

# Swedbank AB

## William Hahn

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	Senior Preferred	Senior Non-Preferred	Outlook
Moody's	Aa3	Baa1	Stable
S&P	A+	A-	Stable
Fitch	AA-	A+	Stable

Source: Moody's, S&P and Fitch

## Background and ownership

Swedbank AB ("Swedbank") is the fourth-largest banking group in Sweden with total assets of SEK2.8trn (EUR279bn) as at end-1Q21. The bank is one of four major banking groups that dominate the Swedish market. Together, these banks account for some three-quarters of loans to and deposits of the Swedish public. Swedbank is the largest in retail banking and has leading market shares in mortgage loans, retail deposits and asset management. It is also the most domestically focused of the four. The bank's non-Nordic operations are focussed on the three Baltic countries of Estonia, Latvia and Lithuania, where the bank holds leading positions in most key market segments.

The group is publicly-traded, and outstanding shares are floated on the Nasdaq OMX Stockholm stock exchange. As at 30 April 2021, the largest shareholders with stakes >4% were as follows: Sparbanksgruppen – group of Swedish savings banks (11.17%), Folksam – Swedish insurance company (7.1%), Norges Bank (4.7%), Alecta Pension Insurance (4.56%), and AMF Pension Funds (4.11%).

## Main activities

Swedbank is a retail and commercial bank providing a wide variety of products and services, including deposit-taking, savings facilities, loans and mortgages, as well as investment, cash management, trade finance, payment processing, investment banking, asset management services and insurance. The group is organised along three main business lines: **Swedish Banking** (58% of revenues in 1Q21) provides retail financial products and services through the bank's branches in Sweden – including those of affiliated savings banks – and other direct channels. This segment also includes a number of subsidiaries as well as the retail operations of branch offices in Denmark, Norway, Finland and Luxembourg. It serves four million private customers and incorporates Sweden's largest private bank; **Baltic Banking** (19%) comprises banking services to private and corporate customers in Estonia, Latvia and Lithuania; whilst **Large Corporates & Institutions** (18%) services Nordic and Baltic large companies, financial institutions, organisations and banks. The bank also has two main wholly owned subsidiaries which are consolidated into the above business lines and benefit from Swedbank's multiple distribution channels: Swedbank Robur, one of the largest asset managers in the Nordic region, and Swedbank Försäkring, which focuses on pension plans and pension insurance.

## Potential repercussions from AML failings persist in the U.S.

In March 2020 Swedbank was fined SEK4bn (~EUR400m) by the Swedish Financial Services Authority (FSA) for serious deficiencies in its anti-money laundering controls and for withholding documents from Swedish and Estonian regulators. The bank's branches in the Baltics processed high-risk payment transactions of roughly EUR37bn between 2014 and 2019. Despite paying the fine to the FSA Swedbank remains exposed to those from U.S. and Estonian authorities. A March 2020 report by the bank's law firm underlines the view that U.S. penalties are unlikely to exceed the ~EUR400m fine applied by Swedish authorities. Profit is a key factor and can be multiplied by up to 4x under U.S. sentencing guidelines. Swedbank said that it earned about USD100m from its Baltic non-resident business, which therefore leads us to believe that fines would not exceed USD400m. This does not rule out larger fines as there is still the possibility that U.S. authorities uncover further evidence of wrongdoings. Shareholder lawsuits may also be filed against the bank.

With regards to sanctions violations, the bank's law firm identified only USD4.8m in transactions that may have violated U.S. sanctions. U.S. sentencing guidelines allow U.S. authorities to seek penalties up to 2x the amount of the transactions. Therefore, any potential sanctions penalties on Swedbank in the U.S. could be relatively low at around USD10m. The expectation is that this kind of multiple is more likely to be applied in cases with transaction amounts in the low millions rather than those in the billions.

Swedbank could face investor suits in the U.S. related to AML failings. The precedent was set in the case of Danske Bank where holders of American depository receipts (ADRs) sued the Danish lender for securities fraud in connection with its money-laundering problems. Swedbank ADR investors may do the same, alleging that the bank misrepresented or failed to disclose adverse information about its business and operations. In March 2020, the bank's law firm concluded that certain Swedbank AML disclosures or statements were inaccurate or omitted key information. However, such suits usually settle for significantly lower sums, usually around 2.5% - 5% of the damages that shareholder's request.

