MOODY'S
INVESTORS SERVICE

CREDIT FOCUS

Rate this Research

Nordic Specialised Lenders: Peer Comparison

The four institutions deliver strong creditworthiness via different business models

RATINGS

Nordic Specialised Lenders	
Kommunekredit	Aaa
Kommuninvest I Sverige AB	Aaa
Kommunalbanken AS	Aaa
Municipality Finance Plc	Aaa

Analyst Contacts:

LONDON +44.20.7772.5454

Jan Skogberg +44.20.7772.1319
Analyst
jan.skogberg@moodys.com

FRANKFURT +49.69.70730.700

Harald Sperlein +49.69.70730.906
Vice President - Senior Analyst
harald.sperlein@moodys.com

LONDON +44.20.7772.5454

Simon Harris +44.20.7772.1576
Managing Director - Financial Institutions
simon.harris@moodys.com

Summary

» The four Nordic specialised lenders, Sweden's Kommuninvest i Sverige Aktiebolag (Kommuninvest), Norway's Kommunalbanken, Denmark's Kommunekredit and Finland's Municipality Finance Plc (MuniFin) belong to a small group of financial institutions in Moody's rating universe with Aaa credit ratings, identical to their sovereigns.

» The very highest ratings reflect the specialised role these institutions play as lenders and debt managers for regional and local governments in wealthy and stable Nordic countries. They have a narrow mandate to issue debt to a wide array of investors and lend these funds, at a low rate of interest, to regions, municipalities, cities and related entities such as municipal housing corporations and public sector-guaranteed energy firms.

» Their credit risks are exceptionally limited because they exclusively lend to the public sector and related entities. Consequently, the credit risk arising from lending is ultimately backed by the public sector's ability to raise taxes. The specialized lenders' only other credit exposure is to investments in highly rated debt instruments (such as Aaa-rated sovereign debt and covered bonds) for liquidity purposes, and hedging counterparties.

» Despite the similarities, their operating models differ to some extent.

» **Ownership** – ownership ranges from 100% state-ownership in Norway (Kommunalbanken) to 100% local government ownership in Sweden and Denmark (Kommuninvest and Kommunekredit). MuniFin is jointly owned by the Republic of Finland, the local government sector and a local government pension fund.

» **Guarantees** – Sweden's Kommuninvest and Denmark's Kommunekredit are jointly and severally guaranteed by their local government owners. MuniFin is jointly guaranteed by Finnish municipalities. State-owned Kommunalbanken has no guarantees, though the Norwegian government has a duty to ensure Kommunalbanken is always able to meet its financial obligations (maintenance obligation).

» **Market share** – Kommuninvest's market share in public sector lending is below 50% in Sweden contrasting with Kommunekredit's 95% in Denmark. Kommunalbanken's and MuniFin's market shares are 49% and 75%, respectively.

» **Capital** – Only Kommunekredit's leverage ratio is in excess of the 3% proposed as a minimum under Basel III global capital standards (although it is the only entity of the four which is exempt from Basel-III requirements). We nevertheless view all four as adequately capitalized in light of their low risk of losses.

» **Liquidity** – All four Nordic specialised lenders hold large and highly rated liquidity portfolios. They have an unbroken record of debt-market access through the recent global financial crisis, when they were viewed as safe havens. Kommunalbanken and MuniFin have mismatches between their lending and borrowing maturities, while Kommuninvest and Kommunekredit are in our view match-funded.

Detailed Discussion

Narrow public policy mandates support exceptional creditworthiness

The four Nordic specialised lenders have similar roles; to act as not-for-profit debt management offices for regional and local governments in their respective countries. They operate within a narrow public policy mandate, issuing debt in the capital markets and lending these funds to municipalities and other public bodies such as municipal housing and energy companies. Crucially, 100% of their lending is to (or guaranteed by) Nordic regional, local or central governments which represent minimal credit risk. For example, Finland based MuniFin mainly lends to municipalities. The institution also extends lending for the purpose of social housing construction and this part of MuniFin's loan-book is guaranteed by the Aaa-rated Finnish central government.

