SEB Group

"Second Quarter 2022 Conference Call"

Thursday, July 14, 2022, 09:00 CET

MODERATORS: JOHAN TORGEBY, PRESIDENT AND CHIEF EXECUTIVE OFFICER

MASIH YAZDI, CHIEF FINANCIAL OFFICER

OPERATOR: Good morning. This is the conference operator. Welcome and thank you for joining the SEB Second Quarter 2022 Conference Call. As a reminder, all participants are in listen-only mode. You can register for questions at any time by pressing "*" and "1" on your touchtone telephone.

At this time, I would like to turn the conference over to Mr. Johan Torgeby, President and CEO. Please go ahead, sir.

JOHAN TORGEBY: Thank you very much, and welcome everyone to this Q2 2022 summer quarter report. As customary, you can find the presentation that together with our CFO, Masih Yazdi, we will go through today on our website.

Starting on Page 2, with summarizing the highlights of this quarter, we can see that we've had a very solid operating performance despite the worsening macroeconomic outlook and the Russia's war in Ukraine, and we thank this very much to the very well-diversified business model of SEB. I also want to point out that as we've had heightened uncertainty and higher volatility, the demand for short-term services and products that we have had increased quite markedly, and we'll come back to that later in the presentation.

Return on equity came in at 12.3% and broadly unchanged regulatory minimum buffer of 480 basis points. We continue to see a robust asset quality with low expected credit losses of 6 basis points in this quarter.

Clicking to the next slide, just a few comments on macro which has clearly been the theme of this quarter. The equity markets have continued to show some weakness, although some stabilization in the last couple of weeks. Interest rates have continued to be at elevated levels, but also in interest rates there has been signs of some stabilization lately, but credit spreads have more or less continued to widen during the second quarter, and this is of course, mainly due to the inflation rates that are affected by the war in Ukraine, and now being spread around the economy, and hence monetary policy has changed dramatically during this year.

On Page 4, we just summarized the year so far. Financial performance have gone up 6%, measured as operating income and we have a solid underlying result of up 5%, before credit losses and imposed levies. The imposed levies is the word for the Resolution Fund fee and the bank tax together. However, including the more normalized level of expected credit losses compared to last year, as the very short increase in imposed levies, both higher Resolution Fund fee and the introduction of bank tax, we have so far this year came out with the bottom line result 2% below previous years.

Now I'd like to double click on 3 areas of the bank during this quarter. So on Page 5, we are focusing on SEB's diversified business model in the context of fees and commissions. As a universal bank, we are more or less exposed to all areas of the financial markets at all times, and this is a little bit like swings and roundabouts. The stability is very obvious on the top line, however, a lot of things are happening beneath that top line. And here as the 9% increase year-on-year in fees and commissions needs to be split, you can clearly see that lending fees, payment fees and card activities are the 2 beneficiaries, partly because of the COVID recovery, but also that lending demand has increased during the quarter, and we've seen very high activity in establishing loans.

The3 weakness are anything that is more or less directly linked to asset under management or asset under custody, or you've hurt by the volatility in the market which reduces activity such as ECM. And you can see there, that in the quarter we were 90% down in custody and mutual funds, that is the life, investment management and investor wealth. Secondary markets and derivatives which I'll come back to showed a 3% decline which is a very modest decline given the very sharp volatility and changes in the market, and issuance of securities and advisory predominantly driven by weaker ECM business and IPOs, down 3%.

On the next page, you can see Page #6, we double click on the business area we broadly call markets, which is fixed income, currencies and commodities and equities. Also here the Group as a whole in the markets area show a modest increase compared to the same quarter last year, however, beneath that a lot of things have happened.

The obvious negatives have come from the fixed income area, where the inventory, the market valuation impact of increased real…increased rates and increased credit spreads have been very pronounced in this quarter, minus 81%. Predominantly, this is driven by market valuations on securities that you have on the books. However, currencies and commodities have clearly benefited. So the volatility, the increased need for hedging, risk implication, reallocation of portfolios and taking care of whatever strategy that real [ph] companies may have around sourcing of energy and other commodities have been very, very high activity. And equities, I'll come back to.

To the right, we can double click on fixed income because you know we have more or less the flat results, zero P&L contribution for what we call rates. These are more or less the risk free or very low credit risk elements of the fixed income business that we conduct. However, we had a small uptick in the fixed income of credits. This is in our opinion a very strong result in an area which has had enormous challenges during this year, so even though it is down 81%, we come in at a very stable results

On the equity side, it's important to know that we are also here a full service provider, so equity sales and trading which is the volatile part has also gone down in the year but we also have a large business in equity finance which has been very robust during the quarter hence creating a big cushion, and therefore you haven't really seen any drop in the whole area of markets during this quarter compared to last year.

Then we go back to our credit slide on the credit portfolio Page #7, and what we normally show here is just the exposure, and just to remind everyone, exposure is different from lending as it is the sum of the normal amount that we have signed up for with the client. It's the credit exposure at risk. The client in certain products thereafter decide if they actually want to borrow the money or not, and that's the lending.

We have today also included lending as the philosophy in moving around in these markets. So first on corporates, we can just note a 21%

increase in the corporate credit exposure compared to last year, however, we've had a very significant depreciation of the Swedish krona and as roughly half of our businesses outside only half of this is real volume FX adjusted, that's the 9%.

We also had, if you remember, the fourth quarter this year a significant uptick in exposure because we had several severe large events that we were involved in. Those have now more or less fallen off, the balance sheet and they've been converted into other type of capital markets transactions, and therefore, year-to-date we are more or less flat when it comes to the credit exposure. However, as we have replaced all of those nominal amounts during this quarter, but a much higher activity in the lending area than we saw Q2 last year, we have therefore need to replace and all these volumes with other business. We've also seen a clear trend that more money has been drawn, and this is of course more related to NII looking at the lending by sector. And here the year-to-date lending is now up 6% and in the quarter it was at 1% increase indicating roughly a4% annual rate for that. We'll come back to mortgages later and commercial real estate.

With those few introductory remarks, I'll handover to Masih to go through the financial results.

MASIH YAZDI: Thank you very much, Johan. As I am on Page 9 and look at Q2 results isolated, and you can see that operating income is down 2% compared to previous quarter. The main highlights here is net interest income that's up 10% compared to the previous quarter and 20% compared to the same quarter last year. The big negative is the net financial income line which has halved compared to the previous quarter, I'll come back to that. On the expenses, you can see that it's up quite significantly during this quarter, that's predominantly due to the fact that we had low expenses in Q1 due to the falling share price, and as the share price has stayed at that…those low levels, we're now more in line with the target we've set for the full year being at SEK 24.5 billion in expenses on an FX adjusted basis.

Expected credit losses down from the previous quarter and at 6 basis points we believe that are on low levels. And here again, you can see that compared to last year imposed levies have increased quite significantly with the bank tax being introduced and the resolution fund fee going up.

If I move to net interest income, we have seen a 16% increase so far this year compared to last year or SEK 2 billion. Most of that is coming from volume growth, mainly on the corporate side. But we've lately also seen some improvements when it comes to deposit margins due to the rate hikes so far this year. Quarter-on-quarter 10% increase of NII that is coming from deposit margins improving as rates going up, but that's been partly offset by lower lending margins mainly in mortgages. I'll come back to that on the next slide.

As Johan mentioned, we've had some bridges and some of these were paid down or syndicated out in late June. They haven't had any negative effect on NII really during the quarter, but that will come in the coming quarters. We've also seen some improvements in NII within our fixed income business and overall we believe that during this quarter about 200 million to 300 million of net interest income is short-term in nature and should in the coming quarters come down again.

At the same time, given the fact that we had a rate hike by the end of June that hasn't had impact on NII so far. We do still see some volume growth and we do see prospects for improving lending margins on the corporate side as credit spreads have widened significantly. This doesn't necessarily mean that net interest income will come down in coming quarters. We have to see what happens in the market.

Just a couple of comments on mortgage margins. We're looking here on the…on Slide 11 on the left hand side. What's happened to our pricing on a 5 year mortgage compared to the average pricing of our peers, and we're comparing that to the spread of a 5 year covered bond. This is not a…sort of, this is not our funding cost, it's just a proxy for our funding costs. In practice, we have a mixture of different funding sources when looking at our funding costs.

But as you can see, both the prices from the banks, as well as, the 5 year cover bond had gone up sharply. In the chart in the middle, you can see our price minus the 5 year cover bond and our peer's price minus the 5 year cover bond, and you can see that this has pretty much collapsed during Q2. And our price or our margin in this sense has gone down by 50 basis points during the quarter, and…but at the same time the average margin for our peers has gone down by 80 basis points, so is there a big difference there in terms of delta 30 basis points. And this can very much explain the fact that we've had lower mortgage lending growth so far this year compared to our peers.

We're slightly surprised when it comes to price discipline on this market. And we do have the ambition in the long-term to be pretty much in line with our back book market share of close to 14%. And we'll make sure that in the coming few months, we'll adjust our service, availability and price to make sure that happens.

