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Transaction Update: S-Bank PLC CBA Covered Bond Program

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Table Of Contents

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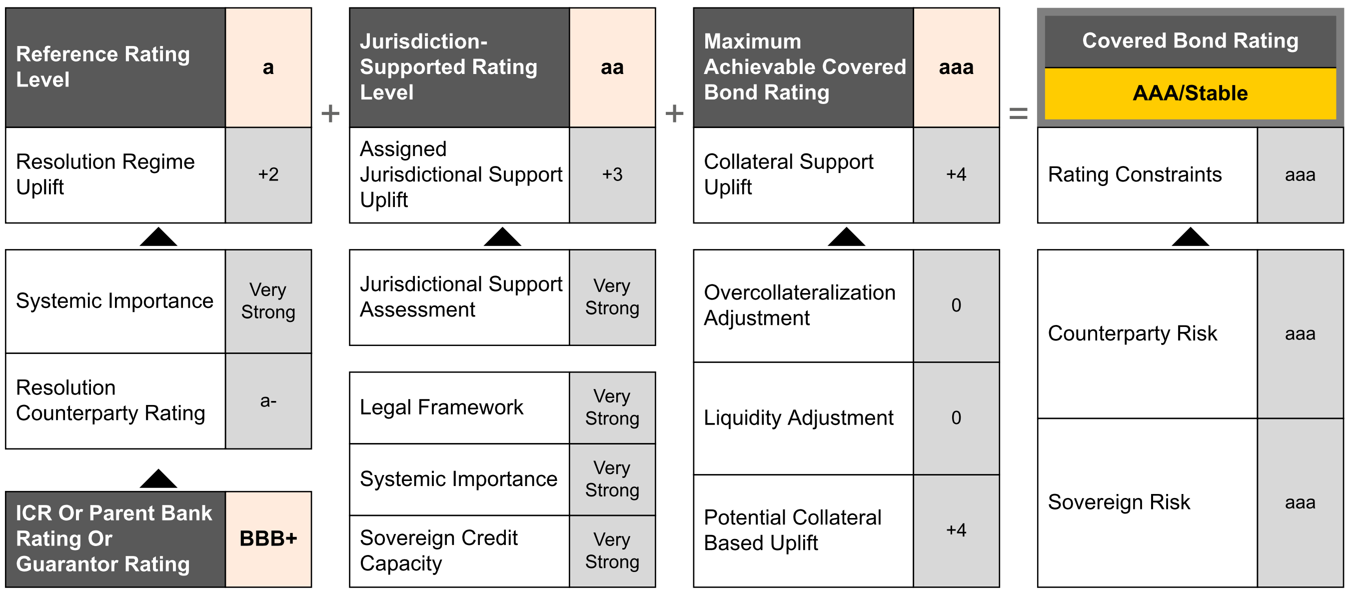
Ratings Detail



ICR--Issuer credit rating.

Major Rating Factors

Strengths

- The cover pool backing the covered bond comprises prime Finnish residential loans.
- The covered bond's soft-bullet repayment profile mitigates short-term liquidity risk.
- The program benefits from one unused notch of uplift that would protect the ratings in the event of a downgrade of the issuer.
- The structure benefits from a public commitment by the issuer to maintain overcollateralization consistent with a 'AAA' rating.

Weaknesses

- The cover pool has a current loan-to-value (CLTV) ratio that is, on average, relatively higher than the Finnish programs we rate. We address this risk in our determination of default frequency and loss severity.
- The pool is less seasoned than other Nordic programs we rate. We have considered it while determining default

frequency.

- The pool is concentrated in Southern Finland, slightly above the thresholds set in our criteria.

Outlook

S&P Global Ratings' stable outlook on the 'AAA' ratings on S-Bank PLC's (S-Pankki Oyj) CBA mortgage covered bond program and two issuances reflects that the one unused notch of ratings uplift will protect the covered bonds ratings if S-Bank (BBB+/Stable/A-2) were to be downgraded by one notch, all else being equal.

