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Standard & Poor's Research

December 1, 2011

Research Update:
BRFkredit A/S 'A-/A-2' Ratings Affirmed On Bank Criteria Change; Outlook Stable

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Research Update:

BRFkredit A/S 'A-/A-2' Ratings Affirmed On Bank Criteria Change; Outlook Stable

Overview

- Following a review under Standard & Poor's revised bank criteria (published Nov. 9, 2011), we have affirmed our 'A-' long-term and 'A-2' short-term counterparty credit ratings on Denmark-based BRFkredit A/S (BRF). The outlook is stable.
- The ratings reflect BRF'S adequate business position, adequate capital and earnings, adequate risk position, average funding, and adequate liquidity.
- We consider BRF to have moderate systemic importance in Denmark, which we classify as supportive.
- The stable outlook reflects our view that BRF will comfortably maintain a risk-adjusted capital ratio of about 8% and defend its domestic market position in Denmark.

Rating Action

As we previously announced on Dec. 1, 2011, Standard & Poor's Ratings Services has affirmed its 'A-' long-term and 'A-2' short-term counterparty credit ratings on Denmark-based BRFkredit A/S (BRF). The outlook is stable.

Rationale

Standard & Poor's bases its ratings on BRF on the bank's "adequate" business position, "adequate" capital and earnings, "adequate" risk position, "average" funding, and "adequate" liquidity, as our criteria define those terms. The bank's stand-alone credit profile (SACP) is 'bbb+'. In our view, BRF has "moderate" systemic importance, which lifts the long-term rating one notch above the SACP.

Our bank criteria 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. The anchor for a commercial bank operating only in Denmark is 'bbb+'.

Our economic risk assessment reflects our view that Denmark is a politically stable, wealthy, and high-income country, which has suffered since the 2008-2009 financial crisis. Consequently, we expect economic growth to be weak over the short to medium term. However, this is balanced by fiscal policy flexibility. On the external side, Denmark has posted sizable current account surpluses for more than a decade, and we expect this to continue.

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We expect the fallout from the financial crisis to lead to increased consolidation as weak institutions are either taken over by stronger competitors or eliminated from the market. Further bank failures are a possibility. The Danish banking system has a relatively low share of core customer deposits, at 20% of total loans, and a relatively high share of net external funding at 18% of total loans. The latter is, however, related to the structure of the Nordic banking sector, with considerable cross-border activity. These higher risk characteristics are partly offset by a well developed domestic bond market that remained open and functioning throughout the financial crisis.

We consider BRF's business position to be "adequate", reflecting the bank's well established position as the fourth largest financial institution in Denmark, with a stable 9% market share in mortgage lending and assets amounting to Danish krone (DKK) 223.8 billion as of June 30, 2011 (€30 billion at DKK7.44 to €1). Revenue generation is based on stable interest income. We expect that BRF will focus on its new retail banking strategy, with an increased focus on low-risk segments such as subsidized housing, while discontinuing lending to the high-risk development sector.

We assess BRF's capital and earnings as "adequate", but forecast that the bank's capital will decline over the next few years in terms of our risk-adjusted capital (RAC) framework. We estimate that BRF's RAC ratio will decline to about 8% by year-end 2012. The forecast decline reflects a negative earnings buffer that we factor into our RAC calculation to reflect BRF's low-margin business and elevated normalized losses (of about DKK660 million a year) that we assign according to our RAC model. However, we believe that these normalized losses are high relative to the risk in BRF's overall loan portfolio because the bank has discontinued lending to the development sector and still has collateralized corporate exposure. In addition, recent across-the-board margin increases are likely to support stronger earnings.

BRF's risk position is "adequate", in our view, reflecting the bank's decision to exit the development business in combination with a focus on servicing its core retail customer base and selected niches. We believe the RAC ratio adequately reflects BRF's risk position, including the bank's concentrated exposure to the domestic real estate sector. BRF's recent loss history is to a large extent explained by lending to the development sector. We think the bank's provisioning cycle has already peaked (impairments in 2010 were down 77% from 2009) and that it has set aside adequate provisions for the portfolio of nonperforming assets.

BRF's funding is "average", in our view, and reflects the bank's access to the Danish covered bond market. One strength specific to Danish mortgage bond legislation is a regulation limiting liquidity mismatches. However, we acknowledge that refinancing risk has changed in the Danish market with the growth of a more varied product offering and, in particular, shorter-dated bonds of 1-5 years. Nevertheless, a predominance of domestic investors was an important factor that created stability in the Danish market in 2008-2010, and we anticipate that this will remain an important structural strength over the

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medium term. In our view, BRF's liquidity is "adequate" and we believe it to be appropriate for the business the bank conducts.

Outlook

The stable outlook on BRF reflects our expectation that the bank will successfully execute its new strategy, thereby supporting an improvement in operating performance while comfortably maintaining a RAC ratio of 7%-10% and a sustained, stable business position in the Danish market.

We could take a negative rating action if a significant deterioration in operating performance and increased loan loss provisioning were to cause a substantial decline in the bank's capital. A significant increase in the bank's risk profile, failure to execute the new strategy, or a weakening of BRF's domestic business position could also trigger a negative rating action.

A positive rating action is currently unlikely, but could materialize if the bank were to demonstrate significantly stronger capital generation than we currently expect.

Ratings Score Snapshot

Issuer Credit Rating	A-
SACP	bbb+
Anchor	bbb+
Business Position	Adequate (0)
Capital and Earnings	Adequate (0)
Risk Position	Adequate (0)
Funding and Liquidity	Average and Adequate (0)
Support	1
GRE Support	0
Group Support	0
Sovereign Support	1
Additional Factors	0

Related Criteria And Research

All articles listed below are available on RatingsDirect on the Global Credit Portal.

- Banks: Rating Methodology And Assumptions, Nov. 9, 2011
- Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- Group Rating Methodology And Assumptions, Nov. 9, 2011
- Bank Hybrid Capital Methodology And Assumptions, Nov. 1, 2011

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Ratings List

Ratings Affirmed

BRFkredit A/S

Counterparty Credit Rating	A-/Stable/A-2

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