MOODY'S
INVESTORS SERVICE

CREDIT OPINION
26 April 2019

Update

Rate this Research

RATINGS

SkandiaBanken AB

Domicile	Sweden
Long Term CRR	Aa3
Type	LT Counterparty Risk Rating - Fgn Curr
Outlook	Not Assigned
Long Term Debt	Not Assigned
Long Term Deposit	A2
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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SkandiaBanken AB

Update to credit analysis

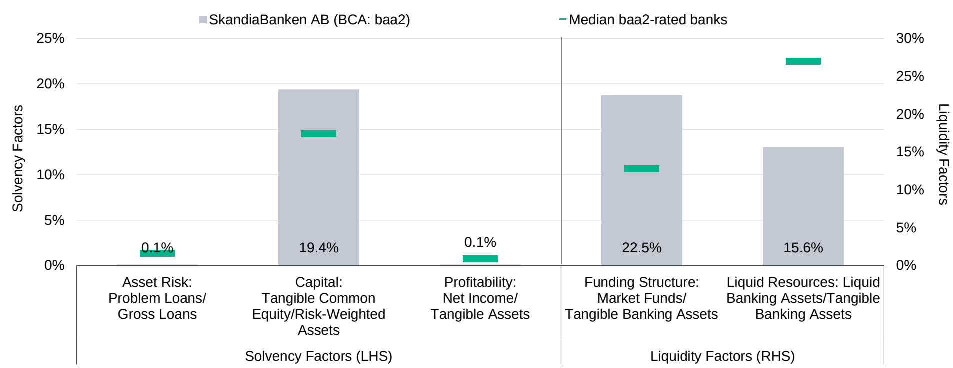
Summary

We assign A2/Prime-1 long-term and short-term deposit ratings with a stable outlook to SkandiaBanken AB (SkandiaBanken), a baa2 Baseline Credit Assessment (BCA) and an a3 Adjusted BCA. We also assign long-term and short-term Counterparty Risk (CR) Assessments of Aa3(cr)/Prime-1(cr).

SkandiaBanken's baa2 BCA reflects the bank's solid asset quality, very strong capital and leverage position and healthy funding structure focused on retail deposits. These strengths are balanced against the bank's historically above-market growth rate in mortgage lending, which is picking up after dipping in 2018, as well as the bank's improving although still-weak standalone efficiency and low profitability. The Adjusted BCA of a3 reflects our very high assumptions of affiliate support from the bank's parent, Skandia Insurance Company Ltd. (insurance financial strength A2 stable), resulting in two notches of uplift.

SkandiaBanken's A2 long-term deposit rating also includes a one-notch uplift resulting from our Advanced Loss Given Failure (LGF) analysis, reflecting our view that the bank's junior depositors face a low unexpected loss given failure.

Exhibit 1
Rating Scorecard- Key financial ratios



Asset risk and profitability ratios reflect the weaker of either the latest reported or three-year average ratios. Capital ratio is the latest reported figure. Funding structure and liquid resources ratios reflect the latest year-end figures.
Source: Moody's Financial Metrics

Credit strengths

» Strong asset quality

» Very strong capitalisation and higher-than-peers leverage ratio

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

» Growing importance in the wider Skandia group

Credit challenges

» Historical high lending growth

» Lower-than-peers efficiency and weak profitability

Outlook

SkandiaBanken's long-term deposit ratings carry a stable outlook, with the bank's strong asset quality and capital, retail-based funding profile and adequate liquidity buffers balancing risks arising from the bank's high lending growth and weak profitability and efficiency.

Factors that could lead to an upgrade

» SkandiaBanken's BCA could be upgraded following a significant improvement in its efficiency and profitability ratios, or maintaining its more prudent underwriting standard over time, targeting more affluent and less leveraged customers. An upgrade of the bank's BCA would not automatically result in an upgrade of its deposit ratings if support assumptions remain the same, with the Adjusted BCA remaining at a3.

