Danske Bank A/S

Update

Banks
Universal Commercial Banks
Denmark

Ratings

Foreign Currency

Long-Term IDR	A
Short-Term IDR	F1
Derivative Counterparty Rating	A+(dcr)
Viability Rating	a
Government Support Rating	ns

Sovereign Risk

Long-Term Foreign- and Local-Currency IDR	AAA
Country Ceiling	AAA

Outlooks

Long-Term Foreign-Currency IDR	Stable
Sovereign Long-Term Foreign- and Local-Currency IDR	Stable

Applicable Criteria

Bank Rating Criteria (September 2022)

Related Research

Large European Banks Quarterly Credit Tracker (December 2022)

Resilience Test for Nordic Property Markets (December 2022)

Western European Banks Outlook 2023 (December 2022)

Global Economic Outlook (December 2022)

Highly Rated Nordic Banks Resilient to Downturn (November 2022)

Fitch Affirms Denmark at 'AAA'; Outlook Stable (August 2022)

Analysts

Michal Bryks, FCCA
+48 22 103 3024
michal.bryks@fitchratings.com

Christian Scarafia
+44 20 3550 1012
christian.scarafia@fitchratings.com

Key Rating Drivers

High Credit Quality: Danske Bank A/S's ratings reflect its strong universal banking franchise in Denmark and, increasingly, across the Nordic region. Danske's strong pan-Nordic focus provides stable revenue generation across a wide range of products, while taking on low levels of risk. Its strong financial profile is underpinned by its stable and diversified funding, solid capitalisation and stable asset quality. This offsets its subdued profitability, which has remained under pressure since 2019.

Resolved AML Case: In December 2022, the bank finalised the settlement with the US and Danish authorities regarding past anti-money-laundering (AML) control deficiencies in its Estonian branch, which resulted in a fine for the bank. The penalty was rating neutral and comfortably absorbed by the bank's earnings and capital surplus.

Leading Danish Bank: Danske is the largest bank in Denmark and the second largest in the Nordic region. It is a growing challenger in Sweden, Norway and Finland, and also has a small franchise in Northern Ireland. Its revenue has been broadly stable, with a business model focused on traditional commercial banking, and capturing a larger share of its customers' spending by offering wealth and life insurance products.

Low Risk Profile: Fitch Ratings expects Danske's risk profile to remain resilient to the current economic downturn due to its consistently low-risk and tested underwriting standards. Danske's loan book is diversified by industry and geography, and is prudently collateralised with conservative loan/value ratios. At end-September 2022, 60% of Danske's credit exposure was to low-risk sectors, dominated by mortgage loans, which is a natural asset-quality stabiliser due to historically low levels of impaired loans and muted credit losses.

Stable Asset Quality: Danske enters the economic slowdown with strong asset-quality metrics. Its impaired loans ratio is weaker than at highly rated Nordic peers', but it has been broadly stable since 2018. We expect the bank's impaired loans ratio to rise to 2.8% by end-2023, but loan impairment charges (LICs) should be contained, due to prudent collateralisation and large adjustments to impairment models (34bp of loans).

Profitability Turnaround: The bank's profitability has recently suffered from expensive compliance investments, deposit margin pressure and higher funding cost than peers'. In 2022, we expect a weak operating profit/risk-weighted assets (RWAs) due to inflated costs, subdued trading, insurance and fee income. The ratio should sustainably improve to above 2% in 2023 despite higher LICs. The improvement stems from a gradual completion of remediation projects and a material net interest income (NII) growth due to interest rate hikes.

Solid Capitalisation: Danske's common equity Tier 1 (CET1) ratio decreased modestly to 16.9% at end-September 2022 from 17.1% at end-June 2022, well above its regulatory requirement of 12.4%. Danske's leverage ratio is moderate, but still adequate in light of its low-risk profile. The bank's loss-absorption capacity was sufficient to cushion the fine without material impact on its regulatory capital buffers.

Stable Diversified Funding: Danske is reliant on wholesale funding, like most Nordic banks, due to a well-developed covered bond market matching mortgage lending and structural deposit shortage in the region.

