Transcription

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Presentation

Gregori Karamouzis

Good morning everyone and thank you for joining us on this presentation of Swedbank's Q1 results for 2020. With me in the room I have our CEO, Jens Henriksson; our CFO, Anders Karlsson; and our Chief Credit Officer, Lars-Erik Danielsson. After their introductory remarks we will open up for questions. Jens, please.

Jens Henriksson

Thank you Gregori, and good morning to everyone. We are now seeing the consequences for the economy of the Corona crisis, and let's be totally honest, a global recession is coming, and IMF is calling it the great lockdown. But unlike the subprime crisis of 2007 and 2008, this time the banks are a part of the solution, not the problem.

Swedbank have adapted quickly to the new requirements in our way of working in the way of the corona epidemic. All employees who have the need to do so can work remotely and to achieve this, we have increased the capacity in digital channels without sacrificing security and the technology works extremely well. And the IT-related investments we make to adjust our organisation to the corona crisis will add approximately 250 million krona to our total cost this year.

Now, many of our customers need advice and many need lines of credit. Our main task now is to do everything we can to help them manage the situation. We still have branch offices open in all our regions in Estonia, Latvia and Lithuania and in Sweden 159 out of 161 offices are open and many branches offer special opening hours for seniors so they can visit us without risking exposure to the infection. The telephone bank has strengthened and in March, our customer centre handled half a million customer contacts via phone. That is 30% more than normal.

And we've been able to respond quickly to changing customer needs by being agile and by developing new digital service in a record-breaking speed and that's something I'm extremely proud of. I'll just give you one example. We produced the digital application for the amortization easing in just a few hours. We have received some 25,000 applications from household and corporates in a few weeks of which about 15,000 had been granted and the rest are in the process.

We participate both in the government's guarantee programme for companies and the Riksbank's credit facilities. And the banks have an important role to play in order for these measures to have effect where they are the most needed without delay. And in the middle of all this, in the middle of the corona crisis outbreak, Swedbank settled our history with anti-money laundering. On March 19, the financial supervisory authorities in Sweden and Estonia presented the results of their investigations and the Estonian FSA they gave us a precept with 25 points to rectify within eight months. And the Swedish FSA gave us a warning and a fine of 4 billion Swedish kronor. It is the highest fine ever imposed by a Swedish authority.

At the same time Clifford Chance came out with their report of what went wrong in the bank from 2007 until March 2019 and the message from the investigation is coherent and crystal clear: That Swedbank's governance and control were not good enough and the bank has not lived up to the expectations that customers, US investors, and society at large have the right to set on us and we have not done enough to stop suspected money laundering in our bank. And the board of directors had decided to accept the decision of the financial supervisory authorities.

The US authorities continue to investigate Swedbank and this is working process and it's a process that will take time to conclude. The cost of doing this is great. The AML-related investigation costs will amount to 1.6 billion krona this year according to our estimates. And add that to last year's cost of 1.1 billion krona means we're talking 2.7 billion Swedish krona to be open and transparent about our history. And add to this the 4 billion krona that came from the fine and it's a lot of money and now I'm not even calculating all the time that has been spent by management and all other on this and it shows you that not having good enough order and internal control, it will cost a lot of money and it's evident that the bank's ambition to make money on non-residents without having a fully functioning AML process was one of the worst deal in Swedbank's history.

The good thing with this is that now we can leave history behind, regaining confidence you can lose really quick, but regaining confidence takes time. Regaining confidence, you do by being clear about your history and we've published the whole Clifford Chance report and then you need to focus on delivering right now.

As you know, we have a comprehensive action plan to improve the bank's routines to stem system support and processes for crime prevention. And when I presented at the Q3 report last year, we had a 132-point programme. By Q4 it had grown 152 points and now we're up to 217 points out of which 87 have been concluded. This is something I will continue to talk about because it's an important part of making sure that we are fully compliant, and we expect this programme to almost end at the end of this year.

And it feels good to have reached the beginning of the end of this very painful money laundering crisis. As with any large investments, it's important to use external experts to make an assessment. I've talked about Clifford Chance and the financial supervisory authorities and an independent validation is also made of how the banks working as money laundering and other financial crime progresses in the three-year period 2020 and forward. An assessment is made of the bank's compliance function with the aim of reaching the highest industry standard and it's obvious that we've had shortcomings in terms of governance and control and therefore Swedbank's corporate governance is also evaluated.

So, what about the Q1 result? Well, to summarise it, it's a solid underlying business during an unprecedented quarter with a large fine from the Swedish supervisory financial authorities. The underlying profit was 2.3 billion krona, excluding the fine from the Swedish FSA. But after that, the net result for the quarter was a loss of 1.7 billion krona. Our return on equity for the quarter was 6.5%, substantially lower than the bank's normal performance. Our goal and target of 15% return on equity still stands. We have a capital buffer of around 300 basis points and the fact that the Swedish FSA lowered their countercyclical capital buffer added some 200 basis points. Our strong financial position gave us a lot of space for credit expansion in support of our customers.

To state that the outlook for the rest of the year is characterised by uncertainty is no exaggeration. As you have seen, we published information about increased cost on April 8 and the total costs for the full year 2020 are now estimated at approximately 21.5 billion, excluding the fine of 4 billion. And compared to the previous estimate that's an increase of 1.5 billion.

Over the rest of the year we will operate with higher costs than what will be required next year and onwards. And this is necessary to secure the success of our AML work and the work related to the ongoing US investigations. But our goal to be one of the most cost-efficient banks in our category remains. And when we reach year's end, we will be able to present a more detailed plan of the development of bank's customers offering, and increased efficiency. But with the investigation behind us, we can now look forward.

