TRIS RATING
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GOVERNMENT SAVINGS BANK

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FINANCIAL INSTITUTIONS

Company Rating:	AAA
Outlook:	Stable

Last Review Date: 08/11/18

Company Rating History:

Date	Rating	Outlook/Alert
21/11/16	AAA	Stable

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RATIONALE

TRIS Rating affirms the company rating on Government Savings Bank (GSB) at "AAA" with a "stable" outlook. The rating reflects GSB's status as a specialised financial institution (SFI) whose mandate is to provide policy-related services. The rating takes into account our view of the strong likelihood that GSB will receive extraordinary support from the government in the event of financial distress. As prescribed in the Government Savings Bank Act, B.E. 2489 (1946), the government guarantees the payment of all of GSB's obligations including principals, interest on deposits, and all other payment obligations.

KEY RATING CONSIDERATIONS

Strong government support

GSB's company rating factors in TRIS Rating's view that among the SFIs, the likelihood that the government will provide timely financial support to GSB when needed is the strongest. This is based on the supportive legal framework and strategic importance of the bank to the government in serving public policy.

The Government Savings Bank Act, B.E. 2489 (1946) stipulates explicit guarantees of all of GSB's obligations by the government. These include repayment of the principals, interest on deposits, and all other payment obligations. Furthermore, if required, additional capital can be allocated to GSB from the Specialised Financial Institutions Development Fund, annual government budget, or other government sources, subject to the Cabinet's approval.

State-backed policy role

In TRIS Rating's opinion, it is unlikely that other private entities can perform GSB's public service roles. GSB serves a mandate in providing policy-related services and supportive measures. The government provides support to GSB in carrying out this mandate as these activities usually generate low or no profit. The government generally helps GSB, for example, by compensating for interest subsidies, operating expenses, and, in some cases, credit losses.

Part of GSB's principal missions is to provide access to financial services to segments not covered by commercial banks. GSB provides soft loans under the Public Service Account (PSA) programme to target low-income groups and small- and medium-sized enterprises (SMEs). The bank also encourages savings and improved financial literacy among its customers. These remain the focal point of its new 5-year strategy (2020-2024). Key execution areas include youth savings, financial well-being of the elderly, career development of low-income groups, and financial soundness of local communities.

Strength in core retail banking

In our opinion, the strong retail banking franchise continues to underpin GSB's business position. Its retail banking serves a diverse group of clients at a wide range of income levels. Key segments include low-income earners, general retail customers, and owners of smaller SMEs. GSB also operates a strong deposit franchise as the country's leading savings institution. Extensive coverage through branches and alternative channels in provincial areas as well as digital banking through mobile applications further help sustain its retail franchise strength, comparable to the large Thai commercial banks. The bank

Note: GSB owns 13.52% of TRIS Rating's parent company, TRIS Corporation Ltd. (TRIS), which holds a 51% stake in TRIS Rating.

also aims to expand into areas where it has limited presence, such as the younger generation, including university students and the first jobbers.

GSB's asset size is the largest among the SFIs and comparable to each of the top five commercial banks designated as domestic systemically important banks (D-SIB), with Bt2.7 trillion in assets at the end of the first half of 2019 (H1/19). At that time, the bank commanded an 11% market share in loans and 12% in deposits among Thai commercial banks and SFIs. GSB is also among the major providers of housing loans holding a 9% market share in 2018, according to TRIS Rating's database. As of H1/19, GSB's total loan comprised retail (57%), SMEs (5%), and large corporate and public sector (38%). GSB also has a network of 1,063 physical branches, 900 of which are in provincial areas.

Lending business drives earnings

We expect GSB's revenue to continue to derive mainly from lending activities over the next three years, whilst gradually expanding its fee income. One of the strategies to diversify its earnings sources is to bring on-board a more complete suite of wealth products. To date, the key components of fee income include transaction-related fees, card-related fees, bancassurance fees, and fund management fees. Net fee income made up around 7% of GSB's total revenue between 2018 and H1/19, below the average of around 20% among the 11 listed Thai commercial banks.

Moderate risk appetite should contain asset quality pressure

In our opinion, GSB's conservative lending policies and risk mitigation already in place should help contain any future credit risks that GSB may face. GSB has shifted its focus towards more secured lending to retail and smaller SME borrowers. At the same time, it continues lending to government-related entities with good credit standings. Risk mitigations, namely government compensation and guarantee coverage by Thai Credit Guarantee Corporation (TCGC), can help limit credit losses from policy lending under selective PSA programmes and SME lending, respectively.

