

CREDIT OPINION

1 September 2017

Update

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RATINGS

SBAB Bank AB (publ)

Domicile	Sweden
Long Term Debt	A1
Type	Senior Unsecured - Fgn Curr
Outlook	Stable
Long Term Deposit	A1
Type	LT Bank Deposits - Fgn Curr
Outlook	Stable

Please see the [ratings section](#) at the end of this report for more information. The ratings and outlook shown reflect information as of the publication date.

Analyst Contacts

Niclas Boheman 44-20-7772-1643
AVP-Analyst
niclas.boheman@moodys.com

Maria Asensio 44-20-7772-1078
Associate Analyst
maria.asensio@moodys.com

Jean-Francois Tremblay 44-20-7772-5653
Associate Managing Director
jean-francois.tremblay@moodys.com

Sean Marion 44-20-7772-1056
MD-Financial Institutions
sean.marion@moodys.com

SBAB Bank AB (publ)

Update following recent upgrade to A1

Summary Rating Rationale

We assign a A1/P-1 long- and short-term deposit and senior unsecured debt ratings to SBAB Bank AB (publ) (SBAB). Further, we assign a baa1 baseline credit assessment (BCA) and a baa1 adjusted BCA. We also assign a long-term issuer rating of A1, subordinated debt rating of Baa2, and a long-term Counterparty Risk Assessment (CR Assessment) at Aa3(cr)/Prime-1(cr).

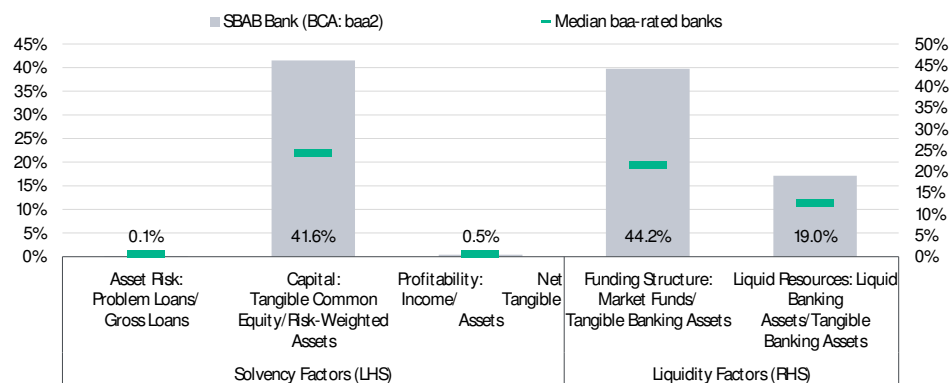
SBAB's baa1 BCA reflects the bank's predominantly retail focus, operating in the strong Swedish economic environment, and very strong asset quality metrics. The standalone assessment takes into account SBAB's improving profitability and funding profile, although the bank's reliance on market funding remains very high rendering the bank vulnerable to investor sentiment. The upgrade and the assigned BCA reflects the bank's sustained increase in deposits as a funding source as well as SBAB's improving, however low, profitability. The limited capital generating ability is viewed in the context of its limited credit risk as a mortgage lender.

The stable outlook on SBAB's long term deposit and senior unsecured ratings reflects our expectations that the bank's financial performance will remain stable over the coming 12 to 18 months.

Exhibit 1

Rating Scorecard- Key Financial Ratios

SBAB Bank's Scorecard ratios compared to the median peers



Source: Moody's Financial Metrics

Credit Strengths

- » An efficient mortgage lender
- » Low loan losses
- » Good risk-based capitalisation
- » Large volume of deposits and senior unsecured debt resulting in deposits and senior unsecured ratings benefiting from a very low expected loss-given-failure

Credit Challenges

- » High leverage
- » High reliance on market funding mitigated by increased funding duration

Rating Outlook

The stable outlook on SBAB's long-term ratings primarily reflects our expectation that SBAB will be able to maintain its current financial performance, including its high capitalisation, very strong asset risk, and stable profitability supported by a stable operating environment.

