# Financial Institutions Ratings
# DNB Bank ASA – AT1 rating report

## Security ratings

| | |
|---|---|
| Outlook | Stable |
| 5.75% USD 750m Fixed Rate Reset Perpetual Additional Tier 1 Capital Notes | BBB- |
| 6.5% USD 750m Fixed Rate Reset Perpetual Additional Tier 1 Capital Notes | BBB- |

The ratings have not been solicited by the issuer; the analysis is based solely on public information.

## Rating rationale

**Scope rates at BBB-, Stable the above referenced Fixed Rate Reset Perpetual Additional Tier 1 Capital Notes issued by DNB Bank ASA. The rating is based on the following considerations:**

- Senior unsecured debt rating: A+, Stable Outlook
- Minimum notches down from senior unsecured debt rating: 4
- Additional notches: 1

In accordance with our rating methodology, the starting point for notching down when rating capital instruments is the senior unsecured debt rating. The minimum four notches reflect the deeply subordinated status of AT1 capital instruments in the priority of claims, their going concern loss absorbing features and investors' exposure to coupon-cancellation risks. Please refer to Scope's *Bank Capital Instruments Rating Methodology* published in May 2018 for more details.

The additional notch for these securities primarily reflects the relatively narrow gap to CET requirements when the Pillar 2 requirement is included. At the same time, we note DNB's proven track record in generating earnings and capital, the comparatively high regulatory requirements in Norway and the ongoing application of the Basel 1 transitional floor.

In Norway, Pillar 2 requirements are currently not part of the calculation for determining when automatic restrictions on distributions apply (i.e. MDA trigger level). However, this may no longer be the case in the future, as the Norwegian FSA has proposed that Pillar 2 requirements be included to fully implement CRR/CRD IV. If the FSA's proposal is adopted, Scope does not expect the ratings on DNB's AT1 securities to change as they already incorporate the effect of such an eventuality.

The release of this rating report does not constitute a rating action. Last rating action was assigned on 3 June 2015. For further information on the last rating action and regulatory information please click here.

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## Issuer credit profile

The Issuer Rating of AA- on DNB Bank ASA is based on the strength of the group, DNB ASA. The group's rating is driven by its strong franchise as the leading financial services provider in Norway. The group has demonstrated the ability to generate resilient earnings capable of absorbing higher-than-average loan impairments stemming from the oil-related sector while strengthening its capital position. Importantly, management is clearly aware of the need to "own the customer relationship" due to increasing competition from non-bank players, more open infrastructure and lower switching costs. We see DNB proactively addressing these challenges.

Further, Scope expects the operating environment to remain supportive as Norway benefits from solid economic growth, low unemployment and high wealth levels. DNB's market funding profile has also improved with the greater use of covered bonds.

The government's 34% ownership stake in DNB is not a driver for the rating. The group is financially sound and in line with our rating methodology Scope does not notch up the Issuer Rating of AA- based on the expectation of state support. Further, a sale of the government's stake would not in and of itself lead to a rating change.

## Summary terms

| **Issuer** | **DNB Bank ASA** |
|---|---|
| **Issue Date** | **26 March 2015** |
| **Amount** | USD 750m (NOK 5.9bn) |
| **Coupon** | • 5.75% fixed annual coupon until first call date (26 March 2020)<br>• Thereafter reset every five years at 5y Mid Swap rate + 407.5bps<br>• Payable annually in arrear |
| **Format** | • Fixed Rate Reset Perpetual Additional Tier 1 Capital Notes<br>• Redeemable by the issuer on first call date and on every Interest Payment Date thereafter, subject to regulatory approval |
| **ISIN** | XS1207306652 |

| **Issue Date** | **18 October 2016** |
|---|---|
| **Amount** | USD 750m (NOK 6.1bn) |
| **Coupon** | • 6.5% fixed annual coupon until first call date (26 March 2022)<br>• Thereafter reset every five years at 5y Mid Swap rate + 508 bps<br>• Payable annually in arrear |
| **Format** | • Fixed Rate Reset Perpetual Additional Tier 1 Capital Notes<br>• Redeemable by the issuer on first call date and on every Interest Payment Date thereafter, subject to regulatory approval |
| **ISIN** | XS1506066676 |

