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Various Rating Actions On Four Danish Banks After Review Of Government Support And Additional Loss-Absorbing Capacity

Primary Credit Analyst:
Alexander Ekbom, Stockholm (46) 8-440-5911; alexander.ekbom@standardandpoors.com

Secondary Contacts:
Sean Cotten, Stockholm (46) 8-440-5928; sean.cotten@standardandpoors.com
Olivia Fleischmann, Stockholm (46) 8-440-5904; olivia.fleischmann@standardandpoors.com

OVERVIEW

- We now consider the likelihood of extraordinary government support for banks in Denmark to be uncertain and therefore no longer include an uplift for such support in our ratings on systemic Danish banks.
- That said, Denmark's bank resolution framework is now well advanced, and we now include an uplift in our ratings on systemic banks we expect will hold sizable buffers of bail-in-able instruments in the coming years.
- At the same time, some banks' stand-alone credit profiles have strengthened, offsetting the removal of the uplift from the ratings.
- We are lowering our long-term rating on Nykredit to 'A' from 'A+' and affirming the 'A-1' short-term rating, while affirming our ratings on DLR Kredit, Danske Bank, and Jyske Bank.
- The negative outlook on Nykredit reflects uncertainties about the bank's performance relative to our baseline projections. The outlooks on the other three banks are stable.

STOCKHOLM (Standard & Poor's) July 13, 2015--Standard & Poor's Ratings Services today took various rating actions on Danish banks following the introduction of a bank resolution framework in Denmark. These rating actions also reflect the ongoing regulatory impetus to have systemic banks hold sizable buffers of bail-in-able instruments that the authorities could use to recapitalize them, and our view that there are reduced prospects for extraordinary government support for banks' senior unsecured creditors.

Our resulting review of the four banks we rate in Denmark has led to the following rating actions:

- We lowered our long-term counterparty credit ratings on Nykredit Realkredit A/S to 'A' from 'A+' and removed them from CreditWatch negative, where we placed them on May 12, 2015. The outlook is negative. We affirmed the 'A-1' short-term counterparty credit ratings.
- We affirmed our 'BBB+/A-2' long- and short-term counterparty credit ratings on DLR Kredit A/S and removed them from CreditWatch negative, where we placed them on May 12, 2015. The outlook is stable.
- We affirmed our 'A-/A-2' long- and short-term counterparty credit ratings on Jyske Bank A/S. The outlook remains stable.
- We have revised our outlook on Danske Bank A/S to stable from negative and affirmed our 'A/A-1' long- and short-term counterparty credit ratings.

These rating actions have led to corresponding rating actions on the banks' "core" subsidiaries, because those ratings reflect our expectation that government support received by the parent would flow to the subsidiary.

We have not taken actions on our issue ratings on Nykredit's or Danske Bank's hybrid or subordinated capital instruments because we already consider that the holders of these instruments are unlikely to benefit from systemic support.

RATIONALE

Our rating actions reflect Denmark's implementation of the EU's Banking Recovery and Resolution Directive (BRRD), which provides the authorities with bail-in powers over banks via two new laws that took effect on June 1, 2015. This leads us to believe that prospects for extraordinary government support now appear uncertain, even for systemically important banks (including mortgage banks), before any burden-sharing by senior unsecured creditors.

However, we expect that the Danish regulator will require banks to build buffers of bail-in-able debt instruments in a manner that offers a material level of protection to senior unsecured creditors on a nonviability (or "gone concern") basis.

Today's rating actions are similar to those on German and U.K. banks on June 9, 2015 (see "S&P Takes Various Rating Actions On Certain U.K. And German Banks Following Government Support And ALAC Review," on RatingsDirect). We expect to take similar actions on banks in most EU countries as authorities introduce bail-in powers.

SYSTEMIC SUPPORT IS NOW "UNCERTAIN" BUT NOT IMPOSSIBLE

Our base-case expectation has been that we would reclassify the likelihood of support from the Danish government as "uncertain" and remove notches of uplift for extraordinary government support from our ratings on systemic banks (see "

Various Rating Actions On Danish Banks On EU Bank Recovery And Resolution Directive To Be Implemented In Denmark," published May 12, 2015). This is indeed the outcome of our review.

