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Presentation

Operator
Ladies and gentlemen, welcome to the First Quarter Report 2017. Today I'm pleased to present Gregori Karamouzis, Head of Investor Relations. For the first part of this call all participants will be in listen-only mode, and afterwards there will be a question and answer session. Gregori, please begin.

Gregori Karamouzis
Thank you. Good morning, everyone, and thank you for dialling into this call presenting our first quarter result. With me I have our CEO Birgitte Bonnesen, our CFO Anders Karlsson and our CRO Helo Meigas. With that I'll hand the word over to Birgitte.

Birgitte Bonnesen
Thank you, Gregori, and welcome to our first quarter call. We have, as you've seen, a very strong quarter, where we succeeded in mitigating the headwinds of increased resolution fund fee, seasonal and day effects. On the upside, we have the one-off gain from the sale of Hemnet and increased volumes in mortgages in Sweden. Despite a more subdued demand in the corporate space, Swedish Banking has still seen more activity and a slight pick-up in volumes.

As mentioned in previous quarters, we have a goal, a wanted position, and we deliver in all areas of our plan. This quarter, activity in the organisation has been extremely high. We have created a CVM unit, working with customer value, based on data, proactivity and relevance in the offers. We have delivered a large number of new services to the customers across the different product and business areas. The digitalisation of the lending process reached one goal this quarter and delivered a fully digital consumer loan functionality in Sweden. We also entered into collaboration with the FinTech Mina Tjänster, which is an app for managing different service agreements in Sweden. This we do both for revenue reasons but a lot for loyalty reasons. It complements our own services, and it increases customer satisfaction. In Baltics we launched Smart ID, which is an app for identification and signing of agreements. This is something that will enable the use of digital devices even more and significantly change the way of doing business in the market. It is a true game changer. These are just three examples of deliveries, and they show the areas that we focus on. We will come back to other areas. One that I will just mention, before I go to the figures, that the inflow we've seen in Robur, in the funds area, for the first time in a very, very long time, and it's a quality net inflow.

We'll come back to this, but all in all, the first quarter shows an ROE of 15.9, strict cost culture .38 in cost income, a strong capital buffer of the 250 basis points and a continued low loss level. Our previous guidance on cost credit losses and credit growth remains. And with this, I'll leave the word to Anders.

Anders Karlsson
Thank you, Birgitte. I will, as usual, first talk you through the highlights in each of the three business segments and thereafter sum it all up at group level. Lastly, I will mention the quarterly developments with regards to our capitalisation. Before starting, I just want to remind you that we have made some reporting changes in the quarter that have impacted the business segments, although the group reported result is not impacted. This means that some historic figures for Swedish Banking and Large Corporates & Institutions are not directly comparable. I will comment on them specifically. The biggest reporting change, however, is how we report the compensation to the savings banks, and that is reflected in restated historical figures.

Now, moving to Swedish Banking, they delivered a strong underlying result. NII was flat in the quarter, despite increased resolution fee, fewer days and transfers of customers and volumes to Large Corporates & Institutions; all in all, 250 million in headwind. The strong underlying NII is mainly due to further backward mortgage margin expansion and loan volume growth, but also slightly increased deposits and corporate margins. Mortgage margins on new lending fell with a couple of basis points in the quarter. A positive stock market development and net fund inflows, as Birgitte mentioned, improved asset management income, income from cards was seasonally weaker. The sale of Hemnet to the real estate advertising website generated a one-off tax-free capital gain of SEK 680 million. Asset quality continued to be resilient.

Turning to Baltic Banking, yet another quarter with a resilient performance. NII was negatively impacted by fewer days and FX effects, while increased private lending volumes supported income. Mortgage lending margins and deposit margins were flat in the quarter, while corporate margins were slightly down. Net commission income was negatively impacted by normal seasonal effects, both in card payments and asset management. And I want to remind you that in Q4 we had a performance fee in asset management in Latvia, which is not coming back in Q1. Expenses were slightly down due to seasonality and FX effects, and asset quality continued to be solid.

Lastly, looking at LC&I, LC&I delivered a somewhat lower result before impairments. NII was impacted negatively by the increased resolution fund fee, fewer days and lower average lending volumes in the quarter. Also, positive one-offs of around 40 million in Q4 impacted the comparability. The customer transfer from Swedish Banking increased NII this quarter with approximately SEK 90 million. Net commission income was lower in the quarter compared to a very strong Q4, due to seasonal effects and performance fees in asset management cards and brokerage. Net gains and losses were also lower versus the very active Q4. Trading income, especially within FX and equity, was slower in Q1. Also, valuation effects in derivative exposures quarter over quarter impacted negatively. Credit impairments in the quarter were lower than in Q4 and, yet again, came from provisions in the oil-related segments. Helo will talk more about the outlook in the oil and offshore portfolio in a short while.

To summarise this on group level, we delivered another strong set of results. Mortgage volumes and margin expansion supported NII and mitigated the negative pressure from the increased resolution fee and fewer days. Commission income was lower due to seasonal effects. Activity is high in the market, which bodes well for the remaining part of the year, at the same time as we have inflows again in our asset management business. Net gains and losses were lower in the customer-related part, but were supported by better results in Group Treasury. Normalisation in the FX swap market, following some volatility over year end, reversed the negative valuations from Q4. The Hemnet capital gain mentioned earlier will be part of the distributable result in 2017. Expenses came in seasonally lower in the quarter.

Let me spend a few minutes on Group Treasury result and expenses for 2017 before I move on to capital. Our Group Treasury result guidance for the full year of 2017 remains. That means total income, looked at by combining NII and NGL and excluding the one-off gain of the Visa transactions, is expected to be about the same level as in 2016. This, of course, assumes no change in interest rates, covered bond spreads and FX swap rates. The outcome in the first quarter does not change the overall guidance, but the outlook on NII and NGL has slightly changed. NII is expected to be around the same level as in 2016 and so does NGL.