We would lower our covered bond ratings if we lower our ICR on S-Bank by more than one notch or if the available credit enhancement decreases below the overcollateralization commensurate with the current rating.

Rationale

We assigned our 'AAA' credit ratings to S-Bank's CBA covered bond program and its inaugural issuance on Sept. 26, 2023.

We are publishing this transaction update as part of our periodic review of S-Bank's mortgage 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.

The program's covered bond is issued under the Finnish Act on Mortgage Credit Banks and Covered Bonds (laki kiinnitysluottopankeista ja katetuista joukkolainoista, 151/2022) (the CBA).

From our analysis of S-Bank's CBA covered bond program and the Finnish covered bond legislation, we consider that the assets registered in the cover pool register 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 allows us to rate the covered bond higher than our long-term issuer credit rating (ICR) on S-Bank.

Based on our operational risk analysis--which reviews 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 bonds and the program.

S-Bank 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 S-Bank 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. Under our covered bonds criteria, the resulting reference rating level (RRL) is 'a', which reflects the two-notch uplift from the 'BBB+' ICR.

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. This results in a jurisdiction-supported rating level (JRL) of 'aa'.

Our collateral support analysis is based on the asset information as of June 30, 2024. The cover pool balance comprises solely Finnish residential mortgage loans. From the total reported of €3.30 billion, we deduct 1.36% of the pool, of loans granted to S-Bank's employees, due to the risk of these loans being set off if the issuer were to become insolvent. This results in a €3.26 billion cover pool (current balance). Based on our collateral support analysis, the available credit enhancement of 225.71% (based on current loan balances) exceeds the target credit enhancement (TCE)of 15.58%, 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 S-Bank's commitment to maintain overcollateralization at a level sufficient to achieve a 'AAA' rating on the covered bonds and because we consider that the liabilities soft-bullet feature mitigates short-term liquidity risk.

Operational, 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	2023
Covered bond type	Legislation-enabled
Outstanding covered bonds (mil. €)	1000
Redemption profile	Soft-bullet
Underlying assets	Finnish residential mortgage loans
Jurisdictional support uplift	3
Unused notches for jurisdictional support	0
Target credit enhancement (%)	15.58
Credit enhancement for current rating (%)§	13.3
Available credit enhancement (%)	225.71
Achievable collateral support uplift	4
Notches required for 'AAA' rating	2
Unused notches for collateral support as per covered bond criteria	2
Unused notches as per counterparty criteria	1
Total unused notches	1

*Based on anaysis for June 2024 pool and outstanding liabilities. §Level of credit enhancement required to cover 'AAA' credit risk plus 50% of refinancing costs.

S-Bank is part of S-Group, a leading retail group in Finland, and focuses on offering banking and wealth management services to retail customers. S-Group is a customer-owned Finnish network of companies in the retail and service sectors, with over 1,800 outlets in Finland. S-Bank was established in 2007. It primarily focuses on providing free daily banking services to cooperative members, consumer loans, and mortgages to retail customers, as well as loans to housing companies, credit cards, and wealth management. Additionally, it provides retail services, where unsecured consumer and mortgage loans contribute just under half of revenue. S-Bank is the eighth-largest credit institution in Finland. The bank has expanded through organic growth and acquisitions. Its product offering is built on four pillars: daily banking (accounts, cards, payments, etc.), mortgage loan lending, credit cards and consumer loans, and corporate banking (financing and other services).

With total assets of approximately €11 billion as of June 30, 2024, and about 700,000 active customers, S-Bank holds about 4% market share in mortgages and is the fourth-largest credit institution in Finland by deposits. Given its ownership, we see untapped organic growth potential from the 3.2 million S-Group customers who currently don't have an active relationship with S-Bank.

On June 28, 2024, issuer rating was raised to BBB+ from BBB, reflecting our expectation that S-Bank will sustain its improved sound profitability over the next two years and our view that we no longer see it as a negative performer in its peer group. The upcoming acquisition of Handelsbanken's portfolio also supports this view.

