FitchRatings

Banks
Retail & Consumer Banks
New Zealand

First Credit Union

Ratings

Foreign Currency	
Long-Term IDR	BB
Short-Term IDR	B
Local Currency	
Long-Term IDR	BB
Short-Term IDR	B
Viability Rating	bb
Government Support Rating	ns
Sovereign Risk	
Long-Term Foreign-Currency IDR	AA
Long-Term Local-Currency IDR	AA+
Country Ceiling	AAA

Outlooks

Long-Term Foreign-Currency IDR	Stable
Long-Term Local-Currency IDR	Stable
Sovereign Long-Term Foreign-Currency IDR	Positive
Sovereign Long-Term Local-Currency IDR	Stable

Applicable Criteria

Bank Rating Criteria (November 2021)

Related Research

Fitch Affirms First Credit Union at 'BB'; Outlook Stable (February 2022)

Fitch Ratings 2022 Outlook: Asia-Pacific Developed Market Banks (December 2021)

Key Rating Drivers

Risk Profile Above Peers: First Credit Union's (FCU) Issuer Default Ratings (IDR) are driven by its Viability Rating (VR), which is in line with the implied VR. The VR captures FCU's greater risk profile relative to peers, reflected in its high proportion of personal loans, modest market position and some geographical concentration.

Stable Operating Environment: We expect economic conditions in New Zealand to be broadly stable over the next two years, underpinning the stable outlook on our operating environment score of 'a-'. The score is below the 'aa(cat)' score implied by Fitch Ratings' criteria to reflect high household debt in New Zealand.

We also adjust for the less stringent regulatory framework for non-bank deposit takers like FCU in this assessment. The framework is moving towards the bank framework, at which point we may equalise the operating environment score with the New Zealand bank score of 'a'.

Stable Business Model, Small Franchise: FCU's relatively simple and consistent business model partly offsets the credit union's small market position, contributing to Fitch assigning a business profile factor score of 'bb', above the 'b(cat)' implied score.

Modest Asset Quality Weakening: We expect some weakening in FCU's asset-quality metrics over the next two years, as Covid-19 pandemic-related support measures are unwound. FCU's core metric, impaired loans/gross loans, was 2.5% in the financial year ended June 2021 (FY21). This was higher than that of some peers, reflecting FCU's loan mix. Geographical and product concentrations mean we adjusted the factor score to 'bb' from the implied 'bbb(cat)'.

Strong Earnings Rebound: FCU reported a strong rebound in earnings for FY21, supported by improving economic conditions. We expect profitability to be maintained until FY23, with an operating profit/risk-weighted asset ratio of around 0.6%. This is commensurate with the 'bb' score for earnings. Ongoing IT investments could limit efficiency improvements in the short term, but should boost profitability in the longer term.

Capital Ratios to Stabilise: We expect the credit union's Fitch core capital and total regulatory capital ratios to remain steady. We expect loan growth to moderate, which should alleviate pressure on capital ratios. The assigned score is below the implied 'a(cat)' score due to the small absolute size of the capital base of just NZD57 million (USD40 million) at FYE21.

Limited Funding and Liquidity Pressure: We expect funding and liquidity, scored two notches above the VR at 'bbb-', to remain a credit strength for FCU's financial profile. We expect limited funding and liquidity pressure over the next two years, given the high system liquidity. The score remains below the 'a(cat)' implied score as credit unions lack access to the Reserve Bank of New Zealand's lender of last resort facilities, which could lead to deposit outflows in a funding-market shock.

Rating Sensitivities

Weakening Risk Profile: The Long-Term IDRs and VR may be downgraded upon a deterioration in FCU's risk profile, potentially aimed at increasing market share and profitability, that leads to greater volatility in the financial profile through the cycle.

This may be reflected in a combination of: impaired loans/gross loans consistently above 10%; operating profit/risk-weighted assets below 0.25% for a sustained period; the Fitch core capital ratio declining below 9.5% without a credible plan to replenish capital buffers; or the loans/customer deposit ratio increasing above 100% on a sustained basis.

