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Transaction Update: Swedbank Mortgage AB Covered Bond Program (Säkerställda Obligationer)

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(Säkerställda Obligationer)

Ratings Detail

Reference Rating Level	aa+	+	Jurisdiction-Supported Rating Level	aaa	+	Maximum Achievable Covered Bond Rating	aaa	=	Covered Bond Rating	
Resolution Regime Uplift	+2		Assigned Jurisdictional Support	+3		Collateral Support Uplift	+2		AAA/Stable	
Systemic Importance	Very Strong		Jurisdictional Support Assessment	Very Strong		Overcollateralization Adjustment	-1		Rating Constraints	aaa
Resolution Counterparty Rating	AA-		Legal Framework	Very Strong		Liquidity Adjustment	-1		Counterparty Risk	aaa
Issuer Credit Rating	AA-		Systemic Importance	Very Strong		Potential Collateral Based Uplift	+4		Country Risk	aaa
			Sovereign Credit Capacity	Very Strong						

Major Rating Factors

Strengths

- The cover pool comprises mortgages with low loan-to-value (LTV) ratios compared with the maximum allowed by legislation.
- There are two unused notches of jurisdiction-based uplift, and two unused notches of collateral-based uplift, which provide a rating buffer if we downgrade the issuer.
- The current available credit enhancement significantly exceeds the target credit enhancement commensurate with the maximum achievable rating on the covered bond program.

Weaknesses

- The real estate market shows signs of significant overvaluation. The price-to-income ratio remains approximately 29% above its long-term average.
- The issuer could reduce overcollateralization, which currently supports the assigned rating to the regulatory minimum. This may not always be sufficient to support the current rating.
- No committed coverage of 180 days of liquidity.

Outlook: Stable

S&P Global Ratings' stable outlook on Swedbank Mortgage AB's Swedish mortgage covered bonds ("säkerställda obligationer") reflects the cushion of four unused notches that would protect the ratings on the covered bonds if we were to lower the long-term issuer credit rating (ICR) on Swedbank Mortgage (AA-/Negative/A-1+).

We would lower our ratings on the covered bonds if we lower the long-term ICR on the issuer by more than the available unused notches or if the available credit enhancement becomes insufficient to cover the credit enhancement that is commensurate with the current rating on the program.

Rationale

We are publishing this transaction update following our periodic review of Swedbank Mortgage's Swedish mortgage covered bond program.

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

Swedbank Mortgage is domiciled in Sweden, 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 to Sweden. These factors increase the likelihood that the issuer would continue servicing its covered bonds without accessing the cover pool or receiving jurisdictional support, even following a bail-in of its senior unsecured obligations. Under our covered bonds criteria, a very strong systemic importance means the reference rating level (RRL) is the maximum between two notches above the long-term ICR and the resolution counterparty rating (RCR). Given that the RCR on Swedbank AB, of which we consider Swedbank Mortgage a core entity, is at the same level as the ICR, ('AA-'), the RRL is 'aa+', which reflects the two-notch uplift from the ICR.

Based on a very strong jurisdictional support assessment for mortgage covered bonds in Sweden, the program can potentially benefit from up to three notches of uplift from the RRL. Therefore, we assess the jurisdiction-supported rating level (JRL) as 'aaa' (see "Assessments For Jurisdictional Support According To Our Covered Bonds Criteria," published on March 3, 2020).

Following the assessment of the RRL and JRL, we analyze the cover pool's credit quality and the availability of liquidity support and committed overcollateralization to determine the maximum potential collateral-based uplift.

All covered bonds issued have hard bullet maturities. Considering the lack of 180-liquidity coverage and the absence of committed overcollateralization, the maximum potential collateral-based uplift is reduced by two notches.

The 'AAA' ratings on the program and outstanding covered bonds reflect our RRL of 'aa+' and JRL of 'aaa', and the overcollateralization coverage of 'AAA' credit risk.

Lastly, the ratings on the cover pool and related issuances are not constrained by legal, operational, counterparty, or country risks.

