

# POLICE GENERAL HOSPITAL SAVING AND CREDIT COOPERATIVE LTD.

No. 147/2021

13 September 2021

## FINANCIAL INSTITUTIONS

Issuer Rating: BBB+

Outlook: Stable

Last Review Date: 28/09/20

### Issuer Rating History:

Date	Rating	Outlook/Alert
27/07/12	BBB+	Stable

## RATIONALE

TRIS Rating affirms the issuer rating on Police General Hospital Saving and Credit Cooperative Ltd. (PHSC) at “BBB+” with a “stable” outlook. The rating reflects PHSC’s satisfactory operating performance, consistently high loan quality, and the competitive edge of savings cooperatives from having tax privileges and priority claims against debtors under the savings cooperative law. However, the rating is constrained by the weak regulatory supervision of savings and cooperatives in general, PHSC’s aggressive funding policy to attract deposits from affiliated members, weak capitalization, and key-person risk.

The rating also takes into consideration PHSC’s readiness to cope and comply with regulatory changes following the enactment of new legislation governing the operations of savings cooperatives.

## KEY RATING CONSIDERATIONS

### Readiness to cope and comply with new regulations

We hold the view that PHSC is well prepared to cope and comply with the new regulations with no serious concerns over its operations. The new law is basically designed to ensure tighter control over the deposit taking, lending, and investment activities of savings cooperatives. We view the law as an important step to alleviate concerns over the long-term stability of savings cooperatives that forms an important part of Thailand’s financial system.

Nevertheless, we expect the new law will constrain opportunities for growth and weaken PHSC’s financial performance in the short term. In particular, the more stringent capital requirements, leverage, and lending criteria will likely affect PHSC’s profitability. However, we do not expect the potential impact on PHSC’s profitability will materially impact its overall credit profile. On the other hand, the new requirements will likely strengthen PHSC’s risk management and capital structure, and thus enhance its long-term stability.

### Savings cooperatives enjoy privileges

Under the new law, the privileges granted to savings cooperatives in the forms of tax exemptions and priority claims against debtors remain unchanged. Savings cooperatives and their respective members are exempt from interest savings tax, value added tax, and tax on investment returns. The law also stipulates that a primary savings cooperative has priority claim over any other creditors to receive interest and repayments from its debtors. The priority claim privilege is an important competitive advantage over other lending institutions in lending to cooperative members. Most of the loans extended to ordinary members of primary savings cooperatives are under an arrangement with the borrower’s employer to deduct interest and principal installments from the borrower’s monthly salary. This explains the high loan quality and low credit costs for most primary savings cooperatives.

### Weak regulatory supervision

Savings cooperatives are not subject to the same degree of close supervision and rigorous examination as banking institutions. In our view, this is the major weakness that constrains the credit standings of savings cooperatives in Thailand. Although the current law lays out the framework for tighter controls on savings cooperatives’ activities, but effective enforcement of rules and regulations resting on periodic rigorous examinations of savings cooperatives

### Contacts:

Siriwan Weeramethachai  
siriwan@trisrating.com

Jittrapan Pantaleard  
jittrapan@trisrating.com

Taweekok Jiamsakunthum  
taweekok@trisrating.com



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to ensure compliance seems unlikely to happen anytime soon.

#### **Reliance on deposits from affiliated members**

PHSC's funding comes primarily from the deposits of its members. PHSC has two types of members, ordinary members and affiliated members. By law, ordinary members of a savings cooperative have to be employees of the employing organization. The employees of Police General Hospital (PGH) and its related entities are the only people qualified to be ordinary members of PHSC. Affiliated members are members who are not PGH's employees but are related to an ordinary member or have some form of affiliation with PHSC. In its efforts to attract deposits, PHSC has in the past adopted rather lax criteria in accepting affiliated members.

Of PHSC's total deposits as of March 2021, approximately 85% were from affiliated members and 15% were from ordinary members. By offering attractive interest rates and tax-exempt interest returns to members, PHSC has attracted a substantial number of deposits from affiliated members. The overly high proportion of deposits from affiliated members has caused concerns over the stability of PHSC's funding base in the long run. Unlike ordinary members who benefit from their membership, the majority of affiliated members will likely maintain their deposits only if PHSC can continue offering attractive returns. PHSC has adjusted its policy to gain more funding from other savings cooperatives to compensate for a potential decrease in deposits from affiliated members. As of March 2021, deposits from other savings cooperatives accounted for 11% of PHSC's total deposits, an increase from 3%-6% of total deposits over the past two years. However, we consider the instability of deposits from other savings cooperatives to be on the same level as deposits from affiliated members. In addition, deposits from other savings cooperatives could lead to a rise in deposit concentration risk.

To mitigate liquidity risk in relation to the stability of its deposits, PHSC has maintained sizable liquid assets and credit facilities from financial institutions. We view that PHSC's liquidity risk is manageable based on our expectation of PHSC's ability to continue offering attractive returns because of the tax privileges and the maintenance of adequate liquid assets. Going forward, we expect PHSC to gradually reduce its reliance on funding from affiliated members owing to the stricter rules on accepting affiliated members under the new regulations.

