Conference call

Interim report – first nine months 2020

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Investor Relations

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Claus I. Jensen – Danske Bank – Head of Investor Relations

Welcome to the conference call for Danske Bank's financial results for the first nine months of 2020. Thank you all for taking the time to listen in on this call today. My name is Claus Ingar Jensen, and I am the Head of Danske Bank's Investor Relations. With me today, I have our CEO, Chris Vogelzang, and our CFO, Stephan Engels.

Slide 1, please. In today's call, we will present Danske Bank's financial results for the first nine months of 2020. We aim to keep this presentation to around 25 minutes. After the presentation, we will open up for the Q&A session as usual. And afterwards, feel free to contact the Investor Relations department if you have any more questions.

I will now hand over to Chris.

Chris Vogelzang – Danske Bank – CEO

Thanks, Claus, and good afternoon, everybody. Thanks for dialling in. The first nine months of 2020 were a challenging period, not only for society but also for banks as the outbreak of the coronavirus pandemic had a huge impact on the global economy. Consequently, we saw a steep decline in GDP across almost all countries. However, as the lockdown measures have varied from country to country, the economic impact has also been different. In this context, the Nordic economies have held up relatively well and despite overall lower economic activity. Our underlying business remains strong, characterised by good customer activity and stable income driven by our Nordic markets and large corporate customers. However, as the corona crisis continues to evolve, we also continue to have clouded visibility regarding future economic developments.

It's also been a busy period for us. Across our business units, several initiatives have been launched at the same time we've supported our customers in handling the effects of the corona crisis. At Banking DK, we have introduced FlexLife, a fixed-rate mortgage loan type and a new setup for servicing retail customers planned for launch in 2021. Banking Nordic was able to continue the onboarding of many new retail customers despite the corona turmoil. At Corporates & Institutions, they have been busy securing liquidity facilities for our large corporates, while at the same time, providing advisory services and access to primary debt and equity markets. There was thus an increasing number of transactions with a strong sustainability focus and financed by green loans.

In Wealth Management, we have now completed the remediation of the Flexinvest Fri case and solved the issue with the authorities, while at the same time improving net sales in the institutional segment. Both Danica Pension and Asset Management have been busy launching new investment solutions for our customers with a strong focus on sustainability. Financially, we're today presenting a result for the first nine months with good evidence of steady progress in most of our income lines, lower costs and with a net profit for the first nine months of DKK 3.1 billion.

On that basis, on October 27, we announced a revised net profit outlook for the full year. We now expect net profit for 2020 to be in the range from DKK 4-4.5 billion, based on improved developments in the financial markets as well as lower costs and continually good progress in our underlying business. We saw slightly higher net interest income, and both fee and trading income maintained good momentum despite higher overall activity last year. In order to align our pricing more with the market situation and following pricing initiatives for our corporate deposits, we've today announced lower thresholds for our retail customers in Banking DK. The initiatives we have announced today are specifically designed to ensure that we continue to have an attractive offer for our customers.

Our expenses came in higher than last year, due primarily to costs related to the Better Bank transformation, continued compliance remediation and of course the Estonia case. In the third quarter, we saw that our cost management initiatives are starting to yield results, and we also continued to launch a range of further initiatives across the organisation in order to ensure a good trajectory towards our 2023 ambitions.

To further accelerate the process, we have recently announced the discontinuation of up to 1,600 positions across the Group. As a first step, who have initiated voluntary redundancy agreements for staff in our operations in Denmark. Furthermore, we continue to make progress on product simplification, not only as part of our cost programme but also as part of our overall simplification aspiration, and we are well underway to meet or exceed our targets for 2020 of reducing products by 30%. Adjusted for the one-off income item in 2019, profit before loan impairment charges came in 11% below the level in the first nine months of last year. Credit quality remained strong despite low impairment charges being the most significant reason why the results for the first nine months of 2020 is lower than the result for the same period the year before. The relatively good performance of the Nordic economies I mentioned earlier led to very limited credit quality deterioration among our customers. Most of the model-driven impairment charges recognised in Q1 due to coronavirus have now been reversed. However, they have been replaced by increased post-model adjustments, as visibility regarding future economic developments remains clouded. Our oil-related credit exposure suffered from difficult market conditions throughout most of the period. Stephan will comment on this in more detail later in this call.

