Credit Union Baywide

Ratings

Foreign Currency

Long-Term IDR	BB
Short-Term IDR	B

Local Currency

Long-Term IDR	BB
Short-Term IDR	B
Viability Rating	bb
Support Rating	5
Support Rating Floor	NF

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 (February 2020)

Related Research

Fitch Revises Outlook on Credit Union Baywide and Subsidiary to Stable (March 2021)

Fitch Ratings 2021 Outlook: Asia-Pacific Developed Market Banks (December 2020)

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Key Rating Drivers

Risk Appetite Drives Ratings: Credit Union Baywide's (CUB) Issuer Default Ratings (IDR) and Viability Rating are driven by its greater risk appetite relative to New Zealand banks and building societies, as reflected in a focus on riskier segments, such as high loan/value mortgages and consumer lending. However, Fitch Ratings regards CUB's risk controls as acceptable and consistent with similarly sized peers.

Downside Risks Abated: Our March 2021 revision of the Outlook on CUB's Long-Term IDRs to Stable reflects substantial abatement of downside risk, particularly around asset quality, since we originally revised the Outlook to Negative in May 2020. CUB's credit profile appears sufficient to withstand a scenario modestly worse than our base case.

Some Asset Quality Weakening: We expect some weakening in CUB's asset quality metrics during 2021 as pandemic-related support measures are reduced or removed, but large buffers mean deterioration that is moderately worse than our base case can be absorbed at the current score of 'bb'. We revised the factor outlook to stable as a result. CUB's impaired loans/gross loans ratio was relatively stable in the financial year ended June 2020 (FY20), at 2.3%.

Limited Earnings Headroom: We expect CUB to return to profitability in FY21 following losses in FY19 and FY20. However, its profitability remains weaker than that of most peers. We view the headroom at the current factor score as limited and therefore maintain a negative factor outlook. Low rates, merger-related costs and restructuring of CUB's subsidiary, New Zealand Association of Credit Unions (NZACU, BB-/Stable), pose some risks to earnings.

Moderate Capital Buffers: CUB's capitalisation is a weakness for its rating. Its total regulatory capital ratio was 10.2% at end-2020, a buffer of about 220bp over the 8.0% regulatory minimum. Consolidation of NZACU for regulatory capital purposes may be required as part of the subsidiary's restructuring, further eroding this buffer. However, we believe this will be the low point for CUB's total capital ratio.

Generally Stable Funding Profile: We expect customer deposits to remain CUB's main source of funding. The credit union has managed liquidity well through the pandemic, but lacks access to the central bank as a lender of last resort. This, combined with a moderate franchise, leaves CUB susceptible to deposit outflow in a severe funding-market shock.

Rating Sensitivities

Weaker Capital, Increased Risk: CUB's Long-Term IDRs and Viability Rating may be downgraded if its regulatory capital ratio continues to weaken, possibly as a result of ongoing integration and restructuring activity that dampens profitability. Increased risk appetite, potentially aimed at increasing market share and profitability, may lead to greater volatility of the financial profile through the cycle and pressure the ratings.

The above scenarios may manifest in a combination of: impaired loans/gross loans consistently above 10%; operating profit/risk-weighted assets below 0.25% for a sustained period; or the Fitch core capital ratio declining below 9.5% without a credible plan to replenish capital buffers.