Looking at the expenses for this year, as a consequence of the reporting changes we made during the quarter, moving the variable part of the compensation to the savings banks to NII, we adjust the total expense guidance for full year 2017 to around 15.8 billion.

Turning to capital, capitalisation remains strong, with a Common Equity Tier 1 capital ratio of 24.2% and a minimum requirement of 21.7%, including a counter-cyclical buffer increase to 2% and current risk exposure amount levels as base. Our buffer to the minimum requirement remains solid at around 250 basis points. We still await clarity on primarily the expected Basel proposals and the subsequent implementation by the EU before we will set our management buffer level. The CET 1 capital base was adversely impacted this quarter by around 0.5 billion as a result of lower discount rate when valuing our pension liabilities, the so-called IAS 19 effect.

Risk exposure amount increased by SEK 16.6 billion, mainly due to model adjustments relating to default frequencies in the corporate portfolio. As part of a model review, in conjunction with preparations for submitting the planned model related to the increased capital requirements for corporate exposures that the Swedish FSA took a decision on last year, we found that one of the corporate models has been underestimating the default frequencies. To rectify for this problem, we have as a consequence decided to hold more capital for expected PD increases already in Q1 2017, leading to high risk exposure amounts, which is captured in the other credit risk category, while waiting for the model update to be approved by the Swedish FSA. Let me now hand over to Helo to walk you through the asset quality.

Helo Meigas

Thank you, Anders. We continue to have strong credit quality in our home markets, both at Swedish Banking and Baltic Banking. So, reversals in Q1 with SEK 3 million and SEK 66 million recoveries respectively. In Large Corporates & Institutions, we report SEK 408 million credit impairments in our oil and offshore portfolio. This is in line with what we communicated during the previous quarter, that we may see further provisioning need during 2017. Referring back to the guidance we gave last quarter, which was 10–15 basis points credit impairments to the credit portfolio, as Birgitte mentioned, we remain with the same guidance for this year. We have not seen improvement in the oil-related industry, and even though there are first consolidation transactions ongoing, the situation remains strained and further provisioning during the year may be needed.

Gregori Karamouzis

Thank you, Helo. Operator, we'll hand back to you and happy to take any questions from the audience.

Q&A

Operator

Ladies and gentlemen, if you have a question for the speakers, please press zero one on your telephone keypad. Our first question comes from the line of Magnus Andersson from ABG. Please go ahead, your line is now open.

Magnus Andersson

Yes, good morning, just a few questions on NII. First of all, you talk about continued expansion of back-book Swedish mortgage margin, so 3-4 basis points, if you can say something about for how long you expect this to continue. And secondly, just I note that your NSFR is now 109%, and previously, Anders, you talked about a target level of 103–105%, and roughly, I think, we were discussing around 100 million NII impact per percentage points in NSFR. If you could give us some update on that target or how you expect to arrive there. Also, finally, more technical perhaps, but if we could get resolution fund fee, the increase of 183 million, quarter on quarter, per business area which facilitates the analysis. Yes, that's it on NII. Thanks.

Anders Karlsson

Thank you, as always relevant and difficult questions to answer. But on the mortgage book or the re-pricing, you can, sort of, divide the stock or the back book as well as the three months floating that is sort of constantly re-priced. And then you have around 200 billion of fixed mortgages coming in. And it's primarily in the latter part that you see that the mortgage expansion – or the margin expansion is continuing.

When it comes to NSFR, I kind of regret that I ever mentioned that, but I still stick to that. We shouldn't have a higher NSFR than necessary. Why we are at 109 now is that we have, since the capital markets have been very benign, and we have a fairly large maturities in the year, we have front loaded the funding agenda. So, there is no sort of ambition to keep up a 109 NSFR for going forward.

And the third question was about the resolution fund fee per business area. I have it somewhere, but I ask Gregori to –

Gregori Karamouzis

Yes, Magnus, as you can see in the fact book, the resolution fund fee in total for the quarter was 343 million. And if you look at the approximate split that we gave you in the press release on April 3rd, 66 of that belongs to Swedish Banking, 26 to LC&I and 8% to Baltic Banking. So, that's the split out of the total fee. The deltas – the deltas in the quarter were an increase in Swedish Banking of 130 million versus last quarter and 95 million increase in LC&I versus last quarter. And the Baltic Banking correspondingly then decreases with the difference.

Magnus Andersson

Yes, okay, just sorry, on the back book re-pricing, this 200 billion, for how long do you think this will continue? Should we expect the same amount in the coming quarters – same magnitude?

Anders Karlsson

Yes, it's not evenly spread in terms of maturities, but it goes on for a couple of years still.

Magnus Andersson

Right, okay, and just one final question on capital, do you know anything more about the timing of the phasing in of corporate risk rates?

Helo Meigas

We have started the preparations for submitting the model update to SFSA, but it will take a bit of time. So, we expect to submit it in – definitely before the year-end, in the later part of the second half of the year, but then it's up to the SFSA when they will give us approval for this, the most likely, 18.

Magnus Andersson

Okay, thank you very much.

Gregori Karamouzis

Thank you, Magnus.

Operator
Our next question comes from the line of Andreas Håkansson from Exane. Please go ahead, your line is now open.

Andreas Håkansson
Yes, good morning. Following-up on Magnus questions on NII, could you just continue? You sent out the press release in the quarter, saying that you're re-pricing parts of your SME book. Could you just give us a bit of detail to that, and when do you expect to see a positive impact on that re-pricing? Also, could you give us a number? You mention in the text that the rising interest rates did have a positive impact in the quarter. Could you tell us the size of that please?

