FitchRatings

**Banks**
Retail & Consumer Banks
**Denmark**

# Realkredit Danmark A/S

## Key Rating Drivers

**Support-Driven IDRs:** The Issuer Default Ratings (IDRs) and Shareholder Support Rating (SSR) of Realkredit Danmark A/S reflect Fitch Ratings' view of a very high probability of support from Danske Bank A/S (A+/Stable), if ever required. The Stable Outlook on Realkredit's Long-Term IDR mirrors that of the parent.

**Shareholder Support:** In Fitch's view, Danske has a very high propensity to support Realkredit, given the latter's role as the group's domestic mortgage provider (about 40% of the group's total loans). Mortgage lending is an integral part of Danske's domestic business and, as a result, a potential default of Realkredit would constitute huge reputational risk for Danske, and would materially hurt its domestic franchise.

We also take into consideration the high level of management and operational integration, and capital and funding fungibility between Danske and Realkredit. We believe any potentially required support could be material, albeit manageable, relative to Danske's ability to provide it. Realkredit is not included in Danske's single-point-of-entry resolution strategy, but it must observe its own bail-in-able debt buffer requirement, which comprises equity and bonds issued to the parent.

**Strong Intrinsic Creditworthiness:** Realkredit's VR reflects 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.

**Low Risk Profile:** Credit risk exposure solely comprises mortgage lending, with tight underwriting standards underpinned by conservative Danish covered bond and mortgage lending legislation. Its loan book is geographically concentrated in Denmark and strongly linked to the performance of the Danish economy and real estate market.

**Strong Asset Quality:** Realkredit's asset quality is a rating strength, underpinned by low arrears and defaults, prudent collateralisation and underwriting standards, contained growth and low levels of loan impairment charges (LICs) through the cycle. We expect Realkredit's impaired loan ratio to slightly increase to 1.6% by end-2024, while LICs should remain contained at 6bp.

**Moderate but Stable Earnings:** Realkredit's profitability is weaker than that of similarly rated banks as its income almost solely relies on lending. However, the lack of revenue diversification is offset by limited credit losses and robust cost efficiency. In 2023, we expect Realkredit's operating profit to rise to 3.5% of risk-weighted assets (RWAs) due to higher net interest income from its securities portfolio, while LICs should remain contained.

**Strong Capitalisation:** Realkredit's capitalisation is underpinned by its low-risk business model and solid capital surplus over regulatory minimums. We also consider Realkredit's high product concentration and potential ordinary capital support from the parent. Capital fungibility across the Danske group is constrained by Realkredit's standalone prudent capital requirements.

**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.

## Ratings

| | |
|---|---|
| **Foreign Currency** | |
| Long-Term IDR | A+ |
| Short-Term IDR | F1 |
| Viability Rating | a |
| Shareholder Support Rating | a+ |
| **Sovereign Risk (Denmark)** | |
| Long-Term Foreign-Currency IDR | AAA |
| Long-Term Local-Currency IDR | AAA |
| Country Ceiling | AAA |
| **Outlooks** | |
| Long-Term Foreign-Currency IDR | Stable |
| Sovereign Long-Term Foreign-Currency IDR | Stable |
| Sovereign Long-Term Local-Currency IDR | Stable |

## Applicable Criteria

Bank Rating Criteria (September 2023)

## Related Research

Global Economic Outlook – December 2023

Fitch Affirms Denmark at 'AAA'; Outlook Stable (November 2023)

Fitch Upgrades Realkredit to 'A+'; Outlook Stable (September 2023)

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## Rating Sensitivities

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

Realkredit's IDR and SSR would be downgraded if Danske's IDR were downgraded, as Realkredit's ratings are driven by institutional support. Realkredit's IDR and SSR are also sensitive to a weakening of Danske's propensity to support the subsidiary, for example, if Realkredit became a less strategic entity for the group, or if the entity became significantly less integrated within the group, which we do not expect.

We would downgrade Realkredit's VR if we expected its impaired loans ratio to increase durably above 2.5% and its common equity Tier 1 (CET1) ratio to shrink durably below 14%. This could be due to a more severe and prolonged economic downturn than we expect.

