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SEB

Nordic Bank Liability Seminar

12 May 2011

Regulatory waters difficult to navigate

SEB

Authority

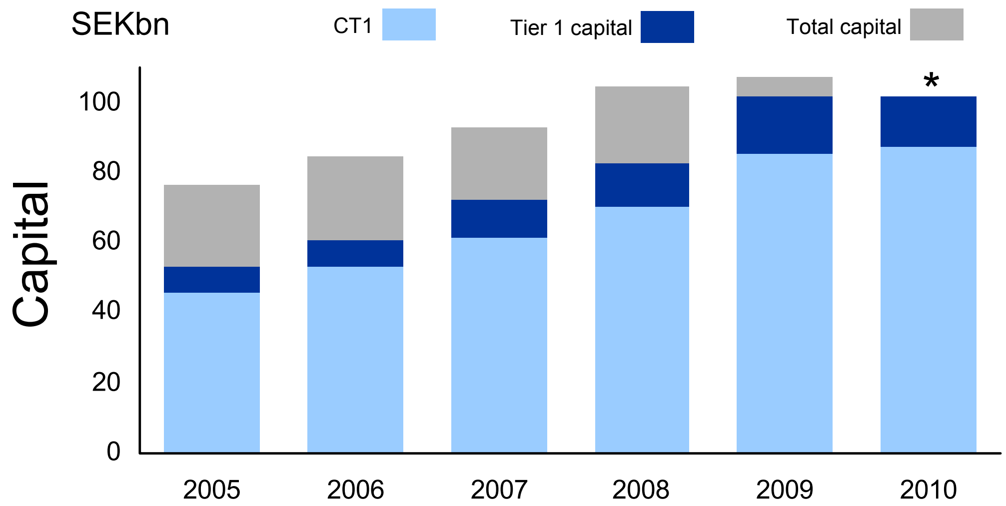
G-20 | Basel committee | EU | Swe

Regulatory areas

- Capital
- Liquidity
- Funding
- Leverage ratio
- Insurance / Solvency 2

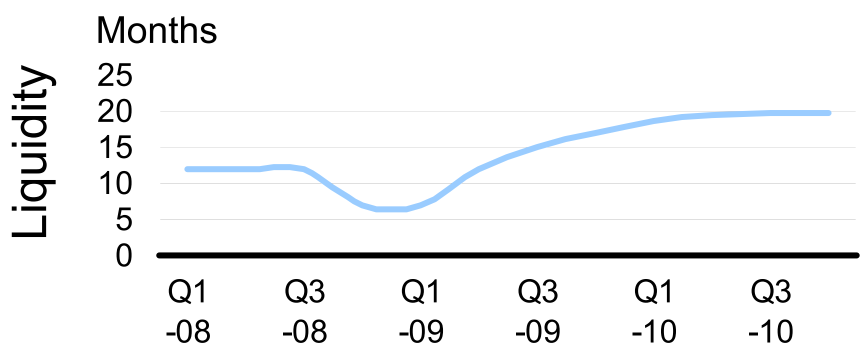
Great uncertainty on how ”directional ” requirements will be converted into detailled regulations and the desired internationel harmonization, incl. time table for the introduction of Swedish rules

Capital and liquidity – SEB´s record



- Increased capital base through earnings retention, rights issue, loss absorbing hybrid issuance and Tier 2 buy-backs
- Core capital accounts for the biggest increase
- Last Tier 2 issue in 2006

SEB´s “matched funding” horizon



- Matched funding on a higher level
- Pricing of liquidity risk is important part of financial steering

*Total capital is lower than CT1 and Total Tier 1 capital in 2010

Central issues for SEB 1 (2)

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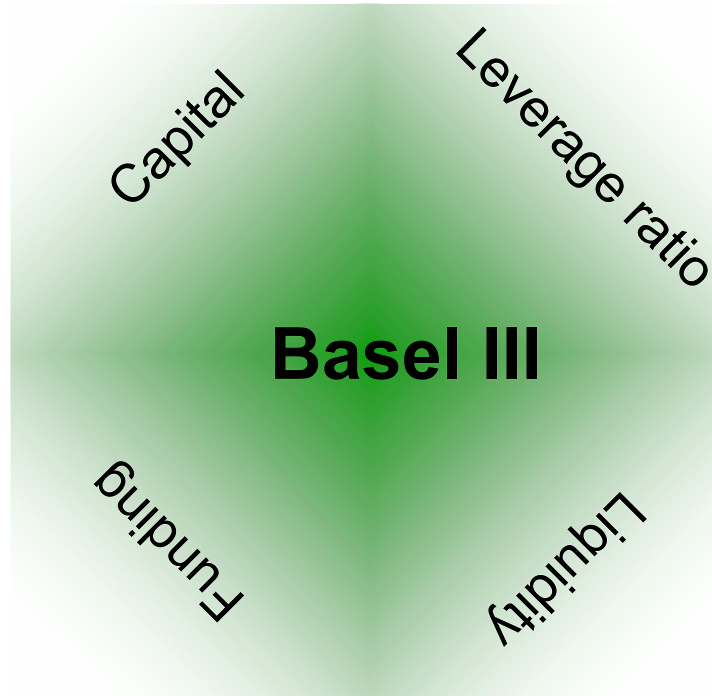
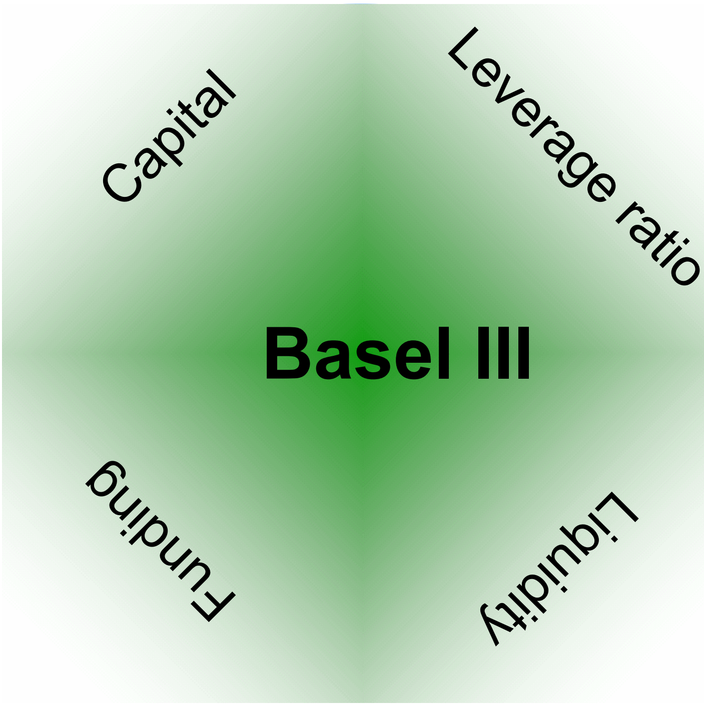
1. Speedy and clear information on buffer required, allowed capital instruments and resolution regime (bail-in)
2. Basel 3 and Solvency 2 must be aligned to arrive at workable forms and conditions for maturity transformation
3. Analysis of ”lagom” size of credit expansion and foreign borrowings
4. Take the risk of ”unintended consequences” seriously – analysis of proposed regulations



Central issues for SEB 2 (2)

