

Rating Action: Moody's assigns first time Baa2 Deposit and Issuer ratings to Borgo AB; outlook stable

18 Jan 2022

Stockholm, January 18, 2022 -- Moody's Investors Service ("Moody's") has today assigned first time long and short-term Baa2/P-2 Deposit and Issuer ratings to Borgo AB (Borgo), a Counterparty Risk Rating (CRR) of A3/P-2, and a Counterparty Risk Assessment of A3(cr)/P-2(cr). Furthermore, a Baseline Credit Assessment and an Adjusted Baseline Credit Assessment of baa3 have been assigned. The outlook on the long-term Deposit and Issuer ratings is stable.

Borgo AB (Borgo) is a new Swedish credit market company, which will be originating mortgages for 5 owner companies: ICA Banken (not rated), Ikano Bank (not rated), Söderberg & Partners (not rated), Ålandsbanken (not rated), and Sparbanken Syd (Baa1/Baa1 Negative, baa3). In addition to originating mortgages, the company attracts deposits protected under the Swedish Deposit Guarantee Scheme and will issue covered bonds.

The Baa2 long-term Deposit and Issuer ratings incorporate: 1) the Baseline Credit Assessment (BCA) of baa3, reflecting very low risk assets consisting of Swedish prime mortgages and strong capitalisation balanced against low expected profitability, a high reliance on market funding and the monoline nature of the company's operations with limited diversification in revenues; 2) Borgo's limited track record as well as the governance challenges involved in establishing a new credit market company; and 3) a one notch positive adjustment due to the volumes of loss absorbing liabilities protecting depositors in case of failure, as indicated by Moody's Advanced Loss Given Failure analysis (LGF).

The stable outlook on the long-term issuer and deposit ratings reflects Moody's expectations that Borgo will successfully execute its issuance strategy with broadly stable capitalisation and asset risk over the next 12 to 18 months.

A full list of ratings can be found at the end of the press release.

RATINGS RATIONALE

BASELINE CREDIT ASSESSMENT

Borgo's baa3 BCA balances the nature of its assets, very low risk Swedish mortgages, agreed levels of capitalisation between the owners and Borgo, against the limited track record of the monoline company, limited financial history, and reliance on market funding.

Moody's assessment is that asset risk will be very strong, with the rating agency forecasting a problem loans ratio to gross loans of 0.1%, due to the loan portfolio of low-risk Swedish mortgages originated with underwriting standards in line with other Swedish prime mortgage lenders. Borgo will have discretion on the underwriting standards and with all credit risk remaining with Borgo.

The solvency of Borgo will be supported by its industry owners, who have committed to transfer existing mortgages to Borgo, and inject capital in order to maintain a buffer above regulatory requirements when new mortgages are originated. Borgo's capitalisation is also supported by significant capital contribution from financial investors. Moody's expects that tangible common equity to risk weighted assets (TCE/RWA) will remain above 14% during the next two years with TCE to tangible assets not dropping below 4.5%.

Moody's expects that profitability will remain low. Borgo will be moderately loss making in 2022 but net income to tangible assets will increase to between 0.1%-0.2% by 2023 as volumes grow, with Borgo initially taking a larger share of margins to cover costs. IT and back office are to a large extent outsourced with predictable cost structures.

During Q1 2022, Borgo will acquire an existing cover pool with high quality mortgages and associated covered bonds from Ålandsbanken via a change of issuer clause, and in conjunction also plans its initial senior unsecured issuance. Moody's expects Borgo to acquire further portfolios of mortgages during 2022 as well as

originate new mortgages via their partners. Borgo estimates that it will have an outstanding portfolio of mortgages surpassing SEK 25 billion by the end of 2022.

Borgo is expected to issue covered bonds and senior unsecured debt equivalent to a market funding ratio of approximately 40%, which brings market funding reliance in line with other Swedish mortgage providers, where Moody's views that SEK denominated covered bonds have lower refinancing risks than other debt due to the dual recourse characteristics of covered bonds and the large domestic investor base in the asset class which has a long history of remaining liquid even during market stress.

In line with most other retail mortgage lenders in the Nordics the BCA incorporates one negative notch, reflecting the company's limited business diversification.