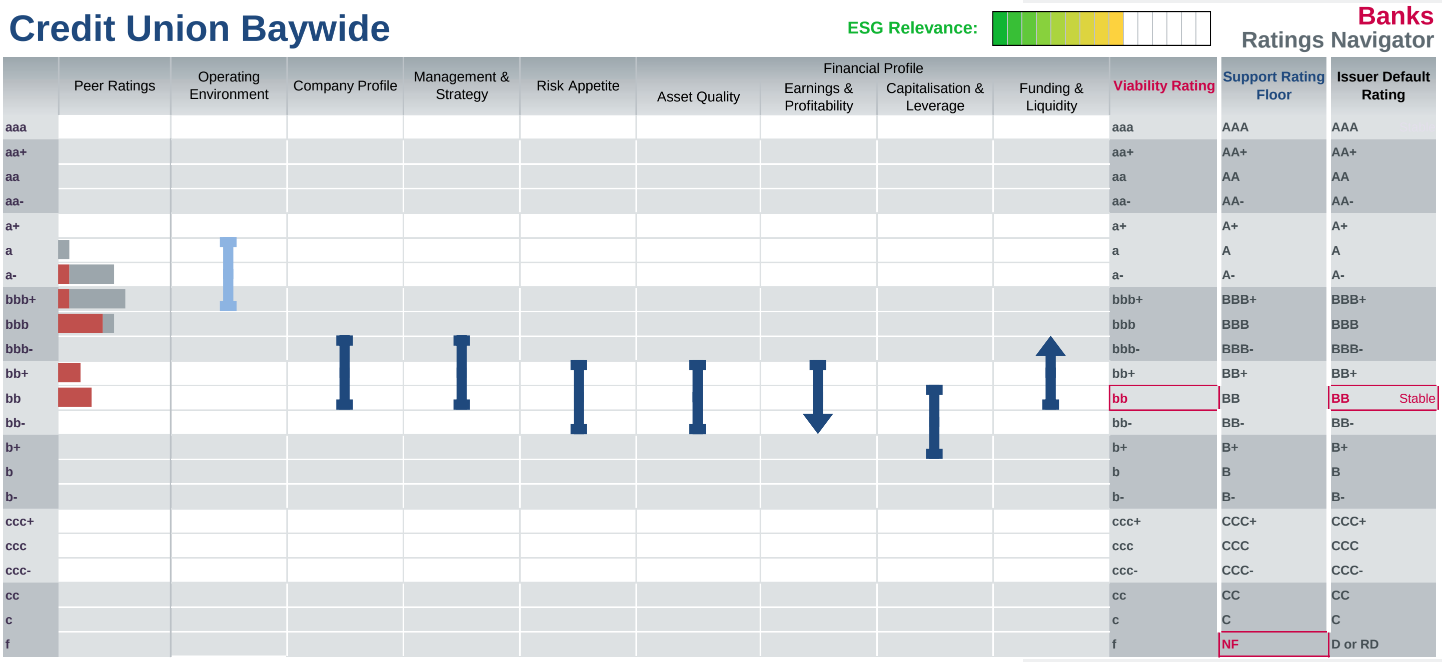
Upgrade Unlikely: An upgrade of the Viability Rating and Long-Term IDRs is unlikely in the short term, as it would require an improved risk appetite, resulting in more stable asset quality through a cycle, and an increase in capital ratios towards levels reported by non-bank deposit taking (NBDT) peers.

Sovereign/Institutional Support Assessment

Support Rating Floor			Value
Typical D-SIB SRF for sovereign's rating level (assuming high propensity)			A or A-
Actual country D-SIB SRF			N/A
Support Rating Floor:			**NF**
Support Factors	Positive	Neutral	Negative
Sovereign ability to support system			
Size of banking system relative to economy			✓
Size of potential problem		✓	
Structure of banking system			✓
Liability structure of banking system		✓	
Sovereign financial flexibility (for rating level)		✓	
Sovereign propensity to support system			
Resolution legislation with senior debt bail-in			✓
Track record of banking sector support		✓	
Government statements of support			✓
Sovereign propensity to support bank			
Systemic importance			✓
Liability structure of bank	✓		
Ownership		✓	
Specifics of bank failure		✓	
Policy banks			
Policy role			
Funding guarantees and legal status			
Government ownership			

CUB's Support Rating and Support Rating Floor reflect our view that, while support from the New Zealand sovereign (AA/Positive) is possible, it cannot be relied on. CUB is not part of the open bank resolution scheme, which allows for the imposition of losses on depositors and senior debt holders to recapitalise failed institutions. However, Fitch believes the existence of the scheme, in conjunction with CUB's low systemic importance, makes sovereign support doubtful.

Ratings Navigator



Significant Changes

Operating Environment Outlook Revised to Stable

Fitch has revised the factor outlook on the 'a-' operating environment score assigned to New Zealand NBDTs to stable, from negative. This reflects plans by authorities to bring NBDTs under the same regulatory framework as banks; the less stringent framework applied to NBDTs currently is the key reason for the one-notch difference between the operating environment score of NBDTs and banks (a/negative). It also considers New Zealand's success in combatting the coronavirus pandemic, although downside risks remain. We will consider equalising the NBDT operating environment score with the bank score closer to the implementation of the new framework.

