

Svenska Handelsbanken: Possible UK Subsidiarization



Scope
Ratings

In this short report Scope examines the possible conversion of the UK retail branches of Svenska Handelsbanken (SHB) into a subsidiary, in light of the uncertainty surrounding the UK's future position inside or outside the Single Market.

As Brexit approaches, SHB (Issuer Rating: A+, Stable Outlook) is in a class of its own, as the largest passported retail branch banking business in the UK. SHB's strategy since entering the UK market in the 1980s has been to grow its branch network off the balance sheet of Svenska Handelsbanken AB in Sweden, rather than following the more usual model of setting up a separate subsidiary and branching out of it. SHB's operations in the other Nordic countries and in the Netherlands operate on the same lines. Thus to date SHB has avoided the need for a local capital base in the UK or in its other retail markets outside Sweden. It is primarily supervised by Sweden's Finansinspektionen rather than the UK's Prudential Regulatory Authority (PRA), with the Swedish National Debt Office being responsible for deposit insurance covering all of its branch customers. Such an approach means that liquidity, capital and many other important concerns can be and are dealt with in Sweden.

Although the UK is SHB's second largest home market after Sweden, accounting for 10% of FY16 operating profit and 12% of YE16 assets, the bank still has a relatively small share of the UK banking market. It has been able to grow as a challenger bank, without much advertising, often by taking away customers from the incumbent high street players. SHB positions itself to do personalised business in local branches, particularly with small business owners who demand a high level of service, although it also serves individuals. Credit decisions are taken at branch level, and any follow-ups are also localised. This closely mirrors SHB's approach in Sweden. SHB currently has 207 UK branches, and (unlike larger competitors looking to close branches) is looking to open one more later this year.

The UK business is profitable (ROE 13.5% Jan-Sept 2017), albeit not yet with the strong efficiency level of the Swedish branch network. Scope views SHB's UK operation as positive for the credit, as it provides a cushion against any domestic downturn. We also note that one of SHB's key credit strengths is its ability to manage asset quality through credit cycles. Although the non-Swedish operations have less longevity than those in Sweden, and asset quality therefore can't be judged over the same long period, so far there has been no cause for concern.

SHB has been able to operate through branches in the UK to date because Sweden and the UK are both within the Single Market. The provisions of CRD IV give Sweden, the home member state, the right to authorize a bank domiciled there to operate in the whole of the EU/EEA area (the Single Market), either through setting up a branch (without separate authorization) or the direct provision of services cross-border, in conjunction with appropriate product 'passporting' arrangements.

Passporting requires contact with the host country supervisor and reassurance from the home country counterpart, but doesn't involve the host country placing heavy regulatory burdens on the bank, of which the largest would usually be capital requirements. If the UK leaves the Single Market, Scope expects that the 77 banks currently based in the EEA area and authorized to take deposits within the UK will be dealt with on the same terms as presently apply to non-EEA banks – requiring at the very least separate branch authorization, and in some cases setting up of a subsidiary.

Analyst

Jennifer Ray
j.ray@scoperatings.com

Investor Outreach

Michael Pinkus
m.pinkus@scopegroup.com

Scope Ratings AG

Suite 301
2 Angel Square
London EC1V 1NY
Phone +44 20 3457 04524

Headquarters

Lennéstraße 5
10785 Berlin
Phone +49 30 27891 0
Fax +49 30 27891 100

info@scoperatings.com
www.scoperatings.com



Bloomberg: SCOP

Because it has over 200 UK retail branches, SHB's case is complex. Non-EEA banks can receive branch authorization allowing deposit-taking activities, provided that as a whole the bank meets the PRA's Threshold Conditions for authorization. In essence, the PRA would need to assess the home country's supervisory regime to be closely equivalent to that in the UK, and to accept the home country's supervision of the branch as sufficient¹. However, most branches of foreign banks operating in the UK focus on wholesale activities, and the PRA expects new branches of non-EEA banks to do the same – which is clearly not true of SHB.

