Conference call

Interim report – first half 2017

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Investor Relations

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Operator

Good day, and welcome to the Danske Bank financial results for the first half 2017 conference call. Today's conference is being recorded.

At this time, I would like to turn the conference over to Thomas F. Borgen, CEO. Please go ahead, sir.

Thomas Borgen - Danske Bank - CEO

Thank you, operator, and thank you all for taking time to listen to this call today. Together with me today, I have the CFO, Jacob Aarup-Andersen; and the Head of IR, Claus Ingar Jensen.

Slide 1, please. In today's call, we have the pleasure of presenting Danske Bank's financial results for the first half of 2017. We aim to keep this presentation to around 15 minutes. After the presentation, we will open up for a Q&A session, as usual. Afterwards, feel free to contact our IR department if you have any more questions.

Slide 2, please. The first half of 2017 was a satisfactory period for Danske Bank. Our net profit amounted to DKK 10.3 billion, up 10% from the level in the same period the year before. The result represents a return on shareholders' equity of 13.5%, an increase of more than 1 percentage point from the first half of 2016. In isolation, our Q2 result showed a continuation of our solid business development with a return on equity of 12.6%. We continue to build Danske Bank as a solid, balanced and predictable institution. The strong underlying business momentum continued in the first half of the year, driven by stronger customer activity at all business units, and particularly in Norway and Sweden, where we continued to strengthen our position as a Nordic universal bank.

The expansion of our footprint in the Nordics is on a solid path, and we will continue on a balanced and predictable basis. During the period, loan growth for the Group was up 3% from the same period of last year despite headwinds from currency effects. We saw good inflows of new business in Norway and in Sweden in particular, where our second partnership agreement took effect in the second quarter. Our relatively new Wealth Management division is now starting to show traction, and we continue to see good long-term potential within this area.

At C&I, we continue to see solid progress in terms of servicing our customers with strong advice and good execution capabilities. Our risk appetite is at a moderate level, and capital consumption is presently at low levels. The development in the first half of the year was backed by better macroeconomic trends in all of the Nordic regions. The development in the financial markets supported the business momentum as customer activity remained high, particularly in the first quarter. The high activity level had a positive effect on trade income, whereas fee income benefited from good demand for capital market solutions.

Expenses rose from the level in the first half last year due to higher customer activity. Our decision to further enhance our digital capabilities and initiatives are taken to meet increased regulatory requirements. Based on the speed of customer adaptation to new digital solutions, we see ample opportunities. However, certain investments are made with a view to securing the medium- to long-term competitive position for the bank.

Credit quality is solid. And in the second quarter, as in the first, we booked a net reversal, which had a positive effect on the financial results. Our capital position remained very strong. The core capital ratio of 16.2%, which is above our target level, is net of the total share buy-back programme of DKK 10 billion we are currently executing. Finally, we have revised our outlook for the full year. We now expect net profit to be in the range of DKK 18 billion to DKK 20 billion. We will comment on this later in this call.

I will now turn the presentation over to Jacob, who will take you through the financial results in more detail. Slide 3, please.

Jacob Aarup-Andersen - Danske Bank - CFO

Thank you, Thomas. Let's take a look at the main items of our financial results. Starting with net interest income, here, we came in at DKK 11.4 billion. This is 6% above the level in the same period the year before, and it was driven by lending growth of 3%.

Excluding currency effects, NII was up 7%. Net interest income was adversely affected by a one-off of DKK 90 million. And in Q2, there was one more interest day than in the preceding quarter. Net fee income came in at DKK 7.6 billion, up 13% from the level last year, when fee income was low due to subdued investment activity. The increase came from all Nordic business units, but Wealth Management in particular. Net trading income came in at DKK 4.5 billion, up 21%, and was driven by strong customer activity at C&I primarily in the first quarter. Other income fell significantly from the level last year, where we benefited from the sale of our domicile property in Copenhagen. Adjusted for the sale, other income was down only slightly.

