

CREDIT OPINION

31 October 2022

Update



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RATINGS

Spar Nord Bank A/S

Domicile	Aalborg, 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 to credit analysis

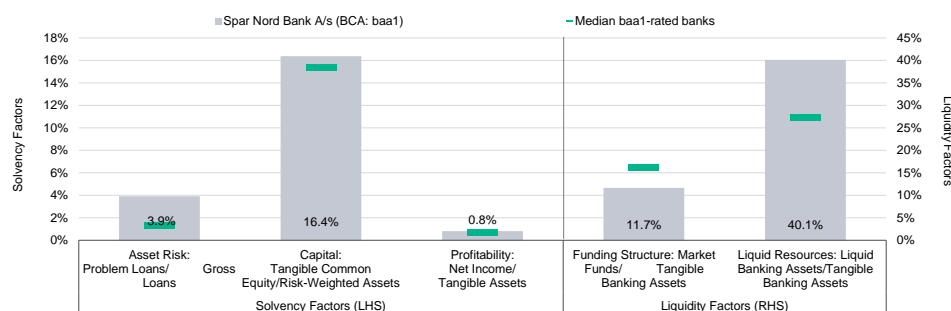
Summary

[Spar Nord Bank A/S](#) (Spar Nord) A1 long-term deposit and (P)A1 senior unsecured ratings reflect the bank's baa1 standalone Baseline Credit Assessment (BCA); and 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 capitalisation as well as its low dependence on market funding and strong liquidity buffer. At the same time, it takes into account the bank's nonperforming loan ratio, which, despite improvements, remains higher than the system average, along with moderately higher loan growth than the system average.

Exhibit 1

Rating Scorecard - Key financial ratios



These ratios are calculated based on our [Banks Methodology](#) scorecard. The bank's problem loan and profitability ratios are the weaker of the average of the latest three year-end ratios and the latest reported ratio. The bank's capital ratio is the latest reported figure. The bank's funding structure and liquid resources ratios are the latest year-end figures.

Source: Moody's Financial Metrics™

Credit strengths

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

Credit challenges

- » Relatively high problem loans
- » Relatively high cost-to-income ratio compared with peers

Outlook

The stable outlook on the bank's long-term deposit ratings reflects our view that the bank will be relatively resilient in the face of high inflation and slowdown in economic activity; with stable capitalisation and asset risk while profitability is expected to improve slightly as key policy rate hikes take effect.

Factors that could lead to an upgrade

- » Spar Nord's ratings could be upgraded following an upgrade of the BCA, which could occur if we observe a sustained improvement in the bank's asset risk metrics, including lower problem loans, potentially along with reduced concentrations; and a sustained improvement in the bank's profitability without a deterioration in its risk profile.
- » Spar Nord's long-term deposit and debt ratings, Counterparty Risk Assessment (CRA) and Counterparty Risk Rating (CRR), already have the maximum uplift because of loss given failure and would, therefore, not receive further uplift from increased subordination or increased issuance volumes.

Factors that could lead to a downgrade

- » Factors that could lead to a downgrade of Spar Nord's ratings include a lower BCA or reduced uplift in the LGF analysis. A downgrade of the BCA could occur if we observe a significant deterioration in asset quality or if concentrations and exposures to more volatile segments increase; a persistent weakening in the bank's recurring earnings power and operating efficiency; a substantial increase in market funding reliance beyond our current expectations; or weaker capital ratios that are below the bank's current capital targets of Common Equity Tier 1 of at least 13.5% and own funds ratio of 17.5%.
- » Downward pressure on the bank's long-term deposit and senior unsecured 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 significant reduction in junior deposit amounts, which would result in lower rating uplift than currently assumed under our Advanced LGF framework.

This publication does not announce a credit rating action. For any credit ratings referenced in this publication, please see the issuer/deal page on <https://ratings.moody.com> for the most updated credit rating action information and rating history.

