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Jyske Bank A/S

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Table Of Contents

Jyske Bank A/S

SACP	bbb+	+	Support	+1	+	Additional Factors	0

Anchor	bbb+	
Business Position	Adequate	0
Capital and Earnings	Adequate	0
Risk Position	Adequate	0
Funding	Average	0
Liquidity	Adequate	

GRE Support	0
Group Support	0
Sovereign Support	+1

Issuer Credit Rating
A-/Stable/A-2

Major Rating Factors

Strengths:	Weaknesses:
• A strong domestic franchise in retail and commercial banking. • Borderline strong capitalization.	• Relatively weak, but improving, asset quality metrics. • Use of short-term wholesale funding for mortgage loans. • Limited geographic diversity.

Outlook: Stable

The stable outlook on Jyske Bank S/A reflects Standard & Poor's Ratings Services' view that the possible removal of government support from the ratings on both Jyske and BRFkredit by year-end 2015 might be offset by strengthening capital, such that our risk-adjusted capital (RAC) ratio sustainably exceeds 10%. We expect that this would be supported by stronger, more stable earnings resulting from synergies of the merger.

We might remove the notch of uplift for extraordinary government support from the ratings on Jyske and BRFkredit by year-end 2015 if we consider that such support is less predictable under the new EU legislative framework. If, however, the group can deliver improvements in earnings stability and capital generation, and we expect that it can achieve and maintain a RAC ratio higher than 10%, we could revise our assessment of capital and earnings to "strong" from "adequate."

We could consider an upgrade if we believe that potential extraordinary government support for Jyske's senior unsecured creditors is unchanged in practice, despite the introduction of bail-in powers and international efforts to increase banks' resolvability. We would also assess any steps Jyske might take to mitigate bail-in risks for senior unsecured creditors, such as building a large buffer of subordinated instruments.

Given the existing synergies and our anticipation of a smooth transition, we consider it unlikely that bank-specific factors would lead us to lower the ratings on Jyske Bank in the next two years. However, ongoing high loan impairments could lead us to reassess the group's risk position. We also continue to review the impact of proposed changes in regulations to reduce refinancing risk for Denmark's mortgage institutions, including BRFkredit. We could lower the ratings if expected future improvement in the combined entity's funding and liquidity profile cannot bring it in line with that of its larger domestic peers.

The stable outlook on BRFkredit mirrors that on Jyske Bank.

Rationale

The ratings reflect our view of Jyske Bank's "adequate" business position of Jyske Group, following the April 2014 merger of Denmark's third-largest bank with the country's fourth-largest mortgage company, BRFkredit. The ratings and analysis reflect the combined entity. The bank's capital and earnings position is "adequate," in our view. We believe Jyske will achieve a RAC ratio of about 9.5%-10% by year-end 2015 supported by increasing earnings generation.

We assess Jyske Bank's risk position as "adequate," reflecting that the inclusion of BRFkredit's lower-risk mortgage loan book provides diversification and improves the overall quality of the bank's domestic loan book, which has been under recent pressure. Our view of Jyske Bank's funding as "average" and liquidity as "adequate" reflects the resulting funding profile of the merger of deposit-funded Jyske Bank with BRFkredit, which in Denmark has an above-average share of short-term wholesale funding.

We see the merged entity, Jyske Bank and BRFkredit, as having "moderate" systemic importance in Denmark, which lifts the long-term rating one notch above the stand-alone credit profile due to the likelihood of extraordinary government support.

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

Our bank criteria use our Banking Industry Country Risk Assessment (BICRA) economic risk and industry risk scores to determine a bank's anchor, the starting point in assigning an issuer credit rating. Our anchor for Jyske Bank is 'bbb+' reflecting its Danish regulatory headquarters and its credit and deposit exposure, both to a very large extent to the Danish economy. The anchor is derived from the economic risk score of '3' and the industry risk score of '4'.

We view Denmark as a politically stable, wealthy, and high-income country, which has suffered since the global financial market crisis. Overinvestments before 2007 and high growth in private individual leverage have dampened domestic consumption, but we expect that much of the deleveraging process has already taken place. Consequently, we expect an improvement in the Danish economy. We think the Danish government has balanced fiscal policy flexibility and a strong external position manifested through sizable current account surpluses in the past decade.

