

**Rating Action: Moody's affirms the A3/Prime-2 deposit ratings of Volvofinans Bank AB; outlook remains stable**

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Global Credit Research - 14 Dec 2016

London, 14 December 2016 -- Moody's Investors Service today affirmed the A3/Prime-2 long-term and short-term deposit ratings of Volvofinans Bank AB (Volvofinans). The outlook on the long-term deposit rating remains stable. Concurrently, the rating agency also affirmed the bank's baseline credit assessment (BCA) and adjusted BCA of baa2 and its long-term and short-term Counterparty Risk assessments (CR assessments) of A2(cr)/Prime-1(cr).

The affirmation of Volvofinans' long-term deposit rating of A3 reflects (1) the bank's solid standalone financial fundamentals and a comparatively low correlation with its industrial parent for a captive finance entity, resulting in a BCA and adjusted BCA of baa2; and (2) Moody's Advanced Loss Given Failure (LGF) analysis, which indicates likely very low loss severity for deposits in the event of the bank's failure, adding two notches above the bank's adjusted BCA. Moody's assumption of a low probability of government support for deposits does not lead to any rating uplift.

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 and its relatively high share of deposit funding compared to peers. 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 Ba2, 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. As such, Volvofinans' BCA of baa2 is positioned three notches above Volvo's Ba2 rating.

**AFFIRMATION PRIMARILY DRIVEN BY SOLID STANDALONE CREDIT PROFILE**

In recent years, Volvofinans exhibited loan losses that are much lower than peers, notably due to the fact that approximately 75% of the lending book ("sales finance cars" and "sales finance trucks") benefits from recourse agreements with the Volvo Dealers. In 2015, the bank recorded loan loss charges equivalent to only 4 basis points of gross outstanding loans. Moody's expects the 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 20% on a transitional basis at end-September 2016, a capitalisation Moody's considers solid, viewing the relatively contained asset risks of the bank.

In addition, profitability is improving on the back of strong 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 continuously in the last four years, reaching 0.92% in the first six months of 2016. As for many auto banks, Volvofinans relies in part on the wholesale markets for the funding of its operations, a relative constraint for the BCA. At year-end 2015, market funds represented 37% of tangible banking assets, under Moody's calculations. However, deposits represented 55% of funding at year-end 2015, a ratio above that of most peers.

**OPERATIONAL AND FINANCIAL INDEPENDENCE FROM VOLVO UNDERPIN RATING DIFFERENTIAL**

In general, given the intricate links between an auto manufacturer and its auto financing bank, Moody's tightly links their ratings, with the bank's BCA rarely moving more than one notch above the rating of the industrial parent. Nonetheless, Moody's positions Volvofinans' BCA (baa2) significantly above Volvo's rating (Ba2) as Volvofinans is better ring-fenced from the auto manufacturer than what is usually the case.

While Volvo's influence in Volvofinans' strategic direction is significant, it owns only 50% of the shares and its

joint ownership with the Volvo Dealers ensures that there is adequate corporate governance. In addition, Volvofinans' asset quality benefits from a strong protection from the Volvo Dealers through loan recourse agreements, whereby the dealers cover the losses that arise from the car and truck financing they have originated. Lastly, the bank has relatively diversified revenues within the auto sector as it provides car financing for multiple car brands outside Volvo, including second hand cars and trucks. This is significantly different compared to other auto banks across Europe.

#### 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.

#### WHAT COULD MOVE THE RATINGS UP/DOWN

Volvofinans' BCA and deposit ratings could be upgraded if (1) Volvo was upgraded and (2) 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.

#### LIST OF AFFECTED CREDIT RATINGS

Issuer: Volvofinans Bank AB

Affirmations:

...LT Bank Deposits (Local & Foreign), Affirmed A3, Outlook remains Stable

.ST Bank Deposits (Local & Foreign), Affirmed Prime-2

...Counterparty Risk Assessment, Affirmed A2(cr)/P-1(cr)

...Adjusted Baseline Credit Assessment, Affirmed baa2

...Baseline Credit Assessment, Affirmed baa2

Outlook Action:

...Outlook, Remains Stable

#### PRINCIPAL METHODOLOGY

The principal methodology used in these ratings was Banks published in January 2016. Please see the Rating Methodologies page on [www.moodys.com](http://www.moodys.com) for a copy of this methodology.

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