MOODY'S
INVESTORS SERVICE

CREDIT OPINION
26 September 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 following deposit ratings affirmation at A2

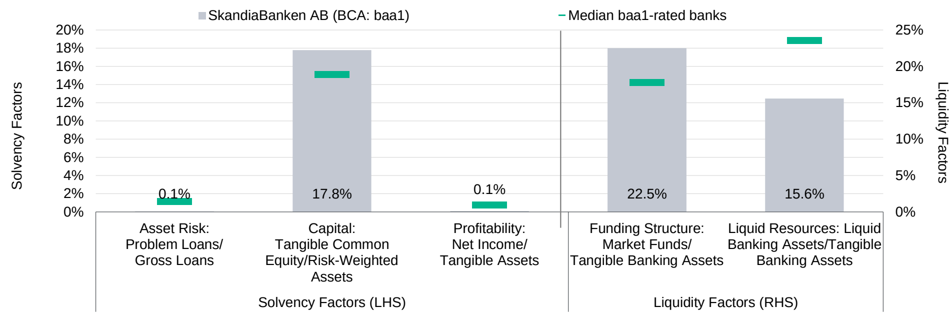
Summary

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).

SkandiaBanken's baa2 BCA reflects the bank's solid asset quality, strong capital 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, 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. (insurance financial strength A2 stable).

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. The 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

» 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 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 illustrated 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.

Key indicators

Exhibit 2

SkandiaBanken AB (Consolidated Financials) [1]

	06-19[2]	12-18[2]	12-17[2]	12-16[2]	12-15[2]	CAGR/Avg.[3]
Total Assets (SEK Million)	80,155.0	72,044.0	69,407.0	65,214.0	58,735.0	9.3[4]
Total Assets (USD Million)	8,639.1	8,126.0	8,477.2	7,178.5	6,966.9	6.3[4]
Tangible Common Equity (SEK Million)	3,672.0	3,622.0	3,621.0	3,484.0	3,921.0	(1.9)[4]
Tangible Common Equity (USD Million)	395.8	408.5	442.3	383.5	465.1	(4.5)[4]
Problem Loans / Gross Loans (%)	0.1	0.1	0.0	0.0	0.1	0.1[5]
Tangible Common Equity / Risk Weighted Assets (%)	17.8	19.4	15.4	15.2	19.6	17.5[6]
Problem Loans / (Tangible Common Equity + Loan Loss Reserve) (%)	1.2	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 (%)	0.5	0.4	0.8	0.5	-0.1	0.4[6]
Net Income / Tangible Assets (%)	0.1	0.1	0.2	0.2	-0.2	0.1[5]
Cost / Income Ratio (%)	88.6	94.4	81.2	88.0	103.0	91.0[5]
Market Funds / Tangible Banking Assets (%)	25.8	22.5	22.4	20.6	19.3	22.1[5]
Liquid Banking Assets / Tangible Banking Assets (%)	17.4	15.6	13.8	12.4	11.4	14.1[5]
Gross Loans / Due to Customers (%)	161.3	147.8	152.6	149.3	129.8	148.2[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 Investors Service; 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 June 2019, SkandiaBanken reported a consolidated asset base of SEK80.2 billion (€7.6 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

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 SEK80.2 billion as of June 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 to be 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 six 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 the majority of the Swedish mortgage lenders.

SkandiaBanken has grown significantly over the last years but missed its previous growth target: in 2013, management set a target of doubling the lending volume in five years. However, as of June 2019, SkandiaBanken reported SEK65.3 billion of outstanding mortgages, an increase of around 146% since 2012 (excluding the Norwegian operations).