Its well-diversified funding base and an established presence in the international debt markets have been resilient to the negative news from the AML investigations and economic downturns, enabling the bank to execute its funding plan. The bank's low refinancing risk is underpinned by well-spread maturities, a strong captive domestic investor base and ample liquidity surplus.

Rating Sensitivities

Factors that Could, Individually or Collectively, Lead to Negative Rating Action/Downgrade

Fitch could downgrade the bank's ratings if its CET1 ratio surplus over its requirement decreases materially below 250bp (about EUR3 billion), coupled with durably deteriorated profitability and asset quality, which could be triggered by a more severe and prolonged economic downturn than we currently expect.

Factors that Could, Individually or Collectively, Lead to Positive Rating Action/Upgrade

Following the Estonia case settlement, the most likely trigger for an upgrade would be the successful implementation of the bank's transformation plan. This would have to be demonstrated by a durable recovery in the operating profit/RWAs to at least 2.5%. An upgrade would also be contingent on the bank maintaining a CET1 ratio of at least 15%.

Other Debt and Issuer Ratings

Rating Level	Rating
Long- and short-term deposits and senior preferred debt	A+/F1
Senior non-preferred debt	A
Tier 2 subordinated debt	BBB+
Additional Tier 1 notes	BBB-

Source: Fitch Ratings

Danske's Derivative Counterparty Rating (DCR) and its long-term senior preferred debt and deposit ratings are one notch above the Long-Term Issuer Default Rating (IDR), and its long-term senior non-preferred debt is aligned with its Long-Term IDR. This reflects the protection that could accrue to senior creditors from the bank's more junior bank resolution debt and equity buffers. We expect Danske's resolution debt buffer to remain comfortably above 10% of RWAs in the long term, adjusted for Realkredit Danmark A/S (A/Stable/a), its domestic mortgage bank subsidiary, which is excluded from Danske's resolution strategy. At end-June 2022, these buffers were equivalent to 19% of RWAs.

The bank's short-term senior preferred debt and deposit ratings are mapped to their respective long-term ratings and also reflect our assessment of the bank's funding and liquidity at 'a+'.

Danske's Tier 2 debt is rated two notches below its Viability Rating (VR) to reflect the poor recovery prospects of this type of debt. Additional and legacy Tier 1 securities are rated four notches below the VR to reflect their poor recovery prospects (two notches) and high risk of non-performance (an additional two notches). Fitch's assessment is based on an expectation that the bank will continue operating with a CET1 capital ratio comfortably above its maximum distributable amount.

Significant Changes from Last Review

3Q22 Performance Hurt by AML Settlement and Inflated Expenses

Danske's ratings are unaffected by the DKK15.3 billion (about EUR2.1 billion) fine related to past AML control deficiencies in its Estonian branch. The settlement was finalised on 13 December, but Danske provided for the potential fine already in 3Q22 and consequently reported a quarterly loss of almost DKK14 billion. Fitch regards the penalty as a non-operating expense, with a material one-off impact on bottom-line profitability, but neutral for its CET1 ratio. The bank's expectation of an annual loss not higher than DKK5.3 billion, including a one-off gain of about DKK0.4 billion in 4Q22, is credible.

The CET1 ratio impact from the fine was almost fully neutralised by a reversal of proposed dividend, lower RWAs for market risk and lower CET1 capital deduction for the insurance business. The bank's CET1 ratio requirement was lowered by 90bp to 12.4% due to a release of a DKK7.5 billion Pillar 2 capital add-on, earmarked for a potential liability related to the Estonian AML case. The requirement will increase to 13.6% from end-June 2023 due to announced higher countercyclical buffers in Denmark, Sweden and Norway.

The bank's 3Q22 operating profit fell 39% yoy to DKK2.6 billion, mainly due to DKK1.3 billion settlement of errors identified in a legacy debt collection case. Danske also incurred DKK1.6 billion goodwill impairment, which we treat as a non-operating cost. NII was 14% up yoy, benefitting from a significant increase in deposit margins and solid credit demand. The recent rate increases and the withdrawal of domestic negative deposit rates will moderately support NII in 4Q22, and will provide more significant support in 2023. However, credit demand should subside next year due to the economic slowdown. Recurring expenses were in line with the annual target of DKK25.5 billion despite inflation, which we believe bodes well for the bank's ambitious cost reduction target next year.

