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CREDIT OPINION
24 March 2020

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

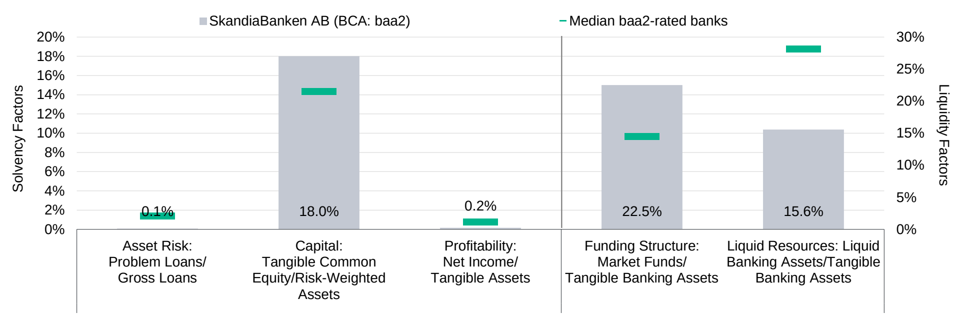
Summary

We assign SkandiaBanken AB (SkandiaBanken) A2/Prime-1 long-term and short-term deposit ratings with a stable outlook, 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) to the bank.

SkandiaBanken's baa2 BCA reflects the bank's solid asset quality, strong capital position and robust funding structure focused on retail deposits. These strengths are balanced against the bank's historically above-market growth rate in mortgage lending, as well as the bank's low efficiency and weak profitability. The Adjusted BCA of a3 reflects our very high assumption of affiliate support from the bank's parent, Skandia Insurance Company Ltd. with an insurance financial strength rating of A2 stable.[1]

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



These represent our Bank Methodology scorecard ratios, whereby asset risk and profitability reflect the weaker of either the latest reported or the average of 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 Financial Metrics

Credit strengths

» Strong asset quality

» Strong capitalisation

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

» Growing importance in the wider Skandia group

Credit challenges

» Historically high lending growth

» Lower-than-peer 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 the risks arising from its 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 if it maintains more prudent underwriting standards 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 the 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, leading to increased predictability of the size of the buffer 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. Increased risk could be exhibited by a significantly lower proportion of senior unsecured debt funding in the bank's liability structure or by an importantly lower-than-expected volume of junior deposits.

This publication does not announce a credit rating action. For any credit ratings referenced in this publication, please see the ratings tab on the issuer/entity page on www.moodys.com for the most updated credit rating action information and rating history.

Key indicators

Exhibit 2
SkandiaBanken AB (Consolidated Financials) [1]

	09-19[2]	12-18[2]	12-17[2]	12-16[2]	12-15[2]	CAGR/Avg.[3]
Total Assets (SEK Million)	79,699.0	72,044.0	69,407.0	65,214.0	58,735.0	8.5[4]
Total Assets (USD Million)	8,106.0	8,126.0	8,477.2	7,178.5	6,966.9	4.1[4]
Tangible Common Equity (SEK Million)	3,724.0	3,622.0	3,621.0	3,484.0	3,921.0	(1.4)[4]
Tangible Common Equity (USD Million)	378.8	408.5	442.3	383.5	465.1	(5.3)[4]
Problem Loans / Gross Loans (%)	0.1	0.1	0.0	0.0	0.1	0.1[5]
Tangible Common Equity / Risk Weighted Assets (%)	18.0	19.4	15.4	15.2	19.6	17.5[6]
Problem Loans / (Tangible Common Equity + Loan Loss Reserve) (%)	1.1	1.5	0.4	0.7	0.8	0.9[5]
Net Interest Margin (%)	1.0	1.1	1.2	1.1	1.2	1.1[5]
PPI / Average RWA (%)	0.8	0.4	0.8	0.5	-0.1	0.5[6]
Net Income / Tangible Assets (%)	0.1	0.1	0.2	0.2	-0.2	0.1[5]
Cost / Income Ratio (%)	83.2	94.4	81.2	88.0	103.0	89.9[5]
Market Funds / Tangible Banking Assets (%)	25.1	22.5	22.4	20.6	19.3	22.0[5]
Liquid Banking Assets / Tangible Banking Assets (%)	14.2	15.6	13.8	12.4	11.4	13.5[5]
Gross Loans / Due to Customers (%)	166.2	147.8	152.6	149.3	129.8	149.1[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.
Sources: Moody's Investors Service and company filings

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 September 2019, SkandiaBanken reported a consolidated asset base of SEK79.7 billion (€7.4 billion).

