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Ratings

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New Issue: The Mortgage Society of Finland (Mortgage Covered Bond Program)

€1.5 Billion Covered Bond Program

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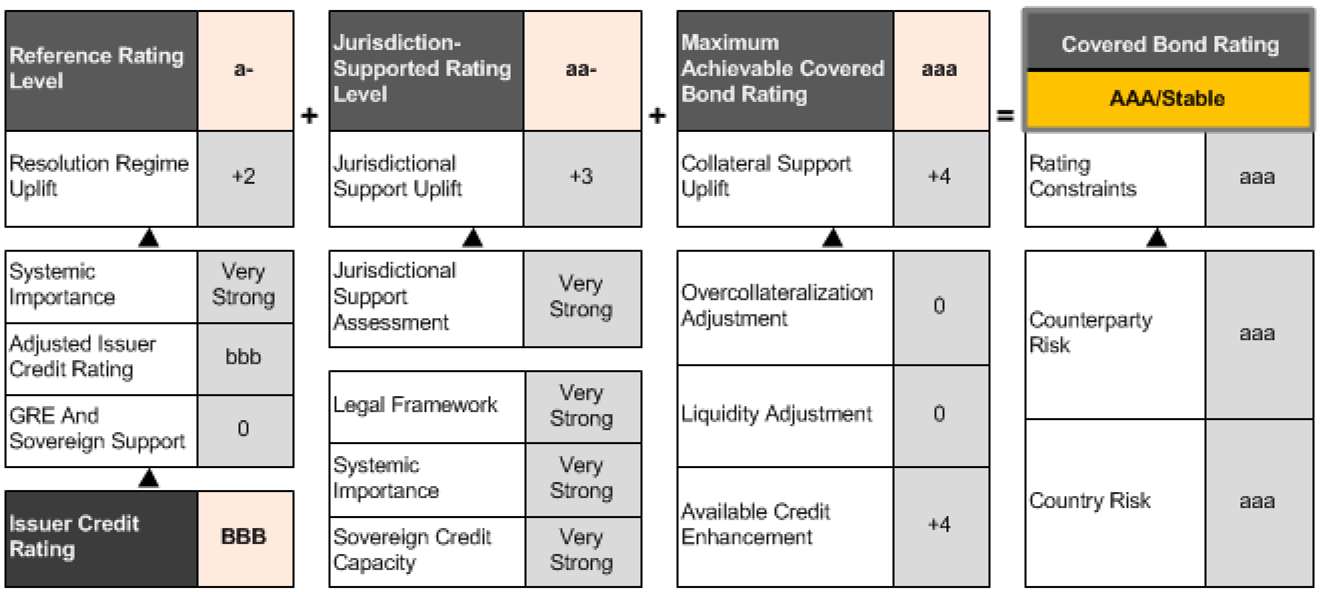
Ratings Detail



Major Rating Factors

Strengths

- The cover pool comprises loans with low loan-to-value (LTV) ratios.
- The available credit enhancement exceeds what is required to achieve a 'AAA' rating.
- The program benefits from a public commitment to maintain a level of overcollateralization that is consistent with the rating. Furthermore, liquidity risk is covered through the soft-bullet repayment profile of the bond.

Weaknesses

- High asset-liability mismatch in the covered bond program, given that there is a single covered bond outstanding with a relatively short maturity.
- The structure benefits from an interest rate swap, but we do not give credit to it in our analysis given that it does not comply with our counterparty criteria.
- Almost 50% of the pool comprises housing associations, which we view as a higher risk to the program's creditworthiness than residential mortgages.

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Outlook: Stable

The stable outlook reflects the fact that the ratings on the covered bonds benefit from one unused notch of collateral-based uplift under our covered bonds criteria (see "Covered Bonds Criteria," published on Dec. 9, 2014 and "Methodology And Assumptions For Analyzing Mortgage Collateral In Finnish And Norwegian Covered Bonds," published on Dec. 10, 2014). Therefore, if we were to lower our long-term issuer credit rating (ICR) on The Mortgage Society of Finland (Suomen Hypoteekkiyhdistys, or Hypo), we would not lower our ratings on the covered bonds, all else being equal.

