S&P Global
Ratings

RatingsDirect®

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

Saerligt Daekkede Obligationer

Primary Credit Analyst:
Phuong Nguyen, Paris +33 1 44 20 66 59; phuong.nguyen@spglobal.com

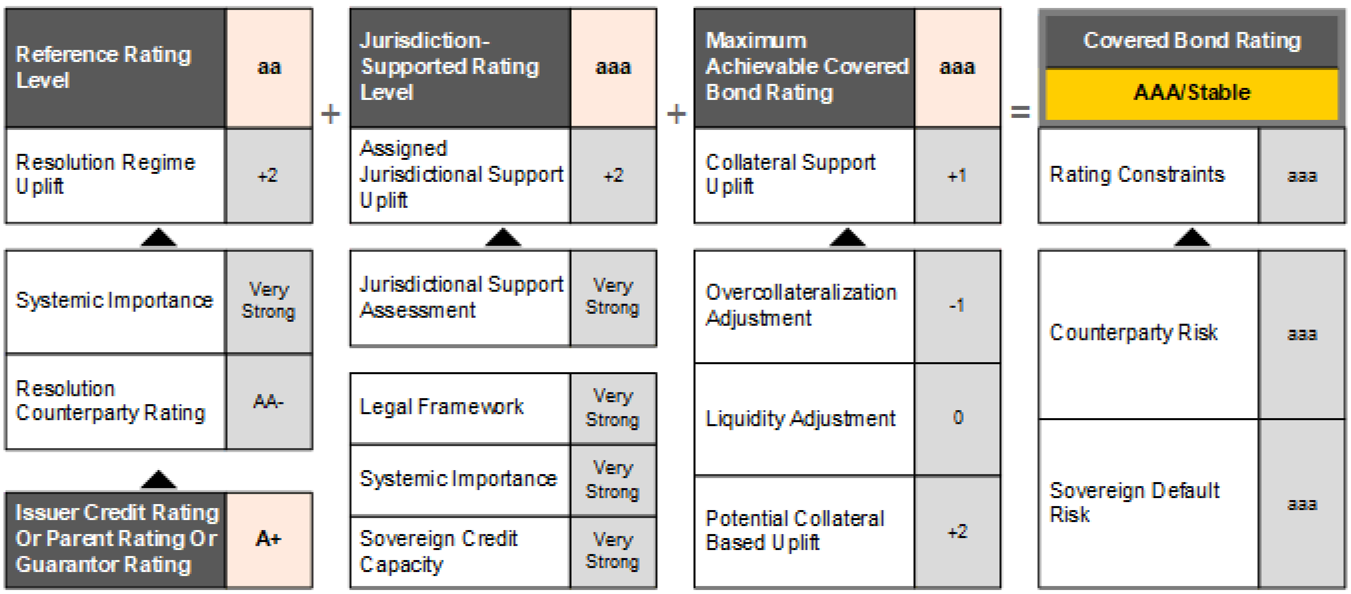
Research Contributor:
Saisadwik Chodavarapu, CRISIL Global Analytical Center, an S&P affiliate, Mumbai

Table Of Contents

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

Saerligt Daekkede Obligationer

Ratings Detail



Note: As a starting point of the analysis, we may use the ICR on the parent or guarantor when the issuer is not rated, but it belongs to a group with a rated parent, or payments under the covered bonds are guaranteed by another rated entity.

Major Rating Factors

Strengths

- Very strong jurisdictional support assessment, and 'aaa' jurisdiction-supported rating level (JRL).
- Liquidity risk is mitigated by the bonds' soft-bullet repayment profile.
- The program benefits from two unused notches that would protect the covered bond ratings if we were to lower the long-term issuer credit rating (ICR) on Danske Bank A/S.

Weaknesses

- The available overcollateralization is provided voluntarily, reducing the collateral-based uplift by one notch.
- The cover pool includes about 52.7% of second-lien loans, which we consider have a higher risk than first-lien loans.

Outlook

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) reflects our view that we would not automatically lower the ratings if we were to lower our long-term ICR on Danske Bank by up to two notches.

We would lower our ratings on the covered bonds if the 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.

From our analysis of the legal and regulatory framework for covered bonds in Denmark, we believe that the cover pool assets are isolated from the issuer's bankruptcy or insolvency risks. This asset isolation allows us to assign a higher rating to the covered bond program than the long-term ICR on Danske Bank.

