MOODY'S
INVESTORS SERVICE

Rating Action: Moody's Investors Service assigns Baa1 issuer rating to Eika Boligkreditt AS.

Global Credit Research - 02 Jun 2017

Limassol, June 02, 2017 -- Moody's Investors Service, ("Moody's") has today assigned a first time Baa1 issuer rating and long- and short-term Counterparty Risk Assessment (CRA) of A3(cr) and Prime-1(cr) respectively to Eika Boligkreditt AS, a specialized covered bond issuer owned by an alliance of 72 Norwegian savings banks.

The assigned ratings reflect Moody's view of the fundamental credit risk profiles of the individual banks forming the Eika alliance, as well as the agency's assessment of the likelihood that these banks will support Eika Boligkreditt in case of need. The assigned outlook on the issuer rating is stable.

Eika Boligkreditt's primary business purpose is to provide access to the international debt markets to its owners, 72 Norwegian savings banks belonging to the Eika alliance, the third largest banking group in Norway with 10.2% combined market share of retail lending and 6.5% of total banking system assets. Although individual members operate independently from each other, Moody's notes that the Eika alliance provides various benefits such as a shared information technology infrastructure, marketing and credit risk monitoring, which act as incentives for member banks to remain members of the Eika alliance and support Eika Boligkreditt.

A full list of affected ratings can be found at the end of this press release

RATINGS RATIONALE

The key drivers for Eika Boligkreditt's long-term issuer rating of Baa1 and long-term CRA of A3(cr) are: 1) the predominantly investment grade credit profiles of the banks that form the alliance which is also reflected in the high quality assets the banks transfer to Eika Boligkreditt; and 2) Moody's assessment of the probability that member banks would provide support to the covered bond entity, taking into account the balance of their obligations and incentives to do so under the Eika structure.

THE ANCHOR POINT FOR EIKA BOLIGKREDITT REFLECTS THE OWNER BANKS' INDIVIDUAL AND COLLECTIVE CREDIT PROFILES

The credit profiles of the banks that collectively form the alliance and support Eika Boligkreditt's Baa1 long-term issuer rating are underpinned by three key components: 1) the individual member banks' standalone credit profiles, as established by their respective business models, geographic areas of operations, financial characteristics and any relevant qualitative factors; 2) their capacity and willingness to help each other in case of failure of one or more members; and 3) Moody's Loss Given Failure analysis of the individual members' liability structures in order to assess the extent to which junior debt classes could cushion the impact of any regulatory "bail in" of the banks' creditors, as would likely be the case under the European Bank Recovery and Resolution Directive (BRRD), which Norway has committed to implement.

The credit profiles of the alliance banks constitute the anchor point which drives the ratings assigned to Eika Boligkreditt.

--The alliance banks' standalone credit risk profiles

To establish a view on the credit risk profile of the alliance banks, Moody's conducted a credit analysis of the member banks.

The majority of the alliance banks maintain relatively strong financial fundamentals, with limited variations in overall credit quality amongst individual members. While most of them focus on mortgage, retail and small and medium-sized enterprise (SME) lending in a relatively small geographic area, which typically translate in high concentration levels, they also tend to feature similar strengths, such as strong overall asset quality metrics and robust capital buffers.

More specifically, asset quality tends to be better than domestic peers, as reflected in the weighted average ratio of problem loans (impaired loans plus loans that are more than 90 days past due) to gross loans of 1.35% as of September 2016, as opposed to 1.85% for rated Norwegian banks. The main source of asset risk is structural, in that the banks' concentration to the broad housing and commercial real estate sector is sizeable and exposes banks in a downside scenario. In contrast, large exposures to single borrowers are generally not a concern.

To buffer any asset quality deterioration, Moody's notes that the Eika alliance's banks feature robust capital levels that are in average higher than their Norwegian peers. The weighted average Tier 1 ratio of Eika alliance banks stood at 18.8% as of September 2016 (including interim profit) versus 17.7% as of December 2016 for Norwegian rated banks. Furthermore, Moody's notes that the Eika banks generally use the more conservative so-called standard approach to risk weight assets. Meanwhile, to sustain these capital levels, profitability is broadly in line with their domestic peers, though it is slightly more vulnerable in Moody's view, given the limited scope for cost reduction at a number of the smaller banks.

The alliance banks also maintain stable liquidity buffers and their reliance on potentially volatile wholesale funding is lower than peers. The alliance banks' weighted average market funds ratio was 18% of total assets (25% when we include covered bonds issued through Eika Boligkredit), below the 42% market funds to tangible banking assets of Norwegian rated peers.