We would lower the ratings on the covered bonds if we were to lower our long-term ICR on The Mortgage Society of Finland by more than one notch.

Rationale

On May 10, 2016, S&P Global Ratings assigned its 'AAA' credit rating to The Mortgage Society of Finland's mortgage covered bond program and related issuances (see "The Mortgage Society of Finland Covered Bond Program Assigned 'AAA' Rating; Outlook Stable").

Our covered bond ratings process follows the methodology and assumptions outlined in our "Covered Bonds Criteria," published on Dec. 9, 2014, and "Covered Bond Ratings Framework: Methodology And Assumptions," published on June 30, 2015.

From our analysis of Hypo's new program and the Finnish legislative covered bond framework, we have concluded that the assets in the cover pool are isolated from the issuer's insolvency risk. The asset isolation allows us to rate the covered bond program at a higher rating level than the long-term ICR on Hypo.

We conducted a review of Hypo's mortgage operations, which we view as prudent. We believe there are sufficiently prudent and effective underwriting and servicing procedures in place to support our ratings on the covered bonds.

Under our covered bonds criteria, we first assess the reference rating level (RRL), which for Hypo's covered bonds is 'a-'. This reflects the ICR on Hypo, minus any notches of uplift for extraordinary sovereign support incorporated in the ICR (in this case, none), plus two notches of uplift to reflect our view of the protection offered to covered bondholders by the bail-in provisions specified under the EU's Bank Recovery and Resolution Directive (BRRD), which Finland has implemented.

We then consider the likelihood of jurisdictional support, which for mortgage programs in Finland we assess as very strong. This leads us to apply three notches of uplift from the RRL to determine the jurisdiction-supported rating level (JRL), which we therefore assess as 'aa-'.

The covered bonds are eligible for four notches of collateral-based uplift from the JRL. Hypo has provided a public statement stating its intention to maintain a level of overcollateralization that is consistent with the current rating. We consider that the soft-bullet structure of the planned issuance covers liquidity risk.

Our credit analysis is based on cover pool data as of April 2016. The program's underlying assets comprise €368.03 million of Finnish residential mortgage loans (50.3%) and loans to housing companies (49.7%). Our measure of the weighted-average foreclosure frequency (WAFF; representing the level of defaults) stands at 22.84%, and the weighted-average loss severity (WALS; our measure of possible losses upon default) at 10.43%, based on a 'AAA' stress level.

We performed a cash flow analysis of the program's first €250 million, five-year soft-bullet covered bond. The available credit enhancement of 47.21% exceeds the target credit enhancement of 22.14%.

There are currently no rating constraints to the 'AAA' ratings relating to counterparty and country risks.

Program Description

Table 1

Program Overview*	
Jurisdiction	**Finland**
Year of first issuance	2016
Covered bond type	Legislation-enabled
Covered bonds (mil. €)	250
Redemption profile	Soft bullet
Underlying assets	Residential mortgages and housing association loans
Jurisdictional support uplift	3
Unused notches for jurisdictional support	0
Target credit enhancement (%)	22.14
Available credit enhancement (%)	47.21
Collateral support uplift	4
Unused notches for collateral support	1
Total unused notches	1

*Based on data as of April 2016.

Hypo has established a €1.5 billion program from which senior unsecured notes, subordinated debentures, and covered bonds can be issued. The covered bonds issued from the program are secured by a cover pool of Finnish residential mortgage loans and loans to Finnish housing companies.

Hypo is a licensed credit institution and mutual company founded in 1860, with the sole purpose of granting long-term loans against mortgage or other safeguarding collateral. The customers of the bank are members of the society as long as they have loans outstanding and no arrears. The bank is only active in the Helsinki metropolitan area, the Uusimaa region, and in specified growth centers in Finland. Hypo operates solely from its headquarters in Helsinki and services its clients also through online and telephone banking.