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 the higher of (i) two notches above the long-term ICR; and (ii) the resolution counterparty rating (RCR). Given the RCR on Danske Bank is 'AA-', the RRL is 'aa', two notches above its ICR.

Our jurisdictional support analysis determines the JRL of the covered bonds as 'aaa'. We considered the likelihood of jurisdictional support for mortgage covered bonds in Denmark, which we assess as very strong, resulting in a jurisdictional support uplift from the RRL of up to three notches. Danske Bank's covered bonds use two notches to achieve a JRL of '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-based uplift.

The 'AAA' ratings reflect our RRL of 'aa' and JRL of 'aaa', as well as the available overcollateralization of 9.59% as of June 30, 2024, exceeding the 3.02% credit enhancement commensurate with a 'AAA' rating.

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

Program Description

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

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

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 currently Euro-denominated.

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, and I 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)	42.02
Rating at closing/year	'AAA'/2007
Redemption profile	Soft-bullet
Assigned jurisdictional support uplift	2
Unused notches for jurisdictional support	1
Target credit enhancement (%)	12.29
Credit enhancement for current rating	3.02
Available credit enhancement (%)	9.59
Collateral support uplift	1
Unused notches for collateral support	1
Total unused notches	2

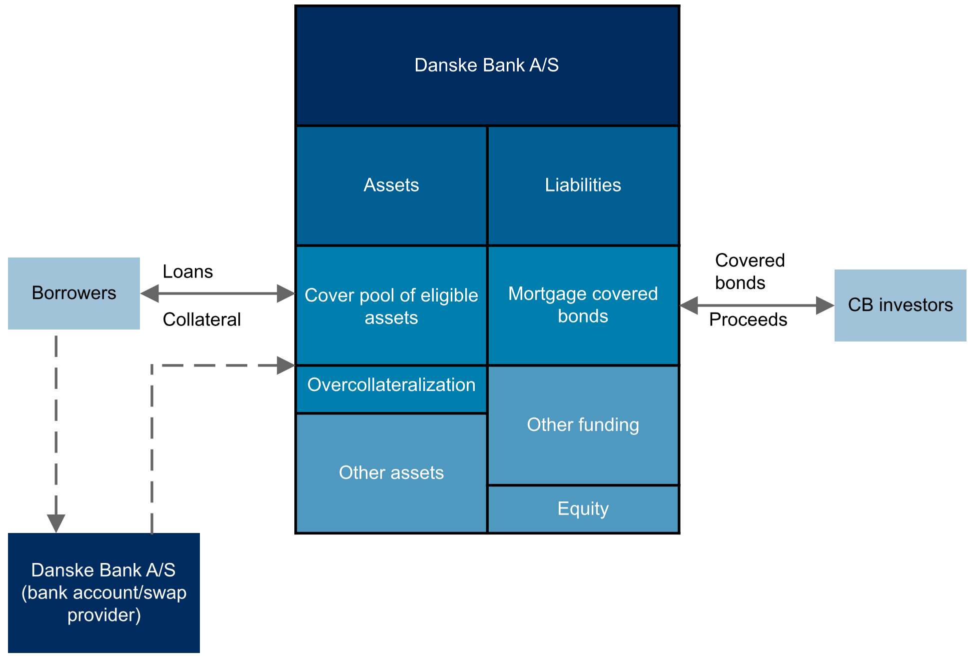
*Based on data as of June 30, 2024.

Table 2

Program participants

Role	Name	Rating	Rating dependency
Issuer	Danske Bank A/S	A+/Stable/A-1	Yes
Originator	Danske Bank A/S	A+/Stable/A-1	No
Bank account provider	Danske Bank A/S	A+/Stable/A-1	No
Swap provider	Danske Bank A/S	A+/Stable/A-1	Yes

Program structure



Rating Analysis

Legal and regulatory risks

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.

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 rate the covered bonds above the long-term rating on the issuer.

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

Danske Bank's cover pool D covered bond investors have a primary secured claim against all cover pool assets. The ratings on the covered bonds issued from cover pool D rely on the issuer's active management of the overcollateralization to support the current ratings.

To become eligible as collateral, mortgage loans must be entered in the Danish land register. The registration is legally binding and will form the basis of any bankruptcy proceedings. If bankruptcy proceedings have been initiated, a trustee appointed by the bankruptcy court will administer the cover pool assets. The trustee is ordered by law to meet all payment obligations as they fall due.

