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ISSUER IN-DEPTH
9 June 2017

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RATINGS

Eika Boligkreditt AS

Domicile	Norway
Counterparty Risk Assessment	A3(cr)/P-1(cr)
Issuer Rating - Dom Curr	Baa1
Outlook	Stable

Source: Moody's Investors Services

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Eika Boligkreditt AS

A leading Norwegian covered bond issuer owned by savings banks

On 2 June we assigned a first time issuer rating of Baa1 and a Counterparty Risk Assessment (CRA) of A3(cr)/Prime-1(cr) to Eika Boligkreditt AS. Following this rating action, on 6 June we upgraded the mortgage covered bonds of Eika Boligkreditt AS to Aaa from Aa1.

Eika Boligkreditt is a credit institution that raises covered bond finance on the international debt markets on behalf of its owners, the 72 Norwegian regional savings banks that form the Eika banking alliance. The member banks ownership' of the institution is proportional to the funding they receive from it, and is rebalanced on an annual basis. The Eika alliance is the third largest banking group in Norway, with a 10.2% combined market share of retail lending, and a 6.5% share of total banking system assets.

This form of strategic alliance is common in the Norwegian banking sector due to the large number of savings banks that operate in the country. Most Norwegian savings banks are mutually-owned. They play an important role in supporting local communities, and have a long history and a strong sense of identity. Strategic alliances allow them to maintain their independence while benefiting from economies of scale and shared services.

Below we address some frequently-asked questions (FAQs) about Eika Boligkreditt and the Eika bank alliance.

1. What is the Eika alliance business model, and what benefits does it offer its members?

The Eika alliance brings together small banks so that they can purchase services, develop products, or raise debt more cheaply than would be possible individually. Member banks have similar characteristics and are predominantly focused on retail and small-and-medium enterprise (SME) lending. Retail loans account for 75% of their combined loan book (81% including loans transferred to Eika Boligkreditt).

Cost-sharing across the alliance unlocks economies of scale, allowing even very small savings banks to provide customers with highly sophisticated services, while maintaining their independence and local focus. Alliance members receive the following benefits:

» **Infrastructure and IT.** The alliance provides strong operational support to its members by developing common IT systems and platforms. The Eika alliance has a joint platform supporting online banking, mobile banking and individual bank websites. Payment processing and digital services are also carried out on a centralised basis, making the banks more competitive.

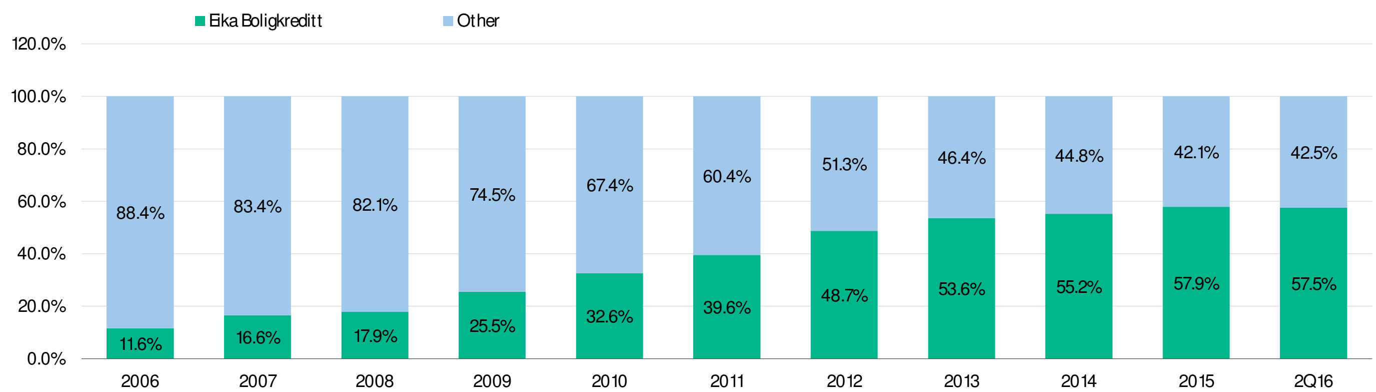
- **Credit Monitoring and Coordination.**Through common IT platforms, Eika ensures member banks comply with regulatory requirements. Risk policies and procedures are established centrally by the Eika alliance, which individual banks customise according to their risk preference. As a result, there is a standardized model for the banks' classification of customers by risk profile. Further support through back office functions such as auditing, financial reporting and regulatory reporting is also provided.
- **Marketing.** The member banks share a logo and brand, strengthening their market recognition. They also centralise their marketing campaigns, with Eika acting as a support brand and concept and content provider to the local banks
- **Financial Products and Services to Bank Clients.** Eika-owned companies provide asset management services (Eika Kapitalforvaltining AS), insurance products (Eika Forsikring AS), leasing, car financing and credit cards (Eika Kredittbank AS), as well as real estate products (Aktiv Eiendomsmegling AS) to the customers of the member banks.
- **Covered Bond Funding.**Issuing covered bonds through Eika Boligkreditt gives member banks access to funding on similar terms to those available to larger Norwegian banks. Eika's funding is competitive in terms of loan tenure and depth of access, as well as pricing. This enhances Eika members' competitiveness.

