Norwegian bank M&A

Savings bank consolidation a long-term trend with positive credit implications

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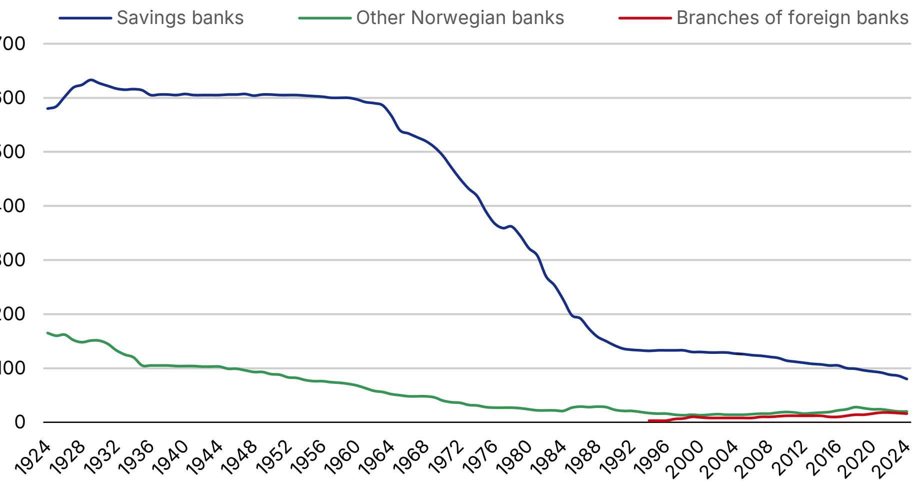
Norwegian bank mergers have accelerated in 2024, with five deals completed. Where integration risks and capital impacts are well controlled, we view consolidation in the sector as positive from a credit risk perspective.

For the smaller banks in particular, mergers provide the economies of scale needed to remain competitive in an evolving financial landscape. Some deals offer additional benefits of broader business models in terms of geographical diversification and added service offerings. Capital impacts from M&A transactions have generally been contained, as most deals have been equity swaps rather than cash deals. Integration risks appear well managed, owing in large part to cultural and business model affinities between merging institutions.

We expect the savings banks will continue to dominate Norwegian bank M&A activity. If the current pace of consolidation is maintained, the number of savings banks will decline from 80 to around 50 by the end of the decade.

Much will depend on the continued viability of a strategy that emphasises local relationships and physical presence in markets where digital solutions dominate. If this strategy continues to be successful, consolidation may slow. Conversely, if customer behaviour further shifts towards digital solutions and commoditised service offerings, and the market becomes increasingly national, we would expect the pace of mergers to intensify. The emergence of much larger multi-region savings banks could pave the way to overcome the geographical obstacles to further consolidation. If so, we may see significant developments in credit profiles and potentially a transformed competitive landscape.

Figure 1: Number of banks operating in Norway historically



Source: Norges Bank; Finans Norge; Scope Ratings

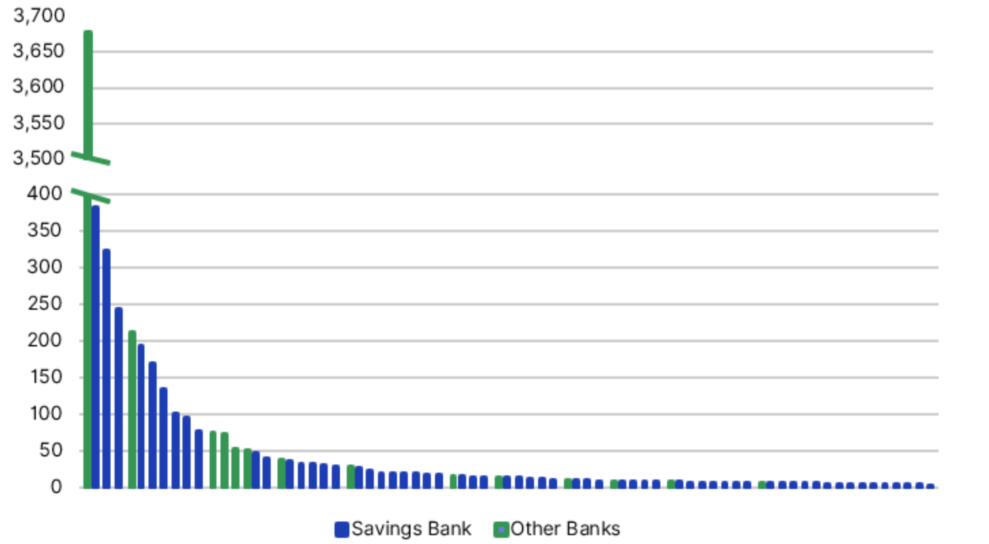
1. Savings banks' mergers drive sector consolidation

The need for scale is the major driver of M&A activity.

The number of commercial and other banking players domiciled in Norway has been relatively stable since the 1980s. By contrast, the number of savings banks has continued to decline, albeit at a slower pace (Figure 1).

