MOODY'S
INVESTORS SERVICE

Credit Opinion: SkandiaBanken AB

Global Credit Research - 30 May 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

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Key Indicators

SkandiaBanken AB (Consolidated Financials)[1]

	[2]3-14	[2]12-13	[2]12-12	[2]12-11	[2]12-10	Avg.
Total Assets (SEK million)	106,460.0	98,597.0	84,638.0	76,767.0	68,101.0	[3]11.8
Total Assets (EUR million)	11,913.7	11,140.9	9,868.3	8,626.3	7,550.8	[3]12.1
Total Assets (USD million)	16,420.0	15,351.6	13,010.3	11,198.2	10,129.8	[3]12.8
Tangible Common Equity (SEK million)	4,256.0	3,907.0	3,169.0	2,726.3	2,601.6	[3]13.1
Tangible Common Equity (EUR million)	476.3	441.5	369.5	306.3	288.5	[3]13.4
Tangible Common Equity (USD million)	656.4	608.3	487.1	397.7	387.0	[3]14.1
Net Interest Margin (%)	1.3	1.2	1.4	1.4	1.2	[4]1.3
PPI / Average RWA (%)	1.8	0.8	1.2	0.3	0.5	[5]0.9
Net Income / Average RWA (%)	1.3	0.9	1.0	0.5	0.7	[5]0.9
(Market Funds - Liquid Assets) / Total Assets (%)	20.9	4.3	-17.8	-27.5	-17.7	[4]-7.5
Core Deposits / Average Gross Loans (%)	94.7	111.8	137.2	130.9	122.5	[4]119.4
Tier 1 Ratio (%)	10.6	10.9	10.6	10.0	9.7	[5]10.4
Tangible Common Equity / RWA (%)	11.0	10.9	10.5	9.9	9.7	[5]10.4
Cost / Income Ratio (%)	62.8	82.4	78.2	94.1	90.8	[4]81.7
Problem Loans / Gross Loans (%)	0.2	0.2	0.3	0.4	0.3	[4]0.3
Problem Loans / (Equity + Loan Loss Reserves) (%)	3.2	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 (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 deposit base as a strength because we generally believe that deposits are less confidence sensitive than market funding. That said, we view the issuance of covered bonds and senior unsecured debt (from 2012/13) as a positive development because it diversifies the bank's funding profile. Moreover, we also positively note that the duration of the bank's funding lengthened as a result of the debt issuances.

Skandiabanken's A3 long-term global local currency (GLC) deposit ratings benefits 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 in Norway and Sweden. However, the bank benefits from its strategic role in the Skandia group which enables the bank to access a large insurance client base

- Very strong asset quality because of low-risk retail mortgage business model

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

- A track-record of weak profitability and low efficiency

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 would be negatively affected in the event of an increase in credit risk resulting in weaker profitability -- and in turn capitalisation -- or a weaker franchise strength. 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 IN NORWAY AND SWEDEN. HOWEVER, THE BANK BENEFITS FROM ITS STRATEGIC ROLE IN THE SKANDIA GROUP WHICH ENABLES THE BANK TO ACCESS A LARGE INSURANCE CLIENT BASE

Skandiabanken is a small bank in both Sweden and Norway. It was established in 1994 as a telephone bank and now it is almost exclusively internet-focused. That said, 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. 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.

- VERY STRONG ASSET QUALITY 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 year end-2013. The bank's lending almost exclusively consists of mortgage lending although the bank also offers products such as personal loans, credit cards and car loans (Norway). We view this 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, we note that loan growth has been high in recent years. The three year average loan growth has been between 6% and 13% during the previous four years. Growth has been particularly aggressive in 2013 and 2012 when the lending book grew by 30% and 12%, respectively. Nearly all of the increase in lending in 2013 occurred in Norway where house prices have increased significantly. We view the aggressive expansion and low mortgage-loan seasoning as a risk 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. 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.

The bank recorded a 10.9% Tier 1 capital ratio at year end-2013. The ratio takes into account a SEK 300 million capital injection from the bank's parent Skandia AB in November 2013. 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. The bank expects the Swedish FSA to approve the IRB application in 2014.

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

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 increased 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.

- A TRACK-RECORD OF WEAK PROFITABILITY AND LOW EFFICIENCY

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. Given the intense market competition we believe that margins are likely to remain depressed for some time.

We think that profitability will remain under pressure with any improvement likely to be contingent on an increase in scale. This scale is hard to achieve for small banks, such as Skandiabanken, without aggressive pricing and by cutting already slim margins. On that background, our assessment is that the bank will focus in cross-selling banking products to current Skandia Group insurance and pensions customers. We also note that the bank's efficiency is weak and this is reflected by its 82% cost to income ratio. That said, we positively note that the ratio has come down from +90% in previous years and we expect this positive development to continue as the bank grows in size.

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.