

**This is a replacement Product Disclosure Statement. It replaces the Product Disclosure Statement dated 8 March 2019 relating to an Offer of Secured Redeemable Shares in Credit Union Baywide (trading as NZCU Baywide)**

Date: 18 March 2019



*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 <https://disclose-register.companiesoffice.govt.nz/disclose>. Credit Union Baywide 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 to make an investment decision.*

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### 1. Which products are offered under this PDS?

This offer is for secured redeemable shares (the *Shares*) in one or more of the share accounts (the *Accounts*) offered by Credit Union Baywide (trading as NZCU Baywide) (*Credit Union Baywide, we, us or our*) which rank equally with all other Shares issued (the *Offer*). Prospective and existing Members (*you*) are invited to subscribe for Shares at \$1.00 per Share, to be held in one or more of the Accounts operated by Credit Union Baywide.

Each Share Account is either on-call or for a fixed term, and (where applicable) the term is agreed when you invest. Under the Friendly Societies and Credit Unions Act 1982 (the *FSCU Act*), as part of the terms and conditions of the Shares, we may require a 60 day notice period for withdrawal from time to time.

The rate of return on Shares is dependent on the type of Account you invest in, the terms of the account and the duration of your investment.

We offer a number of different Accounts to our Members including On-Call Accounts, Term Accounts and Special Share Investment Accounts.

Further details on our On-Call Accounts, Term Accounts and Special Share Investment Accounts terms and conditions, fees and charges and interest rates can be found on the Offer Register at <https://disclose-register.companiesoffice.govt.nz/disclose>, at any Branch Office, or by visiting our website: [nzcubaywide.co.nz](http://nzcubaywide.co.nz).

The Shares are treated as debt securities under the Financial Markets Conduct Act 2013, and this PDS is prepared under Schedule 7 of the Financial Markets Conduct Regulations 2014.

You may apply for Shares if you currently reside or formerly resided in New Zealand, and you are:

- (a) an individual;
- (b) a charitable entity as defined by the Charities Act 2005; or
- (c) an incorporated society registered under the Incorporated Societies Act 1908.

We reserve the right to accept or decline any application without giving you any reason for our decision.

## **2. Credit Union Baywide and what it does**

### **Overview of Credit Union Baywide**

We are a financial co-operative registered as a credit union under the FSCU Act.

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

We operate in accordance with our trust deed dated 22 August 2016 (the *Trust Deed*) and our Rules (the *Rules*), both as amended from time to time, which are registered in accordance with the FSCU Act. The Trust Deed and the Rules are available on the Offer Register at <https://disclose-register.companiesoffice.govt.nz/disclose>, our website, [nzcubaywide.co.nz](https://nzcubaywide.co.nz) and upon request at our registered office.

We are registered on the Financial Service Providers Register with the registration number FSP27482. We are a non-bank deposit taker (*NBDT*) in terms of the Non-bank Deposit Takers Act 2013 (the *NBDT Act*) and are licensed under section 14 of the NBDT Act, subject to conditions imposed by the Reserve Bank of New Zealand (Reserve Bank). We are not a registered bank in terms of the Reserve Bank of New Zealand Act 1989.

Recently, the Friendly Societies and Credit Unions (Regulatory Improvements) Amendment Act 2018 (the *Amendment Act*) was passed. The Amendment Act will have some implications on our operation as a credit union including:

- (a) a process for us to become incorporated;
- (b) permitting financing of small to medium enterprises where the small and medium sized enterprise is related to a member within specified thresholds, if authorised under our Rules;
- (c) allowing Co-op Money NZ to provide a wide range of services to any non-member entity, if authorised under their Rules; and
- (d) enabling us to have all of the powers of a natural person in pursuance of our objects described above.

The Amendment Act comes into force from 1 April 2019 and credit unions must apply to the Registrar for incorporation before 1 October 2019. We intend to complete the process to become incorporated prior to this date. Incorporations are effective on 1 January 2020.

### **Operations and Main Activities of Credit Union Baywide**

Our primary activities over the five years preceding the date of this Product Disclosure Statement (*PDS*) and since our inception on 10 August 1971 have been to provide a co-operative savings facility and banking services for our Members to form a loan fund.

