3.13 FINLAND

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I. FRAMEWORK

In Finland, the legal basis for covered bond issuance is the Act on Mortgage Credit Bank Operations (688/2010). The current legal framework will be replaced by new framework in 2022 (Act 151/2022). The new law will be entered into force on 8th July 2022. The new legislative framework will be adopting the necessary changes of the harmonized EU legal framework (EU directive 2019/2162 and EU Regulation 2019/2160).

II. STRUCTURE OF THE ISSUER

The issuer of Finnish covered bonds can be a universal bank or a specialist mortgage bank. Generally, entities that can issue covered bonds are credit institutions authorised to engage in mortgage credit bank operations. Starting from 2022 onwards the application for the authorization process will be based on the EU harmonized legal framework. Currently the issuer of Finnish Covered Bonds can be a specialised mortgage bank, but also deposit banks or credit entities are entitled to apply for a license to engage in mortgage credit bank operations (i.e., issue covered bonds).

There are currently nine potential issuers of Finnish covered bonds and one more to start during the year 2022.

The Finnish Covered Bond Law stipulates certain requirements to receive a covered bond issuance license. The covered bond issuer should provide a business plan, show stability, expertise in mortgage credit operations, risk management and practices concerning valuation of collateral. Interestingly, the requirements to receive a Finnish Covered Bond License seem very similar to the requirements to receive a German Pfandbrief License.

The issuer holds the cover assets on the balance sheet. A subsequent transfer of the cover assets to another legal entity is not taking place. A direct legal link between single cover asset and the covered bonds issued does not exist. All obligations from Finnish Covered Bonds are direct and unconditional obligations of the issuing bank as a whole (dual recourse). In the case of insolvency, the cover pool is segregated by law from the general insolvency estate and is reserved only for the claims of the holders of Finnish Covered Bonds.

Issuers may have several active cover pools.

III. COVER ASSETS

Finnish covered bonds have a cover pool register that includes all cover pool assets, covered bonds and derivatives. Eligible assets for Finnish covered bonds are residential mortgage loans (including shares in Finnish housing companies), commercial mortgage loans, public sector loans in accordance with Article 129(1) CRR and substitution assets. At least 90% of the cover pool loans must consist of residential mortgage loan or public sector loans. In the new law (151/2022) the amount of substitution assets is limited to 20% of the cover pool. Assets securing the liquidity requirement (180 days outflow coverage) are excluded of this restriction. The geographical scope of cover assets is restricted to the European Economic Area.

Enforcement of non-Finnish cover pool assets would usually be determined by the laws of the jurisdiction in which the assets are located. Due to European Union law, inside the EU, enforcement is safeguarded in all Member States anyway. However, majority of Finnish issuers have only Finnish assets in the covered bond pools. Going forward the assets eligible as cover pool assets need to fulfil the EU Regulation 575/2013 article 129 requirements.

Specialised mortgage credit bank can grant an intermediate credit to a deposit bank or a credit entity. This intermediate credit must be covered with eligible cover assets as stated above. These assets must also be recorded into the cover register.

Up to 20% of the mortgage cover pool is allowed to consist of substitute cover assets; bonds and other debt obligations issued by the State, a municipality or another public-sector organisation or another credit institution rather than one belonging to the same consolidation group as the issuer. A guarantee as for own debt granted by a public sector organisation or credit institution referred above; a credit insurance given by an insurance company other than one belonging to the same group, referred to in the Act on Supervision of Finance and Insurance Groups; cash assets of the issuer deposited in the Bank of Finland or a deposit bank with the restriction that if the issuer is a deposit bank the cash deposit may not be in a deposit bank belonging to the same consolidation group as the issuer. ABS or MBS tranches are not eligible for the cover pool.

Derivatives are eligible for the cover pools only if they are used for hedging purposes. The nature of the cover pool is dynamic. Currency risk is perfectly matched, as the law requires cover assets to be in the same currency as the covered bonds.

IV. VALUATION AND LTV CRITERIA

The property valuation within the legal framework for covered bonds in Finland is based on market values, valuations are based on "current value", market value determined in accordance with FFSA regulations. Based on the updated regulation, the issuer needs to monitor the valuation of the property also based on statistical methods (indexed value) quarterly and set limits for the acceptable changes of the values. Should the value exceed or drop below the limits the property valuation needs to be updated accordingly.

There are different LTV levels for residential and commercial mortgage loans: 70% of the value of the residential property and 60% of the value of the commercial property accepted. This LTV is a relative limit, i.e. when a loan exceeds the 60%/70% limit, the part of the loan up to 60%/70% LTV remains eligible to the cover pool. A loan placed as collateral for a covered bond may not exceed the current value of the property standing as collateral.

V. ASSET – LIABILITY MANAGEMENT

There are legal standards for Asset-Liability Matching in the Finnish Covered Bond System. For instance, the aggregate interest received on the cover assets in any 12-month period must exceed the interest paid on the outstanding covered bonds. This regulation takes derivatives for hedging purposes into account.

The total amount of collateral of covered bonds shall continuously exceed the remaining combined capital of the covered bonds.

