Rating Methodology

TRIS RATING
A Strategic Partner of S&P Global

Savings Cooperative Rating Methodology

28 August 2023

Contacts:

Jittrapan Pantaleard
jittrapan@trisrating.com

Siriwan Weeramethachai
siriwan@trisrating.com

Taweechok Jiamsakunthum
taweechok@trisrating.com

Raithiwa Naruemol
raithiwa@trisrating.com

WWW.TRISRATING.COM

OVERVIEW AND SCOPE OF THE CRITERIA

The criteria apply to savings cooperatives and the federation of savings cooperatives established and operating under Thailand's Cooperatives Act B.E. 2542, and other entities that have similar operating characteristics as a savings cooperative. The key characteristics of a savings cooperative are 1) members mutually own the cooperative through holding of the cooperative's shares; 2) the fundamental sources of funds for a savings cooperative's operation are members' monthly paid-up capital and deposits; and 3) the fundamental uses of funds are lending to the cooperative's members and institutional lending transactions to other primary savings cooperatives, funding investments, and/or undertaking activities under the scope stated in the Cooperatives Law.

This article supersedes the rating methodology for "Savings Cooperative Rating Methodology" published by TRIS Rating, dated 28 September 2020.

CHANGES FROM PREVIOUS CRITERIA

We have made a few adjustments to the previous criteria to enhance the rating framework for savings cooperatives. These changes are as follows:

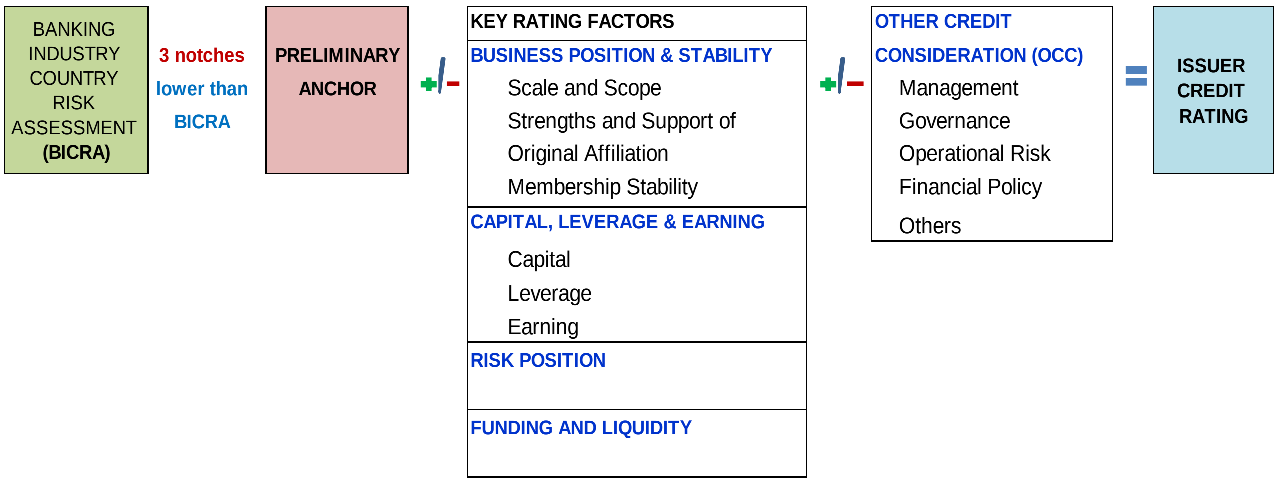
- We have expanded the rating framework to include the "Banking Industry Country Risk Assessment (BICRA)" as a fundamental starting point for determining the preliminary anchor rating for a savings cooperative.
- For the "Membership Stability" rating factor, we have introduced a sub-factor called "Age demographic of members." This sub-factor aims to assess the age distribution of the cooperative's members as a reflection of its long-term sustainability and potential changes in its business model over time.
- To better differentiate risk levels, we have redefined the level of the "Risk Position" from three levels to four: "neutral", "moderately high", "high", and "very high".

