NASDAQ OMX

Event: Swedbank Interim Report January-June 2013

Date: 16 July 2013

Speaker: Michael Wolf
Göran Bronner
Håkan Berg

Call Duration: 01:05:29

OPERATOR: Ladies and gentlemen, welcome to the Swedbank Interim Report January to June 2013. Today I am pleased to present Mr Michael Wolf, President and CEO. 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. Mr Michael Wolf, please begin.

MICHAEL WOLF: Good morning and thanks for attending our results presentation. If you look at the second quarter, we saw continuous improvement in our home market economies. Globally, things are more mixed. In the US and Japan things are looking slightly brighter, whilst in China it's -- we're seeing more challenges. In Europe we seem to see some sort of stabilisation, although from a low level. At the same time, signals from some central banks that the time when they will stop using quantitative easing is getting closer, which creates certain market volatilities. On the regulatory side, we have clarity on the risk weights for mortgages and more clarity around the recovery and resolution regime. Both came out within our expectations. We're now awaiting the final wordings before the Board of Directors can firm up capital targets, but management's view is that the target would be more around the 15% level, than earlier guided 13% to 15%. Our business is developing in a very stable manner during quarter, despite continuous weak credit demand. Our net interest income was also stable and supported by the re-pricing effects on lending to the corporate sector.

We have seen a gradual improvement of our market position in the Swedish mortgage sector and reached 14% market share on new saves in May and the trend was further strengthened in June. In Baltic banking a new start has been launched regarding re-pricing on lending in order to adjust to the new regulatory requirements. The domestic consumption growth in the three Baltic countries supported improved commission income. One business area that I would like to highlight is LCI. They continue to improve their market position step by step and have succeeded in enhancing their share wallet on our customer base and, as a consequence, we see more volumes in the advisory area, as well as in the payments area. Also, our operation in Norway has developed well since the merger with First Securities. The work to create a balance sheet with low risk has been confirmed during the quarter by Moody's upgrade of the Bank, as well as the central banks' financial stability report. This is, of course, important as we seek to create a competitive advantage through our funding cost.

We're also publishing the 2013 stress test in this report, which confirms the same trends that the central bank's report. We also have an ECOFIN decision on approving Latvia's entry into the Eurozone, which is also improving the overall risk situation on the Bank. Going forward then; well our focus is on the creating an operation platform where simplicity is key to the future success, and that platform work continues according to plan. Some of the cornerstones in this transformation: One is the gradual transformation of our client responsibility for mass market customers, from the regions to Channel and Concepts, and that has started. Secondly, product complexity; more work needs to be done in this area. It's a very complex area, but simplicity drives also that notion. And the third strong trend that we see, which is continuously confirming itself, is the digitalisation. Our mobile bank customers are adopting to this new channel very, very quickly. In June we launched a new service where customers can trade mutual funds and already within 24 hours, 13% of all fund purchases were done through the mobile channels, so that is a very positive thing for us. Overall, customer activity is picking up and we are prepared if the economy turns to the better, but we are also prepared for a continuous environment with low credit demand and low interest rates.

With that I would like to hand over to Mr Bronner.

GÖRAN BRONNER: Thank you Micke. First, I would like to just say that I think overall the result in the quarter is, underlying, very stable and very much according to plan. We have a couple of one-off items that I will come back to in detail. I think we're also very happy with the fact that we get confirmation from Moody's and also from – continue to get confirmation from the Riksbank through the stability report really, of the transformation of the Bank. And we continue, as a result of stable results and high profitability really to build capital and in this particular quarter we've been helped by the valuation of the pension liability, but we have a significant increase on capital in the quarter. Now, turning to the financials more in detail, starting with our retail operation. It continues to be an extremely low volatility business for us and this quarter is no exception there. We have stable income lines and we do also have stable cost lines, even though we have more traffic than can be visible from this particular picture.

I think, as Micke said, we -- in the business we are getting more market share on the mortgage markets. We are regaining our back book position in that area and, to some degree that is hurting our front book margins, which are declining with 10 to 15 basis points during the quarter. The difference between the front book sales and the back book margins. And that will, of course, be a drag on NII going forward. As the quality continues to be extremely good and we do see positive PD migrations in the retail area during the quarter. Moving on to LCI, a large corporate division. I think the positive trend we've seen there for a number of quarters is continuing in this -- in this quarter, even though the net profitability is slightly weak. It is impacted by internal cost charges and also by some one-offs. Underlying that, I think we do have, see, that we continue to improve our client share of the overall profits. The lending book is increasing in volumes and is also expanding in margins, which is very positive, and, as Micke said, we do have -- we have seen in the quarter higher activity in the corporate finance area, particularly in Norway, which is very positive. On the impairment side, we have decided to take a SEK 56 million impairment charge relating to old IT systems, and the reason for that is really that we are in a position to change IT systems and we need to shorten the write-off period for some old systems, and, therefore, we have that small charge. Costs are generally well under control in this area as well. Moving on to the Baltics, I think this is -- I am not certain actually, but I think it is the first quarter that we – I can't change the slide. We have a problem flipping the slides here, so I have to talk to you instead.

The Baltics is basically showing a slightly improved profitability during the quarter, even though their lending book is flat. We have seen a lot of good customer activity, particularly in commission-related income. That is driving revenue. And we also have a slight uptick in NII relating to improved margins in the Baltics. We continue to see recoveries coming through with regards to the old legacy portfolio, according to plan. And Latvia, as you know, are sort of well on track now for introducing Euro at the year end.

