MOODY'S
INVESTORS SERVICE

CREDIT OPINION
11 October 2017

Update

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RATINGS

Sydbank A/S

Domicile	Denmark
Long Term Debt	Baa1
Type	Senior Unsecured - Fgn Curr
Outlook	Positive
Long Term Deposit	A3
Type	LT Bank Deposits - Fgn Curr
Outlook	Positive

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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Sydbank A/S

Update following ratings affirmation, outlook changed to positive

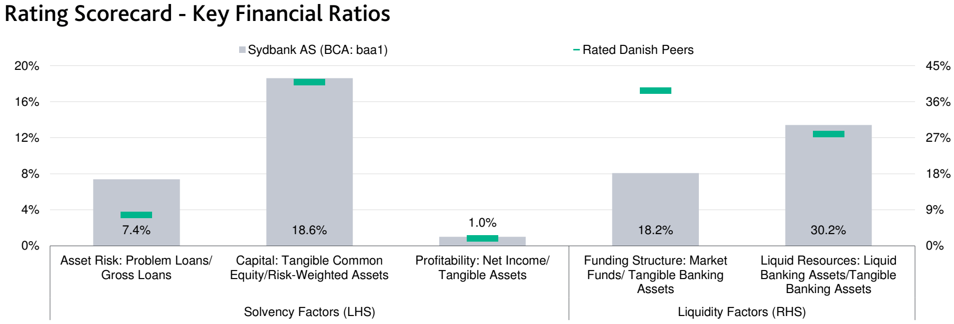
Summary

On 29 September 2017, we affirmed Sydbank A/S (Sydbank)'s long- and short-term deposit ratings at A3/P-2, as well as its long-term senior unsecured debt ratings at Baa1. Further, we upgraded Sydbank's standalone baseline credit assessment (BCA) and Adjusted BCA to baa1 from baa2, as well as the bank's long-term CR Assessments to A1(cr) from A2(cr). Sydbank's short-term CR Assessment was affirmed at P-1(cr).

Sydbank's ratings reflect (1) the bank's baa1 BCA and Adjusted BCA, (2) the results of our Advanced Loss Given Failure (LGF) analysis, which takes into account the severity of loss faced by the different liability classes in the unlikely event of the bank's failure and its resolution under the European Banking Recovery and Resolution Directive, providing one notch of rating uplift to its deposit ratings and zero rating uplift to Sydbank's senior unsecured debt rating; and (3) our assumption of a "low" probability of government support, resulting in no additional rating uplift for Sydbank's long-term ratings.

Sydbank's baa1 standalone BCA reflects the bank's (1) solid capitalization; (2) sound funding structure and liquidity profile; as well as (3) sustained profitability despite the low interest rate environment. At the same time, Sydbank's standalone BCA is constrained by its still elevated - albeit improving - asset quality, including geographic and real estate sector concentrations.

Exhibit 1
Rating Scorecard - Key Financial Ratios



Source: Moody's Banking Financial Metrics

Credit strengths

- Solid capital ratios and ample capital buffer in excess of regulatory requirements
- Solid funding structure and liquidity profile
- Resilient profitability supported by the a reduction in credit costs

Credit challenges

- Still elevated - but improving - asset quality, as well as geographic and real estate concentrations

Rating outlook

- Sydbank's long-term deposits and senior unsecured debt ratings carry a positive outlook due to our expectation of an increase in the volume of senior unsecured debt towards the end of the outlook period. In addition, we expect that the bank's key credit characteristics will remain supported by the benign domestic operating environment over the next 12 to 18 months, despite continued pressures from the persistent low interest-rate environment on the bank's earnings.
- The positive outlook reflects the bank's plan to issue an increasing proportion of senior unsecured debt to support balance sheet growth. We note that the successful execution of this plan might result in lower-than-expected losses for junior depositors and senior unsecured debt under our Advanced Loss Given Failure analysis, providing a higher degree of protection to these debt classes.

Factors that could lead to an upgrade

- Upward pressure on Sydbank's ratings could develop from (1) a further improvement in asset-quality, especially in relation to agricultural lending; (2) a further sustained improvement in profitability, without a material increase in its risk profile; and (3) a strengthening of the bank's capitalization beyond the rating agency's current expectations.
- Upward rating momentum for the long-term ratings of Sydbank could alos develop as a result of a change in the group's funding structure, such as the issuance of higher volumes of senior unsecured debt or subordinated debt that would result in notching uplift under our LGF framework. Also, a lower-than-expected loss for junior depositors could result if the percentage of junior deposits is significantly higher than our assumption of 10% of total deposits.

