

CREDIT OPINION

24 May 2024

Update

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RATINGS

Kommunalbanken AS

Domicile	Oslo, Norway
Long Term CRR	Aaa
Type	LT Counterparty Risk Rating - Fgn Curr
Outlook	Not Assigned
Long Term Debt	Aaa
Type	Senior Unsecured - Fgn Curr
Outlook	Stable
Long Term Deposit	Not Assigned

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.

Contacts

Tom Ogden +46.8.5179.1294
Analyst
tom.ogden@moodys.com

Jonathan Stenbaek +46.851.791.297
Ratings Associate
jonathan.stenbaek@moodys.com

Nondas Nicolaides +357.2569.3006
VP-Sr Credit Officer
nondas.nicolaides@moodys.com

Simon James Robin +44 207 772 5347
Ainsworth
Associate Managing Director
simon.ainsworth@moodys.com

Kommunalbanken AS

Update to credit analysis

Summary

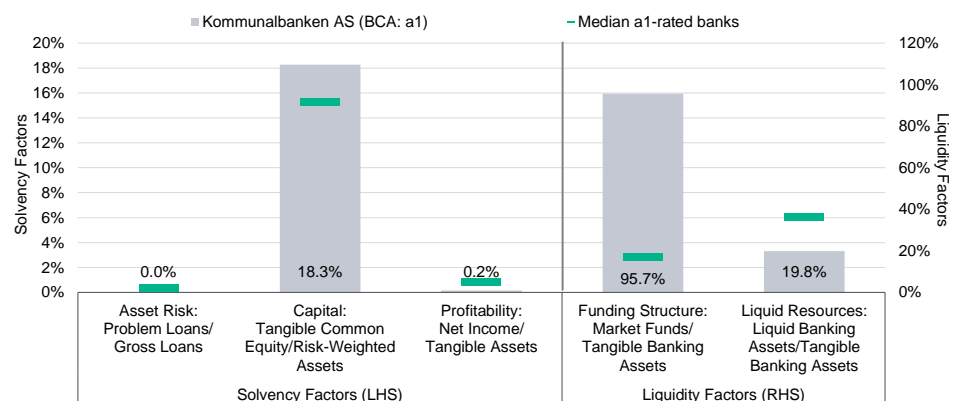
[Kommunalbanken AS](#)' (KBN) Aaa senior unsecured debt rating reflects its a1 Baseline Credit Assessment (BCA); our Advanced Loss Given Failure (LGF) analysis that results in a two-notch rating uplift from the a1 BCA, given its significant volume of senior unsecured debt; and our view of a very high likelihood of support from the [Government of Norway](#) (Aaa stable) because of its full ownership of KBN and KBN's role as the principal financier of the Norwegian regional and local government (RLG) sector, resulting in a further two notches of rating uplift to Aaa.

We apply our Advanced LGF analysis on the institution's liabilities because they are not guaranteed by the Norwegian public sector, and KBN is also within the scope of the Bank Resolution and Recovery Directive (BRRD).

KBN's a1 standalone BCA is driven by its position in Norway as the largest provider of funding to the RLG sector; its strong asset quality, which is derived from the credit quality of the Norwegian RLGs that the agency serves; and its robust capital levels relative to risks that are well above regulatory requirements, and moderate leverage. The BCA also reflects KBN's modest profitability, in line with its public policy mandate, and strong efficiency; and a high reliance on market funding, with some asset and liability maturity mismatches that are mitigated by a diverse funding profile and strong liquidity.

Exhibit 1

Key financial ratios as of 31 December 2023



These are our [Banks Methodology](#) scorecard ratios. Asset risk and profitability reflect the weaker of either the three-year average or the latest annual figure. Capital is the latest reported figure. Funding structure and liquid resources reflect the latest fiscal year-end figures

Source: Moody's Ratings

Credit strengths

- » Largest lender to the Norwegian public sector, in line with its public policy mandate, underpinning the stability of its operations
- » Excellent asset quality, which rests on RLGs' predictable revenue streams and central government oversight
- » Very strong capital position relative to risks and substantially above regulatory requirements
- » Strong operating efficiency

Credit challenges

- » Some lending concentrations resulting from a limited customer base
- » Modest profitability that is commensurate with the public policy mandate and low-risk profile
- » High reliance on market funding, with some asset and liability mismatches

Outlook

The outlook on KBN's senior unsecured debt ratings is stable, reflecting our expectation that its public policy role will be maintained along with an unchanged willingness to support from the Norwegian government.

