

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

### Saerligt Daekkede Obligationer

**Primary Credit Analyst:**

Casper R Andersen, Frankfurt + 49 69 33 999 208; casper.andersen@spglobal.com

**Research Contributor:**

Ashlesha N Raikar, CRISIL Global Analytical Center, an S&P affiliate, Mumbai

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## Saerligt Daekkede Obligationer

### Ratings Detail

<b>Reference Rating Level</b>	<b>aa-</b>	+	<b>Jurisdiction-Supported Rating Level</b>	<b>aaa</b>	+	<b>Maximum Achievable Covered Bond Rating</b>	<b>aaa</b>	=	<b>Covered Bond Rating</b>	
Resolution Regime Uplift	+2		Assigned Jurisdictional Support	+3		Collateral Support Uplift	+2		<b>AAA</b>	
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
<b>Issuer Credit Rating</b>	<b>A</b>		Systemic Importance	Very Strong		Potential Collateral Based Uplift	+3		Country Risk	aaa
			Sovereign Credit Capacity	Very Strong						

### Major Rating Factors

#### Strengths

- Relatively high long-term issuer credit rating (ICR), allowing for a 'AAA' rating to be reached with the jurisdictional support and the coverage of 'AAA' credit risk.
- The program benefits from two unused notches of collateral uplift, which would protect the rating if we downgraded the issuer.
- Due to the covered bonds' soft-bullet maturities, we consider six months liquidity covered.
- The current level of overcollateralization covers potential setoff and commingling risk.

#### Weaknesses

- The cover pool's assets comprise only commercial real estate loans, which we consider to be riskier than residential real estate loans.
- The Norwegian assets have some concentration in the region of Trondelag.
- There is a risk that borrowers of certain loans contained in the cover pool retain a residual right to setoff.

- The available overcollateralization is provided on a voluntary basis, reducing the amount of collateral-based uplift by one notch.

## Outlook: Stable

S&P Global Ratings' stable outlook on the ratings on Danske Bank A/S' cover pool C mortgage covered bonds ("saerligt daekkede obligationer"; SDOs) reflects our view that we would not automatically lower the ratings on the covered bonds if we were to lower our long-term ICR on Danske Bank by up to two notches.

## Rationale

This transaction update follows our periodic review of Danske Bank's cover pool C mortgage covered bonds. Our rating analysis for the covered bonds follows the framework set out in our criteria article "Covered Bond Ratings Framework: Methodology And Assumptions," published on June 30, 2015.

The 'AAA' ratings reflect our reference rating level (RRL) of 'aa-' and our jurisdiction-supported rating level (JRL) of 'aaa', as well as the overcollateralization coverage of the 'AAA' credit risk.

The ratings on the program and related issuances are not constrained by legal, operational, counterparty risks, or country risks.

## Program Description

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

We currently rate the category C, D, and I covered bonds issued under the €30,000,000,000 global covered bond program.

Cover pool C contains mortgage loans denominated in Swedish krona (SEK) and Norwegian krone (NOK), secured on Swedish and Norwegian commercial properties. The covered bonds are issued in euros and Swedish krona. The transaction features interest rate swaps and cross-currency swaps on both assets and liabilities.

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.

The bonds are senior-secured obligations. They rank pari passu with other obligations in the same cover pool. If the issuer were to become bankrupt, the pools would be separated and managed independent of each other.