Key indicators

Exhibit 2

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

	06-22 ²	12-21 ²	12-20 ²	12-19 ²	12-18 ²	CAGR/Avg. ³
Total Assets (DKK Million)	118,845.0	116,497.0	101,264.0	92,534.0	82,252.0	11.1 ⁴
Total Assets (USD Million)	16,707.3	17,751.1	16,645.7	13,900.3	12,600.0	8.4 ⁴
Tangible Common Equity (DKK Million)	10,039.0	10,224.0	9,355.0	8,663.0	8,128.0	6.2 ⁴
Tangible Common Equity (USD Million)	1,411.3	1,557.9	1,537.8	1,301.3	1,245.1	3.6 ⁴
Problem Loans / Gross Loans (%)	3.4	3.6	4.2	4.5	7.8	4.7 ⁵
Tangible Common Equity / Risk Weighted Assets (%)	16.4	16.9	17.1	15.5	15.1	16.2 ⁶
Problem Loans / (Tangible Common Equity + Loan Loss Reserve) (%)	15.7	15.5	17.0	19.8	32.7	20.1 ⁵
Net Interest Margin (%)	1.5	1.5	1.6	1.7	1.9	1.6 ⁵
PPI / Average RWA (%)	1.8	2.5	2.1	2.1	2.0	2.1 ⁶
Net Income / Tangible Assets (%)	0.8	1.2	0.7	1.1	0.9	0.9 ⁵
Cost / Income Ratio (%)	68.0	59.7	63.6	63.3	65.3	64.0 ⁵
Market Funds / Tangible Banking Assets (%)	10.8	11.7	9.9	10.3	5.3	9.6 ⁵
Liquid Banking Assets / Tangible Banking Assets (%)	40.9	40.1	41.4	36.7	34.9	38.8 ⁵
Gross Loans / Due to Customers (%)	77.7	79.4	76.0	83.7	81.4	79.6 ⁵

[–] Further to the publication of our revised methodology in July 2021, only ratios from annual 2020 onwards included in this report reflect the change in analytical treatment of the "high-trigger" Additional Tier 1 instruments. [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 because of the scale of reported amounts. [4] Compound annual growth rate (%) based on the periods for the latest accounting regime. [5] Simple average of periods for the latest accounting regime. [6] Simple average of Basel III periods.

Sources: Moody's Investors Service and 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 60 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 banking group in Denmark, with DKK119 billion (around €16.0 billion) total reported assets as of June 2022. It has a strong presence in the northern Jutland region of Denmark, where it has a market share of around 32%. Its national market share as of June 2022 was 1.4% in loans (excluding loans transferred to mortgage credit institutions [MCI]) and 4.7% in deposits.

Recent developments

Macroeconomic developments

Following a real GDP expansion of 4.9% in 2021 in Denmark with the economy gradually recovering from the pandemic's economic effects, we [forecast](#) a real GDP growth of 3.0% in 2022. However, heightened geopolitical risks stemming from Russia's invasion of Ukraine create significant uncertainty, mainly through higher inflation, supply chain constraints and lower willingness to invest.

BankNordik

In February 2021, Spar Nord completed the acquisition of the Danish retail business from [P/F BankNordik](#) (A2/A2, positive, baa1) that was [announced](#) in December 2020.