We make loans from your investments and retained surpluses. The availability of loans to Members is dependent upon the availability of our funds. Loans to Members will only be made in accordance with our Rules, the Trust Deed, and the provisions of the FSCU Act, which may from time to time specify the maximum amount which may be loaned to any Member, the maximum term of loans, or the lending to assets ratio to be observed by us. Please contact us for details of the conditions existing under the Rules and the FSCU Act at the date of application. Further information on the composition and maturity of the loan portfolio can be found in the notes to our financial statements which can be found on the Offer Register at <https://disclose-register.companiesoffice.govt.nz/disclose>. All loans

are subject to our lending criteria and we reserve the right to decline any application for a loan without giving any reason.

### **Main sector in which Credit Union Baywide operates**

We operate as a NBDT in the financial services industry with a focus on savings and lending for individuals and families who live in New Zealand.

### **Aspects of the business that are key to generating income**

The aspects of our business that are key to generating income are as follows.

#### *Growing the Loan Portfolio*

We make loan advances from your investments and retained surpluses to our Members. We make income from the interest charged on these loans. The majority of our loan advances are of a consumer nature and are made to assist Members with residential home loans or to fund various personal items such as vehicle purchases, holidays and debt consolidations. As the loan portfolio provides the majority of our surplus, it is desirable to grow the loan portfolio.

#### *Other Products and New Markets*

We also generate income from commissions on loan insurance, KiwiSaver products and retail transactional banking. Historically, our membership has been concentrated in the lower North Island but we have recently expanded our national presence. The intended merger through transfers of engagements under the Heads of Agreement described below would further expand our national presence.

#### *Investment*

We have a number of investments which contribute to our overall income including, deposits with banks, deposits with Co-op Money NZ and Base Capital Notes issued by Co-op Money NZ.

### **Merger of Credit Unions**

On 15 March 2019, the Members of Credit Union Baywide passed a resolution authorising Credit Union Baywide to accept the required transfers of engagements, as part of the intended multi-party credit union merger further described below. Subsequently, on 15 March 2019, the board of directors of Credit Union Baywide also approved the acceptance of the transfers of engagements from Credit Union South, Credit Union Central, and Aotearoa Credit Union.

Since December 2018, a process has been underway to consider the possible merger of Credit Union Baywide, Credit Union South, Credit Union Central, Steelsands Credit Union and Aotearoa Credit Union (*Participating Credit Unions*) into a single credit union. The process to achieve this would be a series of transfers of engagement in accordance with the FSCU Act. The Participating Credit Unions entered into a Heads of Agreement dated 17 December 2018, which provided the Participating Credit Unions with the opportunity to undertake due diligence and seek the necessary approvals and consents in connection with the transfers of engagements. Further to this, the Participating Credit Unions entered into a Transfer Agreement on 14 January 2019, amended on 24 January 2019 to extend the timeline for completion of the merger.

During the week beginning 11 March 2019, all of the Participating Credit Unions held meetings requesting their respective Member approvals in connection with the transfers of engagements. Member approval to the transfer of engagements was given for Credit Union South, Credit Union Central, and Aotearoa Credit Union. Member approval to the

transfer of engagements was not obtained for Steelsands Credit Union and therefore they will not complete a transfer of engagements to Credit Union Baywide.

As noted above, on 15 March 2019 the Members of Credit Union Baywide passed a resolution authorising Credit Union Baywide to accept the required transfers of engagements necessary to proceed with the merger.

Members, or other persons that feel that they may be adversely affected by the transfer of engagements, have six weeks to lodge written objections to the transfer of engagements with the Registrar of Friendly Societies and Credit Unions, Private Bag 92061, Victoria Street West, Auckland 1142. The Registrar's confirmation is required before the transfer of engagements takes effect.

It is intended that the transfer of engagements will take effect from 1 May 2019. Under this process, Credit Union Baywide will assume all assets and liabilities of each of Credit Union South, Credit Union Central, and Aotearoa Credit Union (the *Transferring Credit Unions*). Following this, Credit Union Baywide will operate as a single merged entity, and each Transferring Credit Union will cease to exist. This process will 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.