Let me now update you on the redesign of our organisation we have announced as part of our continuous execution of and progress on the Better Bank agenda. Towards the end of August, we announced the next big step in our efforts to decrease complexity and simplify the organisation. The new design will ensure a better quality of processes and make us a more competitive bank. The announced changes include the merger of Wealth Management and C&I into a new large Corporates & Institutions unit. Furthermore, we are consolidating Banking DK and Banking Nordic into the new Personal & Business customers unit. We thus bring the number of business units down from four to two with the aim of breaking down internal silos and utilising knowledge and expertise across the organisation. Furthermore, the introduction of the new Commercial Leadership Team was announced to build a talent pipeline and to improve the knowledge exchange across the organisation. And of course, very much in order to drive revenues under the commercial agenda. We also continue to make tangible progress in terms of our anti-money laundering effort. Currently more than two million ODD reviews have been conducted year-to-date. About 75% of the reviews for customers categorised as low-risk have been processed automatically. Our internal investigation into the non-resident portfolio at the now closed Estonia branch is progressing, with some of the tracks completed in Q3 as planned. We expect to finish all our investigations in the fourth quarter of 2020, as previously announced.

And then, I'd like to hand over to Stephan for the financial results in more detail.

Stephan Engels – Danske Bank – CFO

Yes. Thank you, Chris, and over to slide 3, please. Let us look a bit more closely at the financial results for the period, which overall reflect steady progress. Across our markets, we have seen generally lower economic activity. However, key economic indicators such as housing market activity and consumer spending hold up well, supported by low unemployment and few bankruptcies. The better-than-expected macroeconomic development is evidenced by our Nordic lending activities, increasing 4% in local currency terms from the same period last year. The major government support packages that were not fully utilised were phased out at the end of the summer and replaced by more bespoke facilities aimed at specific business sectors. The very recent increase in contagion has led to new support initiatives from the Danish government, however, not of the same magnitude as we saw in March. The new restrictions that came into effect last week are not causing the same degree of lockdown that we saw also in March. Customer activity, including housing market activity, is holding up well despite clouded visibility regarding future economic developments.

Excluding one-off effects, total income was in line with the level in the same period last year. Overall, total income came in at DKK 31.4 billion, or 4% lower, due to a one-off gain from the sale of Danica Pension Sweden in 2019. Net interest income increased as a result of good business activity and despite negative currency effects. The development was driven by a strong development for deposits, which increased 22% in the period, primarily because of corporate deposits at market rates, whereas the increase in retail deposits, primarily on ordinary transaction accounts, was due to changes in consumer spending behaviour during the period.

Given the continuous increase in deposits and what seems to be a permanent negative rate environment, we have taken initiatives to adapt to the current market conditions. As announced today, we will adjust the threshold for the charging of negative interest rates on retail deposits at Banking DK to DKK 250,000. And in September, we announced that commercial customers in Denmark will be charged negative interest rates on their entire deposits. Both adjustments will take effect from 1 January.

Fee income, excluding one-off effects, maintained the good momentum from last year, driven by Wealth Management and despite lower remortgaging activity at Banking DK and lower activity as a result of the corona crisis. Fee income in Q3 was affected by the compensation related to Danske Porteføljepleje and was lower than the preceding quarter, which benefited from extraordinary items at Wealth Management.

Trading income was up slightly from the level the year before on the basis of good customer activity at C&I and a reversal of negative valuation effects. The level of trading income in Q3 reflects continually good activity, however, not to the same extent as in the very busy second quarter.

Expenses came in lower in Q3 than in the preceding quarter, not only due to seasonality effects, but also as a result of cost management initiatives. Compared to the same period last year, costs continue to be affected by transformation initiatives under our 2023 agenda and high costs for the Estonia case and compliance remediation. We now expect costs for the full year to be around DKK 28 billion. The outlook encompasses the planned costs for the Better Bank transformation, including severance payments, and in addition, full year may also include a small extraordinary amortisation of intangible assets subject to final decision closer to year-end. The lower expected costs for 2020 are a good starting point for the cost target for 2021 of around DKK 26 billion.

Loan impairment charges, which, to a high degree explained the difference to the financial results for the same period last year, amounted to DKK 6.3 billion for the period, but were unchanged at DKK 1 billion from the preceding quarter. The accumulated charges for the first nine months account for between 85-90% of the charges we expect for 2020. Overall credit quality remains strong with very limited losses caused by the corona crisis. Two items explain the development. Firstly, model-driven charges recognised in Q1 have been reversed and replaced by post-model adjustments; secondly, an adverse development for our oil-related exposure. I will come back to credit quality later in this presentation. The net result for the third quarter in isolation was DKK 2.1 billion, which was lower than in the second quarter, whereas the net result for the full nine-month period amounted to DKK 3.1 billion, against DKK 10 billion last year.

Slide 4, please. Now let us take a closer look at the underlying development in net interest income. Compared to the same period in 2019, NII saw positive effects from good customer activity in the form of volume growth, and deposit margins benefited from the Danish rate hike in March. The positive effect was, to some extent, offset by headwinds from the Norwegian krone, in particular, but also from the pressure on lending margins resulting from the low interest rate environment. Adjusted for currency effects, NII was up 3%. NII was stable from the preceding quarter as positive effects from FX and days compensated for a lower lending volume. As part of the pricing initiatives I mentioned earlier, we are now adapting to current market conditions in Denmark by lowering the threshold for the charging of negative interest rates on retail deposits from DKK 1.5 billion to DKK 250,000, and altogether removing the threshold on corporate deposits, which was previously DKK 200,000, both with effect from 1 January, 2021. In isolation, both initiatives will contribute positively to NII with an annual effect of approximately DKK 0.5 billion, and all else equal and subject to changes in customer behaviour and deposit balance developments at Banking DK, this should counterbalance some of the ongoing NII pressure.

