

## CREDIT OPINION

20 January 2023

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	A1
Type	Senior Unsecured - Dom Curr
Outlook	Stable
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

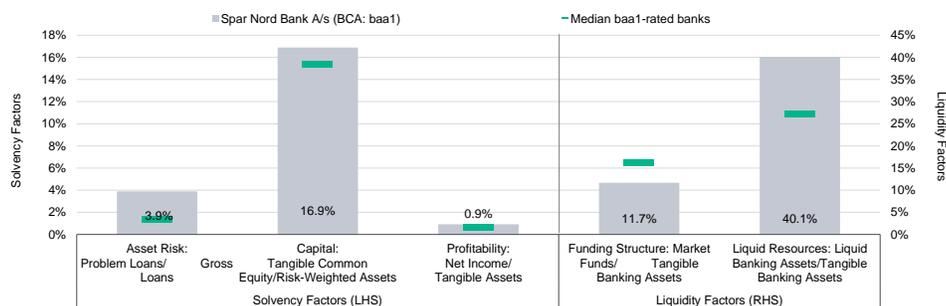
#### Summary

[Spar Nord Bank A/S](#)' (Spar Nord) A1 long-term deposit and 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 loss severity for junior depositors and senior creditors should the bank enter into resolution. The bank's long-term deposit and senior unsecured ratings have a stable outlook.

Spar Nord's baa1 standalone BCA balances the bank's robust capitalisation, strong recurring profitability, and strong liquidity buffer against the higher levels of nonperforming loans to gross loans compared to peers.

#### 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 higher problem loans ratio compared to peers
- » High cost to income ratio compared to peers

## Outlook

The stable outlook on the long-term deposit and ratings reflects Moody's view that Spar Nord has sufficient buffers in term of strong capital and improving profit margins to manage a deterioration in borrowers' repayment capacity during the next 12 to 18 months.

## 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 senior unsecured debt ratings, Counterparty Risk (CR) Assessment and Counterparty Risk Ratings (CRRs) already have the maximum uplift in our 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; there is a persistent weakening in the bank's recurring earnings power and operating efficiency; its market funding reliance increases substantially beyond our current expectations; or its capital ratios remain below the bank's current capital targets of a Common Equity Tier 1 (CET1) capital ratio of at least 13.5% and an own funds ratio of 17.5%.
- » Downward pressure on Spar Nord'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 volumes 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'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]

	09-22 <sup>2</sup>	12-21 <sup>2</sup>	12-20 <sup>2</sup>	12-19 <sup>2</sup>	12-18 <sup>2</sup>	CAGR/Avg. <sup>3</sup>
Total Assets (DKK Million)	121,147.0	116,497.0	101,264.0	92,534.0	82,252.0	10.9 <sup>4</sup>
Total Assets (USD Million)	15,961.6	17,751.1	16,645.7	13,900.3	12,600.0	6.5 <sup>4</sup>
Tangible Common Equity (DKK Million)	10,285.0	10,224.0	9,355.0	8,663.0	8,128.0	6.5 <sup>4</sup>
Tangible Common Equity (USD Million)	1,355.1	1,557.9	1,537.8	1,301.3	1,245.1	2.3 <sup>4</sup>
Problem Loans / Gross Loans (%)	3.2	3.6	4.2	4.5	7.8	4.7 <sup>5</sup>
Tangible Common Equity / Risk Weighted Assets (%)	16.9	16.9	17.1	15.5	15.1	16.3 <sup>6</sup>
Problem Loans / (Tangible Common Equity + Loan Loss Reserve) (%)	14.8	15.5	17.0	19.8	32.7	19.9 <sup>5</sup>
Net Interest Margin (%)	1.5	1.5	1.6	1.7	1.9	1.7 <sup>5</sup>
PPI / Average RWA (%)	2.2	2.5	2.1	2.1	2.0	2.2 <sup>6</sup>
Net Income / Tangible Assets (%)	0.9	1.2	0.7	1.1	0.9	1.0 <sup>5</sup>
Cost / Income Ratio (%)	63.5	59.7	63.6	63.3	65.3	63.1 <sup>5</sup>
Market Funds / Tangible Banking Assets (%)	11.6	11.7	9.9	10.3	5.3	9.7 <sup>5</sup>
Liquid Banking Assets / Tangible Banking Assets (%)	41.1	40.1	41.4	36.7	34.9	38.9 <sup>5</sup>
Gross Loans / Due to Customers (%)	77.0	79.4	76.0	83.7	81.4	79.5 <sup>5</sup>

[<sup>-</sup>] 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 total reported assets of DKK121 billion (around €16.3 billion) as of September 2022. It has a strong presence in the northern Jutland region of Denmark, where it has a significant market share. Its national market share as of October 2022 was 1.4% in loans (excluding loans transferred to mortgage credit institutions [MCIs]) and 4.7% in deposits.

