

Research Update:

Digital Lender Bank Norwegian Outlook Revised To Stable On Earnings Resilience In Downturn; 'BBB/A-2' Ratings Affirmed

November 12, 2020

Overview

- Bank Norwegian's earnings performance in the first nine months of 2020 demonstrate resilience amid COVID-19 fallout, and its capital and provisions are strong enough to absorb losses even in a more adverse scenario.
- The bank's expansion to new markets planned to start late 2021 could diversify its revenues and loan portfolio, but only well beyond our outlook horizon.
- We are revising the outlook on Bank Norwegian to stable from negative and affirming the ratings at 'BBB/A-2'.
- The stable outlook reflects our view the bank will defend its high risk-adjusted profitability and maintain strong capital buffers through 2022.

PRIMARY CREDIT ANALYST

Salla von Steinaecker
Frankfurt
+ 49 693 399 9164
salla.vonsteinaecker
@spglobal.com

SECONDARY CONTACT

Marcus Kylberg
Stockholm
+ 46 8 440 5916
marcus.kylberg
@spglobal.com

Rating Action

On Nov. 12, 2020, S&P Global Ratings revised to stable from negative its outlook on digital consumer lender Bank Norwegian. At the same time, we affirmed our 'BBB/A-2' long- and short-term issuer credit ratings on the bank.

Rationale

The outlook revision to stable reflects our view that Bank Norwegian has demonstrated its ability to adjust its operating model in the COVID-19-induced recession. Furthermore, we believe that Bank Norwegian's business prospects will benefit from the expected improvements in the operating environment.

The Norwegian economy has started to recover from COVID-19 fallout and the registered unemployment has materially decreased from the historical peak seen in March 2020. Similarly, consumption is normalizing across Bank Norwegian's other Nordic markets. These developments

abate our previous concerns on the bank's resilience to COVID-19-related headwinds, and we believe its performance indicate new business potential after two stagnating quarters. That said, uncertainty persists as a second wave of pandemic-related setbacks materialize.

We view positively that Bank Norwegian has tightened its underwriting standards and maintained a strong cost focus to protect its underlying profitability. Bank Norwegian reported a risk-adjusted total loan yield of 10.8% in third-quarter 2020, which is stronger than in the same period in 2019. We also note that the bank's still sound return on equity of 19.6%, despite the COVID-19-related challenges, increased capitalization and large liquidity buffers (36.6% of total assets). Furthermore, its flexible and cost-efficient operating model underpinned by cost-income ratio of 25% continues to support the earnings before loan loss provisions.

Bank Norwegian's robust capitalization remains the key rating strength and, as the bank continues to grow, a buffer against adverse developments in its home markets. Our risk-adjusted capital ratio equaled 19.4% at mid-2020 on the back of the solid earnings and limited increase in risk-weighted assets. Similarly, the regulatory common equity tier 1 ratio of 21.4% shows a buffer of 510 basis points above the minimum regulatory requirements as of Sept. 30, 2020. In our view, this provides Bank Norwegian a strong loss absorption capacity in the next two years but also shields further expansion.

Our combined view of Bank Norwegian's capital and risk position remains neutral for the rating. This is because of the bank's risk appetite in unsecured lending and weaker-than-peers' asset quality metrics. The bank's reported non-performing loans (NPL; defined as Stage 3 loans) reached almost Norwegian krone (NOK) 10 billion due to some stage transfers and currency effects of weaker Norwegian krone. This, combined with the stagnating gross loans, resulted in a weakened NPL ratio of 22.3% in third-quarter 2020 versus 17.3% at year-end 2019. While Bank Norwegian's underlying credit losses have temporarily been on a decreasing trend and the bank has sent fewer loans to collection, it has taken extraordinary loan loss provisions over the past three quarters. Consequently, the NPL coverage improved to 40.4% as of end-September 2020 (Stage 3 loans overdue by more than three years are fully provisioned), still lower than at rated peers. Contrary to many peers Bank Norwegian tends to keep the NPL in its own balance sheet owing to attractive yields and favourable recovery prospects in Nordic markets, therefore demonstrating weaker asset quality metrics, but we do not exclude NPA sales over the next two years.

Bank Norwegian solidified its aspirations to expand outside the Nordics following this summer's strategic review. It announced its intentions to enter Germany and Spain in the second half of 2021 by using a cross-border digital offering in its three products: Consumer loan, credit card, and savings product. We consider that, over time, these markets could diversify the bank's revenues and loan portfolio, but likely well beyond our outlook horizon. We do not believe the bank will sacrifice its high cost-efficiency and profitability to gain rapidly market share outside Nordics.

