Financial Institutions Ratings
Nordea Bank AB – AT1 rating report

Security ratings

Outlook	Stable
6.125% USD 0.5bn perpetual AT1 notes (Sept 2014) temporary writedown	BBB-
5.5% USD 1bn perpetual AT1 notes (Sept 2014) temporary writedown	BBB-
Multicurrency perpetual AT1 notes (March 2015) temporary writedown	BBB-
3.5% EUR 750mn perpetual AT1 notes (Nov 2017) temporary writedown	BBB-

The ratings have not been solicited by the issuer; the analysis is based solely on public information.

Rating rationale

Scope rates Nordea's four above-referenced Additional Tier 1 notes at BBB-, with Stable Outlook. The ratings are based on the following considerations:

- Senior unsecured debt (eligible for MREL): A+, stable outlook
- Minimum notches down from the senior unsecured debt rating: 4
- Additional notches: 1

In line with our rating methodology, the starting point for notching down when rating capital instruments is the senior unsecured debt rating and not the Issuer Rating. Please refer to Scope's Bank Capital Instruments Rating Methodology (May 2018) for more details.

The minimum 4 notches reflect the deeply subordinated status of AT1 capital instruments in the priority of claims, their going concern loss absorbing features and investors' exposure to coupon-cancellation risks.

The additional notch for these securities reflects the following considerations:

- The presence of a double trigger, of which the one based on group CET1 is a high trigger of 8%
- The low asset risk intensity of Nordea's balance sheet, which may cause volatility in the capital ratios.

The release of this rating report does not constitute a rating action. Last rating action was assigned on 03 June 2015. For further information on the last rating action and regulatory information please click here.

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Issuer credit profile

Nordea has an Issuer Rating of AA-, with a Stable Outlook.

The ratings are driven by Nordea's long track record of strong operating profitability, with low levels of non-performing assets and credit losses. The ratings also reflect the Group's geographic diversification, which partly cushions Nordea from localised macro downturns in the countries where it operates.

At the same time, our forward-looking ratings acknowledge the challenges Nordea faces in such a low-interest rate environment. Results have also been negatively affected by the front-loading of costs associated with Nordea's digital transformation programme, which is expected to run into 2021, although efficiency remains strong compared to many international peers. The asset management business is delivering strong results – which we expect to continue to support revenues.

We note that the reliance on wholesale funding, including in foreign currency, exposes the bank to sudden changes in the funding environment, which remains favourable at present. Partly mitigating these concerns, Nordea has a sizeable liquidity buffer to help manage short-term liquidity risk, and actively hedges its foreign currency exposures.

Summary terms

Issuer	Nordea Bank AB
Issue Date	**23 September 2014**
Amount	USD 500mn
Coupon	• Paid semi-annually (23/3 and 23/9) • 6.125% from 9/2014 to 9/2024 • then: 5 year US Mid-Swap Rate + Margin (3.388%)
Format	Perpetual Non-Call Additional Tier 1 Notes (issued under USD25bn GMTN Program) • Redeemable by the issuer on first reset date (2024) and every interest payment date thereafter, subject to regulatory approval. • Redeemable at any date, subject to regulator's approval, in case of change in capital or tax treatment
ISIN	US65557CAN39 (Rule 144A) / US65557DAL55 (Regulation S)

Issue Date	23 September 2014
Amount	USD 1bn
Coupon	• Paid semi-annually (23/3 and 23/9) • 5.50% from 9/2014 to 9/2019 • then: 5 year US Mid-Swap Rate + Margin (3.563%)
Format	Perpetual Non-Call Additional Tier 1 Notes (issued under USD25bn GMTN Program) • Redeemable by the issuer on first reset date (2019) and every interest payment date thereafter, subject to regulator's approval. • Redeemable at any date, subject to regulator's approval, in case of change in capital or tax treatment
ISIN	US65557CAM55 (Rule 144A) / US65557DAM39 (Regulation S)