» Maintaining its higher volumes of senior unsecured debt over time, and issuance of junior senior debt, with increased predictability of the size of the cushion of loss-absorbing liabilities, could lead to an upgrade of the long-term deposit ratings.

Factors that could lead to a downgrade

» A significant deterioration in the fundamentals of the bank, including capitalisation and asset risk could lead to a downgrade of the BCA, and most likely of the Adjusted BCA. A change in our assessment of the probability of parental support could also lead to a lower Adjusted BCA.

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

Key indicators

Exhibit 2
SkandiaBanken AB (Consolidated Financials) [1]

	12-18[2]	12-17[2]	12-16[2]	12-15[2]	12-14[2]	CAGR/Avg.[3]
Total Assets (SEK million)	72,044	69,407	65,214	58,735	114,918	-11.0[4]
Total Assets (EUR million)	7,108	7,060	6,806	6,413	12,132	-12.5[4]
Total Assets (USD million)	8,126	8,477	7,179	6,967	14,680	-13.7[4]
Tangible Common Equity (SEK million)	3,622	3,621	3,484	3,921	5,036	-7.9[4]
Tangible Common Equity (EUR million)	357	368	364	428	532	-9.5[4]
Tangible Common Equity (USD million)	409	442	384	465	643	-10.7[4]
Problem Loans / Gross Loans (%)	0.1	0.0	0.0	0.1	0.2	0.1[5]
Tangible Common Equity / Risk Weighted Assets (%)	19.4	15.4	15.2	19.6	12.1	16.3[6]
Problem Loans / (Tangible Common Equity + Loan Loss Reserve) (%)	1.5	0.4	0.7	0.8	3.4	1.4[5]
Net Interest Margin (%)	1.1	1.2	1.1	1.2	1.3	1.2[5]
PPI / Average RWA (%)	0.4	0.8	0.5	-0.1	1.5	0.6[6]
Net Income / Tangible Assets (%)	0.1	0.2	0.2	-0.2	0.4	0.1[5]
Cost / Income Ratio (%)	94.4	81.2	88.0	103.0	67.0	86.7[5]
Market Funds / Tangible Banking Assets (%)	22.5	22.4	20.6	19.3	15.9	20.2[5]
Liquid Banking Assets / Tangible Banking Assets (%)	15.6	13.8	12.4	11.4	16.1	13.9[5]
Gross Loans / Due to Customers (%)	147.8	152.6	149.3	129.8	120.3	140.0[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 due to scale of reported amounts. [4] Compound Annual Growth Rate (%) based on time period presented for the latest accounting regime. [5] Simple average of periods presented for the latest accounting regime. [6] Simple average of Basel III periods presented.
Source: Moody's Financial Metrics

Profile

SkandiaBanken AB (SkandiaBanken) is a Stockholm-based bank that provides retail banking products and services, as well as mutual funds, equity trading and discretionary asset management services, in Sweden. While the bank does not have any branches, it does sell banking products through the branch network of the wider Skandia group. As of 31 December 2018, SkandiaBanken reported a consolidated asset base of SEK72.1 billion (€7.1 billion).

For further information on the bank's profile, please see SkandiaBanken AB: Key Facts and Statistics - 9M September 2018, 13 November 2018.

Detailed credit considerations

A limited standalone franchise with growing importance in the wider Skandia group

SkandiaBanken is the banking arm of Skandia Insurance Company Ltd., which is owned by Livförsäkringsbolaget Skandia, ömsesidigt, a leading Swedish life insurer. The bank reported assets as of year-end 2018 of SEK72.1 billion and a share of around 2% 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 around 79% of its operating income in 2018. This structural dependence results in a one-notch qualitative downward 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 few years: in 2013, management set a target of doubling the lending volume in five years' time, and as of year-end 2018, SkandiaBanken reported SEK59.9 billion of outstanding mortgages, a volume increase of around 125% since 2012 (excluding the Norwegian operations). Although the loan growth of SkandiaBanken has however slowed down, with the volume of outstanding gross loans increasing by 2.2% as of year-end 2018 from a year earlier, we expect the bank to regain momentum with high customer interest in new competitive offers launched in the fall of 2018.

