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KBN Kommunalbanken Norway

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This report does not constitute a rating action.

Credit Highlights

Issuer Credit Rating
AAA/Stable/A-1+

Overview

Enterprise risk profile	Financial risk profile
A low-risk municipal sector, a very strong management team, and significant market share underpin credit quality.	Very strong capitalization and liquidity position provide financial buffers.
Very strong management and governance is supported by compliance with banking regulatory standards.	Sustained high levels of capitalization supported by no significant concentration on its lending portfolio.
The Norwegian local government sector exhibits key structural features that support high credit standing.	Excellent name recognition supports strong market access and a deep investor base.
Significant market share with a diversified revenue base.	Robust risk management supports strong liquidity buffers.

In our view, timely and sufficient extraordinary support of Kommunalbanken (KBN) in the event of financial distress is extremely high. We think KBN has a very important role and integral link with Norway's central government, resulting in an extremely high likelihood of receiving extraordinary support in the unlikely event of financial distress.

Robust risk management practices and close oversight of Norway's central government support our view of high asset quality in KBN's lending and treasury portfolios. In addition to KBN's robust credit risk function, the Norwegian Ministry of Local Government and Regional Development has close oversight of the sector and the bank's governance, which supports our view of its high asset quality.

We expect KBN to maintain a very strong financial profile supported by compliance with banking regulatory standards. KBN operates under a relatively strict regulatory standard set by Norway's Financial Supervisory Authority (FSA). We expect the bank to remain compliant with all regulatory requirements, which will further support its very strong financial risk profile.

Outlook

The stable outlook reflects our view that there is little risk that KBN's market relevance, ownership structure, or implicit support from the Norwegian government will change in the next few years.

We could lower our ratings if we thought KBN's public policy role was subsiding, or if there were a change to its ownership, resulting in a lower likelihood of extraordinary support from the Norwegian government. The ratings could also come under pressure if KBN's financial indicators weakened significantly, or if management failed to achieve its strategy and experienced a structural reduction of its market share, limiting its ability to fulfill its mandate.

Rationale

Enterprise risk profile: Low-risk municipal sector, very strong management and governance, and a significant market share.

KBN has a long track record of fulfilling its public policy role and has been active under adverse market conditions, as demonstrated during the pandemic and recent market volatility. KBN was established in 1926 by an act of parliament and assumed its current organizational structure in 1999 via a conversion act. The bank was 80% owned by the Norwegian government and 20% owned by Kommunal Landspensjonskasse (KLP) until 2009, when the Norwegian government bought the KLP shares and became the sole owner.

Over the years, the Norwegian government has ratified its support of KBN via the Ministry of Local Government and Regional Development and has made capital injections to the bank in 2008, 2012, and 2015. In 2020 its mandate was reinforced by a capital injection from the government, which increased KBN's capacity to respond to municipalities' funding needs during the pandemic.

The central government's unwavering support of the local government sector throughout the pandemic buttressed KBN's resilience and helped maintained its robust asset quality. While rising interest rates could add pressure to local government finances, the sector exhibits key structural features that should continue supporting its high credit standing.

Our assessment of Norway's low risk Public Industry Country Risk Assessment is supported by its wealthy economy. After GDP contraction in 2020, we expect it will expand in 2022. Furthermore, our view is supported by the advanced financial system in Norway and the tight link between the local government sector and the 'AAA' rated sovereign. Moreover, the central government's close oversight of local and regional governments (LRGs) enables timely mitigating actions before the sector enters financial distress.

The Norwegian LRG sector has slightly higher leverage than peers, although it remains modest. We forecast the sector's direct debt will reach about 106% of its operating revenues by 2022 and its interest-to-operating-expense ratio will stay slightly below 2%.

KBN's public-sector mandate is to provide long-term funding to, or guaranteed by, Norwegian LRGs. It has been a countercyclical lender and played an active role throughout the pandemic. KBN aims to complement market participants and, as a result, tries to maintain a market share below 50%. Lending from banks to the LRG sector is decreasing while funding from the capital markets is increasing. Husbanken (the Housing Bank), which directly funds social housing, is also becoming more active. This has resulted in KBN's market share declining slightly to 45% in 2021, from 47% in the previous two years.

The bank's very strong management and governance is underpinned by its robust compliance with banking regulatory requirements, the central government's tight oversight of its activities, its prudent risk management with a low-risk appetite, and its robust record of fulfilling its public-policy mandate through credit cycles.

KBN's capacity to act as a countercyclical lender further demonstrates its broad access to markets. Its innovative product offering, which responds to changing market and customer needs, has enabled KBN to remain relevant to its customers. The bank has also been well supported by its owner, the central government, which forewent dividend distributions in 2019 and 2020.

KBN has kept a strong focus on sustainable financing--one of the key pillars of its 2022-2024 strategy and in line with national climate goals.