Further information about the risks relating to the intended merger is provided in Section 6 of this PDS, under the heading "Merger of Credit Unions – potential risks".

### 3. What is Credit Union Baywide’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 Baywide has been rated by Fitch Ratings. Fitch Ratings gives ratings from AAA through to C. We have a local and foreign currency long-term issuer credit rating of **BB with a stable outlook** and a short-term issuer credit rating of **B**, issued on 17 October 2016 and affirmed on 30 December 2018.

Rating	AAA	AA	A	BBB	BB	B	CCC	CC	D
Strength	Extremely strong	Very strong	Strong	Adequate	Less Vulnerable	More vulnerable	Currently vulnerable	Currently highly vulnerable	Default imminent or inevitable
Historic likelihood of default over 5 years <sup>1</sup>	1 in 600	1 in 300	1 in 150	1 in 30	1 in 10	1 in 5	1 in 2	1 in 2	

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 (one to two years) 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.

Further information regarding our credit rating is outlined in “Specific risks – Credit Ratings” in Section 6.

Credit Union Baywide’s credit rating may be reviewed and amended by Fitch Ratings if the transfers of engagement under the Transfer Agreement are completed or there is any other significant market change.

### 4. Credit Union Baywide’s financial information

Credit Union Baywide is required by law and its Trust Deed to meet certain financial requirements. The Key Ratios table shows how Credit Union Baywide is currently positioned against those requirements. These are minimum requirements. Meeting them does not mean that Credit Union Baywide is safe. The section on specific risks of investing sets out risk factors that could cause its financial position to deteriorate. The Offer Register at <https://disclose-register.companiesoffice.govt.nz/disclose> provides a breakdown of how the figures in this table are calculated, as well as full financial statements.

For further details on the current position, refer to the “Risk of non-compliance with the prudential requirements for NBDTs” section on page 13.

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

### **Prior Ranking Debt**

The Shares 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 of our present and after acquired personal property ("Supervisor's Security Interest").

Under the Trust Deed, we are permitted, with the consent of the Supervisor, 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 more detail below.

Under the terms and conditions of our banking arrangements with Co-op Money NZ, a settlement bond is held by way of term deposits with Co-op Money NZ. The settlement bond is an agreement between us and Co-op Money NZ, consented to by the Supervisor, whereby a sum of up to 3% of our total tangible assets is excluded from the Supervisor's Security Interest over those assets. In the event that we are unable to settle our inter-bank requirements the settlement bond provides security to Co-op Money NZ.

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

### **Key Ratios**

The key ratios and other financial information tables can be found on the Offer Register at <https://disclose-register.companiesoffice.govt.nz/disclose>.

### **Other limitations, restrictions and prohibitions**

Set out below is a summary of the other limitations, restrictions and prohibitions applicable to us. For further details refer to the Trust Deed on the Offer Register at <https://disclose-register.companiesoffice.govt.nz/disclose>.

### **Financial Covenants**

Under the Trust Deed, we have agreed that we will not grant any charge or other security interest in priority to or ranking equally with the security interest granted in favour of the Supervisor, without the Supervisor's prior written consent. Credit Union Baywide has further covenanted, subject to the terms and conditions contained in the Trust Deed, not to:

- (a) permit its secured liabilities to exceed 1% of its total tangible assets;
- (b) permit its liquid assets to be less than 8% of its total tangible assets;
- (c) 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;
- (d) fail to ensure that it has sufficient assets at all times to discharge all debts as they fall due;
- (e) permit the aggregate of its secured investments, unsecured investments and listed securities, to exceed 15% of its total tangible assets;
- (f) permit the aggregate of its unsecured investments to exceed 1% of its total tangible assets;
- (g) allow the capital ratio, as calculated under the Deposit Takers (Credit Ratings, Capital Ratios and Related Party Exposures) Regulations 2010 (the *NBDT Regulations*) to be less than 8% as Credit Union Baywide has a credit rating;

- (h) allow its aggregate exposure to related parties to exceed 15% of capital (as calculated in accordance with the regulations mentioned in (g) above). For further details on the current position, refer to the "Risk of non-compliance with the prudential requirements for NBDTs" section on page 13; and
- (i) borrow any monies except on terms and conditions to which the Supervisor has previously consented in writing. Such borrowing is not to exceed 15% of Credit Union Baywide's total equity, unless the borrowing is to fund expenditure of a capital nature subject to the prior approval of the Supervisor.

