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Ratings

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New Issue: Danske Hypotek AB (Mortgage Covered Bond Program)

Säkerställda Obligationer (Mortgage Covered Bonds)

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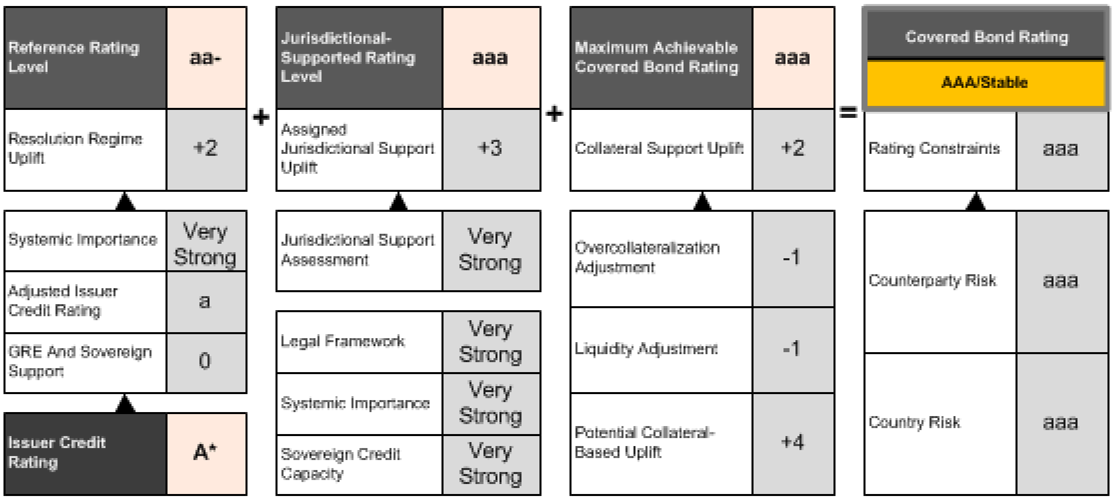
Ratings Detail



*We use the long-term rating on Danske Bank A/S, to which the issuer is deemed a core entity.

Major Rating Factors

Strengths

- The cover pool comprises loans with low loan-to-value (LTV) ratios compared with the maximum allowed by legislation.
- 'AAA' rating reached with the jurisdictional support and a relatively low level of required credit enhancement.
- Interest rate risk mismatches between the assets in the cover pool and the covered bonds are hedged.

Weaknesses

- Aside from the legislative minimum, there is no other commitment regarding the available overcollateralization in the cover pool.
- Around 62% of the mortgage loans in the pool have interest-only repayment profiles, which we view as having higher credit risk compared to standard repayment loans.
- 180 days of liquidity risk are not covered.

Outlook: Stable

The stable outlook reflects the fact that the ratings on Danske Hypotek AB's mortgage covered bonds benefit from two unused notches of collateral-based uplift under our covered bonds criteria (see "Covered Bonds Criteria," published on Dec. 9, 2014). Therefore, if we were to lower our long-term issuer credit rating (ICR) on Danske Hypotek up to two notches, we would not lower our ratings on the covered bonds, all else being equal.

We could downgrade the covered bonds if the available credit enhancement were to decrease below the overcollateralization commensurate with their maximum achievable ratings.

Rationale

On Aug. 31, 2017, S&P Global Ratings assigned its 'AAA' credit ratings to Danske Hypotek's mortgage covered bond program and related issuances (see "Danske Hypotek Mortgage Covered Bond Program Assigned 'AAA' Rating; Outlook Stable").

Our covered bond ratings process follows the methodology and assumptions outlined in our "Covered Bonds Criteria," published on Dec. 9, 2014, and "Covered Bond Ratings Framework: Methodology And Assumptions," published on June 30, 2015.

