Research Update:

Denmark-Based Securities Brokerage Firm Saxo Bank A/S Assigned 'BBB' Rating; Outlook Positive

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Rating Action Overview

- Saxo Bank A/S (Saxo) is a licensed banking group that is one of Europe's top retail securities brokers in terms of product offering, with a developing institutional franchise.
- Saxo has a well-established franchise in Europe, a historically cautious risk-management stance that we expect will evolve as margin lending expands after its 2019 BinckBank acquisition, and moderate scale relative to larger, more diversified global peers.
- In our base-case scenario, we expect Saxo will be appointed a systemically important bank by the Danish Financial Supervisory Authority (FSA) in the coming months, which could make it eligible for additional loss-absorbing capacity (ALAC) consideration/uplift.
- We therefore assigned our 'BBB' long-term issuer credit rating to Saxo.
- The positive outlook reflects that we could upgrade Saxo if we anticipate that the resolution strategy for the group and its expanding ALAC buffers could enhance the likelihood that senior preferred obligations continue to be paid on time and in full, even if the group failed.

Rating Action Rationale

The rating on Saxo reflects its modest business position, strong capital and earnings, limited risk appetite, and strong funding structure as a securities firm holding a bank license. With total assets of about Danish krone (DKK) 90.5 billion (about €12.2 billion) at year-end 2022, Saxo has established a scalable, high-functionality securities brokerage platform over the past 30 years. Nearly 70% of 2022 trading-related and interest earnings can be attributed to the direct business via its trader and investor segments, with the other 30% relating to the Saxo Institutional customer business. We note that about 40% of trading-related and interest earnings for 2022 were considered recurring in nature. Although Saxo remains much smaller in scale relative to its primary peer IBG LLC (BBB+/Stable/--), with total client assets of about DKK584 billion ($83 billion) versus IBG's $306.7 billion, Saxo has a broad product offering of over 60,000 instruments and a long-term customer base with multi-year client relationships. In addition, with the 2019 acquisition of Dutch BinckBank, Saxo gained enhanced capability in margin lending and an expanding subscription service offering that provides an avenue for growth. As a result of the acquisition, Saxo's total assets more than doubled, and at year-end 2022 it had about 876,000 customers, of which approximately half were direct retail clients, and the other half end clients of institutional wholesale partners.

Our 'bbb-' anchor--the starting point for the rating--for Danish securities firms is two notches lower than the 'bbb+' anchor for Danish banks to reflect our view of higher industry risk relative to commercial banks. These risks include higher competitive risk and less stable, more transactional revenue. Similarly, securities firms' economic risks may exceed those of banks because they are exposed to equity market volatility and dependent on market liquidity to monetize their assets. From a regulatory framework perspective, we see that some securities firms face similar prudential regulation to banks and are actively supervised by the Danish FSA to ensure financial stability for Denmark. We believe that where deposits typically form a large portion of a securities firm's funding base, the Danish regulator is more likely to require it to have a banking license. However, not all securities firms carry banking licenses, leaving them without access to central bank funding.

We expect capitalization will remain a rating strength, with risk-adjusted capital (RAC) sustained above 15%. This view is supported by management's commitment to maintain conservative capital levels, and a regulatory framework that drives demanding minimum capital requirements. At year-end 2022, we calculate the bank's RAC ratio at 19.6%. From a regulatory perspective, Saxo reported a common equity Tier 1 (CET1) capital ratio of 24.0% and a total capital ratio of 31% on the same date, relative to the regulatory requirements of 11.1% and 16.8%, respectively. Management has defined a buffer of at least 600 basis points (bps) relative to total capital requirements. This, in addition to the anticipation that capital requirements would increase in line with Saxo's pending systemically importance designation, support our belief that capitalization will remain stable over the next two years.

We view Saxo's relatively modest risk appetite as neutral for the ratings. Saxo has built a solid information technology (IT) framework to enable real-time monitoring of client margin exposures and ensure all collateral is actively managed. Automatic stop-outs are in place to ensure that positions are quickly liquidated if a client's balance falls below margin requirements. Like peers, Saxo actively limits exposures on a per-client and per-product basis, some of which is via pricing, and may impose additional limitations if deemed necessary. Following the BinckBank acquisition, we anticipate the bank will expand within margin lending. However, we believe it will adhere to robust margin requirements and compliance standards as it onboards new clients.

