

Rating Action: Moody's downgrades senior unsecured debt ratings of Danske Bank to A3 and changes the outlook to stable; affirms long-term deposit ratings at A2 with a negative outlook

10 Dec 2019

Stockholm, December 10, 2019 -- Moody's Investors Service (Moody's) has downgraded all long-term debt ratings of Danske Bank A/S (Danske), including the senior unsecured debt ratings to A3 from A2, junior senior (commonly referred to as senior non-preferred by the market) unsecured debt ratings to Baa3 from Baa2, and the baseline credit assessment (BCA) to baa2 from baa1. The senior unsecured debt ratings now carry a stable outlook. At the same time, the rating agency also affirmed the long-term deposit ratings and maintained the negative outlook.

The rating action follows the announcement that the bank lowered its earnings expectations, which will likely bottom out at an expected return on equity (ROE) of between 5-6% in 2020. This indicates that the bank's earnings have taken a more significant hit compared to what Moody's previously expected, as the fallout of the bank's alleged money laundering through its Estonian branch between 2007-2015 continues to impact compliance as well as funding costs at the same time as net interest margins are under pressure and trading income has fallen significantly.

The current BCA reflects Moody's assessment that the bank would be able to withstand fines or settlement(s) resulting from the ongoing investigations in the US, Denmark and Estonia within one year's earnings.

The stable outlook on the senior unsecured debt ratings reflects our view that the bank -- at the current BCA positioning -- will maintain its financial performance over the next 12-18 months in the context of moderate economic growth and ultra-low interest rates.

The affirmation of the deposit rating is based on the current balance sheet which provides an important loss-absorbing cushion for deposits as the bank has frontloaded its senior non-preferred issuance. The negative outlook reflects the risk that the volume and subordination cushion may potentially diminish over time as senior unsecured debt volumes mature.

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

RATINGS RATIONALE

A CONTINUED WEAKENING IN PROFITABILITY DRIVE BCA DOWNGRADE

The key driver for today's downgrade of Danske's BCA to baa2 from baa1 is the continued weakening of the bank's net income, with ROE expected to decline to 5-6% in 2020. Profitability is under pressure from: 1) continued repair work and increased compliance investments to further strengthen the bank's anti-money laundering (AML) capabilities, 2) increased funding costs due to front-loading of senior non-preferred debt issuances along with relatively higher funding costs compared to large Nordic peers, 3) net interest margins (NIMs) under pressure in the context of the ultra-low interest rate environment, particularly in its home market Denmark, and 4) significantly weaker trading income, which is expected to remain at a lower level going forward.

Governance considerations, specifically previous deficiencies in compliance and controls, have been a key factor behind the weakening profitability and therefore a driver of this rating action. Danske is subject to investigations in the US, Denmark, Estonia and France, 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 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 continue to consume a significant amount of managerial focus and bank

resources.

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. Additionally, Danske has boosted its capital buffer to comply with its home regulator's order to set aside a minimum of DKK 10 billion (approximately € 1.3 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".

Danske's dominant market position in Denmark, along with its presence in the other three Nordic markets, is supportive of the baa2 BCA. The bank also benefits from good asset quality, robust capital and a diversified funding profile, with demonstrated market access also during the past year and a half.

DOWNGRADE OF SENIOR UNSECURED AND JUNIOR DEBT RATINGS

The downgrade of the senior unsecured debt, and junior 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 funding needed to comply with the current Minimum Requirements for own funds and Eligible Liabilities (MREL), including the subordination requirement which needs to be fulfilled by 1 January 2022.

This analysis indicates that Danske's senior creditors are likely to face low loss-given-failure, due to the loss absorption provided by the senior non-preferred issuance. This results in one notch of uplift for senior unsecured debt ratings, which are further supported by our view of "moderate" probability of government support, which results in an additional uplift for this rating class, leading to long-term senior unsecured ratings of A3. Moody's does not incorporate government support in the Baa3 junior senior debt ratings, as this debt class has been introduced by the authorities to absorb losses.

(Please see: FAQ: Update on Nordic banks' senior nonpreferred debt http://www.moodys.com/research/--PBC_1200040)

The downgrade of the high-trigger Additional Tier 1 (AT1) ratings to Ba2(hyb) from Ba1(hyb) also follows from the downgrade of the bank's Adjusted BCA, as per Moody's notching guidelines for junior securities.

