

## CREDIT OPINION

5 February 2024

Update



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### RATINGS

#### Borgo AB (publ)

Domicile	Sweden
Long Term CRR	A3
Type	LT Counterparty Risk Rating - Fgn Curr
Outlook	Not Assigned
Long Term Debt	Not Assigned
Long Term Deposit	Baa2
Type	LT Bank Deposits - Fgn Curr
Outlook	Negative

Please see the [ratings section](#) at the end of this report for more information. The ratings and outlook shown reflect information as of the publication date.

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## Borgo AB (publ)

### Update to credit analysis

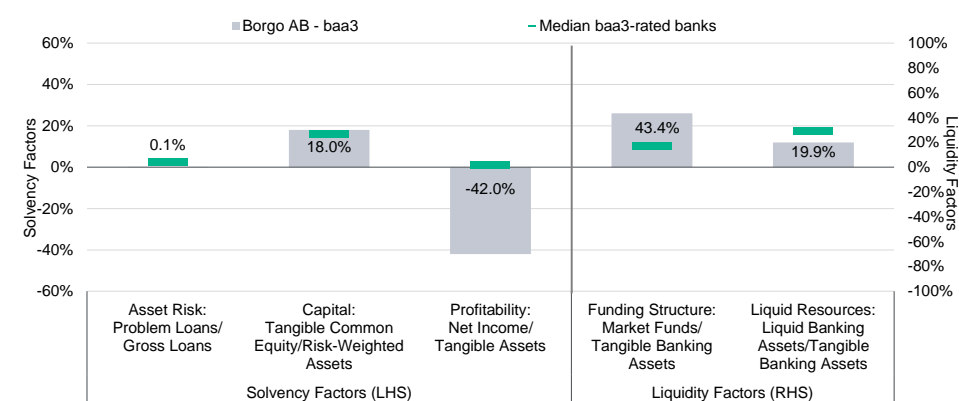
#### Summary

[Borgo AB \(publ\)](#) (Borgo) is a Swedish credit market company that originates mortgages for its owner banks. Apart from originating mortgages, Borgo takes deposits from the public, which are protected under the Swedish deposit insurance scheme.

Borgo's long-term deposit and issuer ratings of Baa2 reflect its Baseline Credit Assessment (BCA) of baa3 and our forward-looking Advanced Loss Given Failure analysis, which results in a one notch positive adjustment because of the volume of loss absorbing liabilities protecting depositors and senior creditors in case of failure. Borgo's baa3 BCA reflects its low risk assets consisting of Swedish prime mortgages and strong capitalization balanced against low expected profitability, its high reliance on market funding and the monoline nature of the bank's operations with limited revenue diversification. In addition, the bank's BCA incorporates a one notch negative adjustment for corporate behaviour, reflecting Borgo's limited track record and the inherent governance challenges involved in establishing a new lender.

Exhibit 1

#### Rating Scorecard - Key financial ratios



These represent our [Banks Methodology](#) scorecard ratios. Asset-risk and profitability ratios reflect the weaker of either the latest reported or three-year average ratios. The capital ratio is the latest reported figure. Funding structure and liquidity ratios reflect latest year-end figures.

Source: Moody's Investors Service

#### Credit strengths

- » Very strong asset quality, with lending consisting of Swedish mortgages
- » Demonstrated investor backing and access to capital

## Credit challenges

- » Limited financial track record and governance risks stemming from outsourcing of key services
- » Loss making, given the rising funding costs and fast balance sheet growth
- » Monoline business model, with limited revenue diversification

## Outlook

The negative outlook on the long-term deposit and long-term issuer ratings reflects the worsened operating conditions for Borgo, resulting in negative net interest income whereby the break-even point has been pushed further into the future, impacting the bank's capital.

