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PRESENTATION

Operator

Good morning, ladies and gentlemen, and welcome to the second quarter 2009 conference call. My name is Faye, and I'll be your coordinator for today's conference. For the duration of the call, you will be on listen-only. However, at the end of the call, you will have the opportunity to ask questions. If at any time you need assistance, please press star zero on your telephone keypad, and you will be connected to an operator.

I'm now handing you over to Michael Wolf to begin today's conference. Thank you.

Michael Wolf - *Swedbank AB - President and CEO*

Good morning, and welcome to Swedbank second quarter results presentation.

The financial crisis has stabilized, but the recession in the real economy is affecting us all, and will continue to do so for quite some time. In light of this reality, the changes that we outlined in conjunction with the first quarter results presentation, has been our focus during this quarter. We have worked hard on changing Swedbank to take the necessary steps to get the resilience required.

Our staff have shown strong commitment to the cause and good ability to support our clients. The results of our actions has been positive, and improved our financial strength. We are presently following the [same] path guided for in Q1, and our overall credit portfolios are developing in line with assumptions.

Sweden Estonia is developing better than expected, whilst Ukraine, Latvia and, to a certain extent Lithuania, is slightly worse than expected. Despite impairment losses of SEK6.7 billion in the second quarter, our Tier 1 has been strengthened, thanks to the capability of the Organization to reduce risk-weighted assets. The magnitude is SEK43 billion. It's like a small rights issue.

The business areas have, during the quarter, made the necessary preparations to launch cost adjustments measures to mitigate the effect on its business due to the declining economical activity. We have had a good momentum in our efforts to enhance our organizational capabilities and structure, as well to enhance our corporate governance framework. All in all, we have moved further ahead in our ability to meet the challenges that still lie ahead of us.

During the period, both the Swedish Riksbank and the FSA has published their stress tests on Swedish banks, confirming our resilience to an even more severe development in the economy. There is a strong alignment between different observers' view on the effects, both in the base, and the more stress scenario, which is some evidence of that visibility is improving, although from a low level.

We cannot effect the macro, but we are well prepared for any possible scenario. An important preparation for the future is, of course, having the right competence and organizational structure. During the quarter, we have successfully been able to get most building blocks in place. I believe in broad involvement and clear accountability to be one of the key success factors, and this has been achieved by the formation of the senior management fora, and at the same time, Sweden taking away one level in their organization, which means that there is actually only two degrees of separation between me and the Swedish branch manager.

What else have we done on the organizational side? In the risk area, we have now integrated the Organization, and we have a common Organization across all geographies. We have our work-out units fully operational in the Baltic States and Ukraine. In Sweden, we have a new regional management team that will start in August. Swedbank Markets and Swedbank Robur is integrated across the markets, and we have recruited new heads in HR Compliance, Treasury, and Swedbank Markets. This means that we now can move to the next phase for building the future. Therefore, during the autumn, our aim is to focus on the following.

The integration of all Group staff functions will start to take place. The aim is to create common processes across the Group, which should lead to synergies and lowering of operational risks.

We will also address our lending strategies in those markets, and our ambition is to go to a more traditional banking model. Looking at the progress made in our four focus areas, being asset quality, earnings capacity, liquidity and funding and, finally, capital, I am very pleased to report that we're getting good traction through the new management team and the co-operation with the business areas.

Asset quality and our ability to mitigate losses is, of course, the single most important area in defending earnings going forward. Having fully operational work-out units in all markets has clearly improved our capability in this area, and we stand by our guidances in the first quarter, which Goran will come back to.

We are taking the necessary steps to right-size the business units to reflect the lower economical activity in the banking sector as a whole. All in all, we will lower the number of staff, with 3,600 employees by the end of Q2 2010 compared with year end 2008. Already during the first six months in 2009, the reduction has reached 860 full time employees.

But most importantly, we have been able to reduce risk-weighted assets with SEK43 billion in the second quarter, without hurting our franchise, or our ability to support our core clients in our home markets.

Our pre-provision earnings are in light of the environment, showing reasonable resilience. And provisions for impaired loans are in line with our guidance in the first quarter. Net interest earnings have been affected by the economical climate, but we are able to re-price our lending book, which will have positive effects going forward.

We have deliberately been conservative in taking risk, and will have a more balanced risk-taking view going forward. Costs are under good control, and the capacity adjustments announced in the business areas will support further improvement in this area.

If we then look at the business areas, I would like to start with the strong performance in Swedish Bank in the Swedish banking unit. We do not see any major deterioration in the credit quality. Goran will talk more about it. We have been able to keep our ratio on deposits, so all in all, we are very pleased with the development in the Swedish Banking Unit.

Baltic Banking has experienced a perfect storm. Erkki will dwell more about it. International banking, of course, very tough environment in Ukraine, but it was expected to be a weak quarter in that unit.

Swedbank Markets has once again shown good ability to create results, and in the asset management area, we continue to have good net inflow.

So with that, I would like to hand over to Erkki, who will give you more details on the financial results.

Erkki Raasuke - *Swedbank AB - Head of Baltic Banking*

Thank you. I will cover more in detail than the income statement. More details also around our work rate capacity adjustments, and I will also comment a bit the standing around liquidity and funding.

