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DLR Kredit's Capital Centre B Section 33e Bond Issuances Assigned Preliminary 'BBB+/A-2' Ratings; Outlook Positive

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OVERVIEW

- We have assigned our preliminary 'BBB+/Positive' long-term rating and preliminary 'A-2' short-term rating to DLR Kredit's upcoming issuances of "section 33e" bonds (junior ranking mortgage bonds) out of its Capital Centre B.
- We have assigned these ratings based on our principles of credit ratings. The current approach does not envisage any additional rating uplift from that of the senior unsecured debt rating on the issuer, due to the specific characteristics of these bonds.

LONDON (Standard & Poor's) Nov. 23, 2012--Standard & Poor's Ratings Services today assigned a preliminary 'BBB+' long-term credit rating and a preliminary 'A-2' short-term rating to DLR Kredit A/S' issuances of Danish section 33e bonds (DKSE33e; Danish legislation-enabled junior ranking mortgage bonds) out of its Capital Centre B. The outlook is positive (see list below).

We understand that DLR Kredit intends to issue section 33e bonds to raise funds to replace existing government guaranteed debt and for posting additional collateral in its Capital Centre B, which issues "saerligt daekkede obligationer" (SDO; Danish senior covered bonds). DLR Kredit's Capital Centre B is an existing capital center, which has separate program documentation and is specifically set up to allow the issuer to issue SDO bonds. The section 33e

bonds will be issued under separate documentation for the capital center.

RATING RATIONALE

We note that section 33e bonds rank junior to the traditional (senior) covered bonds in the capital center that they are issued from, but rank senior to the issuer's senior unsecured debt for funds from the associated capital center. The proceeds from the issuance of section 33e bonds must be placed in particularly secure assets, as defined by the covered bond act, which in turn are to be placed in separate accounts dedicated to the specific capital center. Any surplus of the cover pool after making payments to covered bonds and section 33e bonds will be transferred to the bankruptcy estate. Not until then will the senior unsecured creditors have access to assets from the cover pool.

If the issuer defaults, payments on the section 33e bonds are deferred until all respective senior covered bonds have been redeemed, unless the bankruptcy administrator is confident that the senior covered bonds can be repaid. The bonds are dual-recourse instruments as they are secured by the residual or remaining assets within the individual capital center, and will rank *pari passu* with the senior unsecured creditors' claims if not repaid using the funds in the capital center.

In our opinion, section 33e noteholders are unlikely to receive full payment of principal and interest and will not receive any interest on deferred interest in such an event. As our ratings address timely payment of interest and ultimate payment of principal, we believe that our ratings on the section 33e bonds issued out of DLR's Capital Centre B would be lowered if the issuer defaults.

The reason for this is twofold. First, the notes rank *pari passu* with the senior unsecured claims on the issuer in case the cover pool is not sufficient to repay the section 33e bonds. Second, we give no benefit to the cover pool in our analysis of the section 33e bonds. As a result, we would generally expect our ratings on the section 33e bonds to reflect any changes in our ratings on DLR Kredit's senior unsecured debt.

We do not consider the benefit of any recourse to the cover pool in our rating analysis as we do not believe that the issuer can commit to or manage levels of overcollateralization to support section 33e bonds that are similar to what we typically see for standard covered bonds. This is due to the specific payment mechanics of the Danish section 33e bonds and their purpose to raise funds to provide additional overcollateralization for the senior covered bonds.

Consequently, our preliminary 'BBB+' long-term and 'A-2' short-term ratings on the section 33e bonds are directly linked to the ratings on the issuer's senior unsecured debt. As a result, the outlook assigned to the long-term rating on the section 33e bonds reflects the positive outlook assigned to the issuer credit rating on DLR Kredit.