In order to rectify the above-mentioned shortcomings Swedbank has invested heavily in improved governance and from 2021 onwards progressively implemented international best practices in line with U.S. and European regulatory AML frameworks. Specifically, the bank implemented a comprehensive remediation plan, comprising 244 points (90% already completed at FY20) and hired external consultants to conduct annual AML reviews for the next three years.

## Financial strength indicators

**Profitability** – The group reported a net profit of SEK4.97bn in 1Q21, up 10% qoq helped by lower expenses and lower loan loss provisions (LLP). Adjusted for the SEK4bn AML fine, profitability was greatly improved against the same period last year (+115% yoy) as Swedbank was able to reduce LLPs by SEK2bn given the improved outlook for the operating environment. Group income of SEK11.4bn was predominantly comprised of NII (57% of total), which was down 2.1% yoy due to lower average loan volumes, FX-effects and rising deposit volumes. Excess liquidity and intense competition in the Swedish mortgage market, in which Swedbank is one of the two largest players, makes it susceptible to changes in mortgage margins. Net commission income was up 4% to SEK3.3bn due to higher AuM that increased to SEK1.3tr (+38.4% yoy). This helped offset declines in commission income from cards, payment processing and insurance. Revenues were also supported by growth in trading income that overturned a loss of SEK322m during 1Q20 into a profit of SEK585m in 1Q21. Strong results from FX and fixed income trading supported the bottom line. Swedbank reported a fall in expenses to SEK4.9bn (-7.3% yoy) helped by declining AML related investigation costs. The bank's operating efficiency as measured by the adjusted cost to income ratio improved to 44% from 52% one year prior. Improved bottom-line profitability resulted in a strong quarterly ROE of 12.8% that was in line with its previously sector-leading ROE of 12-14%. The bank's own target rate of 15% may prove elusive given the reliance on NII and expected elevated dividend payouts.

**Asset quality** – Swedbank's balance sheet has been gradually growing in recent years on the back of a growing loan book, fuelled by the booming housing market. Total assets stood at SEK2.82tr (+5.75% yoy). Asset quality was strong and supported by the robust legal and economic environment. Impaired loans (stage 3 as per IFRS9) amounted to a very low 0.47% of gross loans as at end-1Q21 (1Q20: 0.79%), 34% covered by loan loss provisions (1Q20: 44.4%). The healthy asset quality also reflects the bank's focus on Swedish private customers and SMEs, which accounted for 73% of the bank's loan book. Exposure to Large Corporates and Institutions accounted for 16% of the loan book, whilst exposure to the Baltic countries at 11%. That said, 57% of the loan book exposure is to private mortgages, which makes the bank somewhat vulnerable to significant price corrections, particularly in the Swedish housing market. Supported by high demand and limited supply, house prices have increased significantly in recent years, yet housing investments and stricter lending criteria introduced by the local regulator has led to a stabilisation in the market. Of the SEK534bn in corporate lending the largest sectoral exposures related to real estate (incl. residential, commercial, industrial and others) at 46% of the total, followed by agriculture (12%) and manufacturing (7%).

**Funding and Liquidity** – In line with its Swedish peers, Swedbank displays high reliance on confidence-sensitive wholesale markets for funding as customer deposits only contribute 46% towards the bank's non-equity funding. This results in a high loan-to-deposit ratio of 134% as at 1Q21, albeit down from its recent high of 172% at 1Q19. SEK830bn in debt securities issued accounted for 31% of Swedbank's funding but only SEK120bn (14%) were issued in senior unsecured format. The remainder was mostly comprised of covered bonds (55%) and commercial paper (29%). Wholesale funding is accessed through a variety of different debt programmes for publicly and privately placed bonds in different currencies. Issuance needs for 2021 are expected to be in line with 2020 volumes that saw long-term debt volumes amount to SEK78bn. As at 1Q21, Swedbank issued SEK32bn, already reaching more than 40% of its funding target. Issuance needs in 2020 and 2021 are lower than in previous years, as the abundance of liquidity accessible to the bank has increased.