Our focus shifts from 2007 to 2025 and the good thing is that a lot of customer — we can use this opportunity to regain trust because it is a challenging environment for our customers.

Mr Karlsson, the floor is yours.

Anders Karlsson

Thank you, Jens. I would also like to start with some general comments before we deep dive into the details into the quarter.

As Jens already mentioned, we have faced unprecedented challenges in the quarter when we look at the P&L development in the quarter, most income lines were affected negatively by the COVID-19 situation. However, our most important income source, net interest income, was strong.

We again had extraordinary expenses due to the AML-related investigations and reviews that weighed on the Q 1 result. This was expected as we informed the market in early April about higher total expenses for the full year. Credit impairments were, as we also pre-announced in April, higher as we provisioned both at portfolio and individual levels, taking worsening macroeconomic outlooks into account. The administrative fine imposed by the Swedish FSA was booked in its entirety this past quarter, but our capital and liquidity position remained strong with solid buffers.

In contrast to many previous crises, the current crisis does not stem from the financial sector and banks can thus play a vital role in supporting economic activity of households and companies. We can use our financial strength and focus on helping our customers through this difficult time and Swedbank is doing exactly that. This is evidenced by the lending growth we saw in the quarter. Corporate lending in Sweden and large corporates and institutions increased net by 11 billion. Most of the increase came in March as we had some large repayments early in the year. Swedish private mortgages increased by 5 billion, corresponding to a somewhat improved market share in new lending, which is a positive development compared to last quarter.

Our Baltic operations did also see significant lending growth albeit bolstered by the weaker Swedish krona relative to the euro. Deposit inflows amounted to 55 billion. The increase is strongly correlated to both private and corporate customers building liquidity buffers by reducing risk in their savings and drawing down on liquidity facilities.

Let me say a few more words about corporate lending in the quarter. We clearly see that long-term investments are being put on hold, resulting in near term lower loan demand. On the other hand, we lent roughly 40 billion to corporate customers across our home markets. In addition, we had around 10 billion of signed committed credit facilities as there also were some large scheduled repayments in the first two months of the quarter, the net lending volume growth landed a 16 billion.

A large part of the increase came from drawdowns of revolving credit facilities, especially in LC&I. I would describe these actions as precautionary corporates are building liquidity buffers. We had around 200 billion krona of committed revolving credit facilities at the end of Q1, roughly 10 billion more than in Q4. Utilization increased also by 10 billion to roughly 70 billion.

Now let's look at the result in more detail starting off with net interest income, which is higher quarter over quarter. Lending volumes were lower in average terms, therefore not contributing to the increase. The lending volumes increased towards the end of the quarter as mentioned earlier and will support NII in Q2. Margins in total did contribute slightly positive. Deposit margins were higher while mortgage margins were lower on the back of higher market rates and corporate lending margins were stable.

Group treasury’s NII was impacted positively by the repricing mismatch we talked about last quarter. The asset side repricing was phased in during Q1. In addition, somewhat larger covered bond buyback volumes and maturing senior debt funding did also impact positively. Lastly, as expected, the resolution fund fee was around 100 million lower in the quarter.

Over to net commission income, which was weaker this quarter. In addition to the usual seasonal effects in cards, as usage is typically lower than in the fourth quarter, transaction volumes were negatively impacted by the changed customer behaviour due to COVID-19. The asset management business was also negatively impacted following the sharp stock market declines in March despite a strong start in January and February.

Turning to net gains and losses and other income. We saw significant negative valuation effects in net gains and losses. Wider CDS and credit spreads in the quarter led to large negative valuation effects in derivatives and in corporate bond inventories. In addition, share price development in the Visa and Asiakastieto holdings resulted in around 330 million of negative effect. On the back of the higher volatility client trading activity in equities, fixed income and FX was solid.

Other income was also lower. Insurance saw higher claims in sickness and unemployment policies, income from the partly-owned savings banks was lower due to the low result in their operations, and as you remember, Entercard had a sale of a credit portfolio last quarter that generated 165 million, which was not repeated in Q1.

Let us now look at asset quality and the credit provisions that were made in the quarter. I will ask our Chief Credit Officer, Lars-Erik Danielsson, to join me on this part of the presentation. We will run you through our loan portfolio and talk about the sectors that are mostly impacted by the current situation. In addition, we will be as detailed as possible about the assumptions that were used leading up to the credit impairments for the quarter. We will also do a brief deep dive into the oil-related segments and describe the stage one to three movements within the quarter. Please bear in mind that the crisis is still unfolding. The situation calls for continued monitoring and new assessments will be made on a regular basis.

With that I hand over to you, Lars-Erik.

Lars-Erik Danielsson

Thank you, Anders. The overall economic environment changed completely in March compared to the beginning of the year. What is pretty much still the same is the composition of Swedbank's loan portfolio. To provide you with a real economic and business-related impact on our portfolio, we have divided the portfolio into four main groups: sectors with insignificant impact from the COVID-19 crisis; sectors with slight impact; sectors with moderate impact; and sectors with considerable impact.

Close to 90% of the total exposures are related to sectors that are insignificantly or slightly impacted of the corona effect. A large part of Swedbank's core loan portfolio consists of mortgage lending and forestry and agriculture. Both have been through at least two financial crises in the 90s and the 20s and have proven to be very resilient with very low loan losses.

Our commercial real estate and Tenant Owner Association portfolios have since 2015 been through strict lending criteria where we firstly have avoided to finance only yield-driven market values. Secondly, the net operating income has been in focus and stressed to make sure that the cash flow-based buffers are at hand in the specific asset as well as the portfolio of assets. The average LTV is therefore today around 50% with a 6–8% stress on financial costs within the cash flow estimations.

