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Replacement Product Disclosure Statement

This Replacement Product Disclosure Statement
replaces the Product Disclosure Statement dated 8 March 2019
2019 relating to an Offer of Debt Securities in Credit Union South
(trading as NZCU South)

This document gives you important information about this investment to help you decide whether you want to invest. There is other useful information about this Offer on www.business.govt.nz/disclose available by searching offer number OFR10365. Credit Union South has prepared this document in accordance with the Financial Markets Conduct Act 2013. You can also seek advice from a financial adviser to help you make an investment decision.

Dated: 14 March 2019

The logo for NZCU South features the letters 'nzcu' in a bold, lowercase, black sans-serif font. To the right of 'nzcu' is a registered trademark symbol (®). Below 'nzcu' is the word 'south' in a smaller, lowercase, orange sans-serif font.

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1. Which products are offered under this PDS?

This Product Disclosure Statement (**PDS**) contains information on the continuous offer to subscribe for fully paid-up, redeemable shares (**Shares**) in one or more of the share accounts (**Accounts**) offered by Credit Union South trading as NZCU South (**Credit Union South**).

The Shares are treated as debt securities under the Financial Markets Conduct Act 2013 (**FMCA**), and this PDS is prepared in accordance with the Financial Markets Conduct Regulations 2014 (**Regulations**) under Schedule 7 NBDT Category 2 Debt Securities.

When you invest money with Credit Union South, you obtain the right to be repaid that money together with any accrued interest (depending on your Account). Based on your Account, you may be repaid your money when you wish to withdraw it, or when your term deposit comes to an end. Shares offered by Credit Union South are more similar to a deposit in a savings account, than they are to shares in a company.

Holders of Shares in Credit Union South are known as “Members”. The offer of Shares is open only to people who meet the following membership criteria:

- any person residing or working in New Zealand, including any such person 16 years or younger;
- any registered charitable entity; or
- any incorporated society.

Prospective and existing Members are invited to subscribe for Shares at \$1.00 per Share, which must be held in one or more of the Accounts operated by Credit Union South. You may nominate which Accounts you wish your Shares to be held in, and you are able to invest in a number of different Accounts.

Each Account is either on call or fixed term. Shares held in On-Call Accounts and Notice of Withdrawal Accounts can be redeemed at call or with the required notice period (if applicable), Credit Union South has, however, the right at any time to require a 60 day notice period for withdrawals under the Friendly Societies and Credit Unions Act 1982 (**FSCU Act**) for any type of Account.

The interest rate applicable to the Shares and the frequency of the interest payments depends on the type of Account nominated to invest in and the term of any such investment.

Credit Union South may vary the terms and conditions of any Account by giving notice on Credit Union South’s website: www.nzcusouth.co.nz.

Further details on Credit Union South’s On-Call Accounts, Notice of Withdrawal Accounts, Term Accounts and Christmas Saver Accounts, terms and conditions, fees and charges and interest rates can be found by viewing the document titled “Summary of Accounts and Fees” on the Offer Register at <http://www.business.govt.nz/disclose> by searching offer number OFR10365, at any Branch Office, or by visiting Credit Union South’s website: www.nzcusouth.co.nz.

2. Credit Union South and what it does

Overview of Credit Union South

Credit Union South is a financial co-operative, which was registered as a credit union on 9 June 1988 under the FSCU Act (registration number 1802885).

Credit Union South is also a registered financial service provider under the Financial Service Providers (Registration and Dispute Resolution) Act 2008 (**FSP Act**), under the registration number FSP27046.

Credit Union South is a non-bank deposit taker (**NBDT**) in terms of the Non-bank Deposit Takers Act 2013 (**NBDT Act**) and was licensed by the Reserve Bank as a NBDT on 16 February 2015. Credit Union South is not a registered bank in terms of the Reserve Bank of New Zealand Act 1989 (**Reserve Bank Act**).

The objects of Credit Union South are:

- the promotion of thrift amongst its Members by the accumulation of their savings;
- the use and control of the Members' savings for their mutual benefit;
- the training and education of the Members in the wise use of money and in the management of their financial affairs; and
- at the discretion of Credit Union South and as a minor adjunct to its other objects, the welfare of its Members and the making of donations for charitable, cultural, benevolent or philanthropic purposes.

Credit Union South is committed to meeting its objectives, and in doing so, offers a variety of financial products and services to Members including savings accounts, loans, and budgeting education.

Credit Union South has one subsidiary company, Taxcheck.co.nz Limited. At the request of Credit Union South, the Registrar of Companies has provided public notice of the intention to remove Taxcheck.co.nz Limited as a company under section 318 of the Companies Act 1993. Taxcheck.co.nz Limited is expected to be dissolved and removed as a company by the end of March 2019. Taxcheck.co.nz Limited and the discontinued TaxCheck service it provided are further described below.

Credit Union South has in place a Securitisation Programme which enables it to access additional funding, and which is described in more detail below. The Credit Union South Warehouse A Trust (**Trust**), established on 9 February 2016, forms part of the Securitisation Programme and is a controlled entity in terms of generally accepted accounting principles.

Credit Union South operates in accordance with a trust deed dated 18 December 2015 as amended on 21 November 2016 (**Trust Deed**) and its own Rules which are registered in accordance with the FSCU Act. The Trust Deed and the Rules are available on the Offer Register by searching offer number OFR10365, via Credit Union South's website at www.nzcusouth.co.nz and upon request at the registered office of Credit Union South.

Under the Trust Deed, Trustees Executors Limited is appointed as the supervisor of Credit Union South (**Supervisor**). The role of the Supervisor is to monitor the operations of Credit Union South, and assist it in complying with its statutory obligations.

Operations and Main Activities of Credit Union South

For over 30 years, Credit Union South has offered a range of financial services designed to assist Members' in their use and management of their money. Credit Union South operates as a NBDT in the financial services industry. It has a particular focus on lending to New Zealand individuals and families, and helping them achieve their savings goals.

As a financial service provider registered under the FSP Act, Credit Union South is part of the financial services industry and offers loans, on call accounts and term deposit accounts to Members. Its subsidiary, Taxcheck.co.nz Limited, offered a tax return service. While this service was discontinued on 1 October 2018 as it did not form part of the core business of Credit Union South, it remains accessible for Members with tax returns filed prior to that date, and which have not yet been processed. It is anticipated that Taxcheck.co.nz Limited will be dissolved and removed as an entity by the end of March 2019, at which point the TaxCheck service will no longer operate.

Aspects of the Business that are Key to Generating Income

Credit Union South has highlighted several aspects of its business which are key to generating income:

Assets of Credit Union South

Credit Union South owns principal assets which are key to it generating income. The principal assets include its loan pool (including mortgage advances to customers and finance receivables), deposits and other investments. These assets are used solely for furthering the objectives of Credit Union South and generating income. From time to time loans are sold to the Trust as part of the Securitisation Programme.