Further, the PRA would only be content for authorized non-EEA banks to undertake retail banking activities beyond de minimis levels if it received a very high level of assurance from the home state supervisor over resolution. Even more important in SHB's case, the PRA also takes into account the impact of a possible failure on financial stability, which includes access to 'transactional accounts'. The PRA expects new non-EEA branches to have insured deposits of less than GBP 100 mn. It also assesses that there is a possible risk to financial stability if the branch (in SHB's case the branch network) has more than 5,000 customers. In these circumstances Scope believes that the PRA is likely to request a subsidiary structure for SHB.

Planning is under way to deal with the possible need to set up such a subsidiary, and Scope believes that SHB is managing this with the appropriate degree of urgency. The Prudential Regulatory Authority asked banks for their contingency plans earlier this year, and SHB has responded.

We also note that, if the UK were to remain within the Single Market, a local subsidiary may not prove necessary. With a UK deposit base of GBP 9.1 bn at 3Q17, SHB is not yet large enough to be caught by ring-fencing rules, which kick in once core deposits (mainly from retail and SME customers) reach a 3-year average of GBP 25 bn.

Finally, SHB has said that although there are costs involved in setting up a new subsidiary in the UK, many of these would have eventually been incurred in any event. While the UK operation is profitable it is also SHB's largest non-domestic network and would benefit long-term from additional investment in governance and information systems, which could also help to improve efficiency.

¹ See Supervisory Statement SS10/14: Supervising international banks: the Prudential Regulation Authority's approach to branch supervision, September 2014



Svenska Handelsbanken: Possible UK subsidiarization

Scope Ratings AG

Headquarters Berlin

Lennéstraße 5
D-10785 Berlin

Phone +49 30 27891 0

London

Suite 301
2 Angel Square
London EC1V 1NY

Phone +44 203-457 0 4444

Oslo

Haakon VII's gate 6
N-0161 Oslo

Phone +47 21 62 31 42

Frankfurt am Main

Neue Mainzer Straße 66-68
D-60311 Frankfurt am Main

Phone +49 69 66 77 389-0

Madrid

Paseo de la Castellana 95
Edificio Torre Europa
E-28046 Madrid

Phone +34 914 186 973

Paris

33 rue La Fayette
F-75009 Paris

Phone +33 1 82 88 55 57

Milan

Via Paleocapa 7
IT-20121 Milan

Phone +39 02 30315 814

info@scoperatings.com

www.scoperatings.com

Disclaimer

© 2017 Scope SE & Co. KGaA and all its subsidiaries including Scope Ratings AG, Scope Analysis GmbH, Scope Investor Services GmbH (collectively, Scope). All rights reserved. The information and data supporting Scope's ratings, rating reports, rating opinions and related research and credit opinions originate from sources Scope considers to be reliable and accurate. Scope cannot however independently verify the reliability and accuracy of the information and data. Scope's ratings, rating reports, rating opinions, or related research and credit opinions are provided "as is" without any representation or warranty of any kind. In no circumstance shall Scope or its directors, officers, employees and other representatives be liable to any party for any direct, indirect, incidental or otherwise damages, expenses of any kind, or losses arising from any use of Scope's ratings, rating reports, rating opinions, related research or credit opinions. Ratings and other related credit opinions issued by Scope are, and have to be viewed by any party, as opinions on relative credit risk and not as a statement of fact or recommendation to purchase, hold or sell securities. Past performance does not necessarily predict future results. Any report issued by Scope is not a prospectus or similar document related to a debt security or issuing entity. Scope issues credit ratings and related research and opinions with the understanding and expectation that parties using them will assess independently the suitability of each security for investment or transaction purposes. Scope's credit ratings address relative credit risk, they do not address other risks such as market, liquidity, legal, or volatility. The information and data included herein is protected by copyright and other laws. To reproduce, transmit, transfer, disseminate, translate, resell, or store for subsequent use for any such purpose the information and data contained herein, contact Scope Ratings AG at Lennéstraße 5 D-10785 Berlin.