MOODY'S
INVESTORS SERVICE

Credit Opinion: SkandiaBanken AB

Global Credit Research - 29 Nov 2013

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
Richard (Blake) B. Foster/London	44.20.7772.5454
Oscar Heemskerk/London	
Simon Harris/London	
Forssen, Daniel/London	

Key Indicators

SkandiaBanken AB (Consolidated Financials)[1]

	[2]**6-13**	[2]**12-12**	[2]**12-11**	[2]**12-10**	[2]**12-09**	**Avg.**
Total Assets (SEK million)	**87,940.0**	**84,657.0**	**76,767.0**	**68,101.0**	**69,133.8**	[3]**6.2**
Total Assets (EUR million)	**10,023.6**	**9,870.5**	**8,626.3**	**7,550.8**	**6,748.6**	[3]**10.4**
Total Assets (USD million)	**13,029.2**	**13,013.2**	**11,198.2**	**10,129.8**	**9,682.5**	[3]**7.7**
Tangible Common Equity (SEK million)	**3,194.0**	**3,130.0**	**2,726.3**	**2,601.6**	**2,691.4**	[3]**4.4**
Tangible Common Equity (EUR million)	**364.1**	**364.9**	**306.3**	**288.5**	**262.7**	[3]**8.5**
Tangible Common Equity (USD million)	**473.2**	**481.1**	**397.7**	**387.0**	**376.9**	[3]**5.9**
Net Interest Margin (%)	**1.3**	**1.4**	**1.4**	**1.2**	**1.3**	[4]**1.3**
PPI / Average RWA (%)	**1.1**	**0.9**	**0.3**	**0.5**	**1.0**	[5]**0.8**
Net Income / Average RWA (%)	**0.7**	**1.0**	**0.5**	**0.7**	**0.7**	[5]**0.7**
(Market Funds - Liquid Assets) / Total Assets (%)	**1.1**	**-24.6**	**-27.5**	**-17.7**	**-23.2**	[4]**-18.4**
Core Deposits / Average Gross Loans (%)	**126.3**	**137.2**	**130.9**	**122.5**	**133.3**	[4]**130.0**
Tier 1 Ratio (%)	**9.9**	**10.2**	**10.0**	**9.7**	**8.9**	[5]**9.7**
Tangible Common Equity / RWA (%)	**9.9**	**10.3**	**9.9**	**9.7**	**9.5**	[5]**9.9**
Cost / Income Ratio (%)	**77.2**	**82.6**	**94.1**	**90.8**	**81.6**	[4]**85.3**
Problem Loans / Gross Loans (%)	**0.2**	**0.3**	**0.4**	**0.3**	**0.4**	[4]**0.3**
Problem Loans / (Equity + Loan Loss Reserves) (%)	**4.3**	**5.1**	**7.4**	**6.1**	**6.2**	[4]**5.8**

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 rates Skandiabanken AB A3 deposit rating and C-/baa1 standalone bank financial strength rating (BFSR)/baseline credit assessment (BCA). The C- BFSR 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 (Skandia Insurance Company Ltd, financial strength A2 stable, SICL). The rating also reflects more negative factors such as its limited standalone franchise strength, low profitability and low efficiency.

We view the bank's dependence on deposits as its main funding source as a strength as we believe deposits are less confidence sensitive than market funding. However, we also note the benefits of funding diversification which remains limited, although this improved over 2012-13 following the issuance of covered bonds and senior unsecured funding, which also increased the bank's funding duration.

Skandiabanken's A3 long-term global local currency (GLC) deposit ratings benefit from one notch of uplift from its baa1 standalone credit strength. This reflects Moody's expectation that under its Joint Default Analysis methodology, the bank would benefit from a high probability of support from its 100% owner, Skandia Insurance Company Ltd, and a moderate probability of systemic support.