LEGAL CONSIDERATIONS

The 2007 amendment to the Danish covered bond legislation introduced the requirement to regularly revalue the collateral securing the mortgage loans in order to make certain Danish covered bonds compliant with the Capital Requirements Directive. With the amendment, the regulators introduced section 33e bonds to allow mortgage credit institutions issuing SDOs to raise capital in order to maintain sufficient overcollateralization in the event that the loan-to-value ratio of the mortgage assets were to increase above regulatory limits.

The Danish covered bond legislation refers to section 33e bonds as bonds issued with the purpose of funding additional overcollateralization. Some mortgage banks refer to section 33e loans as "junior covered bonds" while other market participants may refer to them as the "issuance of senior debt in pursuance of section 33e of the Act on Mortgage Loans and Mortgage Bonds etc".

We understand that no acceleration occurs on the covered bonds, derivatives, or section 33e bonds if the mortgage credit institution is declared bankrupt. However, a bankruptcy administrator may pay back section 33e bondholders if the administrator is confident that funds are sufficient to repay all remaining issued covered bonds and derivative counterparties registered in the specific capital centers.

OTHER CONSIDERATIONS

Should an issuer choose not to refinance the section 33e bonds, this may lead to a decrease in the overcollateralization available to a capital center. Changes in available overcollateralization may lead to changes in the ratings on covered bonds issued out of DLR Kredit's Capital Centre B.

The issuance of Danish section 33e bonds is only one of the methods that Danish covered bond issuers are utilizing to meet the legal requirements of additional posting of collateral when property prices decline. If the issuer becomes insolvent, all assets in the cover pool secure the preferential claim of the outstanding covered bonds.

The Danish covered bond legislation requires that the proceeds from issuance of section 33e bonds are invested in a defined group of high quality assets. Furthermore, the legislation states that any assets that are funded by the issuance of section 33e bonds must remain in the capital center from where the section 33e bonds were issued. This means that the part of the overcollateralization in a given capital center that the rating on the (senior) covered bonds relies on is in effect, committed to the capital center. Furthermore, management cannot remove it at their discretion as long as the corresponding section 33e bonds are outstanding.

We currently rate SDO issuances from DLR Kredit's Capital Centre B at 'AAA/Stable/A-1+'. As of June 30, 2012, Capital Centre B had available

overcollateralization levels of 14.79%. We expect DLR Kredit to issue DKK4 billion worth of section 33e bonds with a further amount to be issued in 2013. The intended first issuance could potentially increase available overcollateralization by 3.91% in Capital Centre B. We expect DLR Kredit to continue issuances out of the capital center, albeit at a lower level, as long as property prices continue to fall in Denmark.

RELATED CRITERIA AND RESEARCH

- DLR Kredit's Capital Centre B Covered Bond Issuances Assigned 'AAA/A-1+' Ratings; Outlook Stable, Oct. 24, 2012
- DLR Kredit Outlook Positive On Improved Capitalization; 'BBB+/A-2' Ratings Affirmed, Off CreditWatch, Sept. 7, 2012
- Standard & Poor's Ratings Definitions, June 22, 2012
- Ratings Assigned To Nykredit Realkredit's Danish Section 33E Bond Issuances, April 18, 2012
- European Structured Finance Scenario And Sensitivity Analysis: The Effects Of The Top Five Macroeconomic Factors, March 14, 2012
- Global Structured Finance Scenario And Sensitivity Analysis: The Effects Of The Top Five Macroeconomic Factors, Nov. 4, 2011
- Principles Of Credit Ratings, Feb. 16, 2011
- Understanding Standard & Poor's Rating Definitions, June 3, 2009
- Evolution, Not Revolution—Proposed Changes To The Issuance Of Danish Covered Bonds, Jan. 25, 2007

RATINGS LIST

Program/	Rating
Country: Covered bond type	

RATINGS AND OUTLOOK ASSIGNED

DLR Kredit A/S - Capital Centre B

Long-term: BBB+/Positive

Short-term: A-2

Denmark: "Danish Section 33e Bonds" (Legislation-Enabled Junior Ranking Mortgage Bonds)

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