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21 September 2020

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RATINGS

Svenska Handelsbanken AB	
LT Senior Unsecured/Deposits	Aa2/Aa2
Baseline Credit Assessment	a2
SEB AB	
LT Senior Unsecured/Deposits	Aa2/Aa2
Baseline Credit Assessment	a3
Swedbank AB	
LT Senior Unsecured/Deposits	Aa3/Aa3
Baseline Credit Assessment	baa1
Nordea Bank Abp	
LT Senior Unsecured/Deposits	Aa3/Aa3
Baseline Credit Assessment	a3
Danske Bank A/S	
LT Senior Unsecured/Deposits	A3/A2
Baseline Credit Assessment	baa2
DNB Bank ASA	
LT Senior Unsecured/Deposits	Aa2/Aa2
Baseline Credit Assessment	a3

Source: Moody's Investors Service

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Svenska Handelsbanken, SEB, Swedbank, Nordea, Danske, DNB

Provisioning surges in the first half of the year but capital buffers remain intact

Loan-loss provisions surged at large Nordic banks[1] in the first half of 2020 as the COVID-19 pandemic pushed the region's economies into recession. Provisioning levels varied widely by bank, reflecting different degrees of exposure to stressed sectors and provisioning approaches. Higher provisions took a toll on profits but capital buffers remained intact.

Average provisioning costs for the six large banks rose to 49 basis points in the first half of 2020, from 7 basis points in the first half of 2019. Handelsbanken bucked the trend with provisions of just 4 basis points. In contrast, provisioning levels soared to between 34 basis points for SEB and 95 basis points for DNB. For large Nordic banks, provisions were lower than for large European banks, where average charges were 105 basis points[2].

Loans to oil, gas and shipping sectors drove a large part of provisions. All but Handelsbanken needed to set aside large provisions for these exposures, although they accounted for only a small part of loans. Provisions made for the rest of the loan book were lower, ranging from 22 basis points for SEB to 55 bps for Nordea.

Variations in provisioning approaches remain wide, despite narrowing from the first quarter. Inherent flexibility of IFRS 9 accounting standards means that macroeconomic scenarios will not be fully aligned. Management add-ons, a significant part of provisions, are also based on judgement.

Despite higher provisions, loan quality deterioration has been muted so far. Government support measures have softened the adverse impact on borrowers for now, with Stage 3 (non-performing) loans remaining below 2% for all banks. Loan quality will weaken once measures are gradually lifted, but we expect large Nordic banks to fare better than their Eurozone peers.

Higher provisions took a toll on profits, but capital buffers remained intact. First-half net profits declined by 46% on average for all six large banks compared to the same period in 2019. Danske suffered the greatest drop and Handelsbanken the smallest. However, no bank was loss making and solid capital buffers remained intact at all six banks.

Provisions in the second half of the year will be lower. Nordea guided for less than €1 billion of provisions (around 40 basis points) for the full year, with 85% already taken. SEB guided for SEK6 billion (around 25 basis points), with 70% taken. Danske said its provisioning so far should represent 70%-80% of the total for the full year (around 35-40 basis points).

DNB said most of its 2020 provisions have been taken. Barring Handelsbanken, we believe that the banks have already taken the lion's share of their required provisioning in 2020.

This report updates our June research: Loan book structure and different IFRS 9 applications lead to significant variations in provisions at large Nordic banks

Large Nordic banks reported higher provisioning charges in the first half of 2020

Large Nordic banks reported much higher provisioning charges in the first half of 2020, a consequence of the coronavirus-induced economic recession. Provisioning costs averaged 49 basis points for the six large banks in the first half of 2020, a considerable increase from an average of 7 basis points over the same period a year earlier. Provisioning levels varied widely, reflecting varying degrees of exposure to stressed sectors along with different provisioning approaches, but the discrepancies were less pronounced than in the first quarter. Nevertheless, large Nordic banks reported lower loan losses than large European banks, with average losses of 105 basis points in the same period.

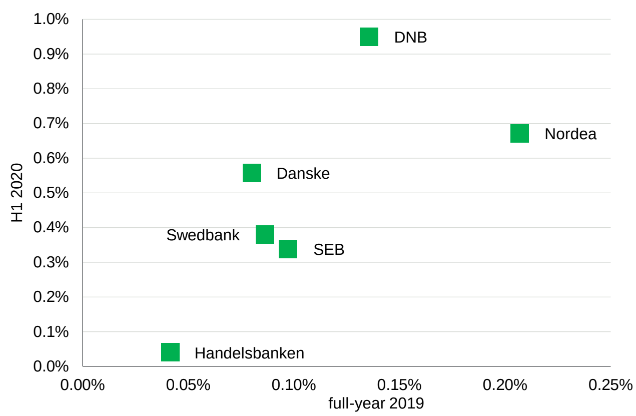
Handelsbanken bucked the trend with provisioning levels of just 4 basis points of total loans[3] for the half-year, in line with pre-crisis levels. In contrast, provisioning levels rose to 34 basis points for SEB, 38 basis points for Swedbank, 56 basis points for Danske, 67 basis points for Nordea and 95 basis points for DNB, from less than 10 basis points in the first half of 2019 for all banks.

