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New Issue: Sp Mortgage Bank PLC €3 Billion Covered Bond Program (Mortgage Covered Bond Program)

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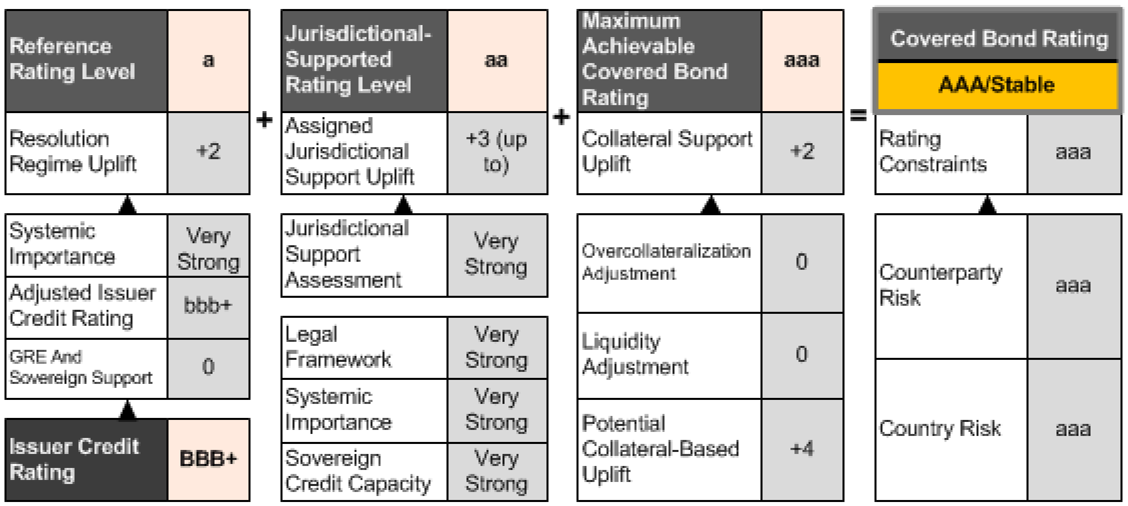
Ratings Detail



Note: We apply the notches of ratings uplift to the long-term rating on the Central Bank of Savings Banks Finland PLC, whose rating reflects the Savings Banks Group, to which we consider Sp Mortgage Bank to be a core entity, to derive the ratings on the covered bonds.

Major Rating Factors

Strengths

- The available credit enhancement exceeds what is required to achieve a 'AAA' rating.
- The cover pool has a low original loan-to-value (LTV) ratio compared to other Finnish pools.
- There is a public commitment to maintain overcollateralization that is in line with the current ratings on the covered bonds.

Weaknesses

- Due to the high level of constant annuity mortgages included in the cover pool, an increase in interest rates will result in delayed repayment of the mortgage assets.
- Commingling risk in the transaction is not contractually or structurally addressed.
- The cover pool has low seasoning compared to other Finnish mortgage pools.

Outlook: Stable

S&P Global Ratings' stable outlook on its ratings on Sp Mortgage Bank PLC's mortgage covered bonds reflects the fact that the ratings on the covered bonds benefit from two unused notches of collateral-based uplift under our covered bonds criteria (see "Covered Bonds Criteria," published on Dec. 9, 2014). We would not necessarily lower our ratings on the covered bonds if we were to lower our long-term issuer credit rating (ICR) by up to two notches or our long-term rating on Finland by up to three notches. We could lower our ratings on the covered bonds if the available credit enhancement were to decrease below the overcollateralization that is commensurate with their maximum achievable ratings under our criteria.

Rationale

We have assigned our 'AAA' credit ratings to Sp Mortgage Bank's mortgage covered bond program and inaugural issuance (see "Sp Mortgage Bank Finnish Mortgage Covered Bond Program And Issuance Assigned 'AAA' Ratings; Outlook Stable," published today).