## Factors that could lead to an upgrade

- » The rating outlooks on the long-term deposit and long-term issuer ratings could return to stable if Borgo demonstrates improving profitability without increasing its risk appetite and with maintained capitalisation

## Factors that could lead to a downgrade

- » Borgo's ratings could be downgraded if its financial profile does not improve over during the next 12 to 18 months. More specifically, if Borgo does not show improving results during 2024, a one notch downgrade is likely. The ratings could also be downgraded due to substantial decline in asset quality, a deterioration in its tangible common equity/risk weighted assets; or failure to access funding sources to sustain its operations.

This publication does not announce a credit rating action. For any credit ratings referenced in this publication, please see the issuer/deal page on <https://ratings.moody's.com> for the most updated credit rating action information and rating history.

## Key indicators

Exhibit 2

### Borgo AB (publ) (Consolidated Financials) [1]

	09-23 <sup>2</sup>	12-22 <sup>2</sup>	12-21 <sup>2</sup>	12-20 <sup>2</sup>	12-19 <sup>2</sup>	CAGR/Avg. <sup>3</sup>
Total Assets (SEK Million)	37,150.1	18,333.8	2,290.8	27.5	39.9	519.2 <sup>4</sup>
Total Assets (USD Million)	3,419.5	1,759.6	253.2	3.3	4.3	495.1 <sup>4</sup>
Tangible Common Equity (SEK Million)	2,176.8	1,149.8	252.9	20.3	36.6	197.2 <sup>4</sup>
Tangible Common Equity (USD Million)	200.4	110.4	28.0	2.5	3.9	185.6 <sup>4</sup>
Problem Loans / Gross Loans (%)	0.1	0.0	0.0	--	--	0.0 <sup>5</sup>
Tangible Common Equity / Risk Weighted Assets (%)	18.0	19.6	52.9	--	--	30.2 <sup>6</sup>
Problem Loans / (Tangible Common Equity + Loan Loss Reserve) (%)	1.0	0.0	0.0	--	--	0.3 <sup>5</sup>
Net Interest Margin (%)	-0.3	0.0	-0.1	--	--	-0.1 <sup>5</sup>
PPI / Average RWA (%)	-2.4	-3.3	-12.0	--	--	-5.9 <sup>6</sup>
Net Income / Tangible Assets (%)	-0.5	-0.6	-2.0	-164.9	-28.6	-39.3 <sup>5</sup>
Cost / Income Ratio (%)	-193.9	-888.7	-3742.2	11159.7	5047.3	2276.4 <sup>5</sup>
Market Funds / Tangible Banking Assets (%)	43.4	43.4	0.1	3.8	0.8	18.3 <sup>5</sup>
Liquid Banking Assets / Tangible Banking Assets (%)	18.6	19.9	97.7	34.0	3.5	34.8 <sup>5</sup>
Gross Loans / Due to Customers (%)	383.4	334.6	0.8	--	--	239.6 <sup>5</sup>

[1] All figures and ratios are adjusted using Moody's standard adjustments. [2] Basel III - fully loaded or transitional phase-in; IFRS. [3] May include rounding differences because of the scale of reported amounts. [4] Compound annual growth rate (%) based on the periods for the latest accounting regime. [5] Simple average of periods for the latest accounting regime. [6] Simple average of Basel III periods.

Sources: Moody's Investors Service and company filings

## Profile

Borgo AB (publ) (Borgo) is a Swedish mortgage credit institution, established in 2018 and headquartered in Stockholm. It is subject to supervision under the Swedish Financial Supervisory Authority (SFSA) and has a license to issue covered bonds since March 2021. Borgo is co-owned by ICA Banken, Ikano Bank, Söderberg & Partners, Ålandsbanken, [Sparbanken Syd](#) (Baa1/Baa1 positive, baa3)<sup>1</sup> and other financial investors. The industrial owners are well known in their respective fields in Sweden.

Borgo does not have a retail branch network but instead originates mortgages that the industrial owners can distribute to their customers under their respective brand. The distribution partners set their own prices and handle the first line of customer support. Borgo does not distribute mortgages through its own channels.

