

Realkredit Danmark's Capital Centres S & T Covered Bond Programmes – Peer Review

Three-Notch Downgrade Buffers: The 'AAA'/Stable ratings of Realkredit Danmark A/S's (A/Stable/F1) mortgage covered bonds issued out of Capital Centre (CC) S and T are based on the Long-Term Issuer Default Rating (LT IDR) of 'A' and eight notches of various uplifts above the IDRs granted to the programmes. This provides buffers of three notches against an IDR downgrade to maintain the ratings.

Credit Loss: The credit loss is the main component of Fitch Ratings' "AAA" break-even OC for both capital centres, modelled at 5.6% for CC S and 6.6% for CC T. The higher credit loss for CC T's cover pool is due to the larger share of variable rate mortgages and commercial loans.

Differing Interest Rate Type: A key difference between the capital centres is the interest-rate type distribution of the collateral loans. CC S contains predominantly fixed rate assets for the life of the loan, variable rate assets are refinanced through CC T.

Minimal Asset Liability Mismatches: The balance principle of Danish mortgage covered bonds ensures a close connection between the cash flow received from the borrowers and the cash flow due to the bondholders, minimising interest rate, FX and liquidity risks. This is achieved by issuing a bond, or a portfolio of bonds, with terms matching the characteristics of the loans.

Stable PCU: The six-notch payment continuity uplift (PCU) for CC S reflects the liquidity protection in place for at least 12 months, as 99% of the outstanding bonds have a pass-through amortisation profile. The six-notch PCU for CC T reflects the extendable maturity feature of the soft bullet bonds (100%). At least three months of interest payment are also covered by government bonds held as liquid assets for both programmes.

Covid-19: Fitch expects coronavirus containment measures to negatively impact the performance of mortgage assets. However, the covered bonds' ratings benefit from a significant cushion between the overcollateralisation (OC) which Fitch relies on in its analysis and Fitch's 'AAA' break-even OC. In addition, the ratings are well-protected by the buffer against a downgrade of the issuer. Also, payment holiday take-ups in Denmark have been very limited. Nevertheless, the agency expects the OC cushions to decrease as a consequence of the coronavirus crisis.

Key Rating Drivers

Programme	Realkredit Danmark A/S – SDRO Capital Centre S (CC S)	Realkredit Danmark A/S – SDRO Capital Centre T (CC T)
LT IDR	A	A
Resolution uplift (notches)	0	0
PCU (notches)	6	6
Timely payment rating level	AA+	AA+
Recovery uplift (notches)	2	2
Covered bond (CVB) rating	AAA	AAA
CVB Outlook	Stable	Stable
Buffer against IDR downgrade	3	3
Break-even OC for rating (%)	4	6
OC Fitch relies upon (%)	5.9	6.5

Source: Fitch Ratings

Break-even OC for Covered Bonds Rating



Source: Fitch Ratings



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Cover Pool – Peer Analysis

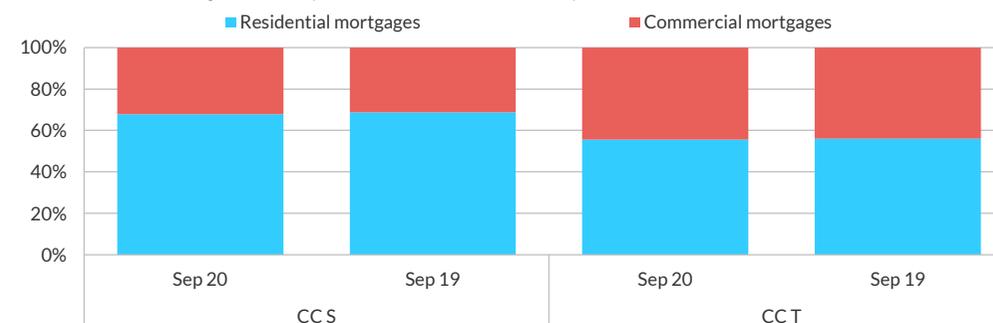
Cover Assets Credit Analysis

	CCS	CCT
Covered bonds rating	AAA	AAA
Rating default rate (RDR) for rating (%)	18.2	23.5
Rating recovery rate (RRR) for rating (%)	64.4	67.6
Rating loss rate (RDR*(1-RRR) for rating (%)	6.5	7.6
'B' case loss rate (%)	0.6	0.6

