

HAS NORDIC BANK CREDITWORTHINESS REACHED ITS PEAK?

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This commentary does not reflect a rating action.

With an average credit assessment of 'bbb+' for the fifth year in a row, a sample of over 300 Nordic banks demonstrated stable creditworthiness in 2018. Nordic Credit Rating's (NCR's) bank assessments were also stable when assessing country- or segment-level creditworthiness. However, for the first time since 2011, the average score that underlies our assessments did not improve from the previous year, based on NCR's Financial Institutions Rating Methodology¹, 14 Aug. 2018.

NCR believes that this could signal an end to the steady improvement that Nordic banks of all shapes and sizes have made over the past decade. There is certainly potential for further consolidation, continued automation and an increased focus on financial crime to improve the stability of the sector on the margin. However, reduced focus on capital accumulation, increasing margin pressure and higher risk appetite associated with a growing share of unsecured consumer lending could contribute to a lack of further progress for Nordic banks. In addition, slowing growth across Europe could extend expansionary monetary policies or spur a potential increase in credit losses from very low levels.

Figure 1. Average credit assessment score for Nordic financial institutions by sector, 2010-2018

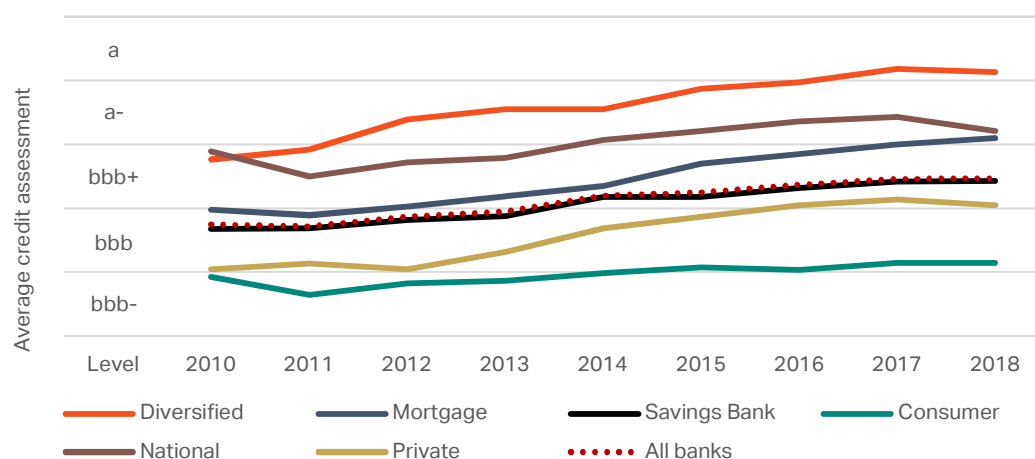
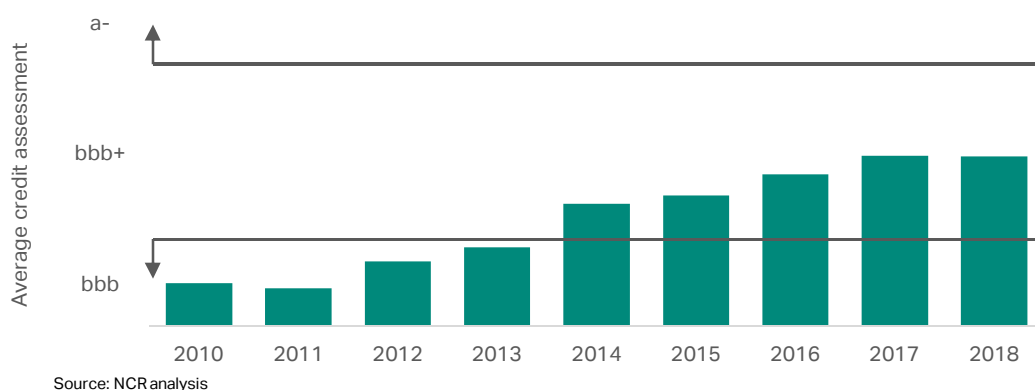


