S&P Global
Ratings

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Nykredit Realkredit A/S

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Nykredit Realkredit A/S

SACP	a-
Anchor	bbb+	
Business Position	Adequate	0
Capital and Earnings	Strong	+1
Risk Position	Adequate	0
Funding	Average	0
Liquidity	Adequate	

+

Support	+1
ALAC Support	+1
GRE Support	0
Group Support	0
Sovereign Support	0

+

Additional Factors	0

Issuer Credit Rating
A/Stable/A-1

Major Rating Factors

Strengths:	Weaknesses:
• Leading mortgage bank in Denmark. • Highly collateralized nature of the loan book. • Sustainable and improving core earnings and profitability, despite low interest rate environment.	• Structural mismatch of assets and liabilities. • Low-margin nature of domestic residential mortgage lending business. • High household debt in the Danish economy.

Outlook: Stable

The stable outlook on Denmark-based financial institution Nykredit Realkredit A/S and its subsidiary Nykredit Bank A/S reflects S&P Global Ratings' view that the Nykredit Realkredit will improve its additional loss-absorption capacity (ALAC) and continue to successfully realign its funding profile over the next two years. In our view, the improvements in earnings capacity, strong ALAC issuance performance in the last 12 months, and expectations of additional capital via an IPO in the next 24 months support a stable outlook. Nevertheless, we acknowledge that the bank's funding and liquidity metrics remain weaker than peers', and despite the strengthening of Nykredit Realkredit's funding profile, further improvements are necessary to reduce the use of short-term wholesale funding.

We could lower the long-term rating if we saw a deviation from our projection of material further improvement in Nykredit Realkredit's funding profile, in particular after large amounts of debt mature in 2017. This could lead us to revise down our assessment of Nykredit Realkredit's stand-alone credit profile (SACP) and lower the ratings. In addition, a downgrade could occur if ALAC issuances stall, reducing the protection these instruments provide for senior unsecured creditors that we currently view as supportive of the current ratings.

We are unlikely to raise the rating at this time. We note that the completion of a successful IPO could improve Nykredit Realkredit's SACP by strengthening our assessment of capital and earnings. However, this would reduce the excess capital in the bank's ALAC buffers, likely leading us to remove the additional notch for ALAC support.

Rationale

Our ratings on Nykredit Realkredit reflect its anchor of 'bbb+', its adequate business position, strong capital and earnings, adequate risk position, average funding, and adequate liquidity. We equalize our ratings on Nykredit Bank A/S with those on its parent. This is based on our assessment of Nykredit Bank as a core subsidiary of the Nykredit group, as defined under our group rating methodology.

Anchor: 'bbb+' for banks operating only in Denmark

Under our bank criteria, we use our Banking Industry Country Risk Assessment's economic risk and industry risk scores to determine a bank's anchor, the starting point in assigning an issuer credit rating. Our anchor for a commercial bank operating only in Denmark is 'bbb+', based on an economic risk score of '3' and an industry risk score of '4'.

We view Denmark as a politically stable, wealthy, and high-income country that has suffered since the 2008-2009 global financial market crisis. The economy is competitive and diverse and once again in an expansionary phase, with house price appreciation and credit growth expected to increase in the coming two years. Although decreasing, household debt remains high and a constraint to our assessment of economic risk. Consequently, we expect Denmark's economy will continue improving, supported by its balanced fiscal policy flexibility and strong external position following a decade of sizable current account surpluses.

We view the regulatory environment in Denmark as in line with that of other EU countries. We observe an overall improvement in the banking sector's profitability that, in our view, should continue through cost-cutting and decreasing losses. This should enable the sector, including lower yielding mortgage banks, to report a return on equity (ROE) of 6%-7% for 2015. We also note the banking sector's higher reliance than peers' on functioning wholesale markets. However, we expect this dependence will reduce further, due to continuing measures of individual banks and the regulator.

Table 1

Nykredit Realkredit A/S Key Figures

		--Year ended Dec. 31--			
(Mil. DKK)	**2016***	**2015**	**2014**	**2013**	**2012**
Adjusted assets	1,407,041	1,383,518	1,455,049	1,414,360	1,429,700
Customer loans (gross)	1,186,102	1,175,085	1,197,647	1,192,772	1,193,977
Adjusted common equity	62,355	60,607	55,606	55,055	52,754
Operating revenues	4,835	12,636	8,120	10,803	10,889
Noninterest expenses	2,435	4,964	5,021	5,391	4,903
Core earnings	1,803	5,258	658	2,408	3,262

*Data as of June 30. DKK--Danish krone.

