

Credit Opinion: Jyske Bank A/S

Global Credit Research - 01 Jun 2012

Silkeborg, Denmark

Ratings

Category	Moody's Rating
Outlook	Stable
Bank Deposits	Baa1/P-2
Bank Financial Strength	C-
Baseline Credit Assessment	(baa2)
Adjusted Baseline Credit Assessment	(baa2)
Senior Unsecured	Baa1
Subordinate MTN	(P)Ba1
Jr Subordinate	Ba1 (hyb)
Pref. Stock	Ba2 (hyb)
Other Short Term	(P)P-2

Contacts

Analyst	Phone
Oscar Heemskerk/London	44.20.7772.5454
Richard (Blake) B. Foster/London	
Simon Harris/London	
Jessica Svantesson/London	

Key Indicators

Jyske Bank A/S (Consolidated Financials)[1]

	[2]3-12	[2]12-11	[2]12-10	[2]12-09	[2]12-08	Avg.
Total Assets (DKK million)	256,667.0	270,210.0	244,108.2	224,593.8	236,301.7	[3]2.1
Total Assets (EUR million)	34,500.1	36,356.0	32,757.1	30,183.6	31,747.3	[3]2.1
Total Assets (USD million)	45,943.7	47,195.4	43,945.1	43,305.6	44,130.2	[3]1.0
Tangible Common Equity (DKK million)	15,763.9	14,477.1	12,788.3	12,352.3	10,116.2	[3]11.7
Tangible Common Equity (EUR million)	2,118.9	1,947.9	1,716.1	1,660.0	1,359.1	[3]11.7
Tangible Common Equity (USD million)	2,821.8	2,528.6	2,302.2	2,381.7	1,889.2	[3]10.5
Net Interest Margin (%)	1.9	2.0	2.0	2.0	1.6	[4]1.9
PPI / Avg RWA (%)	3.4	2.1	2.7	3.2	1.5	[5]2.6
Net Income / Avg RWA (%)	1.4	0.5	0.7	0.5	0.5	[5]0.7
(Market Funds - Liquid Assets) / Total Assets (%)	4.6	3.0	4.2	7.4	9.0	[4]5.6
Core Deposits / Average Gross Loans (%)	88.5	98.6	85.0	79.6	77.7	[4]85.9
Tier 1 Ratio (%)	15.0	13.3	13.6	13.5	9.9	[5]13.1
Tangible Common Equity / RWA (%)	14.7	13.2	12.2	12.3	8.6	[5]12.2
Cost / Income Ratio (%)	56.0	67.6	59.6	52.5	67.6	[4]60.7
Problem Loans / Gross Loans (%)	--	5.4	6.4	5.8	2.0	[4]4.9
Problem Loans / (Equity + Loan Loss Reserves) (%)	--	37.4	44.4	41.6	22.1	[4]36.4

Source: Moody's

[1] All ratios are adjusted using Moody's standard adjustments [2] Basel II; IFRS [3] Compound Annual Growth Rate based on IFRS reporting periods [4] IFRS reporting periods have been used for average calculation [5] Basel II &

IFRS reporting periods have been used for average calculation

Opinion

RECENT CREDIT DEVELOPMENTS

On 30 May 2012, Moody's downgraded Jyske Bank's standalone rating to C- from C and its debt and deposit ratings to Baa1 from A2. The bank's Prime-1 short term ratings were downgraded to Prime-2. The bank's preferred stock ratings were downgraded to Ba2 (hyb) from Baa3 (hyb), reflecting the downgrade of the bank's standalone rating. Similarly, the junior subordinated debt ratings were downgraded to Ba1 (hyb) from Baa2 (hyb).

This concludes the review initiated on 15 February 2012, and reflects our view that the challenges Jyske Bank faces have increased, notably regarding the operating environment and asset quality concerns.

The downgrade reflects the difficult operating environment for Danish banks, and specifically Jyske Bank's relatively high exposure to agricultural and commercial real estate lending, as well as the bank's reliance on second and sequential lien mortgages in household and corporate lending. The latter factor is in line with other Danish banks and results from the stronger funding position of mortgage credit institutions that fund the first lien mortgage loans, but compared to the bank's international peers we view this position as credit negative, particularly in the current environment of weakening asset quality. Moody's positively notes that Jyske Bank maintains a strong position in the Danish market with an estimated market share of approximately 10% for bank loans and deposits and with a good national presence. Jyske Bank has also proved that it still has access to funding markets and has a sizeable liquidity portfolio, substantially consisting of other Danish institutions' covered bonds. Jyske Bank also successfully completed a DKK1.2 billion share issue in Q1 2012.

