

Nordic consumer banks improve margins to offset higher loss provisions

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The third quarter of 2022 saw an improvement in Nordic consumer banks' margins as interest rates rose, despite continued widening of their credit spreads. Banks have actively increased their deposit rates in all currencies to reflect not only higher market rates, but also to ensure they remain attractive to customers to protect liquidity buffers. Despite high inflation and increasing consumer pessimism, average loan loss provisions rose only modestly from the second quarter and non-performing loan (NPL) metrics continued to fall. Average loans grew by over 5%, pushing capital ratios down somewhat from the previous quarter.

Nordic Credit Rating (NCR) expects inflation and interest rates to have a greater impact on consumer banks and their customers in the fourth quarter of 2022 and the first half of 2023 before stabilising. Banks have been raising interest rates on customer loans, and individuals with already weak financial profiles are also affected by inflationary pressures. Homeowners face material increases in interest costs, and housing prices are coming down from record highs, affecting customer sentiment. We believe these factors could impact consumption patterns and demand for consumer loans through to the end of 2023.

Sweden-based banks in our sample – Nordax, Collector, Resurs, Marginalen, TF Bank and Avida – are awaiting feedback from the Swedish regulator about the Pillar 2 guidance (P2G) capital requirements. Thus far, Klarna Bank and Ikano Bank have been assigned P2G of 7.5% and 5.5%, respectively. NCR's understanding is that the Swedish regulator's evaluation of P2G takes account of banks' capital situation in stress scenarios after considering the capital conservation buffer of 2.5% and operational earnings. Given the relatively low earnings of Klarna and Ikano, it is unclear whether these high P2G levels will be in line with the outcomes for the other banks in our sample. However, we continue to expect P2G to be higher than the sector-wide 1–1.5% level indicated by the regulator. In addition, where capital ratios need to be increased, we expect the P2G to be implemented on a bank-specific timeline agreed with the regulator, rather than being applied as an immediate capital requirement.

In November, Nordax and Bank Norwegian have received all necessary approvals for their intra-group merger and are expected to merge on 30 Nov. 2022. The merger is expected to have a material impact on Nordax's capital requirements, with the removal of the Norwegian systemic risk buffer requirements for Bank Norwegian.

Figure 1. Nordic consumer banks' net loans by product, Q3 2022

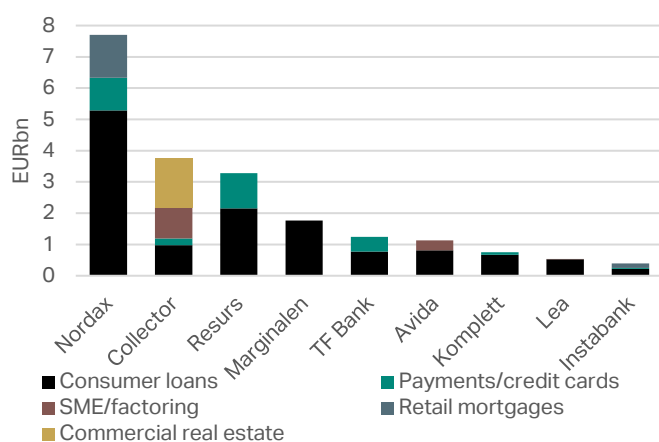
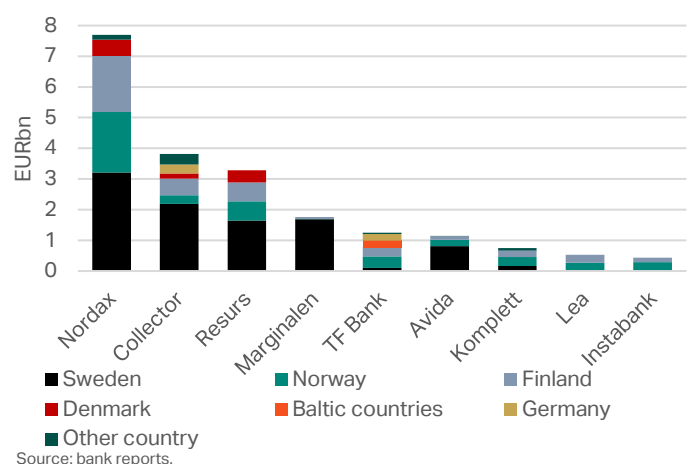


Figure 2. Nordic consumer banks' net loans by country, Q3 2022



Source: bank reports.