The net present value of the total amount of collateral of covered bonds shall continuously exceed by at least 2% the total net present value of the payment liabilities resulting from the covered bonds. The net present value test helps mitigate interest-rate, currency and liquidity risk. The regulative minimum OC level will be redescribed on the new legal framework.

As mentioned above, interest receivable on cover assets must be sufficient to cover interest payable on covered bonds on a twelve-month rolling basis. Moreover, the test needs to be stressed by +/- 1%. In case of a breach of one of these rules mentioned, the issuer might face sanctions from the FSA. Ultimately, the issuer might face the loss if its licence. In addition to the 2% net present value legal minimum, further overcollateralisation may be committed by contract. Non-performing loans (defined as 90 days past due) are excluded from cover tests. Assets that are ineligible for Finnish covered bonds (e.g. non-performing loans) are excluded from the cover tests but can be retained in the cover pool and lead to additional overcollateralisation.

VI. TRANSPARENCY

The annual and interim reports of the issuer indicate, in addition to that provided in the act on Credit Institutions, the basis of the valuation of the collateral and the amount of residential mortgage loans and possible intermediary loans and public sector loans issuer has granted, as well as the amount of covered bonds issued.

While there are no statutory transparency rules in current legislation, Finnish covered bond issuers have adopted the ECBC Label initiative for Covered Bonds and publish Finnish National Transparency Template on their websites: https://www.coveredbondlabel.com/issuers/national-information-detail/9/.

The ECBC Label Transparency Guidelines included in the Covered Bond Label Convention for 2014 are fully aligned and compliant with Art. 129 (7) CRR.

On top of the regulatory requirements all issuers provide additional information about the cover pools, ratings and other relevant topics on their websites. Please find the information about the website below (section X).

VII. COVER POOL MONITOR AND BANKING SUPERVISION

The issuer carries out the monitoring of the cover pool. The issuer reports to the FSA on a monthly basis. With regard to UCITS 52(4), this supervision of a specialised bank as issuer of the covered bond is compliant to the "special supervision". The FSA is responsible for overall supervision, covered bond licensing, issuing regulations and compliance with the law.

The FSA has the legal power to take appropriate measures. It is allowed to conduct inspections at the bank in question or to require documents. Also, the FSA could issue a public warning or admonition. Ultimately, it is up to the FSA to revoke the banking license of the bank in question.

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VIII. SEGREGATION OF COVER ASSETS AND BANKRUPTCY REMOTENESS OF COVERED BONDS

A cover register allows identifying the cover assets. The legal effect of a registration of assets into the cover register is to create the priority claim of covered bond holders to these cover assets in case of an insolvency of the issuer. The cover register is managed by the corresponding bank, which in turn is supervised by the FSA.

The cover register contains information about the principle amount of covered bonds issued, the mortgages and substitute assets covering these bonds as well as derivative transactions hedging these bonds or funds placed as their collateral. The Finnish Covered Bond Law specifically excludes set-off against cover pool assets. The law also specifically excludes claw-back risk.

Asset segregation

The cover pool is a part of the general estate of the bank as long as the issuer is solvent. If the insolvency proceedings are opened, by operation of law, the assets recorded in the cover registers are excluded from the general insolvency's estate. When the insolvency proceedings are opened, the FSA appoints a special cover pool administrator. Within the insolvency procedure, the derivative counterparties rank pari passu to covered bond holders. The cover assets do form a separate legal estate, which is ring-fenced by law from other assets of the issuer.

Impact of insolvency proceedings on covered bonds and derivatives

Covered bonds do not automatically accelerate when the issuing institution becomes insolvent. The legal consequences for the derivatives in case of an insolvency of the issuing bank depend on the relevant contracts. The cover pool administrator can only accelerate the covered bonds if the cover tests can no longer be fulfilled. This would trigger the sale of the cover pool assets.

The cover pool supervisor will supervise cover pool cash flows and payments to covered bondholders. The general administrator also has powers to act in the interests of the covered bondholders under the direction of the cover pool supervisor. This includes the ability to assign the liability for a covered bond as well as the related cover pool assets to another licensed covered bond issuer (with the permission of the FSA).

Preferential treatment of covered bond holders

Covered bond holders enjoy a preferential treatment as the law stipulates the separation of the cover assets on the one hand and the insolvency's estate on the other.

Covered bond holders are allowed claims on both on the issuer and cover pool assets (dual recourse) meaning that creditors also participate in the insolvency proceedings in respect of the remaining assets of the bank.

A moratorium on the insolvency's estate cannot delay the cash flows from the cover assets and, therefore, endanger the timely payment of covered bond holders.

Access to liquidity in case of insolvency

With the appointment of the cover pool administrator, this person acts on behalf of the covered bond holders. The pool administrator has access to the cover assets. Cover assets may only be disposed with the consent of the FSA. Additionally, the pool administrator has also the first access on cash flows generated by the cover assets. The law foresees a possibility for the pool administrator together with the bankruptcy trustee to take up a loan on behalf of the cover pool to create more liquidity.