At the time, we also raised our long-term RCR to 'A-' from 'BBB+ (see "Related Research").

Although the bank lacks an extensive customer performance track record, given that mortgage lending is reasonable recent, we believe it follows a prudent approach in its mortgage loan underwriting, demonstrated in its good asset quality and very low arrears levels to date.

S-Bank's first covered bond program is set up to issue covered bonds under Finland's Covered Bond Act (CBA, 151/2022), effective since July 8, 2022. The mortgage covered bonds will be issued under S-Bank's €3.0 billion program for the issuance of senior preferred notes, covered bonds, and additional tier 1 capital notes (latest supplement number approved as of Sept. 20, 2024).

S-Bank's covered bond program was established in December 2020, when it was first approved by the Finnish Financial Supervisory Authority (FIN-FSA); the prospectus regulation authority in Finland). After the implementation of the European Covered Bond Directive, the updated prospectus was approved in December 2022.

Covered bondholders and derivative counterparties related to the covered bond program have a priority claim only on the assets registered in the covered bond program.

The covered bonds constitute direct unconditional and unsubordinated debt obligations of S-Bank and are secured by a cover pool of eligible residential mortgage loans registered in the cover pool, in line with the CBA.

S-Bank will continue to benefit from granular retail deposits while gradually diversifying into covered bonds to support its growth ambitions. Core customer deposits accounted for 83% of the funding base as of June 30, 2024, with the majority coming from Finnish households. In anticipation of the upcoming acquisition, the bank has over the recent 12 months complemented its funding profile with the issuance of €1 billion of covered bonds to bridge the financing gap.

The program currently has two €500 million fixed-rate covered bonds outstanding, with five- and six-year scheduled maturities, respectively, and a one-year maturity extension. During the extension period, the covered bonds will pay the one-month Euro Interbank Offer Rate (EURIBOR), plus a margin.

The mortgage borrowers pay their loan installments into an internal bank account. Under our legal analysis, the cover pool is potentially exposed to commingling risk if the issuer becomes insolvent, for cash collections received before its insolvency. The cover pool will have a normal claim in line with all other bank creditors on any cash commingled in the bank and money may be lost.

The covered bonds benefits from S-Bank's commitment to maintain overcollateralization sufficient to support a 'AAA' rating.

S-Bank CBA Covered Bond Program

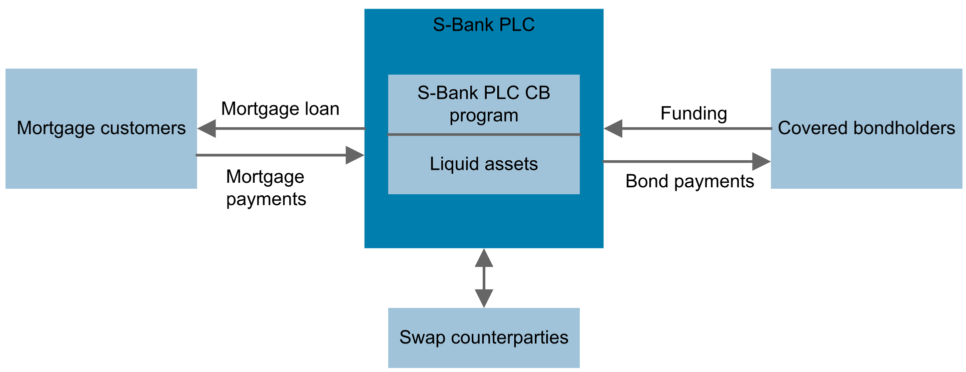


Table 2

Program participants

Role	Name	Rating	Rating dependency
Issuer	S-Bank PLC	BBB+/Stable/A-2	Yes
Originator	S-Bank PLC	BBB+/Stable/A-2	No
Bank account provider	S-Bank PLC	BBB+/Stable/A-2	No
Interest rate hedge provider	Nordea Bank Abp	AA-/Stable/A1+	Yes
Interest rate hedge provider	Swedbank AB (publ)	A+/Stable/A1	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 Finnish CBA, which implemented the Covered Bond Directive into Finnish legislation. The CBA governs covered bonds issued after July 8, 2022, and replaced the Finnish Act on Mortgage Credit Bank Activity, the Mortgage Covered Bond Act (688/2010; MCBA).

