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CREDIT OPINION
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Update

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Eika Boligkreditt AS

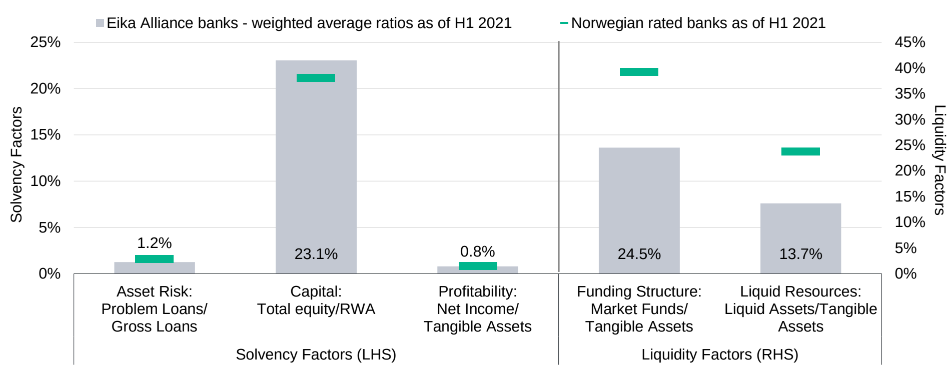
Update following ratings affirmation - outlook changed to positive

Summary

Eika Boligkreditt AS's Baa1 long-term issuer rating, its A3 Counterparty Risk Rating (CRR) and its A3(cr) Counterparty Risk (CR) Assessment reflect the respective weighted-average credit profiles of the 62 banks[1]. that are shareholders and users of Eika Boligkredittas well as, our assessment of the likelihood that the Eika banks will support Eika Boligkreditt, in case of need, taking into account the balance of their formal obligations and other incentives to do so under the Eika structure.

Our view of the owner banks' credit profiles reflects (1) our view of the strong financial fundamental of the alliance banks including their strong capitalisation, solid historical asset quality and low-risk retail lending focus, which is also reflected in the high quality assets the banks transfer to Eika Boligkreditt, but also taking into account their high indirect exposure to Norway's real estate sector; (2) the high level of integration with the member banks, who in turn have committed to provide limited capital and liquidity support to the covered bond issuer in case of need, albeit falling short of a legally-binding commitment amongst the banks to support each other; and (3) our Advanced Loss Given Failure (LGF) analysis on the banks' liability structure that leads to rating uplift for their issuer ratings, CRRs, and CR Assessments.

Exhibit 1
Rating Scorecard - Key Financial Ratios



Source: Eika Boligkreditt and Moody's Investors Service

Credit strengths

» Eika alliance bank's stand-alone creditworthiness, which is supported by solid capital and historically strong asset quality

» The member banks' commitment to safeguard Eika Boligkreditt's access to sufficient liquidity and capital

Credit challenges

» High concentration of the individual banks and Eika Boligkreditt in the Norwegian real estate market

» Lack of an explicit guarantee by the owner banks towards Eika Boligkreditt's obligations

Rating outlook

The positive outlook on Eika Boligkreditt's issuer rating, reflects the improvements in capitalisation and asset quality since 2018 and the expectation that problem loans will continue to decline in 2022 and that profitability will improve following the change in supplier of the group's core banking system.

Factors that could lead to an upgrade

» Eika Boligkreditt's ratings could be upgraded following an improvement in profitability combined with sustained risk profiles and capitalisation of the owner banks.

» A strengthening of the owner banks legal commitment to Eika Boligkreditt's could result in a rating upgrade.

Factors that could lead to a downgrade

» Albeit unlikely considering the positive outlook, the ratings could be downgraded if the credit profile of a significant portion of the alliance banks' financial fundamentals weakened.

» Eika Boligkreditt's ratings would also be downgraded in case of reduced likelihood of the owner banks supporting it, for example by a loosening in the support agreements that are currently in place between Eika Boligkreditt and the banks.

