

Rating Action: Moody's downgrades Bank of Nova Scotia's ratings; outlook negative

Global Credit Research - 25 Jan 2016

Toronto, January 25, 2016 -- Today, Moody's Investors Service downgraded the long term debt and deposit ratings of Bank of Nova Scotia (BNS) and its subsidiaries to Aa3 from Aa2, its long term counterparty risk assessment to Aa2(cr) from Aa1(cr) and its baseline credit assessment to a2 from a1. Moody's also downgraded BNS's senior unsecured shelf and deposit note program ratings to (P)Aa3 from (P)Aa2 and subordinate shelf ratings to (P)A3 from (P)A2. Subordinated debt and non-cumulative preferred share obligations are also downgraded according to Moody's standard notching convention. Meanwhile Moody's affirmed BNS's Prime-1 short-term deposit rating, short-term Counterparty Risk Assessment and other short term ratings. The outlook for all BNS ratings is negative, reflecting Moody's view that the balance of risk related to government support has shifted to the downside. The affected entities are listed below:

Bank of Nova Scotia

Bank of Nova Scotia, Houston Branch

Bank of Nova Scotia, New York Agency

Montreal Trust Company of Canada

Scotiabank Capital Trust

Scotiabanc Inc.

Scotiabank Europe Plc

Scotiabank Tier 1 Trust

RATINGS RATIONALE

Moody's said the ratings change was prompted by Bank of Nova Scotia (BNS) having taken significant measures to increase its profitability that signal a fundamental shift away from the bank's traditionally low risk appetite. This risk positioning was a key part of the rationale for what had been its superior credit standing. While the bank's strategic actions are intended to enhance current profitability -- BNS reports the lowest domestic net interest margin of the six largest Canadian banks -- in Moody's view, they increase the prospect of future incremental credit losses.

Over the last two years, in accordance with its strategic initiatives, BNS has accelerated the growth in its credit card and auto finance portfolios -- both of which are particularly prone to deterioration during an economic downturn and exhibit higher defaults and loss severities than mortgage portfolios. In addition, the bank has made a series of acquisitions away from its strong domestic franchise towards higher-growth but less stable international markets. BNS has aspirations to continue to grow its international earnings, which in Moody's view adds to bondholder risk.

Moody's believes it is likely that BNS's increased risk tolerance and strategic imperative to increase profitability by shifting the asset mix towards higher yielding categories of consumer credit, both domestically and in international operations, will persist.

WHAT COULD CHANGE THE RATING UP/DOWN

Given its very high ratings, upward rating pressure on BNS is unlikely.

Downward pressure will depend upon future trends in business mix and asset quality. Significantly increased exposure to credit card and auto finance portfolios, substantially increased reliance on earnings from international operations and/or, unexpected profitability erosion or control problems would be credit negative.

The principal methodology used in these ratings was Banks published in January 2016. Please see the Credit Policy page on www.moodys.com for a copy of this methodology.

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