**Table 1**

Program Description*	
Jurisdiction	Denmark

**Table 1**

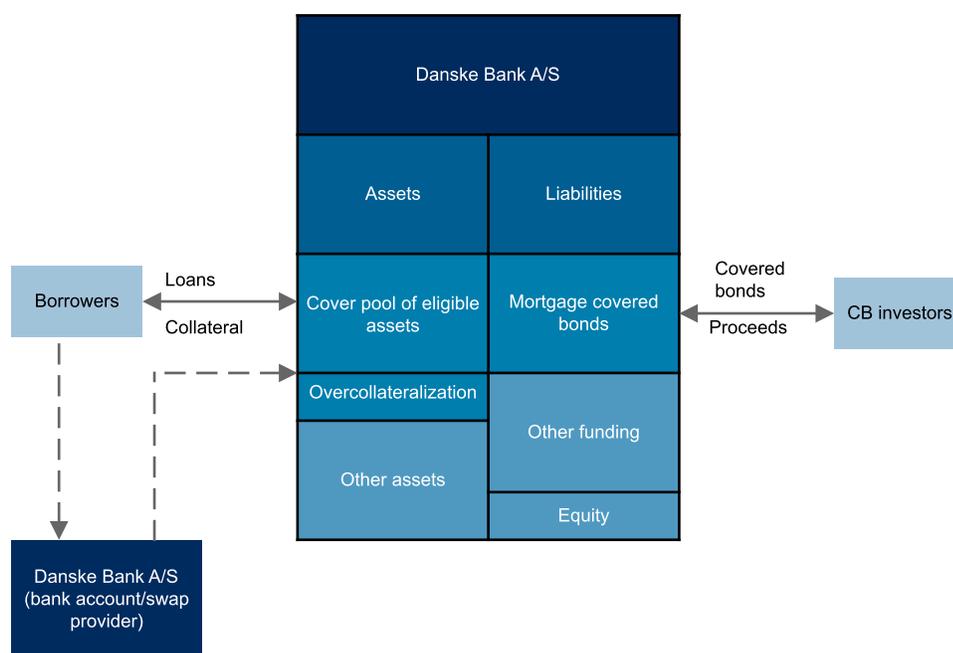
Program Description* (cont.)	
Covered bond type	Legislation-enabled
Underlying assets	Commercial mortgage loans
Outstanding covered bonds (bil. SEK)	74.75
Year of first issuance	2010
Rating at closing	'AAA'
Extendible maturities	Yes
Target credit enhancement (%)	20.56
Available credit enhancement (%)	19.23

\*Based on data as of Sept. 30, 2020. SEK--Swedish krona.

**Table 2**

Program Participants			
Role	Name	Rating	Rating dependency
Issuer	Danske Bank A/S	A/Stable/A-1	Y
Swap provider	Danske Bank A/S	A/Stable/A-1	Y
Bank account provider	Danske Bank A/S	A/Stable/A-1	N
Originator	Danske Bank A/S	A/Stable/A-1	N

**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 criteria and our legal criteria (see "Asset Isolation And Special-Purpose Entity Methodology," published on March 29, 2017). This enables us to assign ratings to the covered bonds that exceed the long-term ICR 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 Supervisory 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), the Organization for Economic Cooperation and Development (OECD), as well as loans granted to public bodies 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 bonds.
- 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 annually.

If Danske Bank becomes insolvent, the covered bondholders have a preferential claim on the proceeds generated by the pool. Danish covered bonds do not automatically accelerate if the issuer becomes insolvent. The cover pool is managed by a bankruptcy administrator, who is obliged to ensure timely payment. To this end, the administrator is entitled to take appropriate measures aimed at raising liquidity by selling or borrowing against unmatched assets, in order to repay the maturing covered bonds' principal. The cover pool bears costs, which rank senior to the covered bondholders' claims.

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 if 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. 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**

We analyze operational and administrative risk by applying our covered bonds framework, and consider Danske Bank's origination, underwriting, collection, and default management procedures for the cover pool assets. We also

consider the cover pool management and administration.

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 believe that a replacement servicer could be found were the issuer to become insolvent. We consider Denmark to be an established covered bond market and the assets in the cover pool to be standard, hence not limiting the range of available cover pool managers or servicers.

### Resolution regime analysis

As part of our covered bonds criteria, our analysis considers the presence of resolution regimes when determining the RRL. As Denmark is part of the EU and is required to implement the EU's Bank Recovery and Resolution Directive (BRRD), this analysis considers the support provided by the adoption of the regime.

The program's RRL is equal to the greater of (i) the ICR on the issuing bank, plus up to two notches for programs in jurisdictions with effective resolution regimes that exempt covered bond from bail-in, and (ii) the resolution counterparty rating (RCR) on the issuing bank, where applicable.

