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

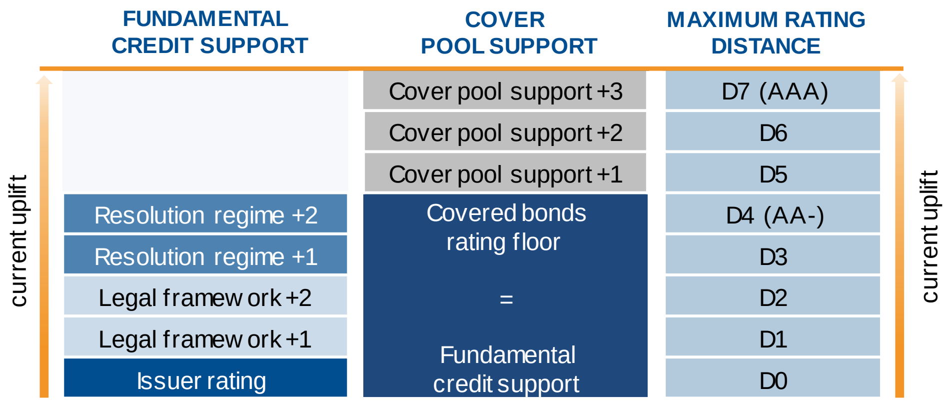
The AAA rating with a Stable Outlook assigned to the Norwegian mortgage-covered bonds issued out of Verd Boligkreditt AS (Verd) is based on the bank's private issuer rating, enhanced by seven notches of cover pool support. Four notches thereof reflect our assessment of the strong fundamental credit support provided by the Norwegian legal covered bond and resolution frameworks.

Cut-off date	Cover pool	Cover asset type	Covered bonds	Rating/Outlook
31 March 2020	NOK 9.94bn	Residential mortgage loans	NOK 8.25bn	AAA/Stable

Verd is a specialised credit institution, dedicated to providing secured covered bond funding to its owners – nine local banks in southern and western Norway. Verd's sound investment grade credit quality is based on the investment-grade credit profiles of its owner banks. The banks are well established in their local markets and have reassuring prudential metrics.

Fundamental credit support from the Norwegian legal and resolution framework provide a four-notch uplift above the bank's rating. This effectively forms a rating floor at AA-. Cover pool support enables the programme to be rated AAA.

The programme does not benefit from any rating buffer against an issuer downgrade as the maximum theoretical uplift of seven notches is fully depleted to achieve the highest ratings.



Stable Outlook

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

Changes since the last performance update

Since March 2019 the cover pool has increased to NOK 9.94bn (+5.7%). Relevant risk metrics such as the loan-to-value (LTV) ratio and the remaining term have remained relatively stable. However, loans in LTV buckets of 70% and above decreased to 14% from 17%, positively driving stressed recoveries.

The weighted average remaining life (WAL) of the bonds went down by 0.7 years to 3.3 years as of March 2020. The same reduction was observed for the cover assets keeping the WAL gap stable.

Ratings & Outlook

Issuer rating	**Not disclosed**
Outlook	Not disclosed
Covered bond rating	**AAA**
Outlook	Stable
Rating action	Affirmation
Last rating action date	11 May 2020

Rating Team (covered bonds)

Mathias Pleißner
+49 69 6677389-39
m.pleissner@scoperatings.com

Reber Acar
+49 69 6677389-50
r.acar@scoperatings.com

Lead Analyst (banks)

Pauline Lambert
p.lambert@scoperatings.com

Related Research

Scope affirms AAA ratings to Norwegian Verd Boligkreditt's mortgage-covered bonds – Outlook Stable
May 2020

Norway first out of the blocks to align with EU covered bond directive
January 2020

