

The Danish mortgage bond market

July 2014

Important disclosures and certifications are contained from page 64 of this presentation.

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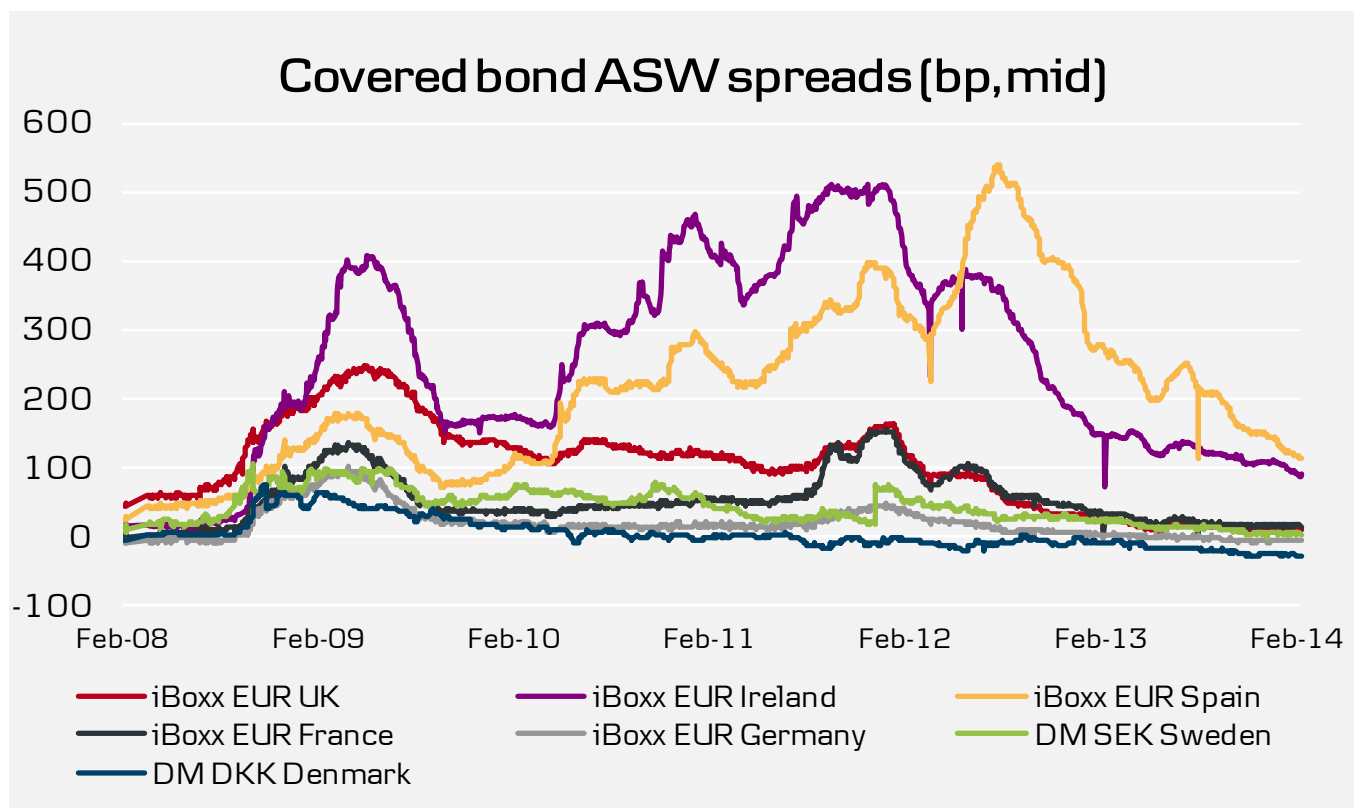
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- Pricing of non-callable bullet bonds

Why is Danish covered bonds an interesting asset class?

- The Danish bond market has been almost unaffected from the European debt crisis. Investors have used the Danish bond market as "safe heaven".
- Danish mortgage bonds are issued under the Danish mortgage act:
 - The balance principle under the Danish mortgage limits the amount of risk which a Danish mortgage bank can undertake.
 - The Danish title number and land register ensures that a mortgage bank can overtake a house if a borrower default on his/her loan. Hence, the credit risk is limited on Danish mortgage bonds.
- The spreads between Danish mortgage bonds and swaps have been stable during the last couple of years despite the high volatility on the European government bond markets.
- The liquidity of the short-dated non-callable have been quite high - and at times higher than the liquidity of Danish government bonds.
- Danish mortgage bonds still offer a high pick-up against Danish government bonds and swaps.
- The excess return of Danish mortgage bonds against Danish government bonds has over the last couple of years been quite high.

ASW spreads – Danish bonds compared to EUR covered



Key points on the Danish mortgage market

1. System, products and developments

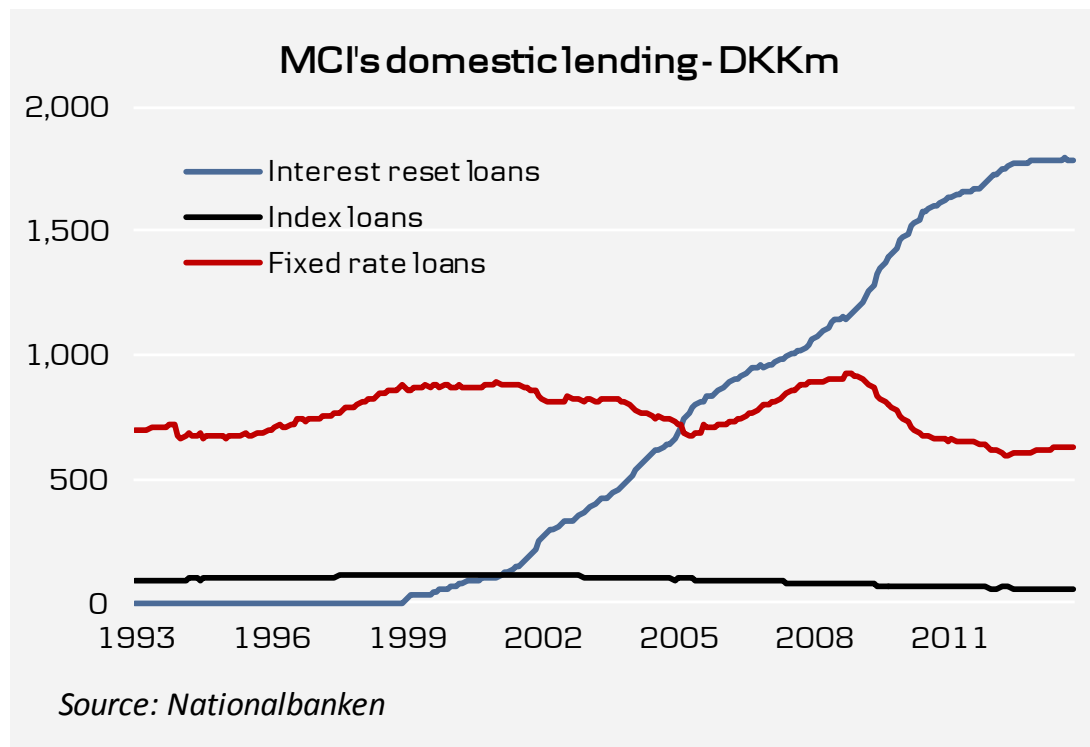
- Key elements of mortgage system
 - Balance-principle and pass-through and special mortgage legislation
 - Low risk for investors and mortgage banks ensure low yields on loans
 - Liquid mortgage bond market with large domestic investor base
- Long tradition of Danes owning their house – loan in mortgage banks
- Different types of loans – hence, different types of bonds (balance principle)

	Callable annuity bonds	Non-callable bullet bonds	Floating-to-fixed/floaters/capped floaters
Interest payments	Quarterly	Annual	Quarterly
Repayment	Annuity or IO	Bullet	Annuity or IO
Coupon	Fixed	Fixed	Floating, capped
Currency denomination	DKK	DKK or EUR	DKK or EUR
Maturities	10-30 years	1-11 years	1-30 years
Issuance	Tap	Tap or auction	Tap
Opening period	3 years	Maturity	3 years or maturity
Loan	Fixed rate callable	Adjustable rate (1-10Y)	Adjustable rate (6M) - possible cap

- Increase of adjustable rate loans and reduction in fixed rate callable loans the last 10Y. Interest only loans represents 55% of the market.

2. System, products and developments

- Today, 55% of the loans/bonds are IO
- Non-callable fixed rate loans represent the majority of the market
- Large changes in the market the last 10 years – from fixed to adjustable rates



3. Bond market support mortgage loan market

- Large domestic investor base support demands for Danish bonds – together with a small government market there, this creates a demand for low risk and liquid mortgage bonds
- Danes have large savings and pension funds. Denmark's largest banks are big compared to GDP.
- Investors are comfortable with mortgage bonds and experts in pricing the bonds
- Due to the balance principle granting of loans gives bond supply. All loans are “eligible” as opposite to EUR covered bonds markets (only “best” loans funded by covered bonds)

4. Covered bonds affects mortgage rates directly

- Borrowers pays the funding cost of issuing mortgage bonds– this is due to the balance principle
- Cost of funding the bonds

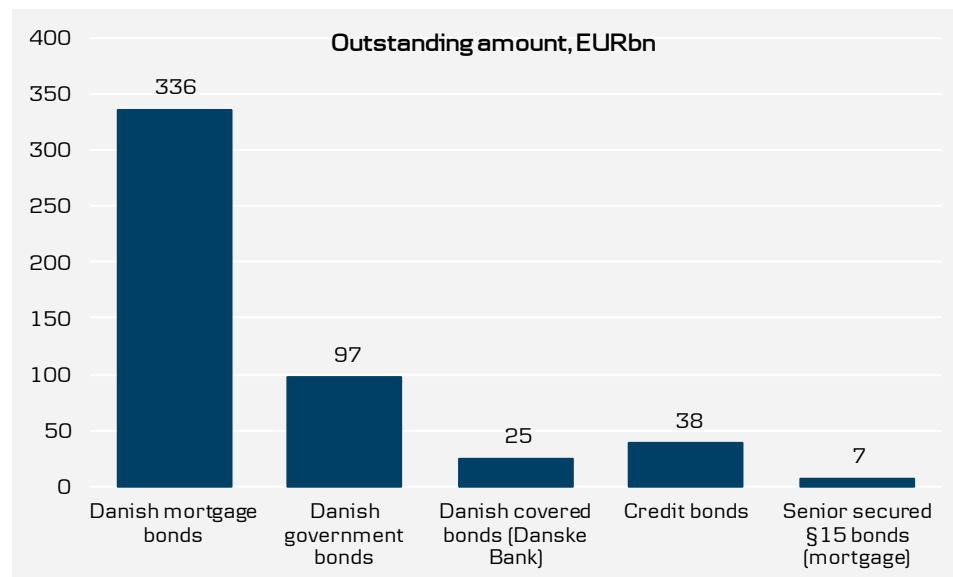
Example: 30Y fixed rate (callable) loans is funded by issuing a 30Y fixed rate (callable) 3% bond @ 98. For borrowing EUR 250.000, mortgage banks sells 255.102 bonds ($250.000 / 98 * 100$). This gives a yield of 3,06% for the borrower.

Example: 30Y adjustable rate (fixed for 1Y) is funded by issuing a 1Y fixed rate (non-callable) 2% bond @ 101. This gives a yield of 1% for 1Y.

- Besides the funding cost, borrower pays a margin to the mortgage banks. The margins covers administration costs and losses. For 0-80% LTV margin cost is around 0,75%
- Margin cost is equal for all borrowers with the same loan type – there is solidarity

5. Main characteristics of the Danish bond market

- Danish mortgage bonds are the largest asset class by far in Denmark
- Only Danske Banks issued European-style covered bonds (floaters and fixed rate bullet bonds)
- Low government debt compared to GDP (40%) (fixed rate bullet bonds)



6. Data and Danish mortgage market

- Lots of information on the cover pools behind Danish mortgage bonds – investors know the credit risk
 - Distribution of loan sized, average loan maturity, commercial/retail loans, property category, distribution of LTVs, loan in arrears, repossessed homes, geographical distribution
 - Distribution of investors on bond level (banks, insurance, pension funds, etc.)
- Mortgage banks have credit information on borrowers
- Risk analysis on borrowers interest rate sensitivity by the Central bank
 - It is possible to combine borrowers loans, loan type and interest rates, personal income grouped on family level, family's assets (deposits, financial assets, etc.), other kind of debt than mortgage debt and number of kids, level of education, age, etc.
 - Then it's possible to stress test the borrowers with increase in interest rates (5%) and shift from IO loan to amortization
 - Conclusion: Borrowers with mortgage loans have lower credit risk than Danes without mortgage loans. Borrowers ability to pay debt is very solid – even in case of large increase in interest rates.

The Danish mortgage system

Danish covered bond legislation

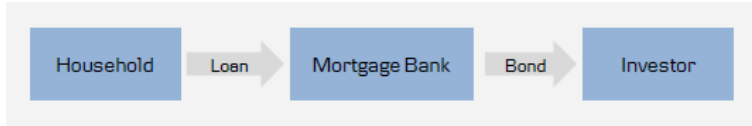
- The first Danish mortgage bonds date back **more than 200 years**
- Today Danish mortgage banks and one commercial bank grant loans against **registered mortgages on real property** funded by covered bond issues
- Mortgage lending has been regulated by **special mortgage legislation** since 1850
- The main principle of **low risk for investors**, as established in the 1850 legislation, is still the mainstay of Danish mortgage legislation
- The **new Danish covered bond legislation** took effect on 1 July 2007, where the mortgage banks now have to add assets in case house prices decline and LTV's are lower than 80%

The Danish mortgage system

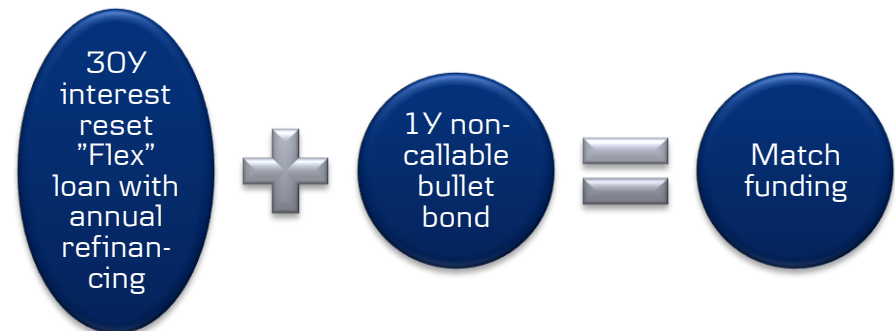


The balance principle

- All MCIs followed a strict balance principle until 1. July 2007, where the loan to the household was matched exactly by the bond bought by the investor.
- A pure pass-through system as shown below, where the MCI did not take interest rate, volatility, FX or liquidity risks.

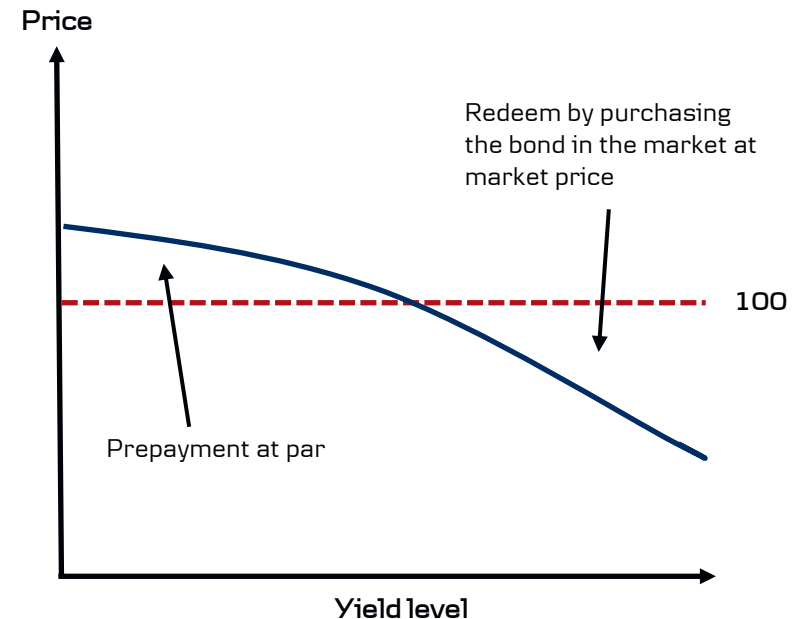


- On 1 July 2007, an amendment to the legal framework came into force which allowed MCIs as well as the universal banks the possibility to issue under two different balance principles.
 - The specific balance principle, which is very close to the old balance principle.
 - The general balance principle, which is more in line with what we see in euroland.



Significant consumer protection through the prepayment option and buy-back option

- Borrowers are entitled to pay all or part of their principal at any time. Borrowers raising a callable mortgage loan are entitled to prepay the mortgage at par prior to maturity.
- Basically, a borrower's right to prepay is embedded in one or two prepayment options:
 - Callable loans have an embedded call option and a delivery option
 - Non-callable loans have an embedded delivery option only
- Under the Balance Principle, the borrower's call option must be embedded in issued covered bonds in order to achieve a perfect hedge, ie, the mortgage banks do not suffer a loss when call options are exercised.
- Since the value of homes and the associated mortgage bonds tend to move in the same direction, the borrower is protected against negative equity.



Mortgage bank lending is crucial for Denmark

Mortgage bank lending exceed commercial bank lending.

