROUP as at 30 September 2020 **On balance sheet credit exposures**	Total exposure after credit risk mitigation	Risk weighting	Risk weighted exposure	Minimum pillar one capital requirement
Cash	520	0%	-	-
Multilateral development banks	105,880	0%	-	-
Public sector entities	85,035	20%	17,007	1,361
Banks	126,768	20%	25,354	2,028
Banks	273,325	50%	136,663	10,933
Corporates				
Rating grade 1	18,001	20%	3,600	288
Rating grade 2	36,592	50%	18,296	1,464
Rating grade 3 - 4	106	100%	106	8
Rating grade 5	569	150%	854	68
Residential mortgages				
<= 80% loan to value ratio (LVR)	1,574,261	35%	550,991	44,079
80 <= 90% LVR	59,737	50%	29,869	2,390
90 <= 100% LVR	2,474	75%	1,856	148
Past due	7,856	100%	7,856	628
Impaired	412	100%	412	33
Property investment residential mortgage				
<= 80% LVR	927,999	40%	371,200	29,696
80 <= 90% LVR	6,458	70%	4,521	362
90 <= 100% LVR	1	90%	1	-
Residential mortgages first home loans				
<= 90% LVR	500,705	35%	175,247	14,020
90 <= 100% LVR	98,689	50%	49,345	3,948
Reverse residential mortgage loans				
<= 60% LVR	66,671	50%	33,336	2,667
60 <= 80% LVR	6,413	80%	5,130	410
80 <= 100% LVR	108	100%	108	9
Equity holdings	2,036	300%	6,108	489
Other assets	894,546	100%	894,546	71,564
Non-risk weighted assets	47,057	0%	-	-
Total on balance sheet credit exposures	4,842,219		2,332,406	186,593

Off balance sheet credit exposures	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
Commitments with uncertain drawdown	63,981	50%	31,991	74%	23,666	1,893
Commitments to extend credit which can be unconditionally cancelled	354,931	0%	-	0%	-	-
Market related contracts[1]						
Interest rate contracts	3,619,368	n/a	15,411	20%	3,082	247
Credit valuation adjustment (CVA)					306	24
Total off balance sheet credit exposures	4,038,280		47,402		27,054	2,164
Total credit risk	8,880,499		47,402		2,359,460	188,757
Operational risk	n/a				294,732	23,579
Market risk	n/a				133,570	10,686
Total risk weighted assets	8,880,499				2,787,762	223,022

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

All in $000's

12. Capital Adequacy - Unaudited (continued)

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

	BANKING GROUP	
	30/09/2020	30/09/2020
LVR range	On balance sheet	Off balance sheet
0 - 80%	2,643,763	210,823
80 - 90%	506,441	4,428
90% +	101,580	6,011
Total residential mortgages	**3,251,784**	**221,262**

First Home Loans make up 97% of the residential mortgages in the 90% + loan to valuation grouping and 87% of the 80 - 90% loan to valuation grouping. The First Home Loan product is fully insured by Housing New Zealand Corporation.

(d) Reconciliation of mortgage related amounts

	BANKING GROUP
	30/09/2020
Gross residential mortgage loans (Note 5)	3,227,993
Other lending residentially secured	31,757
Provision for credit impairment relating to residential mortgages (Note 6(a))	(13,206)
Deferred fee revenue and expenses relating to residential mortgages	5,240
Residential mortgage loans net of provision for impairment	3,251,784
Off balance sheet exposures - undrawn commitments (Note 12(c))	221,262
Total on and off balance sheet residential mortgage loans	**3,473,046**

(e) 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.

	BANKING GROUP	
	30/09/2020	30/09/2020
Interest rate exposures	End of Period	Peak End of Day
Implied risk weighted exposure	133,570	147,375
Aggregate capital charge	10,686	11,790

(f) 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 banks 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 $30 million to cover these identified risks (30 September 2019 $30 million; 31 March 2020 $30 million).