## Recent developments

### Macroeconomic developments

The global economy is on the [verge](#) of a downturn because of the extraordinarily high level of uncertainty amid persistent inflation, monetary policy tightening, fiscal challenges, geopolitical risks and financial market volatility. Global growth will slow in 2023 and remain sluggish in 2024. Still, a period of relative stability could emerge by 2024 if governments and central banks manage to navigate their economies through the current difficulties.

### BankNordik

In February 2021, Spar Nord completed the acquisition of the Danish retail business from [P/F BankNordik](#) (A2/A2 positive, baa1<sup>1</sup>) 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 its loan book quality will deteriorate moderately in the coming year as borrowers are constrained by higher inflation and subdued economic growth. 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 the first nine months of 2022, the bank's loan loss provisions amounted to a low DKK21 million due to increasing macroeconomic risks following Russia's invasion of Ukraine. During 2021, the bank released significant loan loss reserves of DKK120 million as a result of decreased expected impacts of the Covid-19 pandemic, following DKK309 million build-up of loan loss provisions in 2020.

As of September 2022, Spar Nord's problem loans (defined as IFRS 9 stage 3 loans) stood at 3.2% of gross loans and these were adequately covered by loan loss reserves at 89.2%. The bank's problem loan ratio remains higher than the system average of 1.4% as of June 2022<sup>2</sup>, which partly reflects the higher quality off-balance sheet mortgages it transfers to its mortgage distributors, but where Spar Nord still holds part of the risk and is contractually committed to cover part of the losses.

Exhibit 3

### Spar Nord's problem loans have declined since 2016



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 but partners with Totalkredit (subsidiary of [Nykredit Realkredit A/S](#) [A1 stable, a2]) and DLR Kredit (not rated) to originate mortgages. The bank covers all losses for mortgages transferred to DLR Kredit, while for mortgages transferred to Totalkredit, no guarantees are needed since 2022. However, the bank carries the first loss on loans issued prior to that date. As of September 2022, Spar Nord had on-balance sheet loans and advances of DKK52.9 billion, and had transferred mortgages of DKK113.8 billion to MCIs (for 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 has moderate sector concentration. As of September 2022, real estate loans made up 11.2% of total loans; construction and engineering 4.5%; and loans to the agriculture sector, which is a historically volatile segment, accounted for 4.5% of the total, albeit down from 10.2% in 2012.

### Robust capitalisation and a strong leverage ratio

Our assigned a1 Capital score reflects Spar Nord's solid capital position with tangible common equity to risk weighted assets (TCE/RWA) remaining at 16.9% at the end of September 2022, 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 to remain strong and well above regulatory requirements. Furthermore, Spar Nord uses the standardised approach to calculate risk weights, and this renders the bank less susceptible to a rise in risk exposure amounts from the macroeconomic downturn. When the bank implements the internal rating based (IRB) model, it is likely that risk weighted capital ratios will improve.

Spar Nord's reported CET1 ratio was 15.7% as of September 2022 (December 2021: 16.3%) and its total capital ratio was 20.2% (December 2021: 20.8%). The decline compared with year-end 2021 was mainly driven by capital release to shareholders through dividends and share buybacks. The bank's capital metrics however remain well above its regulatory requirements of 9.6% solvency need as of September 2022 and 14.1% for the total capital ratio, which include the Danish Financial Supervisory Authority's (FSA) Pillar 1 and Pillar 2 components, a 2.5% capital conservation buffer, a 1.0% countercyclical capital buffer (CCyB) and a 1.0% systemically important financial institution (SIFI) requirement<sup>3</sup>.

Spar Nord resumed capital distributions in 2022, paying out 45% of the 2021 profit, within its dividend policy of 30%-50%. This follows suspended dividends in 2019 to comply with Danish FSA 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 RWA/total assets, was 50.3% as of September 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 RWAs. The effect on the bank's RWAs is likely to be significant, and the change is projected to be completed within the next 12-18 months.

Spar Nord's tangible common equity/tangible banking assets was 8.5% as of September 2022 which compares well with the average of around 5.0%-5.5% for other Nordic and euro area banks. 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 rebounded because of mitigating actions and lower loan loss provisions**

Our assigned baa2 Profitability score reflects our expectation that Spar Nord's profitability will continue to improve as the Danish central bank continues to hike the policy rate, allowing for increased net interest margins.