SEB

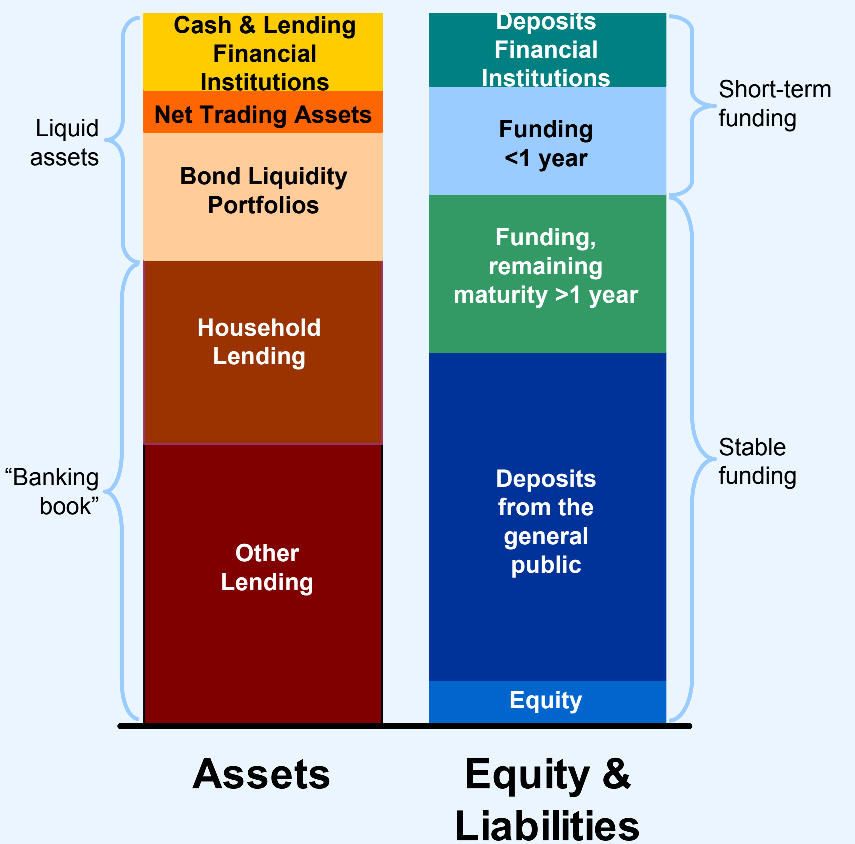
- **5** Greater scope for covered bonds in liquidity buffer acc to Basel 3 – there is enough government paper!
- **6** ’Net Stable Funding Ratio’ should be applied under Pillar 2
- **7** Corporate customer deposits should get higher credit as source of stable funding in ’Net Stable Funding Ratio’
- **8** Tougher regulations on deposit companies and consumer dredit companies



