MOODY'S
INVESTORS SERVICE

CREDIT OPINION
21 December 2016

Update

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RATINGS

SkandiaBanken AB

Domicile	Sweden
Long Term Deposit	A2
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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SkandiaBanken AB

Semiannual Update

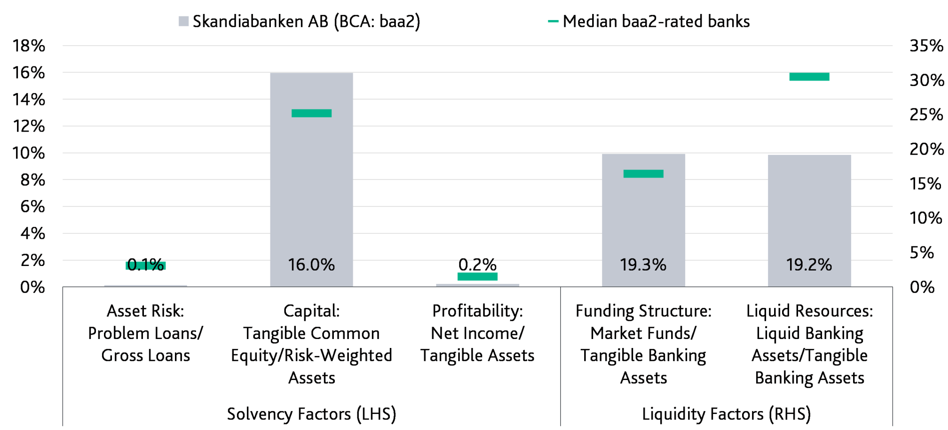
Summary Rating Rationale

We assign a baa2 baseline credit assessment (BCA), a3 Adjusted BCA and A2/Prime-1 long- and short-term deposit ratings with a negative outlook. We also assign a long-term and short-term counterparty risk assessment (CRA) of Aa3(cr)/Prime-1(cr) to the bank.

SkandiaBanken's baa2 baseline credit assessment reflects the bank's strategic role as the banking arm of the Skandia Group, very low reported problem loan ratio, and reliance on retail deposit funding. The BCA is limited by the bank's limited standalone franchise strength, its strong loan growth and weak profitability.

The bank benefits from a supportive insurance-parent (Skandia Insurance Company Ltd.; insurance financial strength rating A2 stable) which translates into an adjusted BCA of a3.

Exhibit 1
Rating Scorecard - Key Financial Ratios



Source: Moody's Financial Metrics

Credit Strengths

» Growing importance in the wider Skandia Group

» Strong asset quality

» Strong capital and higher-than-peers leverage ratio

» A retail-based funding profile and adequate liquidity given wholesale funding needs

» SkandiaBanken's BCA supported by Sweden “Very Strong-” Macro Profile

Credit Challenges

» Limited standalone franchise

» High lending growth

» Lower-than-peers efficiency and weak profitability

Rating Outlook

The negative outlook on SkandiaBanken's long-term deposit ratings reflects Moody’s forward-looking view of the bank’s balance sheet, given its plan to increase covered bonds issuance to support its planned growth. Moody’s notes that, under its Advanced Loss Given Failure analysis, a lower proportion of senior unsecured would result in lower protection for junior depositors. A higher-than-expected loss for junior depositors could also result if the share of junior deposits is significantly below our assumption of 10% of total deposits.

Factors that Could Lead to an Upgrade

SkandiaBanken’s BCA could be upgraded following a significant improvement in its efficiency and profitability ratios and/or a slowdown in its growth rate, whilst maintaining its asset quality, capital and liquidity metrics. An upward movement in its BCA would likely result in an upgrade of its deposit ratings.

Factors that Could Lead to a Downgrade

A weakening in the Swedish operating environment, impacting SkandiaBanken’s ability to absorb losses via earnings and capital, along with an increased reliance on confidence-sensitive wholesale funding could lead to a lower BCA. A change in Moody’s assessment of the probability of parental support could also lead to a lower Adjusted BCA. A downward movement in SkandiaBanken’s BCA and Adjusted BCA would likely result in a downgrade of its deposit ratings.

