S&P Global Ratings

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Police Financial Services Ltd. (trading as BankVic)

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Police Financial Services Ltd. (trading as BankVic)

Rating Score Snapshot

Issuer Credit Rating
BBB/Positive/A-2

SACP: bbb → **Support: 0** → **Additional factors: 0**

Anchor	bbb+	
Business position	Constrained	-2
Capital and earnings	Very strong	+2
Risk position	Adequate	0
Funding	Moderate	-1
Liquidity	Adequate	
CRA adjustment		0

ALAC support	0
GRE support	0
Group support	0
Sovereign support	0

Issuer credit rating
BBB/Positive/A-2

ALAC--Additional loss-absorbing capacity. CRA--Comparable ratings analysis. GRE--Government-related entity. ICR--Issuer credit rating. SACP--Stand-alone credit profile.

Credit Highlights

Overview

Key strengths	Key risks
Very strong capitalization.	Small market share.
Sound asset quality.	Susceptible to funding pressure.

Australia-based Police Financial Services Ltd.'s (trading as BankVic) very strong capital position underpins its credit profile. We project a stable risk-adjusted capital (RAC) ratio of about 22.5% for the mutual bank over the next two years. This reflects our view that the bank will maintain loan growth at about system levels while its net interest margin (NIM) will recover modestly, given a rising interest rate environment. As of June 30, 2022, our RAC ratio for BankVic was 22.6%.

The small scale and high cost base of BankVic's operations constrain its ability to compete. Australian mutual banks, including BankVic, are price-takers in their key operations of funding mortgages with deposits. Consequently, we view all mutual lenders in Australia to be susceptible to price competition from Australia's largest lenders.

Australia's small financial institutions, including BankVic, are vulnerable to funding competition from the major banks. Despite this, we view BankVic's retail deposit-dominated funding base to be comparatively stable.

Outlook

The outlook on BankVic is positive. We see upside to the stand-alone credit profiles (SACPs) of all banks operating in Australia, including BankVic. This reflects a positive trend for Australian banking industry risk on the back of growing systemwide customer deposits and falling offshore borrowing--both as a proportion of domestic customer loans.

In our base case, we expect economic risks facing Australian banks to remain low. We forecast that house prices in Australia will fall in an orderly manner by about 15% over the next two years. Largely reflecting our relatively benign outlook on the economy, we project that systemwide credit losses will remain close to pre-pandemic levels at about 15 basis points (bps) of customer loans. Nevertheless, rising interest rates and falling consumer and business confidence could trigger a steeper fall in house prices and heighten economic risks for banks.

Upside scenario

We expect to raise our ratings on BankVic over the next two years if we form a view that the Australian banking system's net external borrowings would remain sustainably below 20% of domestic customer loans.

Downside scenario

We expect to revise our outlook on BankVic to stable if we form a view that industry risks faced by Australia's banking sector are unlikely to fall in the next two years.

Key Metrics

Police Financial Services Ltd.--Key Ratios And Forecasts

	--Fiscal year ended June 30--				
(%)	**2021a**	**2022a**	**2023f**	**2024f**	**2025f**
Growth in operating revenue	(3.8)	11.0	5.6-6.8	4.1-5.0	4.0-4.9
Growth in customer loans	1.9	11.9	4.5-5.5	4.5-5.5	4.5-5.5
Growth in total assets	15.4	6.1	4.5-5.5	4.5-5.5	4.5-5.5
Net interest income/average earning assets (NIM)	1.9	1.9	1.8-2.0	1.9-2.0	1.9-2.0
Cost to income ratio	71.4	73.3	73.2-77.0	73.3-77.0	73.1-76.9
Return on average common equity	5.3	5.5	4.7-5.1	4.6-5.1	4.6-5.1
Return on assets	0.4	0.4	0.3-0.4	0.3-0.4	0.3-0.4
New loan loss provisions/average customer loans	(0.0)	(0.0)	0.0-0.0	0.0-0.0	0.0-0.0
Gross nonperforming assets/customer loans	0.8	0.6	0.5-0.5	0.5-0.5	0.5-0.5
Net charge-offs/average customer loans	0.0	0.0	0.0-0.0	0.0-0.0	0.0-0.0
Risk-adjusted capital ratio	N/A	22.6	22.0-23.1	22.0-23.1	22.0-23.1

All figures are S&P Global Ratings-adjusted. a--Actual. f--Forecast. NIM--Net interest margin.