Key indicators

Exhibit 2

Eika Boligkreditt AS (Consolidated Financials) [1]

	06-21[2]	12-20[2]	12-19[2]	12-18[2]	12-17[2]	CAGR/Avg.[3]
Total Assets (NOK Billion)	118.4	120.6	105.8	108.0	99.6	5.1[4]
Tangible Common Equity (NOK Billion)	5.0	5.2	5.2	4.6	4.2	5.3[4]
Tangible Common Equity / Risk Weighted Assets (%)	13.3	14.1	15.2	13.5	13.3	13.9[5]
Net Interest Margin (%)	0.7	0.7	0.6	0.6	--	0.6[5]
PPI / Average RWA (%)	0.1	0.3	0.2	0.5	--	0.3[5]
Net Income / Tangible Assets (%)	0.0	0.1	0.1	0.1	0.1	0.1[5]
Cost / Income Ratio (%)	69.7	37.5	56.7	29.4	25.2	43.7[5]
Market Funds / Tangible Banking Assets (%)	51.1	51.4	50.0	50.3	50.5	50.7[5]
Liquid Banking Assets / Tangible Banking Assets (%)	17.8	17.2	13.5	16.3	14.5	15.9[5]

[-] Further to the publication of our revised methodology in July 2021, for issuers that have "high trigger" additional Tier 1 instruments outstanding, not all ratios included in this report reflect the change in treatment of these instruments. [1] All figures and ratios are adjusted using Moody's standard adjustments. [2] Basel II; IFRS. [3] May include rounding differences because of the scale of reported amounts. [4] Compound annual growth rate (%) based on the periods for the latest accounting regime. [5] Simple average of Basel II periods. [6] Simple average of periods for the latest accounting regime.

Sources: Moody's Investors Service and company filings

Profile

The Eika alliance is the third-largest banking group in Norway that as of June 2021 was made up of a group of 52[2] Norwegian local savings banks together with Eika Boligkreditt, Eika Gruppen, and Eika Banksamarbeidet. Total assets of the Eika alliance were equivalent to €45 billion and it had 177 local branch offices. As of end-June 2021 the Eika alliance held a 9.4% combined market share in retail lending.

Individual members operate independently from each other, but the Eika alliance provides a number of services which also act as incentives for member banks to remain members of the Eika alliance. Eika Boligkreditt's purpose is to provide access to the international debt capital markets to its owner savings banks. Eika Gruppen provide services such as a shared information technology infrastructure, marketing, and credit risk monitoring. Eika Banksamarbeidet procures products and services on behalf of the alliance members.

Recent developments

Bank specific developments

With effect 25 October 2021 10 banks left the Eika Alliance and were decoupled from the system infrastructure. The distribution agreements with Eika Forsikring and Eika Kapitalforvaltning were terminated on the same day. The termination was initially announced in January 2018, when the banks gave notice of termination to Eika Gruppen AS.

Macroeconomic developments

Russia-Ukraine crisis injects new risks into global economic outlook. Russia's (Ca negative) invasion of Ukraine (Caa2 RUR-) and the economic sanctions that the US (Aaa stable), European governments and other allies have subsequently imposed on Russia have increased risks to the global economic outlook. In particular, further escalation of the Russia-Ukraine conflict would put Europe's economic recovery at risk. Heightened geopolitical risks are unambiguously negative for economic activity. The magnitude of the effects will depend on the length and severity of the crisis.

Norway's trade flows with Russia are very limited as they export the same type of goods with the production of oil and gas among the most significant to the Norwegian economy. As European countries are looking to reduce imports from Russia, Norway is likely to be positively affected by increased demand in Europe. There are also oil reserves that are planned to be left unexplored due to the Paris agreement, but that could change due to geopolitical concerns.