The long-term deposit ratings could also be downgraded if Moody's considers that SkandiaBanken’s changing liability structure results in a structural increase in risk for this instrument. This could be evidenced by a lower proportion of senior unsecured debt funding in the bank’s liability structure and/or by a lower than expected volume of junior deposits.

Key Indicators

Exhibit 2

SkandiaBanken AB (Consolidated Financials) [1]

	9-16[2]	12-15[2]	12-14[2]	12-13[2]	12-12[3]	Avg.
Total Assets (SEK million)	63,017.0	58,735.0	114,918.0	98,597.0	84,638.0	-7.1[4]
Total Assets (EUR million)	6,545.2	6,413.4	12,131.6	11,140.9	9,868.3	-9.8[4]
Total Assets (USD million)	7,355.4	6,966.9	14,679.9	15,351.6	13,010.3	-13.3[4]
Tangible Common Equity (SEK million)	3,578.0	3,921.0	5,036.0	3,907.0	3,169.0	3.1[4]
Tangible Common Equity (EUR million)	371.6	428.1	531.6	441.5	369.5	0.1[4]
Tangible Common Equity (USD million)	417.6	465.1	643.3	608.3	487.1	-3.8[4]
Problem Loans / Gross Loans (%)	0.0	0.1	0.2	0.2	0.3	0.2[5]
Tangible Common Equity / Risk Weighted Assets (%)	16.0	19.6	12.1	10.9	10.5	14.7[6]
Problem Loans / (Tangible Common Equity + Loan Loss Reserve) (%)	0.6	0.8	3.4	3.5	5.2	2.7[5]
Net Interest Margin (%)	1.1	1.2	1.3	1.2	1.4	1.3[5]
PPI / Average RWA (%)	0.8	0.2	1.5	0.7	1.2	0.8[6]
Net Income / Tangible Assets (%)	0.2	0.8	0.4	0.3	0.3	0.4[5]
Cost / Income Ratio (%)	80.6	95.7	67.0	81.0	78.2	80.5[5]
Market Funds / Tangible Banking Assets (%)	20.3	19.3	15.9	12.9	2.4	14.2[5]
Liquid Banking Assets / Tangible Banking Assets (%)	13.4	19.2	16.1	13.8	21.4	16.8[5]
Gross loans / Due to customers (%)	143.8	129.8	120.3	103.1	77.7	114.9[5]

[1] All figures and ratios are adjusted using Moody's standard adjustments [2] Basel III - fully-loaded or transitional phase-in; IFRS [3] Basel II; IFRS [4] Compound Annual Growth Rate based on IFRS reporting periods [5] IFRS reporting periods have been used for average calculation [6] Basel III - fully-loaded or transitional phase-in & IFRS reporting periods have been used for average calculation

Source: Moody's Financial Metrics

Detailed Rating Considerations

The financial data in the following sections are sourced from SkandiaBanken's third quarter 2016 financials or Moody's Financial Metrics, unless otherwise stated.

A Limited Standalone Franchise With Growing Importance in the Wider Skandia Group

SkandiaBanken is the banking arm of Skandia Insurance Company Ltd (A2, stable), which is owned by Livförsäkringsbolaget Skandia, ömsesidigt (Skandia Liv), a leading Swedish life insurer. The bank reported assets at end-September 2016 of SEK63 billion and a 1.9% share of the Swedish mortgage market.

SkandiaBanken focuses on mortgage lending and aims to grow its fee and commissions through higher volumes of customer transactions, both savings and payments. The bank sells its products on the internet, by phone, and through the branch network of the wider Skandia insurance group (54 branches). We consider it to be a monoline with a business model focused on mortgages, with earnings highly dependent on retail interest income, which represented over 70% of its operating income during the first nine months of 2016. This structural dependence results in a one-notch qualitative downwards adjustment to the BCA in respect of Business Diversification, an adjustment shared with the majority of the Swedish mortgage lenders.