Business position: Denmark's premier mortgage provider, striving for higher returns

Nykredit Realkredit's business position is adequate, reflecting its sustained business stability even throughout a period of extraordinary market stress in Europe, and Denmark specifically. This is partially offset by our expectation of continued limited business diversification. The group's primary focus is mortgage lending in Denmark, while commercial banking services--where Nykredit Bank has a market share of roughly 5%--and asset management are still of secondary importance to the group's performance. The Danish mortgage market is built on a business model that has proven stability and relatively low margins for more than 150 years.

Nykredit Realkredit reported total assets of Danish krone (DKK)1.4 trillion as of June 30, 2016 (€188 billion). Nykredit Realkredit's share of the domestic mortgage lending market varies by segment, but averages about 41%, making it the market leader. Through its subsidiary Totalkredit's cooperation with partner banks, we expect Nykredit will remain the market leader in residential real estate financing. It derives about 73% of its core earnings from its mortgage lending platform, and its core subsidiary Nykredit Bank the remainder.

Nykredit Realkredit and its global peers will be subject to increased capital requirements in the coming years and will be required to comply with higher core equity tier 1 capital (CET1) and capital ratios. In order to prepare for this, Nykredit Realkredit has announced its plan to raise equity via an initial public offering (IPO) and eventual listing on the Copenhagen stock exchange. We do not anticipate a significant increase in strategic risks or the risk profile as a result of new ownership. In addition, Nykredit Realkredit increased its administration margins for all Totalkredit loans applicable from July 1, 2016, in an effort to improve its long-term capital situation and return on required capital metrics. Nykredit Realkredit faced significant negative media due to this change and announced that, as of end April, DKK2.6 billion in loans with Totalkredit had been terminated. We note, however, that the market has calmed and that key competitors Danske Bank and Nordea increased their margins in June. Moreover, Nykredit Realkredit introduced a profit-sharing model "KundeKroner", where Nykredit Realkredit will share the profits with customers in the form of discounts financed by future dividends paid out to the Nykredit Association.

We have historically seen strength in Nykredit Realkredit's mutual organization and note that, the Nykredit Association is expected to retain its controlling interest even after the IPO. Nykredit Realkredit is Denmark's leading provider of mortgage financing, its second-largest financial services group, fifth-largest commercial bank, and the largest lender by domestic volume in Denmark. In our view, Nykredit Realkredit's prominent role in the Danish mortgage market and its mutual model have contributed to relatively lower margins for all Danish mortgage banks when compared with similar international mortgage lenders. However, Nykredit Realkredit redefined its strategic objectives earlier in 2015 and aims to achieve a pre-tax ROE of 11% by 2018. We recognize that Nykredit Realkredit's market position allows significant pricing power and believe that the recent administrative fee increase will help Nykredit Realkredit to move toward its targets in preparation for the IPO and contribute to better overall profitability within the Danish mortgage market.

Strategically, we expect Nykredit Realkredit to aim to improve market share outside of its dominant mortgage position and to compete more directly with other larger banking groups such as Nordea, Danske Bank, and Jyske Bank by offering to provide their private individual retail clients a full-service offering via its subsidiary, Nykredit Bank. As part of its new strategy, Nykredit Realkredit envisages a gradual expansion of its banking and asset management operations to support the full-service customer concept in a market with limited credit demand. We believe the group is able to retain its position in mortgage finance, building on its strong cooperation with regional banks via its Totalkredit subsidiary. Accordingly, over the short to medium term, we expect the group's strategic focus will remain on improving its financial performance to rival its strong Nordic peer group prior to the IPO.

Table 2

Nykredit Realkredit A/S Core Income Per Business Line

(Mil DKK)						2016Q2	FY2015	FY2014
Core income	**Retail**	**Wholesale clients**	**Totalkredit partners**	**Wealth management**	**Group items**	**Total**	**Total**	**Total**
-Business operations	3,063	1,074	1,300	338	50	5,825	11,945	11,509
-Value adjustments derivatives	--	--	--	--	--	--	410	(3,362)
-Senior and subordinated debt	(48)	(4)	(72)	0	(108)	(232)	(610)	(936)
-Other					21	21	38	130
Total core income	3,015	1,070	1,228	338	(37)	5,614	11,783	7,341
Operating costs	1,612	336	282	194	11	2,435	5,066	5,103
Core earnings before impairments	1,403	734	946	144	(48)	3,179	6,717	2,238
Impairments	267	(167)	8	23	(6)	125	920	2,351
Core earnings	1,136	901	938	121	(42)	3,054	5,797	(113)

DKK--Danish krone.

