Credit Ratings & Research

Credit Rating Report
Police and Families Credit Union Incorporated

Company No: 1802854

Credit Rating Report

Date: 10th December 2024

Prepared for: Police and Families Credit Union Incorporated

Report prepared by: Equifax Australasia Credit Ratings Pty Ltd ("Equifax")

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Job Number: 393244

Currency used in this report: This report is presented in New Zealand Dollars unless otherwise noted.

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1. Executive Summary

Police And Families Credit Union Incorporated ('PFCU')

PFCU is a not-for-profit, Non-Bank Deposit Taking (NBDT) organisation that is domiciled and licenced to operate in New Zealand. PFCU receives deposits from, and provides consumer loans to, current and retired police and NZ defence force personnel and their family members.

Equifax has assigned PFCU a credit rating of 'BB' at Sep24, which is a near-prime classification with a low to moderate level of risk. The rating has been downgraded by one notch to 'BB' at Jun24 (affirmed at Sep24) from 'BB+' at Jun23 owing to a deteriorating operating profile as evidenced by an increase in underlying operating loss in FY24, higher operating expenses, rising cost of funding and limited loan growth.

The rating reflects PFCU's strong capitalisation, funding profile and liquidity, the quality of its loan assets (benefitting from security position over NZ Police retirement accounts and access to NZ Police payroll), and the benefits of its strategic investment in financial technology solutions provider Finzsoft Solutions (New Zealand) Limited that supports its overall earnings profile. The rating is constrained by PFCU's subdued core operating performance, competitive pressures and limited franchise, increasing exposure to residential mortgages – which has introduced property market risks to its asset portfolio and the impact of ongoing macroeconomic headwinds.

Strengths

- PFCU's Tier 1 capital ratio remains strong and better than the industry average at 25.2% at Sep24 (Jun24: 25.8%), being 3.2 times the minimum regulatory requirement of 8.0%. Capitalisation has increased and remained consistently above average due to limited loan growth in the recent past. This strong buffer provides PFCU the headroom to grow its risk weighted assets/loan portfolio while supporting its capacity to absorb performance volatility.

- The quality of PFCU's loan book remains high, supported by the strength of its client base which primarily comprises government employees who provide essential public services. A large portion of PFCU's gross loan book (~58.7% at Sep24) is secured by a charge over retirement funds in the Police Superannuation Scheme (PSS) and the Government Superannuation Fund (GSF). This collateral, along with PFCU's access to NZ Police payroll, improves the likelihood of repayment and recovery of loans advanced to members.

- PFCU's funding profile and liquidity have been supported by healthy reinvestment rates on term deposits (12- month average of 87.0% at Sep24), coupled with a modest loan portfolio. This is reflected in its above average deposit to loan ratios of 3.4x (Jun24: 3.5x, Jun23: 3.7x) and liquid assets of 69.8% at Sep24 (Jun24: 70.1%, Jun23: 71.8%, Jun22: 71.6%).

- PFCU's strategic investment in its banking software/financial technology solutions provider Finzsoft Solutions (New Zealand) Limited ('Finzsoft') in partnership with First Credit Union continues to contribute financial and operational benefits. Whilst PFCU's investment was initially a strategic necessity to secure operational capacity, the growth of the Finzsoft investment has provided some diversification to PFCU's earnings profile. Further, PFCU's investment in digitisation using Finzsoft's capabilities to automate a majority of manual tasks is expected to drive operational efficiencies, going forward.

Constraints

- PFCU's core operating performance continued to remain subdued and registered an underlying operating loss for -$23k for three months period ended Sep24 (FY24: -$0.5m). The loan book largely remained stable over the reviewed period (3MSep24: $35.4m, Jun24: 34.2m, Jun23: 34.4m) and interest generated on member loans as a proportion of overall interest income declined further (3MSep24: 33.0%, FY24: 40.0%, FY23: 45.0%), thereby further increasing the reliance of PFCU on managing the favourable spread between interest paid on member deposits and interest generated on bank deposits to meet its operating expense. That said, we note that PFCU maintains strong capitalisation buffers to absorb potential performance volatility and it operates as a not-for profit credit union, with a mandate to service the needs of its members.

- In addition to limited loan growth, recent changes to PFCU's funding composition have also impacted its performance, in our view. In an unprecedented development, PFCU's deposits declined by 6.2%, while deposits on call declined by a cumulative 7.0% across FY24 and 3MFY25. While a reduction in term deposits primarily impacts funding stability, the reduction of lower cost call deposits within the funding mix has the potential to pressure profitability and net interest margins, going forward, in the absence of meaningful loan growth.

- Operating as an NBDT focused on its membership and their families, PFCU's competitive position is influenced by its limited franchise. If PFCU is unable to grow its active membership and provide services desired by members, its competitive position and capacity to operate sustainably will be impacted. That said, we note that PFCU recently launched its services to NZ Defence Force members and their families with total lending of ~$2.0m as of 15th Nov24, which presents an opportunity to increase its addressable market and grow its operations.

- The NBDT sector players including PFCU face significant macroeconomic headwinds in the short-term, despite the recent cuts in interest rates, due to the lagged effect on the economy and therefore pressures on asset quality will persist, in our view. PFCU's overall exposure to residential mortgages and market risks related to property prices has increased further at Sep24, stemming from lending to traditional mortgages as well as its new product offering – 'First Home Together'. As a result of this growth, asset quality is more exposed to the impact of adverse property price movements while the change in income mix may also lead to net interest margins trending lower than PFCU's historical averages.

The outlook for PFCU's credit rating is 'Stable' at Sep24.

A rating upgrade, while unlikely over the near term, would require a sustainable improvement in loan book size and core earnings profile, while sustaining overall balance sheet strength. However, the rating may migrate lower in the following instances on an individual or collective basis if there is:

a. a continued deterioration in core operating profitability and/or a contraction in the loan book,
b. a weakening of current balance sheet strength/asset quality metrics.

Risk Rating

BB

Outlook: Stable

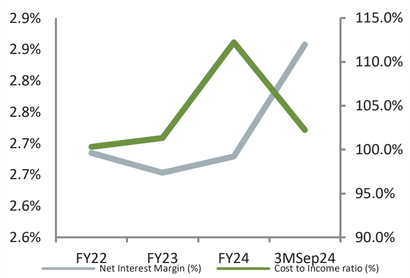
Type: Public, Monitored

Industry Percentiles

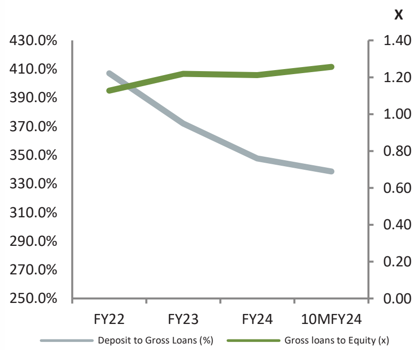
Scale:	Percentile
Total Assets	50%
Gross Loans	17%
Profitability:	
NIM	25%
ROE	25%
ROA	25%
Efficiency Ratio	83%
Capitalisation:	
Leverage (Gross loans to Equity)	83%
Capital Ratio	92%
Capital to Total Assets	92%
Funding and liquidity:	
Loan to deposit Ratio	0%
Liquid Assets to Total Assets	100%
Asset Quality:	
Net Charge-offs	58%
Impaired Loans	0%
Provision for Loan Losses	25%

Key Trends

Cost-to-income ratio and NIMs



Leverage and Funding ratio



2. Scope of Report

The purpose of this report is to provide a credit rating and associated rationale on Police and Families Credit Union Incorporated ("PFCU").

We have complied with our rating services guidelines in order to derive the credit rating on Police and Families Credit Union Incorporated. The credit ratings and observations contained herein are solely statements of opinion and not statements of fact or recommendations to purchase, hold, or sell any securities or make any other investment decisions. The details pertaining to this report are outlined below:

Report Details	
Date of Report	**10 December 2024**
Request Type	**Issuer**
Assessment Type	**Under Ongoing Monitoring**
Rating Initiation	**Issuer based (solicited)**
Rating Distribution	**Public Rating**
Report Distribution	**Unrestricted**
Purchased by	**Police and Families Credit Union Incorporated**
Report Fee	**Fixed Price**
Ancillary fees	**Nil**
Issuer Name	**Police and Families Credit Union Incorporated**
Issue Name	**Not Applicable**
Issuer First Time Rated	**No**
Issue First Time Rated	**Not Applicable**
Financial Scope	**Consolidated Entity**
Structure	**Credit Union**
Industry	**Financial Services**
Sector	**Non-Bank Deposit Takers**

This Report should be taken as a whole and cannot be abridged or excerpted for any reason.

We have conducted this assessment on the basis of the information provided to us by Police and Families Credit Union Incorporated, publicly available information and from our own enquiries. We have derived a credit rating on PFCU based on the understanding that it has no contingent liabilities, cross guarantees, or other liabilities to any other entity other than as disclosed to us or as detailed in the financial statements. Our duty does not include auditing the financial statements.

