MOODY'S
INVESTORS SERVICE

Rating Action: Moody's affirms Volvofinans Bank AB's A3 deposit ratings; changes outlook to negative

03 Jun 2020

Stockholm, June 03, 2020 -- Moody's Investors Service, ("Moody's") today affirmed Volvofinans Bank AB's long- and short-term, foreign and local currency A3/P-2 deposit ratings. The baseline credit assessment (BCA) and the adjusted BCA were affirmed at baa2. The subordinated debt rating was affirmed at Baa3. Furthermore, the long-term and short-term, foreign and local currency counterparty risk ratings (CRR) of A2/P-1, and the long-and short-term counterparty risk assessments (CRA) of A2(cr)/P-1(cr) were affirmed. The outlook on the long-term deposit rating was changed to negative from stable.

The affirmation of Volvofinans Bank AB's (Volvofinans) long-term deposit rating of A3 incorporates (1) the affirmation of the bank's baa2 BCA, reflecting Moody's expectation of a moderate deterioration in asset risk and subsequent dampening of profitability, driven by the challenging operating environment, balanced against the protection afforded to the bank by its recourse agreements with Volvo dealers and Volvofinans' very strong capitalisation; and (2) the results from Moody's Advanced Loss Given Failure (LGF) analysis, which takes into account the sizable volumes of liabilities that would cushion depositors in case of failure, leading to two notches of uplift.

The negative outlook on Volvofinans' long-term deposit ratings reflects the higher likelihood downside risks affecting automotive manufacturing sector crystalising, which could trigger incremental deterioration in the bank's asset risk and profitability beyond Moody's current expectations. Accordingly, the negative outlook also takes into account the linkages with the car maker, Volvo Car AB (Ba1, Negative), whose negative outlook reflects the severe impact that the coronavirus will have on Volvo Car's operating performance and credit metrics into 2021.

The full list of the affected ratings and rating inputs can be found at the end of this press release.

RATINGS RATIONALE

The affirmation of Volvofinans' BCA at baa2 reflects Moody's view that the expected moderate deterioration in the bank's asset risk and profitability, will most likely be mitigated by its very strong capitalisation, as well as the additional protection the bank has against loan losses from the recourse agreements it has with Swedish Volvo dealers.

Due to the coronavirus, demand for new vehicles has fallen sharply as companies delay investments and households remain hesitant in their decisions to purchase cars. While Swedish authorities have chosen to keep Sweden open during the spread of the pandemic, Moody's forecasts a contraction in GDP by 3.8% during 2020 and increased unemployment. Profitability will therefore dampen over the next 12 to 18 months as business volumes decline but remain firmly in positive territory. For Volvofinans, the fall in revenues on new car financing will continue to be partly mitigated by the performance of its stock of loans and continued activity in the used car market.

This deterioration in the operating environment will also lead to moderate increases in Volvofinans' problem loans, however, the recourse agreements with the Swedish Volvo Dealers on 76% of its loans and leases will help contain loan loss provisions.

Continued internal capital generation and low loan loss provisions means that the bank's strong capitalisation will remain a material credit strength. This will be enhanced by the absence of a 2020 dividend payment, which will provide additional buffer against potential losses or increases in risk weights.

Volvofinans has reduced its reliance on wholesale markets for the funding of its operations, which will help contain funding costs in the current environment with heightened uncertainty, with the bank's loans to deposit ratio declining to 179% in 2019 from 205% as of year-end 2018.

OUTLOOK

The negative outlook on Volvofinans' long-term deposit ratings reflects the mounting downside risks in the auto sector, where future demand for vehicles could be weaker than our current estimates, thereby leading to a deterioration in the bank's asset risk and profitability beyond Moody's current expectations. Moody's forecasts a 20% decline in unit shipments for the global automotive sector during 2020, with a steep year-over year contraction in the second and third quarters followed a modest rebound in the fourth quarter. The rating agency expects 2021 industry unit sales to rebound and grow by approximately 11%. A weaker than anticipated demand for vehicles would increase the liquidity strain on Volvo dealers, which could result in difficulties honouring recourse agreements, especially if this is combined with higher than anticipated number of borrowers struggling to meet their repayments.