Asset Quality Outlook Revised to Stable

We have revised the outlook on CUB's asset quality factor score to stable, from negative, to reflect that we believe the credit union has sufficient buffers at its current score to withstand a scenario that is more severe than our base case. We expect some deterioration in metrics during 2021, but not to a level that would pressure the current 'bb' score.

Funding and Liquidity Outlook Revised to Positive

We have revised the outlook on CUB's funding and liquidity factor score to positive, from stable, and are likely to upgrade the score to 'bbb-' if the credit union can maintain its improved metrics at current levels.

Influence of Asset Quality, Earnings and Profitability, Moderates

We have revised the influence of the asset quality and earnings and profitability factors to moderate, from higher, as we believe these factors no longer have a greater influence on the Viability Rating relative to other factors, except the operating environment, which remains of lower influence. This follows the revision of the Outlook on the IDRs to Stable, from Negative.

Bar Chart Legend

Vertical bars – VR range of Rating Factor

Bar Colors – Influence on final VR

- Higher influence
- Moderate influence
- Lower influence

Bar Arrows – Rating Factor Outlook

⇧	Positive	⇩	Negative
⇳	Evolving	▫	Stable

Company Summary

Operating Environment Risks Manageable

Our outlook on the operating environment has improved since early 2020, largely due to New Zealand's success in handling the coronavirus health crisis. Fitch expects real GDP to rise by 4.6% in 2021, following a contraction of 2.6% in 2020. However, risks remain, with widespread vaccination unlikely to occur until late 2021, meaning international borders are likely to remain largely closed until the end of the year. Outbreaks of the virus in the community may also prompt localised or national lockdowns, while support measures will be gradually unwound during the year as well.

Strong house-price growth that is fuelled by credit growth poses risk in the medium-term if it leads to a significant increase in household leverage. This would leave households even more susceptible to any sudden increase in interest rates. We already consider New Zealand's high level of household debt when assigning the operating environment score.

Limited Competitive Advantages

CUB is New Zealand's largest credit union following a 2019 merger with three other credit unions; Credit Union South, Central Credit Union and Aotearoa Credit Union. The merger provided CUB with a greater level of geographic diversification within New Zealand relative to many NBDT peers, but CUB still only accounts for less than 0.1% of domestic bank and non-bank system assets. The credit union has limited competitive advantages and is generally a price taker in its main operating segments as a result. The business model focuses on providing residential mortgages and consumer loans to customers funded by retail deposits. We expect CUB's earnings to be more volatile than those of bank and building society peers through a cycle, as credit unions typically have greater appetite for risk.

CUB also owns NZACU, which provides core banking, card and payment services to CUB and third parties, including other credit unions. NZACU is reorganising under a corporate structure.

Little Pandemic Impact on Management and Strategy

Strategic objectives were unchanged by the pandemic and remain focused on supporting members to achieve their financial goals, which involves continued investment in technology. CUB's FY21 goals are weighted toward furthering the integration of the entities with which it merged in 2019 and completing the restructure of NZACU. This should improve profitability if successful. CUB has shown its ability to execute strategic objectives historically, although investment, integration and the pandemic pose risks in the shorter term.

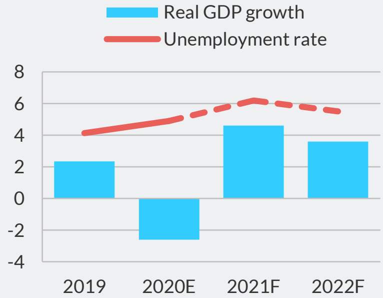
Above Average Risk Appetite Relative to Many Peers

CUB, along with other domestic credit unions, has a greater exposure to non-mortgage consumer loans and high loan/value mortgages than most bank and building society peers; we view this as being indicative of above-average risk appetite. The proportion of non-mortgage consumer loans in CUB's loan book doubled to more than 40% at FYE20 from FYE18. This was initially due to higher consumer-loan exposure at the 2019 merger partners but more recently also reflects a strategy by the credit union to focus growth on consumer loans to support profitability and rebuild capital buffers. Mortgages have declined at the same time.

