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Fitch Affirms Nykredit Realkredit A/S at 'A'; Outlook Stable

Fitch Ratings - Warsaw - 11 Jun 2021: Fitch Ratings has affirmed Nykredit Realkredit A/S's (Nykredit) and its subsidiary Nykredit Bank A/S's Long-Term Issuer Default Ratings (IDRs) at 'A' with Stable Outlooks and Short-Term IDRs at 'F1'. Fitch has also affirmed Nykredit's Viability Rating (VR) at 'a'. A full list of rating actions is below.

Key Rating Drivers

IDRS, VR AND SENIOR NON-PREFERRED DEBT

Nykredit's ratings reflect its conservative risk appetite, demonstrated by 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.

The Stable Outlook reflects our view that the bank's financial profile is likely to remain resilient under various possible downside scenarios to our baseline expectation of steady economic recovery (with 3.1% GDP growth in Denmark in 2021 and 3.5% in 2022), with limited asset quality deterioration and manageable loan impairment charges (LICs) in a downside.

Nykredit is a leading Danish mortgage lender. Its market share has been stable (about 44% at end-March 2021), reflecting the bank's well-entrenched market position. The bank has limited direct exposure to industries that are vulnerable to the economic implications of the coronavirus pandemic. Its loan book is geographically concentrated in Denmark and is therefore strongly linked to the performance of the Danish economy.

Nykredit's asset quality is a key rating strength. Although we expect impaired loans to increase, we believe that credit quality in personal mortgage loans (61% of all loans) will hold up reasonably well, assuming an only moderate spike in unemployment. At end-March 2021, impaired loans (Stage 3 loans under IFRS 9) accounted for slightly over 1% of gross loans, and we expect the ratio to remain below 2% under our baseline scenario.

Nykredit's capitalisation is underpinned by its low-risk business model and limited exposure to high-risk assets. It maintains a solid capital surplus over regulatory minimums, giving the bank a sufficient cushion to absorb losses and inflationary pressure on risk-weighted assets (RWAs) from rating migrations. At end-March 2021, the bank's common equity Tier 1 (CET1) ratio of 20.1% was about 400bp above its capital policy target, or about 950bp above the capital requirement.

Nykredit's operating profit benefits from healthy and recurring revenue, tight cost control and historically contained LICs. We expect the bank's ratio of operating profit/RWAs to return to pre-pandemic levels by 2022 as a result of lower LICs and resilient income. In 2020, Nykredit's results benefited from solid loan growth, stronger wealth management income (following acquisition of Sparinvest) and resilient fee income supported by remortgaging activity, which partly offset the pandemic-driven increase in LICs.

Nykredit relies extensively on wholesale funding because mortgage lending is by law entirely funded by covered bonds in Denmark. We believe 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.

Nykredit's Short-Term IDR and short-term debt rating of 'F1' are the lower of the two options mapping to a Long-Term IDR of 'A'. This reflects our assessment of the bank's funding and liquidity factor at 'a', compared with the minimum level of 'aa-' required for a Short-Term IDR of 'F1+' under our criteria.

SENIOR PREFERRED DEBT

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 (QJD) and senior non-preferred debt. At end-March 2021 this buffer was 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 SECURITIES

Subordinated debt and additional Tier 1 debt issued by Nykredit are all notched down from its VR. We rate subordinated debt two notches below Nykredit's VR, in line with the baseline notching under our criteria, reflecting poor recovery prospects for this type of debt.

Fitch rates Nykredit's additional Tier 1 securities four notches below the entity's 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.

SUBSIDIARIES

Nykredit Bank A/S is Nykredit's 100%-held universal banking subsidiary. Its IDRs and debt ratings are aligned with Nykredit's. This reflects the subsidiary's core role within the Nykredit group and high reputational risk for the parent in case of subsidiary's default. We have not assigned a 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 unsecured preferred debt and long-term 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.

SUPPORT RATING AND SUPPORT RATING FLOOR

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.

Nykredit Bank's Support rating of 1 reflects the extremely high likelihood of support being made available from its parent in case of need.

