MOODY'S
INVESTORS SERVICE

CREDIT OPINION
23 December 2016

Update

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RATINGS

Sydbank A/S

Domicile	Denmark
Long Term Debt	Baa1
Type	Senior Unsecured - Fgn Curr
Outlook	Stable
Long Term Deposit	A3
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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Sydbank A/S

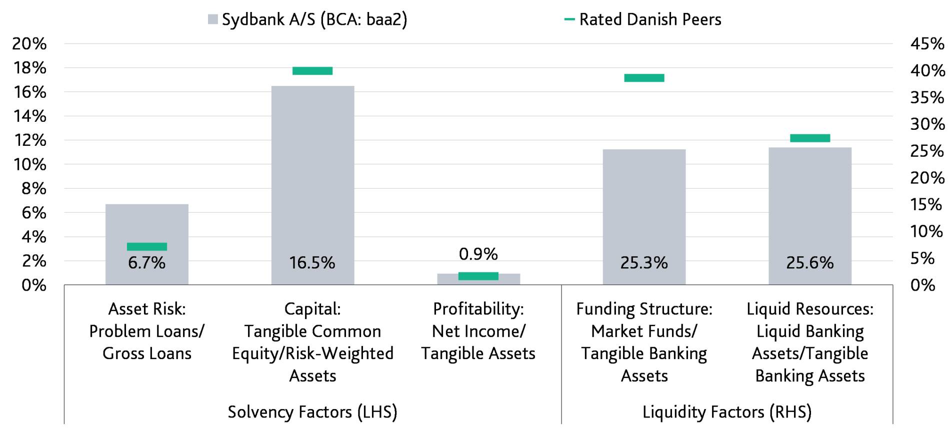
Update to Discussion of Key Credit Factors

Summary Rating Rationale

We assign a Baa1 long-term senior unsecured debt rating and an A3/Prime-2 deposit rating to Sydbank, as well as a baa2 baseline credit assessment (BCA). We also assign a long-term and short-term counterparty risk assessment (CRA) of A2(cr) / Prime-1(cr) to the bank.

Sydbank's standalone BCA of baa2 reflects a combination of a continued elevated level of problem loans and relatively low, albeit improving, profitability. The bank's high level of capitalisation and good liquidity mitigate these challenges. The bank's deposit rating of A3 and the senior unsecured debt ratings of Baa1 reflect the Advanced Loss Given Failure (LGF) analysis of the bank's own volume of debt and deposits and securities subordinated to them in our creditor hierarchy. Our Advanced LGF analysis for Sydbank suggests a very low loss given failure for depositors, and a low loss given failure for senior creditors, resulting in a two notch uplift to the deposit ratings and one-notch uplift for long-term senior debt rating from the group's BCA. The bank's ratings do not benefit from any government support uplift.

Exhibit 1
Rating Scorecard- Key Financial Ratios as of September 2016



Source: Moody's Financial Metrics

Credit Strengths

» Sydbank's BCA is supported by its “Strong+” Macro Profile

» Blue growth strategy to further improve core earnings

» Satisfactory capital position

» Improving funding structure and satisfactory liquidity profile

» Large volume of deposits resulting in deposit ratings benefiting from a very low loss-given-failure rate and two-notch uplift from the BCA. For senior unsecured debt, our LGF analysis indicates a one-notch uplift from the BCA

Credit Challenges

» Still elevated problem loans, but positive trend in asset quality on the back of a positive macro trend

Rating Outlook

Sydbank's ratings carry a stable outlook reflecting the bank's satisfactory capital buffers and our expectation that still elevated problem loans will benefit from the positive macro trend.

Factors that Could Lead to an Upgrade

» Upward pressure on Sydbank's ratings could develop from (1) a sustained increase in profitability from core operations without an increase in its risk profile; and/or (2) improved asset-quality metrics, especially in relation to more volatile segments such as agriculture and commercial real estate.