Provisioning costs were multiple times the levels seen in the same period a year earlier, ranging from 5.2x for SEB to 11.2x for Danske. Only Handelsbanken booked lower provisions than a year ago (see Exhibit 2).

Exhibit 1

Most of the large Nordic banks recorded a sharp rise in provisions

H1 2020 (annualised) vs FY 2019 provisions % credit exposures*

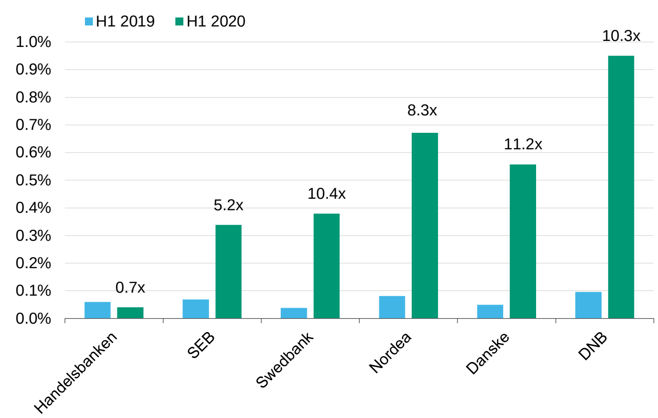


Note: *Credit exposures definitions differ across banks (see Endnotes).
Sources: Moody's Investors Service; banks' financial statements

Exhibit 2

For most, provisions increased multiple times vs H1 2019

Provisioning costs (%) credit exposures;* label indicates nominal increases



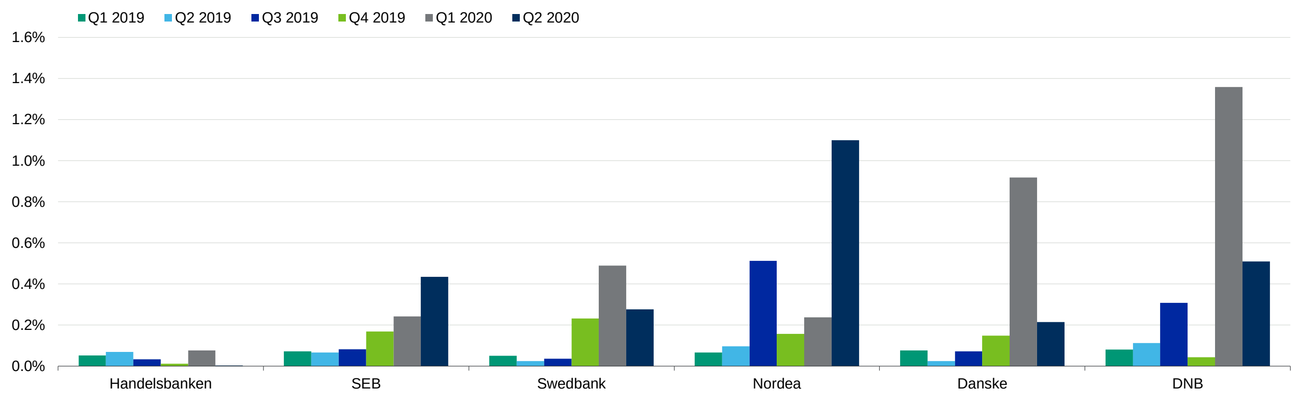
Sources: Moody's Investors Service; banks' financial statements

Diverging trends in quarterly provisioning levels

The quarterly evolution of provisioning costs (cost of risk) shows some diverging trends. The costs came down for DNB, Danske and Swedbank, but increased for Nordea and, to a lesser extent for SEB. This was primarily due to different provisioning approaches in the first quarter and reflected timing constraints and the front-loading of provisions in stressed sectors for some banks. Average cost of risk fell to 42 basis points in the second quarter, from 55 basis points in the first quarter.