Anders Karlsson
Thank you, Andreas. On the first part, which is the re-pricing on the corporate, it is a – as we also say, it's a small portion of the corporate portfolio. It's around 40 billion that is – where the sort of base rate is administratively set by us. It's not an IBOR-related base rate. So, the bank sort of have the possibility to set the rates ourselves. We did that in March. 40 basis points was the increase, and you can calculate the yearly effect of that, which is 160, obviously not that much in the quarter though, since it was in March. And then we have seen – but again, it's not a trend – we have seen that in some sectors we have been able to re-price even on the IBOR-related lending. But the ones we mention is that. The other question was about how much –

Andreas Håkansson
Interest rate.

Anders Karlsson
Yes, sorry, please repeat the question.

Andreas Håkansson
No, it was if you could give us the size of the impact of rising interest rates that you mention in the text.

Gregori Karamouzis
Is it on deposits in particular, you mean, Andreas, yes?

Andreas Håkansson
Yes, that's right, yes.

Gregori Karamouzis
Yes.

Anders Karlsson
It's – I would say it's between one and two basis points.

Andreas Håkansson
Excellent, and then your final question, we talked about the back book of mortgages, and you said that the front book declined a bit in the quarter. Could you tell us you – some banks re-priced mortgages up in the quarter, and what's the outlook for the front book from here, if you could?

Anders Karlsson
Oh, that's a very good question. I think we also increased our rates, but as we have said in the past, and we stick to that, we will not be the first mover. So, we – I think that what you will see, if anything, if rates continue to increase, is incremental small changes, step by step, by us and different actors in the market.

Andreas Håkansson
Okay, thank you.

Operator
Our next question comes from the line of Willis Palermo from Goldman Sachs. Please go ahead, your line is now open.

Willis Palermo
Hi, good morning. I have two questions. The first one is on the fee income, as you mentioned that there was some quite inflow now from Robur. I was wondering if you could elaborate a bit of quality, what do you mean, and where do you see those inflows coming from and if we can talk about a trend reversal in that business now and what kind of growth you had in mind going forward. That's the first question.

Anders Karlsson
Okay, if we start with the asset management, what we mean by high quality is that it's sticky money. It's private individuals buying into our funds. Institutional monies, as you know, are now a bit more volatile. As far as the action comes on how we, sort of, proceed with asset management and our initiatives, there I hand over to Birgitte.

Birgitte Bonnesen
We have – this year we have a very ambitious plan for the savings area overall. And we have increased our activities in support for the branches and also in the digital channels for sales of savings products. We've also increased the activity and changed, you know, a big part of Robur. We have a new CEO in Robur, the asset management company. And we will – for example, all our funds now have a sustainability profile. We have launched two new funds this quarter. This is the first time in years, I would say. And they have been extremely successfull from the beginning, sold really, really well. So, this is what we see. We'll continue working intensively with the asset management company and with the frontline in support. And it's primarily pensions we're targeting, and that has been successful so far.

Anders Karlsson
And just to add to it. I mean, this inflow has a limited impact on the income in the quarter, obviously. That is more related to the fact that the stock exchange or the markets have been very benign.

Willis Palermo
Yes, of course, thanks. And just related to that, do you still believe that – you still continue to have a more attractive pricing than competitors, and do you think this is also part of the bearing fruit now? Do you think it starts to materialise?

Birgitte Bonnesen
You know, we have a very attractive offering. You can have anything from funds where you pay 10–20 basis points, up to a very actively managed at about 125. So, we have, sort of, this is a range where we move, and within that range we have a very good combination of different funds. And I think our – you know, our offering as a whole is very attractive.

Willis Palermo
Okay, thank you. And the second question was on the costs and more specifically on the trajectory you would expect for the full year, as when we analyse the first quarter it's currently running above the full-year target. And if you could please remind us about the initiative you started last year, and the magnitude and the indicators, maybe an idea of the timing when they will feed through the cost line to meet the target, the 15 point something.

Anders Karlsson
Yes, around 15.8. Yes, if you take four and multiply it by four it becomes more than 15.8. So, it's a very good question. I mentioned it before, and it's still very relevant. It will although come during the year. We have a lot of procurement initiatives going on. They will pay off as the year goes along. We have near-shored a large number of services and FTEs to the Baltics. That is gradually coming into the cost on a positive note. And thirdly, I expect us to see fewer FTEs during the year within the bank. So, I'm very confident in that sense. But the first quarter is a bit on the higher end compared to 15.8. But that's the ambition, and that's the target.

Willis Palermo
Okay, thank you very much.

Operator
Our next question comes from the line of Anton Kryachok from UBS. Please go ahead, your line is open.

Anton Kryachok
Oh, good morning, and thank you very much for the presentation. Just two questions, please. One following-up on the net interest income and the mortgage margin trends, given that mortgage pricing has lagged a little bit the pace of the increase in STIBOR, I was wondering if you can lay out the key constraints in your mind that have prevented you from pricing up the

mortgage book on the front end at the same pace as the rate rises. And the second question please on the inflation in the year that we have seen this quarter. Can you just confirm that the change related to the technical default frequency was caused entirely by your internal reviews rather than the regulator having a look at the models? And have you finished reviewing all of the models or are you still in the process of doing that on the corporate side? Thank you so much.

Anders Karlsson
To start off with your question on the mortgage re-pricing, I think that – I mean, first of all, we are not changing list prices as STIBOR moves. That would be new prices every day. So, you will see, as I said earlier, incremental shifts upwards, if STIBOR stays or further increases. So, it takes time. It will be gradual. It's not something we do on a daily basis. As far as the risk exposure amount comes, I will hand over to Helo.

