

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

### Saerligt Daekkede Obligationer

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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>	<b>AAA</b>
Resolution Regime Uplift	+2		Assigned Jurisdictional Support Uplift	+3		Collateral Support Uplift	0		Rating Constraints	aaa
Systemic Importance	Very Strong		Jurisdictional Support Assessment	Very Strong		Overcollateralization Adjustment	-1		Counterparty Risk	aaa
Resolution Counterparty Rating	A-		Legal Framework	Very Strong		Liquidity Adjustment	0		Country Risk	aaa
<b>Issuer Credit Rating</b>	<b>A</b>		Systemic Importance	Very Strong		Potential Collateral Based Uplift	+1			
			Sovereign Credit Capacity	Very Strong						

### Major Rating Factors

#### Strengths

- The long-term issuer credit rating (ICR) on the issuer is such that the program needs to cover 'AAA' credit risk in order to achieve a 'AAA' rating.
- Due to the covered bonds' soft-bullet maturities, six months liquidity coverage is ensured.

#### Weaknesses

- The available overcollateralization is provided on a voluntary basis, meaning that we deduct one notch from the collateral-based uplift.
- At present, the program does not benefit from any unused notches of collateral uplift.

### Outlook: Stable

S&P Global Ratings' stable outlook on the ratings on Danske Bank A/S' cover pool I mortgage covered bonds ("saerligt

daekkede obligationer"; SDOs) reflects the stable outlook on the issuer. That means we would automatically lower the ratings on the covered bonds if we were to lower our long-term ICR on Danske Bank by one notch.

## **Rationale**

This transaction update follows our periodic review of Danske Bank's cover pool I 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 I contains mortgage loans denominated in Norwegian krone (NOK) and, to a smaller extent, Swedish krona (SEK), secured on Norwegian and Swedish residential properties. The covered bonds are issued in euros, Norwegian krone, and Swiss francs. The transaction features interest rate swaps and cross-currency swaps on both assets and liabilities.

In 2017, through its Swedish subsidiary, Danske Hypotek, Danske Bank launched a covered bond program entirely backed by Swedish residential mortgages. Ever since, the share of Swedish assets in Cover Pool I has decreased, as loans that refinance get transferred to the Swedish program and loans that mature are not replaced by new origination.

The bonds are senior-secured obligations. They rank pari passu with other obligations backed by the same cover pool. If the issuer were to become bankrupt, the pools would be managed separately.

**Table 1**

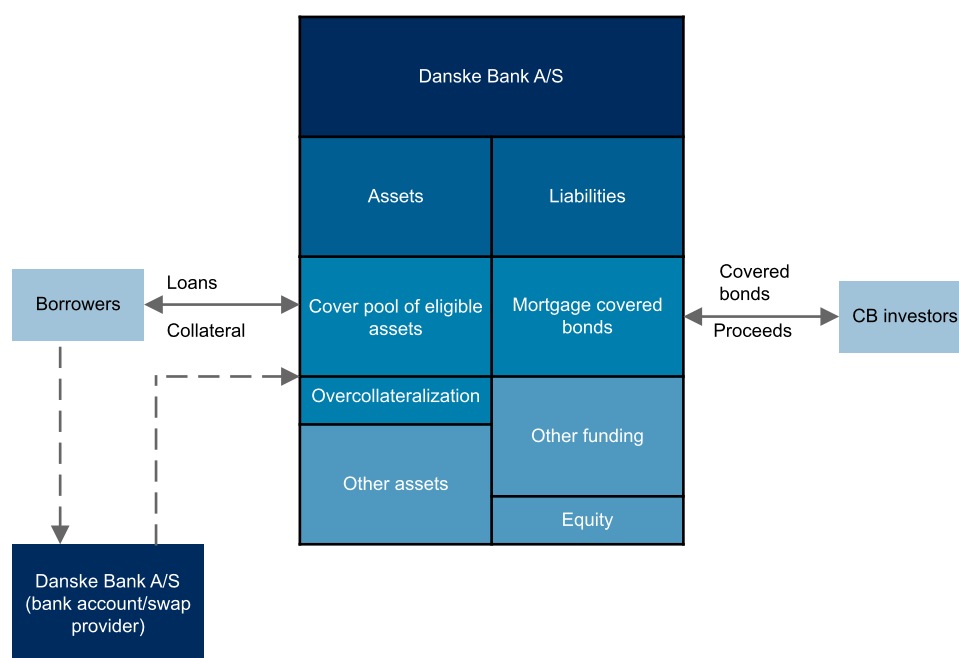
Program Description*	
Jurisdiction	Denmark
Covered bond type	Legislation-enabled
Underlying assets	Residential mortgage loans
Outstanding covered bonds (Bil. NOK)	146.20
Rating at closing	'AAA'
Extendible maturities	Yes
Target credit enhancement (%)	16.08
Available credit enhancement (%)	10.11