At the end of Q3, we had completed a significant part of our funding need for the year. Overall funding spreads have decreased from the level in the same period last year, due primarily to a change in the issuance mix and a notable decline in spreads for non-preferred senior debt. However, the average spread for new funding exceeds the level for redeemed funding this year, confirming the negative impact on NII.

Slide 5, please. Lending at Banking DK was down 2% year-on-year due to the declining demand for credit from municipalities in particular because of the various effects resulting from the corona crisis support measures. Lending to commercial and retail customers was lower for the same reason. However, lending volume stabilised in Q3 from the level in Q2, driven by better housing market activity. The pressure on lending margins was most evident at Banking DK, where we see the effect of our customers' shift towards longer-term fixed-rate mortgages with lower margins.

At Banking Nordic, we saw growth in business activity, with lending up 1%, or 4% in local currency, as a result of strong growth in Retail Sweden and Norway, where the inflow from the partnership agreements continued in the first nine months of the year. We also saw higher lending in Commercial Finland. NII at Banking Nordic improved from the same period last year, benefiting from the volume growth as well as an improvement in lending margins. C&I saw higher customer activity during the first nine months, reflecting an increase in short-term credit facilities provided to support customers during the corona crisis. Overall lending at C&I was down due primarily to collateral value adjustments. However, within General Banking, lending was up 1% year-on-year. Specifically for Q3, we saw a decline due to lower utilisation of short-term credit facilities from the very high levels in the preceding quarters when we granted a significant amount of credit facilities. NII and C&I benefited year-over-year from higher lending and significantly higher deposit volumes at market rates. The elevated level of deposits as well as some of the short-term lending facilities provided to corporate customers should be seen in the context of current uncertainty and are, therefore, not necessarily of a permanent nature.

Slide 6, please. Let's have a look at fee income. Fee income maintained the good momentum and was in line with the same period last year. Overall, we saw a positive development for investment and pension activities, whereas activity-based fee income was lower due to the effects of the corona crisis. Adjusted for the extraordinary items within pension and insurance, fee income in Q3 was in line with income in Q2. Investment fee income in Q3 saw an adverse impact from the compensation booked for the Danske Porteføljepleje case.

At both Banking DK and Banking Nordic, activity-based fee income declined from the same period last year due to the lower level of activity that resulted from the corona crisis. However, quarter-on-quarter, activity-based income was stable. Fee income at Banking DK benefited from better housing market activity in Q3 than in Q2, which generated higher fee income from lending and guarantees. In the first nine months of 2019, remortgaging activity was historically high, which explains the decline year-on-year. Fee income generated by our capital markets activities at C&I came in higher than last year due to strong customer activity in the primary markets. However, usual seasonality explains the decline from quarter to quarter. At Wealth Management, fee income from investment and pension and insurance activities increased from the level last year, due primarily to positive effects at Danica Pension and a positive development for assets under management.

Slide 7, please. Now let's turn to trading income. In the third quarter, despite being the summer holiday period, we continued to see relatively high customer activity, albeit not as strong as in the unusually good Q2. Positive developments and value adjustments, or xVA, also contributed to the result. Trading income was slightly up year-on-year, as significantly higher income at C&I compensated for lower income in the other business units. The higher income at Corporates & Institutions was the result of stronger activity among our FI&C customers and improved market conditions as well as positive value adjustments. At both Banking DK and Banking Nordic, trading income came in lower due to lower investment activity among customers, and at Banking DK lower remortgaging activity was also a factor as remortgaging activity was unusually high last year. At Wealth Management, trading income year-on-year as well as quarter-on-quarter was lower as a result of market developments and a decrease in the yield curve that affected the investment result in the health and accident business in Danica Pension.

Slide 8, please. On the expense line, we now see the first effects of the cost management initiatives we have launched during the year. In Q3, costs came in at DKK 6.7 billion, down 4% from the preceding quarter, driven by lower staff costs and seasonality, whereas the planned costs for the Better Bank transformation, compliance remediation and the Estonia case impacted expenses for the first nine months, which came in at DKK 20.4 billion, up 6% from the same period last year. In order to execute on our 2023 plan and to ensure strong progress towards a lower cost base, which is essential for our ability to remain competitive, we have recently announced further cost-saving initiatives in the form of voluntary redundancy agreements in Denmark. During the next 6-12 months, we expect to discontinue up to 1,600 positions across the Group. As a first step, we have initiated voluntary redundancy agreements for our staff operations in Denmark, and we maintain a strong focus on further cost-saving initiatives such as product simplification and non-personnel expenses.