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

Key Indicators

Exhibit 2

Sydbank A/S (Consolidated Financials) [1]

	9-16[2]	12-15[2]	12-14[2]	12-13[3]	12-12[3]	Avg.
Total Assets (DKK million)	146,224.0	142,742.0	152,316.0	147,892.0	152,713.0	-1.1[4]
Total Assets (EUR million)	19,637.3	19,127.6	20,455.1	19,823.8	20,468.4	-1.0[4]
Total Assets (USD million)	22,068.4	20,778.2	24,751.7	27,316.1	26,985.4	-4.9[4]
Tangible Common Equity (DKK million)	10,994.0	11,024.0	10,887.0	9,805.0	9,870.0	2.7[4]
Tangible Common Equity (EUR million)	1,476.5	1,477.2	1,462.1	1,314.3	1,322.9	2.8[4]
Tangible Common Equity (USD million)	1,659.2	1,604.7	1,769.2	1,811.0	1,744.1	-1.2[4]
Problem Loans / Gross Loans (%)	6.7	7.1	8.6	9.1	7.0	7.7[5]
Tangible Common Equity / Risk Weighted Assets (%)	16.5	16.2	15.0	13.5	13.9	15.9[6]
Problem Loans / (Tangible Common Equity + Loan Loss Reserve) (%)	39.8	41.3	44.9	48.7	41.8	43.3[5]
Net Interest Margin (%)	1.7	1.7	1.9	1.9	2.1	1.8[5]
PPI / Average RWA (%)	2.8	2.5	2.8	2.8	3.3	2.7[6]
Net Income / Tangible Assets (%)	0.9	0.8	0.7	0.1	0.3	0.6[5]
Cost / Income Ratio (%)	58.1	60.1	57.4	56.5	52.1	56.8[5]
Market Funds / Tangible Banking Assets (%)	25.3	22.9	34.3	34.1	41.0	31.5[5]
Liquid Banking Assets / Tangible Banking Assets (%)	25.6	25.6	34.0	38.0	33.5	31.3[5]

Gross loans / Due to customers (%)	113.1	110.9	107.9	108.2	117.7	111.6[5]

[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] Compound Annual Growth Rate based on IFRS reporting periods [5] IFRS reporting periods have been used for average calculation [6] Basel III - fully-loaded or transitional phase-in & IFRS reporting periods have been used for average calculation
Source: Moody's Financial Metrics

Detailed Rating Considerations

SYDBANK'S BCA IS SUPPORTED BY ITS "STRONG+" MACRO PROFILE

Sydbank is almost exclusively active in Denmark with some minor operations in Germany accounting for 4% of its operating income. The bank's operating environment and hence its macro profile is therefore aligned with that of Denmark at "Strong +". Danish banks and mortgage credit institutions benefit from an improving operating environment and a strong institutional and legal framework.

Our assessment however, also factors in the sector's still large stock of problem loans, and high household debt. The financial sector has considerable wholesale funding needs, which – although reducing – creates some susceptibility to adverse events. In addition, the relatively fragmented structure of the banking industry and strong competition constrain profitability.

BLUE GROWTH STRATEGY TO FURTHER IMPROVE CORE EARNINGS

We believe Sydbank's strategic plan, announced in October 2015 and called Blue Growth, intends to maintain the positive trend in core earnings which we observe since the beginning of 2014. However, we consider the bank's objectives ambitious as the plan anticipates to increase its net operating income by around DKK240 million until 2018. In addition to Sydbank's targeted ratio of a 12% return on equity (2015: 10.1%, 2014: 9.8%), further elements include (1) an increase core income by a minimum of DKK50 million per annum; (2) reduce costs by DKK50 million per annum - compared with a current cost base of DKK2.6 billion; and (3) reach average impairment charges of a maximum of 50 basis points on its loan book during one economic cycle.

Sydbank's ability to deliver on its profitability targets, including tight cost control and fostering new business, will be a key factor to improve our assigned profitability score of ba2, in particular due to pressure on revenues from the low interest rate environment, low credit demand in Denmark, and the general high competition in the Danish banking sector. Net interest income is Sydbank's main source of revenue, accounting for around two thirds of operating income. During the first nine months of 2016, Sydbank reported pretax profits of DKK1,309 million (20% increase year-on-year), driven by improvements in costs, impairment charges, investment portfolio earnings and non recurring items, while core income declined by 5% to DKK3,131 million.

