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Coordinated relief package supports bank creditworthiness

ANALYSTS

Sean Cotten
+46 735 600 337
sean.cotten@nordiccreditrating.com

Geir Kristiansen
+47 9078 4593
geir.kristiansen@nordiccreditrating.com

COMMERCIAL MANAGERS

Gustav Liedgren
+46 736 49 65 43
gustav.liedgren@nordiccreditrating.com

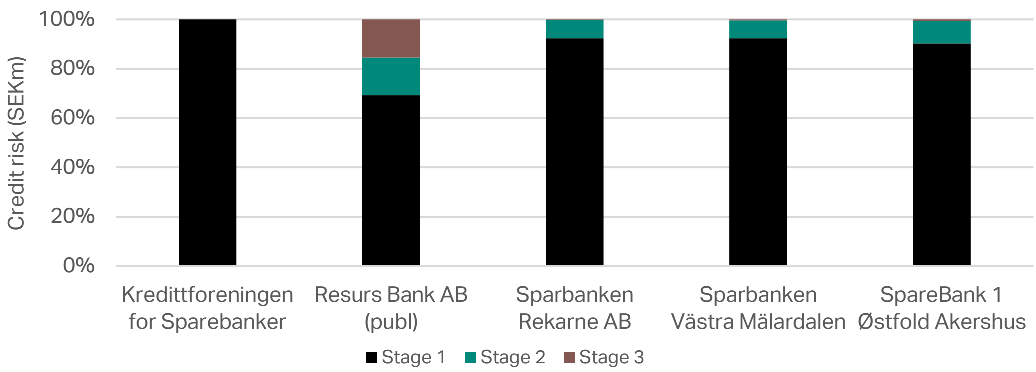
Kristine Klyve Sunde
+47 99 32 69 79
kristine.sunde@nordiccreditrating.com

Nordic Credit Rating believes that the intermediate steps taken by the Norwegian and Swedish financial authorities and central banks supports our existing credit ratings on Swedish and Norwegian banks. In particular, the reduction of capital and liquidity requirements and calls to cancel dividend payments is expected to reduce the likelihood of regulatory intervention for most financial institutions. In connection with considerable liquidity support from the central banks, financial authorities are encouraging banks to provide additional credit to the market despite significant increases in credit spreads and capital market disruptions.

As in any financial crisis, the biggest risk for banks solidity is a downward revaluation of the assets on their balance sheet. In 2008, the revision of market values on asset-backed securities sent shockwaves across financial markets. Now, while lower market valuations of financial assets could affect some assets, the key focus is on Nordic banks' lending books. While reducing capital buffers provides leeway for nonperforming loans and loss reserves, it remains unclear how banks will report and apply loss reserves if there are national restrictions on interest payments or mandatory forbearance on mortgage loans. The implementation of IFRS 9 and the need to classify loans in three stages of performance could have meaningful impacts on banks reserves for customers that face temporary or long-term issues as social distancing takes hold.

In light of unprecedented social and financial disruptions and drastic measures to slow the outbreak of the corona virus, the outlook for each region and country is nearly impossible to project due to an uncertain timeline for social distancing. Even the political response to the crisis and mandatory social distancing is being enacted differently in Norway and Sweden. Only time will tell how each country's medical establishment responds to the inevitable increase in patients and the impact that has on businesses, social norms and macroeconomic factors. Given the uncertainty, we maintain a tight dialog with our issuers with respect to disruptions in their own operations and will respond to perceived changes in creditworthiness as the situation develops.

Figure 1. IFRS 9 credit exposures by stage, end 2019



Source: Bank reports

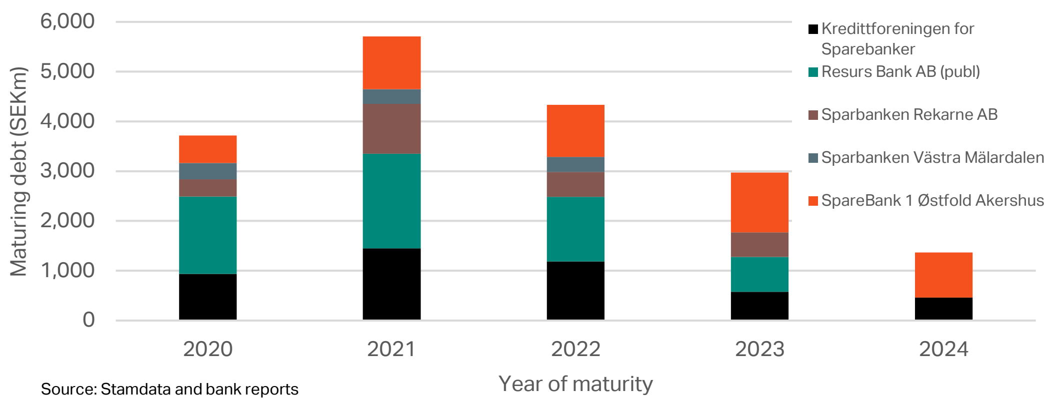
Below is a summary of the Norwegian and Swedish financial stability response to the ongoing crisis and short comments on each of the financial institutions rated by NCR.

