

CREDIT OPINION

3 June 2022

New Issue



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RATINGS

Arbejdernes Landsbank A/S

Domicile	Copenhagen, Denmark
Long Term CRR	A2
Type	LT Counterparty Risk Rating - Fgn Curr
Outlook	Not Assigned
Long Term Debt	Withdrawn
Type	Senior Unsecured - Fgn Curr
Outlook	Not Assigned
Long Term Deposit	A2
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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Arbejdernes Landsbank A/S

New Issuer - Danish workers' bank becomes SIFI following acquisition

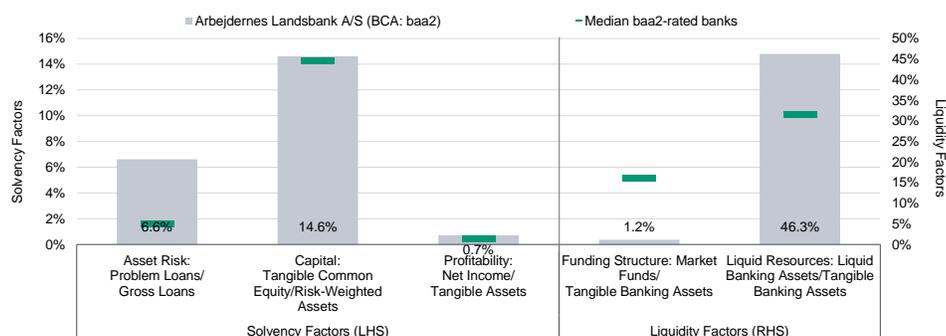
Summary

On May 31, Moody's assigned deposit ratings of A2/P-1 to Arbejdernes Landsbank A/S (AL Bank) and a Baseline Credit Assessment (BCA) and Adjusted BCA of baa2. The outlook on the long-term deposit ratings is stable.

The deposit ratings reflect AL Bank's baa2 BCA, which captures the bank's very strong capitalization, along with a stable deposit base and high liquidity buffers, balanced against elevated asset risks, stemming primarily from the majority stake in Vestjysk Bank A/S (Vestjysk Bank), and volatile profitability. The ratings also reflect the strong loss protection given failure, because of significant amounts of loss-absorbing liabilities, as per our Advanced Loss Given Failure (LGF) analysis.

Exhibit 1

Rating scorecard - Key financial ratios



Source: Moody's Investors Service

The metrics presented in the exhibit are our [Banks Methodology](#) scorecard ratios. Asset risk and profitability reflect the weaker of either the three-year average or the latest annual figure. Capital is the latest reported figure. Funding structure and liquid resources reflect the latest fiscal year-end figures.

Credit strengths

- » Popular retail franchise across Denmark, now also catering to corporates through Vestjysk Bank
- » Strong capitalization

- » Very strong funding and liquidity profile

Credit challenges

- » High asset risk, which increased with consolidation of Vestjysk Bank
- » Modest profitability with risk of being volatile

Rating outlook

The stable outlook reflects Moody's expectations that AL Bank will have a stable capitalisation and liquidity position, while working on gradually reducing the volumes of non-performing loans in Vestjysk Bank. Profitability will remain modest with higher interest rate income being offset by increased investments in IT.

Factors that could lead to an upgrade

- » The ratings could be upgraded once there is evidence of a strong governance control of Vestjysk Bank by AL Bank, with an integrated risk overview of the banks. Furthermore, the ratings could be upgraded if asset risk is reduced meaningfully, combined with higher capitalisation.

Factors that could lead to a downgrade

- » The ratings could be downgraded if the BCA is downgraded or if the LGF uplift decreases. The BCA could be downgraded if: (i) problem loans increase rapidly; or (ii) capitalisation declines below 13%; or (iii) recurring profitability declines or if there is large volatility in profitability; or (iv) the liquidity position significantly deteriorates.
- » The LGF uplift for senior notes could reduce, if the bank issues significantly lower amounts of senior non-preferred debt than Moody's estimations, with the bank expected to issue in excess DKK8.8 billion by the end of 2025.

