

# Fitch Places Swedbank on Rating Watch Negative

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Fitch Ratings-Warsaw/London-02 April 2019: Fitch Ratings has placed Swedbank AB's 'AA-' Long-Term and 'F1+' Short-Term Issuer Default Ratings on Rating Watch Negative (RWN). The bank's 'aa-' Viability Rating and all debt ratings have also been placed on RWN. A full list of rating actions is at the end of this rating action commentary.

The Rating Watch on Swedbank reflects Fitch's view that the ongoing allegations of its potential involvement in money laundering through its Baltic operations, and specifically Estonia, have revealed weaknesses in the bank's management, which could ultimately affect its franchise. The RWN also reflects uncertainty over the bank's management of operational and reputational risks, which might no longer be in line with the bank's high rating, as well as the risk of capital erosion should Swedbank's money laundering allegations be confirmed and result in substantial capital-depleting fines.

The weak handling of these allegations by management has affected Swedbank's credibility and led to the dismissal of the bank's CEO last week. Management's stance so far has been neither to confirm nor to deny the news stories nor to provide additional information on the volumes of potentially suspicious transactions. The bank states that it is restricted by confidentiality laws and regulations, and in addition, it is currently under investigation by the Swedish and Baltic authorities.

## KEY RATING DRIVERS

IDRS, VIABILITY RATING, DERIVATIVE COUNTERPARTY RATING AND SENIOR DEBT

The ratings of Swedbank reflect its ability to generate stable revenue from its low-risk core business and to maintain best-in-class cost-efficiency and strong asset quality.

Fitch believes that the bank's response to the money laundering allegations has weakened management's credibility, and it will take some time to rebuild it. In addition board oversight appears weaker than at other highly-rated peers.

However, the bank's strategic objectives for the core business remain unchanged, supporting Fitch's expectations that the bank will continue to deliver strong operating results. High profitability provides the bank with a material capacity to absorb unexpected losses. The bank generated a net income of SEK21 billion (USD2.4 billion) in 2018.

Capitalisation is strong, and risk-weighted ratios in particular compare well with similarly rated peers'. The bank reported a fully-loaded common equity Tier 1 ratio of 16.3% at end- 2018. Its Basel leverage ratio of 5.1% was in line with peers'. Nevertheless, the RWN also reflects the risk of a large fine that could weaken capital materially.

Swedbank is predominantly a retail bank with a strong Swedish retail franchise. So far, following the media revelations, there has been no sign of a notable weakening of its franchise, as illustrated by stable deposit flows, but we believe that if the allegations are confirmed its franchise could be at risk of weakening. In the Baltic countries, Swedbank is a market leader, and as such has been exposed to higher risk, non-resident customers, as with all Baltic banks.

We expect asset quality to remain solid, supported by strong underwriting standards, a large, low-risk domestic mortgage portfolio and a benign operating environment. Stage 3 loans amounted to a low 0.7% of gross loans at end-2018.

Similar to its Nordic peers, Swedbank is reliant on wholesale funding due to a structural shortage of deposits in Sweden. The risks are mitigated by prudent liquidity management and a strong focus on covered bonds, with a sizeable portion placed with a domestic captive investor base consisting of large Swedish insurance and pension funds. According to the bank's management, both deposits flows and covered bond funding have been little affected by the media revelations.

Swedbank's Derivative Counterparty Rating (DCR) is at the same level as the Long-Term IDR because under Swedish legislation, derivative counterparties have no

preferential status over other senior obligations in a resolution.

## SUBORDINATED DEBT AND OTHER HYBRID SECURITIES

The ratings on the subordinated and additional Tier 1 debt issued by Swedbank have been placed on RWN as they are notched off the bank's Viability Rating. In accordance with Fitch's criteria, subordinated (lower Tier 2) debt is rated one notch below Swedbank's Viability Rating to reflect the above-average loss severity of this type of debt.

Additional Tier 1 securities are rated five notches below Swedbank's Viability Rating to reflect higher-than-average loss severity of these securities (two notches) as well as the high risk of non-performance (an additional three notches).

## RATING SENSITIVITIES

### IDRS, VIABILITY RATING, DERIVATIVE COUNTERPARTY RATING AND SENIOR DEBT

Fitch expects to resolve the RWN when more information on the bank's involvement in money laundering activities and the investigations becomes available. We expect to review the ratings at the latest in early 4Q19, given that the Swedish authorities have announced that its investigations should be completed in October.

Swedbank's ratings would be downgraded if there is confirmation of material deficiencies in anti-money laundering controls that indicate a weaker management of operational, reputational and litigation risks that is no longer commensurate with a rating in the 'aa' range. The ratings could also be downgraded if the outcome of the investigations results in substantial fines, leading to a material weakening of the capitalisation, or if reputational risk and weakened management credibility result in franchise damages or a weaker funding profile, including reduced wholesale funding access.

The ratings would be affirmed and a Stable Outlook assigned if the bank demonstrates that it can effectively cope with the reputational risk linked to the allegations and that it can rebuild management's credibility. In addition, the confirmation of no material deficiencies in anti-money laundering controls, and risks control in general, and increased certainty that potential fines would not weaken capital materially, would support the assignment of a Stable Outlook.

## SUBORDINATED DEBT AND OTHER HYBRID SECURITIES

The drivers for the resolution of the RWN on the subordinated and additional Tier 1 debt issued by Swedbank are the same as for the bank's Viability Rating.

The rating actions are as follows:

Long-Term IDR: 'AA-' placed on RWN

Short-Term IDR: 'F1+' placed on RWN

Viability Rating: 'aa-' placed on RWN

Derivative Counterparty Rating: 'AA-(dcr)' placed on RWN

Senior unsecured debt: 'AA-'/F1+' placed on RWN

Commercial paper: 'F1+' placed on RWN

Certificates of deposit: 'AA-'/F1+' placed on RWN

Subordinated debt: 'A+' placed on RWN

Additional Tier 1 instruments: 'BBB' placed on RWN

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### **Applicable Criteria**

[Bank Rating Criteria \(pub. 12 Oct 2018\)](#)

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- Swedbank AB