Credit Union South receives cash in return for the sale. This Programme is permitted by the Supervisor. Other than the Securitisation Programme and as provided in the Trust Deed and consented to by the Supervisor, the principal assets are not subject to any other obligations or security interests, in favour of another person, that modify or restrict Credit Union South's ability to deal with the assets. For more information on Security Interests see section 4 (Credit Union South's financial information) in this PDS.

Growing the Loan Portfolio

Credit Union South makes loan advances from its share capital to its Members. Credit Union South receives income from the interest charged on these loans. Credit Union South's loan advances are residential mortgages and consumer finance provided to Members for personal, domestic and household purposes such as vehicle purchases, holidays and debt consolidations. As the income generated by the loan portfolio provides the majority of Credit Union South's surplus, it is desirable to grow the loan portfolio.

The ability of growing loans to Members is, among other things, dependent on the availability of funds to Credit Union South from its share capital at any particular time. As part of its strategy to grow its loan portfolio, Credit Union South put in place a Securitisation Programme in December 2015 to allow Credit Union South to offer more loans to Members by providing additional funding up to \$25 million. For further information on the Securitisation Programme, see section 6 (Specific risks of investing) of this PDS, and the "Summary of the Securitisation Programme" on the Offer Register at www.business.govt.nz/disclose by searching offer number OFR10365.

Other Products and New Markets

Credit Union South also generates income from fees, commissions on loan insurance, Kiwisaver products and retail transactional banking services. While Credit Union South historically concentrated its membership in the South Island, it has also expanded its network into the larger market of the North Island.

Investment

Credit Union South has a number of investments which contribute to the overall income of Credit Union South, including deposits with registered banks, deposits with the New Zealand Association of Credit Unions (trading as Co-Op Money) (**NZACU**), and, until its recent discontinuation, profits from Credit Union South's subsidiary Taxcheck.co.nz Limited.

Securitisation

Credit Union South has diversified its funding by entering into a Securitisation Programme arranged by Westpac New Zealand Limited (**Westpac**). The Securitisation Programme uses a special purpose trust that purchases certain loans from Credit Union South. The Securitisation Programme gives Credit Union South access to additional funding up to a maximum of \$25 million, and is designed to enable Credit Union South to generate further loans and income through lending. Credit Union South recognises that while the Securitisation Programme introduces some risks to Members, it is of the opinion that, on the whole, the implementation of the Securitisation Programme provides more benefits than risks to Members by providing diversification of funding and liquidity. For further information regarding the risks see section 6 (Specific risks of investing) of this PDS.

For further information on the Securitisation Programme see the "Summary of the Securitisation Programme" on the Offer Register at www.business.govt.nz/disclose, available by searching offer number OFR10365.

Merger of Participating Credit Unions

On 13 March 2019, Members of Credit Union South passed a special resolution approving a transfer of the engagements of Credit Union South to Credit Union Baywide, as part of the proposed multi-party credit union merger further described below:

Credit Union South, together with Aotearoa Credit Union, Credit Union Central, Steelsands Credit Union and Credit Union Baywide (**Participating Credit Unions**) entered into a Heads of Agreement on 17

December 2018 (**Heads of Agreement**) and a Transfer Agreement on 14 January 2019 (**Transfer Agreement**). It is intended that Credit Union Baywide will accept a transfer of engagements from each other Participating Credit Union which successfully approves the transfer of its engagements to Credit Union Baywide (**Transferring Credit Unions**), resulting in a single merged entity (**Transfer of Engagements**). The Transfer Agreement was amended on 24 January 2019, to extend the timeline for completion of the Transfer of Engagements. The Transfer of Engagements remains subject to the satisfaction of certain other conditions, but is intended to take effect from 1 May 2019.

Under the Transfer of Engagements, Credit Union Baywide would assume all assets and liabilities of each of the Transferring Credit Unions. Following this, Credit Union Baywide would operate as a single merged entity, and each Transferring Credit Union would cease to exist. This process would involve Credit Union Baywide accepting a transfer of assets from, and undertaking to meet the liabilities of, each Transferring Credit Union, in accordance with the FSCU Act.

On 13 March 2019, the Members of Credit Union South passed a special resolution approving the Transfer of Engagements, and authorising the Board of Credit Union South to enter into all documents, and take all steps, as may be necessary to effect the merger. A period of six weeks from this date is provided for Members to lodge any objections, and the special resolution will not take effect until this period has expired, and all objections determined or withdrawn. Members who feel they would be adversely affected by the Transfer of Engagements may lodge their objections in writing to the Registrar of Friendly Societies and Credit Unions, Private Bag 92061, Victoria Street West, Auckland 1142.

The Transfer of Engagements also remains subject to the approval of the members and the board of directors of Credit Union Baywide. This is in addition to any regulatory consents and approvals as may be required by the Supervisor, the FSCU Act, or otherwise.

It is intended that the Transfer of Engagements will take effect from 1 May 2019. In the event one or more Participating Credit Unions (other than Credit Union Baywide) is unable to proceed with the Transfer of Engagements, it is proposed that Credit Union Baywide and the Transferring Credit Unions may carry out the Transfer of Engagements notwithstanding this. Therefore, it could be that all or a lesser number of the Participating Credit Unions implement a transfer of engagements to Credit Union Baywide.

In conjunction with the entry into the Heads of Agreement and the Transfer Agreement, Credit Union South entered into a Liquidity Facility Agreement on 20 December 2018 with the other Participating Credit Unions, that enables Aotearoa Credit Union to borrow up to \$1,250,000 from the other Participating Credit Unions (**Liquidity Facility Agreement**) in order to provide it with the funding it expects will be required in the period leading up to completion of the Transfer of Engagements. All moneys drawn by Aotearoa Credit Union under the Liquidity Facility Agreement are therefore repayable by 1 May 2019. Moneys payable under the Liquidity Facility Agreement are unsecured, ranked behind, and are subordinated to, the moneys payable under the trust deed of Aotearoa Credit Union.

Financial Covenant Breaches

Credit Union South breached its related party exposure obligations under the Trust Deed and the Deposit Takers (Credit Ratings, Capital Ratios and Related Party Exposures) Regulations 2010 (**NBDT Regulations**) for the period of 31 July 2018 until 5 October 2018. This is because the membership of NZACU reduced to ten credit unions, resulting in all member credit unions holding a 10% or greater controlling stake in NZACU. Due to the increased controlling stake and under the NBDT Regulations, Credit Union South was deemed to be a related party of NZACU. The main related party exposure for Credit Union South is the Settlement Bond. Refer to section 4 (Credit Union South's financial information) for further details on the Settlement Bond.

In order to rectify the breach, Credit Union South along with other credit unions obtained an exemption from the Reserve Bank of New Zealand (**RBNZ**) on 5 October 2018, being the Non-bank Deposit Takers (Exposures to Co-op Money NZ) Exemption Notice 2018 (**Exemption Notice**). For the period from 31 July 2018 until the exemption was granted, RBNZ had issued a notice stating that, subject to conditions, no action or enforcement would be taken by RBNZ in relation to the breach. On 31 July 2018 the Supervisor

provided consent to enable Credit Union South to continue to issue securities, and provided confirmation that it will take no action as a result of the event of default under the Trust Deed subject to certain conditions.

