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Various Rating Actions Taken On Swedish Banks On Continued Government Support And Heightened Economic Risks

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OVERVIEW

- We believe that the Swedish government remains willing and able to provide support to its systemically important banks' senior creditors, despite the implementation of the Bank Recovery and Resolution Directive.
- In our view, the Swedish government's tone and actions continue to indicate its intention to avoid a systemic financial crisis by supporting its four largest banks prior to resolution or bail-in of senior unsecured creditors.
- However, we believe that the house price appreciation and resurgence in household debt are on an unsustainable path and continue to diverge from fundamentals.
- We see heightened economic risk for Swedish banks, which contributes to the negative outlook on six banks, reflecting the possibility that we could revise our view of economic imbalances and/or credit risk in the Swedish economy over the coming two years.
- As such, we are raising the rating on Swedbank AB given our expectations of continued government support. The outlook is negative, reflecting heightened economic risks.
- We are revising the outlook on SEB to stable on the expectation that

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improvements in capital are likely to offset any reassessment of our views on the Swedish banking sector.

STOCKHOLM (Standard & Poor's) Dec. 2, 2015--Standard & Poor's Ratings Services said today that it has taken various rating actions on Sweden-based banks (see Ratings List below).

RATIONALE

Our review of Swedish banks reflects two main themes. First, we believe that the Swedish government remains likely to provide support to its systemically important banks prior to entering a resolution process or bail-in by senior unsecured creditors. Second, we believe that current trends in house price appreciation are on an unsustainable path and see the resurgence in household debt as an indication that low interest rates, strong tax incentives for debt, and a persistent housing shortage are increasing economic risks.

- We raised the ratings on Swedbank AB to 'AA-/A-1+' to reflect our view of Sweden's ongoing support of its systemically important banks. As such, we have removed the negative adjustment notch in place since July, which reflected an expected negative transition due to the potential removal of government support. The outlook on the rating is negative, reflecting our view of heightened economic risk for Swedish banks.
- We affirmed the 'A+/A-1' ratings on Skandinaviska Enskilda Banken AB (SEB). We have revised the outlook to stable from negative to reflect our expectation of continued government support and our view that we could revise upward SEB's stand-alone credit profile (SACP) as it continues to generate capital, offsetting the negative trend for the banking sector.
- We affirmed the 'AA-/A-1+' ratings on Nordea Bank AB and Svenska Handelsbanken AB and our 'A/A-1' ratings on SBAB Bank AB. The outlook on these banks remains negative. We have updated our rationale for our negative outlook to indicate that asset appreciation and higher debt levels could lead us to lower the ratings on these banks.
- We affirmed the 'BBB+/A-2' ratings on Sparbanken Skane given our expectation for continued improvement in capital. The outlook remains positive.
- Finally, we affirmed the 'A-/A-2' ratings on Landshypotek Bank AB and Swedbank Sjuharad AB. We have revised our outlooks on these banks to negative from stable to reflect our view of increased economic risks.

See the Ratings List below for details of rating actions on all related subsidiaries. The ratings on Tier 1 and Tier 2 capital instruments on the above banks and related entities are unaffected because they are notched down from the SACPs of the banks, which remain unchanged.

We have not included Swedish Export Credit nor Lansforsakringar Bank in this review owing to the substantial government-related entity (GRE) support and core group status that the respective banks benefit from, which reduces the rating sensitivity to the banks' SACPs.

SWEDISH IMPLEMENTATION OF BRRD, THE BANK SUPPORT LAW, AND ASSOCIATED FUNDS

Despite the expected implementation of the Bank Recovery and Resolution

Directive (BRRD) in Sweden in February 2016, we continue to classify the Swedish government as "supportive" of its systemically important banks. The government has a history of successful intervention in the banking system, most recently via support measures during the 2008-2009 global financial crisis, but also in the form of significant capital injections in the 1990s domestic banking crisis. With the implementation of BRRD, some of the government's flexibility to provide support to the banking sector has been reduced. However, in our view, the government remains clear in its political tone and actions that it intends to avoid a systemic crisis by providing preemptive capital support to its systemically important banks during a crisis.