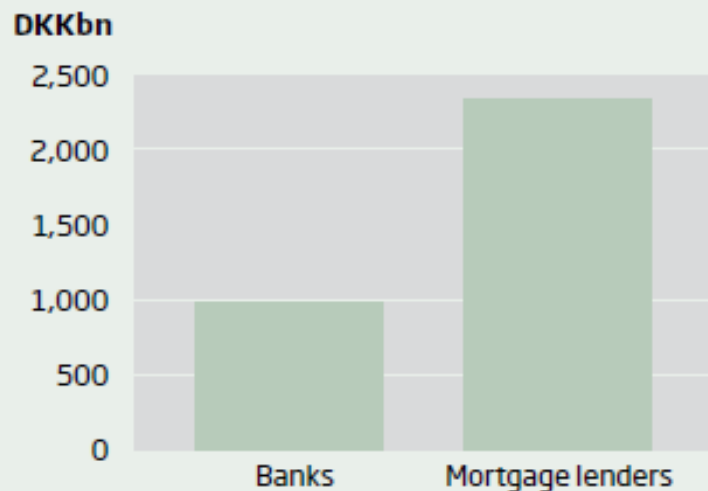


Figure 1: Retail and commercial lending by commercial banks and mortgage banks, March 2012. (Source: Danmarks Nationalbank)

Breakdown of mortgage lending by type of property. Most lending is for owner-occupied properties and holiday homes.

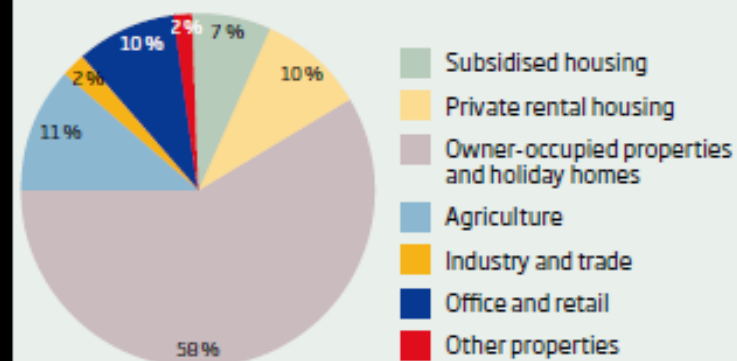
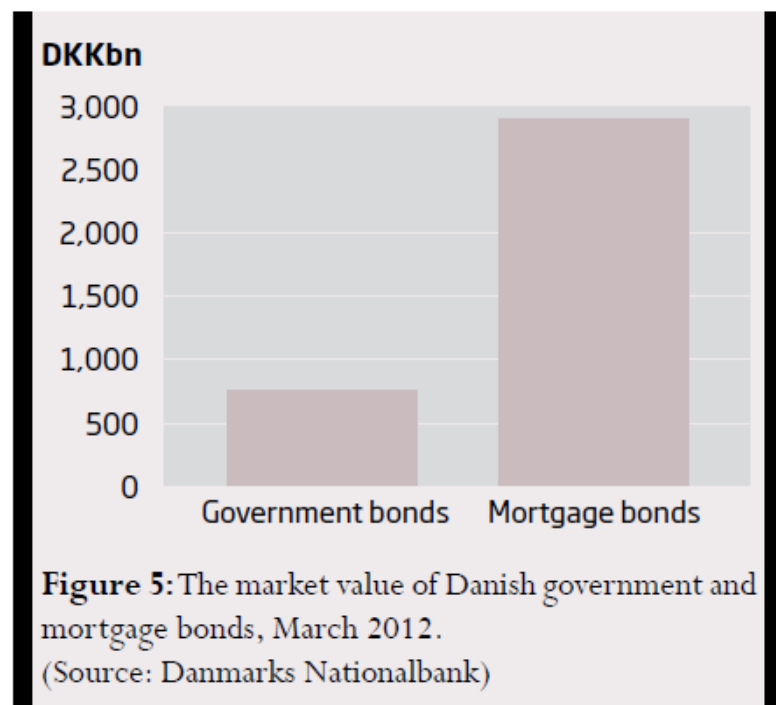


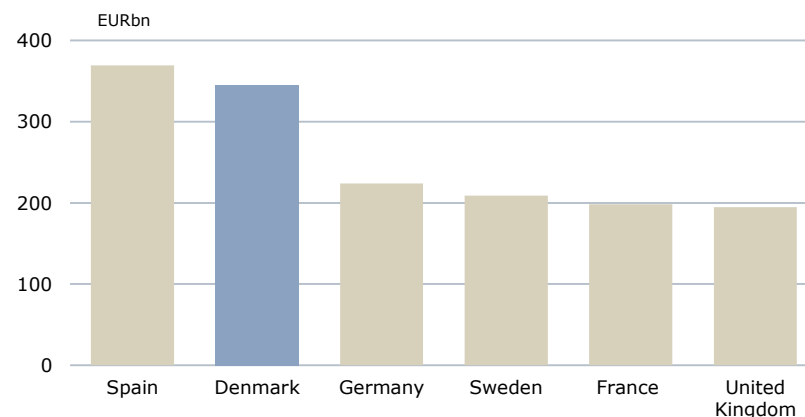
Figure 2: Breakdown of mortgage lending by type of property, Q1/2012. (Source: The Association of Danish Mortgage Banks)

The Danish mortgage bond market is significantly bigger than Danish government bond market, and among the largest in Europe

The Danish mortgage bond market is more than four times larger than the Danish government bond market.



Covered mortgage bonds outstanding, 2011



Source: ECBC 2012

The second largest covered bond market in the world

- Persistent demand for housing finance in Denmark has made the Danish covered bond market one of the largest in the world.
- On covered bonds, Denmark is the second largest country, exceeded only by Spain.
- Overall, taking into account covered bonds with public loans as collateral, Denmark ranks fourth.

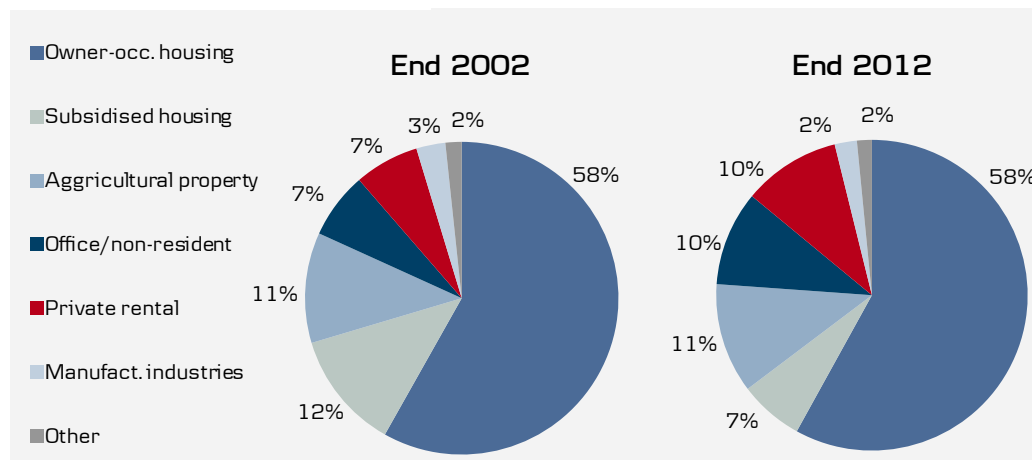
Table 6. Volume outstanding covered bonds end-2011 (EURm)

	Public Sector	Mortgage	Ships	Mixed Assets	Total
Australia	0	2,142	0	0	2,142
Austria	27,223	12,547	0	0	39,770
Canada	0	38,610	0	0	38,610
Cyprus	0	5,200	0	0	5,200
Czech Republic	0	8,546	0	0	8,546
Denmark	0	345,529	5,999	0	351,528
Finland	0	18,758	0	0	18,758
France	77,835	198,395	0	89,768	365,998
Germany	355,673	223,676	6,641	0	585,990
Greece	0	19,750	0	0	19,750
Hungary	0	5,175	0	0	5,175
Ireland	31,760	30,007	0	0	61,767
Italy	12,999	50,768	0	0	63,767
Latvia	0	37	0	0	37
Luxembourg	26,700	0	0	0	26,700
Netherlands	0	54,243	0	0	54,243
New Zealand	0	3,656	0	0	3,656
Norway	3,759	91,852	0	0	95,611
Poland	112	527	0	0	639
Portugal	1,400	32,283	0	0	33,683
Slovakia	0	3,768	0	0	3,768
Spain	32,657	369,208	0	0	401,865
Sweden	0	208,894	0	0	208,894
Switzerland	0	71,881	0	0	71,881
United Kingdom	3,656	194,783	0	0	198,439
United States	0	9,546	0	0	9,546
EU-27	570,015	1,782,093	12,640	89,768	2,454,516
Total	573,774	1,999,780	12,640	89,768	2,675,962

Source: ECBC European Covered Bond Fact Book 2012

Lending segments

- Mortgages on a variety of categories of real property are eligible as collateral for mortgage bonds. However, mortgages on residential property dominate most collateral pools.
- In the last decade, the domination of mortgages on residential property has been further strengthened. New lending products, house price inflation and remortgaging opportunities have spurred demand from homeowners and in 2011 loans secured by mortgages on residential property accounted for 58 per cent of total net new lending.



Source: The association of Danish mortgage banks

Issuers, bond types and investors

The issuers

- Danish covered bonds are issued by a total of seven mortgage banks of which three are specialised in commercial lending. The fairly low number of issuers adds to the liquidity of the bonds issued.
- In addition, market concentration is high, with Nykredit/Totalkredit and Realkredit Danmark accounting for almost 66% of all covered bonds issued.

Table 8. Volumes and market shares of Danish MCIs, end of 2012

	DKK bonds		EUR bonds		Total volume (EURbn)	Market share (%)
	Volume (EURbn)	Share (%)	Volume (EURbn)	Share (%)		
Nykredit/Totalkredit	137.7	40.6%	15.6	36.2%	153.3	40.1%
Realkredit Danmark	92.9	27.4%	5.8	13.4%	98.7	25.8%
Nordea Kredit	40.9	12.1%	1.5	3.6%	42.5	11.1%
Danske Bank	25.3	7.5%	14.8	34.4%	40.1	10.5%
BRFkredit	26.9	7.9%	0.2	0.4%	27.1	7.1%
DLR Kredit	13.7	4.0%	5.2	12.1%	18.9	4.9%
LRF	1.9	0.6%			1.9	0.5%
FIH Realkredit	0.02	0.0%			0.02	0.0%
Total	339.4	100.0%	43.0	100.0%	382.5	100.0%

Source: Danske Bank Markets

Bond types

- The covered bond market in Denmark has experienced a rapid and profound transition over the past decade.
- Traditionally, callable annuity bonds predominated, mirroring the dominance of callable fixed rate mortgage loans in the Danish property market.
- Non-callable bullet bonds were introduced to fund interest-reset loans, which were launched in 1996. Since then, a sustained demand for interest-reset loans has shifted the Danish covered bond market to such an extent that non-callable bullet bonds as at the end of 2012 made up almost 46% of total market volume.

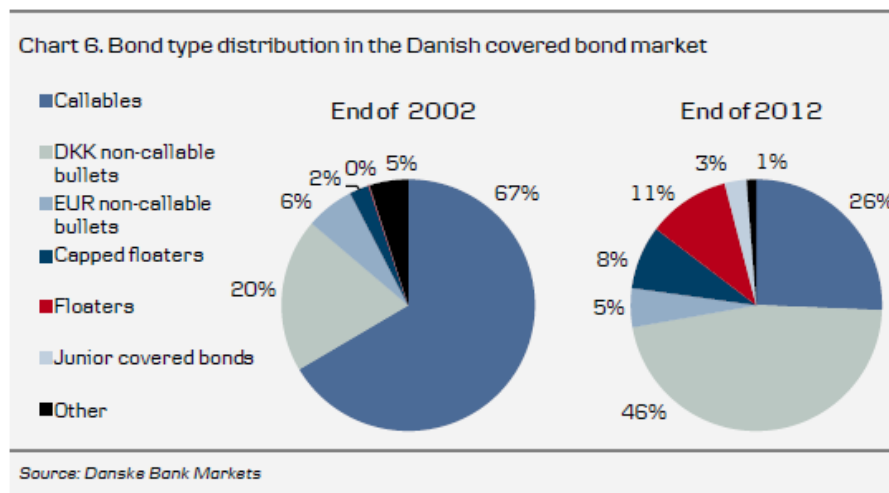


Table 50. Bond structures

	Callable annuity bonds	Non-callable bullet bonds	Floating-to-fixed/floaters/capped floaters
Interest payments	Quarterly	Annual	Quarterly
Repayment	Annuity or IO	Bullet	Annuity or IO
Coupon	Fixed	Fixed	Floating, capped
Currency denomination	DKK	DKK or EUR	DKK or EUR
Maturities	10-30 years	1-11 years	1-30 years
Issuance	Tap	Tap or auction	Tap
Opening period	3 years	Maturity	3 years or maturity

Note: IO = interest only

Source: Danske Bank Markets

Danish Covered bonds and Realkreditobligationer

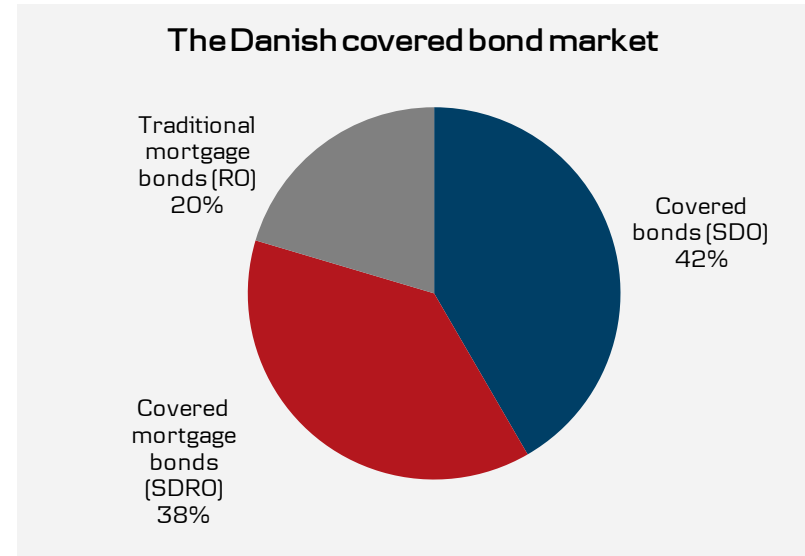
There are three different types of covered bonds in Denmark

- SDO – covered bonds.
- SDRO – covered mortgage bonds.
- Traditional mortgage bonds issued before 31 December 2007.

Traditional mortgage bonds issued after 31 December 2007 are not CRD compliant and higher risk weights for banks apply for these bonds relative to SDOs/SDROs – 20% versus 10%, respectively

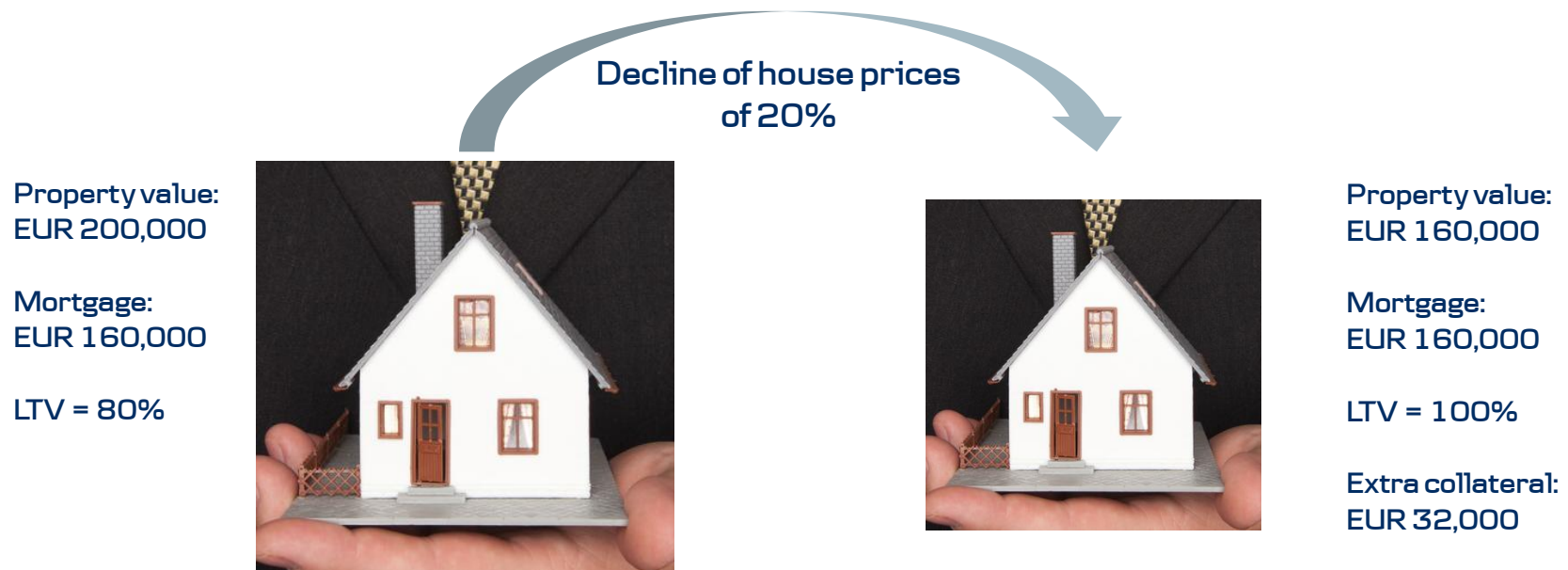
The covered bonds (SDOs/SDROs etc.) makes up the bulk part of the market – currently 80%

Traditional mortgage bonds are currently 20% of the market.



