Credit Rating Announcement

04 July 2024

# Scope assigns first-time AAA rating for Danske Mortgage Bank PLC's covered bonds. Outlook Stable

**The rating on Danske Mortgage Bank PLC's Finnish mortgage covered bonds (Katettu joukkolaina) reflects the issuer's credit rating enhanced by up to five notches of governance-support based uplift. The cover pool provides additional rating stability.**

## Rating action

Scope Ratings GmbH (Scope) has today assigned AAA ratings on the Finnish mortgage covered bonds (Katettu joukkolaina) issued by Danske Mortgage Bank PLC (Danske Kiinnitysluottopankki Oyj). The outlook is Stable.

## Rating rationale

**Issuer rating (Positive)**. The issuer rating[1] (A+/Stable) on Danske Mortgage Bank Plc (DMB) is aligned with its Danish parent, Danske Bank A/S. Danske Banks assessment reflects the broad diversification of its resilient universal business model, which includes retail and corporate banking, capital market activities, insurance and asset management. In all these areas, the bank has a strong franchise in Denmark and other Nordic markets. The ratings also consider Danske's robust asset quality metrices and an operating performance that provides a solid buffer against potentially increasing cost of risk. Conservative capital buffers and stable and diversified funding and liquidity also add to the rating. Scope considers Danske Mortgage Bank to be fully supported by its parent in case of need given its strategic importance and relevance within the group.

**Governance credit support (Positive)**. Governance support is the primary rating driver, providing the covered bonds with up to five notches of uplift above the issuer rating thereby supporting the highest achievable covered bond rating. Governance support factors are based on Scope's view on: i) the strong legal covered bond framework in Finland; and ii) the credit positive impact of the resolution regime and systemic importance of Danske Mortgage Bank and its mortgage covered bonds. (ESG factor)

Two notches from Scope's legal framework analysis reflect that i) the cover pool is segregated from the parent's insolvency estate; ii) bond payments can continue after insolvency; and iii) identified risks can be mitigated by overcollateralisation, which generally remains available after insolvency. Finnish covered bonds also benefit from iv) specific regulatory oversight as well as liquidity and other risk management guidelines.

Three additional notches reflect Scope's resolution-regime assessment pertinent to DMB. DMB is a Finnish regulated covered bond issuer but in resolution the Danish resolution authority will be the lead supervisor.

Complexity around resolution reinforced by the Finnish less advanced resolution framework and the small to moderate size and relevance of DMB may make an orderly wind-down or sale to another covered bond issuer more likely than a going concern under its Danish parent. We therefore have not assigned the maximum uplift of four notches under our resolution-regime assessment. The three notches of uplift reflect: i) the implementation of the Bank Recovery and Resolution Directive in Finland and the exemption of covered bonds from bail-in; ii) moderate incentives that prevent regulatory intervention in the issuer affecting the covered bonds' credit quality and performance; iii) strong product-, issuer- and country-specific aspects relevant to the systemic importance of covered bonds in Finland; and iv) the pro-active stakeholder Finnish community.

One or more key drivers of the credit rating action are considered an ESG factor.

## Rating-change drivers

Scope's Stable Outlook on the mortgage covered bonds reflects our rating on the issuer, governance support and the strong cover pool. Cover pool support could provide up to three notches of additional uplift. The rating may be downgraded upon: i) an issuer rating downgrade by more than four notches; ii) a deterioration in Scope's view on governance support factors relevant to the issuer and Finnish covered bonds in general and on the interplay between complexity and transparency, and/or iii) the inability of the cover pool to provide an additional uplift in case the issuer rating is downgraded by more than one notch.

## Quantitative analysis and assumptions

Scope performed a cover pool analysis to assess the cover pool's ability to provide additional support should the issuer be downgraded by more than one notch.

**Cover pool support**[2]. The mortgage cover pool could provide additional rating stability. This is reflected by:

1. **Cover pool complexity category**. Scope has assigned the interplay between complexity and transparency with a cover pool complexity risk category of 'Low', allowing for up to three notches of uplift on top of the governance support uplift. This categorisation reflects the ongoing availability of detailed, regular, current and forward-looking transparency on key credit and market risk factors as well as information on lending products, underwriting and credit risk procedures together with visibility on origination and issuance strategy as well as counterparty risk information. (ESG factor)

2. **Overcollateralisation**. The current 29.0% of overcollateralisation as of 31 March 2024 could shield the AAA/ Stable rating against a potential issuer downgrade of up to four notches.

3. **Sound credit quality**. Scope has calculated an annual default probability of 1.0% together with a coefficient of variation of 60%. The base recovery rate stands at 96.8%. The stressed rate at 80.2%. The bonds are covered by a portfolio of domestic owner-occupied mortgage loans. The securing properties are spread in Finland, with a concentration to Uusimaa region in which Finland's capital Helsinki is located. Granularity is high. As of March 2024, the portfolio accounts for 69k loans and a top 10 of only 0.15%. The mortgage loans have a moderately low loan-to-market value of on average 53.0%. NPL's account for 0.1%.

4. **Maturity mismatches driving market risks**. Market risks exist as the programme is exposed to maturity mismatches. The weighted average maturity (WAL) of cover assets of 8.9 years compares to 3.1 years of the liabilities. Such mismatches are partly mitigated by the bond's legal soft-bullet structure

as well as by available overcollateralsiation. Interest rate mismatches from the fixed covered bonds are hedged into floating, matching the asset's profile. The covered bonds are not exposed to FX risks as all assets and bonds are denominated in EUR.

