

CREDIT OPINION

28 October 2024

Update



RATINGS

Bluestep Bank AB (publ)

Domicile	STOCKHOLM, Sweden
Long Term CRR	A2
Type	LT Counterparty Risk Rating - Fgn Curr
Issuer Rating	A3
Type	LT Issuer Rating
Long Term Deposit	A3
Type	LT Bank Deposits - Fgn Curr
Outlook	Negative

Please see the [ratings section](#) at the end of this report for more information. The ratings and outlook shown reflect information as of the publication date.

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Bluestep Bank AB (publ)

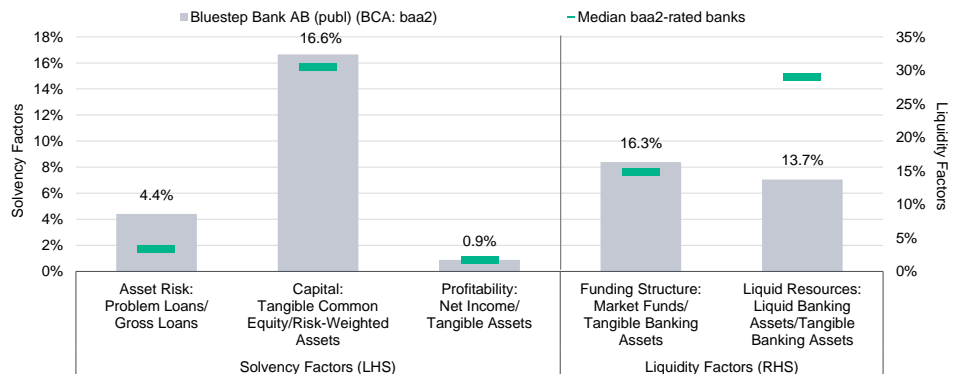
Update following affirmation of all ratings, outlook changed to negative from stable

Summary

Bluestep Bank AB (publ)'s (Bluestep) A3 long-term deposit and issuer ratings incorporate the bank's standalone creditworthiness, as indicated by a baa2 Baseline Credit Assessment (BCA), and very low loss given failure under our Advanced Loss Given Failure (LGF) analysis, which results in a two-notch uplift to the rating. Low probability of support coming from the Government of Sweden (Aaa stable) does not result in further uplifts to the ratings.

The baa2 BCA reflects the bank's strong recurring earnings stemming from a leading position in the specialised mortgage market in the Nordic region, further strengthened through the acquisition of Bank2 ASA (Bank2) in 2023, and robust capitalisation. These strengths are balanced against relatively higher asset risk compared to other Nordic mortgage banks due to Bluestep's focus on non-prime and near-prime borrowers, and reliance on market funding and internet sourced deposits.

Exhibit 1
Rating Scorecard - Key financial ratios



These represent our [Banks Methodology](#) scorecard ratios, whereby asset risk and profitability reflect the weaker of either the latest reported or the average of the last three year-end and latest reported ratios. Capital is the latest reported figure. Funding structure and liquid resources ratios reflect the latest year-end figures.

Source: Moody's Ratings

Credit strengths

- » Sound capitalisation materially above regulatory requirements
- » High repayment rates supported by generous governmental unemployment benefits and state run collection agencies
- » Strong profitability supported by high interest rate margins, with a large market share within the niche non-prime and near-prime Swedish and Norwegian mortgage markets

Credit challenges

- » Elevated asset risk, through lending to non-prime borrowers
- » Reliance on market funding, which renders the bank vulnerable to fluctuations in investor sentiment
- » Limited transparency regarding any additional access to capital in case of need
- » Monoline business, which increases reliance on a single source of revenue

Outlook

The outlook on the long-term deposit and issuer rating is negative, reflecting Bluestep's deteriorating asset quality, which could also weaken the bank's deposit franchise and access to market funding.

Factors that could lead to an upgrade

An upgrade is unlikely given the negative outlook. The outlook on the long-term deposit and issuer rating could be changed to stable following a stabilisation or reduction of problem loans, provided that profitability remains stable and capital robust.