Exhibit 3

Evolution of quarterly provisioning costs (annualised)

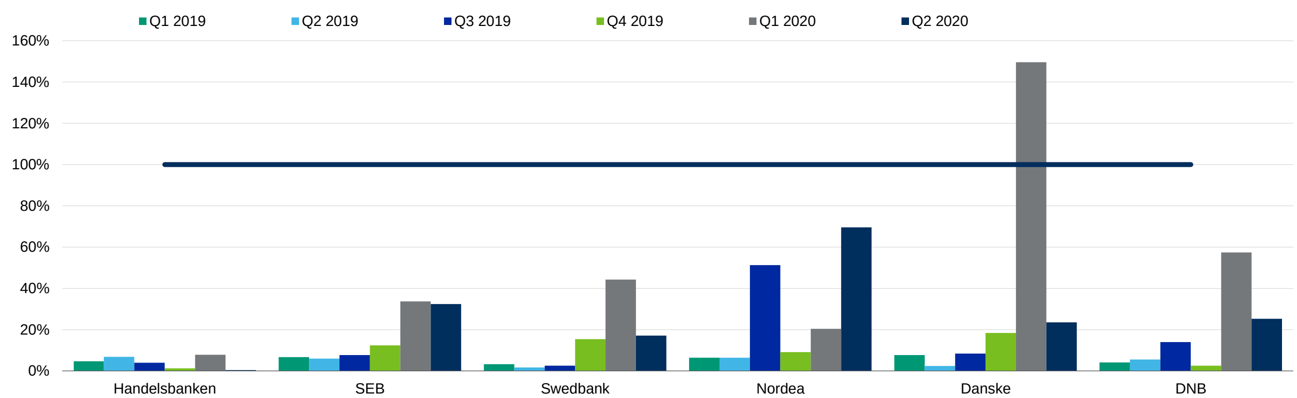


Note: Excluding asset quality review (AQR) related provisions, Q3 provisioning costs for Nordea decline to 0.1%
Sources: Moody's Investors Service; banks' financial statements

Pre-provision income (PPI) absorbed second-quarter provisioning charges for all banks. A recovery in financial markets reversed some of the valuation and trading losses that the banks incurred in the first quarter, which supported PPI. DNB recorded a decline in net gains on financial instruments at fair value due to exchange rate effects on the bank's Additional Tier 1 capital, but this did not have a significant impact on the bank's historically strong PPI.

Exhibit 4

Most banks have sufficient pre-provision income to absorb higher provisioning charges
Provisions as a % of pre-provision income



Notes: i For Nordea, excluding AQR-related provisions, provisions / PPI falls to less than 10% for Q3 2019. ii PPI excludes the impact of money-laundering fines imposed on Swedbank in Q1 2020 and SEB in Q2 2020, and impairment of capitalised IT systems for Nordea in Q3 2019.
Sources: Moody's Investors Service, banks' financial statements

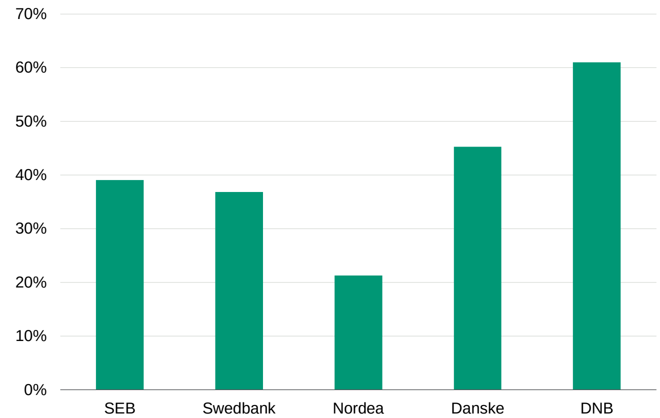
Loans to oil, gas and shipping sectors drove a large part of provisions; provisions for the rest of the loan book were lower

All banks set aside substantial provisions on their exposure to the stressed oil, gas and shipping sectors, with the exception of Handelsbanken, which has only marginal exposure. These sectors drove a large part of banks' provisions (see Exhibit 5), despite accounting for a small part of their overall lending**.** DNB is most exposed (see Exhibit 6)[4].

Exhibit 5

Loans to the stressed oil, gas and shipping sectors drove a large part of banks' provisions

Estimates for oil, gas and shipping provisions / total provisions (H1 2020)



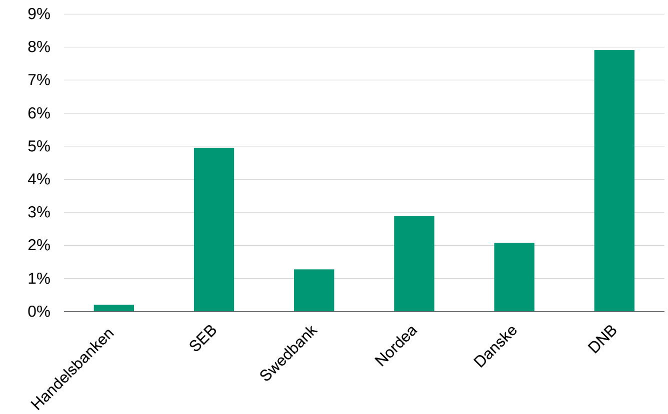
Note: For Handelsbanken, data is not available but the figure is small. For SEB and Danske, disclosures on oil-related provisions are only partial. For SEB, the change in ECL allowance for loans was used as a proxy to estimate oil, gas and shipping related provisions, ECL on off-balance sheet items excluded. For Danske, only individual provisions are provided (i.e. no disclosure on management adjustment). Shipping component is not adjusted for Danske due to lack of data.