Nykredit Realkredit's plan involves focusing on homeowners and increasing its market share in traditional retail products, while also continuing to develop its partnership with local Danish banks through subsidiary Totalkredit. The plan further entails downscaling of its market activities not directly supporting its core clients, continued decreases in headcount and costs, and the aim to meaningfully reduce capital consumption.

We believe the plan to be achievable and consequently expect Nykredit Realkredit will compete more directly with other larger banking groups such as Nordea, Danske Bank, and Jyske Bank by offering to provide their private individual retail clients a full-service offering. We believe the group is able to retain its position in mortgage finance, building on its strong cooperation with regional banks. As part of its new strategy, Realkredit envisages a gradual expansion of its banking and asset management operations to support the full-service customer concept in a market with limited credit demand. Accordingly, over the short to medium term, we expect the group's strategic focus will remain on increasing revenues by acquiring more full-service clients and improving cost efficiency.

Table 3

Nykredit Realkredit A/S Business Position

		--Year ended Dec. 31--			
(%)	**2016***	**2015**	**2014**	**2013**	**2012**
Loan market share in country of domicile	30.3	30.6	31.0	31.4	31.1
Deposit market share in country of domicile	5.5	5.1	5.5	5.8	4.6
Total revenues from business line (mil. DKK)	4,835	12,636	8,120	10,803	10,889
Commercial banking/total revenues from business line	22.1	21.3	11.7	15.3	19.9
Retail banking/total revenues from business line	87.8	72.9	84.1	62.9	53.8
Commercial & retail banking/total revenues from business line	109.9	94.2	95.7	78.2	73.6
Asset management/total revenues from business line	7.0	6.4	9.7	7.3	7.2

Table 3

Nykredit Realkredit A/S Business Position (cont.)					
		--Year ended Dec. 31--			
(%)	2016*	2015	2014	2013	2012
Other revenues/total revenues from business line	(16.9)	(0.5)	(5.4)	14.5	19.2
Return on equity	5.8	5.3	(0.5)	2.9	4.7

*Data as of June 30. DKK--Danish krone.

Capital and earnings: Retained earnings support steady capital built over many years

We expect Nykredit Realkredit's capital and earnings will remain strong, reflecting our expectation that the company's risk-adjusted capital (RAC) ratio, which stood at 11.2% on June 30, 2016, will remain at 11%-12% over the next 18-24 months (excluding any proceeds from the eventual IPO) and remain sustainably above our 10% threshold. In our measure of total adjusted capital, we include the €500 million additional tier 1 instrument issued in early 2015 and the €600 million tier 2 contingent capital instruments issued in May 2014 as hybrids.

We believe Nykredit Realkredit will be able to further build capital internally and later through the proposed IPO to satisfy higher regulatory requirements. Nykredit Realkredit targets a CET1 capital level of 17.5% in 2019. This is equivalent to approximately DKK70 billion of CET1 capital, compared with DKK61.6 billion on June 30, 2016. The CET1 ratio was 20.2% on the same date. We anticipate that management's plan to generate annual net profits of about DKK4.5 billion-DKK5 billion in 2017 and 2018 is achievable, supporting our capital assessment. We consider the quality of capital to be high, as 7% capital trigger hybrids form around 12% of total adjusted capital.

Higher capital requirements are expected, due to the expected implementation of a capital floor for institutions under Institutional Review Board regulation in 2017 and introduction of floors to the parameters used in the internal models (PD and LGD), leading to higher capital requirements for mortgage loans. We acknowledge that Nykredit Realkredit is preparing to increase capital levels through its IPO to be able to meet the regulatory requirements, which further underpin our forecast of a RAC ratio comfortably higher than 10% over the next 24 months.

