Nordic consumer banks report strong fourth-quarter 2021 results

ANALYSTS
Gustav Nilsson
+46735 42 04 46
gustav.nilsson@nordiccreditrating.com

Sean Cotten
+46735600337
sean.cotten@nordiccreditrating.com

Nordic consumer banks face intensive scrutiny in the year ahead from domestic and EU regulators alike. The Swedish Financial Supervisory Authority (FSA) has announced that it intends to investigate consumer lenders more extensively in the course of the year and some niche lenders have already received preliminary assessments that they are not compliant with the Swedish Consumer Credit Act on the basis of an investigation of credits dating back to 2019. In addition, the region's consumer banks face possible revisions in the EU's Consumer Credit Directive of 2008, which could increase underwriting requirements, dampen growth in small-ticket payment loans, and increase costs and processing times.

In our view, increased regulatory and media scrutiny could have a greater impact on consumer lenders relative to providers of non-traditional mortgages due to more comprehensive underwriting processes and lower interest rates.

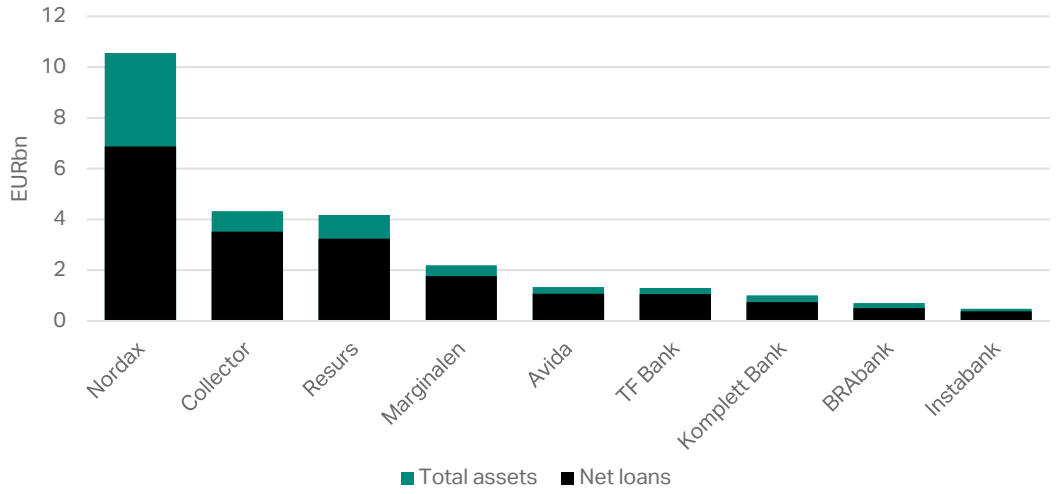
The intensification of regulatory oversight comes amid seismic changes in the competitive landscape. In November 2021, Sweden's Nordax Bank AB (publ) acquired Bank Norwegian to emerge as the clear leader of the Nordic consumer lending sector with a broad product offering and an extended geographic footprint.

The wider consumer banking sector remains in robust good health, with the key regional players reporting strong results and increased activity in the fourth quarter of 2021. Adjusting for one-off expenses in the final quarter, loan losses decreased and pre-provision earnings remained strong despite margin pressure in consumer lending, which we expect to continue. Alternative areas of lending such as non-traditional mortgages, credit cards, payment loans, SME lending and factoring, and commercial real estate loans continued to drive growth in the final quarter. We continue to expect banks with greater product and geographic diversity to be less impacted by the ongoing regulatory initiatives in the sector, which could, in our opinion, constrain growth opportunities and push niche lenders further into non-traditional segments in search of profitability.

