FitchRatings

RATING ACTION COMMENTARY

Fitch Affirms First Credit Union at 'BB'; Outlook Stable

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Fitch Ratings - Sydney - 10 Dec 2024: Fitch Ratings has affirmed New Zealand-based First Credit Union's (FCU) Long-Term Foreign- and Local-Currency Issuer Default Ratings (IDRs) at 'BB'. The Outlook is Stable. Fitch has also affirmed the Short-Term IDRs at 'B', Viability Rating (VR) at 'bb' and Government Support Rating (GSR) at 'ns'.

KEY RATING DRIVERS

IDRs Driven by VR: FCU's Long-Term IDRs are driven by its VR, which is assigned in line with the implied VR. The VR captures FCU's greater risk appetite relative to New Zealand banks and building societies, reflected in its higher exposure to personal loans than sector peers. This could make FCU's financial profile more volatile through the cycle. The ratings also capture FCU's small size compared with total system assets and geographical concentration in parts of New Zealand.

Reduced Household Sector Risk: Fitch has revised the operating environment score for New Zealand non-bank deposit takers (NBDTs) to 'a'/stable, from 'a-'/stable. The change reflects a sustained reduction in risks from the household sector over the past decade, due partly to a strengthened regulatory environment in the banking sector, which has also benefited the NBDTs. However, household debt remains high relative to many other jurisdictions, so we maintain the score below the implied 'aa' category score to reflect this.

We also incorporate the less stringent regulatory oversight of NBDTs relative to registered banks in the operating environment assessment, resulting in a score one notch below that of New Zealand banks. New Zealand is aligning regulation of all deposit takers under one framework, and we may consider aligning the NBDT operating environment score with that of banks when the framework is in place.

Concentrated, Consistent Business Model: FCU's simple and consistent business model partly offsets the credit union's small market position. This contributes to Fitch assigning a business profile factor score of 'bb', above the 'b' category implied score. FCU accounts for less than 0.1% of combined bank and NBDT system assets, which limits its pricing power.

Exposure to Non-Mortgage Loans: FCU's greater exposure to consumer loans than most New Zealand bank and building-society peers is an indication of an above-average risk appetite, in Fitch's view. The proportion of non-mortgage consumer loans in FCU's loan book has dropped in recent years, but remains high relative to that of broader-sector peers.

Modest Asset-Quality Weakening: We expect FCU's impaired-loan ratio to weaken modestly and peak in 2025. Low unemployment and FCU's increase in residential mortgage lending over recent years are likely to mean the deterioration will be manageable. Rapid interest cuts by the Reserve Bank of New Zealand are likely to support improved asset quality in 2026. The factor score of 'bb' is lower than the implied 'bbb' category score due to FCU's product and geographical concentration.

Profitability Below Peers: We expect FCU's profitability metrics to remain modest over the financial year ending June 2025 (FY25), driven by higher operating expenses from the merger with a smaller, weak performing credit union in FY24. We believe profitability will improve over the long term, when the integration is completed and cost synergies are achieved.

Strong Capital Buffers: We expect the Fitch Core Capital and total regulatory capital ratios to remain broadly stable in FY25 and for FCU to maintain strong buffers over regulatory minimums. Merger activity in 2024 led to a moderate decline in FCU's capitalisation, which nonetheless remains commensurate with the assigned score. Our forecast for modest loan growth means capitalisation is unlikely to be under pressure over the next two years.

However, retained earnings generation is also likely to be weaker until cost synergies from the merger are realised. The assigned 'bb+' score is below the implied 'a' category score due to the small absolute size of the capital base of only NZD70 million at FYE24.

Fully Deposit-Funded: We expect FCU's funding profile to be broadly stable over the next two years and for FCU to remain wholly deposit-funded. We have applied a negative adjustment on FCU's funding score of 'bbb-', from the 'a' category implied score, to reflect the lack of access to the central bank's liquidity facilities and modest deposit franchises.

RATING SENSITIVITIES

Factors that Could, Individually or Collectively, Lead to Negative Rating Action/Downgrade

Long-Term IDRs and VR

FCU's Long-Term IDRs and VR may be downgraded if there is a weakening in the business profile, potentially reflected in persistent below-system growth in deposits and loans, above-system net interest margin attrition due to the need to price more sharply to compete or a prolonged deterioration in the loan/customer deposit ratio.