Source: Danmarks Nationalbank, end of 2013

The change in the mortgage act in 2007 meant a significant change in the OC requirement of Danish mortgage banks



- Before 2007 there was very little focus on the LTV's of Danish houses and OC requirements
- However, the change in the mortgage act in 2007 meant that a decline in the house prices would lead to additional collateral in the cover pools (the capital centre) such that the $LTV < 80\%$ as shown in the example

Hence, the capital centre of a mortgage bank was changed

- Initially, the OC initially consisted of the mandatory OC
- In 2007, the mortgage act required mortgage banks to add OC if house prices declined
- After the collapse of Lehman, the rating agencies have increased the OC requirements to mortgage banks significantly to address the refinancing risk
- Finally, the new regulation increase the capital requirements (solvency) for the mortgage banks

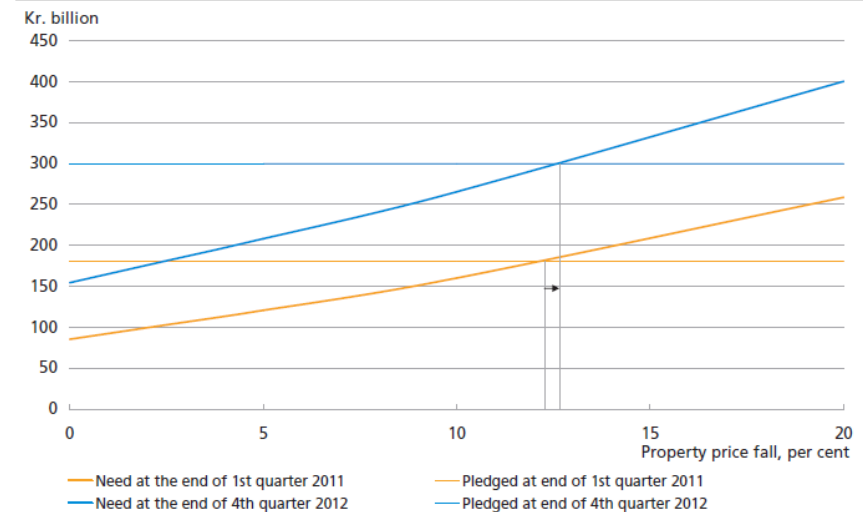
Capital centre	
Assets	Liabilities
Mortgage Loans - Private residential loans (Max LTV = 80%) - Commercial loans (Max LTV = 60%) Loans to public authorities Claims with banks	Covered bonds
Eligible assets - Government bonds, covered bonds etc.	Senior secured bonds
Mandatory OC = 8% of RWA + voluntary OC	Equity

There is plenty of OC in the cover pools of Danish mortgage banks – house prices can decline by additional 12%, before they need to top up with additional capital

- The Danish Central Bank calculates the need for increasing OC on the back of declining house prices
- Currently the mortgage banks have plenty of excess capital - by the end of Q4, 2012, they had DKK 300bn in excess capital - up from 185bn in Q1, 2011
- They needed to build up extra OC as house prices had declined by 7% in that period by some DKK 60bn
- But they increased OC with DKK 115bn to DKK 300bn by the end of 2012
- Given stable house prices, the need to issue senior secured debt has declined significantly – No new issuance.

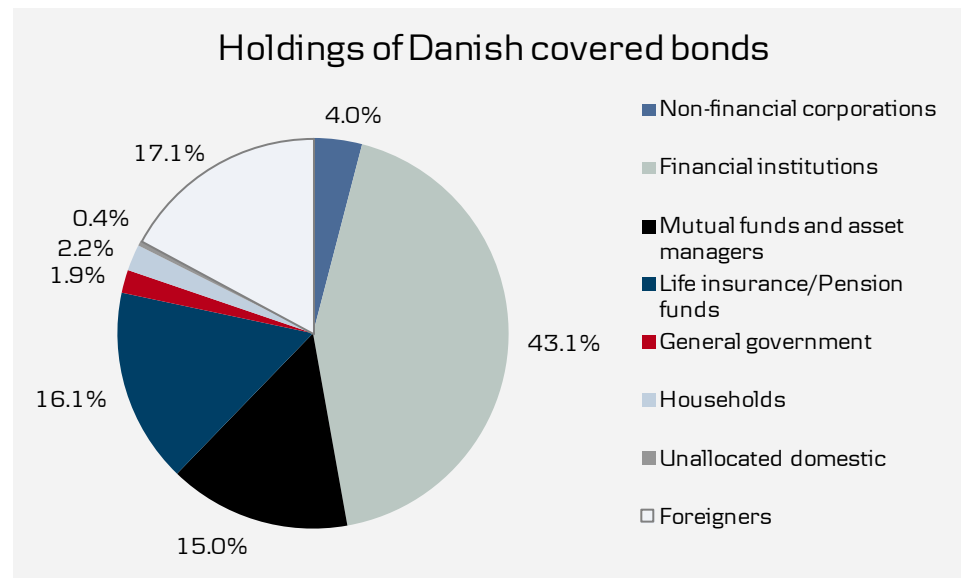
NEED FOR TOP-UP COLLATERAL ON FALL IN PROPERTY PRICES

Chart 6-6

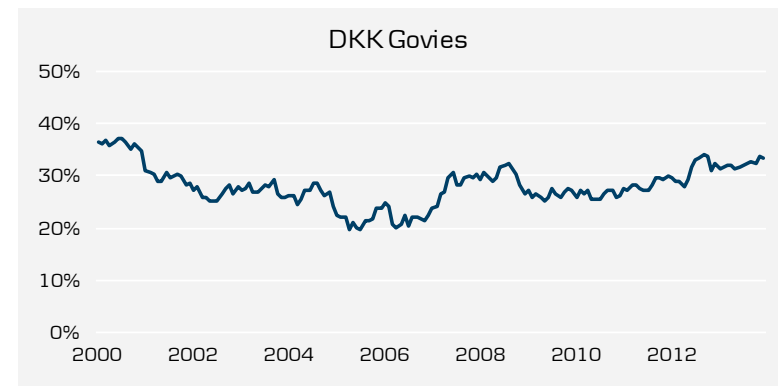
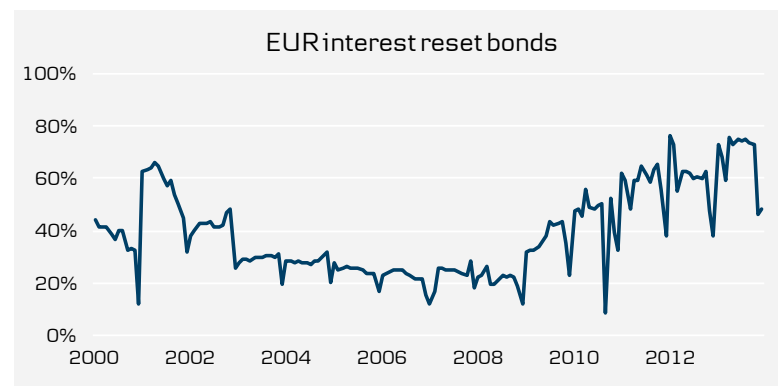
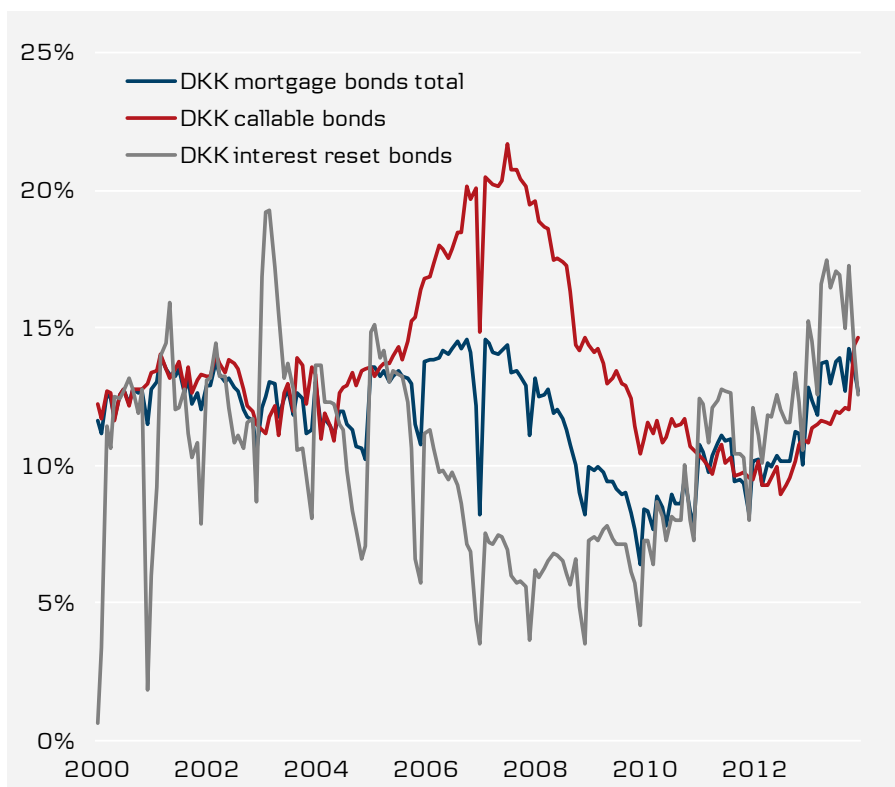


Investors in Danish Covered Bonds

- The largest resident investor group in Danish covered bonds is financial institutions.
- These hold 43% of the total volume of covered bonds as December 2013.
- The second largest domestic investor group in the Danish covered bond market is life insurance companies and pension funds, which hold 16% of the total volume.
- Traditionally, foreign investors have been big players in the Danish government bond market, but in recent years they have also shown an increased interest in Danish covered bonds.

