# Verd Boligkreditt AS
## Norwegian Covered Bonds – Performance Update

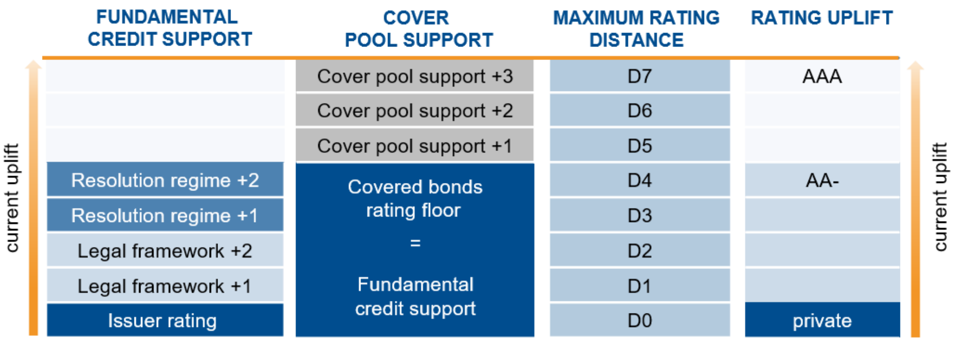
**The AAA rating with a Stable Outlook assigned to the Norwegian mortgage-covered bonds issued by Verd Boligkreditt AS (Verd) is based on our credit view on the bank enhanced by seven notches of cover pool support. Four of those notches reflect our assessment of the strong fundamental credit support provided by the Norwegian legal covered bond and resolution framework.**

| Cut-off date | Cover pool | Cover asset type | Covered bonds | Rating/Outlook |
|---|---|---|---|---|
| 31 Dec 2021 | NOK 12.29bn | Residential mortgage loans | NOK 10.29bn | AAA/Stable |

Verd is a specialised credit institution dedicated to providing secured covered bond funding to its owners – 19 local banks in Norway ('owner banks' or 'member banks'). Verd's investment-grade credit quality is based on the investment-grade credit profiles of its owner banks, which are well-established in their local markets and maintain reassuring prudential metrics.

Fundamental credit support factors from the Norwegian legal and resolution framework provide a four-notch uplift above our credit view on Verd. This forms a rating floor at AA-.

The interplay between complexity and transparency is classified with a cover pool complexity (CPC) score of 1, allowing for the maximum uplift of three notches on top of the fundamental uplift. This uplift, combined with cover pool support, enables the programme to be rated AAA. The programme does not benefit from a rating buffer against an issuer downgrade as the maximum theoretical uplift of seven notches is needed to reach the highest rating.




## Stable Outlook

The Stable Outlook on the covered bond rating reflects our expectation that: i) the credit performance of Verd and its 19 member banks will continue to be stable; ii) Verd will maintain its covered bond programme's prudent risk profile; and iii) Verd's member banks and direct issuer will remain willing and able to provide sufficient overcollateralisation (OC) and equity to support the covered bonds' very high credit quality.

## Changes since the last performance update

Verd's mortgage assets grew by 11% since our last analysis in March 2021. 3.9% of the total cover pool balance was contributed by the new co-owners – local savings banks organised under the LokalBank Alliance (LBA). Only five out of the 10 LBA banks had transferred assets to Verd as of December 2021. Hence, growth is expected to continue. The average loan-to-value (LTV) ratio remained stable at 50%.

The programme's lifetime mean default rate dropped by 4.5 pp as we revised amortisation in our cash flow modeling. Fundamentally, credit risk remains stable.

### Ratings & Outlook

| | |
|---|---|
| **Issuer rating** | **Not disclosed** |
| Outlook | Not disclosed |
| **Covered bond** | **AAA** |
| Outlook | Stable |
| Rating action | Affirmation |
| Last rating action | 8 Feb 2022 |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### Related Research

Scope affirms Verd Boligkreditt AS mortgage-covered bonds at AAA/Stable
Feb 2022

Earnings outlook for Norwegian banks more nuanced than zero interest rates suggest
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Jan 2020


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## The issuer

Established in 2009, Verd is a covered bond issuer owned by 19 independent savings banks in Norway. The ownership structure is unusual as most covered bond issuers are owned by a single parent bank. The owner banks are part of De Samarbeidende Sparebankene (DSS) or the aforementioned LBA. Both alliances enhance negotiating power with suppliers and operational efficiencies while enabling expertise-sharing.

In December 2020, the 10 banks organised in LBA entered into an agreement with Verd to become additional co-owners of Verd after they left the EIKA alliance. The agreement allows the LBA banks to refinance eligible mortgage loans with covered bonds issued by Verd. Any effect on the credit quality of Verd's cover pool and covered bonds will only emerge slowly given that mainly newly originated mortgage loans will be added. This is because some of the LBA banks' eligible mortgage loans (currently held by Eika Boligkreditt) can only be released when the corresponding covered bonds mature.

As seen throughout Norway, banking alliances play an important role in sustaining individual banks' efficiency and business franchises. This includes shared ownership of companies offering a range of financial products, such as insurance, leasing and securities services.

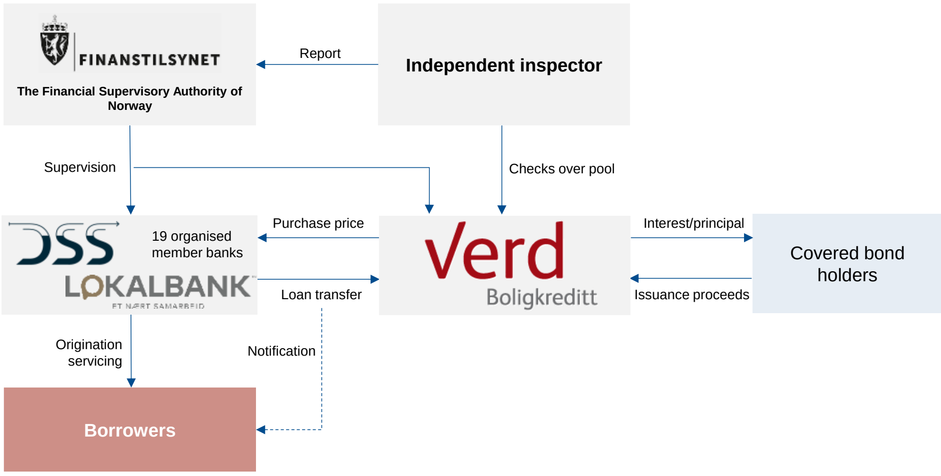
The original owners of Verd were nine savings banks from the DSS alliance. In 2021, the 10 LBA banks began using Verd and became co-owners. The DSS banks are concentrated in the southern and western part of the country, in the counties of Rogaland, Agder and Hordaland. The LBA banks are concentrated more in the eastern and northern part of the country, in the counties of Trondelag, Vestfold and Telemark – resulting in stronger diversification for Verd's asset profile.

