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DBRS Confirms Coast Capital Savings Federal Credit Union at BBB (high); Trend Stable

Bloomberg: DBRS Confirms Ratings of Coast Capital at BBB (high)

Industry Group: Financial Institutions

Sub-Industry: Credit Unions & Building Societies

Region: Canada

DBRS Limited (DBRS) confirmed the ratings of Coast Capital Savings Federal Credit Union (Coast Capital or the Credit Union), including the Credit Union's Long-Term Issuer Rating of BBB (high) and Short-Term Issuer Rating of R-1 (low). The trend for all ratings is Stable.

Coast Capital's Support Assessment (SA) was changed to SA3 from SA2, as the Credit Union achieved federal continuance on November 1, 2018, and is no longer provincially regulated. Therefore, DBRS no longer expects timely systemic external support from the Province of British Columbia (B.C. or the Province; rated AA (high)/R-1 (high) with Stable trends by DBRS) through Central 1 Credit Union (rated A (high) with a Stable trend by DBRS), particularly in the form of liquidity. Coast Capital is now regulated by the Office of the Superintendent of Financial Institutions (OSFI) under the Bank Act. Furthermore, the Credit Union now has potential to access the Bank of Canada (BOC)'s Emergency Liquidity Assistance subject to Bank of Canada terms and conditions at time of any application request for funding. Consequently, the Credit Union's short-term ratings now benefit from the exception granted to deposit-taking institutions on DBRS's short-term scale.

KEY RATING CONSIDERATIONS

The ratings reflect Coast Capital's important franchise in its footprint area in lower mainland B.C. This position is bolstered by the importance of credit unions in the Province, which count 41% of the provincial population as members. Furthermore, the Credit Union successfully moved to a federal charter with little impact on its funding. On the other hand, the ratings also consider the concentration risk of operating primarily in the Greater Vancouver Area, which makes Coast Capital more susceptible to a potential real estate market correction. Moreover, expanding operations outside of the Province could pose challenges, particularly in terms of operational risk.

RATING DRIVERS

Ratings could be positively affected by sustained membership growth, especially among younger members, and an increase in the member share of wallet leading to a strengthening in the franchise. Additionally, a significant and sustained improvement in earnings through the growth of non-interest income and/or improved efficiency could also improve the ratings. Alternatively, ratings could come under pressure should Coast Capital be unable to manage funding under the federal charter, especially directly raised deposits. Furthermore, significant losses in the loan portfolio as a result of unforeseen weakness in the underwriting and/or risk management process, or a sustained reduction in internal capital generation could also have a negative impact on the ratings.



RATING RATIONALE

Coast Capital is the second-largest credit union in the Province, with \$19.6 billion in assets as of YE2018. The Credit Union serves 29% of the Province's credit union system membership base through both retail and small business commercial offerings. Coast Capital has 52 branches in its footprint area in addition to a digital presence. Moreover, the Credit Union has a small national presence through its commercial leasing subsidiaries: Coast Capital Equipment Finance Ltd. and Travelers Finance Ltd.

On November 1, 2018, Coast Capital obtained a federal charter under the supervision of OSFI, making it only the second federal credit union in Canada and the first in B.C. The process of obtaining the charter began in December 2016 when members voted in favour of obtaining federal continuance.

Ahead of federal continuance, Coast Capital strengthened its digital capabilities as well as enhanced its product offerings with the objective of deepening its relationships with existing members while preparing to attract members outside of B.C. Overall, earnings have continued their upward trajectory, with net interest income up by 3% in 2018, as the Credit Union experienced solid asset growth. Owing to its no frills type of accounts and relatively younger members, Coast Capital has one of the lowest revenue per member ratios among credit unions at \$783 for 2018. Meanwhile, the Credit Union has been able to contain the costs associated with federal continuance, maintaining an efficiency ratio of 75% (including one-time gains from the redemption of Central 1 Class E shares). Although Coast Capital now has access to prospective new members outside of B.C., DBRS is cautious that remote deposit acquisition might come at a higher cost than expected given the highly competitive dynamics in the industry that includes the large banks, other online platforms, as well as local credit unions.

Coast Capital experienced healthy loan growth of 9% in 2018, with residential mortgages up by 8% to \$11.0 billion, while commercial mortgages and loans increased by 12% to \$4.7 billion. Although asset quality metrics remain strong, with gross impaired loans at only 0.07% of gross loans, in DBRS's view, Coast Capital is likely to see higher delinquencies in the event of a real estate market correction particularly if accompanied with rising levels of unemployment. On the other hand, with the conversion to a federal charter, Coast Capital has had to extensively review its policies and procedures to comply with OSFI's more robust guidelines, creating more enhanced risk management frameworks, which is viewed positively by DBRS.

With federal continuance, Coast Capital's previously unlimited deposit coverage under the Credit Union Deposit Insurance Corporation was replaced by deposit insurance of up to \$100,000 per account provided by the Canada Deposit Insurance Corporation (CDIC), a federal Crown corporation. This particular feature of the conversion raised uncertainties about Coast Capital's funding, as there was the potential for deposit outflows, especially for large retail and institutional deposits. However, CDIC has agreed to grandfather the guarantees for Coast Capital's deposits raised ahead of federal continuance for a period of six months for demand deposits, while term deposits will continue to be insured until they mature. In anticipation of potential outflows, Coast Capital made extensive efforts to shore up its deposit base, which included paying higher interest rates. As a result, total deposits increased by 14% in 2018 to \$16.4 billion, with the majority of the growth being driven by directly raised deposits. In addition, Coast Capital strengthened its liquidity



buffer to counteract potential demands on its balance sheet, with liquid assets to total assets reaching 20% as of December 31, 2018.

Capitalization levels are good in DBRS's view, as there is a sizable cushion over regulatory minimums to absorb potential losses. Coast Capital's total capital ratio stood at 15.7% in 2018, implying a capital cushion of \$483 million over the minimum regulatory requirement. The Credit Union generates sufficient capital to support balance sheet growth, which is a positive given its plans to expand outside of the Province.

Notes:

All figures are in Canadian dollars unless otherwise noted.

The applicable methodology is Global Methodology for Rating Banks and Banking Organisations (July 2018), which can be found on our website under Methodologies & Criteria.

The related regulatory disclosures pursuant to the National Instrument 25-101 *Designated Rating Organizations* are hereby incorporated by reference and can be found on the issuer page at www.dbrs.com.

The rated entity or its related entities did participate in the rating process for this rating action. DBRS had access to the accounts and other relevant internal documents of the rated entity or its related entities in connection with this rating action.

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For more information on this credit or on this industry, visit www.dbrs.com.

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Issuer	Obligation	Rating Action	Rating	Trend
Coast Capital Savings Federal Credit Union	Long-Term Issuer Rating	Confirmed	BBB (high)	Stable
Coast Capital Savings Federal Credit Union	Long-Term Senior Debt	Confirmed	BBB (high)	Stable
Coast Capital Savings Federal Credit Union	Subordinated Debt	Confirmed	BBB	Stable
Coast Capital Savings Federal Credit Union	Short-Term Issuer Rating	Confirmed	R-1 (low)	Stable
Coast Capital Savings Federal Credit Union	Short-Term Instruments	Confirmed	R-1 (low)	Stable

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