Helo Meigas
On your first question of – yes, I do confirm that this was purely our own – on our own finding, as part of the regular model review, and because we started to prepare for the model update. So, it was us who went to the regulator and said that we had found a deficiency. About reviewing all the models, this is an ongoing process. This is not something that is done within one year. So, we continuously review the models and see whether the actual default frequency in the models are in line with what we see in the real life. So, this is an ongoing process. But we don't expect any further significant adjustments as we had this quarter.

Anton Kryachok
That's very clear. Thank you so much. I'm sorry, if I might just come back to the mortgage margin question. I'm curious to understand, how do you think about passing on higher interest rates to the consumers on the mortgage side? Do you evaluate there the benefits that you get on the deposit side from higher rates versus your mortgage pricing and you kind of look at the two together? Or do you look at mortgage prices separately, only in conjunction with your funding costs and kind of ignoring the benefits that you get from deposit margin expansion in the rising rate environment?

Anders Karlsson
Okay, thank you very much for reminding me of the deposit ease because that is a very relevant comment. No, we are not looking at them together. When you look at the pricing in the mortgage market, you see that there are different actors acting differently in this quarter. Some are more aggressive than others. We have said that we will follow the market. We will not be the leading player in terms of re-pricing, and that is what we continue to work with. But it will be incrementally rather than any major shift in pricing. But you shouldn't view them as – we don't view them as in combination. We view them as separate products and pricing are separate.

Anton Kryachok
Perfect, thank you so much for that.

Operator
Our next question comes from the line of Jan Wolter from Credit Suisse. Please go ahead, your line is now open.

Jan Wolter
Yes, morning, Jan Wolter here, Credit Suisse. Can you hear me okay?

Gregori Karamouzis
Yes, we can.

Jan Wolter
So, first on the NII sensitivity, when I look into the disclosures in the fact book this quarter, it looks like it's now 4.8 billion NII increase for 100 basis point higher interest rate. So, although we can discuss what the right number is, what drove the increase between the fourth quarter and the first quarter, just in principle? So, that's the first question, if you have any details on that.

Anders Karlsson
Yes, Jan, thank you. The main reason for the change in the sensitivity is the fact that STIBOR has increased, and, as you might remember, we have a chunk of corporate loans where we have floored the rate. So, when rates move closer to zero, you will get a sort of higher effect from – in the sensitivity calculations. That is the main reason for it.

Jan Wolter

Okay, thanks, that's very clear. And then, I think when we look at the model adjustment that Swedbank disclosed this quarter here, I think lifting the REA by around 20–22 billion, and I think – is that related to the oil book only? Because the lending, the oil lending-related book is around 26 billion, when I look into the presentation. So, there is an REA increase of 22 billion. I just wonder what books should we look at? The book of 22 billion increase or the book of 26 billion gross lending, that seems like a lot.

Helo Meigas

No, it was not only oil book. It was actually consists of two parts. One is related to how we capture the late payments related to our leasing contracts. And then the second part is about the oil. And the bigger part is actually related to the leasing contracts. But this is a purely technical matter. It has nothing to do with a change in the credit quality. We basically – what it means is that if a client is over 90 days overdue we need to kind of register it as a default, and we have had process deficiencies in capturing this. In reality, all these clients, even if they have been in over 90 days overdue, have actually paid so we have not had credit losses. So, with – in fact we expect to come out from the models over the – basically four to five years' time as the kind of basically the time rolls forward.

Jan Wolter

So, how big is the leasing book then, which drove, together with the oil and offshore book, this REA increase?

Helo Meigas

Yes, the REA increase is – about two thirds comes from the leasing side and one third from the oil. But the problem with the models is that it's not about the size of the leasing book. It's actually, if you have a total client exposure, and you have an overdue in one single contract of it, then it kind of contaminates the whole exposure. So, that's related to the clients who have leasing contracts and if they have been over 90 days overdue.

Jan Wolter

Okay, many thanks for that. And the final question here, the re-pricing of corporate volumes outside the books where the contract is based on an administrative rate, could you say anything about what are the most likely volumes that we can see re-pricing and where the company intends to offset the higher costs from the resolution fund? Thank you.

Anders Karlsson

Yes, if you look at the corporate portfolios, we have said in previous quarters, with the continued subdued demand in large parts of the corporate sector, the competition is very fierce. So, we have seen anecdotal evidence of it, but it's not really happening the way we thought. The only sector where have seen a possibility and also acted on it more specifically is in the real estate sector. So, we will see as the year moves on, Jan. I don't have a much better answer than that.

Jan Wolter

Okay, but many thanks for that, very clear. Thank you.

Operator

Our next question comes from the line of Matti Ahokas from Danske Bank. Please go ahead, your line is open.

Matti Ahokas

Yes, good morning, two questions from my side as well. Firstly, regarding asset quality, you say that credit impairments were in line with your expectations. Does this mean that we should see write-backs in the Baltic operations with this magnitude also in the following quarters? Second question is regarding the Swedish mortgage market. You also have in your presentation a slide showing the house price growth in Sweden. And recently Moody's said that Sweden is one of the four countries most vulnerable in the world for house pricing correction. How have you taken this into consideration in your risk management, volume appetite and pricing measures in the Swedish mortgage market? Thanks.

Helo Meigas

Well, first of all, the credit impairments and our guidance, and if it was in line. We comment on it on a total level, not on a business area level. I mean the write banks in Baltic banking, we have said it previously that we expect them to come to an end. They continue coming in, but I continue to redirect. We expect them to come an end; we don't expect to see write backs of the same magnitude going forward. So guidance is only on a total level.