Source: Fitch Ratings

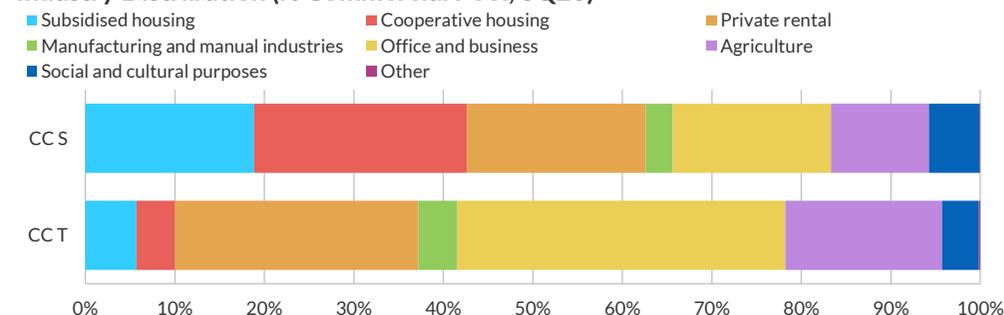
- Mixed Asset Cover Pools: CC S comprises 68% residential assets and 32% commercial assets, while the respective figures for CC T are 56% and 44%. Commercial loans within Realkredit cover pools are SME loans in such sectors as retail, real estate and agriculture.
- For the residential assets, Fitch has derived foreclosure frequency (FF) assumptions based on the analysis of vintage cumulative default data. The expected FF is 1% for the residential assets in CC S and 1.47% for CC T, to which Fitch has applied high rating scenario multiples to derive FF in each rating scenarios. This is due to the mild economic environment in Denmark and low cumulative defaults. On recovery prospects, we give full credit to the automated valuation model used for regulatory purposes.
- Fitch differentiates between the social and cooperative housing segments and other commercial segments, given their very good historical performance. The expected annual average default rate for the performing commercial mortgage portfolio was set at 1.5% whereas that for the social and cooperative housing segment was set at 0.5%. We continue to take into account that this segment may gradually decrease in both capital centres.
- The 50bp increase in Fitch's 'AAA' break-even OC in 2021 for CCS reflects the higher default rates of the commercial pool. This is the result of loans having longer tenors and a slight increase in the pool correlation regarding industry concentration. Recovery rates have also decreased as the weighted average loan-to-value (LTV) has increased in the pool.
- The 100bp reduction in Fitch's 'AAA' break-even OC in 2021 for CCT reflects the decreased weighted average LTV predominantly in the residential pool but also to a lesser extent in the commercial pool, which increases recovery rates. The portfolio composition in the share of residential and commercial assets also remained stable with good residential asset performance.

Cover Pool Composition (% of Total Cover Pool)



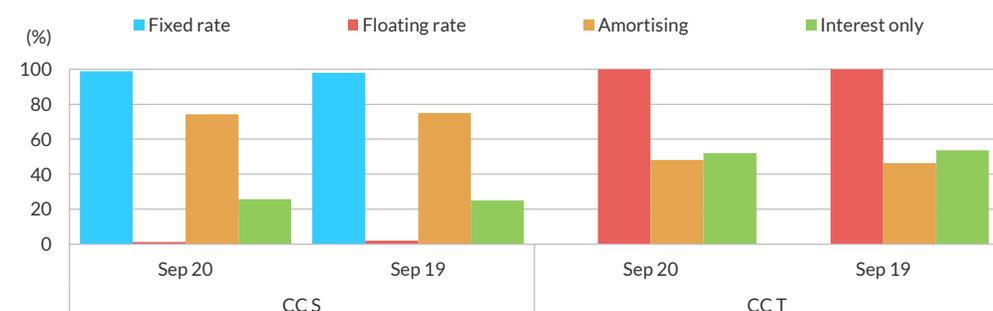
Source: Fitch Ratings, Realkredit

Industry Distribution (% Commercial Pool, 3Q20)



Source: Fitch Ratings, Realkredit

Loan Type



Source: Fitch Ratings, Realkredit

Break-even Overcollateralisation – Peer Analysis

AAA Break-even OC Components

Programme	ALM loss (%)	Credit loss (%)
CC S	-1.5	5.6
CC T	-0.6	6.6

Source: Fitch Ratings

Credit Loss

The credit loss component reflects the stressed credit loss derived by Fitch under its analysis of each cover pool in the 'AA+' timely payment rating level, which is the driving scenario for the 'AAA' break-even OC.

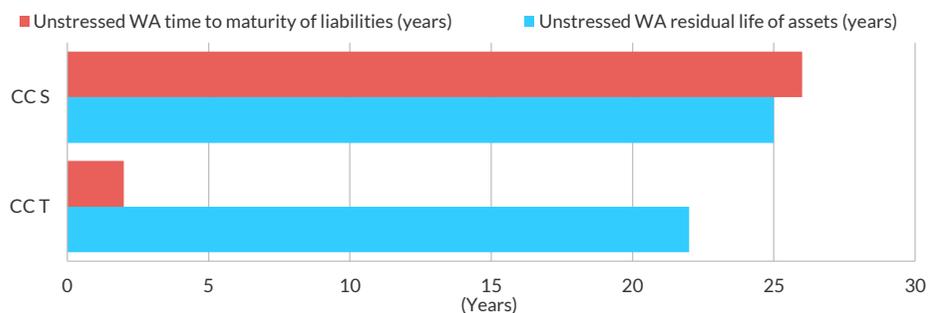
The floating rate characteristics of CC T, along with its higher share of commercial assets and lower share of social and cooperative housing, results in a high credit loss of 6.6% compared to that of CC S with 5.6%.

