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CREDIT OPINION
23 February 2023

Update

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BankVic

Update following rating affirmation

RATINGS

BankVic

Domicile	Australia
Long Term CRR	A3
Type	LT Counterparty Risk Rating - Fgn Curr
Outlook	Not Assigned
Long Term Debt	(P)Baa1
Type	Senior Unsecured MTN - Fgn Curr
Outlook	Not Assigned
Long Term Deposit	Baa1
Type	LT Bank Deposits - Fgn Curr
Outlook	Stable

Please see the ratings section at the end of this report for more information. The ratings and outlook shown reflect information as of the publication date.

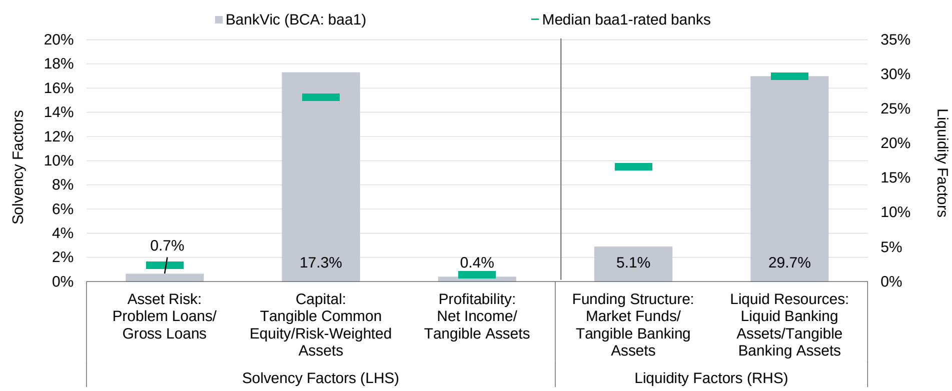
Summary

BankVic's Baa1 long-term issuer rating reflects the bank's focus on conservatively underwritten owner-occupied residential mortgage lending with principal and interest repayments, which has supported its strong asset quality to date, and will provide a buffer against the impact of high inflation and rising interest rates. In addition, more than half of the bank's members are employed in essential services, with above-average employment and income stability, further supporting asset quality.

The bank's capital will remain strong on the back of moderately improved earnings prospects amid rising interest rates. Its funding profile will remain conservative, being primarily funded by retail deposits, despite declining systemwide savings ratios and retail deposit growth from their pandemic highs.

Exhibit 1

Rating Scorecard - Key financial ratios



Source: Moody's Financial Metrics

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Asia Pacific	852-3551-3077
Japan	81-3-5408-4100
EMEA	44-20-7772-5454

Credit strengths

» Strong asset quality, underpinned by a focus on low-risk mortgages and the fact that the portfolio is skewed toward essential workers

» Strong capitalization

» Conservative funding profile, dominated by retail deposits, and ample liquidity

Credit challenges

» High cost base, which constrains the bottom line

» Asset and geographic concentration

Outlook

The outlook on the rating is stable, reflecting our expectation that the bank's conservative loan underwriting standards will contain credit costs as interest rates rise while it will maintain a strong balance sheet over the next 12-18 months.

Factors that could lead to an upgrade

We could upgrade the rating if structural risks in the housing sector subside; or if the bank's credit profile strengthens, for example, its tangible common equity (TCE)/risk-weighted assets (RWA), or the TCE ratio, increases to 20%.

Factors that could lead to a downgrade

We could downgrade the rating if the bank's asset quality deteriorates significantly, with its problem loans/gross loans rising above 1%; the TCE ratio drops below 15%; or its liquid asset coverage of unsecured wholesale debt maturities due within 12 months falls below 100%.

The method for the calculation of Australian banks' regulatory capital ratios has been amended in 2023, and we may adjust the bank's TCE ratio rating thresholds accordingly.

