

CREDIT OPINION

27 April 2020

New Issue



Closing date

27 April 2020

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Bluestep Bank AB (publ) - Mortgage Covered Bonds

New Issue – Swedish covered bonds

Ratings

Exhibit 1

Cover Pool (SEK)	Ordinary Cover Pool Assets	Covered Bonds (SEK)	Rating
3,000,511,570	Residential Mortgage Loans	1,700,000,000	Aa1

Source: Moody's Investors Service

Summary

The covered bonds issued by Bluestep Bank AB (publ) (the issuer, Bluestep) under its mortgage covered bond programme are full recourse to the issuer and are secured by a cover pool of assets consisting entirely of non-conforming residential mortgage loans in Sweden. Bluestep is the largest specialist mortgage lender in Sweden and Norway. The non-conforming mortgage market is a small niche, currently accounting for less than 0.5% of the mortgages market in these two countries.

Credit strengths include the full recourse of the covered bonds to the issuer and support provided by the Swedish legal framework for covered bonds, which provides for the issuer's regulation and supervision.

Credit challenges include the credit quality of the loans in the cover pool, which is lower than that of Swedish traditional banks, and covered bonds' high level of dependency on the issuer. As with most covered bonds in Europe, there are few restrictions on the future composition of the cover pool.

Our credit analysis takes into account the cover pool's credit quality, which is reflected in the collateral score of 15.0%, and the current over-collateralisation (OC) of 76.5% (on a nominal basis) as of 15 April 2020.

Credit strengths

» **Recourse to the issuer:** The covered bonds are full recourse to Bluestep (A2(cr)). While the issuer performs its payment obligations, there will be no loss to covered bondholders. (See "Covered bond analysis")

- » **The issuer is located in Sweden (Aaa, stable):** Sweden's credit profile reflects its high wealth levels, resilient and diversified economy and strong growth potential. Furthermore, Swedish banking sector remains resilient to downside risks from high house prices and household debt, with a strong shock-absorption capacity stemming from strong asset quality, solid capital adequacy and profitability. (See "Covered bond description")
- » **Support provided by the Swedish legal framework:** The covered bonds are governed by the Swedish covered bond legislation, which provides for the issuer's regulation and supervision and sets certain minimum requirements for the covered bonds and the cover pool. Notable aspects of the Swedish covered bonds framework include the requirement for the issuer to exclude non-performing assets from coverage tests at 60 days past due. The framework restricts loans backed by commercial property to 10.0% of the cover pool. Issuers must also stress test cover pools against falls of up to 30.0% in mortgaged property values. (See "Moody's related publications: Covered Bond Legal Frameworks" and "Covered bond description")
- » **Mitigants to refinancing risk:** Following what we call a 'covered bond (CB) anchor event', refinancing risk would be mitigated to some extent by the fact that the issuer can reset loan rates on floating rate residential mortgages (25.2% of the cover pool) on a quarterly basis (in the event of issuer's default, the insolvency administrator will be able to similarly reset the loan rates every three months), which improves the sales value of the cover pool. A CB anchor event occurs when the issuer, or another entity within the issuer group that supports the issuer, ceases to service the payments on the covered bonds. (See "Covered bond analysis")
- » **No currency risk:** There is currently no currency risk in this programme because all of the assets and liabilities are denominated in Swedish Kronas (SEK).

Credit challenges

- » **High level of dependency on the issuer:** As with most covered bonds, before the insolvency of the issuer, the issuer can materially change the nature of the programme. For example, the issuer can add new assets to the cover pool, issue new covered bonds with varying promises and enter into new hedging arrangements. Also similar to most covered bonds in Europe, this programme has few restrictions on the future composition of the cover pool. These changes could affect the credit quality of the cover pool, as well as the overall refinancing and market risks. Further, if the quality of the collateral deteriorates below a certain threshold, the issuer would have the ability, but not the obligation, to increase the OC in the cover pool. (See "Covered bond analysis")
- » **Lower credit quality of the cover pool:** The covered bonds are supported by a cover pool of non-conforming loans (See "Cover pool description - Swedish non-conforming loans"). The pool includes, amongst others, (i) loans to borrowers with credit remarks; and (ii) debt consolidation loans. The collateral quality is reflected in the collateral score, which is currently 15.0%. This collateral score is higher than in other Swedish covered bond programmes. As mitigants, the cover pool consists of single family housing loans (62.2%) and loans to tenant owner rights (37.8%), both backed by residential properties in Sweden. Most loans (74.8%) carry a fixed rate of interest, which makes these loans less susceptible to rising interest rates, and all the loans in the cover pool are amortizing (unlike in other Swedish cover pools). Furthermore, by law, cover pools are stress-tested against falls of up to 30% in property values and loans backed by commercial property are not permitted to exceed 10% of the cover pool (there are currently no loans backed by commercial property in the cover pool). (See "Cover pool analysis")

This publication does not announce a credit rating action. For any credit ratings referenced in this publication, please see the ratings tab on the issuer/entity page on www.moody's.com for the most updated credit rating action information and rating history.

- » **Refinancing risk:** There are several factors that increase the refinancing risk in this transaction, among others: (i) the cover pool loans are non-standard in Sweden, and likely less liquid than traditional loans if the issuer or the administrator needs to sell them or raise funds against them; the non-conforming lending segment in Sweden is underdeveloped with only few lenders active in this market segment; this limits the number of potential suitors that would take over such a pool following failure of the issuer, (ii) the outstanding covered bonds have a hard bullet repayment, and (iii) upon a CB anchor event we expect the cover pool assets will have a significantly higher weighted average life (WAL) than the outstanding covered bonds, as with most covered bonds in Europe. The timely payment indicator (TPI) assigned to this transaction is Improbable, while the rest of Swedish covered bond programmes currently have a TPI of Probable-High. The TPI reflects the probability that payments on the covered bond will be made in a timely fashion following a CB anchor event. Refinancing risk is the single most important risk to timely payment for most programmes. (See "Covered bond analysis")
- » **Market risks:** Following a CB anchor event, covered bondholders may need to rely on proceeds that are raised via the sale of, or borrowed against, cover pool assets to make timely payments of the principal on the bonds. The market value of these assets may be subject to high volatility after a CB anchor event. Furthermore, there is an asset-liability mismatch because 74.8% of the cover pool assets carry a fixed rate of interest, while the outstanding covered bond carries a floating rate of interest. The issuer has not entered into any swap arrangement in the cover pool to mitigate this risk. However, the Swedish covered bond law requires issuers to consider market risks (including interest-rate and currency stresses) in the NPV asset coverage test if these risks are not mitigated by hedging arrangements. (See "Covered bond analysis")
- » **Time subordination:** After a CB anchor event, later-maturing covered bonds are subject to time subordination. Principal cash collections may be used on a first-come, first-served basis, paying earlier-maturing covered bonds before later-maturing covered bonds. This subordination could lead to the erosion of OC before any payments are made to later-paying covered bonds. (See "Covered bond analysis")
- » **Lack of liquidity facility:** The programme would not benefit from any designated source of liquidity if cash flow collections are interrupted. (See "Covered bond analysis")
- » **Economic uncertainty:** Our analysis has considered the increased uncertainty relating to the effect of the coronavirus outbreak on the Swedish economy as well as the effects that the announced government measures put in place to contain the virus, will have on the covered bond sponsor entity and the cover assets' performance. We regard the coronavirus outbreak as a social risk under our ESG framework, given the substantial implications for public health and safety. It is a global health shock, which makes it extremely difficult to provide an economic assessment. The degree of uncertainty around our forecasts is unusually high.