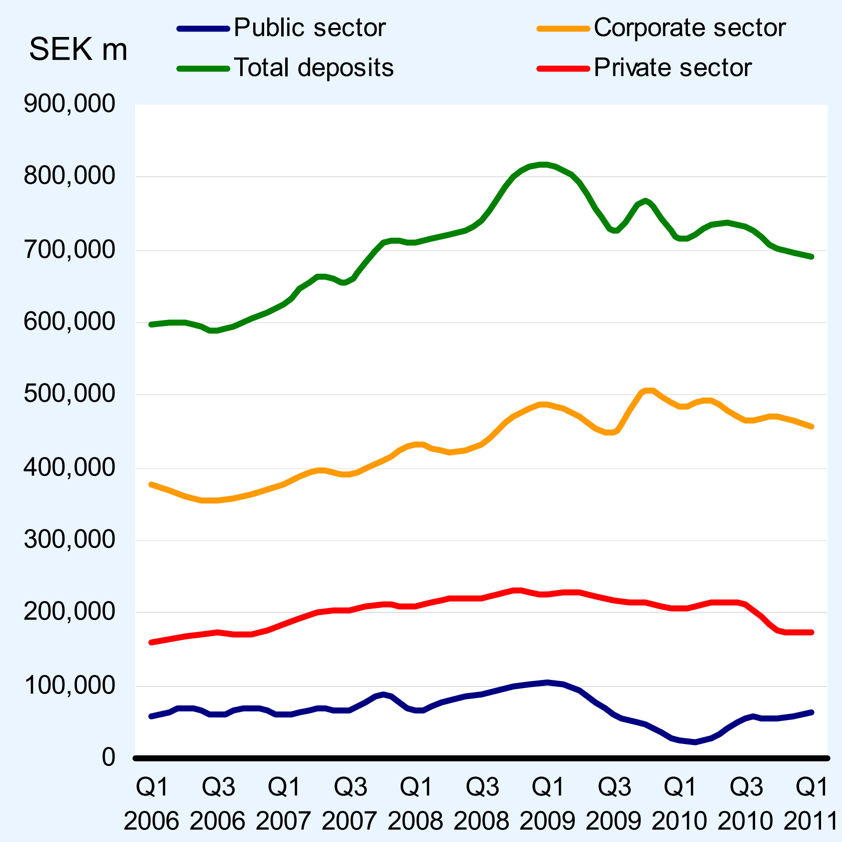
Liquidity & Funding

Strong and well-aligned balance sheet structure

Balance Sheet structure

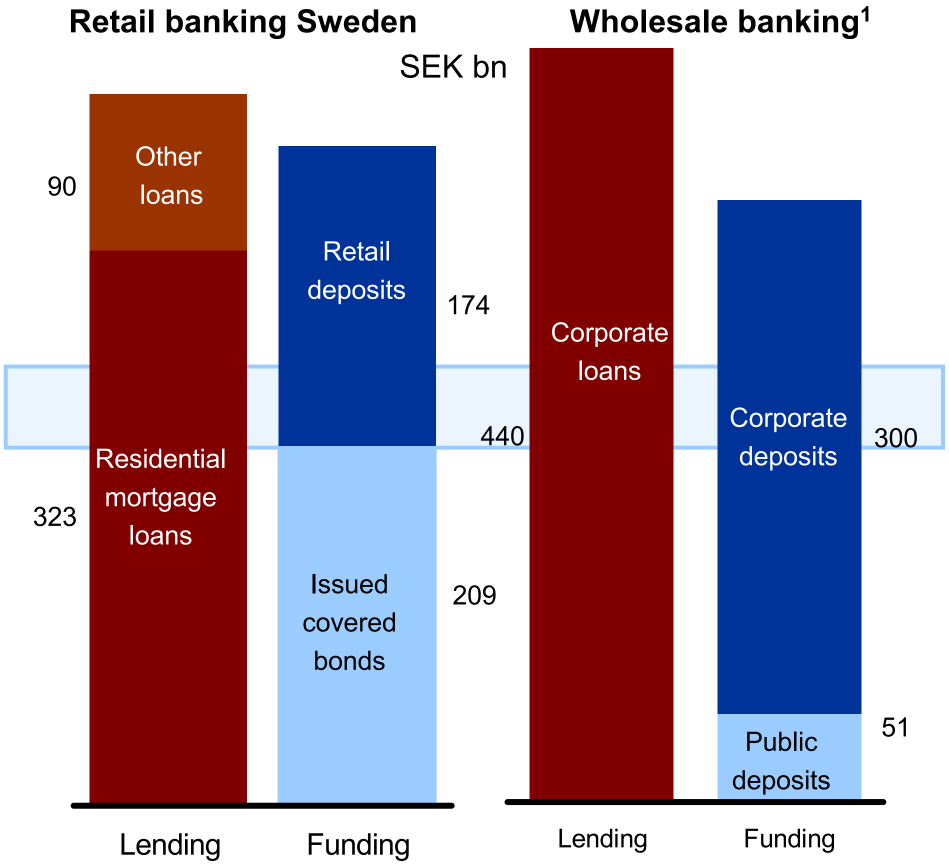


Development of deposits from the general public, excl repos



Strong structural liquidity situation

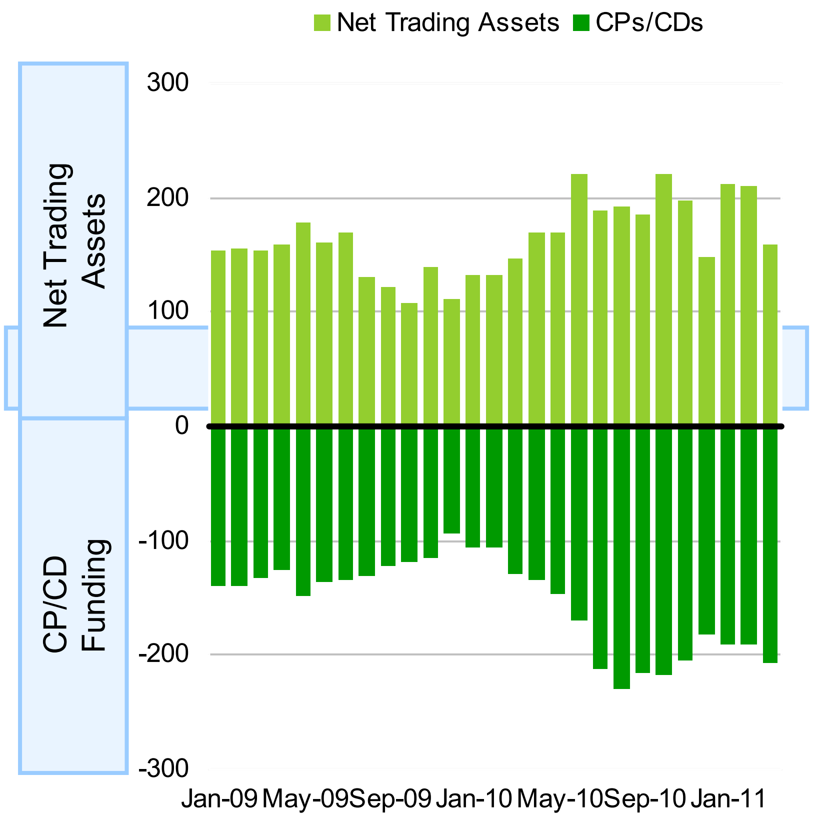
Strong structural liquidity situation in the two most important business areas; 80% of all lending



Balance mis-matches funded via long-term debt issuance

1. Excluding repos and reclassified bonds

Short-term funding[1] moves in line with Net Trading Assets[2] (SEK bn)



1. CPs/CDs
2. Net Trading Assets excluding Derivatives

Net liquidity position: Allows for sustained periods of no market access

Funding raised with original maturity ≥ 1 year

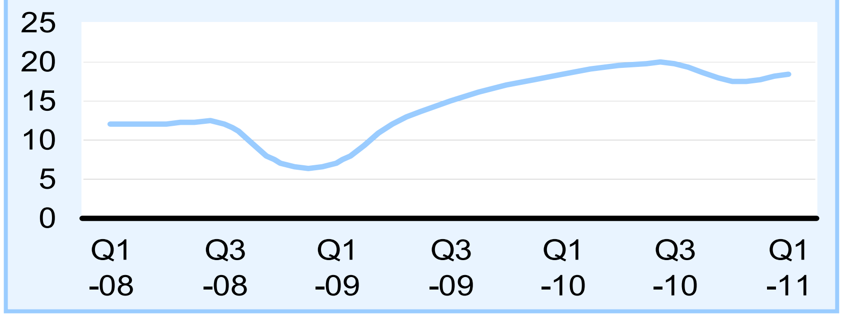
SEK bn

Instrument	Full year 2009	Full year 2010	Q1 2011*
Yankee CD	3,1	2,9	0,0
Senior unsecured SEB AG	5,2	0,4	0,2
Senior unsecured SEB AB	60,4	13,9	4,5
Structured bonds	8,3	3,2	1,5
Covered bonds SEB AG	24,4	10,7	0,0
Covered bonds SEB AB	25,7	71,0	43,9
Hybrid tier 1	3,3	0,0	0,0
Total	**130,4**	**102,1**	**50,1**

* As per April 5

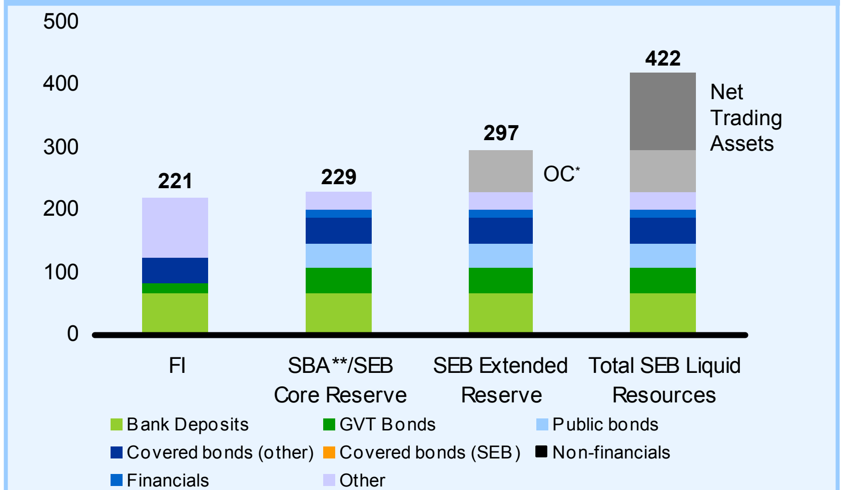
SEB's matched funding horizon 1)

Months



External vs. Internal Liquidity Reserve definitions (SEK BN)