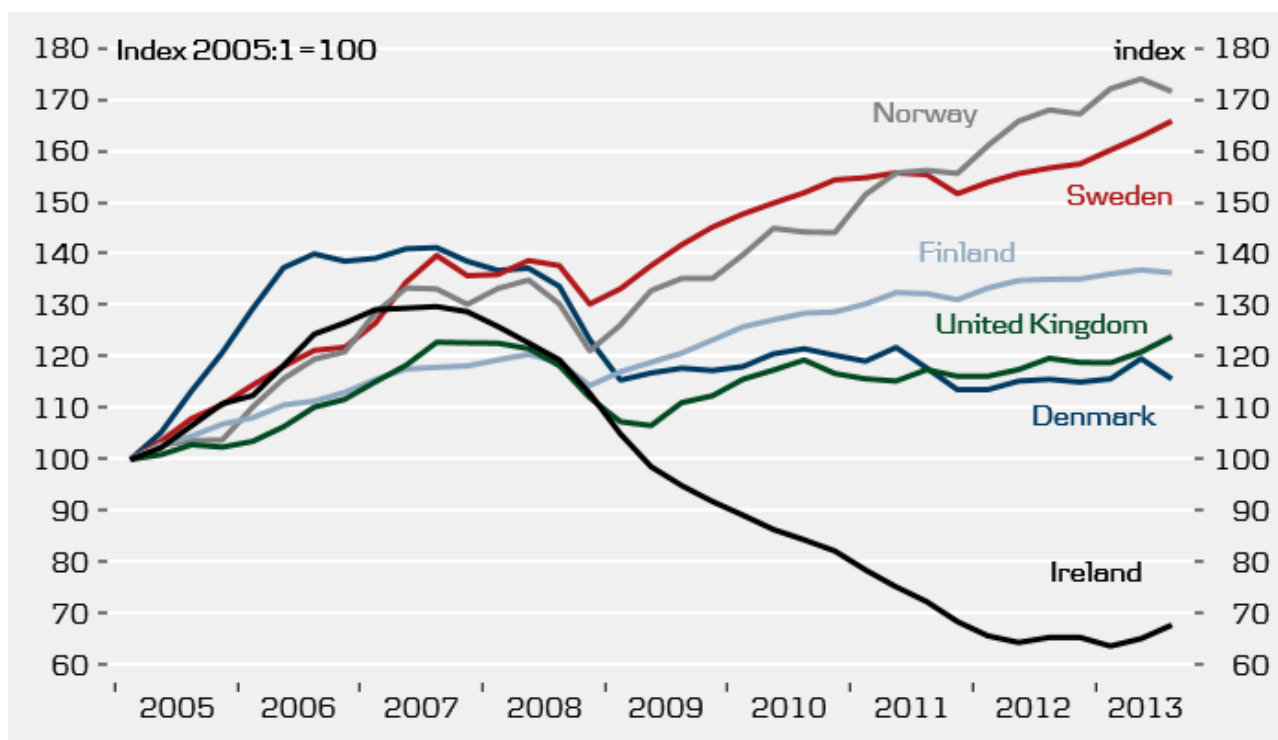


Foreign holdings of Danish mortgage bonds

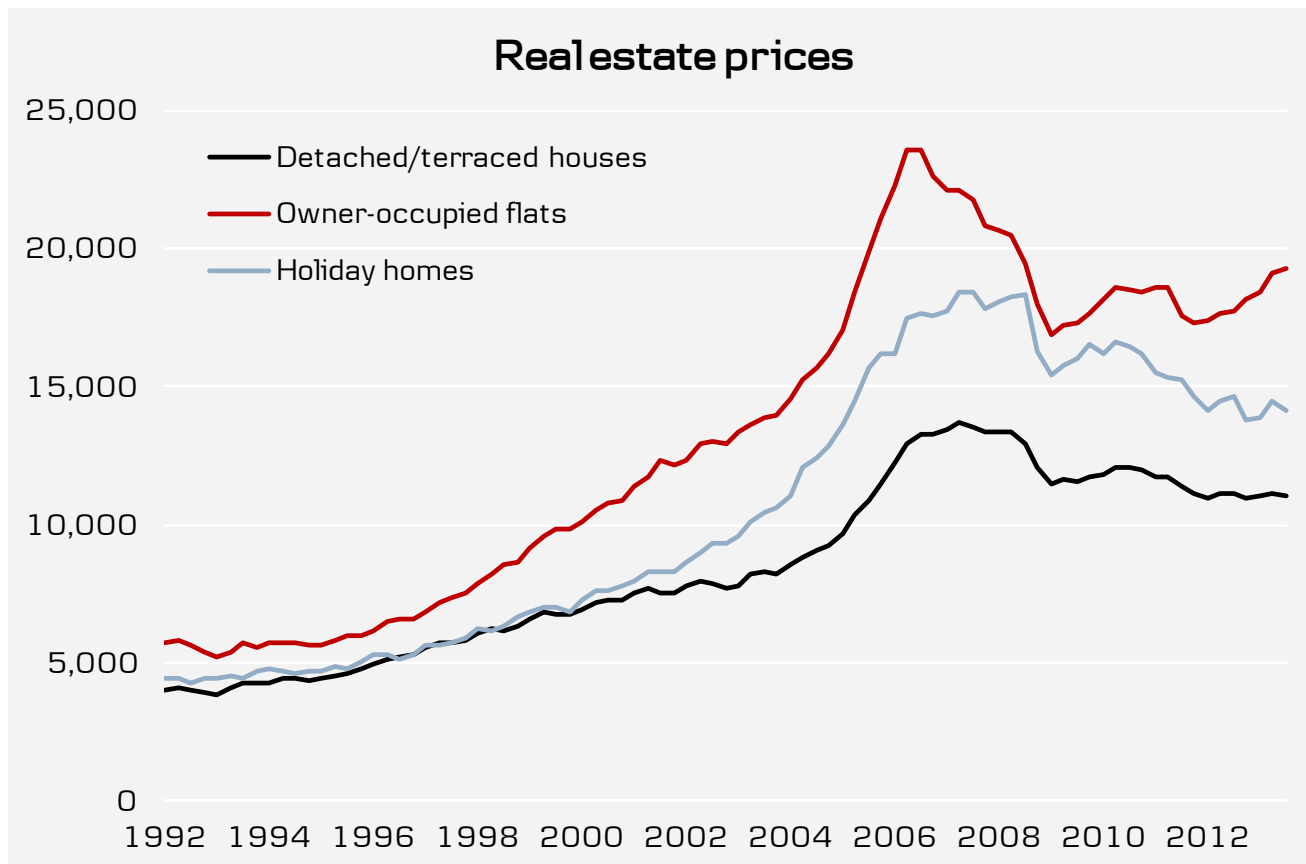


The housing market

House price development compared to European peers

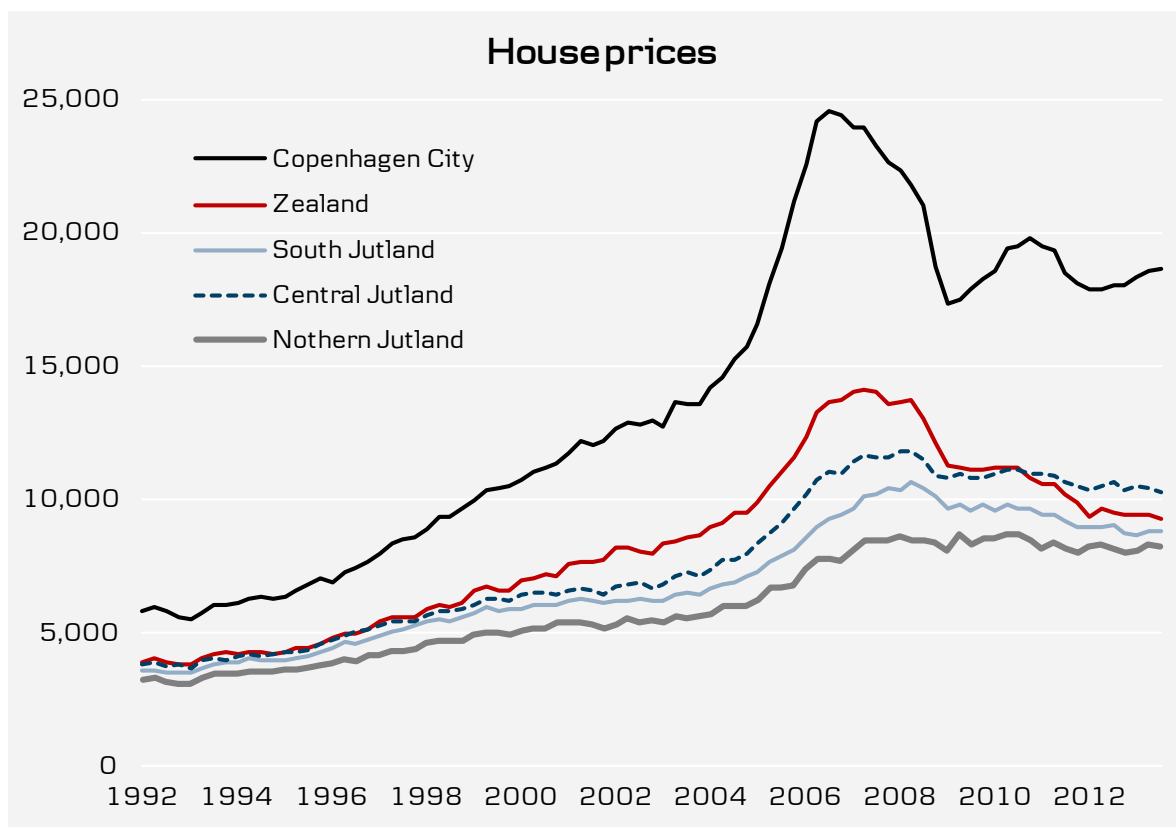


Stabilisation of real estate prices



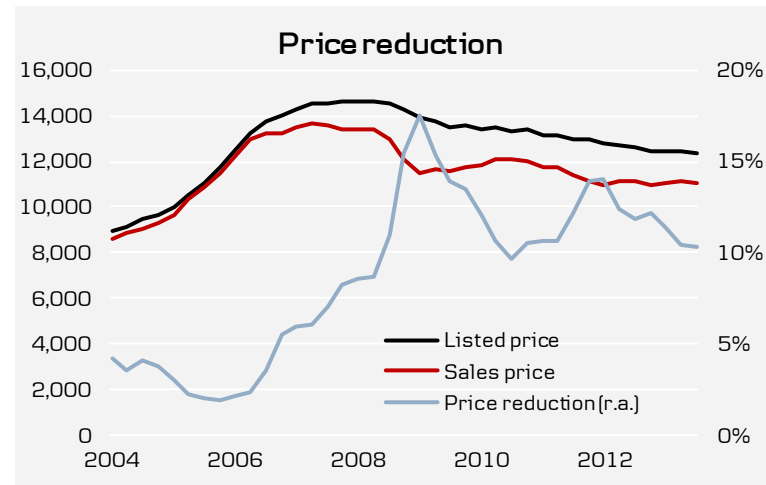
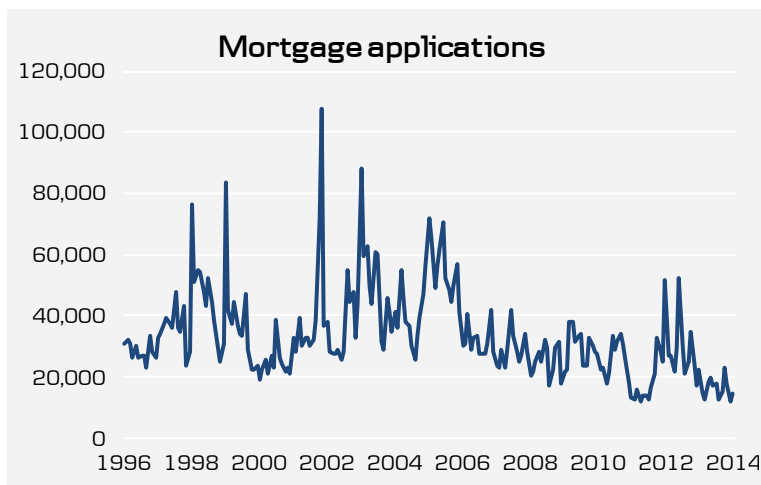
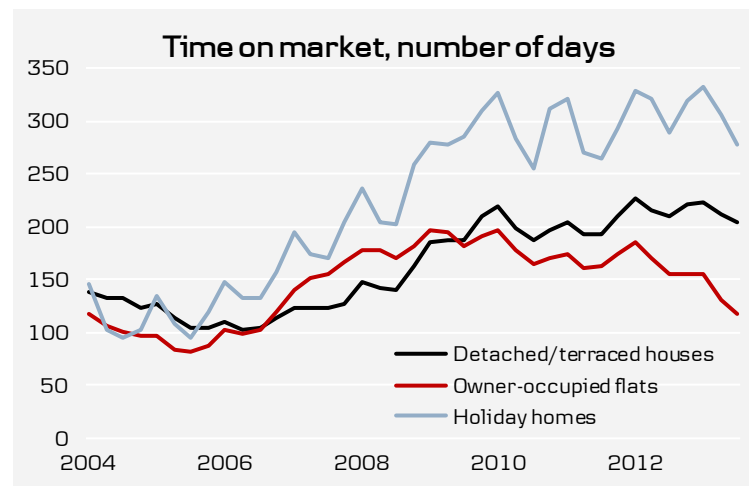
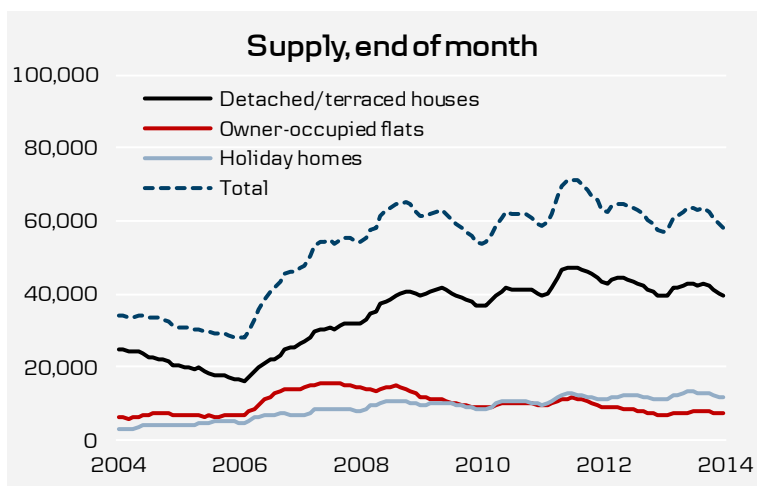
Source: Association of Danish mortgage banks

Large regional differences – Copenhagen City hit hardest



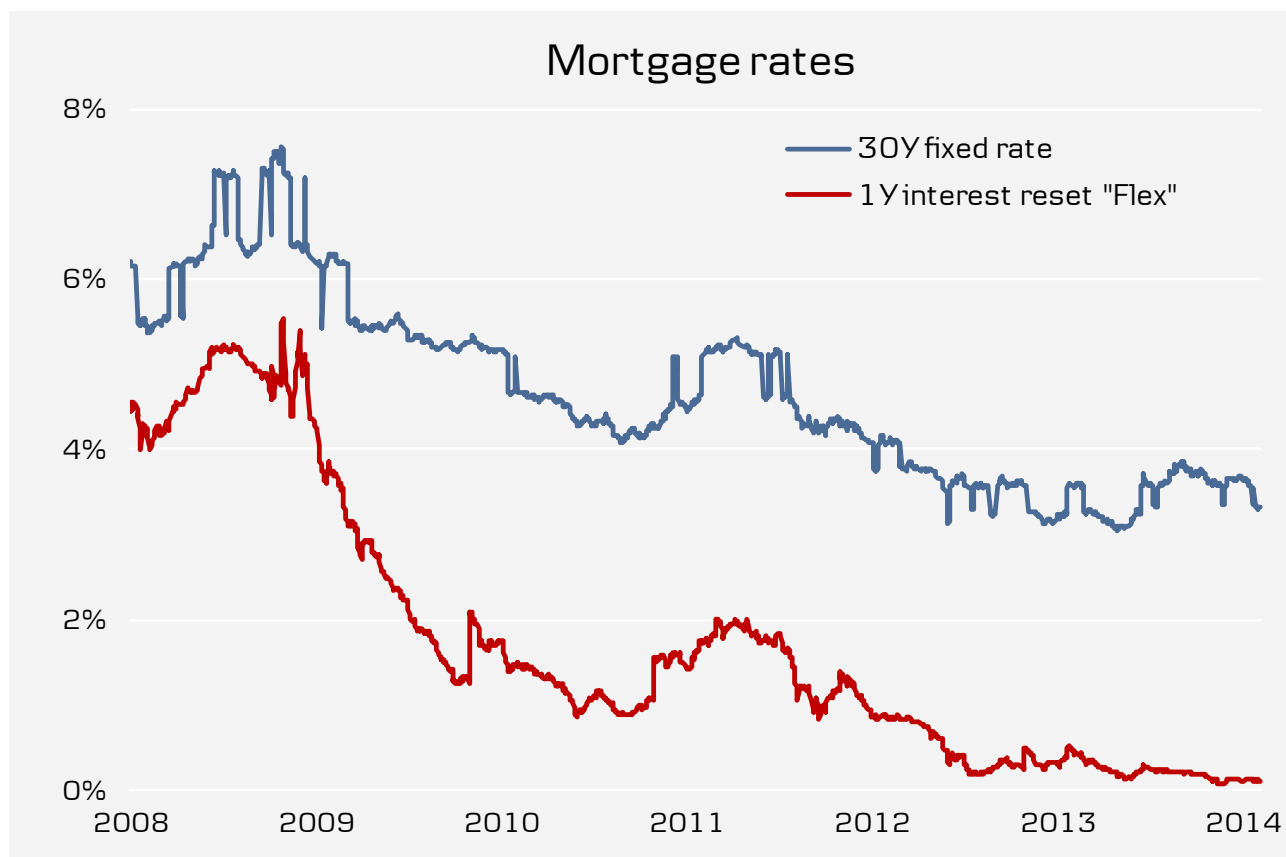
Source: Association of Danish mortgage banks.

High supply, long time-on-market ...



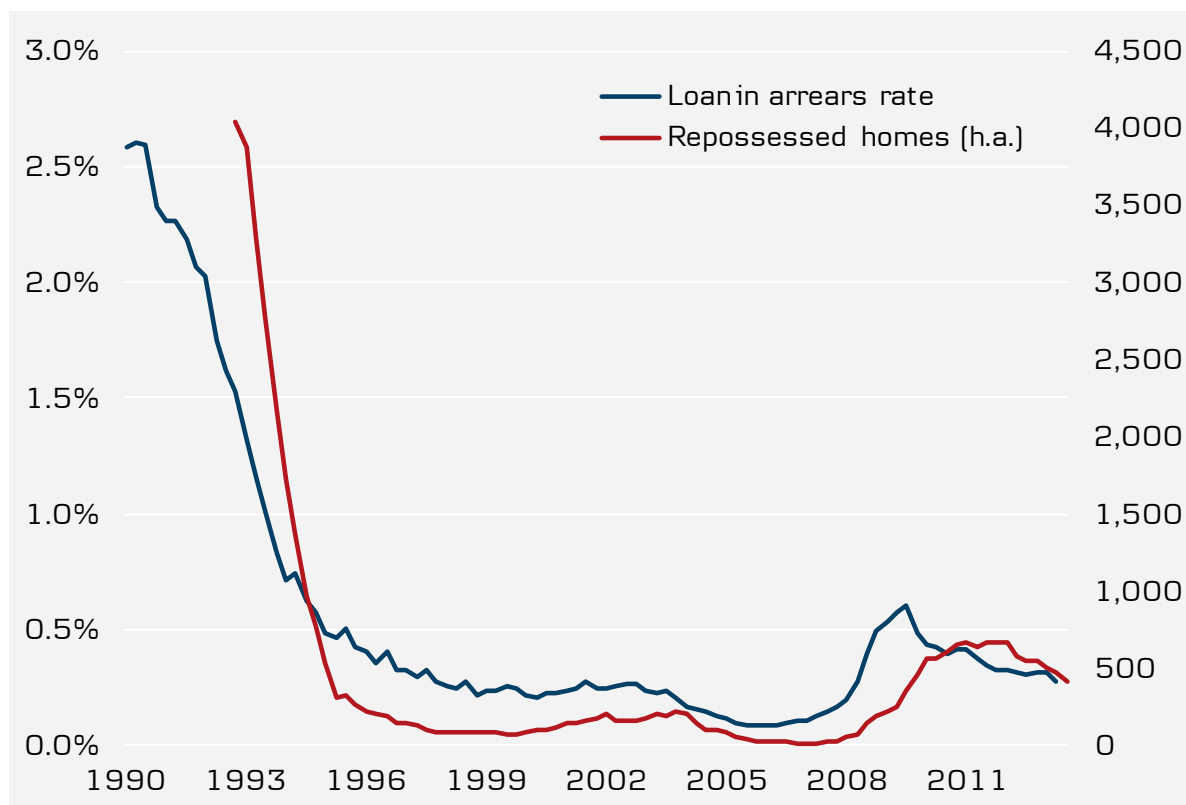
Source: Association of Danish mortgage banks

The economy has been supported by low interest



Source: Danske Markets

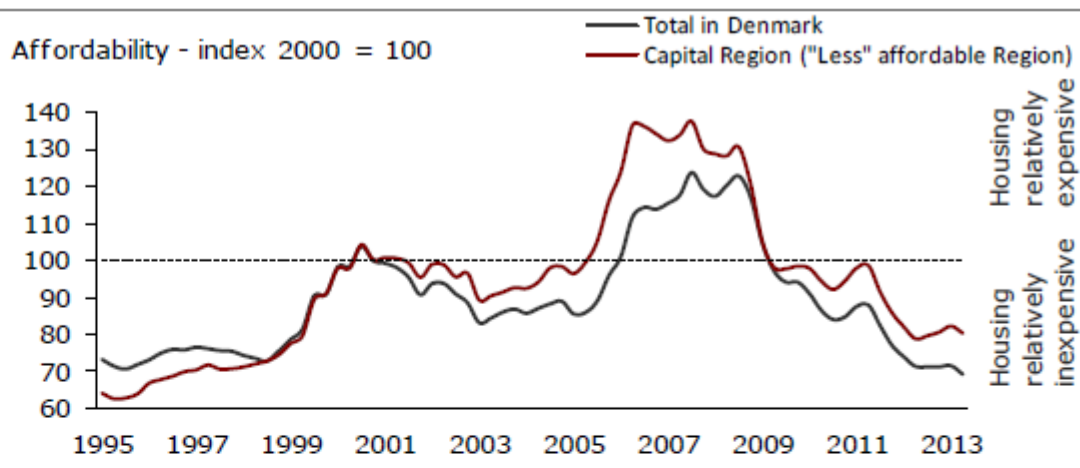
However, the credit quality improves as loan in arrears is declining



Homeowners affordability and foreclosures

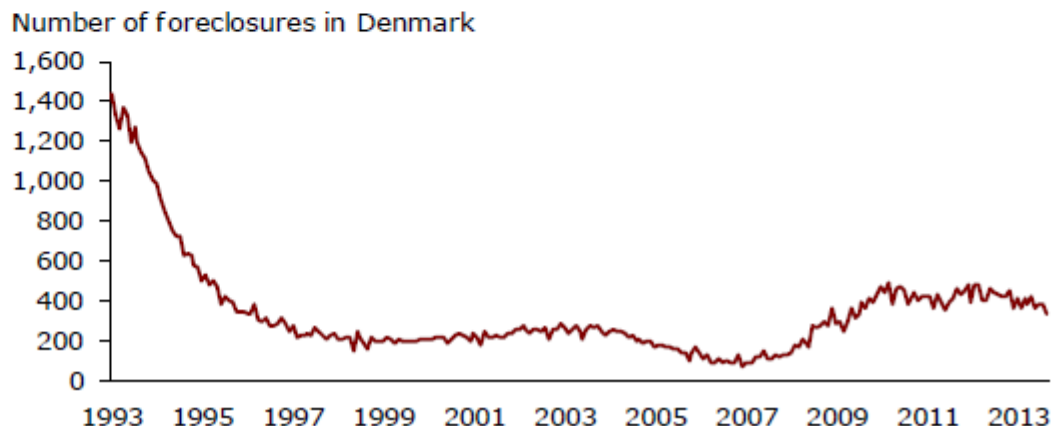
Homeowner Affordability

- House price deflation and lower interest rates has made housing more affordable even in the Copenhagen area
- Housing costs are now at the lowest level since the middle of the 1990's