Factors that could lead to a downgrade

The long-term deposit and issuer ratings could be downgraded in case of a lower BCA or lower share of loss absorbing liabilities protecting depositors in case of failure. The BCA could be downgraded if the bank experiences a further significant deterioration in asset quality or capital, or access to funding is jeopardised.

This publication does not announce a credit rating action. For any credit ratings referenced in this publication, please see the issuer/deal page on <https://ratings.moody.com> for the most updated credit rating action information and rating history.

Key indicators

Exhibit 2

Bluestep Bank AB (publ) (Consolidated Financials) [1]

	06-24 ²	12-23 ²	12-22 ²	12-21 ²	12-20 ²	CAGR/Avg. ³
Total Assets (SEK Million)	32,807.2	31,236.5	23,750.6	21,002.2	20,281.6	14.7 ⁴
Total Assets (USD Million)	3,097.9	3,099.5	2,279.4	2,321.5	2,469.6	6.7 ⁴
Tangible Common Equity (SEK Million)	2,296.7	2,151.4	1,615.1	1,696.4	1,621.3	10.5 ⁴
Tangible Common Equity (USD Million)	216.9	213.5	155.0	187.5	197.4	2.7 ⁴
Problem Loans / Gross Loans (%)	4.4	4.1	1.9	1.7	2.0	2.8 ⁵
Tangible Common Equity / Risk Weighted Assets (%)	16.6	16.7	16.9	20.0	19.7	18.0 ⁶
Problem Loans / (Tangible Common Equity + Loan Loss Reserve) (%)	47.9	45.2	22.3	17.3	19.8	30.5 ⁵
Net Interest Margin (%)	3.5	3.8	4.2	4.1	4.1	3.9 ⁵
PPI / Average RWA (%)	3.0	3.9	4.2	4.1	3.3	3.7 ⁶
Net Income / Tangible Assets (%)	0.9	0.8	1.2	1.2	0.8	1.0 ⁵
Cost / Income Ratio (%)	63.8	58.2	58.7	60.5	68.1	61.9 ⁵
Market Funds / Tangible Banking Assets (%)	18.2	16.3	22.1	28.0	21.2	21.2 ⁵
Liquid Banking Assets / Tangible Banking Assets (%)	12.6	13.7	12.9	11.2	13.5	12.8 ⁵
Gross Loans / Due to Customers (%)	124.8	121.9	146.5	171.0	132.1	139.2 ⁵

[1] All figures and ratios are adjusted using Moody's standard adjustments. [2] Basel III - fully loaded or transitional phase-in; IFRS. [3] May include rounding differences because of the scale of reported amounts. [4] Compound annual growth rate (%) based on the periods for the latest accounting regime. [5] Simple average of periods for the latest accounting regime. [6] Simple average of Basel III periods.

Sources: Moody's Ratings and company filings

Profile

Bluestep Bank AB (publ) (Bluestep) is a specialised mortgage bank, wholly owned by Bluestep Holding AB. Bluestep is headquartered in Sweden and operates across Sweden (43% of the loan portfolio as at June 2024), Norway (53%) and Finland (4%). As of June 2024 the bank reported total assets of SEK32.8 billion (€2.9 billion). Bluestep Bank is the regulated entity of the group and is under the supervision of the Swedish Financial Supervisory Authority (SFSA), with a banking license since 2016.

Bluestep was established in 2004 in Sweden and expanded into Norway in 2010, and to Finland in 2020. The bank specialises in mortgages to customers with a limited or more adverse credit history, having sold its personal unsecured lending business in early 2021 (5% of gross loans at the time). In Sweden, Bluestep also markets an equity release product targeting customers 60 years and older. Furthermore, Bluestep has been gathering retail deposits in Sweden since 2008, in Norway since 2010 and in Germany since 2023, with the latter market providing euro-denominated funding for the loan book in Finland.