Program Description

Table 1

Program Overview*	
Jurisdiction	Sweden
Year of first issuance	2007
Covered bond type	Legislation-enabled
Outstanding covered bonds (bil. SEK)	558.13
Redemption profile	Hard bullet
Underlying assets	Residential and commercial mortgages, and public sector assets
Jurisdictional support uplift	3
Unused notches for jurisdictional support	2
Overcollateralization level commensurate with current rating (%)	5.3
Target credit enhancement (%)	22.61
Available credit enhancement (%)	77.44
Collateral support uplift	2
Unused notches for collateral support	2
Total unused notches	4

*Based on data as of Sept. 30, 2019. SEK--Swedish Krona.

Sweden-based Swedbank Mortgage is a specialized mortgage bank and a core subsidiary of Swedbank AB. Swedbank Mortgage's operations are integrated with those of its parent company. The covered bonds ("säkerställda obligationer") are senior, direct, secured, and unconditional obligations of Swedbank Mortgage.

Swedbank Mortgage issues mortgage covered bonds under Swedish legislation. The covered bonds can be issued under a number of documents related to the same cover pool and benefit from the ownership of Swedbank AB. All covered bonds issued under the program rank equally regardless of the program documentation.

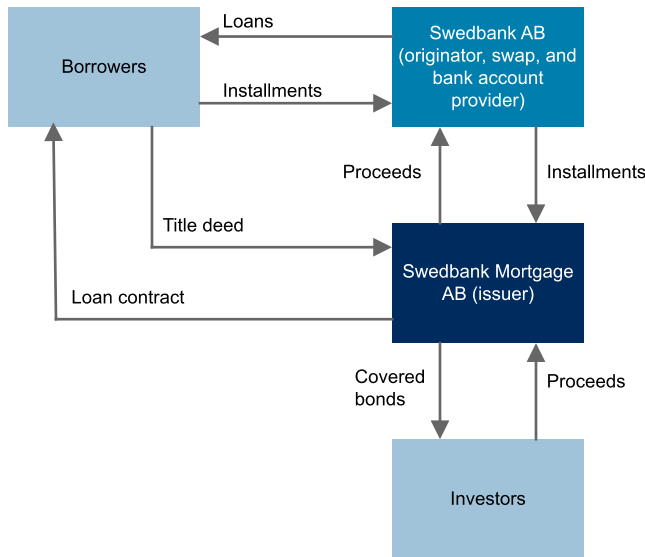
The collateral comprises a pool of prime residential and commercial loans secured on residential and commercial mortgage deeds in Sweden and public sector collateral. All assets are denominated in Swedish krona (SEK). As Swedbank Mortgage's covered bonds are issued in a number of currencies, swap agreements mitigate exposure to foreign exchange risk (see "Derivatives").

Swedbank Mortgage is the issuer of the Swedbank Group's covered bonds, making up the primary source of wholesale funding for the Group. Swedbank Mortgage relies on an extensive network of savings bank branches to originate mortgage loans under a centrally managed origination policy.

As of Sept. 30, 2019, there were SEK558.125 billion of covered bonds outstanding, backed by a cover pool of SEK990.325 billion of mortgage and substitute assets.

Chart 1

Swedbank Mortgage AB Covered Bond Program



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Table 2

Program Participants			
Role	Name	Rating	Rating dependency
Issuer	Swedbank Mortgage AB	AA-/Negative/A-1+	Y
Bank account provider	Swedbank AB	AA-/Negative/A-1+	Y
Swap provider	Swedbank AB	AA-/Negative/A-1+	Y

Legal and regulatory risks

We base our analysis of legal risk on the guidelines in "Structured Finance: Asset Isolation And Special-Purpose Entity Methodology," published on March 29, 2017.

In our opinion, the Swedish covered bond legal framework satisfies the relevant legal requirements of our covered bond criteria. This enables us to rate the covered bonds above our long-term ICR on the issuer.

Swedish covered bonds—"saekerstaellda obligationer"—are issued under the Swedish Covered Bond Act ("Lag

2003:1223 om utgivning av saekerstaellda obligationer"). The legal framework also includes secondary legislation that provides further guidance on the assessment of the cover pool's collateral value and general risk management.