The Supervisor has agreed that in calculating the amounts under (f) above, the amount of \$1,434,629 (being a proportion of the Base Capital Notes issued by the Co-op Money NZ on terms further set out in the Notes to the Financial Statements, which can be found on the Offer Register at <https://disclose-register.companiesoffice.govt.nz/disclose>) may be disregarded.

## **5. Guarantors**

The Shares and return on the Shares are not guaranteed by us, the Supervisor or any other person. We are solely responsible for repayment of the Shares.

## **6. Specific risks of investing**

In this section we have described the circumstances of which we are aware, that exist or are likely to arise, that significantly increase the risk that we may default on our payment obligations under the shares.

### **Specific risks relating to Credit Union Baywide's creditworthiness**

#### ***Liquidity risk***

Liquidity risk is about ensuring that we have sufficient levels of liquid assets so that we can promptly meet our obligations as they fall due, in a wide range of operating circumstances including unknown and unforeseen events and times of extreme liquidity pressure.

We are reliant on funding from retail depositors only. The contractual maturity profile highlights that the funding maturity profile is shorter than the lending maturity profile. Therefore 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 our payment obligations. We rely on high reinvestment rates for Term Accounts, a consistent and reliable level of On-Call and Special Share Investment Accounts, and regular receipts of principal and interest from borrowers. If reinvestment rates, Member Account balances or borrower repayments were to reduce materially, there is a risk that we may not have enough cash on hand at any one time to repay Members in a timely manner.

We manage liquidity risk by:

- continuously monitoring forecast and actual daily cash flows;
- maintaining adequate cash reserves, currently at least 11.5% of total tangible assets as liquid assets, to meet Member withdrawals when requested. Should the liquidity ratio fall below this level, then we may limit or suspend loans, obtain new deposits, utilise borrowing facilities and assess what assets can be sold;
- reviewing the maturity profiles of financial assets and liabilities;
- regularly monitoring loan repayments and comparing to forecast cash flows; and



- maintaining a liquidity mismatch ratio so we have sufficient funds available to meet any short term funding deficit.

Further information on liquidity, including expected maturity analysis and reinvestment assumptions, can be found in the Notes to the Financial Statements. The Financial Statements can be found on the Offer Register at <https://disclose-register.companiesoffice.govt.nz/disclose>.

### ***Loan default risk***

Loan default risk is the risk that a borrower does not repay the full amount of principal and interest due to us. Loan default risk includes both credit risk and security position risk as outlined below.

Credit risk is the risk that the other party to a financial instrument will fail to discharge their obligation resulting in a financial loss. This usually occurs when borrowers fail to repay their loans.

We have a risk policy for loans to manage credit risk. The key points are:

- credit assessment of all applications for loans and facilities is based on potential credit risk, suitability of security offered, and ability to repay;
- specifying the level and type of security required for a loan;
- setting exposure limits for individual borrowers;
- reassessment and review of the credit exposures on loans and facilities;
- monitoring and reviewing loans in arrears;
- establishing appropriate provisions for impaired loans;
- maintaining and reviewing the performance of debt recovery; and
- regular compliance monitoring by internal audit.

If we experience significant credit losses (i.e. borrowers not repaying their loans), this will have an adverse impact on financial performance and the ability to pay returns to Members. If this was sufficiently substantial so as to cause the liquidation and winding up of our operations, then the value returned to you, in respect of your Shares, may be less than the amount you invested.

We may take security from a Member for loans to them. To the extent that we do or do not take security or we take security that ranks subsequent in priority to another party's security, then in a default situation:

- our ability to realise the Member's assets taken as security may be restricted or prohibited by the terms of any prior ranking security;
- where the Member's assets are realised, the value of those securities taken may fluctuate due to market prices; and
- where the Member's assets are realised, the Member may be unable to repay some or all of the remaining funds advanced by us.

