Conference call

Interim report – first quarter 2020

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Investor Relations

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Chris Vogelzang – Danske Bank – CEO

Hello, and welcome to the presentation of Danske Bank's financial results for the first quarter of 2020. Thank you for all -- thank you all for taking the time to listen in on this call today. My name is Chris Vogelzang, I'm the CEO. And with me, we have our new CFO, Stephan Engels, and CRO, Carsten Egeriis; and our Head of Investor Relations, Claus Ingar Jensen.

Slide 1, please. In today's call, we will present Danske Bank's financial results for the first quarter of 2020. We aim to keep this presentation to around 20 minutes. After the presentation, we will open up for Q&A as usual. And of course, you can always contact our IR department if you have any more questions.

Slide 2, please. From a financial perspective, the first quarter of this year turned out to be very different from what we expected at the beginning of the year due to the corona pandemic. During most of the period, we experienced good business momentum from higher customer activity and increased lending in most of our business. At Banking Nordic, we saw a good inflow from our partnership agreements, but there was also good momentum at Banking DK as remortgaging activity continued. In addition to this, our capital markets business at C&I benefited from increased numbers of transactions in debt as well in equity markets. In March, however, the lockdown of societies all over the world caused a sudden change in economies. This triggered significant changes to all macroeconomic forecasts, but also caused the financial markets to become very volatile. Due to the assumed impact on trading income and loan impairment charges, we announced on 16th of March that we expect a lower profit for the year and suspended guidance until there was more visibility regarding the situation. Therefore, and as expected, both trading income and loan impairment charges had negative -- had a significantly negative impact on the results. Trading income was impacted by the very high volatility in the financial markets in March, which caused a collapse of the normal correlation between rates and equities as well as a credit spread widening. A sizeable part of the loan impairment charges was triggered by extensive and timely model adjustments and sector-wide impairments. And we believe a substantial downside is now included in the charges recognised in the first quarter. Excluding the effects of the coronavirus pandemic, loan impairments were in line with the previous loan impairment trend. The result for the quarter represents a return on shareholders' equity of minus 3.8%, against 7.7% for the same period the year before. Expenses were affected by previously announced investments related to our compliance under control agenda and thus came in higher than the year before. Our capital position remains strong. The CET1 capital -- the Core Tier 1 capital ratio of 17.6% includes the effect of the proposal to cancel dividends for 2019. The ratio is well above the minimum regulatory requirement and in line with our target level of above 16%.

Finally, we have decided to resume guidance for 2020. However, as uncertainty prevails as a result of the impact of the coronavirus pandemic, the uncertainty related to our guidance is also higher than usual, reflecting the limited visibility for the macroeconomic situation and the developments in financial markets. On that basis, we now aim for a net profit of at least DKK 3 billion. This represents our best estimate based on a timely assessment of the current situation and the likely impact on our business for the rest of the year. The most significant change to our outlook is higher loan impairment charges, which we will comment on in more detail later in this presentation.

Next slide, please. Before our new CFO, Stephan Engels, goes into the financial details for the quarter, let me address the thing that has been on everybody's mind and has affected us all over the past few months; the outbreak of the coronavirus pandemic. As one of the largest banks in the Nordic countries and the biggest bank in Denmark, we play an important role in contributing to minimising the negative economic consequences for our customers and, of course, for society as a whole. We take this role and our responsibility very seriously. And as you can see here, we have supported our customers, society and employees in numerous ways, both financially and in terms of offering advice and support through this difficult time. And let me just say that I think our employees have done a fantastic job keeping the bank running and helping our many customers, all whilst working from home. So far, what we have seen is demand for credit lines and overdraft facilities so that if this crisis gets worse, customers will have access to liquidity. Since the start of the coronavirus pandemic, we have made more than DKK 70 billion in new or increased credit facilities available to our business customers, and we're able -- we're happy to be able to help our customers in that way. It is also important to mention that we have helped our customers navigate through these difficult times while still retaining strong capital, liquidity and funding positions. We continue to be a solid and well-capitalised bank, and this means that we're able to continue helping our customers and society through this crisis.

Slide 4, please. And over to Stephan for more details on the numbers.