The covered bonds under the program are the direct unconditional and unsubordinated debt obligations of the issuer and rank pari passu among themselves. The covered bonds are secured by a cover pool of euro-denominated Finnish residential mortgage loans and loans to housing companies. The first issuance is denominated in euros. The covered bondholders have a priority claim on the cover pool's assets.

Chart 1

The Mortgage Society of Finland Covered Bond Program
Transaction Structure

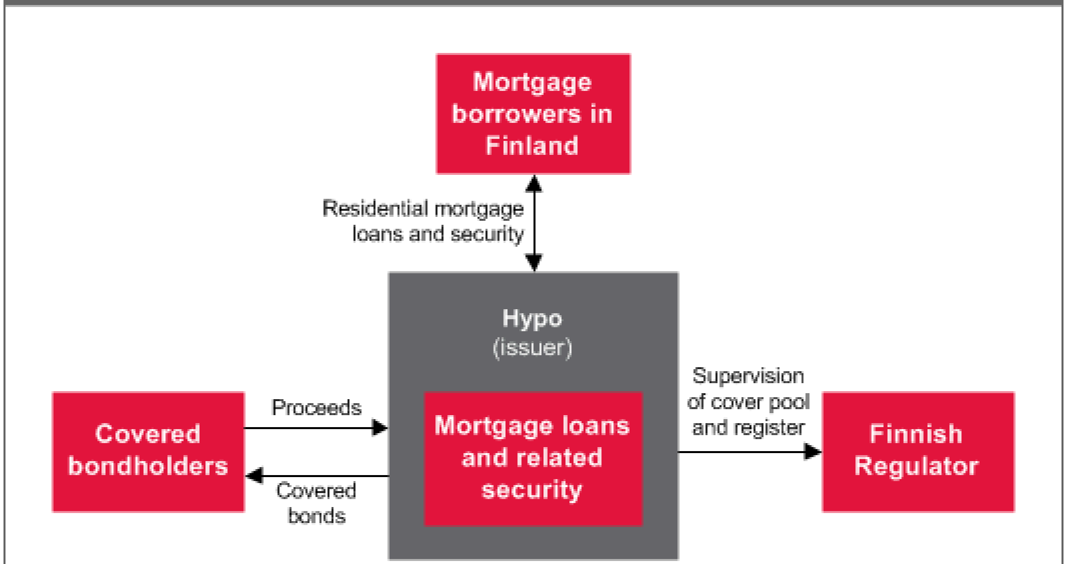

Table 2

Covered Bond Program Participants

Role	Name	Rating	Rating dependency
Issuer	The Mortgage Society of Finland	BBB/Negative/A-3	Yes
Originator	The Mortgage Society of Finland	BBB/Negative/A-3	No
Bank account	Nordea Bank Finland PLC	AA-/Negative/A-1+	Yes
Bank account	Danske Bank A/S	A/Stable/A-1	Yes
Bank account	OP Corporate Bank PLC	AA-/Negative/A-1+	Yes
Swap counterparty	Nordea Bank AB	AA-/Negative/A-1+	No

Rating Analysis

Legal and regulatory risks

In our legal risk analysis, we applied our European legal criteria (see "Europe Asset Isolation And Special-Purpose Entity Criteria--Structured Finance," published on Sept. 13, 2013). The Finnish Covered Bond Act of 2010 sets out the legal framework for issuing Finnish covered bonds. In our opinion, the Finnish covered bond legal framework is in line with the relevant legal requirements of our covered bond criteria. This enables us to rate the covered bonds above the long-term ICR on Hypo.

Under the Covered Bond Act, if the issuer defaults, covered bondholders have a preferential claim to the cover pool. They can also initiate regular insolvency proceedings against the issuer. Under the legislation, the cover pool can comprise residential mortgage loans, commercial mortgage loans, public-sector loans, and substitute assets from European Economic Area countries.