## Programme structure

**Specialised mortgage bank issuing covered bonds**

The Norwegian legal covered bond framework is mainly based on the relevant section on covered bonds in the Financial Institutions Act along with a related regulation on mortgage credit institutions, both introduced in 2007. Under this framework, issuance is only permitted through specialist covered bond issuers. Most issuers of covered bonds (called Boligkreditt, or specialised residential mortgage institutions) are subsidiaries that rely on loans originated by their respective parent banks. In contrast, Verd is a funding platform jointly owned by its owner banks. A Boligkreditt issues covered bonds whose proceeds are used to purchase mortgage assets from its parent bank(s), thereby financing the latter's lending business.

**Current issuance structure**




Source: Scope Ratings

## Fundamental credit support analysis

Fundamental credit support factors enhance the covered bond rating by four notches above our credit view on Verd. This is based on our view of: i) Norway's covered bond legal framework; and ii) the resolution regime and systemic importance of Verd's covered bonds, as well as the cohesiveness of its member banks.

### Legal framework analysis

**Two notches of uplift based on legal framework analysis**

We consider the Norwegian covered bond framework to be one of Europe's strongest, fully satisfying our criteria for protecting investors. We have therefore assigned the highest credit differentiation of two notches.

As of 17 December 2021, the Norwegian government proposed new legislation to implement the European Covered Bond Directive. The Covered Bond Directive has not yet been incorporated in the Agreement on the European Economic Area (EEA Agreement). The ministry of finance is planning to incorporate the new legislation before it takes effect in the EU on 8 July 2022.

**No impact from proposed legislation**

The proposed directive is based on the same principles as the current Norwegian covered bond framework. This means no major changes were implemented in the directive. Consequently, it will not negatively impact our assessment. In fact, some of the changes may even improve the credit profile of the bonds. For example, the new minimum OC is 5%, compared to the 2% required for residential and commercial mortgage loans under the current legislation. Our assessment (below) is based on Norway's current covered bond legislation.

**Segregation of cover pool upon insolvency**

The legislation gives bondholders a preferential claim over the cover pool if the issuer is placed under public administration. The term 'covered bonds' (in Norwegian 'obligasjoner med fortrinnsrett' or OMF) is protected by law. The assets in the pool remain with the estate if the issuer is placed under public administration, but bondholders and derivative counterparties have an exclusive, equal and proportionate preferential claim over the cover pool, and the administrator is bound to assure timely payment, provided the pool gives full cover to said claims.

**Ability to continue payments after issuer insolvency**

The legislation does not allow covered bond issuers to be declared bankrupt. Rather, they must be placed under public administration if they face solvency or liquidity problems. This gives the authorities more flexibility to deal with covered bond companies while maintaining the rights of holders of covered bonds. The liquidator's job is to ensure proper management of the cover pool and verify that holders of covered bonds and derivative counterparties receive agreed payments on time. Public administration or insolvency does not automatically give holders of covered bonds and derivative counterparties a right to accelerate their claims. If it is not possible to make contractual payments when claims are due and an imminent change is unlikely, the liquidator must halt payments.

**Programme enhancements remain available**

Norwegian covered bonds have a mandatory minimum OC requirement of 2% (nominal). All voluntary OC is part of the cover pool.

**Liquidity and other risk management guidelines**

The issuer must adopt strict internal regulations with respect to liquidity risk, interest rate risk and currency risk. However, liquidity measures, in particular, are relatively weak as they are described as general guidance. In fact, issuers rely entirely on maturity extensions and do not provide liquid assets at all. However, this will change in the near term as the Norwegian FSA has proposed including a 180-day liquidity buffer, even for soft-bullet covered bonds, following amendments made to the regulation due to the EU Covered Bond Directive.

**Liquidity**: A credit institution must ensure that payment flows from the cover pool enable it to honour its payment obligations to holders of covered bonds and derivative counterparties at all times. It must create a liquidity reserve that it must include in the cover pool as substitute assets, in addition to carrying out periodic stress tests to ensure satisfactory liquidity management.

**Interest rate risk**: A covered bond issuer must never assume greater risk than what is prudent. It must establish a limit on interest rate risk in relation to its own funds and potential losses. This limit must be based on a parallel shift of one percentage point in all interest rate curves as well as non-parallel shifts in the same curves. The interest rate curves must be divided into time intervals, and value changes for each time interval must be limited to a prudent portion of the overall limit on interest rate risk that has been set for the institution.

**FX risk**: A covered bond issuer must not be exposed to any substantial foreign exchange risk and is thus obliged to set limits on such risks. For the largest issuers, issuance is often denominated in EUR with a fixed rate, whereas mortgages are typically in NOK and have a floating rate.

**Derivatives**: Norwegian issuers may use derivatives to remove FX and interest rate risk and to satisfy regulatory requirements. If a derivative agreement has a positive mark to market value, the amount will be part of the cover pool. If the value is negative, the counterparties in the derivative agreement will have a preferential claim in the pool, and they will rank pari passu with the holders of covered bonds. As a corollary to this, the counterparties in the derivative agreements will be subject to the same restrictions as the bondholders with respect to declaration of default.

**Covered bond oversight**

Norwegian issuers are subject to a supervisory regime involving an independent inspector (cover pool monitor) and the public supervisor, the FSA. There are no limitations on issuance. An exception is the FSA's option to instruct an institution to not issue covered bonds if its financial strength causes concern.

The mortgage institution must maintain a register of issued covered bonds, and of the cover assets assigned to those bonds, including derivative agreements. The FSA must appoint an independent inspector to verify that the register is maintained correctly. The inspector must also regularly review compliance with the requirements concerning the balance principle and report related findings to the FSA.

## Resolution regime analysis

**Two notches of additional uplift reflecting resolution regime**

Verd's covered bonds benefit from an additional two-notch uplift reflecting a bail-in exemption and support from a strong external stakeholder community. The uplift is constrained by the combination of: i) the low likelihood that the covered bond issuer will be maintained in a resolution scenario; ii) Verd's low visibility as a covered bond issuer; and iii) the support of the owner banks, which provide investors with limited documented or public commitments on minimum levels of liquidity or OC. However, we acknowledge that the updated transfer and service agreements between the member banks and Verd have strengthened the cohesiveness of the member banks.

### Exclusion from bail-in

Norwegian covered bonds benefit from a bail-in exemption. Norway is in the European Economic Area, and the EU's Bank Recovery and Resolution Directive (2014/58/EU – BRRD) is adapted by its member states. We believe that the current capital structure would allow regulators to restructure Verd using available resolution tools should the need arise.

### Resolution

As just mentioned, we believe that the current capital structure would, in theory, allow regulators to restructure Verd using available resolution tools should the need arise. However, the most likely scenario would be a transfer or takeover by another bank. An orderly wind-down is another plausible scenario. Verd's size and setup as a joint issuance vehicle make resolution less likely compared to a 100%-owned subsidiary should it or its shareholders fail. As a result, investors might not benefit from an issuer structure that may be maintained as a going concern.

