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Transaction Update: Realkredit Danmark A/S (Capital Center T Mortgage Covered Bond Program)

Unlimited SDROs ("saerligt daekkede realkreditobligationer")

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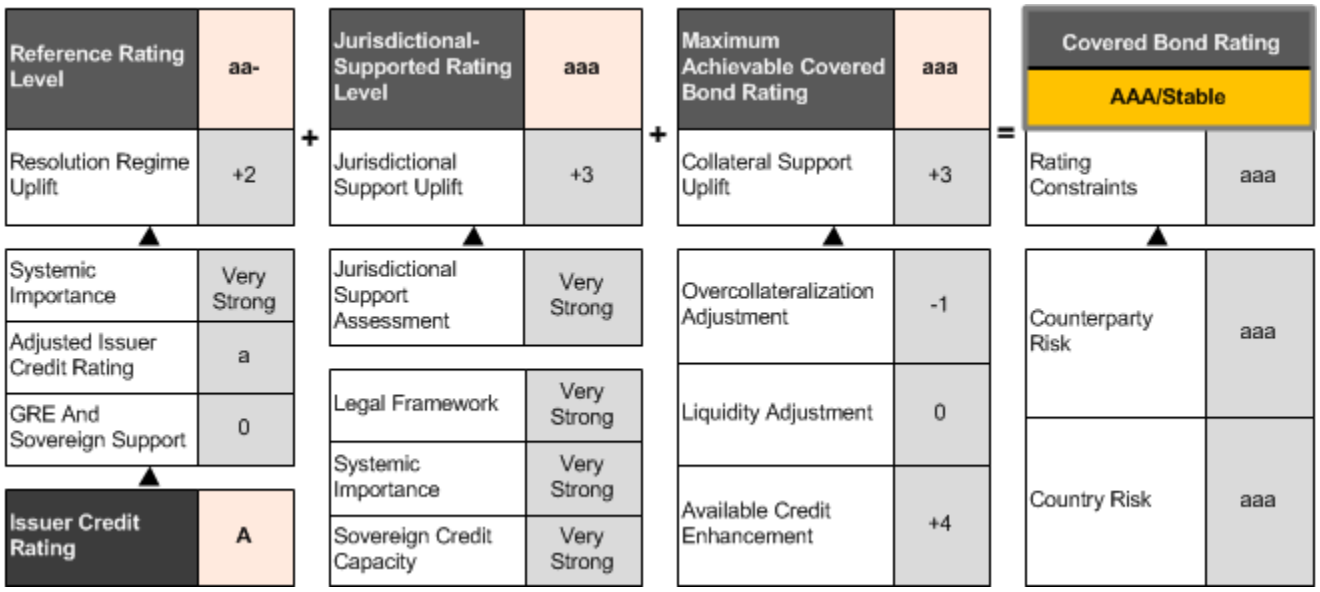
Ratings Detail



Note: Under our "Group Rating Methodology," Realkredit Danmark A/S is a core subsidiary of Danske Bank A/S. We therefore raise the ratings on the covered bonds according to the long-term ICR on Danske Bank A/S.

Major Rating Factors

Strengths

- Jurisdiction-supported rating level (JRL) of 'aaa', resulting in a low level of overcollateralization required to maintain the 'AAA' rating.
- The match-funded structure of the capital center helps to mitigate liquidity risk.

Weaknesses

- Aside from the legislative minimum, no other commitment regarding available overcollateralization in the cover pool.
- The assets are all adjustable-rate mortgages, which we view as more likely to default than fixed rate assets.
- The cover pool is exposed to borrower concentration risk, which is a driver in our analysis.

Outlook

Standard & Poor's Ratings Services' stable outlook on its ratings on Realkredit Danmark A/S' Capital Center T mortgage covered bonds reflects the fact that we would not automatically lower our ratings on the covered bonds if we were to downgrade Danske Bank A/S, Realkredit Danmark's parent company. This is because the program is eligible for six notches of uplift above the rating reference level (RRL) of 'aa-', but only requires three notches to achieve a 'AAA' rating.

Rationale

We are publishing this transaction update as part of our review of Realkredit Danmark's Capital Center T mortgage covered bond program. On Dec. 4, 2015, we affirmed our 'AAA' credit ratings on the Capital Center T covered bond program and all series of "særligt dækkede realkreditobligationer" (SDRO) covered bonds issued under it (see "Ratings Affirmed On Realkredit Danmark's Capital Center T Mortgage Covered Bonds Following Review; Outlook Stable").