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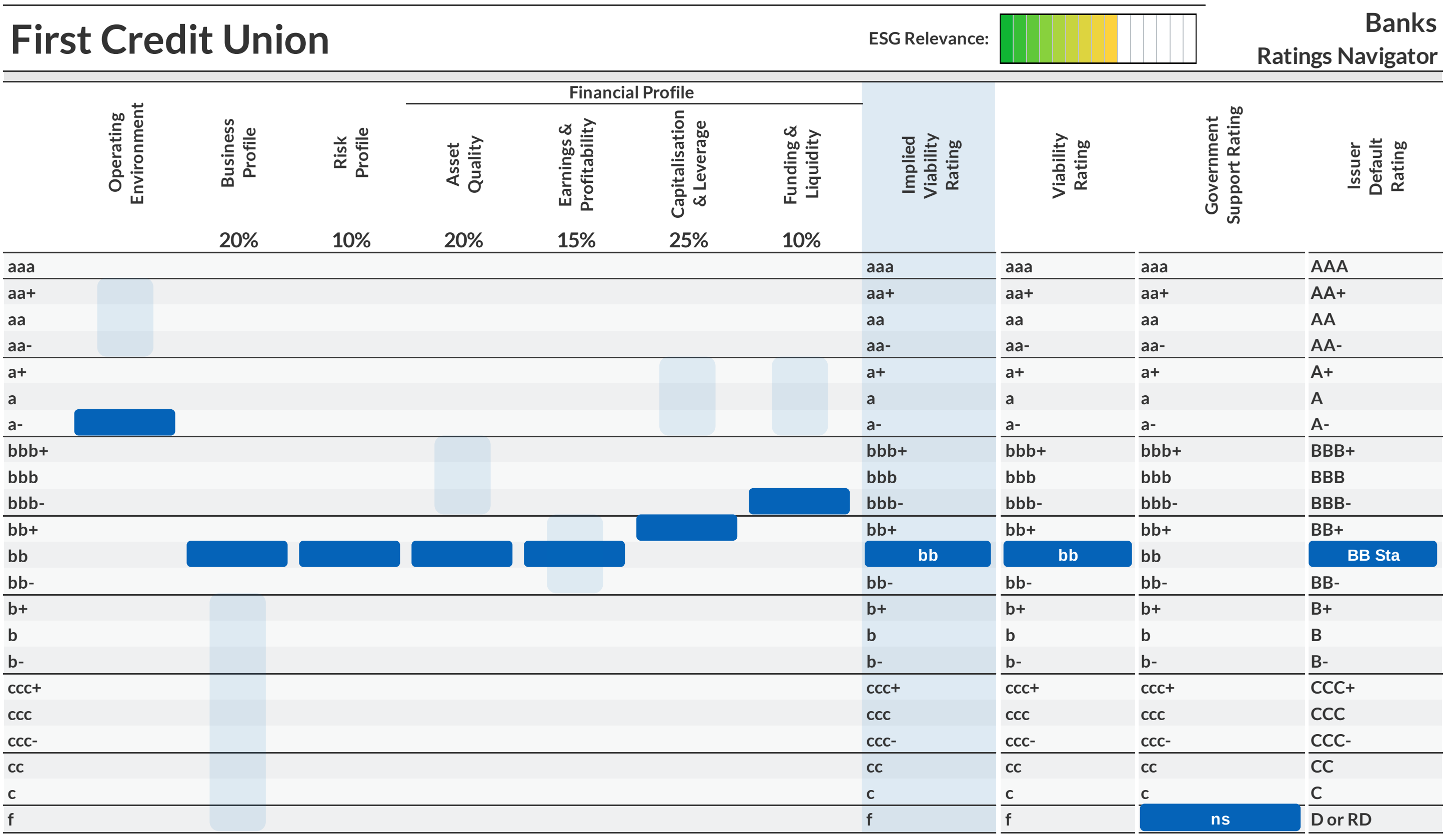
Ratings Navigator



The Key Rating Driver (KRD) weightings used to determine the implied VR are shown as percentages at the top. In cases where the implied VR is adjusted upwards or downwards to arrive at the VR, the KRD associated with the adjustment reason is highlighted in red. The shaded areas indicate the benchmark-implied scores for each KRD.