Given Danske Bank's 'A+' RCR, and our very strong systemic importance assessment for covered bonds in Denmark, the RRL is 'aa-', two notches above the ICR.

### Jurisdictional support analysis

Under our analysis of jurisdictional support in our covered bonds criteria, we determine a JRL of 'aaa', 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 Bond Criteria," published on Nov. 27, 2020). 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 Danske Bank's cover pool C mortgage covered bonds.

### Collateral support analysis

Table 3

Cover Pool Composition*				
Asset type	As of Sept. 30, 2020		As of Dec. 31, 2019	
	Value (mil. SEK)	Percentage of cover pool (%)	Value (mil. SEK)	Percentage of cover pool (%)
Residential	-	0	-	0
Commercial	90,877	100	79,656	100
Substitute assets	-	0	-	0
Other asset type	-	0	-	0
Total	90,877	100	79,656	100

\*This is based on S&P Global Ratings' classification and therefore does not necessarily equal publicly available information (e.g., we classify multifamily homes as commercial).

**Table 4a**

<b>Key Credit Metrics: Swedish Assets</b>		
	<b>As of Sept. 30, 2020</b>	<b>As of Sept. 30, 2019</b>
Weighted-average loan-to-value ratio (%)	48.3	51.02
Balance of loans in arrears (%)	0	0
Credit analysis results		
Weighted-average foreclosure frequency (%)	23.80	24.12
Weighted-average loss severity (%)	45.61	46.92

**Table 4b**

<b>Key Credit Metrics: Norwegian Assets</b>		
	<b>As of Sept. 30, 2020</b>	<b>As of Sept. 30, 2019</b>
Weighted-average loan-to-value ratio (%)	45.54	45.22
Balance of loans in arrears (%)	0	0
Credit analysis results		
Weighted-average foreclosure frequency (%)	25.99	26.41
Weighted-average loss severity (%)	43.13	42.51

**Table 4c**

<b>Key Credit Metrics</b>		
	<b>As of Sept. 30, 2020</b>	<b>As of Sept. 30, 2019</b>
Weighted-average foreclosure frequency (%)	24.17	24.78
Weighted-average loss severity (%)	45.19	45.66

**Table 5a**

<b>Loan-To-Value Ratios: Sweden</b>		
	<b>As of Sept. 30, 2020</b>	<b>As of Sept. 30, 2019</b>
<b>(%)</b>	<b>Percentage of cover pool (%)</b>	
0 to 60	82.91	67.59
60 to 70	15.46	20.55
70 to 80	1.63	8.02
80 to 90	0	1.74
90 to 100	0	1.13
Above 100	0	0.97
Weighted-average loan-to-value ratios	48.3	51.02

**Table 5b**

<b>Loan-To-Value Ratios: Norway</b>		
	<b>As of Sept. 30, 2020</b>	<b>As of Sept. 30, 2019</b>
<b>(%)</b>	<b>Percentage of cover pool (%)</b>	
0 to 60	92.52	93.29
60 to 70	4.11	2.31
70 to 80	1.35	0.62
80 to 90	0.13	3.59

**Table 5b**

<b>Loan-To-Value Ratios: Norway (cont.)</b>		
	<b>As of Sept. 30, 2020</b>	<b>As of Sept. 30, 2019</b>
<b>(%)</b>	<b>Percentage of cover pool (%)</b>	
90 to 100	1.87	0
More than 100	0	0.18
Weighted-average loan-to-value ratios	45.54	45.22

**Table 6a**

<b>Geographic Distribution Of Loan Assets: Sweden</b>		
	<b>Percentage of cover pool (%)</b>	
	<b>As of Sept. 30, 2020</b>	<b>As of Sept. 30, 2019</b>
West Sweden	25.3	24.44
Stockholm	23.58	21.76
East Middle Sweden	20.98	19.4
South Sweden	13.44	14.24
Smaland and the islands	10.1	10.07
North Middle Sweden	4.31	7.35
Middle Norrland	1.61	2.14
Upper Norrland	0.69	0.59
Total	100	100

