

CREDIT OPINION

28 March 2022

Update



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RATINGS

Sparbanken Syd

Domicile	Sweden
Long Term CRR	A3
Type	LT Counterparty Risk Rating - Fgn Curr
Outlook	Not Assigned
Long Term Debt	Not Assigned
Long Term Deposit	Baa1
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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Sparbanken Syd

Update following ratings affirmation - outlook changed to stable

Summary

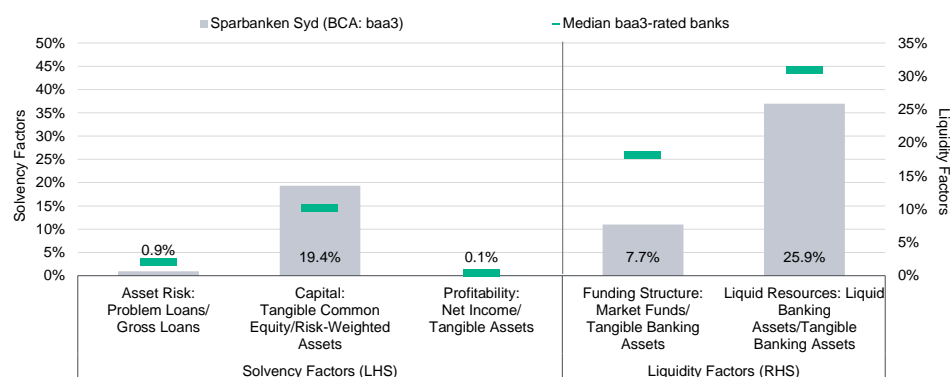
[Sparbanken Syd](#)'s issuer and deposit ratings of Baa1/P-2 incorporate the Baseline Credit Assessment (BCA) and Adjusted BCA of baa3, and very low expected losses given failure because of considerable loss-absorbing liabilities protecting depositors, resulting in a two-notch uplift as indicated by our Advanced Loss Given Failure (LGF) analysis.

Sparbanken Syd's baa3 BCA reflects its stable asset quality and strong capitalisation, balanced against its consistently low profitability. Since February 2022 Sparbanken Syd is part-owner of [Borgo AB](#) (Baa2 stable, baa3)¹ (Borgo), a Sweden-based credit market company that distributes mortgages for its owner banks. The ownership will enable Sparbanken Syd to fund its mortgages through Borgo, enabling a repurchase its mortgage book from [SBAB Bank AB \(publ\)](#) (A1/A1, stable, baa1) (SBAB) and provide a sustainable source of funding for the bank's future mortgage activities.

The bank's Counterparty Risk (CR) Assessment is positioned at A3(cr)/P-2(cr) and Counterparty Risk Ratings (CRRs) are positioned at A3/P-2, incorporating three notches of uplift to the BCA according to our LGF analysis.

Exhibit 1

Rating Scorecard - Key financial ratios



These represent our [Banks Methodology](#) scorecard ratios, whereby asset risk and profitability reflect the weaker of either the latest reported or the average of the last three year-end and latest reported ratios. Capital is the latest reported figure. Funding structure and liquid resources ratios reflect the latest year-end figures.

Source: Moody's Financial Metrics™

Credit strengths

- » Good asset quality with low levels of problem loans, although exposed to geographical and sector concentrations
- » Sound capitalisation
- » Sizeable liquidity portfolio and large volume of deposits

Credit challenges

- » Weaker profitability and cost efficiency than those of its Nordic peers
- » Weak governance and limited effectiveness in implementing its business strategy

Outlook

The change to stable from negative outlook on the long-term deposit and issuer ratings reflects the progress that Sparbanken Syd has made in finding a solution for setting up a long-term source of funding for its mortgage activities via Borgo, removing the uncertainty over whether the bank would be able to put in place a long-term funding alternative to SBAB and determining capital needs.