New analysis on mortgage covered bonds issued by Verd Boligkreditt AS
May 2019

Scope Ratings GmbH

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

Phone +49 69 66 77 389 0

info@scoperatings.com
www.scoperatings.com

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Table of contents

The issuer

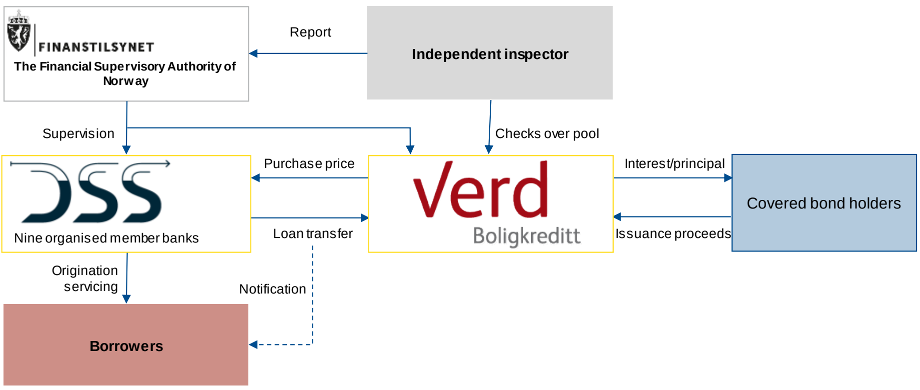
Unlike most covered bond issuers, Verd is not a subsidiary of a single parent bank. Established in 2009, Verd is owned and used by nine independent savings banks in southern and western Norway. The banks are part of De Samarbeidende Sparebankene (DSS), an alliance which increases negotiating power with suppliers, enhances operational efficiencies and enables expertise sharing. As seen throughout Norway, alliances are important for sustaining the business franchises of individual banks. This includes the shared ownership of companies offering a range of financial products, such as insurance, leasing and securities services.

For further details on our bank credit analysis see Appendix: Verd Boligkreditt Credit Considerations and the initial rating report.

Programme structure

The Norwegian legal covered bond framework is mainly based on the relevant section on covered bonds in the Financial Institutions Act together with a related regulation on mortgage credit institutions, both introduced in 2007. Under this framework, issuance is only permitted through specialist covered bond issuers. For more information, see also our related research. 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.

Issuance structure



Source: Scope Ratings

Fundamental credit support analysis

Fundamental credit support enhances Verd's covered bond rating by four notches above our credit view on the issuer. This is based on our view of: i) Norway's covered bond legal framework (two notches); and ii) the resolution regime and systemic importance of Verd and its covered bonds (two notches).

Two notches of uplift based on legal framework analysis…

We consider the Norwegian covered bond framework to be one of Europe's strongest, meeting our criteria for protecting investors. Therefore, we assign the highest credit differentiation of two notches.

…plus two notches of 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: i) the low likelihood that the covered bond issuer will be maintained in a resolution scenario; ii) the low visibility of Verd as a covered bond issuer; and iii) limited documented or public commitments from owner banks as regards support, e.g. a minimum level of liquidity or oc. For more information, see our related research.

Cover pool characteristics

Reporting date	Mar 2020	Mar 2019
Balance (NOK bn)	9.9	9.4
Residential (%)	100	100
Substitute (%)	0.0	0.0

Property type (%)

Reporting date	Mar 2020	Mar 2020
Single-family house	80.0	81.7
Apartment	14.4	13.1
Others	5.6	5.2

Property location (%)

Reporting date	Mar 2020	Mar 2019
Rogaland	43.5	41.2
Vest-Agder	27.6	28.2
Hordaland	10.5	10.3
Others	18.3	20.3

General information

Reporting date	Mar 2020	Mar 2019
No. of obligors*	6.181	5.718
Avg. size (NOK m)	1.5	1.5
Top 10 (%)	0.7	0.7
Remaining term (y)	18.5	19.3
LTV (%)	52.6	53.1

*per Scope aggregated borrower

Asset Interest rate type (%)

Reporting date	Mar 2020	Mar 2019
Floating	100	100
Fixed	0.0	0.0

Cover pool analysis

Verd's mortgage-covered bond ratings are cover pool supported. The cover pool provides the maximum seven-notch uplift to our credit view on the issuer. Fundamental credit support provides for a four-notch rating uplift and, effectively, a floor against a deterioration in cover pool credit quality.

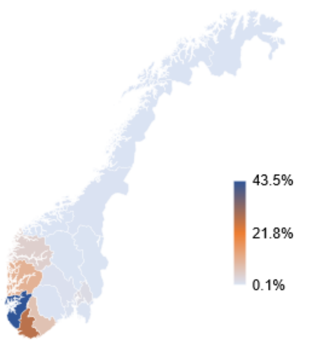
Since our last review in 2019, the minimum supporting oc needed to achieve the highest rating remained unchanged at 4.0%. Credit loss accounts for 1.2pp of the supporting oc (down from 1.8pp) but does not constitute a lower level of oc considering the programme's market risks. Market risks reflect the programme's exposure to: i) interest rate mismatches; ii) asset sales as a consequence of maturity mismatches and; iii) carry costs resulting from high asset prepayments.