In our opinion, the CBA satisfies the relevant legal aspects of our covered bonds criteria. We have concluded that the assets in the cover pool are effectively isolated for the benefit of covered bondholders. 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 S-Bank.

We understand that under the CBA, the issuer's bankruptcy would not automatically trigger the covered bond's 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 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 cover pool register, including the recording of assets, and the issuer must regularly 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 register. Derivatives must also remain effective despite the issuer's bankruptcy, liquidation, or resolution. Derivative counterparties benefit from the same statutory priority right as covered bondholders.

S-Bank'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.

The CBA introduces a 180-day liquidity requirement, whereby the cover pool must include sufficient substitute assets to meet the maximum net outflow connected 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 will 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 covered bondholders' interests with powers to direct the issuer's general bankruptcy administrator.

Upon issuer insolvency, covered bondholders and derivative counterparties (including termination fees) have a preferential claim to cover pool assets, 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 commercial estate properties can be included in the determination of overcollateralization. Our analysis considers preferential claims on all loan parts. This may lead to differences in available overcollateralization, depending on whether this is reported based on the eligible balance or the full balance.

Based on our legal analysis, we understand that the CBA excludes setoff 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).

S-Bank has no traditional branch network but uses S-Group's existing retail stores to service both mortgage and consumer loan customers. S-Group is the market-leading retail group in Finland, with stores based in the country's economically stronger regions. The program's CLTV ratio exceeds that of its peers. This also reflects the bank's relatively short history in mortgage loan origination, starting in 2017.

In our most recent meeting with the issuer, we reviewed its origination, underwriting, collection, and default management procedures for the cover pool assets. We also reviewed the cover pool's management and administration and have not observed any major changes or new risks arising. We consider that the issuer actively manages the cover pool and has strict underwriting and loan management policies.

S-Bank originates its loans through its distribution channels and origination process. Loan origination must comply with the origination criteria. The original LTV (OLTV) ratio follows FIN-FSA regulation and is limited to 90%, or 95% for first-time buyers. The bank's current policy limits the OLTV ratio to 90%. To assess credit risk at origination, the bank follows a detailed analysis of the lender's creditworthiness, financial situation, and payment capacity. A strict valuation process applies at the time of origination. In most cases, the original valuation is based on the purchase price, which is validated against a statistical model and assessed by the presenter and underwriter.

The FIN-FSA continues to focus strongly on ensuring strict household lending underwriting criteria. It applies an 85% cap on loan-to-collateral ratios on new mortgage loans and a 95% cap for first-time buyers. The borrower's ability to pay the loan and handle regular living costs is stress-tested with a 6% interest rate.

In our opinion, operational risk from the cover pool's management and loan origination does not constrain the ratings on the covered bonds and the program to the same level as our long-term ICR on S-Bank.

We believe that a replacement cover pool manager would be available if the issuer were to become insolvent. We consider Finland to be an established covered bond market and that the mortgage loans in S-Bank'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

As part of our covered bonds criteria, our analysis considers any resolution regime existing in Finland to determine the RRL. S-Bank is domiciled in Finland, which is subject to the EU's BRRD, and our analysis considers the support provided by its eventual adoption. We assess the systemic importance for Finnish mortgage programs as very strong. Under our covered bonds criteria, a very strong systemic importance means the RRL is the maximum between two notches above the long-term ICR and the RCR, when there is one. Given that the assigned RCR on S-Bank is 'A-', the RRL is 'a', which reflects a two-notch uplift from 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 above 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 RMBS criteria (see "Global Methodology And Assumptions: Assessing Pools Of Residential Loans," published on Jan. 25, 2019 and "Global Methodology And Assumptions: Assessing Pools Of Residential Loans--Europe Supplement," published on April 4, 2024).