We may incur losses in the above circumstances, which may affect our profitability and returns payable to you. Therefore, we make provision for doubtful debts in our financial statements in accordance with industry standards, to reflect this risk.

Our loan portfolio, subject to lending criteria, includes loans to Members with high Loan-to-Value (LVR) ratios. These Members are more susceptible to credit losses if there are fluctuations in market prices. We may be exposed to increased security risk in the residential property market if house prices fall. To mitigate this risk we limit the proportion of high LVR lending at a portfolio level.

In the unlikely event that the security position deteriorates for a significant number of Members this could have an adverse impact on our financial performance. If this was sufficiently substantial so as to cause the liquidation and winding up of our operations, then the value returned to you, in respect of your Shares, may be less than the amount you invested.

The Trust Deed provides that indebtedness of a Member must not exceed:

- 10% of our total tangible assets, in the case of a secured loan;
- 5% of our total tangible assets, in the case of an unsecured loan; or
- such lesser amount as we 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 our total tangible assets. We are therefore not exposed to any one large loan to a Member going into default.

### ***General Credit risk – debt securities, term investments, cash and cash equivalents***

Credit risk is the risk that the other party to a financial instrument will fail to discharge their obligation resulting in a financial loss. This usually occurs when debtors fail to settle their obligations to us.

Our investments include call deposits and term deposits with banks and Co-op Money NZ and an equity investment in Base Capital Notes issued by Co-op Money NZ. These investments are permitted under our Trust Deed, however there are no trust or security arrangements governing these investments. Member credit unions invest in Base Capital Notes to fund Co-op Money NZ which enables them to provide core services to us. The Base Capital Notes constitute unsecured obligations of Co-op Money NZ and rank equally and without priority to other Co-op Money Base Capital Notes. The Base Capital Notes rank after creditors in the event of winding up Co-op Money NZ. Further, there is no active market for the Base Capital Notes issued by Co-op Money NZ.

Accordingly, there is a concentration of credit risk with respect to our investments in Co-op Money NZ, which are unsecured. If Co-op Money NZ runs into financial difficulties and defaults on its obligations, we could experience losses which could affect payment obligations to Members (Refer to Specific Credit Risk – Co-op Money NZ, Service Risk – Co-op Money NZ and Information Technology Risks below for further information). We continue to actively monitor Co-op Money NZ's performance, our exposure to this credit risk, and the need to impair our investments with Co-op Money NZ.

### ***Specific Credit Risk – Co-op Money NZ***

Co-op Money NZ is reliant upon maintaining a certain level of business, including non-member business, in order to have the scale to provide its essential services efficiently. Its revenue is concentrated on a small number of customers. Recently, some members have reduced and/or ceased the utilisation of some services from Co-op Money NZ and have indicated further planned reductions thus reducing Co-op Money NZ's future revenue streams. Co-op Money 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.

Co-op Money NZ 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 Co-op Money NZ and adversely impact the value and/or returns of our investments in Co-op Money NZ and/or increase the cost of services obtained from Co-op Money NZ.

Co-op Money NZ's credit rating has recently been downgraded by Fitch Ratings to a B+ from a BB, with a stable outlook.

We are working with Co-op Money NZ to improve their financial position including consideration of a potential restructuring.

### ***Services risk - Co-op Money NZ***

We invest deposits in, and are reliant on Co-op Money NZ to provide us with essential services such as our core banking system, a central bank and "treasury" function and debit card facilities. In the event that, for whatever reason, Co-op Money NZ was unable to provide services then the short term ability for us to continue to provide services to our Members will be impeded. This would likely impact the confidence Members have in us and have an adverse impact on withdrawal and reinvestment rates for Member deposits, which could affect our ability to meet our payment obligations to our Members. Co-op Money NZ has an extensive business continuity and disaster recovery program that is regularly tested and audited and we are supporting Co-op Money NZ in their efforts to develop and deliver their business strategies to ensure continuity of essential services.

### ***Credit risk – credit rating***

As at the date of this PDS, we have a local and foreign currency long-term issuer credit rating of BB and a short-term issuer credit rating of B, with a stable outlook, issued by Fitch Ratings.

