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Research Update:

Government-Owned Swedish Mortgage Lender SBAB Affirmed At 'A/A-1' And 'K-1'; Outlook Remains Negative

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Overview

- SBAB has continued to increase its deposit base and we no longer see funding risk as a downside risk.
- The bank's repositioned strategy since 2014 has stabilized earnings.
- We are therefore affirming our counterparty ratings on SBAB at 'A/A-1', as well as our 'K-1' regional scale rating.
- The outlook is negative, reflecting our view of increasing economic risks in Sweden as a result of growing imbalances associated with household debt.

Rating Action

On Dec. 19, 2016, S&P Global Ratings affirmed its 'A' long-term and 'A-1' short-term counterparty credit rating on 100% government-owned Swedish mortgage lender SBAB Bank AB (publ). The outlook is negative. At the same time, we affirmed the 'K-1' Nordic regional scale rating.

Rationale

The affirmation reflects our view that the bank's 2014 strategy has reinforced its earnings stability. While revenues are concentrated to the Swedish property market, SBAB's customer base has grown along with the increasing deposit base.

As Sweden's fifth-largest bank, SBAB's primary business focus is domestic mortgage lending to private individuals and tenant-owned associations. Over the past several years, the bank has been able to increase its market share to about 7%-8% within retail mortgages. This has been aided by SBAB's efficient cost structure, as clients are served only by phone and internet. This enables a cost-to-income ratio of about 32%, which is among the lowest levels when compared with Nordic and European peers. As such, we continue to view SBAB's business position as adequate.

As of June 30, 2016, SBAB's risk-adjusted capital (RAC) ratio was 13.4%, which is commensurate with a strong capital and earnings profile. From year-end 2015, the bank's RAC ratio has improved to over 100 basis points (bps) thanks to retained earnings growth and issuance of additional Tier 1 (AT1) hybrid capital instruments, offsetting some risk-weighted asset growth. We anticipate

over the next 18-24 months that SBAB's RAC ratio will remain about 13.5%-14.0%. This is supported by our expectation of annual mortgage lending growth of 5%-7% and that the bank's earnings buffer will continue to be near 100bps-110bps.

SBAB's loan portfolio remains concentrated on residential real estate risk in Sweden. This is particularly apparent in light of the nearly 14% growth for 2015 within its dominant market of retail mortgages. While our main scenario is that a shock to the Swedish system would predominantly affect private consumption and impact primarily the small and midsize companies, we do believe that increasing economic imbalances could lead to losses if various risks for the household sector materialize. However, we anticipate new loan-loss provisions to be minimal, given the operating environment and the bank's average loan-loss rate of a mere 1 basis point for the past nine years running.

We view SBAB's funding to be average and liquidity to be adequate, given that the bank has continued to make strides to build its deposit base. As of third-quarter 2016, SBAB now captures nearly 4% of the retail deposit market in Sweden and core deposits represent 25% of the funding base. This is further seen in the improvement of SBAB's stable funding ratio, which as of Sept. 30, 2016, was 101.9% (up from 73.5% in 2010).

The bank has also actively worked to lengthen its maturity profile; the weighted average maturity is now approximately 2.9 years. This, in addition to building a large liquidity portfolio, has improved SBAB's ratio of broad liquid assets to short-term wholesale funding to 1.1x as of third-quarter 2016 from 0.4x in fourth-quarter 2010. While SBAB continues to have a relative reliance on wholesale funding, we now believe its broader funding metrics will continue to converge nearer the levels of Nordic peers.

Outlook

The negative outlook on SBAB reflects our view that economic imbalances in Sweden have been increasing at an unsustainable rate. In particular, household debt continues to increase unabated, and given the rapid pace of house price appreciation, we believe that economic risks will continue to rise if the measures introduced by the Swedish regulator fail to mitigate such developments.

As such, our negative outlook accounts for the at least one-in-three likelihood that we could downgrade SBAB by one notch over the next two years if we believed that efforts to inhibit further debt accumulation or house price appreciation were derailed, leading us to increase the economic risk scoring used in our Banking Industry Country Risk Assessment for the Swedish economy. This would in turn lead us to revise downward our assessment of SBAB's anchor to 'bbb+' and to assign a higher risk weight to SBAB's domestic loan exposures in our RAC ratio. In such a scenario, we anticipate SBAB's sound capital level and risk position would prevent a two-notch downgrade.

We could revise the outlook to stable if we see Swedish economic imbalances stabilizing, indicated by a more balanced development of household debt. In addition to this, further improvements in SBAB's capital position could lead us to revise our outlook to stable; however, we see this as unlikely over the next 18-24 months.

Ratings Score Snapshot

Issuer Credit Rating	A/Negative/A-1
SACP	a-
Anchor	a-
Business Position	Adequate (0)
Capital and Earnings	Strong (+1)
Risk Position	Moderate (-1)
Funding and Liquidity	Average and Adequate (0)
Support	(+1)
ALAC Support	(0)
GRE Support	(+1)
Group Support	(0)
Sovereign Support	(0)
Additional Factors	(0)

Related Criteria

- General Criteria: Rating Government-Related Entities: Methodology And Assumptions, March 25, 2015
- Criteria - Financial Institutions - Banks: Bank Hybrid Capital And Nondeferrable Subordinated Debt Methodology And Assumptions, Jan. 29, 2015
- General Criteria: National And Regional Scale Credit Ratings, Sept. 22, 2014
- General Criteria: Group Rating Methodology, Nov. 19, 2013
- Criteria - Financial Institutions - Banks: Quantitative Metrics For Rating Banks Globally: Methodology And Assumptions, July 17, 2013
- Criteria - Financial Institutions - Banks: Revised Market Risk Charges For Banks In Our Risk-Adjusted Capital Framework, June 22, 2012
- Criteria - Financial Institutions - Banks: Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 09, 2011
- Criteria - Financial Institutions - Banks: Banks: Rating Methodology And Assumptions, Nov. 09, 2011
- Criteria - Financial Institutions - Banks: Bank Capital Methodology And

Assumptions, Dec. 06, 2010

- Criteria - Financial Institutions - Banks: Methodology For Mapping Short- And Long-Term Issuer Credit Ratings For Banks, May 04, 2010
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009
- Criteria - Financial Institutions - Banks: Commercial Paper I: Banks, March 23, 2004

Ratings List

Ratings Affirmed

SBAB Bank AB (publ)

Counterparty Credit Rating	A/Negative/A-1
Nordic Regional Scale	--/--/K-1
Senior Unsecured	A
Subordinated	BBB
Junior Subordinated	BB+
Commercial Paper	A-1
Commercial Paper	K-1

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Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.globalcreditportal.com and at spcapitaliq.com. All ratings affected by this rating action can be found on the S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following S&P Global Ratings numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; Stockholm (46) 8-440-5914; or Moscow 7 (495) 783-4009.

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