Detailed credit considerations

Asset risk will remain strong despite risks in the operating environment

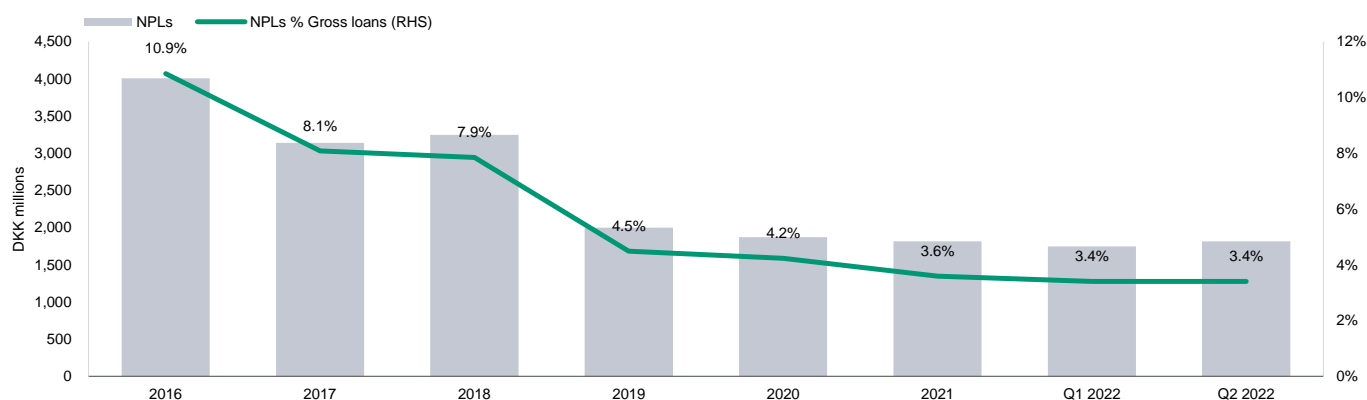
Our assessment of Spar Nord's asset risk, reflected in our assigned Asset Risk score of baa3, takes into account the bank's problem loan ratio, which has declined in recent years; and our expectation that the bank's loan book quality will remain resilient throughout the current high inflation operating environment, given the bank's sustained improvement in asset quality, combined with the Danish government's strong track record of mitigating external shocks. 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, and limited concentration in a couple of higher risk or cyclical sectors.

In 2020, as a response to the uncertainties around the Covid-19 pandemic, the bank set aside DKK309 million of provisions, equivalent to 0.7% of gross loans¹, to cover future losses. Following the buildup of provisions in 2020, the bank released significant loan loss reserves of DKK120 million in 2021 and DKK2 million as of 1H 2022.

As of June 2022, Spar Nord's problem loans (defined as IFRS 9 stage 3 loans) stood at 3.4% of gross loans and these were adequately covered by loan loss reserves at 85.5%. The bank's problem loan ratio remains higher than the system average of 1.4% as of June 2022², which 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.

Exhibit 3

Spar Nord's problem loans declined since 2016 and are stable at around 3.5%



Gross loans exclude reverse repos.

Sources: Company and Moody's Investors Service

Like other medium-sized Danish banks, Spar Nord does not own or consolidate an MCI. The bank originates the loans and, under two cooperation agreements, transfers mortgage loans to Totalkredit (subsidiary of [Nykredit Realkredit A/S](#) (A1, stable, a2)) and DLR Kredit. The bank covers all losses for mortgages transferred to DLR Kredit while for mortgages transferred to Totalkredit, there is no longer any guarantees needed. As of June 2022, Spar Nord had on-balance sheet loans and advances of DKK51.8 billion, and had transferred mortgages and mortgage-like loans of DKK114.3 billion to MCIs (on which it earns a fee).

Our assessment of Spar Nord's Asset Risk score also takes into consideration the bank's loan growth, which has been higher than the sector average over the last five years. Furthermore, the bank exhibits moderate sector concentration. As of June 2022, real estate loans made up 10.9% of total loans; construction and engineering 4.2%; and loans to the agriculture sector, which we consider a vulnerable segment, were 4.3% of the total, down from 10.2% in 2012.

Robust capitalisation 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. We expect capital ratios to decrease moderately because of growth, share buybacks and dividends, but remain strong and well above regulatory requirements. Furthermore, Spar Nord currently uses the standardised approach to calculate risk weights, and this renders them less susceptible to a rise in risk exposure amounts from the macroeconomic downturn. If the bank successfully implements internal rating-based models (IRB), it is likely that risk-weighted capital ratios will improve.