Operating expenses were up 3% to DKK 11.5 billion. The figure for the same period last year was based on lower customer activity and included one-offs. In the first half of this year, expenses reflect high activity and our continued focus on digitalisation. Furthermore, expenses for regulatory compliance projects increased. The cost income ratio came in at 47.1%, a decline of more than 1 percentage point from the year before. Finally, we saw net reversals of loan impairment charges of DKK 0.5 billion as a result of improved credit quality, in particular at Business Banking.

Slide 4, please. In the first half of the year, our two Nordic banking units, Personal Banking and Business Banking, benefited from good business momentum in all markets. The improvement in the results was based on higher customer activity than last year and a good inflow of new business in Norway and Sweden in particular. In Northern Island, lower UK rates and the development in the pound sterling had an adverse effect on the financial results.

Now let's look more closely at the three units. Personal Banking delivered good results with profit before loan impairment charges up 13% to DKK 2.6 billion. Total income was 6% higher than last year, owing to improvements in all income lines. In the first quarter last year, both fee and trading income were adversely affected by the low customer activity. Expenses were up 2%, owing primarily to regulatory-driven investments and IT development. Impairment charges remained low, although higher than last year. And finally, the return on allocated capital was 21.7%.

Total lending volume was up 2%, owing to growth in Norway and Sweden, where lending volume measured in local currency rose 10% and 18%, respectively. These strong gains came primarily from our partnership agreements. In Denmark, where volume was stable, the trends toward higher mortgage lending and lower lending in conventional loan products continued, however at a lower pace. In Finland, lending volume was up 1%.

Turning to Business Banking, here we continued the good progress in all markets. Overall profit before loan impairment charges was up 7%. Lending volume measured in local currency was up in all markets, most notably in Sweden, were it rose 8%, followed by Norway and Finland, where we saw increases of 6% and 5%, respectively. In Denmark, excluding Realkredit Danmark, lending rose 8%.

Total income was 3% higher than last year due to higher customer activity. The improvement was driven by NII and fee income. Expenses were down 2%, owing to efficiency measures offsetting higher regulatory costs. Impairments charges showed a significant reversal in the period, which I will comment on later in the call. Finally, the return on allocated capital was 17.9%.

Moving to Northern Ireland. Here, the result was adversely affected by the depreciation of the pound sterling after the UK referendum last year. Lower interest rates and reduced loan impairment reversals also had an impact on the reported results from the level in the same period last year. Total income fell 9%. Adjusted for the depreciation of the currency, it was unchanged from the level last year despite an interest rate cut in the UK in August. Expenses were unchanged. Adjusted for FX, they were up 10%, partly due to increased pension-related costs and investments. The return on the allocated capital was 16.1% against 14.6% last year, driven mainly by lower capital.

Slide 5, please. Let's have a look at the units that are more dependent on the capital markets. At C&I, profit before impairments rose 47% over the level last year when customer activity was low due to challenging market conditions. A number of geopolitical events fuelled activity this year, primarily in the first quarter. The activity level in FICC in particular normalised somewhat in the second quarter, whereas activity remained high in capital markets.

Total income rose 27%, owing to improvements in all major income lines. Fee income benefited from good customer activity both from general banking and intense issuance activity within capital markets. Expenses were up 4% due to higher activity and positive one-offs in the first half of 2016.

Impairments, which by nature fluctuate at C&I, amounted to 0.2 billion. The charges were primarily against exposure to the oil sector. Despite high activity at C&I, capital consumption was stable and was down 5% from the level in Q1 because of lower counterparty and market risk.

At Wealth Management, profit before tax was up 10% as the unit, like the other business units, benefited from improved market conditions and higher customer activity. Fee income was up 15% from the level last year, driven mainly by an increase in assets under management and higher customer activity. Expenses were up 8% because of higher activity and an increase in regulatory compliance costs. Assets on the management were up 12% from the level in the same period last year. In the first half of this year, premiums in Danica and net sales from asset management amounted to DKK 20 billion and DKK 13 billion, respectively.