From our analysis of Danske Hypotek's new program and the Swedish legislative covered bond framework, we have concluded that the assets in the cover pool are isolated from the issuer's insolvency risk. The asset isolation allows us to potentially assign a higher rating to the covered bond program than our long-term ICR on the issuer.

We conducted a review of Danske Hypotek's mortgage operations, which we view as prudent. We believe satisfactory procedures are in place to support our ratings on the covered bonds.

Danske Hypotek is domiciled in Sweden and is a wholly owned subsidiary of Danske Bank A/S, which is domiciled in Denmark. We understand from the European resolution directive that institutions with operations in more than one jurisdiction would be subject to the cooperation from the authorities in the relevant jurisdictions in a resolution scenario. Both Sweden and Denmark are subject to the EU's Bank Recovery and Resolution Directive (BRRD) and we consider that mortgage covered bonds in both jurisdictions have a very strong systemic importance. These factors increase the likelihood that Danske Bank would continue servicing its covered bonds without accessing the cover pool or receiving jurisdictional support, even following a bail-in of its senior unsecured obligations.

Under our covered bonds criteria, we assess the reference rating level (RRL) as 'aa-'. We then consider the likelihood of jurisdictional support, which we assess as very strong for mortgage programs in Sweden. This leads us to apply three notches of uplift from the RRL to determine the jurisdiction-supported rating level (JRL), which we therefore assess as 'aaa' (see "Assessments For Jurisdictional Support According To Our Covered Bonds Criteria," published on July 20, 2016).

We have reviewed the asset information provided as of June 30, 2017. The portfolio comprises solely Swedish residential mortgage loans. Based on our cash flow analysis, we believe that the available credit enhancement exceeds the required credit enhancement for a 'AAA' rating.

The covered bonds are eligible for four notches of potential collateral-based uplift from the JRL. Considering the lack of 180 days' liquidity coverage and the absence of committed overcollateralization, the maximum rating uplift is reduced by two notches.

The portfolio's underlying assets comprise Swedish krona (SEK) 30.0 billion of Swedish residential mortgage loans. Our measure of the weighted-average foreclosure frequency (WAFF; representing the level of defaults) stands at 14.71%, and the weighted-average loss severity (WALS; our measure of possible losses upon default) at 60.76%, based on a 'AAA' stress level.

We have modeled our cash flow analysis with the new issuance of SEK5 billion, five-year hard-bullet covered bonds. The available credit enhancement of 493.35% exceeds the credit enhancement required for the 'AAA' rating, 6.66%.

The average credit enhancement to cover credit risk of the other covered bond programs we rate in Sweden is 4.6% (as of June 2017). The level in Danske Hypotek (6.66%) is currently not directly comparable to this average as we have not yet analyzed the other programs under our European residential loans criteria (see "Methodology And Assumptions: Assessing Pools Of European Residential Loans," published on Aug. 4, 2017).

The swap documentation has been structured to address the risk factors and include replacement language that is in line with our criteria (see "Counterparty Risk Framework Methodology And Assumptions," published on June 25, 2013 and "Global Derivative Agreement Criteria," published on June 24, 2013).

We assess country risk by applying our structured finance ratings above the sovereign (RAS) criteria (see "Ratings Above The Sovereign - Structured Finance: Methodology And Assumptions," published on Aug. 8, 2016). In light of our 'AAA' long-term sovereign rating on Sweden, country risk does not constrain our 'AAA' ratings on the covered bonds.

Program Description

Table 1

Program Overview*	
Jurisdiction	Sweden
Year of first issuance	2017
Covered bond type	Legislation-enabled
Covered bonds (SEK/bn)	5
Redemption profile	Hard bullet
Underlying assets	Residential mortgages
Jurisdictional support uplift	3
Unused notches for jurisdictional support	0
Available credit enhancement (%)	493.35
Credit enhancement commensurate with rating (%)	6.66

*Based on data as of June 2017.