The Exemption Notice allows Credit Union South to exclude exposures to NZACU when calculating the maximum limit on aggregated related party exposures as set out in the NBDT Regulations and the Trust Deed. NZACU is proposing to restructure its business operations with effect from mid-2019, which will rectify the compliance issue. The Exemption Notice will expire on 30 September 2019. Refer to section 6 (Specific risks of investing) under the heading “Non Compliance with NBDT Act – Related Party Exposures Risk” for further detail.

Credit Union South breached the terms of its previous Trust Deed by making distributions of interest and dividends in excess of surplus earned by Credit Union South for the month of September 2015. On 19 October 2015, the Supervisor consented, pursuant to clause 5.2(b) of the previous Trust Deed, to Credit Union South continuing to offer and issue Shares while in breach of the provisions of the Previous Trust Deed.

Credit Union South breached the terms of its previous Trust Deed by making distributions of interest and dividends in excess of surplus earned by the Credit Union South for the month of November 2013. On 16 December 2013, the Supervisor consented, pursuant to clause 5.2(b) of the previous Trust Deed, to Credit Union South continuing to offer and issue Shares while in breach of the provisions of the Previous Trust Deed.

3. What is Credit Union South’s credit rating?

A credit rating is an independent opinion of the capability and willingness of an entity to repay its debts (in other words, its creditworthiness). It is not a guarantee that the financial product being offered is a safe investment. A credit rating should be considered alongside all other relevant information when making an investment decision.

Credit Union South has been rated by Fitch Ratings. Fitch Ratings gives ratings from AAA through to D. Credit Union South was given a long-term issuer credit rating of **BB** with a **Stable Outlook** and a short-term issuer credit rating of **B** on 8 November 2017. This rating was affirmed by Fitch on 30 December 2018 following the announcement of the planned merger of the Participating Credit Unions, discussed in more detail in section 2 (Credit Union South and what it does) under the heading “Merger of Participating Credit Unions”. For further information on Credit Union South’s credit rating see section 6 (Specific risks of investing) under the heading “Change in credit rating”.

Summary of the opinions reflected by Fitch Ratings

Credit Rating for Fitch Ratings	Summary Description of Credit Rating	Historic likelihood of default over 5 years ¹
AAA	Extremely strong	1 in 600
AA	Very strong	1 in 300
A	Strong	1 in 150
BBB	Adequate	1 in 30
BB	Less vulnerable	1 in 10
B	More vulnerable	1 in 5
CCC	Currently vulnerable	1 in 2
CC	Currently highly vulnerable	1 in 2
C	Default imminent or inevitable	
D	Default has occurred	

¹Reserve Bank of New Zealand publication ‘Know your credit ratings’, dated March 2010, <https://www.rbnz.govt.nz/research-and-publications/fact-sheets-and-guides/factsheet-know-your-credit-ratings>.

Ratings from 'AA' to 'B' may be modified by the addition of a plus (+) or minus (-) sign to show relative standing within the major rating categories. A Fitch Ratings rating may also include an 'Outlook' assessment. An Outlook assessment considers the potential direction of a long-term credit rating over the intermediate term (twelve to twenty four months) but does not mean the rating will change. The principal Outlook definitions include: Positive – the rating may be raised; Negative – the rating may be lowered; and Stable – the rating is not likely to change. A copy of the full Fitch Rating can be found on the Offer Register at www.business.govt.nz/disclose by searching offer number OFR10365, or on Credit Union South's website, <https://nzcusouth.co.nz/about-nzcu-south/investor-information/>.

The credit rating of Credit Union Baywide (as the merged entity) will be reviewed and may be amended by Fitch Ratings as a consequence of the Transfer of Engagements under the Heads of Agreement and Transfer Agreement, as described in section 2 (Credit Union South and what it does) under the heading "Merger of Participating Credit Unions" being completed, or if there is any other significant market change. Fitch Ratings may also review and amend the credit rating of Credit Union South in the event the Transfer of Engagements does not proceed for any reason.

4. Credit Union South's financial information

Credit Union South is required by law and its Trust Deed to meet certain financial requirements. The Key Ratios and Selected Financial Information tables show how Credit Union South is currently meeting those requirements. These are minimum requirements, and meeting them does not mean that Credit Union South is safe. The section on specific risks of investing sets out risk factors that could cause its financial position to deteriorate. The Offer Register provides a breakdown of how the figures in this table are calculated, as well as full financial statements.

Key Ratios

The Key Ratios and Selected Financial Information tables are available separately to this PDS. These tables and other financial information can be found in the most recent Credit Union South Quarterly Report available under the additional NBDT financial information tab on the Offer Register at www.business.govt.nz/disclose, by searching offer number OFR10365.

Prior Ranking Security Interests

Shares in Credit Union South are secured to the extent permitted by law by a first ranking security interest granted in favour of the Supervisor under the Trust Deed over all present and after acquired personal property of Credit Union South (**Supervisor's Security Interest**). Under the Trust Deed, Credit Union South is, with the consent of the Supervisor, permitted to create security interests that rank prior to, or equally with, the Supervisor's Security Interest. Those permitted prior ranking security interests are set out in greater detail below:

Security Interests over Leased Assets

The Supervisor has agreed to Credit Union South leasing particular photocopiers and office assets from Fuji Xerox Finance Limited (**Fuji Xerox**), which is a deemed security interest registered on the Personal Property Securities Register. This security interest does not secure the payment or performance of an obligation of Credit Union South, as it registers Fuji Xerox's interest in its own property leased to Credit Union South in order to protect ownership of that property under the Personal Property Security Register. Therefore, the leased assets do not have an asset value to Credit Union South. This security interest ranks in priority to the Supervisor's Security Interest in relation to the specified leased office photocopiers.

NZACU Settlement Bond

Under the terms and conditions of Credit Union South's banking arrangements with NZACU, a settlement bond is held by way of term deposit with NZACU's central bank. The Settlement Bond is an agreement between Credit Union South and NZACU, consented to by the Supervisor, whereby a sum of up to 3.5% of

Credit Union South's total tangible assets are excluded from the Supervisor's Security Interest over those assets. In the event that Credit Union South is unable to settle its inter-bank requirements, the Settlement Bond enables NZACU to make the required payment. Settlement Bonds with NZACU are held on trust, for the benefit of Credit Union South.

Security Interests in Loans under Securitisation Programme

The Securitisation Programme provides Credit Union South access to additional funding up to an amount agreed with Westpac, currently \$25 million. Under the Securitisation Programme, Credit Union South may sell eligible loans to the Trust as a means of raising further funds to allow it to offer more loans to Members and to assist it in meeting its objectives.

