

Presale:

# Bank of Aland CBA Covered Bond Program

February 24, 2023

**PRIMARY CREDIT ANALYST**

**Ana Galdo**  
Madrid  
+ 34 91 389 6947  
ana.galdo  
@spglobal.com

**SECONDARY CONTACT**

**Phuong Nguyen**  
Frankfurt  
(49) 0 69-33-999-313  
phuong.nguyen  
@spglobal.com

<b>Reference Rating Level</b>	<b>a</b>	+	<b>Jurisdiction-Supported Rating Level</b>	<b>aa</b>	+	<b>Maximum Achievable Covered Bond Rating</b>	<b>aaa</b>	=	<b>Covered Bond Rating</b>	
Resolution Regime Uplift	+2		Assigned Jurisdictional Support Uplift	+3		Collateral Support Uplift	+4		<b>AAA/Stable(prelim)</b>	
									Rating Constraints	aaa
Systemic Importance	Very Strong		Jurisdictional Support Assessment	Very Strong		OC Adjustment	0		Counterparty Risk	aaa
Resolution Counterparty Rating	N/A		Legal Framework	Very Strong		Liquidity Adjustment	0		Country Risk	aaa
ICR Or Parent Bank Rating Or Guarantor Rating	BBB+		Systemic Importance	Very Strong		Potential Collateral Based Uplift	+4			
			Sovereign Credit Capacity	Very Strong						

ICR--Issuer credit rating. N/A--Not applicable.

## Major Rating Factors

### Strengths

- The proposed cover pool backing the covered bonds comprises prime Finnish residential loans to affluent customers.
- The program benefits from two unused notches of collateral based-uplift.
- The proposed bond's soft-bullet repayment profile mitigates short-term liquidity risk.
- The proposed structure benefits from a public commitment by the issuer to maintain overcollateralization consistent with four notches of collateral-based uplift and with a preliminary 'AAA' rating.

## **Weaknesses**

- The pool exhibits a relatively high concentration in the Aland Islands, which we have considered in our determination of default frequency.
- The pool is less seasoned than other Nordic programs we rate, which is reflected in our default frequency.

## **Outlook: Stable**

S&P Global Ratings' stable outlook on the preliminary 'AAA' ratings on the Bank of Aland PLC's (Alandsbanken Abp) CBA mortgage covered bond program and the inaugural issuance reflects the stable outlook on the long-term issuer credit rating (ICR) on Bank of Aland (BBB+/Stable/A-2) and the program's two unused notches of collateral-based uplift. This means that we would not automatically lower the ratings on the covered bonds if we were to lower our long-term ICR on Bank of Aland by up to two notches, all other things being equal.

## **Rationale**

We have assigned our preliminary 'AAA' credit ratings to Bank of Aland's CBA covered bond program and its inaugural issuance (see "Bank of Aland PLC CBA Covered Bond Program, First Issuance Assigned Preliminary 'AAA' Rating; Outlook Stable," published on Feb. 22, 2023).

The CBA Covered Bonds from Bank of Aland are covered bonds issued under the Finnish Act on Mortgage Credit Banks and Covered Bonds (laki kiinnitysluottopankeista ja katetuista joukkolainoista, 151/2022) (the CBA).

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 Bank of Aland's CBA covered bond program and the Finnish covered bond legislation, we consider that the assets registered in the cover pool are effectively isolated for the benefit of the covered bondholders if the issuer becomes insolvent. The protection of the cover pool assets and the continued management of the cover pool allows us to rate the covered bonds higher than our long-term ICR on Bank of Aland.

Based on our operational risk analysis, which covers a review of origination, underwriting, collection, and default management procedures, as well as cover pool management and administration, we believe satisfactory procedures are in place to support our preliminary ratings on the covered bond and the program.

Bank of Aland is domiciled in Finland, 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 in Finland. These factors increase the likelihood that Bank of Aland would continue servicing its covered bonds without accessing the cover pool or receiving jurisdictional support, even following a bail-in of its senior unsecured obligations. Under our covered bonds criteria, the resulting reference rating level (RRL) is 'a', which reflects the two-notch uplift from the ICR.

We considered the likelihood of jurisdictional support. Based on a very strong jurisdictional support assessment for mortgage covered bonds in Finland, we assigned three notches of uplift from the RRL. This results in a jurisdiction-supported rating level (JRL) of 'aa'.

## Presale: Bank of Aland CBA Covered Bond Program

Our collateral support analysis is based on the asset information as of Nov. 30, 2022. The €311.9 million cover pool (current balance) comprises solely Finnish residential mortgage loans. Based on our collateral support analysis, the available credit enhancement exceeds the target credit enhancement for the two scenarios of proposed issuance, which means that the covered bonds are eligible for up to four notches of collateral-based uplift above the JRL. We do not reduce the total collateral-based uplift owing to Bank of Aland's commitment to maintain overcollateralization at a level sufficient to obtain the maximum potential collateral-based uplift of four notches and because we consider that the liabilities' soft-bullet feature mitigates short-term liquidity risk.