Covered bond investors have a preferential claim to a cover pool of assets and to the issuer (but not to its parent company). The cover pool may comprise exposures to properties and rights equivalent to real property located in Sweden or a member state of the EU. Under covered bonds law, mortgages may be used as security up to a certain estimated value of the property: 75% for residential properties, 70% for agricultural properties, and 60% for commercial properties. The cover pool may also include exposures to public-sector entities from a wider geographical area than is the case for the mortgage assets. Additionally, highly liquid assets can serve as substitute assets and can comprise up to 20% of the mortgage pool. Finally, commercial mortgage loans may not exceed 10% of the cover pool. Unlike our analysis, the Swedish covered bond law does not consider multifamily housing and condo association as commercial properties.

The law requires a minimum of 2% overcollateralization, and an issuer may commit to a certain level. The Swedish covered bond law does not directly require that issuers cover 180 days of liquidity needs at all times, but the Swedish FSA requires that liquidity risk is addressed on a group level--i.e., Swedbank AB ensures adequate liquidity for Swedbank Mortgage.

An independent inspector (trustee) monitors the cover pool as long as the issuer is solvent. The law does not provide for a separate cover pool administrator if the issuer becomes insolvent. Instead, the receiver-in-bankruptcy represents all investors. The Swedish FSA appoints the receiver-in-bankruptcy, and also regularly conducts special covered bond supervision.

Operational and administrative risks

We believe sound operational procedures have been in place to support our ratings on the covered bonds since we assigned the first ratings on Swedbank Mortgage's mortgage covered bonds.

We communicate continuously with Swedbank Mortgage and conduct regular meetings. We consider Swedbank Mortgage's procedures for monitoring the pool's credit quality to be prudent, and have not identified any operational or administrative risks that would affect our assessment of the program.

The issuer actively manages maturity redemptions by buying back covered bonds prior to maturity. The active management of asset-liability mismatch helps the issuer gradually repay a maturity and limits potential refinance risk. Loans in arrears for more than 60 days must be disregarded for the purposes of the matching tests under the Swedish covered bond law and are currently removed by the issuer from Swedbank Mortgage's cover pool.

Covered bonds are a key funding tool for Swedbank AB and Swedbank Mortgage. Consequently, we believe that Swedbank Mortgage will continue to manage overcollateralization and liquidity in line with the current rating level.

Furthermore, we believe that potential replacement servicers would be available if Swedbank Mortgage became unable to manage the program, considering that Sweden is an established covered bond market and that the cover pool of residential assets does not comprise product features that would materially limit the range of available servicers.

We analyzed operational and administrative risk by applying our covered bonds framework.

Resolution regime analysis

As part of our covered bonds criteria, our analysis considers any resolution regime in place in Sweden to determine the RRL. The RRL on Swedbank Mortgage, which is the starting point for any further uplift in our analysis, is 'aa+'. We consider the following factors:

- Swedbank Mortgage is domiciled in Sweden, which is subject to the EU's BRRD;
- We add two notches to the ICR because we consider covered bonds to have very strong systemic importance to Sweden.
- The RCR on Swedbank is 'AA-'.

The resulting RRL is higher of ICR plus two notches and RCR, which results in an RRL of 'aa+'.

These factors collectively increase the likelihood that Swedbank Mortgage would continue servicing its covered bonds without accessing the cover pool, even if Swedbank Mortgage became insolvent.

Jurisdictional support analysis

Under our covered bonds criteria, we conduct a jurisdictional support analysis to assess the likelihood that a covered bond program facing stress would receive support from a government-sponsored initiative. This is reflected in our JRL, which is our assessment of the creditworthiness of a covered bond program, taking into account jurisdictional support, but before giving benefit to the issuer's ability to access other refinancing sources.