In October 2015, SkandiaBanken spun off its Norwegian business, which had accounted for 54% of total lending as of 30 September 2015 and was the most profitable business of the bank.

Strong asset quality, but high lending growth

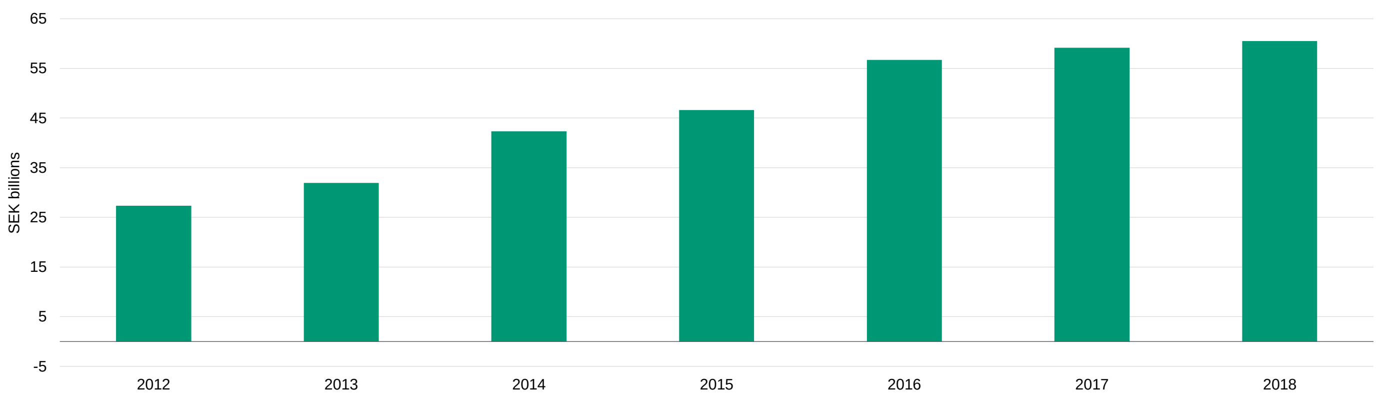
Our a2 Asset Risk score reflects SkandiaBanken's very low problem loan ratio — in line with that of ther Swedish mortgage lenders — balanced against its significant lending growth over the last few years, a result of the strategic plan to increase the bank's market share and size (see Exhibit 3). Aggressive loan growth is often a precursor of asset-quality challenges down the road.

Lending growth has nevertheless subsided and the volume of outstanding loans to the public increased only by 2.2% to SEK60.5 billion as of year-end 2018 from SEK59.2 billion as of year-end 2017. However, SkandiaBanken aims to resume its high mortgage lending growth by offering its customers a transparent pricing model and among the lowest rates in the market. This will be done by increased cross-selling, offering the best rates to those customers who have pension savings in Skandia. This segment is generally affluent with lower LTV's, and would point to better indicators in its mortgage portfolio going forward.

Exhibit 3

Outstanding loans to the public in the Swedish business

SkandiaBanken's high lending growth slowed down in 2017 and 2018



Source: Company reports

SkandiaBanken's problem loan ratio as of year-end 2018 was very low at 0.09%: in line with other Swedish mortgage lenders, its asset quality has benefited from low interest rates and the Swedish households' ability to service their debts. However, in September 2017, we lowered the Swedish Macro Profile to Strong+ from Very Strong- because Sweden's buildup of household indebtedness against the backdrop of rapid house price appreciation poses latent risks to its economy and banks. We expect SkandiaBanken's solid asset risk and very strong capitalisation to provide sufficient buffers against risks embedded in the Swedish operating environment.