There are no rating constraints to the preliminary 'AAA' ratings relating to legal, counterparty, or sovereign risks.

We based our analysis on criteria articles referenced in the "Related Criteria" section.

The preliminary ratings are based on the latest information available to us as of the date of this publication. Subsequent information may result in the assignment of final ratings that differ from the preliminary ratings. Final ratings are contingent on our review of the swap documentation--should it be entered into. Alternatively, upon receiving the issued bond's terms and conditions, the final ratings will not differ from the preliminary ratings if there are no material changes to the collateral composition, and the available credit enhancement continues to be at least equal to the overcollateralization commensurate with the rating, all else being equal.

## Program Description

Table 1

### Program Overview\*

Jurisdiction	Finland
Year of first issuance	2023
Covered bond type	Legislation-enabled
Outstanding covered bonds (mil. €)	250
Redemption profile	Soft-bullet
Underlying assets	Finnish residential mortgage loans
Jurisdictional support uplift	3
Unused notches for jurisdictional support	0
Target credit enhancement (%)	3 year soft-bullet: 22.52 5 year soft bullet: 21.13
Credit enhancement for current rating (%)§	3 year soft-bullet: 14.81 5 year soft-bullet: 14.59
Available credit enhancement (%)	24.78
Achievable Collateral support uplift	4
Nocthes required for 'AAA' rating	2
Unused notches for collateral support	2
Total unused notches	2

\*Based on cash flows from Nov. 2022 pool and new expected issuance. §Level of credit enhancement required to cover 'AAA' credit risk plus 50% of refinancing costs.

## Presale: Bank of Aland CBA Covered Bond Program

Bank of Aland, established in 1919, is a regional Finnish bank provider of retail, private banking, and asset management services to high-net-worth clients in certain selected areas in Finland and in Sweden, with a strong presence in the Finnish region of the Aland Islands. The bank has a modest market share of 1% in Finland but holds a lead position in its wealthy but very small home region, Aland Islands, with an estimated loan market share of 50% in its core business of private and premium retail banking.

As of December 2022, its total assets totaled €5.9 billion and its loan portfolio amounted to €4.3 billion. Its loan book focuses on retail (76% of the net loan book) through primarily mortgages to individuals in Finland and Sweden.

We believe Bank of Aland follows a prudent approach in its mortgage loan underwriting, demonstrated in its good asset quality and very low arrears levels. On July 13, 2022, we raised our ratings on Bank of Aland ( see "Bank of Aland PLC Upgraded To 'BBB+' On Increased Capital; Outlook Stable").

This is Bank of Aland's second Finnish covered bond program. It is set up to issue covered bonds under Finland's Covered Bond Act (CBA, 151/2022), which has been in place since July 8, 2022. The mortgage covered bonds will be issued under Bank of Aland's €2.0 billion program for the issuance of senior preferred notes, covered bonds, tier 2 notes, and additional tier 1 capital notes.

Bank of Aland's covered bond program was established in September 2012 and now incorporates two separate cover pools: the newly established cover pool governed by the CBA (the "CBA Covered Bond Program"), and Bank of Aland's existing covered bonds (the "MCBA Covered Bond Program"), which continue to be governed by the Finnish Act on Mortgage Credit Bank Operations (MCBA,688/2010). The covered bonds issued under the CBA Covered Bond Program rank pari passu among themselves but do not relate to the MCBA Covered Bond Program. Covered bondholders and derivative counterparties related to the CBA Covered Bond Program have a priority claim only on the assets registered in the CBA Covered Bond Program. Similarly, covered bondholders and derivative counterparties related to the MCBA Covered Bond Program have a priority claim only on the assets registered under the MCBA covered bond program.

Bank of Aland's funding profile reflects a stable core customer deposit base, which now covers 77% of the bank's funding. Over the past few years, Bank of Aland has increased its use of wholesale funding via covered bonds to aid lending growth, representing 11% of the bank's funding base as of Dec. 31, 2022.

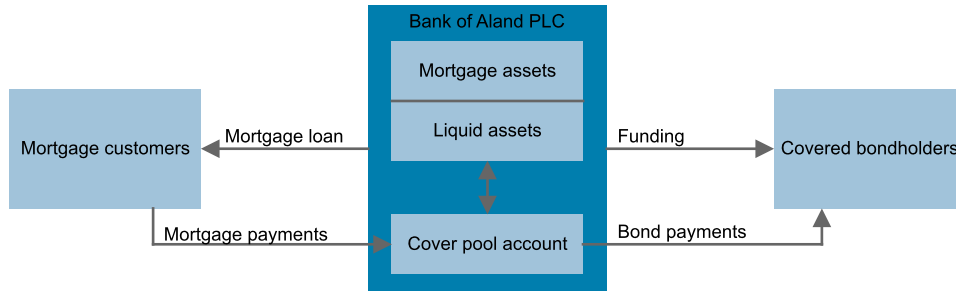
The covered bonds constitute direct unconditional and unsubordinated debt obligations of Bank of Aland and are secured by a cover pool of eligible residential mortgage loans registered in the cover pool, in line with the CBA.

