MOODY'S
INVESTORS SERVICE

Rating Action: Moody's affirms Volvofinans Bank's A3 rating; stable outlook

26 Feb 2019

Stockholm, February 26, 2019 -- 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- and short-term, foreign and local currency counterparty risk ratings of A2/P-1, and the long-and short-term counterparty risk assessments of A2(cr)/P-1(cr) were affirmed. The outlook remains stable.

Volvofinans Bank AB's (Volvofinans) long-term deposit rating of A3 incorporates (1) the bank's BCA of baa2, underpinned by strong asset quality with problem loans to gross loans consistently below 1%, solid capitalisation, and improving profitability with net income to tangible assets 0.98% for the first nine months 2018, balanced against a high reliance on market funding and (2) the results from our Advanced Loss Given Failure (LGF) analysis, which takes into account the severity of loss faced by the different liability classes in resolution, leading to two notches of uplift for Volvofinans' deposit rating.

The outlook on Volvofinans' long-term deposit rating is stable. This reflects our expectation that its diversified client base, its conservative loan book, and a supportive operating environment will contribute to steady income despite its monoline business operations and keep its credit profile broadly in line with its historical track record.

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 primarily reflects the bank's solid financial fundamentals, including its consistently strong asset quality, solid capitalisation, improving profitability balanced against a high reliance on market funding. In addition, although the bank is inherently concentrated on the auto sector, notably in relation to the operations of Volvo Car AB (Volvo; long-term corporate family rating Ba1, stable), 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. As such, Volvofinans' BCA of baa2 is positioned two notches above Volvo's Ba1 rating.

Furthermore, Volvofinans' strong asset risk is illustrated by loan losses that are much lower than those of its peers, notably due to the fact that approximately 76% of the lending book ("sales finance cars" and "sales finance trucks") benefits from recourse agreements with the Volvo Dealers. During 2018, the bank recorded annual loan loss charges equivalent to only 3 basis points of gross outstanding loans, below the 5 bps during years 2014-2017. Moody's expects the continued low interest environment to be beneficial to the customers of the non-guaranteed part of the lending activities, namely the consumer finance business (Volvo Card) and the fleet finance business, and therefore loan losses to remain low.

Volvofinans reported a common equity tier one (CET1) ratio of 18.1% on a transitional basis at year-end 2018, a capitalisation Moody's considers solid, viewing the relatively contained asset risks of the bank.

In addition, profitability remains strong on the back of higher car financing volumes and net interest margins that remain relatively insensitive to the situation of interest rates. Net income as a proportion of tangible assets has improved, reaching 0.98% in the first nine months of 2018 compared to 0.78% in 2017 and 0.83% in 2016 .

As for many auto banks, Volvofinans relies on the wholesale markets for the funding of its operations, a relative constraint for the BCA. At year-end 2017, market funds represented 44% of tangible banking assets, under Moody's calculations. However, deposits represented 48% of funding at end-September 2018, a ratio above that of most of its peers.

LOSS GIVEN FAILURE ANALYSIS

Volvofinans is subject to the EU Bank Recovery and Resolution Directive (BRRD), which Moody's considers to be an Operational Resolution Regime. In accordance with its methodology, the agency therefore applies its Advanced Loss Given Failure (LGF) analysis, considering the risks faced by the different debt and deposit classes across the liability structure should the bank be placed into resolution. Moody's Advanced LGF analysis indicates likely very low loss severity for deposits in the event of the bank's failure, thanks to the thickness of the deposit base, adding two notches above the bank's adjusted BCA.

DEPOSIT RATINGS

The long-term deposit ratings incorporate two notches of LGF uplift above the bank's adjusted BCA of baa2, reflecting the volumes of loss absorbing obligations protecting depositors in case of failure.

SUBORDINATED DEBT

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.

The debt, is a plain vanilla subordinated debt instrument with a Tier 2 regulatory treatment. It has no coupon-skip mechanism, and no write-down or conversion clauses. Therefore, Moody's considers that the probability of default is aligned with the Adjusted BCA, which is at the same level as the BCA, baa2, for Volvofinans. Loss severity is captured by Moody's LGF analysis, which is high due to the loss absorption characteristics of the instrument in case of failure, indicating a negative one notch.

COUNTERPARTY RISK RATINGs (CRRs)

The CRRs reflect the agency's advanced Loss-Given-Failure (LGF) approach that takes into account the level of subordination to CRR liabilities in the institutions' balance sheet and assumes a nominal volume of such liabilities.