Norges Bank increased the reference rate by 25 bps in September and December 2021, resulting in a reference rate of 0.5% as of year-end 2021, while indicated that further rate hikes will occur in 2022 and that it expects the reference rate to reach 1.7% by year-end 2024. The counter cyclical buffer (CCyB) requirement has been increased from 1% currently to 1.5% in end June 2022 and to 2.0% by the end of December 2022.

Detailed credit considerations

Source of facts and figures cited in this report

Unless noted otherwise, system ratios refer to the weighted average of rated Norwegian banks. The data presented in Exhibit 1 and discussed in the text refer to the weighted average ratios for the Eika alliance banks, while Exhibit 2 presents the data for Eika Boligkreditt itself.

The predominantly investment-grade credit profiles of the banks that own Eika Boligkreditt form the starting point for the company's ratings

The credit profiles of the banks that collectively form the alliance and own Eika Boligkreditt are underpinned by three key components: (1) the individual member banks' stand-alone creditworthiness, as established by their respective 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) the application of our Advanced LGF analysis on 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.

Eika Alliance banks' standalone creditworthiness

To establish a view on the credit risk profile of the alliance we analyse the individual member banks. The majority of the alliance banks maintain relatively strong financial fundamentals, with limited variations in overall credit quality amongst individual members.

The banks also continue to benefit from operating in Norway's Very Strong - operating environment, which reflects the country's economic resilience, built on its ample natural resources and a fiscal framework that shields the economy from the impact of oil price volatility. Norwegian banks benefit from operating in a wealthy, developed country with very high economic, institutional and government financial strength, as well as very low susceptibility to adverse events.

Norwegian banks will maintain good asset quality, strong capitalisation, and solid profitability. Their dependence on market funding will remain high, although mitigate by ample liquidity. The main risks to the system stem from a high level of household indebtedness, elevated real estate prices and domestic banks' reliance on market funding. However, these risks are mitigated by the strength of households' ability to service debt, banks' adequate capitalisation, and the relatively small size of the banking system compared to the total size of the economy.

Historically strong asset quality, although exposure to Norway's real estate sector is high

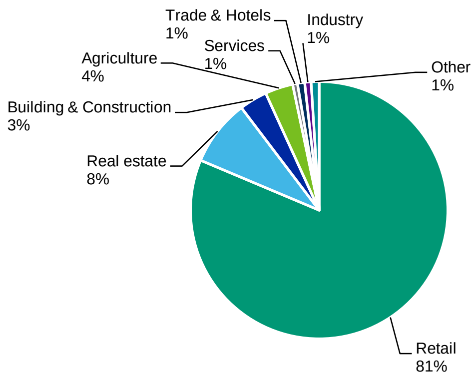
Historical asset quality for Eika Alliance banks has been strong, driven by a high proportion of retail mortgage lending. However, considering their mortgage lending activities and direct lending to real estate and construction the banks are highly exposed to Norway's property sector. We expect the banks' asset quality to remain broadly stable supported by Norway's improved operating conditions and even as support measures to businesses and households relating to the coronavirus pandemic are gradually lifted as Norwegian households will continue to service their debts supported by low unemployment levels.

The banks' weighted average ratio of problem loans (impaired loans and loans overdue by more than 90 days) to gross loans on the banks' own books was 1.2% as of end-June 2021, which was lower than the average of 1.6% for other rated Norwegian banks as of the same date. The member banks' strong recent asset performance reflects their retail banking focus. Loans to households, predominantly residential mortgages, made up on average 81% of the banks' total loan books as of year-end 2020 (including the loans transferred to Eika Boligkreditt). In addition, the banks' have little to no exposure to shipping and the oil sector, and moderate levels of large exposures to single borrowers, which have been declining.