Key indicators

Exhibit 2
BankVic (Unconsolidated Financials) [1]

	06-22[2]	06-21[2]	06-20[2]	06-19[2]	06-18[2]	CAGR/Avg.[3]
Total Assets (AUD Million)	2,827.7	2,664.1	2,308.0	2,062.8	1,830.3	11.5[4]
Total Assets (USD Million)	1,944.5	2,000.1	1,589.1	1,447.6	1,352.3	9.5[4]
Tangible Common Equity (AUD Million)	217.2	205.6	195.0	185.1	177.2	5.2[4]
Tangible Common Equity (USD Million)	149.4	154.4	134.3	129.9	130.9	3.4[4]
Problem Loans / Gross Loans (%)	0.6	0.8	0.5	0.5	0.2	0.5[5]
Tangible Common Equity / Risk Weighted Assets (%)	17.3	17.5	18.4	18.8	20.1	18.4[6]
Problem Loans / (Tangible Common Equity + Loan Loss Reserve) (%)	5.7	6.7	4.7	4.1	2.0	4.6[5]
Net Interest Margin (%)	1.9	1.9	2.1	2.3	2.4	2.1[5]
PPI / Average RWA (%)	1.3	1.4	1.6	1.7	2.2	1.6[6]
Net Income / Tangible Assets (%)	0.4	0.4	0.4	0.5	0.7	0.5[5]
Cost / Income Ratio (%)	73.3	71.4	70.5	71.1	65.3	70.3[5]
Market Funds / Tangible Banking Assets (%)	5.0	3.8	8.1	7.2	5.7	6.0[5]
Liquid Banking Assets / Tangible Banking Assets (%)	29.7	33.3	24.7	18.9	20.7	25.5[5]
Gross Loans / Due to Customers (%)	80.7	75.5	90.5	97.3	93.9	87.6[5]

[1] All figures and ratios are adjusted using Moody's standard adjustments. [2] Basel III - fully loaded or transitional phase-in; IFRS. [3] May include rounding differences because of the scale of reported amounts. [4] Compound annual growth rate (%) based on the periods for the latest accounting regime. [5] Simple average of periods for the latest accounting regime. [6] Simple average of Basel III periods.
Sources: Moody's Investors Service and company filings

Profile

BankVic is a mutually owned authorized Australian deposit-taking institution (ADI). As of June 2022, it reported total assets of AUD2.8 billion and residential mortgages accounted for 98% of its loans. Of BankVic's total loans, 95% were originated from the state of Victoria and more than half were to employees in the state's essential services, including police, healthcare, emergency and the public service sector.

Detailed credit considerations

Good asset quality supported by lending focus on low-risk mortgages and the fact that the portfolio is skewed toward essential workers

BankVic's problem loans/gross loans remained below 1% throughout the pandemic and was 0.64% at June 2022 when pandemic-related risks receded.

High inflation and rising interest rates are exerting pressure on borrowers. Additionally, the bank retains a high geographic concentration in Victoria, a state that has experienced higher house price volatility, especially in Melbourne, over recent years, although this risk is partly offset by BankVic's wide presence across the state and the state's diversified economic base.

However, we expect the bank's share of nonperforming loans to rise only modestly in 2023 because of its conservative underwriting. The bank's principal and interest loans accounted for 94% of total loans, owner-occupier for 83%, and loans with a loan-to-value ratio of no more than 80% for 84% as of June 2022. It has also applied minimum serviceability buffers when assessing loan applications. This minimum buffer was 2.5 percentage points higher than the actual loan rates before October 2021, when the buffer increased to three percentage points, indicating the extent to which borrowers should be able to withstand interest rate increases.

Further, more than half of BankVic's members are employed in the country's essential services, with above-average employment and income stability, further supporting asset quality.

These considerations underpin our downward adjustments to the Asset Risk and Business Diversification sections of our scorecard.

Moderate profitability largely because of high cost base

BankVic's net interest margin (NIM) increased to 1.91% from 1.87% over the fiscal year that ended June 2022 (fiscal 2022), and will likely improve further in the coming year amid rising policy rates, although the benefits will be moderated by competition for high-quality loans and a pick up in funding costs.