Management's policies and practices are prudent and oversight from the Norwegian FSA ensures continuity of managerial practices and mitigates key risks, a distinctive feature of KBN when compared to most of its global peers. KBN's organizational structure allows it to respond appropriately to stakeholder needs and requirements. Additionally, the Ministry of Local Government and Regional Development's participation in supervisory board meetings increases oversight.

In our view, KBN's management team is experienced, and key members generally have long tenure with the funding agency. Superior risk-management policies and practices mitigate key risks in the bank's operations.

We expect KBN to remain compliant after the upcoming banking reform packages come into force. In May 2020, the FSA announced that the deadline for fulfilling the minimum requirement for own funds and eligible liabilities (MREL) would be postponed to Jan. 1, 2024. While the consequences of MREL should therefore be very limited for KBN, national implementation of MREL provisions could require KBN to issue senior nonpreferred instruments. KBN has also stepped up its internal processes to align with the upcoming ESG disclosure requirements, which will enter into force for fiscal year 2022, with reporting in 2023.

Financial risk profile: Very strong capitalization and liquidity position provide financial buffers

KBN's risk-adjusted capital (RAC) ratio before adjustments remained very high at 69% at March 31, 2022. In 2021, the bank resumed dividend distributions to the state after two years of the government waiving these payments amid the pandemic. KBN's capital position has strengthened after the central government's capital injection of Norwegian krone (NOK) 750 million in April 2020. This paid-in capital offset KBN's lower profitability during the pandemic.

When factoring in our adjustment for single-name concentration in underlying borrowers, KBN's S&P Global Ratings-adjusted RAC ratio declines to but remains at a very strong 31%. As of March 2022, KBN does not have any significant concentration in its loan book and has funded every municipality in Norway; the top-20 largest borrowers represented about 39% of the total loan book.

KBN has not experienced any losses and has no past due or impaired exposures. Risk management remains very robust and KBN uses internal models for capital requirements for market, liquidity, and operational risks. It also implements strong credit risk monitoring of all its customers and processes for granting loans and is gradually incorporating ESG considerations.

KBN's compliance with regulatory capital requirements supports our expectation that its S&P Global Ratings-adjusted RAC ratio will be comfortably above our 15% threshold in the next two years and remain a key feature of its financial risk profile. As of December 2021, KBN's common equity tier 1 capital adequacy (CET1) ratio of 18.8% was well above the minimum regulatory tier 1 capital ratio of 15.1%. We note that risk weights applicable under FSA Norway are significantly higher than those applied under our RAC framework methodology; therefore, KBN's adjusted RAC ratio is higher than its CET1 ratio.

KBN has adapted its capital structure to new capital requirements and issued additional tier 1 (AT1) capital notes in June 2017. Our RAC ratios include capital from these notes because these meet the conditions for intermediate equity content under our hybrid criteria. The instruments are perpetual and have a call date that we expect will be approximately 10 years from issuance. In addition, they do not contain a coupon step-up and have loss-absorption features on a going-concern basis. Although we expect the Norwegian government would prevent a conversion to equity of these AT1 capital notes, they are available to KBN to provide equity if triggered.

KBN's excellent name recognition and deep investor base further supports our view of its funding profile. Its funding strategy is focused on benchmark issuance in strategic markets. It also has a record of more than 10 years of green bond issuance, which has further expanded its investor base. During 2021 the bank issued NOK7.9 billion through three green bonds in three currencies.

As of March 2022, KBN's funding ratio remain very solid after strengthening to 2.3x from 1.9x in the first quarter of 2021. The funding ratios are still very strong after including its undrawn lending commitments, at 2.2x.

The majority of KBN's funding instruments are plain vanilla and it has reduced its exposure to callable funding and Japanese retail Uridashi funding.

KBN also remains proactive in its liquidity management and has very strong liquidity buffers. Its policy is to hold minimum liquidity equal to the projected payment obligations over the coming 12 months without access to funding. In line with our expectations, all KBN's derivative counterparties have now moved to bilateral credit support annexes with a daily exchange of collateral.

Our 12-month liquidity ratio was 2.2x as of March 2022 after including undrawn loan commitments. This indicates that KBN would be able to cover all committed lending and debt repayments for at least one year, even under extremely stressed market conditions and without access to the capital markets.

Extremely high likelihood of support from the Norwegian government

The 'AAA' rating on KBN is two notches higher than its stand-alone credit profile (SACP) because we think the bank has a very important role and integral link with the Norwegian government. Therefore, we think there is an extremely high likelihood that the central government would provide timely and sufficient extraordinary support to KBN in the event of financial distress.

