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Transaction Update: Wuestenrot Bausparkasse AG (Mortgage Covered Bond Program)

Hypothekenpfandbriefe

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Ratings Detail

Reference Rating Level	a+
Resolution Regime Uplift	+2
Systemic Importance	Very Strong
Resolution Counterparty Rating	N/A
Issuer Credit Rating	A-

N/A--Not applicable.

+

Jurisdiction-Supported Rating Level	aa+
Assigned Jurisdictional Support Uplift	+3
Jurisdictional Support Assessment	Very Strong
Legal Framework	Very Strong
Systemic Importance	Strong
Sovereign Credit Capacity	Very Strong

+

Maximum Achievable Covered Bond Rating	AAA
Collateral Support Uplift	+3
Overcollateralization Adjustment	-1
Liquidity Adjustment	0
Potential Collateral Based Uplift	+4

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Covered Bond Rating	
AAA/Stable	
Rating Constraints	aaa
Counterparty Risk	aaa
Country Risk	aaa

Major Rating Factors

Strengths

- Granular, well-seasoned and geographically well diversified cover pool, comprising of exposures to German predominately residential mortgages.
- Well-matched asset and liability maturity profiles.
- Very strong jurisdictional support and 180 days' liquidity coverage required by law.

Weakness

- Commingling and bank account risk before the issuers insolvency that is not addressed structurally or by the German legal framework, but is mitigated by the available collateralization.

Outlook

S&P Global Ratings' stable outlook on Germany-based Wuestenrot Bausparkasse AG's (WBSK) mortgage covered bonds ("Hypothekenpfandbriefe") reflects our view that a two notch lowering of our long-term issuer credit rating (ICR) would not in itself trigger a downgrade of the covered bonds, all else remaining equal. This is because the program benefits from two unused notches of uplift.

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

Rationale

We are publishing this transaction update as part of our periodic review of WBSK's mortgage covered bond program.

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 covered bonds in Germany, we believe that the assets in WBSK's cover pool are isolated from the risk of the issuer's bankruptcy or insolvency. This asset isolation allows us to assign a higher rating to the covered bonds than our long-term ICR on WBSK.

We conducted a review of WBSK's operations in 2018, which we view as prudent. We believe satisfactory procedures are in place to support our ratings on the covered bonds.

WBSK is domiciled in Germany, which is subject to the EU's Bank Recovery and Resolution Directive (BRRD). We consider that mortgage covered bonds have a very strong systemic importance to Germany. Therefore, under our covered bonds criteria, we assess the reference rating level (RRL) as 'a+'. This uplift recognizes the increased likelihood that the issuer could still service its covered bonds without reverting to a sale of assets in the cover pool, even after writing down or stopping payments to senior unsecured obligations.

We considered the likelihood for the provision of jurisdictional support. Based on a very strong jurisdictional support assessment for mortgage programs in Germany, we assigned three notches of uplift from the RRL (see "Assessments For Jurisdictional Support According To Our Covered Bonds Criteria," published on Oct. 16, 2018). Therefore, we assess the jurisdiction-supported rating level (JRL) as 'aa+'.

Following the assessment of the RRL and JRL, we analyze the cover pool's credit quality and the availability of liquidity support and committed overcollateralization to determine the maximum collateral uplift above the JRL. Our credit and cash flow analysis is based on data as of Oct. 1, 2018. The portfolio comprises German residential (80.8%) and non-residential mortgages (13.4%), and substitute assets (5.9%). Based on our cash flow analysis, the available credit enhancement (27.4%) exceeds the required credit enhancement for a 'AAA' rating (7.9%).

The covered bonds are eligible for three notches of collateral based uplift, given that the available credit enhancement covers the target credit enhancement, the covered bonds benefit from 180 days of liquidity, but there is no overcollateralization commitment commensurate with the rating.

The ratings on the program and related issuances are not constrained by legal, operational, country, or counterparty risks.

