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CREDIT OPINION
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Update

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Eika Boligkreditt AS

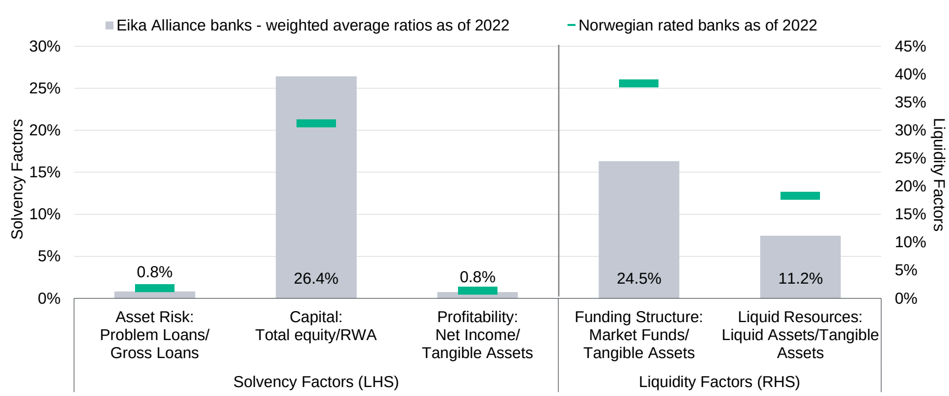
Update following rating upgrade to A3

Summary

Eika Boligkreditt AS's A3 long-term issuer rating, its A2 Counterparty Risk Rating (CRR) and its A2(cr) Counterparty Risk (CR) Assessment reflect the respective weighted-average credit profiles of the 49 banks[1] that are shareholders and users of Eika Boligkreditt as 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) 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 level of integration with the member banks, which 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



The weighted average ratios were calculated for all banks, including LBA banks.
Source: Eika Boligkreditt and Moody's Investors Service

Credit strengths

» Eika alliance banks' 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 concentrated exposure of the individual banks and Eika Boligkreditt to the Norwegian real estate market

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

Rating outlook

The stable outlook on Eika Boligkreditt's long-term issuer rating reflects our view that the owner banks' high capital base and strong asset quality will endure, while profitability will be supported by higher interest rates and efficiency gains, partly offset by lower lending growth and margins, combined with some loan and deposit regional concentrations.

Factors that could lead to an upgrade

» Eika Boligkredit's ratings could be upgraded following further improvements 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 combined with higher level of integration among member banks could also result in a rating upgrade.

Factors that could lead to a downgrade

» The ratings could be downgraded if the credit profile of a significant portion of the alliance banks' financial fundamentals weakened, or if or a large number of the stronger banks exited the alliance.

» 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]

	06-23[2]	12-22[2]	12-21[2]	12-20[2]	12-19[2]	CAGR/Avg.[3]
Total Assets (NOK Billion)	124.3	126.6	114.9	120.6	105.8	4.7[4]
Tangible Common Equity (NOK Billion)	6.0	5.9	5.2	5.2	5.2	4.3[4]
Problem Loans / Gross Loans (%)	--	0.0	0.1	--	--	0.0[5]
Tangible Common Equity / Risk Weighted Assets (%)	15.7	15.2	13.8	14.1	15.2	14.8[6]
Problem Loans / (Tangible Common Equity + Loan Loss Reserve) (%)	--	0.4	0.9	--	--	0.6[5]
Net Interest Margin (%)	0.5	0.4	0.7	0.7	0.6	0.6[5]
PPI / Average RWA (%)	0.5	-0.3	0.0	0.3	0.2	0.1[6]
Net Income / Tangible Assets (%)	0.1	-0.1	0.0	0.1	0.1	0.0[5]
Cost / Income Ratio (%)	30.8	-286.7	103.5	37.5	56.7	-11.7[5]
Market Funds / Tangible Banking Assets (%)	49.8	50.7	50.4	51.4	50.0	50.5[5]
Liquid Banking Assets / Tangible Banking Assets (%)	19.4	20.0	15.6	17.2	13.5	17.2[5]

[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 periods for the latest accounting regime. [6] Simple average of Basel II periods.
Sources: Moody's Investors Service and company filings

Profile

The Eika alliance is the third-largest banking group in Norway that as of December 2022 was made up of a group of 50[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 180 local branch offices, while as of December 2022 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.