MREL requirements have shifted Swedbank's issuance behaviour towards MREL eligible debt securities such as Senior-Non Preferred (SNP) bonds. The implementation of BRRD II into Swedish law, which contains provisions on minimum MREL requirements, was scheduled to take effect by end-2020 but was delayed until July-2021. Domestically the Swedish National Debt Office (SNDO) sets the bank's MREL requirement which is 6.22% of total liabilities and own funds (TLOF). As per 1Q21 investor presentation this equals SEK159bn. Swedbank stated that it has SEK255bn available to meet requirements, including SEK20bn in SNP and SEK85bn in senior-preferred (SP) bonds. Requirements are expected to be updated by the SNDO once the implementation of BRRD II into Swedish law is concluded. With regards to liquidity, Swedbank's position is comfortable as it can draw on a liquidity reserve of SEK646bn which is mostly made up of cash and balances with central banks (76%). Liquidity indicators such as LCR and NSFR are also adequate and above requirements at 154% and 123% respectively.

**Capitalisation** – Swedbank's fully loaded CET1 stood at 18% at 1Q21, one of the strongest in Europe. Buffers over requirements are sizeable at +560bps, well above the bank's own target buffer range of 100-300bps. We expect some downward pressure on the capital position going forwards stemming from the bank's proposed dividend payout ratio of 50% as well as regulatory headwinds (Pillar 2 Requirement & Guidance), lingering litigation risk regarding AML failings and adjustments to IRB models during 2021-2022. The leverage ratio stood at 4.8%, up 10bps yoy, against a 3% requirement.

Swedbank AB – Key Data			
Key Ratios (%)	1Q21	1Q20	1Q19
CET1	18.0	16.1	15.9
Total Capital	21.6	20.1	20.0
NPL	0.5	0.8	0.7
NPL Coverage	34.2	44.5	36.3
LCR	154	162	167
Cost to Income	44	52	40
Balance Sheet (SEKbn)			
Total assets	2,829	2,675	2,462
Loans to customers	1,667	1,066	943
Customer deposits	1,238	1,441	1,357
Debt securities	830	908	919
Total Equity	153	141	126
Income Statement (SEKbn)			
Revenues	11.4	10.2	11.3
o/w NII	6.5	6.6	6.4
Operating Expenses	4.9	9.3	4.5
Impairment charge	0.2	2.1	0.2
Net Income	4.9	-1.6	5.2

Source: Company earnings reports, Bloomberg

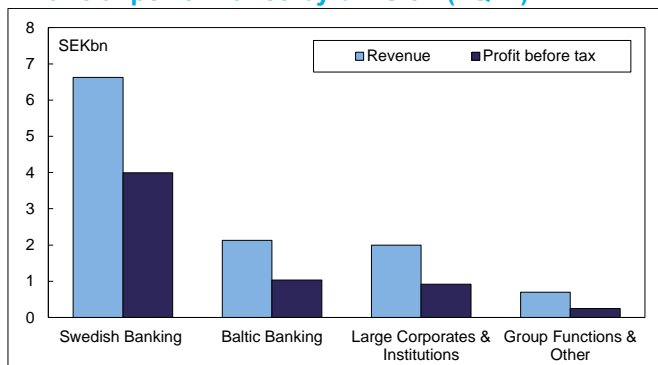
## Rating agencies' views

**Moody's:** Swedbank's ratings reflects the bank's strong credit quality, with a focus on Swedish mortgages, which Moody's consider low risk, and solid capitalisation expected to remain resilient despite the coronavirus-induced economic disruption. The bank's strong and recurring earnings will face some pressure in the current economic downturn. Similar to many of its Nordic peers, the ratings also reflect the bank's high reliance on market funding. In addition, they incorporate a one-notch negative adjustment for corporate behaviour, reflecting governance and risk management deficiencies, which crystallised in the systematic breaching of anti-money laundering rules over an extended period of time.

**S&P:** The October 2020 rating report states that Swedbank's long-term 'A+' rating is underpinned by the stable and low-risk operating environment in Sweden where Swedbank mainly operates, as well as the bank's solid balance sheet and leading market position in its home country and the Baltics. It also reflects the bank's strong capitalisation and S&P expect it to improve slowly through 2022 on the back of sustained capital generation, and despite mounting pressure on its revenues and asset quality as a result of the COVID-19 pandemic and subdued oil prices. The bank's robust underlying profitability provides resilience and financial flexibility and supports the current capital assessment, as does a more prudent dividend payout policy. However, the assessment also factors historical AML deficiencies and regulatory misconduct in the bank's Baltic operations between 2007 and 2019. Swedbank's funding and liquidity profile is neutral to the rating because its higher-than-international-peers' wholesale funding share is counterbalanced by its proven access to the capital market and solid reputation. S&P factor into their rating approximately SEK80bn of subordinated debt instruments by 2024 to meet the minimum requirement for own funds and eligible liabilities and, in turn, support the rating through the ALAC buffer.

