

## RATING ACTION COMMENTARY

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

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Fitch Ratings - Frankfurt am Main - 31 Oct 2024: Fitch Ratings has affirmed Danske Bank A/S's (Danske; A+/Stable/F1) mortgage covered bonds secured by cover pool C at 'AAA' with a Stable Outlook.

The affirmation follows Fitch's periodic review of the programme.

## KEY RATING DRIVERS

**Four Notches Above IDR:** 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 Stable Outlook reflects that on Danske Bank's IDR, along with a six-notch buffer against an IDR downgrade.

**Uplifts Granted:** 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.

**Two-notch Resolution Uplift:** 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. The two-notch resolution uplift results in an 'AA' resolution reference point.

**Six-notch PCU:** Fitch's PCU for Danske C programme is six notches, reflecting the principal liquidity protection provided by a 12-month maturity extension and three months protection for interest payments.

**Two-notch Recovery Uplift:** 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 weighted average life of the assets, which is shorter or marginally longer than that of the liabilities. No other material downside risks to recoveries have been identified.

**Cover Pool Description:** In 2Q24, the cover pool consisted of residential (28%) and commercial (72%) real estate properties, located across Norway (33%) and Sweden (67%). The majority of the residential properties are buy-to-let (92.6%) and the remainder owner occupied. The breakdown of commercial properties by type is retail (59.4%), industrial (23.6%), agriculture (15.7%) and other commercial uses (1.3%).

**Relied-Up on OC:** As Danske's IDRs are 'A+'/'F1', Fitch relies on the lowest observed OC over the last 12 months. The relied-up on OC is 20.3% and provides more protection than the increased 'AAA' break-even OC of 20.0%. As of end-June 2024, Danske's cover pool C outstanding covered bonds (DKK38.3 billion equivalent) were secured by DKK46.9 billion equivalent of cover assets, resulting in an OC of 22.5%.

**'AAA' Break-even OC:** The 20.0% Fitch 'AAA' break-even OC (up from 18.5% at December 2023) supports timely payments in a 'AA+' stress scenario and a one-notch recovery uplift to 'AAA'. It is composed of an increased credit loss of 19.3% (up from 17.5%) and the ALM (asset-liability mismatch) loss component of 0.5%, and has been rounded up to the nearest 0.5%, in line with Fitch's Covered Bonds Rating Criteria. The ALM loss has decreased to 0.5% from 0.7% previously.

**Portfolio Concentration Drives Credit Loss:** 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 total pool, representing 23.8% (as per Fitch's calculations). For the large obligors, Fitch applies a minimum one-year probability of default (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 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.

**SME Balance Sheet Criteria:** Fitch analysed the commercial portfolio under Appendix 11 of its Covered Bonds Rating Criteria, which references Fitch's SME Balance Sheet Securitisation Rating Criteria. To derive stressed losses for these assets, the agency used its Portfolio Credit Model. In its asset analysis, Fitch applied a benchmark one-year PD

of 1.25% and 1.75% for loans secured by Swedish and Norwegian commercial real estate, respectively. The PD has a floor of 0.5% for these assets in both pools.

**MVD Assumptions:** 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 the 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.

**Prepayments Assumptions:** 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.

## **RATING SENSITIVITIES**

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

The covered bonds' rating would be vulnerable to a downgrade if any of the following occurs: (i) Danske's 'A+' Long-Term IDR was 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 20.0%.

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.

### **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.

## **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>.

## RATING ACTIONS

ENTITY / DEBT ↕	RATING ↕	PRIOR ↕
Danske Bank A/S		
senior secured, Mortgage Covered Bonds, Cover Pool C	LT AAA Rating Outlook Stable Affirmed	AAA Rating Outlook Stable

[VIEW ADDITIONAL RATING DETAILS](#)

### FITCH RATINGS ANALYSTS

#### Carlos Venegas

Senior Analyst

Primary Rating Analyst

+49 69 768076 128

carlos.venegasmonard@fitchratings.com

Fitch Ratings – a branch of Fitch Ratings Ireland Limited

Neue Mainzer Strasse 46 - 50 Frankfurt am Main D-60311

#### Sebastian Seitz, CFA, CAIA

Director

Secondary Rating Analyst

+49 69 768076 267

sebastian.seitz@fitchratings.com

#### Vessela Krmnicek, CFA

Senior Director

Committee Chairperson

+49 69 768076 298

vessela.krmnicek@fitchratings.com

## **MEDIA CONTACTS**

**Athos Larkou**

London

+44 20 3530 1549

athos.larkou@thefitgroup.com

Additional information is available on [www.fitchratings.com](http://www.fitchratings.com)

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## **APPLICABLE CRITERIA**

[Structured Finance and Covered Bonds Counterparty Rating Criteria \(pub. 28 Nov 2023\)](#)

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

[Global Structured Finance Rating Criteria \(pub. 19 Jan 2024\) \(including rating assumption sensitivity\)](#)

[SME Balance Sheet Securitisation Rating Criteria \(pub. 19 Feb 2024\) \(including rating assumption sensitivity\)](#)

[Bank Rating Criteria \(pub. 15 Mar 2024\) \(including rating assumption sensitivity\)](#)

[Structured Finance and Covered Bonds Country Risk Rating Criteria \(pub. 20 Jun 2024\)](#)

[Covered Bonds Rating Criteria - Effective from 1 August 2024 to 30 October 2024 \(pub. 20 Jun 2024\)](#)

## **APPLICABLE MODELS**

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

Covered Bonds Cash Flow Model, v2.1.7 (1)

Portfolio Credit Model, v2.16.2 (1)

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EU Issued, UK Endorsed

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