

MOODY'S

INVESTORS SERVICE

CREDIT OPINION

3 December 2019

New Issue

 Rate this Research

RATINGS

Spar Nord Bank A/S

Domicile	Denmark
Long Term CRR	A1
Type	LT Counterparty Risk Rating - Fgn Curr
Outlook	Not Assigned
Long Term Debt	(P)A1
Type	Senior Unsecured MTN - Fgn Curr
Outlook	Not Assigned
Long Term Deposit	A1
Type	LT Bank Deposits - Fgn Curr
Outlook	Stable

Please see the [ratings section](#) at the end of this report for more information. The ratings and outlook shown reflect information as of the publication date.

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Spar Nord Bank A/S

Update following assignment of debt programme ratings

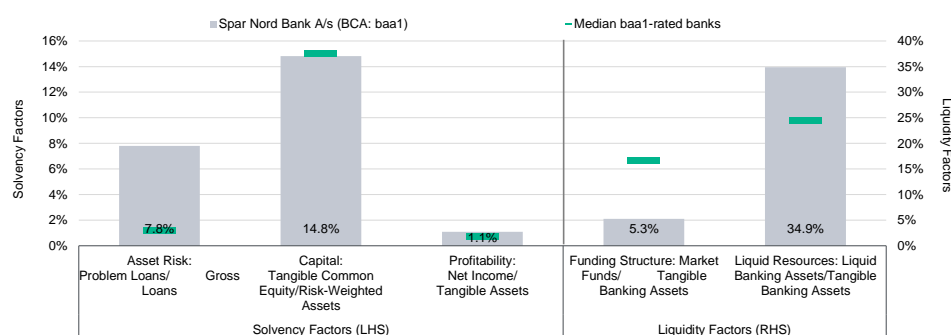
Summary

[Spar Nord Bank A/S](#)' (Spar Nord or the bank) A1 long-term deposit and (P)A1 senior unsecured ratings reflect (1) the bank's baa1 standalone Baseline Credit Assessment (BCA); and (2) three notches of rating uplift from our Advanced Loss Given Failure (LGF) analysis, which takes into account the risks faced by different liability classes should the bank enter into resolution. The bank's long-term deposit ratings carry a stable outlook.

Spar Nord's baa1 standalone BCA reflects the bank's robust capitalization as well as its low dependence on market funding and strong liquidity buffer. At the same time, it takes into account the bank's relatively high, although improving, nonperforming loan ratio, along with moderately higher growth than the system average, as a higher level of unseasoned loans could prove difficult in a downturn. The BCA also takes into account the fact that profitability, although resilient so far, will be under continued pressure because of ultralow interest rates and relatively weak efficiency compared with that of its Nordic peers.

Exhibit 1

Rating Scorecard - Key financial ratios



Asset risk and profitability ratios reflect the weaker of either the last reported or the average of the latest three annual periods and the year-to-date figure. The capital ratio is the latest reported figure. Funding structure and liquidity ratios reflect the latest year-end figures.

Source: Moody's Investors Service

Credit strengths

- » Robust capitalization and a strong leverage ratio
- » Low dependence on market funding
- » Strong liquidity buffer

Credit challenges

- » Relatively high, although improving, problem loan ratio, along with moderately high loan growth, which could present challenges in a downturn
- » Continued pressure on profitability because of ultralow interest rates and a high cost-to-income ratio

Outlook

The stable outlook on the bank's long-term deposit ratings reflects our view that the bank will continue to report resilient financial performance in the context of moderate economic growth and its credit profile will remain broadly unchanged over the next 12-18 months.

Factors that could lead to an upgrade

- » Upward pressure on Spar Nord's BCA could emerge if we observe (1) a sustained improvement in the bank's asset-risk metrics, including lower problem loans, potentially along with reduced concentrations; and (2) a sustained improvement in the bank's profitability without a deterioration in its risk profile.
- » An upward movement in the BCA and adjusted BCA would have an impact on Spar Nord's long-term deposit and debt ratings, CRA and CRR, as well as any significant change in the liability structure if it were to impact Moody's LGF assessment.