REDUCED CAPITAL AND LIQUIDITY REQUIREMENTS PROVIDE SUPPORT

In Norway, the Ministry of Finance decided on the 13th of March to follow the central bank's advice to reduce the countercyclical capital buffer requirement to 1% from 2.5% of risk weighted assets (RWA) with immediate effect. This adds about NOK 250bn to Norwegian banks' lending capacity. The Central bank has also cut the policy rate by 50bps to 1% and now offers extraordinary three-month loans at an interest rate equal to the prevailing policy rate for as long as deemed necessary. Moreover, over the weekend, the government announced a NOK 50bn guarantee scheme for new bank loans to SMEs and has revived the NOK 50bn Government Bond Fund, managed by the Government Pensions Fund, which supported funding of banks and corporates by participating in bond issues during the financial crisis 2009-2015. We also note Norwegian FSA's letter 16 March which says that "under the prevailing conditions, the FSA will, if necessary, allow banks not to meet the requirements for liquidity buffer and/or total capital buffer. Efforts will be made to ensure that the use of the buffers does not lead to reduced lending capacity".

Swedish measures have been similar. Following an emergency meeting of the Financial Stability Board, the FSA has removed the countercyclical capital buffer, effective the 16th of March, reducing banks' capital requirements by up to 2.5% of RWA and adding approximately SEK 900bn to Swedish banks' lending capacity. The FSA has also permitted banks to breach liquidity buffer requirements for each currency and in total. In addition, Riksbanken has opened SEK 500bn in credit to Swedish companies via two-year collateralised loans to the banking sector at interest equivalent to the policy rate, currently 0%. The central bank has also made it clear that it is "ready and prepared to take further measures and to supply necessary liquidity". This would most likely come in the form of revised policy rates and buying additional government bonds. In addition, there is the possibility that covered bonds, bank senior unsecured bonds or even highly-rated corporate debt could be added to a future quantitative easing package.

Figure 2. Maturing debt of rated banks



Source: Stamdata and bank reports

KREDITTFORENINGEN FOR SPAREBANKER

Our 'A-' rating on Kredittforeningen for Sparebanker (KfS) reflects the company's strong capitalisation and low risk appetite. The company funds only investment-grade savings banks, resulting in concentrated but high-quality credit exposure and the bank has never had non-performing loans. KfS is funded by senior loans with approximately the same maturity as its individual loans and has minimal refinancing and interest rate risk. The company was established in 2004 to help small savings banks with funding in a difficult environment, and the current crisis may help to revitalize its business model.

RESURS BANK

Our 'BBB-' rating on Resurs Bank (Resurs) reflects the bank's strong risk-adjusted earnings, granular consumer loan portfolio and moderate risk appetite relative to its Nordic niche bank peers. The bank is mainly funded by deposits and we note that the deposit base grew by 19% (SEK 4bn) in 2019, demonstrating its ability to attract deposit customers in a market that is sure to grow due to individuals' increasing risk aversion. Resurs Holding issued SEK 300m in Additional Tier 1 capital in December 2019, of which SEK 200m was credited as equity to Resurs, increasing the Tier 1 capital ratio to 14.6% from 13.4%. A large increase in non-performing loans and higher loss reserves is, however, a significant risk factor if the current lock down of the economy were to continue for several months. We will therefore closely monitor the development in the bank's past due loans and reserving practices as well as the Nordic governments' response to lower levels of economic activity and rising unemployment.

SPARBANKEN REKARNE

Our 'A-' rating on Sparbanken Rekarne (Rekarne) incorporates the bank's 50% ownership by Swedbank AB. Our current assessment is that Swedbank's ownership will continue to be a valuable contributor to Rekarne's resilience during a period of stress, including the potential for capital injections and liquidity support. Rekarne's credit portfolio is largely comprised of residential mortgage loans, multi-family and commercial real estate and, to a lesser degree, agriculture. We will monitor the impact on the bank's local economy given the share of manufacturing in the region and how the unfolding situation affects Eskilstuna's development plans.

SPARBANKEN VÄSTRA MÄLARDALEN

Our 'BBB+' rating on Sparbanken Västra Mälardalen (SBVM) considers the bank's very strong capital and liquidity positions. SBVM's 2020 revenues are likely to be affected more than anticipated if Swedbank cancels its proposed dividend, which we had projected to ca SEK 20m based on a 50% dividend by Swedbank. SBVM's credit portfolio is highly collateralized with a majority of residential mortgage loans, multi-family and commercial real estate and agricultural properties. We will monitor the impact on the Västra Mälardalen economy given the share of manufacturing in bank's primary markets.

SPAREBANK 1 ØSTFOLD AKERSHUS

Our 'A' rating on Sparebank 1 Østfold Akershus reflects the bank's strong profitability and capitalisation, as well as its exposure to a growth region of Norway. The bank has one bond maturity in 2020 (13 May) with NOK 135m remaining due. Østfold Akershus is predominantly a retail mortgage bank but also has exposure to commercial real estate lending (no oil-related exposures). We will closely monitor the economic development in the region as the social distancing measures impact the local economy.

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