Since 2017 Bluestep has been owned by EQT VII, a private equity fund established by the investment firm EQT Group. Following a strategic review in 2022, the private equity fund decided to remain committed to Bluestep. In October 2023, Bluestep acquired Bank2, a Norwegian non-prime mortgage lender, which increased the bank's loan portfolio by approximately NOK 5 billion.

Detailed credit considerations

Elevated asset risk, through lending to nonconforming borrowers

The assigned Asset Risk score of ba1, which is three notches below the Macro Adjusted score, reflects Bluestep's residential mortgage lending with a focus on non-prime mortgages and historically high loan growth, as well as the inclusion of Bank2, which we consider to hold higher asset risk. Given the profiles of the bank's customers, asset risk is more sensitive to economic shocks compared to prime mortgage lenders.

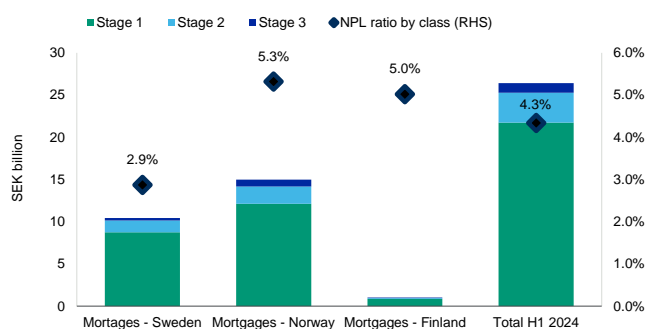
Debt service costs have increased for home owners over the past two years because of elevated inflation and increased interest rates. This has resulted in a deterioration in asset quality for Bluestep, with the stage 3 loan ratio increasing from 1.92% by year end 2022, to 4.41% as of Q2 2024. The acquisition of Bank2 in 2023 increased the stage 3 loan ratio of Bluestep, but even when excluding Bank2, the stage 3 loan ratio would be 3.1% as of Q2 2024. Reduced inflation and a more benign rate cycle will limit further underlying deterioration in asset quality.

We regard Bluestep's coverage (loan loss reserves/problem loans) of 12.9% as of June 2024 to be low. The LTV ratios are higher than that of many of the company's Nordic peers because of the faster turnover in its portfolio. At the end of 2023, 31% of mortgages had an LTV of 80% and above. Due to the high LTVs and non-prime borrowers, Bluestep risks increasing credit losses during a more severe economic downturn with sharply falling house prices and increasing unemployment. On the other hand, Bluestep's average loan size is relatively small in the Nordic context, which could support loan affordability even if unemployment increases further. Unemployment benefits are more generous in the Nordic countries than in most other European countries, allowing people to continue paying interest on their mortgages while unemployed.

Although the bank's loan growth has been high for many years, regulatory reforms (including amortisation requirements) have moderated the pace of expansion in recent years. Gross loans increased by 37.4% in H1 2024 compared to H1 2023, or SEK7.2 billion, mainly due to the acquisition of Bank2 in Norway which added SEK5.1 billion to the loan book. Bluestep follows the current regulations that stipulate that a mortgage cannot exceed an 85% LTV ratio at origination. In Finland where Bluestep has started its mortgage activities recently, the maximum LTV is 95% according to regulation, but we do not expect Bluestep to extend mortgages with such high LTV. Bluestep requires customers to amortize their mortgages, even when there is no legal requirement to do so.

Exhibit 3

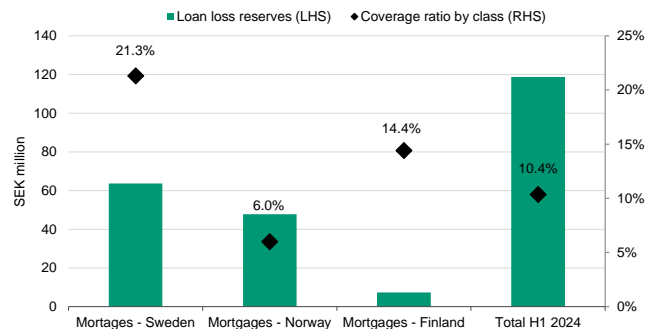
Level of problem loans, illustrated by Stage 3 exposures, are higher than that of its Nordic peers, driven by the Norwegian portfolio