Sources: Moody's estimates; banks' disclosures

Exhibit 6

DNB is most exposed, Handelsbanken has marginal exposure

Exposure to oil, gas and shipping (%) credit exposures* (June 2020)



*Credit exposures definitions differ across banks[5]

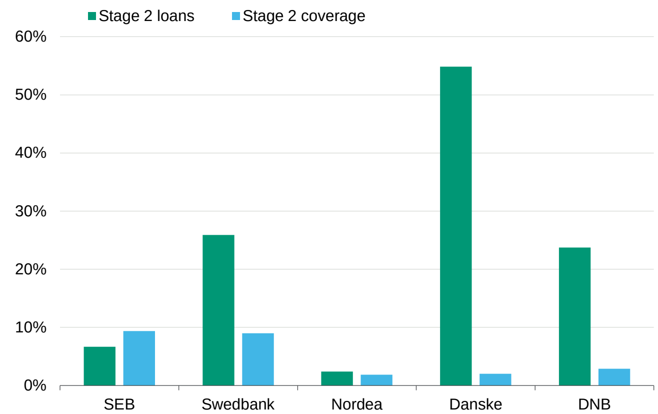
Sources: Moody's Investors Service, banks' financial statements and presentations

These sectors, and mainly the offshore sector, represent the highest source of credit risk for the large Nordic banks, as shown by their sizeable share of Stage 2 and Stage 3 loans (see Exhibits 7 & 8). Risk for these sectors remains high in view of the ongoing oil price volatility and lower collateral values. Coverage levels diverge widely.

Exhibit 7

Loans to stressed oil, gas and shipping industries show signs of significantly increased credit risk

Stage 2 oil, gas and shipping loans % of total sector loans and coverage ratio

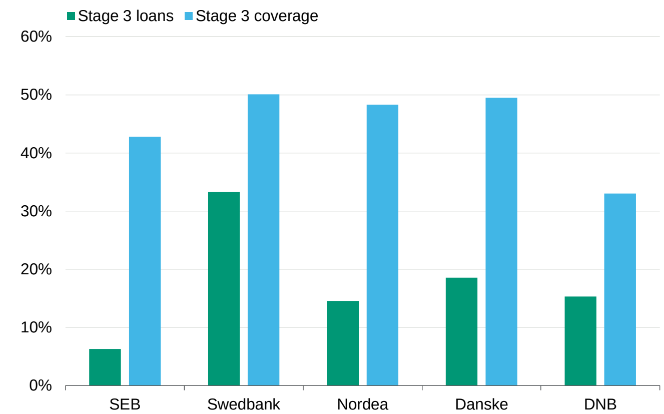


Note: Stage 2 classification is for loans with significantly increased credit risk. Stage 3 are problem loans (non-performing).
Sources: Moody's Investors Service; banks' financial statements

Exhibit 8

Impaired loans in the oil, gas and shipping industries are high despite low exposure

Stage 3 oil, gas and shipping loans % of total sector loans and coverage ratio



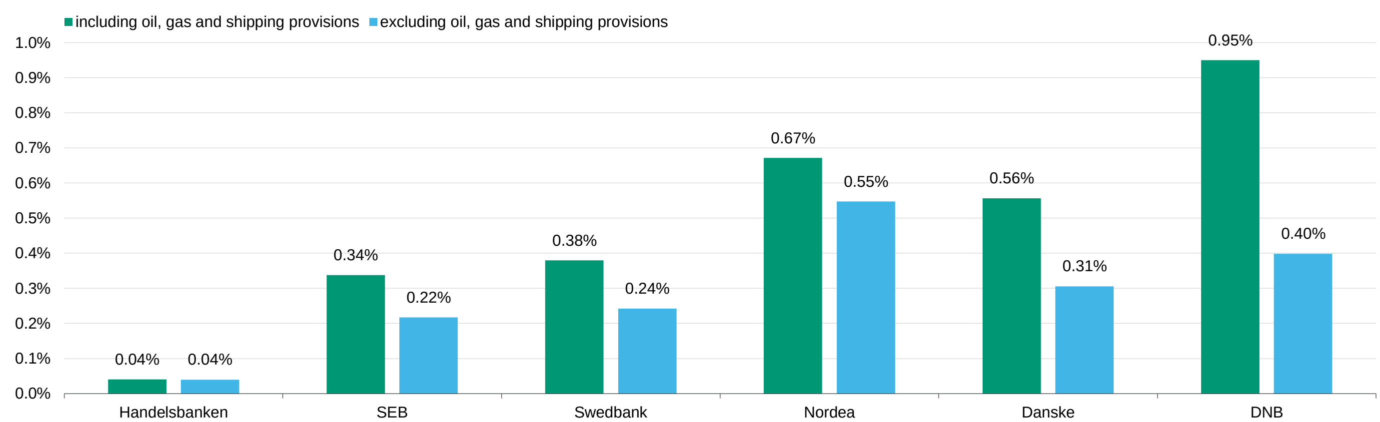
Sources: Moody's Investors Service; banks' financial statements