We will continue to monitor Bank Norwegian's strategy to meet its end-point minimum requirement on own fund and eligible liabilities (MREL) requirement by January 2024, access to the senior nonpreferred issuance (SNP) market, and any associated effect on the funding costs. The Norwegian Financial Supervisory Authority has decided Bank Norwegian's sizable MREL will be 37.135% of consolidated risk-weighted assets, which we think could be positive for the bank's senior creditors. In time, a substantial amount of liabilities at holding company level could be available under a bail-in resolution scenario to restore the bank's own funds and its viability.

We note that Bank Norwegian is seeking to merge with the holding company Norwegian Finans Holding (NFH) in order to simplify the legal structure, and this would lead to MREL issuance out of the operating company. The merger will be subject to the regulatory approval and could materialize in the second quarter 2021.

We do not consider the ratings on Bank Norwegian to be immediately affected by the financial distress at its partner Norwegian Air Shuttle and the reported decision by the Norwegian government to refrain from further financial support to the airline. While the challenges at Norwegian Air Shuttle could constrain Bank Norwegian's business momentum, we believe the setbacks would have limited magnitude given the bank's strong brand. Bank Norwegian continues to hold a long-term commercial agreement with Norwegian Air Shuttle regarding the use of the brand name, IP rights, and cooperation on reward program. Ultimately, we believe that the bank could replace the reward program, if the airline defaulted.

S&P Global Ratings believes there remains a high degree of uncertainty about the evolution of the coronavirus pandemic. Reports that at least one experimental vaccine is highly effective and might gain initial approval by the end of the year are promising, but this is merely the first step toward a return to social and economic normality; equally critical is the widespread availability of effective immunization, which could come by the middle of next year. We use this assumption in assessing the economic and credit implications associated with the pandemic (see our research here: www.spglobal.com/ratings). As the situation evolves, we will update our assumptions and estimates accordingly.

Outlook

The stable outlook reflects our expectation that Bank Norwegian will maintain a robust risk-adjusted capitalization and adequate buffers as it its loan book grows at a more moderate pace over the next two years. We believe that the expected recovery of Nordic economies from COVID-19 fallout will support Bank Norwegian's profitable business generation and that its asset quality won't suffer enduring repercussions. This could lead us to incorporate a positive adjustment notch into our assessment of Bank Norwegian's stand-alone credit profile, specifically, in our business or risk position assessment. We also believe that the bank won't compromise its strong operating efficiency and risk-adjusted profitability while it expands into new markets starting from late 2021.

Downside scenario

We could lower the ratings if the bank's performance jeopardized its risk-adjusted profitability and asset quality, or if we observed a more aggressive expansion strategy or capital policy leading the risk-adjusted capital (RAC) ratio to fall below 15%. Furthermore, any additional pressure on business prospects from the second wave of COVID-19 or setbacks spewing from distressed partner Norwegian Air Shuttle on the bank's reputation and business could prompt a downgrade.

Upside scenario

We could take a positive rating action if the bank maintains its intrinsic credit strength while demonstrating access to the senior non-preferred market and building a sustainable buffer of bail-in-able debt instruments. Ratings upside also hinges on a well-defined resolution strategy that would likely ensure full and timely payment on all of the bank's senior preferred obligations.

Ratings Score Snapshot

	To	From
Issuer Credit Rating	BBB/Stable/A-2	BBB/Negative/A-2
Stand-Alone Credit Profile	bbb-	bbb-
Anchor	a-	a-
Business Position	Weak (-2)	Weak (-2)
Capital and Earnings	Very strong (+2)	Very strong (+2)
Risk Position	Weak (-2)	Weak (-2)
Funding and Liquidity	Below average and Adequate (-1)	Below average and Adequate (-1)
Support	0	0
ALAC Support	0	0
GRE Support	0	0
Group Support	0	0
Sovereign Support	0	0
Additional Factors	1	1

Related Criteria

- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Financial Institutions | General: Risk-Adjusted Capital Framework Methodology, July 20, 2017
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- Criteria | Financial Institutions | Banks: Bank Rating Methodology And Assumptions: Additional Loss-Absorbing Capacity, April 27, 2015
- Criteria | Financial Institutions | Banks: Quantitative Metrics For Rating Banks Globally: Methodology And Assumptions, July 17, 2013
- Criteria | Financial Institutions | Banks: Banks: Rating Methodology And Assumptions, Nov. 9, 2011
- Criteria | Financial Institutions | Banks: Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Ratings List

Ratings Affirmed; Outlook Action

	To	From
Bank Norwegian AS		
Issuer Credit Rating	BBB/Stable/A-2	BBB/Negative/A-2

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. A description of each of S&P Global Ratings' rating categories is contained in "S&P Global Ratings Definitions" at https://www.standardandpoors.com/en_US/web/guest/article/-/view/sourceId/504352 Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following S&P Global Ratings numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; Stockholm (46) 8-440-5914; or Moscow 7 (495) 783-4009.