We believe the fallout from the crisis will continue to spur consolidation in Denmark's banking industry, and that further failures among smaller banks cannot be ruled out. The industry shows a relatively low share of core customer deposits. It also has a fairly high share of net external funding, which, however, relates to 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 market turmoil.

Table 1

Jyske Bank A/S Key Figures					
		--Year-ended Dec. 31--			
(Mil. DKK)	**2014***	**2013**	**2012**	**2011**	**2010**
Adjusted assets	516,369.0	257,124.0	252,765.0	261,273.0	227,314.2
Customer loans (gross)	339,077.0	115,808.0	110,608.0	112,417.0	110,149.9
Adjusted common equity	27,349.0	17,047.0	15,258.0	13,275.0	12,812.6
Operating revenues	6,352.0	8,239.0	7,516.0	6,673.0	6,899.8
Noninterest expenses	4,115.0	4,791.0	4,825.0	4,592.0	4,098.5
Core earnings	727.3	1,808.0	596.0	493.0	757.1

*Data as of Sept. 30.

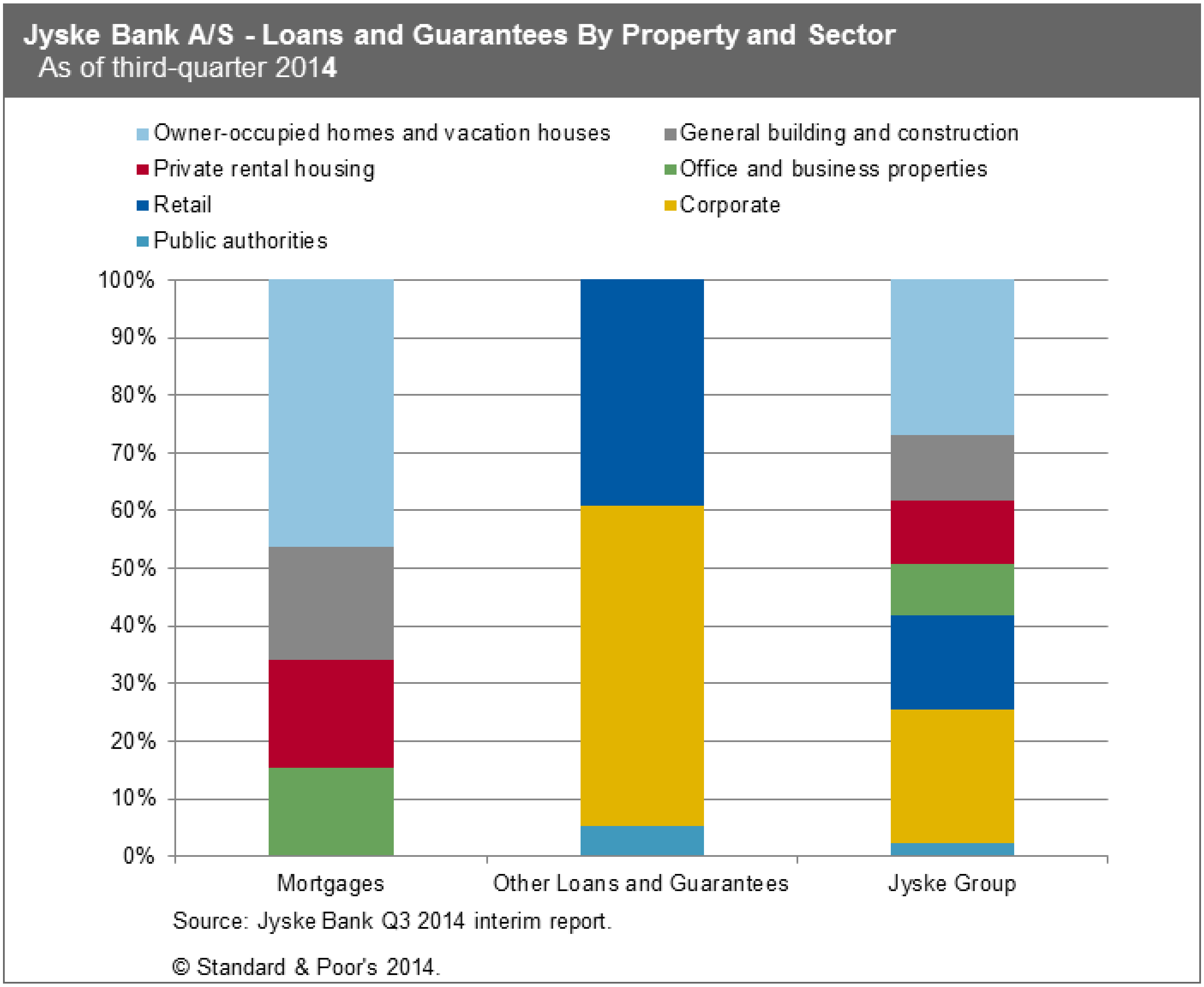
DKK--Danish krone.