March 2011

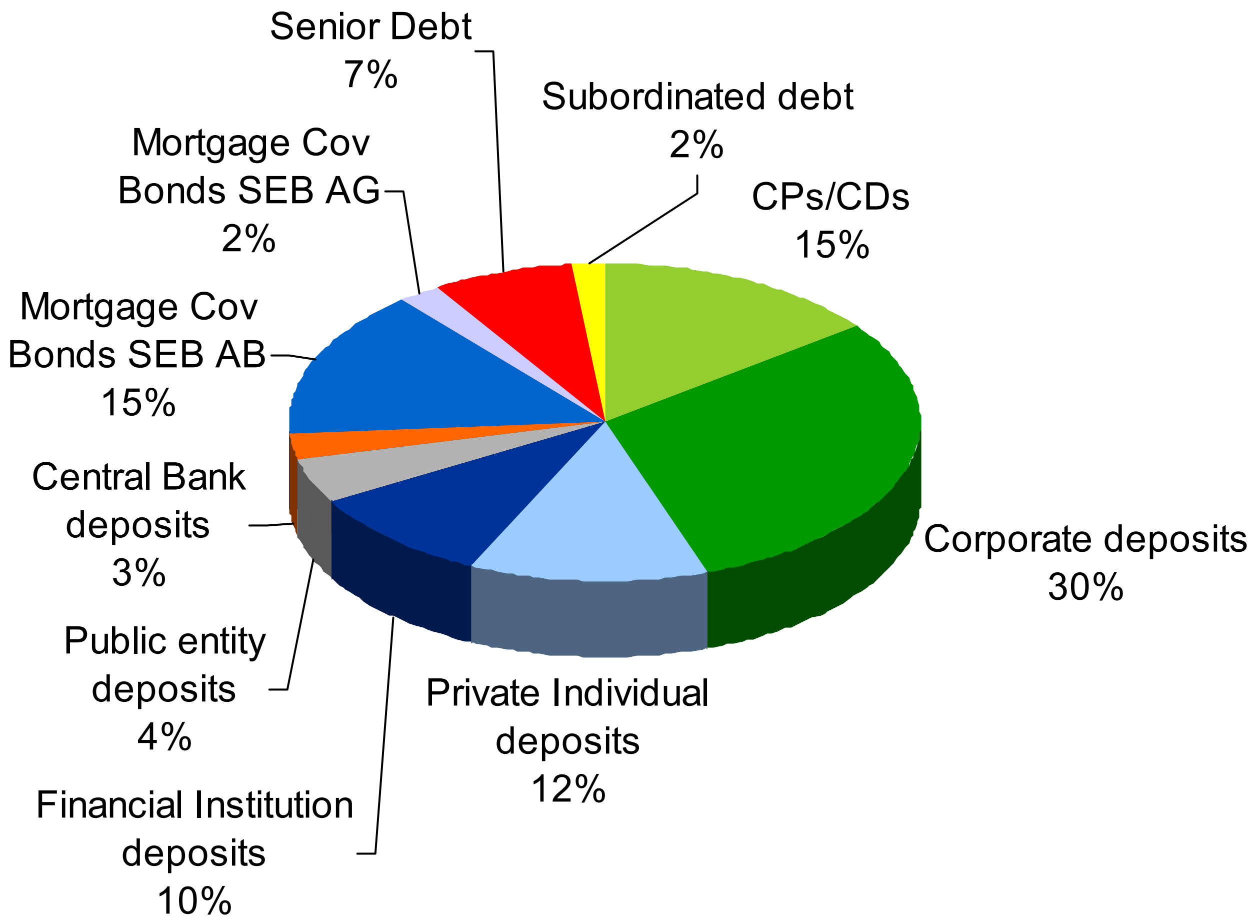


*Overcollateralisation net of Moody's requirement for AAA rating (13.5%)

**Swedish Bankers Association (Bankföreningen)

Overall liability & funding mix

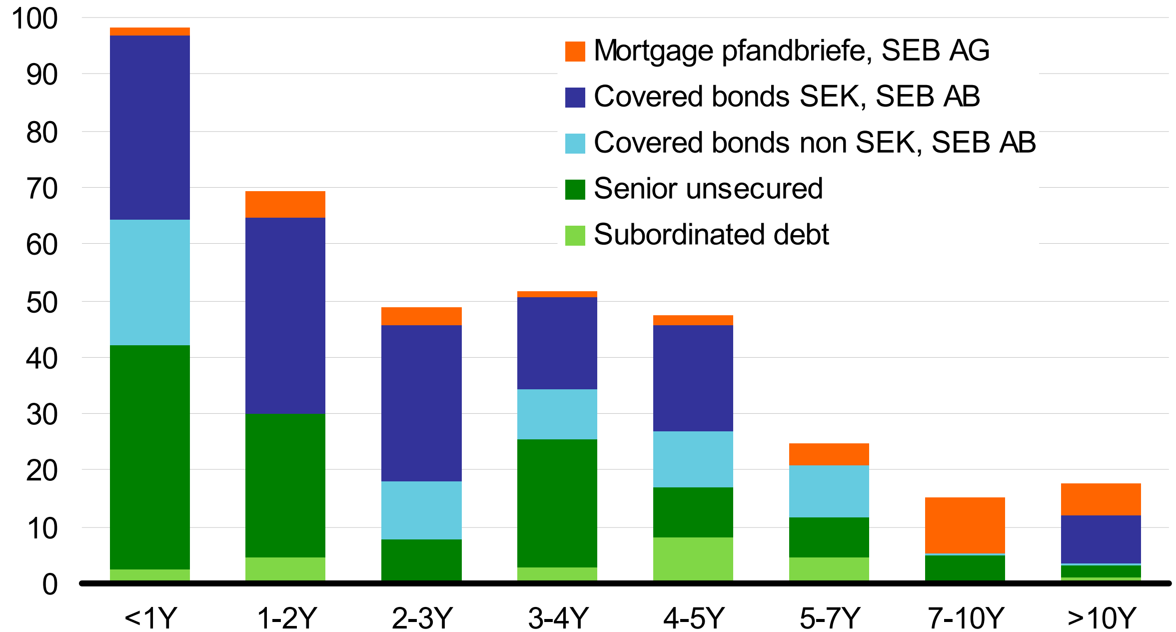
SEB Group, SEK 1,392 bn (EUR 156 bn), March 2011



Well-diversified across instrument and market

Maturity of long-term funding Dec 2010

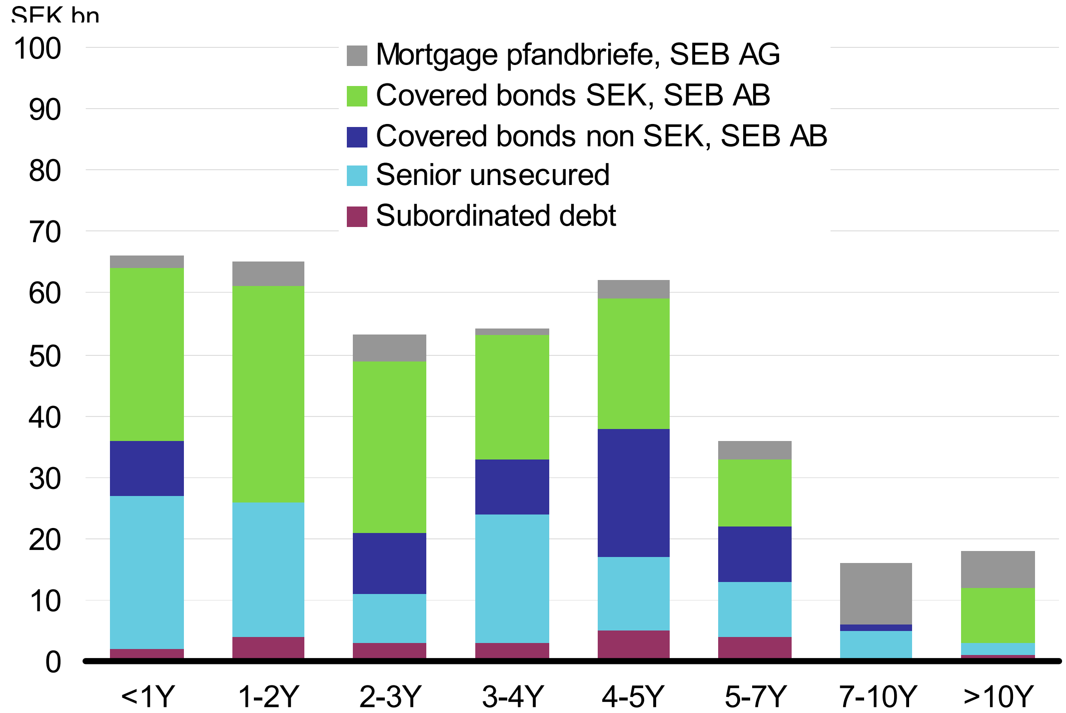
SEK bn



Product	<1Y	1-2Y	2-3Y	3-4Y	4-5Y	5-7Y	7-10Y	>10Y	Total
Subordinated debt	2.4	4.5	0.0	2.7	8.1	4.5	0.0	1.2	**23**
Senior unsecured	39.5	25.5	7.9	22.8	8.8	7.3	5.1	2.1	**119**
Covered bonds non SEK, SEB AB	22.4	0.0	10.1	8.9	9.7	8.9	0.2	0.2	**61**
Covered bonds SEK, SEB AB	32.6	34.7	27.5	16.1	18.8	0.0	0.0	8.4	**138**
Mortgage pfandbriefe, SEB AG	1.4	4.4	3.3	1.1	1.9	3.9	9.8	5.8	**32**
Total	**98**	**69**	**49**	**52**	**47**	**25**	**15**	**18**	**373**

Longer duration and lower roll-over risk

Maturity of long-term funding March 2010



SEK bn Product	<1Y	1-2Y	2-3Y	3-4Y	4-5Y	5-7Y	7-10Y	>10Y	Total
Subordinated debt	-2	-4	-3	-3	-5	-4	0	-1	-23
Senior unsecured	-25	-22	-8	-21	-12	-9	-5	-2	-104
Covered bonds non SEK, SEB AB	-9	0	-10	-9	-21	-9	-1	0	-59
Covered bonds SEK, SEB AB	-28	-35	-28	-20	-21	-11	0	-9	-151
Mortgage pfandbriefe, SEB AG	-2	-4	-4	-1	-3	-3	-10	-6	-31
Total	**-66**	**-66**	**-52**	**-54**	**-62**	**-36**	**-15**	**-18**	**-368**