Factors that could lead to an upgrade

Sparbanken Syd's ratings could be upgraded based on evidence of a sustainable funding strategy and continued high liquidity buffers combined with higher recurring profitability while maintaining a prudent risk appetite. Furthermore, the ratings could be upgraded if the bank significantly increases the levels of loss-absorbing obligations protecting creditors and depositors in case of failure.

Factors that could lead to a downgrade

Sparbanken Syd's ratings could be downgraded if:

- » The partnership with Borgo is unsuccessful and the bank is unable to establish a stable funding source to finance its mortgage business
- » Its profitability deteriorates, leading to recurring losses and lower capital generation
- » Its asset quality deteriorates significantly
- » Exposure to high-risk sectors increases
- » Loss absorbing liabilities decrease, lowering the cushion of protection to creditors and depositors in case of failure

This publication does not announce a credit rating action. For any credit ratings referenced in this publication, please see the ratings tab on the issuer/entity page on www.moody's.com for the most updated credit rating action information and rating history.

Key indicators

Exhibit 2

Sparbanken Syd (Unconsolidated Financials) [1]

	12-21 ²	12-20 ²	12-19 ²	12-18 ²	12-17 ²	CAGR/Avg. ³
Total Assets (SEK Million)	12,746.6	11,554.4	10,625.7	10,633.9	10,143.9	5.9 ⁴
Total Assets (USD Million)	1,408.9	1,406.9	1,135.1	1,199.4	1,238.9	3.3 ⁴
Tangible Common Equity (SEK Million)	1,207.1	1,189.5	1,181.8	1,179.2	1,169.2	0.8 ⁴
Tangible Common Equity (USD Million)	133.4	144.8	126.2	133.0	142.8	(1.7) ⁴
Problem Loans / Gross Loans (%)	0.8	1.0	1.0	1.0	0.8	0.9 ⁵
Tangible Common Equity / Risk Weighted Assets (%)	19.4	22.4	20.3	18.8	19.2	20.0 ⁶
Problem Loans / (Tangible Common Equity + Loan Loss Reserve) (%)	5.9	5.6	5.8	5.9	5.0	5.6 ⁵
Net Interest Margin (%)	1.5	1.6	1.6	1.6	1.7	1.6 ⁵
PPI / Average RWA (%)	0.5	0.4	0.1	0.5	0.5	0.4 ⁶
Net Income / Tangible Assets (%)	0.2	0.1	0.0	0.2	0.3	0.1 ⁵
Cost / Income Ratio (%)	91.2	93.1	97.1	89.0	88.3	91.7 ⁵
Market Funds / Tangible Banking Assets (%)	7.7	3.5	6.8	9.6	10.1	7.5 ⁵
Liquid Banking Assets / Tangible Banking Assets (%)	25.9	39.8	35.5	31.8	27.2	32.1 ⁵
Gross Loans / Due to Customers (%)	90.4	70.3	79.4	86.9	94.1	84.2 ⁵

[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

Sparbanken Syd is Sweden's oldest savings bank, primarily operating in Skåne County in the southernmost parts of Sweden. Operating for nearly 200 years, the bank is well established in the region among retail as well as corporate customers. Sparbanken Syd is the only independent savings bank in Sweden, with its ownership structured in an independent foundation, in accordance with its structure as a savings bank. As of year-end 2021, the bank had total assets of SEK12.7 billion (€1.2 billion).

Recent developments

On 14 February 2022, Sparbanken Syd became a new owner in Borgo and will join as member of Borgo's board. Borgo is already co-owned by ICA Banken, Ikano Bank, Söderberg & Partners and the Bank of Åland. Sparbanken Syd will be able to use Borgo to finance the repurchase of mortgages originated since its previous funding partnership with SBAB Bank AB was terminated in November 2017, without raising additional capital instruments.

The new funding arrangement will also allow Sparbanken Syd to continue originating mortgages. Distribution using Borgo will likely start during 2022 while the timing for the transfer of Sparbanken Syd mortgages from SBAB to Borgo has not been disclosed.

