CREDIT OPINION
7 November 2023

Update

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RATINGS

Bluestep Bank AB (publ)

Domicile	Sweden
Long Term CRR	A2
Type	LT Counterparty Risk Rating - Fgn Curr
Outlook	Not Assigned
Long Term Debt	Not Assigned
Long Term Deposit	A3
Type	LT Bank Deposits - Fgn Curr
Outlook	Stable

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 rating action

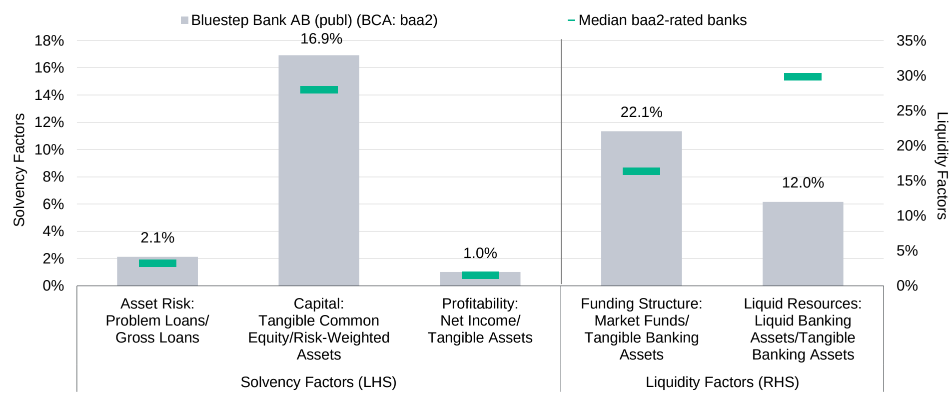
Summary

Bluestep Bank AB (publ)'s (Bluestep) A3/P-2 deposit rating incorporates the bank's baa2 Baseline Credit Assessment (BCA) and two notches of uplift as indicated by our Advanced Loss Given Failure (LGF) analysis, capturing the large volumes of loss-absorbing obligations protecting depositors in case of failure.

The baa2 BCA reflects the strengthening in the bank's Norwegian franchise with the acquisition of Bank2, a smaller non-conforming lender in Norway, robust capitalization, and strong recurring earnings. These strengths are balanced by relatively high asset risk compared to other mortgage banks due to the banks focus on non-prime and near-prime borrowers, and reliance on market funding and internet sourced deposits. We view the operational and execution risks associated with the acquisition to be limited.

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 Investors Service

Credit strengths

» Strong capitalisation

» High repayment rates supported by generous governmental unemployment benefits and state run collection agencies

» Strong profitability, with a large market share within the niche nonconforming Swedish and Norwegian mortgage markets

Credit challenges

» Elevated asset risk, through lending to nonconforming borrowers

» Reliance on market funding

Outlook

» The stable outlook reflects Moody's expectations that the acquisition of Bank2 will result in fundamentals in line with the current baa2 BCA. The outlook also reflects an increased issuance of at least SEK100 million senior unsecured debt within the coming quarters to support the current advanced LGF two notches uplift.

Factors that could lead to an upgrade

» The BCA could be upgraded if the bank reduces asset risk by an increased focus on prime customers, alongside a sustained reduction in the level of non-performing loans. An upgrade in the BCA would result in the deposit ratings being upgraded.

Factors that could lead to a downgrade

» The deposit 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: (i) the bank experienced a significant deterioration in asset risk, including the proportion of problem loans to gross loans rising above 4%, or the volume of Stage 2 loans increasing rapidly; and (ii) tangible common equity declining to below 16% of risk weighted assets; or (iii) a deterioration in fundamentals as a result of unexpected events linked to the acquisition with Bank2.

