Research

Transaction Update: Danmarks Skibskredit A/S General Capital Center (Ship Covered Bond Program)

Skibskreditobligationer

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Table Of Contents

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Ratings Detail

Reference Rating Level	**a-**
Resolution Regime Uplift	+1
Systemic Importance	Moderate
Resolution Counterparty Rating	N/A
Issuer Credit Rating	**BBB+**

+

Jurisdiction-Supported Rating Level	**a**
Assigned Jurisdictional Support Uplift	+1
Jurisdictional Support Assessment	Moderate
Legal Framework	Very Strong
Systemic Importance	Moderate
Sovereign Credit Capacity	Very Strong

+

Maximum Achievable Covered Bond Rating	**a**
Collateral Support Uplift	N/A
Overcollateralization Adjustment	N/A
Liquidity Adjustment	N/A
Potential Collateral Based Uplift	N/A

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Covered Bond Rating	**A/Stable**
Rating Constraints	a
Counterparty Risk	a
Country Risk	aaa

N/A—Not applicable.

Major Rating Factors

Strength

- Although the characteristics of the ship loans do not directly match the characteristics of the covered bonds, the issuer must comply with the Danish balance principle.

Weaknesses

- With the relatively small volume of outstanding ship covered bonds, our assessment of jurisdictional support is moderate.
- The rating is currently limited to the jurisdiction-supported rating level as we do not assign any notches of collateral-based uplift and due to the application of our counterparty risk criteria.

Outlook: Stable

S&P Global Ratings' stable outlook on the 'A' credit ratings on Danmarks Skibskredit A/S' general capital center ship covered bonds reflects the stable outlook on the issuer credit rating (ICR) on the issuer, Danmarks Skibskredit (BBB+/Stable/A-2), as the covered bonds do not benefit from any unused notches of rating uplift under our covered bonds criteria (see "Covered Bonds Criteria," published on Dec. 9, 2014). Therefore, any rating action on our long-term ICR on Danmarks Skibskredit would result in a similar rating action on the covered bonds, all else being equal.

Rationale

We are publishing this transaction update following our periodic review of the Danmarks Skibskredit general capital center ship covered program and related issuances.

Our covered bond ratings process follows the methodology and assumptions outlined in our "Covered Bonds Criteria," and "Covered Bond Ratings Framework: Methodology And Assumptions," published on June 30, 2015.

From our analysis of Danmarks Skibskredit's program documentation and the Danish legislative covered bond framework, we have concluded that the assets in the cover pool are isolated from the issuer's insolvency risk. The asset isolation allows us to potentially assign a higher rating to the covered bond program than our long-term ICR on the issuer.

We conducted a review of Danmarks Skibskredit's operations, which we view as prudent. We believe satisfactory operational procedures are in place to support our ratings on the covered bonds.

Danmarks Skibskredit, internationally known as Danish Ship Finance (DSF), is a Danish lender specializing in first-lien mortgage lending to the Danish shipping industry and select international shipping companies. We consider Denmark to have an effective resolution regime in place, which exempts covered bonds from bail-in. The regime allows an issuer to service its covered bonds following a bail-in of its senior unsecured obligations. This means that a bank facing failure that is resolved may continue to make payments on its covered bonds without accessing the cover pool. These factors increase the likelihood that Danmarks Skibskredit would continue servicing its covered bonds without accessing the cover pool or receiving jurisdictional support, even following a bail in of its senior unsecured obligations. We consider that DSF's covered bonds in this jurisdiction have a moderate systemic importance.

Under our covered bonds criteria, we assess the reference rating level (RRL) as 'a-'. We then consider the likelihood of jurisdictional support for covered bonds backed by shipping collateral, in addition to considering the relatively small volume of such covered bonds. Shipping remains an active sector in Denmark, but in our view, ship construction has lost importance, and we therefore believe that the sovereign would provide comparably more support to the mortgage market as shipping assets play a smaller role for the general economy. Therefore, our assessment of systemic importance is moderate. This results in a moderate jurisdictional support assessment, which leads us to apply one notch of uplift from the RRL to determine the jurisdiction-supported rating level (JRL), which we therefore assess as 'a'.

