

Research Update:

# Nykredit Realkredit A/S Ratings Raised To 'A+' On Increasing Loss-Absorbing Capacity; Outlook Stable

November 5, 2019

## Overview

- Nykredit has made rapid progress in recent months building its buffers of capital that can be bailed in, which provide protection to senior creditors should Nykredit ever approach a point of nonviability.
- The bank also maintains strong capitalization, low credit losses, and a dominant market position in the Danish mortgage lending segment, which makes it compare well with highly rated peers in the Nordics and the rest of Europe.
- We are therefore raising our long-term issuer credit ratings on Nykredit Realkredit and its core subsidiary, Nykredit Bank A/S, to 'A+' from 'A'.
- The stable outlook reflects our expectation that our ratings on the bank will remain unchanged over the next two years, supported by the bank's stable funding and liquidity, strong capitalization and earnings capacity, and substantial additional loss-absorbing buffers that we expect to further strengthen following the planned issuance of additional capital instruments that can be bailed in.

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## Rating Action

On Nov. 5, 2019, S&P Global Ratings raised the long-term issuer credit ratings on Denmark-based financial institution Nykredit Realkredit A/S and its core subsidiary, Nykredit Bank A/S, to 'A+' from 'A'. We affirmed the 'A-1' short-term issuer credit ratings. The outlook on the long-term ratings is stable. We also raised our resolution counterparty ratings on Nykredit Realkredit and Nykredit Bank to 'AA-/A-1+' from 'A+/A-1'.

## Rationale

We have raised the long-term issuer credit ratings on Nykredit Realkredit and Nykredit Bank to reflect the progress the bank is making in building up its additional loss-absorbing capacity (ALAC) buffers to provide protection to senior creditors in case of a bail-in-led resolution process. To date, Nykredit Realkredit has issued Danish krone (DKK) 26.7 billion of senior nonpreferred notes

that qualify as additional loss-absorbing instruments, and we understand that it plans to issue an additional DKK3 billion to DKK5 billion before the end of the year. These amounts enable Nykredit to accumulate a cushion of loss-absorbing instruments in resolution safely exceeding 8% of its risk-weighted assets by year-end 2019.

The upgrades also reflect our view that Nykredit compares well with peers rated 'A+', such as Skandinaviska Enskilda Banken AB and Lloyds Bank plc, despite its relative concentration in domestic mortgages. Nykredit has a dominant position and demonstrated pricing power in the domestic mortgage segment, which has proven rather resilient in economic downturns. Also, we expect that Nykredit will maintain strong capitalization and earnings capacity as well as good cost efficiency through 2021.

The ratings also reflect stability in Nykredit Realkredit's revenues, underpinned by stable and predictable performance of its mortgage book and access to the well-functioning Danish covered bond market. Nykredit has reported strong earnings to date, and we expect it to have solid profitability through 2021. We note that high levels of remortgaging activity continue to support the bank's profitability.

Due to significant volumes of new instruments that can be bailed in--senior nonpreferred debt--that the bank has issued to date and the planned additional issuance of up to DKK5 billion, capital cushions have increased. This capital provides protection to senior creditors should Nykredit ever approach a point of nonviability. We now consider the bank's ALAC buffers to be above 8% as of Sept. 30, 2019, and we expect they will remain substantially above 8% by year-end 2019 and through 2021 (versus 7.3% as of year-end 2018). Since we expect the ALAC ratio will be above the threshold of 8%, we now incorporate two notches of uplift above the bank's SACP in the ratings.

Our calculations also take into account our recent revision of the Danish Banking Industry Country Risk Assessment--we think that economic risks for banks operating in Denmark have subsided, which we reflect in applying lower risk weights to assets located in Denmark in our risk-adjusted capital analysis.