Key Indicators

Exhibit 2

Arbejdernes Landsbank A/S (Consolidated Financials) [1]

	12-21 ²	12-20 ²	12-19 ²	12-18 ²	CAGR/Avg. ³
Total Assets (DKK Million)	107,365.8	62,842.6	58,957.3	55,097.7	24.9 ⁴
Total Assets (USD Million)	16,359.8	10,330.0	8,856.4	8,440.3	24.7 ⁴
Tangible Common Equity (DKK Million)	9,080.8	6,328.6	6,071.2	5,560.3	17.8 ⁴
Tangible Common Equity (USD Million)	1,383.7	1,040.3	912.0	851.8	17.6 ⁴
Problem Loans / Gross Loans (%)	6.6	4.9	5.4	8.8	6.4 ⁵
Tangible Common Equity / Risk Weighted Assets (%)	14.6	17.6	17.1	16.9	16.6 ⁶
Problem Loans / (Tangible Common Equity + Loan Loss Reserve) (%)	28.1	17.0	18.4	29.7	23.3 ⁵
Net Interest Margin (%)	1.8	1.8	1.9	1.9	1.8 ⁵
PPI / Average RWA (%)	1.4	0.9	1.4	0.6	1.1 ⁶
Net Income / Tangible Assets (%)	0.9	0.5	0.8	0.4	0.7 ⁵
Cost / Income Ratio (%)	76.4	84.7	78.3	88.2	81.9 ⁵
Market Funds / Tangible Banking Assets (%)	1.1	2.9	3.9	4.4	3.1 ⁵
Liquid Banking Assets / Tangible Banking Assets (%)	46.2	49.5	49.0	49.6	48.6 ⁵

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Gross Loans / Due to Customers (%) 59.9 54.7 55.8 57.2 56.9⁵

[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

Arbejdernes Landsbank A/S (AL Bank) is a commercial bank established in 1919 by Danish Unions as a workers' bank. Headquartered in Copenhagen, it offers banking services through 71 branches across Denmark as of December 2021, targeting retail and corporate clients. It also offers vehicle financing through its subsidiary AL Finans A/S. AL Bank increased its ownership of Vestjysk Bank to 72.7% in 2021, as part of its expansion strategy for 2025, with the decision to maintain the two banks' franchises separate.

The bank held total assets of DKK107 million as of December 2021 and, with market shares in terms of loans and deposits of 0.9% and 4.6% in Denmark as of end-December 2020, is recognized as a systemically important institution in Denmark since June 2021. The bank is majority owned and controlled by five large Danish trade-unions, with smaller unions, and around 23,000 individual shareholders owning the remainder of the bank's equity.

Detailed credit considerations

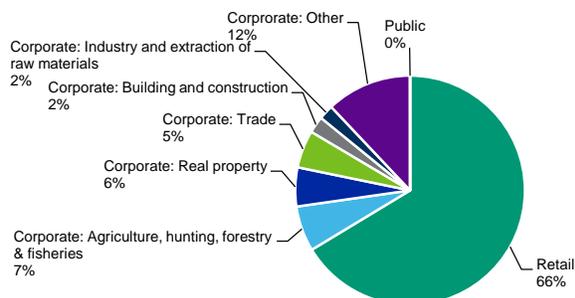
High asset risk, considering consolidation of Vestjysk Bank

Our assigned ba2 Asset Risk score reflects Arbejdernes Bank's good track record, but also heightened asset risk following the acquisition of Vestjysk Bank in the first half of 2021, which carries a higher risk loan portfolio. Our score also takes into account the loan portfolio's concentration to real estate at 8% and 7% to agriculture, forestry and fisheries of the total credit exposures as of year-end 2021 (Exhibit 3) and moderately high single name concentration with 17% of gross loans extended to the 20 largest borrowers.

Exhibit 3

The loan portfolio is more diversified since the acquisition of Vestjysk Bank

Loans and guarantees by sectors as of end-December 2021



Source: AL Bank's 2021 annual report

Arbejdernes Bank's nonperforming loans (NPLs) accounted for 6.6% of gross loans as of year-end 2021, marking a notable increase from 4.9% at year-end 2020 prior to the acquisition of Vestjysk Bank, which has relatively higher risk appetite, evidenced by a problem loans' ratio of 9.1% as of year-end 2021. We also acknowledge that the bank's NPL ratio has been historically higher than its Danish rated peers' aggregate average of 4.1% (Exhibit 4). The pandemic did not lead to a weakening in asset quality, as evidenced by the higher NPL ratio of 5.4% as of year-end 2019 compared to 2020.