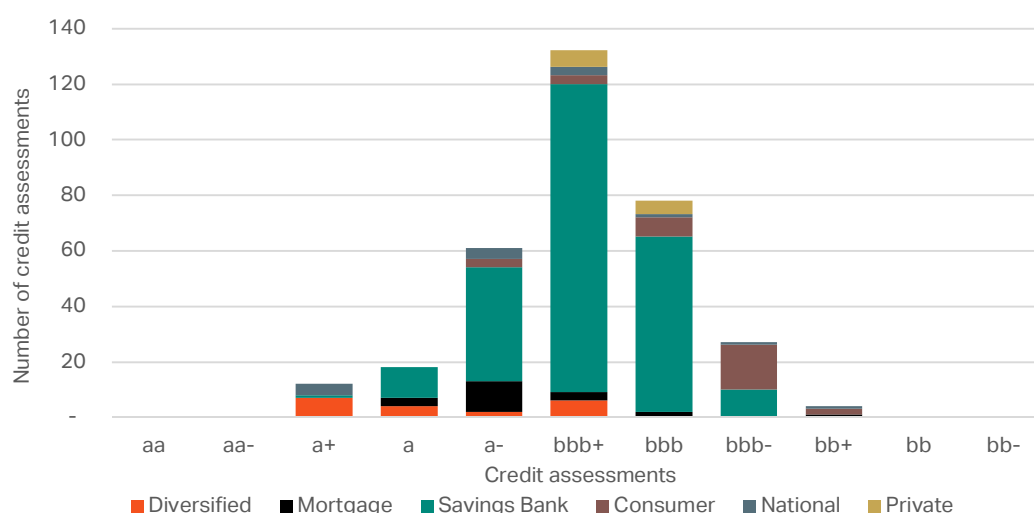
Figure 2. Average credit assessment score for Nordic financial institutions, 2010-2018



SEGMENT ASSESSEMENTS VARY BY RISK PROFILE

At the segment level, diversified Nordic issuers (19 Nordic banks) have an average credit assessment of 'a' using NCR's methodology. A collection of "national" lenders (14 municipal, export or otherwise nationally-important issuers) and mortgage lenders (20 primarily mortgage lenders) average 'a-'. A large group of savings, regional and cooperative banks (237 banks in total) and private banks (11 banks focused on private banking and investment) average 'bbb+'. Finally, "consumer" lenders (31 unsecured and secured consumer lenders) average 'bbb' but have the highest number of assessments at 'bbb-'.

Figure 3. Nordic financial institution credit assessments by sector, 2018



Source: NCR analysis

Over the past decade, our assessments of most bank types have steadily improved as shown in Figure 1. This trend was broken in 2018 for diversified banks due to a weaker assessment for capital and risk-adjusted earnings for some banks and an increasing risk appetite associated with high credit growth for others. For national banks, the change is primarily due to material increases in lending affecting our risk appetite assessment or deteriorating asset quality in 2018.

Looking further into the subfactors used in the 2018 assessments, NCR highlights some of the strengths and weaknesses of the associated banking segments. For example, the larger diversified banks tend to have a stronger market presence, resulting in a higher assessment of competitive position. Mortgage lenders tend to have weaker earnings, but very strong loss experience. While consumer and secured lenders tend to have higher margins, price-dependent funding and relatively weak asset quality.