Summary terms – Multicurrency, March 2015

Issue Date	12 March 2015
Amount	USD 550mn / NOK 1.25bn / SEK 2.25bn
Coupon	• USD 5.25% / NOK NIBOR + 310bps / STIBOR + 310 bps ' • SEK and NOK notes are paid quarterly (12/3, 12/6, 12/9 and 12/12) whilst USD notes are paid annually on 13/09 every year. • USD notes are initially set to pay 5.25% coupons from 3/2016 to 9/2021. Then: 5 year US Mid-Swap Rate + Margin (3.244%). SEK and NOK notes are set to pay the applicable 3-month NIBOR or STIBOR + 310bps .throughout the life of the instrument.
Format	Perpetual Non-Call Additional Tier 1 Notes (issued under USD25bn GMTN Program) • Redeemable by the issuer on first reset date (varies depending on tranche) and every interest payment date thereafter, subject to regulator's approval. • Redeemable at any date, subject to regulator's approval, in case of change in capital or tax treatment
ISIN	XS1202090947 / XS1202091671 / XS1202091325

Summary terms – 3.5% EUR 750mn, November 2017

Issue Date	12 November 2017
Amount	EUR 750 mn
Coupon	• Paid annually (12/3) • 3.50% from 3/18 to 3/25 • then: 5 year EURIBOR Mid-Swap Rate + Margin (3.003%)
Format	Perpetual Non-Call Additional Tier 1 Notes (issued under USD25bn GMTN Program) • Redeemable by the issuer on first reset date and every interest payment date thereafter, subject to regulator's approval. • Redeemable at any date, subject to regulator's approval, in case of change in capital or tax treatment
ISIN	XS1725580465

Main Risks	
Coupon Cancellation	• Fully discretionary • Mandatory in case of: (i) lack of available distributable items • (ii) payment causing the Maximum Distributable Amount (MDA) to be exceeded • (iii) request from the supervisory authority
Principal Loss Absorption	Temporary write-down: • upon occurrence of a trigger event, by an amount sufficient to restore the CET1 ratio(s) to the trigger level(s); • or, if insufficient, write down to USD1 by the supervisory authority at the Point of non-viability • Reinstatement, if a Positive net profit at Issuer and Group level is recorded
Trigger for Principal Loss Absorption	• 5.125% in relation to the CET1 Ratio of the Issuer on a solo basis and • 8% in relation to the CET1 Ratio of the Group on a consolidated basis.

Source: Prospectuses, Scope Ratings

Key risks

A. Coupon cancellation

Key risk: Coupon cancellation

Coupon payments on the security are fully discretionary and are subject to distribution restrictions

Available distributable Items

The concept of Available Distributable Items (ADI) is defined in the CRR (Art.4.1-128) as "the amount of the profits at the end of the last financial year plus any profits brought forward and reserves available for that purpose before distributions to holders of own funds instruments less any losses brought forward, profits which are non-distributable pursuant to provisions in legislation or the institution's by-laws and sums placed to non-distributable reserves in accordance with applicable national law or the statuses of the institution, those losses and reserves being determined on the basis of the individual accounts of the institution and not on the basis of the consolidated accounts".

As of YE17 Nordea disclosed its distributable amount (before dividends) at EUR 24.4 bn, including EUR 23.3bn of retained earnings and EUR 1.1bn of share premium reserve. As of 1Q18 the available distributable amount was EUR 22.3 bn. It should be noted that due to the Group's reorganisation as of 1 Jan 2017, turning the subsidiaries in Finland, Norway and Denmark into branches, a materially larger portion of Nordea's assets and liabilities sit on the parent company balance sheet. The distributable items reported for the pre-restructured Nordea parent as of YE16 amounted to EUR15.8 bn. We do not expect lack of distributable items to be a limiting factor in the payment of coupons for Nordea.

B. Principal loss absorption

Key risk: Principal loss absorption

The mechanism for loss absorption is temporary write-down	The rated securities have double triggers: • 5.125% based on Nordea AB unconsolidated • 8% based on Nordea Group consolidated accounts

In our view, the existence of a double trigger represents a factor of risk, partly offsetting the benefits of Nordea's diversification, a key factor supporting the Issuer credit strength rating of the group.

Combined buffer requirement (CBR) and CET1 total requirement

Nordea will be redomiciling its lead bank to Finland from Sweden, which is expected to occur as of 1st October 2018. Therefore, while considering the current situation, under which the bank is supervised by the Swedish Finansinspektionen (FSA), we also need to consider the implications of a change of supervisor, as Nordea's lead supervisor in future will be the ECB, in conjunction with the Finnish regulator. The ECB will therefore be taking over responsibility for setting Nordea's capital requirements.