Capital

Economic Capital – SEB Methodology

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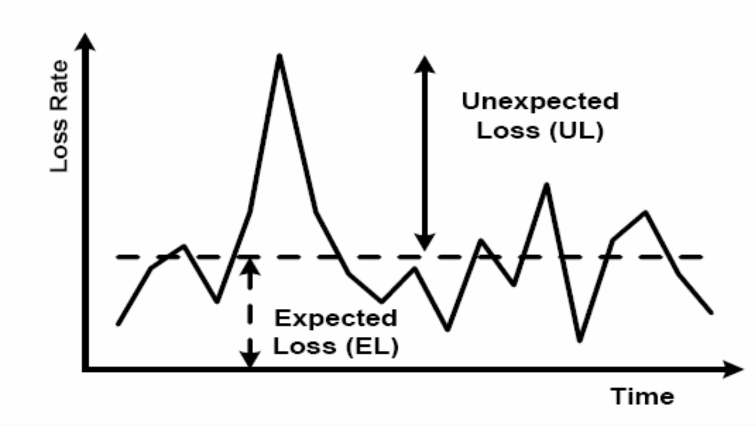
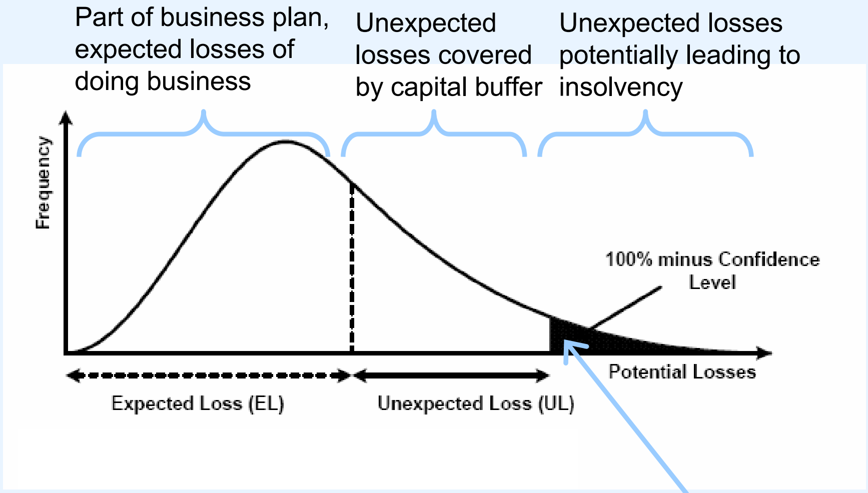
Economic capital, CaR and Business Equity

- Economic Capital is a measure of capital needed to give the institution a probability of default corresponding to the chosen rating target
- The SEB “brand” of EC is nicknamed CAR: Capital At Risk
- EC implemented in business steering is called Business Equity and is identical to CaR but excludes concentration/diversification components