Information Sources	
Financial statements	**Management accounts for the three-month interim period to Sep24. Audited Financial statements for the years ended Jun24 (FY24), Jun23 (FY23) and Jun22 (FY22).**
Name of auditor	**BDO**
Other Information Sources	**PFCU's response to our requests for information, PFCU website, industry and regulatory websites, management interviews, media articles, adverse searches, and other internet searches.**
Subject participation	**Full**
Material financial adjustments	**None**
Limitations of assessment	**None noted**
Outsourced rating activities	**No**
Confidentiality agreement	**No**
Material client	**No**
Rating amended post issuer disclosure	**No**
Potential conflict of interest	**No**
Rating methodology	**Financial Institution Rating Criteria**

This report should be read within the context of Equifax's Ratings Services Guide.

3. General Background of the Subject

Subject Name	Police and Families Credit Union Incorporated
Type of Entity	Credit Union – licenced as an NBDT with the RBNZ, and registered as number 610 under Part III of the Friendly Societies and Credit Unions Act 1982
Head Office Address	Level 11, 57 Willis Street Wellington 6011 New Zealand
Date of Incorporation	12 Nov 2014
Principal Activities	PFCU provides secured and unsecured personal loans, residential mortgages, transactions and savings accounts, and term deposit services to its members. Members can use PFCU-issued Debit MasterCard to access their funds through ATMs and carry out transactions.
History	Police and Families Credit Union Incorporated is a Non-Bank Deposit Taking (NBDT) institution licensed with the Reserve Bank of New Zealand (RBNZ). PFCU is a not-for-profit credit union with membership open to current and retired police employees and their families. PFCU was established initially to meet the borrowing needs of police employees and their families and has since evolved into a provider of a comprehensive range of banking services to meet the needs of its members. Pursuant to legislative changes, PFCU amended its rules to become an incorporated entity, effective 1 Jan 2020.

4. Industry Risks

Systemic risks factors (GDP, unemployment, economic cycles interest rates etc), level of competition, market structure and the regulatory framework are key sources of industry risks that determine the operating environment of financial institutions (FIs). A summary[1] of the above risk factors and their outlook in the context of the New Zealand economy is included in paragraphs below.

Systemic Risk Factors

Economic activity in New Zealand is subdued, in part due to restrictive monetary policy.

The Monetary Policy Committee (MPC) noted that, since the August Monetary Policy Statement, the New Zealand economy has evolved largely as expected. The Committee agreed that excess capacity has dampened inflation expectations, and price and wage changes are now more consistent with a low-inflation environment. New Zealand's annual consumer price inflation is assessed to currently be within the Committee's 1 to 3 percent target band and is expected to converge to the target midpoint.

MPC noted that, Global economic growth remains below its long-run trend and is expected to remain so for the year ahead. Economic growth in the United States and China is expected to slow. The disinflationary process in advanced economies has led to further reductions in official policy interest rates.

MPC agreed that increasing excess capacity is leading to lower inflationary pressure in the New Zealand economy. Economic growth is weak, in part because of low productivity growth, but mostly due to weak consumer spending and business investment. High-frequency indicators point to continued subdued growth in the near term. Some exporting businesses have been supported by higher export prices, particularly in the dairy industry.

The Committee noted that while wholesale and bank interest rates have declined, financial conditions remain restrictive, and credit demand remains subdued. The current preference for shorter-term mortgage rates by borrowers will increase the speed with which changes in the OCR influence household cashflows over coming months.

MPC, in its meeting in Aug24, Oct24 and Nov24, has reduced the Official Cash Rate thrice by 0.25%, 0.50% and 0.50% respectively (from 5.50% to 4.25%). The Committee assesses that annual consumer price inflation is within its 1 to 3 percent inflation target range and converging on the 2 percent midpoint.

[1] RBNZ Financial Stability Report Nov 2024, RNBZ Monetary Policy Statement August 2024, RBNZ Monetary Policy Media Release Oct 2024, RBNZ Website and various of Publications of RBNZ.

Inflation is converging to target

The MPC agreed that monthly price indices signal a continued decline in consumer price inflation in New Zealand. Recent business visits suggest that weak demand is restricting the pass-through of increased input costs to prices faced by consumers. This is consistent with business surveys, which show a declining share of businesses intending to increase prices. Business price-setting behaviour is now more consistent with the Committee's inflation remit.

The Committee assesses headline consumer price inflation to be within its 1 to 3 percent target band in the September 2024 quarter and to remain around the midpoint in the medium-term.

	Consumers price index (CPI)	Consumers price index (CPI)	Consumers price index (CPI)
	(Index)	(q/q%)	(y/y%)
Unit	Index	%	%
Series Id	CPI.Q.C.ia	CPI.Q.C.iaq	CPI.Q.C.iay
Sep 2021	1106	2.2	4.9
Dec 2021	1122	1.4	5.9
Mar 2022	1142	1.8	6.9
Jun 2022	1161	1.7	7.3
Sep 2022	1186	2.2	7.2
Dec 2022	1203	1.4	7.2
Mar 2023	1218	1.2	6.7
Jun 2023	1231	1.1	6.0
Sep 2023	1253	1.8	5.6
Dec 2023	1259	0.5	4.7
Mar 2024	1267	0.6	4.0
Jun 2024	1272	0.4	3.3
Sep 2024	1280	0.6	2.2

Global and Domestic Risks

Members discussed how recent events in the Middle East could pose significant risks to both global economic activity and energy prices. Should conflict escalate, oil prices and shipping costs could rise, and adverse investor sentiment could trigger asset price corrections and tighter financial conditions. Members noted that the current market pricing of risk was especially sensitive to downside economic surprises.

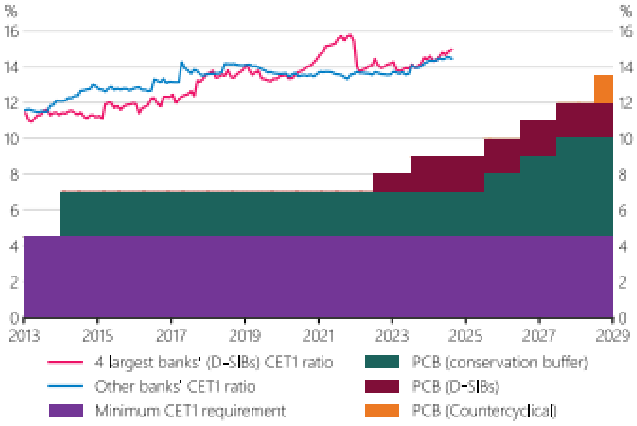
Members noted that while domestic price-setting behaviour is now more in line with its mandate, there are still risks that further adjustments might be faster or slower than currently expected.

New Zealand's banking system remains well positioned to handle economic or financial shocks

The New Zealand banking system remains well placed to handle external shocks and a downturn in the economy. Bank capital ratios remain well above regulatory requirements and banks are well progressed towards meeting the new requirements being gradually phased in through to 2028. Indicators of bank profitability have eased from recent elevated levels. Net interest margins have come off recent highs as depositors continue to transition from on-call accounts to term deposits in response to high interest rates. Broader measures of bank profitability are also declining as banks have made provisions for increased loan impairments.

Figure 4.1

Common Equity Tier 1 ratio for locally incorporated banks



Source: RBNZ *Capital Adequacy survey*, RBNZ estimates.

Figure 4.4

Bank profitability measures

Source: RBNZ *Income Statement survey*, registered banks' *Disclosure Statements*.

Cyclicality

Due to strong linkage between economic activity and interest rates financial institutions remain vulnerable to vagaries of economic cycles. During recessionary times interest rates drop and business sentiment remains weak, thus undermining the ability of financial institutions to raise deposits and make loans. Similarly, during periods of inflation, interest rates usually rise and purchasing power of households dwindles thereby exposing financial institutions to asset quality risks. NBDTs' strong reliance on retail deposits for funding, limited product range, geographically concentrated operations, and smaller scale makes them more susceptible to the adverse operating and financial impacts of cyclicality compared to systemically important banks and other tier-2 banks. As a result, a study of economic cycles and its phases is vital to accurately assess the exposure to various market risks

Asset Movement

House prices have increased from recent lows, but housing activity remains weak

Housing market activity remains weak overall as high interest rates have reduced borrowing capacity and investor demand. As a result, house sales have been subdued and days to sell remain elevated. Recent house price increases have been underpinned by rental growth, driven by population growth outstripping new supply. Strong net immigration has increased the demand for rental housing, while the supply of new housing is expected to slow once developers complete existing projects. Faced with elevated uncertainty, many house buyers are preferring to purchase existing properties rather than buy new builds off the plans. As a result, many developers are finding it difficult to achieve the levels of pre-sales required by banks to finance new projects.

Figure 6.4
House price growth
(annual)

Source: CoreLogic, RBNZ estimates.

