Nordea Bank AB
Issuer Rating Report

STABLE
AA-

Overview

Scope Ratings assigns an Issuer Rating of AA- to Nordea Bank AB, with Stable Outlook, and a Short-Term rating of S-1+ with Stable Outlook.

The ratings were not solicited by the issuer. Both ratings and analysis are based solely on publicly available information. The issuer has participated in the process. The ratings are not applicable to unguaranteed subsidiaries of the rated parent.

Highlights

- 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, as its net interest margin remains under pressure while inexpensive funding and competition continue to erode its return on assets. Results have been negatively affected by the front-loading of costs associated with Nordea's digital transformation programme, which is expected to run into 2021, although the bank's 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.

Rating drivers (summary)

The rating drivers, in decreasing order of importance in the rating assignment, are:

- Track record of strong and resilient earnings, including throughout the financial crisis, with low credit losses
- Geographic and business diversification, mainly in strong economies, contributes to earnings stability over time
- Significant reliance on short-term FX funding, albeit mitigated by access to covered bond markets, which account for about a quarter of funding
- Returns are pressured due to very low interest rates, lower loan volumes and upfront spending on digital transformation, but remain strong thanks to the successful asset management business and cost discipline

Ratings & Outlook

Issuer Rating	AA-
Outlook	Stable
Senior unsecured debt	A+
Additional Tier 1 instruments	BBB-
Short term debt rating	S-1+
Short term debt rating outlook	Stable

Lead Analyst

Jennifer Ray
j.ray@scoperatings.com

Associate

Alvaro Dominguez Alcalde
a.dominguez@scoperatings.com

Team Leader

Sam Theodore
s.theodore@scoperatings.com

Scope Ratings GmbH

Suite 301
2 Angel Square
London EC1V 1NY

Phone +44 203-457 0 4444

Headquarters

Lennéstraße 5
10785 Berlin

Phone +49 30 27891 0
Fax +49 30 27891 100

info@scoperatings.com
www.scoperatings.com

Bloomberg: SCOP

Rating change drivers

Material deterioration in asset quality. In recent years, Nordea has shown very strong asset quality metrics, in part driven by a supportive credit environment in most of its markets. As such, we believe that current asset quality metrics may not prove fully sustainable throughout the economic cycle. For example, Sweden is experiencing high levels of household debt, and a trend of correction in house prices has been in evidence since 4Q17. A material deterioration in asset quality would be negative for the bank's credit profile.

A significant acquisition or a change in strategic direction that materially alters Nordea's risk or earnings profile. We view the bank as having a well-balanced business model, notably with the bulk of its assets located in strong economies within the Nordic region. Nordea's considerable track record in consolidating banks would lead us to expect a measured approach to any potential acquisition.

Weaker performance of the Wealth division impacting revenues and earnings. The weight of the Wealth division in Nordea's overall revenue and profit pool has increased consistently in recent years, with the unit contributing 29% of operating profit in 2017 (up from 17 % five years earlier in 2012). We expect this trend to continue as low-interest rates keep pressuring the traditional banking business, while the group's successful asset management platform increases assets under management. Should the performance of the Wealth business weaken significantly, group profitability would suffer, with potentially negative implications for the rating.

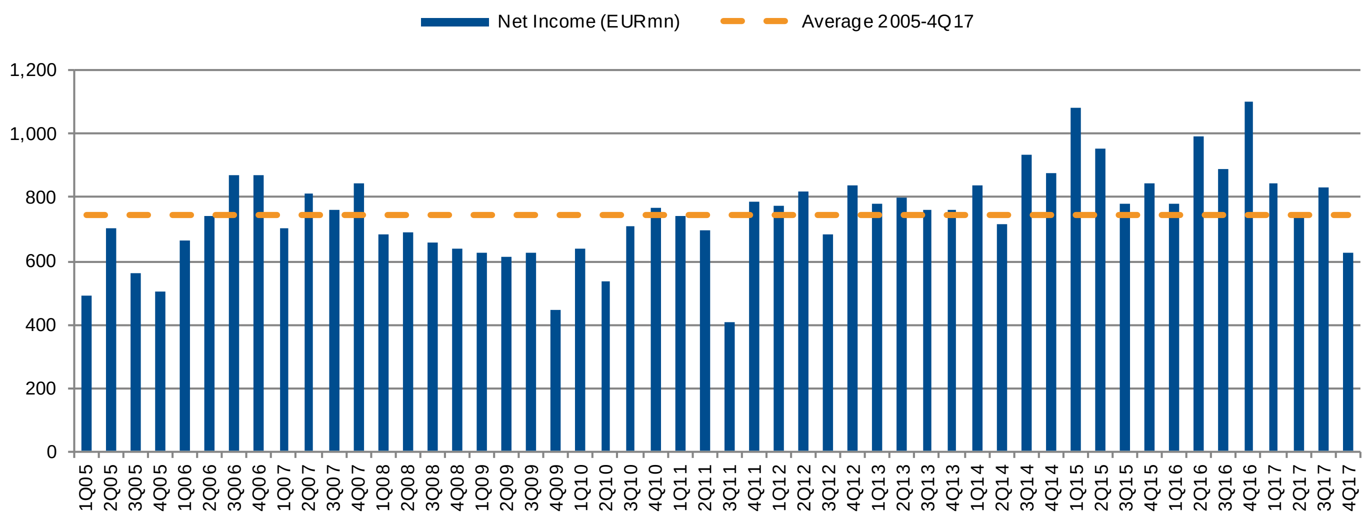
Preserving reassuring financial performance in the event of a more serious downturn in Sweden. Exposure to the Swedish real estate sector is significant, despite the group's diversification. Resilient financial performance in a less favourable environment in Sweden would in our view add to the already impressive track record of Nordea.