In 2018, the bank started targeting Skandia group customers offering large rebates for occupational insurance clients with low LTVs. This strategy has gathered increasing interest and during first half of 2019 SkandiaBanken's lending increased by 9%. If the bank succeeds in reaching its current target of SEK80 billion in mortgages, a 22% growth from end-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 despite high growth

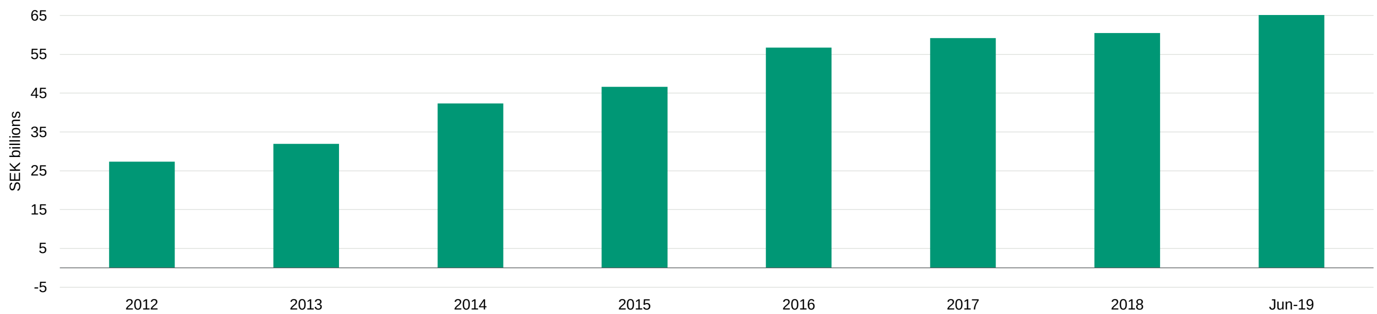
Our a1 Asset Risk score reflects SkandiaBanken's very low problem loan ratio — in line with that of its Swedish mortgage lenders — balanced against its significant lending growth over the last few years, a result of the strategic plan to increase the bank's market share and size (see Exhibit 3).

Lending growth picked up in the first six months of 2019 after a sluggish 2018, with gross loans increasing to SEK65.9 billion as of June 2019 from SEK58.6 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 LTV's 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 six months of 2019



Source: Company reports

SkandiaBanken's problem loan ratio as of June 2019 was 0.07%; which is very low compared to peers, domestic as well as elsewhere in Europe. Its asset quality has benefited from low interest rates and the Swedish households' ability to service their debt. However, in September 2017, we lowered the Swedish Macro Profile to Strong+ from Very Strong- because Sweden's buildup of household indebtedness against a backdrop of rapid house price appreciation poses latent risks to its economy and banks. Our assessment is that SkandiaBanken's solid asset risk and very strong capitalisation provides sufficient buffers against risks embedded in the Swedish operating environment.

The SEK65.9 billion loan book comprises almost entirely mortgages, which amounted to SEK65.3 billion as of June 2019. Lending with single-family houses as collateral accounted for around 57% of the total book and tenant-owner flats for 42% as of year-end 2018. Most of the loans are 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 bank's current underwriting standards are aligned with those of its peers.

Although very 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 due to balance sheet growth and the SFSA's proposal to move the risk weight floor on mortgages to Pillar I from Pillar II. As of June 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 4.8% as of June 2019, which is at par with the average for Swedish peers of 4.8% as of year-end 2018. SkandiaBanken's tangible common equity/total tangible assets was 4.59% as of June 2019, a decrease compared to 5.03% at end-year 2018, and below the threshold of 5% where we apply negative adjustments for leverage.

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 but also the increasing leverage.

Lower-than-peer efficiency and weak profitability

The b3 Profitability score reflects SkandiaBanken's weaker-than-peer profitability with net income/tangible assets of 0.1% for first six 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 recognise 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 their cost-efficiency by diluting the impact of the fixed costs.

SkandiaBanken's net income was SEK41 million in the first six months of 2019, compared with SEK50 million during the same period in 2018. This was driven by a 1.8% annual decline in net interest income, reflecting higher interest costs on the back of an increased resolution fee and increasing funding costs. The bank's operating expenses were relatively stable for the first six months of 2019 at SEK412 million, compared with SEK414 million during the same period in 2018. The bank's administrative expenses decreased by 3% in the first six months of 2019 from the year-earlier period, which was however offset by a 6% yearly increase in personnel expenses.

