

# THE FEDERATION OF SAVINGS AND CREDIT COOPERATIVES OF THAILAND LTD.

No. 147/2020

28 September 2020

## FINANCIAL INSTITUTIONS

**Company Rating:** A-  
**Outlook:** Stable

**Last Review Date:** 15/08/19

### Company Rating History:

Date	Rating	Outlook/Alert
29/07/14	A-	Stable

### Contacts:

Siriwan Weeramethachai

siriwan@trisrating.com

Jittrapan Pantaleard

jittrapan@trisrating.com

Taweetchok Jiamsakunthum

taweetchok@trisrating.com



WWW.TRISRATING.COM

## RATIONALE

TRIS Rating affirms the company rating on The Federation of Savings and Credit Cooperatives of Thailand Ltd. (FSCT) at “A-” with a “stable” outlook. The rating reflects FSCT’s steady operating performance, consistently high asset quality, and the competitive edge of savings cooperatives from having tax privileges and priority claims against debtors under the savings cooperatives law. The rating is, however, constrained by the weak regulatory supervision of savings cooperatives in general, FSCT’s loans and investment concentration risk, refinancing risk, and relatively high leverage.

The rating also takes into consideration FSCT’s readiness to cope with regulatory changes following the enactment of new law governing the operations of savings cooperatives.

## KEY RATING CONSIDERATIONS

### FSCT’s readiness to cope with regulatory changes

We hold the view that FSCT is well prepared to cope with the regulatory changes with no serious concern over the potential impact on its operation. The new law governing the operations of savings cooperatives, Cooperative Act (No. 3) B.E. 2562 (2019), took effect in May 2019. The new law is basically designed to ensure tighter controls over the deposit taking, lending, and investment activities of savings cooperatives. We view the new law as an important step to alleviate the concern over the long-term stability of savings cooperatives that form an important part of Thailand’s financial system.

We expect the changes will constrain opportunities for growth and weaken FSCT’s financial performance in the short term. For instance, more stringent investment criteria and reserve requirements for liquidity and loan losses under the new law will mean less flexibility in FSCT’s investment activities and lower returns on assets. However, we do not expect the potential impact on FSCT’s profitability will alter our view on FSCT’s financial strength. On the other hand, the new requirements will likely strengthen FSCT’s risk management, and thus enhance its long-term stability.

### Savings cooperatives continue to enjoy privileges under the new law

The privileges granted to savings cooperatives in the form of tax exemptions and priority claims against debtors remain unchanged under the new law. Savings cooperatives and their respective members are exempt from interest savings tax, value added tax, and tax on the investment returns. The law also stipulates that a primary savings cooperative has priority claim over any other creditors to receive interest and repayments from its debtors. The priority claim privilege is an important competitive advantage over other lending institutions in lending to cooperative members. Most of the loans extended to ordinary members of primary savings cooperatives are under an arrangement with the borrower’s employer to deduct interest and principal installments from the borrower’s monthly salary. This explains the high asset quality and low credit costs for most primary savings cooperatives which consequently support the loan quality of a secondary savings cooperatives like FSCT.

### Weak regulatory supervision

Savings cooperatives are not subject to the same degree of close supervision and rigorous examinations as banking institutions. In our view, this is the major weakness that constrains the credit standings of savings cooperatives in

Thailand. Although the new law lays out the framework for tighter controls on savings cooperatives' activities, it does not ensure that all savings cooperatives will actually adhere to the new regulations. The effective enforcement of any rules and regulations will rest on periodic rigorous examinations of savings cooperatives to ensure compliance, which seems unlikely to happen anytime soon.

### **Important role as a financial intermediary**

We expect that FSCT will continue to serve as a financial intermediary for its cooperative members by taking deposits and making loans. FSCT also plays a key role in the promotion and development of the savings cooperative movement in Thailand. FSCT plays an important role in two ways: through its responsibility according to the cooperative laws, and by serving as a representative of its cooperative members. FSCT has participated in a number of national committees and in the activities of the savings cooperative movement in order to support, promote, plan for, and develop the savings cooperative industry in Thailand. Primary savings cooperatives provide loans and welfare benefits for their members. In the same way, FSCT lends funds to its cooperative members and also provides benefits in the form of consulting services, training, and seminars with the main objective to enhance the operations and financial strength of its cooperative members.

