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Fitch Affirms Realkredit at 'A'; Outlook Stable

Fitch Ratings - Warsaw - 05 Oct 2022: Fitch Ratings has affirmed Realkredit Danmark A/S's (Realkredit) Long-Term Issuer Default Rating (IDR) at 'A' with a Stable Outlook and Viability Rating (VR) at 'a'. A full list of rating actions is below.

Fitch has withdrawn Realkredit's Support Rating of '1' as it is no longer relevant to the agency's coverage following the publication of its updated Bank Rating Criteria in November 2021. In line with the updated criteria, Fitch has assigned Realkredit a Shareholder Support Rating (SSR) of 'a'.

Key Rating Drivers

Strong Credit Profile: Realkredit's ratings reflect its low risk appetite and strong asset-quality metrics, which balance its monoline business model and undiversified, but stable, earnings. They also reflect Realkredit's entrenched mortgage lending franchise in Denmark, strong capitalisation and manageable reliance on wholesale funding. The bank's IDRs are also underpinned by potential support from its parent, Danske Bank A/S (Danske, A/Stable/a).

Realkredit's Short-Term IDR is the lower of two options mapping to the Long-Term IDR. This reflects our assessment of the bank's funding and liquidity at 'a'.

Capital Fungibility Constraints VR: Realkredit's VR is aligned with Danske's to reflect the high level of capital fungibility between both entities. Consequently, we are likely to retain Realkredit's VR within one notch of that of its parent, unless capital becomes less fungible.

Strong Market Position: Realkredit is the second-largest specialist mortgage bank in Denmark, with a market share of about 25%. It serves all customer segments in Denmark (where the vast majority of its credit exposure resides), while in Sweden and Norway it serves large commercial and residential real estate companies. Its monoline business model is mitigated by its low-risk appetite and stable income.

Strong Asset Quality: Realkredit's asset quality is a rating strength. Credit risk exposure solely comprises mortgage lending, the tight underwriting of which is underpinned by conservative Danish covered-bond and mortgage-lending legislation. Realkredit's loan book is geographically concentrated in Denmark and strongly linked to the performance of the Danish economy and domestic real estate market. The bank enters the current economic downturn with low arrears and default levels. We expect the bank's impaired loan ratio to increase only modestly to 1.6% by end-2023.

Undiversified but Stable Earnings: Realkredit's profitability is weaker than that of similarly rated peers as its income solely relies on lending. Its lack of revenue diversification is offset by limited credit losses and robust cost efficiency. In 2022, we expect its operating profit to rise to 2.8% of risk-weighted assets (RWAs) due to lower RWAs and broadly stable operating profit. In 2023, we expect the ratio to be modestly below 2.5% mainly as a result of higher loan impairment charges and mildly lower net interest income.

Strong Capitalisation: Realkredit's capitalisation is underpinned by its low-risk business model and solid capital surplus over regulatory minimums, giving the bank a sufficient cushion to absorb potential credit losses and RWA inflation. We believe that capital is fungible across the Danske group, but Realkredit is subject to standalone capital requirements, which underpins our view of its capitalisation.

Solely Wholesale-Funded: Realkredit relies extensively on wholesale funding because mortgage lending is, by law, entirely funded by covered bonds in Denmark. We believe the risk of Realkredit not being able to access the covered bond market is low due to strong demand for these bonds from Danish financial institutions, insurance companies and pension funds. Refinancing risk is also mitigated by the bank's good liquidity buffer and potential ordinary support from Danske, if needed.

Shareholder Support Likely: Realkredit's SSR reflects a very high probability that support would be provided by Danske, if required. In Fitch's view, Danske would have a high propensity to support Realkredit given the latter's role as the group's main domestic mortgage provider. Any required support would likely be manageable relative to Danske's ability to provide it.

Rating Sensitivities

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

A downgrade of Danske's VR by more than one notch could lead to a downgrade of Realkredit's ratings, given the high correlation we believe exists between the two ratings.

We would also downgrade Realkredit's VR if we expect its impaired loans ratio to increase durably above 2.5% and its common equity Tier (CET1) ratio to shrink durably below 14%. This could be due to a more severe and prolonged economic downturn than we currently expect.

An adverse change in investor sentiment requiring extraordinary support from the parent, due to a material weakening of Realkredit's ability to access competitively priced covered-bond funding, would be negative for the bank's VR. An increased reliance on international debt investors who could prove less stable during financial stress would also put negative pressure on the ratings.

Realkredit's SSR is sensitive to changes in Danske's IDR or in Danske's propensity to support.

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

Realkredit's IDR and SSR could be upgraded if Danske's IDRs are upgraded, assuming Realkredit retains its important role within the group.

VR ADJUSTMENTS

The business profile score of 'a-' is above the 'bbb' category implied score due to the following adjustment reason: market position (positive).

The capitalisation and leverage score of 'a' is below the 'aa' category implied score due to the following adjustment reasons: risk profile and business model (negative).

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

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

Realkredit's IDRs are aligned with Danske's. Realkredit's SSR is based on likelihood of extraordinary support from Danske, if needed.

ESG Considerations

Unless otherwise stated 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 to the way in which they are being managed by the entity. For more information on our ESG relevance scores, visitwww.fitchratings.com/esg.

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Rating Actions

ENTITY/DEBT	RATING			RECOVERY	PRIOR
Realkredit Danmark A/S	LT IDR	A	Affirmed		A
	ST IDR	F1	Affirmed		F1
	Viability	a	Affirmed		a
	Support	WD	Withdrawn		1
	Shareholder Support	a	New Rating		

RATINGS KEY	OUTLOOK	WATCH
POSITIVE		
NEGATIVE		
EVOLVING		
STABLE		

Applicable Criteria

Bank Rating Criteria (pub.07 Sep 2022) (including rating assumption sensitivity)

Additional Disclosures

Solicitation Status

Endorsement Status

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