ALM Loss

The balance principle of Danish bonds minimises interest rate, volatility, FX and liquidity risks. Fitch does not model a sale of assets in its cash flow analysis, but considers the possibility of bond refinancing post insolvency or models the pass-through or maturity extension of bonds with these features. Asset and liability management (ALM) losses are low for CC S and CC T, being minus 1.5% and minus 0.6% respectively.

Due to the floating nature of CC T loans which usually offer lower interest rates than fixed-rate loans, they are funded by the issuance of bonds with shorter maturities than the loan terms, creating a refinancing need when they mature. The Weighted Average (WA) time to maturity of the bonds is therefore low in CC T at two years, compared to the WA time to maturity of the assets of 22 years.

Unstressed Assets & Liabilities Maturity Mismatches (3Q20)



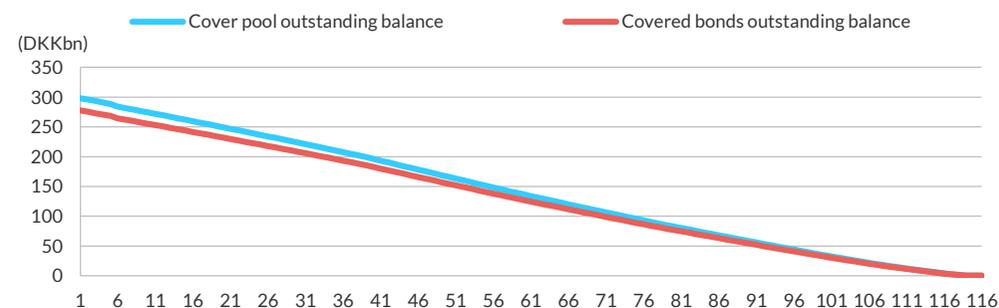
Source: Fitch Ratings, Realkredit

Cash Flow Analysis Driving Scenarios

Programme	Driving prepayment scenario	Driving interest-rate scenario	Driving default timing scenario
CC S	Low	Increasing	Quarter 1
CC T	High	Decreasing	Quarter 1

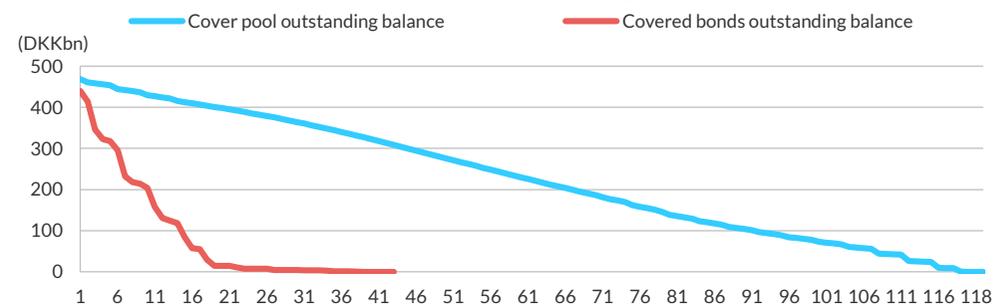
Source: Fitch Ratings

CC S - Assets and Liabilities Amortisation Profile (2Q20)



Source: Fitch Ratings

CC T - Assets and Liabilities Amortisation Profile (2Q20)



Source: Fitch Ratings

Resolution Uplift, PCU and Recovery Uplift – Peer Analysis

Continuity Uplift Assessment

Programme	Resolution uplift (notches)	PCU (notches)
CC S	0	6
CC T	0	6

Source: Fitch Ratings

Resolution Uplift

- Realkredit CC S and CC T programmes have been granted zero-notch resolution uplifts. This is because Realkredit is a specialised mortgage lender not operationally integrated into a parent bank and the bail-in tool is not applicable to specialised mortgage banks in Denmark.
- According to Fitch’s interpretation of the EU’s Bank Recovery and Resolution Directive (BRRD), specialised mortgage institutions that cannot receive deposits are not subject to the minimum requirement for own funds and eligible liabilities (MREL) as covered bonds issued by those institutions will be resolved according to specific winding-down procedures under which they could bear losses. The Danish legislation specifies that the bail-in tool is not applicable to specialised mortgage institutions.
- The resolution uplift applies to programmes issued from jurisdictions with an advanced bank resolution regime that includes a bail-in tool for senior liabilities and from which fully collateralised covered bonds or secured debt are exempt. In addition, resolution must not result in the direct enforcement of the recourse against the cover pool.

