MOODY'S
RATINGS

Rating Action: Moody's Ratings affirms Islandsbanki's A2 long-term deposit and A3 long-term issuer ratings, outlook stable

10 Jun 2025

London, June 10, 2025 -- Moody's Ratings (Moody's) has affirmed Islandsbanki's (ISB) A2 long-term and P-1 short-term foreign and local currency deposit ratings, the A3 long-term foreign and local currency issuer ratings and A3 senior unsecured rating, the baa2 Baseline Credit Assessment (BCA) and Adjusted BCA.

We have also affirmed the senior unsecured, junior senior unsecured and subordinated local and foreign currency medium term note (MTN) program ratings at (P)A3, (P)Baa2 and (P)Baa3 respectively. The long- and short-term Counterparty Risk Ratings (CRR) of A2/P-1 and long- and short-term Counterparty Risk Assessments (CR Assessment) of A2(cr)/P-1(cr) were also affirmed.

The outlook on the long-term deposit, long-term issuer and senior unsecured debt ratings remains stable.

RATINGS RATIONALE

The affirmation of ISB's baa2 BCA and Adjusted BCA reflects the bank's strong capitalization coupled with good recurring profitability, a low level of problem loans and adequate liquidity balanced against elevated single name and geographical concentrations and a reliance on market funding. The bank's reported CET1 reached 18.6% at end March 2025 well above the minimum requirement of 15.4% supported by the bank's strong profitability. Return on tangible assets was 1.3% at the end of the first quarter, as the bank continued to benefit from the higher interest rate environment, while problem loans to gross loans remained broadly unchanged at 1.8%.

The affirmation also takes into consideration any potential impact from a merger with Kvika Banki hf. (Kvika) following announcement from Islandsbanki that its board of directors has proposed opening merger talks with the board of directors of Kvika [1]. The affirmation reflects that the credit profile of the merged entity would result in a business combination with similar performance metrics. Furthermore, our credit view balances the eventual integration risks, which we expect to be orderly, against the long-term potential for franchise enhancement.

For a transaction to proceed, the shareholders of both banks would need to endorse the terms of the potential merger. The board of Kvika has yet to substantively respond to the indicative offer. In addition, any transaction would be subject to a range of approvals from the Icelandic Competition Authority and the Central Bank of Iceland.

ISB's long-term ratings are underpinned by the bank's Adjusted BCA of baa2 and our Advanced Loss Given Failure (LGF) analysis which takes into account the severity of loss faced by the different liability classes in the event of a failure. Our analysis for ISB 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, respectively, of rating uplift from the bank's baa2 Adjusted BCA to A2 for the long-term deposit ratings and A3 for the long-term issuer ratings.

STABLE OUTLOOK

The stable outlook on ISB's long-term deposit, long-term issuer and senior unsecured debt ratings reflects the our expectation that the bank will continue its strong performance in the next

12-18 months, while managing asset risk prudently and optimizing its capital base and the potential integration of Kvika will be orderly.

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

Upward rating pressure could develop if ISB improves 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.

For the issuer and program ratings, upward rating pressure could also develop because of a larger cushion of loss absorbing obligations protecting creditors and depositors in case of failure.

Downward pressure could emerge if ISB's (1) asset quality and risk profile was to deteriorate, for example as a result of increased concentration risk emanating from its exposures to more volatile sectors, increased single name concentrations within Iceland's small and interlinked operating environment and/or or changes in strategy driven by inorganic growth; (2) risk profile increases more than the agency anticipates, driven by non-credit related risks such as market risk, foreign exchange risk and/or increasing consumer price index (CPI) imbalance or potential integration of Kvika is with material costs or time overruns; (3) profitability was to deteriorate due to increased asset risk; (4) financing conditions were to become more difficult; or (5) the macroeconomic environment deteriorates significantly leading to a lower Macro Profile.

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

PRINCIPAL METHODOLOGY

The principal methodology used in these ratings was Banks published in November 2024 and available at https://ratings.moodys.com/rmc-documents/432741. 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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The Global Scale Credit Rating(s) discussed in this Credit Rating Announcement was(were) issued by one of Moody's affiliates outside the EU and is(are) endorsed for use in the EU in accordance with the EU CRA Regulation.

REFERENCES/CITATIONS

[1] https://view.news.eu.nasdaq.com/view?id=bfd293a857fa1ce6c4140cb6fbe617f77&lang=en&src=micro

Please see https://ratings.moodys.com for any updates on changes to the lead rating analyst and to the Moody's legal entity that has issued the rating.

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