Nordic Credit Rating

FINANCIAL INSTITUTION

Norway
8 Feb. 2024

# Kredittforeningen for Sparebanker

Full Rating Report

LONG-TERM RATING

**A-**

OUTLOOK

**Stable**

SHORT-TERM RATING

**N2**


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## RATING RATIONALE

Our 'A-' long-term issuer rating on Kredittforeningen for Sparebanker (KfS) reflects the company's strong capitalisation and low risk appetite. KfS is a non-profit credit institution serving Norwegian savings banks. The company has a concentrated loan portfolio, but funds only investment grade savings banks. KfS has never experienced loan losses. The company is funded by senior bonds with approximately the same maturity as the individual loans it makes. It has no obligation to refinance these loans, and refinancing and pricing risk are consequently minimal.

Until interest rates started rising in 2022, previously low interest rates had put pressure on KfS' margins and reduced demand for funding from the savings banks that it serves. However, the interest rate increases of the past few years have had a positive effect on margins and helped stabilise lending. Since 2021, KfS has helped small domestic savings banks to access green funding, an initiative with the potential to revitalise the company's business model. Adaptation to the EU's finalised banking package currently presents a challenge. The European Banking Authority considers that membership contributions in the form of pure core capital instruments, as practised at KfS, do not meet its requirements. Moreover, the maximum loan limit has been reduced and KfS' capital requirement has increased by 1.5pp (the EU's SME discount is not applicable). We believe that KfS will most likely be able to adapt to the new regulations, given that the banks it serves value the benefit of its services.

## STABLE OUTLOOK

The outlook is stable, reflecting the resilience and strong credit quality of the Norwegian savings bank sector and KfS' modest risk profile. We do not believe that possible challenges to the company's business model will result in higher default risk, given its high asset quality and low refinancing and liquidity risk. The business model would, in our opinion, simplify an orderly portfolio run-off, if necessary, without significant deterioration in the company's credit quality or increased liquidity risk.

### POTENTIAL POSITIVE RATING DRIVERS

- A combination of two or more drivers, such as stronger market position, stronger capitalisation and/or higher earnings.

### POTENTIAL NEGATIVE RATING DRIVERS

- Lower credit quality of debtors, either due to idiosyncratic or economic stress.
- A fall in business volumes or increased concentration on lower credit quality.
- A total capital ratio below 18%.

Figure 1. KfS key credit metrics, 2019–2025e

| (%) | 2019 | 2020 | 2021 | 2022 | 2023e | 2024e | 2025e |
|---|---|---|---|---|---|---|---|
| Net interest margin | 0.2 | 0.1 | 0.1 | 0.2 | 0.3 | 0.3 | 0.2 |
| Loan losses/net loans | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Pre-provision income/REA | 0.2 | 0.0 | -0.2 | 0.0 | 0.6 | 0.4 | 0.3 |
| Cost-to-income | 48.4 | 73.8 | 93.7 | 134.1 | 56.4 | 63.0 | 68.3 |
| Loan growth | -7.4 | -16.6 | 3.1 | -11.2 | 0.8 | 4.0 | 5.0 |
| CET1 ratio | 17.8 | 18.6 | 17.5 | 21.3 | 20.6 | 20.1 | 19.4* |
| Capital ratio | 22.8 | 24.5 | 23.2 | 27.8 | 27.2 | 26.5 | 25.5* |

REA–risk exposure amount. e–estimate. All metrics adjusted in line with Nordic Credit Rating (NCR) methodology. Based on NCR estimates and company data. CET1–common equity Tier 1. *Does not account for the effect of higher risk weights from 2025.