As we communicated on 27 October, we now expect expenses for the full year to be around DKK 28 billion. This includes costs for the planned transformation of DKK 1.5 billion including severance payments. And in addition, full year may also include a small extraordinary amortisation of intangible assets related to IT software, subject to final decision closer to year-end. As I mentioned previously, we also reiterate our 2021 cost target of DKK 26 billion, including a transformation budget of around DKK 0.5 billion.

Slide 9, please. The impairment charges for the third quarter reflect a further reversal of DKK 1 billion of model-driven charges we recognised in Q1 as a result of the outbreak of the coronavirus pandemic. In total, we have now reversed DKK 1.5 billion of the DKK 1.7 billion recognised in Q1 as a result of more positive developments for all key economic drivers and thus continually strong credit quality among most of our customers. However, as visibility regarding economic developments remains clouded and based on our timely approach, we have increased sector-specific post-model adjustments by 1 point...

Claus I. Jensen – Danske Bank – Head of Investor Relations

I think we have a technical issue. Please stay online. Thank you.

Stephan Engels – Danske Bank – CFO

So I'm not sure where we lost you. I'll start with the impairment charges. In the third quarter -- the impairment charges recognised in the third quarter equivalent to a reported loan loss ratio of 22 basis points, however, with significant fluctuations between business units. As a result, the allowance account, which stands at more than DKK 23 billion in total, now includes impairments recognised for anticipated credit deterioration of DKK 2.2 billion. The oil-related exposure, the offshore service and drilling segment in particular, continues to be challenged and led to additional impairments of DKK 0.5 billion in Q3. This exposure continues to be challenged by difficult market conditions and low activity that makes restructuring increasingly difficult, and we see pressure on collateral values affecting impairments. Total impairment charges for the first nine months, which amount to DKK 6.3 billion, are in line with our guidance and represent most of what we expect for the full year. Under current assumptions, the impairment charges booked year-to-date should represent 85-90% of what we expect for the full year.

Slide 10, please. Our capital position remains strong with a reported CET1 capital ratio of 18.2% at the end of the quarter. The CET1 capital ratio was up 0.6 percentage points, driven mainly by lower market risk REA and the effect of net earnings after dividend accruals. The fully loaded CET1 capital ratio was 17.9%. Total REA came in at DKK 19 billion lower than at the end of the last quarter due to a DKK 20 billion decrease in market risk as the higher risk levels we saw in Q2 reversed in Q3. Credit risk REA was up DKK 1 billion as we are starting to see the effect of implementation of the EBA guidelines, which was countered by lower lending volume and FX effects. Counterparty risk was unchanged quarter-on-quarter. In Q4 2020, we expect an impact on credit risk REA from model updates related to further implementation of EBA guidelines of DKK 20-30 billion, all else equal, with further increases expected in 2021. The leverage ratio was unchanged at 4.4% according to both transitional and fully phased-in rules.

Slide 11, please. And then the revised version of our financial outlook for 2020, which was announced on 27 October. The outlook for NII is unchanged. We expect net interest income to be at around the same level as in 2019 as margin pressure and higher funding costs will offset continued volume growth. Net fee income is now expected to be slightly lower than the level in 2019 as improved developments in financial markets has partly offset lower remortgaging activity. Fee income is subject to uncertainty regarding assets under management, customer activity and market development. Expenses are now expected to be around DKK 28 billion, including planned costs for the Better Bank transformation. In addition, full year may also include a small extraordinary amortisation of intangible assets. Loan impairment charges in 2020 are expected to be significantly higher due to the impact of the coronavirus pandemic on the economic outlook, with most impairments recognised already in the first nine months of the year. And finally, we now expect net profit to be in the range from DKK 4-4.5 billion due to the improved developments in the financial markets and continually good progress in the underlying business.

Slide 12, please, and over to Claus.

Claus I. Jensen – Danske Bank – Head of Investor Relations

Thank you, Stephan. Those were our initial comments and messages. We are now ready for your questions. (Operator Instructions) And a transcript of this conference call will, as usual, be added to our website and the IR app within the next few days. Operator, we are ready for the Q&A session.

Operator

(Operator Instructions) We have a question from Mads Thinggaard from ABG Sundal Collier.

Mads Thinggaard – ABG Sundal Collier

Mads from ABG here. The first one here is on costs. Stephan, I think you mentioned before that the transformation costs you expected for '21 was still DKK 0.5 billion and also with DKK 26 billion for 2021 guided still. And then I was just wondering a bit about the kind of lower -- I mean, the drop in cost guidance for 2020 and what implication that has for the underlying cost base in 2021? Is it -- I mean, can you kind of help a bit about, it's probably still DKK 22.5 billion. But I mean, is it -- how much is from the FTE cut? And how much is from the improvements, I think you pointed to in Q2? That was the first question.