Losses due to risk taking over time

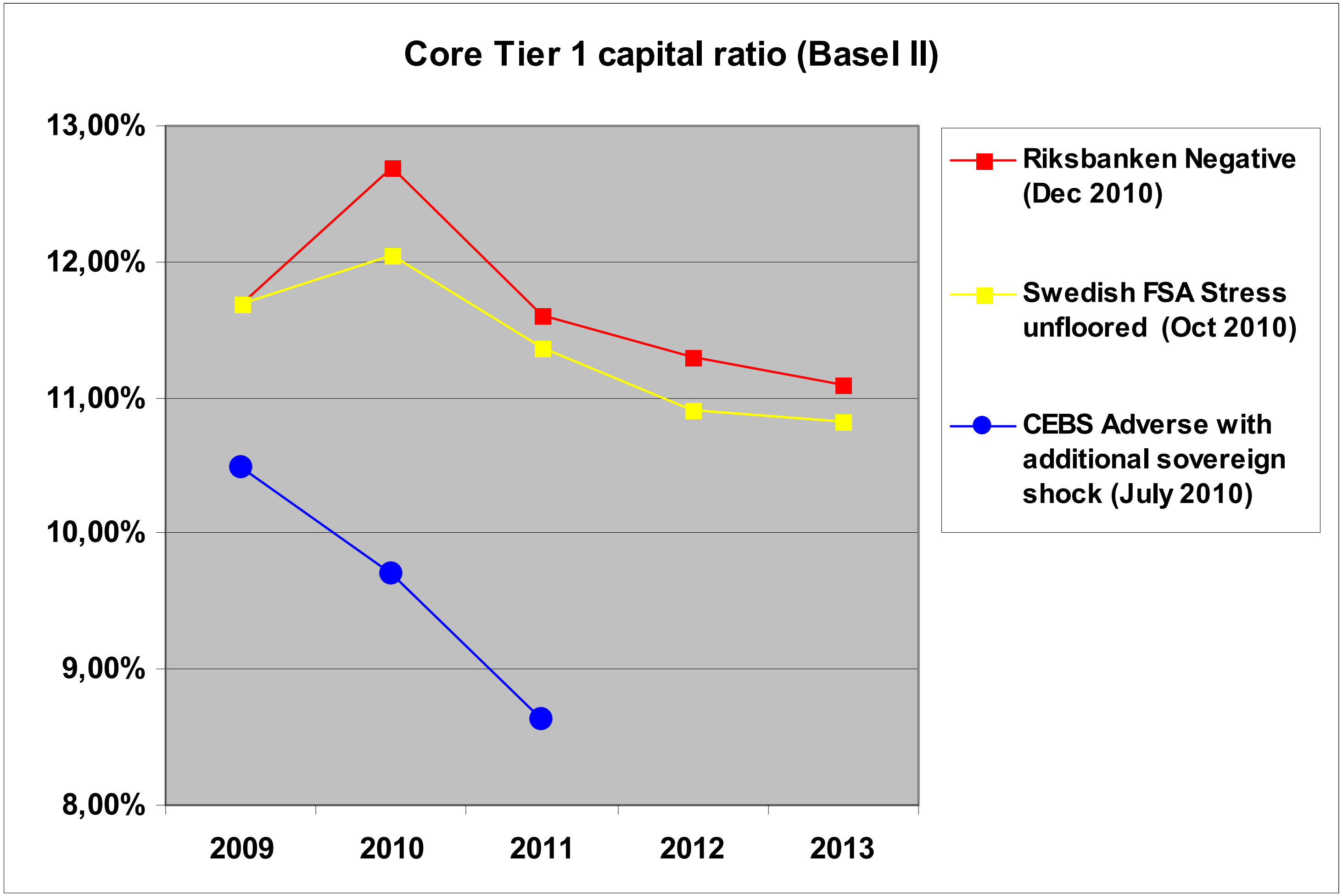


Risk appetite leading to capital levels



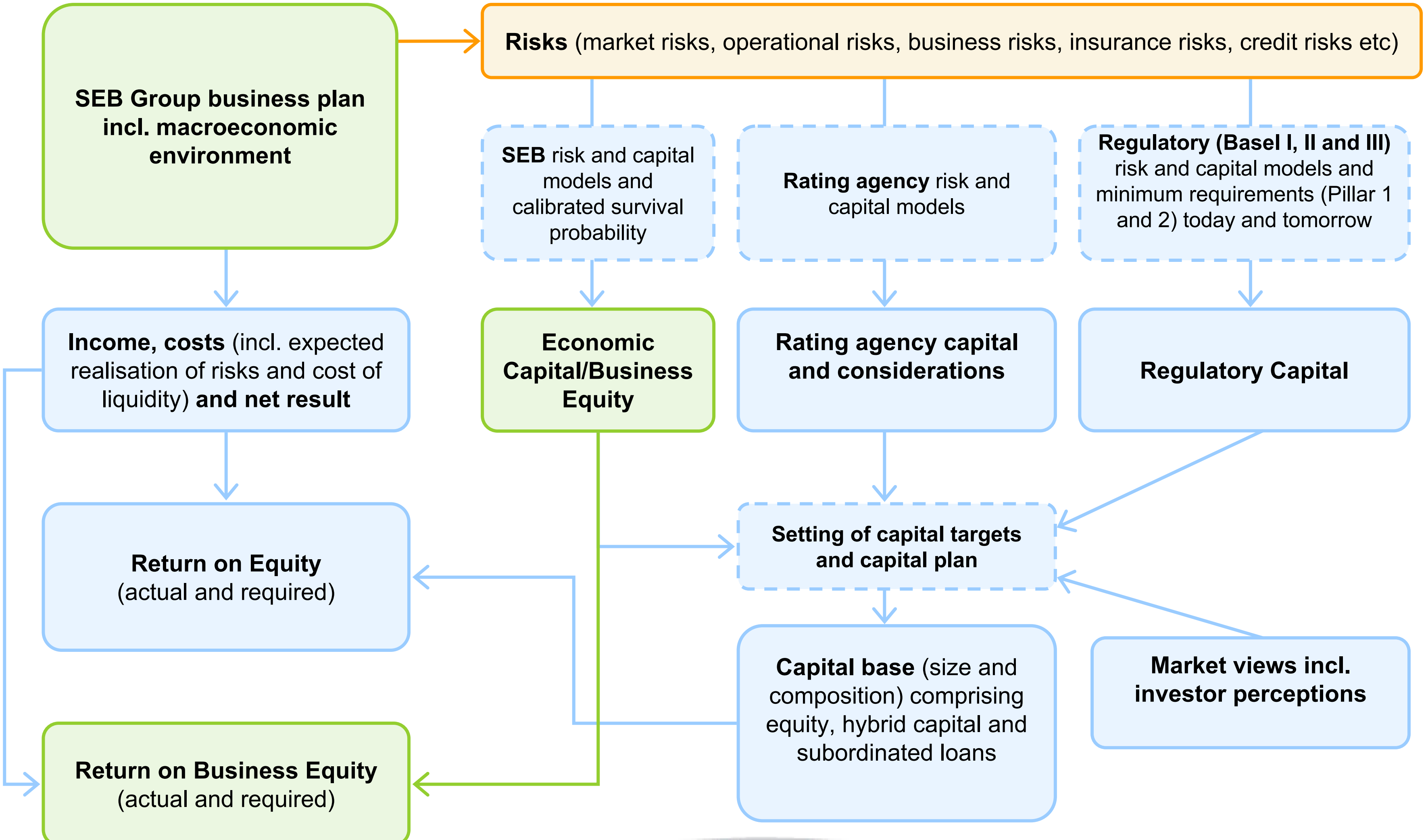
Confidence level chosen linked to rating ambition, e.g. AA corresponds to 99.97% and used in CaR, regulatory minimum 99.9%