Key indicators

Exhibit 2

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

	06-23[2]	12-22[2]	12-21[2]	12-20[2]	12-19[2]	CAGR/Avg.[3]
Total Assets (SEK Million)	22,687.9	23,750.6	21,002.2	20,281.6	19,253.5	4.8[4]
Total Assets (USD Million)	2,100.5	2,279.4	2,321.5	2,469.6	2,056.8	0.6[4]
Tangible Common Equity (SEK Million)	1,658.5	1,615.1	1,696.4	1,621.3	1,497.9	3.0[4]
Tangible Common Equity (USD Million)	153.5	155.0	187.5	197.4	160.0	(1.2)[4]
Problem Loans / Gross Loans (%)	2.1	1.9	1.7	2.0	1.9	1.9[5]
Tangible Common Equity / Risk Weighted Assets (%)	16.9	16.9	20.0	19.7	18.2	18.3[6]
Problem Loans / (Tangible Common Equity + Loan Loss Reserve) (%)	24.0	22.3	17.3	19.8	20.1	20.7[5]
Net Interest Margin (%)	4.0	4.2	4.1	4.1	4.5	4.2[5]
PPI / Average RWA (%)	4.4	3.8	4.1	3.3	4.2	4.0[6]
Net Income / Tangible Assets (%)	1.1	1.0	1.2	0.8	0.8	1.0[5]
Cost / Income Ratio (%)	56.2	62.7	60.5	68.1	60.6	61.6[5]
Market Funds / Tangible Banking Assets (%)	19.0	22.1	28.0	21.2	31.4	24.3[5]
Liquid Banking Assets / Tangible Banking Assets (%)	6.5	12.0	9.8	13.5	11.2	10.6[5]
Gross Loans / Due to Customers (%)	137.5	146.5	171.0	132.1	141.5	145.7[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 Investors Service and company filings

Profile

Bluestep Bank AB (publ) (Bluestep) is wholly owned by Bluestep Holding AB and is the parent of the Bluestep Bank Group, which includes four subsidiaries that operate in Sweden, Finland and Norway. As of June 2023 the bank reported total assets of SEK22.7 billion (€1.9 billion). Bluestep Bank is the regulated entity of the group and is under the supervision of the Swedish Financial Supervisory Authority (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. In November 2020 Bluestep agreed to sell its personal unsecured lending business (5% of gross loans at the time) and the portfolio was transferred on 1 January 2021. Furthermore, Bluestep has been gathering retail deposits in Sweden since 2008 and in Norway since 2010.

Since 2017 Bluestep has been owned by EQT VII, a private equity fund established by the investment firm EQT Group, with €3.1 billion of assets under management and total investments of €16.2 billion as of June 2023.

Recent developments

On 21 June 2023 Bluestep Bank announced that it is acquiring Norwegian non-prime mortgage bank Bank2 ASA. Bank2 is a Norwegian bank that provides specialist mortgages and refinancing services exclusively for the Norwegian market. The bank was established in 2005 and has served more than 10,000 customers since inception. Bank2 has a loan portfolio of approximately NOK 4.5 billion per end of March 2023 with 36 employees, all at the head office in Oslo, Norway. Bank2 operates under a banking license in Norway and is under the supervision of the Norwegian Financial Supervisory Authority. The purchase price amounts to around NOK 1 billion and the acquisition was completed in October 2023.

In the beginning of 2022 EQT VII, the owner, initiated a strategic review to explore strategic alternatives for its ownership, including a potential public listing on the stock exchange among other alternatives. This is in line with its strategy to hold its portfolio companies between four to six years. The strategic review concluded with EQT VII deciding to remain committed to Bluestep Bank.

During 2022 Bluestep Bank notified the Swedish Financial Services Authority of the intention to provide cross-border services by offering deposit products to customers residing in Germany. The notification was acknowledged by the Swedish Financial Services Authority and thereafter also by the German Federal Financial Supervisory Authority ("BaFin"). This will enable Bluestep Bank to further diversify the Group's funding.

On 27 November 2020, Bluestep announced the divestment of its personal loan portfolio to Svea Ekonomi as part of the bank's strategy to fully focus on mortgage lending. The portfolio was transferred on 1 January 2021. We view the sale of Bluestep's personal loan portfolio as positive.

Detailed credit considerations

Bluestep's asset quality likely to deteriorate moderately

Due to high inflation and increased interest rates, debt service costs are increasing for borrowers. Due to Bluestep's exposure to weaker borrowers, we expect asset quality to deteriorate moderately; with the non-performing loan ratio to increase moderately from 3.3% including Bank2 (pro-forma) at end of June 2023, compared to 1.92% for Bluestep Bank as of year-end 2022. If we see a scenario with rapidly increasing unemployment, the increase in problem loans would be steeper. The assigned Asset Risk score of baa3 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. The asset risk score also reflects the increase in problem loans that will occur if unemployment rates rise.