If I move on to Slide 12, look at net fees and commission, Johan has commented on both things here. So, as he said lending fees and cards are up in this quarter, whereas asset under management fees and mainly investment banking related fees are down.

Just a couple of comments on the fairly large net outflows you can see in the quarter, and just mentioned here that about SEK 13 billion of the net outflows is related to the new partnership with [indiscernible] bank, that we've put on that have now been moved to their distribution. And the remaining part is really coming from one institutional mandate with very low margins.

If you look at the underlying business within private wealth management and family offices and our retail business, flows are actually pretty stable during the quarter, which is fairly good given the high volatility in the markets.

If I move to net financial income, here you wanted to also comment on a few of the developments. But overall, we think it's an underlying...solid underlying business development with strengths within commodities and effects and very challenging environments within fixed income.

The main reason for the decline here is due to valuation effects. So, you have a negative XVA effect of about SEK 300 million compared to the previous quarter, but the main negative effect here is coming from the liquidity book within treasury where you have an inventory of very high quality assets such as covered bonds and supranational, but with widening credit spreads you get a negative valuation effects. So, going forward, if spreads do come down again, this should reverse, and if they don't over time, this liquidity book will reprice at higher levels and lead to a higher net interest income.

On Slide 14, looking at operating leverage, and so far this year it looks good. We've increased the operating profit before credit losses and impose levies by half a billion per quarter. So, far, it seems like investing more in your business can continue to lead to positive operating leverage.

Page 15, on the capital development fairly simplified this quarter with a marginal decline of the buffer from 490 basis points to 480 basis points, we've added 40 basis points net of the 50% reserve for dividends, but at the same time, the weakening krona has led to the capital buffer coming down by 50 basis points. Over time a weakening krona is not bad for our business, as it leads to higher income. But in the short term as the balance sheet is adjusted, very immediately you have this negative effect on capital.

On Slide 16, looking at expected credit loss allowances, so all the allowances, all the reserves we have in the bank relative to the exposures that we have, that is at SEK 8.6 billion during Q2 up by SEK 400 million versus the previous quarter.

We have kept the overall model overlays of SEK 2 billion intact, but we've done...what we've done during the quarter is to fully release the

COVID-19 reserves within the 2 divisions, C&PC and the Baltic, but we've done a reassessment of the balance sheet of the lending book based on the geopolitical interest rate and inflation risk that we see, and on account party by counterparty level we have made new model overlays that adds up to approximately the same level to fully compensate for the release of the COVID-19 overlays. And you can see the distribution of the overlays, as well as, the underlying credit reserves based on the divisions on the right-hand side.

On some key ratios and a couple of things I'll point out. The main thing here is the very strong deposit inflows. We're increasing deposits by about SEK 500 billion over 2 quarters, and we have a loan depo [ph] ratio in Q2 at 0.93, which is by far the lowest level this bank has ever had. So, we see a big demand for depositing assets on our balance sheet.

Liquidity ratios are slightly weaker compared to end of last year, but they are stronger compared to Q1. And then finally, you can see the capital and the total cap ratio compared to Q1 which you can't see here has improved as we issued an AT1 during the quarter.

On the last slide, you have the financial targets, they were kept unchanged. Dividend, capital ratio 100 to 300 basis points, we'll try to be there by the end of 2024, and we want to have a return on equity that's competitive with peers, with the long term aspiration of 15%. And we have continued to repurchase shares of about SEK 1 billion during Q2, and we'll continue to do that according to the current mandate, until October.

That was it. And I think we can open up for Q&A.

Q&A

OPERATOR: Excuse me, this is the conference operator. We will now begin the question and answer session. The first question is from Andreas Hakansson with Danske Bank. Please go ahead.

ANDREAS HAKANSSON: Thank you, and good morning, everyone. And could we start with NII, and you talked this morning about SEK 480 million of NII coming from more treasury and trading related areas. So, Masih, when you say that SEK 200 million to SEK 300 million is not sustainable, is that really what we should be taking out from that SEK 480 million? That's the first question.

MASIH YAZDI: Yes. Thank you, Andreas. In this kind of environment, there are a lot of things happening at the same time. And so, it's very difficult to try to get an understanding of the NII development going forward, it's not a linear trend, because you have…when it comes to treasury, for example, you have the…how much Treasury charges the divisions are lending and how much they pay to the divisions on deposits and you have different models there. And then, over time, they can move in different directions on a quarterly basis, but it shouldn't head out in the long-term. What I'm saying…I'm not saying that SEK 200 million to SEK 300 million is unsustainable. We can just confirm that about SEK 200 million to SEK 300 million during the quarter is short-term in nature and it is based on bridge facilities and a higher net interest income within our fixed income business than we've had historically. It is absolutely possible that going forward that is offset by further strength within fixed income, and with new bridges coming up.

And then we have this fact that rates have increased further and we are fairly positive on lending margins on the corporate side, as credit spreads have widened and there's a lag in the system where banks over time will adjust their prices according to the new spreads in the market. It just happens much faster in the capital markets. And then it happens when it comes to our lending and the margins we charge from our customers. So yes, we think about SEK 200 million to SEK 300 million are short-term in nature, and if it's not replaced by something else, that should have come off the books and that NII line in the coming couple of quarters.

ANDREAS HAKANSSON: But [multiple speakers]?

MASIH YAZDI: Sorry. Say again, please.

ANDREAS HAKANSSON: You know, just SEK 200 million SEK 300 million if it falls some like Masih said that doesn't mean that NII has to go down that could be offset by the higher margins and the higher rates and so on, right?

MASIH YAZDI: Yes, that's absolutely possible. And to the extent that spreads are where they are now and stayed at that level, and the liquidity book in Treasury, for example, is reinvested in higher yielding securities that should also lead to higher NII, so it just depends on what happens to credit spreads. And given how fast the market is moving, it's very difficult to predict or give any guidance on what's going to happen, but the general trend is that rates are going up, which is positive for deposit margins and the general trend is that credit spreads are going up, which typically is good for lending margins in the longer term.

I just want to take the opportunity to highlight that if you use the investment grade credit spreads of 50 basis points at year end as a proxy currently above a 100, the natural effect is of course that we have not doubled the NII…expected NII on any given portfolio compared to the past. The pain with having that positive statement is that you need to take the modified duration of the average portfolio times that change and take it as a negative right now.

So and as an old fixed income guy, I actually think it's quite healthy for the fixed income market, although we're going to have a lot of volatility and a lot of pain to go through before we normalize rates, then we will have a different level. And of course adjustments will be made to portfolios. I'm not making a prediction. I'm just stating the obvious, perhaps.

ANDREAS HAKANSSON: Yes. Perfect. And then of course, then on mortgages, on Slide 11, you show that mortgage margins are coming down, but it's not really correct because what if it's only been 45% to 50%? I haven't calculated on Q2 now of your mortgages actually funded with cover bonds while the rest are deposit funded where you haven't started to pay anything. So shouldn't you say that mortgage margins are actually flat in the quarter?

MASIH YAZDI: Yes, I mean, we're not…it's really just comparing the rates to the 5 year cover bond, which is a proxy for the margin, it's not the actual margin. And I think different banks have different models. What we do typically is that we blend covered bonds with senior unsecured funding, when we look at our funding costs for mortgages, and whether you mix deposits into that or if you see deposits at different products, you can have different models for it. But in general, you can see in the quarter, irrespective of what duration you look at that funding costs have gone up clearly more than the average price of each mortgage...for each tenure. So there is a clear margin decline for the mortgages so far, very lately, last couple of weeks, spreads are going down on covered bonds and banks have started to adjust their pricing downwards. So maybe this will sort of average out over time. But it's slightly surprising how little mortgage rates have gone up relative to the sort of our funding costs will go up in the long-term.

ANDREAS HAKANSSON: All right. And then finally, after mortgages as well, we saw that activity levels in the housing market slowed quite a bit in May. Could you tell us a bit about volumes in June and July? Are we seeing a real slowdown or how does it look?

JOHAN TORGEBY: Yes, and there's...when it comes to transactions, there's a slowdown of around 25% to 30% to my recognition. But when we look at our mortgage book, we are issuing pretty much the same amount of mortgages this June as we did June last year, as prices are higher now than they were a year ago. At the same time, given that our pricing has differed a bit compared to most of our peers, we see an outflow of all mortgages, so to say, so therefore, we come up with a net increase of zero basically in June, but we do issue mortgages at a fairly high level still, it's more than SEK 10 billion per month of volume growth gross, but then that's not netted out with as much outflows. But there is obviously a slowdown in the transaction market and generally, we are more dependent on transactions happening from mortgage books to grow. We are not as strong when it comes to people just moving their mortgage loan from one institution to another. And then, we are more focused on the large cities and as prices nominally are higher there and prices are going down, that could have a larger nominal effect on our mortgage book compared to most of our peers.

ANDREAS HAKANSSON: Well, thanks very much.

OPERATOR: The next question is from Magnus Andersson with ABG. Please go ahead.