Brief Company Summary

Solid Outlook for Operating Environment

Our economic forecast for New Zealand has improved significantly since the beginning of the pandemic in 2020. This has largely been driven by the success of the authorities in dealing with the health crisis, allowing the domestic economy to reopen quickly. Fitch expects real GDP to have expanded by 5.0% in 2021, and forecasts further growth of 3.5% in 2022, although there may be some pressure in the near term as an outbreak of the Omicron Covid-19 variant gathers pace. The unemployment rate has fallen to a record low of 3.4%, which should provide some support to bank asset quality as the effect of the unwinding of pandemic-related support measures works its way through the economy. Inflation has accelerated, prompting an increase in the cash rate of 50bp in 2H21 by the Reserve Bank of New Zealand (RBNZ). We expect a further 75bp increase in 2022.

House price growth accelerated significantly through late 2020 and 2021 and could pose a risk to financial stability in the medium term. As a result, the RBNZ reimplemented macroprudential limits that are tighter than those in place before the pandemic and the government enacted policies aimed at moderating price growth. The RBNZ has also flagged additional measures, including debt/income limits, that could be enforced in 2022. New Zealand's high household leverage relative to that of other countries is factored into our operating environment assessment for non-bank deposit takers. Household debt/disposable income was 169% at end-June 2021, a record high.

We also incorporate the less stringent regulatory oversight of non-bank deposit takers relative to banks in our assessment of the operating environment, although the implementation of the Deposit Takers Act from 2023 should result in regulatory oversight transitioning towards levels required for banks. We expect greater clarity on the implementation timetable in 2022.

Modest Franchise, Limited Pricing Power

FCU is one New Zealand's largest credit unions, primarily operating in the upper North Island around the city of Hamilton, where it is headquartered and regionally concentrated. FCU accounts for less than 0.1% of New Zealand bank and non-bank system assets. This means that it has limited competitive advantages and is generally a price-taker in its core operating segments. FCU's business model centres around providing residential mortgages and consumer loans to members funded by retail deposits. The credit union has low reliance on volatile business segments, which we expect to continue, underpinning our business profile assessment of 'bb', which is above the implied score of 'b(cat)'.

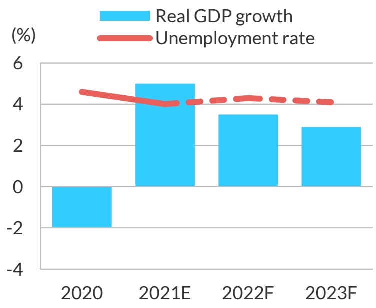
Above-Average Risk Appetite Relative to New Zealand Banks, Building Societies

FCU has greater exposure to non-mortgage consumer loans than most New Zealand bank and building society peers, which we consider as indicative of above-average risk appetite. The proportion of non-mortgage consumer loans in FCU's loan book (FYE21: 32%) has declined over the last two years as a result of weaker consumer spending and the rise of buy-now-pay-later offerings, but it remains high relative to broader sector peers.

FCU's underwriting standards and serviceability assessment are generally in line with industry practice. All loans are assessed on an amortising basis using an interest rate that is higher than the offered or advertised rate. Collateral is taken on most loans and is used as a backstop to losses. Exposures to commercial lending is limited despite laws being recently amended in 2018 to allow credit unions to lend to SMEs.

FCU's risk control framework is acceptable for its operations but less sophisticated than those observed at larger New Zealand banks. Operational and market risk frameworks are similarly acceptable given the low sales incentive pay structure and lack of trading activity. FCU's disaster recovery and business continuity planning appear reasonably developed and was successfully tested following the onset of the pandemic.

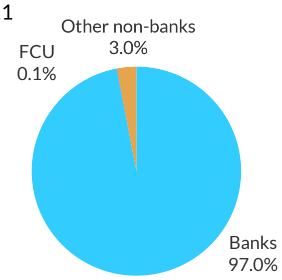
Economic Outlook



Source: Fitch Ratings, Fitch Solutions

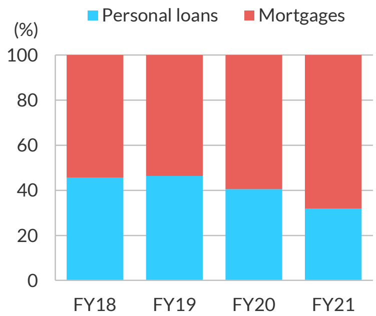
Market Share

Sep 21



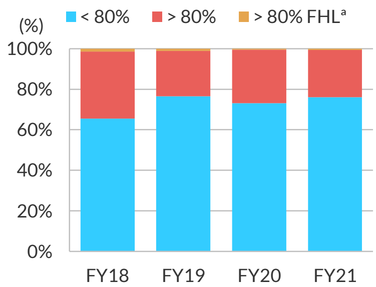
Source: Fitch Ratings, Reserve Bank of New Zealand

