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Speakers: Gregori Karamouzis, Birgitte Bonnesen, Anders Karlsson and Helo Meigas

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Introduction and Presentation

Operator

Ladies and gentlemen, welcome to the Swedbank's Second Quarter Report 2016. Today, I am pleased to present Birgitte Bonnesen, Acting CEO, Göran Bronner, CFO, and Anders Karlsson, CRO.

For the first part of this call, all participants will be in listen-only mode, and afterwards, there will be a question and answer session. Speakers, please begin.

Gregori Karamouzis

Thank you operator, hi everyone, good morning, this is Gregori, Head of Investor Relations. I just want to make a short correction on the announcement. Of course in the room we have Birgitte Bonnesen, our CEO, Anders Karlsson, our CFO, and Helo Meigas, our Chief Risk Officer.

Good morning, everyone. I'll hand over to Brigitte.

Birgitte Bonnesen

Good morning. I will come back to the new management team a bit later in my presentation. But I'm sure you all know who we are. And thank you for participating in our Q2 earnings call this morning.

I will start off a bit with the outside world and the turbulent time that we live in with weak government, fragile economic development in Europe, and some geopolitical tension. This means that we will continue to see volatility in markets, a certain cautiousness and low interest rates.

In the midst of this, Sweden and the Baltic countries stand very strong. We see healthy growth rates, and I'm very pleased to report this strong result for Swedbank. It is important to the continued strengthening of our position as the leading bank in four markets for the many household and corporates.

The strong NII and provision income reflects a broad base increased customer activity. We've seen increase in payments and card transactions. Lending volumes continue to grow primarily in Swedish mortgages.

The introduction of the mandatory amortisation requirement led to an increased activity in mortgages in this quarter. We introduced these rules last year, but the entire market seems to have sort of woken up to these new standards, and that generated extra activity.

The amortisation requirements also triggered a slow down in house prices in Stockholm and Gothenburg. However, I believe it's much too early to draw any conclusions regarding future mortgage loan volumes, and also on future house price developments.

But I can tell you that our ambition as we've said before, is to capture the equivalent of our back book market share in new lending. And to continue to provide our customers with advice that is relevant to the financial situation of the individual.

We also increased lending in corporate banking, and we had a very active quarter in our investment bank. We stay close to our customers and we participated in several advisory and capital raising transactions. We also saw an increase in trading, in FX, and equity markets.

The Baltic loan book also continued to show slow growth which started actually last quarter, but we see a continuation, although this quarter, it is supported by the migration of the portfolio, the retail portfolio that we acquired from Danske Bank. This is primarily in Lithuania, and some in Latvia too.

All in all, the loan volume growth combined with margin expansion, strengthened the net interest income in the quarter despite a continued margin pressure on deposits.

Cost efficiency remains in focus and performance in the quarter was according to plan. The asset quality was solid in Sweden and in the Baltics which was demonstrated by recoveries and just smaller provisions.

As we have previously communicated, the challenges in the oil-related part of the loan book has continued and we saw that this quarter in provisions relating to just a few counterparties. Our Norwegian entity is an established part of our corporate banking strategy, and this means that when there are difficulties in one part of the Norwegian sector, we experience that too. Helo will come back and talk more about this later in the call.

All in all, it was a very strong result, and in addition to that, we have the Visa transaction that we have informed you about. And that came through this quarter. Also this quarter, I appointed a new management team. This is a team that will take Swedbank through the transition and create the bank of the future together with the colleagues in all four countries.

This is the management team that I believe will best execute on our strategy, and also deliver on our financial goals. I've selected a team of individuals with long experience in banking, and with very strong execution skills. We know where we are going, so being able to execute, is going to be crucial. Also an equally important part of Swedbank's corporate culture and our values. I also decided to establish a new unit this quarter, called Digital Banking, that will focus on developing our group wide digital offering, and also the tools used both by customers, and internally.

Our four home markets are some of the most digitalised countries in the world, and we'll continue to stay ahead and be proactive towards our customers. I'm very excited about this because I strongly believe that we have so much expertise in the bank, but we need to get it together to leverage.

Our focus was demonstrated in the quarter, as we launched a number of new functionalities in the internet bank, both in Sweden and in the Baltics. And we also, this quarter, launched our first partnership with a FinTec in Sweden. It was a social equity trading platform Sprinklebit. We start this by rolling it out to all employees, and then later in the year, we'll make it available to our customers.

We also introduced a collaboration with an external digital partner in the Baltics that offers a service for our corporate clients.

One event that I would just want to mention before I close off and hand over to Anders, is one thing that made me very proud this quarter, and that is the fact that we are now rated AA- by Fitch, and that means that we are one of the few banks in the world with a AA rating from the three major rating agencies.