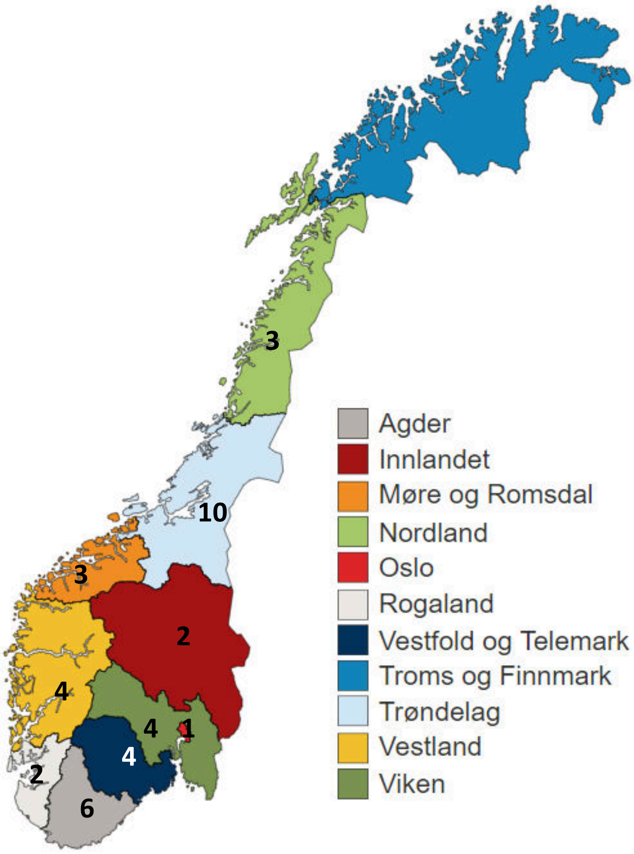
## ISSUER PROFILE

KfS is licensed as a credit institution and provides medium- and long-term senior loans to Norwegian savings banks. It was established in 2004 by Eiendomskreditt AS, a mortgage company that finances commercial real estate, and local and regional savings banks to secure funding in difficult market conditions. KfS and Eiendomskreditt are based in the city of Bergen, and parts of KfS' operations are outsourced to Eiendomskreditt. Eiendomskreditt and KfS jointly have 11 employees, five of which are partly allocated to KfS (2.2 full-year equivalents).

KfS is organised as a credit association and is operated according to cooperative principles. Its borrowers, which are solely Norwegian savings banks, become members of the association. The association's non-profit model allows member banks to achieve lower borrowing costs by diversifying their risk across KfS.

KfS is a vehicle for small savings banks with limited access to the bond market. The median gross on-balance sheet lending of the member banks is NOK 3.6bn (2022), ranging from NOK 0.7bn to NOK 98bn. The members are spread throughout Norway, with the strongest presence in the central county of Trøndelag and the weakest in the north of the country.

**Figure 2. KfS member banks (39) by county, end-2023**




Source: company.

## OPERATING ENVIRONMENT

Operating environment assessment 'a-'

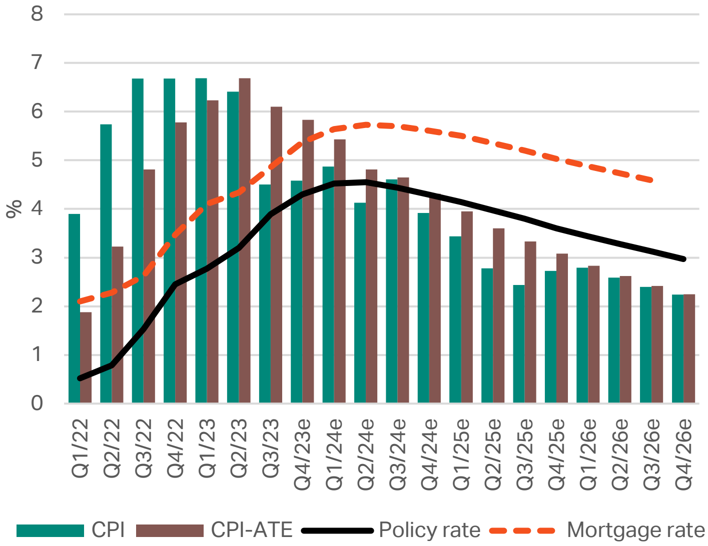
KfS' member banks operate in rural or semirural regions with low to moderate unemployment and lower housing prices than in more urban areas. However, growth prospects are also lower than in more urban regions, and we generally assess the operating environment for savings banks exposed to rural areas as weaker than the wider national economy.

Rising interest rates have significantly increased net interest margins for Norwegian savings banks for the past two years. Together with strong lending growth, this has boosted earnings across the sector. However, we believe that core earnings growth in the sector will come to an abrupt halt this year due to greater competition, a likely fall in interest rates, and increased loan losses. Among NCR-rated savings banks, we expect a marginal decline in core profit in 2024, but anticipate that normalisation of non-core revenues will contribute to an 8% increase in pre-tax profit.

As intended, currently high interest rates are helping to slow the economy. We believe that these relatively high interest rates and weak economic conditions will lead to higher loan-loss provisions among savings banks over the next 12 months, but that levels will vary significantly between individual players. Norway's savings banks are well-capitalised and have strong pre-provision profitability, which makes them resilient to increased credit losses.