Anchor: Resilient Economy, Conservative Regulations, And Low Risk Appetite Mitigate Housing Risks

The starting point for our ratings on BankVic--similar to all other banks operating predominantly in Australia--reflects our assessment of Australia's macroeconomic environment.

Australia has a wealthy, open, and resilient economy that has performed relatively well following economic downcycles and external shocks. Banks in Australia are exposed to economic risks resulting from rapid house price growth during 2019-2021 and high household debt. We forecast property prices to fall through to about mid-2023 and thereafter grow slowly. Credit losses over the next two years should remain low, and close to pre-pandemic levels even as rate hikes erode debt serviceability for highly leveraged borrowers.

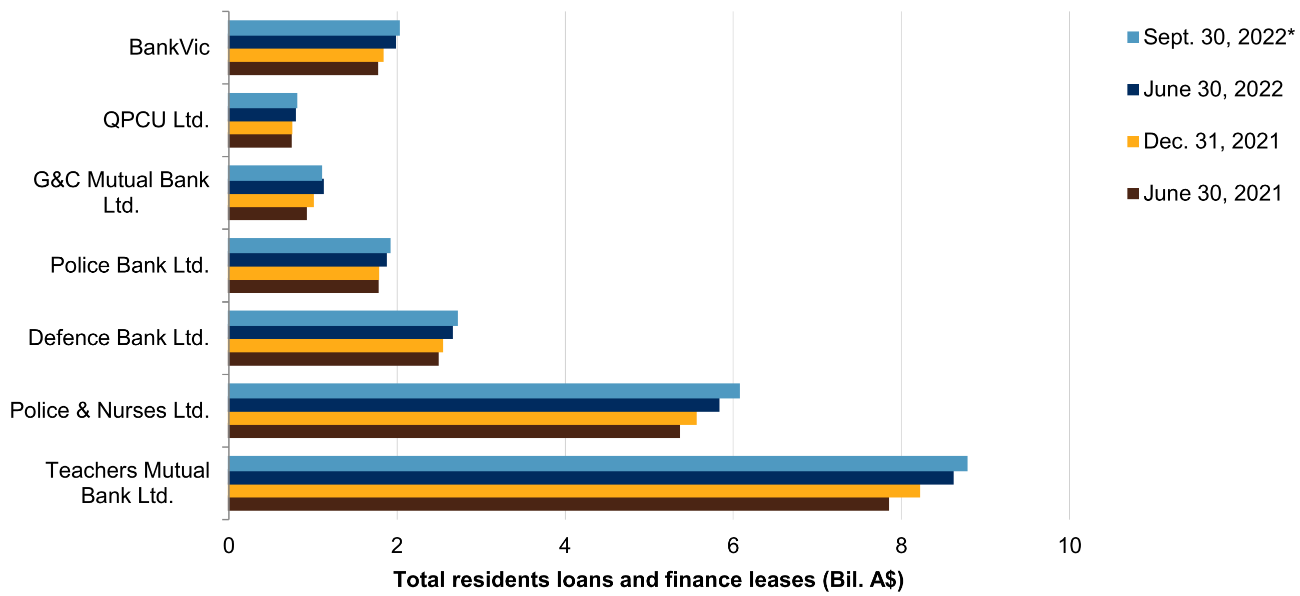
We consider Australia's prudential regulatory standards to be conservative. We believe the country's banking industry structure supports stability; a small number of strong retail and commercial banks dominate the sector. Bank earnings should remain sound on the back of low credit losses and interest rate hikes. Notwithstanding an improving trend in funding structure, a material dependence on external borrowing exposes Australian banks to a disruption in access to funding if there is a dislocation in international financial markets.