Cover pool composition

The cover pool comprises Norwegian granular, first-lien residential mortgage loans denominated in Norwegian kroner. As of March 2019, the mortgage portfolio accounts for 6,473 loans. The average loan size remains small at NOK 1.5m (around EUR 150,000). The top 10 largest exposures* account for 0.7%.

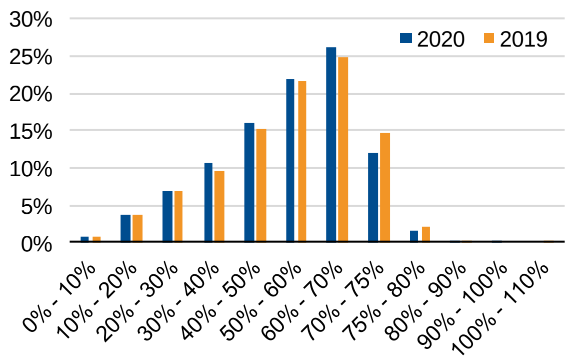
The weighted average Scope-calculated LTV is 52.6%. This compares to 53.1% one year ago and does not show much variation between the owner banks. While the average LTV has remained fairly stable, the share of loans exceeding 70% has dropped to 14% from 17% one year earlier. This is driven by loan amortisation and property price indexation. The lower share is positive for our stressed recovery rates because loans in the lower LTV categories are less affected or not affected by our security value haircuts.

Regional distribution



Source: Scope Ratings, Verd.

LTV distribution (by maximum drawable amount)



Source: Scope Ratings, Verd.

The LTV is calculated based on the maximum drawable amount for re-drawable loans (flexible loans) which make up 21% (down from 23%) of the cover pool. These loans have an embedded credit line which can be redrawn without new credit approval. Flexible loans will only be granted if the loan's LTV does not exceed 60%. Existing flexible loans may only draw up to a level of 60%.

Verd's cover pool is concentrated in the Norwegian oil regions. These areas are also home to diversified, export-oriented businesses and sectors, like fisheries, shipbuilding, tourism and hydro power. Exposures in Rogaland, Hordaland and Vest/Aust-Adger and Sogn og Fjordane account for an unchanged 91% of the cover pool. Exposures outside the core region are driven by the bank's provision of financing to local customers. These are exceptions and are only granted to borrowers with above-average credit quality.

Asset risk analysis

Strong credit quality translates into low credit risk

The credit quality of the cover pool remains strong. We assumed an unchanged cumulative probability of default of 10.5% over the life of the loans (or 57 bps annually). We also incorporated an average cure base rate of 55%, which effectively reduces the annual default probability to 26 bps.

The unchanged volatility of default (weighted average coefficient of variation) was assumed to be 55%. This factors in the higher sensitivity to economic shocks in the western regions of Norway but also takes into account the diversification in these areas compared to more concentrated peers.

Our projection of default on mortgage loans uses an inverse Gaussian distribution, based on available credit performance data provided by the bank (in particular, IFRS9 reporting and background documentation, static delinquency history and loan-level probabilities of default) and benchmarking.

Recovery rates range from 98.1% (from 97.3%) in the base case to 81.3% (from 76.6%) in the most stressed scenario. Higher recoveries are driven by: i) revised market value decline assumptions for properties located in the south western part of Norway (2.5% down); and ii) lower LTVs.

We applied a fire-sale discount of 30% on top of our market value decline assumptions. This results in total stressed security value haircuts ranging between 50% and 62.5%. The fire sale discount reflects the value discount of properties sold under non-standard market or distressed conditions. For Verd we assumed a discount which is higher than for its Norwegian peers. The higher haircut is supported by the bank's internal analysis (IFSR9) and is justified by the member banks' core markets in more regional areas of Norway for which liquidity may be lower.

Cash flow risk analysis

Supporting oc breakdown

Source: Scope Ratings

The unchanged rating-supporting oc of 4.0% mainly reflects the programme's market risk. Market risk accounts for 2.8% pp (up from 2.2%) of the 4.0% supporting oc. It is related to interest rate mismatches and asset liability mismatches and is driven by the programme's sensitivity to high prepayments that create a large amount of cash. This cash reduces the transaction's available excess spread – especially in scenarios for which we combined margin compression and frontloaded default timings.

Credit loss accounts for 1.2 pp of the supporting oc and has fallen by 0.6pp from 1.8pp one year ago. The reduction is driven by lower market value declines and a lower share of loans exceeding an LTV of 70%.

