21 June 2017

Financial Institutions

Danske Bank A/S Issuer Rating Report

STABLE OUTLOOK

A+

On 8 June 2017 Scope Ratings upgraded its Issuer Rating on Danske Bank A/S to A+ (from A) with a Stable Outlook. The upgrade reflects the material improvement in the bank's fundamentals, primarily on profitability, as well as the material derisking of the balance sheet.

For the full list of ratings see the **Ratings** section at the end of this report.

The ratings were not solicited by the issuer. Both the ratings and analysis are based solely on public information. The issuer has participated in the process.

Highlights

The ratings are driven by the group's strong franchise as the leading universal bank in its domestic market, Denmark. Having largely recovered from the financial crisis, the group has managed to improve its returns, even in an environment of subdued growth and negative interest rates. While Danske pursues a Nordic universal bank strategy, its measured expansion outside of Denmark helps to manage the usual risks associated with fast growth in mature markets.

The relatively high dependence on market funding is substantially mitigated by the large and stable component of covered bonds.

In 2016, Danske reported a ROE of 13.1%, which is ahead of the 12.5% long-term target.

We continue to monitor the group's expansion in Norway and Sweden in light of the potentially less favourable market dynamics in these countries.

Rating drivers (Summary)

The rating drivers, in decreasing order of importance in the rating assignment, are:
1. Strong franchise as the leading financial institution in Denmark
2. Reassuring capital metrics, supported by improved earnings and regulatory requirements
3. Management's measured execution of its strategy to be a Nordic universal bank
4. Material dependence on market funding, but the large and stable component of covered bonds substantially mitigates this risk

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Bloomberg: SCOP

Rating-change drivers

Changes in business strategy that increase the group's risk profile. Having largely recovered from earlier expansion strategies, as well as from the financial crisis, management now faces more demands over future growth and profitability. Danske's profitability in 2016 exceeded its long-term target (12.5%). Nevertheless, the interest rate environment still pressures Danske's revenues, and its Nordic growth aspirations could lead it into segments where it lacks expertise.

Evidence of the resilient group fundamentals in a downturn. Earnings have returned to more normal levels, as the impact of non-core businesses has become immaterial amid the improved economic conditions. However, the ultimate test for the reshaped business model will come at the next downturn. Maintaining strong fundamentals through a deterioration in the macro environment would be positive for the credit.

Rating drivers (Details)

1. Strong franchise as the leading financial institution in Denmark

Danske is by far the largest banking and financial group in Denmark, with a market share of over 25%. Other systemically important groups include Nykredit Realkredit, primarily a mortgage bank, and Nordea Bank Denmark, which respectively account for about 20% and 10% of total banking assets.

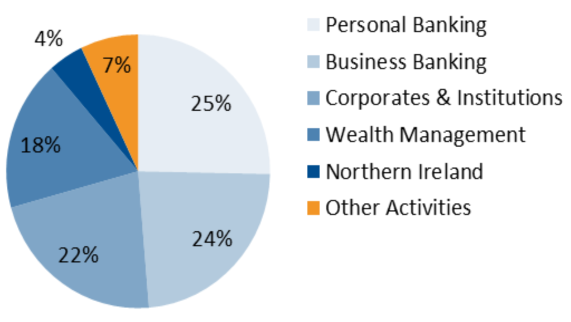
As a universal bank, the group offers a wide range of financial services, including insurance, mortgage finance, asset management, brokerage, real estate and leasing services. Management continues to review and adjust the group's business model. Optimising customer offerings and using digital opportunities to provide innovative solutions are key priorities.

Danske pursues its strategy to be a Nordic universal bank with operations in Denmark, Sweden, Norway, Finland, and the Baltic region. Danske Bank Northern Ireland – which holds about 20% of the local lending market – operates as a separate business unit as there are limited operational synergies and customer interactions with the rest of the group.

The Wealth Management unit comprises private banking, pension savings and asset management.