Business Position: Small Scale And Concentrated Business Base

BankVic's small size relative to the major banks and larger peers limits its ability to benefit from economies of scale. The scale and incumbency of Australia's major banks enables them to be price-setters on both sides of the balance sheet. As of Sept. 30, 2022, BankVic had a loan book of A$2.0 billion. Of this, 98% was residential mortgages. This gives the mutual bank a market share of about 0.1% of the overall Australian lending market and places it at the smaller end of other mutual peers that S&P Global Ratings rates (see chart 1). Still, we see the strength and stability of BankVic's business as similar to most other mutual banking institutions that we rate.

Chart 1

BankVic's Small Loan Book Constrains Its Competitive Flexibility



Source: S&P Global Ratings, Australian Prudential Regulatory Authority. * Year to date.

We expect BankVic to strengthen its presence among Victorian police and law enforcement personnel. In our view, the mutual bank has a good reputation in this customer set, which represents the foundation of its franchise. It is also likely to retain its smaller but stable presence in the Victorian healthcare sector. This is another parochial member base that can provide some insulation from competition with the larger lenders. We believe niches like this can help smaller lenders compete against larger institutions in the domain.

BankVic has sound management and governance. The mutual bank's executive management team have adequate skills to navigate the competitive landscape of the Australian residential lending market, in our view. Similarly, the mutual bank will likely continue to upskill its board of directors by nominating new members with banking-sector experience to upcoming vacancies.

Capital And Earnings: Very Strong Capital

BankVic's very strong capital is a strength to its credit profile. We project that our RAC ratio for BankVic will remain stable at about 22.5% over the next two years. The mutual bank will likely maintain loan growth at about system levels and book a moderately higher NIM (see key assumptions in table 1). As of June 30, 2022, our RAC ratio for BankVic was 22.6%.

BankVic will likely maintain capital levels well above regulatory minimums. As of June 30, 2022, the mutual bank had a common equity tier-1 ratio of 16.5%, versus 8.5% required by the regulatory framework for standardized banks.

Official cash rate hikes will likely swing the NIM momentum to positive. Despite its price-taker status, BankVic's margins will likely see a moderate increase. This is given the natural lag between cash rate hike flowthroughs to funding versus lending. While we expect these tailwinds at the front end of BankVic's book to continue, we believe the mutual bank will maintain its competitive pricing to generate growth as a small player in the Australian retail banking sector. Similarly, BankVic holds about 25% of its mortgage book in inexpensive COVID-era fixed-rate mortgages, which will slow the positive momentum in NIM until the bank reprices at higher rates.

Risk Position: Low-Risk Residential Lending Underpins Stable Asset Quality

BankVic's risk profile is consistent with the broader Australian banking system. We believe the standard risk weights we apply in our capital and earnings assessment adequately capture the mutual bank's risk profile. We also see its risk management practices as sufficient for an organization of its size and complexity.

Like most Australian mutuals, BankVic's portfolio is concentrated by product and geography. Nearly all of the mutual bank's lending exposure is to residential mortgages originating in metropolitan Victoria. This makes the mutual bank more susceptible to localized economic pressures than more diversified mutual peers. The underwriting standards of Australian mutual lenders, including BankVic, should remain generally conservative in the face of rising interest rates and declining serviceability prospects.

We expect BankVic's credit losses to remain low and broadly in line with mutual peers over the next two years, at about 3 bps. We see the repayment behaviors of BankVic's public sector borrowers to be reasonably predictable. This is due to the relative stability of their employment. Still, similar to other mortgage lenders in Australia, the mutual bank is not immune to systemwide house price deterioration and falling serviceability prospects due to inflation pressures.

Funding And Liquidity: Retail Deposit Focus Supports Funding Stability

Australia's regional and mutual financial institutions, including BankVic, are vulnerable to funding pressure from the major banks. We consider the funding profiles of the four major banks and Macquarie Bank Ltd. to be stronger than all other banking institutions in Australia, including BankVic. This is because we believe the major banks could potentially bring funding pressure on all other Australian financial institutions if they decided, or were forced, to compete more aggressively for domestic deposits due to a dislocation in overseas wholesale funding markets.