Nykredit Realkredit's dual objective strategy is intended to improve the group's core business result by DKK1.5 billion, with full effect in 2018, compared with our 2016 forecast results of DKK3.8 billion. Most of this increase should come from higher margins and increased revenues by capturing more full-service customers with additional income streams. Margins have increased since 2011, and will increase further thanks to revised fees that took effect in July 2016. The net interest margin was at 0.87% for 2015, slightly up from 0.82% in 2014. We expect the group will be able to limit cost growth to achieve a stable cost-to-income ratio between 40%-45% over the next two years and maintain a low level of impairments.

Nykredit Realkredit's core earnings capacity is stable, in our view, given that the group predominantly depends on recurring interest income and that realized credit losses, apart from the acquisition of the problematic Forstaedernes Bank in 2008, were well below our normalized annual loss level of DKK3.9 billion as of 2015. We project actual credit losses to remain between 5 basis points (bps)-10bps in our capital forecast. With volume growth limited by low market demand, the group has focused on margins and cost efficiencies. Core earnings to adjusted assets was 0.26% on June 30, 2016, and we expect the ratio to increase over the next two years, in large part due to higher mortgage margins.

Table 4

Nykredit Realkredit A/S Capital And Earnings

	--Year ended Dec. 31--				
(%)	**2016***	**2015**	**2014**	**2013**	**2012**
Tier 1 capital ratio	21.3	20.5	17.2	18.9	19.1
S&P Global Ratings' RAC ratio before diversification	11.2	10.9	10.4	10.2	9.3
S&P Global Ratings' RAC ratio after diversification	10.3	10.0	9.4	9.3	8.4
Adjusted common equity/total adjusted capital	88.0	87.9	83.0	88.9	88.2
Double leverage	53.9	54.4	51.2	52.6	52.5
Net interest income/operating revenues	113.4	94.0	139.8	95.6	99.5
Fee income/operating revenues	(2.3)	(1.6)	0.6	(2.2)	2.0
Market-sensitive income/operating revenues	(13.4)	6.0	(42.8)	3.7	(4.1)
Noninterest expenses/operating revenues	50.4	39.3	61.8	49.9	45.0
Preprovision operating income/average assets	0.3	0.5	0.2	0.4	0.4
Core earnings/average managed assets	0.3	0.4	0.0	0.2	0.2

*Data as of June 30. RAC--Risk-adjusted capital.

Table 5

Nykredit Realkredit A/S Risk-Adjusted Capital Framework Data

(DKK 000s)	Exposure*	Basel II RWA	Average Basel II RW (%)	S&P Global Ratings' RWA	Average S&P Global Ratings' RW (%)
Credit risk					
Government and central banks	58,832,770	0	0	1,764,983	3
Institutions	62,976,848	7,236,835	11	7,357,101	12
Corporate	343,667,724	128,846,221	37	224,609,418	65
Retail	895,551,463	104,720,014	12	290,144,024	32
Of which mortgage	851,460,402	92,701,561	11	256,640,118	30
Securitization§	0	0	0	0	0
Other assets	6,112,924	5,368,170	88	6,877,039	113
Total credit risk	1,367,141,728	246,171,240	18	530,752,565	39
Market risk					
Equity in the banking book†	4,291,179	12,304,140	296	31,470,190	733
Trading book market risk	--	26,038,115	--	39,057,172	--
Total market risk	--	38,342,254	--	70,527,363	--
Insurance risk					
Total insurance risk	--	--	--	0	--
Operational risk					
Total operational risk	--	19,635,924	--	28,968,657	--
(DKK 000s)		**Basel II RWA**		**S&P Global Ratings' RWA**	**% of S&P Global Ratings' RWA**
Diversification adjustments					
RWA before diversification		305,701,696		630,248,584	100

Table 5

Nykredit Realkredit A/S Risk-Adjusted Capital Framework Data (cont.)				
Total Diversification/Concentration Adjustments	--		58,834,136	9
RWA after diversification	305,701,696		689,082,720	109
(DKK 000s)	**Tier 1 capital**	**Tier 1 ratio (%)**	**Total adjusted capital**	**S&P Global Ratings' RAC ratio (%)**
Capital ratio				
Capital ratio before adjustments	65,005,898	21.3	70,830,000	11.2
Capital ratio after adjustments‡	65,005,898	21.4	70,830,000	10.3

