

Q&A: Swedbank judgement and share price impacts on Swedish savings banks

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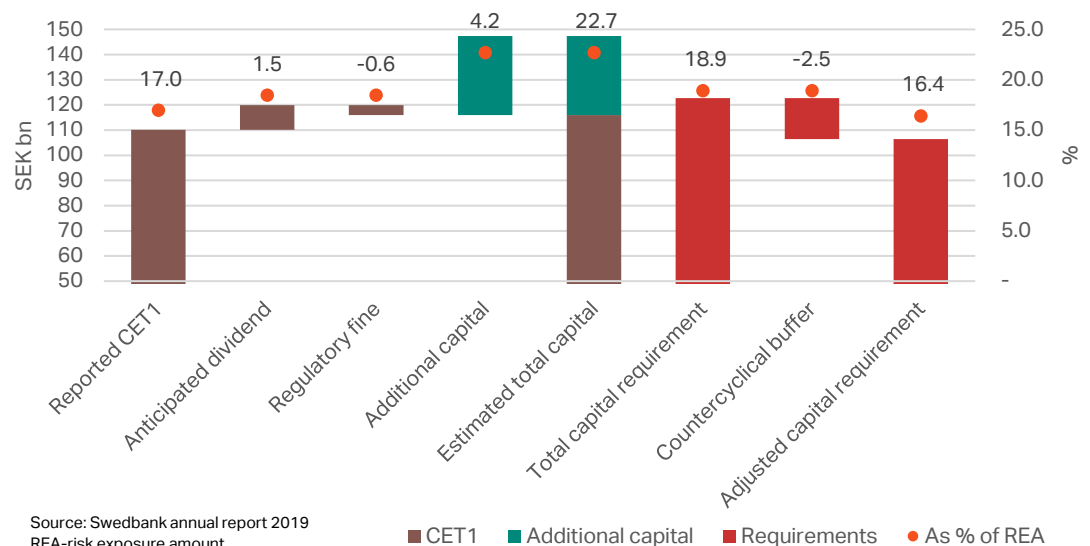
On 19 Mar. 2020, Swedbank received a final judgement from the Swedish financial supervisory authority (FSA) with respect to alleged money laundering activities at its Estonian branch. While the FSA believed that the regulatory breaches were serious enough to reconsider Swedbank's banking license, the regulator said that the bank's internal transformation and efforts to remedy the problems would be sufficient to prevent a repeat of such infringements. The bank was given a strongly worded warning and ordered to pay a SEK 4bn fine. Swedbank has accepted responsibility and will pay the fine without appeal.

Nordic Credit Rating (NCR) believes that the fine was largely priced into Swedbank's share price, but is of the opinion that the punishment and the uncertain effects and timeline of the corona virus will contribute to any decision by Swedbank to reduce or cancel its dividend for 2019. On 20 Mar. 2020, Swedbank postponed its Annual General Meeting and noted that it is still evaluating whether to go forward with its proposed dividend of SEK 8.80 per share for 2019.

WHAT IS THE IMPACT ON SWEDBANK'S CAPITAL SITUATION?

Swedbank's capital situation remains strong even after the punishment. The bank reported a common equity Tier 1 (CET1) ratio of 17% at the end of 2019 based on SEK 110bn in CET1 capital. This included a deduction for an anticipated dividend of SEK 9.9bn which is now in question – given statements by Swedish authorities – and follows significant liquidity support by the central bank, the removal of the countercyclical capital buffer for all Swedish banks earlier in March 2020, and uncertain economic conditions. Cancellation of the dividend, which has yet to be decided, would more than cover the costs of the fine and result in a net improvement in the bank's CET1 ratio to 17.9% and total capital to 22.7% including Additional Tier 1 and Tier 2 instruments. This compares with Swedbank's reported total capital requirement of 18.9% at end-2019, which was reduced to 16.4% when the countercyclical buffer was removed on 13 Mar. 2020. It is also important to point out that Swedbank's quarterly profits have averaged SEK 5bn in recent years, though the future of loss provisions remains highly uncertain.