Under the legal framework, the cover pool's assets must be registered in the issuer's cover pool to be isolated from the issuer's other assets in the event of insolvency. The issuer must report the information in the register to the Finnish regulator quarterly. The register also includes the counterparties to derivative contracts, which must be able to survive the issuer's insolvency. This means that swap counterparties would continue performing with no claim to the cover pool.

If the issuer were to become insolvent, the Finnish regulator would appoint a special cover pool administrator to supervise the covered bondholders' interests. If necessary, the administrator can sell assets to make payments on the covered bonds. The administrator could also accelerate the payment of the covered bonds if it considers this to be in the bondholders' best interests, subject to Finnish regulatory approval. We consider this scenario to be rating remote, as our credit and cash flow analysis accounts for the ability of the cover pool to service the payments on the covered bonds.

To facilitate liquidity management, up to 15% of a mortgage cover pool can temporarily include substitute assets, and up to 20% of state, municipal, or other public-sector or financial entities assets.

Under the Covered Bond Act, the issuer's bankruptcy would not result in the covered bonds' early redemption or the suspension of payments to bondholders. Accordingly, we rate the covered bonds on the basis of their legal final maturity.

Operational and administrative risks

In our opinion, there is no operational risk from the cover pool's management and loan origination that would constrain the covered bond ratings to the same level as the long-term ICR.

Our analysis of operational and administrative risks follows the guidelines in our criteria (see "Covered Bond Ratings Framework: Methodology And Assumptions," published on June 30, 2015). Hypo's credit underwriting policy consists of three main documents: General Terms (approved by the Supervisory Board), Credit Policy (approved by the Board of Directors), and the Employee Authorization (approved by a steering group). We view Hypo's underwriting criteria as prudent.

We believe that it is highly likely that a replacement servicer would be appointed if the issuer were to become insolvent. We consider Finland to be an established covered bond market and we believe that the mortgage assets in Hypo's cover pool do not have product features that would materially limit the range of available replacement cover pool managers or servicers.

We consider the issuer's underwriting and servicing standards to be sufficient to support our ratings on the covered bonds. We therefore did not apply any analytical adjustments to account for operational and administrative risks.

Resolution regime analysis

Hypo's covered bonds will be subject to refinancing risk due to mismatches between the maturities of the mortgage assets in the cover pool and the covered bonds. As a result, we link the covered bond rating to the issuer's creditworthiness and determine the maximum achievable covered bond rating above the long-term ICR by analyzing the factors set out in our criteria.

Hypo is domiciled in Finland, which is part of the eurozone. We consider that Finland has implemented the bail-in provisions specified under the Bank Recovery and Resolution Directive (BRRD), and our analysis gives credit to the adoption of BRRD. Therefore, under our covered bonds criteria, we assess the reference rating level (RRL) as 'a-'.

Jurisdictional support analysis

Under our analysis of jurisdictional support in our covered bonds criteria, we determine a JRL, which is our assessment of the creditworthiness of a covered bond program once we have considered the level of jurisdictional support, but before giving credit to the amount of collateral.

In our jurisdictional support analysis, we assess the likelihood that a covered bond program facing stress would receive support from a government-sponsored initiative instead of from the liquidation of collateral assets in the open market. Our assessment of the expected jurisdictional support for Finnish mortgage covered bond programs is very strong (see "Assessments For Jurisdictional Support According To Our Covered Bond Criteria," published on Dec. 22, 2015). Under our covered bonds criteria, this means that the program can receive up to three notches of jurisdictional uplift from the RRL. This leads to a JRL for Hypo's mortgage covered bonds of 'aa-'. The JRL cannot exceed the rating on the sovereign providing the support to the covered bond, which in this case is 'AA+'.

Collateral support analysis

The cover pool comprises Finnish residential mortgage loans and housing company loans originated by The Mortgage Society of Finland. We base our analysis on loan-by-loan data as of a cut-off date of April 22, 2016.