In taking our decision, we took into account our view that:

- The Danish government appears less willing to use taxpayer funds to bail out systemically important banks;
- Even if the Danish government wished to provide capital support to a failed systemic bank, the bank resolution framework it has implemented in response to the BRRD constrains its capacity to do so without substantial burden-sharing by senior unsecured creditors; and
- Some senior unsecured creditors face substantial risk of being mandatorily bailed in as part of a bank's resolution, unless they are protected by the bank having a substantial buffer of junior instruments.

While we do not rule out the possibility that Denmark's systemic banks might receive extraordinary government support, we see the predictability of such support as having materially reduced to the point that we regard it as being "uncertain." As a result, we no longer include such support in the ratings on these banks.

That said, if a systemic bank experienced financial difficulties and we saw clear evidence that government support would be forthcoming, we could still reflect this "additional short-term support" in the ratings on the bank.

DANISH MORTGAGE BANKS

Denmark has introduced an exemption from the bail-in tool for mortgage banks from its implementation of the BRRD. Instead, the Danish authorities are requiring mortgage banks to build up a bail-in-able buffer equivalent to 2% of unweighted loans, in addition to all applicable capital requirements. However, all other tools to resolve a bank under the BRRD, such as establishing a bridge bank or an asset-separation exercise, will be available to the authorities to resolve a Danish mortgage bank. The 2% buffer will be gradually phased in over four years starting June 1, 2016, and can comprise a broad variety of instruments including equity, hybrids, and nondeferrable subordinated debt. It can also contain senior unsecured debt, which at the Danish regulator's discretion may be required to have contractual write-down features. This could create the foundation for a new liability class in Denmark that would likely rank junior to other senior unsecured debt (potentially only in a resolution scenario), but ahead of nondeferrable subordinated debt.

In our view, this structure implies that the potential for government support for Danish mortgage banks' senior unsecured creditors is limited. We understand that there is no formal requirement in the new laws to use part or all of the buffer before the government can support an ailing mortgage bank. However, we expect the authorities will make use of this buffer and potentially other forms of outstanding debt to safeguard covered bond investors. Therefore, we believe government support is now also less predictable for the senior unsecured creditors of mortgage banks.

Because mortgage banks are exempt from a bail-in, a resolution would likely take the form of establishing a bridge bank or an asset-separation exercise in which the instruments in the 2% buffer--alongside junior liabilities such as equity, other capital instruments, and nondeferrable subordinated debt--would remain at the failing bank. We believe that any additional senior unsecured issuance outside the buffer could potentially be used to create a new viable operating bank.

BANK RESOLUTION FRAMEWORKS ARE NOW "EFFECTIVE" AND RAMP-UP PERIODS AWAIT MORTGAGE BANKS

On April 29, 2015, we announced a new component called additional loss-absorbing capacity (ALAC) to our framework for rating banks globally. This new component of our criteria adds another route for assessing extraordinary external support in our bank rating framework. Notably, as government support becomes less predictable in Denmark, the ALAC criteria allow us to better reflect the reduced likelihood of default for senior unsecured creditors as a result of the bail-in of more junior instruments in the event of a bank resolution.

Following the Danish authorities' conversion of the BRRD and its bail-in provisions into national legislation in June 2015, we regard the resolution regime as being sufficiently well-defined to allow for the effective recapitalization of a failing systemic bank (including mortgage banks), aided by associated liquidity or funding support. This view acknowledges that the final requirements for each bank's bail-in buffer--known in the EU as the minimum requirement for eligible liabilities (MREL)--will be set only in late 2015 or early 2016, but we consider the underlying principles and broad quantitative expectations to be clear. For mortgage banks, we consider the 2% buffer to be the equivalent of the MREL requirements from which they are exempt. Where relevant, our rating actions also acknowledge that other aspects, such as banks' prepositioning of the bail-in buffer among material subsidiaries and the regulator's preferred resolution strategy, will only become clearer over time.

The paragraphs below provide an overview of our rationale for the rating actions on each bank.