A large fall in the proportion of mortgages with loan/value ratios of above 80% – to 40% of total mortgages at FYE20, from 60% at FYE18 – can in part be explained by the decline in overall mortgages, with higher loan/value borrowers benefitting from strong house price growth that has allowed them to refinance at other institutions for lower rates. About 6pp-7pp of the high loan/value mortgages relate to government-guaranteed loans, limiting the risk of loss for CUB.

CUB's risk control framework remains acceptable for the type of operations it undertakes, but is less sophisticated than those observed at New Zealand banks. Operational and market risk frameworks are similarly acceptable. Cyber risk is a key focus in light of a number of domestic incidents over the past year. Disaster recovery and business continuity planning appear well developed, with CUB experiencing little disruption as a result of the rapid shift to working from home at the onset of the pandemic.

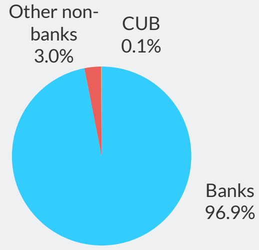
Economic Outlook



Source: Fitch Ratings, Fitch Solutions

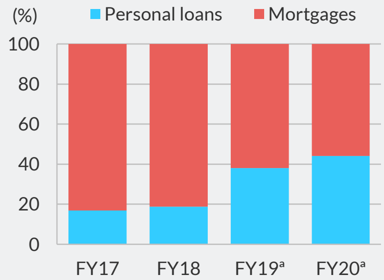
Market Share

Sep 20



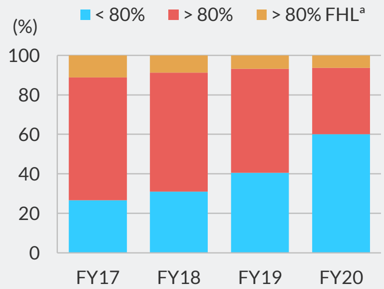
Source: Fitch Ratings, Reserve Bank of New Zealand

Loan Book



[a] Post-merger
Source: Fitch Ratings, CUB

Mortgage Loan/Value Ratios



[a] Government guaranteed
Source: Fitch Ratings, CUB

Summary Financials and Key Ratios

	30 Jun 20		30 Jun 19	30 Jun 18	30 Jun 17
	Year end	Year end	Year end	Year end	Year end
	(USDm)	(NZDt)	(NZDt)	(NZDt)	(NZDt)
	Audited - unqualified	Audited - unqualified	Audited - unqualified	Audited - unqualified	Audited - unqualified
Summary income statement					
Net interest and dividend income	20	31,345.0	18,112.0	13,910.0	12,982.0
Net fees and commissions	0	651.0	34.0	96.0	511.0
Other operating income	0	-90.0	35.0	16.0	10.0
Total operating income	21	31,906.0	18,181.0	14,022.0	13,503.0
Operating costs	17	26,811.0	16,363.0	12,545.0	12,136.0
Pre-impairment operating profit	3	5,095.0	1,818.0	1,477.0	1,367.0
Loan and other impairment charges	4	5,491.0	3,303.0	468.0	156.0
Operating profit	0	-396.0	-1,485.0	1,009.0	1,211.0
Other non-operating items (net)	n.a.	n.a.	-250.0	n.a.	n.a.
Tax	n.a.	n.a.	n.a.	n.a.	n.a.
Net income	0	-396.0	-1,735.0	1,009.0	1,211.0
Other comprehensive income	n.a.	n.a.	n.a.	n.a.	n.a.
Fitch comprehensive income	0	-396.0	-1,735.0	1,009.0	1,211.0
Summary balance sheet					
Assets					
Gross loans	225	349,447.0	394,146.0	275,110.0	267,501.0
- Of which impaired	5	8,194.0	9,431.0	891.0	943.0
Loan loss allowances	3	4,974.0	7,664.0	616.0	555.0
Net loans	221	344,473.0	386,482.0	274,494.0	266,946.0
Interbank	74	114,718.0	89,495.0	89,003.0	25,085.0
Derivatives	n.a.	n.a.	n.a.	n.a.	n.a.
Other securities and earning assets	7	11,248.0	6,767.0	3,252.0	3,252.0
Total earning assets	302	470,439.0	482,744.0	366,749.0	295,283.0
Cash and due from banks	21	32,719.0	27,568.0	9,627.0	14,277.0
Other assets	7	10,643.0	10,718.0	4,622.0	2,736.0
Total assets	330	513,801.0	521,030.0	380,998.0	312,296.0
Liabilities					
Customer deposits	286	445,517.0	455,310.0	336,874.0	269,569.0
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	286	445,517.0	455,310.0	336,874.0	269,569.0
Other liabilities	7	10,771.0	7,811.0	3,231.0	2,843.0
Preference shares and hybrid capital	n.a.	n.a.	n.a.	n.a.	n.a.
Total equity	37	57,513.0	57,909.0	40,893.0	39,884.0
Total liabilities and equity	330	513,801.0	521,030.0	380,998.0	312,296.0
Exchange rate		USD1 = NZD1.556178	USD1 = NZD1.493875	USD1 = NZD1.483459	USD1 = NZD1.365