Factors that could lead to a downgrade

- » Downward pressure on Spar Nord's BCA could emerge if we observe (1) a material deterioration in asset quality or if concentrations and exposures to more volatile segments increase; (2) a persistent weakening in the bank's recurring earnings power and operating efficiency; (3) a substantial increase in market funding reliance beyond our current expectations; or (4) weaker capital ratios that are below the bank's current capital targets.
- » A downward movement in the BCA and adjusted BCA would have an impact on Spar Nord's long-term deposit and debt ratings, CRA and CRR.
- » Negative pressure on the bank's long-term deposit and debt ratings would also arise if there is a shift in the bank's funding mix, such as lower loss-absorbing instrument volume or a material reduction in junior deposit amounts, which would result in lower rating uplift than currently assumed under our Advanced LGF framework.
- » The long-term deposit, senior unsecured and junior senior unsecured programme ratings could also be downgraded if the subordination requirements under the Danish MREL framework were lowered following the implementation of BRRD2 in Denmark.

This publication does not announce a credit rating action. For any credit ratings referenced in this publication, please see the ratings tab on the issuer/entity page on www.moody's.com for the most updated credit rating action information and rating history.

Key indicators

Exhibit 2

Spar Nord Bank A/S (Consolidated Financials) [1]

	09-19 ²	12-18 ²	12-17 ²	12-16 ²	12-15 ²	CAGR/Avg. ³
Total Assets (DKK Million)	93,494.3	82,252.0	79,673.0	77,743.0	75,052.9	6.0 ⁴
Total Assets (USD Million)	13,651.7	12,600.0	12,849.7	11,028.1	10,925.0	6.1 ⁴
Tangible Common Equity (DKK Million)	8,465.0	8,128.0	7,865.0	7,507.0	7,199.2	4.4 ⁴
Tangible Common Equity (USD Million)	1,236.0	1,245.1	1,268.5	1,064.9	1,047.9	4.5 ⁴
Problem Loans / Gross Loans (%)	4.5	7.8	8.1	10.9	--	7.8 ⁵
Tangible Common Equity / Risk Weighted Assets (%)	14.8	15.1	15.9	15.8	15.5	15.4 ⁶
Problem Loans / (Tangible Common Equity + Loan Loss Reserve) (%)	19.7	32.7	33.2	43.0	51.7	36.1 ⁵
Net Interest Margin (%)	1.7	1.9	1.9	2.2	2.4	2.0 ⁵
PPI / Average RWA (%)	2.3	2.0	2.4	2.9	2.6	2.4 ⁶
Net Income / Tangible Assets (%)	1.1	0.9	1.2	1.1	0.9	1.1 ⁵
Cost / Income Ratio (%)	60.9	65.3	61.8	57.6	60.7	61.3 ⁵
Market Funds / Tangible Banking Assets (%)	13.2	5.3	4.9	7.3	9.0	7.9 ⁵
Liquid Banking Assets / Tangible Banking Assets (%)	38.8	34.9	36.2	38.3	38.5	37.4 ⁵
Gross Loans / Due to Customers (%)	83.2	81.4	79.8	79.4	--	81.0 ⁵

[1]All figures and ratios are adjusted using Moody's standard adjustments. [2]Basel III - fully-loaded or transitional phase-in; IFRS. [3]May include rounding differences due to scale of reported amounts. [4]Compound Annual Growth Rate (%) based on time period presented for the latest accounting regime. [5]Simple average of periods presented for the latest accounting regime. [6]Simple average of Basel III periods presented.

Source: Moody's Investors Service; Company Filings

Profile

Spar Nord Bank A/S (Spar Nord) is a full-service commercial bank in Denmark that provides retail, corporate and private banking services, with a focus on private individuals and small and medium-sized enterprises. It operates through a network of 49 branches in Denmark. Spar Nord was founded in 1824 and merged with Sparbank A/S, a smaller Danish regional bank, in 2012.