As at 28 February 2019, Credit Union South has a facility balance under the Securitisation Programme of \$13.5 million, together with eligible securitisable receivables available to facilitate an additional \$4.3 million in funding. The Trust is funded by Westpac and Credit Union South, and the Supervisor has agreed to a security interest being registered in favour of The New Zealand Guardian Trust Company Limited (**NZGT**) as trustee of the Trust.

This security interest secures the performance obligations of Credit Union South to sell the loans to the Trust. As at 28 February 2019, the amount of liability that is secured is the value of the senior funding, being \$13.5 million, together with the value of the assets that are subject to the security interest and all the loans sold to NZGT (including their proceeds), combining to a total aggregate value of \$17.7 million. The loans subject to the security interest as at 28 February 2019 represents 16.8% of the total loan book. This security interest ranks in priority to the Supervisor's Security Interest in relation to the specified assets being all the sold loans.

For further information on the Securitisation Programme see the "Summary of the Securitisation Programme" on the Offer Register at www.business.govt.nz/disclose by searching offer number OFR10365.

Other limitations, restrictions and prohibitions

Set out below is a summary of the other limitations, restrictions and prohibitions on Credit Union South. For further details refer to the Trust Deed on the Offer Register at www.business.govt.nz/disclose, available by searching offer number OFR10365.

Financial Covenants

Credit Union South has covenanted with the Supervisor under the Trust Deed, as set out below:

Capital Ratio Requirement

Due to the Securitisation Programme and the terms of the Trust Deed, Credit Union South will not permit its capital ratio to be less than 10%. Notwithstanding that, the minimum capital ratio under the NBDT Regulations is stipulated to be 8%.

The **capital ratio** is a measure of the extent to which Credit Union South is able to absorb losses without becoming insolvent. The lower the capital ratio, the fewer financial assets Credit Union South holds relative to its financial exposure

Liquidity Requirements

Credit Union South will not permit its liquid assets to be less than 8% of Total Tangible Assets (as that term is defined in the NBDT Regulations).

Credit Union South will not permit its liquid assets to be less than 115% of any deficit arising from the contracted principal and interest due to it in the next 3 months, less the aggregate of 20% of the principal due on specified securities, 100% of the interest due on those specified securities (in each case based on contractual maturities), and 20% of its undrawn committed lending facilities.

These liquidity requirements help to ensure that Credit Union South has sufficient realisable assets on hand to pay its debts as they become due in the ordinary course of business.

Restriction of Distributions

Credit Union South will not make distributions to Members other than in accordance with FSCU Act and any other applicable law.

No Prior Ranking Debt

Except as otherwise agreed with the Supervisor, Credit Union South will ensure that all debts or liabilities owed to it by third parties (other than normal trade creditors) are Subordinated Debt (as that term is defined in the Trust Deed).

External Secured Liabilities Restriction

Except as otherwise agreed with the Supervisor in respect of any advances from NZACU, Credit Union South will not permit External Secured Liabilities to exceed 1% of Total Tangible Assets (as those terms are defined in the Trust Deed).

Lending and Investment Quality Restrictions

Credit Union South will not permit the aggregate of Prime Debtor Investments, Other Investments and Listed Securities to exceed 15% of Total Tangible Assets (as those terms are defined in the Trust Deed).

Except as otherwise agreed with the Supervisor in respect of any advances to NZACU, Credit Union South will not permit the aggregate of Other Investments to exceed 1% of Total Tangible Assets.

Restriction on Borrowing

Credit Union South will not borrow any monies except on terms and conditions previously consented to in writing by the Supervisor and will not at any time borrow an amount greater than that permitted by FSCU Act or more than 15% of Credit Union South's total paid up share capital plus its reserves, provided this covenant does not apply to expenditure of a capital nature where the Supervisor has given its prior written approval.

Credit Union South's ability to borrow is restricted by sections 101(2) and 109 to 117 of the FSCU Act.

Section 101(2) of the FSCU Act provides that a credit union may take no action or do anything which is not directly pursuant to or incidental to its objects or in furtherance of them or is in contravention of the FSCU Act or its Rules. The objects of Credit Union South are set out section 2 (Credit Union South and what it does) of this PDS.

Section 109 of the FSCU Act provides that a credit union may borrow money if that borrowing is authorised by, and in accordance with, its Rules and the Trust Deed. The Rules allow Credit Union South to borrow as approved by the Trustees and is in accordance with the Trust Deed.

Related Party Restrictions

Credit Union South covenants with the Supervisor that it will not, without the prior consent of the Supervisor other than lending to a related party, acquire or dispose of any asset or engage in services of any related party other than for full market value on an arm's length basis and in the ordinary course of Credit Union South's business and after having given not less than 10 Business Days' notice of its intention to do so to the Supervisor.

In addition to this restriction under the Trust Deed, Credit Union South must also comply with the related party exposures under the NBDT Regulations. Under those regulations and the Trust Deed, the maximum limit on aggregated related party exposure is 15% of capital. Refer to section 2 (Credit Union South and what it does) in relation to Financial Covenant Breaches and section 6 (Specific risks of investing) under

the heading “Non Compliance with NBDT Act - Related Party Exposures Risk” for further information on related party restrictions.

Securitisation

Credit Union South will not undertake a Securitisation Programme without the written consent of the Supervisor and will comply with any conditions that are imposed as part of the consent given, including those in relation to financial ratios. The Supervisor provided consent to the Securitisation Programme on 12 August 2015.

Land and buildings

Section 113 of the FSCU Act provides that Credit Union South may only hold an interest in land or buildings if authorised by, and in accordance with, the Rules and the Trust Deed. The Trust Deed and the Rules allow Credit Union South to own land and buildings for the purposes of conducting its business. Credit Union South currently owns the land and buildings of its Invercargill branch.

Credit Union South may hold an interest in land as security for a loan to a Member.

Investment

Under section 117 of the FSCU Act Credit Union South may invest its funds only if authorised by, and in accordance with, the Rules and the Trust Deed. Credit Union South is authorised to invest funds under its Rules and the Trust Deed. This includes the investment of funds with NZACU or registered New Zealand banks.

5. Guarantors

The Shares and return on the Shares are not guaranteed by Credit Union South, the Supervisor or any other person. Credit Union South is solely responsible for the payment of the Shares.

6. Specific risks of investing

Credit Union South sets out below circumstances that it is aware of that exist or are likely to arise, that significantly increase the risk that Credit Union South may default on Credit Union South's payment obligations under the Shares.

Loan Default Risk

Credit Union South relies on its Members to repay their loans and to make interest payments on the due date of the loan. The loans are made to Members in accordance with Credit Union South's credit policy and are repayable on demand. If too many Members default on their loans and fail to make repayments to Credit Union South, the ability of Credit Union South to generate profit and pay returns to Members will likely be negatively affected.

If loan default by Members is so substantial that it causes the liquidation and winding up of Credit Union South, then the value returned to you, in respect of your Shares, may be less than the amount you invested with Credit Union South. Credit Union South has procedures in place to monitor past due and impaired loans to Members.

