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Transaction Update: DNB Boligkreditt AS (Legislation-Enabled Mortgage Covered Bonds)

€60 Billion Covered Bond Program

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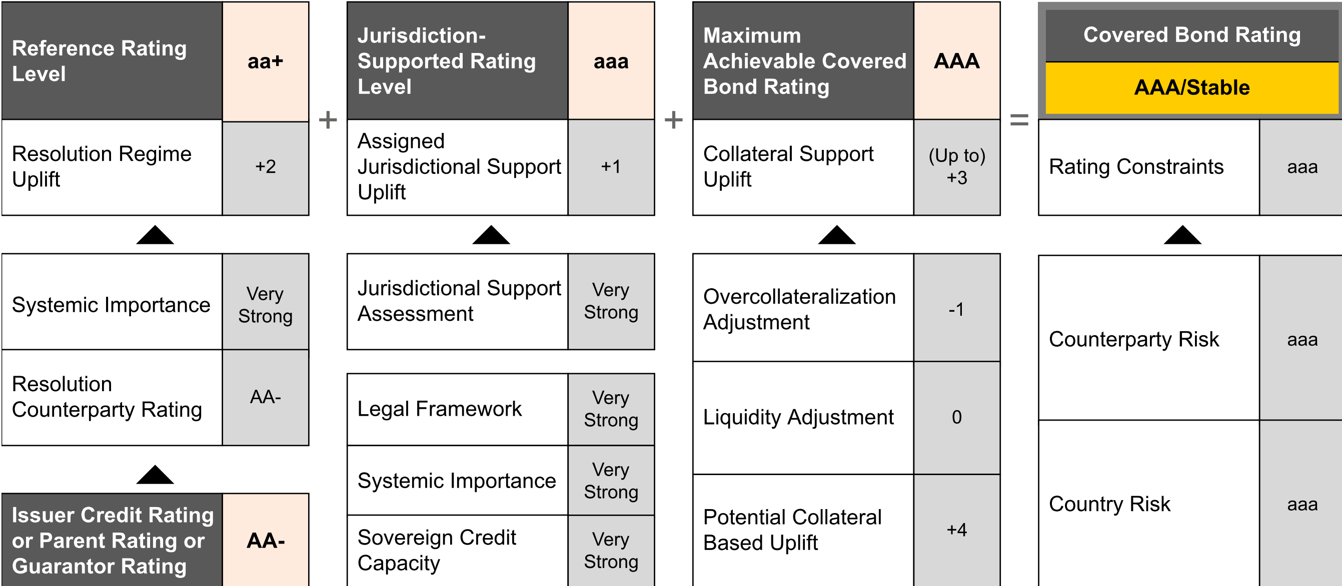


Note: As a starting point of the analysis, we may use the ICR on the relevant parent or guarantor when the issuer is not rated but belongs to a group with a rated parent or payments under the covered bonds are guaranteed by another rated entity. ICR--Issuer credit rating.

Major Rating Factors

Strengths

- High issuer rating that allows the program to achieve a 'AAA' rating at a JRL level.
- The program benefits from four unused notches of uplift, which will protect the ratings on the covered bonds if the issuer is downgraded.

Weaknesses

- The cover pool is geographically concentrated in Eastern Norway, above the concentration thresholds defined by our criteria.
- No overcollateralization commitment limits the maximum available uplift and the final number of unused notches of uplift by one notch.

Outlook

Under our covered bonds criteria, we derive the starting point of our analysis on the covered bond program from the long-term issuer credit rating (ICR) on the parent, DNB Bank ASA (AA-/Stable/A-1+). S&P Global Ratings' stable outlook on its ratings on Norway-based DNB Boligkreditt AS' (DNBB) legislation-enabled mortgage covered bonds reflects that we would not automatically lower our ratings on the covered bonds following a downgrade of the parent company, DNB Bank, as the program benefits from four unused notches of uplift.