Although Moody's considers that Volvofinans benefits from a degree of strategic, operational and financial independence that makes its credit profile less correlated to its auto manufacturing parent than typically observed with other captive auto banks (partly because of its 50/50 joint ownership by Volvo and the Volvo Dealers and the dealers' operations with other auto manufactures), the Volvo brand is an integral part of Volvofinans Bank's business model. Therefore, the rating agency believes it would be affected by a deterioration in Volvo Cars' credit profile.

ESG

The widening spread of the coronavirus outbreak, deteriorating global economic outlook, falling oil prices, and asset price declines are creating a severe and extensive credit shock across many sectors, regions and markets. The combined credit effects of these developments are unprecedented. The automotive sector has been one of the sectors most significantly affected by the shock given its sensitivity to consumer demand. Moody's further regards the coronavirus outbreak as a social risk under its ESG framework, given the substantial implications for public health and safety.

RATIONALE FOR THE BANK'S LONG-TERM RATINGS

Volvofinans long-term deposit and subordinated debt ratings reflect the bank's BCA and Adjusted BCA of baa2 and the application of Moody's Advanced Loss Given Failure (LGF) analysis to its liabilities, reflecting the volumes of loss absorbing obligations protecting creditors and depositors in case of failure. The A3 deposit rating reflects the adjusted BCA and two additional notches due to the large volumes of obligations protecting depositors in case of failure. The Baa3 rating on Volvofinans subordinated debt reflects the BCA of baa2 and a negative notch due to the higher expected loss on this type of instrument.

Volvofinans's long-term CRRs incorporates three notches of LGF uplift above the bank's Adjusted BCA of baa2. Volvofinans long-term CR Assessment incorporates three notches of LGF uplift above the bank's Adjusted BCA of baa2.

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

An upgrade of Volvofinans ratings and assessments is unlikely given the negative outlook currently assigned to the bank's long-term ratings. Volvofinans' deposit ratings could return to stable outlook if the auto industry sector shows clear signals of recovery, allowing the bank to avoid more severe downside scenarios while manufacturer and dealers maintain stable credit profiles.

A downgrade of the BCA and the long-term deposit rating could follow (i) a significant deterioration in profitability and asset quality following the crystalisation of downside risks in the auto sector, (ii) a lack of access to wholesale funding or, (iii) a substantial reduction in the volume of deposits relative to the bank's tangible banking assets, resulting in higher loss severity for deposits in the event of the bank's failure. Furthermore, a downgrade of Volvo Car's ratings following a further deterioration in the auto sector could trigger a downgrade of the bank.

LIST OF AFFECTED RATINGS

..Issuer: Volvofinans Bank AB

Affirmations:

.... Adjusted Baseline Credit Assessment, Affirmed baa2

.... Baseline Credit Assessment, Affirmed baa2

.... Long-term Counterparty Risk Assessment, Affirmed A2(cr)

.... Short-term Counterparty Risk Assessment, Affirmed P-1(cr)

.... Long-term Counterparty Risk Rating, Affirmed A2

.... Short-term Counterparty Risk Rating, Affirmed P-1

.... Short-term Bank Deposits, Affirmed P-2

....Long-term Bank Deposits, Affirmed A3, Outlook Changed to Negative from Stable

....Subordinate, Affirmed Baa3

Outlook Actions:

....Outlook, Changed to Negative from Stable

PRINCIPAL METHODOLOGY

The principal methodology used in these ratings was Banks Methodology published in November 2019 and available at https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC_1147865 . Alternatively, please see the Rating Methodologies page on www.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 at: https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC_79004.

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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://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC_1133569 .

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

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