PCU

- The six-notch PCU for both programmes reflects the liquidity protection in place for at least 12 months. Ninety-nine percent of the outstanding bonds in CC S have pass-through amortisation profiles and all CC T bonds feature extendible maturity. The remaining bonds of CC S are hard-bullet, whose redemptions are covered by liquid assets for at least 12 months.
- The specific balance principle applied to these programmes allows for matching between the interest payments received from the mortgages and the interests due on the bonds. Another protection is the government bonds held for OC purposes (Danish government bonds rated ‘AAA’) which may be used to face liquidity shortfalls. They currently cover more than three months of interest due on the bonds from both programmes.

Recovery Uplift Assessment

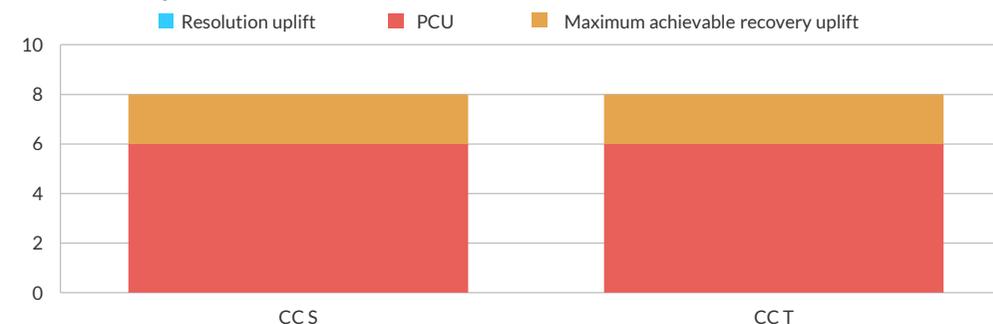
Programme	CVB rating	Credit loss (%) in CVB rating stress scenario	OC (%) Fitch relies upon in its analysis	Maximum achievable recovery uplift (notches)
CC S	AAA	5.6	5.9	2
CC T	AAA	6.6	6.5	2

Source: Fitch Ratings

Recovery Uplift

- The recovery uplift granted for both programmes is two notches as we expect the covered bonds to benefit from outstanding recoveries as no material risks to these recovery expectations were identified and the timely payment rating level is in the investment-grade range.
- Both programmes also contain standard assets in the form of residential and commercial mortgages.

Maximum Uplift Above IDR - Number of Notches



Source: Fitch Ratings

ESG Considerations

ESG Relevance Scores Recap

	CCS	CCT
Environmental (E)	GHG emissions & air quality	2
	Energy management	1
	Water & wastewater management	1
	Waste & hazardous materials management; ecological impacts	2
	Exposure to environmental impacts	2
Social (S)	Human rights, community relations, access & affordability	2
	Customer welfare – fair messaging, privacy & data security	3
	Labour relations & practices	1
	Employee wellbeing	1
	Exposure to social impacts	3
Governance (G)	Rule of Law, institutional and regulatory quality	3
	Transaction & collateral structure	3
	Transaction parties & operational risk	3
	Data transparency & privacy	3

Source: Fitch Ratings

Credit-Relevant ESG Scale - Definitions

How relevant are E, S and G issues to the overall credit rating?

5	Highly relevant; a key transaction or programme rating driver that has a significant impact on an individual basis
4	Relevant to transaction or programme ratings; not a key rating driver but has an impact on the ratings in combination with other factors
3	Minimally relevant to ratings; either very low impact or actively mitigated in a way that results in no impact on the transaction or programme ratings
2	Irrelevant to the transaction or programme ratings; relevant to the sector
1	Irrelevant to the transaction or programme ratings; irrelevant to the sector

Source: Fitch Ratings

ESG Considerations

The highest level of ESG credit relevance is typically a score of 3 - ESG issues are credit neutral or have only a minimal credit impact on the programme, either due to their nature or the way in which they are being managed by the issuer. For CC S and CC T, Fitch assigned a maximum ESG relevance score of 3.

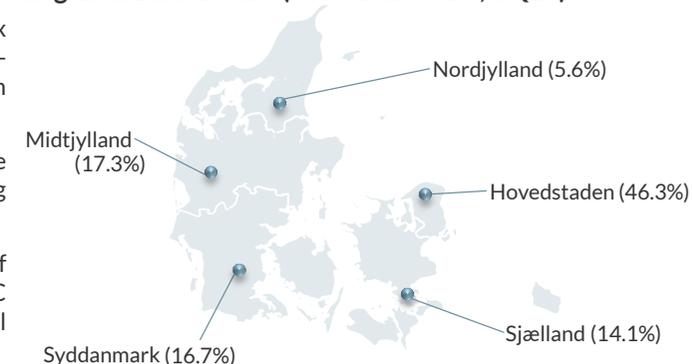
For more information on our ESG Relevance Scores, visit www.fitchratings.com/esg

