

### Research Update:

# Danske Bank Downgraded To 'A' On Asset Quality Deterioration; Outlook Negative

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## Overview

- The asset quality of Denmark-based Danske Bank A/S dropped sharply in the year to September 2009.
- We are lowering our long-term counterparty credit ratings on the bank to 'A' from 'A+'.
- The negative outlook reflects our view that the bank's asset quality will deteriorate further in 2010.

## Rating Action

On Dec. 18, 2009, Standard & Poor's Ratings Services lowered its long-term counterparty credit ratings on Denmark-based Danske Bank A/S and subsidiary Sampo Bank PLC to 'A' from 'A+'. At the same time, the long-term counterparty credit and insurer financial strength ratings on Danske Bank's core subsidiary, Danica Pension, Livsforsikringsaktieselskab (Danica) were lowered to 'A' from 'A+'. The outlook on Danske Bank and Danica, and Sampo Bank is negative. At the same time we affirmed the 'A-1' short-term counterparty credit rating on both Danske Bank and Sampo Bank, and the 'K-1' short-term Nordic scale rating on Danske Bank.

At the same time the long-term subordinated debt rating on Danica's €400 million perpetual callable issuance was lowered to 'BBB+' from 'A'. The notching has been reviewed and widened to two notches from the long-term counterparty credit rating in light of recent developments in the hybrid market. This brings the issuance into line with most other hybrid instruments issued by European insurers.

Danske Bank's government-guaranteed long-term and short-term issues are unaffected by this rating action. See "Danske Bank A/S Government-Guaranteed Senior Unsecured Issues Raised To 'AAA'," published Feb. 10, 2009 and "Danske Bank A/S Danish State-Guaranteed U.S. Commercial Paper Issues Maturing On Or Before Sept. 30, 2010 Rated 'A-1+'," published Oct. 16, 2009 on RatingsDirect.

## Rationale

The rating actions reflect a sharp deterioration in Danske Bank's asset quality during the four quarters ended Sept. 30, 2009 in both its domestic market and several other markets where the bank operates, particularly in Ireland and the Baltic countries of Latvia and Lithuania. They also reflect our expectation that the bank's asset quality will remain under significant pressure in 2010 and therefore that the bank's profitability will remain

subdued as it is not likely to be supported by the high level of gains from market-related activities reported in 2009.

Our assessment of the bank's stand-alone credit profile was lowered to 'A-', partly offset by incorporating a one-notch uplift of potential external support. Potential for extraordinary support was illustrated by a hybrid capital injection that the bank received in 2009. We believe that additional external support would be provided, if required, reflecting Danske Bank's high systemic importance within Denmark and the supportive attitude of the Danish authorities.

Danske Bank's overall asset quality worsened sharply in the four quarters ended Sept. 30, 2009 and is likely to deteriorate further in 2010. The bank's ratio of non-performing loans to total loans on Sept. 30, 2009 was 4.46% compared with 1.26% a year earlier and only 0.72% at year-end 2007. The large impairments have arisen from large exposures in the bank's capital market division and from the recession in the Danish economy that has put enormous pressure on the quality of the bank's exposure to small and midsize companies and on the construction and real estate industries. We expect the resulting pressure on Danske's domestic lending book to continue through 2010. Furthermore, the operations in the two Baltic countries and Ireland have experienced sizeable loan losses in recent quarters, particularly in their commercial real estate portfolios. Our expectation is that loan losses will remain at very high levels in Ireland, Latvia, and Lithuania during 2010. For the first three quarters of 2009, Danske Bank announced credit losses of Danish krone (DKK) 20.7 billion compared with only DKK2.8 billion in the corresponding period of 2008.

Danske Bank's profitability in 2008 and 2009 has been heavily impacted by high credit losses and goodwill impairments. Despite the extraordinary income from its market-related activities, which we do not believe are sustainable, loan impairments resulted in a marked decline in profitability in the four quarters ended Sept. 30, 2009. The bank reported a net loss in two of the quarters and very low net income in the other two. Net operating profit after impairments declined to barely 0.33% of risk assets in the first three quarters of 2009 and 0.43% in 2008 compared with 1.68% in 2007.