Key characteristics

Exhibit 2

Covered bond characteristics

Moody's Programme Number:	474
Issuer:	Bluestep Bank AB (publ)
Covered Bond Type:	Residential Mortgage Loans
Issued under Covered Bonds Law:	Yes
Applicable Covered Bonds Law:	Swedish Legal Framework for Covered Bonds
Entity used in Moody's TPI analysis:	Bluestep Bank AB (publ)
CR Assessment:	A2 (cr)
CB Anchor:	CR Assessment +1 notch
Senior unsecured/deposit rating:	Baa1
Total Covered Bonds:	SEK 1,700,000,000
Main Currency of Covered Bonds:	SEK (100.0%)
Extended Refinance Period:	No
Principal Payment Type:	Hard bullet
Interest Rate Type:	Floating rate covered bonds (100%), Fixed rate covered bonds (0.0%)
Committed Over-Collateralisation:	2.0%
Current Over-Collateralisation:	76.5% (on a nominal basis)
Intra-group Swap Provider:	n/a
Monitoring of Cover Pool:	Independent inspector appointed by the SFSA
Trustees:	n/a
Timely Payment Indicator:	Improbable
TPI Leeway:	1 notch

Sources: Moody's Investors Service, issuer data

Exhibit 3

Cover pool characteristics

Size of Cover Pool:	SEK 3,000,511,570
Main Collateral Type in Cover Pool:	Single family housing (62.2%), Tenant owner rights (37.8%)
Main Asset Location of Ordinary Cover Assets:	Sweden (100.0%)
Main Currency:	SEK (100.0%)
Loans Count:	3,083 Single family housing, 1,839 Tenant owner rights
Number of Borrowers:	2,238 Single family housing, 1,325 Tenant owner rights
WA Unindexed LTV:	67.0% Single family housing, 67.0% Tenant owner rights
WA Indexed LTV:	n/a
WA Seasoning (in months):	47 Single family housing, 33 Tenant owner rights
WA Remaining Term (in months):	429 Single family housing, 442 Tenant owner rights
Interest Rate Type:	Fixed rate assets (74.8%), Floating rate assets (25.2%)
Collateral Score:	15.0%
Cover Pool Losses:	32.1%
Further Cover Pool Details:	See Appendix 1
Pool Cut-off Date:	15 April 2020

Sources: Moody's Investors Service, issuer data

Exhibit 4

Transaction counterparties

Counterparty Type	Transaction Counterparty
Sponsor (if applicable)	n/a
Servicer (if not group entity)	n/a
Back-up servicer	n/a
Back-up servicer facilitator	n/a
Cash manager (if not group entity)	n/a
Back-up cash manager	n/a
Account bank	Danske Bank A/S
Standby account bank	n/a
Account bank guarantor	n/a

n/a: not applicable

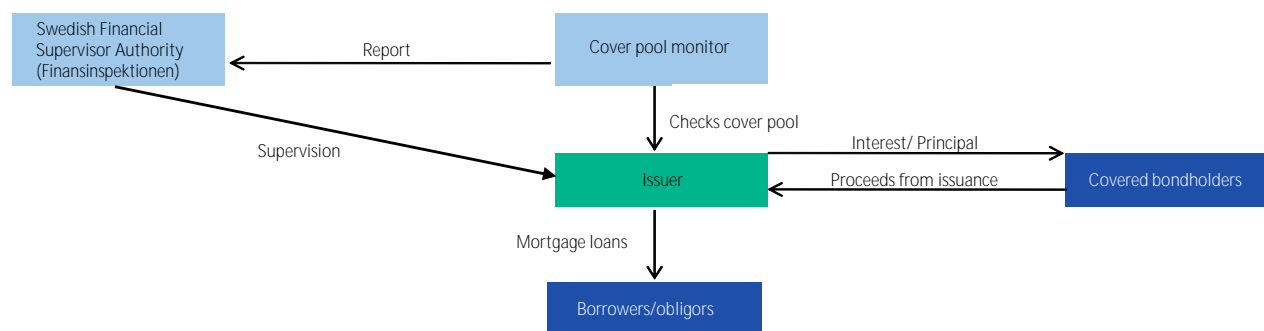
Sources: Moody's Investors Service, issuer data

Covered bond description

The covered bonds issued under the mortgage covered bond programme of Bluestep Bank AB are full recourse to the issuer. Upon a CB anchor event, covered bondholders would have access to a cover pool of residential mortgage loan receivables.

Structural diagram

Exhibit 5

Legal structure of Bluestep's covered bond transaction

Source: Moody's Investors Service

Structure description**The bonds**

All outstanding covered bonds have a bullet repayment at maturity, without any extension period for the repayment of the bonds.

Issuer recourse

The covered bonds are full recourse to the issuer. Therefore, the issuer is obliged to repay principal and pay interest on the covered bonds. The credit strength of Bluestep (A2(cr)) implies a credit strength of the covered bonds because while the issuer performs its payment obligations, there will be no loss to covered bondholders.

Recourse to cover pool and OC

If the issuer becomes insolvent, the covered bondholders would have priority claims over a pool of assets (cover pool). (See "Cover pool description" for the cover pool characteristics and "Cover pool analysis" for our analysis of the pool)

As of 15 April 2020, the level of OC in the programme was 76.5% on a nominal basis.

The current covered bond rating relies on an OC within the minimum legal requirements by the Swedish covered bond framework. The OC must exceed the principal balance of the bonds by 2% on a nominal and an NPV basis. Based on data as of 15 April 2020,

11.5% of OC is sufficient to maintain the current covered bond rating. This shows that our analysis currently relies on OC that is not in committed form.

Although the issuer has the ability to increase the OC in the cover pool if collateral quality deteriorates below a certain threshold, the issuer does not have any obligation to do so. The failure to increase OC following a deterioration of the collateral could lead to a negative rating action.

Sweden and its banking system

The credit profile of Sweden (Aaa, Stable) reflects its high wealth levels, resilient and diversified economy and strong growth potential. Competitiveness and innovation are key strengths and are underpinned by a highly skilled labour force and the country's technological advancement. While we do not expect the coronavirus-induced global recession expected for 2020 to alter the strength of Sweden's credit profile, it will affect its open economy, with risks to forecasts of economic growth tilted to the downside. (See [Government of Sweden – Aaa stable](#), April 2020, for an update on Sweden's credit profile).

Sweden's banking system outlook remains stable as we expect the country's lenders to be broadly resilient to the coronavirus outbreak. The negative economic growth in 2020 will increase banks' problem loans and add pressure on their profitability. However, the increase in non-performing loans starts from a very low base, and will be to some extent mitigated by policy measures aimed at supporting household and corporate finances. We also expect Swedish banks' capital to remain robust. (See [Banking System Outlook Update - Sweden](#), March 2020, for an update on Sweden's banking system).

Legal framework

The covered bonds are governed by the Swedish Covered Bond Issuance Act. There are a number of strengths in the Swedish covered bond legislation, including the regulation of the issuer by the Swedish Financial Supervisory Authority (SFSA or *Finansinspektionen*), as well as certain minimum requirements for the covered bonds and cover pool (see "Cover pool analysis - Additional cover pool analysis - Eligible assets"). A description of the general legal framework for Swedish covered bonds is available in Moody's covered bond legal framework report for Sweden. (See [Covered Bonds: Sweden - Legal Framework for Covered Bonds](#), January 2018, for a description of the general legal framework for Swedish covered bonds)

Commingling risk

The Swedish covered bond law requires that cover pool collections are held in a dedicated account. This should facilitate the identification and segregation of the issuer's funds relating to the cover pool following an issuer default. The issuer's accounts are provided by Danske Bank A/S. This adds a credit exposure to Danske Bank A/S, although its rating (deposit rating of A2/P-1) is a mitigating factor.

Covered bond analysis

Our credit analysis of the covered bonds primarily focuses on the issuer's credit quality, refinancing risk, interest rate risk and currency risk, as well as the probability that payments on the covered bonds would be made in a timely fashion following a CB anchor event, which we measure using the Timely Payment Indicator (See "Timely Payment Indicator").

Primary analysis

Issuer analysis - Credit quality of the issuer

The issuer's CR Assessment is A2(cr). (For a description of the issuer's rating drivers, see [Credit Opinion](#), published February 2020)

The reference point for the issuer's credit strength in our analysis is the CB anchor, which for this covered bond programme under the covered bond law in Sweden is the CR Assessment plus one notch.

Issuer analysis - Dependency on the issuer's credit quality

The credit quality of the covered bonds depends primarily on the credit quality of the issuer. If the issuer's credit strength were to deteriorate, there would be a greater risk that a CB anchor event would occur, leading to refinancing risk for the covered bonds. Consequently, the credit quality of the covered bonds would deteriorate unless other credit risks were to decrease.

In the event that the CB anchor deteriorates, the issuer would have the ability, but not the obligation, to increase the OC in the cover pool. Failure to increase the level of OC under these circumstances could lead to a negative rating action.

Reasons for the high level of dependency of the covered bonds with the issuer also include exposure to decisions made by the issuer in its discretion as manager of the covered bond programme. For example, before a CB anchor event, the issuer may add new assets to the cover pool and remove assets from the cover pool, issue further bonds and enter new hedging arrangements. Such actions could reduce the value of the cover pool.