Unique Aaa ratings

The Nordic specialised lenders' Aaa ratings put them on a par with the world's wealthiest sovereigns. The high ratings stem from the fact that their lending activities are confined to highly creditworthy Nordic regional and local governments (and related entities), which benefit from stable revenues and effective supervision from Aaa-rated sovereigns. In particular:

1) The regional and local governments generate much of their revenue by raising taxes

2) Another main revenue source is grants from Aaa-rated central governments

3) Financially weaker regional and local governments are supported through equalization systems

4) Regional and local governments are overseen by the central government, which will intervene in financial management in the case of financial distress.

These four factors ensure that regional and local governments have the financial means to carry out tasks as mandated by the central government. Indeed, Nordic regional and local governments are mandated by their central governments to deliver services such as education and healthcare. We believe that the Nordic consensus view (irrespective of political orientation) is that these public services must be available to the population. This is why the specialized lenders play an important role in Nordic societies - the underlying reason for why all four specialized lenders are rated Aaa.

Hedging

The specialized lenders' business models give rise to various financial risks including currency and interest rate risks. They mitigate against these two risks by entering into hedging agreements with mainly well known international banks. As a result, currency risk is effectively eliminated. Their interest rate risk is small relative to their equity after taking into account hedging agreements. These ISDA/CSA agreements are normally with highly rated banks that frequently post collateral to the specialized lenders thus minimizing their counterparty credit risks.

Each specialised lender has a distinctive business model

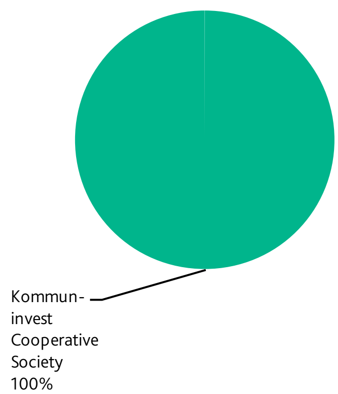
Despite their similar roles, the four Nordic specialised lenders have distinct operating models. We do not favor one model over another, and we rate all four entities Aaa with a stable outlook.

Ownership and guarantee structure

All four institutions are 100% owned by the public sector, which is a statutory requirement (by law or articles of association). Their ownership compositions are extremely stable but show some differences.

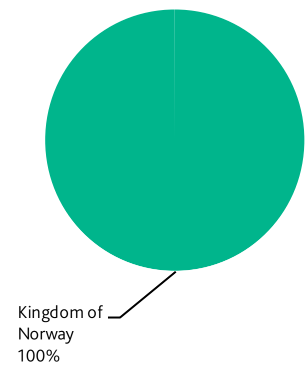
The specialised lenders have diverse ownership models