All in $000's

13. Fair Value of Financial Instruments

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:

	Unaudited Carrying value 30/09/2020	Unaudited Fair value 30/09/2020	Unaudited Carrying value 30/09/2019	Unaudited Fair value 30/09/2019	Audited Carrying value 31/03/2020	Audited Fair value 31/03/2020
Financial assets						
Advances to customers	4,070,566	4,066,716	4,070,073	4,065,783	4,138,394	4,143,139
Total financial assets	**4,070,566**	**4,066,716**	**4,070,073**	**4,065,783**	**4,138,394**	**4,143,139**
Financial liabilities						
Redeemable shares	3,376,926	3,380,087	3,295,627	3,315,458	3,378,387	3,388,247
Deposits from customers	173,044	174,853	148,527	150,676	134,655	135,300
Subordinated redeemable shares	105,438	111,955	105,128	114,251	103,865	109,275
Total financial liabilities	**3,655,408**	**3,666,895**	**3,549,282**	**3,580,385**	**3,616,907**	**3,632,822**

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.

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

As at 30/09/2020 (Unaudited)	Level 1	Level 2	Level 3	Total
Financial assets				
Derivative financial assets	-	8,331	-	**8,331**
Investment securities	2,036	549,546	-	**551,582**
Advances to customers	-	-	74,031	**74,031**
Total financial assets	**2,036**	**557,877**	**74,031**	**633,944**
Financial liabilities				
Derivative financial instruments	-	39,785	-	**39,785**
Total financial liabilities	**-**	**39,785**	**-**	**39,785**

As at 30/09/2019 (Unaudited)	Level 1	Level 2	Level 3	Total
Financial assets				
Derivative financial assets	-	8,168	-	**8,168**
Investment securities	2,909	566,407	-	**569,316**
Advances to customers	-	-	72,645	**72,645**
Total financial assets	**2,909**	**574,575**	**72,645**	**650,129**
Financial liabilities				
Derivative financial instruments	-	41,238	-	**41,238**
Total financial liabilities	**-**	**41,238**	**-**	**41,238**

As at 31/03/2020 (Audited)	Level 1	Level 2	Level 3	Total
Financial assets				
Derivative financial assets	-	8,587	-	**8,587**
Investment securities	1,729	531,130	-	**532,859**
Advances to customers	-	-	73,448	**73,448**
Total financial assets	**1,729**	**539,717**	**73,448**	**614,894**
Financial liabilities				
Derivative financial instruments	-	43,682	-	**43,682**
Total financial liabilities	**-**	**43,682**	**-**	**43,682**

Further information on valuation techniques and assumptions for specific asset classes is included in Notes 19 and 20 of the Bank's annual Disclosure Statement.

All in $000's

14. Concentrations of Funding

(a) Concentrations of funding by geographical location	Unaudited 30/09/2020
North Island other	606,779
Auckland	851,379
Canterbury	763,043
Otago	700,910
Southland	1,015,352
South Island other	335,837
Overseas	100,719
Total concentrations of funding by geographical location	**4,374,019**
(b) Concentrations of funding by product	
Redeemable shares	3,376,926
Deposits from customers	173,044
Commercial paper	334,522
Due to other financial institutions	384,089
Subordinated redeemable shares	105,438
Total concentrations of funding by product	**4,374,019**

15. Insurance Business

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

The total assets of Southsure Assurance Limited as at 30 September 2020 are $22.8 million which is 0.5% of the total assets of the Banking Group.

16. Subsequent Events

There have been no material subsequent events after 30 September 2020.