Data is based on the mortgage loan portfolios.
Source: Company reports

Exhibit 4

Loan-loss reserves and coverage ratio are adequate, given the large amount of collateral



Source: Company reports

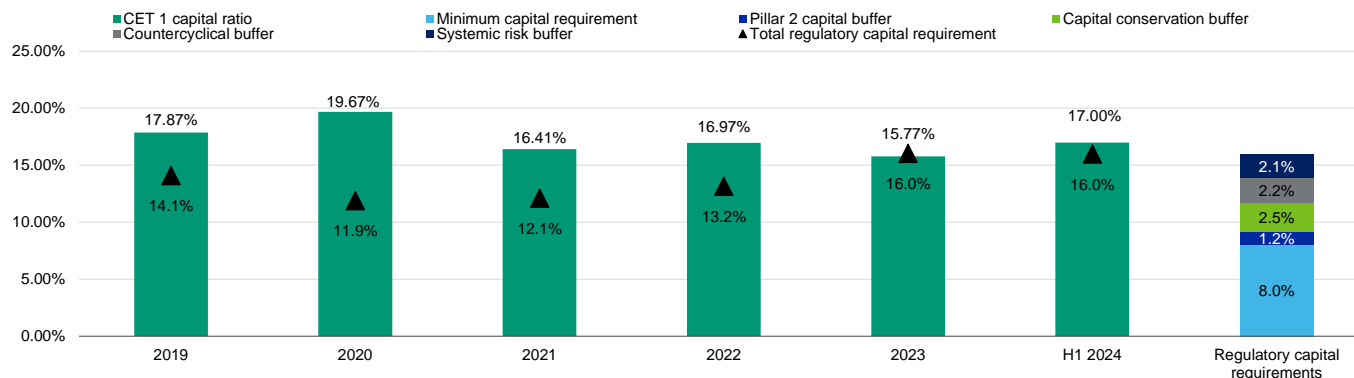
Sound capitalisation materially above regulatory requirements, but limited transparency regarding any additional access to capital

We view Bluestep's capitalisation as strong, as indicated by the a1 assigned Capital score. The score is two notches below the Macro Adjusted score, to reflect higher uncertainty on access to capital in case of need, as the bank is owned by a closed end private equity fund.

The bank does not have any stated dividend policy. A dividend of SEK37 million for 2022, was paid out during 2023, after a distribution of SEK300 million the prior year, and the TCE/RWA ratio stood at 16.6% as of Q2 2024, broadly unchanged from year-end 2023. We expect Bluestep's capitalisation to remain at a TCE/RWAs level of around 16% (equivalent to an initial score of aa2).

On a consolidated basis Bluestep's Common Equity Tier 1 (CET1) capital ratio increased to 17.0% as of June 2024 compared to 15.5% as of December 2023 and a CET1 target of 16%. The increase is largely explained by the approval from the Swedish FSA in Q1 2024 to include capital issued by Bluestep Holding in late 2023 in own funds. The total capital ratio stood at 19.1% as of June 2024, which is comfortably above the regulatory requirement of 16.0% (see Exhibit 5). However, there is limited transparency regarding access to additional capital in case of need. Bluestep's shares are held as one investment of many within one of the funding vehicles of EQT Group. We expect the CET1 ratio to remain above 16% and increase with retained earnings.

Exhibit 5

Capitalisation will remain stable with a good buffer over regulatory requirements

Source: Company reports

TCE/total assets ratio was 7.0% as of June 2024 (June 2023: 7.3%).

Strong profitability supported by high interest rate margins, but integration costs limit near term improvement

The assigned Profitability score of baa1, which is in line with the Macro Adjusted score, reflects Bluestep's solid margins and expected efficiency improvements during the outlook period of 12-18 months from further scale advantages across the three markets and synergies from the acquisition of Bank2. However, profitability in 2024 will be somewhat subdued because of integration costs.