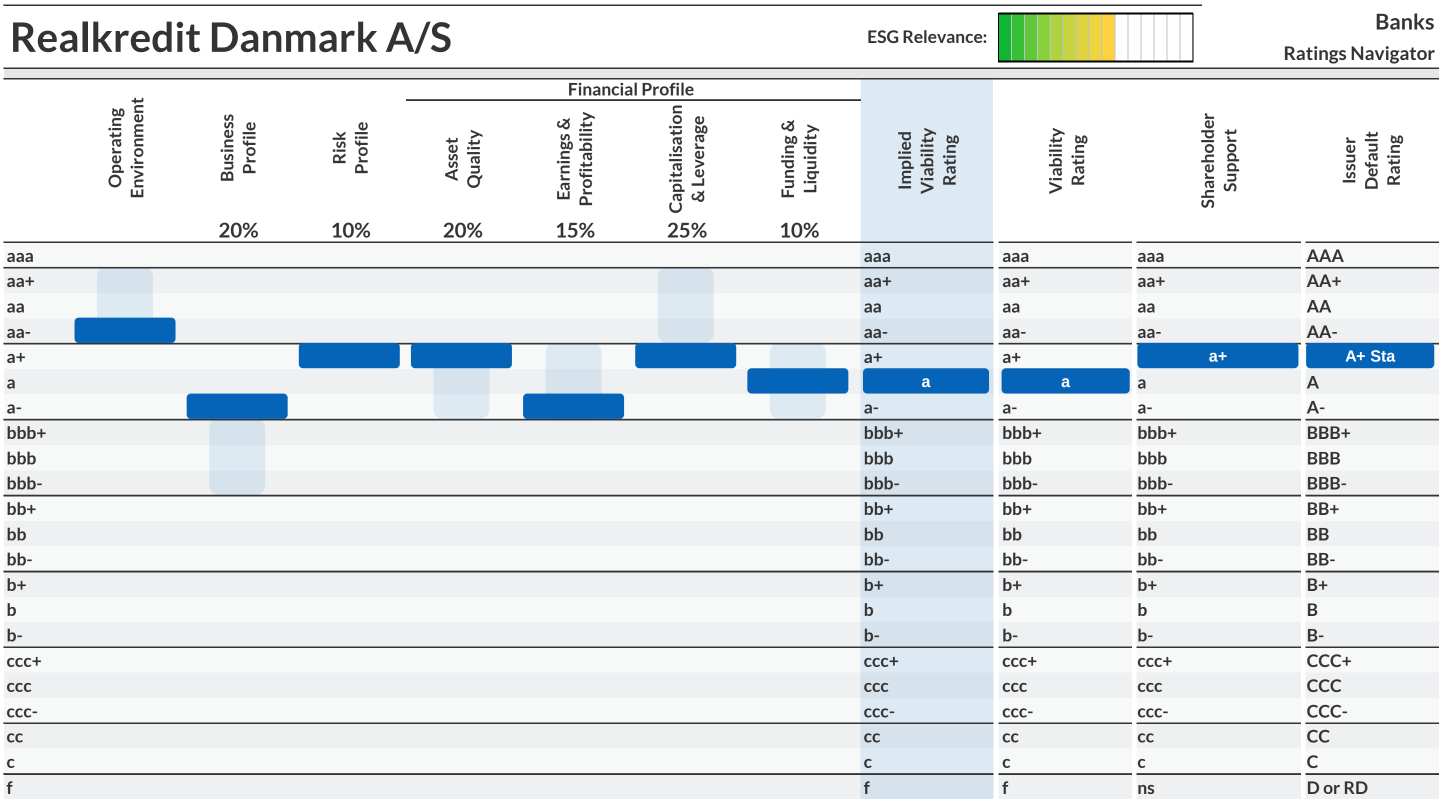
An adverse change in investor sentiment requiring extraordinary support from the parent, due to a material weakening of Realkredit's ability to access competitively priced covered-bond funding, would be negative for the bank's VR. An increased reliance on international debt investors, who could prove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

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

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

Realkredit's VR is constrained by its limited product range. In the longer term, an upgrade would be contingent on the bank broadening its product offering, providing it with significantly more diversified revenue streams.