In the first quarter, we announced highest ever NII and net gains and losses, but we also commented that keeping these levels would be challenging going forward, and we would expect them to come lower. And over the second quarter, we have now seen these expected headwinds starting to materialize. Low interest rates, higher cost of funds, decreasing volumes, and those increasing amounts of the impaired loans, they all are contributing, and they have been taking our NII down. Change between first and second quarter has been SEK560 million.

If we open it up more by the business area, then in Swedish Banking, we have had continuously solid performance. It is also partly supported by structural interest rate hedge.

In the Baltic Banking, the headwinds are most apparent, and mitigative actions are least effective at this point of time. So what we have, we have falling portfolios, low interest rates, relatively slower re-pricing; they are all contributing in a compressed period of the time.

In Swedbank Markets, in Q1 was at a very high, I would say almost elevated level of NII. So they have also stepped back now, partly due to the lower volumes; partly also due to as we have a quite higher funding cost.

Going forward, it's fair to say that we expect these headwinds to continue, but some of them will continue perhaps with lower impact. If we look to the interest rates, lower interest rate levels then at all of our home markets, we have now reached the levels where it's difficult to envisage of any drop further. If the interest rates would start to move higher, that would be clearly beneficial to the NII quite shortly.

We're also gaining the speed in re-pricing of the credit portfolio. The best short term outlook here is in Sweden, which is also the largest of our markets. As already said, Baltics will be slower, but eventual magnitude of the re-pricing, what we're expecting out of this market, is going to be much, much bigger.

On the funding side, we have been extending our maturities, and I will be back on that, but we do it with a very careful eye on the cost. What we also have seen is a very well functioning guarantee program for our benefit, as we have seen also improved pricing on our credit.

Basically, to conclude that part is that we will work hard to protect and enhance the quality of the NII going forward. As Michael already said that we have been very restricted to the new risk, or rather we have basically lowered it quite considerably, but now the lower level of the risk weighted-assets, and also steadily a slowly improving funding situation, allows us to be more balanced in taking up the risk.

If we move on to the net gains and losses then after its best ever trading results in first quarter, Swedbank Markets has posted another very strong quarter. The trading environment continues to be good, and the outlook is fairly similar also going forward.

I was also commenting in Q1, our historic volatilities, what we have had in relation to our funding operations, there are two large areas where we conduct our funding; Swedbank Mortgage and the parent bank. We have been able to lower this valuation related volatility in Swedbank Mortgage through the second quarter now, where we still have some of this volatility in the parent bank. And basically, the source for that is that we have done a sizeable amount of medium/long term funding, which we have been swapping back to the short term [channels], and this associates with certain valuation effects, and they are also the ones what we see here. Our ambition is to manage it in a way that we will see lower volatility going forward.

If we move on then to the other significant contributors to the results in second quarter, then we had a three one-off transactions. We sold nine branches in Sweden, which was netting more than SEK370 million. We have agreed the sale of shares of [Pisa] International, which was netting over SEK320 million. And we also have reversed performance pay reserves in the Baltic Banking, which was remaining poor there, and now it's clear they won't be eligible to be paid out. And that has lowered profit-based staff costs by SEK200 million.

So all-in-all, we ended second quarter with a profit before impairments SEK4.8 billion, exactly the same spot as we were a quarter ago. We have formed a new loan loss provisions [growth] of SEK6.7 billion. Goran will be back on that. And we ended the quarter with a SEK2 billion loss.

During the second quarter, we have also brought in some more clarity about the needed capacity going forward. Michael was already commenting on that, so on the next slide, I am showing slightly more detail in where it's going to be executed.

I said over the first half of 2009, we have been reducing headcount more than 800 already. We are going to accelerate this speed now, having better visibility and expectations of the capacity needed in there in the future. So over the second half of this year, we will see a reduction of another 1,300, and similar magnitude also first half of 2010.

We have a less -- we have been less clear, and we still are less clear about our needed size in the Group staff functions. So as you also can see, there has been a small increase over the first half here. This work goes on. We hope to be back on that over the third quarter. It's currently clear that some of the areas will need further strengthening, but also, the overall smaller size of the headcount probably also will have the impact there, helping to bring down larger operational areas like IT operations, etc.

If we then move on to the Liquidity & Funding area; turnover the second quarter, we have had some small steady positive developments in here. We have further lifted our liquidity, which is the ever highest at this point of the time. We feel very comfortable with that. Once again, I will reiterate what I said; it's been said already many times that we have been extremely risk-averse, so also in this year, we have not been opportunistic at all. We have not taken any chances. Really, we have been just been building up the positions for going further.

The state guarantee program has been functioning well. We were re-opening our US CP program below the guarantee program in the beginning of May, and we issued off from that within following four weeks more than $8 billion. So it was opening with quite success, I would say.

We also have issued, after quite a time gap, first international covered bond again. This is without the guarantee. And we have managed to increase the maturity profile of our wholesale funding by about four months over the first half of this year.

So with that, I will hand over to Goran to dwell deeper into the asset quality issues.

Goran Bronner - *Swedbank AB - CRO*

Thank you, Erkki. I will cover three areas. Firstly, I will give a glimpse of the development of the asset quality during the quarter and guidance going forward. Then I will quickly run through a little bit of what is taking place in the work-out units that we are now resourcing and staffing. And lastly, I will cover the capital efficiency work that is currently ongoing in the Bank.