MAGNUS ANDERSSON: Yes, hi. Good morning. Continuing on NII there, if you could give us some flavor around the competitive situation on the deposits. First of all, you note that the deposit base with all that it has increased quite significantly, if you could say where that's coming from.

Secondly, if you could say something about how higher I think rates can go before you will have to change rates on transaction accounts. I know that you recently raised rates on your [indiscernible] products for 3 to 6 months. But I guess that's a quite small product, but you didn't do anything to your other savings account. And following to that, if that [indiscernible] is that the 2% of your deposits in corporate and private customers. So that's the first one on NII.

MASIH YAZDI: Yes, I mean, as you can see in the numbers, we've seen very strong deposit inflow so far this year. It's a very sort of polarized environment, right there, out right now. So you have some companies needing more liquidity because of working capital needs and because of that, we have some lending growth, but then you have some companies with a lot of excess liquidity and especially financial institutions and the risk appetite has gone down. So you see some inflows coming in deposits. So obviously, given the current pricing, we still generate and attract a lot of deposits. So in that perspective, the competition isn't that high, I would say…we don't feel pressure to increase prices at this point to generate or attract deposits. As you can see, I mean, our loan to deposit [ph] ratio is at its lowest level ever. But then, with quantitative pricing structurally, liquidity in the system should be slightly drained. And you should see deposits structurally go down. But at this point, we don't see that we need to change prices too much to attract more deposits.

On the transaction accounts, we don't envisage that we will pay an interest rate anytime soon. Historically, we've only paid an interest rate on transaction accounts when the repo rate has been above 3%, 4%. So we're far away from that. We will probably pay an interest rate on savings accounts. And as you said, we're paying that on the sort of the 3 and 6 month tenor savings accounts, and those are very small, but obviously there could be flows from the current savings accounts where the interest rate is zero to these tenor accounts, given the fact that we're paying an interest rate of 0.5 for the 6 months and 0.25% for the 3 months. So those kinds of flows can happen and that will have an impact on the margins. But here and now there isn't high competition for deposits I will say because there's still a lot of excess liquidity in the system.

MAGNUS ANDERSSON: Okay, thank you very much. And then just on a more detailed note on your net commission income that was really strong in the quarter just if you can say something, I think the deviation is primarily driven by very strong lending courses [ph], if you could say something about the sustainability there.

JOHAN TORGEBY: Yes, I mean, outlook on fees is clearly more negative than the outlook on net interest income. And there are a couple of reasons for that. Then lending fees are very high this quarter. I think, it's not a sustainably high level. It should come down even though, I mean, our balance sheet has grown quite a lot, so if we keep the same size of the balance sheet, lending fees are structurally higher than they were a year ago but probably not as high as they were in Q2.

And then on asset management business, obviously, at the end of the quarter, asset prices are clearly lower than the average of the quarter. So if you assume that equity prices will stay where they are now, you should see some further sort of headwinds on the asset management fees going forward.

And then investment banking, you should be aware that we did have a very high level of activity by the end of last year and early parts of this year before volatility increased. And that activity has sort of some legacy elements to it. So you still continue to get some fees with sort of related activity to that activity. But over time, if volatility stays high, that should sort of taper off. But then, yeah, you could see better sort of development within markets with volatility staying high. But the general thing I would say is that the outlook on fees is clearly not as positive as the outlook on net interest income.

MAGNUS ANDERSSON: And the card fee level, something strange embedded for quite substantially 17% quarter-on-quarter?

JOHAN TORGEBY: Well, now it's a combination of the recovery from the pandemic, but at the same time also the fact that you have 8% inflation which means that just to consume the same basket, you consumed a year ago, you need to pay the 8% more. So this morning that the inflation is up to 8.5%, so obviously that has a positive effect. Over time, if this leads to people having to reduce their discretionary consumption, that could have a negative effect on the card business because if you are paying more for your housing and electricity bill, which you typically don't pay with your card, you pay with an invoice, your consumption using your card could go down. So there are positive and negative effects there, but I think we are sort of on a new post pandemic level now. Obviously, we shouldn't go down to sort of the during pandemic levels again.

MAGNUS ANDERSSON: Okay. Thank you very much.

OPERATOR: The next question is from Nicolas Mcbeatah with DNB. Please go ahead.

NICOLAS MCBEATAH: Thanks and good morning. So first, a clarification on the NII, so in Q1, I think you mentioned that you had SEK 200 million in unsustainable NII coming from bridge financing and now you have increased your NII by around SEK 700 million quarter-on-quarter and your assessment now is that there is between SEK 200 million to SEK 300 million of NII that maybe not fully sustainable. So does this imply that more or less entire increase in NII in the quarter, you find sustainable. So the…yes, not really am incremental NII of sustainable nature in this quarter? That's my first question.

JOHAN TORGEBY: Yeah, I mean you are right. So the reason we add up to a S|EK 100 million to that short-term nature of NII it's really the fixed income NII increase we have seen in the quarter. The bridges are sort of unchanged, as I said before. Some of them will pay down by the end of the quarter in Q2 but haven't really had an impact on net interest income. So it is correct that the remaining part of NII should be fairly sustainable, I mean to the extent you can say it's sustainable, it depends on interest rate levels and volumes and all that, but it's more sustainable than the SEK 200 million to SEK 300 million.

NICOLAS MCBEATAH: Okay. Thanks. And then a question on the property management loan book and if you see any increased amount for bank loans from property companies that may look to replace bond financing given the worsening bond financing conditions and whether you are happy to take on more property managements running volumes should you see a good business case for doing that. I know you have historically been somewhat conservative with increasing your overall exposure to the segment, so yeah, any comments regarding that would interesting there, please.

MASIH YAZDI: Yeah, absolutely. I think I can take that. There has been some tendency for the capital markets to be shying away from some of these refinancing of bonds and you have also seen a significant credit spread widening. However, the average maturity for most of the active participants it's fairly low. So there has been very little requirement to test the volume depths of the bank over the ECM markets. At this point, it is more like observable prices on the sheet. But there is a small tendency that discussions have gone up with these companies in order to shore up liquidity and other things, but it's not this quarter or next, it's for the next couple of years if this were to be maintained at the level. And it's very different. I would say the majority of real estate companies do not have any of this discussion but some might do.

When it comes to risk appetite for us, we change nothing. So underwriting standards are intact and we continued with a cautious, very conservative view on how much commercial real estate in particular we allow and as I think we have said many times in the past, we have an internal measure never to go above 10% of the nonfinancial loan book, non [indiscernible] loan book in terms of real estate and that will be maintained. But to support existing clients is one of our key values. So we will definitely if transactions are good, meet our underwriting standards to be able to, if we want to support companies.

NICOLAS MCBEATAH: Okay. Thanks. And then a follow-up on that. Given your underwriting and collateral in this portfolio, how large price declines in the commercial property market do you think it would take for you to start to make meaningful loan loss provisions in the segments. Could you share any comments on what kind of internal guidelines you have with regards for loan to values in property management? If you have any caps that you don't do landing above when it comes LTV?

MASIH YAZDI: Yeah, Nicolas, we did include in the presentation an appendix slide on our commercial...our real estate facility in general. You can see that on Page 21. There you can also see the average LTV we have currently on commercial real estate as well as residential real estate and housing co-ops. So you can make your own calculations on how much prices need to drop for those averages to be above a 100%.

I would say generally, the lending we do is very sort of cash flow based. So it's more interesting to look at what's happening to the cash flows of these companies and we do include on that slide a stress test we have done of the 20 largest real estate companies that we have as customers and there you can see that we've stressed them based on a 3 months LIBOR going up by 400 basis points and look at their interest coverage ratio in that scenario. As you can see, all of them will be at 1 or above 1 in terms of interest coverage ratio with average at 2.1.

One other point, when it comes to the price decline, just remember that there are risk-based floors [ph] on both commercial as well as residential real estate and there we can conclude that prices need to drop by 25% before we see any capital effect of real estate prices coming down and now I am only talking about commercial and residential property on mortgages prices which need to drop by much, much more than that before there is any capital impact.

JOHAN TORGEBY: And if I may, just this has been of course, the topic of this quarter. And I think it's important that when anyone does analysis to differentiate between the equity markets outlook, the profitability of any given property company compared to the loan losses, this will incur for the financial banking system, there is a huge difference in those 2 and other. We have seen and observed significant drops in share prices for real estate companies and significant credit spread widening but you know for a bank, you need a systemic proportion of these companies to have a failure to pay the obligations to the bank and therefore, the catch flow is the first most important thing. And even if you have a 400 basis points, we don't have any of the large companies in our book that we won't think be able to pay. And that's by the way assuming they cannot increase any of the rents.

So it's just, [indiscernible] part of those, everything else being constant, you know, putting in the interest rate. The other debate [ph] is that once that happen that might not trigger a default or an expected credit loss either because it's subject to timing and financing and thereafter you need the LTVs to be above a 100 for you to incur a loss where the market liquidity to be so poor you can't sell any household or residential or commercial real estate. There is no price for them. So that's a banking analysis and that's a quite separate one for what is going on mostly in the media right now and that is about the profitability of any particular real estate company. So I just want to make that point.