NORDAX EMERGES AS REGIONAL MARKET HEAVYWEIGHT

Nordax completed its acquisition of Bank Norwegian on 3 Nov. 2021, effectively forming the largest consumer bank in the Nordic region. The merged loan book stood at SEK 70.7bn as of end-2021, more than twice the size of that of Resurs Bank AB (publ), its next largest regional peer with a primary focus on Nordic consumer lending. The acquisition expanded the combined loan book by SEK 34.6bn, of which 71% was consumer loans and 29% credit card debt. In addition, the transaction expanded Nordax's footprint outside the Nordic region with the acquisition of Bank Norwegian's consumer loans and credit card debt located in Germany and Spain. As of end-2021, consumer loans and credit cards constituted 82% of the total combined loan book, and equity-release and non-traditional mortgages the remainder.

Figure 1. Nordic consumer banks' total assets and net loans, end-2021

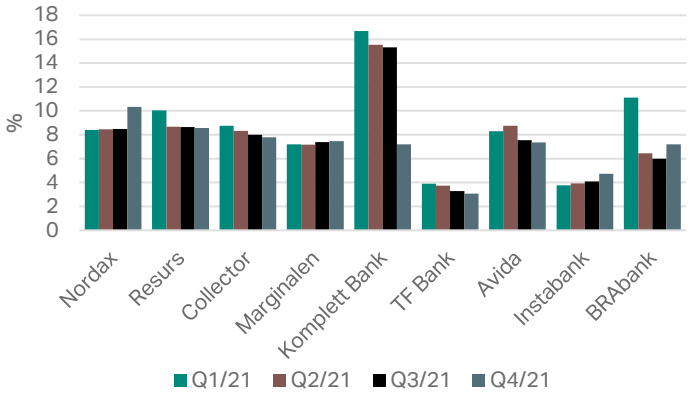


Source: bank reports.

LOAN LOSS PROVISIONS STABLE, BUT COULD REQUIRE REVISION

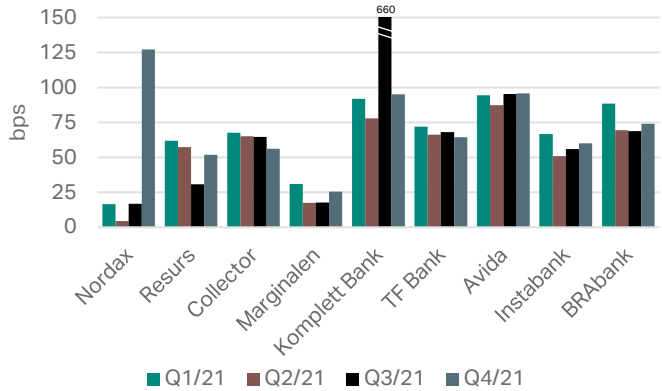
Asset quality in the sector continues to improve as loan loss provisions shrink, while portfolio sales and loan growth are driving lower levels of non-performing loans (NPLs). Overall, net Stage 3 NPLs decreased in the fourth quarter of 2021. Notably, a previously announced sale of NPLs by Norway's Komplett Bank resulted in an 8pp decrease in its ratio of net Stage 3 loans to net loans in the final quarter. In conjunction with the sale, the bank established forward flow agreements in Sweden and Finland in November to reduce revaluation risk in its balance sheet (see Nordic consumer banks perform well in eventful third quarter, published 25 Nov. 2021). Sweden's Collector Bank AB (publ) also reduced its NPL ratio, mainly by expanding its corporate lending, while Nordax increased its NPL ratio and recorded large one-off loan losses associated with stage 1 and 2 provision effects as a result of the Bank Norwegian acquisition.

Figure 2. Nordic consumer banks' net Stage 3 NPLs to net loans, Q1 2021–Q4 2021



Source: bank reports.

