

PRESS RELEASE

APRIL 14, 2022

# DBRS Morningstar Confirms Innovation Credit Union at R-1 (low), Stable Trend

## BANKING ORGANIZATIONS

DBRS Limited (DBRS Morningstar) confirmed Innovation Credit Union's (Innovation or the Credit Union) Short-Term Issuer Rating and Short-Term Instruments rating at R-1 (low) with Stable trends. Innovation's Support Assessment (SA) is SA2, which reflects DBRS Morningstar's expectation of timely systemic external support from the Province of Saskatchewan (Saskatchewan or the Province; rated AA (low) with a Stable trend by DBRS Morningstar) through Credit Union Central of Saskatchewan (SaskCentral; rated R-1 (low) with a Stable trend by DBRS Morningstar), particularly in the form of liquidity. At present, the SA2 designation does not result in any uplift for Innovation's Short-Term Instruments rating.

## KEY RATING CONSIDERATIONS

The ratings reflect Innovation's solid franchise within its operating area, tempered by its moderate size, and the benefits of its membership in the well-established credit union system. Innovation's above-average revenue per member underpins its good earnings power, which supports the ratings. Moreover, the Credit Union's pending move to a federal charter, while ultimately a potential growth engine, could pose some initial funding challenges and has led to an increase in expenses as the Credit Union prepares for a new primary regulator.

## RATING DRIVERS

DBRS Morningstar views Innovation as well placed in its rating category. Over the longer term, sustained membership growth resulting in increased scale or a significant improvement in earnings metrics, especially through the growth of noninterest income and/or improved efficiency, would lead to an upgrade. Ratings would be downgraded should Innovation be unable to manage funding as it moves to a federal charter causing potential deposit outflows. Furthermore, significant losses in the loan portfolio, especially as a result of unforeseen weakness in the underwriting and/or risk management process, an inability to control costs, or a sustained reduction in internal capital generation, would also lead to a ratings downgrade.

## RATING RATIONALE

Innovation is the third-largest credit union in Saskatchewan with \$3.0 billion in assets as of December 31, 2021. The Credit Union serves nearly 12% of the Province's credit union system membership base through 26 advice centres in its footprint area and provides retail and small business commercial offerings, as well as an active digital platform. With approximately 58,800 members, Innovation has consistently grown its membership base since 2014 and expanded its market share within Saskatchewan's credit union system.

In December 2017, Innovation's members voted to pursue federal continuance, which would place the Credit Union under the Office of the Superintendent of Financial Institutions' (OSFI) supervision. Innovation submitted its formal application to OSFI in July 2018 and continues to work with all counterparties to finalize its federal charter application in 2022. In DBRS Morningstar's opinion, while Innovation has strong fundamentals, the proposed conversion to a federal credit union raises significant uncertainties about its prospects, especially with respect to funding. With federal continuance, deposit insurance of up to \$100,000 per account from the Canada Deposit Insurance Corporation, a federal Crown corporation, would replace Innovation's previously unlimited

deposit insurance coverage under Saskatchewan's Credit Union Deposit Guarantee Corporation (CUDGC); thus, the Credit Union could potentially experience deposit outflows from large retail and institutional depositors. Furthermore, although a federal charter would provide Innovation with access to prospective new members or retail customers, especially through online platforms, remote deposit acquisition might come at a higher cost than expected, given the highly competitive dynamics in a space that includes the large banks, other online platforms, and local credit unions.

In DBRS Morningstar's assessment, Innovation generates good profitability metrics and recurring earnings that can cover heightened levels of provisioning expenses. Overall, noninterest income comprised 22% of operating revenue in 2021, putting Innovation in the middle of its peer group. Innovation's revenue per member of \$1,477 in 2021 remains one of the highest among all DBRS Morningstar-rated credit unions. The Credit Union continues to enjoy one of the highest net interest margins among its peers following a 3-basis-point (bp) improvement year over year (YOY) to 2.54% in 2021, driven by improving spreads and a shift in the balance sheet structure. While credit unions typically have a high cost base because of their business model, Innovation usually maintains good expense control with its emphasis on technology. The Credit Union's efficiency ratio modestly deteriorated YOY by 70 bps to 77.8% in 2021. Provision for credit losses declined by 37% in 2021 to \$7.4 million from \$11.7 million in the previous year to form 33.9% of income before provisions and taxes.