Similar to other small banks, Borgo sources business process operations and IT platform through an external service provider, Ålandsbanken, and its subsidiary, Crosskey. The main processes provided include credit origination, treasury, payments and accounting (among other services).

Borgo takes retail deposits from the public through its website and via partners. Borgo's savings accounts are covered by the Swedish deposit insurance scheme.

## Recent developments

In September 2023, Borgo acquired a mortgage portfolio from Ålandsbanken consisting of mortgages worth around SEK5.8 billion. This was the second time in two years that Borgo acquired a mortgage portfolio from Ålandsbanken, with the first one being completed in February 2022 with a portfolio worth SEK10.5 billion. Borgo completed a total of three mortgage portfolio acquisitions during 2023, totalling SEK13.7 billion. This is a part of their growth strategy within the mortgage segment. All of the acquisitions were financed by a mix of own funds, market funding, deposit funding and bridge financing.

In May 2023 Borgo acquired Sparbanken Syd's SEK4.8 billion stock of mortgages mediated via the collaboration with SBAB Bank AB (publ) (SBAB, A1/A1 stable, baa1). Borgo also acquired a mortgage portfolio directly from Sparbanken Syd of around SEK3.1 billion in March 2023.

## Detailed credit considerations

### Low risk mortgage lending based on strong industrywide underwriting standards and initial portfolio acquired from established banks

Borgo's assigned Asset Risk score of aa3 reflects the mortgage company's good asset quality, with strong underwriting standards expected to be in line with those of other prime mortgage lenders in Sweden, partially offset by substantial operational risks associated with being a newly established entity.

Borgo's mortgages are sold and distributed via partners. However, the credit market company maintains the key functions related to credit origination, credit management, funding, risk management and the critical aspects of customer support, as well as managing relationships with suppliers. As a newly established financial institution, Borgo is exposed to significant operational risks during its initial period of operations. However, these risks are significantly mitigated by Borgo's decision to outsource the IT services and back-office functions to Crosskey, an established provider with a good track record. The outsourcing of these key functions does however increase governance risk.

We consider Borgo's loans to consist of prime Swedish mortgages, which typically have very low risk because of strong collateral of the loans and Swedish banks' conservative underwriting criteria, with loan-to-value below 85% and stress testing of borrowers ability to pay, along with the legal structure that results in a strong repayment culture in Sweden. This is also reflected in Swedish mortgages' historical performance with very limited credit losses.

The acquired loan portfolios has very low levels of non-performing loans. Given the institution's underwriting criteria, which are in line with the sector, we expect asset risk to remain very low and in line with the mortgage portfolios of SBAB, [Skandiabanken AB](#) (A2 stable, baa1), [Lansforsakringar Bank AB \(publ\)](#) (LF Bank, A1/A1 stable, a3) or larger Swedish banks. The weighted average problem loans to gross loans ratio for Swedish mortgage lenders (SBAB, LF Bank and Skandiabanken) was 0.15% for 2016-22, hitting a peak of 0.19% in 2020, 2021 and 2022 because of a deterioration in non-mortgage portfolios and the new definition of default.

Although higher interest rates and a general higher cost of living will increase debt service costs for borrowers, we expect Borgo's asset quality and problem loans/gross loans to be in line with those of other Swedish mortgage lenders at around 0.1%, equivalent to an initial score of aa1.

### Robust risk-adjusted capitalisation and a low leverage ratio

We view Borgo's capital position as strong, with a Common Equity Tier 1 capital ratio of 17.4% as of September 2023. Capitalization is likely to remain above 14% over the next three years because of the quarterly capital injections from distribution partners in accordance with budgeted origination volumes and the financial investors' commitments to Borgo. Therefore, we assign a Capital score of a2 to reflect the bank's strong capitalization, given its business model and low risk profile. This includes a one notch negative adjustment for high nominal leverage because we estimate that tangible common equity to tangible assets ratio will trend towards 5% over the outlook period of 12-18 months.