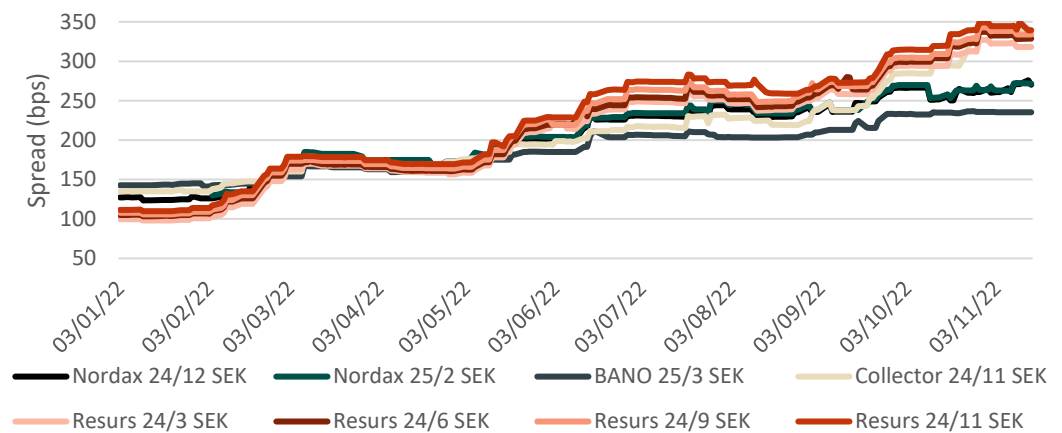
Source: bank reports.

BOND SPREADS AND COMPETITION DRIVE UP DEPOSIT RATES

Future economic uncertainty and the likelihood of recession in 2023 rose in the third quarter and contributed to further increases in bond spreads for those banks in our sample with outstanding bonds, i.e. Resurs Bank, Collector Bank and Nordax Bank, including Bank Norwegian (BANO). As risk premiums and market rates for capital market financing continue to increase, funding from customer deposits has become even more important and more competitive.

Market spreads increased for all issuers towards the end of the third quarter and have continued to rise through late November. As shown below, spreads on senior unsecured bonds issues by Nordax and its subsidiary Bank Norwegian have shown more resilience since the end of the third quarter than those of Resurs and Collector. We believe the difference most likely reflects Nordax's greater scale and diversification than those of Resurs and Collector.

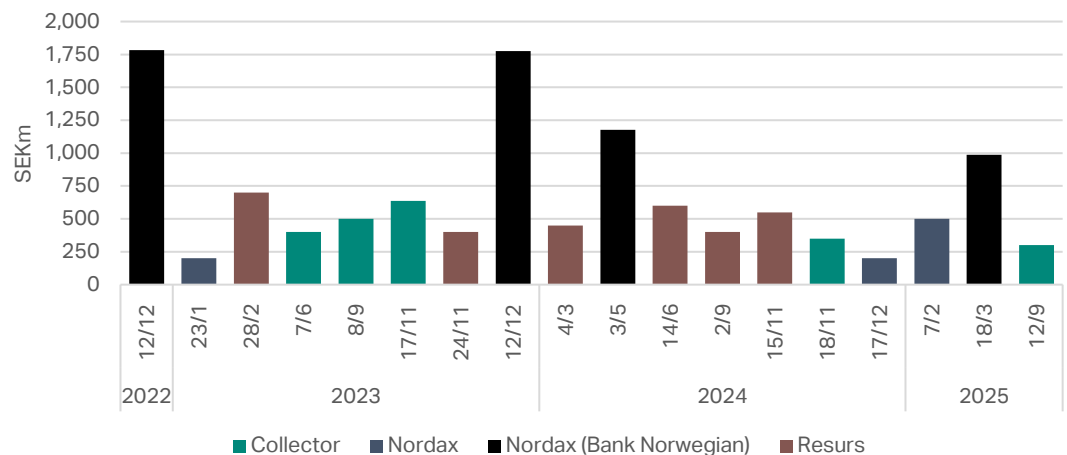
Figure 3. Bond spreads for SEK-denominated instruments maturing in 2024 and 2025, Jan. 2022–22 Nov. 2022