Outside oil-related exposures, provisions for the remainder of the loan portfolios were lower. According to our estimates, these range from 22 basis points for SEB, 24 basis points for Swedbank, 31 basis points for Danske and 40 basis points for DNB. For Nordea, they were relatively higher than its peers, at 55 basis points (see Exhibit 9).

Exhibit 9

Provisioning levels are lower when excluding oil, gas and shipping-related provisions

Provisioning levels including and excluding oil, gas and shipping provisions (H1 2020)



Note: For Handelsbanken, there is minimal impact when excluding oil, gas and related provisions. SEB's non-oil provisions are Moody's estimates due to only partial disclosure.
Sources: Moody's estimates; banks' financial statements

Handelsbanken stood out with considerably lower provisioning charges than its five peers. This is because Handelsbanken is less exposed to vulnerable sectors. The bank also has a strong track record of lower loan losses during previous downturns, reflecting conservative underwriting standards, a risk-averse approach to credit risk management and a weak correlation between its asset quality and the macroeconomic environment. Nevertheless, the lower provisioning also reflects the bank's approach to general provisioning.

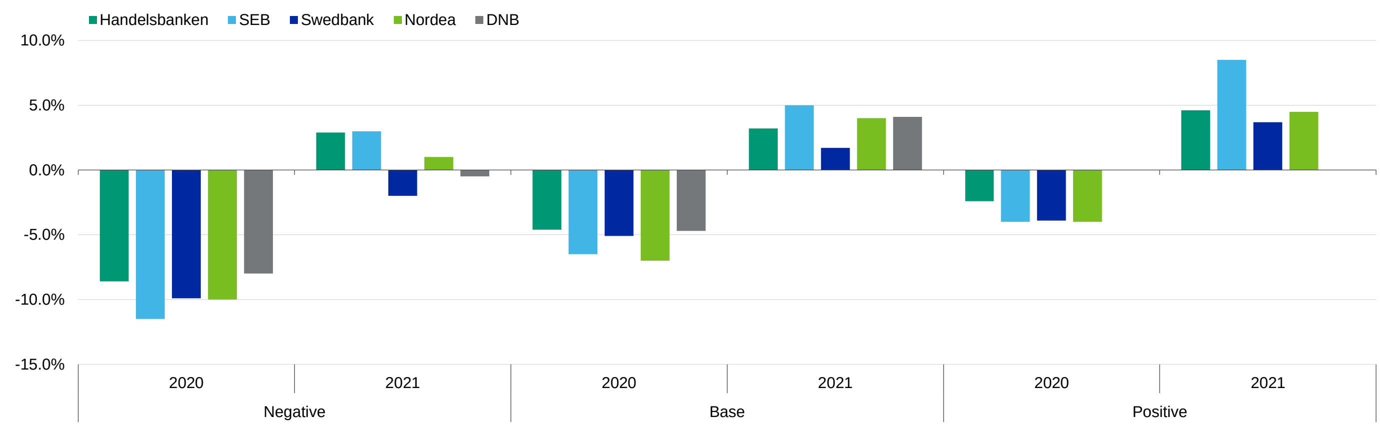
Discrepancies in provisioning approaches remain wide

Deteriorating macroeconomic scenarios as part of the banks' IFRS 9 expected credit loss calculations affected provisioning levels. The two banks that did not update their macroeconomic scenarios in the first quarter (Nordea and Handelsbanken) did so in the second quarter. All banks but DNB introduced further updates to their scenarios. SEB and Swedbank applied more negative macroeconomic scenarios in the second quarter, leading to additional impairments. Danske also incorporated a more adverse GDP scenario (4.2% Nordic GDP contraction for 2020 compared with a 0.1% contraction used in the first quarter) in its base scenario, but at the same time softened the assumption of residential property price declines (0.6% decline for 2020 compared with 2.1% decline used in the first quarter). This led to a small net reversal due to lower loss-given-default (LGD) assumptions.