Our assessment of the expected jurisdictional support for Swedish mortgage covered bond programs is very strong (see "Assessments For Jurisdictional Support According To Our Covered Bonds Criteria," published on March 3, 2020). This means that, under our criteria, Swedbank Mortgage's covered bond program can receive up to three notches of jurisdictional uplift from the RRL. As the RRL is aa+, the program only uses one notch of jurisdictional support to achieve JRL of 'aaa' for the covered bonds. This results in two unused notches of jurisdictional support, which means that the overcollateralization commensurate with the assigned rating would only change if we downgrade Swedbank AB by three notches or more, all else equal.

Collateral support analysis

As of Sept. 30, 2019, the cover pool comprised residential mortgage assets (79.1%) and commercial type mortgages (20.9%, including condo associations and multifamily housing) located in Sweden. In addition, the cover pool includes 0.6% of substitute assets--mainly loans to Swedish municipalities, which we analyze as public sector assets.

The residential mortgage cover pool has a relative high weighted-average seasoning and low original LTV ratio (OLTV), which are positive factors in our credit analysis. As of Sep. 30, 2019, the weighted-average seasoning and OLTV ratio stood at about 5.9 years and 64.11%, respectively. The commercial mortgage pool has a current LTV ratio of 41.19%.

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

Overall, the results of our credit analysis have increased compared to our previous review. For the combined mortgage portfolio, the WAFF is 11.29% and the WALS is 41.70% as of Sept. 30, 2019, compared to respectively 11.89% and 44.37% as of Dec. 31, 2018. The slight improvement in the WAFF is mainly due to a lower weighted-average original LTV ratio and a lower proportion of interest-only loans on residential properties, despite a lower weighted-average seasoning. The drop in the WALS can be attributed to a lower weighted-average current LTV ratio and our assessment of a reduced overvaluation in house prices compared to our previous review.

Metrics for commercial loans were stable overall, with a slight decrease in weighted average current loan-to-value.

The proportion of assets that we analyze under our commercial real estate criteria (multifamily homes, housing associations, forest and agricultural assets, other commercial assets) remained stable, at 20.9% of the total pool.

Table 3

Pool Composition				
Asset type	Sept. 30, 2019		Dec. 31, 2018	
	Value (bil. SEK)	Percentage of cover pool	Value (bil. SEK)	Percentage of cover pool
Mortgage assets	984.65	99.44	962.31	99.42
Single family homes	562.14	56.77	551.67	56.99
Condominium apartments (tenant-owner rights)	215.10	21.72	207.87	21.47
Multifamily homes	47.86	4.83	46.48	4.8
Housing associations	88.06	8.89	88	9.09
Forest and agricultural assets	59.67	6.03	60.21	6.22
Other commercial assets	11.83	1.19	8.08	0.83
Public sector assets	5.56	0.56	5.66	0.58
Total cover pool assets	990.21	100	967.97	100

SEK--Swedish Krona.

Table 4

Key Credit Metrics		
	As of Sept. 30, 2019	As of Dec. 31, 2018
Current balance of residential mortgage loans in the cover pool (bil. SEK)	777.24	759.54
Current balance of commercial-type mortgage loans in the cover pool (bil. SEK)	207.42	202.77
Residential assets		
Weighted-average original LTV ratio (%)	64.11	67.16
Weighted-average cover pool LTV ratio (%)*	53.74	57.81
Weighted-average loan seasoning (years)§	5.71	6.14
Current arrears (%)	0.00	0.00
Interest rate type	Variable (60%)	Variable (62%)
Commercial assets		
Weighted-average cover pool LTV ratio (%)*	41.19	42.03

Table 4

Key Credit Metrics (cont.)		
	As of Sept. 30, 2019	As of Dec. 31, 2018
Credit analysis results		
WAFF (%)	11.29	11.89
WALS (%)	41.70	44.37
'AAA' credit risk (%)	5.30	6.81
Country averages:		
WAFF (%)	15.56	14.43
WALS (%)	45.20	49.07
'AAA' credit risk (%)	7.46	4.93

*Adjusted for property price developments based on the Swedish property price index. §Seasoning refers to the elapsed loan term. SEK--Swedish Krona. LTV--Loan to value. N/A--Not available. WAFF--Weighted-average foreclosure frequency. WALS--Weighted-average loss severity.