Foreclosures

- The number of foreclosed properties in Denmark in September 2013 was 331
- We expect the numbers to stay at the current level throughout 2013
- The duration of a foreclosure is approx. 6 months from missed payments to completion



Source: Realkredit Danmark, Risk report 3Q 2013

Very small actual losses in the Danish cover pools – an example from Nykredits loan book

Losses ascertained as a percentage of debts outstanding

	Owner-Occ.	Commercial	Agriculture	Rental housing	Total
1992	0,40%	1,05%	0,18%	0,16%	0,42%
1993	0,37%	1,86%	0,32%	0,19%	0,56%
1994	0,21%	1,51%	0,33%	0,17%	0,42%
1995	0,13%	1,26%	0,22%	0,07%	0,31%
1996	0,05%	0,61%	0,10%	0,09%	0,15%
1997	0,04%	0,46%	0,04%	0,01%	0,09%
1998	0,02%	0,37%	0,01%	0,01%	0,06%
1999	0,02%	0,15%	0,05%	0,00%	0,04%
2000	0,01%	0,16%	0,01%	0,01%	0,03%
2001	0,02%	0,05%	0,01%	0,01%	0,02%
2002	0,03%	0,13%	0,02%	0,01%	0,04%
2003	0,03%	0,02%	0,02%	0,01%	0,02%
2004	0,02%	0,07%	0,00%	0,01%	0,02%
2005	0,01%	0,06%	0,01%	0,00%	0,01%
2006	0,00%	0,03%	0,02%	0,00%	0,01%
2007	0,00%	0,04%	0,01%	0,01%	0,01%
2008	0,00%	0,00%	0,00%	0,00%	0,00%
2009	0,02%	0,05%	0,00%	0,01%	0,02%
2010	0,05%	0,09%	0,01%	0,03%	0,05%
2011	0,06%	0,13%	0,01%	0,04%	0,06%
2012	0,08%	0,14%	0,09%	0,11%	0,10%
2Q 2013	0,05%	0,04%	0,03%	0,03%	0,04%

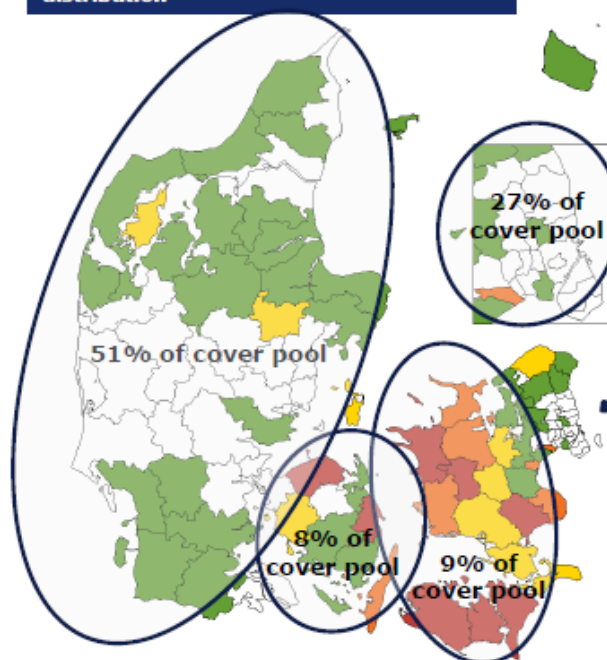
Source. Nykredit

.. the losses are in the “country-side” –(we use Nykredit as an example)

Nykredit

Limited exposure to challenged areas

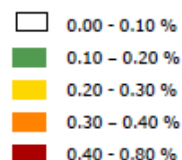
Cover pool exposure – geographic distribution



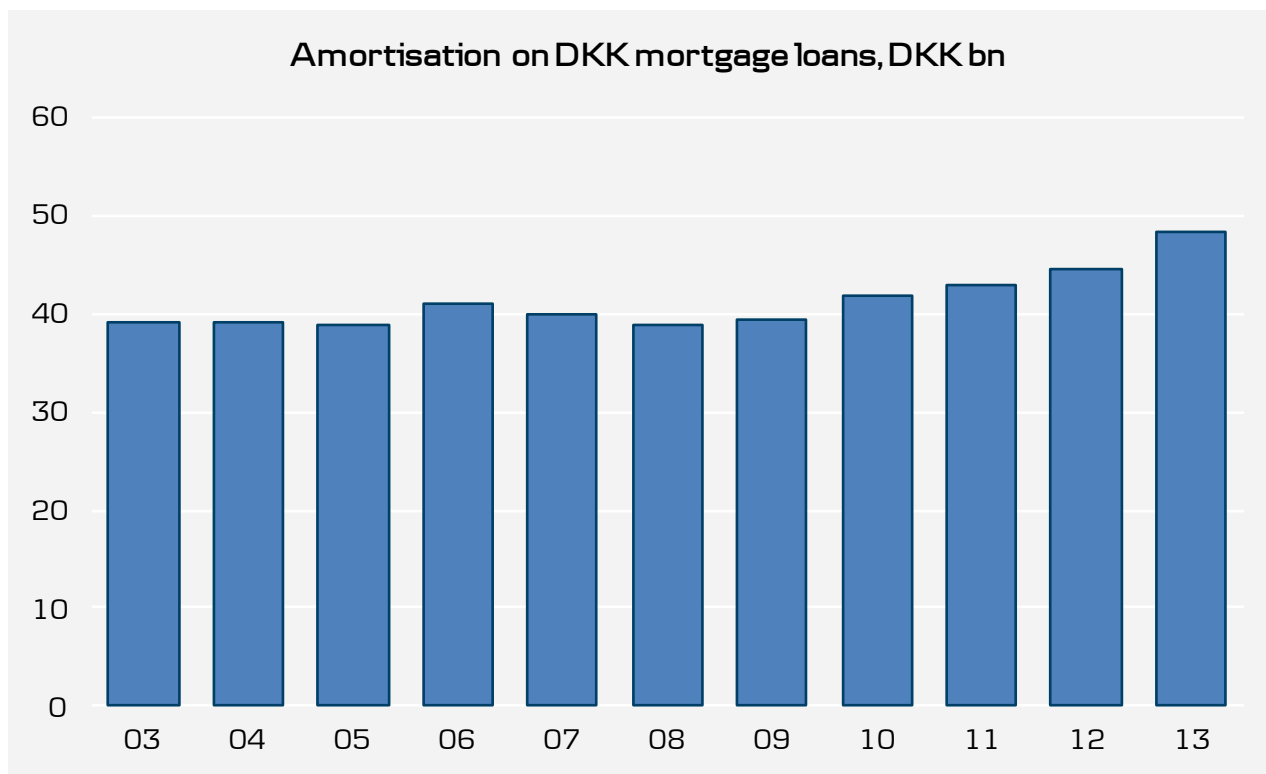
Divorce and disease spurs losses



Recognised loss past 12 months as % of total lending



Borrowers are increasing the amortisation on their mortgage loans (although slow pace)



New law proposal from the Ministry of Business and Growth

The new proposal from the Ministry of Business & Growth and the Danish Central Bank

- The aim is to deal with the refinancing risk – remove the refinancing risk and satisfy the rating agencies
- Furthermore, maintain the F1-loans but at the same time satisfy the NSFR for the mortgage banks
- The original proposal has been changed significantly – but the law will be passed and in place after April 1, 2014 (bonds with a maturity of up to 12 mths) and Jan 1, 2015 (bonds with a maturity > 12 months)
- Hence, the upcoming auction is not affected and bonds issued before are “grandfathered”
- However, the new proposal has one very important feature – The Danish Central Bank can now raise rates without risking a significant negative macroeconomic impact in order to maintain the currency peg

The new proposal - the main features

- The law applies for bonds where the maturity of the mortgage loan is longer than the maturity of the underlying bonds. The law applies for bonds with a refinancing period of up to 12 months that have been issued from 1 April 2014 and for bonds with a refinancing period of more than 12 months that have been issued from 1 January 2015.
- The extension is triggered by:
 - The interest rate trigger – If the yield level at a refinancing auction increases by more than 5%-points within a period of one year and the underlying bonds are issued with a maturity of up to two years, the maturity can be extended by one year. The yield of the extended bond will be the yield level one year ago plus 5%-point. A maturity extension triggered by a rise in the yield level of 5%-points is limited to one year.
 - The failed auction trigger – If a mortgage bank is unable to sell bonds at a refinancing auction the maturity of the underlying bond will be extended by one year. If the mortgage bank is still unable to sell the bonds the following years the maturity of the bond will be extended with one additional year every year until the mortgage bank is able to sell the bonds in the market.

If a mortgage bank is unable to sell the bonds at a refinancing auction and the maturity is extended by one year, the yield of the maturity extended bond will be the yield one year ago plus 5%-point. If the mortgage bank is still unable to sell the bonds in the market after the first maturity extension the yield is unchanged.

- The bankruptcy trigger – Maturities of bonds of a mortgage bank under resolution will be extended 12 months at a time, rather than matching underlying loan (with a maturity of up to 30 years)

The new proposal – the expected effects

- The existing bonds are grandfathered – they will richen modestly given the domestic investors preference for "closed for issuance" series.
- Although the premium will be limited as only 1Y-2Y covered bonds are affected by the proposal.
- We will have a lot more ISIN codes as new bonds will have to be introduced.
- The new bonds will still be eligible with the Danish Central Bank and the EUR-den. covered bonds eligible with the ECB – but otherwise there could be some issues here.
- We will never have a failed auction – the cost would be too expensive, and there is an incitement for both banks and mortgage banks to make certain that this never happens
- It looks as a soft bullet structure - but it is not as there is an external trigger (the interest trigger).
- Danske Bank's covered bonds are not affected by the law as we do not have auctions or issue under the strict balance principle

The new law proposal – an overview

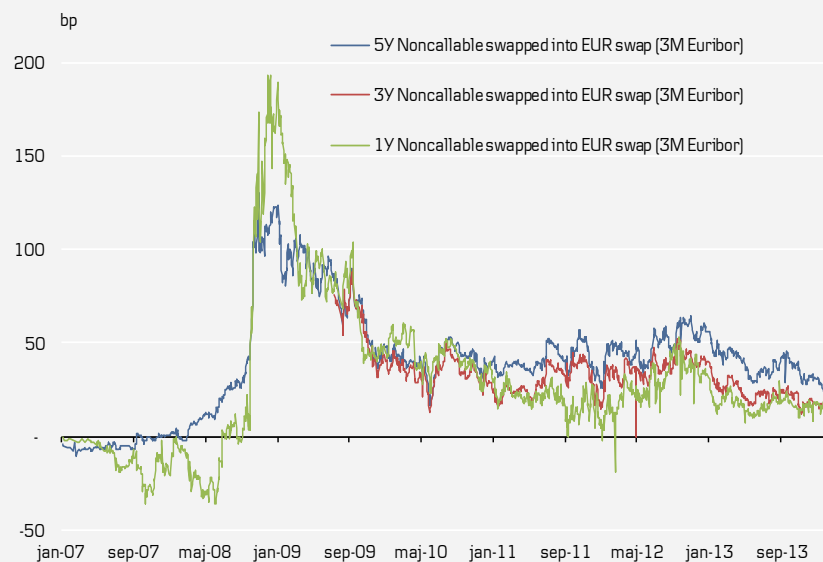
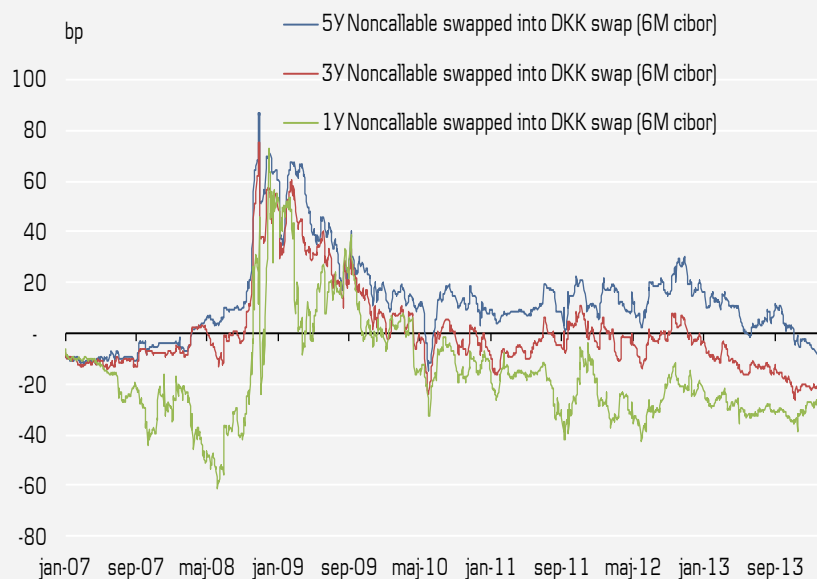
Bond type	1st maturity criteria	2nd maturity criteria	Increase in yield of more than 5pp	Failed auction	Liquidation
Fixed rate bonds	Bonds issued with a refinancing period of up to 24 months	Bonds with a maturity of up to and including 12 months at refinancing.	<p>The maturity is extended by 12 months once if the yield level at a refinancing auction increases by more than 5pp relative to the yield level at the time of issuance.</p> <p>The yield is set to the yield level at the previous refinancing auction plus 5pp.</p>	<p>The maturity is extended by 12 months if there is an insufficient number of buyers at an auction held before existing bonds expire.</p> <p>The yield is set to the yield level at the latest refinancing auction plus 5pp. The yield remains unchanged if the maturity is extended more than once.</p>	<p>If the mortgage bank is being wound up, a maturity extension will happen if:</p> <ol style="list-style-type: none"> 1) in the opinion of the liquidator the claims of all bond investors are not likely to be satisfied if refinancing is chosen; 2) a refinancing auction fails. <p>If maturity extension is triggered, the yield will be determined at a benchmark 1Y reference yield (e.g. CITA) in the same currency as the issued plus 0-5pp.</p>
		Bonds with a maturity above 12 months at refinancing.	<p>The maturity is extended by 12 months once if the yield level at a refinancing auction increases by more than 5pp relative to the yield level for a corresponding bond at its issuance 11-14 months previously.</p> <p>The yield is set to the yield level on a corresponding bond traded 11-14 month earlier plus 5pp.</p>	<p>The maturity is extended by 12 months if there is an insufficient number of buyers at an auction held before existing bonds expire.</p> <p>The yield is set to the yield level on a corresponding bond traded 11-14 month earlier plus 5pp. The yield remains unchanged if the maturity is extended more than once.</p>	
	Bonds issued with a refinancing period above 24 months		No restrictions in the event of increasing yield level.	<p>The maturity is extended by 12 months if there is an insufficient number of buyers at an auction held before existing bonds expire.</p> <p>The yield is set to the yield level on a corresponding bond with a maturity of 11-14 months traded 11-14 months earlier, plus 5pp. The yield remains unchanged if the maturity is extended more than once.</p>	
Floating rate bonds	Bonds issued with a refinancing period of up to and including 24 months relative to the issue date.		<p>If the interest rate for the interest rate fixing is more than 5pp higher than the last fixed interest rate, the coupon will be fixed at the last fixed interest rate plus 5pp.</p> <p>The fixed interest rate shall remain unchanged for a minimum of 12 months, unless a lower interest rate is set within these 12 months.</p> <p>The restrictions will apply for the setting of the coupon subsequent to the expiry of the minimum of 12 months.</p>	<p>The maturity is extended by 12 months if there is an insufficient number of buyers at an auction held before existing bonds expire.</p> <p>The coupon will be fixed at the last fixed interest rate plus 5pp. The new fixed interest rate shall remain unchanged during the 12 months. The coupon remains unchanged if the maturity is extended more than once.</p>	
	Bonds issued with a refinancing period above 24 months relative to the issue date.		No triggers in the event of an increasing yield level.		
Junior covered bonds			If an auction has failed and the underlying bonds are extended or modified, the term of the loan obtained as extra collateral pursuant to §15 (junior covered bonds) must be extended or modified accordingly. This applies for JCBs that reach ordinary maturity during the extension period and that are linked to the bonds being extended or renewed.		