\*Based on data as of June 30, 2021. NOK--Norwegian krona.

**Table 2**

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.

Denmark passed the law to transpose the EU Harmonization Directive on Covered Bonds in June 2021. The new covered bond legislation will be fully implemented in 2022 (see "Covered Bond Harmonization In The EU Remains A Work in Progress," published on July 13, 2021).

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. In such a scenario, 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.

Danske Bank adheres to the general balancing principle (in contrast to the specific balancing principle) in order to manage market risk exposure. The issuer may 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 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, in our view.

### **Operational and administrative risks**

In June 2021, 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 believe that a replacement servicer can be found should the issuer 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. Denmark is a member of the EU and implemented the EU's Bank Recovery and Resolution Directive (BRRD), therefore 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

Our analysis of jurisdictional support in our covered bonds criteria determines 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 Bonds Criteria," published on Nov. 27, 2020). 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 I mortgage covered bonds.

### Collateral support analysis

**Table 3**

Cover Pool Composition				
Asset type	As of June 30, 2021		As of Sept. 30, 2019	
	Value (Mil. NOK)	Percentage of cover pool (%)	Value (Mil. NOK)	Percentage of cover pool (%)
Residential	163,696.2	100.0	144,611.5	100.0
Commercial	0.0	0.0	0.0	0.0
Substitute assets	0.0	0.0	0.0	0.0
Other asset type	0.0	0.0	0.0	0.0
Total	163,696.2	100.0	144,611.5	100.0

NOK--Norwegian krone.

**Table 4a**

<b>Key Credit Metrics: Norwegian Assets</b>		
	<b>As of June 30, 2021</b>	<b>As of Sept. 30, 2019</b>
Weighted-average loan-to-value ratio (%)	59.8	58.9
Balance of loans in arrears (%)	0.1	1.0
<b>Credit analysis results</b>		
Weighted-average foreclosure frequency (%)	13.8	14.3
Weighted-average loss severity (%)	34.8	41.1

**Table 4b**

<b>Key Credit Metrics: Swedish Assets</b>		
	<b>As of June 30, 2021</b>	<b>As of Sept. 30, 2019</b>
Weighted-average loan-to-value ratio (%)	47.5	58.7
Balance of loans in arrears (%)	0.0	0.1
<b>Credit analysis results</b>		
Weighted-average foreclosure frequency (%)	10.0	11.9
Weighted-average loss severity (%)	26.7	57.5

**Table 4c**

<b>Key Credit Metrics</b>		
	<b>As of June 30, 2021</b>	<b>As of Sept. 30, 2019</b>
Weighted-average foreclosure frequency (%)	13.7	13.9
Weighted-average loss severity (%)	34.5	44.5

**Table 5a**

<b>Loan-To-Value Ratios: Norway</b>		
	<b>As of June 30, 2021</b>	<b>As of Sept. 30, 2019</b>
(%)	Percentage of cover pool (%)	
0 to 60	49.1	47.9
60 to 70	18.9	17.6
70 to 80	18.1	16.5
80 to 90	9.4	12.0
90 to 100	2.5	3.1
More than 100	2.0	2.8
Weighted-average loan-to-value ratios	59.8	58.9

**Table 5b**

<b>Loan-To-Value Ratios: Sweden</b>		
	<b>As of June 30, 2021</b>	<b>As of Sept. 30, 2019</b>
(%)	Percentage of cover pool (%)	
0 to 60	73.2	56.0
60 to 70	7.9	15.1
70 to 80	6.1	13.5
80 to 90	8.9	9.2