Danske enters the economic slowdown with strong asset quality metrics, with Stage 3 loans that decreased by 4% qoq, while Stage 2 loans were stable. LICs were only DKK0.4 billion net of releases, and included DKK0.7 billion extra charges related to the settlement of the debt collection case. Credit losses should remain contained in 4Q22 but are likely to increase in 2023.

Contained Asset-Quality Pressure in the Real Estate Exposure

Housing and commercial real estate (CRE) loans represent the largest share of Danske's credit exposure. The risks are rising due to the notably more challenging operating environment, but we expect these portfolios to perform well.

Home prices started falling in summer 2022 in the Nordic region, and we expect that this will continue next year. Most of the large price gains reported during the pandemic since early 2020 could be reversed, with the biggest decline most likely in Sweden. However, the risk of negative equity is low for most borrowers. Fitch expects prices to start to recover in 2024, but it will be different across the region. In Sweden, the price contraction could exceed 20%, but a complete reversal of pandemic gains is unlikely. In Denmark, we forecast nominal home prices to decrease by up to 10% in 2023. The risk of a housing market crash is cushioned by a strong labour market and only a moderate economic downturn in the region that should contain the inflow of forced sellers.

CRE exposure is well-diversified by borrower and geography, and it mainly comprises high-quality borrowers with sustainable income sources. The increasing yield requirements are pushing property prices down, but the refinancing risk should be manageable. Asset-quality pressure in CRE exposure could be amplified if a deeper than originally expected economic downturn materially hurts rental income, while funding costs remain prohibitive and access to the debt markets stays restricted for a prolonged period.

Ratings Navigator

Danske Bank A/S

ESG Relevance:

Banks
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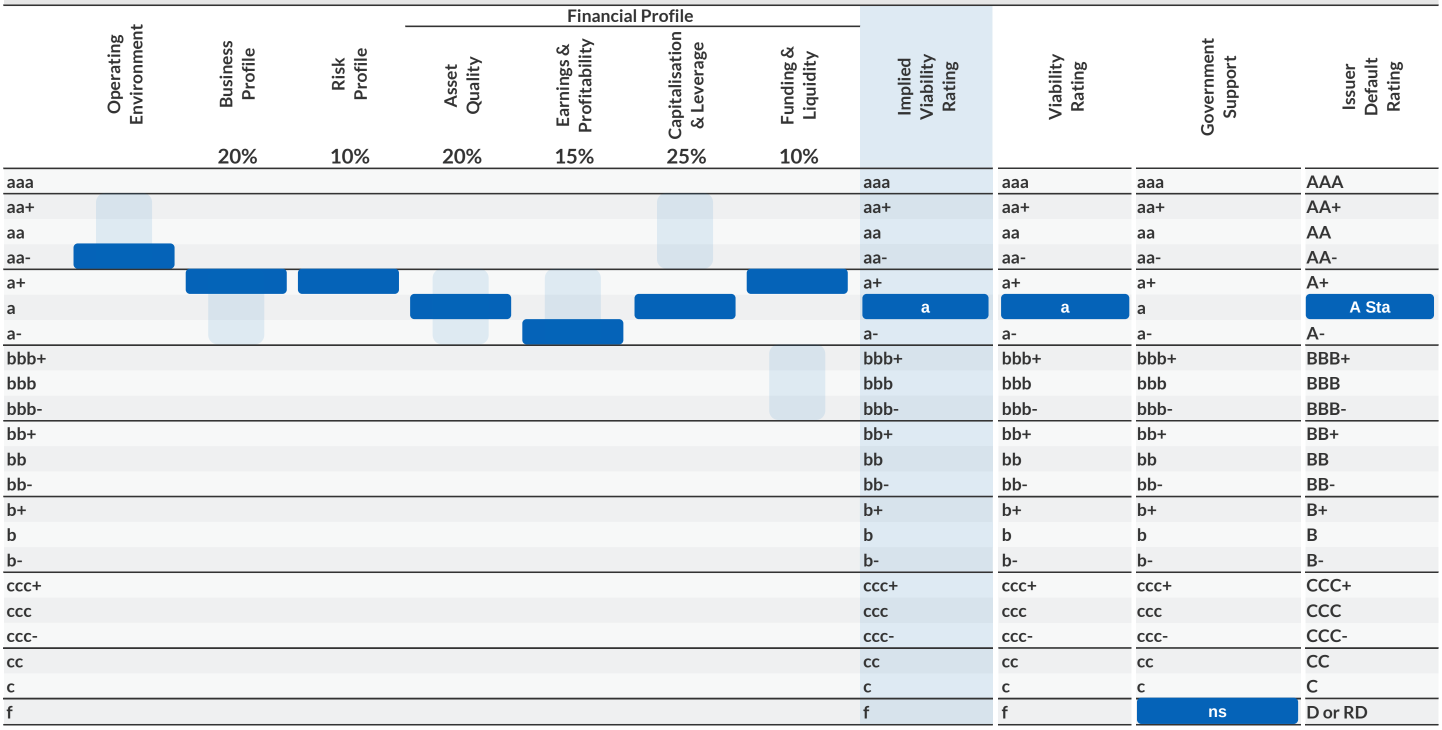