--Affiliate Support

Although there are strong incentives for the banks to support each other in case of stress and there exist past examples of such mutual assistance, Moody's assessment of the banks' credit profile does not result in any rating uplifts for the purpose of establishing the collective strength of the banks behind the Eika alliance. Moody's notes that the banks do not have a legally binding commitment to support each other in case of need. Further, there is limited benefit that can be incorporated in the banks' ratings given the small variations in credit quality among banks. Instead, the banks are more likely to allocate their resources in support of Eika Boligkreditt itself, which is captured in the CRA of A3(cr).

Moody's notes that the banks' credit profiles do not benefit from a rating uplift due to government support, reflecting the agency's assumption of a low likelihood of support from the government in case of need. Moody's expectation of a low likelihood of government support is driven by the banks' small individual national market shares.

---Loss Given Failure Analysis

Moody's assessment of the member banks' credit risk profiles also incorporates an analysis of individual banks' liability waterfalls in line with the rating agency's Loss Given Failure analysis. As part of this analysis and given the banks' small size and more retail and SME focus, the rating agency assumes that 10% of the banks' deposit base is more loss absorbing (i.e., "junior" deposits), in contrast with the standard assumption of 26%. The results of the banks' respective LGF analysis vary, ranging from one to two negative notches at issuer rating levels, depending on the liability structure of individual banks.

MOODY'S VIEW OF THE LIKELIHOOD BANKS WILL SUPPORT EIKA BOLIGKREDITT

The ratings assigned to Eika Boligkredit incorporate Moody's view of the likelihood that the owner banks will support Eika Boligkreditt and its creditors, which translates into a long-term Issuer rating of Baa1 and a long-term CRA of A3(cr). While there is no explicit commitment from the banks to directly support Eika's obligations vis-à-vis its bondholders, the agency notes that legal and publicly-available agreements currently in place between the banks and Eika Boligkreditt safeguard Eika Boligjkreditt's own access to adequate liquidity and capital. Moreover, in case one or more of Eika's owners are not able to provide their share of capital or liquidity the remaining banks may be required by Eika Boligkredit to increase their contribution up to a maximum of twice their initial allocation.

Additionally, the agency's view also reflects other factors that contribute in its assessment such as the absence of any provision to avoid payment under the agreement, Eika Boligkreditt's strategic fit and strong operational integration with the alliance banks, as well as the reputational and operational risks associated to the sharing of a common brand and a common technology platform.

OUTLOOK

The stable outlook assigned to Eika Boligkreditt's issuer rating reflects Moody's expectation that the banks' financial profiles and their capacity and willingness to support Eika Boligkreditt will remain broadly in line with their current standing over the next 12 to 18 months.

WHAT WOULD MOVE THE RATINGS UP/DOWN

Positive pressure would develop on the ratings following improvements in the risk profile of a significant proportion of the owner banks, as evidenced by improving asset quality metrics and reduced concentration to CRE. A full guarantee of Eika Boligkredit's obligations by the owner banks would also result in an upgrade.

The ratings would be downgraded if the credit profile of a significant portion of the banks weakens significantly, as evidenced by worsening financial fundamental including profitability, asset quality and capital or a reduced likelihood of the banks supporting Eika Boligkredit, as indicated by a loosening in the support agreements between Eika Boligkreditt and the banks that are currently in place.

LIST OF AFFECTED RATINGS

Issuer: Eika Boligkreditt AS

Assignments:

....LT Issuer Rating (Local Currency), Assigned Baa1, Outlook assigned Stable

....LT Counterparty Risk Assessment, Assigned A3(cr)

....ST Counterparty Risk Assessment, Assigned P-1(cr)

Outlook

...Outlook assigned Stable

PRINCIPAL METHODOLOGY

The principal methodology used in these ratings was Banks published in January 2016. Please see the Rating Methodologies page on www.moodys.com for a copy of this methodology.

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Melina Skouridou, CFA
Asst Vice President - Analyst
Financial Institutions Group
Moody's Investors Service Cyprus Ltd.
Porto Bello Building
1, Siafi Street, 3042 Limassol
PO Box 53205
Limassol CY 3301
Cyprus
JOURNALISTS: 852 3758 1350
Client Service: 44 20 7772 5454

Sean Marion
MD - Financial Institutions
Financial Institutions Group
JOURNALISTS: 44 20 7772 5456
Client Service: 44 20 7772 5454

Releasing Office:
Moody's Investors Service Cyprus Ltd.
Porto Bello Building
1, Siafi Street, 3042 Limassol
PO Box 53205
Limassol CY 3301
Cyprus
JOURNALISTS: 852 3758 1350
Client Service: 44 20 7772 5454

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