As with most covered bonds in Europe, there are few contractual restrictions on the future composition of the cover pool, which creates substitution risk. Nevertheless, cover pool quality over time will be protected by, among other things, the requirements of the Swedish covered bond framework. (See "Cover pool analysis - Additional cover pool analysis - Eligible assets" and "Moody's related publications: Covered Bond Legal Frameworks")

Refinancing risk

Following a CB anchor event, the "natural" amortisation of the cover pool assets alone cannot be relied on to repay the principal. We assume that funds must be raised against the cover pool at a discount if covered bondholders are to receive timely principal payment. Where the portion of the cover pool that is potentially exposed to refinancing risk is not contractually limited, our expected loss analysis typically assumes that this amount is in excess of 50% of the cover pool.

After a CB anchor event, the market value of these assets may be subject to volatility. Examples of the stressed refinancing margins we use for different types of prime-quality assets are published in our Rating Methodology. (See "Moody's related publications - Moody's Approach to Rating Covered Bonds")

The refinancing-positive aspects of this covered bond programme include the following:

- » The support provided by the Swedish legal framework. The bankruptcy administrator has the ability to enter into senior-ranking liquidity loans and other financial arrangements to mitigate refinancing risk following issuer default. We understand that the administrator would also have the power to sell assets under the general law.
- » The relative size and depth of the Swedish market, its reliable domestic base and the importance of the covered bonds as a source of funding. These factors may incentivize existing market participants to acquire a cover pool at a better price.
- » The ability of the issuer to reset and increase loan rates at the interest rate date. As of 15 April 2020, 25.2% of the loans in the cover pool are mortgages with an interest reset date of three months. This right will also apply to any bankruptcy administrator in charge of the cover pool after an issuer default. This possibility to reset margins should materially reduce the level of refinancing risk compared with other markets where borrower's interest rates are fixed for long periods.

The refinancing-negative aspects of this covered bond programme include the following:

- » The mortgage loans backing the cover pool are non-conforming loans. These loans could be less liquid than standard loans in Sweden if the issuer or the administrator needs to sell them or raise funds against them following a CB anchor event. A yield higher than that of the traditional Swedish loans can make Bluestep's loans more attractive, though.
- » All outstanding covered bonds have a bullet repayment at maturity, without any extension period for the repayment of the bonds.
- » In line with other European covered bond programmes, upon a CB anchor event we expect the cover pool assets will have a significantly higher WAL than the outstanding covered bonds. While the WAL of the covered bonds is expected to be short (currently three years), the WAL of the loans in the cover pool is particularly long, rounding 24 years. The main reason is that loans usually have a very long life in Sweden. However, unlike other pools in Sweden, all the loans in the cover pool are amortizing, and show an average prepayment rate higher than that of other Swedish cover pools.
- » The covered bonds do not benefit from liquidity reserves or structural alternatives such as a pre-maturity test.

Interest rate and currency risk

As with most European covered bonds, there is potential for interest rate and currency risks to arise from the different payment promises and durations of the cover pool and the covered bonds.

Exhibit 6

Overview of assets and liabilities

	WAL Assets (Years)	WAL Liabilities (Years)	Assets (%)	Liabilities (%)
Fixed rate	24.1	n.a	52.7%	0.0%
Variable rate	24.1	3.0	47.3%	100.0%

WAL: weighted average life

Fixed-rate loans that reset within the next 12 months are treated as variable rate in this table

n/a: not applicable

Sources: Moody's Investors Service, issuer data

In the event of issuer insolvency, we currently do not assume that the insolvency administrator would always be able to efficiently manage any natural hedge between the cover pool and the covered bonds. Therefore, following a CB anchor event, our model would separately assess the impact of increasing and decreasing interest rates on the expected loss of the covered bonds, taking the path of interest rates that leads to the worst result. The interest rate and currency stresses used over different time horizons are published in our Rating Methodology.

Aspects of this covered bond programme that are market-risk positive include the following:

- » There is currently no currency risk in this programme because all of the assets and liabilities are denominated in Swedish Kronas (SEK).
- » The Swedish covered bond law requires issuers to consider market risks (including interest-rate and currency stresses) in the NPV asset coverage test if these risks are not mitigated by hedging arrangements.

Aspects of this covered bond programme that are market-risk negative include the following:

- » A vast majority of the cover pool assets (74.8%) carry a fixed rate of interest, but the outstanding covered bond carries a floating rate of interest.
- » The WAL of the covered bonds is expected to remain shorter than the WAL of the cover pool assets, as with most covered bonds in Europe. A potential sale of fixed-rate assets (to meet due payments on covered bonds following issuer's default) could therefore lead to a crystallisation of mark-to-market losses caused by interest-rate movements.
- » No hedging arrangements have been entered into the cover pool. Including hedging arrangements in the cover pools is typical for Swedish covered bond programmes.

Timely Payment Indicator

Our Timely Payment Indicator (TPI) assesses the likelihood that timely payments would be made to covered bondholders following a CB anchor event, and thus determines the maximum rating a covered bond programme can achieve with its current structure while allowing for the addition of a reasonable level of OC. We have assigned a TPI of Improbable to these covered bonds.

The TPI leeway measures the number of notches by which we might lower the CB anchor before the rating agency downgrades the covered bonds because of TPI framework constraints. Based on the current TPI of Improbable, the TPI leeway for this programme is one notch.

The TPI-positive aspects of this covered bond programme include:

- » The refinancing-positive aspects discussed in the "Refinancing Risk" section.
- » The level of support expected for covered bonds in Sweden.
- » The Swedish covered bond law also requires minimum OC of 2.0% on a nominal and an NPV basis (at present, the cover pool has OC of 76.5% on a nominal basis).

The TPI-negative aspects of this covered bond programme include:

- » The refinancing-negative aspects discussed in the "Refinancing Risk" section.

- » The credit quality of the cover pool assets, which is reflected in the collateral score of 15.0%.
- » There could be commingling risk if Danske Bank A/S becomes insolvent, but its rating is a mitigating factor. (See "Covered bonds description - Structure description - Commingling risk")

Additional analysis

Liquidity

The covered bond programme does not benefit from any designated source of liquidity if cash flow collections are interrupted. After an issuer default, the bankruptcy administrator has the ability to enter into senior-ranking liquidity loans to make timely payments on the bonds. Although not specifically addressed by the covered bond law, we understand that the administrator would also be empowered to sell cover pool assets under the general law.

Time subordination

After a CB anchor event, later-maturing covered bonds would be subject to time subordination. Principal cash collections may be used on a first-come, first-served basis, paying earlier-maturing covered bonds before later-maturing covered bonds. Such payments could result in the erosion of OC before any payments are made to later-paying covered bonds. If the law's matching requirements can no longer be met, the cover pool no longer has to be maintained as a unit and bondholders can be paid *pari passu* and in principle, at the same time. However, this may not prevent the erosion of OC before a determination that the matching requirements can no longer be met.

Cover pool description

Pool description as of 15 April 2020

As of 15 April 2020, the cover pool consisted of non-conforming residential mortgage loans backed by properties in Sweden.

On a nominal value basis, the cover pool assets total SEK 3.0 billion, which back SEK 1.7 billion in covered bonds, resulting in an OC level of 76.5% on a nominal basis.

For Bluestep underwriting criteria, see "Appendix: Income underwriting and valuation".

The typical loan is a SEK 850,000, 3-year-fixed rate loan, with an LTV of 70%, amortizing, with monthly installments and SEK denominated. The maximum term is 40 years.

Swedish non-conforming loans

These are residential mortgage loans granted to borrowers who do not meet the Swedish tight standard lending criteria, and are, for different reasons, rejected by Swedish traditional banks. Bluestep applies a differentiated approach to assessing borrowers' credit worthiness, focusing on understanding each customer's situation and their future financial ability to service the debt, and applying broader underwriting criteria than Swedish traditional banks. Its underwriting is detailed and allows it to make a careful assessment of the risks. This is supported by the good data availability in Sweden (UC reports) that allows lenders to verify information needed for the debt affordability calculation.

The non-conforming segment in Sweden is small and underdeveloped, representing less than 0.5% of the market.

These loans have a higher interest rate than standard loans in Sweden. The interest rate usually ranges from 4% to 7%, depending on the credit quality. This interest rate is higher than that of the traditional banks, which currently move around 1.25%-2%. The prepayment rate of Bluestep mortgage loans is usually higher than that of traditional banks.

