FITCH UPGRADES SWEDBANK TO 'AA-'; OUTLOOK STABLE

Fitch Ratings-London-26 May 2016: Fitch Ratings has upgraded Swedbank AB's (Swedbank) Long-Term Issuer Default Rating (IDR) to 'AA-' from 'A+', Viability Rating (VR) to 'aa-' from 'a+', and Short-Term IDR to 'F1+' from 'F1'. The Outlook on the Long-Term IDR is Stable. A full list of rating actions is available at the end of this rating action commentary.

The ratings actions are part of a periodic portfolio review of major Swedish banking groups rated by Fitch.

KEY RATING DRIVERS
IDRS, VR AND SENIOR DEBT
The upgrade reflects Swedbank's strong execution of its low-risk strategy since 2009, and our expectation that this strategy will continue under the new management team. Swedbank's reshaped balance sheet is producing resilient financial metrics and the bank's focus on conservative risk-returns and on tight underwriting standards, both domestically and in the Baltics, is supporting asset quality. The high ratings mean further upgrades are now unlikely, which is reflected in the Stable Outlook.

Swedbank's Swedish retail franchise is strong (over 20% market shares in deposits and lending), although fairly geographically concentrated with domestic assets accounting for around 80% of the group's total. Some diversification is obtained through its activities in the Baltics, where Swedbank is market leader. As a predominantly retail bank, maintaining its close relationships with customers to attract a large share of additional services, and keeping a high operating efficiency are crucial. We expect loan impairment charges to remain low.

Asset quality should remain solid, supported by a large low-risk domestic mortgage loan portfolio and a strong Swedish economy. The bank has a significant property management exposure, but this is largely made up of large strong corporate clients with sound cash flows and access to debt and capital markets, a typical feature of the Swedish property management sector. Swedbank's corporate lending (excluding property management) is smaller than at most of its peers'.

Swedbank's capitalisation is strong and compares well with peers', both on a risk-weighted and un-weighted basis. At end-March 2016, its Fitch core capital/risk exposure amount ratio was 28%, and its fully loaded Basel III leverage ratio was 5% at end-2015.

As with its Nordic peers, Swedbank is reliant on wholesale funding due to a structural shortage of deposits in Sweden. The risks are mitigated by prudent liquidity management and a strong focus on covered bonds, with a sizeable portion placed with a domestic captive investor base consisting of large Swedish insurance and pension funds. Swedbank's senior unsecured debt issuance is limited.

SUPPORT RATING AND SUPPORT RATING FLOOR
Swedbank's '2' Support Rating (SR) and 'BBB-' Support Rating Floor (SRF) reflect Fitch's expectation that support from the Swedish authorities remains highly likely in case of need. Sweden has been the leading EU advocate of flexibility, partly due to its experience of cleaning up banks in its 1990s crisis, but also because it has a concentrated, largely homogenous banking sector that relies on attracting international and foreign currency funding. The banking sector's wholesale funding reliance, with a material interconnectedness between the banks, means faltering investor confidence could spill over to the whole sector. For this reason, prudential requirements for its banks are very high.

In maintaining control over supervision and resolution decisions, Sweden has more flexibility to interpret and apply the EU's Bank Recovery and Resolution Directive (BRRD) than Banking Union member countries. While Sweden is likely to retain a high propensity to support its major banks to safeguard financial stability in light of the concentrated structure, Sweden is bound by EU state aid rules, meaning it does not have full control over support decisions.

SUBORDINATED DEBT AND OTHER HYBRID SECURITIES
The ratings on the subordinated and additional Tier 1 debt issued by Swedbank are notched off the bank's VR.

In accordance with Fitch's criteria, subordinated (lower Tier 2) debt is rated one notch below Swedbank's VR to reflect the above-average loss severity of this type of debt.

Additional Tier 1 securities are rated five notches below Swedbank's VR to reflect higher-than-average loss severity risk of these securities (two notches) as well as high risk of non-performance (an additional three notches).

RATING SENSITIVITIES
IDRS, VR AND SENIOR DEBT
The Stable Outlook on Swedbank's Long-Term IDR reflects Fitch's view that Swedbank will maintain its robust capitalisation, strong asset quality and a healthy liquidity profile. Fitch expects Swedbank's financial metrics to outperform most peers', offsetting the bank's reliance on its domestic market and its smaller equity base than similarly rated peers.

While not expected by Fitch, a downgrade could result from a prolonged inability to competitively access debt capital markets or renewed uncertainty in its Baltic portfolio. A shift away from long-term funding or significant reliance on international investors would likely be rating-negative.

Given Swedbank's high exposure to Sweden, the bank's ratings are sensitive to a severe downturn in Sweden. This would particularly be the case should a downturn lead to a significant correction in house prices and wider losses in both Swedbank's mortgage lending and corporate portfolios, including its property management exposure. However, this is not Fitch's central scenario.

SUPPORT RATING AND SUPPORT RATING FLOOR
An upgrade to the SR and upward revision to the SRF 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.

The SR and SRF are also sensitive to the implementation of minimum own funds and eligible liabilities (MREL) in Sweden. In particular, while the Swedish resolution authority appear to promote part of eligible liabilities being debt securities, the status of these securities will be important to the SR. This is particularly the case as 20% of risk-weighted assets (or 8% of liabilities) need to be bailed-in before any public funds can be used, and this is after the point of non-viability is reached. Should these MREL buffers be in the form of senior debt, ie requiring the bail-in of senior unsecured creditors before support can be considered, Fitch is likely to downgrade the SR to '5' and revised the SRF to 'No Floor'.

SUBORDINATED DEBT AND OTHER HYBRID SECURITIES
The ratings on the subordinated debt and additional Tier 1 securities are sensitive to a change in Swedbank's VR.

Additional Tier 1 securities are also sensitive to Fitch changing its assessment of the probability of their non-performance risk relative to the risk captured in Swedbank's VR.

The rating actions are as follows:

Swedbank AB
Long-Term IDR: upgraded to 'AA-' from 'A+'; Outlook Stable
Short-Term IDR: upgraded to 'F1+' from 'F1'
Viability Rating: upgraded to 'aa-' from 'a+'
Support Rating: affirmed at '2'
Support Rating Floor: affirmed at 'BBB-'
Senior unsecured debt: upgraded to 'AA-'/'F1+' from 'A+'/'F1'
Commercial paper: upgraded to 'AA-'/F1+' from 'A+'/F1'
Certificates of deposit: upgraded to 'F1+' from 'F1'
Subordinated debt: upgraded to 'A+' from 'A'
Additional Tier 1 instruments: upgraded to 'BBB' from 'BBB-'

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Applicable Criteria
Global Bank Rating Criteria (pub. 20 Mar 2015)
https://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=863501

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