Partnership with SBAB

In late November 2017, SBAB unilaterally terminated an asset purchase programme it had previously established with Sparbanken Syd to fund the latter bank's mortgages. The funding arrangement enabled Sparbanken Syd (and other banks) to sell mortgages to SBAB, with most of the bank's mortgages (representing a large share of the bank's total lending) being funded through this channel. The white label partnership enabled Sparbanken Syd to sell its mortgages to SBAB for a commission, thereby moving them off the balance sheet and reducing its funding needs, as well as credit risk and capital requirements, while maintaining customer relationships. The partnership formally ended in November 2019, but Sparbanken Syd has some flexibility to buy back the originated mortgages, latest by December 2023.

Detailed credit considerations

Sweden's Strong + Macro Profile underpins Sparbanken Syd's BCA

Sparbanken Syd's ratings incorporate our assessment of Sweden's Macro Profile of Strong +², reflecting a diversified and competitive economy, robust public institutions and a stable political environment that supports consensus-oriented policymaking. However, we view Swedish households' high debt levels and the multiyear growth in household debt as key vulnerabilities in the financial system, as reflected in our Macro Profile.

Moderate asset risk deterioration

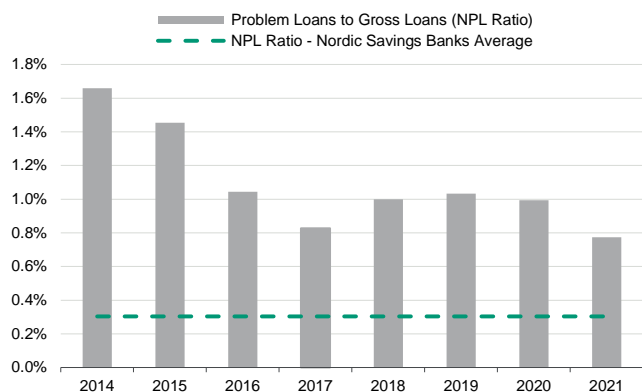
While the Swedish economy has recovered well after the pandemic, we expect asset quality to weaken moderately in 2022, as problem loans is a lagging indicator and as authorities support measures are phased out. Sparbanken Syd's problem loans to gross loans ratio decreased to 0.8% as of year-end 2021, significantly lower than the 1.7% reported in 2014 (see Exhibit 3).

The bank's asset risk is strong by global standards and has stabilised in recent years. The bank has a significant share of exposure to small and medium-sized enterprises (SMEs) in the Skåne region. Such a concentration can pose a higher risk in a downturn, and these customers account for around half of the risk that the bank retains on its balance sheet. From November 2020, all new mortgages are held on Sparbanken Syd's balance sheet following the termination of the contract with SBAB, but this change will have limited effects on asset risk during the outlook period.

As of year-end 2021, the total originated loan volume (mostly mortgages) sold to SBAB decreased by 25% to SEK6.9 billion from SEK9.2 billion recorded at year-end 2020 since Sparbanken Syd no longer selling new loans to SBAB. Instead, retail lending increased on its own balance sheet by 51% to SEK6.2 billion as of year-end 2021.

Exhibit 3

Asset risk has remained relatively stable during the last decade

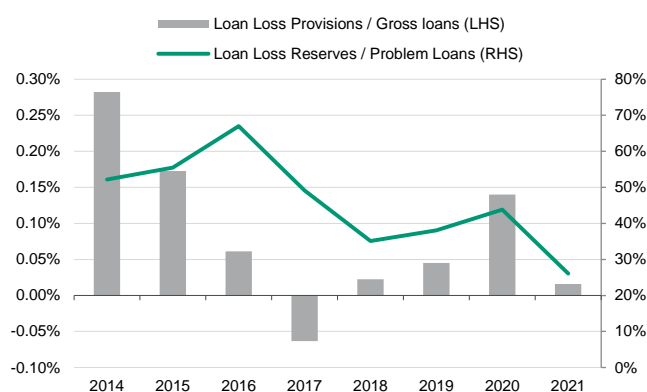


Average of Nordics savings banks' problem loans/gross loans (including Skandiabanken AB and Lansforsakringar Bank AB) that we rate as of year-end 2021 or latest available.