Furthermore, the BCA also includes an additional negative notch reflecting Borgo's limited financial track record and governance challenges stemming from the outsourcing of key services. Financial institutions with limited history may undergo rapid evolution initially, before developing readily distinguishable and stable operating characteristics. Partly mitigating these risks is the track record of the service provider, Ålandsbanken, in providing outsourced services to other banks.

LOSS GIVEN FAILURE

Moody's applies its Advanced Loss-Given-Failure (LGF) analysis on Borgo as it is subject to the EU Bank Recovery and Resolution Directive (BRRD), which Moody's consider to be an Operational Resolution Regime. For this analysis Moody's assume that equity and losses stand at 3% and 8% respectively of tangible banking assets in a failure scenario. Moody's also assume a 25% run-off of "junior" wholesale deposits and a 5% run-off in preferred deposits. Moreover, Moody's assign a 25% probability to junior deposits being preferred to senior unsecured debt. These are in line with our standard assumptions. Given the Borgo's focus on retail and SME deposits, Moody's assume the junior deposits to account for 10% of total deposits, in line with other retail mortgage banks in Sweden. Our LGF assessment is forward looking and incorporates continued issuance of senior unsecured debt during the next 12 months.

The deposit and issuer ratings of Baa2 receive one notch uplift above the BCA of baa3 according to the LGF analysis due to the expected amounts of issuances of senior unsecured debt, deposit growth and balance sheet growth, and the resulting amounts of loss absorbing liabilities that would protect creditors in case of failure. Our analysis places focus on near term issuances and up to 12 months in the future due to the limited track record of the company.

Borgo's A3/Prime-2 CRRs incorporate three notches of uplift as indicated in the LGF analysis.

Borgo's A3(cr)/Prime-2(cr) Counterparty Risk Assessment incorporate three notches of uplift above BCA as indicated by the LGF analysis.

GOVERNMENT SUPPORT CONSIDERATIONS

Owing to the small size of Borgo's retail operations, Moody's assumes a low probability of government support, resulting in no uplift in any of its ratings or assessments.

OUTLOOK

The stable outlook on the long-term issuer and deposit ratings reflects Moody's expectations that over the next 12 to 18 months, Borgo successfully executes its strategy to transfer mortgages and covered bond issuances to its balance sheet and originate mortgages to its partners without significantly lowering its capitalisation.

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

Ratings could be upgraded following a demonstrated track record of mortgage lending operations, with successful issuance of covered bonds and senior unsecured debt while sustaining strong capitalisation and improved profitability combined with very strong asset quality.

Furthermore, the deposit and issuer ratings could be upgraded if there are significant issuances of additional loss-absorbing debt, leading to higher buffers of protection in case of failure.

Borgo's ratings could be downgraded if its financial profile and risk profile weakens materially; including a significant deterioration in asset quality, or that tangible common equity to risk-weighted assets declines below 14%; or weaker than expected recurring profitability, and/or higher reliance on market funding. A failed

issuance of either covered bonds or senior unsecured debt would trigger a downgrade.

LIST OF AFFECTED RATINGS

..Issuer: Borgo AB

Assignments:

...Adjusted Baseline Credit Assessment, Assigned baa3

...Baseline Credit Assessment, Assigned baa3

...Long-term Counterparty Risk Assessment, Assigned A3(cr)

...Short-term Counterparty Risk Assessment, Assigned P-2(cr)

...Long-term Counterparty Risk Ratings, Assigned A3

...Short-term Counterparty Risk Ratings, Assigned P-2

...Long-term Issuer Ratings, Assigned Baa2, Outlook Assigned Stable

...Short-term Issuer Ratings, Assigned P-2

...Long-term Bank Deposit Ratings, Assigned Baa2, Outlook Assigned Stable

...Short-term Bank Deposit Ratings, Assigned P-2

Outlook Action:

...Outlook, Assigned Stable

PRINCIPAL METHODOLOGY

The principal methodology used in these ratings was Banks Methodology published in July 2021 and available at https://www.moody.com/researchdocumentcontentpage.aspx?docid=PBC_1269625 . Alternatively, please see the Rating Methodologies page on www.moody.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.moody.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 http://www.moody.com/researchdocumentcontentpage.aspx?docid=PBC_1288235.

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

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