The supporting oc reflects the results of further sensitivity tests including a margin compression down to 80 bps, effectively reducing the excess spread. In addition, we tested the programme's sensitivity to higher refinancing spreads, additional covered bonds issued and frontloaded defaults.

Asset-liability mismatches

	Assets	Liabilities
NOK	100%	100%
Fixed	0.0%	5.3%
Floating	100%	100%
WAL (years)	11.1	3.3

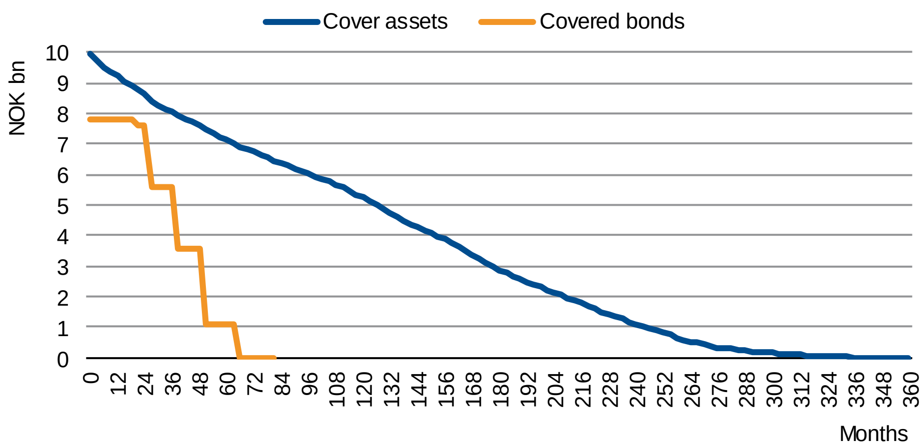
As of Q1 2020, the WAL of the outstanding and extended covered bonds is 3.3 years, down from 4.0-year one year ago. This compares to an unstressed WAL for the cover assets of 11.1 years (down from 11.9 years). This has kept the WAL gap relatively stable at 7.8 years (from 7.9 years).

NOK 8,250m in covered bonds are predominantly issued at a floating rate, with Verd hedging the 5.3% of fixed coupon bonds into floating until the bonds' scheduled maturity date. During the extension period the fixed bonds pay a floating coupon according to the respective terms and conditions.

Our analysis does not take hedging into account, mainly because the termination events in the swap agreements are not excluded for Verd. The issuer has however recently amended its hedging documents. The revised documents will be used for new hedges should additional fixed bonds be issued. Hence, we are likely to give benefit to future hedges that address the current limitations.

There is no foreign exchange risk as assets and liabilities are denominated in Norwegian kroner. At this stage we do not expect any foreign currency-denominated issuances.

Figure 1: Amortisation profile



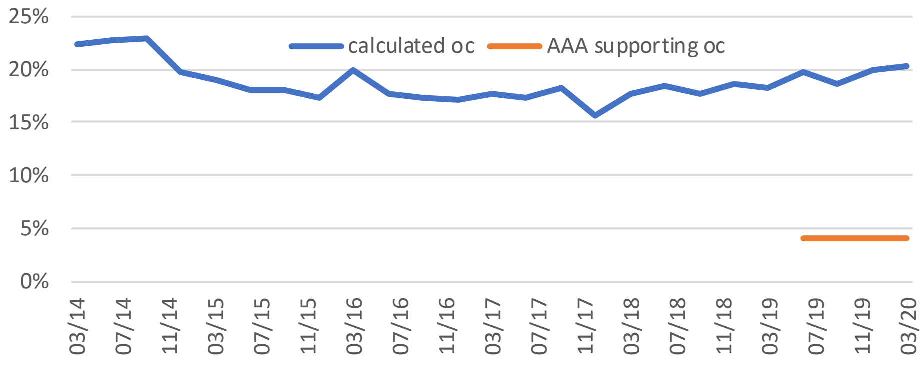
Source: Scope Ratings, Verd

Availability of overcollateralisation

oc fully taken into account

Our current credit view of Verd and its owner banks allows us to fully account for the provided oc. We are not aware of plans that would significantly change Verd's risk profile or reduce available oc to levels that would no longer support the current rating uplift.