Spar Nord's reported Common Equity Tier 1 (CET1) capital ratio stood at 15.6% as of June 2022 (December 2021: 16.3%) and its total capital ratio was at 19.9% (December 2021: 20.8%). The decline compared with year-end 2021 was mainly driven by an increase in risk-weighted assets (RWAs), and capital releases to shareholders through dividends and share buybacks. Despite the increase in RWAs, the bank's capital metrics are well above its regulatory requirements of 9.5% solvency need as of June 2022 and 13.0% for the total capital ratio, which include both the Danish financial supervisory authority (FSA) Pillar 1 and Pillar 2 components, a 2.5% capital conservation buffer, a 1.0% systemically important financial institution (SIFI) requirement³.

Spar Nord resumed capital distributions, paying out 45% of 2021 profit, within its dividend policy of 30%-50%, following suspended dividends in 2019 to comply with DFSA recommendations.

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%. Taking into account the bank's current capitalisation and targets, we expect Spar Nord to maintain strong capital ratios in the next 12-18 months.

Spar Nord's risk density, measured as RWAs as a percentage of total assets, was 51.6% as of June 2022, reflecting the bank's standardised approach for calculating risk weights. With its designation as a SIFI, the bank has launched a project to move to the IRB approach to optimise its RWA. The effect on the bank's RWAs is likely to be significant, and is projected to be completed within the next 12-18 months.

Spar Nord's tangible common equity-to-total assets ratio was 8.5% as of June 2022. 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 those of most of its regional peers.

Profitability rebounded because of mitigating actions and lower loan loss provisions

Our assigned baa1 Profitability score reflects Spar Nord's relatively stable profitability over the last few years, and our expectation that profitability will continue improving as the Danish central bank continues hiking the policy rate, allowing for increased net interest margins. The bank's efforts in 2021 to impose negative deposit rates helped mitigate the strain on lending margins because of prolonged period of extremely low interest rates. On the other hand, the bank has started issuing more expensive (compared with low cost deposits) senior non-preferred (which we classify as junior senior) debt. Spar Nord's profitability is stronger than that of its Danish peers we rate that consolidate MCIs because profitability for low-risk mortgages is typically lower than that for corporate lending.

The bank's net income-to-tangible assets ratio decreased to 0.8% in H1 2022 (H1 2021: 1.2%, full-year 2021: 1.2%). The decrease in net income compared with the level a year earlier was primarily because of a loss of DKK7 million in market value adjustments and dividends during the first six months of 2022, against an income of DKK216 million in the first six months of 2021. The decrease in value adjustments were largely driven by negative adjustments of DKK159 million on the bank's share and bond portfolio, reflecting the turbulence in financial markets since Russia's invasion of Ukraine and increasing interest rates. The Moody's adjusted cost-to-income ratio reached 68% during H1 2022, slightly higher than its Nordic peers.

Following the central bank's latest 75 bps key policy [rate hike](#) on 8 September 2022, negative rates on deposits were reversed, and the bank was able to reprice lending and deposit rates to achieve a margin without the use of negative rates.

The bank expects net income for 2022 to be in the range of DKK1,000-1,250 million, compared with DKK1,368 million in 2021, indicating a net income to tangible assets of 0.8% up to 1%.

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 (58%) as of June 2022. Furthermore, the bank's reliance on confidence sensitive market funding remained low at 10.8% of tangible banking assets as of June 2022.

We expect the bank's market funding to increase moderately as the bank issues eligible debt to meet its minimum own funds and eligible liabilities (MREL) requirements. The Bank expects that the MREL requirement, when fully phased-in, will lead to a total need for issuing MREL eligible debt of around DKK8 billion. The outstanding amount of senior non-preferred debt as of June 2022 was DKK4.6 billion, and the bank plans another DKK2-3 billion to be issued before the next phasing in at 1 January 2023.

