Supervisory support leads to diverging impacts for Nordic covered bonds

Policy measures introduced by regulators, supervisors, central banks, and government agencies across the Nordic region to ease the impact of the pandemic on banks and their customers have left different marks on their cover-pool compositions.

On the back of ongoing strong issuer support, the credit quality of Nordic covered bonds remains well shielded and is not expected to result in any lasting impacts.

Finansinspektionen, the Swedish regulator, exempted the amortisation of loans collateralised by residential property from regulatory requirements. Entering into force on 14 April 2020, this could potentially apply to payments through to 31 August 2021. Earlier, rules had been introduced whereby new mortgages with a loan-to-value (LTV) ratio above 70% must be amortised by at least two percent of the original loan amount each year. Loans that have an LTV below 70% must be amortised by a minimum of 1% annually until the LTV has reached 50%. These rules have been suspended, with the effect of more risky bullet loans.

Norwegian supervisors also eased mortgage regulations, in particular the percentage of mortgages that can deviate from macroprudential mortgage rules. The macroprudential mortgage lending regulation allows for a certain amount of a bank's approved loans to deviate from requirements (the so-called traffic light system). This quarterly quota is 10% of a lender's approved loans outside Oslo and 8% for mortgages in Oslo. On 23 March, the Ministry of Finance increased both quotas to 20% from 1 April to 30 June 2020.

The Norwegian requirements have caps on the LTV on residential mortgages and home equity credit lines of 85% and 60%, respectively. There is also an amortisation requirement for loans with an LTV above 60%; lenders should allow for an interest-rate increase of five percentage points when assessing a borrower's debt-servicing ability. Further, there are caps on place to borrowers' total debt (debt-to-income, DTI) at five times gross annual income.

No dedicated easing of macro financial regulations was introduced in Finland or Denmark, avoiding a dilution in the risk profile of residential mortgage loans.

Norwegian amortisation levels back at pre-Covid levels

September 2020 cover pool reports from Nordic covered bond issuers show that the Norwegian measures only resulted in a moderate temporary increase in bullet loans in the first two quarters of 2020 (see Figure 1).

Figure 1: Interest only loans

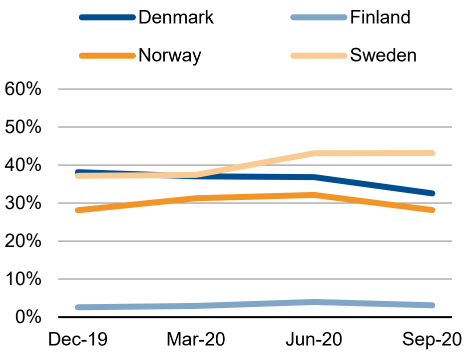
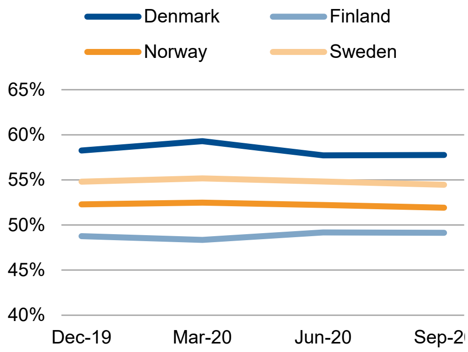


Figure 2: Loan to Value (indexed)



Source: Nordic issuers with HTT reporting

Analysts

Mathias Pleissner
+49 69 66 77 389-39
m.pleissner@scoperatings.com

Team leader

Karlo Fuchs
+49 69 66 77 389-78
k.fuchs.scoperatings.com

Media

Keith Mullin
k.mullin@scopegroup.com

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Scope Ratings GmbH

Neue Mainzer Straße 66-68
D-60311 Frankfurt am Main

Phone +49 69 66 77 389-0

Headquarters

Lennéstraße 5
10785 Berlin

Phone +49 30 27891-0
Fax +49 30 27891-100

info@scoperatings.com
www.scoperatings.com

Bloomberg: RESP SCOP

Norway: Increase in risky loans dropped with expiring exception

The average increase was only in the region of three percentage points. When the easing of macroprudential measures for mortgage loans expired in September 2020, the increase reverted, and the composition of cover pools went back to pre-Covid levels. Similarly, it appears that loans under moratorium have halved down to around 4% since the second quarter peak. This shows that borrowers used them as a defensive measure.

Sweden still up

Sweden: Easement still valid. Risky loans at peak

Unlike Norway, the relaxation in Sweden's amortisation requirements are still in place and have increased by six percentage points compared to the pre-Covid situation. Some issuers have even increased the average share of bullet loans by more than 11 percentage points. Finansinpektioner reported that as of September 2020, 195,000 households (4% of the total) had been granted such exemptions. The number of new exemption applications has decreased from peak levels in recent months.

The amount of loans subject to moratorium has not reduced as significantly as in Norway and is relatively stable at around 9%-10% for Norwegian covered bond issuers.

Danish and Finnish cover pools – stable performance in absence of macroprudential easing

No such exceptions in Denmark and Finland

Danish cover pools do not show a marked impact from the pandemic. In fact, the trend of lowering interest-only (IO) exposures – a credit positive – has continued. IO loans make borrowers more exposed to payment shocks if they are forced to refinance at higher rates, further exacerbated by potential amortisation requirements.