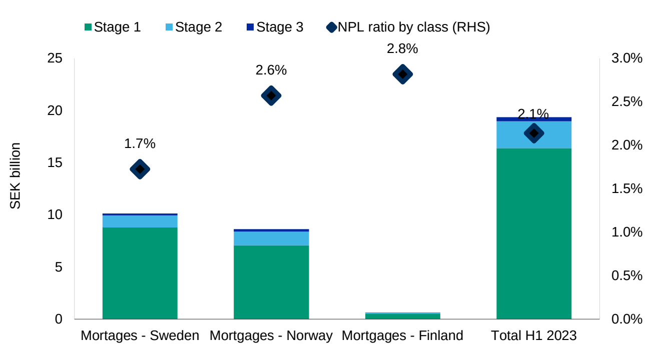
Bluestep's problem loans to gross loans ratio deteriorated slightly during 2023 to 2.14% as of June 2023 from 1.92% at the end of 2022. As of February 2020 Bluestep stopped offering private unsecured loans, pursuing its strategy to completely focus on residential mortgages. The Swedish unsecured personal loan portfolio that accounted for 4% at year-end 2020 was sold on 1 January 2021, whereby we expect the asset risk profile of the bank to continue to improve.

We regard Bluestep's coverage (loan loss reserves/problem loans) of 15.8% as of June 2023 to be low (see Exhibit 4). However, the bank's problem loans/TCE and loan-loss reserves ratio was a relatively strong 24.0% as of June 2023. The LTV ratios are higher than that of many of the company's Nordic peers because of the faster turnover in its portfolio. In Sweden, 39% of the exposures had an LTV higher than 80% at the end of 2022. In Norway the figure was 31%, and in Finland 22%. Due to the high LTVs and weak borrowers, Bluestep risks not being able to collect the outstanding debt 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. 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 6.4% in H1 2023 compared to H1 2022, with the volumes affected by a weaker Norwegian krona. 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.

Exhibit 3

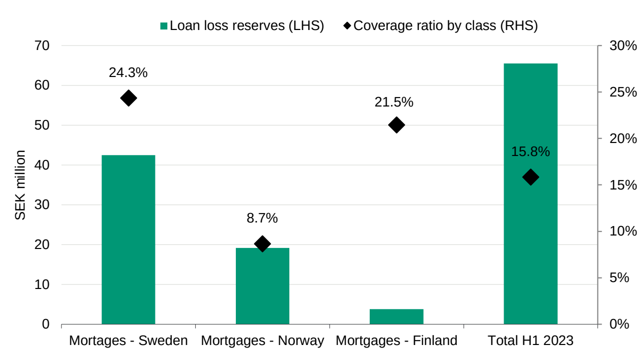
Level of problem loans, illustrated by Stage 3 exposures, are higher than that of its Nordic peers, but low in an international context



Source: Company reports

Exhibit 4

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



Source: Company reports

Acquisition reduces the bank's capitalisation, although robust buffers above regulatory capital requirements remain

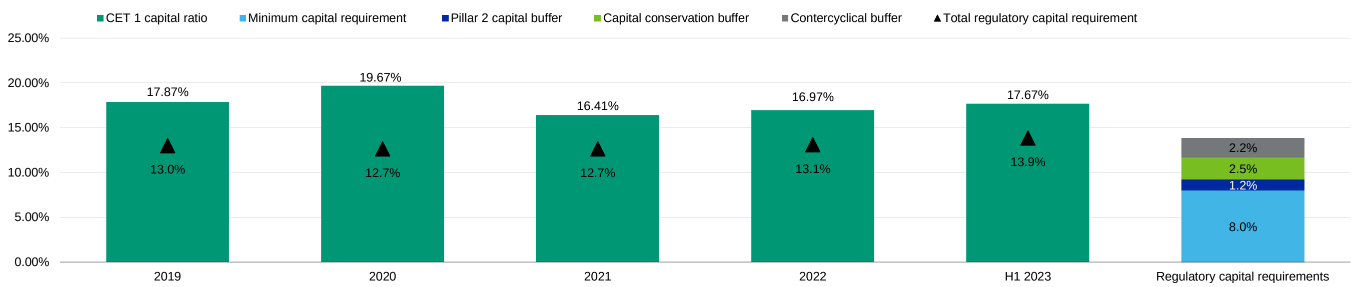
We view Bluestep's capitalisation as strong, although we apply a negative adjustment to Bluestep's assigned capital score of a1, given the limited transparency regarding the access to capital in case of need.