Program Description

Table 1

Program Overview*	
Jurisdiction	Germany
Covered bond type	Legislation-enabled
Outstanding covered bonds (Bil. €)	2.15
Redemption profile	Hard bullet
Underlying assets	Residential mortgages, commercial mortgages & substitute assets
Assigned jurisdictional support uplift	3
Unused notches for jurisdictional support	0
Available credit enhancement (%)	27.37
Target credit enhancement (%)	9.34
Credit enhancement required for current rating (%)	7.85
Assigned collateral support uplift	1
Unused notches for collateral support	2
Total unused notches	2

*Based on data as of Oct. 1, 2018.

WBSK is a German Bausparkasse, residential mortgage loan provider, and covered bond issuer. It is the core banking entity of Germany-based Wuestenrot & Wuerttembergische AG.

The covered bonds are regulated by the German covered bond framework and are issued under WBSK's debt issuance program, or stand-alone documentation. The cover pool assets are segregated from the issuer's remaining assets through entry in a cover pool register. Investors in covered bonds have recourse to WBSK and to a portfolio of mortgage and substitute assets assigned to the cover pool as collateral.

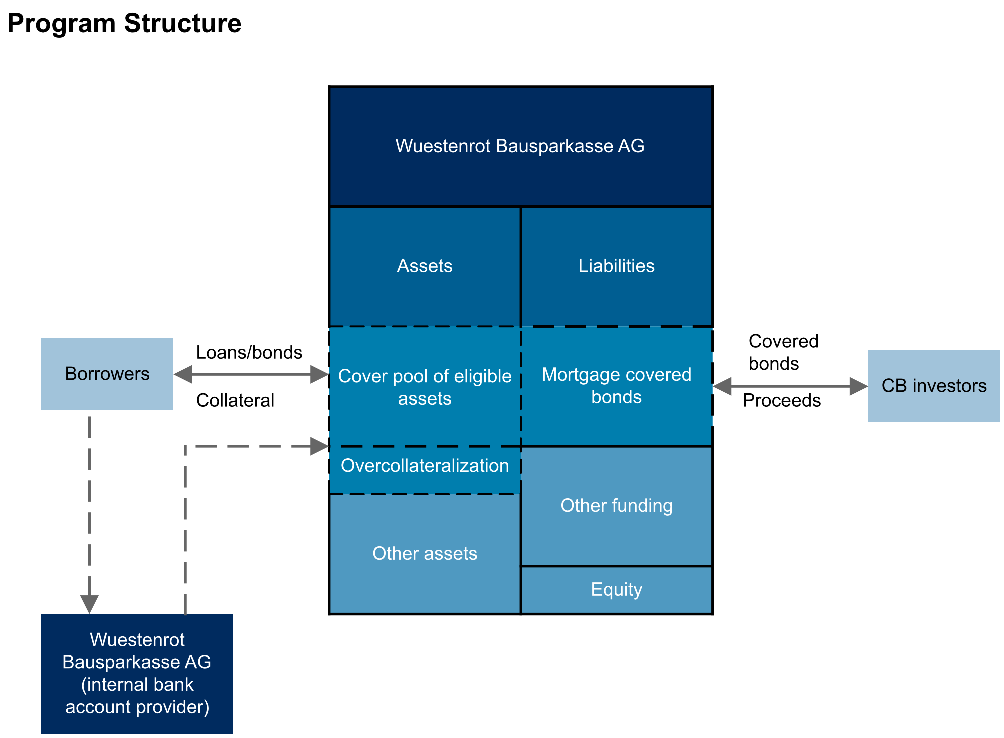
The covered bonds and cover pool assets are euro-denominated. There are no derivatives in the cover pool. WBSK is the issuer and bank account provider (see chart below).

Table 2

Program Participants

Role	Name	Rating	Rating dependency
Issuer	Wuestenrot Bausparkasse AG	A-/Stable/A-1	Yes
Account bank	Wuestenrot Bausparkasse AG	A-/Stable/A-1	No

Chart 1



Rating Analysis

Legal and regulatory risks

We consider that the German covered bond legal framework satisfies the relevant legal aspects of our covered bonds criteria. This enables us to assign ratings to the covered bonds that exceed the long-term ICR on the issuer.

The German Covered Bond Act (Pfandbriefgesetz; "PfandBG") and the relevant secondary legislation provide the legal framework for the issuance of German covered bonds (Pfandbriefe). The Covered Bond Act was introduced in 2005. Under the framework, banks can issue public-sector, mortgage, ship, and aircraft covered bonds.