As Borgo's balance sheet grows, the owner banks are contractually obliged to inject further capital into the bank to increase the volumes of originated mortgages. For that reason, the low internal capital generation is not a constraint to future growth. The partners are committed to the continued development of Borgo and will cover certain additional unforeseen project or operating costs related to the launch and initial phase of operations of the bank through unconditional shareholders' contributions, with an aggregate amount of up to SEK 250 million.

We do not expect any dividend to be paid out during the initial growth phase. Raising additional capital in times of stress is assessed to be possible, given the strong commitments from the industrial owners and financial investors.

Borgo's target is to maintain a buffer of 1.5 percentage point above the regulatory total capital requirement and a buffer of 1 percentage point above the regulatory leverage ratio requirement. Credit risk is estimated using the standardized approach.

### Borgo adversely affected by increasing interest rates, with funding costs rising faster than interest income.

The assigned Profitability score of caa1 reflects our expectation of weak profitability going forward driven by the added pressure of rising interest rates, which has led to a negative interest rate margin as Borgo focuses on growing its balance sheet.

Borgo's growing funding needs during a period of tightening monetary policy has placed pressure on its interest rate margins, resulting in an annualised negative 0.46% net income to tangible assets ratio during the first nine months of 2023. We estimate Borgo's underlying profitability will trail behind that of its Swedish peers, and that they won't be profitable until 2025 at the earliest. However, this should be viewed in the context of Borgo's low risk loan portfolio and its shared margins with its partners. The company is likely to have good cost control because the IT and back office related costs are fixed as a percentage of volumes. Revenue is based on operational costs and funding costs. As scale increases and interest rates stabilise, we expect the bank's margin to improve.

Borgo's net interest income will depend on the mortgage volumes generated by the distribution partners and its net interest margin. As net interest income will make up almost 100% of revenue, relatively low margins for prime mortgages will only be mitigated by higher loan volumes. While banks' profitability are generally helped by rising interest rates, Borgo has been adversely affected compared to universal banks. This is because interest rate margins on Swedish mortgages tend to decline during an increasing interest rate environment, whereas rates on non-retail deposit source of funds tend to be fully passed through, and therefore Borgo's relatively smaller volumes of retail deposits results in lower lending margins compared to universal banks.

Borgo is fully digital with no retail branches and will operate with a low number of full-time employees. Similar to other small banks, Borgo sources business process operations and its IT platform through an external service provider, Ålandsbanken. Ålandsbanken has a track record of supplying IT services to other banks, including S-Pankki (one of the larger banks in Finland), and we view this as a mitigant, decreasing the operational risks involved as Borgo will use systems with demonstrated effectiveness for credit origination and treasury (among other services). Borgo, in turn, has application programming interface (API) solutions in place to allow its partner banks to integrate the mortgage application and disbursements into their own user interfaces, restricting the need for manual intervention and supporting a slim organization with low staff costs.

Borgo's cost to income ratio will be significantly weaker than that of its Swedish peers (which report a weighted average cost to income ratio of around 56%), even though we expect Borgo to maintain a low cost base.

#### **High reliance on market funding, mitigated by the use of covered bonds**

The Funding Structure score of baa3 reflects Borgo's buildup of market funding. The high reliance on market funding is mitigated by a large share of local currency denominated covered bonds. Swedish krona denominated covered bonds benefit from a deep local market because of a large investor base of banks, insurance companies and pension funds. Therefore, this debt class is a very stable source of funding, which is reflected by the upward adjustments to the Funding Structure score.

