

Danish Mortgage Bank BRFkredit Assigned 'A-/A-2' Ratings; Outlook Stable

Overview

- BRFkredit is the fourth-largest mortgage bank in Denmark.
- We believe BRFkredit benefits from a stable business model, sound funding position, adequate capitalization, and strong earnings quality.
- BRFkredit ratings are constrained by concentration risks and low earnings diversification.
- We are assigning our 'A-/A-2' long- and short-term ratings to BRFkredit A/S.
- The stable outlook reflects our expectation that the bank will successfully execute its strategy to decrease real estate development exposure while maintaining current capital levels and improving earnings.

Rating Action

On Oct. 12, 2011, Standard & Poor's Ratings Services assigned its 'A-' long-term and 'A-2' short-term counterparty credit ratings to BRFkredit A/S, a Danish mortgage bank headquartered in Copenhagen. The outlook is stable.

Rationale

The ratings reflect BRFkredit's stable market position in the Danish mortgage market, its adequate capitalization, strong earnings quality, and sound funding profile based on the domestic covered bond market.

The ratings are constrained by the company's concentration on the Danish property market, which limits earnings diversification and increases risks to asset quality. In addition, the Danish mortgage market's low margin characteristics offer only limited preprovision earnings to absorb outside credit impairments, as could be seen by BRFkredit's losses in 2008-2010.

Primary Credit Analysts:

Alexander Ekbohm

Stockholm

(46) 8-440-59 11

alexander_ekbom@

standardandpoors.com

Secondary Contact: Per Tornqvist

Stockholm

(46) 8-440-5904

per_tornqvist@

standardandpoors.com

Additional Contact: Financial

Institutions Ratings Europe

FIG_Europe@

standardandpoors.com

Publication Date

Oct. 12, 2011

BRFKredit is Denmark's fourth-largest mortgage bank and the fourth-largest financial services group by assets. It also has a small banking subsidiary, BRFKredit Bank A/S (not rated), which provides complimentary retail banking services. Total assets amounted to Danish krone (DKK) 223.8 billion at June 30, 2011 (€30 billion at DKK7.44 to €1).

The ratings are underpinned by BRFKredit's stable business model and market position in the Danish mortgage market, which provides recurrent net interest income revenues. BRFKredit has a total market share of 9%. It finances about 20% of private rental property and subsidized housing, and about 7% of the retail segment.

Capitalization is adequate according to Standard & Poor's measures. The group reported a risk-adjusted capital (RAC) ratio of 9.9% before adjustments at year-end 2010. This compares favorably with the majority of a group of international banks (see "Despite Significant Progress, Capital Is Still A Rating Weakness For Large Global Banks," published Jan. 18, 2011, on RatingsDirect on the Global Credit Portal). However, when we take into account BRFKredit's concentrated geographic and sector exposure, the RAC ratio after our adjustments drops to 7.7%, which limits our assessment to "adequate". Total adjusted capital is high quality, according to our definition, and is composed entirely of common equity.

We believe earnings quality to be strong and recurrent, as interest income is the main source of income. However, some volatility incurs from the assets held in the investment portfolio. In 2008-2010, bottom-line profits were negative or very small and hit heavily by losses suffered in the bank subsidiary resulting from a number of exposures to the real estate development sector. We believe the provisions incurred adequately cover the potential losses (70% coverage ratio in respect of the bank's nonperforming real estate development loans) and we understand that BRFKredit Bank has discontinued lending to the real estate development sector. We therefore expect little additional need for further provisioning. We consider BRFKredit's asset quality in the mortgage-related book to be strong, supported by sound underwriting standards and low demonstrated losses.

BRFKredit funds itself almost entirely through wholesale Danish covered bonds, but its funding profile is supported by the strict matching principles inherent in the Danish mortgage legislation. While interest rate sensitivity has increased due to the growth of adjustable-rate mortgages, the domestic bond market has continued to function well through the past few years of financial turmoil, thanks to strong incentive for domestic investors to continue their commitment to the market.

Although we see BRFKredit's business model as a strength, we see exposure to predominantly one sector, real estate financing in Denmark, as a ratings constraint. In our opinion, BRFKredit's three leading domestic competitors have broader business activities and consequently a more diversified earnings capacity. But BRFKredit has managed to defend its position in the Danish market so far, due to its role as a mortgage partner for the banking sector, especially in the subsidized housing segment, but also based on its own distribution channels and cooperation with real estate agents. In addition, BRFKredit is the only independent mortgage provider other than the Big Three (Danske Bank A/S [A/Negative/A-1; Nordic national scale —/—/K-1], Nordea Kredit Realkredit A/S [not rated] and Nykredit Realkredit A/S [A+/Stable/A-1]). Although we anticipate consolidation of the Danish banking market, this structure is likely to remain.

Danish mortgage market margins are low, and this is a ratings constraint. The bank has historically been able to generate sufficient capital through earnings to support loan growth. But the financial crisis in 2007-2009 has led to an increased awareness of risk-based pricing, and BRFKredit is presently

working to implement a more differentiated pricing model. Standard & Poor's expects that margin increases will be realized only very gradually, however.

Outlook

The stable outlook reflects our expectation that management will execute its revised strategy with increased focus on lower-risk segments within the Danish real estate market. Furthermore, the outlook incorporates the expectation that this can be accomplished in such a way that capitalization is not weakened and that retained earnings remain sufficient to capitalize additional loan growth. We expect capitalization to remain adequate at about 10% before adjustments based on Standard & Poor's RAC framework.