The net income to tangible assets ratio of 0.9% annualized for the first half of 2024 is weaker compared to 1.1% in the year-earlier period. The decrease in the bank's profitability ratio in the first half 2024 was caused by increased costs associated with the merger of Bank2.

Bluestep's underlying profitability is driven by the relatively high interest rates on its mortgages, ranging from around 6% to above 10%, compared with an average of floating rates of around 4.5% for all banks in the Swedish market in July 2024. This resulted in a very strong net interest rate margin of 3.5% for the first half of 2024 slightly down from 4.0% in the year-earlier period. Net interest income is Bluestep's main source of income, accounting for 97.5% of total operating income the first half of 2024. The higher interest rates help to offset higher loan loss provisions needed if asset quality deteriorates.

While most Nordic peers cost-to-income ratio is around 48% or lower, Bluestep's efficiency is relatively weaker with a cost-to-income ratio of 64% for the first half of 2024, which has deteriorated from 56% in the year earlier period due to costs relating to the Bank2 acquisition. Bluestep's higher cost-to-income ratio is also due to the bank's largely manual underwriting process. Furthermore, Bluestep suffers from higher early repayment levels as customers leave, on average, after four years, following improvements in their credit scores. This compares with the average seven-year duration of mortgage loans at traditional banks.

Bluestep continues its investments in digital processes including IT and product development. This together with the centralisation of back-office functions, will lead to meaningful cost reductions.

Reliance on market funding, which renders the bank vulnerable to fluctuations in investor sentiment

Bluestep's assigned funding score of baa2 is three notches below the Macro Adjusted score, and reflects the bank's high reliance on market funding in the form of covered bonds and senior unsecured funding and sourcing deposits through internet channel, which we consider to be less sticky. A deterioration in asset quality could also weaken the bank's deposit franchise and access to market funding.

The bank issued its first covered bond in April 2020 and had SEK5.2 billion outstanding covered bonds by June 2024. Bluestep continues to be active in the senior unsecured market with outstanding volumes of SEK2.8 billion in first half of 2024, after making its first issuance in December 2018. Bluestep also issued Tier 2 notes of SEK300 million in 2024, bringing the total Tier 2 debt to SEK300 million and NOK60 million, the latter instrument issued by Bank2.

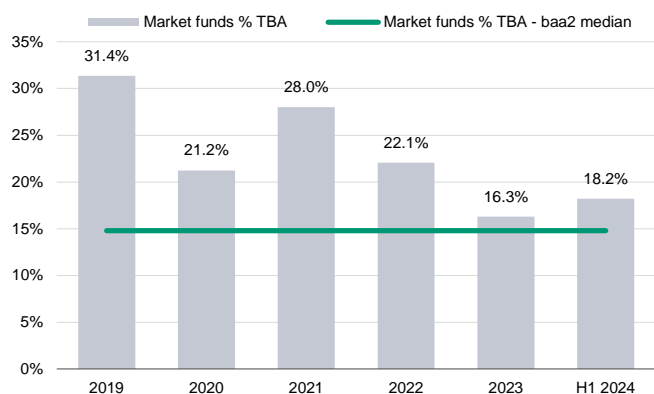
Bluestep's Moody's adjusted market funds to TBA ratio was 18.2% as of June 2024 (2023: 16.3%), including the 50% deduction of all covered bonds as per our Banks Methodology. Bluestep's issuances of covered bonds has helped the bank attract more domestic

investors, who we consider less likely to sell in a stressed market scenario compared with foreign investors. However, due to the relatively untested market for covered bonds with non-conforming borrowers, we apply Moody's standard 50% covered bond adjustment to Bluestep's funding structure assessment, which is lower than for other SEK denominated covered bonds where we deduct 75% of outstanding volumes. As the bank continues to tap the covered bond market, we expect that the term structure will be managed to avoid larger refinancing hurdles.