Factors that could lead to a downgrade

- Downward pressure on Sydbank's ratings could emerge if (1) asset quality deteriorates from current levels; (2) its risk profile increases (e.g., as a result of increased exposures to more volatile asset classes); and/or (3) the bank's capital ratio or profitability weakens.
- Sydbank's long-term ratings could be downgraded following (1) a downgrade of the bank's BCA; and/or (2) an increase in the expected loss severity following a shift in the bank's funding mix, which could result in less rating uplift under our LGF framework.

Key Indicators

Exhibit 2

Sydbank A/S (Consolidated Financials) [1]

	6-17[2]	12-16[2]	12-15[2]	12-14[2]	12-13[3]	CAGR/Avg.[4]
Total Assets (DKK million)	134,697	137,453	133,253	137,248	147,892	-2.6[5]
Total Assets (EUR million)	18,117	18,486	17,856	18,432	19,824	-2.5[5]
Total Assets (USD million)	20,663	19,498	19,397	22,303	27,316	-7.7[5]
Tangible Common Equity (DKK million)	11,178	11,372	11,024	10,887	9,805	3.8[5]
Tangible Common Equity (EUR million)	1,503	1,529	1,477	1,462	1,314	3.9[5]
Tangible Common Equity (USD million)	1,715	1,613	1,605	1,769	1,811	-1.5[5]
Problem Loans / Gross Loans (%)	6.2	6.0	8.0	9.4	9.1	7.7[6]
Tangible Common Equity / Risk Weighted Assets (%)	18.6	17.9	16.2	15.0	13.5	16.9[7]
Problem Loans / (Tangible Common Equity + Loan Loss Reserve) (%)	31.9	33.2	41.3	44.9	48.7	40.0[6]
Net Interest Margin (%)	1.5	1.7	1.7	1.9	1.9	1.8[6]
PPI / Average RWA (%)	3.4	3.0	2.5	2.8	2.8	2.9[7]
Net Income / Tangible Assets (%)	1.2	1.1	0.9	0.8	0.1	0.8[6]
Cost / Income Ratio (%)	56.8	57.2	60.1	57.4	56.5	57.6[6]
Market Funds / Tangible Banking Assets (%)	10.5	18.2	18.9	29.3	34.1	22.2[6]
Liquid Banking Assets / Tangible Banking Assets (%)	30.3	30.2	27.6	38.0	38.0	32.8[6]
Gross Loans / Due to Customers (%)	87.0	99.2	98.2	98.6	108.2	98.2[6]

[1] All figures and ratios are adjusted using Moody's standard adjustments [2] Basel III - fully-loaded or transitional phase-in; IFRS [3] Basel II; IFRS [4] May include rounding differences due to scale of reported amounts [5] Compound Annual Growth Rate (%) based on time period presented for the latest accounting regime [6] Simple average of periods presented for the latest accounting regime. [7] Simple average of Basel III periods presented

Source: Moody's Financial Metrics

Profile

Sydbank is a regional and full-service commercial bank in Denmark that provides retail, corporate, investment and private banking services to private individuals, and small and mediumsize enterprises (SMEs). As of end-June 2017, the bank reported assets of DKK140 billion (around €18.9 billion), and operated through a network of 64 branches in Denmark and 3 branches in Germany, and had around 2,037 full-time employees.

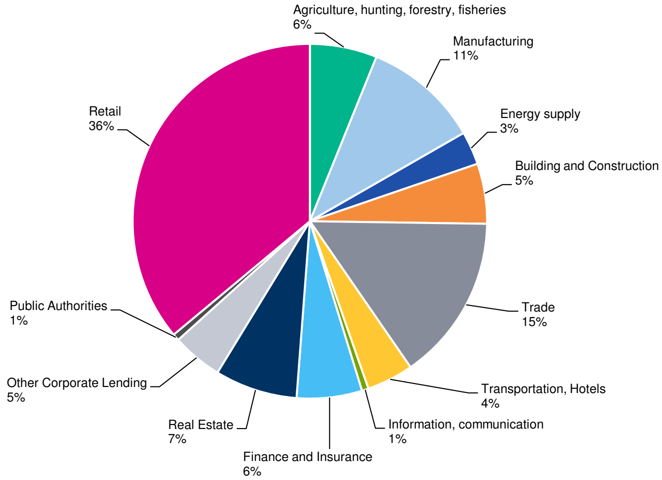
Detailed Credit Considerations

Still elevated - but improving - asset quality, as well geographic and real estate concentrations