The Key Rating Driver (KRD) weightings used to determine the implied VR are shown as percentages at the top. In cases where the implied VR is adjusted upwards or downwards to arrive at the VR, the KRD associated with the adjustment reason is highlighted in red. The shaded areas indicate the benchmark-implied scores for each KRD.

VR - Adjustments to Key Rating Drivers

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

The funding and liquidity score of 'a+' is above the 'bbb' implied category score due to the following adjustment reasons: liquidity coverage (positive) and non-deposit funding (positive).

Financials

Financial Statements

	30 Sep 22		31 Dec 21	31 Dec 20	31 Dec 19
	9 months - 3rd quarter	9 months - 3rd quarter	Year end	Year end	Year end
	(USDm)	(DKKm)	(DKKm)	(DKKm)	(DKKm)
	Reviewed - unqualified (emphasis of matter)	Reviewed - unqualified (emphasis of matter)	Audited - unqualified	Audited - unqualified	Audited - unqualified
Summary income statement					
Net interest and dividend income	2,681	20,456	26,774	28,118	27,892
Net fees and commissions	1,124	8,572	12,117	10,786	10,469
Other operating income	341	2,598	8,463	7,466	7,875
Total operating income	4,146	31,626	47,354	46,370	46,236
Operating costs	3,050	23,266	30,822	32,821	30,960
Pre-impairment operating profit	1,096	8,360	16,532	13,549	15,276
Loan and other impairment charges	96	730	141	7,090	1,730
Operating profit	1,000	7,630	16,391	6,459	13,546
Other non-operating items (net)	-1,939	-14,791	180	-155	276
Tax	273	2,080	3,651	1,715	-1,250
Net income	-1,211	-9,241	12,920	4,589	15,072
Other comprehensive income	-461	-3,519	326	-230	639
Fitch comprehensive income	-1,673	-12,760	13,246	4,359	15,711
Summary balance sheet					
Assets					
Gross loans	232,355	1,772,570	1,856,064	1,860,621	1,846,233
- Of which impaired	4,383	33,437	43,071	45,523	38,382
Loan loss allowances	2,466	18,814	20,381	20,599	19,248
Net loans	229,889	1,753,756	1,835,683	1,840,022	1,826,985
Interbank	17,534	133,762	33,422	31,453	82,040
Derivatives	71,245	543,506	260,224	379,566	293,980
Other securities and earning assets	214,707	1,637,939	1,434,026	1,489,002	1,410,811
Total earning assets	533,376	4,068,963	3,563,355	3,740,043	3,613,816
Cash and due from banks	26,284	200,515	293,386	320,702	99,035
Other assets	5,597	42,699	79,093	48,486	48,199
Total assets	565,257	4,312,177	3,935,834	4,109,231	3,761,050
Liabilities					
Customer deposits	155,914	1,189,421	1,169,829	1,195,319	964,533
Interbank and other short-term funding	40,491	308,896	320,913	372,010	494,769
Other long-term funding	132,033	1,007,239	1,125,248	1,136,861	1,211,058
Trading liabilities and derivatives	93,918	716,472	374,959	499,335	299,695
Total funding and derivatives	422,356	3,222,028	2,990,949	3,203,525	2,970,055
Other liabilities	120,193	916,914	753,427	727,948	610,473
Preference shares and hybrid capital	2,208	16,846	20,251	17,587	24,251
Total equity	20,500	156,389	171,207	160,171	156,271
Total liabilities and equity	565,257	4,312,177	3,935,834	4,109,231	3,761,050
Exchange rate		USD1 = DKK7.6287	USD1 = DKK6.5749	USD1 = DKK6.1138	USD1 = DKK6.6759