Covered bond investors have a preferential claim to a cover pool of assets. For mortgage covered bonds, this may comprise exposures to properties and rights equivalent to real property located in a member state of the European Union, the European Economic Area, Switzerland, the U.S., Canada, or Japan. The issuer may use mortgages as cover pool assets up to the first 60% of the property's value only, as estimated in accordance with the PfandBG. The cover pool may also include exposures to public-sector entities from the same geographic area as stipulated for the mortgage assets. Additionally, the cover pool can comprise eligible substitute assets.

According to the PfandBG, the issuer must maintain overcollateralization of at least 2% on a net present value basis for the outstanding covered bonds, and ensure 180 days of liquidity needs at all times.

An independent trustee is responsible for monitoring the cover pool (cover pool monitor) until an independent cover pool administrator is appointed in case of the issuer's insolvency. The German Federal Financial Supervisory Authority (BaFin), appoints and supervises the cover pool monitor and cover pool administrator. BaFin also regularly conducts a special covered bond audit, usually every two years.

We have analyzed the risk that, if the issuer becomes insolvent, cash received from the cover pool assets could be commingled with the cash belonging to the bank, resulting in a loss to the cover pool. We have determined that the German Covered Bond Act effectively segregates cash received after the issuing bank's insolvency, but that cash received shortly before insolvency and not reinvested in the cover pool assets could be exposed to commingling risk. We address this risk in our counterparty section.

In our analysis of legal risk we considered the guidelines in "Asset Isolation And Special-Purpose Entity Methodology," published on March 29, 2017, as well as our covered bonds rating framework criteria.

Operational and administrative risks

We review operational risk according to our covered bonds rating framework criteria. We consider the procedures used by the issuer in the origination and monitoring of the cover pool assets. We have conducted a review of origination, underwriting, collection, risk monitoring, and default management procedures for WBSK's cover pool assets. We also reviewed the cover pool's management and administration. In our view, WBSK has prudent underwriting and loan management policies. Therefore, we have not applied any adjustments to our credit or cash flow assumptions as a result of our assessment of operational risk.

WBSK maintains, voluntarily, overcollateralization levels that exceed the legal minimum requirement, in order to support the current ratings on the covered bonds. Covered bonds are a key funding tool for WBSK, and we believe that the issuer will continue to manage overcollateralization at the current rating level.

Furthermore, in our view potential backup servicers would be available if the issuer were to become unable to manage the program, considering that Germany is an established covered bond market and the underlying mortgages do not comprise product features that would materially limit the range of available servicers.

Resolution regime analysis

As part of our covered bonds criteria, our analysis considers the resolution regime in place in Germany to determine the RRL. The RRL on WBSK, which is the starting point for any further ratings uplift in our analysis, is 'a+'. We consider the following factors:

- WBSK is domiciled in Germany, which is subject to the EU's Bank Recovery And Resolution Directive (BRRD).
- The 'A-' ICR does not include any uplift for the likelihood of extraordinary government support or intervention.
- We assign two notches of uplift to the ICR because we assess the systemic importance for German mortgage covered bonds as very strong.

These factors collectively increase the likelihood that WBSK would continue servicing its covered bonds without accessing the cover pool, even if it were to face failure.

Jurisdictional support analysis

The JRL for the issuer's mortgage covered bonds is 'aa+'. Based on the application of our covered bonds criteria, ratings on mortgage covered bonds in Germany, would be eligible for three notches of uplift above the RRL given our very strong jurisdictional support assessment of German mortgage covered bonds (see "Assessments For Jurisdictional Support According To Our Covered Bonds Criteria," published on Oct. 16, 2018). We also consider that the issuer's cover pool continues to comply with legal and regulatory minimum standards in Germany and that there are no limitations from the foreign currency rating on the German sovereign.

Collateral support analysis

The cover pool comprises German mortgage loans and substitute assets. We base our credit and cash flow analysis on data provided by the issuer as of as of Oct. 1, 2018. Since our previous review the collateral pool's composition and credit quality have remained stable. As more covered bonds were issued the credit enhancement reduced to 27.4% from 48.6% but remains well above the target credit enhancement of 9.34% commensurate with the maximum collateral based uplift.