Rating drivers (details)

Track record of strong and resilient earnings, including throughout the financial crisis, with low credit losses.

Nordea exhibited significant revenue and earnings resilience throughout the financial crisis. Not only did the bank maintain a positive bottom line in every quarter throughout the crisis in 2007, but earnings also displayed little volatility, including in quarters when many European and regional peers posted net losses due to significant asset quality deterioration or market-related trading losses. We believe this track record is an important reputational asset for the bank - both in terms of client franchise and in terms of lower cost of funding in wholesale markets.

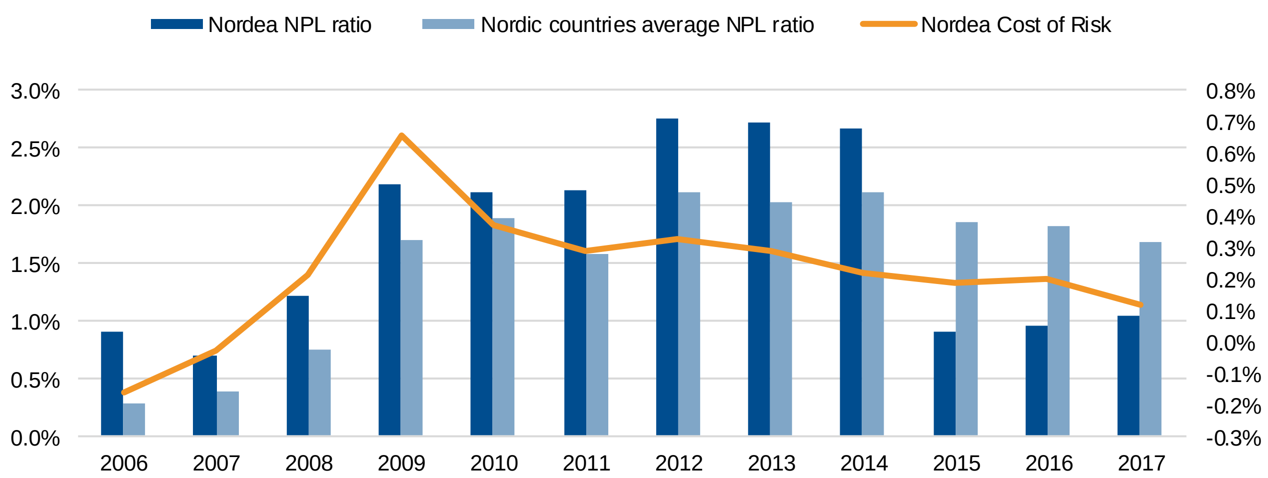
Figure 1: Nordea earnings stability throughout and subsequent to the financial crisis



Source: Company data, Scope Ratings

The current asset quality metrics of Nordea are very strong. Nordea's Group loan loss ratio was just 12 bps in 2017, down from 15bps in 2016.

Figure 2: Nordea NPLs and Cost of Risk, 2006-2017



Note: Nordic Countries' average NPL ratio is weighted to reflect Nordea portfolio split
Source: Company data, World Bank, Bank of Finland, Scope Ratings

In our view, the two main reasons for such stability are:

1. A relatively favourable macro and credit environment in the Nordic region, with resilient internal demand, underpinned by low interest rates, supporting debt service affordability.