Source: Fitch Ratings

Summary Financials and Key Ratios

	30 Jun 20	30 Jun 19	30 Jun 18	30 Jun 17
Ratios (annualised as appropriate)				
Profitability				
Operating profit/risk-weighted assets	-0.1	-0.3	0.3	0.4
Net interest income/average earning assets	6.6	4.5	4.1	4.5
Non-interest expense/gross revenue	83.8	90.0	89.5	89.9
Net income/average equity	-0.7	-3.7	2.5	3.1
Asset quality				
Impaired loans ratio	2.3	2.4	0.3	0.4
Growth in gross loans	-11.3	43.3	2.8	25.4
Loan loss allowances/impaired loans	60.7	81.3	69.1	58.9
Loan impairment charges/average gross loans	1.5	0.4	0.2	0.1
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	11.6	10.6	11.3	12.9
Tangible common equity/tangible assets	10.2	10.2	10.1	12.4
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	6.2	3.4	0.7	1.0
Funding and liquidity				
Loans/customer deposits	78.4	86.6	81.7	99.2
Liquidity coverage ratio	n.a.	n.a.	n.a.	n.a.
Customer deposits/funding	100.0	100.0	100.0	100.0
Net stable funding ratio	n.a.	n.a.	n.a.	n.a.

Source: Fitch Ratings

Key Financial Metrics – Latest Developments

Manageable Asset Quality Deterioration

We expect CUB's asset quality metrics to weaken through 2021 as support measures implemented to offset the impact of the pandemic on the economy are unwound. However, New Zealand's strong economic rebound following its successful containment of the virus means that weakening is likely to be much less severe than what Fitch expected when we revised the factor outlook to negative in May 2020. We expect our current asset quality factor score of 'bb' to adequately capture a weakening of metrics that is even moderately worse than our base case and therefore have revised the factor outlook to stable.

The assigned factor score is lower than CUB's core metric of impaired loans/gross loans would imply under Fitch's Bank Rating Criteria. This reflects CUB's greater focus on non-mortgage consumer loans and higher risk mortgages relative to non-credit union NBDT peers. We expect this to result in greater asset quality volatility and higher impaired-loan metrics through a cycle. CUB has also yet to transition to the New Zealand equivalent of IFRS9, which is due to occur from FY23. We expect the core metric to increase after the transition, as stage 3 loans have a wider definition than is captured under the current impaired-loan definition.

Risks to Earnings Remain Despite Improved Outlook

Fitch expects CUB to return to profitability in FY21, following two consecutive years of losses. However, we maintain a negative factor outlook on our 'bb' earnings score, as there is limited headroom under our base case. More persistent and larger costs related to the ongoing integration and to restructuring NZACU may result in weaker profitability than we expect in our base case. These factors provide headwinds in addition to the low-rate environment.

However, a successful completion of the merger process – including a reduction in the overlap of services and functions among the four merged entities as well as returning NZACU to sustainable profitability – would underpin stronger profitability for CUB. In the shorter term, the credit union's focus on increasing consumer loans rather than mortgages should support profitability, but comes with the potential for greater impairment charges in the medium term.