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, including LBA 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 oil price volatility. Norwegian banks benefit from operating in a wealthy, developed country with very high economic, institutional and government financial strength, and very low susceptibility to adverse events.

The main risks to the banking system stem from its extensive use of market funding, and from Norway's increased household debt and high real estate prices. However, the household sector's strong debt servicing ability, the Norwegian government's well-coordinated monetary and regulatory policies, and the country's sizeable sovereign wealth fund, which supports the economy during crises, mitigate these risks. Furthermore, commercial real estate (CRE) prices have declined only marginally so far and rental agreements are linked to inflation. Also, exposures in individual banks' balance sheets are manageable compared with their core capitalisation.

A significant decrease in either CRE prices or house prices could potentially strain Norway's macro profile.

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. Despite the long-term risks of increasing household debt levels in the higher inflation and interest rate environment, we expect loan quality for this segment to remain strong over the next 12-18 months, given the strong debt serviceability of Norwegian households, and the conservative average loan-to-value of Eika member banks (60% at end June 2023).

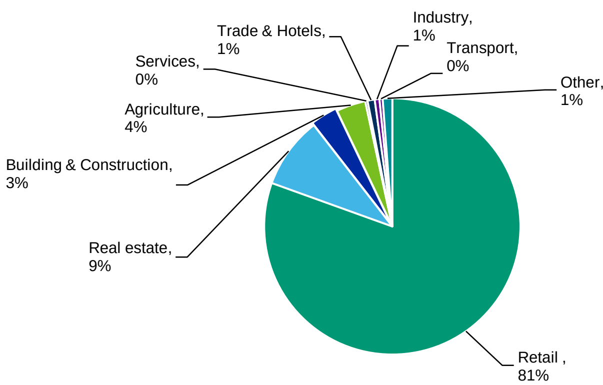
Going forward we broadly expect the banks' asset quality to deteriorate modestly - driven by the small to medium sized enterprise (SME) sector, given the higher debt servicing costs for borrowers and inflationary pressures - but to remain sound.

The banks' weighted average ratio of problem loans (impaired loans and loans overdue by more than 90 days) to gross loans (including loans transferred to Eika Boligkreditt) was 0.8% as of year-end 2022, which was lower than the average of 1.2% 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 2022 (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 2022



Source: Eika Boligkreditt

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. We expect capitalisation to remain strong going forward on the back of high capital requirements.

The Ministry of Finance has decided to fully restore the countercyclical capital buffer (CCyB) to 2.5% effective from 31 March 2023, which will ensure high capital levels going forward. Furthermore, the systemic risk buffer will increase to 4.5% from 3% on Norwegian exposures for banks under the standardized approach in December 2023 (for the IRB banks it is implemented already).

The median equity to risk weighted assets ratio of the Eika Alliance banks stood at 26.0% as of year-end 2022 (see the first Exhibit below), higher compared to 20.8% for other Norwegian rated banks. The lowest equity/RWA ratio by an alliance bank was 20.7%, and the highest 34.6% as of year-end 2022. The weighted average consolidated Common Equity Tier 1 ratio of the Eika alliance banks was 20.5%, 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.