Loan Book



Source: Fitch Ratings, FCU

Mortgage Loan/Value Ratios



[a] Government guaranteed
Source: Fitch Ratings, FCU

Summary Financials and Key Ratios

	30 Jun 21		30 Jun 20	30 Jun 19	30 Jun 18
	Year end	Year end	Year end	Year end	Year end
	(USDm)	(NZDm)	(NZDm)	(NZDm)	(NZDm)
	Audited - unqualified	Audited - unqualified	Audited - unqualified	Audited - unqualified	Audited – unqualified (emphasis of matter)
Summary income statement					
Net interest and dividend income	9	12,566.0	13,072.0	13,091.0	13,173.0
Net fees and commissions	4	6,254.0	5,906.0	6,350.0	6,334.0
Other operating income	1	1,172.0	1,301.0	1,223.0	18.0
Total operating income	14	19,992.0	20,279.0	20,664.0	19,525.0
Operating costs	12	16,990.0	17,803.0	17,434.0	17,964.0
Pre-impairment operating profit	2	3,002.0	2,476.0	3,230.0	1,561.0
Loan and other impairment charges	1	1,150.0	1,786.0	2,128.0	819.0
Operating profit	1	1,852.0	690.0	1,102.0	742.0
Other non-operating items (net)	0	15.0	108.0	1,883.0	6.0
Tax	0	0.0	14.0	29.0	n.a.
Net income	1	1,867.0	784.0	2,956.0	748.0
Other comprehensive income	n.a.	n.a.	n.a.	95.0	n.a.
Fitch comprehensive income	1	1,867.0	784.0	3,051.0	748.0
Summary balance sheet					
Assets					
Gross loans	193	276,441.0	226,184.0	205,065.0	199,897.0
- of which impaired	5	6,900.0	8,966.0	8,763.0	8,588.0
Loan loss allowances	2	2,880.0	2,960.0	2,770.0	2,670.0
Net loans	191	273,561.0	223,224.0	202,295.0	197,227.0
Interbank	67	95,625.0	133,865.0	142,235.0	123,299.0
Derivatives	n.a.	n.a.	n.a.	n.a.	n.a.
Other securities and earning assets	6	9,061.0	1,012.0	3,949.0	5,410.0
Total earning assets	265	378,247.0	358,101.0	348,479.0	325,936.0
Cash and due from banks	15	20,924.0	18,895.0	15,663.0	11,633.0
Other assets	11	16,142.0	23,922.0	18,837.0	20,454.0
Total assets	291	415,313.0	400,918.0	382,979.0	358,023.0
Liabilities					
Customer deposits	246	352,156.0	337,358.0	319,929.0	298,196.0
Interbank and other short-term funding	n.a.	n.a.	n.a.	n.a.	n.a.
Other long-term funding	n.a.	n.a.	n.a.	n.a.	n.a.
Trading liabilities and derivatives	n.a.	n.a.	n.a.	n.a.	n.a.
Total funding and derivatives	246	352,156.0	337,358.0	319,929.0	298,196.0
Other liabilities	3	3,662.0	3,218.0	3,492.0	3,320.0
Preference shares and hybrid capital	n.a.	n.a.	n.a.	n.a.	n.a.
Total equity	42	59,495.0	60,342.0	59,558.0	56,507.0
Total liabilities and equity	291	415,313.0	400,918.0	382,979.0	358,023.0
Exchange rate		USD1 = NZD1.42898	USD1 = NZD1.556178	USD1 = NZD1.493875	USD1 = NZD1.483459