In line with the group's strategic plan, SkandiaBanken has significantly grown over the last years: in 2013 management set a target of doubling the lending volume in five years' time and, at end-September 2016, SkandiaBanken reported SEK54 billion of outstanding mortgage, a 70% volume increase since 2013 (excluding the Norwegian operations). In October 2015, SkandiaBanken spun-off its Norwegian business, which had accounted for 54% of total lending at 30 September 2015 and was the most profitable part of the bank.

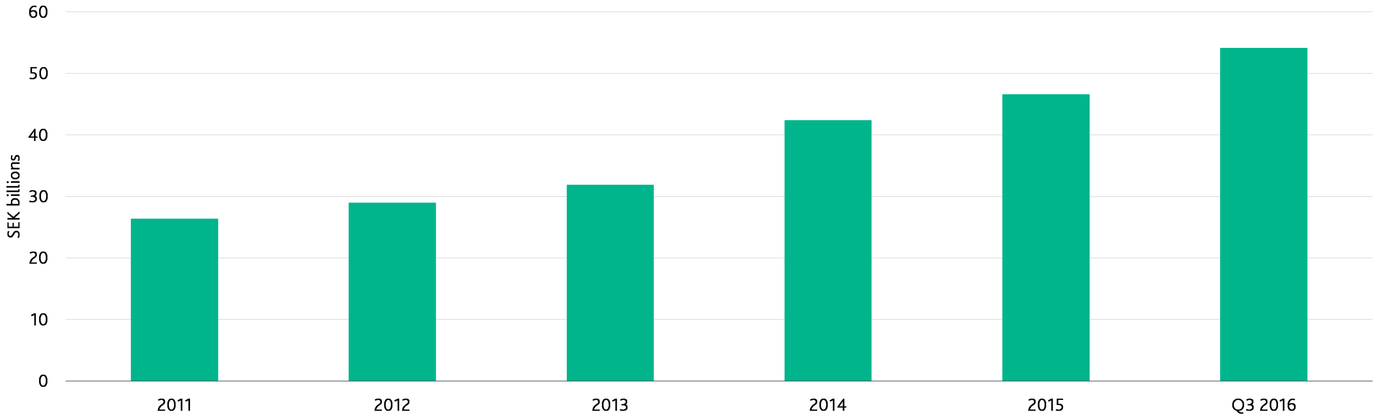
Strong Asset Quality, But High Lending Growth

Our a3 Asset risk score reflects SkandiaBanken's very low problem loan ratio – in line with all the Swedish mortgage lenders – and its significant lending growth over the last years, a result of the strategic plan to increase the bank's market share and size (see Exhibit 3).

Exhibit 3

Outstanding Loans to the Public in the Swedish Business

Skandiabanken has experienced significant lending growth over the past few years



Source: Company reports

SkandiaBanken reported problem loans ratio at end of September 2016 was very low at 0.04%: in line with other Swedish mortgage lenders, its asset quality has benefitted from low interest rates, increasing property prices, and the Swedish households' ability to service their largely non-amortising debts.

The SEK54 billion lending book comprises almost entirely mortgages: at end-2015 lending to finance houses and vacation homes accounted for 60% of the total book and tenant-owner apartments for 38%, the remaining part was marginal. The large majority of the loans is concentrated in Stockholm.

At end of September 2016 SkandiaBanken's gross outstanding loans had increased by 18.6% on an annual basis, mainly driven by the offer of competitive rates. In our view the bank's above-market growth of its mortgage book poses some risk because it is less clear how these mortgages, which have been originated during a period of very low interest rates and are for the majority base on variable interest rates, will perform in the future compared to a more seasoned loan portfolio.