A dividend of SEK300 million for 2021, was paid out during 2022, reducing TCE/RWA to 16.9% from 20.0% in 2021. We expect the bank's capitalisation to remain at a TCE/RWAs level of around 16% (equivalent to an initial score of aa2).

On a consolidated situation Bluestep's Common Equity Tier 1 (CET1) capital ratio increased to 17.67% as of June 2023 compared to 16.97% in the year-earlier period. The CET1 capital ratio is still comfortably above the regulatory requirement of 13.9% as of June 2023 (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. With the acquisition of Bank2, we expect capital injections from the owners to largely offset the increase in RWA's and intangible assets in order to preserve capitalisation levels. We expect that CET1 ratio will remain above 16% and increase with retained earnings.

On June 22, 2022, the Swedish FSA decided to raise the countercyclical buffer (CCB) to 2% with effect from 22 June 2023, largely restoring the pre-pandemic CCB of 2.5%. In our view, Bluestep's total capital ratio is well above the increased requirement and this does not cause a restriction on Bluestep's ability to extend further lending.

Exhibit 5
Capitalisation will remain stable with a good buffer over regulatory requirements



Source: Company reports

TCE/total assets ratio was 7.3% as of June 2023 (June 2022: 6.8%).

Strong profitability supported by high interest rate margins

The assigned Profitability score of a3 reflects Bluestep's strong margins, improving efficiency, and the expected level of profitability during the outlook period of 12-18 months.

Bluestep’s recurring profitability is strong, with the net income to tangible assets ratio of 1.1% annualized for the first half of 2023, which is stronger compared to 0.9% in the year-earlier period. The increase in the bank's profitability in the first half 2023 was caused by increasing net interest income and lower operating expenses, partly offset by higher loan loss provisions.

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 4.57% for all banks in July 2023. This resulted in a very strong net interest rate margin of 4.0% for the first half of 2023 slightly down from 4.2% in the year-earlier period. Net interest income is Bluestep’s main source of income, accounting for 94.4% of total operating income the first half of 2023 and it increased due to loan growth and the higher interest rate environment. The higher interest rates will help to offset higher loan loss provisions if asset quality deteriorates.

While most Nordic peers cost-to-income ratio is around 46% or lower, Bluestep’s efficiency is relatively weaker with a cost-to-income ratio of 56% for the first half of 2023, however improving significantly from 69% in the year earlier period (which was affected by the investments in the launch of their Finnish operations and equity release product “60plusbanken”). 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 three 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, is leading to meaningful cost reductions.

Funding structure is a mix of deposits, covered bonds and senior unsecured bonds

Bluestep's assigned funding score of baa2 reflects the high reliance on market funding in the form of covered bonds and senior unsecured funding and sourcing deposits through internet channel, which Moody's considers to be less sticky. Their assigned liquidity score of baa3 reflects that Bluestep's liquid resources is relatively stable over time.

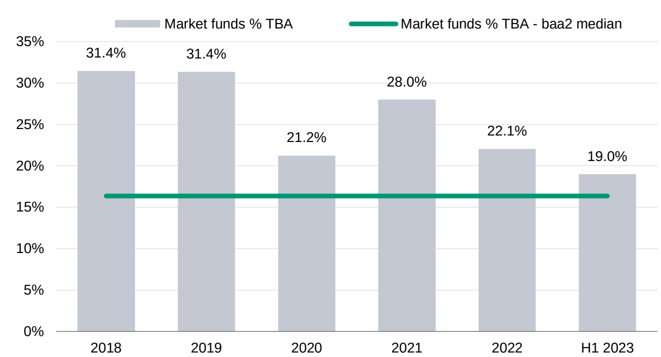
The bank issued its first covered bond in April 2020 and had SEK4.0 billion outstanding covered bonds by June 2023 and the last RMBS was redeemed in May 2022. Bluestep continues to be active in the senior unsecured market with outstanding volumes of SEK1,550 million and NOK550 million in first half of 2023, after making its first issuance in December 2018.