Going forward, I think the focus in the Baltics will continue to be to improve risk-adjusted returns on the weaker part of the books that have been sort of in the lower rating segments; seeing to it that we actually get paid for the risk that we are carrying out there and also to continue to work on efficiency. But, overall, we feel that the business area is very well placed to reap benefits from an improved macro-economic environment coming through in the Baltics eventually. Summarising these financials for the Group, we have a stable NII, even though we have a slight decline coming in treasury as expected, which we guided for previously. We continue -- we do see good commission income. We have one-off effects coming through, not only in the impairments on the intangible assets relating to IT and LC&I, but also intangible assets relating to the finance company where we write down SEK 110 million. We do, also, write down an impairment with regards to Ektornet, SEK 200 million with repossessed assets, of which a significant portion is one big hotel in the US.

Of those one-offs we also see that the buy-backs that we have done primarily on the Government guaranteed debt in the treasury area has created a one-off in net gains and losses, as well as other valuation effects in that area. But, overall, even though the sort of bottom line comes in weaker than the Q1, I think the quality of the result is -- continues to be good against a large proportion of deviation -- actually relating to one-offs.

Now, turning to capital. We were at 16.4 full Basel 3 Core Tier 1 ratio for bottom three core equity one ratio in the first quarter. During this quarter we have, through profit generation and also the fact that the lending book and the business do not require any further capital; on the contrary it releases the bit of capital, and together with the effects that we get on the pension liability, as I described, we are actually making our way all the way up to 17.2 Core Tier 1 ratio. So, as Micke said, with the new information we have around CRD IV and the new information around risk weight mortgages in Sweden, we think an appropriate calibration of any capital target, as we see it right now, is around 15%.

We continue to be on schedule for IRB Advanced, which will be of benefit on top of this for us going forward, but still wait for, particularly in the short term, more clarification during the second half of the year with regards to the resolution regime and that mechanism and how that will impact the capital structure and the minimum levels that will be required for banks in general. And then, of course, we follow with interest, discussion around corporate risk weights and leverage ratio. But, most likely, that will take some further time for us to clarify, but -- and being on a very, very strong capital note. With that, I hand over to Håkan.

HÅKAN BERG: Thank you. Well, the positive economic environment in our home markets has continued in the second quarter and in combination with good asset quality and proactive risk management, the previous trends with low credit impairments and stable development has continued in this quarter. As Göran was mentioning, yes, the quality in Sweden continuing to show very good results. The positive economic environment continues also in the Baltic countries. The decision to approve Latvia joining the Euro will have additional positive effect on the Latvian economy. The demand for lending is picking up in all the countries, in particular in Estonia, but the trend is still fairly slow and reporting net recoveries is slower compared to last year, but that is in line with our previously communicated expectations. Impaired loans in the Baltic countries continue to decrease at almost the same pace as previous quarter in local currency. On Group level though the decrease in this quarter is small, due to an increase of impaired loans in LC&I and FX effects in the Baltic countries.

Swedbank is, for the third year, reporting the result of the ICAAP in this quarter, which we think is a good and transparent overview of our risks in a stressed scenario. It shows that the Bank is well capitalised, even including the future regulatory changes. The stressed scenario that we have applied and the outcome this year is further elaborated in the fact book. And as Micke was mentioning, the Core Equity Tier 1 ratio is improving through the whole scenario period. If we add the management action, the Core Equity Tier 1 ratio development will be even more strengthened.

MICHAEL WOLF: Thank you, Håkan. With that, we open up for Q&As.

OPERATOR: Ladies and gentlemen, if you'd like to ask a question please press 01 on your telephone keypad. Our first question comes from Mr Omar Keenan from Nomura. Please go ahead.

OMAR KEENAN: Good morning. Thanks very much for taking the questions. I've just got two questions on net interest income please. Firstly, just your discussion on mortgage margins, that it's currently 10 to 15 basis points below the current back book. I was wondering if you could give us a little bit more colour as to what you expect is happening to the average cost of funding, because I assume when you're referring to 10 to 15 basis points, that's below the current average funding cost or measured against the -- using the current average funding cost. So, can you talk about whether you expect some mitigation of the head winds that we're seeing on current price -- front book pricing towards customers? Okay, thanks. And then I just have a quick second question as well.

GÖRAN BRONNER: I think when we talked about 10 to 15 basis points of the margin shrinkage in the mortgage market, we talked about it taking into account that we get some funding relief as well coming through in the internal FTP process as well. That -- and there should you also bear in mind that's that -- the re-pricing of the mortgage book is happening rather fast in -- since such a high degree is three months variable rates while the funding book has an average maturity of, what, 36 months, Jonas? So, you have a little bit of mismatch there as well. Sorry, your second question was relating to ...

MICHAEL WOLF: Customer pricing going forward. I mean, it's very hard to gauge. It's a very competitive market that you are seeing, but we also have very firm regional heads that wants to protect their earnings capacity. So, it's a balance act, but our focus is not to lose good affluent customers in this -- in this business area, and that focus remains.

OMAR KEENAN: Okay, that's great. Thanks very much.

OPERATOR: Our next question comes from Mr Alvaro Serrano from Morgan Stanley. Please go ahead.

ALVARO SERRANO: Hi. Thank you taking our questions. Just a follow-up on the mortgages. You mentioned that you've taken back market share. How does that compare to the minimum 25% you've mentioned and that it would be where you want to be, or at least minimum? And is there any further colour you can give us on what the NII impact could be if the whole back book re-prices in millions maybe and how quickly that would happen? And, also, on the buy-backs you've done in the quarter, the debt buy-backs, how can that compensate to some extent in terms of lower funding cost? And then very quickly on the corporate re-pricing. Obviously, large corporates have done very well in this quarter in NII, volumes have seemed to pick up, at least the loan growth doesn't seem to be much, much stronger. Can you just mention how much there is more to go in there and in re-pricing could we see further margin improvements in the second half of the next year? Thank you.