Moving into asset quality, I think overall we had a development of impaired loans, as expected. They came in at SEK9.7 billion during the quarter, which is just a touch higher than during the first quarter. If we dwell further down into these numbers, there are some areas which are clearly positive. I think Sweden and Estonia developed better than we had expected. In Sweden especially, I think we are seeing some increases of covenant breaches. We are seeing a moderate growth on the watch list. But overall, the credit quality is not at all deteriorating that you could have expected only three months ago, very much helped by low interest rates, of course.

If we look at the countries Latvia, Lithuania and Ukraine, I think they are -- continue to be very weak and hurt by the macroeconomic development. And that has -- and it's really there where we have seen the growth, continued growth in impaired loans for us. If we look at especially Latvia and Ukraine, you can see that now the portfolios are to very high degree impaired. We are reaching 18% in Latvia and 24% in Ukraine. And, of course, these were the countries where the credit bubble went the furthest, and have seen the most severe hit from a macro perspective. Overall, in these impaired loans, roughly 20% are related to private individuals and 80% -- and the clear majority is, of course, corporate-related impaired loans.

Moving into provisions, I think overall visibility is increasing somewhat for us in this area. We have taken impairment losses during the quarter of SEK6.7 billion. We are continuing to do a Group collective provision in Ukraine to keep up the provisioning ratio at 100% for reasons I will come back to.

The provisioning ratio in the Baltics are staying the same, and overall, we remain roughly -- we are down 1%, but roughly the same provisioning ratio.

Total provisions in the Group are currently at SEK18.8 billion, while write-offs is very early stage; SEK534 million during the quarter.

Going forward, I think what will happen is that impairment losses and individual impairment losses will continue to be high for the next quarter as the work-out units are becoming more and more efficient, and we'll during the second half of the year most likely dissolve some of the collective provisions.

Then going forward, guiding on this area, we are still of the opinion that impaired loans will level off somewhat during the second half of this year. We have had impaired loans of just below SEK20 billion for the first half of the year, and we think that the second half of the year will be less than that number. We also believe that the provisioning ratio that we guided for, 30% to 50% through the cycle, still is valid. We have learned more of the problematic loans during the quarter, and we have also -- get a better understanding of the collateral position, and there is nothing new information there that says that the provisioning ratio over the cycle should be different.

Currently, the provisioning ratio is standing at 63%, so we will at some point in time start to move that down, and I think we will continue to see upon that as we did in the first quarter. When we will see a leveling off in impaired loans or see that the visibility in terms of repayment capabilities of the borrowers where the collateral values increases, that will be the trigger point for us to move that down.

Moving into restructuring work then; I think it's fair to say that we have spent a lot of time in building resources and structure in handling these problematic loans. By the end of August, we will be roughly 300 persons in the Group working with problematic loans. We're a little bit more than 200 in the Baltic States, 40 in Ukraine, and a little bit more than 40 in Sweden.

It is a continuous effort to separate good loans from bad loans, in order to secure that we have the right competencies in handling these bad and problematic loans, and also to secure duality. We will establish action plans for every single borrower, which is very time consuming. We have created a holding structure for the SPVs where we foresee us to overtake collaterals. And we have also created special credit committees in order to be speedy and competent and do the right decisions.

Looking at other countries, I think Ukraine, I just want to highlight this; a very special case for us. It has extremely low visibility. It is a weak legal system, which makes it difficult for us to enforce collaterals. The macro has been extremely negative, and the political situation is in limbo. And I also would like to highlight on the positive side that Sweden has developed much better than expected. The problems we have seen in Sweden has been very much related to sub-supplier, to export and core industry. And we have, during the quarter, had one larger write-off. so beneath the numbers, the figures are actually even better.

Going forward, I think the risk appetite is increasing. We are seeing more and more interest from bargain hunters wanting to buy cheap assets from us, and especially real estate. We have taken the stance that we are not interested at this point in time. We see upon this as a long term investment horizon in order to secure shareholder value.

Going forward, just a very quick brief where we are on the repossessed assets. I think it's very early stage of the cycle. You see the picture on the Baltic countries here. Where we have seen an increase, of course, is within the Transport segment with passenger cars and commercial vehicles, which have increased rapidly. During the last month, we have also seen a quite clear increase in appetite to sell these from buyers of these cars, so the turnover of cars is increasing. Going forward, we think the second half of the year will see a sharp increase in the Real Estate side of this.

Now moving to capital efficiency and risk-weighted assets. I think it is -- we have during the quarter managed to reduce risk-weighted asset by SEK43 billion, which is equivalent of a small rights issue of SEK4.5 billion. I think it's amazing to see how well the Organization has responded to a very clear message from the management, and we have really got the attention in all business areas on this work.

Of course, we will not be able to continue to do this kind of magnitude going forward. Of the SEK43 billion, we would say SEK13 billion is non-recurring. Among other things, we have moved Swedbank Finance into IRB, which gave us SEK10 billion in savings. We have also seen decreased volumes help us, with savings of SEK20 billion. That is partly volumes that we, of course, would not like to see be decreased in the Baltics, but in other parts of the Organization it's, of course, a management wish to reduce unprofitable business. We have also devoted a lot of time into improved processes and collateral position that has saved us roughly in the neighborhood of SEK10 billion.