Slide 6, please. Moving on to expenses. Total expenses for the first half of the year amounted 11.5 billion, that's up 3% from the level last year. In the first half in last year, expenses benefited from positive one-offs and lower customer activity than we have seen this year. The increase in expenses related to higher customer activity and digitalisation efforts. Furthermore, significant resources are invested in IT-related regulatory compliance, enabling us to implement regulatory requirements, such MiFID II, GDPR, PSD2 and others. The underlying cost development remains satisfying. Based on the higher activity level and the heavy regulatory agenda, we have decided however to adjust our outlook for expenses for the full-year, something I will return to later in this call.

Slide 7, please. The positive trend in credit quality continued in the second quarter, and as in the preceding quarter, we had a net reversal for the Group. The reversal in the first half of the year was 0.5 billion, against a net reversal 0.2 billion for the same period in 2016. The loan loss ratio for the first half of 2017, excluding non-core activities, was minus 5 basis points. With the net reversal of 0.3 billion in the second quarter, Business Banking had the largest decline, as the positive effect of increased collateral values in the commercial property segment and the positive outcome of workout cases, mainly in Denmark, continued. Market conditions for the agriculture industry improved and reversals of 0.2 billion were made in the second quarter.

At personal banking, we had a small reversal of 53 million, reflecting strong and stable credit quality. At C&I, we booked impairment charges of 0.2 billion in the second quarter, mainly against the oil-related exposure, as the difficult market conditions for subcontractors in the oil and gas industry continued. The individual impairment charges against this industry amounted to 0.1 billion, and collective charges now stand at 1.1 billion, which is almost unchanged from the preceding quarter.

Slide 8, please. Our capital position remained very strong, with the reported common equity tier 1 capital ratio of 16.2%, which is up 0.7 percentage points from the preceding quarter, and well above our target of 14% to 15%. The full deduction of the DKK 10 billion share buy-back programme was booked in the first quarter.

The total capital ratio was 21.1%, up from 20.4% at the end of the first quarter. The REA level fell 20 billion in the second quarter, owing to a reduction in all risk categories. Credit risk was reduced because of continued improvement in overall credit quality, whereas both market and counterparty risk benefited from lower volatility in the financial markets. The leverage ratio was 4.1%, according to both transitional rules and fully phased-in new rules. The share buy-back of 10 billion in 2017 is progressing according to plan. As of the end of week 28, we had bought back 18.6 million shares, representing a gross value of 4.5 billion.

Slide 9, please. In short, as Thomas mentioned in the beginning of the call, we are changing our outlook for net profit for 2017. On the basis of the satisfactory financial performance in the first half of the year, we now expect net profit for the full year to be in the range of 18 billion to 20 billion, that is up from our previous outlook of between 17 billion and 19 billion. Fee income is now expected to be higher than in 2016, subject to customer activity, whereas we expect expenses to be around to same level as in 2016. Finally, for loan impairment charges, we now expect them to remain low.

Slide 10, please, and over to you, Thomas.

Thomas Borgen - Danske Bank - CEO

Thank you, Jacob. Those where our initial comments and messages, we are now ready for your questions. Please limit yourself to two questions. If you are listening to the conference call from our website, you're welcome to ask questions by e-mail. Operator, we're now ready for the Q&A session.

Operator

Thank you. (Operator Instructions). We shall now take our first question from Mads Thinggaard from Handelsbanken.

Mads Thinggaard - Handelsbanken

This is Mads from Handelsbanken with two questions. And the first is relating to lending growth in Personal Banking in Sweden, where it seems you have a rather high growth rate here in Q2, I guess in local currencies around 5% quarter-on-quarter. And compared to official statistics, that implies perhaps over 2 percentage points month-on-month in June.

Could you put a bit of flavour on what to expect going forward on this and if we should kind of annualise this over 2% in June, or is it initially from TCO, or what should we expect here?

And then my second question relates to the margins in Personal Banking in Norway, where there seemed to be again now a quite hefty uptick in NII quarter-on-quarter. And as far as I can calculate, the margins go up by 9 basis points versus Q1. And is that reflecting improved market conditions, less competition in the Norwegian household market, or is it more a technical effect of Nibor going down in Q2? Thanks.

Thomas Borgen - Danske Bank - CEO

Thanks very much, Mads. I will take the first one. You're right to point out that we have substantial growth in Personal Banking in Sweden from Q1 to Q2.

