NORDIC NICHE BANKS – POLITICAL RISK REMAINS A SIGNIFICANT RISK FACTOR

ANALYSTS

Geir Kristiansen
+47 907 845 93
geir.kristiansen@nordiccreditrating.com

Sean Cotten
+46-732 324 378
sean.cotten@nordiccreditrating.com

CLIENT SERVICES

Gustav Liedgren
+46 736 496 543
gustav.liedgren@nordiccreditrating.com

Kristine Sunde
+47 993 269 79
kristine.sunde@nordiccreditrating.com

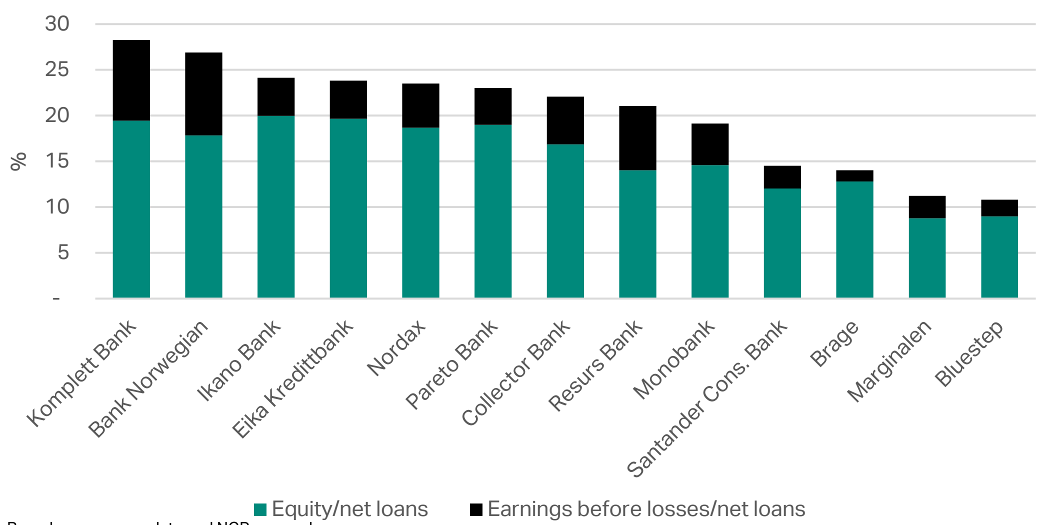
Nordic niche banks focusing on unsecured consumer lending have recently encountered headwinds from regulators and in the stock market, particularly in Norway. While political risk is a concern, we believe that from a credit perspective, default risk in the sector remains moderate since deposits and other interest-bearing debt are protected by strong capitalisation and profitability.

CONSUMER LENDERS UNDER PRESSURE IN NORWAY

Consumer lending across the Nordic region has been growing rapidly in recent years, boosted by a growing number of aggressive niche banks. (See "Rapidly growing and profitable niche banks face challenges" published 26 Mar. 2019 [the March report] for a broader description of the causes.) This growth has led to negative media comments and a backlash in the form of new regulations, which have already succeeded in dampening such growth in Norway. This in turn, has spurred Norwegian consumer banks to enter other Nordic markets to seek new growth opportunities but at the risk of incurring higher credit losses, particularly before sufficient market data are accumulated. Three newly created debt registries will come into force in Norway from 1 Jul. 2019. These will probably curtail consumer lending growth in the short term and lead to increased competition for a reduced number of eligible borrowers, while at the same time reducing credit risk in the sector.

Unsecured consumer lending in Norway accounts for only 3% of total lending compared with 9% in Sweden. The negative media coverage in Norway is largely related to credit risk and provisioning levels at individual banks and the risk for equity holders rather than, arguably insignificant, systemic risk. However, some Norwegian commentators advocate reduced protection for unsecured creditors, akin to the Danish system. We believe that reduced creditor protection would increase risks for providers of unsecured consumer loans significantly, with material impacts on debt and equity investors.

Figure1. Nordic consumer bank equity and earnings before loan losses to net loans, 2018