More on the effects as well as the response from investors and rating agencies

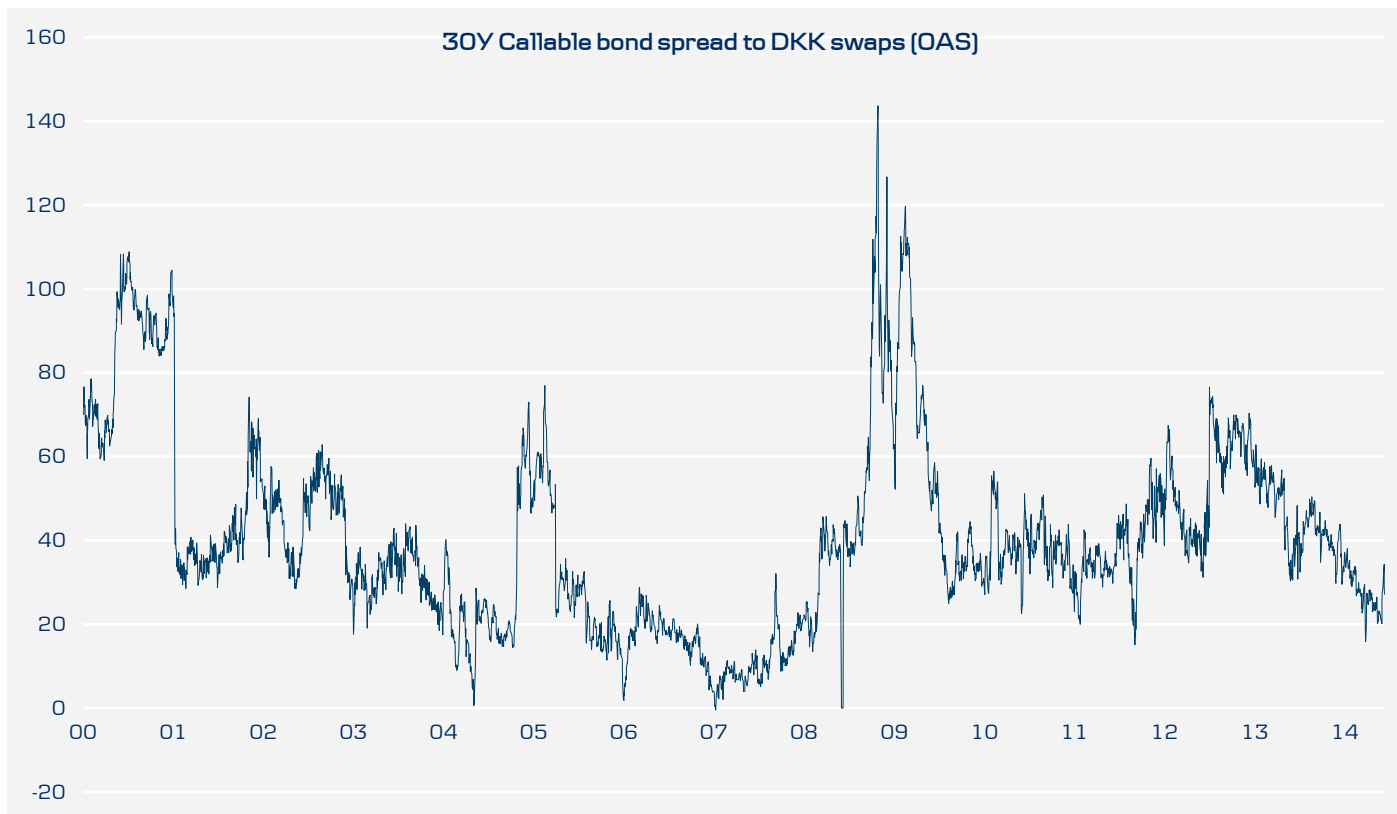
- The law describes what happens after a failed auction/bankruptcy
- The law proposal is expected to be positive for issuer ratings and reducing the OC requirement and easier to maintain a AAA rating
- There is a small premium for the new bonds with the extension trigger, but the premium is small as it is only 1Y and the prob. of a failed auction is close to 0%
- However, some investors may not be able to buy it , and the interest trigger is "procyclical". A number of domestic investors have been negative on the proposal
- Furthermore, no clear signal from rating agencies. S&P has stated that the law proposal is a step in the right direction – but they are still concerned about the high amount of interest reset loans with 1Y refinancing.

Historic and actual pricing

ASW-spreads have tightened to pre-crisis levels for the 1Y to 5Y noncallables



Also low spreads on 30Y callable bonds



Refinancing auctions – non-callable bullet bonds (Example)

February/March 2014 refinancing auctions

- Nykredit will be holding its auctions from Monday 17 February to Friday 28 February RD from Monday 24 February to Friday 28 February and Nordea from Tuesday 25 February to Thursday 27 February, while DLR will be in the market from Monday 3 March to Friday 7 March.
- Nykredit's floater auction will be held on Thursday 27 February.
- BRFkredit will carry out bond sale on 26 and 27 February.

Auction Schedule

	RD	Nykredit	Nordea	BRF	DLR
17-Feb-14		●			
18-Feb-14		●			
19-Feb-14		●			
20-Feb-14		●			
21-Feb-14		●			
24-Feb-14	●	●			
25-Feb-14	●	●	●		
26-Feb-14	●	●	●	●	
27-Feb-14	●	●●	●	●	
28-Feb-14	●	●			
03-Mar-14					●
04-Mar-14					●
05-Mar-14					●
06-Mar-14					●
07-Mar-14					●

●: Fixed rate non-callable bullet bonds - auctions

●: Floaters (CIBOR) bonds

●: Fixed rate non-callable bullet bonds - bond sale

February/March 2014 refinancing auctions

- The total auction amount in the non-callable bullet bonds amounts to DKK 195bn.
- The auctions amounts in 3Y and 5Y non-callable bullets are DKK18.1bn and DKK2.5bn, respectively.
- Comparing with the supply at the March 2013 auctions, the supply this time is around DKK35bn lower all in all, with DKK7bn less in 1Y non-callable bullets and DKK17bn less in 5Y non-callable bullets.
- Reasons for the large fall in the 5Y segment may include the Ministry of Housing, Urban and Rural Affairs not announcing any refinancing in the social housing sector, whereas in recent years it has remortgaged many of its loans into 5Y ARM loans. At the March 2013 auctions, remortgaging here accounted for DKK8bn of the 5Y segment.

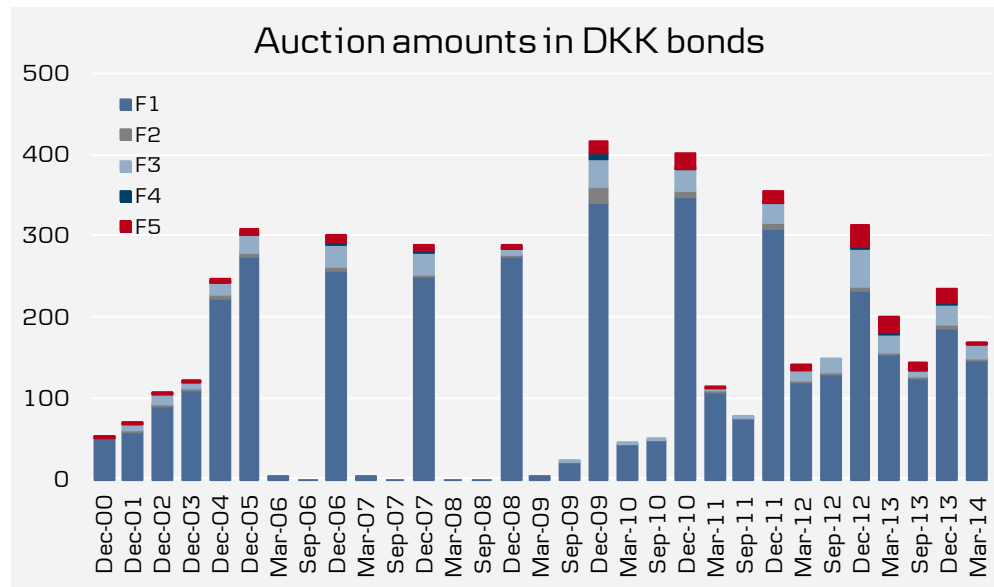
	Auction amounts						Total DKK Bonds	1Y EUR	Total DKK
	1Y	2Y	3Y	4Y	5Y	> 5Y			
RD	36.1	1.2	12.5	0.0	1.4	0.0	51.2	0.3	53.6
Nykredit	83.6	0.9	4.0	0.0	1.0	0.0	89.5	1.9	104.0
Nordea	13.5	0.3	1.3	0.0	0.1	0.0	15.2	0.2	16.4
BRF	4.2	0.0	0.0	0.0	0.0	0.0	4.2	0.0	4.2
DLR	9.9	0.1	0.3	0.0	0.0	0.0	10.3	0.7	15.4
Total	147.3	2.4	18.1	0.0	2.5	0.0	170.3	3.1	193.6

Refinancing principles

- Bids for fixed-rate non-callable bullet bonds must be made in terms of amount and price. With respect to bonds maturing within 14 months, bids must be made in prices correct to three decimals. Otherwise, bids must be made correct to two decimals.
- Bids for all DKK-denominated bonds must be made in multiples of DKK 100,000 and bids for all EUR-denominated bonds in multiples of EUR 10,000.
- One or more bids may be made in the same ISIN.
- With respect to fixed-rate bullet bonds, bids above the fixing price will be settled in full at the fixing price. Bids at the fixing price may be accepted on a pro rata basis.
- All bonds will be subject to long settlement. The value date of all trades executed at the auctions will be 1 April 2014.

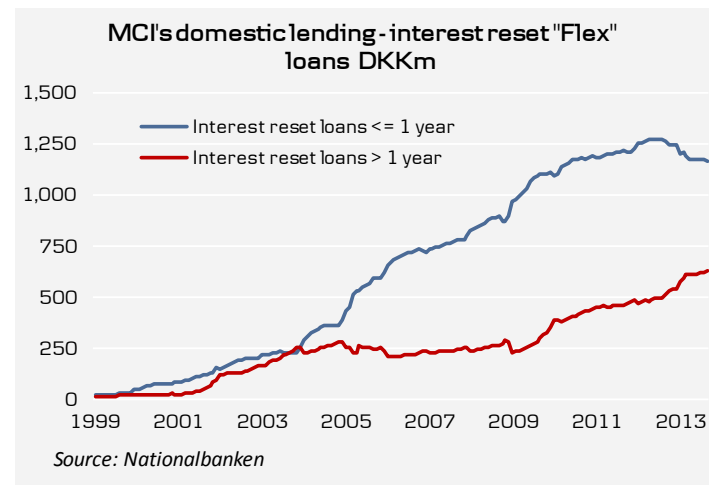
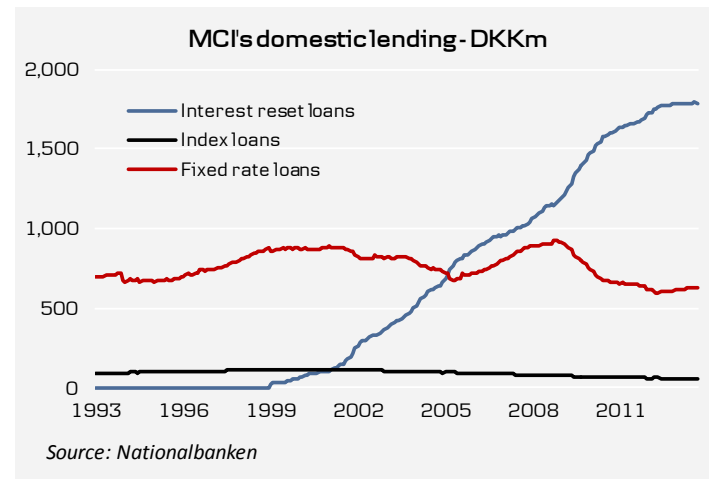
The supply at the Nov/Dec auction has decreased...

- The supply at the November/December auctions has gradually decreased over the last years as the MCIs stopped issuance in January bonds in 2005 (Nykredit) and 2010 (RD, Nordea Kredit, BRF and DLR).
- The supply at the March and September auctions has increased and hence the auction supply in the non-callable bullet bonds are spread out over three (four in 2014 as Nykredit is issuing July bonds) terms instead of one auction per year.
- In addition, the borrowers are extending the length of the refinancing periods from 1Y to 3Y or 5Y.



Borrowers are extending the length of the refinancing period

- The MCIs have over the last years recommmed borrowers to extend the length of the refinancing period from 1 year to for example 3 or 5 years in order to reduce the the overall refinancing risk in order to meet future regulatory demands (Basel III) and requirements from the rating agencies.
- The MCIs have increased the contribution margins on the 1Y interest reset loans and interest only loans relative to order types of mortgage loans in order to increase the motivation to extend the length of the refinancing period or alternatively to choose a fixed annuity loan.
- In the recent years we have seen a gradually derease of the amount of 1Y interest reset loans and an increase in the amount of interest reset loans with a refinacing period longer than 1 year.



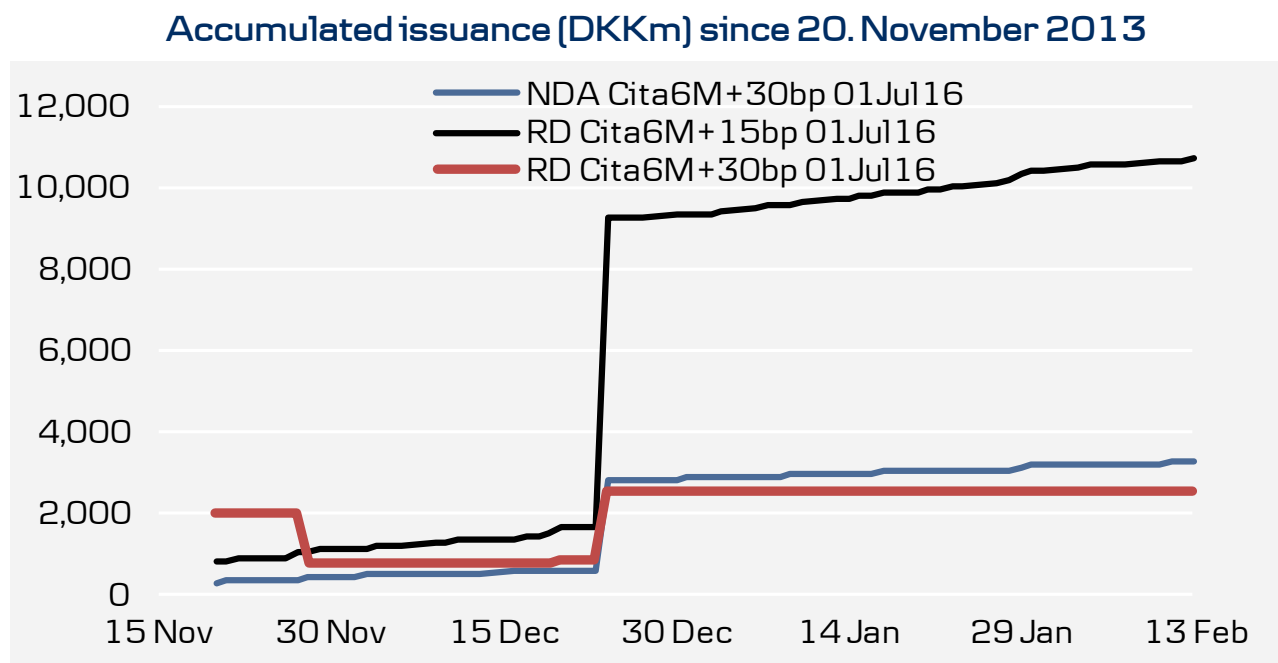
Some MCIs offer CITA loans as an alternative to F1 loans

- Realkredit Danmark and Nordea Kredit have introduced CITA loans as an alternative to interest reset loans with annual refinancing (F1 loans).
- Nykredit and DLR have also introduced CITA loans but they only offer CITA loans as an alternative to CIBOR loans – not as an alternative to F1 loans.
- The monthly payment (after tax) on a F1 loan (with redemptions) of DKK 1 mio. is DKK 3,430 compared to DKK 3.320 on a FlexKort loan (CITA loan).
- The underlying bonds have a 3 year maturity and the coupons are fixed against the 6 month CITA rate (the Danish equivalent to the EONIA rate) plus an interest rate spread.