Independent Review Report

To the Members of Southland Building Society

Report on the half year disclosure statement

Conclusion

Based on our review of the interim consolidated financial statements and supplementary information of the Southland Building Society (the "Registered Bank") and its subsidiaries (the "Banking Group") on pages 5 to 24 , nothing has come to our attention that causes us to believe that:

i. the interim consolidated financial statements do not present fairly in all material respects the Banking Group's financial position as at 30 September 2020 and its financial performance and cash flows for the 6 month period ended on that date;

ii. the interim consolidated financial statements (excluding the supplementary information disclosed in accordance with Schedules 5, 7, 9, 13, 16 and 18 of the Registered Bank Disclosure Statements (New Zealand Incorporated Registered Banks) Order 2014 (as amended) (the "Order")), have not been prepared, in all material respects, with NZ IAS 34 Interim Financial Reporting ("NZ IAS 34");

iii. the supplementary information, does not fairly state, in all material respects, the matters to which it relates in accordance with Schedules 5, 7, 9, 13, 16 and 18 of the Order; and

iv. the supplementary information relating to capital adequacy and regulatory liquidity requirements, has not been prepared, in all material respects, in accordance with the Banking Group's conditions of registration, Capital Adequacy Framework (Standardised Approach) (BS2A) and disclose it in accordance with Schedule 9 of the Order.

We have completed a review of the accompanying half year disclosure statement which comprises:

- the interim consolidated financial statements formed of:
  - the consolidated statement of financial position as at 30 September 2020;
  - the consolidated income statement, statements of comprehensive income, changes in equity and cash flows for the 6 month period then ended; and
  - notes, including a summary of significant accounting policies and other explanatory information.
- the supplementary information prescribed in Schedules 5, 7, 9, 13, 16 and 18 of the Order.

Basis for conclusion

A review of the half year disclosure statement 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, consisting of making enquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures.

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.

Our firm has also provided other services to the Banking Group in relation to assurance services on the calculation of net tangible assets of Funds Administration New Zealand. 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 reviewer of the Banking Group. The firm has no other relationship with, or interest in, the Banking Group.

Emphasis of Matter – Estimation Uncertainty in the Preparation of the Interim Consolidated Financial Statements

We draw attention to Note 6 (f) *COVID-19 Impact on credit performance* in the interim consolidated financial statements, which describes increased estimation uncertainty in the preparation of the interim consolidated financial statements, specifically as it relates to the potential impacts of Coronavirus (COVID-19) pandemic on the Banking Group's allowance for credit losses (ECL). These disclosures include key judgements and assumptions in relation to the ECL model inputs and the sensitivity of the provision amount to changes in these assumptions.

As described in Note 6 (f) *COVID 19 Impact on credit performance,* given the large amount of uncertainty in the current economic environment, expected credit losses should be considered as a best estimate within a range of possible estimates.

In our view, these judgements and assumptions are fundamental to the users' understanding of the financial position and performance of the Banking Group.

Our conclusion on the interim financial statements is not modified in respect of this matter.

Use of this independent review report

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

Responsibilities of the Directors for the half year disclosure statement

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

— the preparation and fair presentation of the half year disclosure statement in accordance with NZ IAS 34 and Schedules 3, 5, 7, 13, 16 and 18 of the Order;

- the preparation and fair presentation of the supplementary information in regards to capital adequacy and regulatory liquidity requirements in accordance with the Banking Group's conditions of registration, Capital Adequacy Framework (Standardised Approach) (BS2A) and Schedule 9 of the Order;
- implementing necessary internal control to enable the preparation of a half year disclosure statement that is 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 review of the half year disclosure statement

Our responsibility is to express a conclusion on the half year disclosure statement based on our review. We conducted our review in accordance with NZ SRE 2410. NZ SRE 2410 requires us to conclude whether anything has come to our attention that causes us to believe that the:

- the interim consolidated financial statements do not present fairly in all material respects the Banking Group's financial position as at 30 September 2020 and its financial performance and cash flows for the 6 month period ended on that date;
- the interim consolidated financial statements do not, in all material respects, comply with NZ IAS 34;
- the supplementary information does not, fairly state, in all material respects, the matters to which it relates in accordance with Schedules 5, 7, 13, 16 and 18 of the Order; and
- the supplementary information relating to capital adequacy and regulatory liquidity requirements is not, prepared in all material respects, in accordance with the Banking Group's Conditions of Registration, Capital Adequacy Framework (Standardised Approach) (BS2A) and disclosed in accordance with Schedule 9 of the Order.

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 half year disclosure statement.

KPMG

KPMG
Christchurch

20 November 2020