FitchRatings

Banks
Retail & Consumer Banks
Denmark

Nykredit Realkredit A/S

Key Rating Drivers

Low Credit Risk: Nykredit Realkredit A/S's (Nykredit) ratings reflect its conservative risk appetite, demonstrated in healthy and resilient through-the-cycle asset-quality metrics and robust capitalisation. They also consider its leading mortgage lending franchise in Denmark, moderate profitability, wholesale funding and ample liquidity.

Robust Capitalisation: Nykredit's strong capital surplus over regulatory minimums gives the bank sufficient cushion to absorb losses and inflation of risk-weighted assets (RWAs). At end-March 2020, the bank's common equity Tier 1 (CET1) ratio of 20.2% was about 500bp above its capital policy target or about 950bp above the capital requirement. In addition, the key owners have earmarked about DKK16.4 billion (about 4% of RWAs at end-March 2020) to recapitalise the bank if needed.

Conservative Risk Appetite: Nykredit's low risk appetite and low-risk business model reflect prudent underwriting standards, robust risk controls, reasonable loan growth and low market risk exposure. Credit risk exposure is dominated by mortgage lending, the tight underwriting of which is underpinned by conservative Danish covered bond and mortgage lending legislation.

Resilient Asset Quality: Asset quality is a key rating strength and we expect it to remain sound during the economic downturn. We expect impaired loans to increase, but credit quality in personal mortgage loans (60% of all loans) should hold up reasonably well, assuming an only moderate increase in unemployment.

Profitability Headwinds: Nykredit's results will be challenged in 2020 due to high loan impairment charges (LICs) and valuation losses on financial assets. Earnings will be moderately eroded by slower loan demand, although this will be partly cushioned by solid re-mortgaging activity until mid-March 2020.

Low Refinancing Risk: Nykredit relies extensively on wholesale funding because mortgage lending is by law entirely funded by covered bonds in Denmark. Fitch Ratings believes that the risk of Nykredit not being able to access the covered bond market is low, due to the strong demand for these bonds from Danish financial institutions, insurance companies and pension funds. Refinancing risk is mitigated by the bank's limited use of short-term debt and significant liquidity.

Rating Sensitivities

Stable Outlook: Nykredit's ratings have sufficient headroom to withstand various downside scenarios to Fitch's baseline economic forecast. However, the ratings could be downgraded if the economic and financial market disruption arising from the pandemic is materially worse than expected, which would place severe and sustained pressure on the group's asset quality and earnings.

Material Capital Erosion: We would downgrade Nykredit's ratings if we think it will not be able to maintain its CET1 ratio above 14% or restore it to that level within a short period of time. This could be due to significantly higher than expected LICs driven by a prolonged recession, high unemployment and material property price correction.

Funding Access: Pressure on the ratings would also arise from an adverse change in investor sentiment materially affecting Nykredit's ability to access competitively priced funding or from weaker liquidity management. An increased reliance on international debt investors that may prove less stable during financial stress or increasing risk appetite – particularly at its subsidiary Nykredit Bank A/S – would also put pressure on ratings.

Ratings

Foreign Currency	
Long-Term IDR	A
Short-Term IDR	F1
Viability Rating	a
Support Rating	5
Support Rating Floor	NF
Sovereign Risk	
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 (February 2020)

Related Research

Global Economic Outlook: June 2020 - Coronavirus Disruption Easing

Fitch Revises Outlook on Nykredit to Stable; Affirms at 'A' (June 2020)

Coronavirus Leads to Rating Actions on Nine Nordic Banking Groups (April 2020)

Nykredit Realkredit A/S Rating Report (April 2020)

Analysts

Michal Bryks, FCCA
+48 22 338 6293
michal.bryks@fitchratings.com

Erik Rankeskog
+46 85510 9445
erik.rankeskog@fitchratings.com

Related Issuer Ratings

Rating level	Nykredit Bank A/S
Long-Term IDR	A/Stable
Short-Term IDR	F1
Support Rating	1
Long- and short-term deposits and senior preferred debt	A+/F1

Source: Fitch Ratings

Nykredit Bank's Issuer Default Ratings (IDRs) and debt ratings are aligned with those of Nykredit. The Support Rating of '1' reflects the subsidiary's core position within the Nykredit group, including full ownership, a strong support record and high reputational risk from a default of the subsidiary. We have not assigned a Viability Rating (VR) to the subsidiary because it does not have a meaningful standalone franchise that could exist without the ownership of the parent, due to its close integration into the larger group (including various shared services).