The mortgage cover pool is granular and well-seasoned with low loan-to-value (LTV) ratios compared to other German covered bond programs we rate.

We base our credit analysis of mortgage assets on our European residential loans criteria and our commercial real estate criteria (see "Methodology And Assumptions: Assessing Pools Of European Residential Loans," published on Aug. 4, 2017, and "Methodology And Assumptions: Analyzing European Commercial Real Estate Collateral In European Covered Bonds," published on March 31, 2015).

The below tables provide an overview of the cover pool's composition.

Table 3

Cover Pool Composition

	As of Oct. 1, 2018		As of Sept. 30, 2017	
Asset type	**Value (€)**	**Percentage of cover pool (%)**	**Value (€)**	**Percentage of cover pool (%)**
Residential mortgages	2,208,439,013	80.76	2,513,100,420	82.47
Commercial mortgages	366,160,671	13.39	394,096,682	12.93
Substitute/public finance assets	160,000,000	5.85	140,000,000	4.59
Total	2,734,599,684	100	3,047,197,102	100.00

Table 4

Key Credit Metrics

	As of Oct. 1, 2018	As of Sept. 30, 2017
Average loan size (€)	62,364	63,800
Weighted-average original LTV ratio (%)	57.08	52.00
Weighted-average loan seasoning (months)*	136.32	127.97
Balance of loans in arrears (%)	0.3	0.32

Table 4

Key Credit Metrics (cont.)

	As of Oct. 1, 2018	As of Sept. 30, 2017
Credit analysis results:		
Weighted-average foreclosure frequency (%)	9.73	9.48
Weighted-average loss severity (%)	8.13	7.95
'AAA' credit risk (%)	6.36	6.59

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

Table 5

Cover Pool Assets By Loan Size

	Percentage of cover pool (%)	
(€ 's)	As of Oct. 1, 2018	As of Sept. 30, 2017
0 – 50,000	22.8	20.2
50,000 – 100,000	41.8	39.4
100,000 – 150,000	21.0	21.8
150,000 – 200,000	8.1	8.5
200,000 – 250,000	3.1	3.5
250,000 – 300,000	1.1	1.6
300,000 – 350,000	0.5	0.7
350,000 – 400,000	0.2	0.5
400,000 – 450,000	0.3	0.4
450,000 – 500,000	0.2	0.4
500,000 – 550,000	0.2	0.3
550,000 – 600,000	0.1	0.3
> 600,000	0.5	2.5

Table 6

Original LTV Ratios (%)

	Percentage of cover pool (%)	
	As of Oct. 1, 2018	As of Sept. 30, 2017
0-60	53.1	59.2
60-80	46.9	40.8
80-90	0.0	0.0
90-100	0.0	0.0
>100	0.0	0.0
Total	100.0	100.0

Table 7

Residential Mortgages Seasoning Distribution*

	As of Oct. 1, 2018	As of Sept. 30 2017
Weighted-average loan seasoning (months)*	136.32	127.97
	Percentage of cover pool (%)	
Less than 5 years	11.89	16.51

Table 7

Residential Mortgages Seasoning Distribution* (cont.)		
	As of Oct. 1, 2018	**As of Sept. 30 2017**
Between 5 and 6 years	7.06	7.08
Between 6 and 7 years	7.39	7.76
Between 7 and 8 years	7.94	4.17
Between 8 and 9 years	4.19	6.42
Between 9 and 10 years	5.79	8.09
More than 10 years	55.47	49.97

*Seasoning refers to the elapsed loan term.