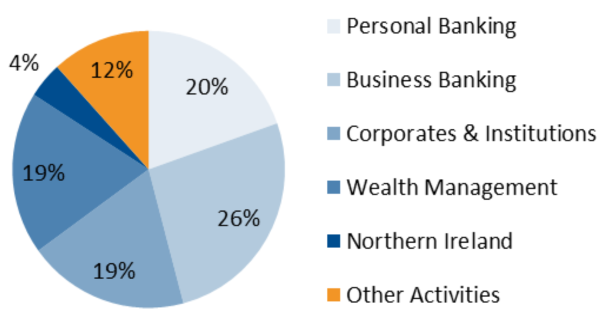
The Corporate & Institutions business accounts for about a fifth of the group's total income and is an important part of Danske's offering as a Nordic universal bank. Over half of the unit's income is derived from trading (capital markets, sales and research, and market-making). However, with market and regulatory changes impacting profitability, management is now aiming to increase client-driven income, reduce volatility in the FICC business, and enhance cost and capital efficiency.

Figure 1: Total income by business unit



Notes: Data as of year-end 2016.
Source: Company data, Scope Ratings

Figure 2: Pre-tax income by business unit



Notes: Data as of year-end 2016.
Source: Company data, Scope Ratings

2. Reassuring capital metrics, supported by improved earnings and regulatory requirements

In 2016, Danske reported net attributable profits of almost DKK 20bn, its highest level ever and well above the pre-crisis peak in 2007. Also, as opposed to previous years, no material goodwill impairments tarnished the strong operating performance. The reported RoE of 13.1% is above the long-term management target of 12.5%. The strong profitability offers additional protection on losses, on top of an already strong capital position.

At year-end 2016, the group's total capital ratio was 21.8%, with the CET1 ratio being 16.3%, above Danske's own capital targets (19% and 14-15% respectively).

Both ratios were also well ahead of regulatory requirements: for 2016, Danske was subject to a solvency need of 10.6%, including 8% under Pillar 1 and 2.6% under Pillar 2. The bank also had a combined buffer requirement of 2.2%, including a countercyclical buffer (0.4%), a systemic buffer (1.2%) and a capital conservation buffer (0.6%).

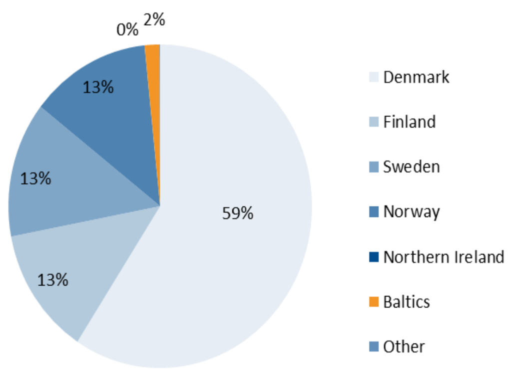
Since June 2014, Denmark's FSA has designated Danske as being systemically important financial institution. Consequently, the group is subject to a capital buffer requirement of 3%, which is being phased in between 2015 and 2019 and must be met with CET1 capital. This comes on top of the capital conservation buffer (2.5%), also subject to phasing in. An additional countercyclical buffer requirement may be imposed for Danish assets during periods of high loan growth. The bank is already subject to countercyclical capital requirements in its Swedish and Norwegian operations, totaling 0.4% at YE16. We estimate that the total combined buffer requirement will reach 6% by 2019.

Including all buffers, we estimate Danske's total capital requirement in 2019 to stand at 16.6%.