Despite some convergence since the first quarter (for example, Danske's revised Nordic GDP assumptions of 9.5%, 4.2% and 3.9% contraction in 2020 GDP under the negative, base and positive scenarios respectively are broadly in line with the corresponding 9.6%, 5.4% and 3.4% figures used by Handelsbanken), differences in macroeconomic forecasts between banks remain. For example, assumptions for Swedish GDP growth vary significantly for those banks that publicly disclosed their scenarios, particularly for 2021. Differences also exist for other macroeconomic factors such as unemployment and housing prices, which have an even more significant explanatory power in banks' models than GDP growth. Banks use various sources, both internal and external, to develop their macroeconomic scenarios. The flexibility in the IFRS 9 framework means that banks' macroeconomic scenarios will not be fully aligned.

Exhibit 10

Banks' scenarios for GDP growth in Sweden diverge significantly



Note: No comparable data for Danske. DNB discloses a base case and base case alternative scenario with more negative assumptions.
Sources: Moody's Investors Service; banks' financial statements

Management add-ons overlaying models are also based on judgement and explain a significant part of provisions. For example, management adjustments at Nordea built up coverage for future loan losses to €650 million in June, from €142 million at the end of 2019. This buffer now covers future loan losses not covered by models (€430 million), IFRS 9 model improvements (€110 million) and nonperforming loan provisioning requirements under the European Central Bank's new guidelines effective in the fourth quarter of 2020. The last two adjustments, which were not triggered by Covid-19 but their level was potentially affected by the outbreak, partly explain Nordea's higher provisioning level for the second quarter. Handelsbanken's revised model overlay calculation led to a small reversal in the second quarter.

With model updates in place for all banks and following strengthening of precautionary management add-ons for most banks, the range of the six large banks' provisioning costs narrowed to around 90 basis points in the first half of 2020 (95 basis points for DNB and 4 basis points for Handelsbanken), from around 130 basis points in the first quarter of 2020 (136 basis points for DNB, 8 basis points for Handelsbanken). However, significant differences remain and we do not expect full harmonisation in banks' provisioning policies, given the high degree of judgement and flexibility that is inherent in the IFRS 9 accounting rules. (See our previous report for a more in-depth discussion on the IFRS 9 expected credit loss (ECL) framework). The divergence in provisioning levels also reflects the banks' varying degrees of exposure to stressed sectors.

Despite higher provisions, loan quality deterioration has been muted so far

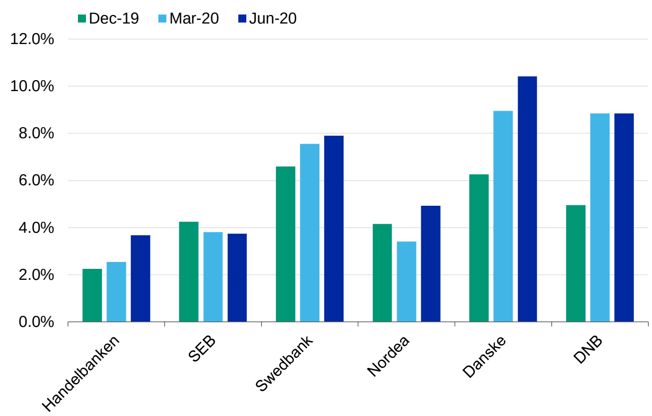
Despite higher provisioning, actual asset quality deterioration has been limited so far, owing to a comprehensive policy response by the Nordic countries to soften the impact of the outbreak of the virus. For most banks, non-performing (Stage 3) loans remained stable from end-2019 levels, with the exception of SEB and DNB, where increases were mainly driven by oil exposures. For all banks, Stage 3 exposures remained below 2% of total.

The banks did record an increase in loans showing signs of significantly increased credit risk (Stage 2) from end-2019 levels, mainly in most vulnerable sectors (see Exhibit 11 below). These reflected updated macroeconomic assumptions, with weaker economic scenarios leading to higher probabilities of default under the IFRS 9 expected loss regime and so to Stage 2 classifications. Stage 2 loans dropped at SEB due to the migration of oil exposures from Stage 2 to Stage 3.