The most impacted sector as of today are manufacturing, transportation, retail, hotels and restaurants and shipping and offshore. The level of impact is different in the respective sub sectors where we see food and groceries less impacted and restaurants and hotels more impacted. The large corporates and large mid-corp segments have plans, are active and have a lot of tools to deal with the upcoming situation, where we see that day to a large extent are buffering up liquidity to cope with a different cash flow situation or to cover refining needs of coming bond maturities.

For SME and SSE, we are willing to help them out in this difficult situation with both grace periods or liquidity support. Important is that together with the client find solution where all stakeholders come together and contribute. All clients are not helped with new money injections as some already before the crisis had a stressed economic situation. There are a lot of governmental initiatives to help out with support and increased liquidity as postponed tax, export guarantees, state guaranteed bank lending and so on. But so far there is not so much demand from this segment on new lending as new money may not be the solution in the long run.

When it comes to provisioning in the quarter, the main effect under IFRS 9 has been: 1) Change macroeconomic outlook. 2) Review of existing provisioning on individual exposures in the oil-related sectors and the need to increase them based on the oil price development. 3) Sector-based increased risk and straight transfer from one to two under the IFRS 9.

The changed macroeconomic outlook in March with expected negative BNP development and expected increase of unemployment figure has been implemented in our IFRS 9 models and has affected the portfolio provisioning with approximately 650 million SEK. You can, for example on this slide, see the assumptions made for the Swedish economy: a base case scenario, a positive and a negative scenario. The trends are very similar in our Baltic home markets too and you can find more details in the appendix.

We did also do an expert adjustment on sector level as we saw clear signs of increased risk in different sectors. We have estimated rating downgrades for our expert-based models with stage one to stage two transfer as a result. This expert-based judgment under IFRS 9 with a portfolio-based sector provisioning give us a further increase of provisioning with approximately 700 million SEK. The sectors that are mostly affected were the manufacturing, retail, hotels and restaurants, and shipping and offshore.

During Q2 the work with rerating will be focused on an individual assessment of the specific clients, which will give us a better and more insightful understanding. And lastly, we have increased provisioning in some oil-related cases which already are seen as impaired exposures. The reason was the increased uncertainty on future cash flow and collateral values that decreased oil price. The increase in provisioning this quarter is around 800 million SEK for clients in this segment. Our total exposure toward this segment is relatively small and we have, as you know, taken action and provision whenever we have seen a deterioration during the past five years.

In terms of stage transfers, the described provisioning represent the largest movements from stage one to stage two. We have so far not seen any effect in transfers from either stage one to stage three or from stage two to stage three, indicating that the underlying asset quality has not changed and that the individual impact from COVID-19 is not seen particularly in Q1. In addition, we have provision close to 10 billion SEK throughout the years, which give us an initial caution. And by that, Anders, back to you.

Anders Karlsson

Thank you, Lars-Erik. Now we turn to capital. The CET1 capital ratio decreased to 16.1% and the buffer to the Swedish FSA's minimum requirement stands at around 300 basis points. The negative result in the quarter impacted CET1 capital base negatively. On the other hand, the pension liability valuation following significantly lower inflation expectations contributed positively. The risk exposure amount increased by almost 42 billion in the quarter. The main drivers were the lending growth, adjustments relating to default frequencies in the corporate portfolio, and FX movements.

Before we spend some time on forward-looking aspects, I would like to remind you of the strong financial position that Swedbank enters this crisis with. We have during the past ten years built a robust liquidity and capital position which is now enabling us to continue supporting the economy. Swedbank's liquidity metrics are very strong. They are based on a strategic priority to extend the maturity profile of our capital markets funding and of course, on our solid deposit base. The average maturity in our term wholesale funding stood at 35 months at the end of the first quarter. Our liquidity reserve was 484 billion Swedish krona out of which almost 300 billion were deposits with central banks.

Let me give you a flavour of what this means in real terms. Considering that we have maturities of around 124 billion for the remaining part of the year, our liquidity position would allow us to stay out of the funding markets for more than a year. We are, however, continuing to be active in the funding markets despite elevated spreads, primarily issuing covered bonds. It is important to maintain presence in the market. Also, it's worth mentioning that we have an over-collateralisation in our covered bond pool of close to 300 billion that could either be used for issuance or be pledged with the central bank.

From a capital perspective, as mentioned earlier, our buffer to the minimum requirement stood around 300 basis points. This corresponds to an absolute amount of around 21 billion. As an example, we could lend over 400 billion krona to corporates with this amount of capital, assuming an average risk rate of 40%.

We discussed our asset quality a few moments ago. Swedbank's loan portfolio consists primarily of well-collateralised exposures with collateral mainly in real estate, but also in other types of assets. As you know, the first line of defence in any crisis is the ability to generate capital and liquidity through one's underlying operations. Swedbank's pre-provision earnings are at historically high levels. The stable income from our private and SME customer segments is the foundation. It corresponds to around 85% of pre-provision income and also the share of our income that stems from more volatile capital markets-related activities is relatively small. These are strong fundamentals, both from an income and balance sheet perspective. And it provides us with the ability to continue to support our customers.

Let us now look ahead and provide you with some forward-looking comments. It goes without saying that the uncertainty is extremely high. What is certain, however, is that we have only seen the beginning of the financial impact, both in the economy and in the banking system. Starting off by looking at some of the income sources. A large part of the higher loan volumes in Q1 was originated at the end of the quarter and in addition, we have seen further increase of liquidity requests from corporates in April by as much as 25 billion. So, these lending flows will support NII in Q2 and onwards.

Pricing on new lending is market based and therefore risk-adjusted return should be supportive for return on equity. Also, the amortisation reliefs that are being approved will on the margin boost NII as net loan volumes will remain higher than otherwise would have been the case. Our priority remains to maintain origination discipline and risk-adjusted pricing.