Source: Fitch Ratings, Fitch Solutions, FCU

Summary Financials and Key Ratios

	30 Jun 21	30 Jun 20	30 Jun 19	30 Jun 18
Ratios (annualised as appropriate, %)				
Profitability				
Operating profit/risk-weighted assets	0.6	0.2	0.4	0.3
Net interest income/average earning assets	3.4	3.7	3.9	4.0
Non-interest expense/gross revenue	86.0	87.8	84.4	92.0
Net income/average equity	3.1	1.3	5.1	1.3
Asset quality				
Impaired loans ratio	2.5	4.0	4.3	4.3
Growth in gross loans	22.2	10.3	2.6	0.8
Loan loss allowances/impaired loans	41.7	33.0	31.6	31.1
Loan impairment charges/average gross loans	0.5	0.8	0.3	0.4
Capitalisation				
Common equity Tier 1 ratio	n.a.	n.a.	n.a.	n.a.
Fully loaded common equity Tier 1 ratio	n.a.	n.a.	n.a.	n.a.
Fitch Core Capital ratio	16.9	15.6	17.6	17.1
Tangible common equity/tangible assets	14.3	13.9	14.3	14.3
Basel leverage ratio	n.a.	n.a.	n.a.	n.a.
Net impaired loans/common equity Tier 1	n.a.	n.a.	n.a.	n.a.
Net impaired loans/Fitch Core Capital	7.5	12.3	12.6	12.8
Funding and liquidity				
Gross loans/customer deposits	78.5	67.1	64.1	67.0
Liquidity coverage ratio	n.a.	n.a.	n.a.	n.a.
Customer deposits/total non-equity funding	100.0	100.0	100.0	100.0
Net stable funding ratio	n.a.	n.a.	n.a.	n.a.

Source: Fitch Ratings, Fitch Solutions, FCU

Key Financial Metrics – Latest Developments

Modest Weakening in Asset Quality Expected

Fitch expects FCU's impaired-loan ratio to rise over the next two years as pandemic-related support measures are unwound and interest rates increase. However, we expect the weakening to be manageable, supported by ongoing economic recovery. Notwithstanding the weakening ratio, we believe the impaired-loan ratio will remain stronger than pre-pandemic levels (2018-2019) due to the proportional reduction in non-mortgage consumer loans over the last two years.

The assigned factor score of 'bb' is lower than the implied ‘bbb(cat)’ score to reflect greater concentration relative to larger peers, particularly geographically. We expect this, combined with the exposure to non-mortgage consumer lending, to result in greater asset quality volatility and higher impaired loan metrics and write-off rates through a cycle.

Earnings Outlook Improved, Some Pressures Remain

Fitch expects FCU's earnings and profitability will be maintained at around FY21 levels over the next two years. Weakening net interest margins from changes in loan mix, increased investment expenditure and ongoing competition is likely to partially offset increased earnings from loan growth in the short term. We expect longer-term profitability to improve gradually as FCU increases its scale and completes its technology investments. We believe the core metric, operating profit/risk-weighted assets, will remain consistent with the 'bb' score over the next two years. FCU's profitability rebounded significantly in FY21 following a badly hit FY20 as a result of increased pandemic-related impairment charges.

Capital Buffers Weakened, Remain Adequate

We expect the Fitch Core Capital (FCC) ratio to improve modestly over the next two years. FCU's FCC ratio remains at the top end of Fitch-rated New Zealand non-bank deposit takers and we believe this will remain the case. Loans surged by 22% in FY21, but the FCC ratio improved as it was skewed towards lower capital-intensive exposures such as residential mortgages. This is likely to continue and, combined with moderating loan growth, should limit downward pressure on the FCC ratio.

The regulatory total capital ratio, which is the only regulatory capital metric required to be calculated by FCU, declined about 200bp to 13.5% by FYE21, although still well above the 8% regulatory minimum. The decline was primarily due to FCU increasing its shareholding in Finzsoft, its core banking platform provider, which is deducted from regulatory capital. We do not expect the ratio to significantly weaken further.

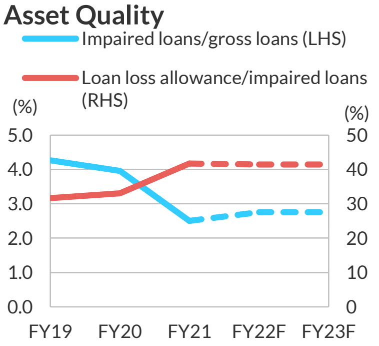
The assigned factor score of 'bb+' is lower than the implied ‘a(cat)’ score due to FCU's small absolute size and capital base.