Going forward here, it's the management intentions to continue to drive this capital efficiency program further in the Organization. And that will be done through -- continue to focus on improved processes and collateral positions, and also a stronger focus on core clients. We are not in a situation that we are hurting the core franchise of this Bank in this work, which is very positive, so it's very much more things to do here.

I just wanted to end the presentation then with a snapshot of the capital ratios of the Bank. We were at 9.4% going out of the first quarter. We had a negative result. We got some help from the dividend from the insurance company. We had a massive help from the risk -- RWA reduction, and we can end the quarter at 9.83%, which is actually higher than at the beginning of the year. I think that is a sign of strength, considering that during the first six months of this year has taken SEK13.5 billion in provisions, and currently have SEK30 billion impaired loans on the books.

By that, I would like to hand over to Michael.

Michael Wolf - *Swedbank AB - President and CEO*

Thank you, Goran. Just to summarize, we have focused on four areas; managed to -- and lowered the risk level in the Bank; adjust the capacity for the prevailing global economical situation, to take steps to be self-sufficient in funding and improve our capital buffer, and I think we have done good in all four areas.

Going forward, the second half of this year we'll continue to focus on these four areas. We'll start the effort to integrate -- integration of the other Group staff functions. We will continue to develop our Nordic corporate strategy, and we'll come back with a new brand promise, vision and values at the end of this year.

So with that, I'd like to hand over the floor for Q&As.

QUESTIONS AND ANSWERS

Operator

Thank you. (Operator Instructions). The first question comes from the line of Chintan Joshi at Nomura. Please go ahead.

Chintan Joshi - *Nomura Securities - Analyst*

Hi; good morning. I've got a couple of questions and then one detail question. The first one is, you say in the presentation that loan losses are expected to level off in the second half of the year. Could you just give some more clarity on what you mean by level off, and also the basis of this guidance, just to explain why you think it's leveling off?

The second question is on capital ratios. We've seen the risk-weighted asset calculation change from direct to indirect. I just wonder what the capital ratios would look like if you had the old way of calculating risk-weighted assets, just to get an idea when I compare it to other banks.

And then the detail question was, the wholesale funding maturity has lengthened to 18 months. I just wanted to know from what maturity it has lengthened to 18 month; if you can give us the start of year number. Thank you very much.

Michael Wolf - *Swedbank AB - President and CEO*

All right. Maybe before we actually get there, maybe we can clarify the second question. You say this, that the risk-weighted assets going from direct to indirect; I didn't really understand that question.

Chintan Joshi - *Nomura Securities - Analyst*

I think risk-weighted assets come out of the capital requirement. I'm referring to the Cheuvreux presentation, the Swedbank presentation made at the Cheuvreux conference, where you explained that the capital -- the risk-weighted assets is output of the capital requirement rather than an input.

Jonas Erikson - *Swedbank AB - Head of Group Treasury*

Hi, this is Jonas Erikson here. That is the function of moving into Basel II in terms of regulation how you come up with a risk-weighted asset number. Under Basel I, basically we just add very rough risk-weightings of each part of the balance sheet leading up to the risk-weighted asset number, whereas now, it's obviously a quite different model calculation including through a VaR-based credit risk system calculating the capital requirement, and that gives in turn risk-weighted assets. That's simply a matter of moving into Basel II.

Chintan Joshi - *Nomura Securities - Analyst*

Okay, I'll take that offhand.

Goran Bronner - *Swedbank AB - CRO*

Okay, your first question. It's Goran here. You asked about the guidance, how much. We have not chosen to specify that, but I can say that in the first half of the year, we had roughly SEK20 billion in impaired loans. And, of course, we expect impaired to increase in the second half of this year as well. But the only thing we have chosen to state at this point in time is it will be less than it is in the first half.

And your second part of that question is what do you really base that on, and I think one thing is that we feel now, now we are two quarters into this sharp increase, and we take a little bit of comfort in that the second quarter shows that there is no excess growth above the first quarter. So from that, you see two similar quarters coming. You also are starting to see quite a bit of dissimilarities between countries, so you really start to see where the problems are. And that relates also that we are now going through the books. We learn more as each week goes by, and that gives us some comfort.

Then, of course, I would like to state if we would have to see a change to the exchange rate system happening as of today or something, that would have a negative impact on this guidance.

Michael Wolf - *Swedbank AB - President and CEO*

Yes, and finally then, wholesale funding. It has moved higher, and it has moved higher by about four months during the first six months of this year.

Chintan Joshi - *Nomura Securities - Analyst*

Thank you very much.

Operator

Thank you. The next question comes from the line of Aaron Ibbotson at Goldman Sachs. Please go ahead.

Aaron Ibbotson - *Goldman Sachs - Analyst*

Yes, hi there. I've just three quick questions. First of all, looking at the development in Ukraine where you have written off some -- or taken impairments of 20% of the loan book for the first half, and -- but if I look at your GDP forecasts, they seem to be worse for the three Baltic countries than for Ukraine, and there's no obvious macro indicators, apart from the FX that is worse in Ukraine. So I just wanted to understand what the differences are; if you think that you have an extraordinary bad book in the Ukraine versus the competition, or what's driving this difference? And also, if this is the type of loss that we should expect in Ukraine, should you see a devaluation.