Factors that could lead to an upgrade

- » The likelihood of an upgrade of KBN's BCA is limited because it is already at the higher end of peers' and banks' BCAs globally. Furthermore, an upgrade of the BCA will not translate into a higher senior unsecured rating, because it is already at Aaa.

Factors that could lead to a downgrade

- » Downward pressure on KBN's BCA could arise as a result of weaker asset quality; a dilution of KBN's public policy mandate and lower importance for the RLG sector; a weaker position in the debt capital markets or reduced liquidity; and sustained weaker financial performance.
- » KBN's senior ratings could also be under pressure if the likelihood of government support for either of these debt classes diminishes or if the sovereign rating is downgraded.

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

Kommunalbanken AS (Consolidated Financials) [1]

	12-23 ²	12-22 ²	12-21 ²	12-20 ²	12-19 ²	CAGR/Avg. ³
Total Assets (NOK Billion)	522.2	453.9	449.2	461.8	449.2	3.8 ⁴
Tangible Common Equity (NOK Billion)	17.4	15.3	16.0	14.5	13.3	7.0 ⁴
Tangible Common Equity / Risk Weighted Assets (%)	18.3	19.0	19.7	17.8	16.7	18.3 ⁶
Net Interest Margin (%)	0.4	0.4	0.3	0.3	0.4	0.4 ⁵
PPI / Average RWA (%)	2.0	-0.3	1.9	1.9	2.4	1.6 ⁶
Net Income / Tangible Assets (%)	0.2	0.0	0.3	0.3	0.3	0.2 ⁵
Cost / Income Ratio (%)	15.8	627.5	13.9	14.1	11.9	136.6 ⁵
Market Funds / Tangible Banking Assets (%)	95.7	95.3	94.9	95.1	95.1	95.2 ⁵
Liquid Banking Assets / Tangible Banking Assets (%)	19.8	17.1	20.3	23.3	24.1	20.9 ⁵

[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 Ratings and company filings

Profile

Kommunalbanken AS (KBN) provides loans to Norwegian counties and municipalities, as well as intermunicipal companies and other companies that carry out tasks at a municipal level. The loans are granted against either a municipal or government guarantee. KBN's lending is funded by issuing securities in the international capital markets.

KBN is fully owned by the Norwegian state, with the Ministry of Local Government and Regional Development acting as KBN's owner. The ministry appoints KBN's board of directors, supervisory board and the external auditor.

KBN was established in November 1999 by special law as a limited company, taking over all activities from the government-owned Norges Kommunalbank (NKB). NKB was established as a state institution in 1926 with the sole purpose of lending to Norwegian local governments by issuing bonds, all of which were covered by state guarantees. However, NKB's lending was kept within government-fixed lending limits. KBN does not have to obey such limits, which gives it greater freedom in its borrowing and lending operations; however, its funding is not explicitly guaranteed.

KBN strives to be a leader in green finance in Norway and to contribute to the transition to a low-carbon society. In 2013, KBN was the first financial institution in the Nordics to issue a public green bond.

Recent developments

April 2024: KBN publishes new Green Bond Framework. Replaces version from 2021, and emphasizes nature- and climate-related risks. This to further contribute to the aim of the Norwegian Government, which was strengthened 2022, to reduce climate-related emissions by at least 55% by 2023, within its Nationally Determined Contribution.

December 2023: The Norwegian FSA (Finanstilsynet) delivered its decision regards Pillar 2 requirements (SREP) for KBN. The bank will have a Pillar 2 requirements consisting of 2.0% of the basis for calculation under Pillar 1, a reduction by 0.1 percentage points. The decision came into force on 31 December 2023.

Detailed credit considerations

KBN is the largest lender to the Norwegian public sector, underpinning the stability of its operations

KBN benefits from operating in a wealthy and developed country with very high economic, institutional and government financial strength, as well as very low susceptibility to adverse events. KBN's macro profile is aligned with that of Norway at '[Very Strong -](#)'.