### Systemic relevance of covered bonds

We generally classify Norwegian covered bonds as a systemic refinancing product, particularly for residential mortgages. The combined outstanding volume of covered bonds has averaged more than 30% of GDP since 2011 and was more than 40% at the end of 2020. Annual issuance hovers around EUR 25bn and reached EUR 30bn in 2020. Norway has 24 active specialised covered bond issuers, issuing residential, commercial and public sector-backed covered bonds. Globally, Norway was the seventh-largest issuer in 2020 and the eighth-largest issuer by total outstanding size.

### Relevance/importance of CVB funding for Verd

In our view, Verd's covered bond issuing activities and market share only result in low to moderate systemic importance. Relative to the market, this has not changed materially since the LBA banks joined the platform. Verd only issues in the domestic market, which should reduce negative repercussions on other issuers in the event of a failure. However, we also have taken into account that most of Norway's covered bond issuers are subsidiaries of similar small to mid-size banks. Hence, even the failure of a covered bond issuer of Verd's size and setup could result in contagion, effectively creating systemic problems for other issuers that rely on this refinancing channel for their core product, residential mortgage lending. This risk is reinforced within the DSS and LBA associations because all member banks have a strong interest in maintaining this mutual funding platform.

### Proactive stakeholder community

The country's covered bond issuers actively cooperate under the umbrella of the Norwegian Covered Bond Council to promote the product and initiate any changes to the framework, such as the March 2017 increase in minimum OC to 2% to avoid potential challenges for cover pool derivatives due to the European Market Infrastructure Regulation. Domestic covered bond investors such as banks and insurers actively use covered bonds not only as a substitute for long-dated, NOK-denominated government debt, but also to manage liquidity. Moreover, Norway's central bank has demonstrated its support for covered bonds by using them in its repo operations and running a covered bond to government debt 'swap programme' during 2008-14. Norway's FSA also has an active interest given the widespread use of covered bonds to refinance residential mortgage lending.

In addition, Norway was the first out of the blocks to align its covered bond framework with the EU's new Covered Bond Directive, and it is planning to meet the deadline to transpose the directive into national law. These are further signs of the high systemic importance of the product and the activity of the local community.

### Cover pool characteristics

| Reporting date | Dec 2021 | Dec 2020 |
|---|---|---|
| Balance (NOK bn) | 12.29 | 10.89 |
| Residential (%) | 91.6 | 93.1 |
| Substitute (%) | 8.4 | 6.9 |

### Property type (%)

| Reporting date | Dec 2021 | Dec 2020 |
|---|---|---|
| Single-family house | 78.8 | 79.1 |
| Apartment | 13.9 | 13.7 |
| Other | 7.3 | 7.2 |

### General information

| Reporting date | Dec 2021 | Dec 2020 |
|---|---|---|
| No. of loans | 7,068 | 6,666 |
| No. of obligors | 6,972 | 6,573 |
| Avg. size (NOK m)* | 1.6 | 1.5 |
| Top 10 (%) | 0.5 | 0.5 |
| Remaining life (y) | 18.1 | 16.0 |
| LTV ratio (%) | 50.1 | 50.6 |

*per Scope-aggregated borrower

### Interest rate type (%)

| Reporting date | Dec 2021 | Dec 2020 |
|---|---|---|
| Floating | 100.0 | 100.0 |
| Fixed | 0.0 | 0.0 |

### Repayment type (%)

| Reporting date | Dec 2021 | Dec 2020 |
|---|---|---|
| Annuity | 80.7 | 79.2 |
| Flexible loan | 18.8 | 20.3 |
| Interest-only | 0.4 | 0.5 |

## Cover pool analysis

Verd's mortgage-covered bond ratings are cover pool-supported, providing seven of the seven notches of uplift needed to achieve the highest rating. Fundamental credit support provides a four-notch rating uplift and an effective floor against a deterioration in cover pool credit quality. Our assessment of the interplay between complexity and transparency translates to a CPC score of 1, which allows for the maximum three-notch uplift on top of the fundamental uplift.

The minimum supporting OC needed to achieve the highest rating remains unchanged at 5%, supported by the sound credit metrics of the cover pool and low market risks. The latter arise from maturity mismatches that nevertheless benefit from the bonds' soft-bullet structure.

### Cover pool composition

The cover pool comprises granular, first-lien Norwegian residential mortgage loans denominated in NOK and further benefits from 8.4% of liquid, substitute assets. These assets mainly comprise Norwegian mortgage-covered bonds (64%) but also deposits with Sparebank Vest (22%), public sector bonds, and bonds issued by the European Investment Bank.

As of December 2021, the loans were granted to 6,972 (up from 6,573) obligor groups. By balance, 3.9% accounts for mortgage loans originated by LBA. Five out of 10 LBA banks contributed mortgage assets to the programme as of December 2021. The total share and number of contributors will increase over time with new originations from LBA banks and from existing collateral released from maturing EIKA covered bonds.

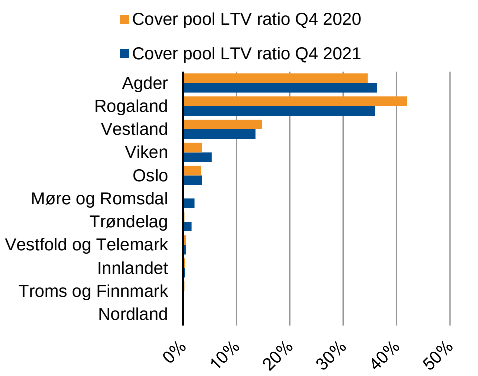
LBA loans transferred to Verd currently show worse credit metrics compared to DSS. For instance, LTV ratios for LBA stand at 61% on average versus 50% for DSS. Also, internal risk scores imply that LBA loans are of lower quality given some concentration in riskier classes. Due to the low number of loans, this is not significant for overall performance. However, we will closely monitor how this trend develops.

