Media Release:

Guarantee Liability The Kaohsiung Third Credit Co-Operative
Assigned 'twBBB/twA-2' Ratings; Outlook Stable

April 11, 2024

Overview

− In our view, Taiwan-based Guarantee Liability The Kaohsiung Third Credit Co-Operative has a small market presence and less-diversified business scope as a regional financial institution, and operates mainly in Taiwan's southern Kaohsiung region.
− We forecast Kaohsiung Third Credit Co-Operative will maintain adequate capitalization with good asset quality over the next two years.
− We are assigning our 'twBBB' long-term and 'twA-2' short-term issuer credit ratings on Kaohsiung Third Credit Co-Operative.
− The stable rating outlook reflects our view that Kaohsiung Third Credit Co-Operative's risk-adjusted capital (RAC) ratio will remain at 7%-8% with stable asset quality over the next two years.

Rating Action

Taiwan Ratings Corp. today assigned its 'twBBB' long-term and 'twA-2' short-term issuer credit ratings on Kaohsiung Third Credit Co-Operative. The outlook on the long-term rating is stable.

Rationale

The ratings on Kaohsiung Third Credit Co-Operative reflect the credit cooperative's adequate capitalization and satisfactory asset quality relative to its relatively simple risk profile, as well as the cooperative's appropriate funding and liquidity profile. Counterbalancing factors include its constrained business position due to the cooperative's small scale and concentrated business activities compared with its commercial banking peers.

We apply our 'bbb' anchor for Taiwan's banking sector. Our 'bbb' anchor for Kaohsiung Third Credit Co-Operative reflects our view that the credit cooperative is exposed to similar economic and industry risks as Taiwan banks, given the cooperative’s deposit-taking and lending business, and the fact that the cooperative is subject to similar compliance requirements as commercial banks. Kaohsiung Finance Bureau supervises Kaohsiung Third Credit Co-Operative, with indirect supervision from Taiwan's Financial Supervisory Commission. The anchor also reflects the credit cooperative's sole operations in Taiwan.
Small scale and concentrated business activities constrain the business position. Kaohsiung Third Credit Co-Operative has a small scale in Taiwan's financial system, with around a 0.2% share of loans underwritten by banks and credit cooperatives. The majority of its businesses are originated in Kaohsiung City. By contrast to commercial banks that have diverse product lines, Kaohsiung Third Credit Co-Operative focuses more on traditional deposit taking and lending activities. It has a narrower client base than banks' and faces regulatory constraints to enter new businesses. We believe these factors will limit Kaohsiung Third Credit Co-Operative's ability to grow and diversify its business operations and make the cooperative more vulnerable to adverse operating conditions in Taiwan's competitive financial sector.

Capitalization will likely remain adequate. The credit cooperative's capitalization as measured by our RAC ratio was 8.0% as of the end of December 2023. We forecast the ratio will hover around 7%-8% by the end of 2026, which qualifies for our assessment of adequate capitalization. We base this projection on our view that Kaohsiung Third Credit Co-Operative will continue to pursue mid-single digit loan growth and focus on its niche market in regional real estate lending (including mortgages), with limited wealth management and proprietary trading activities. We also forecast the credit cooperative's ratio of core earnings to average adjusted assets will remain at 0.25%-0.35% over the next two years, which is below the average for Taiwan banks, with moderate dividend distribution to the credit cooperative's members.

Adequate risk position reflects its good track record managing relatively simple business operations. Kaohsiung Third Credit Co-Operative has a relatively simple lending profile which mainly focuses on residential real estate lending where it has proven expertise. The credit cooperative's nonperforming loan ratio averaged 0-9 basis points over the past five years and is below the domestic bank average with a reserve coverage higher than 1,000% at the same time. This is despite the credit cooperative's simpler risk management framework and higher concentration on residential real estate lending than banks. Kaohsiung Third Credit Co-Operative also has a simple investment risk profile with limited market risk exposure, in our view.

We assess Kaohsiung Third Credit Co-Operative's concentration risk is higher than its industry peers. The credit cooperative's geographical concentration is higher than for banks because it operates mostly in the Kaohsiung region. Kaohsiung Third Credit Co-Operative also faces concentration risk in real estate lending. As of Dec. 31, 2023, mortgage lending represented 49% of the credit cooperative's total loans, with an additional 27% coming from bridge loans backed by residential real estate and 10% from land loans. Kaohsiung Third Credit Co-Operative's business performance can therefore be sensitive to movements in the real estate market.

Stable funding and ample liquidity supported by retail deposits in the home market. We assess Kaohsiung Third Credit Co-Operative's overall funding and liquidity profile to be adequate, supported by ample market liquidity in Taiwan, and the sticky and diversified deposit profile of its members. The credit cooperative's usage of short-term, confidence-sensitive wholesale funding is limited due to its limited interbank activities and regulatory constraints to issue debt.

We view the cooperative has appropriate liquid assets to cover its short-term funding needs against unexpected volatility over the next one to two years. The credit cooperative's liquidity ratio was 24.10% as of Dec. 31, 2023, and consistently has met the minimum regulatory requirement of 10%. We anticipate that ample market liquidity, stable market confidence, and Kaohsiung Third Credit Co-Operative's liquid assets will be sufficient to cover short-term funding needs with an adequate buffer to meet unexpected volatility over the next two years.
Outlook

The stable rating outlook reflects our view that Kaohsiung Third Credit Co-Operative will maintain adequate capitalization to support its business operations over the next two years. We also forecast the credit cooperative will maintain stable asset quality metrics with adequate risk controls relative to its simpler risk framework over the period.

Downward scenario

We may lower the long-term rating on Kaohsiung Third Credit Co-Operative if:

- Asset quality deteriorates due to aggressive growth or if the credit cooperative explores new business areas without adequate risk controls; or
- Capitalization weakens significantly, as indicated by the RAC ratio falling below 7% due to weak capital accumulation or overly aggressive business growth.

Upward scenario

We could upgrade Kaohsiung Third Credit Co-Operative if the cooperative improves its capitalization through improving operating earnings on a sustainable basis as indicated by the RAC ratio rising to consistently above 10%, with unchanged asset quality metrics.

Related Criteria & Research

Related Criteria

- Criteria | Financial Institutions | Banks: Banking Industry Country Risk Assessment Methodology And Assumptions - December 09, 2021
- Criteria | Financial Institutions | General: Risk-Adjusted Capital Framework Methodology - July 01, 2019
- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings - October 10, 2021
- General Criteria: Group Rating Methodology - July 01, 2019
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings - April 07, 2017
- General Criteria: National And Regional Scale Credit Ratings Methodology - June 08, 2023
- General Criteria: Principles Of Credit Ratings - February 16, 2011

Related Research

- Taiwan Ratings' Ratings Definitions – November 11, 2021

(Unless otherwise stated, these articles are published on www.taiwanratings.com)

Ratings List

New Ratings; Outlook

<table>
<thead>
<tr>
<th>Guarantee Liability The Kaohsiung Third Credit Co-Operative</th>
</tr>
</thead>
<tbody>
<tr>
<td>Issuer Credit Rating</td>
</tr>
</tbody>
</table>

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.taiwanratings.com for further information. Complete ratings information is available to subscribers of Rating Research Service at rrs.taiwanratings.com.tw. All ratings affected by this rating action can be found on Taiwan Ratings' public website at www.taiwanratings.com.
Media Release: Guarantee Liability The Kaohsiung Third Credit Co-Operative Assigned 'twBBB/twA-2' Ratings; Outlook Stable