Deposits accounted for 70% of non equity funding as of June 2024, up from 67% one year-earlier. The loans to deposit ratio increased slightly to 125% at the end of June 2024 compared to 122% at the end of 2023.

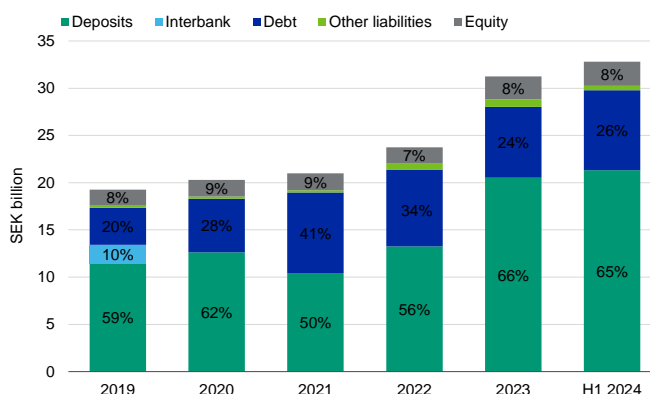
The assigned liquidity score of baa3, which is in line with the Macro Adjusted score, reflects the relative stability in Bluestep's liquid resources over time. Bluestep holds adequate liquid reserves of high-quality assets and cash at banks. The bank's liquid assets is around SEK4.1 billion as of June 2024, stable on the same level since year-end 2023, corresponding to the Moody's adjusted liquid assets to tangible banking assets ratio of 12.6%, which is low. This is broadly in line with the ratio of the bank's high quality liquid assets and lending to credit institutions to tangible banking assets of 12.4%.

Exhibit 6
Bluestep has a high reliance on market funding



baa2 median is per H1 2024.
 Source: Company reports and Moody's Ratings

Exhibit 7
Bluestep has gradually shifted away from interbank borrowing and RMBS to senior unsecured debt and covered bonds



Source: Company reports

Monoline business increases reliance on a single source of revenue

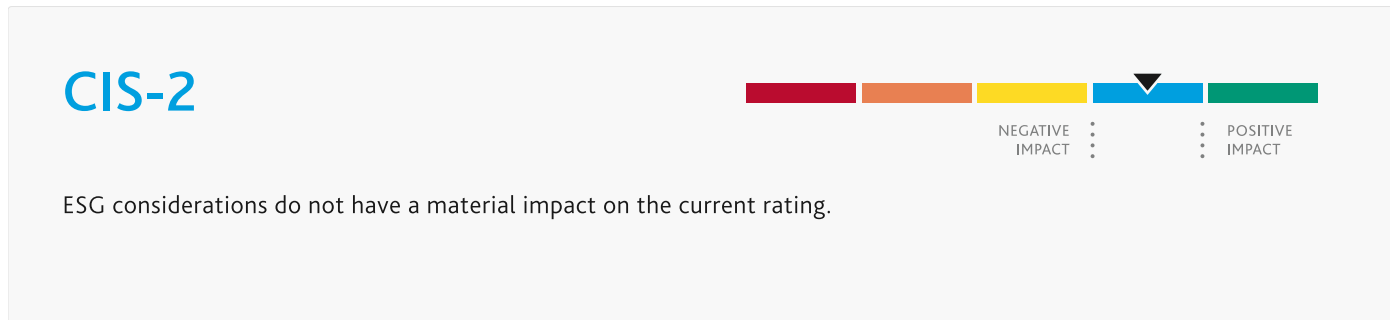
Because Bluestep derives most of its income from its mortgage customers, primarily in the form of net interest income, the BCA includes a one-notch negative adjustment to reflect its monoline business model, similar to what we apply to other mortgage banks.