Exhibit 4

Problem loans increased and loan loss coverage decreased after consolidation of Vestjysk Bank

Sources: AL Bank's financial statements, Moody's Investors Service

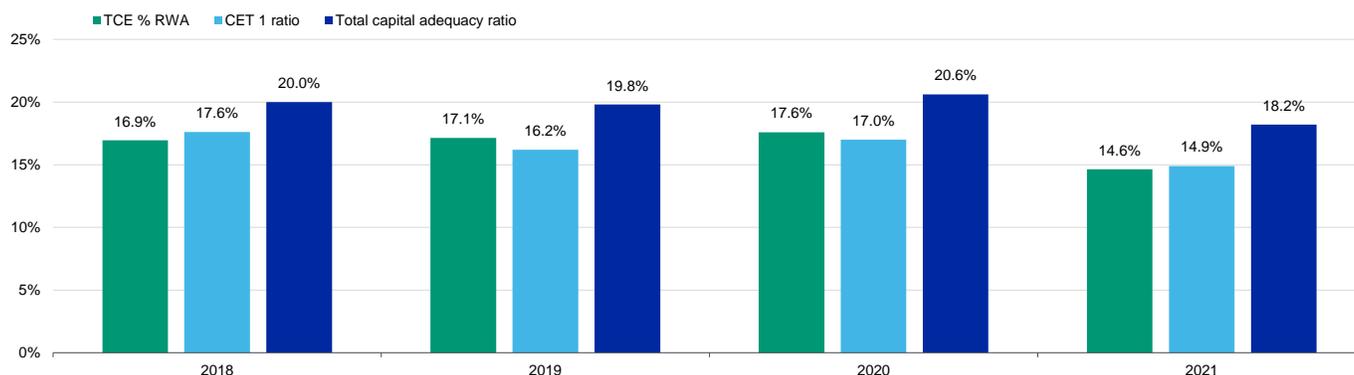
Provisioning coverage for the Group stood at 36% as of year-end 2021, down from 69% a year earlier, meaning that further loan loss provisions could be needed if operating environment deteriorates. The management overlay for potential unexpected pandemic impact was DKK225 million for the Group as of December 2021. Credit costs have increased in 2020 (0.12% of average gross loans) as the bank's response to the pandemic outbreak and in 2021 (0.52%) to cover the asset risk onboarded from Vestjysk Bank; in previous periods, the bank had reported a reversal in loan loss provisions.

Strong capitalization

Arbejdernes Landsbank's capitalization is strong, reflected in the a2 assigned score, although its capital buffers have declined relatively to its risk-weighted assets following the acquisition of Vestjysk Bank in the first half of 2021. Ahead of the completion of the acquisition of Vestjysk Bank's majority share, AL Bank issued DKK1.8 billion of shares to support the bank's expansion. Our assigned score also reflects the increase in risk-weighted assets over time and future dividends, which are expected to be in the range of 20%-40% of net income. Despite the capital injection the bank's tangible common equity (TCE)-to-RWA ratio declined to 14.6% by year-end 2021, from 17.6% a year earlier and 17.1% at year-end 2019. The bank's TCE-to-RWA ratio is slightly higher than the 14.3% of global peers with a baa2 BCA and below the aggregate average of 17.7% for Danish rated peers.

The bank's Common Equity Tier 1 (CET1) capital ratio was 14.9% and the total capital ratio was 18.2% as of year-end 2021 (Exhibit 5), comfortably above the regulatory requirements of 8.1% and 12.5%, respectively. The bank has been recognized as a systemically important financial institution since June 2021, following the acquisition of Vestjysk Bank, thereby requiring the bank to hold an additional buffer requirement of 1% from year-end 2022 onwards. The Ministry of Industry, Business and Financial Affairs has also decide to re-instate the countercyclical buffer to 1% from September 2022 and raising it to 2% by year-end 2022. Further, the Systemic Risk Council recommended to further increase the countercyclical buffer to 2.5% by March 2023.

Exhibit 5

Capitalisation is strong, but declined due to acquisition of majority stake in Vestjysk Bank

Sources: AL Bank's financial statements, Moody's Investors Service

Modest profitability with risk of being volatile

We view AL Bank's profitability as modest, with the assigned baa2 profitability score also reflecting the owners' targets of return on equity of below 10%. AL Bank's profitability has been volatile over the past few years, partly as a result of the higher provisions taken amid the pandemic and merger costs.

