Research Update:

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

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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.

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	Below average and	Below average and
Liquidity	Adequate (-1)	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