Danske Hypotek is a wholly owned subsidiary of Danske Bank. On June 26, 2017, the Swedish FSA (SFSA) granted Danske Hypotek a license to conduct financing business as a credit market company to issue covered bonds under the Covered Bonds Act. It has been primarily established for the purpose of managing the group's issuance of covered bonds in Swedish krona backed by Swedish krona assets. Under the program, Danske Hypotek can issue covered bonds in Swedish krona or euro, primarily aimed for investors on the Swedish domestic covered bond market. The covered bonds are governed by Swedish law and the operations from the issuer are supervised by the Swedish FSA (SFSA).

The issuer's main activity is to acquire Swedish mortgages from Danske Bank's Swedish branch funded with the issuance of covered bonds. The acquired mortgages are included in the cover pool and must comply with the requirements under the Covered Bonds Act. There is a transitional period in which the issuer can acquire Swedish mortgage loans from Danske Bank's cover pool I as the covered bonds backed by them mature.

Mortgage borrowers pay into their respective account number with Danske Bank. Upon the sell and inclusion of a mortgage loan in the cover pool of Danske Hypotek, borrowers are informed of the sale and their registration number within their account number changes. At that point, Danske Hypotek becomes the account provider and Danske Bank the loan servicer. Commingling risk is covered through the Swedish covered bond law, as long as the funds belonging to the cover pool are always identifiable, which is the case in this structure.

Danske Hypotek has entered into an interest rate swap agreement with Danske Bank to mitigate interest rate risk.

The covered bonds issued under the program are senior, direct, secured, and unconditional obligations of Danske Hypotek. The covered bond noteholders benefit from the ownership of Danske Bank and have recourse to the portfolio of mortgage loans included in Danske Hypotek.

