



RATING ACTION COMMENTARY

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

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[Danske Bank A/S - Cover Pool C](#)

Fitch Ratings - Frankfurt am Main - 11 Mar 2021: Fitch Ratings has affirmed Danske Bank AS's (Danske, A/Negative/F1) mortgage covered bonds secured by the bank's cover pool C at 'AAA' with a Stable Outlook.

KEY RATING DRIVERS

The covered bonds' rating is based on Danske's Long-Term Issuer Default Rating (IDR) of 'A', the various uplifts above the IDR granted to the programme and also considers the over-collateralisation (OC) protection for covered bond holders.

The covered bonds are rated five notches above the bank's IDR. This is out of a maximum achievable uplift of nine notches, consisting of a resolution uplift of two notches, a payment continuity uplift (PCU) of five notches and a recovery uplift of two notches.

Fitch relies on the lowest level of OC of the last 12 months of 20.1%, which provides more protection than Fitch's 'AAA' break-even OC of 17%.

Feedback

The Stable Outlook on Danske's covered bonds reflects the four-notch buffer against a downgrade of the bank's IDR, which has a Negative Outlook.

'AAA' Break-even OC

The unchanged 17% Fitch 'AAA' break-even OC supports timely payments in a 'AA+' stress scenario and a one-notch recovery uplift to 'AAA'.

The enlarged credit loss of currently 16.3% remains the largest component of the break-even OC. In its asset analysis, Fitch applied a benchmark one-year probability of default (PD) of 1.7% for loans secured by Swedish commercial real estate, with a PD floor of 0.5%, and a benchmark one-year PD 2.2% for loans secured by Norwegian commercial real estate (with a floor at 0.5%). The benchmark one-year PDs were reduced by 0.15% for both countries from last year, but still account for the ongoing uncertainties with regard to the Covid-19 pandemic.

The larger credit loss component is driven by the higher proportion of large obligors (increased to 16.3% from 16% in 4Q19) and an increase in geographical concentration (Swedish assets increased to 84% from 67% in 4Q19). For the large obligors, Fitch applies a minimum one-year PD of at least 1%, a correlation uplift of 50% and a recovery rate multiplier of 0.5x, in line with its criteria. In assessing the cover pool's PD, Fitch has assumed a three-year longer maturity for the interest-only loans (28%) than originally scheduled to reflect the longer effective term as those borrowers are expected to seek to refinance their loans at maturity. Fitch also assumed a 40% cure rate in a 'B' scenario.

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

The ALM (assets/liabilities mismatch) loss narrowed to 0.6% from 1.2% previously, as the shorter weighted-average life (WAL) of the bonds of 3.1 years (previously 3.5) is closer to the assets' at 2.8 years. The driving scenario in our cash flow model of high prepayment puts a strain on the negative cost of carry of holding cash before repaying the maturing bonds. In the cash flow modelling, the low and high stressed prepayment rate assumption is 5% and 25%, respectively, and a foreclosure timing assumption of 36 months is applied.

Uplifts

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

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

The recovery uplift for the programme is two notches, as Fitch deems that the foreign-exchange risk in a recovery given default scenario is mitigated by the shorter WAL of the assets than the liabilities'. No other material downside risks to recoveries have been identified.

RATING SENSITIVITIES

Factors that could, individually or collectively, lead to positive rating action/upgrade:

The covered bonds' rating is 'AAA', which is the highest level on Fitch's scale, and therefore cannot be upgraded.

Factors that could, individually or collectively, lead to negative rating action/downgrade:

- Downgrade of Danske's Long-Term IDR by five notches to 'BB+' or below

- Decrease in the level of OC Fitch gives credit to in its analysis to below the 'AAA' break-even OC for the programme of 17.0%

- A fall in the actual OC to the legal minimum of 0% would result in the covered bonds being downgraded to 'AA', three notches above the bank's IDR. The Outlook on the covered bonds' ratings would then be aligned with the Outlook on the bank's IDR.

Pandemic Downside Scenario Stress Sensitivity:

Fitch expects the coronavirus-containment measures to negatively affect the performance of Norwegian and Swedish commercial real-estate loans. However, the covered bonds' rating benefits from a cushion between the OC (20.1%) that Fitch relies upon in its analysis and Fitch's 'AAA' break-even OC (17%). Danske also has eligible

mortgage loans on its balance sheet, allowing it to replenish the cover pool with performing loans. In addition, the rating is well protected by the four-notch buffer against a downgrade of Danske's IDR. Nevertheless, Fitch expects the OC cushion to reduce as a consequence of the coronavirus crisis.

When Fitch performed downside sensitivity scenario stresses to the programme by increasing the cover pool's PD assumption, decreasing recovery rates on the mortgage loans, increasing the obligor concentration, as well as increasing the stressed cost to refinance the cover pool, the current OC still provided sufficient protection for the 'AAA' rating of the programme.

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

BEST/WORST CASE RATING SCENARIO

International scale credit ratings of Financial Institutions and Covered Bond issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of four notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit [\[https://www.fitchratings.com/site/re/10111579\]](https://www.fitchratings.com/site/re/10111579)

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

PUBLIC RATINGS WITH CREDIT LINKAGE TO OTHER RATINGS

The covered bonds' rating is driven by the credit risk of Danske Bank as measured by its Long-Term IDR.

ESG CONSIDERATIONS

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3'. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg

RATING ACTIONS

ENTITY/DEBT	RATING			PRIOR
Danske Bank A/S				
● senior secured, Mortgage Covered Bonds, Cover Pool C	LT	AAA Rating Outlook Stable	Affirmed	AAA Rating Outlook Stable

VIEW ADDITIONAL RATING DETAILS

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Additional information is available on www.fitchratings.com**APPLICABLE CRITERIA**[Structured Finance and Covered Bonds Counterparty Rating Criteria \(pub. 29 Jan 2020\)](#)[Structured Finance and Covered Bonds Counterparty Rating Criteria: Derivative Addendum \(pub. 29 Jan 2020\)](#)[Bank Rating Criteria \(pub. 28 Feb 2020\) \(including rating assumption sensitivity\)](#)[EMEA CMBS and CRE Loan Rating Criteria \(pub. 12 Jun 2020\) \(including rating assumption sensitivity\)](#)[Structured Finance and Covered Bonds Country Risk Rating Criteria \(pub. 23 Sep 2020\)](#)[Structured Finance and Covered Bonds Interest Rate Stresses Rating Criteria \(pub. 13 Nov 2020\)](#)[Covered Bonds Rating Criteria \(pub. 18 Nov 2020\) \(including rating assumption sensitivity\)](#)**APPLICABLE MODELS**

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

Covered Bonds Cash Flow Model, v2.0.1 ([1](#))Portfolio Credit Model, v2.12.0 ([1](#))**ADDITIONAL DISCLOSURES**[Dodd-Frank Rating Information Disclosure Form](#)[Solicitation Status](#)[Endorsement Policy](#)

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Danske Bank A/S

EU Issued

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Feedback

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