Research Update:

Swedbank AB Downgraded To 'A+/A-1' On Regulators Finding Anti-Money-Laundering Deficiencies; Outlook Stable

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Overview

- The Swedish and Estonian Financial Supervision and Resolution Authorities have completed a parallel investigation that found serious anti-money-laundering (AML) deficiencies and regulatory misconduct at Swedbank between 2015 and the first quarter of 2019, and they have issued a warning, guidelines, and a Swedish krona 4 billion fine.
- The law firm the bank appointed to conduct an independent investigation also presented its results, and it concluded that Swedbank's management failed to establish a clear and effective AML risk framework in 2007-2019.
- During 2019, Swedbank replaced much of its top management, limited the reputational impact on its franchise, and expressed its commitment to amend the deficiencies in control and governance. However, in our view, these changes will take time to implement and prove effective.
- As a result, we are lowering our long- and short-term ratings on Swedbank AB and its subsidiary Swedbank Mortgage AB to 'A+/A-1' from 'AA-/A-1+'.
- The outlook is stable reflecting our belief that the bank's solid franchise, profitability, and capital should shield it from current worsening economic conditions and the outcome of other pending investigations in Europe and the U.S.

Rating Action

On March 26, 2020, S&P Global Ratings lowered its long- and short-term issuer credit ratings on Swedbank AB and its core subsidiary Swedbank Mortgage AB to 'A+/A-1' from 'AA-/A-1+'. The outlook is stable.

Rationale

The downgrade follows the disclosure by the Swedish and Estonian FSAs of their parallel investigations into Swedbank's Baltic operations. Moreover, on Monday March 23, the bank disclosed the findings of the independent investigation carried out by the law firm it hired, Clifford Chance.

Although the fine imposed by the FSAs is manageable, totaling about 20% of 2019's net income, the findings regarding Swedbank's management hamper our view of its conservative risk management and effective corporate governance, and, in turn, compromise Swedbank's creditworthiness since management failed to live up to standards expected of one of the world's highest rated banks. The bank has taken several steps to address the deficiencies identified, but we think it will take time to improve risk management culture across the group, implement a complete overhaul of the practices, strengthen the organizational structure, and then demonstrate the effectiveness of these measures.

The regulatory and independent investigations revealed material organizational and management failures in client onboarding, risk assessment, and anti-money-laundering (AML) practices. The FSAs and the independent investigation also revealed a series of major deficiencies in governance, control, and reporting systems at both the subsidiary and the parent level. Specifically, the management at the time was unresponsive to many alerts it received over the last decade, seemingly lacking appreciation of risk and effective AML tools.

The Clifford Chance report specifically highlighted a flow (about €18 billion inflow and €19 billion outflow) of transactions representing a high risk of potential money laundering activity in the Baltic subsidiaries in 2014–2019. It also stated that the Estonian and Latvian subsidiaries actively pursued high-risk customers, some of which were also allowed to open accounts in Sweden (all of them have now been offboarded).

Swedbank concurs that the bank had--and still has some--shortcomings in its AML activities, including the know-your-customer and risk assessment areas.

Although the FSAs' reviews have concluded, Swedbank remains under investigation by the Estonian and Swedish Economic Crime Authorities, which will opine on whether there were actually money-laundering incidents. The bank is dealing as well with inquiries by several U.S. authorities. Although the outcome of these investigations is uncertain in time, pattern, and magnitude, we will monitor if further potential risks arise for Swedbank's financial profile, franchise, and reputation.

One positive we see is that the bank's initiatives in recent months to address the highlighted deficiencies have limited the impact on its customer franchise and reputation, and largely restored market confidence. The bank replaced four of the nine members on its board of directors, including appointing Goran Persson, the former Swedish prime minister, as chairman. More recently, it appointed Jens Henriksson as CEO and Rolf Marquardt, formerly Handelsbanken's chief financial officer, as chief risk officer.

Moreover, the bank has changed several other senior management positions, including the head of the Estonian subsidiary, the head of communications, and the head of compliance. It has furthermore set up an anti-financial-crime unit, with more than 300 people. We consider that Swedbank's management is committed to taking measures to tighten its risk management standards to comply with regulatory guidelines. A comprehensive program is underway already, including 152 different initiatives, of which 67 were already implemented as of December 2019.

Our ratings on Swedbank continue to factor in the bank's solid balance sheet and leading market position in its home country. Our risk-adjusted capital (RAC) ratio was 12.1% as of June 30, 2019, and we expect it to remain at around this level in the next two years on the back of sustained capital generation. Despite the current economic turmoil, we expect the bank to maintain higher profitability than peers' (although lower than its year-end 2019 reported return on equity of 14%) and resilient asset quality metrics, given its predominant exposure to residential mortgages. This should provide Swedbank with enough financial flexibility and support our current capital assessment, in addition to the more prudent dividend payout policy already reduced to 50% from 75%.