**Table 5b****Loan-To-Value Ratios: Sweden (cont.)**

	As of June 30, 2021	As of Sept. 30, 2019
90 to 100	2.3	3.7
Above 100	1.5	2.6
Weighted-average loan-to-value ratios	47.5	58.7

**Table 6a****Loan Seasoning Distribution: Norway**

	As of June 30, 2021	As of Sept. 30, 2019
	Percentage of cover pool (%)	
Less than 5 years	72.4	76.2
5-6	7.2	4.0
6-7	5.9	2.5
7-8	1.9	3.4
8-9	1.5	2.4
9-10	2.2	1.9
More than 10 years	8.8	9.1
Weighted-average loan seasoning (years)	3.9	4.0

\*Seasoning refers to the elapsed loan term.

**Table 6b****Loan Seasoning Distribution: Sweden**

	As of June 30, 2021	As of Sept. 30, 2019
	Percentage of cover pool (%)	
Less than 5 years	38.3	59.3
5-6	2.6	3.7
6-7	2.0	4.2
7-8	0.8	4.2
8-9	1.6	4.5
9-10	1.9	5.6
More than 10 years	52.6	18.5
Weighted-average loan seasoning (years)	8.0	5.5

\*Seasoning refers to the elapsed loan term.

**Table 7a****Geographic Distribution Of Loan Assets: Norway**

	Percentage of cover pool (%)	
	As of June 30, 2021	As of Sept. 30, 2019
East	60.2	84.3
West	9.8	4.3
Trondelag	14.0	11.4
North	5.3	0.0
South	10.8	0.0



**Table 7a****Geographic Distribution Of Loan Assets:  
Norway (cont.)**

Total	100.0	100.0
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**Table 7b****Geographic Distribution Of Loan Assets: Sweden**

	Percentage of cover pool (%)	
	As of June 30, 2021	As of Sept. 30, 2019
Smaland and the islands	45.8	42.4
South Sweden	53.6	57.3
Stockholm	0.3	0.0
Upper Norrland	0.3	0.4
Total	100	100

**Table 8****Collateral Uplift Metrics**

	As of June 30, 2021	As of Sept. 30, 2019
Asset WAM (years)	11.80	11.94
Liability WAM (years)	4.40	3.88
Maturity gap (years)	7.40	8.06
Available credit enhancement	10.11	16.86
AAA' credit risk	4.90	8.64
Credit enhancement for first notch of collateral uplift (%)	7.70	12.03
Credit enhancement for second notch of collateral uplift (%)	10.49	15.43
Credit enhancement for third notch of collateral uplift (%)	13.29	18.82
Credit enhancement for maximum uplift (%)	16.08	22.21
Potential collateral-based uplift (notches)	1	2
Adjustment for liquidity (Y/N)	N	N
Adjustment for committed overcollateralization (Y/N)	Y	Y
Collateral support uplift (notches)	0	1

WAM--Weighted-average maturity.

We base our credit analysis on the loan-level data provided by the issuer as of June 30, 2021. The cover pool comprises residential mortgage loans backed by Norwegian (96.2%) and Swedish (3.8%) assets. The share of Swedish residential mortgages decreased compared to last review to some extent as loans that refinance get transferred to the Swedish program and loans that mature are not replaced by new origination.

This is the first time that we analyze these pools under our global RMBS criteria (see "Global Methodology And Assumptions: Assessing Pools Of Residential Loans," published on Jan. 25, 2019).

The pool's current weighted-average foreclosure frequency (WAFF) remained stable at 13.7%.

In the Norwegian subpool, the WAFF slightly decreased to 13.8% from 14.3%, mainly due to the fact that, under our global RMBS criteria, we use the WAFF on 100% current loan-to-value (LTV) ratio compared to 100% original LTV at

our previous review. This results in an effective LTV of 66.3% compared to an original LTV of 60.3%. We have also adjusted the effective LTV to account for the overvaluation we see in the market.