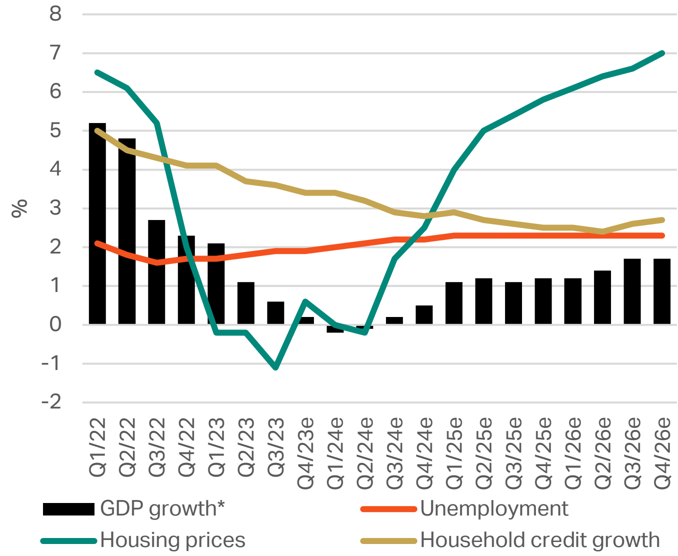
Merger activity in the savings-bank sector has been moderate in recent years. However, the announcement in October 2023 that SpareBank 1 SR-Bank and SpareBank 1 Sørøst-Norge intend to merge has triggered increased merger activity and speculation about more possible mergers. This could threaten KfS' business model, as larger banks could obtain cheaper funding by themselves. We acknowledge that savings banks could face pressure to seek partners due to increasing reporting and compliance requirements and pressure on profitability. Broadly, however, we believe that a full-scale consolidation of the wider savings bank sector would be a lengthy undertaking and is currently unlikely.

**Figure 3. Norwegian inflation and interest rates, 2022–2026e**



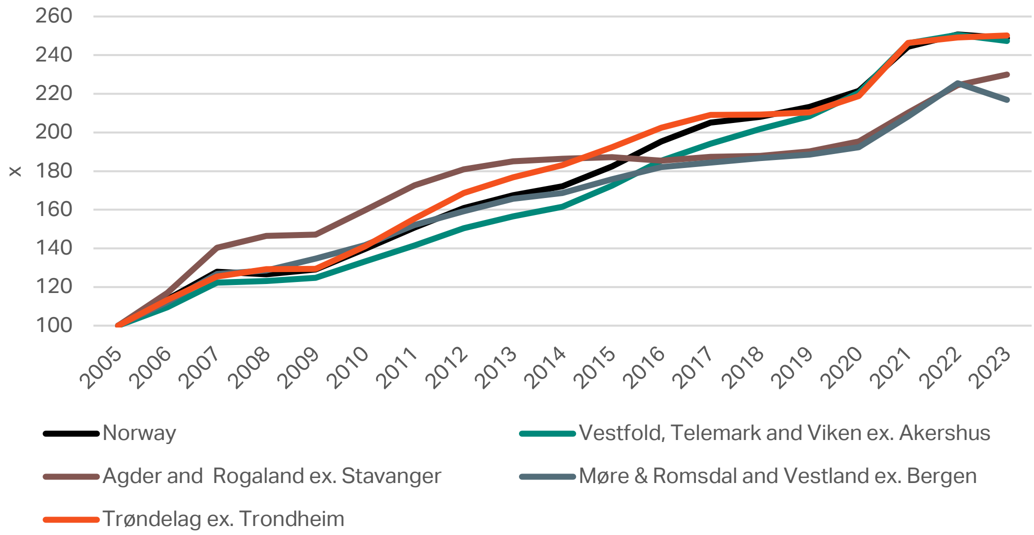

Source: Norges Bank. e-estimate. CPI-consumer price index. ATE excluding energy, tax-adj.

**Figure 4. Norwegian economic indicators, 2022–2026e**




Source: Norges Bank. e-estimate. *Mainland Norway.

**Figure 5. Norwegian regional housing prices (indexed), 2005–2023**




Source: Statistics Norway.

## RISK APPETITE

Risk appetite assessment 'a'

KfS has a low-risk business model, with a focus on achieving the best possible loan terms in the capital markets for its members. The company has never experienced credit losses, is strongly capitalised and has ample liquidity reserves. In our view, risk governance and internal risk reporting are adequate, considering the company's risk profile and lack of complexity.

**Simple business model and adequate risk governance**

Risk governance 'bbb'

KfS has a relatively simple business model and low transaction volumes. The company has few employees and key-person risk is not insignificant. However, the company has adequate risk governance, a competent board of directors, and its cooperation with Eiendomskreditt provides access to additional and flexible resources. We believe that risk resources are proportionate and adequate given the company's risk profile.