Commercial real estate under pressure

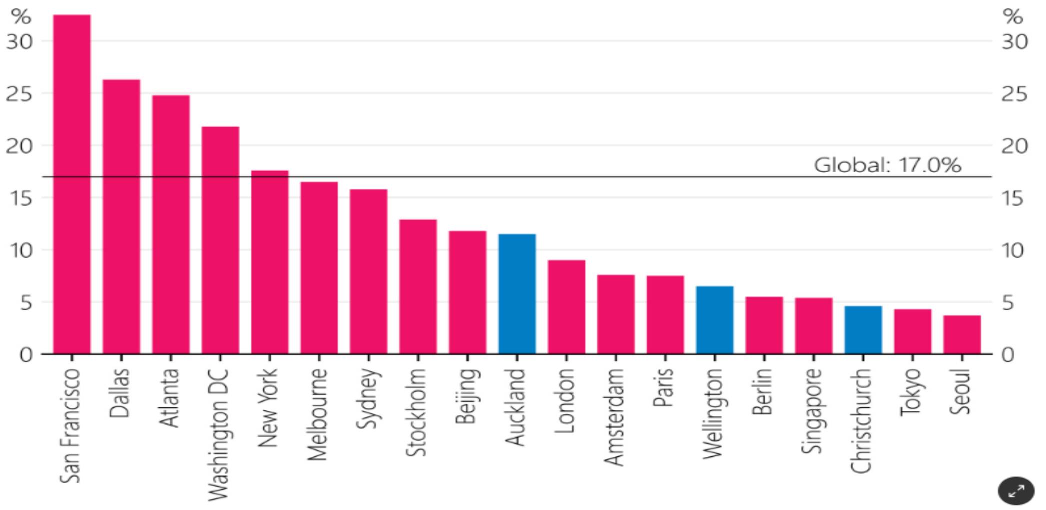
The New Zealand commercial property market is facing similar headwinds to those affecting other countries. The shift towards working from home during the pandemic has been less persistent, but online retailing has become relatively embedded. Property values have fallen from their peak over the past couple of years, primarily reflecting higher interest rates. Tenancy demand and rental growth has been divergent across subsectors:

- A flight to quality in the office sector has contributed to a rise in vacancies in lower quality office buildings and weaker rent growth, while prime office properties have performed well.
- The growth of online shopping and generally soft consumer spending are creating challenging market conditions for the retail sector, affecting rental growth.
- Industrial sector rents have been relatively strong as supply continues to be constrained by land availability, while demand has remained robust.

Figure 5

Office vacancy rates of selected cities

(as of April 2024)



Source: JLL

Foreign Currency Risks

The adverse movement in exchange rate poses direct and indirect risks to financial institutions depending on its balance sheet and contribution of foreign trade to overall economy. For economies highly reliant on foreign trade adverse changes in exchange rates can affect overall GDP levels and business profitability thus heightening the financial institutions vulnerability to asset quality risks. Further financial institutions may raise capital from or lend to foreign investors / borrowers and hence adverse movement in the exchange rates may impact the financial institutions borrowing costs / lending incomes.

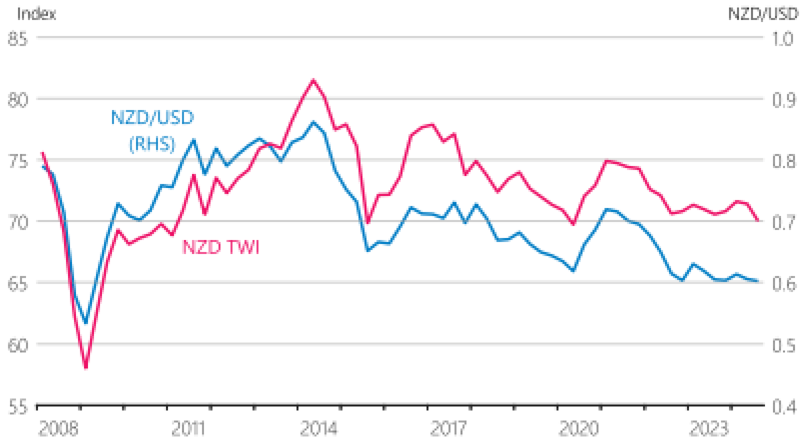
New Zealand Exchange Rate

Over the past year, the NZD exhibited fluctuation against the USD, influenced by both domestic and global factors. The primary drivers of these movements included changes in interest rate differential between the Reserves Bank of New Zealand and the Federal Reserves, shifts in commodity prices and market sentiments regarding global economic conditions. Notably, the RBNZ’s monetary policy adjustments, including rate cuts in Aug24 and Oct24, contributed to periods of relative NZD weakness. Additionally, the strength of the USD, driven by its safe haven status amidst global uncertainties, exerted downward pressure on the NZD. Overall. While the NZD faces challenges, its performance remained reflective of the broader macro-economic landscapes and market dynamics.

Figure 7.11

New Zealand dollar exchange rates

(quarterly average)



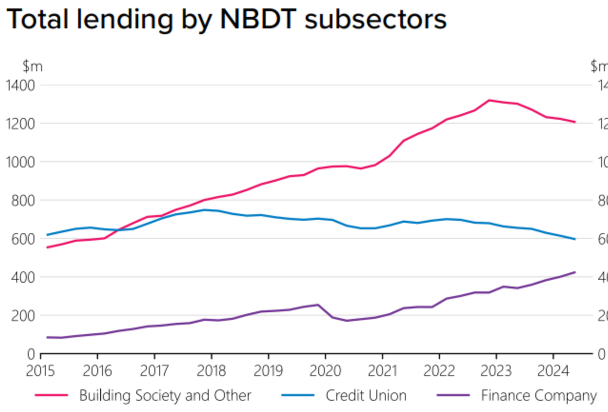
Source: NZFMA, RBNZ.

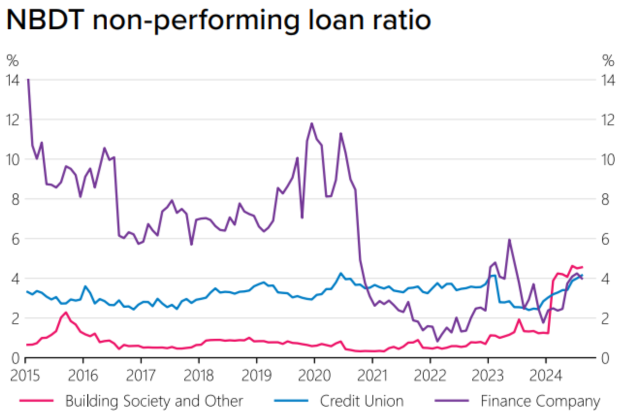
5. Market Overview

There are 14 NBDTs operating in New Zealand, which include building societies, credit unions, and deposit-taking finance companies. They have diverse business models, asset sizes, geographic concentrations and product mixes. Total lending by NBDTs is around $2.2 billion, the sector is very small relative to the banking sector in total lending but provides services to a relatively large number of customers. NBDT capital levels have been generally stable in the past year. Aggregate capital ratios are above their regulatory minimums. Asset quality has been stable, with non-performing loan ratios at their historical averages. However, borrowers may be increasingly challenged by the subdued economic outlook and higher debt servicing costs.

NBDTs are diverse in terms of asset size however the lack of economies of scale continues to weigh on profitability for many. This has been a long-standing challenge in parts of the sector with operating costs tend to be high relative to income, and the capacity to raise capital is limited. The business models of individual lenders tend not to be well diversified in terms of geographic exposure and products. These factors contribute to lower resilience in the NBDT sector compared to the banking sector. The sector has consolidated in recent years, particularly for credit unions and further consolidation and/or changes to the business model may happen. However, the NBDT sector remains diverse, with some building societies and finance companies better able to build resilience in the long term.

There has been a broad-based slowdown in new lending by NBDTs in the last 18 months, particularly from building societies and credit unions, driven by the high interest rate environment, subdued demand for credit and an uncertain economic outlook. Moreover, Non-performing loans have increased from their low point in 2022, reflecting the slowing economy





Source: *RBNZ Financial Stability Report- Nov24*

5.1 Prudential Framework

The Reserve Bank regulates non-bank deposit takers (NBDTs) in New Zealand for the purposes of promoting the maintenance of a sound and efficient financial system, and avoiding significant damage to the financial system that could result from the failure of an NBDT. NBDTs are entities that make an NBDT regulated offer (as defined in section 5 of the Non-bank Deposit Takers Act 2013) and carry on the business of borrowing and lending money, or providing financial services, or both. The prudential regulation of NBDTs is provided under the Non-bank Deposit Takers Act 2013 and associated regulations. Trustee companies also have obligations under the Act. These include ensuring certain prudential content is included in licensed NBDTs' trust deeds. Trustees must report to the Bank any non-compliance with the Act and regulations by the licensed NBDT. Trustees are licensed by the Financial Markets Authority under the Financial Markets Supervisors Act 2011. The table summarises certain key prudential requirements [1]for NBDTs currently in force.

Credit Rating	Licensed NBDTs are required to have a local currency (New Zealand dollar), long-term, issuer rating given by approved rating agencies.
Governance	Licensed NBDTs that are companies or building societies must have a chairperson who is not an employee of either the licensed NBDT or a related party and must have at least two independent directors. Licensed NBDTs that are subsidiaries of another person are prohibited from including provisions in their constitutions that would allow directors to act otherwise than in the best interests of the NBDT.
Risk Management	Licensed NBDTs are required to have a risk management programme that outlines how the licensed NBDT identifies and manages its credit, liquidity, market and operational risks. This programme is to be submitted to, and approved by, the licensed NBDT's trustee.
Capital Ratio	A minimum capital ratio (the level of capital in relation to the credit exposures and other risks of the NBDT or its borrowing group) is required to be included in licensed NBDTs' trust deeds. This ratio must be at least 8% for licensed NBDTs with a credit rating from an approved credit rating agency. For licensed NBDTs without a credit rating from an approved rating agency, the minimum capital ratio specified in the trust deed must be at least 10%.