RATING METHODOLOGY

TRIS Rating views a savings cooperative as a deposit-taking institution like a commercial bank. A savings cooperative's activities are mainly involved in deposit taking, lending and securities investment. However, the supervision and governance of savings cooperatives are totally separate from those of commercial banks in Thailand. Savings cooperatives in Thailand are supervised by the Cooperative Promotion Department (CPD) and audited by the Cooperative Auditing Department (CAD) under the Ministry of Agriculture and Cooperatives (MOAC) and governed by the Cooperatives Act B.E. 2542. Separately, commercial banks in Thailand are under the supervision of The Bank of Thailand (BOT) and governed by the Financial Institutions Businesses Act B.E. 2551.

"Savings Cooperative Rating Framework" is aligned with that of our "Commercial Bank Rating Methodology", starting with the determination of the preliminary anchor, followed by assessments of the four key rating factors for financial institutions, and adjustments to reflect other credit considerations, if any.

COOPERATIVE RATING FRAMEWORK



PRELIMINARY ANCHOR RATING

We set the anchor rating for a savings cooperative three notches below the anchor rating for a commercial bank in Thailand. For the commercial bank anchor rating, we consider the economic risk and industry risk as part of Banking Industry Country Risk Assessment (BICRA). The three-notch gap between the commercial bank anchor rating and savings cooperative anchor rating addresses the relatively weak regulatory supervision, relaxed financial reporting and accounting standard, narrow scope of business operation, and lack of access to a broad range of funding sources of savings cooperatives, in comparison to those of commercial banks. In setting the preliminary anchor rating, we also take into consideration the positive operating aspects of savings cooperatives, especially the consistently high asset quality. Savings cooperatives in Thailand also enjoy the exclusive benefits of tax privileges and the priority right over other creditors in claims against a debtor.

KEY RATING FACTORS

Under the rating framework, the preliminary anchor rating is adjusted in accordance with the results of assessments of the key rating factors. The key rating factors are 1) business position and stability, 2) capital, leverage, and earnings, 3) risk position, and 4) funding and liquidity. The assessment of each of the key rating factors is further broken down into assessments of sub-factors. The assessment of each of the rating factors involves evaluation of the obligor's position among its peers in the sector. We have collected data from a large group of savings cooperatives in Thailand to help us establish benchmarks for evaluating a savings cooperative's position on each rating factor, in comparison to peers in the sector.

1. Business Position and Stability

We assess a savings cooperative's business position and stability based on three primary factors: scale and scope of the business, strengths and support of original affiliation, and membership stability.

1.1) Scale and scope of business

The size of a savings cooperative is a significant factor indicating its business position. A large-sized savings cooperative, in terms of assets, is considered to have an operating advantage from economies of scale and operating efficiency that supports its ability to compete. A large-sized savings cooperative typically has a lengthy operating history, with a large base of members from which the cooperative can mobilize monthly deposits and capital to strengthen its funding base. A large-sized savings cooperative is also typically more capable of delivering satisfactory operating results, investment returns, and other types of benefits to its members.

Scope of business for a savings cooperative is restricted by the law. A savings cooperative's activities are mainly involved in deposit taking, lending and securities investment, aiming to mutually benefit the members of the savings cooperative.

1.2) Strengths and support of original affiliation

We consider the strengths of the affiliated entity as a key factor to enable members of the savings cooperative to participate in the cooperative activities consistently and continuously. These strengths will help the savings cooperative attain stable growth over the long term. The strengths of the affiliated entity are evaluated based on the relevant track record of business operation, and/or the stability of the entity with respect to staff turnover. These entities could be government entities, state-owned enterprises (SOEs), or large-sized private companies.

The strengths of the affiliated entity tend to be associated with savings cooperatives of government entities, state-owned enterprises, or large-sized private companies. These entities also tend to have a strong influence in managing their savings cooperative members to comply with their cooperative policy directions and actively participate in cooperative activities. A savings cooperative that is closely aligned with or is integrated as a part of, or as a division of a strong affiliated entity, will likely score high in this sub-factor and receive a notch-up from the primary anchor.