Our covered bond ratings process follows the methodology and assumptions outlined in our covered bonds criteria and our covered bond ratings framework criteria (see "Covered Bond Ratings Framework: Methodology And Assumptions," published on June 30, 2015).

From our analysis of the program's documents, legal opinions and the Finnish legislative covered bond framework, we have concluded that the assets in the cover pool are isolated from the issuer's and the issuer's group'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 the Central Bank of Savings Banks Finland.

We consider the issuer to be a core entity to the Savings Banks Group, as is the Central Bank of Savings Banks Finland, and we derive the starting point of our analysis from the long-term ICR on the Central Bank of Savings Banks Finland, whose rating reflects the creditworthiness of the Savings Banks Group. Sp Mortgage Bank is domiciled in Finland, which applies the EU's Bank Recovery and Resolution Directive (BRRD). We assess the systemic importance of covered bonds in Finland as very strong. A successful resolution of the Savings Banks Group increases the likelihood that the issuer would continue servicing its covered bonds without accessing the cover pool or receiving jurisdictional support, even following a bail-in of the bank's senior unsecured obligations. Therefore, under our covered bonds criteria, we assess the reference rating level (RRL) at 'a', two notches above the long-term ICR on the issuer, adjusted for any sovereign support.

We then consider the likelihood of jurisdictional support, which we assess as very strong for mortgage covered bond programs in Finland. 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'.

Based on cash flows as of November 2016, the available credit enhancement of 31.15% exceeds the 22.16% credit enhancement that is commensurate with a 'AAA' rating. The available credit enhancement is also commensurate with the target credit enhancement for a fourth notch of collateral uplift.

We have sized commingling risk based on a projected quarterly review of the program's cash flows.

Our 'AAA' ratings are not constrained by legal, operational, counterparty, or country risks.

Program Description

Table 1

Program Overview (Based On Data As Of November 2016)	
Jurisdiction	Finland
Covered bond type	Legislation-enabled
Outstanding covered bonds (bil. €)	0.50
Redemption profile	Soft bullet
Underlying assets	Residential mortgages
Jurisdictional support uplift	3
Unused notches for jurisdictional support	0
Target credit enhancement (TCE) (%)*	29.38
Available credit enhancement (%)	31.15
Collateral support uplift	4
Unused notches for collateral support	2
Total unused notches	2

*TCE refers to the overcollateralization for the maximum potential uplift of four notches.

Sp Mortgage Bank belongs to the Savings Banks Amalgamation and is a member bank of the Savings Banks' Union Coop. The credit institution members of the Amalgamation share joint and several liability. However, the cover pool is for the benefit of the covered bondholders. Sp Mortgage Bank was established in March 2016 in order to provide competitive funding to the savings banks. The new program's covered bonds will be the issuer's direct unconditional and unsubordinated debt obligations and will rank pari passu among themselves. The covered bonds are secured on a cover pool of euro-denominated Finnish residential mortgage loans. The initial loan pool consists of existing loans transferred from the savings banks in the network, new loans originated via the savings banks' network, and a one-off portfolio transfer from the group's previous covered bond funding partner, Aktia Real Estate Mortgage Bank. The covered bondholders have a priority claim on the cover pool's assets. The inaugural issuance is denominated in euros and pays a fixed rate of interest. Future issuances may be denominated in different currencies and can be fixed, floating or zero-coupon.

Table 2

Program Participants

Role	Name	Rating	Rating dependency
Issuer	Sp Mortgage Bank PLC	NR	Yes
Arranger	BNP Paribas	A/Stable/A-1	No
Originator	Savings Banks	NR	No
Bank account provider	Central Bank of Savings Banks	BBB+/Positive/A-2	No
Servicer	Savings Banks	NR	No

Table 2

Program Participants (cont.)			
Role	**Name**	**Rating**	**Rating dependency**
Swap counterparty	Nordea Bank Finland PLC	AA-/Negative/A-1+	Yes
Swap counterparty	BNP Paribas	A/Stable/A-1	Yes

NR--Not rated

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 the Central Bank of Savings Banks Finland .