KBN's government-related footprint is substantial, reflecting its establishment through legislation, its public policy mandate and full government ownership. In addition, the company benefits from oversight by the Ministry of Local Government and Regional Development and supervision by the Norwegian Financial Supervisory Authority (FSA or Finanstilsynet). KBN benefits from a maintenance obligation, according to which the Norwegian central government ensures that KBN can fulfill its mandate to provide low-cost financing to the Norwegian RLG sector.

With a reported market share of 51% as of December 2023, KBN is the largest provider of funding to RLGs and companies owned by RLGs in Norway and therefore plays an important role in the Norwegian economy. KBN's customer base includes all Norwegian municipalities. Some RLGs also use their own funding programmes to raise funds; this is particularly applicable for the larger RLGs because they have a stronger capacity to make direct use of capital markets.

KBN's public policy mandate and the above factors underpin the stability of KBN's operations and our positive adjustment for Business Diversification.

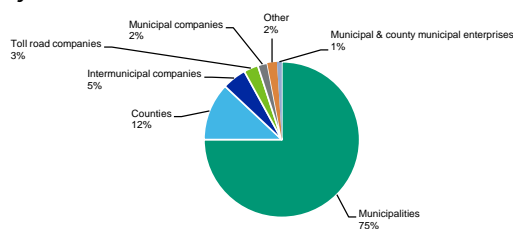
Excellent asset quality rests on RLGs predictable revenue streams and central government oversight

We expect KBN's asset quality to remain excellent even during more challenging economic times, as its creditworthiness is based on the high credit quality of the Norwegian RLG sector that the agency serves (see Exhibit 3). This is also demonstrated by KBN's problem loan ratio of 0% and the fact that the institution (and its predecessor NKB) has never recorded a loss on its loan book, which is reflected in our aa1 Asset Risk score.

Exhibit 3

KBN lends to the Norwegian RLG sector

Outstanding lending by customer category as of year-end 2023



Source: Company

We consider the Norwegian RLG sector financially strong because of the supportive and closely supervised system that underpins the sector. Much of Norwegian RLGs' revenue comes from government grants, and the equalisation principle ensures that all RLGs have the financial means to deliver consistent service delivery throughout the country. Furthermore, all budgets are supervised by the central government and RLGs are not allowed to budget for an operating deficit, while RLGs can only borrow for certain purposes. If an RLG experiences a deficit, it is placed under close government oversight until the deficit is eliminated.

Importantly, RLGs cannot be declared insolvent and payments cannot be canceled; payments can only be deferred and interest would accrue normally. Given this background, KBN has not recorded a loss from lending during more than 90 years of operations. Although KBN has never incurred a credit loss, in line with IFRS 9 accounting standards, the lender had made provisions for theoretical losses on loans and bond investments of NOK44 million as of December 2023, slightly reduced from year-end 2022. The amount remained small against relevant exposures of NOK328 billion, all of which continue to be considered Stage 1.

However, indebtedness of the Norwegian RLG sector has increased in recent years, along with an increasing standard of public services, and a portion of these borrowings would be sensitive to higher interest rates. Further, similar to its peers, KBN's customer base is small in number, which inherently leads to single-borrower concentrations in its loan book. Nonetheless, KBN complies with all regulations, including those on large exposures.

KBN's risk policy allows for minimal exposure to interest rate and currency risk, which are managed through the matching of assets and liabilities, and hedging through derivatives. Counterparty risk is mitigated through standard international swap and derivative association agreements and collateral support annexes with all counterparties.

Capital position is robust relative to risks and substantially above regulatory requirements; leverage is moderate