The issuer must maintain an overcollateralization level of at least 2% of covered bonds outstanding on a nominal basis. Banking supervision is carried out by the Danish Financial Supervisory Authority (DFSA, or "Finanstilsynet"). The DFSA can issue an order with which the issuer must comply. In case of severe or multiple breaches, the DFSA may revoke the license.

All Danish covered bonds matching the mortgage maturity may be extended if a refinancing fails. The issuer or administrator must attempt to refinance such extended bonds annually. For covered bonds without a maturity match (as this is the case in Danske Bank D's cover pool), the administrator (appointed in case of the issuer's insolvency) may extend the maturities of the covered bonds.

The legislation to transpose the EU Covered Bond Directive in the Danish legal framework was passed in May 2021 and became effective on July 8, 2022. The amendments are essentially refinements and, given that the Danish legislation was already well aligned to the requirements of the directive, the new legislation does not affect our analysis of the Danish legal framework.

Under the 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 that it can provide sufficient overcollateralization to maintain a 'AAA' rating, any increase of assets in the pool to maintain this rating would likely be considered "ordinary," and therefore not subject to clawback, in our view.

Operational and administrative risks

In June 2024, we conducted a review of Danske Bank's origination, underwriting, collection, and default management procedures for cover pool assets. We also reviewed the cover pool management and administration. We consider that Danske Bank actively manages the cover pool and has adequate underwriting and loan management policies in place. 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, which we have reflected in our originator adjustment.

We believe that a replacement cover pool manager would be available if the issuer were to become insolvent. We consider Denmark to be an established covered bond market and believe that the mortgage assets in the cover pool do not comprise product features that would materially limit the range of available replacement cover pool managers.

Our analysis of operational and administrative risks follows the principles laid out in our covered bonds criteria.

Resolution regime analysis

As part of our covered bonds criteria, our analysis considers the 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. Our very strong assessment of the systemic importance of Danish mortgage covered bonds, which allows for two notches of uplift from the ICR on Danske.

These factors recognize that resolution regimes like the BRRD increase the probability that an issuer could service its covered bonds even following a default on its senior unsecured obligations, because the law exempts covered bonds from bail-in. We consider this an internal form of support because the bail-in of certain creditors does not require direct government support.

Jurisdictional support analysis

The JRL on Danske Bank's covered bonds is 'aaa'. 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. Therefore, the program can receive up to three notches of jurisdictional uplift from the RRL. Two notches are used to achieve a 'AAA' rating, resulting in one unused notch for jurisdictional support.

Collateral support analysis

We base our analysis on the loan-level data and asset and liability cash flow projections provided by the issuer as of June 30, 2024. The cover pool comprises only residential mortgages in Denmark.

Table 3

Cover pool composition

	June 30, 2024		June 30, 2023	
Asset type	**Value (DKK)**	**Percentage of cover pool**	**Value (DKK)**	**Percentage of cover pool**
Residential assets	45,299,689,598	98.37132	42,098,776,265	98.36444
Substitute assets	750,000,000	1.62868	700,000,000	1.63556
Total	46,049,689,598	100.00	42,798,776,265	100.00

Table 4

Key credit metrics

	As of June 30, 2024	As of June 30, 2023
Weighted-average effective LTV (%)*	62.25	62.42
Weighted-average loan seasoning (years)§	5.43	5.93

Table 4

Key credit metrics (cont.)

	As of June 30, 2024	As of June 30, 2023
Balance of loans in arrears (%)	0.00	0.00
Weighted-average LTV ratio (%)	56.65	56.80
Credit analysis results		
Weighted-average foreclosure frequency (%)	12.03	12.41
Weighted-average loss severity (%)	36.10	37.64
AAA credit risk (%)	3.02	3.14

*The effective LTV ratio is the result of the application of our global RMBS criteria, which weight 100% of current indexed whole loan LTV ratio for the WAFF calculation. §Seasoning refers to the elapsed loan term. LTV--Loan-to-value. N/A--Not applicable.

Table 5

Seasoning

	As of June 30, 2024	As of June 30, 2023
Seasoning (months)	**Percentage of portfolio**	
0-24	37.92	40.53
24-48	24.13	17.63
48-60	6.53	7.25
60-72	5.54	2.61
72-84	2	0.72
84-96	0.53	0.77
96-108	0.58	1.59
108-120	1.22	1.75
More than 120	21.55	27.16
Weighted-average loan seasoning (years)	5.43	5.93

*Seasoning refers to the elapsed loan term.

