

Transaction Update: Danske Bank A/S (Cover Pool D Mortgage Covered Bonds)

Saerligt Daekkede Obligationer

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Ratings Detail

Reference Rating Level	aa-	+	Jurisdiction-Supported Rating Level	aaa	+	Maximum Achievable Covered Bond Rating	aaa	=	Covered Bond Rating	
Resolution Regime Uplift	+2		Assigned Jurisdictional Support Uplift	+3		Collateral Support Uplift	+1		AAA/Stable	
Systemic Importance	Very Strong		Jurisdictional Support Assessment	Very Strong		Overcollateralization Adjustment	-1		Rating Constraints	aaa
Resolution Counterparty Rating	A+		Legal Framework	Very Strong		Liquidity Adjustment	0		Counterparty Risk	aaa
Issuer Credit Rating	A		Systemic Importance	Very Strong		Potential Collateral Based Uplift	+3		Country Risk	aaa
			Sovereign Credit Capacity	Very Strong						

Major Rating Factors

Strengths

- Very strong jurisdictional support assessment and 'aaa' jurisdictional-supported rating level (JRL).
- Well-seasoned residential loans in Denmark with low loan-to-value (LTV) ratios.
- Due to the soft-bullet maturities on the notes, liquidity coverage is being met, according to our criteria.

Weakness

- The available overcollateralization is provided on a voluntary basis, reducing the amount of collateral-based uplift by one notch.
- Our outlook on Danske Bank's long-term issuer credit rating is negative.

Outlook: Stable

S&P Global Ratings' stable outlook on its ratings on Danske Bank A/S' cover pool D mortgage covered bond program and related issuances of "saerligt daekkede obligationer" (SDOs) is stable, despite the negative outlook on the issuer and reflects our view that we would not automatically lower the ratings if we were to lower our long-term rating on Danske Bank by up to three notches (see "Danske Bank Outlook Revised To Negative, Hybrids Downgraded, On Further Disclosure On Money Laundering Issues In Estonia," published on Sept. 25, 2018). We could also lower our ratings if credit enhancement needed to maintain the ratings were to exceed the available credit enhancement.

Rationale

We are publishing this transaction update following our periodic review of Danske Bank's cover pool D's mortgage covered bond program and related issuances.

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.

In our analysis, we assume that the issuer has defaulted and look to the resolution regime, the jurisdictional support, and the cover pool to repay the covered bonds. The ratings reflect the likelihood of the covered bonds being repaid in a timely manner on their legal final maturity.

Danske Bank is domiciled in Denmark, which is subject to the EU's Bank Recovery and Resolution Directive (BRRD). We consider that mortgage covered bonds have a very strong systemic importance to Denmark. These factors increase the likelihood that the issuer 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. Therefore, under our covered bonds criteria, we assess the reference rating level (RRL) as 'aa-' (see "Covered Bonds Criteria," published on Dec. 9, 2014).

We considered the likelihood for the provision of jurisdictional support. Based on a very strong jurisdictional support assessment for mortgage programs in Denmark, we assigned three notches of uplift from the RRL. Therefore, we assess the JRL as 'aaa'.

Following the assessment of the RRL and JRL, we analyze the credit quality of the cover pool and the availability of liquidity support and committed overcollateralization to determine the maximum collateral uplift.

The 'AAA' ratings reflect our RRL of 'aa-' and JRL of 'aaa', as well as the overcollateralization coverage of the 'AAA' credit risk.

Lastly, the ratings on the cover pool and related issuances are not constrained by legal, operational, counterparty risks, or country risks.

Program Description

Danske Bank is the leading Danish financial services group. It operates primarily in Denmark, Finland, Sweden, Norway, and Ireland.

Under the program, Danske Bank can issue category C, D, R, and I covered bonds for up to €30 billion. We currently rate categories C, D, and I.

Cover pool D comprises only Danish krone (DKK) denominated mortgage loans secured by residential properties in Denmark originated by Danske Bank and the liabilities are denominated in Swiss franc (CHF), DKK, euro, and Norwegian krone (NOK).