We performed our analysis using loan-by-loan data provided by S-Bank as of June 30, 2024, and the projected asset and liability cash flows provided by S-Bank considering the two soft-bullet covered bond issuances outstanding (with a five- and six-year maturity, respectively, and the one-year maturity extension modeled).

The cover pool comprises prime residential mortgage loans originated by S-Bank and located in Finland. The total current balance is €3.30 billion (deducting 1.36% of loans granted to S-Bank's employees, due to the risk of these loans being set off if the issuer were to become insolvent), with a CLTV ratio that represents, on average, 64.6% of the property's current value. Finnish property prices have increased since 1996 but have stabilized since 2012 and are, in our opinion, undervalued compared to historical house price to income statistics.

The residential portfolio's weighted-average seasoning is about 4.5 years and the interest rate on 97% of the loans is floating (most linked to 12-month EURIBOR). Most of the loans are on owner-occupied properties. The cover pool does not include loans in arrears nor loans to borrowers with a negative credit history. Of the total pool, 8% of the loans are fixed-rate amortization loans; however, we would not expect a payment shock at the end of the loan's life, given the loan's maturity can be extended if interest rates rise.

The pool has relatively high OLTV and CLTV ratios compared to the average of Finnish programs and relatively lower seasoning.

Geographically, the pool has relatively high concentration in the southern Finland region, including Helsinki (55.03%). Under our RMBS criteria, we adjust our base foreclosure frequency according to the percentage over a maximum defined threshold of concentration, which is 50% for this region.

Under the CBA, bondholders and derivative counterparties have a priority of payment right on 100% of the properties' value. We therefore determined the available overcollateralization on the entire current balance. At the same time, our determination of potential losses is also based on the entire current balance of the loans.

For the loans in the pool, we estimated the foreclosure frequency and the loss severity in a 'AAA' stress scenario and, by multiplying the foreclosure frequency by the loss severity, the potential loss associated with each loan. To quantify the potential losses associated with the entire pool, we weigh 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. We assume that the probability of foreclosure is a function of both borrower and loan characteristics and will become more likely--and the realized loss on a loan more severe--as the economic environment deteriorates.

At a 'AAA' stress level, the WAFF is 17.68% (19.41% in our previous analysis) and the WALS is 23.38% (22.67% previously).

The main drivers of the WAFF in this cover pool are the OLTV ratio and the relatively low seasoning. The improvement compared to our last analysis is driven by a decrease in ELTV, slight increase in seasoning as well as slightly lower loans granted to self-employed borrowers. Under our RMBS criteria, we apply multiples to the base foreclosure frequency based on the effective LTV (ELTV) ratio. The weighted-average ELTV ratio is 72.77% (74.76% previously) and is based on the ELTV ratio from weighting 80% of the OLTV ratio and 20% of the current whole loan LTV ratios. Furthermore, the pool seasoning is about four years. Under our RMBS criteria, loans more than five years seasoned benefit from a reduction to the base foreclosure frequency, and only 32.5% of the pool benefits from this reduction.

The cover pool comprises about 8% of fixed installment mortgage loans, which means that periodic installments are fixed for the entire duration of the loan. If the interest rate increases to a level where the periodic installment amount due only includes interest payments, the maturity on these loans can be extended from that set at origination. We believe this maturity extension mitigates an immediate payment shock on the borrowers and therefore we do not apply a payment shock adjustment to these loans.

Employment status has not been reported for 2.80% of the pool. We assumed that these borrowers are self-employed, bringing the final percentage of self-employed borrowers to 6%.