The cover pool will be an accurate representation of all mortgage loans in the balance sheet. Non-conforming loans include, amongst others:

- » loans to borrowers with credit remarks at the Central Credit Reference Agency (UC), which is Sweden's leading business and credit reference agency. The UC gathers and processes information so it can be used by companies and private individuals to make more reliable business decisions. It captures almost 100% of the mortgages. The UC stores three years of payment history, so credit remarks are cleaned after three years. Some of these borrowers may have unpaid debts with the Swedish Enforcement Authority (KFM). The KFM can collect debts for individuals and businesses as well for the government. The KFM has a range of responsibilities, including enforcement, debt collection and injunctions to pay, and assistance, debt relief and supervision in bankruptcy. All borrower's unpaid debts with the KFM need to be redeemed at payout of the mortgage granted by Bluestep.
- » debt consolidation loans, which help borrowers without payment remarks to take out a mortgage loan to pay off other loans, usually unsecured and more expensive than a mortgage loan.
- » loans to borrowers with limited credit history or variable income
- » loans to self-employed borrowers or borrowers with modern jobs
- » loans to retirees

Single family housing loans

As Exhibit 6 below shows, residential mortgage loans backed by single family housing amount to SEK 1.9 billion (62.2% of the cover pool). All the properties backing these residential loans are located in Sweden with particular geographical concentration in *Östra mellansverige* (21.4%). All assets in the cover pool are performing or not in arrears for more than 60 days.

The weighted average unindexed LTV for single family housing residential loans is 67.0%.

Exhibits 7 through 8 show more details about the cover pool characteristics.

Loans to tenant owner rights

Individual apartments are usually not for sale in Sweden — only the right to reside in one (through becoming a member of a co-operative) can generally be purchased.

The co-operative owns the property (e.g. an apartment block) in which the tenant owner apartment is situated. The co-operative is an incorporated, non-profit association with limited liability whose members consist of the individuals living in the various tenant owner apartments within the co-operative's apartment block. The co-operative usually has a mortgage outstanding (the major part of which would have been taken out by the cooperative upon its establishment to purchase the apartment block), secured by mortgage deed (*pantbrev*) over its apartment block.

By becoming a member of the co-operative, the borrower is granted a perpetual right to reside in the relevant tenant owner apartment. The borrower funds the purchase of this right through a tenant owner right loan. Co-operative memberships together with these associated perpetual rights command a market value and can be bought and sold in the residential market. Also, the borrower will have to pay a monthly fee to the co-operative to cover a proportion of the servicing of any mortgage taken out by the co-operative and any on-going fees to cover maintenance of the co-operative's apartment block.

As Exhibit 8 below shows, residential mortgage loans backed by tenant owner rights amount to SEK 1.1 billion (37.8% of the cover pool). All the properties backing these residential loans are located in Sweden with particular geographical concentration in *Stockholms län* (54.6%). All assets in the cover pool are performing or not in arrears for more than 60 days.

The weighted average unindexed LTV for the loans to tenant owner rights is 67.0%.

Exhibits 9 through 10 show more details about the cover pool characteristics.

Exhibit 7

Cover pool summary - Single family housing residential assets

Overview		Specific Loan and Borrower characteristics	
Asset type:	Residential	Loans with an external guarantee in addition to a mortgage:	0.0%
Asset balance:	1,867,729,464	Interest only Loans / Flex Loans	0.0% / 0.0%
Average loan balance:	605,816	Loans for second homes / Vacation:	2.2%
Number of loans:	3,083	Buy to let loans / Non owner occupied properties:	0.0%
Number of borrowers:	2,238	Limited income verified:	0.0%
Number of properties:	2,160	Adverse credit characteristics (**)	3.5%
WA remaining term (in months):	429		
WA seasoning (in months):	47		
Details on LTV		Performance	
WA unindexed LTV	67.0%	Loans in arrears (≥ 2months - < 6months):	0.0%
WA Indexed LTV	n/a	Loans in arrears (≥ 6months - < 12months):	0.0%
Valuation type:	Market Value	Loans in arrears (≥ 12months):	0.0%
LTV threshold:	75.0%	Loans in a foreclosure procedure:	0.0%
Junior ranks (*):	0.0%		
Loans with Prior Ranks:	0.0%		

(note *) Internal junior ranks: delta between Unindexed whole loan WA LTV including internal junior ranks and unindexed WA LTV excluding internal junior ranks.

(note **) Typically borrowers with a previous process related to "Foreclosure".

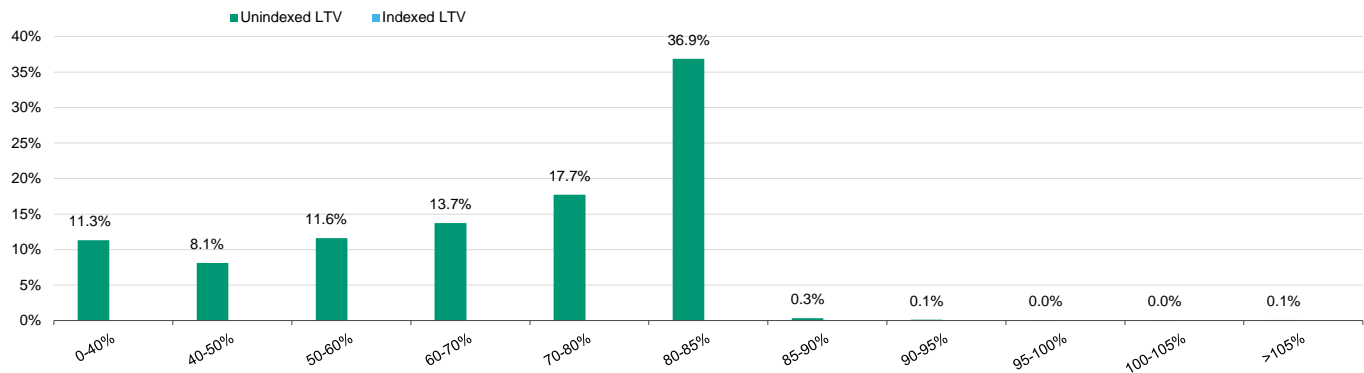
Sources: Moody's Investors Service, issuer data