We consider Danske Bank's capitalization to be only modest. Although it was enhanced in June 2009 by a DKK26 billion hybrid capital contribution from the Danish State, it remains modest given the sizeable impairments that the bank is likely to book in the next few months. As at Sept. 30, 2009, the bank reported a Tier 1 ratio of 12.6% under Basel II rules. This ratio benefits from the DKK26 billion hybrid capital contribution in June 2009. The composition and quality of the bank's capital has deteriorated significantly over the past few years as a result of the financing of large acquisitions in Ireland and Finland through hybrid capital and subordinated debt.

## Outlook

The negative outlook reflects our opinion that Danske Bank's asset quality, particularly in its domestic small and midsize enterprise portfolio, will be further impaired in 2010 by the current slowdown in the Danish economy. In addition, it reflects our expectation of a further deterioration in the asset quality of the bank's operations in Latvia, Lithuania, and Ireland. Our base expectation factored into the outlook is that in 2010 the bank will book impairments broadly in line with those reported in 2009, resulting in very low pre-tax profit for the year.

A further negative rating action could follow if the bank's asset quality deteriorates further than we currently expect, resulting in a sizeable pre-tax loss and thereby lowering our expectations about its future earnings capacity and capitalization levels. Given Danske bank's high systemic importance Denmark, we may add more than one notch of explicit support into the rating if we gain greater insight into the likelihood of support and into the form that such support might take. This could ease pressure on the ratings if the bank's intrinsic creditworthiness were to deteriorate materially.

Conversely, we might revise the outlook to stable if Danske Bank's financial profile were to show more resilience than expected in the face of the challenging economic and operating conditions that lie ahead, and if the group significantly reduces its exposure to risky areas.

## Related Research

FI Criteria: Bank Rating Analysis Methodology Profile, March 18, 2004

## Ratings List

### Downgraded; Ratings Affirmed

	To	From
Danske Bank A/S		
Counterparty Credit Rating	A/Negative/A-1	A+/Negative/A-1
Certificate Of Deposit	A/A-1	A+/A-1
Sampo Bank PLC		
Counterparty Credit Rating	A/Negative/A-1	A+/Negative/A-1
Certificate Of Deposit	A/A-1	A+/A-1

### Downgraded

	To	From
Danske Bank A/S		
Senior Unsecured	A	A+
Subordinated	BBB	A-
Junior Subordinated	BB+	BBB

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Danica Pension, Livsforsikringsaktieselskab		
Counterparty Credit Rating	A/Negative/--	A+/Negative/--
Financial Strength Rating	A/Negative/--	A+/Negative/--
Subordinated	BBB+	A

Danske Corp., Delaware		
Commercial Paper*	A	A+

Sampo Bank PLC		
Senior Unsecured	A	A+
Subordinated	A-	A
Junior Subordinated	BB+	BBB

Ratings Affirmed

Danske Bank A/S		
Counterparty Credit Rating (Nordic Scale)	K-1	
Commercial Paper	A-1	
Commercial Paper (Nordic Scale)	K-1	
Short-Term Debt	A-1	

Danske Corp., Delaware		
Commercial Paper*	A-1	

Sampo Bank PLC		
Short-Term Debt	A-1	

\*Guaranteed by Danske Bank A/S

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Complete ratings information is available to RatingsDirect on the Global Credit Portal subscribers at [www.globalcreditportal.com](http://www.globalcreditportal.com) and RatingsDirect subscribers at [www.ratingsdirect.com](http://www.ratingsdirect.com). All ratings affected by this rating action can be found on Standard & Poor's public Web site at [www.standardandpoors.com](http://www.standardandpoors.com). Use the Ratings search box located in the left column. Alternatively, call one of the following Standard & Poor's numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; Stockholm (46) 8-440-5914; or Moscow (7) 495-783-4011.

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