

# Various Rating Actions Taken On Five Danish Banks As Denmark's Banking Market Offers Mixed Blessings

October 23, 2019

- We see lower economic risks in Denmark. Private sector leverage and households' vulnerability to interest rate hikes have decreased, and the share of amortizing mortgage loans continues to rise, supporting stability in the banking sector.
- We expect interest rates to remain low and competitive pressure to weigh on the overall sector's profitability, and we see a higher industry risk for local banks.
- Lower economic risks offer an upside in our assessment of the sector's capitalization and additional loss-absorbing capacity (ALAC).
- Substantial ALAC buildup is therefore leading us to raise our ratings on Jyske Bank, maintain our positive outlook on Nykredit Realkredit, and revise our outlook on Danske Bank to stable from negative.
- However, we are revising our outlook on DLR Kredit to stable from positive, owing to sector trends and our view that DLR Kredit's ALAC buffers have not increased.
- We are affirming our ratings and maintaining the stable outlook on Danmarks Skibskredit because its lower exposure to the Danish banking market means it is not directly affected by our economic and industry risk assessments for Denmark.

STOCKHOLM (S&P Global Ratings) Oct. 23, 2019--S&P Global Ratings said today that it had taken the following rating actions on Denmark-based banks it rates:

- We revised the outlook on Danske Bank A/S to stable from negative and affirmed all the ratings.
- We affirmed all the ratings on Nykredit Realkredit A/S and maintained the positive outlook.
- We raised our ratings on Jyske Bank A/S and assigned a stable outlook.
- We revised the outlook on DLR Kredit A/S to stable from positive and affirmed all the ratings.
- We affirmed our ratings and maintained the stable outlook on Danmarks Skibskredit A/S.

The rating actions are driven by our view that the economic risk for banks operating in Denmark has subsided, but industry risks are now higher than before. We see a higher industry risk for local banks, stemming from returning pressure on the sector's earnings. Profitability in the Danish banking market has previously been on an improving trend, with the sector's return on equity (ROE) improving to above 11% in 2017 from negative territory in 2009. The increase was driven

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largely by improving credit conditions and higher pricing in the mortgage segment.

However, systemwide ROE reduced to 8% in 2018 and banks' core earnings have been on a declining trend since 2016 (after excluding fair value adjustments). Moreover, after several years of improvement, mortgage administrative margins are again declining as a result of borrowers moving to less-risky products, and deposit-taking institutions are seeing their interest margins pressured by the country's negative interest rate environment (the central bank deposit rate is -0.75% since September 2019). In addition, mounting price competition in the context of limited credit growth, in particular for corporate clients, and intensifying efforts in compliance and anti-money-laundering further pressure the banking sector's earnings outlook.

Although increased activity in mortgage refinancing should support bank earnings in the short term, we do not expect systemwide ROE to significantly improve from its 2018 level in the next three years, and, hence, we also expect it will remain below ROE in peer countries where we assess competitive dynamics as representing a low risk, such as the other Nordic banking markets, Netherlands, or Australia.

At the same time, we consider that economic risks, and in particular credit risk, have decreased in Denmark. The household sector continues to deleverage as a share of national GDP, with gross debt dropping to 115% in 2018 from 143% in 2009. Furthermore, macroprudential measures are proving successful in continuously increasing the share of mortgages amortizing or with fixed interest rates. We expect both of these trends to continue, and that gross household debt will decrease to 110% of GDP in 2021 from the current 115%.

Still, Danish household indebtedness in terms of disposable income remains one of the highest globally, at 236% in 2018 by our calculation. However, it is mitigated by their high net financial assets and savings, and the effective social security and pension systems, which are all supporting factors in our assessment of economic risks. Consequently, we expect credit losses and nonperforming loans to remain low for banks' exposures in the low-interest-rate environment, despite potential headwinds for the country's economic outlook. We anticipate national house prices will increase only moderately in 2019-2021, and credit losses at a low 4-9 basis points (bps) on an aggregate level, with losses remaining higher for banks than for mortgage institutions.

As a result of lower economic risks, we now apply lower risk-weights to assets located in Denmark in our risk-adjusted capital (RAC) analysis. This leads to higher RAC ratios for all rated Danish entities, and also offers moderate upside to our calculation of the banks' ALAC.

### Danske Bank

We are revising our outlook on Danske Bank and its core subsidiary to stable from negative, and affirming the ratings (see "Danske Bank Outlook Revised To Stable On Increasing Loss Absorption Capacity; 'A/A-1' Ratings Affirmed," published Oct. 24, 2019). We took these actions because of the inclusion of a second ALAC notch, given that its ALAC buffer now exceeds 8% of our risk-weighted assets (RWAs) and our decision to deduct one notch from the issuer credit rating (ICR) due to the continued significant uncertainty related to the regulatory investigations on Danske Bank's Estonian branch. These investigations could weaken the bank's capitalization or business franchise and therefore also weaken our 'a-' assessment of its stand-alone credit profile (SACP).