3. Management's measured execution of its strategy to be a universal Nordic bank

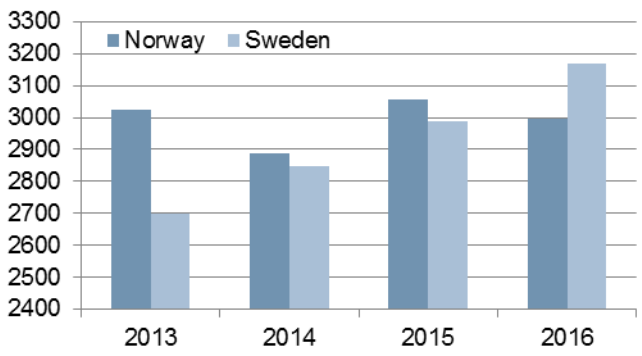
In Norway and Sweden, the group is a challenger bank with a market share of around 5.2% and 5.9% respectively in lending and a focus on mass affluent customers. Danske is targeting growth in these two markets, but given their consolidated nature, progress is expected to be slow. However, in both of these countries, Danske has entered into agreements with professional associations to enable the bank to target specific customer groups. In Sweden, Danske has applied to establish a mortgage finance institution, which should become operational in 2017.

IFigure 3: Personal and business income by country



Notes: Data as of year-end 2016.
Source: Company data, Scope Ratings

Figure 4: Income development in Norway and Sweden (DKK m)



Note: Income is equal to Personal and Banking total income.
Source: Company data, Scope Ratings

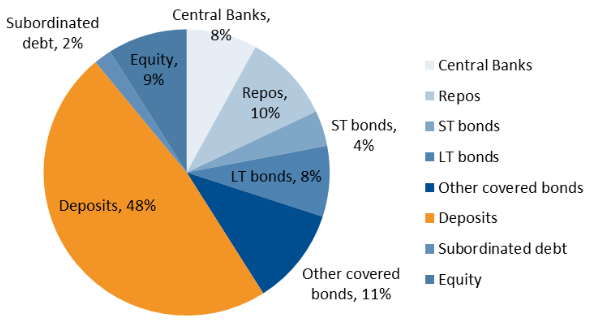
The macro-economic conditions in Norway and Sweden did not suffer materially from the global downturn and did not have recent domestic house price corrections – as occurred in Denmark, Danske's home market, in 2008. Of the three countries, however, Scope believes Norway and Sweden will face greater challenges. Last year, the Danish FSA reviewed Danske's lending in these countries, in light of the group's growth plans and the markets' considerable property price increases over several years. The Danish FSA requested the group to improve its basis for approving credit facilities to personal customers in Sweden, and Danske has communicated that it will. If growth is prudently pursued, the group could benefit from more diversified and stable earnings.

4. Material dependence on market funding, but the large and stable component of covered bonds substantially mitigates this risk

In general, we consider a bank with a material dependence on market funding, especially for long-term loan assets, to be vulnerable to sudden changes in market sentiment, as was evidenced during the recent financial crisis. As with other large Nordic banks, Danske's loan-to-deposit ratio appears high, with group loans being almost double the balance of deposits. However, nearly 50% of the loan portfolio is funded by covered bonds issued by Realkredit Denmark, a fully owned subsidiary and Denmark's second-largest specialist mortgage bank (Figure 6). Realkredit Denmark issues covered bonds under the 'specific balance' principle (pass-through), i.e. by matching its lending and limiting exposure to market risks.

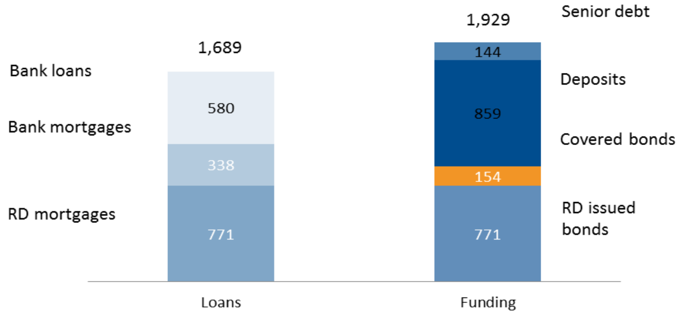
Like other Nordic banks, Danske relies extensively on covered bonds for funding, with deposits accounting for around half of total funding. This is due largely to the market's structure: private customers prefer to place their savings in life insurance/pensions than in deposits. Furthermore, first lien mortgage lending in Denmark has historically been funded by covered bonds. The Danish covered bond market is one of the oldest and largest in the world and has proven to be a stable funding source.