Strong Capital and Higher-than-peers Leverage Ratio

We view SkandiaBanken's capitalisation as strong given its business model focused on mortgages and the support from its parent, which offset the weak internal capital generation through capital injections. The parent supports SkandiaBanken's capital position through direct capital injections (SkandiaBanken received an unconditional capital contribution of SEK 1.7 billion in 2015 and SEK981 million in 2014) and through tax contributions. Our aa3 assigned Capital score reflects this strength as well as our expectation of a negative trend, a consequence of the growth strategy.

SkandiaBanken reported a Common Equity Tier 1 ratio of 15.3% at end-September 2016; its TCE relative to risk-weighted assets under Moody's definition was 16% at the same date. This ratio is lower than peers' (median 24%) because it is calculated under the Standardised Approach for credit risk, whilst the majority of other rated Swedish banks use the Internal Ratings Based approach (IRB). SkandiaBanken is in the process of obtaining IRB approval, which should be implemented by 2018 and the bank currently manages its capital ratio on both standardised and IRB basis.

The reported regulatory leverage ratio was 5.5% at end-2015, which is higher than peers; under Moody's definition, SkandiaBanken's TCE relative on total tangible assets was 5.7% at end-September 2016.

Lower-than-peers Efficiency and Weak Profitability

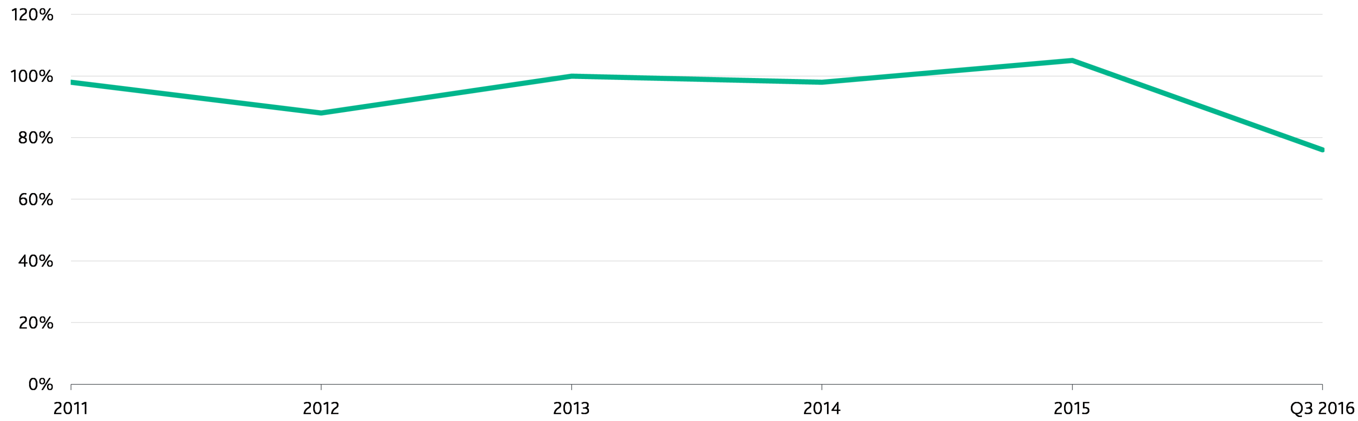
The b3 Profitability score reflects SkandiaBanken's weaker-than-peers profitability with net income / tangible banking assets of 0.22% for the nine month results 2016, a consequence of its relatively low risk products, its aggressive pricing strategy, and its low efficiency. The sale of the Norwegian part of the business, which was more efficient and profitable, was credit negative for the bank. We expect weak profitability to persist over the outlook period.

SkandiaBanken's reported an improved cost to income ratio of 76% (80.56% adjusted for the SEK 43 million non-recurring income from the sale of VISA Europe shares to VISA Inc.) for the first three quarters of 2016 compared with 105% in 2015 (see Exhibit 4). In the coming years, SkandiaBanken plans to reduce its cost base through outsourcing, and increasing efficiency through economies of scale. We expect marginal improvements in the bank's efficiency ratio over the outlook period despite the growth in lending.