Spar Nord is the sixth-largest bank in Denmark, with DKK93.5 billion (around €12.5 billion) assets as of September 2019. It has a strong presence in the northern Jutland region of Denmark, where it has a market share of 32%. Its national market share is 1% in loans (excluding loans transferred to mortgage credit institutions (MCIs)) and 4% in deposits.

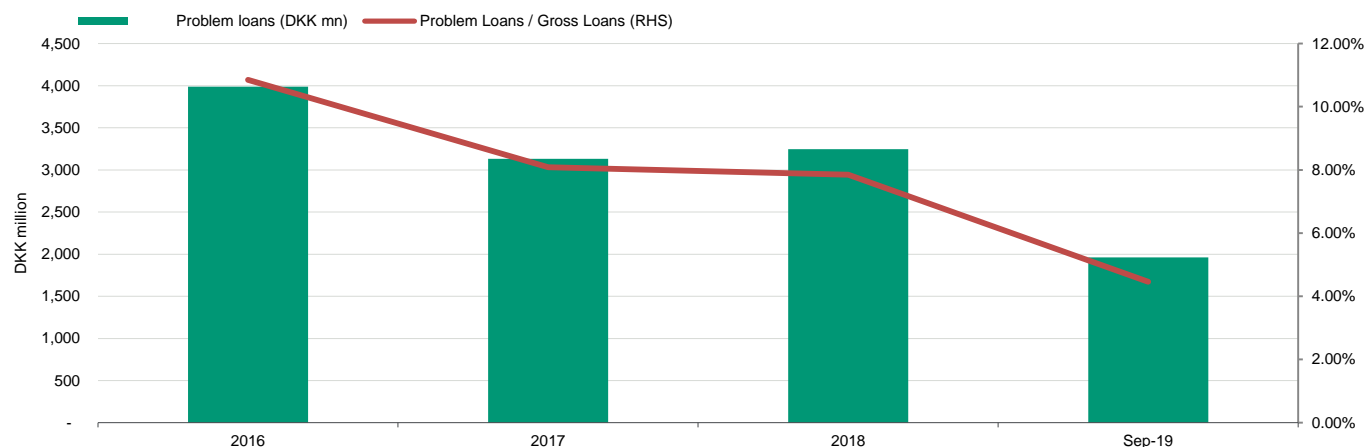
Detailed credit considerations

Higher nonperforming loans than its peers, although improving, along with moderately high loan growth, which could prove difficult in a downturn

Our assessment of Spar Nord's asset risk, reflected in our assigned Asset Risk score of baa3, considers the bank's relatively higher problem loan ratio compared with that of other Danish banks, along with our expectation that the ratio will continue to decline. The bank's relatively high problem loan ratio partly reflects the higher-quality off-balance-sheet mortgages it transfers to its mortgage distributors, but where it still holds part of the risk and is contractually committed to cover part of the losses. Our assigned score also takes into consideration the bank's loan growth, which was slightly higher than the system average over the last five years, as well as limited concentrations to a couple of higher-risk or cyclical sectors.

As of year-end 2018, Spar Nord's problem loans (defined as IFRS 9 stage 3 loans) were 7.9% of gross loans and these were adequately provisioned at 55%. The bank's stock of problem loans has declined gradually since 2016, and as of September 2019, the ratio declined further to 4.5%, following (1) the reclassification of a large agricultural client to performing and the write-off of a large exposure in the first half of 2019 and (2) the reassessment of the bank's own definition of problem loans to align with the IFRS guidelines.