Figure 2: Available overcollateralisation 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 exposure to the issuer and to the issuer's member banks as loan originator and servicer. Further, there is exposure to Sparebank Vest as bank and deposit account as well as paying agent. With regard to most of Vest's responsibilities there are replacement mechanisms in place that would shield the covered bonds from a credit deterioration of Vest, while no such mechanism is in place for the issuer's member banks. However, we believe the strong alignment of interests between the issuer, its member banks and covered bond holders would prevent any negative impact from such risks before regulatory intervention became necessary. We also take a positive view of the use of direct debit for the collections, which ensures payments on accounts and in the name of the issuer from day one.

Sovereign risk does not affect the rating

Sovereign risk does not limit the rating on 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 covered bonds issued by Verd. Environmental aspects, in particular Norwegian energy efficiency standards, have often not been recorded in the bank's main underwriting databases – which is typical for most banks. 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 their recovery proceeds. At the same time, we have indirectly included environmental aspects because collateral valuations reflect the condition of the collateral. Governance aspects, however, are a vital element of our fundamental analysis, which factors in a dedicated legal framework and the country's resolution regime, with the issuer and its owner banks supervised by Finanstilsynet.

Sensitivity analysis

No buffer against potential change in issuer rating

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 utilised to achieve the highest ratings. The covered bond ratings may be downgraded if: i) our issuer rating deteriorates; ii) risk in the covered bond programme increases and the oc provided no longer supports a seven-notch rating uplift; or iii) there is a deterioration in our view on fundamental support factors relevant to the issuer and Norwegian mortgage-covered bonds in general.

Verd Boligkreditt AS Mortgage Covered Bonds

Norwegian Covered Bonds – Performance Update

Reporting date	31 March 2020	31 March 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 = 100% Substitute = 0%	Residential = 100% Substitute = 0%
Issuer rating	Not disclosed	Not disclosed
Current covered bond rating	AAA/Stable	AAA/Stable
Covered bond maturity type	Soft bullet	Soft bullet
Cover pool currencies	NOK (100%)	NOK (100%)
Covered bond currencies	NOK (100%)	NOK (100%)
Fundamental cover pool support	3	3
Maximum achievable covered bond uplift	7	7
Potential covered bond rating buffer	0	0
Cover pool (NOK bn)	9.94	9.40
thereof, substitute assets and deposits (NOK bn)	0.57	0.59
Covered bonds (NOK bn)	8.25	7.87
Overcollateralisation: current / legal minimum	20.1% / 2.0%	19.5% / 2.0%
Overcollateralisation to support current rating	4.0%	4.0%
Overcollateralisation upon a one-notch issuer downgrade	4.0% (AA+)	4.0% (AA+)
Weighted average life of assets	11.1 years	11.9 years
Weighted average life of liabilities[1]	3.3 years	4.0 years
Weighted average life gap	7.8 years	7.9 years
Number of borrowers[2]	6,181	5,718
Average loan size per borrower (NOK m)	1.5	1.5
Top 10 residential borrowers	0.7%	0.7%
Interest rate type – assets	Floating 100% Fixed 0%	Floating 100% Fixed 0%
Interest rate type – liabilities	Floating 94.7% Fixed 5.3%	Floating 94.4% Fixed 5.6%
Weighted average LTV (indexed)	52.6%	53.1%
Geographic split (top 3)	Rogaland = 43.5% Vest-Agder = 27.6% Hordaland = 10.5%	Rogaland = 41.2% Vest-Agder = 28.2% Hordaland = 10.3%
Default measure	Inverse Gaussian	Inverse Gaussian
Weighted average default rate (mortgage) (annualized/cumulative)	57bps / 10.5%	55bps / 10.5%
Cure rate	55%	55%
Coefficient of variation (mortgage)	50%	50%
Weighted average recovery assumption (D0/D7)[3] **(mortgage)**	98.1% / 81.3%	97.3% / 76.6%
Share of loans > three months in arrears (NPL)	0.0%	0.0%
Interest rate stresses (max./min.; currency-dependent)	-1 to 10%	-1 to 10%
FX stresses (max./min.; currency-dependent)	n/a	n/a
Max liquidity premium	150bps	150bps
Average servicing fee	25bps	25bps

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

I. Appendix: Verd Boligkreditt Credit Considerations

Credit drivers (summary)

The credit drivers, in decreasing order of importance, are:

- 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 investment-grade credit profiles of the owner banks form the basis for our credit view on Verd. The owner banks are well established in their local markets and maintain reassuring prudential metrics. The focus on retail customers and mortgage lending underpin strong levels of capitalisation and good asset quality. However, the banks operate in southern and western Norway which are regions more exposed to the cyclical oil and gas industry.
- The 10-plus year relationship between Verd and its owner banks has been highly cooperative and successful. This has ensured that Verd suffers no credit losses and maintains a sound financial profile. The alliance and the various support mechanisms, however, have yet to be tested under more difficult conditions.

