Rating Assigned To Bank of Aland PLC's Covered Bond Program

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OVERVIEW

- We are assigning a 'AA' long-term rating, with a stable outlook, to Finland-based Bank of Aland's three issuances of covered bonds under its €1 billion covered bond program.
- The portfolio backing the bonds consists of first-lien loans secured on mainly residential and multifamily properties in Finland.
- We have assigned the rating based on our criteria for rating covered bonds. However, the methodologies and assumptions underlying these criteria are under review. The ratings on all outstanding covered bonds in this program may be affected as a result of this review.

LONDON (Standard & Poor's) Sept. 18, 2012--Standard & Poor's Ratings Services today assigned a 'AA' long-term credit rating to Finland-based Bank of Aland PLC's €1 billion covered bond program. The rating applies to the three series of Finnish legislation-enabled covered bonds ("Kiinteistövakuudellinen joukkovelkakirjalaina") currently issued under the program. The outlook is stable (see list below).

Standard & Poor's ratings address timely payment of interest and ultimate payment of principal on or before legal final maturity of the bonds.

Bank of Aland (Aalandsbanken) is a relatively small bank that has a strong presence in the Finnish region of the Aaland Islands. The bank's operations are concentrated in the Aaland Islands and its branch network in Southern and Western Finland. The bank focuses on private banking to high-net-worth clients, complemented by recently acquired operations in Sweden.

Aalandsbanken's covered bond program is set up under the recently updated Finnish covered bond law, which allows commercial banks to issue covered bonds. On Sept. 5, 2012, Aalandsbanken issued the first three euro-denominated series under the new program on Sept. 5, 2012. The issuer intends to issue further covered bonds while managing the potential ALMM and liquidity risk of the program.

The covered bond program is a funding tool for Aalandsbanken's assets, liabilities, and liquidity management. It will complement the bank's traditional focus on deposit funding. The covered bonds are senior secured debt issued by Aalandsbanken. The cover pool reflects the general quality of the bank's mortgage loan book and the covered bond rating is linked to the issuer's creditworthiness through our asset-liability mismatch (ALMM) criteria (see "Revised Methodology And Assumptions For Assessing Asset-Liability Mismatch Risk In Covered Bonds," published on Dec. 16, 2009).

The rating assigned to these issuances reflects our level of comfort in the Finnish legal framework for the issuance of covered bonds, as well as the credit quality of the underlying assets and their cash flows.

COVER POOL AS OF SEPT. 5, 2012

All the assets in the cover pool on the set-up date were Finnish private residential mortgage loans totaling €533,139,804 and substitute collateral totaling €120.000.000. The typically amortizing mortgage loans have a maximum maturity of 30 years and are denominated in euro. Each mortgage was originated within the Aalandsbanken branch network, according to the bank's general origination criteria.

We expect future origination to be carried out according to the issuer's current origination standards and do not expect the cover pool to change materially in terms of credit quality, should new loans be added to the cover pool.

The bank's stated strategic focus on high-net-worth customers means that the loan sizes have a "barbell" distribution--i.e., a relatively high proportion of the loans are above-average in size.

Table 1

Loan Size Distribution (%)	
€0-€100,000	25.67
€100,000-€200,000	32.64
€200,000-€300,000	15.14
€300,000-€400,000	7.62
€400,000-€500,000	3.97
€500,000-€600,000	1.33
€600,000-€700,000	1.96
>€700,000	11.41

As of Sept. 5, 2012, the issuer has only included loans with variable-rate interest rates in the cover pool, referring to the three-, six- or 12-month euro interbank offered rates (EURIBOR) and loans that reference to its own standard variable rate (SVR).

Table 2
Loan Interest Types (%)

Standard variable rate (SVR)	22.60
12-month EURIBOR	29.68
Three-month EURIBOR	40.28
Six-month EURIBOR	5.29
Government index	2.15

For the final cover pool composition, loans from the issuer's geographical heartland of the Aaland Islands, comprise 14.53%. A relatively small proportion, 3.8%, of the total cover pool, comprises mortgages on summer houses. We have not applied an additional penalty for the geographical concentration above our normal applied penalty (see Appendix) because the Aaland Islands are relatively wealthy and the region's economic performance has been stable. Should the concentration further increase, we may consider applying an additional stress to the analysis for the concentration risk.