MICHAEL WOLF: Thanks for those questions. I will start on market position. What we have tried to clear communicate is that we do not want to lose customers in the affluent segments due to the pervading sedation in the mortgage market and we communicated that around March, April. And in May we saw some positive things of the activity in the branches and market share in terms of -- front book market share raised to slightly north of 14% from prior levels of 8%, 9%. And if we look at the volumes in June that trend seems to continue. We don't have total market share numbers yet, but the volume picked up continuously in June. Our back book market share is 26%. It's not like we are having a date when we want to be at this sort of percentage point, but we want, of course, the difference between front and back book market shares to shrink. But, most importantly, is not to lose customers and remain profitable.

GÖRAN BRONNER: Yes. I mean, the financial effect of the 10 to 15 basis points is quite easy for you to calculate on, sort of, going forward that will be -- if the prevailing pricing picture remains, that will be the NII impact going forward times the book over the period of time that the duration is. Mitigating factors there with it; some buy-backs so Government guaranteed bonds in this quarter, SEK 100 million in NGL deficit. That will create NII of SEK 100 million going forward you could say. Just a small mitigating factor we don't deal with that really. That is too small to count sort of as an action. We have of course, tried to clear all our Government guaranteed debt as soon as possible.

ALVARO SERRANO: And the corporates in the corporate book in the corporate segments?

GÖRAN BRONNER: In the corporate book, I think -- I think we are -- I think we will become more and more relevant for clients and I think corporate clients in general feel that our LC&I business area is going very well. So, we feel quite good there. Of course then I would say in a world where the banks become better capitalised, I think it's quite unrealistic, as we reach our returning capital targets, to expect margins to continue to expand in that area. So ... but I think we have a good position to actually start to see -- if the economy turns better, start to see volumes contributing as well. Another fact to remember I think in the whole comparison with banks is, of course, also that Swedbank is the only one disclosing NSFR and we are at 95% and you get

-- you get some indication where other peers are in the stability report from the central bank, but to be at 95% is, of course, costing money.

So, apple for apple, that is also a parameter for us to calibrate as we get clarity of where we want to be and where we need to be in the -- by the end of the day.

ALVARO SERRANO: Great. Very clear, thank you.

OPERATOR: Our next question comes from Mr Johan Ekblom from Bank of America. Please go ahead.

JOHAN EKBLOM: Thank you. Just two questions please. First of all, just coming back to NII, which seems to be the topic of the day, just if you take what you said on mortgages. I mean, that should be something like SEK 750 million impact if the whole thing repriced by ten basis points. It should mean that happens over a number of quarters and then I think previously you guided to the treasury results should see a head wind of about SEK 100 million a quarter, and then clearly you have some positives from the buy-back of the Government guarantee debt. But I still end up with a quarterly head wind that is now, you know, well in excess of SEK 200 million per quarter. It seems tough to be to be able to off-set that through volumes which remain pretty weak or through corporate re-pricing. I mean, is there anything I'm missing or should we expect NII to be trending meaningfully lower in coming quarters?

And then, secondly, just to capital, I mean, you're -- you made it very clear that it's too early to communicate a full capital strategy, but you said you hoped to have clarity by year end on resolution, etc. Are you going to have to wait for clarity on where Europe and Sweden will come out in terms of leverage and bail-in before you can communicate? I mean, you allege that could be something further into the future than just the end of this year.

GÖRAN BRONNER: Well, starting off with NII then. I think, just to give you a little bit extra to think about, is that, of course, that you talk about the book being SEK 700 billion and ten basis points all over the book, but the book is mortgages -- private mortgages is one part to recycle culture and there are different things that is booked in the mortgage company as well. So, we are talking about mortgages, for residential mortgages sort of. So, that's one. We don't feel that -- on the other part of the book we have basically no price pressure.

So, will that come later on? Possibly, but it's too early to say. You also need to think about that half of the book if I simplify things, is re-pricing quickly and the other half of the book is re-pricing much more slowly over a two-year period. So that you need to factor in as well. So, a little bit more for you to make your sort of Excel spread sheet there, but clearly I think if I summarise on NII, the head wind if we are worked with re-pricing and sounding improvements and so forth, with a lot of tail wind we are now facing a situation where they are building up sort of head winds in the pricing environment that needs to find out the mitigating factors. So, that's a clear change in the picture I think. I just want to do -- then also add there that we have guided previously that part of the NII coming in the treasury area is relating also to risk income by the shift of interest rates that took place in the latter part of last year -- in the second half of last year that still will come through in lower NII and in the treasury as well.

So, that is also a head wind for us from an NII point of view, but, on the other hand, you could say that volumes, corporate margins, the Baltics, and, potentially, depending on what you think of the interest rates and the profit margins could be a mitigating factor, but you have to draw your own conclusions from the macro there where you think it will go.

MICHAEL WOLF: Thanks, Göran. On capital, I mean, if you look at the total picture, NSFR at 95%, LCR at 129%, the leverage ratio at 4:45, 17.2 Core Tier 1, and more clarity than recently on CRD IV, the corporate risk weights and the recovery resolution regime despite we want to see the final outcome. And then, on top of that, you have IRB advanced coming. I think the language we use is excess capital building, and that is a strong signal from us that we are feeling very comfortable with our capital position. And I don't have a crystal ball of what's going to happen in the next few months, but definitely more clarity will come and, depending on credit demand, and other things, the best guidance we can give is that that the Board will address this issue as earlier communicated in conjunction with the last quarter. And that's where we are today, but a very strong position and conservative position in all important measures.