**Table 6b**

<b>Geographic Distribution Of Loan Assets: Norway</b>		
	<b>Percentage of cover pool (%)</b>	
	<b>As of Sept. 30, 2020</b>	<b>As of Sept. 30, 2019</b>
East	53.0	63.4
West	23.9	17.3
Trondelag	17.3	13.8
North	5.8	3.6
South	0.0	1.9
Total	100.0	100.0

**Table 7**

<b>Collateral Uplift Metrics</b>		
	<b>As of Sept. 30, 2020</b>	<b>As of Sept. 30, 2019</b>
Asset WAM (years)	2.08	2.15
Liability WAM (years)	4.11	4.45
Maturity gap (years)	(2.03)	(2.30)
Available credit enhancement	19.23	18.23
'AAA' credit risk	12.46	13.17
Credit enhancement for first notch of collateral uplift (%)	14.49	15.33
Credit enhancement for second notch of collateral uplift (%)	16.51	17.49
Credit enhancement for third notch of collateral uplift (%)	18.54	19.65

**Table 7**

<b>Collateral Uplift Metrics (cont.)</b>		
	<b>As of Sept. 30, 2020</b>	<b>As of Sept. 30, 2019</b>
Target credit enhancement for maximum uplift (%)	20.56	21.81
Potential collateral-based uplift (notches)	3.00	2.00
Adjustment for liquidity (Y/N)	N	N
Adjustment for committed overcollateralization (Y/N)	Y	Y
Collateral support uplift (notches)	2	1

WAM--Weighted-average maturity.

We base our credit analysis on the loan-level data provided by the issuer as of Sept. 30, 2020. The cover pool comprises only commercial mortgage loans backed by Swedish (83.2%) and Norwegian (16.8%) assets. We analyze these pools under our commercial real estate criteria (see "Methodology And Assumptions: Analyzing European Commercial Real Estate Collateral In European Covered Bonds," published on March 31, 2015).

The pool's weighted-average foreclosure frequency (WAFF) is 24.17% (24.78% as of the September 2019 analysis). The pool's weighted-average loss severity (WALS) is 45.19% (45.66% as of the September 2019 analysis).

The WAFF and WALS slightly improved due to a decrease in the weighted-average loan-to-value ratio, which is partly offset by an increase in geographical concentration in the Norwegian pool.

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 six-month liquidity coverage and the level of committed overcollateralization. Due to the covered bonds' soft-bullet maturities, liquidity coverage is being met, according to our criteria. The available credit enhancement is provided voluntarily, which means that we reduce the amount of collateral-based uplift by one notch.

By applying our credit and cash flow stresses, we calculate the target credit enhancement (TCE), which would allow the program to receive four notches of collateral-based uplift. The TCE calculated with September 2020 data is 20.56%. This is an improvement compared to the 21.81% resulting from the September 2019 analysis, due to the lower credit figures and lower asset-liability mismatch.

Given the JRL of 'aaa', under our covered bonds criteria, coverage of the 'AAA' credit risk, at 12.46%, maintains the current 'AAA' rating, based on jurisdictional support. The available credit enhancement, which is 19.23% after applying a haircut to account for set-off risk, is sufficient to cover this requirement.

Under our commercial real estate criteria, we apply a largest obligor test to address portfolio concentration risk. Our largest obligor test, currently at 4.15%, is lower than the aforementioned 'AAA' credit risk, meaning that it does not floor the overcollateralization requirements.

### **Counterparty risk**

We analyze counterparty risk by applying our counterparty criteria (see "Counterparty Risk Framework: Methodology And Assumptions," published on March 8, 2019).

**Commingling risk.** Pre-insolvency, principal proceeds are either reinvested or immediately used to repay the bondholders. Post-insolvency, proceeds from the borrowers are identified and promptly segregated for the benefit of the bondholders. We size a small amount to account for the potential disruption that might affect payments in a post-insolvency scenario.