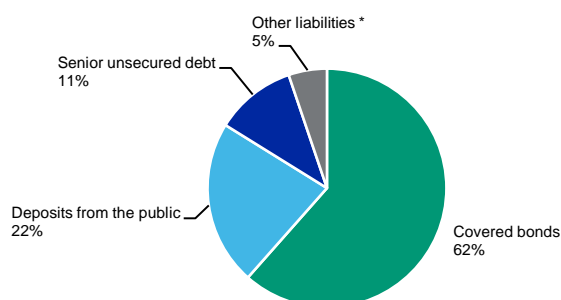
Borgo's market funds to tangible banking assets ratio was 43% as of September 2023. Swedish krona denominated covered bonds will account for more than half of the bank's long-term funding. Borgo diversifies its funding sources through deposits (accounting for around 22% of non-equity funding) and senior unsecured debt (accounting for around 11% of non-equity funding). During 2023 Borgo started to offer deposits through the savings platforms Avanza and Lysa, to grow their deposit funding. During the year Borgo acquired three mortgage portfolios from SBAB, Sparbanken Syd and Ålandsbanken worth a total of SEK13.7 billion. They financed these acquisitions through a mix of own funds, market funds, deposits and bridge financing. Borgo has also announced that they plan to acquire another mortgage portfolio from Ålandsbanken during 2024. They have issued SEK12 billion of covered bonds and SEK1.6 billion of senior unsecured bonds during the first nine months of 2023. We apply a one notch negative adjustment to the Funding Structure score because of Borgo's limited track record in capital markets.

While Borgo's strong growth during a period of tightening monetary policy has resulted in higher than anticipated cost of funding, we anticipate that funding costs will improve over time as the credit institution builds track record and liquidity in the market.

Borgo provides retail deposits through its own website and through partnerships, which are covered by the Swedish deposit insurance scheme. As of the end of September 2023, Borgo had SEK7.8 billion in deposits, an NSFR ratio of 112% and an LCR ratio of 869%.

Exhibit 3

### Breakdown of Borgo's non-equity funding As of 30 September 2023



\* Other liabilities include interbank liabilities and certificates of deposits.

Sources: Company reports and Moody's Investors Service

Borgo's Liquid banking assets / tangible banking assets ratio was at 18.6% as of Q3 2023. The HQLA/ tangible banking assets ratio was 11.27% as of Q3 2023. This is down from 19.93% since year end 2022, mainly due to the growth of tangible banking assets (up 102% since year end 2022). The assigned Liquidity score of baa3 reflects the stock of liquid assets and liquidity management.

### Business diversification

Similar to that for other rated entities focused on one activity, we apply a one notch negative adjustment to Borgo's financial profile for the lack of business diversification. This reflects the likelihood of Borgo's revenue being derived exclusively from its mortgage lending activities because the bank's business model — like that of other mortgage lenders, including SBAB and Skandiabanken in Sweden — is less diversified than that of a full-service bank.

### ESG considerations

#### Borgo AB (publ)'s ESG credit impact score is CIS-4

Exhibit 4

#### ESG credit impact score

# CIS-4

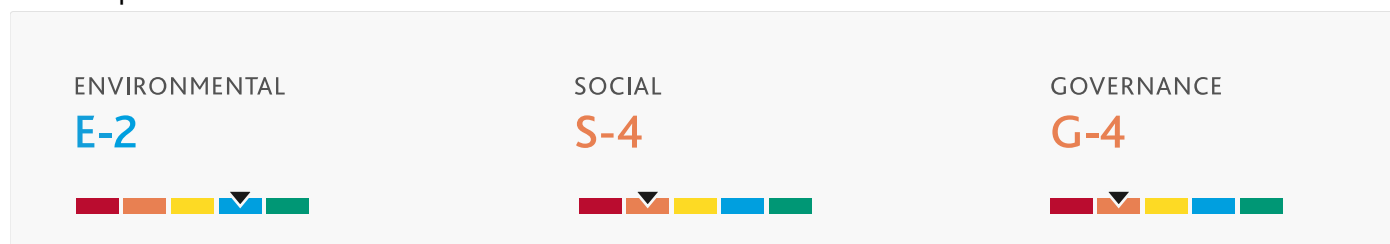


ESG considerations have a discernible impact on the current rating, which is lower than it would have been if ESG risks did not exist. The negative impact of ESG considerations on the rating is higher than for an issuer scored CIS-3.