Figure 3. Nordic consumer banks' loan loss provisions to net loans, Q1 2021–Q4 2021



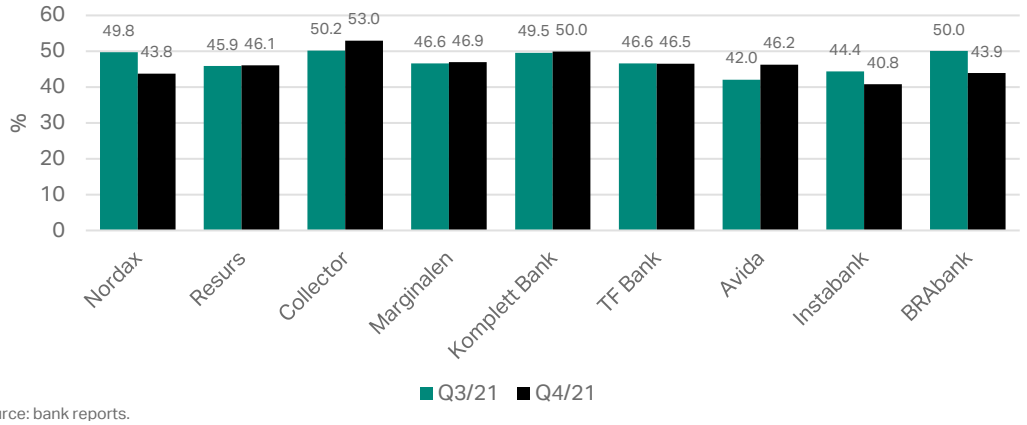
Source: bank reports.

Stage 3 coverage ratios shrank in the fourth quarter, with an average decrease of 87bps relative to the previous quarter but with large variations within the sample. Collector Bank and Sweden's Avida Finans AB recorded increases in their Stage 3 coverage ratios of 2.8pp and 4.2pp respectively because of more prudent provisioning in the fourth quarter. In contrast, Nordax, Norway-based Instabank and BRAbank decreased their Stage 3 coverage ratios by 6.0pp, 3.6pp and 6.1pp, respectively. We note that the fall in Nordax's coverage was attributable to its acquisition of Bank Norwegian, which reported a standalone Stage 3 coverage ratio of 38% at end-2021. We also note that Instabank has no forward flow agreements in place but prefers one-off NPL portfolio sales.

We expect the debt collection market to be negatively affected later this year with a consequent rise in provision levels as a result of new EU NPL backstop rules on Stage 3 loans granted or extended after

April 2019 and which remain on the balance sheet. The backstop incentivises banks to increase their use of forward flow agreements and retain fewer Stage 3 loans on their balance sheets. In our view, the backstop regulations could negatively impact secondary pricing of NPLs which in turn could lead to increased loan losses as banks increase their NPL coverage ratios accordingly.

Figure 4. Nordic consumer banks' Stage 3 coverage ratios, Q3 2021–Q4 2021

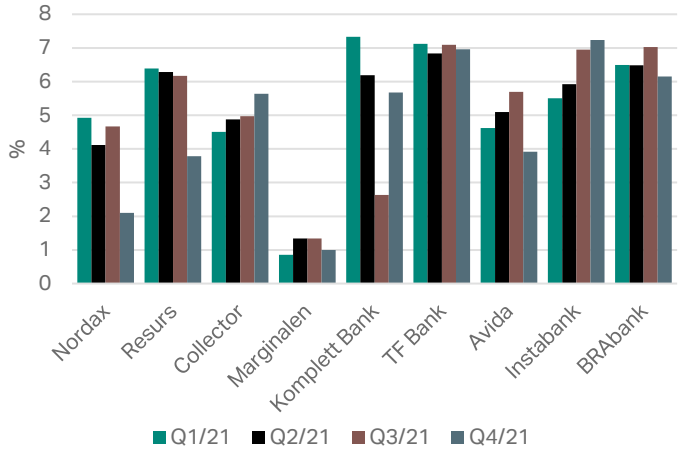


Source: bank reports.