The bank reported net problem loans (stage 3 according to IFRS 9, effective as of 1 January 2018) as a share of total lending to the public of 0.09% as of year-end 2018. This figure is however not directly comparable with the previously reported figures because IFRS 9 features a forward-looking perspective.

The SEK60.5 billion loan book comprises almost entirely mortgages: as of year-end 2018, lending with single-family houses as collateral accounted for around 57% of the total book and tenant-owner flats for 42%. The large majority of loans is concentrated in Stockholm, which thus poses some concentration risks and potential tail risks because of the high appreciation in property prices in recent years. A mitigating factor is the bank's cap on lending at a loan-to-value ratio of 85% because it does not provide unsecured lending to borrowers above that limit for the purpose of buying a property. The bank's loan-to-value ratio of the home mortgage portfolio (exposure-weighted) was low at around 50% as of year-end 2017 and 2018. The bank implemented stricter underwriting standards by introducing caps on the debt-to-income ratio in 2016 and higher stressed interest rates in its loan approval process in 2017, at 5% above the five-year offered mortgage rate. The current underwriting standards are aligned with those of its peers or slightly stricter, from previously having been more generous.

Very strong capitalisation and higher-than-peers capital leverage ratio

As of the end of March 2018, SkandiaBanken received approval from the Swedish Financial Supervisory Authority (SFSA) to apply the internal ratings-based (IRB) approach for calculating regulatory capital for exposures with collateral in real estate. This has resulted in a lower regulatory capital requirement and improved capital ratios. Capitalisation compares favourably with that of its peers, but we expect ratios to fall both because of potential extra dividends and the SFSA's proposal to move the risk weight floor on mortgages to Pillar I from Pillar II. As of year-end 2018, the bank reported a Common Equity Tier 1 capital ratio of 19.2% compared with 20.2% as of year-end 2017, which also includes the risk weight floor in Pillar I.

We view SkandiaBanken's capitalisation as very strong, given its business model focused on low-risk lending and the support from its parent, which offset the weak internal capital generation through capital injections. The parent has a history of supporting SkandiaBanken through direct capital injections, with SEK1.7 billion in 2015 and SEK981 million in 2014. Our aa3 assigned Capital score reflects the bank's very strong capitalisation.

The Tier 1 leverage ratio (Moody's definition) was 5.1% as of year-end 2018, which is at par with the average of Swedish peers of 5.2%. Under our definition, SkandiaBanken's tangible common equity/total tangible assets was 5.0% as of year-end 2018.

Lower-than-peers efficiency and weak profitability

The b3 Profitability score reflects SkandiaBanken's weaker-than-peers profitability with net income/tangible assets of 0.1% for 2018, 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 but recognise a gradually improving trend in efficiency.

SkandiaBanken's net income was SEK64 million in 2018 compared with SEK158 million a year earlier. This was driven by a decline in net interest income by 6% on an annual basis, reflecting increased interest costs on the back of an increased resolution fee and increasing funding costs.

