

07 May 2019 | Affirmation

## Fitch Affirms Danske Bank AS Mortgage Cover Pool C Covered Bonds at 'AAA'

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Fitch Ratings-Frankfurt/London-07 May 2019: Fitch Ratings has affirmed Danske Bank AS's (Danske, A/Negative/F1) mortgage covered bonds secured by the bank's cover pool C at 'AAA' with a Stable Outlook.

### KEY RATING DRIVERS

The covered bonds' rating is based on Danske's Long-Term Issuer Default Rating (IDR) of 'A' and unchanged uplifts of: IDR uplift of two notches; payment continuity uplift (PCU) of five notches and recovery uplift of one notch. In addition, the 21.4% over-collateralisation (OC) that Fitch gives credit to and which is the lowest nominal OC of the last 12 months, provides more protection than the revised 18.5% 'AAA' breakeven OC for the programme. The latter supports a 'AA+' tested rating on a probability of default (PD) basis and a one-notch recovery uplift to 'AAA'. The Stable Outlook on the covered bonds' rating reflects that on Danske and a three-notch buffer against an issuer downgrade, due to the different uplift factors above the bank's IDR.

The revised 'AAA' breakeven OC for the programme, to 18.5% from 18.0%, is driven by an increase in the ALM Loss component to 1.3% in the 'AA+' stress scenario tested for timely payment. This is due to asset liability mismatches in our cash flow modelling, where the loss on reinvestment (cost of carry) in the driving high prepayment scenario has increased following bond issuances and redemptions. In the cash flow modelling, the low and high stressed prepayment rate is 5% and 25%, respectively.

The credit loss component of 17.2%, reduced from 17.4%, continues to be the main driver of the breakeven OC for the programme. In its asset analysis, Fitch applied a benchmark one-year PD of 1.5% for loans secured by Swedish commercial real estate (74%), with a PD floor of 0.5%, compared with 2.00% for loans secured by Norwegian commercial real estate (with a floor at 0.5%). As the pool has a larger geographical exposure to Sweden, the number of obligors representing more than 50bp of the portfolio notional was reduced to 25 as of December 2018 compared with 27 as of March 2018. For these obligors Fitch applies a minimum one-year PD of at least 1.0%, a correlation uplift of 50% and a recovery rate multiplier of 0.5, in line with criteria. In assessing the cover pool's PD, Fitch has assumed a three-year longer maturity for the interest-only loans (28%) to reflect the longer effective term as those borrowers are expected to seek to

refinance their loans at maturity. Fitch also assumed a 40% cure rate in a 'B' scenario.

Fitch applied market value decline (MVD) assumptions according to the SME Balance Sheet Securitisation Rating Criteria, where multi-family properties were treated as residential property, and residential MVDs for Swedish and Norwegian properties defined in the Originator-Specific Residential Mortgage Analysis Rating Criteria were applied. The remaining property types were treated as commercial properties, for which we applied the fall-back MVDs under the SME criteria.

The programme's two-notch IDR uplift reflects that covered bonds issued by retail banks in Denmark are exempt from bail-in, Fitch's assessment that the risk of under-collateralisation at the point of resolution is sufficiently low, and that a resolution of Danske, should it happen, would not result in the direct enforcement of the recourse against the cover pool.

Fitch's PCU for Danske's C programme is five notches, rather than the standard six for mortgage covered bonds with a 12-month principal maturity extension and three-month protection for interest payment. This is due to the lack of formal provisions to find a refinancing solution without delay in the event of a maturity extension.

The recovery uplift for this programme is capped at one notch due to the presence of significant pre-swap FX mismatches between cover assets and liabilities. The FX covered bonds are fully hedged until maturity (including the extension period). However, upon a covered bonds' default, recoveries from SEK- and NOK-denominated assets, could expose holders of non SEK- and non NOK-denominated bonds to FX risk.

#### RATING SENSITIVITIES

The 'AAA' rating of Danske Bank AS's cover pool C mortgage covered bonds would be vulnerable to a downgrade if any of the following occurs: (i) Danske's Long-Term Issuer Default Rating (IDR) is downgraded by four notches to 'BBB-' or below; or (ii) the payment continuity uplift is reduced to one notch or none; or (iii) the level of overcollateralisation (OC) Fitch gives credit to in its analysis fell below the 'AAA' breakeven OC for the programme of 18.5%. If the actual OC is reduced to the legal minimum of 0%, the covered bonds would be downgraded to 'AA', three notches above the bank's IDR.

The Fitch breakeven OC for the covered bond rating will be affected, among others, by the profile of the cover assets relative to outstanding covered bonds, which can change over time, even in the absence of new issuance. Therefore the breakeven OC to maintain the covered bond rating cannot be assumed to remain stable over time.

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### **Applicable Criteria**

[Bank Rating Criteria \(pub. 12 Oct 2018\)](#)

[Covered Bonds Rating Criteria \(pub. 11 Jan 2019\)](#)

[EMEA CMBS and CRE Loan Rating Criteria \(pub. 11 Jan 2019\)](#)

[Fitch Ratings Interest Rate Stress Assumptions for Structured Finance and Covered Bonds \(pub. 08 Mar 2019\)](#)

[Fitch's Foreign-Currency Stress Assumptions for Residual Foreign-Exchange Exposures in Covered Bonds and Structured Finance – Excel File \(pub. 30 Oct 2017\)](#)

[Originator-Specific Residential Mortgage Analysis Rating Criteria \(pub. 11 Jan 2019\)](#)

[SME Balance Sheet Securitisation Rating Criteria \(pub. 26 Mar 2019\)](#)

[Structured Finance and Covered Bonds Counterparty Rating Criteria \(pub. 18 Apr 2019\)](#)

[Structured Finance and Covered Bonds Counterparty Rating Criteria: Derivative Addendum \(pub. 18 Apr 2019\)](#)

[Structured Finance and Covered Bonds Country Risk Rating Criteria \(pub. 23 Oct 2018\)](#)

[Structured Finance and Covered Bonds Interest Rate Stresses Rating Criteria \(pub. 08 Mar 2019\)](#)

## **Additional Disclosures**

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