

MOODY'S

INVESTORS SERVICE

CREDIT OPINION

9 April 2019

Update

✓ Rate this Research

RATINGS

Danske Bank A/S

Domicile	Denmark
Long Term CRR	Aa3
Type	LT Counterparty Risk Rating - Fgn Curr
Outlook	Not Assigned
Long Term Debt	A2
Type	Senior Unsecured - Fgn Curr
Outlook	Negative
Long Term Deposit	A2
Type	LT Bank Deposits - Fgn Curr
Outlook	Negative

Please see the [ratings section](#) at the end of this report for more information. The ratings and outlook shown reflect information as of the publication date.

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Danske Bank A/S

Update to credit analysis

Summary

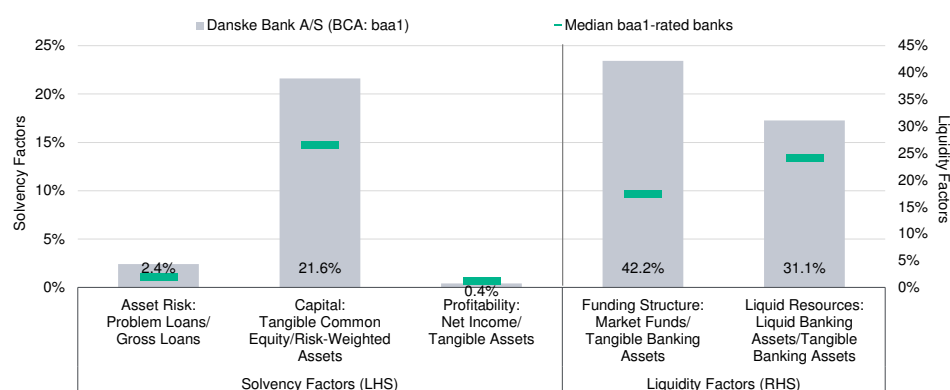
We assign a baa1 baseline credit assessment (BCA) and A2 long-term (LT) deposit and senior unsecured debt ratings, along with Baa2 junior senior debt (often referred to as non-preferred senior) ratings of Danske Bank A/S (Danske). The LT deposit and senior unsecured debt ratings carry a negative outlook.

Danske's baa1 BCA reflects the strengthening of its asset quality, capitalisation and underlying 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.

Danske's A2 LT senior unsecured and Baa2 junior senior debt ratings incorporate Moody's expectations of the bank's issuance of additional loss-absorbing debt in response to its Minimum Requirements for own funds and Eligible Liabilities (MREL). They include a one notch uplift in our advanced Loss Given Failure (LGF) analysis, reflecting our view that the bank's junior depositors and senior creditors face a low loss given failure, and places junior senior one notch below the adjusted BCA. Both deposit and senior unsecured ratings benefit from one notch of government support, but not the junior senior ratings as we do not expect these to benefit from such support.

Exhibit 1

Rating Scorecard - Key Financial Ratios



Note: These represent our Banks methodology scorecard ratios, whereby asset risk and profitability reflect the weaker of either the three-year average and the latest annual figure. Capital ratio is the latest reported figure. Funding structure and liquid resource ratios reflect the latest fiscal year-end figures

Source: Moody's Financial Metrics

Credit strengths

- » Improving asset quality, albeit still below Nordic peers
- » Solid capitalisation
- » Underlying profitability has improved over recent years

Credit challenges

- » Potential fines and other regulatory penalties arising from past money laundering through the bank's Estonian branch between 2007-2015
- » High dependence on market funding, mitigated by more stable covered bonds and adequate liquidity
- » Exposure to problem segments, albeit gradually improving, in Danish agriculture, shipping, and oil & offshore

Outlook

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

In addition to the direct financial and potentially criminal impacts 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.

Factors that could change the outlook to stable

- » The outlook could revert 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.

Factors that could lead to a downgrade

- » 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.

This publication does not announce a credit rating action. For any credit ratings referenced in this publication, please see the ratings tab on the issuer/entity page on www.moody's.com for the most updated credit rating action information and rating history.