The mortgage covered bonds are senior-secured unsubordinated obligations. They rank pari passu with other obligations in the same cover pool register. If the issuer were to become bankrupt, the C, D, I, and R cover pools would be separated and independent of each other.

Table 1

Program Overview*	
Jurisdiction	Denmark
Type of covered bonds	Legislation-enabled
Underlying assets	Residential mortgages
Outstanding covered bonds (bil. DKK)	24.39
Rating at closing/year	AAA'/2007
Extendible maturities	Yes
Target credit enhancement (%)	7.3
Credit enhancement for current rating	2.5
Available credit enhancement (%)	8.8

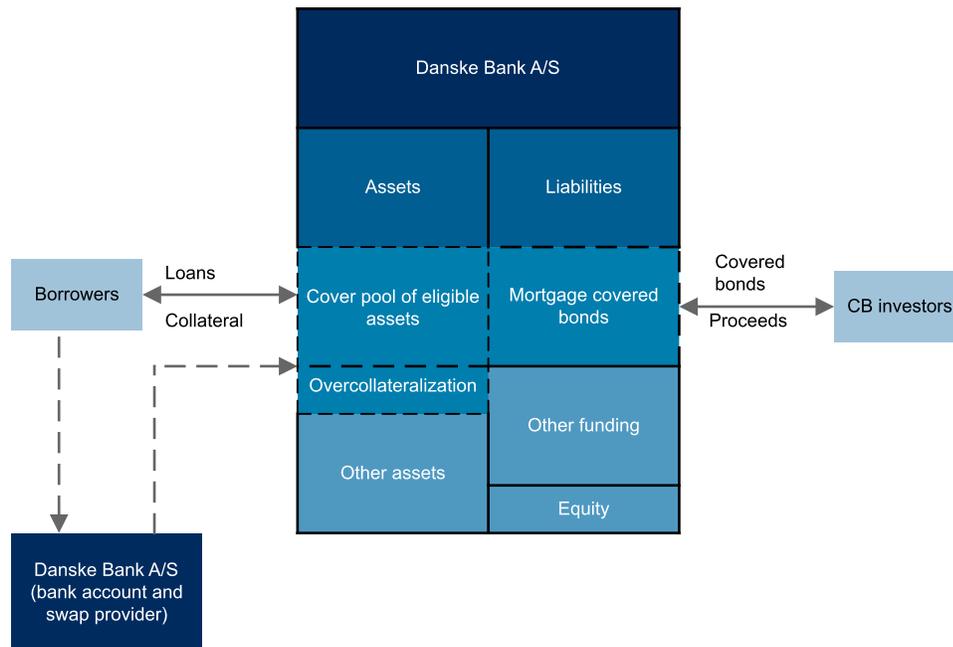
*Based on data as of Sept. 30, 2018.

Table 2

Program Participants			
Role	Name	Rating	Rating dependency
Issuer	Danske Bank A/S	A/Negative/A-1	Yes
Originator	Danske Bank A/S	A/Negative/A-1	No
Bank account provider	Danske Bank A/S	A/Negative/A-1	No
Swap provider	Danske Bank A/S	A/Negative/A-1	Yes
Servicer	Danske Bank A/S	A/Negative/A-1	No

Chart 1

Program Structure



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Rating Analysis

Legal and regulatory risks

In our view, the Danish covered bond framework sufficiently addresses the relevant legal aspects of our covered bonds framework criteria and our legal criteria (see "Structured Finance: Asset Isolation And Special-Purpose Entity Methodology," published on March 29, 2017). This enables us to assign ratings to covered bonds that exceed the long-term rating on the issuer.

The Danish Covered Bond Act provides the legal framework for the issuance of the Danish covered bonds. It also outlines eligibility criteria for the inclusion of assets in the cover pool. The issuer needs to obtain a general covered bond issuing license from the Danish financial authority.