We would lower the ratings on the covered bonds if we were to lower our long-term ICR on DNB Bank by more than four notches or if the overcollateralization commensurate with the rating exceeded the available overcollateralization.

Rationale

We are publishing this transaction update following our annual review of DNBB's mortgage covered bond program and related issuances.

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.

From our analysis of the legal and regulatory framework for Norwegian covered bonds, we concluded that the cover pool assets are isolated from the issuer's risk of bankruptcy or insolvency allowing us to assign a higher rating to the covered bonds than our long-term ICR.

We consider DNBB's mortgage operations as very prudent and the existing satisfactory procedures support our ratings on the covered bonds.

DNBB is domiciled in Norway, which has implemented a resolution regime like the BRRD. Therefore, under our covered bonds criteria, we assess the reference rating level (RRL) as 'aa+', two notches above the long-term ICR on DNB Bank.

We considered the likelihood for the provision of jurisdictional support. Based on a very strong jurisdictional support assessment for mortgage programs in Norway, we can potentially assign three notches of uplift from the RRL, however, only one notch is required to achieve a 'aaa' jurisdiction-supported rating level. Therefore, we assess the jurisdiction-supported rating level (JRL) as 'aaa' leaving two unused notches of jurisdictional support uplift.

We have reviewed the asset information provided as of Dec. 31, 2023. The cover pool comprises Norwegian residential mortgage loans and loans granted to housing cooperatives. Based on our cash flow analysis, we consider that the available credit enhancement exceeds the required credit enhancement for a 'AAA' rating.

The covered bonds are eligible for four notches of collateral-based uplift. This uplift is reduced by one notch because overcollateralization is provided voluntarily, without a public or contractual commitment to maintain an overcollateralization level commensurate with the rating.

We do not adjust for liquidity in our analysis because the law requires a liquidity buffer in the cover pool. This buffer should meet the net liquidity outflow in the covered bond program for the next 180 days.

Counterparty or sovereign default risks do not currently constrain the 'AAA' covered bond ratings.

The stable outlook on the ratings reflects that the program benefits from four unused notches of uplift.

We have based our analysis on the criteria articles referenced in the "Related Criteria" section.