Figure 5: Funding sources



Notes: Data as of year-end 2016. Excludes bonds issued by RD.
Source: Company data, Scope Ratings

Figure 6: Loan portfolio and long-term funding



Note: Data as of year-end 2016; RD: Realkredit Denmark
Source: Company data, Scope Ratings

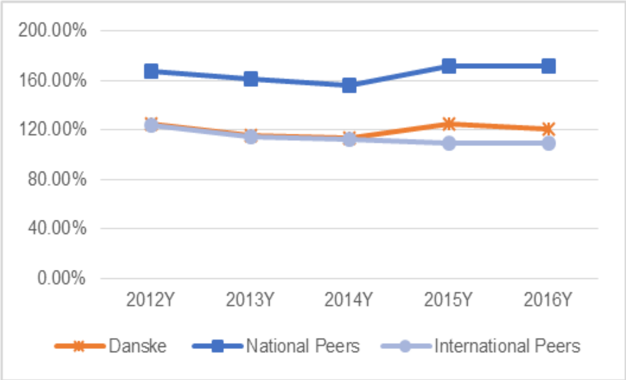
Since 2007, Danske Bank itself has also issued covered bonds under a EUR 30bn global covered bond programme, using assets from banking activities in Denmark, Norway and Sweden. In the future, Swedish banking activities will be funded by covered bonds issued by a separate issuer in Sweden. Residential loans from Finland are also used to issue covered bonds under a EUR 10bn medium-term note and covered bond programme, with Danske Bank plc as the issuer (a fully owned subsidiary). In February 2017 Danske announced that it would be looking to merge Danske Bank plc into the local branch of Danske Bank A/S. At the same time, a new subsidiary – Danske Mortgage Bank plc -- would be established to house the covered bond operations, as Finnish legislation requires that a Finnish limited liability company is the holder of a mortgage credit banking licence.

For liquidity management purposes, the group distinguishes between Danish kroner and other currencies. This is because, for Danish kroner, deposits exceed lending; whereas the opposite applies for the other currencies. The liquidity coverage ratio (LCR) for the group was a reassuring 158%.

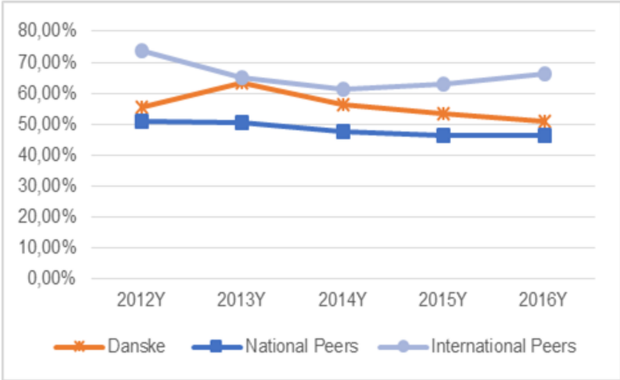
Danske maintains an ample liquidity reserve, DKK 538bn in December 2016, comprising mainly cash and high-quality liquid assets, including central bank deposits, sovereign bonds and covered bonds.