In its reports dated 17 October 2016 and 30 August 2017, Fitch Rating issued us and affirmed a short-term issuer credit rating of B and a long-term issuer credit rating of BB with a stable outlook. This was affirmed by Fitch Ratings in press releases dated 20 July 2018 and 30 December 2018 in respect of foreign currency long-term and short-term issuer credit ratings, and in respect of local currency long-term and short-term issuer credit ratings.

Fitch Ratings' rating reflects that we have a modest organisation with small system market shares, which means we are generally a price taker. However, our competitive position is typically stronger in our local or niche market. Fitch comments that most of the credit union institutions maintain capital ratios above their larger bank peers, which is considered prudent due to our smaller absolute size. Customer deposits are the primary source of funding for us as we generally have limited access to wholesale funding sources and do not have access to the Reserve Bank of New Zealand's repo facility.

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.

The credit rating reflects our greater risk appetite against that of most of our domestic peers with a focus on growth, and higher loan-to-value mortgages and consumer lending. Fitch Ratings believes this increases exposure to weaker performance in a poor economic cycle. In Fitch Ratings view, our risk controls are adequate for our size and consistent with regional peers.

In its press release relating to the affirmation of our credit rating dated 20 July 2018, Fitch Ratings comments that the affirmation reflects their view that we are likely to broadly maintain our financial profile and market position over the next two years. However, Fitch Ratings maintains a negative sector outlook for New Zealand, reflecting

rising macroeconomic risks, driven by high levels of household leverage and elevated house prices.

In the same press release, Fitch Ratings notes that we remain adequately capitalised for our risk profile with sufficient buffers above regulatory minimums. However, Fitch Ratings comments that ongoing growth, which continues to exceed growth in retained earnings, could lead to pressure on regulatory capital ratios if sustained.

Fitch Ratings comments that our funding and liquidity ratios appear adequate for our credit profile. Fitch Ratings notes we remain fully funded by retail deposits, which has displayed significant growth alongside our loan book. Fitch Ratings comments that we have a weaker deposit base relative to larger peers, which may see higher outflows to banks in a stressed economic cycle.

Fitch Ratings also notes that an upgrade of our rating would require an improved risk appetite, possibly through slower and lower risk underwriting or a stronger risk-control framework, evidenced by performance through the cycle. Conversely, a downgrade may result if risk appetite increases substantially. If the credit rating is downgraded for whatever reason, this will have an adverse effect on our reputation, and may decrease its attractiveness as a credit union.

The most recent affirmation of the credit rating, dated 30 December 2018, takes into account the intended merger with the other Participating Credit Unions, referred to in Section 2, above.

The affirmation reflects Fitch's view that the merger is unlikely to result in significant short-term changes to our credit profile, and despite the increased size of the merged entity, it will still constitute only a very small part of the New Zealand financial system and therefore have limited impact on Fitch's view of the company profile.

Fitch ratings notes that, in the longer term, the merger should provide greater economies of scale and geographic diversification, although risks may also emerge due to the relatively large number of entities involved in the process and weaknesses in one of the smaller merger partners, Aotearoa Credit Union. Fitch ratings notes that Aotearoa Credit Union has breached the minimum capital ratio set out by its trust deed and has been advised by its trustee that it needs to seek a merger to address this. Aotearoa Credit Union is prevented from accepting new members in the interim. Further information about Aotearoa Credit Union is provided in the "Merger of Credit Unions – potential risks" section of this PDS.

Fitch ratings also note that, if the merger goes ahead, this could have an impact on their future ratings action.

Positive rating action for the merged entity would likely require a lower risk appetite, potentially through slower growth, lower risk underwriting standards and stronger risk controls. Sound management of the merger risks, such that member numbers are not materially reduced, and the formation of a cohesive culture across the entity will also be important to any positive rating action. This is likely to take several years to develop and observe so positive rating action does not appear imminent. The merger may also provide economies of scale, which could support longer-term profitability, although this is unlikely to drive an upgrade by itself.

Conversely, the merged entity's ratings could be downgraded if management is unable to properly manage the merger-related operational risks or embed a cohesive culture and strategy across the legacy businesses. This may result in weaker financial performance, including a loss of members, and place pressure on the risk appetite in an attempt to improve profitability. Risk appetite that is weaker than we expect and what Fitch currently observe would also likely result in a downgrade. In addition, ratings

pressure may emerge if the issues at ACU take significant management time to address, reducing the focus on the day-to-day operations of the entity.