Stephan Engels – Danske Bank – CFO

Thank you, Chris. Let us look a bit closer at the income statement, where 2 line items, trading income and loan impairments, stand out as significantly impacted by the coronavirus pandemic. Overall, total income came in 11% lower than the year before, due solely to significantly lower trading income. Both net interest income and fee income were stable to slightly higher as a result of good activity and increased lending, adjusted for the headwind from currency effects. NII was stable, whereas fee income was down approximately 10% from the preceding quarter, adjusted for the booking of performance fees in Q4. This was due -- this was due to lower assets under management and the lower remortgaging activity, with the latter being an expected drop from the record-high level we saw in Q4. Trading income was down significantly for the reasons Chris mentioned in the executive summary, but also as a result of negative value adjustments on the derivatives portfolio. Trading income was also down from the level in the preceding quarter. However, please note that Q4 benefited from a gain from a one-off item of approximately DKK 0.8 billion. Our expenses, which I will comment on in more detail later, were up from the same period last year due to planned investments, primarily within regulatory compliance and efforts to combat financial crime. Excluding this, expenses were almost flat. The number for the first quarter is notably down from Q4, which was significantly impacted by a number of one-offs.

Loan impairment charges showed a net charge in the first quarter of DKK 4.3 billion, against a small charge of DKK 0.4 billion for the same period the year before. A majority of the charges derived from changes in model assumptions under IFRS 9 and from post-model adjustments, whereas specific impairment charges are primarily recognised for customers in the oil and gas sector as a result of the historically low oil prices.

Finally, this resulted in a net profit for the period of minus DKK 1.3 billion, against DKK 3 billion for the year-earlier period. The result for the preceding quarter of DKK 5 billion was again affected by a number of one-offs that overall had a positive effect on the results.

Slide 5, please. Now let us take a closer look at the underlying development in net interest income. The increase in volumes had a positive effect, which, however, was partly offset by continued margin pressure due to higher funding costs and a change in the product mix. NII was down 1% from the level of the year-earlier period. Excluding currency effects, NII would have been up 1%. NII was down 1% from the level in the preceding quarter, however, flat adjusted for FX effects. Margins had a positive impact, primarily through the pricing initiatives launched in Norway in the fall of last year. Our funding activities in the quarter took place before the coronavirus pandemic escalated in March, and we acquired funding in the amount of DKK 26 billion, of which DKK 10 billion were in the form of non-preferred senior debt.

Slide 6, please. Lending at Banking DK was down 2% from the same period the year before due to market value adjustments of the mortgage book. Excluding adjustments, lending was flat. The pressure on margins was most significant at Banking DK, where we see the effects of our customers' shift towards longer-term fixed-rate mortgages with lower margins. At Banking Nordic, we saw solid business activity, although lending volumes were affected by a significant depreciation of the Norwegian krone and the Swedish krona. Lending was down 3%, but 4% up in local currency as a result of strong growth in Retail Sweden, where the inflow from the partnership agreements resumed in the first quarter, but also as a result of good growth in terms of our commercial business in Finland and Norway.

At C&I, the lending volume increased 11% from the same period the year before and 4% from the preceding quarter. The increase happened mainly towards the end of the quarter, where we started to see an inflow of requests for credit due to the coronavirus pandemic. Since the outbreak of the pandemic, we have seen strong demand from businesses for support, which means that we had already made more than DKK 70 billion of extra liquidity lines available across our markets by the end of last week. A significant part of the new or increased credit facilities are in the form of loan commitments and are therefore not reflected in lending volumes in the financial report for the first quarter.

Next slide, please. Let's have a look at fee income. Fee income was up 3% from the same quarter last year due mainly to good activity at Banking DK, where remortgaging activity and higher investment fees led to an increase of 17%. At Banking Nordic, fee income increased 3%, with the increase driven by investment activity at the beginning of the year, especially in Finland. At C&I, significantly greater activity in the primary debt market within Debt Capital Markets and equity market transactions led to an increase in Capital Markets fees of 24%. However, activity in both markets came to a halt during March. Investment fees from Wealth Management decreased from the same period the year before, mainly driven by lower assets under management, mitigated, however, by investment fees from other areas. The decline in fee income from our pension and insurance business was due partly to the sale of Danica Pension Sweden in 2019.

Slide 8, please. Now let's turn to trading income, one of the more volatile items in our income statement. Trading income was down 82% from the same period last year. However, the impact came very late in the quarter as we saw normal activity in January and February. However, March was characterised by very turbulent financial markets with significant volatility in rates and equity markets. Trading income was down 69% from the preceding quarter, adjusted for the one-off in Q4 related to the sale of LR Realkredit. At Corporates & Institutions, the significantly wider spreads had a negative impact on trading income in FI&C in particular, but we also saw lower trading income from the equities business. Please note that the FI&C result included negative xVA adjustments of DKK 0.3 billion related to value adjustments of the derivatives portfolio, driven mainly by higher funding spreads. Also at Wealth Management, we saw a negative impact due to a lower investment result in the health and accident business. This was, however, partly mitigated by a higher VA component.

