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Transaction Update: The Mortgage Society Of Finland CBA Covered Bond Program

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Table Of Contents

Major Rating Factors

Outlook

Rationale

Program Description

Rating Analysis

Counterparty risk

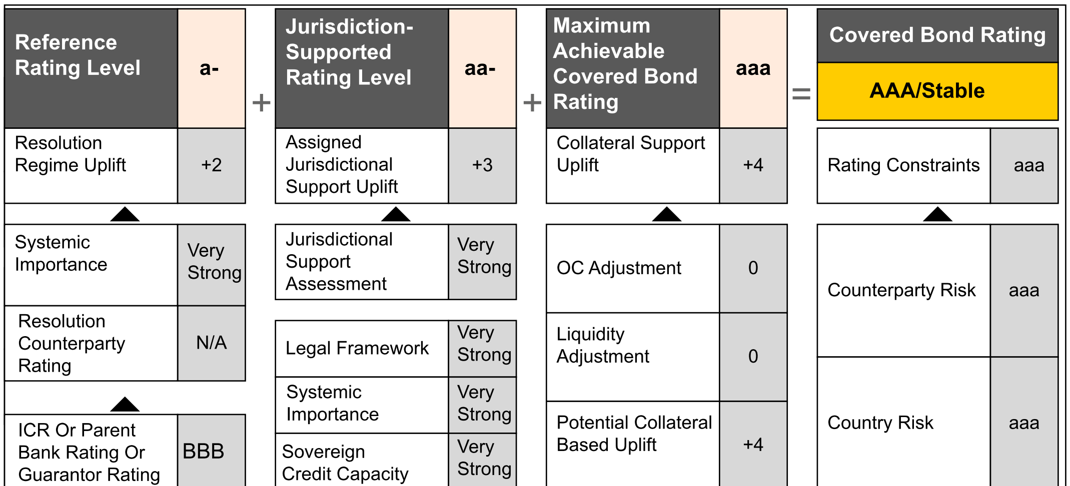
Environmental, Social, And Governance

Related Criteria

Related Research

Transaction Update: The Mortgage Society Of Finland CBA Covered Bond Program

Ratings Detail



Note: As a starting point of the analysis, we may use the ICR of the parent or guarantor when the issuer is not rated, but it belongs to a group with a rated parent or payments under the covered bonds are guaranteed by another rated entity. ICR--Issuer credit rating. N/A--Not applicable.

Major Rating Factors

Strengths

- The cover pool comprises well-seasoned Finnish mortgage loans with lower current loan-to-value (LTV) ratios than other specialized mortgage lenders in the Nordics.
- The bonds' soft-bullet repayment profile mitigates short-term liquidity risk.
- The structure benefits from a public commitment by the issuer to maintain overcollateralization consistent with a 'AAA' rating.

Weaknesses

- Concentration of mortgages in the South of Finland, which we have considered to determine default frequency.
- About 90% of the pool comprises loans to housing companies, which we view as a higher risk to the program's creditworthiness than residential mortgages.

Outlook

S&P Global Ratings' stable outlook on the 'AAA' ratings on the Mortgage Society of Finland's ("Suomen Hypoteekkiyhdistys"; Hypo) CBA mortgage covered bond program and related covered bond issuances reflects one unused notch of collateral-based uplift, which would protect the ratings on the covered bonds in the event of a one-notch downgrade of the long-term issuer credit rating (ICR) on Hypo (BBB/Stable/A-2), all else being equal.

Rationale

This transaction update follows our periodic review of Hypo's CBA covered bond program and related covered bonds issued under Finland's Covered Bond Act, (CBA, 151/2022; the "CBA Covered Bond Program").

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 covered bond program and the Finnish covered bond legislation, we consider that the assets registered in the cover pool are effectively isolated for the benefit of the covered bondholders if the issuer becomes insolvent. The protection of the cover pool assets and the continued management of the cover pool allow us to rate the covered bonds higher than our long-term ICR on Hypo.

Based on our operational risk analysis, which covers a review of origination, underwriting, collection, and default management procedures, as well as cover pool management and administration, we believe satisfactory procedures exist to support our ratings on the covered bond and the program.

Hypo is domiciled in Finland, which is subject to the EU's Bank Recovery and Resolution Directive (BRRD). We consider that mortgage covered bonds have a very strong systemic importance in Finland. 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. We have therefore assigned two notches of uplift above our long-term ICR on Hypo to determine the covered bonds' reference rating level (RRL) of 'a-'.