Chart 1

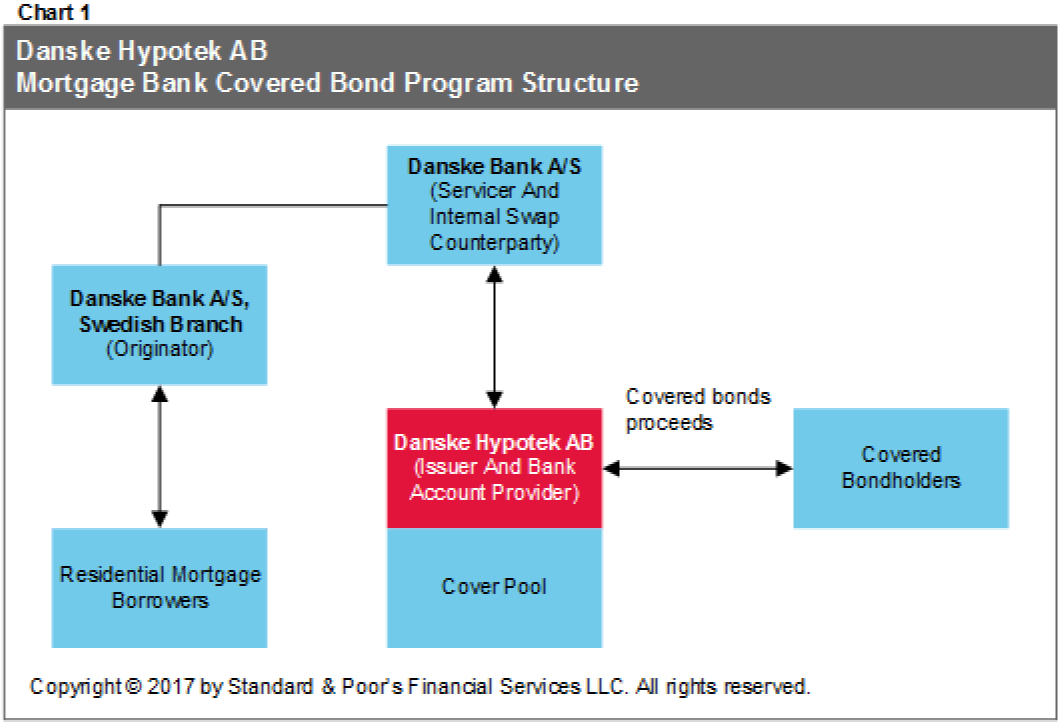


Table 2

Covered Bond Program Participants

Role	Name	Rating	Rating dependency
Issuer	Danske Hypotek	N/A*	Yes
Originator	Danske Bank A/S	A/Stable/A-1	No
Bank account provider	Danske Hypotek	N/A*	No
Swap provider	Danske Bank A/S	A/Stable/A-1	Yes

*There is no public rating on Danske Hypotek but we use the long-term rating on Danske Bank A/S, to which the issuer is deemed a core entity

Rating Analysis

Legal and regulatory risks

We base our analysis of legal risk on the guidelines in "Asset Isolation And Special-Purpose Entity Methodology," published on March 29, 2017.

In our opinion, the Swedish covered bond legal framework satisfies the relevant legal requirements of our covered bonds criteria. This enables us to rate the covered bonds above our long-term ICR on the issuer.

Swedish covered bonds–"saekerstaellda obligationer"—are issued under the Swedish Covered Bond Act ("Lag 2003:1223 om utgivning av saekerstaellda obligationer"). The legal framework was then amended in 2010 to address the range of options available to the program to source external funding and regulatory provisions were passed to complement the framework. Covered bond investors have a preferential claim to a cover pool of assets and to the issuer (but not to its parent company). The cover pool may comprise exposures to properties and rights equivalent to real property located in Sweden or a member state of the European Union. Under the covered bonds law, mortgages may be used as security up to a certain estimated value of the property: 75% for residential properties, 70% for agricultural properties, and 60% for commercial properties. The cover pool may also include exposures to public-sector entities from a wider geographical area than is the case for the mortgage assets. Additionally, highly liquid assets can serve as substitute assets and can comprise up to 20% of the mortgage pool.

There is minimum required overcollateralization of 2%. The Swedish covered bond law does not directly require that issuers cover 180 days of liquidity needs at all times, but the SFSA requires that the issuer maintains sufficient liquidity to discharge obligations as they come due.

An independent inspector monitors the cover pool as long as the issuer is solvent. The law does not provide for a separate cover pool administrator if the issuer becomes insolvent. Instead, the receiver-in-bankruptcy represents all investors and also regularly conducts special covered bond supervision.

Operational and administrative risks

In our opinion, there is no operational risk from the cover pool's management and loan origination that would constrain the covered bond rating to the same level as the long-term ICR.

We believe that it is highly likely that a replacement cover pool manager could be appointed if the issuer were to become insolvent. We consider Sweden to be an established covered bond market and we believe that the mortgage assets in Danske Hypotek's cover pool do not comprise product features that would materially limit the range of available replacement cover pool managers or servicers.

Danske Bank is the second largest bank in the Nordics, with a market share of 25%-30% in Denmark. Its operations cover retail and commercial banking, asset management, life insurance, and investment banking. The group operates primarily in Denmark, Finland, Sweden, and Norway.

Danske Bank views Sweden as a strategically important market and therefore views the establishment of Danske Hypotek as a long-term funding solution for its target growth in this market. Danske's current market share is Sweden in lower compared with the one in Denmark, but the bank aims to challenge existing market players.

Mortgage loan originations are first handled by middle office, branches, or by an automatic online process. Danske Bank's underwriting criteria include LTV caps at 85%, minimum amortization rules for certain loans, and maximum debt to income ratios, among other requirements. Current mortgage loans as well as new origination are concentrated in Greater Stockholm and specific growth centers in Sweden, with about 62% of the loans having interest-only repayment profiles.

We view Danske Bank's underwriting criteria as prudent. Our view is also supported by the low level of delinquencies on the bank's mortgages in Sweden.