Support from the affiliated entity is also a significant rating factor for assessing a savings cooperative's business position and stability. The fundamental concept behind the establishment of a savings cooperative is mutual contribution, members' participation, and benefits sharing. By nature, a savings cooperative typically does not seek to maximize profit. A savings cooperative that receives strong support from its affiliated entity will be evaluated positively for a potential notch-up from the primary anchor. Strong support from the affiliated entity is evidenced by the integration of the savings cooperative's operating policy and internal risk control with the affiliated entity's policies. Support from the affiliated entity could be in the form of long-term and ongoing support of funding and financial liquidity to the savings cooperative in times of stress, in addition to support of the savings cooperative's ordinary operation.

1.3) Membership stability

Membership stability is important in ensuring the long-term success and stability of a savings cooperative. Members of a savings cooperative are its owners, depositors, and borrowers at the same time. Under normal circumstances, membership retention is fostered by satisfactory operating results and benefits delivered to members consistent with the policies and objectives collectively set by the members. Satisfactory benefits delivered to members are typically indicated by dividend payout rates, deposit rates, borrowing rates, and other fringe benefits, in comparison to prevailing market rates.

We view a continuous decline in memberships as a negative rating factor. A decline in membership could be caused by member resignations from the affiliated entity, internal conflicts among members, eroding trust and confidence in the savings cooperative's board of directors and management, or unsatisfactory operating results or benefits delivered to the members. A sizable number of member resignations could cause a significant decrease in a savings cooperative's paid-up capital and deposits, which could expose the cooperative to significant liquidity risk.

The age demographic of members is an important sub-factor influencing changes in the number of members of a savings cooperative as well as shifts in the business model, from a lending-focused savings cooperative to an investment-focused one. A large proportion of members close to retirement age will lead to a sharp decrease in the total number of members and in the lending amount when they retire, as retiring members normally repay all their borrowings to the cooperative and some may exit from membership.

2. Capital, Leverage, and Earnings (CLE)

After assessing the business position and stability, we then focus on the savings cooperative's capital and leverage position as well as earnings capacity. The main purpose is to determine the cooperative's loss absorption capability by evaluating the adequacy of capital and earnings along with the leverage level.

2.1) Capital and leverage

The first step is to evaluate the savings cooperative's capital and leverage position. According to regulatory requirements for savings cooperatives in Thailand, a debt to equity (D/E) ratio of no more than 1.5 times must be maintained. We use the equity to asset ratio as the key metric to evaluate sufficiency of equity capital as a cushion against downside risks and to support future expansion.

The equity to asset ratio is calculated by dividing shareholders' equity by total assets. We do not apply risk weighted assets (RWA) to each type of asset, as savings cooperatives' activities are generally involved in uncomplicated transactions related to lending to its members and other primary savings cooperatives, and investment in securities permitted by law.

2.2) Earnings assessment

In assessing the cooperative's strength in earnings, we apply the ratio of return on average assets (ROAA), as commonly used for earnings measurement for financial institutions in general.

We use a five-year average for both ratios, which is the average of the last two actual years (t-2 and t-1), as well as the projections of the current year (t) and the next two years (t+1, t+2).

2.3) CLE modifier

Lastly, we may take into consideration other qualitative factors that are not incorporated in the quantitative measurements mentioned above. These qualitative assessments may result in adjustments to the results derived from 2.1 and 2.2.

3. Risk Position

In assessing the risk position of a savings cooperative, we focus on the key risk aspects of the cooperative's business operation. We consider three areas of risk associated with a savings cooperative's activities – credit risk, concentration risk, and market risk. The risk position of a cooperative could be evaluated as "neutral", or "negative" to the overall rating. Since the scope of a savings cooperative's activities are restricted by law to control exposure to risk, there is normally little differentiation in risk position among most savings cooperatives. We mostly assess the risk position of a savings cooperative as "neutral". However, some savings cooperatives that have markedly higher risk exposure than peers could be assessed to have a "moderately high", "high" or "very high" risk position.

3.1) Credit risk

The factors that we normally look at for credit risk are the savings cooperative's lending and credit underwriting standards as well as its internal policy in lending to its members and other primary cooperatives, along with investment in debt securities. The credit risk associated with a savings cooperative's lending to its members is typically low, as the legal mechanism allows the affiliated entity to support its savings cooperative by deducting debt servicing amounts from the members' monthly salaries and directly transferring them to the savings cooperative. The loan amount of any single loan is limited by law to not more than 10% of the lending cooperative's paid-up capital and legal reserve. For debt securities, savings cooperatives are legally allowed to invest in securities that are assigned an "A-" rating (Single A Minus) or better.