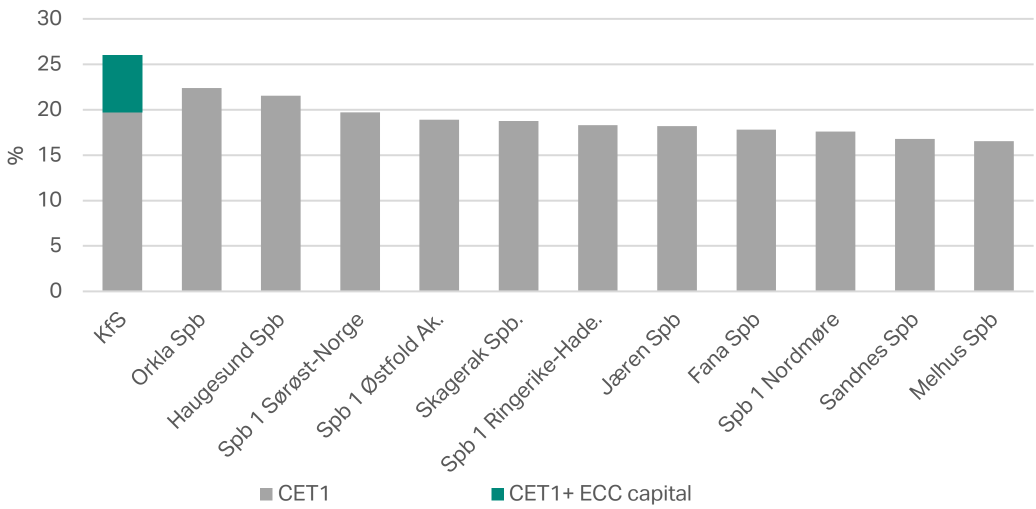
**Changes in capital structure due to regulatory changes**

Capital 'a+'

When a savings bank receives a loan from KfS, it places a member reserve of at least 3% of the loan with the company (equivalent to a common equity Tier 1 [CET1] ratio of 15% for bank exposures). This is refunded after the loan is repaid. These member reserves are regarded as core equity and have lower priority than other capital, including equity capital certificates (ECCs). Since ECC capital has higher priority, it is considered Tier 2 capital and is not included in the calculation of CET1. However, ECC capital is equity capital and NCR considers it as such in its assessment of KfS' capitalisation. KfS' reported CET1 ratio was 20.6% as of end-2023, while its capital ratio (including ECC capital) was 27.0%.

The CET1 requirement is currently 14.3%. The company's total capital requirement is 17.8% while its target is 19.3% (including a self-imposed management buffer of 1.5%). We note that risk weights for loans to unrated savings banks are set to increase to 30% from 20% in 2025. This will reduce KfS' CET1 ratio by about 7pp. We believe that KfS will increase its CET1 capital to counteract this effect.

Figure 6. KfS and selected Norwegian savings banks' capitalisation, Q3 2023




Based on company data.

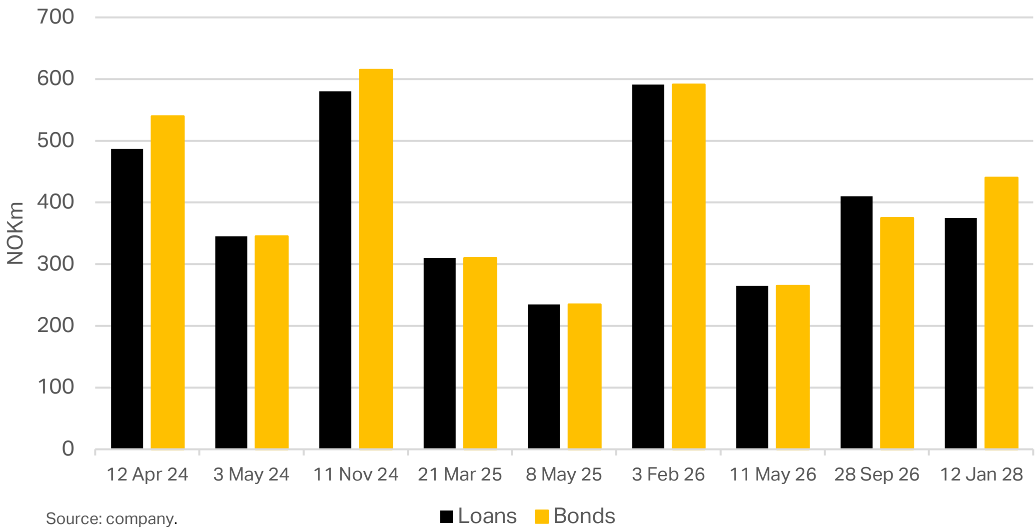
KfS is adapting its capital structure to satisfy the requirements of the EU's CRR2 prudential regulatory package. Since the maximum individual loan exposure will be measured against Tier 1 capital and not total capital, the company has decided to apply to the Norwegian financial supervisory authority for permission to write down its entire equity certificate capital of NOK 50m, while issuing hybrid Tier 1 securities for the same amount. Moreover, the European Banking Authority considers that membership contributions in the form of pure core capital instruments, as practiced at KfS, do not satisfy its requirements. KfS is in discussions with the supervisory authority on how to comply with the banking authority's requirements.