Nykredit Bank's long-term senior preferred debt and deposits are rated one notch above its Long-Term IDR because Fitch expects senior preferred creditors to be protected from losses by Nykredit's resolution buffers. Nykredit Bank's short-term senior preferred debt and deposit ratings of 'F1' are mapped from the respective long-term ratings and reflect our assessment of the group's funding and liquidity.

Debt Rating Classes

Rating level	Rating
Long-term and short-term senior preferred debt	A+/F1
Senior non-preferred debt	A
Subordinated debt and Tier 2 contingent capital notes	BBB+
Additional Tier 1 notes	BBB-

Source: Fitch Ratings

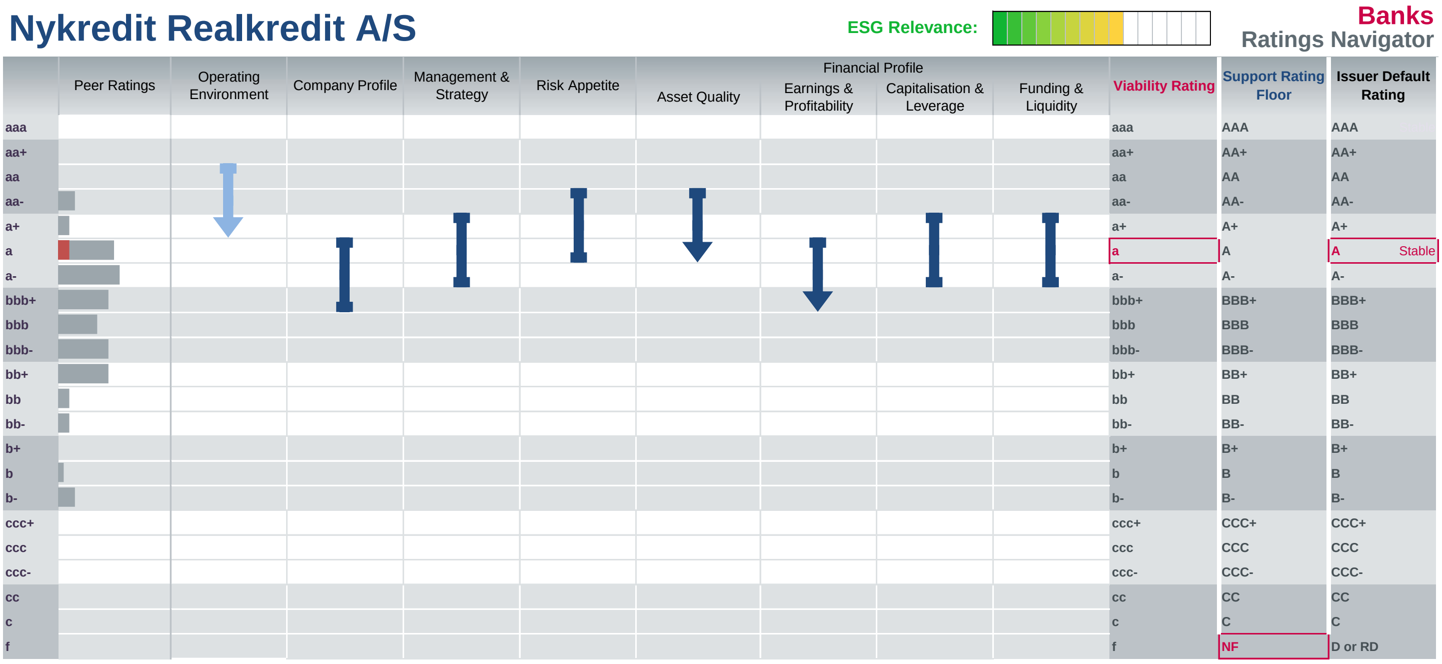
Nykredit's long-term senior preferred debt rating is one notch above the entity's Long-Term IDR because preferred notes have preferential status over the large buffers of qualifying junior debt and senior non-preferred debt. At end-March 2020, this buffer was almost 14% of RWAs and we expect it to remain comfortably above 10%.