Key indicators

Exhibit 2

Danske Bank A/S (Consolidated Financials) [1]

	12-18 ²	12-17 ²	12-16 ²	12-15 ²	12-14 ²	CAGR/Avg ³
Total Assets (DKK million)	3,409,010	3,357,457	3,242,070	3,055,864	3,152,809	2.0 ⁴
Total Assets (EUR million)	456,825	450,942	436,024	409,489	423,402	1.9 ⁴
Total Assets (USD million)	522,218	541,490	459,897	444,826	512,339	0.5 ⁴
Tangible Common Equity (DKK million)	161,674	165,604	159,638	154,726	141,444	3.4 ⁴
Tangible Common Equity (EUR million)	21,665	22,242	21,470	20,733	18,995	3.3 ⁴
Tangible Common Equity (USD million)	24,766	26,709	22,645	22,523	22,985	1.9 ⁴
Problem Loans / Gross Loans (%)	2.4	1.9	2.6	3.0	3.7	2.7 ⁵
Tangible Common Equity / Risk Weighted Assets (%)	21.6	22.0	19.6	18.6	16.4	19.6 ⁶
Problem Loans / (Tangible Common Equity + Loan Loss Reserve) (%)	24.1	18.1	24.5	30.3	39.4	27.3 ⁵
Net Interest Margin (%)	0.9	0.9	1.0	1.1	1.1	1.0 ⁵
PPI / Average RWA (%)	2.5	3.1	3.0	2.5	2.2	2.7 ⁶
Net Income / Tangible Assets (%)	0.4	0.6	0.6	0.5	0.3	0.5 ⁵
Cost / Income Ratio (%)	60.3	51.5	50.4	53.4	56.4	54.4 ⁵
Market Funds / Tangible Banking Assets (%)	42.2	43.6	44.6	43.6	48.1	44.4 ⁵
Liquid Banking Assets / Tangible Banking Assets (%)	31.1	37.3	35.8	27.5	29.0	32.1 ⁵
Gross Loans / Due to Customers (%)	200.8	191.3	201.1	225.7	244.2	212.6 ⁵

[1] All figures and ratios are adjusted using Moody's standard adjustments. [2] Basel III - fully-loaded or transitional phase-in; IFRS. [3] May include rounding differences due to scale of reported amounts. [4] Compound Annual Growth Rate (%) based on time period presented for the latest accounting regime. [5] Simple average of periods presented for the latest accounting regime. [6] Simple average of Basel III periods presented.

Source: Moody's Financial Metrics

Profile

Danske Bank A/S is part of the Danske Bank Group, which also comprises Realkredit Denmark (a mortgage credit institution), Danica Pension (a life insurance company), Danske Hypotek AB (a covered bond issuer in Sweden), Danske Mortgage Bank Plc (a covered bond issuer in Finland), AO Danske Bank (provides corporate banking services in Russia) and Northern Bank Plc (commercial bank in Northern Ireland). As of end-December 2018, the bank held domestic market shares of 27% in terms of loans and 28% in terms of deposits, and reported total consolidated assets of DKK 3.6 trillion (€479.2 billion).

Danske Bank is a universal bank and provides a broad range of products and services, including deposits, loans and other credit, insurance, pensions, leasing, asset management, and trading in fixed-income products, foreign exchange and equities. As of end-December 2018, it distributed its products through 95 domestic and 142 international branches in Sweden, Norway, Finland, Northern Ireland, and the Baltic States, although the Baltic operations will be closed down (see asset quality section).

Danske Bank was established in 1871 as Den Danske Landmandsbank. In 1976, it was renamed Den Danske Bank, and in 2000, Danske Bank. Its shares are listed on the NASDAQ OMX Copenhagen Stock Exchange (Ticker: DANSKE). As of year-end 2018, its largest shareholder was the A.P. Møller Holding Group, which held 20% of the bank's total share capital.