Factors that Could Lead to an Upgrade

- » Upward rating pressure could develop from significant improvements in the bank's financial performance, including: (1) an improvement in Moody's funding profile assessment; and/or (2) an improvement in profitability, without a material increase in the bank's risk profile.

Factors that Could Lead to a Downgrade

- » Downward rating pressure could arise on SBAB's senior unsecured ratings if its cushion of bail-in eligible liabilities shrinks considerably. Moody's would also consider downgrading SBAB Bank's long-term and subordinated ratings if (1) the bank's profitability significantly deteriorates, and/ or (2) the bank's risk profile increases due to increased exposure to more volatile sectors (e.g. unsecured lending).

Key Indicators

Exhibit 2

SBAB Bank AB (publ) (Consolidated Financials) [1]

	6-17 ²	12-16 ²	12-15 ²	12-14 ²	12-13 ³	CAGR/Avg. ⁴
Total Assets (SEK million)	407,893	373,638	371,437	334,592	330,589	6.2 ⁵
Total Assets (EUR million)	42,400	38,994	40,558	35,322	37,355	3.7 ⁵
Total Assets (USD million)	48,360	41,129	44,058	42,742	51,473	-1.8 ⁵
Tangible Common Equity (SEK million)	16,091	15,949	13,065	10,853	9,539	16.1 ⁵
Tangible Common Equity (EUR million)	1,673	1,664	1,427	1,146	1,078	13.4 ⁵
Tangible Common Equity (USD million)	1,908	1,756	1,550	1,386	1,485	7.4 ⁵
Problem Loans / Gross Loans (%)	0.1	0.1	0.1	0.1	0.1	0.1 ⁶
Tangible Common Equity / Risk Weighted Assets (%)	39.2	41.5	34.2	31.7	23.2	36.6 ⁷
Problem Loans / (Tangible Common Equity + Loan Loss Reserve) (%)	1.7	1.6	2.2	2.4	2.1	2.0 ⁶
Net Interest Margin (%)	0.8	0.8	0.7	0.6	0.6	0.7 ⁶
PPI / Average RWA (%)	5.7	5.3	4.2	4.5	1.1	4.9 ⁷
Net Income / Tangible Assets (%)	0.4	0.4	0.3	0.4	0.3	0.4 ⁶

This publication does not announce a credit rating action. For any credit ratings referenced in this publication, please see the ratings tab on the issuer/entity page on www.moody's.com for the most updated credit rating action information and rating history.

Cost / Income Ratio (%)	29.4	29.2	33.7	33.7	40.9	33.4 ⁶
Market Funds / Tangible Banking Assets (%)	45.0	44.2	47.9	49.6	57.1	48.7 ⁶
Liquid Banking Assets / Tangible Banking Assets (%)	21.3	19.0	18.2	19.6	19.7	19.5 ⁶
Gross Loans / Due to Customers (%)	307.6	306.1	387.8	431.8	564.7	399.6 ⁶

[1] All figures and ratios are adjusted using Moody's standard adjustments [2] Basel III - fully-loaded or transitional phase-in; IFRS [3] Basel II; IFRS [4] May include rounding differences due to scale of reported amounts [5] Compound Annual Growth Rate (%) based on time period presented for the latest accounting regime [6] Simple average of periods presented for the latest accounting regime. [7] Simple average of Basel III periods presented

Source: Moody's Financial Metrics

Detailed Rating Considerations

The financial data in this report are sourced from SBAB's financial statements or Moody's Financial Metrics, unless otherwise stated.

An efficient mortgage lender with improving profitability despite the low interest environment

SBAB is a government-owned Swedish bank that provides residential mortgages, loans and savings services to individuals, corporates and tenant-owner associations; its retail mortgage market share at end-June 2017 was 7.52%. Our assigned Profitability score of ba1 reflects the bank's improvement in profitability in recent years and its low cost to income ratio, while also capturing the exceptionally benign operating environment with lower than usual loan loss provisions.