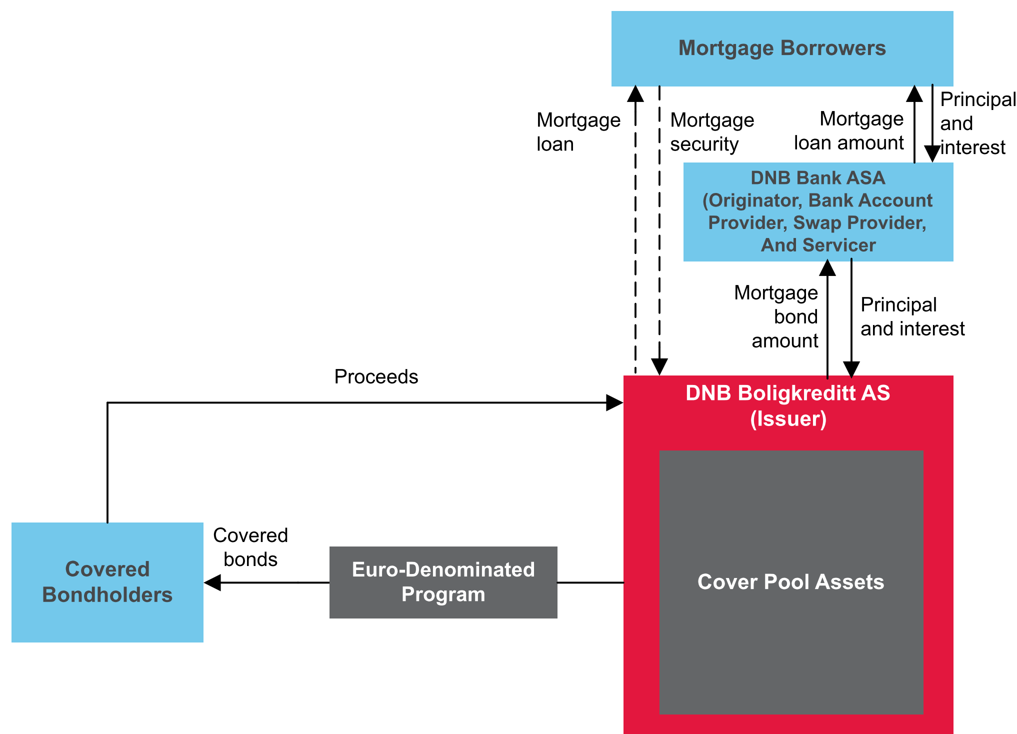
Table 1

Program overview*	
Jurisdiction	Norway
Year of first issuance	2007
Covered bond type	Legislation-enabled
Outstanding covered bonds (bil. NOK)	372.12
Redemption profile	Hard and soft bullet
Underlying assets	Residential mortgages and loans to housing cooperatives
Jurisdictional support uplift	3
Unused notches for jurisdictional support	2
Target credit enhancement (%)**	21.07
Available credit enhancement (%)	71.96
Credit enhancement commensurate with the rating (%)	3.96
Collateral support uplift	3
Unused notches for collateral support	3
Total unused notches covered bond criteria	5
Unused notches counterparty criteria	4
Final total unused notches (lower of the two above)	4

*Based on collateral data and covered bonds outstanding balance as of Dec. 31, 2023. **Considering set-off risk from loans to employees. NOK--Norwegian krone.

Program Description

Program structure



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DNBB is 100%-owned by DNB Bank, a member of DNB Group, the largest banking group in Norway and the third-largest in Scandinavia.

In our view, DNB Bank benefits from its leading position in the Norwegian market and has access to a strong deposit base that has been outgrowing loans. DNB Bank has a stable funding structure that originates from a vast branch network and its position in the Norwegian and euro and U.S. dollar funding markets. Stable core deposits represented about 45% of the funding base in Q3 2023. We expect the bank will continue to have an adequate stable funding ratio of about 95% if DNB Bank maintains a balanced funding profile. DNB Bank, through DNBB, is a frequent issuer in the growing domestic covered bond market, as well as in international markets. It continues to enjoy strong recognition in Norway's covered bond market and has stable access to international markets.

DNBB's €60 billion covered bond program was originally established in 2007 following the enactment of the

Norwegian covered bond law. If DNB Bank were to default, the cover pool assets would benefit the covered bondholders of this program and potential derivative counterparties before any other creditors.

In our previous review, a U.S. dollar covered bond was outstanding, which redeemed in 2023, as well as the $12 billion program.

Covered bondholders will have a pro rata claim on the cover pool assets if DNB Bank became insolvent.

The program's structure has not changed materially since our previous review.

Table 2

Program participants

Role	Name	Rating	Rating dependency
Issuer	DNB Boligkreditt AS	NR*	Yes
Originator	DNB Boligkreditt AS	NR*	No
Originator	DNB Bank ASA	AA-/Stable/A-1+	No
Account provider	DNB Bank ASA	AA-/Stable/A-1+	Yes
Swap provider	DNB Bank ASA	AA-/Stable/A-1+	Yes

*We use the long-term issuer credit rating on DNB Bank ASA (AA-/Stable/A-1+) as the starting point for our analysis. NR--Not rated.

Rating Analysis

Legal and regulatory risks

DNBB's covered bonds are governed by Norwegian law. Specifically, the Financial Institutions Act encapsulates the main covered bonds regulation, and the Norwegian Ministry of Finance supports the regulations on mortgage credit institutions.

The Norwegian covered bond legislation was enacted in 2007, amended in June 2022 to transpose the EU Covered Bond Directive into domestic legislation, and became effective on July 8, 2022. The legislation complies with the EU's Capital Requirement Directive and the Undertakings for Collective Investment in Transferable Securities. This makes Norwegian covered bonds eligible for reduced risk weighting when calculating capital adequacy.