Nykredit is subject to Danish resolution requirements, including a debt buffer equal to at least 2% of mortgage lending for the mortgage institution and minimum requirements for eligible liabilities (MREL) at Nykredit Bank. In addition, from 2022, the group's own funds, liabilities eligible for bail-in and debt buffer should be at least 8% of the consolidated balance sheet.

Subordinated debt and other hybrid capital issued by Nykredit are all notched down from its VR. We rate subordinated debt two notches below Nykredit's VR to reflect the higher than average loss severity of this type of debt.

Nykredit's additional Tier 1 securities are rated four notches below its VR. This is to reflect the higher than average loss severity of these securities (two notches) as well as the high risk of non-performance (two notches). Our assessment is based on Nykredit operating with a CET1 ratio that is comfortably above maximum distributable amount thresholds and our expectation that this will continue.

Ratings Navigator



Significant Changes

Resilience to Coronavirus Stress

Nykredit enters the economic downturn from a position of strength relative to its VR of 'a'. However, the coronavirus disruption will hurt the bank's performance due to the expected recession in 2020 followed by a prolonged recovery, contingent on the health crisis easing in 2H20.

Nykredit revised its 2020 pre-tax profit guidance to DKK2.5 billion-DKK3.5billion, which appears realistic assuming a gradual economic recovery. High re-mortgaging activity in 1Q20 should cushion earnings pressure from a likely lower credit demand. In 1Q20, LICs reached 38bp (annualised) of average gross loans (compared with a single-digit ratio in 2016-2019) and will remain elevated. The loss on financial assets (eroding almost all pre-impairment operating profit in 1Q20) should partly recover due to stabilisation on the financial markets. We expect the bank to maintain its tight cost control, although expenses in 2020 will increase due to the full-year impact of acquisitions made in 2019 and investments in compliance.

The bank's strong starting point implies only remote prospects of material asset-quality deterioration, even under downside scenarios to our baseline. We expect the bank's Stage 3 ratio (under 1% at end-March 2020) to increase, but remain below 2% under our baseline scenario. Asset-quality downside risks arise from Nykredit's moderate exposure to sectors that could be particularly hit in the near term, including, hotels, restaurants, non-food retail, transportation, construction and manufacturing (about 5% of loans). Asset-quality headwinds are mitigated by generous government support measures, demonstrated in low demand for payment holidays and debt restructuring. Most relief measures will end in July 2020, but we expect the government to extend support given its comfortable fiscal space.

In May 2020, the Danish FSA introduced a cap on MREL subordination requirement. This is largely neutral for Nykredit group's senior debt issuance plans because mortgage banks are exempt from MREL. Nykredit has issued about DKK7.5 billion (net) senior debt (mostly preferred) in April-July 2020 and plans to reach DKK10 billion-DKK15 billion by end-2020.