We expect that SBAB will be able to maintain its current profitability level, which has increased in recent years, underpinned by resilience in net interest margins (NIM) despite the prolonged low interest rate environment and a continued focus on cost efficiency. SBAB recorded an increase in net income over tangible assets of 0.4% in H1 2017 (0.4% in 2016 and 0.3% in 2015) and an increase in Net Interest Margin of 0.79% (0.73% in 2016 and 0.68% in 2015). The increase in NIMs are a trait of the Swedish banking system where a large part of retail mortgages are funded with covered bonds. This source of funding has proven to be very beneficial in the low interest environment while lending rates have been resilient. SBAB prices its loans below the announced rates of the larger banks but there is no possibility to negotiate rates, a common characteristic with the larger banks. However, the bank gives rebates for lower LTVs but also higher volumes of loans.

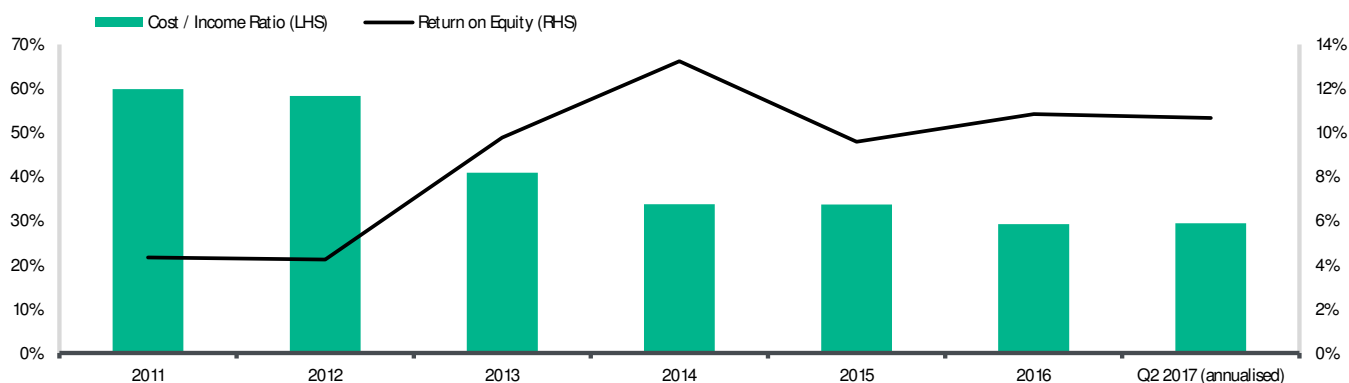
In half-year 2017 SBAB's reported a positive set of results. Pre-tax income in 1H 2017 increased by 17% to SEK 1,088 million (SEK 929 million), driven by higher net interest income (increased by 18% in 1H 17). This is a result of an increase in customer volume (lending to the public increased by around 4.2% YoY), which compensated an increase in expenses by 9% YoY partly driven by increased personnel costs in areas including compliance and sales. SBAB reported an increase in its ROE to 12.7% (11.6%), above the bank's 10% target.

After a number of strategic changes in the last years, management announced in the third quarter of 2014 that the bank would focus on its mortgage lending business. Furthermore, in 2015, the strategy included growing its business under its own brand and decreasing its partnerships with other loan originators. The bank has an overarching target to achieve a return on equity of at least 10% while keeping the CET1 ratio at least 1.5% above the 24.9% estimated requirement in the second quarter of 2017 (based on Finansinspektionen's criteria). To enhance customer offerings, in January 2016 SBAB acquired a majority stake in Booli - one of Sweden's largest housing sites and search engines for homes - which is included in SBAB's retail operations. At year-end 2016 SBAB held 69% of Booli but have an option to acquire the remaining shares at a later date.

SBAB is already an efficient bank - with Moody's adjusted cost to income ratio being 29.4% in the first six months of 2017 and 29.2% in 2016 - because it operates without retail branches and originates loans through the internet, by telephone, or via other distribution channels, including agreements with independent savings banks, domestic financial institutions and real estate brokers.