I'm extremely pleased with what we accomplished this quarter, we stand very strong. We're very well capitalised, we have good return and we have a cost income ratio to be proud of.

We stand for stability, predictability and transparency. And I think that in these turbulent times, these are the characteristics that matter the most, and ultimately, this is what will facilitate strong performance, and allow us to focus on our customers, and build the bank of the future.

And with this, I hand over to Anders.

Anders Karlsson

Thank you, Birgitte. I will go through the key trends in each of the three business areas. And thereafter, sum it all up at group level before I finish off with capitalisation and funding.

So starting off with Swedish banking, they delivered a very strong result. NII supported by continued mortgage lending, and further back book mortgage margin expansion, deposit margins continue to be under pressure as the result of the falling market rates in the quarter.

Deposit volumes increased due to the annual tax refund and seasonal effects in public sector entities.

The increased customer activity Birgitte mentioned translated into seasonally higher card and payment income, commissions from lending, asset management income, and real estate brokerage. Cost was under good control and asset quality continue to be strong.

Turning to Baltic banking, another solid quarter, with resilient and stable result. Deposit margins were pressured by lower markets rate, while lending margins were flat.

Loan volumes were significantly up in the quarter, supporting NII, they stemmed primarily from the acquired Danske retail portfolio that Birgitte mentioned, but also modest broad base lending and FX effect. Deposits also increased significantly in the quarter. The increase was driven by corporate, public sector and retail deposits, but also a small amount from the Danske retail portfolio and FX effect. Cost was as usual under good control and asset quality continued to be solid.

And now, over to large corporates and institutions. They were also able to benefit from the increased customer activity. Lending volumes grew in the quarter, supporting NII. Deposit decreased in the quarter in this case, it was due to regular volatility, in institutional money, and deposit margins continue to be under pressure.

We also saw higher hedging and trading activities from our customers, primarily within foreign exchange and equities on the back of the higher volatility in the quarter. And I'm very glad to say that Swedbank participated in a number of M&A and IPO transactions that required advisory services as well as capital raisings.

Costs were stable, credit impairments were hit by provisions in the oil-related segment. Helo will walk you through the dynamics in that portfolio. So summarising the quarter; we delivered another strong set of results. Loan volumes and lending margin expansion supported NII and mitigated the negative pressure from deposit margins.

We expect that reprising of the mortgage book to continue while front book corporate margins should start moving up later in the year, on the back of the increased capital requirements that the Swedish FSA will introduce in the third quarter.

The back book repricing of the corporate portfolio will however, be slower than for mortgages due to its nature with longer interest rate fixing periods. Loan volumes were strong this quarter. The mortgage market was spurred by the introduction on the amortisation requirements, while the large corporate volumes were fuelled by events driven M&A and other bridge financing. The inclusion of the Danske acquired loans led to an extraordinary increase in the Baltics.

I'm glad that we again, in this quarter, demonstrated that we are well positioned with our customers to capture both generic market activity, but also company specific events. As previously communicated, we have booked the proceeds from the Visa transaction in this quarter, it impacts both NGL, by SEK 457 million and other income by SEK 1.658 billion.

In total, a tax free income of SEK 2.1 billion. Since Visa Sweden has not yet paid out the proceeds to its members and the allocation amount is not yet fixed, the final settlement can vary somewhat from the mentioned amount.

Costs are in line with our expectations, and we are in line with meeting our cost target for the full year of 2016, set at 16.2 billion, and just to be clear to all of you, I will come back to you in conjunction with the third quarter, and communicate our cost ambition for 2017.

Finally, then turning to capital and funding. Market volatility in combination with increased risk exposure amount made us end the quarter with a CET1 ratio of 23%. REA increased by SEK 14.6 billion mainly due to increased credit exposures, but also due to special treatment of the Visa, future Visa proceeds, standing for 4 billion out of the 14.

This REA effect will disappear once the proceeds are paid out. We also saw continued negative PD migrations in our oil-related loan portfolio in Norway, but the effect was offset by positive PD and LGD migrations in other parts of the loan book.

The common equity tier one capital base was adversely affected from pension liabilities increasing and impacting the capital with 1.4 billion as the discount rate was lowered in the quarter.

At a common equity tier one ratio, 23%, we still maintain a buffer of around 200 basis points to the minimum requirement, taking the future Swedish FSA announced capital requirements into consideration. We feel comfortable with this buffer, but as earlier communicated, we have no excess capital.

Our strong liquidity position is maintained with an NSFR ratio of 108%. This is a comfortable situation to be in periods of uncertainty.

Having said that, it is expensive to run a too high NSFR and on the back of increasing deposit volumes, we are continuously revising our funding plan to calibrate ourselves.

