



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

Fitch Ratings - Sydney - 23 December 2019:

Fitch Ratings has affirmed the Long-Term Issuer Default Ratings (IDR) of Credit Union Baywide (CUB) at 'BB'. The Outlook is Stable.

Key Rating Drivers

IDRS AND VIABILITY RATING

CUB's IDRs and Viability Rating capture its greater risk appetite relative to New Zealand banks and building societies, which leaves the credit union's profitability, asset quality and capitalisation more susceptible to an economic downturn. The higher risk appetite is reflected in a focus on riskier segments, such as higher loan/value mortgages and consumer lending, though CUB's risk controls are adequate for its size and consistent with similarly sized peers. That said, Fitch believes these loan classes are susceptible to higher losses through an economic cycle relative to traditional residential mortgages, which are the focus of larger domestic peers. Exposure to consumer lending, which we regard as riskier than mortgages, increased significantly in 2019 due to a merger with three other credit unions in May and could rise further.

CUB's capitalisation is a weakness for the rating. Capital buffers eroded significantly during 2019 due to the merger and the acquisition of all of New Zealand Association of Credit Unions' (trading as Co-op Money NZ; BB-/Stable) base capital notes in November. We believe the credit union has a credible plan to restore capital buffers over the next 18 months, although it could be hampered by the integration process. CUB's total regulatory capital ratio was 10.6% at end-September 2019, a buffer of 2.1pp above the regulatory minimum of 8.5%, although this does not incorporate the impact of the Co-op Money NZ acquisition, which further eroded the ratio.

Earnings are likely to remain subdued over the next two years as CUB progresses through the integration process while also facing lower interest rates and slower loan growth. We believe earning risks are to the downside in the short term, although longer-term, the merger should provide significant cost synergies.

CUB has small system market share, reflecting a moderate franchise and limited competitive advantages in its target markets. This makes CUB a price taker. This is unlikely to change without significant merger activity, which we do not expect given the nature and size of the domestic credit union sector.

Customer deposits are likely to remain the main source of CUB's funding, although one of the merger partners had access to a small warehouse facility that could be re-established by CUB.

SUPPORT RATING AND SUPPORT RATING FLOOR

The Support Rating and Support Rating Floor reflect our view that, while support from the New Zealand sovereign (AA/Stable) 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.

RATING SENSITIVITIES

IDRS AND VIABILITY RATING

CUB's IDRs and Viability Rating are sensitive to a change in its risk appetite. Negative rating action may result from a large increase in risk appetite, possibly following a significant rebalancing of the loan book towards riskier products, without a commensurate increase in profitability and capital buffers. This could damage asset quality, profitability and capitalisation through the cycle. Failure to improve capital buffers following the Co-op Money NZ acquisition would also pressure the ratings, as CUB would have less capacity to withstand a downturn.

Positive rating action would require an improved risk appetite, possibly through more stringent underwriting standards or strengthened risk controls, while also significantly improving capital buffers. This appears improbable in the short to medium term.

SUPPORT RATING AND SUPPORT RATING FLOOR

The Support Rating and Support Rating Floor are sensitive to any change in assumptions around the propensity of the New Zealand government to provide timely support.

ESG Considerations

Unless otherwise disclosed in this section, the highest level of 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 our ESG Relevance Scores, visit www.fitchratings.com/esg

RATING ACTIONS

ENTITY/DEBT	RATING	PRIOR
Credit Union Baywide	LT IDR BB ● Affirmed	BB ●
	ST IDR B Affirmed	B
	LC LT IDR BB ● Affirmed	BB ●
	LC ST IDR B Affirmed	B
	Viability bb Affirmed	bb
	Support 5 Affirmed	5
	Support Floor NF Affirmed	NF

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Applicable Criteria

Bank Rating Criteria (pub. 12 Oct 2018)
Short-Term Ratings Criteria (pub. 02 May 2019)

Additional Disclosures

Dodd-Frank Rating Information Disclosure Form
Solicitation Status
Endorsement Policy

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