Source: Capital IQ

Since our last sector report, Bank Norwegian had a NOK 800m bond maturity in September 2022 and Nordax had a SEK 300m bond maturity on 23 Sep. Neither was refinanced in the capital markets, and, instead, the bank increased deposit financing by nearly SEK 1.5bn during the third quarter. Nordax, via Bank Norwegian, has an additional NOK 1.8bn bond maturing on 12 Dec. and an additional SEK 200m bond maturing in Jan. 2023, which put additional strain on the bank's liquidity situation. However, the bank remains quite liquid, with over SEK 14.6bn in liquid assets as of 30 Sep. 2022. Resurs has an SEK 700m maturity in Feb. 2023, compared with liquid assets of SEK 2.6bn.

Figure 4. Senior unsecured bonds by maturity date, SEKm



LOAN LOSS PROVISIONS INCREASE, NPL SALES CONTINUE

Concerns about inflation continue, and, following an improvement in the second quarter, asset quality dipped in the third quarter as loan loss provisions increased for some banks. Marginalen, Komplet and Lea Bank reported materially higher loss rates, and the sample average increased to 65bps from 59bps of net loans in the third quarter. Credit loss levels were affected by the continued sell-off of NPLs and higher sale prices than book value for some NPL portfolios.

The positive trend in net NPL metrics continued, driven by further portfolio sales and continued loan growth. In our sample, net stage 3 NPLs decreased by 30bps in the third quarter to 6.1%, continuing the steady decline throughout the year. Komplet Bank continued to reduce its NPL ratio and has now cut it to 3.0%, just short of TF Bank's 2.9%, the lowest in the sample. Nordax also continued its positive trend, reducing its NPL ratio to 7.3%. In addition, Instabank, which had an increasing NPL ratio in the first and second quarters, reduced its NPL ratio to 4.3% in the third quarter. Despite Collector's increase during the second quarter due to a concern over exposures in its commercial real-estate portfolio, its NPL ratio remained stable in the third quarter.

Figure 5. Nordic consumer banks' net stage 3 NPLs to net loans, Q4 2021–Q3 2022

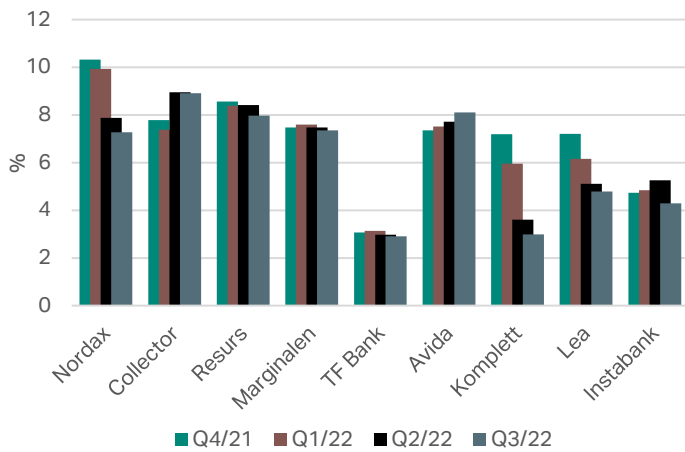
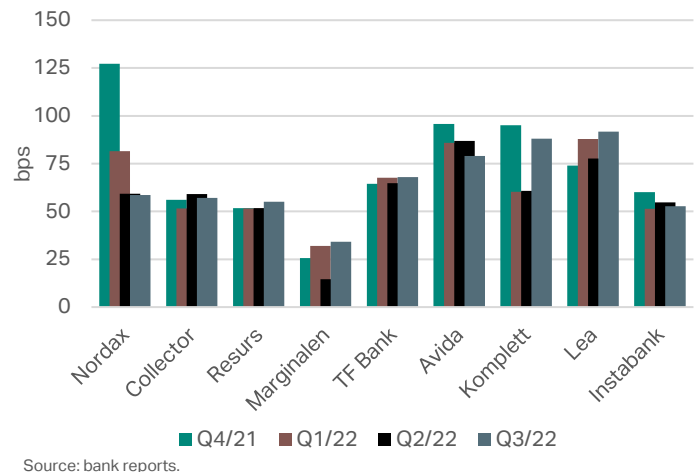