Bluestep's Moody's adjusted market funds to TBA ratio was 19.0% as of June 2023 (2022: 22.1%) (see Exhibit 6), 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 67% of non equity funding as of June 2023, up from 54% one year-earlier. The loans to deposit ratio decreased to 137% at the end of June 2023 compared to 146% at the end of 2022.

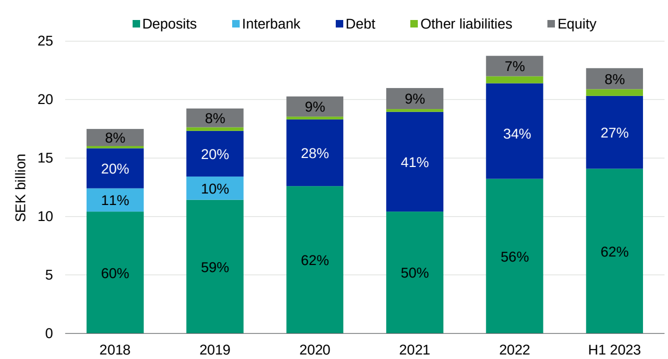
Bluestep holds adequate liquid reserves of high-quality assets and cash at banks. The bank's liquid assets decreased by 48% to SEK1.5 billion as of June 2023 from SEK2.8 billion as of year-end 2022, corresponding to the Moody's adjusted liquid assets to tangible banking assets ratio of 6.5%, which is low. When including the bank's high quality liquid assets, the liquid assets to tangible banking assets ratio increases to 7.9%.

Exhibit 6
Bluestep has a high reliance on market funding



Source: Company reports and Moody's Investors Service

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



Source: Company reports

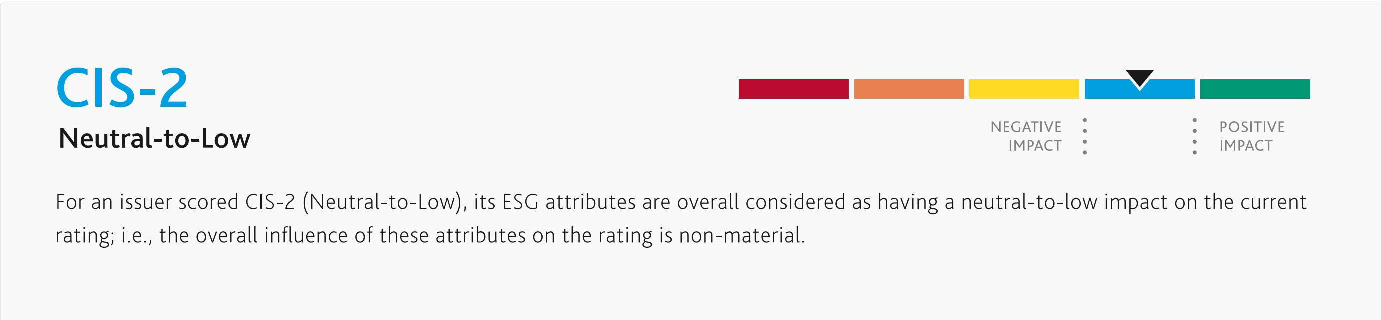
Monoline business increases reliance on a single source of revenue

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 other mortgage banks.

