

Media Release:

Hua Nan Securities Co. Ltd. Ratings Affirmed At 'twAA-/twA-1+' On Solid Group Support; Outlook Stable

April 1, 2020

Overview

- Hua Nan Securities has suffered an unrealized loss of NT\$3.4 billion due to its failure to hedge its warrant issues effectively amid growing market volatility in March 2020.
- We believe the substantial loss has weakened Hua Nan Securities' stand-alone credit profile mainly through a weakening of its capitalization and earnings. However, we continue to expect strong support from the parent Hua Nan FHC group for the securities subsidiary.
- We are affirming our 'twAA-/twA-1+' issuer credit ratings on Hua Nan Securities.
- The stable rating outlook is stable to reflect our view that Hua Nan Securities will remain highly strategic unit of the Hua Nan FHC group and the ratings on the subsidiary will move in tandem with the direction of the consolidated group credit profile.

Rating Action

Taiwan Ratings Corp. today affirmed its 'twAA-' long term and 'twA-1+' short term issuer credit ratings on **Hua Nan Securities Co. Ltd.** The outlook on the long-term rating is stable.

Rationale

On March 24, 2020, Hua Nan Securities announced unrealized losses of New Taiwan dollar (NT\$) 3.4 billion of its derivative trading position. The substantial figure mainly results from Hua Nan Securities' failure to hedge its warrant issues. The company had issued several warrants that are linked to the Taiwan Stock Exchange Corporation (TSEC) Weighted Index. Hua Nan Securities failed to hedge the warrant issues sufficiently at a time of sharp market volatility beginning mid-March. The unrealized loss account for about 26% for the company's consolidated net worth.

We believe Hua Nan Securities' stand-alone credit profile has weakened as the result of this event and we expect its capitalization and earnings to weaken after taking into consideration the potential amount of losses incurred. The capitalization is likely to remain materially weaker than before the event, given Hua Nan Securities' sole shareholder, **Hua Nan Financial**

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Holdings Co. Ltd. (Hua Nan FHC), has no immediate plan to inject capital. Moreover, such a significant loss indicates potential deficiencies in Hua Nan Securities' risk control mechanism, because the company's risk management framework failed to quantify and manage the appropriate risks in advance.

The ratings affirmation reflects our view of strong support from Hua Nan FHC, given Hua Nan Securities' role as a highly strategic subsidiary. Therefore, we believe the ratings on Hua Nan Securities are unaffected by the recent losses, despite the weakening of its stand-alone credit profile. The long-term rating on Hua Nan Securities is higher than the company's stand-alone credit profile to reflect our view that the company carries strategic importance to the parent and will likely receive timely financial support from Hua Nan FHC, if needed. We believe Hua Nan Securities fits the parent group's strategy to serve its customers a more diversified product offering such as arranging investment transactions and capital raising services in Taiwan. In addition, there is high integration between the group and the securities subsidiary.

Outlook

The stable outlook on Hua Nan Securities reflects our expectation that the company will maintain its highly strategic role as the securities services provider for the Hua Nan FHC group over the next one to two years. Hence, the ratings on Hua Nan Securities will move in tandem with the consolidated group credit profile, which highly correlates to the performance of the group's banking unit, **Hua Nan Commercial Bank Ltd.**, which plays a dominant role in the group's overall risk profile.

Downward scenario

In addition to downward rating movement connected with changes in the group credit profile, we may lower the long-term issuer rating on Hua Nan Securities if the company's importance to the group declines significantly over the next one to two years. This could be due to Hua Nan Securities' weakening performance or significantly weakened market position.

Upward scenario

In addition to upward rating movement connected with changes in the group credit profile, we may raise the long-term rating on Hua Nan Securities if we were to reclassify the company as core to the wider group. This would require Hua Nan Securities to increase its contribution to the group significantly, typically in terms of earnings and shareholders' equity over the next two years. However, we view the possibility to be remote over the short term.

Related Criteria

- General Criteria: Group Rating Methodology - July 01, 2019
- Understanding Taiwan Ratings' Rating Definitions, www.taiwanratings.com - June 26, 2018
- Criteria | Financial Institutions | General: Risk-Adjusted Capital Framework Methodology - July 20, 2017
- Criteria | Financial Institutions | General: Nonbank Financial Institutions Rating Methodology - December 09, 2014
- Criteria | Financial Institutions | Banks: Banking Industry Country Risk Assessment Methodology And Assumptions - November 09, 2011

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- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings - April 07, 2017
- General Criteria: Use Of CreditWatch And Outlooks - September 14, 2009

(Unless otherwise stated, these articles are published on www.standardandpoors.com, access to which requires a registered account)

Ratings List

Ratings Affirmed;

Hua Nan Securities Co. Ltd.

Issuer Credit Rating	twAA-/Stable /twA-1+
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Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.taiwanratings.com for further information. Complete ratings information is available to subscribers of Rating Research Service at rrs.taiwanratings.com.tw. All ratings affected by this rating action can be found on Taiwan Ratings' public website at www.taiwanratings.com.

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