FITCH AFFIRMS DANSKE BANK AND REALKREDIT DANMARK

Fitch Ratings-London/Paris-28 November 2013: Fitch Ratings has affirmed Danske Bank's (Danske) and mortgage bank subsidiary Realkredit Danmark's Long-Term Issuer Default Ratings (IDRs) at 'A', Short-Term IDRs at 'F1' and Viability Ratings (VRs) at 'a'. The Outlooks on the Long-term IDRs are Stable. A full list of rating actions is provided at the end of this comment.

KEY RATING DRIVERS - DANSKE BANK's IDRS, VRS AND SENIOR DEBT

The affirmation of Danske's IDRs and VR reflects Fitch's view that Danske's capitalisation and robust core domestic banking business will enable it to absorb continued elevated loan impairment charges (LICs) in Ireland and, to a smaller extent, in Denmark, until these two markets return to sustained economic growth.

The ratings are based on the bank's strong Danish and Nordic franchise, solid capitalisation and fairly diversified earnings, both geographically across the Nordics as well as by product range. They also factor in a high level of impaired loans, particularly on its Irish book, fairly volatile capital markets and insurance income, and reliance on wholesale funding, although risks associated with the latter are mitigated by a large and liquid domestic funding market.

The Irish real estate crisis has affected Danske's loan portfolio, and while representing only about 2% of the loan book, Irish exposures make up around one-fifth of gross impaired loans. The Irish portfolio is now classified as non-core and is being wound down. As the dominant Danish bank, with over half of its loan book in Denmark, Danske has also been affected by the Danish recession and housing downturn. Nonetheless, Fitch expects this cyclical downturn to have largely bottomed out in Denmark and that non-performing loans (NPLs) will flatten out in 2014. The volume of unimpaired exposures remaining in the non-core business is limited, and Fitch expects downside risk to reduce further.

Profitability has been greatly affected by LICs since the start of the downturn, although LICs as a proportion of pre-impairment operating profits have been on a downward trajectory since 2011. Fitch expects LICs will remain elevated as the Irish portfolio is wound down and before growth in Denmark improves. However, the impact on operating profit will continue to reduce in 2014. Boosting revenues and containing costs are key challenges for Danske. Revenues are likely to be somewhat volatile in 2014 as a result of its insurance and capital markets operations and the bank is undergoing a significant cost-cutting programme.

Similar to most Nordic peers Danske has significant reliance on wholesale funding. Its non-deposit taking subsidiary, Realkredit Danmark, largely funds the group's mortgage business, almost exclusively through Danish mortgage bonds. Danske has maintained access to domestic and international funding markets, in particular for its mortgage bonds, although it would be affected by a prolonged dislocation of debt capital markets. Fitch believes that Danske will retain a significant liquidity portfolio to mitigate this risk.

Danske's capital adequacy ratios compare well with those of international peers, but lag behind those of some Nordic peers. Limited growth in risk-weighted assets will support the bank in complying with further regulatory requirements, as well as in maintaining investor confidence in light of its reliance on wholesale funding. Leverage is fairly modest in a European context, with tangible common equity/tangible assets at around 3.7% at end-September 2013.

RATING SENSITIVITIES - VR, IDRS AND SENIOR DEBT

The Stable Outlook reflects Fitch's view that Danske will be able to absorb LICs in the short term, while strengthening its capital and financial flexibility via higher profitability and retained earnings.

The ratings could be downgraded if Danske is unable to competitively access wholesale funding markets, if its Danish business faces a significant deterioration in asset quality that materially affects its capitalisation or if its already subdued earnings further deteriorate, reducing its ability to absorb shocks.

An upgrade is currently unlikely given the bank's already high ratings and ongoing earnings and asset quality pressures. In the medium- to long-term, the ratings could be upgraded following significantly improved asset quality metrics, combined with sustainable and solid internal capital generation.

KEY RATING DRIVERS - REALKREDIT DANMARK's VR AND IDRS

The affirmation of Realkredit Danmark's IDRs and VR reflects Fitch's view that the mortgage bank's profitability, although moderate, will enable it to absorb unexpected shocks in Denmark until economic growth is firmly back on track in the country.

The ratings are based on Realkredit Danmark's strong Danish franchise as the second-largest mortgage lender, its solid capitalisation and its strong asset quality. They also factor in its monoline business model and reliance on wholesale funding, although risks associated with the latter are mitigated by a large, deep and liquid domestic funding market. Fitch also expects that capital is, to an extent, fungible between Danske and Realkredit Danmark, and thus the VRs are invariably inter-connected.

Realkredit Danmark's asset quality is strong, representing the majority of Danske's mortgage exposures. Fitch expects the quality of the mortgage portfolio to remain strong, supported by a stabilising Danish economy.

Profitability is modest, driven by its low-margin mortgage business. Fitch expects Realkredit Danmark will continue to focus on increasing mortgage margins and to keep LICs at a manageable level.

Realkredit Danmark is by law entirely wholesale-funded, largely by issuance of Danish mortgage bonds. Similar to its domestic peers, around one-third of Realkredit Danmark's bonds mature within a year to match the interest term of the underlying mortgage. Generally such a dependence on short-term wholesale funding would suggest a lower rating. However, the supportive dynamics of the Danish mortgage bond market are an important mitigating factor for this risk.