2. A significant degree of geographic and business diversification that allows the bank to withstand isolated asset quality shocks while remaining profitable at group level. Earlier shocks have included Danish real estate and agricultural loans. The agricultural portfolio saw loan loss reversals in 2017. At present Nordea is experiencing some weakness in its EUR 8.4bn (at YE17) shipping, offshore and oil services portfolio. Reduced from EUR 10.5 bn as of YE16, this experienced a net cost of risk of 148 bps in 2017, with an NPL ratio of 3.2% at YE17 (YE16: 2.3%). The bank made extra provisions against these exposures during 2017. Nordea anticipates some improvement in the shipping sector in 2018-2019, as relatively few new ships have been built in recent years, and demand for new charters is expected to outstrip supply.

While regional diversification is a structural feature of the group, we believe the very current strong asset quality metrics may not prove to be fully sustainable throughout the economic cycle. That said, Nordea is proportionately the least exposed of the four large Swedish-based banks to the Swedish housing market, which is entering a period of correction that has been heralded for some time. In Scope's view, Nordea's strong profitability helps to position it well against a normalization in the level of credit losses in this market.

2. Geographic and business diversification, mainly in strong economies, contributes to earnings stability over time

With total assets of EUR 582bn as of December 2017, Nordea is the largest bank in the Nordic region, with an additional presence in Russia and Luxembourg, and in the Baltic countries through Luminor Bank, set up in 2017 as a joint venture which pooled Nordea's Baltic operations with those of DnB. Nordea has strong market shares across the Nordic region in both consumer and corporate lending and deposit-taking, especially in Finland and Denmark.

Figure 3: Market shares in Nordic countries (4Q17)

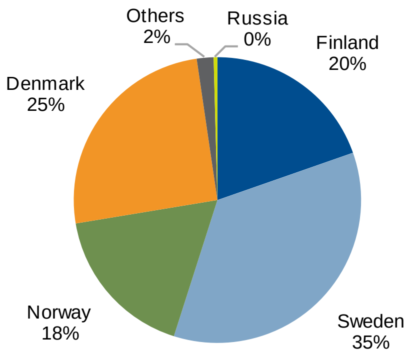
	Denmark	Finland	Norway	Sweden
Mortgage Loans	16.7%	29.7%	10.5%	14.5%
Consumer Loans	17.4%	30.1%	7.1%	5.4%
Corporate Loans	20.1%	25.2%	11.7%	12.2%
Household Deposits	21.3%	28.0%	7.0%	13.7%
Corporate Deposits	25.6%	29.4%	11.5%	14.4%

Source: Company Reports

Within the region, the Group's loan book is well diversified, as demonstrated in Figure 4a. Throughout the Nordic countries the main focus is corporate lending and mortgage lending to households, which at YE17 accounted for 47% and 43% of the loan book respectively.

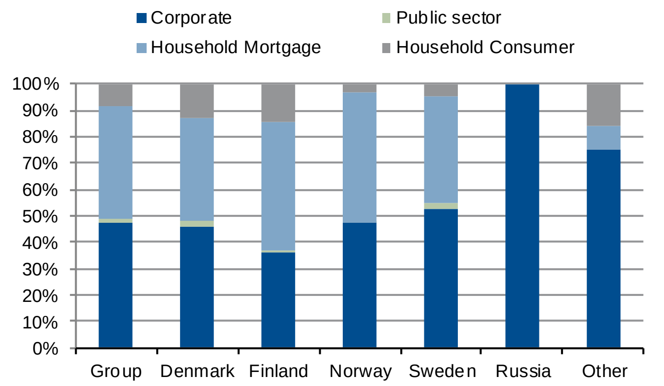
The EUR 42bn real estate portfolio is Nordea's largest corporate industry exposure, accounting for 29% of corporate loans and 13% of total loans, with lending focused primarily on large companies. The bank says that this portfolio consists of large and well diversified companies, with 90% falling within the bank's top four internal rating grades. No other industry accounts for more than 10% of the corporate portfolio.