We view BankVic's retail deposit funding base to be comparatively stable. As of Sept. 30, 2022, deposits comprised about 97% of the mutual bank's liabilities. These were supplemented by a full drawdown of the bank's Reserve Bank of Australia term funding facility in two tranches. As of June 30, 2022, BankVic had a stable funding ratio of 110%. This was marginally stronger than the 4-year average of 105% for Australian rated mutual banking institutions. In our view, BankVic will likely expand its wholesale funding profile using short-tenor instruments over the next 12-24 months to diversify its funding channels beyond just deposits.

BankVic will likely use its excess liquidity to fund balance sheet growth over the next 12-24 months. The mutual bank consistently maintained its minimum liquidity holdings above 28% in the past 12 months. This was considerably above the regulatory minimum of 9% and reflected the mutual bank's conservative liquidity position during the pandemic.

BankVic has sufficient on-balance sheet liquidity to meet at least six months of general market stress. The mutual bank had a short-term wholesale coverage ratio (which measures on-balance sheet liquidity cover for wholesale funding maturing within 12 months) of 6.9x as of June 30, 2022. This was higher than the 2.1x for mutual sector peers that we rate. We expect this to fall marginally as BankVic funds balance sheet growth with excess liquidity over the next 12-24 months. The mutual bank also holds about 22% of liabilities as a source of contingent liquidity through internal securitization facilities.

Support: Extraordinary Government Support Unlikely

As of Sept. 30, 2022, BankVic accounted for about 0.1% of residential assets and 0.2% of total household deposits in the Australian banking sector. Given the mutual bank's small market share, we consider it unlikely that any failure by the mutual bank would disrupt the larger financial system or economy. Therefore, it is unlikely that the Australian government would provide extraordinary support if needed, in our view.

Environmental, Social, And Governance

ESG Credit Indicators

E-1	**E-2**	E-3	E-4	E-5	S-1	**S-2**	S-3	S-4	S-5	G-1	**G-2**	G-3	G-4	G-5

ESG credit indicators provide additional disclosure and transparency at the entity level and reflect S&P Global Ratings' opinion of the influence that environmental, social, and governance factors have on our credit rating analysis. They are not a sustainability rating or an S&P Global Ratings ESG Evaluation. The extent of the influence of these factors is reflected on an alphanumerical 1-5 scale where 1 = positive, 2 = neutral, 3 = moderately negative, 4 = negative, and 5 = very negative. For more information, see our commentary "ESG Credit Indicators: Definition And Applications," published Oct. 13, 2021.

ESG factors have no material influence on our credit rating analysis of BankVic.

We see ESG factors for BankVic to be mostly in line with those for industry and domestic peers. In our view, the risk management and governance policies and practices of the mutual bank are adequate for an organization of its size and complexity.

Australian mutual lenders, including BankVic, maintain sound social franchises in their communities. This is supported by their member-owned structure and an ethos of providing benefits to both their member base and the wider communities in which they operate. While BankVic's involvement with Victorian essential service employment groups (and their respective unions) provides an element of stability to its franchise, we see this as only being marginally supportive of BankVic's credit quality.

We view environmental factors as broadly neutral to BankVic's creditworthiness. The mining sector accounts for only about 1% of the total domestic lending by the Australian banking sector. Still, we believe BankVic is indirectly exposed to environmental factors because it operates in an economy where the commodities sector is significant. Evolution of domestic and global environment standards and legislations and changing customer preferences leading to a transition toward less carbon intensive forms of energy could weaken the broader economy, and consequently, the mutual bank's lending portfolio.