Despite that, we view GSB's asset quality could remain under pressure amid a soft economic environment and with the country's persistently high level of household debt. Although GSB has placed emphasis on collateral value when underwriting loans, it continues to face exposure to vulnerable segments of lower-middle income borrowers. A recent uptick in the non-performing loan (NPL) ratio from an internal reclassification, which largely affected mortgage and teacher loans, reveals such vulnerability, in our opinion. This one-time reclassification carried out at the end of 2018 affected some restructured loans previously not reported as NPLs. As a result, GSB's NPL ratio[1] at end-H1/19 rose to 2.69% from 2.05% at end-H1/18. That said, it remains below the 3.11% average for the Thai commercial banks reported by the Bank of Thailand (BOT). The figure was also below the 4.53% average for the SFIs reported by the Fiscal Policy Office (FPO) for the same period. GSB's collateral per total loan at 56% at end-H1/19 was also above that of several other major Thai commercial banks.

We also expect GSB to continue building up its moderate loan loss reserves. This is due to its preparation for the implementation of TFRS9[2] and as a cushion against rising NPLs. The NPL coverage ratio stood at 113% at end H1/19, falling from 130% at end H1/18 as NPLs rose. Accordingly, we forecast credit costs to stay at an elevated 70-80 basis points (bps) level over the next three years. The figure rose to 85bps in 2018, from 23bps in 2017, which was also above our forecast of normalised credit costs of 35-45 bps. Yet, these levels remain below recent figures at most other Thai commercial banks.

Adequate capital for GSB's exposure

TRIS Rating forecasts a Basel-II compliant Tier-1 capital ratio of GSB at around 14% over the next few years. This is based on our assumptions of a 5%-7% loan growth and a 55% dividend pay-out of GSB. More conservative lending to segments with lower-risk weights and moderate profitability should uphold GSB's adequate capital, in our opinion. GSB's return on average assets (ROAA) was 1.15% in 2018. GSB pays no taxes.

However, a number of factors could weigh down the bank's profitability over the next few years. These include lower loan yields from more conservative lending and social lending, as well as potential rises in credit costs. We forecast GSB's risk-adjusted net interest margin (NIM) in a range of 1.8%-1.9%. The figure dropped to 1.7% in 2018 from 2.0% in 2017, as credit costs rose.

Solid broad-based retail funding

We expect GSB to maintain solid deposit funding. The bank's sizable market share in deposits across commercial banks and SFIs underscore its status as a leading savings institution. Deposits at GSB comprise a majority of broad-based sticky retail deposits, and a smaller but not insignificant portion of deposits from government-related entities. GSB's unique lottery-

[1] Including interbank.
[2] Scheduled implementation of TFRS9 for SFIs is in 2025.

linked fixed deposits offering attractive yields and current account-savings account (CASA) deposits underpin the bank's core deposit funding.

As of H1/19, deposits made up a high 95% of GSB's total funding, with a small percentage of borrowings making up the rest. The bank has been able to maintain its loan-to-deposit (LDR) ratio within a conservative target of 85%-97%. The figure as of end-H1/19 stood at 95%.

Strong liquidity

GSB continues to be a net lender in the interbank market. At the same time, it is a liquidity provider for government agencies and other SFIs. Liquid assets per short-term financial liabilities and total deposits, including interbank borrowing, were at a satisfactory level of 40.8% and 24.5% respectively at end-H1/19.

BASE-CASE ASSUMPTIONS

The following are our base-case assumptions for 2019-2021:

- Loan growth: around 5%-7%
- Credit cost: around 70-80 bps
- NPL ratio (not including interbank): around 2.9%-3%
- CET-1 ratio: around 14%
- Risk-adjusted NIM: around 1.8%-1.9%

RATING OUTLOOK

The "stable" rating outlook reflects TRIS Rating's expectation that GSB will continue to receive strong support from the government, given its status as an SFI with an important mandate.

RATING SENSITIVITIES

TRIS Rating could revise the credit rating and/or outlook of GSB down if the legal status of GSB, the explicit guarantee of all obligations, and/or the importance of GSB's role in relation to government policies weakens.

COMPANY OVERVIEW

GSB was established under the "Klung Omsin Act" on 1 April 1913, named the "Savings Office" and placed under the Royal Treasury. Initial capital was Bt100,000, bestowed by His Majesty King Vajiravudh (Rama VI). The main objective of the Savings Office was to promote savings habits among people nationwide. On 18 December 1946, the Government Savings Bank Act B.E. 2489 (1946) was enacted. The Savings Office was transferred to the Ministry of Finance (MOF) and renamed "Government Savings Bank".

On 2 April 2015, the MOF officially mandated that all SFIs, including GSB, be supervised and examined by the Bank of Thailand (BOT). In the second half of 2015, all SFIs, including GSB, were obliged to contribute 0.18% of deposits to the SFI System Development Fund. The current contribution rate of 0.25% was set in 2017. However, GSB benefits from an exemption from corporate income tax. Savings and special savings deposits at GSB are also non-taxed. GSB distributes 50%-55% of its net profit to the MOF.

