

ISSUER COMMENT

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 Rate this Research

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Danske Bank A/S

Dismissal of US lawsuit against Danske Bank removes one hurdle, but risk of significant financial penalties remains

On 24 August, a US federal district court dismissed a civil lawsuit brought against [Danske Bank A/S](#) (A2 negative/A3 stable, baa2¹) and certain former bank executives in the US alleging they misled investors regarding the extensive failures in anti-money-laundering (AML) controls at the bank's previous Estonian branch.

The dismissal of the lawsuit is credit positive for Danske because it eliminates one potential financial penalty for the bank. However, Danske is still exposed to potentially significant financial penalties from ongoing regulatory and legal proceedings related to allegations of money laundering at the bank's previous Estonian branch between 2007 and 2015. The now-dismissed complaint sought unspecified damages on behalf of a group of investors in the bank's American Depositary Receipts (ADRs)² between 9 January 2014 and 29 April 2019.

The bank remains under investigation by authorities in the US, Denmark, Estonia and France. Additionally, a number of other shareholder lawsuits are pending in connection to the Estonian case.

The potential fines and other regulatory penalties remain a key credit challenge for Danske. Previous deficiencies in compliance and controls were a key factor behind the bank's weakening profitability in recent quarters, as funding and operational costs increased as customer and investor confidence waned and spending on AML capabilities rose. The ultra-low interest rate environment, particularly in the bank's Danish home market, was also a source of negative pressure on profitability. The economic fallout from the coronavirus-induced disruption added to the bank's profitability challenges this year, and we expect those forces to continue over the next 12-18 months.

Moreover, as indicated by similar past cases and the reported number of regulators involved in the investigations, the prolonged and complex nature of the probes and remediation procedures will continue to consume a significant amount of managerial focus and bank resources.

However, the bank's capitalisation is solid: as of 30 June 2020, the bank's Common Equity Tier 1 (CET1) capital ratio was 17.6%. As a response to increased capital requirements and general uncertainty about future regulatory developments, the bank increased its short- to medium-term CET1 target to above 16% in 2019.

Past governance failures also manifest themselves in higher capital requirements: in October 2018, the Danish Financial Supervisory Authority (FSA) required the bank to set aside a minimum of DKK10 billion (around \$1.7 billion) in Pillar II capital (in the form of CET1) to

cover for what the Danish regulatory authority characterised as "heightened compliance and reputational risks." Danske also cancelled its share buyback program in response. In the third quarter of 2019, the Danish FSA ordered the bank to set aside an additional Pillar II add-on of DKK4 billion to reflect "general product governance risk following the Flexinvest Fri³ investigation and increased risk following an inspection of the bank's IT governance structure."

Endnotes

- ¹ The bank ratings shown in this report are the bank's deposit rating, senior unsecured debt rating and Baseline Credit Assessment.
- ² ADRs are negotiable securities that allow US investors to trade non-US shares locally while receiving dividends directly in USD.
- ³ In June 2019, Danske found that it had overcharged customers investing in one of its products, Flexinvest Fri, over a certain period.

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