The reports issued by Fitch Ratings are available on the Offer Register at <https://disclose-register.companiesoffice.govt.nz/disclose>.

### **Capital Risk**

Capital risk management is about ensuring we have sufficient capital to meet the regulatory requirements, including the NBDT Regulations, which provides a buffer against unexpected losses and supports the ability to fund future investment in products and services.

We are reliant on generating surpluses to provide retained earnings to increase our capital. Our asset growth over recent periods has resulted in a reduced capital ratio. We manage our capital risk by:

- maintenance of a capital adequacy policy and reporting requirements
- continuously monitoring the actual and forecast capital ratio
- restricting lending if required
- managing interest rate margin and other revenue and expense items

Further information on capital requirements can be found in the Notes to the Financial Statements and on the Key Ratios Table. The Financial Statements and Key Ratios Table can be found on the Offer Register at <https://disclose-register.companiesoffice.govt.nz/disclose>.

### **Geographic concentration**

The concentration of deposits from Members and loans to Members in an area can create a risk from those groups of Members having similar risks due to common underlying factors, e.g. economic sector or geographical location.

In a significant event, such as a natural disaster or economic downturn, in an area where there are a significant number of Members it, could have an adverse impact on withdrawal and reinvestment rates for Member deposits and the ability of Members to meet their repayment obligations to us. This could affect our ability to meet our payment obligations to our Members. We have no single name concentration exposure to any individual Member. We mitigate this risk by limiting exposure to individual Members and monitoring exposure by regions. We also have business continuity and disaster recovery plans in place.

Further information on current geographic concentration, including regions with greater than 5% of our total loans and/or deposits, can be found in the Notes to the Financial Statements. The Financial Statements can be found on the Offer Register at <https://disclose-register.companiesoffice.govt.nz/disclose>.

### ***Interest rate margin risk***

We are subject to interest rate margin risks. This is because we make the bulk of our income from the difference in the interest rate we pay to Members for deposits and what interest rate we earn from Members who borrow funds and our investments. This difference is called net interest margin. As some of these interest rates are fixed for differing periods on some loans and Member accounts, there is a risk that changes in market interest rates may cause fluctuations in net interest margin, as Members Accounts and loans to Members re-price at different times.

We adopt an 'on-book' hedging strategy to manage interest rate risk. The objective of this approach is to match the interest rate repricing profile of loans provided to Members and our investments to the repricing profile of the borrowing of funds from Members. The approach is ultimately limited by the investment and borrowing decisions of individual Members that impact the repricing profile. We do not currently use derivatives, such as interest rate swaps, to manage interest rate risk.

We maintain a market risk policy which covers how this risk will be managed to minimise interest rate margin risk. In the event of a reduced net interest margin, resulting from an interest rate repricing mismatch, there would be an adverse impact on our financial performance. If this was sufficiently substantial so as to cause the liquidation and winding up of our operations, then the value returned to you, in respect of your Shares, may be less than the amount you invested.

Further information on interest rate risk, including interest rate risk analysis can be found in the Notes to the Financial Statements included on the Offer Register. <https://disclose-register.companiesoffice.govt.nz/disclose>.

### ***Risk of non-compliance with the prudential requirements for NBDTs***

The NBDT Act governs matters such as 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. There are also regulations which apply to NBDTs which provide for minimum liquidity and capital standards and limit related party exposures. Failure to comply with NBDT requirements could in some circumstances result in us having our NBDT licence revoked and being ordered to cease trading.

Under the terms and conditions of our banking arrangements with Co-op Money NZ, we place some funds on term deposit with Co-op Money NZ. As noted in the Prior Ranking Debt section in section 4 above, Co-op Money NZ holds security over these funds to a maximum of 3% of our total tangible assets. Further to this we maintain a current account with Co-op Money NZ linked to the provision of banking services.

The number of member credit unions in Co-op Money NZ reduced to 10 on 1 August 2018 and each member credit union now controls 10% of the voting rights in Co-op Money NZ. As a result, Co-op Money NZ became a related party of Credit Union Baywide.

