

Rating Action: Moody's takes rating actions on two Danish banks because of MREL

16 May 2018

Limassol, May 16, 2018 -- Moody's Investors Service (Moody's) has today upgraded the long-term deposit and senior unsecured ratings of Sydbank A/S (Sydbank) to A2 from A3 and Baa1 respectively and maintained the positive outlook on these ratings. Sydbank's short-term deposit ratings were also upgraded to P-1 from P-2 and its short-term program rating to (P)P-1 from (P)P-2. At the same time, Moody's affirmed Jyske Bank A/S' (Jyske Bank) long-term deposit and senior unsecured ratings at **A3** and **Baa1** respectively and revised the outlook on the bank's senior unsecured ratings to positive from stable. The rating agency also affirmed Sydbank's and Jyske Bank's Baseline Credit Assessment (BCA) at baa1.

Today's rating actions incorporate Moody's forward-looking Loss Given Failure (LGF) analysis and the rating agency's expectations that the banks will issue additional loss-absorbing instruments, mainly in the form of non-preferred senior debt, referred to as "junior senior" unsecured notes by Moody's, in response to bank-specific minimum requirements for own funds and eligible liabilities (MREL) set by the Danish Financial Supervisory Authority (FSA). Future issuance of additional loss-absorbing debt will potentially reduce loss severity for junior depositors and senior unsecured creditors according to Moody's Advanced LGF analysis.

The full list of the affected ratings can be found at the end of this press release.

RATINGS RATIONALE

ACTION REFLECTS REDUCED LOSS SEVERITY FOR CREDITORS BECAUSE OF EXPECTED ISSUANCE OF ADDITIONAL LOSS-ABSORBING DEBT

Today's rating actions reflect Moody's expectation that the banks will need to issue additional loss-absorbing instruments, predominantly in the form of non-preferred senior (or junior-senior) debt, as a response to the Danish FSA's final bank-specific MREL.

Non-preferred senior debt is being introduced in Denmark through legislation in order to allow banks to issue this new class of debt, which is senior to subordinated debt and regulatory capital instruments and junior to other ordinary unsecured claims, that facilitates loss-absorption via a conversion or write-down in resolution. Moody's expects the passage of this draft legislation in the second quarter of 2018, with it taking effect on 1 July 2018. However, the law will apply retroactively to 1 January 2018, allowing institutions to issue non-preferred senior debt before July 2018.

The Danish FSA has recently published its final resolution principles for systemically important banks and set the MREL for Sydbank at 27.3% of the bank's risk exposure amount or 12.4% of its total liabilities and own funds and for Jyske Bank at 28.1% of risk exposure amount or 12.7% of total liabilities and own funds. For additional details on Denmark's MREL implementation please see the report "Banking: Denmark's MREL implementation for large banks will increase their loss-absorbing capacity" available here: https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC_1119488

MREL must be met by 1 July 2019, but until the end of 2021 banks can grandfather senior debt (senior preferred liabilities) issued before 1 January 2018 as part of their MREL. From 1 January 2022 onward, MREL must be met exclusively with capital and junior debt instruments that are written down or converted into equity before simple creditors in resolution or bankruptcy.

Moody's attaches a high degree of confidence to the likelihood that these banks will fulfil MREL along with the subordination required as of 2022, and therefore applies a forward looking time-horizon.

Bank-specific reasons for the rating actions are outlined below.

-- SYDBANK A/S

The upgrade to A2 of Sydbank's deposit and senior unsecured ratings reflects Moody's expectation that the

bank's issuance of junior debt will provide a greater cushion to protect these creditors resulting in higher rating uplift under the agency's Advanced LGF framework. Sydbank will have to issue MREL-eligible debt or increase capital before the July 2019 implementation date because it has no senior debt eligible to grandfather. Moody's estimates that the bank will need to issue around DKK5-6 billion of non-preferred senior debt over the coming quarters to meet its MREL in light of Sydbank's total capital ratio target of around 17%, versus a reported capital ratio of 20.2% as of end-March 2018.

Under these assumptions, Moody's LGF analysis indicates a very low loss-given-failure for deposits and senior unsecured debt, leading to a two notch uplift from the bank's baa1 Adjusted Baseline Credit Assessment (BCA), from which these ratings are notched.

The positive outlook on the bank's long-term deposit and senior unsecured ratings reflects the likely evolution of the bank's liability structure and further potential upward pressure that may arise on these ratings should the bank issue more junior instruments than the minimum amounts estimated above, for example in order to maintain a management buffer over MREL, leading to lower loss-given-failure.

Moody's affirmed Sydbank's baa1 standalone BCA reflecting the bank's (1) solid capitalisation with a common equity tier 1 (CET1) capital ratio of 16.6% and shareholders' equity-to-total assets of 8.4% as of March 2018; (2) sound funding structure and liquidity profile; and (3) sustained profitability, although under some pressure by the low interest rate environment. At the same time, Sydbank's BCA also takes into account credit concentrations, including to single borrowers and some higher-risk or volatile sectors, and the bank's through-the-cycle asset quality performance. However, the rating agency expects that low interest rates and the relatively robust economic growth in Denmark will continue to support the bank's asset quality over the next 12-18 months.