| Regional bank | Alliance | Ownership | Loans transferred | LTV ratio | Seasoning | Remaining term | Flexilån |
|---|---|---|---|---|---|---|---|
| Skudenes & Aakra Sparebank | DSS | 17.5% | 18.6% | 50.6% | 4 | 20 | 22% |
| Haugesund Sparebank | DSS | 16.7% | 16.5% | 48.6% | 5 | 20 | 25% |
| Spareskillingsbanken Kristiansand | DSS | 14.7% | 16.0% | 46.8% | 4 | 20 | 19% |
| Flekkefjord Sparebank | DSS | 11.3% | 14.2% | 56.0% | 3 | 21 | 3% |
| Søgne & Greipstad Sparebank | DSS | 7.1% | 7.8% | 48.3% | 4 | 21 | 17% |
| Etne Sparebank | DSS | 6.6% | 8.4% | 53.7% | 4 | 21 | 23% |
| Luster Sparebank | DSS | 6.3% | 6.5% | 44.0% | 5 | 19 | 31% |
| Lillesands Sparebank | DSS | 6.0% | 6.3% | 46.2% | 5 | 21 | 22% |
| Askim & Spydeberg Sparebank | LBA | 3.4% | 2.2% | 60.3% | 2 | 26 | 4% |
| Voss Sparebank | DSS | 1.8% | 1.9% | 44.8% | 5 | 18 | 13% |
| Sparebank Din | LBA | 1.5% | 0.0% | n/a | n/a | n/a | n/a |
| Sparebank 68 Nord | LBA | 1.3% | 0.1% | 59.2% | 7 | 22 | 0% |
| Drangedal Sparebank | LBA | 1.2% | 0.0% | n/a | n/a | n/a | n/a |
| Selbu Sparebank | LBA | 1.1% | 0.0% | n/a | n/a | n/a | n/a |
| Stadsbygd Sparebank | LBA | 1.1% | 0.9% | 63.2% | 2 | 25 | 1% |
| Nidaros Sparebank | LBA | 0.8% | 0.1% | 57.9% | 5 | 23 | 0% |
| Aasen Sparebank | LBA | 0.7% | 0.5% | 57.1% | 5 | 24 | 7% |
| Ørland Sparebank | LBA | 0.5% | 0.0% | n/a | n/a | n/a | n/a |
| Tolga – Os Sparebank | LBA | 0.4% | 0.0% | n/a | n/a | n/a | n/a |

The average loan size remains small at NOK 1.6m. The top 10 largest obligors account for 0.5%. The weighted average indexed whole LTV ratio is 50.1% (down from 50.6%). Re-drawable loans (flexible loans), make up around 19%, relatively unchanged from our analysis one year ago. Flexible loans have an embedded credit line that can be redrawn without new credit approval. Flexible loans will only be granted if their LTV ratio does not exceed 60%. Existing flexible loans may only be drawn up to 60%. Another 0.4% of the loans have an interest-only period. The remaining loans are normal amortising loans.

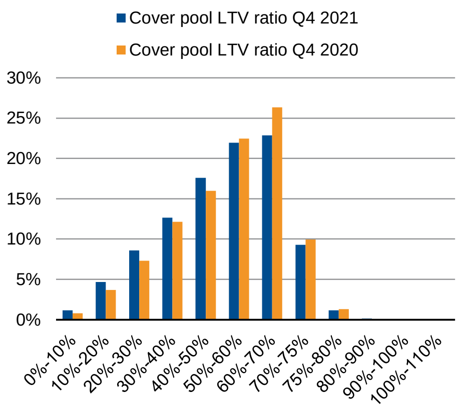
DSS loans are more concentrated in the counties of Rogaland, Agder and Hordaland, which are more exposed to the oil industry. They are also home to diversified, export-oriented businesses and sectors like fisheries, ship-building, tourism and hydro power. The LBA banks are concentrated in the eastern and northern part of the country in the counties of Trondelag, Vestfold and Telemark, but are still underrepresented in the total portfolio. Exposures outside of the core region of each savings bank are driven by the bank's provision of financing to local customers. They are exceptions and are only granted to borrowers with above-average credit quality.

**Figure 1: Regional distribution**




Source: Scope Ratings, Verd

**Figure 2: LTV distribution**




Source: Scope Ratings, Verd

79% of the portfolio is made up of single-family and terraced houses, while apartments comprise 14%. Holiday homes account for 1.5%, and land or agricultural property accounts for another 3.7%.

## Asset risk analysis

**Strong credit quality translates into low credit risk**

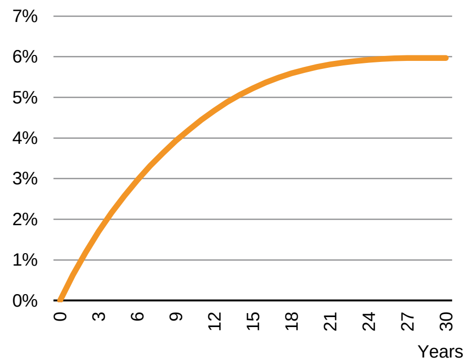
The cover pool's credit quality remains strong. We assume an annual average default probability of 66 bps, which provides a comfortable cushion against the banks' internal point in time assessment. This assumption has been established by considering the banks' risk scoring and our probability of default mapping, benchmarked to that of other Norwegian residential mortgage lenders. The average borrower's probability of default is commensurate with a BB+ rating.

This translates to a cumulative term default rate of 6.0% (down from 10.5%). The lower term default does not reflect a fundamental improvement in the credit quality of the underlying assets, but rather a model calibration that effectively takes into account the loans' legal amortisation profile. We acknowledge cure rates ranging between 55%-70% according to Verd's IFRS 9 reporting. While these are likely to impact on our expected defaults, high cures are less likely under a stressed scenario. Consequently, we do not give additional benefit to our term default rate from potential cures.

The legal amortisation profile was calculated assuming all flexible loans have an initial loan term equal to the average annuity loan, but they are not expected to amortise during their remaining life. Further, we assumed them to be fully drawn.

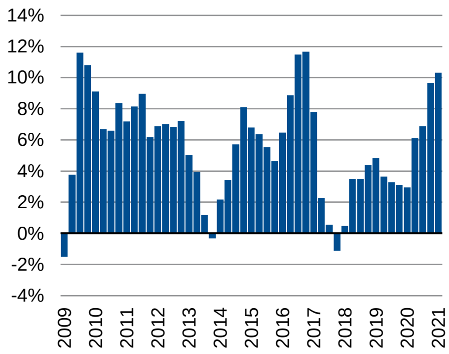
Our projection of default on mortgage loans uses an inverse Gaussian distribution, based on the available credit performance data provided. We have further maintained our assumption of a coefficient of variation of 55% for the mortgage assets. This factors in higher sensitivity to economic shocks in the western regions of Norway, but it also considers the diversification within these areas compared to more concentrated peers.

**Figure 3: Expected term defaults, cumulative**




Source: Scope Ratings, Verd

**Figure 4: House price growth in Norway, annualised**




Source: Scope Ratings, statOECD

We analysed substitute asset defaults with a non-parametric distribution using a Monte Carlo method. The applied correlation factor sums up to 22% and is based on an asset's regional exposure and type. We derived default expectations based on individual credit assessments of each issuer. The low default rate of 0.1% and very high coefficient of variation reflect high individual credit quality but also very high obligor concentration. The asset recovery rate assumptions ranged between 100% in the base case and 57.9% in the most stressed scenario.