On the back of market rate movements in March and April, the Swedish mortgage margins have decreased further while deposit margins have increased. We expect these margins movements to more or less cancel each other out with regards to NII impact for 2020, assuming stable market rates. Two products that have been heavily impacted by the crisis are cards and asset management. Card transactions in total in March and April are down by around 5–10% compared to previous periods. If the situation prevails, we expect provision income to be negatively impacted, especially the part that is linked to foreign transaction volumes. Other payment related income is not dependant on the transaction flows.

The significant stock market declines in March and April have impacted both the assets under management in the mutual funds business but also the flows. As we exited Q1, one should bear in mind that asset under management was significantly lower than the average during Q1. To give you an idea of the potential impact, depending of course how the market develops from here. Robur, our asset management division has about 75% of its assets in equities. So, if the stock markets decline by 10%, the assets under management will decline by 7.5.

In terms of other types of income, we expect the capital markets-related activity to remain subdued, such as debt capital markets, equity capital markets, corporate finance, while client trading activity should remain elevated. Negative valuation effects experienced in Q1 could be reversed at some point when the markets have normalised. As discussed earlier on the call with regards to asset quality, we are closely monitoring the development and here, I ask Lars-Erik to give you further insights. Please, Lars-Erik.

Lars-Erik Danielsson

Thank you. In Q2 there are a lot of ongoing activities related to asset quality. We will make an individual assessment of our counterparts down to the specific situation of each client. And this will lay the ground for a potential individual risk rating change. We expect client proposals for new liquidity and amortisation deferrals to increase. We also expect to get a better understanding of the effect government support initiative will have on our client situation. The macroeconomic outlook should also become clearer. I will not speculate today if and how large increased provisioning will be in Q2, but I would like to repeat what I said earlier. We have already provisioned for close to 10 billion SEK which could offset possible future credit losses.

Anders Karlsson

Thank you, Lars-Erik. And to continue, the Swedish mortgage and housing market performed well in January and February with growing transaction volumes and increasing prices. We noticed a slowdown towards the end of March, continuing into April. If this prevails, we would expect it to become somewhat visible in lending volumes in the next few months.

When it comes to capital, as previously mentioned, our pre-provision earnings generation capacity is strong. We expect the individual assessment, mentioned by Lars-Erik earlier, to lead to negative PD migrations in Q2. It is however not possible to quantify at this point.

The Board announced yesterday evening that the AGM will be held on May 28. The Board notes that the bank's financial position is strong. However, it proposes that decision on dividend shall not be made at the Annual General Meeting, but when the consequences of the COVID-19 pandemic are clearer.

Lastly, let's look at expenses for this year. We pre-announced the revision of our total expenses guidance for the full year of 2020. We estimate them to amount to 21.5 billion, excluding the administrative fine imposed by the Swedish FSA. The biggest increase with 750 million stems from the Clifford Chance investigation costs and future legal advice. In total, these expenses are expected to amount to 1.55 billion this year.

If we use the underlying expenses of 18.35 billion as the starting point and specifically look at the additional 3.15 billion, taking us to 21.5, I would say that around 60% of this addition is a one-off nature that will eventually fall off, while 40% will build run rate. We don't know how quickly the one-off expenses will fall off, as there is still high uncertainty linked to this type of expenses, but they will. This is again our best guess at this moment. As Jens mentioned, towards the end of the year we will come back to you and talk about how we will continue developing our customer offerings and increased efficiency.

I believe we are now ready to take any questions you might have. Operator, please.

Q&A

Operator

Thank you. If you wish to ask a question, please press 01 on your telephone keypad now to enter the queue. Once your name has been announced you can ask your question. If you find it has been answered before it's your turn to speak you can dial 02 to cancel. So once again, that's 01 to ask a question or 02 if you need to cancel.

And our first question comes from the line of Magnus Andersson of ABG. Please go ahead. Your line is open.

Magnus Andersson

Yes, good morning. I thought I'd start off with cost. First of all, thanks for pre-announcing your guidance already a couple of weeks ago. The sooner the better. But just about the level for 2020, considering that the AML initiatives you are undertaking during the year are increasing every quarter is the guidance of 21.5 could that be subject to change depending on the further development of the AML initiatives, or do you feel now that everything is covered by the 21.5?

Anders Karlsson

Thank you, Magnus. I mean if you look at the slide, you clearly see that there are two types of costs. One is the one that is related to AML investigations. That is always difficult, as you know by now, to predict. We have taken a large chunk of the Clifford Chance investigation costs in Q1 and part of it will come in April. So, in that respect, we have much more clear visibility on what would come. The other part, which is your main question is the one which is investments related to AML initiatives. The reason for increasing them a bit this year are two: one is, as Jens alluded to, the Estonian precept with a number of new initiatives where we have a clear deadline to deliver, which is in the end of this year. That is adding to the investments that were originally planned.

The second reason for the increase is some of the findings in Clifford Chance's investigation that we need to rectify as quickly as possible and that is partly the underlying reason why Jens is moving from 132 points to over 200 points. I do not expect this to be an underestimation of what is needed to finalise the activities for AML-related development.

Magnus Andersson

OK, thank you. And just then about the future. I mean, you ended by saying that if you take the 18.35 and add 40% of the 3.55, we should have a run rate. Then I think we should add some kind of cost inflation to that when looking forward. Do you think we will be down there already from the beginning of 2021, so to speak, or will it be more gradual and take longer than that?

Anders Karlsson

I need to be a bit cautious, Magnus. In order to have immediate effect in 2021, you need to take a lot of actions already now. We are doing that, but I would expect it to be gradually coming into 2021.

