MOODY'S
INVESTORS SERVICE

Credit Opinion: SkandiaBanken AB

Global Credit Research - 26 Nov 2014

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

Contacts

Analyst	Phone
Jan Skogberg/London	44.20.7772.5454
Oscar Heemskerk/London	
Simon Harris/London	
Forssen, Daniel/London	

Key Indicators

SkandiaBanken AB (Consolidated Financials)[1]

	[2]6-14	[2]12-13	[2]12-12	[2]12-11	[2]12-10	Avg.
Total Assets (SEK million)	111,888.0	98,597.0	84,638.0	76,767.0	68,101.0	[3]13.2
Total Assets (EUR million)	12,223.9	11,140.9	9,868.3	8,626.3	7,550.8	[3]12.8
Total Assets (USD million)	16,736.3	15,351.6	13,010.3	11,198.2	10,129.8	[3]13.4
Tangible Common Equity (SEK million)	4,310.0	3,907.0	3,169.0	2,726.3	2,601.6	[3]13.5
Tangible Common Equity (EUR million)	470.9	441.5	369.5	306.3	288.5	[3]13.0
Tangible Common Equity (USD million)	644.7	608.3	487.1	397.7	387.0	[3]13.6
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]0.8
(Market Funds - Liquid Assets) / Total Assets (%)	17.4	4.3	-17.8	-27.5	-17.7	[4]-8.3
Core Deposits / Average Gross Loans (%)	99.9	111.8	137.2	130.9	122.5	[4]120.4
Tier 1 Ratio (%)	10.6	10.9	10.6	10.0	9.7	[5]10.4
Tangible Common Equity / RWA (%)	10.7	10.9	10.5	9.9	9.7	[5]10.3
Cost / Income Ratio (%)	63.5	82.4	78.2	94.1	90.8	[4]81.8
Problem Loans / Gross Loans (%)	0.2	0.2	0.3	0.4	0.3	[4]0.3
Problem Loans / (Equity + Loan Loss Reserves) (%)	3.1	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 (Skandiabanken). 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 low efficiency.

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 high probability of support from the bank's 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 consistent growth in retail operations and an increased focus on cost containment.

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 profitability or/and if the bank assumes excessive credit risks relative to its capital base.

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. We understand from the bank that its market share is 1.4% of household lending in Sweden. 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 40 branches 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 June 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 understand that the bank intends to push for aggressive growth at least during the next few years in order to achieve a foothold in the Swedish and Norwegian mortgage markets and in order to improve efficiency.

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 common equity 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. We understand from Skandiabanken that the Swedish FSA shortly could approve the bank's application to implement the IRB approach.

Skandiabanken has a track record of receiving capital injections from its parent in order to enable very 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.

We understand that Skandiabanken intends to improve its profitability by 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 Q2 2014 (per Moody's calculation) stood at 64%. However, this strategy comes with risks to asset quality.

- 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.

At year end-2013 the bank held a liquidity reserve of SEK 19 billion (SEK16 billion under the more restrictive Swedish FSA definition), which consisted 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 not only by the bank's standalone bank financial strength of C-, mapping to a baa1 baseline credit assessment, but also by Sweden's local currency deposit ceiling of Aaa. We see moderate probability of support from the sovereign should such need arise.

The deposit rating also incorporates a very high likelihood of support from Skandia Insurance Company Ltd. 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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