Nordic Credit Rating

SECTOR COMMENT

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Nordic consumer banks' earnings continue to offset elevated provisions

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Nordic consumer banks saw a further decline in credit losses and some improvement in risk-adjusted earnings in the second quarter. Most of our sample of nine regional consumer banks maintained strong earnings, which offset elevated loan-loss provisions in the period. However, non-performing (Stage 3) loans and loans showing signs of weakness (Stage 2 loans) continued to rise as a proportion of overall lending. Positively, some banks have found solutions since mid-year to reduce their on-balance-sheet non-performing loan (NPL) exposures to protect their capital ratios from the punitive impact of European NPL backstop regulations.

Falling inflation and lower policy rates set by the Swedish, Danish and European central banks should help consumer and small business borrowers over the next few quarters. Despite some relief, we expect loan-loss provisions to remain elevated. The Norwegian central bank has yet to revise its policy rates and has indicated that they will likely remain at current levels into 2025.

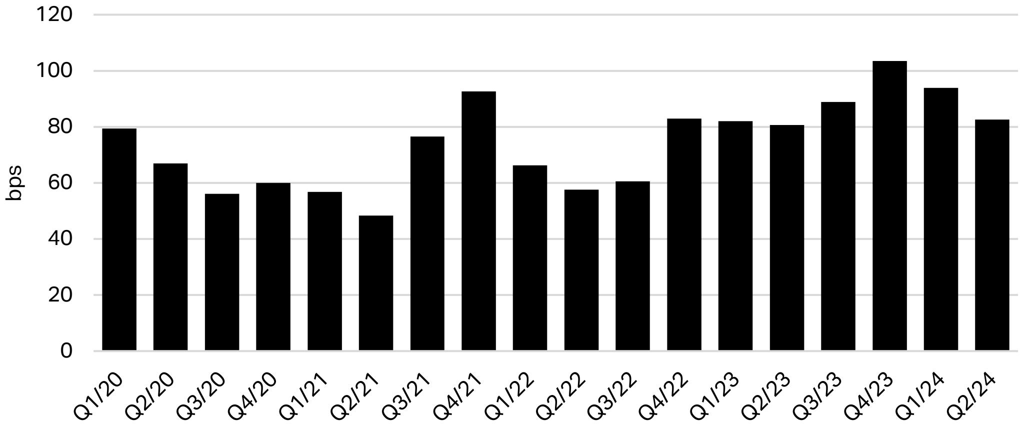
Since our last report in June, Lea Bank has received a bank licence in Sweden via its Swedish subsidiary Lea Bank AB and is aiming to move its headquarters to Sweden through an internal merger. Similarly, Morrow Bank is actively discussing a move to Sweden or Finland and a new regulatory environment. In our view, such moves are focused on reducing capital requirements and improving return on equity for shareholders.

The sector also received news that Resurs Holding could be on the verge of becoming a private company via a joint acquisition by global private equity company CVC Capital Partners and the bank's current largest owner, Waldakt AB (see Relevant Research (i)).Conversely, NOBA Bank confirmed in late August that its owners are considering a possible initial public offering for the bank following the July completion of an intragroup merger that simplified the bank's structure.

STILL-HIGH LOAN-LOSS PROVISIONS FALL TO LOWEST LEVEL IN A YEAR

Credit losses fell for most banks in our sample in the second quarter, with weighted average provisions falling materially to 83bps of average net loans from 94bps in the first quarter. Loss levels across our sample remain elevated compared with historical levels, particularly if one-off provisions in previous quarters are removed.

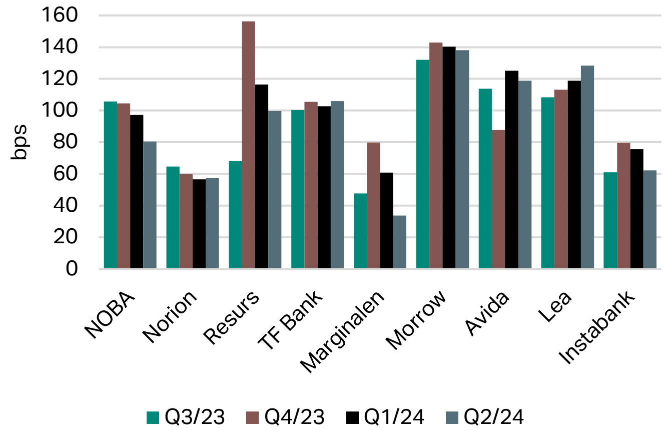
Figure 1. Nordic consumer banks' quarterly loan-loss provisions to average net loans, Q1 2020 to Q2 2024



Source: bank reports. The figures above are not adjusted for one-off loss reserves.

