S&P Global Ratings

Research

Transaction Update: OP Mortgage Bank

€20 Billion Medium-Term Covered Bond Program

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Ratings Detail

Reference Rating Level	**aa+**
Resolution Regime Uplift	+2
Systemic Importance	Very Strong
Resolution Counterparty Rating	AA-*
Issuer Credit Rating	**AA-***

+

Jurisdiction-Supported Rating Level	**aa+**
Assigned Jurisdictional Support Uplift	0
Jurisdictional Support Assessment	Very Strong
Legal Framework	Very Strong
Systemic Importance	Very Strong
Sovereign Credit Capacity	Very Strong

+

Maximum Achievable Covered Bond Rating	**aaa**
Collateral Support Uplift	+3
Overcollateralization Adjustment	-1
Liquidity Adjustment	0
Potential Collateral Based Uplift	+4

=

Covered Bond Rating	**AAA/Stable**
Rating Constraints	aaa
Counterparty Risk	aaa
Country Risk	aaa

*We used the long-term rating on OP Corporate Bank PLC, which reflects the creditworthiness of OP Financial Group to which OP Mortgage Bank is considered a core entity.

Major Rating Factors

Strengths	Weaknesses
• The cover pool's assets are seasoned Finnish residential mortgage loans, which have low current average loan-to-value (LTV) ratios compared with Scandinavian peers. • The interest rate characteristics of the mortgage assets are matched to the liabilities through swaps. • The ratings on the covered bonds benefit from three unused notches of jurisdictional support and two unused notches of collateral based uplift.	• There is no legally binding obligation for the issuer to provide overcollateralization to maintain the currently assigned rating on the program. • About 49% of the mortgages in the cover pool are subject to equal installments, hence any increase in interest rates will result in delayed principal repayment of the mortgage assets and a potential borrower payment shock.

Outlook: Stable

S&P Global Ratings' stable outlook on the ratings on OP Mortgage Bank's (OPMB) mortgage covered bonds reflects the fact that the ratings on the covered bonds benefit from five unused notches of support under our covered bonds criteria. This means that the ratings on the covered bonds would be unaffected if we were to lower our long-term issuer credit rating (ICR) on the issuer by up to five notches, all else being equal.

Rationale

We are publishing this transaction update as part of our periodic review of OPMB's 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 OPMB's 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 potentially rate the covered bond program at a higher rating level than the long-term ICR on the issuer.

We conducted a review of OPMB'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 a core entity to its parent, the OP Financial Group, and we derive the starting point of our analysis from the long-term ICR on OP Corporate Bank, whose rating reflects the creditworthiness of the wider OP Financial Group.

Under our resolution regime analysis, we determined a reference rating level (RRL) of 'aa+'. This is based on the fact that the issuer is domiciled in Finland, which is subject to the EU's Bank Recovery and Resolution Directive (BRRD), and on our very strong assessment of the systemic importance of mortgage covered bonds in Finland. These factors increase the likelihood that OPMB 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 then consider the likelihood for the provision of jurisdictional support, which for mortgage programs in Finland we assess as very strong. This leads us to apply up to three notches of uplift from the RRL. However, the jurisdictional support uplift is limited by our long-term rating on the Finnish sovereign, 'AA+'. Therefore, we assess the jurisdiction-supported rating level (JRL) as the same level as the RRL on the program, 'aa+'.

We have reviewed the asset information provided as of June 30, 2020. The program's underlying assets comprise €15.6 billion of Finnish residential mortgage loans. 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 reduce the potential collateral-based uplift by one notch due to the lack of committed overcollateralization commensurate with the ratings. We consider that the soft-bullet structure of the liabilities mitigates liquidity risk for 180 days.

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

We have based our analysis on our relevant criteria (see "Related Criteria").

Program Description

Table 1

Program Overview*	
Jurisdiction	Finland
Year of first issuance	2011
Covered bond type	Legislation-enabled
Outstanding covered bonds (bil. €)	13,665
Redemption profile	Yes
Underlying assets	Finnish residential mortgage loans
Jurisdictional support uplift	3
Unused notches for jurisdictional support	3
Target credit enhancement (%)	2.5
Available credit enhancement (%)	14.7
Collateral support uplift	3
Unused notches for collateral support	2
Total unused notches	5

*Based on cash flows as of May 31, 2020.