#### **Sufficient liquidity**

In TRIS Rating's view, PHSC should have sufficient liquidity over the next 12 months to cover any temporary liquidity shortfall at the current scale of operations, as the company has available credit facilities from several financial institutions. Furthermore, liquid assets (cash and investments) accounted for 51% of its total assets as of March 2021. PHSC ended March 2021 with a liquidity ratio of around 7.4%, which met the new liquidity reserve requirement of 3%. PHSC had a THB695 million exposure in senior unsecured debentures of Thai Airways International PLC (THAI) at the end of March 2021, equivalent to 4% of its total assets and 30% of its total equity. THAI is presently in a court-approved business rehabilitation. The rating has taken into account the effect of probable losses from the investment in THAI's debentures. PHSC has set aside an additional reserve for cooperative stability to absorb potential losses incurred from the investment. The reserve was equivalent to 12% of its net profit in fiscal year (FY) 2020 (year-ended 30 September 2020), up from around 0.4%-0.6% of net profit in the past few years.

#### **Weak capitalization**

PHSC's capitalization is weak due to its aggressive funding policy. Although the cooperative's equity has increased continuously, raising the ratio of equity to total assets to an improved level of 14.3% at the end of FY2020 from 7.7% at the end of FY2017, the ratio is still considered low. In comparison, other long-established, large savings cooperatives have an average equity to total asset ratio of around 40%.

#### **High loan quality**

PHSC has had no non-performing loans (NPLs; loans of more than 90 days overdue) since FY2007. PHSC's loan portfolio accounted for 49% of its total assets at the end of March 2021. Around 93% of the loan portfolio was made up of loans extended to other savings cooperatives, with the remainder being loans extended to ordinary members. These loans provide better returns than the investment portfolio. However, the demand for loans from ordinary members has been small.

PHSC has made a significant reduction in loan concentration risk over the past few years. Loans made to the 10 largest cooperatives constituted 26% of total savings cooperative borrowings as of March 2021, down from an average of 30% over the past few years. We expect PHSC to further reduce its loan concentration risk because of the single-borrower limit under the current regulations. We also expect that PHSC will continue to maintain its prudent credit risk policies.

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### Developing standard procedures to reduce key-person risk

PHSC has been able to pay dividends to shareholders at the highest level allowed by the regulator of around 10% of its paid-up shares since FY2009. PHSC's financial position and performance have been largely driven by one key member of the management team. We are of the view that PHSC has been overly reliant on one person to drive its operations. To mitigate the key-person risk, PHSC has been developing and implementing standard operating procedures, as well as applying other tools to support its operations.

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### BASE-CASE ASSUMPTIONS

TRIS Rating's base-case assumptions for PHSC's performance during FY2021-FY2023 are as follows:

- Equity to grow by 20% per annum on average.
- Loans to grow by 50% in FY2021 and to drop by 5% per annum in FY2022-FY2023.
- Spread of around 0.60%.
- Deposits from affiliated members to gradually decrease.

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### RATING OUTLOOK

The "stable" outlook reflects our expectation that PHSC will continue to generate acceptable returns to its ordinary members. We also expect PHSC to cope well and comply with the current regulations.

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### RATING SENSITIVITIES

The prospect of a rating upgrade is constrained by the lack of close supervision and rigorous examination of savings cooperatives in general. A downgrade scenario could arise should there be indications of higher vulnerability of the deposit base due to deteriorating confidence from affiliated members, or more aggressive operating and financial policies that lead to a deterioration in asset quality or a material loss on investment. Any regulatory change that erodes the tax and priority claim privileges currently enjoyed by savings cooperatives could also have a negative effect on the rating.

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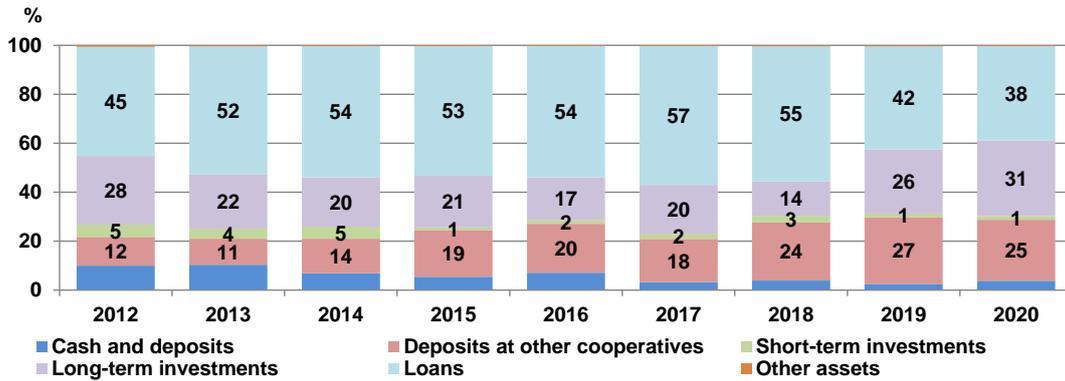
### ORGANIZATION OVERVIEW

PHSC was established in 2002 through the initiative of the top management of PGH. Before establishing PHSC, the PGH staff who wanted the benefits and services of a savings cooperative had to be members of the Saving and Credit Cooperative of Royal Thai Police Headquarters, Ltd. To enlarge its funding base, PHSC started to accept affiliated members who were allowed to use only the deposit services.