Ongoing investment in digital transformation, risk management and compliance, in addition to a structurally high cost base, will somewhat offset an improved NIM and keep the bank's net income/tangible assets at a moderate level, which was 0.4% for fiscal 2022, well below that of large Australian commercial banks. The bank's loan loss provisioning has come down from its pandemic-related high but may rise again due to the impact of inflationary pressures and rising interest rates on household finances.

Capitalization to remain strong

The TCE ratio fell to 16.9% as of September 2022 from 19.6% as of June 2018, but still remains strong relative to its risk profile and peers. For the coming year, the bank will remain strongly capitalized on the back of better earnings prospects.

The downward adjustment to the Capital sub-score in our scorecard reflects very limited capital-raising options for mutuals. Although mutual capital instruments could enhance capital management flexibility, the issuance of such instruments has been rare and the bank has no immediate issuance plan.

Conservative funding profile and ample liquidity

Wholesale funding remained low at 5.4% of BankVic's total funding as of June 2022, but the bank may require additional wholesale funding to fund credit growth and refinance the Reserve Bank of Australia's (RBA) pandemic-related Term Funding Facility (TFF, 3.4% of total funding as of June 2022), given a decline in the systemwide household savings ratio and retail deposit growth from their pandemic highs.

However, any increase will be gradual because the bank continues to focus on deposits and its high on-balance-sheet liquid asset holdings can be used to fund credit growth, explaining the downward adjustments to the Funding Structure score in our scorecard.

Funding costs are picking up because of higher interest rates, competition for deposits, and a shift in customer preference to term deposits from low-cost at-call deposits, which accounted for a high 80% of customer deposits as of June 2022. In addition, the cheap RBA TFF will be refinanced by more expensive funding sources.

The bank has maintained a high level of liquid assets since early 2020 in response to the pandemic, indicated by on-balance-sheet liquid assets/banking assets of 30%. It can also create additional liquidity through internal residential mortgage-backed securities that are repo-eligible with the RBA. Such securities made up more than 20% of the bank's liability base as of June 2022.

BankVic's rating is supported by Australia's Strong+ macro profile

Australia's Strong+ macro profile reflects the country's robust economic strength, institutions and governance strength, and low susceptibility to event risk. Our baseline scenario projects real GDP growth will slow to 1.9% in 2023 as higher interest rates constrain growth, before improving to 2.3% in 2024.

The Australian economy has continued to perform strongly after a period of fiscal and monetary stimulus provided to combat the dampening economic effects of the pandemic-related health measures. Very tight labor markets and strong economic growth, boosted by strong household consumption and high levels of public and private investment, have resulted in the unemployment rate falling to a very low 3.5% as of November 2022. Rising interest rates, in response to high inflation, are likely to temper growth in 2023. High levels of household debt, combined with an increase in debt burden as interest rates rise, are key economic vulnerabilities. Household debt relative to income remains high, at 188.5% as of September 2022, and rising interest rates have led to national average house prices falling 8.4% from April 2022 to December 2022. Further improvement in banks' asset quality is unlikely as rising interest rates could reduce buffers built by borrowers or put some borrowers under financial pressure. However, low unemployment, and low loan-to-value ratios on home loans and small business loans, which are typically secured by residential properties, should provide buffers against asset-quality risk.

Australian banks' very strong pricing power has historically been supported by the high level of concentration in the banking sector. Net interest margins are expanding as interest rates rise; however, funding costs will rise as banks begin to repay the cheap funding provided by the central bank from 2023 onward. This could constrain further net interest margin gains in 2023.

Australia's structural reliance on external financing remains a key vulnerability. However, Australian banks have been extending the term structure of their wholesale market funding for a number of years and pre-funding upcoming maturities well in advance.