Under certain restrictions, an SDO cover pool can include mortgage credit assets secured on residential and commercial properties within the European Economic Area (EEA) and the Organization for Economic Cooperation and Development (OECD), as well as public sector credit assets granted to (or guaranteed by) a public body in the EEA and OECD. It may also include supplementary assets, such as securities from eligible financial institutions in the EEA or the OECD.

Under the law:

- The cover pool must register all derivatives used for hedging mismatches. The derivatives rank pari passu with the bondholders.
- The cover pool's value must always exceed that of the covered bonds.
- The law requires the prudent market valuation of the mortgage credit assets according to recognized principles, and collateral valuation is performed once per year.

If Danske Bank becomes insolvent, the covered bondholders have a preferential claim on the assets' proceeds. Danish covered bonds do not automatically accelerate if the issuer becomes insolvent. The bankruptcy administrator manages the cover pool. Because the administrator is obliged to ensure timely payments on the covered bonds, the administrator is entitled to take appropriate measures to raise liquidity by selling or borrowing against unmatched assets to repay the maturing covered bonds' principal, and generally act in the bondholders' interest. The cover pool bears potential costs, which rank senior to the covered bondholders' claims.

Danske Bank adheres to the general balance principle--in contrast to the specific balance principle--in order to manage market risk exposure. The issuer has the flexibility to issue covered bonds that are delinked from the mortgage assets, and the mortgage collateral acts as overcollateralization.

Under Danish law, collateral added to a cover pool less than three months before the bankruptcy of the issuer may be "clawed back" or challenged by other creditors on the basis that the covered bondholders received preferential treatment at the expense of the issuer's ordinary creditors. If such a challenge were to succeed, fewer assets would be available for covered bondholders from the relevant cover pool. We continuously monitor the transfer of collateral and consider the credit rating on the issuer in determining the size of a potential clawback, if Danske Bank becomes insolvent. As Danske Bank has shown a pattern of providing sufficient overcollateralization to maintain a 'AAA' rating, any increase in the asset pool to maintain this rating would likely be considered "ordinary," and therefore not subject to clawback.

Operational and administrative risks

In May 2018, we conducted a review of Danske Bank's origination, underwriting, collection, and default management procedures for the cover pool assets. We also reviewed the cover pool management and administration. We consider that Danske Bank actively manages the cover pool and has strict underwriting and loan management policies. We have not identified any operational or administrative risks that would affect our assessment of the program.

We consider the servicing and origination procedures to be in line with those of other European covered bond issuers and we have applied a positive originator adjustment to reflect a solid-quality cover pool in our credit analysis.

The assets are standardized mortgages and we anticipate the need for a replacement servicer by considering the simulated servicing fee, which is included in the cash-flow analysis. Our analysis of operational and administrative risks follows the principles laid out in our covered bond ratings framework.

Resolution regime analysis

As part of our covered bonds criteria, our analysis considers any resolution regime in place in Denmark to determine the RRL. The RRL on the issuer, which is the starting point for any further uplift in our analysis, is 'aa-'. We consider the following factors:

- The issuer is domiciled in Denmark, which is subject to the EU's BRRD.
- For Danish mortgage covered bonds, we consider two resolution support uplift notches for the RRL as we consider systemic importance to be very strong.

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 Danish mortgage covered bond programs is very strong (see "Assessments For Jurisdictional Support According To Our Covered Bonds Criteria," published on Oct. 16, 2018). 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 of 'aaa' for the covered bonds.