Sydbank's profitability is in line with the average for rated Danish peers. For the first nine months of 2016, the bank's net income to tangible banking asset ratio was 0.9%. We note the positive movement in the bank's impairment charges, accounting for around 8% of pre-provision income (PPI) in the first nine months of 2016 compared with around 19% in the same period last year. While the Danish banking sector has been deleveraging over the last years, Sydbank has been able to maintain the size of its loan book also on the back of gaining market share from competitors. At end-September 2016, the bank's loan book increased by 6.8% compared with the same period last year.

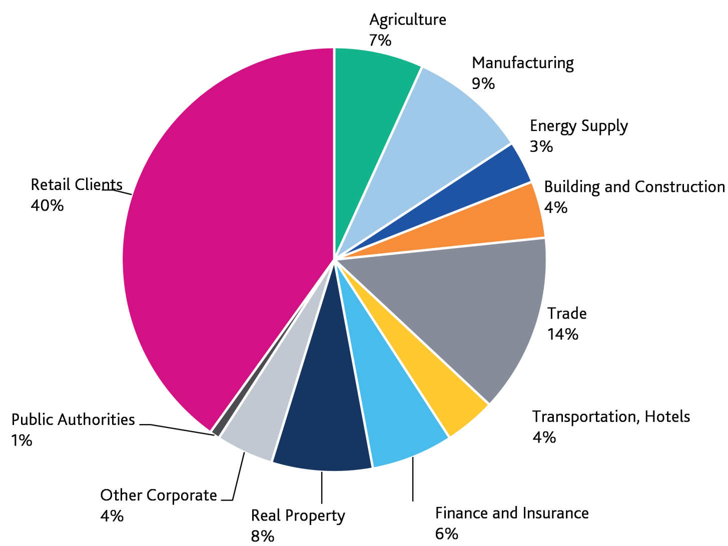
STILL ELEVATED PROBLEM LOANS, BUT POSITIVE TREND IN ASSET QUALITY ON THE BACK OF POSITIVE MACRO TREND

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-September 2016, Sydbank's problem loans (measured as gross loans subject to individual impairments) amounted to 6.7% of gross loans, down from 7.1% at year-end 2015 (8.6% at year-end 2014). Problem loans remain elevated both relative to the pre-crisis level (2% at end- December 2008) and to many Nordic and European peers. We expect the more positive recent trend to continue, reflecting the more benign Danish macro environment.

In parallel with the positive trend in problem loans and an already adequate level of balance sheet reserves against these (provision coverage of 66% at end-September 2016), Sydbank's loan loss provisioning has declined significantly in recent years, resulting in a material increase in the group's profitability.

The continued elevated level of problem loans reflects the relatively high impact of the Danish financial crisis on the economy and prolonged weak economic growth following the start of the crisis, which only recently started to improve. In addition, in recent years the Danish FSA tightened impairment rules with respect to the treatment and valuation of collateral. At the end of September 2016, approximately 30% of problems loans were related to agriculture, hunting, forestry and fisheries, in line with year-end 2015. The continued elevated level of problem loans illustrates the difficulties faced, especially by the Danish agricultural industry, which we expect to persist in the coming years. In August 2016 Sydbank announced it will offer selected agricultural clients the option to convert part of their debt into subordinated loan capital in a bid to create better prospects and encourage farmers to continue to work towards increasing earnings. The bank expects to reduce impaired loans by around DKK 1.0 billion and approximately DKK 0.5 billion to be written off. The bulk of the selected exposures is expected to be converted in the fourth quarter of 2016.

Exhibit 3
Breakdown of Sydbank's loan portfolio by sector at end-September 2016



Source: Moody's, company reports

Around 40% of Sydbank's loan portfolio is to retail customers. As mortgage loans financed by Totalkredit/Nykredit and DLR do not appear on Sydbank's balance sheet, many on-balance-sheet loans benefit from second liens on collateral. Sydbank provides a guarantee on losses on loans transferred to DLR Kredit, whereas losses on loans transferred to Totalkredit/Nykredit are deducted from the fees paid by these mortgage credit institutions.