## Ratings Navigator




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 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).

## Company Summary and Key Qualitative Factors

### Operating Environment

Realkredit's operations are concentrated in Denmark, which presents very good opportunities for banks to be consistently profitable. The economic environment and sovereign credit profile are strong, and structural weaknesses are very limited, underpinned by strong levels of employment and a healthy sovereign fiscal position. We envisage a moderate economic slowdown due to higher interest rates and cost-of-living pressures. Fitch expects real GDP growth for this year of 1.4% and 1.3% both next year and 2025, as capacity and labour market pressures in the economy ease, in the context of interest rates having reached their peak and real incomes recovering.

Danish banks are in a strong position to weather the current economic downturn given their prudent capitalisation and strong asset quality. We expect a moderate rise in bankruptcies, largely coming from financially weaker corporates in the sectors worst hit by the rapid rise in interest rates and higher commodity prices, such as in parts of the agriculture, manufacturing and construction sectors. Residual risk is limited due to conservative provisioning and underwriting standards. Liquidity in the banking sector is ample, and we anticipate wholesale funding markets (covered bonds) to operate normally.

Danish household debt is high in an international context, due to high ownership of dwellings financed by mortgage loans. The reduction in households' overall debt burden has been substantial, with the household debt/disposable income ratio decreasing to 184.4% in 2Q23 (end-2021: 233.5%), driven by the refinancing of fixed-rate mortgage loans to typically variable-rate loans with lower levels of debt.

The lower debt level reduces the risks for the household sector from the impact of higher interest rates, while the higher share of variable rates makes the overall structure of housing loans riskier. There remains a latent risk that some households may face debt-servicing stress from higher interest rates, but the recovery in real incomes expected over the next two years will mitigate this.

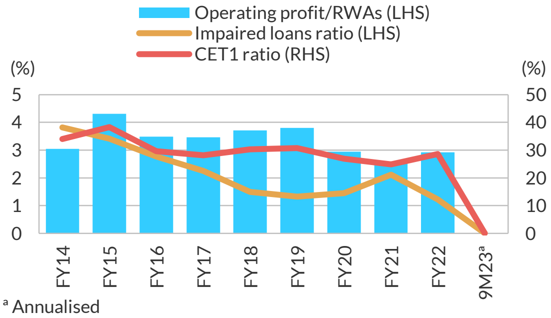
### Business Profile

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. The bank is an integral part of Danske group and is used as the key funding vehicle for domestic mortgage lending. Management and operational integration with the parent are visible in the form of harmonised strategy and risk management.

The bank's income is principally generated from the administrative margin on mortgage loans, which is included in net interest income. Realkredit is significantly less sensitive to changes in interest rates than commercial banks because of the mortgage financing pass-through model in Denmark. Mortgage lending is, by law, financed through covered bonds and Realkredit is a large issuer of these securities domestically and internationally.

Mortgage loans for private individuals and SMEs are distributed through Realkredit's own real estate agency chain and Danske's branch network. The largest customers in Denmark, Norway and Sweden are served by a dedicated unit specialised in property mortgage advisory.

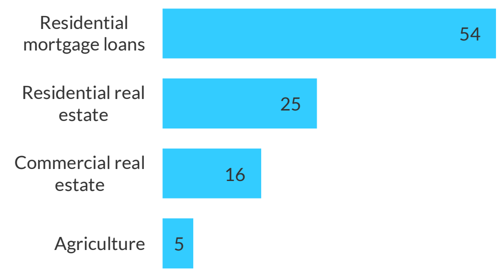
### Performance Through the Cycle




[a] Annualised
Source: Fitch Ratings, Fitch Solutions, Realkredit

### Loan Split by Sector (%)

End-2022




Source: Fitch Ratings, Fitch Solutions, Realkredit

## Risk Profile

The bank's risk controls are robust and its market risk exposure is very low. Realkredit observes tight underwriting standards for mortgage loans, underpinned by the conservative Danish covered bond legislation and regulatory constraints set by the Danish Financial Services Authority. Realkredit applies a loan-to-value (LTV) regulatory cap of 80% for most mortgage loans, and 60% for riskier lending, such as financing for agricultural, office or retail properties.