NICOLAS MCBEATAH: Perfect. Thanks. That's very clear.

OPERATOR: The next question is from Robin Rane with Kepler Cheuvreux. Please go ahead.

ROBIN RANE: Yes, hi, good morning. Thanks for the presentation. So back to the mortgage margin there and perhaps a clarification, so you say the SEB margin on mortgages is down 50 basis points, is there any timing effect here. So, it's that funding cost have increased faster now than we've been able to increase prices, that's my first question?

JOHAN TORGEBY: Yes, just to point out our margin is down 50 basis points, we are just comparing here the 5-year price versus the 5-year cover bond, that's not the same thing as the margin, it's just a proxy for that, we are just trying to illustrate what's happened during the quarter. Yes it's definitely a timing effect that's given the sharp increase of cover bond spreads and funding cost in general, there's been different strategies seemingly among the banks to adjust prices, and we can just conclude that we have adjusted prices more, not as much as funding cost have gone up, but more than our peers and that largely explains the fact that we have had very poor mortgage lending growth recently, that's the point with that slide.

ROBIN RANE: And do you think you need to adjust down prices in order to protect the backward share...of backward market share or do you think the peers will eventually catch up?

JOHAN TORGEBY: Yes, we won't be in a rush to go back to our backward market share, but we will have an ambition to go back there over the next few months, maybe by year end will see how fast we will do that. But, I think it will be a combination of others...banks, adjusting their prices to more sort of reflect the changes in funding cost and maybe to some degree of having to adjust our prices to be more in line with our historical price which has been sort of mid-range among the banks, where typically slightly lower because we have a different customer base than the average of our peers. And then obviously, we will look at other aspects as well, I mean, we do want to sort of serve our customers as well as we can in terms of availability and general service level and if you can pull those levers, it's typically better levers then just adjusted price.

ROBIN RANE: Okay. Thank you. And then, you've previously talked about costs being some…some parts of the cost base being normalized following the pandemic? Is that something that you already are seeing or could we expect more headwinds from costs normalizing going forward?

JOHAN TORGEBY: We are… I mean, the main cost decline we had during the pandemic was travel and entertainment that came down from the average level about SEK 100 million per quarter to close to zero during the pandemic. And in this quarter, you can see that it's up to SEK 80 million, we don't think it's going to stay at that level, we think it's going to be lower than that, so we do see a reduction, a structural reduction versus pre-pandemic expenses. But, there is in the short-term now we have seen a lot of activity, a lot of customers that wants to meet us both due to the volatility, but also due to the fact that we haven't met them physically for some time. So, we think that the level you see in the quarter is actually higher than we will have long-term in the bank.

But, overall, I mean we are running the investments we do in the bank in line with the strategy we set forward 6 months ago, we are doing the investments in private wealth management, and we are doing the investments within the investment banking and all the investments we need to do within all the compliance relating to International Crime Prevention. And that's running very much according to the plan, so we think we are sort of on target.

And in terms of development, we do see already that we are getting a positive development from the sort of front office investments we are doing in the divisions, you see that in PWM the client intake has been clearly higher so far this year than it was last year and it's been clearly higher than the targets we set forward and that's just one aspect of it. So, we do believe that investments that we planned for in our strategy are paying fruit already, but we are only 2 quarters into a 9-year Plan. So, we will have to see what happens going forward.

ROBIN RANE: Okay. That's very clear. Last question, so one of the reasons you previously kept the COVID overlays was that you saw a risk for a sort of pent-up bankruptcies that would perhaps increase when…when government support schemes ended, do you see a risk for that, still now that you reversed the COVID overlays or/and is this covered by the new sort of geopolitical overlays or how do you think about that? Thanks.

JOHAN TORGEBY: Yes, I mean we don't think there is any reason to have the COVID overlays anymore and that's why we have taken them out. We don't see the risks related to COVID anymore really, but obviously new risks have emerged and therefore we have done new assessments of the exposures we have and vulnerabilities we see in them and that is due to the sort of current concerns we have with geopolitics, rates and inflation. And based on that we have just done new assessments and this is a very sort of bottom up assessments looking at client-by-client level and see to the extent if they are vulnerable to the current developments and in the end we just ended up with pretty much the same kind of total overlays as we had before related to COVID, but it's a completely new assessment based on completely new risks, so it has nothing to do with the historical overlays related to COVID.

ROBIN RANE: Okay, very good. Thank you very much.

OPERATOR: The next question is from Omar Keenan with Credit Suisse. Please go ahead.

OMAR KEENAN: Good morning, thank you very much for taking the questions. So, I just had one as follow on Magnus' question, please? And I had a second question on capital planning. So, firstly, I was wondering if you could help us a little bit with the rate sensitivity number, you have seen in really good deposit growth and, you know, you are probably seeing how the banks behaves after customary [ph] hikes. So, could you give us an updated rate sensitivity number, that's gross of any lack of mortgage margin pass-through, please?

And my second question on capital planning, so when you are looking forward to 2023 clearly it's a more difficult market environment and you give us some very interesting color around what kind of asset price falls are needed to even impact LGD flows? Could you help us understand a little bit around how probabilities of default change in the book just so that we can sort of understand what the risk of rating migration is? Thank you.

JOHAN TORGEBY: Yes, thank Omar. On the rate sensitivity, it's our previous guidance is that when it comes to Swedish rates, 25 basis points higher rates means about SEK 1 billion of gross sensitivity just looking at deposit side, and you have to make your own assumptions on the lending side and what's going to happen to margins on the lending side. And so, that's the growth number and typically it's less than that because typically lending margins especially for mortgages come down when rates go higher. It's very difficult in the short-term to say whether you are going to see a linear effect. As I said before, there are many things moving, at the same time you have liquidity books that will be re-priced at higher levels, but that takes time, you get a initial negative effect on your valuations that overtime you get a higher NII. So, there are many things moving around and you shouldn't assume this will be very linear, but overtime the sensitivity should be around that.

Then we also have a sensitivity to EURIBOR or European rates, in our corporate lending business that we do in euros and in our Baltic business. But we have said before that when it comes to the EURIBOR sensitivity, that's moving from negative territory of 50 basis points to zero, that has negative effect on us as we have some EURIBOR floors in our lending. We have seen half of that negative effect during Q2 and given where your EURIBOR is now, the second half should come in the next quarter. But, then we have positive sensitivity in the Baltics. So, I mean, we have some sensitivity and it's sort of working as we expected that the positive inflows is mainly coming from financial institutions and corporates, where you typically don't really have margin on the deposits. It's hasn't really changed the sensitivity that we have.

On the capital planning, I mean there are so many things we take into consideration when we do our capital plan, it's the volume growth we see, it's the micro risks that we see, and as you mentioned the sort of potential risk migration. During this quarter, we have had some negative net risk migration, at the same time the new lending we've done and has been at good risk weights, so overall the averages were actually down during the quarter. And with this kind of macro outlook, you should expect net negative risk migration and which will have a negative effect on the capital. We have said that in the past and it hasn't happened, but this time around, it should have happen, but to what extent that will impact our capital buffer is difficult to say, and given the fact that we have so many risk weight floors now on mortgages and CRE and RRE, and the impact isn't that large, given that the concerns really are within those areas where we have risk weight floors. So yes, we take into account more sort of long-term effects of IRB models, needed to be reapproved by the FSA as well as Basel 4 being introduced in 2025. And so that we will do here and now, we stand at 480 basis points, clearly above our target range, and we're still doing the dividend of 50% and the share buybacks that we have announced. And the Board will take sort of new decisions every time there is a need to do so, and the next step for them is to take a new decision in October, to what extent, and whether we do share buybacks from October until the AGM, so that's the next sort of decision point for the Board. Thank you.

OMAR KEENAN: Okay, thank you. Thank you very much.

OPERATOR: The next question is from Sofie Peterzens with JP Morgan. Please go ahead.

SOFIE PETERZENS: Yeah, hi. Yeah, here is Sofie from JP Morgan. Obviously, one of my first question would be on kind of the credit quality of the new lends, on the profit side you have seen profits and growth year-to-date and you've seen unprecedented growth on the commercial real estate side. And you also have seen a kind of bridge financing lending facilities in the second quarter and first quarter. Can you just kind of give a broad overview of this corporate and commercial real estate and bridge finance lending? How much is investment grade and what share is non-investment grade? That would be my first question.

JOHAN TORGEBY: Okay Sofie, I can answer the general themes**.** So first most only…most of the lending growth you've seen is actually drawn on existing facility, so it's exactly the same for that part in credit quality as the SEB credit quality so to speak. For the new business that has been you know, gross numbers had been quite large in non-real estate, and that's mostly investment grade, and some structured finance private equity which of course you have collateral and something else, very similar to the mix that we have in the bank, so I would say for argument sake, there is no change in risk profile in the new business that we do. And the last point was investment grade share [indiscernible]?