Whilst efficiency is a strength, SBAB's profitability has historically been weak and volatile (see Exhibit 3), with its reported return on equity fluctuating between 4% and 13% in the last decade. Going forward we expect earnings to remain stable because fair valuation volatility, previously caused by their portfolio of liquid securities, will be contained through more efficient use of hedge accounting, similarly to other Swedish banks.

Exhibit 3

SBAB's Cost to Income Ratio and Return on Equity

Source: Moody's Financial Metrics

We consider SBAB's business model to be less diversified than that of a full-service bank and we reflect this in a negative adjustment for business diversification, an adjustment shared with other mortgage lenders in Sweden.

High reliance on market funding but deposit base is increasing

We view SBAB's significant reliance on market funding as a weakness - albeit mitigated by the fact that a large portion of the funding is local currency denominated covered bonds, recent efforts to increase funding duration - and a sustained increase in deposit funding.

SBAB's high reliance on confidence sensitive wholesale funding – debt securities in issue and liabilities to credit institution represented around 69% of the balance sheet at end-June 2017 – is a structural weakness. Additionally, a significant proportion of its market funding is short term (15% of total securities in issue had a maturity less than 12 months), whilst we note that foreign currency funding accounted for 34% of the total securities in issue at same date.

However, a number of factors mitigate this weakness. SBAB's Aaa rated covered bonds account for more than half of its long term funding; and by the end of June 2017, 72% of these were SEK denominated. These securities benefit from a deep local market and we reflect this feature by treating covered bonds denominated in local currency as retail funding, an adjustment shared with other Swedish banks.

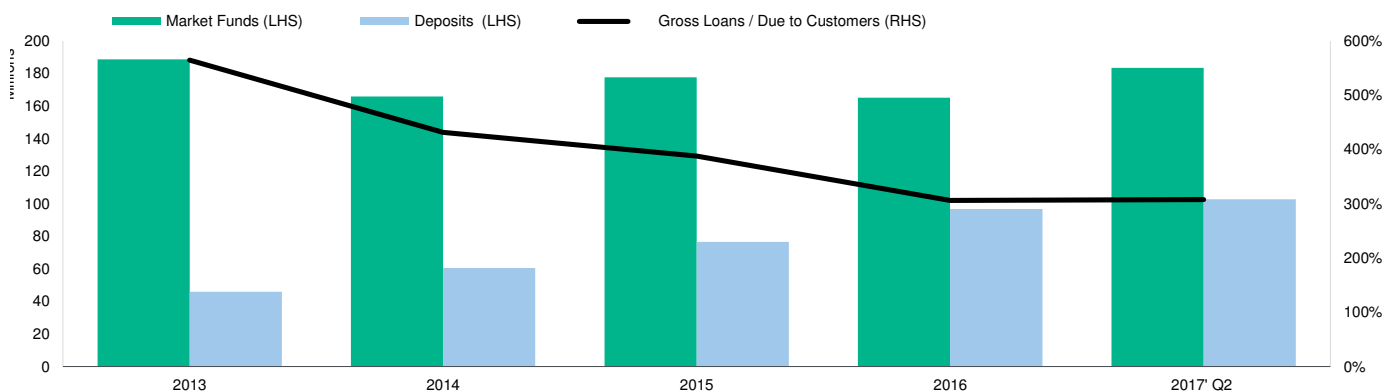
SBAB's funding profile has improved over the last year following the strategic aim to extend the maturity, with successful benchmark issues in the first quarters of 2017, and reducing foreign currency exposures. In January, a EUR 1 billion seven-year covered bond was issued, in February a SEK 5 billion nine-year covered bond was issued and in March a EUR 750 million ten-year covered bond was issued. Issues in 2Q included a SEK 3 billion five-year unsecured bond in the Swedish market. The increased maturities on individual issues, which shows the ability of the bank to tap the market with long maturities, has extend the average debt maturity profile to 3.4 years by end-June 2017, from 2.9 years at December 2016. This is comparable to peers in Sweden where investors typically demand maturities shorter than 5 years, but shorter than the average debt maturity profile for EU peers.