Credit-change drivers

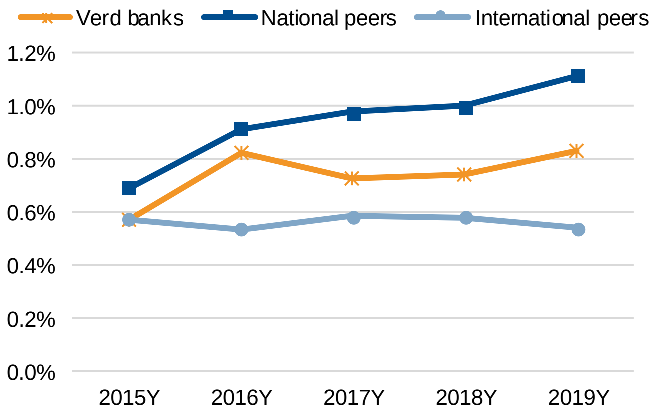
Further clarity and documentation of the owner banks' duties and obligations to support the credit fundamentals of Verd in situations of need. We note that the relationship between Verd and its owner banks is based on a high degree of mutual understanding and cohesion. More explicit details regarding support mechanisms (e.g. liquidity support) would be viewed positively.

Change in composition of owner banks. Being an open platform, other savings banks could join Verd and further diversify the mortgage assets available for transfer. For example, one of the current owners, Voss Sparebank, joined in 2017. On the other hand, the geographic diversification of mortgage assets could suffer if the composition of the owner banks changed.

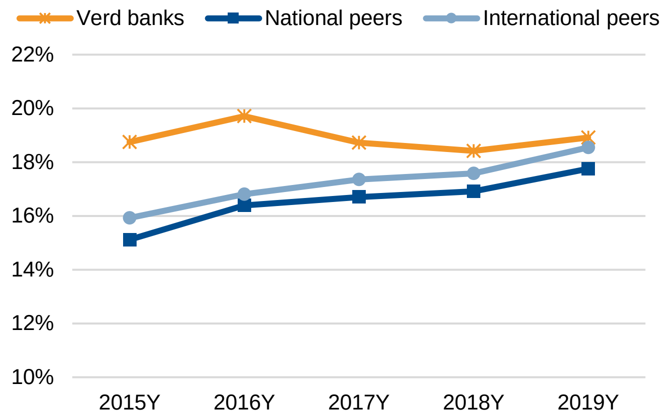
Material deterioration in the credit fundamentals of owner banks. This could impact the quality of the assets available for transfer as well as the banks' ability to meet obligations under the servicing and shareholder agreements.

II. Appendix: Peer comparison

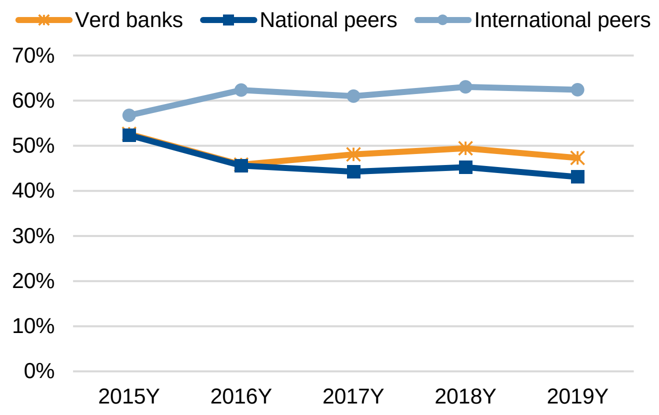
Return on average assets (%)



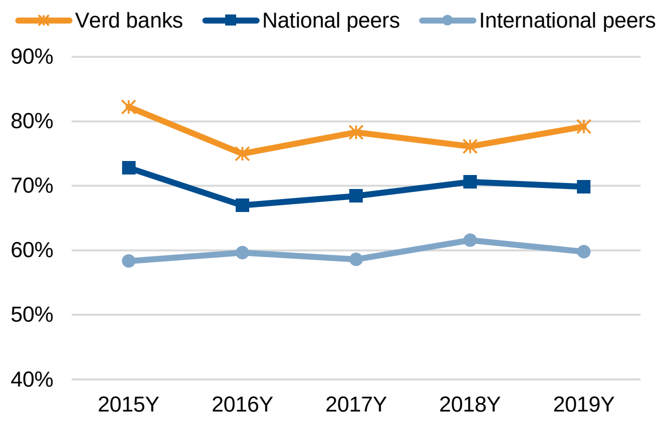
CET1 ratio (%, transitional basis)