EXHIBIT 1
Sweden's Kommuninvest is owned by a cooperative society



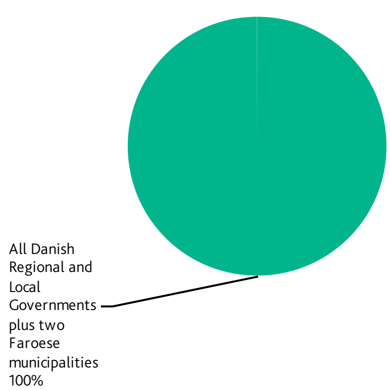
Source: Kommuninvest I Sverige AB

EXHIBIT 2
Norwegian state owns Kommunalbanken



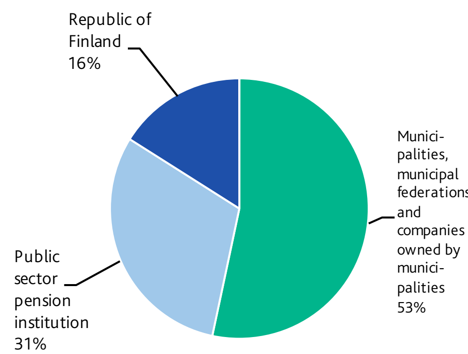
Source: Kommunalbanken

EXHIBIT 3
Kommunekredit is owned by the Danish RLGs



Source: Kommunekredit

EXHIBIT 4
Finland's MuniFin has a broader ownership



Source: Municipality Finance Plc

Kommuninvest is solely owned by the Kommuninvest Cooperative Society that accepts Swedish municipalities and county councils as members. When a new member joins the society, it signs a joint-and-several guarantee that covers all Kommuninvest's obligations. At year end-2013, 93% of Swedish municipalities and 40% of county councils were members of Kommuninvest Cooperative Society.

Kommunalbanken is 100% owned by the Kingdom of Norway and does not benefit from a local government guarantee. However, this specialized lender is a "state instrumentality" that benefits from a maintenance obligation from the Norwegian government. This means that the government has a duty to ensure Kommunalbanken is always able to meet its financial obligations.

Denmark's **Kommunekredit** was formed as an association (not a financial institution) through an act of parliament more than 100 years ago (the Act was updated in 2006). It has no separate ownership organization. All municipalities and regions in Denmark are members, who are jointly and severally liable for all the association's obligations.

Finland's **Municipality Finance Plc** has the most diverse ownership structure of the Nordic specialised lenders. Keva, a public-sector pension fund, holds 30.66% of MuniFin's shares, the Republic of Finland holds another 16% and the City of Helsinki (capital city) has 10.41% of the shares. The remaining shares are held by municipalities. MuniFin's liabilities are guaranteed by a separate entity named Municipal Guarantee Board (MGB, Aaa, stable). Effectively all municipalities in Finland are members of the MGB and they have a joint (but not several) obligation under the guarantee. We do not view the joint guarantee as materially weaker than a joint and several guarantee in this instance because we do not believe that smaller municipalities would be able to cover the obligations of larger peers under a stress scenario. Moreover, by the time the largest municipalities faced financial difficulty, the Finnish economy would likely be under severe stress and a joint-and-several guarantee would likely be of limited added value.

Market share

The four institutions are the largest lenders to regional and local governments and related entities in their respective countries. For example, Kommunekredit's market share of such loans in Denmark is around 95% and Finland's MuniFin similarly has a market share of 75% (measured by annual lending). These dominant positions are mainly because loans from these institutions cost Munifin's customers less than loans from commercial banks.

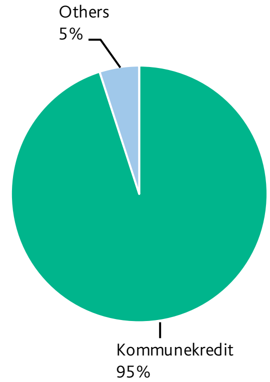
These high market shares also reflect the strategic decision of the largest regional and local governments to borrow from the specialised lenders (which benefit from a broader investor base and capital markets expertise) rather than issuing debt independently. The specialized lenders are particularly valuable for small local governments. It is unlikely that small local governments would be able to access capital markets independently because their bonds would likely be too small to attract interest among investors as is the case for small regional and local governments in other countries.

The market share calculation methodology is not disclosed by any of the specialized lenders. The market shares might therefore measure different things. For example, the data for MuniFin is based on annual lending. Kommuninvest's market share is based on its own projections.