### Fully matched funding and lending

Funding and liquidity 'a+'

KfS is funded by senior bonds that are virtually matched in terms of maturity with the loans that it issues. Individual loans are bundled and, in some cases, several individual loans mature on the same date. The company has no obligation to refinance loans, so refinancing and pricing risk are minimal.

Figure 7. KfS debt maturity profile, 31 Dec. 2023




Source: company.

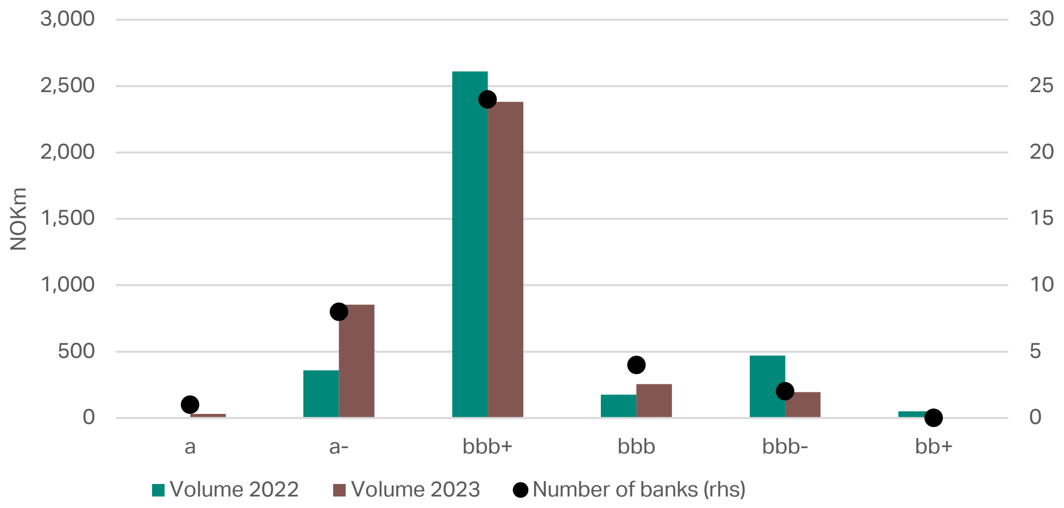
What remains is the risk that one or more banks might be unable to repay debt at maturity, which would put a strain on KfS' liquidity. We believe that the has adequate procedures in place to handle such risk . For example, individual loans that fall due on a certain date cannot constitute more than one-third of a member bank's capital base or two-thirds of KfS' capital base. KfS must hold or expect liquidity inflow amounting to a minimum of 100% of all bonds maturing in the next 30 days. In addition, the company must hold a liquidity buffer of at least 25% of expected loans due over the next 30 days, as well as a liquidity buffer to comply with a regulatory 100% net stable funding ratio requirement.

### Low credit risk

Credit risk 'a'

Despite the small number of KfS member banks, we assess the company's credit risk appetite as low. The company lends only to Norwegian savings banks, which are heavily regulated and supervised. KfS uses official ratings or credit scores from up to four brokers to classify the risk of its member banks. A member bank needs to have a rating or equivalent credit score of 'BBB-' or higher to qualify for a loan from KfS. We have carried out confidential credit assessments of the banks on the company's loan book and find that the credit assessments range from 'a' to 'bbb'. The average score of the banks on the company's loan book is 'bbb+'. We believe that our credit assessments are likely to lie within a range of plus or minus one notch of an actual credit rating in most instances.

Figure 8. NCR's credit assessments of KfS member banks




Based on NCR data.

We believe that the main credit risk factor for KfS is concentration risk. With only 39 active members, the company's average loan was NOK 95m at end-2023, or 43% of the estimated total capital base. The largest loan was NOK 150m as of end-2022, or 68% of the estimated total capital base. The number of savings banks in Norway is slowly declining and there is a risk that, over time, consolidation will create larger banks of presumably higher credit quality that will have better access to the capital markets directly or larger funding needs than KfS can satisfy. This might lead to a gradual reduction in credit quality if only smaller or less creditworthy banks choose KfS financing.

We are generally concerned about the risk of real-estate collateral being negatively affected by significant climate events (see relevant research below), and note that KfS has not conducted an evaluation of this risk in its portfolio. However, we consider this risk to be lower for KfS than for individual savings banks, due to the latter's significant geographic diversity across Norway, making it unlikely that individual events will impact a large number of member banks.

