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Eksportfinans ASA

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Related Criteria

Eksportfinans ASA

SACP	bbb+
Anchor	a-
Business Position	Moderate -1
Capital and Earnings	Very Strong +2
Risk Position	Moderate -1
Funding	Below Average
Liquidity	Adequate
Funding and Liquidity	-1

+

Support	0
ALAC Support	0
GRE Support	0
Group Support	0
Sovereign Support	0

+

Additional Factors	0

Issuer Credit Rating
BBB+/Positive/A-2

Major Rating Factors

Strengths:	Weaknesses:
• Robust capitalization. • Orderly wind-down in accordance with the company's strategy.	• Challenging macroeconomic environment due to the combined effects of the COVID-19 pandemic and a decline in oil prices. • Residual exposure to structured funding and derivatives. • Operational risks during the wind-down.

Outlook: Positive

The positive outlook on Norway-based Eksportfinans ASA reflects S&P Global Ratings' view that the likelihood of the company's orderly wind-down will continue to increase as the funded loan book reduces. This is despite the challenging macroeconomic environment, reflecting the combined effects of a decline in oil prices and the COVID-19 pandemic.

We could upgrade Eksportfinans in the next two years if the significant maturities and associated reduction in the loan book, alongside reduced derivative exposure over the next two years, increase the likelihood of the full and timely repayment of the senior debt. The reductions in Eksportfinans' balance sheet and risks should continue supporting the company's capital buffers at exceptionally high levels.

We could revise our outlook to stable on signs of operational instability during Eksportfinans' wind-down process, or if its capital position weakened materially due to extraordinary dividend payments to its owner banks. We view the latter scenario as unlikely, though, unless it occurs in conjunction with the sale of the company.

Rationale

The ratings on Eksportfinans point to our view of the increased possibility of an orderly wind-down of the company in the coming two years. This is despite the challenging macroeconomic environment due to the combined effects of a decline in oil prices and the COVID-19 pandemic. In our view, a further reduction of the balance sheet and Eksportfinans' exceptional capitalization diminish the likelihood of the nonpayment for the senior creditors. The company still relies on a considerable share of structured products in its overall funding mix. However, the decrease in nonpayment risk due to the balance-sheet contraction, and the significant bank and government guarantees on loan exposures, largely offset this additional risk.

Anchor: 'a-' owing to blended economic risk, dominated by exposure to the Norwegian market

The 'a-' anchor reflects Eksportfinans' focus on the Norwegian market. Our assessment of low economic risk in Norway balances the rising stress for the banking sector from the COVID-19 pandemic with the country's high level of wealth, strong returns from the sovereign investment fund, and predictable political environment. We expect government programs aimed at businesses and households to substantially offset the pressures of a sharp decline in oil prices and a recessionary environment prompted by the COVID-19 pandemic. In our base case, we project that Norway undergoes a sharp recession, with a 6.2% contraction in GDP in 2020, followed by a 3.9% rebound in 2021. We believe that the macroeconomic stress will result in intensifying pressure for the banking sector's asset quality, revenues, and profitability over the next two years. Specific segments of concern include the oil sector, small and midsize enterprises, commercial real estate, and other cyclical sectors.

Government authorities in Norway and many other European countries have made unprecedented policy response to the COVID-19 pandemic, in the form of monetary, fiscal, and regulatory support to their economies. Given the ample reserves in its sovereign wealth fund, we believe that Norway enjoys a unique position with respect to its ability to fund its fiscal support programs. We consider that this, in turn, will largely support the banking sector's asset quality. In addition, we consider that Norwegian banks' accumulated earnings and capital buffers will allow them to absorb the increase in credit losses due to the current stress in 2020-2021, and will support their credit standing.

We consider that residential mortgage portfolio, which accounts for about 55% of total bank loans, will be more resilient to the present stress than the corporate sector exposure, thanks to various government employment and income-support measures. That said, we recognize some latent risks to banks from structurally high levels of household debt (232% of GDP at year-end 2019), driven by strong growth in house prices over the past decade, and banks' exposure to the cyclical commercial real estate segment.

Our assessment of industry risks for Norwegian banks incorporates our view of effective banking regulation, a stable competitive environment, and the strong capitalization of the banking sector. We consider that the government authorities, including the banking regulator, have been proactively addressing the difficulties related to the current stress, including the introduction of an unprecedented cut in a key policy rate and a temporary relaxation of the countercyclical capital buffer requirements, as well as the provision of liquidity support to the banking sector.