Source: Moody's Investors Service

Exhibit 4

Sparbanken Syd has a low cost of risk



Source: Moody's Investors Service

The assigned Asset Risk score of baa1 reflects the low level of problem loans, as well as geographical and sector concentration risks.

Sound capitalisation, but weak internal capital generation

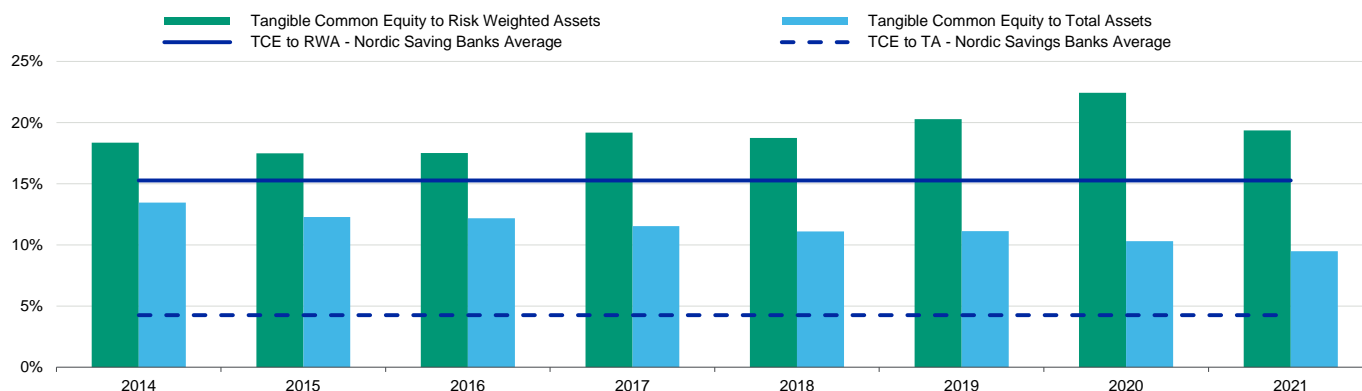
Sparbanken Syd's capitalisation is strong, with tangible common equity (TCE) to risk-weighted assets (RWA) of 19.4% and TCE to total assets of 9.5% as of year-end 2021. However, the bank's profitability is low, leading to weak internal capital generation.

Sparbanken Syd has become a co-owner in Borgo with a capital commitment, decreasing the bank's capitalisation by a limited amount. We expect a lower TCE/RWA ratio of 18.7%, as Sparbanken Syd makes the initial investment in Q1 2022. However, we also expect Sparbanken to transfer mortgages on its own book to Borgo in the future reducing RWAs.

The bank reported a Common Equity Tier 1 (CET1) capital ratio of 18.6% as of year-end 2021, down from 22.4% as of year-end 2020. Its total capital adequacy ratio decreased to 21.0% as of year-end 2021 from 25.3% as year-end 2020. The decrease in Sparbanken Syd's capital metrics relate to the significant increase in lending on its own balance sheet. The bank had a sizeable buffer above its regulatory minimum CET1 requirement of 13.1%, including a Pillar 2 requirement of 2.6%, at year-end 2021. Sparbanken Syd applies the standardised approach for measuring credit risk.

We expect raising additional capital in times of stress to be difficult given the bank's organisational structure as a savings bank without strategic corporate shareholders or direct capital market access. The lack of access to capital also impedes large acquisitions thereby constraining the option of acquiring the mortgages currently with SBAB, eventually losing the revenue stream from those mortgages.

Exhibit 5

Sparbanken Syd has strong capital metrics

Average of Nordic savings banks we rate (including Skandiabanken AB and Länsförsäkringar Bank) as of year-end 2021 or latest available.

Source: Moody's Investors Service

Sparbanken Syd's Capital score of a1 is two notches below the macro-adjusted score, reflecting our view of that the bank's capitalisation is strong albeit challenged by the weak internal capital generation due to the bank's consistently low profitability and lack of direct access to capital markets. Furthermore, we expect capitalisation to decrease over the outlook period of 12 to 18 months due to the capital commitment in Borgo.