**Other risks**

Other risks 'a'

Market risk is negligible, in our view, given that KfS does not trade financial instruments and that it matches the financing and floating rates on both loans and funding (thereby eliminating interest rate risk), maintains low risk limits, and has no currency exposure.

## COMPETITIVE POSITION

Competitive position assessment 'bb-'

Deposit growth and easy access to low-cost market funding for smaller banks have undermined KfS' competitive position in recent years. However, higher interest rate levels, increasing bond spreads and higher funding costs for small banks could restore the company's competitiveness. KfS aims to act as a driving force in achieving a sustainable society. To this end, it started to offer its member banks green bond funding in 2021. In addition, KfS has obtained green certification (ECO Lighthouse) for its own operations. These measures have improved the company's value to its member banks, providing them with a higher level of sustainable financing and giving them access to green investors. So far, KfS has issued green bonds amounting to NOK 1.5bn, attracting several new member banks. Currently 27 of the 39 member banks have obtained green funding through KfS.

The new regulations discussed earlier also represent a challenge for KfS' business model, and could have negative implications for the company's attractiveness as a funding source by increasing capital requirements.

Figure 9. KfS gross loans, membership and average loan size, 2007–Q3 2022


Source: company.

## PERFORMANCE INDICATORS

Performance indicators assessment 'bbb+'

KfS defines itself as a non-profit company, and the lending margin is set at a level that covers costs, dividends on ECCs and tax. This means that profitability has limited loss-absorbing capacity. However, KfS has a record of stable performance, and has never experienced loan losses or non-performing loans. The last default by a Norwegian savings bank occurred in the early 1930s, and increasing capital requirements in the sector and continuing consolidation are resulting in greater stability for the remaining banks.

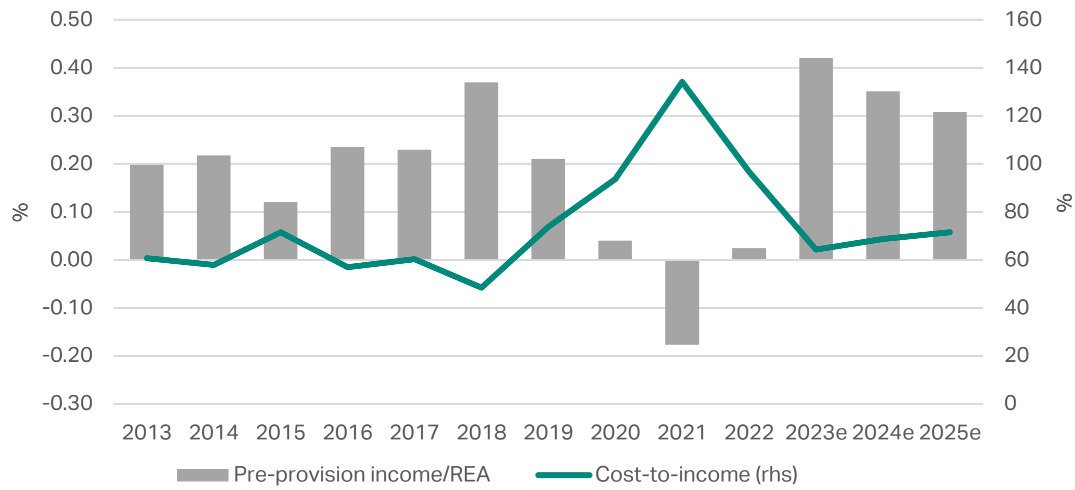
### Higher interest rates boost profit

Earnings 'bb'

Loss performance 'aa'

KfS has a strong cost focus and benefits from its shared location and co-operation with Eiendomskreditt. Higher interest rates since 2021 have increased profitability, due to higher yields from investments. However, KfS continues to operate at close to break-even and we believe that it will be unable to pay dividends on its ECC capital at a rate commensurate with market interest rates on subordinated debt (which has been the norm) over our forecast period through 2025.

Figure 10. KfS earnings performance indicators, 2013–2025e




Source; company. e-NCR estimate.

## ENVIRONMENTAL, SOCIAL AND GOVERNANCE FACTORS

Moderately positive aggregate ESG impact

ESG factors are considered throughout our analysis where material to the credit assessment. On aggregate, we view the company's ESG profile as having a moderately positive impact on its creditworthiness.

