

Securing the future for HBS

After much analysis and consideration, your Board of Directors believes the best future for HBS and our members is to merge with Southland Building Society (SBS Bank).

We are presently in discussions with SBS Bank and once our due diligence and other investigations are concluded, we expect to ask for your support to merge with SBS Bank: to be locally known as HBS Bank.

The ultimate decision will be yours as a member and mutual owner of HBS.

We have set out an overview of the reasons for and benefits of our proposal in this document and invite you to read this carefully.

We will also be holding a number of member workshops that you are welcome to attend, and there will be an opportunity for discussion at our upcoming Annual General Meeting (AGM). You will then be invited to discuss further and vote at an Extraordinary General Meeting (EGM) either in person or by proxy.

Your Board is unanimous in its support of this opportunity. Should you wish to discuss this matter personally, please contact any one of your Directors, you'll find our details at the conclusion of this document.



Frank Spencer, Chairman
HBS Board of Directors



1. Q. Why is a merger necessary?

- A. The operating environment for all financial institutions has changed dramatically as a consequence of the global financial crisis. The Reserve Bank of New Zealand (RBNZ) has been encouraging smaller financial institutions such as HBS, to join together or merge with others to form larger and stronger organisations.

Some of the changes are summarised below:

- Meeting the credit rating agencies' criteria (see Note 1);
- Crown Retail Deposit Guarantee (see Note 2);
- Increasing pressure on funding margins (see Note 3).

HBS prefers to be a leader rather than a follower in this new operating environment; to be making the best decisions rather than having dictates imposed on us. We want to make decisions that will lead to HBS obtaining a stronger international credit rating and being even better positioned for the future as a secure haven for deposits at attractive interest rates. All the while retaining our local identity, reputation for excellent personal service, and local community support through our many sponsorships.

HBS is also very committed to the fundamental principles of mutuality; we want to remain owned by our members and operating for the benefit of our members, who are our investing and borrowing customers. We firmly believe that mutuality is a key to why we are a favourite financial institution for our customers.

Our proposed merger means HBS will enjoy all the benefits of a registered bank including stronger credit rating, wider range of products and services, and more attractive interest rates.

HBS Bank will retain the same staff, the same personal service and gain even more funds for local sponsorships. We will continue to serve the Hawke's Bay community.

2. Q. Why SBS Bank?

- A. SBS Bank is a mutual Building Society, wholly owned by its members, just like HBS. It has been serving its community for even longer than HBS; 141 years in fact.

SBS Bank is also a registered bank and as such is subject to the very extensive scrutiny and regulation of the RBNZ. It is New Zealand's only customer-owned Community Bank and it may be the only building society in the world to have achieved bank registration while maintaining the mutual structure of being owned by its members.

This merger remains true to the HBS Board Charter of a 'commitment to mutuality'; a mutual society owned by members.

SBS Bank is also in a very strong financial position: SBS Bank has assets of \$2.63 billion, whilst HBS has assets of \$185 million. SBS Bank has recently posted a solid operating surplus of \$19.4 million, up from \$18.5 million last year.

Note 1:

From 1 March 2010, it became mandatory for all non-bank deposit takers (NBDTs), of which HBS is one, to obtain a credit rating from a credit rating agency approved by the RBNZ. The cost of obtaining and maintaining a credit rating is significant. It is also not possible for NBDTs to achieve a credit rating as strong as a registered bank, as credit ratings value scale and book diversity.

Note 2:

The current Crown Retail Deposit Guarantee scheme (RDGS) expires on 12 October 2010, and the extended scheme expires on 31 December 2011. The cost for HBS to opt into the extended RDGS is estimated to be in excess of \$750,000. This cost would reduce significantly if HBS had the scale, diversity and credit rating of a registered bank. The need to join the RDGS would be lessened.

Note 3:

During the global financial crisis, the major New Zealand banks struggled to access funding from the offshore wholesale money markets. In addition, the RBNZ introduced a new core funding ratio specifying that banks must have 65 percent of their funding from stable sources by later this year, with this threshold rising to 75 percent in two years. Consequently the major banks have re-focused on the domestic retail market, which is the traditional market for savings institutions such as HBS. This increased competition has driven up the cost of retail money and eroded our interest margins.