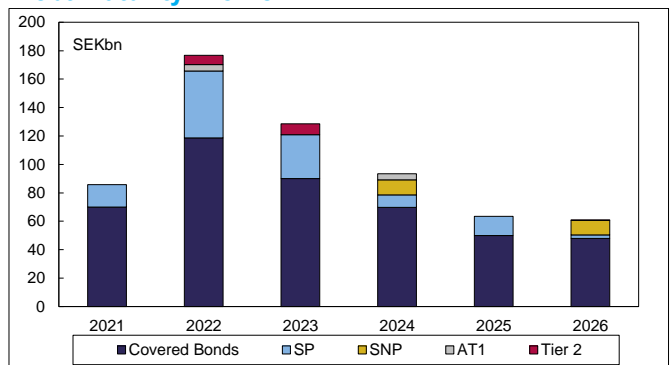
**Fitch:** In November 2020, Swedbank's ratings reflect Fitch's assessment of the bank's risk appetite, which is balanced by the bank's strong asset quality, capitalisation and profitability. The agency's view on the bank's risk appetite incorporates the material shortcomings in its anti-money laundering (AML) risk controls identified by Swedish and Estonian regulators in March 2020. Fitch has assigned an ESG Relevance Score of '5' for the bank's governance structure due to these shortcomings as the assessment of the bank's risk appetite has a high influence on the bank's rating. Swedbank has acknowledged these shortcomings and planned to address all of the recommendations received from both regulators by end-2020. The bank's progress in addressing AML control deficiencies in 9M20 is underpinned by independent reviews of corporate culture, governance and compliance, and by the management's strategic priority to regain trust of the public and investors. From 2021, Swedbank plans additional AML improvements that are needed to meet the CEO's ambition to introduce international best practices in AML control.

### Financial performance by division (1Q21)



Source: Company reports

### Debt Maturity Profile



Source: Company reports

### Recent Benchmark Transactions

Issue Date	Security	Maturity/Call	Currency	Size (m)	Type	Coupon	Yield	Final Spread (bps)
12/05/2021	SNP (Green)	6NC5	EUR	1,000	Fixed	0.30%	0.338%	MS +57
09/03/2021	SP	3Y	USD	750	Fixed	0.85%	0.87%	T + 55
07/01/2021	SNP	7Y	EUR	750	Fixed	0.20%	0.211%	MS + 63

Source: BondRadar

This is an issuer profile and contains factual statements only. All statements are sourced from Swedbank's financial reports, which can be found at <https://www.swedbank.com/investor-relations/reports-and-presentations.html>

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The statements in the preceding paragraphs are made as of May 2021.



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3) Samty Residential Investment became a consolidated subsidiary of Daiwa Securities Group Inc. effective 10 September 2019.

4) On 30 May 2019, Daiwa Securities Group Inc. formalized an equity/business alliance with Samty, and as of 14 June 2019 it owned 16.95% of shares outstanding in Samty along with convertible bonds with a par value of ¥10bn. Conversion of all of said convertible bonds into common shares would bring the stake of Daiwa Securities Group Inc. in Samty to 27.28%.

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- For derivative and margin transactions etc., our company may require collateral or margin requirements in accordance with an agreement made beforehand with you. Ordinarily in such cases, the amount of the transaction will be in excess of the required collateral or margin requirements\*\*.
- There is a risk that you will incur losses on your transactions due to changes in the market price of financial instruments based on fluctuations in interest rates, exchange rates, stock prices, real estate prices, commodity prices, and others. In addition, depending on the content of the transaction, the loss could exceed the amount of the collateral or margin requirements.
- There may be a difference between bid price etc. and ask price etc. of OTC derivatives handled by our company.
- Before engaging in any trading, please thoroughly confirm accounting and tax treatments regarding your trading in financial instruments with such experts as certified public accountants.

\* The amount of the trading commission cannot be stated here in advance because it will be determined between our company and you based on current market conditions and the content of each transaction etc.

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