As part of the EU, Sweden is required to convert EU directives into domestic regulations and adopt EU regulations. As such, Sweden will implement BRRD and bail-in provisions, likely on Feb. 1, 2016, with limited ability to apply national discretions. However, we note that the Swedish government expended considerable political capital to include options that allow governments to support failing banks under certain circumstances. In particular, we note the Swedish role in allowing preemptive capital injections outside of resolution to fill capital gaps identified by stress tests and the retention of pre-financed, earmarked government funds for this purpose. Furthermore, Sweden pushed for flexibility to include 20% of the risk-weighted asset (RWA) requirement, to complement the 8% minimum loss-absorbing liabilities, for countries with a resolution fund worth at least 3% of the deposit guarantee fund and for banks smaller than €900 billion (notably larger than Nordea Bank AB). In order to maximize its flexibility in the event of resolution, the government is expected to triple existing bank fees in order to build its existing resolution fund to levels in excess of Swedish krona (SEK) 40 billion, from SEK12 billion as at July 2015, targeting 3% of guaranteed deposits by 2020.

In our view, the most convincing argument for continued government support arises from the measures and preparedness to respond to a banking crisis prior to a resolution scenario for its four largest banks. In addition to implementing the BRRD, we expect the government to alter its existing bank support law, to reflect the restrictions imposed by the BRRD. In our view, the revised bank support law still provides for preemptive government support in the form of government-guaranteed funding or capital injections to solvent credit institutions prior to resolution to preserve financial stability. Given the interlinkages and similar exposures of its four largest banks, we consider it likely that the authorities would consider a stress to any of these banks as a threat to the financial stability of the system as a whole, permitting the use of government support outside of resolution. To finance any such measures, the government will maintain the earmarked, government-financed stability fund of SEK41 billion as at July 2015, rather than returning these funds to the general government budget as compensation for support provided to the banking sector in 2008-2009. The stability fund, as well as a separate resolution fund financed by fees on bank liabilities, will have credit lines decided annually, meaning that parliament can pledge additional government funds for support purposes prior to, or in the event of, risks to financial stability.

We note that the use of the stability fund for recapitalization is subject to a decision from the European Commission's EU state aid rules. As such, conditions for state aid may include writing down or converting subordinated capital instruments, but do not require a write down of senior unsecured debt. Absent a change in the EU state aid law, we maintain the view that the Swedish government is likely to provide support to senior unsecured creditors of its systemically important banks. We anticipate the use of the stability fund for preemptive capital injections, where private solutions are exhausted. While current EU State Aid Rules permit "supervisory action such as early intervention measures or other remedial actions to overcome the shortfall defined by the supervisory authority" as options to avoid converting subordinated instruments into equity, we do not believe that the government has direct intentions to support subordinated capital instruments and could still consider restricting coupons or otherwise using these instruments for recapitalization in some scenarios. While we do not see a heightened risk for these instruments initially, we continue to monitor authorities' appetite and views about the potential for converting these instruments in a preemptive capitalization scenario.

In our view, the ability of the Swedish government to provide support to its major banks in the future is not without hurdles. We note in particular that the proposed implementation of standardized risk weights, risk weight floors, and the planned review of the preemptive capitalization clause in Article 32 of the BRRD could affect our view of the ability and timing of potential government support for Sweden's largest banks. However, we believe that BRRD will be an effective resolution regime in Sweden upon implementation and could consider additional loss-absorbing capacity (ALAC) in the final ratings of systemically important banks if our view on government support changed.

INCREASING ECONOMIC RISKS

As the financial stability authorities have focused on BRRD implementation and measures to improve the amortization culture in Sweden, economic imbalances have worsened and household credit growth has gained momentum. We now believe that there is an increased likelihood that we could revise down the anchor for Swedish banks to 'bbb+' from 'a-' unless there is a significant change in direction. For six of the eight banks reviewed we believe that a change in the anchor would likely lead to a lowering of the long-term rating on the bank.