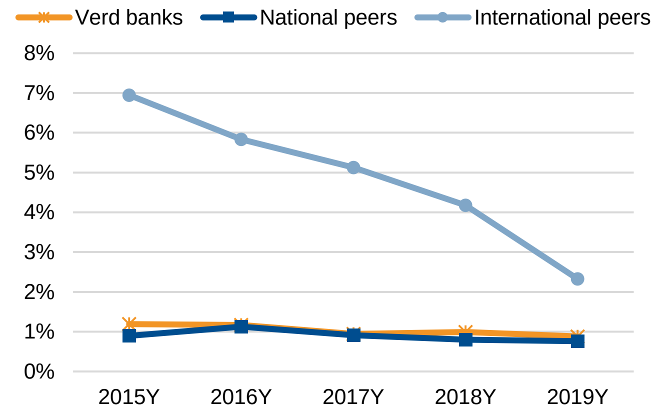
Costs % Income (%)



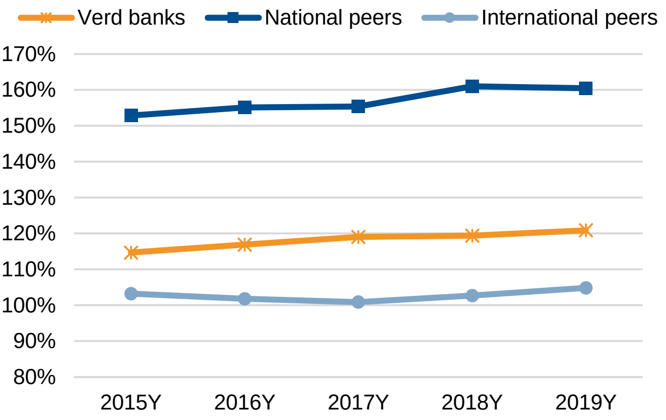
Net interest income % Operating income



Problem loans % Gross customer loans



Net loans % Deposits



National peers: Verd banks, DNB, Sparebank 1 SR-Bank, Sparebank 1 SMN, Sparebanken Vest, Landkreditt Bank, Sandes Sparebank, Totens Sparebank, Sparebank 1 Nordvest
International peers: Verd banks, Hypo-Bank Burgenland, Bausparkasse Wustenrot, Banca Popolare di Sondrio, Credito Emiliano, Kutxabank, Unicaja, Coventry Building Society
Note: Figures for the Verd banks are weighted averages based on each bank's ownership interest in Verd.

Source: SNL, Scope Ratings

III. Appendix: Selected Financial Information – Verd Boligkreditt AS

	2015Y	2016Y	2017Y	2018Y	2019Y
Balance sheet summary (NOK m)					
Assets					
Cash and interbank assets	7	125	109	163	205
Total securities	346	398	387	282	414
of which, derivatives	43	26	13	3	-
Net loans to customers	5,218	6,928	7,982	8,772	9,335
Other assets	1	(0)	0	-	0
Total assets	**5,572**	**7,451**	**8,478**	**9,216**	**9,954**
Liabilities					
Interbank liabilities	466	695	656	838	946
Senior debt	-	-	-	-	-
Derivatives	-	2	0	2	3
Deposits from customers	-	-	-	-	-
Subordinated debt	4,809	6,361	7,362	7,834	8,372
Other liabilities	17	12	21	19	22
Total liabilities	**5,293**	**7,070**	**8,039**	**8,693**	**9,343**
Ordinary equity	244	346	404	470	558
Equity hybrids	35	35	35	53	53
Minority interests	-	-	-	-	-
Total liabilities and equity	**5,572**	**7,451**	**8,478**	**9,216**	**9,954**
Core tier 1/ common equity tier 1 capital	*226*	*326*	*375*	*445*	*525*
Income statement summary (NOK m)					
Net interest income	68	56	80	91	94
Net fee & commission income	(30)	(23)	(34)	(39)	(41)
Net trading income	(8)	2	(1)	(11)	(0)
Other income	0	0	0	(0)	(0)
Operating income	**30**	**35**	**45**	**41**	**53**
Operating expenses	5	7	7	7	9
Pre-provision income	**25**	**28**	**39**	**34**	**44**
Credit and other financial impairments	-	-	-	-	-
Other impairments	-	-	-	-	-
Non-recurring income	-	-	-	-	-
Non-recurring expense	-	-	-	-	-
Pre-tax profit	**25**	**28**	**39**	**34**	**44**
Income from discontinued operations	-	-	-	-	-
Income tax expense	7	7	9	8	9
Other after-tax Items	-	-	-	-	-
Net profit attributable to minority interests	-	-	-	-	-
Net profit attributable to parent	18	21	29	26	35