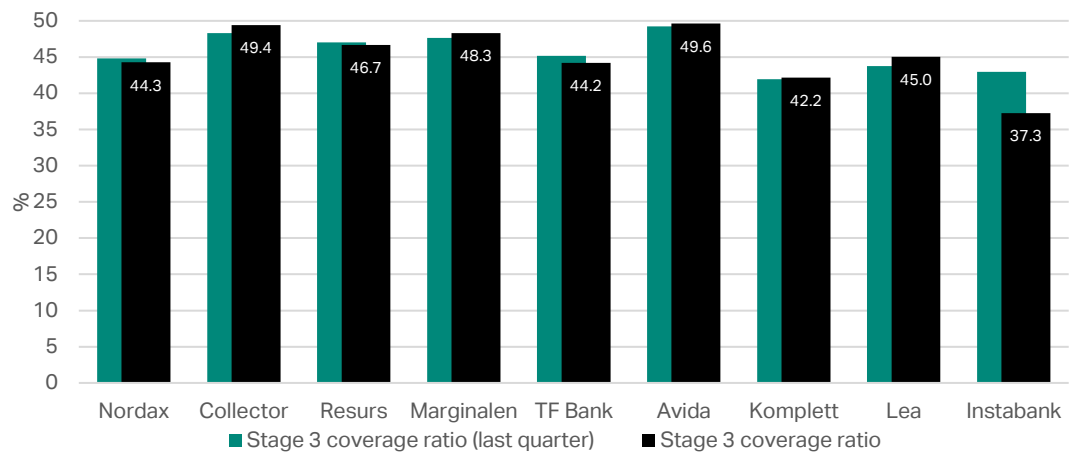
Figure 6. Nordic consumer banks' loan loss provisions to net loans, Q4 2021–Q3 2022



NOTE: For all charts in the report, Nordax's Q3 2021 figures are based on a combination of Nordax Group and Bank Norwegian ASA's separately reported figures. Nordax's Q4 2021 figures exclude one-off acquisition expenses of SEK 563m.

On average, stage 3 coverage ratios decreased by an average of 44bps in the third quarter to 45.2% for the sample. Instabank showed the most material change in the stage 3 coverage ratio, decreasing from 42.9% to 37.3%. In the third quarter, the bank sold two NPL portfolios in Norway and Finland, representing a net value of NOK 66 million.

Figure 7. Nordic consumer banks' stage 3 coverage ratios, Q2 2022–Q3 2022



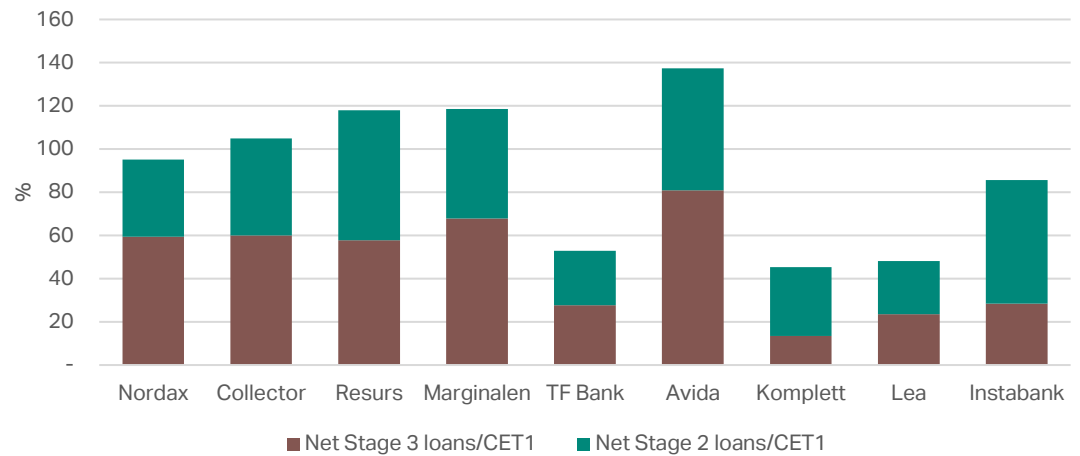
Source: bank reports.