Table 3

Cover Pool Composition					
Asset type	Sept. 30, 2018		Sept. 30, 2017		
	Value (DKK)	Percentage of cover pool (%)	Value (DKK)	Percentage of cover pool (%)	
Residential assets	26,536,311,700	100.00	30,552,759,749	100.00	
Total	26,536,311,700	100	30,552,759,749	100	

Table 4

Key Credit Metrics		
	As of Sept. 30, 2018	As of Sept. 30, 2017
Weighted-average original LTV (%)	75.27	74.28
Weighted-average loan seasoning (months)*	112.75	105.25
Balance of loans in arrears (%)	0.01	0.01
Weighted-average LTV ratio (%)	58.28	61.89
Credit analysis results		
Weighted-average foreclosure frequency (%)	10.28	10.75
Weighted-average loss severity (%)	51.26	55.40
AAA credit risk (%)	2.50	2.50

*Seasoning refers to the elapsed loan term. LTV--Loan to value.

Table 5

Covered Pool Assets By Loan Size		
Seasoning (months)	As of Sept. 30, 2018	As of Sept. 30, 2017
	Percentage of portfolio (%)	
Less than 18 months	3.56	1.11
18-60	10.20	11.70
60-72	3.27	5.56

Table 5

Covered Pool Assets By Loan Size (cont.)		
	As of Sept. 30, 2018	As of Sept. 30, 2017
Seasoning (months)	Percentage of portfolio (%)	
72-84	5.63	9.10
84-96	9.16	8.49
96-108	8.39	10.33
108-120	9.58	20.94
More than 120	50.20	32.77
Weighted-average loan seasoning (months)	112.75	105.25

*Seasoning refers to the elapsed loan term.

Table 6

Loan-To-Value Distribution		
	As of Sept. 30, 2018	As of Sept. 30, 2017
(%)	Percentage of cover pool (%)	
0-10	0.11	0.10
10-20	0.59	0.49
20-30	2.03	1.52
30-40	5.84	4.06
40-50	15.84	13.51
50-60	26.69	11.44
60-70	33.66	39.04
70-80	14.88	29.50
80-90	0.16	0.08
90-100	0.11	0.06
>100	0.10	0.20
Weighted-average loan-to-value (%)	58.28	61.89

Table 7

Geographical Distribution	
	As of Sept. 30, 2018
(%)	Percentage of cover pool (%)
Hovedstaden	6.18
Midtjylland	22.81
Nordjylland	5.22
Sjaelland	44.03
Southern Denmark	20.79
Total	100

Table 8

Collateral Uplift Metrics		
	As of Sept. 30, 2018	As of Sept. 30, 2017
Asset WAM (years)	11.75	12.31

Table 8

Collateral Uplift Metrics (cont.)		
	As of Sept. 30, 2018	As of Sept. 30, 2017
Liability WAM (years)	5.34	4.53
Available credit enhancement (%)	8.79	11.97
AAA credit risk (%)	2.50	2.50
Coverage of 'AAA' credit risk and 25% of refinancing costs (%)	2.50	6.00
Coverage of 'AAA' credit risk and 50% of refinancing costs (%)	3.41	9.95
Coverage of 'AAA' credit risk and 75% of refinancing costs (%)	5.37	13.91
Target credit enhancement for maximum uplift (%)	7.33	17.86
Potential collateral-based uplift (notches)	4	2
Adjustment for liquidity (Y/N)	N	N
Adjustment for committed overcollateralization (Y/N)	Y	Y
Collateral support uplift (notches)	3	1

WAM--Weighted-average maturity.

We base our analysis on the loan-level data provided by the issuer as of Sept. 30, 2018. The cover pool comprises only residential mortgages in Denmark. We have applied our updated European residential loans criteria, using the specific stresses for Danish residential mortgage assets (see "Methodology And Assumptions: Assessing Pools Of European Residential Loans," published Aug. 4, 2017).

The weighted-average foreclosure frequency (WAFF) has decreased marginally to 10.28% from 10.75% in September 2017. This is mainly due to a higher seasoning. The weighted-average loss severity (WALS) has decreased to 51.26% from 55.40% over the same period. This decrease is mainly due to the lower current weighted-average loan-to-value ratios in the portfolio.