Our analysis of operational and administrative risks follows the guidelines in our criteria (see "Covered Bond Ratings Framework: Methodology And Assumptions," published on June 30, 2015).

Resolution regime analysis

Danske Hypotek is domiciled in Sweden and is a wholly owned subsidiary of Danske Bank A/S, which is domiciled in Denmark. We understand from the European resolution directive that institutions with operations in more than one jurisdiction would be subject to the cooperation from the authorities in the relevant jurisdictions in a resolution scenario. Both Sweden and Denmark are subject to the EU's BRRD. We assess the systemic importance for mortgage covered bonds in both jurisdictions as very strong.

Under our covered bonds criteria, this means that the RRL can be two notches above the adjusted long-term ICR (adjusted by removing the uplift allocated to reflect extraordinary government support to the issuer). This uplift recognizes that resolution regimes like the BRRD increase the probability that an issuer could service its covered bonds even following a default on its senior unsecured obligations because the law exempts covered bonds from bail-in risk if there is a bank resolution. We consider this as an internal form of support, because the bail-in of certain creditors of the issuer does not require direct government support.

Under our covered bonds criteria, we assess the RRL as 'aa-', that is, two notches above the ICR of Danske Hypotek (given that it incorporates no notches of uplift due to sovereign or government-related entities support). We derive the ICR on Danske Hypotek from our ICR on Danske Bank, to which this issuer is deemed to be a core entity.

Jurisdictional support analysis

Under our analysis of jurisdictional support in our covered bonds criteria, we determine a JRL, which is our assessment of the creditworthiness of a covered bond program once we have considered the level of jurisdictional support, but before giving credit to the amount of collateral.

In our jurisdictional support analysis, we assess the likelihood that a covered bond program facing stress would receive support from a government-sponsored initiative instead of from the liquidation of collateral assets in the open market. Our assessment of the expected jurisdictional support for Swedish mortgage covered bond programs is very strong. Under our covered bonds criteria, this means that the program can receive up to three notches of jurisdictional uplift from the RRL. This leads to a JRL for Danske Hypotek's mortgage covered bonds of 'aaa'. The JRL cannot exceed the rating on the sovereign providing the support to the covered bond, which in this case is 'AAA'.

Collateral support analysis

The cover pool comprises Swedish residential mortgage loans originated by the Swedish branch of Danske Bank. We based our analysis on loan-by-loan data as of a cut-off date of June 30, 2017. The final updated pool as of Aug. 28, 2017, is the same one we analyzed as of June 30, 2017, with only the removal of a small number of loans. Therefore, we believe that the final pool has the same credit quality as the provisional pool.

The SEK30.0 billion cover pool is fairly granular. It includes loans granted to borrowers with multiple loan parts and, in some occasions, backed by different properties. The average LTV ratio of the loans is 49.7%, considerably below the maximum 75% LTV ratio allowed for residential properties by legislation, despite the portfolio's low seasoning. The pool comprises loans that are secured on Swedish residential retail properties and tenant-owner rights.

Swedish property prices have risen over the past years and we expect this trend to continue. House prices and income levels have not tended to move in tandem over the past years, leading to a material overvaluation in the housing market, in our view. This overvaluation is incorporated in our loss severity calculation in line with our criteria.

The cover pool is fairly unseasoned compared to other Swedish covered bond programs we rate, with a weighted-average seasoning of about 3.5 years. The loans are concentrated in larger cities, like Stockholm, and 62% of the cover pool balance pays interest-only until maturity. Although these factors could drive upwards our foreclosure risk assessment, the portfolio's historical performance has been good and we believe the quality of the loan origination and underwriting processes is prudent. We have reflected this by applying a positive pool-level adjustment factor in our analysis.

We assess the credit quality of a typical residential mortgage cover pool by estimating the credit risk associated with each loan in the pool. For this program, we base our credit analysis on the application of our European residential loans criteria.