The proposed €250 million inaugural fixed-rate bond will have either a three-year or a five-year scheduled maturity, each with a one-year maturity extension. During the extension period, the bond will pay one-month Euro Interbank Offer Rate (EURIBOR) plus a margin.

The mortgage borrowers pay their loan installments into an internal bank account. As per our legal analysis, the cover pool is potentially exposed to commingling risk if the issuer becomes insolvent. The cover pool will have a normal claim in line with all other creditors of the bank on any cash commingled in the bank and money may be lost.

The covered bond will benefit from Bank of Aland's commitment to maintain overcollateralization sufficient to support four notches of collateral-based uplift or a 'AAA' rating on the covered bonds.

### Bank of Aland CBA Covered Bonds



Copyright © 2023 by Standard & Poor's Financial Services LLC. All rights reserved.

Table 2

### Program Participants

Role	Name	Rating	Rating dependency
Issuer	Bank of Aland PLC	BBB+/Stable/A-2	Yes
Originator	Bank of Aland PLC	BBB+/Stable/A-2	No
Bank account provider	Bank of Aland PLC	BBB+/Stable/A-2	No

### Rating Analysis

#### Legal and regulatory risks

We base our legal analysis on our criteria "Asset Isolation and Special-Purpose Entity Methodology," published on March 29, 2017.

The covered bonds are governed by the CBA, which implemented the Covered Bond Directive into Finnish legislation. The CBA applies since July 8, 2022, and repealed the MCBA.

In our opinion, the CBA satisfies the relevant legal aspects of our covered bond criteria. We have concluded that the assets in the cover pool are effectively isolated for the benefit of covered bondholders. The protection of the assets and the continued management of the cover pool allows us to rate the covered bond program above the long-term ICR on Bank of Aland.

We understand that under the CBA, the issuer's bankruptcy would not automatically trigger the covered bonds' early redemption or the suspension of payments to bondholders. Accordingly, we rate the covered bonds based on the legal final maturity.

The CBA requires issuers to have a license from the Finnish Financial Supervisory Authority (FIN-FSA) to issue covered bonds. Further, they must maintain a register for the covered bonds and the collateral forming the cover pool. The FIN-FSA monitors the management of the register, including the recording of assets, and the issuer must regularly report the information in the register to the FIN-FSA.

## **Presale: Bank of Aland CBA Covered Bond Program**

The CBA defines the eligibility criteria for the cover pool assets that comprise residential mortgage loans, commercial mortgage loans, public-sector loans, and substitute assets to facilitate liquidity management.

Derivatives are allowed for risk hedging purposes and must be registered in the cover register. Derivatives must also remain in force despite the issuer's bankruptcy, liquidation, or resolution.

Bank of Aland's cover pool does not comprise any intermediary loans.

Under the CBA, issuers must have 2% overcollateralization on a net present value (NPV) basis. This requirement increases to 5% on an NPV basis if certain requirements of article 129 of the Capital Requirements Regulation are not fulfilled.

The CBA introduces a 180-day liquidity requirement whereby the cover pool must include sufficient substitute assets to meet the maximum net outflow connected to the covered bonds during the upcoming 180-day period. We understand that in calculating the net outflow related to the covered bonds, issuers may consider the extension of the maturity.

Under the CBA, an extension of the maturity of the covered bonds by up to 12 months is permissible, subject to approval by the FIN-FSA and certain conditions being met, including:

- The issuer being unable to obtain long-term financing from ordinary sources;
- The issuer being unable to meet the liquidity requirement under the CBA upon payment of the covered bonds; and
- Such extension not affecting the order of the maturity based on the original maturity dates of covered bonds secured by the same cover pool.

If the issuer becomes insolvent, the FIN-FSA would appoint a supervisor to supervise the management of the cover pool. While a bankruptcy administrator (appointed by a court) manages both the issuer's insolvency estate and the cover pool, the supervisor's role is to protect the interests of covered bondholders with powers to direct the issuer's general bankruptcy administrator.

Upon issuer insolvency, covered bondholders and derivative counterparties (including termination fees) have a preferential claim to the assets in the cover pool, which would be isolated from the issuer's other assets.