Weak profitability due to limited economies of scale and ability to grow.

As a pure savings bank, Sparbanken Syd operates with low targets on return on equity, between 2% to 5%. Furthermore, its weak profitability is challenged by limited economies of scale and the low interest rate environment.

Sparbanken Syd improved its net income to a still very low SEK19.1 million for 2021 compared to SEK7.7 million for the same period in 2020. Net interest income improved moderately by 4.9% in 2021 because of increased lending on the bank's own balance sheet. The bank continues to earn interest on the mortgages that are held on SBAB's balance sheet until end of December 2023, but keeping them on their own balance sheet which would generate higher margins. The bank's operating expenses grew slightly due to the set-up of the partnership with Borgo. In addition, net fee and commission income increased to SEK112 million in 2021 from SEK106 million in the year-earlier period, because of increased brokered savings in funds and insurance.

Although the bank is increasing its focus on cost control, the cost-to-income ratio remained significantly weaker than peers at 91.2% in 2021 and we expect efficiency to remain a challenge. When Sparbanken Syd transfers its on-balance sheet mortgages to Borgo, there will be capital and funding resources to grow the SME segment, which typically has higher margins than retail lending, but could also lead to higher asset risk.

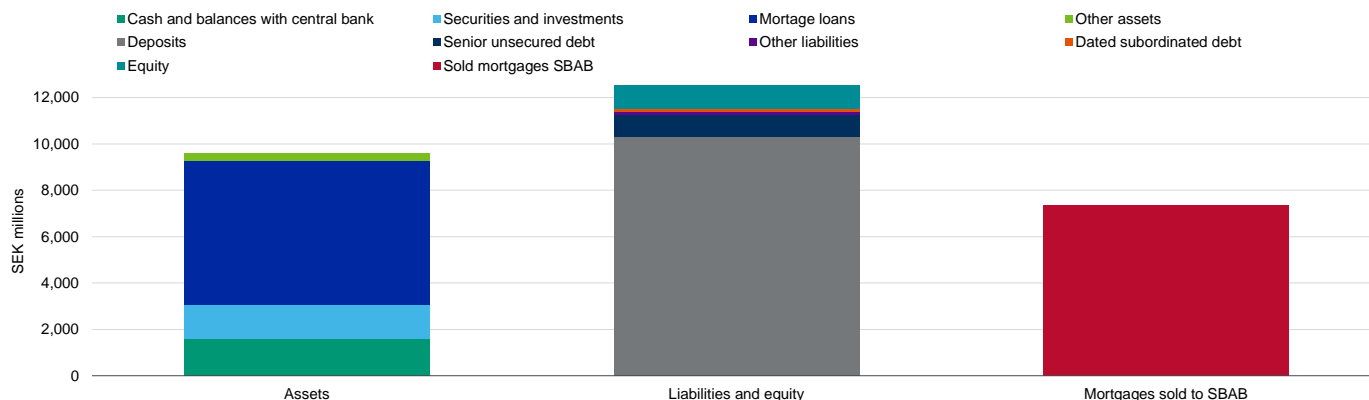
We assign Sparbanken Syd a Profitability score of b3, reflecting Sparbanken Syd's low profitability and ongoing profitability challenges.

Positive developments regarding Sparbanken Syd's funding strategy

Sparbanken Syd is primarily deposit funded with deposit funding representing 90% of non-equity funding as of year-end 2021 and the 12-month deposit growth of 6%. The Borgo agreement aims to ensure access to covered bond funding because the current funding sources, deposits and senior unsecured debt, are insufficient to fund a repurchase of the entire pool of mortgages from SBAB.

The agreement with Borgo aims to fund growth in new mortgages and the repurchase of mortgages currently held by SBAB, SEK6.9 billion as of year-end 2021, which is large compared to the combined retail (SEK6.2 billion) and corporate lending (SEK3.1 billion) retained on Sparbanken Syd's own balance sheet.