**Swaps.** Danske Bank is the sole swap counterparty for this program. Hedging addresses interest rate and currency mismatches between the pool's mortgage loans and the payments due to covered bondholders. Termination costs are not subordinated and we consider the collateral posting framework as adequate.

The swap agreements contain a replacement trigger set at 'A-', which we consider refers to the RCR of the issuer. As the counterparty is related to the issuer, the counterparty criteria consider the trigger at the corresponding RRL. This translates to a replacement trigger of 'a', which combined with an adequate collateral framework, is supportive of a 'AAA' rating on the program.

**Set-off risk.** 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. In order to mitigate this risk the issuer will include additional assets in the cover pool, up to a value that is equal to the set-off risk as calculated quarterly. We reduce the available overcollateralization accordingly to 19.23%.

### **Sovereign risk**

We assess country risk by applying our structured finance sovereign risk criteria (see "Incorporating Sovereign Risk In Rating Structured Finance Securities: Methodology And Assumptions," published on Jan. 30, 2019).

The assets are domiciled in Norway and Sweden (unsolicited), which are both rated 'AAA/Stable'. The issuer is domiciled in Denmark, which is also rated 'AAA/Stable' (unsolicited). Therefore, our rating on the program is not limited by the application of these criteria.

### **Environmental, social, and governance (ESG) credit factors**

Danske Bank's cover pool C exposure to environmental and social factors is in line with other Danish issuers we rate. Danske Bank's cover pool C issues "særligt dækkede obligationer" (SDOs) backed by mainly commercial real estate in Norway and Sweden. SDO programs must ensure continuous LTV compliance on an individual loan basis and not just at origination, if collateral values drop during the loan maturity, the issuer must pledge additional assets to the cover pool. For program governance, the issuer commits to maintain a minimum level of OC below the minimum required for the current ratings. In our analysis, we reflect this by reducing the maximum collateral-based uplift to three notches (from four). We consider liquidity coverage to be covered as all outstanding issues are soft-bullet bonds with a one-year maturity extension.(see "ESG Industry Report Card: Covered Bonds," on Nov. 9, 2020).

### **Potential effects of COVID-19**

S&P Global Ratings believes there remains high, albeit moderating, uncertainty about the evolution of the coronavirus pandemic and its economic effects. Vaccine production is ramping up and rollouts are gathering pace around the world. Widespread immunization, which will help pave the way for a return to more normal levels of social and economic activity, looks to be achievable by most developed economies by the end of the third quarter. However, some emerging markets may only be able to achieve widespread immunization by year-end or later. We use these assumptions about vaccine timing in assessing the economic and credit implications associated with the pandemic (see our research here: [www.spglobal.com/ratings](http://www.spglobal.com/ratings)). As the situation evolves, we will update our assumptions and estimates

accordingly.

## **Related Criteria**

- Global Framework For Payment Structure And Cash Flow Analysis Of Structured Finance Securities, Dec. 22, 2020
- Counterparty Risk Framework: Methodology And Assumptions, March 8, 2019
- Incorporating Sovereign Risk In Rating Structured Finance Securities: Methodology And Assumptions, Jan. 30, 2019
- Asset Isolation And Special-Purpose Entity Methodology, March 29, 2017
- Covered Bond Ratings Framework: Methodology And Assumptions, June 30, 2015
- Methodology And Assumptions: Analyzing European Commercial Real Estate Collateral In European Covered Bonds, March 31, 2015
- Covered Bonds Criteria, Dec. 9, 2014
- Principles Of Credit Ratings, Feb. 16, 2011

## **Related Research**

- Global Covered Bond Characteristics And Rating Summary Q4 2020, Dec. 17, 2020
- Global Covered Bond Insights Q4 2020, Dec. 17, 2020
- European Central Bank Ratings Affirmed At 'AAA/A-1+'; Outlook Stable, March 27, 2020
- Assessments For Target Asset Spreads According To Our Covered Bonds Criteria, Nov. 27, 2020
- Assessments For Jurisdictional Support According To Our Covered Bond Criteria, Nov. 27, 2020
- Credit FAQ: The Danish Covered Bond Market Explained, July 15, 2014

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