Exhibit 4

Cost to Income Ratio for Skandiabanken's Swedish Operations

Skandiabanken has maintained high cost-income ratio over several years



Source: Company reports

SkandiaBanken reported pre-tax income was SEK160 million for the first three quarters of 2016 compared with negative SEK25 million during the same period in 2015 (exclusive of the Norwegian business), driven by a 16% growth of the mortgage book to SEK54 billion in 2016. As a result of the high Cost to Income ratio, we expect weak profitability to persist over the next 12-18 months.

A Retail-based Funding Profile and Adequate Liquidity Given Wholesale Funding Needs

Our a1 Funding Structure score captures SkandiaBanken's high share of retail deposits as a proportion of its assets, as well as our expectation of an increasing reliance on wholesale funding to support balance sheet growth, although mainly via covered bonds issuances.

Reported retail deposits were SEK38 billion at end-September 2016, or 60% of total balance sheet. The large majority of these retail deposits are internet-based because the bank does not have its own branch network and, in our view, they are more price and confidence sensitive compared to deposits sourced through branches. SkandiaBanken reported a loan-to-deposit ratio was 144% at end-September 2016 compared with 130% at end-2015. The SEK16 billion gap between customer loans and deposits at end-September 2016 – a result of the sustained growth in mortgage lending – is funded mainly with the issuance of debt securities: SEK15 billion covered bonds, SEK3 billion senior unsecured funding, and SEK0.9 billion subordinated debt.

We expect the bank to continue increasing its reliance on confidence sensitive wholesale funding to support its balance sheet growth, a credit negative. This is however mitigated by the fact that most of the issuance will be in SEK-denominated covered bonds, which in our view are less confidence-sensitive than senior unsecured bonds because they benefit from a deep local market. We reflect this feature by treating covered bonds denominated in local currency as retail funding, an adjustment shared with most other Swedish banks.

SkandiaBanken's liquidity position is adequate given its wholesale funding needs, as captured by our baa2 assigned Liquid Resources score.

The liquid resources/tangible banking assets ratio was 19.2% at end-2015 and reported liquidity reserves were SEK11 billion at the same date, which account for 61% of the outstanding debt. The portfolio consists mainly of cash and balances with central banks, and highly rated government securities and secured and unsecured debt issued by financial institutions, mostly Nordics. SkandiaBanken reported a Liquidity Coverage ratio (LCR) of 233% at end-2015.

Supportive Operating Environment as Expressed by the Very Strong- Macro Profile for Sweden

As a domestic bank, SkandiaBanken's operating environment is determined by Sweden (Aaa, stable) and its Macro Profile is thus aligned with Sweden at Very Strong-. Swedish banks benefit from a competitive and diverse economy, robust public institutions and a stable political environment that supports consensus orientated policy making. However, we view Swedish households' debt levels (around 80% of which consist of mortgages) and the multi-year growth in household debt as key vulnerabilities to the financial system.

Notching Considerations

Affiliate Support

The a3 Adjusted BCA incorporates Moody's assessment of a very high probability of support from the bank's parent Skandia Insurance Company Ltd. (Insurance Financial Strength A2/Stable) in the event of need.

Loss Given Failure

We apply our advance loss-given-failure analysis on SkandiaBanken as the bank is subject to the EU Bank Recovery and Resolution Directive (BRRD), which we consider to be an Operational Resolution Regime. For this analysis we assume that equity and losses stand at 3% and 8%, respectively, of tangible banking assets in a failure scenario. We also assume a 25% run-off of "junior" wholesale deposits and a 5% run-off 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 the bank's junior deposits to account for 10% of total deposits, in line with other retail mortgage banks.

We believe that SkandiaBanken's deposits are likely to face low loss-given-failure, due to the loss absorption provided by subordinated debt and senior unsecured debt (should deposits be treated preferentially in a resolution). SkandiaBanken's long-term deposit ratings consequently receive a one-notch uplift to A2.

