# Nordea's Move to Finland: Comments on Changing Capital Requirements

**In this short report Scope comments on the recent disclosures from Nordea Bank AB (issuer rating: AA-, stable outlook), focusing on the state of play regarding changes to the bank's future capital requirements once the ECB becomes its primary supervisor.**

Following Nordea's decision on 6th September 2017 to start the process of relocating the bank to Finland, Nordea has released additional information on its progress. Pending approval from shareholders, Nordea now expects that its change of domicile will occur on or around 1st October 2018, and has entered into dialogue with the ECB, which will be responsible for setting the Group's new capital requirements. No formal requirements have yet been transmitted to the bank, but the following considerations apply:

- Nordea expects 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. The bank says that it expects to know more about its new capital requirements by the time its re-domiciliation is completed.
- 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. Despite high headline capital ratios, in part driven by Pillar 1 buffer requirements imposed by Swedish regulators, and extra Pillar 2 requirements (see Figure 1) compared to international peers, Swedish banks' leverage is slightly below European bank norms (Nordea's was 4.9x at 3Q17), 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). Some observers have assumed that coming under the ECB's supervision and being evaluated via the TRIM process could lower Nordea's real capital requirements. While the headline capital ratio may fall, Scope does not believe that this is the case. Lower real capital requirements do not appear to constitute Nordea's motivation for its move to Finland. Importantly, the bank has also affirmed that it does not intend to make changes to its current capital and dividend policies, and that maintaining credit ratings in the AA range continue to be part of management's strategy. Amongst other factors, Scope will monitor leverage ratios and risk asset intensity in addition to reported capital ratios post-transition.
- Given the extensive differences in the applicable regulatory regimes, Scope agrees with Nordea's stated opinion that it is still too soon to say how much its total capital requirements will change.
- 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.

**Analyst**

Jennifer Ray
j.ray@scoperatings.com

**Associate**

Alvaro Dominguez Alcalde
a.dominguez@scoperatings.com

**Related Research**

Nordea's New Structure and Domicile Plans: A Manageable Challenge
4 October 2017

**Scope Ratings AG**

Suite 301
2 Angel Square
London EC1V 1NY

Phone +44 20 3457 04524

**Headquarters**

Lennéstraße 5
10785 Berlin

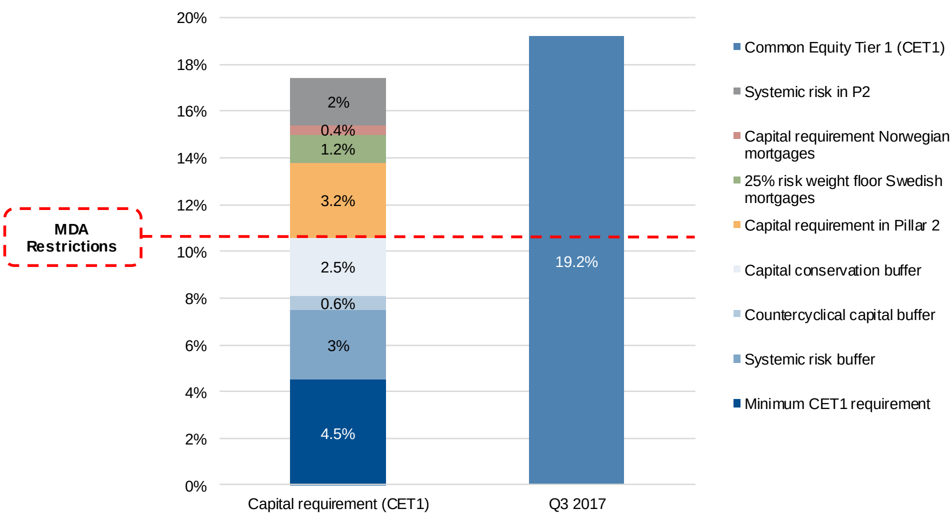
Phone +49 30 27891 0
Fax +49 30 27891 100