Detailed credit considerations

Improving asset quality, albeit still below peers

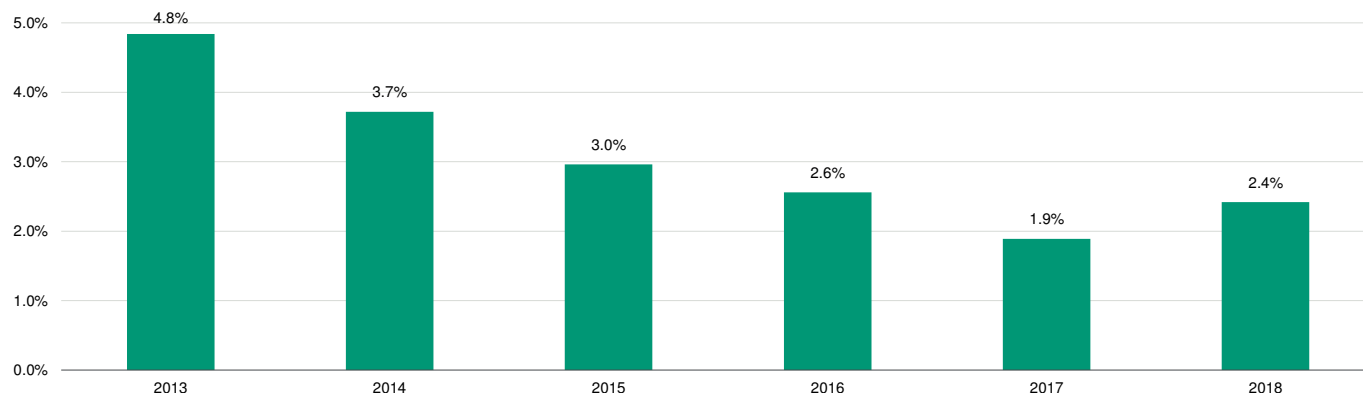
Our assigned baa1 asset risk score reflects our assessment that the recent positive underlying trends in asset quality are sustainable, even though the change in definition related to the introduction of IFRS9 stage 3 gross loans implied a level increase to 2.4% at year-end 2018 (compared to YE 2017). Problem segments are shipping and agriculture.

Danske Bank has gradually been disposing its non-core assets, which previously were mainly performing residential mortgages in Estonia and Ireland only. In February 2019, Estonia's Financial Supervision Authority (FSA) ordered Danske Bank A/S to cease operating in Estonia within eight months. Danske also announced the same day the intention to close down its other Baltic operations in Lithuania and Latvia (with the exception of the bank's shared services center in Lithuania), as well as in Russia as the bank wants to focus on its Nordic core markets.

Exhibit 3

Danske Bank's Problem Loans as % Gross Loans

We expect Danske Bank's asset quality to continue to gradually improve



Note: IFRS9 stage 3 gross loans as of 2018

Source: Moody's Banking Financial Metrics

We expect a moderate improvements in the group's underlying asset quality during 2019, supported by the domestic economy, which we expect to grow by 2.0% in 2019 and 1.8% in 2020, and continued low interest rates.

The bank's asset risk score includes negative adjustments to reflects our view that Danske faces potential reputational and operational risk, as the money laundering findings, and the bank's delayed response to previous concerns by internal and external stakeholders, have casted doubts over the corporate culture of the bank, which could dampen the confidence of some customers, investors and counterparties.

Solid capitalisation

Danske Bank's solid capital buffers is a relative strength for its credit profile. The bank's capital ratios improved in recent years, increasing the bank's ability to absorb potential future losses. At year-end 2018, the bank's Common Equity Tier 1 (CET1) was 17.0% (17.6% at year-end 2017).

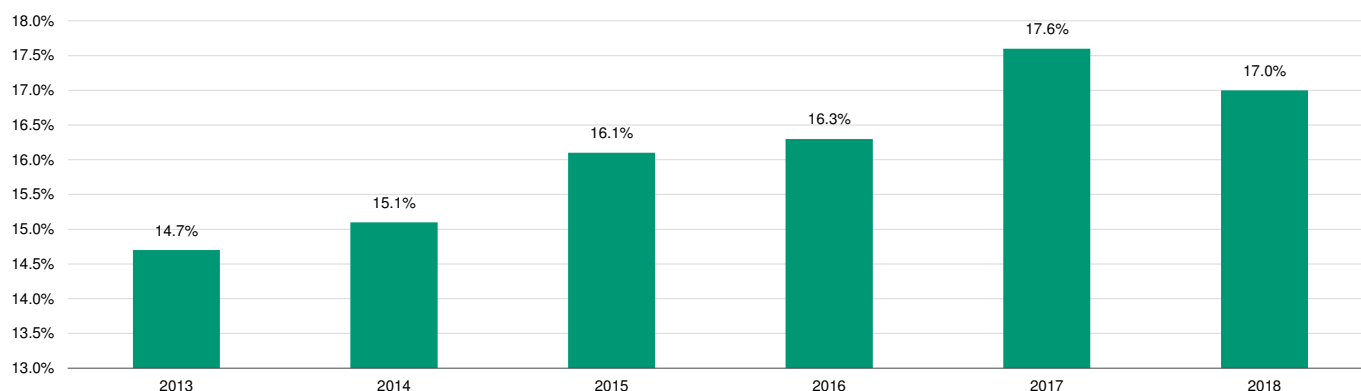
As a response to the Danish FSA's decision that Danske needs to set aside a minimum of DKK 10 billion (approximately USD 1.7 billion) in Pillar II capital (in the form of CET1) to cover for what the Danish regulatory authority characterized as "heightened compliance and reputational risks", the bank has increased its short- to medium-term CET1 target to 16% from the previous 14-15%. Danske also cancelled its share buy-back program in response.