Exhibit 6

Sparbanken Syd's assets, funding and mortgages sold to SBAB as of year-end 2021

Source: Company reports

Sparbanken Syd has SEK900 million outstanding in senior unsecured debt at year-end 2021. Sparbanken Syd's market funding ratio is lower than that of its peers at 7.7% as of year-end 2021, up from 3.5% as of year-end 2020. Furthermore, the bank has a SEK150 million subordinated bond maturing in 2024 (not included in the market funding ratio).

We assign the bank a Funding Structure score of baa3, balancing the positive developments regarding the bank's funding strategy against the dependency on an external partner for funding.

Liquid assets provide a buffer against increasing wholesale funding

We assign Sparbanken Syd a Liquidity score of a3, reflecting its stock of high-quality liquid assets, comprising highly rated covered bonds and government securities. This resulted in liquid assets to tangible banking assets of 25.9% as of year-end 2021. Additionally, Sparbanken Syd has a granular deposit base, which further underpins the bank's liquidity.

The transfer of mortgages to Borgo is expected to lead to a liquidity surplus (expecting cash of SEK4.2 billion as of year-end 2022 compared to SEK1.5 billion as of year-end 2021), leading to a liquidity ratio of almost 50% in year-end 2022. We expect Sparbanken Syd to reduce the surplus and slowly come down to a liquidity ratio of around 30% over the coming years to, as Sparbanken Syd will increase lending to corporates.

ESG considerations

In line with our general view for the banking sector, Sparbanken Syd has a low exposure to environmental risks and moderate exposure to social risks. See our [environmental risk heat map](#) and [social risk heat map](#) for further information.

The most relevant social risks for banks arise from the way they interact with their customers. Social risks are particularly high in the area of data security and customer privacy, which are mitigated by sizeable technology investments and banks' long track record of handling sensitive client data. Fines and reputational damage because of product mis-selling or other types of misconduct are a further social risk. Social trends are also relevant in a number of areas, such as shifting customer preferences towards digital banking services, increasing information technology costs, ageing population concerns in several countries affecting the demand for financial services or socially driven policy agendas that may translate into regulation that affects banks' revenue base. Furthermore, we regard the coronavirus pandemic as a social risk under our environment, social and governance (ESG) framework, given the substantial implications for public health and safety. Overall, banks face moderate social risks.

Governance is highly relevant for Sparbanken Syd, as it is to all competitors in the banking industry. Corporate governance weaknesses can lead to a deterioration in a company's credit quality, while governance strengths can benefit its credit profile. Governance risks are largely internal rather than externally driven.

Sparbanken Syd's ratings include a one-notch negative adjustment to Corporate Behaviour reflecting the remaining uncertainties in executing the funding plan and longer term challenges in increasing profitability.

Support and structural considerations

Affiliate support

Sparbanken Syd is an independent savings bank and, consequently, the bank does not benefit from any affiliate support.

Loss Given Failure (LGF) analysis

We apply our Advanced LGF Analysis on Sparbanken Syd because the bank is subject to the European Union Bank Recovery and Resolution Directive, which we consider an operational resolution regime. For this analysis, we assume that equity and losses are 3% and 8%, respectively, of tangible banking assets in a failure scenario. We also assume a 25% runoff in junior wholesale deposits and a 5% runoff in preferred deposits. Moreover, we assign a 25% probability to junior deposits being preferred to senior unsecured debt. These are in line with our standard assumptions. We assume the bank's junior deposits account for 26% of total deposits, in line with banks with a diversified deposit base.

The deposit and issuer ratings have a very low loss rate given failure, indicated by a two notch uplift under Moody's Advanced LGF Analysis, because of the large volume of subordinated and senior unsecured debt, providing a cushion of protection to creditors in case of failure.

Government support

Sparbanken Syd's deposit market share was small at around 0.1% as of year-end 2021. Given the limited scope of the bank's operations and its low market share in deposits, we assume a low probability of government support in case of need. As a result, Sparbanken Syd's deposit and issuer ratings do not benefit from any uplift because of government support.