ESG considerations

Bluestep Bank AB (publ)'s ESG credit impact score is CIS-2

Exhibit 8

ESG credit impact score

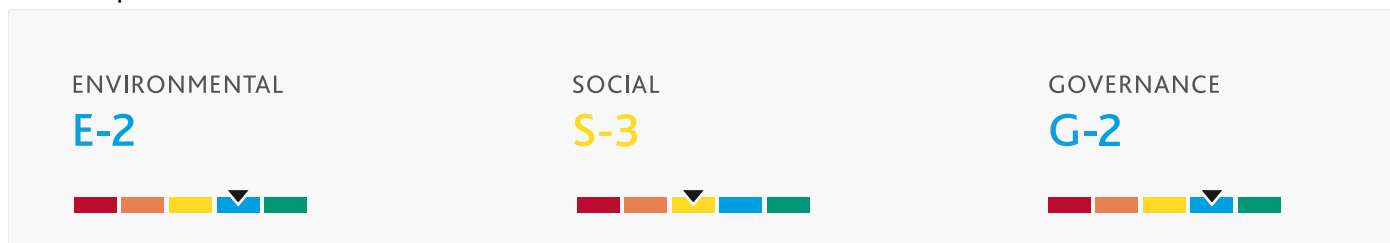


Source: Moody's Ratings

Bluestep's CIS-2 indicates that ESG considerations do not have a material impact on the current rating.

Exhibit 9

ESG issuer profile scores



Source: Moody's Ratings

Environmental

Bluestep faces low environmental risks, specifically in relation to carbon transition risks. This is because of the structure of its loan book, predominantly mortgages, which typically carry low carbon transition risk.

Social

Bluestep faces moderate industry-wide social risks related to customer relations and associated regulatory and litigation risks, requiring high compliance standards. These risks are mitigated by the bank's developed policies and procedures. High cyber and personal data risks are mitigated by the bank's strong IT framework. Bluestep has strong customer relationships and close monitoring as necessitated by its focus on non-prime and near-prime customers.

Governance

Bluestep faces low governance risks. Since 2017 the bank is owned by the private equity fund, EQT VII, leading to limited transparency regarding access to capital in case of need. However, the owner's strategic direction has been clear, in that Bluestep is to be a pure mortgage lender. While the acquisition of Bank2 initially increases risks related to financial strategy and risk management, management has demonstrated a strong track record of reducing asset risk and we assess that Bluestep will continue to do so with Bank2. The governance risks are also mitigated by Bluestep's regulated status and its strong track record of operation.

ESG Issuer Profile Scores and Credit Impact Scores for the rated entity/transaction are available on Moodys.com. In order to view the latest scores, please click [here](#) to go to the landing page for the entity/transaction on MDC and view the ESG Scores section.

Support and structural considerations

Loss Given Failure (LGF) analysis

We apply our Advanced LGF analysis to Bluestep because the bank operates in Sweden, Norway and Finland, which we consider operational resolution regimes. For this analysis, we assume that the equity and losses are 3% and 8%, respectively, of tangible banking assets in a failure scenario. We also assume a 25% runoff in junior wholesale deposits and a 5% runoff in preferred deposits. Moreover, we assign a 25% probability to junior deposits being preferred to senior unsecured debt. These are in line with our standard assumptions. Given the bank's focus on retail deposits, we assume that the bank's junior deposits account for 10% of total deposits, in line with those of other retail mortgage banks in Sweden.

Our forward-looking LGF analysis indicates that Bluestep's depositors and senior unsecured bondholders are likely to face moderate loss given failure because of the loss absorption provided by subordinated debt, and by the volume of Bluestep's senior debt and deposits (including our expectation of future issuance and deposit growth). The LGF analysis results in a two-notch uplift to Bluestep's long-term deposit and issuer ratings.

Government support considerations

Because of the small size of Bluestep's retail operations, we assume a low probability of government support for the bank, resulting in no uplift to any of its ratings or assessments.

Methodology and scorecard

About Moody's Bank Scorecard

Our scorecard is designed to capture, express and explain in summary form our Rating Committee's judgement. When read in conjunction with our research, a fulsome presentation of our judgement is expressed. As a result, the output of our scorecard may materially differ from that suggested by raw data alone (though it has been calibrated to avoid the frequent need for strong divergence). The scorecard output and the individual scores are discussed in rating committees and may be adjusted up or down to reflect conditions specific to each rated entity.