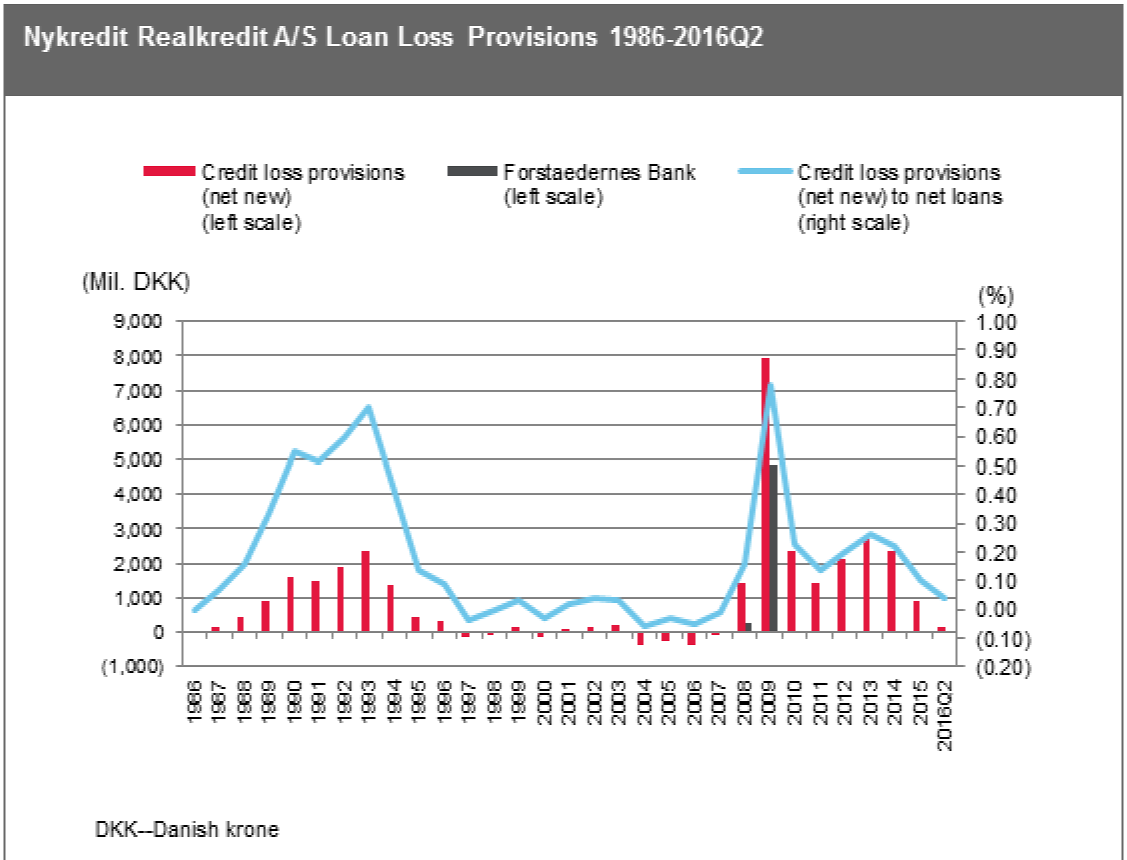
*Exposure at default. §Securitisation Exposure includes the securitisation tranches deducted from capital in the regulatory framework. †Exposure and S&P Global Ratings' risk-weighted assets for equity in the banking book include minority equity holdings in financial institutions. ‡Adjustments to Tier 1 ratio are additional regulatory requirements (e.g. transitional floor or Pillar 2 add-ons). RWA--Risk-weighted assets. RW--Risk weight. RAC--Risk-adjusted capital. DKK--Danish krone. Sources: Company data as of June 30, 2016, S&P Global Ratings.

Risk position: First-priority mortgages with relatively low losses

Our analysis of a bank's risk position serves to refine the view of its actual and specific risks beyond our capital and earnings assessment. The adequate risk position assessment reflects that Nykredit Realkredit's asset quality is comparable with that of peers, both domestically and internationally, and aligned with the capital requirements we apply as part of our analysis of capital for its portfolio of mainly retail and commercial mortgages and some commercial mortgages.

As a consequence of the group's position as the country's largest mortgage lender, Nykredit Realkredit's asset quality has a strong correlation between developments in the Danish economy and the domestic property market. When the crisis began in 2008, losses mounted in line with a rise in bankruptcies and property foreclosures and continued with sizable losses in 2009, due in large part to the acquisition of Forstaedernes Bank (see chart).

