

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

03 Jul 2024

London, July 03, 2024 -- 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 ratings, the baa2 Baseline Credit Assessment (BCA) and Adjusted BCA.

We have also affirmed, the senior unsecured, junior senior 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 Assessment (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 combined with a well-diversified banking profile and enhanced focus on risk adjusted returns. 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 1.3% in at end March 2024, helping to boost the bank's capitalization to 18.8% CET1 compared to a requirement of 15.4%. Asset quality has also been resilient despite the steep interest rate increases by the Central Bank of Iceland with non-performing loans to gross loans increasing only marginally to 1.9% at end March 2024 from 1.7% at end 2023; while non-credit related continue to be well managed.

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 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

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 and/or increased single name concentrations; (2) risk profile increases driven by non-credit related risks such as market risk and fx risk and/or increasing CPI imbalance (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 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 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.

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