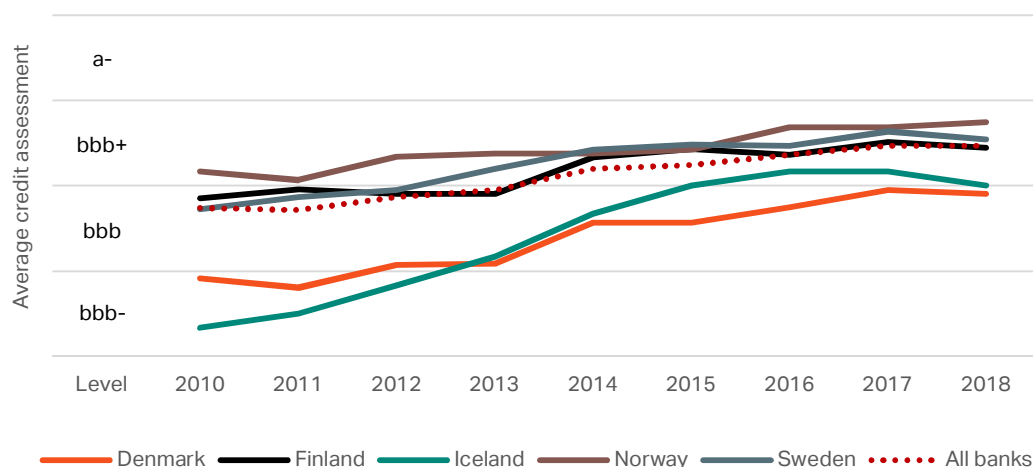
Figure 4. Average Nordic financial institution assessments by subfactor and segment, 2018

	WEIGHT (%)	DIVERSIFIED	NATIONAL/ MUNI	MORTGAGE	SAVINGS BANKS	CONSUMER / SECURED	PRIVATE
Credit Assessment	100.0	a	a-	a-	bbb+	bbb	bbb+
Op. Environment	20.0	a-	bbb+	bbb+	bbb	bbb	bbb+
Risk Appetite	50.0	a	a	a-	a-	bbb	bbb+
of which Capital	17.5	a	aa-	a-	a+	bbb+	bbb+
of which Funding	15.0	a-	a-	bbb+	a-	bbb	bbb+
of which Credit Risk	7.5-10.0	a+	a	a	bbb+	bbb	bbb
Competitive Position	15.0	a	bbb-	bbb-	bb	bb-	bb-
Performance	15.0	a-	a-	a-	bbb+	bbb	a-
of which Earnings	7.5	a-	a-	bbb	bbb+	a-	a-
of which Losses	7.5	a	a-	a+	a	bbb-	a
Total assessments		19	14	20	237	31	11

NORWEGIAN BANKS CONTINUE TO ADVANCE

Holding to the theme that Nordic banks have reached their peak, four of the five Nordic markets show a slight deterioration in the average credit assessment in 2018. The exception is in Norway, where loss performance improvements in 2018 reflected improvements in asset quality, primarily in the western oil-related regions. Unsurprisingly, Icelandic and Danish banks have shown the largest improvement since 2010, moving from average 'bbb-' assessments to the brink of a 'bbb+' average assessment, alongside the rest of the Nordic market. In Iceland, the relatively large reversal in the average assessment in 2018 is due to lower capital ratios as the largest banks adjust the composition of their capital and somewhat lower earnings metrics (note: there are only 6 Icelandic financial institutions in the sample).