Under the CBA, covered bondholders and derivative counterparties have a priority of payment right to 100% of the properties' value, although only 80% of the market value of residential properties and 60% of the market value of commercial estate properties can be included in the determination of overcollateralization.

Based on our legal analysis, we understand that the CBA excludes set-off against cover pool assets and claw-back risk.

## **Operational and administrative risks**

Our analysis of operational and administrative risks follows the guidelines in our criteria (see "Covered Bond Ratings Framework: Methodology And Assumptions," published on June 30, 2015).

Bank of Aland is an established covered bond issuer, and this is the second covered bond program that we rate. Bank of Aland's underwriting and main focus on high-net-worth clients in its wealthy but small home region Aland islands, and in certain selected areas in mainland Finland, with LTV ratio comparable to its peers, translates into robust asset quality and low credit losses.

## **Presale: Bank of Aland CBA Covered Bond Program**

In our most recent meeting with the issuer, we reviewed its origination, underwriting, collection, and default management procedures for the cover pool assets. We also reviewed the cover pool management and administration and have not observed any major changes or new risks arising. We consider that the issuer actively manages the cover pool and has strict underwriting and loan management policies.

Bank of Aland's credit decisions are made by the bank's customer advisors within limits set by the executive team. Internal instructions stipulate each person's limit--both geographically and monetarily. The large credits have to be approved by the Head of Credit and/or the Credit Committee.

All properties securing the loans are valued by an independent evaluator at origination. The customer advisor contacts the evaluator and no credit is granted without it.

The FIN-FSA continues to focus strongly on ensuring strict underwriting criteria for household lending. It applies an 85% cap on loan-to-collateral ratios on new mortgage loans and a 95% cap for first-time buyers. Borrower's ability to pay the loan and handle the regular living costs is stress tested with a 6% interest rate.

In our opinion, there is no operational risk from the cover pool's management and loan origination that would constrain the preliminary rating on the covered bonds to the same level as our long-term ICR on Bank of Aland.

We believe that a replacement cover pool manager would be available to manage the cover pool if the issuer were to become insolvent. We consider Finland to be an established covered bond market and we believe that the mortgage loans in Bank of Aland's cover pool do not comprise product features that would materially limit the range of available replacement cover pool managers or servicers.

## **Resolution regime analysis**

As part of our covered bonds criteria, our analysis considers any resolution regime in place in Finland to determine the RRL. Bank of Aland is domiciled in Finland, which is subject to the EU's BRRD, and our analysis considers the support provided by its eventual adoption. We assess the systemic importance for Finnish mortgage programs as very strong. Under our covered bonds criteria, a very strong systemic importance means the RRL is the maximum between two notches above the long-term ICR and the resolution counterparty rating (RCR). Given that we have not assigned an RCR to Bank of Aland, the RRL is 'a', which reflects the two-notch uplift from the ICR.

This uplift recognizes that resolution regimes like the BRRD increase the probability that an issuer could service its covered bonds even following a default on its senior unsecured obligations because the law exempts covered bonds from bail-in risk if there is a bank resolution. We consider this as an internal form of support because the bail-in of certain creditors of the issuer does not require direct government support.

## **Jurisdictional support analysis**

Under our analysis of jurisdictional support in our covered bonds criteria, which is our assessment of the creditworthiness of a covered bond program once we have considered the level of jurisdictional support, but before giving credit to the amount of collateral.

In our jurisdictional support analysis, we assess the likelihood that a covered bond program facing stress would receive support from a government-sponsored initiative instead of from the

## Presale: Bank of Aland CBA Covered Bond Program

liquidation of collateral assets in the market.

Our assessment of the expected jurisdictional support for Finnish mortgage programs is very strong. In addition, our sovereign rating on Finland (AA+/Stable/A-1+) does not constrain the JRL. Under our covered bonds criteria, the covered bonds therefore receive three notches of jurisdictional uplift over the RRL leading to a JRL of 'aa'.

### Collateral support analysis

Our analysis of the residential mortgage loans is based on the specific adjustments defined for Finland under our global RMBS criteria (see "Global Methodology And Assumptions: Assessing Pools Of Residential Loans," published on Jan. 25, 2019).

We performed our analysis using loan-by-loan data provided by Bank of Aland as of Nov. 30, 2022, and the projected asset and liability cash flows provided by Bank of Aland considering the potential soft-bullet covered bond issuance of €250 million and two possible maturity scenarios, three years and five years.

The cover pool comprises prime residential mortgage loans originated by Bank of Aland and located in Finland. The total current balance is €311.9 million, with a current LTV ratio that represents, on average, 55.65% of the property's current value. Finnish property prices have followed an upward trend since 1996 but have stabilized since 2012, and are undervalued by 1.1%.

