Research

Transaction Update: OP Mortgage Bank PLC (Medium-Term Covered Bond Program)

€10 Billion Medium-Term Covered Bond Program

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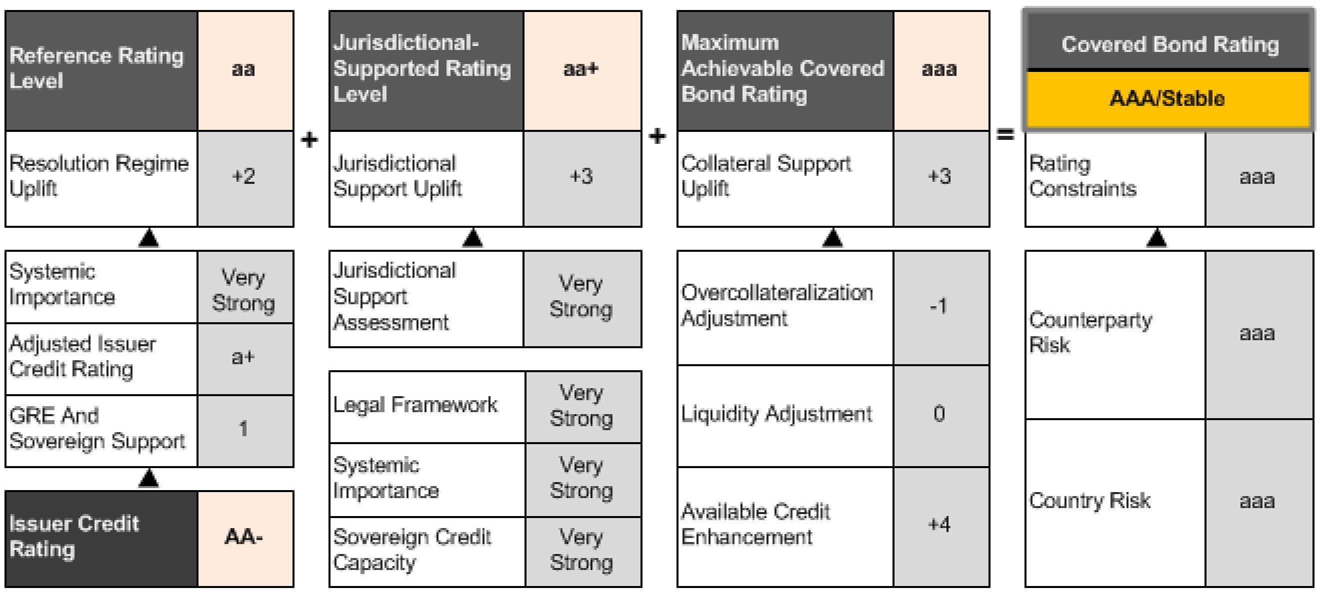
Ratings Detail



Major Rating Factors

Strengths

- The cover pool's assets are Finnish residential mortgage loans, which have low weighted-average loan-to-value (LTV) ratios.
- The available credit enhancement significantly exceeds the target credit enhancement commensurate with the maximum achievable ratings on the covered bonds.
- The ratings on the covered bonds benefit from three unused notches of jurisdictional support and two unused notches of collateral based uplift.

Weaknesses

- The issuer has committed to comply with the regulatory matching requirements and may provide more overcollateralization than required by law. However, there is no legally binding obligation for the issuer to provide excess overcollateralization to maintain the currently assigned rating on the program. Therefore, the overcollateralization that currently supports the assigned rating could, at the management's discretion, decline to the regulatory minimum. This may not always be sufficient to support the rating on the program.
- Due to the high level of floating-rate mortgages included in the cover pool, any increase in interest rates will result in an increase to borrower payments.

- Competition in the mortgage market may lead to compression of the margins earned on mortgage loans, resulting in lower cash flows that are available to support the payments due on the covered bonds.