With that, I hand over to Helo, to walk you through the asset quality.

Helo Meigas

Thank you, Anders. I am now moving to risk and commenting on the asset quality. Overall, we had a good and balanced portfolio growth in all business areas, and we continue to see strong underlying asset quality in all our businesses in Sweden and the Baltics.

Swedish banking showed recoveries as a result of the release of individual provisions for one customer, while Baltic banking got a series of quarters of recoveries, is reporting a SEK 60 million credit impairment. This is a result of a provision that is related to one customer in Estonia.

The main area of concern is, as we have also communicated previously, our oil-related exposure in Norway. If you remember in Q1, we took an active decision to change the sector, on the exposures which are negatively affected by the oil price. And as a result, we changed the probability of default and this resulted in an increase of risk exposure amount, and we also did portfolio provisioning.

Now in Q2, we have been going through this portfolio on an individual client level. And this has now resulted in a further risk exposure amount increase which for this portfolio in Q2, was SEK 3.7 billion, and then we also are reporting credit impairments of SEK 570 million.

Going forward, we expect the risk exposure amount to stay fairly stable even if we need to make some small adjustments in the second half of the year. And with regards to credit impairments, we still have uncertainties as the restructuring discussions are on-going, so additional provisioning may be necessary, but will depend on the outcomes in a few on-going cases.

A few words also on the restructuring work, it is going according to plan, we are expecting to be ready with the first phase of restructuring negotiations by the end of the year. Our clients have taken an active part in restructuring their business and their financials. They are putting in place cost reduction programmes, they're cancelling and postponing investments, they are making equity injections, bondholders are stepping in with reduced coupons and change maturities.

And then banks are also asked to change the loan conditions and these are then the syndicated deals that we are talking about where we are present, and we have been asked to change temporarily, the amortisation schedules as well as then postpone maturities. There has been no write off of exposures at this stage.

As we progress with the restructurings, we are making our own assessments about whether the restructuring is strong enough, and in case we see that this is not the case, we are putting aside money for possible future losses in order to handle the risks prudently, and this is what we are reporting this quarter as credit impairments.

I think I'll stop here.

Gregori Karamouzis

Great, we'll hand it over back to the operator and we will be happy to take any questions that the audience have.

Q&A

Operator

Thank you. Ladies and gentlemen, if you have a question for the speakers, please press 01 on your telephone keypad, and you'll enter the queue. After announced, please ask your question. Please hold until the first question.

Our first question comes from Omar Keenan of Deutsche Bank. Go ahead sir, your line is open.

Omar Keenan

Good morning. Thank you very much for taking the question. I just had a question on margins and then secondly, a question on capital.

So firstly, on mortgage margins, I can see that in June, it looks like the front book increased a little bit versus the back book. So I was wondering if you could give us an update of what the front versus back book position on the mortgages is.

And then just a related question to that, I was wondering if you could give us some colour on the difference between margins or mortgages and housing cooperative loans, I just noticed that the largest player in the market with a 40% to 50% market share, kind of treats these as corporate loans, so how meaningful capital increases are about to go through. So I just wanted to get your idea on, you know, should we be thinking about these loans as mortgages? And what kind of margin increase could come through on that book?

And then the second question is on capital. If I'm not mistaken, I think the pension discount rate is 2.5%. Can you just update us what the sensitivity is to further changes in the discount rate is on capital, given that kind of bond yields have fallen further efficiency under the quarter, I think? Thank you.

Anders Karlsson

Okay, thank you for your question. We might have to actually take the last part of it once again if I missed that. But starting off with margins, the front book versus back book is around 10 basis points. As far as the tenant-owner associations or housing cooperatives as you also call them, we are treating them as private currently. When it comes to the capital situation and the IAS19 sensitivity, it's not a linear straight through way of calculating it but I would say that 25 basis points are typically impacting us around 1 billion.

And then you had a last question, Omar, that I lost you there. So I think –

Omar Keenan

Yeah, okay. So I guess the 25 basis point sensitivity is around also 25 basis points on core tier one and I think the question was on the housing cooperatives loan which you said is treated as private exposures. What's the difference on margins between housing associations and then the residential mortgage – the private residential mortgages?

Anders Karlsson

A good question. I don't have it on the top of my head, so we will revert to you on that one.

Omar Keenan

Okay. Have you seen any repricing in that particular segment? Because I guess the point I was making is that the largest player with the 40% to 60% market share, you know, currently risk weights those loans at about 4% and they're probably going to increase by a multiple of that. Just wanted to get your take, you know, firstly, whether you're aware of that, and then secondly, what do you think is the impact on pricing?

