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Transaction Update: The Mortgage Society of Finland (Mortgage Covered Bond Program)

€2 Billion Covered Bond Program

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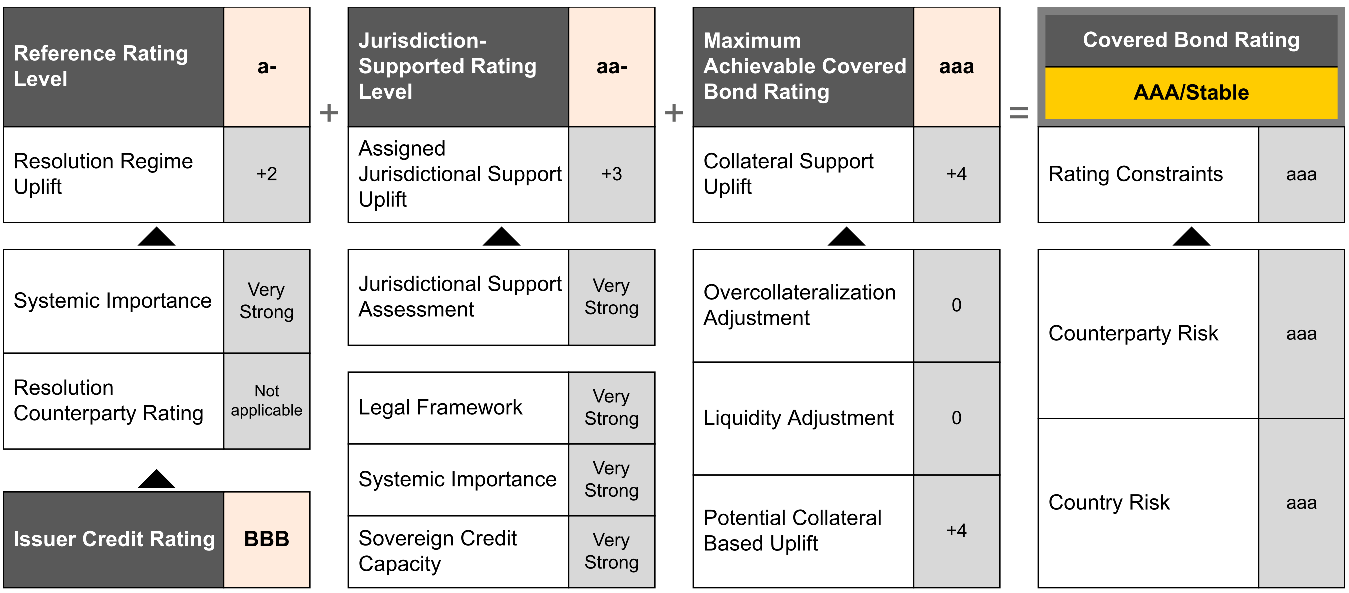
Ratings Detail



Major Rating Factors

Strengths

- The cover pool comprises loans with low loan-to-value (LTV) ratios.
- The program benefits from a public commitment to maintain a level of overcollateralization that is consistent with the rating.
- Liquidity risk is mitigated by the soft-bullet repayment profile of the bonds.

Weaknesses

- The cover pool's relatively low weighted-average seasoning compared with other Finnish covered bond issuers we rate.
- About 66% of the pool comprises housing associations, which we view as a higher risk to the program's creditworthiness than residential mortgages.

Outlook: Stable

S&P Global Ratings' stable outlook on its ratings on the mortgage covered bonds issued by The Mortgage Society of Finland ("Suomen Hypoteekkiyhdistys", or Hypo) reflects the stable outlook on its long-term issuer credit rating (ICR, BBB/Stable/A-2). This means that if we were to lower our long-term ICR on Hypo by one notch, we would also lower our ratings on the covered bonds, all else being equal.

Rationale

We are publishing this transaction update following our periodic review of Hypo's mortgage covered bond program and related issuances.

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 the legal and regulatory framework for Finnish covered bonds, 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.