Outlook: Stable

The stable outlook reflects the fact that the ratings on the covered bonds benefit from three unused notches of jurisdictional support and two notches of unused collateral based uplift under our covered bond criteria (see "Covered Bonds Criteria," published on Dec. 9, 2014 and "Methodology And Assumptions For Analyzing Mortgage Collateral In Finnish And Norwegian Covered Bonds," published on Dec. 10, 2014). Therefore, if we were to lower our long-term issuer credit rating (ICR) on Pohjola Bank PLC, we would not necessarily lower our ratings on the covered bonds. We could downgrade the covered bonds if the available credit enhancement were to decrease below the target credit enhancement commensurate with their maximum achievable ratings.

Rationale

We are publishing this transaction update as part of our review of OP Mortgage Bank (OPMB)'s covered bond program.

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

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.

OPMB is domiciled in Finland, which is part of the European monetary union (EMU). We therefore expect that Finland will implement the Bank Recovery and Resolution Directive (BRRD), and our analysis gives credit to the eventual adoption of BRRD. Therefore, under our covered bonds criteria, we assess the reference rating level (RRL) as 'aa', which reflects the removal of one notch of sovereign support from the long-term ICR on the issuer. 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 Pohjola Bank, whose rating reflects the creditworthiness of the wider OP Financial Group. The RRL is derived by removing sovereign support incorporated in the ICR and adding two notches of uplift to reflect extraordinary government support to the issuer and the increased probability that the issuer can service its covered bonds.

We consider the likelihood for the provision of jurisdictional support. Based on a "very strong" jurisdictional support assessment for mortgage programs in Finland, we assign three notches of uplift from the RRL, which is limited by the rating of the Finnish sovereign. Therefore we assess the jurisdiction-supported rating level (JRL) as 'aa+'.

The covered bonds are eligible for four notches of collateral based uplift, although this is reduced to three because of the lack of committed overcollateralization that is commensurate with the ratings. We consider that the soft bullet structure of the majority of the liabilities covers most liquidity risk while we believe the European Central Bank (ECB) will remain a possible source of assistance for EMU covered bond issuers during a sovereign default (see

"Methodology And Assumptions For Ratings Above The Sovereign--Single-Jurisdiction Structured Finance," published on May 29, 2015).

Our credit analysis is based on the cover pool as of March 31, 2015. At this time, the program's underlying assets comprise €8.041 billion of Finnish residential mortgage loans. Our measure of the weighted-average foreclosure frequency (WAFF; representing the level of defaults) stands at 11.67% (11.4%), and the weighted-average loss severity (WALS; our measure of possible losses upon default) at 7.36% (6.04%), based on a 'AAA' stress level.

We performed a cash flow analysis of the covered bond program as of May 27, 2015. As of this date, the program's underlying assets comprise €8.3 billion of Finnish residential mortgage loans. The current outstanding covered bonds total €6.565 billion which includes a €20 million covered bond issuance dated May 27, 2015.

The program's available credit enhancement of 22.2% (22.2%) significantly exceeds the 3.96% (5.47%) target credit enhancement that we currently view as being commensurate with our 'AAA' ratings on the covered bonds.

The program's documented replacement frameworks address counterparty risk in accordance with our counterparty criteria (see "Counterparty Risk Framework Methodology And Assumptions," published on June 25, 2013).

We assess country risk by applying our nonsovereign ratings criteria (see "Methodology And Assumptions For Ratings Above The Sovereign--Single-Jurisdiction Structured Finance," published on May 29, 2015). In light of our 'AA+' sovereign rating on Finland, and the country's membership in the EMU, country risk does not constrain our 'AAA' ratings on the covered bonds.

Program Description

Table 1

Program Overview*	
Jurisdiction	Finland
Year of first issuance	2011
Covered bond type	Legislation-enabled
Outstanding covered bonds (bil. €)	6.565
Redemption profile	Yes
Underlying assets	Finnish residential mortgage loans
Jurisdictional support uplift	3
Unused notches for jurisdictional support	0
Target credit enhancement (%)	5.41
Available credit enhancement (%)	22.3
Collateral support uplift	3
Unused notches for collateral support	2
Total unused notches	2

*Based on data as of March 31, 2015.

