

Rating Action: Moody's downgrades long-term deposit and senior unsecured debt ratings of Danske Bank to A2 and maintains a negative outlook

12 Oct 2018

This action follows the announcement that Danske Bank is the subject of criminal investigations by the US Department of Justice

London, 12 October 2018 -- Moody's Investors Service (Moody's) has downgraded all long-term ratings of Danske Bank A/S (Danske), including the long-term deposit and senior unsecured debt ratings to A2 from A1, junior senior unsecured debt ratings to Baa2 from Baa1, and baseline credit assessment (BCA) to baa1 from a3. The long-term deposits and senior unsecured ratings continue to carry a negative outlook.

The rating action follows the announcement that the bank is the subject of criminal investigations by the US Department of Justice (DoJ) linked to money laundering through its Estonian branch between 2007-2015.

The downgrade reflects Moody's opinion that this development, in conjunction with the ongoing investigations of European authorities regarding money laundering, 1) has increased the probability that Danske will receive substantial financial fines, and 2) will consume a significant amount of resources and managerial focus, owing to the expected length and complexity of the US investigation and the potential for additional remediation requirements.

Danske's baa1 BCA also reflects the strengthening of its asset quality, capitalization and profitability in the aftermath of the financial crisis, which brought its credit profile broadly in line with those of its large Nordic peers. The negative outlook captures further related operational and reputational risks stemming from ongoing investigations, which could affect negatively Danske's franchise.

The full list of the affected ratings can be found at the end of this press release.

RATINGS RATIONALE

RISKS RELATED TO MONEY LAUNDERING INVESTIGATIONS DRIVE DOWNGRADE

The key driver for today's ratings downgrade of Danske's BCA to baa1 from a3 is the recent news of money laundering investigations by US authorities, which 1) heighten the risk of material monetary penalties; and 2) will exert pressure on both financial and human resources and managerial time, given the complexity and scope of the investigations and related remedial actions.

In addition to the investigation launched by US authorities, Danske is also the subject of parallel investigations in Denmark and Estonia, including for potential criminal activities, linked to money laundering of a significant scale through the bank's Estonian branch between 2007-2015. Even though Moody's acknowledges the high degree of uncertainty surrounding the magnitude of any potential fines resulting from the investigations, an analysis of past money laundering cases involving US authorities suggests financial penalties alone (i.e. excluding internal operational and remediation costs) could represent a sizable figure relative to the bank's annual net income.

Furthermore, as indicated by similar cases in the past and considering the reported number of regulators involved in investigations, Moody's considers that the prolonged and complex nature of the investigation and remediation procedures will consume a significant amount of bank resources and managerial focus.

Moody's recognises that, in the context of earlier investigations by the Danish regulators, the bank has already taken a number of steps to address its Board and Executive level governance and control and specifically its money laundering process controls deficiencies. These actions underpins the baa1 BCA assigned to the bank along with its strengthened capital, solid asset quality and diversified funding profile. Danske closed down its non-resident customer portfolio in 2015, strengthened governance and oversight in the Baltics along with nominated new Baltic management. Additionally, Danske has boosted its capital buffer in order to comply with its home regulator's order to set aside a minimum of DKK 10 billion (approximately USD 1.7 billion) in Pillar II capital (in the form of CET1) to cover for what the Danish regulatory authority characterized as "heightened

compliance and reputational risks". The bank cancelled its share buy-back program in response.

SENIOR UNSECURED, DEPOSIT AND JUNIOR DEBT RATINGS

The downgrade of the deposit and senior unsecured debt ratings follows the downgrade of the bank's adjusted BCA. Moody's Advanced Loss Given Failure (LGF) analysis is based on the group's current balance sheet structure and its capital and funding plans up to the beginning of January 2022, when the subordination requirement for Minimum Requirements for own funds and Eligible Liabilities (MREL) is applicable.

This analysis indicates that Danske's depositors and senior creditors are likely to face low loss-given-failure, due to the loss absorption provided by the non-preferred senior issuance. This results in one notch of uplift for deposits and senior unsecured debt ratings, which are further supported by our view of "moderate" probability of government support, which results in an additional uplift for these two rating classes, leading to long-term deposit and senior unsecured ratings of A2. Moody's does not incorporate government support in the Baa2 junior senior ratings, as this debt class has been introduced by the authorities to absorb losses.