Magnus Andersson

OK, super. And then moving to capital. Since your risk weighted assets were up quite a lot – 40 billion, quarter on quarter you had – that's slide 23 where we see the credit risk was an important driver and then also the Article 3 CRR. I might have missed it, but if you could just tell us what that is and whether that's a one-time Q1 impact or whether it will continue.
Thirdly, I guess we will also see when looking ahead some effects of risk migration or PD migrations. So, just if you could give us some feeling from Q1 now, and linked to corporate lending growth as well, we saw what it was in Q1 – we heard your comments about questions for further credit facilities et cetera in Q2. Do you think that 13.7 will remain at that level or was there kind of a panic during a couple of weeks in March, which means that things should calm down? How should we think about the 13.7 going forward? And secondly, how much potentially, if you could say anything about risk migration or PD migration impacts here the pro-cyclicality of the risk weighted assets?

Anders Karlsson

Thank you, Magnus, for a very easy question. If we start off with the credit risk increase of 13.7 as you see on the slide, it's a combination of new lending, but it's also impact on the derivatives portfolio where mark-to-markets have increased during the quarter. So, part of it is driven by underlying movements in interest rates and FX, so that is difficult to have a view on.

What I would do if I were you, coming back to me telling you about an increased request on lending during the latter part of the quarter moving into April, is that I would assume a risk weight of 40% on that exposure change. We have seen a flattening of the requests during April, so it was very sharp at the end of March continuing into the two/three first weeks of April, but now it's gradually at the plateau. That doesn't mean that it will come back. That is very much if a function of how the capital markets will function and when there are corporate bonds maturing, whether they can have access to the capital markets or if they need revolving facilities to be used. It is the large corporate part of the portfolio that we have seen this, as Lars-Erik said, in the smaller and medium sized corporates, they are still very cautious.

As far as PD migration comes, Magnus, it's extremely difficult for me to have any view on it. My gut feeling is that they come. It will be an increase of risk exposure amount. At the same time, part of that migration effect will be counteracted by us then having the possibility to decrease the Article 3 add-ons that we have taken on. So, it will not entirely be captured in increase of risk exposure amount.

Magnus Andersson

OK, thank you. And then finally, just one question on asset quality and the oil-related part of the exposure which you have been struggling with since 2016 really. If the oil price – I mean the oil price is down somewhat since late of April when you announced these loan loss provisions. If the oil price stays around these levels, would that automatic in some way trigger more provisions for that portfolio or is this within your expectations on making those positions?

Lars-Erik Danielsson

It's more within the already taken into account expectations, however it's not direct correlated to the oil price. The sub-sectors that we are within are expecting to get order books from the oil source owner so to say. So, it's depending on the contractual situation that we will see going forward. That's the best answer I can give you at this point.

Magnus Andersson

OK, thank you very much.

Operator

Thank you. Our next question comes from the line of Chris Hartley at Redburn. Please go ahead. Your line is open.

Chris Hartley

Great, thanks everybody. First question is actually just to follow up on the cost you were talking about earlier. You mentioned that you're happy with what you've got there in terms of an increase in expenses. Does that include what might come out of the US as well? How confident are you that they will always come up with a bit of a curveball? And maybe do you think we should expect a slightly different timeline on the US given what's going on in the world with things slowing down a bit?

And then just second on the corporate lending. I was actually just wondering if you could give a bit of colour around the state guarantee loans that you may or may not be issuing. What your sort of view of that scheme is, what the take-ups like, and also what the economics of those loans are for you perhaps in terms of margin, capital treatment, et cetera. Thanks.

Anders Karlsson

Thank you. On your first question, we have not taken any potential fine into account when it comes to the US authorities' investigations. We are trying - having said that, what we are trying to do in our cost guidance is to try to forecast what increased cost in terms of legal advice is needed to manage the US authorities' questions and requests for this year. And as far as the timeline for US investigations comes, I hand over to you Jens.

Jens Henriksson

Well, I could just say a few words also on the costs of this investigation. Of course, it's a tremendous cost, let's be totally honest about that. The reason for that is that we have made a priority on having a good quality and on time, and I think one thing that sort of struck me, at least, when Clifford Chance presented their report was that nobody really questioned the report as such. They questioned our behaviour and I think that was the right thing to do. But the report now in many ways concluded our lookback on history.

Now, what has happened now is that now we have the information to the US authorities and that means that they can look at the Swedish FSA, the Estonian FSA, and the Clifford Chance Report. And if they come up with – I'm sure they will – they will come up with complementary questions. We have a margin so we can provide that information, but now it will be a little bit more focused on costs for running the investigation while, because Clifford Chance is finished with their report and we published everything in the - sort of being totally transparent about this.

Anders Karlsson

Lars-Erik, did you have anything you want to say about? The state guarantees loans.

Lars-Erik Danielsson

As I've said, related to SME and SSE. There is a low demand on increased liquidity in terms of taking on loans as of today and by that the state guaranteed loan has been very, very limited in terms of distribution. We expected that to increase and the lending is related to market rate.

Anders Karlsson

So, the terms are market-based.

Lars-Erik Danielsson

Yes.

Chris Hartley

OK, great. That's great, thank you very much.

Operator

Thank you. Our next question comes from the line of Andreas Håkansson of Danske Bank. Please go ahead. Your line is open.

Andreas Håkansson

Hey, good morning. We actually covered what I wanted to ask, so I'm fine thank you.

Operator

Thank you. Just as a reminder, it's 01 to ask a question or 02 if you need to cancel. The next question comes from the line of Peter Kessiakoff of SEB. Please go ahead. Your line is open.