### **Exposure to market risks due to shift in investment portfolio**

FSCT is exposed to market risk due to its investment activities. We view that FSCT has recently shifted towards a more aggressive investment policy by increasing the weight of investment in equity securities, which is a high-risk asset class given the high volatility of asset prices. The ratio of investment to total assets stood at 32% at the end of fiscal year (FY) 2019. The investment portfolio comprised equity securities of 45%, debentures of 51% and others of 4% in FY2019, compared with equity securities of 5%, debentures of 84% and others of 11% for the conventional portfolio over the past few years. We expect that FSCT will limit its exposure in equity investment going forward. The higher investment exposure will translate into a higher risk position, which will consequently affect the credit rating.

The rating has been taken into account the effect of FSCT's probable full provision to cover potential losses from investing in senior unsecured debentures of Thai Airways International PLC (THAI). FSCT had an exposure in THAI's senior unsecured debentures at the end of March 2020 of THB1.9 billion, which is accounted for 1% of its total assets and 6% of total equity.

### **High leverage and moderate equity base**

FSCT's equity base, including paid-up share capital, legal reserves, reserves mandated under by-laws, unrealized gains or losses from investments, and net profit, has increased steadily. The leverage ratio increased to 24.8% in FY2018 from 19.4% in FY2016. However, it is still at a relatively low level compared with the average of around 40% among large, long-established savings cooperatives. In FY2019, despite the increase in FSCT's paid-up share capital, the ratio of equity to total assets declined to 19.7% due to unrealized losses from investment activities.

As required by FSCT's by-laws, the cooperative members need to purchase additional shares in proportion to the paid-up share capital they already own. In a normal situation, FSCT's paid-up share capital will keep increasing. The paid-up share capital of each cooperative member will increase automatically, thanks to the traditional mechanism of monthly share purchased by members. TRIS Rating expects FSCT will be able to strengthen its capital base if needed in order to cope with any adverse changes in domestic savings cooperative sector or financial market.

### **Sufficient liquidity but some refinancing risk**

We expect FSCT will be able to maintain sufficient liquidity as it has secured a large number of credit facilities from several financial institutions. The total amount of available credit facilities should be enough to fund its operations and cover any liquidity shortfalls should they arise.

On average, borrowings from commercial banks have accounted for 12% of total liabilities or 9% of total assets in the past few years. All commercial bank borrowings have been short-term. However, in our view, wholesale funding from financial institutions carries a higher level of risk (rollover risk) compared with funding through deposits and borrowings from cooperative members. The high proportion of external short-term funding exposes FSCT to a significant refinancing risk. However, FSCT has an investment portfolio large enough to cover all of the external short-term borrowings, which helps mitigate liquidity risk. Nevertheless, the pledged securities are subject to price risk and potential loss in a forced liquidation scenario.

FSCT's liquid assets accounted for 41.4% of total assets as of March 2020. FSCT ended July 2020 with a liquidity ratio of 14.3%, well above the new regulatory requirement of 6%.

### Loan concentration but well managed asset quality

In our view, FSCT is exposed to significant loan concentration risk. The 20 largest loans made to cooperative members accounted for 50% of total loans at the end of FY2019. FSCT provided loans to just 256 cooperative members, out of a total of 1,093 members as of 31 March 2020. Loans made to cooperative members represented the largest portion (58%) of FSCT's total assets at the end of FY2019. About 32% of FSCT's total assets were investments while the remainder (10%) was made up of cash and other assets. However, FSCT's loans concentration risk is mitigated by the high quality of its loan portfolio.