Government Support

Owing to the relatively small size of its retail operations, we assume a low probability of government support for SkandiaBanken's long-term deposit ratings.

Counterparty Risk Assessment

The CR assessment is an opinion of the counterparty risk related to a bank's covered bonds, contractual performance obligations (servicing), derivatives (e.g., swaps), letters of credit, and liquidity facilities. The CR Assessments is distinct from debt and deposit ratings in that they consider only the risk of default rather than both the likelihood of default and the expected financial loss suffered in the event of default.

SkandiaBanken's CR Assessment is positioned at Aa3(cr) and P-1(cr), based on the cushion against default provided by junior deposits, senior unsecured, and subordinated debts and does not benefit from any government support, in line with deposits and senior unsecured debt ratings.

Rating Methodology and Scorecard Factors

Exhibit 5

SkandiaBanken AB

Macro Factors							
Weighted Macro Profile	**Very Strong -**	**100%**					

Financial Profile						
Factor	**Historic Ratio**	**Macro Adjusted Score**	**Credit Trend**	**Assigned Score**	**Key driver #1**	**Key driver #2**
Solvency						
Asset Risk						
Problem Loans / Gross Loans	0.1%	aa1	←→	a3	Loan growth	
Capital						
TCE / RWA	16.0%	aa2	←→	aa3	Expected trend	
Profitability						
Net Income / Tangible Assets	0.2%	b1	←→	b3	Return on assets	
Combined Solvency Score		a1		baa1		
Liquidity						
Funding Structure						
Market Funds / Tangible Banking Assets	19.3%	a2	←→	a1	Market funding quality	Expected trend
Liquid Resources						
Liquid Banking Assets / Tangible Banking Assets	19.2%	baa2	←→	baa2	Stock of liquid assets	
Combined Liquidity Score		a3		a3		
Financial Profile				baa1		
Business Diversification				-1		
Opacity and Complexity				0		
Corporate Behavior				0		
Total Qualitative Adjustments				-1		
Sovereign or Affiliate constraint:				Aaa		
Scorecard Calculated BCA range				baa1-baa3		
Assigned BCA				baa2		
Affiliate Support notching				--		
Adjusted BCA				a3		

Balance Sheet	**in-scope (SEK million)**	**% in-scope**	**at-failure (SEK million)**	**% at-failure**
Other liabilities	18,980	30.2%	21,616	34.4%
Deposits	37,653	59.9%	35,017	55.7%
Preferred deposits	33,888	53.9%	32,193	51.2%
Junior Deposits	3,765	6.0%	2,824	4.5%
Senior unsecured bank debt	3,452	5.5%	3,452	5.5%
Dated subordinated bank debt	900	1.4%	900	1.4%
Equity	1,886	3.0%	1,886	3.0%
Total Tangible Banking Assets	62,871	100%	62,871	100%

Debt class	De jure waterfall		De facto waterfall		Notching		LGF notching guidance versus 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 Assessment	14.4%	14.4%	14.4%	14.4%	3	3	3	3	0	aa3 (cr)
Deposits	14.4%	4.4%	14.4%	9.9%	1	2	1	1	0	a2

Instrument Class	Loss Given Failure notching	Additional notching	Preliminary Rating Assessment	Government Support notching	Local Currency rating	Foreign Currency rating
Counterparty Risk Assessment	3	0	aa3 (cr)	0	Aa3 (cr)	--
Deposits	1	0	a2	0	A2	A2

Source: Moody's Financial Metrics

Ratings

Exhibit 6

Category	Moody's Rating
SKANDIABANKEN AB	
Outlook	Negative
Bank Deposits	A2/P-1
Baseline Credit Assessment	baa2
Adjusted Baseline Credit Assessment	a3
Counterparty Risk Assessment	Aa3(cr)/P-1(cr)
PARENT: SKANDIA INSURANCE COMPANY LTD.	
Outlook	Stable
Insurance Financial Strength	A2

Source: Moody's Investors Service

REPORT NUMBER 1052750

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