The issuer is domiciled in Finland, which is subject to the EU's Bank Recovery and Resolution Directive (BRRD). We assess the systemic importance of covered bonds in Finland as very strong. These factors increase the likelihood that Hypo would continue servicing its covered bonds without accessing the cover pool or receiving jurisdictional support, even following a bail-in of its senior unsecured obligations. Therefore, under our covered bonds criteria, we assess the rating reference level (RRL) as 'a-', two notches above the long-term ICR on the issuer.

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-'.

We have reviewed the asset information provided as of March 2020. The program's underlying assets comprise €1.6 billion of Finnish residential mortgage loans (34.2%) and loans to housing companies (65.8%). Based on our cash flow analysis, the available credit enhancement in the program exceeds the target credit enhancement, which means that covered bonds are eligible for up to four notches of collateral-based uplift. We do not reduce the total collateral-based uplift by any notches owing to Hypo's public statement committing to maintain a level of overcollateralization that is consistent with the current rating, and because we consider that the soft-bullet structure of the liabilities covers liquidity risk for 180 days.

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

We have based our analysis on the criteria articles referenced in the Related Criteria section.

Program Description

Table 1

Program Overview*	
Jurisdiction	Finland
Year of first issuance	2016
Covered bond type	Legislation-enabled
Covered bonds (mil. €)	1,300
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 (%)	20.54
Available credit enhancement (%)	25.33
Collateral support uplift	4
Unused notches for collateral support	0
Total unused notches	0

*Based on data as of March 2020.

In 2016, Hypo 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 associations. The program size was increased to €2 billion in June 2018.

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 (with a positive track record in property values and population). 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. We base our credit analysis on loan-by-loan data as of the March 31, 2020 cut-off date. The cover pool composition and the loans' credit quality has remained in line with our previous analysis. The covered bond issuances are also denominated in euros. The covered bondholders have a priority claim on the cover pool's assets.