Fitch expects demand for Danish mortgage bonds to remain strong in light of the need from predominantly domestic financial institutions, insurance companies and pension funds to hold highly liquid, high-quality, securities in domestic currency. This is reinforced by the fairly limited outstanding volume of Danish government bonds. Nonetheless, maintaining a significant liquidity portfolio to mitigate any refinancing risk is key to the ratings. Realkredit Danmark's move to extend bond maturities has further helped to mitigate refinancing risk. The Danish government has put forward a proposal that mortgage covered bonds should include mandatory extension provisions which would address liquidity risk associated with concentrated refinancing via bond auctions (see 'Danish Mortgage Bond Extension Would Cut Refinancing Risk', dated 27 November 2013, at www.fitchratings.com).

Realkredit Danmark's capital adequacy ratios compare well with those of domestic and international peers. Low risk weights on mortgages boost reported capital ratios, although leverage is modest in a European context, with tangible common equity/tangible assets at around 6% at end-September 2013.

RATING SENSITIVITIES - VR AND IDRS

The Stable Outlook reflects Fitch's view that Realkredit Danmark will continue to maintain its focus on asset quality and its adequate earnings to absorb unexpected shocks and to internally generate capital.

A rating downgrade would most likely be a result of Realkredit Danmark being unable to competitively access wholesale funding markets or if it significantly increases its reliance on international debt investors that may be less stable during financial stress. A downgrade of Danske's ratings, or reduced focus on liquidity, would also be rating-negative.

An upgrade is currently unlikely given the bank's already high ratings and monoline business model.

KEY RATING DRIVERS - SUPPORT RATING AND SUPPORT RATING FLOOR

The banks' Support Ratings and Support Rating Floors reflect Fitch's expectation of an extremely high probability of support from the Danish authorities if required. This is driven by Danske's and Realkredit Danmark's systemic importance within the Danish financial sector.

The agency also believes Danske would have an extremely strong willingness to provide support to Realkredit Danmark, although given the relative size and likely correlation in a stressed scenario, Danske's ability to do so may be limited.

RATING SENSITVITIES - SUPPORT RATING AND SUPPORT RATING FLOOR

The Support Ratings and Support Rating Floors are potentially sensitive to any change in Fitch's assumptions about the ability (as reflected in its ratings) or willingness of the Danish state to provide timely support to the banks, if required. They are also sensitive to a change in Fitch's assumptions around the availability of sovereign support for banks more generally.

In Fitch's view, there is a clear intention ultimately to reduce implicit state support for financial institutions in the EU, as demonstrated by a series of legislative, regulatory and policy initiatives. On 11 September 2013, Fitch outlined its approach to incorporating support in its bank ratings in light of evolving support dynamics for banks worldwide (see "Fitch Outlines Approach for Addressing Support in Bank Ratings" and "Bank Support: Likely Rating Paths", at www.fitchratings.com).

The Support Rating would be downgraded and the Support Rating Floor revised down if Fitch concludes that potential sovereign support has weakened relative to its previous assessment.

KEY RATING DRIVERS AND SENSITIVITIES - DANSKE's SUBORDINATED DEBT AND OTHER HYBRID SECURITIES

Subordinated debt and other hybrid capital issued by Danske are all notched down from the bank's VR. Therefore, their respective ratings have been affirmed and are sensitive to any change in Danske's VR.

The ratings are in accordance with Fitch's criteria 'Assessing and Rating Bank Subordinated and Hybrid Securities' reflecting each instrument's respective non-performance and relative loss severity risk profiles, which vary considerably.

Danske's CRD IV-compliant Tier 2 instruments are notched down once below the bank's VR to reflect the notes' higher expected loss severity relative to senior unsecured creditors. The notching also takes into consideration a lack of contractual full write-down or conversion language (which according to Fitch's criteria may be reflected by notching down twice).

Fitch rates Danske's other Tier 2 instruments three notches below the VR to reflect loss severity (one notch) and incremental non-performance risk (two notches). Fitch has applied additional notching for incremental non-performance risk to legacy issues because of the issuer's ability to defer coupons. The ability to defer interest is the differentiation between the old-style Tier 2 instruments and the new CRD IV compliant Tier 2 notes.

Hybrid Tier 1 securities are rated four notches below Danske's VR to reflect the higher loss severity risk of these securities relative to average recoveries (two notches from the VR) as well as high risk of non-performance (an additional two notches).

The rating actions are as follows:

Danske Bank
Long-term IDR: affirmed at 'A', Outlook Stable
Short-term IDR: affirmed at 'F1'
Viability Rating: affirmed at 'a'
Support Rating: affirmed at '1'
Support Rating Floor: affirmed at 'A-'

Commercial paper programme: affirmed at 'F1'
Long-term senior debt: affirmed at 'A'
Short-term senior debt: affirmed at 'F1'
CRD IV-compliant Tier 2 instrument (ISIN: XS0974372467): affirmed at 'A-'
Subordinated notes: affirmed at 'BBB'
Tier 1 instruments: affirmed at 'BBB-'

Danske Corporation
Commercial paper programme: affirmed at 'A'/'F1'

Realkredit Danmark
Long-term IDR: affirmed at 'A', Stable Outlook
Short-term IDR: affirmed at 'F1'
Viability Rating: affirmed at 'a'
Support Rating: affirmed at '1'
Support Rating Floor: affirmed at 'A-'

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Applicable criteria, 'Global Financial Institutions Rating Criteria', dated 15 August 2012; Evaluating Corporate Governance', dated 12 December 2012; and 'Assessing and Rating Bank Subordinated and Hybrid Securities', dated 5 December 2012, are available at www.fitchratings.com.

Applicable Criteria and Related Research:
Global Financial Institutions Rating Criteria
http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=686181
Evaluating Corporate Governance
http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=694649
Assessing and Rating Bank Subordinated and Hybrid Securities
http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=695542