

MOODY'S

RATINGS

Rating Action: Moody's Ratings affirms Arion Bank hf.'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 Arion Bank hf.'s (Arion) long-term and short-term foreign and local currency deposit ratings of A2/P-1, 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-term and short-term Counterparty Risk Ratings (CRR) of A2/P-1 and long-term and short-term Counterparty Risk Assessments (CR Assessment) of A2(cr)/P-1(cr) as well as the preferred stock rating of Ba2 (hyb) 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 Arion's baa2 BCA and Adjusted BCA reflects the bank's sustained performance supported by its clear strategy to continue leveraging on the bancassurance model. As a result, Arion continues to benefit by strong profitability and capitalization while maintaining strong asset quality. Arion's return on tangible banking assets was 1.9% in at end March 2025, helping to boost the bank's capitalization to 18.3% CET1 compared to a requirement of 15.3%. Despite strong asset quality overall non-performing loans to gross loans increased to 2.7% from 1.9% at end March 2024 primarily driven by the impact of higher interest rates to the bank's construction lending portfolio.

The affirmation also takes into consideration any potential impact from a merger with Kvika Banki hf. (Kvika) following the announcement from Arion 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.

The affirmation on the banks deposit and issuer ratings takes into account the severity of loss faced by the different liability classes in the event of a failure. Our analysis indicates an extremely low loss-given-failure for Arion's depositors and a very low loss-given-failure for senior debt holders, leading to three 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.

OUTLOOK

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

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

Upward pressure could develop if Arion 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.

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

Downward pressure could emerge if Arion's (1) asset quality and risk profile was to deteriorate, for example as a result of increased exposures to more volatile sectors, increased single name concentrations or changes in strategy driven by inorganic growth; (2) risk profile increases driven by non-credit related risks such as market risk and foreign exchange risk and/or increasing consumer price index (CPI) imbalance or potential integration of Kviká is with material costs or time overruns; (3) recurring profitability weakens significantly limiting the bank's internal capital generation; (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 as a result of our Advanced Loss Given Failure (LGF) analysis 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.

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REFERENCES/CITATIONS

[1] <https://www.arionbanki.is/english/about-us/investor-relations/press-releases/single-press-release/?id=590c90f6-2c34-4c80-b848-3653bca9ff0e>

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