

Global Credit Research - 22 Apr 2010

Stockholm, Sweden

## Ratings

| Category                   | Moody's Rating |
|----------------------------|----------------|
| Outlook                    | Stable         |
| Issuer Rating              | Aa1            |
| Senior Unsecured -Fgn Curr | Aa1            |
| Senior Unsecured -Dom Curr | Aa1            |
| Subordinate                | Aa2            |
| Jr Subordinate MTN         | Aa3            |
| Preferred Stock            | Aa3            |
| Commercial Paper           | P-1            |
| Other Short Term           | P-1            |

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## Key Indicators

### Swedish Export Credit Corporation

|                              | [1]2009 | 2008   | [2]2007 | 2006   | 2005   | [3]Avg.  |
|------------------------------|---------|--------|---------|--------|--------|----------|
| Total assets (SEK billion)   | 371.59  | 370.01 | 297.24  | 245.22 | 207.49 | [4]18.05 |
| Total assets (EUR billion)   | 36.27   | 33.66  | 31.46   | 27.18  | 22.10  | --       |
| Total capital (SEK billion)  | 16.60   | 13.72  | 7.45    | 7.36   | 6.99   | [4]21.94 |
| Return on average assets     | 0.46    | 0.04   | 0.13    | 0.16   | 0.18   | 0.20     |
| Recurring earnings power [5] | 0.70    | 0.23   | 0.18    | 0.23   | 0.26   | 0.32     |
| Net interest margin          | 0.60    | 0.54   | 0.35    | 0.39   | 0.43   | 0.46     |
| Cost/income ratio (%)        | 15.57   | 32.92  | 38.66   | 36.25  | 35.06  | 31.69    |
| Problem loans % gross loans  | 0.00    | 0.00   | 0.01    | 0.00   | --     | 0.00     |
| Tier 1 ratio (%)             | 17.90   | 14.82  | 6.50    | 9.40   | 9.70   | 11.66    |

[1] As of December 31. [2] Statement period in which the bank switched to Basel II accounting framework. [3] The average calculations are based on Basel I and Basel II data where applicable. [4] Compound annual growth rate. [5] Preprovision income % average assets.

## Opinion

### SUMMARY RATING RATIONALE

In accordance with Moody's rating methodology for government-related issuers (GRIs), the Aa1/Prime-1 ratings of Swedish Export Credit Corporation (SEK) reflect the following inputs: a baseline credit assessment (BCA) of between

2 and 4 (on a scale of 1 to 21, where 1 represents the lowest credit risk), the Aaa local currency deposit ceiling of the Swedish government, high dependence and high support.

The BCA is underpinned by SEK's strong and long-established expertise in its niche segment of export financing, satisfactory financial fundamentals and a relatively low risk profile. SEK's lending activities have a low risk profile due to the credit enhancement of its export loan portfolio via sovereign and bank guarantees. SEK enjoys a unique role as the only financial institution authorised to grant export credits at subsidised and concessionary rates in Sweden (the so-called 'S' system). It is also the only specialised export lender in the country.

Moody's views default dependence as high due to SEK's high correlation with the Swedish government. We also view the probability of support as high in light of SEK's strategic public role and its 100% ownership by the Kingdom of Sweden, which clearly reinforces the expectation of support in a distress scenario. The owner's support was clearly demonstrated through a direct capital injection and the creation of dedicated borrowing facilities to allow SEK to continue to fulfil its essential public policy role in 2009.

### **Credit Strengths**

- 100% ownership by the Kingdom of Sweden
- Strong franchise protected by its important public role and well-established business relationships
- Satisfactory financial fundamentals
- Strong quality of lending book despite high loan concentration

### **Credit Challenges**

- Maintenance of a low risk profile and solid asset quality while fulfilling its public policy role
- Full reliance on wholesale funding
- Significant degree of exposure to market risk and earnings volatility due to the large size of its securities portfolio
- Ability to maintain a diversified and conservative securities portfolio

### **Rating Outlook**

The outlook is stable.

### **What Could Change the Rating - Up**

A further strengthening of government support on top of the government ownership, such as a full guarantee of SEK's assets and liabilities, could create upward rating pressure.

### **What Could Change the Rating - Down**

Any decrease in the government's commitment or support, together with a weaker public role, could weigh on the ratings. SEK's low risk profile and good asset quality also remain key rating drivers. Consequently, any material deterioration in these areas could result in negative rating actions.