Appendix A: Peer comparison

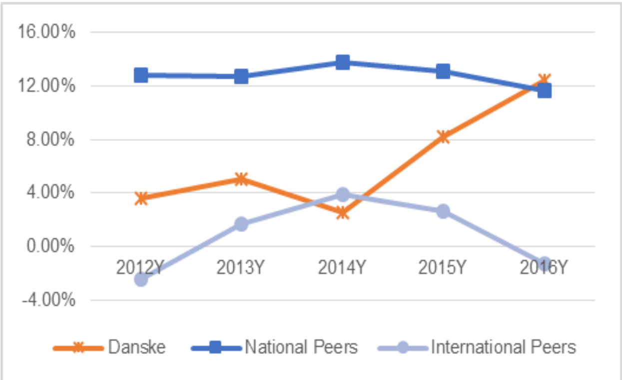
Gross loans % Total deposits



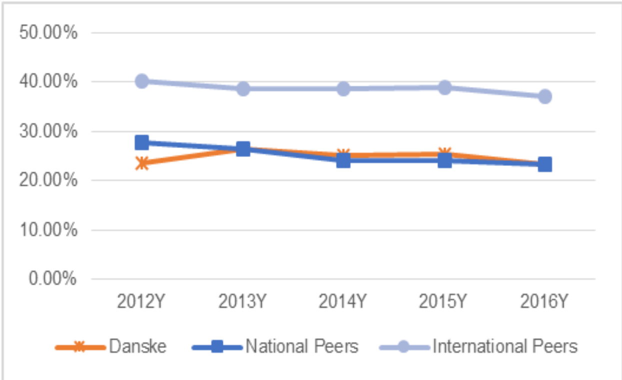
Cost % Income



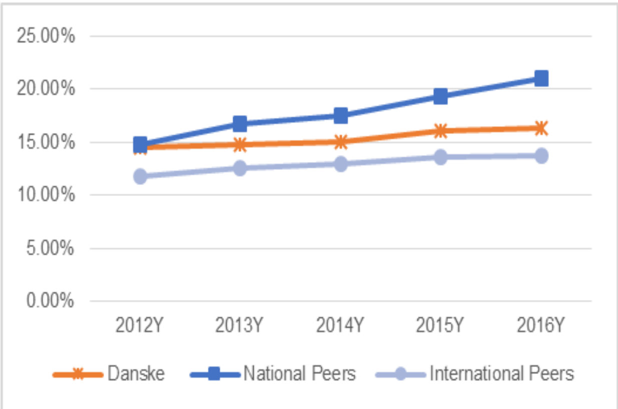
Return on average equity (ROAE) (%)



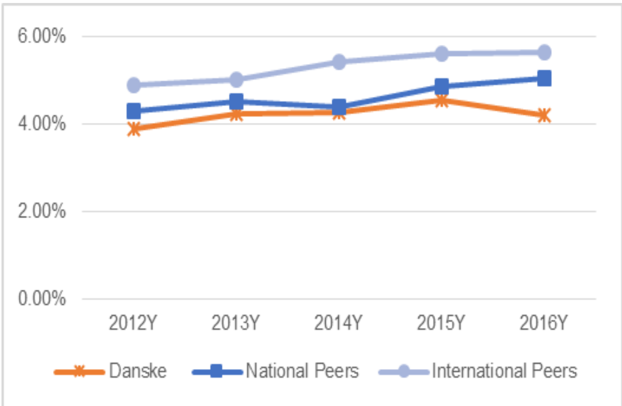
Asset risk intensity (RWAs % total assets)



Common equity tier 1 ratio (transitional) (%)



Tier 1 leverage ratio (%)



Source: SNL, Scope Ratings
*Nordic peers: Danske, DNB, Handelsbanken, SEB, Swedbank, Nordea.
**Cross-border peers: Credit Agricole, RBS, BPCE, Lloyds, Rabobank, Credit Mutuel, Intesa, Commerzbank, Danske, DZ Bank, ABN AMRO, Caixa bank, Handelsbanken, DNB, SEB, Swedbank, La Banque Postale, Sadabell, Banco Popular, Bank of Ireland, Banco Popolare, UBI Banca, National Bank of Greece, AIB, Caixa Geral