The 2022 amendments introduced a liquidity buffer, maturity extensions, loan-to-value (LTV) ratio, overcollateralization, and the cover pool's surveillance.

The Norwegian covered bond law defines the eligibility criteria for the type of assets that may and may not be included in the cover pool. The "Finanstilsynet," the Norwegian Financial Supervisory Authority (FSA), appoints an independent inspector to regularly review compliance, oversee the cover pool register, and ensure that the cover pool's value always exceeds the issued covered bonds. The law also stipulates the issuer must be a specialized credit institution and obtain a license from the Norwegian FSA.

If the issuer becomes insolvent, the legal framework's bankruptcy legislation requires the appointment of a cover pool administrator and gives investors a senior claim over the cover pool assets. The legal framework restricts the type of business that mortgage credit institutions can engage in. It includes requirements for the cover pool's composition and

the appointment of an independent inspector responsible for oversight and compliance of the cover pool.

In our legal analysis, we applied our legal criteria and our criteria for rating covered bonds (see "Asset Isolation And Special-Purpose Entity Methodology," published on March 29, 2017). Our analysis of the legal and regulatory framework for Norwegian covered bonds indicates that the cover pool's assets are isolated from the issuer's risk of bankruptcy or insolvency, allowing us to assign a higher rating to the covered bond program than the long-term ICR on the issuer.

Operational and administrative risks

As a core entity within DNB Bank, DNBB is based in the same headquarters in Oslo. The two entities can access the same loan management systems and may share customer files electronically, which limits the scope for operational errors. We consider DNB Bank's credit procedures to align with current market standards.

Under the transaction documents, the cover pool can include mortgages that either DNB Bank or DNBB has originated. In either case, the origination and underwriting process is the same, and follows a five-step process: Application, loan approval, document control, processing of land and establishing legal protection, and disbursement. As part of the underwriting process, checks are performed on the borrower's ability to pay under current conditions, as well as in a rising interest rate scenario.

If a loan becomes nonperforming, DNB Bank first works on a plan with the borrower to ensure the loan becomes performing again. If loan rehabilitation is not possible, it requests the borrower to sell the property voluntarily, as this typically yields a better price. If DNB Bank has to foreclose on the property, it will initiate forced-sale proceedings and the property will be auctioned, generally within a four- to six-months' liquidation period.

In our opinion, the cover pool's management and loan origination processes do not give rise to any new operational or administrative risks that would constrain the covered bond ratings to the same level as the long-term ICR.

We view the bank's underwriting criteria as prudent. Our analysis of operational and administrative risk follows the principles laid out in our covered bond ratings framework.

Resolution regime analysis

DNB Bank is domiciled in Norway, which is part of the European Economic Area. The implementation of a resolution regime similar to the EU's BRRD came into effect in Norway on Jan. 1, 2019. We consider that mortgage covered bonds have a very strong systemic importance to Norway. 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 RRL is the maximum between two notches above the long-term ICR and the resolution counterparty rating (RCR). Given that the RCR on DNB Bank is at the same level as the ICR ('AA-'), the RRL is 'aa+', which reflects the two-notch uplift from the ICR.

Jurisdictional support analysis

Under our analysis of jurisdictional support in our covered bonds criteria, we determine a JRL, which is our assessment of the covered bond program's creditworthiness once we have considered the level of jurisdictional support, but before giving credit to the amount of collateral.

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 open market. Our assessment of the expected jurisdictional support for Norwegian mortgage covered bond programs is very strong. Under our covered bonds criteria, this means that the program can receive up to three notches of jurisdictional uplift from the RRL of 'aa+'. This leads to a JRL of 'aaa' and two unused notches of jurisdictional support uplift.

Collateral support analysis

We base our credit analysis on the loan-level data provided by the issuer as of Dec. 31, 2023. The cover pool comprises seasoned prime Norwegian residential mortgage loans and loans to housing cooperatives (see table 3).