As to the – as to the mortgage market, we continue to be very confident about the credit quality in the mortgage market. We do see our clients' buffers increasing because of the general increase on the household wealth, as well as because the mortgage cost or the housing costs are at the very low levels. And that was also confirmed by the SFSA in its recent mortgage review. So of course if the house prices continue to go up, then – kind of the fragility of kind of the house price itself will increase. So the probability for correction is higher. At the same time, this, we believe, will primarily be affecting consumption, not the – how the – whether our clients are able to pay all their mortgages or not.

Matti Ahokas
So if I understand you correctly, you haven't basically taken any significant measures to kind of prepare for this.

Helo Meigas
No, we – I mean, what we have been working on, we have debt to income cap, which we have not changed. This is at 500%. We do look at some of the – kind of the more vulnerable sectors of the – of the portfolio where we see that the affordability margins are – are smaller. And if they also have high LTVs and they have – they are borrowing very close to our debt to income cap, then we are more cautious with them and then we ask them to kind of – to look at the increased amortisations. But LTVs are growing just at a very – to remain at a very low level, and in general we have not made any significant changes in our origination criteria.

Anders Karlsson
So just to remind you that the LTV of the Swedish mortgage portfolio on average is about 50%, so even if you see a price correction, there is a big buffer.

Matti Ahokas
Great, thanks.

Operator
Our next question comes from the line of Geoff Dawes from Société Générale. Please go ahead, your line is now open.

Geoff Dawes
Hi, good morning, everyone. Two questions from me and then a quick clarification, if I may. First of all the questions, if I look at the shipping oil portfolio, the absolute level of non-performing loans actually declined quarter on quarter, and you had quite a big step up in the coverage ratio, which was the reason for the new losses. Can you just talk a little bit about that dynamic and specifically whether Europe, both in NPL level and coverage ratio that you're happy with, or if we go through the year that coverage ratio will need to go higher again.

Second question is on the mortgage volumes. You've obviously been growing at a slower pace than the market overall. Can you just clarify, is that a pricing issue or is that sort of a reticence or a caution issue vis-à-vis growing new volumes?

And then finally the clarification. You mentioned some net interest income guidance in the opening section had been flat year on year, so flat 2017 versus 2016. Can you just clarify, was that Swedish banking, was that the group? I didn't quite pick it up, sorry. That's it. Thank you very much.

Anders Karlsson
So let's start from the end, then. The guidance I gave you was on group treasury, and that was the combination of NII and NDL, where I said that 2017 will be in line with 2016. So it had nothing to do with Swedish banking.

Geoff Dawes
Got it, that's clear, then. That's good to clarify, thank you.

Anders Karlsson
And the second question was about the volumes in the mortgage market. It's a combination of both, actually. As Helo alluded to, we are a bit more cautious in specific segments where you can see that the vulnerability is higher than what we want to see, and it's also price issues. It's a combination of both.

Helo Meigas
And then on your question on – on the question on the coverage ratio, we are comfortable with what we have now, but we are guiding that we may need to rotate the provisions during the year. It will depend on how the restructurings will be finalised, and if there is a need to make for the provisions, then we do.

Geoff Dawes

Okay, but I guess the dynamic that I'm looking at, it's roughly that 41% probably reflects some NPL where you don't expect any losses and some NPLs where you expect quite a big build-up over the year, which is why you've got absolute NPLs coming down at the same time as coverage going up. Is that correct?

Helo Meigas

Yes, that's roughly correct. That's the range where we have also been, kind of, previously.

Geoff Dawes

Okay, clear. Thank you very much.

Operator

Our next question comes from the line of Ronit Ghose from Citigroup. Please go ahead, your line is open.

Ronit Ghose

Yeah, good morning, thanks. It's Ronit from Citi. I just wanted to follow-up on the volume question from Geoff. Specifically, if I look at loans, if I adjust for FX – FX movements quarter on quarter, am I looking at basically a flattish loan book? You know, plus or minus 0% loan growth? And in terms of thinking ahead for the rest of the year, I'm just wondering how much of a deceleration – do you think Q1's a bit of a one-off? A seasonal one-off? Or is there a bit of a deceleration in the loan book?

On the other side of the balance sheet, on the deposits side, corporate customer deposits are up quite strongly – up 34% Q-on-Q. How much of that jump in the quarter is FI deposits? Is the – you know, can you give us some feel for what the underlying corporate client deposits are like? Your retail deposits are flat again quarter on quarter. I'm just trying to get a sense again of the underlying business momentum here. If I strip out the – you know, you usually have a big FI deposit swing in the first quarter.

And my final question is to circle back to all the questions we've had on mortgage pricing. Now, of course I understand when STIBOR moves you're not going to change your list prices every day, Anders, but the 2-3 basis point decline we saw in the front book – if STIBOR continues to rise on the same – on the same magnitude as Q1, should we assume a similar type of front book decline, or would the ambition be to absorb front book pricing pressure? Thank you.

Anders Karlsson

Thank you. Lots of questions. Let's see if I remember them all, otherwise you have to remind me. But the first one –

Ronit Ghose

Sure.

Anders Karlsson

The first one on volume development – you can see two things happening in the quarter. One is that mortgages is growing in Swedish banking, and also corporates, to a certain extent. In LC&I you see corporates decreasing. There are two reasons for the volume development in LC&I specifically. One is that there are a couple of large corporates that has repaid their debt and gone to the debt capital markets, which was expected. And the second thing is it's not that we cannot take volumes, but it has been, to a very large extent, a price issue. When it comes to Baltic banking, it's more or less you can say you see growth in particular in private but corporate is fairly flat.

If we go to your next – or your last question, because I don't remember the one in the middle, about – about mortgage pricing, I stick to what I say. The ambition is absolutely to re-price if STIBOR goes up. As you know, it's a competition out there, and as I also said, we will incrementally do it, because I don't think that it is wise to have a very volatile lift price in a volatile underlying market. So the ambition is definitely there.