[1] RBNZ

Related party exposure limits	The exposures to related party, as defined in the Act, shall not exceed a maximum limit of 15% of capital.
Liquidity	Liquidity regulations require every licensed NBDT and its trustee to ensure that the licensed NBDT's trust deed include one or more quantitative liquidity requirements that are appropriate to the characteristics of the licensed NBDT's business, and that take into account the liquidity of the licensed NBDT and the liquidity of any borrowing group.
Suitability assessment of certain directors and senior officers	Licensed NBDTs must notify the Reserve Bank when one of its directors or senior officers (or a person who is proposed to be appointed as a director or senior officer) raises a "suitability concern".
Change in ownership	An application must be made to the Reserve Bank to approve a transaction that will result in a person: 1. having the direct or indirect ability to appoint 25% or more of a licensed NBDT's governing body; or 2. having a qualifying interest in 20% or more of the voting securities issued by the licensed NBDT.

The Deposit Takers Act 2023

The Deposit Takers Bill ('DTA') will replace the existing prudential regulatory regime contained in the Banking (Prudential Supervision) Act 1989 and the Non-bank Deposit Takers Act 2013. The integration of these previously separate regimes will create a single, consistent framework for the regulation and supervision of financial institutions that essentially engage in the same activity – the business of taking 'deposits' from the public, and lending to individuals, households, and businesses.

It will take some years for the Reserve Bank to develop and consult on the secondary legislation that will implement the regulatory requirements for the new regime and complete a licensing process for deposit takers to operate under the regime. The parts of the current Reserve Bank Act relating to the regulation and supervision of registered banks and the Non-bank Deposit Takers Act 2013 will remain in force until the remaining parts of the DTA have been fully implemented.

Recent Developments

- The Depositor Compensation Scheme (DCS) will protect customers for up to $100k if their deposit taker fails. The DCS will be funded through levies (fees) on deposit takers and is expected to commence in mid-2025.
- In Mar24 Proportionality Framework for developing prudential standards was published. The framework is the first step in developing standards as it sets out how RBNZ will take a proportionate approach in developing the DTA standards. Under the framework, deposit takers will be allocated into four groups with 'Group Three' for locally incorporated deposit takers with total assets of less than $2.0bn

Source: *RBNZ Financial Stability Report*

6. Business Risks

6.1 Market Risk Exposures and Controls

Interest Rate Risk

PFCU controls and manages the impact of interest rate changes by minimising the duration mismatch between its assets (members' loans) and liabilities (members' deposits). The duration gap is measured monthly by the Asset and Liability Committee (ALCO) to identify any large exposures to interest rate movements and any such exposures are rectified through management of or change in interest rates on member deposit accounts and/or member loan accounts.

PFCU offers fixed rate terms only on its home loans and for a maximum period of two years. All other loan facilities are offered on variable interest rates. PFCU has historically had minimal exposure to residential mortgages. However, with the decline in the overall loan book and competitive pressures affecting the personal loan portfolio, residential mortgages accounted for 34.9% PFCU's total loans as at Sep24 (Jun24: 32.5%, Jun23: 24.7%, Jun22: 10.6%).

PFCU has an internal policy in place to maintain a majority of its total term deposits with NZ registered banks with a maturity shorter than 12 months. PFCU monitors this on a regular basis and as at Sep24, they were in-line with the internal policy requirements.

Repricing Analysis ($ - Jun24)	Total	Floating interest rate	Within 6 months	6 months to 1 year	1 to 5 years	Non-interest sensitive	Wghtd Avg effective Int rate
Financial Assets	**137,756**	**27,566**	**56,073**	**39,354**	**14,763**	**-**	
Cash & equivalents	**2,508**	2,508	-	-	-	-	4.00%
Bank term deposits	**101,125**	-	52,973	38,299	9,853	-	5.41%
Loans to members - Fixed	**9,065**	-	3,100	1,055	4,910	-	6.67%
Loans to members - Floating	**25,058**	25,058	-	-	-	-	9.67%
Financial liabilities	**119,318**	**66,502**	**34,640**	**15,615**	**2,247**	**314**	
Members' deposits	**119,004**	66,502	34,640	15,615	2,247	-	2.94%
Trade and other payables	**314**	-	-	-		314	0.00%

As at Jun24, PFCU modelled the sensitivity of its assets and liabilities to a 3.0% fluctuation in interest rates. Based on FY24 audited accounts, the impact on earnings from a 3.0% adverse movement in interest rates is estimated at ~$695k of FY24 profits. The same is a sizeable proportion of PFCU's earnings, however, its impact to the credit profile is partially mitigated by PFCU's strong capitalisation and funding profile.

Liquidity Risk

PFCU manages liquidity risk by investing in short-term liquid deposits with NZ registered banks. PFCU monitors its liquidity via a daily cash summary report that aims to highlight any breaches in liquidity policy. PFCU has an internal policy is place which details the necessary steps and contingency plans to be undertaken and implemented by the CFO and CEO should the liquidity ratio fall below an internally set target.

Moreover, PFCU's trust deed stipulates a minimum liquidity ratio of 10.0%. PFCU's calculation of liquidity ratio as per its trust deed is more conservative than the industry standard. PFCU only includes deposits maturing within 183 days in its computation of internal liquidity. Overall liquidity was computed at 69.8% as at Sep24 (Jun24: 70.1%, Jun23: 71.8 and Jun22: 71.6%), and in Equifax's view, it is deemed to be conservative, relative to peers.

Liquidity Management Policies also require that the mix of deposits be controlled for reasons of deposit base stability and minimising average cost of funds. PFCU requires that the amount of deposit by any individual member shall not exceed $250,000 individually or $500,000 jointly across all share accounts to mitigate the concentration risk associated with deposits. Management monitors this on a regular basis and takes suitable action, if required.

6.2 Credit Risk Exposures and Controls

Credit risk is the risk that the counterparty will be unable to meet obligations to PFCU under the terms of any loan or advance (with members), or terms deposits (with banks). PFCU is exposed to credit risk on both term deposits held with NZ registered banks, and loans granted to members in the form of mortgages or personal or other loans. Measures and controls have been adopted by PFCU to minimize risk of loss due to concentration to any individual counterparty.

Term deposits with banks –The policies require that PFCU does not maintain more than 50% of its total investment funds being held with any individual counterparty (NZ registered banks).

Loans to members – Loans are made in accordance with PFCU's lending policy. Key features of this policy are:

- Fixed rate offerings are only for mortgages and up to two years, and all remaining offerings are on variable rates.
- PFCU has set a maximum limit on the amount of loan and the maximum tenure for the loan offered is 30 years.
- The loan amounts are secured by a charge on PSS/GSF. Deposit ranges and tenures depend upon the security cover provided.
- PFCU has set limits for the maximum tenure and loan amount to purchase a motor vehicle or for any other approved purpose using motor vehicle as security. PFCU also has a minimum-security cover target.

- PFCU has set limits for the maximum tenure and loan amount for unsecured loans.

- PFCU has a very low proportion (less than 0.1% of total loan book as at Sep24) of unsecured loans. Exposure to loans secured by residential mortgages increased to 34.9% as at Sep24 (Jun24: 32.5%, Jun23: 24.7% and Jun22: 10.6%) driven by an increase in lending under this segment, including those in relation to its new product offerings. A large proportion (~65.0%) of PFCU's loan portfolio remains secured by a charge over retirement funds in PSS and GSF for current and former NZ police employees and their family members. PFCU's credit risk for loans secured by PSS and GSF is low.

- PFCU's loan book has relatively low concentration risk as the loans are spread across a large number of borrowers, however, with an increased lending towards mortgages the aggregate outstanding amounts over six largest borrowers has shown a modest increase, representing 11.8% of gross loans at Jun24 (Jun23: 11.6%).

- Credit risk on the PFCU portfolio is also mitigated by limited concentration to any particular geographic area. Residential mortgages are spread across main cities such as Auckland, Christchurch, Wellington as well as regional towns and areas.

6.3 Structure and Service Delivery Platform

Structure

In Apr17, the Friendly Societies and Credit Unions (Regulatory Improvements) Amendment Bill was introduced to amend the Friendly Societies and Credit Unions Act 1982. This Bill was intended to;

- remove unnecessary operating and compliance costs,
- promote greater efficiency, innovation, and accountability,
- bring credit unions into alignment with other financial service providers in New Zealand, and
- maintain the element of mutuality and the requirement of a common bond between members.

This bill received the Royal Assent on 4 Jul 2018 and the Friendly Societies and Credit Unions (Regulatory Improvements) Amendment Act 2018 was passed with a commencement date of 1 Apr 2019.

Some of the most important changes as a result of the Friendly Societies and Credit Unions (Regulatory Improvements) Amendment Act 2018 are as follows;

- No person, society, or body of persons (whether incorporated or unincorporated) may trade or carry on business as a credit union unless it is registered. Existing credit unions were given 6 months from the commencement date (1 Apr 2019) to apply for incorporation. This eliminated the need for trustees with credit unions becoming entities in their own right.