STABLE OUTLOOK ON SENIOR UNSECURED DEBT RATINGS

The stable outlook on the senior unsecured debt ratings reflects our view that the bank -- at the current BCA positioning -- will demonstrate adequate financial performance in the context of moderate economic growth and that its credit profile will remain broadly unchanged over the next 12-18 months.

AFFIRMATION OF DEPOSIT RATINGS

The affirmation of the deposit ratings is based on the current balance sheet, which provides an important loss-absorbing cushion for deposits as the bank has frontloaded its senior non-preferred issuance while senior unsecured debt volumes are still in the process of maturing. This indicates a very low loss-given failure and results in two notches of uplift for deposit ratings, which are further supported by our view of "moderate" probability of government support, which results in an additional uplift for this rating class, leading to deposit ratings of A2.

NEGATIVE OUTLOOK ON DEPOSIT RATINGS

The negative outlook reflects the risk that the volume and subordination cushion may potentially diminish over time as senior unsecured debt volumes mature, unless the bank issues significantly higher senior non-preferred debt volumes than justified by its current MREL requirement.

The Danish MREL requirements are currently more conservative, requiring higher subordination than indicated by the Bank Recovery and Resolution Directive 2 (BRRD2). There is thus a risk that these requirements may be lowered once the BRRD2 is implemented in Denmark.

WHAT COULD CAUSE RATINGS TO GO UP

The BCA and adjusted BCA could be upgraded if the company demonstrates it has fully addressed compliance shortcomings and that the repercussions of the historical issues in Estonia will not have any further

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 return to significantly higher levels of profitability on a sustained basis without any noticeable deterioration in its funding profile, along with a reduction of the potential risk of further material financial penalties that the bank could not contain within one year's earnings.

The long-term senior unsecured debt and junior senior unsecured debt ratings could also be upgraded if the bank were to significantly increase its senior non-preferred debt issuance, providing additional loss-absorbing cushion, over time.

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 ratings 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) indications of monetary penalties greater than current expectations, which would put the bank's capital under significant pressure; or (iii) signs that funding becomes significantly more costly or that access to certain markets or instruments becomes more limited.

The long-term deposit ratings could also be downgraded if the current volume and subordination (based on Q3 2019), which is supported by the bank having frontloaded its senior non-preferred issuance, were to decline importantly going forward.

LIST OF AFFECTED RATINGS

..Issuer: Danske Bank A/S

Downgrades:

- Adjusted Baseline Credit Assessment, Downgraded to baa2 from baa1
- Baseline Credit Assessment, Downgraded to baa2 from baa1
- Long-term Counterparty Risk Assessment, Downgraded to A1(cr) from Aa3(cr)
- Long-term Counterparty Risk Ratings, Downgraded to A1 from Aa3
- Long-term Issuer Rating, Downgraded to A3 from A2, Outlook changed to Stable from Negative
- Other Short-Term, Downgraded to (P)P-2 from (P)P-1
- Senior Unsecured Medium-Term Note Program, Downgraded to (P)A3 from (P)A2
- Senior Unsecured Regular Bond/Debenture, Downgraded to A3 from A2, Outlook changed to Stable from Negative
- Junior Senior Unsecured Medium-Term Note Program, Downgraded to (P)Baa3 from (P)Baa2
- Junior Senior Unsecured Regular Bond/Debenture, Downgraded to Baa3 from Baa2
- Commercial Paper, Downgraded to P-2 from P-1
- Preferred Stock Non-cumulative, Downgraded to Ba2(hyb) from Ba1(hyb)

Affirmations:

- Long-Term Bank Deposit Ratings, Affirmed A2, Outlook remains Negative
- Long-Term Deposit Note/CD Program, Affirmed (P)A2
- Short-term Bank Deposit Ratings, Affirmed P-1
- Short-Term Deposit Note/CD Program, Affirmed (P)P-1
- Short-Term Deposit Note/CD Program, Affirmed P-1

.... Backed Short-Term Deposit Note/CD Program, Affirmed P-1
.... Short-Term Counterparty Risk Assessment, Affirmed P-1(cr)
.... Short-Term Counterparty Risk Ratings, Affirmed P-1

Outlook Action:

....Outlook, Changed To Negative(m) From Negative
..Issuer: Danske Bank A/S (London Branch)

Affirmations:

....Long-Term Deposit Note/CD Program, Affirmed (P)A2
....Short-Term Deposit Note/CD Program, Affirmed (P)P-1

Outlook Action:

....Outlook, Remains Negative

The principal methodology used in these ratings was Banks Methodology published in November 2019. Please see the Rating Methodologies page on www.moody.com for a copy of this methodology.

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