Our assigned a1 capital score reflects these strengths, but also takes into account the bank's high leverage. Tangible common equity stood at 4.7% of total assets as of December 2018, which is at the lower end of its large Nordic peers.

Exhibit 4

Danske Bank's CET1 Ratio

We view capitalisation as a relative strength for Danske Bank



Source: Company report

The bank has a target of a 40-60% pay-out ratio of net profits.

Satisfactory underlying profitability, but increased costs

Danske Bank's profitability in 2018 was negatively affected by increased costs, partly related to the Estonia case. Net income in 2018 was 0.4% of tangible assets (0.6% in 2017). The firm's strategy currently focuses on enhancing its wealth management capabilities, reducing its operating costs and continuing to improve customer satisfaction in its core markets (Denmark, Sweden, Norway and Finland).

The bank's primary source of revenues is net interest income (around half of total income in 2018), which declined by 1.0% in 2018 (compared to 2017), due to a fall in lending margins, currency effects, and higher capital costs (due to the additional tier 1 issue in Q218). Net trading income was weak in 2018 and decreased by 34% from the level in 2017. In this environment, we see Danske Bank's ability to maintain tight cost control as very important. The efficiency gap against peers has widened in 2018, with a cost-to-income (as per our definition) of 60% in 2018, which is an increase compared to 52% in 2017. As of December 2018, Danske Bank's operating expenses have increased by 10% from the levels as of December 2017 mainly due to higher compliance costs, including costs relating to the Estonia case, expenses resulting from the integration of SEB Pension Danmark, one-off expense for the DKK 1.5 billion donation of the estimated gross income from the non-resident portfolio at the Estonian branch and finally the continuous ambitious digital transformation.

Danske Bank continued recording low impairments in core activities during 2018, driven by net reversals of DKK 650 million reflecting improving credit quality, supported by recovering asset values. Danske reported a return on equity (ROE) of 9.8% for 2018, falling short of the bank's target to rank in the top three among major Nordic peers in terms of ROE.

Moody's expects the bank's net income to continue to be negatively affected going forward by additional remediation costs, higher funding costs along with potential fines linked to the Estonian affair, which is reflected in our forward-looking assigned ba1 profitability score.

Whereas the rating agency acknowledges the high degree of uncertainty surrounding the magnitude of any potential fines resulting from the US 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.

High dependence on market funding, in particular covered bonds; liquidity is adequate

While the share of deposit funding has increased in recent years to around 30% of total funding at year-end 2018, Danske Bank relies heavily on wholesale funding. Market funds accounted for 42.3% of tangible banking assets at end-December 2018 (43.6% at YE2017).

This high reliance exposes the bank to changes in market conditions, and renders Danske more sensitive to swings in investor confidence. The current situation, with increased regulatory scrutiny around the money laundering in Estonia, has resulted in widening

spreads for the bank's senior unsecured and non-preferred senior debt, and downside risks to funding costs remain. Nevertheless, the bank has retained good access to the market, and issued about DKK 60 bn of non-preferred senior instruments since the start mid-2018.

The majority of the group's market funds are covered bonds (mainly taken up by Realkredit Danmark, the bank's mortgage subsidiary). As indicated in our banks methodology, we reflect the greater stability of covered bonds compared to unsecured market funding through a standard adjustment to the funding structure ratio. Given the long history of the Danish covered bond markets, local currency and deep domestic investor base, we make additional (positive) adjustments for local currency (LC) denominated covered bonds issued in this market. Moody's assigned ba2 funding structure score also reflects the rating agency's view of the Danish covered bond market.

We take some comfort from Danske Bank's sizeable reported liquidity buffer - most of which can be used as collateral for central bank liquidity - amounting to DKK 512 billion or 17% of tangible banking assets at year-end 2018, leading to a baa1 assigned liquidity score. At the same date, Danske Bank's Liquidity Coverage Ratio (LCR) according to the new European Union (EU) standards was 121% (decreased from 171% as of year-end 2017) due to reduced carry-trades in USD.