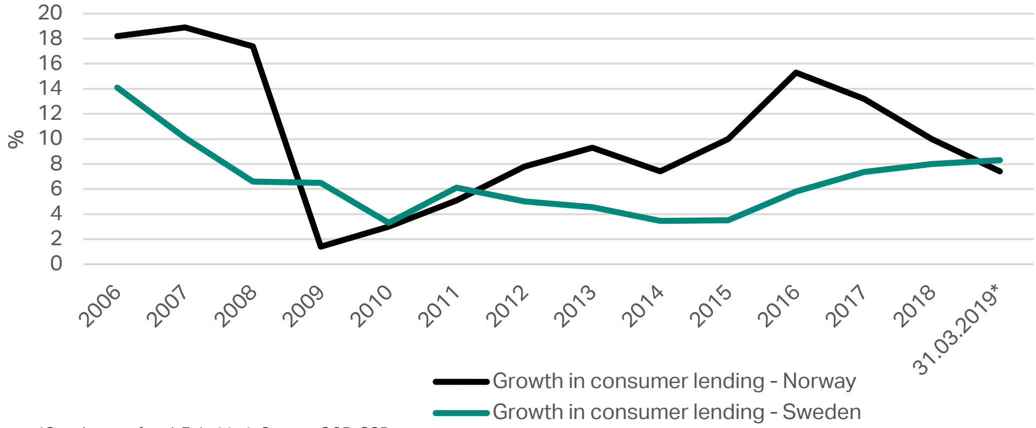


Based on company data and NCR research

NEW REGULATIONS CURTAIL CONSUMER LENDING IN NORWAY

Consumer lending growth in Norway fell from 10% in 2018 to 7.4% (12 month rolling) as of the end of the first quarter of 2019, which implies that the growth level in consumer lending in the first quarter isolated was around 5% and lower than total lending growth. The lower growth was due to stricter adherence to lending regulations (e.g. maximum loan amounts of 5x income and maximum repayment periods of five years). From 1 Jul. 2019, the new debt registries will come into force, which will make it difficult to circumvent regulations and likely further curtail lending growth.

Figure 2. Norwegian and Swedish consumer lending growth, 2006-Q1 2019



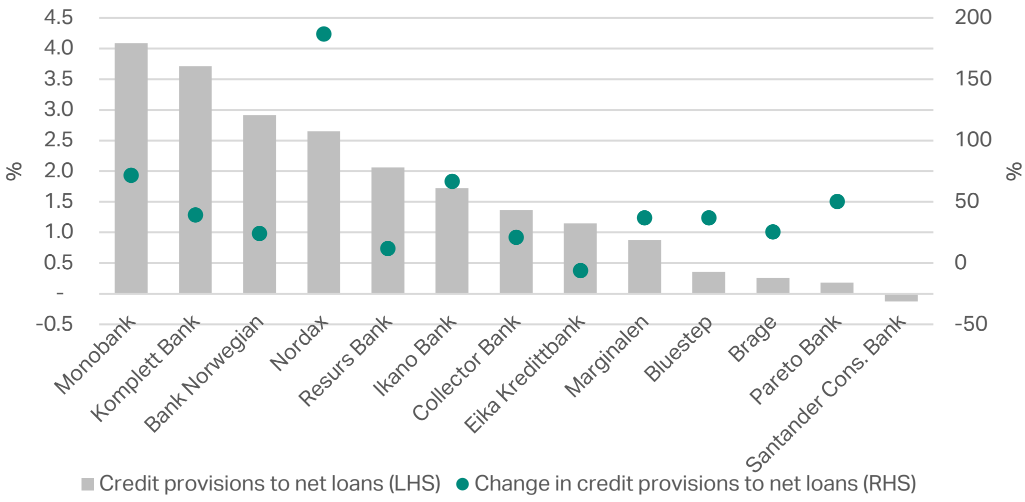
*Sweden as of end-Feb. 2019. Source: SCB, SSB

Lower consumer lending growth and the new debt registries are positive from a credit perspective. However, we are concerned by those advocating lower creditor protection for unsecured consumer loans. Those advocating lower protection are proposing the Danish system as an example. Debt collection in Denmark is costlier than in the Norwegian and Swedish systems due to a legal requirement that attorneys be involved at an early stage and a lack of a proper fast-track solution for collection of claims exceeding DKK 50,000. In Denmark, such claims have to go to court even if they are undisputed. Higher costs and longer and riskier processes reduce the value of Danish non-performing loans (NPLs) compared with both Norwegian and Swedish NPLs, making it less attractive for consumer banks to offload Danish NPLs to debt purchasers. However, we are not aware of any proposals to make it possible for Norwegian individuals to escape unpaid claims by declaring bankruptcy.

From 1 Sep. 2018, Sweden implemented a regulatory restriction on interest rates, preventing consumer lenders from charging more than 40pp above a reference rate. More importantly for the banks covered in this report, the total interest costs on a given loan cannot exceed the original loan amount. We believe that the main effect will be to reduce the value of NPLs when sold to debt purchasers. Sales of NPLs have become common in recent years because they carry higher prices than values after write-downs and due to efforts by lenders to reduce the level of NPLs on their balance sheets.

