

## RATING ACTION COMMENTARY

# Fitch Upgrades Millennium Bank Hipoteczny's Pass-Through Covered Bonds to 'AAA'; Outlook Stable

Wed 03 Jul, 2024 - 09:20 ET

Fitch Ratings - Frankfurt am Main - 03 Jul 2024: Fitch Rating has upgraded Millennium Bank Hipoteczny S.A.'s (MBH) mortgage covered bond to 'AAA' from 'AA+'. The Outlook is Stable.

The rating action follows the upgrade of Bank Millennium S.A.'s (BM) Long-Term Issuer Default Rating (IDR) to 'BB+' (See "Fitch Upgrades Bank Millennium to 'BB+'; Outlook Positive" dated 28 June 2024), which acts as reference IDR for the programme.

## KEY RATING DRIVERS

**10 Notches Above IDR:** The covered bonds are rated 10 notches above BM's Long-Term Issuer Default Rating (IDR) of 'BB+', using all notches of uplift granted to the programme, which comprise a resolution uplift of zero notches, a payment continuity uplift (PCU) of eight notches and a recovery uplift of two notches. It also considers the programme's over-collateralisation (OC) protection for covered bond holders. The Outlook on the covered bonds is Stable, even though BM's IDR is on Positive Outlook, because the covered bonds are rated at the highest possible level on our rating scale.

**Sufficient OC Protection:** MBH has committed to holding OC in line with Fitch's break-even (BE) OC for the rating. The Polish covered bond legislation stipulates a minimum OC of 5% for this type of covered bond programme. Fitch relies on the committed OC of currently 10.5%, which corresponds to Fitch's 'AAA' BE OC.

**No Resolution Uplift:** Fitch does not assign any resolution uplift to MBH's mortgage covered bonds as information on the resolution strategy for Polish specialised mortgage banks remains insufficient. As a result, the possibility of separate resolutions for mortgage and parent banks that could lead to an enforcement of the cover pool cannot be excluded.

**Eight-notch PCU:** The eight-notch PCU reflects the bonds' CPT feature and 180-day liquidity buffer as stipulated in the Polish covered bond legislation. The bonds can extend the bond principal maturity by 12 months following an issuer bankruptcy and can then ultimately switch to pass-through with a bond maturity three years after that of the longest asset.

The liquidity buffer is based on the maximum cumulative net outflows over 180 days, including maturity extension for the bonds. The programme is expected to hold a stable amount of liquid assets, sufficient to cover at least three months of senior fees and interest expenses. Liquid assets held under the buffer are considered at their market value.

**'AAA' BE OC:** Fitch calculated a 'AAA' BE OC of 10.5%. The 'AAA' BE OC allows the covered bond to attain a timely payment rating level of 'AA' and supports two notches of recovery uplift to 'AAA'.

**Two-notch Recovery Uplift:** The two-notch recovery uplift is based on the covered bonds being Polish zloty-denominated, the same currency as the cover assets. Furthermore, the 'AA' timely payment rating level is in the investment-grade range, and Fitch expects outstanding recoveries on the cover pool consisting of standard residential mortgage loans.

**ALM Loss Drives BE OC:** The main component of the 'AAA' BE OC is the ALM (assets-liabilities mismatch) loss component of 6.8%, which represents the non-credit loss component of the BE OC for the rating and reflects modelled interest-rate mismatches. No principal maturity mismatches were modelled for the programme, reflecting the CPT structure embedded in Polish covered bond legislation. Fitch has factored in another five-year covered bond of an estimated same size as the inaugural issue into the modelled liability structure. The resulting liability structure is deemed more representative in Fitch's forward-looking analysis.