Appendix 1A – CC S

Programme Structure

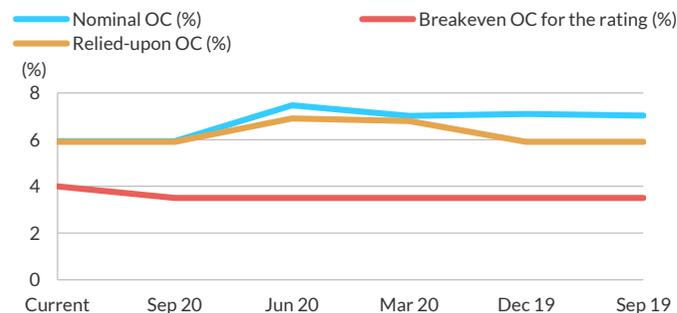
- Key Rating Drivers:** The 'AAA' rating of the covered bonds is based on Realkredit Danmark A/S's IDR of 'A', a PCU uplift of six notches, a two-notch recovery uplift and the OC Fitch relies upon of 5.9%, which provides more protection than the 'AAA' break-even OC of 4%. The Stable Outlook on the rating reflects the Outlook on Realkredit's IDR and the three-notch buffer against an IDR downgrade due to the different uplift factors above the bank's IDR.
- Cover Pool Composition:** The covered bonds are secured by mostly fixed rate Danish residential and commercial loans that are geographically diversified within Denmark. At end-September 2020, total cover assets stood at DKK301 billion (including substitute assets) with a weighted average current loan-to-value (WA CLTV) of 57.7% and a WA seasoning of 2.4 years.
- Rating Sensitivities:** The 'AAA' rating of Realkredit's CC S mortgage covered bonds would be vulnerable to a downgrade if one of the following occurred: (i) Realkredit's Long-Term IDR was downgraded by four notches to 'BBB-' or below; or (ii) the level of OC Fitch gives credit to in its analysis falls below the 'AAA' break-even OC of 4%. Should the relied-upon OC decrease to the legal minimum of 8% (of risk-weighted assets), the covered bonds would be downgraded to 'A+', one notch above the bank's IDR.

Regional Distribution (% of total assets, 3Q20)



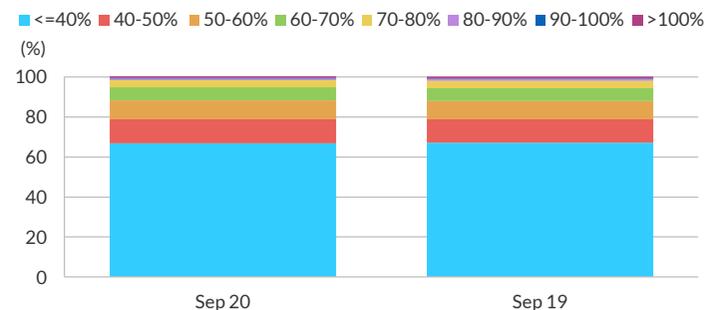
Source: Fitch Ratings, Realkredit

Overcollateralisation Breakdown



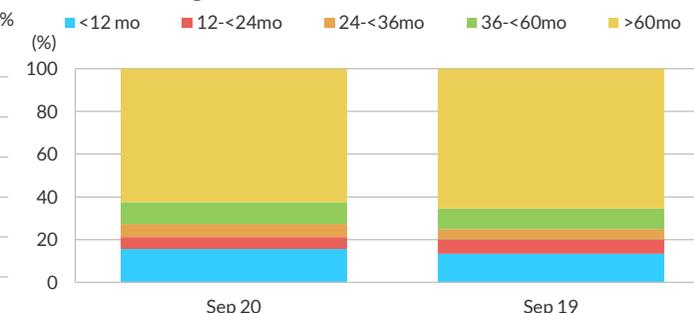
Source: Fitch Ratings, Realkredit

CLTV (% Residential Pool)



Source: Fitch Ratings, Realkredit

Loan Seasoning (% Residential Pool)