Concurrently SBAB has actively reduced reliance on market funding through further diversification into deposits, thereby reducing its gross loans/deposits ratio to 307% at end-June 2017 from 432% in 2014. Customer deposits were 25% of total liabilities at end-June 2017, compared with 14% at end-2013. We view the increase in deposits as a sustainable improvement that provides the bank with relatively sticky funding given the gradual and granular increase in the flow of new depositors.

Exhibit 4

SBAB's gradual increase in deposits is sustainable

Market funds and Deposits in SEK Billion, Gross Loans/Due to Customers in percent



Source: Moody's financial metrics

The assigned funding score of baa2 reflects the high reliance on market funding, the deep market for SEK denominated covered bonds and a sustained increase in deposits.

SBAB's liquidity position is adequate, as captured by the baa2 assigned liquid resources score. Liquid banking assets, consisting of highly rated securities, totaled SEK74 billion at end-June 2017. SBAB's reported LCR was 240% and its liquid banking assets were 21.3% of its tangible banking assets at same date, the highest among peers.

SBAB will continue showing very low loan loss provisions but tail risks remain.

SBAB's reported problem loans ratio at end-June 2017 was very low at 0.09%. In line with other Swedish mortgage lenders, SBAB's asset quality has remained stable for decades. The high quality of assets is reflected in our aa3 asset risk score.

SBAB's SEK316 billion lending book comprises almost only mortgages: single-family dwellings (37% of the lending book at end-June 2017), tenant-owner rights (35%), tenant-owner associations (16%), and private multi-family dwellings (10%). The remaining part is marginal and includes exposure to commercial properties and unsecured lending. The large majority of the loans is concentrated in the Stockholm and Öresund region (around 80% of the lending book). We note that SBAB has extended residential mortgages with a high LTV above 70%, although, in line with the legislation, loans are capped at 85% LTV and require amortization down to 50%. At end 2Q 2017 the average LTV in SBAB's mortgage portfolio was 60%.

Although SBAB'S loan book decreased during the fourth quarter of 2016, largely due to the transfer of Sparbanken Öresund's loan portfolio to Swedbank, the loan book increased by 4.2% to SEK 316bn at end-June 2017 compared to SEK303bn at end-June 2016 (SEK 296 billion at end-2016). While we view this as a positive development for credit quality compared to the 2015 growth, when SBAB's retail mortgage lending grew at almost twice the speed as the mortgage market (16.7% and 8.4% respectively), we expect that the bank will continue its credit expansion at a faster pace than the market average. We do not expect to see a significant increase in problem loans over the outlook period, but note potential tail-risk related to increased interest rates or falls in property prices, because loan growth has been high during a period of very low interest rates and strong property price appreciation. Like most other banks, the share of total lending with a 3-month fixed-interest period amounted to 68.3% at end-June 2017. These borrowers are more exposed to interest rate changes. Other considerations include high lending growth and price appreciation in the Swedish property market although we see a cooling effect on the market post amortization requirement (see appendix). However, we expect Swedish banks' consumer lending, SME, and CRE exposures to be hit before residential mortgages. SBAB's exposure to commercial properties is low at 1.4% as of end-June 2017 of the loan book.

We do note a number of mitigants due to good underwriting standards and full recourse on mortgages. SBAB conducts a 7% interest rate stress tests on borrowers during the application process, as is usual in Sweden. Furthermore SBAB conducts stress tests on its stock of loans with severe scenarios of higher interest rates, high unemployment and dramatic drops in property prices. In these stressed scenarios, the bank does well with loan losses not exceeding yearly profits. The bank has gradually imposed stricter underwriting

standards during recent years that has both reduced debt-to-income and LTV in new lending. We also expect the full recourse on mortgages and the values of collateral to limit losses in the loan portfolio, even in an economic downturn.

The assigned asset risk score of aa3 reflects the macro adjusted score of aa1 and two negative notches due to the expected high lending growth and the large exposure to the retail mortgage sector.