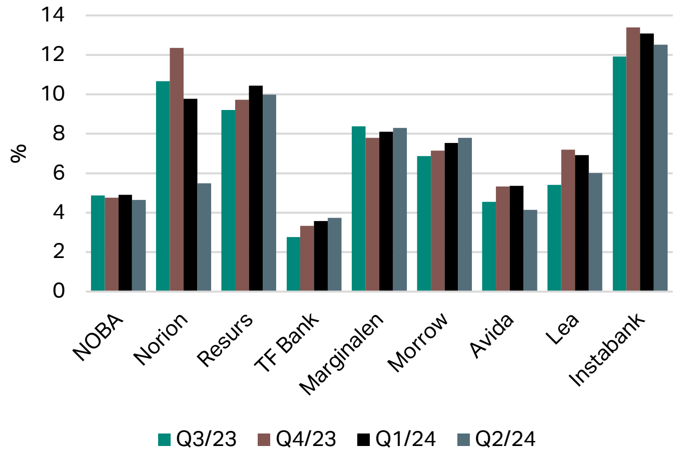
NOBA Bank and Resurs Bank saw the biggest declines in provisions in the second quarter, though Marginalen Bank and Instabank also saw material falls. Conversely, Lea Bank's loss provisions rose for a third consecutive quarter, to 128bps, with only Morrow Bank's provisions (138bps) rising by more. Lea Bank cited continued financial pressure on households, but the bank's rising credit losses also reflect high credit losses of 11% on its growing Spanish loan book, compared with 6.8% for all lending. Norion Bank and TF Bank reported only marginal increases in provisioning during the quarter.

Figure 2. Nordic consumer banks' loan-loss provisions to average net loans, Q3 2023–Q2 2024



Source: bank reports.

Figure 3. Nordic consumer banks' net Stage 2 loans to net loans, Q3 2023–Q2 2024



Source: bank reports.

Norion Bank's corporate and real-estate exposures saw a further shift to Stage 3 from Stage 2 during the quarter. However combined Stage 2 and 3 net loans fell to 19.6% from 23.1% a quarter earlier, and an absence of any increase in provisions confirms the bank's view that its secured lending is adequately backed by collateral. Once again, migration in Norion Bank's portfolio had a material impact on the sample averages cited throughout this report.

The level of net Stage 2 lending across our sample fell to 6.1% in the second quarter from 7% in the first. Excluding Norion Bank, the trend was still positive, with net Stage 2 loans decreasing by about 30bps and in line with the level at end-2023. While a number of banks reported significant declines in Stage 2 loans during the quarter, the increasing volume of Stage 3 loans is an indication that the risk of further loan-loss provisions is still high.

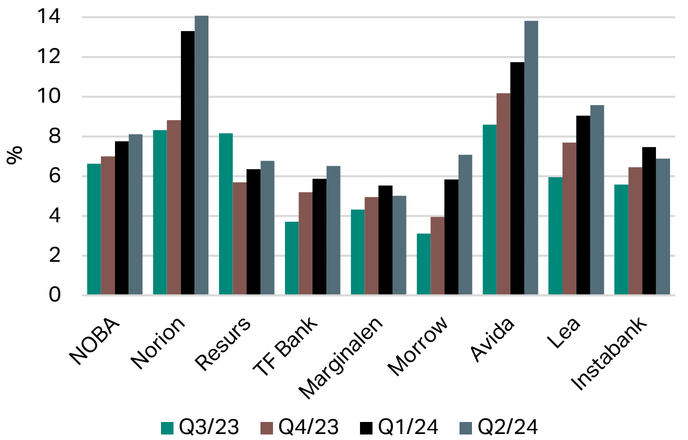
BANKS FIND NEW SOLUTIONS FOR RISING NPLS

While alternative solutions have become more commonplace since mid-year, continued weakness in the Nordic NPL market has reduced banks' ability to offload NPLs and negatively impacted their asset quality metrics in the second quarter. Only Instabank and Marginalen Bank saw their net Stage 3 lending decline in the quarter. The weighted average for the sample rose to 8.8% from 8.3% in the previous quarter earlier and 6.5% a year earlier. Even excluding Norion Bank, the trend remains clear, with net NPLs increasing by 40bps to 7.7% during the quarter at the other eight banks.