We then calculate the aggregate risk to assess the cover pool's overall credit quality. In order to quantify the potential losses associated with the entire pool, we weight each loan's foreclosure frequency and loss severity by its percentage of the total pool balance. The product of this WAFF and WALS estimates the required loss protection, assuming all other factors remain unchanged.

The WAFF and WALS for the pool are 14.71% and 60.76%, respectively, in a 'AAA' credit stress scenario.

In order to mitigate interest rate risk arising from the differences between assets and covered bonds, the issuer has entered into a swap agreement with Danske Bank.

For the final cash flow analysis we have modeled the new issuance of SEK5 billion, five-year hard-bullet covered bond, issued on Aug. 31, 2017. The results of our analysis indicate that the available credit enhancement of 493.35% is sufficient to cover 'AAA' credit risk, which is the credit enhancement level required for a 'AAA' rating, 6.66%.

The average credit enhancement to cover credit risk of the other covered bond programs we rate in Sweden is 4.6%. The level in Danske Hypotek (6.66%) is currently not directly comparable to this average as the other programs have not been yet analyzed under our European residential loans criteria.

Table 3

Cover Pool Composition

	As of Aug. 28, 2017	
Asset type	**Value (SEK)**	**Percentage of cover pool**
Residential mortgages	29,751,718,117	100.00

Tables 4 to 7 below show the characteristics of the June 30, 2017 pool we analyzed.

Table 4

Key Credit Metrics

	As of June 30, 2017
Weighted-average current LTV ratio (%)	49.60
Weighted-average loan seasoning (years)*	3.54
Balance of loans in arrears (%)	0.00
Second homes (%)	5.52
Interest-only loans (%)	62.34
Loans backed by tenant-owner rights	40.15
Credit analysis results:	
Weighted-average foreclosure frequency (WAFF; %)	14.71
Weighted-average loss severity (WALS; %)	60.76
AAA credit risk (%)	6.66

*Seasoning refers to the elapsed loan term.

Table 5

Pool LTV Ratios

	As of June 30, 2017
Current LTV (%)	Percentage of portfolio
0-10	0.91
10-20	4.39
20-30	8.34
30-40	12.84
40-50	20.22
50-60	23.43
60-70	22.63

Table 5

Pool LTV Ratios (cont.)

	As of June 30, 2017
>70	7.24
Weighted-average LTV ratio	49.60

Table 6

Loan Seasoning Distribution*

	As of June 30, 2017
Months	Percentage of portfolio
0-60	71.70
60-72	5.90
72-84	6.20
84-96	3.19
96-108	4.89
108-120	2.39
More than 120	5.73
Weighted-average loan seasoning (years)	3.54

*Seasoning refers to the elapsed loan term.

Table 7

Geographic Distribution Of Loan Assets

	As of June 30, 2017
Region	Percentage of portfolio
Smaland and the islands	3.56
South Sweden	8.56
Stockholm	50.60
Upper Norrland	0.32
Middle Norrland	1.38
West Sweden	17.43
East Middle Sweden	15.52
North Middle Sweden	2.62
Total	100

Table 8

Collateral Uplift Metrics

	As of Aug. 28, 2017
Asset WAM (years)	21.80
Liability WAM (years)	5.25
Available credit enhancement (%)	493.35
Credit enhancement commensurate with rating (%)	6.66
Potential collateral-based uplift (notches)	4
Adjustment for liquidity (Y/N)	Y
Adjustment for committed overcollateralization (Y/N)	Y
Collateral support uplift (notches)	2

Table 8

Collateral Uplift Metrics (cont.)	
	As of Aug. 28, 2017
Unsused notches of collateral-based uplift	2
Total unused notches of uplift	2

WAM--Weighted-average maturity.