Moreover, we consider that Norwegian banks have benefited from being at the forefront of the digital transformation in banking, including offering mobile-payment and investment solutions and mortgages, among other things. A high adoption rate of digital technology, as well as the population's openness toward sharing data, have helped drive this progress. In a context of social-distancing requirements, Norwegian banks should continue to provide a high-quality service to customers, as they moved from branch-based operations to a predominantly digital environment a while ago. We consider that this will also help Norwegian banks keep their costs under control, which will support their profitability, given the revenue pressure we anticipate over the next two years. Although domestic deposits in the total funding base are lower in Norway than in many other European markets, we believe that Norwegian banks will continue to have reliable access to domestic and international capital markets, in addition to deposits.

Table 1

Eksportfinans ASA--Key Figures

	--Year ended Dec. 31--				
(Mil. NOK)	**2020***	**2019**	**2018**	**2017**	**2016**
Adjusted assets	15,440.0	14,575.0	19,225.0	22,398.0	33,170.0
Customer loans (gross)	4,119.0	5,535.0	7,866.0	11,360.0	17,270.0
Adjusted common equity	5,992.0	6,101.0	6,100.0	6,591.0	6,983.0
Operating revenues	(80.0)	229.0	184.0	(224.0)	(641.0)
Noninterest expenses	26.0	88.0	89.0	114.0	107.0
Core earnings	591.0	45.0	118.0	84.0	177.0

*Data as of March 31. NOK--NOK-Norwegian krone.

Business position: Increasing cash flow stability in line with the gradual wind-down and debt repayment

The wind-down of Eksportfinans' balance sheet continues in an orderly fashion, gradually reducing the overall risk of nonpayment to senior creditors as loans continue to mature. In addition, compared with its peers, Eksportfinans benefits from guarantee mechanisms from the Norwegian government and Nordic financial institutions.

We now expect that the Norwegian banking sector will experience intensified pressure on its asset quality, revenues, and profitability. However, we think that Eksportfinans will be able to withstand this pressure better than its peers, thanks to the fact that government and bank guarantees cover almost 90% of the total loan portfolio. In addition, Eksportfinans' very high capitalization continues to support the ratings by providing ample buffers against a potential deterioration in asset quality. At the same time, Eksportfinans is not immune to the challenges of weaker macroeconomic environment. We now expect that the company's financial results in 2020-2021 will be very volatile. In particular, the revaluation of Eksportfinans' security portfolio might lead the company to report negative results for 2020, similar to those in the first quarter of this year.

Eksportfinans' ownership has been very stable over the past decade. The bank is owned by the Norwegian government (15%) and 23 banks (85%). The main shareholders are DNB Bank ASA, Nordea Bank Abp, and Danske Bank A/S, which together account for 71.3% of the capital.

The run-off of Eksportfinans' business is a consequence of the Norwegian government's decision in November 2011 to terminate the company's responsibility for commercial interest reference-rate loans under the Organization for Economic Co-operation and Development's consensus agreement of 1978. Since then, the company has been in run-off, a process that we expect to take several years, given the long-dated loans and financing on its balance sheet.

We expect that Eksportfinans' balance sheet--which amounted to Norwegian krone (NOK) 14.6 billion (€1.5 billion) as of Dec. 31, 2019--will continue to contract by 20%-25% annually over the coming two years as a substantial portion of the debt matures, further reducing the risk of nonpayment for senior creditors. In 2019 the company's balance sheet decreased by 24% compared with 2018 to represent less than 7% of total assets at the end of 2011.

Table 2

Eksportfinans ASA--Business Position					
	--Year ended Dec. 31--				
(%)	**2020***	**2019**	**2018**	**2017**	**2016**
Total revenues from business line (currency in millions)	(80.0)	229.0	184.0	(224.0)	(401.0)
Commercial banking/total revenues from business line	100.0	100.0	100.0	100.0	100.0
Return on average common equity	(4.7)	1.6	1.1	(3.7)	(4.6)

*Data as of March 31.

Capital and earnings: Very strong capital metrics, driven by the continued reduction of the balance sheet

Our assessment of Eksportfinans' capital and earnings reflects its very robust capitalization. In addition, most of the company's assets carry low risk weights, given the guarantees from financial institutions with comparatively high ratings or from the Norwegian sovereign.