The specialist lenders dominate their local markets

EXHIBIT 5

Denmark's Kommunekredit has a 95% market share

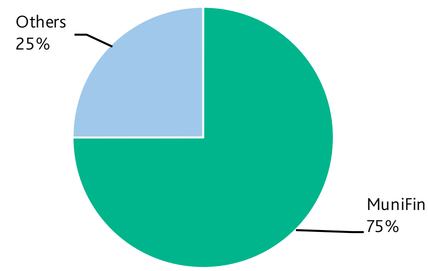


Date: May 2014

Source: Kommunekredit

EXHIBIT 6

MuniFin is the dominant player in Finland

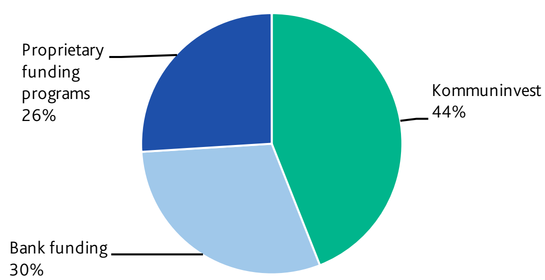


Date: 31 Dec 2013

Source: Municipality Finance Plc

EXHIBIT 7

Kommuninvest's market share is likely to increase as its membership grows

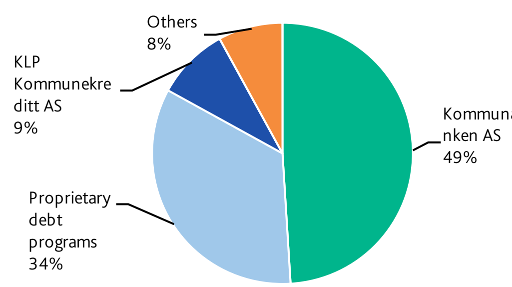


Date: 31 Dec 2013

Source: Kommuninvest

EXHIBIT 8

Norway has two regional government lenders



Date: 31 Mar 2014

Source: Kommunalbanken AS

Sweden's **Kommuninvest** reports a market share of 44%, considerably lower than its Finnish and Danish peers. This is partly because some large Swedish regional governments issue their own debt. However, membership of the Kommuninvest Cooperative Society is growing and Kommuninvest's market share will likely increase (though members do retain the ability to issue debt independently). Another reason for Kommuninvest's relatively lower market share is that local governments in Sweden also actively borrow from commercial banks.

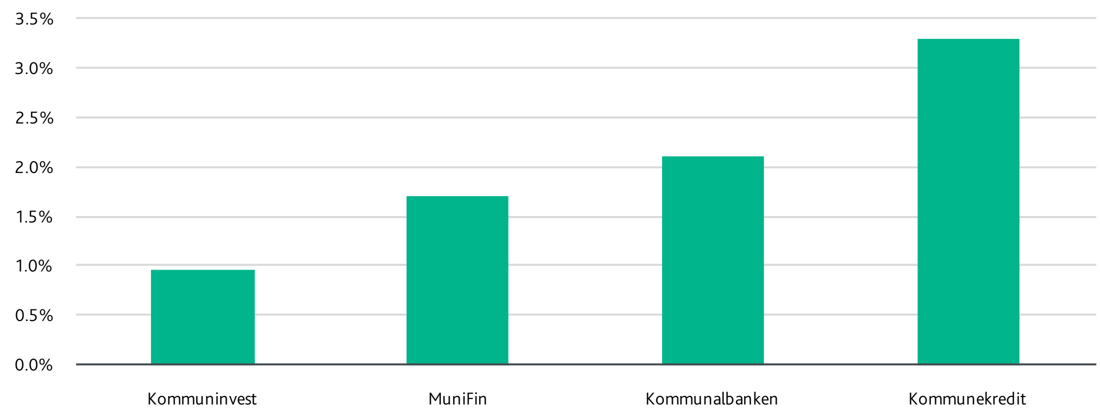
Kommunalbanken has a market share of around 50% in Norway. Unlike its peers it competes with another local government lender, KLP Kommunekreditt. KLP is a subsidiary of the largest public sector pension provider in Norway and has a share of approximately 10% in the municipal lending market. It remains to be seen if covered bond-funded KLP Kommunekreditt can continue to compete with Kommunalbanken, given Kommunalbanken's low funding costs. That said, we understand that the Norwegian authorities view the presence of another lender and the resulting competition in the municipal lending market as positive.