Our covered bonds ratings process follows the methodology and assumptions outlined in our "Covered Bonds Criteria," published on Dec. 9, 2014.

From our analysis of the legal and regulatory framework for covered bonds in Denmark, we believe that the assets in Realkredit Danmark Capital Center T's cover pool are isolated from the risk of the issuer's bankruptcy or insolvency. This asset isolation allows us to assign a higher rating to the covered bond program than the long-term issuer credit rating (ICR) on Danske Bank. Although the issuer of the covered bonds is Realkredit Danmark, we use the rating on Danske Bank A/S as the starting point of our analysis. This is because, in accordance with our criteria "Group Rating Methodology," published on Nov. 19, 2013, we consider Realkredit Danmark to be a "core" entity of Danske Bank.

In accordance with our covered bonds criteria, we determine the issuer's RRL, and attribute notches of uplift from this level by assessing jurisdictional support and collateral-based support. Based on Danske Bank's long-term ICR of 'A' and our assessment of jurisdictional support, we assess the RRL at 'aa-' and the JRL at 'aaa'. In addition, the program could benefit from up to four notches of collateral-based uplift.

We determine the total collateral-based uplift by analyzing the cover pool's asset credit quality, payment structure, and cash flow mechanics. As of Sept. 30, 2015, the cover pool amounts to Danish krone (DKK) 471 billion, made up of residential and commercial mortgages and substitute assets (commonly called a "reserve fund" in traditional Danish covered bonds).

We generally analyze the cover pool's mortgage credit quality with the help of two key indicators:

- The weighted-average foreclosure frequency (WAFF), which reflects the expected default rate; and
- The weighted-average loss severity (WALS), which describes the expected loss given default.

Our analysis, as of Sept. 30, 2015, shows that the available credit enhancement is 9.15%. This is greater than the 3.65% credit enhancement commensurate with a 'AAA' rating, a level which is driven by an out-of-model test to address

potential concentration risk.

As part of our analysis, we reviewed Realkredit Danmark's origination, underwriting, collection, and default management procedures. We believe satisfactory policies are in place to support our ratings on the covered bonds. As there are no further legal, counterparty, or country risk constraints on our rating, we have affirmed our 'AAA' rating on the program.

Our covered bond ratings criteria outlines our rating methodology (see "Covered Bond Ratings Framework: Methodology And Assumptions," published on June 30, 2015).

Program Description

Table 1

Program Overview*	
Jurisdiction	Denmark
Year of first issuance	2011
Covered bond type	Legislation-enabled
Outstanding covered bonds (Bil. DKK)	431
Redemption profile	Mixed
Underlying assets	Residential and commercial mortgages
Jurisdictional support uplift	3
Unused notches for jurisdictional support	0
Target credit enhancement (%)§	7.05
Credit enhancement commensurate with rating (%)†	3.65
Available credit enhancement (%)	9.15
Collateral support uplift	3
Unused notches for collateral support	3
Total unused notches	3

*Based on data as of Sept. 30, 2015. §Level of credit enhancement corresponding to 100% of refinancing costs. †Level of credit enhancement is driven by the outcome of the largest obligor test.

Realkredit Danmark is a wholly-owned subsidiary of Danske Bank and is a specialist mortgage bank in Denmark, second in size to Nykredit Realkredit A/S. Realkredit Danmark is an established issuer of Danish mortgage covered bonds, "realkreditobligationer" (ROs), and SDROs.

Capital Center T is currently actively issuing bonds, which includes mortgage assets--backed by both residential and commercial properties--as well as a reserve fund consisting primarily of Danish covered bonds. All residential and subsidized mortgages included in the cover pool are adjustable-rate mortgage (ARM) loans.

Danske Bank acts as the main bank account provider. To mitigate counterparty risk, the issuer has replacement language in place, which is in line with our current counterparty criteria (see "Counterparty Risk Framework Methodology And Assumptions," published on June 25, 2013).

The cover pool assets would be ring-fenced if Realkredit Danmark were to become insolvent under the respective

Danish legislative framework. SDRO covered bondholders have a primary secured claim against all assets in the cover pool.