My second question relates to your through-the-cycle guidance of 30% to 50% coverage ratio. And since basically all your non-performing loans is related to emerging markets, and the other banks in Europe provide between 80% and 120% for non-performing loans in emerging markets, I'm just surprised that you feel that 40% is a reasonable level for emerging market non-performing loans, also obviously factoring in falling collateral values.

And finally, just on the lending margins, if you expect them to increase in the second half. Thank you.

Goran Bronner - *Swedbank AB - CRO*

Right. If we take the first question, I think there is several differences between Ukraine and the Baltics. To start with, one of them has passed through devaluation already. There is a very weak legal system in Ukraine, which creates the problems in actually repossessing assets. And also, I think that it's fair to say that the lending that took place in Swedbank came at a late stage in the cycle. So we are very conservative on Ukraine, and that's why we are keeping a 100% provisioning ratio. And we expect that impaired loans in Ukraine will continue to come in during the second half of the year.

Then you said that you consider the Baltic countries being emerging markets and requiring a provisioning ratio about 100%. I think I would disagree to that statement, since these countries are part of the EU and have bankruptcy laws and are, to a much higher degree -- in my mind, they are not at all emerging markets. I've encountered emerging markets in Indonesia, Philippines and so forth, and Thailand, but -- and some other parts of Eastern Europe, but I would not classify the Baltic countries as emerging markets.

Aaron Ibbotson - *Goldman Sachs - Analyst*

But, sorry, can I just clarify? When you say that their legal system is much weaker than in Ukraine when it comes to repossessing collateral, I was under the impression that it could take over a year to repossess, say, a house in Latvia. But are you telling me that it's taking even longer in Ukraine, and that basically there's no way of recouping the collateral? Or what do you mean with a weaker legal system?

And secondly, do you see Latvia and Lithuania different from the other EU members that are not part of the euro when it comes to legal systems and the framework for repossessing assets? Because I guess I was referring to the other European banks with their Eastern European exposures. Thank you.

Goran Bronner - *Swedbank AB - CRO*

To start with, I'm not an expert in repossessing assets in all of Europe, but I would -- I mean, it's a cumbersome process to repossess assets in basically many countries. Even in Sweden, it takes time to repossess assets. And it definitely takes time in Latvia as well. I think the difference with Ukraine is, can you repossess assets in some circumstances? And what are you having to do to repossess assets?

Aaron Ibbotson - *Goldman Sachs - Analyst*

Okay.

Erkki Raasuke - *Swedbank AB - Head of Baltic Banking*

If I move on to the last question, on the lending margin is that -- the headline lending margins, or the margins with regards to the customers, have been increasing all the time, and they will keep increasing. But if we see that the margins are either being flat or falling in some areas that associated funding cost also has been increasing, and that has obviously been increased and priced through quicker than headline lending rates.

What I said is that we don't give quantified guidance for the quarter, or next quarter, or next two quarters. But what we do expect is that, in the light of the global re-pricing of the risk, the re-pricing of the risk also throughout our portfolios obviously will take place, and we work hard on that to accelerate that also to the speed what we possibly can do.

Having said that, also it's -- there is no doubt that the current historical low interest rates have offered an enormous [cushion] also on the asset quality side. So -- and in short term, one could say that this is basically what -- in relevance to the bottom line, that this is probably significantly bigger than the smaller changes in lending margins.

Aaron Ibbotson - *Goldman Sachs - Analyst*

Okay, thank you.

Operator

Thank you. The next question comes from the line of Per Lofgren at Morgan Stanley. Please go ahead.

Per Lofgren - *Morgan Stanley - Analyst*

Thank you very much. It's Per Lofgren from Morgan Stanley. I have two questions. First of all, I'm going back to the capital and RWA reduction again. You know, when you walked us through this, I completely understood the non-recurring part of this, and that a lot is coming from Swedbank Finance. But could you talk me through -- as I understand is, when you say the decreased volumes of SEK20 billion, where exactly is this coming from? I was just looking over the balance sheet and trying to understand how it comes together.

Also, when you say here you can reduce risk-weighted assets by improving your process, can you please explain that a little bit? It's, at least not to me, clear.

And finally, I wanted to ask -- I guess this question is connected, but please guide me a little bit here. The project to enhance the quality of the net interest income, what are you going to do with your balance sheet to achieve this? We can maybe start from there. Thank you.

Goran Bronner - *Swedbank AB - CRO*

Yes, that was -- I'm just trying to remember all the questions. I think with regard to risk-weighted assets then and declining volumes, it's of course happening in the corporate segment of the bank. It is in the Eastern European countries. I mean it's just a lack of credit demand that is driving that number.

But then it's also happening in the Swedish organization as well, that we have -- or trying to sort of, through capital efficiency measures, see to it that we [just do] the transactions that meets the orders, and also to reduce the exposures where it doesn't meet the orders basically. So that's an ongoing process that will intensify during the third quarter actually, to see to it that our corporate exposure is meeting orders.

With regards to improving processes and collateral position, I mean, an example of improving collateral position is, of course, not to, for example, lend to holding companies that hold property assets, but rather secure lending with the property as collateral. So it's a number of these issues that you can work with a plan [to follow] all the clients actually.

Per Lofgren - *Morgan Stanley - Analyst*

Do I understand you correctly here? Is it the same type of lending that you do to, let's say, economically the same clients, but it's a matter of that you can change the legal structure; you lend it from the holding company direct, taking collateral in property for example?