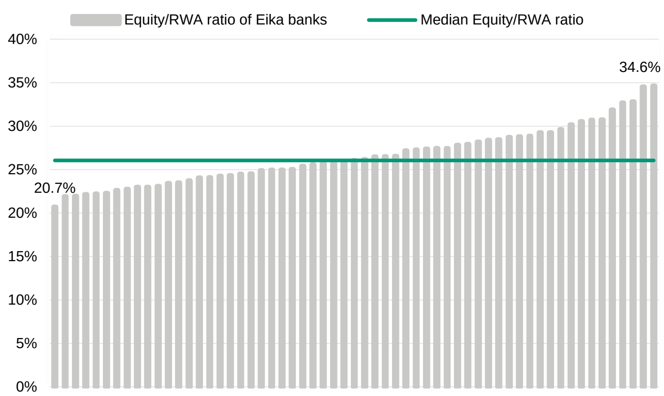
Furthermore, equity to total assets (including loans transferred to Eika Boligkreditt) is strong at a median of 9.9% as of year-end 2022 (see the second Exhibit below) and compares favourably to regional peers (8.0% for other Norwegian rated banks). Since all Eika banks apply the standardised approach in calculating RWAs, the banks' capital metrics 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 with equity in the past, there is no legally binding support agreement that requires member banks to support each other. Furthermore, 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 primarily 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 year-end 2022

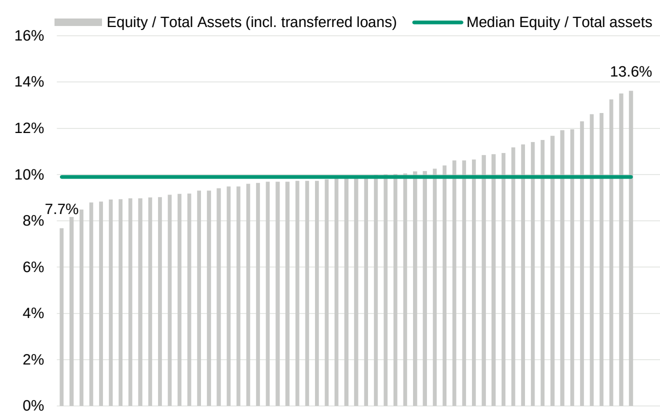


Source: Eika Boligkreditt

Exhibit 5

...supported by strong leverage

Total equity to total assets ratio as of the end of year-end 2022



Source: Eika Boligkreditt

Focus on cost control and higher interest rates will support profitability in 2023-24

Profitability of the Eika alliance banks was in line with domestic peers, as reflected in their weighted-average net profit to total assets ratio of 0.8% for the year-end 2022, compared with the average of 0.9% for the rated Norwegian banks.

Norway's central bank has increased the reference rate to 4.25% in September 2023. The central bank has been increasing the reference rate gradually since September 2021, which is credit positive for Norwegian banks because the higher interest rates will moderate property price appreciation and reduce 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 their agreement with their core banking supplier and 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 had a negative effect on profitability in 2021 and 2022, but the agreement is expected to strengthen the bank's long-term competitiveness through significant cost efficiency. The transition is expected to be completed in 2023 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 48.5% for the year-end 2022, which is higher than the 41.8% for the Norwegian banking sector. However, we expect cost-to-income ratio to improve in 2024 once the banks start to experience cost savings from the transition to TietoEvery.

High liquidity buffers mitigate some reliance, albeit limited, on wholesale funding

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 year-end 2022, below the 38.4% of Norwegian rated banks as of the same date. Concurrently, some banks exhibit certain deposit concentrations, which could pose downside risks to their funding profile if not managed properly.

The Eika alliance banks maintain solid liquidity buffers with an average of 11.2% of liquid assets to tangible banking assets as of year-end 2022, and average LCR was a strong 246%. Besides cash and dues from other banks, the banks' liquidity buffers include securities portfolios, which mainly comprise covered bonds, local and government bonds, senior bank issues and money market funds.

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. 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 A3 issuer rating, A2(cr) CR Assessment, and A2 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 A2(cr) CR Assessment is an input in the rating of the entity's covered bond instruments.

Counterparty Risk Ratings

Eika Boligkreditt's A2 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	Stable
Counterparty Risk Rating	A2/P-1
Counterparty Risk Assessment	A2(cr)/P-1(cr)
Issuer Rating -Dom Curr	A3

Source: Moody's Investors Service

Endnotes

1 There are in total 59 banks that are members of the Eika Alliance. 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.

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

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