ESG considerations

BankVic's ESG Credit Impact Score is Neutral-to-Low CIS-2

Exhibit 3
ESG Credit Impact Score

CIS-2
Neutral-to-Low

NEGATIVE IMPACT
POSITIVE IMPACT

For an issuer scored CIS-2 (Neutral-to-Low), its ESG attributes are overall considered as having a neutral-to-low impact on the current rating; i.e., the overall influence of these attributes on the rating is non-material.

Source: Moody's Investors Service

BankVic's ESG Credit Impact Score is neutral-to-low (**CIS-2**) reflecting the limited credit impact of environmental and social risk factors on the ratings to date and low governance risks.

Exhibit 4
ESG Issuer Profile Scores

ENVIRONMENTAL	SOCIAL	GOVERNANCE
E-2	S-4	G-2
Neutral-to-Low	Highly Negative	Neutral-to-Low

Source: Moody's Investors Service

Environmental
BankVic faces neutral-to-low environmental risks. The bank's lower-than-industry-average environmental risk is driven by its limited exposure to carbon transition risks because its loan book is concentrated in Australian residential mortgages, with very low exposures to commercial and unsecured loans.

Social
BankVic faces high industrywide social risks from customer relations (regulatory risk, litigation exposure and high compliance standards). As a mutual banking institution, it is run for the benefit of the members and is focused on supporting the community from which its membership base is drawn. We see these attributes as positively supporting the bank's social risk profile. Nevertheless, the banking sector as a whole remains subject to a high level of scrutiny and accountability that heightens social risks from customer relations. In particular, digitalization and the extent to which the bank could be subject to data security and customer privacy breaches, as well as weigh on earnings, is an important consideration. Ongoing investment in technology will support the bank in meeting rising digital expectations from customers.

Governance
BankVic faces low governance risks. The bank's risk management policies and procedures are commensurate with its risk appetite, evident by its track record of strong asset quality and balance sheet strength. As a mutual bank, BankVic has a relatively simple organizational structure reflecting its domestic and retail-oriented franchise.

ESG Issuer Profile Scores and Credit Impact Scores for the rated entity/transaction are available on Moodys.com. In order to view the latest scores, please click here to go to the landing page for the entity/transaction on MDC and view the ESG Scores section.

Support and structural considerations

Loss Given Failure (LGF) analysis

Australia does not have a statutory bail-in framework. As a result, we do not consider Australia to have an operational resolution regime (as defined in our Banks rating methodology). We apply a Basic LGF approach in rating Australian banks' junior securities.

To determine whether Australia has an operational resolution regime, we take both the current resolution framework and Australian policymakers' public stance into account. Although Australia is a member of the Financial Stability Board, which has highlighted the lack of statutory bail-in as a gap compared with international standards, the Australian authorities have so far adopted a more nuanced public stance on this issue.

On 2 December, the Australian Prudential Regulation Authority (APRA) released its final loss-absorbing capacity requirements for domestically important banks (D-SIBs). This follows APRA's release, on 29 November, of its final capital framework. The new rules raise the minimum Common Equity Tier 1 (CET1) capital ratio requirement to 10.25% from 8% for D-SIBs, to 9.25% from 7% for banks authorized to use their internal models to calculate RWA, and to 8% from 7% for banks that use standardized RWA. The APRA has chosen to raise the CET1 requirement by increasing the capital conservation buffer and setting the countercyclical buffer at 1%, which was previously set at 0%

The APRA's final loss-absorbing capacity requirements will add 4.5 percentage points to the minimum total capital requirements for D-SIBs, a 1.5-percentage-point increase from the three-percentage-point interim requirement announced in 2019. This new requirement is likely to be met with Tier 2 capital.