Stressed recovery rates remained relatively stable at 77.8% versus 77.2% one year ago. The recovery partly reflects the drop in the portfolio's LTV ratio (from rising house prices), but it is also driven by more conservative value haircuts reflecting extraordinary property value growth during the pandemic. We see price growth in Norway, significantly above 3%, as unsustainable and so we have increased our stressed market value haircuts (MVD) by 2.5%.

**Figure 5: Norwegian security value haircuts (SVH)**

| Region | Base MVD | Stressed MVD | Firesale Discount | Stressed TSVH |
|---|---|---|---|---|
| **Oslo** | 0% | 55.0% | 30% | 62.5% |
| **Southwest** | 0% | 35.0% | 30% | 45.0% |
| **Rest of Norway** | 0% | 42.5% | 30% | 52.5% |

Our base recovery expectation remains very strong at 98.2%.

We have kept the fire sale discount unchanged at 30%. It is applied to properties sold under non-standard market or distressed conditions. For Verd, we assume a higher discount than for Norwegian peers. This is justified by its internal analysis (IFSR 9) and the fact that the member banks' core markets are in more rural parts of Norway, for which liquidity may be lower.

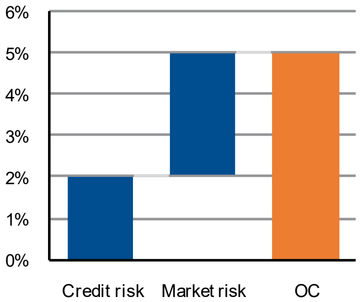
Our recovery analysis further sizes for 2.5% of variable costs and NOK 70,000 of fixed costs.

For the substitute assets, we calculated stressed recovery rates of 59%.

## Cash flow risk analysis

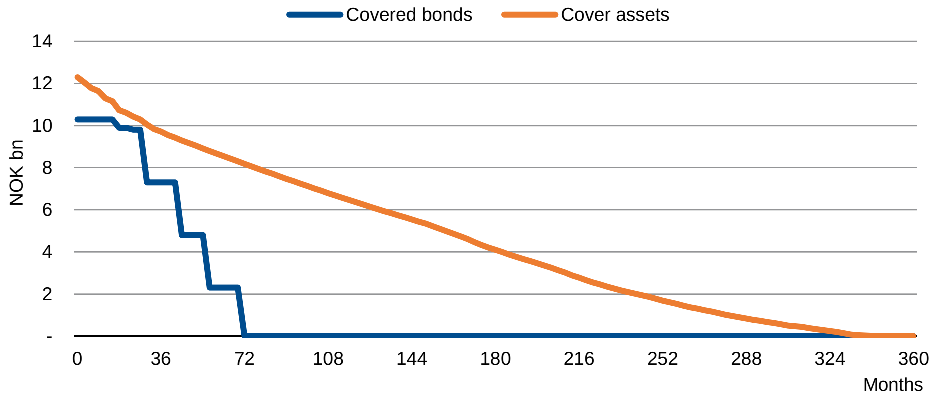
The unchanged rating-supporting OC of 5.0% mainly reflects the programme's maturity mismatch risk accounting for 3.0 pp. These are driven by the programme's sensitivity to high pre-payments, which generate large cash balances. This cash reduces the transaction's available excess spread – especially in sensitivity scenarios featuring both margin-compression and front-loaded default timings.

### Supporting OC breakdown




Source: Scope Ratings

**Figure 6: Amortisation profile**




Source: Scope Ratings, Verd

We have calculated asset margins based on the loan-by-loan data provided, resulting in a weighted average margin of 97 bps for the mortgage loans. This compares to 29 bps under the covered bonds.

In the event of recourse to the cover pool, we assume assets will be sold at a discount of up to 150 bps if the cash accumulated from cover pool amortisation is insufficient to pay interest and principal on the covered bonds on time. The cover pool does not currently include short-term substitute assets.

### Asset-liability mismatches

| | Assets | Liabilities |
|---|---|---|
| **NOK** | 100% | 100% |
| **Fixed** | 0.0% | 0.0% |
| **Floating** | 100% | 100% |
| **WAL (years)** | 11.9 | 3.7* |

*incl. one-year extension

Other market risks are limited as cover assets and covered bonds are both floating rate with the fixed rate bond having matured. Also, there is no foreign exchange risk as both assets and liabilities are denominated in NOK. At this stage, we do not expect foreign currency-denominated issuances.

Credit risk only accounts for 2.0 pp (down from 2.8 pp) of the rating-supporting OC. This is low, reflecting the lifetime mean default rate of 6.0% (down from 10.5%), an unchanged coefficient of variation of 55%, and a stressed recovery rate of 77.8% (up from 77.2%). Our lower lifetime mean default rate dropped by 4.5 pp as we revised amortisation in our cash flow modelling. Fundamentally, credit risk remains stable.

We have further assumed a recovery lag of 24 months, reflecting Norway's lean and digital sale procedures as well as the more regional asset exposure.

We conservatively established the assets' amortisation profile assuming that all flexible lines were fully drawn. The bonds' amortisation profile was calculated assuming that the one-year maturity extension was executed.

We have tested the programme's resilience against high (15%) and low (1%) pre-payments as well as a set of rising and declining interest rate scenarios. The covered bonds are most exposed to a low pre-payment scenario in combination with low interest rates. Consequently, we assume asset sales under discounts in order to meet the bonds' payment obligations.

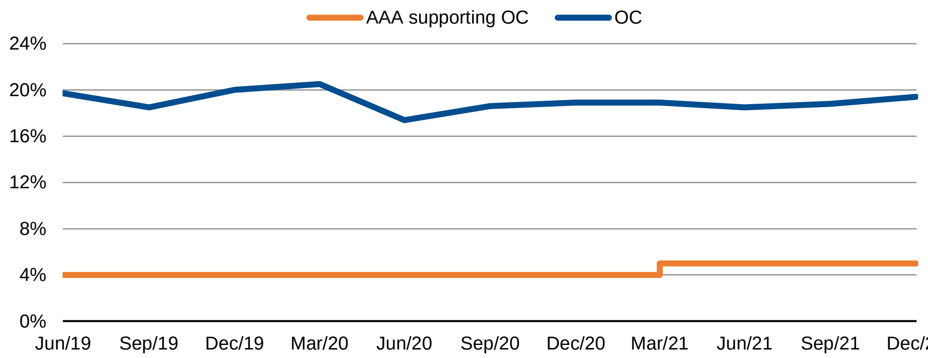
Further, we tested sensitivities to a 50% margin compression, front-loaded defaults, 25% pre-payments and a liquidity premium of up to 200 bps.

## Availability of OC

**Overcollateralisation fully taken into account**

Our credit view on Verd allows us to fully account for the provided OC of 19.4%, which is above the level of OC supporting the programme's AAA rating. We are not aware of plans that would significantly change the risk profile or reduce available OC to levels that would no longer support the current rating uplift.

