Nordic niche banks well-prepared for continued uncertainty in 2022

ANALYSTS
Sean Cotten
+46735600337
sean.cotten@nordiccreditrating.com

Geir Kristiansen
+4790784593
geir.kristiansen@nordiccreditrating.com

Nordic Credit Rating (NCR) believes that Nordic niche banks are entering 2022 with strong earnings and capital buffers. This offers adequate protection against continued margin pressure and impacts as it appears the ongoing pandemic and renewed social-distancing measures could affect yet another year of economic activity. The banks in our sample have demonstrated resilience thus far in the pandemic, in part due to variable marketing costs, strong capital generation, government support programmes for laid-off employees and strong savings rates improving banks' access to inexpensive deposit financing.

However, the banks, which seemed primed for growth opportunities as recently as October, are likely to be less optimistic about growth prospects as we enter 2022, given the resurgence of the pandemic. In addition, regulatory focus on the segment has increased, along with concerns about sustainable lending practices, which could result in regulatory changes or measures designed to protect consumers. Lower growth will add to existing pressure on lending margins, and we expect banks to continue to diversify away from traditional consumer loans and into credit cards, short-term buy-now-pay-later loans and non-traditional mortgages to support profits.

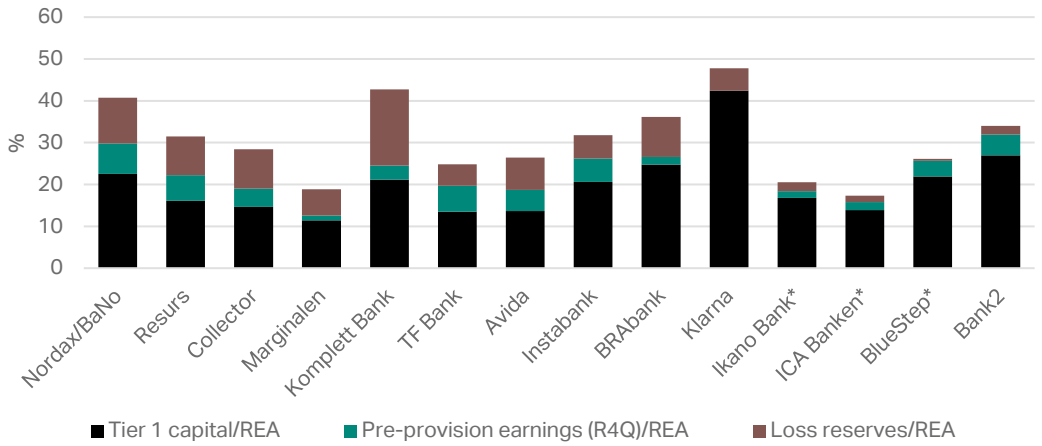
Even as the pandemic moves back into focus, we do not anticipate a rise in loan loss provisions, as occurred at the onset of the pandemic due to the extreme uncertainty then. However, we believe there is the potential for some consumer banks to re-evaluate their loss provisions during 2022 in response to lower pricing of non-performing large-ticket consumer loan portfolios. Sales of non-performing loan portfolios to external debt collection companies drove a reduction in Stage 3 non-performing loans in 2021, and additional sales could further affect pricing and banks' loss reserve levels in 2022.

The new year will also see the emergence of a new market leader, due to Nordax Bank's (Nordax) acquisition of Bank Norwegian. We see the potential for further consolidation in the Nordic niche bank sector, but it is unlikely to be on the same scale.

BANKS HAVE STRONG BUFFERS HEADING INTO 2022

The banks remain well capitalised and generally have strong pre-provision earnings buffers, given high margins and a strong degree of digitalisation. There is, however, relatively wide variation among the banks in the sample. Klarna has reported negative pre-provision earnings over the last four quarters, while during the same period half of the sample has reported pre-provision earnings of over 4% of their risk exposure amount, reflecting strong capital generation and significant loss buffers.

Figure 1. Nordic niche banks' loss-absorbing buffers as a share of risk exposure amount, Q3 2021



Source: bank reports. Nordax/BaNo is a combination of Nordax Group AB and Bank Norwegian ASA. Klarna Bank loss reserves as of Q2 2021. Komplett noted in its announcement that the pro-forma CET1 ratio will improve once sold non-performing portfolios are transferred from the bank's balance sheet in November. *As of Q2 2021.