JOHAN EKBLOM: Sorry, can you just comment on -- that 4:45 leverage ratio, is that a full Basel III leverage ratio, or is just equity assets?

GÖRAN BRONNER: Can we come back with that one?

JOHAN EKBLOM: Absolutely.

GÖRAN BRONNER: I need to -- I need to clarify that.

JOHAN EKBLOM: No problem. Many thanks.

OPERATOR: Our next question comes from Mr Nick David from UBS. Please go ahead.

NICK DAVEY: Yes, good morning everyone. A couple of questions please then from my side. Firstly, on costs. Obviously we've been talking a fair amount about the NII head winds, which you see picking up and clearly your ambitions for flat costs in 2013 was set at the time where, as you put it, Göran, I guess there were as many tail winds as there were head winds. And clearly, as the years evolve and your rethorics become more cautious, can I just get a flavour from you really as to what it would it take for you to reconsider this flat costs target? Second question please then on NII and the Euroisation of Latvia please. Just a flavour of how that will shift your liquidity usage in Lats and your use of deposits in local currencies and whether we can expect any margins or NII improvements from that process. Thank you.

MICHAEL WOLF: If I just start then with a clarification. It's on full Basel three. You find it in the fact book under key figures, five years.

GÖRAN BRONNER: Costs, I think we have a slight up-ticking cost in the second quarter. I think it's quite natural to see -- to see that considering the significant sort of cost reduction that took place in the prior year. I do not feel that we are -- anything else done on track for flat cost, so I feel okay. We're more into the planning period sort of for 2014 that we hope to give more flavour on -- going forward during the autumn. The last question was relating to the Euro and the liquidity, Jonas, so, what are you going to do there?

JONAS ERIKSON: Sorry, I missed the question.

GÖRAN BRONNER: Can you repeat the last question?

NICK DAVID: On the Euroisation of Latvia in 2014, how would that impact, how -- the currencies that you keep your Latvian liquidity in and whether you can then optimise your liquidity position by giving Euro-denominated deposits.

JONAS ERIKSON: I don't think it's going to be a big difference to liquidity side at all, to be honest. It's going to impact a little bit how we hedge certain positions and it's going to be easier to hedge positions there, but that's more a matter of sort of having a matched funding towards the loan book, but it's not a big liquidity issue for it.

NICK DAVID: Okay, thank you.

OPERATOR: Our next question comes from Mr Masih Yazdi from SEB. Please go ahead.

MASIH YAZDI: Hi, this is Masih Yazdi from SEB. Just a couple of questions on Ektornet. You had somewhat larger write downs this quarter compared to earlier quarters. Can we expect that this is sort of the new level going forward or should write downs go back to sort of around SEK 100 million per quarter going forward? And when do you think the total of SEK 3 billion of assets in Ektornet should be divested? Thank you.

GÖRAN BRONNER: In general, I would just override it and say that the wind down on the Ektornet is going quicker and faster and better than -- sort of we expected if you go back some time. In this quarter we have one particular impairment relating to a big ski resort hotel in Telluride, the US, one of the repossessed assets in Lehman that we are preparing for sale. In general, you -- we had -- previously we had booked the impairments -- when we sell things we get impairments on the impairments, but you should also remember that when we sell things with profit, which we do quite often as well, we actually book those under other income. So, you can't really take this other impairment line and make it as a credit loss line. The true picture is, together -- to mixing the two together. Going forward, I don't think that the -- we don't have any big assets like the one we had. I don't envisage that kind of write down going forward.

MASIH YAZDI: And when it comes to divesting the whole portfolio, when do you think that would happen?

GÖRAN BRONNER: I think by the end of this year we are -- we would be well advanced in closing down the number of countries and we will be left with a tail in some of the Baltics countries, because they will constitute residential smaller properties to some degree and the value that we have in there will be significantly smaller. So, coming back to the overriding statement, I think it's going much better and it will also be a positive cost contributor, of course, since we -- in 2012 we actually had SEK 600 million in cost. In this year it will be a significantly lesser proportion and in 2014 it will also contribute to costs control in the back.

MASIH YAZDI: Great. Thanks very much.

OPERATOR: Our next question comes from Mr Andreas Håkansson from Exane. Please go ahead.

ANDREAS HÅKANSSON: Yes, hi. Thank you. I mean, we've gone through most of the areas, but just to follow-up on capital perhaps. Micke, you said that 15 is where you believe you're going to end up now and if we had full visibility on regulations and the Board agrees and decide that 15 needs to go to a number, given that you're at 17.2 today, and if you get full IRB approval, I guess you're about 20, what would be your recommendation to the Board and how you're going to address that problem, so to say?

MICHAEL WOLF: That is something we will revert to in Q4, of course. I mean, I think we have all the optionalities at hand. We have all the approvals from the NGL to do what we need to do on that topic when the Board comes to a firm conclusion on the matter.

ANDREAS HÅKANSSON: But if we get the firm conclusion on 15, is it anything else you need to wait for before you start to action on these decisions or could you start quite quickly after that?

MICHAEL WOLF: The only thing we know from the past is that the material is a moving material and you can never rule out that you get out there matters that you need to consider, but with the present visibility we have outlined some of the key issues that needs to be clarified, being CRD IV in the Swedish version, the recovery resolution regime and then we're also lifting the issues around leverage ratio, which we think will become a factor going forward from a regulatory aspect and we're looking very fine on that line as well. But it's an issue that is increasing in importance in our view.