Peter Kessiakoff

Hi, thanks for that. I had a few questions. First of all, Jens, you're mentioning that focus is now going to 2025. Should we read anything into the fact that you're mentioning five years out in terms of perhaps that's the point when you believe Swedbank will reach the full cost efficiency again that we've seen historically? Or is it just a reference on a year, a few years out?

Jens Henriksson

Well, I wish I was that smart. No, but it's a way of saying that we're now— Let's be totally honest, we've been focused inward, maybe focusing on history. Now I want to say to everybody working in the bank is that, OK, we've not had good enough governance, internal controls and yes, we've let suspected money launderers use Swedbank. That's not OK. We're now open about history. Now, let's make sure that we have a fully compliant system and then look forward.

I think 2025 is an important year in the sense that, if you look on my experience from both working at the International Monetary Fund and the Ministry of Finance, what you see is if you have a recession that will impact unemployment quite a lot. And if you can mitigate the consequences and we as a bank can be a part of mitigating the consequences, you can avoid unemployment going too high up because what happens in situations like this is that the US unemployment goes up really rapidly and goes down quick. The European economy is much more rigid and that means once unemployment is up there is a hysteresis effect and that means that unemployment falls much more slowly, but it rises also slowly. So, when I talked about 2025, it's more about that. I have expectations for efficiency much quicker than that.

Peter Kessiakoff

All right. And then just a few small detailed questions and I guess to Anders to start off with, but looking at the mortgage side and I guess with the funding costs coming up, what's the view on mortgage margins over the coming quarter or two? And is it possible to say anything on the direction of new lending margins versus the back book, et cetera?

Anders Karlsson

Thank you, Peter. My best answer under these circumstances is that the margins will be a function of how market rates are moving.

Peter Kessiakoff

OK. Short but sweet. Then finally just a question on the sectors that was mentioned that were more or less exposed to COVID-19, just a detailed one. But looking at private other which I assume includes consumer loans, you put that within slightly impacted sectors, is there anything that in particular we should take into account to why it's within slightly impacted, rather than perhaps considerably impact or perhaps moderately? I would have assumed unsecured consumer loans could be somewhat more at risk in this environment.

Anders Karlsson

I will start off, Peter, and then Lars-Erik will fill in. I agree with you. Consumer loans have higher risk than mortgages. I've been talking about our ambition when it comes to consumer lending for a number of years and unfortunately, we have not delivered on our ambition. Today I am to a certain extent grateful for that because when we look into our consumer lending portfolio, it is of extremely high quality and the loan losses have so far been on the very, very low level.

Having said that, of course if you look at how private individuals tend to behave in a crisis where they are unemployed or their financial situations are impacted negatively, they tend to prioritise their housing. So, too early to say. Higher risk, yes. In relative terms, I would argue that we have a fairly low risk in our consumer finance portfolio.

Peter Kessiakoff

All right. That was all from me, thanks.

Operator

Thank you. Our next question comes from the line of Sofie Peterzéns of JPMorgan. Please go ahead. You line is open.

Sofie Peterzéns

Yeah, hi. Here’s Sofie from JP Morgan. I was wondering when I look on slide 2 where you talk about the great lockdown and we see the GDP forecasts for the Baltics, I think that you have -5. But when I look at the IFRS 9 scenarios on slide 29, you have around 1–2% GDP growth for the Baltics this year. Could you just, on the macro adjustments that you have done, how much are all of these macro adjustments only for Sweden or what share is for the Baltics? Thank you.

Anders Karlsson

Thank you. The slide where you see the scenarios is Sweden and oil price, and then there are similar patterns in all our home markets, but I think it would have been virtually impossible for you and us to make any pedagogical explanation using all the different variables that we are looking into. So, when you look at that slide, it's Sweden and it's based on our macro research team’s estimates and forecasts at the latter part of March.

Sofie Peterzéns
So, just to clarify. You basically haven't taken any macro overlay provision for the Baltics?

Anders Karlsson
We have. We have taken a, I would say, fairly significant amount for the Baltics as well. The slide that we used in the presentation was just for you to get a sense of how we have taken worsening macroeconomic conditions into account in our IFRS 9 calculations. But the Baltics have been impacted. You can see that in the appendix of the presentation. Again, this is Sweden as an example.

Sofie Peterzéns
OK. And the EBA has a new forbearance rule. Have you taken advantage of these that you have been done, kind of customer reclassification from stage one into stage two, even if they've got an amortisation or a payment holiday in line with the EBA guidance? And if you didn't have done this, what kind of impact would that have had on your asset quality information?

Anders Karlsson
Thank you. We have taken that into consideration. It's not automatically deteriorated credit quality due to the fact that you are given an amortisation relief. So, we have not been putting those applications that we have granted into a forbearance situation. I don't have the numbers on the top of my head so what it is exactly, but it's a fairly limited number in terms of volume.

Sofie Peterzéns
OK. And then a question on money laundering. You mentioned that you have several US investigations ongoing. Can you give a little bit more details on who is looking at you?

Jens Henriksson
No.

Sofie Peterzéns
Can you give details on how many entities are looking at you?

Jens Henriksson
Plural.

Sofie Peterzéns
OK. So, is it fair to assume that it's double digit in terms of numbers; mid-single digits? How should I think about it?

Jens Henriksson
I'm just going to say it's more than one. Thank you.

Sofie Peterzéns
And in terms of the sanctions breach, you came out and said that you only had 5 million of exposures that had kind of OFAC sanction breach pre 2014, but when we look through the Clifford Chance report, there are some mentioning of OFAC criteria. If you look pre 2014, do you expect the number to be significantly higher and could you give details around what level we potentially could have seen?

Jens Henriksson
Well, Clifford Chance has not looked back further than this. A five-year period you have to look upon and we've talked with OFAC and we've self-reported the 4.8 million US dollars and it was 586 transactions.