Income from the refinancing of adjustable-rate mortgages amounted to DKK 120 million, slightly less than in Q1 2019. This was a result of a shift towards fixed-rate mortgages, due mainly to continued remortgaging activity. However, remortgaging activity contributed to higher trading income at Banking DK.

Slide 9, please. Moving on to expenses. Total expenses for the first quarter amounted to DKK 6.8 billion and were up 10% from the level in the same period last year. Compared with expenses for the preceding quarter, expenses saw a 19% decline due to one-offs in Q4 as well as seasonality. The increase in staff and consultancy costs relates to up-staffing related to our compliance under control agenda. All business units continue to be impacted by higher costs for regulatory requirements and compliance. However, the effect of the group-wide cost programme is gradually showing in our expenses. In the first quarter, 400 positions in the bank were discontinued, and we continued to make progress on further cost-saving initiatives such as product simplification and focus on non-personnel expenses.

And now over to Carsten for details on credit topics.

Carsten Egeriis – Danske Bank – Chief Risk Officer

Thank you, Stephan. Impairments in the first quarter amounted to DKK 4.3 billion, equivalent to a loan loss ratio of 90 basis points for the core activities. The outbreak of the coronavirus pandemic and the resulting lockdown of societies led to significant changes to macroeconomic assumptions in the IFRS 9 model. The effect of this and additional charges against sectors severely affected by the pandemic amounted to DKK 1.7 billion and DKK 0.5 billion, respectively. Specific charges against single-name exposure for which a deterioration of creditworthiness has been identified amounted to DKK 2.1 billion, due mainly to increased impairments in oil-related exposure because of the unprecedented drop in oil prices. This explains the high charge at C&I, where charges against oil-related exposures amounted to approximately DKK 1.4 billion. The remaining part was mostly against exposure to the retailing industry. Excluding the effect of the coronavirus pandemic and the fall in oil prices, loan impairments were in line with the previous loan impairment trend. We expect further impairments related to the coronavirus pandemic during the year, however, not at the same level. The extensive changes to forward-looking estimates in the first quarter are believed to capture the substantial downside on the affected portfolios. We will now provide additional comments on industries affected by the coronavirus pandemic.

Slide 11, please. When looking at impairments for this quarter, it has been key to consider the industries immediately impacted by the coronavirus, and this led to a review of existing as well as new non-performing loans, especially in the oil and retailing industries. It is important to notice, however, that the exposure we have to highly affected industries is limited and amounts to less than 4% of total Group exposure. Over the past years, we've had a selective approach to these industries. Besides looking at individual customer loan impairment charges, we have increased impairments against exposure to these selected industries. More details on the exposures, expected credit losses and more can be found on selected industries in the appendix on slide 26.

And just finally from my side, let's have a look at our updated model assumptions. And this is slide 12, please. As a consequence of the coronavirus pandemic, we have changed the scenarios used in the first quarter in order to reflect the worsening of the macroeconomic outlook. This has led to impairment charges of around DKK 1.7 billion of the total charges recognised in Q1. The base case scenario, which is applied with a 65% weighting is the old downside scenario in Q4 2019. It reflects a noticeable decline in overall macro in 2020, followed by a recovery in 2021 and assumes the effects of substantial government support packages. The downside scenario, which is applied with a 25% weighting, reflects a further deterioration of macroeconomic conditions, including substantial increases in unemployment and decreases in house prices. It also reflects the risk that government support packages are insufficient to sustain the recovery.

Finally, the upside scenario has a 10% weighting and is largely similar to the old base case scenario for Q4 2019. It represents a better outlook than the new base case scenario across macroeconomic parameters and assumes a recovery already in 2020. Please note that since the full effects of the coronavirus pandemic are not yet known, the assumptions and the weighting of the scenarios are subject to uncertainty. And you can find more details on the macroeconomic assumptions in the appendix, and that's on slide 29.

Then please turn to slide 13, and back to you, Stephan.