And when it comes to the deposit volumes, you're right, it's the increase you see in the quarter is primarily related to LC&I and its financial institutions to a very large extent. So I don't – I don't view it as sticky, and we are charging for it.

Ronit Ghose

Right, just to clarify, Anders. So the – so deposits, private clients – flat; corporate deposits up SEK 120 – oh, SEK 120, SEK 130-odd billion – SEK 115 billion.

Anders Karlsson
I see your point. Yeah, and that's the other part of it is treasury that is related to the short-term money market fund placement from the US. They tend be – they tend to disappear and they – at certain points in time and then the comeback.

Ronit Ghose
Totally. So if I take out those money market fund deposits, what's the underlying corporate deposit balance like? Is it sort of flattish? Is it growing? I'm just curious how big the US fund number is.

Anders Karlsson
It's – it's very large. It's around SEK 90 billion, I would say. So the underlying deposit growth is around SEK 30 billion, but in that you have some financial institutions. So I wouldn't say that it's a strong growth, but the corporate deposit growth is – it's not strong at all. It's there, but it's not strong.

Ronit Ghose
Okay, that's really clear. Can I just ask one clarification? You talked about there's a bit of pricing issue giving up volume on the loan side. Was that specifically on LCI or were you talking about –

Anders Karlsson
Yes.

Ronit Ghose
– corporate – okay, LCI. Thank you. That's very clear, Anders.

Anders Karlsson
Thank you.

Operator
Our next question comes from the line of Peter Kessiakoff from SEB. Please go ahead, your line is open.

Peter Kessiakoff
Yes, hi. Thank you. Most of my questions have been asked, but some – some detailed ones, however. First on payments, I think that you're mentioning in the report that you've made some price adjustments now in Q1 following, I guess, the interchange system – cap that came in slightly more than a year ago. If you just can elaborate a bit more on that.

And then secondly in terms of risk exposure of the market risks, which were down now in Q1 as well and they were down in Q4, and I think back then – back at the Q4 report you mentioned that it should probably pick up again in Q1, but it declined again. If you can just elaborate a bit on that as well. Thank you.

Gregori Karamouzis
Hi Peter, it's Gregori here. On the first question on card payments, what it really is is that the key card providers, MasterCard and Visa, have changed their pricing models – in particular, Visa towards the end of last year – and that is now shining through or coming through in the first quarter. So it's fee and pricing and rebate changes that those two providers have made.

Peter Kessiakoff
Okay, so the kind of additional decline that we saw in Q1 is – that's – you can say that's the new run rate.

Gregori Karamouzis
Yes, that's sustainable. Correct.

Peter Kessiakoff
Okay. And then my question on market risk?

Anders Karlsson
I think it is extremely difficult to view if it's a trend, Peter. Market risk in between quarters is – is volatile. So I wouldn't even dare going into giving you a trend on market risk.

Peter Kessiakoff

Okay, okay. I think I'll stop there. Thank you.

Anders Karlsson
Thank you, Peter.

Operator
Our next question comes from the line of Adrian Cighi from RBC. Please go ahead, your line is now open.

Adrian Cighi
Hi there, this is Adrian. Thank you for taking my questions. I have two clarifications, please. One on NII and one on asset quality. On NII, apologies if I missed this, but can you specify that front book mortgage margins are still above the back book level?

And then second one on asset quality, your net credit impairments in the quarter were 9 basis points with obviously a significant chunk coming from the oil-related impairments. However, at the beginning of the call, as I understood, you reiterated your full-year guidance for basically full-year levels in line with 2016 levels? Do you expect oil-related losses to remain at these elevated losses for the remainder of this year, or do you have a buffering your guidance for potential deterioration in the rest of the book? Thank you.

Anders Karlsson
Okay, thank you. Starting off with the mortgage book, if you look at the back book and the front book, the gap is closed. What I said is that when you look at the back book, it consists of, you can say, two different parts. One part is the one that is running on floating rate three months fixing, and the other part is fixed rate, which was written a long time ago. The one that is written a long time ago, which is equivalent to around SEK 200 billion, there is still a gap between front and back. But on average, the gap is closed in this quarter.

Helo Meigas
And then on the – on the credit impairment, we guide for 10-15 basis points. We are at nine basis points. I think we are well within the guidance. And where does it come from? We – majority of it is – in the guidance is related to the oil portfolio. The credit quality in the home market continues to be very strong. The first quarter we have had no credit impairment, but this is not normal. One should have credit impairment when one gives out loans to customers. So of course within this number there are some credit impairments for the rest of the market, of our portfolio as well.

Adrian Cighi
Okay, very clear. Thank you.

Operator
Our next question comes from the line of Daniel Do-Thoi from JP Morgan. Please go ahead, your line is open.

Daniel Do-Thoi
Hi, good morning. Just two questions from me. The first one is on IFRS 9. I think last quarter you mentioned – or you estimated the impact would be between 40 and 80 basis points. Just wanted to – to know whether that is still the case.

And then secondly, on mortgages, I believe the FSA has made a few comments this quarter that they would like to see a lower share of households on floating rate mortgages. Is that something that you are actually currently seeing, particularly as rates begin to rise? Or is that something that you're expecting to see? A bit of thoughts around that would be helpful. Thank you.

Anders Karlsson
Okay, thank you. To start off with, IFRS 9, we have said 40-80. And clarity comes as time goes by and development internally is progressing. What we see as we speak is rather an effect of 30-60 basis points.

On the floating versus fixed, you can see that it's been a healthy debate in the media around that in Sweden lately, and you can see a gradual shift. Some clients are moving more into fixed than floating, but it's – it's very – it is very gradual. It's not a significant jump.