The average LTV ratio was 51% at end-June 2023 (end-2020: 60%) and less than 2% of lending has an LTV above 80%. Average LTVs have gradually declined across all customer segments since 2H12, driven partly by conservative underwriting standards and partly by increasing property prices. This trend started to reverse in 2022 due to a moderate fall in residential property prices, which we view as a natural cool-off after the pandemic-driven surge in prices over 2020–2021. Lower expected inflation in 2024, together with higher wages and a reduction in mortgage rates, should support stable home prices.

Realkredit's principal segment is residential mortgage loans (owner-occupied housing and holiday homes, about 55% of loans). The remaining segments are mortgage lending to residential rental, commercial real estate and agriculture. We do not expect the bank's segment mix to change in the foreseeable future.

The share of fixed-rate residential mortgage loans was 43% at end-June 2023. We do not believe that the relatively large share of variable-rate loans has a material negative effect on the bank's retail lending profile because of prudent LTV ratios, stress testing of repayment capacity at considerably higher rates, and still fairly long fixed-interest-rate periods in variable lending by international standards (generally at least one year).

The bank stress tests borrowers' repayment capacities during the underwriting of long-term loans with an interest-rate fixed for a short period (such as five years). The customer must be able to service the principal repayments together with an interest rate equal to a fixed rate over 30 years plus 1% (currently about 6%); however, this must not be less than 4%.

In 2022 there was significant re-mortgaging activity in Denmark driven by increasing interest rates, which has significantly reduced the market value of the bank's loan book (down 10% since end-2021). This has now stabilised as interest rates have stabilised, and loan growth in 1H23 was almost flat. We expect annual credit expansion to remain subdued, but from 2H24 lending growth should gradually gain momentum.

Realkredit's very low market risk exposure reflects an insignificant interest rate mismatch between mortgage loans and covered bonds due to the pass-through model. Loans and bonds are carried at fair value because borrowers are entitled to prepay their loan at any time. In addition, Realkredit is obliged by law to invest its equity in high-quality securities, and therefore holds a securities portfolio (6% of total assets at end-June 2023), of which about 40% is measured at fair value.

# Financial Profile

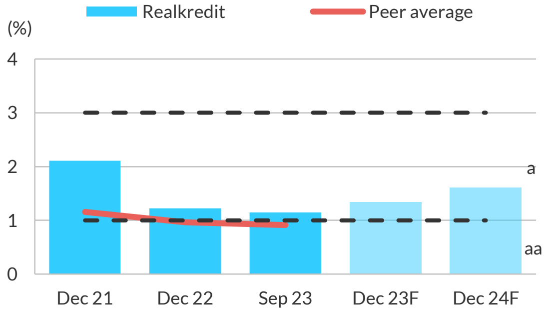
## Asset Quality

Asset-quality metrics have been resilient in recent years due to prudent collateralisation and underwriting standards, the absence of excessive growth, and the strong property market. However, the full effects of higher interest rates have not yet been realised. The bank entered the current economic downturn with low arrears and default levels. We expect the impaired loans ratio to deteriorate slightly to 1.6% by end-2024, given rising interest rates and affordability pressures. LICs should remain contained given the bank's good collateralisation, as only a small 2% of exposures had an LTV above 80%, and 6% had an LTV above 60%.

Realkredit's low coverage of impaired loans by specific loan-loss allowances (end-1H23: 12%) is appropriate given the low LTVs and a long record of low credit losses. LICs had a decade high of about 20bp of gross loans in 2013, and they equalled about 3bp between 2017 and end-June 2023. The Danish legislative framework enforces creditor rights and incentivises mortgage repayment.