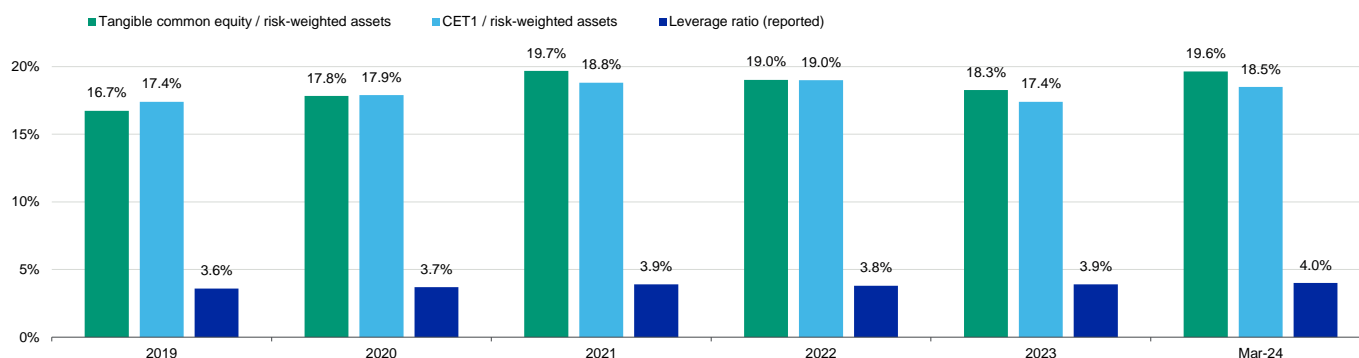
We consider KBN's capitalisation commensurate with its low-risk assets, which drives our aa2 Capital score. As of March 2024, the institution's tangible common equity/risk-weighted assets was 19.6% (see Exhibit 4). In April 2020, the Norwegian government executed an equity injection of NOK750 million into KBN to support its role in financing the RLG sector in light of market turmoil. In addition to the equity injection in April 2020, the bank has managed to continue to strengthen its capital through retained earnings.

As of March 2024, KBN reported an 18.5% Common Equity Tier 1 (CET1) capital ratio and a 23.2% total capital ratio. These metrics are equal to a minimum current CET1 requirement of 17.4% and a total capital requirement of 21.9% for that period, which include a pillar 2 add-on of 2.0% specific to KBN that is set by the Norwegian FSA.

Exhibit 4

KBN's capital is solid with substantial buffer above capital requirements

Capital metrics evolution



Sources: Company and Moody's Financial Metrics

KBN is required to apply a 20% risk-weight on lending to RLGs, whereas its Nordic peers typically assign a zero risk weight to this type of lending. As a consequence, KBN's risk-weighted capital metrics are below those of its Nordic peers that are government-related issuers. As of March 2024, KBN reported a Basel leverage ratio of 4.1%, compared with 3.9% as of year-end 2022. Although moderate, this level is above the 3% minimum leverage ratio requirement for KBN.

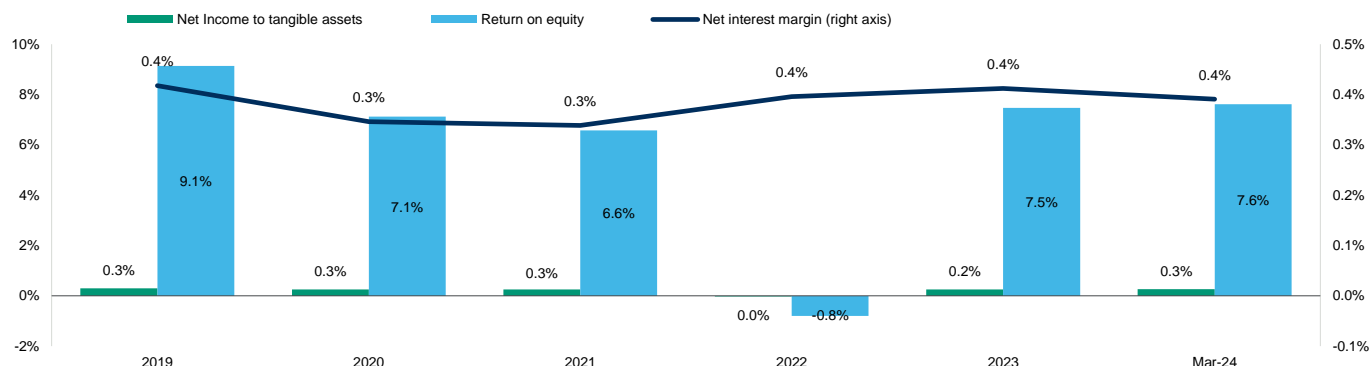
Modest profitability in line with public policy mandate and low-risk profile; operating efficiency is strong

Like other lenders with a public policy mandate, KBN's profitability is modest because it aims to offer cost-effective lending to its customers rather than to maximise profit. Net income/tangible assets increased to 0.25% as of December 2023 from -0.03% in December 2022 (see Exhibit 5), and remained largely stable at 0.26% in the three months to March 2024.