Figure 4a: Loan book, geographical split (YE 2017)



Source: Company data, Scope Ratings

Figure 4b: Loan-book composition by country (YE 2017)



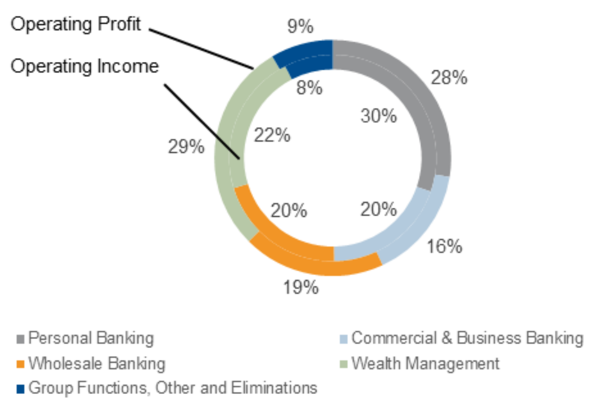
Source: Company data, Scope Ratings

In our view, well established geographical diversification, especially in strong economies, provides some degree of protection against localised shocks, and is a positive credit driver for the bank. The economic performances of Sweden, Norway, Finland and Denmark are correlated to a material degree due to strong trade and financial links within the region, yet we see Nordea as being better diversified than domestic peers or peers with monoline concentration risks within a single country.

Retail and commercial banking is Nordea's largest segment, accounting for 50% of group revenues in 2017, though only 44% of operating profit.

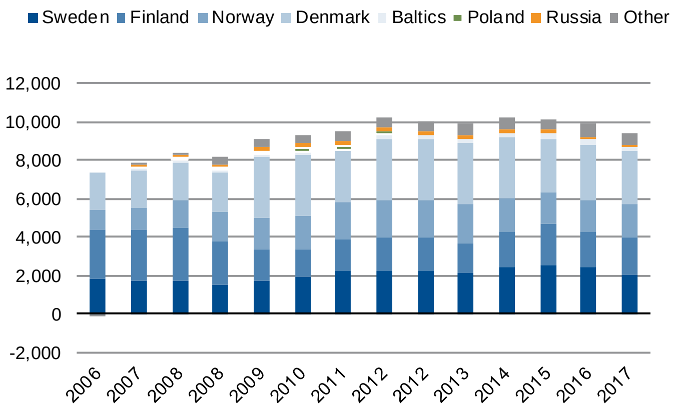
Wholesale banking (20% of 2017 revenues) serves large corporations and institutional clients and includes Nordea Markets, corporate and investment banking (CIB), and the shipping, offshore and oil services (SOOS) business lines. Wealth (22% of revenues) includes Nordea Life and Pension, asset management and private banking.

Figure 5a: Nordea divisional operating income and operating profit split (2017)



Source: Company data, Scope Ratings

Figure 5b: Nordea evolution of operating profit by geography) (EUR mn)



Source: Company data, Scope Ratings

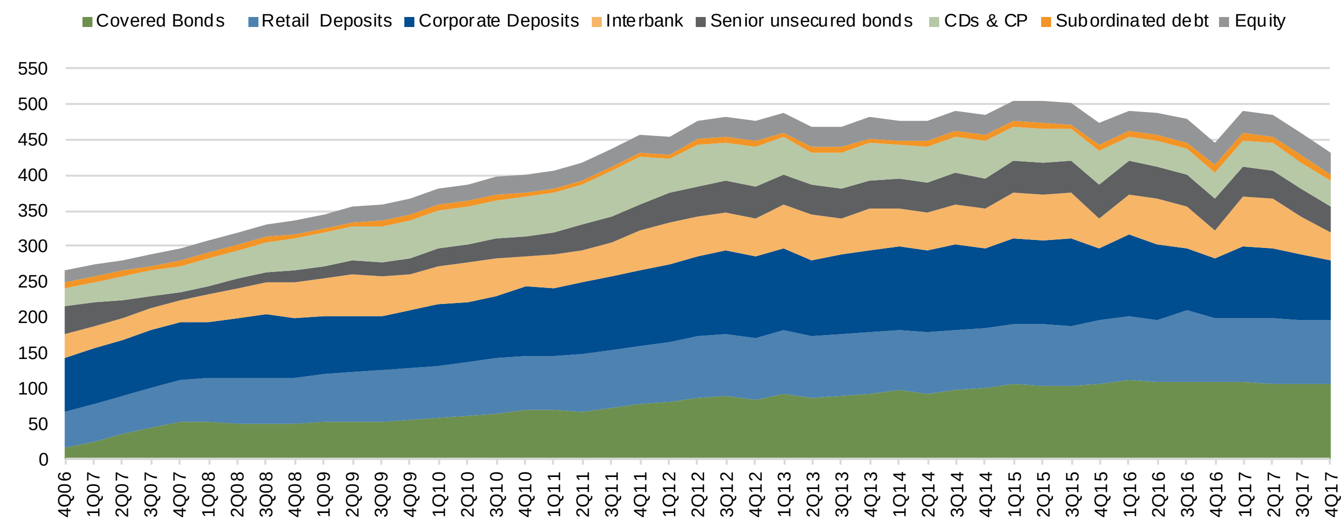
Scope believes that recent changes to the group structure and the planned relocation of Nordea's lead bank from Stockholm to Helsinki are unlikely to threaten the Group's diversified business model. Historically the Nordic operations were organized as separate legal entities controlled by Nordea AB. On 2nd January 2017, the Norwegian, Danish and