- Credit unions can extend loans to Small and Medium-sized Enterprises (SME) related to a member (provided the member has the power, directly or indirectly, to exercise, or to control the exercise of, the rights to vote attaching to 25% or more of the voting products) so long as the related SMEs have no more than 19 full-time equivalent employees. The loan is to be used for the purposes of a business being carried on by that SME.
- The minimum number of members of an association of credit unions is reduced from seven to two.

In order to ensure compliance with the new provisions, PFCU held a special general meeting and amended its rules in Jun19. Pursuant to its application for incorporation under the new provisions within the relevant deadline, PFCU's incorporation by the Registrar of Credit Unions was effective from 1 Jan 2020.

PFCU has ownership of itself rather than trustees owning it on behalf of the members. In spite of the above changes, PFCU's structure is considered simple, and the lack of structural complexity improves transparency and reduces operating risks.

PFCU does not carry any external debt and hence, there is minimal risk of structural subordination or double leverage to increase the asset portfolio. PFCU's ability to raise wholesale funding is adversely affected by limitations imposed by its trust deed. PFCU is prohibited by its trust deed from creating security interest over any of its assets. The risk from this limitation is considered quite low in our view, given PFCU has a very strong funding profile with an industry leading deposit to gross loan ratio of 338% as at Sep24. Moreover, PFCU being a not-for-profit entity does not have any return on capital objective and reinvests 100% of its surplus earnings into the business, which further reduces the risk from its inability to access wholesale funding.

Service Delivery Platform

The business offers three main classes of product in the form of accepting deposits from members, granting personal loans (secured and unsecured) including motor vehicle loans, and residential mortgages (comprising traditional residential mortgages, shared home ownership mortgages and reverse mortgages). PFCU's customer segment consisting of NZ Police employees (current and retired), their family members and recently started expansion of its loan portfolio into New Zealand Defence Forces.

PFCU's members can join PFCU through completion of a web-based form on its website. The website also provides internet banking services for the members to keep track of and manage their funds. Additionally, PFCU provides its members with access to their accounts through a mobile application and personal banking services. PFCU also enables its members to apply for loans using its website and the mobile application. To improve customer experience and shorten the application processing time, PFCU has recently implemented an electronic identification and verification system. Further, PFCU has implemented a system to perform automatic review of members bank statements. PFCU solely uses Westpac for settling transactions of its issued Debit MasterCards which in our view, enables PFCU to better manage operational risks.

6.4 Strategic Vision

PFCU's main strategic objective is to service the financial needs of its members better through competitive pricing and financial health offerings.

PFCU assists its members to save and invest funds with PFCU, which are, in turn, used to make loans to other members in need of borrowing products. PFCU's purpose is not to maximise profitability but to provide value to members while ensuring long-term profitability and solvency of the business.

6.5 Execution of Strategy

PFCU operates and looks to achieve its strategic goals through the implementation of a fairly simple and conservative business model. PFCU aims to provide competitive, above market average deposit and below market borrowing rates to its members, and to minimise the interest rate reset gap between its assets and liabilities. With a stagnant loan book, PFCU's management has recently engaged a new marketing platform and launched new product offerings over the last few months –

- Retire Easy (Reverse Mortgage): A loan for members aged 70+ to free up the cash in their home to help make retirement more comfortable; typically called a "reverse" or "reverse equity" mortgage.

- First Home TOGETHER (shared ownership): A home loan package where PFCU provides a deposit help of up to 10% of the price of the home (interest free for up to 10 years) and the borrower shares ownership of their first home with PFCU.

- PFCU's strategy is to grow its penetration into families of Police with widened criteria for family that qualifies for membership, grow its penetration into civilian and non-civilian Defence Force personnel and their families, and to expand in 2025/2026 to St Johns Ambulance and Wellington Free Ambulance (staff and volunteers).

Substantial benefits from the above new products are yet to materialise and are expected to evolve over the next 6-12 months. That said, we note that the change in lending mix (with increasing loans to residential mortgages versus its traditional PSS secured personal loans) exposes PFCU's asset quality metrics to adverse trends in property prices.

6.6 Management

Name	Position
Lane Todd	Chair

Ian Harris	Vice Chair
Gail Gibson	Director
Natasha Rodley	Director
Helen Hatchard	Director
Stuart Taylforth	Director
Bronwyne Rozier	Manager Operations/ Blue Trust
Amy Linwood	Manager Market and Products
Mike Davy	Chief Executive Officer
Lucy Haberfield	Chief Financial Officer

PFCU's Board currently comprises six members – a Chair, a Vice Chair and four directors.

6.7 Governance and Oversight

<u>Internal</u>

PFCU's internal Credit Risk Policy governs the approval parameters for the loans to members. PFCU's exposure to mortgage lending has increased over the recent periods and offers fixed rates for a maximum term of two years on mortgages. PFCU does not offer fixed rate terms on any of the other loan products.

PFCU's board and all employees are responsible for risk management activities, which include –

- The Board reviews upcoming legislative changes through updates from their external lawyers and other material and discuss any impact at Board meetings.
- A checklist of all existing regulatory filing requirements is completed monthly. This is reviewed as part of the Internal Controls program.
- Compliance with AML/CFT policies and procedures is assessed monthly as part of the internal controls program.

In order to manage risk on an ongoing basis and have built-in checks, PFCU has three lines of defence:

- First Line, Business Operations – Risk and control policies in the business lending criteria.
- Second Line, Oversight functions – Internal Controls Programme that monitors lending portfolio on a periodic basis through pricing committee and ALCO.
    - PFCU's pricing committee meets weekly and analyses PFCU's prices for fixed / floating home loans and personal loans, and deposit rates. The rates are compared with the big five banks and other banks like RaboDirect and the Cooperative Bank. Changes to the rates are recommended to maintain competitiveness and relative attractiveness to the members.

    - ALCO meets monthly and reviews the funding and liquidity positions with respect to concentration risk to any individual counterparty for term deposits, and member loans and deposits, and liquidity risk in form of proportion of deposits with maturity over 12 months. The committee also assesses the capital ratio, liquidity ratio, retention ratio for matured member deposits, one-month mismatch ratio and one-year funding ratio, against the internal management targets or trust deed mandated levels. In case of a breach or possible risk of significant deviation, measures are suggested to bring the ratio within levels of comfort.

- Third Line, Independent assurance – KPMG as the Internal Auditor and BDO as the External Auditor act as independent assurance providers for the internal control processes and highlighting any significant or material weaknesses.

In our view, PFCU's risk management system prima facies appear to be in line with widely accepted risks management practises and is deemed to be adequate in our view in absence of any information to suggest otherwise.

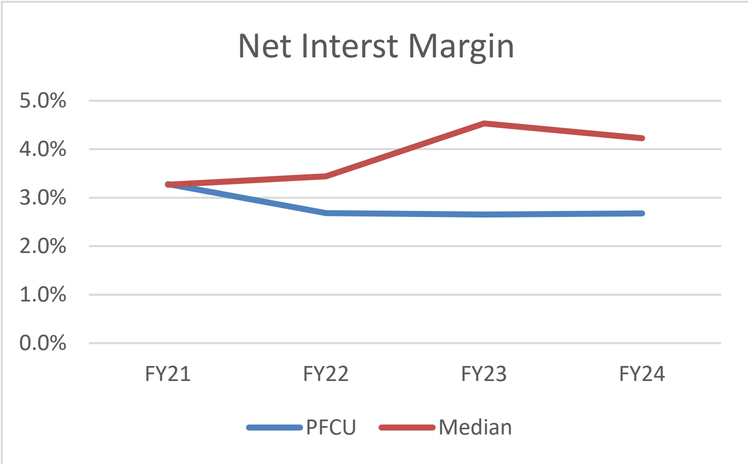
<u>External</u>

BDO, as PFCU's external auditor, acts as an independent assurance provider for the internal control processes and is responsible to highlight any significant or material weaknesses. BDO's latest audit report for FY24 revealed no significant or material weakness.

7. Financial Indicators

7.1 Profitability

Net interest Margin



Source: Reported financial statements of Peer Group from FY21 – FY24.

**Median figure for FY24 is based on entities for which financial statements were available at Nov24.*

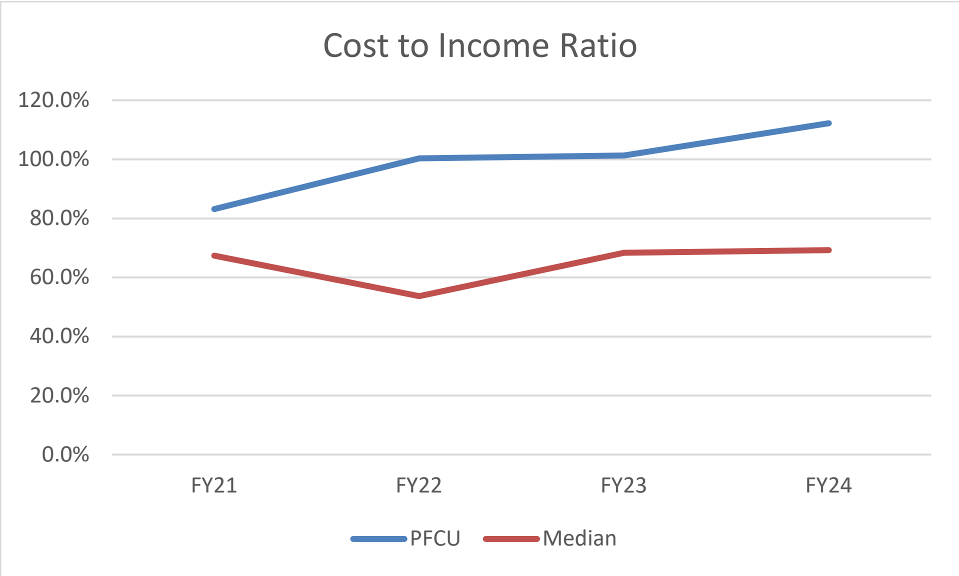
Most credit unions and NBDTs are largely dependent on retail deposits for funding, and hence, the NIM differences amongst peers is largely a function of variations in asset mix, and differing proportions of unsecured loans, secured personal loans, residential mortgages, and term deposits with banks. Some credit unions have a higher-than-average NIM due to a greater exposure to higher risk personal loans which are advanced at a higher interest rate than traditional mortgages.