The pool's weighted-average loss severity (WALS) is 34.5%, lower than the September 2019 WALS of 44.5%.

In the Norwegian subpool, the WALS decreased to 34.8% from 41.1%. The weighted-average current LTV, based on our calculations, is 59.8%, slightly higher compared to 58.9% previously. Therefore, the main driver for the decrease of the WALS is the lower share of jumbo valuations as the jumbo threshold is higher under our global RMBS criteria. In the Swedish subpool, the WALS decreased significantly to 26.7% from 57.5%, mainly driven by the higher jumbo valuation thresholds under our criteria and the lack of adjustment to the market value decline of tenant-owner-right loans (which represent about 34% of the cover 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 adjust 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 deduct one notch from the potential notches of collateral-based uplift.

By applying our credit and cash flow stresses, we calculate a target credit enhancement (TCE), which would allow the program to receive four notches of collateral-based uplift. The TCE calculated on June 2021 data is 16.1%. This is lower than the 22.2% resulting from the September 2019 analysis, due to the lower credit coverage, an increase in excess spread, and the improved asset-liability mismatch.

Our global RMBS criteria identifies basis risk in relation to standard variable rate (SVR) mortgage loans given that the lender may change the SVR at any time and for a variety of reasons (for example, changes in the cost of funding or to retain borrowers). As the current SVR rates in Danske Bank's cover pool I reflect a competitive environment, we have not applied a haircut to these SVR rates in our analysis. However, we may apply a stress in the future if the SVR dynamics were to change.

Given the JRL of 'aaa', under our covered bonds criteria, only coverage of the 'AAA' credit risk, at 4.9%, is required to maintain the current 'AAA' rating, based solely on jurisdictional support. The available credit enhancement, which is 10.11% after applying a haircut to account for set-off risk, is sufficient to cover this requirement.

### **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.

Given that the counterparty is related to the issuer, the applicable counterparty rating is the RRL, according to our criteria. We deem the commitment made by the counterparty to replace itself upon downgrade to be satisfactory, and the collateral framework to be moderate.

The swap agreements contain a replacement trigger set at 'A-', which we map to its corresponding RRL, of 'A'.

Given the issuer's RRL, the collateral framework and the replacement trigger, the swap we see in this program is supportive of a 'AAA' rating.

**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 deduct this amount from the cover pool balance when calculating the transaction's available overcollateralization. As of June 2021, the amount at risk is equal to roughly DKK1 billion.

### **Sovereign risk**

We consider country risk in line with our 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)**

We view Danske Bank's cover pool I's exposure to environmental and social factors in line with other Danish issuers. In its cover pool I, Danske Bank issues the covered bonds under the Danish SDO framework backed solely by Norwegian and Swedish 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. On the governance side, the issuer is committed to maintain a minimum level of overcollateralization that is below the minimum required for the current ratings. This leads to a one-notch adjustment to the collateral-based uplift we assign. 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
- 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
- Global Methodology And Assumptions: Assessing Pools Of Residential Loans, Jan. 25, 2019
- Asset Isolation And Special-Purpose Entity Methodology, March 29, 2017

- Covered Bond Ratings Framework: Methodology And Assumptions, June 30, 2015
- Covered Bonds Criteria, Dec. 9, 2014
- Principles Of Credit Ratings, Feb. 16, 2011

## **Related Research**

- Global Covered Bond Insights Q3 2021, Sept. 9, 2021
- Covered Bond Harmonization In The EU Remains A Work in Progress, July 13, 2021
- S&P Global Ratings Definitions, Jan. 5, 2021
- Denmark Ratings Affirmed At 'AAA/A-1+'; Outlook Stable, Aug. 28, 2020
- Assessments For Target Asset Spreads According To Our Covered Bonds Criteria, Nov. 27, 2020
- Assessments For Jurisdictional Support According To Our Covered Bonds Criteria, Nov. 27, 2020
- Various Rating Actions Taken On Five Danish Banks As Denmark's Banking Market Offers Mixed Blessings, Oct. 23, 2019
- Glossary Of Covered Bond Terms, April 27, 2018
- Credit FAQ: The Danish Covered Bond Market Explained, July 15, 2014

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