Figure 11. KfS priority ESG factors

| Issue/area | Risk/opportunity | Impacted subsections (impact on credit assessment*) |
|---|---|---|
| Sustainable/green bond framework | Ability to offer green funding to savings banks is an advantage, as it allows them to diversify funding sources and access additional markets/investors. | Competitive position (++) |
| Physical climate risk to collateral | Climate-related damage to real-estate collateral (closely linked to supervision of insurance). Longer-term term effects on market values in flood-risk areas. | Credit risk (0)<br>Loss performance (0) |
| Anti-money laundering capacity | Risk of sanctions and fraud due to insufficient control of customers. Less relevant due to responsibility lying mainly with individual savings banks. | Risk governance (0) |
| Control of sustainability issues | Credibility of green bond framework depends on rigour of application and allocation/impact reporting. | Competitive position (+)<br>Risk governance (0) |

*Defined according to a 5-step scale ranging from double minus (--) to double plus (++), with (--) representing the most negative impact and (++) the most positive. See ESG factors in financial institution ratings.

## ADJUSTMENT FACTORS

### Support analysis

Support analysis neutral

We view KfS' ownership as supportive of our standalone credit assessment, but do not raise it by additional notches to reflect such support. The company's capital consists mainly of member reserves, and we have taken this structure into account in our capital score.

Figure 12. KfS  ECC ownership structure, 30 Sep. 2023

| Owner | Share of ECCs |
|---|---:|
| Eiendomskreditt | 10.0% |
| Sparebanken Vest | 9.4% |
| SpareBank 1 Sørøst-Norge | 7.4% |
| Sparebanken Sogn og Fjordane | 6.4% |
| Sparebanken Øst | 5.5% |
| Other (35 savings banks) | 61.3% |
| Total | 100.0% |

Source: company.

## ISSUE RATINGS

Our rating on KfS' unsecured senior debt is in line with the 'A-' issuer rating.

## SHORT-TERM RATING

The 'N2' short-term rating is the higher of two alternatives, given the 'A-' long-term issuer rating. This reflects our assessment that KfS' liquidity is adequate, which we base on the company's average liquidity coverage ratio of 3,400% over the last four quarters.

## METHODOLOGIES USED

(i) Financial Institutions Rating Methodology, 18 Feb. 2022.
(ii) Rating Principles, 24 May 2022.
(iii) Group and Government Support Rating Methodology, 18 Feb. 2022.

## RELEVANT RESEARCH

(i) Norwegian savings banks face margin squeeze in 2024, 11 Dec. 2023
(ii) Mid-sized Norwegian savings banks navigate economic challenges, 28 Aug. 2023.
(iii) High real-estate exposure poses climate risk for Swedish and Norwegian banks, 12 Apr. 2022.

## Figure 13. KfS key financial data, 2018–Q3 2023 YTD

| Key credit metrics (%) | FY 2018 | FY 2019 | FY 2020 | FY 2021 | FY 2022 | Q3 2023 YTD |
|---|---|---|---|---|---|---|
| **INCOME COMPOSITION** | | | | | | |
| Net interest income to op. revenue | 98.4 | 96.1 | 98.1 | 109.2 | 107.5 | 91.9 |
| Net fee income to op. revenue | -0.3 | -0.2 | -0.2 | -0.4 | -0.2 | -0.1 |
| Net trading income to op. revenue | 1.1 | 4.1 | -2.9 | -8.8 | -7.3 | 8.4 |
| Net other income to op. revenue | 0.8 | | 5.0 | | 0.0 | -0.1 |
| **EARNINGS** | | | | | | |
| Net interest income to financial assets | 0.1 | 0.2 | 0.1 | 0.1 | 0.2 | 0.2 |
| Net interest income to net loans | 0.1 | 0.2 | 0.1 | 0.1 | 0.2 | 0.2 |
| Pre-provision income to REA | 0.4 | 0.2 | 0.0 | -0.2 | 0.0 | 0.6 |
| Core pre-provision income to REA (NII & NF&C) | 0.4 | 0.2 | 0.0 | -0.1 | 0.1 | 0.5 |
| Return on ordinary equity | 1.2 | 0.7 | 0.1 | -0.6 | 0.0 | 1.4 |
| Return on assets | 0.1 | 0.0 | 0.0 | 0.0 | 0.0 | 0.1 |
| Cost-to-income ratio | 48.4 | 73.8 | 93.7 | 134.1 | 96.6 | 55.9 |
| Core cost-to-income ratio (NII & NF&C) | 49.4 | 76.9 | 95.7 | 123.3 | 90.1 | 60.9 |
| **CAPITAL** | | | | | | |
| CET1 ratio | 16.9 | 17.8 | 18.6 | 17.5 | 21.3 | 21.8 |
| Tier 1 ratio | 16.9 | 17.8 | 18.6 | 17.5 | 21.3 | 21.8 |
| Capital ratio | 21.5 | 22.8 | 24.5 | 23.2 | 27.8 | 28.2 |
| REA to assets | 20.2 | 20.2 | 20.5 | 20.4 | 20.2 | 20.2 |
| Dividend payout ratio | 67.2 | | | | | |
| Leverage ratio | 3.4 | 3.4 | 3.8 | 3.6 | 4.3 | 4.4 |
| **GROWTH** | | | | | | |
| Asset growth | 0.5 | -7.6 | -16.4 | 2.6 | -11.2 | 1.9 |
| Loan growth | 0.8 | -7.4 | -16.6 | 3.1 | -11.2 | 1.9 |
| Deposit growth | | | | | | |
| **LOSS PERFORMANCE** | | | | | | |
| Credit provisions to net loans | | | | | | |
| Stage 3 coverage ratio | | | | | | |
| Stage 3 loans to gross loans | | | | | | |
| Net stage 3 loans to net loans | | | | | | |
| Net stage 3 loans/ordinary equity | | | | | | |
| **FUNDING & LIQUIDITY** | | | | | | |
| Loan to deposit ratio | | | | | | |
| Liquid assets to deposit ratio | | | | | | |
| Net stable funding ratio | 100.0 | 98.0 | 101.0 | 99.0 | 101.0 | 101.0 |
| Liquidity coverage ratio | 13283.0 | 15043.0 | 8397.0 | 4757.0 | 4894.0 | 2212.0 |