Loans to members (by PFCU) are extended in the form of personal loans secured by a charge on PSS/GSF, motor vehicle loans, unsecured loans, and residential mortgages. PFCU historically did not write many property loans, however, its exposure to residential mortgages has increased more recently and the proportion of personal loan as a percentage of total loan book has reduced to 65.1% at Sep24 (Jun24: 67.5%).

PFCU's NIMs have trended downward in FY20 and FY21, due to loan book contraction and is worse than peers as noted in the graph above. However, we note that PFCU's NIMs stabilised post FY21 with 2.9% at 3MSep24 (FY24: 2.7% and FY23: 2.7% and FY22: 2.7%). Growth in PFCU's interest cost during 3MSep24 and FY24 was not fully offset by the growth in interest income potentially due to timing of repricing on its term deposits held with NZ registered banks. Further, management advised of a neutral impact of the steep cut in official cash rate by RBNZ, as significant portion of the loan portfolio is on floating interest rate.

Excluding the share of profits from Finzsoft, PFCU reported an underlying loss of -$482k in FY24 (FY23: -$61k, FY22: -$15k), indicative of increased competitive pressures, relatively stable loan book in 3mSep24 and FY24 and lagged repricing on its term deposits.

Operating Efficiency



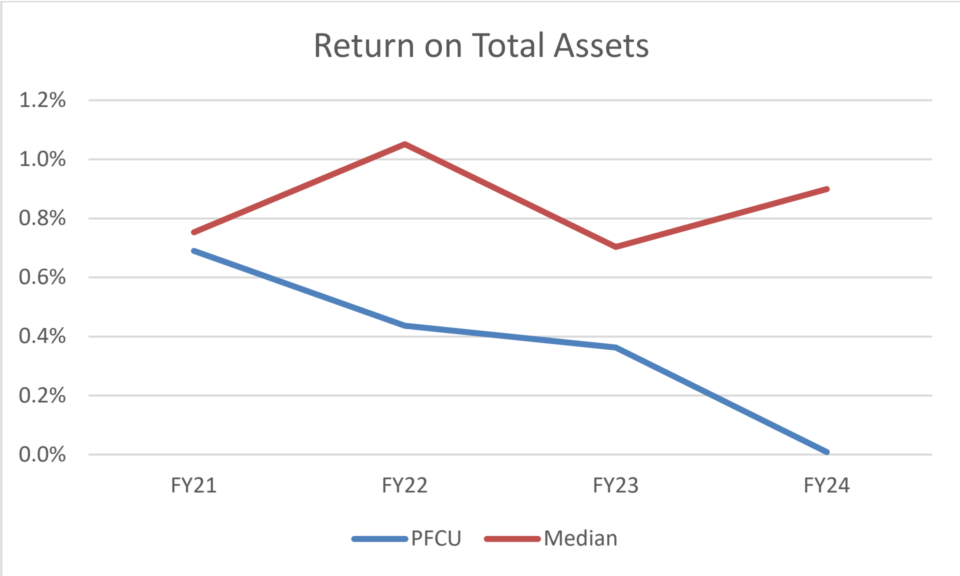
Source: Reported financial statements of Peer Group from FY21 – FY24.

**Median figure for FY24 is based on entities for which financial statements were available at Nov24.*

PFCU's cost to income ratio has steadily deteriorated (since FY15) and has remained worse than its peers over the last four years. A 10.0% increase in operating costs in FY24 combined with relatively stable operating income underpinned further deterioration in PFCU's cost to income ratio to 112.2% in FY24 (FY22: 100.3%, FY21: 83.1%, FY20: 81.9%).

The continued deterioration in PFCU's cost-to-income ratio mirrors the contraction of its net income with efficiency expected to remain under pressure until it can further reduce operating costs and/or improve its earnings profile, going forward.

Return on Total Assets (ROA)



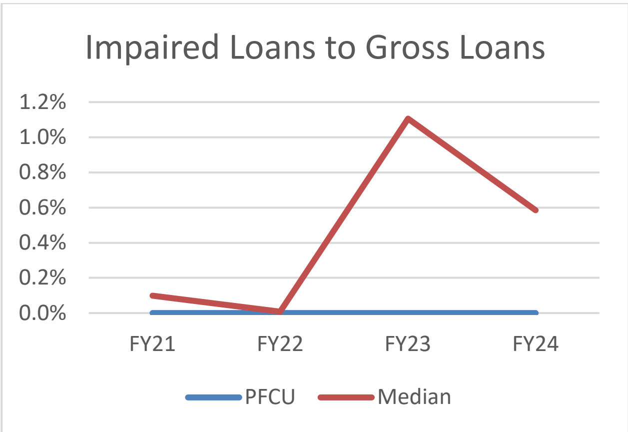
Source: Reported financial statements of Peer Group from FY21 – FY24.

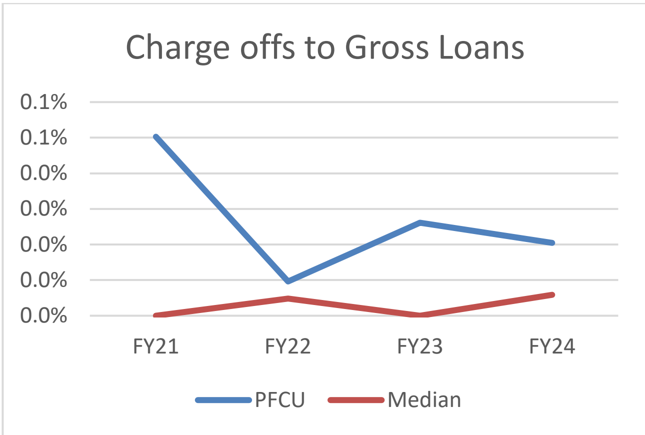
**Median figure for FY24 is based on entities for which financial statements were available at Nov24.*

PFCU's return on total assets continued to deteriorate in recent periods (FY24: <0.1%, FY23: 0.4%, FY22: 0.4%) and have diverged further away from sector median primarily due to the subdued earnings profile.

7.2 Asset Quality

Impaired Loans



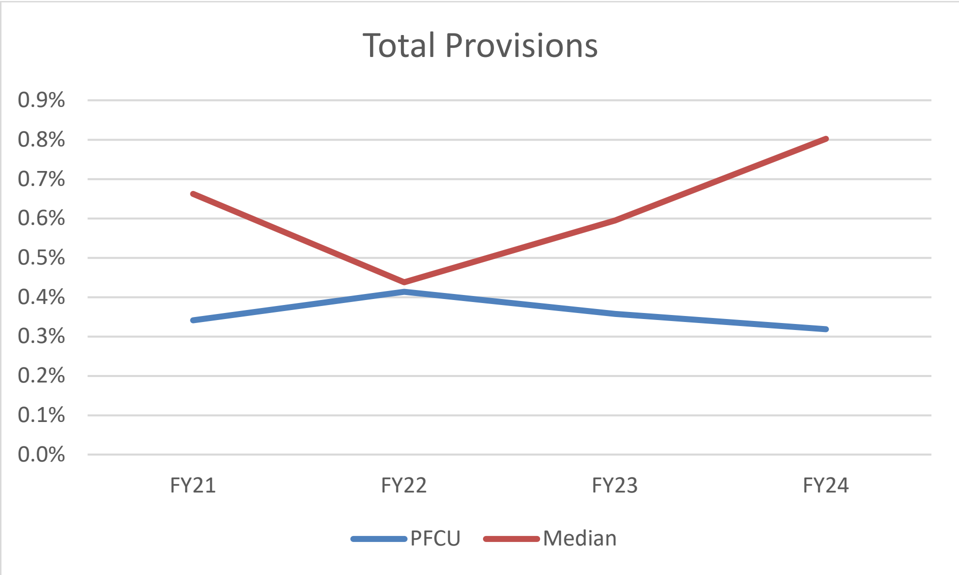


Source: Reported financial statements of Peer Group from FY20 – FY23.

**Median figure for FY23 is based on entities for which financial statements were available at Nov23.*

Despite its significant exposure to personal lending products, PFCU's portfolio currently exhibits low delinquency levels which in our view, reflects the quality of its borrowers and the security position over retirement accounts and access to NZ Police payroll . We note that PFCU's exposure to residential mortgages has increased recently to be 34.9% of its loan book at Sep24 (Jun24: 32.5%. Jun23: 24.7%, Jun22: 10.6%, Jun21: 9.5%) in line with its focus on loan book growth.