However, the economy in Denmark is recovering and both foreclosures and bankruptcies are on a clear positive trend toward recovery, as well. We expect Nykredit Realkredit will maintain its current provision level, remaining between 5 bps-10bps of loans for the next two years, given the low interest rate environment and the slow, but steady, recovery of the rural housing markets in Denmark.



The bank's mortgage portfolio includes personal customers, which form 61% of the mortgage loans; commercial loans form 31% and agriculture loans the remaining 8%. Overall, the loan-to-value (LTV) ratio for the entire mortgage loan book was around 65% at June 2016. We consider the risk management practices as adequate and believe the management is prudent in its lending and underwriting standards.

The agricultural sector in Denmark continues to trail the broader economy, in particular for pork farmers, and dairy prices are volatile. Combined with high initial leverage, the agricultural sector has seen an elevated number of defaults over the past five years. However, recent data suggest an improved economic situation for a majority of pork farmers, as prices have stabilized. There has been a recent resurgence in arrears over 75 days, but we expect Nykredit Realkredit, which is the first-lien mortgage lender, to be in a relatively good position and its portfolio of DKK94 billion to be well-provisioned for any future bankruptcies in the sector. In addition, the bank has a lower LTV limit of 60% for agriculture mortgage loans and the average LTV was 58% at June 2016.

In October 2013, Denmark's financial supervisory authority Finanstilsynet adjusted provisioning requirements for swap contracts with weak counterparties within the "Andelsboligforeninger" sector (cooperative housing associations). As of June 30, 2016, the total accumulated impairment provisions for valuation changes in interest rate swaps amounted to DKK6.1 billion compared with a total loss on terminated contracts of DKK716 million since the start of 2012. The reason for the provisions derives mainly from the increasing market values of 30-year swap contracts as interest rates have come down, leading to a less favorable position for the borrowers. A recent Supreme Court decision overturned a previous ruling in favor of Nykredit Realkredit, allowing housing associations to go into bankruptcy in certain situations. We believe that the current swap provisions more than cover the outstanding value of swaps for the small number of cooperatives where a default would be likely.

We consider Nykredit Realkredit's concentration and diversity as adequate. Since Nykredit Realkredit is the largest mortgage lender in Denmark, mortgage loans form 80% of the total asset size of Nykredit Realkredit as of June 30, 2016, with 95% of exposures within Denmark and the remaining 5% in Sweden, Germany, and other European countries. Within Denmark, the loans are well diversified.

Table 6

Nykredit Realkredit A/S Risk Position

		--Year ended Dec. 31--			
(%)	**2016***	**2015**	**2014**	**2013**	**2012**
Growth in customer loans	1.9	(1.9)	0.4	(0.1)	4.0
Total diversification adjustment / S&P Global Ratings' RWA before diversification	9.3	9.7	10.6	9.4	10.6
Total managed assets/adjusted common equity (x)	22.6	22.8	26.2	25.7	27.2
New loan loss provisions/average customer loans	0.0	0.1	0.2	0.3	0.2
Net charge-offs/average customer loans	0.0	0.0	0.0	0.0	0.1
Gross nonperforming assets/customer loans + other real estate owned	1.7	1.9	1.8	1.5	1.3
Loan loss reserves/gross nonperforming assets	39.5	38.7	43.0	46.3	46.2

*Data as of June 30. RWA--Risk-weighted assets.

Funding and liquidity: Price initiatives having a substantial positive impact on funding imbalances

Table 7

Nykredit Realkredit A/S Funding And Liquidity Metrics

Outstanding One-Year ARM Loans

	Stable funding ratio (%)	**Broad liquid assets/short-term wholesale funding (x)**	**Stock of outstanding 1-year ARM loans (DKK billion)**
2013	76	0.36	299
2014	77	0.41	242
2015	86	0.49	120
2016Q2	86	0.50	92

ARM Loans--Adjustable resetting mortgage loans. DKK--Danish krone.