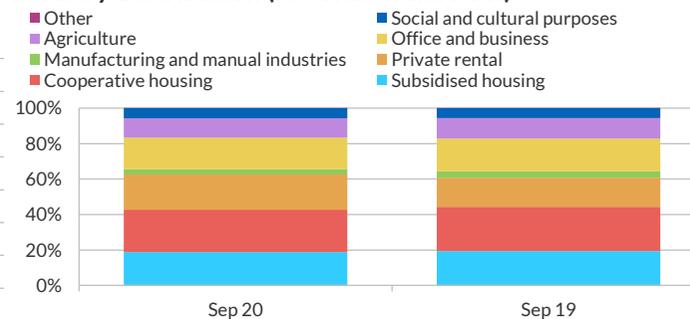
Source: Fitch Ratings, Realkredit

Assets and Liabilities



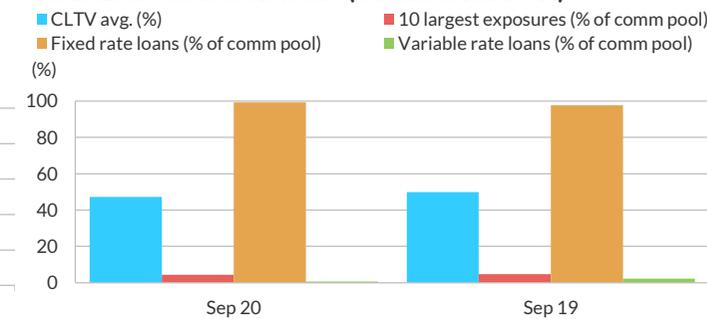
Source: Fitch Ratings, Realkredit

Industry Distribution (% Commercial Pool)



Source: Fitch Ratings, Realkredit

Other Loan Characteristics (Commercial Pool)



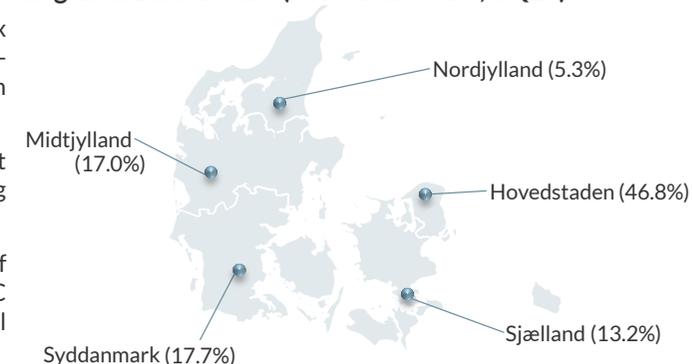
Source: Fitch Ratings, Realkredit

Appendix 1B – Focus on CCT

Programme Structure

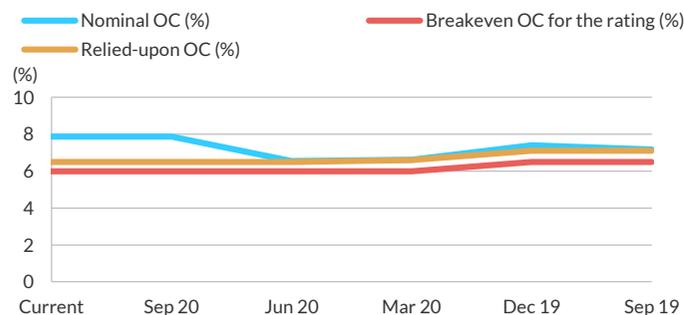
- Key Rating Drivers:** The 'AAA' rating of the covered bonds is based on Realkredit Danmark A/S's IDR of 'A', a PCU uplift of six notches, a two-notch recovery uplift and the OC Fitch relies on of 6.5%, which provides more protection than the 'AAA' break-even OC of 6%. The Stable Outlook on the rating reflects the Outlook on Realkredit's IDR and the three-notch buffer against an IDR downgrade due to the different uplift factors above the bank's IDR.
- Cover Pool Composition:** The covered bonds are secured by mostly variable rate Danish residential and commercial loans that are geographically diversified within Denmark. At end-September 2020, total cover assets stood at DKK470.9 billion (including substitute assets) with a weighted average current loan-to-value (WA CLTV) of 54.7% and a WA seasoning of 2.6 years.
- Rating Sensitivities:** The 'AAA' rating of Realkredit's CCT mortgage covered bonds would be vulnerable to a downgrade if any of the following occurs: (i) Realkredit's Long-Term IDR was downgraded by four notches to 'BBB-' or below; or (ii) the level of OC Fitch gives credit to in its analysis falls below the 'AAA' break-even OC of 6%. Should the relied-on OC decrease to the legal minimum of 8% (of risk-weighted assets), the covered bonds would be downgraded to 'A+', one notch above the bank's IDR.

Regional Distribution (% of total assets, 3Q20)