**Cover Pool Credit Quality:** Based on the default vintages for residential mortgage loans available for pooling, the base-case foreclosure frequency (FF) assumption is 3.6%. We have excluded the last few quarters from the base-case FF extrapolation as reported default data for these quarters were driven by participation in Poland's Borrowers Support Fund, which overstates default rates. Mortgage arrears have remained low for these quarters. For this reason, we have applied a 'High' multiple of 1.3x to the FF assumption in a 'B' rating case. We then apply 'High' multiples to derive the 'AAA' FF, in turn yielding a significant buffer against the long-term average historical performance.

The weighted average (WA) FF at the 'AA' timely payment rating is 24.9% and the WA 'AA' recovery rate is 85.9%. This is equivalent to an expected loss rate of 3.6% at the 'AA' rating. Recovery rates are adjusted downward to apply Fitch's minimum loss assumptions for Polish residential mortgage loans, which drive the asset-analysis results.

## **RATING SENSITIVITIES**

### **Factors That Could, Individually or Collectively, Lead to Positive Rating Action/Upgrade:**

The mortgage covered bonds are rated 'AAA', which is the highest level on Fitch' scale and cannot be upgraded.

### **Factors That Could, Individually or Collectively, Lead to Negative Rating Action/Downgrade:**

The mortgage covered bonds' 'AAA' rating would be vulnerable to a downgrade on a downgrade of BM's 'BB+' Long-Term IDR or on a decline in Fitch's relied-on OC to below the 'AAA' BE OC of 10.5%. The rating would also be downgraded following a downgrade of the Polish sovereign rating.

If the OC that Fitch relies on in its analysis decreases to the legal minimum OC of 5%, the covered bond rating would likely be downgraded to 'A+'.

## **REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING**

The principal sources of information used in the analysis are described in the Applicable Criteria.

## **PUBLIC RATINGS WITH CREDIT LINKAGE TO OTHER RATINGS**

The covered bonds' rating is driven by the credit risk of BM as measured by its Long-Term IDR.

## **ESG CONSIDERATIONS**

The highest level of ESG credit relevance is a score of '3', unless otherwise disclosed in this section. A score of '3' means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. Fitch's ESG Relevance Scores are not inputs in the rating process; they are an observation on the relevance and materiality of ESG factors in the rating decision. For more

information on Fitch's ESG Relevance Scores, visit  
<https://www.fitchratings.com/topics/esg/products#esg-relevance-scores>.

## RATING ACTIONS

ENTITY / DEBT ⇅	RATING ⇅	PRIOR ⇅		
Millennium Bank Hipoteczny S.A.				
senior secured, Mortgage Covered Bonds, Hipoteczne listy zastawne	LT	AAA Rating Outlook Stable	Upgrade	AA+ Rating Outlook Positive

[VIEW ADDITIONAL RATING DETAILS](#)

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## **APPLICABLE CRITERIA**

[European RMBS Rating Criteria \(pub. 21 Jun 2023\) \(including rating assumption sensitivity\)](#)

[Covered Bonds Rating Criteria \(pub. 09 Oct 2023\) \(including rating assumption sensitivity\)](#)

[Structured Finance and Covered Bonds Counterparty Rating Criteria \(pub. 28 Nov 2023\)](#)

[Originator-Specific Residential Mortgage Analysis Rating Criteria \(pub. 29 Jan 2024\)  
\(including rating assumption sensitivity\)](#)

[Structured Finance and Covered Bonds Interest Rate Stresses Rating Criteria \(pub. 05 Apr 2024\)](#)

[Structured Finance and Covered Bonds Country Risk Rating Criteria \(pub. 20 Jun 2024\)](#)

[Originator-Specific Residential Mortgage Analysis Rating Criteria - Supplementary Data File \(pub. 26 Jun 2024\)](#)

## **APPLICABLE MODELS**

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

[ABS Loss Forecaster Model, v1.2.1 \(1\)](#)

[Covered Bonds Cash Flow Model, v2.1.6 \(1\)](#)

## **ADDITIONAL DISCLOSURES**

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Millennium Bank Hipoteczny S.A.

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