

CREDIT OPINION

22 November 2016

Update

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RATINGS

SBAB Bank AB (publ)

Domicile	Sweden
Long Term Debt	A2
Type	Senior Unsecured - Fgn Curr
Outlook	Positive
Long Term Deposit	A2
Type	LT Bank Deposits - Fgn Curr
Outlook	Positive

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.

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SBAB Bank AB (publ)

Semiannual Update

Summary Rating Rationale

On 21 October 2016, we affirmed SBAB Bank AB (publ) (SBAB)'s deposit and senior debt ratings at A2/P-1, underpinned by: (1) the bank's baa2 standalone baseline credit assessment (BCA); (2) the low expected loss given failure under our Advanced Loss Given Failure (LGF) analysis; and (3) our assessment of a moderate probability of government support. We also affirmed the long-term issuer rating at A2, the subordinated debt rating at (P)Baa3, and the Counterparty Risk Assessment (CR Assessment) at A1(cr)/Prime-1(cr). At the same time, we changed the outlook to positive from stable.

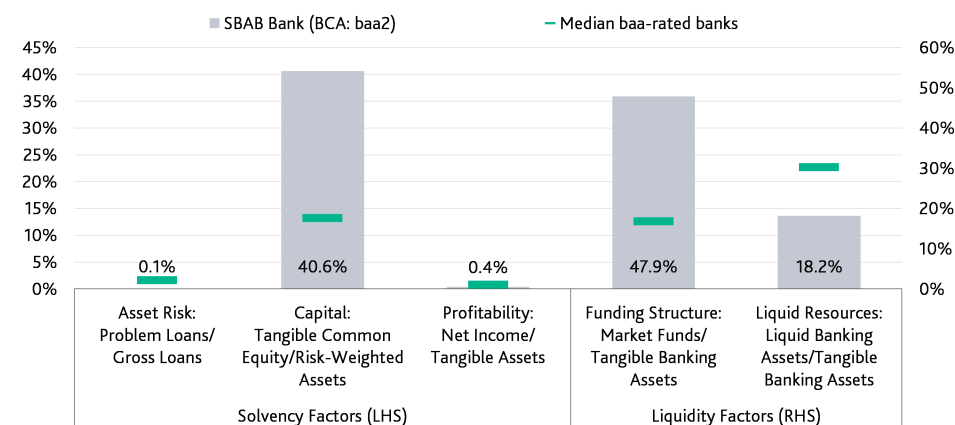
The change in outlook to positive reflects our expectations that the bank's historically volatile earnings will stabilise at current levels or even increase slightly, while its funding profile will continue to improve, which would bring SBAB's credit profile more in line with baa1-BCA peers.

SBAB's baa2 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 historically limited profitability and high market funding reliance, which renders the bank more vulnerable to investor sentiment. Nevertheless we acknowledge that the bank has increased its deposit funding and improved its maturity profile in recent years, and view SBAB's low profitability and limited capital generating ability in the context of its limited credit risk as a mortgage lender.

Exhibit 1

Rating Scorecard - Key Financial Ratios

SBAB Bank's scorecard ratios compared to the median for banks with baa2 BCA



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
- » SBAB's BCA is supported by Sweden's Very Strong- Macro Profile

Credit Challenges

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

Rating Outlook

The positive outlook on SBAB's long-term ratings primarily reflects our expectation 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. SBAB recorded net income over tangible assets of 0.38% at H1 2016 and NIM of 0.70%.

The other key driver for the change in outlook is the expectation that SBAB will continue to reduce reliance on market funding through further diversification into deposits, thereby reducing its gross loans to deposits ratio of 344% at end-June 2016, as well as extending the bank's average maturity profile of its market debt.

Factors that Could Lead to an Upgrade

As implied by the rationale supporting the positive outlook on SBAB's ratings, the ratings could be upgraded if (1) the recent improvement in SBAB's funding profile proves sustainable and deposits exhibit stability if their price level reduces; and/or (2) profitability is sustained without a corresponding increase in risk profile.

Factors that Could Lead to a Downgrade

Although a low-probability scenario given the positive outlook currently assigned to SBAB's ratings, SBAB's senior unsecured ratings could be downgraded 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).

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.com for the most updated credit rating action information and rating history.