The Mortgage Society of Finland Covered Bond Program
Transaction Structure

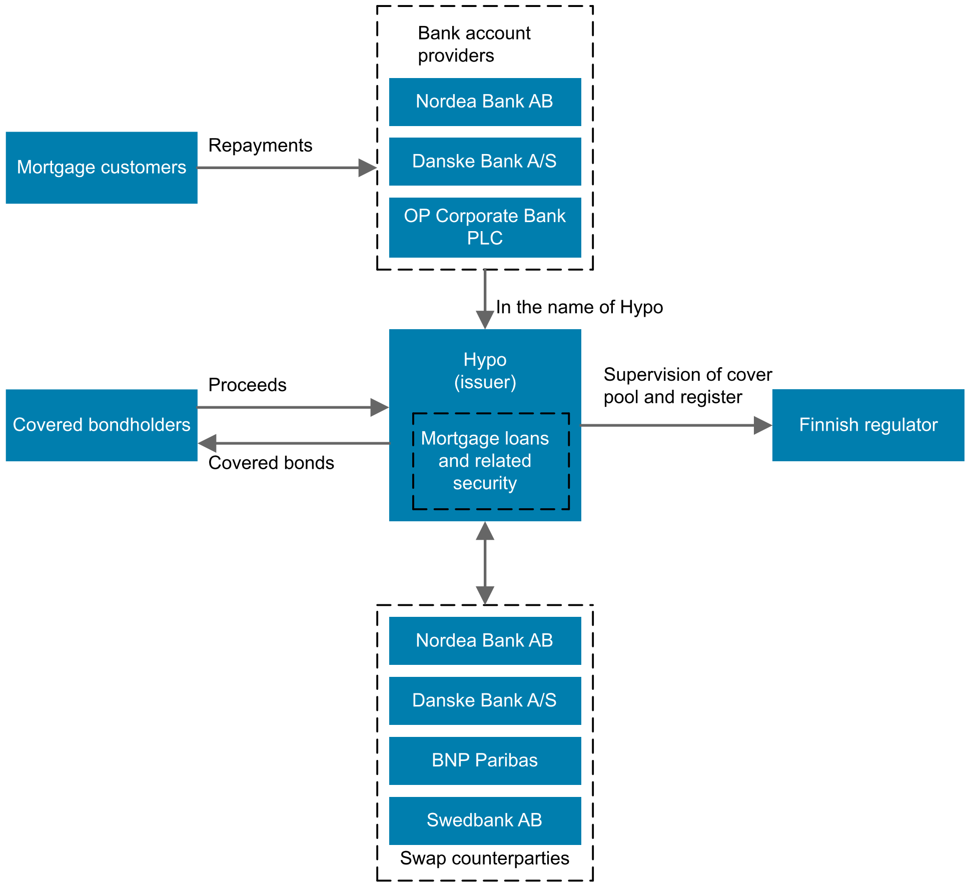


Table 2

Covered Bond Program Participants

Role	Name	Rating	Rating dependency
Issuer	The Mortgage Society of Finland	BBB/Stable/A-2	Yes
Originator	The Mortgage Society of Finland	BBB/Stable/A-2	No
Bank account	Nordea Bank Abp	AA-/Negative/A-1+	Yes
Bank account	Danske Bank A/S	A/Stable/A-1	Yes
Bank account	OP Corporate Bank PLC	AA-/Stable/A-1+	Yes
Interest rate hedge provider	Nordea Bank Abp	AA-/Negative/A-1+	Yes
Interest rate hedge provider	Danske Bank A/S	A/Stable/A-1	Yes
Interest rate hedge provider	BNP Paribas	A+/Negative/A-1	Yes
Interest rate hedge provider	Swedbank AB	A+/Stable/A-1	Yes

Rating Analysis

Legal and regulatory risks

In our legal risk analysis, we applied our legal criteria (see "Asset Isolation And Special-Purpose Entity Methodology," published on March 29, 2017). 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 based on their legal final maturity.

Operational and administrative risks

Hypo is a licensed credit institution and mutual company founded in 1860, with the sole purpose of granting mortgage loans to Finnish households and housing associations. The bank originates its loans in the Helsinki metropolitan area, the Uusimaa region, and other specified growth areas in Finland. Hypo's sole physical branch is located in Helsinki. Its services are complemented through online and telephone banking.

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 Hypo's management group). We view Hypo's underwriting criteria as prudent, as reflected by the low average LTV ratio of its loan book and low historical levels of nonperforming loans.

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. Furthermore, 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.

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).

Resolution regime analysis

Hypo is domiciled in Finland, which is part of the EU's BRRD. We assess the systemic importance of Finnish mortgage covered bond programs as very strong (see "Assessments For Jurisdictional Support According To Our Covered Bonds Criteria," published on March 3, 2020). Under our covered bonds criteria, this means the RRL will be the greater of: (i) the issuing bank's ICR, plus two notches, and (ii) the RCR on the issuing bank, where applicable. As Hypo has no RCR assigned, the resulting RRL is 'a-', two notches above the ICR.

This uplift recognizes that resolution regimes like the BRRD increase the probability that an issuer could service its covered bonds even following a default on its senior unsecured obligations. This is because the law exempts covered bonds from bail-in risk if there is a bank resolution. We consider this as an internal form of support, because the bail-in of certain creditors of the issuer does not require direct government support. This increases the likelihood that Hypo would continue servicing its covered bonds without accessing the cover pool or receiving jurisdictional support, even if it were to face insolvency.

Jurisdictional support analysis

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. 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 credit analysis on loan-by-loan data as of a cut-off date of March 31, 2020.

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 about 33% of the property's current value. Finnish property prices have generally 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 portfolio's weighted-average seasoning is approximately three and a half years and the interest rate on about 97% of the loans is floating.

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: Assessing Pools Of European Residential Loans," published on Aug. 4, 2017. 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.

We then calculate the aggregate risk to assess the cover pool's overall credit quality. 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 for the portfolio is 16.41% whereas the WALS stands at 12.35%. These measures are in line with the credit results as of December 2018, with a WAFF of 16.42% and a WALS of 12.08%, showing that the cover pool's credit quality has remained stable.