We considered the likelihood of jurisdictional support. Based on a very strong jurisdictional support assessment for mortgage covered bonds in Finland, we assigned three notches of uplift from the RRL to determine the jurisdiction-supported rating level (JRL) of 'aa-'.

Our collateral support analysis is based on the asset information as of June 2024. The €1,147 million cover pool (current balance) comprises Finnish residential mortgage loans (9.9%) and loans to housing companies (90.1%). Based on our collateral support analysis, the available credit enhancement exceeds the target credit enhancement (TCE), which means that the covered bonds are eligible for up to four notches of collateral-based uplift above the JRL. We do not reduce the total collateral-based uplift owing to Hypo's commitment to maintain overcollateralization at the 'AAA' rating and because we consider that the liabilities' soft-bullet structure mitigates short-term liquidity risk. The achieved collateral support uplift is therefore four notches above the JRL, of which three notches are used to attain a 'AAA' rating, leaving one unused notch of collateral support.

Legal, counterparty, or sovereign risks do not constrain the 'AAA' ratings.

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

Program Description

Table 1

Program overview*	
Jurisdiction	Finland
Year of first issuance	2022
Covered bond type	Legislation-enabled
Outstanding covered bonds (mil. €)	900
Redemption profile	Soft-bullet
Underlying assets	Finnish residential mortgage loans and loans to housing companies
Jurisdictional support uplift	3
Unused notches for jurisdictional support	0
Target credit enhancement (%)	19.4
Credit enhancement for 'AAA' rating (third notch of collateral uplift, %)	15.62
Available credit enhancement (current balance, %)	27.43
Collateral support uplift	3
Unused notches for collateral support	1
Total unused notches	1

*Based on cash flows as of June 30, 2024.

Founded in 1860, Hypo is the oldest private credit institution in Finland. It is a licensed bank and a mutual company operating under Finland's Act on Mortgage Societies and is governed by its members. With total assets of about €3.6 billion and a loan portfolio of €2.8 billion as of June 30, 2024, Hypo is a small player in Finland's banking sector (market share of about 1% in 2023). Its focus is purely on low-risk residential mortgage lending to Finnish households and housing companies. Hypo is active in urban arears in Finland--Helsinki, southern Finland, and other growth centers--benefiting from ongoing urbanization trends.

This is Hypo's second covered bond program. It was set up in late 2022 to issue covered bonds under Finland's Covered Bond Act, effective July 8, 2022. The mortgage covered bonds are issued under Hypo's €2.5 billion program for the issuance of senior preferred notes, subordinated debentures, and covered bonds.

Hypo's first cover pool was established in November 2016 and contains covered bonds issued before the implementation of the EU Covered Bond Directive on July 8, 2022, under the Finnish Act on Mortgage Credit Bank Activities (688/2010) (the "MCBA Covered Bond Program"), which we analyze separately.

The covered bonds issued under the CBA Covered Bond Program rank pari passu among themselves but do not relate to the MCBA Covered Bond Program. Covered bondholders and derivative counterparties related to the CBA Covered Bond Program have a priority claim only on the assets registered in the CBA Covered Bond Program. Similarly, covered bondholders and derivative counterparties related to the MCBA Covered Bond Program have a priority claim only on the assets registered under the MCBA covered bond program.

Covered bonds are a vital funding tool for Hypo, representing 44% of total funding as of June 30, 2024. In April 2024, Hypo issued its third €300 million fixed interest rate paying covered bond under the CBA Covered Bond Program.

The covered bonds constitute direct unconditional and unsubordinated debt obligations of Hypo and are secured by a cover pool of eligible assets including residential mortgage loans and loans to housing companies registered in the cover pool, in line with the CBA.

To hedge the interest rate mismatch arising from the floating-rate assets and the fixed-rate covered bonds, Hypo entered into interest rate hedge swaps with Natixis SA and Nordea Bank Abp, alongside its existing swaps with Swedbank AB and Danske Bank A/S. Hypo decided not to swap the third covered bond issuance under the program, which we model as per its terms and conditions in our cash flow analysis.

The mortgage borrowers pay their loan installments into external bank accounts in Hypo's name or in the name of its wholly owned subsidiary. We view the resulting account bank risk as mitigated by Hypo's commitment to replace these accounts within 90 calendar days should their long-term ICR drops below 'BBB'.

The covered bonds benefit from Hypo's commitment to maintain overcollateralization sufficient to support a 'AAA' rating.