Taking the current situation first, we note that based on the FSA Capital Memoranda for both 4Q17 and 1Q18, the Capital requirement relevant for MDA calculation at Nordea stood at 10.7%:

- A minimum Pillar 1 CET1 requirement of 4.5%
- A capital conservation buffer of 2.5%
- A Pillar 1 systemic risk buffer of 3%
- A countercyclical buffer of 0.7%

On top of the Pillar 1 buffers, Nordea is subject to additional CET1 requirement guidance under Pillar 2, which we calculate at 6.9%. This is based on the 1Q18 FSA memorandum, and includes 3.3% own fund requirement, 2% systemic buffer, and 1.6% for Swedish and Norwegian Mortgages). I

Including the Pillar 2 add-on, which is not relevant to the MDA trigger level calculation. Nordea's CET1 minimum capital requirement guidance stood at 17.6% at the end of March 2018. We note that in Sweden, the Pillar 2 add-on is not considered a hard requirement until a formal decision is taken, and is rather a "strict guidance". As such, it does not affect MDA calculations for Nordea. The FSA has further indicated that it does not intend, in normal circumstances, to take a formal decision.

Table 1: Combined buffer requirements

	2016	2017	Q4 2017 Estimate under Article 458	Q1 2018
Required CET1 associated with distribution restrictions under Pilar 1:	**10.6%**	**10.7%**	**10.7%**	**10.7%**
Combined buffer (CBR)				
- Capital conservation	2.5%	2.5%	2.5%	2.5%
- Systemic	3.0%	3.0%	3.0%	3.0%
- Countercyclical	0.6%	0.7%	0.7%	0.7%
Pillar 1 CET1 requirement	4.5%	4.5%	4.5%	4.5%
Pillar 2 CET1 guidance including systemic risk buffer (not included in MDA calculation)	6.9%	6.9%	6.1%	6.9%
CET1 Capital Requirement and hard guidance (incl. Pillar 2)	17.4%	17.6%	16.8%	17.6%
Nordea Group CET1, transitional (EUR bn)	24.5	24.5	24.5	24.3
Nordea Group CET1, transitional (%)	18.4%	19.5%	18.0%	19.8%
Distance to CET1 requirement incl. CBR (%)	**7.8%**	**8.8%**	**7.3%**	**9.1%**
Distance to CET1 requirement incl. CBR (EUR bn)	**10.4**	**11.1**	**9.9**	**11.2**
RWAs (EUR bn)	133	126	136	123

Source: Company data, Scope Ratings estimates

As of 1Q18, Nordea's CET1 ratio stood at 19.8%. This offers ample distance to the Pillar 1 Combined Buffer Requirement. There is a more modest buffer of 220 bps to its total CET1 requirement. Nordea has indicated it will maintain a buffer of 50-150bps over the CET1 requirement, which is more comfortably exceeded than in any previous period.

Going forward, considering the situation after the bank has redomiciled, Nordea has indicated its expectation that its formal capital requirements will be addressed as part of the formal Supervisory Review and Evaluation Process (SREP) for 2018, and that the requirements imposed during the 2017 SREP will apply until then.

In addition to undergoing an asset quality review (AQR), Nordea anticipates being the subject of a targeted review of internal models (TRIM) once under the ECB's aegis. This is likely to be a detailed process. The Swedish FSA to date has taken a different approach to assessing internal models compared to other banking supervisors, and one consequence has been that risk weights applied to Swedish banks' loan portfolios are on average lower than for many international peers. Hence despite high headline capital ratios Swedish banks' leverage is slightly below European bank and their risk asset intensity is also lower than average.

Scope believes that the transition to an ECB-approved internal model will affect Nordea's risk weighting process, and Nordea confirms that it expects some effect on its measured risk exposure amount (REA). It is too early to say what the impact may be. Importantly, the bank has affirmed that it does not intend to make changes to its current capital and dividend policies, and that maintaining issuer credit ratings in the AA range continue to be part of management's strategy.

Aside from any changes resulting from the TRIM process, the bank also notes that REA is expected to increase for more generic reasons, due to upcoming regulatory changes covered by CRR2/CRD V and the output floors specified under Basel IV, and as a result of this Pillar 2 requirements are likely to be lower.