3. Q. What are the benefits of becoming a bank?

- A. Banks have credibility brought about by the conditions of their banking licence, and the ongoing scrutiny and supervision of the RBNZ. Banks also have stronger credit ratings, due to larger scale and book diversity.

Currently HBS is a Non Bank Deposit Taker (NBDT) and this sector faces many significant challenges. Your Board believes that HBS will be better positioned to successfully meet these challenges as part of a registered bank.

4. Q. What will be the impact on current members?

- A. HBS members will become members of SBS Bank and receive all benefits afforded to SBS Bank members.

In addition, all members who hold a Term Investment with HBS as at the merger date will receive a special bonus offer of an additional 0.5 percent interest above the advertised term rates, when they renew their term deposit for a minimum six month term.

5. Q. What about the special qualities of HBS and our relationships in Hawke's Bay?

- A. Your Board is proud of what HBS has contributed to our Hawke's Bay community. We want to see that continued and in fact we have negotiated an increase; a guaranteed 50 percent increase in the level of community distribution compared to the 2009 and 2010 financial year sponsorship expenditures.

We will be retaining all our same staff and the friendly philosophy that drives our award winning service.

6. Q. Are we giving total control to Invercargill?

- A. While the Head Office of SBS Bank is in Invercargill, Hawke's Bay will still have a proportional voice as SBS Bank will be creating an extra Board position for a nominee of the HBS Board.

Maintaining that seat on the Board will be dependent on HBS members voting in strength at the time of the next SBS Bank AGM when the newly elected Director is required, under the Rules of the Society, to stand for election.

Also a local Hawke's Bay Member Council will be created so that we maintain a voice from Hawke's Bay.

SBS Bank has branches around New Zealand and is already well established in successfully supporting each of these communities.

7. Q. What happens in the event of another bank, local or overseas, making a takeover offer for SBS Bank?

- A. Ultimately it will be the members who decide, and the Hawke's Bay members will have equal voting rights with the SBS Bank members.

Should there be a significant change of ownership of SBS Bank within five years of this merger, your Board has negotiated a condition that ensures the equity transferred through the merger (approximately \$17 million), is returned to a yet to be established Hawke's Bay Trust for the ongoing benefit of our community.

8. Q. Are the cultures of SBS Bank and HBS compatible?

- A. Yes, we are both Mutuals, meaning we are owned by our members, and the Boards of both Societies have a strong and unwavering commitment to mutuality. Your Board firmly believes that the friendliness and exemplary personal service offered by HBS is totally in line with the way SBS Bank operates.

9. Q. When is the merger taking effect?

- A. Once the merger of the two Societies has been finalised and registered by the Registrar of Building Societies, all members of HBS will have their on-call accounts, term deposits and/or mortgages transferred to SBS Bank with equivalent terms, conditions and entitlements.

We are targeting 1 October 2010 as the effective date subject to registration by the Registrar of Building Societies.

10. Q. What happens next?

- A. A series of workshops will be held from 12 to 16 July and members are invited to attend should they wish. These will be small discussion groups of between 12 to 15 people plus HBS staff and Board members. The objective is to fully outline the motivation for the merger. Should you wish to attend one of these workshops, please phone HBS on 872 7299.

Naturally, the proposed merger will be discussed in full at our upcoming AGM (21 July).

There will be an Extraordinary General Meeting scheduled for 31 August at which qualifying members will be invited to vote. Voting papers and Offer Documents will be mailed to those members ahead of this meeting.

Once the merger of the two Societies has been finalised, it will need to be registered by the Registrar of Building Societies. While we cannot control how long this process takes, we are anticipating the date to be around 1 October 2010.

Updated information will be available on our website www.hbsnz.com

Feel free to discuss any matter relating to this proposal with your Board of Directors. You can phone HBS on 872 7299 or 0800 124 271 and we will arrange for a Director to call you back, or you can phone them directly:

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Jacqui Gray	021 548 573
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