The Mortgage Society of Finland CBA Covered Bond Program

Transaction structure

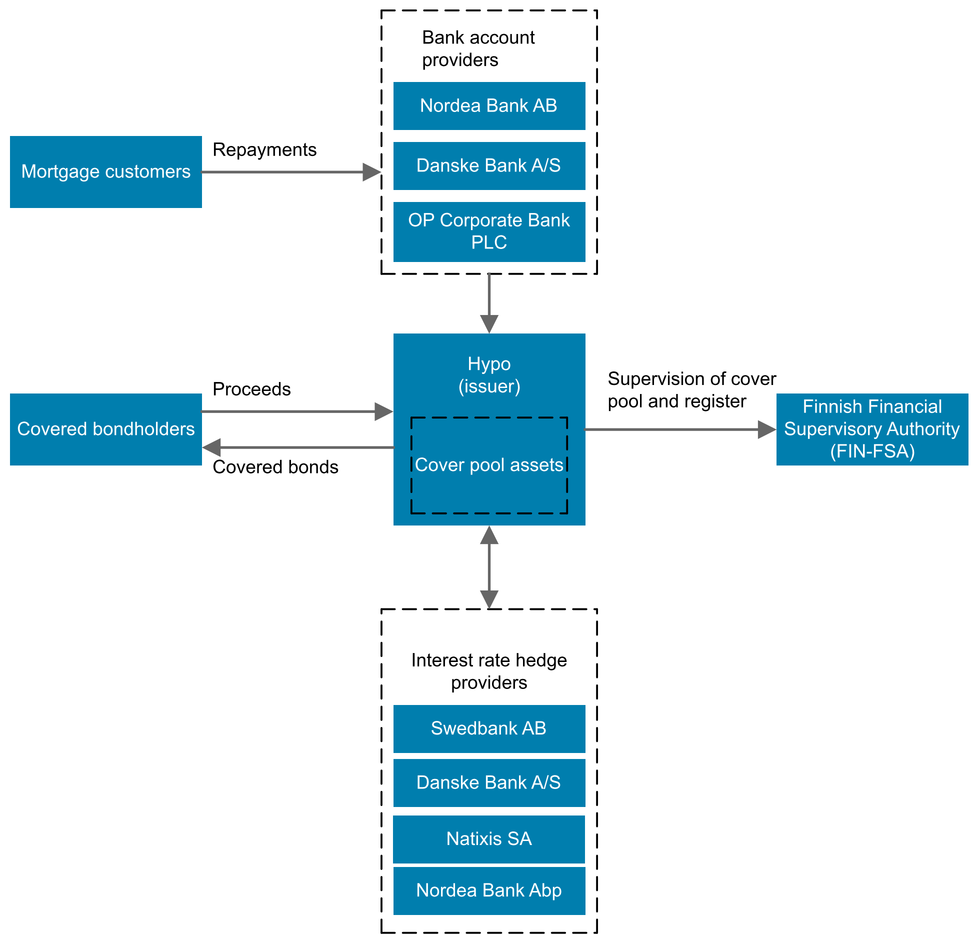


Table 2

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 and interest rate hedge provider	Nordea Bank Abp	AA-/Stable/A-1+	Yes
Bank account and interest rate hedge provider	Danske Bank A/S	A+/Stable/A-1	Yes
Bank account provider	OP Corporate Bank PLC	AA-/Stable/A-1+	Yes
Interest rate hedge provider	Swedbank AB	A+/Positive/A-1	Yes
Interest rate hedge provider	Natixis SA	A+/Stable/A-1	Yes

Rating Analysis

Legal and regulatory risks

We base our legal analysis on our criteria "Asset Isolation and Special-Purpose Entity Methodology," published on March 29, 2017.

The covered bonds are governed by the CBA, which implemented the Covered Bond Directive into Finish legislation. The CBA applies since July 8, 2022, and repealed the MCBA.

In our opinion, the CBA satisfies the relevant legal aspects of our covered bond criteria. We have concluded that the assets in the cover pool are effectively isolated for the benefit of covered bondholders (see "A Closer Look At Finland's Covered Bond Framework," published on Sept. 27, 2023). The protection of the assets and the continued management of the cover pool allow us to rate the covered bond program above the long-term ICR on Hypo.

Under the CBA, the issuer's bankruptcy would not automatically trigger the covered bonds' early redemption or the suspension of payments to bondholders. Accordingly, we rate the covered bonds based on the legal final maturity.

The CBA requires issuers to have a license from the Finnish Financial Supervisory Authority (FIN-FSA) to issue covered bonds. Further, they must maintain a register for the covered bonds and the collateral forming the cover pool. The FIN-FSA monitors the management of the register, including the recording of assets, and the issuer must quarterly report the information in the register to the FIN-FSA.

