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## Research Update:

# Denmark's DLR Kredit Outlook Revised To Stable From Positive On Funding Reassessment; 'BBB+/A-2' Ratings Affirmed

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## Research Update:

# Denmark's DLR Kredit Outlook Revised To Stable From Positive On Funding Reassessment; 'BBB+/A-2' Ratings Affirmed

## Overview

- We have reviewed the funding strategies of various Danish banks against the backdrop of expected regulatory changes.
- In our view, Danish banks, including DLR Kredit A/S, generally show a greater asset-liability mismatch than banks in comparable developed markets.
- We are revising our outlook on DLR Kredit to stable from positive and affirming our 'BBB+/A-2' ratings.
- The stable outlook reflects the balance between our belief that DLR Kredit will improve its capitalization and our view of its weak funding and liquidity compared with peers'.

## Rating Action

On July 19, 2013, Standard & Poor's Ratings Services revised its outlook on Denmark-based DLR Kredit A/S to stable from positive. The 'BBB+' long-term and 'A-2' short-term counterparty credit ratings were affirmed.

## Rationale

The rating actions follow our review of Danish banks' strategies in light of expected regulatory changes. We are increasing our efforts to differentiate banks on the basis of their funding and liquidity profiles and provide further insight into our rationale for rating Danish banks. In our view, Danish banks generally show a greater asset-liability maturity mismatch than banks in comparable developed markets.

DLR Kredit's funding and liquidity profile compares negatively with that of international and domestic peers. In our view, DLR Kredit is more reliant on short-term funding, and has a larger maturity mismatch between assets and liabilities than international peers'. At year-end 2012, DLR Kredit's broad liquid assets represented only 0.13x its short-term wholesale funding, and the funding ratio was stable at 38.0%. Both ratios have been largely unchanged over the past three years, and reflect that the bank is refinancing long-term loan commitments with short-term funding sources.

Because we expect that the Danish government will provide ongoing support to systemically important financial institutions, we continue to assess DLR

Kredit's liquidity position as neutral to the ratings, according to our criteria. However, we note the ongoing debate in the Danish government about funding imbalances and the proposal by the committee on the regulation of systemically important financial institutions to introduce measures that reduce the maturity mismatches in the sector. We believe that changes to the regulatory framework for Danish banks will serve to reduce the banking sector's reliance on short-term refinancing.

DLR Kredit's weak funding and liquidity ratios mainly reflect the Danish mortgage market, which is characterized by a widespread preference for one-year fixed rate refinancing of 30-year loan commitments. This is further exacerbated by the "balance principle" regulation in Denmark, which requires domestic mortgage banks to refinance loans and bonds simultaneously, resulting in minimal balance sheet liquidity. This makes Danish mortgage banks stand out among their Norwegian and Swedish peers, whose liability maturity profiles tend to be marginally longer than their asset profiles. We note that the Danish regulations prevent banks from cooperating with each other on product design, which underlines regulators' important role in defining market boundaries. Should DLR Kredit's structural mismatch of asset and liability maturities decline as a consequence of regulatory changes or at the initiative of the bank, which we consider less likely, we expect a very direct positive impact on our core measures of funding and liquidity.

## Outlook

The stable outlook reflects our expectation that DLR Kredit will strengthen its capitalization, in accordance with its recapitalization plan. As a result, we believe that our risk-adjusted capital ratio will come close to the 15% threshold we consider commensurate with "very strong" capital and earnings. We believe DLR Kredit will also continue to provide its owner banks products for lending to the agriculture, cooperative housing, residential rental property, and commercial real estate sectors. The outlook also incorporates our revised assessment of DLR Kredit's funding and liquidity, which limits the possibility of an upgrade in the near term.

We could revise the outlook back to positive over the next 24 months if, as we anticipate, DLR Kredit improves its funding and liquidity metrics, reducing its market confidence sensitivity; sustains its current earnings performance; and continues building capital.

We could revise the outlook to negative or lower the ratings if economic deterioration, particularly in Denmark's agriculture sector, triggered a material increase in DLR Kredit's credit losses or nonperforming assets that exceeded industry averages. A downgrade could also occur if DLR Kredit did not take initiatives to strengthen its capital as we expect and its earnings fell short of our base-case forecast.

## Ratings Score Snapshot

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

## Related Criteria And Research

### Related criteria

- Quantitative Metrics For Rating Banks Globally: Methodology And Assumptions, July 17, 2013
- Banks: Rating Methodology And Assumptions, Nov. 9, 2011
- Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- Bank Hybrid Capital Methodology And Assumptions, Nov. 1, 2011
- Bank Capital Methodology And Assumptions, Dec. 6, 2010

### Related research

- Banking Industry Country Risk Assessment: Denmark, May 7, 2013
- Various Outlook Actions On Five Danish Banks Due To Funding Reassessment; All Ratings Affirmed, July 19, 2013

## Ratings List

Ratings Affirmed; Outlook Action		
	To	From
DLR Kredit A/S		
Counterparty Credit Rating	BBB+/Stable/A-2	BBB+/Positive/A-2
Junior Subordinated	BB+	

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