Table 3
Geographical Distribution (%)

South Finland	55.99
Western Finland	29.06
Aaland	14.53
East Finland	0.12
Lapland	0.28
Oulu	0.12

Property valuation in Finland is based on market values. The Finish covered bond framework establishes different limits on loan-to-value (LTV) levels for residential and commercial mortgage loans. Under the framework, 70% of the value of a residential property and 60% of the value of a commercial property is eligible. If a loan exceeds these limits, the part of the loan up to 60%/70% LTV remains eligible for the cover pool. In effect, the issuer applies a haircut to the valuation of the securities for ineligible loan parts, i.e., should 5% of a loan be ineligible for covered bond funding according to the Finnish law, 5% of the valuation for this loan is subtracted.

Table 4
Loan-To-Value Distribution (%)

0%-10%	0.85
10%-20%	2.85
20%-30%	4.65

30%-40%	7.58
40%-50%	12.92
50%-60%	20.12
60%-70%	42.44
70%-80%	8.61

CASH FLOWS

We have reviewed the asset and cash flow information provided as of Sept. 5, 2012, to determine that under our criteria the program is assessed as "category 2" and the current ALMM measure is "low." The first measure indicates our view of the ability to obtain third-party liquidity or sell assets to fund any mismatch after the issuing bank fails, while the second indicates the scale and urgency of any asset-liability mismatches in the program. As we consider the cover pool to be representative for Finish covered bonds, we have classified Aalandsbanken program as category 2. According to our covered bond criteria, the combination of both factors potentially allows for a six-notch uplift above the issuer credit rating (see "Revised Methodology And Assumptions For Assessing Asset-Liability Mismatch Risk In Covered Bonds," published on Dec. 16, 2009).

We have based the rating on the program's current issuance profile and use of hard bullet repayment structures, i.e., the principal will be paid on the expected maturity dates. All further issued bonds are expected to be small-sized issuances with variable interest rates, mostly denominated in euro.

Comparing our assessment of the target credit enhancement with the available credit enhancement, we anticipate that the cover pool will be able to fully support the potential rating uplift for our 'AA' rating on these legislation-enabled mortgage covered bonds.

The stable outlook reflects our view of the creditworthiness of the issuer. We also consider that Aalandsbanken has the ability and willingness to manage the covered bonds in conditions commensurate with the rating that we have assigned.

Should the creditworthiness of the bank or the ALMM categorization change, it would have a direct effect on the rating on Aalandsbanken's covered bonds program.

Table 5
Aalandsbanken's Key Characteristics (As Of Sept. 5, 2012)

Classification of ALMM mismatch	Low
Program categorization	2
Maximum potential rating	AA
Current available credit enhancement (%)	117.71[1]
Target credit enhancement commensurate with the highest credit rating (%)	59.08[1]

Note that we calculate the current credit enhancement as (assets – liabilities)/liabilities.
[1]Including liquid assets registered in the cover pool.

LEGAL BACKGROUND

The assets registered in the cover pool must mainly be mortgage credits. At least 90% of the book value of the mortgage credits must be housing loans or, temporarily, supplementary collateral. The remainder can be mortgage credits for nonresidential mortgage assets. Up to 20% of all collateral in the cover pool may temporarily consist of supplementary collateral, such as short-term deposits or cash.

The issuer carries out the monitoring of the cover pool and reports to the Finnish Financial Services Authority (FSA) each month. The FSA has the legal power to take appropriate measures and may ultimately revoke the banking license of the bank in question.

If the issuer becomes insolvent, the covered bondholders will have recourse to a separate, ringfenced cover pool, and any substitute assets registered in the cover pool. Furthermore, an assigned administrator will administer the cover pool, and if required, the Finnish covered bond law enables the pool administrator and the bankruptcy trustee to take up loans on behalf of the cover pool to create further liquidity. Further, we understand that an administrator will also be required to maintain a pool of liquid assets that meets the requirements listed in the program documentation.

If the issuer becomes insolvent, the insolvency administrator must direct all cash flows attributable to cover pool assets to benefit the cover pool. The administrator must open a new bank account as soon as possible. If cash is available in the insolvency estate, that cash belongs to the cover pool. However, should no cash be available, the administrator would place a general claim on the cover pool, and cash may be lost.

COUNTERPARTY RISK ANALYSIS

Our counterparty criteria introduced minimum requirements for counterparties supporting securities of a certain rating level. The current assessment of the creditworthiness of the bank acting as an account bank is, however, not sufficient to support the highest rating achievable according to our ALMM criteria.

To mitigate the potential transaction account risk and achieve the highest rating achievable under our ALMM criteria, the issuer has "registered" liquid assets worth a maximum of the larger of €120 million or 10% of the cover pool asset balance. Should prepayment increase above 5% on a quarterly basis and 15% on a yearly basis, all collected prepayments are channeled into the liquid assets holdings and registered to the benefit of the covered bond holders. The same happens if the amount increases above the minimum of €120 million.