In 2023, KBN posted a profit of NOK1,432 million, compared with a loss of NOK60 million in 2022. Net interest income rose by NOK239 million or 13% to NOK2,105 million in 2023 from NOK1,866 million as in 2022. Since KBN has a high portion of financial instruments and loans measured at fair value, it is sensitive to market movements. In 2023, KBN reported unrealised gains on financial instruments totaling NOK212 million, while in 2022 it reported unrealised losses of NOK1,615 million.

Despite fluctuations in the fair value of financial instruments, we consider KBN's underlying profitability stable and predictable because the institution is a market leader and the composition of its RLG customer base is likely to remain stable. Moreover, KBN's customers are low risk for the reasons explained in the section above. These drivers are already captured in our ba3 Profitability score for the issuer.

Exhibit 5

KBN's profitability is modest in light of its public policy mandate**Evolution of profitability metrics**

Source: Moody's Ratings

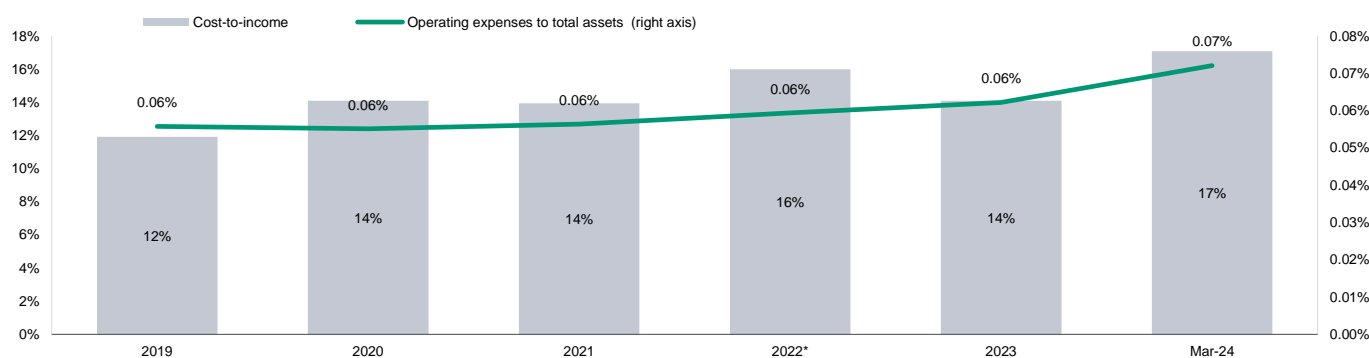
Over the next 12-18 months, we expect KBN's profitability to remain stable. The return on KBN's liquidity portfolio will decline somewhat going forward because of the planned interest rate declines in the later part of 2024. However, we expect continued competition from capital markets to limit the expansion in net interest margin.

Further, KBN's green loans that are financed from the proceeds of green bond issuances are offered to borrowers at a discount of up to 10 basis points, which could put some pressure on the bank's margins if not fully matched by cheaper funding. Outstanding green loans amounted to 15% of gross loans as of December 2023, and the institution expects this share to increase.

KBN's financial flexibility is helped by strong operating efficiency, with a cost to income ratio of only 17% as of March 2024, broadly unchanged from previous years, and with operating expenses maintained at a low 0.06% of total assets as of December 2023 (see Exhibit 6). Due to high unrealized losses amounting to NOK1.6 billion in 2022, the bank's cost to income ratio temporarily increased to 627%. Excluding these unrealized losses, the cost to income ratio is in line with previous periods at around 16%.

KBN's low costs are consistent with its peers, and expenses will remain low because of KBN's unchanged business model and efficient distribution. The increase in expenses in recent years was associated with IT development costs and the increased hiring of staff for the compliance function.

Exhibit 6

KBN demonstrates strong operating efficiency with a low level of operating expenses

KBN recorded unusually high unrealized losses on its financial instruments in 2022. Cost to income ratio for 2022 is adjusted to improve comparability across periods.