We base our credit analysis of mortgage assets on our global RMBS criteria (see "Global Methodology And Assumptions: Assessing Pools Of Residential Loans," published on Jan. 25, 2019) and our commercial real estate criteria (see "Methodology And Assumptions: Analyzing European Commercial Real Estate Collateral In European Covered Bonds," published on March 31, 2015).

We assess a typical mortgage cover pool's credit quality 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. 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 the weighted-average loss severity (WALS) estimate the required loss protection, assuming all other factors remain unchanged.

Both the WAFF and WALS for the total pool have slightly increased since our previous review.

The WAFF increased to 10.11% as of December 2023 from 9.32% in December 2022 mainly due to negative factors in the residential loans--such as relatively higher effective LTV ratios and increased interest-only loans, and the percentage of loans where loan-to-income (LTI) ratio is higher than five. The factors are partially offset by higher seasoning and a slightly lower concentration in Eastern Norway. The WAFF for housing cooperatives has remained stable and has a lower base default frequency than other commercial loans.

Over the same period, the WALS has marginally increased to 29.99% from 26.17%. The increase for residential and housing cooperative loans is due to increased LTV ratios and an increase overvaluation in the residential assets. These negative factors have been partially offset by a decreased percentage of jumbo valuations following the application of higher jumbo valuation thresholds in our residential loans criteria.

Table 3

Cover pool composition

	As of Dec. 31, 2023		As of Dec. 31, 2022	
Asset type	**Value (Bil. NOK)**	**Percentage of cover pool**	**Value (Bil. NOK)**	**Percentage of cover pool**
Residential mortgages	649.06	97.44	667.48	97.24
Housing cooperatives	17.05	2.56	18.96	2.76
Total	666.10	100.00	686.44	100.00

NOK--Norwegian krone.

Table 4

Key credit metrics

	As of Dec. 31, 2023	As of Dec. 31, 2022
RESIDENTIAL LOANS		
Average loan size (NOK)	2,255,912	2,224,490
Weighted-average current LTV ratio (%)	56.21	52.05
Weighted-average original LTV ratio (%)	66.35	63.3
Weighted-average effective LTV ratio (%)	64.89	61.58
Weighted-average loan seasoning (years)*	5.75	5.54
Balance of loans in arrears (%)	0.0	0.0
Buy-to-let loans (%)	0.04	0.04
Interest-only loans (%)	22.99	21.12
Jumbo valuations (%)	29.83	50.08
Loan to Income >5x	52.08	47.45
HOUSING COOPERATIVES		
Weighted-average whole LTV ratio (%)	31.17	28.65
Geographic concentration: East Norway	40.02	40.1
Credit analysis results:		
Residential loans		
Weighted-average foreclosure frequency (%)	9.91	9.09
Weighted-average loss severity (%)	30.29	26.45
AAA credit risk (%)	3.00	2.40
Housing Cooperatives		
Weighted-average foreclosure frequency (%)	17.65	17.62
Weighted-average loss severity (%)	18.35	15.66
AAA credit risk (%)	3.24	2.76
TOTAL POOL		
Weighted-average foreclosure frequency (%)	10.11	9.32
Weighted-average loss severity (%)	29.99	26.17
AAA credit risk (%)	3.03	2.44

*Seasoning refers to the elapsed loan term. NOK--Norwegian krone. LTV--Loan-to-value.

Table 5

LTV ratios (residential loans)

Current LTV ratios (%)	As of Dec. 31, 2023	As of Dec. 31, 2022
	Percentage of cover pool	
0-60	58.10	57.65
60-70	17.71	19.25
70-80	17.23	16.48
80-90	3.28	4.64
90-100	1.14	0.79
Above 100	2.55	1.18

Table 5

LTV ratios (residential loans) (cont.)