Stephan Engels – Danske Bank – CFO

Thank you, Carsten. Our capital position remains strong with a reported core Tier 1 capital ratio of 17.6% at the end of the first quarter. The capital requirement of 13.2% reflects that countercyclical buffers were either reduced or removed by the respective governments due to the coronavirus pandemic. The core Tier 1 capital ratio increased 0.3 percentage points, with the increase driven by the cancellation of the dividend for 2019. The fully loaded core Tier 1 capital ratio of 17.4% is well above our target of above 16% in the short term. The total capital ratio was 22.3%, down 0.4 percentage points from the end of Q4 2019 due to the call of an AT1 instrument during Q1. The REA came in slightly higher than at the end of last year. This was due to higher counterparty risk of DKK 7 billion, driven mainly by exposure increases due to interest rate movements. Market risk was up DKK 3 billion, driven by higher volatility in the financial markets. However, we expect an increase in REA of a low double-digit billion amount in the second quarter due mainly to increasing market risk. The leverage ratio was 4.5% according to transitional rules and 4.4% according to fully phased-in rules.

Slide 14, please. And then finally, and as Chris mentioned at the beginning of this call, we have decided to resume guidance for 2020 after having suspended the guidance since mid-March. However, as uncertainty as a result of the impact of the coronavirus pandemic prevails, the uncertainty related to our guidance is also higher than usual, reflecting the limited visibility for the macroeconomic situation and developments in the financial markets. On that basis, we now aim for a net profit of at least DKK 3 billion. This represents our best estimate based on a timely assessment of the current situation and the likely impact on our business for the rest of the year. The other changes we have made to the lines in the outlook relate to fee income and impairment charges. All other lines are unchanged. We now expect fee income to be lower than in 2019 due to lower remortgaging activity and subject to significant uncertainty for assets under management, customer activity and market development. Loan impairments are now expected to be significantly higher due to the impact of the coronavirus pandemic on the economic outlook, with a large part recognised in the first quarter of the year. The financial target for 2023, where we have an ambition for a return on equity of 9% to 10%, is unchanged.

Slide 15, please, and over to Chris.

Chris Vogelzang – Danske Bank – CEO

All right. Thank you, Stephan. And I would like to end this presentation with an update on the four key focus areas for our better bank transformation journey. In November last year, we began the journey with ambitious targets in 2023 for all our stakeholders. Customers, employees, society and investors. To reach those ambitions, we launched group-wide and business unit specific initiatives to enable us to be a better bank in '23. The better bank transformation is now fully moving from detail into the execution phase. And whilst the broad transformation will continue, we have prioritised four of the initiatives for the remainder of 2020. Compliance under control, group-wide cost programme, and agile transformation, and purpose, brand, culture and engagement. This prioritisation will enhance the speed of the transformation by ensuring the necessary attention and resources. As you know, compliance under control is imperative for Danske Bank. And here, we are continuously improving the foundation to build a first-class compliance function. This year, we will continue putting large investments into developing capabilities in the area of AML, conduct framework, trade surveillance and market abuse. We have already made tangible progress by launching the new Cobra platform for business customers, and we have launched a new digital and totally automated review solution for handling the ODD cases.

Cost is another key area for 2020 as we remain committed to our ambitious return on equity and cost/income targets. In February, we carried out the first redundancies, and we also removed several products as Stephan mentioned earlier. And we are continuously simplifying our organisation and creating a less complex bank. To be continued!

The third focus area, agile transformation, will essentially enable us to digitalise end-to-end processes for the benefit of customers and employees alike. This initiative will continue to look into acceleration of key customer journeys, starting with buying and owning a home in Denmark and across the Nordics, to improve customer satisfaction and reduce costs by end-to-end digitisation. There will be a ramp-up throughout the rest of 2020, affecting around 4,000 to 5,000 employees.

Lastly, purpose, brand and culture is important to ensure Danske Bank's relevancy, health and growth in the future, and it is important for our employees. Therefore, work will continue to define our purpose and target culture, remove barriers to perform and increase employee engagement. The most recent step we have taken was conducting group-wide culture surveys, and it gave us important insights, which we're now debating with many people in the organisation. As mentioned, the transformation in breadth will continue in light of the four key focus areas and all initiatives need to be executed between now and '23. Therefore, both bank-wide programmes and those that are part of the current business unit plans will continue to execute, as it is still essential, for instance, to integrate sustainability in everything we do and, for example, reduce product complexity. One example is that we have launched an initiative called Better Nordic Retail Bank to improve the profitability of the retail segment in the Nordics.

Slide 16. Those were the initial comments and messages. We are now ready for your questions. Please limit yourself to two. If you're listening to the conference call from our website, you are welcome to ask all questions by e-mail. Operator, we are ready for the Q&A session.

Operator

(Operator Instructions) Our first question comes from the line of Jakob Brink from Nordea.