Counterparty risk

We have identified counterparty risks to which the planned issuances are exposed. However, as these are either structurally addressed or mitigated by the inclusion of replacement language in line with our current counterparty criteria, we believe that they do not constrain the rating from a counterparty risk perspective (see "Counterparty Risk Framework Methodology And Assumptions," published on June 25, 2013).

Bank account provider and commingling risk

Mortgage borrowers pay into their respective account number with Danske Bank. Upon the sale and inclusion of a mortgage loan in Danske Hypotek's cover pool, borrowers are informed of the sale and their registration number within their account number changes. At that point, Danske Hypotek becomes the account provider and Danske Bank the loan servicer. Commingling risk is covered through the Swedish covered bond law, as long as the funds belonging to the cover pool are always identifiable, which is the case in this structure.

Swaps

The issuer has entered into a swap agreement to support the planned issuances with Danske Bank.

On the asset side, the issuer swaps the loans' base rate into three-months Stockholm Interbank Offered Rate (STIBOR). The base rate on the loans is paid into the swap on the interest payment dates of the mortgage loans (which is monthly) and every three months the issuer receives three-months STIBOR.

On the liability side, the issuer pays three-month STIBOR and receives the corresponding fixed interest rate.

The reset dates on the assets and the covered bonds are the same, hedging the program from basis risk.

The swap documentation has been structured to address the risk factors and includes replacement language that is consistent with our counterparty criteria.

Country risk

We assess country risk by applying our RAS criteria. Under these criteria, we consider that the assets in the pool have a moderate sensitivity to country risk. We can rate the covered bonds up to three notches above the rating on the sovereign, Sweden (AAA/Stable/A-1+). Based on the current sovereign rating, country risk does not constrain our ratings on the covered bonds.

Potential Effects Of Proposed Criteria Changes

Our ratings are based on our applicable criteria, including our covered bonds criteria.

However, the resolution regime analysis section of these criteria is under review (see "Request For Comment:

Methodology For Incorporating The Effect Of Resolution Regimes Into Covered Bond Ratings," and "Request for Comment: Methodology For Assigning Financial Institution Resolution Counterparty Ratings," both published on Jan. 31, 2017).

As a result of this review, we may amend certain paragraphs of our covered bonds criteria. This change may affect the ratings on the outstanding covered bonds issued under this covered bond program. Until this time, we will continue to rate and surveil these covered bonds using our existing criteria (see "Related Criteria").

Related Criteria

- Criteria - Structured Finance - General: Methodology And Assumptions: Assessing Pools Of European Residential Loans, Aug. 4, 2017
- Legal Criteria: Structured Finance: Asset Isolation And Special-Purpose Entity Methodology, March 29, 2017
- Criteria - Structured Finance - General: Ratings Above The Sovereign - Structured Finance: Methodology And Assumptions, Aug. 8, 2016
- Criteria - Structured Finance - Covered Bonds: Counterparty Risk Analysis In Covered Bonds, Dec. 21, 2015
- Criteria - Structured Finance - Covered Bonds: Covered Bond Ratings Framework: Methodology And Assumptions, June 30, 2015
- Criteria - Structured Finance - Covered Bonds: Covered Bonds Criteria, Dec. 9, 2014
- Criteria - Structured Finance - General: Counterparty Risk Framework Methodology And Assumptions, June 25, 2013
- Criteria - Structured Finance - General: Global Derivative Agreement Criteria, June 24, 2013
- General Criteria: Methodology: Credit Stability Criteria, May 3, 2010
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Related Research

- Danske Hypotek Mortgage Covered Bond Program Assigned 'AAA' Rating; Outlook Stable, Aug. 31, 2017
- Request For Comment: Methodology For Incorporating The Effect Of Resolution Regimes Into Covered Bond Ratings, Jan. 31, 2017
- Request for Comment: Methodology For Assigning Financial Institution Resolution Counterparty Ratings, Jan. 31, 2017
- Assessments For Jurisdictional Support According To Our Covered Bonds Criteria, July 20, 2016