| Main Risks | |
|---|---|
| **Coupon Cancellation** | • Fully discretionary.<br>• Mandatory in case of:<br>(i) trigger event<br>(ii) insufficient distributable items<br>(iii) if payment exceeds the Maximum Distributable Amount (MDA) upon a breach of the Combined Buffer Requirement<br>• Norwegian FSA has discretion to cancel coupon payments |
| **Principal Loss Absorption** | • Upon trigger event, the principal amount of the Notes will be written down<br>• At the issuer's discretion, the principal amount of the Notes may be written up subject to the Maximum Write-Up Amount and to the MDA, pro-rata with any written down AT1 instruments<br>• Subject to write-down under the Norwegian Financial Enterprises Act<br>• When the Bank Recovery and Resolution Directive (BRRD) is adopted in Norway then subject to general bail-in tool and write-down or conversion at the point of non-viability |
| **Trigger for Principal Loss Absorption** | • DNB Bank CET1 ratio < 5.125%, or<br>• DNB Bank Group CET1 ratio < 5.125%, or<br>• DNB Group CET1 ratio < 5.125%. |

Source: Prospectuses, Scope Ratings

## Key risks

### A. Coupon cancellation

**Key risk: Coupon cancellation**

Coupon payments on the Notes are fully discretionary and are subject to distribution restrictions

Coupons are mandatorily cancelled if the issuer has insufficient distributable items, the combined buffer requirement (CBR) is not met and coupon payments would exceed the Maximum Distributable Amount (MDA) or the regulator requires that coupon payments be cancelled. In addition, if the trigger has been breached, all accrued interest will be cancelled.

We do not consider distributable items to be a limiting factor for DNB to pay coupons as we estimate that DNB Bank ASA had available distributable items of about NOK 150bn as of end-2017 (calculated as total equity of NOK 170bn minus share capital of NOK 18bn).

#### Combined buffer requirement (CBR)

Upon a breach of the CBR, the MDA would be determined and coupons on the Notes would be limited. The CBR for DNB is comprised of a 2.5% capital conservation buffer, a 3% systemic risk buffer, a 2% systemically important institution buffer and a 1.6% countercyclical buffer. Together with the minimum Pillar 1 CET1 capital requirement of 4.5%, this means that DNB must maintain a CET1 ratio of at least 13.6% in 2018 to avoid restrictions on paying coupons on the Notes (Table 1). Capital requirements must be met at group level (DNB ASA), bank group level (DNB Bank Group) and bank level (DNB Bank ASA).

DNB Bank ASA, the issuer of the Notes, is the operating bank in Norway, with DNB Bank Group also incorporating foreign banking subsidiaries and some investment holding companies. DNB ASA, the parent company, consolidates DNB Bank Group and the group's asset management and insurance activities. In accordance with Norwegian regulations, the banking, asset management and insurance activities are organised in separate limited companies under the group holding company, DNB ASA. DNB is highly integrated, and most of its assets are domestic. Scope therefore does not consider the Bank, the Bank Group and DNB Group to have significantly different credit profiles.

### Status of Pillar 2 requirements subject to change

Under the supervisory review and evaluation process (SREP), DNB is subject to a total CET1 requirement of 15.2% for 2018 as SREP includes a Pillar 2 requirement of 1.6%. Currently, Pillar 2 requirements are not included in the MDA trigger level and a breach of SREP requirements does not lead to automatic distribution restrictions. However, the group would need to present a plan to the Norwegian FSA for restoring capital ratios.

In April 2018, the Norwegian FSA submitted a consultation paper to the Ministry of Finance with its proposals for the final implementation of CRR/CRD IV. In line with the EU, the FSA suggested that Pillar 2 requirements be included in the calculation of the MDA trigger level.

For some time, Scope has considered that AT1 investors and regulators would be more comfortable with DNB maintaining a CET1 capital ratio above the higher SREP requirement. Given the group's comparatively high capital requirements, the gap to SREP requirements is expected to remain relatively narrow. At the same time, we acknowledge DNB's track record in generating earnings and capital. The group currently targets a CET1 ratio of around 16.1%.