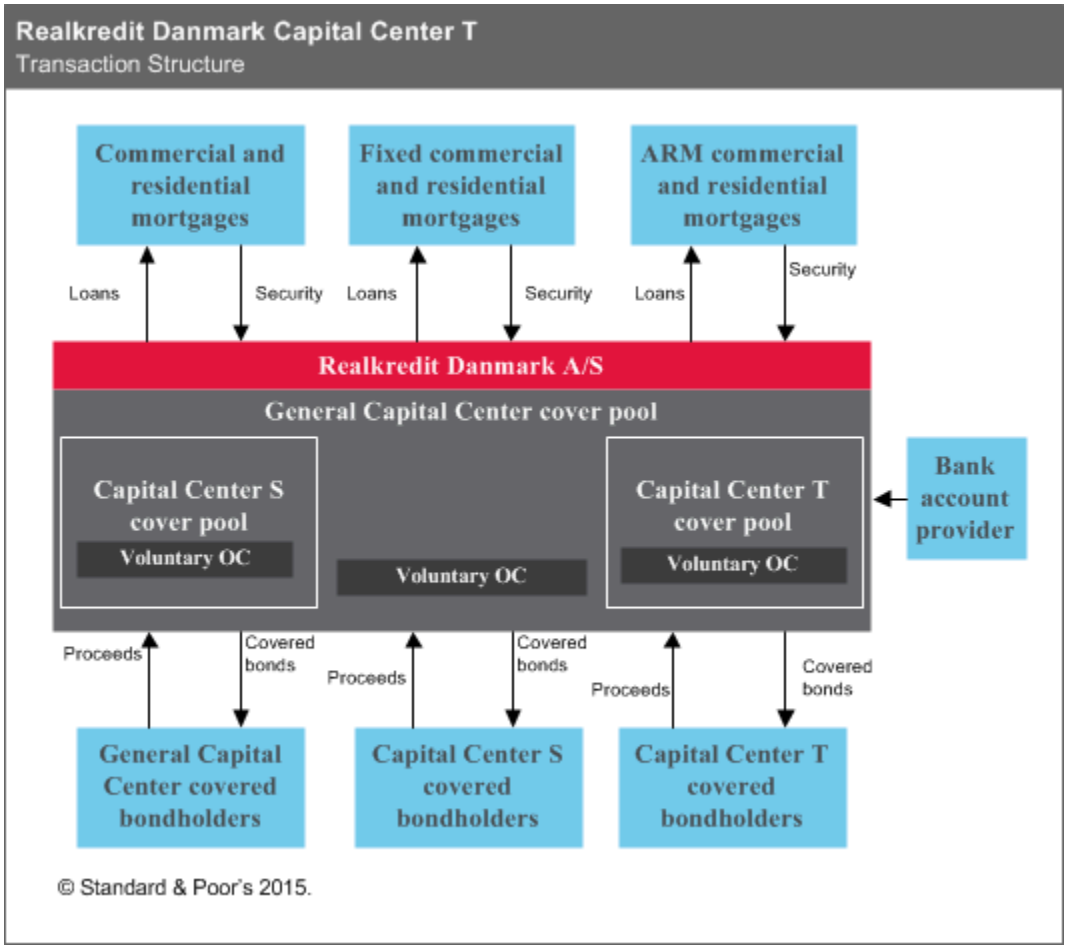


Table 2

Program Participants

Role	Name	Rating	Rating dependency
Issuer	Realkredit Danmark A/S	NR*	Y
Originator, arranger and servicer	Danske Bank A/S	A/Stable/A-1	N
Bank account provider	Danske Bank A/S	A/Stable/A-1	Y
Bank account provider	Jyske Bank A/S	A-/Stable/A-2	Y
Bank account provider	Nordea Bank Danmark A/S	AA-/Negative/A-1+	Y
Bank account provider	Grønlandsbanken	NR	Y

*In our analysis, we uplift the rating from the long-term issuer credit rating on the parent Danske Bank A/S.

Rating Analysis

Legal and regulatory risks

We analyzed legal risk by applying our European legal criteria and our criteria for rating covered bonds (see "Europe Asset Isolation And Special-Purpose Entity Criteria--Structured Finance," published on Sept. 13, 2013, and other covered bond ratings criteria listed in "Related criteria").