Up to 20% of the cover pool may consist of liquid substitute cover assets. Substitute assets are deposits, bonds or guarantees of public sector entities or credit institutions and certain credit insurance. With the consent of the FSA, this limit may even be higher. As all cover assets entered into the cover register are ring-fenced in case of an insolvency of the issuer, this results also in the insolvency remoteness of voluntary overcollateralisation.

Some Finnish covered bonds mitigate liquidity risk via contractual twelve-month maturity extensions ("Soft Bullet"). The extension provides additional time for principal amounts to be refinanced. Combined with the interest coverage test, maturity extensions improve the chance that principal and interest payments can be met without refinancing the covered bonds for the first twelve months after issuer default.

The 2022 updated legislation discusses in details about the procedures related to the possible insolvency situation and about the liquidity buffer requirement.

IX. RISK-WEIGHTING & COMPLIANCE WITH EUROPEAN LEGISLATION

Finnish Covered Bonds comply with the requirements of Art. 52(4) UCITS Directive. The legislation when taken to- gether with the practices processes and procedures across the industry should fall within the criteria of Article 129 of the Capital Requirements Regulation (CRR)[1]. Therefore, these bonds are 10% risk weighted in Finland. Following the common practice in Europe, they accordingly enjoy a 10% risk weighting in most European countries and will fulfill the requirement to be considered European Covered Bonds (Premium) quality.

Finnish Covered Bonds are also eligible in repo transaction with national central bank, i.e. within the Euro-zone.

As far as the domestic issuers are aware, there are no further specific investment regulations regarding Finnish Covered Bonds.

European Commission has approved and published the legislative package on Covered Bonds (Directive (EU) 2019/2162 and Regulation (EU) 2019/2160). The Directive dated 27 November 2019 has entered into force and the national transposition period will last until 8 July 2021. National measures shall be applied starting at the latest from 8 July 2022. In Finland the new and updated Covered Bond legislation is defined as "Act 151/2022" ("Act of Mortgage Banks and Covered Bonds").

With regards to the Regulation, it will apply from 8 July 2022 (Regulation Art 2), in parallel with the deadline for the national application of the Directive.

1 Please click on the following link for further information on the UCITS Directive and the Capital Requirements Regulation (CRR): https://hypo.org/ecbc/covered-bonds/.

The current Finnish Covered Bond legislation includes already most of the topics described in the EU Harmonization package (Article and Directive). The new legislation content is more detailed mirroring the requirements of the above-mentioned Directive and Regulation. The amendments include:

> The process of applying to operate as Mortgage Bank and Covered Bond issuer is further clarified. The regulative authority handling the applications is FIN-FSA.

> Specification that the eligible collateral in the cover pool needs to fulfill CRR article 129 requirements. (EU Covered Bond (premium) -class requirement.)

> The received collateral related to cover pool derivatives and possible receivables from insurance coverage of the cover assets are included in the cover pool as eligible collateral.

> The updated levels of regulative overcollateralization 2-5% (2%) and LTV cap 80%. (70%)

> Introduction of liquidity buffer covering 180 days net outflow of the Cover Pool cashflows (The Article 16). Soft Bullet structure of the issued bond will be recognized as significant part of the management tools.

> Determination of the terms triggering the Soft Bullet option. Authority approval is added.

> Public transparency (website information) of the Mortgage bank operation is added as regulative requirement whereas it has currently been voluntary or regulative recommendation.

> The status of cover pool in the potential Bail-in or bankruptcy situation has been clarified but changes to the current legislation are limited.

X. REGULATIVE LIMITS IN MORTGAGE LENDING

Financial service providers have a statutory obligation to identify and know their customers.

The loan cap limiting the maximum LTV level is currently 85%. For a first home purchase the cap is at 95%.

Borrower’s ability to pay the loan and handle the regular living costs is stress tested with 6% interest rate.

Issuers: Aktia Bank Plc, Danske Bank, OP Mortgage Bank, Nordea Mortgage Bank, Ålandsbanken AB, The Mortgage Society of Finland, SP-Mortgage Bank Plc, Oma Savings Bank, S-Bank Plc, Bonum Bank Plc (2022)

COVERED BOND · LABEL · : OP Mortgage Bank (1 pool), Danske Mortgage Bank Plc (1 pool), Nordea Mortgage Bank Plc (1 pool), Sp Mortgage Bank Plc (1 pool).

For the most up-to-date information, please consult the new ECBC Covered Bond Comparative Database webpage on the Covered Bond Label website www.coveredbondlabel.com.

In the context of the transposition of the Covered Bond Directive (the final deadline for which was 8 July 2022), the ECBC has undertaken a full review and update of the Covered Bond Comparative Database to take account of the latest regulatory developments. This unique reference tool can be accessed via the link hosted on the Covered Bond Label website (www.coveredbondlabel.com/legislation/comparative_database).

For further national information on the Finnish market, please see compare.coveredbondlabel.com/frameworks. To access the “Country Comparison” feature of the database, please see compare.coveredbondlabel.com/compare/select/frameworks.