Despite the weak market for NPLs, some small portfolio sales took place in the second quarter, with Instabank selling NOK 167m in Norwegian NPLs and NOBA Bank completing the sale of a DKK 180m NPL portfolio in Denmark. Marginalen Bank said the decline in its Stage 3 lending mostly reflected improved repayment capacity and recoveries of around SEK 100m in previously non-performing lending.

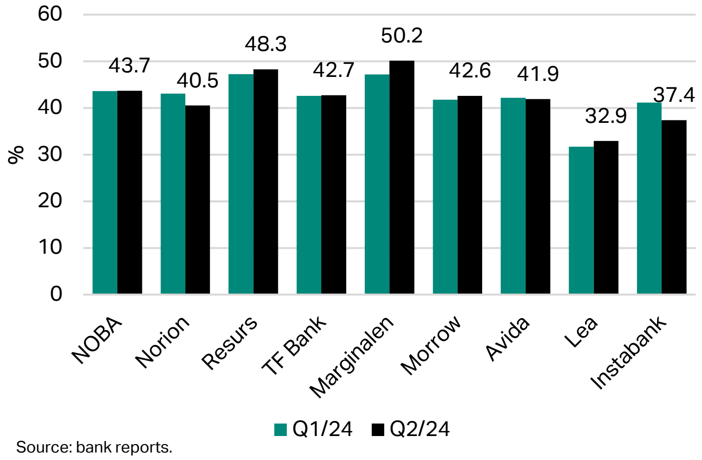
So far in the third quarter, banks in our sample have used risk transfers via securitisation to reduce their NPLs exposures and protect their capital ratios from the punitive impacts of the European regulatory NPL backstop. NOBA Bank completed a previously announced SEK 700m NPL securitisation in Sweden in July, while Marginalen Bank announced an agreement to securitise NPLs worth SEK 1bn in the same month. TF Bank underwent restructuring by creating a new subsidiary, Rediem, which acquired SEK 1.3bn in NPLs from the bank. The bank plans to have Rediem classified as a specialised debt restructuring agency in 2025. According to a letter of intent, more than 80% of Rediem will be sold to Alektum Holding and Erik Selin Fastigheter. The restructuring is indicative of changes in the wider Nordic NPL market and we expect greater use of specialised debt restructurers.

Figure 4. Nordic consumer banks' net Stage 3 NPLs to net loans, Q3 2023–Q2 2024



Source: bank reports.

Figure 5. Nordic consumer banks' Stage 3 coverage ratios, Q1 2024–Q2 2024



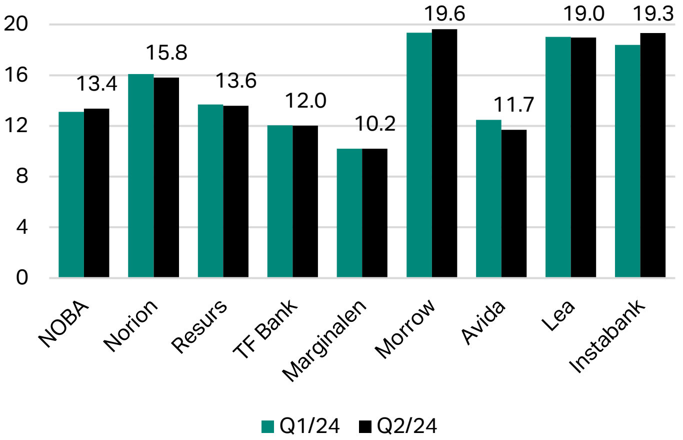
Source: bank reports.

Weaker NPL markets should be reflected by higher provisioning for Stage 3 NPLs, though this has yet to happen. Using a weighted average, Stage 3 coverage ratios fell again in the second quarter of 2024, to 43.2% from 43.6% in the previous quarter and from 46.8% a year earlier. The figures are heavily skewed by the increase in State 3 corporate loans at Norion Bank. Excluding Norion Bank, Stage 3 coverage rates were unchanged at 43.8%.