Source: Moody's Ratings

Diverse funding and adequate liquidity, but with some asset and liability mismatches

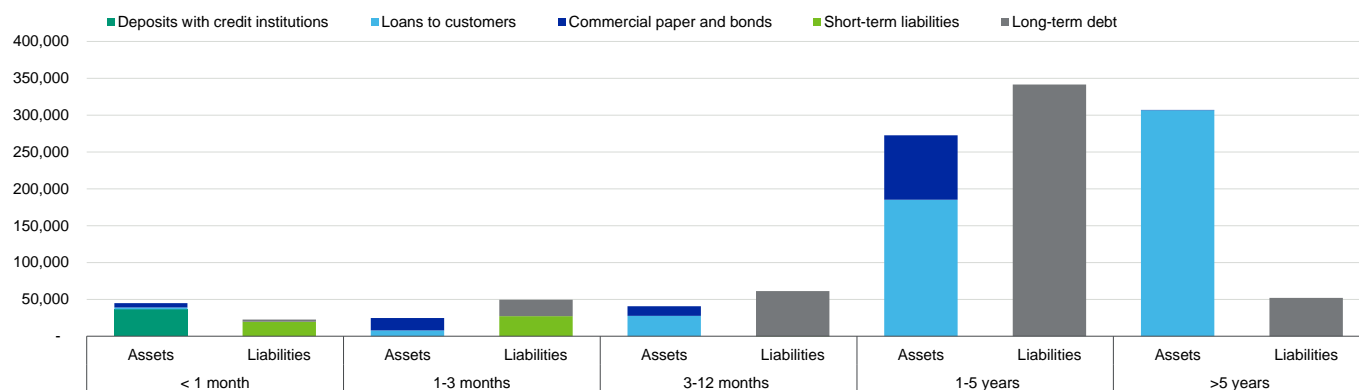
Similar to most peers in the Nordics and Europe, KBN is entirely wholesale funded. Also in line with peers, KBN employs a diversified funding strategy, whereby it issues debt in several markets and currencies, subscribed to by a wide variety of investors.

KBN has some contractual mismatches between assets and liabilities (see Exhibit 7), but is match-funded based on an anticipated average maturity on the assets according to historical data. Similar to peers, KBN issues debt with option-like features, and such structured funding could suddenly shorten KBN's liability profile. However, for funding and liquidity management purposes, KBN assumes its structured funding will be called on the first possible call date. All these elements are taken into account in our baa2 Funding score.

Exhibit 7

KBN has some asset and liabilities maturity mismatches mitigated by a strong liquidity position

Exposure by contractual time to maturity and exposure type



Source: Company

KBN's liquidity portfolio totaled NOK116 billion as of March 2024 and was principally made up of assets of strong credit quality. Our liquid assets to total assets ratio was 18.9% at the end of the period. This is equivalent to 32% of total loans as of March 2024.

KBN's aim is to maintain liquid assets that would allow it to sustain operations for the next 12 months if funding markets become unavailable. However, KBN does not have access to regular central bank liquidity facilities, unlike some of its peers. KBN's overall liquidity coverage ratio (LCR) was 271% as of December 2023 (year-end 2023: 266%, year-end 2022: 261%).

Sources of facts and figures cited in this report

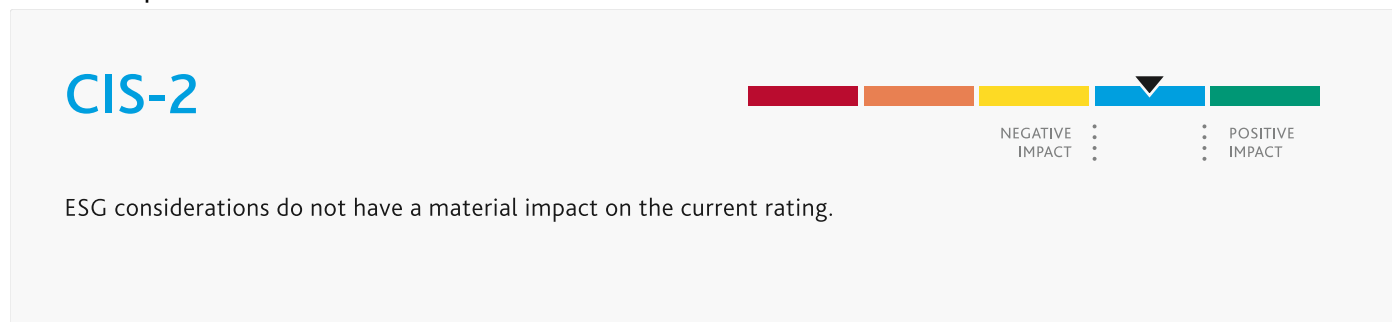
Issuer-specific figures originate from its financial reports. All figures are based on our own chart of accounts and may be adjusted for analytical purposes. Please refer to the document [Financial Statement Adjustments in the Analysis of Financial Institutions](#), published on 9 August 2018.