While Klarna compensates for its lower earnings with higher capital ratios than peers, the Swedish regulator's October decision on Klarna makes it clear that regulation of these banks is likely to be tighter going forward. With its decision to increase the bank's Pillar 2 requirement, the Swedish regulator surprised Klarna by raising its total capital requirement to 18.83% as of 30 Sep. 2021 from 10.55% as of 30 Jun. 2021. Similarly, its leverage ratio requirement increased to 9% from 3% a quarter earlier. The increased capital requirement reflects the regulator's revised Pillar 2 requirement for Klarna, but was a surprise to the bank, which, despite having well over twice the regulatory requirement (total capital ratio of 42.7%), has formally complained about the decision to the regulator.

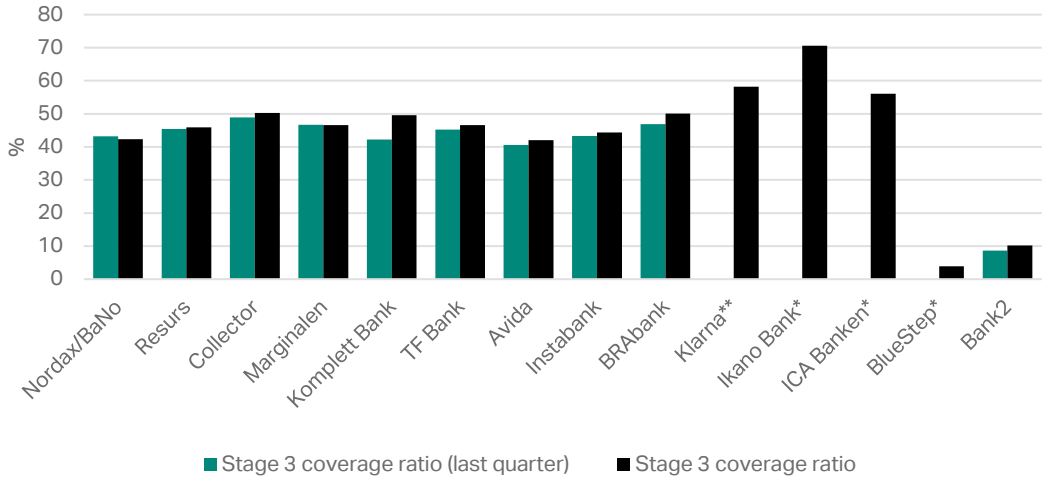
In our view, the regulator's Pillar 2 guidance for Klarna seems likely to be a precursor to decisions on other Swedish niche banks, with some banks publicly acknowledging the likelihood of increased capital requirements. The original guidance from the regulator when the Pillar 2 guidance was introduced was that most banks would be subject to a requirement of 1–1.5%. However, Swedish niche banks have lower risk-based capital and leverage requirements than their Norwegian peers and, in our view, the regulator's Pillar 2 guidance could be an attempt to close this gap between the two countries.

LOAN LOSSES EXPECTED TO BE STABLE, BUT RESERVES COULD NEED REVISIONS

In our view, Komplett's third quarter announcement of additional loan losses and other one-off losses following a review of its entire loan book could be a signal that other banks need to review their own reserves for Stage 3 non-performing loans. The bank noted that this was "partly due to lower than previously expected recoverability from larger ticket loans and an increase in average balances over time". The revision increased the bank's Stage 3 reserve ratio to 49.5% (from 42.2% in the previous quarter), moving from one of the lowest provisioning levels to one of the highest in the peer group. Given that the trigger for Komplett's revision was the sale of non-performing loans, we believe that other banks may need to adjust provisioning practices, which could lead to higher reserves on non-performing loans by peer banks, in particular for banks with larger consumer loans.

Non-traditional mortgage lenders BlueStep and Bank2 have much lower reserve rates, given collateral in residential mortgages. The mortgage lenders' inclusion in a sample of primarily consumer lenders highlights the differences in risk profile for non-traditional mortgages, which is a growth area for Nordax and Instabank.

