MOODY'S
RATINGS

Rating Action: Moody's Ratings affirms Kvika Banki hf.'s long-term deposit and senior unsecured ratings with a stable outlook

04 Jul 2024

London, July 04, 2024 -- Moody's Ratings (Moody's) today affirmed Kvika Banki hf.'s (Kvika) long-term and short-term deposit ratings of Baa1/P-2, the long-term senior unsecured and issuer ratings of Baa2, and the Baseline Credit Assessment (BCA) and Adjusted BCA of ba1. The (P)Baa2 senior unsecured Euro Medium Term Notes (EMTN) program ratings, and (P)Ba2 subordinated EMTN program ratings were also affirmed. The junior senior unsecured EMTN program ratings were upgraded to (P)Ba1 from (P)Ba2.

Kvika's long-term and short-term Counterparty Risk Ratings (CRR) of Baa1/P-2 and the long-term and short-term Counterparty Risk Assessments (CR Assessment) of Baa1(cr)/P-2(cr), were also affirmed.

The outlooks on the long-term deposit, long-term issuer and senior unsecured ratings remain stable.

RATINGS RATIONALE

The affirmation of Kvika's ba1 BCA reflects our expectation that the bank's updated strategy, focusing on banking operations, will provide support to its capitalization, profitability and liquidity profile. Kvika benefits from a strong capital base, with a reported capital ratio of 22.1%, compared to a minimum requirement of 19.1% at end March 2024. Kvika's capital base will be further strengthened from the retention of proceeds from the sale of TM insurance in order to support the bank's growth plans. We expect profitability to improve from the 1.3% return on tangible assets reported in 2023 reflecting the impact of the interest rate cycle, and further cost cutting efforts by the bank.

Kvika's strengths are balanced against a higher lending risk profile than domestic peers, evident from a nonperforming loans ratio of 4.1% at end March 2023, reflecting the bank's focus on vehicle financing, UK bridge financing, CRE and securities backed lending; and our expectation for increased use of market funds and somewhat more price sensitive deposit base.

Kvika's BCA continues to incorporate a negative notch for corporate behavior, reflecting the bank's rapidly evolving strategy and growth through sustained M&A activity, a high risk appetite and in our view a weaker strategic rationale for some acquisitions.

Although the sale of TM insurance and the renewed focus on the banking operations simplifies Kvika's structure, the bank still has a high level of operational complexity given its relative size. This is driven by the investment banking operations of the group as well as by the various mergers and acquisitions, which pose a significant operational risk. These considerations represent key governance risks under Moody's ESG framework, and are reflected in the bank's BCA by including one negative notch, reduced from two previously, for opacity and complexity.

LOSS GIVEN FAILURE (LGF) ANALYSIS

The affirmation of the long-term deposit and senior unsecured ratings of Baa1 and Baa2 respectively, are underpinned by the bank's Adjusted BCA of ba1 and our of the severity of loss faced by the different liability classes in the event of a failure. Our analysis of Kvika indicates an extremely low and very low loss-given-failure for depositors and senior unsecured creditors, leading to three and two notches of rating uplift respectively, from the bank's ba1 Adjusted BCA for deposit and issuer ratings.

The upgrade of the junior senior unsecured MTN program ratings to (P)Ba1 from (P)Ba2, reflects the increased level of subordinated liabilities which results in an alignment of the ratings with Kvika's Adjusted BCA of ba1.

OUTLOOK

The stable outlook on Kvika's long-term deposit, long-term issuer and senior unsecured ratings reflects our expectation that the group's renewed focus on the banking operations will continue to support its strong capital position and profitability despite some credit and non-credit related risks 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 (1) a successful implementation of updated strategy that would lead to material improvement in asset risk; (2) a simplified group structure leading to reduction in operational risk; (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 and/or improved deposit quality.

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) profitability was to stabilize at lower levels (4) the bank holds a lower stock of liquid assets; (5) the group's risk profile increases driven by non-credit related risks; (6) financing conditions were to become more difficult or (7) the macroeconomic environment deteriorates significantly leading to a lower Macro Profile.

PRINCIPAL METHODOLOGY

The principal methodology used in these ratings was Banks Methodology published in March 2024 and available at https://ratings.moodys.com/rmc-documents/409852 . 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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At least one ESG consideration was material to the credit rating action(s) announced and described above.

Moody's general principles for assessing environmental, social and governance (ESG) risks in our credit analysis can be found at https://ratings.moodys.com/documents/PBC_1355824 .

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