Under normal circumstances, the Finnish covered bond law allows for a maximum of 20% of cover pool asset to be in the form of liquid assets or cash. Given that the issuer has currently invested 18.37% in liquid assets, we assume that under normal circumstances a maximum of 1.63% of cash could be lost were a counterparty to default. Additionally, due to our quarterly surveillance cycle, the issuer may have accumulated one quarter's worth of collections on their bank account.

We size for these amounts at risk taking into consideration the liquid assets (currently 18.37% of the cover pool). Further, we size for the loss of a further month of collections caused by a potential borrower notification risk. Finally, we expect the liquid assets included in the cover pool to be adequate in size and quality to cover six months of covered bond maturities any time over the life of the transaction.

For us to give full benefit to such liquid assets, they must be "eligible investments" under our criteria for such investments (see "Global Investment Criteria For Temporary Investments In Transaction Accounts," published on May 31, 2012, or for other longer-dated securities, see "Request For Comment: Methodology And Assumptions For Market Value Securities," published on Aug. 31, 2010). If required, we may apply a haircut to reflect the stressed market value of such securities. Although Finnish covered bonds are also eligible to be pledged with the national central bank for repurchase agreement transactions, we rely on the availability and quality of liquid assets to cover the liquidity risk. To ease liquidity requirements, the issuer currently plans to mainly issue smaller-sized issuances; it does not intend to issue bonds sized above €150 million. We expect the issuer to increase the amount of liquid assets to match the size of such issuances.

Due to the transaction account risk being mitigated by the inclusion of a liquid asset facility, we intend to conduct close surveillance on the liquidity holdings of the cover pool.

TRANSACTION SUMMARY AND PORTFOLIO CHARACTERISTICS

Table 6
Key Portfolio Characteristics (As Of Sept. 5, 2012)

Total principal balance (EUR)	533,139,804
Liquid asset balance (EUR)	120,000,000
Bonds outstanding (EUR)	300,000,000
Total number of loans	4,803
Largest loan value (EUR)	4,969,189
Average loan (EUR)	111,001
Weighted-average LTV ratio (whole pool) (%)[1]	60.85

Level of arrears (whole pool) (%)	1.50

Arrears above 90 days are normally continuous removed from the cover pool by the issuer.

Weighted-average seasoning (whole pool) (months)	28.9
>18 months	62.9
>60 months	14.98
Proportion of letting loans (%)	8.4
Proportion of IOF loans (%)	19.65
Loans to staff (%)	0.0
Proportion of loans to self employed (%)	0.65
Top 20 loans as % of pool	7.7

Current liquid assets included in the cover pool:

Finnish government (AAA/Stable) (%)	62.5
Belgian Government (AA/Stable)	33.3
Other 'AAA' rated entity	4.2

[1]Based on Standard & Poor's adjusted calculation.
LTV--Loan-to-value.
IOF--Interest-only feature.

Our credit analysis accounts for these characteristics. In particular, we assess individual borrower and loan characteristics, including:

- The size of the weighted-average foreclosure frequency (WAFF) ratio, which we essentially base on the loan-to-value (LTV) ratio of the underlying borrowers; and
- The size of the weighted-average loss severity (WALS) ratio, which we derive from the LTV ratio and the expected market value decline of the property.

The product of the WAFF and WALS is the net loss that we assume may affect the portfolio in a 'AAA' scenario. At a 'AAA' rating level, the closing WAFF and WALS results, as of Sept. 9, 2012, were:

WAFF	20.12%
WALS	9.66%
Assumed net credit loss (WAFF x WALS)	1.94%

Aalandsbanken continues to originate loans into the cover pool but as the bank is currently the largest retail bank on the Aaland Islands, we expect many of the new loans to be originated on the Finnish mainland. That said, although we expect the percentage of mortgage loans on Aaland to decrease, we consider the cover pool to be an established cover pool and do not expect the issuer to materially change the current credit composition of the cover pool.

APPENDIX

BASE ASSUMPTIONS FOR THE CREDIT ANALYSIS OF FINNISH MORTGAGE LOANS: RESIDENTIAL

Table 7
Base Weighted-Average Foreclosure Frequency (%)

AAA	12

Table 8
Adjustments To The Weighted-Average Foreclosure Frequency

80% LTV:	Base foreclosure frequency multiplied by 1
80-90% LTV:	Base foreclosure frequency multiplied by 1.5
90-95% LTV:	Base foreclosure frequency multiplied by 2
95-100% LTV:	Base foreclosure frequency multiplied by 3
Above 100% LTV:	Base foreclosure frequency multiplied by 4

Seasoning
Between 10% and 25% reduction to base, no adjustment applied to loans in arrears.