2. How has Eika Boligkreditt's role changed over time?

We believe that Eika Boligkreditt has become increasingly important to its member banks since the institution was established in 2006.

From a low base at inception, Eika Boligkreditt's contribution to its owner banks' external funding has risen steadily to almost 60% (NOK 73.4 billion as of March 2017). Customer deposits account for most of the remainder followed by senior and junior debt (see Exhibit 1). The share of covered bonds in the banks' total funding has stabilized in recent years, and we expect it to stay close to current levels going forward.

Exhibit 1
Eika Boligkreditt's share of total member bank funding has risen steadily



Source: Eika Boligkreditt

Eika Boligkreditt's underwriting criteria are generally more conservative than required under Norwegian regulations. The maximum loan to value of the loans making up the cover pool is 60% at the time of origination, below the 75% ceiling stipulated under Norwegian law. The asset pool is valued on a quarterly basis by an independent third party. As of 30 September 2016, residential mortgage loans and mortgage loans to housing cooperatives accounted for 74.3% and 11.2% of the covered pool respectively. The remaining 14.5% consisted of substitute assets. All properties serving as loan collateral are located in Norway[1].

3. To what extent are member banks committed to supporting Eika Boligkreditt?

The owners banks are committed to providing Eika Boligkreditt with capital and liquidity support at all times, which is limited up to two times their current pro-rata funding allocation from the institution. As a result, more than half of the member banks would have to default before Eika Boligkreditt were unable to raise the required capital/liquidity.

This support obligation falls short of a full irrevocable and unconditional commitment of the kind which would allow an alignment of Eika's creditworthiness with that of its shareholders. Eika alliance banks' obligation to support Eika Boligkreddditt is set out in the following agreements:

» **Capital support agreement (Shareholders Agreement).** In a scenario where one member of the alliance defaults on its obligations to Eika Boligkreditt, the remaining shareholders are jointly liable for making up the resulting shortfall. However, their support commitment is limited to two times their current pro-rata funding allocation. Any member bank that failed to fulfil its obligation to contribute additional capital would be considered to be in default. In this scenario, the other members become liable for any sums owed by the defaulting bank to Eika Boligkreditt, such as past and future fees.

» **Liquidity support agreement (Note Purchase Agreement).** The obligation to provide liquidity support to Eika Boligkreditt is proportional to each shareholder's pro-rata participation in each issuance. If a participating shareholder fails to purchase issuer notes, then the remaining shareholders must increase their purchase proportionally to their pro-rata allocation, but should not exceed twice the current funding allocation.

» **Distribution Agreement.** Eika Boligkreditt and the owner banks also have a distribution agreement which provides Eika Boligkreditt with some protection from losses due to bad loans. These require member banks to cover 80% of any losses on loans transferred to the Boligkredit, subject to a cap set at 1% of the owner bank's total portfolio. For a 12-month period, Eika Boligkreditt has the right to deduct the remaining losses from the commissions paid to the banks. Eika Boligkreditt has to date never triggered these agreements, as banks have until now replenished non-performing loans. The transfer of member banks' loans to Eika Boligkreditt is considered a true sale. As a result, with the banks receiving fees based on the interest rates attached to the transferred loans. These are recognized in their income statements as fee income.

4. How would bank default or failure affect the alliance?

In a scenario where one or more members of the alliance faced failure or default, we believe the stronger members would support their weaker peers through capital injections, or by acquiring them. Although no legally binding mutual support commitment is in place, there are strong links between alliance members, giving them an incentive to assist each other if required.

Since the banks share operations, back office systems, and branding and logos, providing support to weaker members would reduce reputational risk for the alliance as a whole. The broad similarity between member banks' businesses also encourages mergers in a stress scenario, as merger partners would likely benefit from synergies via branch and headcount reductions. Disruption for clients would likely be minimal, since Eika alliance banks operate using the same back office operations and platforms.

There are a few recent clear examples of alliance members assisting each other, when Eika members provided capital support to weaker peers by participating in their rights issues. Some financially strong alliance members are currently in the process of merging with weaker ones.

In an extreme scenario of market stress affecting the banking sector as a whole, the member banks faced with default or failure would likely exit the alliance as there is no legal obligation for the other members to provide assistance. The lack of a legally binding agreement encourages member banks to protect their own interests, reducing the alliance's indiosyncratic risk.

A member bank can cancel its distribution agreement with Eika Boligkreditt with a three month notice period, while Eika Boligkreditt must provide 12 months' notice. However, Boligkreditt's minimum notice period falls to 3 months if it decides to cancel all current agreements with authorised distributors as a result of legal changes. During the notice period, all parties concerned must work actively to achieve an expiry that is to their mutual benefit, and to that of the mortgagees.