Norion Bank's loan-loss provisioning fell to 40.5% from 43.1% in the second quarter. The bank maintained a relatively high 54.4% coverage ratio (compared with 54.7% in the previous quarter) for Stage 3 consumer loans but saw its coverage ratio for Stage 3 corporate and real-estate exposures fall further to 20.4% (23.9%). The secured nature of the real estate portfolio warrants a lower coverage ratio for such lending, but real estate loans remain a risk, which we reflect in our negative outlook on the rating on the bank (see Relevant Research (iv)).

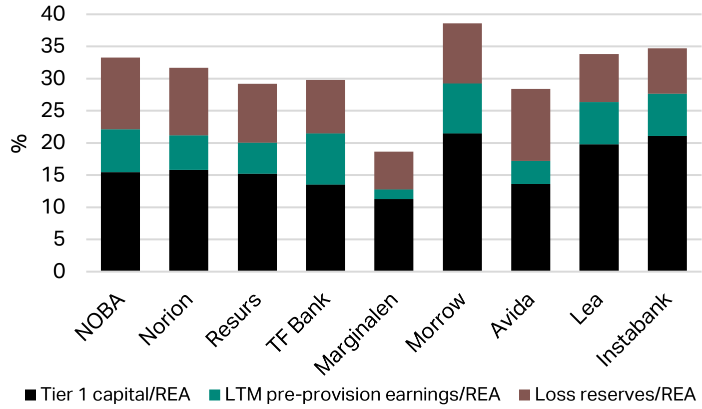
CAPITAL RATIOS STAGNANT DESPITE STRONG EARNINGS

Figure 6. Nordic consumer banks' CET1 ratios, Q1 2024–Q2 2024



Source: bank reports. Marginalen Bank's ratios relfect consolidated capital.

Figure 7. Nordic consumer banks' loss-absorbing buffers as a proportion of REA*, Q2 2024



Source: bank reports. Marginalen Bank's ratios relfect consolidated capital. REA-risk exposure amount. LTM-last 12 months.

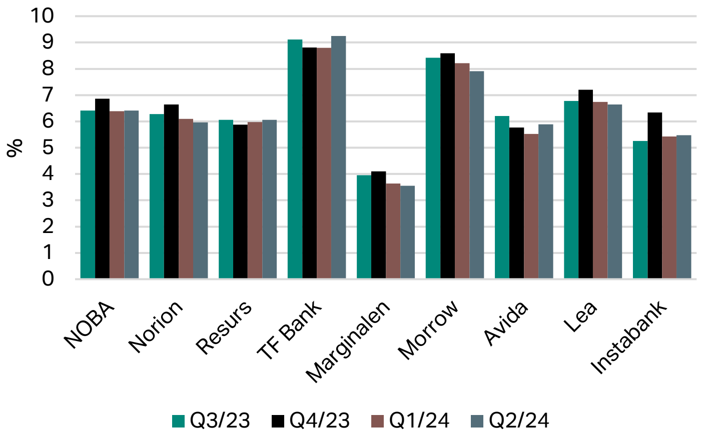
Weighted average common equity Tier 1 (CET1) ratios in our sample steadied at 14% in the second quarter. For most of the sample, capital movements were minimal. The sale of NPLs supported Instabank's CET1 ratio, which improved by 0.9pp after falling by 0.5pp in the first quarter. NOBA Bank's CET1 ratio also recovered after a first quarter fall, but is likely to decline again by nearly 30bps in the third quarter as a result of an intragroup merger. The negative impact of the merger on the Tier 1 ratio is likely to prove more modest and we expect the bank to maintain its Tier 1 ratio above 15% for the remainder of 2024. We maintain our view that NOBA Bank's capital ratios will benefit from the implementation of new capital regulations in 2025, primarily due to the low leverage in the bank's equity-release mortgage loans to elderly borrowers (see Relevant Research (iii)). Avida's CET1 ratio fell by nearly 80bps in the second quarter as net losses reduced CET1 capital while the bank's REA and net loans remained relatively stable (see more on Avida's earnings below).