The weighted-average seasoning of the residential portfolio is about 3.97 years and the interest rate on 96% of the loans is floating (most linked to 12-month EURIBOR). Most of the loans are on owner-occupied properties. The cover pool does not include loans in arrears nor loans to borrowers with a negative credit history. Of the total pool, 59% of the loans are fixed rate amortization loans, considered to attract a payment shock at the end of the loan's life.

The pool has a relatively high concentration in the Aland Islands of 24.97%, as the bank holds a historical strong presence in this region of Finland.

A 10.19% of the pool are loans that pay interest only up until maturity and which attract an adjustment to the base foreclosure frequency as per our residential loans criteria.

Under the CBA, bondholders and derivative counterparties have a priority of payment right on 100% of the properties' value. We therefore determined the available overcollateralization on the entire current balance. At the same time, our determination of potential losses is also based on the entire current balance of the loans.

For the loans in the pool, we estimated the foreclosure frequency and the loss severity in a 'AAA' stress scenario and, by multiplying the foreclosure frequency by the loss severity, the potential loss associated with each loan. 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. We assume that the probability of foreclosure is a function of both borrower and loan characteristics and will become more likely--and the realized loss on a loan more severe--as the economic environment deteriorates.

At a 'AAA' level of stress, the WAFF is 15.06% and the WALS is 21.38%.

The main drivers of the WAFF in this cover pool are current LTV ratios and the relatively low seasoning. Under our global RMBS criteria, we apply multiples to the base foreclosure frequency



## Presale: Bank of Aland CBA Covered Bond Program

based on the effective LTV ratio. The loans weighted-average effective LTV is 55.52% and is based solely on current whole loan LTVs. Given the current whole loan LTV distribution of the loans, only 38% of the loans benefit from a reduction to their base foreclosure frequency. Further, the pool seasoning is about four years. As per our RMBS criteria, loans more than five years seasoned benefit from a reduction to the base foreclosure frequency, and only 29.15% of the pool benefits from this reduction. Additionally, exposure to the Aland Islands (24.97%) exceeds our regional concentration limit of 1% and attracts a 1.2x increase to their base foreclosure frequency of 23.97% on the excess above the limit.

We assume that 18% of the pool balance are buy-to-let loans as we did not have the occupancy status for this percentage of the pool. This results in a total percentage of buy-to-let loans of 33%, which attracts a 1.7x adjustment to the base foreclosure frequency.

The cover pool contains about 59% of fixed installment mortgage loans, which means that periodic instalments are fixed for the entire duration of the loan. The maturity on these loans cannot be extended (from the one set at origination) and if the interest rate increases so that the periodic installment amount, which remains the same, only includes interest payments, this may lead to an accumulation of principal pending to be repaid on the maturity date. This could create an immediate payment shock for the borrowers at the end of the loan's life as it may lead to principal accumulation on the maturity date. We take this into account in our foreclosure frequency calculation by applying a 1.2x payment shock adjustment.

The main drivers behind the WALs for the loans in this pool are the current LTV ratios after house price indexation and market value decline assumptions, and the jumbo valuations. We have determined a weighted-average current LTV ratio of 55.65% and jumbo valuations represent 66.39% of the pool's outstanding balance.

We observe continuous house prices development in Finland, with prices rising in some areas and declining in others. However, we have not observed an overheating of the real estate market, and currently our analysis considers Finnish residential properties as slightly undervalued.

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

Table 3

### Cover Pool Composition

Asset type	As of Nov. 30, 2022	
	Value current balance (mil. €)	Percentage of cover pool (%)
Residential mortgage loans (housing loans)	311.94	100
Housing association loans	0	0
Substitute assets	0	0
Total	311.94	100

Table 4

**Key Credit Metrics**

	As of Nov. 30, 2022
	<b>Residential mortgage loans</b>
Average loan size (€)	148,615
Weighted-average effective LTV ratio (%)*	55.52
Weighted-average cover pool current LTV ratio (%)§	55.65
Weighted-average loan seasoning (years)†	3.97
Balance of loans in arrears (%)	0
Buy-to-let loans (%)	33.02
Interest only loans to maturity	10.19
Equal installment mortgages (%)	59
<b>Credit analysis results:</b>	
WAFF (%)	15.06
WALS (%)	21.38
AAA* credit risk (%) for three-year soft-bullet	7.1
AAA credit risk (%) for 5 year soft-bullet	8.04

\*The effective LTV corresponds to 100% of current indexed whole loan LTVs for the WAFF calculation. §Weighted-average current indexed LTV based on current balance. †Seasoning refers to the elapsed loan term. LTV--Loan to value. WAFF--Weighted-average foreclosure frequency. WALS--Weighted-average loss severity. N/A--Not applicable.