Bar Chart Legend

Vertical bars – VR range of Rating Factor

Bar Colors – Influence on final VR

- Higher influence
- Moderate influence
- Lower influence

Bar Arrows – Rating Factor Outlook

⇧ Positive	⇩ Negative
⇳ Evolving	▫ Stable

Summary Financials and Key Ratios

	31 Mar 20		31 Dec 19	31 Dec 18	31 Dec 17
	3 months - 1st quarter (USDm) Unaudited	3 months - 1st quarter (DKKm) Unaudited	Year end (DKKm) Audited - unqualified	Year end (DKKm) Audited - unqualified	Year end (DKKm) Audited - unqualified
Summary income statement					
Net interest and dividend income	421	2,871	11,207	11,019	11,618
Net fees and commissions	11	76	-433	-488	-232
Other operating income	-217	-1,476	3,764	1,781	4,321
Total operating income	216	1,471	14,538	12,312	15,707
Operating costs	208	1,416	5,346	4,890	5,068
Pre-impairment operating profit	8	57	9,197	7,413	10,660
Loan and other impairment charges	192	1,312	995	380	379
Operating profit	-184	-1,255	8,202	7,033	10,281
Other non-operating items (net)	n.a.	n.a.	564	0	-200
Tax	-55	-376	1,339	1,293	2,077
Net income	-129	-879	7,427	5,740	8,004
Other comprehensive income	-2	-15	22	-7	-5
Fitch comprehensive income	-131	-894	7,449	5,733	7,999
Summary balance sheet					
Assets					
Gross loans	200,292	1,365,151	1,361,342	1,262,502	1,227,999
- Of which impaired	1,955	13,325	13,683	13,088	18,044
Loan loss allowances	1,324	9,024	7,891	7,643	7,601
Net loans	198,968	1,356,127	1,353,451	1,254,859	1,220,398
Interbank	4,360	29,714	48,927	19,188	43,728
Derivatives	3,422	23,322	21,500	18,457	19,269
Other securities and earning assets	23,177	157,973	167,968	138,549	132,124
Total earning assets	229,927	1,567,136	1,591,846	1,431,053	1,415,519
Cash and due from banks	1,656	11,287	7,210	8,861	2,070
Other assets	1,909	13,014	11,263	8,062	9,157
Total assets	233,492	1,591,437	1,610,319	1,447,976	1,426,746
Liabilities					
Customer deposits	11,817	80,544	85,375	76,918	75,914
Interbank and other short-term funding	5,056	34,460	29,195	31,937	30,033
Other long-term funding	199,699	1,361,110	1,381,228	1,229,830	1,213,567
Trading liabilities and derivatives	3,039	20,712	17,580	17,323	15,211
Total funding	219,611	1,496,826	1,513,378	1,356,008	1,334,725
Other liabilities	1,631	11,117	12,575	12,085	13,251
Preference shares and hybrid capital	560	3,816	3,777	3,772	3,765
Total equity	11,690	79,678	80,589	76,111	75,005
Total liabilities and equity	233,492	1,591,437	1,610,319	1,447,976	1,426,746
Exchange rate		USD1 = DKK6.8158	USD1 = DKK6.6759	USD1 = DKK6.5194	USD1 = DKK6.2077

Source: Fitch Ratings, Fitch Solutions, Nykredit Realkredit A/S

Summary Financials and Key Ratios

	31 Mar 20	31 Dec 19	31 Dec 18	31 Dec 17
Ratios (annualised as appropriate)				
Profitability				
Operating profit/risk-weighted assets	-1.3	2.2	2.1	3.1
Net interest income/average earning assets	0.7	0.7	0.8	0.8
Non-interest expense/gross revenue	96.3	36.8	39.7	32.3
Net income/average equity	-4.4	9.6	7.7	11.1
Asset quality				
Impaired loans ratio	1.0	1.0	1.0	1.5
Growth in gross loans	0.3	7.8	2.8	3.3
Loan loss allowances/impaired loans	67.7	57.7	58.4	42.1
Loan impairment charges/average gross loans	0.4	0.1	0.0	0.0
Capitalisation				
Common equity Tier 1 ratio	20.2	19.5	21.0	20.6
Tangible common equity/tangible assets	4.9	4.9	5.2	5.2
Basel leverage ratio	4.7	4.4	4.8	4.6
Net impaired loans/common equity Tier 1	5.6	7.8	7.5	15.1
Funding and liquidity				
Loans/customer deposits	1,694.9	1,594.5	1,641.4	1,617.6
Liquidity coverage ratio	385.0	955.0	752.0	383.0
Customer deposits/funding	5.4	5.7	5.7	5.7
Net stable funding ratio	n.a.	n.a.	n.a.	n.a.