Weighted-average current LTV ratios	56.21	52.05
Original LTV ratios (%)	**As of Dec. 31, 2023**	**As of Dec. 31, 2022**
	Percentage of cover pool	
0-60	33.93	39.34
60-70	21.54	20.73
70-80	32.30	34.14
80-90	7.65	3.79
90-100	1.88	0.88
Above 100	2.70	1.12
Weighted-average original LTV ratios	66.35	63.30
Effective LTV ratios (%)	**As of Dec. 31, 2023**	**As of Dec. 31, 2022**
	Percentage of cover pool	
0-60	36.97	41.80
60-70	22.76	22.73
70-80	28.57	30.49
80-90	7.36	3.43
90-100	1.73	0.74
Above 100	2.61	0.8
Weighted-average original LTV ratios	64.89	61.58

LTV--Loan-to-value.

Table 6

Residential loan seasoning distribution*

	As of Dec. 31, 2023	**As of Dec. 31, 2022**
	Percentage of portfolio	
>0 and <=2years	26.04	28.55
>2 and <=4 years	23.8	23.01
>4 and <=5 years	8.14	7.55
>5 and <=6 years	6.43	6.54
>6 and <=7 years	5.56	5.93
>7 and <=8 years	5.07	4.69
>8 and <=9 years	4.08	3.57
>9 and <=10 years	3.11	2.87
>10 years	17.77	17.30
Weighted-average loan seasoning (years)	5.75	5.54

*Seasoning refers to the elapsed loan term.

Table 7

Geographic distribution of residential loan assets

	As of Dec. 31, 2023	As of Dec. 31, 2022
Top five concentrations	**Percentage of cover pool**	
East	69.35	69.73
West	14.44	14.4
North	8.09	7.88
South	2.69	2.67
Trondelag	5.43	5.32
Total	100	100

Table 8

Collateral uplift metrics

	As of Dec. 31, 2023	As of Dec. 31, 2022
Asset WAM (years)	14.18	13.54
Liability WAM (years)	4.73	4.61
Asset-liability maturity mismatch (ALMM)	9.45	8.93
Available credit enhancement	71.96	76.58
Credit enhancement commensurate with the rating (%)	3.96	3.43
Required credit enhancement for first notch of collateral uplift (%)	3.96	3.43
Required credit enhancement for second notch of collateral uplift (%)	12.51	12.41
Required credit enhancement for third notch of collateral uplift (%)	16.79	16.89
Target credit enhancement for maximum uplift (%)	21.06	21.38
Potential collateral-based uplift (notches)	4	4
Adjustment for liquidity (Y/N)	N	N
Adjustment for committed overcollateralization (Y/N)	Y	Y
Collateral support uplift (notches)-available	3	3

WAM--Weighted-average maturity.

According to our criteria, the maximum potential collateral-based uplift on a covered bond program above the JRL is four notches. We adjust the maximum collateral-based uplift in the absence of six months' liquidity coverage and overcollateralization commitment. Liquidity is now covered by law, but the covered bonds issued by DNBB do not benefit from any public or contractual overcollateralization commitment. Therefore, the maximum collateral-based uplift is currently limited to three notches.

By applying credit and cash flow stresses, we calculated a target credit enhancement (TCE) of 21.06% as of Dec. 31, 2023, slightly lower than the 21.38% calculated as of Dec. 31, 2022. The overcollateralization commensurate with the rating (here, the 'AAA' credit risk) is 3.96%, slightly higher than the previous year's figure of 3.43%, mainly due to lower excess spread and higher credit losses. Additionally, the TCE was slightly affected by an increased maturity gap of 0.52 years between assets and liabilities (asset-liability maturity mismatch-ALMM) over the period. This negative factor has been offset by the lower share of bonds redeeming within the next two years and the higher start interest rate.

The TCE of 21.06% remains below the available credit enhancement of 71.96% from 76.58% in December 2022,

allowing for four potential notches of collateral-based uplift. With a JRL of 'aaa', the program currently does not require collateral-based uplift to attain a 'AAA' rating but must cover 'AAA' credit risk of 3.96%.

