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CLIENT BRIEFING

THE DANISH MORTGAGE SYSTEM

THE MECHANICS OF THE DANISH MORTGAGE SYSTEM AND THE CAPITAL MARKETS

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This client briefing provides an overview of the main features of the Danish mortgage system and the mechanics of its interaction with the capital markets.

1, MARKET OVERVIEW

According to the European Mortgage Federation the Danish mortgage system offers one of the lowest interest rates to borrowers across Europe and the lowest borrowing costs for the first priority tranche of the property value due to Denmark's unique mortgage credit system. The combination of a tightly regulated framework, credit & risk management and wholesale funding through a pass-through system provides close to capital markets funding conditions through the issuance of individually matched bonds for each individual borrower. The high liquidity and the attractiveness of the bonds due to their high security level ensure borrowers very low and competitive prices.

With a volume of approximately EUR 330 billion the Danish mortgage bond market is the second largest covered bond market in Europe after the German Pfandbrief market. It is more than four times larger than the Danish government bond market and mortgage bank lending exceeds commercial bank lending. The bond investors are primarily financial institutions, pension funds and investment funds.

There are seven mortgage credit institutions active in the Danish mortgage market. Some are affiliated with commercial banks (e.g. Nordea Kredit, Realkredit Danmark), while others operate on a standalone basis (e.g. Nykredit, BRFKredit). The market share of the five largest lenders is approximately 95% of the Danish market.

2. REGULATION

Danish Mortgage Credit Institutions ("**MCI**") are specialised lenders that operate in a highly regulated environment. The market is regulated by the Mortgage Credit Act (the "**Act**") (Realkreditloven).

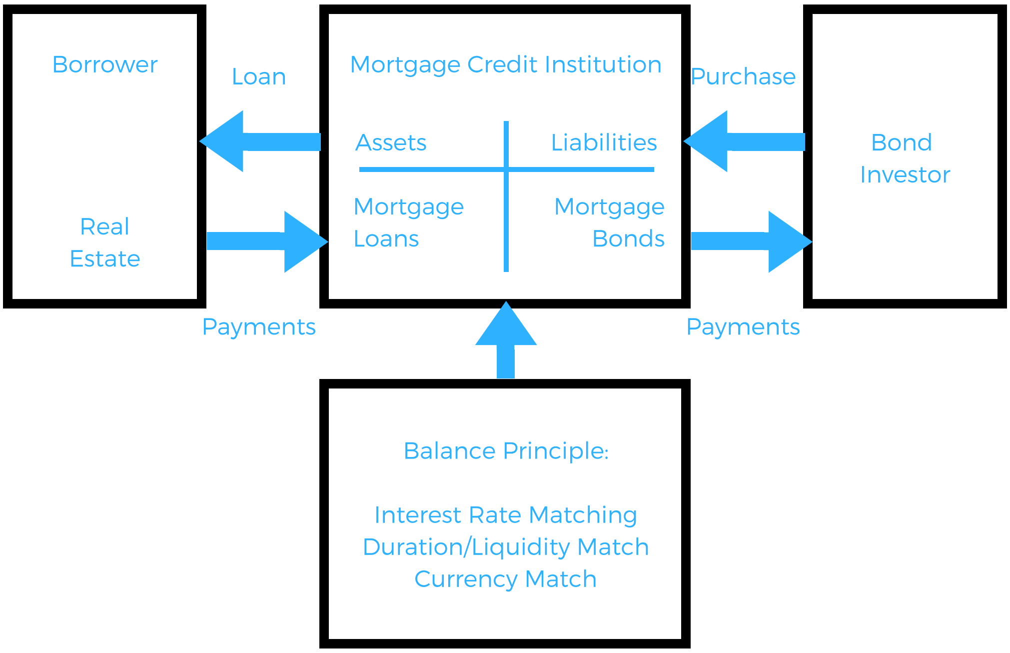
The scope of activities permitted for MCIs is limited to the origination and servicing of mortgage loans, their funding, exclusively through the issuance of mortgage bonds, and activities deemed accessory. Regulated MCIs are not authorised to fund their credit activity with deposits or to issue guarantees.

The MCIs are supervised by the Danish FSA (Finanstilsynet) pursuant to chapter 5 of the Act and the credit facilities of the MCIs are governed by statute, section 5 of the Act.