Marginalen Bank's capital remains an issue. On a standalone basis, the bank reported a CET1 ratio of 9.9% for a second successive quarter, in line with its minimum regulatory requirement, including buffer requirements of 4.5% and a Pillar 2 guidance (P2G) requirement of 0.8%. On a consolidated basis, parent ESCO Marginalen AB reported a CET1 ratio of 10.2%, 0.8% above requirements. An appeal against the Swedish regulator's P2G of 5% For Marginalen Bank and 2% for ESCO Marginalen remains unsettled. On 31 Jul. 2024, Marginalen Bank entered into an agreement with UK private equity company Christofferson, Robb & Co. to securitise SEK 1.0bn in loans. This resulted in immediate capital relief of SEK 100m, increasing to SEK 650m over the next three years by avoiding the full impact of the NPL backstop on the securitised portfolio. Provided financial results are stable in the third quarter, the move should be enough to improve Marginalen Bank's buffers to above its internal consolidated capital goal of at least 1pp over regulatory requirements. In addition, ESCO Marginalen has announced plans to test market interest in capital instruments to improve its consolidated capital, though appetite could prove weak. Since October 2023, Marginalen Bank has deviated from market practice by not calling two Tier 2 instruments totalling SEK 600m on their scheduled call dates. It has yet to announce its intentions on an additional Tier 1 instrument with a call date on 16 Oct. 2024.

MARGINS CONTINUE DOWNWARD TREND

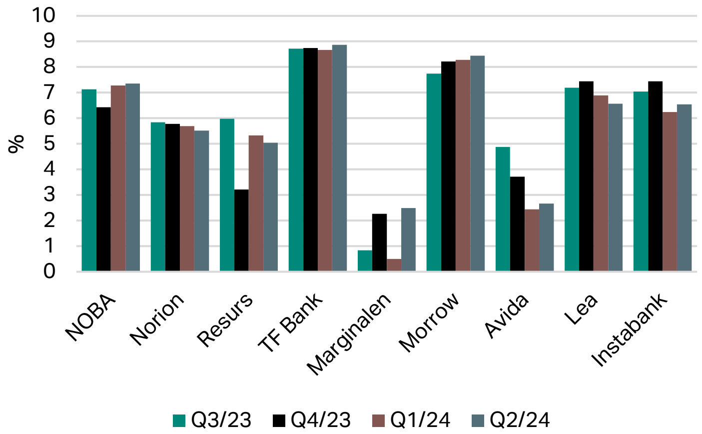
Net interest margins stabilised in the second quarter after a dramatic fall in the first. The weighted average net interest margin in our sample was 6.3% for a second consecutive quarter, a strong indication that funding costs are levelling off. Weighted average margins are under pressure and remain about 20bps lower than in the second quarter of 2023.

Figure 8. Nordic consumer banks' annualised net interest margins, Q3 2023–Q2 2024



Source: bank reports.

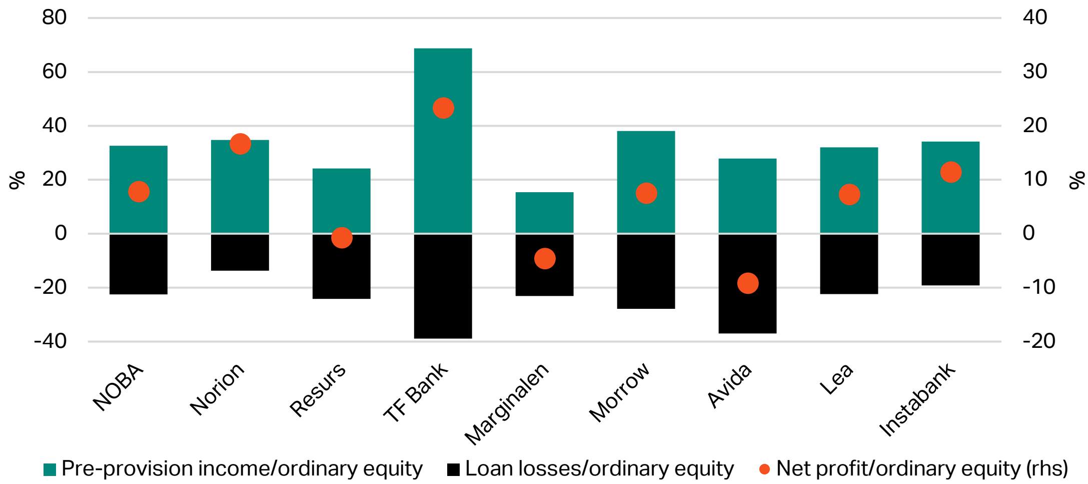
Figure 9. Nordic consumer banks' annualised pre-provision income to average REA, Q3 2023–Q2 2024



Source: bank reports.