And the second question, I was -- I mean, now you're talking a bit about a potential small intangible write-down in Q4. It doesn't sound like it's a very big one. You still have quite some intangible assets. I think it's DKK 9 billion. If you were to do a larger adjustment, would you consider adjusting the kind of profit for the dividend decision? Would you adjust for intangible write-down for that base? Those were my two questions.

Stephan Engels – Danske Bank – CFO

Mads, you did very well in putting many questions under the heading of two questions, but I'll try to at least attend some of them. I confirm that the DKK 26 billion guidance for '21 has DKK 0.5 billion for the transformation budget as has the 2020 guidance, DKK 1.5 billion also for the transformation budget. The question I heard you saying is like what does the performance in 2020 tell about 2021? I think what you can say about 2020, obviously, is that since the guidance on AML remediation and Estonia remains the same as well as the transformation budget remains the same, that underlying costs are obviously developing a bit better. I think that gives us, first and foremost, reason to believe that we can achieve the 2021 target. With any more specific detail, I would still like to wait until we have the full-year results and then go to the guidance in 2021.

The intangible asset stuff, first of all, it's something where IFRS also sets certain rules. So you are not completely free, obviously, in what you want to do there. What we are doing is reviewing mainly IT and software to find out where we need to adapt following the reduction from four to two business units. So that may shorten the life cycle of one or the other stuff, and we have also retired quite some products this year. So that may also give reason for proper early write-off. We expect, let's call it, a couple of hundred million in 2020, which then, as I said, would be on top of the expense line and still wouldn't change our net profit guidance. I hope that answers most of your two questions?

Mads Thinggaard – ABG Sundal Collier

If you were to make a -- I mean, this is a bit theoretical, if you were to make a much larger adjustment, would you then also adjust the net profit, you base your dividend decision on?

Stephan Engels – Danske Bank – CFO

I think, Mads, this is now more speculation than anything else. As I said, IFRS sets limits to what you can do. And I think the IT stuff is something that makes sense and can be done, and I think we should stop the discussion there.

Operator

Our next question comes from the line of Sofie Peterzéns from J.P. Morgan.

Sofie Peterzéns – J.P. Morgan

Yes. It's Sofie from J.P. Morgan. I was wondering if you could give any update on the U.S. investigation. I realise that in the report, you're just saying that you don't have much additional information, but there were some press articles, a few weeks ago now, where the CEO allegedly was in Washington discussing with the U.S. Is there anything you potentially could share of these discussions with us? Do you have any view on a potential time frame? Have you had any additional information requests? And what are kind of the next points that you are waiting for? So that would be my first question.

My second question would be on the dividend. I recognise that we have a dividend ban in Europe, but have you had any communication with the Danish authorities on potentially being able to pay a dividend on 2020 earnings? And kind of what's your view on a potential dividend next year?

Chris Vogelzang – Danske Bank – CEO

Okay. Thank you for the question. This is Chris. I'll answer the first one. There is -- beyond what I've just said and which is in the report, there's essentially nothing to say about this, the Estonia case. I mean, we have worked through almost all the things we have to do, and the ball is, in that sense, in the hands of the authorities. With regards to my alleged visit to the United States, I think we are on a continuous basis in discussions with all the authorities. And I think it will be very wrong to give more information on that.

Stephan Engels – Danske Bank – CFO

Yes. On the dividend issue, again, you are right, the dividend discussion is still on. We are accruing 60% of net profit so far. I sense a bit of a discussion that is also kind of flowing a bit back and forth depending on what the corona contagion wave version 2 is doing and what government programmes are doing. I think it's far too early to really judge where the jury will end up. I have also heard quite some comments across Europe that banks with a stronger capital ratio may be allowed at least to pay partly dividends. But again, I think it's far too early to really tell. And we stick to what our dividend policy says, and then we need to see where we get to in the spring next year.

Operator

Our next question comes from the line of Kazim Andac from Deutsche Bank.

Kazim Andac – Deutsche Bank

A question on the impairment outlook. Just to get a bit colour on how should we think about impairments in the coming quarters? Given increased restrictions across Europe and their likely impacts on growth. Do you plan to revisit your macro assumptions here? How should we think about the impairment outlook going forward? And the second one is on the growth and margin outlook in your core markets. You continue to lose market share in Sweden, in particular in the mortgage segment, while you have the highest negotiated price among the major players. If you can elaborate the strategy here and perhaps the bank's performance in other markets on mortgage and business lending? And lastly, if you -- please provide us on how back book and front book -- loan book repricing developing again in mortgage and corporate segments? Any colour, much appreciated.