Copyright © 2020 by Standard & Poor's Financial Services LLC. All rights reserved.

No content (including ratings, credit-related analyses and data, valuations, model, software or other application or output therefrom) or any part thereof (Content) may be modified, reverse engineered, reproduced or distributed in any form by any means, or stored in a database or retrieval system, without the prior written permission of Standard & Poor's Financial Services LLC or its affiliates (collectively, S&P). The Content shall not be used for any unlawful or unauthorized purposes. S&P and any third-party providers, as well as their directors, officers, shareholders, employees or agents (collectively S&P Parties) do not guarantee the accuracy, completeness, timeliness or availability of the Content. S&P Parties are not responsible for any errors or omissions (negligent or otherwise), regardless of the cause, for the results obtained from the use of the Content, or for the security or maintenance of any data input by the user. The Content is provided on an "as is" basis. S&P PARTIES DISCLAIM ANY AND ALL EXPRESS OR IMPLIED WARRANTIES, INCLUDING, BUT NOT LIMITED TO, ANY WARRANTIES OF MERCHANTABILITY OR FITNESS FOR A PARTICULAR PURPOSE OR USE, FREEDOM FROM BUGS, SOFTWARE ERRORS OR DEFECTS, THAT THE CONTENT'S FUNCTIONING WILL BE UNINTERRUPTED OR THAT THE CONTENT WILL OPERATE WITH ANY SOFTWARE OR HARDWARE CONFIGURATION. In no event shall S&P Parties be liable to any party for any direct, indirect, incidental, exemplary, compensatory, punitive, special or consequential damages, costs, expenses, legal fees, or losses (including, without limitation, lost income or lost profits and opportunity costs or losses caused by negligence) in connection with any use of the Content even if advised of the possibility of such damages.

Credit-related and other analyses, including ratings, and statements in the Content are statements of opinion as of the date they are expressed and not statements of fact. S&P's opinions, analyses and rating acknowledgment decisions (described below) are not recommendations to purchase, hold, or sell any securities or to make any investment decisions, and do not address the suitability of any security. S&P assumes no obligation to update the Content following publication in any form or format. The Content should not be relied on and is not a substitute for the skill, judgment and experience of the user, its management, employees, advisors and/or clients when making investment and other business decisions. S&P does not act as a fiduciary or an investment advisor except where registered as such. While S&P has obtained information from sources it believes to be reliable, S&P does not perform an audit and undertakes no duty of due diligence or independent verification of any information it receives. Rating-related publications may be published for a variety of reasons that are not necessarily dependent on action by rating committees, including, but not limited to, the publication of a periodic update on a credit rating and related analyses.

To the extent that regulatory authorities allow a rating agency to acknowledge in one jurisdiction a rating issued in another jurisdiction for certain regulatory purposes, S&P reserves the right to assign, withdraw or suspend such acknowledgment at any time and in its sole discretion. S&P Parties disclaim any duty whatsoever arising out of the assignment, withdrawal or suspension of an acknowledgment as well as any liability for any damage alleged to have been suffered on account thereof.

S&P keeps certain activities of its business units separate from each other in order to preserve the independence and objectivity of their respective activities. As a result, certain business units of S&P may have information that is not available to other S&P business units. S&P has established policies and procedures to maintain the confidentiality of certain non-public information received in connection with each analytical process.

S&P may receive compensation for its ratings and certain analyses, normally from issuers or underwriters of securities or from obligors. S&P reserves the right to disseminate its opinions and analyses. S&P's public ratings and analyses are made available on its Web sites, www.standardandpoors.com (free of charge), and www.ratingsdirect.com (subscription), and may be distributed through other means, including via S&P publications and third-party redistributors. Additional information about our ratings fees is available at www.standardandpoors.com/usratingsfees.

STANDARD & POOR'S, S&P and RATINGSDIRECT are registered trademarks of Standard & Poor's Financial Services LLC.