Source: Fitch Ratings, Fitch Solutions, Nykredit Realkredit A/S

Sovereign Support Assessment

Support Rating Floor			Value
Typical D-SIB SRF for sovereign's rating level (assuming high propensity)			A+ to A-
Actual country D-SIB SRF			NF
Support Rating Floor:			**NF**
Support Factors	Positive	Neutral	Negative
Sovereign ability to support system			
Size of banking system relative to economy			✓
Size of potential problem	✓		
Structure of banking system			✓
Liability structure of banking system		✓	
Sovereign financial flexibility (for rating level)			✓
Sovereign propensity to support system			
Resolution legislation with senior debt bail-in			✓
Track record of banking sector support		✓	
Government statements of support		✓	
Sovereign propensity to support bank			
Systemic importance		✓	
Liability structure of bank		✓	
Ownership		✓	
Specifics of bank failure		✓	
Policy banks			
Policy role			
Funding guarantees and legal status			
Government ownership			

Nykredit's Support Rating of '5' and Support Rating Floor of 'No Floor' reflect Fitch's view that senior creditors cannot rely on receiving extraordinary support from the Danish sovereign in the event that the bank becomes non-viable. The EU's Bank Recovery and Resolution Directive provides a framework for resolving banks that is likely to require senior creditors participating in losses, if necessary, instead of, or ahead of, a bank receiving sovereign support.

Environmental, Social and Governance Considerations

FitchRatings

Nykredit Realkredit A/S

Banks
Ratings Navigator

Credit-Relevant ESG Derivation

Nykredit Realkredit A/S has 5 ESG potential rating drivers

- Nykredit Realkredit 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.

			Overall ESG Scale
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)

General Issues	E Score	Sector-Specific Issues	Reference	E Scale
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	Company Profile; Management & Strategy; Risk Appetite; Asset Quality	1

Social (S)

General Issues	S Score	Sector-Specific Issues	Reference	S Scale
Human Rights, Community Relations, Access & Affordability	2	Services for underbanked and underserved communities: SME and community development programs; financial literacy programs	Company Profile; Management & Strategy; Risk Appetite	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; Company Profile; Management & Strategy; Risk Appetite	4
Labor Relations & Practices	2	Impact of labor negotiations, including board/employee compensation and composition	Company Profile; Management & Strategy	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	Company Profile; Financial Profile	1

Governance (G)

General Issues	G Score	Sector-Specific Issues	Reference	G Scale
Management Strategy	3	Operational implementation of strategy	Management & Strategy	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	Management & Strategy; Earnings & Profitability; Capitalisation & Leverage	4
Group Structure	3	Organizational structure; appropriateness relative to business model; opacity; intra-group dynamics; ownership	Company Profile	3
Financial Transparency	3	Quality and frequency of financial reporting and auditing processes	Management & Strategy	2
				1

How to Read This Page
ESG scores range from 1 to 5 based on a 15-level color gradation. Red (5) is most relevant and green (1) is least relevant.

The Environmental (E), Social (S) and Governance (G) tables break out the individual components of the scale. The right-hand box shows the aggregate E, S, or G score. General Issues are relevant across all markets with Sector-Specific Issues unique to a particular industry group. Scores are assigned to each sector-specific issue. These scores signify the credit-relevance of the sector-specific issues to the issuing entity's overall credit rating. The Reference box highlights the factor(s) within which the corresponding ESG issues are captured in Fitch's credit analysis.

The Credit-Relevant ESG Derivation table shows the overall ESG score. This score signifies the credit relevance of combined E, S and G issues to the entity's credit rating. The three columns to the left of the overall ESG score summarize the issuing entity's sub-component ESG scores. The box on the far left identifies some of the main ESG issues that are drivers or potential drivers of the issuing entity's credit rating (corresponding with 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 Priniciples for Responsible Investing (PRI) and the Sustainability Accounting Standards Board(SASB).

Sector references in the scale definitions below refer to Sector as displayed in the Sector Details box on page 1 of the navigator.

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'. This means ESG issues are credit-neutral or have a minimal credit impact on the entity, either due to their nature or to the way in which they are being managed by the entity. For more information on our ESG Relevance Scores, visit www.fitchratings.com/esg.

The ratings above were solicited and assigned or maintained at the request of the rated entity/issuer or a related third party. Any exceptions follow below.