Stephan Engels – Danske Bank – CFO

On the impairment outlook, I think all what we are -- one general answer, and then I'll try to give more detail. I think in general, what we see right now on the macro side is better than what we have modelled in our IFRS 9 models. That is why you see these continuous releases throughout the last two quarters. I think it's a bit too early to really give the 2021 outlook on impairments. But so far, as I said, we have quite a good chunk of post-model adjustments. And we will -- once we are having the full year in -- and again, have a little bit of more visibility of how the second wave of corona will look like and how government programmes will develop going forward, we will update you on that part. But so far, I am of the opinion that the second wave of corona will probably go along with less, far less intrusive lockdowns that we have seen so far and also with far less disturbance of the international supply chains. So in that sense, let's see.

On general, I'm not sure whether I got your mortgage question completely right. Mortgage business is something that is pressured this year, specifically on the margin side because many of the customers are going for longer-term fixed-rate stuff, which obviously has lower margins. That's kind of a bit across markets. In general, we still have good growth in all our Nordic markets on the loan book. In general, I think that's no surprise if you look at how the interest rate development was over the last years, back book margins tend to be better than front book margins. And I expect that to be the fact and the reality for quite a while since the interest rate environment from my point of view is not going to change, at least not to the better.

Operator

Our next question comes from the line of Jakob Brink from Nordea.

Jakob Brink – Nordea

Just coming back to costs, please. So just -- I guess, I was a bit surprised about your update the other week where you're now guiding for the lower end of the DKK 28-29 billion range. I think also, I can't remember exactly what you said, but that you've been hinting towards the upper end of the range before. So what has changed and also on that matter, usual seasonality between Q3 and Q4 is around DKK 1 billion. And as you pointed out or as -- looking at your presentation, you have still around DKK 700 million left of transformation or Better Bank costs for Q4. So that would be a DKK 1.7 billion seasonality and hence, your cost would end at the upper end of the range. So what is it that it's so much better than normal? And what is it that is -- or not happening in Q4 this year? I guess that was my first question.

Then just coming back to margins. In your NII bridge in the presentation, you have a small, I think, DKK 3 million, positive q-on-q impact from lending margins. But looking in the fact book, basically, every segment is down, apart from LC&I, which, of course, is a smaller part of the group. So how should I look at this, please?

Stephan Engels – Danske Bank – CFO

Okay. I honestly do not remember that I have been hinting or that we have been hinting at costs being at the higher end of DKK 28-29 billion. So wherever you got that from, at least it was not intentionally from us. I think what the consensus has been for most of the -- at least last six months that I am here or 7 or 8 is that it was kind of in the midpoint between DKK 28-29 billion.

Then you asked about seasonality for Q4. Now traditionally, Q4 has a number of IT projects and other stuff that normally gets finished, delivered and then also built. So there's a bit of that seasonality, I think which is the usual stuff. The second part is, as I mentioned before, we expect to book quite some severance pay in Q4. So the transformation budget now is roughly DKK 800 million so far for the first nine months, and we expect that to go to DKK 1.5 billion, which is the originally expected volume. As I said before, a mix of IT, other projects and stuff that we do under the Better Bank transformation as well as severance, so I think that should pretty well explain the difference between where we are right now and where the last quarter should end up.

Jakob Brink – Nordea

But just on that -- sorry. Can I just follow-up on that? Yes. So exactly, this is my point. So if you have DKK 700 million left of transformation or severance for Q4, I guess, the transformation or DKK 700 million remaining is earmarked for severance pay. And then you have the normal seasonality. If you don't -- or if you have that, you end way above the DKK 28 billion. So why is the normal seasonality not there in Q4 this year?

Stephan Engels – Danske Bank – CFO

Now, first of all, it's not DKK 700 million severance pay. So part of the normal seasonality will be part of the transformation budget because a number of the projects or the good part of the projects that we are doing this year is part of the transformation budget. So that is one part of it. I would expect severance to be like DKK 500 million for the full year, keeping in mind that we have booked already something like DKK 237 million. So I think that should put that into perspective. And then other than that, some of the better performance to get to the DKK 28 billion is obviously also reflected in underlying cost.

Jakob Brink – Nordea

So you said DKK 500 million, leaving around DKK 250 million for Q4 of severance. Is that correctly understood?

Stephan Engels – Danske Bank – CFO

Yes. Yes. It's DKK 500 million in total, and we have booked something like DKK 237 million, if I have it correct, and the remainder would then be booked in Q4. If we would have higher numbers, I would guess that we will probably also book a bit more and then exceed the transformation budget in that sense, but that should still keep us well within the range of our net profit guidance.

Jakob Brink – Nordea

But how can you only book DKK 250 million, if laying off 1,600?

Stephan Engels – Danske Bank – CFO

Yes. We are not laying of 1,600 this year. We are laying 1,600 off over the next 6-12 months. And IFRS, as you know, requires you to have certain trigger points met before you can book severance pay.