Loan default risk is mitigated by Credit Union South, as the FSCU Act restricts the size of the loans it may provide to any one Member. The Rules, FSCU Act, the Trust Deed and Credit Union South's lending policies may specify the maximum amount which Credit Union South can loan to any one Member, the maximum term of loans, or the lending to asset ratio to be observed by Credit Union South.

The loan book of Credit Union South is also made up of many smaller loans, which helps spread the risk of default to a manageable level.

Credit Union South continuously monitors the current and forecasted New Zealand economic environment and key indicators such as the residential property environment, interest rates and other general economic indicators. Where these indicators indicate an increased exposure or risk, Credit Union South assesses these risks and then adjusts its appetite or exposure to these risks as appropriate.

Credit Union South may be exposed to increased risk in the residential property market if house prices fall. This is because Credit Union South holds mortgages as security for its lending to some Members, and where house prices fall, Credit Union South's ability to exercise the mortgage and recover the full amount of the loan may be negatively impacted. Credit Union South has monitoring processes in place to ensure any property market trend is identified and addressed as necessary. These procedures are further explained below.

As at the date of this PDS, the Trust Deed provides that any indebtedness by a Member to Credit Union South must not exceed:

- 10% of Credit Union South's total tangible assets, in the case of a secured loan (clause 7.2(m) of the Trust Deed);
- 5% of Credit Union South's total tangible assets, in the case of an unsecured loan (clause 7.2(l) of the Trust Deed); or
- such lesser amount as Credit Union South may from time to time determine.

As at the date of this PDS, the maximum indebtedness of any one Member does not exceed 1% of Credit Union South's total tangible assets. Credit Union South is not, therefore, exposed to any one Member going into default.

Credit Union South has established lending policies and procedures which are regularly reviewed and updated, relating to how Credit Union South:

- uses credit assessments and approval processes to make sure loans and facilities are only offered when Members meet acceptable risk assessment and security requirements;
- limits and reduces its risk exposure to individual borrowers, non-mortgage secured loans, commercial lending and geographic and industry groups considered at high risk of default;
- reassesses and reviews the credit exposures on loans and facilities;
- establishes appropriate provisions to recognise the impairment of loans;
- manages its debt recovery procedures; and
- regularly reviews its compliance requirements as part of its internal audit scope.

Geographic Concentration

The concentration of deposits from Members and loans to Members in a particular area can create risk, due to the underlying factors Members in that geographical area share. These factors could include a significant economic event, or a natural disaster such as an earthquake which may affect all of those Members' ability to maintain their deposits or make repayments on their loans.

In the unlikely event of a significant incident such as a natural disaster or economic downturn in an area with a significant number of Members, there could be an adverse impact on withdrawal and reinvestment rates for Member deposits, and the ability of Members to meet their repayment obligations to Credit Union

South. This could affect Credit Union South's ability to generate income and meet payment obligations to its Members.

Credit Union South has no concentrated exposure to any individual Member, and further mitigates geographical concentration risk by limiting exposure to individual Members and monitoring exposure on a regional basis. Credit Union South also has business continuity and disaster recovery plans in place.

Liquidity Risk

Credit Union South's ability to meet its payment obligations to Members is connected to the loans it makes to Members from its share capital and other funding sources. As a large proportion of Members can withdraw their funds at any time (or with relatively short notice), there is a risk that at any one time there might not be enough funds to meet Credit Union South payment obligations.

Liquidity risk can also arise due to a mismatch in the maturity of Members' Accounts and the loans provided to Members. Historically, the loans offered to Members by Credit Union South take longer to mature than the investments made by Members in Accounts. As money invested by Members in Accounts tends to be available for withdrawal quicker than Credit Union South can recover money loaned to Members, a risk exists that due to this mismatch, Credit Union South may not have enough cash available at any one time to repay Members in a timely manner.

Credit Union South may also not have adequate cash on hand if reinvestment rates, Members' savings balances or borrower repayments were to reduce materially. This is because Credit Union South relies on high reinvestment rates for Term Accounts, a consistent and reliable level of Member savings, and regular receipts of principal and interest from borrowers in order to ensure it maintains a strong level of liquidity.

Liquidity risk is managed by:

- continuously monitoring forecast and actual daily cash flows;
- reviewing the maturity profiles of financial assets and liabilities;
- maintaining adequate reserves, liquidity support facilities and reserve borrowing facilities;
- regularly monitoring loan repayments and comparing to forecast cash flows;
- an uncommitted overdraft facility of \$2.5 million (subject to change) with NZACU to provide support to Credit Union South should this be necessary at short notice; and
- the Securitisation Programme with Westpac, under which mortgage receivables can be sold to the Trust.

If necessary, Credit Union South may put in place an alternative third party overdraft facility with a New Zealand trading bank.

Interest Rate Risk

Credit Union South makes the bulk of its income from the difference in the interest rate Credit Union South pays to its Members for deposits in Accounts, and the interest rate it earns from Members who borrow funds, together with income generated from Credit Union South's investments. This difference is called the **net interest margin**. As some of these interest rates are fixed for differing periods on loans and Member Accounts, there is a risk changes in market interest rates may cause fluctuations in the net interest margin, as Members Accounts and loans to Members re-price at different times.

An increase in market interest rates could increase the amount of interest Credit Union South pays its Members on their Account deposits, adding to Credit Union South's costs. There is a risk that due to the fixed interest rates charged on some loans, these added costs may not be recoverable until lending revenue can be improved by increasing lending interest rates. The resulting drop in the net interest margin could affect returns paid to Members.

This risk is mitigated by maintaining a balanced "on book" strategy, ensuring that the net interest rate gap between Members' loans and Members' Shares is not excessive. Credit Union South measures this gap monthly in 3 month ranges, to identify any significant risks to interest rate movements. Credit Union South rectifies these risks to within acceptable levels by making targeted fixed interest rate products available.

Security Position Risks

Before making a loan advance, Credit Union South assesses both a Member's ability to repay the loan and any security offered by the Member as collateral. Credit Union South may take security over all or part of the Member's assets (generally personal property, motor vehicles, real property and/or Credit Union South Shares).

The following are some risks that may arise in relation to Credit Union South's security position:

- *Taking no or low-ranking security:* If Credit Union South does not take security from a Member, or if it takes security from a Member which ranks lower in priority to another person's security, then if that Member defaults on the loan:
 - i. the ability of Credit Union South to sell or realise the Member's assets and recover the loaned money may be restricted or prohibited by the terms of any higher ranking security; and/or
 - ii. if the collateral is realised, the amount available to Credit Union South after the higher ranking security holder has taken their share, may be insufficient to discharge the loan, in which case Credit Union South will have to write-off that undischarged amount.
- *Security pricing risk:* Where security is taken for a loan advance, the value of that security (based on its market price) may fluctuate, and may decrease. If the market price of the security has decreased it may be possible that if the borrower defaults and Credit Union South realises the secured collateral, the amount realised may be insufficient to discharge the loan. If this is the case, Credit Union South will have to write-off that undischarged amount.