Business position: Adding BRF provides diversifies revenues by segment and improves national coverage

We assess Jyske Bank's business position as "adequate." The merger with BRF nearly doubled Jyske's consolidated assets to Danish krone (DKK) 521 billion (€70 billion at DKK7.46 to €1), as of Sept. 30, 2014. Jyske remains the fourth-largest lender in Denmark after the merger and has about 14% market share in loans and 7% of deposits.

The merger improves revenue and geographical diversification and creates a bank with business and risk profiles that largely reflect the risks associated with the Danish economy. Jyske has been particularly strong in small and medium enterprise (SME) lending and deposit gathering in the Jutland region, while BRF adds a strong residential and commercial real estate customer base more in the Copenhagen and Aarhus regions. The combined entity is considerably more diversified (Chart 1).

Chart 1



While we expect the merger to be a smooth transition and have a sound strategic rationale, we believe there are always execution risks involved. In our view, these risks are somewhat mitigated by the long history of previous cooperation and more intense recent work on a joint funding structure and linked IT platform.

One of the key hurdles for the combined entity is the severed cooperation with Nykredit Realkredit and its subsidiary, Totalkredit. The cancellation relieved Jyske of its guarantees on nearly DKK90 billion of transferred residential mortgage loans and led Nykredit to stop commission payments to Jyske Bank. Jyske has initiated arbitration proceedings in the matter and believes that it has not broken the contract. The impact on Jyske's revenues is anticipated to be DKK250 million-DKK300 million in 2014 and falling as borrowers' loans are repatriated. We view the repatriation of these loans (DKK70.5 billion at end third-quarter 2014, down from DKK86.7 billion at quarter-end 2013) as a key strategic objective for Jyske during the next two or three years.

We anticipate that the merger will not affect Jyske's strategy of focusing on relationship-based commercial banking for households and SMEs. We also expect BRF to continue to use existing distribution channels, though some banks have publicly committed to transfer future loans to Nykredit instead of BRF. Jyske also provides other value-added services such as asset management, mainly to retail clients, and develops cost-sharing structures with other smaller Danish banks to improve its IT efficiency.

Since the Danish banking crisis began in 2008, Jyske Bank has also been active in market consolidation, acquiring the assets of two smaller banks, Fjordbank Mors and Spar Lolland. Jyske is also the largest shareholder in agricultural mortgage lender DLR Kredit, and recently increased its ownership share to 12.6%. We anticipate it will consider smaller additional transactions, as opportunities for organic growth are rare in Denmark.

We believe Jyske Bank has a strong and stable management team and a prudent corporate strategy that has helped it to weather the Danish banking crisis without needing extraordinary capital or liquidity support from the state. Return on equity is expected to reach a long-term level of 7%-8%, excluding one-off and restructuring costs. We note, however, that one-off items contributed much higher returns in the first half of 2014, including a DKK2.36 billion gain on the acquisition of BRFkredit and DKK296 million due to the sale of Silkeborg Data.

Table 2

Jyske Bank A/S Business Position					
		--Year-ended Dec. 31--			
(%)	**2014***	**2013**	**2012**	**2011**	**2010**
Loan market share in country of domicile	N/A	7.0	7.0	6.0	6.0
Deposit market share in country of domicile	N/A	6.0	7.0	7.0	7.0
Total revenues from business line (currency in millions)	9,008.0	8,239.0	7,516.0	6,673.0	6,899.8
Commercial & retail banking/total revenues from business line	59.1	86.6	85.8	87.7	88.3
Trading and sales income/total revenues from business line	2.7	6.0	8.1	5.2	6.5
Other revenues/total revenues from business line	38.2	7.4	6.1	7.1	5.2
Investment banking/total revenues from business line	2.7	6.0	8.1	5.2	6.5
Return on equity	19.5	10.9	4.0	3.6	5.9

*Data as of Sept. 30. N/A--Not applicable.