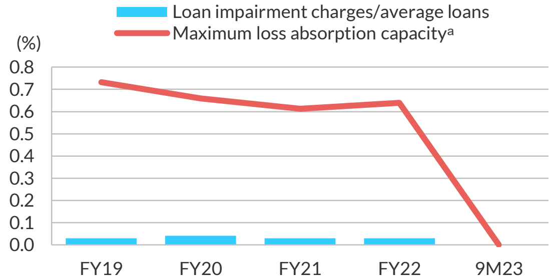
The agriculture portfolio (about 5% of loans) is the riskiest exposure, although we do not expect it to be a source of material losses in the coming periods. The commercial real estate loan portfolio is also a potential source of risk, as higher interest rates will put pressure on interest coverage ratios and yield requirements are rising quickly, which reduces property valuations. However, for material credit losses to arise, it would take a large and prolonged shock to property prices beyond Fitch's current forecasts, coupled with significant volumes of distressed property sales and a worsened economic environment.

### Impaired Loans/Gross Loans




Source: Fitch Ratings, Fitch Solutions, banks

### P&L Loss Absorption Capacity




[a] Pre-impairment operating profit/average loans
Source: Fitch Ratings, Fitch Solutions, banks

## Earnings and Profitability

The bank's overall profitability is moderate, mainly due to thin margins, but it should be viewed in light of its low-risk business model, its healthy and recurring revenue, tight cost control and historically contained credit losses. The bank's income is principally generated from net interest income. Interest-rate cycles have a limited impact on net interest income because the income from mortgage lending is not directly linked to market interest rates. Mortgage loans in Denmark are funded by covered bonds, the cost of which is directly passed on to borrowers, while Realkredit charges an administrative margin, which has been broadly stable through the cycle. However, the bank holds a large debt securities portfolio, the repricing of which will continue to support net interest income.

In 2023 we expect operating profit/RWAs to rise moderately above 3%, but in 2024 the ratio is likely to be lower, mainly due to higher LICs and some manageable inflationary pressure.

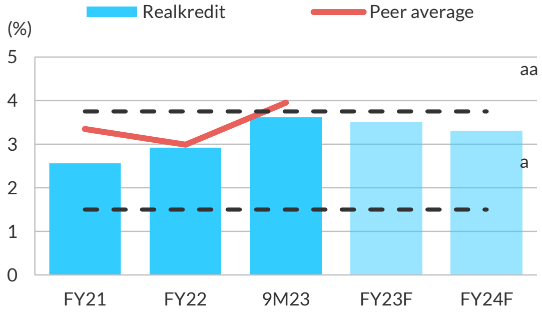
The bank's superior cost efficiency reflects the low burden from overheads that are centralised at the parent level, which we regard as ordinary support due to Realkredit's important role in the group.

## Capital and Leverage

Realkredit's CET1 ratio of 28.6% at end-1H23 benefits from low risk-weights on mortgage loans, but its leverage ratio (end-2022: 5.7%) is adequate in a European context. Realkredit's total regulatory capital ratio (almost solely comprising equity) was about 11pp above the requirement. This level is sufficient to absorb the expected material inflation in RWAs in the coming years as a result of European Banking Authority guidelines and Basel IV.

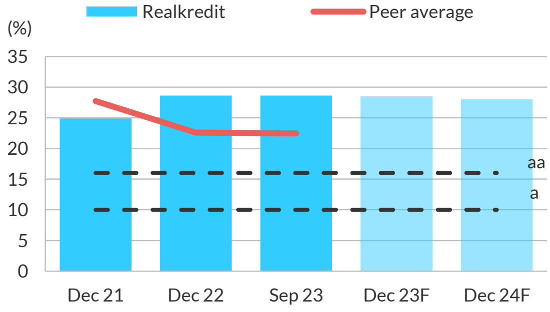
Danish mortgage banks are exempt from the minimum requirements for own funds and eligible liabilities, but must maintain a bail-in-able debt buffer corresponding to 2% of loans. Realkredit observes this buffer using mainly its capital surplus and a small senior non-preferred loan from Danske (DKK2 billion).