INTEREST MARGINS IMPROVE IN NON-TRADITIONAL LENDING

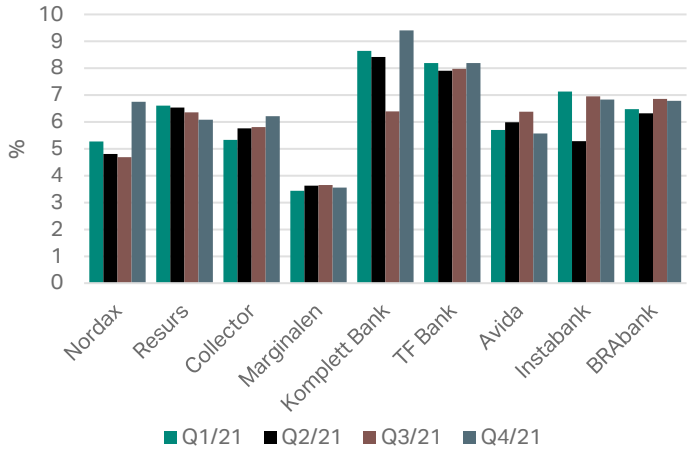
Net interest margins among our sample banks are mixed. Collector Bank's net interest margins continued to improve in the fourth quarter of 2021, particularly in the bank's corporate and real estate divisions, which accounted for 59% of its net lending at end-2021 compared with 54% a year earlier. Conversely, Resurs Bank's net interest margin fell to 6.1% in the fourth quarter from 6.4% in the third. The decline was largely a result of falling volumes in Norway, higher-ticket loans in consumer lending, and mix effects in the bank's Payment Solutions division. In addition, increased business volumes from low-margin retailers negatively impacted Resurs Bank's pre-provision income in the final quarter. Sweden-based TF Bank's interest margins increased in the fourth quarter of 2021 due to higher interest income generated from its German credit card business and lower funding costs for German and Norwegian deposits. A one-off revision of Komplett Bank's loan book resulted in a sharp decline in net interest margins in the third quarter of 2021, but they returned to more normal levels in the fourth. Nordax's net interest margins improved in the fourth quarter as Bank Norwegian's higher margin lending was consolidated into the accounts. The bank's pre-provision earnings temporarily dipped due to one-off acquisition expenses. Despite margin compression and some one-off impacts affecting comparability between quarters, risk-adjusted earnings remain high across the sector.

Figure 5. Nordic consumer banks' annualised pre-provision income to average risk exposure amount (REA), Q1 2021–Q4 2021



Source: bank reports.

Figure 6. Nordic consumer banks' annualised net interest margins, Q1 2021–Q4 2021



Source: bank reports.

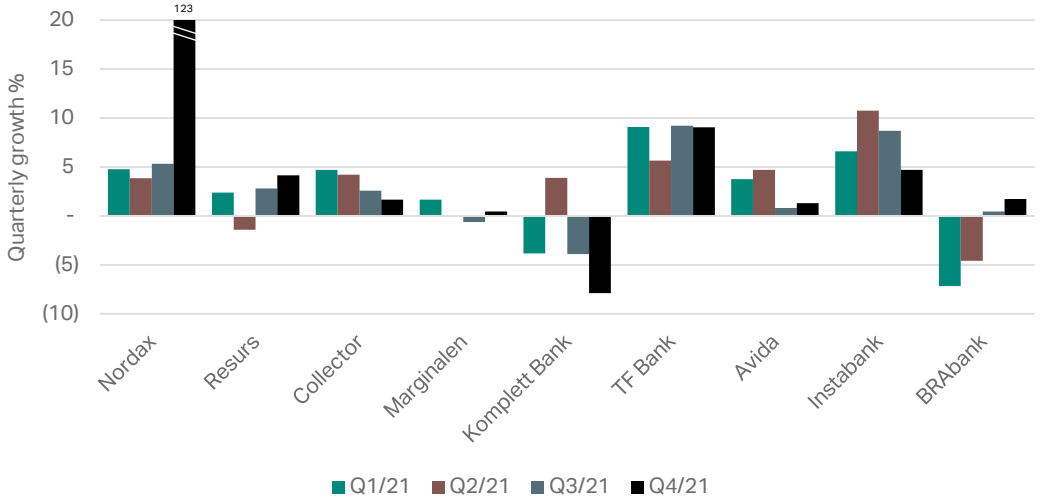
Last year, the Swedish National Debt Office set the final fee for the country's deposit insurance scheme at a higher level than previously estimated. Interest expenses for 2021 were retroactively charged in