We expect that Eksportfinans' capitalization will remain very strong, with the risk-adjusted capital (RAC) ratio before adjustments for diversification and concentration likely to remain above 100% over the next two years, which is well above our 15% limit for a very strong capitalization assessment. This is exceptionally high by global standards. As of Dec. 31, 2019, we calculated Eksportfinans' RAC ratio at 110.2%, compared with 119.2% a year ago. This reflects a further significant reduction in the loan portfolio in 2019. Our forecast reflects a further planned reduction in the loan portfolio of 20%-25% per year over the next two years.

In 2019, Eksportfinans reported NOK106 million of net profit, after showing losses in 2014-2017. At the same time, we expect the 2020 results to be much more volatile due to the negative effects of the weak macroeconomic environment because of the COVID-19 pandemic and the decline in oil prices. In line with these expectations, as of the first quarter of 2020, Eksportfinans reported a loss of NOK79 million, predominantly the result of higher unrealized losses on the securities and lending portfolio than in previous periods.

Nevertheless, this does not materially affect our view of Eksportfinans' capital or overall credit standing, since we expect it to maintain robust capital buffers to absorb unexpected losses. In our view, given the challenging environment in 2020-2021, the shareholders will continue with conservative capital management and are not likely to consider a potential capital distribution in the near term.

Table 3

Eksportfinans ASA--Capital And Earnings					
	--Year ended Dec. 31--				
(%)	**2020***	**2019**	**2018**	**2017**	**2016**
Tier 1 capital ratio	118.9	125.5	113.9	94.2	61.0
S&P Global Ratings' RAC ratio before diversification	N/A	110.2	119.2	N/A	74.1

Table 3

Eksportfinans ASA--Capital And Earnings (cont.)					
	--Year ended Dec. 31--				
(%)	2020*	2019	2018	2017	2016
S&P Global Ratings' RAC ratio after diversification	N/A	50.5	59.7	N/A	40.9
Adjusted common equity/total adjusted capital	100.0	100.0	100.0	100.0	100.0
Net interest income/operating revenues	(62.5)	70.3	72.3	(85.3)	(40.6)
Fee income/operating revenues	1.3	(0.4)	(0.5)	0.4	0.2
Market-sensitive income/operating revenues	161.3	30.1	28.3	184.8	140.9
Noninterest expenses/operating revenues	(32.5)	38.4	48.4	(50.9)	(16.7)
Preprovision operating income/average assets	(2.8)	0.8	0.5	(1.2)	(1.5)
Core earnings/average managed assets	15.7	0.3	0.6	0.3	0.4

*Data as of March 31. N/A--Not applicable.

Table 4

Eksportfinans ASA RACF--Risk-Adjusted Capital Framework (RACF) Data					
(NOK 000s)	Exposure*	Basel III RWA	Average Basel III RW(%)	S&P Global Ratings RWA	Average S&P Global Ratings RW (%)
Credit risk					
Government & central banks	704,615	5,685	1	21,309	3
Of which regional governments and local authorities	28,425	5,685	20	1,023	4
Institutions and CCPs	8,300,709	2,954,029	36	1,652,160	20
Corporate	4,910,603	0	0	447,678	9
Retail	5,071	1,775	35	1,176	23
Of which mortgage	5,071	1,775	35	1,176	23
Securitization§	0	0	0	0	0
Other assets†	278,320	12,320	4	677,188	243
Total credit risk	14,199,318	2,973,809	21	2,799,511	20
Credit valuation adjustment					
Total credit valuation adjustment	--	0	--	224,750	--
Market Risk					
Equity in the banking book	0	0	0	0	0
Trading book market risk	--	1,252,524	--	1,878,786	--
Total market risk	--	1,252,524	--	1,878,786	--
Operational risk					
Total operational risk	--	406,688	--	604,973	--
(NOK 000s)	Exposure	Basel III RWA	Average Basel II RW (%)	S&P Global Ratings RWA	% of S&P Global Ratings RWA
Diversification adjustments					
RWA before diversification	--	4,633,021	--	5,508,019	100
Total Diversification/ Concentration Adjustments	--	--	--	6,513,294	118
RWA after diversification	--	4,633,021	--	12,021,313	218