Anders Karlsson

Yeah. I'm – you're mathematically more skilled than I am but you have a point in the fact that when risk weights will increase during the third quarter going into the end of the year, that will have an impact on these exposures as well. And therefore, logically, the way we've been doing historically, we repriced that portfolio as well. But I'll have to get back on the details.

Omar Keenan

Okay, great. Thank you very much.

Operator

Thank you. And our next question comes from Andreas Håkansson of Exane BNP Paribas. Please go ahead, sir.

Andreas Håkansson

Yes. Hi, good morning, everyone. First question is also on the NII. In Q1, Göran talked about good possibility to grow NII going forward. In this quarter, NII did actually grow quite nicely, both compared to Q1 and in the previous year, despite rates going down. Could you tell us a little bit of the outlook – because volumes are strong, could you tell us the outlook if let's assume that rates are flat from here, will we still agree with Göran's comments on what's the outlook at the moment? Thanks.

Anders Karlsson

Yes, I will do my best. I think the tailwind that Göran talked about, we still see it. As we have said in previous quarters, there is a back book in the mortgages coming in for repricing still on the back of higher capital requirements. We also know that the corporate risk rates will increase in the third quarter. And as I said, that will impact the front book. Although the credit demand is subdued, it will also impact the back book but that will take a bit of a longer time.

We have also seen increased deposit volumes during the quarter which is obviously a cheaper funding source than issuing bonds. We have to see if it's – if it's as sticky as we think. But, yes, I am positive on NII going forward.

Andreas Håkansson

Thank you. And then on loan-loss provisions in Norway, is it possible that you give us any type of indication how much more we're going to see? I mean are we going to extrapolate this level now for the next two years or we're going to expect it one more quarter or what should we be looking for?

Helo Meigas

Thank you for the question. It's Helo here. I kind of expected to have this. No, we – I will reiterate what we have been saying before as well. We do not want to be very specific on the provisioning of the – of our oil-related exposure because as you know, as we've been telling, it's a small portfolio. It is about 30 clients – stock exchange listed clients, out of which 20 are negatively affected by the oil price. So the outcome of the provisions will be very much dependent on how we will – what we will achieve in our restructuring negotiations.

So – but we do continue to be of the opinion that the oil sector is challenged by the low oil prices and the investments have not been picking up. And that will continue well into 2017 and maybe also even longer. So if I then will kind of instead give you a little bit of a feel about what – how we are thinking about our credit impairments, then I would rather just kind of reiterate what we've been saying that we think that on the total loan portfolio, you could expect credit impairments in the range of 10 to 15 basis points. And – but we do of course admit that this is the guidance which is very much dependent on how our loan portfolio is going to – in Norway is going to develop and what we shall achieve in our negotiations with our clients in restructuring.

Andreas Håkansson

Okay, thank you.

Anders Karlsson

Before we take the next question, Mark, I just want to clarify the question from Omar before on the housing association, tenant-owner associations. The margins have been flat over the last few years on the back book. And there is a difference between front and the back book of around 5 basis points currently. As far as the future price development and to your point about treating this as corporate exposures, I think it still remains a bit unclear how the Swedish FSA will treat housing associations as part of their new requirements for capital exposures. So we will probably to wait and see how that treatment pans out before we can comment on future margin development.

Operator

Thank you. And our next question comes from Willis Palermo of Goldman Sachs. Please go ahead. Your line is open.

Willis Palermo

Hi, good morning. I have three questions. One is actually a follow-up on asset quality on what you say. And I just wanted to have more colour on your discussions with clients in the oil and gas sector. Are these changed by you know the year despite – with – in light of the better oil price and condition in the market, do you see more restructuring to come? And when you discuss with these clients, when do they think being ready to start investing again, do we think about 2018 or should we look forward in time?

And then the two questions on your number. The first one is on the fee income. The run rate is actually a bit stronger than the beginning of the year. Should we expect some of these elements to remain by the end of the year? And second one is on costs. So now you're also running below your target for the full year. Should we expect some inflation at the end of the year or could we assume that this is the normal run rate at 16 billion for the year? Thank you.

Helo Meigas

We'll start – I'll start then with the asset quality and our oil portfolio and restructuring negotiations. What we have been seeing now in the first half of the year is actually a very constructive approach from our clients. And they kind of – when at the beginning maybe there was a little bit of more hesitance about how we progress. So now we are doing very good progress there. And that is also the reason why we actually have seen a little bit of an earlier provisioning than we guided in last quarter. That means we have been able to close some of the negotiations earlier than we expected when we were discussing the results and our oil portfolio before in the first half of the year.