Goran Bronner - *Swedbank AB - CRO*

Yes, that's correct. I mean, you basically improve the Bank's security position, and by doing that, you reduce the capital need.

Per Lofgren - *Morgan Stanley - Analyst*

Okay, and I guess it's in this area where you say that the work will continue. How much can be done in this regard?

Goran Bronner - *Swedbank AB - CRO*

In that regard, of course, there is a limited space where you can work. So as this capital efficiency program runs further, at some point in time, it will be more and more of a problem.

Michael Wolf - *Swedbank AB - President and CEO*

But to come back to your last question Per. We want to have a better balanced bank, between lending and deposits overall, and we want to extend our relationships with core clients in non-credit business. So we're looking for a better balance. And, at the same time, we do experience a market out there with good opportunities to attract new customers.

But you need to remind yourself where we were three months ago, and that's why we deliberately have been very conservative in terms of risk taking in the quarter to ensure that we have the financial strength and the room to be more balanced going forward. So you will see us being slightly more focused on getting business onboard with the right returns, going forward, as well as the effects of re-pricing of the lending portfolio will start to show more in the numbers in the next couple of quarters than it has so far.

So it's a combination of a lot of efforts where our focus in the quarter has been to enhance our financial resilience to the downturn.

Erkki Raasuke - *Swedbank AB - Head of Baltic Banking*

If I move more deeper into the second question, asking how we're going to enhance the NII going forward is that I will just expand the same topic already touched, is that when we look to the reduction of the risk-weighted assets, clearly, we are looking first of all to the relationships where we have only poor lending relationships without any auxiliary business, when we might be in the club financing, or syndicated financing bank number three, four or five, where the returns are not adequate in today's market. And basically, being the smaller brother this time around has allowed us also to actually reduce these exposures, and we see the good possibility also to distance ourselves also, going forward.

I say this, that the Swedish market is good in terms of the re-pricing. I mean, obviously, we are in a competitive market, and we are very much concerned where our franchise value also going forward. Having said that, is that 50% of our mortgage portfolio in Sweden is a floating rate base, and basically, it turns around with three months. So within three months, we can re-price the half of our portfolio, and the remaining part of the portfolio also in terms of its fixing period is, I think the average is just around one year.

Corporates, all in all, the turnover there is fairly quick. Now here is the question more on the strength of the portfolio. Like Goran was saying is that in parts of our geographies where the impairment levels have exceeded already 20% in a corporate portfolio, then the kind of re-pricing obviously does not heal that.

One single also to be transparent about, that a kind of concern area in terms of the re-pricing, is the whole Baltic mortgage portfolio. This is built on the long term Euribor based financing. The size of that is about EUR7 billion, and basically there really in a short run, we can re-price that only in a case when a customer initiates the interaction with us, or if there is a violation of the covenants.

What we're doing, and what is already in place, is that we're actually having to reduce now the prime based, prime rate based pricing mechanism going forward. And all of the exposures coming to the renegotiation to the change of terms, etc., we're converting over to the prime based pricing model. But that will be the process which will take a longer period of the time.

And finally, once again coming back to the low risk profile, we have not used any [carriage] rates, or anything like that, what have been perhaps quite popular recently in the market, Central banks supplying the medium term funding to the market. We actually have not been participating in there, and we have not used these tools to enhance our earnings.

Per Lofgren - *Morgan Stanley - Analyst*

Okay. Can I ask you one final thing? And this is more of a top-down strategic question. The CEO commented -- you was saying that you keep on focusing on improving the loan-to-deposit ratios, and so on. I wanted to ask you -- I think it's fair to say that -- you will probably agree that the funding situation remains stretched, and I guess that this is a focus point of improving that to going from a stress situation into some kind of new normalized world.

Do you think the key to go from where you are to achieve that, is that to improve, for example, the loan-to-deposit ratios and the balance that you were talking about in your balance sheet? Or is it, you know, do you have to take down the corporate exposure in the Baltics? Or is it a combination of both?

Michael Wolf - *Swedbank AB - President and CEO*

At the end of the day, our fundamental ambition is to get out of the state guarantee program and be self sufficient. That's where we are heading towards.

When it comes to the Bank, mind you that we have doubled our balance sheet in the last five years during the peak of the economy. So, of course, there is a lot of assets there that long term doesn't reach the wanted hurdles. And we will aggressively pursue that. But on the same time, there is a lot of very interesting business opportunities out there, so we want to get room for the interesting business opportunities by taking out the not so interesting assets in the balance sheet. And this is something that we're going to focus relentlessly on.

I mean, at the end of the day, the reason for having this crisis is that banks went berserk the last couple of years and grew their balance sheets. We want to be in a traditional banking model. We want to work with core clients, and have a good share of the volume with these clients. And by having that, we can give them the highest possible attention. So it's a simple equation.

Per Lofgren - *Morgan Stanley - Analyst*

Fantastic. Thank you.

Operator

Thank you. The next question comes from the line of Geoff Dawes of FPK. Please go ahead.

Geoff Dawes - *Fox-Pitt Kelton - Analyst*

Hi, thank you. Good morning, everyone. Geoff Dawes here from Fox-Pitt, Kelton. I've got a couple of questions remaining. One is on NPLs in the Real Estate sector, and the second is a slight clarification on the RWA reduction.