Daniel Do-Thoi
Can I just follow up on that fixed versus floating a bit? I mean, I guess as I look at your list prices it's sort of encouraging customers to move out in terms of duration, so just wondered if that is something that you actually are actively steering your customers towards?

And then secondly, what would that actually mean in terms of margins if customers start to increasingly switch out to longer duration mortgages? Thank you.

Anders Karlsson

I see your point. Yeah, we – when we – I mean, we talk about sustainable lending, and when we look at customers and their repayment capacity, that is taken into account. So if you are on the weaker side, we definitely recommend people to at least partly fix some of the rates. And you're – you're perfectly right that the list price curve is a bit flattish, so if – which essentially means that, as we speak, the margins are a bit lower on the fixed rate than on the floating rate. But as you also know, market rates are moving all the time, so we'll see where that ends up. But it's a gradual shift, and – and I personally think that it's good that people are fixing more from a risk perspective.

Daniel Do-Thoi

Okay. And sorry, just a follow-up one last time, the – the margin differential that you mentioned, could you just give us a feel for how much that is? Let's say between a floating and a – and let's say a five-year mortgage?

Anders Karlsson

If you look at the last six months it's been varying between 0 and 40 basis points. Less margin.

Daniel Do-Thoi

Okay. And on average, somewhere in between, or...

Anders Karlsson

I don't have that on the top of my head. But that could be a fair assumption.

Daniel Do-Thoi

Right. Okay. Thank you very much.

Anders Karlsson

You're welcome.

Operator

Our next question comes from the line of Johan Ekblom from Bank of America. Please go ahead, your line open.

Johan Ekblom

My questions have been covered, thank you.

Operator

Our next question comes from the line of Riccardo Rovere from Mediobanca. Please go ahead, your line is now open.

Riccardo Rovere

Yes, good morning to everybody. Couple of questions, if I may. The first one is on risk-weighted assets, again. How much of the kind of SEK 20 billion you reported in this quarter can be considered as an anticipation of what could come after the approval of the PD models from the Swedish FSA? This is my first question.

The second question I have is – is on oil-related loan losses. I'm a bit confused. Now you are taking all these losses but the Brent prices started collapsing more than a year and a half ago. So I was wondering why such a long time, first. And secondly, you have increased the coverage ratio, the exposure is going down, you have updated PDs, LGBs, all the model stuff, but you keep saying that you might continue to have provisions related to the oil and gas exposure. And I am just trying to understand – to understand why after the provisions of the higher coverage ratios you might have more to come in the coming quarters, if I get your comments right. Thanks.

Helo Meigas

If I start with your question regarding the REA increase, yes, all of it – all of it is what we expect we need the one[?] as part of the model update. And this is our best estimate as of today.

Then on the dynamics of the provisioning in the oil portfolio, I mean, the – of course oil price is an important variable when we look at the underlying quality and how well our clients are doing; however, the bigger impact is related to the investments. And there have been expectations that we will see improvement in the market in – in the end of 2017/2018. 2017 we now expect to be a very difficult year for the oil sector because the occupancy rate for the rigs and the supply vessels are at historic low levels – prices.

For the services are not going up, profitability in the market is very low, so clients have difficulties with their cash flows. We have not finalised fully the first phase of restructuring. This is one uncertainty why we think that before we will say how much credit impairments we need, we need to finalise the work we are in the middle of. We also see that there may be – already we are starting to see clients starting to restructure the – their exposures again, because the market has not been improving. This, however, we don't think will result in further credit impairments as we see it now, but it's – but it is a difficult situation, and that's why we continue to guide on the possibility for the further credit impairments during 2017.

Riccardo Rovere
Right, but wasn't this the case over the – the same story over the past 18 or 24 months? What has changed? We now should be a little bit better, no, than maybe 18 months ago?

Helo Meigas
No, but I mean now the – we have had the – there has been no change in the story. It is exactly what I would have been telling. These are – this is a sector with – with a difficult situation in front of it, so we have exposures which need restructuring, where we have multiple stakeholders who need to agree. Things take time. The input to the situation is an oil price which is very difficult to predict to any of us. There are adjustments on-going in the market. But we don't think that there has been a significant improvement compared to 2018. So I believe we have not changed our story.

Riccardo Rovere
Okay, okay. Thank you very much. And if I may – very final question – what is your base case assumption with regard to monetary policy from the Riksbanken from now going forward?

Anders Karlsson
That's a very good question, Riccardo. I think you – I think we have given you the guidance to our macroeconomists. And it's really – the expectations is that it will start to – we will start to see some increases in the repo rates in the beginning of – of next year. But again, as you know, the central bank of Sweden need to act in – in sort of harmony with what the ECB is doing. But we – we stick to that. And we'll see.

Riccardo Rovere
Right, okay. Very clear, thanks.

Anders Karlsson
Thank you.

Operator
Our next question comes from the line of Jacob Kruse from Autonomous. Please go ahead, your line is now open.

Jacob Kruse
Hi, thank you. Just I guess two questions. Firstly on the cost side you say that this quarter is a bit higher, then – then you get the benefits. Does that mean that when we get to Q4 you should have an exit run rate that is below your current target, 15.8, so that when we look at 2018 and 2019 you could see cost declining on an absolute level relative to this year?

And my second question – I guess my second question was just on you – you used to, a couple of years back, have this big IT simplification programme in place, where I think you had 1,100 system or products and 800 systems, and you were bringing those numbers down. Is that still an on-going process, and – and where you now, and what could be the benefits of doing that? Thank you.

Anders Karlsson
Thank you. To start off with your first question, not necessarily. So I understand what you ask it. It really depends on the investment agenda that we have. So the run rate at the end of the year, let's come back to that.