OPMB established the €20 billion mortgage covered bond program to issue a series of covered bonds, which are secured on a cover pool of residential mortgage loans. The assets are registered in the cover asset register and the covered bondholders have a priority claim on the cover pool's assets. The program's first issuance was in 2011. OPMB established the new program following the enactment of the new Finnish Covered Bond Act in 2010.

The issuer is a part of the OP Financial Group, a statutory amalgamation of the Finnish cooperative banks. The group is a financial consortium under the Act on Amalgamations of Deposit Banks. The group established OPMB to refinance its prime mortgage assets by issuing covered bonds. Its funding plans are an integral part of the cooperative group's funding strategy. OPMB is also subject to the Covered Bond Act, which provides specific regulations for a Finnish covered bond issuer.

The Finnish covered bond law allows deposit banks and credit societies to participate indirectly in the issue of covered bonds by means of intermediary loans granted by a mortgage credit bank.

The program's covered bonds are the issuer's direct unconditional and unsubordinated debt obligations and rank pari passu among themselves. The covered bonds are secured on a cover pool of Finnish residential mortgage loans. The cover pool assets and outstanding liabilities are all denominated in euro.

Chart 1

OP Mortgage BankCovered Bond Program Structure

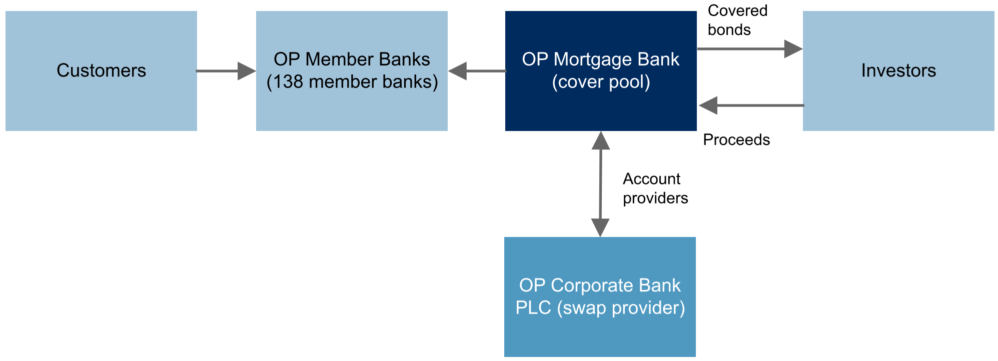

Table 2

Program Participants

Role	Name	Rating	Rating dependency
Issuer	OP Mortgage Bank	N/A*	Yes
Originator	OP Mortgage Bank	N/A§	No
Bank account provider	OP Corporate Bank PLC	AA-/Negative/A-1+	Yes
Interest rate hedge provider	OP Corporate Bank PLC	AA-/Negative/A-1+	Yes

*The issuer is a core entity to its parent, the OP Financial Group. Therefore, we derive the ratings on the covered bonds by applying notches of uplift to the long-term ICR on OP Corporate Bank PLC, whose rating reflects the creditworthiness of the wider OP Financial Group. §Mortgage loan origination by member banks of the wider OP Financial Group. N/A--Not applicable.

Rating Analysis

Legal and regulatory risks

We base our analysis of legal risk on the guidelines in "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 OP Corporate Bank.

If the issuer defaults, bondholders can initiate insolvency proceedings. In addition, under the Covered Bond Act, they have a preferential claim to a cover pool. 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 monthly. The register also includes the counterparties to derivative contracts, which must be able to survive the issuer's insolvency.

The Finnish covered bond law allows deposit banks and credit societies to participate indirectly in the issue of covered bonds by means of intermediary loans granted by a mortgage credit bank. The cover pool includes as of June 2020 65% of mortgages funded by intermediary loans. We consider the security of the collateral backing intermediary loans to be comparable to direct transferred mortgage loans. We therefore consider all intermediary loans as would they already be transferred to the cover pool.