Key Indicators

Exhibit 2

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

	9-16 ²	12-15 ²	12-14 ²	12-13 ³	12-12 ³	Avg.
Total Assets (SEK million)	387,899.0	371,437.0	334,592.0	330,589.0	334,428.0	3.8 ⁴
Total Assets (EUR million)	40,288.5	40,558.2	35,322.1	37,354.8	38,992.5	0.8 ⁴
Total Assets (USD million)	45,276.2	44,058.2	42,741.6	51,472.8	51,407.4	-3.1 ⁴
Tangible Common Equity (SEK million)	16,600.0	13,065.0	10,853.0	9,539.0	8,683.0	17.6 ⁴
Tangible Common Equity (EUR million)	1,724.1	1,426.6	1,145.7	1,077.9	1,012.4	14.2 ⁴
Tangible Common Equity (USD million)	1,937.6	1,549.7	1,386.4	1,485.2	1,334.7	9.8 ⁴
Problem Loans / Gross Loans (%)	0.1	0.1	0.1	0.1	0.1	0.1 ⁵
Tangible Common Equity / Risk Weighted Assets (%)	40.6	34.2	31.7	23.2	15.3	35.5 ⁶
Problem Loans / (Tangible Common Equity + Loan Loss Reserve) (%)	1.9	2.2	2.4	2.1	2.9	2.3 ⁵
Net Interest Margin (%)	0.7	0.7	0.6	0.6	0.6	0.6 ⁵
PPI / Average RWA (%)	5.1	4.2	4.5	1.1	0.5	4.6 ⁶
Net Income / Tangible Assets (%)	0.4	0.3	0.4	0.3	0.1	0.3 ⁵
Cost / Income Ratio (%)	29.6	33.7	33.7	40.9	58.3	39.3 ⁵
Market Funds / Tangible Banking Assets (%)	47.0	47.9	49.6	57.1	85.8	57.5 ⁵
Liquid Banking Assets / Tangible Banking Assets (%)	19.2	18.2	19.6	19.7	17.3	18.8 ⁵
Gross loans / Due to customers (%)	326.8	387.8	431.8	564.7	926.7	527.6 ⁵

[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] Compound Annual Growth Rate based on IFRS reporting periods [5] IFRS reporting periods have been used for average calculation [6] Basel III - fully-loaded or transitional phase-in & IFRS reporting periods have been used for average calculation

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 historically volatile earnings

SBAB is a government-owned Swedish bank that provides residential mortgages, loans and savings services to individuals, corporates and tenant-owner associations; its mortgage market share at end-September 2016 was 7.7%. Our assigned Profitability score of ba1 reflects the bank's historically low and volatile earnings but also acknowledges the bank's improvement in profitability in recent years and its low cost to income ratio.

SBAB's reported pre-tax income in 3Q16 was SEK534 million compared with SEK378 million one year earlier, driven by higher volume (lending to the public increased by around 7% year on year) and reduced interest expenses, equating an annualised return on equity of 12.3%. 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 requirement set by the Swedish Financial Supervisory Authority (22.9% for SBAB in the second quarter 2016). To enhance growth in market share, in January 2016 SBAB purchased a 71% stake in Booli - one of Sweden's largest housing sites and search engines for homes - which is included in SBAB's retail operations. SBAB has also an option to acquire the remaining shares at a later date.