Appendix B: Selected financial information – Danske

	2012Y	2013Y	2014Y	2015Y	2016Y
Balance sheet summary (DKK Mn)					
Assets					
Cash and interbank assets	297,913	175,102	146,636	180,696	298,690
Total securities	920,651	857,641	1,073,509	890,322	853,014
of which derivatives	408,990	249,535	409,444	331,013	326,432
Net loans to customers	1,894,578	1,816,809	1,834,511	1,820,917	1,907,570
Other assets	371,807	377,505	398,359	400,943	424,396
Total assets	**3,484,949**	**3,227,057**	**3,453,015**	**3,292,878**	**3,483,670**
Liabilities					
Interbank liabilities	459,932	312,597	329,048	271,588	272,883
Senior debt	954,330	924,373	986,172	1,058,450	1,119,244
Derivatives	388,696	228,940	389,746	320,270	328,080
Deposits from customers	929,092	943,901	966,197	863,474	943,865
Subordinated debt	67,785	66,219	41,028	39,991	37,831
Other liabilities	547,110	605,370	588,441	578,275	615,152
Total liabilities	**3,346,945**	**3,081,400**	**3,300,632**	**3,132,048**	**3,317,055**
Ordinary equity	138,000	145,657	146,708	149,513	152,272
Equity hybrids	0	0	5,673	11,317	14,343
Minority interests	4	0	2	0	0
Total liabilities and equity	**3,484,949**	**3,227,057**	**3,453,015**	**3,292,878**	**3,483,670**
Core tier 1 / common equity tier 1 capital	119,097	125,509	130,403	134,358	132,694
Income Statement summary (DKK Mn)					
Net interest income	34,954	33,432	34,607	33,333	32,329
Net fee & commission income	8,233	8,790	9,814	10,679	10,147
Net trading income	12,735	8,146	8,854	6,908	13,096
Other income	-6,608	-8,093	-7,847	-4,133	-7,136
Operating income	**49,314**	**42,275**	**45,428**	**46,787**	**48,436**
Operating expense	27,462	26,715	25,572	24,897	24,647
Pre-provision income	**21,852**	**15,560**	**19,856**	**21,890**	**23,789**
Credit and other financial impairments	12,529	5,420	3,718	-61	-168
Other Impairments	784	81	9,169	4,489	0
Non-recurring items	0	0	1,000	300	1,400
Pre-tax profit	**8,539**	**10,059**	**7,969**	**17,762**	**25,357**
Discontinued operations	0	0	0	0	0
Other After-tax Items	0	0	0	0	0
Income tax expense	3,814	2,944	4,020	4,639	5,500
Net profit attributable to minority interests	4	0	2	0	0
Net profit attributable to parent	**4,721**	**7,115**	**3,946**	**13,123**	**19,858**

Source: SNL, Scope Ratings

Appendix C: Ratios – Danske

	2012Y	2013Y	2014Y	2015Y	2016Y
Funding and Liquidity					
Loans / Deposits (%)	125.0%	115.3%	113.1%	125.0%	120.9%
Liquidity Coverage Ratio (%)	121.0%	127.0%	129.0%	125.0%	158.6%
Asset mix, quality and growth					
Loans / Assets (%)	54.4%	56.3%	53.1%	55.3%	54.8%
Impaired & Delinquent Loans/ Loans (%)	NA	NA	NA	NA	NA
Loan-loss reserves / Impaired loans (%)	48.8%	57.7%	56.7%	55.9%	56.8%
Net loan growth (%)	2.6%	-4.1%	1.0%	-0.7%	4.8%
Impaired loans/ Tangible equity & reserves (%)	57.7%	46.3%	39.6%	30.2%	24.7%
Asset growth (%)	1.8%	-7.4%	7.0%	-4.6%	5.8%
Earnings and Profitability					
Net interest margin (%)	1.1%	1.1%	1.2%	1.1%	1.1%
Net interest income / RWAs (%)	4.0%	4.1%	3.9%	3.8%	3.9%
Net interest income / Revenues (%)	70.9%	79.1%	76.2%	71.2%	66.7%
Fees & commissions / Revenues (%)	16.7%	20.8%	21.6%	22.8%	20.9%
Cost / income ratio (%)	55.7%	63.2%	56.3%	53.2%	50.9%
Operating expenses / RWAs (%)	3.1%	3.3%	2.9%	2.9%	3.0%
Pre-provision income / RWAs (%)	2.5%	1.9%	2.3%	2.5%	2.9%
Loan-loss provision charges / Pre-provision income (%)	57.3%	34.8%	18.7%	-0.3%	-0.7%
Loan-loss provision charges / Gross loans (%)	1.0%	0.5%	0.3%	0.0%	0.0%
Pre-tax profit / RWAs (%)	1.0%	1.2%	0.9%	2.0%	3.1%
Return on average assets (%)	0.1%	0.2%	0.1%	0.4%	0.6%
Return on average RWAs (%)	0.5%	0.9%	0.5%	1.5%	2.4%
Return on average equity (%)	3.7%	5.0%	2.6%	8.3%	12.4%
Capital and risk protection					
Common equity tier 1 ratio (%, fully loaded)	14.5%	14.7%	13.8%	15.4%	16.2%
Common equity tier 1 ratio (%, transitional)	14.5%	14.7%	15.1%	16.1%	16.3%
Tier 1 capital ratio (%, transitional)	18.9%	19.0%	16.7%	18.5%	19.1%
Total capital ratio (%, transitional)	21.3%	21.4%	19.3%	21.0%	21.8%
Tier 1 leverage ratio (%)	3.9%	4.2%	4.3%	4.5%	4.2%
Asset risk intensity (RWAs / total assets, %)	23.5%	26.4%	25.1%	25.3%	23.4%
Market Indicators					
Price/ Book (x)	0.7x	0.9x	1.1x	1.2x	1.3x
Price/ Tangible Book (x)	0.8x	1.0x	1.2x	1.3x	1.4x
Dividend payout ratio (%)	0.0%	28.1%	149.5%	63.2%	44.9%