Despite very low inflation, we anticipate that residential real estate prices will have appreciated by over 20% in most regions and over 30% in Stockholm since the onset of 2014, with prices accelerating throughout 2015. The pace of growth is supported by anecdotal signs of overheating as mortgage rates have fallen toward 1.5% for the average borrower. The authorities plan to implement mandatory amortization on new lending in May 2016; however, market data indicates that amortization has seen a stepwise increase in recent years with little impact on our concerns about imbalances and the new rules, applied only to new loans, are unlikely to break the trend without other further measures. In addition, we note that debt accumulation in the economy is growing at nearly twice the rate of GDP, despite a subdued contribution from the corporate segment. The corporate segment, aside from property-related lending, has shown little interest for credit in recent years, but higher growth expectations could eventually lead to a resurgence in investment-related borrowing. At this stage, we believe a long-term, multi-faceted effort is necessary to change the trajectory of debt accumulation and realign asset prices with fundamental factors.

We acknowledge that structural factors support relatively high house prices and encourage household indebtedness, but we believe that the pace of development is unsustainable and may, eventually, affect our view of overall risk in Sweden's banking sector. As we have said previously, we do not believe that bank losses will begin in the mortgage segment. Rather, we believe there is a high consumption elasticity of households to real asset prices and financial asset prices, given their high sensitivity to interest rates and the relatively high private wealth invested in equities and mutual funds. The negative trend we see for economic risks indicates our view that this sensitivity increases as debt and asset prices appreciate.

In addition, we believe that concerns about the Swedish housing market could affect demand for Swedish covered bonds, increasing funding costs for banks and raising mortgage rates for borrowers. As the central bank points out, reduced foreign demand for Swedish assets would further devalue the krona, increase inflation, and potentially accelerate the normalization of monetary policy. While bank revenues would improve with more normalized interest rates, an abrupt shift could derail what has already been a fragile economic cycle.

The following paragraphs provide a more detailed rationale and outlook for our rating actions on each bank.

SWEDBANK

We have raised the ratings on Swedbank to 'AA-/A-1+' from 'A+/A-1' by removing the negative notch of adjustment included since July, which reflected an expected negative transition due to the potential removal of government support. As we now believe that the government retains the ability to provide support, we have removed this negative notch. The ratings on Swedbank reflect its strong business position, strong capital and earnings, adequate risk position, average funding, adequate liquidity, and one notch of government support.

The negative outlook on Swedbank reflects our view of heightened economic risks associated with growing economic imbalances in Sweden. We could lower the ratings if the negative trends we see for Swedish economic risk caused us to revise down our anchor for banks operating in Sweden, including Swedbank, to 'bbb+' from 'a-'. We could revise our assessment of Swedbank's SACP downward if, contrary to our current expectation, the bank is unable to maintain a risk-adjusted capital (RAC) ratio sustainably above 10%, our threshold for a "strong" capital and earnings assessment. We could revise the outlook to stable if we consider that the trend for economic risk affecting the Swedish banking sector had stabilized.

SKANDINAVISKA ENSKILDA BANKEN

We have affirmed our ratings on SEB at 'A+/A-1'. The ratings reflect its adequate business position, adequate capital and earnings, adequate risk position, average funding, adequate liquidity, and two notches of government support above its 'a-' SACP. We acknowledge the bank's recent improvements in efficiency, capital, and earnings and expect that the bank will continue to improve its capital and earnings metrics despite top-line pressure on interest margins given its higher share of fee-based business.

We revised the outlook on SEB to stable, reflecting our view that improvements in the SACP, particularly in our view of the bank's positive capital and earnings developments, could offset the downside risk to the SACP due to heightened economic risks in Sweden, SEB's primary market.

Note that a one-notch improvement of the SACP would result in a one-notch reduction in government support, as per our criteria, meaning that the issuer credit rating on the bank would remain unchanged. We could revise the outlook to negative, or lower the rating, if a revision of our view of economic risk coincided with a reduction in capital generation at SEB.

NORDEA BANK

We have affirmed our ratings on Nordea Bank at 'AA-/A-1+' and maintain our negative outlook. The ratings on Nordea Bank reflect its strong business position, adequate capital and earnings, strong risk position, average funding, adequate liquidity, and one notch of government support above its 'a+' SACP. We anticipate that Nordea will continue to support its improved funding and liquidity profile, as our ratios of broad liquid assets to short-term wholesale funding and long-term stable funding now reflect a near-balanced profile.