In our view, the Danish covered bond framework sufficiently addresses the relevant legal aspects of our covered bond and European legal criteria. This enables us to rate the covered bonds above our long-term ICR on the issuer's parent bank. The Danish Covered Bond Act provides the legal framework for the issuance of the Danish covered bonds.

SDRO covered bond investors have a primary secured claim against all assets in the cover pool. The ratings on the covered bonds issued from Capital Center T 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 assets. The trustee is ordered by law to meet all payment obligations as they fall due. If payments from the cover assets are insufficient to meet the payment obligations, the trustee has the authority to raise additional loans.

The issuer must maintain an overcollateralization of at least 8% of risk-weighted assets. Banking supervision is carried out by the Danish Financial Supervisory Authority (FSA). The FSA has the authority to issue an order with which the issuer must comply. In case of severe or multiple breaches, the FSA may revoke the license.

Operational and administrative risks

In June 2015, we conducted a review of Realkredit Danmark's origination, underwriting, collection, and default management procedures for the capital center's cover pool assets. We also reviewed the cover pool's management and administration. We consider that Realkredit Danmark actively manages the cover pool and has strict underwriting and loan management policies. In addition to an annual meeting, we have ongoing regular contact with the issuer.

We analyzed operational and administrative risk by applying our covered bonds criteria.

Resolution regime analysis

As part of our covered bonds criteria, our analysis considers any resolution regime in place in Denmark to determine the RRL. The EU's Banking Resolution and Recovery Directive (BRRD) was transposed into Danish law and came into effect on June 1, 2015. In Denmark, mortgage credit institutions like Realkredit Danmark are excluded from bail-in, but are required to issue a certain amount of "bail-inable" debt instruments. This does not affect our resolution regime analysis, as the covered bonds are still protected during resolution. As such, we assign two notches of uplift from the adjusted ICR, resulting in a RRL of 'aa-'.

Jurisdictional support analysis

In analyzing jurisdictional support, we assess the likelihood of a covered bond under stress receiving support from a government-sponsored initiative instead of from the liquidation of collateral assets in the open market. Our assessment of jurisdictional support for mortgage programs in the Denmark is "very strong" (see "Assessments For Jurisdictional Support According To Our Covered Bond Criteria," published on Dec. 22, 2014). The assessment of "very strong"

means that the program can receive up to three notches of jurisdictional uplift. The JRL is therefore 'aaa'. This is the rating the program can achieve by covering the legal minimum overcollateralization requirement, according to our covered bonds criteria.

Collateral support analysis

We have reviewed the mortgage asset and substitute collateral information as of Sept. 30, 2015. We have analyzed the mortgage loan-by-loan data from the issuer and applied stresses commensurate with a 'AAA' rating scenario to estimate the WAFF and WALS. The cover pool primarily comprises Danish residential and commercial mortgages (91.3%), and also includes substitute assets (8.7%).

The WAFF is almost unchanged compared to June 2014, at 21.55%. On the other hand, WALS has increased to 37.12% from 31.04% during the same period. These results are mostly driven by the application of our new criteria for commercial real estate mortgage loans, which include higher market value decline assumptions (CRE criteria, see "Methodology And Assumptions: Analyzing European Commercial Real Estate Collateral In European Covered Bonds," published on March 31, 2015).

From a foreclosure frequency standpoint, its effect is broadly neutral, with favorable (no more adjustment for ARM loans, lower adjustment for geographic concentration) and unfavorable impact (no more benefit given the seasoning, more conservative adjustment for high loan-to-value ratios).

Loss severity increases due to higher market value decline assumptions as well as a higher proportion of jumbo loans in the cover pool.

Our credit analysis of the substitute pool (also referred to as the "reserve fund") includes an asset-by-asset review of underlying securities to estimate the credit risk of each individual exposure. To determine the default and loss on the reserve fund, we apply our "Methodology And Assumptions For Assessing Portfolios Of International Public Sector And Other Debt Obligations Backing Covered Bonds And Structured Finance Securities," published on Dec. 9, 2014.