Net loans grew 11.3% YOY to \$2.3 billion in 2021 as the Credit Union has established strategic partnerships with third parties to purchase residential and commercial mortgages that fall within its risk appetite in order to supplement growth from its legacy footprint. As a reflection of its footprint area in Northern and Western Saskatchewan, Innovation's proportion of agricultural loans at 20% of the loan portfolio is much higher than that of its peers, but has a long track record of strong performance and there are currently zero impaired loans within this sector. Nevertheless, DBRS Morningstar remains cautious that a weakening economy or pricing pressure in the agricultural sector could lead to an increase in impairment levels. Overall, impairment levels declined to 0.94% of gross loans from 1.71% in 2020, which can largely be attributed to the resolution of a large commercial loan. Furthermore, net write-offs remain manageable, forming 0.73% of average net loans, given that the majority of the loan book is secured either through real estate or government guarantees.

Innovation's funding has been resilient throughout the pandemic, and the Credit Union maintained prudent levels of liquidity. Commercial and retail deposits are the main source of Innovation's funding. The stability of credit union deposits is enhanced by the CUDGC guarantee; therefore, federal continuance could potentially lead to some deposit outflows. The Credit Union also has access to wholesale funding in the form of securitized borrowings via the Canada Mortgage Bonds program and broker deposits, which constitute 7.6% of funding. In addition, Innovation has various sources of liquidity, including credit facilities with SaskCentral, and reported a robust liquidity coverage ratio of 765% (166% using OSFI's calculation), well above the regulatory minimum of 100%. As with other financial institutions, Innovation saw outsized deposit growth during the pandemic and could face some core deposit runoff in the near term in line with the continued economic recovery. Nevertheless, its strong liquidity position will provide buffers to meet increased liquidity needs.

DBRS Morningstar views the Credit Union's capitalization levels as good with a sizable cushion over regulatory minimums to absorb potential losses. Innovation's Common Equity Tier 1 ratio, which is based on Basel III requirements, stood at 13.8% in 2021, down 60 bps from the previous year.

## ESG CONSIDERATIONS

A description of how DBRS Morningstar considers ESG factors within the DBRS Morningstar analytical framework can be found in the DBRS Morningstar Criteria: Approach to Environmental, Social, and Governance Risk Factors in Credit Ratings at <https://www.dbrsmorningstar.com/research/373262>.

Notes:

All figures are in Canadian dollars unless otherwise noted.

The principal methodology is the Global Methodology for Rating Banks and Banking Organisations (July 19, 2021; <https://www.dbrsmorningstar.com/research/381742>). Other applicable methodologies include the DBRS Morningstar Criteria: Approach to Environmental, Social, and Governance Risk Factors in Credit Ratings (February 3, 2021; <https://www.dbrsmorningstar.com/research/373262>).

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.dbrsmorningstar.com](http://www.dbrsmorningstar.com).

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

Generally, the conditions that lead to the assignment of a Negative or Positive trend are resolved within a 12-month period. DBRS Morningstar's outlooks and ratings are under regular surveillance.

For more information on this credit or on this industry, visit [www.dbrsmorningstar.com](http://www.dbrsmorningstar.com).

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## Ratings

### Innovation Credit Union

Date Issued	Debt Rated	Action	Rating	Trend	Attributes
14-Apr-22	Short-Term Issuer Rating	Confirmed	R-1 (low)	Stb	CA
14-Apr-22	Short-Term Instruments	Confirmed	R-1 (low)	Stb	CA

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