The cover pool comprises loans secured by ships and a reserve fund. Our ratings currently do not reflect any collateral-based uplift due to lack of visibility, in our view, of the legal status of enforceability of the assets securing the covered bonds in a severe stress scenario, which is the one assumed in our analysis for any collateral-based uplift. Additionally, the replacement framework in the counterparty documentation is not in line with our counterparty criteria (see "Counterparty Risk Framework: Methodology And Assumptions," published on March 8, 2019).

Therefore, our ratings on the covered bonds are constrained at 'A'.

We assess sovereign risk by applying our structured finance sovereign risk criteria (see "Incorporating Sovereign Risk In Rating Structured Finance Securities: Methodology And Assumptions," published on Jan. 30, 2019). Sovereign risk does not constrain our current ratings on the covered bonds.

Additionally, there are currently no rating constraints related to administrative and operational risks on the 'A' ratings.

Program Description

Table 1

Program Overview*

Jurisdiction	Denmark
Year of first issuance	1961
Covered bond type	Legislation-enabled
Covered bonds amount (mil. DKK)	35,619.3
Redemption profile	Hard bullet
Underlying assets	Ship mortgages
Jurisdictional support uplift	1
Unused notches for jurisdictional support	0
Available credit enhancement (%)	21.63
Credit enhancement commensurate with rating (%)	N/A

*Based on data as of December 2022. DKK--Danish kroner. N/A--Not applicable.

Table 2

Covered Bond Program Participants

Role	Name	Rating	Rating dependency
Issuer	Danmarks Skibskredit A/S	BBB+/Stable/A-2	Yes
Collection/bank account provider	Danske Bank A/S	A+/Stable/A-1	Yes
Bank account provider	Jyske Bank A/S	A/Stable/A-1	Yes
Collection/bank account provider	Nordea Bank Abp	AA-/Stable/A-1+	Yes
Bank account provider	Skandinaviska Enskilda Banken AB	A+/Stable/A-1	Yes
Swap counterparty (CC)	Danske Bank A/S	A+/Stable/A-1	Yes
Swap counterparty (CC)	Jyske Bank A/S	A/Stable/A-1	Yes
Swap counterparty (CC)	Nordea Bank Abp	AA-/Stable/A-1+	Yes
Swap counterparty (CC)	Skandinaviska Enskilda Banken AB (publ)-SEB	A+/Stable/A-1	Yes

CC--Cross currency. IR--Interest rate.

DSF is a small, highly specialized organization and a material lender to the shipping industry that services very large clients by financing vessels against a first-lien mortgage, reporting total assets of Danish kroner (DKK) 56.0 billion as of Dec. 31, 2022.

In 2021, the issuer updated its sustainability policy and ramped up its sustainability efforts significantly. Moreover, DSF reported the climate alignment of its portfolio to the Poseidon Principles to further improve transparency and incentivize stakeholders to act.

In general, the shipping industry fared well during 2022, with healthy growth in demand, freight rates, and second-hand prices (see "Danmarks Skibskredit A/S", published on March 11, 2022).

The loan portfolio is concentrated, with the 10 largest exposures making up more than 47.65%, reflecting the company's chosen corporate lending strategy of working primarily with select shipping companies, e.g., shipping operators the issuer considers able to manage difficult markets and adjust operating capacity through the cycle. DSF has approximately 70 clients, for which it finances about 678 vessels, exposing the institution to significant revenue concentration risk in a highly cyclical sector. From the total number of clients and loans, the bank selects the loans placed in each covered bond capital center.