We also note that the Swedish regulator (FSA) is proposing, as of 31 December 2018, to apply a hard Pillar 1 requirement for Swedish residential mortgages under the provisions of Article 458 of the Capital Requirements Regulation (CRR). This allows a competent home supervisory authority to apply risk-weight measures relating to assessed systemic or macro-prudential risks.

In this context, Nordea will no longer fall under the FSA's supervision. However, the FSA expects that the new requirements may affect branches of non-Swedish banks with exposures to Swedish mortgages. The FSA has made it clear that the proposal is largely designed to help to achieve a level risk-weighting playing field for banks within the Swedish mortgage market as a direct result of Nordea's redomiciliation.

With regard to the possible impact on branches, we believe the FSA is referring to the Memorandum of Understanding (MOU) between supervisors in Sweden, Norway, Denmark and Finland, which relates to prudential supervision of significant branches. This was enacted on 2 December 2016. Reciprocal measures could occur with respect to the capital requirements imposed on Nordea in Finland, assuming Sweden's proposal is adopted reciprocally by Finnish regulators/the ECB.

Scope expects the proposal to go ahead as specified in Sweden, although it is not clear when (or whether) it will encompass what will be Nordea's branch there, as this depends on other regulators acting in line with the FSA's proposal.

For Swedish banks (and any affected branches), the Pillar 1 requirement will replace the current arrangement. At present the FSA imposes, through Pillar 2 guidance, a risk-weight floor of 25% for Swedish mortgages. This applies on a consolidated basis to Swedish banks which use the IRB approach to calculate residential mortgage exposures.

For Swedish banks the metrics that most investors in AT1 instruments focus on – the distance to the CBR and CET1 capital requirements and the distance to trigger – will decrease, both as a percentage of risk-weighted assets (RWAs) and in nominal terms. This is because the denominator in the capital ratio -- i.e. the risk exposure amount (REA) – will rise as a result of an effective increase in risk weights on Swedish residential mortgages. As noted above, historically this has been captured via Pillar 2, but in future a more onerous risk weight floor will be applied through Pillar 1 instead.

The Swedish FSA has provided some estimates of the impact of the new measures on banks' total reported capital ratios, and has included Nordea in its calculations. Based on these, which rely on 4Q17 numbers, we estimate that Nordea''s headline CET1 ratio could fall by around 150 bps (see Figure 1), which appears manageable, and is considerably less than for those banks which conduct the majority of their business in Sweden. The distance to the CET1 requirement would fall to a still comfortable 7.3%.

Distance to trigger

The low 5.125% trigger is so distant from Nordea AB's current CET1 level (18.6% as of YE17) as to be almost irrelevant – less so now than in the past, given that the Group's unification of its balance sheet within a single large Nordic bank means a much reduced ability on the part of host country regulators of local branches to restrict capital flows within the Group.

On the other hand, the 8% trigger at the group level is considered a high trigger – even in the context of Swedish high capital requirements.

Table 2: Distance to trigger

	2016	2017	Q4 2017 Estimate under Article 458	Q1 2018
Trigger level	8.0%	8.0%	8.0%	8.0%
Nordea Group CET1, transitional (EUR bn)	24.5	24.5	24.5	24.3
Nordea Group, CET1, transitional (%)	18.4%	19.5%	18.0%	19.8%
Distance to trigger (%)	**10.4%**	**11.5%**	**10.0%**	**11.8%**
Distance to trigger (EUR bn)	**13.8**	**14.5**	**13.6**	**14.5**

Source: Company data, Scope Ratings estimates

Based on 1Q18 data, Nordea's CET1 ratio is 11.8% higher than the trigger point. The management target of 50-150bps ahead of the total CET1 requirement (17.6% currently) would imply a c.10.6% distance-to-trigger target. We therefore view this as ample, although noting the high sensitivity of Nordea's capital ratios to changes in RWA calculation inputs. This is explicitly identified in the terms and conditions of the notes.

Specifically referring to the proposals of the Swedish FSA to impose higher risk weights on Swedish mortgages via Pillar 1, we estimate that the distance to the high 8.0% trigger could fall by a manageable 150 bps, to 10.0%, based on 4Q17 data. We would still consider this as ample.

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