The negative outlook on Nordea Bank reflects our view of heightened economic risks in the bank's core markets of Sweden, Finland, and Norway. An increased economic risk score in any of the three countries would likely lead us to revise down the bank's anchor to 'bbb+' from 'a-', and would imply an increased risk for the bank's balance-sheet exposures and that operating conditions could dampen earnings prospects. We could revise the outlook to stable if we consider that the trends for the varying economic risks affecting the Nordic banking sector have stabilized or if capital strengthening is such that it helps offset ratings pressure arising from the negative trends in its primary markets.

SVENSKA HANDELSBANKEN

We have affirmed our ratings on Svenska Handelsbanken (SHB) at 'AA-/A-1+' and maintain our negative outlook. The ratings on SHB reflect its strong business position, adequate capital and earnings, strong risk position, average funding, adequate liquidity, and one notch of government support above its 'a+' SACP.

The outlook on SHB remains negative as we see heightened economic risks in

Sweden, the bank's primary market.

We could lower the ratings if the negative trends we see for Swedish economic risk caused us to revise down the bank's anchor to 'bbb+' from 'a-'. We could revise the outlook to stable if we consider that the trend for economic risk affecting the Swedish banking sector has stabilized. We could also revise our outlook to stable if SHB's capital generation exceeds our expectations, resulting in a RAC ratio reaching a level sustainably above 10%, although we see this as unlikely over the next 18-24 months.

SBAB BANK AB

We have affirmed our ratings on 100% government-owned mortgage lender SBAB Bank AB at 'A/A-1' and maintain our negative outlook to reflect the negative economic risk trends in Sweden. The ratings on SBAB reflect its adequate business position, strong capital and earnings, moderate risk position, average funding, adequate liquidity, and one notch of GRE support above its 'a-' SACP. SBAB has improved its funding and liquidity profile, as indicated by our metrics of broad-liquid assets to short-term wholesale funding and long-term stable funding. The bank, however, remains more reliant on wholesale funding relative to Nordic peers. SBAB is likely to continue increasing its share of retail deposit funding, and we see a negative rating action related to funding and liquidity profile factors as remote at this time.

The negative outlook on SBAB reflects that we could revise down our anchor for banks operating in Sweden to 'bbb+' from 'a-' given current trends in Sweden. SBAB is a profit-seeking enterprise that provides a select commercial offering, without a clear public policy role. We could revise the outlook to stable if there was a concrete change in SBAB's mandate, such that the bank's importance to the government was increased. An example of this would be a government-sponsored capital injection that would be used specifically for new building projects in order to address structural housing shortages. We could also revise our outlook to stable if we consider that the trend for economic risks affecting the Swedish banking sector had stabilized.

LANDSHYPOTEK BANK

We have affirmed our ratings on Landshypotek Bank at 'A-/A-2' and revised our outlook to negative to reflect the negative economic risk trends in Sweden. The ratings on Landshypotek reflect its moderate business position, very strong capital and earnings, adequate risk position, below average funding, and adequate liquidity. We do not include any government support notches in the rating.

The negative outlook on Landshypotek reflects that we could lower the ratings if the negative trends we see for Swedish economic risk caused us to revise down our anchor for banks operating in Sweden, including Landshypotek, to 'bbb+' from 'a-'. We could also consider lowering the ratings on Landshypotek if we saw any further weakening in the Swedish agricultural sector, which could undermine the quality of the bank's loan book. We could revise the outlook to stable if we consider that the trend for economic risk affecting the Swedish banking sector had stabilized, provided that the bank continues to uphold its position as the primary first-lien lender for the agricultural and forestry sectors in Sweden, and maintains its strong loan-to-value profile and low level of loan losses.

Given the bank's funding and sector concentrations, we see limited upside to the ratings at this time. Although deposits are becoming an increasing share of funding, we do not anticipate revising our view of the bank's funding profile over the next two years.