Buy-to-let loans: Base multiplied by 1.8

IOF loans:

5-10 year maturity:	Base multiplied by 3
10-20 year maturity:	Base multiplied by 1.5

Jumbo loans: (>€300,000 for southern Finland and >€200,000 for the rest of the country): 1% to 20% of base.
(Increases as loan size increases and caps when loan size reaches €1.5 million).

Geographic concentration
A 1% addition to the adjusted base foreclosure frequency of all loans in the region is applied if the following concentration limits are exceeded:

Southern Finland:	50% of cover pool balance
Eastern Finland:	10% of cover pool balance
Western Finland:	35% of cover pool balance
Oulu (A):	6% of cover pool balance
Oulu (B):	3% of cover pool balance
Lapland:	3% of cover pool balance
Aaland:	1% of cover pool balance

Arrears
Case-by-case consideration depending on arrears management and performance data: All loans more than 30 days in arrears receive a 75% foreclosure

frequency.

Bankruptcy
Case-by-case consideration: Up to 100% foreclosure frequency.

WAFF--Weighted-average foreclosure frequency.
LTV--Loan-to-value.

Table 9
Base Market Value Decline (%)

AAA	40

Table 10
Adjustment To Valuation
Valuation haircut: A haircut may be applied to calculation of WALS, should valuation information be as of a period of high price volatility.
WALS--Weighted-average loss severity.

Table 11
Adjustment To Loss Severity
Jumbo properties (>€375,000 in the south of €250,000 in rest of the country will have their market value declines scaled up by (1+ scaling factor) where the scaling factor increases exponentially and caps at 20% when the loan size reaches approximately €1.5 million.

POTENTIAL EFFECTS OF PROPOSED CRITERIA CHANGES

We have assigned the ratings on these covered bonds based on our criteria for rating covered bonds (see "Revised Methodology And Assumptions For Assessing Asset-Liability Mismatch Risk In Covered Bonds," published on Dec. 16, 2009). As part of our cash flow analysis, we used Standard & Poor's Covered Bond Monitor cash flow tool to calculate the target credit enhancement for the covered bonds. However, the assumptions and methodologies used in this cash flow analysis are under review (see "Request For Comment: Investment Criteria Methodology," published on Dec. 8, 2011).

This review may result in further changes to the criteria. As a result, our future assumptions and methodologies used in the credit analysis and our Covered Bond Monitor model may differ from our current criteria. The criteria change may affect the ratings on all outstanding covered bonds in this program. Until such time that we adopt new criteria for rating covered bonds, we will continue to rate and surveil these covered bonds using our existing criteria (see "Related Criteria And Research").

RELATED CRITERIA AND RESEARCH

- Finland-Based Bank of Aland PLC Rated 'BBB/A-3'; Outlook Stable, Aug 10, 2012
- Covered Bond Ratings Framework: Methodology And Assumptions, June 26, 2012

- Counterparty Risk Framework Methodology And Assumptions, May 31, 2012
- Covered Bonds Counterparty And Supporting Obligations Methodology And Assumptions, May 31, 2012
- Global Investment Criteria For Temporary Investments In Transaction Accounts, May 31, 2012
- Assessing Asset-Liability Mismatch Risk In Covered Bonds: Revised Methodology And Assumptions For Target Asset Spreads, April 24, 2012
- Request For Comment: Investment Criteria Methodology, Dec. 8, 2011
- Request For Comment: Methodology For Assessing Operational Risk In Structured Finance Transactions, Oct. 4, 2011
- Principles Of Credit Ratings, Feb. 16, 2011
- Request for Comment: Methodology And Assumptions For Market Value Securities, Aug. 31, 2010
- Methodology: Credit Stability Criteria, May 3, 2010
- Revised Methodology And Assumptions For Assessing Asset-Liability Mismatch Risk In Covered Bonds, Dec. 16, 2009
- Understanding Standard & Poor's Rating Definitions, June 3, 2009
- European Legal Criteria For Structured Finance Transactions, Aug. 28, 2008
- Covered Bond Monitor: Technical Note, Feb. 14, 2006

RATINGS LIST

Program/Rating
Country: Covered bond type

RATING AND OUTLOOK ASSIGNED

Bank of Aland PLC – Aalandsbanken Adp
Long-term: AA/Stable

Finland: Kiinteistövakuudellinen joukkovelkakirjalaina (Legislation-Enabled Covered Bonds)

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