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

COUNTERPARTY RISK (CR) ASSESSMENT

CR Assessments are opinions of how counterparty obligations are likely to be treated if a bank fails, and are distinct from debt and deposit ratings in that they (1) consider only the risk of default rather than expected loss, and (2) apply to counterparty obligations and contractual commitments rather than debt or deposit instruments. The CR Assessment is an opinion of the counterparty risk related to a bank's covered bonds, contractual performance obligations (servicing), derivatives (for example, swaps), letters of credit, guarantees and liquidity facilities.

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

The main difference with our Advanced LGF approach used to determine instrument ratings is that the CR Assessment captures the probability of default on certain senior obligations rather than expected loss. Therefore, we focus purely on subordination and take no account of the volume of the instrument class.

OUTLOOK

The outlook on Volvofinans' long-term deposit rating is stable. This reflects our expectation that the its diversified client base despite being a monoline, its conservative loan book, and a supportive operating environment will contribute to steady income and keeping its credit profile broadly in line with its historical track record.

WHAT COULD MOVE THE RATINGS UP/DOWN

Volvofinans' BCA and deposit ratings could be upgraded if the bank strengthened its profitability without accumulating more credit risk whilst simultaneously maintaining solid capital and reducing its reliance on market funding.

A downgrade of the BCA and the long-term deposit rating could follow (i) a deterioration of asset quality which could, for instance, result from increased unsecured consumer lending, (ii) a deterioration in profitability, (iii) a materially increased use of short-term wholesale funding and/or, (iv) 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, notwithstanding the fact that Volvofinans is better ring-fenced from its industrial parent than certain peers, a downgrade of Volvo's rating could cause a downgrade of Volvofinans' ratings if Moody's believes that a deterioration of Volvo's creditworthiness would likely have spillover impacts on the bank's financing volumes, profitability and/or ability to fund itself in the wholesale markets.

PRINCIPAL METHODOLOGY

The principal methodology used in these ratings was Banks published in August 2018. Please see the Rating Methodologies page on www.moodys.com for a copy of this methodology.

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

....Subordinate Regular Bond/Debenture, Affirmed Baa3

.... Long-term Bank Deposits, Affirmed A3, Outlook Remains Stable

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

..Outlook Action:

....Outlook Remains Stable

REGULATORY DISCLOSURES

For ratings issued on a program, series or category/class of debt, this announcement provides certain regulatory disclosures in relation to each rating of a subsequently issued bond or note of the same series or category/class of debt or pursuant to a program for which the ratings are derived exclusively from existing ratings in accordance with Moody's rating practices. For ratings issued on a support provider, this announcement provides certain regulatory disclosures in relation to the credit rating action on the support provider and in relation to each particular credit rating action for securities that derive their credit ratings from the support provider's credit rating. For provisional ratings, this announcement provides certain regulatory disclosures in relation to the provisional rating assigned, and in relation to a definitive rating that may be assigned subsequent to the final issuance of the debt, in each case where the transaction structure and terms have not changed prior to the assignment of the definitive rating in a manner that would have affected the rating. For further information please see the ratings tab on the issuer/entity page for the respective issuer on www.moodys.com.

For any affected securities or rated entities receiving direct credit support from the primary entity(ies) of this credit rating action, and whose ratings may change as a result of this credit rating action, the associated regulatory disclosures will be those of the guarantor entity. Exceptions to this approach exist for the following disclosures, if applicable to jurisdiction: Ancillary Services, Disclosure to rated entity, Disclosure from rated entity.

Regulatory disclosures contained in this press release apply to the credit rating and, if applicable, the related rating outlook or rating review.

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

Please see the ratings tab on the issuer/entity page on www.moodys.com for additional regulatory disclosures for each credit rating.

Niclas Boheman
Asst Vice President - Analyst
Financial Institutions Group
Moody's Investors Service (Nordics) AB
Norrlandsgatan 20
Stockholm 111 43
Sweden
JOURNALISTS: 44 20 7772 5456
Client Service: 44 20 7772 5454

Sean Marion
MD - Financial Institutions
Financial Institutions Group
JOURNALISTS: 44 20 7772 5456
Client Service: 44 20 7772 5454

Releasing Office:
Moody's Investors Service (Nordics) AB
Norrlandsgatan 20
Stockholm 111 43
Sweden
JOURNALISTS: 44 20 7772 5456
Client Service: 44 20 7772 5454