Claus I. Jensen – Danske Bank – Head of Investor Relations

Can you please repeat your question on the lending margin, Jakob?

Jakob Brink – Nordea

Yes, it was just in the presentation, you have this slide showing NII from Q2 to Q3. I think it says a positive lending margin impact of DKK 3 million. But if I look at the fact book on every single business unit, except for LC&I, it's down quarter-on-quarter, i.e. the lending margin?

Claus I. Jensen – Danske Bank – Head of Investor Relations

Yes. That's not exactly a picture I can recognise. It's -- first of all, it's very small numbers, right? So it's down in Banking DK and Banking Nordic, but it's up in C&I and it's also up in Northern Ireland.

Stephan Engels – Danske Bank – CFO

Maybe we take this offline since the amount is not -- probably not driving share price really today.

Operator

Next question comes from the line of Per Grønborg from SEB.

Per Grønborg – SEB

I only have one question left on my note block. Credit losses. The last couple of quarters there, it's pretty easy, C&I has been driving all the losses. Now they seem to be spreading out. Denmark is ticking up. Sweden is ticking up. Any background on this trend?

Stephan Engels – Danske Bank – CFO

No. I think what you basically see there ticking up, if you look at the BUs, is the allocated post-model adjustments and not real loss experience, except maybe for Sweden, where we have had some single names that we booked. But in general, specifically, if you talk about Banking DK, it's more a reflection of the post-model adjustments.

Per Grønborg – SEB

Actually thought the post-model adjustments, they were allocated to the segments, were they not?

Stephan Engels – Danske Bank – CFO

That's what I'm saying. That drives, for example, the charges also in Banking DK as well as in Banking Nordic as well as in C&I, where a good part of it is oil and gas then.

Operator

(Operator Instructions) Our next question comes from the line of Jacob Kruse from Autonomous.

Jacob Kruse – Autonomous

So I just wanted to ask on your cost plan, the one that was presented last, I guess, November. If I'm looking at the underlying cost you're running at, at the moment, how much of the cost benefits are left to be delivered or should be delivered by the year-end of 2021? I guess what I'm asking is if you're running DKK 26 billion, including DKK 0.5 billion of restructuring costs by the end of -- for 2021. How much benefits are remaining in your original plan to credit 2022 cost basis?

Stephan Engels – Danske Bank – CFO

Okay. I hope I got your question right because your transmission was kind of disturbed a bit. Again, I think 2021 guidance is something that we will discuss with the release of our full year numbers. So far, the focus here has been on kind of breaking the trend in our cost development, which is something that we have seen in Q3. Going forward, 2021 is mainly, let's call it, an 8-10% cost cut, which probably is a little bit in better shape now than we originally thought because we are coming off a somewhat lower level in 2020 – in this year. But anything further than that, I think, needs to be left to our 2021 guidance call in February next year.

Jacob Kruse – Autonomous

Okay. And can I just also ask on the cost side, do you have an estimate of how much below budget you're running for the corona-related cost savings or T&E marketing expenses, things like that. Is there a meaningful tailwind in the 2020 number from the corona?

Stephan Engels – Danske Bank – CFO

That is a very theoretical question, and we are not normally disclosing budget really. So in that sense, you can say, in travel -- and maybe in travel, you can see, obviously, some savings, but that also has been partly offset by additional spend on facility and other services to have higher disinfection and cleaning rates and stuff like that. So I think it's a bit difficult number to really discuss.

Operator

Our next question comes from the line of Riccardo Rovere from Mediobanca.

Riccardo Rovere – Mediobanca

I just wanted to get back one second on impairments. When I look at slide 9, if I understand it correctly, in Q1, you charged DKK 1.7 billion of, I don't know how to call it, COVID-19 overlay or something like that, that has been almost entirely released over the following two quarters. And now you're left with only DKK 0.2 billion to be allocated just to understand -- just for me to understand, to be allocated for further credit exposures in the coming quarters also because in the interim report, you clearly stated that you expect a deterioration in NPL ratio and so on in the coming quarter. This is something that you clearly state in the interim report. Am I getting it right? Or should I plug it, should I add the sector-specific post-model adjustments, which is another way of seeing the original DKK 1.7 billion?

Stephan Engels – Danske Bank – CFO

I think in principle, I can confirm that the DKK 1.7 billion IFRS 9 macro model adjustment has basically migrated into post-model adjustment or management buffer. And other than that, I can confirm that the real loss experience with the exception of the oil and gas segment, or at least the drilling part of the oil and gas segment, is pretty, call it undisturbed or good or strong. We all allow looking forward in what will happen if the government programmes run out, but that is why we basically have kept these management buffers or post-model adjustments to make sure that we are prepared for that, if and when that happens.