Exhibit 8

Cover pool characteristics - Single family housing

Exhibit A

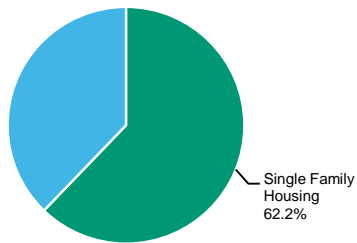
Balance per LTV band



Sources: Moody's Investors Service, issuer data

Exhibit B

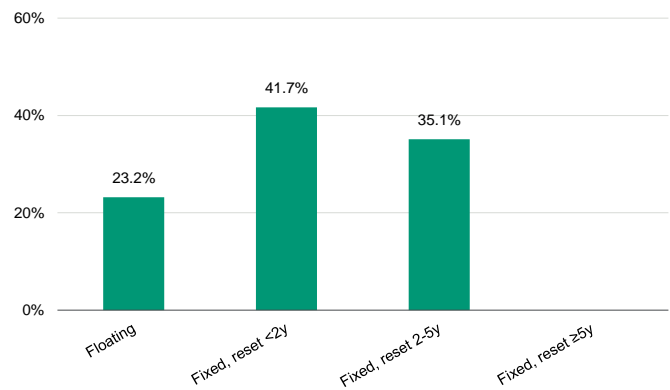
Percentage of residential assets



Sources: Moody's Investors Service, issuer data

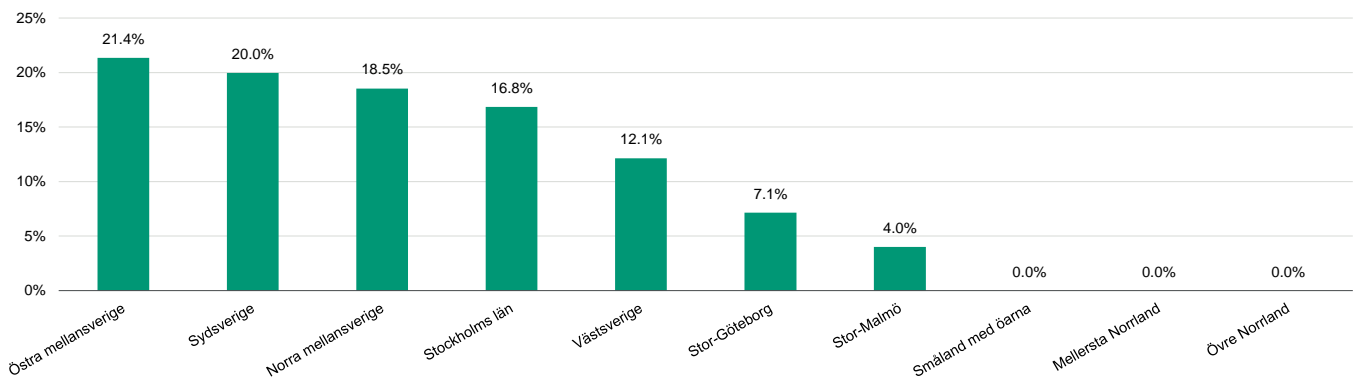
Exhibit C

Interest rate type



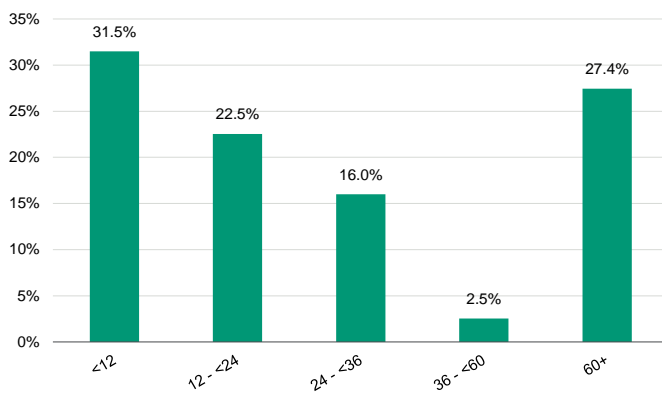
Sources: Moody's Investors Service, issuer data

Exhibit D

Main country regional distribution

Sources: Moody's Investors Service, issuer data

Exhibit E

Seasoning (in months)

Sources: Moody's Investors Service, issuer data

Exhibit 9

Cover pool summary - Tenant owner rights

Overview		Specific Loan and Borrower characteristics	
Asset type:	Residential	Loans with an external guarantee in addition to a mortgage:	0.0%
Asset balance:	1,132,782,106	Interest only Loans / Flex Loans	0.0% / 0.0%
Average loan balance:	615,977	Loans for second homes / Vacation:	0.0%
Number of loans:	1,839	Buy to let loans / Non owner occupied properties:	0.0%
Number of borrowers:	1,325	Limited income verified:	0.0%
Number of properties:	1,304	Adverse credit characteristics (**)	2.3%
WA remaining term (in months):	442		
WA seasoning (in months):	33		
Details on LTV		Performance	
WA unindexed LTV:	67.0%	Loans in arrears (≥ 2months - < 6months):	0.0%
WA Indexed LTV:	n/a	Loans in arrears (≥ 6months - < 12months):	0.0%
Valuation type:	Market Value	Loans in arrears (≥ 12months):	0.0%
LTV threshold:	75.0%	Loans in a foreclosure procedure:	0.0%
Junior ranks (*)	0.0%		
Loans with Prior Ranks:	0.0%		

(note*) Internal junior ranks: delta between Unindexed whole loan WA LTV including internal junior ranks and unindexed WA LTV excluding internal junior ranks.

(note **) Typically borrowers with a previous process related to "Foreclosure".

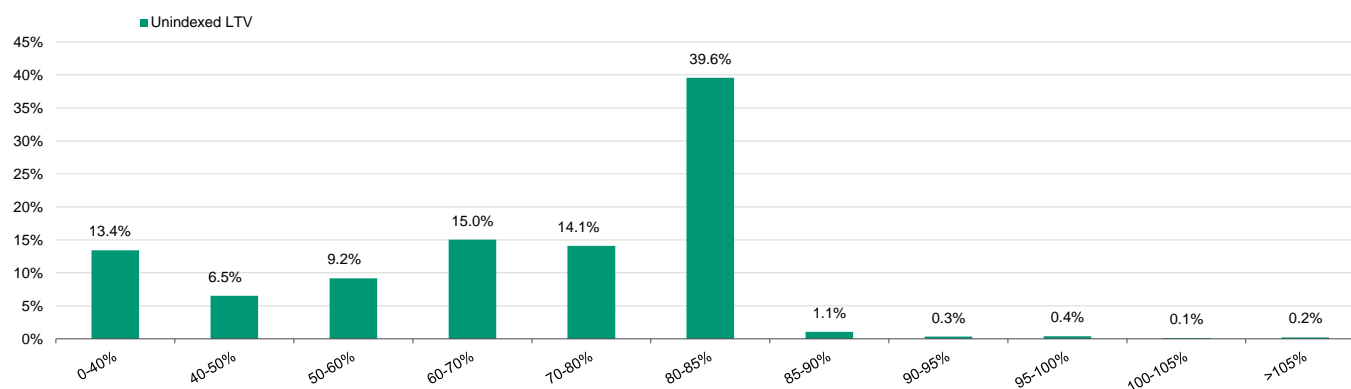
Sources: Moody's Investors Service, issuer data

Exhibit 10

Cover pool characteristics - Tenant owner rights

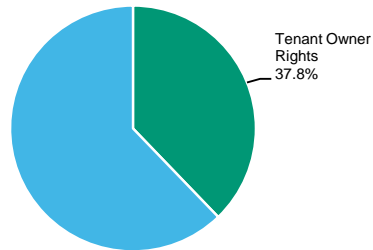
Exhibit A

Balance per LTV band



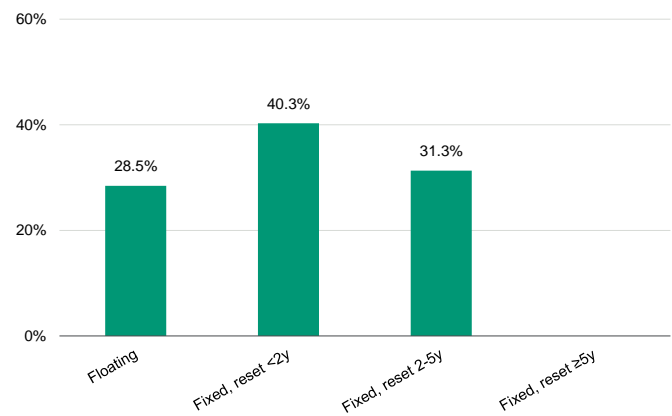
Sources: Moody's Investors Service, issuer data

Exhibit B

Percentage of residential assets

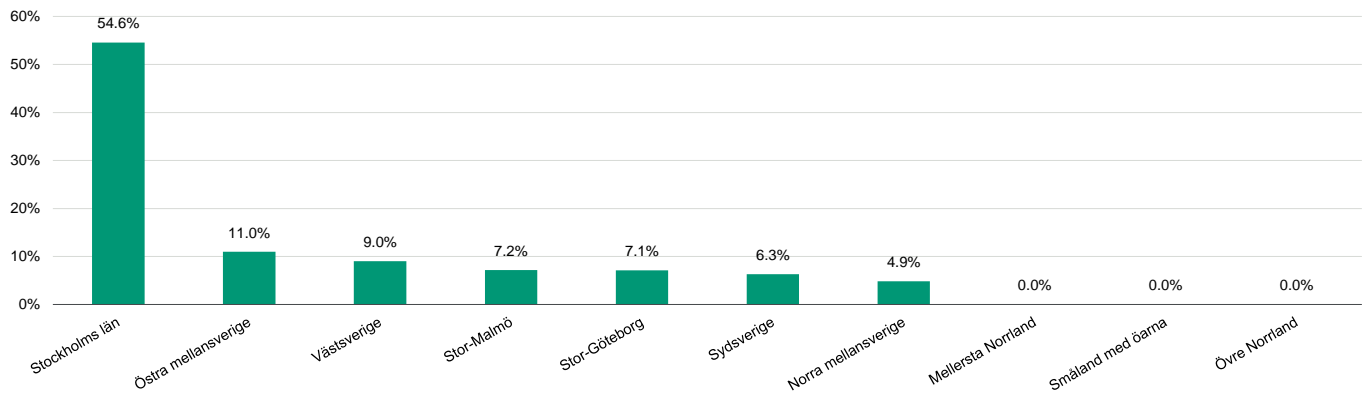
Sources: Moody's Investors Service, issuer data