RATING SENSITIVITIES

IDRS, VR AND SENIOR NON-PREFERRED DEBT

Factors that could, individually or collectively, lead to positive rating action/upgrade:

An upgrade of Nykredit's ratings is unlikely in the near term given the group's limited product breadth. In the longer term, an upgrade would be contingent on Nykredit broadening its product offering, providing it with significantly more diversified revenue streams.

Factors that could, individually or collectively, lead to negative rating action/downgrade:

We would downgrade Nykredit's ratings if we expect that it is not 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.

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 who may prove less stable during financial stress, or increasing risk appetite - particularly at its subsidiary Nykredit Bank A/S - would also put pressure on the ratings.

SENIOR PREFERRED DEBT

Nykredit's long-term senior preferred debt and long-term deposit ratings are notched up from and are sensitive to the bank's Long-Term IDR. The ratings could be downgraded by one notch if the resolution law in Denmark allows Nykredit to use preferred debt to observe the MREL requirements and if the buffer of QJD and senior non-preferred debt falls below 10% of RWA.

SUBORDINATED DEBT AND OTHER HYBRID SECURITIES

Subordinated debt and additional Tier 1 debt ratings are sensitive to a change in Nykredit's VR and the assessment of their non-performance risk relative to the risk captured in Nykredit's VR. The additional Tier 1 debt ratings could be downgraded if non-performance risk increases relative to the risk captured in Nykredit's VR, for example if capital buffers over regulatory requirements are eroded.

SUBSIDIARIES

Nykredit Bank's ratings are sensitive to a change in Nykredit's ratings. Nykredit Bank's deposit ratings are sensitive to a change in its parent's senior preferred debt ratings.

SUPPORT RATING AND SUPPORT RATING FLOOR

An upgrade of the Support Rating and upward revision of the Support Rating Floor would be contingent on a positive change in the sovereign's propensity to support its banks. While not impossible, this is highly unlikely, in Fitch's view.

Best/Worst Case Rating Scenario

International scale credit ratings of Financial Institutions and Covered Bond issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of four notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit https://www.fitchratings.com/site/re/10111579

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

Nykredit Bank's IDRs and debt ratings are aligned with Nykredit's. Nykredit Bank's Support Rating is based on expected support from its parent Nykredit.

ESG Considerations

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3'. This 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. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg

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Rating Actions

ENTITY/DEBT	RATING			RECOVERY	PRIOR
Nykredit Realkredit A/S	LT IDR	A	Affirmed		A

ENTITY/DEBT	RATING			RECOVERY	PRIOR
	ST IDR	F1	Affirmed		F1
	Viability	a	Affirmed		a
	Support	5	Affirmed		5
	Support Floor	NF	Affirmed		NF
• Senior non-preferred	LT	A	Affirmed		A
• Senior preferred	LT	A+	Affirmed		A+
• subordinated	LT	BBB+	Affirmed		BBB+
• subordinated	LT	BBB-	New Rating		
• Senior preferred	ST	F1	Affirmed		F1
Nykredit Bank A/S	LT IDR	A	Affirmed		A
	ST IDR	F1	Affirmed		F1
	Support	1	Affirmed		1

ENTITY/DEBT	RATING			RECOVERY	PRIOR
• senior unsecured	LT	A+	Affirmed		A+
• long-term deposits	LT	A+	Affirmed		A+
• senior unsecured	ST	F1	Affirmed		F1
• short-term deposits	ST	F1	Affirmed		F1

RATINGS KEY	OUTLOOK	WATCH
POSITIVE	⊕	⬘
NEGATIVE	⊖	⬙
EVOLVING	⊙	◆
STABLE	⊡	

Applicable Criteria

Bank Rating Criteria (pub.28 Feb 2020) (including rating assumption sensitivity)

Additional Disclosures

Solicitation Status

Endorsement Status

Nykredit Bank A/S	EU Issued, UK Endorsed
Nykredit Realkredit A/S	EU Issued, UK Endorsed

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Endorsement policy

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