AL Bank has relatively lower profitability targets than other commercial banks, which translates to a modest net income-to-tangible assets ratio. In 2021, the ratio improved to 0.9%, from 0.5% in 2020, returning close to its 2019 level of 0.8%. We expect that profitability ratio will remain at 0.9% over the next 12-18 months. However, there is a risk that profitability will be volatile due to provisioning needs and IT investments over the coming years, thereby partly offsetting improved interest margins on the back of increased interest rates.

Very strong funding and liquidity profile

Arbejdernes Landbank's operations are primarily funded through deposits, accounting for 73% of total liabilities as of year-end 2021, while historically-low market funding is expected to increase with the bank issuing a considerable amount of senior debt in order to meet its 2025 minimum requirement for own funds and eligible liabilities (MREL) of 23.5%. Market funds accounted for 1.2% of the bank's consolidated tangible banking assets as of year-end 2021, with the only debt being issued by Vestjysk Bank. By the end of 2025, we expect that market funds ratio will be approximately 10% as Minimum Requirements for own funds and Eligible Liabilities (MREL) will force the bank to issue in excess of DKK 8.8 billion in senior non-preferred debt. During the phase-in period, the market funds ratio will gradually increase.

As with other medium-sized Danish banks, Arbejdernes Landbank can secure mortgage financing through specialised mortgage lenders, for example, Totalkredit A/S or DLR Kredit A/S. Loans funded by these specialised lenders are transferred to these institutions and do not appear on the bank's balance sheet.

AL Bank's liquidity buffers are strong, with its liquid banking assets at 46% of tangible banking assets as of December 2021, and is likely to continue strengthening in the coming years as debt is issued. Liquid assets comprised of cash and equivalents (at 11% of total assets), interbank (1%) and trading securities (27%). Arbejdernes Landbank's liquidity coverage ratio is comfortably above the 100% minimum requirement, set by the Danish FSA.

The bank's net loan-to-deposit ratio was 59% as of December 2021, up from 53% a year earlier.

ESG considerations

In line with our general view of the banking sector, AL Bank has low exposure to environmental risks (see our [environmental risk heat map](#) for further information).

The most relevant social risks for banks arise from the way they interact with their customers (see our [social risk heat map](#) for further information). 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 further social risks. Societal trends are also relevant in a number of areas, such as shifting customer preferences towards digital banking services, increasing information technology cost, ageing population concerns in several countries, including Denmark, affecting demand for financial services or socially driven policy agendas that may translate into regulations that affect banks' revenue base. We also regard the pandemic as a social risk under our environmental, social and governance (ESG) framework, given the substantial implications for public health and safety. Overall, banks, including AL Bank, face moderate social risks.

Governance is highly relevant for AL Bank, as it is to all participants in the banking industry. Nonetheless, corporate governance remains a key credit consideration and requires ongoing monitoring. The BCA reflects a one notch negative adjustment to reflect the strategic risks related to the acquisition of the majority stake in Vestjysk Bank. The acquisition increases AL Bank's governance and control risks, due to the subsidiary retaining its own independent risk management function and establishing its own risk appetite. AL Bank is responsible for the overall group's risk tolerance and is implementing a coherent risk approach for the two banks. While the group risk tolerance and several group risk policies are in place, the downward notching speaks to that the operational implementation of these are not yet fully integrated yet.

Support and structural considerations

Loss Given Failure (LGF) analysis

Arbejdernes Bank is subject to the EU's Bank Recovery and Resolution Directive (BRRD), which we consider an operational resolution regime. Therefore, in accordance with our methodology, we apply our Advanced LGF analysis to the bank's liabilities, considering the risk exposures of the different debt and deposit classes across its liability structure if the group enters resolution.

Our Advanced LGF analysis is applied to the bank's consolidated group in line with the Danish FSA's single-point-of-entry resolution strategy. In our Advanced LGF analysis, we use our standard assumptions and assume residual tangible common equity of 3% and losses post-failure of 8% of tangible banking assets. We also assume a 25% run-off in "junior" wholesale deposits and a 5% runoff in preferred deposits, and assign a 25% probability to deposits being preferred to senior unsecured debt.

Under these assumptions and using a forward-looking horizon, for Arbejdernes Landsbank's A2 deposit rating, our LGF analysis indicates a extremely low loss given failure, leading to three notches of rating uplift from the entity's baa2 Adjusted BCA. The forward looking LGF takes into account Moody's estimate of upcoming issuances of senior non-preferred debt in excess of DKK8.8 billion up until end of 2025, based on a fully phased in MREL of 27.4%.