Table 5

Original Loan-To-Value Ratios: Residential Pool*		
(%)	As of Sept. 30, 2019	As of Dec. 31, 2018
0-60	27.13	20.29
60-70	14.32	14.52
70-80	58.55	65.18
80-90	-	0
90-100	-	0
Above 100	-	0
Weighted average loan-to-value ratios	64.11	67.16

*The data about residential assets is based on a representative sample.

Table 6

Whole-Loan-To-Value Ratios: Commercial Pool		
	Commercial pool (%)	
(%)	As of Sept. 30, 2019	As of Dec. 31, 2018
0-60	85.13	81.14
60-70	10.72	12.6
70-80	3.89	5.64
80-90	0.14	0.07
90-100	0.04	0.09
Above 100	0.08	0.46
Weighted-average current loan-to-value ratios	41.19	43.72

Table 7

Loan Seasoning Distribution		
	Residential mortgages (%)	
Seasoning (months)	As of Sept. 30, 2019	As of Dec. 31, 2018
Less than 18 months	18.86	15.99
18-24 months	6.84	6.88

Table 7

Loan Seasoning Distribution (cont.)		
Seasoning (months)	Residential mortgages (%)	
	As of Sept. 30, 2019	As of Dec. 31, 2018
24-36 months	12.39	12.88
36-48 months	10.83	10.97
48-60 months	8.92	8.21
More than 60 months	42.14	45.05
Weighted-average loan seasoning (months)	70.51	73.68

*Seasoning refers to the elapsed loan term. The data is based on a representative sample.

Table 8

	As of Sept. 30, 2019		As of Dec. 31, 2018	
	Residential loans (%)	Commercial loans (%)	Residential loans (%)	Commercial loans (%)
East Middle Sweden	15.18	17.08	15.07	18.39
Middle Norrland	2.72	4.58	2.53	3.44
North Middle Sweden	6.31	5.21	5.63	5.74
Smaland and the islands	9.43	8.75	9.03	8.58
South Sweden	13.23	15.37	13.11	15.14
Stockholm	26.09	28.30	27.54	28.92
Upper Norrland	3.82	3.49	3.76	3.68
West Sweden	23.22	17.21	23.33	16.1
Total	100	100	100	100

Table 9

Collateral Uplift Metrics		
	As of Sept. 30, 2019	As of Dec. 31, 2018
Asset WAM (years)	12.43	12.20
Liability WAM (years)	3.33	3.56
Available credit enhancement (%)	77.44	102.35
'AAA' credit risk	5.30	6.81
Required credit enhancement for current rating (%)	5.30	6.81
Target credit enhancement for maximum uplift (%)	22.61	23.49
Potential collateral-based uplift (notches)	4	4
Adjustment for liquidity (Y/N)	Y	Y
Adjustment for committed overcollateralization (Y/N)	Y	Y
Collateral support uplift (notches)	2	2

WAM--Weighted-average maturity.

We analyze the cash flows by applying our 'AAA' credit stresses as determined above, as well as our liquidity and interest rate stresses. We also run different default timing and prepayment patterns.

By applying our credit and cash flow stresses, we calculate a target credit enhancement (TCE) of 22.61% for the

September 2019 data, compared to 23.49% in our previous analysis. This decrease is mainly driven by better credit results as described above, despite a slight increase in the assets and liabilities mismatch. Furthermore, we determined that the required credit enhancement to cover a 'AAA' credit stress under our covered bonds criteria is 5.30%, compared to 6.81% previously. The available credit enhancement of 77.44% exceeds both figures, although it is lower than the 102.35% we recorded as of December 2018.

Swedish residential mortgage loans do not always have a final agreed amortization profile. Instead, borrowers periodically agree with lenders the amount of principal they will repay over a given timeframe--for example, the following year--and may choose to pay no principal over the period. Banks often allow borrowers to roll over these interest-only periods. As a result, loans can remain interest-only for considerable periods and may not have a formal amortization schedule for the whole legal mortgage term.

We consider this loan characteristic to be in line with paragraph 281 of our European residential loans criteria. We analyze commercial loans according to their legal final maturity.