Leading up to the change in membership there was a general concern that credit unions might breach the related party exposure limits. Co-op Money NZ and the credit unions applied to the Reserve Bank for an exemption for certain exposures to Co-op Money NZ to be considered as related party exposures. Co-op Money NZ treasury arrangements and an exemption from the Reserve Bank have resulted in a low likelihood of Credit Union Baywide breaching the related party exposure limits.

### ***Information technology risks***

Information technology plays a critical role in our business, with the delivery of financial services to customers dependent on the availability and reliability of our information technology systems. Our ability to compete effectively in the future will, in part, be driven by our ability to maintain an appropriate information technology platform for the efficient delivery of our products and services. Our operations are likely to be significantly affected should our information technology systems fail or not operate in an efficient manner. We mitigate this risk by ensuring we have appropriate information security and backup systems in place and all third party suppliers have appropriate disaster recovery procedures.

We have worked with Co-op Money NZ to implement and embed a new banking platform, and we transitioned to this new system in March 2018. The banking platform is integral to our operations and on-going development of relevant products and services for our Members. The project has experienced delays and an escalation in costs which have adversely impacted the financial position of Co-op Money NZ. In the event that the delays and cost escalations relating to the transition of the remaining credit unions were significantly prolonged or excessive, this could have a further adverse financial impact on Co-op Money NZ. The risks associated with this project are managed through project safeguards.

### ***Cyber security risk***

Cyber security risk is the risk of a breach or unauthorised access to our customer data, or other confidential information, or the risk of an incident occurring that causes us or our service providers to suffer data breaches, data corruption or lose operational functionality. A successful cyber-attack may result in negative consequences, including loss of revenue, additional regulatory scrutiny, remediation costs, litigation and reputational damage. Information technology controls are in place to mitigate the risk of cyber-attacks that could destroy or damage data and critical systems and hamper the smooth running of our operations.

### ***Merger of Credit Unions - potential risks***

The intended merger of the Participating Credit Unions described in section 2 above raises some additional risks for Credit Union Baywide.

#### *Credit risk*

As part of the Heads of Agreement and Transfer Agreement signed between the Participating Credit Unions, Credit Union Baywide (in conjunction with other Participating Credit Unions) has provided an unsecured liquidity support loan to Aotearoa Credit Union (the *Liquidity Facility Agreement*). This Liquidity Facility Agreement was 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 recently 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 its losses for the financial year ending 30 September 2018.

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 merger be significantly delayed, or if it does not proceed.

This may result in financial loss for Credit Union Baywide 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](http://www.business.govt.nz/disclose) by searching offer number OFR11170.

#### *Operational risk*

The merger will require a review of operational activities and governance, as well as a commitment in terms of time, capital and resources. This may also create operational risk for Credit Union Baywide in the short term while the different entities are merged.

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 Co-op Money NZ 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 Co-op Money NZ members, which could affect the operations and efficiency of Co-op Money NZ.

#### *Sector reputational risk*

If Aotearoa Credit Union is unable to participate in the merger, or if this does not proceed 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 Baywide and an increase in withdrawals, impacting the liquidity of Credit Union Baywide and its ability to meet its repayment obligations to Members.

The approval provided by the Members and the board of directors of Credit Union Baywide represents a significant step forward towards the realisation of the transfer of engagements.

## **7. Register entry**

Further information regarding Credit Union Baywide and the Shares on offer can be found on the Offer Register at <https://disclose-register.companiesoffice.govt.nz/disclose> or on request from the Registrar of Financial Service Providers by emailing: [registrar@fspr.govt.nz](mailto:registrar@fspr.govt.nz).

The information contained on the Offer Register includes among other things a copy of the Trust Deed, financial information for Credit Union Baywide, the Rules, new member application form, details of each of the Accounts available and their associated fees and interest rates.

A copy of this PDS, the Rules, the Trust Deed and other information regarding Credit Union Baywide and our Accounts can also be found on our website, [nzcubaywide.co.nz](http://nzcubaywide.co.nz) or free of charge on request at any of our Branch Offices.