An example of distribution agreement cancellation occurred in January 2016, when alliance member OBOS Banken announced plans to set up its own wholly-owned covered bond company OBOS-boligkreditt AS. The board of Eika Boligkreditt decided to cancel OBOS

Banken's distribution agreement in February 2016. Following the expiry of the 12 month notice period, OBOS Banken lost the right to transfer new mortgages to Eika Boligkreditt. OBOS Banken can not withdraw its existing portfolio at a rate quicker than the maturities of Eika Boligkreditt 's funding, as per the provisions on the distribution agreement. A separate agreement for a planned run-off of was negotiated.

We believe the likelihood of government support for member banks in a stress scenario is low, given their small individual shares of the Norwegian market. In addition, Norway is in the process of transposing the EU Banking Resolution and Recovery Directive (BRRD), which restricts the use of public funds to rescue failing banks, into national legislation.

5. How does Eika Boligkreditt compare with other covered bond issuers in Norway?

Eika Boligkredit is one of the largest bond-issuing institutions in Norway, and plays an important role in supporting the Eika alliance banks by reducing their financing risk, and reinforcing their competitiveness (see Exhibit 2).

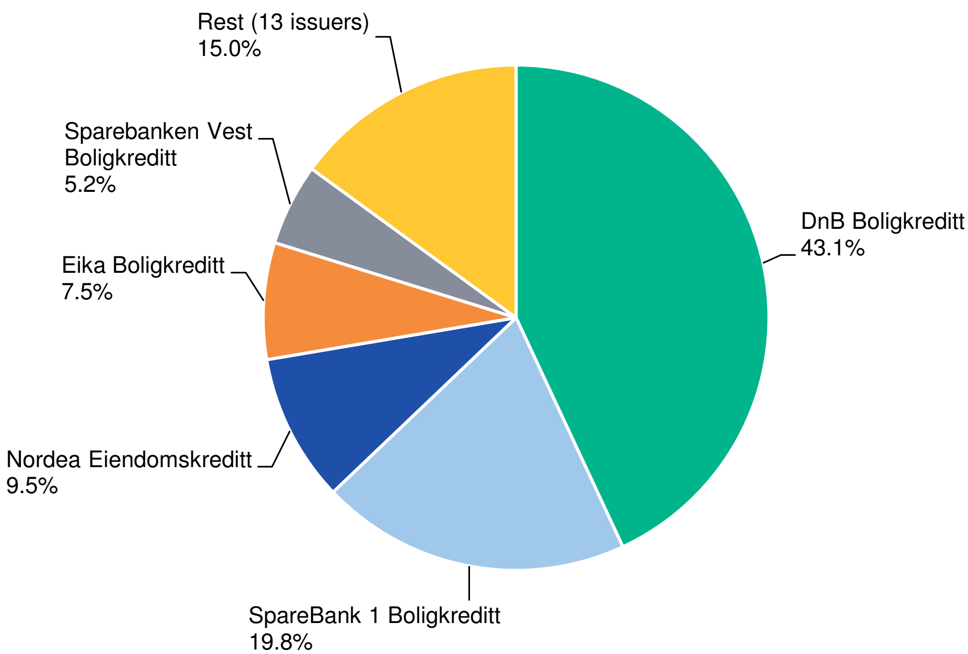
Through Eika Boligkreditt, Eika alliance banks have access to funding on similar terms to those offered to larger Norwegian banks. This ensures that their customers achieve competitive terms for their residential mortgages.

Covered bonds are widely used by Norwegian banks to cover their financing needs and are one of their primary debt instruments. As of end 2015, Norwegian outstanding covered bonds were equivalent to approximately 30% of Norway's GDP, equivalent to an outstanding amount of NOK 1 trillion (EUR 100 billion).

Exhibit 2

Eika Boligkreditt is one of the largest covered bond-issuing institutions in Norway

Outstanding covered bonds rated by Moody's per issuer in percentage



Data as of Q3 2016

Source: Moody's Investors Service

Moody's Related Research

Credit Opinions:

- Eika Boligkreditt AS: First Time Rating
- Obos-Banken AS: Semiannual update with year-end 2016

Press Releases:

- Moody's Investors Services assigns Baa1 issuer rating to Eika Boligkreditt AS

Banking System Outlooks:

- Norway

Covered Bonds:

- Press Release: Moody's Upgrades Eika Boligkreditt's mortgage covered bonds
- New Issuer Report: Eika Boligkreditt Mortgage Covered Bonds
- Credit Opinion: OBOS Boligkreditt AS Mortgage Covered Bond Programme
- Performance Review: Eika Boligkreditt AS - Mortgage Covered Bonds
- Sector In Depth: Moody's Global Covered Bonds Monitoring Overview: Q3 2016

Endnotes

1 Eika Boligkreditt Mortgage Covered Bonds

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