ANDREAS HÅKANSSON: Okay, thank you.

OPERATOR: Our next question comes from Ms Sofie Peterzens from JP Morgan. Please go ahead.

SOFIE PETERZENS: Yes, hi. Here is Sofie Peterzens from JP Morgan. I have a question on the capital target, so the 15%. Could you just remind us how you get to the 15%? Does it include the higher mortgage risk weights and does it include any other buffers –

contra-cyclical buffers that you expect for Sweden or anything else? So, if you could remind us on that. And then I was wondering how we should look at losses going forward. If I exclude the Ektornet losses, you still have extremely low level of Group losses. Do you expect losses? What's kind of a normalised run rate as we should assume for 2014 going forward? Thank you.

GÖRAN BRONNER: I think the logic behind 15 is 12, together with mortgage risk weights, together with some type of macro buffer for ourselves. And, of course, the risk weights we know, the 12 we don't know exactly sort of, what will be the ramifications of going through 12 on there and if that -- and if that is something. So, we don't really know precisely where we will put our own buffer in the structure, so -- but if we -- as long as we can interpret things today, it will be around these levels and we have always tried to be rather more on the conservative side, on the interpretation with not being hit by something unexpected.

HÅKAN BERG: On the losses, credit impairments as I mentioned. We have a stable environment and we really don't see any changes in the trends that we have. Given the very low levels we have we may, though, see some volatility in between the quarters, but that will not be material.

SOFIE PETERZENS: But what would you say -- is that kind of normalised as run rate, three basis points of losses, five, ten?

HÅKAN BERG: We haven't communicated any normalised loss rates and we don't do that this quarter as well. It's more a trying time to understand the trends and what may move upwards and downwards and what we see is continued very low credit impairments in Sweden. We will have write-backs in the Baltics, but they will be at the lower level compared to last year in the Baltic countries.

SOFIE PETERZENS: Okay, thank you very much.

OPERATOR: Our next question comes from Mr Peter Wallin from Handelsbanken. Please go ahead.

PETER WALLIN: Yes, thank you. Good morning. Most of it is covered already, but coming back to the Swedish mortgage market, I would like to know whether your margin guidance or margin guidance squeeze here, is that -- how much of that is a consequence of, if you would say that that's the case, an increased margin pressure in the Swedish market or competitive pressure in the Swedish market as of this spring, compared to maybe six months ago. At least in the Swedish media that's been sort of like highlighting the case that list prices have been coming down pretty much recently. What's your view on that?

GÖRAN BRONNER: Göran here. I think it's a dynamic evolution happening. If you go back a year, or even more, it's been quite clear that we have seen some competitors being much more aggressive on pricing and we have felt over time, as we lose prioritised clients, we don't want to trade with the front book that this has been so low. So that has been a prioritised area, as Micke has stated. It's very clear that we do not want to send a signal internally that it's on price that you compete primarily, but if you try to stop losing clients to a competitor who are significantly under-pricing you, you have to do something on price as well. So ... but that is the evolution and we have -- and then in the last quarter I think we have also seen other banks becoming more concerned about their market position and that has led to cumulative sort of price erosion. I think Swedbank has been definitely not a price leader in terms of bringing down the prices. That has not been, and will not -- it will continue not to be our strategy going forward, but we do want to stop losing prioritised clients and that is very important for us.

MICHAEL WOLF: On top of that, I mean, the shift in focus is just recent so let's not take the first quarter as a big, sort of, "If it stays this for, what's going to happen tomorrow?" I mean, there is dynamic effects, we have regional heads that want to preserve earnings, so it's too early to say, but, I mean, the market is more competitive today than it was and banks are more profitable than they were.

PETER WALLIN: Yes, okay. Thank you very much.

OPERATOR: Our next question comes from Mr Magnus Andersson from ABG. Please go ahead.

MAGNUS ANDERSSON: Yes, hi. I had a couple of questions on the Baltic banking division. First of all, you talk about, and in terms if I focus on re-pricing, I'd just like to know whether that's a general trend in the markets if your competitors, they're following, and whether there are any significant differences between the three countries? Secondly, assuming that they should be at the trough earnings currently in the Baltics, you were with the cost-income ratio below 40% before the crisis, just did you think you would be able to reach pre-crisis levels in terms of cost efficiency, again in the Baltics? And, secondly, whether it's the 15% group, our re-target on allocated capital, you think you will reach there or if the profitability -- you think the profitability in the Baltics will deviate in any way from the Group level? Thank you.

GÖRAN BRONNER: I think it's very difficult to say -- it's very difficult to say what the competitors are doing in the market place. I will refrain from doing that. The only thing I will say is that as we see how we have re-priced the most capital-intensive part of the books with regards to increased capital demand, regulatory capital needed, we still have a re-pricing to do in the Baltics. I think part of that was difficult to do in a period when the borrowers were extremely weak, but now I think some of that re-pricing continues, we need to see to it that we get the risk adjusted return that is meeting sort of the hurdles that we want to see in the group overall. In terms of differences between the countries, Lithuania is clearly having lower margins than the other countries and is more of a difficult area to re-price, but also has, of course, more to do. So, we try to re-price more there.