One should always be cautious to make too hard conclusions based on a quarter's growth. So said, remember that the TCO agreement went live on the 1st of April, which is a part of our strategy to have sustainable and healthy growth in the Nordic markets, basically in Norway, Sweden, and to some extent Finland.

What we could expect is always difficult to be very precise on, but I think we should be able to see healthy double digits. And then we will need to see where this will end going forward.

This is a long-term agreement. We have it with Saco. We have it with TCO. TCO has good potential. But I think we should be cautious to put any numbers for the time being, as it's only been running for a quarter. But I think it's appreciative that it has started off to a good footing.

Jacob Aarup-Andersen - Danske Bank - CFO

And then, Mads, let me just take the other question on Personal Banking in Norway. You are right that our margin in the second quarter was improving versus the first quarter. There are two effects in in that number. First, do remember that, when we announced the price increases towards the end of Q4, we said that it would come in phases during Q1.

So what you're seeing in Q2 is the full effect of the price increases that came in, in Q1. One of the price increases was in January, and the other one was in March. So there is the full effect of those price increases.

And you're right. Then there is also a benefit from Nibor, which all Norwegian players have. But here in Q2, the big move you see is the lagged effect from Q1.

Mads Thinggaard - Handelsbanken

Okay. So no big positive news on less competition in Norway from the uptick.

Jacob Aarup-Andersen - Danske Bank - CFO

We think the competitive environment in Norway is good and strong, the way it's been for a number of quarters, but we're not seeing any major changes to report there.

Mads Thinggaard - Handelsbanken

Okay. Thanks a lot.

Operator: We will now take our next question from Willis Palermo from Goldman Sachs. Please go ahead.

Willis Palermo - Goldman Sachs

Hello. Thanks for the presentation and taking my questions. The first one is on the cost for the new guidance, as the current first return rate is higher than the 2016 level. What items were unusually high in the first half and would disappear in the second half to reach that target?

Jacob Aarup-Andersen - Danske Bank - CFO

Okay. Let's start on the cost here. So first of all, you're right. First half is higher than last year. When you look at the difference between the first half of '17 and the first half of '16, there's a number of moving parts. We take them a little bit high-level.

First of all, last year, we did have around DKK 140 million of positive one-offs, which we flagged to you at that point. What you're seeing in this half versus last year is also a higher performance-based pay, which is obviously reflecting the higher activity.

You're seeing higher severance of around DKK 80 million. You're seeing higher IT expenses, I believe around DKK 130 million. And then you see some higher rent as well as a consequence of our selling our buildings.

But especially IT, performance-based pay and also, say, to some extent, the staff-related cost affecting the regulatory projects are all effects you're seeing in the first half due to these things we mentioned, i.e. the regulatory projects and the activity-based expenses.

So some of that run rate, sorry, some of these effects, like severance and activity-based expenses, have been very strong in the first half and are expected to be lower in the second half. And then you have seen, as we also said just now in the speech, in the first half in Northern Ireland, for example, we have taken some restructuring cost and investment cost.

So there are a number of places where we've been investing in the first half. Some of that will come down. And so I think it's a multitude of factors.

Willis Palermo - Goldman Sachs

Okay. Thank you. That's very clear. And the second question is on capital. So core tier 1 was up quite a lot and well above the target. Firstly, are there any elements in the risk-weighted asset decrease that may reverse in the second half? And secondly, if the capital position allows it, compared to your target, will you consider a capital return with a payout ratio above 100% when asking the Danish FSA for approval, or would you limit yourself to that cap? Thanks.

Thomas Borgen - Danske Bank - CEO

I will do the last one, and then Jacob will take you through the RWA. We have a very clear capital strategy, which remains in place, which we have communicated throughout the last couple of years. So there's no change that we have the intention to be very solid, and that is to have a capital core tier 1 ratio between 14% and 15%.

Then we have a dividend policy to be between 40% and 50%. And then we will take and support what we see as profitable growth in those markets we operate in. And here, you can see that we are able to capture very healthy growth, particularly in Norway, Sweden, but also Denmark is picking up.

Then, if we have any excess capital, we will distribute that back to the shareholders in one way or another. And what we have done, as you alluded to, we've done that through share buy-backs the last couple of years.