Capital and earnings: Borderline strong capital ratios, though uncertainties prevent a higher assessment

We assess Jyske Bank's capital and earnings as "adequate." We consider that potential improvements in the group's capitalization could offset a lower likelihood of government support. This is because we see potential for our RAC ratio to increase meaningfully above 10%, from its June 2014 level of 9.7%. However, the outcome is dependent on the outcome of the Nykredit arbitration, the repatriation of loans from Nykredit, and restructuring costs through 2016.

We believe that Jyske could potentially improve capital in time through retained earnings, diversified revenues, and cross-selling opportunities. We expect Jyske to post annual net profits exceeding DKK2 billion by 2016, excluding one-off costs and conservative expectations for repatriation of loans and excluding any potential commissions from Nykredit following arbitration.

Our earnings buffer metric is in the range of 70 basis points (bps) to 80 bps, indicating that the bank's earnings generation provides a meaningful cushion against decreasing revenues and deteriorating asset quality.

Table 3

Jyske Bank A/S Capital And Earnings					
		--Year-ended Dec. 31--			
(%)	**2014***	**2013**	**2012**	**2011**	**2010**
Tier 1 capital ratio	16.2	15.9	15.3	13.3	14.1
Standard & Poor's risk-adjusted capital ratio before diversification	N.M.	9.8	9.4	7.9	8.3
Standard & Poor's risk-adjusted capital ratio after diversification	N.M.	9.7	9.0	7.5	8.0
Adjusted common equity/total adjusted capital	100.0	100.0	100.0	100.0	100.0
Net interest income/operating revenues	73.1	60.9	64.9	71.1	68.5
Fee income/operating revenues	17.8	21.0	22.0	19.6	19.1
Market-sensitive income/operating revenues	0.4	7.2	4.0	(0.5)	6.3
Noninterest expenses/operating revenues	64.8	58.2	64.2	68.8	59.4
Preprovision operating income/average assets	0.8	1.3	1.0	0.8	1.2
Core earnings/average managed assets	0.2	0.7	0.2	0.2	0.3

*Data as of Sept. 30. N.M.--Not meaningful.

Table 4

Jyske Bank A/S RACF [Risk-Adjusted Capital Framework] Data					
(Mil. DKK)	**Exposure***	**Basel II RWA**	**Average Basel II RW (%)**	**Standard & Poor's RWA**	**Average Standard & Poor's RW (%)**
Credit risk					
Government and central banks	19,548	0	0	522	3
Institutions	35,566	6,787	19	7,214	20
Corporate	186,579	75,687	41	107,152	57
Retail	214,664	39,492	18	78,247	36
Of which mortgage	165,638	20,167	12	44,866	27
Securitization	1,001	0	0	405	40
Other assets	4,623	4,655	101	5,205	113
Total credit risk	461,980	126,621	27	198,744	43
Market risk					
Equity in the banking book§	2,072	0	0	17,951	866
Trading book market risk	--	25,108	--	37,206	--
Total market risk	--	25,108	--	55,156	--
Insurance risk					
Total insurance risk	--	--	--	0	--
Operational risk					
Total operational risk	--	17,038	--	21,949	--
(Mil. DKK)		**Basel II RWA**		**Standard & Poor's RWA**	**% of Standard & Poor's RWA**
Diversification adjustments					
RWA before diversification		168,767		275,849	100

Table 4

Jyske Bank A/S RACF [Risk-Adjusted Capital Framework] Data (cont.)				
Total adjustments to RWA	--		10,053	4
RWA after diversification	168,767		285,903	104
(Mil. DKK)	**Tier 1 capital**	**Tier 1 ratio (%)**	**Total adjusted capital**	**Standard & Poor's RAC ratio (%)**
Capital ratio				
Capital ratio before adjustments	27,618	16.4	26,786	9.7
Capital ratio after adjustments**	27,618	16.4	26,786	9.4

*Exposure at default. €Securitisation Exposure includes the securitization tranches deducted from capital in the regulatory framework. §Exposure and Standard & Poor's 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, 2014, Standard & Poor's.