Exhibit 11

Deteriorating economic scenarios have increased the probability of defaults

Stage 2 exposures / Total exposures*



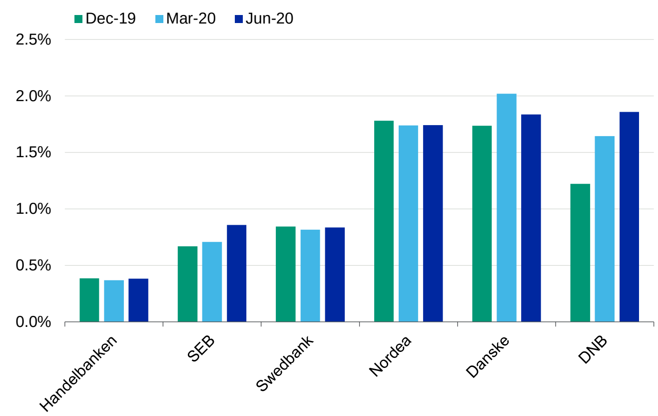
Notes; i Stage 2 loans are those showing significantly increased credit risk. ii *Credit exposures definitions differ across banks[6]

Source: Banks' financial statements

Exhibit 12

Nonperforming loans have largely remained steady

Stage 3 exposures / Total exposures*



Notes: i Stage 3 loans are non-performing. ii*Credit exposures definitions differ across banks (see Endnotes).

Source: Banks' financial statements

We expect asset quality to show some deterioration once government support measures are phased out and defaults start to emerge. But we expect Nordic economies to fare better than eurozone countries and Nordic banks to be more resilient than their eurozone peers, with lower problem loan formation and less extensive provisioning charges. The average quarter-on-quarter[7] GDP contraction in the second quarter for the four Nordic countries was 6.5%, compared with 12.1% for the eurozone.

Nordic households are highly indebted but we believe that households will remain resilient. This because underwriting standards are conservative and payment culture is very strong. This resilience has been demonstrated in past crises, where credit quality deterioration of mortgages, which provide the bulk of the household exposure, was very limited. Nordic countries also have comparatively strong social safety nets.

The corporate sector is hardest hit in this crisis, but the financial health of Nordic firms has strengthened overall in the run-up to the outbreak, and large corporates to which large Nordic banks are exposed, generally entered the crisis from a robust position and with good liquidity.

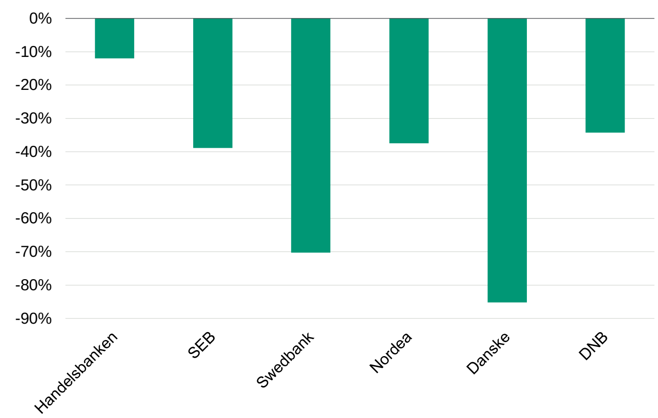
Higher provisions took a toll on profits, but capital buffers remained intact

In the first half of 2020, all large Nordic banks reported a drop in earnings compared with the same period in 2019, with the average decline at 46% for all six large banks. Danske suffered the greatest drop of 85%, while Handelsbanken fared best, reporting a 12% decline (see Exhibit 13).

No bank was loss making. This was despite higher loan loss provisions and other pressures on profitability stemming from the outbreak of the virus, which included financial market volatility. Swedbank and SEB incurred money laundering fines of SEK4 billion and SEK1 billion respectively, imposed by the Swedish authorities in Q1 2020 and Q2 2020 respectively. Danske Bank faces ongoing profitability pressures, including, among others, increased operational and compliance costs relating to ongoing money laundering investigations.

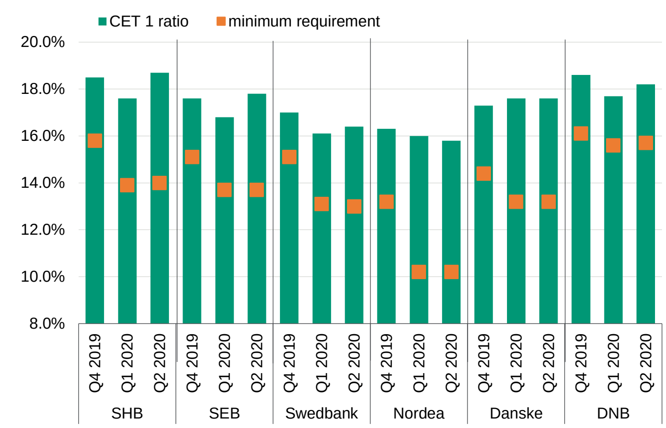
Most of the large banks have strong underlying earnings or are focused on cost cuts to help absorb losses. Despite the significantly lower earnings, all large banks' solid capital buffers remained intact, with some banks benefitting from the application of the European Union's revised Capital Requirement Regulation (known as the CRR2 "quick fix"), which includes a lower risk-weighting for small and medium enterprises exposures. Common equity tier 1 (CET1) capital ratios increased in the second quarter for all banks barring Danske (flat) and Nordea (marginal decline). Capital at all banks well exceeds regulatory requirements, which will help them weather the crisis (see Exhibit 14).