The CBA defines the eligibility criteria for the cover pool assets that comprise residential mortgage loans, commercial mortgage loans, public sector loans, and substitute assets to facilitate liquidity management.

Derivatives are allowed for risk hedging purposes and must be registered in the cover pool register. They must also, according to their terms, remain effective despite the issuer's bankruptcy, liquidation, or resolution. Derivative counterparties benefit from the same statutory priority right as covered bondholders.

The CBA allows deposit banks and credit societies to participate indirectly in the issuance of covered bonds via intermediary loans granted by a mortgage credit bank. Hypo's cover pool does not comprise any intermediary loans.

Under the CBA, issuers must have 2% overcollateralization on a net present value (NPV) basis. This requirement increases to 5% on an NPV basis if certain requirements of article 129 of the Capital Requirements Regulation are not fulfilled.

Under the CBA, the cover pool must continuously contain sufficient substitute assets (liquid assets) to meet the maximum net outflow related to the covered bonds during the upcoming 180-day period. We understand that in calculating the net outflow related to the covered bonds, issuers may consider the extension of the maturity.

Under the CBA, an extension of the maturity of the covered bonds by up to 12 months is permissible, subject to approval by the FIN-FSA and certain conditions being met, including:

- The issuer being unable to obtain long-term financing from ordinary sources;

- The issuer being unable to meet the liquidity requirement under the CBA upon payment of the covered bonds; and
- Such extension not affecting the order of the maturity based on the original maturity dates of covered bonds secured by the same cover pool.

If the issuer becomes insolvent, the FIN-FSA would appoint a supervisor to supervise the management of the cover pool. While a bankruptcy administrator (appointed by a court) manages both the issuer's insolvency estate and the cover pool, the supervisor's role is to protect the interests of covered bondholders with powers to direct the issuer's general bankruptcy administrator.

We understand that under the CBA, acceleration can only occur (upon the request or approval of the supervisor) if the total collateral amount requirements for the covered bonds cannot be met. The essence of the cover pool supervisor's role, which also applies in this instance, is to protect the covered bondholders' interests.

Upon issuer insolvency, covered bondholders and derivative counterparties (including termination fees) have a preferential claim to the assets in the cover pool, which would be isolated from the issuer's other assets.

Under the CBA, covered bondholders and derivative counterparties have a priority of payment right to 100% of the properties' value, although only 80% of the market value of residential properties and 60% of the market value of commercial estate properties can be included in the determination of overcollateralization.

The CBA excludes set-off against cover pool assets and claw-back risk.

Operational and administrative risks

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 focuses on low-risk mortgage lending to households (about 29% of the total portfolio as of June 2024) and housing companies (69% of total portfolio), secured by residential property collateral. Hypo expects loan growth to be balanced between retail and housing company loans, reflective of its low-risk appetite.

Mortgage loans are euro-denominated and mainly have a floating rate. As of June 2024, Hypo's average LTV ratio stood at 30.3%, which is well below that of many specialized mortgage lenders in the Nordics. Furthermore, mortgage loans are almost entirely amortizing with an average maturity of 23.5 years.

Hypo is active only in Helsinki, southern Finland, and specified growth centers in the rest of the country. Its sole physical branch is in Helsinki, with services complemented through online and telephone banking.

Hypo's underwriting policy comprises three main pillars:

- General terms (approved by the supervisory board), which lay down the core principles applicable to all lending activities such as requirements for collateral and overall collateral evaluation, and customer creditworthiness and cash flow sufficiency;
- Principles of credit risk management (approved by the board of directors), which include specific lending rules and principles such as acceptable collateral, collateral evaluation and haircuts, customer selection, minimum criteria for cash flow evaluation, LTV limits, the credit granting process, and reporting and auditing requirements; and

- Employee authorization (approved by Hypo's management group).

Hypo assesses the creditworthiness of potential retail customers through an internal grading system, which includes stress testing based on a 6%/25-year stress calculation, borrower solvency analysis, prior customer payment behavior analysis, and public credit default register checks. The borrower's solvency is assessed on monthly net income and housing costs, as well as mandatory costs of living, based on the household size. When calculating the collateral value, Hypo applies a haircut of 30-50%, depending on the type of collateral.

We understand that Hypo has not experienced credit losses from housing companies, housing companies with properties under construction, or housing investors since the Finnish banking crisis in the 1990s. This demonstrates the bank's highly prudent risk approach. Its nonperforming loan ratio stood at 0.18% as of June 30, 2024, well below that of peers.