VARYING NPL LEVELS AS THE NPL BACKSTOP TAKES EFFECT

We see the potential for banks to increase reserve rates and coverage ratios as markets tighten. Many of the larger debt-purchasing companies are considered high-yield in the capital markets (rated 'BB+' or below by other credit rating agencies), and could face considerable difficulties refinancing bond maturities or financing future growth in the current market climate. This is important, as the EU's NPL backstop regulation will affect the banks' reported capital for the first time at the end of 2022.

On average, the net stage 3 loans in relation to common equity Tier 1 (CET1) declined to 46.6% from 48.3% in our sample in the third quarter. However, there are still significant differences among the peer group. TF bank, Komplett Bank, Lea and Instabank (which transfer a significant portion of NPLs to third-party collectors) average only 23% by this measure, while the other 5 banks in our sample average 66%. Avida Finans has the highest level at 80.9%, compared with Komplett Bank's low of 13.4%. Banks with a lower share of NPLs to CET1 have a lower risk of revaluation as the NPL backstop regulation takes effect. We expect some banks to maintain NPLs that pre-date the backstop regulation and to maintain the customer relationship rather than transfer a significantly higher share of NPLs to third-party collectors.

Figure 8. Net stage 2 and stage 3 loans as a percentage of CET1, Q3 2022

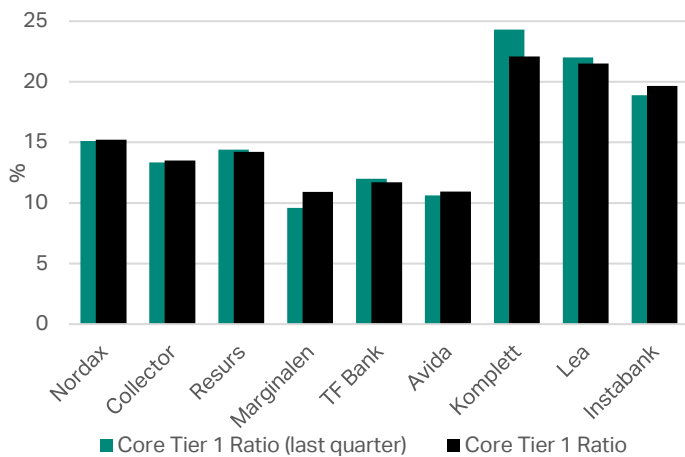


Source: bank reports.

LOAN GROWTH DRIVES LOWER CAPITAL RATIOS FOR MOST BANKS

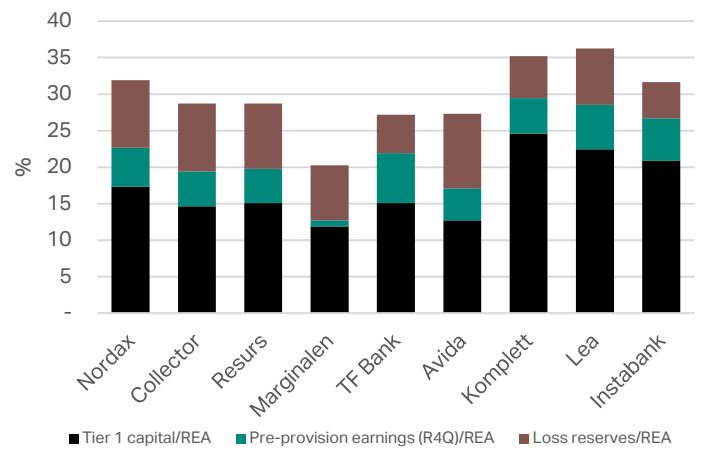
Capital buffers fell by 6bps to 15.5% at the end of the third quarter of 2022. Following an increase in the second quarter, Komplett Bank's CET1 ratio declined by 2.2pp to a sample high of 22.1%. Both Marginalen and Instabank increased their CET1 ratios by 1.3pp and 0.8pp to 10.9% and 19.7%, respectively. The rest of the sample remained somewhat stable from the second to third quarter of 2022. The banks' loss-absorbing buffers represent an average 29.7% of their risk exposure, up 50bps from the second quarter. Loss-absorbing buffers as a proportion of the total risk exposure amount (REA) consist of Tier 1 capital ratios, rolling four-quarter pre-provision earnings and loss reserves, which averaged 17.2%, 4.9% and 7.7%, respectively.