Exhibit 3

Retail lending forms the bulk of the Eika banks' operations; however, there is also concentration towards the real estate and construction sectors

Loan book breakdown by sector (including the loans transferred to Eika Boligkreditt) as of year-end 2020



Source: Eika Boligkreditt

The average loan-to-value (LTV) of the bank's mortgage portfolio was a conservative 53.2% as of year-end 2020. In November 2019, Eika Boligkreditt made it possible for banks to transfer loans originated with a maximum LTV of 75%, up from 60%, in line with domestic peers. However, we do not expect this change to materially shift the structure of banks' mortgage books and 83% of mortgages have an LTV below 60%. The banks use Eika Boligkreditt for roughly 30% of their mortgages.

Our assessment of the Eika banks' asset risk also considers the concentration to Norway's general real estate sector both through the banks' mortgage lending activities but also through direct lending to the real estate, building and construction sectors that made up a further 11.8% of their loan books as of year-end 2020.

Solid capital levels provide a buffer against potential credit losses

Capital levels for the Eika alliance banks are robust with both total equity to risk-weighted assets (RWA) and equity to tangible assets on average higher than their rated Norwegian peers but. We expect capitalisation to remain strong going forward on the back of high and increasing capital requirements.

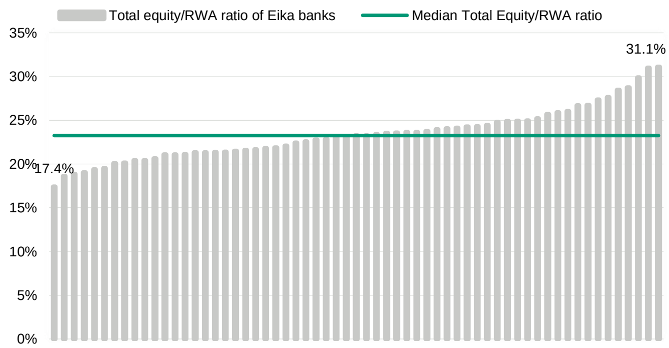
The Ministry of Finance has decided to increase the countercyclical capital buffer (CCyB) to 1.5% by mid-2022 and 2.0% by December 2022, reflecting strong improvement in the operating environment of Norwegian banks. We expect the CCyB to gradually be restored to 2.5% in 2023, which will ensure high capital levels going forward. Furthermore, the systemic risk buffer will increase to 4.5% from 3% on Norwegian exposures in December 2022.

The median equity to risk weighted assets ratio of the Eika Alliance banks stood at 23.1% as of end-June 2021 (see the first Exhibit below), higher compared to 21.1% for other Norwegian rated banks. The lowest equity/RWA ratio by an alliance bank was 17.4%, and the highest 31.1% as of end-June 2021. The weighted average consolidated Common Equity Tier 1 ratio of the Eika alliance banks was 17.8%, with most banks having sufficient buffers above the regulatory requirements and we expect the Eika banks to continue to meet their overall regulatory requirements with a buffer[3].

Furthermore, equity to total assets is strong at a median of 9.8% as of end-June 2021 (see the second Exhibit below) and compares favourably to regional peers (8.0% for other Norwegian rated banks). Since all Eika banks apply the standardised approach in calculating RWAs the banks' capital metric are less sensitive to rises in credit risk compared to banks using more risk-sensitive models and to potential amendments in regulatory methods to calculating RWAs, including floor requirements.

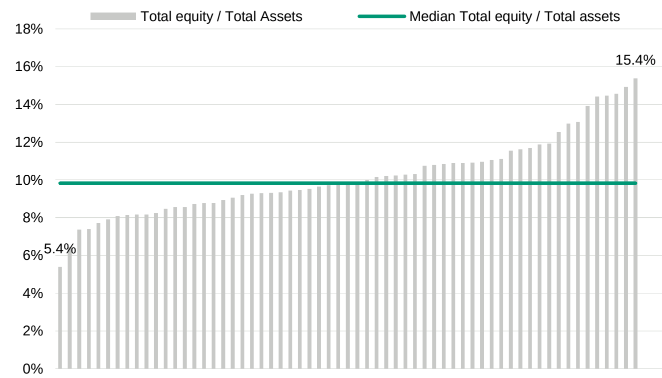
Although Eika Alliance banks have supported weaker banks in the past, there is no legally binding support agreement that requires member banks to support each other and in our view the Eika alliance banks. have limited access to capital in case of need given the small size of the banks' and because the majority of the member banks are not publicly listed. This mean the banks rely on earnings retention to shore up their buffers and finance growth.