3. MORTGAGE CREDIT INSTITUTIONS AND THE BALANCE PRINCIPLE

The balance principle set out in Decree on Bond Issues, Balance Principle and Risk Control No. 1425 dated 16 December 2014, chapter 2, imposes strict matching rules between the assets (e.g., mortgage loans) and the liabilities (e.g., mortgage bonds) of MCIs. Each new loan is in principle funded by the issuance of new mortgage bonds of equal size and identical cash flow and maturity characteristics. The proceeds from the sale of the bonds are passed to the borrower and similarly, interest and principal payments are passed directly to investors holding mortgage bonds.

The Balance Principle



By essentially limiting the role of MCIs to conduits between mortgage borrowers and mortgage bond investors, the system allows the former to benefit from financing conditions directly derived from those that prevail in capital markets, for the type of loan they request, at the time the borrowing takes place. The service provided by the mortgage institution is paid for by borrowers through front-end fees, annual administrative fees, and pre-payment fees.

The MCIs do not retain prepayment risk due to the balance principle which requires all callable Danish mortgage bonds to be pass-through securities, i.e. the MCIs fund their lending activities by issuing mortgage bonds with cash-flows that fully match those of the underlying mortgage loans.

MCIs are specialised institutions regulated as stand-alone entities. Other institutions, notably banks, may also offer loans secured by mortgages. However, only mortgage banks have the opportunity to fund mortgage loans by issuing Danish mortgage bonds (Realkreditobligationer). Every time a borrower is granted a loan, bonds of equal size and characteristics are issued by the MCI. This creates transparency between borrowers and investors.

4. FEATURES

Danish mortgage loans are highly standardised and accordingly mortgage lending rates to borrowers and associated fees and commissions are highly uniform. The uniform pricing is combined with almost full standardisation of loans, including the elimination of differences in credit risk among borrowers. This is achieved through a combination of regulation, in particular different loan-to-value ratios for retail and commercial borrowers, an element of quantity rationing and to a limited extent through different fee charges for commercial borrowers. Thus, even though all borrowers have access to market-based financing, the uniform pricing and standardisation of Danish home mortgages mean that the market clears through credit rationing rather than risk-based pricing.

The strongest benefits of the Danish mortgage system are:

- Low, competitive market-based pricing of loans against mortgages on real property.
- Long credit commitment up to 30 years (section 3 of the Act).
- Transparency in prices and repayment terms for the loans.
- No prepayment penalty. The loan can be prepaid by buying the underlying bonds at market price.
- Flexibility: Mortgage banks offer fixed-rate loans, adjustable-rate mortgages and floating-rate loans.

4.1. Loan to Value Percentages

The Loan-To-Value limits are set out in section 5 of the Act re stated by law as follows: (i) residential property up to 80%; (ii) agricultural up to 70%; and (iii) commercial real estate up to 60%. The MCIs are not permitted to fund real estate projects. They can only finance completed developments which have been valued.

4.2. Taps

Unlike most other types of bond issuance which occurs through a single auction or series of auctions (tranches), Danish mortgage bonds are issued by means of "taps" on a daily basis, in response to loan origination and refinancing.

4.3. Prepayment and Repurchase

Borrowers may redeem their mortgage loans at any time without negotiating the price, as prepayment may always take place at the prevailing market prices. Danish mortgage borrowers may terminate their loans by buying back the mortgage bonds in the bond market and delivering them to the mortgage bank. This option is referred to as the delivery option or the buy-back option. The buy-back option applies to all mortgage bonds whether callable or non-callable.

The buy-back option is a special feature of the Danish mortgage finance system, and borrowers therefore always know the ISIN code(s) of the bonds behind their mortgage loans. The buy-back option constitutes a significant difference between the US and the Danish mortgage finance system. The US system only allows mortgage loan prepayment at par (100).

5, MECHANICS

A conservative valuation scheme guides the MCIs when determining the value of the property serving as collateral. Strict rules are imposed on lending, including maximum LTV ratios and lending periods for each property category. The LTV ratio for dwellings cannot exceed 80%. LTV ratios must be observed and adjusted for each category as set out in section 5 of the Act.