In our assessment we reflect that we consider Nykredit Realkredit's funding and liquidity metrics compare negatively with those of international and domestic peers. In our view, Nykredit Realkredit has a larger maturity mismatch between assets and liabilities than international peers. On June 30, 2016, Nykredit Realkredit's broad liquid assets represented only 0.50x its short-term wholesale funding, up from 0.41x on Dec. 31, 2014, and the stable funding ratio was 86.1%, up from 77% on Dec. 31, 2014. Despite the relative weakness of these ratios, they are a pronounced improvement on historical metrics, and we expect the trend to continue as Nykredit Realkredit and its Danish peers adapt to domestic restrictions on short-term financing in the supervisory mortgage diamond and international net stable funding regulations. We note that, through pricing incentives and a flat yield curve, Nykredit Realkredit has reduced the share of one-year adjustable rate mortgages (and corresponding one-year covered bonds thanks to the match principle) to DKK100 billion from DKK300 billion at the end of 2012.

In our base case, we think Nykredit Realkredit will reduce the structural mismatch of asset and liability maturities. However, we expect this change to happen only gradually, with the bank achieving a more balanced profile in 2018. The most important factor underpinning the improvement will be price incentive for borrowers to take up loans with longer maturities, including the margin increases in effect as of July 1, 2016. In addition, the trend toward extending refinancing periods has also been highlighted as one of five key aspects to reduce risk in the sector by the regulatory supervisory diamond on mortgage institutions that proposes to limit mortgage banks' refinancing on a three- and 12-month basis.

Table 8

Nykredit Realkredit A/S Funding And Liquidity					
		--Year ended Dec. 31--			
(%)	**2016***	**2015**	**2014**	**2013**	**2012**
Core deposits/funding base	5.4	4.9	4.9	5.0	4.2
Customer loans (net)/customer deposits	1,693.8	1,863.4	1,822.0	1,817.3	2,177.6
Long term funding ratio	76.6	77.8	68.3	69.2	63.5
Stable funding ratio	86.0	86.4	77.3	76.3	69.7
Short-term wholesale funding/funding base	24.7	23.4	33.3	32.3	38.3
Broad liquid assets/short-term wholesale funding (x)	0.5	0.5	0.4	0.4	0.3
Net broad liquid assets/short-term customer deposits	(240.4)	(256.2)	(428.1)	(453.6)	(704.2)
Short-term wholesale funding/total wholesale funding	25.9	24.5	34.7	33.8	39.7
Narrow liquid assets/3-month wholesale funding (x)	2.1	1.3	1.1	0.8	0.6

*Data as of June 30.

Support: One notch of ALAC support, on expectations of building ALAC of up to 5% by 2017

We include one notch of uplift in the long-term rating on Nykredit Realkredit based on our assessment of its additional loss absorbing capacity (ALAC). We estimate a pro forma ALAC of 3.1% of S&P Global Ratings' risk-weighted assets as of year-end 2015. This includes the bank's two issuances of €500 million in tier 3 senior resolution notes in June and July of 2016, as they also qualify for ALAC ("Nykredit Realkredit's Proposed Senior Subordinated Tier 3 Notes Rated 'BBB+'," May 26, 2016). In addition, Nykredit Realkredit issued three ALAC-eligible instruments in 2015, additional tier 1 capital of €500 million and two tier 2 instruments of €800 million and €50 million. We expect the ALAC will grow to above 5% in 2017 largely through the issuance of additional tier 2 or tier 3 instruments to offset approximately DKK12 billion (€1.6 billion) in junior covered bonds as they mature, and improving ALAC as Nykredit Realkredit prepares for an IPO in the next two years. Also, we expect further issuances to satisfy the debt buffer of 2% of unweighted loans imposed by Danish authorities on the mortgage banks. Given that Danish mortgage banks are exempt from the bail-in powers under BRRD, the Danish authorities have established a 2% buffer of unweighted loans for mortgage banks--to be gradually phased in over five years from 2016 until 2020--in addition to their capital requirements. We expect this buffer will be used in a resolution scenario.

Although we currently include one-notch positive adjustment for ALAC support from the 'a-' SACP, we note that a successful IPO could improve our assessment of the bank's capital and earnings, which would bolster Nykredit

Realkredit's SACP. However, this would reduce the excess capital in Nykredit Realkredit's ALAC buffers, likely prompting us to remove the additional notch for ALAC support.

We view Denmark's resolution regime as effective under our ALAC criteria because, among other factors, we believe it contains a well-defined bail-in process under which authorities would permit non-viable systemically important banks to continue critical functions as going concerns following a bail-in of eligible liabilities. In addition to the tier 3 instruments, we include all Nykredit Realkredit's junior subordinated and nondeferrable subordinated debt instruments (excluding those required for a strong capital and earnings assessment) in our ALAC assessment because, over our projection period, we believe they have capacity to absorb losses without triggering a default on Nykredit Realkredit's senior obligations.