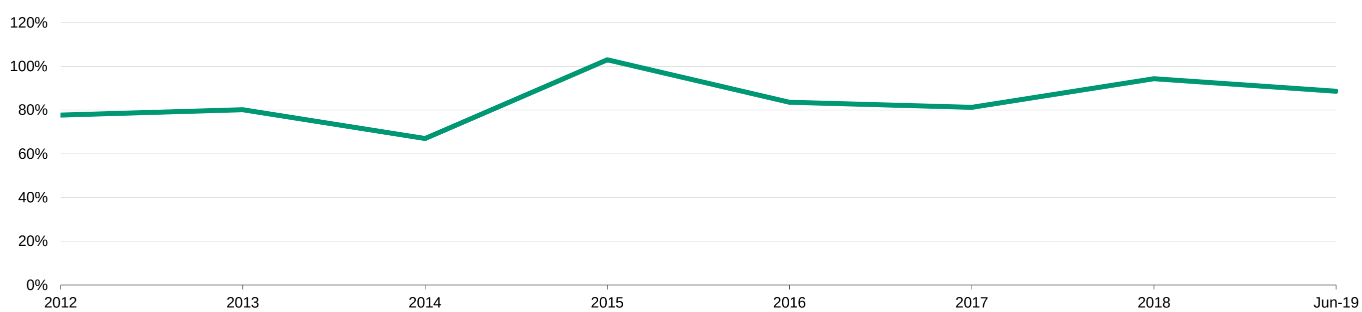
The bank continues to demonstrate weak efficiency, well below that of its Swedish peers, who report an average cost-to-income ratio near or below 50%. The bank's cost-to-income ratio increased in the first six months of 2019 to 89% from around 86% during the same period in 2018 (see Exhibit 4), although 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 and targets a cost/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 revenues due to 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, although mainly via covered bonds' issuances.

Reported retail deposits were SEK40.9 billion as of June 2019, or 51% 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 161% as of

June 2019, compared with 147% as of year-end 2018. The SEK25.0 billion gap between customer loans and deposits as of June 2019 is funded mainly with the issuance of debt securities: SEK27.4 billion covered bonds, SEK5.9 billion senior unsecured funding and SEK0.9 billion subordinated debt. SkandiaBanken made 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 fulfill the Minimum Requirements for own funds 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 17.4% as of June 2019, and its reported liquidity reserves were SEK14 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 234% as of June 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 heatmap 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 due to product mis-selling or other types of misconduct is 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 players 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.

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 (LGF) analysis

We apply our Advanced LGF analysis to SkandiaBanken as the bank is subject to the EU Bank Recovery and Resolution Directive (BRRD), 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 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

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 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	←→	a1	Sector concentration	Loan growth
Capital						
Tangible Common Equity / Risk Weighted Assets (Basel III - transitional phase-in)	17.8%	aa2	↓	a1	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		
Qualitative Adjustments				Adjustment		
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				2		
Adjusted BCA				a3		

Balance Sheet	**in-scope (SEK Million)**	**% in-scope**	**at-failure (SEK Million)**	**% at-failure**
Other liabilities	29,991	37.5%	32,853	41.0%
Deposits	40,882	51.1%	38,020	47.5%
Preferred deposits	36,794	46.0%	34,954	43.7%
Junior deposits	4,088	5.1%	3,066	3.8%
Senior unsecured bank debt	5,883	7.3%	5,883	7.3%
Junior subordinated bank debt	900	1.1%	900	1.1%
Equity	2,402	3.0%	2,402	3.0%
Total Tangible Banking Assets	80,058	100.0%	80,058	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	15.3%	15.3%	15.3%	15.3%	3	3	3	3	0	aa3
Counterparty Risk Assessment	15.3%	15.3%	15.3%	15.3%	3	3	3	3	0	aa3 (cr)
Deposits	15.3%	4.1%	15.3%	11.5%	1	3	1	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

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