Figure 9. Nordic consumer banks' CET1 ratios, Q3 2022



Source: bank reports.

Figure 10. Nordic consumer banks' loss-absorbing buffers as a proportion of REA, Q3 2022



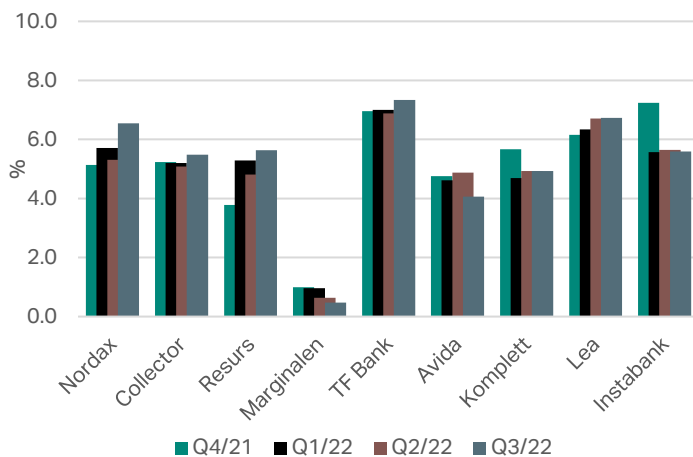
Source: bank reports. REA=risk exposure amount. See above for Nordax adjustments..

SHORT-TERM MARGIN PRESSURE FROM HIGHER INTEREST RATES

During the autumn, consumer banks have raised interest rates on customer deposits, and we expect that this increase in funding costs will eventually be offset by increases in rates charged to customers. However, given the rate of increases in funding costs, there has been a short-term impact on margins as banks carefully raise interest rates to avoid a sudden increase in missed loan payments and to support loan growth as demand weakens.

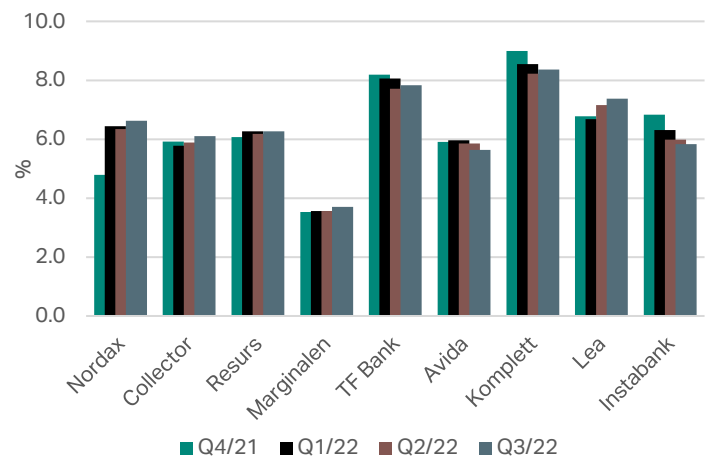
Despite this, the average net interest margin increased slightly, to 6.4% from 6.3% in the previous quarter. We expect banks to show further margin gains over the next few quarters as lending rates on new and existing loans increase faster than funding costs. This will improve the banks' risk-adjusted earnings (pre-provision income to REA) as revenue growth exceeds costs. After falling steadily for many quarters, risk-adjusted earnings increased to 5.2%, compared with 5.0% in the previous two quarters. Historically, banks have benefitted from rising interest rates, and we still expect the banks to increase lending rates further in line with market rates.

Figure 11. Nordic consumer banks' annualised pre-provision income to average REA, Q4 2021–Q3 2022



Source: bank reports. REA=Risk exposure amount. See above for Nordax adjustments.