Provisioning

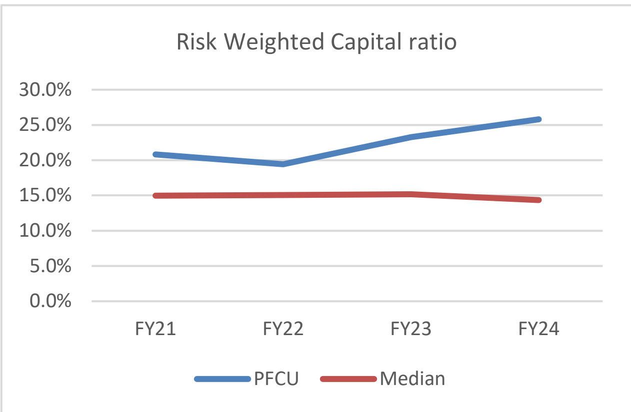


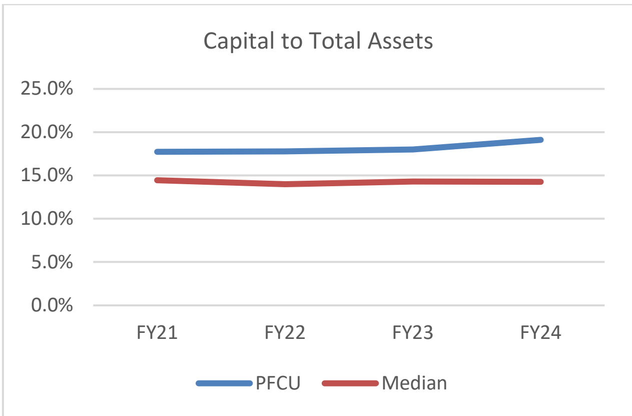
Source: Reported financial statements of Peer Group from FY21 – FY24.
**Median figure for FY24 is based on entities for which financial statements were available at Nov24.*

PFCU's loan provisioning (specific and collective provisions) remained stable at 0.3% of gross loans at Jun24 (Jun23:0.4%, Jun22: 0.4%, Jun21: 0.3%, Jun20: 0.3%). The total provisions remained largely stable at $109k at Jun24 (Jun23: $123k).

While growing exposure to mortgage lending increases market risks, in our view, PFCU's borrowers primarily comprise government employees who provide an essential public service. PFCU's borrowers' stability of employment, and hence capacity to repay, is not materially linked to macro-economic volatility.

7.3. Capitalisation





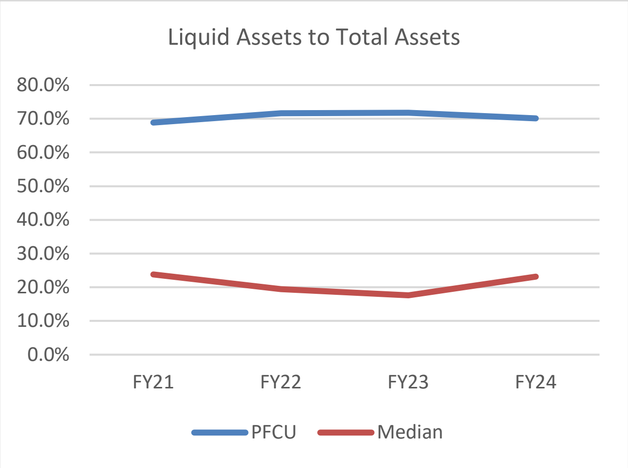
Source: Reported financial statements of Peer Group from FY21 – FY24.

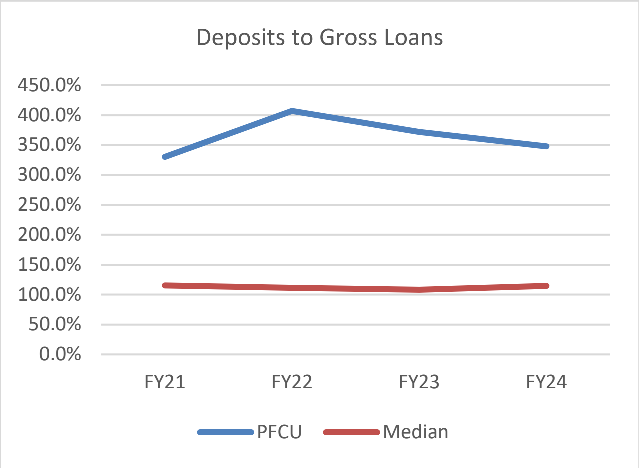
**Median figure for FY24 is based on entities for which financial statements were available at Nov24.*

PFCU's Capital ratio (Tier 1 capital to risk weighted assets ratio) is better than benchmark average as a result of its conservative financing (as its trust deed disallows raising of debt) and business strategy. The regulatory capital requirement for PFCU under the RBNZ guidelines is 8% (relates to credit unions that are rated by an RBNZ licenced credit rating agency). PFCU's Tier 1 capital requirement under its trust deed is 10%.

PFCU's tier 1 capital to risk weighted assets ratio improved at Jun24, with the ratio being reported at 25.8% (Jun23: 23.3%, Jun22: 19.4%, Jun21: 20.8%, Jun20: 23.3%). PFCU continues to maintain ample headroom above the regulatory/trust deed requirements, enabling it to adapt, in case regulatory changes require it to hold higher capital.

7.4. Funding and Liquidity





Source: Reported financial statements of Peer Group from FY21 – FY24.

**Median figure for FY24 is based on entities for which financial statements were available at Nov24.*

PFCU lacks access to wholesale funding. Member deposits, at call and fixed term, constitute more than 80% of the total funding for PFCU, the balance comprises retained earnings. A potential funding risk, posed by PFCU's constitutional prohibition on the use of wholesale funds, is mitigated by its above industry-average deposit to loan ratio.

Deposits in excess of loans are invested in highly liquid term deposits with major NZ registered banks, which provides a substantial liquidity buffer. PFCU's liquidity ratio, when calculated as cash equivalents and short-term deposits as a percentage of total assets, was 70.1% as at Jun24 (Jun23: 71.8% and Jun22: 71.6%), which Equifax deems to be extremely conservative.

PFCU was assessed as having sufficient headroom to trust deed requirements with respect to liquidity, which supports PFCU's capacity to withstand a funding shock. Moreover, PFCU's members' deposits have a consistently healthy reinvestment rate. As of Sep24, the average monthly reinvestment rate and the annual reinvestment rate were sound at ~94% and ~87% respectively.

8. Financial Benchmarks

Description	Percentile	Police and Families Credit Union	Sector Median*
Financial Period		FY24	FY24
Scale:			
Operating income ($ 000s)	42%	3,885	4,645
Total Assets ($ 000s)	50%	147,777	147,777
Gross loans ($ 000s)	17%	34,231	89,434
Profitability:			
Net Interest Margin (%)	25%	2.7%	4.2%
Non Interest Income to total income (%)	17%	1.8%	13.7%
ROE (%)	25%	0.0%	7.3%
Return on total assets (%)	25%	0.0%	0.9%
Cost to Income (%)	83%	112.2%	69.2%
Capitalisation:			
Leverage (Gross loans to Equity) (x)	83%	8.1	6.1
Capital ratio - risk adjusted (%)	92%	25.8%	14.4%
Capital to total assets ratio (%)	92%	19.1%	14.9%
Funding and liquidity:			
Gross loans as a % of total assets (%)	0%	23.2%	73.2%
Gross loans to deposit (%)	0%	28.8%	87.3%
Liquid assets to total assets (%)	92%	31.7%	23.2%
Asset Quality:			
Write-offs to gross loans (%)	58%	0.0%	0.0%
Impaired loans to gross loans (%)	0%	0.0%	0.6%
Total provision to gross loans (%)	25%	0.3%	0.8%

* Sector Median calculated on the basis of publicly available financial information (financial year 2024 or interim FY24 available) of 13 NBDTs in the sector.