Table 4

Eksportfinans ASA RACF--Risk-Adjusted Capital Framework (RACF) Data (cont.)				
(NOK 000s)	**Tier 1 capital**	**Tier 1 ratio (%)**	**Total adjusted capital**	**S&P Global RAC Ratings ratio (%)**
Capital ratio				
Capital ratio before adjustments	5,813,181	125.5	6,071,000	110.2
Capital ratio after adjustments‡	5,813,181	125.5	6,071,000	50.5

*Exposure at default. §Securitization Exposure includes the securitization tranches deducted from capital in the regulatory framework. †Exposure and S&P Global Ratings' risk-weighted assets for equity in the banking book include minority equity holdings in financial institutions. ‡Adjustments to Tier 1 ratio are additional regulatory requirements (e.g. transitional floor or Pillar 2 add-ons). RWA--Risk-weighted assets. RW--Risk weight. RAC--Risk-adjusted capital. NOK--Norwegian krone. Sources: Company data as of Dec. 31 2019, S&P Global Ratings.

Risk position: A still-high share of structured funding and counterparty concentration

Our assessment of Eksportfinans' risk position reflects our view of the complexity of the company's structured funding with unknown maturity, which comprises more than 40% of total funding at end-December 2019. In addition, Eksportfinans depends on access to the derivatives market to control risk.

Derivative risk management places considerable demands on the company's administrative resources, in our view. We understand that Eksportfinans would have access to the key personnel of its major owner banks if it were to lose staff in functions associated with funding or derivatives management.

We believe that strong government and bank guarantees continue to mitigate Eksportfinans' credit risk. Most of its loan portfolio is guaranteed either by the Norwegian Export Credit Guarantee Agency (GIEK; 44% of total loans) or Norwegian banks. The majority of guarantees from Norwegian banks are provided by DNB Bank. Given the high-quality guarantees, direct exposure to corporate risk is limited, but the company still has exposure to a small number of key financial entities that it used to offload the risk inherent in its structured borrowings.

Furthermore, credit losses have been minimal over Eksportfinans' operating history. The nonperforming loans (stage 3 loans according to International Financial Reporting Standard 9) accounted for NOK632 million as of end-March 2020, or about 13% of total loans, versus NOK26 million as of end-2019. At the same time, majority of loans including nonperforming loans were guaranteed either by the Norwegian government via GIEK or by private banks, most of which operate in Norway, mitigating potential losses for Eksportfinans. As of end-March 2020, 66.8% of the loan book is measured at fair value through profit or loss, while around 33.2% of loans are measured at amortized costs.

Table 5

Eksportfinans ASA--Risk Position					
	--Year ended Dec. 31--				
(%)	**2020***	**2019**	**2018**	**2017**	**2016**
Growth in customer loans	(25.6)	(29.6)	(30.8)	(34.2)	(29.4)
Total diversification adjustment/S&P Global Ratings' RWA before diversification	N/A	118.0	99.6	N/A	81.1
Total managed assets/adjusted common equity (x)	2.6	2.4	3.2	3.4	4.8
Gross nonperforming assets/customer loans + other real estate owned	0.7	0.5	0.4	0.2	0.4

*Data as of March 31. N/A--Not applicable.

Funding and liquidity: Below-average funding, reflecting the uncertain nature and risks of structured funding

In our view, Eksportfinans' financial profile balances the use of structured funding with uncertain maturities against the owners' stated willingness to assist in an orderly run-off. As such, we assess Eksportfinans' funding as below average and its liquidity position as adequate.

In the company's baseline assumptions for the maturity of its balance sheet, excess cash flows are present throughout the unwinding. Structured funding with unknown maturity due to triggers and calls continues to comprise a significant share at 43% of total funding as of end-December 2019. Contractually, these structured instruments are long term in nature, some expiring after 2021. However, their maturities could shorten materially due to triggers primarily associated with fluctuating exchange rates of the U.S. dollar and the Japanese yen, and the Australian dollar and the yen. Therefore, maturity of this funding is dependent on market movements and trends in interest and exchange rates, which could deviate from the company's baseline expectations, representing liquidity risk for the company. However, we consider that the company has adequate liquidity buffers amounting to total NOK 8.8 billion as of March 31, 2020 (equivalent to 57% of total assets), comprising of the securities portfolio of NOK7.4 billion and cash equivalents of NOK1.4 billion.