	FlexKort floater (30bp)	FlexKort floater (15bp)	KortRente floater
Issuer	Realkredit Danmark	Realkredit Danmark	Nordea Kredit
ISIN	DK0009290777	DK0009291072	DK0002029594
Bond type	SDRO (CC T)	SDRO (CC T)	SDRO (CC 2)
Maturity	01-Jul-16	01-Jul-16	01-Jul-16
Initial coupon (until 1 Jan 2014)	0.35%	0.17%	0.35%
Coupon fixing	6M CITA * 365/360 + 0.30%	6M CITA * 365/360 + 0.15%	6M CITA * 365/360 + 0.30%
Interest rate floor	Yes	Yes	No - negative coupon possible
Fixing dates	Semi-annual, 4th business day	Semi-annual, 4th business day	Semi-annual, 4th business day
Amortisation	Hybrid	Hybrid	Hybrid

Limited issuance in Cita floaters since New Year

- The issuance in Cita floaters has been limited since New Year (Total issuance DKK 1.7bn)



Plenty of liquidity in Q1, 2014 in Denmark

Redemptions and coupons

• DKK-den. Non-callables maturing Apr. 2014	DKK 216bn
• EUR-den. Non-callables maturing Apr. 2014	DKK 26bn
• T-bills maturing on 3 Mar. 2014	DKK 29bn
• Coupons	DKK 11bn
• Redemptions from callables	DKK 17bn
• Total	DKK 300bn (EUR 40bn)
• Supply of non-callables in Feb-Mar.	DKK 194bn (EUR 26bn)

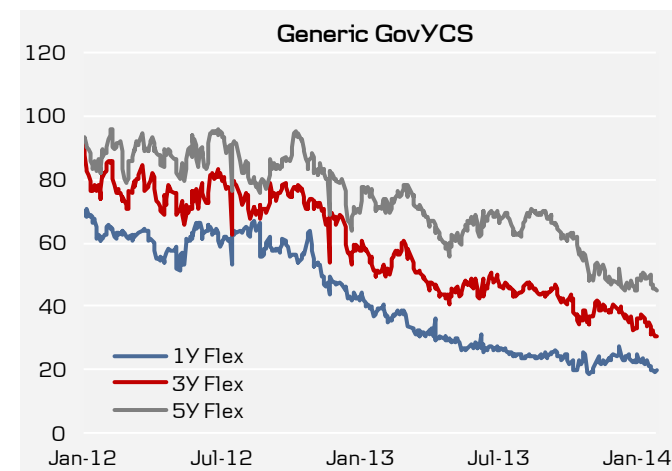
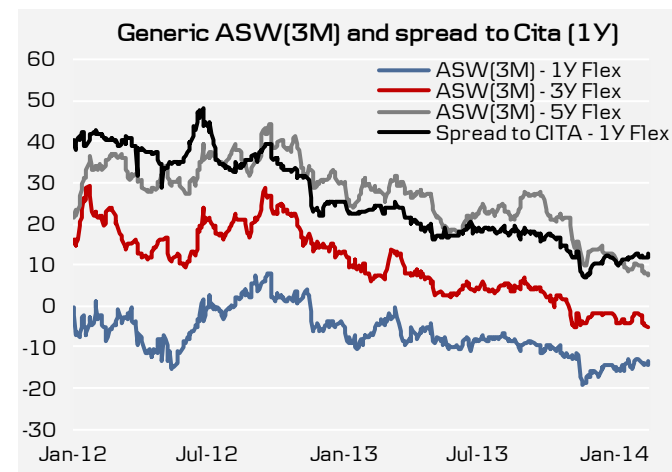
EXCESS LIQUIDITY

DKK 105bn (EUR 14bn)

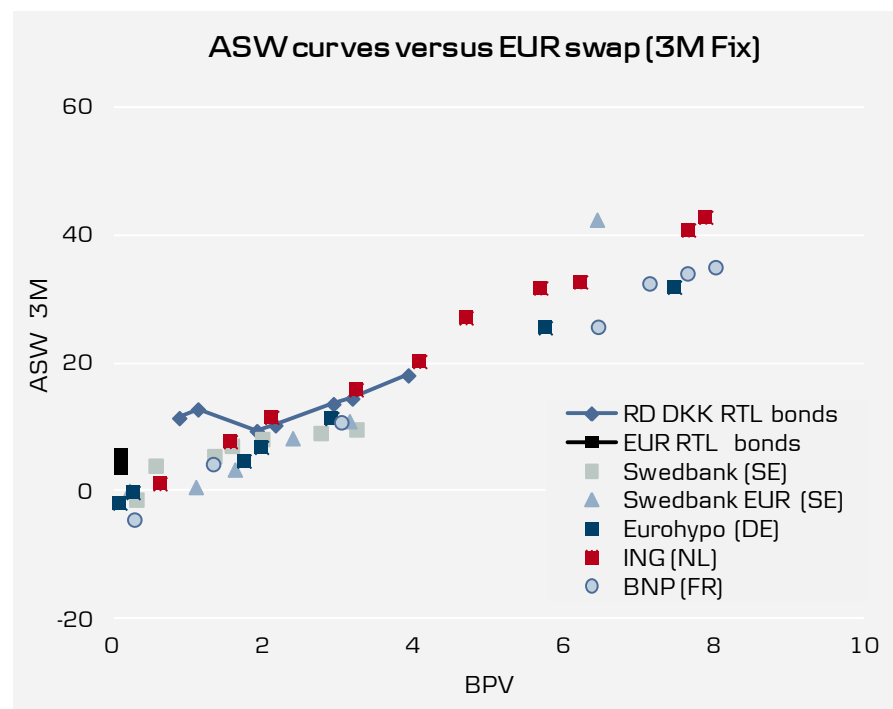
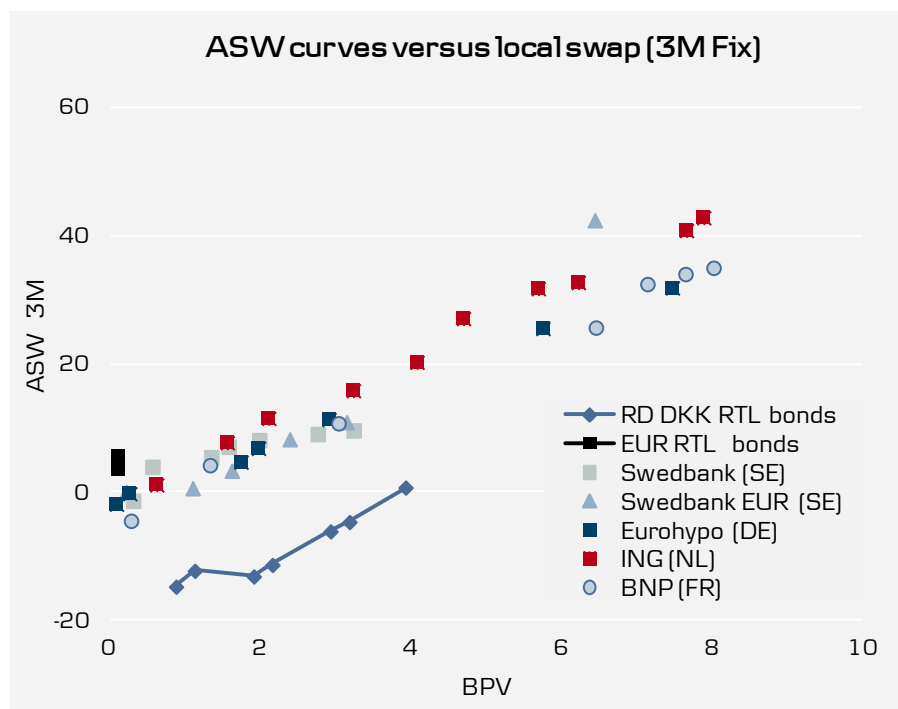
Pricing of non-callable bullet bonds

Pricing of the non-callable bullet bonds

- Non-callable bullets have outperformed DGBs (and swaps), with especially the 5Y non-callable bullets performing well after having been priced cheaper than their 3Y equivalents.
- Until now, the repayment profile shifts triggered by the January ARM refinancing round have caused limited debtor movement away from 1Y to 3Y and 5Y.
- The law proposal from the Ministry of Business and Growth should have a positive effect on the pricing of the existing non-callable bullet bonds as the bonds will be grandfathered and without any kind of optionality.
- We are generally positive on the non-callables - especially the 3Y and 5Y bonds.

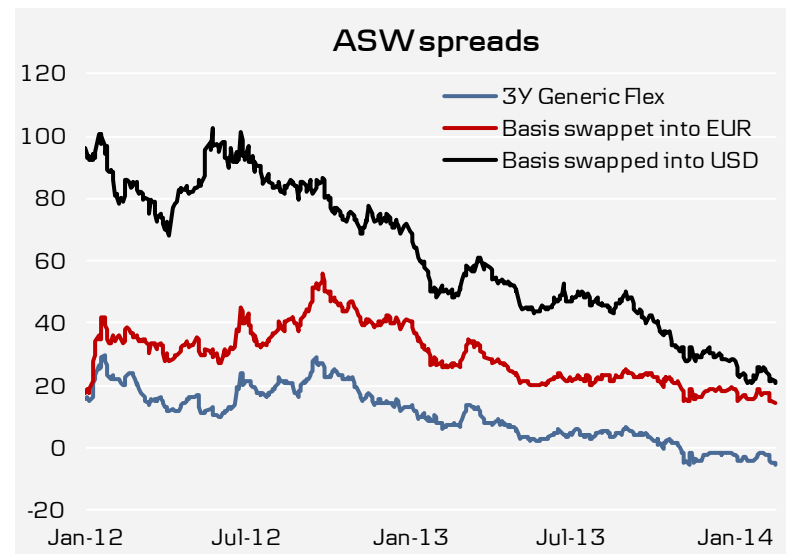
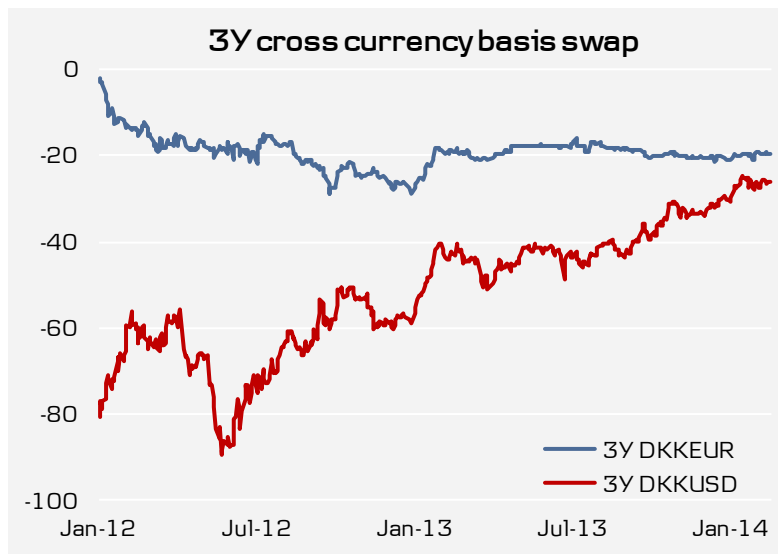


Danish non-callable covered bonds are fair priced relative to other European covered bond markets

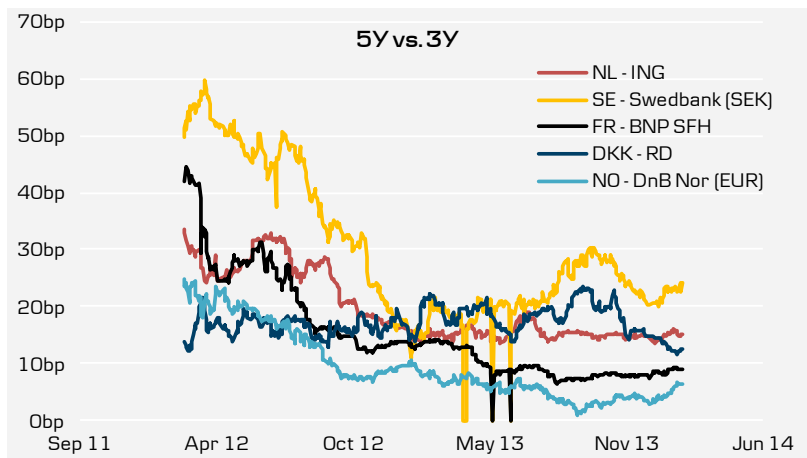
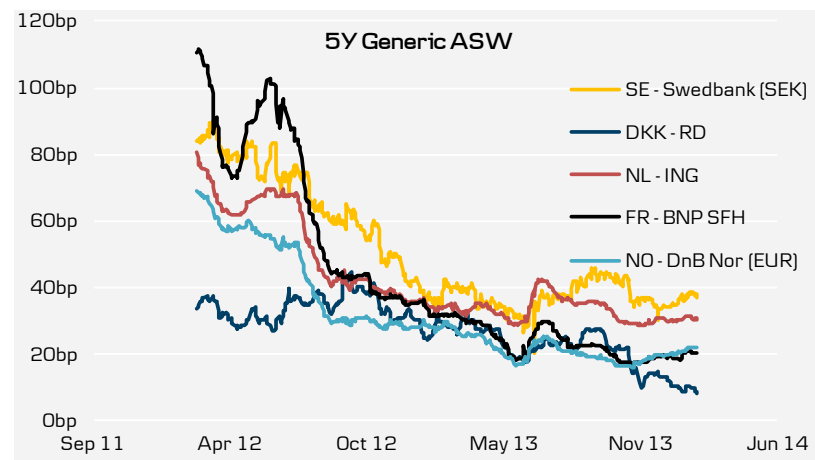
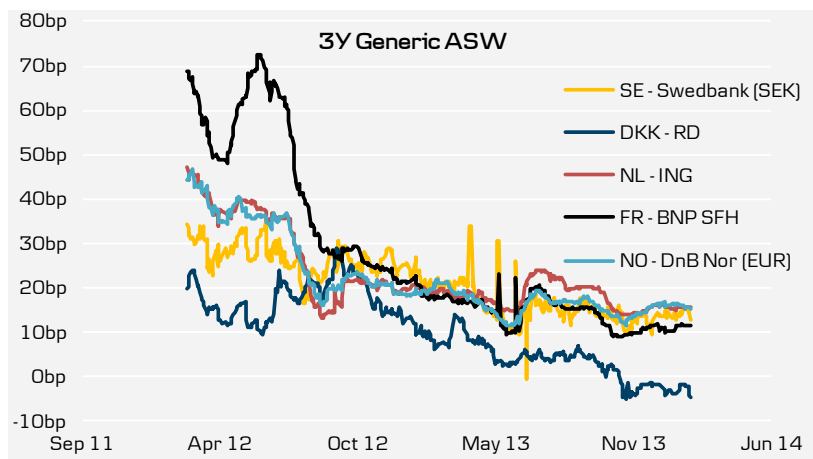


Spreads have tightened significantly

- Foreign investors can gain a pick up in DKK-denominated non-callable bullet bonds and basis-swap these bonds into currencies such as USD or GBP.
- However, cross currency ASW spread have generally tightened – especially in 3Y and 5Y segments.

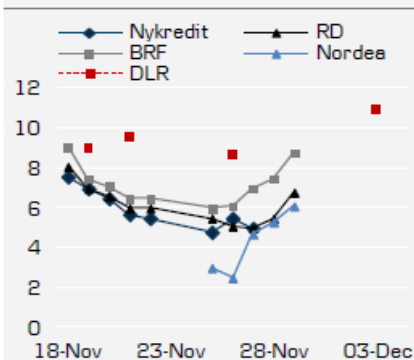


The 5Y DKK denominated non-callable "Flex" bonds have outperformed Swedish Bostäder



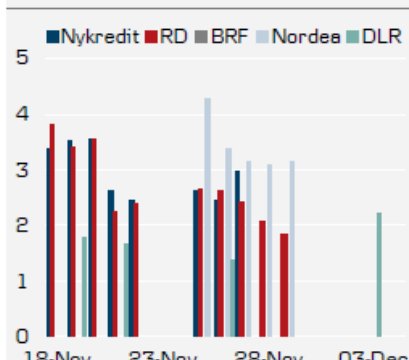
Auction results – recent refinancing auctions

Chart 2. 1Y DKK Flex: Spreads to CITA



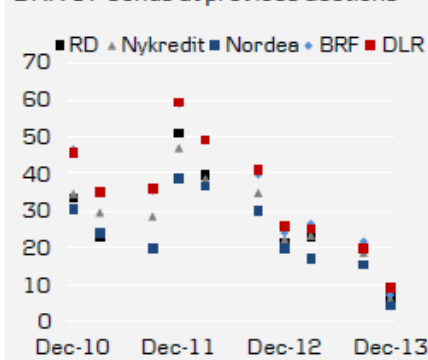
Source: Danske Bank Markets

Chart 3. 1Y DKK Flex: Bid-to-cover



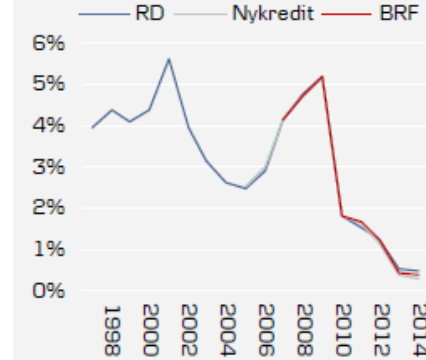
Source: Danske Bank Markets

Chart 10. Avg. spreads to CITA for DKK 1Y bonds at previous auctions



Source: Danske Bank Markets

Chart 11. Development in F1 rates



Source: Mortgage bank web sites

Table 4. Average spreads (CITA/Swap (3M)/Eonia) at recent auctions

		RD	Nykredit	Nordea	DLR	BRF
1Y DKK	Dec. 2013	6.2	6.0	4.3	9.2	7.2
	Sep. 2013		18.6	15.3	21.6	19.7
	Mar. 2013	22.8	23.2	17.0	26.4	25.1
	Dec. 2012	21.0	22.1	19.9	25.9	
	Sep. 2012		34.8	29.8	41.2	
3Y DKK	Dec. 2013	-6.0	-6.6	-6.1	-2.7	-4.1
	Sep. 2013		3.0	5.9	12.5	
	Mar. 2013	9.5	13.2	6.1	20.9	
	Dec. 2012	14.1	13.6	14.2	23.4	
	Sep. 2012		18.0	17.4	37.0	
5Y DKK	Dec. 2013	9.3	10.7	11.8	11.9	10.8
	Sep. 2013		21.0	28.2	39.0	26.1
	Mar. 2013	24.7	29.8	23.8	42.8	
	Dec. 2012	28.8	29.3	29.5	40.5	
	Sep. 2012		31.1	31.7	50.4	
1Y EUR	Dec. 2013	13.7	13.7	13.6	17.1	14.8
	Sep. 2013			26.5		
	Mar. 2013	25.9	29.2	23.4	36.7	
	Dec. 2012	23.3	22.7	22.5	32.9	
	Sep. 2012			35.0		

Source: Danske Bank Markets

Table 5. Average bid-to-cover ratios at recent auctions

		RD	Nykredit	Nordea	DLR	BRF
1Y DKK	Dec. 2013	2.7	2.9	3.4	1.6	
	Sep. 2013		3.1	2.8	2.0	
	Mar. 2013	2.6	2.4	3.9	2.4	3.1
	Dec. 2012	3.7	3.4	4.1	1.5	
	Sep. 2012		2.4	2.5	2.6	
3Y DKK	Dec. 2013	3.5	4.9	5.9	NA	
	Sep. 2013		3.7	4.1	3.2	
	Mar. 2013	3.6	2.3	3.0	2.1	
	Dec. 2012	3.5	3.5	4.1	1.9	
	Sep. 2012		3.5	3.7	2.7	
5Y DKK	Dec. 2013	4.3	4.1	3.4	NA	
	Sep. 2013		4.0	1.8	3.0	
	Mar. 2013	3.7	2.3	4.0	2.8	
	Dec. 2012	2.9	2.2	4.3		
	Sep. 2012		4.5	2.4	2.0	
1Y EUR	Dec. 2013	2.7	2.6	2.7	NA	NA
	Sep. 2013			3.2		
	Mar. 2013	3.3	3.0	5.4	1.5	
	Dec. 2012	3.5	2.6	3.1	1.4	
	Sep. 2012			2.8		

