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Research Update:

Nykredit Realkredit Outlook Revised To Stable On Stronger Additional Loss-Absorption Capacity; 'A/A-1' Ratings Affirmed

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Table Of Contents

Overview

Rating Action

Rationale

Outlook

Ratings Score Snapshot

Related Criteria And Research

Ratings List

Research Update:

Nykredit Realkredit Outlook Revised To Stable On Stronger Additional Loss-Absorption Capacity; 'A/A-1' Ratings Affirmed

Overview

- We see that Nykredit Realkredit has made progress in issuing capital instruments qualifying for additional loss-absorption capacity (ALAC), and we estimate that the bank's ALAC ratio will surpass 5% by the end of 2017.
- Our concerns related to the bank's ALAC ratio reaching the 5% threshold have consequently decreased, also based on our projections of tier 2 or tier 3 issues and our expectation of a possible IPO in the next 24 months.
- We are therefore revising our outlook on Nykredit Realkredit and its subsidiary Nykredit Bank to stable from negative, and affirming our 'A/A-1'.
- The stable outlook on Nykredit Realkredit and Nykredit Bank reflects our view that the bank will improve its ALAC and continue to successfully realign its funding profile over our two-year rating horizon.

Rating Action

On July 8, 2016, S&P Global Ratings revised to stable from negative its outlook on Denmark-based financial institution Nykredit Realkredit A/S and its subsidiary Nykredit Bank A/S. We affirmed our 'A/A-1' long- and short-term counterparty credit ratings on both entities.

At the same time, we assigned our 'BBB+' issue rating to Nykredit Realkredit's €500 million tier 3 senior resolution notes.

Rationale

The outlook revision reflects our view that Nykredit Realkredit has made significant progress in issuing capital instruments, including the first global issuance of a tier 3 senior resolution note in June 2016. This issuance qualifies for additional loss-absorption capacity (ALAC), and we now expect the ALAC ratio for the bank to surpass our 5% threshold by 2017. In addition, the February 2016 announcement of an initial public offering (IPO) over the next 24 months would, if executed successfully, support the current ratings. We do not anticipate a significant increase in Nykredit Realkredit's strategic risks or risk profile as a result of new owners entering via the planned IPO. While Brexit could impact the Danish economy, we note that capital markets are functioning, including for U.K. issuers, and we anticipate that Nykredit

Realkredit will want to issue tier 2 and tier 3 instruments over the coming years.

In addition to the June 2016 tier 3 instrument, 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 estimate a pro forma ALAC of 3.1% of S&P Global Ratings' risk-weighted assets for Nykredit Realkredit as of year-end 2015. This includes the bank's new issuance of €500 million in tier 3 senior resolution notes since it also qualifies for ALAC. As such, the bank has issued a total €1 billion in tier 3 instruments so far in 2016. We expect the bank will issue additional tier 2 or tier 3 instruments to offset approximately Danish krone (DKK) 12 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.

We continue to include a one-notch positive adjustment for ALAC support from Nykredit Realkredit's 'a-' stand-alone credit profile (SACP). We note, however, that a successful IPO could improve our assessment of the bank's capital and earnings, which would bolster Nykredit'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.

The 'A' rating on Nykredit Realkredit reflects its 'bbb+' anchor and our assessment of the bank's adequate business position, strong capital and earnings, adequate risk position, average funding and adequate liquidity, and one notch of ALAC support.

Nykredit Realkredit's adequate business position reflects the bank's sustained business stability and its market-leading position in the Danish mortgage market, which continues to afford the bank demonstrable pricing power. This is partially offset by our expectation of continued limited business diversification. Our assessment of the bank's strong capital and earnings reflects our expectation that the bank's risk-adjusted capital ratio, which stood at 10.9% on Dec. 31, 2015, will increase toward 11%-12% over the next 18-24 months (excluding any proceeds from the eventual IPO) and remain sustainably above our 10% threshold. We note that, to meet upcoming stricter regulatory capital requirements, Nykredit Realkredit intends to raise capital through an IPO over the coming two years, which serves as a backstop in case planned ALAC issuance does not transpire and supports a stable outlook, in our view.

The adequate risk position reflects that Nykredit Realkredit's asset quality is comparable to 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 private individuals and some commercial mortgages. Our assessment of average funding and adequate liquidity primarily reflects Nykredit Realkredit's ongoing measures and the announced supervisory mortgage diamond to address the mismatch between its assets and liabilities. As Nykredit Realkredit and peers realign their funding profiles, we continue to expect that structural support of the Danish mortgage market will ensure access to future refinancing needs.

Outlook

The stable outlook on Nykredit Realkredit and Nykredit Bank reflects our view that the bank will improve its ALAC and continue to successfully realign its funding profile over our two-year rating horizon. 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's SACP and lower the ratings. In addition, a downgrade could occur if ALAC issuances and the IPO process stall, reducing the protection these instruments and the transaction 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.

Ratings Score Snapshot

	To	From
Issuer Credit Rating	A/Stable/A-1	A/Negative/A-1
SACP	a-	a-
Anchor	bbb+	bbb+
Business Position	Adequate (0)	Adequate (0)
Capital and Earnings	Strong (+1)	Strong (+1)
Risk Position	Adequate (0)	Adequate (0)
Funding	Average (0)	Average (0)
and Liquidity	and Adequate	and Adequate
Support	+1	+1
GRE Support	0	0
Group Support	0	0
Sovereign Support	0	0
ALAC Support	+1	+1

Additional Factors	0	0
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Related Criteria And Research

Related Criteria

- Criteria - Financial Institutions - Banks: Methodology For Mapping Short-Term 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
- Criteria - Financial Institutions - Banks: Bank Capital Methodology And Assumptions - December 06, 2010
- Criteria - Financial Institutions - Banks: Banking Industry Country Risk Assessment Methodology And Assumptions - November 09, 2011
- Criteria - Financial Institutions - Banks: Revised Market Risk Charges For Banks In Our Risk-Adjusted Capital Framework - June 22, 2012
- General Criteria: Use Of CreditWatch And Outlooks - September 14, 2009

Related Research

- The Future Of Banking: Nordic Banks Looking Svelte In The Fintech Race, June 14, 2016
- Nykredit Realkredit's Proposed Senior Subordinated Tier 3 Notes Rated 'BBB+', May 26, 2016
- Bulletin: Nykredit Realkredit's Planned Capital Strengthening Initiatives Have No Immediate Rating Impact, Feb. 4, 2016
- Banking Industry Country Risk Assessment: Denmark, Jan. 28, 2016
- Nykredit Realkredit A/S, Oct. 7, 2015

Ratings List

Outlook Action; Ratings Affirmed

	To	From
Nykredit Realkredit A/S		
Nykredit Bank A/S		
Counterparty Credit Rating	A/Stable/A-1	A/Negative/A-1

Ratings Affirmed

Nykredit Bank A/S

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Certificate Of Deposit	A/A-1
Senior Unsecured	A

Nykredit Realkredit A/S

Senior Unsecured	A
Subordinated	BBB
Subordinated*	BBB+
Junior Subordinated	BB+
Junior Subordinated	BBB

New Rating

Nykredit Realkredit A/S

Subordinated*	BBB+
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*Tier 3 senior resolution notes.

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