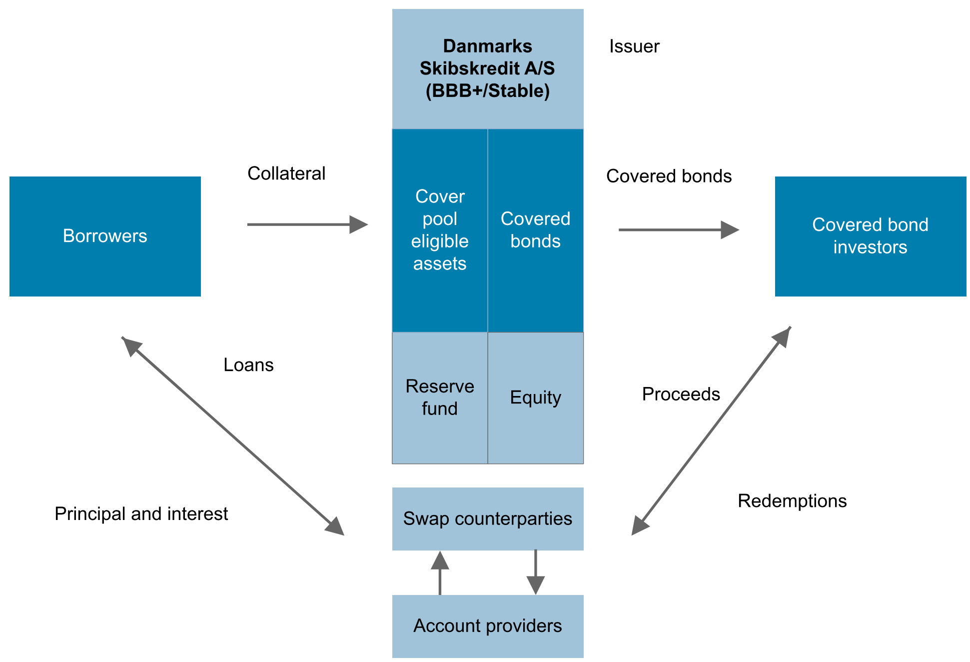
Partly counterbalancing its narrow business franchise, DSF has a strong operational track record, performing robustly both after the 2009 downturn in global shipping markets and amid the COVID-19-induced downturn. We believe this shows the resilience of its business model. We also recognize DSF's proven track record of issuing covered bonds in the Danish market. Under the covered bond program, DSF issues covered bonds denominated in Danish kroner and euro, primarily aimed for investors of the Nordic capital market. The Danish covered bond law governs each covered bond, and the issuer's operations are under the supervision of the Danish financial services authority (FSA).

The program has transaction accounts held with various counterparties. As there is no replacement language in line with our criteria, in our view, there is a risk that if the issuer becomes insolvent, payments may be caught up in the default or default of the counterparties.

The issuer currently issues Danish ship mortgage bonds ("skibskreditobligationer", or "SMBs", formerly called "SOs") as well as ship covered bonds ("særligt dækkede obligationer", or "SCBs", formerly called "SDOs"). SCBs and SMBs are issued to finance loans collateralized by ship mortgages. SMB's that meet the requirements of the Covered Bonds Directive may in future be designated European Covered Bonds, while SCB's that meet the supplementary Capital Requirements Regulation (CRR) requirements for overcollateralization and ongoing compliance with loan-to-value (LTV) limits may be eligible for the European Covered Bonds (Premium) designation.

The issuer has another capital center (Capital Center A) from which it issues SCBs, which we also rate (see "Transaction Update: Danmarks Skibskredit A/S Capital Centre A (Ship Covered Bond Program)," published on April 19, 2023).

Program Structure



Rating Analysis

Legal and regulatory risks

We base our analysis of legal risk on the guidelines in "Asset Isolation And Special-Purpose Entity Methodology," published on March 29, 2017.

In our opinion, the Danish covered bond legal framework satisfies the relevant legal requirements of our covered bond criteria. This enables us to rate the covered bonds above our long-term ICR on the issuer.

SMBs are issued in line with the same law as Danish mortgage covered bonds, while the assets are regulated by the law and the executive order for ship finance. The issuer opened Capital Center A in 2019 for the issuance of SCBs, which can only be done from a new capital center (cover pool) as the law requires issuances of SMBs and SCBs to be kept separate.

The issuer is regulated by "The Danish Act On A Ship Finance Institute," executive orders for a ship finance institute bond issuance, the balance principle, and certain provisions in the Danish Financial Business Act. The law regulates how the issuer may originate loans and defines limits for maturity and amortization, currency/interest/liquidity risk, and overcollateralization requirements.

The Danish FSA regulates the issuer. Inspections regularly occur on the issuer's business address and the FSA receives frequent reports from the issuer.

The cover pool comprises loans secured on ships or ships under construction, mainly in Europe and North America, and a reserve fund. Under the law, mortgages may be used as security up to a certain estimated value of the collateral of 70%. The LTV ratio can be higher if additional collateral is made available (the LTV above 70% must be covered by the overcollateralization in the capital center).

There is minimum required overcollateralization of 8% of risk-weighted assets. The balance principle requires that the issuer maintains sufficient liquidity to repay obligations as they become due.

Valuations of vessels in the cover pool are obtained from brokers twice a year, while the cover pool as a whole is subject to audit. The law does not provide for a separate cover pool administrator if the issuer becomes insolvent. Instead, the receiver-in-bankruptcy represents all investors and regularly conducts special covered bond supervision.