The rating action also captures Moody's view that exposures to more volatile sectors such as agriculture and commercial real estate may give rise to increased need for provisions. We also caution that low interest-rate levels have thus far supported borrowers' ability to repay their debts but loans with variable rates are vulnerable to interest-rate hikes.

SUMMARY RATING RATIONALE

Moody's rates Jyske Bank Baa1/Prime-2/C-The C- standalone bank financial strength rating (BFSR) assigned to Jyske Bank, which maps to baa2 on the long-term scale, reflects the bank's good domestic franchise. However, the rating is constrained by the bank's limited net profit and volatile earnings (due to mark-to-market adjustments), as well as the ongoing need to focus on its managing asset quality, particularly that of large single-name exposures, through the economic downturn.

Moody's considers Denmark as a low support country, primarily reflecting the government's willingness to impose losses on senior creditors and depositors in accordance with the bail-in legislation implemented in October 2010 (Bank Package III) and as evidenced by the bail-in of Amagerbanken in February 2011. In view of Jyske Bank's position in Denmark and strength in Jutland and despite its only moderate nationwide coverage, Moody's takes into account a one-notch systemic support uplift for Jyske Bank's Baa1 long-term GLC deposit rating from its baa2 standalone financial strength.

Rating Drivers

- Good domestic franchise
- Adequate core profitability, but weakened due to operating environment factors
- Adequate funding and liquidity profile, but continued pressure following implementation of Bank Package III
- Asset quality deterioration, and some credit concentration in the lending portfolio

Rating Outlook

The outlook on all ratings is stable.

What Could Change the Rating - Up

Rating upgrades are unlikely in the near future, for the reasons described in "Recent Credit Developments". A limited amount of upward rating momentum could develop if Jyske Bank demonstrates (i) continued good access to capital markets, (ii) stronger and more stable earnings generation without an increase in its risk profile and/or (iii) improved asset quality management especially in relation to more volatile segments such as agriculture and commercial real estate.

What Could Change the Rating - Down

While the current rating levels incorporate a degree of expected further deterioration, ratings may decline further if (i) Jyske Bank's financing conditions become more difficult, (ii) its asset quality deteriorates more than we anticipate and/or (iii) its risk profile increases, for example as a result of increased exposures to more volatile sectors or increased involvement in more risky operations such as capital market activities.

DETAILED RATING CONSIDERATIONS

Detailed considerations for Jyske Bank's currently assigned ratings are as follows:

Bank Financial Strength Rating

Moody's assigns a C- standalone BFSR to Jyske Bank. The assigned rating is one notch lower than the outcome of Moody's bank financial strength scorecard for Jyske Bank based on three-year average data, but in line with the scorecard outcome based on the most recent year. This primarily reflects Jyske Bank's exposures to more volatile industries such as agriculture and commercial real estate, which we deem more vulnerable to the current less favourable operating environment and more likely to lead to larger provisioning needs if credit quality deteriorates.

Good Domestic Franchise

Jyske Bank enjoys a solid franchise as one of the leading banks in Denmark, with total assets of DKK 270.2 billion (EUR 36 billion) at YE 2011. A large proportion of mortgage loans originated by the bank are financed by Totalkredit, DLR Kredit and Nykredit Realkredit, and as such do not appear on the bank's balance sheet. Additionally, a smaller part of the bank's home loan products are expected to be financed through covered bonds issued by BRFKredit.

Jyske Bank is the third largest bank for both deposits and lending with market shares, based on Moody's estimates, of approximately 8% and 9%, respectively. The bank has a nationwide presence, with its strongest franchise in Jutland, where the majority of its branches and its headquarters are located.

In September 2011, Jyske Bank acquired part of the leasing arm of Spar Nord, Easy Fleet and Finans Nord. Moody's expect that this will further strengthen Jyske Bank's growth strategy and increase lending potential for the group.

Additionally, in October 2011, the bank took over deposits of DKK 3.5 billion and total lending of DKK 2.3 billion through the acquisition of parts of Fjorbank Mors from the Financial Stability Company. Moody's positively notes that this has given Jyske Bank a key presence in the Mors region in Jutland. Moody's expect further consolidation of the Danish banking sector throughout 2012 which will give more opportunities to gain market share in a market where organic growth is limited.

Jyske Bank has cooperation agreements with mortgage and life insurance providers, which enable it to maintain cost efficiency while maintaining market share.