Support and structural considerations

Loss Given Failure analysis

Danske Bank is subject to the EU's Bank Recovery and Resolution Directive (BRRD), which we consider to be an operational resolution regime. We apply our advanced Loss Given Failure (LGF) analysis to Danske Bank's liabilities, considering the risks faced by the different deposit and debt classes across its liability structure at failure. We assume residual tangible common equity of 3% and losses post failure of 8% of tangible banking assets, a 25% run-off in "junior" wholesale deposits and a 5% run-off in preferred deposits. These are in line with our standard assumptions.

The assigned LGF notching for long-term senior unsecured bank debt is positioned one notch higher than the corresponding LGF notching guidance. This reflects our expectation that Danske will issue non-preferred senior debt in order to comply with the Danish MREL decision. The junior deposit and senior unsecured debt ratings therefore reflect our advanced LGF analysis of the group's current balance sheet structure and its capital and funding plans up to 1 January 2022, when the subordination requirement for MREL is applicable. Our advanced LGF analysis indicates that Danske's depositors and senior creditors are likely to face low loss-given failure, due to the loss absorption provided by additional loss-absorbing debt, generated by the non-preferred senior issuance. This results in one notch of uplift for junior deposits and senior unsecured debt.

We attach a high degree of confidence to the likelihood that the bank will fulfil the regulatory MREL requirement, along with a buffer, with the subordination required as of 2022, and therefore apply a forward looking time-horizon as per our updated methodology. We expect that depositors and senior unsecured creditors of Danske Bank would benefit from sufficient subordination in the liability structure by year-end 2021, which would likely reduce the loss given failure, resulting in a one notch uplift.

Government support considerations

Although the implementation of the BRRD has prompted us to reconsider the potential for government support to benefit certain creditors, we continue to consider a moderate probability of government support for Danske Bank, resulting in one notch of government support uplift in the bank's A2 long-term deposit and senior unsecured debt ratings. This reflects the fact that Danske Bank is Denmark's largest financial institution, and the market leader in most financial products.

Counterparty Risk Assessment

Counterparty Risk Assessments (CRAs) are opinions of how counterparty obligations are likely to be treated if a bank fails and are distinct from debt and deposit ratings in that they (1) consider only the risk of default rather than both the likelihood of default and the expected financial loss suffered in the event of default and (2) apply to counterparty obligations and contractual commitments rather than debt or deposit instruments. The CRA is an opinion of the counterparty risk related to a bank's covered bonds, contractual performance obligations (servicing), derivatives (e.g., swaps), letters of credit, guarantees and liquidity facilities.

Danske Bank's CRA is positioned at Aa3(cr)/Prime-1(cr).

The CRA is positioned four notches above the Adjusted BCA of baa1, based on the substantial cushion against default provided to the senior obligations represented by the CRA by subordinated instruments. The main difference with our Advanced LGF approach used to determine instrument ratings is that the CRA captures the probability of default on certain senior obligations, rather than expected loss, therefore we focus purely on subordination and take no account of the volume of the instrument class.

Counterparty Risk Rating

CRRs are opinions of the ability of entities to honour the uncollateralised portion of non-debt counterparty financial liabilities (CRR liabilities) and also reflect the expected financial losses in the event such liabilities are not honoured. CRRs are distinct from ratings assigned to senior unsecured debt instruments and from issuer ratings because they reflect that, in a resolution, CRR liabilities might benefit from preferential treatment compared with senior unsecured debt. Examples of CRR liabilities include the uncollateralised portion of payables arising from derivatives transactions and the uncollateralised portion of liabilities under sale and repurchase agreements.

Danske Bank's CRR is positioned at Aa3/Prime-1.

The counterparty risk rating of Aa3 reflects the Adjusted BCA of baa1, four notches of uplift reflecting the extremely low loss-given failure from the high volume of instruments that are subordinated to CRR liabilities. The CRR also benefits from one notch of systemic support, as an assumption of a moderate likelihood of government support. The short-term CRR is P-1.