Risk position: Diversification and collateralized lending from BRF improve asset quality metrics

Jyske Bank's risk position is "adequate" in our view, primarily because the quality of the bank's domestic loan book is in line with our assessment of industry risk for the Danish banking system using our BICRA methodology. We believe the acquisition of BRFkredit provides further diversification and meaningfully improves the combined asset quality metrics.

Both entities have experienced elevated credit losses since 2009, but Jyske Bank, as a result of its SME exposure, showed a clear downward trend from 2011 to 2013, while BRFkredit's portfolio improved further. We also note the one-off nature of recent impairment provisions resulting from guidelines from the Danish financial supervisory authority and an alignment of policies in the overall group. These included one-time provisions and management adjustments made during the Asset Quality Review, completed in October 2014, for the group in second-quarter 2014 and third-quarter 2014 of DKK456 million and a one-time adjustment for BRF in first-quarter 2014 of DKK965 million, about 45 bps of BRF's loan book (this adjustment is not in the group's figures, given that the merger occurred on April 30, 2014). Our normalized loss assessment for Jyske is DKK1.6 billion, which is in line with our aggregate expectation of losses for 2014 and given the improvements in the Danish economy, we expect losses to go down successively in 2015 and 2016.

Nonperforming loans (NPLs) have reduced dramatically after the incorporation of BRF's loan book (see Chart 2). We anticipate that NPLs will gradually decline as the Danish economy finds its footing (see "Banking Industry Country Risk Assessment: Denmark," published on Oct. 24, 2013, on RatingsDirect). Some of the increase for Jyske in 2013 reflected the loan books taken over from Spar Lolland and Fjordbank Mors, which we consider to be well provisioned.

Danish borrowers have suffered in recent years from the downturn in commercial and residential property markets and weak economic conditions with subdued consumption. This has put substantial pressure on the domestic SME sector, which caused the majority of Jyske Bank's losses. For BRF, the nonperforming loans are largely concentrated on the commercial real estate sector, which suffered significant price declines and resulted in large credit losses in the Danish banking sector after 2008.