For most of the banks in our sample, the stabilisation in net interest margins and cost efficiency imply relatively stable risk-adjusted earnings. Weighted average pre-provision earnings as a proportion of average REA improved slightly to 6.2% during the second quarter from 6% in the first, while cost efficiency metrics were relatively stable for most of the sample. Marginalen Bank's pre-provision earnings have fluctuated significantly in recent quarters, largely due to fair value adjustments.

Figure 10. Nordic consumer banks' pre-provision income, loan losses and net profit as a share of average ordinary equity, 12 months to 30 Jun. 2024



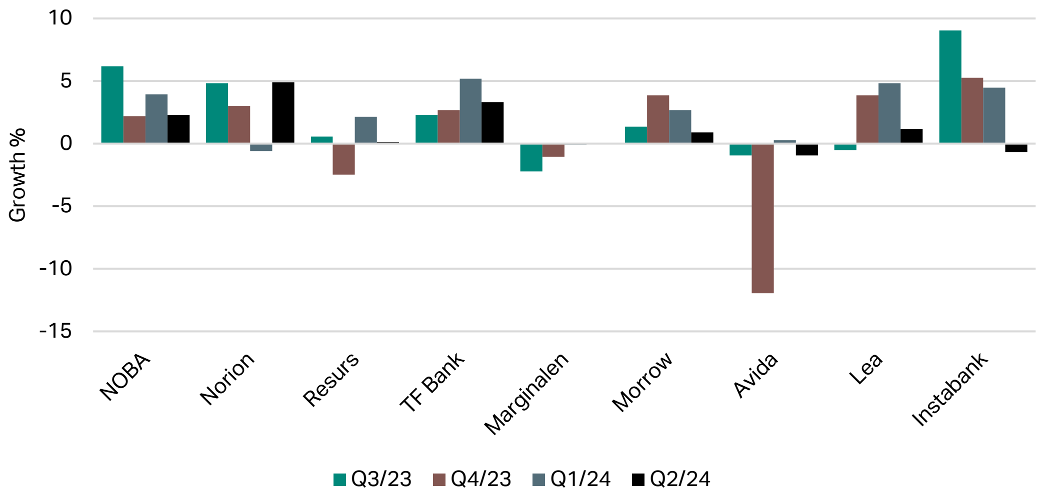
Source: bank reports.

Most of the banks in our sample have generated adequate capital and posted strong returns on ordinary equity over the past 12 months, despite higher losses. TF Bank has reported a strong return of 23.3% over the past year, due to increased scale and cost efficiency, offsetting the bank's relatively high credit provisions. Norion Bank (16.7%) and Instabank (11.4%) also achieved strong returns over the period. In addition, material improvements in scale and efficiency, and a reduction in merger-related costs in recent quarters improved NOBA Bank's annualised return on ordinary equity to 10.3% in the first half. Conversely, Marginalen Bank had a minus 4.6% return on equity due to net losses over the past year due to one-off charges, higher credit losses, and weaker-than-peer net interest margins.

Avida continues to struggle with profitability, and its earnings metrics remained weak during the second quarter. The bank's net losses of SEK 123m so far in 2024 (minus 18.6% return on equity) reflect transformation investments, which it hopes will lead to future growth and more efficient operations.

LENDING GROWTH REMAINS MUTED ACROSS THE SECTOR

Figure 11. Nordic consumer banks' net loan growth, Q3 2023–Q2 2024



Source: bank reports.

Weighted average net loan growth across our sample steadied at 2% in the second quarter. Norion Bank reported the strongest growth in real estate lending, while TF Bank and NOBA Bank reported the strongest growth in credit cards. In contrast, Avida saw a contraction in SME lending that offset marginal increases in factoring and consumer lending, while Instabank's loan volume dropped in large part due to the sale of NOK 167m in Norwegian NPLs and slower consumer loan growth.

Appreciation of the Norwegian krone against the euro dampened growth in the Finnish exposures of the Norway-based banks in our sample.