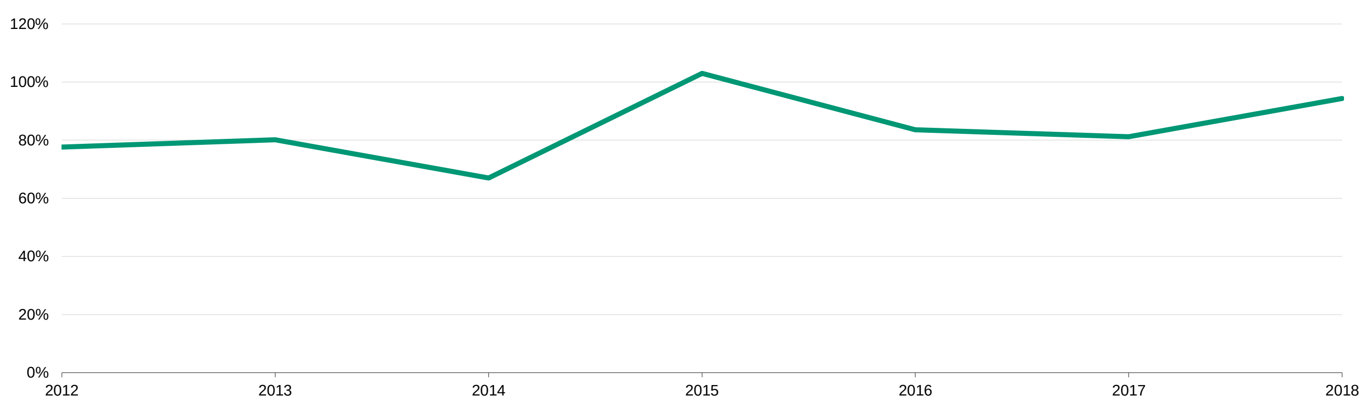
The bank continues to demonstrate weak efficiency, well below that of its Swedish peers, which report an average cost-to-income ratio near or below 50%. The bank's cost-to-income ratio increased in 2018 to 94% from around 81% in 2017 (see Exhibit 4), although it has improved slightly from the 105% in 2015 (excluding the Norwegian business). In the coming years, SkandiaBanken plans to reduce its cost base and increase efficiency through economies of scale. Because of its limited size, we expect IT costs, regulatory and compliance costs, as well as general administration costs to be difficult to reduce considerably, and therefore expect marginal improvements in the bank's efficiency ratio over the outlook period despite the growth in lending.

The bank's operating expenses increased to SEK858 million in 2018 from SEK771 million in 2017. The increase was largely driven by regulatory developments and business development initiatives, which consequently increased personnel and administrative expenses on an annual basis by 8% and 13%, respectively.

Exhibit 4

Cost-to-income ratio for SkandiaBanken's Swedish operations

SkandiaBanken faces challenges in improving efficiency



Sources: Company reports

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

Our a3 Funding Structure score captures SkandiaBanken's high proportion of retail deposits, 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 SEK40.9 billion as of year-end 2018, or 57% of the 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 with deposits sourced through branches. SkandiaBanken's loan-to-deposit ratio stood at 147% as of year-end 2018 compared with 152% as of year-end 2017. The SEK19.6 billion gap between customer loans and deposits as of year-end 2018 is funded mainly with the issuance of debt securities: SEK19.7 billion covered bonds, SEK5.8 billion senior unsecured funding and SEK0.9 billion subordinated debt. SkandiaBanken made a senior unsecured debt issuances in September 2018, amounting to SEK500 million in total.

We expect the bank to continue to increase its reliance on confidence-sensitive wholesale funding to support its balance-sheet growth. 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. We expect SkandiaBanken to start issuing non-preferred senior bonds in the coming years to fulfil the Minimum Requirements for own fund and Eligible Liabilities (MREL). According to the current decision by the Swedish National Debt Office, SkandiaBanken needs to have 6.5% of its total liabilities and capital in subordinated liabilities.

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

The bank's liquid resources/tangible banking assets was 15.6% as of year-end 2018 and its reported liquidity reserves were SEK11 billion as of the same date. 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 in the Nordics. SkandiaBanken reported a Liquidity Coverage ratio (LCR) of 188% as of year-end 2018, up from 180% as of year-end 2017.

Source of facts and figures cited in this report

Unless noted otherwise, we have sourced data relating to systemwide trends and market shares from the central bank. Bank-specific figures originate from the banks' reports and Moody's Banking Financial Metrics. All figures are based on our own chart of accounts and may be adjusted for analytical purposes. Please refer to the document Financial Statement Adjustments in the Analysis of Financial Institutions, published on 9 August 2018.

