FitchRatings

19 Jun 2020 | Rating Changed Outlook to Stable

Fitch Revises Outlook on Nykredit to Stable; Affirms at 'A'

Fitch Ratings-Warsaw-19 June 2020:

Fitch Ratings has revised the Outlook on Nykredit Realkredit A/S's (Nykredit) Long-Term Issuer Default Rating (IDR) to Stable from Negative and affirmed the Long-Term IDR at 'A' and Viability Rating (VR) at 'a'. A full list of rating actions is below.

The Outlook revision reflects our view that Nykredit's ratings have sufficient headroom to absorb significant shocks under our updated assessment of various possible downside scenarios to our baseline economic forecast. This primarily reflects our assessment of the group's asset quality (a+/negative), profitability (a-/negative) and capitalisation (a/stable). Nykredit's asset quality and profitability will come under pressure in 2020 and 2021 reflecting the economic impact of the coronavirus pandemic. However, we expect Nykredit's capitalisation to be able to underpin the bank's ratings even in case of a downside scenario given its robust capital buffers and the owners' commitment to inject fresh equity in case of stress.

Key Rating Drivers

IDRS, VR AND SENIOR NON-PREFERRED DEBT

Nykredit's 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, and wholesale funding and ample liquidity.

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. Additionally, Forenet Kredit, which owns about 80% of Nykredit, together with a number of Danish pension funds, has earmarked about DKK16.4 billion (about 4% of RWAs at end-March 2020) to recapitalise the bank if needed.

Fitch believes that Nykredit's asset quality is a key rating strength and we expect it to remain sound during the downturn. Nevertheless, 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 spike in unemployment. At end-March 2020, impaired loans (Stage 3 loans under IFRS 9) accounted for just under 1% of gross loans, and we expect the ratio to remain below 2% under our baseline scenario.

Nykredit's results will be challenged in 2020 due to high loan impairment charges (LICs) and valuation losses on financial assets. In 1Q20, the former represented 38bp (annualised) of average gross loans (compared with a single-digit ratio in 2016-2019) and we expect LICs to remain elevated for some time. The bank's earnings will be moderately eroded by slower loan demand, although this will be partly cushioned by solid remortgaging activity until mid-March 2020.

We do not expect immediate pressure on the bank's funding profile, given Nykredit's limited use of short-term debt and sufficient liquidity. Nykredit relies extensively on wholesale funding because mortgage lending is by law entirely funded by covered bonds in Denmark. Fitch believes that the risk of Nykredit not being able to access the covered bond market is low. The Danish mortgage bonds market remained liquid despite coronavirus disturbance (although interest rates went up), supported by the strong demand for these bonds from Danish financial institutions, insurance companies and pension funds. They need to hold highly liquid and highly-rated securities in domestic currency, and there are limited outstanding volumes of Danish government bonds.

SHORT-TERM RATING

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-' for a Short-Term IDR of 'F1+'.

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 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 SECURITIES

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.

We have upgraded Tier 2 contingent capital instruments to 'BBB+' from 'BBB' because we see no incremental non-performance risk given the low level of the write-down trigger at 7% of the CET1 ratio. The rating is two notches below Nykredit's VR to reflect the higher than average loss severity of these securities.

Nykredit's additional Tier 1 securities are rated 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.

SUBSIDIARY - NYKREDIT BANK A/S

Nykredit Bank A/S' IDRs and debt ratings are aligned with Nykredit's. The Support Rating of '1' reflects the subsidiary's core position within the Nykredit group, including full ownership, a strong track record of support, and high reputational risk from a default of the subsidiary. 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.

RATING SENSITIVITIES

IDRS, VR AND SENIOR NON-PREFERRED DEBT

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

Nykredit's ratings have sufficient headroom to withstand various downside scenarios to Fitch's baseline economic forecast. However, Nykredit's 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, earnings and capitalisation.

We would downgrade Nykredit's ratings if we expect that 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.

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.

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 risks posed by the coronavirus shock and 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.

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 buffer of QJD and senior non-preferred debt falls below 10% of RWA.

SUBORDINATED DEBT AND OTHER HYBRID SECURITIES

Subordinated debt and other hybrid securities are sensitive to a change in Nykredit's VR and the assessment of the probability of their non-performance risk relative to the risk captured in Nykredit's VR. The additional Tier 1 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.

SUBSIDIARY - NYKREDIT BANK A/S

Nykredit Bank's ratings are sensitive to a change in Nykredit's ratings or to the parent's propensity to support it. 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 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. The Support Rating of Nykredit Bank is based on expected support from its parent Nykredit Realkredit.

ESG Considerations

The highest level of ESG credit relevance, if present, is a score of 3. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity(ies), either due to their nature or to the way in which they are being managed by the entity(ies). For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg.

Nykredit Realkredit A/S; Long Term Issuer Default Rating; Affirmed; A; RO:Sta
; Short Term Issuer Default Rating; Affirmed; F1
; Viability Rating; Affirmed; a
; Support Rating; Affirmed; 5
; Support Rating Floor; Affirmed; NF
----subordinated; Long Term Rating; Upgrade; BBB+
----Senior non-preferred; Long Term Rating; Affirmed; A
----Senior preferred; Long Term Rating; Affirmed; A+
----subordinated; Long Term Rating; Affirmed; BBB+
----subordinated; Long Term Rating; Affirmed; BBB-
----Senior preferred; Short Term Rating; Affirmed; F1
Nykredit Bank A/S; Long Term Issuer Default Rating; Affirmed; A; RO:Sta
; Short Term Issuer Default Rating; Affirmed; F1
; Support Rating; Affirmed; 1
----senior unsecured; Long Term Rating; Affirmed; A+
----long-term deposits; Long Term Rating; Affirmed; A+
----senior unsecured; Short Term Rating; Affirmed; F1
----short-term deposits; Short Term Rating; Affirmed; F1

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Additional information is available on www.fitchratings.com

Applicable Criteria

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

Additional Disclosures

Dodd-Frank Rating Information Disclosure Form
Solicitation Status
Endorsement Status
Endorsement Policy

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