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## Research Update:

# DLR Kredit A/S Upgraded To 'A-' On Additional Loss-Absorbing Capacity; 'A-2' Rating Affirmed; Outlook Stable

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## Research Update:

# DLR Kredit A/S Upgraded To 'A-' On Additional Loss-Absorbing Capacity; 'A-2' Rating Affirmed; Outlook Stable

## Overview

- Denmark-based financial institution DLR Kredit A/S has made progress in issuing capital instruments qualifying for additional loss-absorption capacity (ALAC), and we estimate that the bank's ALAC ratio will sustainably surpass 5% by the end of 2017.
- We are therefore raising our long-term rating on DLR Kredit to 'A-' from 'BBB+', while affirming our 'A-2' short-term rating.
- The stable outlook on DLR Kredit reflects our view that the bank will improve its ALAC and continue to successfully realign its funding profile over our two-year rating horizon.

## Rating Action

On May 19, 2017, S&P Global Ratings raised its long-term counterparty credit rating on Denmark-based financial institution DLR Kredit A/S to 'A-' from 'BBB+'. The outlook is stable. We affirmed our 'A-2' short-term rating.

## Rationale

The upgrade reflects our view that DLR Kredit has made significant progress in issuing capital instruments, including its planned first issuance of a Danish krone (DKK) 1 billion (approximately €130 million) tier 3 senior resolution note in June 2017. This issue will qualify for additional loss-absorbing capacity (ALAC), and we now expect the ALAC ratio for the bank will durably surpass our 5% threshold by the end of 2017.

In addition to the planned tier 3 instrument, we expect DLR Kredit to continue issuing tier 2 and tier 3 instruments to comply with the Danish government's requirement that mortgage banks issue at least 2% of nominal lending in additional buffers between 2016 and 2020. Furthermore, we expect the Danish capital market to continue functioning and consequently enabling such issuance plans. We estimate a pro forma ALAC of 5.9% of S&P Global Ratings' risk-weighted assets for DLR Kredit as of year-end 2017, including the bank's planned June issue of tier 3 notes, since they also qualify for ALAC. In addition, we expect that the bank will issue additional tier 2 or tier 3 instruments of approximately DKK3 billion in the next two to three years.

As a result of the increased ALAC, we now include a one-notch positive

adjustment from DLR Kredit's 'bbb+' stand-alone credit profile (SACP).

The 'A-' long-term rating on DLR Kredit reflects its 'bbb+' anchor and our assessment of the bank's moderate business position, strong capital and earnings, adequate risk position, average funding, and adequate liquidity, and one notch of ALAC support.

DLR Kredit's moderate business position reflects its comparatively narrow client base and revenues concentrated in lending to the Danish agriculture sector. DLR Kredit's primary market is first-lien mortgage loans in Denmark, mainly on agriculture properties, but also on commercial and residential real estate. Our assessment of the bank's strong capital and earnings reflects our expectation that the bank's risk-adjusted capital (RAC) ratio, which stood at 13.3% on Dec. 31, 2016, will remain stable over the next 18-24 months and sustainably above our 10% threshold. DLR Kredit's capital adequacy was reinforced in April 2017 by a DKK603 million sell-back of treasury shares to its shareholding banks.

The adequate risk position reflects the strength of the guarantees provided by DLR Kredit's owner banks, including the ability for DLR Kredit to reduce future commissions. In our view, this compensates for the degree of concentration in the agricultural and commercial real estate segments. Our assessment of average funding and adequate liquidity primarily reflects DLR Kredit's ongoing measures to increase the maturity profile of its funding and the announced supervisory mortgage diamond to address the mismatch between its assets and liabilities. As DLR Kredit and peers realign their funding profiles, we continue to expect that structural support of the Danish mortgage market will ensure access to future refinancing needs.

## Outlook

The stable outlook reflects our view that DLR Kredit's stand-alone credit profile (SACP) is unlikely to change over our two-year rating horizon. The outlook also assumes slow, but steady, improvements in DLR Kredit's RAC ratio and funding profile over the next two years.

An upgrade is unlikely at this point.

We could consider a downgrade if DLR Kredit is unable to maintain progress in terms of extending the maturity profile of its funding or its liquidity situation over the next two years. In particular, we could revise our assessment of funding downward to below average and lower the ratings if the trend of improvement in the funding and liquidity profile were to stagnate. In addition, a downgrade could occur if ALAC issuances stall, reducing the protection these instruments provide for senior unsecured creditors that we currently view as supportive of the current ratings.

## Ratings Score Snapshot

Issuer Credit Rating	To A-/Stable/A-2	From BBB+/Stable/A-2
SACP	bbb+	bbb+
Anchor	bbb+	bbb+
Business Position	Moderate (-1)	Moderate (-1)
Capital and Earnings	Strong (+1)	Strong (+1)
Risk Position	Adequate (0)	Adequate (0)
Funding and Liquidity	Average (0) and Adequate	Average (0) and Adequate
Support	+1	0
GRE Support	0	0
Group Support	0	0
Sovereign Support	0	0
ALAC Support	+1	0
Additional Factors	0	0

## Related Criteria

- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings , April 7, 2017
- Criteria - Financial Institutions - Banks: Bank Rating Methodology And Assumptions: Additional Loss-Absorbing Capacity, April 27, 2015
- Criteria - Financial Institutions - Banks: Bank Hybrid Capital And Nondeferrable Subordinated Debt Methodology And Assumptions, Jan. 29, 2015
- Criteria - Financial Institutions - Banks: Quantitative Metrics For Rating Banks Globally: Methodology And Assumptions, July 17, 2013
- Criteria - Financial Institutions - Banks: Revised Market Risk Charges For Banks In Our Risk-Adjusted Capital Framework, June 22, 2012
- Criteria - Financial Institutions - Banks: Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- Criteria - Financial Institutions - Banks: Banks: Rating Methodology And Assumptions, Nov. 9, 2011
- Criteria - Financial Institutions - Banks: Bank Capital Methodology And Assumptions, Dec. 6, 2010
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

## Related Research

- DLR Kredit A/S Proposed Senior Resolution Notes Rated 'BBB', May 19, 2017
- Banking Industry Country Risk Assessment: Denmark, Dec. 19, 2016

- DLR Kredit A/S, Sept. 23, 2016
- The Future Of Banking: Nordic Banks Looking Svelte In The Fintech Race, June 14, 2016

## **Ratings List**

Upgraded; Ratings Affirmed

	To	From
DLR Kredit A/S Counterparty Credit Rating	A-/Stable/A-2	BBB+/Stable/A-2

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Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at [www.standardandpoors.com](http://www.standardandpoors.com) for further information. Complete ratings information is available to subscribers of RatingsDirect at [www.globalcreditportal.com](http://www.globalcreditportal.com) and at [spcapitaliq.com](http://spcapitaliq.com). All ratings affected by this rating action can be found on the S&P Global Ratings' public website at [www.standardandpoors.com](http://www.standardandpoors.com). Use the Ratings search box located in the left column. Alternatively, call one of the following S&P Global Ratings numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; Stockholm (46) 8-440-5914; or Moscow 7 (495) 783-4009.

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