Sofie Peterzéns
OK, but you don't have any details on anything before the 2014?

Jens Henriksson
Correct.

Sofie Peterzéns
OK. That was all my questions. Thanks very much.

Operator
Thank you. Our next question comes from the line of Johan Ekblom of UBS. Please go ahead. Your line is open.

Johan Ekblom
Thank you. Just a few follow-ups. In terms of the guaranteed loan schemes, when you say it's based on market terms, does that imply that you price it as though there was no guarantee, or does it imply that you price it as though a large proportion of it is sovereign risk? That's the first question. Secondly, in terms of the op-risk RWA adjustment you made, do you have any estimate as to how the FSA's fine might impact the op-risk RWA going forward? And then finally, just in terms of the funding, given the covered bond buybacks that you did during Q1, your net issuance was very close to zero. So, how should we think about the total issuance need, and in particular, if you have unused capacity on the covered bond side, why are you so aggressively buying back when there is such an increase in credit demand?

Jens Henriksson
Jens here. As Anders said, we have a market pricing of this and of course we take into account that there is a guarantee from the government, but we also pay a fee for that according to the rules set up by the Swedish National Debt Office. Anders?

Anders Karlsson
Thank you. On your first question Johan on operational risk. No, I don't have that on the top of my head. It depends very much on one single – I don't remember the name of it – but there is a… In theory we need to add this to our operational losses and therefore it could have a negative impact on our risk exposure amount going forward when the new rules are put into play. But that depends on how the Swedish FSA will decide on the slope of a function that is added. If they set that function at one, the impact will be limited. If the slope is steeper, it will have a higher impact on our risk exposure amount going forward. We have done a couple of calculations. I don't have it on the top of my head, but we can maybe talk about that in more detail bilaterally. On your second question, I think you need to repeat that because I lost you.

Johan Ekblom
Yeah, I'm just thinking on the funding. If we look at the covered bond buybacks that you did there's zero net issuance in Q1.

Anders Karlsson
Yeah. First of all, that is not in any way aggressive. It's part of how we usually are handling our maturities coming in. We are buying them back long before they mature rather than having - as you know, the Swedish covered bond market is working the way that you have fairly large maturities at one point in time. You want to avoid that. So, we are spreading the refinancing risk over the year rather than having it at one point in time.
Secondly, we are not issuing because we don't need to issue. We issue when we need to issue, and we are trusting the covered bond markets. If worse comes to worst, we could use that space to put as a collateral with the central bank, but we don't need that at this point. What we do need, unfortunately, due to cost of funding, is to issue senior unsecured at some point during this year. You saw that the National Debt Office prolonged the implementation period for MREL debt. But they did not - the new senior non-preferred, but they did not change their requirements. So, we need to issue some senior during the year, and we will issue covered bonds when we need to issue covered bonds.

Johan Ekblom
Thank you.

Operator
Thank you. Our next question comes from the line of Martin Leitgeb of Goldman Sachs. Please go ahead. Your line is open.

Martin Leitgeb
Yes, good morning. I have three question please. And the first one, I was just wondering if you could give us a steer on how high risk cost should be for given GDP scenario? I think one of the European peers yesterday came out with a loan loss assumption based on a certain GDP scenario and I was just wondering if say your base case of -4.4 for Sweden would occur, what is the kind of risk cost for the year you would expect. I'm just trying to tie up some of the data points out there. Obviously, the risk experienced during 2009 but equally EBA stress test data, which obviously both would suggest are comparatively higher level of loan losses compared to the 50 bits for the first quarter.

The second question, I was just wondering if you could comment on the loan guarantee schemes in Sweden and how effective you think they would become. In a way, how should we think about the take-up in terms of new SME lending? Should be expected that most loans will feature under that guarantee? Or will this be essentially a comparatively small portion of your loan book going forward?

And the final question, the third question, I was just wondering if you could update us on the major capital headwinds you foresee over the next one or two years, and this is just in light of the dividend suspension which should keep deducting from capital. So, your capital headroom all else equal - would be north of 400 basis points and I was just wondering. A lot would need to happen for Swedbank not to generate capital in terms of risk costs. So, I was just wondering what are the major capital headwinds you could anticipate. Thank you.

Anders Karlsson
Thank you. I think your first question is extremely relevant, but virtually impossible to answer. But to give you a flavour of what we have done, we have based our IFRS 9 calculations on three different scenarios, as you saw. The base scenario at that point in time was a GDP drop of 4% in Sweden in 2020. The alternative worsening scenario was a GDP drop of nearly 8% during 2020. So, if the macroeconomic development stays in accordance with that scenario, in theory we have provisioned adequately going forward for this year.

I think the main question when you think about cost of risk going forward is the timeline. If the macroeconomic situation continues and it is worsening over a longer period of time, you will definitely see cost of risk increasing in the banking system. In the scenario that we used, the base scenario, the economy came back in 2021, so it was a fairly, I would say, V-shaped economic development. So, there are two things to think about: one is the magnitude and secondly, the time until the economy comes back.

When it comes to your question on loan guarantee schemes, I would say that in the Baltics and in Sweden, if there is a demand for new loans from small and medium sized corporates, they will most likely be under the guarantee scheme. We have seen very little demand up until now, it's difficult for us to forecast, but as Lars-Erik alluded to, loans and indebtedness is not necessarily the best solution for many of those corporates. There are other ways of handling their situation which is more effective.

On your last question which was about potential capital headwinds going forward. I would argue that they are tightly related to what I said in the beginning about IFRS 9 and the provisioning. It's macroeconomic outlook and potential PD migrations coming from that. That's the sort of short-term headwind that you can expect in a world that looks like it does today.