In November 2015, the European Banking Authority (EBA) published the results of its transparency exercise which shows elevated NPL levels at 11.3% compared to the bank's reported 8.6% NPL ratio at that time reflecting differences in the classification of loans that are still performing, but may become impaired.

SATISFACTORY CAPITAL POSITION

Our assigned aa3 Capital score reflects Sydbank's satisfactory capital position, a relative strength in the assessment of the bank's standalone profile. As of September 2016, Sydbank's Tier 1 and total capital ratios were 16.2% and 18.0%, respectively (15.9% and 17.6% as of end -December 2015), compared with an individual solvency requirement according to the Danish FSA calculation of 10.0% in September 2016 (9.7% at end-2015). In February 2016, Sydbank initiated a share buyback programme of DKK350 million and will be completed by 31 December 2016.

Considering Sydbank's risk profile and internal capital-generation capability, we continue to view its economic capital as satisfactory. In July 2016 Sydbank participated in the Danish FSA stress test, based on the EBA's EU-wide stress test common methodology and guidelines. The results revealed that Sydbank, comfortably exceeded the minimum capital ratios that result from the ECB's Supervisory Review and Evaluation Process (SREP), even in the adverse scenario (12.6% capital ratio).

IMPROVING FUNDING STRUCTURE AND SATISFACTORY LIQUIDITY PROFILE

Our baa1 Combined Liquidity Score reflects Sydbank's improved funding profile. Sydbank's dependence on short-term interbank liabilities has decreased significantly. Sydbank's deposit base represented around 62% of total funding at end-September 2016 (64% at end-2015) and has shown an increasing trend in recent years, while the bank's reliance on short-term interbank funding has continued to fall. Excluding repo transactions which account for 6% of its total funding, unsecured bank lending accounts for around 10% of the total funding down from more than 20% in 2007, but remains short term. Given the reduction in reliance on interbank funding we see the baa1 Funding Structure score on an improving trend.

In common with other regional and local banks, Sydbank funds its retail and commercial mortgage loans off balance sheet through mainly Totalkredit/Nykredit Realkredit and to a lesser extent DLR Kredit (unrated). The April 2014 acquisition of BRFKredit (unrated) by Jyske Bank (long-term deposit rating of A3) means that Sydbank no longer uses BRFKredit to fund mortgages, but has become the largest distribution partner for Nykredit/Totalkredit, which has strengthened its position in this relationship, a credit positive.

At the end of September 2016, liquid banking assets accounted for around 26% of tangible banking assets (similar level compared to 2015 compared to 34% in 2014) part of which are used for repo transactions. The ratio is at a similar level to recent years and compares well with those of peers. We consider the bank's liquidity to be relatively high compared with the Danish requirement. Our Liquid Resources score reflects our view that liquidity is a relative strength for Sydbank's standalone credit assessment.

Notching Considerations

Affiliate Support

Loss Given Failure

Sydbank is subject to the EU Bank Recovery and Resolution Directive, which we consider to be an Operational Resolution Regime. 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, a 5% run-off in preferred deposits, and assign a 25% probability to deposits being preferred to senior unsecured debt. These are in line with our standard assumptions.

The bank's A3 deposit rating and Baa1 senior unsecured debt ratings take into account our LGF analysis of the bank's own volume of debt and deposits and securities subordinated to them in our creditor hierarchy. Our advanced LGF analysis for Sydbank suggests a very low loss given failure for depositors, and a low loss given failure for senior creditors, resulting in a two-notch uplift to the deposit ratings and one-notch uplift for long-term senior debt rating from the bank's BCA.

Government Support

The implementation of the EU Bank Recovery and Resolution Directive has caused us to reconsider the potential for government support to benefit certain creditors. Within the EU, we now assess the probability of government support to be moderate only for the largest and most complex institutions. For Sydbank, we assess the probability of government support to be low, meaning that the bank's debt and deposit ratings no longer benefit from rating uplift from government support.

COUNTERPARTY RISK 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 A2(cr)/Prime-1(cr). The CR Assessment is positioned three notches above the adjusted BCA of baa2, based on the substantial cushion against default provided to the senior obligations represented by the CR Assessment by subordinated instruments. The main difference with our Advanced LGF approach used to determine instrument ratings is that the CR Assessment captures the probability of default on certain senior obligations, rather than expected loss, thereby focusing purely on subordination and taking no account of the volume of the instrument class.