Capitalisation

The four specialised lenders are adequately capitalised to cover any unexpected losses in our view. Their loan books, while concentrated, are very low risk. A Nordic regional and/or local government has never defaulted and non-performing loans are non-existent. We think this is because: (1) their revenues are predictable mainly in the form of taxes and government grants (2) effective regulation by their respective sovereigns, with features such as balanced budget requirements, debt limits and transparent reporting; and (3) fiscal equalisation programmes that aim to provide financially weaker regional and local governments with transfers to meet local needs.

EXHIBIT 9

Only Kommunekredit reported a leverage ratio in excess of 3% at year end-2013



Source: Kommuninvest, MuniFin and Kommunekredit. The leverage ratio for Kommunalbanken is an estimate calculated by Moody's using data from Kommunalbanken.

The specialised lenders do not report similar capital ratios for various reasons.

Sweden's **Kommuninvest** and Finland's **MuniFin** reported Tier 1 capital ratios of 37% and 35%, respectively, at year end-2013. Both lenders must hold some capital mainly to cover counterparty credit risks arising from their hedging activities and because some of their liquid investments are not zero risk-weighted (though their loanbooks are). We note that the majority of payments from hedging counterparties to MuniFin are guaranteed by the MGB (effectively all Finnish regional and local governments) which in our view effectively removes all counterparty credit risk that arises from its hedging activities.

Kommunalbanken reported a Core Tier 1 ratio of 12.39% at year end-2013, considerably lower than Kommuninvest or MuniFin, mainly because Norway applies a 20% risk-weight to regional and local governments, i.e. the main part of its loanbook (as opposed to zero in Sweden and Finland). We consider Kommunalbanken's capital as adequate in light of its low-risk balance sheet.

Denmark's **Kommunekredit** is exempt from publishing its capital ratios as it is not legally recognized as a financial institution. It was set up more than 100 years ago as an association and is supervised by the Ministry of Economic Affairs and the Interior rather than the Danish Financial Supervisory Authority. For the same reason Kommunekredit is also exempt from EU regulation concerning financial institutions such as the Bank Recovery and Resolution Directive (BRRD) and the EU's transposition of Basel III rules, known as CRR/CRD 4. We consider, nevertheless, that Kommunekredit's capital levels are at least in line with its Finnish and Swedish peers because the association has the highest leverage ratio (equity divided by total assets) of all four specialised lenders.

The CRR/CRD 4 regulation introduces a leverage ratio requirement, and current indications are that a 3% requirement will come into force in 2018. Kommunekredit will be exempt from that requirement due to its association status, although we estimate that the Danish lender's leverage ratio is currently above 3%.

A 3% leverage ratio would, however, mean that the remaining three entities would have to raise more capital. Kommunalbanken has not outlined how it intends to comply with the new regulation although the Norwegian government has a track record of injecting capital into Kommunalbanken. Sweden's Kommuninvest is aiming to reach a 1.5% leverage ratio by accumulating earnings, but a 3% ratio would require additional measures such as capital injections from the Swedish local government sector or the issuance of junior debt that counts as capital. MuniFin is targeting a 3% leverage ratio in 2018 mainly by accumulating earnings. We view such a target as achievable because MuniFin has already started to build its capital base and the institution can also limit its lending volume in order to comply with a 3% leverage ratio. MuniFin could also issue hybrid debt in order to meet a 3% leverage ratio.

In our view Nordic regional and local governments comfortably have the ability to inject additional capital and thereby raise these entities leverage ratios to 3% in each of the three countries. That said, it is less clear if they have the willingness to contribute such additional capital because the specialized lenders were established in order to lower regional and local government's funding cost. An additional capital contribution would mean that it would be more expensive for regional and local governments to fund themselves through the specialized lenders. This is because the capital contribution would be an expense for the regional and local governments in a similar way that interest payments are expenses.