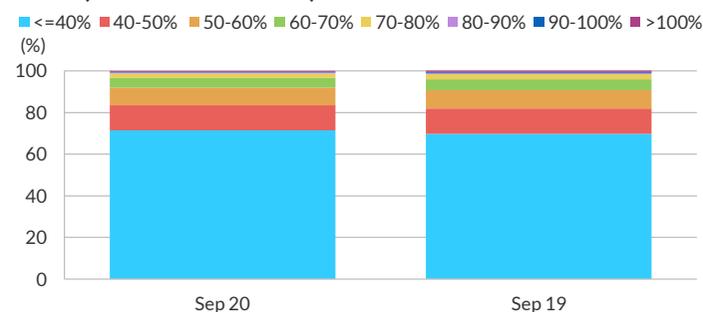
Source: Fitch Ratings, Realkredit

Overcollateralisation Breakdown



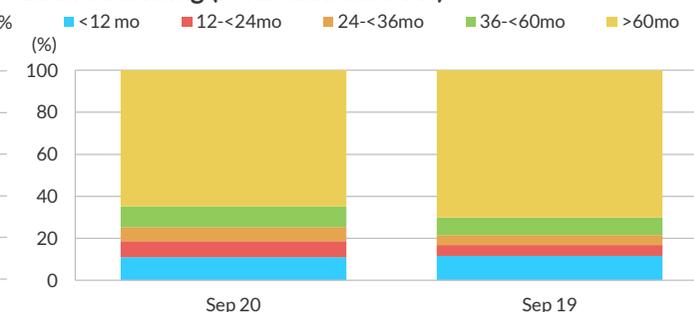
Source: Fitch Ratings, Realkredit

CLTV (% Residential Pool)



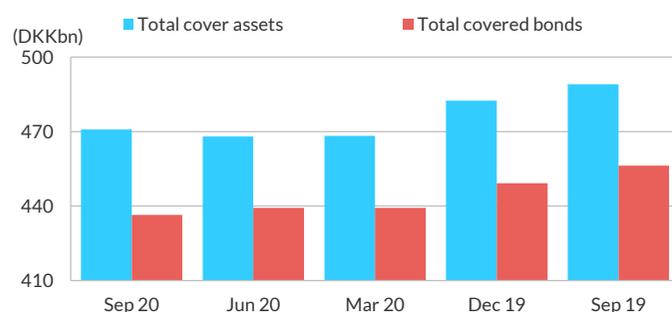
Source: Fitch Ratings, Realkredit

Loan Seasoning (% Residential Pool)



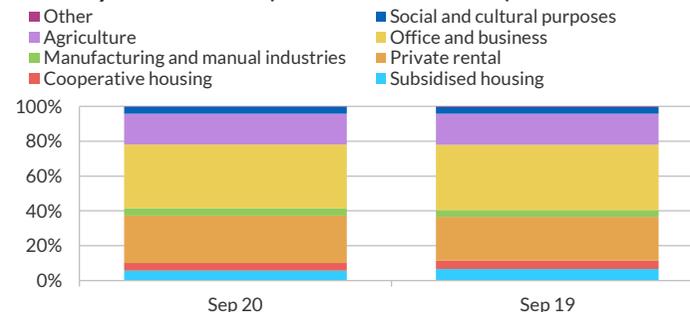
Source: Fitch Ratings, Realkredit

Assets and Liabilities



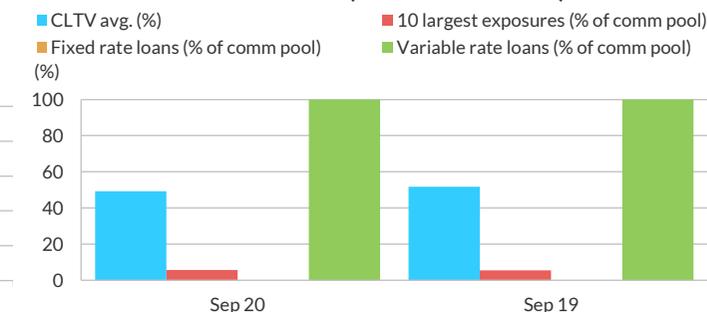
Source: Fitch Ratings, Realkredit

Industry Distribution (% Commercial Pool)



Source: Fitch Ratings, Realkredit

Other Loan Characteristics (Commercial Pool)