Table 3

Hypo Covered Bond Program Cover Pool Composition

	As of March 31, 2020		As of Dec. 31, 2018	
Asset type	**Value (mil. €)**	**Percentage of cover pool (%)**	**Value (mil. €)**	**Percentage of cover pool (%)**
Residential mortgages	558,108,963	34.25	440,893,940	34.18
Housing association loans	1,071,181,163	65.75	849,193,923	65.82
Total	1,629,290,126	100	1,290,087,863	100

Table 4

Hypo Covered Bond Program Key Credit Metrics

	As of March 31, 2020	As of Dec. 31, 2018
Weighted-average current LTV ratio (%)	33.48	32.80
Weighted-average loan seasoning (months)	43.28	42
Balance of loans in arrears > 30 days (%)	0.56	0.70
Buy-to-let loans (%)	2.8	3.9
Interest-only loans (%)	8.0	10.4
Credit analysis results:		
Weighted-average foreclosure frequency (%)	16.41	16.42
Weighted-average loss severity (%)	12.35	12.08
'AAA' credit risk (%)	3.24	2.72

LTV--Loan to value.

Table 5

Hypo Covered Bond Program LTV Ratios

	As of March 31, 2020	As of Dec. 31, 2018
Current LTV (%)	**Percentage of cover pool (%)**	
0-10	16.49	14.98
10-20	20.66	22.68
20-30	18.20	18.74

Table 5

Hypo Covered Bond Program LTV Ratios (cont.)

	As of March 31, 2020	As of Dec. 31, 2018
Current LTV (%)	**Percentage of cover pool (%)**	
30-40	12.78	13.59
40-50	8.36	7.90
50-60	5.90	5.87
60-70	6.11	6.23
70-80	8.73	7.67
80-90	1.45	1.08
>90	1.33	1.26
Weighted-average LTV ratios	33.48	32.80

Table 6

Hypo Covered Bond Program Loan Seasoning Distribution*

	As of March 31, 2020	As of Dec. 31, 2018
	Percentage of portfolio	
0-60	76.66	82.30
60-72	9.77	7.50
72-84	5.61	3.80
84-96	3.37	2.00
96-108	1.64	1.00
108-120	0.71	1.30
More than 120	2.23	2.10
Weighted-average loan seasoning (months)	43.18	42.00

*Seasoning refers to the elapsed loan term.

Table 7

Hypo Covered Bond Program Geographic Distribution Of Loan Assets

	As of March 31, 2020	As of Dec. 31, 2018
Top five concentrations	**Percentage of cover pool (%)**	
East	0.25	0.40
Oulu	2.18	2.00
West	18.63	17.70
South	78.94	80.00
Lapland	0.01	0.00
Total	100	100

According to our criteria, the maximum potential collateral-based uplift on a covered bond program above the JRL is four notches. We then adjust the maximum collateral-based uplift by reviewing the coverage of six months of liquidity and the level of commitment for the overcollateralization. The covered bonds issued by Hypo benefit from any public commitment on the level of overcollateralization. Additionally, the program only includes soft-bullet issuances (with a 12-month an extendable maturity). Therefore, the maximum collateral uplift remains at four notches.

By applying our credit and cash flow stresses, we calculate a target credit enhancement of 20.54%, higher than on February 2019, when it stood at 15.37%. The increase in mainly driven by the higher asset-liability mismatch in the program.

The target credit enhancement is less than the available credit enhancement of 25.33%, allowing for the full four notches of collateral-based uplift. With a JRL of 'aa-', the program only requires three notches of collateral uplift to attain a 'AAA' rating. The overcollateralization that is commensurate the rating is therefore 16.22% (which corresponds to 'AAA' credit risk plus 75% refinancing costs).

There are no unused notches of uplift in this program given that if we were to lower our long-term ICR on Hypo by one notch, we would also lower our ratings on the covered bonds as per our counterparty risk criteria, all else being equal (see 'Counterparty risk').

Table 8

Hypo Covered Bond Program Collateral Uplift Metrics

	As of March 2020	As of February 2019
Asset WAM (years)	9.47	9.58
Liability WAM (years)	4.62	5.75
Available credit enhancement	25.33	22.77
Required credit enhancement for first notch of collateral uplift (%)	7.57	5.88
Required credit enhancement for second notch of collateral uplift (%)	11.89	9.05
Required credit enhancement for third notch of collateral uplift (%)	16.22	12.21
Target credit enhancement for maximum uplift (%)	20.54	15.37
Potential collateral-based uplift (notches)	4	4
Adjustment for liquidity (Y/N)	N	N
Adjustment for committed overcollateralization (Y/N)	N	N
Collateral support uplift (notches)	4	4

WAM--Weighted-average maturity.