Adequate Core Profitability, But Weakened Due To Operating Environment

Based on three year average data, Jyske Bank's risk weighted profitability of 2.72% indicates an adequate profitability, with the 2011 full year number of 1.97% revealing a relative weakening. Despite an increase in net interest income and a 10% increase in retail and corporate customers, results were negatively affected by negative value adjustments and an increase in operating costs. Moody's positively note that the bank has taken measures to reduce its cost base by streamlining the workforce which resulted in a one off cost of DKK 80 million in 2011.

For the full year 2011, Jyske Bank reported a pre-tax profit of DKK 601 million, down 40% from DKK 1 billion at year-end 2010, which was attributable to a number of one-off items adversely affecting core earning by a total of DKK 497 million. More substantially, due to the worsening of the European debt crisis, Jyske Bank's portfolio of Greek bonds was negatively adjusted to reflect market value, resulting in total expenses of DKK 299 million.

Loan loss provisions decreased from approximately DKK 1.6 billion in 2010 to DKK 1.5 billion in 2011, and accumulated loan loss provisions amounted to DKK 3.9 billion of which 84% was related to corporate customers, primarily from agriculture, real estate and construction.

At end-March 2012 Jyske Bank reported core earnings before impairment charges of DKK 746 million, up from DKK 541 million relative to the same period in 2011. The increase is partly due to higher net interest and fee income, as well as an increase of DKK 215 million in value adjustments. We note that value adjustments were adversely affected by the forced conversion of Jyske Bank's holdings of Greek government bond under the Private Sector Initiative (PSI).

It will be important for Jyske Bank to improve its core top-line results going forward in order to mitigate any deterioration of the loan portfolio where Moody's expect customers to face increased challenges due to, amongst others, the effects of a slow growth environment and falling asset prices in real estate and agriculture. Jyske Bank has raised margins multiple times in 2011 and the effects are expected to be seen from the third quarter of 2012.

Adequate Funding Profile, But Continued Pressure Following Implementation Of Bank Package III

Jyske Bank's deposit funding profile is improving. As year-end 2011, deposits covered 95% of loans and accounted for approximately 47% of Jyske Bank's total funding. Interbank funding increased to 12.75% of total funding at year-end 2011, up from 10.22% at year-end 2010, with market funding making up the remainder.

In addition, the bank continues to place its mortgage loans with Nykredit Realkredit / Totalkredit and DLR.

Jyske Bank announced in January 2012 a new funding tool allowing the bank to fund part of its new origination of private client home loans through covered bonds issued by BRFKredit (unrated). This provides Jyske Bank with a flexible long-term funding alternative at a time when access to unsecured markets remains expensive.

Moody's notes that Jyske Bank has not participated in the Danish government's funding support scheme (banking package II) and that the bank was able to issue a benchmark issue of DKK 3.7 billion (EUR 500 million) on a standalone basis during 2011. In Moody's opinion, funding pressure will increase going forward post Bank Package III, as funding costs remain at elevated levels, in particular senior unsecured markets, therefore the new agreement with BRFKredit offers some relief, although this will only represent a smaller part of the bank's funding need. The political agreement "Bank Package IV", announced in August 2011 and proposed in law in December, supports banks that have liquidity problems during a takeover process. The package was successfully used in the resolution of Max Bank in October 2011 and later in April 2012 for Sparekassen Ostjylland and Spar Salling, however it remains to be seen to what extent this mitigating tool will be used further.

Jyske Bank also completed a new share issue through a private placement to existing international and domestic shareholders in Q1 2012, resulting in gross proceeds of nearly DKK 1.2 billion.

At year-end 2011, the bank's liquid assets stood at nearly 40% of total assets, giving it a satisfactory liquidity profile, since a majority of these assets can be used for repos with the central bank. The bank's bond portfolio consists mainly of mortgage bonds from Denmark and Europe, as well as government bonds.

Asset Quality Deterioration but good capital cushion

At end-December 2011, loan impairments accounted for around 78% of pre-provision income. Loans for which an objective indication for impairment occurred almost tripled from DKK2.7 billion (2.0% of gross loans) in 2008 to DKK8.7 billion (7% of gross loans) in 2011. Only around 33% of total lending and guarantees were to private individuals at YE2011, as the mortgage loans financed via Totalkredit, Nykredit and DLR do not appear on Jyske Bank's balance sheet. Danish mortgage loans tend to be originated by banks, but then transferred to specialist mortgage institutions - such as Nykredit Realkredit and DLR Kredit - in return for a periodic fee. This practice primarily reflects the funding advantage of mortgage credit institutions, due to their use of covered bond funding. As a result, mortgage institutions hold most lower-risk first-lien loans, whilst the banks, including Jyske Bank, tend to hold either second or sequential-lien loans. Jyske Bank's largest industry exposures include credit, finance and insurance at around 29%, property administration & services at around 8%, manufacturing, mining, and energy at almost 8%, and agriculture exposures to corporates represent 6% of lending. The loan book is mainly focused on Denmark (almost 90%).