Capital adequacy
Outcome of recent stress tests

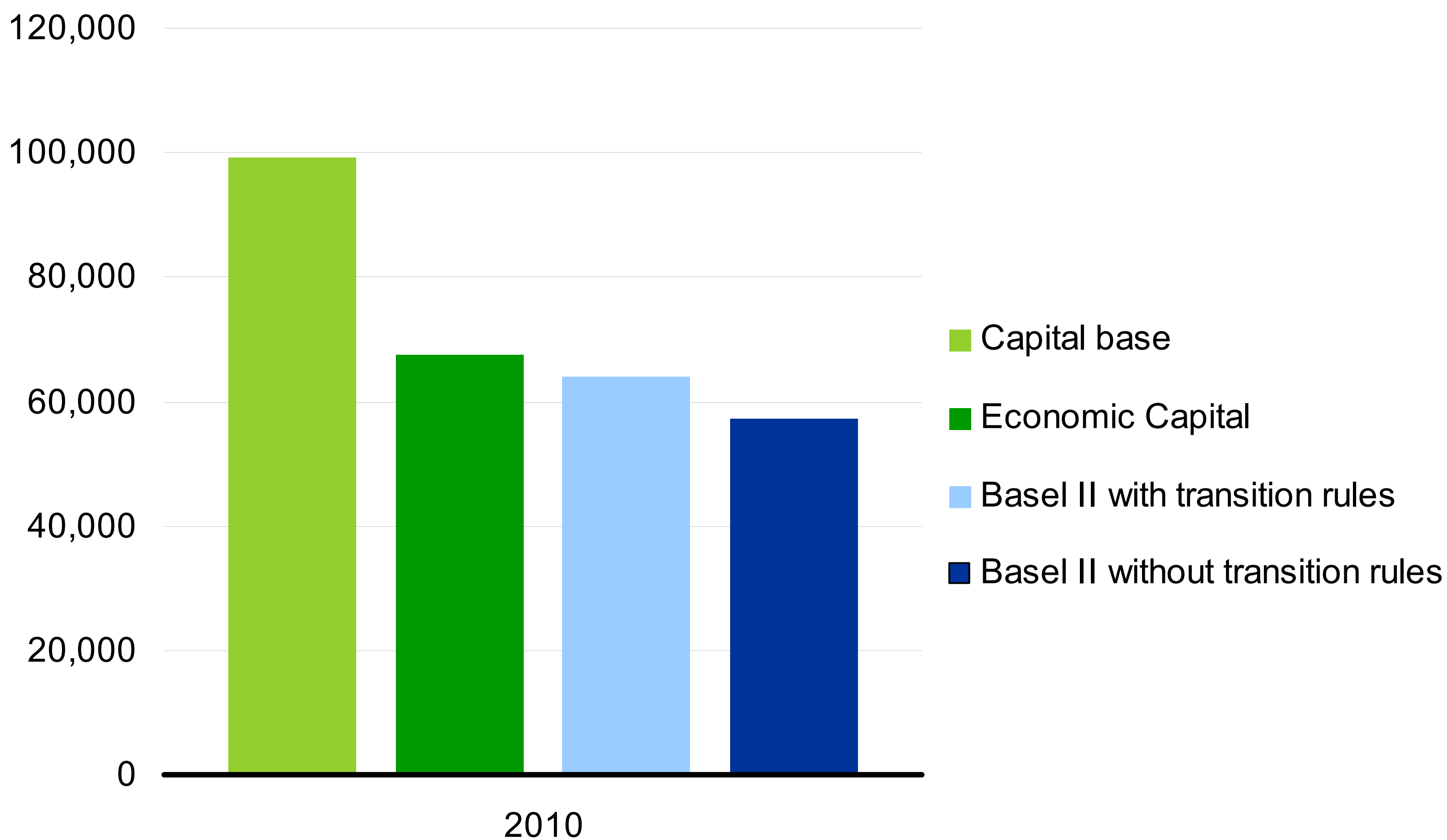


Holistic Financial Steering

Relating risk to capital and reward

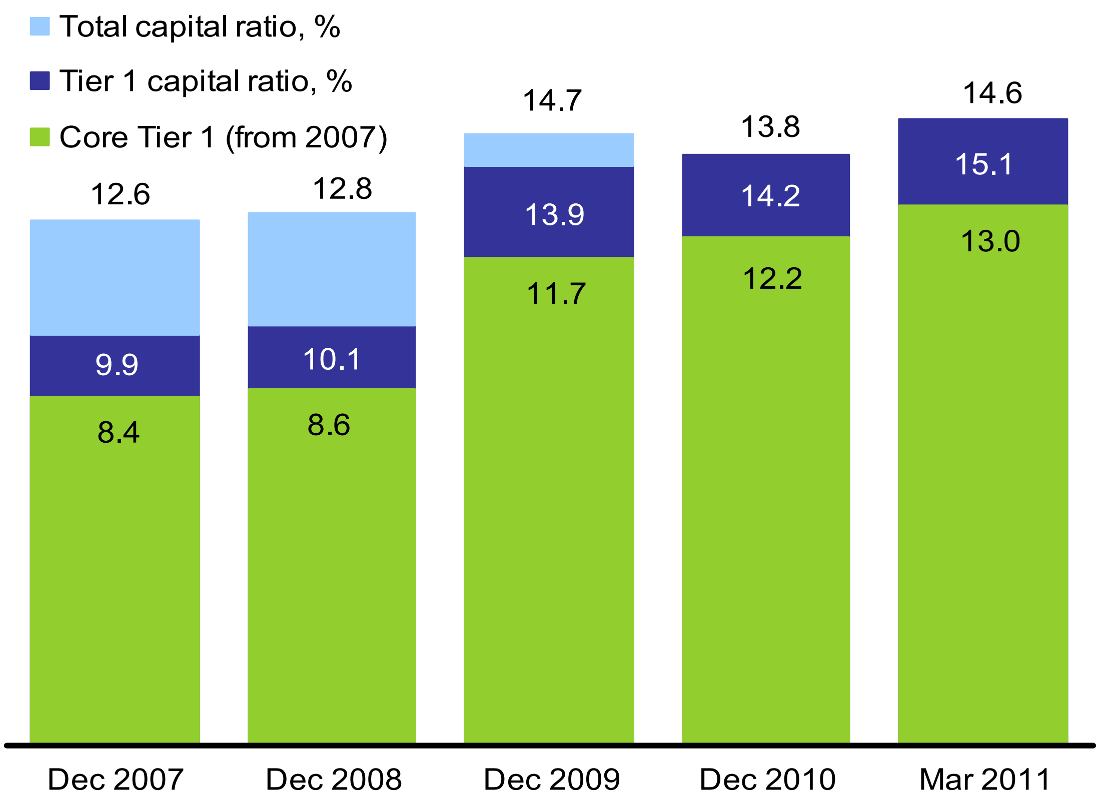


Capital base vs internal and external requirements SEKbn



Capital adequacy, SEB Group

Basel II (without transition rules)



SEK bn	Dec 2007	Dec 2008	Dec 2009	Dec 2010	Mar 2011
Tier 1 capital	72.7	82.5	101.6	102.0	102.1
Capital base	93.0	104.7	107.3	99.1	98.8
Risk-w. Assets	737	818	730	716	678

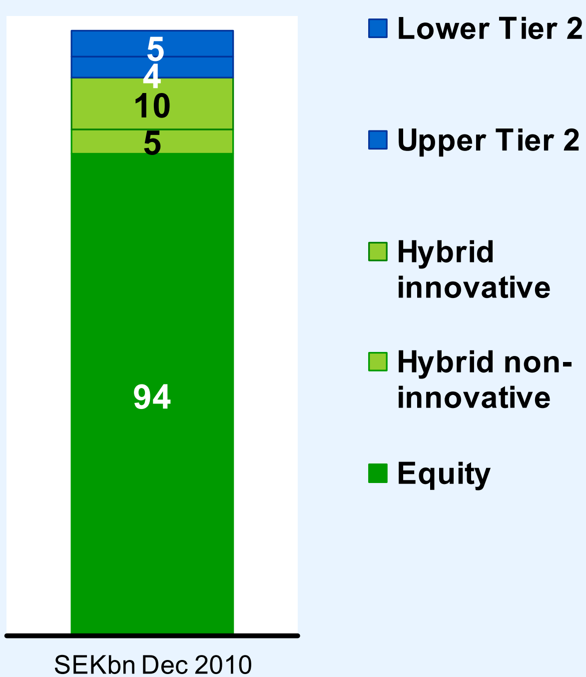
Target: A Tier 1 capital ratio of 10% (Basel II)

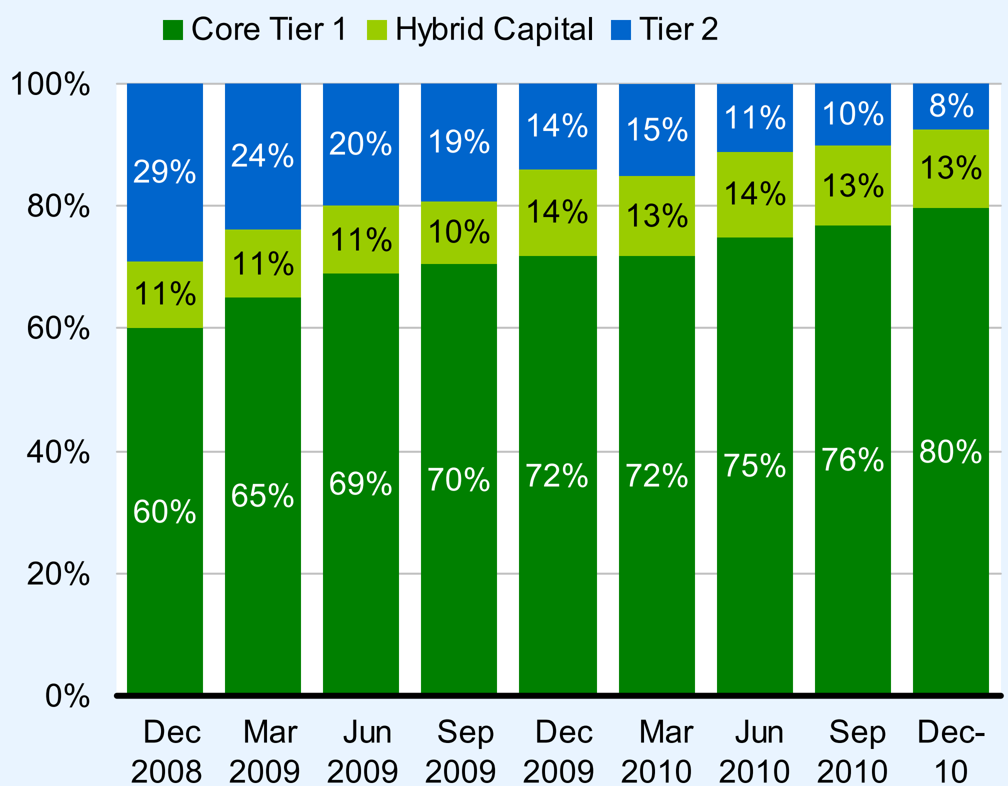
Note:
In order to improve quality, capital management in 2010 has focused on shifting the capital base from Tier 2 to Tier 1. The end effect, when combined with certain deductions to be made from the total capital resources, is that
Tier 1 capital becomes larger than the capital base from 2010.