The most commonly cited goals of bank mergers in recent years have been strengthening market positions and the need for scale to better compete for customers while managing ever greater regulatory demands. Between 2019 and 2024, more than 70% of deals involved acquired banks with total assets of less than NOK 10bn. As takeovers have invariably been friendly, this indicates a need among the smallest banks for greater scale.

Figure 2: Norway domiciled banks by consolidated total assets as of Q2 2024, NOK bn



Note: Non-consolidated covered bonds vehicles and other institutions that do not take deposits have been excluded.
Source: SNL; Scope Ratings

Despite a fragmented market, certain structural features prevent quick consolidation.

Despite recent mergers, the banking market is still fragmented. At the end of Q2 2024, there were still more than 80 Norwegian savings banks, half of them with a total balance sheet of no more than NOK 10bn (Figure 2). Yet, several structural factors may prevent consolidation from progressing at an even faster pace.

First, Norway's savings banks operate locally or regionally. Takeovers of banks in distant regions are not feasible in terms of local market expertise and risk management strategy. Despite the high degree of commoditisation implied by the highly digitalised service offerings of Norwegian banks, several savings banks have increased the number of local or regional branches in recent years. This reflects business strategies centred on personal engagement and local expertise as key differentiating factors.

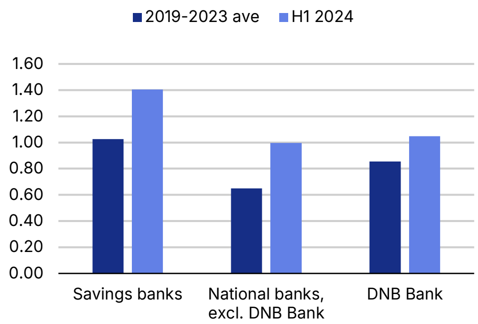
Second, despite high concentrations in low-risk lending segments and the additional costs associated with maintaining a local physical presence, Norwegian savings banks consistently generate better total asset returns than comparable Norwegian banks (Figure 3) and European peers. This is largely explained by consistently higher net interest margins, which adds credibility to the value proposition of the local, relationship driven approach. For many banks, robust returns may moderate the need to consolidate.

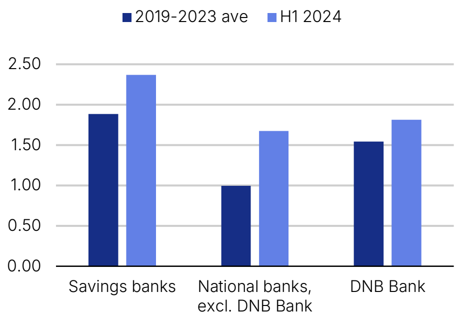
Third, most Norwegian savings' banks are members of alliances that already provide significant economies of scale. These are achieved, in part, through shared product companies (e.g. asset management, non-life insurance, consumer finance, and leasing) for which member banks act as distributors. These alliances also share covered bond vehicles, technological solutions, and regulatory expertise.

Fourth, supporting and engaging with local communities are defining features of the savings banks. It is not uncommon for management to express a preference for remaining local and for local ownership.

Finally, we believe the governance structures of savings banks may be an element slowing down the pace of mergers, even when deals would create clear equity value. Equity holders do not ultimately control the savings banks, as their representation is limited by statute to 40%. Supervisory boards, the highest decision-making bodies of the savings banks, comprise representatives of depositors, employees and, in some cases, elected local government officials as well as equity investors.

Figure 3: Return on average assets (%) and net interest margin (%)





Note: Norway domiciled banks. Consumer banks and pure play commercial banks not included.
Source: SNL; Scope Ratings

2. Credit implications

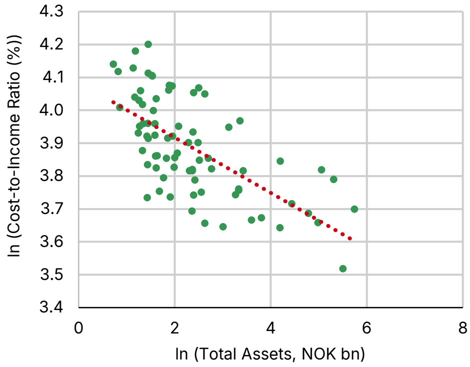
We consider the credit implications of the consolidation trend to be positive at the margin, given added economies of scale, strengthening of market positions, and greater business and geographical diversification. Capital impacts have been contained, and integration risks have typically been well managed given similarities between merging institutions.

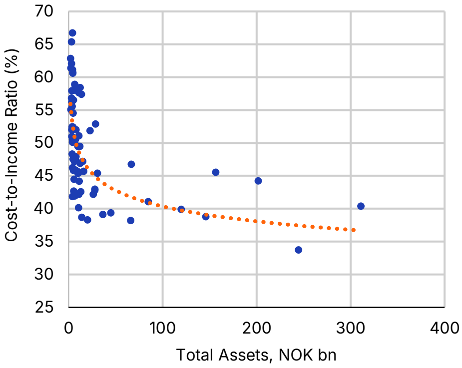
Scale drives efficiency

Greater scale tends to be the most significant of these factors. Our analysis of cost-to-income ratios to total assets indicates that the smallest banks may have the most to gain from greater scale (Figure 4). Controlling for business-model variability by considering savings banks only, scale accounts for well over 40% of cross-sectional variability in cost-to-income. Indeed, this is consistent with the banks' goals of merging to gain scale to remain competitive.