Additional rating factors: None

No additional factors affect this rating.

Core subsidiary: Nykredit Bank A/S

We equalize the rating on core subsidiary Nykredit Bank A/S, Nykredit Realkredit's banking subsidiary, with the ratings on Nykredit Realkredit, according to our group methodology. Nykredit Bank, the group's banking arm, is integral to the group for its payment services and market activities in relation to its funding operations. It also provides all the banking services that are not performed by the parent company.

Related Criteria And Research

Related criteria

- Criteria - Financial Institutions - Banks: Methodology For Mapping Short- And Long-Term Issuer Credit Ratings For Banks - May 04, 2010
- Criteria - Financial Institutions - Banks: Commercial Paper I: Banks - March 23, 2004
- General Criteria: Group Rating Methodology - November 19, 2013
- Criteria - Financial Institutions - Banks: Quantitative Metrics For Rating Banks Globally: Methodology And Assumptions - July 17, 2013
- Criteria - Financial Institutions - Banks: Bank Rating Methodology And Assumptions: Additional Loss-Absorbing Capacity - April 27, 2015
- Criteria - Financial Institutions - Banks: Bank Hybrid Capital And Nondeferrable Subordinated Debt Methodology And Assumptions - January 29, 2015
- Criteria - Financial Institutions - Banks: Banks: Rating Methodology And Assumptions - November 09, 2011
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- Banking Industry Country Risk Assessment: Denmark, Jan. 28, 2016
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- Various Rating Actions On Danish Banks On EU Bank Recovery And Resolution Directive To Be Implemented In Denmark, May 12, 2015
- Credit FAQ: The Danish Covered Bond Market Explained, July 15, 2014
- Credit FAQ: Why Denmark's Proposed Covered Bond Law Doesn't Fully Eradicate Refinancing Risks, Feb. 4, 2014

Anchor Matrix

Industry Risk	Economic Risk									
	1	2	3	**4**	5	6	7	8	9	10
1	a	a	a-	bbb+	bbb+	bbb	-	-	-	-
2	a	a-	a-	bbb+	bbb	bbb	bbb-	-	-	-
3	a-	a-	bbb+	**bbb+**	bbb	bbb-	bbb-	bb+	-	-
4	bbb+	bbb+	bbb+	bbb	bbb	bbb-	bb+	bb	bb	-
5	bbb+	bbb	bbb	bbb	bbb-	bbb-	bb+	bb	bb-	b+
6	bbb	bbb	bbb-	bbb-	bbb-	bb+	bb	bb	bb-	b+
7	-	bbb-	bbb-	bb+	bb+	bb	bb	bb-	b+	b+
8	-	-	bb+	bb	bb	bb	bb-	bb-	b+	b
9	-	-	-	bb	bb-	bb-	b+	b+	b+	b
10	-	-	-	-	b+	b+	b+	b	b	b-

Ratings Detail (As Of October 19, 2016)	
Nykredit Realkredit A/S	
Counterparty Credit Rating	A/Stable/A-1
Junior Subordinated	BB+
Junior Subordinated	BBB
Senior Secured	AA-
Senior Secured	AA-/Stable
Senior Secured	AAA
Senior Secured	AAA/Stable
Senior Unsecured	A
Short-Term Debt	A-1
Subordinated	BBB
Subordinated	BBB+
Counterparty Credit Ratings History	
08-Jul-2016	A/Stable/A-1
13-Jul-2015	A/Negative/A-1
12-May-2015	A+/Watch Neg/A-1
19-Jul-2013	A+/Negative/A-1

Ratings Detail (As Of October 19, 2016) (cont.)	
Sovereign Rating	
Denmark (Kingdom of)	AAA/Stable/A-1+
Related Entities	
Nykredit Bank A/S	
Issuer Credit Rating	A/Stable/A-1
Certificate Of Deposit	
Local Currency	A-1
Senior Unsecured	A
Short-Term Debt	A-1
Totalkredit A/S	
Senior Secured	AAA
Senior Secured	AAA/Stable

*Unless otherwise noted, all ratings in this report are global scale ratings. S&P Global Ratings' credit ratings on the global scale are comparable across countries. S&P Global Ratings' credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.

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