Liquidity

All four specialised lenders hold large liquid portfolios to cover for the (unlikely) eventuality that their ability to borrow in the capital market becomes constrained. The large liquidity portfolio's also allow the specialized lender to lend at short notice without first having to source funds from the capital markets. We consider all four entities' liquidity portfolios as ample for their needs. Moreover, we consider Sweden's Kommuninvest and Denmark's Kommunecredit to be match-funded, ie the maturities of their assets (loans and liquidity portfolio) match the maturities of their liabilities (capital market borrowing), which provides additional security by limiting the possibility of cash shortfalls if capital markets close.

	MuniFin	Kommunalbanken	Kommuninvest	Kommunekredit
Liquidity Portfolio	Yes	Yes	Yes	Yes
Match-Funded	No	No	Yes	Yes
Central Bank Access	Yes	No	Yes	No

Sweden's **Kommuninvest's** lending and borrowing has a maturity mainly in the one to five year range, making it effectively match-funded, meaning that in a stress scenario with no debt refinancing, Kommuninvest could wind down its lending business using maturing loan repayments. Kommuninvest also maintains a large liquidity reserve. Some 78% of these investments are Aaa rated with a duration of only 1.9 years (at year end-2013). Moreover, Kommuninvest, has the ability to use eligible assets in its liquidity reserve for repurchase agreements with the Central Bank in case of need.

Denmark's **Kommunekredit** is also in our view match-funded. More than half of the association's lending has a maturity of less than one year, while around half of its borrowing has a maturity ranging from one year to five years. In a currently unlikely stress-scenario, it, too, could run down its lending book without having to refinance its debt. The association maintains a liquidity portfolio which is highly rated (68% is Aaa and 30% at least Aaa3 at year end-2013). The portfolio also has a short maturity to ensure its liquidity. Under present Danish law, however, Kommunekredit (as a non-financial institution) cannot enter into repo agreements with the Danish Central Bank.

Norway's **Kommunalbanken** is not, in our view, match-funded like its two peers above. Much of its debt has a maturity ranging from one year to five years. In comparison, the bulk of its lending has a maturity in excess of five years. We note that much of Kommunalbanken's lending comes with interest rates that the lender can reset periodically. Kommunalbanken could increase interest rates if it wanted its customers to refinance their borrowing with other lenders. However, it is debatable which other lenders would remain standing if an institution currently as creditworthy as Kommunalbanken were to face a liquidity problem. Moreover, Kommunalbanken issues a considerable amount of callable debt. Our assessment that Kommunalbanken is not match-funded is based on the assumption that callable bonds mature at the first call-date. Kommunalbanken also has a large liquidity portfolio with an average credit rating of Aa1. The average maturity of the portfolio is below one year.

MuniFin, too, is in our view not match-funded. This is because its lending normally has a maturity in excess of five, sometimes 10, years. In comparison, much of MuniFin's borrowing has a maturity in the one-to-five year range. Like its peers, MuniFin issues a considerable amount of debt with callable features. Our assessment that MuniFin is not match-funded is based on the assumption that its outstanding debt is called at the first call-date. We also note that, like its peers, MuniFin has a highly rated liquidity portfolio. Like Kommuninvest (and unlike Kommunalbanken and Kommunekredit), MuniFin also has the ability to repo eligible assets with its Central Bank in case of need.

Summary Table

	MuniFin	Kommunalbanken	Kommuninvest	Kommunekredit
Ownership	Municipalities, municipal federations and companies owned by municipalities: 53.34% Public sector pension institution: 30.66% Republic of Finland: 16%	Kingdom of Norway: 100%	Kommuninvest Cooperative Society: 100%	Regional and local governments plus two Faroese municipalities: 100%
Guarantee	Effectively all Finnish RLGs jointly through Aaa rated Municipal guarantee board (MGB)	None	93% of municipalities and 40% county councils in Sweden provide a joint and several guarantee	All Danish RLGs provide a joint and several guarantee
Market share	75%	49%	44%	95%
Leverage ratio	1.70%	2.10%	0.96%	3.30%
Liquidity portfolio	Yes	Yes	Yes	Yes
Match-funded	No	No	Yes	Yes
Central bank access	Yes	No	Yes	No