The legislation to transpose the EU Covered Bond Directive in the Danish legal framework was passed in May 2021 and became effective on July 8, 2022. The amendments introduced a nominal statutory overcollateralization requirement of 2%. This does not include the cost of managing a cover pool that is winding down. It also introduced a formal requirement for coverage of 180 days of liquidity needs. Most Danish covered bond programs are match-funded and exempt from this requirement. The amendments are essentially refinements and, given that the Danish legislation was already well aligned to the requirements of the directive, the new legislation does not affect our analysis of the Danish legal framework.

Banking supervision is carried out by the Danish Financial Supervisory Authority (DFSA, or "Finanstilsynet"). The DFSA has the authority to issue an order with which the issuer must comply. In case of severe or multiple breaches, the DFSA may revoke the license.

Operational and administrative risks

In our opinion, systems and processes mitigate operational risk from the cover pool's management and loan origination that would otherwise constrain the covered bond rating to the same level as the long-term ICR.

Although there are currently no other specialized financers of ship finance, several Scandinavian and European banks remain active in the market. Therefore, we believe it is highly likely that a replacement cover pool manager could be appointed if the issuer were to become insolvent. We consider Denmark to be an established covered bond market and we believe that the ship assets in the cover pool do not comprise product features that would materially limit the range of available replacement servicers.

Danmarks Skibskredit was founded on Dec. 22. 2003, replacing "Danmarks Skibskreditfond". Danmarks Skibskreditfond was established June 6, 1961, by Danish banks, insurance companies, shipping companies, shipyards--represented by their respective industry associations--and Danmarks Nationalbank (the Danish central bank).

Danish Ship Finance Holding A/S (DSH), a consortium comprising private equity and pension funds, owns approximately 86.6% of DSF's shares. Den Danske Maritime Fund (Danish Maritime Fund) holds 10% of the share capital and has a claim on 15% of net profits. The remaining 3.4% is owned by a few minority shareholders.

All ship mortgage loan originations are made from DSF's own offices, which also provides in house shipping analysis and asset monitoring. Their underwriting criteria include LTV ratio caps of 70% and straight amortization rules for most loans. Current ship mortgage loans as well as new origination are concentrated in Europe and North America.

We view DSF's underwriting criteria as prudent. Our view is also supported by the low level of realized losses from the bank's loan book.

Our analysis of operational and administrative risks follows the guidelines in our criteria.

Resolution regime analysis

DSF is a Danish issuer of covered bonds with a global focus, operating from Denmark. Denmark is subject to the EU's Bank Recovery and Resolution Directive (BRRD). DSF, like mortgage banks in Denmark, is exempt from minimum requirements for own funds and eligible liabilities (MREL) and any bail-in according to the BRRD. We consider that the capital centers will be separated from a defaulted parent after a potential bail in.

We assess the systemic importance for ship covered bonds in this jurisdiction as moderate.

Under our covered bonds criteria, this means that the RRL can be one notch above the long-term ICR. This uplift recognizes that resolution regimes increase the probability that an issuer could service its covered bonds even following a default on its senior unsecured obligations because the law exempts covered bonds from bail-in risk if there is a bank resolution. We consider this as an internal form of support, because the bail in of certain creditors of the issuer does not require direct government support.

Under our covered bonds criteria, the RRL is the higher of the issuer's resolution counterparty rating (RCR) and the issuer's ICR plus one notch (for a moderate systemic importance). Given that DSF does not have an RCR assigned, we assess the RRL as 'a-', that is, one notch above the ICR on DSF.

Jurisdictional support analysis

Under our analysis of jurisdictional support in our covered bonds criteria, we determine a JRL, which is our assessment of the creditworthiness of a covered bond program once we have considered the level of jurisdictional support, but before giving credit to the amount of collateral.

In our jurisdictional support analysis, we assess the likelihood that a covered bond program facing stress would receive support from a government-sponsored initiative instead of from the liquidation of collateral assets in the open market. Our assessment of the jurisdictional support for Danish ship covered bond programs is moderate. Under our covered bonds criteria, this means that the program can receive one notch of jurisdictional uplift from the RRL. This leads to a JRL for DSF's ship covered bonds of 'a'. The jurisdictional support uplift cannot exceed the rating on the sovereign providing the support to the covered bond, which in this case is 'AAA'.

