

*Summary*

SBAB – added value,  
diversity and competition  
(RiR 2012:19)



## Summary

### SBAB – added value, diversity and competition RiR 2012:19

The Swedish National Audit Office (Swedish NAO) has audited the efficiency and effectiveness of SBAB. According to a decision by the Riksdag, SBAB shall contribute to diversity and competition on the basis of customary business objectives and an effective organisation. Thus the company is to create value and also contribute to diversity and competition in the residential mortgage market. In addition, central government is to contribute to a healthy credit market. The audit has therefore paid particular attention to the Government's management of the company and to whether the Government in its management has taken account of whether SBAB through its actions in the residential mortgage market has affected the fulfilment of other overall economic policy objectives.

#### **Audit background**

*Audit reasons:* SBAB, the Swedish National Housing Finance Corporation (from 2011, SBAB Bank), is a wholly state-owned bank with a primary focus on the residential mortgage market. The company was formed in December 1984 following a decision by the Riksdag. The company's mission was to finance the funds needed for state residential mortgages. The purpose was to relieve the state budget of residential borrowing and lending. Since then, the company has developed in several stages to become a major actor in the mortgage market and, in 2010, it also received a banking licence.

SBAB constitutes a relatively large financial asset for central government. It is therefore in the public interest that the company is managed in an efficient manner that creates a good return, while fulfilling the other objectives of the company's operations. The mortgage market is also an important part of the Swedish economy, and the risks of house price trends and the concomitant accumulation of debt in households have received increasing attention in recent years. Since central government, through SBAB, is a not insignificant lender, it is important for Swedish economic stability that central government does not contribute to an unhealthy development of household debt and house prices.

*Audit purpose:* The purpose of the audit is to examine whether SBAB has achieved the company objectives set by the owner and whether the Government's management of the company has been effective and appropriate. It has also been audited whether the Government in its management of SBAB has appropriately taken into account other risks to economic development to which SBAB might have contributed.

*Audit implementation:* The audit is based primarily on document studies and analysis of government bills, written communications and annual reports as well as on in-depth interviews with persons responsible at the Ministry of Finance and SBAB. The audit mainly relates to the period 1996–2011, although the development of the company since its inception in 1984 has been taken into account to some extent. Possible effects of the development of the company into SBAB Bank have not been analysed.

## **Audit results**

*Has SBAB achieved the company objectives set by the owner?* The Government and the Riksdag have had two objectives for SBAB. The overarching objective has been for the company to create value. In addition to this, the company is to contribute to diversity and competition in the residential mortgage market.

SBAB's profitability target, or required return, is the target that the owner has placed on the company in order for the company to create financial value for citizens. The company has largely lived up to its required return, but has not however created value for the owner in the sense of the company's value having increased over time. It is true that equity has increased significantly, but the valuations we have had access to on site suggest that the market value today is no higher than it was ten years ago.

However, SBAB's development is on a par with the rest of the sector since the market value of the major banks has not increased either over the same period.

In the years following the turn of the millennium, SBAB contributed to a decrease in the average margin on mortgages. During this period, it may be said that SBAB made an active contribution to increased competition in the mortgage market. However, this price-reducing role came to an end when other banks began to offer "lowest price guarantees". Since abandoning the ambition of being a price reducer, SBAB's market share of the private mortgage market has remained largely unchanged. SBAB was also the first to eliminate the difference in interest rates on loans for houses and tenant-owned housing.

In summary, it can be established that SBAB has lived up to the owner's required return, that the value increase has been limited however and that the company has had an effect on the functioning of the residential mortgage market in the period to which the audit has related. However, this effect has decreased over time, and it is difficult to ascertain how large a contribution to diversity and competition SBAB offers today.

*Has the Government's management of SBAB been effective and appropriate?* The Government's main principle has been to not exercise active management over SBAB. The company has, with a few exceptions, made independent decisions on its activities, including the terms of lending and the setting of interest rates. The owner has accepted the changes that SBAB has introduced, a position that is in line with the company being responsible for business decisions.