Source: SNL, Scope Ratings

Ratings *

Issuer Rating	**A+**
Outlook	Stable
Senior unsecured debt	A
Additional Tier 1 instruments	BBB-
Short-term debt rating	S-1
Short-term debt rating outlook	Stable
Senior secured Danish mortgage-covered bonds (cover pools C, D and I) AAA	
Covered bonds rating outlook	Stable

* The ratings are not applicable to debt issued by unguaranteed subsidiaries of the rated parent.

Legal and regulatory disclosures

Information pursuant to Regulation (EC) No 1060/2009 on credit rating agencies, as amended by Regulations (EU) No. 513/2011 and (EU) No. 462/2013

Responsibility
This report is issued by Scope Ratings AG, Berlin, District Court for Berlin (Charlottenburg) HRB 161306 B, Executive Board: Torsten Hinrichs (CEO), Dr Stefan Bund.
The Lead Analyst is Jennifer Ray, Executive Director.
Responsible for approving all rating actions: Sam Theodore, Managing Director.

Rating history
Rating for DANSKE BANK A/S was first assigned 19.11.2014 and last updated on 08.06.2017

The rating outlook indicates the most likely direction of the rating if the rating were to change within the next 12 to 18 months. A rating change is, however, not automatically ensured.
The ratings were not requested by the issuers (unsolicited rating) and were prepared with participation of the issuers.

Key sources of information for the rating

Key sources: Third parties and Public domain. Key information: Website of the rated entity | Annual reports/semi-annual reports of the rated entity | Data provided by external data providers | other public information

Scope Ratings considers the quality of the available information on the evaluated company to be satisfactory. Scope uses information and data that it considers to be accurate and reliable. Scope cannot, however, independently verify the reliability and accuracy of such information and data.

Examination of the rating by the rated entity prior to publication
Prior to publication, the rated entities were given the opportunity to examine the rating and the rating drivers, including the principal grounds on which the credit rating or rating outlook is based. The rated entity was subsequently provided with at least one full working day, to point out any factual errors, or to appeal the rating decision and deliver additional material information. Following that examination, the ratings were not modified.

Methodology
The methodologies applicable for this rating actions “Bank Rating Methodology” (May 2017) is available on www.scoperatings.com. The historical default rates of Scope Ratings can be viewed on the central platform (CEREP) of the European Securities and Markets Authority (ESMA): http://cerep.esma.europa.eu/cerep-web/statistics/defaults.xhtml. A comprehensive clarification of Scope’s default rating, definitions of rating notations and further information on the analysis components of a rating can be found on www.scoperatings.com.

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