Table 5

**Loan-To-Value Ratios**

	As of Nov. 30, 2022	
<b>Residential mortgages (housing loans, %)</b>	<b>Effective whole loan LTV (%)*</b>	<b>Current balance LTV (based on current balance, %)</b>
0-40	20.81	20.77
40-50	16.79	16.13
50-60	19.84	20.37
60-70	22.13	22.08
70-80	9.1	9.32
80-90	7.46	6.2
90-100	3.87	5.13
Above 100	0	0
Weighted-average LTV ratio	55.52	55.65

\*100% of current indexed whole-loan LTV ratio. LTV--Loan-to-value.

Table 6

**Loan Seasoning Distribution\***

	As of Nov. 30, 2022
	<b>Percentage of current pool balance (%)</b>
Less than 2 years	47.24
2 to 4	16.62
4 to 5	6.98
5 to 6	6.69
6 to 7	3.8
7 to 8	4.01
8 to 9	2.01
9 to 10	1.43
More than 10 years	11.21
Weighted-average loan seasoning (years)	3.97

\*Seasoning refers to the elapsed loan term.

Table 7

**Geographic Distribution Of Loan Assets**

	As of Nov. 30, 2022
	Percentage of current pool balance (%)
Southern Finland	47.36
Eastern Finland	0.11
Western Finland	27.55
Oulu	0
Lapland	0.01
Aland	24.97
Total	100

Table 8

**Collateral Uplift Metrics**

	As of Nov. 30, 2022	
	Scenario 1: three-year soft-bullet bond	Scenario 2: five-year soft-bullet bond
Asset WAM (years)	9.74	9.74
Liability WAM (years)	3 (extendible to 4)	5 (extendible to 6)
Available credit enhancement	24.78	24.78
Required credit enhancement for coverage of 'AAA' credit risk (%)	7.10	8.04
Required credit enhancement for first notch of collateral uplift (%)	10.96	11.31
Required credit enhancement for second notch of collateral uplift (%)*	14.81	14.59
Required credit enhancement for third notch collateral uplift (%)	18.67	17.86
Target credit enhancement for maximum uplift (%)	22.52	21.13
Potential collateral-based uplift (notches)	4	4
Adjustment for liquidity (Y/N)	N	N
Adjustment for committed overcollateralization (Y/N)	N	N
Achievable collateral support uplift (notches)	4	4
Required overcollateralization for AAA rating (notches)	2	2
Unused notches of collateral support uplift	2	2

\*Required overcollateralization for 'AAA' rating. WAM--Weighted-average maturity.

The results of our credit analysis--the portfolio's WAFF and WALs--represent inputs to our cash flow analysis. Our analysis of the covered bonds' payment structure shows that cash flows from the cover pool assets would be sufficient, at the given preliminary rating, to make timely payment of interest and ultimate principal to the covered bond on its legal final maturity.

We have modeled the terms and conditions of two possible covered bond issuances, that is, we perform two cash flow analysis scenarios:

- In the first scenario, we have modeled a bond with a notional balance of €250 million, a term to maturity of three years with a one-year maturity extension. No swap in place.
- In the second scenario, we have modeled a bond with a notional balance of €250 million, a term to maturity of five years with a one-year maturity extension. No swap in place.

As per our criteria, we stress the cover pool's cash flows, incorporating various default patterns, default timings, and interest rate paths. We also stress cash flows under different prepayment

## Presale: Bank of Aland CBA Covered Bond Program

rates, and delinquency assumptions, which we run at different points over the weighted-average life of the covered bonds.

The proposed structure is exposed to an asset-liability maturity mismatch because the covered bonds' repayment profile is not aligned with that of the assets. Our model simulates a stressed sale of assets whenever a liquidity gap occurs in our analysis. The adjustment applied for residential loans is 425 basis points, on top of the stressed interest rate at the time of the shortfall (when assets need to be sold). Where cover pools contain buy-to-let mortgage assets exceeding 15% of the pool balance, we typically double the stressed refinancing spread assumption on the share of these loans that exceeds the threshold.

We also model the possibility that the spread on the mortgages compresses over time, due to defaults, prepayments, and product switches. To account for this, we reduce margins, assuming that a percentage of the higher-yielding loans exit the portfolio. We also stressed basis risk.

Our 'AAA' credit risk shows the amount of overcollateralization commensurate with our credit risk assessment. This figure is 7.10% for the first scenario and 8.04% for the second scenario.

Our target credit enhancement includes the additional credit enhancement that we expect is required to refinance the cover pool in a stressed environment. By applying our credit and cash flow stresses, we calculate a target credit enhancement of 22.52%% in the first scenario and 21.13% in the second scenario, all below the available credit enhancement of 24.78%.

Because we consider there is an active secondary market for cover pool assets, the program can potentially achieve four notches of collateral-based uplift above the JRL. From this potential uplift, we make no deductions because Bank of Aland's covered bond features a 12-month maturity extension, which satisfies the liquidity coverage requirement under our criteria. Furthermore, Bank of Aland commits to maintaining an overcollateralization level commensurate with the assigned preliminary rating. Therefore, the maximum collateral uplift is four notches, allowing the covered bond to attain a preliminary 'AAA' rating.