We consider the pool of substitute assets to exhibit low granularity as the 10 largest obligors account for 90% of total substitute assets. For low granularity pools, in a 'AAA' stress scenario, we assume that assets with a Standard & Poor's rating of 'AAA' will not default, save for covered bonds that are issued by other Realkredit Danmark capital centers (we assume these default as our analysis presumes the issuer has already defaulted). For the assets that default, we determine the recovery by applying paragraphs 76 and 77 of the aforementioned criteria. As all of the bonds that we assume to default are structurally match-funded covered bonds, we are able to apply higher recoveries (see table 5 of the criteria). The analysis results in an assumed default rate of the reserve fund of 1.06% and a recovery rate of 39.44%.

Table 3

Cover Pool Composition

Asset type	As of Sept. 30, 2015		As of June 30, 2014	
	Value (DKK)	**Percentage of cover pool (%)**	**Value (DKK)**	**Percentage of cover pool (%)**
Residential mortgages	244,079,579,261	50.92	227,265,682,166	49.85
Subsidized housing	20,441,076,144	4.26	16,775,635,702	3.68
Commercial mortgages	173,783,365,852	36.26	165,425,840,406	36.29

Table 3

Cover Pool Composition (cont.)				
Reserve fund	41,008,980,788	8.56	46,392,008,442	10.18
Total	479,313,002,046		455,859,166,715	

Table 4

Key Credit Metrics		
	As of Sept. 30, 2015	**As of June 30, 2014**
Weighted-average LTV ratio (%)	67.20	65.44
Weighted-average loan seasoning (months)*	53.38	48.64
Balance of loans in arrears (%)	0.67	0.71
Credit analysis results		
Weighted-average foreclosure frequency (%)	21.55	21.58
Weighted-average loss severity (%)	37.12	31.04
AAA credit risk (%) **	3.65	2.50

LTV--Loan to value. *Seasoning refers to borrower's relationship term, as loans are often refinanced. **September 2015 result floored by the largest obligor test.

Table 5

Covered Pool Assets By Loan Size		
(DKK '000s)	**Percentage of cover pool (%)**	
Residential assets (DKK '000s)	**As of Sept. 30, 2015**	**As of June 30, 2014**
0-500	3.44	4.06
500-1,000	14.97	16.61
1,000-1,500	20.12	21.75
1,500-2,000	17.70	18.43
2,000-2,500	13.27	13.42
2,500-3,000	8.99	8.59
Greater than 3,000	21.50	17.15

DKK--Danish krone.

Table 6

Loan-To-Value Ratios*		
	As of Sept. 30, 2015	**As of June 30, 2014**
	Percentage of cover pool (%)	
Residential and subsidized assets (%)		
0-60	35.66	33.49
60-70	18.44	17.05
70-80	38.96	39.56
80-90	6.58	8.53
90-100	0.13	0.54
Above 100	0.23	0.83

LTV--Loan to value. *LTV ratios presented here are calculated by aggregating all exposures at a borrower level.

Table 7

Loan Seasoning Distribution*

Residential mortgages	Percentage of portfolio (%)	
	As of Sept. 30, 2015	**As of June 30, 2014**
Less than 18 months	17.05	17.85
18-24 months	8.41	7.38
24-36 months	9.27	13.20
36-48 months	11.63	9.45
48-60 months	7.14	16.93
More than 60 months	46.51	34.66
Weighted-average loan seasoning (months)	53.38	51.08

*Seasoning refers to borrower's relationship term, as loans are often refinanced. Performing loans only.

Table 8

Geographic Distribution Of Loan Assets

Residential mortgages	**As of Sept. 30, 2015**	**As of June 30, 2014**
	Percentage of cover pool (%)	
Regional concentration		
Residential assets		
Central Denmark Region	16.7	16.9
North Denmark Region	5.1	5.2
Region Zealand	19.6	19.7
Region of Southern Denmark	14.7	14.7
Capital Region of Denmark	43.9	43.5
Total	100.0	100.0
Commercial assets		
Central Denmark Region	18.7	19.4
North Denmark Region	7.3	8.3
Region Zealand	12.2	12.6
Region of Southern Denmark	23.1	23.1
Capital Region of Denmark	31.2	29.9
Sweden, Norway and Danish dependencies	7.4	6.6
Total	100.0	100.0

Our analysis of the covered bonds' payment structure shows that cash flows from the cover pool assets would be sufficient, at the existing rating level, to make timely payments of interest and principal to the covered bondholders.