Finnish operations became branches of the Swedish bank, with the aim of achieving a simplified structure and clearer governance. With respect to the relocation to Finland (tentatively planned to occur on 1st October 2018), Nordea believes that the ECB's approach as the primary supervisory authority within the Banking Union (in tandem with Finland's Financial Supervisory Authority) will offer a more predictable regulatory regime than Sweden's. As the Nordic region's only G-SIB, it should become easier for investors to compare Nordea with international peers. Although supervision by the ECB may bring changes to risk weights applied to Nordea's exposures, it is too soon to judge the extent of any future changes. Given the scale of Nordea's 'significant branch' operations in Sweden, Denmark and Norway, these countries' regulators, are expected to remain involved with the supervision of Nordea via the Memorandum of Understanding agreed between them in December 2016. Scope will monitor developments but currently sees no rating implications.

3. Material reliance on short-term FX funding, albeit mitigated by access to covered bond markets, which account for about a quarter of funding

Nordea's headline loan-to-deposit of 180% as of YE17 is high compared to international peers. The deposit base is split fairly evenly between households and corporates, while the gap between loans and deposits is funded via a diversified mix of wholesale funding sources.

Figure 6: Nordea funding and capital structure evolution 2006-2Q 2017 (EUR bn)



Source: Company data, Scope Ratings

One-quarter of total funding comes from covered bonds, which we regard as a relatively stable source. The loan to deposit ratio falls to 111% if these are included. Other funding sources, such as commercial paper, certificates of deposit and unsecured borrowing through bond issues or interbank sources may be inherently less stable in times of stress. We also note that although much of the currency risk is hedged, a material part of market funding is in foreign currency, although it does not directly fund FX assets on Nordea's balance sheet.

Partly mitigating these concerns, Nordea has a liquidity buffer which averaged EUR 116bn during 2017 (2016: EUR 113 bn). This buffer is primarily made up of central bank-eligible sovereign bonds, and also includes cash held with central banks. Nordea actively hedges its structural foreign currency exposures into euros.

At the end of 2017 the overall Liquidity Coverage Ratio (LCR) for Nordea was 147% according to Swedish rules, and stood at 257% for EUR and 170% for USD.

4. Returns have been under pressure from low interest rates and investment in new digital banking platforms, but remain strong thanks to successful asset management business and cost discipline

While earnings have remained stable enough since the beginning of the crisis, they have done so against an increased asset base, as total assets grew 49% in the decade between 2007 and 2017. Return on average assets (ROAA) for Nordea declined from 0.85% in 2007 to 0.5% in 2017, despite a favourable funding environment for Nordic banks.

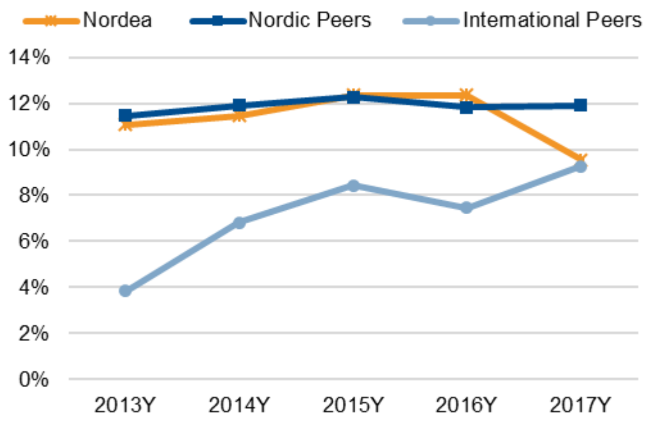
Pressured net interest margins due to prevailing low interest rates is the main reason for the fall in asset productivity. The yield on interest-earning assets was 3.7% in 2007 and 1.3% in 2017, with the net interest margin falling from 1.2% to 0.8% over the same period We expect the challenging outlook for net interest income at Nordea to continue as policy rates remain very low or negative in its main operating countries. The net interest margin remained almost flat at 0.87% in 2017, compared to 0.86% in 2016.