**Figure 7: Available OC versus current rating-supporting level**




Source: Scope Ratings, Verd

## Other risk considerations

**Counterparty risk mitigated by alignment of interests**

The rated covered bonds have counterparty exposures to the issuer, as well as to the issuer's parent as loan originator, servicer, bank account provider and paying agent. However, if a regulator were to intervene, we believe the strong alignment of interests between the bank and the holders of the covered bonds would prevent any negative impact. We also view positively the fact that collections are generally made via direct debit, which enables a relatively swift redirection of payments if necessary.

**Sovereign risk does not affect the ratings**

Sovereign risk does not limit the ratings of Verd's mortgage-covered bonds. We believe the risks of an institutional framework meltdown, legal insecurity or currency-convertibility problems are currently remote.

**No impact from ESG**

We have not directly included ESG aspects in our rating of Verd's covered bonds. Verd is planning to establish an ESG policy and a green bond framework this year. Owner banks will be encouraged to finance green residential buildings through Verd. As of today, the share of loans with EPC-label information is very limited. Based on building standards, more loans may become eligible as green collateral. Still, it remains a limitation in regard to green collateral, but also as a quantitative basis for analysing the impact on performance.

Environmental aspects, particularly Norwegian energy efficiency standards, have often not been recorded in the banks' main underwriting databases. We were therefore unable to perform a specific analysis of environmental or social factors and their impact on the cover assets' probability of default or recovery proceeds. At the same time, we have indirectly included environmental aspects because collateral valuations reflect the condition of collateral.

## Sensitivity analysis

**No buffer against potential change in our credit view on the issuer**

Verd's mortgage-covered bond ratings do not benefit from a buffer against an issuer downgrade as the maximum uplift of seven notches granted to the programme was needed to reach the rating. The covered bond ratings could be downgraded if: i) our view on the issuer deteriorated by one notch or more; ii) risk in the covered bond programme increased, and the OC provided no longer supported a seven-notch uplift; or iii) there was a deterioration in our view on the fundamental support factors relevant to the issuer and Norwegian mortgage-covered bonds in general.

## Summary of covered bond characteristics

| Reporting date | 31 Dec 2021 | 31 Dec 2020 | 31 Dec 2019 |
|---|---|---|---|
| Issuer name | Verd Boligkreditt AS | | |
| Country | Norway | | |
| Covered bond name | Obligasjoner med fortrinnsrett (Norwegian mortgage-covered bonds) | | |
| Covered bond legal framework | Norwegian legal covered bond framework | | |
| Cover pool type | Residential mortgage loans | | |
| Composition | Residential = 91.6% | Residential = 93.1% | Residential = 94.3% |
| | Substitute = 8.4% | Substitute = 6.9% | Substitute = 5.7% |
| Issuer rating | Not disclosed | Not disclosed | Not disclosed |
| Current covered bond rating | AAA/Stable | AAA/Stable | AAA/Stable |
| Covered bond maturity type | Soft bullet | Soft bullet | Soft bullet |
| Cover pool currencies | NOK (100%) | NOK (100%) | NOK (100%) |
| Covered bond currencies | NOK (100%) | NOK (100%) | NOK (100%) |
| Fundamental support | 4 | 4 | 4 |
| Maximum additional uplift from CPC score | 3 | n/a | n/a |
| Maximum achievable covered bond uplift | 7 | 8 | 8 |
| Potential covered bond rating buffer | 0 | 0 | 0 |
| Cover pool (NOK bn) | 12.29 | 10.89 | 9.94 |
| thereof, substitute assets (NOK bn) | 1.03 | 0.75 | 0.57 |
| Covered bonds (NOK bn) | 10.29 | 9.16 | 8.25 |
| Overcollateralisation: current / legal minimum | 19.4% / 2.0% | 18.9% / 2.0% | 20.1% / 2.0% |
| Overcollateralisation to support current rating | 5.0% | 5.0% | 4.0% |
| Overcollateralisation upon a one-notch issuer downgrade | 5.0% (AA+) | 5.0% (AA+) | 4.0% (AA+) |
| Weighted average life of assets | 11.9 years | 11.1 years | 11.1 years |
| Weighted average life of liabilities[1] | 3.7 years | 3.6 years | 3.3 years |
| Number of loans | 7,068 | 6,666 | 6,181 |
| Average loan size (NOK m) | 1.6 | 1.5 | 1.5 |
| Top 10 residential | 0.5% | 0.5% | 0.7% |
| Interest rate type – assets | Floating 100% | Floating 100% | Floating 100% |
| | Fixed 0% | Fixed 0% | Fixed 0% |
| Interest rate type – liabilities | Floating 100% | Floating 95.2% | Floating 94.7% |
| | Fixed 0% | Fixed 4.8% | Fixed 5.3% |
| Weighted average LTV ratio (indexed) | 50.1% | 50.6% | 52.6% |
| Geographic split (top three) | Vest-Agder = 36.3% | Rogaland = 42.0% | Rogaland = 43.5% |
| | Rogaland = 36.0% | Vest-Agder = 28.2% | Vest-Agder = 27.6% |
| | Vestland = 13.6% | Hordaland = 9.7% | Hordaland = 10.5% |
| Default measure | Inverse Gaussian | Inverse Gaussian | Inverse Gaussian |
| Weighted average default rate (mortgage/substitute) | 66 bps / 6.0% | 57 bps / 10.5% | 57 bps / 10.5% |
| Weighted average coefficient of variation (mortgage/substitute) | 55% | 55% | 55% |
| Weighted average recovery assumption (D0/D7)[2] | 98.3% / 77.8% | 98.1% / 77.2% | 98.1% / 81.3% |
| Share of loans > three months in arrears (NPL) | 0.0% | 0.0% | 0.0% |
| Interest rate stresses (max./min.; currency-dependent) | -1% to 10% | -1% to 10% | -1% to 10% |
| FX stresses (max./min.; currency-dependent) | n/a | n/a | n/a |
| Maximum liquidity premium | 150 bps | 150 bps | 150 bps |
| Average servicing fee | 25 bps | 25 bps | 25 bps |

[1] Including the 12-month extension
[2] D0 and D7 denote the stresses commensurate with the rating distance between our credit view on the issuer and the covered bond ratings.

## Appendix I: Summary credit view on Verd

Scope's credit view reflects Verd's low risk busines model and the investment-grade credit profile of its owner banks.

As dictated by its legislative status and strategic purpose, Verd pursues a restricted and low risk business. Verd issues covered bonds whose proceeds are used to selectively purchase residential mortgage assets from its owner banks, thereby financing the latter's lending business.

The owner banks are well established in their local markets and maintain reassuring prudential metrics. The focus on retail customers and mortgage lending underpins good asset quality and sound levels of capitalisation. The original owner banks which form the DSS alliance operate in southern and western Norway, regions more exposed to the cyclical oil and gas industry. However, the addition of banks from the LBA alliance which operate in eastern and northern Norway will gradually diversify the assets of the cover pool.