As there is an active secondary market for mortgages in Denmark, the program can benefit from up to four notches of collateral-based uplift according to our covered bonds criteria. Before determining the number of collateral-based notches needed to reach a 'AAA' rating, we consider the following adjustments:

- According to paragraphs 73-74 of the criteria, a one-notch reduction applies if the program does not benefit from at least six months of liquidity. Due to the match-funded nature of the Realkredit Danmark Capital Center T, we

consider that liquidity coverage is met. Each covered bond is matched to a specific mortgage loan, and any payments from the loan will be used to make payments on the bond.

- According to paragraph 76 of the criteria, a further one-notch reduction applies if the program does not benefit from any form of commitment on overcollateralization. As Realkredit Danmark's Capital Center T only has voluntary overcollateralization without any commitment, this results in a one-notch reduction to the potential collateral-based uplift.

Given the JRL of 'aaa', the program only needs to cover 'AAA' credit risk to reach a 'AAA' rating. In this instance, the 'AAA credit risk is driven by a supplemental test to address borrower concentration. Under our CRE criteria, we apply an out-of-model test to address borrower concentration risk.

In particular, this supplemental test captures concentration risks in the cover pool. The assumed number of defaulted obligors is a function of the applicable stress scenario ('AAA', in our case) and the obligors' credit quality. Since assets in this pool are not rated, we assume an obligor rating in the 'B' to 'CCC-' range, so the credit enhancement commensurate for the cover pool is at least equal to the loss related to the 10 largest obligors, as defined by the gross outstanding balance of the largest loans in the cover pool. This represents 3.65% of overcollateralization. In order to cover a 'AAA' credit stress scenario, the available credit enhancement must exceed this net loss result.

We analyzed the cash flows under 'AAA' credit stresses, as well as liquidity, interest rate, and currency stresses to reflect the fact that the pool does not have recourse to derivatives but relies on "natural hedging." The terms of the issued bonds match those of the underlying mortgages due to the balancing principle. We also ran different default timing and prepayment patterns.

In our analysis the recession starts on day one. This is because we assume the insolvency of the issuing bank as the starting point of the analysis, and we assume that the bank would default at the beginning of the 'AAA' recession.

For prepayments, we ran a "low" scenario, with a 0.5% conditional prepayment rate (CPR) and a "high" scenario with a 24% CPR.

The target credit enhancement has increased to 7.05% in September 2015 from 6.47% in June 2014, driven by the higher WALS, as discussed above.

Our cash flow analysis is based on the applicable criteria in the "Related criteria" section below.

Table 9

Collateral Uplift Metrics

	As of Sept. 30, 2015	As of June 30, 2014
Asset WAM (years)	13.1	13.9
Liability WAM (years)	14.5	15.6
Available credit enhancement (%)	9.15	11.51
AAA' credit risk (%)*	3.65	2.50
Required credit enhancement for first notch of collateral uplift (%)	3.64	2.50
Required credit enhancement for second notch of collateral uplift (%)	4.78	N/A
Required credit enhancement for third notch collateral uplift (%)	5.91	N/A
Target credit enhancement for maximum uplift (%)	7.05	6.47

Table 9

Collateral Uplift Metrics (cont.)		
Potential collateral-based uplift (notches)	4	N/A
Adjustment for liquidity (Y/N)	N	N/A
Adjustment for committed overcollateralization (Y/N)	Y	N/A
Collateral support uplift (notches)	3	N/A

*September 2015 result driven by the largest obligor test. WAM--Weighted-average maturity. N/A--Not applicable.

Counterparty risk

We have identified several counterparty risks to which the covered bonds could be exposed. However, these are mitigated through either structural mechanisms, or by applying the Danish Covered Bond Act. Therefore, we consider them not to constrain our ratings on the covered bonds.

Commingling risk. The collection accounts are not held in Capital Center T's name, but under Realkredit Danmark's name. This introduces potential commingling risk. Indeed, the funds in the accounts are commingled with the funds collected for the other Realkredit Danmark capital centers, as well as with Realkredit Danmark's funds. However, under the Danish covered bond legislation, we understand that covered bondholders have the right to these funds. Therefore, we do not consider cash to be lost, but that it could be temporarily unavailable for a period of time. Therefore, commingling risk amounts not to a credit loss but to a liquidity stress.