The main drivers behind the pool's WALS are the CLTV ratios after house price indexation and market value decline assumptions, as well as jumbo valuations. We have determined a weighted-average CLTV ratio of 64.55 (62.19% previously) and jumbo valuations represent 12.48% of the pool's outstanding balance (39.43% previously). The reduction in the percentage of jumbo valuations results from the revision upwards of the jumbo thresholds in our criteria since our previous credit analysis from June 2023. Jumbo valuation thresholds have been revised in our criteria to €600,000 in the region of Southern Finland and Aland Islands and €350,000 in the rest of Finland, compared with €375,000 in the region of Southern Finland and Aland Islands and €250,000 in the rest of Finland previously.

House prices have been changing in Finland, with prices rising in some areas and declining in others. However, the real estate market has not overheated, and currently our analysis considers Finnish residential properties as slightly undervalued.

The below tables summarize the cover pool's composition.

Table 3

Cover pool composition

	As of June 30, 2024		As of June 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)	3,257	100	3,149	100
Substitute assets	0	0	0	0
Total	3,257	100	3,149	100

Table 4

Key credit metrics

	As of June 30, 2024	As of June 30, 2023
	Residential mortgage loans	**Residential mortgage loans**
Average loan size (€)	112,474	118,373
Weighted-average effective LTV ratio (%)*	72.77	74.76
Weighted-average original LTV ratio (%)	74.77	77.9
Weighted-average current LTV ratio (%)§	64.55	62.19
Weighted-average loan seasoning (years)†	4.49	4.23
Balance of loans in arrears (%)	0.38	0.56
Buy-to-let loans (%)	7.80	7.79
Interest-only loans to maturity	0.15	0.3
Equal installment mortgages (%)	8.13	12.18
Jumbo valuations (%)	12.48	39.43
Credit analysis results:		
WAFF (%)	17.68	19.41
WALS (%)	23.38	22.67
AAA credit risk (%)	11.01	11.58

*The effective LTV ratio corresponds to 80% of the original LTV ratio and 20% of the current indexed whole loan LTV ratios for the WAFF calculation. §Weighted-average current indexed LTV ratio based on the current balance. †Seasoning refers to the elapsed loan term. LTV--Loan to value. WAFF--Weighted-average foreclosure frequency. WALS--Weighted-average loss severity.

Table 5

Loan-to-value ratios

	As of June 30, 2024			As of June 30, 2023		
Residential mortgages (housing loans, %)	**Effective whole loan LTV (%)***	**Original LTV (%)**	**Current balance LTV (based on current balance, %)**	**Effective whole loan LTV (%)***	**Original LTV (%)**	**Current balance LTV (based on current balance, %)**
0-40	9.17	8.59	16.40	6.67	5.70	17.81
40-50	7.90	7.41	10.01	6.61	5.66	11.74
50-60	10.45	10.03	12.43	10.80	9.29	14.25
60-70	13.94	13.37	14.53	14.64	13.42	15.73
70-80	15.28	14.23	17.27	16.54	15.24	17.67
80-90	20.83	21.76	16.65	20.29	22.01	16.30
90-100	18.83	17.39	12.11	20.57	19.92	5.61
Above 100	3.61	7.22	0.60	3.88	8.76	0.89
Weighted-average LTV ratio	72.77	74.77	64.55	74.76	77.89	62.19

*100% of current indexed whole-loan LTV ratio. LTV--Loan-to-value.

Table 6

Loan seasoning distribution*

	Percentage of pool balance	
	As of June 30, 2024	**As of June 30, 2023**
Less than 2 years	24.54	27.85
2 to 4	31.32	31.5

Table 6

Loan seasoning distribution* (cont.)		
4 to 5	11.62	11.59
5 to 6	9.8	6.01
6 to 7	5.03	6.35
7 to 8	5.16	3.8
8 to 9	3.11	2.28
9 to 10	1.81	1.61
More than 10 years	7.61	8.46
Weighted-average loan seasoning (years)	4.49	4.23

*Seasoning refers to the elapsed loan term.