According to our covered bonds criteria, the maximum potential collateral-based uplift on a 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 this program, we lower the maximum collateral-based uplift to reflect liquidity risk. Moreover, the issuer provides overcollateralization that is higher than the legal minimum requirement, in order to support the covered bond rating, on a voluntary basis only. Consequently, the maximum potential collateral-based uplift is further reduced by another notch, resulting in a potential collateral-based uplift of just two notches.

Given that the JRL of Swedbank Mortgage's mortgage covered bonds is 'aaa', under our covered bonds criteria, coverage of the 'AAA' credit risk, which for this program results in a 5.30% of credit enhancement, is sufficient to achieve the current 'AAA' rating. This means that Swedbank Mortgage's covered bonds currently benefit from two unused notches of collateral-based uplift in addition to the two unused notches of jurisdiction support.

Counterparty risk

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

Bank account and commingling risk

Swedbank Mortgage has a separate account with Swedbank AB. Swedbank Mortgage has publicly committed on Swedbank AB's website to replace the accounts holding the collections with an appropriately rated bank if we were to downgrade Swedbank AB below the minimum rating that we view as commensurate with the credit enhancement that is sufficient to support an 'AAA' rating on the program. The replacement trigger for limited exposure is set at 'A' and at 'BBB' for minimal exposure. Commingling risk is covered through the Swedish covered bond law as long as the funds belonging to the cover pool are always identifiable, which the issuer has confirmed.

Derivatives

Swedbank Mortgage uses swap agreements to manage interest rate and foreign exchange risks. The swap agreements are made internally with Swedbank AB. We consider the swaps as related counterparties with senior termination

payments. Existing swap agreements document replacement option two of our 2013 counterparty criteria, which allows posting of collateral on the loss of a 'A' rating and warrants a replacement of the counterparty on the loss of a 'A-' rating. We assess this commitment to be in line with a collateral framework assessment of adequate, supporting a 'AAA' rating on the covered bonds.

We therefore consider that counterparty risk does not constrain our ratings on the covered bonds.

Country risk

We assess country risk by applying our structured finance sovereign risk criteria (see "Incorporating Sovereign Risk In Rating Structured Finance Securities: Methodology And Assumptions," published on Jan. 30, 2019).

As the covered bonds are issued in a country that is not a member of a monetary union, and the program does not include structural coverage of refinancing needs over a 12-month period, the program can be rated up to two notches above the long-term sovereign rating. Given that assets in this cover pool are domiciled in Sweden and the current unsolicited ratings on Sweden (AAA/Stable/A-1+), our rating on the program is not limited by the application of our structured finance sovereign risk criteria.

Related Criteria

- 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 | General: Methodology And Assumptions: Assessing Pools Of European Residential Loans, Aug. 4, 2017
- Legal Criteria: Structured Finance: Asset Isolation And Special-Purpose Entity Methodology, March 29, 2017
- Criteria | Structured Finance | Covered Bonds: Covered Bond Ratings Framework: Methodology And Assumptions, June 30, 2015
- Criteria - Structured Finance - Covered Bonds: Methodology And Assumptions: Analyzing European Commercial Real Estate Collateral In European Covered Bonds, March 31, 2015
- 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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- General Criteria: Methodology: Credit Stability Criteria, May 3, 2010
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Related Research

- Swedbank AB, March 26, 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
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- Global Covered Bond Insights Q4 2019, Dec. 12, 2019
- Global Covered Bond Characteristics And Rating Summary Q4 2019, Dec. 12, 2019
- Global Outlook: Covered Bond Harmonization Set To Raise The Bar In 2020, Nov. 26, 2019
- Request for Comment: Global Methodology And Assumptions: Assessing Pools Of Residential Loans (Sweden, Norway, Finland, And Denmark), Nov. 6, 2019
- S&P Global Ratings Definitions, Sept. 18, 2019
- Swedish Covered Bond Market Insights, April 29, 2019
- Global Covered Bond Characteristics And Rating Summary Q4 2019, Dec. 12, 2019
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- Glossary Of Covered Bond Terms, April 27, 2018

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