We continue to view the combination of capital and risk assessment as a rating strength for Nykredit Realkredit. The strong capitalization is underpinned by our expectation that the bank's risk-adjusted capital (RAC) ratio will stay within the 13.9%-14.3% range in the next two years, supported by its strong revenue generation. We expect that the bank will maintain good asset quality, with nonperforming loans at less than 1% of the total loan portfolio and credit costs around 0.1% of average customer loans. This is supported by our view of receding economic risks in Denmark, on the back of expected annual real GDP growth of about 1.7% until 2022.

We consider Nykredit Realkredit's funding and liquidity as neutral rating factors, despite the bank's somewhat lower S&P Global Ratings-adjusted metrics. On June 30, 2019, Nykredit Realkredit's ratio of broad liquid assets to short-term funding was 0.76x, compared with 0.61x in 2018, 0.66x in 2017, and 0.41x at year-end 2014. Its stable funding ratio was about 91.5% as of June 30, 2019, up from 90.0% in 2018.

We expect pension funds' demand for low-risk domestic assets to continue to support stable demand for Danish covered bonds.

## **Outlook**

The stable outlook reflects our expectation that our ratings on Nykredit Realkredit and Nykredit Bank will remain unchanged over the next two years, supported by the bank's stable funding and liquidity, strong capitalization and earnings capacity, and substantial ALAC buffers that we expect

to further strengthen following the planned issuance of additional capital instruments that can be bailed in.

## **Downside scenario**

We could lower the long-term rating if Nykredit Realkredit's RAC ratio falls below 10% or if its ALAC ratio becomes materially lower than we currently expect, reducing the protection these instruments provide for senior unsecured creditors in a resolution scenario.

## **Upside scenario**

We consider an upgrade remote at this point.

## **Ratings Score Snapshot**

Issuer Credit Rating: A+/Stable/A-1

SACP: a-

Anchor: bbb+

- Business Position: Adequate (0)
- Capital and Earnings: Strong (+1)
- Risk Position: Adequate (0)
- Funding and Liquidity: Average and Adequate (0)

Support: +2

- ALAC Support: +2
- GRE Support: 0
- Group Support: 0
- Sovereign Support: 0

Additional Factors: 0

## **Related Criteria**

- General Criteria: Hybrid Capital: Methodology And Assumptions, July 1, 2019
- General Criteria: Group Rating Methodology, 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

- Criteria | Financial Institutions | Banks: Quantitative Metrics For Rating Banks Globally: Methodology And Assumptions, July 17, 2013
- Criteria | Financial Institutions | Banks: Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- Criteria | Financial Institutions | Banks: Banks: Rating 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

## Ratings List

### Upgraded

	To	From
<b>Nykredit Realkredit A/S</b>		
<b>Nykredit Bank A/S</b>		
Resolution Counterparty Rating	AA-/--/A-1+	A+/--/A-1

### Nykredit Bank A/S

Certificate Of Deposit		
Foreign Currency	A+	A

### Nykredit Bank A/S

Senior Unsecured	A+	A
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### Upgraded; CreditWatch/Outlook Action; Ratings Affirmed

	To	From
<b>Nykredit Realkredit A/S</b>		
<b>Nykredit Bank A/S</b>		
Issuer Credit Rating	A+/Stable/A-1	A/Positive/A-1

### Upgraded; Ratings Affirmed

	To	From
<b>Nykredit Bank A/S</b>		
Certificate Of Deposit		
Local Currency	A+	A

### Ratings Affirmed

<b>Nykredit Realkredit A/S</b>		
Senior Subordinated	BBB+	BBB+
Subordinated	BBB	BBB
Junior Subordinated	BB+	BB+
Junior Subordinated	BBB	BBB

### Nykredit Bank A/S

Certificate Of Deposit	A-1	A-1
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Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at [www.standardandpoors.com](http://www.standardandpoors.com) for further information. Complete ratings information is available to subscribers of RatingsDirect at [www.capitaliq.com](http://www.capitaliq.com). All ratings affected by this rating action can be found on S&P Global Ratings' public website at [www.standardandpoors.com](http://www.standardandpoors.com). Use the Ratings search box located in the left column.

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