OPMB established the €10 billion mortgage covered bond program to issue multiple series of covered bonds, which are secured on a cover pool of residential mortgage loans. The assets are registered in the cover asset register. The program's first issuance was in 2011. OPMB established the program following the enactment of the new Finnish Covered Bond Act in 2010. This program is OPMB's primary covered bond issuance platform. OPMB's other covered bond program (the old program) (under the previous Act on Mortgage Credit Banks, dated 2007), has redeemed its last outstanding issuance.

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

Chart 1

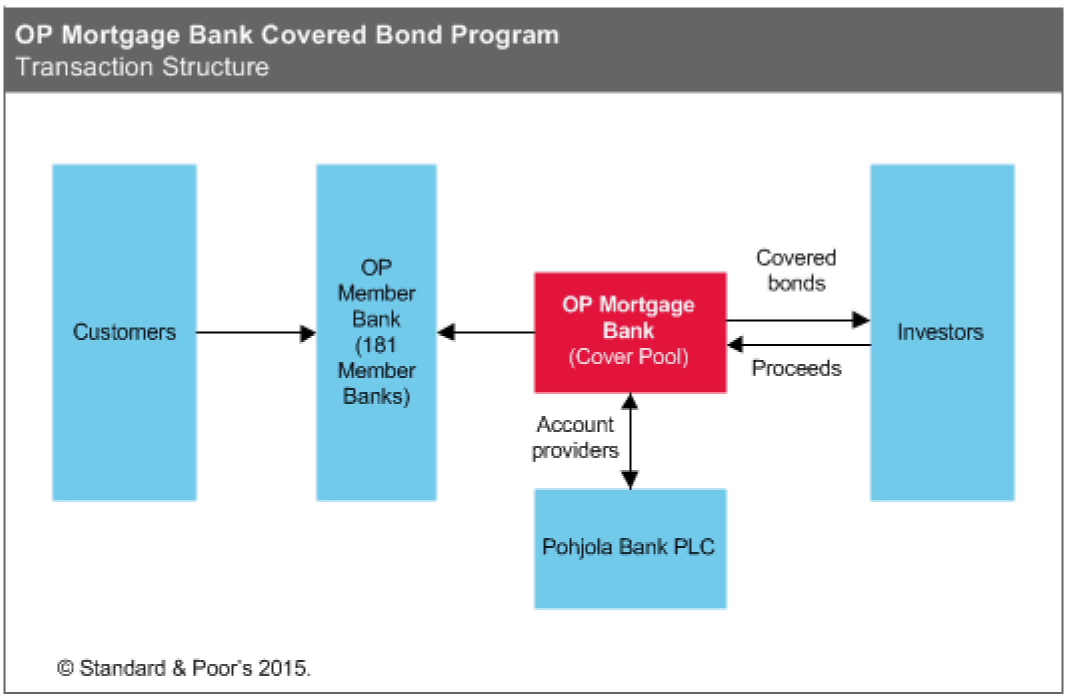


Table 2

Program Participants			
Role	**Name**	**Rating**	**Rating dependency**
Issuer	OP Mortgage Bank PLC	NR*	Yes
Originator	OP Mortgage Bank PLC	NR§	No
Bank account provider	Pohjola Bank PLC	AA-/Negative/A-1+	Yes
Swap counterparty	Pohjola Bank PLC	AA-/Negative/A-1+	Yes

Table 2

Program Participants (cont.)

*Under our group rating methodology, 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 Pohjola 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. 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 Pohjola Bank.

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. 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.

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/financial entities.

In preparation for the May 2015 covered bond issuance, the OPMB cover pool included intermediate loans for the first time. Mortgages backing intermediate loans remain on the balance sheet of the member banks, while the right to the mortgage is transferred to the issuer. The intermediate loans currently total €21 million (0.26% of the cover pool). Our legal analysis has concluded that the security and access to the intermediary loans is comparable to direct transferred mortgage loans.