Total assets (USDm)	36,042.0	59,655.0	43,200.4	34,029.5
Tangible common equity (USDm)	610.6	1,348.6	266.3	1,107.3
Net Interest Margin	0.58%	0.46%	0.35%	0.27%
PPI / Average RWA (Basel II)	11.08%	2.50%	14.91%	*
Net Income / Average RWA (Basel II)	9.79%	1.81%	11.63%	*
(Market Funds - Liquid Assets) / Total Assets	68.84%	69.12%	74.33%	73.87%
Tier 1 Ratio (Basel II)	35.42%	12.39%	37.00%	*
Tangible Common Equity / Risk Weighted Assets (Basel II)	34.55%	13.12%	38.36%	*
Cost / Income Ratio	12.91%	6.67%	24.45%	22.43%

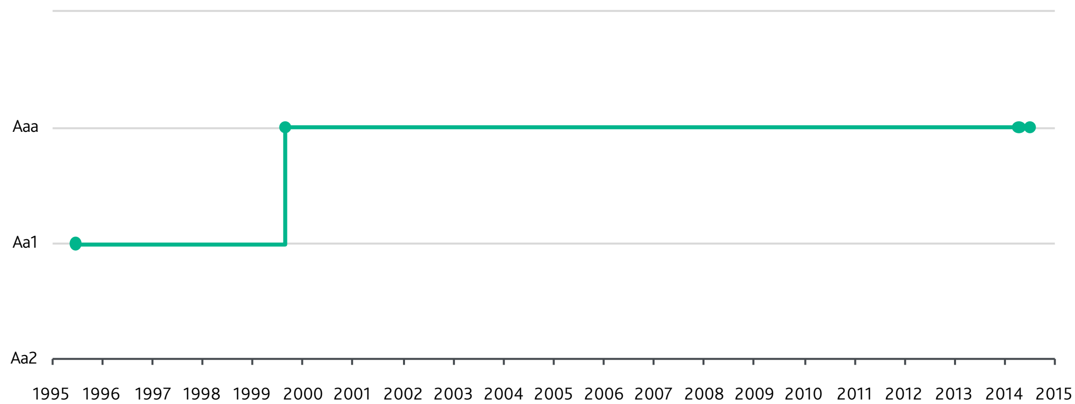
Source: Top part of page: Ownership and market shares data is from the specialized lenders. Leverage ratios are reported except for Kommunalbanken which is a Moody's calculation based on data from Kommunalbanken. Bottom section of table is based on Moody's calculations using data from 2013 annual reports.

* *Kommunekredit is an association and not obliged to report risk weighted assets*