Rating methodology and scorecard factors

Exhibit 10

Rating Factors

Macro Factors							
Weighted Macro Profile	Very Strong -	100%					
Factor	Historic Ratio	Initial Score	Expected Trend	Assigned Score	Key driver #1	Key driver #2	
Solvency							
Asset Risk							
Problem Loans / Gross Loans	4,4%	baa1	↔	ba1	Quality of assets	Collateral and provisioning coverage	
Capital							
Tangible Common Equity / Risk Weighted Assets (Basel III - transitional phase-in)	16,6%	aa2	↔	a1	Access to capital		
Profitability							
Net Income / Tangible Assets	0,9%	baa1	↔	baa1	Return on assets		
Combined Solvency Score		a2		baa1			
Liquidity							
Funding Structure							
Market Funds / Tangible Banking Assets	16,3%	a2	↓	baa2	Deposit quality	Expected trend	
Liquid Resources							
Liquid Banking Assets / Tangible Banking Assets	13,7%	baa3	↔	baa3	Stock of liquid assets		
Combined Liquidity Score		baa1		baa2			
Financial Profile							
Qualitative Adjustments				Adjustment			
Business Diversification				-1			
Opacity and Complexity				0			
Corporate Behavior				0			
Total Qualitative Adjustments				-1			
Sovereign or Affiliate constraint				Aaa			
BCA Scorecard-indicated Outcome - Range				baa1 - baa3			
Assigned BCA				baa2			
Affiliate Support notching				0			
Adjusted BCA				baa2			
Balance Sheet							
		in-scope (SEK Million)	% in-scope	at-failure (SEK Million)	% at-failure		
Other liabilities		7 101	21,8%	8 593	26,4%		
Deposits		21 316	65,5%	19 823	60,9%		
Preferred deposits		19 184	58,9%	18 225	56,0%		
Junior deposits		2 132	6,5%	1 599	4,9%		
Senior unsecured bank debt		2 800	8,6%	2 800	8,6%		
Dated subordinated bank debt		360	1,1%	360	1,1%		
Equity		977	3,0%	977	3,0%		
Total Tangible Banking Assets		32 553	100,0%	32 553	100,0%		

Debt Class	De Jure waterfall		De Facto waterfall		Notching		LGF Notching Guidance vs. Adjusted BCA	Assigned LGF notching	Additional Notching	Preliminary Rating Assessment
	Instrument volume + subordination	Sub-ordination	Instrument volume + subordination	Sub-ordination	De Jure	De Facto				
Counterparty Risk Rating	17,6%	17,6%	17,6%	17,6%	3	3	3	3	0	a2
Counterparty Risk Assessment	17,6%	17,6%	17,6%	17,6%	3	3	3	3	0	a2 (cr)
Deposits	17,6%	4,1%	17,6%	12,7%	2	3	2	2	0	a3
Senior unsecured bank debt	17,6%	4,1%	12,7%	4,1%	2	1	2	2	0	a3

Instrument Class	Loss Given Failure notching	Additional notching	Preliminary Rating Assessment	Government Support notching	Local Currency Rating	Foreign Currency Rating
Counterparty Risk Rating	3	0	a2	0	A2	A2
Counterparty Risk Assessment	3	0	a2 (cr)	0	A2(cr)	
Deposits	2	0	a3	0	A3	A3
Senior unsecured bank debt	2	0	a3	0	A3	A3

[1] Where dashes are shown for a particular factor (or sub-factor), the score is based on non-public information.

Source: Moody's Ratings

Ratings

Exhibit 11

Category	Moody's Rating
BLUESTEP BANK AB (PUBL)	
Outlook	Negative
Counterparty Risk Rating	A2/P-1
Bank Deposits	A3/P-2
Baseline Credit Assessment	baa2
Adjusted Baseline Credit Assessment	baa2
Counterparty Risk Assessment	A2(cr)/P-1(cr)
Issuer Rating	A3

Source: Moody's Ratings

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