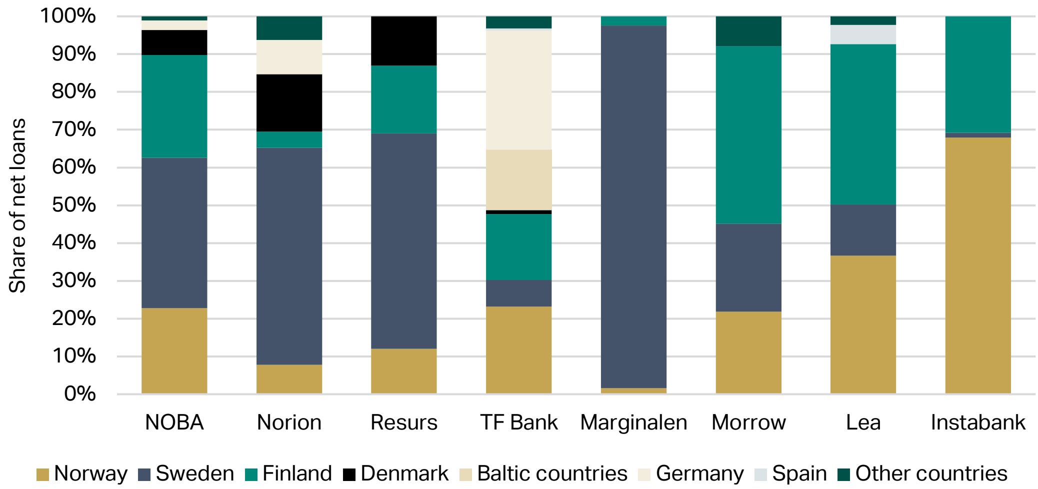
NORWEGIAN BANKS LOOKING FOR REGIME CHANGE

Since our last report in June, Lea Bank has received a bank licence in Sweden through Swedish subsidiary Lea Bank AB and is aiming to move its headquarters to Sweden via an internal merger that will leave the Swedish subsidiary as the surviving entity. Similarly, Morrow Bank is considering its structural options with a focus on moving to a "different regulatory regime", referencing the capital requirements of its Swedish peers. Morrow Bank has suggested a merger with or reverse takeover by a Swedish or Finnish bank or moving its headquarters to Sweden or Finland as the most likely options.

In our view, such moves are intended to reduce capital requirements and level the regional playing field. Reduced capital requirements would likely close the return on equity gap between these banks and their peers (see Figure 10). NOBA Bank's acquisition of Bank Norwegian has resulted in lower capital requirements and enabled the bank to expand its portfolio and scale materially. Proposed regulatory changes could make consumer loans less attractive for Swedish borrowers. However, we note that both Morrow Bank and Lea Bank have significantly more loan exposure to Finland than either Sweden or Norway, and the capital benefits available in Sweden should allay concerns about the Swedish proposals.

Morrow Bank has announced its acquisition of two portfolios of Swedish loans since the end of the second quarter. The bank acquired a SEK 700m portfolio from payment solutions provider Qliro AB in July and SEK 1.6bn portfolio from Lunar Bank in August increasing the proportion of Swedish loans in its loan book to around 35% from around 23% on 30 Jun. 2024.

Figure 12. Nordic consumer banks' share of loans by country, 30 Jun. 2024



Source: bank reports. Avida is excluded as it no longer reports the country split of its exposures in quarterly reporting.

NCR-RATED CONSUMER BANKS

The following table summarises NCR's ratings on Nordic consumer banks as of 10 Sep. 2024.

Figure 13. NCR ratings on Nordic consumer banks

	Resurs Bank	Norion Bank	NOBA Bank Group
Long-term issuer rating	BBB	BBB-	BBB
Outlook	Negative	Negative	Stable
Subfactors:			
Operating environment (20%)	bbb-	bbb-	bbb-
Risk appetite (50%)	bbb	bbb+	bbb
Market position (15%)	bb+	bb	bbb-
Performance indicators (15%)	bbb+	bbb+	bbb+
Ownership adjustment	0	0	0

See NCR's company rating reports for details.

RELEVANT RESEARCH

(i) NCR Comments: Resurs Bank 'BBB' rating and outlook unchanged following acquisition offer, 26 Jun. 2024
(ii) Credit loss uncertainty rises for Nordic consumer banks, 11 Jun. 2024
(iii) NOBA Bank Group AB (publ) 'BBB' long-term issuer rating affirmed; Outlook stable, 22 Apr. 2024
(iv) Norion Bank AB outlook revised to negative; 'BBB-' long-term issue rating affirmed, 20 Mar. 2024
(v) Resurs Bank AB 'BBB' long-term issuer rating affirmed; Outlook negative, 20 Mar. 2024
(vi) The pressure is rising for Nordic consumer banks (report), (webinar slides), 13 Mar. 2024
(vii) Nordic consumer banks increase credit losses, 29 Nov. 2023

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