info@scoperatings.com
www.scoperatings.com

Bloomberg: SCOP

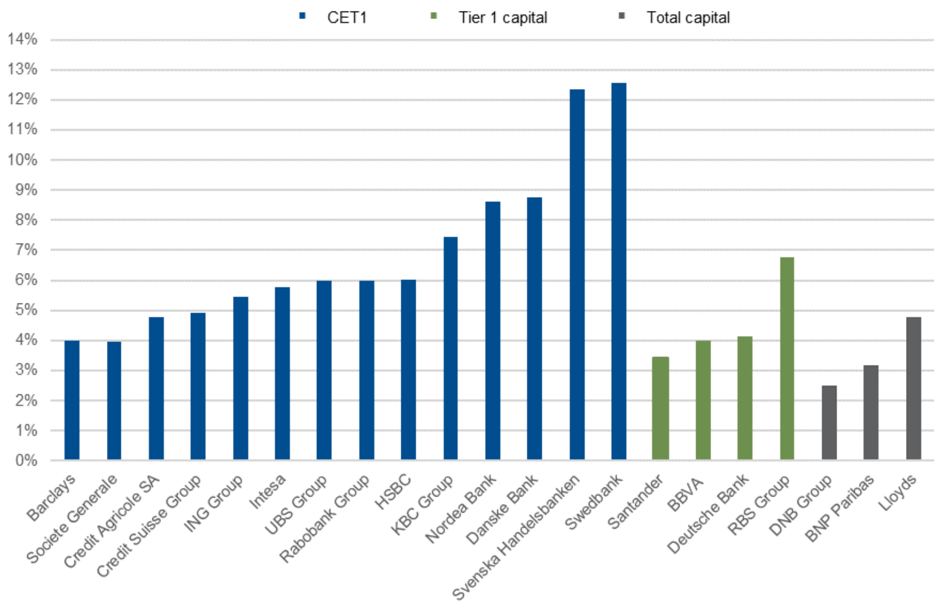
- Sweden's Finansinspektionen (FSA) discloses detailed capital requirements for Swedish banks on a quarterly basis, most recently for 3Q17. Within Pillar 1 for CET1 requirements, in addition to the usual 4.5% minimum, Nordea must adhere to a 3.0% systemic risk buffer, a 2.5% capital conservation buffer and an exposure-weighted 0.6% countercyclical capital buffer (see Figure 1). The 3.0% systemic risk buffer within CET1 doesn't currently apply in Finland. However, Nordea expects that Finland will have a legal framework allowing supervisors to set a similar buffer (between 1% and 5%) prior to its change of domicile.
- Within Pillar 2 Nordea is at present subject to a 2.0% CET1 capital requirement for systemic risk and a 1.6% CET1 capital requirement covering risk-weight floors for Swedish and Norwegian mortgages. Nordea has also been set institution-specific Pillar 2 requirements amounting to 3.2% of CET1 capital. Under the ECB's supervision these Swedish Pillar 2 requirements are expected to be replaced by a more 'holistic' approach. As is the case for other banks under ECB supervision, Nordea expects to be given a Pillar 2 requirement (P2R), which will be public, and an unpublished add-on known as Pillar 2 Guidance (P2G). Nordea notes that its peers have P2R requirements in the range of 1.25% to 3.25% in terms of CET1, as of 2Q17, but that P2G is impossible to estimate.
- None of the Pillar 2 add-ons currently required by the Swedish FSA have any effect on the maximum distributable amount (MDA) level which would trigger automatic restrictions on AT1 coupon distributions linked to the combined buffer requirement. They do not form part of the combined buffer requirement and although they are taken seriously by the Swedish FSA and shortfalls could lead to some form of regulatory action, they in effect constitute guidance similar to P2G. With the addition of formal P2R Nordea expects the MDA restriction level to increase under the ECB's supervision, as all capital requirements including P2R as well as the combined buffer will be relevant for determining the MDA threshold. We note that although the more domestically focused Swedish banks have higher headroom versus the MDA trigger, Nordea's headroom is amongst the highest within Scope's rated universe of AT1 securities (see Figure 2).

**Figure 1: Common Equity Tier 1 (CET1) requirement and current CET1 ratio for Nordea**




Source: Swedish FSA and company reports

**Figure 2: Headroom to MDA relevant requirements**




Note: Based on capital figures as of 3Q 2017 except for Rabobank which is based on capital figures as of 2Q 2017
Source: Company data, Scope Ratings

In conclusion, contrasts between the two very different supervisory regimes are likely to come under the spotlight to the extent that Nordea's real capital requirements change in either direction after its relocation within the Banking Union. This may affect investors' views on Nordea, but could also have ramifications for the remaining Swedish banks, especially if the real or headline impact is extensive. In this context, we would caution that Nordea's business mix is substantially different to that of other Swedish-based banks, being more international, and also with a greater focus on corporate lending, so the detailed risk weighting considerations will also vary considerably.

## Scope Ratings AG

### 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 82 88 55 57

### 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