SPARBANKEN SKANE

We have affirmed our 'BBB+/A-2' ratings on Sparbanken Skane and maintain the positive outlook. The ratings reflect its moderate business position, very strong capital and earnings, moderate risk position, average funding, and adequate liquidity. We do not include any government support notches in the rating on the bank and reflect its long-standing cooperation with Swedbank in our assessment of its business position. We expect the bank to maintain its close ties with Swedbank even as it maintains a higher share of its own mortgage exposures.

The positive outlook on Sparbanken Skane reflects our expectation that the recently consolidated bank will maintain a robust capital level over the next 18-24 months. These improvements could mitigate the increasing economic risks we see in Sweden. We could raise the rating if economic risks in the Swedish economy stabilize, and the bank continues to generate capital. We could revise the outlook to stable or lower the ratings if the bank is unable to maintain its RAC ratio of 15% on a sustainable basis given the expected pace of growth in its on balance sheet mortgage book and our view of economic risks in Sweden. We could also take a negative rating action if the bank's cooperation with Swedbank weakened materially.

SWEDBANK SJUHARAD

We have affirmed our 'A-/A-2' ratings on Swedbank Sjuharad and revised the outlook to negative from stable to reflect the negative economic risk trends in Sweden. The ratings on the bank reflect its moderate business position, very strong capital and earnings, moderate risk position, average funding and adequate liquidity. We do not include any government support notches in the rating and reflect the bank's long-standing cooperation with Swedbank in our assessment of its business position. We expect the bank to maintain its close ties with Swedbank even as it maintains a higher share of mortgages on its own books.

The negative outlook on Swedbank Sjuharad reflects that we could lower the ratings if the negative trends we see for Swedish economic risk caused us to revise down our anchor for banks operating in Sweden to 'bbb+' from 'a-'. In addition, we could take a negative rating action if Swedbank Sjuharad's ties with Swedbank weakened considerably or if Swedbank Sjuharad is unable to maintain capital in line with our forecast. This could happen, for example, if lending growth outpaced capital accumulation or if the bank incurred materially higher losses.

We could revise the outlook to stable if we consider that the trend for economic risks affecting the Swedish banking sector had stabilized. A positive rating action is unlikely because we consider an improvement of other bank-specific factors to be remote at present.

RATINGS LIST

	To	From
Upgraded		
Swedbank AB		
Counterparty Credit Rating	AA-/Negative/A-1+	A+/Stable/A-1
Affirmed; Outlook Revised To Stable		
Skandinaviska Enskilda Banken AB (publ)		
Counterparty Credit Rating	A+/Stable/A-1	A+/Negative/A-1
Affirmed; Outlook Revised To Negative		
Swedbank Sjuharad AB		
Counterparty Credit Rating	A-/Negative/A-2	A-/Stable/A-2
Landshypotek Bank AB		
Counterparty Credit Rating	A-/Negative/A-2	A-/Stable/A-2
Affirmed		
Nordea Bank AB		
Counterparty Credit Rating	AA-/Negative/A-1+	
Svenska Handelsbanken AB		
Counterparty Credit Rating	AA-/Negative/A-1+	
SBAB Bank AB (publ)		
Counterparty Credit Rating	A/Negative/A-1	
Sparbanken Skane		
Counterparty Credit Rating	BBB+/Positive/A-2	

NB: This list does not include all ratings affected.

RELATED CRITERIA AND RESEARCH

Related criteria

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- National And Regional Scale Credit Ratings, Sept. 22, 2014
- Principles For Rating Debt Issues Based On Imputed Promises, Dec. 19, 2014
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- Credit FAQ: How Standard & Poor's Applied Its Government Support And ALAC Criteria To European Banks In December 2015, Dec. 2, 2015
- Standard & Poor's To Conclude Its Review Of Systemic Support For Remaining EU Banks By Early December 2015, Oct. 1, 2015
- Government And ALAC Support Ratings Uplift For Systemically Important European Banking Groups, Oct. 1, 2015
- How The Regulatory Reform Process Could Reshape Banks' Business Models And Affect Issuer Ratings, Aug. 18, 2014
- Standard & Poor's Takes Various Rating Actions On European Banks Following Government Support Review, April 29, 2014
- Credit FAQ: The Rating Impact Of Resolution Regimes For European Banks, April 29, 2014

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