MASIH YAZDI: Yes, the share of investment grade lending.

JOHAN TORGEBY: …what's the share of investment grade lending.

MASIH YAZDI: Well, it's the majority but then yes, I'll take-up the numbers you wanted, exactly. If I just make a general comment there, Sofie, I think in general, when you have these kind of markets where all the risks are surfacing, you should be less concerned about lending growth, because everyone is so diligent in the underwriting, in this kind of market you should generally be more concerned about high lending growth, it's a good market because at that point you don't see the risks as clearly as you do now.

SOFIE PETERZENS: And always more thinking about like if I did FAS for example that files for Chapter 11 in the U.S., last week, it looks based on their kind of perspective [indiscernible] similarly, I guess that some of the commercial real estate companies that that we know that they have a lot of funding issue, they've gone as well as the funding market. And I know you are kind of limited in your commercial real estate kind of growth ambition, but 9% growth year-to-date is still quite a lot. So I was just wondering if these exposures are due to kind of weaker credit quality clients that you have on the books, but I guess it's unlikely, it's not the case.

JOHAN TORGEBY: No, that's not the case at all and then and generally speaking, the effects that we can't comment on although it is public that we are the financial advisor, but I can say that everything has been taken into account in the 6 basis points of future expected credit losses and would we have anything, we would've disclosed it of that later, but there's nothing to comment on over and beyond that.

SOFIE PETERZENS: Okay. And my second question would be on the IRB overhaul, the Swedish have to say these quite...I don't know worried or very pleased. But they are kind of guiding that the IRB overhaul could potentially have a really very big impact on the Swedish bank. So I was just wondering how do you think about this IRB overhaul impact for SEB and really coming fourth quarter or this quarter next year, if you could give a little bit more details here.

JOHAN TORGEBY: Yeah, I'll start to do Sofie, and yeah, that process is ongoing, and it will probably take a year or so before we get a final decision on what it's going to mean for us, and we're working on our sort of application as we speak. And generally, if you look at the current models that we have and relate that to the historical defaults that we've had, we believe that they are conservative. And if you compare our risk weights that we in general have to European banks risk weights relative to the historical defaults, I'm pretty sure that that analysis will show you that we have been much more conservative than basically all European banks. That's our input in this discussion with the FSA when we do this overall, and we'll obviously try to convince them that it is important to look at the data when you do these models and the data shows that we've had very low losses relative to the capital we reserved against those losses. But in the end, I mean the decision is up to them but we'll do our modeling, we will try to validate that as well as we can and document it, and then in the end it's going to be a discussion with them at what calibration level these new models are approved at.

SOFIE PETERZENS: Okay, but also, I guess, it's…Sweden haven't had a credit event in the past 30 years, that clearly that you have impacted the models?

JOHAN TORGEBY: But, if you look at the data, the data shows that Swedish GDP per capita has grown as much as European GDP per capita in the last 5 or 10 years. So it's been a very similar economic developments, but I think people miss in this is that banks up here have pretty good underwriting standards, and I relate that a lot to the financial crisis we had in the early 90s, that a lot of this changed, we had a much bigger crisis here and I think the banks in general, not SEB, but all banks here learned a lot from that, so past experiences are important when it comes to underwriting standards. So…and another point I would look at, if you look at our net interest income, the net interest margin, it is clearly lower than European banks on average, so either we do have better asset quality or we are extremely poor at pricing risk and you have to make your own mind up around that.

SOFIE PETERZENS: But related to that, I guess that your model is going to go back to early 1990s, for any model or probability of default, of those given default. So, I guess your models would only cover maybe the past 10, 20 years max. Though you haven't had a credit depo or you haven't had any loss experience in your models?

JOHAN TORGEBY: Yeah, the requirements is that the model should be based on 5 years of history and we use much more than 5 years and we still have elements of the 90s crisis in our models.

SOFIE PETERZENS: Okay. Thank you. And the final question, could you just confirm that you still have around SEK 7.6 billion of total assets in Russia and Ukraine, and that you have no provision against this exposure?

JOHAN TORGEBY: Can you repeat that, please?

SOFIE PETERZENS: Yes sir, in your Annual Report, if I look SEB had a combined total asset in Russia and Ukraine of SEK 7.6 billion. You had around SEK 1 billion of book value in Russia and Ukraine. Can you just confirm that these fixed total assets are still unchanged and that you have no provision against these lines or total assets?

JOHAN TORGEBY: Yeah, I can confirm that. Well, in terms of exposure, I mean it's a lot of deposits that we have at Central Bank in Russia and in terms of lending, we have a big majority, more than 90% is…there is a parent guarantee from a Nordic or German company on that exposure. And we feel comfortable with those parent's of those subsidiaries we lend money to in Russia.

SOFIE PETERZENS: But it's still legal entity, the exposure in Russia or Ukraine, right?

JOHAN TORGEBY: Yes but guaranteed by the parent, so it's not the legal entity's credit quality that comes in the equation, it's the parent, if the guarantee holds no loss.

SOFIE PETERZENS: Okay, thank you.

JOHAN TORGEBY: Yes. We just got the number here from a very adept colleague and so around 65% of the volumes that we've written under this quarter was investment grade, and therefore that means 35% wasn't and that's 5 percentage points higher than the average, so the balance sheet is currently 60% investment grade, 40% is below BBB minus.

SOFIE PETERZENS: Thank you.

OPERATOR: And the next question is from Namita Samtani with Barclays. Please go ahead.

NAMITA SAMTANI: Hi, I've got 2 questions, please. Firstly, I understand your M&A policy, but I wondered if your appetite for M&A has increased in the past few months, given the valuation [indiscernible] fintechs and even other financial players is significantly dropped or looking at it from another angle, given a notable proportion of employees have been let go from some of these fintechs? Do you have appetite to increase hiring in the tech or the data space?

And just a follow-up on that question about the preference between balance sheet growth, buybacks and M&A? And secondly, just a question on German business, how do you intend to protect this given the macro vulnerabilities in Germany right now? Thanks.

MASIH YAZDI: Yes, thank you. Nothing has changed on the call it acquisitive appetite…M&A appetite, given the market turbulence lately, and that is then to say that we have in our Business Plan and our strategy a predominantly, if and organic. So no assumptions in the bank are really based on anything, but an organic expansion in this strategy that we released 6 months ago. We did open up for partnerships and within partnerships, there are of course, sometimes interesting co-operations that entail that you acquire or you share part of the equity with companies. And we've done this very successfully mostly in fintech and Greentech as you have seen in the past, so nothing has really changed. What has changed and you have to stand up to these days. Things are moving around in the market, there's definitely going to be problems and opportunities being created. So, there is an increased focus in monitoring what's out there, both on the West Coast of the U.S., as there's a lot of fintech center around there. So, there's definitely heightened activity levels. And as you have seen the valuations in the technology space in the startup space, it is very volatile and have been moving around a lot.

Then hiring tech, we are super interested in hiring tech people that are now being laid off. There is now as far as I know, 63,000 people that has been laid off this year within the startup and technology companies around the globe. And this is definitely an area where we have often talked about the very tough competition for talent. And there were the new economy, the start up of the fintechs of course, have attracted a lot of good talent. That is now of course coming to us. And we have already hired in the strategy that we have some during the last months.

Was there another…was those 2, oh! Germany, sorry, Germany, we are doing everything we can on call it the academic level. So, we're stress testing the bank given the extreme uncertainty around how particularly the gas supply will develop. We've also used the Bundesbank scenario. So, they've done a lot of work on how this could affect the German economy, if the worst come, and we put that through and do all the preparations, and feel fairly comfortable right now that we can handle those issues, given the strong capitalization, the strong liquidity and the very strong asset base that we have in Germany, in particular, where you have a very focused in large corp focus business for SME.

NAMITA SAMTANI: That's helpful. Thank you.

OPERATOR: The next question is from Rickard Strand with Nordea. Please go ahead.

RICKARD STRAND: Hi, good morning. A follow-up question on the Swedish…your Swedish mortgage growth. So you mentioned in Q1, that you had some issues with your customer service center. Just want to hear if those issues are resolved now. And also a follow on to that one, if we see the market growth slowing down substantially in the coming quarters and you also mentioned that the SEB naturally has some headwind there if we have a scenario where transactions slowed down, in such a scenario, do you still feel that you would prioritize coming back to growing in line with the market or would you rather then prioritize margins instead in such a scenario?

JOHAN TORGEBY: Yes, thanks, Rickard. When it comes to customer service, no, it's not fully solved, it's never fully solved, because we want to improve all the time. I think it has improved since Q1, and we see further improvements going forward. But if we look at the data, it seems like the main reason we're not taking our fair share is the price. But then obviously, we've tried to sort of pull the service level lever as much as we can, because that's a better way of serving your customer than just reducing price, but as continued sort of improvements all the time.

In terms of the transaction level, and whether that sort of could lead us not taking our fair share, I mean, you're right, I mean, if there are structural reasons why we in the short term cannot take our fair share, we'll take that into account. The main thing for us is that we don't want to lose good customers of the bank. And we'll do whatever we can, both in terms of service level and price to make sure that they don't leave us. That's the main point.