With a JRL of 'aa', the program requires two notches of collateral uplift to attain a 'AAA' rating. Therefore, two notches of collateral-based uplift are unused.

The overcollateralization commensurate with a 'AAA' preliminary rating (corresponding to the second notch of collateral uplift) equals 14.81% in the first scenario and 14.59% in the second scenario.

## Counterparty risk

We analyze counterparty risk under our criteria (see "Counterparty Risk Framework: Methodology And Assumptions," published on March 8, 2019).

## Bank account and commingling risk

Borrowers will make mortgage payments into internal bank accounts. This means that the cover pool is potentially exposed to commingling risk if the issuer becomes insolvent. Pre-insolvency of the issuer payments received from the cover assets are not separated from the issuer's other cash flows. Hence, funds collected pre-issuer insolvency are potentially not necessarily available to service the claims in relation to the covered bonds. The cover pool will have a normal claim in line with all other creditors of the bank on any cash commingled in the bank and money may be lost.

We have considered the frequency of our access to information on the program's available credit enhancement, which will be monthly, to estimate the size of the account bank and commingling

## Presale: Bank of Aland CBA Covered Bond Program

risk. In our view, overcollateralization sufficiently mitigates this risk.

Following the insolvency of the issuer based on the relevant sections of the CBA, we are comfortable that post insolvency funds are secured by the administrator for the benefit of the covered bonds, are not at risk of being commingled and will only be available to pay covered bonds' creditors.

## Swaps

We do not expect the program to feature a swap at closing.

## Sovereign risk

We analyze sovereign risk according to our "Incorporating Sovereign Risk In Rating Structured Finance Securities: Methodology And Assumptions," published on Jan. 30, 2019. Under these criteria, covered bonds backed by mortgages issued in a jurisdiction that is within a monetary union that include structural coverage of refinancing needs over a 12-month period (provided by the 12-month extendible maturity profile of the soft-bullet bond in this instance) exhibit low sensitivity to country risk. As a result, we can rate the covered bond up to five notches above the sovereign rating. Given our 'AA+' long-term rating on Finland, sovereign risk does not constrain our rating on these covered bonds.

## Environmental, Social, And Governance

### ESG Credit Indicators

E-1	<b>E-2</b>	E-3	E-4	E-5	S-1	<b>S-2</b>	S-3	S-4	S-5	G-1	<b>G-2</b>	G-3	G-4	G-5
-----	------------	-----	-----	-----	-----	------------	-----	-----	-----	-----	------------	-----	-----	-----

ESG credit indicators provide additional disclosure and transparency at the entity level and reflect S&P Global Ratings' opinion of the influence that environmental, social, and governance factors have on our credit rating analysis. They are not a sustainability rating or an S&P Global Ratings ESG Evaluation. The extent of the influence of these factors is reflected on an alphanumerical 1-5 scale where 1 = positive, 2 = neutral, 3 = moderately negative, 4 = negative, and 5 = very negative. For more information, see our commentary "ESG Credit Indicators: Definition And Applications," published Oct. 13, 2021.

ESG factors have no material influence on our credit rating analysis of the Bank of Aland's CBA mortgage covered bonds. The issuer currently does not offer specific mortgage products focused on environment or social factors, which could affect the credit results. Bank of Aland is committed to maintain a minimum level of overcollateralization in the program commensurate with four notches of collateral-based uplift, or a 'AAA' rating. Additionally, the bonds' soft-bullet repayment structure mitigates 180 days of liquidity risk. The program's governance initiatives support the preliminary ratings assigned and the credit enhancement required for the rating.

## **Related Criteria**

- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- Criteria | Structured Finance | General: Global Framework For Payment Structure And Cash Flow Analysis Of Structured Finance Securities, Dec. 22, 2020
- Criteria | Structured Finance | General: Counterparty Risk Framework: Methodology And Assumptions, March 8, 2019
- Criteria | Structured Finance | General: Incorporating Sovereign Risk In Rating Structured Finance Securities: Methodology And Assumptions, Jan. 30, 2019
- Criteria | Structured Finance | RMBS: Global Methodology And Assumptions: Assessing Pools Of Residential Loans, Jan. 25, 2019
- Legal Criteria: Structured Finance: Asset Isolation And Special-Purpose Entity Methodology, March 29, 2017
- Criteria | Structured Finance | Covered Bonds: Covered Bond Ratings Framework: Methodology And Assumptions, June 30, 2015
- Criteria | Structured Finance | Covered Bonds: Covered Bonds Criteria, Dec. 9, 2014
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