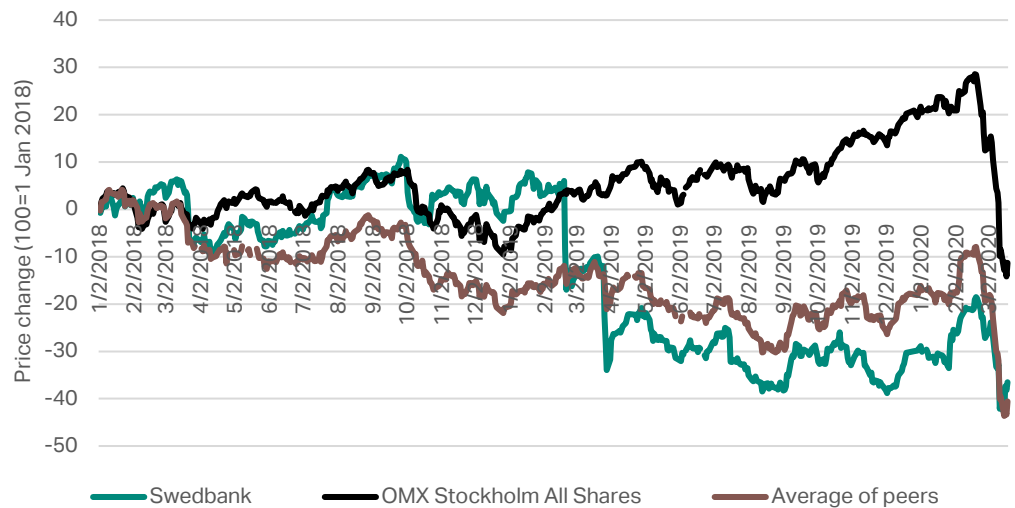
Figure 1. Changes to Swedbank's CET1 position and capital requirement changes, proforma 2019



HOW DOES SWEDBANK'S SHARE PRICE IMPACT SWEDISH SAVINGS BANKS' PROFITS?

The FSA judgement itself had only a modest impact on Swedbank's share price as the SEK 4bn fine was in line with expectations. However, the share price has fallen considerably since February 2019 and significant uncertainty in the capital markets has pushed it down by over 12% from year-end levels and as much as 25% from mid-February highs of over SEK 160 per share (see Figure 2).

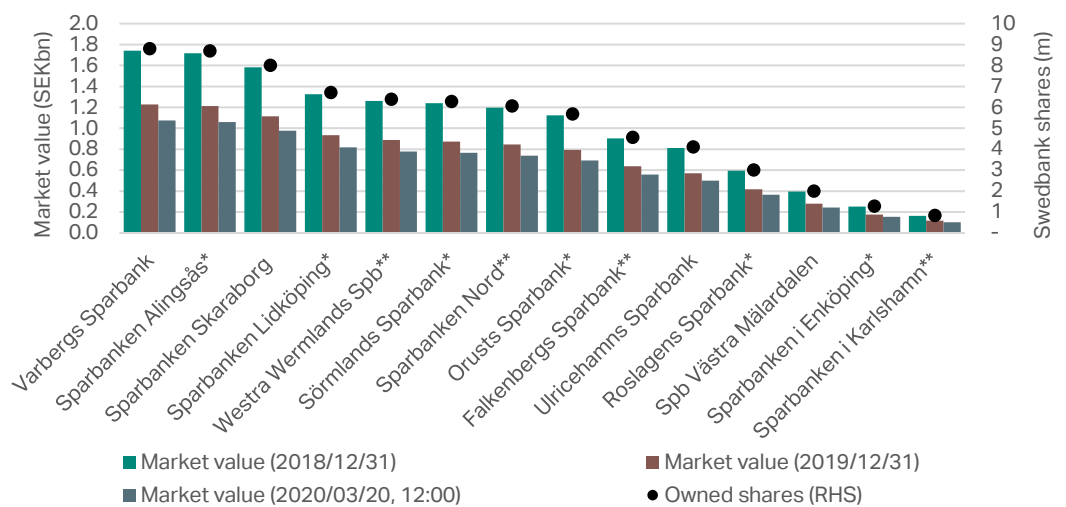
Figure 2. Swedbank share price vs OMX index and Nordic peers, 1 Jan. 2018 to 19 Mar. 2020



Source: CapitalIQ. Peers include Nordea, SEB, Handelsbanken, DNB and Danske Bank

For Swedish savings banks with relatively large volumes of Swedbank shares (see Figure 3), the resulting change in the market value of their reported shareholdings has been significant. However, domestic savings banks report changes in the fair value of their Swedbank shareholdings as "other comprehensive income", meaning that the valuation changes affect equity, but not reported net profit.

Figure 3. Swedish savings banks' Swedbank shareholdings and market value, 2018-March 20, 2020



*Based on June 2019 reported holdings. **Based on end-2018 reported holdings figures. Source: Bank reports

HOW MANY SWEDBANK SHARES DO SWEDISH SAVINGS BANKS OWN?