The continued balance-sheet contraction and capital market issues are reflected in our funding metrics for Eksportfinans. These metrics have remained stable over the past few years, with the stable funding ratio at 119.5% at end-March 2020, compared with 93.9% at end-2019 (based on contractual/expected maturities of funding instruments; if adjusted for the structured instruments with unknown maturities, respective metrics would be lower).

We consider that the company has adequate liquidity buffers amounting to total NOK 8.8 billion as of March 31, 2020 (equivalent to 57% of total assets), comprising of the securities portfolio of NOK7.4 billion and cash equivalents of NOK1.4 billion.

In calculating Eksportfinans' metrics, we assume that all loans require stable funding over one year, which is less relevant for a company in run-off. We expect that loans maturing from the end of 2019 will mature without complications and reduce the balance sheet according to the company's forecast. Lastly, we do not see material cash flow risks given the current improvements in the company's liquidity and funding ratios.

Table 6

Eksportfinans ASA--Funding And Liquidity					
	--Year ended Dec. 31--				
(%)	**2020***	**2019**	**2018**	**2017**	**2016**
Long-term funding ratio	76.8	70.6	73.2	88.2	60.3
Stable funding ratio	119.5	93.9	89.6	N/A	67.8
Short-term wholesale funding/funding base	45.5	56.1	42.1	17.5	52.2
Broad liquid assets/short-term wholesale funding (x)	1.6	0.9	0.8	1.4	0.4

*Data as of March 31. N/A--Not applicable.

Support: No uplift above stand-alone credit profile

We do not incorporate any additional notches for potential government support in the ratings on Eksportfinans, despite the government's ownership of a minority stake in its capital. This is because we do not think that the government considers Eksportfinans to play an important role in the financial sector.

Additional rating factors: None

No additional factors affect this rating.

Related Criteria

- Criteria | Financial Institutions | General: Risk-Adjusted Capital Framework Methodology, July 20, 2017
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- Criteria - Financial Institutions - Banks: Bank Rating Methodology And Assumptions: Additional Loss-Absorbing Capacity, April 27, 2015
- General Criteria: Group Rating Methodology, Nov. 19, 2013
- Criteria | Financial Institutions | Banks: Quantitative Metrics For Rating Banks Globally: Methodology And Assumptions, July 17, 2013
- Criteria | Financial Institutions | Banks: Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- Criteria - Financial Institutions - Banks: Banks: Rating Methodology And Assumptions, Nov. 9, 2011
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009
- Criteria | Financial Institutions | Banks: Commercial Paper I: Banks, March 23, 2004

Anchor Matrix

Industry Risk	Economic Risk									
	1	**2**	3	4	5	6	7	8	9	10
1	a	a	a-	bbb+	bbb+	bbb	-	-	-	-
2	a	a-	a-	bbb+	bbb	bbb	bbb-	-	-	-
3	a-	**a-**	bbb+	bbb+	bbb	bbb-	bbb-	bb+	-	-
4	bbb+	bbb+	bbb+	bbb	bbb	bbb-	bb+	bb	bb	-
5	bbb+	bbb	bbb	bbb	bbb-	bbb-	bb+	bb	bb-	b+
6	bbb	bbb	bbb-	bbb-	bbb-	bb+	bb	bb	bb-	b+
7	-	bbb-	bbb-	bb+	bb+	bb	bb	bb-	b+	b+
8	-	-	bb+	bb	bb	bb	bb-	bb-	b+	b
9	-	-	-	bb	bb-	bb-	b+	b+	b+	b
10	-	-	-	-	b+	b+	b+	b	b	b-

Ratings Detail (As Of June 26, 2020)*	
Eksportfinans ASA	
Issuer Credit Rating	BBB+/Positive/A-2
Senior Unsecured	BBB+

Ratings Detail (As Of June 26, 2020)*(cont.)	
Short-Term Debt	A-2
Issuer Credit Ratings History	
23-Nov-2017	BBB+/Positive/A-2
28-Nov-2016	BBB+/Stable/A-2
29-Feb-2016	BBB/Positive/A-2
Sovereign Rating	
Norway	AAA/Stable/A-1+

*Unless otherwise noted, all ratings in this report are global scale ratings. S&P Global Ratings' credit ratings on the global scale are comparable across countries. S&P Global Ratings' credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.