Riccardo Rovere – Mediobanca

So just -- so the post-model adjustment is not allocated to any individual position at the moment. It's just another -- it's just a buffer. It's just an overlay?

Stephan Engels – Danske Bank – CFO

It is allocated in the sense to segments or industries, but it is not allocated to customers.

Riccardo Rovere – Mediobanca

Okay, not to single names? It is not allocated to single names?

Stephan Engels – Danske Bank – CFO

Yes. No, normally not, you may find one or the other as well. But in general, it's what it is, a post-model adjustment and not a customer-specific granular line item assessment of customers.

Operator

Our next question comes from the line of Robin Rane of Kepler Cheuvreux.

Robin Rane – Kepler Cheuvreux

So on capital, the market risk came down quite a bit this quarter and -- from the elevated level in the second quarter, how do you see the market risk level now? Is this level sustainable given the outlook that you see now for markets? Or do you think it can come up a bit again? And then just a short question on -- do you partake in any TLTRO? And if yes, how much and the impact from that, please?

Stephan Engels – Danske Bank – CFO

TLTRO, I can answer easily. Whatever the effect is, I'm afraid, it's so small that I don't know the number really. But we can check that and come back later to you through IR. On market risk, in all honesty, I left my crystal ball at home this morning. So I don't really know, but my expectation would be that once the situation around the U.S. election has probably kind of found its way home that we will probably see some more volatility in Q4 than we have in Q3, but not at all to the levels that we have seen in Q1 and Q2 would be my expectation. But again, that is a guess rather than knowledge.

Operator

Our next question comes from the line of Maria Semikhatova of Citi.

Maria Semikhatova – Citi

Two questions from my side. First, if I look at your credit portfolio, stage 2 loans dropped around 40% over the quarter. Just wanted to get a little bit more colour, what drove this improvement? And secondly, if you have any estimate of the proposed banking tax in Denmark, what that would be -- what that would mean for Danske?

Claus I. Jensen – Danske Bank – Head of Investor Relations

I can start with your question on the stage 2 movements over the quarter. This is due to the reversal we have done of model-related impairment charges. That is essentially booked against names, and that is why a reversal of those impairments is also moving exposure from stage 2 into stage 1.

Stephan Engels – Danske Bank – CFO

And on banking tax, I guess you refer both to the Swedish banking tax that will be introduced as well as the Danish banking tax. I don't really have a number to offer because I think some of the detail still is a little bit out in the woods.

Claus I. Jensen – Danske Bank – Head of Investor Relations

Can we have the last question, please?

Operator

Our final question comes from the line of Nick Davey of Exane BNP Paribas.

Nick Davey – Exane BNP Paribas

Two questions, please. The first one, on this dynamic on your balance sheet, where you have, I think, about DKK 200 billion of deposit inflows in the last year against a loan book, which is flat. I just wondered whether that, in any way, changes your wholesale funding plans? And the second question, please, on the slide that you helpfully give us, 29, about the switch from floating to fixed rate loans in Denmark. I wondered if you could talk structurally about this trend. If there's anything you can do to kind of combat this ongoing source of margin pressure? Or if you think the competition at the fixed-rate end of the market is too intense to be able to soften it?

Stephan Engels – Danske Bank – CFO

The growth in the deposit base is reflective of several things. One is there's a certain level of deleveraging at commercial customers. Secondly, there is obviously far less spend of customers, specifically in Q1 and Q2. And if you look across the Nordics, you can see deposits going up basically across all the banks. Then some of the corporates basically did draw short-term credit facilities and redeposited the money back with the banks. So that has also driven the deposit flow. Again, as long as we can price these deposits accordingly, I think we are okay with that. In terms of modelling and liquidity, I think we have to assume that not all of them are sticky enough to really change your funding patterns, given that a good part of our funding is anyway done by covered bonds. On the competition with the -- you want to do it? Yes?

Claus I. Jensen – Danske Bank – Head of Investor Relations

Yes. Your question on this fixed-rate for mortgages, Nick. It's a trend we have seen for a while, and it is driven purely by the level of interest rates, where our customers have a clear preference for fixed-rate loans. As they can lock in a very, very low fixed rate for the next 30 years. So it's not driven by any pricing competition, as the pricing on different loan types between the Danish mortgage banks is actually quite stable. And this is something that has been penalising our NII in the Danish part of the business for a while. It's something we share with other Danish banks. And I do not expect that the customer preference for fixed-rate loans will go down in the foreseeable future.

Chris Vogelzang – Danske Bank – CEO

Okay. Thank you all for your interest in Danske Bank and for your good questions. As always, you're welcome to contact our IR department if you have more questions after you have had the time to look at the financial results in detail. So again, thank you very much all for dialling in, and hopefully, you're all safe and we speak soon.

Stephan Engels – Danske Bank – CFO

Thank you. Bye.