Rating methodology and scorecard factors

Exhibit 5

Danske Bank A/S

Macro Factors

Weighted Macro Profile **Strong +** **100%**

Factor	Historic Ratio	Initial Score	Expected Trend	Assigned Score	Key driver #1	Key driver #2
Solvency						
Asset Risk						
Problem Loans / Gross Loans	2.4%	a2	← →	baa1	Operational risk	Collateral and provisioning coverage
Capital						
TCE / RWA	21.6%	aa1	← →	a1	Nominal leverage	
Profitability						
Net Income / Tangible Assets	0.4%	ba1	← →	ba1	Expected trend	
Combined Solvency Score		a2		baa1		
Liquidity						
Funding Structure						
Market Funds / Tangible Banking Assets	42.2%	b1	← →	ba2	Market funding quality	
Liquid Resources						
Liquid Banking Assets / Tangible Banking Assets	31.1%	a2	← →	baa1	Quality of liquid assets	
Combined Liquidity Score		ba1		baa3		
Financial Profile				baa2		
Business Diversification				0		
Opacity and Complexity				0		
Corporate Behavior				0		
Total Qualitative Adjustments				0		
Sovereign or Affiliate constraint:				Aaa		
Scorecard Calculated BCA range				baa1-baa3		
Assigned BCA				baa1		
Affiliate Support notching				0		
Adjusted BCA				baa1		

Balance Sheet	in-scope (DKK million)	% in-scope	at-failure (DKK million)	% at-failure
Other liabilities	1,812,197	61.9%	1,903,680	65.1%
Deposits	896,894	30.6%	805,411	27.5%
Preferred deposits	663,702	22.7%	630,517	21.5%
Junior Deposits	233,192	8.0%	174,894	6.0%
Senior unsecured bank debt	93,941	3.2%	93,941	3.2%
Junior senior unsecured bank debt	26,441	0.9%	26,441	0.9%
Dated subordinated bank debt	9,161	0.3%	9,161	0.3%
Equity	87,793	3.0%	87,793	3.0%
Total Tangible Banking Assets	2,926,427	100%	2,926,427	100%

Debt class	De Jure waterfall		De Facto waterfall		Notching		LGF	Assigned	Additional	Preliminary
	Instrument	Sub-volume + ordination	Instrument	Sub-volume + ordination	De Jure	De Facto	Notching Guidance vs. Adjusted BCA	LGF notching	notching	Rating Assessment
Counterparty Risk Rating	13.4%	13.4%	13.4%	13.4%	3	3	3	3	0	a1
Counterparty Risk Assessment	13.4%	13.4%	13.4%	13.4%	3	3	3	3	0	a1 (cr)
Deposits	13.4%	4.2%	13.4%	7.4%	1	1	1	1	0	a3
Senior unsecured bank debt	13.4%	4.2%	7.4%	4.2%	1	-1	0	1	0	a3
Junior senior unsecured bank debt	4.2%	3.3%	4.2%	3.3%	-1	-1	-1	-1	0	baa2
Non-cumulative bank preference shares	3.0%	3.0%	3.0%	3.0%	-1	-1	-1	-1	-2	ba1 (hyb)

Instrument class	Loss Given Failure notching	Additional Notching	Preliminary Rating Assessment	Government Support notching	Local Currency Rating	Foreign Currency Rating
Counterparty Risk Rating	3	0	a1	1	Aa3	Aa3
Counterparty Risk Assessment	3	0	a1 (cr)	1	Aa3 (cr)	--
Deposits	1	0	a3	1	A2	A2
Senior unsecured bank debt	1	0	a3	1	--	A2
Junior senior unsecured bank debt	-1	0	baa2	0	--	Baa2
Non-cumulative bank preference shares	-1	-2	ba1 (hyb)	0	Ba1 (hyb)	Ba1 (hyb)

[1] Where dashes are shown for a particular factor (or sub-factor), the score is based on non-public information.

Source: Moody's Financial Metrics

Ratings

Exhibit 6

Category Moody's Rating

DANSKE BANK A/S

Outlook	Negative
Counterparty Risk Rating	Aa3/P-1
Bank Deposits	A2/P-1
Baseline Credit Assessment	baa1
Adjusted Baseline Credit Assessment	baa1
Counterparty Risk Assessment	Aa3(cr)/P-1(cr)
Issuer Rating	A2
Senior Unsecured	A2
Junior Senior Unsecured	Baa2
Junior Senior Unsecured MTN	(P)Baa2
Pref. Stock Non-cumulative	Ba1 (hyb)
Commercial Paper	P-1
Other Short Term	(P)P-1

DANSKE BANK A/S (LONDON BRANCH)

Outlook	Negative
Deposit Note/CD Program	(P)A2/(P)P-1

DANSKE CORPORATION

Bkd Commercial Paper	P-1
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Source: Moody's Investors Service

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