At the end of FY2019, FSCT had only THB18.9 million of non-performing loans (NPLs), accounting for only 0.02% of outstanding loans. FSCT's high asset quality reflects the low credit risk in lending to primary savings cooperatives whose lending practices are supported by the priority claim privilege and salary deduction arrangements with the borrowers' employers as mentioned above. We expect that FSCT will continue to maintain its strict lending criteria to prevent any potential credit losses in the future.

### BASE-CASE ASSUMPTIONS

TRIS Rating's base-case assumptions for the performance of FSCT during FY2020-FY2022 are as follows:

- Total equity to grow by 15% per annum on average.
- Loans to grow by 10%-12% per annum on average.
- The spread to be in the range of 0.48%-0.63%.
- Full provision to cover losses from investing in THAI's senior unsecured debentures.

### RATING OUTLOOK

The "stable" outlook reflects our expectation that FSCT will maintain its important role in the savings cooperatives movement. The outlook also reflects its steady operating performance, high asset quality, and core funding base from its members. We also expect FSCT will be able to comply with the new regulations.

### RATING SENSITIVITIES

The prospect of a credit upgrade is constrained by the lack of close supervision and rigorous examinations, as well as the uncertainty of regulatory change. In contrast, a downgrade scenario could arise should there be indications of more aggressive investment, operating and financial policies being adopted and leading to deterioration of the overall credit profile. Any regulatory changes that erode the tax and priority claims privileges currently enjoyed by the savings cooperatives will also have a negative effect on the rating.

### COMPANY OVERVIEW

FSCT is the first savings cooperative federation in Thailand. The Cooperative League of Thailand (CLT) and 81 savings cooperatives established FSCT as a national savings cooperative federation in 1972. FSCT started operations in 1973. According to the Cooperatives Act, FSCT is a secondary savings cooperative, or a savings cooperative which has primary savings cooperatives as its members.

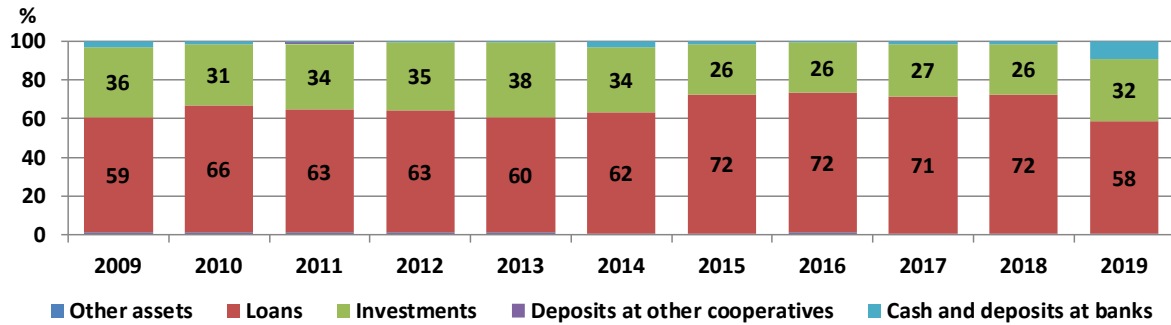
Over 40 years, the number of members has increased steadily. FSCT had 81 cooperative members when it was founded. The number of members had increased to 1,093 by the end of March 2020. More than two-thirds of all primary savings cooperatives in Thailand are members of FSCT.

FSCT is the largest savings cooperative federation in Thailand, in terms of both asset size and the number of members. FSCT serves as a funding intermediary for its cooperative members by taking deposits from and making loans to its members. FSCT also provides additional benefits for its members, mostly in the forms of consulting and training services.

FSCT plays an important role in the promotion and development of savings cooperatives in Thailand. In addition to striving to fulfill its responsibility in accordance with the cooperatives laws, FSCT also serves as a representative of savings cooperatives.