Source: Fitch Ratings, Fitch Solutions, Danske

Key Ratios

	30 Sep 22	31 Dec 21	31 Dec 20	31 Dec 19
Ratios (annualised as appropriate)				
Profitability				
Operating profit/risk-weighted assets	1.2	1.9	0.8	1.8
Net interest income/average earning assets	0.7	0.7	0.8	0.8
Non-interest expense/gross revenue	73.6	65.1	70.6	67.5
Net income/average equity	-7.4	7.8	2.9	10.1
Asset quality				
Impaired loans ratio	1.9	2.3	2.5	2.1
Growth in gross loans	-4.5	-0.2	0.8	2.5
Loan loss allowances/impaired loans	56.3	47.3	45.3	50.2
Loan impairment charges/average gross loans	0.1	0	0.3	0.1
Capitalisation				
Common equity Tier 1 ratio	16.9	17.7	18.3	17.3
Tangible common equity/tangible assets	3.5	4.1	3.7	3.9
Basel leverage ratio	4.6	4.9	4.5	4.7
Net impaired loans/common equity Tier 1	10.3	14.9	17.3	14.4
Funding and liquidity				
Gross loans/customer deposits	149	158.7	155.7	191.4
Liquidity coverage ratio	159.3	163.7	154	140.1
Customer deposits/total non-equity funding	44.2	42.2	41.9	35.8
Net stable funding ratio	126.3	130.5	n.a.	n.a.

Source: Fitch Ratings, Fitch Solutions, Danske

Support Assessment

Commercial Banks: Government Support	
Typical D-SIB GSR for sovereign's rating level (assuming high propensity)	A+ to A-
Actual jurisdiction D-SIB GSR	ns
Government Support Rating	ns
Government ability to support D-SIBs	
Sovereign Rating	AAA/ Stable
Size of banking system	Negative
Structure of banking system	Negative
Sovereign financial flexibility (for rating level)	Positive
Government propensity to support D-SIBs	
Resolution legislation	Negative
Support stance	Neutral
Government propensity to support bank	
Systemic importance	Neutral
Liability structure	Neutral
Ownership	Neutral

The colours indicate the weighting of each KRD in the assessment.
Higher influence Moderate influence Lower influence

Danske's Government Support Rating of 'no support' reflects Fitch's view that senior creditors cannot rely on receiving full extraordinary support from the sovereign in the event of the bank becoming non-viable. The EU's Bank Recovery and Resolution Directive provides a framework for resolving banks that will require senior creditors to participate in losses, if necessary, instead of or ahead of a bank receiving sovereign support.

Environmental, Social and Governance Considerations

FitchRatings **Danske Bank A/S**

Banks
Ratings Navigator

Credit-Relevant ESG Derivation

Danske Bank A/S has 6 ESG potential rating drivers

- Danske Bank A/S has exposure to compliance risks including fair lending practices, mis-selling, repossession/foreclosure practices, consumer data protection (data security) but this has very low impact on the rating.
- Danske Bank A/S has exposure to shift in social or consumer preferences as a result of an institution's social positions, or social and/or political disapproval of core banking practices but this has very low impact on the rating.
- Governance is minimally relevant to the rating and is not currently a driver.