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

Detailed credit considerations

The global spread of the coronavirus is resulting in simultaneous supply and demand shocks. We expect these shocks to materially slow economic activity, particularly in the first half of this year. The full extent of the economic costs will be unclear for some time. Fear of contagion will dampen consumer and business activity. The longer it takes for households and businesses to resume normal activity, the greater the economic impact while fiscal and monetary policy measures will likely help limit the damage. Policy announcements from fiscal authorities, central banks and international organizations so far suggest that policy response is likely to be strong in affected. The coronavirus outbreak will have a direct negative impact on the asset quality and profitability of banks, in some cases in a pronounced manner, for example for undiversified banks with material exposure to high-risk sectors and small and medium-sized enterprises. We also view risks to be elevated for business models reliant on spread income, equity indices and sustained low rates. While Skandiabanken's loan portfolio consists of Swedish mortgages, which we consider low risk, a deterioration in asset quality due to higher unemployment and reduced activity in the housing market is likely.

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 of SEK79.7 billion as of September 2019 and a share of around 2% of the Swedish mortgage market as of year-end 2018.

SkandiaBanken focuses on mortgage lending and aims to grow its fees 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 a monoline with a business model focused on mortgages, with earnings highly dependent on retail interest income, which represented around 80% of its operating income in the first nine months of 2019. This structural dependence results in a one-notch qualitative downward adjustment to the bank's BCA in respect of Business Diversification, an adjustment shared with most of the Swedish mortgage lenders.

In 2018, the bank started targeting Skandia group customers by offering large rebates for occupational insurance clients with low loan-to-values (LTVs). This strategy has gathered increasing interest and during first nine months of 2019, SkandiaBanken's lending increased by 12.5%. If the bank succeeds in reaching its current target of SEK80 billion in mortgages, a 21% growth from the end of June 2019, it will be better placed to improve its efficiency without materially altering its risk profile.

In October 2015, SkandiaBanken spun off its Norwegian business, which had accounted for 54% of total lending as of 30 September 2015.

Strong asset quality with low LTV, but coronavirus increases risks

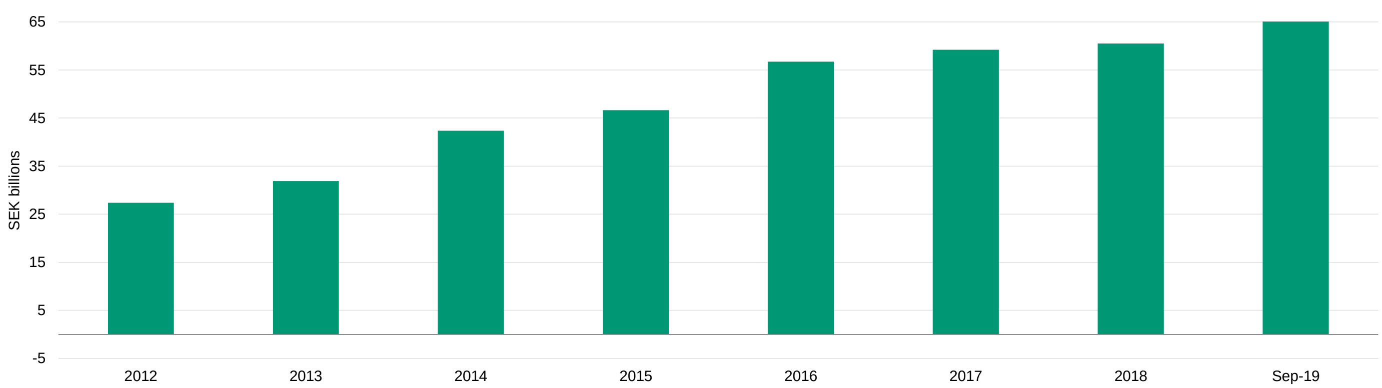
Our a1 Asset Risk score reflects SkandiaBanken's very low problem loan ratio — in line with that of its Swedish mortgage lenders — balanced against its significant lending growth over the last few years, a result of the strategic plan to increase the bank's market share and size (see Exhibit 3). As mentioned earlier, there are currently heightened risks facing banks due to the supply and demand shocks to the economy, which can result in higher unemployment and falling house prices.

Lending growth picked up in the first nine months of 2019 after a sluggish 2018, with gross loans increasing to SEK68.1 billion as of September 2019 from SEK58.4 billion a year earlier. SkandiaBanken aims to sustain its mortgage lending growth by offering its customers a transparent pricing model and rates that are among the lowest in the market. By increased cross-selling to Skandia group clients with low LTVs, the bank is able to grow while maintaining prudent asset risk metrics.