Table 8

Geographic Distribution Of Loan Assets		
	Percentage of cover pool (%)	
	As of Oct. 1, 2018	**As of Sept. 30, 2017**
Residential mortgages		
Baden-Wuerttemberg	18.35	18.35
Bavaria	17.37	17.29
Berlin	2.53	2.44
Brandenburg	5.48	5.48
Bremen	0.46	0.45
Hamburg	0.86	0.85
Hesse	9.32	9.25
Lower Saxony	8.35	8.41
Mecklenburg-Vorpommern	2.39	2.36
North Rhine-Westphalia	14.45	14.6
Rhineland-Palatinate	5.67	5.76
Saarland	1.41	1.44
Saxony	4.21	4.21
Saxony-Anhalt	2.88	2.84
Schleswig-Holstein	3.33	3.29
Thuringia	2.96	2.98
Total	100	100
Commercial mortgages		
Baden-Wuerttemberg	13.52	13.80
Bavaria	10.65	10.24
Berlin	14.66	14.04
Brandenburg	4.87	4.98
Bremen	0.17	0.15
Hamburg	1.20	1.22
Hesse	11.82	11.57
Lower Saxony	5.39	5.55
Mecklenburg-Vorpommern	3.34	3.32
North Rhine-Westphalia	15.74	15.98

Table 8

Geographic Distribution Of Loan Assets (cont.)		
Rhineland-Palatinate	3.35	3.51
Saarland	1.21	1.20
Saxony	6.34	6.13
Saxony-Anhalt	2.84	2.99
Schleswig-Holstein	1.61	1.61
Thuringia	3.30	3.71
Total	100	100

Table 9

Collateral Uplift Metrics		
	As of Oct. 1, 2018	**As of March. 31, 2018**
Asset WAM (years)	4.20	4.10
Liability WAM (years)	5.80	5.30
Available credit enhancement	27.37	48.55
Required credit enhancement for first notch of collateral uplift (%)	7.11	7.78
Required credit enhancement for second notch of collateral uplift (%)*	7.85	8.98
Required credit enhancement for third notch of collateral uplift (%)	8.60	10.17
Target credit enhancement for maximum collateral uplift (%)	9.34	11.36
Potential collateral-based uplift (notches)	4.00	4.00
Adjustment for liquidity (Y/N)	N	N
Adjustment for committed overcollateralization (Y/N)	Y	Y
Collateral support uplift (notches)	3.00	3.00

*Credit enhancement required for current rating. WAM--Weighted-average maturity.

We assess the credit quality of the mortgage cover pool 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 product of the weighted-average foreclosure frequency (WAFF) and weighted-average loss severity (WALS) estimates the required loss protection, assuming all other factors remain unchanged.

Our credit results have remained stable compared to our previous review. As of Oct. 1, 2018, for the combined residential and commercial mortgage pool we estimated a WAFF of 9.73% and an expected loss given default (WALS) of 8.13%. We base these metrics on the 'AAA' credit stresses that we applied. The minor increase in our WAFF and WALS assumptions is due to a small increase in the proportion of commercial mortgages for which we apply higher default and market value decline assumptions than for residential mortgages.

The issuer actively manages substitute cover pool assets, which leads to some variation in the portfolio's size and our default risk assessment over time. In line with our criteria "Methodology And Assumptions For Assessing Portfolios Of International Public Sector And Other Debt Obligations Backing Covered Bonds And Structured Finance Securities," published on Dec. 9, 2014, we consider that the substitute portfolio exhibits low granularity. We therefore assume that in a 'AAA' stress scenario all substitute assets rated lower than 'AAA' default. We currently assess the asset default risk of 100% and calculate a recovery rate of 42.5%.

We consider that there is an active secondary market for mortgages in Germany. As a result, the program can benefit from up to four notches of collateral-based uplift above the JRL according to our covered bonds criteria.

We then consider whether adjustments to the maximum collateral-based uplift are required. This depends on whether the covered bonds benefit from the coverage of six months of liquidity and the level of overcollateralization commitment. WBSK's covered bonds benefit from 180 days of liquidity coverage at all times as required under the PfandBG. At the same time, aside from the legislative minimum overcollateralization, there is no other commitment in place to maintain the available overcollateralization in the program. Therefore, we deduct one notch from the maximum potential uplift of four notches for uncommitted overcollateralization. This results in a collateral-based uplift of three notches above the JRL.

As of Oct. 1, 2018, the target credit enhancement that would allow the covered bonds to receive all four notches of potential collateral-based uplift is 9.34% (reduced to three after taking into account the lack of overcollateralization commitment). It has reduced compared to our previous review mainly due to our updated constant prepayment rate assumption outside recession, which now also considers historical prepayment rates (see "Guidance: Covered Bonds Criteria," published on May 2, 2018).