So we'll start with the NPL question. If I look at the Baltic real estate management and construction NPLs, you're running at just under 50%, five-zero percent, in Latvia, but substantially lower in Estonia and Lithuania -- about 10% to 15% for those markets. In terms of external real estate data, it's limited, but there doesn't seem to be much to pick between the three markets. So what is the explanation behind the very, very large gap between the experience in Latvia and the experience in Estonia and Lithuania?

Second question, on the RWA reduction, can I just confirm, are there any credit hedges that are taking place with which to reduce the volumes and the overall RWAs, or is it all real volume reduction that's coming through? Thank you very much.

Goran Bronner - *Swedbank AB - CRO*

Just quickly, your question number two is, no. Or going back to your first question it's, yes. It's always difficult in a huge organization to say that everything is 100% classified right, and things, but overall, the Latvian real estate market is much -- in a much worse condition than the other two countries. The credit expansion went a lot further there, and also some of the lending were down against land loss to some degree. So I think the bubble went further there.

Geoff Dawes - *Fox-Pitt Kelton - Analyst*

Okay. Could you perhaps clarify that last point? You said more lending against land. Could you give us an idea of how much of that real estate portfolio in Latvia is land relative to the other two markets?

Goran Bronner - *Swedbank AB - CRO*

At this point in time, we said we're not going to release these numbers, because I feel overall we're still in sort of a -- clarifying, getting more information, and things are coming in. We have the overall picture of things, so I think -- but we are most surely we will come back to the market on these issues and be more specific as we feel that we have better quality on that.

Geoff Dawes - *Fox-Pitt Kelton - Analyst*

Okay, that's fair; and just a final question. You say the real estate market looks much worse. Is that in terms of price performance or customer repayment, client repayment; so cash flow on the assets essentially?

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Goran Bronner - *Swedbank AB - CRO*

Basically, I think in price performance. It looks bad everywhere, but it's also very, very low activity. There's basically no activity taking place unless with forced sales. I think the overhang, or if you say the overbuild situation, is much higher in Latvia than it is in the other situations, so the route to recovery will be longer in Latvia.

Geoff Dawes - *Fox-Pitt Kelton - Analyst*

That's great. Clear. Thank you very much.

Operator

Thank you. The next question comes from the line of Peter Grabe at Handelsbanken. Please go ahead.

Peter Grabe - *Handelsbanken - Analyst*

Yes, thank you. Peter Grabe at Handelsbanken; just two quick ones. Firstly, if you could just give an updated view on your assessment of the asset quality development in the Swedish operation the second half of this year and next year. And also, if you can elaborate a bit about the reduction in the reserve ratio in Russia. It's down to 62% -- 64% from 100%. Is this a sign of better comfort in terms of your portfolio there?

Goran Bronner - *Swedbank AB - CRO*

The second question there, I don't think you should read too much into it since it's very small numbers, and it's very much affected by specific and individual provisions. So it's not a message built into that change. Overall, I think we feel rather good about Russia, but we have people going through doing second opinions on all of the larger clients there.

With regards to your first question on Sweden, I think it's fair to say that we are positively surprised. I would have expected more problems to start to show up in the system during this quarter than has actually happened. Of course, we have more clients on the watch list and there are covenant breaches in certain -- within certain clients. But there are actually quite few serious problems that we see of any magnitude. There we have a number of small exposures that we are working with, and that is normal to expect when the economic cycle is like this.

Going forward, I think it is absolutely too early to say that you are out of the woods, so we continue to watch this very carefully and expect things to deteriorate somewhat during the second half of the year.

But, of course, our borrowers are very much helped by the low interest rate environment. And if you see the real economy start picking up, it would be strange to them if that materializes to see a very sharp increase as well. So cautiously optimistic is my stance at the moment.

Michael Wolf - *Swedbank AB - President and CEO*

I think it's worth pointing out as well that the commercial real estate segment is very much funded by short term interest rates, so you get the positive impact very quickly there. And if you add that up to the mortgage book, it's close to 90% of our loan book. It's about 85% of our loan book.

Goran Bronner - *Swedbank AB - CRO*

Then another point, one of the risk pictures, looking out a little bit in time is, of course, that the interest rates go up and really interest rates go up, and that will hurt -- could hurt some of the property-related lending. So that's something we're working with with clients to now see to it that they're actually securing the interest rates at these levels.

Peter Grabe - *Handelsbanken - Analyst*

Okay. Thank you.

Operator

Thank you. The next question comes from the line of Johan Ekblom from Bank of America Merrill Lynch. Please go ahead.

Johan Ekblom - *Bank of America Merrill Lynch - Analyst*

Hi. It's Johan Ekblom from Bank of America Merrill Lynch; just a couple of questions. Firstly, on the cost side in Swedish banking, there's quite a bit jump in other expense, and I guess about a third of it is due to IT. Can you just elaborate on what the rest is, and if we should expect a higher level of other cost if this may be related to restructuring, etc?

Secondly, in terms of trading income, there's a relatively big negative trading line in the shared services. If you could just elaborate on what this is related to.

And finally, if I look at note 13 in the disclosure financial instrument care that's fair value, it appears like the interest-bearing securities not valued by quoted market prices has fallen by about SEK10 billion quarter-on-quarter. Is this due to a reclassification, or have you actually sold these securities? And if so, was there any realized loss on those?