Loss absorption – capital base

Composition and development

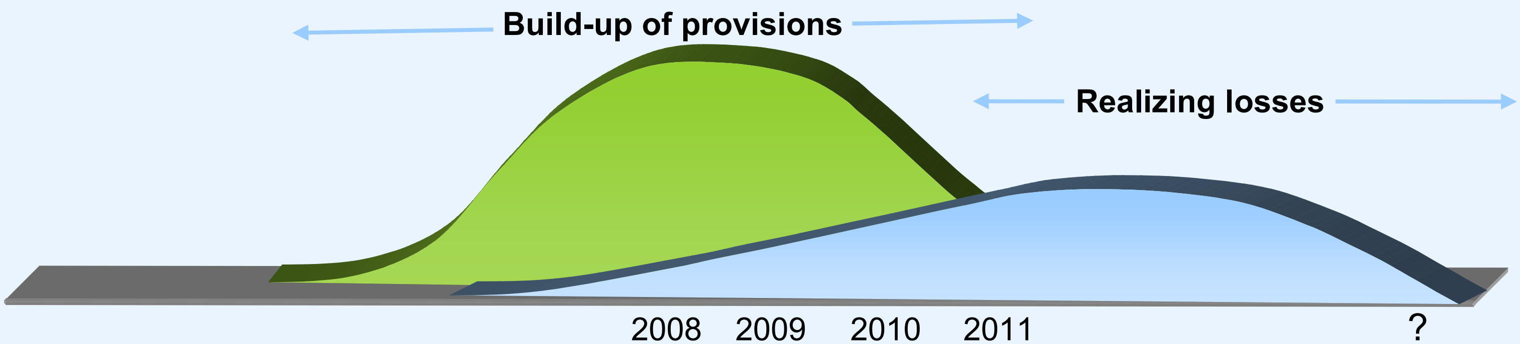
Improved quality of the capital base

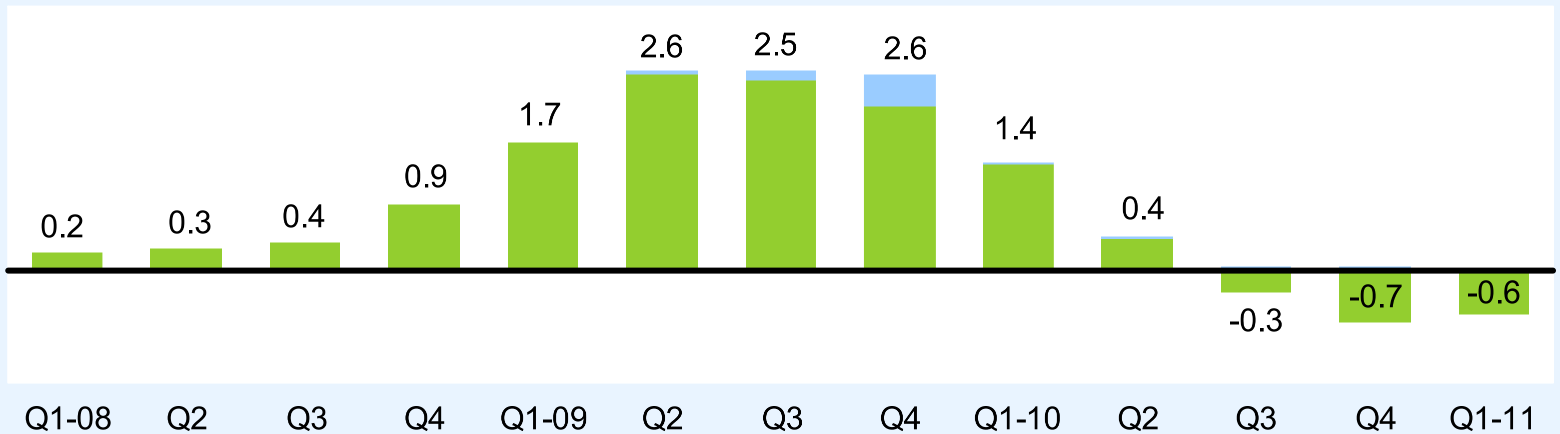




Pro-active and conservative provisioning cycle with write-back potential

Net credit loss dynamics, SEK bn





Expected Applicability of Capital Instruments

	Regulatory Minimum	Buffer Capital (If any)	Leverage Ratio	S&P RAC Ratio	Funding
"High Strike" Coco (~7% Core Tier 1)					
Hybrid Tier 1	✓	✓	✓	✓	✓
LT2	✓	?	X	X	✓
"Low Strike"Coco (~5%Core Tier 1)					
Hybrid Tier 1	✓	?	✓	✓	✓
LT 2	✓	?	X	X	✓
New-Style Hybrid Tier 1					
Hybrid Tier 1	✓	X	✓	✓	✓

Source: Morgan Stanley

Loss absorbing subordinated debt spectrum

Broad definition	**Loss absorbing subordinated debt**		
Narrow definitions	**“Known” Basel III hybrid capital**		**“True” contingent capital**
Instruments	Basel III hybrid Tier 1	Non-viability Tier 2	Mimic Basel III, equity features
Application	Minimum **150bps** of RWA to most efficiently meet the Tier 1 capital requirement	Minimum **200bps** of RWA to most efficiently meet the Total Capital requirement	***Swiss finish***: — up to 9% of 19% total capital requirement **FSB:** — greater (G)-SIFI loss absorption capacity

- **Still waiting for…**
  - clarity / guidance from the European Commission on Tier 1 and Tier 2
  - first guidance from the Basel Committee and FSB on “true” contingent capital

Source: Deutsche Bank

What triggers and why?

Host	What triggers are required?	What does this mean?
Tier 2	■ Contractual non-viability – Decision to inject public sector capital – Decision of the regulator that a write-off / conversion, without which the firm would become non-viable, is necessary, or… ■ …statutory regime with equivalent outcome	■ Less regulator discretion ■ Loss absorption linked to the failure of the institution ■ Trigger out-of-the-money?
Tier 1	■ Regulator discretion (coupon and principal loss absorption) ■ Core Tier 1 ratio, c. 5.125% or higher ■ Non-viability as above	■ Explicit regulator discretion ■ More issuer discretion ■ Dynamic triggers (regulatory definitions) ■ Interaction of going concern and contingent capital triggers?

Comparison of effective triggers ?

Remoteness

- **Full regulator discretion**
- **7%** Core Tier 1 / Common Equity Tier 1 (Credit Suisse BCN, Rabobank SCN)
- **5.125%** Core Tier 1 / Common Equity Tier 1 (requirement for Tier 1)
- **5%** Core Tier 1 (Lloyds ECN)
- **Non-viability**

What features can be added?

- Share price trigger
  - Downside
  - Upside
- Other market based trigger
- "Cure" periods

For illustration purposes only – in practice regulator discretion and/or non-viability may take effect at varying points

Source: Deutsche Bank

Contingent capital – instrument options

SEB

Regulatory requirements for the role of contingent capital will directly impact final structures (for instance definition and relative interaction of triggers)

However, issuers and investors are establishing (and voicing) their structural preferences now in the context of future hybrid Tier 1

Conversion into equity

- Trigger is set at a fixed (regulatory capital) ratio
- Conversion can be triggered by the regulator at their sole discretion

Write-down of principal

- Write-down and write-up if future profitability & capital levels are sufficiently restored
- Write-off

\+ Upside participation / attaching warrants

\+ Option to settle nominal in shares at any time at then current share price

Source: Deutsche Bank

Assessing an instrument: What are the critical features?

Due to the potential nature of this security, an investor base may include

Real money

Insurance

Equity linked

Equity

Hedge funds

Retail

Strategic investors / SWFs

Trigger levels

Relative trigger: Low	High

- Real money
  - Precise definitions preferred and there is a focus on the risks of non-viability
  - Existence of multiple or dynamic triggers will depend on existing capital buffers and the issuer's funding and liquidity profile
  - Triggers in the 7% area preferred for contingent capital
  - Ultimately the level of comfort on the trigger is credit specific
- Hedge funds
  - Share price trigger is a point of interest
  - Contractual non-viability may require a premium
  - Insurance
  - Focus on objective triggers with little discretion of the issuer in non-viability situations
  - Triggers important for modelling expected loss
  - Cure periods preferred

Deferral

- Real Money
  - Regulator discretion is accepted but would entail a pricing premium
  - This is not seen as a critical risk in the structure
- Hedge funds – deferral is less important
- Insurance
  - Issuer discretion to defer to be relatively constrained
  - Somewhat comfortable with regulator discretion
  - Specific deferral language is instrumental

Source: Deutsche Bank