Figure 2. Nordic niche banks' stage 3 reserve ratios, Q2 2021–Q3 2021

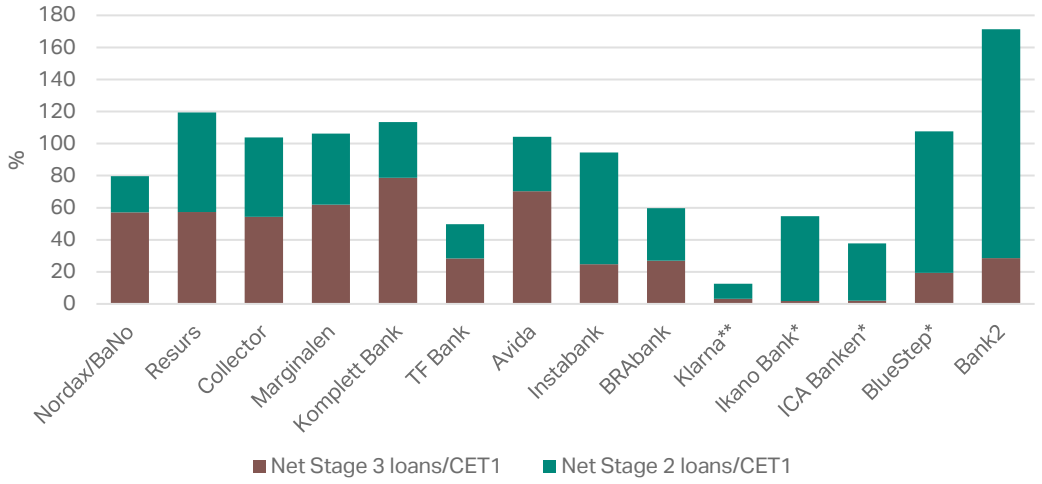


Source: bank reports. *As of Q2 2021. **As of Q4 2020, Klarna Bank does not report IFRS 9 loan stages in interim reports.

The risk of additional provisioning affecting capital buffers is not negligible. Komplett's adjustment reduced its common equity Tier 1 (CET1) ratio to 18.8% as of 30 Sep. 2021 from 22.3% a quarter earlier (the bank reported that the proforma CET1 ratio would be 20.1% when the sold non-performing loans left the balance sheet in November). Figure 3 shows that some banks have combined net Stage 2 (increased credit risk) and net Stage 3 loans (non-performing loans) in excess of CET1 capital, with most consumer banks having Stage 3 loans in excess of 50% of CET1. A relatively small 5–10% increase in reserves could therefore have a material impact on capital for some banks.

There are a number of notable exceptions among the lenders, given the different degrees to which they transfer non-performing loans from their balance sheets using forward flow contracts with third-party debt collectors. Klarna, Ikano Bank and ICA Banken maintained exceptionally low net non-performing loans as a share of CET1 capital in their most recent public reporting. In addition, TF Bank, Instabank and BRAbank also have considerably lower net Stage 3 loans as a share of CET1 than their consumer banking peers.

Figure 3. Nordic niche banks' net Stage 2 and Stage 3 loans to common equity Tier 1 capital, Q3 2021

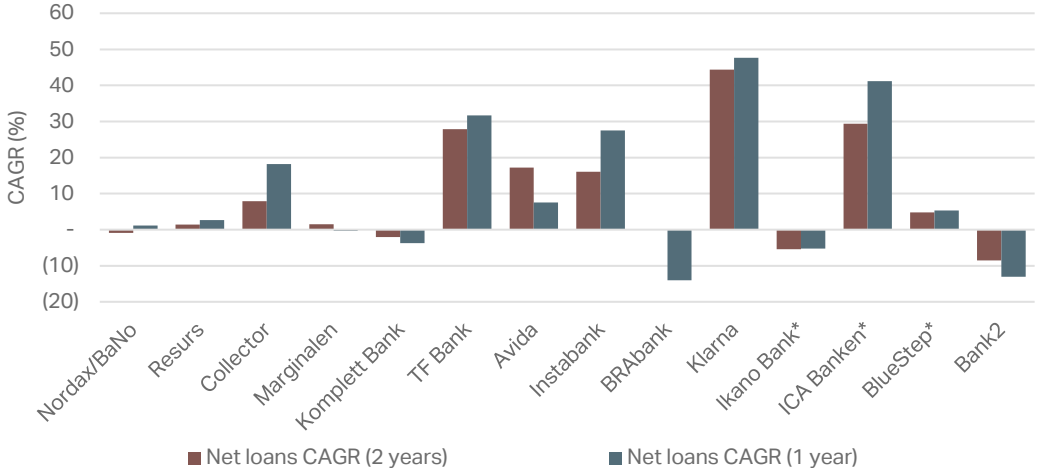


Source: bank reports. *As of Q2 2021. **As of Q4 2020, Klarna Bank does not report IFRS 9 loan stages in interim reports.

