

Nordic Credit Rating publishes its methodology for covered bonds

Today Nordic Credit Rating AS (NCR) published its first covered bond rating methodology, with a focus on Nordic covered bond issuers, national regulations and market characteristics.

We are requesting comments about the proposed methodology and encourage interested parties to provide direct feedback via criteria@nordiccreditrating.com by 10 May 2019. We will review all received comments with the intention to publish an anonymized summary of comments and the final criteria before the end of June 2019.

"We believe that our proposed methodology reflects the underlying characteristics of the Nordic covered bond markets, the legal nuances of the national regulations and the impact of the EU's Bank Recovery and Resolution Directive (BRRD) on the prioritised status of covered bonds in the creditor hierarchy", said Sean Cotten, lead analyst for the proposed methodology.

"While the BRRD and national regulations provide considerable underlying credit support for most covered bond issuers, the proposal is also designed to reflect additional potential support from covered bond assets where the initial credit assessment reveals a need for further bottom-up pool analysis to reach the highest potential credit ratings."

Methodology summary

Our covered bond ratings are forward-looking assessments that consider:

- the ongoing strength of the issuing entity to make timely payments and maintain asset quality and overcollateralisation levels in the covered pool;
- the treatment of covered bonds in the creditor hierarchy;
- the national regulatory framework;
- the bank resolution regime and/or likelihood of restructuring; and,
- the ability of the covered pool to support timely principal and interest payments in the event of an issuer default and rundown of the covered pool, if necessary.

NCR believes that repayment capacity for covered bonds is linked to the credit quality of the issuer, the issuer's banking group, or, in some instances, the collective owners of the issuer. This reflects ongoing ability to provide capital and liquidity and manage covered pool assets from outside the covered pool itself. As such, our covered bond criteria is linked to the issuer ratings of financial institutions as defined in our Financial Institutions Rating Methodology, 14 Aug. 2019. Given the preference for covered bonds in Nordic bank debt hierarchies, the starting point for covered bond ratings is generally one notch higher than the rating on the senior unsecured commitments of the issuer. This reflects the implementation of the BRRD, which explicitly defines covered bonds as having priority over senior unsecured debt obligations in the default hierarchy of financial institutions.

In addition to protections accorded by the BRRD, national regulations play an important role in ensuring the bankruptcy remoteness of covered bonds, ringfencing covered pool assets,

regulating the quality and management of covered pool assets, ensuring compliance with overcollateralisation requirements and the administration and refinancing of covered pools in the event of issuer bankruptcy. This additional credit support for covered bonds is reflected in additional notching in our criteria.

We then consider the probability of an issuer's resolution and/or restructuring which would result in continuing operations of the resolved or restructured parent or banking group and continuous support for the respective covered bonds. The result is an estimate of the likelihood of a standalone credit pool, which we define as the indicative credit assessment.

The depth of the covered pool analysis is dependent on the indicative credit assessment. When the indicative assessment is 'aaa', a top-down analysis of the covered pool is conducted given the extremely low likelihood of a covered pool relying entirely on its own assets to fulfil its commitments. It is expected that the covered pool assets would provide at least additional support to the credit quality of the pool. However, the incremental support is of marginal value to the assessment of the issue rating on the covered bond. When the indicative credit assessment results in an assessment below 'aaa', a bottom up analysis of the covered pool is undertaken to determine the ability of the underlying assets to support timely payments and full repayment over the life of the covered bond. Details of our standalone covered pool analysis can be found in the proposal.

The full criteria documents are available at:

<https://nordiccreditrating.com/article/nordic-credit-rating-publishes-its-methodology-covered-bonds>

Contact details:

Sean Cotten, Lead analyst, +46 732 32 43 78

Michael Andersson, Chief Rating Officer, +46 732 32 43 22

About Us

Nordic Credit Rating AS is a credit rating agency headquartered in Oslo with a branch in Stockholm. The company provides credit ratings to companies and financial institutions in the Nordic region, and bases its analysis on local insights. Nordic Credit Rating is registered with the European Securities and Markets Authority (ESMA).

Attachments

[Nordic Credit Rating publishes its methodology for covered bonds](https://nordiccreditrating.com/article/nordic-credit-rating-publishes-its-methodology-covered-bonds)