Rating Drivers

- Limited standalone franchise in Norwegian and Swedish markets but benefits from strategic role as part of the Skandia Group with access to large insurance client base

- Very strong asset quality related to low-risk retail mortgage business model

- Minimal market-funding reliance but deposit-based funding strategy lacks diversification

- Weak historical profitability and efficiency levels

Rating Outlook

The outlook on all ratings is stable

What Could Change the Rating - Up

Any upgrade of Skandiabanken's BFSR would have to 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 BFSR and/or an upgrade of the support provider's ratings.

What Could Change the Rating - Down

Conversely, the BFSR would be negatively affected in the event of an increase in credit risk leading to deterioration in profitability -- and in turn capitalisation -- or a weakening in franchise strength. The long-term deposit rating could be downgraded following a downgrade of the BFSR, a downgrade of the support provider and/or a decrease in Moody's assessment of parental support.

DETAILED RATING CONSIDERATIONS

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

Bank Financial Strength Rating

- LIMITED STANDALONE FRANCHISE IN NORWEGIAN AND SWEDISH MARKETS BUT BENEFITS FROM STRATEGIC ROLE AS PART OF THE SKANDIA GROUP WITH ACCESS TO LARGE INSURANCE CLIENT BASE

Skandiabanken had Swedish market shares of 1% for lending and 2% for deposits, and similar levels in Norway at end-2012, demonstrating its limited positions in both countries. Its strategy is based on its position as a direct bank, originally established in 1994 as a phone bank but now almost exclusively internet-focused, although the bank is increasingly using the wider Group's branch network to sell banking products. Whilst weak in terms of standalone franchise strength, the bank benefits from its position within the Skandia Group which allows Skandiabanken access to the Group's large insurance customer base, although we caution that monetising insurance relationships has historically proved difficult for banks due to a lack of regular contact.

- VERY STRONG ASSET QUALITY RELATED TO LOW-RISK RETAIL MORTGAGE BUSINESS MODEL

Skandiabanken's asset quality is very strong, as reflected in its problem loans of 0.2% of gross loans at end-June 2013. The bank's loan book was split (1) 67% mortgage loans secured on single-family houses; (2) 26% mortgage loans secured by apartments; (3) smaller amounts of vehicle financing and other retail lending; and (4) negligible corporate lending at end-2012. We view this emphasis on retail mortgage lending as lower risk than corporate lending although it does leave the bank with a relatively undiversified exposure to the retail real estate market in Sweden and Norway and has a negative impact on profitability.

More negatively, we note that loan growth has been fairly high, particularly in Sweden where it averaged 11% between 2008-2012, resulting in a less seasoned loan book, although in the six months to June 2013, the Swedish loan book has not grown at all. In Norway, the 2008-2012 growth rate was a more measured 6% although it then grew 16% over the first half of 2013 as Skandiabanken declined to match the full extent of the rate rises seen at the vast majority of other banks. High growth rates imply a degree of credit risk associated with the bank's ability to sustain the currently low problem-loan levels.

As in many Nordic banks, Skandiabanken's credit risk concentration is high in terms of borrower concentration, although the largest exposures are through the bank's liquidity portfolio holdings in the securities of large Nordic financial institutions. However, unlike most of its peers, Skandiabanken's industry exposure is extremely small due to its negligible corporate lending activities.

The bank recorded a Tier 1 capital ratio at end-September 2013 of 10.1%. In November, the bank received a SEK 300 million capital injection from its parent, Skandia AB. Applying this injection to the end-September Tier 1 capital ratio would have increased it to 10.9%. The bank's capital ratios are at the lower end of its Swedish peer group reflecting both the bank's retail focus and the Internal-Ratings Based (IRB) approach of most of its larger peers, although the bank remains hopeful its application will be approved towards the start of 2014.

- MINIMAL MARKET-FUNDING RELIANCE BUT DEPOSIT-BASED FUNDING STRATEGY LACKS DIVERSIFICATION

Skandiabanken has traditionally been almost exclusively deposit-funded, with deposits at end-June 2013 constituting 94% of total funding. During 2012, the bank started a market funding programme, issuing both commercial paper and bonds in Sweden and Norway. During 2013, the bank also issued its first tranche of covered bonds. Whilst we continue to view deposits as preferable to market funding, in Skandiabanken's case, we view the diversification benefits of the market funding positively, notwithstanding the short term nature of the majority of the market funding with 85% with a maturity less than a year at end-June 2013. We expect the bank to ramp up its covered bond funding over time which will have a positive impact on the duration of the market funding.