So has there been any change during the year as the oil price has stabilised? Not really. I think all of our clients are as concerned as we are about the level of investments which are not picking up. So they are – they are putting in new cash because they understand that they need time, at least two years if not more, to survive with the current low level of investments. And whether the investments are expected to pick up in 2018 or later – I mean 2018 is a very optimistic view on that. I think it probably could even be later than that. So we are, in our restructurings, we are talking about stabilising the cash flows minimum two years. In some cases, we try to get up to four years.

Anders Karlsson
Okay. And as far as the development on the net commission income, I mean there are two parts. We typically say that one part of it follows the economic development, which is payments and cards and that type of commission income. And then you have the corporate finance related income which is very difficult to have any firm view on going forward. It is volatile and very much up to the market sentiment.

When it comes to costs, I reiterate what we said previously. We are in line with the cost value that we communicated for 2016 which is 16.2 billion. And for 2017, I will come back in the third quarter. Thank you.

Willis Palermo
Thank you. That is very clear.

Operator
Thank you. Our next question comes from Anton Kryachok of UBS. Go ahead, sir. Your line is open.

Anton Kryachok
Good morning and thank you for the presentation. Just two questions, please. The first one on NII. I was encouraged to hear that you expect widening of corporate margins on the back of the higher capital requirements, but maybe you can give us a little bit more colour on which elements of your corporate book do you think you will see this repricing benefit coming through and how do you expect this to play out for Swedbank and lead this repricing or would you expect your peers to move first?

That's the first question, please. And the second question on risk-weighted assets or REA, we've seen a strong increase in Q1, you've – sorry, in Q2. You've explained where it came from. But if we look forward to 2017, what are the main driving factors that you see when it comes to REA? Is it just volume of new business that you write or do we need to take into account other things such as rating migration, etc.? Thank you.

Birgitte Bonnesen
Okay, if I just start off with the margins on corporate lending, you know, as a consequence of increased risk weights coming from the FSA, it's – this is the way the market works. We already started to guide for higher prices on corporate lending. And I think that you will see that in the last week, our competitors have done exactly the same. So I think the Swedish market is very rational in that respect. And the fact that we already started to talk about it early in the – in this quarter in – with our corporate clients, yeah, it will happen. I can't tell you exactly how much and when, but we have started to work on it.

Anders Karlsson
And just to elaborate a little bit further on it, as I said, there is a subdue lending growth, so the front book is sort of – it's the thing that grows quickest, but then on the other hand is don't see large volumes in that. Secondly, when the back book comes – and these capital requirements will impact different sectors differently, depending on the risk weights in the different sectors. One sector that has relatively low risk weights is the one that is collateralised typically by real estate. And there you will see an impact, as to give you an example, but this needs to be seen coming into the third quarter.

When it comes to the risk exposure amount, I think that absolutely exposure change will be the main driving factor. As far as rating migration and LGD changes comes, it's extremely difficult to forecast. What Helo said though is that we expect the risk exposure amount in the oil-related portfolio to be fairly stable going forward.

Anton Kryachok
Thank you. That's very clear.

Operator
Thank you. Our next question comes from Magnus Andersson of ABG. Go ahead, sir. Your line is open.

Magnus Andersson
Yes, good morning. First on capital, I would just like to know if you can confirm that you received the preliminary SREP letter from the Swedish FSA and that's it – that it's in line with what you – what you think your capital requirement will be.

Anders Karlsson
Thank you. Yes, we have received the preliminary SREP. It's in line with our expectations and no negative surprises.

Magnus Andersson
Okay, good. And also, about the timing, now you will get a Pillar 2 requirement covering for the higher – or compensating for the higher risk weights in the corporate segment as of Q3. When do you think you will have your models revised and approved so that we will see this in risk-weighted assets instead?

Anders Karlsson
It's a very good question. You have to ask the Swedish FSA about that. I – it will most likely take time because there are numerous models that need to be revised. So that will take time. But we will be transparent anyway with the Pillar 2 charges in that.

Magnus Andersson
So are we talking mid 2017 or –?

Anders Karlsson
You have to ask the Swedish FSA. I'm sorry, I can't answer on their behalf.

Magnus Andersson
Okay. Then just on the PD migration, in Q1 you had I think around 5 billion of PD migration in Norway and you thought that there would be no more rating migrations from there and now we get another 3.7 billion in this quarter and you think that there will be no more rating migrations from here. Can we be more certain about that now than after the Q1 report or what are the main uncertainties here regarding those rating migrations?

Helo Meigas
The rating migrations are coming from two sources. First, you do a sector assessment and then you roll through the clients individually. What we did in Q1, we did a sector adjustment where we basically took a view that we think that the oil sector, in general, needs to have an increased PD. And that was actually around a little bit over 7 billion. I do not think that we guided that there will be no further PD adjustments because at this point we had not gone through the portfolio on a case by case basis. So now as we have been going through the portfolio one by one, we have much more confidence on our PDs on an individual client level. And that is why I feel confident to confirm that we don't expect to see any major changes going forward.