Exhibit 3

Spar Nord's problem loans are declining

Source: Moody's Investors Service, Company Reports

We note that Spar Nord's through-the-cycle asset quality performance was a little better compared with that of its domestic peers, with credit costs averaging 0.9% of net loans during 2008-18, a period which included a collapse of a previous housing bubble and seven years of anemic economic growth. Credit costs reached a high of 1.5% in 2012. Impairment charges have come down significantly in recent years, with reported credit costs at 0.0% of loans for the first nine months of 2019.

Like other medium-sized Danish banks, Spar Nord does not own/consolidate a MCI. The bank originates the loans, and under two cooperation agreements, it transfers mortgage loans to Totalkredit and DLR Kredit, and provides a guarantee for a portion or all of the loan. Spar Nord carries no credit risk for the transferred loan to Totalkredit in the loan-to-value bracket of 0%-60%, but covers the losses for transferred mortgages in the loan-to-value bracket of 60-80%. The bank covers all losses for mortgages transferred to DLR Kredit. Therefore, its problem loan metrics against on-balance-sheet loans appear weaker than what they would have been if these lower-risk mortgages had been kept on the balance sheet. As of end- September 2019, Spar Nord had on-balance-sheet loans and advances of DKK43.9 billion, and had transferred mortgages and mortgage-like loans of DKK86.6 billion to MCIs (on which it earns a fee). Conversely, its profitability and market funding ratios are stronger for the same reason compared with Danish banks that consolidate an MCI.

Our assessment of Spar Nord's Asset Risk score also takes into consideration the bank's loan growth, which over the last five years has been slightly higher than the sector average. The bank grew its loan book by 2% between 2013 and 2018, a period of anemic growth for the sector. Furthermore, the bank exhibits some moderate sector concentrations. As of end- September 2019, property loans made up 12% of total loans, construction and engineering 4.3%, while loans to the agriculture sector, which we consider a vulnerable segment, were 4.9% of the total, down from 10.2% in 2012.

Robust capitalization and strong leverage ratio

Our assigned a1 Capital score reflects Spar Nord's solid capital position, a relative strength in our assessment of the bank's standalone profile. Spar Nord's Common Equity Tier 1 (CET1) capital ratio was 13.9% as of September 2019 and its total capital ratio reached 17.6%. These metrics are well above the bank's 2019 regulatory requirements of 9.2% for the CET1 ratio and 12.7% for the total capital ratio, which include both the Danish financial supervisory authority(FSA)'s Pillar 1 and Pillar 2 components, a 2.5% capital conservation buffer and an additional 1.0% countercyclical buffer. The bank was designated as a systemically important financial institution (SIFI) in January 2019 and will be subject to a fully loaded SIFI buffer of 1%, phased in by December 2020. The countercyclical buffer will also increase to 2% as of December 2020.

Our assessment also takes into consideration Spar Nord's capital targets, which the bank increased because of its SIFI designation, with the bank's CET1 ratio target currently at 13.5%. Considering the bank's current capitalization and targets, we expect Spar Nord to maintain strong capital ratios in the next 12-18 months, also supported by its ability to generate capital internally.

Spar Nord's risk density, measured as risk-weighted assets (RWA) compared with total assets, was 61% as of September 2019, a reflection of the bank's current use of the standardized approach for calculating risk weights. With its designation as a SIFI, the bank has launched a project to move to the internal ratings-based (IRB) approach to optimize its RWA. The effect on the bank's RWA is likely to be significant, and the project is likely to be completed by year-end 2022.

Spar Nord's tangible common equity/tangible assets was 9.1% as of September 2019. This compares well with other Nordic and euro area banks, where the average would hover around 5.0%-5.5%. While Spar Nord's move to the IRB model for calculating risk weights will likely reduce this ratio, we expect the bank's leverage ratio to remain higher than that of most of its regional peers.

Profitability to remain under pressure because of ultralow interest rates and weak efficiency

We expect Spar Nord's profitability to remain under pressure as competition and extremely low interest rates compress margins. In addition, the bank will have to issue more expensive (compared with cheap deposits) senior non-preferred (which we classify as junior senior) debt. Nevertheless, we expect the bank to continue to report relatively healthy profit, sustained by low credit costs. This view is reflected in our assigned Profitability score of baa2. Spar Nord's profitability is stronger than that of its Danish peers we rate that consolidate MCIs as profitability for low-risk mortgages is typically lower than for corporate lending.