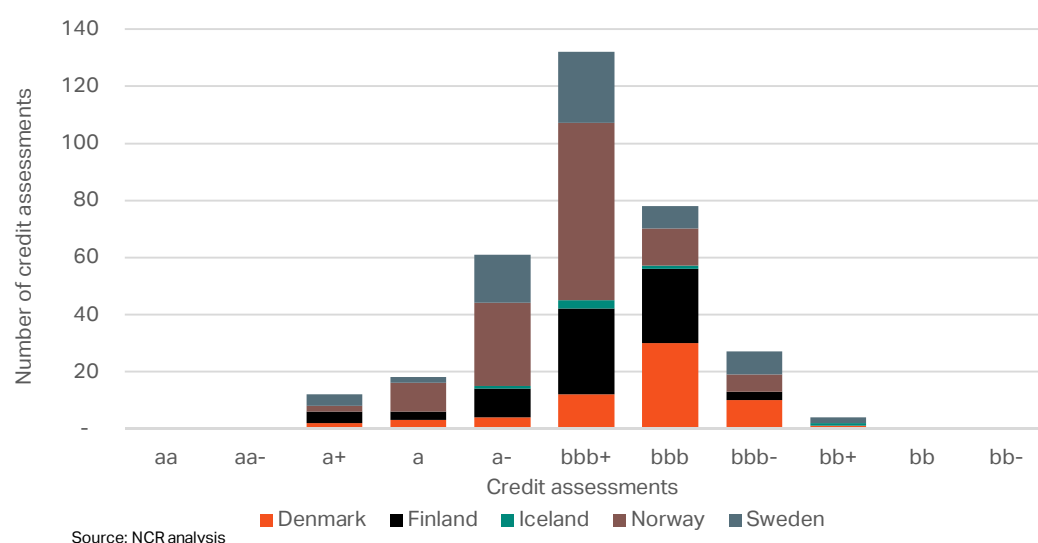
Figure 5. Average credit assessment score for Nordic financial institutions, 2010-2018



Source: NCR analysis

The national assessments shown in Figure 6 demonstrate the influence of the high number of Norwegian savings banks, which have both high capital and relatively strong earnings metrics. By contrast, in Denmark, Finland and Sweden, the markets are relatively top-heavy with large diversified banks and strong mortgage companies dominating the market landscape.

Figure 6. Nordic financial institution credit assessments by country, 2018



Looking further into the scoring at national level, a few key differences stand out. Primarily the strength of the capital measures for Finnish banks, the strength of earnings metrics for Norwegian banks and the relatively low earnings and asset quality for Danish banks in 2018. Given the composition of the Icelandic banking market, a high share of the banks in the sample have dominant market positions compared with the other Nordic banking markets.

Figure 7. Average financial institution assessments by subfactor and country, 2018

	WEIGHT (%)	DENMARK	FINLAND	ICELAND	NORWAY	SWEDEN	NORDIC
Credit Assessment	100.0	bbb	bbb+	bbb	bbb+	bbb+	bbb+
Op. Environment	20.0	bbb	bbb-	bbb-	bbb+	bbb+	bbb
Risk Appetite	50.0	a-	a	a-	a-	a-	a-
of which Capital	17.5	a	aa-	a	a	a	a
of which Funding	15.0	a	a-	a-	a-	a-	a-
of which Credit Risk	7.5-10.0	bbb+	bbb+	bbb	bbb+	bbb+	bbb+
Competitive Position	15.0	bb-	bb+	bb+	bb+	bb+	bb
Performance	15.0	bbb-	bbb+	a-	a	a-	bbb+
of which Earnings	7.5	bbb-	bbb	bbb+	a-	bbb+	bbb+
of which Losses	7.5	bbb	a	a	a	a	a-
Total assessments		62	76	6	122	66	332

ASSESSMENT METHODOLOGY

NCR's credit assessments are conducted using a top-down analysis of each bank's annual public reporting and broad assumptions about qualitative factors such as risk governance, other material risks, credit risk concentrations, risks associated with regional or sectoral concentrations and similar. NCR expects that about 90% of the credit assessments conducted in this manner would be within one notch of the actual rating for the issuer, with the exception of additional notches for ownership support or government role, or notching to reflect specific peer comparisons or transitions. The weightings by risk factor are based on NCR's *Financial Institutions Rating Methodology*¹. When NCR evaluates banks during an actual rating process we take a long-term and forward-looking approach to quantitative measures and qualitative assessments to avoid year-to-year volatility in our ratings.

¹ <https://nordiccreditrating.com/pdf/Nordic%20Credit%20Rating%20-%20Financial%20Institutions%20Rating%20Methodology.pdf>

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