ESG considerations

Kommunalbanken AS' ESG credit impact score is CIS-2

Exhibit 8

ESG credit impact score



Source: Moody's Ratings

KBN's ESG Credit Impact Score is neutral-to-low (**CIS-2**). This reflects the low credit impact of environmental and social risk factors on the rating, and low governance risks.

Exhibit 9

ESG issuer profile scores



Source: Moody's Ratings

Environmental

We view KBN's environmental risks as low, but municipalities, KBN's principal borrowers, are exposed to climate risk, such as severe weather phenomena, although KBN's green bond programme aims to finance the sector's transition to be more climate resilient.

Social

KBN's government-related footprint is substantial, reflecting its establishment through legislation, its public policy mandate and full government ownership. KBN's public policy mandate and the above factors underpin the stability of KBN's operations and our positive adjustment to the rating for Business Diversification.

Governance

KBN faces low governance risks and its risk management, policies and procedures are in line with industry best practices. Despite sectoral concentration, the bank benefits from strong underwriting standards which mitigate these concerns. The bank has a track record of sound capital and liquidity management and earnings stability while it has never recorded a credit loss.

ESG Issuer Profile Scores and Credit Impact Scores for the rated entity/transaction are available on Moody's.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

Loss Given Failure (LGF) analysis

Norway has transposed the EU BRRD into local legislation effective from January 2019, and therefore, we consider the country an operational resolution regime. Despite its ownership and public mandate, KBN is not excluded from the scope of Norway's BRRD implementation. Therefore, in accordance with our methodology, we apply our Advanced LGF analysis, considering the risks faced by different debt classes across the liability structure in the unlikely event that KBN would enter resolution.

In our Advanced LGF analysis, we use our standard assumptions and assume residual tangible common equity of 3% and losses post-failure of 8% of tangible banking assets.

Under these assumptions, for KBN's senior unsecured debt, our LGF analysis indicates a very low loss given failure because of the loss absorption provided by the significant amount of senior unsecured debt outstanding. This leads to two notches of rating uplift for senior unsecured debt from KBN's a1 Adjusted BCA.

Our Advanced LGF analysis also shows that KBN's subordinated debt would absorb losses in a currently unlikely failure scenario, resulting in a Preliminary Rating Assessment before government support of a2, one notch below the Adjusted BCA.

Government support considerations

Moody's assesses that there is a very high likelihood of support from the Norwegian government for all debt classes. This is based on the 100% ownership of Kommunalbanken by the Norwegian government, its public policy mandate to support RLGs, and the owners proven capacity of providing capital injections in stressed scenarios. The commitment and support showed by the Norwegian

government results in our assessment of a very high probability of government support for KBN's, resulting in a two-notch uplift to their senior unsecured debt resulting in a Aaa rating, and a two-notch uplift to their dated subordinated debt, resulting in a Aa3 rating.

Counterparty Risk Ratings

CRRs are opinions of the ability of entities to honour the uncollateralized portion of non-debt counterparty financial liabilities (CRR liabilities), and also reflect the expected financial losses in the event such liabilities are not honoured. CRR liabilities typically relate to transaction with unrelated parties. Examples of CRR liabilities include the uncollateralized part of payables arising from derivatives transactions and the uncollateralized part of liabilities under sale and repurchase agreements. CRRs are not applicable to funding commitments or obligations associated with covered bonds, letters of credits, guarantees, servicer and trustee obligations, and other similar obligations that arise from a bank performing its essential operating functions.

KBN's CRRs are at Aaa/Prime-1

The CRR is positioned four notches above the a1 BCA due to our buffer provided by more junior classes of liabilities, resulting in a three notch uplift, in conjunction with the very high government support assumption providing one further notch in uplift.

Counterparty Risk Assessment

The CR Assessment is an opinion of the counterparty risk related to a bank's covered bonds, contractual obligations (servicing), derivatives (for example, swaps), letters of credit and liquidity facilities. The CR Assessments are distinct from debt and deposit ratings in that they consider only the risk of default rather than both the likelihood of default and the expected financial loss suffered in the event of default.