The bank's net income/tangible assets decreased to 0.9% in the nine months that ended September 2022 (Q1-Q3 2021: 1.2%). The decrease in net income compared with a year earlier was primarily because of a gain of DKK58 million in market value adjustments and dividends during the first nine months of 2022, down from DKK297 million in the first nine months of 2021. The decrease in value adjustments was largely driven by negative adjustments of DKK179 million on the bank's share and bond portfolio, reflecting the turbulence in financial markets since Russia's invasion of Ukraine and rising interest rates. The bank's Moody's adjusted cost to income ratio was 63.5% during the first nine months of 2022, slightly higher than that of its Nordic peers.

Spar Nord's profitability is stronger than Danish peers that consolidate MCIs because profitability for low risk mortgages is typically lower than that for bank lending. However, we adjust our profitability score down by one notch to reflect Spar Nord's guarantees on taking the first loss on transferred mortgages, which could result in the bank taking the first loss in case of a deterioration in asset quality. The bank has a DKK113bn (end of September 2022) portfolio of mortgages with Totalkredit and DLR Kredit.

Following the central bank's 75 basis points (bps) key policy [rate hike](#) on 8 September 2022, and the 60 bps hike on 28 October 2022, higher interest margins are supporting improving profitability.

The bank's guidance for net income for 2022 is in the range of DKK1,350-DKK1,450 million, compared with DKK1,368 million in 2021, indicating a net income to tangible assets ratio of around 1.0%.

### **Low dependence on market funding and a 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 (53%) as of September 2022. Furthermore, the bank's reliance on confidence sensitive market funding remained low at 11.7% of tangible banking assets as of September 2022.

We expect Spar Nord's market funding to increase moderately as the bank issues eligible debt to meet its minimum requirements for own funds and eligible liabilities (MREL). The bank expects MREL, when fully phased-in, to lead to a need to issue MREL-eligible debt of around DKK8 billion. The outstanding amount of senior non-preferred debt as of September 2022 was DKK5.5 billion.

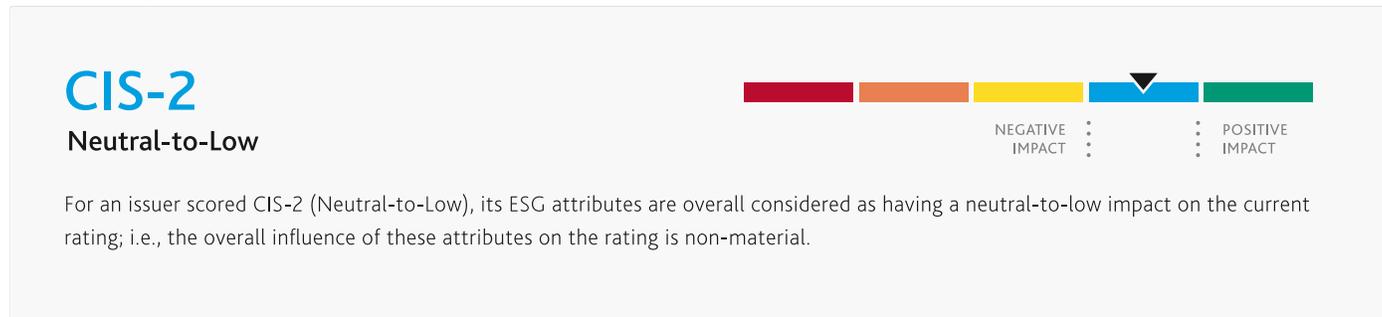
As of September 2022, Spar Nord's liquid banking assets (including reverse repos) accounted for 40% of its tangible banking assets. Our assigned a2 Liquidity score takes into consideration some asset encumbrance. The bank also reported a strong liquidity coverage ratio of 217% in September 2022 (248% 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

### Spar Nord Bank A/S' ESG Credit Impact Score is Neutral-to-Low CIS-2

Exhibit 4

#### ESG Credit Impact Score



Source: Moody's Investors Service

Spar Nord's ESG Credit Impact Score is neutral-to-low (**CIS-2**). This reflects the limited credit impact of environmental and social risk factors on the rating to date, and the neutral-to-low governance risks.

Exhibit 5

#### ESG Issuer Profile Scores



Source: Moody's Investors Service

### Environmental

Spar Nord faces moderate environmental risks primarily because of its portfolio exposure to carbon transition risk as a diversified bank. In line with its peers, the bank is facing mounting business risks and stakeholder pressure to meet broader carbon transition goals. In response, Spar Nord is developing its climate risk and portfolio management capabilities.