NYKREDIT REALKREDIT

NYKREDIT BANK A/S

The one-notch downgrade of Nykredit Realkredit and its core subsidiary Nykredit Bank (Nykredit) reflects that the removal of the uplift for extraordinary government support in the long-term ratings is only partly offset by a one-notch uplift for ALAC. In our base case, we expect Nykredit's ALAC to exceed our threshold of 5% of Standard & Poor's risk-weighted assets (RWAs), driven in part by its requirement to create a 2% buffer for mortgage banks and supported by ongoing capital generation. We expect Nykredit to issue nondeferrable subordinated debt or senior unsecured instruments with contractual write-down features that could protect other senior creditors in a resolution scenario. We currently view Nykredit's stand-alone credit profile

(SACP) as stable.

The negative outlook reflects our uncertainty on the bank's projected ALAC in our base case, given what we view as a stretch target on earnings and debt issuance. We note Nykredit's low initial ALAC, the uncertainty of our capital generation forecast, and the potential challenge Nykredit may face in achieving sufficient issuance to surpass our ALAC threshold of 5% of RWAs for a one-notch uplift. In addition, the negative outlook reflects the group's comparably weaker funding and liquidity metrics than those of domestic peers, and our view that, despite the strengthening of Nykredit's funding profile, further improvements are necessary to reduce the use of short-term wholesale funding.

We could lower the long-term ratings if we saw a deviation from our projection of significant further improvement in the funding profile, in particular after large amounts of debt mature in 2017. This could lead us to revise our assessment of Nykredit's SACP downward and lower the ratings. In addition, a downgrade could materialize if the group fails to issue or accumulate the amount of ALAC required to reach our 5% threshold, reducing the associated protection for senior unsecured creditors that we currently assume for the ratings, given the timeline to implement the buffer.

We could consider revising the outlook to stable should our concerns related to ALAC and the funding position dissipate, for example, due to Nykredit's issuance and earnings retention and an improvement of the maturity schedule in the funding profile.

DLR KREDIT A/S

The rating affirmation reflects that our combined view of DLR's capital and risk position mitigates the removal of the uplift for government support from the long-term rating. In particular, we consider that DLR's risk position has improved to "adequate" from "moderate," owing to existing and new owner-bank guarantee programs and DLR's ability to reduce future commission payments to further offset credit losses. We believe these factors significantly reduce the potentially negative impact of credit risk on DLR's capital position and our concerns about concentrations in the loan book.

The stable outlook on DLR reflects the balance between our expectations of future ALAC issuance and the need for further strengthening of the bank's funding maturity profile. We believe that DLR is likely to build a buffer of debt instruments from the beginning of 2016, which could eventually combine with its already strong capital to reach our ALAC threshold of 5% of RWAs. On the other hand, DLR continues to show relatively weak funding and liquidity metrics, despite the ongoing strengthening of its funding profile. We see a need for DLR to continue reducing its use of short-term wholesale funding if we are to maintain our current assessment.

We could consider an upgrade if bail-in risks for senior unsecured creditors reduce further as DLR builds an ALAC buffer, apart from our capital assessment, or if there was a stronger-than-expected increase in the risk-adjusted capital (RAC) ratio to sustainably above 15%.

We would consider a downgrade if DLR is unable to progressively lengthen its debt maturity profile over the next two years. In particular, we could revise our assessment of funding to "below average" and lower the ratings if improvement in the funding and liquidity profile were to stagnate.

JYSKE BANK A/S

The affirmation of our ratings on Jyske Bank and its core subsidiary BRFkredit reflects our expectation of future capital, efficiency, and asset-quality gains as the Danish economy continues to strengthen. In our view, the improvement of Jyske's SACP due to more robust capital and risk positions has offset the removal of uplift for government support from the long-term rating.

The stable outlook reflects our view that Jyske will maintain a RAC ratio sustainably above 10%. Our view of healthier capital is supported by stronger, more stable earnings resulting from better efficiency as the bank reports lower-than-expected implementation costs and begins to benefit from synergies related to its April 2014 merger with BRFkredit.

While presently unlikely, we could consider an upgrade if bail-in risks for senior unsecured creditors were reduced by the development of a significant ALAC buffer, which is not otherwise acknowledged in our "strong" capital assessment.

We could consider a downgrade if the bank is unable to strengthen its asset quality metrics, in particular, if loan impairments and nonperforming loans lead us to negatively reassess the group's risk position or change our capital projections. In addition, we continue to monitor refinancing risk for Denmark's mortgage institutions, including BRFkredit. Although increasingly unlikely, we could lower the ratings if the combined entity's funding and liquidity profile were to weaken.