			Overall ESG Scale
key driver	0	issues	5
driver	0	issues	4
potential driver	6	issues	3
not a rating driver	3	issues	2
	5	issues	1

Environmental (E)

General Issues	E Score	Sector-Specific Issues	Reference	E Scale
GHG Emissions & Air Quality	1	n.a.	n.a.	5
Energy Management	1	n.a.	n.a.	4
Water & Wastewater Management	1	n.a.	n.a.	3
Waste & Hazardous Materials Management; Ecological Impacts	1	n.a.	n.a.	2
Exposure to Environmental Impacts	2	Impact of extreme weather events on assets and/or operations and corresponding risk appetite & management; catastrophe risk; credit concentrations	Business Profile (incl. Management & governance); Risk Profile; Asset Quality	1

Social (S)

General Issues	S Score	Sector-Specific Issues	Reference	S Scale
Human Rights, Community Relations, Access & Affordability	2	Services for underbanked and underserved communities: SME and community development programs; financial literacy programs	Business Profile (incl. Management & governance); Risk Profile	5
Customer Welfare - Fair Messaging, Privacy & Data Security	3	Compliance risks including fair lending practices, mis-selling, repossession/foreclosure practices, consumer data protection (data security)	Operating Environment; Business Profile (incl. Management & governance); Risk Profile	4
Labor Relations & Practices	2	Impact of labor negotiations, including board/employee compensation and composition	Business Profile (incl. Management & governance)	3
Employee Wellbeing	1	n.a.	n.a.	2
Exposure to Social Impacts	3	Shift in social or consumer preferences as a result of an institution's social positions, or social and/or political disapproval of core banking practices	Business Profile (incl. Management & governance); Financial Profile	1

Governance (G)

General Issues	G Score	Sector-Specific Issues	Reference	G Scale
Management Strategy	3	Operational implementation of strategy	Business Profile (incl. Management & governance)	5
Governance Structure	3	Board independence and effectiveness; ownership concentration; protection of creditor/stakeholder rights; legal /compliance risks; business continuity; key person risk; related party transactions	Business Profile (incl. Management & governance); Earnings & Profitability; Capitalisation & Leverage	4
Group Structure	3	Organizational structure; appropriateness relative to business model; opacity; intra-group dynamics; ownership	Business Profile (incl. Management & governance)	3
Financial Transparency	3	Quality and frequency of financial reporting and auditing processes	Business Profile (incl. Management & governance)	2
				1

How to Read This Page
ESG scores range from 1 to 5 based on a 15-level color gradation. Red (5) is most relevant and green (1) is least relevant.

The Environmental (E), Social (S) and Governance (G) tables break out the individual components of the scale. The right-hand box shows the aggregate E, S, or G score. General Issues are relevant across all markets with Sector-Specific Issues unique to a particular industry group. Scores are assigned to each sector-specific issue. These scores signify the credit-relevance of the sector-specific issues to the issuing entity's overall credit rating. The Reference box highlights the factor(s) within which the corresponding ESG issues are captured in Fitch's credit analysis.

The Credit-Relevant ESG Derivation table shows the overall ESG score. This score signifies the credit relevance of combined E, S and G issues to the entity's credit rating. The three columns to the left of the overall ESG score summarize the issuing entity's sub-component ESG scores. The box on the far left identifies some of the main ESG issues that are drivers or potential drivers of the issuing entity's credit rating (corresponding with scores of 3, 4 or 5) and provides a brief explanation for the score.

Classification of ESG issues has been developed from Fitch's sector ratings criteria. The General Issues and Sector-Specific Issues draw on the classification standards published by the United Nations Principles for Responsible Investing (PRI) and the Sustainability Accounting Standards Board (SASB).

Sector references in the scale definitions below refer to Sector as displayed in the Sector Details box on page 1 of the navigator.

CREDIT-RELEVANT ESG SCALE

How relevant are E, S and G issues to the overall credit rating?

5	Highly relevant, a key rating driver that has a significant impact on the rating on an individual basis. Equivalent to "higher" relative importance within Navigator.
4	Relevant to rating, not a key rating driver but has an impact on the rating in combination with other factors. Equivalent to "moderate" relative importance within Navigator.
3	Minimally relevant to rating, either very low impact or actively managed in a way that results in no impact on the entity rating. Equivalent to "lower" relative importance within Navigator.
2	Irrelevant to the entity rating but relevant to the sector.
1	Irrelevant to the entity rating and irrelevant to the sector.

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.

The ratings above were solicited and assigned or maintained at the request of the rated entity/issuer or a related third party. Any exceptions follow below.