Growing regulatory and investment burdens in an increasingly digitalised market may reduce FCU's competitive standing and also put pressure on the business profile assessment. This may prompt FCU to increase its appetite for riskier exposures, resulting in greater earnings volatility and pressure on capitalisation through the cycle.

The above scenario may be reflected in a combination of the following:

- the four-year average of stage 3/gross loans increasing above 4% for a sustained period (FY21-FY24 average: 2.0%);

- the four-year average of operating profit/risk-weighted assets falling to below 0.25% for a sustained period (FY21-FY24 average: 0.6%);

- the Fitch Core Capital ratio declining to below 9.5% without a credible plan to replenish regulatory capital buffers (FY24: 16.2%);

- the four-year average of the loan/customer deposit ratio sustained significantly above 100% (FY21-FY24 average of 83.1%).

Factors that Could, Individually or Collectively, Lead to Positive Rating Action/Upgrade

Long-Term IDRs and VR

An upgrade of the VR and Long-Term IDRs is unlikely in the short term, as it would require a significant improvement in the risk profile that results in more stable asset quality and earnings through the cycle.

An increased propensity for New Zealand's authorities to provide support would be required for an upgrade of the Government Support Rating (GSR), but this appears unlikely in light of the resolution framework in place and FCU's small size relative to the country's overall financial system.

OTHER DEBT AND ISSUER RATINGS: KEY RATING DRIVERS

Short-Term IDRs: The Short-Term IDRs map to the Long-Term IDRs.

GSR: The GSR of 'ns' assigned to FCU reflects our expectation that there is no reasonable assumption of support being 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. However, the existence of the scheme, in conjunction with FCU's low systemic importance, makes sovereign support doubtful.

OTHER DEBT AND ISSUER RATINGS: RATING SENSITIVITIES

Short-Term IDRs

Factors that Could, Individually or Collectively, Lead to Negative Rating Action/Downgrade:

A downgrade of the Short-Term IDRs appears unlikely, as this would require a downgrade of the Long-Term IDRs to 'CCC+' or below.

Factors that Could, Individually or Collectively, Lead to Positive Rating Action/Upgrade:

An upgrade of the Short-Term IDRs would require an upgrade of the Long-Term IDRs to at least 'BBB-'.

GSR

The GSR is already at the lowest level on Fitch's rating scale and cannot be downgraded.

An increased propensity for the New Zealand authorities to provide support would be required for an upgrade of the GSR, but appears unlikely in light of the resolution framework in place and FCU's small size relative to the country's overall financial system.

VR ADJUSTMENTS

The operating environment score of 'a' has been assigned below the 'aa' category implied score for the following adjustment reasons: level and growth of credit (negative), regulatory and legal framework (negative).

The business profile score of 'bb' has been assigned above the 'b' category implied score for the following adjustment reason: business model (positive).

The asset-quality score of 'bb' has been assigned below the 'bbb' category implied score for the following adjustment reason: concentration (negative)

The capitalisation and leverage score of 'bb+' has been assigned below the 'a' category implied score for the following adjustment reason: size of capital base (negative).

The funding and liquidity score of 'bbb-' has been assigned below the 'a' category implied score for the following adjustment reason: liquidity access and ordinary support (negative).

Sources of Information

The principal sources of information used in the analysis are described in the applicable criteria.

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

ESG CONSIDERATIONS

The highest level of ESG credit relevance is a score of '3', unless otherwise disclosed in this section. A score of '3' means 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. Fitch's ESG Relevance Scores are not inputs in the rating process; they are an observation on the relevance and materiality of ESG factors in the rating decision. For more information on Fitch's ESG Relevance Scores, visit https://www.fitchratings.com/topics/esg/products#esgrelevance-scores.

RATING ACTIONS

ENTITY / DEBT	RATING			PRIOR
First Credit Union	LT IDR	BB Rating Outlook Stable	Affirmed	BB Rating Outlook Stable
	ST IDR	B	Affirmed	B

	LC LT IDR	BB Rating Outlook Stable Affirmed	BB Rating Outlook Stable
	LC ST IDR	B Affirmed	B
	Viability	bb Affirmed	bb
	Government Support	ns Affirmed	ns

VIEW ADDITIONAL RATING DETAILS

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APPLICABLE CRITERIA

Bank Rating Criteria (pub. 16 Mar 2024) (including rating assumption sensitivity)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

First Credit Union	EU Endorsed, UK Endorsed

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European Parliament and of the Council of 16 September 2009 and The Credit Rating Agencies (Amendment etc.) (EU Exit) Regulations 2019 respectively.

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