Similar to other medium-sized 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 June 2022, Spar Nord's liquid banking assets (including reverse repos) accounted for 40% of its tangible banking assets. Our assigned a2 Liquidity score takes into consideration some asset encumbrance. The bank also reported a strong liquidity coverage ratio

of 212% in June 2022 (248% as of year-end 2021). Spar Nord's liquidity coverage ratio is well above the 100% minimum requirement, set by the Danish FSA.

ESG considerations

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

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 mitigated by sizeable 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, ageing population concerns in Denmark affect the demand for financial services or socially driven policy agendas that may translate into regulations that affect banks' revenue base. For further information, please refer to our [social risks heat map](#).

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. 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 apply our Advanced LGF analysis to Spar Nord's liabilities, taking into account the risks faced by different debt and deposit classes across the liability structure should the bank enter resolution. In our Advanced LGF analysis, we take a forward-looking view on how the bank's balance sheet will evolve over the next 12-18 months.

For the 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 that just 10% of deposits will be treated as junior. This reflects the bank's more retail-based deposit structure. Our forward-looking LGF analysis takes into account our assessment of MREL and the needed issuances of senior non-preferred debt. Our assessments include that with an average growth in the balance sheet of more than 4% annually, Spar Nord will need to maintain DKK6-7 billion in eligible liabilities outstanding as of year-end 2022. We expect Spar Nord will fulfill the requirement by issuing senior non-preferred debt.

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 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. The bank's subordinated programme rating is assigned a (P)Baa2 rating, one notch below the BCA, while the LGF analysis indicates a zero notching. The negative adjustment incorporates our forecasts of lower levels of subordination as the balance sheet grows.

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.

Counterparty Risk Ratings (CRRs)

Spar Nord's CRRs are A1/P-1

The CRRs are 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**Spar Nord's CR Assessment is 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		3.9%	a3	↔	baa3	Sector concentration	
Capital							
Tangible Common Equity / Risk Weighted Assets (Basel III - transitional phase-in)		16.4%	aa2	↓↓	a1	Expected trend	
Profitability							
Net Income / Tangible Assets		0.8%	baa1	↔	baa1	Expected trend	
Combined Solvency Score			a2		baa1		
Liquidity							
Funding Structure							
Market Funds / Tangible Banking Assets		11.7%	a2	↓	a3	Expected trend	
Liquid Resources							
Liquid Banking Assets / Tangible Banking Assets		40.1%	aa3	↓	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			17,565	18.2%	22,372	23.2%	
Deposits			68,672	71.1%	63,865	66.1%	
Preferred deposits			61,805	64.0%	58,715	60.8%	
Junior deposits			6,867	7.1%	5,150	5.3%	
Junior senior unsecured bank debt			4,757	4.9%	4,757	4.9%	
Dated subordinated bank debt			1,516	1.6%	1,516	1.6%	
Preference shares (bank)			1,180	1.2%	1,180	1.2%	
Equity			2,898	3.0%	2,898	3.0%	
Total Tangible Banking Assets			96,588	100.0%	96,588	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	16.0%	16.0%	16.0%	16.0%	3	3	3	3	0	a1
Counterparty Risk Assessment	16.0%	16.0%	16.0%	16.0%	3	3	3	3	0	a1 (cr)
Deposits	16.0%	10.7%	16.0%	10.7%	3	3	3	3	0	a1
Senior unsecured bank debt	16.0%	10.7%	10.7%	10.7%	3	2	3	3	0	a1
Junior senior unsecured bank debt	10.7%	5.8%	10.7%	5.8%	1	1	1	1	0	a3
Dated subordinated bank debt	5.8%	4.2%	5.8%	4.2%	0	0	0	-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	A3	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	A3
Junior Senior Unsecured MTN	(P)A3
Subordinate MTN	(P)Baa2

Source: Moody's Investors Service

Endnotes

¹ Gross loans excluding reverse repos.

² According to data from the central bank, Nationalbanken.

³ Spar Nord was designated as a SIFI in January 2019. The Systemic Risk Council recommends to increase the CCyB to 2.5% effective 31 March 2023.

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