### **Recent Results and Company Events**

In 2009, SEK's pre-tax income increased substantially to SEK2.369 billion from SEK185 million for 2008. Net interest income, SEK's main core income component, rose 29% year-on-year mainly thanks to an increase in loan volumes (+ 17% from year-end 2008) and higher interest margins. Pre-tax profit was also significantly helped by a reversal in market conditions that had generated negative market valuations on its large securities portfolio in previous years. As a result, net results of financial transactions generated SEK1.1 billion compared to a loss of SEK457 million in 2008, mainly related to unrealised changes in market value of financial assets. Tier 1 and total capital ratios, according to Basel II transitional rules, rose to 17.9% and 18.7% at end-2009 from 14.8% and 15.5% respectively, at end-2008, which reflected the benefit of the government capital increase.

### **DETAILED RATING CONSIDERATIONS**

Detailed considerations for SEK's currently assigned ratings are as follows:

## Qualitative Factors

### Franchise Value

Trend: Neutral

SEK has a leading position as a provider of long-term export financing to large Swedish companies. This role is crucial to the Swedish government considering the importance of the export sector to the Swedish economy (exports accounted for around 50% of GDP in 2009).

SEK's public role, its niche franchise as a long-term specialised player in export finance and its close ties with the Kingdom of Sweden are important competitive advantages to the other commercial banks. SEK enjoys also a unique role as the only financial institution in Sweden that is authorised to grant export credits at subsidised and concessionary rates. The 'S' system credits accounted for an 8% share of the total credits outstanding at end-2009.

To complement its core business, SEK has expanded into new business areas ranging from debt capital markets to advisory services and project financing, broadening its customer base to also include local and municipal authorities and smaller size corporates. Those activities, however, still account for a comparatively small proportion of SEK's overall profit. Going forward, a key challenge for SEK will be to successfully develop its position using new products while maintaining a stable and conservative risk profile.

### Risk Positioning

Trend: Neutral

Due to its 100% government ownership, SEK departs from the requirements for corporate governance in a few areas, which are described below. That said, we have no concerns about SEK's corporate governance because (i) there are no minority shareholders that could suffer under the current ownership structure and (ii) we are comfortable with the level of management integrity.

SEK's risk-related management and control is directed towards credit, market, liquidity and operational risks. Risk control is carried out by the risk control function, which reports to the head of risk & IT and to the president.

Although funding and lending are in a variety of currencies, SEK eschews residual net foreign currency risk by principally matching all assets and liabilities in all individual currencies. To this end, the institution utilises its assets and liabilities as well as derivatives. A limited currency exposure is allowed in relation to its investments or as part of locked-in arrangements. The maximum currency risk limit - set in relation to a ten-percentage-point change in the exchange rate for Swedish kronor - is SEK15 million. At end-2009 the actual currency risk amounted to SEK4 million (SEK13 million in 2008).

Interest rate risk is calculated from a parallel shift in the yield curve of one percentage point and the maximum interest rate risk limit is set at SEK70 million. The actual exposure is well below the limit. Interest rate risks are managed at an individual contract and total portfolio level, with active use of derivatives.

### Regulatory and Operating Environments

See Moody's latest Banking System Outlook on Sweden for a discussion of the regulatory and operating environments.

## Quantitative Factors

### Profitability

Trend: Neutral

In line with similar specialised lenders, SEK's core profitability is historically relatively modest, reflecting the lower margins of its traditional lending business coupled with a still limited contribution from its business expansion into new activities. However, over the past few years, SEK has been able to improve its profitability through higher volumes of export lending and more significantly increasing income from its large securities portfolio (total securities accounted for around half of its total assets as at end 2009). This last component has also resulted in SEK's earnings experiencing significant volatility due to the mark-to-market valuations of its financial assets.

SEK's net income for 2009 was exceptionally high. Net interest income, which was up by 30% in 2009, benefited from strong growth in lending volumes and improved lending margins, reflecting falling competition during the year as global banks rationalised lending under tight liquidity conditions (in contrast to SEK's comfortable funding position).

Net interest margin rose to 0.6% from 0.5% helped by lower competition. In addition, net financial income for 2009 was positive thanks to the strong performance of the liquidity portfolio, resulting in large unrealised profits. Impairments of assets (financial assets and loans) fell from 2008 levels, helped by exceptional reversals of provisions in the loan portfolio of Venantius, (the 100% state-owned company established during the Swedish banking crisis to manage bad assets transferred by domestic banks), which was consolidated into SEK during 2008.

Under exceptional circumstances, SEK has been able to improve its profitability significantly in 2009. However, with market conditions and the competitive landscape returning to normal, we expect core profitability to have less room for improvement. In particular, we expect higher pressure on funding costs to pressurise net interest margins.