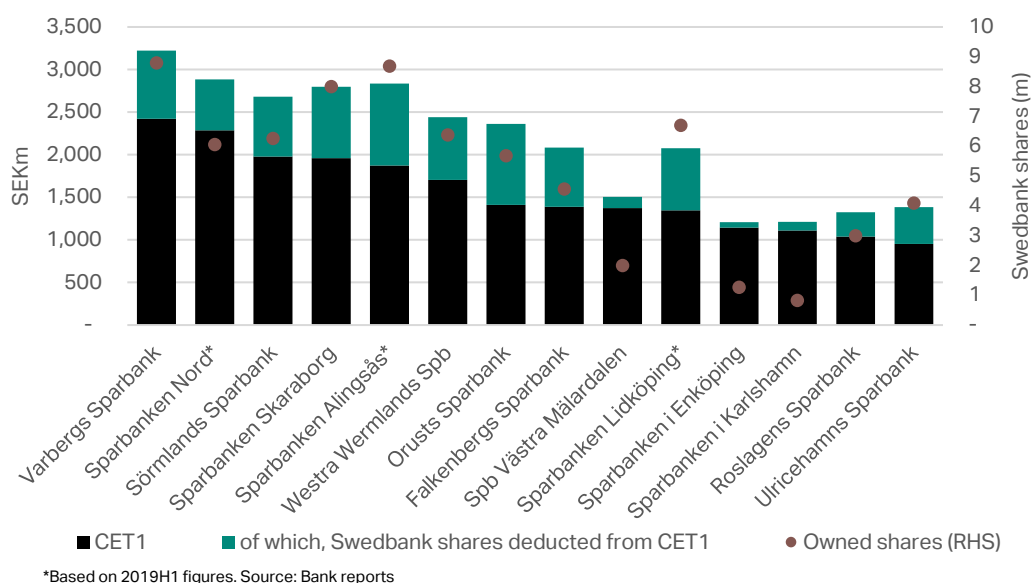
At the top of the list of Swedbank's owners is the Savings Bank Group (Sparbankernas Ägareförening), which owned an 11.0% stake as of 29 Feb. 2020 (10.7% in February 2019). Most Swedish savings banks own shares in Swedbank, either directly or via the foundations which own the banks (Sparbanksstiftelser), which in turn own an additional 3.5% of Swedbank (3.4% in February 2019).

Many Swedish savings banks have taken the opportunity to increase their holdings in Swedbank as the share price has fallen. Disregarding the possibility of as yet uncertain asset writedowns, Swedbank's current share price could provide further opportunities for domestic savings banks, which are well-stocked with capital, to increase their ownership and long-term influence over the bank. This in turn could impact the terms of future cooperation agreements which are often renegotiated before maturity (the current agreements expire in 2024).

WHAT IS THE IMPACT ON SAVINGS BANKS' SOLVENCY AND CAPITAL RATIOS?

So far, the fall in Swedbank's share price has had a modest impact on savings banks' capital levels because they deduct their respective Swedbank shareholdings exceeding 10% of their CET1 capital from it. This deduction remains a buffer for the savings banks as shown in Figure 4. However, the impact could increase if the value of the holdings falls below 10% of CET1. Despite the large CET1 deductions, the change in market value of the shares has reduced these capital buffers materially since the end of 2018 when Swedbank traded at SEK 198 per share. We note that the banks' distance to regulatory requirements was increased by 2.5pp with the removal of the countercyclical buffer, providing additional lending capacity and capital flexibility.

Figure 4. Savings banks' CET1 capital and deduction for ownership of Swedbank shares, end-2019