Table 6

Current loan-to-value distribution

	As of June 30, 2024	As of June 30, 2023
	Percentage of cover pool	
0-40	23.99	24.69
40-50	15.66	15.42
50-60	19.45	17.07
60-70	15.59	16.74
70-80	14.74	11.75
80-90	4.88	8.01
90-100	1.66	2.62
>100	4.03	3.71
Weighted-average loan-to-value (%)	56.65	56.80

Table 7

Geographical distribution

	As of June 30, 2024	As of June 30, 2023
	Percentage of cover pool	
Capital Region of Denmark	49.70	47.60
Central Denmark Region	15.51	15.71
North Denmark Region	5.37	5.48
Region Zealand	13.15	13.31
Region of Southern Denmark	16.27	17.90
Total	100	100

Table 8

Collateral uplift metrics

	As of June 30, 2024	As of June 30, 2023
Asset WAM (years)	13.89	13.98
Liability WAM (years)	4.70	4.52
Available credit enhancement (%)	9.59	10.14
AAA credit risk (%)	3.02	3.14
Coverage of 'AAA' credit risk and 25% of refinancing costs (%)	5.34	5.54
Coverage of 'AAA' credit risk and 50% of refinancing costs (%)	7.66	7.94
Coverage of 'AAA' credit risk and 75% of refinancing costs (%)	9.97	10.34
Target credit enhancement for maximum uplift (%)	12.29	12.74
Potential collateral-based uplift (notches)	2	2
Adjustment for liquidity (Y/N)	N	N
Adjustment for committed overcollateralization (Y/N)	Y	Y
Collateral support uplift (notches)	1	1

WAM--Weighted-average maturity.

For the loans in the pool, our analysis estimated the foreclosure frequency and the loss severity and--by multiplying the foreclosure frequency by the loss severity--the potential loss associated with each loan. To quantify the potential losses associated with the entire pool, we calculated a weighted-average foreclosure frequency (WAFF) and a weighted-average loss severity (WALS) assuming 'AAA' credit stresses. The product of these two variables estimates the required loss protection, in the absence of additional factors. We assume that the probability of foreclosure is a function of both borrower and loan characteristics and will become more likely--and the realized loss on a loan more severe--as the economic environment deteriorates.

As of June 30, 2024, our WAFF and WALS have improved since our previous review as of June 2023. The WAFF decreased to 12.0% from 12.4%, mainly due to a lower share of second-lien loans and slightly lower effective loan-to-value (LTV) ratio, partially offset by a lower weighted-average seasoning, and a higher share of interest-only loans. The WALS decreased to 36.1% from 37.6%, mainly due to lower current LTV ratios and a lower share of second-lien loans.

By applying our credit and cash flow stresses, we calculate a target credit enhancement (TCE) of 12.29 % (12.74%

previously) and a 'AAA' credit risk of 3.02% (3.14% previously). The lower mortgage assets' credit coverage and lower spread compression have positively affected the 'AAA' credit risk, which is partially offset by lower excess spread. The lower TCE is further driven by lower asset-liability maturity mismatch.

Our global RMBS criteria identify basis risk relating to standard variable rate (SVR) mortgage loans, given that the lender may change the SVR at any time and for various reasons (for example, changes in the cost of funding or to retain borrowers). As current SVR rates in Danske's cover pool D reflect a very competitive environment, with spreads at lower levels, we have not reduced the SVR rates in our analysis. However, we may apply a stress as rates change.

Given the JRL of 'aaa', under our covered bonds criteria, coverage of 'AAA' credit risk or 3.02% of credit enhancement is required to achieve a 'AAA' rating, solely based on jurisdictional support.

As the available credit enhancement (9.59%) exceeds the coverage of 'AAA' credit risk and 50% of refinancing costs (7.66%), the maximum potential collateral-based uplift above the JRL is two notches. We reduce these two notches by one because there is no commitment to maintain overcollateralization at the current rating level. We make no deductions for the lack of 180 days of liquid assets because the covered bonds' soft-bullet maturities satisfy the liquidity coverage requirement under our criteria. Therefore, the maximum collateral uplift above the JRL is one notch.

