MOODY'S
INVESTORS SERVICE

Credit Opinion: SkandiaBanken AB

Global Credit Research - 30 Jan 2015

Sweden

Ratings

Category	Moody's Rating
Outlook	Stable
Bank Deposits	A3/P-2
Bank Financial Strength	C-
Baseline Credit Assessment	baa1
Adjusted Baseline Credit Assessment	a3
Parent: Skandia Insurance Company Ltd.	
Outlook	Stable
Insurance Financial Strength	A2

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Key Indicators

SkandiaBanken AB (Consolidated Financials)[1]

	[2]9-14	[2]12-13	[2]12-12	[2]12-11	[2]12-10	Avg.
Total Assets (SEK million)	113,598.0	98,597.0	84,638.0	76,767.0	68,101.0	[3]13.6
Total Assets (EUR million)	12,475.1	11,140.9	9,868.3	8,626.3	7,550.8	[3]13.4
Total Assets (USD million)	15,759.1	15,351.6	13,010.3	11,198.2	10,129.8	[3]11.7
Tangible Common Equity (SEK million)	4,441.0	3,907.0	3,169.0	2,726.3	2,601.6	[3]14.3
Tangible Common Equity (EUR million)	487.7	441.5	369.5	306.3	288.5	[3]14.0
Tangible Common Equity (USD million)	616.1	608.3	487.1	397.7	387.0	[3]12.3
Net Interest Margin (%)	1.3	1.2	1.4	1.4	1.2	[4]1.3
PPI / Average RWA (%)	1.7	0.8	1.2	0.3	0.5	[5]0.9
Net Income / Average RWA (%)	1.2	0.9	1.0	0.5	0.7	[5]0.9
(Market Funds - Liquid Assets) / Total Assets (%)	21.3	4.3	-17.8	-27.5	-17.7	[4]-7.5
Core Deposits / Average Gross Loans (%)	96.6	111.8	137.2	130.9	122.5	[4]119.8
Tier 1 Ratio (%)	11.5	10.9	10.6	10.0	9.7	[5]10.5
Tangible Common Equity / RWA (%)	10.6	10.9	10.5	9.9	9.7	[5]10.3
Cost / Income Ratio (%)	61.8	82.4	78.2	94.1	90.8	[4]81.4
Problem Loans / Gross Loans (%)	0.2	0.2	0.3	0.4	0.3	[4]0.3
Problem Loans / (Equity + Loan Loss Reserves) (%)	3.0	3.4	5.1	7.4	6.1	[4]5.0

Source: Moody's

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

Opinion

SUMMARY RATING RATIONALE

Moody's has assigned an A3 deposit rating and a baa1 baseline credit assessment (BCA) to Skandiabanken AB. The baa1 BCA reflects the bank's very strong asset quality, low-risk retail mortgage-oriented business model and its strategic role as the banking arm of the Skandia Group. The rating also reflects more negative factors such as its limited standalone franchise strength, low profitability and efficiency associated with its Swedish operations.

Skandiabanken's A3 long-term global local currency (GLC) deposit ratings benefit from a one notch uplift from its baa1 standalone credit strength. This assessment is based on a very high probability of support from the bank's sole owner, Skandia Insurance Company Ltd.

Rating Drivers

- The bank has a limited standalone franchise but plays a role in the wider Skandia group

- Asset quality is strong because of low-risk retail mortgage business model

- Capital adequate relative to risks but low compared to other banks

- A track-record of weak profitability and low efficiency

- Funding profile is becoming more diversified

Rating Outlook

The outlook on all ratings is stable.

What Could Change the Rating - Up

Any upgrade of Skandiabanken's BCA would likely be accompanied by an improvement in profitability without a significant increase in risk appetite. This is most likely to be achieved through cost containment combined with some level of lending growth. An upgrade of the long-term deposit rating could occur following an upgrade of the BCA and/or an upgrade of the support provider's ratings.

What Could Change the Rating - Down

The BCA could be negatively affected if the bank in the long-term fails to improve its efficiency and profitability of its Swedish business given that it is planning to divest its Norwegian branch. The long-term deposit rating could be downgraded following a downgrade of the BCA or a downgrade of the support provider.

DETAILED RATING CONSIDERATIONS

Detailed considerations for Skandiabanken's assigned ratings are as follows:

Bank Financial Strength Rating

- THE BANK HAS A LIMITED STANDALONE FRANCHISE BUT PLAYS A ROLE IN THE WIDER SKANDIA GROUP

Skandiabanken is a small bank in both Sweden and Norway. Its market share is less than 1% of lending in Sweden. It remains unclear if the bank's plans to grow in Sweden will bear fruit given the competitive household lending market in the country. 15 January 2015 Skandiabanken said that it is planning to exit the Norwegian market which accounted for 60% of its lending at the end of Q3, 2014.

