FitchRatings

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Fitch Affirms Danske Bank A/S's Mortgage Cover Pool C Covered Bonds at 'AAA'; Outlook Stable

Fitch Ratings - Frankfurt am Main - 01 Dec 2023: Fitch Ratings has affirmed Danske Bank A/S's (A+/Stable/F1) mortgage covered bonds secured by the bank's cover pool C at 'AAA' with a Stable Outlook. The affirmation follows Fitch's periodic review of the programme.

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 the over-collateralisation (OC) protection for covered bond holders.

The covered bonds are rated four notches above the bank's IDR. This is out of a maximum achievable uplift of 10 notches, consisting of a resolution uplift of two notches, a payment continuity uplift (PCU) of six notches and a recovery uplift of two notches.

As Danske's IDRs are 'A+'/'F1', Fitch relies on the lowest reported OC over the last 12 months of 20.7%, which provides more protection than Fitch's 'AAA' break-even OC of 18.5%. The Stable Outlook on Danske's covered bonds reflects the six-notch buffer against an issuer downgrade, due to the different uplift factors above the bank's Long-Term IDR.

'AAA' Break-even OC

The 18.5% Fitch 'AAA' break-even OC (up from 17.0% at December 2022) supports timely payments in a 'AA+' stress scenario and a one-notch recovery uplift to 'AAA'. It has been rounded up to the nearest 0.5% in line with Fitch's Covered Bonds Rating Criteria.

Fitch analysed the commercial portfolio under the Appendix 11 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.

The unchanged credit loss of 17.5% remains the largest component of the 'AAA' break-even OC. In its asset analysis, Fitch applied a benchmark one-year probability of default (PD) of 1.25% for loans secured by Swedish commercial real estate, with a PD floor of 0.5%, and a benchmark one-year PD of 1.75% for loans secured by Norwegian commercial real estate (with a floor at 0.5%).

The credit loss component is driven by the proportion of large obligors in the cover pool that have a loan amount greater than 0.5% of the pool, representing 23.2% (vs 22.8% in 3Q22). 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 (25% of the cover pool) than originally scheduled. This reflects the longer effective term as these borrowers are expected to seek to refinance their loans at maturity. Fitch also assumed a 40% cure rate in a 'B' scenario.

The cover pool composition has changed since 3Q22. Norwegian assets have increased, growing to 31% in 3Q23 from 13% in 3Q22. Consequently, there has been a reduction in the percentage of Swedish assets within the pool to 69% in 3Q23 from 87% in 3Q22.

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 has increased to 0.7% from -0.6% previously, driven by the longer weighted-average life (WAL) of the bonds of 3.5 years from 2.8 years previously, while the WAL of the assets is 2.8 years from 2.5 years previously (as per Fitch's classification). 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. Furthermore, a bond issuance in September 2023 at a higher margin led to a decline in the excess spread.

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 six notches, reflecting mortgage covered bonds with a 12-month principal maturity extension and three-month protection for interest payments

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 shorter 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 any of the following occurs: (i) Danske's 'A+' Long-Term IDR is downgraded by seven notches to 'BB' or below; or (ii) the level of OC Fitch gives credit to in its analysis falls below the 'AAA' breakeven OC of 18.5%. If the actual OC reduces to the legal minimum of 2%, the covered bonds would be downgraded to 'AA+', three notches above the bank's IDR.

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 Danske Bank's Long-Term IDR.

ESG Considerations

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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Rating Actions

ENTITY/DEBT	RATING			RECOVERY	PRIOR
Danske Bank A/S					
• senior secured, Mortgage Covered Bonds, Cover Pool C	LT	AAA	Affirmed		

RATINGS KEY	OUTLOOK	WATCH
POSITIVE		
NEGATIVE		
EVOLVING		
STABLE		

Applicable Criteria

Bank Rating Criteria (pub.01 Sep 2023) (including rating assumption sensitivity)

Covered Bonds Rating Criteria (pub.09 Oct 2023) (including rating assumption sensitivity)

Covered Bonds Refinancing Spread Level Assumptions - Supplementary Data File (pub.09 Oct 2023)

EMEA CMBS and CRE Loan Rating Criteria (pub.09 Jun 2023) (including rating assumption sensitivity)

Global Structured Finance Rating Criteria (pub.01 Mar 2023) (including rating assumption sensitivity)

Originator-Specific Residential Mortgage Analysis Rating Criteria (pub.24 Oct 2023) (including rating assumption sensitivity)

Originator-Specific Residential Mortgage Analysis Rating Criteria - Supplementary Data File (pub.24 Oct 2023)

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

Structured Finance and Covered Bonds Counterparty Rating Criteria (pub.28 Nov 2023)

Structured Finance and Covered Bonds Counterparty Rating Criteria: Derivative Addendum (pub.28 Nov 2023)

Structured Finance and Covered Bonds Country Risk Rating Criteria (pub.07 Jul 2023)

Structured Finance and Covered Bonds Interest Rate Stresses Rating Criteria (pub.28 Dec 2022)

Applicable Models

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

Covered Bonds Cash Flow Model, v2.1.4 (1)

Portfolio Credit Model, v2.16.2 (1)

Additional Disclosures

Solicitation Status

Endorsement Status

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The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Fitch also provides information on best-case rating upgrade scenarios and worst-case rating downgrade scenarios (defined as the 99th percentile of rating transitions, measured in each direction) for international credit ratings, based on historical performance. A simple average across asset classes presents best-case upgrades of 4 notches and worst-case downgrades of 8 notches at the 99th percentile. Sector-specific best- and worst-case scenario credit ratings are listed in more detail at https://www.fitchratings.com/site/re/10238496

Endorsement policy

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