Jakob Brink – Nordea

So two questions from my side. I think both of them on net interest income. The first one, the guidance for 2020, you keep it unchanged for net interest income. And you talk about margin pressure, and you talk about higher funding costs offset higher volumes. But isn't it so that, first of all, you mentioned before, I think, Stephan, in your presentation, that there's pressure on mortgage margins. But as far as I can tell, they're actually up in Q1. I don't know why that happened? And secondly, I guess you could also argue at least many of your peers are arguing that there are some margin stabilisation now after the COVID-19 outbreak. And finally, on funding cost, why are these higher than they used to be? I would argue they were probably lower now with the lower countercyclical buffer. And finally, on the guidance, how does the higher short rates in Denmark play into the new guidance or the not new guidance?

Stephan Engels – Danske Bank – CFO

Yes. Thank you for the question. I think the general trend that influences NII in -- especially in the year-over-year comparison - prevails, which is a negative interest rate environment, which definitely has a play on our deposit base. We're also seeing, as I've mentioned earlier, remortgaging activity tending towards longer fixed rate products, which also is something, which is a good thing for the customers to do, but is a pressure on margins. So I think that is continuing trends, which we see also, again, going forward. On the funding side, you know that we have throughout 2019 taken on quite a significant amount of non-preferred senior, which comes at a certain cost that we will see the full-year cost of these funding instruments being reflected throughout the full year 2020, which, again, is another pressure on the NII.
As you rightfully said, we are trying to compensate that with better volume and wherever we can, also with adjusted pricing. The two things, which are where I would say, I would be cautious about how they really develop is, what would the interest rate curves really do, what we see on the short term, how does the steepness of the curve develop, and things like that. I think that's pretty early days to really draw a conclusion from that. So I think the underlying assumptions is what has been driving the NII outlook.

Jakob Brink – Nordea

Just one follow-up on that. So basically, what you're saying is that if interest rates are up 27 basis points on average in Q2 so far, if that is maintained throughout the year, that's not included in your guidance? And just remind me again, what is the sensitivity from a 25 basis points increase in the short Danish rate?

Claus Ingar Jensen – Danske Bank – Head of Investor Relations

Yes, the sensitivity is basically unchanged. And that would mean approximately DKK 1 billion, if you see an increase of 25 basis points across all the countries where we are operating.

Jakob Brink – Nordea

And that's not included in the guidance?

Claus Ingar Jensen – Danske Bank – Head of Investor Relations

The guidance is based on what you saw, you can say, year-end. And then we are fully aware that there has been some changes, especially in Norway, but I would say the changes have been not significant for the time being. So that is not reflected in the guidance.

Jakob Brink – Nordea

Okay. And then just my second question also on net interest income. You've been out with some COVID-19 corona support to the Danish economy and against the other economies as well in the Nordics. For example, in Denmark, you mentioned that 90,000 customers with negative rates do not have to pay for the rest of the year, below DKK 500,000. How much will the price be for this? I remember when you lowered it from DKK 1 million to DKK 200,000 not that long ago, it was hardly any impact. So I guess that's true now as well? Or am I missing something?

Stephan Engels – Danske Bank – CFO

No, no. We confirm that, but you need to keep in mind that there is a broader set of things that we have been initiating, for example, including paying suppliers earlier and other stuff. I think there's a lot more than just the one, but the one that you mentioned is.

Jakob Brink – Nordea

And what's the total price of all these initiatives, you think?

Claus Ingar Jensen – Danske Bank – Head of Investor Relations

I think, Jacob, when we have discussed the potential impact from changing the thresholds, we have not disclosed how many deposits we have had. And that is also what we stick to this time.

Jakob Brink – Nordea

But also all the other initiatives like payment holidays...

Stephan Engels – Danske Bank – CFO

Yes. I think, again, it's early days. We are talking a lot about assumptions, and we also need to see how much of these offers are really taken up by the customers, in what fashion. That, by the way, is also true for the lending side, where we have agreed on quite a number of new credit facilities. And then it remains to be seen whether they really get drawn or whether they were just a suspend and build version. And in that sense, as Claus said, a set of assumptions that we have were basically reflecting the end of the year interest rate, and I think that is it.

Operator

And the next question comes from the line of Per Grønborg from SEB.

Per Grønborg – SEB

Also 2 questions from my side. I'll continue first on the same line as Jakob. You are addressing the negative interest rate, that's putting pressure on your NII. We are now seeing that best practice among Danish banks is moving towards a threshold of DKK 250,000 on retail deposits. Any changed stance from your side whether retail clients should pay the cost for you to take the deposits or whether you should continue to subsidise them as much as you have been doing up until now?