Limited Funding and Liquidity Pressure Expected

Fitch expects FCU’s funding and liquidity profile to remain generally stable over the next two years as it maintains one of the strongest core metric, loans/customer deposits, within its peer group. FCU is funded entirely by retail deposits, which we believe will continue. High liquidity in the banking system means we expect limited funding and liquidity pressure for FCU. Deposit reinvestment rates remain stable and geographical concentration is unlikely to change, reflective of the business model.

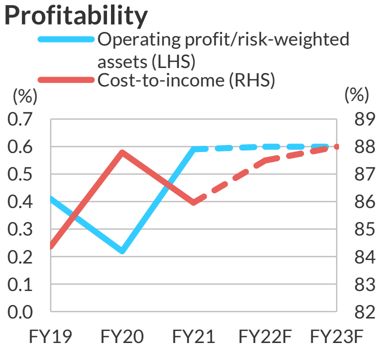
FCU's core metric implies a score in the ‘a(cat)’ but we adjusted it lower to reflect FCU's lack of access to the RBNZ's lender of last resort facilities, which could lead to deposit outflows in a funding market shock.

Asset Quality



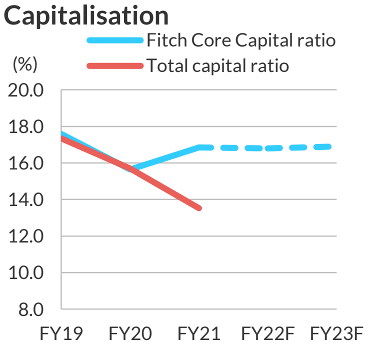
Source: Fitch Ratings, Fitch Solutions, FCU

Profitability



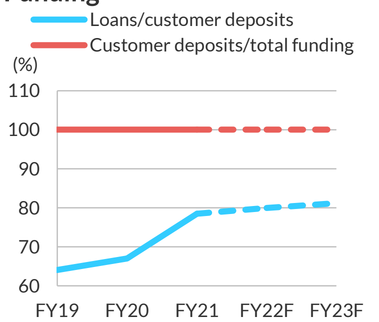
Source: Fitch Ratings, Fitch Solutions, FCU

Capitalisation



Source: Fitch Ratings, Fitch Solutions, FCU

Funding



Source: Fitch Ratings, Fitch Solutions, FCU

Government/Shareholder Support

Commercial Banks: Government Support Rating KRDs	
Typical D-SIB GSR for sovereign's rating level (assuming high propensity)	A or A-
Actual jurisdiction D-SIB GSR	N/A
Government Support Rating	**ns**
Government ability to support D-SIBs	
Sovereign Rating	AA/ Positive
Size of banking system	Negative
Structure of banking system	Neutral
Sovereign financial flexibility (for rating level)	Neutral
Government propensity to support D-SIBs	
Resolution legislation	Negative
Support stance	Negative
Government propensity to support bank	
Systemic importance	Negative
Liability structure	Positive
Ownership	Neutral

The colours indicate the weighting of each KRD in the assessment.
Higher influence Moderate influence Lower influence

The Government Support Rating of 'ns' assigned to FCU reflects our expectation there is no reasonable assumption of support forthcoming because of New Zealand's open bank resolution scheme (OBR). FCU is not part of the OBR, which allows for the imposition of losses on depositors and senior debt holders to recapitalise failed institutions. Fitch believes the existence of the scheme, in conjunction with FCU's low systemic importance, makes sovereign support doubtful.

Environmental, Social and Governance Considerations

FitchRatings

First Credit Union

Banks
Ratings Navigator

Credit-Relevant ESG Derivation

First Credit Union has 5 ESG potential rating drivers

- First Credit Union has exposure to compliance risks including fair lending practices, mis-selling, repossession/foreclosure practices, consumer data protection (data security) but this has very low impact on the rating.
- Governance is minimally relevant to the rating and is not currently a driver.