As the program does not need to makes use of any notches of collateral-based uplift to achieve the "AAA" rating, there are three unused notches of collateral-based uplift, according to our covered bond criteria.

Counterparty risk

We have identified several counterparty risks exposing the covered bonds. However, as these are structurally addressed in line with our counterparty criteria, we believe that they do not constrain the rating from a counterparty risk perspective (see "Counterparty Risk Framework: Methodology And Assumptions," published on March 8, 2019).

Bank account provider

DNB Bank is the program's originator and bank account provider. An account agreement covers the issuer's accounts with DNB Bank. We consider the agreement replacement trigger of 'A' to be in line with our counterparty criteria, and therefore counterparty risk from the account provider does not constrain our ratings on the covered bonds.

Swaps

Swaps mitigate interest rate and currency mismatches between the mortgage loans in the cover pool and the payments due to the covered bondholders. A swap agreement governs the program's asset swaps and liability swaps, which provide various replacement options if the swap provider, DNB Bank, is downgraded below 'A'. We consider the swaps as related counterparties with senior termination payments. The current swap agreement documents replacement option 2, which, combined with the issuer RRL and immaterial presence of cross-currency float-to-float swaps, aligns with an "adequate" collateral framework assessment that supports a 'AAA' rating.

On the asset side, fixed-rate loans, which account for 5.68% of the pool, are swapped to floating (three-month Norwegian interbank offered rate; NIBOR). Most assets (94.69%) pay a standard variable rate (SVR) and are not swapped. On the liability side, any fixed-rate bonds are swapped to floating before being swapped into Norwegian krone (if issued in a foreign currency), with the floating component based on three-month NIBOR. Since most assets pay SVR and liabilities pay NIBOR on a post swap basis, we model basis risk in our cash flow results for the transaction.

We consider the swap agreements to be in line with our counterparty criteria, and therefore counterparty risk from the swaps does not constrain our ratings on the covered bonds. However, it limits the number of unused notches to four.

Sovereign default risk

We base our analysis of sovereign default risk on the application of our "Incorporating Sovereign Risk In Rating Structured Finance Securities: Methodology And Assumptions," published on Jan. 30, 2019. As Norway is currently rated 'AAA', sovereign default risk does not constrain the ratings. DNBB's 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. Therefore, the maximum rating above the sovereign would be two notches of uplift.

Environmental, social, and governance

Environmental and social credit considerations influence the credit quality of DNBB's cover pool in a broadly similar way to other Norwegian covered bond issuers we rate. Governance factors are a moderately negative consideration in

our credit analysis of DNBB's mortgage covered bonds. The issuer does not commit to maintain a minimum overcollateralization in the program beyond the minimum legal requirement. This reduces the unused notches of uplift by one.

Related Criteria

- Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- Global Framework For Payment Structure And Cash Flow Analysis Of Structured Finance Securities, Dec. 22, 2020
- Counterparty Risk Framework: Methodology and Assumptions, March 8, 2019
- Incorporating Sovereign Risk In Rating Structured Finance Securities: Methodology And Assumptions, Jan. 30, 2019
- 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: Methodology And Assumptions: Analyzing European Commercial Real Estate Collateral In European Covered Bonds, March 31, 2015
- Criteria - Structured Finance - Covered Bonds: Covered Bonds Criteria, Dec. 9, 2014
- Global Derivative Agreement Criteria, June 24, 2013
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Related Research

- Global Covered Bond Insights Q2 2024:Strong Start To The Year For Issuance, March 27, 2024
- Norwegian And Finnish Covered Bond Market Insights 2024, March 11, 2024
- Covered Bonds Outlook 2024: Stability Amid Turbulence, Dec. 11, 2023
- Banking Industry Country Risk Assessment: Norway, Nov. 27, 2023
- Update: DNB Bank ASA, Nov. 3, 2023
- DNB Bank ASA, April 14, 2023
- S&P Global Ratings Definitions, June 9, 2023
- Glossary of Covered Bond Terms, April 27, 2018

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