Can we meet the financial -- ROE-target and cost/income below 40 over time? Absolutely. That I'm absolutely convinced off. We have a Baltic franchise that has gone through a tremendous difficult period, clearly the market leader, we are the most profitable one, but we are -- we can cater for a lot of more lending volumes and business activity on the prevailing cost base. So, the marginal add-on from increased sort of activity is quite good and we also have a very pro-cyclical capital situation in the whole Basel 2 world that really, in my opinion, is grossly exaggerating the capital needed for the Baltic banking. So, even there I do think with PD development and migration, with time we will be able to add on marginal business with very little capital, as well as cost contribution. So, of course, from a shareholder value point of view, that's very exciting, especially if you're number one in the market and we believe in the market.

PETER WALLIN: Now, if I just follow up there. On the re-pricing, is it primarily in the corporate segment or are you also trying to re-price the mortgage segment, although it's in a worse shape? And secondly, on the infrastructure there, you've cut down on your headcount and the number of branches quite significantly since 2008, but should I read it as that you have been -- with the current infrastructure you would be able to absorb at least the growth for the coming two, three years?

MICHAEL WOLF: If we look at the re-pricing, it's mainly on the corporate sector, but it's also done, as you can, due to the limitations of agreements with the -- with private, so it's more gradual on the private side. So, the re-pricing is mainly on the corporate side. Infrastructure, I mean, what is very positive in the Baltics is that they have, due to the demographic situation and average income, had to be very efficient in the digital space in order to be profitable and bring down costs to serve. So, a lot of the things we hope to do in Sweden has already been executed in the Baltics and, therefore, I think we have a platform that is very scalable and not that dependent on branch network, as the Swedish has been traditionally.

PETER WALLIN: And finally, just could you remind us on how long it takes to re-price the corporate and mortgage loan books roughly?

GÖRAN BRONNER: The corporate loan book is, you say, average between two to three years.

PETER WALLIN: And the mortgage book still eight, nine years, or ...?

MICHAEL WOLF: You’re probably right, yes.

PETER WALLIN: Yes, okay. Thank you.

OPERATOR: Our next question comes from Mr Jacob Kruse of Autonomous Research. Please go ahead.

JACOB KRUSE: Hi, thank you. Just a couple of questions. Firstly, just on bail-in buffers and the discussing there, do you expect this to be implemented and do you expect that you can use the 20% of risk-related assets rather than the 8% of liabilities? And secondly on that, would you look to make your senior debt outside of that buffer and basically fill it with subordinated debt and equity? And then my other question was just the ECB stress test that is -- that is planned to be run, do you have any indication on whether or not the Swedish regulators or Riksbank would run something in parallel on that? And, lastly, just on corporate margins in Sweden, if you could say anything about the development and how to look for those. Thank you.

MICHAEL WOLF: If you look at the stress tests firstly. What we do with the regulator is also connected to the European level. Whether they're going to use these stress tests or not we'll see, but it's well integrated into the European structure right now, so it's a joint decision paper that is being produced. So, that's on that and then --

GÖRAN BRONNER: I think Jonas, if you can answer on the funding strategy.

JONAS ERIKSON: Sorry, Jacob, on the bail-in, your question, if I understood it right, was how do we see the calculation happening in the future, was that the question.

JACOB KRUSE: Yes.

GÖRAN BRONNER: It's more an open question on the capital structure really, that we see coming.

JONAS ERIKSON: I mean, the way we interpret it is that there will be a Swedish finish on this calculated 20 % of RWA:s and if you look at the deposit side, sort of uninsured corporate deposits will be included in the numerator there. It's all about metric. I mean, we're quite fine as things stand. And then the question and the mix that we will have on senior versus subordinated once this is finalised, it's too early to say I think.

JACOB KRUSE: But would you be okay with having your senior debt as part of the bail-in buffer in principle?

JONAS ERIKSON: I think it very much depends on how much total bail-in capital we need to sort of fill up with. And it also -- you have to remember, it also depends on how the Swedish implementation of CRD IV is happening, because if you have sort of the current proposal from the Swedish FSA then the Swedish cyclical buffer will be a minimum requirement. And if you have a minimum requirement of then 9½ plus capped conservation, then sort of the point of non-liability in Sweden will be so high that we won't really have the differentiation between different types of subordinated debts and then it remains to be seen exactly how that will play into senior. So, I think there is still a few outstanding issues that we need clarity on.

JACOB KRUSE: Okay, thanks.

OPERATOR: Our next question comes from Ms Claire Kane from RBC. Please go ahead.

CLAIRE KANE: Hi, it's Claire Kane from RBC. I just wanted to ask two questions really on the income outlook, but firstly just to clarify the guidance on NII going forward. Should we look at the mortgage base really as the SEK 577 billion going forward, so potentially around SEK 600 million head wind on an annualised basis? And then another SEK 400 million, say, for the treasury NII going down, which would effectively take it to almost zero, which was your original guidance. And then if we look at SEK 1 billion head wind pre any off-sets, is that the guidance you are giving?

And then if you go then onto the fees and commissions, clearly there has been a pick-up in activity this quarter, but do you think this is a good run rate going forward. And I thought the outlook statement, because I saw some positive signs, so could we see a continued pick-up in the trends there? Thank you.

GÖRAN BRONNER: On the NII, I do think we don't give a guidance on the actual NII. It's important to say. We try -- we tried to describe the driving factors for us in there rather than pinpointing and giving you a number, because there are so many variable parts in that equation really, but we are highlighting that we have more head wind on mortgages, we have earlier communicated that some part of the NII in treasury is one-off related to a shift in short-term interest rates. That is coming to an end. These two are head winds for us and the tail wind that we have earlier seen coming through, through re-pricing and other things, are sort of coming to an end. So, other than that I leave it to you really to use your analytical skill in order to produce a projection for where it's going from here. We don't want to be more precise, because there are so many variable parts in there.