If a materially large number of loan security interests are not put in place correctly or market conditions significantly reduces the value of the securities held, Credit Union South may experience losses which could affect payment obligations to Members.

Credit Union South minimises this risk of losses in the above circumstances by making provision for doubtful debts in a manner consistent with generally accepted accounting principles.

New Zealand Association of Credit Unions Credit Risk

Investments with NZACU

Credit Union South has the ability to make deposits of excess liquidity with NZACU. Credit Union South also maintains deposits with NZACU in relation to its Settlement Bond as explained in section 4 (Credit Union South's financial information) under the heading "Prior Ranking Security Interests." As at the date of this PDS, Credit Union South had \$2.5m invested as call and term deposits through NZACU's central banking deposit scheme as a Settlement Bond.

The vast majority of the Settlement Bonds invested with NZACU are held in a separate bank account, on trust, and may not be used by NZACU except for the purposes of settling Credit Union South's financial obligations if it fails to do so.

To mitigate Credit Union South's credit risk exposure to NZACU the Board of Credit Union South has also resolved to limit deposits with NZACU to the Settlement Bond. The NZACU deposits are unsecured.

Member credit unions of NZACU, including Credit Union South, have invested in base capital notes issued by NZACU. These investments assist in enabling NZACU to provide credit unions with essential services such as the core operating system, data processing and support, banking services, Accesscard and text banking services, a central bank and treasury function, debit card facilities and insurance products.

The base capital notes issued to Credit Union South constitute unsecured obligations of NZACU and rank equally and without priority or preference with the other base capital notes. The base capital notes rank after creditors in the event of the winding up of NZACU, and may only be sold or transferred to another

credit union that is a member of NZACU and with the consent of the NZACU Board of Directors. As at the date of this PDS, Credit Union South holds \$3.1m of base capital notes issued by NZACU.

Although the investment in base capital notes is permitted under the Trust Deed, there are no trust or security arrangements governing these investments. Further, there is no active market for base capital notes issued by NZACU.

The base capital notes held by Credit Union South undertook an impairment review in 2018. This review concluded, on 18 June 2018, that the investment in the base capital notes was not impaired. This means that as at the date of the review, the book value of the base capital notes was not more than the value which Credit Union South can recover from the base capital notes upon repayment.

The position of NZACU remains questionable following a sustained decline in financial performance. In November 2018, the credit rating of NZACU was downgraded from BB to B+ by Fitch Ratings, which cited weakening capitalisation and an increased likelihood that NZACU's core operations will remain unprofitable over the next 18 months. NZACU has also received notice from a particular member credit union requesting the repayment of the base capital notes held by that credit union.

Accordingly, given the weak financial position of NZACU, there is a liquidity risk that NZACU may be unable to repay Credit Union South (and other credit unions) the investments held with NZACU including the base capital notes and the portion of Settlement Bonds not held in trust.

Third Party Service Level Risk

NZACU is reliant upon maintaining a certain level of business in order to have the scale to provide its essential services efficiently. Its revenue is concentrated on a small number of customers. Some members have reduced and/or ceased the utilisation of some services from NZACU, reducing NZACU's future revenue streams. NZACU could be requested to repay certain base capital notes it has issued, and also has on-going capital spending requirements to deliver its current, planned and future projects.

NZACU has experienced a number of issues impacting its financial performance, liquidity and capital base. There is a risk that any downturn in business levels or a failure to meet its forecasted financial growth will cause financial difficulties for NZACU and adversely impact the value and/or returns of our investments in NZACU and/or increase the cost of services obtained from NZACU.

As at the date of this PDS, Credit Union South is regularly asking for updated information on NZACU's financial performance and proactively liaising with NZACU regarding its current position and the timely completion of actions to improve its financial position. The NZACU Board has confirmed to member credit unions including Credit Union South that it continues to regularly monitor NZACU's cashflow.

Member Service Level Risk

Over 2017 and 2018, some member credit unions of NZACU have reduced, or ceased, their use of some of the services it provides. Decreases in the use of NZACU services is likely to cause its revenue streams to decline, and increased service costs for the member credit unions who still use those services.

Due to the decreased use of NZACU services by third parties and member credit unions, there is a risk that NZACU will be unable to continue to provide essential services at the same standards of cost efficiency and effectiveness that Credit Union South and its Members currently enjoy. This is because decreased use of NZACU services may cause a drop in revenue, which could result in increased cost of services from NZACU.

Decreases in revenue from services provided by NZACU could also affect its financial position, which may result in Credit Union South's investments with NZACU being impaired. As Credit Union South's investments with NZACU are unsecured, if NZACU runs into further financial difficulties and defaults in its obligations, Credit Union South could experience losses which could affect payment obligations to Members.

An investment impairment or increased NZACU service costs would both likely have a negative impact on Credit Union South's financial performance and profitability, and could result in increases in the costs of services provided by Credit Union South to its Members.

To minimise these risks, Credit Union South continues to actively monitor NZACU's performance, its exposure to this credit risk, and any need to impair its investments with NZACU.

New Zealand Association of Credit Unions Services Risk

Credit Union South relies on NZACU to provide Credit Union South with essential services such as its core computer operating system, transactional and bureau services, a central bank and "treasury" function, and debit card facilities. These systems are required by Credit Union South in order for it to provide transactional and other key services to Members, including Members' ability to deposit, withdraw and bank money through Credit Union South. Accordingly, there is a concentration of service risk in the event the services provided by NZACU are affected.

In the event that NZACU or its systems failed, the immediate ability of Credit Union South to continue to provide services to its own Members could be impeded. This could affect the confidence Members have in Credit Union South and have an adverse impact on withdrawal and reinvestment rates for maturing Shares, which could affect Credit Union South's ability to meet its payment obligations to its Members. To help mitigate this risk, NZACU has an extensive business continuity and disaster recovery program that is regularly tested and audited.

Credit Union South continues to actively monitor NZACU's performance and its exposure to services risk. In order to mitigate the NZACU services risks, Credit Union South, along with other member credit unions have been assisting NZACU to develop a step-in agreement. This step-in agreement would allow for key NZACU services to continue, in the event that NZACU is unable to effectively carry out these services due to financial or other circumstances.

The step-in agreement and related amended service contracts are intended to be executed by all relevant parties in early to mid 2019.

Information Technology Risks

Information technology plays a critical role in Credit Union South's business, with the delivery of financial services to Members dependent on the availability and reliability of our information technology systems. The ability to compete effectively in the future will, in part, be driven by Credit Union South's ability to maintain a modern information technology platform for the efficient delivery of products and services. Operations are likely to be significantly affected should information technology systems fail or not operate in an efficient manner. Credit Union South mitigates this risk by ensuring it has appropriate information security, backup systems and disaster recovery in place and all third party suppliers have appropriate disaster recovery procedures.

Credit Union South worked with NZACU to replace the existing banking platform and transitioned to a new system on 31 March 2018. The new system is integral to operations and the on-going development of relevant products and services for Members.