Good capitalisation but weak leverage ratio

We view SBAB's capital position as adequate given its risk profile, resulting in an assigned capital score of a1 - a relative strength for the rating. SBAB has one of the highest risk weighted capital ratios among peers and the aa1 macro adjusted score is aligned with baa1 BCA peers. As with other Swedish banks, we apply -3 negative notches to our capital score for nominal leverage, resulting in an a1 assigned capital score.

SBAB uses the internal ratings based approach to calculate its risk-weighted assets. At end-June 2017, SBAB reported a Common Equity Tier 1 (CET1) ratio of 31.4% (2016: 32.2%) and a Tangible Common Equity on risk-weighted assets under Moody's definition of 39.2%, which includes SBAB's SEK3 billion additional Tier 1 (AT1) capital instruments.

Due to the 100% government ownership, SBAB is not a listed company, hence it does not have direct access to the equity capital markets, this is a weakness as it limits the bank's ability to raise capital.

At end-June 2017, SBAB's Tangible Common Equity to Tangible Assets ratio was 3.95%, which includes the AT1 securities issued in 2015 and 2016. The difference between the risk-based ratio and the leverage is due to the use of the internal ratings based approach for calculating its capital requirements where household mortgages receive very low risk weighted averages. The regulatory risk weight floor of 25% is applied in Pillar II and does not affect the risk based ratio calculations.

SBAB's BCA is supported by Sweden's Very Strong- macro profile

Sweden's (Aaa stable) Macro Profile benefits from a competitive and diverse economy, robust public institutions and a stable political environment that supports consensus orientated policy making. However, we view Swedish households' debt levels (around 80% of which consist of mortgages) and the multi-year growth in household debt as key vulnerabilities to the financial system.

Although the banking system is concentrated around four banks, we believe that competition in the Swedish banking industry is healthy. On a negative note, Swedish banks are structurally reliant on market funding and that exposes them to swings in investor sentiment; this risk is partially mitigated because: (i) Sweden has its own currency and, (ii) domestic investors hold almost three quarters of the country's bonds.

Notching Considerations

Loss Given Failure

We apply our advance loss-given-failure analysis to SBAB as it is subject to the EU Bank Recovery and Resolution Directive (BRRD), which we consider to be an Operational Resolution Regime. We assume residual tangible common equity of 3% and losses post-failure of 8% of tangible banking assets, a 25% run-off in "junior" wholesale deposits, a 5% run-off in preferred deposits, and assign a 25% probability to deposits being preferred to senior unsecured debt, in line with our standard assumptions. Particular to SBAB and other Swedish pure mortgage lenders, we assume the proportion of deposits considered junior at 10%, relative to our standard assumption of 26%, due to their largely retail oriented depositor base.

Based on SBAB's balance sheet structure at end-June 2017, our Advanced LGF Analysis indicates that deposits are likely to face a very low loss given failure, due to the loss absorption provided by subordinated debt and preference shares and, potentially, by senior unsecured debt should deposits be treated preferentially in a resolution, as well as the volume of deposits assumed as junior. This suggests a preliminary rating assessment (PRA) of A2, two notches above the BCA.

Similarly, senior long term debt is likely to face a very low loss given failure, which leads to a PRA of A2.

Junior securities are likely to face a high loss given failure due to the loss absorption provided by its own very modest volume and the amount of debt subordinated to it, resulting in a rating of Baa2.

SBAB's deposit and senior unsecured debt ratings are positioned at A1/Prime-1, and take into account the bank's baa1 BCA, our view of a very low loss given failure on these instruments, resulting in two notches of LGF uplift.

Government Support

SBAB is fully owned by the Swedish government and has a meaningful market share in the Swedish residential mortgage market. This guides our expectation of a moderate probability of government support from Sweden (Aaa stable) for SBAB's deposit and senior unsecured debt results in a one notch rating uplift for each of the debt classes.