Source: Danske Bank Markets

Ratings

Ratings from S&P

Capital centre	Classification	Rating (ICR/covered bond)	Outlook	Current ALMM Risk	WAFF	WALS	Target CE	Actual CE	Maximum uplift above the ICR	Unused uplift
Realkredit Danmark		A-	Stable outlook							
Capital centre S	SDRO	AAA	Stable outlook	Low	18.48%	28.69%	5.51%	11.12%	7 notches	1 notch
Capital centre S	JCB	A-	Stable outlook							
General capital centre	Grand RO	AAA	Stable outlook	Low	16.48%	23.31%	4.02%	5.09%	7 notches	1 notch
Capital centre T	SDRO	AAA	Stable outlook	Low	22.52%	29.39%	9.43%	11.63%	7 notches	1 notch
Capital centre T	JCB	A-	Stable outlook							
Danske Bank		A-	Stable outlook							
Register C	SDO	AAA	Stable outlook	Low	22.39%	25.41%	35.12%	43.03%	7 notches	1 notch
Register D	SDO	AAA	Stable outlook	Low	12.80%	37.82%	17.68%	22.59%	7 notches	1 notch
Register I	SDO	AAA	Stable outlook	Low	13.97%	18.43%	17.18%	18.56%	7 notches	1 notch
Nykredit Realkredit		A+	Negative outlook							
Capital centre C	Grand RO	AAA	Stable outlook	Low	14.98%	9.91%	4.76%	4.80%	7 notches	3 notches
Capital centre D	Grand RO/ New RO	AAA	Stable outlook	Low	20.43%	25.29%	5.70%	6.31%	7 notches	3 notches
Capital centre D	JCB	A+	Negative outlook							
Capital centre E	SDO	AAA	Stable outlook	Low	14.97%	26.97%	4.74%	9.45%	7 notches	3 notches
Capital centre E	JCB	A+	Negative outlook							
Capital centre G	New RO	AAA	Stable outlook	Low	27.24%	86.29%	23.92%	25.52%	7 notches	3 notches
Capital centre H	SDO	AAA	Stable outlook	Low	19.49%	29.19%	5.67%	6.48%	7 notches	3 notches
Capital centre H	JCB	A+	Negative outlook							
Capital centre I	New RO	AAA	Stable outlook	Low	12.68%	94.94%	11.96%	14.40%	7 notches	3 notches
General capital centre	Grand RO	AAA	Stable outlook	Low	17.75%	20.53%	34.52%	475.07%	7 notches	3 notches
Totalkredit CC C	Grand RO	AAA	Stable outlook	Low	11.28%	15.59%	1.86%	5.17%	7 notches	3 notches
Nordea Kredit		AA-	Negative outlook							
Capital centre 1	Grand RO	AAA	Stable outlook	Low	13.99%	25.61%	5.49%	11.83%	7 notches	4 notches
Capital centre 2	SDRO	AAA	Stable outlook	Low	19.20%	34.50%	7.64%	16.08%	7 notches	4 notches
BRFkredit		A-	Negative outlook							
Capital centre B	Grand RO	AAA	Stable outlook	Low	20.94%	34.44%	7.58%	11.00%	7 notches	1 notch
Capital centre E	SDO	AAA	Stable outlook	Low	19.27%	37.09%	6.16%	12.00%	7 notches	1 notch
Capital centre E	JCB	A-	Negative Outlook							
General capital centre	Grand RO	AAA	Stable outlook	Low	15.94%	41.27%	14.61%	47.45%	7 notches	1 notch
DLR Kredit A/S		BBB+	Stable outlook							
Capital centre B	SDO	AAA	Stable outlook	Low	31.10%	41.24%	13.47%	17.18%	7 notches	0 notch
Capital centre B	JCB	BBB+	Stable outlook							
General capital centre	Grand RO	AAA	Stable Outlook	Low	26.10%	16.86%	6.22%	7.07%	7 notches	0 notch

Source: Global Covered Bond Characteristics And Rating Summery Q3 2013 and BRFkredit General Capital Centre Covered Bonds Upgraded to 'AAA' from 27 December 2013.

Ratings from Fitch

Capital centre	Classification	Rating (IDR/covered bond)	Outlook	Discontinuity Caps	Asset Segregation	Liquidity gap and systemic risk	Alternative management (cover pool specific)	Alternative management (systemic)	Privileged derivatives
Danske Bank		A	Stable Outlook						
Register D	SDO	AAA	Stable Outlook	3 (moderate high risk)	Low	Mod. high*	Mod.	Low	Mod.
Register I	SDO	AAA	Stable Outlook	3 (moderate high risk)	Low	Mod. high*	Mod. high*	Low	Mod. high*
Register C	SDO	AAA	Stable Outlook	3 (moderate high risk)	Low	Mod. high*	Mod. high*	Low	Mod. high*
Realkredit Danmark		A	Stable Outlook						
Capital centre S	SDRO	AAA	Stable Outlook	3 (moderate high risk)	Very low	Mod. high*	Mod.	Low	Very low
Capital centre T	SDRO	AA+	Stable Outlook	2 (high risk)	Very low	High*	Mod.	Low	Very low
Nykredit Realkredit		A	Stable Outlook						
Capital centre E	SDO	Not rated							
Capital centre H	SDO	Not rated							

*: Limiting risk component.

Source: "Fitch Ratings: Covered Bonds Surveillance Snapshot, October 2013".

- **Asset segregation:** the degree to which cover assets are considered adequately ring-fenced
- **Liquidity gap and systemic risk:** the liquidity risk is the risk arising from incoming cash flows from cover assets not matching payments due on outstanding bonds.
- **Alternative management (cover pool specific):** the ease with which assets can be transferred to the alternative manager in a data/IT context.
- **Alternative management (systemic):** in the event of an issuer default, the management of cover assets and timely payments to bondholders will be transferred to a third party.
- **Privileged derivatives:** 'privileged derivatives' are those derivatives with the special purpose of hedging the cover assets following an issuer default.

Ratings from Moody's

Capital centre	Classification	Rating (Issuer/covered bond)	Outlook	TPI	TPI Leeway	Collateral Score	Current OC	Minimum OC requirement
Realkredit Danmark								
Capital centre S	SDRO	Withdrawn						
Capital centre S	JCB	Not rated						
General capital centre	Grand RO	Withdrawn						
Capital centre T	SDRO	Not rated						
Capital centre T	JCB	Not rated						
Danske Bank								
		Baa1	Positive outlook					
Register C	SDO	Not rated						
Register D	SDO	Withdrawn						
Register I	SDO	Withdrawn						
Nykredit Realkredit								
		Baa2	Negative outlook					
Capital centre C	Grand RO	Withdrawn						
Capital centre D	Grand RO/ New RO	Withdrawn						
Capital centre E	SDO	Withdrawn						
Capital centre E	JCB	Withdrawn						
Capital centre G	New RO	Withdrawn						
Capital centre H	SDO	Withdrawn						
Capital centre H	JCB	Withdrawn						
General capital centre	Grand RO	Withdrawn						
Totalkredit CC C	Grand RO	Withdrawn						
Nordea Kredit								
		A1	Stable outlook					
Capital centre 1	Grand RO	Aaa	Stable outlook	Very High	4	11.1%	10.8%	5.0%
Capital centre 2	SDRO	Aaa	Stable outlook	High	3	14.7%	15.3%	13.0%
BRFkredit								
		Withdrawn						
Capital centre B	Grand RO	Withdrawn						
Capital centre E	SDO	Withdrawn						
Capital centre E	JCB	Not rated						
General capital centre	Grand RO	Withdrawn						
DLR Kredit A/S								
		Withdrawn						
Capital centre B	SDO	Withdrawn						
Capital centre B	JCB	Not rated						
General capital centre	Grand RO	Withdrawn						

Source: "Rating action: Moody's: Danske Bank A/S' Baa1 rating affirmed, outlook changed to positive, 10. Dec. 2013", PO reports for Nordea Kredit, 9. Dec. 2013

GRAND RO: Grandfathered RO bonds issued before 2008

New RO: RO bonds issued after 2007

CC: Capital center

OC: Overcollateralisation

ALMM: Asset-liability mismatch

WAFF: Weighted-average foreclosure frequency

WALS: Weighted-average loss severity

CE: Credit enhancement

ICR: Issuer credit rating

IDR: Issuer default rating

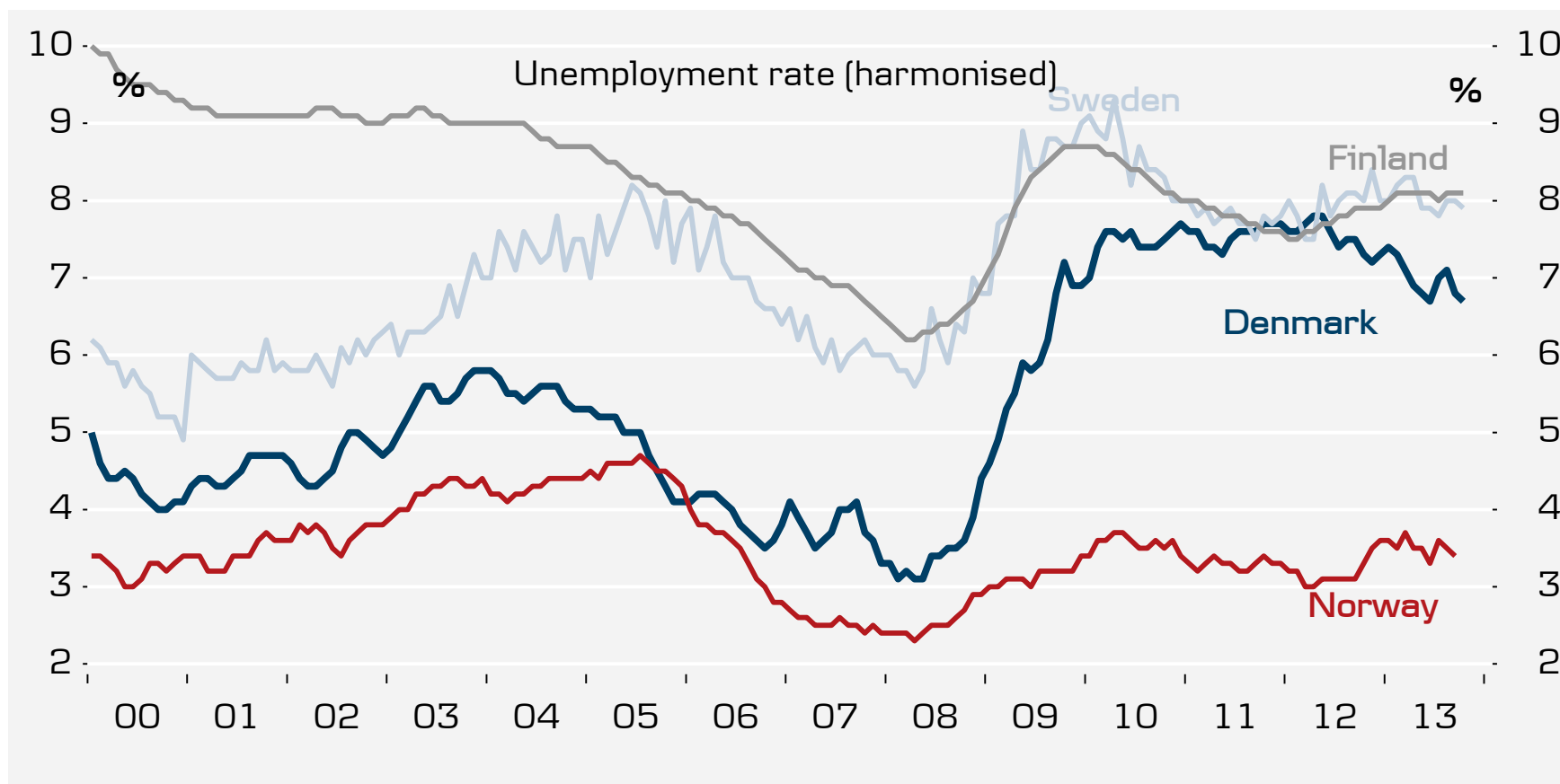
Discontinuity Caps: corresponds to the maximum rating uplift from the IDR to the covered bond rating

Appendix

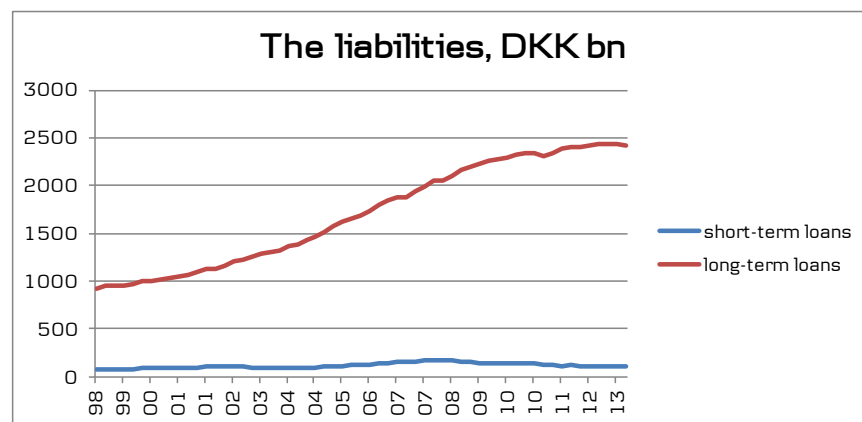
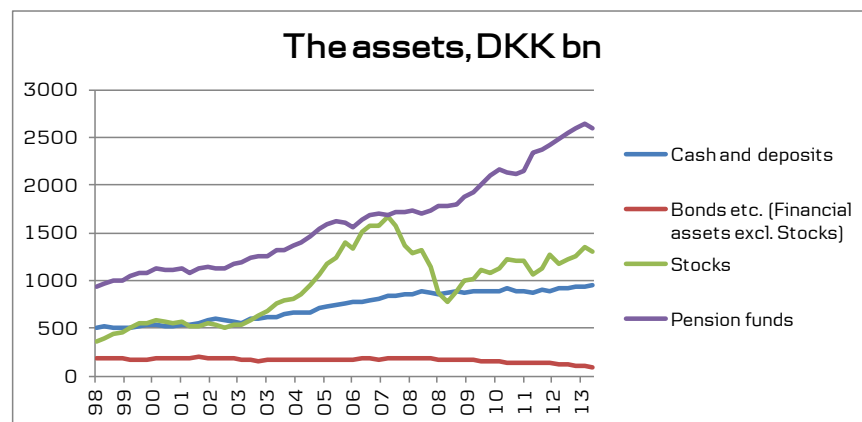
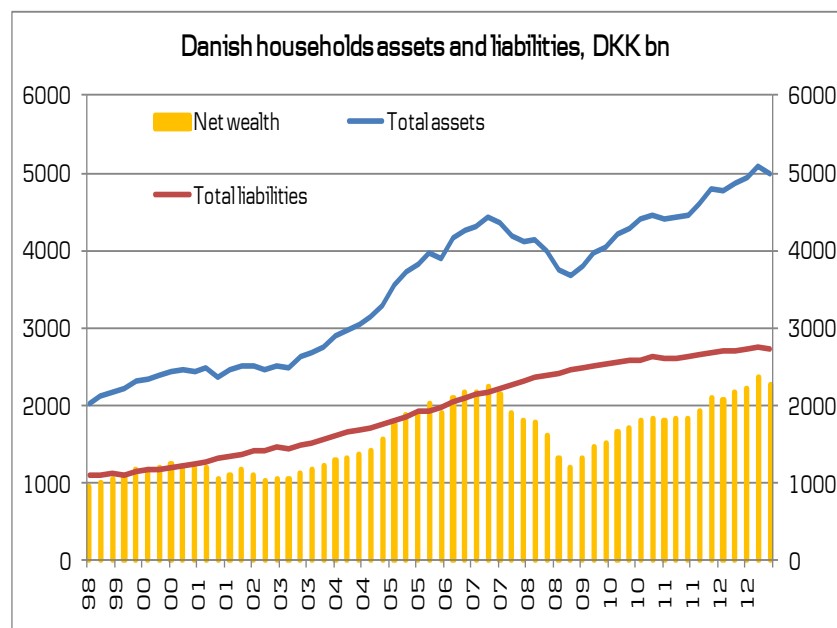
Macroeconomic outlook

Denmark			
	Current forecast		
% y/y	2013	2014	2015
GDP	0,4	1,5	2,1
Private consumption	0,5	0,9	1,5
Public consumption	0,2	1,1	0,6
Gross fixed investment	1,5	-0,8	2,8
Exports	0,6	3,1	3,6
Imports	2,0	2,0	2,7
Gross unemployment (thousands)	153	148	139
Inflation	0,8	1,3	1,5
Government balance, % of GDP	-0,8	-1,5	-2,8
Current account, % of GDP	6,9	7,1	7,2

Unemployment slowly improving



Household net wealth is rising – and it is not all in sticky assets such as pension funds



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