			Overall ESG Scale
key driver	0	issues	5
driver	0	issues	4
potential driver	5	issues	3
not a rating driver	4	issues	2
	5	issues	1

Environmental (E)

General Issues	E Score	Sector-Specific Issues	Reference	E Scale
GHG Emissions & Air Quality	1	n.a.	n.a.	5
Energy Management	1	n.a.	n.a.	4
Water & Wastewater Management	1	n.a.	n.a.	3
Waste & Hazardous Materials Management; Ecological Impacts	1	n.a.	n.a.	2
Exposure to Environmental Impacts	2	Impact of extreme weather events on assets and/or operations and corresponding risk appetite & management; catastrophe risk; credit concentrations	Business Profile (incl. Management & governance); Risk Profile; Asset Quality	1

Social (S)

General Issues	S Score	Sector-Specific Issues	Reference	S Scale
Human Rights, Community Relations, Access & Affordability	2	Services for underbanked and underserved communities: SME and community development programs; financial literacy programs	Business Profile (incl. Management & governance); Risk Profile	5
Customer Welfare - Fair Messaging, Privacy & Data Security	3	Compliance risks including fair lending practices, mis-selling, repossession/foreclosure practices, consumer data protection (data security)	Operating Environment; Business Profile (incl. Management & governance); Risk Profile	4
Labor Relations & Practices	2	Impact of labor negotiations, including board/employee compensation and composition	Business Profile (incl. Management & governance)	3
Employee Wellbeing	1	n.a.	n.a.	2
Exposure to Social Impacts	2	Shift in social or consumer preferences as a result of an institution's social positions, or social and/or political disapproval of core banking practices	Business Profile (incl. Management & governance); Financial Profile	1

Governance (G)

General Issues	G Score	Sector-Specific Issues	Reference	G Scale
Management Strategy	3	Operational implementation of strategy	Business Profile (incl. Management & governance)	5
Governance Structure	3	Board independence and effectiveness; ownership concentration; protection of creditor/stakeholder rights; legal /compliance risks; business continuity; key person risk; related party transactions	Business Profile (incl. Management & governance); Earnings & Profitability; Capitalisation & Leverage	4
Group Structure	3	Organizational structure; appropriateness relative to business model; opacity; intra-group dynamics; ownership	Business Profile (incl. Management & governance)	3
Financial Transparency	3	Quality and frequency of financial reporting and auditing processes	Business Profile (incl. Management & governance)	2
				1

How to Read This Page
ESG scores range from 1 to 5 based on a 15-level color gradation. Red (5) is most relevant and green (1) is least relevant.

The Environmental (E), Social (S) and Governance (G) tables break out the individual components of the scale. The right-hand box shows the aggregate E, S, or G score. General Issues are relevant across all markets with Sector-Specific Issues unique to a particular industry group. Scores are assigned to each sector-specific issue. These scores signify the credit-relevance of the sector-specific issues to the issuing entity's overall credit rating. The Reference box highlights the factor(s) within which the corresponding ESG issues are captured in Fitch's credit analysis.

The Credit-Relevant ESG Derivation table shows the overall ESG score. This score signifies the credit relevance of combined E, S and G issues to the entity's credit rating. The three columns to the left of the overall ESG score summarize the issuing entity's sub-component ESG scores. The box on the far left identifies some of the main ESG issues that are drivers or potential drivers of the issuing entity's credit rating (corresponding with scores of 3, 4 or 5) and provides a brief explanation for the score.

Classification of ESG issues has been developed from Fitch's sector ratings criteria. The General Issues and Sector-Specific Issues draw on the classification standards published by the United Nations Principles for Responsible Investing (PRI) and the Sustainability Accounting Standards Board (SASB).

Sector references in the scale definitions below refer to Sector as displayed in the Sector Details box on page 1 of the navigator.

CREDIT-RELEVANT ESG SCALE

How relevant are E, S and G issues to the overall credit rating?

5	Highly relevant, a key rating driver that has a significant impact on the rating on an individual basis. Equivalent to "higher" relative importance within Navigator.
4	Relevant to rating, not a key rating driver but has an impact on the rating in combination with other factors. Equivalent to "moderate" relative importance within Navigator.
3	Minimally relevant to rating, either very low impact or actively managed in a way that results in no impact on the entity rating. Equivalent to "lower" relative importance within Navigator.
2	Irrelevant to the entity rating but relevant to the sector.
1	Irrelevant to the entity rating and irrelevant to the sector.

Unless otherwise disclosed in this section, the highest level of environmental, social and governance (ESG) credit relevance is a score of '3' - ESG issues are credit neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg.

The ratings above were solicited and assigned or maintained at the request of the rated entity/issuer or a related third party. Any exceptions follow below.