Chris Vogelzang – Danske Bank – CEO

This is a leading question, Per. This is Chris. I think we go through this ceremony every quarter. If there's anything which would change, I would not tell you, I would tell the whole market. So at the moment, as long as we're not changing anything, we're not changing anything.

Per Grønborg – SEB

My second question is related to your IFRS 9 modelling. When I look at page 12 of the slides or was it we, where we had the details further in the back, your base scenario is based on a GDP growth of minus 1% for this year. Doesn't that sound reasonably optimistic compared to where GDP forecasts have moved the last couple of months?

Carsten Egeriis – Danske Bank – Chief Risk Officer

Per, it's Carsten here. The approach we've taken is, basically, we've used the mild scenario and the stress scenario that we used in our quarter 4 impairment modelling and also used for our ICAAP purposes. So basically, how we see this is, we adjust the ratings to those old mild and severe stress scenarios to get a macroeconomic environment where you do have GDP contractions over the next two years. But more importantly, you have a quite significant increase in unemployment and quite a significant decrease in house prices. And really, I would, therefore, suggest that you don't get too caught up into whether it's a minus 1% or minus 2% or 3% in GDP, but the weighted average of an unemployment rate that increases by around 20% or over 1 percentage point. And house prices that fall between 5% to 6%. Again, that's just looking over the overall Nordic as an average.

Per Grønborg – SEB

Okay. Just looking at GDP, it looked strange, but I think I can, of course, see the rationale when you're saying that it says, it's the other factors that is driving the model.

Operator

And next question comes from the line of Mads Thinggaard from ABG.

Mads Thinggaard – ABG Sundal Collier

This is Mads from ABG. The first one is on your reiterated financial targets, 9% to 10% ROE in '23. I think you mentioned before, cost-cutting or cost being the control element for this - for reaching this target. I wondered if you could put a bit of words on how you see the role of costs in the equation now. Has that come - is it a larger role for cost to play now? Or a smaller one? If you could put a bit of comment on that. And then going on to the risk side, you're giving an outlook for REA growing more than, I guess, DKK 10 billion next quarter, but primarily from market risk, could you put a bit of comment on how you see credit risk evolve Q2 to Q4 here with corona? And of course, without the FX help or FX reduction in REA here in Q1?

Chris Vogelzang – Danske Bank – CEO

Right. Thank you for this question. On 2023, again, we reiterate our targets there. And indeed, last quarter, I said, that if revenues don't materialise, we will make it up in costs. And one of the drivers behind that also was that we were including costs to actually manage those revenues. And when those revenues are not there, you have to make less cost there. So that was one of the elements. But in general, we said that, that costs indeed was the thing which we could play with, so to say. So that's all true. We are now six to eight weeks into this crisis. We're talking about 2023. It doesn't change anything on our current interventions and our current cost programmes, which we're working on and which you will see increasingly materialise over the next quarters. And let's then take it from there, once we're a little bit further in this crisis. It doesn't change anything to the way we're acting now. That's too early.

Mads Thinggaard – ABG Sundal Collier

Okay. Can we still expect an update on transformation? Or how does that look?

Chris Vogelzang – Danske Bank – CEO

Yes, yes, absolutely. I mean, we will -- I mean, this quarter has, of course, been very much dominated by impairments, et cetera. But as I said, the whole transformation programme is still on track. And everything we have said, including cost trajectory is still out there, also for 2021. So don't assume any changes.

Carsten Egeriis – Danske Bank – Chief Risk Officer

Mads, this is Carsten. I mean on your question on REA, REA sensitivities, and I believe the question on REA outlook. In terms of market risk, the market risk REA predominantly is driven by the xVA components and the blow-out in our own funding spreads and the FDA component related to that. Clearly, we've seen that tightening again in April, but it does have some impact on REA. And then the second component is, of course, credit related. And I think it's too early to say what the REA impact is from a credit perspective. But I do want you to keep in mind that, of course, there is a through-the-cycle approach to a very large part of our credit portfolio. And therefore, we don't expect major sensitivities to a large part of our REA component.

Mads Thinggaard – ABG Sundal Collier

Okay. That's helpful. So not like a big jump here in the start of the crisis?

Carsten Egeriis – Danske Bank – Chief Risk Officer

Correct.