RICKARD STRAND: Thanks. And then the second question on costs. I know you haven't given any guidance on the cost levels after those levels for the coming years, but you have hinted of cost income of around 4% to 5%. And just sort of, how should we think about if interest rates give a positive contribution…or rate hikes give a positive contribution to NII? Should we still consider 4% to 5% to be a level you'll be around or would you reconsider that given the sort of uncertainty of the long term implications, and how sustainable the rates are, and also the uncertainty about sort of loan loss impact et cetera, just curious to hear your reasoning around that.

JOHAN TORGEBY: Yes, firstly on the 0.45, that's nothing that sort of dictates how much we invest a certain year, that's more of a long term implicit level we think we need to be at to reach the 15% return on equity. So, that's just how we use it. It's an implicit target. It's not an explicit target.

Secondly, you should just be aware that this year, we've moved the resolution fund fee out of the NII number, and it's below the cost income line. So, everything else equal, we should actually have a lower cost income level than 0.45 to reach to 15%. And we'll revisit this by year-end to make the necessary adjustments to that. So, I mean by the end of this year, we'll look at the investments we think we need to do for next year, and based on that we will make a decision on the cost target for next year. And those investments will be based on what we need to do in '23 to reach the 2030 targets we put forward in our strategy. And we calibrate that based on the development so far, the appetite we have, and obviously the profitability of the bank here.

And now, if rates go up, and that leads to a better income line than we have expected, then obviously that sort of creates room to do more investments in the short term, but we don't...we don't want to make the decisions based on that, we want to make decisions on what makes sense for the bank to do. So, yes, that's how we look at it. I mean, there's one big uncertainty when it comes to next year that we haven't faced in many years. And that's salary inflation. We've been very used to about 2%, 2.5%, 3% salary inflation for a long period of time. And now, this is a big uncertainty for next year, given the high inflation numbers. So, we'll have to wait and see where that lands when it comes to the centralized negotiations. And obviously, that will also impact how much extra investments we can do in addition to the salary inflation that we might get next year. So, that's sort of added uncertainty this year.

RICKARD STRAND: Thank you very much.

OPERATOR: The next question is from Jens Hallén with Carnegie. Please go ahead.

JENS HALLÉN: Thank you. Yes, 2 risk questions. And first, on the model overlay reallocation, can you say something about the sectors where you apply them to? And then second question straightaway is on commercial real estate. And thanks for the useful stress that you put in into presentation. I just wonder, when you do this stresses, do you also then do a stress when the wholesale market is closed for these companies i.e. you know, if it's close, they have lots of short term funding, could that potentially be a liquidity stress for the commercial real estate companies breaking covenants and then in the end, your exposures i.e. How much do you look at the whole debt structure for these companies maybe the stresses [ph]. And so those are my 2 questions.

JOHAN TORGEBY: Okay, thanks, Jens. On the model overlay, I wouldn't look at sectors, it's more of counterparty-by-counterparty, but obviously, to the extent that a company has a lot of expenditures related to energy for example, that's going to have a negative impact on their cash flows. So, it's more based on individual names in different sectors, rather than sort of certain sectors being impacted.

On the CRE, I mean, what we do take into account, as you saw there on that slide, we assumed rates to go up by 400 basis points, but then a lot of these companies have hedges on, which means that their funding costs doesn't go up to the same degree as the short term rates go up. So, we take that into account.

In terms of sort of a liquidity crunch, these companies not being able to refinance themselves, it doesn't really affect in the short term, because they don't have to refinance themselves, a lot of them in the short term. But then also, there's a potential possibility for them to get bank financing instead. But the general answer is that, no, I mean, this type of stress test, you look at their funding costs going up. And you assume that they can fund themselves. It's absolutely impossible to fund yourself at any spread levels, then that's a different scenario.

MASIH YAZDI: Yes, and I'd like to add 2 things, Jens. First, on the model overlay, so every counterparty has taken in the normal expected credit losses. Overlays are over and beyond and you do it bottom up when uncertainty is particularly high because it's almost like an expert judgment. Yes, you can say that this is the probability as a default, from a company who is heavily dependent on energy prices, you know that your point estimate in this particular instance is more uncertain than normal. So, you use an expert judgment, some wisdom and some sounds thinking that we need to put a little bit because the world is moving. And that's why it is very much so and of course, exposure to Russia is one of the factors going in.

And then well you are alluded to on the real estate side is the liquidity analysis rather than the credit quality analysis. So, that's not necessarily in there. There is some part of credit and liquidity analysis that marries and that's the availability of funds, et cetera. But right now, I think your point is a very important one. Right now, this is not the credit quality issue. It's a very high uncertainty around liquidity. And can I refinance a debt at a reasonable price tomorrow, rather than necessarily the quality of the asset might not have changed from yesterday, but the markets appetite to refinance might have changed and those are very separate analytical tools and the PB doesn't change because the probability of you not meeting your obligations is kind of the same from the company operational side, but it's significantly reduced because you don't have liquidity to pay your bills.

JENS HALLÉN: Okay, it makes sense. Thank you very much.

OPERATOR: The next question is from Martin Leitgeb with Goldman Sachs. Please go ahead.

MARTIN LEITGEB: Yes, good morning. Thank you. Thank you for taking my question. I really only have 2 follow-ups on commercial real estate. And thank you very much for all the color given in the call already. And the first one is just I was wondering if there's any portion of your commercial real estate book you're particularly focused on, I mean, historically, when we have seen large moves in commercial real estate, it's some form of speculative development and stuff like that, which creates credit issues going forward. Is there anything you could comment in there, in terms of your overall book and the disclosure on Slide 20 is very helpful you know, on…what percent of your overall CRE book you're particularly focused on?

And secondly, I was just wondering, and you made a comment earlier, with regard to lease indexation. And I was just wondering if that's very common in Sweden or basically, most of the commercial leases, in your CRE book index [indiscernible] a meaningful offset to obviously higher swap rates? Thank you.

JOHAN TORGEBY: Yes, thank you. If you can, in this day and age, you probably understand that the sub segments of the real estate exposure, which you are particularly focusing on comes from 3 areas. First, the category that has a pass through contractual strength or not. So, if you have inflation, do you have a real estate exposure where you have pre agreed with a tenant how to increase it or not, if you don't, you are more exposed, of course, to see how negotiations would go in the future, and that goes both for increased costs and increased inflation in general terms. The other one subject it's not everyone has the same cash flow, it's the relatively weaker cash flow metric. So, we show on our slide we are today averaging 4.6 and interest cover ratio, that means that operating profit available to service your interest rate is 4.6 times higher, and then that's sub segments, which is in the weaker end, that's where you particularly need to focus right now to stay close. And then that is natural, then to say the third is leverage. So, it will be very intertwined. So, right now, it's more the ones who have relied heavily on high indebtedness, they are, of course, more exposed than the ones who are hard looking and lower on both cash flow metrics, and LTV metrics. And we have shared with you there, the averages of our portfolio at 46 for the commercial, residential side, and at 27 for the coop side on the residential side.

And then I don't dare to answer the percentage or proportion of what is indexed or not. But I hear from many clients that there is a lot of the retail lease contract that are indexed in some shape or form. But I don't know Masih, if you want to give some more color on that mix.

MASIH YAZDI: Yes, I mean, I'll just a couple of general comments in commercial listed companies in general have will index their rents to inflation levels, and that typically happens in October every year. So, in the very short term, given that on the funding side, they have a lot of hedges and they don't need to do a lot of funding, in next 12 months, you'll see a lot of real estate companies actually improving their cash flows, because their income will go up more than their interest expenses. So, that's pretty interesting. And obviously, it will be good if they keep some of these cash flows for potential funding costs going up later on.

If I would talk about concerns in general, I would say that we are clearly less concerned about the large real estate companies that we have exposure to, because they are scrutinized quite a lot. And it will be more concerned about really small real estate companies with maybe SEK 50 million of loans that they've invested in the last few years, where you have sort of difficulties fully getting grips of the entire book, because we're talking about many more exposures, where you don't have this sort of process of going through several committees in the bank when the credits approved. So, in general, I will be more concerned about the smaller ones rather than the larger ones.

MARTIN LEITGEB: Very helpful. Thank you very much.

OPERATOR: The next question is from Maria Semikhatova with Citibank. Please go ahead.

MARIA SEMIKHATOVA: Yes, hello, thank you for the presentation. Couple of questions, first, clarifying on net interest income, if I look in your fact book, funding cost on customer deposits increased from 3 basis points to 22 basis points over the quarter. So, just wanted to clarify, what parts of your deposit portfolio have been re-priced up in second quarter. And following up on NII, if it's possible to isolate the impact from FX moves quarter-over-quarter. And then your interest rates in securities implies roughly SEK 250 million from a 25 basis point hike on deposit margins. And we saw that the increase in NII was over SEK 400 million from deposit volumes and margins. I know there are different things going on there. But is it fair to assume that so far the repricing is trending above your expectation or your guidance on interest rate impact. And then separately on cost of risk outlook, you reiterated the outlook for the full-year that you expect costs to be...cost of risk to be below...to be at low levels this year. So, we're now at 7 basis points in the first half, is there anything you could add, let's say on the outlook for the second half compared to the first half?