Spar Nord's profitability has been relatively resilient over the last few years, despite the low interest rate environment. For the first nine months of 2019, net income (excluding one-offs)-to-tangible assets ratio was 1.1% (full year 2018: 0.9%). Despite an increase in lending volume, pressure on the margins led to a slight decline in the net interest margin to 1.7% (full year 2018: 1.9%). Net fee and commission income, however, driven by high remortgaging activity, increased by 9% year-on-year. Overall, total non-interest income made up 53% of total revenue. Operating expenses remain relatively high compared with those of its Nordic peers, with the Moody's-adjusted cost-to-income ratio at 61% as of September 2019. The bank's credit costs declined in the first nine months of September 2019, and remain at a very low level, supporting net income.

Similar to its domestic peers, we believe Spar Nord's core profitability will remain under pressure by the ultralow interest rate environment over the next 12-18 months, but expect net income to continue to be supported by the benign trend in asset quality and low credit costs.

Low dependence on market funding and strong liquidity buffer

Our a3 score for Funding Structure reflects Spar Nord's relatively solid funding profile. Spar Nord's customer deposits (excluding deposits from pooled plans and repo transactions) accounted for the bulk of total assets (57%) as of end - September 2019. Furthermore, the bank's reliance on confidence-sensitive market funding was low at 13% of tangible banking assets as of the same date.

We expect the bank's market funding to increase moderately as the bank starts issuing senior non-preferred debt to meet its minimum own funds and eligible liabilities (MREL) requirements ahead of the 1 January 2022 deadline. The bank expects to issue around DKK7 billion of senior non-preferred debt by 2022.

Similar to other medium-size Danish banks, Spar Nord funds a portion of its mortgage loans off balance sheet through Totalkredit and, to a lesser extent, through DLR Kredit.

As of the end of December 2018, Spar Nord's liquid banking assets (including reverse repos) accounted for around 34% of tangible banking assets. Our assigned a2 Liquidity score takes into consideration some asset encumbrance, which results from the bank's market-making activities in covered bonds. The bank also reported an adequate liquidity coverage ratio of 159% in September 2019 (174% as of year-end 2018). Spar Nord's liquidity coverage ratio is well above the 100% minimum requirement, set by the Danish FSA.

Environmental, social and governance considerations

In line with our general view for the banking sector, Spar Nord has a low exposure to environmental risks. See our [Environmental risks heat map](#) for further information.

Spar Nord's exposure to social risks is moderate, in line with our general assessment for the global banking industry. The most relevant social risks for banks arise from the way they interact with their customers. Social risks are particularly high in data security and customer privacy, which are partly mitigated by sizable technology investments and banks' long track record of handling sensitive

client data. Fines and reputational damage because of product mis-selling or other types of misconduct is a further social risk. Social trends are also relevant in a few areas, such as shifting customer preferences toward digital banking services, increasing information technology cost, aging population concerns in Denmark affect the demand for financial services or socially driven policy agendas that may translate into regulations that affects banks' revenue base. See our [Social risk heat maps](#) for further information.

Governance is highly relevant for Spar Nord, as it is to all banks in the industry. Corporate governance weaknesses can lead to a deterioration in a bank's credit quality, while governance strengths can benefit its credit profile. Governance risks are largely internal rather than externally driven, and for Spar Nord we do not have any particular governance concern. Nonetheless, corporate governance remains a key credit consideration and requires ongoing monitoring.

Support and structural considerations

Loss Given Failure (LGF) analysis

Spar Nord operates in Denmark and is subject to the European Union Bank Recovery and Resolution Directive, which we consider an operational resolution regime. In accordance with our methodology, we therefore apply our Advanced LGF analysis to Spar Nord's liabilities, considering the risks faced by different debt and deposit classes across the liability structure should the bank enter resolution.