Rating Methodology and Scorecard Factors

Exhibit 5

SBAB Bank AB (publ)

Macro Factors

Weighted Macro Profile **Very Strong -** **100%**

Factor	Historic Ratio	Macro Adjusted Score	Credit Trend	Assigned Score	Key driver #1	Key driver #2
Solvency						
Asset Risk						
Problem Loans / Gross Loans	0.1%	aa1	← →	aa3	Quality of assets	Sector concentration
Capital						
TCE / RWA	39.2%	aa1	← →	a1	Nominal leverage	
Profitability						
Net Income / Tangible Assets	0.4%	baa3	← →	ba1	Return on assets	Expected trend
Combined Solvency Score		aa3		a2		
Liquidity						
Funding Structure						
Market Funds / Tangible Banking Assets	44.2%	b1	← →	baa2	Market funding quality	
Liquid Resources						
Liquid Banking Assets / Tangible Banking Assets	19.0%	baa2	← →	baa2	Stock of liquid assets	
Combined Liquidity Score		ba2		baa2		
Financial Profile						
Business Diversification				-1		
Opacity and Complexity				0		
Corporate Behavior				0		
Total Qualitative Adjustments				-1		
Sovereign or Affiliate constraint:				Aaa		
Scorecard Calculated BCA range				a3-baa2		
Assigned BCA				baa1		
Affiliate Support notching				0		
Adjusted BCA				baa1		

Balance Sheet	in-scope (SEK million)	% in-scope	at-failure (SEK million)	% at-failure
Other liabilities	229,417	56.3%	236,605	58.0%
Deposits	102,675	25.2%	95,488	23.4%
Preferred deposits	92,408	22.7%	87,787	21.5%
Junior Deposits	10,268	2.5%	7,701	1.9%
Senior unsecured bank debt	58,962	14.5%	58,962	14.5%
Dated subordinated bank debt	4,439	1.1%	4,439	1.1%
Equity	12,232	3.0%	12,232	3.0%
Total Tangible Banking Assets	407,725	100%	407,725	100%

Debt class	De Jure waterfall		De Facto waterfall		Notching		LGF Notching Guidance vs. Adjusted BCA	Assigned LGF notching	Additional notching	Preliminary Rating Assessment
	Instrument volume + subordination	Sub-ordination	Instrument volume + subordination	Sub-ordination	De Jure	De Facto				
Counterparty Risk Assessment	20.4%	20.4%	20.4%	20.4%	3	3	3	3	0	a1 (cr)
Deposits	20.4%	4.1%	20.4%	18.5%	2	3	2	2	0	a2
Senior unsecured bank debt	20.4%	4.1%	18.5%	4.1%	2	2	2	2	0	a2
Dated subordinated bank debt	4.1%	3.0%	4.1%	3.0%	-1	-1	-1	-1	0	baa2
Non-cumulative bank preference shares	3.0%	3.0%	3.0%	3.0%	-1	-1	-1	-1	-2	ba1 (hyb)

Instrument class	Loss Given Failure notching	Additional Notching	Preliminary Rating Assessment	Government Support notching	Local Currency Rating	Foreign Currency Rating
Counterparty Risk Assessment	3	0	a1 (cr)	1	Aa3 (cr)	--
Deposits	2	0	a2	1	A1	A1
Senior unsecured bank debt	2	0	a2	1	A1	A1
Dated subordinated bank debt	-1	0	baa2	0	Baa2	(P)Baa2
Non-cumulative bank preference shares	-1	-2	ba1 (hyb)	0	Ba1 (hyb)	--

Source: Moody's Financial Metrics

Ratings

Exhibit 6

Category	Moody's Rating
SBAB BANK AB (PUBL)	
Outlook	Stable
Bank Deposits	A1/P-1
Baseline Credit Assessment	baa1
Adjusted Baseline Credit Assessment	baa1
Counterparty Risk Assessment	Aa3(cr)/P-1(cr)
Issuer Rating	A1
Senior Unsecured	A1
Subordinate -Dom Curr	Baa2
Pref. Stock Non-cumulative -Dom Curr	Ba1 (hyb)
Commercial Paper	P-1
Other Short Term	(P)P-1

Source: Moody's Investors Service

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