Counterparty risk

We have identified several counterparty risks to which the covered bonds are exposed. However, these are either structurally addressed in line with our current counterparty criteria or taken into account in our cash flow modeling (see "Counterparty Risk Framework: Methodology And Assumptions," published on March 8, 2019). Therefore, we believe that they do not constrain the rating from a counterparty risk perspective.

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 AB, Swedbank AB, Danske Bank A/S, and BNP Paribas S.A. to swap the variable interest earned on the assets to fixed interest, payable on the covered bonds.

To derive the maximum potential rating on the covered bonds under our counterparty criteria, we consider various factors, including whether the counterparties are related to the issuer, the seniority of termination payments, the replacement commitment, and the collateral posting framework. The swap counterparties in this program are unrelated to the issuer and entitled to termination payments that rank pari passu with payments on the covered bonds. According to the swap documentation, Nordea, Swedbank, and Danske Bank have committed to replacing themselves if their resolution counterparty rating (RCR) falls below 'A-'. If a counterparty fails to meet this commitment, an additional termination event would allow the issuer to terminate the derivative agreement. Furthermore, if we lower our rating on a swap counterparty below 'A-', the counterparties have each committed to post collateral sufficient to cover the issuer's exposure to that counterparty, plus certain volatility risks in the swap value. We categorize the current collateral-posting framework for the counterparties in the derivative contracts as strong.

Although BNP Paribas' commitments are similar, the rating triggers have been set at an RCR of 'A+' and the collateral-posting framework in the derivative contract is categorized as moderate.

The collateral framework assessments, combined with the current RRL on the issuer ('a-') and the different replacement triggers, support a maximum potential rating of 'AAA' under our counterparty risk assessment. However, if we were to lower our long-term ICR on Hypo by one notch, we would also lower our ratings on the covered bonds, all else being equal. As a result, this program does not currently benefit from any unused notches of uplift.

Country risk

Under our structured finance sovereign risk criteria, covered bonds issued in a jurisdiction that is within a monetary union that include structural coverage of refinancing need over a 12-month period to exhibit low sensitivity to country risk. As a result, we can rate these covered bonds up to five notches above the sovereign rating (see "Incorporating Sovereign Risk In Rating Structured Finance Securities: Methodology And Assumptions," published Jan. 30, 2019).

Potential effects of COVID-19

S&P Global Ratings acknowledges a high degree of uncertainty about the rate of spread and peak of the coronavirus outbreak. Some government authorities estimate the pandemic will peak about midyear, and we are using this assumption in assessing the economic and credit implications. We believe the measures adopted to contain COVID-19 have pushed the global economy into recession (see our macroeconomic and credit updates here: www.spglobal.com/ratings). As the situation evolves, we will update our assumptions and estimates accordingly.

Related Criteria

- Counterparty Risk Framework: Methodology And Assumptions, March 8, 2019
- Incorporating Sovereign Risk In Rating Structured Finance Securities: Methodology And Assumptions, Jan. 30, 2019
- Assessing Pools Of European Residential Loans, Aug. 4, 2017
- Asset Isolation And Special-Purpose Entity Methodology, March 29, 2017
- Covered Bond Ratings Framework: Methodology And Assumptions, June 30, 2015
- Methodology And Assumptions: Analyzing European Commercial Real Estate Collateral In European Covered Bonds, March 31, 2015

- Covered Bonds Criteria, Dec. 9, 2014
- Methodology: Credit Stability Criteria, May 3, 2010
- Use Of CreditWatch And Outlooks, Sept. 14, 2009

Related Research

- Global Covered Bond Insights Q1 2020, March 31, 2020
- Global Covered Bond Characteristics And Rating Summary Q1 2020, March 31, 2020
- Global Covered Bonds: Assessing The Credit Effects Of COVID-19, March 25, 2020
- Assessments For Jurisdictional Support According To Our Covered Bonds Criteria, March 3, 2020
- S&P Global Ratings' Covered Bonds Primer, June 20, 2019
- Assessments For Jurisdictional Support According To Our Covered Bonds Criteria, Oct. 16, 2018
- Assessments For Target Asset Spreads According To Our Covered Bonds Criteria, Oct. 16, 2018
- Glossary Of Covered Bond Terms, April 27, 2018