Change in Credit Rating

Credit Union South has a Fitch Ratings long term issuer credit rating of BB with a Stable Outlook and a short-term issuer rating of B. This credit rating was affirmed by Fitch Ratings on 30 December 2018, as further described in section 3 (What is Credit Union South's credit rating?).

Credit Union South's credit rating reflects its higher risk appetite than most of its domestic peers, which is reflected in its focus on consumer lending and meeting its objectives. This increases the vulnerability of its loan performance compared to similar lenders, who have a greater exposure to less risky residential mortgages.

Credit Union South's risk controls are adequate for its size and consistent with regional peers, but are not as developed as larger New Zealand lenders. Credit Union South's earnings and profitability are likely to be variable over an economic cycle, reflecting its risk profile. Credit Union South maintains strong net-interest margins relative to peers, reflecting its higher margin business mix, but its overall profitability is modest due to a high cost base. This is in part due its mutuality - where Members are both owners and customers - but also reflects limited economies of scale.

The deposits by Members in Accounts are the main source of funding for Credit Union South. Partly due to decreasing levels of deposits in recent years, Credit Union South has used alternative wholesale funding, such as its Securitisation Programme, to assist it in growing its loan portfolio. Any substantial increase in the use of wholesale funding could negatively affect Credit Union South's current credit rating, and lead to a loss in confidence among Members.

Fitch Ratings expect further deterioration in Credit Union South's risk-weighted capitalisation ratios due to its modest profitability and continued loan growth. Credit Union South has limited ability to generate common equity outside of internal capital generation due to its mutual structure. Fitch Ratings notes that a number of institutions have experienced strong growth in recent years, which has in some cases resulted in weaker capitalisation, and funding liquidity profiles. However, Fitch Ratings believes changing market conditions, macroprudential rules for banks and slowing credit growth could result in moderating growth rates.

In the event that Credit Unions South's credit rating was downgraded, this may have a material and adverse impact on withdrawal and reinvestment rates for maturing Shares and on Credit Union South's ability to raise new funds from Members and prospective Members. If, as a result of such event, Credit Union South was unable to raise funds, the costs of raising funds were to increase, or significant numbers of Shares were withdrawn, this may have a material and adverse effect on the financial performance and financial condition of Credit Union South which could then affect payment obligations to Members.

There is a risk that following the completion of the Transfer of Engagements described in more detail in section 2 (Credit Union South and what it does) under the heading "Merger of Participating Credit Unions", the credit rating of Credit Union Baywide (as the merged entity) may be downgraded. This may be the case where management of Credit Union Baywide is unable to effectively address operational and strategic risks linked to the legacy businesses of the Transferring Credit Unions, or where significant time and focus is shifted towards management of the merger process, and away from the day-to-day operations of the merged entity.

Regulatory Risk

Credit Union South is required to comply with various legal obligations, and any material failure to comply with these obligations could result in damage to Credit Union South's reputation and expose Credit Union South to financial and other penalties. Severe reputational damage and large financial penalties could increase withdrawal rates and decrease re-investment rates, which could have a material and adverse effect on the financial condition of Credit Union South which ultimately could affect payment obligations to Members.

Any change to existing laws, or the introduction of new laws, could result in additional requirements being imposed on Credit Union South and result in increased costs for Credit Union South. This risk is particular to Credit Union South because as a relatively small entity, it is harder for it to absorb such costs.

The Friendly Societies and Credit Unions (Regulatory Improvements) Amendment Act 2018 (**Amendment Act**) received royal assent on 4 July 2018, with the implementation date of 1 April 2019. This Amendment Act requires credit unions to incorporate within the specified transitional timeframe in order to continue trading, which may place additional financial and procedural strain on the resources of Credit Union South as it converts into an incorporated entity and carries out any consequential changes to its Rules, the Trust Deed or its policies. In the event the Transfer of Engagements proceeds successfully, Credit Union South will not be required to carry out these incorporation steps as it will have merged with Credit Union Baywide, and will have ceased to exist.

The Amendment Act will also allow credit unions, (subject to certain conditions), to undertake business lending to Members' businesses. This may provide for further diversification and growth of the Credit Union South loan book and mitigate part of the costs involved in regulatory compliance.

The NBDT Act governs matters such as the licensing of NBDTs, suitability assessments for directors and senior officers, restrictions on changes of ownership and includes powers for the Reserve Bank to manage instances of distress and failure of NBDTs. Failure to comply with NBDT requirements in some circumstances could result in Credit Union South's NBDT licence being revoked, or it being ordered to cease trading.

Non Compliance with NBDT Regulations - Related Party Exposures Risk

Due to Credit Union South's concentrated exposures to NZACU, Credit Union South breached its related party exposures ratio under the NBDT Regulations for the period 31 July 2018 until 5 October 2018. This was due to the membership of NZACU reducing, on 31 July 2018, to 10 credit unions and triggering NZACU as a related party under section 6 of the NBDT Act. As each member credit union of NZACU now consequentially holds 10% of the voting rights of NZACU, Credit Union South is considered to hold a related party interest.

Along with other credit unions, Credit Union South submitted an exemption application with RBNZ in July 2018, and the Non-bank Deposit Takers (Exposures to Co-op Money NZ) Exemption Notice 2018 (**Exemption Notice**) was granted on 5 October 2018. For the period between the beginning of the breach on 31 July 2018, and the grant of the Exemption Notice, RBNZ had issued a notice that any related party exposure breach occurring within that period would not be actioned or enforced by RBNZ.

The Supervisor gave consent for Credit Union South to continue to issue securities from 31 July 2018 and provided confirmation that it will take no action as a result of the event of default under the Trust Deed subject to certain conditions.

The Exemption Notice exempts Credit Union South from including exposures to NZACU when calculating the maximum limit of related party exposures as set out in the NBDT Regulations and the Trust Deed. RBNZ has granted the exemption on the basis that such exemption is consistent with the maintenance of a sound and efficient financial system, the breach of related party exposure was outside of the control of the NZACU member credit unions and that the NZACU is proposing to restructure its business operations with effect from mid 2019, which will remove the compliance issue that gave rise to the requirement for the exemptions. The Exemption Notice will expire on 30 September 2019.

There is a continuing risk that should NZACU not be able to effectively restructure its business prior to the expiry of the Exemption Notice, Credit Union South may breach its related party exposure obligations again in late 2019. In mitigation of this risk, Credit Union South and NZACU are working towards lowering the exposure Credit Union South holds with NZACU. As part of this process, Credit Union South has arranged for the vast majority of its investment in NZACU Settlement Bonds to be held on trust.

