

03 Apr 2020 | Downgrade

## Fitch Downgrades Swedbank's Long-Term IDR to 'A+', Outlook Stable

Fitch Ratings-Warsaw-03 April 2020:

Fitch Ratings has downgraded Swedbank AB's Long-Term Issuer Default Rating (IDR) to 'A+' from 'AA-' and Viability Rating (VR) to 'a+' from 'aa-'. The Outlook on the Long-Term IDR is Stable. We have also reviewed and resolved ratings placed under criteria observation (UCO).

The downgrade is driven by our view that Swedbank's risk controls are no longer commensurate with a rating in the 'AA' range following confirmation of deficiencies in anti-money laundering (AML) controls.

In March 2020, the Swedish and Estonian financial regulators and Clifford Chance US LLP concluded in their separate investigations that Swedbank did not have adequate control over the money laundering and economic sanctions risk in its Baltic subsidiaries. The Swedish regulator fined Swedbank SEK4 billion (broadly equal to the bank's quarterly net profit) and issued a warning. The Estonian regulator obliged Swedbank to address shortcomings within six months. Clifford Chance's investigation found about USD5 million of suspicious transactions, which constitute potential sanction violations. Swedbank has informed the US Treasury's Office of Foreign Assets Control about these transactions. The bank remains subject to several other inquiries, of which from US authorities, which may result in a material fine.

Swedbank acknowledged deficiencies in AML controls and the new chief executive's strategic priority is to address most of them by end-2020. The bank has been strengthening its AML controls since spring 2019.

Swedbank AB; Long Term Issuer Default Rating; Downgrade; A+; RO:Sta  
 ; Short Term Issuer Default Rating; Downgrade; F1; RW: Off  
 ; Viability Rating; Downgrade; a+; RW: Off  
 ; Support Rating; Affirmed; 5  
 ; Support Rating Floor; Affirmed; NF  
 ; Derivative Counterparty Rating; Affirmed; AA-(dcr); RW: Off  
 ---subordinated; Long Term Rating; Downgrade; A-; RW: Off  
 ---subordinated; Long Term Rating; Affirmed; BBB; RW: Off  
 ---Senior non-preferred; Long Term Rating; Downgrade; A+; RW: Off  
 ---Senior preferred; Long Term Rating; Affirmed; AA-; RW: Off  
 ---long-term deposits; Long Term Rating; New Rating; AA-  
 ---Senior preferred; Short Term Rating; Affirmed; F1+; RW: Off

---short-term deposits; Short Term Rating; New Rating; F1+

## Key Rating Drivers

### IDRS, VIABILITY RATING, SENIOR NON-PREFERRED DEBT

Within Swedbank's risk appetite, the key rating driver is the material shortcomings in AML risk controls. Swedbank has an ESG Relevance Score of '5' for governance structure due these shortcomings, as our assessment of the bank's risk appetite is highly relevant to the bank's rating. The bank received a long list of recommendations from the Estonian regulator regarding its customer due diligence, risk identification, organisational structure and risk reporting. Swedbank's ratings also reflect its low risk retail banking profile and robust financial metrics. The bank's franchise and the confidence of covered bond investors have been largely unaffected by the negative publicity.

The Stable Outlook reflects our expectation that the bank will progressively strengthen its controls to effectively combat and prevent money laundering and that these remedies will become structurally embedded in its corporate governance structure. The Outlook also reflects our view that Swedbank enters the economic downturn from the coronavirus outbreak from a relative position of strength at its rating level, given its strong asset quality, profitability and capitalisation.

We expect a significant deterioration in eurozone GDP growth and this is highly likely to be the case in Sweden as well. We revised our baseline eurozone GDP growth expectation for 2020 to a contraction of 4.2% in our latest forecast. As a result, we have revised our assessment of the Swedish operating environment to negative. The ultimate impact of the coronavirus outbreak will largely depend on its depth and duration, and the effectiveness of fiscal support for the private sector. Sweden has a strong social safety net and effective automatic stabilisers.

We expect Swedbank's asset quality to weaken moderately as the bank has limited direct exposure to industries that are more vulnerable to the coronavirus outbreak. However, its loan book is geographically concentrated in Sweden and thus strongly linked to the performance of the Swedish economy and sensitive to raising unemployment.

Swedbank is well capitalised with a common equity Tier 1 (CET1) and leverage ratios of 17% and 5.4%, respectively, at end-2019. Following the reduction of the Swedish countercyclical buffer to zero, we estimate the surplus CET1 capital above regulatory minimum at 1.6% of gross loans at end-2019 (2.2% if the 2019 dividend is cancelled). We expect Swedbank to maintain its solid capitalisation in light of its wholesale funding reliance and the need to maintain investor confidence.

Profitability headwinds will intensify due to reduced business volumes and rising loan impairment charges. Swedbank's wide net interest rate margins have sufficient space to absorb an upswing in wholesale funding costs and its operating cost efficiency should remain solid, despite costs related to the strengthening of its AML controls.

We do not expect immediate pressure on Swedbank's funding profile, given its ample liquidity and limited use of short-term debt. Swedbank relies significantly on covered bonds and this funding source has been reliable due to a strong captive domestic investor base. Senior bond issuance on international markets is limited. The bank's ample liquidity sufficiently covers its short-term refinancing needs and is sufficient to service even intensified drawdowns of committed credit facilities by companies. The bank's liquidity profile is also underpinned by available central bank's funding facilities.