Capital Buffers Adequate; Improved Profitability Should Support Ratios

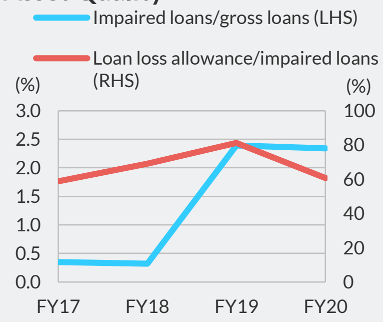
We expect CUB's Fitch core capital and total regulatory capital ratios to increase as profitability improves under our base case and absent consolidation of NZACU for regulatory capital purposes. The 'bb-' factor score is the lowest among domestic NBDTs and considers the small absolute size of the capital base, limited sources of fresh equity as a mutual and more modest headroom to minimum regulatory capital requirements than indicated by the Fitch core capital ratio, which stood at 11.6% at FYE20. Fitch closely monitors the total regulatory capital ratios of NBDTs, as it is the only regulatory capital requirement placed on these entities. We would view a breach of the minimum requirement as indicative of a failure.

CUB may be required to consolidate NZACU as part of the restructure. This would lower its total regulatory capital ratio, largely due to the full deduction of NZACU's intangible assets, and reduce the headroom above the 8.0% regulatory minimum requirement for rated NBDTs. We believe CUB has a credible plan to improve the regulatory capital ratio, even if NZACU is consolidated, but indications that the timetable to return toward the board target of 12.0% will be missed may pressure our assessment of capitalisation.

No Change to Funding Portfolio

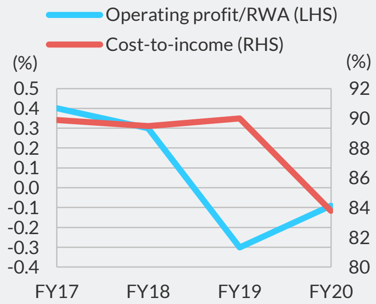
CUB, like the other NBDTs, is completely funded by retail deposits and we do not expect this to change over the next two to three years, as the credit union has ample liquidity to support balance-sheet growth. CUB's loan/deposit ratio improved in FY20, despite a modest decline in deposit balances given loan balances fell more sharply. We have assigned a positive outlook to the factor score of 'bb+' to reflect the likelihood it would be raised if current metrics are maintained. Our assessment also considers the small funding franchise and lack of 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.

Asset Quality



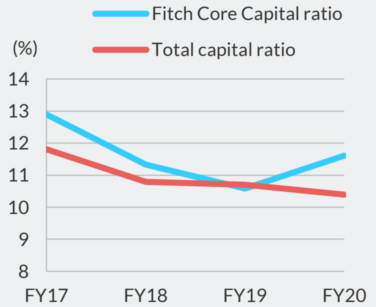
Source: Fitch Ratings, Fitch Solutions, CUB

Profitability



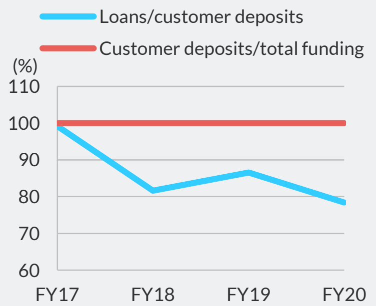
Source: Fitch Ratings, Fitch Solutions, CUB

Capitalisation



Source: Fitch Ratings, Fitch Solutions, CUB

Funding



Source: Fitch Ratings, Fitch Solutions, CUB

Environmental, Social and Governance Considerations

FitchRatings **Credit Union Baywide**

Banks
Ratings Navigator

Credit-Relevant ESG Derivation

Credit Union Baywide has 5 ESG potential rating drivers

- Credit Union Baywide 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	Company Profile; Management & Strategy; Risk Appetite; 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	Company Profile; Management & Strategy; Risk Appetite	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; Company Profile; Management & Strategy; Risk Appetite	4
Labor Relations & Practices	2	Impact of labor negotiations, including board/employee compensation and composition	Company Profile; Management & Strategy	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	Company Profile; Financial Profile	1

Governance (G)

General Issues	G Score	Sector-Specific Issues	Reference	G Scale
Management Strategy	3	Operational implementation of strategy	Management & Strategy	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	Management & Strategy; Earnings & Profitability; Capitalisation & Leverage	4
Group Structure	3	Organizational structure; appropriateness relative to business model; opacity; intra-group dynamics; ownership	Company Profile	3
Financial Transparency	3	Quality and frequency of financial reporting and auditing processes	Management & Strategy	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.