The bank focuses almost exclusively on mortgage lending compared to other Swedish banks that serve both households and companies. Skandiabanken does not operate its own branch network which we normally would view as a competitive disadvantage. However, the wider Skandia Group has around 50 branches in Sweden that also serve customers of Skandiabanken.

Whilst weak in terms of standalone franchise strength, the bank benefits from its position within the Skandia Group which gives Skandiabanken access to the Group's large insurance customer base. However, we caution that monetising insurance relationships has historically proved difficult for banks due to a lack of regular customer contact and intense competition in both Norway and Sweden. Indeed, the bank has broadly the same number of customers it had a year ago. We nevertheless do recognize that Skandiabanken's lending volume has grown significantly during the same time-period.

- ASSET QUALITY IS STRONG BECAUSE OF LOW-RISK RETAIL MORTGAGE BUSINESS MODEL

Skandiabanken's asset quality is very strong, as reflected in its problem loans ratio of 0.2% at 30 September 2014. The bank's lending almost exclusively consists of mortgages although the bank also offers products such as personal loans, credit cards and car loans (Norway). We view its emphasis on retail mortgage lending as lower risk than corporate lending although it leaves the bank with a relatively undiversified exposure to the retail real estate market in Sweden and Norway.

More negatively, loan growth continues to be aggressive. Lending in Sweden grew by 15% during the first three quarters of 2014. The equivalent ratio is 20% for Norway. We view the aggressive expansion and low mortgage book seasoning as risks because it is less clear how these mortgages will perform in the future compared to a more seasoned loan portfolio. We also think that above average growth in a competitive market comes with underwriting risks. Going forward lending growth is likely to be high in Sweden as the bank seeks to address its efficiency and profitability challenges associated with its operations in that country.

Alike many Nordic banks, Skandiabanken's credit risk concentration is high in terms of borrower concentration. That said, the largest exposures originate from the bank's liquidity portfolio which is of high credit quality. Unlike most of its peers, Skandiabanken's industry exposure is extremely small due to its negligible corporate lending activities.

- CAPITAL ADEQUATE RELATIVE TO RISKS BUT LOW COMPARED TO OTHER BANKS

Skandiabanken reported a core tier 1 ratio of 10.2% at 30 September 2014 which is at the lower end compared to other Swedish financial institutions. We nevertheless consider the bank's capital position as adequate given its low risk profile.

Skandiabanken currently applies a standardised approach when calculating credit risks whilst many other Swedish banks use an internal-ratings based (IRB) approach that tends to drive up capital ratios. The bank is no longer pursuing its IRB application with the Swedish FSA.

Skandiabanken has a track record of receiving capital injections from its parent in order to enable aggressive lending growth. For example, 14 November 2014 the bank received a SEK 525 million injection from its parent. Whilst such injections enable aggressive lending growth in order to achieve economies of scale and improved profitability, we also caution the risks associated with such growth (see asset quality section above), that ultimately could hit the bank's capitalisation.

- A TRACK-RECORD OF WEAK PROFITABILITY AND LOW EFFICIENCY

Skandiabanken has a track-record of weak profitability compared with larger Swedish banks and Norwegian banks of similar size. This assessment is based on data since 2011 and various profitability ratios including pre-provision income or net income compared with average risk-weighted assets. The bank's weak profitability reflect its relatively low risk products and its policy of offering competitive interest rates in a competitive market as well as its high cost-base.

Skandiabanken's cost-to-income ratio has consistently been considerably higher compared with other Swedish and Norwegian banks. For example, in 2011 the ratio was 95% only to decrease to 82% in 2013, still considerably higher compared to many other banks. These costs are driven by staff and administration expenses.

Looking ahead, and assuming the bank manages to divest its Norwegian branch, efficiency is likely to be under pressure because its Swedish operations have a track-record of weaker efficiency compared to its Norwegian business. We nevertheless understand that Skandiabanken intends to improve its profitability by cutting costs and increasing lending volume, mainly to customers of the wider Skandia group. This strategy shows some signs of paying dividend; the bank's cost-to-income ratio for Q1 - Q3 2014 stood at 62% per Moody's calculation. However, this improvement mainly comes from the Norwegian branch which Skandiabanken intends to sell.