In our Advanced LGF analysis, in line with our standard assumptions, we assume residual tangible common equity of 3%, losses post failure of 8% of tangible banking assets, a 25% runoff in junior wholesale deposits, a 5% runoff in preferred deposits and we assign a 25% probability to deposits being preferred to senior unsecured debt. We assume, however, that just 10% of deposits will be treated as junior. This reflects the bank's more retail-based deposit structure.

Our analysis reflects our expectation that Spar Nord will issue senior non-preferred debt to comply with Danish MREL requirements, under which both the loss absorbing and recapitalisation amounts need to be subordinated to senior liabilities. The full subordination requirement will need to be met by 1 January 2022. The deposit ratings therefore reflect our view on how the bank's current balance sheet structure will evolve over the coming years to meet these requirements.

Therefore, Spar Nord's A1 deposit and P(A1) senior unsecured ratings incorporate three notches of rating uplift from the bank's baa1 adjusted BCA, reflecting an extremely low loss given failure.

The bank's (P)A3 junior senior unsecured ratings are positioned one notch above the bank's Adjusted BCA, indicating a low loss-given-failure. Our LGF analysis indicates a high loss-given-failure for subordinated debt, leading us to position the rating at (P)Baa2, one notch below the bank's Adjusted BCA.

Government support considerations

We do not incorporate any government support uplift on Spar Nord's ratings because we consider the probability of government support, in case of need, to be low. Our government support assumptions are driven by the implementation of the European Union Bank Recovery and Resolution Directive in Denmark.

Counterparty Risk Ratings (CRRs)

CRRs are opinions of the ability of entities to honor the uncollateralized portion of non-debt counterparty financial liabilities (CRR liabilities) and also reflect the expected financial losses in the event such liabilities are not honored. CRRs are distinct from ratings assigned to senior unsecured debt instruments and from issuer ratings because they reflect that, in a resolution, CRR liabilities might benefit from preferential treatment compared with senior unsecured debt. Examples of CRR liabilities include the uncollateralized portion of payables arising from derivatives transactions and the uncollateralized portion of liabilities under sale and repurchase agreements.

Spar Nord's CRRs are positioned at A1/P-1

The CRRs are positioned three notches above the Adjusted BCA of baa1, reflecting the extremely low loss given failure from the high volume of instruments that are subordinated to CRR liabilities.

Counterparty Risk (CR) Assessment

The CR Assessment is an opinion of how counterparty obligations are likely to be treated if a bank fails, and are distinct from debt and deposit ratings in that they (1) consider only the risk of default rather than both the likelihood of default and the expected

financial loss, and (2) apply to counterparty obligations and contractual commitments rather than debt or deposit instruments. The CR Assessment is an opinion of the counterparty risk related to a bank's covered bonds, contractual performance obligations (servicing), derivatives (for example, swaps), letters of credit, guarantees and liquidity facilities.

Spar Nord's CR Assessment is positioned at A1(cr)/P-1(cr)

For Spar Nord, our Advanced LGF analysis indicates an extremely low loss given failure for the CR Assessment, leading to three notches of rating uplift from the bank's baa1 Adjusted BCA.