the fourth quarter, which reduced the net interest margins of a number of small domestic banks, including some of those in our sample. Following a period of benign financing conditions, we expect the banks in our sample to face increased borrowing costs if interest rates rise, as we think likely. This could further compress net interest margins given the currently competitive conditions in the sector.

REGULATORY PRESSURE COULD NEGATIVELY AFFECT GROWTH AND MARGINS

Consumer lending growth slowed in the fourth quarter of 2021 following a temporary recourse to COVID-19-related restrictions in Sweden and Norway in December. Excluding Nordax, average net loans in the sector grew by 1.9% in the quarter compared with 2.5% in the previous quarter. TF Bank outstripped its peer group with quarterly growth of 9%, while Nordax grew organically by 7% in the quarter on a pro-forma basis (including Bank Norwegian) following strong demand in its consumer lending division. Instabank's lending growth slowed to 4.7% in the fourth quarter due to reduced mortgage lending over the Christmas period. Komplett Bank's sale of NPLs in the third quarter reduced its net lending by 7.9% in the fourth quarter as the loans sold were transferred from the loan book in November.

Figure 7. Nordic consumer banks' net loan growth, Q1 2021–Q4 2021



Source: bank reports.

The Swedish FSA announced on 7 Dec. 2021 that it intends to investigate consumer banks' lending practices more closely given that about one in five borrowers fall subject to collection claims. In February 2022, NCR-rated Resurs Bank and Collector Bank received written notice that preliminary findings indicated that their credit assessment procedures failed to comply with the Consumer Credit Act on the basis of a 2020 investigation into consumer loans granted in 2019. In particular, the regulator criticised the banks' assessment of borrowers' disposable income, saying that spending patterns should be specific to the individual borrower rather than based on national averages. Neither bank agrees with the regulator's assessment and both plan to appeal. Sweden-based Marginalen Bank and payment solutions provider Svea Ekonomi AB are reportedly under review by the FSA, while Wasa Kredit AB, which offers unsecured consumer loans and secured leasing solutions, has said it has received a written notice similar to those received by Resurs Bank and Collector Bank. Nordax-owned Bank Norwegian said in a standalone fourth quarter report that it had implemented all relevant changes to comply with the updated consumer credit guidelines from the FSA.

We see the actions of the Swedish FSA as part of a broad regulatory effort to check the growth of consumer lending across the Nordic region. We believe that increased regulatory review of consumer credit will continue to drive the banks in the sector towards products which attract less scrutiny such as credit cards and non-traditional mortgage loans, or to seek less competitive consumer banking markets. We note that Denmark has gone a step further than Sweden in its revised interpretation of the EU Consumer Credit Directive. The Danish approach appears to incorporate parts of a more recent EU proposal, made in June 2021, to address increased use of automated decision-making systems in approving loans and to protect borrowers from excessive margins on small loans under EUR 200. We note that the revised Danish interpretation has already resulted in some lenders reducing or ceasing

new small domestic loans as they adjust their internal systems, while Copenhagen-based Basisbank A/S has surrendered its banking licence and sold its consumer loans to Ikano Bank of Sweden.