Exhibit 3

Outstanding loans to the public in the Swedish business

SkandiaBanken's lending growth slowed down in 2018 but picked up in the first nine months of 2019



Source: Company reports

SkandiaBanken's problem loan ratio as of September 2019 was 0.06%, which is very low compared with peers — domestic as well as elsewhere in Europe. The portfolio is dominated by mortgages, SEK 67.5 billion out of its SEK68.1 billion loan book as of September 2019. Furthermore, the band has very limited exposures of unsecured lending, strictly enforcing a cap on lending at a LTV ratio of 85%.

The bank's home mortgage portfolio LTV ratio (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 bank's current underwriting standards are aligned with those of its peers.

Although highly capitalised, the bank's leverage is increasing

As of March 2018, SkandiaBanken received approval from the Swedish Financial Supervisory Authority (SFSA) to apply the internal ratings-based 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. The bank's capitalisation compares favourably with that of its peers, but capital ratios have fallen because of balance-sheet growth and the SFSA's proposal to move the risk weight floor on mortgages to Pillar I from Pillar II. As of September 2019, the bank reported a Common Equity Tier 1 capital ratio of 17.5%, compared with 19.2% as of year-end 2018, which also includes the risk weight floor in Pillar I.

The Tier 1 leverage ratio was 4.7% as of September 2019, which is at par with the average for Swedish peers of 4.6% as of the end of June 2019. SkandiaBanken's tangible common equity/total tangible assets was 4.7% as of September 2019, down from 5.03% as of year-end 2018.

We view SkandiaBanken's capitalisation as very strong, given its business model focused on low-risk lending and the support from its parent, which partly offsets 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 a1 assigned Capital score reflects the bank's very strong capitalisation while acknowledging its increasing leverage.

MREL

On 31 December 2019, SkandiaBanken took a SEK 500 million subordinated loan from its ultimate owner, Skandia Liv. This loan is eligible for bail in and can therefore be counted toward fulfilling the bank's Minimum Requirements for own funds and Eligible Liabilities (MREL), which is 4.95% of its total liabilities and own funds from 1 January 2020. The bank intends on issuing senior non-preferred debt to fulfill its requirements ahead of the deadline on 1 January 2022. However, BRRD 2, which is currently being implemented, will likely alter the MREL requirements in Sweden. The new requirements, which we expect will be communicated during 2020, may lower the volumes of senior non-preferred debt that the bank needs to issue.

Lower-than-peer efficiency and weak profitability

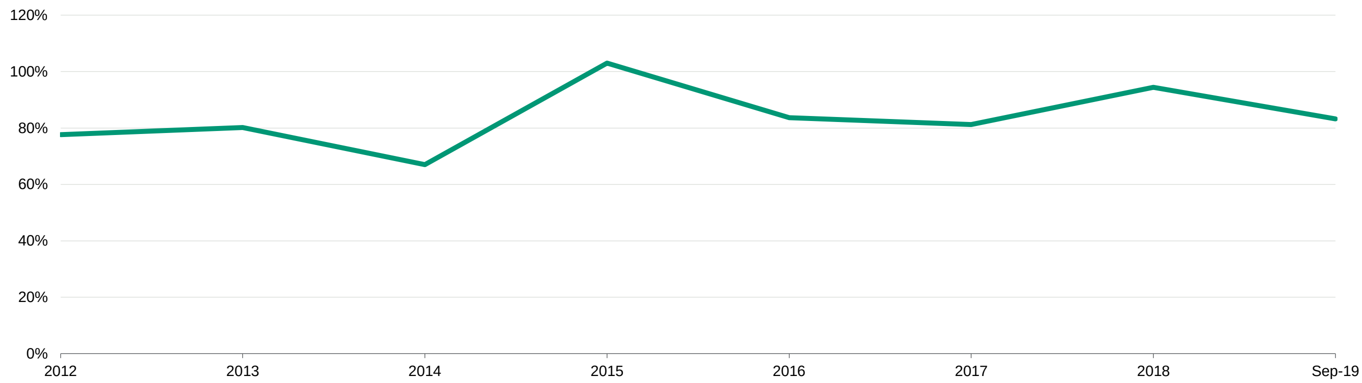
The b3 Profitability score reflects SkandiaBanken's weaker-than-peer recurring profitability, with net income/tangible assets of 0.15% for first nine months of 2019 — a consequence of its relatively low-risk products, aggressive pricing strategy and low efficiency. We expect weak profitability to persist over the outlook period but recognize a gradually improving trend in efficiency. While the strategy to grow volumes by focusing on low-margin mortgages to Skandia group customers will not necessarily help their net interest margins, the higher lending volumes will help the bank's cost efficiency by diluting the impact of the fixed costs.