Securitisation Programme Risks

Credit Union South believes the material risks involved with the Securitisation Programme are as follows:

Smaller Pool of Receivables Legally Owned

The Securitisation Programme gives Credit Union South access to additional funding up to a proportion of eligible receivables agreed with Westpac, currently to a maximum of \$25 million. Credit Union South sells existing mortgage receivables to the Trust, a special purpose trust set up under the Securitisation Programme. Following the sale of mortgage receivables to the Trust, the remaining pool of loans still legally owned by Credit Union South is reduced. This results in a risk that the loans still held by Credit Union South are less diversified and potentially higher risk receivables. If the remaining mortgage receivables were to default in a significant number, then this could affect the financial performance of Credit Union South and in turn affect payment obligations to Members. This risk is mitigated by the sold mortgage receivables being replaced with cash and subordinated debt by virtue of the Securitisation Programme. In addition, Credit

Union South's Supervisor requires a higher capital adequacy ratio than the minimum required by the NBDT Regulations.

Prior Ranking Debt of the Trust

The majority of the Trust's funding is provided by Westpac. That funding is senior first ranking debt, and is repaid in priority to the subordinated debt provided by Credit Union South. There is a risk that Credit Union South could not be repaid all or some of that subordinated debt in the event of a significant number of receivables sold to the Trust being in default. This could affect the financial performance of Credit Union South due to a large write down of debt which in turn, would affect payment obligations to Members. This risk is mitigated by specific selection criteria being applied to receivables sold into the Trust to ensure that the Trust receivables pool is of good quality.

Risk of Additional Funding for the Trust

There is a risk that there may be commercial pressure to provide additional funding to prevent a closure of the Securitisation Programme in the event of severe degradation of the credit performance of the receivables. The provision of such funding could adversely affect the financial position of Credit Union South and potentially the payment obligations to Members. This risk is mitigated by such a decision only being made following careful consideration of Credit Union South's own financial position.

For further information on the Securitisation Programme see the "Summary of the Securitisation Programme" on the Offer Register at www.business.govt.nz/disclose by searching offer number OFR10365.

Merger of Participating Credit Unions Risks

The potential merger of the Participating Credit Unions described in section 2 (Credit Union South and what it does) under the heading "Merger of Participating Credit Unions" raises some additional risks for Credit Union South. These risks are addressed below:

Credit Risk

As part of the Heads of Agreement and Transfer Agreement signed by the Participating Credit Unions, Credit Union South (in conjunction with other Participating Credit Unions) has provided an unsecured liquidity support loan to Aotearoa Credit Union through the Liquidity Facility Agreement. The Liquidity Facility Agreement is intended to assist Aotearoa Credit Union in its operations until the Transfer of Engagements takes effect.

Aotearoa Credit Union, following discussions with its auditors, has reassessed its accounts and financial information on a realisation basis, rather than on the basis of a going concern. The restatement has not resulted in any material changes to carrying values in the accounts, but it has had a number of other related effects on the accounts including a restatement of the losses of Aotearoa Credit Union for the financial year ending 30 September 2019.

As at the date of this PDS, Aotearoa Credit Union is in breach of its capital ratio requirements provided in its trust deed and under the NBDT Regulations. Furthermore, Aotearoa Credit Union has also breached section 38 of the NBDT Act and its trust deed by allowing its related party exposures to exceed the maximum permitted limit as a result of loans provided to related parties now forming a greater proportion of its exposures. Due to these and other breaches relating to the financial position of Aotearoa Credit Union, enforcement action could be taken against Aotearoa Credit Union by its prudential supervisor or regulators.

There is accordingly a risk that Aotearoa Credit Union will be unable to discharge its repayment obligations under the Liquidity Facility Agreement should its involvement in the Transfer of Engagements be

significantly delayed, or if it does not proceed. This may result in financial loss for Credit Union South as it may be unable to recover the loaned sums.

For further information relating to the financial and operational status of Aotearoa Credit Union, please see the most recently registered product disclosure statement of Aotearoa Credit Union available on the Offer Register at www.business.govt.nz/disclose by searching offer number OFR11170.

Operational Risk

The proposed Transfer of Engagements will require a review of operational activities and governance, as well as a commitment in terms of time, capital and resources. This may create operational risk for Credit Union South in the short term while the Transferring Credit Unions are merged, as the normal operations of Credit Union South may be disrupted during this process.

The successful completion of the Transfer of Engagements will have the effect of merging the Transferring Credit Unions into Credit Union Baywide. As a result of this, the number of member credit unions of NZACU will decrease, as each Transferring Credit Union will cease to exist. Accordingly, there may be resulting changes to how member credit unions vote and make decisions in their capacities as NZACU members, which could affect the operations and efficiency of NZACU.

Sector Reputational Risk

If Aotearoa Credit Union is unable to participate in the Transfer of Engagements planned under the Heads of Agreement and Transfer Agreement, or if the merger does not proceed with Aotearoa Credit Union for any reason, it is likely that Aotearoa Credit Union will be placed into receivership. Should this happen, the reputation of the credit union sector will be adversely affected and this could lead to a loss of confidence among Members. This could potentially result in reductions in Members' deposits with Credit Union South and an increase in withdrawals, impacting the liquidity of Credit Union South and its ability to meet its repayment obligations to Members.

The approval provided by the Members of Credit Union South under the special resolution passed on 13 March 2019 represents a step forward towards the realisation of the Transfer of Engagements. This improves the likelihood that the Transfer of Engagements will be successful, and decreases the risks associated with the Transfer of Engagements not proceeding.

7. Register Entry

Further information regarding Credit Union South and the Shares on offer can be found on the Offer Register at www.business.govt.nz/disclose by searching offer number OFR10365, or on request from the Registrar of Financial Service Providers by emailing: registrar@fspr.govt.nz.

The information contained on the Offer Register includes among other things a copy of the Trust Deed and a summary of the Trust Deed, financial information for Credit Union South, the Rules, an Account application form, details of each of the Accounts available and their associated fees and interest rates, and details of material contracts if applicable.

A copy of this PDS, the Rules, the Trust Deed and other information regarding Credit Union South and its Accounts can also be found on Credit Union South's website, www.nzcusouth.co.nz or free of charge on request at any Credit Union South Branch Office.

8. How to complain

If you have concerns relating to your investment in Shares in Credit Union South, we maintain a comprehensive complaints policy and you are welcome to lodge a complaint with us through your nearest

branch centre (a list of our branch centres is available at <https://nzcusouth.co.nz/contact-us/>), or by using our details below:

Call: Contact Centre 0800 696 636
Sales and Lending: 0800 536 328

Email: enquiries@nzcusouth.co.nz

Online: <https://nzcusouth.co.nz/contact-us/>

If you are dissatisfied with our response, you can lodge a complaint with our external Dispute Resolution Service provider, Financial Services Complaints Limited (**FSCL**).

FSCL operates an approved dispute resolution scheme under the FSP Act. If at the end of our internal complaints resolution process you remain unsatisfied, you may refer it to FSCL at:

Call: 0800 347 257

Email: info@fscl.org.nz

Online: www.fscl.org.nz

Write: Financial Services Complaints Ltd (FSCL)
PO Box 5967
Wellington 6145

FSCL will not charge a fee to any complainant to investigate or resolve a complaint.