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

Operational and administrative risks

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). The mortgage loan business is OP

Financial Group's core business. OP Financial Group's central cooperative institution isheadquartered in Helsinki and sets the group's basic lending criteria. However, OPMB can set additional limits. The member banks that originate the loans also service them. OPMB reviews daily the member cooperative banks' newly originated loans, and gives feedback about any actions that need to be taken. OPMB's credit risks, among others, are reported and compared with the set risk limits on a monthly basis and an internal audit is carried out at least once a year. The cover pool may include loans in arrears, which have installments that are 90 days overdue or less. These loans are not part of the program's eligible balance. The cover pool currently includes 0.10% of loans which are more than 30 days in arrears.

In February 2015, OP Financial Group announced an offer of grace periods to all customers current with their payments. The grace period is considered an award to loyal customers who are offered either six or 12 months, during which time the customer only pays interest. The offer was extended to June 30, 2015 and OP received almost 80,000 applications for the grace period by the end of May 2015.

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

OPMB'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 bonds. As a result, we link the covered bond rating to the issuer's creditworthiness and determine the maximum achievable covered bond rating above the long-term ICR by analyzing the factors set out in our criteria.

OPMB is domiciled in Finland, which is part of the EU. We expect Finland to implement BRRD legislation in the near future. Therefore, under our covered bonds criteria, we assess the RRL as 'aa', reflecting the long-term ICR on the issuer miunus one notch of sovereign support, which is replaced by two notches of support under our covered bond criteria as we assess the systemic importance of covered bonds as "very strong".

Jurisdictional support analysis

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

In our jurisdictional support analysis, we assess the likelihood that a covered bond program facing stress would receive support from a government-sponsored initiative instead of from the liquidation of collateral assets in the open market. Our assessment of the expected jurisdictional support for Finnish mortgage covered bond programs is "very strong" (see "Assessments For Jurisdictional Support According To Our Covered Bond Criteria," published on Dec. 22, 2014). 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 OPMB's mortgage covered bonds of 'aa+'. The JRL cannot exceed the rating of the sovereign providing the support to the covered bond.

Collateral support analysis

We based our credit analysis on loan-by-loan data as of March 31, 2015. The pool comprises seasoned loans that are secured on Finnish residential properties. Since our previous review, a number of low LTV and high seasoned mortgage loans have been transferred to the cover pool from OPMB's now redeemed "old program".

Table 3

Cover Pool Composition				
	March 31, 2015		March 31, 2014	
Asset type	**Value (mil. €)**	**Percentage of cover pool (%)**	**Value (mil. €)**	**Percentage of cover pool (%)**
Finnish residential mortgage loans	8.041	100	6.349	100
Substitute assets	0	0	0	0
Other asset type	0	0	0	0
Total	8.041	100	6.349	100

We have observed increased credit risk for the mortgage assets compared with our previous analysis. This is primarily due to the application of our criteria specific to Finnish residential mortgage loans (see "Methodology And Assumptions For Analyzing Mortgage Collateral In Finnish And Norwegian Covered Bonds," published on Dec. 10, 2014). We assess asset credit quality by stressing the WAFF and WALS at a 'AAA' rating level.

As of the cut-off date, the WAFF is 15.0% and the WALS is 18.6%, considering the criteria sets a minimum projected loss of 4.00% at the 'AAA' rating level. The WAFF and WALS reflect the criteria which set a "floor" or minimum projected losses of 4.00% at the 'AAA' rating level. This is higher than the corresponding figures of 11.4% and 6.0%, respectively, as of March 31, 2014. We mainly attribute the increase in the WAFF and WALS of the minimum projected loss of the new criteria and our focus on the original LTV compared with the previous current LTV. The increase in WALS is further driven by an increase in jumbo valuations.