Magnus Andersson
Okay, good. And just finally on the corporate lending margins, can you remind us again about – of the duration of that corporate lending book in Swedish banking? Is it still two, three years repricing we should expect or –?

Anders Karlsson
Yeah, it's two to two-and-a-half years, approximately.

Magnus Andersson
Okay, thank you.

Operator
Thank you. And our next question comes from Adonis Catic of Swedbank. Go ahead, sir. Your line is open.

Adonis Catic

Yes. Good morning, everyone. Adonis from Swedbank Research here. I just have some questions here, one follow-up on credit quality. When you are talking about the 10 to 15 basis points, is that for 2016 or should we also expect a similar level in 2017? So that was my first question.

Helo Meigas

We are talking about 2016 now because we have – we think it's a bit too early to guide for 2017. As we progress with our restructurings and we see how the market and the external environment develops, we may give further guidance on that as well, but not now.

Adonis Catic

Okay. That was clear. And then our question on the NII, do you see any potential on deposit repricing, for example, in the SME segment?

Anders Karlsson

We stick to what we have said earlier that we selectively charge larger institutions and corporates for deposits and that still remains.

Adonis Catic

Okay. Thank you very much. And then I'll follow up on capital. Now that we will receive the new requirement from Q3, are you happy to have a buffer of 200 basis points or how should we view your ambitions when it comes to capital buffer?

Anders Karlsson

I'm very confident with the buffer going forward.

Adonis Catic

When do you expect to update the market on capital target?

Anders Karlsson

I think we have been quite clear that – and as we have seen in the quarter we need a buffer. To change any guidance, to give any guidance on that, I think we need to have much more clarity when it comes to Basel IV regulations. So their timeline will most likely have an impact.

Adonis Catic

Okay. That was very clear. Thank you very much.

Operator

Thank you. Our next question comes from Geoff Dawes of Soc Gen. Please go ahead, sir.

Geoff Dawes

Good morning, everyone. Geoff Dawes here from Soc Gen. I'll be quite brief with couple of questions, mainly related to the oil book. And the key thing that I wanted to ask about was that exploration book which is about SEK 10 billion, which I guess is where most of the sensitivity lies. Can you just give us a little bit more colour on that specifically in terms of the geographical breakdown? Is this all Nordic area or did you participate in syndications outside of the Nordics? And second of all, how much of that oil exploration book is you participating as a syndicate member and how much is self-originated?

And then the second question on the overall book relates to the RWA sensitivity. You said at the start that you didn't expect any further RWA increases from this oil book. Can you just give us an idea of why you have that confidence and whether there are any variables that could change that? So anything that could change, that could cause RWAs to go up in due course rather than just feeding through in the impairments line. Thank you very much.

Helo Meigas

Yes, well starting first of all of what is the book – what we are talking about. We have exposures only in the Nordic regions. These are all syndicated loans. So we have no self-originated loans in our book. Then on the second question, on the RWA sensitivity, we are confident because we have gone through the loan portfolio on a case by case basis. And we make an assessment based on where we currently are in the negotiations with our client.

Can that be changed if the negotiations will change dramatically and some of the kind of the early commitments that we have been seeing will not be signed up? Theoretically possible. But that's what we discuss with our clients. We feel that we have a fairly good understanding about what needs to be done. And that is why we are currently quite confident with our forecast on the RWA.

Geoff Dawes

Thank you. And going back on the issue of syndication, I assume that you're kind of a mid-level member of most of those syndicates. So essentially, we're talking about a very similar portfolio to those that we've already seen up in Nordic banks, is that fair?

Helo Meigas

I would not comment to their portfolios or other Nordic banks, but you are right, we are a mid-range participant in the syndications.

Geoff Dawes

Okay. That's very clear. Thank you.

Operator

Thank you. And our next question comes from Riccardo Rovere of Mediobanca. Go ahead, sir. Your line is open.

Riccardo Rovere

Hi, good morning to, everyone. Just a couple of questions from my side. On capital, let's assume the next quarter your capital requirement is going to up because of the corporate – revised corporate Pillar 2. And let's assume that the negative PD migration goes on, so your risk weighted assets go up. Would the capital requirement to eventually go down in the future because in the meantime, some of the capital requirement Pillar 2 would be incorporated the risk-weighted assets? Or would a higher capital requirement be applied on a higher amount of risk-weighted assets? So this is the first question.