Table 7

Geographic distribution of loan assets		
	Percentage of pool balance	
	As of June 30, 2024	As of June 30, 2023
Southern Finland	55.03	55.18
Eastern Finland	7.28	7.46
Western Finland	28.23	27.91
Oulu	6.83	6.81
Lapland	2.62	2.63
Aland	0.01	0.01
Total	100	100

The results of our credit analysis--the portfolio's WAFF and WALS--represent inputs to our cash flow analysis. Our analysis of the covered bond's 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 bond on its legal final maturity.

We have modeled the terms and conditions of the two soft-bullet covered bond issuances, with a notional balance of €500 million each, a five- and six-year, respectively, term to maturity , and post swap cash flows. Two liability swaps hedge the interest rate mismatch arising from the floating interest rate received from the assets and the fixed interest rate payable to the covered bonds.

Under our criteria, 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 bond.

The structure is exposed to an asset-liability maturity mismatch (ALMM) because the covered bond's 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 loans is 425 basis points, on top of the stressed interest rate at the time of the shortfall (when assets need to be sold).

Compared to the initial rating analysis, with only one covered bond issuance, ALMM has reduced, from 3.78 years to

2.3 years, which is positive for the TCE results.

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, assuming 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, which for the inaugural issuance results in 11.01% compared with 11.58% when the initial rating was assigned.

Our TCE includes the additional credit enhancement that we expect to be required to refinance the cover pool in a stressed environment. By applying our credit and cash flow stresses, we calculate a TCE of 15.58% 19.32%, which is below the available credit enhancement of 225.71% (529.86% for the initial rating last year). The TCE has reduced mainly driven by the reduction of ALMM and some other positive factors like an increase in excess spread.

Because we consider 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 S-Bank's covered bonds feature a 12-month maturity extension, which satisfies the liquidity coverage requirement under our criteria. Furthermore, S-Bank 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 two notches of collateral uplift to attain a 'AAA' rating. Therefore, two notches of collateral-based uplift are unused.

However, reflecting our counterparty risk criteria, the program has only one unused notch of collateral-based uplift. This is because if we were to lower our long-term ICR on S-Bank by two notches, we would also lower our ratings on the covered bond and the program under our counterparty risk criteria, all else being equal (see "Swaps").

The overcollateralization commensurate with a 'AAA' rating (corresponding to the second notch of collateral uplift) equals 13.30%.

Table 8

S-Bank collateral uplift metrics

	As of June 30, 2024	As of June 30, 2023
Asset WAM (years)	8.42	9.78
Liability WAM (years)	6.12	6
Asset WAM - liability WAM	2.3	3.78
Available credit enhancement (%)	225.71	529.86
'AAA' credit risk	11.01	11.58
Credit enhancement for current rating (%)	13.3	17.39
Required credit enhancement for first notch of collateral uplift (%)	12.15	13.52
Required credit enhancement for second notch of collateral uplift (%)	13.3	15.45
Required credit enhancement for third notch collateral uplift (%)	14.55	17.39
Target credit enhancement for maximum uplift (%)	15.58	19.32
Potential collateral-based uplift (notches)	4	4
Adjustment for liquidity (Y/N)	N	N

Table 8

S-Bank collateral uplift metrics (cont.)

	As of June 30, 2024	As of June 30, 2023
Adjustment for committed overcollateralization (Y/N)	N	N
Collateral support uplift (notches)	4	4
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 and commingling risk

Borrowers will make mortgage payments into internal bank accounts. This means that the cover pool is potentially exposed to commingling risk if the issuer becomes insolvent. Pre-insolvency of the issuer payments received from the cover assets are not separated from the issuer's other cash flows. Hence, funds collected pre-issuer insolvency are potentially not necessarily available to service the claims in relation to the covered bonds. The cover pool will have a normal claim in line with all other creditors of the bank on any cash commingled in the bank and money may be lost.

We have considered how frequently we can access information on the program's available credit enhancement, which will be monthly, to estimate the size of the account bank and commingling risk. In our view, overcollateralization sufficiently mitigates this risk.