LENDING GROWTH PRIMARILY OUTSIDE NORDIC CONSUMER LOANS

Growth by consumer lenders over the last few quarters has been driven by products outside traditional consumer loans. Instabank, Nordax and Collector's growth was spurred by secured lending in non-traditional mortgages and commercial real estate. For TF Bank, recent growth has been driven by credit card volumes (29% in the third quarter) and international expansion. Klarna's growth is also a result of global expansion, with strong growth in its 20 countries, including the US, a number of European countries and New Zealand.

Figure 4. Nordic niche banks' compound annual growth rate in net loans, as of Q3 2021



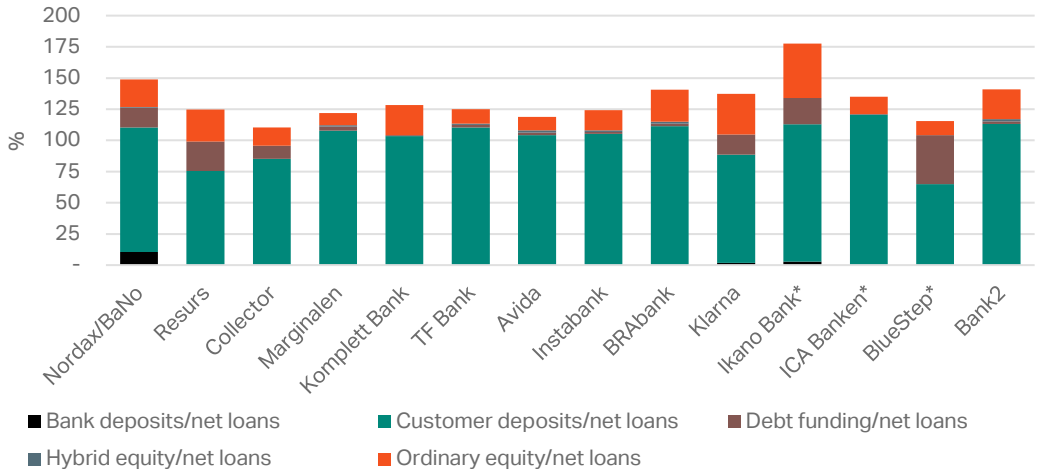
Source: bank reports. *As of Q2 2021. BRAbank is the result of a merger between BRAbank and Easybank, for which the first combined figures were available from Q4/20.

FUNDING DIVERSITY IS IMPROVING

Nordic consumer banks have broad access to consumer deposits, due to increased savings during the pandemic and very low rates on current accounts in traditional banks. This, together with greater access to German deposit funding, has allowed banks to reduce deposit rates, offsetting some of the margin pressure on lending. Due to the price sensitivity of the banks' deposit base, it is important that

they maintain liquidity buffers in the event of a large outflow of deposits and to maintain regulatory requirements on liquidity coverage ratios and net stable funding ratios. Within the peer group, Nordax, Bank Norwegian, Collector, Klarna, Ikano Bank and Resurs have demonstrated access to capital market financing in the form of senior unsecured bonds, as well as senior bonds secured by consumer and mortgage loan assets. BlueStep is primarily funded by covered bonds, secured by its mortgage loan assets.

Figure 5. Nordic niche banks' funding as a share of net lending, Q3 2021



Source: bank reports.

NCR-RATED CONSUMER BANKS

The following table summarises NCR's ratings on Nordic niche banks.

Figure 6. NCR ratings on Nordic niche banks

	Resurs Bank AB (publ)	Collector Bank AB (publ)	Nordax Bank AB (publ)
Long-term issuer rating	BBB	BBB-	BBB
Outlook	Stable	Stable	Stable
Subfactors:			
Operating environment (20%)	bbb-	bbb	bbb
Risk appetite (50%)	bbb	bbb-	bbb
Market position (15%)	bb+	bb	bb+
Performance indicators (15%)	bbb+	bbb+	bbb+
Ownership adjustment	n/a	n/a	n/a

See NCR's company rating reports for details. n/a–not applicable.

DISCLAIMER

NORDIC CREDIT RATING AS

nordiccreditrating.com