The FIN-FSA continues to focus strongly on ensuring strict underwriting criteria for household lending. It implemented legislation mandating a 30-year maximum maturity for household mortgages. Moreover, it applies an 85% cap on loan-to-collateral ratios on new residential mortgage loans and a 95% cap for first-time buyers. Borrowers' ability to pay loan and manage regular living costs is stress-tested with an interest rate of no less than 6%.

Overall, we assess Hypo's lending and underwriting standards as conservative. Its exclusive focus on residential mortgage lending and loans to housing companies in growth centers in Finland, with low LTV ratios, translates into higher asset quality compared with domestic peers.

In our opinion, the cover pool's management and loan origination does not pose any operational risk that would constrain the ratings on the covered bonds to the same level as our long-term ICR on Hypo.

We believe that a replacement cover pool manager would be available to manage the cover pool if the issuer were to become insolvent. We consider Finland to be an established covered bond market, and we believe that the mortgage loans in Hypo's cover pool do not comprise product features that would materially limit the range of available replacement cover pool managers or servicers.

Resolution regime analysis

Hypo is domiciled in Finland, which is subject to the EU's BRRD. We assess the systemic importance for Finnish mortgage programs as very strong. Under our covered bonds criteria, this means the RRL will be the greater of (i) the ICR on Hypo, plus two notches; and (ii) the resolution counterparty rating (RCR) on the issuing bank, where applicable. Because we do not assign an RCR to Hypo, the 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 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.

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 market.

Our assessment of the expected jurisdictional support for Finnish mortgage programs is very strong. In addition, our sovereign rating on Finland (AA+/Stable/A-1+) does not constrain the JRL. Under our covered bonds criteria, the covered bonds therefore receive three notches of jurisdictional uplift over the RRL leading to a JRL of 'aa-'.

Collateral support analysis

Our analysis of the residential mortgage loans is based on the specific adjustments defined for Finland under our global RMBS criteria (see "Global Methodology And Assumptions: Assessing Pools Of Residential Loans," published on Jan. 25, 2019). Our analysis of the housing company loans is based under our commercial real estate criteria (CRE criteria; see "Methodology And Assumptions: Analyzing European Commercial Real Estate Collateral In European Covered Bonds," published on March 31, 2015).

We performed our analysis using loan-by-loan data and projected asset and liability cash flows provided by Hypo as of June 2024.

Following Hypo's third €300 million covered bond issuance in April 2024, the cover pool's notional amount increased significantly, reaching €1,147 million (€756.76 million previously). As of June 2024, the portion of loans granted to housing companies increased to 90.1% from 79.3% previously in the loan portfolio. The remaining share of 9.9% comprised residential mortgages. The cover pool includes 3,051 loans granted to 3,421 borrowers. On average, the outstanding balance of these loans represents about 21.7% of the property's current value, after considering adjustments for house price index developments. The portfolio's weighted-average seasoning is about 6.2 years, and 99.5% of the loans pay a floating rate of interest.

Under the CBA, mortgage loans are included in the cover pool for their total value, while compliance with the regulatory overcollateralization requirement must be based on 80% of the market value of residential properties and 60% for commercial properties. Bondholders and derivative counterparties have a priority of payment right on 100% of the properties' value. We therefore determine the available credit enhancement and the potential losses on the portfolio based on the entire current balance of the loans.

We assess the credit quality of a typical mortgage cover pool by estimating the credit risk associated with each loan in the pool. We then calculate the aggregate risk to assess the cover pool's overall credit quality. 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 this weighted-average foreclosure frequency (WAFF) and weighted-average loss severity (WALS) estimates the required loss protection, assuming all other factors remain unchanged.

As of June 2024, we estimate a WAFF of 18.91% and a WALS of 7.96% for the combined mortgage portfolio at a 'AAA' level of stress. The WAFF and WALS have increased since our previous assessment in September 2023, previously 16.93% and 6.98%, respectively. The slight deterioration is mainly due to the proportionally higher share of loans to housing companies and to the cover pool being concentrated in relatively higher LTV buckets.

The below tables summarize the cover pool's composition.