And the second question I have is on – you say – you keep saying that you have a no excess capital – fine – at the 23% common equity tier 1 ratio. You mentioned Basel IV, I understand that. Can you elaborate a little bit what are your concern related to Basel IV? Sorry. Again, is a risk weight maybe going up for the market risk, cap risk? Can you add a little bit of colour for that, provided that Basel IV is your main concern or do you expect further tightening from your local regulator?

Anders Karlsson

Okay, thank you. That's quite – very good questions. See if I can cover them all. First of all, the 200 basis point buffer that I talked about is actually – I have taken into account the effects of the upcoming PD and maturity factor changes by the FSA. We have said before that it's around – our assessment is that it is around 90 basis points.

I have also taken into account the upcoming increase countercyclical buffer that FSA communicated that will actually come into effect in March next year. So the 200 basis points are – then I have taken those things into consideration.

Then you asked about the Pillar 2, Pillar 1, I did not really get your reasoning there. But I man risk exposure amount impacts the risk rate floors on mortgages, so the size of it. The other Pillar 2 charges are set by the Swedish FSA.

And as far as Basel IV comes, I think my main concern is if they put output floors in place that will wipe out the risk sensitive approach because then you will see we are coming back to the old Basel I where you can't differentiate, at least not in the Pillar 1 calculations.

Other than that, we will cope with it. The visibility is still too low. I think there will be more clarity in the third quarter, so let's come back to it.

Riccardo Rovere

Thanks. Now if I can get back just for a second on the Pillar 2, the question I was referring to is if your capital requirement is going to go up. Let's say, let's speak just to the 90 basis points you mentioned before, this additional 90 basis points would be applied to a larger amount of risk weighted assets if your risk-weighted assets had to go up because of negative migrations in the portfolio related to oil and gas or whatever. Or would the 90 basis point become, I don't know, 70 because in the meantime, the capital requirement included in risk weighted assets would go up?

Anders Karlsson

Okay. Now, I think I got your question. The capital requirement is set in absolute amount, which then obviously means that it will have an impact.

Riccardo Rovere

Okay. Yeah, thanks.

Operator

Thank you. Our next question comes from Adrian Cighi of RBC. Go ahead, sir. Your line is open.

Adrian Cighi

Hi there. This is Adrian Cighi. Two questions for me, please. One on Swedish mortgages and one on cost. On the Swedish mortgages, you mentioned that it's difficult to estimate the impact of the amortisation requirements that recently came into force. However, assuming there's a downward pressure and volumes around these measures, do you expect banks to be able to continue expanding their mortgage margin as they intensify their competition on these lower volumes?

And then secondly, somewhat related on cost. You mentioned you were looking at introducing some new cost ambitions in Q3. Can you give us any colour as to how you're thinking about this? Is this something you think in absolute cost caps or cost income ratios? And do you expect these developments in the Swedish mortgage margins in Q3 to act as an input factor into your cost target? Thank you.

Birgitte Bonnesen

To open off on the mortgage development, it's much too early to tell. What we saw in after 1st June when amortisation became mandatory, we saw, you know, a dampening. It's seasonal. But we actually saw a bit more than that. But the underlying issue in the housing market in Sweden is the fact that there is, you know, an undersupply. And that is not going to go away whatever many amortisation rules or DTI rules you introduce and make mandatory.

So it's a bit of wait and see. We follow this closely. And as you know, we are questioned all over Sweden and we have a well diversified grip on the mortgage market. So it's too early to tell.

And then you talked about cost caps. Yes, Anders, you want to comment on that?

Anders Karlsson

I think that you – we will come back with the costs in absolute terms. We follow cost income, but we don't steer on cost income.

Adrian Cighi

Okay.

Anders Karlsson

Let's talk about that –

Birgitte Bonnesen

So that was more for 2017. We're not going to do anything else in 2016. We'll stick to the cost target that we have.

Adrian Cighi

Perfect. Many thanks.

Operator

Thank you. Our next question comes from Jacob Kruse of Autonomous. Go ahead, sir. Your line is open.

Jacob Kruse
Hi, thank you. Just a couple of questions. Firstly on consumer finance. You talked previously about your ambitions to grow in that area. And I just wanted to ask you, is that still something you see that you have opportunity to do despite I guess quite a lot of new entrants in that space?

And if you're – are you now at the point where your IT platform reports people applying and receiving consumer loans entirely online?

And then my other question was just about this restructuring of oil exposures. How much control do you actually have there, given that you're a partner syndicate and you're I guess not the lead syndicator in this? So are you basically going to have to be a taker of the terms or can you affect that process in a strong way? Thank you.

Birgitte Bonnesen
Happily, I can tell you, yes, you can apply for consumer loan in the internet bank. And also, our ambition remains. And it remains because for many of our customers and the kind of customer that is our core customer, it's a natural thing to actually have all their financing in one place.