As the ratings on DNB's AT1 securities already incorporate these considerations, we do not expect the ratings to change if the FSA's proposal to include Pillar 2 requirements in the calculation of the MDA trigger level is adopted.

**Table 1: Estimated capital requirements**

| | 2016 | 2017 | Q1 2018 |
|---|---|---|---|
| Combined buffer (CBR): | 8.7% | 8.7% | 9.1% |
| - Capital conservation | 2.5% | 2.5% | 2.5% |
| - Systemic | 3.0% | 3.0% | 3.0% |
| - SIFI | 2.0% | 2.0% | 2.0% |
| - Countercyclical | 1.2% | 1.2% | 1.6% |
| Pillar 1 CET1 requirement | 4.5% | 4.5% | 4.5% |
| **Required CET1 associated with distribution restrictions** | **13.2%** | **13.2%** | **13.6%** |
| Pillar 2 CET1 requirement | 1.5% | 1.5% | 1.6% |
| SREP requirement | 14.7% | 14.7% | 15.2% |
| | | | |
| DNB Group CET1, transitional (%) | 16.0% | 16.4% | 16.6% |
| **Distance to CET1 requirement incl. CBR (%)** | **2.8%** | **3.2%** | **3.0%** |
| Distance to SREP requirement (%) | 1.3% | 1.7% | 1.4% |
| | | | |
| DNB Bank Group CET1, transitional (%) | 15.7% | 16.2% | 16.3% |
| **Distance to CET1 requirement incl. CBR (%)** | **2.5%** | **3.0%** | **2.7%** |
| Distance to SREP requirement (%) | 1.0% | 1.5% | 1.1% |
| | | | |
| RWAs (NOK m) | 1,051,498 | 1,042,601 | 1,040,066 |

Source: Company data, Scope Ratings

## B. Principal loss absorption

**Key risk: Principal loss absorption**

The mechanism for loss absorption is principal write-down

The securities have three triggers:

- DNB Bank CET1 ratio < 5.125%, or
- DNB Bank Group CET1 ratio < 5.125%, or
- DNB Group CET1 ratio < 5.125%.

If one of the CET1 capital triggers has been breached, the write-down amount will be the lower of (a) the amount necessary to restore the CET1 ratio of the Bank, the Bank Group and the Group to 5.125% considering the write-down or conversion into equity of any Prior Loss Absorbing Instruments and/or Parity Loss Absorbing Instruments and (b) the amount necessary to reduce the principal amount of the Notes to one cent. As of June 2018, there were no Prior Loss Absorbing Instruments outstanding while there were NOK 3.6bn in Parity Loss Absorbing Instruments outstanding; these are in addition to the securities referenced in this report.

At the full discretion of the issuer, the Notes may be written-up. Reinstatement may only occur if each of the Bank, the Bank Group and Group generates a profit in any given financial year and only a specified percentage of the lowest of any such profits will be available for reinstatement. Any discretionary reinstatement will be applied concurrently and pro-rata with the write-up of other written-down AT1 instruments.

In March 2018, legislation to fully implement BRRD in Norway was approved, with implementation from January 2019. Consequently, the Notes will be subject to the bail-in provisions of BRRD rather than current Norwegian rules regarding loss absorption under the Norwegian Financial Enterprises Act.

### Distance to trigger

As of 1Q 2018, the distance to trigger for DNB Group was over 11%, or about NOK 120bn. The distance to trigger for the Bank and the Bank Group were at similar comfortable levels. As the group's regulatory capital requirements are expected to stay at relatively high levels, we do not expect this gap to materially decline. We further note that DNB's capital ratios are constrained by the Basel 1 transitional floor and do not benefit from low risk weights. We estimate that the asset risk intensity of the group was nearly 40% as of end-2017.

**Table 2: CET1 ratios compared to trigger level**

| | 2016 | 2017 | Q1 2018 |
|---|---|---|---|
| **Trigger level** | **5.125%** | **5.125%** | **5.125%** |
| DNB Group CET1, transitional (%) | 16.0% | 16.4% | 16.6% |
| DNB Bank Group CET1, transitional (%) | 15.7% | 16.2% | 16.3% |
| DNB Bank CET1, transitional (%) | 19.1% | 19.0% | 17.8% |

Source: Company data, Scope Ratings

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