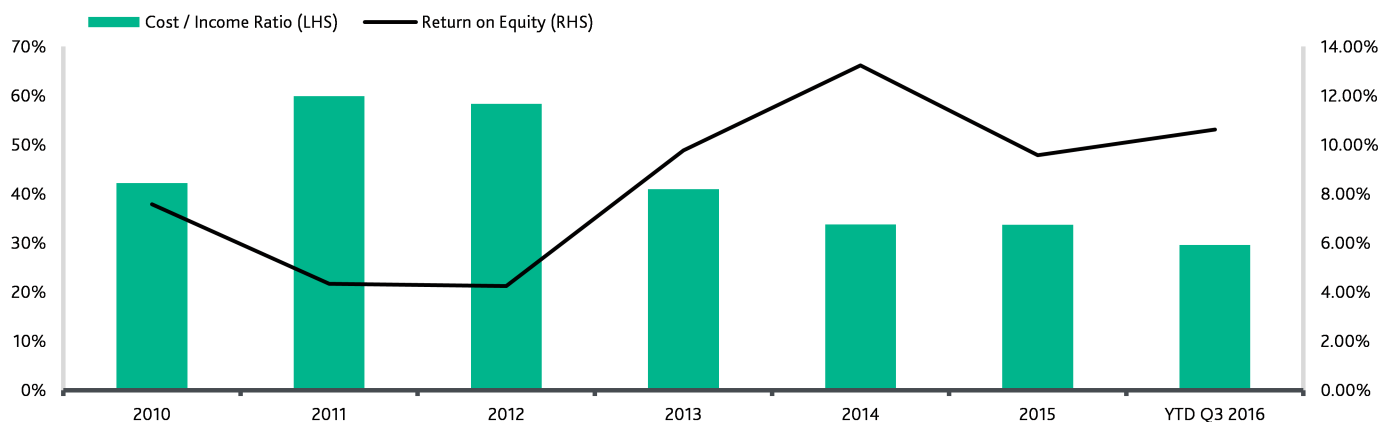
SBAB is already an efficient bank - reported cost-income ratio was 34% in 2015 and 30% in the first three quarters of 2016 - because it operates without branches and originates loans through the internet, by telephone, or via other distribution channels, including agreements with independent savings banks, domestic financial institutions and real estate brokers. With the strategy change to focus on the SBAB brand, the partnership agreements are expected to decrease. Although the loss of the additional business from those partnerships will affect growth rates, margins are expected to be higher as SBAB focuses on direct customer lending.

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. The low profitability reflects the bank's mortgage focus, its lack of scale, and the government ownership.

Exhibit 3

SBAB's Cost to Income Ratio and Return on Equity

Efficient bank with volatile profitability



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 all the pure mortgage lenders in Sweden.

Low loans losses

SBAB's reported problem loans ratio at end-September 2016 was very low at 0.1%. In line with other Swedish mortgage lenders, SBAB's asset quality has benefitted from low interest rates and increasing property prices; additionally, it is easy for Swedish households to service their largely non-amortising debts. The high quality of assets is reflected in our aa2 asset risk score.

SBAB's SEK305 billion lending book comprises almost only mortgages: single-family dwellings (38% of the lending book at end-September 2016), tenant-owner rights (34%), tenant-owner associations (17%), and private multi-family dwellings (9%). 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 amortisation down to 50%. At end-September 2016 the average LTV in SBAB's mortgage portfolio was 64%.

2016 SBAB's annual growth in household mortgage lending was 8.4% at end-September, in line with the overall growth in Swedish household mortgages at 8.2%. 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 still note some residual risk from the unseasoned parts of the loan book. 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, because the loan growth has been high during a period of very low interest rates.

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 uses the internal ratings based approach to calculate its risk-weighted assets. At end-September 2016, SBAB reported a Common Equity Tier 1 (CET1) ratio of 28.5% (2015: 28.6%) and a Tangible Common Equity on risk-weighted assets under Moody's definition of 40.6%, which includes SBAB's SEK3 billion additional Tier 1 (AT1) capital instruments.

Due to the 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.

SBAB's Basel III leverage ratio of 3.77% is weak but improving and in line with other Swedish mortgage lenders. The Tangible Common Equity on Tangible Assets ratio was 4.3% at end-September 2016, 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.

High reliance on market funding mitigated by increased funding duration

We view SBAB's significant reliance on market funding as a weakness - albeit mitigated by the fact that most of the funding is secured (covered bonds denominated in local currency) and by recent efforts to increase funding duration - and its liquidity position is adequate. Our baa3 combined liquidity score reflects this view.

SBAB's high reliance on confidence sensitive wholesale funding – debt securities in issue and liabilities to credit institution represented 69% of the balance sheet at end-September 2016 – is a structural weakness. Additionally, a significant proportion of its market funding is short term (20% of total securities in issue had a maturity less than 12 months at end-2015), 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. Firstly, SBAB's Aaa rated covered bonds account for more than half of its long-term funding; 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. Secondly, SBAB's funding profile has improved over the last year following the strategic aim to extend the maturity and reduce foreign currency exposures. Finally, SBAB has successfully increased its deposit base over the last years. Customer deposits were 24% of total balance sheet at end-September 2016 compared with 14% at end-2013; this increase is credit positive, although we note that it has been achieved by offering competitive internet deposit rates and that we consider internet-sourced deposit as less sticky than branch-sourced.