If the issuer defaults, bondholders can initiate regular insolvency proceedings. In addition, under the Covered Bond Act, they have a preferential claim to a cover pool. Under the legislation, the cover pool can comprise residential mortgage loans including shares in housing companies, public-sector loans, substitute assets and commercial mortgage loans for a maximum of 10% of the pool. The program documentation does not allow commercial mortgages. Cover pool assets must be 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 if it becomes insolvent. 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.

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 or accelerate the payment of the covered bonds if it considers this to be in the bondholders' best interests, subject to Finnish regulatory approval.

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

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

Our analysis of operational and administrative risks follows the guidelines in covered bond ratings framework criteria. Sp Mortgage Bank does not originate loans on its own, but depends on the savings banks' network. Credit decisions of the savings banks are made based on lending guidelines issued by Sp Mortgage Bank and the savings banks are bound to repurchase any loans that would not be compliant with the guidelines. We view Sp Mortgage Bank's underwriting criteria as comparable with market standards.

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 Sp Mortgage Bank's cover pool do not have product features that would materially limit the range of available replacement cover pool managers or servicers. We have modelled a servicing fee we deem sufficient to attract a replacement servicer.

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

Sp Mortgage Bank's covered bonds are subject to refinancing risk due to mismatches between the maturities of the mortgage assets in the cover pool and the covered bond. As a result, we link the covered bond ratings 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. In our notching-up analysis we deem Sp Mortgage Bank to be a core institution to the Savings Banks group and therefore use our long-term ICR on the Central Bank of Savings Banks Finland as a starting point under our group rating methodology.

We consider that Finland has implemented the bail-in provisions specified under the BRRD, and our analysis gives credit to the adoption of the BRRD. We assess the systemic importance for mortgage programs in Finland as very strong (see "Assessments for Jurisdictional Support According To Our Covered Bonds Criteria," published on July 20, 2016). Under our covered bonds criteria, this means that the RRL can be two notches above the adjusted long-term ICR (which adjusts the ICR by removing the uplift allocated to reflect extraordinary government support to the issuer). 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 in the event of 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 support from the government.

The long-term ICR of 'BBB+' on the Central Bank of Savings Banks Finland does not incorporate any notch of uplift for government support. Therefore, the adjusted ICR is equal to the long-term ICR and the RRL is 'a', reflecting two notches of uplift above the adjusted ICR.

Jurisdictional support analysis

In our analysis of jurisdictional support under 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. 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 Sp Mortgage Bank's mortgage covered bonds of 'aa'. The JRL cannot exceed the rating on the sovereign providing the support to the covered bonds, which in this case is Finland, at 'AA+'.

Collateral support analysis

We based our credit analysis on loan-by-loan data as of November 2016. The pool comprises loans that are secured on euro-denominated Finnish residential properties, including shares in housing associations.

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 our "Methodology And Assumptions For Analyzing Mortgage Collateral In Finnish And Norwegian Covered Bonds," published on Dec. 10, 2014.

At a 'AAA' level of stress, the weighted-average foreclosure frequency (WAFF) is 16.7% and the weighted-average loss severity (WALS) is 20.2%. The WAFF and WALS are respectively slightly lower and higher than what we see in other Finnish mortgage programs that we rate. The main characteristics and drivers of the credit results in this portfolio are a very large proportion of constant annuity loans, which attract a payment shock penalty in our analysis, a low seasoning, a low weighted-average original LTV ratio, and a slight concentration risk in East Finland and Lapland.

Our analysis of the planned issuance indicates that 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. We analyze the cash flows under our credit stresses, as well as under liquidity and interest rate stresses. We also run different default timing and prepayment patterns. The program is exposed to structural asset-liability mismatch risk because its features do not fully address the mismatches in its asset-liability profile. To address this market risk, our model simulates a stressed sale of assets whenever a liquidity gap occurs in our analysis. The discount applied for the assets in the cover pool is 425 basis points, on top of the stressed interest rate at the time of the shortfall. This discount is a function of the nature of the assets and is outlined in our "Assessments for Target Asset Spreads According To Our Covered Bonds Criteria" article, published Aug. 15, 2016. The planned issuance includes a one-year maturity extension; we have rated to the legal final maturity date.