Rating methodology and scorecard factors

Exhibit 4

Spar Nord Bank A/S

Macro Factors						
Weighted Macro Profile	Strong +	100%				
Factor	Historic Ratio	Initial Score	Expected Trend	Assigned Score	Key driver #1	Key driver #2
Solvency						
Asset Risk						
Problem Loans / Gross Loans	7.8%	ba1	↑↑	baa3	Expected trend	Quality of assets
Capital						
Tangible Common Equity / Risk Weighted Assets (Basel III - transitional phase-in)	14.8%	a1	↔	a1		
Profitability						
Net Income / Tangible Assets	1.1%	a3	↔	baa2	Expected trend	
Combined Solvency Score		baa1		baa1		
Liquidity						
Funding Structure						
Market Funds / Tangible Banking Assets	5.3%	aa3	↔	a3	Expected trend	
Liquid Resources						
Liquid Banking Assets / Tangible Banking Assets	34.9%	a2	↔	a2	Asset encumbrance	
Combined Liquidity Score		a1		a3		
Financial Profile				baa1		
Qualitative Adjustments				Adjustment		
Business Diversification				0		
Opacity and Complexity				0		
Corporate Behavior				0		
Total Qualitative Adjustments				0		
Sovereign or Affiliate constraint				Aaa		
BCA Scorecard-indicated Outcome - Range				a3 - baa2		
Assigned BCA				baa1		
Affiliate Support notching				0		
Adjusted BCA				baa1		
Balance Sheet		in-scope (DKK Million)	% in-scope	at-failure (DKK Million)	% at-failure	
Other liabilities		19,604	25.5%	23,305	30.3%	
Deposits		52,875	68.7%	49,174	63.9%	
Preferred deposits		47,588	61.8%	45,208	58.7%	
Junior deposits		5,288	6.9%	3,966	5.2%	
Dated subordinated bank debt		1,318	1.7%	1,318	1.7%	
Preference shares (bank)		850	1.1%	850	1.1%	
Equity		2,309	3.0%	2,309	3.0%	
Total Tangible Banking Assets		76,955	100.0%	76,955	100.0%	

Debt Class	De Jure waterfall		De Facto waterfall		Notching		LGF	Assigned	Additional	Preliminary
	Instrument	Sub-	Instrument	Sub-	De Jure	De Facto	Notching	LGF	Notching	Rating
	volume +	ordination	volume +	ordination			Guidance	notching		Assessment
	subordination		subordination				vs.			
							Adjusted			
							BCA			
Counterparty Risk Rating	11.0%	11.0%	11.0%	11.0%	2	2	2	3	0	a1
Counterparty Risk Assessment	11.0%	11.0%	11.0%	11.0%	3	3	3	3	0	a1 (cr)
Deposits	11.0%	5.8%	11.0%	5.8%	0	0	0	3	0	a1
Senior unsecured bank debt	11.0%	5.8%	5.8%	5.8%	0	-1	0	3	0	a1
Junior senior unsecured bank debt	5.8%	5.8%	5.8%	5.8%	-1	-1	-1	1	0	a3
Dated subordinated bank debt	5.8%	4.1%	5.8%	4.1%	-1	-1	-1	-1	0	baa2

Instrument Class	Loss Given Failure notching	Additional notching	Preliminary Rating Assessment	Government Support notching	Local Currency Rating	Foreign Currency Rating
Counterparty Risk Rating	3	0	a1	0	A1	A1
Counterparty Risk Assessment	3	0	a1 (cr)	0	A1(cr)	
Deposits	3	0	a1	0	A1	A1
Senior unsecured bank debt	3	0	a1	0	(P)A1	(P)A1
Junior senior unsecured bank debt	1	0	a3	0	(P)A3	(P)A3
Dated subordinated bank debt	-1	0	baa2	0	(P)Baa2	(P)Baa2

[1]Where dashes are shown for a particular factor (or sub-factor), the score is based on non-public information.

Source: Moody's Investors Service

Ratings

Exhibit 5

Category	Moody's Rating
SPAR NORD BANK A/S	
Outlook	Stable
Counterparty Risk Rating	A1/P-1
Bank Deposits	A1/P-1
Baseline Credit Assessment	baa1
Adjusted Baseline Credit Assessment	baa1
Counterparty Risk Assessment	A1(cr)/P-1(cr)
Senior Unsecured MTN	(P)A1
Junior Senior Unsecured MTN	(P)A3
Subordinate MTN	(P)Baa2
Other Short Term	(P)P-1

Source: Moody's Investors Service

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