Table 3

Cover pool composition

	--As of June 30, 2024--		--As of Sept. 30, 2023--	
Asset type	**Value current balance (mil. €)**	**Percentage of cover pool**	**Value current balance (mil. €)**	**Percentage of cover pool**
Residential mortgage loans (housing loans)	113.63	9.91	156.61	20.69
Housing company loans	1033.35	90.09	600.14	79.3
Substitute assets	0	0	0	0
Total	1146.98	100	756.76	100

Table 4

Key credit metrics

	--As of June 30, 2024--		--As of Sept. 30, 2023--	
	Residential mortgages (housing loans)	**Commercial mortgages (housing company loans)**	**Residential mortgages (housing loans)**	**Commercial mortgages (housing company loans)**
Average loan size (€)	123,510	484,913	122,736	522,319
Weighted-average effective LTV ratio (%)*	53.04	N/A	53.78	N/A
Weighted-average cover pool current LTV ratio (%)§	50.59	18.5	51.30	14.08
Weighted-average loan seasoning (months)†	75.29	74.23	81.05	74.53
Balance of loans in arrears (%)	1.31	2.09	0.64	0
Buy-to-let loans (%)	5.26	N/A	6.86	N/A
Self-employed borrowers (%)	10.44	N/A	8.82	N/A
Equal installment mortgages (%)	9.2	N/A	9.47	N/A
Credit analysis results:				
WAFF (%)	9.51	19.94	9.37	18.91
WALS (%)	14.77	7.21	14.84	4.93

Combined credit analysis results	**As of June 30, 2024**	**As of Sept. 30, 2023**
WAFF (%)	18.91	16.93
WALS (%)	7.96	6.98
'AAA' credit risk (%)	4.27	7.66‡

*The effective LTV corresponds to 100% of current indexed whole loan LTVs for the WAFF calculation. §Weighted-average current indexed LTV based on current balance. †Seasoning refers to the elapsed loan term. ‡Floored by the largest obligor default test result applicable under our CRE criteria. LTV--Loan to value. WAFF--Weighted-average foreclosure frequency. WALS--Weighted-average loss severity. N/A--Not applicable.

Table 5

Loan-to-value ratios

	--As of June 30, 2024--		--As of Sept. 30, 2023--	
Residential mortgages (housing loans, %)	**Effective whole loan LTV (%)***	**Cover pool current LTV (based on current balance, %)**	**Effective whole loan LTV (%)***	**Cover pool current LTV (based on current balance, %)**
0-40	33.16	34.74	34.94	37.48

Table 5

Loan-to-value ratios (cont.)

	--As of June 30, 2024--		--As of Sept. 30, 2023--	
Residential mortgages (housing loans, %)	**Effective whole loan LTV (%)***	**Cover pool current LTV (based on current balance, %)**	**Effective whole loan LTV (%)***	**Cover pool current LTV (based on current balance, %)**
40-50	14.45	14.75	13.93	15.19
50-60	12.09	14.48	13.39	14.05
60-70	14.46	14.84	14.66	13.73
70-80	10.41	10	8.97	7.72
80-90	9.01	7.24	5.61	5.44
90-100	4.38	3.46	3.67	3.14
Above 100	2.03	0.48	4.84	3.26
Weighted-average LTV ratio	53.04	50.59	53.78	51.30
Commercial mortgages (housing company loans, %)				
0-40	N/A	93.79	N/A	96.1
40-50	N/A	3.81	N/A	3.24
50-60	N/A	1.58	N/A	0
60-70	N/A	0.82	N/A	0.66
70-80	N/A	0	N/A	0
80-90	N/A	0	N/A	0
90-100	N/A	0	N/A	0
Above 100	N/A	0	N/A	0
Weighted-average LTV ratio	N/A	18.5	N/A	14.08

*100% of current indexed whole-loan LTV ratio. LTV--Loan-to-value. N/A--Not applicable.

Table 6

Loan seasoning distribution*

	--As of June 30, 2024--		--As of Sept. 30, 2023--	
	Residential mortgage loans' seasoning (% of current residential loan balance)	**Commercial mortgage loans' seasoning (% of current commercial loan balance)**	**Residential mortgage loans' seasoning (% of current residential loan balance)**	**Commercial mortgage loans' seasoning (% of current commercial loan balance)**
>0 and <=2years	17.46	13.77	20.93	21.98
>2 and <=4 years	30.37	16.35	7.34	2.47
>4 and <=5 years	2.89	4.37	1.58	0.87
>5 and <=6 years	3.26	6.88	24.74	29.62
>6 and <=7 years	9.24	18.09	2.55	2.81
>7 and <=8 years	2.79	10.02	1.46	6.7
>8 and <=9 years	1.16	9.96	8.06	8.56
>9 and <=10 years	2.70	8.7	12.21	15.08
>10 years	28.81	11.85	20.5	11.9
Weighted-average loan seasoning (months)	74.23	74.23	81.05	74.53

*Seasoning refers to the elapsed loan term.