Table 4

Key Credit Metrics		
	March 31, 2015	**March 31, 2014**
Average loan size (€)	54,380	66,417
Weighted-average LTV ratio (%)	43.60	49.28
Weighted-average loan seasoning (months)*	62.06	N/A
Balance of loans in arrears (%)	56.9	43.7
Buy-to-let loans (%)	0.10	0.13
Other relevant characteristic (e.g., self-employed borrowers)	0.53	0.70
Credit analysis results		
Weighted-average foreclosure frequency (WAFF; %)	11.67	11.40
Weighted-average loss severity (WALS; %)	7.36	6.04
AAA credit risk (%)	0.86	0.69

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

Table 5

Covered Pool Assets By Loan Size		
	March 31, 2015	**March 31, 2014**
(€ '000s)	**Percentage of cover pool (%)**	
0 to 100	50.1	49.6
100 to 200	37.6	38.5

Table 5

Covered Pool Assets By Loan Size (cont.)		
200 to 300	9.3	8.9
300 to 400	1.9	1.9
400 to 500	0.6	0.6
500 to 600	0.2	0.3
600 to 700	0.2	0.2
Greater than 700		0.1

Table 6

Current LTV Ratios		
	March 31, 2015	**March 31, 2014**
(%)	**Percentage of cover pool (%)**	
0-60	80.60	68.00
60-70	9.90	17.40
70-80	5.90	14.50
80-90	2.90	-
90-100	0.60	-
Above 100	0.20	0.10
Total above 80	9.60	0.20
Weighted-average LTV ratios	43.60	49.28

LTV--Loan-to-value.

Table 7

Original LTV Ratios		
	As of March 31, 2015	**As of March 31, 2014**
(%)	**Percentage of cover pool (%)**	
0-60	64.23	N/A
60-70	17.72	N/A
70-80	10.15	N/A
80-90	6.07	N/A
90-100	1.13	N/A
Above 100	0.69	N/A
Total above 80	7.89	N/A
Weighted-average LTV ratios	62.06	

N/A--Not applicable.

Table 8

Loan Seasoning Distribution*		
	March 31, 2015	**March 31, 2014**
	Percentage of portfolio (%)	
Less than 18 months	12.6	25.0
18 to 60	47.8	49.3
More than 60	39.6	25.7

Table 8

Loan Seasoning Distribution* (cont.)		
Weighted average loan seasoning (months)	57	43.7

*Seasoning refers to the elapsed loan term.

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, the majority of covered bonds includes a 12-month maturity extension, which combined with the countries membership of the EMU we consider to satisfy the six-month liquidity coverage. Regarding the commitment for overcollateralization, OPMB does not provide a commitment. Therefore we do not consider any commitment and the collateral-based uplift is limited to three notches.

We conducted our cash flow analysis by applying the "Methodology and Assumptions for Analyzing Mortgage Collateral in Finnish and Norwegian Covered Bonds," published on Dec. 10, 2014, and our cash flow criteria for European residential mortgage-backed securities (RMBS; see "Methodology And Assumptions: Update To The Cash Flow Criteria For European RMBS Transactions," published on Jan. 6, 2009 and "Cash Flow Criteria for European RMBS Transactions," published on Nov. 20, 2003).

Our analysis of the covered bonds' payment structure indicates 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.

We analyze cash flows under 'AAA' credit stresses, as well as liquidity and interest rate stresses. We consider various default and prepayment patterns. We model the program on a post-swap basis by considering the swap that is in place to hedge interest rate mismatches between the assets and liabilities. To assess market value risk, we apply a target asset spread in our cash flow analysis. We apply a spread of 425 basis points (bps) as outlined in our relevant criteria (see "Assessments For Target Asset Spreads According To Our Covered Bond Criteria," published on Dec. 22, 2014).

Based on our cash flow analysis considering the cover pool as of March 31, 2015 and all outstanding cover bond issuance up to May 27, 2015, we have determined that the available credit enhancement of 22.29% exceeds the target credit enhancement of 3.96%, which we consider to be commensurate with a 'AAA' rating.