Our assigned Asset Risk score of ba1 indicates that asset risk remains a relative weakness for Sydbank. However, following a weakening in asset quality during the financial crisis and the low-growth period that followed, Sydbank's asset-quality challenges have started to ease. At end-2016, the bank's problem loans (measured as gross loans subject to individual impairments) decreased to 6.1% of gross loans (2015: 8.0%), and we believe the improving trend to continue into 2018 given the ongoing economic recovery in Denmark, including in some sectors that have posed challenges in the recent past, such as agriculture and commercial real estate. Sydbank stands to benefit more than other Danish banks from this trend given that 63% of its credit exposure related to corporates and small and medium sized entities and only 36% to retail customers at end-June 2017.

Our assessment also takes into account Sydbank's 1) sizeable domestic real estate exposure, which represented around 48% of its on-balance sheet gross loans at end-June 2017; and 2) above-average loan growth. Since 2012, Sydbank's credit exposure (gross loans including guarantees) increased by around 23% to DKK91.8 billion at end-2016 from DKK74.2 billion in 2012. While the bank's corporate exposure fluctuated between DKK51-54 billion during the period, its retail lending activities increased to DKK37 billion from DKK23 billion. Effective as of January 2017, the ladder figure will exclude those loans which Sydbank has transferred to Totalkredit, reflecting an amended funding agreement with Denmark's largest MCI. While Sydbank remains liable for the credit risk represented by the loan-to-value interval of 60%-80%, those second-lien loans ("Prioritetslån"; DKK6.3 billion at end-June 2017) are removed from its balance sheet. As a result of the new funding agreement, Sydbank's on-balance sheet gross loan book decreased by 8.3% to DKK73.7 billion at end-June 2017 compared with DKK80.3 billion in 2016.

Exhibit 3
Sydbank's credit exposure by sector at end-June 2017



Source: Moody's Investors Service, company reports

At end-June 2017, around 26% of Sydbank's problems loans related to agriculture, hunting, forestry and fisheries (2016: 27%; 2015: 30%). The continued elevated level of problem loans illustrates the difficulties faced, especially by the Danish agricultural industry, which we expect to persist over the next 12 to 18 month, our outlook period. In August 2016, Sydbank announced to offer to selected agricultural clients the option to convert a portion of their debt into subordinated loan capital, in order to encourage farmers to continue to work towards increasing earnings. Sydbank's provision coverage for agriculture loans remained unchanged at 50%.

Solid capital ratios and ample capital buffer in excess of regulatory requirements

Our assigned a1 Capital score reflects Sydbank's solid capital position, a relative strength in the assessment of the bank's standalone profile. Our assessment also takes into account the expected reduction in its common equity tier 1 (CET1) ratio to around 13.5% over the medium term, a target announced under Sydbank's "blue growth" strategy. We expect that Sydbank will sustain its strong capital ratios and excess capital buffer over the foreseeable future, supported by its resilient profitability to generate capital internally.

At end-June 2017, Sydbank's CET1 ratio declined by around 50 basis points to 15.6%, compared with 16.1% in 2016, reflecting the effects from its share buyback programme as well as the repayment of hybrid capital instruments during April and May. Similarly, Sydbank's buffer in excess of its 10.4% individual solvency requirement, which includes the FSA's Pillar 1 and Pillar 2 components, declined to 5.8 percentage points (pp) at end-June 2017 from 8.0pp in 2016, but is still ample to provide the bank financial flexibility, if needed. Based on its medium-term capital target and the full phase-in of regulatory capital buffers, we expect Sydbank's excess capital buffer to decline to around 4pp until 2019.

Sydbank's risk density, measured as risk-weighted assets (RWA) compared with total assets, was adequate at 43% at end-June 2017 (2016: 43%), rendering the bank less sensitive to potential amendments in regulatory methods to calculating RWA, including floor requirements, compared to Danish MCIs. Over the same period, the bank's RWA decreased to DKK60.0 billion from DKK63.6 billion, mainly reflecting the relief from loans transferred to Totalkredit.

At 8.2% at end-June 2017 (2016: 8.0%), Sydbank's leverage ratio (measured as equity to assets) was high compared with other Nordic and international banks (which typically ranges between 4%-10% on average), further underpinning our favorable capital assessment.