The program's available credit enhancement is 27.34%, which exceeds the target credit enhancement, as well as the credit enhancement that corresponds to coverage of 'AAA' credit risk (6.36%).

The program can therefore reach a 'AAA' rating and benefits from two unused notches of uplift from a cash flow perspective.

Counterparty risk

We have assessed counterparty risk under our "Counterparty Risk Framework Methodology And Assumptions," published on June 25, 2013, and "Counterparty Risk Analysis In Covered Bonds," published on Dec. 21, 2015.

There are no derivatives registered in the cover pool. We have identified bank account and commingling risk as relevant counterparty risks for the program.

As commingling and bank account risks are not structurally addressed before the issuer's insolvency, we have modeled them in our assessment of the target credit enhancement. Based on the currently available information, we believe that the available overcollateralization mitigates bank account and commingling risk.

Country risk

We analyze country risk by applying our criteria "Ratings Above The Sovereign - Structured Finance: Methodology And Assumptions," published on Aug. 8, 2016.

This cover pool includes exposures towards German mortgages (94.1%) and substitute assets, which include small exposures to France, Spain, and Ireland.

In light of the unsolicited 'AAA' rating on Germany and the small exposure to other jurisdictions, country risk does not constitute a rating constraint.

Potential Effects Of Proposed Criteria Changes

Our ratings are based on our applicable criteria, including our "Counterparty Risk Framework Methodology And Assumptions," published on June 25, 2013, "Counterparty Risk Analysis In Covered Bonds," published on Dec. 21, 2015, and "Ratings Above The Sovereign - Structured Finance: Methodology And Assumptions," published on Aug. 8, 2016. However, these criteria are under review (see "Request For Comment: Counterparty Risk Framework: Methodology And Assumptions," published on Oct. 9, 2018, and "Request For Comment: Ratings Above The Sovereign - Structured Finance: Methodology And Assumptions," published on Nov. 20, 2018). As a result of these reviews, we may amend certain paragraphs of our rating above the sovereign criteria and our analysis of counterparty risk in a covered bond program. These changes may affect the ratings on the outstanding covered bonds issued under this covered bond program. Until this time, we will continue to rate and surveil these covered bonds using our existing criteria (see "Related Criteria").

Related Criteria

- Criteria - Structured Finance - General: Methodology And Assumptions: Assessing Pools Of European Residential Loans, Aug. 4, 2017
- Legal Criteria: Structured Finance: Asset Isolation And Special-Purpose Entity Methodology, March 29, 2017
- Criteria - Structured Finance - General: Ratings Above The Sovereign - Structured Finance: Methodology And Assumptions, Aug. 8, 2016
- Criteria - Structured Finance - Covered Bonds: Counterparty Risk Analysis In Covered Bonds, Dec. 21, 2015
- 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
- Criteria - Structured Finance - Covered Bonds: Methodology And Assumptions For Assessing Portfolios Of International Public Sector And Other Debt Obligations Backing Covered Bonds And Structured Finance Securities, Dec. 9, 2014
- Criteria - Structured Finance - General: Counterparty Risk Framework Methodology And Assumptions, June 25, 2013
- General Criteria: Methodology: Credit Stability Criteria, May 3, 2010
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Related Research

- European Economic Snapshots For 1Q2019 Published, Dec. 18, 2018

- Global Covered Bond Insights Q4 2018, Dec. 12, 2018
- Global Covered Bond Characteristics And Rating Summary Q4 2018, Dec. 12, 2018
- Request For Comment: Ratings Above The Sovereign - Structured Finance: Methodology And Assumptions, Nov. 20, 2018
- Assessments For Jurisdictional Support According To Our Covered Bonds Criteria, Oct. 16, 2018
- Request For Comment: Counterparty Risk Framework: Methodology And Assumptions, Oct. 9, 2018
- Guidance: Covered Bonds Criteria, May 2, 2018
- Glossary of Covered Bond Terms, April 27, 2018
- Covered Bond Monitor, June 26, 2015