LTVs of Nordic covered bonds remain supportive of their high credit quality

In general, cover-pool LTVs of Nordic covered bonds remain supportive of their high credit quality (see Figure 2). Changes in average LTVs across Nordic covered bond issuers mostly reflect untarnished House Price Index (HPI) increases that have defied the challenges of the pandemic rather than a deleveraging of borrowers by way of amortisation.

Country	Key Nordic monetary and macro-financial changes in response to Covid-19
Sweden	Of the key macro-financial policies implemented, the suspension of amortisation requirements through 31 August 2021 (where banks and borrowers can temporarily agree to reduce or suspend amortisation payments) is directly relevant to the increase in interest only assets. Other measures include: (i) an easing of the countercyclical capital buffer for banks by 2.5 percentage points; (ii) leeway granted to banks to temporarily breach the liquidity coverage ratio (LCR) for individual currencies and total currencies; and (iii) extension of the phase-in period for the banks to comply with the new Minimum Requirements for own funds and Eligible Liabilities (MREL) to 2024 (from 2022). This includes the requirement to replace unsecured bonds with subordinated bonds. Furthermore, the Swedish FSA has urged supervised banks and credit institutions to refrain from paying dividends.
Norway	Of the key macro-financial policies implemented and proposed, the temporary easing of mortgage regulations (in particular an increase in the percentage of mortgages that can deviate from the regulations) is directly relevant to the increase in interest-only assets. Other macro-financial measures include: (i) easing of countercyclical capital buffer by 1.5 percentage points; (ii) the option for banks to temporarily breach the liquidity coverage ratio (LCR); iii) urging by the Ministry of Finance to banks and insurance companies not to distribute profits. Key monetary measures include: (i) reduction in the policy rate by 1.5 percentage points to zero; (ii) provision of additional liquidity to banks in form of loans of differing maturities; (iii) the establishment of a swap facility of USD 30bn between Norges Bank and the US Federal Reserve (mutual currency arrangement); and (iv) the expansion of banks' ability to borrow in US dollars against collateral.

Denmark	Danmarks Nationalbank (DN) increased the policy rate by 15bp to -0.6%. The standing swap line with the ECB was activated and its size was doubled to EUR 24bn. It will remain in place as long as needed. In addition, DN reached an agreement with the Federal Reserve to establish a USD 30bn swap line that will stand for at least six months, and announced the launch of an ‘ extraordinary lending facility’ which will make full-allotment, one-week collateralised loans available to banks at -0.5% on March 20. On March 19, 2020, DN expanded this facility to include three-month variable-rate loans from 27 March 27 and weekly thereafter. DN also increased the interest rate on the previously announced one-week loans to -0.35%. On March 24, DN announced the auction of USD liquidity. The Danish authorities decided on March 12, 2020 to pre-emptively release the countercyclical capital buffer and cancel the planned increases meant to take effect at a later stage. The Danish Financial Stability Authority (DFSA) also announced a case-by-case relaxation of LCR requirements. Banks and insurance companies were urged by the DFSA not to pay dividends or buy back shares.
Finland	Key measures in Finland include: (i) Bank of Finland to support liquidity by investing EUR 1bn in short-term Finnish corporate commercial paper; (ii) A one percentage point reduction in the structural buffer requirements of all credit institutions by removing the systemic risk buffer and adjusting institution-specific requirements. This increases Finnish banks’ international lending capacity by an estimated EUR 52bn. Measures by other countries increase lending capacity to Finnish households and firms by an estimated EUR 30bn); (iii) Finland’s Export Credit Agency is expanding its lending and guarantee capacity to SMEs by EUR 10bn to EUR 14.2bn. T The government increased its coverage of the agency’s credit and guarantee losses from 50% to 80%; (iv) the State Pension Fund will also invest EUR 1bn in commercial paper; (v) a EUR 600m State guarantee for Finnair; (vi) a EUR 600m State guarantee for shipping companies; and (vii) easier re-borrowing of pension contributions; support to restaurants employing workers (EUR 40m) and compensation for the restrictions imposed on activities EUR 83m). The fourth supplementary budget contains financial and liquidity measures, including increased capitalisation of the national climate fund EUR 300m) and capital funding for State-owned enterprises (EUR 770m). On June 29, Finland’s Financial Supervisory Authority relaxed to 90% the macroprudential limit on loan-to-collateral ratios for residential mortgages. On September 30, the board of Finland's Financial Supervisory Authority decided not to extend the validity of the 15% risk-weight floor on housing loans, which is due to expire on 1 January 2021.

Scope Ratings GmbH

Headquarters Berlin
Lennéstraße 5
D-10785 Berlin

Phone +49 30 27891 0

Frankfurt am Main
Neue Mainzer Straße 66-68
D-60311 Frankfurt am Main

Phone +49 69 66 77 389 0

Paris
23 Boulevard des Capucines
F-75002 Paris

Phone +33 1 8288 5557

London
111 Buckingham Palace Road
UK-London SW1W 0SR

Madrid
Edificio Torre Europa
Paseo de la Castellana 95
E-28046 Madrid

Phone +34 914 186 973

Milan
Regus Porta Venezia
Via Nino Bixio, 31
20129 Milano MI

Phone +39 02 30315 814

Oslo
Karenslyst allé 53
N-0279 Oslo

Phone +47 21 62 31 42

info@scoperatings.com
www.scoperatings.com

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