Then you ask, should we pay at more than 100%? I think we need to discuss that when the year is finished, to what level we will pay back to the shareholders and what level it is.

But you're right to point out that the FSA approves all changes in capital structure. And that implies share buy-backs. And I can just confirm that we have a good dialogue with the FSA. And we'll take that discussion with them when we have closed the accounts for the year.

Jacob Aarup-Andersen - Danske Bank - CFO

And let me address the other question in terms of reversing in the second half. If we just take a quick step back and look at what happened in the first, sorry, here in the second quarter, so REA is down DKK 20 billion. If you just look at the different components, so DKK 7 billion is credit risk. That is not driven by any technical model changes or anything like that. It's driven by higher collateral in the book, so generally better credit quality driven by higher collateral and rating migration due to the better credit quality.

When we look at the two other components, counterparty risk was down DKK 6 billion, and market risk was down DKK 7 billion. Here, lower volatility and lower counterparty exposure drives this. Obviously, if you do expect a significant increase in market volatility, you could see some of the market risk reverse. We are acknowledging that we are at low levels in terms of market risk.

Part of that is driven structurally by the change in business model at C&I over the last couple of years. So do remember that when you look at our market risk levels. We have taken market risk down significantly as part of the new business model. But obviously, cyclicality and higher market volatility could lead to the numbers going back up.

Just to add one thing on your first question in terms of cost in the first half, do remember what we spoke about in Q1, where we said that we were making sure that IT was not so backend loaded as it had been in previous years. So IT is more frontend loaded this year than it has been in the previous years when you look at the numbers.

Willis Palermo - Goldman Sachs

Thank you very much.

Operator: We'll now take our next question from Per Grønborg from SEB. Please go ahead.

Per Grønborg - SEB

Yes, thank you. Two questions from my side. First, I will also dig a bit into the cost side. Basically, what is new this quarter? You're addressing that it's regulation. It's IT. Has there been additional requirements this quarter? It doesn't seem like it's additional investments in growing the business, where clearly we had a very nice growth, especially in the beginning of the year.

My second question is related to the deal on part of the Mandatum business that you will take over at some stage. Where should we expect that to come into your accounts capital-wise? Will there be a DKK 2.5 billion charge on your capital when that one is booked, or how should we expect it to be consolidated when the deal is closed at some stage?

Jacob Aarup-Andersen - Danske Bank - CFO

Thanks, Per. Two good questions. First one, let's deal with the cost question. So what is new here in the second quarter? You are right that there has not been another uptick in activity-based expenses, as in your question. On the other hand, activity remains very high.

You cannot just measure activity by our trading income. You also need to measure it by our fee income, etc. So we do see activity-based expenses continuing to be high, but the biggest driver here is the many regulatory projects, where we are investing heavily.

And the main big regulatory projects, such as MiFID II data protection and also AML, are taking a lot of resources as we are investing in not just making the necessary changes, but also making it a real business enabler for us going forward.

So we will continue our focus on taking out structural cost, as we have spoken about many times, through the digitalisation across the bank. And we're not going to derail our digital agenda. So investments in digital will remain high. And we will continue to prepare the bank for the future, which means that, when these heavy regulatory implementation projects come in, we will not slow down in the other key agendas for the future bank.

So you can say it is the combination of that with the continued high activity levels that make us do the change.

Then you ask on Mandatum. First of all, we do not expect the Mandatum transaction to close in 2017. We think it closes in 2018. We have not announced what we are planning to do. The only thing that has been announced is that there is an agreement that Mandatum will no longer hold this portfolio in 2018. We have not yet communicated what we decide to do, whether we will hold this portfolio, etc.

There will not be any hit from Mandatum in our accounts, as this is a transaction done at fair value. And therefore, the assets will be also transacted at fair value. So we do not expect any hit from this transaction.

But anyway, this would be a 2018 transaction as well. And as I said, we haven't decided fully how we will deal with the portfolio.

Per Grønborg - SEB

I would assume, since Sampo expects to book a gain, that an intangible of some sort will pop up in your books, either goodwill or client intangibles, which I guess would have to be deducted from your capital, of course, not from your profit.