According to our covered bonds criteria, the maximum potential collateral-based uplift on a covered bond program above the JRL is four notches. We then look to make adjustments to the maximum collateral-based uplift by reviewing the coverage of six months of liquidity and the level of commitment for the overcollateralization. Due to the soft-bullet maturities on the notes, liquidity coverage is being met. Regarding the commitment for overcollateralization, the available credit enhancement is provided voluntarily, reducing the amount of collateral-based uplift by one notch.

By applying our credit and cash flow stresses, we calculate a target credit enhancement of 7.33% for September 2018. This is a large decrease from the target credit enhancement of 17.86% that we calculated in September 2017. The decrease is driven mainly by the lower asset-liability maturity mismatch and higher expected prepayment rate assumed.

Given the JRL of 'aaa', under our covered bonds criteria, only coverage of the 'AAA' credit risk or 2.5% of credit enhancement is required to achieve the current 'AAA' rating, solely based on jurisdictional support.

The available credit enhancement is commensurate with four notches of potential collateral-based uplift and three notches of collateral-based uplift, after subtracting a notch due to the uncommitted overcollateralization. These three notches of collateral-based uplift are unused.

Counterparty risk

We analyze counterparty risk by applying our current counterparty criteria (see "Counterparty Risk Framework Methodology And Assumptions," published on June 25, 2013, and "Counterparty Risk Analysis In Covered Bonds," published on Dec. 21, 2015).

Proceeds from the borrowers are identified and immediately segregated for the benefit of the bondholders upon default. Additionally, principal proceeds are reinvested immediately and interest proceeds are swapped away. We therefore consider commingling risk to be mitigated and did not size for this risk in our cash-flow analysis.

Swaps in place address interest rate mismatches between the pool's mortgage loans and the payments due to covered bondholders. A swap agreement governs the program's asset and liability swaps. The swaps provide replacement option 2 under our current counterparty criteria, if the long-term rating on the swap provider (Danske Bank) falls below 'A'.

There is a risk that borrowers of certain loans contained in the cover pool retain a residual right under the relevant local legislation to set off claims against the outstanding amount of their loans. All borrowers have contractually agreed that they have no right to set off against the relevant loans.

Country risk

We consider country risk in line with our structured finance ratings above the sovereign criteria (see "Ratings Above the Sovereign - Structured Finance: Methodology And Assumptions," published on Aug. 8, 2016). As Denmark is currently rated 'AAA', country risk does not constrain the rating in any way.

Potential Effects Of Proposed Criteria Changes

Our ratings are based on our applicable criteria, including "Counterparty Risk Framework Methodology And Assumptions," published on June 25, 2013 and "Counterparty Risk Analysis in Covered Bonds," published on Dec. 21, 2015. However, these criteria are under review (see "Request For Comment: Counterparty Risk Framework: Methodology And Assumptions," published on Oct. 9, 2018). We have also updated our "Ratings Above the Sovereign-Structured Finance: Methodology And Assumptions," criteria published on Aug. 8, 2016 (see "Incorporating Sovereign Risk In Rating Structured Finance Securities," published on Jan. 30, 2019, which will be effective March 1, 2019). As a result of these reviews, we may amend our analysis of counterparty and country risks in a covered bond program. These changes 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

- Global Covered Bond Characteristics And Rating Summary Q4 2018, Dec. 12, 2018
- Global Covered Bond Insights Q4 2018, Dec. 12, 2018
- Assessments For Jurisdictional Support According To Our Covered Bonds Criteria, Oct. 16, 2018
- Assessments For Target Asset Spreads According To Our Covered Bonds Criteria, Oct. 16, 2018
- Request For Comment: Counterparty Risk Framework: Methodology And Assumptions, Oct. 9, 2018
- Danske Bank Outlook Revised To Negative, Hybrids Downgraded, On Further Disclosure On Money Laundering Issues In Estonia, Sept. 25, 2018
- Outlook Assumptions for the Danish Residential Mortgage Market, Sept. 4, 2018
- Covered Bonds Criteria Guidance, May 2, 2018
- Glossary Of Covered Bond Terms, April 27, 2018

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