### Operating Profit/Risk-Weighted Assets




Source: Fitch Ratings, Fitch Solutions, banks

### CET1 Ratio




Source: Fitch Ratings, Fitch Solutions, banks

## Funding and Liquidity

Realkredit issues covered bonds on an ongoing basis, and loan origination is not dependent on available liquidity. The bank's refinancing risk is mitigated by the efficient Danish covered bond market (including numerous stress periods), refinancing auctions that are distributed quarterly, and loan pricing, promoting loans with less frequent refinancing periods. At end-June 2023, Realkredit's ratio of gross loans/customer deposits plus covered bonds equalled about 100%, and has been stable since.

The covered bond law transfers the refinancing risk in adjustable-rate mortgage loans to the investor (in the event of a failed auction), but this has not been tested yet. We therefore believe it is important for Realkredit to maintain a significant liquidity portfolio to keep investor confidence. This may be particularly important for foreign investors (about 20% of all covered bond investors at end-July 2023).

High asset encumbrance is mitigated by robust asset quality of loans, large overcollateralisation and no other outstanding senior obligations to a third-party creditor. At end-June 2023 Realkredit's liquidity buffer was about double the regulatory requirement (corresponding to at least 2.5% of mortgage loans).

## Additional Notes on Charts

The forecasts in the charts in this section reflect Fitch's forward view on the bank's core financial metrics under Fitch's *Bank Rating Criteria*. They are based on a combination of Fitch's macro-economic forecasts, outlook at the sector level and company-specific considerations. Fitch's forecasts may therefore materially differ from the guidance provided by the rated entity to the market.

To the extent Fitch is aware of material non-public information with respect to future events, such as planned recapitalisations or merger and acquisition activity, Fitch will not reflect these non-public future events in its published forecasts. However, where relevant, such information is considered by Fitch as part of the rating process.

Black dashed lines represent indicative quantitative ranges and implied scores for Fitch's core financial metrics for banks operating in the environments that Fitch scores in the 'aa' category. Light-blue columns represent Fitch's forecasts.

Peer average includes Danske Bank A/S (VR: a+), Nykredit Realkredit A/S (a), Landshypotek Bank AB (a), Coventry Building Society (a-), Principality Building Society (bbb+), Leeds Building Society (a-), Skipton Building Society (a-), Yorkshire Building Society (a-). Latest average uses 1H23 data for Coventry Building Society, Principality Building Society, Leeds Building Society, Skipton Building Society and Yorkshire Building Society.