DANSKE BANK A/S

The affirmation on Danske Bank and its core subsidiaries reflects that, although we removed the two notches of uplift for government support from the ratings, the group's earnings have strengthened to those of similarly rated peers, allowing us to remove the negative adjustment. We have also added one notch because we believe Danske Bank's ALAC is likely to exceed our adjusted threshold of 4.5% in 2016, indicating the ability to support senior unsecured creditors in an eventual resolution. Danske Bank's year-end 2014 ALAC buffer was 4.2%, based mainly on capital not otherwise captured in our stand-alone assessment, but also on its current outstanding stock of nondeferrable subordinated and hybrid debt. We have lowered our 5% threshold by 50 basis points to reflect that Danske Bank has material insurance operations (representing about 15% of RWAs), which would not be subject to resolution; therefore, the bank's bail-in-able instruments will not be required to support the insurance subsidiary.

While we do not anticipate improvements in other SACP factors at this time, we acknowledge the potential for Danske Bank to achieve and maintain a RAC ratio sustainably higher than 10%, in line with a "strong" capital and earnings assessment over time. If this scenario were to materialize, we would expect to revise upward our assessment of the bank's SACP to reflect the capital improvements. In turn, this would lead us to disregard a large portion of the ALAC buffer and remove the associated notch of support, with a neutral effect on the ratings.

The stable outlook reflects our view that Danske Bank will build an ALAC buffer to protect senior unsecured creditors that would exceed 4.5% of RWAs, supported by increasing earnings and retained capital, as well as maintain its current stock of instruments we consider eligible for ALAC.

A negative rating action could follow if Danske Bank were unable to build an appropriate ALAC buffer over the next two years or strengthen its capital and earnings such that the RAC ratio is sustainably above 10%.

We currently consider a positive rating action remote.

RELATED CRITERIA AND RESEARCH

Related Criteria

- Bank Rating Methodology And Assumptions: Additional Loss-Absorbing Capacity, April 27, 2015
- Bank Hybrid Capital And Nondeferrable Subordinated Debt Methodology And Assumptions, Jan. 29, 2015
- National And Regional Scale Credit Ratings, Sept. 22, 2014
- Group Rating Methodology, Nov. 19, 2013
- Quantitative Metrics For Rating Banks Globally: Methodology And Assumptions, July 17, 2013
- Revised Market Risk Charges For Banks In Our Risk-Adjusted Capital Framework, June 22, 2012
- Banks: Rating Methodology And Assumptions, Nov. 9, 2011
- Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- Bank Capital Methodology And Assumptions, Dec. 6, 2010
- Methodology For Mapping Short- And Long-Term Issuer Credit Ratings For Banks, May 4, 2010
- Use Of CreditWatch And Outlooks, Sept. 14, 2009

Related Research

- S&P Takes Various Rating Actions On Certain U.K. And German Banks Following Government Support And ALAC Review, June 9, 2015
- Various Rating Actions On Danish Banks On EU Bank Recovery And Resolution Directive To Be Implemented In Denmark, May 12, 2015

RATINGS LIST

Downgraded; CreditWatch Action; Rating Affirmed

	To	From
Nykredit Realkredit A/S		
Nykredit Bank A/S		
Counterparty Credit Rating	A/Negative/A-1	A+/Watch Neg/A-1
DLR Kredit A/S		
Counterparty Credit Rating	BBB+/Stable/A-2	BBB+/Watch Neg/A-2

Rating Affirmed

Jyske Bank A/S		
Counterparty Credit Rating	A-/Stable/A-2	
Nordic Regional Scale	--/--/K-1	
BRFkredit A/S		
Counterparty Credit Rating	A-/Stable/A-2	

Rating Affirmed; Outlook Action

	To	From
Danske Bank A/S		
Counterparty Credit Rating	A/Stable/A-1	A/Negative/A-1
Nordic Regional Scale	--/--/K-1	--/--/K-1
Danske Bank A/S, Swedish Branch		
Danske Bank PLC		
Counterparty Credit Rating	A/Stable/A-1	A/Negative/A-1

NB: This list does not include all the ratings affected.

Additional Contact:
Financial Institutions Ratings Europe; FIG_Europe@standardandpoors.com

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