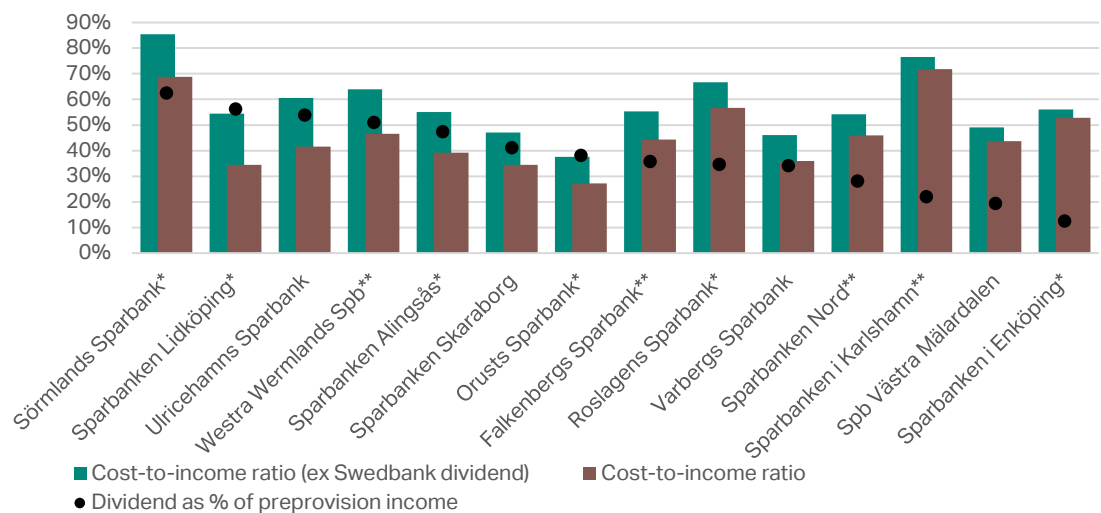
The reduction in the capital buffer has no material impact on our view of rated issuer Sparbanken Västra Mälardalen's capital situation. Our view of the bank takes into account its regulatory CET1 ratio, which was 24.0% at end-2019. This excludes SEK 133m of its SEK 279m shareholdings as of that date. By our measures, the value of the bank's 2 million Swedbank shares fell by an additional SEK 35m during 2020 (based on a price of SEK 122 per share).

WHAT IS THE IMPACT OF A CANCELLED DIVIDEND ON SAVINGS BANKS' PROFITS?

The potential for Swedbank to cancel or lower its dividend could have a material impact for some savings banks' earnings (see Figure 5). Swedbank has paid out 75% of its net profit over the past seven years, including SEK 14.2 per share in the first quarter of 2019 after the revelations about money laundering became public.

Domestic savings banks were already expecting lower dividend revenues in 2020 after Swedbank announced it was reducing its dividend to 50% of net profit. However, the current market, the SEK 4bn fine and regulatory pressure given extraordinary liquidity measures, and the reduced countercyclical buffer could lead Swedbank to further reduce or cancel its dividend in 2020.

Figure 5. Swedbank's dividend as a share of Swedish savings banks' preprovision income and cost-to-income ratios with and without Swedbank dividends, 2019



*Last 12 months to 2019H1. **Year end 2018. Dividend/share in 2019 was higher than in 2018, affecting comparison. Source: Bank reports

The 6-7% dividend return on Swedbank shares has been in line with the savings' banks own overall return on equity ratios and has been attractive to the savings banks and many have increased their shareholdings in recent years as the share price has fallen. The dividends have supported solid cost-to-income ratios for many of the savings banks and exceed 50% of pre-provision income for some of them. Given the potential volatility of Swedbank's dividends, our assessments of the savings banks' earnings focus on core interest and fee income and associated metrics.

WHAT IS SWEDBANK'S ROLE FOR SWEDISH SAVINGS BANKS?

Sweden's savings banks and Swedbank have a long history of cooperation dating back to 1942 and, largely in its current form, 1997. The relationship includes cross ownership, with Swedbank owning shares in some savings banks and most savings banks owning shares in Swedbank. Via Swedbank subsidiaries Swedbank Hypotek, Swedbank Finans, Swedbank Försäkring, and Swedbank Robur, Sweden's savings banks can provide a variety of products and services to their own customers. In addition, Swedbank is the clearing bank for the savings banks and there is cooperation on IT infrastructure, risk modelling, and financial reporting, providing economies of scale and cost efficiency benefits.

WILL LOANS TRANSFERRED TO SWEDBANK BE AFFECTED BY THE MARKETS?

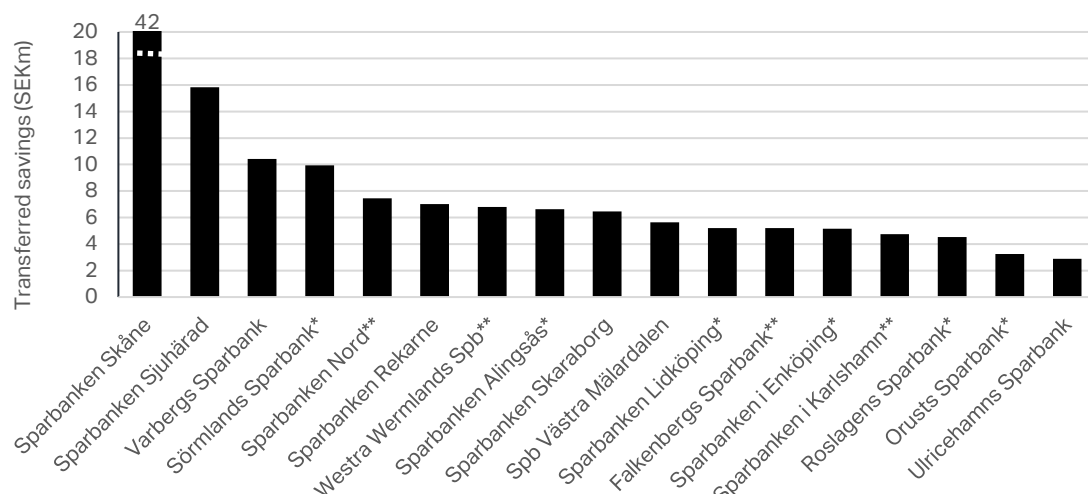
As of end-2019, Swedbank reported that savings banks accounted for 30% of its product sales in the Swedish market. If the current disruption in the capital markets continues, it could affect the savings