When it comes to the second question, I think absolutely so. If you're listening in to the strategy we talk about, which is to digitalise, basically, all our retail daily banking products, in order to be able to do that and to get the efficiencies out of that you need to continuously rationalise within the both product spectrum but also in the IT. But that is something – it's actually progressing well, but it takes a lot of time. But that is definitely part of our ambition going forward.

Jacob Kruse
But if you just – if in 2012 you had 1,100 products and 800 systems, I think you said, what – do you have those numbers now?

Anders Karlsson
I don't have them on the top of my head.

Jacob Kruse
No? Okay. Thank you.

Operator
Our next question comes from the line of Maths Liljedahl from Nordea. Please go ahead, your line is open.

Maths Liljedahl
Yes, good morning. Just a clarification, if I may. You say the NII in group functions or treasuries specifically was very strong from – or positive effect from the covered bond repurchase. Is it possible to quantify that? And how should I – you also say that you will have more covered bond issuance in 2017 compared to 2016, so how should we think of this going forward?

Also we know the relationship between gains and losses and commissions and NII here, but should we see this as a very strong quarter in – in Q1? Because you also guide that the NII level for 2017 could be at about the same level as in 2016. So how should I think about this going forward? Thanks.

Anders Karlsson
Thank you. To start off, I think the – you could roughly say that SEK 100 million comes from two things. One is the – as you remember, we bought back SEK 34 billion of covered bonds in Q4, which is giving an ease on the NII. And then we also had some favourable spreads in the basis swaps helping out. But all in all, that's around 100 –

Maths Liljedahl
Okay, thanks.

Anders Karlsson
And on your second question, we will – as we have large maturities in the year, we will continue to buy back covered bonds. But the effect will not be as evident in those, because more of the volumes are at amortised costs. So that's why we keep the guidance on NII and NGL the way we do.

Maths Liljedahl
Okay, thank you.

Operator
Our next question comes from the line of Alice Timperley from Morgan Stanley. Please go ahead, your line is open.

Alice Timperley
Good morning. And I've got two questions. First one, you mentioned that you've been able to re-price some of the STIBOR-related leaning in your corporate book, but can you perhaps just give a bit more colour on the segments that you've been able to re-price?

And secondly, thinking ahead to January 2018, could you just talk us through how you're positioning for PSD2 and how we should be thinking about payments, payment fees, I guess, in particular going forward? Thank you.

Anders Karlsson
On the first question, it's primarily within the real-estate sector that we've been able to – to see certain re-pricing in the corporate portfolio.

And as far as PSD2 comes, I hand over to Birgitte.

Birgitte Bonnesen

Yes. As you know that we are largest payment bank in all our home market, and the way – the strategy that we have on PSD2 is that it's a combination of collaboration with – with other providers and internal – internal development. And I think we have a very ambitious plan, and we'll be able to roll it out as it comes in.

Alice Timperley

And in terms of the plan, are you able to just give us a bit more – a bit more colour on that, please?

Birgitte Bonnesen

I don't think that there is so much to say other than with a position like ours, we have plans in all areas – the omnicommerce, ecommerce space, but also the aggregation space. So – so we're working with strategies in parallel to be able to sort of maintain the position we have today, and also to be able to, going into PSD2, to be able to continue to, you know, to catch that market share that we have today.

Alice Timperley

That's very clear, thank you.

Operator

And I remind you that if you want to ask a question, you will have to press 01 on your telephone keypad now. Our next question on the line comes from Rajesh Kumar from Société Generale. Please go ahead, your line is open.

Rajesh Kumar

Hi, good morning. Rajesh from Société Generale Research. So two questions from me as well. First up on funding plan, you said that the 2017 funding will be higher than 2016. Any more colour on that, especially on sub debt issuance?

And next on MREL, do you expect the final requirement to be wildly different from what we know now? And on the same topic, what are your thoughts around issuing a non-preferred senior? Thank you.

Anders Karlsson

Yeah, to start off with the funding plan, it's a combination of two things. It's the maturities you see in the year, which are higher this year than it was in the past year, and then we also try to factor in the net growth between lending and deposits. I would – I would – to give you some flavour of it, it's around SEK 180 billion of – of issuance, and we have done so far, I think, SEK 85 billion in the quarter. That's what I meant with the front loading

As far as MREL comes –

Gregori Karamouzis

Yeah, let me – let me jump in here. It's Gregori. Yeah, we – we have estimated the requirement to be around SEK 8 billion, based on the – the documents that the National Debt Office has sent out a few months back. We don't have any reason to – to adjust those calculations for the time being, but we will know what the exact number will be at the end of the year when we have the resolution discussion with the national debt office. And they are keeping this window, themselves, open to make adjustments if there are any clarifications further at the European level.

And then when it comes to us issuing non-preferred senior, for sure, I mean, the requirement that has been described to us includes this type of instruments. The question is the timing, and the timing will depend on a number of things. First we want to know what the requirements are; we want to see how long it will take for the insolvency law to be changed in Sweden to be allowed to issue those type of instruments. If we make the assessment that it takes too long and we want to get starting, we might look at different structures that are being discussed in the market, as you know, with calls and different structures, basically, that allows you to either buy back or convert those instruments into something that is eligible later on.

So timing is – we're not in a hurry. It's a consideration that we are working on and thinking of, but we're not at all in a hurry to come to the market early.

Rajesh Kumar

Very clear, thank you.

Operator

And as a last reminder, if you would like to ask a question, you will have to press 01 on your telephone keypad now. There appear to be no further questions, so I'll hand back the conference to the speakers.

Gregori Karamouzis

Perfect. Thank you operator, and thanks everyone for participating, for all the good questions. We will see you later in the week and speak to you if you have any further questions. Thank you.