JOHAN TORGEBY: Yes, try to go through those questions. On the deposit margin going up from 3 to 22 basis points, most of our deposit is from corporates, where you have market pricing basically. So, with rates going up, you're going to pay more for those deposits. So, you should just be aware that this is a mixture of all the deposits we have, it doesn't mean that we've changed the deposit rates by that much on the retail side, because of being very heavy on the corporate side, this sort of average deposit price goes up as much as you can see. And so, it's mainly corporates basically.

On the interest rate sensitivity, again, there are a lot of moving parts. So, we have a sensitivity to the repo rate, but we also have a sensitivity to STIBOR going up, and given that the 3 months STIBOR expects further repo rate hikes, it means that STIBOR has gone up more and there's some sensitivity to that. So to the extent that we have had higher sensitivity in Q2 relative to the 25 basis points, it also includes the fact that the STIBOR is up more than 25 basis points. And that that's the SEK 400 million, you mentioned that really sort of the deposit margin development in the divisions related to how much treasury charges or pay the divisions on lending and deposits. And there are sort of lags between how much they charge and how much they pay on the lending side and deposit side. And those lags will play out over time. But in a short period of time, we're talking about 60 business days there are lags there. So, you can't sort of fully trust that, that is in line with whatever we guided for on the interest rate sensitivity, we guide for a sort of more normalized level that happens over a period of quarters rather than one single quarter.

Cost of risk, second-half of the year, I mean, the only thing we can say we believe it's going to stay low. We don't see anything here now deteriorating. In terms of asset quality, we think we are well reserved both in terms of the total allowances we have related to the Stage 3 loans, you can see that that's 55%, if I don't recall that incorrectly. And then we have these overlays of SEK 2 billion and that we have for a potential rainy day. So, we think it's going to stay low this year. And then going into next year depends on obviously what happens to macro. We've seen a long period now with negative revisions on the outlook and GDP growth in many countries. And obviously, if that continues, that's going to sort of deteriorate the outlook, but it could also rebound and look differently. So, we have to wait and see what happens. But what we have visibility on is the remaining of this year and we think it's going to stay at low levels.

MARIA SEMIKHATOVA: Thank you very much. Just on the facts, more impact on NII if it's possible to isolate how much has contributed to the increase?

JOHAN TORGEBY: Was that the mortgage impact?

MARIA SEMIKHATOVA: Impact from exchange rate moves?

JOHAN TORGEBY: Okay. Exchange rate moves Q-on-Q is very limited. It's about SEK 50 million in total on income and pretty much unchanged on the cost side, year-to-date versus last year, year-to-date, it's SEK 500 million positive on income, it's more than 50% of that comes on fees, so less than 50% on net interest income and it's about SEK 200 million on costs.

MARIA SEMIKHATOVA: Okay, thank you very much.

OPERATOR: The next question is from Riccardo Rovere with Mediobanca. Please go ahead, sir.

RICCARDO ROVERE: Thanks. Thanks for taking my question. I have a couple for Johan and maybe a couple for Masih too. Starting with Johan, in 2020, at the time of COVID crisis, we saw the corporate…the corporate loan demand going to the roof in the first part of the year, remember well that slide of the new commitment. And then we saw a decline, or let's say, a stabilization or a stagnation in the following quarters. My question here, do you see corporations in those days behaving more or less in the same way, as first half 2020 or do you think this time is different? This is my first question.

The second question I have comes to your green strategy ambition and so on, when you presented your strategy months ago, there was something that was considered to be dark brown, and now is seeing as a bouquet of red roses, does it change anything? Does it open up brand new opportunities for you or we should take that kind of strategy as it was and changes nothing, this is the second question?

Then I have a couple for Masih, the first one is on overlays. Is it possible to have an idea whether in the SEK 2 billions that you had set aside for energy related, war related Russian invasion, whatever. Is there any part of the assets may be includes a specialist as a scenario probability weighted of a complete cutoff of gas from Russia, to the Nord Stream in Germany, and then that will probably go through the whole continent? Is that something that you have taken into account when you have set aside that those SEK 2 billions, which by coincidence are more or less the same number of COVID overlays?

And the other question, I wanted just a clarification more than anything else, when it comes to the part of NII related to fixed income bridge financing, is it SEK 200 million, SEK 300 million that you've been mentioning before, and couple of hundreds that you mentioned in Q1.

Just I need to understand, this is not a one-off or at least is not a one-off by nature, maybe the number is a one-off, this number will continue to be there. It could be higher, lower, could go up and down quarter-by-quarter. But it could actually be zero, but it's not the lump sum that disappears. It is just something that is very difficult to, let's say, also for you to have an understanding how this could be go on. Is that a fair assessment of what you said? Thank you.

JOHAN TORGEBY: Thank you, Riccardo, excellent questions. We can sit here now for some while. So, your observations from 2020, I'd have to remind everyone we did SEK 139 billion extra credit exposure granting in 8 weeks, because there was some sense of panic. And this is again, large corporate. We can compare that to now, where you have actually seen that the outright level what we do today is on par or higher than we were then. So, we have been able to currently maintain that, we call this whole concept of temporary or short term. It's very much a concept of what time perspective do you have? Do you want it to be replicated next quarter? Yes, we are very keen in telling you guys, this cannot necessarily be replicated in the next day. But if you think 3, 5, 10 years, like I do these are super stable businesses, we will have bridge financings, we will have these levels that we've now incurred in the long run replicated, but I have no clue if it's going to be lower or weaker next quarter.

This time, it's very different, and this is how I would reset [ph] Riccardo. Pandemics are by nature, a transitionary feature they come and then they go away. It's a health crisis that you need to deal with that has economic consequences, but it doesn't necessarily change the economic fundamentals of the world. But it might change your perception on how to travel, where to travel and how you do the risk of diseases and pandemics and epidemics, et cetera. But that was, okay, there's been very little panic in the financial markets from a corporate banking perspective, this time around. A war in Ukraine, it's a more slow moving animal. And it has definitely more permanent potential consequences for the planet, for the world, for the geopolitical situation, as you see with energy...energy for the globe, and therefore monetary and fiscal policy, it affects politics, it affects everything. But it's a more slow moving and it's certainly not a passing phenomena. And war might be a passing phenomena, but the consequences could be permanent for humanity.

Therefore, we do see some very small tendencies to a similar pattern, but not this panic all at the same time. And as I pointed to in my presentation, the difference between loan lending this quarter compared to credit exposure is unusually high. That therefore must mean that people are using commitments that had previously been undrawn to cover for the consequences of this economic reality we face today. Hence, working capital goes up, I spoke a little bit about this as a positive potential in Q1 now it came, it's certainly part of why lending is growing in this quarter, because people are using previous commitments maybe to cater for higher input prices, the classical thing, it now costs 10%, 20%, 30% more to get the material and the services you need to produce your good before you can sell it. And there's a time lag, working capital goes up, you need to draw your line, you need to contact your banks. And this is, of course, much more uncertain where this permanently lead.

And I think that we continue to see that this is a potential driver in the future that slowly but surely, particularly given your German situation where rationing…rationing of electricity might be a reality later this year. In Germany, of course, there will be a lot of working capital needs enormous I would say, all these companies need to pay their salaries and their bids, but they might not be able to operate as freely that they have, because they need to shut down for periods of time or even…evenings, so what do I know.

On the green presentation or the dark brown that you now called roses, it is very interesting, we have decided for now not to change anything. So on the brown, the green and the future, the 3 indices that we attract, we are all more or less on track, as we said when we presented them last fall. And the big question is, of course, how to treat natural gas in brown. And just as a reminder, we treat a 100% of the gas as a fossil exposure. We make no difference between oil and gas. If it is a fossil based energy material we include it. And of course, now everyone wants to say that you shouldn't treat them similarly. But to be prudent for now we do treat them both as brown. And then we'll see if this needs to…I mean, we are hoping for a taxonomy. We are hoping for a definition of green exposure in banking and brown exposure to be agreed by everybody. And then we will change these metrics. So, they become comparable, or at least add a metric, so it becomes comparable. But from our viewpoint in our part of the world, we still think that gas is not as good as non-fossil based energy generation, Masih?

MASIH YAZDI: Yes, on the SEK 2 billion overlays, no that does not include a stop of gas to germinate, there will be a clearly more adverse impact on macro.

So, the SEK 2 billion is based on the current macro outlook, but obviously that would be good to have if things get worse.

On NII, you're absolutely right. There are not...these are not one-offs. These are short term in nature, but because people in general see NII as very stable, we just want to mention that there are parts here, there are short term in nature, could easily be replaced but up by other things that are short term in nature. But we don't know at this point, and especially the fixed income part. That's why I say SEK 200 million, SEK 300 million that one could easily stay on the books. We don't know. But it is typically short term in nature.