Counterparty Risk (CR) Assessment

The CR Assessment of Sparbanken Syd are A3(cr)/Prime-2(cr)

The CR Assessment is positioned at A3(cr)/P-2(cr), three notches above the Adjusted BCA of baa3, based on the buffer against default provided by junior deposits, senior unsecured debt and subordinated debt and does not benefit from any government support.

Counterparty Risk Ratings (CRRs)

The CRR's of Sparbanken Syd are A3/Prime-2

The CRRs at A3/P-2 are positioned three notches above the Adjusted BCA of baa3, reflecting extremely low loss given failure from the high volume of instruments that are subordinated to CRR liabilities.

Methodology and scorecard

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 7

Sparbanken Syd

Macro Factors							
Weighted Macro Profile		Strong +	100%				
Factor	Historic Ratio	Initial Score	Expected Trend	Assigned Score	Key driver #1	Key driver #2	
Solvency							
Asset Risk							
Problem Loans / Gross Loans	0.9%	aa2	↔	baa1	Sector concentration	Geographical concentration	
Capital							
Tangible Common Equity / Risk Weighted Assets (Basel III - transitional phase-in)	19.4%	aa2	↔	a1	Access to capital		
Profitability							
Net Income / Tangible Assets	0.1%	b3	↔	b3	Expected trend		
Combined Solvency Score		a2		baa2			
Liquidity							
Funding Structure							
Market Funds / Tangible Banking Assets	7.7%	a1	↓↓	baa3	Lack of market access		
Liquid Resources							
Liquid Banking Assets / Tangible Banking Assets	25.9%	a3	↔	a3	Expected trend		
Combined Liquidity Score		a2		baa2			
Financial Profile				baa2			
Qualitative Adjustments				Adjustment			
Business Diversification				0			
Opacity and Complexity				0			
Corporate Behavior				-1			
Total Qualitative Adjustments				-1			
Sovereign or Affiliate constraint				Aaa			
BCA Scorecard-indicated Outcome - Range				baa2 - ba1			
Assigned BCA				baa3			
Affiliate Support notching				0			
Adjusted BCA				baa3			
Balance Sheet		in-scope (SEK Million)	% in-scope	at-failure (SEK Million)	% at-failure		
Other liabilities		971	7.6%	2,026	15.9%		
Deposits		10,343	81.1%	9,288	72.9%		
Preferred deposits		7,654	60.0%	7,271	57.0%		
Junior deposits		2,689	21.1%	2,017	15.8%		
Senior unsecured bank debt		900	7.1%	900	7.1%		
Dated subordinated bank debt		150	1.2%	150	1.2%		
Equity		382	3.0%	382	3.0%		
Total Tangible Banking Assets		12,747	100.0%	12,747	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	27.1%	27.1%	27.1%	27.1%	3	3	3	3	0	a3
Counterparty Risk Assessment	27.1%	27.1%	27.1%	27.1%	3	3	3	3	0	a3 (cr)
Deposits	27.1%	4.2%	27.1%	11.2%	2	3	2	2	0	baa1
Senior unsecured bank debt	27.1%	4.2%	11.2%	4.2%	2	1	2	2	0	baa1

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	a3 (cr)	0	A3(cr)	
Deposits	2	0	baa1	0	Baa1	Baa1
Senior unsecured bank debt	2	0	baa1	0	Baa1	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 8

Category	Moody's Rating
SPARBANKEN SYD	
Outlook	Stable
Counterparty Risk Rating	A3/P-2
Bank Deposits	Baa1/P-2
Baseline Credit Assessment	baa3
Adjusted Baseline Credit Assessment	baa3
Counterparty Risk Assessment	A3(cr)/P-2(cr)
Issuer Rating	Baa1
ST Issuer Rating	P-2

Source: Moody's Investors Service

Endnotes

- The ratings shown in this report are the long-term senior unsecured and long-term deposit ratings, and the Baseline Credit Assessment.
- Please refer to [Sweden's Macro Profile: Strong +](#), published on 11 October 2021.

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