



Rating Action: Moody's upgrades Arion bank's deposit and issuer ratings; outlook is stable

14 Sep 2023

London, September 14, 2023 – Moody's Investors Service (Moody's) today upgraded Arion Bank hf.'s (Arion) long-term and short term deposit rating to A2/P-1 from A3/P-2, and long-term issuer ratings to A3 from Baa1 as well as the bank's Baseline Credit Assessment (BCA) and Adjusted BCA to baa2 from baa3. Moody's also upgraded the long-term Counterparty Risk (CR) Assessment to A2(cr) from A3(cr) and short-term CR Assessment to P-1(cr) from P-2(cr) and long-term Counterparty Risk Ratings (CRRs) to A2 from A3 and short-term CRRs to P-1 from P-2, senior unsecured and senior unsecured medium term note (MTN) program ratings to A3 from Baa1 and to (P)A3 from (P)Baa1 respectively. The rating agency also assigned (P)Baa2 junior senior unsecured and (P)Baa3 subordinated MTN program ratings.

The outlook on the long-term deposit, senior unsecured and issuer ratings was changed to stable from positive.

RATINGS RATIONALE

The upgrade of the Arion's BCA and Adjusted BCA to baa2 from baa3 reflects the bank's sustained performance following a balance sheet cleanout and shift towards a bancassurance business model over the past 18 months which has supported its profitability and capitalization, while maintaining strong asset quality. Arion bank's return to tangible assets was 1.55% at end June 2023, excluding one-offs, maintaining the strong performance seen during 2022 and 2021. This has continued to support the bank's capitalization reporting a CET1 of 18.9% against a requirement of 14.9% at end Q2 2023 and a leverage ratio of 11.7%, which continues to compare favorably with the European average of close to 6%.

The upgrade on the banks deposit and issuer ratings reflects the higher Adjusted BCA of baa2 and Moody's Advanced Loss Given Failure (LGF) analysis, which assesses the severity of loss faced by the different liability classes in the event of a failure. The LGF analysis for Arion indicates an extremely low loss-given-failure for depositors and a very low loss-given-failure for senior debt holders, leading to three notches and two notches of rating uplift from the bank's baa2 Adjusted BCA respectively to A2 for the long-term deposit ratings and A3 for the long-term issuer ratings.

ESG CONSIDERATIONS

As per Moody's General Principals for Assessing Environmental, Social and Governance Risks Methodology, Arion's governance issuer profile score (IPS) has been raised to G-2 from G-3, reflecting low governance risks following the bank's improved financial strategy and risk management practices. As a result, the bank's Environmental, Social and Governance (ESG) credit impact score has been revised to CIS-2 from CIS-3, indicating that ESG considerations do not have a material impact on the current ratings.

OUTLOOK

The outlook on Arion's long-term deposit and issuer ratings is stable, reflecting Moody's expectation that the bank's profitability will continue to benefit from the bank's diversification in a wide range of activities, supporting its capital generation capacity in the next 12-18 months.

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

Arion's BCA could be upgraded if the bank improves further its risk profile by reducing single name and sector concentrations in combination with a reduction in the use of market funds while maintaining strong capitalisation and strong earnings' generation capacity across the credit cycle. An upgrade of the BCA would likely result in an upgrade of most of Arion's ratings.

Arion's issuer ratings could also be upgraded if the bank increases the cushion of loss absorbing obligations protecting creditors in case of failure.

Arion's BCA could be downgraded if the bank's (1) asset quality and risk profile was to deteriorate, for example as a result of increased exposures to more volatile sectors and/or increased single name concentrations; (2) risk profile increases driven by non-credit related risks such as market risk and FX risk (3) the bank's recurring profitability weakens significantly limiting its internal capital generation (4) financing conditions were to become more difficult or (5) the macroeconomic environment deteriorates significantly leading to a lower Macro Profile. A downgrade of the BCA would likely result in a downgrade of most of Arion's ratings.

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

The principal methodology used in these ratings was Banks Methodology published in July 2021 and available at <https://ratings.moodys.com/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.moodys.com/documents/PBC_1288235.

At least one ESG consideration was material to the credit rating action(s) announced and described above.

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