#### SHORT-TERM RATING AND SENIOR NON-PREFERRED DEBT

Swedbank's Short-Term IDR of 'F1' is the lower of the two options mapping to a Long-Term IDR of 'A+'. This reflects our assessment of the bank's funding and liquidity factor at 'a+', compared with the minimum level of 'aa-' for a Short-Term IDR of 'F1+'.

Senior long-term non-preferred debt is rated in line with Swedbank's Long-Term IDR because it is a direct, unsecured and senior obligation of the bank. Fitch views the probability of default on the senior non-preferred debt as the same as the probability of default of the bank.

#### SENIOR PREFERRED DEBT, DERIVATIVE COUNTERPARTY RATING (DCR) AND DEPOSIT RATINGS

Fitch has affirmed and removed from UCO Swedbank's senior preferred debt and DCR at 'AA-', one notch above the bank's Long-Term IDR of 'A+', to reflect the protection that could accrue to senior preferred debt from the bank's junior resolution debt and equity buffers. The Swedish resolution authority has already set MREL for Swedbank. Only senior non-preferred or junior debt will be MREL-eligible in Sweden from 2022.

We also assigned Swedbank long and short-term deposit ratings of 'AA-/F1+', one notch above the bank's Long-Term IDR, because deposits benefit from the same protection as derivative counterparties and preferred senior creditors coming from the planned build-up of bank resolution debt and equity buffers.

#### SUPPORT RATING AND SUPPORT RATING FLOOR

Swedbank's Support Rating of '5' and Support Rating Floor of 'No Floor' reflect Fitch's view that senior creditors cannot rely on receiving extraordinary support from the Swedish sovereign in the event that the bank becomes non-viable. The EU's Bank Recovery and Resolution Directive provides a framework for resolving banks that is likely to require senior creditors participating in losses, if necessary, instead of, or ahead of, a bank receiving sovereign support.

#### SUBORDINATED DEBT AND OTHER HYBRID SECURITIES

Fitch has downgraded Swedbank's subordinated Tier 2 debt by two notches to 'A-' from 'A+' and removed from UCO. The first notch of the downgrade reflects the downgrade of Swedbank's VR, which is the anchor rating for the bank's subordinated Tier 2 debt rating. The second notch reflects the change in baseline notching for loss-severity to two notches from the VR instead of one previously. The bank does not meet the conditions under our criteria for applying one notch for loss severity.

We have affirmed the additional Tier 1 debt at 'BBB' and removed it from UCO to reflect a change in baseline notching to four notches (from the previous five) from the VR, reflecting a reduction in incremental non-performance risk relative to our previous assumptions. Our assessment is based on the bank operating with a CET1 ratio that is comfortably above maximum distributable amount thresholds and our expectation that this will continue.

## RATING SENSITIVITIES

### IDRS, VIABILITY RATING, SENIOR NON-PREFERRED DEBT

Factors that could, individually or collectively, lead to positive rating action/upgrade:

An upgrade would require evidence that the bank has fully addressed its shortcomings in AML controls in the Baltics; durable improvement in its risk-control framework clearly embedded in the bank's risk culture and board oversight; an increased certainty that further potential fines (particularly in the US) would not weaken its capital materially; and a clear resilience to economic fallout from the coronavirus outbreak.

Factors that could, individually or collectively, lead to negative rating action/downgrade:

The most immediate downside rating sensitivity for the bank's ratings relates to the economic and financial market fallout arising from the coronavirus outbreak. This represents a clear risk to our assessment of asset quality, earnings and capitalisation. The ratings could also be downgraded if the bank receives a substantial fine, leading to a material weakening of its capitalisation.

### DERIVATIVE COUNTERPARTY RATING, SENIOR PREFERRED DEBT, DEPOSIT RATINGS

Swedbank's DCR, long-term senior preferred debt and long-term deposit ratings are notched up from and are sensitive to the bank's Long-Term IDR. The ratings are also sensitive to changes in the bank's resolution buffer requirements, which would lead to a reduction of the level of protection.

### SENIOR NON-PREFERRED DEBT

Swedbank's senior non-preferred debt rating is sensitive to the bank's Long-Term IDR.

### SUPPORT RATING AND SUPPORT RATING FLOOR

An upgrade of the Support Rating and upward revision of the Support Rating Floor would be contingent on a positive change in the sovereign's propensity to support its banks. While not impossible, this is highly unlikely, in Fitch's view.

### SUBORDINATED DEBT AND OTHER HYBRID SECURITIES

The additional Tier 1 ratings could be downgraded if non-performance risk increases relative to the risk captured in Swedbank's VR, for example if capital buffers over regulatory requirements are eroded. The DCR, deposit and

senior preferred debt ratings are sensitive to changes in the bank's resolution buffer requirements which would lead to a reduction of the level of protection.

## Best/Worst Case Rating Scenario

### Best/Worst Case Rating Scenarios - Financial Institutions:

Ratings of Financial Institutions issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of four notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings <https://www.fitchratings.com/site/re/10111579>.

## REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

## ESG Considerations

Swedbank has an ESG Relevance Score of '5' for governance structure due to its shortcomings in money laundering controls, which has a negative impact on our assessment of the bank's risk appetite and is highly relevant to the rating.

Other ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or to the way in which they are being managed by the entity. For more information on our ESG Relevance Scores, visit [www.fitchratings.com/esg](http://www.fitchratings.com/esg).

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