And we also – we are slowly but surely increasing the volume. So we stick to this and we'll continue and we still see lots of potential. And then I'll hand to Helo on the oil.

Helo Meigas
Yes, on the restructuring discussions. It's a very good point what you raised because we are in syndicated deals. And in many of these cases, we have many tens of banks around the table from different parts of the world with sometimes quite diverging views about what needs to be done. We see clearly that the Nordic banks are actually having similar views and that of course helps us to move forward in the discussions.

We are not controlling the discussions in that sense as we are not the leads there. But we are very active. And we were the first ones to actually also raise the issues. We have been starting to guide the market on what we saw as challenges in that sector. And that has given us a position to actually have a quite a big say in the ongoing negotiations.

Jacob Kruse
Okay, thank you. And just on consumer lending side, just to clarify, so the target there, is that still – I seem to remember about 1 billion of NII over a number of years that you're hoping to achieve? And where you say you can apply online, will you also get the funds dispersed or do you need to physically fill out some form or something like that to complete it? Thank you.

Gregori Karamouzis
Hi, Jacob, it's Gregori here. On the NII impact, we haven't specified any ambition or any target. Our ambition is to grow this part of the business and we are taking initiatives to make our offering available to our customers. And that's what we started doing in the Baltics and also in Sweden.

Jacob Kruse
Okay, thank you.

Operator
Thank you. And our next question comes from Masih Yazdi of SEB. Go ahead. Your line is open.

Masih Yazdi
Hi, Masih Yazdi from SEB here. A couple of follow-up questions. Just a clarification on the loan losses, 10 to 15 basis points, that's for the full year 2016 or for the remaining quarters of 2016? And secondly, on group treasury, you've earlier guided for NII and net gains and losses to be in line in 2016 with 2015, those two on aggregate. Is that your guidance now as well? And can you give any kind of split of the trends there in NII and net gains and losses for the remaining quarters of this year?

And then finally on NSFR. As you said, it's pretty expensive to uphold the level of 108% there. Do you have a go-to target on the NSFR and when you believe you'll be at that level?

Helo Meigas

I'll start with the question on the credit losses. The 10 to 15 basis points is for the total of 2016.

Anders Karlsson

Okay. On the group treasury, please stay with our former guidance that it will be in line with 2015, but there will be traffic so it will be more coming on NGL and less on NII. As far as NSFR comes, we believe that it's prudent to be conservative especially in uncertain times, but 108% is too high. We rather would like to talk about 103% to 105%.

Masih Yazdi

Okay, thank you.

Operator

Thank you. And we have a follow-up question from Geoff Dawes of Soc Gen. Go ahead, sir. Your line is open.

Geoff Dawes

Great. Thank you very much. Sorry to come back with another question, but it's very, very brief. Just going back to the oil book, sorry. I can't see anywhere a clarification of what percentage of that book is investment grade versus sub-investment grade and so on, can you provide that? Is that something you can disclose? Thank you.

Helo Meigas

We have a graph, you know, a presentation where we also show the rating migrations. And as of now the most of it not in investment grade anymore.

Geoff Dawes

Yeah, the graph is based on your own categorisations, correct?

Helo Meigas

Yeah.

Geoff Dawes

But do you have anything based on kind of market categorisations?

Helo Meigas

No. No, we don't. No, we don't.

Anders Karlsson

Or you could say that 13 in the graph is where you will find the investment grade.

Geoff Dawes

So basically everything is sub-investment grade now?

Anders Karlsson

Yes.

Geoff Dawes

Okay, thank you.

Operator

Thank you. And we have a follow up from Riccardo Rovere of Mediobanca. Go ahead, sir. Your line is open.

Riccardo Rovere
Yes, thanks. Thanks for taking this follow-up question. So leverage ratio in this quarter stands at 4.2%. And this number has been travelling around between anywhere 4% and 4.5% for quite a long time. Are you happy with that? Is there any plan to eventually improve it? Is there any pressure from anyone to have a better leverage ratio than 4.2%?

Anders Karlsson
Thank you. First of all, as you know, the – we are happy with it. There is no pressure. If we need to adjust, we will adjust. But as we speak, we are happy with it.

Riccardo Rovere
Very clear. Thanks.

Operator
Thank you. Once again, if there are any final questions, please dial 01 now. There are no further questions at this time. Speakers, please go ahead.

Gregori Karamouzis
Thanks, everyone, for participating on this call. We'll meet some of you over the next couple of days. For the rest of you, we wish you a nice summer and we'll speak after the summer. Thanks. Bye-bye.

Anders Karlsson
Bye.