Support and structural considerations

Affiliate support

The a3 Adjusted BCA incorporates our assessment of a very high probability of support from the bank's parent Skandia Insurance Company Ltd. in the event of need.

Loss Given Failure analysis

We apply our Advanced LGF 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.

The considerable buffer of outstanding senior unsecured debt and junior deposits provides a loss-absorption buffer in case of failure, and indicates a one-notch uplift in the bank's deposit rating above the a3 Adjusted BCA, as indicated by our Advanced LGF analysis.

Government support considerations

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 (CR) Assessment

The CR Assessment is an opinion of the counterparty risk related to a bank's covered bonds, contractual performance obligations (servicing), derivatives (for example, swaps), letters of credit, and liquidity facilities. The CR Assessment 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)/P-1(cr)

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

Counterparty Risk Ratings (CRRs)

CRRs are opinions of the ability of entities to honour the uncollateralised portion of non-debt counterparty financial liabilities (CRR liabilities) and also reflect the expected financial losses in the event such liabilities are not honoured. CRR liabilities typically relate to transactions with unrelated parties. Examples of CRR liabilities include the uncollateralised portion of payables arising from derivatives transactions and the uncollateralised portion of liabilities under sale and repurchase agreements. CRRs are not applicable to funding commitments or other obligations associated with covered bonds, letters of credit, guarantees, servicer and trustee obligations, and other similar obligations that arise from a bank performing its essential operating functions

SkandiaBanken's CRRs are positioned at Aa3/P-1

The CRRs are positioned three notches above SkandiaBanken's Adjusted BCA of a3, reflecting extremely low loss given failure from the high volume of instruments that are subordinated to CRR liabilities.

Rating methodology and scorecard factors

Exhibit 5

SkandiaBanken AB

Macro Factors		
Weighted Macro Profile	**Strong +**	**100%**

Factor	**Historic Ratio**	**Initial Score**	**Expected Trend**	**Assigned Score**	**Key driver #1**	**Key driver #2**
Solvency						
Asset Risk						
Problem Loans / Gross Loans	0.1%	aa1	←→	a2	Sector concentration	Loan growth
Capital						
TCE / RWA	19.4%	aa2	←→	aa3	Expected trend	
Profitability						
Net Income / Tangible Assets	0.1%	b3	←→	b3	Return on assets	
Combined Solvency Score		a2		baa1		
Liquidity						
Funding Structure						
Market Funds / Tangible Banking Assets	22.5%	baa1	↑	a3	Market funding quality	
Liquid Resources						
Liquid Banking Assets / Tangible Banking Assets	15.6%	baa2	←→	baa2	Stock of liquid assets	
Combined Liquidity Score		baa1		baa1		
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	22,122	30.8%	24,988	34.7%
Deposits	40,941	56.9%	38,075	52.9%
Preferred deposits	36,847	51.2%	35,005	48.7%
Junior Deposits	4,094	5.7%	3,071	4.3%
Senior unsecured bank debt	5,817	8.1%	5,817	8.1%
Junior subordinated bank debt	900	1.3%	900	1.3%
Equity	2,158	3.0%	2,158	3.0%
Total Tangible Banking Assets	71,938	100%	71,938	100%

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	16.6%	16.6%	16.6%	16.6%	3	3	3	3	0	aa3
Counterparty Risk Assessment	16.6%	16.6%	16.6%	16.6%	3	3	3	3	0	aa3 (cr)
Deposits	16.6%	4.3%	16.6%	12.3%	2	3	2	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 Rating	3	0	aa3	0	Aa3	Aa3
Counterparty Risk Assessment	3	0	aa3 (cr)	0	Aa3 (cr)	--
Deposits	1	0	a2	0	A2	A2

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

Ratings

Exhibit 6

Category	Moody's Rating
SKANDIABANKEN AB	
Outlook	Stable
Counterparty Risk Rating	Aa3/P-1
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

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