Our view of Swedbank's funding and liquidity is unchanged. This is underpinned by our expectation that, despite the current market turbulence, the bank will maintain proven access to the wholesale market, stable customer deposits, and a comfortable liquidity buffer, with a regulatory liquidity coverage ratio of 182% as of December 2019.

Although the market conditions might change the current funding plan, we continue to factor in our ratings approximately SEK70 billion-SEK80 billion of subordinated liabilities by 2022 to meet minimum requirement for own funds and eligible liabilities (MREL) and, in turn, support the ratings through the additional loss absorbing capacity (ALAC) buffer.

Outlook

The stable outlook on Swedbank reflects our view that the bank will be able to deal with a short-term economic shock and maintain resilient earnings and solid capital, with the RAC ratio remaining around 12% in the next 18-24 months while the economic environment gradually recovers.

We also anticipate that Swedbank will continue to build considerable ALAC buffers in the coming years as it fulfils its MREL requirements, likely by replacing a large share of senior unsecured debt with senior subordinated debt instruments through 2022. As such, we believe that Swedbank's ALAC buffer will durably exceed 5% of our risk-weighted assets (RWAs) metric by 2021, which allows us to incorporate one notch of uplift for ALAC support into our long-term rating on Swedbank.

Downside scenario

We could lower our rating if the worsening economic scenario meaningfully hampers the bank's capitalization, with the projected RAC ratio trending below 10%, or if the issuance of ALAC-eligible instruments proves difficult, totalling less than 5% of RWAs. Although unlikely at this stage, we could also downgrade the bank if the investigations still pending in Europe and in the U.S. were to affect its financial strength beyond our current expectations.

Upside scenario

Although unlikely over the next 18-24 months, we could consider raising our rating on the bank if it were to successfully remediate its AML deficiencies and demonstrate a much improved risk-management culture and governance to superior standards able to withstand a higher rating.

Ratings Score Snapshot

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

Related Criteria

- General Criteria: Hybrid Capital: Methodology And Assumptions, July 1, 2019
- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Financial Institutions | General: Methodology For Assigning Financial Institution Resolution Counterparty Ratings, April 19, 2018
- Criteria | Financial Institutions | General: Risk-Adjusted Capital Framework Methodology, July 20, 2017
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- Criteria | Financial Institutions | Banks: Bank Rating Methodology And Assumptions: Additional Loss-Absorbing Capacity, April 27, 2015
- Criteria | Financial Institutions | Banks: Quantitative Metrics For Rating Banks Globally: Methodology And Assumptions, July 17, 2013
- Criteria | Financial Institutions | Banks: Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- Criteria | Financial Institutions | Banks: Banks: Rating Methodology And Assumptions, Nov. 9, 2011
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Related Research

- Banking Industry Country Risk Assessment Update: March 2020 January, March 20, 2020
- Full Analysis: Swedbank AB, March 6, 2020
- ESG Industry Report Card: EMEA Banks, Feb. 11, 2020
- Tech Disruption In Retail Banking: Nordic Techies Make Mobile Banking Easy, Feb. 4, 2020
- Swedbank AB Ratings Off CreditWatch; Outlook Negative While Investigations Continue, Sept. 27, 2019
- Nordic Banks' Capital And Earnings Can Weather The Weakening Credit Cycle, Nov. 14, 2019
- Tech Disruption In Retail Banking: Swedish Consumers Dig Digital--And Banks Deliver, May 14, 2019
- Banking Industry Country Risk Assessment: Sweden, April 11, 2019

Ratings List

Downgraded; CreditWatch/Outlook Action		
	To	**From**
Swedbank AB		
Swedbank Mortgage AB		
Issuer Credit Rating	A+/Stable/A-1	AA-/Negative/A-1+
Downgraded; Ratings Affirmed		
	To	**From**
Swedbank AB		
Certificate Of Deposit	A+	AA-
Downgraded		
	To	**From**
Swedbank AB		
Senior Unsecured	A+	AA-
Senior Subordinated	A-	A
Subordinated	BBB+	A-
Junior Subordinated	BBB-	BBB
Commercial Paper	A-1	A-1+
Ratings Affirmed		
Swedbank AB		
Swedbank Mortgage AB		
Resolution Counterparty Rating	AA-/--/A-1+	

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. A description of each of S&P Global Ratings' rating categories is contained in "S&P Global Ratings Definitions" at https://www.standardandpoors.com/en_US/web/guest/article/-/view/sourceId/504352 Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on 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.