MICHAEL WOLF: If you look at our strength as a Bank being predominantly a retail bank with an excellent market position in the four countries, we are trying to help you by being more gradual on data when it comes to the cards business, the mutual fund business, the insurance business, the payment business, and we feel we have a very strong position overall in these areas to benefit from an increased domestic demand situation. So, if the economy is to continue to take -- long -- in these terms, yes, we are benefiting and what is positive is LCI's progress in that customer segment, whereas the ancillary business is becoming a greater share of the PNL as we improve the penetration towards those customers. And here the balance sheet has been one of our core strengths.

I mean, we have been able to apply the balance sheet both in Sweden and Norway in difficult times, where foreigners have disappeared and with our balance sheet there is great comfort for our customers that we'll be around for the longer term. So, all in all, I think that market situation will continue to prevail and being Nordic, being close to these customers, will give us more opportunities in the future.

CLAIRE KANE: Thank you very much.

OPERATOR: Our next question comes from Mr Ronit Ghose from Citi. Please go ahead.

RONIT GHOSE: Hi. Yes, it's Ronit from Citi. I just had a question -- a quick question on impaired loans and provisions. I know the numbers are low and they're still going down, but can you give us some more colour around LCI. For the last three quarters you've seen a step-up in LCI impaired loans from 246 to 613 to 1167. Is this one particular sector or a small number of counterparties in a particular sector? Any colour on that would be great. Secondly unrelated, on your 31 to 60 days overdue, or you loans past due, there's a pick-up in both the retail and the Baltic Bank; if there's any colour on that as well please?

HÅKAN BERG: If we start with impaired loans in LCI, it's primarily due to one client that is well known, that has been on the watch list, but now has turned into impaired. It's very well collateralised, so it doesn't really have that much of an impact on the credit impairment. So, it doesn't really -- it doesn't really boil down to a trend. It's more of one-off. When it comes to loans past due, it's more of a volatility between the quarters. We don't really see that as a trend. On the contrary we see continued improvements, both, in the asset quality and in the trends -- underlying trends.

RONIT GHOSE: Thank you for that. Just back on the LCI, is it -- are you saying it's the same client, both in Q1 and in Q2?

HÅKAN BERG: No, the client I'm referring to from -- and the Q2 effect, that's a specific client. You know, LCI is a different client from ... that didn't show up in Q1.

RONIT GHOSE: Okay, two different clients. Thank you.

OPERATOR: Our next question comes from Mr Riccardo Rovere from Mediobanca. Please go ahead.

RICCARDO ROVERE: Good morning to everybody. I have two quick questions on capital. Can you please confirm that 15% is the new core capital target, because that is not yet clear to me? Yes or not? The second question I have is yesterday a competitor of yours stated reiterated the 13% target. If the 15% is the new target, can you list precisely the reasons why all of us are then the 13 to 15 per cent target goes to 15 for Swedbank? And the third question I have is, is it fair to say that the capital -- the way you run the Bank, from a capital perspective, is getting less and less dependent from the core tier one and more and more dependent from the leverage ratio, because the feeling I have from outside is that risk weight mortgages go up, pillar one, pillar two, then we talk about corporate risk weights, then you talk about moving up the target. It's just a way to be more and more compliant with the leverage ratio.

Is that a fair assumption? Thank you.

MICHAEL WOLF: I mean, the Bank is, as you know, a very complex animal and you can't just have one measure or two to steer the whole bank. I mean, you know all about the combination of LCR, NSFR, the leverage ratio, the capital situation and that is dependent on the risk level in the entire Bank. Just to be clear, 15% is not a target. What we have communicated from management's point of view was to guide where we think the target just might land at the end of the day, so we guided earlier, 13 to 15, then we got clarity on the mortgage risk weights and there were two options for those risk weights.

One were to be included in the total capital, but the Swedish regulator shows to include it in core tier one, and that's why we ended up in the higher part of that range. And Göran earlier on on the call tried to guide you how we came to the 15, and that was the 12% minimum and then you add the sort of -- add on for the mortgage risk floor, which is approximately 2 and then you have the buffer that we have for macro reasons. The 12, well let's see what the recovery resolution regime does. Can we go through that floor, because we don't have in mind what the mitigating factors from the regulator will be or do we want to stay away from that level. That is totally dependent on the final wordings in the recovery resolution regime. So, there are a few open ones. So, it's for guidance and not for a target.

GÖRAN BRONNER: Can I just comment on the leverage ratio that you were sort of pointing or are we steering the bank on leverage ratio. I don't think we are steering the Bank on leverage ratio, but I think we have also said that the current Basel system has many flaws. And we have, all the way back until 2009, stated that what we think from a capital management point of view is scenario-based stress tests are the way really to gauge your risks and see what kind of capital you need and what it does to your funding really. We have acknowledged that many risk weights in the current system are based on historical data, which is like driving a car and looking in the rear mirror in many aspects, like having -- risk weights on banking systems and so forth, assuming nil default rate. And, also, for Swedish banks, very relevant, has been sort of the low mortgage risk weights and also a very high degree of flexibility for banks to dictate themselves what kind of risk weights --.

From that perspective, leverage ratio plays a role, not as a primary regulatory tool box, but as a complimentary -- a complimentary ratio to show to investors what kind of leverage are we talking about in this business model. And we do feel, from a transparency point of view, leverage ratio and some kind of back stop regulation has some play to role in the future, even though we are strong believers in risk-based pricing.

RICCARDO ROVERE: Okay. If I may, just one final question. On -- can you provide a brief indication sensitivity of the Bank PNL to steepening of deal curve? When I mean "steepening" I mean flat short term rates and rise in long term rates.