The positive benefit of market funding in this instance is increased by the fact that Skandiabanken's deposit base is 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, considering that pure internet banks' relationships with their customers, in terms of products per customer for example, tend to be less secure.

At end-June 2013, the bank held a liquidity reserve of SEK22.2 billion (SEK18.2 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.

- WEAK HISTORICAL PROFITABILITY AND EFFICIENCY LEVELS

Skandiabanken's profitability has historically been low, reflecting the relatively low risk products it offers and its policy of offering competitive interest rates on both savings and loan products as it seeks to add scale. This has been particularly true in Norway over the past year where Skandiabanken has sought to increase its scale by not passing through the rate rises seen in most banks. We do not believe the bank intends to significantly increase its risk profile in terms of product offering in the short to medium term. We also believe that given the intense market competition and the general economic outlook across much of Europe, that margins are likely to remain depressed for some time.

As a consequence of this, we think profitability will remain under pressure with any improvement likely to be contingent on an increase in scale. This scale is hard to achieve without aggressive pricing and cutting already slim margins for a small bank such as Skandiabanken so we expect the bank to instead look to position itself as providing banking solutions to current Skandia Group insurance and pensions customers with an intention to increase cross-selling, although we again caution that this has historically been hard to achieve.

As a consequence of this low profitability combined with the wide range of retail products, such as a trading platform and mutual funds, Skandiabanken's efficiency, as measured by its cost-to-income ratio of 77% at end-June 2013, remains weak for a direct bank although this marks an improvement from the end-2011 figure of 94%. We do not expect the bank to cut back its product range as this would detract from their offering to the Group. Consequently, the bank is concentrating on improving scale and cost cutting in other areas.

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 baa1 on the long-term scale, but also by Sweden's local currency deposit ceiling of Aaa, given Moody's assessment that the probability of systemic support in the event of a stress situation is moderate. Additionally, the rating incorporates the support that would be provided by Skandia Insurance Company Ltd, which we assess as being very high. 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 and shared Group costs such as advertising. In addition, we believe there is a moderate probability that systemic support would also be extended to the bank in the event of a crisis - based on Skandiabanken's broad national presence, its important retail deposit base and the disruption that might occur to the financial system, despite the bank's relatively small market share.

Foreign Currency Deposit Rating

The A3 foreign currency deposit rating of Skandiabanken is unconstrained given that Sweden, in common with other EU members, has a country ceiling of Aaa.

Foreign Currency Debt Rating

The A3 foreign currency debt ratings of Skandiabanken are unconstrained given that Sweden, in common with other EU members, has a country ceiling of Aaa.

ABOUT MOODY'S BANK RATINGS

Bank Financial Strength Rating

Moody's Bank Financial Strength Ratings (BFSRs) represent Moody's opinion of a bank's intrinsic safety and soundness and, as such, exclude certain external credit risks and credit support elements that are addressed by Moody's Bank Deposit Ratings. Bank Financial Strength Ratings do not take into account the probability that the bank will receive such external support, nor do they address risks arising from sovereign actions that may interfere with a bank's ability to honour its domestic or foreign currency obligations. Factors considered in the assignment of Bank Financial Strength Ratings include bank-specific elements such as financial fundamentals, franchise value, and business and asset diversification. Although Bank Financial Strength Ratings exclude the external factors specified above, they do take into account other risk factors in the bank's operating environment, including the strength and prospective performance of the economy, as well as the structure and relative fragility of the financial system, and the quality of banking regulation and supervision.