Source: Moody's Investors Service

**CIS-4** indicates the credit rating is lower than it would have been if ESG risk exposures did not exist. This reflects Borgo's high governance risks, reflecting the bank's limited track record and the inherent governance challenges involved in establishing a new lender. Environmental and social factors have a limited credit impact on the rating to date.

Exhibit 5

**ESG issuer profile scores**

Source: Moody's Investors Service

**Environmental**

Borgo faces low environmental risks, specifically in relation to carbon transition risks. This is because of the structure of its loan book, predominantly mortgages, which typically carry low carbon transition risk.

**Social**

Borgo faces high industry-wide social risks related to regulatory and litigation risks, requiring high compliance standards. These risks are mitigated by the bank's developed policies and procedures. High cyber and personal data risks are mitigated by the bank's strong IT framework.

**Governance**

Borgo faces high governance risks, considering it is a new entity and a bank in transformation. Due to its limited history we expect the company to undergo rapid evolution initially, before developing readily distinguishable and stable operating characteristics. Partly offsetting these risks is the established track record of the service provider, Ålandsbanken, in providing outsourced services to other banks and the large capital commitments by financial investors. Borgo is also strengthening its overall risk management and compliance through recruitments, e.g. the appointment of a compliance officer, instead of outsourcing that function.

ESG Issuer Profile Scores and Credit Impact Scores for the rated entity/transaction are available on Moodys.com. In order to view the latest scores, please click [here](#) to go to the landing page for the entity/transaction on MDC and view the ESG Scores section.

**Support and structural considerations****Parental or affiliate support**

The baa3 Adjusted BCA does not incorporate any affiliate support from the bank's multiple owners with changing ownership shares because of no formal support structure is in place.

**Loss Given Failure (LGF) analysis**

We apply our Advanced LGF analysis to Borgo because the bank is subject to the EU Bank Recovery and Resolution Directive (BRRD), which we assume an operational resolution regime. For this analysis, we assume that equity and losses are 3% and 8%, respectively, of tangible banking assets in a failure scenario. We also assume a 10% runoff in junior wholesale deposits and a 5% runoff in preferred deposits. Moreover, we assign a 25% probability to junior deposits being preferred to senior unsecured debt. These are in line with our standard assumptions. Given the bank's focus on retail deposits, we expect the bank's junior deposits to account for 10% of total deposits, in line with other retail mortgage banks.

Under our forward-looking analysis stretching 12 months into the future, the estimated buffer of outstanding junior deposits and senior unsecured provides a loss-absorption buffer in case of failure, and our Advanced LGF analysis indicates a low loss given failure for the bank's junior deposits and issuer rating, resulting in one-notch uplift from the bank's baa3 Adjusted BCA.

**Government or other institutional support**

Because of the relatively small size of its banking operations, we incorporate a low probability of government support for Borgo's long-term deposit ratings.

### Borgo's Counterparty Risk (CR) Assessment is A3(cr)/P-2(cr)

The CR Assessment is three notches above the Adjusted BCA based on our view that senior obligations represented by the CR Assessment will be more likely preserved than senior unsecured debt to minimise losses, avoid disruption of critical functions and limit contagion.

### Borgo's Counterparty Risk Ratings (CRRs) are A3/P-2

The long-term CRR is three notches above Borgo's Adjusted BCA of baa3, reflecting extremely low loss given failure from the high volume of instruments that are subordinated to CRR liabilities.