Jacob Aarup-Andersen - Danske Bank - CFO

We're happy to take that offline. I think what you're referring to is that Sampo had the asset booked at in their own accounts. And that does not necessarily reflect what a fair market value of the asset is today. And obviously, as Sampo has announced and we have confirmed, there has been an independent valuation of the assets, where we transact that. So from an accounting perspective, a gain at Sampo does not need to be matched by a loss at Danske. But we're happy to take that bilaterally.

Per Grønborg - SEB

Let's do that.

Jacob Aarup-Andersen - Danske Bank - CFO

Thank you.

Operator: We will now take our next question from Andreas Hakansson from Exane BNP Paribas. Please go ahead.

Andreas Hakansson - Exane BNP Paribas

Yes, hi. It's Andreas from Exane here. I had a question. We listened to Nordea this morning. And they talked about moving the headquarters. And the focus was very much about banking union. And there's been a discussion in Denmark and also in Sweden about the banking union. Could you just remind us, what's your stance on the banking union for Denmark, and do you see any impact on yourselves if Denmark will join? Thanks.

Thomas Borgen - Danske Bank - CEO

Thank you, Andreas. The banking union theme was a discussion in the Danish society a couple of years ago, where we were clear in saying that we thought it was good for the Danish society to consider to join the banking union, but there were a couple of specific Danish issues, particularly around the mortgages issues, which needed to be clarified.

We have not changed that view. So we are just supporting that the Ministry of Business is launching an expert group to look into the consequences of joining or not joining the banking union.

For Danske individually, it doesn't mean very much, except that we on the general level support, let's call it, the common principle across all the European markets. And the banking union can be one of the levers in that respect. But in isolation, it will not impact Danske a lot, if anything, but it's more a thing for society, and that's why it's a political decision.

Andreas Hakansson - Exane BNP Paribas

And to be clear, so what you're referring to is the liquidity rules around the covered bonds, right?

Thomas Borgen - Danske Bank - CEO

That's one of the things, which is going to be looked into. It's also how you treat the covered bonds generally.

Andreas Hakansson - Exane BNP Paribas

Okay. Thank you.

Operator: We will now take our next question from Yafei Tian from Citi. Please go ahead.

Ronit Ghose - Citigroup

Hi. Thank you for taking the question. The first question is around net interest income. We were told there's some one-offs in the quarter related to the tax changes booked under net interest income. Can you quantify how much it is and which divisions these are booked? Is it just in Group centre, or is it also distributed into the divisional level? And that's the first.

And the second question is around Denmark loan growth. In the recent data we have seen from the central bank, there seems to be a small pickup in the credit demand in Denmark itself. Do you see that in your numbers, or do you start to see that in the business that you operate in Denmark?

Jacob Aarup-Andersen - Danske Bank - CFO

Okay. Thank you very much. Let's start with the NII. And you're spot on. There was a couple of movements in the numbers. So let's just make them clear.

First of all, when you look quarter-on-quarter on NII, it is down 1% quarter-on-quarter in the reported numbers, but there is a one-off of DKK 91 million, a negative one-off of DKK 91 million in the numbers, which is not attributed to a specific business unit. It's in the Other.

And the two other effects you need to be aware of is obviously the FX effect, which is another negative of around DKK 40 million. And then there was a banking day more, which goes the other way of DKK 60 million.

If you add up those numbers, you will see that our NII was actually up just below a percent in underlying terms. So we're actually quite pleased with that NII performance, as you can imagine.

Your other question on loan growth in Denmark, I guess we need to look at two different markets here because, in Personal Banking, you have seen that we have relatively flat lending volumes. That then splits into two, because we're seeing a decline in our conventional bank lending, while at the same time, we're seeing an increase in our mortgage lending.

There is an underlying demand for the mortgage lending side, but the conventional loan products, we're not seeing any real growth. Business Banking is seeing growth. And we also grew our lending book here in the second quarter. So yes, you are right. We are seeing some growth in the market, more related here to the SME segments and the mortgage market than the conventional bank market.

Ronit Ghose - Citigroup

Okay. Thank you.