Source: Fitch Ratings, Realkredit

Appendix 2 – Summary of Applicable Covered Bonds Legislation

Items	Description
Basis of the framework	Danish covered bond legislation, 2007.
Issuer type	There are three types of Danish covered bonds: <ul style="list-style-type: none"> • Realkreditobligationer (RO): oldest type of bond, issued by mortgage banks only, UCITS-compliant, but not Capital Requirements Regulation (CRR)-compliant if issued after 31 December 2007 • Særligt Dækkede Realkreditobligationer (SDRO): issued by mortgage banks only, both UCITS- and CRR-compliant, a minimum OC of 8% of risk-weighted assets applies. • Særligt Dækkede Obligationer (SDO): implemented in 2007 following changes in legislation, can be issued by both commercial banks and mortgage banks, both UCITS- and CRR-compliant; a minimum OC of 8% of risk-weighted assets applies (only to mortgage bank issuers).
Dual recourse	To the assets of the capital centre, including OC in the case of mortgage banks. To the issuer and, post insolvency, to the insolvency estate of the issuer, before other creditors for specialised mortgage banks or pari passu with other senior creditors for commercial banks.
Segregation	Assets used to cover the bonds have to be segregated into independent cover pools referred to as capital centres for mortgage banks and cover registers for commercial banks.
Minimum overcollateralisation	Danish legislation does not specify an absolute nominal OC requirement. However, capital requirements have to be fulfilled at the capital centre level and at the institution level for mortgage banks and translate into a mandatory OC level of at least 8% of risk-weighted assets. For commercial banks there is no minimum mandatory OC. The OC can be funded by equity and senior debt. In practice, it is mostly invested in securities.
Cover assets	<ul style="list-style-type: none"> • Loans granted against mortgages on real property; • Exposure to public authorities: <ul style="list-style-type: none"> – bonds and debt issued by or guaranteed by central government, central banks, public entities, and regional and local authorities in the EU/EEA; – bonds and debt issued by or guaranteed by multilateral development banks or international organisations if risk-weighted 0% (or risk-weighted 20%, provided they do not exceed 15% of the outstanding covered bonds). • Bonds and debt issued by credit institutions if risk-weighted 20%, provided they do not exceed 15% of the outstanding covered bonds; • Mortgages on ships (only for commercial banks; a register may not include assets secured on both real estate and ships); • Other assets eligible for covered bonds financing according to the Capital Requirements Directive if allowed by the Danish Financial Services Authority (FSA); • In practice, supplementary collateral is made of exposure to public authorities and covered bonds.
Maximum LTV limits for the cover test	<ul style="list-style-type: none"> • ≤ 80% for residential real-estate loans with up to 30 years' maturity and 10 years' interest-only period; • ≤ 75% for residential real-estate loans with up to 30-year interest-only period and for holiday real-estate loans; • ≤ 60% for commercial, agricultural and real-estate loans for commercial use. In some cases, the LTV requirement can be increased to 70% if the bank adds additional collateral.
Eligibility of loans with LTVs higher than the maximum thresholds	Yes, but the part of mortgage loan above the limit is excluded from the calculation of the over-collateralisation (for SDROs and SDOs only).
Balance principle or matched-funding	Meant to ensure a close connection between the cash flow received from the borrowers and the cash flow due to the bondholders.
Treatment of swap counterparties	Derivative counterparties rank pari passu with covered bondholders when derivative contracts were concluded with the purpose of hedging cash flows between assets and liabilities.
Supervision	The Danish FSA
Cover pool administrator	An administrator (trustee) will be appointed by the Danish FSA upon or prior to insolvency of the mortgage lender. An alternative manager has the power to inter alia sell cover pool assets, take out loans and enter into repo agreements on behalf of the cover pool in order to make timely payment on covered bond obligations. This would facilitate actions the alternative manager may seek to take in meeting obligations.

Source: Fitch Ratings

Appendix 3 – Related Research & Definitions of Terms Used

Related Research

Details of the latest rating action for the programmes and the applicable criteria can be found in the following publications:

[Fitch Upgrades Realkredit Danmark's CC T Covered Bonds to 'AAA', Affirms CC S Covered Bonds at 'AAA' \(January 2021\)](#)

[Covered Bonds Rating Criteria \(November 2020\)](#)

[Originator-Specific Residential Mortgage Analysis Rating Criteria \(January 2021\)](#)

[European RMBS Rating Criteria \(December 2020\)](#)

[SME Balance Sheet Securitisation Rating Criteria \(February 2020\)](#)

Related Covered-Bonds Specific Research

[Danish Covered Bond Proposal Clarifies Extension Rules \(December 2020\)](#)

[Danish 20y Mortgage Rates at Record Low but Not as Low as 0% \(January 2021\)](#)

[Covered Bonds Surveillance Snapshot \(January 2021\)](#)

[Global Housing and Mortgage Outlook - 2021 \(December 2020\)](#)

[Fitch Ratings 2021 Outlook: Global Covered Bonds \(November 2020\)](#)

[Cover Pool Loss Rates Resilient to Coronavirus \(November 2020\)](#)

[Covered Bonds Protection Dashboard \(February 2021\)](#)

[Structured Finance and Covered Bonds Interactive ESG Relevance Dashboard - 4Q20 \(January 2021\)](#)

Definitions of Terms Used

CVB	Covered Bonds
LT IDR	Long Term Issuer Default Rating
RRP	Resolution Reference Point
PCU	Payment Continuity Uplift
WA	Weighted Average
WAL	Weighted Average Life
OC	Overcollateralisation
LTV	Loan-to-value
DTI	Debt-to-Income
RO	Realkreditobligationer
SDRO	Særligt Dækkede Realkreditobligationer
SDO	Særligt Dækkede Obligationer
FSA	Danish Financial Services Authority
CRR	Capital Requirements Regulation
CC S	Realkredit Danmark A/S - SDRO Capital Centre S
CC T	Realkredit Danmark A/S - SDRO Capital Centre T

Source: Fitch Ratings

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