There is no structural feature to mitigate time-subordination of longer-dated bonds, however our ratings address the timely repayment of all of the covered bonds, currently limited to the inaugural issuance.

Sp Mortgage Bank's inaugural issuance pays a fixed rate of interest. In order to mitigate interest rate risk arising from the floating-rate assets, the issuer has entered into a swap agreement. We take this hedge into account in our cash flow analysis (see counterparty risk section).

Because there is an active secondary market for the type of assets seen in the cover pool, under our covered bonds criteria, the program can potentially benefit from up to four notches of collateral-based uplift above the JRL.

Based on information as of November 2016, the available credit enhancement is 31.15% and exceeds the required credit enhancement of 22.16% for the covered bonds to achieve 'AAA' ratings. This corresponds to coverage of 'AAA' credit risk and 50% of the refinancing costs. It also exceeds the 29.38% credit enhancement that is commensurate with the target credit enhancement. This means that the program could benefit from four notches of collateral uplift. There are two unused notches of collateral-based uplift. These figures are reflective of the maturity mismatch in the program based on the current single issuance and are therefore very sensitive to the maturity of that issuance. As a result, they could significantly vary in the future depending on the maturity of any new issuance.

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Liquidity risk

We do not apply any adjustment for liquidity risk because the bonds benefit from a one-year maturity extension and because the ratings that we have assigned are higher than the long-term foreign currency rating on the Finnish sovereign, which is a eurozone member state.

Overcollateralization commitment

The issuer has published on its website an overcollateralization commitment that is in line with our criteria. Therefore we do not adjust the collateral support uplift for lack of committed overcollateralization.

Table 3

Cover Pool Composition (As Of November 2016)

Asset type	Value (bil. €)	Percentage of cover pool
Residential Mortgages	0.68	100.00
Total	0.68	100.00

Table 4

Key Credit Metrics As Of November 2016

Weighted-average current LTV ratio (%)	62.02
Weighted-average original LTV ratio (%)	59.62
Weighted-average loan seasoning (months)*	32.47
Balance of loans in arrears (%)	0.16
Buy-to-let loans (%)	0.00
Short-term interest-only loans (%)	0.00
Constant annuity loans	75.72
Credit analysis results:	
Weighted-average foreclosure frequency (WAFF; %)	16.65
Weighted-average loss severity (WALS; %)	20.19
AAA credit risk (%)	14.93

*Seasoning refers to the elapsed loan term.

Table 5

LTV Ratios (Current And Original) As Of November 2016

Current LTV ratios*	
(%)	**Percentage of pool**
0-60	41.42
60-70	19.57
70-80	34.24
80-90	2.05
90-100	0.75
Above 100	1.98
Weighted-average current LTV ratios	62.02
Original LTV ratios*	
(%)	**Percentage of pool**
0-60	48.50

Table 5

LTV Ratios (Current And Original) As Of November 2016 (cont.)	
60-70	24.75
70-80	8.59
80-90	18.04
90-100	0.09
Above 100	0.04
Weighted-average original LTV ratios	59.62

*After S&P Global Ratings' adjustments

Table 6

Loan Seasoning Distribution As Of November 2016

	Percentage of portfolio
Less than 18 months	51.98
18-24	11.47
24-36	2.93
36-48	2.14
48-60	6.86
60-72	8.54
72-84	7.40
84-96	4.49
96-108	1.48
108-120	1.41
More than 120	1.15
Weighted-average loan seasoning (months)	32.47

Note: Seasoning refers to the elapsed loan term.