SkandiaBanken reported an improvement in operating profit of SEK 140 during 2019 compared to SEK 87 million in 2018. This was driven by lower operating expenses, SEK792 million, compared with SEK858 million during 2018 while income levels were roughly flat. The higher volumes in lending were offset by lower interest rate margins and slightly lower fees.

Although costs were reduced in 2019, 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 decreased in the first nine months of 2019 to 83% from around 86% during the same period in 2018 (see Exhibit 4).

In the coming years, SkandiaBanken plans increase efficiency and targets a cost-to-income ratio of 60%. 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, improvements in the bank's efficiency ratio over the outlook period stems primarily from increased revenue because of growth in lending.

Exhibit 4
Cost-to-income ratio for SkandiaBanken's Swedish operations
SkandiaBanken faces challenges in improving efficiency



Source: 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.

The bank's reported retail deposits were SEK41 billion as of September 2019, or 51% of the total balance sheet. Most 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 was 166% as of September 2019, compared with 147% as of year-end 2018. The SEK27.0 billion gap between customer loans and deposits as of September 2019 is funded mainly with the issuance of debt securities: SEK27.2 billion covered bonds, SEK6.2 billion senior unsecured funding and SEK0.9 billion subordinated debt. SkandiaBanken made senior unsecured debt issuances in September 2019, amounting to SEK800 million in total.

We expect the bank to continue to increase its reliance on 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 benefit from a large domestic investor base who seek to hold high quality liquid SEK denominated securities. 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 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 14.2% as of September 2019, 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 of 225% as of September 2019, up from 188% as of year-end 2018.

Environmental, social and governance considerations

In line with our general view for the banking sector, SkandiaBanken has a low exposure to Environmental risks. See our environmental and social risks heatmaps for further information.

The most relevant social risks for banks arise from the way they interact with their customers. Social risks are particularly high in the area of data security and customer privacy, which is partly mitigated by sizeable technology investments and banks' long track record of handling sensitive client data. Fines and reputational damage because of product mis-selling or other types of misconduct are a further social risk. Societal trends are also relevant in a number of areas, such as shifting customer preferences towards digital banking services increasing information technology cost, aging population concerns in several countries impacting demand for financial services or socially driven policy agendas that may translate into regulation that affects banks' revenue base. Overall, we consider banks to face moderate social risks.

Governance is highly relevant for SkandiaBanken, as it is to all participants in the banking industry. Corporate governance weaknesses can lead to a deterioration in a company's credit quality, while governance strengths can benefit its credit profile. Governance risks are largely internal rather than externally driven. For SkandiaBanken, risks related to governance are considered low and we do not apply any corporate behaviour adjustment to the bank.

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 (LGF) analysis

We apply our Advanced LGF analysis to SkandiaBanken as 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 equity and losses stand at 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 the bank's junior deposits 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 our forward looking LGF analysis indicates a one-notch uplift in the bank's deposit rating above the a3 Adjusted BCA.

Government support considerations

Because of 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 the extremely low loss given failure from the high volume of instruments that are subordinated to CRR liabilities.

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.

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	←→	a1	Sector concentration	Loan growth
Capital						
Tangible Common Equity / Risk Weighted Assets (Basel III - transitional phase-in)	18.0%	aa2	↓↓	a1	Expected trend	
Profitability						
Net Income / Tangible Assets	0.1%	b1	←→	b3	Return on assets	
Combined Solvency Score		a1		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		
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				2		
Adjusted BCA				a3		

Balance Sheet	**in-scope (SEK Million)**	**% in-scope**	**at-failure (SEK Million)**	**% at-failure**
Other liabilities	28,662	36.0%	31,530	39.6%
Deposits	40,973	51.5%	38,105	47.9%
Preferred deposits	36,876	46.3%	35,032	44.0%
Junior deposits	4,097	5.1%	3,073	3.9%
Senior unsecured bank debt	6,683	8.4%	6,683	8.4%
Junior subordinated bank debt	900	1.1%	900	1.1%
Equity	2,388	3.0%	2,388	3.0%
Total Tangible Banking Assets	79,606	100.0%	79,606	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	16.4%	16.4%	16.4%	16.4%	3	3	3	3	0	aa3
Counterparty Risk Assessment	16.4%	16.4%	16.4%	16.4%	3	3	3	3	0	aa3 (cr)
Deposits	16.4%	4.1%	16.4%	12.5%	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 Investors Service

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

Endnotes

1 The bank ratings shown in this report are the bank's deposit rating, senior unsecured debt rating (where available) and Baseline Credit Assessment

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