Operator: We will take our next question from Martin Birk from Carnegie. Please go ahead.

Martin Gregers Birk - Carnegie

Hi. Thank you so much for taking my question. My first question is to Personal Banking Norway and Akademikerne. Are you guys still seeing a big inflow of Akademikerne clients, and how much of this growth in Norway comes from the back book?

Thomas Borgen - Danske Bank - CEO

Yes, we are still seeing good traction with private banking in Norway, of which Akademikerne is still a very important source. Of course, percentage wise, the numbers will come down as the stock increases. But in absolute terms, it's more or less at the same level. So it's still solid growth.

But what is even more important now going forward is that we get to service the client 360 degrees around, meaning more products than just accounts and mortgages. And now we have been able to set up a structure to support that.

So overall, we should see even better traction going forward on the cross sales, while I think on the mortgage side, it should more or less be flattish when it comes to the volume, which percentage-wise will be in the low double digits.

Martin Gregers Birk - Carnegie

Okay. Thank you so much. And then my second question is, do you guys have an update on interest rate sensitivity?

Jacob Aarup-Andersen - Danske Bank - CFO

No, there's no news on that. So we have the same sensitivity as we've given in the past, so around DKK 700 million on the upside for 25 basis points and DKK 500 million on the downside. So that's unchanged, but a good question.

Martin Gregers Birk - Carnegie

Thanks so much.

Operator: We will now take our next question from Riccardo Rovere from Mediobanca. Please go ahead.

Riccardo Rovere - Mediobanca

Good afternoon to everybody. Just one question from me. Let's assume nine months down the road we are exactly in the same situation of today, so common equity tier one ratio above 16% and no idea whatsoever what is going to happen to Basel 4. Would you suggest a buy-back also for 2018?

Thomas Borgen - Danske Bank - CEO

I can only repeat, and I do not want to repeat exactly what I said 12 minutes ago. So we are very firm on our capital position and our strategy. And we will stick to that. And we need to wait until the year-end to see where we end up.

Riccardo Rovere - Mediobanca

Okay. Okay. Fine.

Thomas Borgen - Danske Bank - CEO

Sorry about that, but I have no more to add to that question because it's basically the same question as I got this morning.

Riccardo Rovere - Mediobanca

No problem. It's part of our job to try.

Thomas Borgen - Danske Bank - CEO

Okay.

Jacob Aarup-Andersen - Danske Bank - CFO

Thank you, Riccardo.

Operator: We will now take our next question from Jacob Kruse from Autonomous. Please go ahead.

Jacob Max Kruse - Autonomous

Hi. Thank you. I just wanted to ask, when it comes to your recoveries, how dependent are you on the commercial real estate prices there? So what kind of percentage of your provision or your balance sheet provisions would be related to the kind of exposures that are linked to commercial real estate prices?

And secondly, where do your valuations that you use for those collateral valuations, how do they compare to actual market prices in your view? Thank you.

Thomas Borgen - Danske Bank - CEO

The very specifics we don't have because I think it's dangerous to be that detailed. But what we can say is that we have very conservative valuation when we do our security. We both do a haircut and a very robust market valuation. So I would say that we have either you could call it cautious or conservative view on it.

Most of the reversals are basically based on either workouts or basically that the financial position of our debtor has improved substantially, but also in those cases where there's been issues, that the security has improved over a period of time due to basically lower yield requirements, improving the security of that property.

Of course, being a large player in the Nordics, a part of our book is in the commercial property market. We think and we are cautious that we may peak out at these levels. So it should be limited what is left on that by itself even though it will be a lagging indicator. So it may still be a couple of quarters.
But to a more fundamental question, we have a very solid book. We have a very healthy allowance account. That's also why we are revising our outlook for the impairments going forward for the rest of the year.

So overall, it looks healthy. It looks solid. And I think we are on a good trajectory of remaining on very low impairments for 2018. Sorry, for '17.

Jacob Max Kruse - Autonomous

And can I ask for '18? Does it spill over into there, or is that a whole new picture?

Thomas Borgen - Danske Bank - CEO

Sorry, that's a new picture. It's just my slipping tongue here.