3.2) Concentration risk

We evaluate concentration risk from a savings cooperative's lending, deposit-taking, and investing activities. We measure the degree of concentration by comparing a particular exposure with the cooperative's paid-up capital and legal reserve. Qualitatively, we consider the cooperative's policy and criteria with regards to potential concentration risk associated with its lending or investment activities.

3.3) Market risk

Market risk is typically associated with savings cooperatives' investment activities. Savings cooperatives are restricted by law to invest in the equity stocks of state-owned enterprises only. However, the law does not set a ceiling for investment amounts in equity and debt securities, which may expose cooperatives to significant market risk. We typically look at a savings cooperative's investment policy and evaluate the magnitude of its exposure to market risk and equity investment. A track record of losses from investment activities could be considered as "negative" to the overall rating. In addition, we measure the degree of investment risk by comparing exposure to an equity investment with the cooperative's paid-up capital and legal reserve.

4. Funding and Liquidity

We use both quantitative and qualitative approaches to evaluate the strength of funding and liquidity.

4.1) Funding assessment

The main sources of funding for savings cooperatives are from the issuance of new shares to cooperative members and monthly deposits by cooperative members. Apart from members' monthly purchases of new shares that raise a savings cooperative's paid-up capital, assessed as the capital strength in CLE, member deposits are also stable sources of funding for savings cooperatives. The tool we apply to evaluate a savings cooperative's funding position is the ratio of member deposits to total funding. Savings cooperatives that chiefly rely on member deposits for their funding will be viewed positively for the rating to reflect funding stability. On the contrary, savings cooperatives that have a high proportion of deposits from affiliated members (rather than ordinary members) will be viewed negatively as deposits from affiliated members tend to be yield-sensitive and unstable. In addition, savings cooperatives that rely heavily on external sources of funding, like borrowings from commercial banks and other savings cooperatives, are viewed as having vulnerable funding positions.

For the calculation of the member deposits to total funding ratio, we use a two-year average, i.e., the latest actual year (t) and one forecast year (t+1), as we believe the latest data best captures the current funding position.

We also apply qualitative adjustment factors to a savings cooperative's funding assessment, which can be "positive", "neutral", or "negative" to the credit rating. The factors that may enhance the funding assessment are available financial flexibility, for example, credit lines from commercial banks, and potential support from the affiliated entity and/or savings cooperative networks. On the contrary, we consider significant mismatched gaps of assets and liabilities, or a lack of alternative funding sources as "negative" to the rating.

4.2) Liquidity assessment

In assessing a savings cooperative's liquidity position, we use the excess liquidity reserve requirement to total deposits as a start. The ratio is legally set at a minimum of 3% for primary savings cooperatives, and 6% for federations of savings cooperatives. We consider a buffer top-up from these minimum regulatory requirements at an adequate level, based on historical data, as a cushion in the event of stressed liquidity scenarios. We use a two-year average, i.e., the latest actual year (t) and one forecast year (t+1) to reflect the current and short-term funding situation.

We may also apply qualitative adjustment factors in our liquidity assessment, which can be "positive", "neutral", or "negative" to the credit rating. Qualitative factors that we consider are the cooperative's liquidity management plan, track record of liquidity handling, efficient communication with members when facing liquidity stress, and level of liquid assets, or near-cash assets to support liquidity shortfalls.

OTHER CREDIT CONSIDERATIONS

Apart from the key credit considerations discussed above, there could be other credit considerations (OCC) that, in our view, should be captured in assessing a savings cooperative's credit profile. The OCC that could be incorporated in assessing a savings cooperative's credit profile are, for instance, issues related to governance and financial policy. If there is strong evidence to suggest a serious governance issue, it could be reflected as a "negative" rating adjustment. We also assess a savings cooperative's operational risk, which could lead to potential losses resulting from internal political conflicts, human error, fraud, or legal action as "negative".

TRIS Rating Co., Ltd.
Silom Complex Building, 24th Floor, 191 Silom Road, Bangkok 10500, Thailand. Tel: 0-2098-3000