Despite declining margins and a higher capital base, a strong cost/income ratio and falling credit costs have helped to support ROAE, which was in the 11-12% range between 2009 and 2016. However, ROAE fell to 9.5% in FY17, as Nordea's heavy strategic focus on developing its digital banking platforms, which includes sizeable planned staff reductions, has led to noticeable front-loading of costs and consequent erosion of the cost/income ratio. Nordea intends to bring all its core banking products into a single system. Updating the risk and compliance functions is also part of the current investment programme, which will continue until 2021. Nordea targets a cost base of less than EUR 4.8 bn in 2021, including transformation costs, which compares to an expected EUR 4.9 bn in 2018.

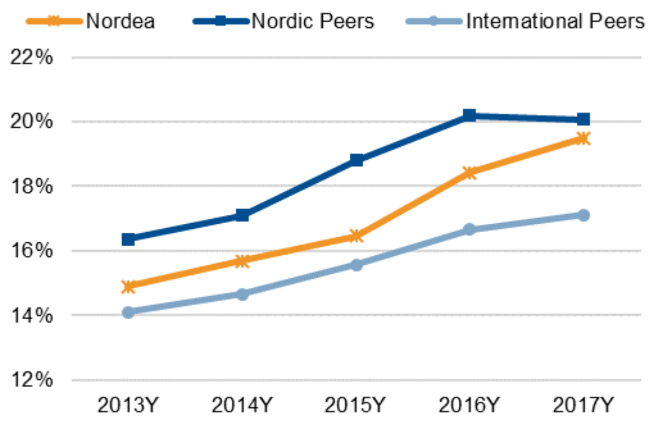
Nordea targets ROE above its Nordic peer group, weighted for business mix, and plans to leverage its asset management platform to support returns given the lower inherent credit risk and capital needs, set against the less favourable environment for the traditional banking business. While customer loans have fallen by 9% in the past two years, to EUR 310 bn, assets under management grew 15% over the period, and reached EUR 330 bn at YE17, exceeding balance sheet loans for the second year running. As a result, net fee and commission income, which accounts for 36% of revenues, rose 4% IN 2017.

I. Appendix: Peer comparison

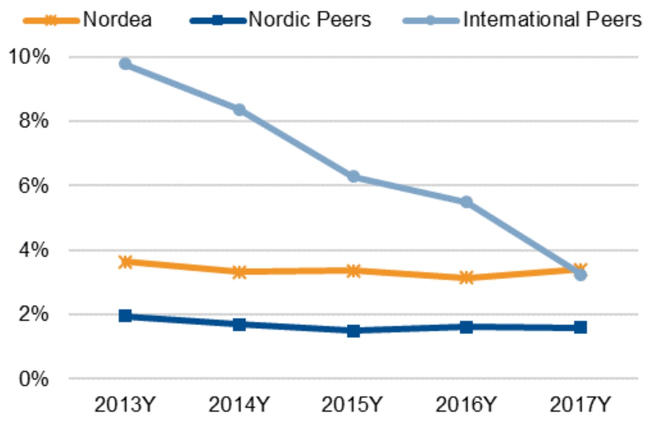
Return on Average Equity (ROAE) (%)



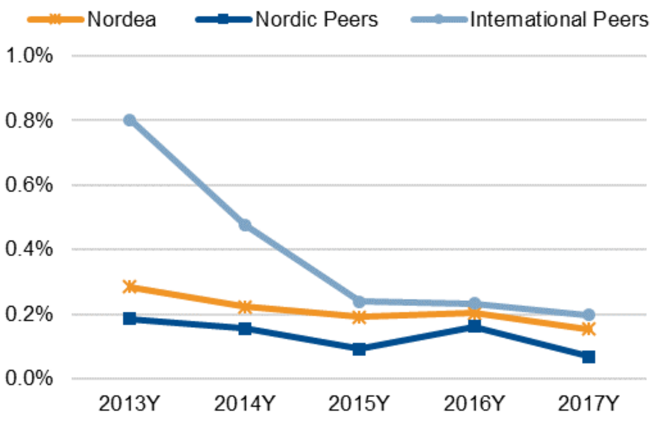
Common Equity Tier 1 Ratio (%,Transitional)