Chart 2

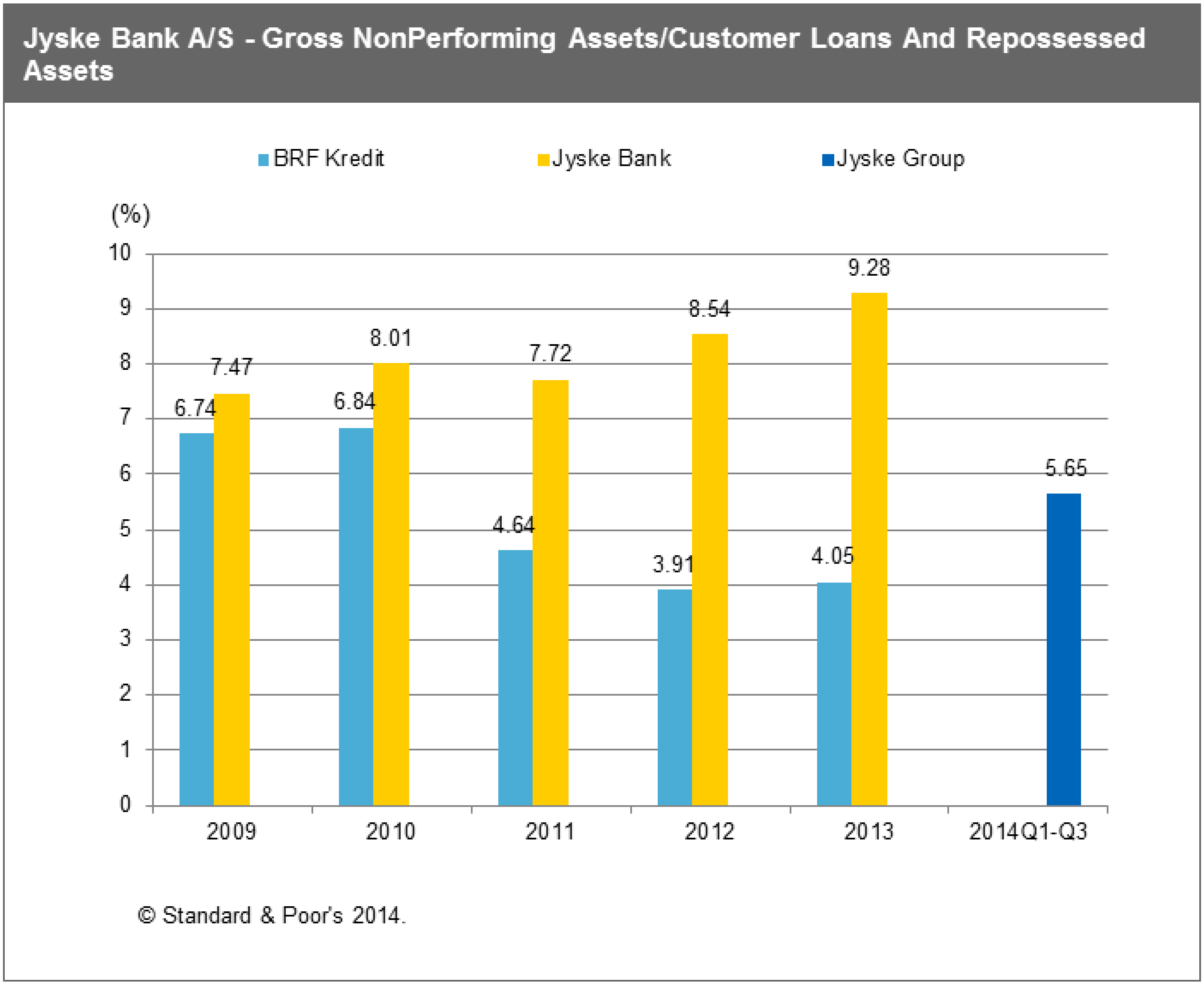


Table 5

Jyske Bank A/S Risk Position

		--Year-ended Dec. 31--			
(%)	**2014***	**2013**	**2012**	**2011**	**2010**
Growth in customer loans	257.1	4.7	(1.6)	2.1	2.3
Total diversification adjustment / S&P RWA before diversification	N.M.	1.5	3.7	4.9	4.0
Total managed assets/adjusted common equity (x)	19.1	15.4	16.9	20.4	19.1
New loan loss provisions/average customer loans	0.9	1.0	1.7	1.3	1.7
Net charge-offs/average customer loans	0.4	1.1	1.0	1.9	0.8
Gross nonperforming assets/customer loans + other real estate owned	5.6	9.3	8.5	7.7	8.0
Loan loss reserves/gross nonperforming assets	28.9	43.7	49.4	44.6	50.0

*Data as of Sept. 30.

Funding and liquidity: Funding profile changes radically with the addition of BRF

Following the addition of BRFkredit's entirely wholesale funded portfolio, Jyske Bank, in our view, is more reliant on wholesale funding and has a profile similar to that of domestic peers. Notably, Standard & Poor's key funding metric, the stable funding ratio, fell below the balanced level of 100%. Jyske Bank's stable funding ratio of 86% at September 2014 fell from 108% at year-end 2013, prior to the merger. The dramatic change is largely due to the large share of short-term wholesale funding associated with F1 loans in BRF. Due to the balance principle in Danish mortgage lending, the F1 loan is a one-year bond used to finance a one-year interest rate fixing on a 30-year mortgage bond (see article "Credit FAQ: The Danish Covered Bond Market Explained", July 15, 2014).

Despite the important contribution of corporate deposits in Jyske's deposit book, we believe the majority to be granular and stable, providing the bank with a steady source of funding for its non-mortgage lending.

We believe that Jyske Bank's liquidity is "adequate", and note the structural support of the Danish covered bond market as well as soft bullet nature of Danish covered bonds since the passage of the Danish law enacted on all new covered bonds since April 2014 (see "Credit FAQ: Why Denmark's Proposed Covered Bond Law Doesn't Fully Eradicate Refinancing Risks," Feb. 4, 2014. We note, however, that at September 2014 our one-year liquidity ratio (broad liquid assets to short-term wholesale funding) fell to 0.77x from 1.3x as a stand-alone entity at year-end. This indicates that after the merger of BRF, the group's liquid reserves no longer cover bonds maturing within one year.