If the issuer becomes insolvent, the Finnish regulator would appoint a 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/financial entities.

Under the Covered Bond Act, the issuer's bankruptcy would not trigger 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

The mortgage loan business is OP Financial Group's core business. OP Financial Group's central cooperative institution is headquartered in Helsinki and sets the group's basic lending criteria, supplies administrative assistance, and is responsible for debt collection. OP Financial Group has maintained cautious lending policies with adequate collateralization (new mortgages are stressed for 6% interest rate and 25 years' maturity). OPMB can set additional limits to the lending criteria and actively selects loans to be included in the cover pool, manages the cover pool, and issues covered bonds.

Member cooperative banks can participate in the covered bond issuance process indirectly via intermediary loans. These loans are backed by mortgage loans that are registered in OPMB's cover pool and serve as collateral for the benefit of covered bond noteholders.

The cover pool may include loans in arrears, which have installments that are up to 60 days overdue. However, these loans do not form part of the program's eligible balance. The cover pool currently includes no loans that are more than 30 days in arrears.

We consider the issuer's underwriting and servicing standards to be sufficient to support our ratings on the covered bonds. 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 the 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

OPMB 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. Under our covered bonds criteria, this means the RRL will be the greater of: (i) the ICR on the issuing bank, plus two notches, that is, 'aa+'; and (ii) the resolution counterparty rating (RCR) on the issuing bank, 'AA-'. As a result, the RRL is 'aa+', 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. This increases the likelihood that the issuer 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

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.

The JRL for the covered bonds is 'aa+', equivalent to the RRL. The JRL is our assessment of 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. Given our very strong assessment of the expected jurisdictional support for Finnish mortgage covered bond programs, the program can receive up to three notches of jurisdictional uplift above the RRL. However, we give no benefit to jurisdictional support in our analysis (that is, zero incremental uplift for jurisdictional support), because the RRL ('aa+') is already at the level of the long-term sovereign rating on Finland.

Collateral support analysis

The cover pool comprises only Finnish residential mortgage loans. We base our analysis on loan-by-loan data as of a cut-off date of June 30, 2020.

Table 3

Cover Pool Composition

	June 30, 2020		June 30, 2019	
Asset type	**Value (mil. €)**	**Percentage of cover pool (%)**	**Value (mil. €)**	**Percentage of cover pool (%)**
Finnish residential mortgage loans	15,616	100	14,071	100
Substitute assets	0	0	0	0
Other asset type	0	0	0	0
Total	15,616	100	14,071	100

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 44% 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 seven years and the interest rate on about 98% 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 the specific adjustments defined for Finland under our global residential loans criteria (see "Global Methodology And Assumptions: Assessing Pools Of Residential Loans," published on Jan. 25, 2019).

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.

Our WAFF and WALS for the portfolio are 13.46% and 9.77%, respectively. Compared with our previous analysis, the WAFF has decreased from 17.97%. The improvement in the portfolio's WAFF is mainly due to the application of our global residential loans criteria, under which we apply multiples based on an LTV ratio that weights 80% of the portfolio at the original LTV ratio of the loan and 20% at the the current LTV ratio (compared with a weight of 100% on the original LTV ratio previously, which is relatively higher), and the higher seasoning of the loans in the portfolio. The WALS has increased from 7.23% due to the cover pool's slightly higher indexed LTV ratio distribution and share of jumbo valuations.

Table 4

Key Credit Metrics

	June 30, 2020	June 30, 2019
Average loan size (€)	52,451	50,528
Weighted-average LTV ratio (%)	44.43	44.2
Weighted-average loan seasoning (months)*	79.82	71.02
Balance of loans in arrears (%)	0	0.02
Buy-to-let loans (%)	0	0.63
Self-employed borrowers (%)	4.09	3.91
Equal installment mortgages (%)	49	57
Credit analysis results:		
Weighted-average foreclosure frequency (%)	13.46	17.87
Weighted-average loss severity (%)	9.77	7.23
'AAA' credit risk (%)	2.5	2.5

*Seasoning refers to the elapsed loan term. LTV--Loan to value. N/A--Not applicable.