If you look further out in time, the one that we have been talking about is the IRB overhaul that EBA announced that means that we have to basically rebuild all our internal models for risk and capital adequacy purposes. That is coming gradually with the finalization time in Q3 2021 and since Nordic banks have relatively low risk weights in their corporate portfolios, we and our peers will be negatively impacted.

What will come this year, according to the Swedish FSA's decision, is as you know a risk weight floors on commercial real estate, and we have communicated around that before and that impact is approximately 50 basis points on our buffer. So, that is my best answers to your questions.

Martin Leitgeb
Perfect. Very clear. Thank you very much.

Operator
Our next question comes from the line of Mats Liljedahl of Handelsbanken. Please go ahead. Your line is open.

Maths Liljedahl
Yes, good morning. Long queue today. A few follow-ups. Anders, if you can comment on the corporate facilities. I get a lot of the drawdowns in Q2 were on old credit facilities from the corporate sector i.e. the margins on those should have been negotiated quite a long time ago when there was a different situation. Could you comment on when you now go in to negotiate new facilities, how the margin differences between old facilities and the new ones coming – just so how I can think in terms of corporate margins?

And then also maybe on impairments. I know a very difficult question to answer, but if we look at your macro scenarios with macro coming back 21/22. Under IFRS 9 we have never tested this. How soon do you think you could see reversals if we should compare to, I mean the Baltic situation, for instance, which was a little bit more longer lasting perhaps? Thanks.

Anders Karlsson
If I try to answer your first question, you're right, a large chunk of the drawdowns have been on already negotiated terms and conditions. There were 10 billion of new revolving credit facilities coming in the quarter. And yes, the price for new lending is substantially higher than it is for the old facilities. So, I will not give you a clear indication on that, but it's higher. We're trying to price it market-based. On your second question.

Maths Liljedahl
That's a difficult one.

Anders Karlsson
I kind of like it. I have asked that myself, but I do not have a firm answer on that. I'm not sure Lars-Erik has either, but maybe he can.

Lars-Erik Danielsson
The different situation in terms of impairment compared to the last financial crisis was that the main part was related to individual exposures. And the reversals and the outcome of this was then related to how went the restructuring or was it a bankruptcy case? Now we have portfolio set-offs. And in theory with IFRS 9 we should have a more point in time view on things. So, in theory, if we see reversals, they should come a little bit sooner, I guess, but as you said, this is untested for us, so it's very hard to give you a correct answer.

Anders Karlsson
I think we are running out of time unfortunately and there are a couple of more questions. We will try to answer very swiftly and if you don't get the possibility, we will reach out to you bilaterally. But please continue.

Operator
OK. I believe we have time for one further question. That's from the line of Riccardo Rovere of Mediobanca. Please go ahead. Your line is open.

Riccardo Rovere
Thanks, and good morning to everybody. Couple of questions, if I may. Considering that the rest of Europe is more or less reopening: Austria, Spain, Italy is supposed to reopen too on the 4th of May at least partially. Germany has never really closed and is just starting a little bit more economic activity. If Sweden has never really shutdown, not as in a draconian way as Italy, France, Spain or Austria, considering if the situation goes on like that, do you think that the amount of provisions, the overlay provisions, that you've taken so far would be kind of enough for what you see today if the situation, let's say does not deteriorate further? This is my first question.

The second question is on your lending approach. I remember, maybe I think it was last quarter where you stated you deliberately decided not to participate to some campaigns and that is altered in market share loss and I was wondering whether the attitude has changed, that you are more inclined to, let's say, to defend as much as you can your market share from now on.

And a very final question I have again in capital headwinds. Sorry to get back one second on this. All the regulation that have been, let’s say, promoted over the past five years seems to have been relaxed dramatically because of what's going on. Especially on the commercial real estate risk weight, do you see any possibility that this might be delayed to this and other eventually initiatives might be delayed too and moved forward as long as the situation does not get clearer. Because that and imposing higher capital would be exactly against anything that has been proposed in Europe for the moment. So, is it really reasonable to see that by the end of this year?

Anders Karlsson
OK, thank you. If we start with your first question. If I understand you correctly, what you're saying is, is your provisioning in the quarter enough if Sweden were to be completely locked down?

Riccardo Rovere
No, no, no, it is exactly the opposite. Sorry. If Sweden does not lock down. Sweden has never been under lockdown. The rest of Europe is reopening. If the situation remains this – that is the question.

Anders Karlsson
OK, but then it's about whether the V-shape is sort of adequately mirroring the economic development going forward and at the point when we calculated our future need for provisions, we based it on the macroeconomic scenarios that I walked you through. If they are changing to the better and that happens quicker, I would argue that the answer is yes, we have provisioned adequately and might even get reversals.

On your second question, we are not participating in campaigns. There are no campaigns as we speak. We are on the other hand not changing list prices as market rates are moving up and down. We are continuing to operate the same way as we have been doing during the last years.

And on your third question: It's a very relevant question. You need to ask the Swedish FSA on their view. It's up to them.

Riccardo Rovere
OK. But would you be surprised if they moved it forward in general, any initiative, commercial risk weight is just one, any initiative – would you be surprised if that would we moved forward?

Anders Karlsson
I think that the Swedish FSA have acted in a very proactive way so far during this crisis. Whether they will continue to do things if needed, I would assume so, but again it's up to them to answer that question.

Riccardo Rovere
All right. OK. Thanks.

Gregori Karamouzis
Hi, operator, it’s Gregori here. I understand we need to close the call. There are a couple of more questions in the queue, a couple of questions, I think. ..after the call.

Operator
Sorry, you broke up there.

Gregori Karamouzis
No, I said that there are a few more questions in queue. Those individuals could contact me directly and I will answer them after this call is closed.