# Financials

## Financial Statements

| | 30 Jun 23 | | 31 Dec 22 | 31 Dec 21 | 31 Dec 20 |
|---|---|---|---|---|---|
| | 6 months - interim | 6 months - interim | Year end | Year end | Year end |
| | (USDm) | (DKKm) | (DKKm) | (DKKm) | (DKKm) |
| | Unaudited | Unaudited | Audited - unqualified | Audited - unqualified | Audited - unqualified |
| **Summary income statement** | | | | | |
| Net interest and dividend income | 446 | 3,057 | 6,110 | 6,285 | 6,496 |
| Net fees and commissions | 0 | 2 | 18 | -127 | -611 |
| Other operating income | 43 | 295 | -152 | -191 | 294 |
| Total operating income | 489 | 3,354 | 5,976 | 5,967 | 6,179 |
| Operating costs | 75 | 516 | 1,105 | 995 | 864 |
| Pre-impairment operating profit | 414 | 2,838 | 4,871 | 4,972 | 5,315 |
| Loan and other impairment charges | -2 | -14 | 212 | 269 | 335 |
| Operating profit | 416 | 2,852 | 4,659 | 4,703 | 4,980 |
| Tax | 104 | 711 | 1,033 | 1,034 | 1,097 |
| Net income | 312 | 2,141 | 3,626 | 3,669 | 3,883 |
| Other comprehensive income | -2 | -14 | -21 | 13 | 14 |
| Fitch comprehensive income | 310 | 2,127 | 3,605 | 3,682 | 3,897 |
| | | | | | |
| **Summary balance sheet** | | | | | |
| **Assets** | | | | | |
| Gross loans | 106,279 | 728,423 | 727,504 | 813,477 | 819,827 |
| - Of which impaired | 1,223 | 8,382 | 8,858 | 17,139 | 11,925 |
| Loan loss allowances | 413 | 2,833 | 2,862 | 2,930 | 2,801 |
| Net loans | 105,865 | 725,590 | 724,642 | 810,547 | 817,026 |
| Interbank | 335 | 2,295 | 3,149 | 14,969 | 24,993 |
| Derivatives | 7 | 51 | 114 | 40 | 39 |
| Other securities and earning assets | 6,939 | 47,559 | 46,722 | 46,435 | 47,187 |
| Total earning assets | 113,147 | 775,495 | 774,627 | 871,991 | 889,245 |
| Cash and due from banks | 669 | 4,582 | 5,612 | 3,674 | 52 |
| Other assets | 173 | 1,189 | 1,989 | 1,334 | 1,971 |
| Total assets | 113,989 | 781,266 | 782,228 | 876,999 | 891,268 |
| | | | | | |
| **Liabilities** | | | | | |
| Interbank and other short-term funding | 292 | 2,000 | 2,000 | 2,000 | 2,000 |
| Other long-term funding | 105,883 | 725,714 | 724,105 | 820,950 | 835,217 |
| Trading liabilities and derivatives | 9 | 62 | 14 | 16 | 17 |
| Total funding and derivatives | 106,184 | 727,776 | 726,119 | 822,966 | 837,234 |
| Other liabilities | 800 | 5,486 | 6,632 | 4,561 | 4,444 |
| Total equity | 7,004 | 48,004 | 49,477 | 49,472 | 49,590 |
| Total liabilities and equity | 113,989 | 781,266 | 782,228 | 876,999 | 891,268 |
| Exchange rate | | USD1 = DKK6.8539 | USD1 = DKK6.994 | USD1 = DKK6.5749 | USD1 = DKK6.1138 |

Source: Fitch Ratings, Fitch Solutions, Realkredit

## Key Ratios

| | 30 Jun 23 | 31 Dec 22 | 31 Dec 21 | 31 Dec 20 |
|---|---|---|---|---|
| **Ratios (%; annualised as appropriate)** | | | | |
| | | | | |
| **Profitability** | | | | |
| Operating profit/risk-weighted assets | 3.6 | 2.9 | 2.6 | 2.9 |
| Net interest income/average earning assets | 0.8 | 0.8 | 0.7 | 0.7 |
| Non-interest expense/gross revenue | 15.4 | 18.5 | 16.7 | 14.0 |
| Net income/average equity | 8.9 | 7.4 | 7.6 | 8.0 |
| | | | | |
| **Asset quality** | | | | |
| Impaired loans ratio | 1.2 | 1.2 | 2.1 | 1.5 |
| Growth in gross loans | 0.1 | -10.6 | -0.8 | 1.7 |
| Loan loss allowances/impaired loans | 33.8 | 32.3 | 17.1 | 23.5 |
| Loan impairment charges/average gross loans | 0.0 | 0.0 | 0.0 | 0.0 |
| | | | | |
| **Capitalisation** | | | | |
| Common equity Tier 1 ratio | 28.6 | 28.6 | 24.9 | 26.9 |
| Tangible common equity/tangible assets | 6.1 | 6.3 | 5.6 | 5.6 |
| Basel leverage ratio | n.a. | 5.7 | 5.1 | 5.0 |
| Net impaired loans/common equity Tier 1 | 12.2 | 13.2 | 31.1 | 20.0 |
| | | | | |
| **Funding and liquidity** | | | | |
| Gross loans/customer deposits + covered bonds | 100.4 | 100.5 | 99.1 | 98.2 |