We view funding as a source of strength for Saxo relative to broker peers, since the group has central bank access and a deposit-taking licence. This contributes to a solid S&P Global Ratings gross stable funding ratio of over 110%. We see no material funding concentrations and deposit stability is enhanced by approximately 42% being covered by a deposit guarantee scheme at year-end 2022. Supported by prudential regulation, we view Saxo as having robust liquidity management and comfortable liquidity relative to its potential needs. Its liquidity reserve is predominantly invested in high-quality, pledge-able liquid assets, such as European government bonds and Danish covered bonds; the weighted duration typically averages just under 1.5 years.

Relative to Danish and European commercial bank peers, Saxo remains concentrated given its business model. Relative to commercial banks that have solid market positions and a broad offering of retail and corporate lending products, Saxo's smaller size and concentration on securities brokerage mean narrower revenue streams. Similarly, compared with global securities firms, Saxo's client asset size indicates less customer base breadth and span, which possibly curbs earnings. In addition, while we view the current shareholder structure as neutral for the rating, this could have bearing on the firm's financial policy over time. We therefore apply a negative comparable ratings adjustment (CRA) to arrive at the 'bbb' stand-alone credit profile (SACP).

We do not anticipate any changes to the ownership structure. Saxo is 51% owned by Geely Financials Denmark A/S, a subsidiary of ultimate parent Zhejiang Geely Holding Group Co. Ltd., a China-based auto manufacturer (BBB-/Negative/--); 19% owned by Sampo PLC, a Nordic insurance group, (A/Stable/--); and 28% owned by CEO and co-founder Kim Fournais. This structure changed in 2018 prior to Saxo's acquisition of BinckBank. However, we assume there is no current operational or financial dependence on Geely and the board structure maintains the distribution of influence over the next two years.

In our base case, we assume

- Modest net income growth because of continued work to increase scale across the bank's trader, investor, and institutional customer segments.
- S&P Global Ratings risk-weighted-asset growth of about 4%-5% over 2023-2024, which covers broad-based growth from credit risk, in addition to increases in market and operational risk.
- The Danish regulator formally designates Saxo as a systemically important bank due to its sizeable deposit base. As a result of a five-year phase-in of the minimum requirement for own funds and eligible liabilities (MREL), senior subordinated issuance will likely be pursued toward year-end 2023.

Outlook

The positive outlook on Saxo reflects our expectation that we could raise our long-term issuer credit rating within the next 12-18 months.

Upside scenario

This could occur if the regulator designates it as a systemically important bank and we anticipate a resolution strategy and subordinated buffers that enhance the likelihood of senior preferred obligations continuing to be paid on time and in full, even if the group failed.

The outlook also incorporates our expectation that the group will use its current platform to expand sustainably via an increasing customer base and maintain strong profitability, while ensuring that asset quality remains robust. In addition, we expect Saxo will maintain a RAC ratio above 15% and a solid funding and liquidity profile.

Downside scenario

Within the same timeframe, we could revise the outlook to stable if:

- We see a reduced likelihood that resolution planning would reduce default risk for senior preferred creditors; or
- We believe growth is being achieved as a result of less prudent risk-management standards,

the group experiences unexpectedly high losses on client or trading exposures, or it reduces tangible capitalization such that the RAC ratio falls below 15%.

Environmental, Social, And Governance

ESG credit indicators: E-2, S-2, G-2

ESG factors are currently a neutral consideration in our credit rating analysis of Saxo.

Ratings Score Snapshot

Issuer Credit Rating	BBB/Positive/--
SACP	bbb
Anchor	bbb-
Business position	Moderate (-1)
Capital and earnings	Very strong (+2)
Risk position	Adequate (0)
Funding and liquidity	Strong and strong (+1)
Comparable ratings analysis	-1
Support	0
ALAC support	0
GRE support	0
Group support	0
Sovereign support	0
Additional factors	0

SACP--Stand-alone credit profile. GRE--Government related entity. ALAC—Additional loss-absorbing capacity.

Related Criteria

- General Criteria: Hybrid Capital: Methodology And Assumptions, March 2, 2022
- Criteria | Financial Institutions | Banks: Banking Industry Country Risk Assessment Methodology And Assumptions, Dec. 9, 2021
- Criteria | Financial Institutions | General: Financial Institutions Rating Methodology, Dec. 9, 2021
- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Financial Institutions | General: Risk-Adjusted Capital Framework Methodology, July 20, 2017
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Related Research

- An Update On Securities Firm Anchors By Country (February 2023), Feb. 3, 2023
- Industry Credit Outlook: U.S. Securities Firms 2023 Outlook: Stable Ratings Through Uncertain Markets, Jan. 18, 2023
- Banking Industry Country Risk Assessment: Denmark, June 9, 2022

Ratings List

New Rating; CreditWatch/Outlook Action	
Saxo Bank A/S	
Issuer Credit Rating	BBB/Positive/--