Exhibit C

Interest rate type

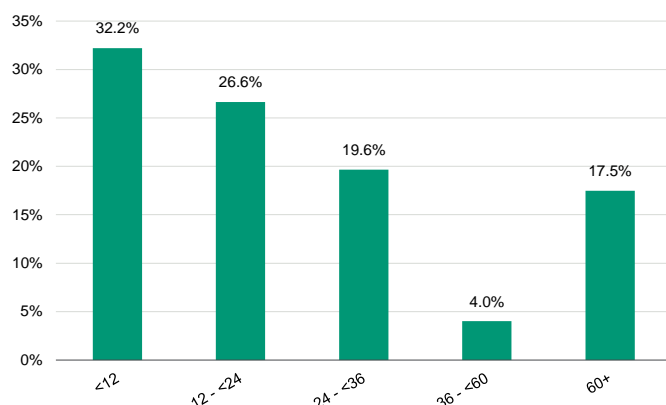
Sources: Moody's Investors Service, issuer data

Exhibit E

Main country regional distribution

Sources: Moody's Investors Service, issuer data

Exhibit F

Seasoning (in months)

Sources: Moody's Investors Service, issuer data

Cover pool monitor

The SFSA appoints an independent inspector (cover pool monitor) whose duties include checking that the cover pool register is correctly maintained and reporting to the SFSA. For more details on the cover pool monitor's role, see Moody's Related Research: Covered Bond Legal Frameworks. (See "Moody's related publications: Covered Bond Legal Frameworks")

Cover pool analysis

Our credit analysis of the pool takes into account specific characteristics of the pool, as well as legal risks.

Primary cover pool analysis

We calculate the collateral score for the residential mortgages using a scoring model that estimates loss in severe recession scenario. Our analysis takes into account, among other factors, the LTV ratios of the mortgage loans, the seasoning and the geographical distribution.

Furthermore, we use performance data provided by the issuer in addition to other relevant data to extrapolate expected losses for the cover pool.

The collateral quality is reflected in the 15.0% collateral score of the pool, which is much higher than the average collateral score of the mortgage covered bonds in Sweden. (For details, see "Moody's related publications - Moody's Global Covered Bonds Sector Update, Q4 2019")

From a credit perspective we view the following pool characteristics as credit positive:

- » All loans in the cover pool are currently performing or in arrears for less than 35 days (following internal rules). Nonperforming assets are excluded from coverage tests at 60 days past due by law.
- » The loans have an average seasoning of 47 months for single family housing loans and 33 for tenant owner rights.
- » The issuer is stressing the interest rate of all loans in the cover pool when assessing the borrower's mortgage affordability. The stress applied is normally 3%, i.e. lower than the stress applied by traditional Swedish banks (around 5%). However, the stressed rate in Bluestep's case usually exceed the stressed rate (around 7%) of traditional banks, as Bluestep's mortgage loans carry higher interest rates at origination.
- » All the loans in the pool are amortizing. This differs from several loans in Swedish cover pools, which are non-amortizing loans, and may be subject to increased default risk if there is a large one-off payment obligation for borrowers at loan maturity.

- » A vast majority of the cover pool loans (74.8%) carry a fixed rate of interest, which makes these loans less susceptible to rising interest rates. However, the average fixing period of these loans is lower than three years.
- » The average debt-to-income ratio (DTI, borrower's total debt over borrower's gross annual income) of the loans in the cover pool is low, rounding 230%. This level is close to the DTI ratio for the entire household sector, which rounds 190%, and below the average debt-to-income ratio among new mortgage borrowers in Sweden, which is almost 300% (according to Finansinspektionen latest mortgage survey).
- » Cover pools must be stress tested against falls of up to 30% in mortgaged property values. Issuers must report the outcome of the tests to the Swedish FSA and state how the issuer will improve cover pool matching if price falls are experienced.
- » There are no commercial loans in the cover pool. Loans backed by commercial property are not permitted to exceed 10% of the cover pool.

From a credit perspective, we regard the following characteristics of the residential mortgage loans as credit negative:

- » Almost 40% of the loans in the cover pool have an unindexed LTV ratio (current loan balance / original property valuation) higher than 80%. We assume one of the key drivers of default probability and loss severity within a market to be the LTV ratio. However, all the loans in the cover pool have an indexed LTV (current loan balance / current property valuation) lower than 80%. In Sweden, mortgage loans may be included in the cover pool to the extent that the loan lies within 75% of the current market value in relation to residential property. Mortgage loan parts that materially exceed the 75% LTV threshold should be removed from the cover pool, supporting the quality of over-collateralisation.
- » Around 37% of the loans in the cover pool were granted to borrowers with credit remarks.
- » Around 30% of the loans in the cover pool were granted for the purpose of debt consolidation.
- » Around 17% of the loans in the cover pool were granted to borrowers with limited credit history or variable income.
- » Loans in the cover pool are bearing high interest rates. The weighted-average interest rate of the pool is 5.4%, much higher than that of standard mortgage loans in Sweden, which can endanger the borrowers' affordability in an economic downturn scenario. On the other hand, the issuer could lower these interest rates in case of need.

Performance data

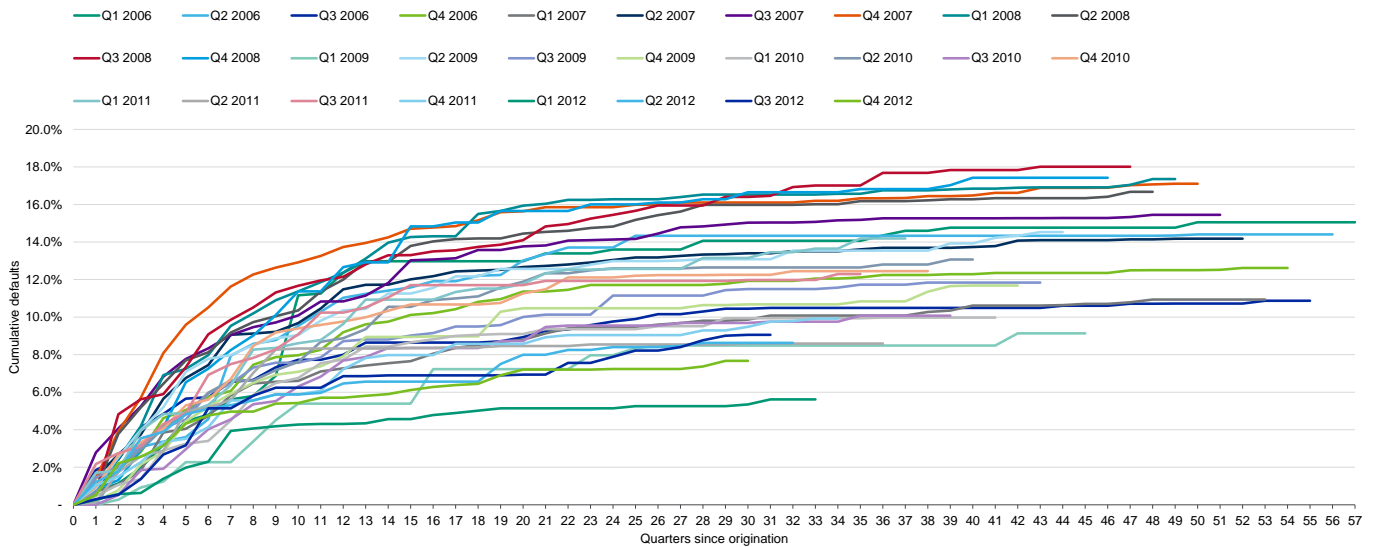
The originator provided us with performance data on its whole mortgage loan portfolio. Both default and recovery data span over a long period (2006 to 2019).

The average extrapolated cumulative default rate on the total portfolio is around 9%; younger vintages are exhibiting better performance than the older ones (see Exhibits 11 and 12).

The average extrapolated cumulative recovery rate on the total portfolio is around 88%; Both old and young vintages are exhibiting a good recovery rate (see Exhibits 13 and 14).