### Social

Spar Nord faces high industry-wide social risks related to regulatory and litigation risks, requiring high compliance standards. These risks are mitigated by the bank's developed policies and procedures. High cyber and personal data risks are mitigated by the bank's strong IT framework.

### Governance

Spar Nord has neutral-to-low governance risks, and its risk management, policies and procedures are in line with industry best practices. Spar Nord is a regional bank with a stable track record of good risk management and financial strategy. The bank has a clear and simple organisational structure with no identified concerns regarding ownership and control.

ESG Issuer Profile Scores and Credit Impact Scores for the rated entity/transaction are available on Moodys.com. In order to view the latest scores, please click [here](#) to go to the landing page for the entity/transaction on MDC and view the ESG Scores section.

## 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 and a 5% runoff in preferred deposits, and we assign a 25% probability to deposits being preferred to senior unsecured debt. We assume that 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 our view that with an average growth in the balance sheet of more than 4% annually, Spar Nord will need to maintain DKK6 billion-DKK7 billion in eligible liabilities outstanding as of year-end 2022. We expect Spar Nord to fulfil the requirement by issuing senior preferred and senior non-preferred debt.

Spar Nord's A1 deposit and 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)Baa1, in line with the 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.

### 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 6

### Spar Nord Bank A/S

<b>Macro Factors</b>							
<b>Weighted Macro Profile</b>		<b>Strong +</b>	<b>100%</b>				
<b>Factor</b>	<b>Historic Ratio</b>	<b>Initial Score</b>	<b>Expected Trend</b>	<b>Assigned Score</b>	<b>Key driver #1</b>	<b>Key driver #2</b>	
Solvency							
Asset Risk							
Problem Loans / Gross Loans	3.9%	a3	↓	baa3	Quality of assets		
Capital							
Tangible Common Equity / Risk Weighted Assets (Basel III - transitional phase-in)	16.9%	aa2	↓	a1	Expected trend		
Profitability							
Net Income / Tangible Assets	0.9%	baa1	↓	baa2	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	Stock of liquid assets		
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			
<b>Balance Sheet</b>							
		<b>in-scope (DKK Million)</b>	<b>% in-scope</b>	<b>at-failure (DKK Million)</b>	<b>% at-failure</b>		
Other liabilities		16,875	17.0%	21,822	22.0%		
Deposits		70,677	71.2%	65,730	66.3%		
Preferred deposits		63,609	64.1%	60,429	60.9%		
Junior deposits		7,068	7.1%	5,301	5.3%		
Junior senior unsecured bank debt		5,481	5.5%	5,481	5.5%		
Dated subordinated bank debt		2,010	2.0%	2,010	2.0%		
Preference shares (bank)		1,180	1.2%	1,180	1.2%		
Equity		2,976	3.0%	2,976	3.0%		
Total Tangible Banking Assets		99,199	100.0%	99,199	100.0%		

Debt Class	De Jure waterfall		De Facto waterfall		Notching		LGF Notching Guidance vs. Adjusted BCA	Assigned LGF notching	Additional Notching	Preliminary Rating Assessment
	Instrument volume + subordination	Sub-ordination	Instrument volume + subordination	Sub-ordination	De Jure	De Facto				
Counterparty Risk Rating	17.1%	17.1%	17.1%	17.1%	3	3	3	3	0	a1
Counterparty Risk Assessment	17.1%	17.1%	17.1%	17.1%	3	3	3	3	0	a1 (cr)
Deposits	17.1%	11.7%	17.1%	11.7%	3	3	3	3	0	a1
Senior unsecured bank debt	17.1%	11.7%	11.7%	11.7%	3	2	3	3	0	a1
Junior senior unsecured bank debt	11.7%	6.2%	11.7%	6.2%	1	1	1	1	0	a3
Dated subordinated bank debt	6.2%	4.2%	6.2%	4.2%	0	0	0	0	0	baa1

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	A1	(P)A1
Junior senior unsecured bank debt	1	0	a3	0	A3	A3
Dated subordinated bank debt	0	0	baa1	0	(P)Baa1	(P)Baa1

[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 7

Category	Moody's Rating
<b>SPAR NORD BANK A/S</b>	
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 -Dom Curr	A1
Junior Senior Unsecured	A3
Junior Senior Unsecured MTN	(P)A3
Subordinate MTN	(P)Baa1

Source: Moody's Investors Service

## Endnotes

- The bank ratings shown in this report are the bank's deposit rating, senior unsecured debt rating (where available) and Baseline Credit Assessment.
- According to data from the central bank, Nationalbanken.
- Spar Nord was designated as a SIFI in January 2019. The CCyB will increase to 1.5% effective 31 December 2022 and to a further 2.5% effective 31 March 2023.

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