#### Liquidity

Trend: Neutral

SEK does not take customer deposits, but is wholly reliant on purchased funds. Its investor base is wide and comprises the US, Europe and Asia that the entity access offering a broad range of funding alternatives .

As a market-funded entity, SEK is dependent on unencumbered access to liquidity at all times, so that its operations can continue should there be any market interruptions. To offset this dependence, SEK's policy is that all credit commitments, including undisbursed credits, will be funded through maturity. SEK remains over-borrowed in all maturities so that normal lending operations could continue without access to additional market funding for approximately one year. Surplus borrowing is invested in assets with good credit quality and liquidity. SEK also has a strict policy for its liquidity risk in its short-term liquidity management. This policy includes requirements for back-up facilities.

In order to ensure that SEK had access to ample liquidity during the financial crisis, the Swedish government has since last year provided SEK with a borrowing facility of up to SEK100 billion and with the option of purchasing state guarantees for its new long-term borrowing up to a total amount of SEK450 billion initially, now reduced to SEK250 billion. So far these facilities have remained unused by SEK as the company has been able to support its lending growth through domestic and international markets.

#### Capital Adequacy

Trend: Neutral

At the end of December 2009, SEK reported Tier 1 and total capital ratios, according to transitional Basel II rules, of 17.9% and 18.7%, respectively, compared to 14.8% and 15.5%, respectively, at end-2008. The improvement of its capital adequacy ratios is mainly the result of the capital actions taken by the government in December 2008, resulting in a total capital increase of SEK5.4 billion through a direct equity injection of SEK3 billion and the incorporation of Venantius AB, which had a book equity of approximately SEK2.4 billion and a loan portfolio with a book value of around SEK0.6 billion. During 2009, SEK has divested Venantius' loan portfolio.

We expect SEK to continue to maintain its current satisfactory capital adequacy ratios going forward.

#### Efficiency

Trend: Neutral

In line with similar institutions, the absence of a branch network represents a cost advantage for SEK, allowing it to post better efficiency ratios than those of commercial banks. In comparison with similar institutions, SEK's efficiency ratios are good, despite deterioration over the past five years. The cost-to-income ratio improved to 16% at end-2009 from 33% at end-2008 due to exceptional revenue growth. In nominal terms, operating expenses rose by 33% year-on-year in 2009, although a significant proportion of this was driven by the increased size of the lending book.

Efficiency remains important for SEK's long-term competitiveness and we expect it to continue focusing on cost control going forward.

#### Asset Quality

Trend: Neutral

SEK has maintained high asset quality over time with respect to its loan portfolio, which accounted for approximately 50% of total assets at end-December 2009 (43% at end-2008). The bulk of SEK's credit exposure is either guaranteed or backed by highly rated sovereigns and financial institutions. At the end of December 2009, SEK's total net exposure included: states and local governments (46%), financial institutions and ABS (44%) and corporates

(10%).

With regard to SEK's loan book, its lending mainly consists of large loans with long maturities, potentially exposing the institution to considerable risks. Nevertheless, as noted above, export credits normally have a guarantee from either an export credit agency, a bank or are covered by other risk-mitigant instruments; as a result, a bulk of the portfolio is guaranteed or backed by high-quality counterparties. Additionally, SEK uses derivatives and collateral agreements to mitigate risk.

SEK benefits from the good quality of its lending book. At end-December 2009, it had no past-due loans (principal or interest that are more than 60 days overdue).

SEK has a sizeable portfolio of interest-bearing securities, which accounts for close to 40% of its total assets. SEK's investment criteria are more flexible than those of most other government/local government-owned specialised lenders. According to its policies, SEK was able to invest in ABS, and has established fixed guidelines as to the type of assets and ratings.

At end-December 2009, SEK 33.6 billion was invested in ABS. Within the ABS portfolio, around 70% is represented by residential mortgage-backed securities (RMBS), most of which are European with very limited exposure to the US market.

The ABS portfolio of SEK is included in the "loans and receivables" accounting category and has therefore not been subject to mark-to-market adjustments. According to Moody's internal stress tests, this portfolio would need to undergo a good degree of impairment if current mark-to-market were to be applied. We consider, however, the probability of these mark-to-market losses materialising as being relatively small for the time being given that SEK's liquidity position remains strong and that its policy is to hold ABS assets until natural maturity. Moody's will continue to monitor the performance of this portfolio to ensure that it remains in line with the credit and risk profile of the institution.

SEK had disclosed some exposure to Icelandic banks. SEK's exposure to Icelandic banks is related to a direct credit exposure to Glitnir Bank (not rated) totalling SEK514 million (accounting for some 4% of total capital at end-December 2009). As at end 2009, SEK had provisioned around 90% of this total exposure.



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