Counterparty risk

We have identified several counterparty risks to which the covered bonds are exposed. However, these are either structurally addressed in line with our counterparty criteria or considered in our cash flow modeling (see "Counterparty Risk Framework: Methodology And Assumptions," published March 8, 2019). Therefore, we believe that they do not constrain the ratings from a counterparty risk perspective.

Commingling risk

Borrowers make their payments via direct debit or bank transfer into the accounts held with the account bank provider. Danske Bank uses these accounts in its normal course of business. Cash collections are accessible at any time. No documented replacement mechanism exists to protect the covered bondholders from the bank account providers' credit deterioration. Therefore, in our cash flow analysis, we considered the risk that cover pool collections may be lost if they have not been reinvested in cover assets or used to pay the covered bonds.

We have stressed this risk in our analysis by sizing a small amount considering the issuer's weekly overcollateralization reporting.

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. To derive the maximum potential rating on the covered bonds under our counterparty criteria, we consider various factors, including whether the counterparties are related to the issuer, the seniority of termination payments, the replacement commitment, and the collateral posting framework.

Danske Bank is a related swap counterparty, and derivative termination costs are not subordinated to payments due to covered bondholders. Because Danske Bank is a related counterparty, we consider the RRL (currently 'aa') as the applicable counterparty rating when assessing counterparty risk. According to the swap documentation, Danske Bank has committed to post collateral and to replace itself within 90 calendar days if its RRL falls below 'a'. We categorize the current collateral-posting framework in the derivative contracts as adequate.

The collateral framework assessment, combined with the current RRL on the issuer ('aa') and the replacement trigger, support a maximum potential rating of 'AAA' under our counterparty risk assessment.

The mortgage covered bonds benefit from three unused notches of uplift under our counterparty risk criteria. This means that the covered bond ratings would be unaffected if we were to lower our long-term ICR on Danske Bank (and consequently its RRL) up by three notches, all else being equal.

Setoff 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. We understand from the issuer that all borrowers have contractually agreed that they have no right to set off against the relevant loans.

Sovereign risk

We analyze sovereign risk using our structured finance ratings above the sovereign criteria (see "Incorporating Sovereign Risk In Rating Structured Finance Securities: Methodology And Assumptions," published on Jan. 30, 2019). Given Denmark's 'AAA' rating (unsolicited), sovereign risk does not constrain the ratings on the covered bonds.

Environmental, Social, And Governance

Environmental and social credit factors influence the credit profile of Danske Bank's cover pool D covered bond program in a broadly similar way to most other Danish covered bond issuers that we rate. In cover pool D, Danske Bank issues covered bonds under the Danish SDO framework backed solely by Danish residential properties. SDO programs must ensure continuous LTV compliance on an individual loan basis and not just at origination, meaning that if collateral values drop, the issuer must pledge additional assets to the cover pool. Governance factors are a negative consideration in our ICR analysis of Danske Bank (the issuer). Moreover, the issuer does not commit to maintain a minimum level of overcollateralization in the program that is commensurate with a 'AAA' rating, which reduces by one the unused notches of uplift. We consider liquidity coverage to be addressed as all outstanding issues are soft-bullet bonds with a one-year maturity extension.

Related Criteria

- Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- Criteria | Structured Finance | General: Global Framework For Payment Structure And Cash Flow Analysis Of Structured Finance Securities, Dec. 22, 2020
- Global Methodology And Assumptions: Assessing Pools Of Residential Loans, Jan. 25, 2019
- Criteria - Structured Finance - General: Counterparty Risk Framework Methodology And Assumptions, March 8, 2019
- Incorporating Sovereign Risk In Rating Structured Finance Securities: Methodology And Assumptions, Jan. 30, 2019

- Legal Criteria: Structured Finance: Asset Isolation And Special-Purpose Entity Methodology, March 29, 2017
- 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
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Related Research

- Global Covered Bond Insights Q4 2024, Sept. 18, 2024
- The Danish Covered Bond Legal Framework: A Closer Look, June 5, 2024
- Denmark 'AAA/A-1+' Ratings Affirmed; Outlook Stable, Feb. 9, 2024
- Danish Covered Bond Market Insights 2023, Nov. 30, 2023
- Danske Bank A/S, Aug. 2, 2023
- Covered Bonds Outlook Midyear 2023: Rising Interest Rate Will Test Asset Performance, July 19, 2023
- S&P Global Ratings Definitions, June 9, 2023
- S&P Global Ratings' Covered Bonds Primer, June 20, 2019
- Glossary Of Covered Bond Terms, April 27, 2018