Table 7

Geographic distribution of loan assets

	--As of June 30, 2024--		--As of Sept. 30, 2023--	
	Percentage of residential loan balance current balance	Percentage of commercial loan balance (housing company loans)	Percentage of residential loan balance current balance	Percentage of commercial loan balance (housing company loans)
Southern Finland	91.53	72.7	94.75	78.81
Eastern Finland	0.16	0.13	0.3	0.08
Western Finland	7.52	24.11	4.66	18.42
Oulu	0.33	2.95	0.28	2.69
Lapland	0.46	0.11	0.01	0
Aland	0.00	0	0.00	0
Total	100	100	100	100

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

We stress the cover pool's cash flows, incorporating various default patterns, default timings, and interest rate paths. We also stress cash flows under different prepayment rates, and delinquency assumptions, which we run at different points over the weighted-average life of the covered bonds.

The structure is exposed to an asset-liability maturity mismatch because the covered bonds' repayment profile is not aligned with that of the assets. Our model simulates a stressed sale of assets whenever a liquidity gap occurs in our analysis. The adjustment applied for residential and commercial mortgage assets is 425 basis points and 1,000 basis points, respectively, on top of the modeled interest rate at the time of the shortfall.

We also model the possibility that the spread on the mortgages compresses over time, due to defaults, prepayments, and product switches. To account for this, we reduce margins, if a percentage of the higher-yielding loans exit the portfolio. We also stressed basis risk.

Our 'AAA' credit risk shows the amount of overcollateralization commensurate with our credit risk assessment. This figure is 4.27%, and it is no longer floored by the result of the largest obligor default test determined under our CRE criteria. Following the increase in the balance of loans to housing companies, the loss related to the 10 largest obligors accounted for a relatively lower share of the cover pool, at 3.54%, compared to 7.66% in our previous analysis.

Our TCE includes the additional credit enhancement that we expect is required to refinance the cover pool in a stressed environment. By applying our credit and cash flow stresses, we calculate a TCE of 19.40% (previously 17.44%) below the available credit enhancement of 27.43%. The increase in credit coverage and the relatively higher applied target asset spread (due to proportionally higher share of loans to housing companies) have driven the increase in the TCE.

Because we consider that an active secondary market for cover pool assets exists, the program can potentially achieve four notches of collateral-based uplift above the JRL. From this potential uplift, we make no deductions because Hypo's covered bond features a 12-month maturity extension, which satisfies the liquidity coverage requirement under our criteria. Furthermore, Hypo commits to maintaining an overcollateralization level commensurate with the assigned rating. Therefore, the maximum collateral uplift is four notches, allowing the covered bond to attain a 'AAA' rating.

With a JRL of 'aa-', the program requires three notches of collateral uplift to attain a 'AAA' rating. The overcollateralization commensurate with a 'AAA' rating equals 15.62% equivalent to 'AAA' credit risk plus 75% of refinancing costs. With the available overcollateralization of 27.43% exceeding the TCE of 19.40%, the covered bonds benefit from one unused notch of collateral-based uplift.

Table 8

Collateral uplift metrics

	As of June 30, 2024	As of June 30, 2023
Asset WAM (years)	8.74	9.34
Liability WAM (years)	5.25	5.88
Available credit enhancement	27.43	26.34
Required credit enhancement for coverage of 'AAA' credit risk (%)	4.27	7.66*
Required credit enhancement for first notch of collateral uplift (%)	8.05	7.71
Required credit enhancement for second notch of collateral uplift (%)	11.83	10.96
Required credit enhancement for third notch of collateral uplift (%)	15.62	14.20
Target credit enhancement for maximum uplift (%)	19.4	17.44
Potential collateral-based uplift (notches)	4	4
Adjustment for liquidity (Y/N)	N	N
Adjustment for committed overcollateralization (Y/N)	N	N
Achievable collateral support uplift (notches)	4	4

*Floored by the largest obligor default test result applicable under our CRE criteria. WAM--Weighted-average maturity.

Counterparty risk

We analyze counterparty risk under our criteria (see "Counterparty Risk Framework: Methodology And Assumptions," published on March 8, 2019.

Bank account provider

Borrowers will make mortgage payments into external bank accounts, which are either in Hypo's name or in the name of its wholly owned subsidiary. Under our counterparty risk criteria, we consider the associated bank account risk as mitigated through Hypo's commitment to replace the account bank providers within 90 calendar days should their ICR drop below 'BBB'.