The 10-plus year relationship between Verd and its original owner banks has been highly cooperative and successful. This has ensured that Verd suffers no credit losses and maintains a sound financial profile. The various support mechanisms as well as the DSS and LBA alliances, however, have yet to be tested under more difficult conditions.

## Outlook and credit view change-drivers

The Stable Outlook reflects the ongoing resilient operating performance of both Verd and its owner banks.

**What could positively impact the credit view**:

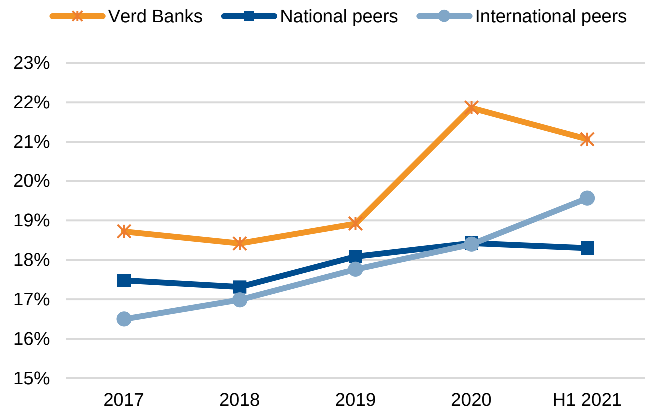
- Change in the composition of the owner banks impacting the mix of mortgage assets positively
- Further clarity and details on the owner banks' duties and obligations to support the credit fundamentals of Verd in situations of need

**What could negatively impact the credit view:**

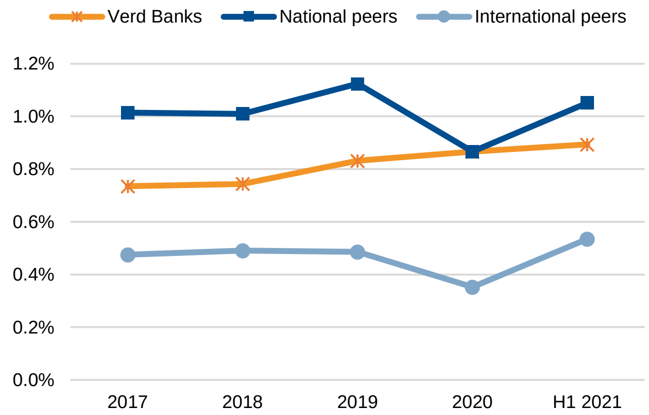
- Material deterioration in the credit fundamentals of the owner banks
- Change in the composition of the owner banks impacting the mix of mortgage assets negatively

## Appendix II: Peer comparison – Verd owner banks vs national and international peers

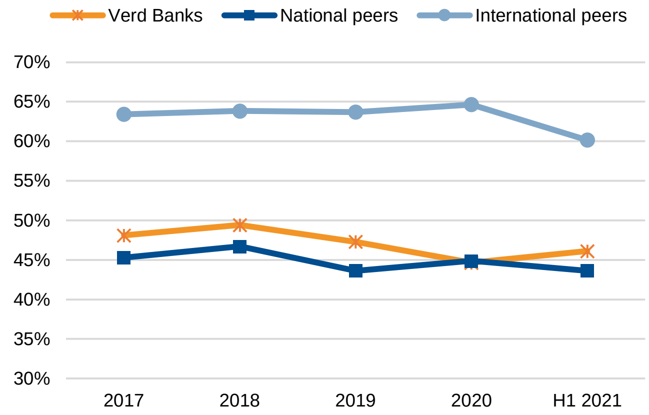
**CET1 capital ratio (%)**



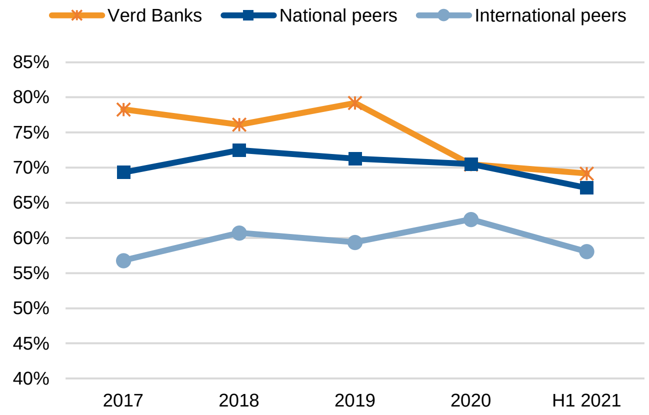

**Return on average assets (%)**



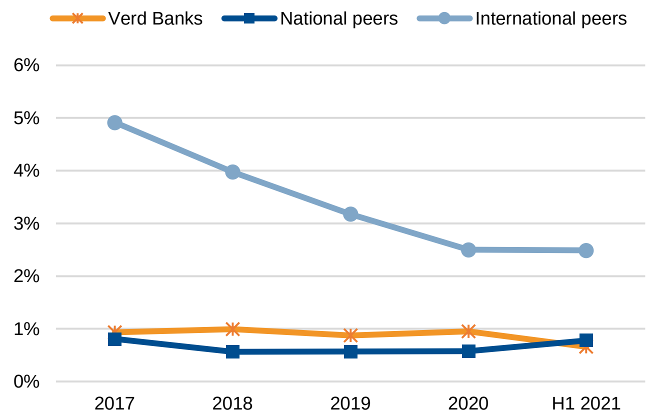

**Costs % Income**



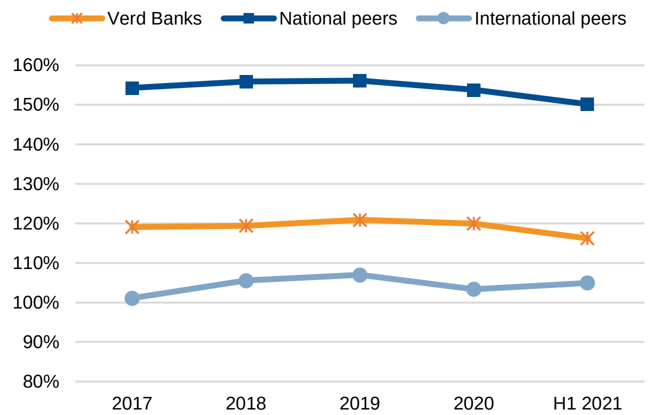

**Net interest income % Operating income**




**Problem loans % Gross customer loans**




**Net customer loans % Deposits**




Note: Figures for Verd owner banks are weighted averages based on each bank's ownership interest in Verd.
National peers: BN Bank, Sparebanken More, Jaeren Sparebank, Sparebank 1 SMN, Landkreditt Bank, Sandnes Sparebank, Totens Sparebank, SpareBank 1 Nordmore.
International peers: Oberbank, Bausparkasse Wustenrot, Banca Popolare di Sondrio, Credito Emiliano, Kutxabank, Unicaja, Principality Building Society, Sparebanken Skane AB.
Source: SNL, Scope Ratings.