banks' loan strategies. The savings banks generally rely on Swedbank for funding of residential and commercial mortgages, but in recent years have used very liquid markets to increase their own balance sheets. Significant increases in credit spreads could affect the savings banks' access to markets and mortgage strategies given widening spreads and market access to covered bonds compared with senior unsecured debt. Market conditions could also affect the margins and commissions Swedbank is willing to pay to the savings banks.

WILL SAVINGS BANKS' OTHER SWEDBANK REVENUES BE AFFECTED?

In addition to mortgages, the savings banks transfer their customers' assets to Swedbank's asset manager, Robur, as well as its insurance subsidiary, Swedbank Försäkring, for which they receive commission income. Given the decline in asset values due to the current disruption of financial markets and the resulting increase in risk aversion, the savings banks' commission revenues for transferred assets are likely to fall in 2020.

Figure 6. Insurance assets transferred to Swedbank and Robur, end-2019

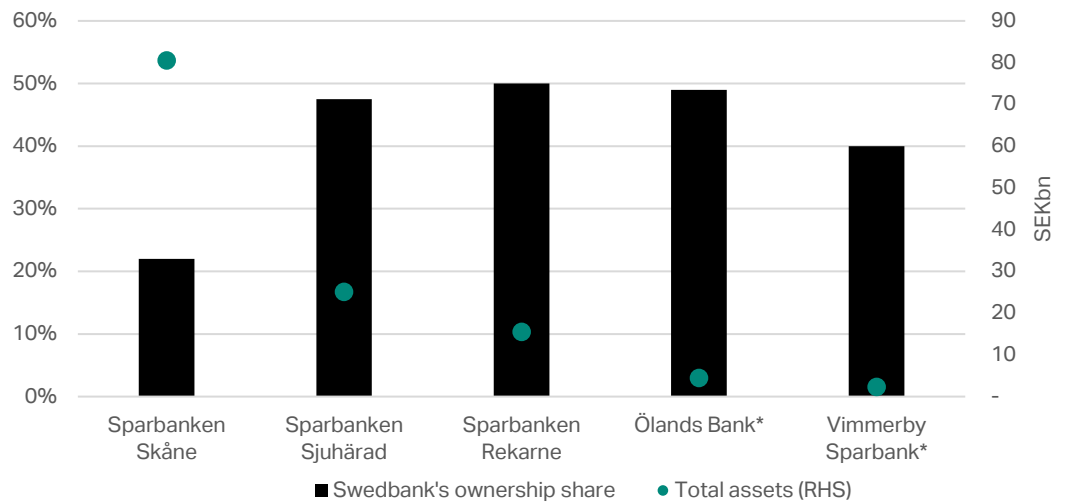


*Based on 2019H1 figures. **Based on 2018 figures. Source: Bank reports

WHICH SAVINGS BANKS ARE OWNED BY SWEDBANK?

The five banks in Figure 7 are owned directly by Swedbank and as such do not own Swedbank shares on their own balance sheets, but via the foundations which also own the remaining shares in each of the five banks. While this reduces the direct impact of recent events on these banks, the foundations' liquidity situation has been affected, reducing access to additional capital.

Figure 7. Savings banks owned directly by Swedbank – ownership share and bank assets, 2019



Source: Swedbank annual report 2019 and bank reports *As of June 2019

NCR has an issuer credit rating on Sparbanken Rekarne which includes a notch of support given its 50% ownership by Swedbank and the influence Swedbank has on the bank's return requirements and capitalisation. While not an immediate concern, a deterioration in Swedbank's credit quality beyond our current expectations, based on our internal credit assessment, could eventually affect our view on the available support from Swedbank to its directly owned banks.

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