Table 9

Geographic Distribution Of Loan Assets

	March 31, 2015	March 31, 2014
	Percentage of cover pool (%)	
Southern Finland	44.1	41.4
Eastern Finland	10.2	12.5
Western Finland	33.6	34.4
Oulu	10.1	9.5
Lapland	1.6	1.8
Aland	0.2	0.4
Total	100	100

Counterparty risk

In our opinion, the program's structural features address its counterparty risk exposure, which therefore does not constrain our rating.

Bank account provider. Pohjola 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 Pohjola Bank for any amounts credited to this account, and Pohjola Bank waives all deposit set-off rights against these funds. If the short-term rating on Pohjola Bank falls below 'A-1', Pohjola Bank will open and maintain an issuer collection account with a bank rated at least 'A-1'. All borrower payments following a downgrade of Pohjola Bank would be transferred to the issuer's collection account on daily basis. If the long-term ICR on Pohjola 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 has entered into hedging agreements with Pohjola 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. The interest rate swap documentation is consistent with our counterparty criteria for achieving a maximum rating of 'AAA'. We therefore gave credit to the swaps in our cash flow modeling.

Country risk

We assess country risk by applying our ratings above the sovereign criteria. In light of the long-term 'AA+' sovereign rating on Finland and the country's membership in the EMU, country risk does not constrain our 'AAA' ratings on the covered bonds. Our 'AA+' sovereign rating caps the achievable rating on the transaction based on the JRL. However, as OPMB is based in an EMU sovereign, we can assign a rating equal to the lower of a three-notch rating elevation above the sovereign and the rating that could be assigned based on the application of our covered bonds criteria. The rating is limited to three notches above the sovereign as not all bonds are extendable.

Related Criteria And Research

Related criteria

- Covered Bond Ratings Framework: Methodology And Assumptions, June 30, 2015
- Methodology And Assumptions For Analyzing Mortgage Collateral In Finnish And Norwegian Covered Bonds, Dec. 10, 2014
- Methodology And Assumptions For Assessing Portfolios Of International Public Sector And Other Debt Obligations Backing Covered Bonds And Structured Finance Securities, Dec. 9, 2014
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- Methodology And Assumptions For Ratings Above The Sovereign--Single-Jurisdiction Structured Finance, Sept. 19, 2014
- General Criteria: Group Rating Methodology, Nov. 19, 2013
- Europe Asset Isolation And Special-Purpose Entity Criteria--Structured Finance, Sept. 13, 2013
- Counterparty Risk Framework Methodology And Assumptions, June 25, 2013
- Global Derivative Agreement Criteria, June 24, 2013
- Covered Bonds Counterparty And Supporting Obligations Methodology And Assumptions, May 31, 2012
- Credit Stability Criteria, May 3, 2010

- Understanding Standard & Poor's Rating Definitions, June 3, 2009

Related research

- Global Covered Bond Characteristics And Rating Summary Q1 2015, June 19, 2015
- Ratings Affirmed On OP Mortgage Bank's Covered Bonds Following Revised Criteria Application; Outlook Stable, June 4, 2015
- Banking Industry Country Risk Assessment: Finland, Jan. 29, 2015
- Outlook Assumptions For The Finnish Residential Mortgage Market, Jan. 12, 2015
- Assessments For Jurisdictional Support According To Our Covered Bond Criteria, Dec. 22, 2014
- Assessments For Target Asset Spreads According To Our Covered Bond Criteria, Dec. 22, 2014
- Summary: Finland, Dec. 19, 2014
- Pohjola Bank PLC, July 30, 2014
- European Structured Finance Scenario And Sensitivity Analysis 2014: The Effects Of The Top Five Macroeconomic Factors, July 8, 2014
- Global Structured Finance Scenario And Sensitivity Analysis: Understanding The Effects Of Macroeconomic Factors On Credit Quality, July 2, 2014
- Covered Bond Monitor: Technical Note, Feb. 14, 2006

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