## Appendix III: Selected financial information – Verd Boligkreditt AS

| | 2017Y | 2018Y | 2019Y | 2020Y | 9M 2021 |
|---|---|---|---|---|---|
| **Balance sheet summary (NOK m)** | | | | | |
| **Assets** | | | | | |
| Cash and interbank assets | 125 | 109 | 163 | 205 | 161 |
| Total securities | 398 | 387 | 282 | 414 | 589 |
| of which, derivatives | 26 | 13 | 3 | 0 | 5 |
| Net loans to customers | 6,928 | 7,982 | 8,772 | 9,335 | 10,141 |
| Other assets | 0 | 0 | 0 | 0 | 0 |
| **Total assets** | **7,451** | **8,478** | **9,216** | **9,954** | **10,892** |
| **Liabilities** | | | | | |
| Interbank liabilities | 695 | 656 | 838 | 946 | 997 |
| Senior debt | 0 | 0 | 0 | 0 | 0 |
| Derivatives | 2 | 0 | 2 | 3 | 0 |
| Deposits from customers | 0 | 0 | 0 | 0 | 0 |
| Subordinated debt | 6,361 | 7,362 | 7,834 | 8,372 | 9,228 |
| Other liabilities | 12 | 21 | 19 | 22 | 26 |
| **Total liabilities** | **7,070** | **8,039** | **8,693** | **9,343** | **10,250** |
| Ordinary equity | 346 | 404 | 470 | 558 | 589 |
| Equity hybrids | 35 | 35 | 53 | 53 | 53 |
| Minority interests | 0 | 0 | 0 | 0 | 0 |
| **Total liabilities and equity** | **7,451** | **8,478** | **9,216** | **9,954** | **10,892** |
| *Core tier 1/ common equity tier 1 capital* | *326* | *375* | *445* | *525* | *557* |
| **Income statement summary (NOK m)** | | | | | |
| Net interest income | 56 | 80 | 91 | 94 | 116 |
| Net fee & commission income | -23 | -34 | -39 | -41 | -51 |
| Net trading income | 2 | -1 | -11 | 0 | -8 |
| Other income | 0 | 0 | 0 | 0 | 0 |
| **Operating income** | **35** | **45** | **41** | **53** | **56** |
| Operating expenses | 7 | 7 | 7 | 9 | 11 |
| **Pre-provision income** | **28** | **39** | **34** | **44** | **45** |
| Credit and other financial impairments | 0 | 0 | 0 | 0 | 2 |
| Other impairments | 0 | 0 | 0 | 0 | 0 |
| Non-recurring income | NA | NA | NA | NA | NA |
| Non-recurring expense | NA | NA | NA | NA | NA |
| **Pre-tax profit** | **28** | **39** | **34** | **44** | **43** |
| Income from discontinued operations | 0 | 0 | 0 | 0 | 0 |
| Income tax expense | 7 | 9 | 8 | 9 | 9 |
| Other after-tax Items | 0 | 0 | 0 | 0 | 0 |
| Net profit attributable to minority interests | 0 | 0 | 0 | 0 | 0 |
| **Net profit attributable to parent** | **21** | **29** | **26** | **35** | **34** |

Source: SNL.

## Appendix IV: Selected financial information – Verd Boligkreditt AS

| | 2017Y | 2018Y | 2019Y | 2020Y | 9M 2021 |
|---|---|---|---|---|---|
| **Funding and liquidity** | | | | | |
| Net loans/ deposits (%) | NA | NA | NA | NA | NA |
| Liquidity coverage ratio (%) | NA | NA | NA | NA | NA |
| Net stable funding ratio (%) | NA | NA | NA | NA | NA |
| **Asset mix, quality and growth** | | | | | |
| Net loans/ assets (%) | 93.0% | 94.2% | 95.2% | 93.8% | 93.1% |
| Problem loans/ gross customer loans (%) | 0.0% | 0.1% | 0.0% | 0.1% | 0.1% |
| Loan loss reserves/ problem loans (%) | 0.0% | 0.0% | NA | 0.0% | 19.7% |
| Net loan growth (%) | 32.8% | 15.2% | 9.9% | 6.4% | 8.6% |
| Problem loans/ tangible equity & reserves (%) | 0.2% | 1.9% | 0.0% | 1.8% | 1.7% |
| Asset growth (%) | 33.7% | 13.8% | 8.7% | 8.0% | 9.4% |
| **Earnings and profitability** | | | | | |
| Net interest margin (%) | 0.8% | 1.0% | 1.0% | 1.0% | 1.1% |
| Net interest income/ average RWAs (%) | 2.4% | 2.9% | 2.9% | 2.8% | 3.2% |
| Net interest income/ operating income (%) | 159.2% | 177.4% | 220.3% | 177.1% | 206.4% |
| Net fees & commissions/ operating income (%) | -64.8% | -75.4% | -93.7% | -76.7% | -91.7% |
| Cost/ income ratio (%) | 19.9% | 14.5% | 18.1% | 17.3% | 19.9% |
| Operating expenses/ average RWAs (%) | 0.3% | 0.2% | 0.2% | 0.3% | 0.3% |
| Pre-impairment operating profit/ average RWAs (%) | 1.2% | 1.4% | 1.1% | 1.3% | 1.2% |
| Impairment on financial assets / pre-impairment income (%) | 0.0% | 0.0% | 0.0% | 0.0% | 4.9% |
| Loan loss provision/ average gross loans (%) | 0.0% | 0.0% | 0.0% | 0.0% | 0.0% |
| Pre-tax profit/ average RWAs (%) | 1.2% | 1.4% | 1.1% | 1.3% | 1.2% |
| Return on average assets (%) | 0.3% | 0.4% | 0.3% | 0.4% | 0.3% |
| Return on average RWAs (%) | 0.9% | 1.1% | 0.8% | 1.0% | 0.9% |
| Return on average equity (%) | 6.2% | 6.9% | 5.1% | 5.9% | 5.4% |
| **Capital and risk protection** | | | | | |
| Common equity tier 1 ratio (%, fully loaded) | NA | NA | NA | NA | NA |
| Common equity tier 1 ratio (%, transitional) | 12.3% | 12.5% | 13.5% | 14.9% | 14.5% |
| Tier 1 capital ratio (%, transitional) | 13.6% | 13.7% | 15.2% | 16.4% | 15.9% |
| Total capital ratio (%, transitional) | 15.3% | 15.2% | 17.3% | 18.4% | 17.7% |
| Leverage ratio (%) | 4.8% | 4.8% | 5.3% | 5.7% | 5.5% |
| Asset risk intensity (RWAs/ total assets, %) | 35.5% | 35.4% | 35.7% | 35.4% | 35.2% |

Source: SNL.

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