Erkki Raasuke - *Swedbank AB - Head of Baltic Banking*

Yes. I will start with the last one, is that, no, there hasn't been any reclassifications. And I also -- maybe I should go back more onto the detail. At least, off of my head, I don't recall any associated losses there either, but we have not reclassified anything.

Goran Bronner - *Swedbank AB - CRO*

I think some of it is related to reducing risk-weighted assets, but it hasn't had any P&L impact, so it's a non-issue from a P&L and balance sheet point of view, or P&L point of view.

Erkki Raasuke - *Swedbank AB - Head of Baltic Banking*

If I go to the first point, is that cost side on Swedish banking, yes, there is a small increase of the costs in Swedish banking. It is technology related, which is partly also there is certain seasonality in there.

Secondly, there has been an area which is -- which we have also highlight earlier and needs continuous attention, and that's actually in relation to the cash transportation. Further increased security measures, etc., have been moving this area up constantly and, basically, the cash in circulation itself hasn't been really reducing. What is the outlook on that? The outlook is more work needed actually to keep them with not growing.

I'm sorry, I actually missed your second question. If you can repeat that, please.

Johan Ekblom - *Bank of America Merrill Lynch - Analyst*

Yes. There was a big negative income on the trading line in shared services.

Erkki Raasuke - *Swedbank AB - Head of Baltic Banking*

Yes, that was exactly what I was commenting, and sorry if I was unclear. I was commenting that these are the valuation effects in relation to our funding portfolio. And we -- if you look now slightly over the longer period of the time, so you see is that there are recurring basically the swings with the pluses and minuses over a longer period of the time. This is the -- it's not a fundamental issue, it's more of the annoyance issue, I would say. And as I said, also is that the ambition is to break this area up differently and reduce that volatility, and also considerably increase the transparency in there going forward.

Michael Wolf - *Swedbank AB - President and CEO*

But it's important to stress that it's not something -- that number will vary over time, and over time, should be zero. And it's not something that impacts on a quarter-by-quarter basis the results from the other business areas.

Erkki Raasuke - *Swedbank AB - Head of Baltic Banking*

True, yes.

Johan Ekblom - *Bank of America Merrill Lynch - Analyst*

Perfect. Thank you very much.

Operator

Thank you. The next question comes from the line of Jan Wolter at Deutsche Bank. Please go ahead.

Jan Wolter - *Deutsche Bank - Analyst*

Yes, good morning. Jan Wolter, Deutsche Bank here. First a question there on capital, getting back to that. Do you expect the Basel II transition rules to expire on January 1 in 2010, as what the original plan? Is the Basel Committee now, together with the [EU] Commission, discussing of prolonging those? So that's the first question.

The second one is just on the RWA there. In the report, you state that you have reclassified the Lehman exposure, and that has had a negative impact on RWA, so taking that down by SEK2 billion. Was that in your stated model changes earlier during the quarter, or is it outside that?

And the third and last question is on debt restructuring, which has now been proposed in Latvia. Also, in Ukraine, the parliament there have already approved the bill imposing temporary moratorium for closures. In Latvia, the current proposal seems to hit 40% of Latvia mortgages. How much of your book would be affected? And I understand that this is just a proposal right now and is under discussion but, as such, do you have any idea how much of your book would be affected? Thank you.

Erkki Raasuke - *Swedbank AB - Head of Baltic Banking*

If I start off with the last one around the restructuring; first of all, it is that the negotiations are at a very beginning phase there, and I wouldn't even call that so much as a negotiation as a rather exploratory idea. In the light of that, IMF has put -- the request is that there should be some of this type of the program in place; many, many open-ends, particularly how it's also going to be funded.

Secondly, is that why we have actually had a very low attention towards that, is that we see very small financial impact out of that. And this small impact is mostly exactly the way how it has been structured of that in relation to the minimum monthly income. This is actually part of our portfolio. It would be very -- it's almost marginal part of the portfolio what it would touch. So that's also the reason we actually -- why we are -- why we haven't been dwelling that issue so much that's it's not significant.

Michael Wolf - *Swedbank AB - President and CEO*

On the first question, when it comes to the Basel II and which number to look at, I think you will have to ask the SFSA about potential changes to their strategy. But I think it's fair to say that we are quite a bit above the regulatory minimum requirement. And I think -- I would assume that the capital markets, which are the actual restriction on capitalization for us, would be more sophisticated not to take into consideration one single number without looking at the full picture.

Goran Bronner - *Swedbank AB - CRO*

Lehman then; I -- we saved a little bit less SEK1.8 billion or SEK1.9 billion on reclassifying Lehman from a capital adequacy point of view during the quarter, which we stated that we would do. That is part of the SEK2 billion out of the SEK13 billion in non-recurring on that slide. So the SEK10 billion was Swedbank Finance moving to IRB, and then SEK2 billion more was Lehman, and then we had something else that made up SEK13 billion.

Jan Wolter - *Deutsche Bank - Analyst*

Okay. Thanks a lot.

Operator

Thank you. We have no further questions coming through, so I'll hand you back to your host.

Michael Wolf - *Swedbank AB - President and CEO*

Okay. Thank you, and have a good day.

Operator

Thank you for joining today's call. You may now replace your handsets.