Table 5

Current LTV Ratios

	June 30, 2020	June 30, 2019
(%)	**Percentage of cover pool (%)**	
0-60	82.01	81.86

Table 5

Current LTV Ratios (cont.)

	June 30, 2020	June 30, 2019
(%)	Percentage of cover pool (%)	
60-70	16.40	12.94
70-80	0.95	3.44
80-90	0.20	0.99
90-100	0.13	0.49
Above 100	0.31	0.28
Total above 80	0.64	1.76
Weighted-average LTV ratios	44.43	44.20

LTV--Loan-to-value.

Table 6

Loan Seasoning Distribution*

	June 30, 2020	June 30, 2019
	Percentage of portfolio (%)	
Less than 18 months	12.3	15.3
18 to 60	31.6	33.0
More than 60	56.0	51.8
Weighted-average loan seasoning (months)	79.8	71.0

*Seasoning refers to the elapsed loan term.

Table 7

Geographic Distribution Of Loan Assets

	June 30, 2020	June 30, 2019
	Percentage of cover pool (%)	
Southern Finland	48.3	48.3
Eastern Finland	8.1	8.4
Western Finland	32.7	32.2
Oulu	8.8	9.4
Lapland	2.0	1.5
Aland	0.2	0.2
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 look to make adjustments to the maximum collateral based uplift by reviewing the coverage of six months of liquidity and the level of commitment for the overcollateralization. For OPMB, all covered bonds include a 12-month maturity extension, which we consider to satisfy the six-month liquidity coverage. OPMB does not provide a commitment for overcollateralization. Therefore, we adjust the maximum collateral-based uplift to three notches.

We conducted our cash flow analysis by applying the specific adjustments defined for Finland under our global residential loans criteria.

The cover pool consists of about 49% equal installment mortgage loans with variable maturity. The installment paid by the borrower must always cover interests, but may lead to the extension of repayments should the whole installment be used for interest. Such loans attract an adjustment of credit risk in line with our criteria. Our analysis of the covered bonds' payment structure shows that the assets' cash flows would be sufficient to make timely payment of interest and ultimate payment of principal to the bondholders at a 'AAA' level.

By applying our credit and cash flow stresses, we calculate a target credit enhancement of 2.5%. The target credit enhancement is less than the available credit enhancement of 14.70%, allowing for the full three notches of collateral-based uplift. With a JRL of 'aa+', the program is only required to cover 'AAA' credit risk to achieve the 'AAA' rating, which also corresponds to an overcollateralization of 2.5%.

Table 8

Collateral Uplift Metrics

	As of May 30, 2020	As of June 30, 2019
Asset WAM (years)	6.82	6.58
Liability WAM (years)	5.38	5.86
Available credit enhancement	14.70	29.61
Required credit enhancement for first notch of collateral uplift (%)	2.50	2.50
Required credit enhancement for second notch of collateral uplift (%)	2.50	2.50
Required credit enhancement for third notch collateral uplift (%)	2.50	4.02
Target credit enhancement for maximum uplift (%)	2.50	4.96
Potential collateral-based uplift (notches)	4	4
Adjustment for liquidity (Y/N)	N	N
Adjustment for committed overcollateralization (Y/N)	Y	Y
Collateral support uplift (notches)	3	3

WAM--Weighted-average maturity.

Counterparty risk

We have identified various potential counterparty risks to which the program is exposed. However, as these are either structurally addressed or mitigated by the inclusion of replacement language in line with our current counterparty criteria, we believe that they do not constrain the rating from a counterparty risk perspective (see "Counterparty Risk Framework: Methodology And Assumptions," published on March 8, 2019).

Bank account provider

OP Corporate Bank is the cover pool's bank account provider. Its commitment to replace itself if its short-term rating falls below 'A-1' mitigates bank account risk.