Global Local Currency Deposit Rating

A deposit rating, as an opinion of relative credit risk, incorporates the Bank Financial Strength Rating as well as Moody's opinion of any external support. Specifically, Moody's

Bank Deposit Ratings are opinions of a bank's ability to repay punctually its deposit obligations. As such, Moody's Bank Deposit Ratings are intended to incorporate those aspects of credit risk relevant to the prospective payment performance of rated banks with respect to deposit obligations, and includes: intrinsic financial strength, sovereign transfer risk (in the case of foreign currency deposit ratings), and both implicit and explicit external support elements. Moody's Bank Deposit Ratings do not take into account the benefit of deposit insurance schemes which make payments to depositors, but they do recognize the potential support from schemes that may provide assistance to banks directly.

According to Moody's joint default analysis (JDA) methodology, the global local currency deposit rating of a bank is determined by the incorporation of external elements of support into the bank's Baseline Credit Assessment. In calculating the GLC rating for a bank, the JDA methodology also factors in the rating of the support provider, in the form of the local currency deposit ceiling for a country, Moody's assessment of the probability of systemic support for the bank in case a stress situation occurs and the degree of dependence between the issuer rating and the LCDC.

National Scale Ratings

National scale ratings are intended primarily for use by domestic investors and are not comparable to Moody's globally applicable ratings; rather they address relative credit risk within a given country. An Aaa rating on Moody's National Scale indicates an issuer or issue with the strongest creditworthiness and the lowest likelihood of credit loss relative to other domestic issuers. National Scale Ratings, therefore, rank domestic issuers relative to each other and not relative to absolute default risks. National ratings isolate systemic risks; they do not address loss expectation associated with systemic events that could affect all issuers, even those that receive the highest ratings on the National Scale.

Foreign Currency Deposit Rating

Moody's ratings on foreign currency bank obligations derive from the bank's local currency rating for the same class of obligation. The implementation of JDA for banks can lead to a high local currency ratings for certain banks, which could also produce high foreign currency ratings. Nevertheless, it should be reminded that foreign currency deposit ratings are in all cases constrained by the country ceiling for foreign currency bank deposits. This may result in the assignment of a different, and typically lower, rating for the foreign currency deposits relative to the bank's rating for local currency obligations.

Foreign Currency Debt Rating

Foreign currency debt ratings are derived from the bank's local currency debt rating. In a similar way to foreign currency deposit ratings, foreign currency debt obligations may also be constrained by the country ceiling for foreign currency bonds and notes, however, in some cases the ratings on foreign currency debt obligations may be allowed to pierce the foreign currency ceiling. A particular mix of rating factors are taken into consideration in order to assess whether a foreign currency bond rating pierces the country ceiling. They include the issuer's global local currency rating, the foreign currency government bond rating, the country ceiling for bonds and the debt's eligibility to pierce that ceiling.

About Moody's Bank Financial Strength Scorecard

Moody's bank financial strength model (see scorecard below) is a strategic input in the assessment of the financial strength of a bank, used as a key tool by Moody's analysts to ensure consistency of approach across banks and regions. The model output and the individual scores are discussed in rating committees and may be adjusted up or down to reflect conditions specific to each rated entity

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)				0.56%			
Net Income % Average RWA (Basel II)				0.75%			
Factor: Liquidity						**C**	**Weakening**
(Market Funds - Liquid Assets) % Total Assets	-23.28%						
Liquidity Management				x			
Factor: Capital Adequacy						**B+**	**Neutral**
Tier 1 Ratio (%) (Basel II)		9.96%					
Tangible Common Equity % RWA (Basel II)	9.96%						
Factor: Efficiency						**E**	**Neutral**
Cost / Income Ratio					89.15%		
Factor: Asset Quality						**A**	**Neutral**
Problem Loans % Gross Loans	0.33%						
Problem Loans % (Equity + LLR)	6.21%						
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.

CREDIT RATINGS ISSUED BY MOODY'S INVESTORS SERVICE, INC. ("MIS") AND ITS AFFILIATES ARE MOODY'S CURRENT OPINIONS OF THE RELATIVE FUTURE CREDIT RISK OF ENTITIES, CREDIT COMMITMENTS, OR DEBT OR DEBT-LIKE SECURITIES, AND CREDIT RATINGS AND RESEARCH