Counterparty Risk (CR) Assessment

BankVic's CR Assessment is positioned at A3(cr)/P-2(cr)

The CR Assessment, before government support, is positioned one notch above the Adjusted Baseline Credit Assessment (BCA) and, therefore, above the Preliminary Rating Assessment of senior unsecured debt obligations. This positioning reflects our view that the probability of default of obligations represented by the CR Assessment is lower than that of senior unsecured debt. We believe that senior obligations represented by the CR Assessment will be more likely preserved to limit contagion, minimize losses and avoid the disruption of critical functions.

For BankVic, the CR Assessment does not benefit from any government support uplift, in line with our support assumptions on senior unsecured debt. This reflects our view that operating activities and obligations reflected by the CR Assessment are unlikely to benefit from any support provisions from resolution authorities to senior unsecured debt.

Counterparty Risk Ratings (CRRs)

BankVic's CRRs are positioned at A3/P-2

The long-term CRR is positioned one notch above BankVic's Adjusted BCA and does not benefit from any government support uplift, in line with our support assumptions on senior unsecured debt.

Methodology and scorecard

About Moody's Bank Scorecard

Our scorecard is designed to capture, express and explain in summary form our Rating Committee's judgment. When read in conjunction with our research, a fulsome presentation of our judgment is expressed. As a result, the output of our scorecard may materially differ from that suggested by raw data alone (though it has been calibrated to avoid the frequent need for strong divergence). The scorecard output and the individual scores are discussed in rating committees, and may be adjusted up or down to reflect conditions specific to each rated entity.

Rating methodology and scorecard factors

Exhibit 5

BankVic

Macro Factors							
Weighted Macro Profile	**Strong +**	**100%**					

Factor	Historic Ratio	Initial Score	Expected Trend	Assigned Score	Key driver #1	Key driver #2
Solvency						
Asset Risk						
Problem Loans / Gross Loans	0.7%	aa2	↔	a1	Quality of assets	Geographical concentration
Capital						
Tangible Common Equity / Risk Weighted Assets (Basel III - transitional phase-in)	17.3%	aa2	↔	aa3	Expected trend	Access to capital
Profitability						
Net Income / Tangible Assets	0.4%	ba1	↔	ba1	Expected trend	
Combined Solvency Score		a1		a2		
Liquidity						
Funding Structure						
Market Funds / Tangible Banking Assets	5.0%	aa3	↔	aa3	Expected trend	Deposit quality
Liquid Resources						
Liquid Banking Assets / Tangible Banking Assets	29.7%	a3	↔	a3	Expected trend	Additional liquidity resources
Combined Liquidity Score		a1		a1		
Financial Profile				a2		
Qualitative Adjustments				Adjustment		
Business Diversification				-2		
Opacity and Complexity				0		
Corporate Behavior				0		
Total Qualitative Adjustments				-2		
Sovereign or Affiliate constraint				Aaa		
BCA Scorecard-indicated Outcome - Range				a3 - baa2		
Assigned BCA				baa1		
Affiliate Support notching				0		
Adjusted BCA				baa1		

Instrument Class	Loss Given Failure notching	Additional notching	Preliminary Rating Assessment	Government Support notching	Local Currency Rating	Foreign Currency Rating
Counterparty Risk Rating	1	0	a3	0	A3	A3
Counterparty Risk Assessment	1	0	a3 (cr)	0	A3(cr)	
Deposits	0	0	baa1	0	Baa1	Baa1
Senior unsecured bank debt	0	0	baa1	0	Baa1	Baa1

[1] Where dashes are shown for a particular factor (or sub-factor), the score is based on non-public information.
Source: Moody's Investors Service

Ratings

Exhibit 6

Category	Moody's Rating
BANKVIC	
Outlook	Stable
Counterparty Risk Rating	A3/P-2
Bank Deposits	Baa1/P-2
Baseline Credit Assessment	baa1
Adjusted Baseline Credit Assessment	baa1
Counterparty Risk Assessment	A3(cr)/P-2(cr)
Issuer Rating	Baa1
Senior Unsecured MTN	(P)Baa1
ST Issuer Rating	P-2
Other Short Term	(P)P-2

Source: Moody's Investors Service

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