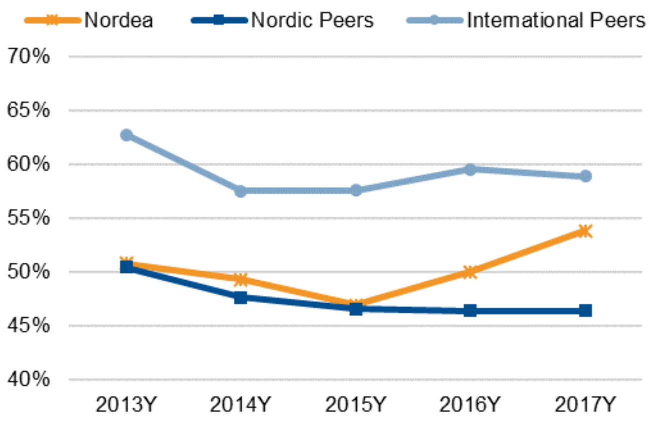
Impaired & delinquent Loans / Loans (%)



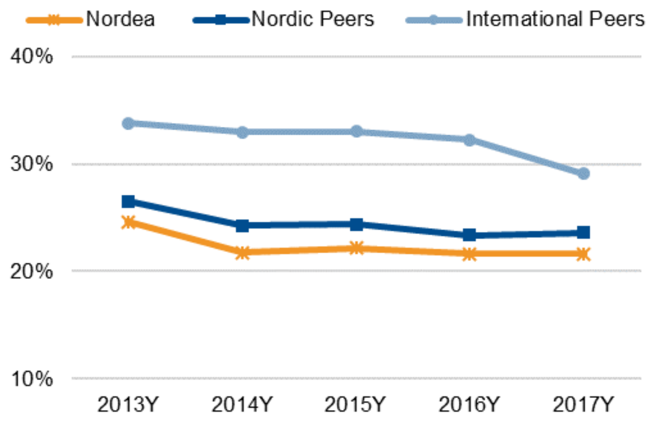
Loan-loss provisions / gross loans (%)



Cost/income ratio (%)



Asset Risk Intensity (RWAs % total assets)



Source: SNL, Scope Ratings
*Nordic peers: Danske Bank, DNB ASA, Nordea, Handelsbanken, Swedbank, SEB.
**International peers based on business model: SEB, Nordea, DNB, Swedbank, Danske, Handelsbanken, , ABN AMRO, Credit Agricole, , Intesa San Paolo, Commerzbank, Rabobank, , Sabadell, , Lloyds, CaixaBank, Allied Irish, Bank of Ireland, , UBI Banca, Nationwide.

II. Appendix: Selected Financial Information – Nordea Bank AB

	2013Y	2014Y	2015Y	2016Y	2017Y
Balance sheet summary (EUR m)					
Assets					
Cash and interbank assets	56,041	50,242	59,486	52,360	56,469
Total securities	201,355	244,385	198,041	184,470	145,237
of which, derivatives	71,195	105,375	80,892	70,137	46,274
Net loans to customers	342,451	348,085	340,920	317,689	310,158
Other assets	30,587	26,630	48,421	61,140	69,748
Total assets	**630,434**	**669,342**	**646,868**	**615,659**	**581,612**
Liabilities					
Interbank liabilities	59,090	56,322	44,209	38,136	39,983
Senior debt	185,602	194,274	201,937	191,750	179,114
Derivatives	67,658	100,758	82,099	71,102	44,163
Deposits from customers	200,743	197,254	189,049	174,028	172,434
Subordinated debt	6,545	7,942	9,200	10,459	8,987
Other liabilities	81,587	82,955	89,342	97,774	103,615
Total liabilities	**601,225**	**639,505**	**615,836**	**583,249**	**548,296**
Ordinary equity	29,207	29,835	31,031	32,409	32,398
Equity hybrids	0	0	0	0	750
Minority interests	2	2	1	1	168
Total liabilities and equity	**630,434**	**669,342**	**646,868**	**615,659**	**581,612**
Core tier 1/Common equity tier 1 capital	23,112	22,821	23,575	24,538	24,515
Income statement summary (EUR m)					
Net interest income	5,525	5,482	4,963	4,727	4,666
Net fee & commission income	2,642	2,842	3,230	3,238	3,369
Net trading income	1,321	1,153	1,400	1,440	1,099
Other income	403	386	371	349	335
Operating income	**9,891**	**9,863**	**9,964**	**9,754**	**9,469**
Operating expense	5,020	4,860	4,674	4,879	5,097
Pre-provision income	**4,871**	**5,003**	**5,290**	**4,875**	**4,372**
Credit and other financial impairments	735	534	479	502	369
Other impairments	20	350	20	7	5
Non-recurring items	0	188	-87	259	0
Pre-tax profit	**4,116**	**4,307**	**4,704**	**4,625**	**3,998**
Discontinued operations	9	-25	0	0	0
Other after-tax Items	0	0	0	0	0
Income tax expense	1,009	950	1,042	859	950
Net profit attributable to minority interests	0	0	0	0	17
Net profit attributable to parent	**3,116**	**3,332**	**3,662**	**3,766**	**3,031**