Operator

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

Sofie Peterzéns – J.P. Morgan

Sofie from J.P. Morgan. I was wondering on the GDP decline and - one of your peers has given kind of guidance on 5% decline in GDP versus their estimates - would you be able to give a similar guidance? What the magnitude of your loan losses would be if GDP again, let's say, is 5% lower than expected? And similarly, your kind of provisions, what kind of oil price assumptions have you assumed? And if oil prices go down $10 a barrel, what impact would that have on your provision? So that will be my first question.

Secondly, I was wondering if you could just share with us the details of your customers that actually have payments holidays. And if you expect these payment holidays to eventually translate into higher NPLs.

And then thirdly, I know you're not regulated by Europe, but did you get any benefit from this IT software intangible benefit that was announced yesterday by the European Commission? And if so, how much should we expect?

Carsten Egeriis – Danske Bank – Chief Risk Officer

Thanks, it's Carsten. Let me take the first two. On macro, so we give the sensitivities on the macro changes related to our upside, base case and downside. We don't do it based just on GDP movement. I would again reiterate that the main impairment drivers is not GDP, but it's unemployment and house price movement. And of course, naturally, there are some correlations between those two and GDP, but those are really the main pieces. But you'll see in the disclosures what the impact would be, for example, of taking 100% of the downside scenario, and 100% of the downside scenario, you can see in the disclosures, is quite a significant drop in GDP. In terms of oil, we, of course, have looked at oil prices when we looked at the individual impairments that we've taken on oil and gas-related exposure in Q1 and feel that we are as up-to-date as at all possible in terms of the name-by-name credit assessments of those exposures. As we then look forward - clearly, there are other dynamics than just oil prices. There's also, obviously, there's supply and demand, there's a key factor around collateral and prices on the various different equipment that we have as collateral on these exposures. But we don't disclose specific forecasts around oil and sensitivities to oil prices stand-alone. Then I think there was a question on payment holidays. I think that's too -- it's too early to tell. In fact, where we've seen most activity is on shift from amortising to interest-only in Finland. There, we've seen quite a lot of activity. But in most of our other countries, it's still relatively low numbers we see in terms of payment holidays and other types of early forbearance, if I can call it that. And then the third question, I didn't quite get.

Sofie Peterzéns – J.P. Morgan

Yes. My third question was basically, yesterday, the European Commission announced that banks don't need to do the software intangible deduction from capital going forward. So I was just wondering if that's going to happen in Denmark. And if so, what potentially impact on Danske is?

Carsten Egeriis – Danske Bank – Chief Risk Officer

Yes. That's a discussion which has been flowing around for a while. So far, that has not translated into a local regulatory requirement or eases in that case.

Operator

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

Robin Rane – Kepler Cheuvreux

Two questions on capital, please. So do you -- I couldn't find any dividend accrual for 2020 -- potential dividend for 2020. Is there - do you do that? Or do you not do that? And If you do not do that? Is there any signal value in that?

And then secondly, on the capital, you say that you have this 16% CET1 target in the short term. What are you looking for in the medium-term to potentially change this target? Is that - do you await more clarity on the -- around the government responses to the abnormal situation, et cetera. If you could give some colour on that, that would be great.

Claus Ingar Jensen – Danske Bank – Head of Investor Relations

Yes. Just -- this is Claus here. Just to your first question on dividend accrual. We have an unchanged dividend policy, 40% to 60%, and we continue to accrue dividend of a 60% payout on a quarterly basis.

Stephan Engels – Danske Bank – CFO

Although we didn't accrue too much in Q1, one has to say. The 16% capital target is indeed a short-term target. And as I think has been released in earlier quarterly calls, we will review how we will deal with this kind of target going forward.

Claus Ingar Jensen – Danske Bank – Head of Investor Relations

Yes, we can, of course, add here that our thinking behind it were that we are getting closer to an implementation of Basel, and based on that, then it would be more prudent for us maybe to move into a buffer target communication instead of having a fixed rate. That was behind our thinking. That's what we said.

Stephan Engels – Danske Bank – CFO

Yes. Nothing changed.

Operator

And the next question comes from the line of Martin Gregers Birk from Carnegie.

Martin Gregers Birk – Carnegie

Two questions from my side. The first question is on your health and accident business in Danica and listening to or reading what the Danish FSA was out saying the other day about a suspension of cross-subsidising products. But, in the meantime, until prices are raised, could we see or expect any actions from the Danish FSA on this area? And then maybe my second question is sort of slightly also coming from that. Other income and Non-core have been extremely volatile over the past quarters and have, all in all, been a rather large drain on profit. When do you guys think that will stabilise? And if it's going to stabilise, what kind of run rate should we expect from here on?