-- JYSKE BANK A/S

The affirmation of Jyske Bank's deposit and senior unsecured ratings and the change in outlook on the senior unsecured ratings to positive primarily reflects the likely evolution of the bank's liability structure. Moody's expects that the bank, in line with its public disclosures, will take advantage of the phase-in period and will gradually replace existing senior debt with MREL-eligible instruments, predominantly non-preferred senior debt. Moody's estimates that the bank will need to issue at least roughly DKK15-16 billion of non-preferred senior debt over the next three and a half years. These amounts are broadly in line with the bank's disclosures whereby its non-preferred senior issues will total EUR2.0-2.5 billion by end-2021.

This buffer of junior instruments issued by Jyske Bank over the coming years will provide additional subordination to the bank's deposits and senior unsecured debt, potentially reducing their expected loss. Under the rating agency's Advanced LGF framework, this could eventually result in rating uplift for Jyske Bank's senior unsecured debt of one notch above the bank's Adjusted BCA, up from no uplift currently, and align the rating with the bank's A3 deposit rating that already benefits from this level of uplift.

Moody's affirmed Jyske Bank's baa1 standalone BCA reflecting the bank's (1) solid capitalisation, with a reported Common Equity Tier 1 (CET1) ratio of 16.5% as of March 2018, while its equity-to-total assets ratio was adequate at 5.7%; and (2) recent robust asset quality performance and our expectation that this will be sustained over the coming quarters in light of the benign operating environment in Denmark. The baa1 BCA also takes into account the bank's relatively high market funding dependence. Moody's expects the bank's core profitability will continue to be pressured by the low interest rate environment, similar to domestic and other European peers.

WHAT COULD CAUSE RATINGS TO GO UP / DOWN

The outlook on Sydbank's deposit and senior unsecured ratings and on Jyske Bank's senior unsecured rating is positive, reflecting Moody's expectation that increased volumes of bail-in-able debt will likely improve the banks' creditors position in a resolution scenario.

The banks' ratings could also be upgraded following an improvement in their fundamental profiles, as indicated by the banks' BCAs, for instance if: (1) asset quality improves, especially in relation to agricultural lending, and credit concentrations reduce; (2) capital and leverage strengthen; and (3) profitability improves without an increase in the banks' risk profile.

The positive outlooks assigned to Sydbank's deposit and senior unsecured ratings and to Jyske Bank's senior unsecured rating would be revised to stable, however, if the banks do not issue junior debt volumes in line with Moody's expectation or if their liability structure changes in a way that negatively affects the volume or

subordination amounts of these instruments. There could also be negative rating pressure on the banks' senior unsecured and deposit ratings if there is a significant shrinkage in deposit, senior debt and subordinated instrument volumes, which could result in lower rating uplift under Moody's Advanced LGF framework.

The ratings could be downgraded due to a deterioration in the banks' fundamental credit profile, for instance if the rating agency observes: (1) a deterioration in asset quality or if their risk profile deteriorates (for example, as a result of increased exposures to more volatile asset classes); (2) a persistent weakening of the banks' recurring earnings power and operating efficiency; and/or (3) weaker capital ratios that are below the bank's current capital targets.

LIST OF AFFECTED RATINGS

Issuer: Sydbank A/S

Upgrades:

...LT Bank Deposits, Upgraded to A2 from A3, Outlook remains Positive

...ST Bank Deposits, Upgraded to P-1 from P-2

...Senior Unsecured Regular Bond/Debenture, Upgraded to A2 from Baa1, Outlook remains Positive

...Senior Unsecured MTN Program, Upgraded to (P)A2 from (P)Baa1

...Other Short Term Program, Upgraded to (P)P-1 from (P)P-2

Affirmations:

...Subordinate, Affirmed Baa2

...Pref. Stock Non-cumulative, Affirmed (P)Ba1 (hyb)

...Pref. Stock Non-cumulative, Affirmed Ba1 (hyb)

...Subordinate MTN Program, Affirmed (P)Baa2

...Junior Subordinate MTN Program, Affirmed (P)Baa3

...Adjusted Baseline Credit Assessment, Affirmed baa1

...Baseline Credit Assessment, Affirmed baa1

...LT Counterparty Risk Assessment, Affirmed A1(cr)

...ST Counterparty Risk Assessment, Affirmed P-1(cr)

Outlook Actions:

...Outlook, Remains Positive

Issuer: Jyske Bank A/S

Affirmations:

...LT Bank Deposits, Affirmed **A3** Stable

...ST Bank Deposits, Affirmed **P-2**

...Senior Unsecured Regular Bond/Debenture, Affirmed **Baa1**, Outlook changed to Positive from Stable

...Junior Subordinate, Affirmed **Baa3** (hyb)

...Pref. Stock Non-cumulative, Affirmed **Ba1** (hyb)

...Senior Unsecured MTN Program, Affirmed **(P)Baa1**

...Junior Subordinate MTN Program, Affirmed (P)Baa3

...Other Short Term Program, Affirmed (P)P-2

...ST Deposit Note/CD Program, Affirmed P-2

...Adjusted Baseline Credit Assessment, Affirmed baa1

...Baseline Credit Assessment, Affirmed baa1

...LT Counterparty Risk Assessment, Affirmed A1(cr)

...ST Counterparty Risk Assessment, Affirmed P-1(cr)

Outlook Actions:

...Outlook, Changed To Stable(m) From Stable

PRINCIPAL METHODOLOGY

The principal methodology used in these ratings was Banks published in April 2018. Please see the Rating Methodologies page on www.moodys.com for a copy of this methodology.

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