9. Summary Financial Data

Police and Families Credit Union Incorporated						
$'000s	**Trend**	**FY21**	**FY22**	**FY23**	**FY24**	**3MFY25**
Income Statement						
Net Interest Income		4,642	3,828	3,840	3,816	1,010
Non Interest Income		152	75	72	69	16
Operating Income		4,794	3,903	3,912	3,885	1,026
Operating Expense		3,986	3,915	3,964	4,360	1,049
Pre Provision Operating Profit		1,041	675	575	20	-23
Credit Impairment Charge / (Reversal)		19	3	9	7	-
Operating Profit Before Tax		1,022	672	566	13	-23
Other non Operating Income / (Expense)		-	-	-	-	-
Net Profit		1,022	672	566	13	-23
Financial Position						
Total Assets		152,232	155,486	156,775	147,777	148,717
Customer Deposits		124,812	126,976	128,026	119,004	120,060
Gross Loans		37,793	31,195	34,404	34,231	35,460
Liquid Assets		104,846	111,331	112,549	103,633	103,857
Ratios						
Profit Before Tax to Operating Income Margin (%)		21.3%	17.2%	14.5%	0.3%	-2.2%
Net Interest Margin (%)		3.3%	2.7%	2.7%	2.7%	2.9%
Cost to Income (%)		83.1%	100.3%	101.3%	112.2%	102.2%
Return on Total Assets (%)		0.7%	0.4%	0.4%	0.0%	-0.1%
Return on Equity (%)		3.9%	2.5%	2.0%	0.0%	-0.3%
Capital Ratio - Risk weighted (%)		20.8%	19.4%	23.3%	25.8%	25.2%
Capital to Total Asset Ratio (%)		17.7%	17.8%	18.0%	19.1%	19.0%
Leverage Ratio - (Gross Loans / Equity) (x)		1.4	1.1	1.2	1.2	1.3
Charges-offs to Gross Loans (%)		0.1%	0.0%	0.0%	0.0%	0.0%
Neither Impaired or Past Due to Gross Loans (%)		2.1%	1.3%	0.5%	0.4%	0.0%
Non-Performing Loans to Gross Loans (%)		0.0%	0.0%	0.0%	0.0%	0.0%
Loan Loss Provision to Gross Loans (%)		0.3%	0.4%	0.4%	0.3%	0.3%
Deposits to Gross Loans (%)		330.3%	407.0%	372.1%	347.6%	338.6%
Liquid Assets to Total Assets (%)		68.9%	71.6%	71.8%	70.1%	69.8%

APPENDICES

1. Explanation of the Equifax's credit rating

1.1 What is a rating?

Credit ratings provide an Agency's opinion as to the capacity, viability and willingness of an entity, issuer, or counterparty to meet their respective financial commitments. As such, Equifax assigns ratings based on the credit worthiness of an entity, commitment, or product, and provides probabilistic assessments of default over the short, medium, and long-term.

Credit ratings are a critical measure used extensively in commercial, financial, and capital markets to support key business decisions. Equifax's credit ratings are used to support debt and bonding decisions, loan origination and recovery, insurance and warranty, funds management, portfolio management, tendering and procurement, counterparty risk assessments and other commercial contracts.

Equifax provides credit ratings on government and commercial agencies, international conglomerates, infrastructure consortia, financial institutions, publicly listed entities, private corporations, and small-to-medium sized enterprises across a range of industry sectors both domestically and internationally. As such, Equifax is also able to provide detailed industry intelligence, benchmarking reports and analysis across a wide range of sectors.

1.2 Equifax's credit rating

Equifax and other credit rating agencies all attempt to measure the probability of an entity being able to honour its financial commitments as and when they fall due. The most recognised credit rating is that based on Bond Rating Equivalents (BRE) used over the past eighty years to determine the proximity of an entity's securities to default (non-payment of interest or principal). The accuracy of this method has been extensively tested and is accepted worldwide.

The Equifax's database contains more than 100,000 financial years of information spanning more than twenty-five years. As such Equifax is in a unique position, having developed a large and empirical data source on entities across various industry sectors with long data histories covering a range of economic conditions and one or more complete business cycles. Equifax has therefore been able to use a variety of quantitative validation tools and comparisons using this information to adequately verify the stability, accuracy, and consistency of its rating models.

Equifax's rating models have been designed to assess the proximity of an entity to defaulting on its financial commitments and obligations. Proprietary risk analytics are used to evaluate the multivariate interrelationship of key risk indicators using scientifically based and empirically derived risk metrics. These models evaluate the financial performance, position, and profile of an entity in the context of its industry, size, and structure. They have been validated on Australian and international data with the assistance of Professor Edward Altman, an internationally recognised leader in the field of credit risk analysis and bankruptcy prediction.

Equifax uses its comprehensive benchmarking database to evaluate the financial position, performance and credit quality of an agency, institution, corporation, or entity relative to an industry and its peers. This enables the identification of key sensitivities, trends, cautionary alerts, and exception reports based on identified anomalies and/or outliers across key credit indicators of a select benchmarking group.

While there is no single method to discriminate unambiguously between firms that will default and those that will not, Equifax can make probabilistic assessments of default. This requires a large database of actual defaults to enable an assessment of default probabilities and actual default rates from empirical evidence. The Australasian market has a comparatively small number of corporate bond issues and a relatively benign credit climate over recent decades, and as such empirical data on Australian default rates is limited. Therefore, Equifax considers it is more appropriate to apply default probabilities using empirical data from international markets over several economic cycles.

Equifax's default statistics have been derived from nearly twenty years' experience analysing mainly US non-financial, non-utility corporate bond issuers. The analysis covered a relatively large number of companies (approximately 1,000 rated each year) and follows the well-established static pool approach used by Credit Rating Agencies to report their default experience. Static pools were created for bond issuers each year by both notch and grade, and the history of these bond issuers was then analysed over the period. The pools were then combined so that long-term average default experience by duration could be calculated, and both annual and cumulative default experience was calculated from the pools.

Equifax's risk analytics enable analysts to evaluate the most critical and sensitive financial and risk items through the Risk Assessment Platform by analysing key indicators to derive a definitive credit risk score and Bond Rating Equivalent (BRE), providing Probabilities of Default (PoD) over the short-, medium- and long-term horizon.

1.3 Rating Definitions

Credit ratings provide an Agency's opinion as to the capacity, viability, and willingness of an entity to meet their respective financial and contractual commitments. As such credit ratings are assigned in accordance with the entity, commitment, or product's proximity to default. Equifax adheres to internationally recognised grades and are similar to other agency classifications, providing ratings across twenty-two credit notches from 'D' (in default) to 'AAA' (extremely strong).

Moody's	Fitch	S&P	Rating	Default rates (5 years)	Classification	Risk Level
Aaa	AAA	AAA	AAA	0.17	High Grade	Negligible
Aa1	AA+	AA+	AA+	0.31		
Aa2	AA	AA	AA	0.44		
Aa3	AA-	AA-	AA-	0.55		
A1	A+	A+	A+	0.76	Investment Grade	Very Low
A2	A	A	A	0.81		
A3	A-	A-	A-	1.47		
Baa1	BBB+	BBB+	BBB+	2.08		Low
Baa2	BBB	BBB	BBB	3.19		
Baa3	BBB-	BBB-	BBB-	4.37		
Ba1	BB+	BB+	BB+	7.13	Near Prime	Low to Moderate
Ba2	BB	BB	BB	7.49		
Ba3	BB-	BB-	BB-	10.52		
B1	B+	B+	B+	16.34	Sub Prime	Moderate
B2	B	B	B	22.21		
B3	B-	B-	B-	24.16		High
Caa1	CCC	CCC+	CCC+	28.16	Credit Watch	Very High
Caa2		CCC	CCC	29.90		
Caa3		CCC-	CCC-	39.16		
Ca		CC	CC	52.87	Distressed	Extremely High
		C	C	55.00		
C	D	D	D	100.00		

Equifax assigns ratings based on the credit worthiness of an entity or a specific financial commitment, and provides probabilistic assessments of default over the short, medium, and long-term. Every entity or commitment has some probability of default over a period of time, even those assigned with the strongest of ratings. An Investment Grade classification is attributed to credits that exhibit a lower probability of default, while a Sub-Prime classification has a greater expectancy of default.

An Equifax's credit rating may also be assigned additional clarification markers (symbols) to qualify the credit risk assessment. These may include:

Conditional Rating (#)
A Conditional Rating is used where Equifax has rated an entity on the basis of significant risk factors and/or report qualifications, with recommendations providing one or more conditions precedent and/or mitigation action(s) to reduce identified uncertainty and risk.

Provisional Rating (*)
A Provisional Rating is used when the most recent financial figures are based on draft management accounts or are deemed out-of-date. Entities with a provisional rating should be re-evaluated as soon as finalised financial statements become available.

Indicative Rating (^)
An Indicative Rating is used where Equifax is engaged to conduct preliminary analysis only, and as such an official rating assignment would require a more detailed and comprehensive investigation and due diligence assessment prior to the provision of our professional opinion.

1.4 Rating Outlooks

Equifax's forward estimates help ascertain the trajectory of ratings as well as the risks to ratings. Ratings with a positive trajectory are assigned 'Positive Outlooks'. Ratings with a negative trajectory are assigned 'Negative Outlooks'. Where Ratings are expected to remain unchanged, a 'Stable Outlook' assigned.

Rating trajectories are closely related to the outlook for the corporate's earnings. Earnings growth that is within sustainable growth parameters together with an attenuation of earnings volatility provide upward rating pressure and so may warrant the assignment of a Positive Outlook.

Credit Concepts measured

The main credit concepts measured against Australian and New Zealand Standard Industry Classifications (ANZSIC) and specific Peer Groups based on entity size are available in Corporate Scorecard's Rating methodology, which can be found at the below-mentioned links

http://www.corporatescorecard.co.nz/services_credit_ratings.php
https://www.corporatescorecard.co.nz/docs/RatingMethodologyFinancial.pdf

2. Regulatory Disclosures and Disclaimer

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The credit rating issued by Equifax Credit Ratings reflects our current opinion of the relative credit risk of the institution. This opinion has been formed in accordance with Equifax's published credit ratings methodology - financial institution rating criteria (Issue 8, November 2022).

https://www.corporatescorecard.co.nz/docs/RatingMethodologyFinancial.pdf

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