Scope's projections of default on the residential mortgage loans were made using an inverse Gaussian distribution, based on the issuer's performance data, market performance, cover pool characteristics and benchmarking. Scope applied rating distance and location-dependent market value declines ranging between 29%-37%. Scope also applied a fire-sale discount of 20%, reflecting a value discount on properties sold under non-standard or distressed market conditions and 10% of sale costs. Assumptions take into consideration specifics of the Finnish housing market. This results into a stressed security value haircut for the properties securing the mortgage loans of 50-55%. Scope assumed a stressed recovery lag of 24 months and applied servicing fees of 25 bp for the residential mortgage loans.

Scope used the resulting loss distributions and default timings to project the covered bond programme's losses. The analysis incorporates the impact of rating distance-dependent interest rate stresses (+10%/-1%) as well as different prepayment scenarios.
Scope tested for low (1%) and high (up to 15%) prepayments to stress the programme's sensitivity to unscheduled repayments. The programme is most sensitive to low prepayments in combination with decreasing interest rates (-1%). This scenario is driven by maturity mismatches driving asset sales.

To calculate a net present value for the residential cover pool in the event of an asset sale, a liquidity premium of 150bps for the Finnish mortgage loans, which predominantly constitute of private residential and shares in housing companies has been added to the rating distance- and scenario-dependent discount curve.

### Rating driver references

1. Issuer Rating
2. Public disclosure

### Stress testing

No stress testing was performed.

### Cash flow analysis

The Credit Rating uplift is based on a cash flow analysis using Scope Ratings' covered bond model (Covered Bonds Expected Loss Model Version 1.1). The model applies Credit Rating distance-dependent stresses to scheduled cash flows to simulate the impact of increasing credit and market risks. The model outcome is the expected loss for a given level of overcollateralisation.

### Methodology

The methodology used for this Credit Rating and Outlook, (Covered Bond Rating Methodology, 24 May 2023), is available on https://scoperatings.com/governance-and-policies/rating-governance/methodologies.
The model used for this Credit Rating and Outlook is (Covered Bonds Expected Loss Model Version 1.1), available in Scope Ratings' list of models, published under https://scoperatings.com/governance-and-policies/rating-governance/methodologies.
Information on the meaning of each Credit Rating category, including definitions of default, recoveries, Outlooks and Under Review, can be viewed in 'Rating Definitions – Credit Ratings, Ancillary and Other Services', published on https://www.scoperatings.com/governance-and-policies/rating-governance/definitions-and-scales. Historical default rates of the entities rated by Scope Ratings can be viewed in the Credit Rating performance report at https://scoperatings.com/governance-and-policies/regulatory/eu-regulation. Also refer to the central platform (CEREP) of the European Securities and Markets Authority (ESMA): http://cerep.esma.europa.eu/cerep-web/statistics/defaults.xhtml. A comprehensive clarification of Scope Ratings' definitions of default and Credit Rating notations can be found at https://www.scoperatings.com/governance-and-policies/rating-governance/definitions-and-scales. Guidance and information on how environmental, social or governance factors (ESG factors) are incorporated into the Credit Rating can be found in the respective sections of the methodologies or guidance documents provided on https://scoperatings.com/governance-and-policies/rating-governance/methodologies.
The Outlook indicates the most likely direction of the Credit Rating if the Credit Rating were to change within the next 12 to 18 months.

### Solicitation, key sources and quality of information

The Rated Entity and/or its Related Third Parties participated in the Credit Rating process.
The following substantially material sources of information were used to prepare the Credit Rating: public domain, the Rated Entity, and

Scope Ratings' internal sources.
Scope Ratings considers the quality of information available to Scope Ratings on the Rated Entity or instrument to be satisfactory. The information and data supporting the Credit Rating originate from sources Scope Ratings considers to be reliable and accurate. Scope Ratings does not, however, independently verify the reliability and accuracy of the information and data.
Prior to the issuance of the Credit Rating action, the Rated Entity was given the opportunity to review the Credit Rating and Outlook and the principal grounds on which the Credit Rating and Outlook are based. Following that review, the Credit Rating and Outlook were not amended before being issued.

### Regulatory disclosures

The Credit Rating and Outlook are issued by Scope Ratings GmbH, Lennéstraße 5, D-10785 Berlin, Tel +49 30 27891-0. The Credit Rating and Outlook are UK-endorsed.
Lead analyst: Fatemeh Torabi Kachousangi, Specialist
Person responsible for approval of the Credit Rating: Karlo Fuchs, Managing Director
The Credit Rating/Outlook was first released by Scope Ratings on 4 July 2024.

### Potential conflicts

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With more than 300 employees operating from offices in Berlin, Frankfurt, London, Madrid, Milan, Oslo and Paris, Scope Group is the leading European provider of independent credit ratings, ESG analysis and fund research. Based on forward-looking and innovative methodologies, Scope offers a European perspective that contributes to greater diversity of opinion for institutional investors worldwide. Scope Ratings is registered in accordance with the EU rating regulation and operating in the European Union with ECAI status. Scope Ratings is the only European rating agency accepted by the ECB for the Eurosystem Credit Assessment Framework (ECAF). The shareholders of Scope Group include CEO and founder Florian Schoeller and anchor shareholder Stefan Quandt, numerous senior personalities in European finance and industry as well as institutional investors from several European countries. More on www.scopegroup.com

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