Exhibit 11

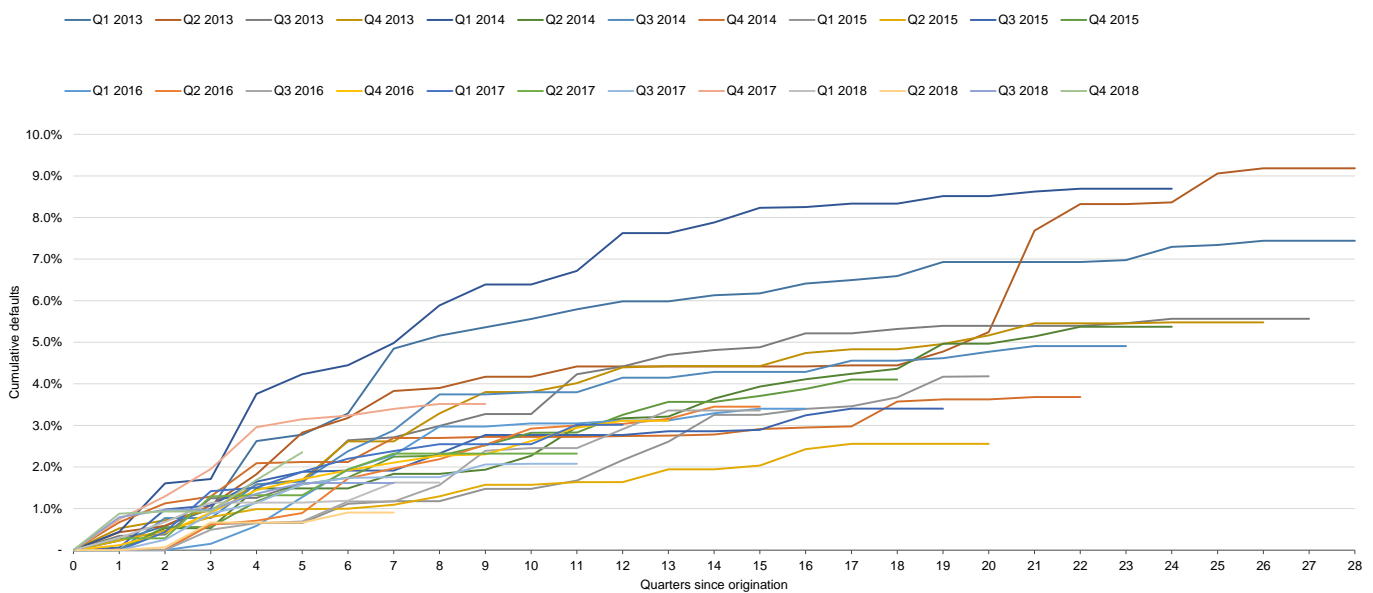
Vintage default data for the total portfolio (2006-2012)



Source: Bluestep

Exhibit 12

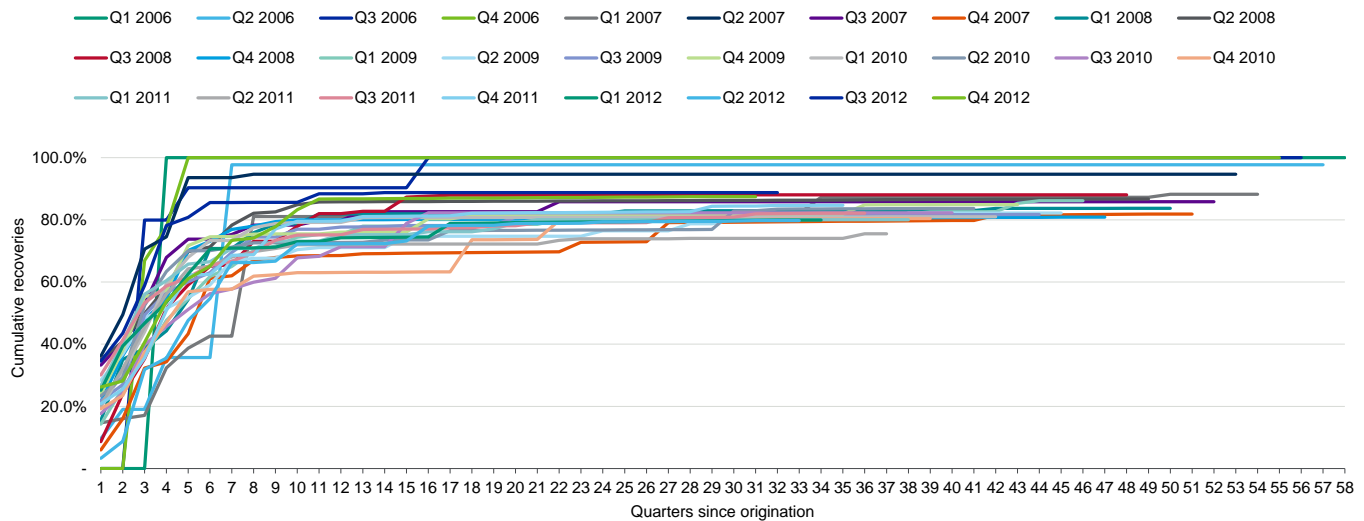
Vintage default data for the total portfolio (2013-2018)



Source: Bluestep

Exhibit 13

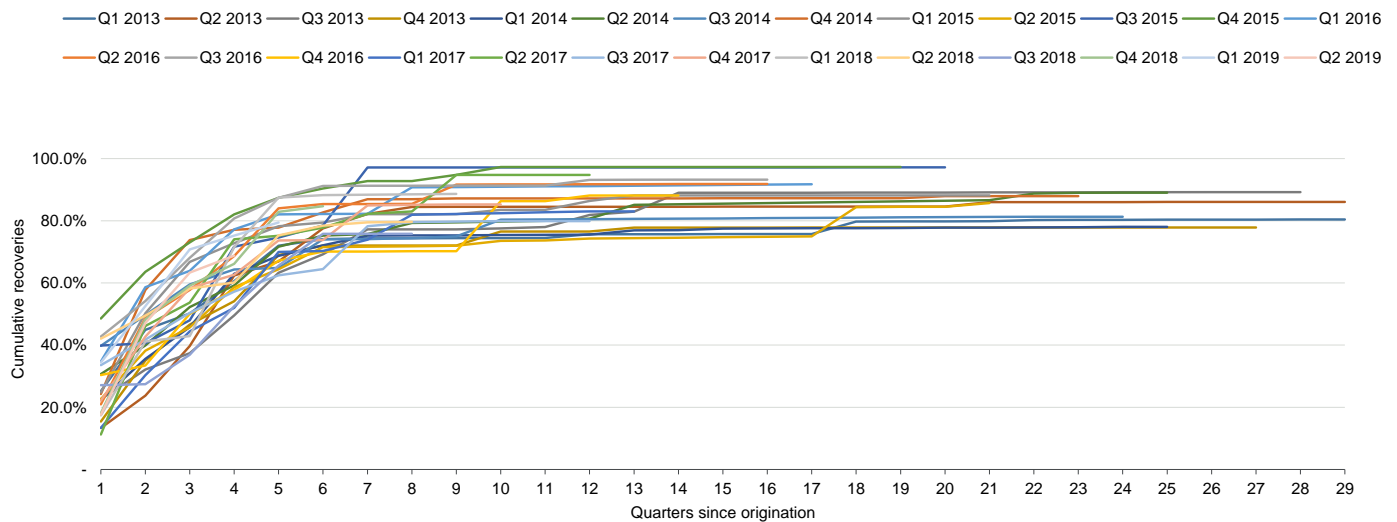
Vintage recovery data for the total portfolio (2006-2012)



Source: Bluestep

Exhibit 14

Vintage recovery data for the total portfolio (2013-2019)