LOAN LOSSES ON THE RISE

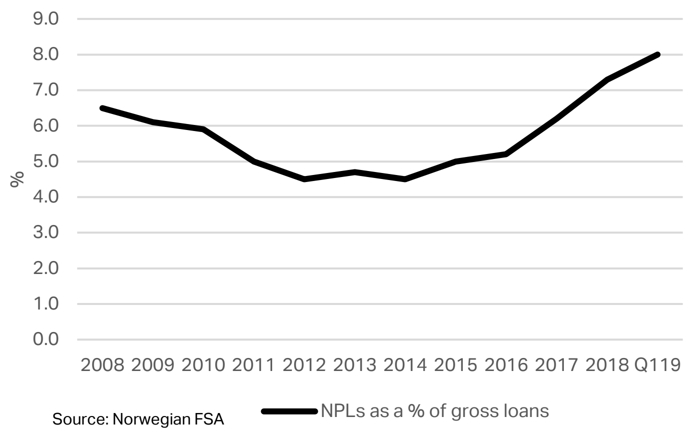
Figure 3. Nordic consumer bank loan losses and changes in loan losses (%), 2018



Based on NCR and company data

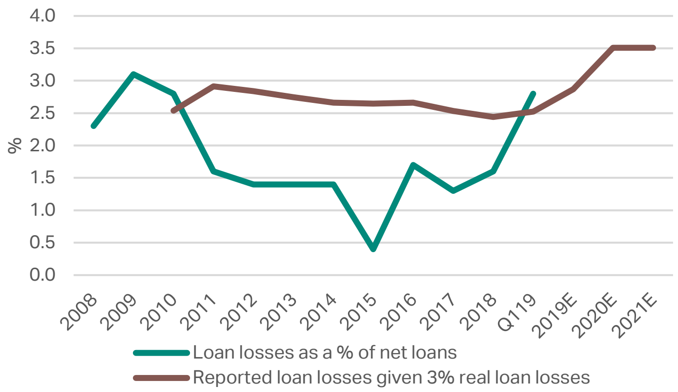
In the March report we mentioned some reasons for increasing credit losses in the Nordic consumer lending market. Data from the Norwegian Financial Supervisory Authority (FSA) shows that NPLs and loan losses continued to increase in the first quarter of 2019. There is a clear possibility that we will see a fall in the volume of unsecured consumer lending in Norway in 2019 and that this will in fact increase loan losses as a proportion of lending. In Figure 5 we illustrate what loan losses would have been if the real loan loss level was 3% of lending with an 18-month lag and given actual lending growth in Norway. We have for illustrative purposes assumed that consumer lending will fall by 10% annually from 2019 onwards.

Figure 4. Non-performing loans, Norwegian consumer lending



Source: Norwegian FSA

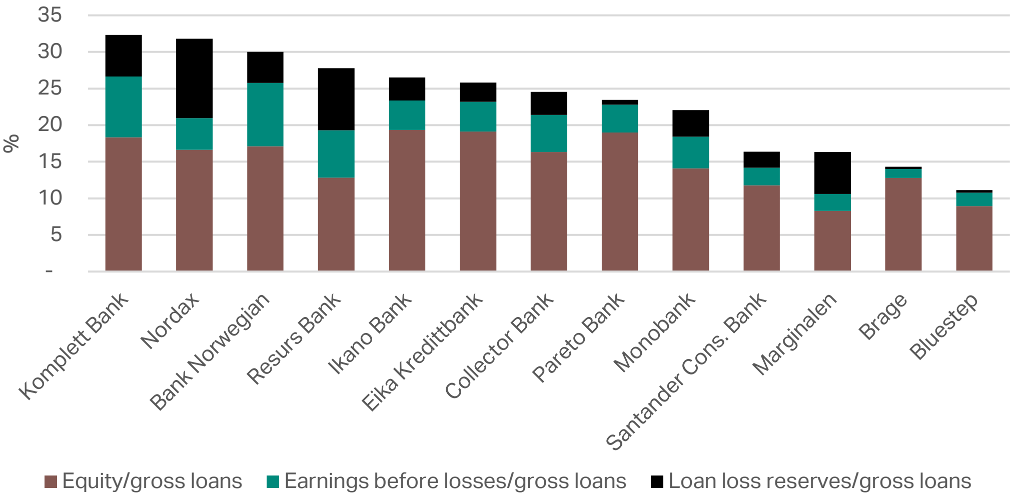
Figure 5. Loan losses and hypothetical loan losses, Norwegian consumer lending



Source: Norwegian FSA

SUBSTANTIAL CUSHION AGAINST LOAN LOSSES

Figure 6. Nordic consumer banks' equity, earnings before loan losses and loan loss reserves to gross loans, 2018



Based on company data and NCR research

In Figure 1 we saw that for niche banks focusing on unsecured loans, the equity to net loan ratio varies from 15% to 19% while including profit before loan losses, it varies from 19% to 28%. If we also include loan loss provisions in the calculations, the total cushion against loan losses for these banks is between 22% and 32% of gross loans (figure 6). Weaker margins could reduce the cushion somewhat, but we do not expect this to have a material impact on our risk assessment.

Under our financial institutions rating methodology, consumer lenders score highly on profitability and lower on loss performance. Norwegian niche banks also score well on capital because of higher capital requirements than in Sweden (see the March report).

NORDIC CREDIT RATING AS

OSLO
Biskop Gunnerus' gate 14A
0185 Oslo
Norway
www.nordiccreditrating.com
post@nordiccreditrating.com

STOCKHOLM
Engelbrektsgatan 9-11
114 32 Stockholm
Sweden