Key Statistics

Table 1

Police Financial Services Ltd.--Key Figures

	--Year-ended June 30--				
(Mil. A$)	**2022**	**2021**	**2020**	**2019**	**2018**
Adjusted assets	2,827.6	2,663.9	2,307.8	2,062.8	1,830.3
Customer loans (gross)	1,977.4	1,766.4	1,733.1	1,668.6	1,442.7
Adjusted common equity	215.6	203.9	193.3	183.4	175.4
Operating revenues	59.9	53.9	56.1	54.9	52.2
Noninterest expenses	43.9	38.5	39.5	39.1	34.1
Core earnings	11.6	10.6	10.1	11.3	12.6

Table 2

Police Financial Services Ltd.--Business Position

	--Year-ended June 30--				
(%)	**2022**	**2021**	**2020**	**2019**	**2018**
Total revenues from business line (currency in millions)	59.9	53.9	56.1	54.9	52.2
Commercial and retail banking/total revenues from business line	100.0	100.0	100.0	100.0	100.0
Other revenues/total revenues from business line	N/A	N/A	0.0	0.0	0.0
Return on average common equity	5.5	5.3	5.3	6.2	N/A

N/A--Not applicable.

Table 3

Police Financial Services Ltd.--Capital And Earnings

	--Year-ended June 30--				
(%)	**2022**	**2021**	**2020**	**2019**	**2018**
Tier 1 capital ratio	16.4	16.6	17.5	17.8	19.6
Adjusted common equity/total adjusted capital	100.0	100.0	100.0	100.0	100.0
Net interest income/operating revenues	87.3	86.0	82.8	81.1	79.3
Fee income/operating revenues	8.9	8.8	11.0	12.1	13.2
Cost to income ratio	73.3	71.4	70.5	71.2	65.3
Preprovision operating income/average assets	0.6	0.6	0.8	0.8	N/A
Core earnings/average managed assets	0.4	0.4	0.5	0.6	N/A

N/A--Not applicable.

Table 4

Police Financial Services Limited--Risk-Adjusted Capital Framework Data

	Exposure*	Basel III RWA	Average Basel III RW(%)	S&P Global Ratings RWA	Average S&P Global Ratings RW (%)
Credit risk					
Government and central banks	132,000,000.0	0.0	0.0	3,960,000.0	3.0
Of which regional governments and local authorities	0.0	0.0	0.0	0.0	0.0
Institutions and CCPs	708,437,621.0	193,031,037.5	27.2	157,540,448.8	22.2
Corporate	0.0	0.0	0.0	0.0	0.0
Retail	2,225,735,768.4	891,184,919.2	40.0	658,955,438.6	29.6
Of which mortgage	2,185,996,477.0	851,445,627.8	39.0	626,069,391.0	28.6
Securitization§	9,328,599.0	1,865,719.8	20.0	1,865,719.8	20.0
Other assets†	4,657,886.0	3,576,886.0	76.8	8,077,746.8	173.4
Total credit risk	3,080,159,874.4	1,089,658,562.5	35.4	830,399,354.0	27.0
Credit valuation adjustment					
Total credit valuation adjustment	--	0.0	--	0.0	--
Market risk					
Equity in the banking book	0.0	0.0	0.0	0.0	0.0
Trading book market risk	--	0.0	--	0.0	--
Total market risk	--	0.0	--	0.0	--
Operational risk					
Total operational risk	--	134,408,376.5	--	121,648,143.8	--
	Exposure	**Basel III RWA**	**Average Basel II RW (%)**	**S&P Global Ratings RWA**	**% of S&P Global Ratings RWA**
Diversification adjustments					
RWA before diversification	--	1,224,066,938.9	--	952,047,497.8	100.0
Total diversification/ Concentration adjustments	--	--	--	325,122,500.1	34.1
RWA after diversification	--	1,224,066,938.9	--	1,277,169,997.8	134.1
		Tier 1 capital	**Tier 1 ratio (%)**	**Total adjusted capital**	**S&P Global Ratings RAC ratio (%)**
Capital ratio					
Capital ratio before adjustments		207,094,000.0	16.9	215,593,000.0	22.6
Capital ratio after adjustments‡		207,094,000.0	16.9	215,593,000.0	16.9

*Exposure at default. §Securitization exposure includes the securitization tranches deducted from capital in the regulatory framework. †Exposure and S&P Global Ratings' risk-weighted assets for equity in the banking book include minority equity holdings in financial institutions. ‡Adjustments to Tier 1 ratio are additional regulatory requirements (e.g. transitional floor or Pillar 2 add-ons). RWA--Risk-weighted assets. RW--Risk weight. RAC--Risk-adjusted capital. Sources: Company data as of June 30, 2022, S&P Global Ratings.