KBN's CR Assessment is Aaa(cr)/Prime-1(cr)

The CRA is positioned four notches above the a1 BCA due to our buffer provided by more junior classes of liabilities, resulting in a three notch uplift, in conjunction with the very high government support assumption providing one further notch in uplift.

Methodology and scorecard

About Moody's Bank Scorecard

Our scorecard is designed to capture, express and explain in summary form our Rating Committee's judgement. When read in conjunction with our research, a fulsome presentation of our judgement is expressed. As a result, the output of our scorecard may significantly differ from that suggested by raw data alone (though it has been calibrated to avoid the frequent need for strong divergence). The scorecard output and the individual scores are discussed in rating committees and may be adjusted up or down to reflect conditions specific to each rated entity.

Rating methodology and scorecard factors

Exhibit 10

Kommunalbanken AS

Macro Factors

Weighted Macro Profile **Very Strong -** **100%**

Factor	Historic Ratio	Initial Score	Expected Trend	Assigned Score	Key driver #1	Key driver #2
Solvency						
Asset Risk						
Problem Loans / Gross Loans	0.0%	aa1	↔	aa1	Quality of assets	
Capital						
Tangible Common Equity / Risk Weighted Assets (Basel III - transitional phase-in)	18.3%	aa1	↔	aa2	Nominal leverage	
Profitability						
Net Income / Tangible Assets	0.2%	b1	↔	ba3	Earnings quality	
Combined Solvency Score		a1		a1		
Liquidity						
Funding Structure						
Market Funds / Tangible Banking Assets	95.7%	caa3	↔	baa2	Market funding quality	
Liquid Resources						
Liquid Banking Assets / Tangible Banking Assets	19.8%	baa2	↔	a2	Quality of liquid assets	
Combined Liquidity Score		b2		baa1		
Financial Profile						
Qualitative Adjustments				Adjustment		
Business Diversification				1		
Opacity and Complexity				0		
Corporate Behavior				0		
Total Qualitative Adjustments				1		
Sovereign or Affiliate constraint				Aaa		
BCA Scorecard-indicated Outcome - Range				aa3 - a2		
Assigned BCA				a1		
Affiliate Support notching				0		
Adjusted BCA				a1		

Balance Sheet	in-scope (NOK Million)	% in-scope	at-failure (NOK Million)	% at-failure
Other liabilities	63 573	12.2%	63 573	12.2%
Senior unsecured bank debt	438 407	84.0%	438 407	84.0%
Dated subordinated bank debt	800	0.2%	800	0.2%
Preference shares (bank)	3 600	0.7%	3 600	0.7%
Equity	15 661	3.0%	15 661	3.0%
Total Tangible Banking Assets	522 041	100.0%	522 041	100.0%

Debt Class	De Jure waterfall		De Facto waterfall		Notching		LGF Notching Guidance vs. Adjusted BCA	Assigned LGF notching	Additional Notching	Preliminary Rating Assessment
	Instrument volume + subordination	Sub-ordination	Instrument volume + subordination	Sub-ordination	De Jure	De Facto				
Counterparty Risk Rating	87.8%	87.8%	87.8%	87.8%	3	3	3	3	0	aa1
Counterparty Risk Assessment	87.8%	87.8%	87.8%	87.8%	3	3	3	3	0	aa1 (cr)
Senior unsecured bank debt	87.8%	3.8%	87.8%	3.8%	2	2	2	-	-	-

Instrument Class	Loss Given Failure notching	Additional notching	Preliminary Rating Assessment	Government Support notching	Local Currency Rating	Foreign Currency Rating
Counterparty Risk Rating	3	0	aa1	1	Aaa	Aaa
Counterparty Risk Assessment	3	0	aa1 (cr)	1	Aaa(cr)	
Senior unsecured bank debt	-	-	-	2	Aaa	Aaa

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

Source: Moody's Ratings

Ratings

Exhibit 11

Category	Moody's Rating
KOMMUNALBANKEN AS	
Outlook	Stable
Counterparty Risk Rating	Aaa/P-1
Baseline Credit Assessment	a1
Adjusted Baseline Credit Assessment	a1
Counterparty Risk Assessment	Aaa(cr)/P-1(cr)
Issuer Rating	Aaa
Senior Unsecured	Aaa
Commercial Paper	P-1
Other Short Term	(P)P-1

Source: Moody's Ratings

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