## **Related Research**

- Bank of Aland PLC CBA Covered Bond Program, First Issuance Assigned Preliminary 'AAA' Rating; Outlook Stable, Feb. 22, 2023
- Bank of Aland PLC, Jan. 13, 2023
- Global Covered Bond Insights Q4 2022, Dec. 16, 2022

Covered Bonds Outlook 2023, Dec. 6, 2023

- Bank of Aland PLC Upgraded To 'BBB+' On Increased Capital; Outlook Stable, July 13, 2022

European Covered Bonds Reach Harmonization Milestone As The Journey Continues, July 12, 2022

- ESG Credit Indicator Report Card: Covered Bonds, April 7, 2022
- S&P Global Ratings Definitions, Nov. 10, 2021
- Glossary Of Covered Bond Terms, April 27, 2018

Copyright © 2023 by Standard & Poor's Financial Services LLC. All rights reserved.

No content (including ratings, credit-related analyses and data, valuations, model, software or other application or output therefrom) or any part thereof (Content) may be modified, reverse engineered, reproduced or distributed in any form by any means, or stored in a database or retrieval system, without the prior written permission of Standard & Poor's Financial Services LLC or its affiliates (collectively, S&P). The Content shall not be used for any unlawful or unauthorized purposes. S&P and any third-party providers, as well as their directors, officers, shareholders, employees or agents (collectively S&P Parties) do not guarantee the accuracy, completeness, timeliness or availability of the Content. S&P Parties are not responsible for any errors or omissions (negligent or otherwise), regardless of the cause, for the results obtained from the use of the Content, or for the security or maintenance of any data input by the user. The Content is provided on an "as is" basis. S&P PARTIES DISCLAIM ANY AND ALL EXPRESS OR IMPLIED WARRANTIES, INCLUDING, BUT NOT LIMITED TO, ANY WARRANTIES OF MERCHANTABILITY OR FITNESS FOR A PARTICULAR PURPOSE OR USE, FREEDOM FROM BUGS, SOFTWARE ERRORS OR DEFECTS, THAT THE CONTENT'S FUNCTIONING WILL BE UNINTERRUPTED OR THAT THE CONTENT WILL OPERATE WITH ANY SOFTWARE OR HARDWARE CONFIGURATION. In no event shall S&P Parties be liable to any party for any direct, indirect, incidental, exemplary, compensatory, punitive, special or consequential damages, costs, expenses, legal fees, or losses (including, without limitation, lost income or lost profits and opportunity costs or losses caused by negligence) in connection with any use of the Content even if advised of the possibility of such damages.

Credit-related and other analyses, including ratings, and statements in the Content are statements of opinion as of the date they are expressed and not statements of fact. S&P's opinions, analyses and rating acknowledgment decisions (described below) are not recommendations to purchase, hold, or sell any securities or to make any investment decisions, and do not address the suitability of any security. S&P assumes no obligation to update the Content following publication in any form or format. The Content should not be relied on and is not a substitute for the skill, judgment and experience of the user, its management, employees, advisors and/or clients when making investment and other business decisions. S&P does not act as a fiduciary or an investment advisor except where registered as such. While S&P has obtained information from sources it believes to be reliable, S&P does not perform an audit and undertakes no duty of due diligence or independent verification of any information it receives. Rating-related publications may be published for a variety of reasons that are not necessarily dependent on action by rating committees, including, but not limited to, the publication of a periodic update on a credit rating and related analyses.

To the extent that regulatory authorities allow a rating agency to acknowledge in one jurisdiction a rating issued in another jurisdiction for certain regulatory purposes, S&P reserves the right to assign, withdraw or suspend such acknowledgment at any time and in its sole discretion. S&P Parties disclaim any duty whatsoever arising out of the assignment, withdrawal or suspension of an acknowledgment as well as any liability for any damage alleged to have been suffered on account thereof.

S&P keeps certain activities of its business units separate from each other in order to preserve the independence and objectivity of their respective activities. As a result, certain business units of S&P may have information that is not available to other S&P business units. S&P has established policies and procedures to maintain the confidentiality of certain non-public information received in connection with each analytical process.

S&P may receive compensation for its ratings and certain analyses, normally from issuers or underwriters of securities or from obligors. S&P reserves the right to disseminate its opinions and analyses. S&P's public ratings and analyses are made available on its Web sites, [www.standardandpoors.com](http://www.standardandpoors.com) (free of charge), and [www.ratingsdirect.com](http://www.ratingsdirect.com) (subscription), and may be distributed through other means, including via S&P publications and third-party redistributors. Additional information about our ratings fees is available at [www.standardandpoors.com/usratingsfees](http://www.standardandpoors.com/usratingsfees).

STANDARD & POOR'S, S&P and RATINGSDIRECT are registered trademarks of Standard & Poor's Financial Services LLC.