One of the most important tools in the management of state-owned companies is the required return that the owner sets for the company. This is intended to ensure the creation of value and to make evaluation possible. SBAB's required return was formulated in 1996 and states that the return after tax in relation to equity shall amount to the five-year government bond yield plus five percentage points on average over a business cycle. As interest rates have fallen sharply since then, the required return has fallen from just over 10 per cent at around the turn of the millennium to about 7 per cent today. This means that citizens' expected return on invested capital has decreased by 30 per cent, while the capital concentrated in the company, the equity, has doubled over the same period. Compared with the major banks, this required return is at present noticeably lower, and relative to other state-owned companies, it is among the lowest. In contrast, SBAB's return on equity was in line with other pure mortgage institutions in Northern Europe before the financial crisis.

*Is the owner's required return appropriate and does it contribute to the effective development of the company?* In the *Annual Report State-owned companies 2011*, the Government describes the profitability targets for state-owned companies as having to take into account "the company's business

plan as well as assessments and comparisons based on the industry in which the company operates”.<sup>1</sup> In 1996, the required return was introduced on the grounds that this corresponds to the long-term return on the stock market. In other words, this return might be equivalent to an opportunity cost for the owner. The measure, however, says little about the possibility of return on the activities that SBAB operates, but might instead be able to serve as a basis for investment decisions for the owner. It is clear that this justification is not consistent with the reason currently stated by the Government for its profitability targets for state-owned companies. It is also unclear as to how SBAB's earning power is linked to the general level of interest rates. Net interest income is the difference between the interest SBAB receives on its lending and the interest it has to pay for its borrowing. Thus, net interest income is not particularly dependent on the general interest rates in the economy.

The owner's dividend principle is that a third of the profit is to be distributed each year. SBAB has not, however, paid any dividends to the owner since 2005. The reason has been a desire by the company to increase its equity in order to enable continued expansion. It is clear that the dividend principle has not governed the owner's actions, but that the desire for a higher equity has taken precedence.

Parts of SBAB's bond programme have what is known as a change of control clause, which means that holders have the right to redeem their bonds in advance if state ownership in SBAB were to fall below 51 per cent. This clause has been a factor impeding attempts to sell the company in 2001 and 2007–2008. Since the Government intends to sell SBAB, when and if the Riksdag consents to this, the Government should evaluate the complications that the change of control clause may entail.

*Has the Government taken into account risks to economic development to which SBAB might have contributed?* The Government has raised no objections to SBAB's choice of loan-to-value ratio and has not taken into account the fact that SBAB, by increasing the residential loan-to-value ratio to 95 per cent, contributed to the build-up of macroeconomic imbalances in the form of high household debt and rising property prices. However, SBAB's role in this may be described as marginal since its actions were no different from those of other actors in any decisive way. SBAB's actions did, however, bring the matter of high mortgage loans to a head.

An interesting issue in this context is whether the credibility of central government as regulation maker, inspector and ultimately opponent of economic imbalances is affected through the furthering of existing imbalances by a company wholly owned by central government. The audit has not been able to demonstrate that the Government has taken this credibility aspect into account.

The Government has not issued SBAB with any specific directives as regards changing its focus of lending activities due to growing macroeconomic imbalances. In 2010, to protect consumers, Finansinspektionen, the Swedish Financial Supervisory Authority, introduced a mortgage cap to counter the risks of individual households overborrowing. Otherwise, it may be noted that the Government has not introduced any powerful measures to reduce the imbalances discussed.

## **Recommendations**

In view of the Swedish NAO's findings and the conclusions drawn above, the Swedish NAO submits the following recommendations:

- The Government should report to the Riksdag on how SBAB contributes to diversity and competition in the residential mortgage market

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<sup>1</sup> Annual Report State-owned companies 2011, p. 31.

- The Government should evaluate the risks that the change of control clause entails and how these can be minimised prior to a potential sale
- The Government should conduct an inquiry and consider a new required return for SBAB that reflects the potential for returns existing in the company's activities
- The Government should clarify the dividend principle. The fact that the owner has, as proposed by the Board, made exceptions to the principle over seven consecutive years demonstrates that the current principle is not a governing principle.