- FUNDING PROFILE IS BECOMING MORE DIVERSIFIED

Skandiabanken has traditionally been almost exclusively deposit-funded, with average deposits at year end-2013 amounting to 90% of average total funding. During 2012, the bank started a market funding programme by issuing commercial paper in Sweden and Norway. In 2013 the bank issued its first covered bonds which were denominated in both SEK and NOK. Generally speaking we continue to view deposits as more stable than market funding. However, in Skandiabanken's case we view the diversification benefit of the market funding positively. We expect the bank to ramp up its covered bond funding over time in order to enable the bank to grow quickly.

The positive benefit of market funding in this instance is countered by the fact that Skandiabanken's deposits are internet-based and we believe that such deposits are less sticky than more traditional deposits. This is because internet deposits tend to be more price and confidence sensitive compared to deposits attracted in a branch through a face-to-face interaction.

Currently, it is unclear what the bank's liability structure will consist of if the bank manages to divest its Norwegian branch. This is because the bank has not yet outlined which liabilities will be transferred to the Norwegian entity. Moreover, it is not yet known if the bank's covered bond investors will consent to the transfer of covered bonds to the Norwegian bank.

The bank held a liquidity reserve of SEK 21 billion which amounted to 19% of liabilities at 30 September 2014. The portfolio consist mainly of cash and balances with central banks, government securities and both secured and unsecured bank securities. Much of the portfolio is Aaa rated which we view positively. The portfolio also contains securities without a rating. We understand that these securities mainly consist of Nordic regional and local government bonds.

Global Local Currency Deposit Rating (Joint Default Analysis)

Moody's assigns a GLC deposit rating of A3 to Skandiabanken AB. The rating is supported by the bank's standalone bank financial strength of C-, mapping to a baa1 baseline credit assessment, and a very high likelihood of support from Skandia Insurance Company Ltd (A2 insurance financial strength rating with stable outlook). The bank shares the same brand name as the Skandia Group and is becoming increasingly incorporated into the group through its offering of banking services to group customers.

Foreign Currency Deposit Rating

The A3 foreign currency deposit rating of Skandiabanken is unconstrained given that Sweden has a country ceiling of Aaa.

Foreign Currency Debt Rating

The A3 foreign currency debt ratings of Skandiabanken are unconstrained given that Sweden has a country ceiling of Aaa.

Rating Factors

SkandiaBanken AB

Rating Factors [1]	**A**	**B**	**C**	**D**	**E**	**Total Score**	**Trend**
Qualitative Factors (50%)						**C-**	
Factor: Franchise Value						**D+**	**Neutral**
Market share and sustainability				**x**			
Geographical diversification				**x**			
Earnings stability			**x**				
Earnings Diversification [2]							
Factor: Risk Positioning						**D+**	**Neutral**
Corporate Governance [2]	**--**	**--**	**--**	**--**	**--**		
- Ownership and Organizational Complexity	**--**	--	--	--	--		
- Key Man Risk	**--**	--	--	--	--		
- Insider and Related-Party Risks	**--**	--	--	--	--		
Controls and Risk Management			**x**				
- Risk Management			x				
- Controls		x					

Financial Reporting Transparency		x					
- Global Comparability	x						
- Frequency and Timeliness	x						
- Quality of Financial Information			x				
Credit Risk Concentration	--	--	--	--	--		
- Borrower Concentration	--	--	--	--	--		
- Industry Concentration	x						
Liquidity Management				x			
Market Risk Appetite	x						
Factor: Operating Environment						B+	Neutral
Economic Stability			x				
Integrity and Corruption	x						
Legal System	x						
Financial Factors (50%)						C	
Factor: Profitability						D	Neutral
PPI % Average RWA (Basel II)				0.77%			
Net Income % Average RWA (Basel II)				0.81%			
Factor: Liquidity						C	Weakening
(Market Funds - Liquid Assets) % Total Assets	-13.67%						
Liquidity Management				x			
Factor: Capital Adequacy						B+	Neutral
Tier 1 Ratio (%) (Basel II)		10.48%					
Tangible Common Equity % RWA (Basel II)	10.44%						
Factor: Efficiency						E	Neutral
Cost / Income Ratio					84.90%		
Factor: Asset Quality						A	Neutral
Problem Loans % Gross Loans	0.29%						
Problem Loans % (Equity + LLR)	5.28%						
Lowest Combined Financial Factor Score (15%)						D-	
Economic Insolvency Override						Neutral	
Aggregate BFSR Score						C	
Aggregate BCA Score						a3	
Assigned BFSR						C-	
Assigned BCA						baa1	

[1] - Where dashes are shown for a particular factor (or sub-factor), the score is based on non-public information.
[2] - A blank score under Earnings Diversification or Corporate Governance indicates the risk is neutral.

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