Solid funding structure and liquidity profile

Our a3 Combined Liquidity Score reflects Sydbank's solid funding and liquidity profile. Sydbank's customer deposits (excluding deposits from pool plans) accounted for around 60% of total liabilities at end-June 2017 (2016: 55%). Further, the bank's reliance on short-term interbank liabilities decreased significantly between 2014 and 2016, and only accounted for 5% of assets at end-June 2017, which also reflects the positive effect from the change in the funding agreement with Totalkredit. Excluding repurchase (repo) transactions which accounted for around 7% of its total funding, unsecured bank lending represented around 3% of the total funding, down from more than 20% in 2007.

Similar to other Danish banks, Sydbank funds a portion of its retail and mortgage loans off-balance sheet through Totalkredit and, to a lesser extent, through DLR Kredit. Since the acquisition of BRFKredit by Jyske Bank A/S (A3 stable/Baa1 stable, baa1)[1] in 2014, Sydbank no longer uses BRFKredit to fund mortgages, but has become the largest distribution partner for Totalkredit, which has strengthened its position in this relationship, a credit positive.

At end-June 2017, Sydbank's liquid banking assets accounted for around 30% of tangible banking assets. However, our assigned baa1 liquidity score takes into account asset encumbrance, which results from the bank's market making activities in covered bonds. Overall, we consider the bank's liquidity to be relatively high compared with the Danish peers, an assessment which further support's our standalone credit assessment for Sydbank.

Resilient profitability supported by a reduction in credit costs

Sydbank's profitability has proven resilient over the last few years, and even showed signs of strengthening despite the low interest rate environment. We believe that the bank will continue to report healthy profits, sustained by lower credit costs, tighter cost control and greater business diversification, as per its so-called "blue growth" strategy announced in October 2015. This view is reflected in our assigned profitability score of baa1.

Sydbank's profitability is higher than those rated Danish peers who consolidate mortgage credit institutions (MCIs). This is because profitability for mortgage banking activities is typically lower than for commercial lending. For the period January to June 2017, the bank's return on assets (ROA) was 1.2% (1.0% in 2016 and 0.8% in 2015), which compares to between 0.3% to 0.5% for mortgage banking, based on our estimates. Sydbank's corporate loans accounted for around 60% of its credit exposure, while retail and mortgages exposure represented around 40%.

During 1H2017, Sydbank reported pre-tax profits of DKK1,047 million (+28% year-on-year), driven by a lower impairment charges, which fell to 1 basis points (bp) of its gross loans (2016: 3 bp; 2015: 42bp; 2014: 101bp). Moreover, the bank's investment portfolio earnings increased to DKK187 million (compared with a loss of DKK8 million during the same period last year), and trading income increased to DKK139 million (DKK123 million in HY 2016). Net interest income is Sydbank's main source of revenue, accounting for around half of operating income. Core income remained almost unchanged at DKK2.1 billion, unchanged compared with the same period last year. Operating expenses remained also unchanged at DKK1.4 billion year-over-year, and are expected to decline by around DKK50 million annually under the bank's "blue growth" strategy, compared with an annual cost base of DKK2.6 billion.

Support and structural considerations

Loss-given-failure

Sydbank is subject to the EU Bank Recovery and Resolution Directive (BRRD), which we consider to be an Operational Resolution Regime. We apply our Advanced Loss Given Failure (LGF) analysis to Sydbank's liabilities, considering the risks faced by the different debt and deposit classes across its liability structure at failure. We assume residual tangible common equity of 3% and losses post failure of 8% of tangible banking assets, a 25% run-off in "junior" wholesale deposits and a 5% run-off in preferred deposits. These are in line with our standard assumptions.

For Sydbank's A3 deposits, our LGF analysis indicates a low loss-given-failure, leading to one notch of rating uplift from the bank's baa1 Adjusted BCA. This is in part attributable to our assumption that only a very small percentage (10%) of Sydbank's deposit base can actually be considered junior and qualify as bail-in-able under the BRRD.

For Sydbank's Baa1 senior unsecured debt, our LGF analysis indicates a moderate loss-given-failure, leading us to position the rating in line with the bank's baa1 Adjusted BCA.

Government Support

The implementation of the EU BRRD has prompted us to reconsider the potential for government support to benefit certain creditors. We continue to consider the probability of government support for Sydbank to be low and hence do not assign any systemic support to the bank's long-term ratings.

Counterparty Risk (CR) Assessment

CR Assessments are opinions 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 suffered in the event of default; 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 (e.g., swaps), letters of credit, guarantees and liquidity facilities.

Sydbank's CR Assessment is positioned at A1(cr)/Prime-1(cr).