Government support considerations

We consider a low probability of support from the Government of Denmark for Arbejdernes Landsbank, resulting in no uplift incorporated in its A2 long-term Deposit rating. This reflects that, although the bank is of systemic importance, with a market share of 4.6% in deposits as of year-end 2020, the bank is small in the context of the Danish banking system.

Counterparty Risk Ratings (CRRs)

Arbejdernes Landbank's CRR is A2/P-1

The CRR, before government support, is three notches above the Adjusted BCA of baa2, reflecting a moderate loss given failure from the volume of instruments that will be subordinated to CRR liabilities. Further, the bank's CRR does not benefit from any rating uplift based on government support, in line with our support assumptions on senior debt.

Counterparty Risk (CR) Assessment

Arbejdernes Landbank's CR Assessment is A2(cr)/P-1(cr)

The preliminary CR Assessment is three notches above the entity's baa2 Adjusted BCA, reflecting the buffer against default provided to more junior obligations represented by the CR Assessment. To determine the CR Assessment, we focus purely on subordination, taking no account of the volume of the instrument class. Finally, the bank's CR Assessment does not benefit from any government support uplift.

Rating methodology and scorecard factors

Exhibit 6

Arbejdernes Landsbank A/S

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	6.6%	ba1	↑	ba2	Quality of assets						
Capital											
Tangible Common Equity / Risk Weighted Assets (Basel III - transitional phase-in)	14.6%	a1	↓	a2	Expected trend						
Profitability											
Net Income / Tangible Assets	0.7%	baa2	↑	baa2	Return on assets						
Combined Solvency Score		baa1		baa2							
Liquidity											
Funding Structure											
Market Funds / Tangible Banking Assets	1.1%	aa1	↓↓	a2	Expected trend						
Liquid Resources											
Liquid Banking Assets / Tangible Banking Assets	46.2%	aa3	↔	aa3	Expected trend						
Combined Liquidity Score		aa2		a1							
Financial Profile											
				baa1							
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				baa1 - baa3							
Assigned BCA				baa2							
Affiliate Support notching				0							
Adjusted BCA				baa2							
Balance Sheet											
		in-scope (DKK Million)	% in-scope	at-failure (DKK Million)	% at-failure						
Other liabilities		12,704	14.2%	19,876	22.2%						
Deposits		71,720	80.0%	64,548	72.0%						
Preferred deposits		53,790	60.0%	51,101	57.0%						
Junior deposits		17,930	20.0%	13,448	15.0%						
Junior senior unsecured bank debt		350	0.4%	350	0.4%						
Dated subordinated bank debt		1,500	1.7%	1,500	1.7%						
Preference shares (bank)		730	0.8%	730	0.8%						
Equity		2,691	3.0%	2,691	3.0%						
Total Tangible Banking Assets		89,694	100.0%	89,694	100.0%						
Debt Class											
		De Jure waterfall		De Facto waterfall		Notching		LGF	Assigned	Additional	Preliminary
		Instrument	Sub-	Instrument	Sub-	De Jure	De Facto	Notching	LGF	Notching	Rating
		subordination	ordination	subordination	ordination			Guidance	notching		Assessment
								vs.			
								Adjusted			
								BCA			
Counterparty Risk Rating	20.9%	20.9%	20.9%	20.9%	3	3		3	3	0	a2
Counterparty Risk Assessment	20.9%	20.9%	20.9%	20.9%	3	3		3	3	0	a2 (cr)
Deposits	20.9%	5.9%	20.9%	5.9%	2	2		2	3	0	a2

Instrument Class	Loss Given Failure notching	Additional notching	Preliminary Rating Assessment	Government Support notching	Local Currency Rating	Foreign Currency Rating
Counterparty Risk Rating	3	0	a2	0	A2	A2
Counterparty Risk Assessment	3	0	a2 (cr)	0	A2(cr)	
Deposits	3	0	a2	0	A2	A2

[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 7

Category	Moody's Rating
ARBEJDERNES LANDSBANK A/S	
Outlook	Stable
Counterparty Risk Rating	A2/P-1
Bank Deposits	A2/P-1
Baseline Credit Assessment	baa2
Adjusted Baseline Credit Assessment	baa2
Counterparty Risk Assessment	A2(cr)/P-1(cr)

Source: Moody's Investors Service

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