Exhibit 4
Eika banks are well capitalised...
Total equity % risk-weighted assets as of the end of June 2021



Source: Eika Boligkreditt and Moody's Investors Service

Exhibit 5
...supported by strong leverage
Total equity to total assets ratio as of the end of June 2021



Source: Eika Boligkreditt and Moody's Investors Service

Focus on cost control and increased interest rates will support profitability in 2022

Profitability of the Eika alliance banks was in line with domestic peers for the first half of 2021, as reflected in their weighted-average net profit to total assets ratio of 0.8% for the first half of 2021, compared with the average of 0.8% for the rated Norwegian banks.

In September and December 2021, Norway's central bank increased the reference rate by 25 bps to 0.5%, and signaled future rate hikes. The higher rate is credit positive for Norwegian banks because it will moderate property price appreciation, reducing banks' asset risks. It will also support banks' already strong profitability and net interest margins. Eika Banks are to a large extent deposit funded and the interest rate hike will improve margins on deposits.

At the end of 2020 the Eika Banks' terminated its agreement with the current core banking supplier and has signed a new agreement with TietoEVRY. The agreement has a duration of five years with the possibility of extensions of a total of four years. The cost of changing the provider of its core banking system (see below) had a negative effect on profitability in 2021 but the agreement will strengthen the bank's long-term competitiveness through significant cost efficiency, strengthened development power and increased strategic flexibility. The transition is expected to be completed in 2022-23 with full savings to be achieved by 2024.

Member banks benefit from operational efficiencies, such as common IT systems and platforms that Eika Gruppen develops, as well as, risk policies and procedures, which the banks can then customise. We also expect the alliance banks to continue to focus on cost control. Nevertheless, the smallest Eika banks have an inflexible cost base and lack the benefits afforded by higher economies of scale. In general, the weighted average cost-to-income ratio of Eika banks was 47.5% as of end-June 2021, which is higher than the 43.4% for the Norwegian banking sector.

Funding and liquidity

Eika banks have a significantly lower reliance on potentially volatile wholesale funding compared with average of rated Norwegian peers. The banks' weighted average market funds ratio (including 50% of covered bonds issued through Eika Boligkreditt was 24.5% of tangible banking assets as of the end-June 2021, below the 39.2% of Norwegian rated banks for the same period.

The Eika alliance banks maintain solid liquidity buffers with an average of 13.7% of liquid assets to tangible banking assets as of end-June 2021. This is lower than the 23.8% of Norwegian peers but we note that liquid assets to total assets was higher of 17.1% as of the same date.

ESG considerations

In line with our general view for the banking sector, Eika Boligkreditt and Eika alliance banks have a low exposure to Environmental risks. See our Environmental risks heat map for further information.

We believe banks face moderate Social risks. The most relevant social risks for banks arise from the way they interact with their customers. Social risks are particularly high in the area of data security and customer privacy which is partly mitigated by sizeable technology investments. Fines and reputational damage due to product misselling or other types of misconduct is a further social risk. Societal trends are also relevant in a number of areas, such as shifting customer preferences towards digital banking services, increasing information technology cost, aging population concerns in several countries, impacting demand for financial services or socially driven policy agendas that may translate into regulation that affects banks' revenue base. These trends are particularly important for Eika banks because they predominantly engage in retail banking activities and play an important role in their local communities. In addition, we regard the coronavirus outbreak as a social risk under our ESG framework, given the substantial implications for public health and safety. See our Social risks heat map for further information.