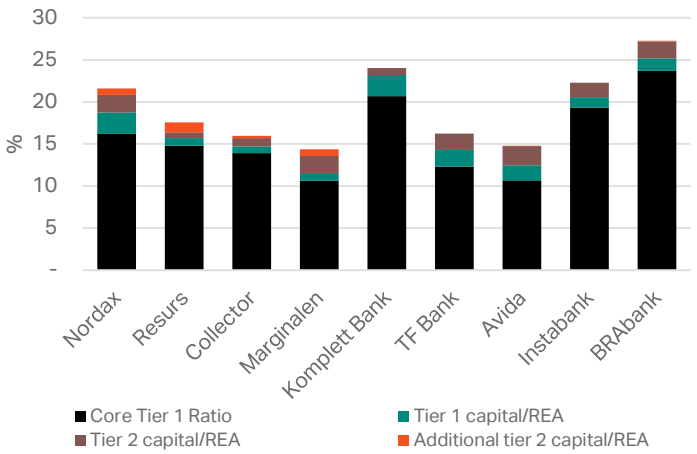
NICHE BANKS REMAIN WELL CAPITALISED AFTER REMOVAL OF DIVIDEND RESTRICTIONS

Nordic niche banks' average Core Tier 1 (CET1) ratio increased to 15.8% during the fourth quarter of 2021, a 17bps increase from the previous quarter. The increase was largely driven by a 1.9pp fourth-quarter increase in Komplett Bank's capital ratio, which resulted from a rebuilding of capital buffers after the NPL portfolio sale, with no dividend proposal for 2021. Excluding Komplett Bank, the average CET1 ratio decreased by 5bps in the quarter as a result of the removal of dividend restrictions. Nordic niche banks remain well capitalised and have strong loss-absorbing buffers, representing an average 30.3% of their risk exposure. Loss-absorbing buffers as a proportion of total risk-weighted assets consist of Tier 1 capital ratios, rolling four-quarter pre-provision earnings and loss reserves, which averaged, 17.4%, 4.6% and 8.2%, respectively at end-2021.

Nordax reported stronger-than-expected capital ratios following the acquisition of Bank Norwegian, with its CET1 ratio at 16.2% at end-2021, compared with our previous estimate of 15.7%. The bank also issued Tier 1 and Tier 2 instruments to fund the acquisition in part which strengthened its capital position relative to its peer group.

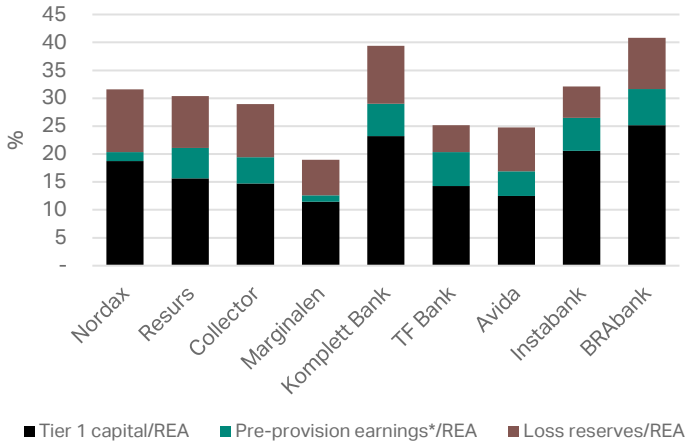
Collector Bank's parent, Collector AB, announced in its fourth-quarter report that its board intends to merge the two entities, a transaction that would increase Collector Bank's regulatory Tier 1 and total capital ratios by about 0.5pp and 0.7pp, respectively, on a pro-forma basis (based on fourth-quarter 2021 data). We expect the merger to be finalised in the second half of 2022.

Figure 8. Nordic consumer banks' capital ratios, end-2021



Source: bank reports.

Figure 9. Nordic consumer banks' loss-absorbing buffers as a proportion of REA, end-2021



Source: bank reports. *Rolling four quarterly basis.

NCR-RATED CONSUMER BANKS

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

Figure 10. NCR ratings on Nordic consumer banks

	Resurs Bank	Collector Bank	Nordax
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	0	0	0

See NCR's company rating reports for details.

DISCLAIMER

NORDIC CREDIT RATING AS

nordiccreditrating.com