RICCARDO ROVERE: Thanks. Thanks a lot, Masih. Just a quick...very, very quick follow-up still on overlays, is it fair to assume that now those SEK 2 billions will be part of the furniture for quite a while?

MASIH YAZDI: Can you repeat that, please.

JOHAN TORGEBY: The SEK 2 billion or it's fair to assume that they will be there for a while?

RICCARDO ROVERE: Yes, exactly that you will not be allowed to release or to use it, given what's happening. It was supposed to go away, they went away, but they've been replaced. And now that the SEK 2 billion will stay again at least this year, for sure, maybe in 2023 too, I would imagine, is that fair to say.

MASIH YAZDI: I think it's fair to say that it triggers for the SEK 2 billion being removed, or a bit more or less or less tangible than the triggers for the COVID-19 to be removed. That's the way I would say it. But I think generally speaking, in principle, these are temporary, because you can't have sort of evergreens in terms of overlays, especially in the discussions with the auditors, it's important to have clear triggers for when these type of expert judgments are on the books and then removed on the books. But yes, you're right it's difficult...more difficult to find triggers for the extended COVID-19 overlays.

RICCARDO ROVERE: Okay, thanks. Thank you.

OPERATOR: The next question is from Nick Davey with BNP Paribas. Please go ahead.

NICK DAVEY: Good morning, everyone. Yes, Nick Davey from BNP Paribas Exane. And 3 questions, please. The first, briefly a follow-up on the point about the German gas switch-off, so you say it's not covered in your SEK 2 billion. Could you give us any insights from your stress tests with Bundesbank as to how bad that could be?

Second question, listening to you talk on capital, you're saying there are possible enormous working capital needs from companies, you are talking about PD migration. Do you think you...we should all be...emphasize buybacks in our thinking for the next few years?

And third question on repricing, we focused a lot on mortgages, and your famous Slide 11. I guess, if you did it for corporates, that spread would be quite negative. And so, would you be more optimistic from here about repricing on mortgages or corporates? Thank you.

JOHAN TORGEBY: Okay, I'll start. Thank you for the question. The German Bundesbanks, I mean, this...what Masih said is absolutely correct. We need to do, every quarter, an assessment with everything we know, and we do that bottom-up. If we find that the bottom-up is scaringly we're worried that it's not adequate because other factors can be taken into such as increased uncertainty. We can have an expert judgment and say that all these companies are particularly difficult, so we add something, the temporary nature. When it comes to stress testing, that's the whole plan of SEB's capital, which it is included in the way that we do adverse and severely across the Lehmann case, and this is part of the ever-growing work in the bank. So, in that sense it is 100% catered for. So, we would have done this update, and so we have adequate capital now to stomach it. But if it does happen, we know that there's been 100% probability that the economy will be affected. Today, it's not 100% probability, therefore that will, of course, change next quarter when we know more. And Nick, the working capital need is, of course, a potential outcome, that if you do get some shortages on keeping your sales up, because you have to shut down from time-to-time, you need to carry more inventory, et cetera. What you are...what was your question on PD migration?

NICK DAVEY: It's more a point, generally, about capital trends. So, it's really the broad observation you're telling us that as the situation deteriorates your PDs might go up, your risk grade of assets might go up, the volume picture is quite strong. So, really, my question...yes?

JOHAN TORGEBY: Yes, I know more about that, but Masih will now tell you why.

MASIH YAZDI: Yes, I mean, in general, I would say that any dividend or buyback for any company is really a sign of weakness to be absolutely honest. It's better to be able to employ all the capital you generate in the business you do. We have a high return than our cost of capital and therefore...the optimal situation would be that we don't pay a dividend and do not buybacks because we can reemploy all the capital and continue to grow our business. So, if there is a higher working capital need and risk is going up, which typically means that margins are going up then it will be better for us to just employ that capital and service our customers. It will be better for them and it will be better for our shareholders as well. So, sure, I mean if that happens then that's good, it's going to create more value than to do the share buybacks.

NICK DAVEY: Okay. And mortgage versus corporate repricing?

JOHAN TORGEBY: I can start. And yes, we've spent a lot of time on this call talking about the retail side of Sweden. And I just want to say that if you do look at the NII, which has improved significantly in this quarter, please look at the slide [indiscernible]. So, what we haven't talked about is the 50% of the banks that is outside Sweden, and the largest division in the bank, and the dynamic between M&A and DCM on the books, under the trading, et cetera. So, I think that there is a clear positive opportunity for the first time in a very, very long time to reprice corporate lending. Just a fraction of what has happened in the corporate bond market would be a very positive endeavor. We also...also as banks, haven't experienced a higher cost of funding in the public debt market. So, even if we can't do what the bond market do on the loans, we definitely need to cater for increasing the price just because of the fact that it's also been more costly to source the funds. So, I'm...I think those margins are going to be much more down to what is corporate banking in Europe having to do in order to cater for higher cost of funding for the European bank, as well as, seeing that the probability to default as it is priced in the public bond market is clearly indicating higher credit spreads.

On mortgages, I would almost say it's the opposite. So, mortgages is one of the safest asset passage you can have, albeit we are at a peakish level right now on valuation of property. And one can ask is the vintage [ph] 2021-2022, they are the peak vintage of mortgages. But this is a very domestic, highly competitive situation, but all banks to different extents, will enjoy or not enjoy a return to positive interest rate environment. And that has very much to do, how much deposit you have, and what dynamic it has on it. But this is the minor question in my mind, the big one is for LC&FI, but that's certainly the case for the Swedish domestic mortgage bond market, and the Swedish deposit taking for retail.

And there, I think it is much more like I have said in the past, much more in...prudent to assume there will be a new equilibrium in 1 or 2 years time between margins on mortgages with margins on deposit which is in-between this interest rate sensitivity assumption, which is that you don't change any margins anywhere else, but enjoy the benefit from deposits. And we have also introduced a positive yield on the savings accounts in Sweden, to 50 basis points for 6 month tenure, and 25 basis points. So, there is something happening on both markets the deposit market and the mortgage markets. So, I guess the answer…the short one to your question is, it differs a lot and it's positive for corporates and negative for mortgages.

NICK DAVEY: Thank you. And sorry, just to pick up on the corporate point, because that's sort of what I was probing at, your response. So, you've been at the forefront of repricing upwards on the mortgage side. And do you think you're there on the corporate side as well, because what we can see in the data so far is that's...it's been quite a muted response compared to what you've seen in the bond market. So, is there anything holding you back other than time?

JOHAN TORGEBY: Yes, we have no pricing power on the corporate side because we are globally exposed to competition. So, I cannot have any meaningful impact by ourselves in any market when it comes to the large corporate multicurrency RCFs, they are priced by 10 banks together, and it's a much more sticky type of thing, where the lowest...the bank who is willing to lowest the cheapest often is the price dictator. And then you get that option to participate or not.

On the domestic side in mortgages, it's much more down to the competition here to dictate what it is. So, we cannot...we don't have a pricelist for corporates, like we have for mortgages, so there is no such resemblance. So, this is more a macro trend. There is a little bit of bilateral pricing power in the corporate space, that's typically also the domestic SME and midcorp, where you can do similar things. But not when it comes to the large exposures we have, it's a global phenomena.

NICK DAVEY: Okay. So, the 10 other banks who are all exposed to the same funding conditions that you are, and all watching the same bond market conditions that you are, you say the other 9 are still dragging their feet and being a bit irrational?

JOHAN TORGEBY: Correct. And we...I've been doing this for 25 years. The difference between a 5 year unsecured exposure on a corporate credit, do the 25-year graph between the bond market and the loan market. Loans are always cheaper, more or less. Not always, but absolutely 95% of the times. And now the difference is the largest one I've seen in the very, very long time. That means that we are dragging up...banks are much more slowly moving. It's also true on the opposite by the way, when spread tightening the bond market banks don't lower the price immediately either. So, we work with these RCF, they are typically 5 years long, and that's kind of our cycle in the corporate bond...the corporate banking markets, while bond markets it's today, it's a one day long they reassess the credit spread every day.

NICK DAVEY: Thanks. That's really interesting.

OPERATOR: Gentlemen, there are no more questions registered at this time. Mr. Torgeby, back to you for any closing remarks.

JOHAN TORGEBY: No. Thank you very much for this. I think it's a particularly tropical time. I wish everyone a good summer. I do need to say one thing that no one asked about, and that was the fees and commission on LC&FI. And I just want to point out that the volume growth in asset under custody was a major thing for us compared to one year ago, why this has performed relatively stable. So, we've gone from SEK 14 trillion to SEK 19 trillion in asset under custody. And I think it's an area we rarely talk about, but I just want to make that point as we have really changed in the last few years...5 years, from also being a custody bank, and that's an important focus area in the strategy going forward, in combination with AUM and AUC. So, thank you, everyone, for today. I wish you all a good summer and hope to see you this fall. Bye-bye.