Governance is highly relevant both for Eika Boligkreditt itself and for its owner banks, similarly to all players in the banking industry. Corporate governance weaknesses can lead to a deterioration in a company's credit quality, while governance strengths can benefit its credit profile. Although Eika banks are typically small and have limited resources and expertise individually to deal with developments in this area, they benefit from systems and training provided by the alliance, such as in the area of anti-money laundering. As such, we currently do not have specific concerns around the banks' own governance. Nonetheless, corporate governance remains a key credit consideration and requires ongoing monitoring.

Support and structural considerations

Our assessment of the banks' credit strength does not incorporate any mutual support uplift among member banks

There are strong incentives for the banks to support each other in case of stress and there are past examples of such mutual assistance. However, our assessment of the banks' credit profiles does not result in any rating uplift for the purpose of establishing the collective strength of the banks behind the Eika alliance.

The banks do not have a legally binding commitment to support each other in case of need. Further, there is limited benefit that could be incorporated in the banks' ratings given the small variations in standalone credit quality among banks. Instead, the banks are more likely to allocate their resources in support of Eika Boligkreditt itself, and this support is already incorporated in the final ratings.

Affiliate support

The Baa1 issuer rating, A3(cr) CR Assessment, and A3 CRR assigned to Eika Boligkreditt incorporate our view of the likelihood that the owner banks will support Eika Boligkreditt.

While there is no explicit commitment from the banks to directly support Eika Boligkreditt's obligations vis-à-vis its bondholders, there are publicly-available and legally enforceable agreements in place between the banks and Eika Boligkreditt to safeguard Eika Boligkreditt's own access to adequate liquidity and capital.

Specifically, on a proportionate basis, banks would need to subscribe to any new covered bond issues in case there is a disruption in the covered bond market, and to new capital issuances to maintain Eika Boligkreditt's metrics above its regulatory requirements. Moreover, in case one or more of Eika Boligkreditt's owners are not able to provide their share of liquidity or capital, the remaining banks may be required by Eika Boligkredit to increase their contribution up to a maximum of twice their initial allocation.

Additionally, our view also reflects additional factors, 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.

The application of our Advanced LGF analysis lifts the banks' credit profiles

In line with our methodology, our assessment of the member banks' credit risk profile incorporates an analysis of individual banks' liability waterfall in line with our Advanced LGF analysis. As part of this analysis and given the banks' small size and more retail and small-and-medium business focus, we assume that 10% of the banks' deposit base is made up of so-called "junior" deposits (i.e., more loss absorbing) rather than our standard assumption of 26%.

Our LGF analysis results, on average, in a two notch uplift to the banks' respective issuer rating levels and a three notch uplift to their respective CR Assessments and CRRs.

Government support

We do not incorporate any government support uplift in the banks credit profiles because of the implementation of a resolution legislation in Norway and the banks' small individual national market shares.

Counterparty Risk (CR) Assessment

Eika Boligkreditt's A3(cr) CR Assessment is an input in the rating of the entity's covered bond instruments.

Counterparty Risk Ratings

Eika Boligkreditt's A3 CRR reflects our view that in a resolution, CRR liabilities might benefit from preferential treatment compared with senior unsecured debt.

Ratings

Exhibit 6

Category	Moody's Rating
EIKA BOLIGKREDITT AS	
Outlook	Positive
Counterparty Risk Rating	A3/P-2
Counterparty Risk Assessment	A3(cr)/P-2(cr)
Issuer Rating -Dom Curr	Baa1

Source: Moody's Investors Service

Endnotes

1 This includes the 10 banks that terminated their agreements with effect from 1 January 2022. It also includes OBOS-banken AS, where the distribution agreement expired in February 2017. Financing from theses banks are decreasing in accordance with an agreed plan. There are 52 banks that are members of the Eika Alliance

2 Including Sandnes Sparebank, the 10 Eika banks that left the Alliance in October 2021 are excluded.

3 Please also see: Norway raises reference rate, hinting at future increases, a credit positive for banks, 29 September 2021

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