Collateral support analysis

The cover pool comprises a mixed portfolio of loans backed by ship collateral originated by DSF. We have not conducted an analysis of the loans currently in the capital center as we do not assign collateral uplift to the program.

The following general capital center information is as of Dec. 31, 2022.

The DKK43.3 billion cover pool comprises loans secured by first-lien claims on shipping collateral and a reserve fund. It includes loans granted to borrowers mainly in U.S. dollars, but also euro and Danish kroner, and to a lower extent Norwegian kroner and British pounds. The average LTV ratio of the loans is 42.61%, considerably below the maximum 70% LTV ratio allowed for shipping assets by the legislation, partly due to shipping being in a high cycle.

The covered bonds are secured by different ship types, with more than 62.6% of the pool comprising bulk carriers, container liners, and crude and product tankers.

Most loans are money-market-based loans, while a minority of loans have fixed-interest periods of between one and 10 years. The loans have relatively short maturities and most mature within a five-year period. Most of the remaining loans mature between five and 10 years. As of Dec. 31, 2022, 4.06% of the pool were loans over 90 days non-performing.

The issuer hedges interest rate and currency exposure using hedges included in the cover pool. There are currently DKK35.6 billion of outstanding covered bonds resulting in 21.63% overcollateralization.

Table 3

Cover Pool Composition

	As of Dec. 31, 2022		As of Dec. 31, 2021	
Asset type	**Value (bil. DKK)**	**Percentage of cover pool (%)**	**Value (bil. DKK)**	**Percentage of cover pool (%)**
Ship mortgages	35,619.3	82.22	35,113.1	83.03
Substitute assets	7,703.7	17.78	7,178.6	16.97
Total	43,323.0		42,291.8	

Table 4

Key Credit Metrics

	As of Dec. 31, 2022	As of Dec. 31, 2021
Weighted-average current LTV ratio (%)	42.61	44.31
Weighted-average customer seasoning (months)	N/A	N/A
Balance of non-performing loans (%)	4.06	4.92
10 largest exposures	47.65	50.46
Interest-only loans (%)	0.80	1.68
Floating rate loans	83.46	83.49
Number of shipping loans	249	297

LTV--Loan-to-value. N/A--Not applicable.

Table 5

Covered Bond Program LTV Ratios

	% of portfolio (as of Dec. 31, 2022)	% of portfolio (as of Dec. 31, 2021)
Current LTV ratio (%)		
>00 - <=40 %	87.82	30.68
>40 - <=60 %	11.33	52.07
>60 - <=70 %	0.36	14.03
>70 - <=80 %	0.25	2.09
>80 - <=90 %	0.13	0.38
>90 - <=100 %	0.00	0.75
>100%	0.12	0.00
Weighted-average LTV ratio	42.61	44.31

LTV--Loan-to-value.

Table 6

Loan Seasoning Distribution*

	As of Dec. 31, 2022	As of Dec. 31, 2021
Months	**Percentage of portfolio (%)**	
Up to 12 months	10.69	1.79
12 - 24 months	5.43	1.07
24 - 36 months	1.75	6.74
36 - 60 months	9.09	13.11
More than 60 months	73.04	77.30

*Seasoning refers to the elapsed loan term.

Table 7

Geographic Distribution Of Loan Assets

	As of Dec. 31, 2022	As of Dec. 31, 2021
Region	**Percentage of portfolio (%)**	
Belgium	2.05	1.86
Denmark	30.21	35.84
Finland	0.76	0.84
France	0.00	0.00
Germany	8.00	9.77
Greece	16.99	12.35
Netherlands	0.72	1.32
Italy	0.30	0.49
Luxembourg	1.09	0.80
Malta	1.40	1.54
Sweden	0.00	0.00
Norway	12.60	12.14
U.K.	12.93	9.33
Singapore	5.93	4.12
Switzerland	0.00	0.00

Table 7

Geographic Distribution Of Loan Assets (cont.)