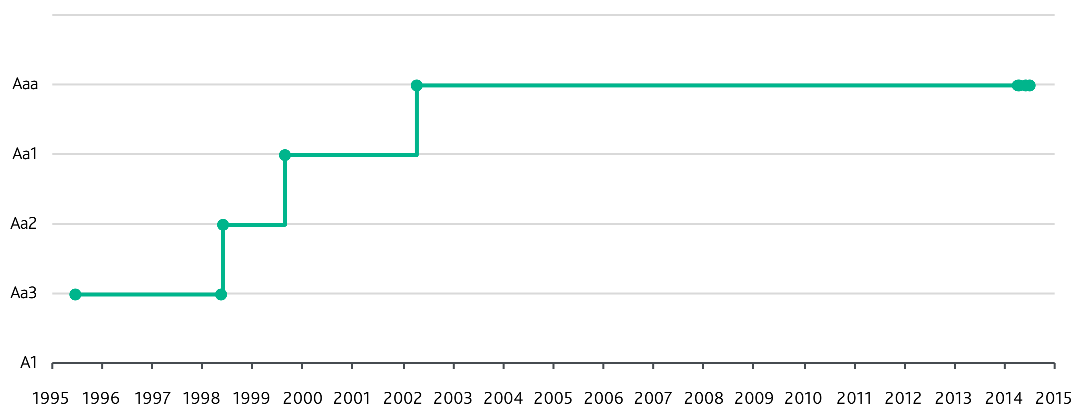
Ratings History

Nordic Specialised Lenders

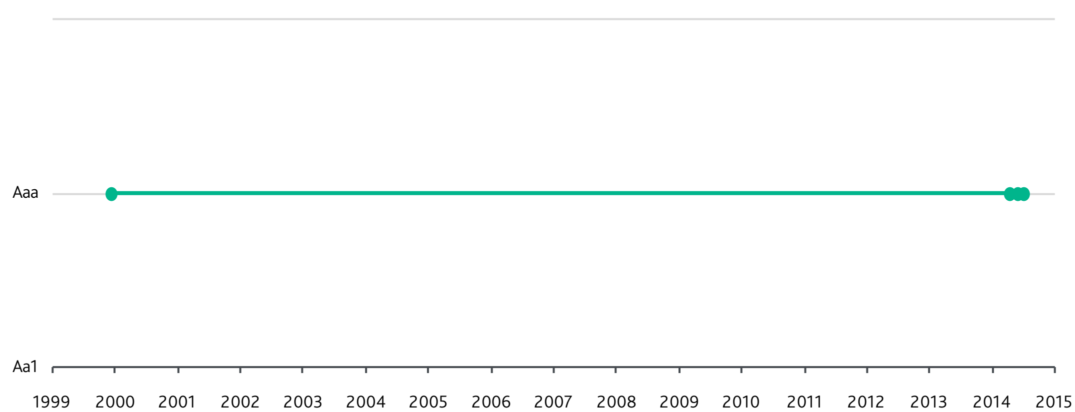
KommuneKredit - LT Issuer Rating



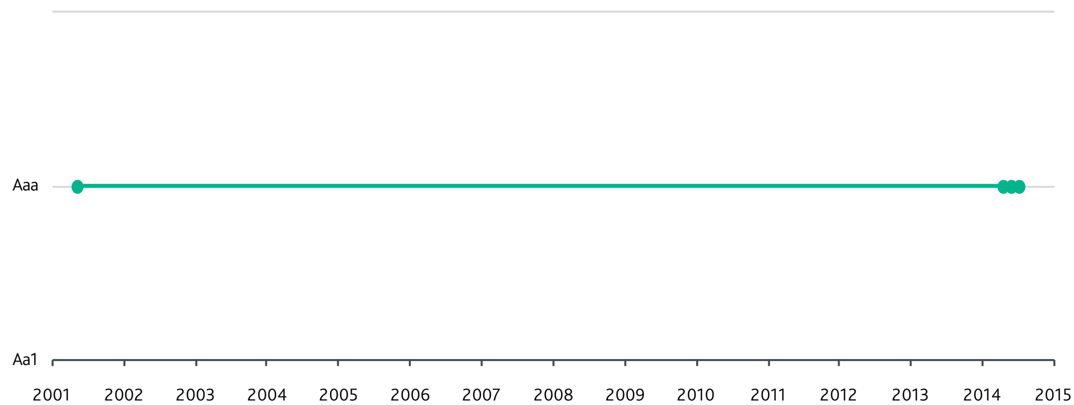
Kommuninvest I Sverige AB - LT Issuer Rating



Kommunalbanken AS - LT Issuer Rating



Municipality Finance Plc - LT Issuer Rating



Moody's Related Research

Credit Opinions:

» Municipality Finance Plc

» Kommuninvest i Sverige Aktiebolag

» Kommunalbanken

» Kommunekredit

Rating Methodologies:

» Global Banks, July 2014 (172997)

» Government-Related Issuers: Methodology Update, July 2010 (126031)

To access any of these reports, click on the entry above. Note that these references are current as of the date of publication of this report and that more recent reports may be available. All research may not be available to all clients.

Rate this Research

Report Number: 172688

Authors
Jan Skogberg
Harald Sperlein

Research Writer
Carolyn Henson

Production Associate
Srinivasan Raghavan

MOODY'S
INVESTORS SERVICE