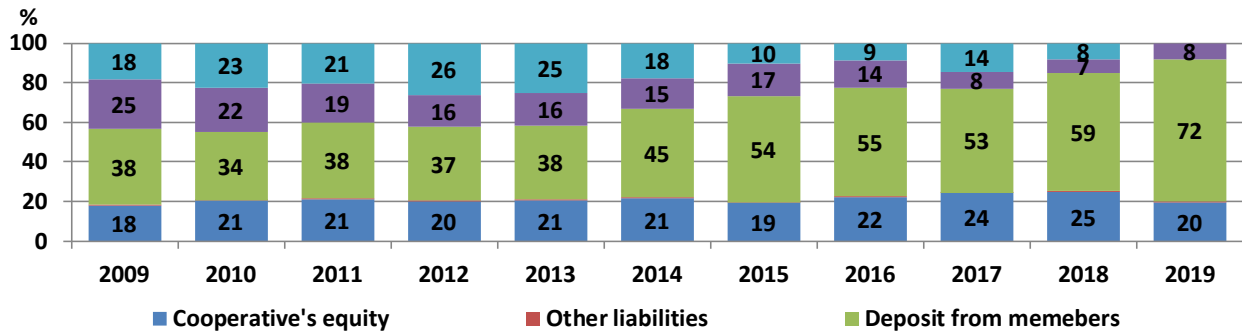
KEY OPERATING PERFORMANCE

Chart 1: FSCT's Asset Structure



Source: FSCT

Chart 2: FSCT's Funding Structure



Source: FSCT

## FINANCIAL STATISTICS AND KEY FINANCIAL RATIOS

Unit: Mil. THB

	-----Year Ended 31 March -----				
	2020	2019	2018	2017	2016
Total assets	153,781	133,289	122,032	110,018	97,993
Total loans	88,788	95,595	86,306	79,707	70,402
Total investment in securities	49,671	35,008	33,105	28,268	25,313
Allowance for doubtful accounts	16	5	6	7	8
Deposits	110,240	79,240	64,264	60,546	52,491
Borrowings	12,429	20,317	27,874	24,551	26,254
Equity	30,228	33,099	29,688	24,640	18,977
Net interest and dividend income	1,791	1,795	1,481	1,332	1,216
Bad debts and doubtful accounts	(1)	(1)	(1)	0	2
Non-interest income	351	80	295	189	44
Operating expenses	176	162	164	165	141
Net income	1,966	1,713	1,612	1,356	1,117

Unit: %

	-----Year Ended 31 March -----				
	2020	2019	2018	2017	2016
<b>Profitability</b>					
Net-interest and dividend income/average assets	1.25	1.41	1.28	1.28	1.45
Non-interest income/average assets	0.24	0.06	0.25	0.18	0.05
Operating expenses/total income	2.85	3.20	3.53	3.52	3.69
Return on average assets	1.37	1.34	1.39	1.30	1.33
Return on average equity	6.21	5.46	5.94	6.22	6.60
<b>Asset Quality</b>					
Non-performing loans/total loans	0.02	0.01	0.01	0.01	0.01
Bad-debts and doubtful accounts/average loans	0.00	0.00	0.00	0.00	0.00
Allowance for doubtful accounts/total loans	0.02	0.01	0.01	0.01	0.01
Allowance for doubtful accounts/non-performing loans	86.79	99.24	99.34	99.42	99.48
<b>Capitalization</b>					
Equity/total assets	19.66	24.83	24.33	22.40	19.37
Equity/total loans	34.04	34.61	34.39	30.91	26.95
<b>Funding and Liquidity</b>					
Member deposits/total funding	89.87	79.59	69.75	71.15	66.66
Liquid assets/(deposits+borrowing+paid-up stocks)	41.56	28.99	29.96	27.59	28.98

## RELATED CRITERIA

- Savings Cooperative Rating Methodology, 28 September 2020

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**The Federation of Savings and Credit Cooperatives of Thailand Ltd. (FSCT)**

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**Company Rating:**

A-

**Rating Outlook:**

Stable

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**TRIS Rating Co., Ltd.**

Silom Complex Building, 24th Floor, 191 Silom Road, Bangkok 10500, Thailand Tel: 0-2098-3000

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