	As of Dec. 31, 2022	As of Dec. 31, 2021
Region	Percentage of portfolio (%)	
U.S.	4.15	5.59
Other	2.87	4.01

Table 8

Collateral Type

	As of Dec. 31, 2022	As of Dec. 31, 2021
Bulk carriers	20.50	22.01
Car carriers	6.16	4.71
Chemical tankers	6.31	6.62
Container feeder	0.87	1.58
Container liners	10.77	12.49
Crude tankers	10.34	11.77
Ferries/RO-RO	8.71	9.55
LNG	0.00	0.00
LPG	7.47	4.64
Offshore units	3.63	6.21
Offshore vessels	3.55	2.90
Others	0.69	1.38
Product tankers	20.98	16.12

RO-RO--Roll--on/roll-off. LNG--Liquefied natural gas. LPG--Liquified petroleum gas.

Counterparty risk

We have identified counterparty risks to which the payments on the covered bonds are exposed. As these are not mitigated structurally or by the inclusion of replacement language in line with our current counterparty criteria, we believe that they constrain the rating from a counterparty risk perspective.

Bank account provider and commingling risk

For account risk, if a bank account or commingling risk exposure is with an entity that is unrelated to the issuer (which is the case for this program), we consider that the issuer has an incentive to manage the risk and that the risk does not reduce the likelihood of jurisdictional support to the covered bond program. Therefore, bank account or commingling risk does not reduce the covered bond rating below the higher of the RRL on the issuer plus one notch, the JRL on the covered bond program, or the applicable counterparty rating under these criteria.

Swaps

Our counterparty criteria consider that for derivatives by unrelated counterparties that are collateralized but with no replacement framework, the covered bond rating is limited based on the applicable table from these criteria (see "Related Criteria").

Sovereign risk

We assess sovereign risk by applying our structured finance sovereign risk criteria. As we are currently not assigning any uplift based on collateral, the main constrain to the rating would be to the jurisdictional-based uplift, which is capped at the long-term ICR on the sovereign of the issuing entity. Based on the current sovereign rating on Denmark (unsolicited; AAA/Stable/A-1+), country risk does not constrain our ratings on the covered bonds.

Environmental, Social, And Governance

ESG Credit Indicators

E-1	**E-2**	E-3	E-4	E-5	S-1	**S-2**	S-3	S-4	S-5	G-1	**G-2**	G-3	G-4	G-5

ESG credit indicators provide additional disclosure and transparency at the entity level and reflect S&P Global Ratings' opinion of the influence that environmental, social, and governance factors have on our credit rating analysis. They are not a sustainability rating or an S&P Global Ratings ESG Evaluation. The extent of the influence of these factors is reflected on an alphanumerical 1-5 scale where 1 = positive, 2 = neutral, 3 = moderately negative, 4 = negative, and 5 = very negative. For more information, see our commentary "ESG Credit Indicators: Definition And Applications," published Oct. 13, 2021.

ESG factors have no material influence on our credit rating analysis of Danmarks Skibskredit Capital Center General's ship covered bonds. The issuer is not committed to maintain a minimum level of overcollateralization in the program. On a net basis, we consider funding under the balance principle to mitigate the risk caused by the lack of a committed overcollateralization. Additionally, since we do not assign collateral support, the lack of such commitments does not affect the rating.

Related Criteria

- Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- Counterparty Risk Framework: Methodology And Assumptions, March 8, 2019
- Incorporating Sovereign Risk In Rating Structured Finance Securities: Methodology And Assumptions, Jan. 30, 2019
- Legal Criteria: Structured Finance: Asset Isolation And Special-Purpose Entity Methodology, March 29, 2017
- Criteria - Structured Finance - Covered Bonds: Covered Bond Ratings Framework: Methodology And Assumptions, June 30, 2015
- Criteria - Structured Finance - Covered Bonds: Covered Bonds Criteria, Dec. 9, 2014
- Principles Of Credit Ratings, Feb. 16, 2011

Related Research

- Transaction Update: Danmarks Skibskredit A/S Capital Centre A (Ship Covered Bond Program), April 19, 2023
- Global Covered Bond Insights Q2 2023, Apr. 12, 2023
- Covered Bonds Outlook 2023, Dec. 6, 2022

- Danish Covered Bond Market Insights 2022, Nov. 22, 2022
- ESG Credit Indicator Report Card: Covered Bonds, April 7, 2022
- Danmarks Skibskredit A/S, March 11, 2022
- European Covered Bonds Reach Harmonization Milestone As The Journey Continues, Says Report, July 12, 2022
- S&P Global Ratings Definitions, Nov. 10, 2021
- S&P Global Ratings' Covered Bonds Primer, June 20, 2019
- Glossary Of Covered Bond Terms, April 27, 2018