Source: SNL

IV. Appendix: Selected Financial Information – Verd Boligkreditt AS

	2015Y	2016Y	2017Y	2018Y	2019Y
Funding and liquidity					
Net loans/ deposits (%)	NA	NA	NA	NA	NA
Liquidity coverage ratio (%)	NA	NA	NA	NA	424.0%
Net stable funding ratio (%)	NA	NA	NA	NA	NA
Asset mix, quality and growth					
Net loans/ assets (%)	93.6%	93.0%	94.2%	95.2%	93.8%
Problem loans/ gross customer loans (%)	0.2%	0.0%	0.1%	0.0%	0.1%
Loan loss reserves/ problem loans (%)	0.0%	0.0%	0.0%	NA	0.0%
Net loan growth (%)	6.9%	32.8%	15.2%	9.9%	6.4%
Problem loans/ tangible equity & reserves (%)	4.2%	0.2%	1.9%	0.0%	1.8%
Asset growth (%)	-4.3%	33.7%	13.8%	8.7%	8.0%
Earnings and profitability					
Net interest margin (%)	1.2%	0.8%	1.0%	1.0%	1.0%
Net interest income/ average RWAs (%)	3.5%	2.4%	2.9%	2.9%	2.8%
Net interest income/ operating income (%)	228.2%	159.2%	177.4%	220.3%	177.1%
Net fees & commissions/ operating income (%)	-100.7%	-64.8%	-75.4%	-93.7%	-76.7%
Cost/ income ratio (%)	17.0%	19.9%	14.5%	18.1%	17.3%
Operating expenses/ average RWAs (%)	0.3%	0.3%	0.2%	0.2%	0.3%
Pre-impairment operating profit/ average RWAs (%)	1.3%	1.2%	1.4%	1.1%	1.3%
Impairment on financial assets / pre-impairment income (%)	0.0%	0.0%	0.0%	0.0%	0.0%
Loan loss provision/ average gross loans (%)	0.0%	0.0%	0.0%	0.0%	0.0%
Pre-tax profit/ average RWAs (%)	1.3%	1.2%	1.4%	1.1%	1.3%
Return on average assets (%)	0.3%	0.3%	0.4%	0.3%	0.4%
Return on average RWAs (%)	0.9%	0.9%	1.1%	0.8%	1.0%
Return on average equity (%)	7.2%	6.2%	6.9%	5.1%	5.9%
Capital and risk protection					
Common equity tier 1 ratio (%, fully loaded)	NA	NA	NA	NA	NA
Common equity tier 1 ratio (%, transitional)	11.1%	12.3%	12.5%	13.5%	14.9%
Tier 1 capital ratio (%, transitional)	12.8%	13.6%	13.7%	15.2%	16.4%
Total capital ratio (%, transitional)	15.1%	15.3%	15.2%	17.3%	18.4%
Leverage ratio (%)	4.4%	4.8%	4.8%	5.3%	5.7%
Asset risk intensity (RWAs/ total assets, %)	36.4%	35.5%	35.4%	35.7%	35.4%

Source: SNL

Scope Ratings GmbH

Headquarters Berlin
Lennéstraße 5
D-10785 Berlin

Phone +49 30 27891-0

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

Phone +49 69 66 77 389-0

Paris
1 Cour du Havre
F-75008 Paris

Phone +33 1 8288 5557

London
3rd Floor
111 Buckingham Palace Road
UK-London SW1W 0SR

Phone +44 20 3457 0444

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

Phone +34 914 186 973

Milan
Via Paleocapa 7
IT-20121 Milan

Phone +39 02 30315 814

Oslo
Haakon VII's gate 6
N-0161 Oslo

Phone +47 21 62 31 42

info@scoperatings.com
www.scoperatings.com

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