On a stand-alone basis, BRF had a broad liquid assets to short-term wholesale funding ratio of only 0.4x at end 2013; however, there are significant changes occurring with respect to the high use of F1 bonds and one-year interest rate fixings in Denmark. We anticipate that the supervisory diamond for mortgage institutions and the future regulatory funding and liquidity requirements will encourage BRF and competitors to develop more long-term funding structures. We expect that the higher pricing introduced on the one- and two-year adjustable rate mortgages will improve the group's overall funding and liquidity profile. As BRF reduces its structural mismatch of asset and liability maturities, we expect a direct positive impact on our core measures of funding and liquidity for the group.

Table 6

Jyske Bank A/S Funding And Liquidity					
		--Year-ended Dec. 31--			
(%)	**2014***	**2013**	**2012**	**2011**	**2010**
Core deposits/funding base	28.4	56.9	50.1	48.9	51.4
Customer loans (net)/customer deposits	269.6	95.9	108.7	107.3	113.2
Long term funding ratio	67.6	66.1	63.4	61.0	59.2
Stable funding ratio	86.1	108.4	105.4	105.1	95.5
Short-term wholesale funding/funding base	34.5	36.8	39.6	41.6	43.8
Broad liquid assets/short-term wholesale funding (x)	0.8	1.3	1.2	1.2	1.1
Net broad liquid assets/short-term customer deposits	(32.5)	22.0	19.5	15.0	6.6
Short-term wholesale funding/total wholesale funding	48.1	85.4	79.4	81.4	90.0
Narrow liquid assets/three-month wholesale funding (x)	1.2	1.7	1.5	1.8	1.8

*Data as of Sept. 30.

External support: One notch of uplift for the likelihood of extraordinary government support

Currently, we consider that Jyske has "moderate" systemic importance in Denmark, which we view as "supportive" of private-sector commercial banks. We base this on its position as the fourth-largest bank in the country and 7% share of domestic deposits. The bank's moderate systemic importance results in one notch of extraordinary government support according to the rating.

However, within Europe we note a move toward avoiding government support for failing banks through bail-ins to share the burden with investors, potentially including senior unsecured creditors. There is a chance that we could remove the notches of uplift for explicit government support from the long-term rating by the end of 2015.

Key Subsidiary: BRFkredit

Although the merger was only completed in April 2014, we view BRFkredit as a "core" subsidiary and align the rating and outlook with those on the Jyske Group. We believe that BRFkredit is highly unlikely to be sold, given its status as a vital part of the combined entity's future funding strategy for Danish residential and commercial mortgages. This is in line with how we see other banking group structures and covered bond-issuing subsidiaries in Denmark. Our assessment of BRFkredit's core status remains underpinned by our expectation that the integration of the two entities will be relatively smooth. We note that they have cooperated with each other for more than a decade and have worked closely in the year before the merger on a joint funding structure and linked information technology platforms for Jyske Bank's Prioritet loans.

Additional rating factors:None

No additional factors affect this rating.

Related Criteria And Research

Related Criteria

- Bank Hybrid Capital And Nondeferrable Subordinated Debt Methodology And Assumptions, Sept. 18, 2014
- Group Rating Methodology, Nov. 19, 2013
- Banks: Rating Methodology And Assumptions, Nov. 9, 2011
- Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- Bank Capital Methodology And Assumptions, Dec. 6, 2010

Related Research

- Denmark's Proposed Regulatory Changes Could Lower Covered Bonds' Credit Risk, Sept. 16, 2014
- 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
- Banking Industry Country Risk Assessment: Denmark, Oct. 24, 2013

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 December 5, 2014)

Jyske Bank A/S	
Counterparty Credit Rating	A-/Stable/A-2
Nordic Regional Scale	--/--/K-1
Certificate Of Deposit	
Foreign Currency	A-2
Senior Unsecured	A-
Short-Term Debt	A-2
Subordinated	BBB-
Counterparty Credit Ratings History	
01-Dec-2011	A-/Stable/A-2
20-Feb-2009	A/Negative/A-1
30-Sep-2008	A+/Negative/A-1
10-Feb-2012 *Nordic Regional Scale*	--/--/K-1
Sovereign Rating	
Denmark (Kingdom of)	AAA/Stable/A-1+

*Unless otherwise noted, all ratings in this report are global scale ratings. Standard & Poor's credit ratings on the global scale are comparable across countries. Standard & Poor's credit ratings on a national scale are relative to obligors or obligations within that specific country.

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