At the end of March 2021, PHSC had 1,898 ordinary members and 3,569 affiliated members. Its total assets were THB18.5 billion. PHSC is classified as a large savings cooperative, ranking in the top 50 of approximately 1,400 savings cooperatives in Thailand.

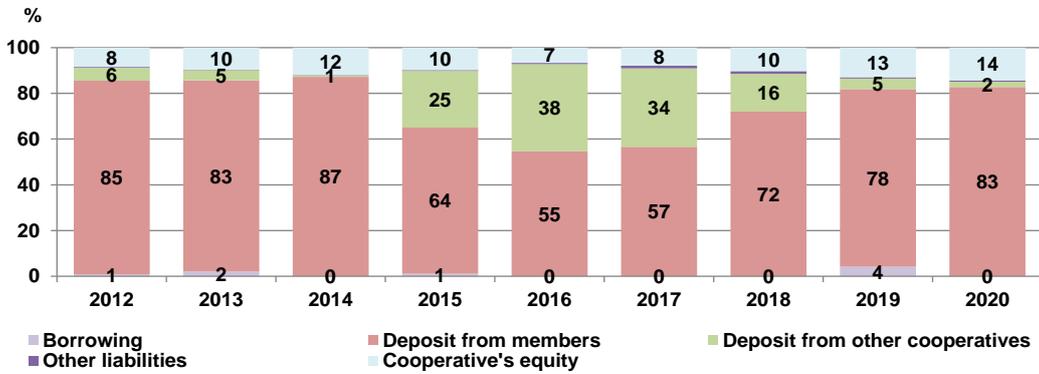
**KEY OPERATING PERFORMANCE**

**Chart 1: PHSC's Asset Structure**



Source: PHSC

**Chart 2: PHSC's Funding Structure**



Source: PHSC

**FINANCIAL STATISTICS AND KEY FINANCIAL RATIOS**
*Unit: Mil. THB*

	-----Year Ended 30 September-----				
	2020	2019	2018	2017	2016
Total assets	15,648	18,327	16,433	18,840	16,761
Total loans	6,023	7,713	9,071	10,714	8,993
Total investment in securities	5,073	5,079	2,749	4,127	3,194
Allowance for doubtful accounts	0	0	0	0	0
Deposits	13,312	15,095	14,542	17,713	15,555
Borrowings	0	760	0	0	0
Equity	2,243	2,371	1,696	1,494	1,111
Net interest and dividend income	192	174	139	155	129
Bad debts and doubtful accounts	0	0	0	0	0
Non-interest income	41	84	160	81	55
Operating expenses	12	10	118 *	9	10
Net income	213	246	179	227	174

\* Including THB109 million in general reserves

*Unit: %*

	-----Year Ended 30 September-----				
	2020	2019	2018	2017	2016
<b>Profitability</b>					
Net-interest and dividend income/average assets	1.08	0.99	0.78	0.87	0.99
Non-interest income/average assets	0.24	0.48	0.91	0.45	0.42
Operating expenses/total income	1.90	1.52	17.90 *	1.25	1.98
Return on average assets	1.25	1.42	1.02	1.28	1.34
Return on average equity	9.22	12.12	11.25	17.74	17.25
<b>Asset Quality</b>					
Non-performing loans/total loans	0.00	0.00	0.00	0.00	0.00
Bad-debts and doubtful accounts/average loans	0.00	0.00	0.00	0.00	0.00
Allowance for doubtful accounts/total loans	0.00	0.00	1.20	0.00	0.00
Allowance for doubtful accounts/non-performing loans	0.00	0.00	0.00	0.00	0.00
<b>Capitalization</b>					
Equity/total assets	14.33	12.94	10.32	7.69	6.63
Equity/total loans	37.24	30.73	18.70	13.52	12.35
<b>Funding and Liquidity</b>					
Member deposits/total funding	97.35	89.84	81.41	62.11	58.78
Liquid assets/(deposits+borrowings+paid-up stocks)	64.54	61.74	46.91	45.12	47.68

\* Including THB109 million in general reserves

**RELATED CRITERIA**

- Savings Cooperative Rating Methodology, 28 September 2020

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**Police General Hospital Saving and Credit Cooperative Ltd. (PHSC)**

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<b>Issuer Rating:</b>	BBB+
<b>Rating Outlook:</b>	Stable

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**TRIS Rating Co., Ltd.**

Silom Complex Building, 24th Floor, 191 Silom Road, Bangkok 10500, Thailand Tel: 02-098-3000

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