Following the issuer's insolvency based on the relevant sections of the CBA, we are comfortable that post-insolvency funds are secured by the administrator for the benefit of the covered bonds and are not at risk of being commingled and will only be available to pay the covered bonds creditors.

Swaps

To hedge the interest rate mismatch arising from the floating interest rate earned on the assets and the fixed interest rate payable to the covered bonds, the issuer has entered into an interest rate hedge swap with Nordea Bank Abp for its first issuance done in September 2023 and with Swedbank Ab for its second issuance done in April 2024.

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

In this case, the counterparties are unrelated to the issuer, and the risk is concentrated and are entitled to termination payments that rank pari passu with payments on the covered bond.

According to the swap documentation, the counterparties have committed to either replace themselves or procure an eligible guarantee for their obligations under the swap, if their applicable RCR falls below 'A-'. Failure to do so within the specified period is an additional termination event, allowing the issuer to terminate the derivative agreement. Furthermore, if we lower our RCR on the swap counterparty below 'A-', both counterparties commit 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 contract as strong.

The collateral framework assessments, combined with the current RRL of 'a' on S-Bank and the counterparties replacement triggers, support a maximum potential rating of 'AAA' under our counterparty risk assessment. If we were to lower our long-term ICR on S-Bank by one notch, the covered bonds would still be able to achieve a 'AAA' rating. However, if we were to lower our long-term ICR on S-Bank by two notches, we would also lower our ratings on the covered bond and the program, all else being equal. As a result, the covered bond benefits from one unused notch of ratings uplift.

Sovereign Default Risk

We analyze sovereign default 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 within a monetary union and that include structural refinancing coverage needs over a 12-month period (provided by the 12-month extendible maturity profile of the soft-bullet bond in this instance) exhibit low sensitivity to country risk. Therefore, we can rate the covered bonds up to five notches above the sovereign rating. Given our 'AA+' long-term sovereign rating on Finland, sovereign risk does not constrain our ratings on the covered bond and the program.

Environmental, Social, And Governance

Environmental, social, and governance factors have no material influence on our credit rating analysis of S-Bank's CBA mortgage covered bond. The issuer currently does not offer specific mortgage products focused on environmental or social factors, which could affect the credit results. S-Bank is committed to maintain a minimum overcollateralization level in the program commensurate with a 'AAA' rating, and the soft-bullet repayment structure partially mitigates refinancing risk, allowing the program to achieve four notches of potential collateral-based uplift.

Related Criteria

- Global Methodology And Assumptions: Assessing Pools Of Residential Loans--Europe Supplement, April 4, 2024
- 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: Covered Bonds Criteria, Dec. 9, 2014
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Related Research

- Global Covered Bond Insights Q4 2024: On Course For A Strong Year, Sept. 18, 2024
- S-Bank PLC, Aug. 23, 2024
- Covered Bonds Outlook Midyear 2024: Growth And Rates Support Performance, July 11, 2024
- Finland-based S-Bank Upgraded To ‘BBB+’ From ‘BBB’ On Improved Profitability; Outlook Stable, June 28, 2024
- A Closer Look At Finland's Covered Bond Framework, Sept. 27, 2023
- Norwegian And Finnish Covered Bond Market Insights 2024, March 11, 2024
- S-Bank PLC CBA Covered Bond Program, First Issuance Assigned 'AAA' Ratings; Outlook Stable, Sept. 26, 2023:
- S-Bank PLC CBA Covered Bond Program, First Issuance Assigned Preliminary 'AAA' Ratings; Outlook Stable, Aug. 28, 2023
- A Closer Look At Finland's Covered Bond Framework, Sept. 27, 2023
- S&P Global Ratings Definitions, June 9, 2023
- Norwegian And Finnish Covered Bond Market Insights 2023, April 18, 2023
- Glossary Of Covered Bond Terms, April 27, 2018