Figure 12. Nordic consumer banks' annualised net interest margins, Q4 2021–Q3 2022



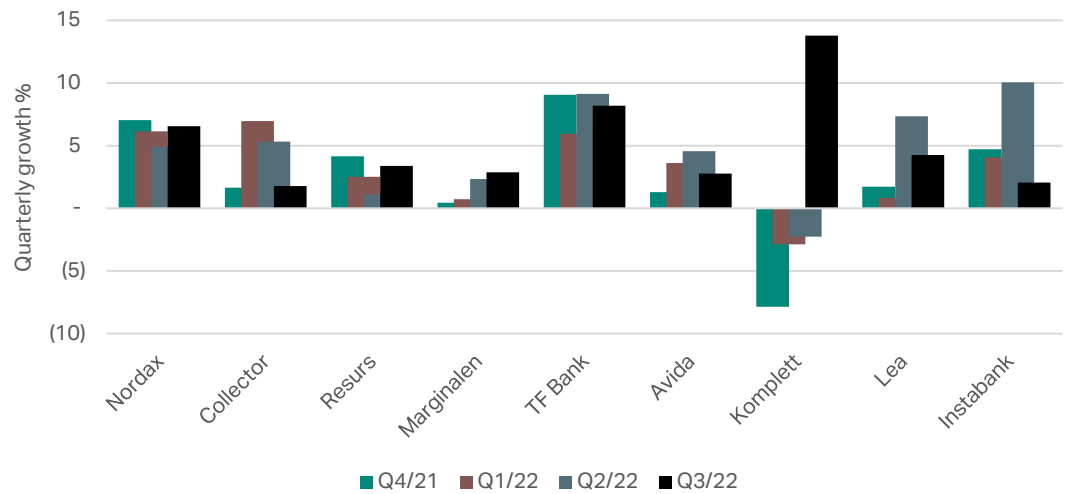
Source: bank reports. See above for Nordax adjustments.

LOAN VOLUMES GREW IN ALL SEGMENTS

Average net loan growth increased to 5.1% for the quarter, though only three of the nine banks were above the average. Komplett Bank previously had negative net loan growth for four consecutive quarters, due to its sale of NPLs. However, Komplett Bank turned the trend around in the third quarter thanks to improved processes and increased automation, and had net loan growth of 13.8% in the third

quarter of 2022. We expect overall lending growth to slow in the coming quarters as banks tighten underwriting and borrowers reconsider their consumption patterns.

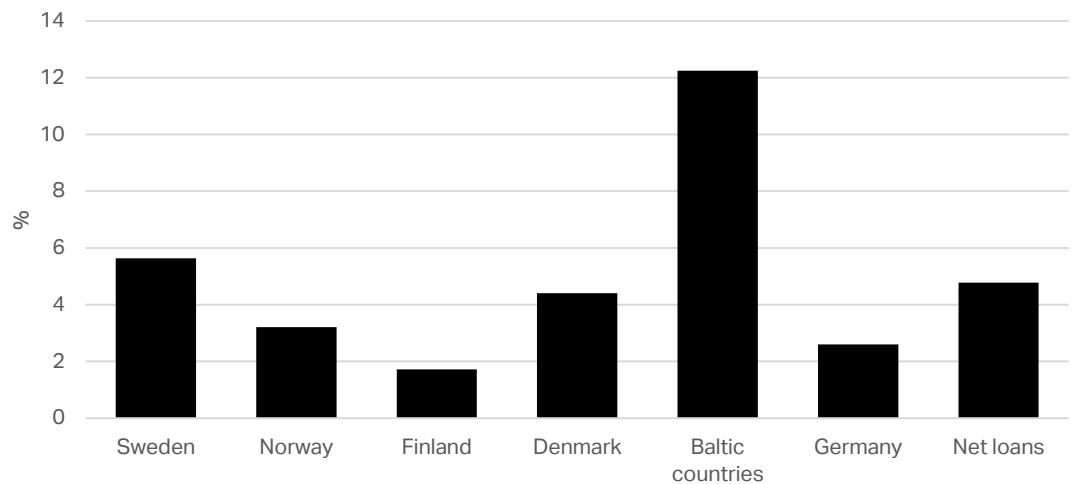
Figure 13. Nordic consumer banks' net loan growth, Q4 2021–Q3 2022



Source: bank reports.