Source: Bluestep

Comparables

Exhibit 15

Comparables - Bluestep Bank AB and other selected mortgage covered bonds

PROGRAMME NAME	BlueStep Bank AB (publ) - Mortgage Covered Bonds	Skandiabanken AB - Mortgage Covered Bonds	Lansforsakringar Hypotek AB - Mortgage Covered Bonds2	The Swedish Covered Bond Corporation (SBAB) - Mortgage Covered Bonds
Overview				
Programme is under the law	Sweden	Sweden	Sweden	Sweden
Main country in which collateral is based	Sweden	Sweden	Sweden	Sweden
Country in which issuer is based	Sweden	Sweden	Sweden	Sweden
Total outstanding liabilities	1,700,000,000	29,173,000,000	179,775,290,000	243,367,736,101
Total assets in the Cover Pool	3,000,511,570	38,410,467,454	240,428,808,727	313,017,812,470
Issuer name	BlueStep Bank AB (publ)	Skandiabanken AB	Lansforsakringar Hypotek	The Swedish Covered Bond Corporation
Issuer CR assessment	A2(cr)	Aa3(cr)	n/a	n/a
Group or parent name	n/a	n/a	Länsförsäkringar Bank AB (publ)	SBAB Bank AB (publ)
Group or parent CR assessment	n/a	n/a	Aa3(cr)	Aa3(cr)
Main collateral type	Residential	Residential	Residential	Residential
Collateral types	Residential 100%, Commercial 0%, Public Sector 0%, Other/Supplementary assets 0%	Residential 100%, Commercial 0%, Public Sector 0%, Other/Supplementary assets 0%	Residential 96%, Commercial 0%, Public Sector 0%, Other/Supplementary assets 4%	Residential 100%, Commercial 0%, Public Sector 0%, Other/Supplementary assets 0%
Ratings				
Covered bonds rating	Aa1	Aaa	Aaa	Aaa
Entity used in Moody's EL & TPI analysis	BlueStep Bank AB (publ)	Skandiabanken AB	Lansforsakringar Bank AB (publ)	SBAB Bank AB (publ)
CB anchor	CR Assessment + 1 notch	CR Assessment + 1 notch	CR Assessment + 1 notch	CR Assessment + 1 notch
CR Assessment	A2(cr)	Aa3(cr)	Aa3(cr)	Aa3(cr)
SUR / LT Deposit	Baa1	n/a	A1	A1
Unsecured claim used for Moody's EL analysis	Yes	Yes	No	No
Value of Cover Pool				
Collateral Score	15.0%	5.0%	5.0%	5.0%
Collateral Score excl. systemic risk	n/a	n/a	n/a	n/a
Collateral Risk (Collateral Score post-haircut)	10.1%	3.4%	3.4%	3.4%
Market Risk	22.1%	6.6%	9.4%	8.3%
Over-Collateralisation Levels				
Committed OC*	2.0%	2.0%	10.0%	2.0%
Current OC	76.5%	31.7%	33.7%	28.6%
OC consistent with current rating	11.5%	0.0%	1.5%	1.5%
Surplus OC	65.0%	31.7%	32.2%	27.1%
Timely Payment Indicator & TPI Leeway				
TPI	Improbable	Probable-High	Probable-High	Probable-High
TPI Leeway	1	4	4	4
Reporting date	15 April 2020	31 December 2019	31 December 2019	31 December 2019

Source: Moody's Investors Service

Additional cover pool analysis

Eligible assets

The Swedish covered bond law provides that mortgage loans may be included in the cover pool to the extent that the loan lies within:

- » 75% of the market value in relation to residential property (including loans backed by multi-family properties);
- » 70% of the market value in relation to agricultural property; or
- » 60% of the market value in relation to property for commercial or office use.

The issuer must continually monitor property values. If these values decline significantly, the portion of the loan in the cover pool should be adjusted downwards so that it remains within the LTV limits specified above.

Loans registered in the cover pool that exceed the LTV thresholds by a certain margin are expected to be removed or reduced before issuer default. However, we expect that any loans that remain in the cover pool post-insolvency would be likely to be subject to priority rights, provided they are properly registered.

Set-off risk

Set-off rights would mainly arise where a mortgage loan borrower is also a deposit holder with the issuer. Following issuer default, it is likely that the borrower would seek to set off the amount of its deposit claim against its mortgage obligation, thereby depleting the cover pool of assets.

The covered bond law does not contain specific provisions on set-off. However, this risk is typically small because retail deposits are covered, at least in part, by the Swedish deposit guarantee scheme. Furthermore, a significant portion of Bluestep customers belong to a segment of the population that may have fewer savings in their deposits account than the average in Sweden.

Methodology and monitoring

The primary methodology we use in rating the issuer's covered bonds is "Moody's Approach to Rating Covered Bonds", published in February 2019. Other methodologies and factors that may have been considered in the rating process can also be found on <http://www.moodys.com>. In addition, we publish a weekly summary of structured finance credit, ratings and methodologies, available to all registered users of our website, at www.moodys.com/SFQuickCheck.

We expect the issuer to deliver certain performance data to us on an ongoing basis. In the event that this data is not made available to us, our ability to monitor the ratings may be impaired. This lack of data availability could negatively affect the ratings or, in some cases, our ability to continue to rate the covered bonds.

Appendix: Income underwriting and valuation

Exhibit 16

Income underwriting and valuation

A. Residential Income Underwriting

1 Is income always checked?	Yes
2 Does this check ever rely on income stated by borrower ("limited income verification") ?	Income stated by borrower only used as a complement to public/third party sources (e.g. UC, employer, Bolagsverket etc.)
3 Percentage of loans in Cover Pool that have limited income verification	Not applicable
4 If limited income verification loans are in the Cover Pool, describe what requirements lender has in place for these loans.	Not applicable
5 Does income in all cases constrain the amount lent (for example through some form of Income Sufficiency Test ("IST"))?	Yes. Full affordability calculation is performed for all loans and this governs the maximum loan amount (in combination with LTV-restrictions) on a case by case basis
6 If not, what percentage of cases are exceptions.	Not applicable
For the purpose of any IST:	
7 Is it confirmed that income after tax is sufficient to cover both interest and principal?	Yes, income after tax covers both interest and amortizations
8 If so over what period is it assumed principal will be paid (typically on an annuity basis)? Any exceptions?	Maximum 40 years with serial amortization (loans with straight-line amortization may have a bullet repayment on year 40, depending on whether yearly amortization is 1%, 2% or 3%)
9 Does the age of the borrower constrain the period over which principal can be amortised?	No
10 Are any stresses made to interest rates when carrying out the IST? If so when and for what type of products?	Yes, interest rates are stressed by 3% (for floating rates and after fixed period for fixed rate loans)
11 Are all other debts of the borrower taken into account at the point the loan is made?	Yes. The customer is always asked to state all their debts. The vast majority of debts is also captured through UC. All debts are subjected to stress tests.
12 How are living expenses of the borrower calculated? And what is the stated maximum percentage of income (or income multiple if relevant) that will be relied on to cover debt payments. (specify if income is pre or post tax)	Debt payments are based on actual costs. Costs related to maintenance of the property (e.g. heating) are calculated on a property-by-property basis. Other living expenses are based on the number of adults and the number of children in the household. A positive "left-to-live-on"-value is required (after all household expenses, including debt servicing).
Other comments	

B. Residential Valuation

1 Are valuations based on market or lending values?	Lending decisions are always based on market values
2 Are all or the majority of valuations carried out by external valuers (with no direct ownership link to any company in the Sponsor Bank group)?	Yes
3 How are valuations carried out where an external valuer not used?	Not applicable
4 What qualifications are external valuers required to have?	Authorized real estate agents or authorized appraisers
5 What qualifications are internal valuers required to have?	Not applicable
6 Do all external valuations include an internal inspection of a property?	No
7 What exceptions?	Valuations performed by authorised real estate agents or authorised appraisers include internal inspections
8 Do all internal valuations include an internal inspection of a property?	Not applicable
9 What exceptions?	Not applicable
Other comments	

Source: Issuer

Moody's related publications

Rating Methodology

- » [Moody's Approach to Rating Covered Bonds, February 2019 \(1154442\)](#)

Sector In-Depth

- » [Coronavirus fallout will test covered bond credit quality, but overall strengths will remain, April 2020 \(1221857\)](#)
- » [Covered bonds – Sweden, Norway and Finland: New EU rules are credit positive, but do not address some negatives in national frameworks, August 2019 \(1185005\)](#)

Special Comments

- » [Norwegian and Swedish central banks scale up repo access for own-issued covered bonds to mitigate coronavirus effects, March 2020 \(1220307\)](#)
- » [Covered Bonds: Sector update – Q4 2019, February 2020 \(1214672\)](#)
- » [Covered Bonds – Europe: 2020 Outlook, December 2019 \(1195667\)](#)
- » [Sector update – Q1 2019: EU covered bond law supports credit standards, May 2019 \(1166962\)](#)

Credit Opinion

- » [Bluestep Bank AB](#)

Webpages

- » Covered Bonds: www.moody.com/coveredbonds
- » Covered Bond Legal Frameworks: www.moody.com/Pages/CoveredBondLegalFrameworks.aspx

To access any of these reports or webpages, click on the entry above. Note that these references are current as of the date of publication of this report and that more recent reports may be available. All research may not be available to all clients.

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