Swaps

The structure benefits from liability hedges with Swedbank AB, Danske Bank A/S, Natixis SA, and Nordea Bank Abp to hedge the risk arising from the interest mismatch from the variable interest earned on the assets and the fixed interest payable on the first and second covered bonds issued under the program.

To derive the maximum potential rating on the covered bonds under our counterparty criteria, we consider various factors, including whether the counterparty is related to the issuer, whether the exposure to counterparties that are unrelated to the covered bond issuer is concentrated or diversified, the seniority of termination payments, the replacement commitment, and the collateral posting framework.

In this case, the counterparties are unrelated to the issuer and entitled to termination payments that rank pari passu with payments on the covered bonds. Furthermore, we assess the counterparty risk exposure as diversified given that each is hedging a notional amount of no greater than 25% of the total notional amount of derivatives.

According to the swap documentation, the counterparties have committed to either replacing themselves or procure an eligible guarantee for their obligations under the swap, if the respective ICR and RCR fall below 'A-' in the case of Danske Bank, and the RCR falls below 'A-' in the case of Swedbank and Nordea. Failure to do so within the specified time is an additional termination event allowing the issuer to terminate the derivative agreement. Furthermore, if we lower our rating on these swap counterparties 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 Natixis' commitments are similar, the rating triggers are dynamic and set at a level that maintains the rating on the covered bonds.

The collateral framework assessments, combined with a diversified counterparty risk exposure, the current RRL on Hypo ('a-'), and the counterparties' replacement triggers, support a maximum potential rating of 'AAA' under our counterparty risk assessment. The application of our counterparty risk criteria does not reduce the unused notch of collateral uplift in the program.

Sovereign risk

We analyze sovereign risk according to our "Incorporating Sovereign Risk In Rating Structured Finance Securities: Methodology And Assumptions," published on Jan. 30, 2019. Under the criteria, covered bonds backed by mortgages issued in a jurisdiction that is within a monetary union that include structural coverage of refinancing needs over a 12-month period (provided by the 12-month extendible maturity profile of the soft-bullet bonds in this instance) exhibit low sensitivity to country risk. As a result, we can rate the covered bonds up to five notches above the sovereign rating. Given our 'AA+' long-term rating on Finland, sovereign risk does not constrain our rating on the covered bonds.

Environmental, Social, And Governance

Environmental, social, and governance considerations have no material influence on our credit rating analysis of Hypo's mortgage covered bonds. The issuer currently does not offer specific mortgage products focused on environment or social factors, which could affect the credit results. The Finnish government guarantees part of the loan on certain residential mortgages but as we do not consider the guarantee timely, it does not affect the credit analysis. Hypo commits to maintain a level of overcollateralization in the program to maintain the rating on the covered bonds. Additionally, the bonds' soft-bullet repayment structure mitigates 180 days of liquidity risk. Both governance initiatives support the current ratings and the credit enhancement required for the rating.

Related Criteria

- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- Criteria | Structured Finance | General: Global Framework For Payment Structure And Cash Flow Analysis Of Structured Finance Securities, Dec. 22, 2020
- Criteria | Structured Finance | General: Counterparty Risk Framework: Methodology And Assumptions, March 8, 2019
- Criteria | Structured Finance | General: Incorporating Sovereign Risk In Rating Structured Finance Securities: Methodology And Assumptions, Jan. 30, 2019
- Criteria | Structured Finance | RMBS: Global Methodology And Assumptions: Assessing Pools Of Residential Loans, Jan. 25, 2019
- Legal Criteria: Structured Finance: Asset Isolation And Special-Purpose Entity Methodology, March 29, 2017
- Criteria | Structured Finance | Covered Bonds: Covered Bond Ratings Framework: Methodology And Assumptions, June 30, 2015
- Criteria | Structured Finance | Covered Bonds: Methodology And Assumptions: Analyzing European Commercial Real Estate Collateral In European Covered Bonds, March 31, 2015
- Criteria | Structured Finance | Covered Bonds: Covered Bonds Criteria, Dec. 9, 2014
- Criteria | Structured Finance | General: Global Derivative Agreement Criteria, June 24, 2013
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Related Research

- Global Covered Bond Insights Q1 2025: Overall A Healthy Year, Dec. 18, 2024
- S&P Global Ratings Definitions, Dec. 2, 2024
- Banking Industry Country Risk Assessment: Finland, Nov. 8, 2024
- The Mortgage Society of Finland, Oct. 4, 2024

- A Closer Look At Finland's Covered Bond Framework, Sept. 27, 2023
- Glossary Of Covered Bond Terms, April 27, 2018