

## PSIS Ltd.

### Rationale

The counterparty credit ratings on PSIS Ltd. (PSIS) reflect the company's small but defensible business profile in the New Zealand personal financial services sector, and its good asset quality by international standards.

Offsetting these strengths are concentration risks associated with PSIS' largely single-sector and product focus, and its small capital base by international standards.

With an 80-year operating history, PSIS has longevity and expertise in core business lines. About 90% of PSIS' loans are to residential borrowers, the majority of these being to owner-occupiers rather than investors.

New Zealand residential mortgages are a relatively low-risk asset class by international standards, which should continue to assist PSIS' asset quality. Asset quality remains good compared with international peers, despite the economic downturn in New Zealand and some deterioration in PSIS' asset quality during fiscal 2009. Constraining factors that tend to have anchoring effect on its credit rating include concentration risk associated with its single-sector and narrow product focus and its small capital base. Small capitalization affords PSIS only moderate protection against major negative, albeit unlikely, operational or other risk events.

Similar to many other New Zealand financial institutions, PSIS has had to navigate the economic downturn as well as dislocated wholesale markets, and so far has done so with no long-term credit deterioration.

While underlying profitability was dampened in the fiscal year ending Mar. 31, 2009, it is likely to improve this year. PSIS has put in place fixed-for-floating swaps that should lock-in higher net-interest income during the current and following fiscal years. PSIS relies primarily on retail rather than wholesale funding sources, which minimizes risk associated with dislocated wholesale funding markets. Liquidity has been increased and has been satisfactorily managed overall, except for mark-to-market volatility in fiscal 2008 and 2009 (now largely removed because of hedging recently implemented) affecting a portfolio of managed fund investments purchased by PSIS in 2007. Although PSIS' capital is small by

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BB+/Stable/B

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international standards its capital ratios are very good as is the quality of its capital base. As a mutual, however, PSIS has less capital flexibility compared with listed financial institutions.

Steady but continuous incremental improvements by PSIS in recent years have a mildly stabilizing effect on the rating.

PSIS has improved its interest-rate risk management and is prudently managing its costs despite its inherently high-cost branch network and infrastructure relative to the size of its business footing. Credit policies have been tightened in the economic downturn, and low-risk core strategies that emphasize increased penetration into the personal financial services sector have been more sharply focused. PSIS has a good, stable, and cohesive management team, in line with the current rating.

### *Short-term credit factors*

Short-term credit factors are being adequately managed.

PSIS has adequate liquidity for the current rating level. Liquid assets to total assets stood at a good 17.5% at Mar. 31, 2009. While core lending activities are underpinned by retail deposit funding sources, PSIS has supplemental wholesale funding facilities via a NZ\$200 million securitization warehouse. This facility is provided by a 'AA' rated New Zealand bank. PSIS also has issued NZ\$6.7 million of capital notes.

## **Outlook**

The stable outlook reflects Standard & Poor's expectation that PSIS' will continue to manage its credit profile satisfactorily during the current economic downturn.

PSIS's lending book has relatively low credit risk by international standards so we don't anticipate a significant further deterioration in asset quality even considering the economic downturn. Rigidity in nonperforming asset levels is unlikely, of itself, to negatively affect the ratings, although would reduce flexibility at the current rating level and retard potential upwards rating movement.

We do not anticipate raising the ratings in the short term, with PSIS' most immediate challenge being the consolidation of its business and profile at the current rating.

In the medium-to-long term, and in contrast to most other New Zealand nonbank deposit-takers, there is potential for upwards rating movement. This could happen if PSIS were to emerge from the economic downturn with its business and financial profile intact, then build on this by positively differentiating itself from peers—particularly by demonstrating a superior financial profile and above-peer asset quality, deposit, liquidity and capital ratios. We would need to be convinced, however, that PSIS was not at risk of being marginalized in New Zealand's highly competitive personal-financial-services sector by larger, stronger banks. We would also need to see that its business profile was likely to remain robust, consistent with a higher rating. Upwards rating momentum in the longer term is likely to be limited to one notch above its current credit standing, based on all known rating factors.

Conversely, ratings could be lowered should asset quality deteriorate beyond tolerances at the current rating level, or should a major negative operational or other risk event pressure PSIS' small capital base or a reputational issue pressure PSIS' currently adequate liquidity.

Nonperforming assets and/or impairment losses in fiscal 2010 materially in excess of those recorded in fiscal 2009 could see the rating being lowered, particularly if we believed the situation was unlikely to abate in fiscal 2011.

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