Jacob Max Kruse - Autonomous

Thank you very much.

Operator: We will now take our next question from Vardhman Jain from Macquarie. Please go ahead.

Vardhman Jain - Macquarie

Yes, hi there. This is Vardhman Jain from Macquarie. Just had couple of questions. First is on your asset quality. If we look at your forbearance data, your forborne loans increased substantially quarter-on-quarter. It was like a 33% increase. I understand a part of it could be because of the reversals from the non-performing into the performing book. But there is still a big chunk, which I couldn't understand. So if you could give more colour on that.

And secondly, if you could give more colour on the margins, you mentioned that there is still pressure on the deposit margin side. I saw that on the margin of the C&I book declined from 72 to 68 basis points in the quarter. So if you could give more colour on that, that would be great. Thanks.

Jacob Aarup-Andersen - Danske Bank - CFO

Okay. Thank you for the questions. First of all, I'm sorry if you've spent a lot of time trying to back out the forbearance numbers because this is a new reporting from us, and due to improved registrations over the last couple of quarters, this number is showing a technical effect.

So the increase you're seeing is unfortunately mainly technical from better registrations. And IR would be happy to help you further on it. But it is not reflecting a significant deterioration in forbearance. Let's just make that very clear. So apologies if you've spent several hours trying to back that out.

The other one is on what was on margins. You asked about deposit margins. You asked about C&I. First of all, do be careful in terms of fluctuations on a quarterly basis, especially when we look at margins on a combined basis.

You mentioned deposit margins. As we discussed over the last couple of quarters, NII other, as we also report, is where our internal bank or funds transfer pricing model goes through. And as there are fluctuations in the fund transfer pricing, it can also impact the pricing you see on deposit margins.

What you've seen over the last couple of quarters is we have seen a significant growth in deposits in Business Banking and C&I. And that increase in Business Banking and C&I, it is a competitive market where people are pricing these deposits, very large deposits, and therefore, you can see a slight deterioration in the reported deposit margin from that.

It's very good business for us to do that because it's obviously still cheap funding for the bank. So there is an effect of a large deposit increase in these units that distort the margin a bit.

We are not seeing a deterioration in lending margins, which could be the inference from your question. We're not seeing a deterioration in lending margins in the large corporate space. So there are these technical effects from funds transfer pricing and the fact that we are taking some large deposits on the book.

Vardhman Jain - Macquarie

Okay. Thank you.

Operator: (Operator Instructions) We will now take our next question from Amal Shah from Redburn. Please go ahead.

Amal Shah - Redburn

Hi. Good afternoon. This is Amal Shah from Redburn. On the new partnership agreement in Sweden, I was just wondering if you can say anything about what sort of penetration rate you can expect to have. And then what rate have you already achieved in Norway? That's the first question. Thank you.

Thomas Borgen - Danske Bank - CEO

Yes, thanks for your question. I will take this as the last question. It's very hard to be precise or even fairly right on what the penetration rate can or should be, as this is a new agreement.

What we can state as a fact is that TCO has 1.3 million members. And we have the exclusivity with that union. I can also confirm, as I did earlier in the call, that we have had a very healthy start.

But let's all remind ourselves we've just been through a quarter. It's been a healthy start. We have some experience with Saco, which is still running at very healthy speed. So I think we are off to a good start. But let's take this slowly but surely as a positive momentum.

In Norway, it's a slightly different agreement, even though it's exclusive with Akademikerne, but also there, we can see that there is a healthy steady growth quarter by quarter, as I alluded to. And it gives a good foundation for a solid balanced [appreciable] growth.

So I will be cautious to be more precise. We just need to watch it, but be happy that it's off to a good start, and the clients seem to be very satisfied with the service they get. And I think that's the key importance going forward.

Amal Shah - Redburn

Okay. Thank you.

Thomas Borgen - Danske Bank - CEO

Okay. Thank you, all, for your interest in Danske Bank and for your very good questions. As always, you are welcome to contact our IR department if you have more questions after you've had time to look at our financial results in more detail. A transcript of this conference call will be added to our website and the IR app within the next few days. Thank you very much.