For Sydbank, our 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.

About Moody's Bank Scorecard

Our scorecard is designed to capture, express and explain in summary form our Rating Committee's judgement. When read in conjunction with our research, a fulsome presentation of our judgement is expressed. As a result, the output of our scorecard may materially differ from that suggested by raw data alone (though it has been calibrated to avoid the frequent need for strong divergence). The scorecard output and the individual scores are discussed in rating committees and may be adjusted up or down to reflect conditions specific to each rated entity.

Rating Methodology and Scorecard Factors

Exhibit 4

Sydbank A/S

Macro Factors		
Weighted Macro Profile	**Strong +**	**100%**

Factor	Historic Ratio	Macro Adjusted Score	Credit Trend	Assigned Score	Key driver #1	Key driver #2
Solvency						
Asset Risk						
Problem Loans / Gross Loans	7.4%	ba1	←→	ba1	Sector concentration	
Capital						
TCE / RWA	18.6%	aa2	←→	a1	Risk-weighted capitalisation	
Profitability						
Net Income / Tangible Assets	1.0%	baa1	←→	baa1	Expected trend	
Combined Solvency Score		a3		baa1		
Liquidity						
Funding Structure						
Market Funds / Tangible Banking Assets	18.2%	a3	←→	a3	Expected trend	
Liquid Resources						
Liquid Banking Assets / Tangible Banking Assets	30.2%	a2	←→	baa1	Stock of liquid assets	
Combined Liquidity Score		a3		a3		
Financial Profile				baa1		
Business Diversification				0		
Opacity and Complexity				0		
Corporate Behavior				0		
Total Qualitative Adjustments				0		
Sovereign or Affiliate constraint:				Aaa		
Scorecard Calculated BCA 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	25,654	21.6%	31,580	26.6%
Deposits	84,654	71.2%	78,728	66.2%
Preferred deposits	76,189	64.1%	72,379	60.9%
Junior Deposits	8,465	7.1%	6,349	5.3%
Senior unsecured bank debt	3,716	3.1%	3,716	3.1%
Dated subordinated bank debt	739	0.6%	739	0.6%
Preference shares (bank)	558	0.5%	558	0.5%
Equity	3,567	3.0%	3,567	3.0%
Total Tangible Banking Assets	118,888	100%	118,888	100%

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 Assessment	12.6%	12.6%	12.6%	12.6%	3	3	3	3	0	a1 (cr)
Deposits	12.6%	4.1%	12.6%	7.2%	1	1	1	1	0	a3
Senior unsecured bank debt	12.6%	4.1%	7.2%	4.1%	1	-1	0	0	0	baa1
Dated subordinated bank debt	4.1%	3.5%	4.1%	3.5%	-1	-1	-1	-1	0	baa2
Junior subordinated bank debt	3.5%	3.5%	3.5%	3.5%	-1	-1	-1	-1	-1	baa3
Non-cumulative bank preference shares	3.5%	3.0%	3.5%	3.0%	-1	-1	-1	-1	-2	ba1 (hyb)

Instrument class	Loss Given Failure notching	Additional Notching	Preliminary Rating Assessment	Government Support notching	Local Currency Rating	Foreign Currency Rating
Counterparty Risk Assessment	3	0	a1 (cr)	0	A1 (cr)	--
Deposits	1	0	a3	0	A3	A3
Senior unsecured bank debt	0	0	baa1	0	--	Baa1
Dated subordinated bank debt	-1	0	baa2	0	--	Baa2
Junior subordinated bank debt	-1	-1	baa3	0	--	(P)Baa3
Non-cumulative bank preference shares	-1	-2	ba1 (hyb)	0	--	Ba1 (hyb)

Source: Moody's Financial Metrics

Ratings

Exhibit 5

Category	Moody's Rating
SYDBANK A/S	
Outlook	Positive
Bank Deposits	A3/P-2
Baseline Credit Assessment	baa1
Adjusted Baseline Credit Assessment	baa1
Counterparty Risk Assessment	A1(cr)/P-1(cr)
Senior Unsecured	Baa1
Subordinate	Baa2
Jr Subordinate MTN	(P)Baa3
Pref. Stock Non-cumulative	Ba1 (hyb)
Other Short Term	(P)P-2

Source: Moody's Investors Service

Endnotes

1 The ratings shown are Jyske Bank's long-term deposit ratings and outlook, its long-term senior unsecured debt ratings and outlook, as well as the bank's baseline credit assessment.

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