Source: Fitch Ratings, Fitch Solutions, Realkredit

## Support Assessment

| Shareholder Support | |
|---|---|
| Parent IDR | A+ |
| Total Adjustments (notches) | 0 |
| Shareholder Support Rating | a+ |
| | |
| **Shareholder ability to support** | |
| Shareholder Rating | A+/ Stable |
| Shareholder regulation | Equalised |
| Relative size | 1 Notch |
| Country risks | Equalised |
| | |
| **Shareholder propensity to support** | |
| Role in group | Equalised |
| Reputational risk | Equalised |
| Integration | Equalised |
| Support record | Equalised |
| Subsidiary performance and prospects | Equalised |
| Legal commitments | 2+ Notches |

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

Realkredit's SSR is equalised with Danske's Long-Term IDR. We believe Danske would have a strong propensity to provide extraordinary support as we consider Realkredit a core and integral part of the group. Danske originates all mortgage loans in Denmark via Realkredit and overall mortgage lending represents the majority of all domestic lending. Realkredit's management and corporate culture are highly integrated into Danske's, and Realkredit shares some central functions and distribution channels with its parent bank, which we regard as ordinary support. Realkredit also benefits from shared risk-management practices within the group. Any required support for Realkredit would be likely to be manageable relative to the ability of Danske to provide it.

## Environmental, Social and Governance Considerations

FitchRatings **Realkredit Danmark A/S**

Banks
Ratings Navigator

### Credit-Relevant ESG Derivation

Realkredit Danmark A/S has 5 ESG potential rating drivers

- Realkredit Danmark 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.
- Governance is minimally relevant to the rating and is not currently a driver.

| | | | ESG Relevance to Credit Rating |
|---|---|---|---|
| key driver | 0 | issues | 5 |
| driver | 0 | issues | 4 |
| potential driver | 5 | issues | 3 |
| not a rating driver | 4 | issues | 2 |
| | 5 | issues | 1 |

### Environmental (E) Relevance Scores

| General Issues | E Score | Sector-Specific Issues | Reference | E Relevance |
|---|---|---|---|---|
| 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) Relevance Scores

| General Issues | S Score | Sector-Specific Issues | Reference | S Relevance |
|---|---|---|---|---|
| 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 | 2 | 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) Relevance Scores

| General Issues | G Score | Sector-Specific Issues | Reference | G Relevance |
|---|---|---|---|---|
| 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 relevance scores range from 1 to 5 based on a 15-level color gradation. Red (5) is most relevant to the credit rating and green (1) is least relevant.

**The Environmental (E), Social (S) and Governance (G) tables** break out the ESG general issues and the sector-specific issues that are most relevant to each industry group. Relevance scores are assigned to each sector-specific issue, signaling the credit-relevance of the sector-specific issues to the issuer's overall credit rating. The Criteria Reference column highlights the factor(s) within which the corresponding ESG issues are captured in Fitch's credit analysis. The vertical color bars are visualizations of the frequency of occurrence of the highest constituent relevance scores. They do not represent an aggregate of the relevance scores or aggregate ESG credit relevance.

**The Credit-Relevant ESG Derivation** table's far right column is a visualization of the frequency of occurrence of the highest ESG relevance scores across the combined E, S and G categories. The three columns to the left of ESG Relevance to Credit Rating summarize rating relevance and impact to credit from ESG issues. The box on the far left identifies any ESG Relevance Sub-factor issues that are drivers or potential drivers of the issuer's credit rating (corresponding with scores of 3, 4 or 5) and provides a brief explanation for the relevance score. All scores of '4' and '5' are assumed to result in a negative impact unless indicated with a '+' sign for positive impact.h 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), the Sustainability Accounting Standards Board (SASB), and the World Bank.

### 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. |

The highest level of ESG credit relevance is a score of '3', unless otherwise disclosed in this section. A score of '3' 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. Fitch's ESG Relevance Scores are not inputs in the rating process; they are an observation on the relevance and materiality of ESG factors in the rating decision. For more information on Fitch's ESG Relevance Scores, visit https://www.fitchratings.com/topics/esg/products#esg-relevance-scores.

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