Source: SNL

III. Appendix: Selected Financial Information – Ratios – Nordea Bank AB

	2013Y	2014Y	2015Y	2016Y	2017Y
Funding and liquidity					
Net loans/deposits (%)	148.7%	150.2%	144.5%	145.4%	144.2%
Liquidity coverage ratio (%)	117.5%	149.0%	201.1%	159.3%	147.3%
Net stable funding ratio (%)	NA	NA	NA	NA	NA
Asset mix, quality and growth					
Net loans/assets (%)	54.3%	52.0%	52.7%	51.6%	53.3%
Impaired & delinquent loans/loans (%)	3.6%	3.3%	3.4%	3.1%	3.4%
Loan-loss reserves/impaired loans (%)	42.7%	42.8%	44.7%	43.7%	38.4%
Net loan growth (%)	-1.1%	1.6%	-2.1%	-6.8%	-2.4%
Impaired loans/tangible equity & reserves (%)	22.7%	21.7%	19.5%	17.9%	19.2%
Asset growth (%)	-5.6%	6.2%	-3.4%	-4.8%	-5.5%
Earnings and profitability					
Net interest margin (%)	0.9%	0.9%	0.8%	0.8%	0.8%
Net interest income/average RWAs (%)	3.4%	3.6%	3.4%	3.4%	3.6%
Net interest income/operating income (%)	55.9%	55.6%	49.8%	48.5%	49.3%
Net fees & commissions/operating income (%)	26.7%	28.8%	32.4%	33.2%	35.6%
Cost/income ratio (%)	50.8%	49.3%	46.9%	50.0%	53.8%
Operating expenses/average RWAs (%)	3.1%	3.2%	3.2%	3.5%	3.9%
Pre-impairment operating profit/average RWAs (%)	3.0%	3.3%	3.6%	3.5%	3.4%
Impairment on financial assets /pre-impairment income (%)	15.1%	10.7%	9.1%	10.3%	8.4%
Loan-loss provision charges/net loans (%)	0.3%	0.2%	0.2%	0.2%	0.2%
Pre-tax profit/average RWAs (%)	2.5%	2.8%	3.2%	3.3%	3.1%
Return on average assets (%)	0.5%	0.5%	0.5%	0.6%	0.5%
Return on average RWAs (%)	1.9%	2.2%	2.5%	2.7%	2.3%
Return on average equity (%)	11.1%	11.5%	12.3%	12.3%	9.6%
Capital and risk protection					
Common equity tier 1 ratio (%, fully loaded)	14.9%	NA	16.5%	18.4%	19.5%
Common equity tier 1 ratio (%, transitional)	14.9%	15.7%	16.5%	18.4%	19.5%
Tier 1 capital ratio (%, transitional)	15.7%	17.6%	18.5%	20.7%	22.3%
Total capital ratio (%, transitional)	18.1%	20.6%	21.6%	24.7%	25.2%
Leverage ratio (%)	4.3%	4.3%	4.5%	4.8%	5.2%
Asset risk intensity (RWAs/total assets, %)	24.6%	21.7%	22.2%	21.6%	21.6%
Market indicators					
Price/book (x)	1.3x	1.3x	1.3x	1.3x	1.3x
Price/tangible book (x)	1.5x	1.4x	1.5x	1.5x	1.4x
Dividend payout ratio (%)	55.1%	74.7%	70.3%	69.9%	90.7%

Scope Ratings GmbH

Headquarters Berlin

Lennéstraße 5
D-10785 Berlin

Phone +49 30 27891 0

Frankfurt am Main

Neue Mainzer Straße 66-68
D-60311 Frankfurt am Main

Phone +49 69 66 77 389-0

Paris

33 rue La Fayette
F-75009 Paris

Phone +33 1 82885557

London

Suite 301
2 Angel Square
London EC1V 1NY

Phone +44 203-457 0 4444

Madrid

Paseo de la Castellana 95
Edificio Torre Europa
E-28046 Madrid

Phone +34 914 186 973

Milan

Via Paleocapa 7
IT-20121 Milan

Phone +39 02 30315 814

Oslo

Haakon VII's gate 6
N-0161 Oslo

Phone +47 21 62 31 42

info@scoperatings.com
www.scoperatings.com

Disclaimer