| Key financials (NOKm) | FY 2018 | FY 2019 | FY 2020 | FY 2021 | FY 2022 | Q3 2023 YTD |
|---|---|---|---|---|---|---|
| **BALANCE SHEET** | | | | | | |
| Total assets | 5,377 | 4,971 | 4,156 | 4,267 | 3,790 | 3,863 |
| Total tangible assets | 5,377 | 4,971 | 4,156 | 4,267 | 3,790 | 3,863 |
| Total financial assets | 5,365 | 4,970 | 4,156 | 4,266 | 3,790 | 3,862 |
| Net loans and advances to customers | 5,215 | 4,829 | 4,026 | 4,150 | 3,686 | 3,758 |
| Total securities | 119 | 136 | 97 | 102 | 79 | 77 |
| Customer deposits | – | – | – | – | – | – |
| Issued securities | 5,128 | 4,739 | 3,946 | 4,063 | 3,576 | 3,638 |
| of which other senior debt | 5,128 | 4,739 | 3,946 | 4,063 | 3,576 | 3,638 |
| of which subordinated debt | – | – | – | – | – | – |
| Total equity | 234 | 228 | 209 | 202 | 213 | 223 |
| of which ordinary equity | 234 | 228 | 209 | 202 | 213 | 223 |
| **CAPITAL** | | | | | | |
| Common equity tier 1 | 184 | 178 | 159 | 152 | 163 | 171 |
| Tier 1 | 184 | 178 | 159 | 152 | 163 | 171 |
| Total capital | 234 | 228 | 209 | 202 | 213 | 221 |
| REA | 1,086 | 1,003 | 851 | 869 | 766 | 782 |
| **INCOME STATEMENT** | | | | | | |
| Operating revenues | 8 | 8 | 7 | 4 | 6 | 7 |
| Pre-provision operating profit | 4 | 2 | 0 | -2 | 0 | 3 |
| Impairments | – | – | – | – | – | – |
| Net Income | 3 | 2 | 0 | -1 | 0 | 2 |

Source: company. FY–full year. YTD–year to date.

**Figure 14. KfS rating scorecard**

| Subfactors | Impact | Score |
|---|---|---|
| National factors | 10.0% | a |
| Regional, cross border, sector | 10.0% | bbb+ |
| Operating environment | 20.0% | a- |
| Capital | 17.5% | a+ |
| Funding and liquidity | 15.0% | a+ |
| Risk governance | 5.0% | bbb |
| Credit risk | 10.0% | a |
| Market risk | - | - |
| Other risks | 2.5% | a |
| Risk appetite | 50.0% | a |
| Competitive position | 15.0% | bb- |
| Earnings | 7.5% | bb |
| Loss performance | 7.5% | aa |
| Performance indicators | 15.0% | bbb+ |
| **Indicative credit assessment** | | **a-** |
| Transitions | | Neutral |
| Peer calibration | | Neutral |
| Borderline assessments | | Neutral |
| **Stand-alone credit assessment** | | **a-** |
| Material credit enhancement | | Neutral |
| Rating caps | | Neutral |
| Support analysis | | Neutral |
| **Issuer rating** | | **A-** |
| Outlook | | Stable |
| **Short-term rating** | | **N2** |

**Figure 15. Capital structure ratings**

| Seniority | Rating |
|---|---|
| Senior unsecured | A- |

## DISCLAIMER



## NORDIC CREDIT RATING AS

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