Chris Vogelzang – Danske Bank – CEO

Claus?

Claus Ingar Jensen – Danske Bank – Head of Investor Relations

Yes. To your first question, yes, we have also read the comments in the media around the Danish FSA's comments on health and accident. However, I think it's a little bit too premature to make any comments from our side. This is, of course, something that we are monitoring. But officially, we cannot comment on that for the time being. And then on your second question on our Non-core - yes, you are completely right Martin in your observations. But you know the deficit or the impact on our Non-core is coming from -- for different reasons. But it has been - over the last couple of quarters - there has been a value adjustment of some of the assets. And then we have also had costs for closing down our activities in the Baltic area that is affecting the result this time. So this should not be the run rate going forward, but it's very difficult to give you any more precise guidance.

Operator

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

Riccardo Rovere – Mediobanca

Just a couple of questions for me. Aside from having used weighted scenarios, baseline, downside and so on, calculating credit losses in this quarter, do you think you have used some kind of relaxation of IFRS 9 when it comes to assessing the DKK 4.25 billion provisions in this quarter? This is my first question. The second question I have, just a clarification on one of your slides. When you say that the downside scenario will generate DKK 5.7 billion of additional provisions, that DKK 5.7 billion should be added to the DKK 4.25 billion that you've charged in this quarter. Did I get it right?

Carsten Egeriis – Danske Bank – Chief Risk Officer

Yes. Thanks for that. I mean, two points there. On relaxation of IFRS 9. We have not done any relaxation of IFRS 9. What we've done is in our macro weighted scenario, the reason it is, where it is and not worse, is because we're, of course, considering this very significant fiscal and monetary policy that we expect to improve the economy towards the end of the year and going into next year. And therefore, you see a sort of weighted average V-shape scenario, if you will. Then on your question around the downside versus upside. What we show here is the macro-modelled impact. So the macro-modelled impact currently on a gross basis is DKK 2.2 billion. We report DKK 1.7 billion, and that's because we've offset the DKK 2.2 billion with some post-model adjustment, where we felt there was double counting. So the DKK 5.7 billion is seen as an addition, not to the DKK 4.3 billion, but to the modelled impact of DKK 2.2 billion.

Claus Ingar Jensen – Danske Bank – Head of Investor Relations

Okay. Operator, can we have the last question, please?

Operator

The last question comes from the line of Jacob Kruse from Autonomous.

Jacob Kruse – Autonomous

Jacob from Autonomous. Could I just ask, in terms of these macro models that you're running, how sensitive are they to prolonging the crisis? So just for reference, if you were to double the length of this downturn, has that doubled losses? Or is -- is that a bigger or less severe impact?

Carsten Egeriis – Danske Bank – Chief Risk Officer

No, I think the best of looking at it is, again, to look at the disclosures and the different impacts of the macro-modelled part that I just answered to before. Because, again, we're looking kind of one to two years ahead. And so the best way of looking at the sensitivity is to look at if you get a pure downside, so 100% downside weighted, which would be a fall in house prices of more than 20% and a fall in GDP of 4.2% and 1.5% year-on-year - In that kind of macro scenario, which, of course, would be extremely severe, you would get an incremental, as was mentioned before, DKK 5.7 billion of impairments.

Jacob Kruse – Autonomous

Okay. And could I also just ask on the cost side, you're talking about offsetting potential revenue losses by cost. I think your current cost programme is very much focused on the back office and the support functions or group centre or whatever you want to call it. Where do you see the main thrust of additional potential for reductions?

Chris Vogelzang – Danske Bank – CEO

I mean, if business volumes are not materialising as they would -- it's also not necessary to have the same kind of level of front-office cost or essentially mid-office cost. So in that sense, there is definitely space in that. There is also space in the back-office costs if volumes will not be as they are. But again, I mean, this is six to eight weeks into this crisis. I mean, we have made - in Q4, we've made all kinds of dependencies going forward over this period. And so far, we are still very confident that we can reach the targets as we have said. And none of the things happening now does actually change our interventions, which we are working on at the moment. So I truly think it's too early to go in great detail here. But again, talking about it several times amongst each other, I feel still very confident about the 9% to 10%.

Okay. Thank you all for your interest in Danske Bank and for your questions. As always, you're welcome to contact Claus and his department if you have more questions after you've had time to look at the financial results in detail. A transcript of this conference call will be added to our website and the IR app in the next few days. Okay. Stay safe, everybody, and we'll talk at some other time, I'm sure, again.

Thank you.