The downgrade of the high-trigger Additional Tier 1 (AT1) ratings to Ba1(hyb) from Baa3(hyb) also follows from the downgrade of the bank's adjusted BCA, as per Moody's notching guidelines for junior securities.

NEGATIVE OUTLOOK

The negative outlook reflects the balance of forward-looking operational and reputational risks stemming from the ongoing investigations, which could further negatively affect Danske's financial profile and franchise.

In addition to the direct financial and potentially criminal impact that could result from penalties, Danske faces reputational and operational risks, as the money laundering findings, could dampen the confidence of some customers, investors and counterparties.

WHAT COULD CAUSE RATINGS TO GO DOWN

The ratings could be downgraded if Moody's observes relapses in terms of governance, control functions or compliance, along with any indications of a renewed aggressive strategy resulting in heightened credit or operational risks. The rating would also come under pressure if the rating agency observes: (i) a sustained loss in clients or business, exerting pressure on the bank's financial profile, (ii) firmer evidence of monetary penalties that would not only put the bank's earnings, but also capital under pressure; or (iii) signs that funding becomes significantly more costly or that access to certain markets or instruments becomes more limited.

WHAT COULD CHANGE THE OUTLOOK TO STABLE

The outlook could revert back to stable if the company demonstrates it has fully addressed compliance shortcomings and that the repercussions of the historical issues in Estonia will not have a material negative impact on Danske's financial profile or its franchise compared to the current positioning of the BCA. The bank would also need to demonstrate satisfactory levels of profitability without any significant deterioration in its funding profile, along with a reduction of the potential risk of further material financial penalties.

LIST OF AFFECTED RATINGS

Issuer: Danske Bank A/S

..Downgrades:

-Long-term Counterparty Risk Ratings, downgraded to Aa3 from Aa2
-Long-term Bank Deposits Rating, downgraded to A2 Negative from A1 Negative
-Long-term Deposit Note/CD Program, downgraded to (P)A2 from (P)A1
-Long-term Counterparty Risk Assessment, downgraded to Aa3(cr) from Aa2(cr)
-Long-term Issuer Rating, downgraded to A2 Negative from A1 Negative
-Baseline Credit Assessment, downgraded to baa1 from a3
-Adjusted Baseline Credit Assessment, downgraded to baa1 from a3

...Senior Unsecured Regular Bond/Debenture, downgraded to A2 Negative from A1 Negative
...Senior Unsecured Medium-Term Note Program, downgraded to (P)A2 from (P)A1
...Junior Senior Unsecured Regular Bond/Debenture, downgraded to Baa2 from Baa1
...Junior Senior Unsecured Medium-Term Note Program, downgraded to (P)Baa2 from (P)Baa1
...Preferred Stock Non-cumulative, downgraded to Ba1(hyb) from Baa3(hyb)

..Affirmations:

...Short-term Counterparty Risk Ratings, affirmed P-1
...Short-term Bank Deposits, affirmed P-1
...Short-term Deposit Note/CD Program, affirmed P-1
...Short-term Deposit Note/CD Program, affirmed (P)P-1
...Backed Short-term Deposit Note/CD Program, affirmed P-1
...Short-term Counterparty Risk Assessment, affirmed P-1(cr)
...Commercial Paper, affirmed P-1
...Other Short Term, affirmed (P)P-1

..Outlook Action:

...Outlook remains Negative

Issuer: Danske Bank A/S (London Branch)

..Downgrade:

...Long-term Deposit Note/CD Program, downgraded to (P)A2 from (P)A1

..Affirmation:

...Short-term Deposit Note/CD Program, affirmed (P)P-1

..Outlook Action:

...Outlook remains Negative

Issuer: Danske Corporation

..Affirmation:

...Backed Commercial Paper, affirmed P-1

..No Outlook assigned

PRINCIPAL METHODOLOGY

The principal methodology used in these ratings was Banks published in August 2018. Please see the Rating Methodologies page on www.moodys.com for a copy of this methodology.

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