Empirical analysis supports the case for efficiency gains through greater scale.

Figure 4: Savings banks – cost-to-income versus total assets, 2019-2023





Note: Cost-to-income and total assets values are based on five-year averages.
Source: SNL; Scope Ratings

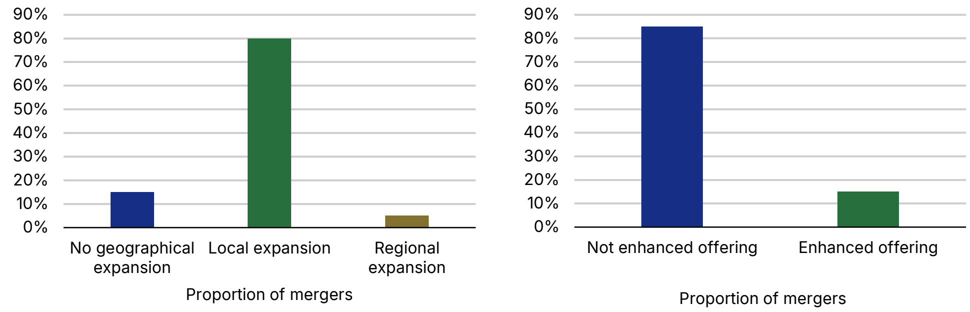
Geographical diversification

Certain recent mergers entail significant geographical expansion.

Virtually all mergers of local or regional players between 2019 and 2024 have included some degree of geographical market expansion (Figure 5). This is nominally credit positive. While in many cases the degree of geographical diversification has been too small to have a material impact on credit profiles, there are two notable exceptions.

One is the merger of SpareBank 1 SR-Bank and SpareBank 1 Sørøst-Norge in Q3. The new bank, SpareBank 1 Sør-Norge, combines complementary market regions across south-western and south-eastern Norway. The planned merger of Sparebanken Vest and Sparebanken Sør will do the same across western and southern Norway, materially expanding geographical reach. Sparebanken Norge, the merged bank, aims to become a national player over time.

Figure 5: Business models with mergers completed 2019-24



Source: Scope Ratings

Limited cross selling benefits

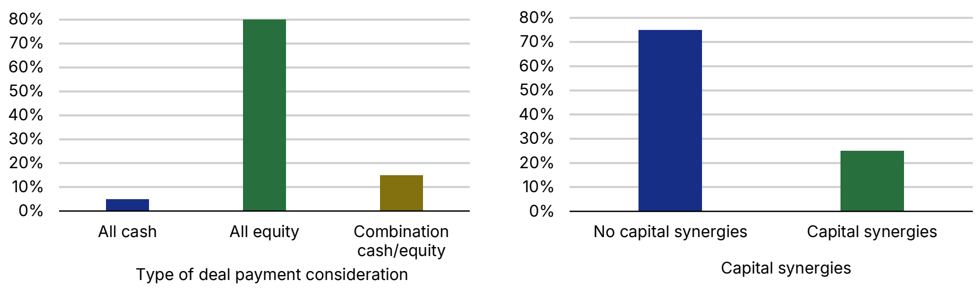
Expanding the range of products and services has the potential to strengthen market positions and diversify sources of income. However, we estimate that only 15% of completed mergers between 2019 and 2024 have actually offered that potential (Figure 5). This is because most mergers have been between savings banks; and because more than 75% of those mergers have involved savings banks from the same alliance, which as mentioned above already have shared product companies.

Capital impacts manageable

Deals have not adversely affected banks' solvency.

The capital implications of mergers may influence credit profiles. Cash deals may adversely affect capital ratios and, therefore, be credit negative. But most mergers in the 2019-2024 period have been all-equity deals (Figure 6), which do not materially affect capital ratios. Larger banks have used all cash or cash/equity combinations when acquiring much smaller banks. Even in these cases, the impacts on capital ratios have been negligible.

Figure 6: Factors affecting capital: mergers 2019-2024



Source: Scope Ratings

In 25% of mergers, there have been potential capital synergies from extending the IRB Approach to the acquired bank's Standardised Approach (SA) portfolios, implying potentially lower future capitalisation. In these cases, we consider any negative credit implications from capital synergies to be balanced out by the comparatively high capital ratios of Norwegian IRB banks, the additional supervisory scrutiny that is applied to them as well as the pricing advantage that may support market position relative to SA banks.

Integration risks contained

Merger integration risks have been well managed. Among the savings banks, we have not observed any adverse developments stemming from integration risk. This is largely due to similarities between merging banks in terms of culture and business models. In many cases, merging banks already share the same alliance as well as IT vendors, possibly helping contain technical aspects of integration risk.

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