5.1. Valuation

Section 10 of the Act requires that the MCI assesses the value of the property on a market-basis price. The percentage is then based on the valuation of the property. The valuation is supervised by the Danish FSA and can be readjusted by the Danish FSA (section 12 of the Act).

For the borrower to qualify for the loan, the borrower must provide the MCI with the standard know-your-customer documentation and all documentation required to value the property and perform a credit assessment of the borrower. The MCI will then conduct a valuation of the property. The process is highly standardised and for some MCIs conducted pursuant to a computerised model authorised by the Danish FSA.

5.2. Mortgage Offer

Based on the valuation of the survey, the MCI will issue a loan offer to the borrower up to the maximum percentage of the property valuation permitted by law. The actual percentage may be adjusted to scale back the credit. Normally the offer will remain open and valid for six months from the date of the offer.

The general terms and conditions of the MCIs state that the offer is available for acceptance by the mortgage borrower for a period of six months from the date of the offer. Pursuant to section 1 of the Contract Act (Aftaleloven) an offer is binding on the MCI when accepted by the borrower in accordance with its terms within the offer period. This makes the financing offer received the MCI "bankable" by the borrower.

5.3. Issuance

When a borrower has qualified for a new mortgage, the MCI adds that mortgage to a pool of identical mortgages with the same pricing and maturity dates. Bonds are then issued on tap by the MCI in individual "series" backed by a specific pool of loans. This pool is financed by investors through bond purchases. The bond series is "open" while new mortgages are being issued into it. Once these mortgages are no longer being issued, the bond series is closed. Loans to all types of borrowers serve as collateral for all bond issues. A standard 30-year callable bond is open for issuance for up to three years.

Each bond series increases in size as loans are granted and matching tap issuance of bonds take place. The result of this process is very large tradable bond issues. The currently issued 30-year bonds which are part of the market-making have a total outstanding volume of more than DKK 215 billion (around EUR 29 billion), with around DKK 50 billion (close to EUR 7 billion) for individual bonds.

Throughout the process the bonds trade openly. Thus the mortgage loan is not made by a bank, it is made by the bond market, with the MCI facilitating. Since all of the mortgages in a given bond series are identical, it is possible to directly balance a performing mortgage – on the basis of its face value as a percentage of the face value of all mortgages in the pool – against an equal share of the trading value of the bond series.

The origination, structuring, issuance and servicing of Danish mortgage bonds take place in a fully integrated system. First the mortgage bank grants a loan to the borrower based on collateral in the property. It then issues a bond to fund the loan. Following this the mortgage bank acts as the mortgage servicer, assuming the responsibility for collecting payments from borrowers and redistributing them to bondholders. The bond is a balance sheet liability of the mortgage bank, backed by the firm's own funds.

As the MCI acts as a pure intermediary, the financing is therefore a pure pass-through product on standard terms and at market rates. The property will be registered digitally in the relevant land registry as first-ranked security for the benefit of the relevant MCI.

6. EURO DENOMINATIONS

While Denmark maintains a fixed exchange-rate policy vis-à-vis the euro and the aim of monetary and foreign exchange policy is to keep the Danish krone stable vis-à-vis the euro to ensure stability, the issues surrounding the flotation of the Swiss Franc vis-à-vis the euro, show that there is a potential currency risk. In relation to transactions contemplated to be denominated in euro, the MCIs have the option to issue Danish real mortgage bonds denominated in euro via Luxembourg rather than NASDAQ Copenhagen.

7. DEFAULT

The MCI deals with all ensuing credit and collection issues. Mortgages have a strong legal position in Denmark owing to their registration in a central registry. Mortgage banks possess a senior claim on the proceeds from a property sale in the event of a borrower's default.

In the event of a borrower's default on mortgage payments, the MCI will enforce a sale of the mortgaged property. Uncovered claims under the mortgage loans will be deleted from the land register, but the MCI will hold a direct unsecured claim against the borrower.

The MCI originator bears full responsibility for timely payments from the borrower. If a borrower defaults on payments, the mortgage is removed from the bond by the MCI at the lower of the market price or par. This system cleanly separates credit risk and interest risk.

The track record for Danish foreclosure processes is good with timely execution at relatively low cost. Strategic default by borrowers is discouraged by the fact that a Danish mortgage borrower remains liable for the full mortgage debt when falling property prices result in negative equity positions.

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