MOODY'S
INVESTORS SERVICE

Rating Action: Moody's affirms Sydbank's long-term deposit and senior ratings; outlook changed to positive from stable

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Baseline credit assessment upgraded to baa1

Frankfurt am Main, September 29, 2017 -- Moody's Investors Service (Moody's) has today affirmed Sydbank A/S's (Sydbank) long- and short-term deposit ratings at A3/P-2, its long-term senior unsecured debt ratings at Baa1 and its short-term program ratings at (P)P-2. Moody's also changed the outlook on Sydbank's long-term ratings to positive from stable.

The affirmation is the result of two components of the bank's credit profile that Moody's says have evolved in opposite directions, specifically 1) an improvement in the bank's standalone credit profile, owing to a strengthening in asset quality and profitability, which has resulted in an upgrade of the bank's baseline credit assessment (BCA) to baa1 from baa2, combined with 2) a reduction in the rating uplift that the bank's long-term ratings have been benefitting from under Moody's Advanced Loss Given Failure (LGF) framework following a recent decline in the amount of outstanding "bail-inable" debt issued by the bank as well as changed assumptions surrounding the amount of junior depositors.

The positive outlook assigned to the bank's long-term deposits and senior unsecured debt ratings reflects the agency's expectations of a high likelihood that the volume of senior unsecured debt will increase again towards the later part of the 12-18 month rating outlook horizon, while continued economic growth in Denmark will further support Sydbank's solvency and liquidity profiles.

Along with the BCA upgrade, Moody's has also upgraded Sydbank's subordinated debt ratings to Baa2 from Baa3, its junior subordinated MTN ratings to (P)Baa3 from (P)Ba1, its non-cumulative preferred stock rating to Ba1(hyb) from Ba2(hyb) as well as the bank's long-term CR Assessment to A1(cr) from A2(cr). Sydbank's short-term CR Assessment was affirmed at P-1(cr).

A full list of affected ratings and rating inputs can be found at the end of this press release.

RATINGS RATIONALE

-- UPGRADE OF SYDBANK'S BASELINE CREDIT ASSESSMENT

The upgrade of Sydbank's BCA reflects the bank's improved asset quality and sustained profitability despite the low interest rate environment and a reduction in the bank's capitalization.

Sydbank's problem loans as a percentage of gross loans have already decreased to 6.1% at end-2016, from 8.0% at the end of 2015 (based on Moody's calculations) and the agency expects 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 relates to corporates and small and medium sized entities.

Sydbank's profitability has proven resilient over the last few years, and even showed signs of strengthening despite the low interest rate environment. During 2016, Sydbank reported a return on assets (ROA) of 1.0%, compared with 0.80% in 2015. During 1H17, the improving trend continued, as underpinned by an annualized ROA of around 1.2%. Going forward, Moody's expect the bank to 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.

Moody's assessment also takes into account the expected reduction in the bank's common equity tier 1 (CET1) ratio to around 13.5%, which will lead to lower excess capital cushion against the bank's regulatory minimum capital requirements. During 1H2017, Sydbank's CET1 ratio declined by around 50 basis points to 15.6% at end-June 2017, compared with 16.1% in 2016, reflecting the effects from a new share buyback programme as well as the repayment of hybrid capital instruments.

REDUCTION IN CUSHION OF DEBT THAT CAN BE BAILED IN IF NEEDED IN TIMES OF STRESS

The other driver for the affirmation of Sydbank's long-term senior unsecured and deposit ratings relates to a recent decline in the amount of debt that could be bailed in by regulators in the unlikely event of the bank's failure, which in turn reduces the amount of protection that senior debt holders would benefit from under a bail in scenario, as calculated under Moody's Advanced Loss Given Failure (LGF) analysis.

The reduced volume of debt calculated by Moody's is attributable to the recent repayment of subordinated debt by the bank as well as changed assumptions regarding the volume of junior depositors that could be bailed in. The change in assumption reflects Moody's view that only around 10% of Sydbank's deposits can actually be considered junior and qualify as bail-in-able under BRRD, as opposed to the previous assumption of 26%.

For deposits, Moody's LGF analysis indicates a low loss-given-failure, leading to a one notch rating uplift from the bank's baa1 Adjusted BCA, from two notches of uplift previously.

For senior unsecured debt, Moody's LGF analysis indicates a moderate loss-given-failure, leading to a positioning of the rating in line with the bank's baa1 Adjusted BCA, compared to one notch of uplift previously.

-- RATIONALE FOR THE POSITIVE OUTLOOK ON DEPOSITS, SENIOR UNSECURED DEBT RATINGS

The rating agency also changed the outlook to positive from stable on Sydbank's long-term ratings, due to the expectation of an increase in the volume of senior unsecured debt towards the end of the outlook period. In addition, Moody's expects that the bank's key credit characteristics will remain supported by the benign domestic operating environment over the next 12 to 18 months.

WHAT COULD CHANGE THE RATING UP/DOWN

Upward pressure on Sydbank's ratings could develop from (1) further improvement in asset-quality metrics, especially in relation to more volatile segments such as agriculture and commercial real estate; (2) a further sustained and material improvement in the group's profitability, without a material increase in its risk profile; and (3) a strengthening of its capitalization beyond the rating agency's current expectations.

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 assets); and/or (3) the bank's capital ratio or profitability weakens.

Upward rating momentum for the long-term ratings of Sydbank could 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 Moody's 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.

Sydbank's long-term ratings could be downgraded following (1) a downgrade of the bank's BCA; or (2) a significant decrease in the bank's bail-inable debt cushions, leading to fewer notches of rating uplift under Moody's Advanced LGF analysis.

LIST OF AFFECTED RATINGS

Issuer: Sydbank A/S

The following ratings of Sydbank were affirmed:

- Long-term bank deposit ratings at A3, outlook changed to positive from stable

- Short-term bank deposit ratings at P-2

- Long-term senior unsecured debt rating at Baa1, outlook changed to positive from stable

- Senior Unsecured MTN, at (P)Baa1

- Other Short Term at (P)P-2

- Short-term Counterparty Risk Assessment at P-1(cr)

The following ratings and rating inputs of Sydbank were upgraded:

- Long-term Counterparty Risk Assessment to A1(cr) from A2(cr)

- Baseline Credit Assessment to baa1 from baa2

- Adjusted Baseline Credit Assessment to baa1 from baa2

- Subordinated debt to Baa2 from Baa3

- Subordinate MTN to (P)Baa2 from (P)Baa3

- Junior subordinated MTN ratings to (P)Baa3 from (P)Ba1

- Preferred Stock Non-cumulative to Ba1(hyb) from Ba2(hyb)

Outlook Action:

- Outlook changed to positive from stable

The principal methodology used in these ratings was Banks published in September 2017. Please see the Rating Methodologies page on www.moodys.com for a copy of this methodology.

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