As of June 2018, the bank has investments larger than 10% shareholding in four financial institutions: Islamic Bank (39.81% shareholding), Thanachart Asset Management Co., Ltd. (25%), MFC Asset Management Co., Ltd. (24.96%), and Dhipaya Life Assurance PLC (25%).

GSB plays a critical role in serving as the people's bank and supporting the government's policies. For more than a century since its establishment in 1913, GSB has consistently delivered solid performance, focusing on banking services for the retail banking segments. The bank's efforts support and are aligned with the government's economic and social development policies.

Like other SFIs, GSB is currently supervised by the BOT based on guidelines that follow the Basel-II framework. The guidelines aim at strengthening SFI's risk management and enhancing their operating efficiency, corporate governance, and transparency. These should help GSB develop long-term sustainability.

As an SFI, GSB's challenge is to strike a balance between meeting its institutional mission to support public policies and maintaining sound financial performance. The bank is obliged to provide policy-related services and supportive measures towards certain economic sectors, though these activities usually do not generate any profit.

FINANCIAL STATISTICS AND KEY FINANCIAL RATIOS[1,2]

Unit: Bt million

	Jan-Jun 2019[3]	----- Year Ended 31 December ----- 2018	2017	2016	2015
Total assets	2,685,196	2,704,967	2,664,411	2,510,033	2,400,716
Average assets	2,695,081	2,684,689	2,587,222	2,455,375	2,329,957
Investment in securities	302,938	256,157	237,321	283,914	246,246
Loans and receivables	2,138,979	2,066,981	1,952,521	1,752,287	1,776,809
Allowance for doubtful accounts	71,869	67,790	57,475	54,506	45,165
Deposits	2,247,566	2,232,431	2,185,122	2,137,341	2,058,139
Borrowings[4]	110,282	119,659	161,206	101,313	79,745
Shareholders' equities	211,441	202,566	202,471	170,853	152,003
Average equities	207,003	202,518	186,662	161,428	149,641
Net interest income	27,825	61,179	55,916	58,547	57,587
Non-interest income[5]	7,440	23,320	15,527	13,690	9,324
Total revenue[5]	35,265	84,499	71,444	72,237	66,911
Operating expenses[6]	17,352	36,498	35,983	36,585	36,104
Pre-provision operating profit (PPOP)	17,914	48,000	35,461	35,652	30,807
Impairment losses on loans and securities	6,062	17,018	4,184	9,548	8,043
Net income	11,852	30,983	31,276	26,104	22,764
Net fee and service income	2,447	6,073	5,766	4,816	4,603
Gains on investments	117	7,635	257	22	515

1 *Consolidated financial statements*
2 *Including public service accounts since 2015*
3 *Non-annualised and unaudited*
4 *Including interbank and money market*
5 *Net of fees and service expense*
6 *Excluding fees and service expense*

Unit: %

	Jan-Jun 2019[3]	---------------- Year Ended 31 December ------------			
		2018	2017	2016	2015
Earnings					
Return on average assets	0.89[7]	1.15	1.21	1.06	0.98
Interest spread	1.83[7]	2.08	1.91	2.14	2.19
Net interest margins	2.06[7]	2.27	2.14	2.36	2.45
Net interest income/average assets	1.03[7]	2.28	2.16	2.38	2.47
Non-interest income/average assets	0.28[7]	0.87	0.60	0.56	0.40
Net fee and service income/total revenue	6.94	7.19	8.07	6.67	6.88
Cost-to-income	49.20	43.19	50.37	50.65	53.96
Capitalisation					
Tier-1 ratio	14.08	13.56	11.85	10.86	10.24
BIS ratio	15.46	14.72	12.47	11.54	10.80
Tier-1/BIS ratio	91.07	92.12	95.03	94.11	94.81
Asset Quality					
Credit costs	0.58[7]	0.85	0.23	0.54	0.48
Non-performing loans/total loans[8]	2.69	2.47	1.71	1.74	1.44
Allowance for loan losses/non-performing loans	112.84	114.07	134.04	135.89	141.84
Funding & Liquidity					
CASA ratio	24.46	23.78	22.62	22.67	20.90
Loan-to-deposit ratio	94.84	92.29	89.05	81.72	86.03
Deposits/total liabilities	90.86	89.21	88.76	91.37	91.53
Liquid assets/total deposits[9]	24.54	27.28	31.71	35.34	30.25
Liquid assets/short-term liabilities[10]	40.84	42.68	48.26	54.12	n.a.

7 Annualised

8 Including interbank; excluding accrued interests

9 Including interbank borrowing

10 Financial liabilities with maturity less than one year

RELATED CRITERIA

- Rating Methodology – Government-Related-Entity, 6 June 2017
- Commercial Banks, 30 March 2017

Government Savings Bank (GSB)

Company Rating:	AAA
Rating Outlook:	Stable

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