This assessment is based on our view of KBN's:

- Very important role for the Norwegian government as a vehicle to limit the cost of debt for Norway's LRG sector. Acting largely as a state instrument, KBN performs an important public policy function in providing low-cost funding to the Norwegian LRG sector and in promoting competition in the municipal loan market; and
- Integral link with the Norwegian government, which has fully owned KBN since 2009. Through a letter of support, the central government has formalized its relationship with KBN and expressed its clear intention of extending timely support should the company find itself in financial distress. The central government confirmed its supportive stance toward KBN in November 2011 and ratified it in 2017 to avoid negative reputational effects associated with Eksportfinans losing its government mandate to provide state-subsidized export credit.

Issue Ratings--Subordination Risk Analysis

We rate KBN's AT1 capital notes 'A+' and its subordinated bond 'AA+'. The starting point for both issue ratings is our 'AAA' issuer credit rating on KBN given our view of the extremely high likelihood of KBN receiving extraordinary support from its owner. This is further supported by our expectation that the Norwegian government would provide financial support to prevent loss absorption and that it could step in early to prevent a conversion, as per the instrument's procedure.

We derive the four-notch difference between the 'A+' issue rating on the AT1 notes and the issuer credit rating on KBN as follows:

- One notch for subordination.
- Two notches for Tier 1 regulatory capital status; and
- One notch because the instruments allow for a full or partial temporary write-down.

The 'AA+' issue rating on KBN's subordinated bond reflects the bond's subordination to KBN's senior unsubordinated debt. We do not apply further notching for a full or partial temporary write-down because we regard this as contradicting our view of government support for KBN.

Key Statistics

Table 1

KBN Kommunalbanken Norway--Selected Indicators					
	--Year ended Dec. 31--				
(Mil. NOK)	**2021**	**2020**	**2019**	**2018**	**2017**
Business Position					
Total adjusted assets	472,924.0	498,088.0	460,652.0	457,585.0	412,729.0
Customer loans (gross)	323,696.0	321,900.0	310,923.0	303,582.0	283,396.0
Growth in loans (%)	0.6	4.0	2.0	7.0	6.0
Net interest revenue	1,585.0	1,672.0	1,874.0	1,885.0	2,162.0
Noninterest expenses	255.0	256.0	251.0	210.0	193.0
Capital & Risk Position					
Total liabilities	453,983.0	479,681.0	444,377.0	442,279.0	398,187.0
Total adjusted capital*	16,484.0	16,577.0	15,639.0	15,561.0	14,099.0
Assets/capital	29.8	31.0	33.0	36.0	35.0
RAC ratio before diversification (%)*	69.9	67.2	46.0	51.0	59.0
RAC ratio after diversification (%)*	30.7	29.5	25.0	29.0	31.0
Funding and Liquidity					
Liquidity ratio with loan disbursement (one year)*	2.2	2.0	1.6	1.3	1.2
Liquidity ratio without loan disbursement (one year)*	2.2	2.0	1.7	1.3	1.5
Funding ratio (one year)*	2.3	1.9	1.5	1.1	1.5

*As of the first quarter of the fiscal year. NOK--Norwegian krone. N.A.--Not available. RAC--Risk-adjusted capital.

Rating Score Snapshot

Table 2

KBN Kommunalbanken Norway--Ratings Score Snapshot	
Issuer Credit Rating	**AAA/Stable/A-1+**
SACP	aa
Enterprise Risk Profile	Strong (2)
PICRA	Strong (2)
Business Position	Strong (2)
Management and Governance	Very Strong (1)
Financial Risk Profile	Very Strong(1)
Capital Adequacy	Very Strong (1)
Funding and Liquidity	Positive and Very Strong (1)
Support	(2)
GRE Support	(2)
Group Support	0
Additional Factors	0

PICRA--Public-Sector Industry Risk And Country Risk Assessment. SACP--Stand-alone credit profile.

Related Criteria

- General Criteria: Hybrid Capital: Methodology And Assumptions, July 1, 2019
- Criteria | Governments | International Public Finance: Public-Sector Funding Agencies: Methodology And Assumptions, May 22, 2018
- 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
- General Criteria: Rating Government-Related Entities: Methodology And Assumptions, March 25, 2015
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Related Research

- Local Government Debt 2022: Why Developed Markets May Not Be Able To Reduce Borrowings, Apr 12, 2022
- Norway, Mar 14, 2022
- Banking Industry Country Risk Assessment: Norway, Oct 19, 2021
- Institutional Framework Assessment: Norwegian Municipalities And Counties, Feb 08, 2021

Ratings Detail (As Of June 7, 2022)*	
KBN Kommunalbanken Norway	
Issuer Credit Rating	AAA/Stable/A-1+

Ratings Detail (As Of June 7, 2022)*(cont.)	
Commercial Paper	
Foreign Currency	A-1+
Junior Subordinated	A+
Senior Unsecured	AAA
Short-Term Debt	A-1+
Subordinated	AA+
Issuer Credit Ratings History	
03-Mar-2000	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.