We assess the credit quality of a typical residential mortgage cover pool by estimating the credit risk associated with each loan in the pool. The analysis of the residential mortgage loans is based on "Methodology And Assumptions For Analyzing Mortgage Collateral In Finnish And Norwegian Covered Bonds," published on Dec 10, 2014. The analysis of the housing company loans is based on "Analyzing European Commercial Real Estate Collateral In European Covered Bonds," published on March 31, 2015.

The cover pool includes loans granted to borrowers with multiple loan parts and, in some occasions, backed by different properties. These loans currently represent on average 38% of the property's current value. Finnish property prices have risen since 1996 but have stabilized in recent years. House prices and income levels have tended to move in tandem, suggesting that the housing market is not overvalued.

The weighted-average seasoning of the portfolio is around 3.5 years and the interest rate on 98% of the loans is floating.

We then calculate the aggregate risk to assess the overall credit quality of the cover pool. In order to quantify the potential losses associated with the entire pool, we weight each loan's foreclosure frequency and loss severity by its percentage of the total pool balance. The product of the weighted-average foreclosure frequency (WAFF) and weighted-average loss severity (WALS) estimates the required loss protection, assuming all other factors remain unchanged. The WAFF and WALS for the pool are 22.84% and 10.43%, respectively.

Our analysis of the covered bonds' payment structure shows that the cash flows from the cover pool assets would be sufficient, at the given rating level, to make timely payment of interest and ultimate payment of principal on the legal final maturity.

The available credit enhancement of 47.21% is sufficient to cover the target credit enhancement of 22.14%.

Table 3

Cover Pool Composition

	As of April 22, 2016	
Asset type	**Value (mil. €)**	**Percentage of cover pool (%)**
Residential mortgages	185,008,564	50.27
Housing association loans	183,021,203	49.73
Total	368,029,767	100

Table 4

Key Credit Metrics

	As of April 22, 2016
Weighted-average Original LTV ratio (%)	45.35
Weighted-average Current LTV ratio (%)	37.90
Weighted-average loan seasoning (months)*	44.66
Balance of loans in arrears (%)	2.23
Buy-to-let loans (%)	2.32
Interest-only loans (%)	22.46
Credit analysis results:	
Weighted-average foreclosure frequency (WAFF; %)	22.84
Weighted-average loss severity (WALS; %)	10.43
AAA' credit risk (%)	3.24
Country averages:	
WAFF (%)	20.91
WALS (%)	14.13
AAA' credit risk (%)	10.9

*Seasoning refers to the elapsed loan term.

Table 5

Covered Bond Program LTV Ratios

	As of April 22, 2016
Original LTV (%)	**Percentage of cover pool (%)**
0-10	6.41
10-20	8.26
20-30	12.28
30-40	13.12
40-50	17.65
50-60	15.47
60-70	26.82

Table 5

Covered Bond Program LTV Ratios (cont.)	
>70	0.00
Weighted-average LTV ratios	45.35
Current LTV (%)	**Percentage of cover pool (%)**
0-10	13.73
10-20	18.59
20-30	18.53
30-40	9.70
40-50	8.62
50-60	6.74
60-70	6.52
70-80	6.06
80-90	6.79
>90	3.01
Weighted-average LTV ratios	37.90

Table 6

Loan Seasoning Distribution*	
	AS of April 22, 2016
	Percentage of portfolio (%)
0-60	76.68
60-72	4.08
72-84	4.55
84-96	4.17
96-108	3.63
108-120	2.34
More than 120	4.55
Weighted-average loan seasoning (months)	44.66

*Seasoning refers to the elapsed loan term.

Table 7

Geographic Distribution Of Loan Assets	
	As of April 22, 2016
Top five concentrations	**Percentage of cover pool (%)**
East	0.75
Oulu	0.19
West	21.63
South	77.38
Lapland	0.05
Total	100

Table 8

Collateral Uplift Metrics	
	As of April 22, 2016
Asset WAM (years)	9.02
Liability WAM (years)	6
Available credit enhancement	47.21
Target credit enhancement for maximum uplift (%)	22.14
Potential collateral-based uplift (notches)	4
Adjustment for liquidity (Y/N)	N
Adjustment for committed overcollateralization (Y/N)	N
Collateral support uplift (notches)	4

WAM--Weighted-average maturity.