Commingling risk

The borrowers make payments to the bank account of the member banks that originated the loans. These funds are credited to the cover pool account on a daily basis. OPMB has a claim against OP Corporate Bank for any amounts credited to this account, and OP Corporate Bank waives all deposit set-off rights against these funds. If the short-term rating on OP Corporate Bank falls below 'A-1', it will open and maintain an issuer collection account with a bank rated at least 'A-1'. All borrower payments following a downgrade of OP Corporate Bank would be transferred to the issuer's collection account daily. If the long-term ICR on OP Corporate Bank falls below 'BBB', within 30 days, the issuer will notify all borrowers to pay directly to the issuer's collection account, thereby mitigating commingling risk.

Swaps

OPMB entered into hedging agreements with OP Corporate Bank to address interest rate mismatches between the assets and liabilities. There are no currency mismatches, as all of the assets and liabilities are euro-denominated.

OP Corporate Bank is a related counterparty to the issuer and it is entitled to termination payments that rank pari passu with payments on the covered bonds. According to the swap documentation, OP Corporate Bank is committed to replace itself if its rating falls below 'BBB+'. If it fails to meet this commitment, an additional termination event would allow the issuer to terminate the derivative agreement. Furthermore, if its rating is lowered below 'A', the swap counterparty is committed to post collateral sufficient to cover the issuer's exposure to the counterparty plus certain volatility risk in the swap value. We categorize the current counterparty's collateral-posting framework in the derivative contract as strong according to our counterparty criteria.

Our counterparty criteria combine the collateral framework assessment with the replacement trigger and the issuer's RRL to derive the maximum potential covered bond rating. While the replacement trigger according to the swap documentation is the 'BBB+' rating on the long-term, unsecured, and unsubordinated debt obligations of OP Corporate Bank, our counterparty criteria state that RRL is the applicable counterparty rating when the counterparty is related to the covered bond issuer. We have therefore derived the applicable replacement trigger from the rating type shown in the documentation.

When the swap documentation does not explicitly refer to a rating type, as is the case in this program (which refers to rating triggers on the long-term, unsecured, and unsubordinated debt obligations of the bank) we generally consider this to be the RCR.

A replacement trigger of 'BBB+' on the RCR equates to a replacement trigger of 'BBB+' on the long-term ICR, because there is currently no notches of difference between the RCR and ICR on OP Corporate Bank. This, in turn, equates to a replacement trigger of 'a' on the RRL (given the very strong systemic importance of mortgage covered bonds in Finland).

The strong collateral framework assessment, combined with the current RRL on the issuer ('aa+') and the replacement trigger at 'a', supports a maximum potential rating of 'AAA' under our counterparty risk assessment.

Country risk

Under our structured finance ratings above the sovereign 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 evolution of the coronavirus pandemic. The current consensus among health experts is that COVID-19 will remain a threat until a vaccine or effective treatment becomes widely available, which could be around mid-2021. We are using this assumption in assessing the economic and credit implications associated with the pandemic (see our research here: www.spglobal.com/ratings). As the situation evolves, we will update our assumptions and estimates accordingly.

Related Criteria

- Global Methodology And Assumptions: Assessing Pools Of Residential Loans, Jan 25, 2019
- Counterparty Risk Framework: Methodology And Assumptions, March 8, 2019
- Incorporating Sovereign Risk In Rating Structured Finance Securities: Methodology And Assumptions, Jan. 30, 2019
- Asset Isolation And Special-Purpose Entity Methodology, March 29, 2017
- Covered Bond Ratings Framework: Methodology And Assumptions, June 30, 2015
- Covered Bonds Criteria, Dec. 9, 2014
- Criteria - Structured Finance - General: Global Derivative Agreement Criteria, June 24, 2013
- General Criteria: Methodology: Credit Stability Criteria, May 3, 2010
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Related Research

- Global Covered Bond Insights Q3 2020, Sept. 17, 2020
- Global Covered Bond Characteristics And Rating Summary Q3 2020, Sept. 17, 2020
- Assessments For Jurisdictional Support According To Our Covered Bonds Criteria, March 3, 2020
- Assessments For Target Asset Spreads According To Our Covered Bonds Criteria, March 3, 2020
- S&P Global Ratings' Covered Bonds Primer, June 20, 2019
- Glossary Of Covered Bond Terms, April 27, 2018