Exhibit 13
All large Nordic banks' suffered declines in first half 2020 earnings
Decline in bottom line earnings in H1 2020 compared to H1 2019



Source: Banks' financial statements

Exhibit 14
Capital buffers remained intact
Quarterly evolution of CET1 ratio and requirement



SHB: Svenska Handeslsbanken. CET1 requirements dropped in Q1 2020 due to the relaxations by various authorities, including relaxation of countercyclical buffers (CCyB). DNB's capital requirement fell less than peers.
Source: Banks' financial statements

Provisions in the second half of the year will be lower

Greater visibility in terms of the impact of the outbreak led some banks to offer guidance for full-year provisioning levels. Nordea guided for less than €1 billion of provisions this year (equivalent to 40 basis points, of which 85% was taken in the first half). SEB guided for a SEK6 billion of provisions (equivalent to 25 basis points, of which 70% was already taken). According to Danske, provisions taken during the first half of 2020 should represent 70%-80% of total provisions for the year, implying a level of between 35 and 40 basis points. DNB re-iterated that most provisions for 2020 have been recognised in the first half of the year. Handelsbanken and Swedbank offered no full-year guidance.

IFRS 9 provisioning is driven by forward-looking macroeconomic assumptions and modelling. It is therefore difficult to predict where the full-year level of banks' provisions will be. The evolution of the coronavirus along with government measures, such as partial or full lockdowns both domestically and for key trading partners, will play a key role on how the macroeconomic outlook develops. Any further deterioration in macroeconomic forecasts, with less favorable developments in unemployment trends and housing prices, will lead to additional provisions (as seen this quarter from SEB and Swedbank).

If economies recover more quickly than previously expected, with both employment and housing prices proving to be resilient, there is a possibility that most banks (barring Handelsbanken) will see reversals at a later stage. For example, DNB is already pointing to an improved macro outlook and higher business activity than expected. As noted above, excluding the oil and offshore segments, the deterioration in asset quality has been very limited so far, and ratings migration has primarily taken place among the more highly rated loan classifications.

Provided there is no significant downward revisions in the macroeconomic outlook, we believe that the lion's share of the banks' required provisioning in 2020 has already been taken. The exception is Handelsbanken. We believe Handelsbanken will most likely need to take higher provisions in the second half of the year. Full-year provisioning costs for the bank will nevertheless remain significantly lower than its peers.

Endnotes

1 Svenska Handelbanken AB (Aa2/Aa2 stable, a2), SEB AB (Aa2/Aa2 stable, a3), Swedbank AB (Aa3/Aa3 stable, baa1) in Sweden, Nordea Bank Abp (Aa3/Aa3, stable, a3) in Finland, Danske Bank A/S (A2 negative/A3 stable, baa2) in Denmark and DNB Bank ASA (Aa2/Aa2 stable, a3) in Norway. The bank ratings shown in this report are the banks' deposit ratings, senior unsecured debt ratings and Baseline Credit Assessment.

2 20 large European banks rated by Moody's

3 Denominators of the loan-loss provisioning ratio differ across banks but without materially affecting comparability. Handelsbanken: loans to the public, SEB: total exposure excluding debt securities; Swedbank: loans to the public and credit institutions; Nordea: amortised cost loans; Danske: net credit exposure (loans at amortised cost, loans at fair value and guarantees and excluding non-core activities); DNB: loans to customers at amortised cost. Provisions are divided over end-period loan or exposure balances. For Nordea, 2019 provisions include provisions taken as part of an asset quality review (AQR) following its relocation to Finland. Excluding these, its 2019 provisioning cost is 10 basis points.

4 For a detailed analysis of banks' exposures, please see the report Loan book structure and different IFRS 9 applications lead to significant variations in provisions at large Nordic banks

5 Handelsbanken; on balance sheet exposures; SEB: loans, includes mining; Swedbank: loans; Nordea: amortised cost and fair value loans excluding repos; Danske: gross credit exposure; DNB: on and off balance sheet exposure

6 Handelsbanken: loans to the public, SEB: total loans; Swedbank: loans to the public; Nordea: amortised cost loans, including central banks and credit institutions; Danske: gross credit exposure (loans at amortised cost, loans at fair value and guarantees for core activities); DNB: on and off-balance sheet exposures

7 Seasonally adjusted basis, mainland GDP for Norway

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