A downgrade could be triggered by a material weakening of the economic conditions in Denmark leading to higher unemployment and falling property prices, which in turn materially impacts earnings and risk cost for BRFkredit. A substantial fall in capitalization could also lead us to downgrade BRFkredit.

An upgrade is unlikely at this stage, but would require material strengthening of the group's business position without an increase in the risk position or a weakening of capitalization.

Related Criteria And Research

All articles listed below are available on RatingsDirect on the Global Credit Portal, unless otherwise stated.

Related criteria

- Bank Rating Analysis Methodology Profile, March 18, 2004
- Criteria | Financial Institutions | Banks: Bank Capital Methodology And Assumptions, Dec. 6, 2010
- Franchise Stability, Confidence Sensitivity, And The Treatment Of Hybrid Securities In A Downturn, Dec. 1, 2008

Related research

- Growth, Normalized Interest Rates, And Receding Losses Drive Nordic Banks' Return From The Crisis, Feb. 24, 2011

Ratings List

New Rating

BRFkredit A/S

Counterparty Credit Rating A-/Stable/A-2

Complete ratings information is available to subscribers of RatingsDirect, Standard & Poor's Web-based credit analysis system, at www.ratingsdirect.com. All ratings affected by this rating action can be found on Standard & Poor's public Web site at www.standardandpoors.com; under Credit Ratings in the left navigation area, select Find a Rating, then Credit Ratings Search.

Published by Standard & Poor's Financial Services LLC, a subsidiary of The McGraw-Hill Companies, Inc. Executive and Editorial offices: 55 Water Street, New York, NY 10041. Subscriber services: (1) 212-438-7280, Option 2. Copyright © 2011 by Standard & Poor's Financial Services LLC (S&P). All rights reserved.

No part of this information may be reproduced or distributed in any form or by any means, or stored in a database or retrieval system, without the prior written permission of S&P. S&P, its affiliates, and/or their third-party providers have exclusive proprietary rights in the information, including ratings, credit-related analyses and data, provided herein. This information shall not be used for any unlawful or unauthorized purposes. Neither S&P, nor its affiliates, nor their third-party providers guarantee the accuracy, completeness, timeliness or availability of any information. S&P, its affiliates or their third-party providers and their directors, officers, shareholders, employees or agents are not responsible for any errors or omissions, regardless of the cause, or for the results obtained from the use of such information. S&P, ITS AFFILIATES AND THEIR THIRD-PARTY PROVIDERS DISCLAIM ANY AND ALL EXPRESS OR IMPLIED WARRANTIES, INCLUDING, BUT NOT LIMITED TO, ANY WARRANTIES OF MERCHANTABILITY OR FITNESS FOR A PARTICULAR PURPOSE OR USE. In no event shall S&P, its affiliates or their third-party providers and their directors, officers, shareholders, employees or agents be liable to any party for any direct, indirect, incidental, exemplary, compensatory, punitive, special or consequential damages, costs, expenses, legal fees, or losses (including, without limitation, lost income or lost profits and opportunity costs) in connection with any use of the information contained herein even if advised of the possibility of such damages.

The ratings and credit-related analyses of S&P and its affiliates and the observations contained herein are statements of opinion as of the date they are expressed and not statements of fact or recommendations to purchase, hold, or sell any securities or make any investment decisions. S&P assumes no obligation to update any information following publication. Users of the information contained herein should not rely on any of it in making any investment decision. S&P's opinions and analyses do not address the suitability of any security. S&P does not act as a fiduciary or an investment advisor. While S&P has obtained information from sources it believes to be reliable, S&P does not perform an audit and undertakes no duty of due diligence or independent verification of any information it receives. S&P keeps certain activities of its business units separate from each other in order to preserve the independence and objectivity of each of these activities. As a result, certain business units of S&P may have information that is not available to other S&P business units. S&P has established policies and procedures to maintain the confidentiality of certain non-public information received in connection with each analytical process.

S&P's Ratings Services business may receive compensation for its ratings and credit-related analyses, normally from issuers or underwriters of securities or from obligors. S&P reserves the right to disseminate its opinions and analyses. S&P's public ratings and analyses are made available on its Web sites, www.standardandpoors.com (free of charge) and www.ratingsdirect.com (subscription), and may be distributed through other means, including via S&P publications and third-party redistributors. Additional information about our ratings fees is available at www.standardandpoors.com/usratingsfees.

S&P uses billing and contact data collected from subscribers for billing and order fulfillment purposes, and occasionally to inform subscribers about products or services from S&P, its affiliates, and reputable third parties that may be of interest to them. All subscriber billing and contact data collected is stored in a secure database in the U.S. and access is limited to authorized persons. If you would prefer not to have your information used as outlined in this notice, if you wish to review your information for accuracy, or for more information on our privacy practices, please call us at (1) 212-438-7280, Option 2 or write to us at: privacy@standardandpoors.com. For more information about The McGraw-Hill Companies Customer Privacy Policy please visit www.mcgraw-hill.com/privacy.html.

Permissions: To reprint, translate, or quote Standard & Poor's publications, contact: Client Services, 55 Water Street, New York, NY 10041; (1) 212-438-7280, Option 2; or by email to: research_request@standardandpoors.com.