Among our sample banks, Swedish exposures grew by 5.6% in the third quarter, while Norwegian exposures grew by 1.7% after a 1.5% decline in the second quarter. In addition, overall growth in euro-based exposures was supported by a continued appreciation of the euro during the third quarter, given that the banks report in either NOK or SEK.

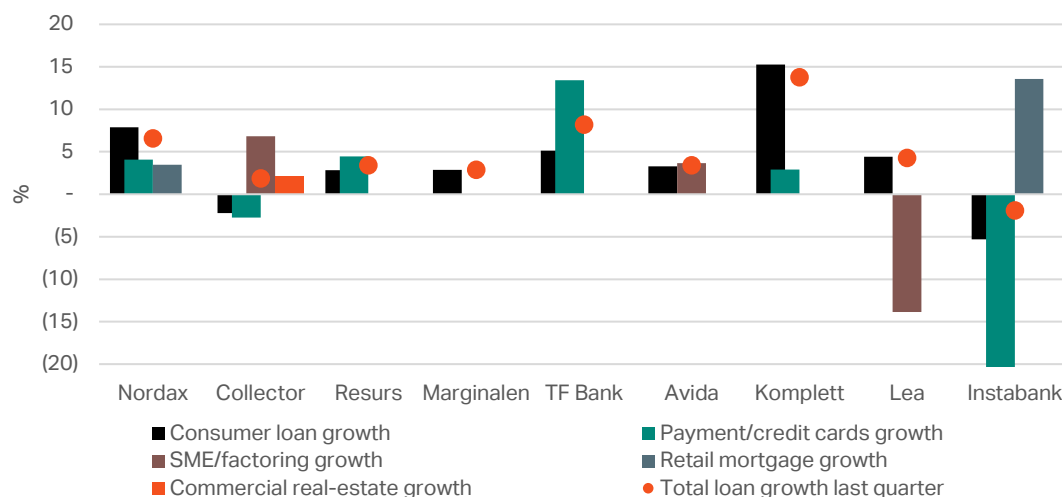
Figure 14. Nordic consumer banks' net loan growth by country, Q3 2022



Source: bank reports. Nordax reports Germany and Spain combined, so Germany reflects growth in Collector and TF Bank.

The source of growth within the sample varied by segment. On aggregate, consumer loans grew by 5.1%, payment and credit cards increased by 4.5%, and retail mortgages increased by 4.4%. At individual bank level, Nordax generated growth in all product types. Collector continued to grow its corporate and real-estate loan book, while reducing exposure to consumer loans and payment loans. Resurs grew in both consumer loans and payments during the third quarter. TF Bank continued to show strong growth in credit cards and in the Baltic countries and Germany, adding 8.2% to loan volumes in the quarter. Avida grew in SME and consumer lending. Lea previously announced it will unwind its SME lending business and reduced its exposure to this segment during the third quarter, as expected, reallocating capital to growth in consumer loans exposure. Instabank further increased its exposure to retail mortgages and reduced its consumer loans and credit cards.

Figure 15. Nordic consumer banks' net loan growth by segment, Q3 2022



INSTABANK SUES LUNAR BANK AFTER FAILED ACQUISITION

In March, Danish consumer challenger bank Lunar Bank A/S announced a cash offer for all shares in Norway-based Instabank ASA. Despite reaching the minimum required shareholder acceptance in April, the acquisition was not approved by the Norwegian financial supervisory authority. In its third-quarter report, Instabank says its operations have been impacted by the acquisition process and was unable to develop the bank as it would otherwise have done in the period. Instabank has not been able to execute its capital plans for 2022, and its shareholders are currently taking legal action against Lunar Bank over the collapse of the merger.

NCR-RATED CONSUMER BANKS

The following table summarises NCR's ratings on Nordic consumer banks as of 28 Nov. 2022.

Figure 16. NCR ratings on Nordic consumer banks

	Resurs Bank	Collector Bank	Nordax Bank
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.

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