## Rating methodology and scorecard factors

Exhibit 6

#### Borgo AB (publ)

Macro Factors							
Weighted Macro Profile		Strong +	100%				
Factor	Historic Ratio	Initial Score	Expected Trend	Assigned Score	Key driver #1	Key driver #2	
Solvency							
Asset Risk							
Problem Loans / Gross Loans	0,1%	aa1	↔	aa3	Expected trend	Operational risk	
Capital							
Tangible Common Equity / Risk Weighted Assets (Basel III - transitional phase-in)	18,0%	aa2	↓↓	a2	Expected trend	Nominal leverage	
Profitability							
Net Income / Tangible Assets	-42,0%	caa3	↔	caa1	Expected trend		
Combined Solvency Score		a2		baa1			
Liquidity							
Funding Structure							
Market Funds / Tangible Banking Assets	43,4%	b1	↑↑	baa3	Expected trend	Market funding quality	
Liquid Resources							
Liquid Banking Assets / Tangible Banking Assets	19,9%	baa2	↔	baa3	Expected trend	Stock of liquid assets	
Combined Liquidity Score		ba2		baa3			
Financial Profile				baa2			
Qualitative Adjustments				Adjustment			
Business Diversification				-1			
Opacity and Complexity				0			
Corporate Behavior				-1			
Total Qualitative Adjustments				-2			
Sovereign or Affiliate constraint				Aaa			
BCA Scorecard-indicated Outcome - Range				baa3 - ba2			
Assigned BCA				baa3			
Affiliate Support notching				0			
Adjusted BCA				baa3			
Balance Sheet		in-scope (SEK Million)	% in-scope	at-failure (SEK Million)	% at-failure		
Other liabilities		23 732	63,9%	24 323	65,5%		
Deposits		8 451	22,7%	7 859	21,2%		
Preferred deposits		7 605	20,5%	7 225	19,5%		
Junior deposits		845	2,3%	634	1,7%		
Senior unsecured bank debt		3 850	10,4%	3 850	10,4%		
Equity		1 114	3,0%	1 114	3,0%		
Total Tangible Banking Assets		37 147	100,0%	37 147	100,0%		



Debt Class	De Jure waterfall		De Facto waterfall		Notching		LGF	Assigned	Additional	Preliminary
	Instrument	Sub-	Instrument	Sub-	De Jure	De Facto	Notching	LGF	Notching	Rating
	volume +	ordination	volume +	ordination			Guidance	notching		Assessment
	subordination		subordination				vs.			
							Adjusted			
							BCA			
Counterparty Risk Rating	15,1%	15,1%	15,1%	15,1%	3	3	3	3	0	a3
Counterparty Risk Assessment	15,1%	15,1%	15,1%	15,1%	3	3	3	3	0	a3 (cr)
Deposits	15,1%	3,0%	15,1%	13,4%	1	3	1	1	0	baa2
Senior unsecured bank debt	15,1%	3,0%	13,4%	3,0%	1	1	1	1	0	baa2

Instrument Class	Loss Given		Preliminary Rating	Government		Local Currency	Foreign
	Failure	Additional		Support	notching		
	notching	notching	Assessment			Rating	Currency
							Rating
Counterparty Risk Rating	3	0	a3	0		A3	A3
Counterparty Risk Assessment	3	0	a3 (cr)	0		A3(cr)	
Deposits	1	0	baa2	0		Baa2	Baa2
Senior unsecured bank debt	1	0	baa2	0		Baa2	Baa2

[1] Where dashes are shown for a particular factor (or sub-factor), the score is based on non-public information.

Source: Moody's Investors Service

## Ratings

Exhibit 7

Category	Moody's Rating
<b>BORGO AB (PUBL)</b>	
Outlook	Negative
Counterparty Risk Rating	A3/P-2
Bank Deposits	Baa2/P-2
Baseline Credit Assessment	baa3
Adjusted Baseline Credit Assessment	baa3
Counterparty Risk Assessment	A3(cr)/P-2(cr)
Issuer Rating	Baa2
ST Issuer Rating	P-2

Source: Moody's Investors Service

## Endnotes

<sup>1</sup> The ratings shown in this report are the bank's long-term deposit/senior unsecured (issuer) debt rating and Baseline Credit Assessment.

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