The stable outlook on Danske Bank incorporates a possible weakening in the bank's stand-alone credit quality due to the ongoing regulatory investigations. This could occur, for example, if the case incurs material damage to the bank's capitalization or franchise. The stable outlook also reflects our expectation that Danske Bank will maintain a very high ALAC and a robust

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capitalization in the next 24 months.

If we revise down the SACP, we would lower our issue ratings on the bank's senior nonpreferred debt and other hybrids.

We could downgrade the bank if the Estonia case eventually resulted in a serious and lasting consequences for both the bank's capitalization and its business franchise. While quite unlikely, we could also lower the rating if the Estonia investigation remained unresolved and we saw a material weakening related to other factors, for example risk appetite, asset quality, or the impact of management changes on the bank's strategy formulation and delivery.

We could upgrade Danske Bank if we believed the bank's ongoing efforts to address historical control deficiencies were proving effective, we had greater clarity over the likely outcome of the regulatory investigations, with manageable regulatory penalties, and if the bank's franchise continues to show resilience. Together, these factors would align the bank's credit quality closer to that of 'A+' rated peers. However, the investigations will likely prolong, so we see little probability of an upgrade in the coming 12-24 months.

Our stable outlook on Danica Pension Livsforsikringsaktieselskab reflects that on Danske Bank. This is because we regard it as a core subsidiary of the bank, and that it would receive support under all foreseeable circumstances if needed.

### Nykredit Realkredit

We affirmed the ratings given our view that Nykredit Realkredit will maintain its dominant role in the Danish mortgage market, as well as its efficient operations and strong capital buffers. The ratings also reflect stability in Nykredit Realkredit's mortgage book and access to the well-functioning Danish covered bond market, even as the bank continues to reshape the maturity profile of its issued securities. Our assessment also factors long-term pressure on net interest income, although high remortgaging activity is supporting the bank's profitability in the near term.

We equalize our ratings on Nykredit Bank A/S with those on its parent. This is based on our assessment of Nykredit Bank as a core subsidiary of the Nykredit group, as defined under our group rating methodology.

We maintained our positive outlook because we think Nykredit Realkredit will continue to increase its subordinated debt buffer by an estimated Danish krone (DKK)20 billion-DKK30 billion and so build ALAC by the end of 2021. All else being equal, we would upgrade Nykredit Realkredit once its ALAC buffer exceeds 8% of our RWAs.

This would have no effect on our assessment of the bank's 'a-' SACP, and so also no effect on our issue ratings on its hybrids.

We could revise the outlook to stable if the bank's subordinated debt issuance seems likely to fall short of our expectation, making it less likely that the bank's ALAC buffer will exceed 8%.

### Jyske Bank

We raised our ICR on the bank to 'A' from 'A-' because of our expectation that its increased ALAC buffer would provide meaningful protection to senior creditors in a resolution scenario. Jyske Bank has been ramping up its issuance of senior nonpreferred instruments since 2018. Applying current risk weights, we estimate that Jyske Bank's ALAC buffer has now sustainably increased above 5% of our RWAs, based on a pro forma RAC calculation of 11.7% for June 2019.

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The outlook on Jyske Bank is stable because we expect that the bank will maintain its ALAC buffer sustainably above 5% of our RWAs in the next 24 months. We also expect that the bank's growth ambitions and dividend payout will not result in deterioration of its strong capitalization. We also expect the bank to maintain its current market position and sound asset quality.

While unlikely, we could lower the ICR if changes in capital distributions or asset growth weakened Jyske Bank's capital adequacy more than we currently expect, resulting in our RAC ratio falling below 10%. Furthermore, we could lower the ICR if the bank's asset quality weakened materially, leading to the need to create substantial new loan loss provisions.

We consider an upgrade remote at this point, even if the bank's ALAC durably exceeded 8% of our RWAs, taking into account the bank's concentration in Denmark and its weaker profitability and asset quality compared with peers in the 'A+' rating category.

### DLR Kredit

We revised our outlook on DLR Kredit to stable from positive to reflect our view of sector trends. We expect that capital and earnings will be strong, with RAC remaining below 15% through 2021. The stable outlook also reflects the bank's access to the well-functioning Danish covered bond market and our expectation that the bank's risk profile is supported to some extent by the fact that the vast majority of its mortgage portfolio will continue to be covered by efficient loss-mitigation agreements with its owner banks, offsetting the risks arising from its revenue concentration in the Danish agriculture and real estate sectors.

We continue to incorporate one notch of uplift into the ICR on DLR Kredit, reflecting our view that ALAC-eligible instruments will continue to sustainably exceed 5.5% of our RWAs over the next 24 months, but will remain below 9%.

We continue to monitor the steady rise in the bank's capitalization, and we could revise up our assessment of the SACP from 'bbb+' if we believed that the RAC ratio would improve comfortably and sustainably beyond 15%. This would benefit our ratings on its hybrid capital instruments, but would not lead us to raise the ICR, given that the ALAC buffer would reduce and the current uplift in the ICR would be eliminated.