Table 5

Police Financial Services Ltd.--Risk Position

	--Year-ended June 30--				
(%)	**2022**	**2021**	**2020**	**2019**	**2018**
Growth in customer loans	11.9	1.9	3.9	15.7	N.M.
Total managed assets/adjusted common equity (x)	13.1	13.1	11.9	11.2	10.4
New loan loss provisions/average customer loans	(0.0)	(0.0)	0.1	(0.0)	N/A
Net charge-offs/average customer loans	0.0	0.0	0.0	0.0	N/A
Gross nonperforming assets/customer loans + other real estate owned	0.6	0.8	0.5	0.5	0.2
Loan loss reserves/gross nonperforming assets	43.5	43.6	69.0	51.2	34.7

N/A--Not applicable. N.M.--Not meaningful.

Table 6

Police Financial Services Ltd.--Funding And Liquidity

	--Year-ended June 30--				
(%)	**2022**	**2021**	**2020**	**2019**	**2018**
Core deposits/funding base	94.2	95.6	91.0	92.0	97.3
Customer loans (net)/customer deposits	80.5	75.3	90.2	97.1	90.3
Long-term funding ratio	96.2	99.5	94.1	92.8	97.6
Stable funding ratio	110.9	118.4	108.9	101.5	108.4
Short-term wholesale funding/funding base	2.3	0.5	0.8	0.6	2.6
Broad liquid assets/short-term wholesale funding (x)	6.9	35.0	19.0	18.5	4.9
Broad liquid assets/total assets	14.4	17.1	14.6	10.0	11.4
Broad liquid assets/customer deposits	16.6	19.5	17.6	12.1	13.1
Net broad liquid assets/short-term customer deposits	14.3	19.2	17.0	11.7	10.6
Short-term wholesale funding/total wholesale funding	39.5	11.9	9.3	7.5	95.8

Police Financial Services Ltd.--Rating Component Scores

Issuer Credit Rating	**BBB/Positive/A-2**
SACP	bbb
Anchor	bbb+
Economic risk	3
Industry risk	3
Business position	Constrained
Capital and earnings	Very strong
Risk position	Adequate
Funding	Moderate
Liquidity	Adequate
Comparable ratings analysis	0
Support	0
ALAC support	0
GRE support	0
Group support	0
Sovereign support	0

Police Financial Services Ltd.--Rating Component Scores (cont.)	
Issuer Credit Rating	**BBB/Positive/A-2**
Additional factors	0

ALAC--Additional loss-absorbing capacity. GRE--Government-related entity. SACP--Stand-alone credit profile.

Related Criteria

- Criteria | Financial Institutions | General: Financial Institutions Rating Methodology, Dec. 9, 2021
- Criteria | Financial Institutions | Banks: Banking Industry Country Risk Assessment Methodology And Assumptions, Dec. 9, 2021
- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Financial Institutions | General: Risk-Adjusted Capital Framework Methodology, July 20, 2017
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Related Research

- Australian Mutual Lenders Unlikely To Reap Full Benefit Of Rising Rates, May 30, 2022
- Ratings on Sixteen Australian Mutual Lenders Affirmed Under Revised Criteria, Jan. 28, 2022
- Why Australia's Mutual Lenders Will Feel The Urge To Merge, Aug. 31, 2021

Ratings Detail (As Of November 20, 2022)*	
Police Financial Services Ltd.	
Issuer Credit Rating	BBB/Positive/A-2
Issuer Credit Ratings History	
20-Nov-2022	BBB/Positive/A-2
Sovereign Rating	
Australia	AAA/Stable/A-1+

*Unless otherwise noted, all ratings in this report are global scale ratings. S&P Global Ratings’ credit ratings on the global scale are comparable across countries. S&P Global Ratings’ credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.