



## RATING ACTION COMMENTARY

# Fitch Affirms Danske Bank AS's Mortgage Cover Pool C Covered Bonds at 'AAA'; Outlook Stable

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### Related Fitch Ratings Content:

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

Fitch Ratings - Frankfurt am Main - 01 Feb 2022: Fitch Ratings has affirmed Danske Bank AS's (A/Stable/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%, which provides more protection than Fitch's 'AAA' break-even OC of 14.5%.

The Stable Outlook on Danske's covered bonds reflects the four-notch buffer against an issuer downgrade, due to the different uplift factors above the bank's Long-Term IDR.

### 'AAA' Break-even OC

The reduced 14.5% Fitch 'AAA' break-even OC (from 17% at March 2021) supports timely payments in a 'AA+' stress scenario and a one-notch recovery uplift to 'AAA'.

Fitch analysed the commercial portfolio under the Appendix 10 of its Covered Bonds Rating Criteria (Commercial Real Estate Loans Securing Covered Bonds Analysis), which references Fitch's SME Balance Sheet Securitisation Rating Criteria. To derive stressed losses for these assets the agency uses its Portfolio Credit Model, which it recently updated, as detailed in Fitch's updated CLO and Corporate CDO Rating Criteria.

The reduced credit loss of 15.2% (from 16.3% previously) remains the largest component of the break-even OC. In its asset analysis, Fitch applied a benchmark one-year probability of default (PD) of 1.25% (from 1.7% previously) for loans secured by Swedish commercial real estate, with a PD floor of 0.5%, and a benchmark one-year PD of 1.75% (from 2.2% previously) for loans secured by Norwegian commercial real estate (with a floor at 0.5%). The reduction in the target portfolio PD reflects changes to the SME Balance Sheet Securitisation Rating Criteria where Fitch now places more emphasis on the originating bank's observed SME loan book performance. Fitch also gives higher credit to cure rates in the 'AA' to 'B' rating categories and has also retired its coronavirus baseline and downside stress scenarios.

The credit loss component is driven by the proportion of large obligors in the cover pool (increased to 18.9% from 16.3% at March 2021). 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 (26% of the cover pool) 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 -0.7% from 0.6% previously, as the shorter weighted-average life (WAL) of the bonds of 2.5 years (previously 3.1) is closer to that of the assets at 2.6 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 assumptions are 5% and 25%, respectively, and we apply a foreclosure timing assumption of 36 months.

## **Uplifts**

The two-notch resolution uplift reflects that covered bonds issued by retail banks in Denmark are exempt from bail-in. It also considers Fitch's assessment that the risk of under-collateralisation at the point of resolution is sufficiently low and that a resolution of Danske, should it happen, 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. Changes to Denmark's covered bond law, which take effect in July 2022, should clarify how and when maturities could be extended. This will be credit positive for the programme and could lead to an increase of the PCU to six notches.

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 WAL of the assets, which is only marginally longer than that of 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 are rated 'AAA', which is the highest level on Fitch's scale and cannot be upgraded.

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

The 'AAA' rating of Danske's cover pool C mortgage covered bonds would be vulnerable to a downgrade if Danske's Long-Term IDR was downgraded by five notches to 'BB+' or below, or the level of OC Fitch gives credit to in its analysis falls below the 'AAA'

breakeven OC of 14.5%. If the actual OC is reduced to the legal minimum of 0%, the covered bonds would be downgraded to 'AA', three notches above the bank's Long-Term IDR.

## 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

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](http://www.fitchratings.com/esg)

## RATING ACTIONS

ENTITY / DEBT ↕

RATING ↕

PRIOR ↕

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Danske Bank A/S

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senior secured,  
Mortgage Covered  
Bonds, Cover Pool C

LT    AAA Rating Outlook Stable  
  
Affirmed

AAA Rating  
Outlook  
Stable

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## [VIEW ADDITIONAL RATING DETAILS](#)

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issuer(s), if any, did not participate in the rating process, or provide additional information, beyond the issuer's available public disclosure.

## APPLICABLE CRITERIA

[Covered Bonds Rating Criteria \(pub. 02 Jun 2021\) \(including rating assumption sensitivity\)](#)

[EMEA CMBS and CRE Loan Rating Criteria \(pub. 03 Jun 2021\) \(including rating assumption sensitivity\)](#)

[Structured Finance and Covered Bonds Interest Rate Stresses Rating Criteria \(pub. 20 Sep 2021\)](#)

[SME Balance Sheet Securitisation Rating Criteria \(pub. 19 Oct 2021\) \(including rating assumption sensitivity\)](#)

[Structured Finance and Covered Bonds Country Risk Rating Criteria \(pub. 28 Oct 2021\)](#)

[Structured Finance and Covered Bonds Counterparty Rating Criteria: Derivative Addendum \(pub. 04 Nov 2021\)](#)

[Structured Finance and Covered Bonds Counterparty Rating Criteria: Derivative Addendum \(pub. 04 Nov 2021\)](#)

## APPLICABLE MODELS

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

[Covered Bonds Cash Flow Model, v2.0.2 \(1\)](#)

[Portfolio Credit Model, v2.14.0 \(1\)](#)

## ADDITIONAL DISCLOSURES

[Dodd-Frank Rating Information Disclosure Form](#)

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Danske Bank A/S

EU,UK Endorsed

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