We believe that downside risk is rather limited at the moment. However, a negative rating action could be triggered by unexpected, substantial, and protracted deterioration of the bank's financial performance.

### Related Criteria

- General Criteria: Group Rating Methodology, July 1, 2019
- General Criteria: Hybrid Capital: Methodology And Assumptions, July 1, 2019
- Criteria | Financial Institutions | General: Methodology For Assigning Financial Institution Resolution Counterparty Ratings, April 19, 2018
- Criteria | Financial Institutions | General: Risk-Adjusted Capital Framework Methodology, July 20, 2017
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- Criteria | Financial Institutions | Banks: Bank Rating Methodology And Assumptions: Additional Loss-Absorbing Capacity, April 27, 2015

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- Criteria | Financial Institutions | Banks: Assessing Bank Branch Creditworthiness, Oct. 14, 2013
- Criteria | Financial Institutions | Banks: Quantitative Metrics For Rating Banks Globally: Methodology And Assumptions, July 17, 2013
- Criteria | Financial Institutions | Banks: Banks: Rating Methodology And Assumptions, Nov. 9, 2011
- Criteria | Financial Institutions | Banks: Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009
- Criteria | Financial Institutions | Banks: Commercial Paper I: Banks, March 23, 2004

## Related Research

- Various Rating Actions Taken On Danish Banks On Signs Of Reducing Economic Risks; Outlooks Positive, July 13, 2018
- Danske Bank And Jyske Bank Outlooks Revised To Positive On Requirements To Issue Bail-In-Able Debt, April 5, 2018
- Banking Industry Country Risk Assessment: Denmark, March 7, 2018

## Ratings List

	To	From
<b>***** Danske Bank A/S *****</b>		
<b>Danske Bank A/S</b>		
Issuer Credit Rating	A/Stable/A-1	A/Negative/A-1
Nordic Regional Scale	--/--/K-1	--/--/K-1
Resolution Counterparty Rating	A+/-/A-1	A+/-/A-1
Certificate Of Deposit		
Foreign Currency	A/A-1	A-1
Local Currency	A/A-1	A/A-1
Senior Unsecured	A	A
Senior Subordinated	BBB+	BBB+
Subordinated	BBB	BBB
Junior Subordinated	BB+	BB+
Certificate Of Deposit	A	A
Commercial Paper	A	A
Commercial Paper	A-1	A-1
<b>Danica Pension Livsforsikringsaktieselskab</b>		
Issuer Credit Rating	A-/Stable/--	A-/Negative/--
Subordinated	BBB	BBB

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	To	From
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### Danske Bank A/S, Swedish Branch

Issuer Credit Rating	A/Stable/A-1	A/Negative/A-1
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### \*\*\*\*\*Nykredit Realkredit A/S\*\*\*\*\*

#### Nykredit Realkredit A/S

Issuer Credit Rating	A/Positive/A-1	A/Positive/A-1
Resolution Counterparty Rating	A+/--/A-1	A+/--/A-1
Senior Subordinated	BBB+	BBB+
Subordinated	BBB	BBB
Junior Subordinated	BB+	BB+
Junior Subordinated	BBB	BBB

#### Nykredit Bank A/S

Issuer Credit Rating	A/Positive/A-1	A/Positive/A-1
Resolution Counterparty Rating	A+/--/A-1	A+/--/A-1
Certificate Of Deposit	A-1	A-1
Certificate Of Deposit		
Foreign Currency	A	A
Local Currency	A/A-1	A/A-1
Senior Unsecured	A	A

### \*\*\*\*\*Jyske Bank A/S\*\*\*\*\*

#### Jyske Bank A/S

Issuer Credit Rating	A/Stable/A-1	A-/Positive/A-2
Resolution Counterparty Rating	A+/--/A-1	A/--/A-1
Nordic Regional Scale	--/--/K-1	--/--/K-1
Senior Subordinated	BBB+	BBB+
Subordinated	BBB	BBB
Junior Subordinated	BB+	BB+
Certificate Of Deposit		
Foreign Currency	A-1	A-2
Senior Unsecured	A	A-
Commercial Paper	A-1	A-2

#### Jyske Realkredit A/S

Issuer Credit Rating	A/Stable/A-1	A-/Positive/A-2
Resolution Counterparty Rating	A+/--/A-1	A/--/A-1

### \*\*\*\*\*DLR Kredit A/S\*\*\*\*\*

#### DLR Kredit A/S

Issuer Credit Rating	A-/Stable/A-2	A-/Positive/A-2
Resolution Counterparty Rating	A/--/A-1	A/--/A-1
Senior Subordinated	BBB	BBB

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	To	From
<b>***** Danmarks Skibskredit A/S *****</b>		
<b>Danmarks Skibskredit A/S</b>		
Issuer Credit Rating	BBB+/Stable/A-2	BBB+/Stable/A-2

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