SBAB's liquidity position is adequate, as captured by our baa2 assigned liquid resources score. Liquid banking assets at end-September 2016 totalled SEK74 billion. SBAB's reported LCR was 191% and its liquid banking assets were 19.15% of its tangible banking assets at same date.

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-September 2016, 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 a3, 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 a3.

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 Baa3.

SBAB's deposit and senior unsecured debt ratings are positioned at A2/Prime-1, and take into account the bank's baa2 BCA, our view of a very low loss given failure on these instruments, resulting in two notches of LGF uplift, and a moderate assessment of government support from Sweden, in case of need, providing one further notch of rating uplift.

Government Support

SBAB is fully owned by the Swedish government and has a meaningful market share in the Swedish residential mortgage market (7.7%). 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 4

SBAB Bank AB (publ)

Macro Factors

Weighted Macro Profile	Very Strong -	100%
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Financial Profile

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	← →	aa2	Quality of assets	
Capital						
TCE / RWA	40.6%	aa1	← →	a1	Nominal leverage	
Profitability						
Net Income / Tangible Assets	0.4%	ba2	← →	ba1	Return on assets	
Combined Solvency Score		aa3		a2		
Liquidity						
Funding Structure						
Market Funds / Tangible Banking Assets	47.9%	b1	← →	baa3	Market funding quality	
Liquid Resources						
Liquid Banking Assets / Tangible Banking Assets	18.2%	baa2	← →	baa2	Stock of liquid assets	
Combined Liquidity Score		ba2		baa3		
Financial Profile				a3		
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				baa2		
Affiliate Support notching				0		
Adjusted BCA				baa2		

Balance Sheet

	in-scope (SEK million)	% in-scope	at-failure (SEK million)	% at-failure
Other liabilities	210,767	54.4%	217,304	56.0%
Deposits	93,390	24.1%	86,853	22.4%
Preferred deposits	84,051	21.7%	79,848	20.6%
Junior Deposits	9,339	2.4%	7,004	1.8%
Senior unsecured bank debt	67,527	17.4%	67,527	17.4%
Dated subordinated bank debt	4,450	1.1%	4,450	1.1%
Junior subordinated bank debt				
Preference shares (bank)				
Senior unsecured holding company debt				
Dated subordinated holding company debt				
Junior subordinated holding company debt				
Preference shares (holding company)				
Equity	11,633	3.0%	11,633	3.0%
Total Tangible Banking Assets	387,767	100%	387,767	100%

Debt class	De jure waterfall		De facto waterfall		Notching		LGF notching guidance versus 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	23.4%	23.4%	23.4%	23.4%	3	3	3	3	0	a2 (cr)
Deposits	23.4%	4.1%	23.4%	21.6%	2	3	2	2	0	a3
Senior unsecured bank debt	23.4%	4.1%	21.6%	4.1%	2	2	2	2	0	a3
Dated subordinated bank debt	4.1%	3.0%	4.1%	3.0%	-1	-1	-1	-1	0	baa3
Non-cumulative bank preference shares	3.0%	3.0%	3.0%	3.0%	-1	-1	-1	-1	-2	ba2 (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	a2 (cr)	1	A1 (cr)	--
Deposits	2	0	a3	1	A2	A2
Senior unsecured bank debt	2	0	a3	1	A2	A2
Dated subordinated bank debt	-1	0	baa3	0	Baa3	Baa3
Non-cumulative bank preference shares	-1	-2	ba2 (hyb)	0	Ba2 (hyb)	--

Source: Moody's Financial Metrics

Ratings

Exhibit 5

Category	Moody's Rating
SBAB BANK AB (PUBL)	
Outlook	Positive
Bank Deposits	A2/P-1
Baseline Credit Assessment	baa2
Adjusted Baseline Credit Assessment	baa2
Counterparty Risk Assessment	A1(cr)/P-1(cr)
Issuer Rating	A2
Senior Unsecured	A2
Subordinate -Dom Curr	Baa3
Pref. Stock Non-cumulative -Dom Curr	Ba2 (hyb)
Commercial Paper	P-1
Other Short Term	(P)P-1

Source: Moody's Investors Service

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