ESG considerations

Bluestep Bank AB (publ)'s ESG Credit Impact Score is Neutral-to-Low CIS-2

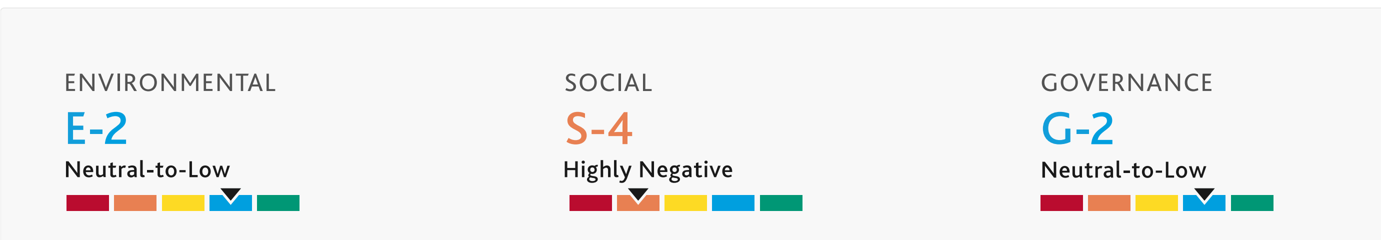
Exhibit 8
ESG Credit Impact Score



Source: Moody's Investors Service

Bluestep's ESG Credit Impact Score is low (**CIS-2**), reflecting that ESG considerations do not have a material impact on the current rating.

Exhibit 9
ESG Issuer Profile Scores



Source: Moody's Investors Service

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 high 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.

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 is subject to the European Union Bank Recovery and Resolution Directive, which we consider an operational resolution regime. 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 LGF assessment is forward looking and incorporates the continued issuance of senior unsecured debt and expected balance-sheet growth. The deposit ratings of A3 incorporate a two-notch positive adjustment to the baa2 BCA because of the LGF analysis. The uplift reflects the large buffer of loss-absorbing liabilities protecting junior depositors in case of failure.

Counterparty Risk Ratings (CRRs)

Bluestep's CRRs are A2/Prime-1, incorporating three notches of uplift from the LGF analysis

There is a considerable volume of loss-absorbing liabilities junior to the CRR obligations. In this case, we assume a nominal volume at failure because we are not able to accurately assess the volume of CRR liabilities at failure or the inherently more volatile nature of such liabilities as the bank approaches failure. The ratings incorporate three notches of uplift for the CRRs from the bank's Adjusted BCA of baa2.

Counterparty Risk (CR) Assessment

Bluestep's CR Assessment is A2(cr)/Prime-1(cr), incorporating three notches of uplift from the LGF analysis

The main difference with our Advanced LGF approach used to determine instrument ratings is that the CR Assessment captures the probability of default on certain senior obligations rather than the expected loss. Therefore, we focus purely on subordination and take no account of the volume of the instrument class.

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

Bluestep Bank AB (publ)

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	2.1%	a1	↔	baa3	Quality of assets	Collateral and provisioning coverage
Capital						
Tangible Common Equity / Risk Weighted Assets (Basel III - transitional phase-in)	16.9%	aa2	↓	a1	Access to capital	Expected trend
Profitability						
Net Income / Tangible Assets	1.0%	a2	↔	a3	Expected trend	
Combined Solvency Score		aa3		a3		
Liquidity						
Funding Structure						
Market Funds / Tangible Banking Assets	22.1%	baa1	↔	baa2	Deposit quality	
Liquid Resources						
Liquid Banking Assets / Tangible Banking Assets	12.0%	baa3	↔	baa3		
Combined Liquidity Score		baa2		baa2		
Financial Profile				baa1		
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	5,688	25.2%	6,674	29.6%
Deposits	14,082	62.4%	13,096	58.1%
Preferred deposits	12,674	56.2%	12,040	53.4%
Junior deposits	1,408	6.2%	1,056	4.7%
Senior unsecured bank debt	2,105	9.3%	2,105	9.3%
Equity	677	3.0%	677	3.0%
Total Tangible Banking Assets	22,551	100.0%	22,551	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	17.0%	17.0%	17.0%	17.0%	3	3	3	3	0	a2
Counterparty Risk Assessment	17.0%	17.0%	17.0%	17.0%	3	3	3	3	0	a2 (cr)
Deposits	17.0%	3.0%	17.0%	12.3%	2	3	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

[1] Where dashes are shown for a particular factor (or sub-factor), the score is based on non-public information.
Source: Moody's Investors Service

Ratings

Exhibit 11

Category	Moody's Rating
BLUESTEP BANK AB (PUBL)	
Outlook	Stable
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)

Source: Moody's Investors Service

REPORT NUMBER 1380537

CLIENT SERVICES

Americas	1-212-553-1653
Asia Pacific	852-3551-3077
Japan	81-3-5408-4100
EMEA	44-20-7772-5454

Moody's
INVESTORS SERVICE