Table 7

Geographic Distribution Of Loan Assets As Of November 2016

Region of Finland	Percentage of cover pool
South Finland	41.67
West Finland	34.98
Oulun	8.31
East Finland	10.57
Lapland	4.47
Aland	0.00
Total	100.00

Table 8

Collateral Uplift Metrics As Of November 2016	
Asset WAM (years)	9.46
Liability WAM (years)	6.25
Available credit enhancement	31.15
Required credit enhancement for coverage of 'AAA' credit risk	14.93

Table 8

Collateral Uplift Metrics As Of November 2016 (cont.)	
Required credit enhancement for first notch of collateral uplift (%)	18.54
Required credit enhancement for second notch of collateral uplift (%)	22.16
Required credit enhancement for third notch of collateral uplift (%)	25.77
Target credit enhancement (TCE) for maximum uplift (%)*	29.38
Potential collateral-based uplift (notches)	4
Adjustment for liquidity (Y/N)	N
Adjustment for committed overcollateralization (Y/N)	N
Collateral support uplift (notches)	2

*TCE refers to the overcollateralization for the maximum potential uplift of four notches. WAM--Weighted-average maturity.

Counterparty risk

We have identified several counterparty risks to which the issuance is exposed. However, they are either mitigated through documentation or we have taken them into account in our modeling. Accordingly, we consider that they do not constrain our ratings on the covered bond.

Bank account provider

Payments from borrowers are made into an account in the name of the issuer with the Central Bank of Savings Banks Finland. There is no downgrade language for the bank account. Therefore, proceeds from the portfolio could be lost through commingling risk, if the bank account provider becomes insolvent. Accordingly, we have stressed a quarter's worth of asset cash flow pre-default, reflecting our understanding of the frequency of our access to information on the program's available credit enhancement. We have also stressed one month of post-default cash flows reflecting the time to redirect borrowers' payments. This stress is included as an additional form of credit enhancement—and we believe that overcollateralization sufficiently mitigates this risk.

Swaps

The issuer has entered into swap agreements with BNP Paribas and Nordea Bank Finland to mitigate interest rate risk on the planned issuance. The documentation is in line with our current counterparty criteria at a 'AAA' level of stress so that we can take these hedges into account in our cash flow analysis with no constraint to the ratings.

Country risk

We assess country risk by applying our structured finance ratings above the sovereign criteria (see "Ratings Above The Sovereign - Structured Finance: Methodology And Assumptions," published on Aug. 8, 2016). As the sensitivity of the underlying assets to sovereign risk is moderate and liquidity risk is mitigated for a year, the bonds can be rated up to four notches above the long-term rating on the sovereign. In light of the long-term 'AA+' sovereign rating on Finland and the country's eurozone membership, country risk does not constrain our 'AAA' ratings on the covered bonds. Because the sovereign rating caps the JRL, we could lower our rating on Finland by up to three notches, all else remaining equal, without automatically lowering our ratings on the covered bonds.

Related Criteria And Research

Related Criteria

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- Criteria - Structured Finance - Covered Bonds: Covered Bond Ratings Framework: Methodology And Assumptions, June 30, 2015
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- General Criteria: Methodology: Credit Stability Criteria, May 03, 2010
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Related Research

- Sp Mortgage Bank Finnish Mortgage Covered Bond Program And Issuance Assigned 'AAA' Ratings; Outlook Stable, Nov. 29, 2016
- Various Positive Rating Actions On Finnish Banks On Improved Economic Conditions, Nov. 17, 2016
- Sp Mortgage Bank Finnish Mortgage Covered Bond Program And Issuance Assigned Preliminary 'AAA' Ratings; Outlook Stable, Nov. 11, 2016
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- Outlook Assumptions For The Finnish Residential Mortgage Market, Sept. 20, 2016
- Finland Outlook Revised To Stable On Gradual Economic Recovery; Ratings Affirmed At 'AA+/A-1+', Sept. 16, 2016
- Assessments for Target Asset Spreads According To Our Covered Bonds Criteria, Aug. 15, 2016
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- What Factors Do We Consider When Analyzing Commingling And Account Bank Risk In Covered Bonds?, Nov. 26, 2012