Due to the balance principle in Danish covered bond law, mortgage banks in practice do not hold large cash balances but reinvest payments received before the bond due date for securities whose maturity matches the remaining maturity and interest of such bonds. Given the limited time--less than a working day--that funds stay in bank accounts, we do not apply a liquidity stress in our cash flow calculations.

Bank account providers. Several banks provide accounts for the program. Incoming cash is invested in a defined group of high-quality assets intraday. As a result, the cash balance on any collection accounts is managed to be as close to zero as practically possible. To mitigate bank account and commingling risk, the issuer has replacement language in place, which is in line with our counterparty criteria. The issuer commits to holding less than 5% cash with commercial banks that are rated at least 'BBB/A-2'. If the bank account provider does not meet this ratings requirement, Realkredit Danmark will make commercially reasonable efforts to replace the account holding bank with a bank that meets our criteria within 30 calendar days.

Derivatives. There are no swap counterparties in the program.

Set-off risk. The issuer is not a deposit-taking institution. The program is therefore not exposed to set-off risk.

Country risk

When applicable, our "Nonsovereign Ratings That Exceed EMU Sovereign Ratings: Methodology And Assumptions" criteria cap our covered bond ratings. These criteria apply to multijurisdictional cover pools such as Capital Center T, where obligors in the pool are located in Denmark (93% of assets), Sweden (6%), and Norway (1%). Under these criteria, we consider the exposure to country risk to be "low," which allows the program to achieve six notches of uplift above the long-term sovereign rating on Denmark (AAA/Stable/A-1+), where most of the obligors are located. Therefore, country risk does not constrain our ratings on the covered bonds.

Potential Effects Of Proposed Criteria Changes

Our analysis is based on our current applicable criteria, including those set out in the criteria article "Methodology And Assumptions For Analyzing Mortgage Collateral In Danish Covered Bonds," published on May 2, 2012. On Nov. 13, 2015, we published a notification announcing our intent to revise these criteria (see "Advance Notice Of Proposed Criteria Change: RMBS In Certain European Jurisdictions"). As a result, our future assumptions and methodologies may differ from our current criteria.

Related Criteria And Research

Related Criteria

- 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
- Methodology And Assumptions For Assessing Portfolios Of International Public Sector And Other Debt Obligations Backing Covered Bonds And Structured Finance Securities, Dec. 9, 2014
- Group Rating Methodology, Nov. 19, 2013
- Europe Asset Isolation And Special-Purpose Entity Criteria--Structured Finance, Sept. 13, 2013
- Counterparty Risk Framework Methodology And Assumptions, June 25, 2013
- Covered Bonds Counterparty And Supporting Obligations Methodology And Assumptions, May 31, 2012
- Methodology And Assumptions For Analyzing Mortgage Collateral In Danish Covered Bonds, May 2, 2012
- Nonsovereign Ratings That Exceed EMU Sovereign Ratings: Methodology And Assumptions, June 14, 2011
- Update To The Cash Flow Criteria For European RMBS Transactions, Jan. 6, 2009
- Methodology: Credit Stability Criteria, May 3, 2010
- Understanding Standard & Poor's Rating Definitions, June 3, 2009
- Commercial Paper I: Banks, March 23, 2004
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Related Research

- Ratings Affirmed On Realkredit Danmark's Capital Center T Mortgage Covered Bonds Following Review; Outlook Stable, Dec. 4, 2015
- Advance Notice Of Proposed Criteria Change: RMBS In Certain European Jurisdictions, Nov. 13, 2015
- Global Covered Bond Characteristics And Rating Summary Q3 2015, Nov. 5, 2015
- Danish Covered Bond Index Report H1 2015: Collateral Performance Improves, Aug. 14, 2015
- Covered Bond Monitor: Technical Note, Aug. 12, 2015
- Danske Bank A/S, July 31, 2015
- Various Rating Actions On Four Danish Banks After Review Of Government Support And Additional Loss-Absorbing Capacity, July 13, 2015
- Advance Notice Of Proposed Criteria Change: Covered Bonds Counterparty And Supporting Obligations, March 5, 2015
- Banking Industry Country Risk Assessment: Norway, Jan. 30, 2015
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- Assessments For Target Asset Spreads According To Our Covered Bond Criteria, Dec 22, 2014
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- Credit FAQ: The Danish Covered Bond Market Explained, July 15, 2014

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