When looking at top 20 limits for single-name exposures, not taking collateral into consideration, in relation to Tier 1 capital, Jyske Bank's borrower concentration is relatively high when compared with that of other European banks,

but this is in line with many Nordic banking peers. The bank had eight exposures accounting for between 5%-7.5%, and three exposures accounting for between 7.5%-10% of the total capital base.

Jyske Bank reports strong capitalisation ratios. At end-2011, Jyske Bank's Tier 1 ratio stood at 13.3%, with a total capital adequacy ratio of 14.7%, as calculated under transitional rules towards full Basel II. The corresponding figures at end-2010 were 14.1% and 15.8%, respectively. The individual solvency requirement for the bank is 10%, which as of end-December 2011 meant the bank had a capital cushion exceeding its individual requirement of DKK 5.1 billion (equivalent to 4.1% of total loans to customers). Jyske Bank raised DKK 1.2 million further capital in March 2012.

As a result, at end-March 2012 the bank reported strong capital ratios of 15% and 16.5% for Tier 1 and total capital adequacy ratios, respectively.

Moody's expect the weaker macro-economic environment in Denmark will put further pressure on the bank's profitability and ultimately on capital adequacy. Given the continued challenges in Jyske Bank's operating environment it remains crucial for the bank to sustain a high capital buffer to mitigate any future asset deterioration. In particular, we remain concerned about exposures to sectors such as agriculture, commercial real estate and SMEs.

Global Local Currency Deposit Rating (Joint Default Analysis)

Moody's assigns a global local currency deposit rating of Baa1 to Jyske Bank. In view of the bank's position in Denmark and strength in its local area of Jutland and despite its only moderate nationwide coverage, the Baa1 global local currency deposit rating receives a one-notch uplift from the baa2 BCA.

Notching Considerations

The ratings for the Bank's hybrid obligations are notched off the BCA according to "Moody's Guidelines for Rating Bank Hybrid Securities and Subordinated Debt" released on 17 November 2009.

Foreign Currency Deposit Rating

The Baa1 foreign currency deposit ratings of Jyske Bank are unconstrained given that Denmark, in common with other EU members, has a country ceiling of Aaa.

Foreign Currency Debt Rating

The Baa1 foreign currency debt ratings of Jyske Bank are unconstrained given that Denmark, in common with other EU members, has a country ceiling of Aaa.

Bank Financial Strength Rating

Moody's Bank Financial Strength Ratings (BFSRs) represent Moody's opinion of a bank's intrinsic safety and soundness and, as such, exclude certain external credit risks and credit support elements that are addressed by Moody's Bank Deposit Ratings. Bank Financial Strength Ratings do not take into account the probability that the bank will receive such external support, nor do they address risks arising from sovereign actions that may interfere with a bank's ability to honor its domestic or foreign currency obligations. Factors considered in the assignment of Bank Financial Strength Ratings include bank-specific elements such as financial fundamentals, franchise value, and business and asset diversification. Although Bank Financial Strength Ratings exclude the external factors specified above, they do take into account other risk factors in the bank's operating environment, including the strength and prospective performance of the economy, as well as the structure and relative fragility of the financial system, and the quality of banking regulation and supervision.

Moody's uses the Baseline Credit Assessment (BCA) to map BFSRs onto the 21-point aaa-c rating scale and like the BFSR, it reflects a bank stand-alone default risk. Each point on the aaa-c scale represents a specific probability of default and therefore allows Moody's to use the BCA as an input to Moody's Joint Default Analysis (JDA), described below. The baseline credit assessment reflects what the local currency deposit rating of the bank with the given BFSR would be without any assumed external support from a government or third party

Global Local Currency Deposit Rating

A deposit rating, as an opinion of relative credit risk, incorporates the Bank Financial Strength Rating as well as Moody's opinion of any external support. Specifically, Moody's Bank Deposit Ratings are opinions of a bank's ability to repay punctually its deposit obligations. As such, Moody's Bank Deposit Ratings are intended to incorporate those aspects of credit risk relevant to the prospective payment performance of rated banks with respect to deposit obligations, and includes: intrinsic financial strength, sovereign transfer risk (in the case of foreign currency deposit ratings), and both implicit and explicit external support elements. Moody's Bank Deposit Ratings do not take into account the benefit of deposit insurance schemes which make payments to depositors, but they do recognize the potential support from schemes that may provide assistance to banks directly.