Rating Methodology and Scorecard Factors

Exhibit 4

Sydbank A/S

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

Financial Profile						
Factor	**Historic Ratio**	**Macro Adjusted Score**	**Credit Trend**	**Assigned Score**	**Key driver #1**	**Key driver #2**
Solvency						
Asset Risk						
Problem Loans / Gross Loans	7.9%	ba1	←→	ba1	Expected trend	
Capital						
TCE / RWA	16.5%	aa2	←→	aa3	Risk-weighted capitalisation	
Profitability						
Net Income / Tangible Assets	0.6%	baa2	↓	ba2	Earnings quality	
Combined Solvency Score		a3		baa2		
Liquidity						
Funding Structure						
Market Funds / Tangible Banking Assets	22.9%	baa1	←→	baa1	Extent of market funding reliance	
Liquid Resources						
Liquid Banking Assets / Tangible Banking Assets	25.6%	a3	←→	a3	Stock of liquid assets	
Combined Liquidity Score		baa1		baa1		
Financial Profile				baa2		
Business Diversification				0		
Opacity and Complexity				0		
Corporate Behavior				0		
Total Qualitative Adjustments				0		
Sovereign or Affiliate constraint:				Aaa		
Scorecard Calculated BCA range				baa1-baa3		
Assigned BCA				baa2		
Affiliate Support notching				0		
Adjusted BCA				baa2		

Balance Sheet	**in-scope (DKK million)**	**% in-scope**	**at-failure (DKK million)**	**% at-failure**
Other liabilities	44,234	33.4%	52,248	39.4%
Deposits	78,567	59.2%	70,553	53.2%
Preferred deposits	58,140	43.8%	55,233	41.6%
Junior Deposits	20,427	15.4%	15,321	11.6%
Senior unsecured bank debt	3,723	2.8%	3,723	2.8%
Dated subordinated bank debt	825	0.6%	825	0.6%
Preference shares (bank)	1,303	1.0%	1,303	1.0%
Equity	3,979	3.0%	3,979	3.0%
Total Tangible Banking Assets	132,631	100%	132,631	100%

Debt class	De jure waterfall		De facto waterfall		Notching		LGF notching guidance versus 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	19.0%	19.0%	19.0%	19.0%	3	3	3	3	0	a2 (cr)
Deposits	19.0%	4.6%	19.0%	7.4%	2	2	2	2	0	a3
Senior unsecured bank debt	19.0%	4.6%	7.4%	4.6%	2	-1	1	1	0	baa1
Dated subordinated bank debt	4.6%	4.0%	4.6%	4.0%	-1	-1	-1	-1	0	baa3
Junior subordinated bank debt	4.0%	4.0%	4.0%	4.0%	-1	-1	-1	-1	-1	ba1
Non-cumulative bank preference shares	4.0%	3.0%	4.0%	3.0%	-1	-1	-1	-1	-2	ba2 (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	a2 (cr)	0	A2 (cr)	--
Deposits	2	0	a3	0	A3	A3
Senior unsecured bank debt	1	0	baa1	0	--	Baa1
Dated subordinated bank debt	-1	0	baa3	0	--	Baa3
Junior subordinated bank debt	-1	-1	ba1	0	--	Ba1
Non-cumulative bank preference shares	-1	-2	ba2 (hyb)	0	--	Ba2 (hyb)

Source: Moody's Financial Metrics

Ratings

Exhibit 5

Category	Moody's Rating
SYDBANK A/S	
Outlook	Stable
Bank Deposits	A3/P-2
Baseline Credit Assessment	baa2
Adjusted Baseline Credit Assessment	baa2
Counterparty Risk Assessment	A2(cr)/P-1(cr)
Senior Unsecured	Baa1
Subordinate	Baa3
Jr Subordinate MTN	(P)Ba1
Pref. Stock Non-cumulative	Ba2 (hyb)
Other Short Term	(P)P-2

Source: Moody's Investors Service

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