Counterparty risk

We have identified several counterparty risks to which the covered bonds are exposed. However, as these are either structurally addressed in line with our current counterparty criteria or taken into account in our cash flow modeling, we believe that they do not constrain the rating from a counterparty risk perspective (see "Counterparty Risk Framework Methodology And Assumptions," published on June 25, 2013 and "Counterparty Risk Analysis In Covered Bonds," published on Dec. 21, 2015).

Bank account provider

Payments from borrowers are made into a number of external bank accounts in Hypo's name. The accounts benefit from replacement language consistent with our counterparty criteria.

Swaps

The program benefits from swaps with Nordea Bank Finland PLC to swap the variable interest earned on the assets to fixed interest, payable on the covered bond. However, the contracts do not reflect our current counterparty criteria. As our covered bond ratings are above the long-term ICR on the swap counterparty, we consider that the latter could default and leave the covered bond program unhedged.

The deviations in the swap contracts from our counterparty criteria cannot be classified as a "variant". This means that, according to our covered bond counterparty criteria, the covered bond rating could not exceed the higher of the issuer's RRL plus one notch, the JRL and the counterparty's long-term ICR unless, the available credit enhancement were to be sufficient to cover the risk of a default of the derivative counterparty. All this is subject to the termination payments being subordinated to payments on the covered bonds.

We understand that, if the issuer defaults, any termination payments will be subject to Hypo's bankruptcy estate and the cover pool will not take over the issuer's obligations o under the swap agreements.

As a result, we have performed our cash flow analysis without giving credit to the swaps in the transaction. Conversely, we also look at the case where the swap counterparty performs and look at the cash flows including the swaps. We then retain the most conservative result.

Country risk

We assess country risk by applying our ratings above the sovereign criteria (see "Methodology And Assumptions For Ratings Above The Sovereign--Single-Jurisdiction Structured Finance," published on May 29, 2015).). Under these criteria, we consider that the assets in the pool have a moderate sensitivity to country risk. According to our criteria, due to the 12-month maturity extension feature of the issued covered bond, we can rate the covered bond up to four notches above the rating on the sovereign, Finland (AA+/Negative/A-1+). Based on the current sovereign rating, country risk does not constrain our rating on the covered bond.

Related Criteria And Research

Related criteria

- Methodology And Assumptions For Ratings Above The Sovereign--Single-Jurisdiction Structured Finance, May 29, 2015
- Counterparty Risk Analysis In Covered Bonds, Dec. 21, 2015
- Methodology And Assumptions: Analyzing European Commercial Real Estate Collateral In European Covered Bonds, March 31, 2015
- Covered Bond Ratings Framework: Methodology And Assumptions, June 30, 2015
- Covered Bonds Criteria, Dec. 9, 2014
- Methodology And Assumptions For Analyzing Mortgage Collateral In Finnish And Norwegian Covered Bonds, Dec. 10, 2014
- Europe Asset Isolation And Special-Purpose Entity Criteria--Structured Finance, Sept. 13, 2013
- Counterparty Risk Framework Methodology And Assumptions, June 25, 2013
- Methodology: Credit Stability Criteria, May 3, 2010
- Understanding Standard & Poor's Ratings Definitions, June 3, 2009

Related research

- The Mortgage Society of Finland Covered Bond Program Assigned 'AAA' Rating; Outlook Stable, May 10, 2016
- Banking Industry Country Risk Assessment: Finland, Jan. 25, 2016
- Global Covered Bond Characteristics And Rating Summary Q4 2015, Dec. 29, 2015
- Assessments For Jurisdictional Support According To Our Covered Bonds Criteria, Dec. 22, 2015
- Assessments For Target Asset Spreads According To Our Covered Bonds Criteria, Dec. 22, 2015
- The Mortgage Society of Finland, Sept. 17, 2015

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