According to Moody's joint default analysis (JDA) methodology, the global local currency deposit rating of a bank is determined by the incorporation of any external elements of support into the bank's Baseline Credit Assessment. In assigning the local currency deposit rating to a bank, the JDA methodology also factors in the rating of the various potential support providers (parent company, cooperative group, regional or national governments), as well as the degree of dependence that may exist between each one of them and the bank. Moody's assessment of the probability of systemic support (by a national government) is derived from the analysis of the capacity of a government and its central bank to provide support on a system-wide basis. The systemic support indicator is determined for a particular country and serves as an input for all bank ratings in that country. The support indicator can be set at, above or, in rare cases, below the government's local currency bond rating for that country.

Foreign Currency Deposit Rating

Moody's ratings on foreign currency bank obligations derive from the bank's local currency rating for the same class of obligation. The implementation of JDA for banks can lead to high local currency ratings for certain banks, which could also produce high foreign currency ratings. Nevertheless, it should be noted that foreign currency deposit ratings are in all cases constrained by the country ceiling for foreign currency bank deposits. This may result in the assignment of a different, and typically lower, rating for the foreign currency deposits relative to the bank's rating for local currency obligations.

Foreign Currency Debt Rating

Foreign currency debt ratings are derived from the bank's local currency debt rating. In a similar way to foreign currency deposit ratings, foreign currency debt ratings may also be constrained by the country ceiling for foreign currency bonds and notes; however, in some cases the ratings on foreign currency debt obligations may be allowed to pierce the foreign currency ceiling. A particular mix of rating factors are taken into consideration in order to assess whether a foreign currency bond rating pierces the country ceiling. They include the issuer's global local currency rating, the foreign currency government bond rating, the country ceiling for bonds and the debt's eligibility to pierce that ceiling.

About Moody's bank financial strength scorecard

Moody's bank financial strength model (see scorecard below) is a strategic input in the assessment of the financial strength of a bank, used as a key tool by Moody's analysts to ensure consistency of approach across banks and regions. The model 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 Factors

Jyske Bank A/S

Rating Factors [1]	A	B	C	D	E	Total Score	Trend
Qualitative Factors (50%)						C	
Factor: Franchise Value						D+	--
Market Share and Sustainability			x				
Geographical Diversification				x			
Earnings Stability				x			
Earnings Diversification [2]							

Factor: Risk Positioning						C-	--
Corporate Governance [2]							
- Ownership and Organizational Complexity	--	--	--	--	--		
- Key Man Risk	--	--	--	--	--		
- Insider and Related-Party Risks	--	--	--	--	--		
Controls and Risk Management		x					
- Risk Management			x				
- Controls	x						
Financial Reporting Transparency		x					
- Global Comparability	x						
- Frequency and Timeliness	x						
- Quality of Financial Information		x					
Credit Risk Concentration					x		
- Borrower Concentration	--	--	--	--	--		
- Industry Concentration	--	--	--	--	--		
Liquidity Management			x				
Market Risk Appetite	x						
Factor: Operating Environment						B	--
Economic Stability				x			
Integrity and Corruption	x						
Legal System	x						
Financial Factors (50%)						C	
Factor: Profitability						C	--
PPI / Average RWA - Basel II		2.72%					
Net Income / Average RWA - Basel II				0.60%			
Factor: Liquidity						C	--
(Mkt funds-Liquid Assets) / Total Assets			4.77%				
Liquidity Management			x				
Factor: Capital Adequacy						A	--
Tier 1 Ratio - Basel II	13.63%						
Tangible Common Equity / RWA - Basel II	12.95%						
Factor: Efficiency						C	--
Cost / Income Ratio			59.12%				
Factor: Asset Quality						D	--
Problem Loans / Gross Loans				5.88%			
Problem Loans / (Equity + LLR)				40.16%			
Lowest Combined Score (15%)						D	
Economic Insolvency Override						Neutral	
Aggregate Score						C	
Assigned BFSR						C-	

[1] - Where dashes are shown for a particular factor (or sub-factor), the score is based on non public information [2] - A blank score under Earnings diversification or Corporate Governance indicates the risk is neutral



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