

Rating Action: Moody's upgrades Kvika Banki's deposit ratings to Baa1; outlook remains stable

29 Jun 2022

London, June 29, 2022 -- Moody's Investors Service ("Moody's") has upgraded Kvika Banki hf.'s (Kvika) long-term deposit ratings to Baa1 from Baa2. The agency also affirmed Kvika's long-term issuer ratings of Baa2, the Baa1 long-term and P-2 short-term Counterparty Risk Ratings (CRRs) and Baa1(cr) long-term and P-2(cr) short-term Counterparty Risk (CR) Assessment. The outlook on the deposit and issuer ratings remains stable.

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

RATINGS RATIONALE

Kvika's long-term deposit ratings are underpinned by the bank's Adjusted Baseline Credit Assessment (BCA) of ba1 and Moody's Advanced Loss Given Failure (LGF) analysis which takes into consideration the severity of loss faced by the different liability classes in the event of failure. The primary driver for the upgrade of the deposit ratings is Iceland's approach regarding deposit preference in resolution. Following greater clarity on creditor hierarchies in resolution provided by the Central Bank of Iceland, Moody's has modified the weighting on the de jure scenario on the Loss Given Failure analysis to 100%, from 25% previously, to reflect the full depositor preference in resolution over senior unsecured debt holders. This change has resulted deposit ratings to receive three notches of support, from two previously, reflecting the extremely low loss-given-failure from the high volume of instruments that are subordinated to deposits.

Kvika's issuer ratings of Baa2 are underpinned by the bank's Adjusted BCA of ba1 and Moody's Advanced LGF analysis. The LGF analysis for Kvika indicates a very low loss-given-failure for senior unsecured creditors, leading to two notches of rating uplift from the bank's ba1 Adjusted BCA for the issuer ratings.

Kvika's CR Assessment (CRA) is Baa1(cr)/Prime-2(cr), three notches above the bank's Adjusted BCA of ba1, based on the substantial cushion against default provided by subordinated instruments to the senior obligations represented by the CRA. Concurrently, the CRRs of Baa1/Prime-2 are three notches above the Adjusted BCA of ba1, reflecting also the extremely low loss-given-failure from the high volume of instruments that are subordinated to CRR liabilities.

OUTLOOK

The stable outlook on Kvika's long-term deposit and issuer ratings reflects Moody's expectation that the group will continue to benefit from a strong capital position, and diversified sources of income, balanced against credit and non-credit related risks and the group's complicated structure, in the next 12 to 18 months.

FACTORS THAT COULD LEAD TO AN UPGRADE OR DOWNGRADE OF THE RATINGS

Upward rating momentum could develop if Kvika demonstrates (1) a successful completion of the integration of Ortus Financing, TM tryggingar and Lykill without compromising its financial performance or crystallising operational risk; (2) a simplified group structure; (3) a scale down of the investment banking operations relating to the bank's hedge portfolio; (4) sustained robust earnings without compromising its risk profile or (5) lower use of confidence sensitive market funds.

Downward pressure could emerge if (1) Kvika's asset quality was to deteriorate from current levels; (2) credit growth in the higher risk areas of the bank's lending activities was to increase significantly above market rates; (3) the bank holds a lower stock of liquid assets; (4) the group's risk profile increases driven by non-credit related risks; (5) financing conditions were to become more difficult or (6) the macroeconomic environment deteriorates significantly leading to a lower Macro Profile.

Furthermore, a reduction in the rating uplift as a result of our LGF analysis triggered by structural funding changes to the bank's balance sheet could lead to downward rating pressure.

LIST OF AFFECTED RATINGS

..Issuer: Kvika Banki hf.

Upgrades:

...Long-term Bank Deposit Ratings, Upgraded to Baa1 from Baa2, Outlook Remains Stable

Affirmations:

...Long-term Counterparty Risk Assessment, Affirmed Baa1(cr)

...Short-term Counterparty Risk Assessment, Affirmed P-2(cr)

...Long-term Counterparty Risk Ratings, Affirmed Baa1

...Short-term Counterparty Risk Ratings, Affirmed P-2

...Short-term Bank Deposit Ratings, Affirmed P-2

...Long-term Issuer Ratings, Affirmed Baa2, Outlook Remains Stable

Outlook Action:

...Outlook, Remains Stable

PRINCIPAL METHODOLOGY

The principal methodology used in these ratings was Banks Methodology published in July 2021 and available at <https://ratings.moodys.com/api/rmc-documents/71997> . Alternatively, please see the Rating Methodologies page on <https://ratings.moodys.com> for a copy of this methodology.

REGULATORY DISCLOSURES

For further specification of Moody's key rating assumptions and sensitivity analysis, see the sections Methodology Assumptions and Sensitivity to Assumptions in the disclosure form. Moody's Rating Symbols and Definitions can be found on <https://ratings.moodys.com/rating-definitions> .

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Moody's general principles for assessing environmental, social and governance (ESG) risks in our credit analysis can be found at https://ratings.moody's.com/documents/PBC_1288235.

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