GÖRAN BRONNER: I think we have in the fact book, we have a simulation of what happens for a parallel shift of the deal curve. We are significantly more sort of prone to PNL effects in the short term than we are in the long end, and the long end impact will mostly relate to valuation effects coming into the treasury book that will, over time, reverse itself. So, much less significance in the stress on the -- both capital and the result actually. On the capital side, we are even gaining on it since our pension liability sort of decreasing in size.

RICCARDO ROVERE: Okay, thank you very much.

GÖRAN BRONNER: And on the short end, you have it in the fact book.

RICCARDO ROVERE: Thanks.

OPERATOR: Our next question comes from Mr Pawel Wyszynski from Nordea. Please go ahead.

PAWEL WYSZYNSKI: Yes, hello. This is Pawel from Nordea. Just two quick questions, one last shot on the NII if I can. In Q1 you said that you would expect to lose some SEK 100 million from head winds and treasury. First of all, given the rates, how they have changed, is the SEK 100 million per quarter still correct? And the second question is on how we should view a risk-weighted assets going forward in the Baltic countries given, I mean, much better credit quality?

GÖRAN BRONNER: On the NII and treasury I think we talked about losing £100 million a quarter for the three quarters. If I roughly became guidance going forward I think I would perhaps roughly modify it to say, "In three quarters of it would be between SEK 200 million and SEK 300 million". We have seen some -- this quarter we have a little bit less effect than expected, even though rates didn't change anything in the short term. RWA, are you looking for guidance there? What – in the Baltics, what was your question really.

PAWEL WYSZYNSKI: I'm guessing that given the recent years you have improved credit quality. I mean, that should translate in lower risk-weighted assets and nothing about how the lending will grow. I mean, if we assume lending is flat and credit quality stays at these levels, how should we expect risk-weighted assets to move? How much can you gain there so to say?

HÅKAN BERG: Starting with the risk question. Yes, due to the crisis, the risk weights are, you know -- as we continue improving the economies in the three countries, of course the risk weights will come down. So, everything else equal, risk weights and assets will go down. What happens with a risk-weighted asset of course will depend on how the growth will be in the countries. We do see a growth currently, but it's fairly slow. Depending on at what pace that will pick up, it's difficult to say whether it will be a net -- an increase of risk-weighted assets, or whether it will decrease. So, I guess you have to make your own evaluation on how that will balance going forward.

PAWEL WYSZYNSKI: Fair enough. Thank you.

JONAS ERIKSON: If you were –the PD migration coming from the models being pro-cyclical, as Göran alluded to earlier, that it's a fairly slow moving process, so --

PAWEL WYSZYNSKI: Okay.

JONAS ERIKSON: -- I think you need a couple of years before you see that sort of materialising in anything that --.

PAWEL WYSZYNSKI: Okay, thank you.

OPERATOR: Our next question comes from Mr Peter Kessiakoff from Carnegie. Please go ahead.

PETER KESSIAKOFF: In the covered pool, the over-collateralisation level has risen quite sharply from the Q1 reports to now almost 46%. Could you perhaps talk a bit about that? What's behind the increase there?

JONAS ERIKSON: It is, we had found about SEK 12 billion that came into the pool that hasn't previously been included in --, for more technical reasons than anything else and how to deal with how we match collateral etc and how we've made some system changes so we can now include those in the pool.

PETER KESSIAKOFF: Okay. And do you think that -- I mean, will this change your plans from the funding mix going forward, covered versus senior, and so on?

JONAS ERIKSON: Not materially, no.

PETER KESSIAKOFF: Okay, thank you.

OPERATOR: Our next question comes from Mr Omar Keenan from Nomura. Please go ahead.

OMAR KEENAN: Hi. Sorry to ask another net interest income question, but just coming back to the topic of funding, because we've discussed quite a lot of the tail winds, the head winds as they're coming through, but I just want to get a better understanding of how to think of perhaps some of the positive effects on NII coming through. And if I look at the amount of covered bonds in Krona, then it's about SEK 300 billion, so if I think that perhaps the front versus back book dynamic on covered bonds at above 40 bps, then that's essentially about SEK 1.2 billion off-setting and positive that'll come through -- you know, spread out over three years. I mean, have I thought about that incorrectly? I mean, could you give us, you know, a bit more colour of, you know, what those trends are pointing to and what they're telling you? Thank you.

GÖRAN BRONNER: I think in general, sort of, it's filtering through to the clients much more rapidly and on-going than the -- while it's a much more dynamic process between the re-pricing clients and actually the market rates. So, I don't think you can draw that -- those conclusions. I think we have -- if I try to simplify things a little bit, I -- we would have a bit of tail wind in terms of our relative funding spread closing in on our peers in our front book funding compared to back book funding. That will give us sort of an uplift going forward that we will keep for shareholders, so to say, and on top of that, as I said earlier, it cost us money to be at 95 in NSFR. We are eager to see where the regulation -- the regulatory discussion will take us. That is also sort of a funding risk related question to be solved where we are actually, in a very positive territory in a competitive sense. That can impact the NII going forward.

OMAR KEENAN: Okay. Sorry, just could you perhaps, you know, clarify what the back book covered bond funding spread is then, then we can make our own kind of assumptions.

GÖRAN BRONNER: The back book covered is 80 -- 81 basis points.

OMAR KEENAN: Great. Thank you very much.

OPERATOR: There are no further questions on the telephone. Please go ahead, Mr Michael Wolf.

MICHAEL WOLF: Then I am thanking all for being so active today and I look forward meeting you at the next quarterly results presentation. Thanks.