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Transaction Update: Bank of Aland PLC (Category SWE Mortgage Covered Bonds)

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Ratings Detail

Reference Rating Level	**a-**
Resolution Regime Uplift	+2
Systemic Importance	Very Strong
Resolution Counterparty Rating	N/A
Issuer Credit Rating	**BBB**

+

Jurisdiction-Supported Rating Level	**aa-**
Assigned Jurisdictional Support Uplift	+3
Jurisdictional Support Assessment	Very Strong
Legal Framework	Very Strong
Systemic Importance	Strong
Sovereign Credit Capacity	Very Strong

+

Maximum Achievable Covered Bond Rating	**aaa**
Collateral Support Uplift	+3
Overcollateralization Adjustment	0
Liquidity Adjustment	0
Potential Collateral Based Uplift	+3

=

Covered Bond Rating	**AAA/Stable**
Rating Constraints	aaa
Counterparty Risk	aaa
Country Risk	aaa

N/A--Not applicable.

Major Rating Factors

Strengths

- The issuer is committed to manage available credit enhancement so it exceeds the required credit enhancement for the current rating.
- There is a public commitment from the issuer to cover 180 days of liquidity risk.

Weaknesses

- The cover pool's expected loss is higher than other Swedish residential pools, mainly driven by the high percentage of loans with jumbo valuations and loans secured by tenant-owner rights, compared to the other programs we rate, to which we apply an adjustment under our European residential loans criteria.
- Bank account risk and commingling risk are not legally or structurally addressed.
- The program features a timing mismatch between the weighted-average maturity on the assets and the liabilities that is higher than for other programs that we rate.

Outlook: Stable

Under our covered bonds criteria, Bank of Aland PLC's SWE mortgage covered bond program is eligible for three notches of uplift above the jurisdictional rating level (JRL), which is the same number of notches it requires to achieve a 'AAA' rating (see "Covered Bonds Criteria," published on Dec. 9, 2014). The stable outlook reflects the positive outlook on the issuer and the commitment from the issuer to maintain a level of collateral commensurate with the current rating. According to the issuer's commitment we expect that, in the event of an issuer one-notch downgrade, the overcollateralization would be increased to be consistent an additional notch of uplift in order to maintain the current rating.

Rationale

We are publishing this transaction update as part of our periodic review of Bank of Aland's SWE mortgage covered bond program.

Our rating process follows the methodology and assumptions outlined in our covered bonds criteria.

In our analysis, we assume the issuer's insolvency and look to the resolution regime, the jurisdictional support, and the pool to repay the covered bonds. The ratings reflect the likelihood of the covered bonds being repaid in a timely manner at their legal final maturity.

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 to Finland. These factors increase the likelihood that Bank of Aland (BBB/Positive/A-2) 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, a very strong systemic importance means the reference rating level (RRL) is the maximum between two notches above the long-term issuer credit rating (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.

We consider the likelihood for the provision of jurisdictional support, which we assess as very strong for covered bonds in Finland. This could result in a potential uplift from the 'a-' RRL of up to three notches under our covered bonds criteria. As a result, we assess the JRL as 'aa-'.

We have assessed the cover pool's credit risk by reviewing the loan-level data as of Dec. 31, 2019, and we have run cash flows based on aggregated information as of December 2019. The cover pool comprises Swedish residential mortgages. Based on our cash flow analysis, we believe that the available credit enhancement exceeds the required credit enhancement for a 'AAA' rating.

Lastly, the ratings on the program and related issuances are not constrained by legal, operational, country, or counterparty risks.

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

Program Description

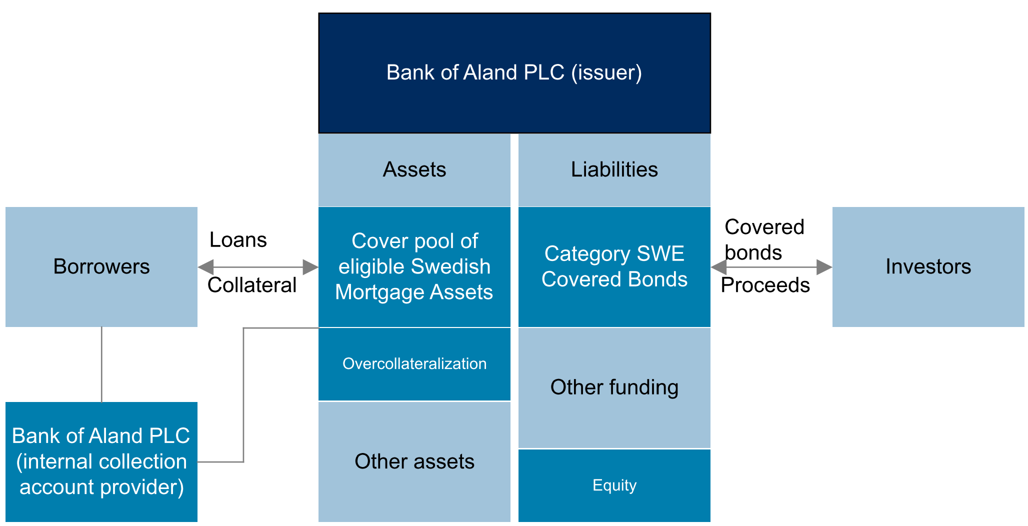
Table 1

Program Overview*	
Jurisdiction	Finland
Year of first issuance	2014
Covered bond type	Legislation-enabled
Outstanding covered bonds (bil. SEK)	2.5
Redemption profile	Soft bullet
Underlying assets	Swedish residential mortgage loans
Jurisdictional support uplift	3
Unused notches for jurisdictional support	0
Target credit enhancement (%)	58.25
Available credit enhancement (%)	54.41
Credit enhancement required for current rating (%)§	47.61
Collateral support uplift	3
Unused notches for collateral support	0
Total unused notches	0

*Based on data as of Dec. 31, 2019. §Given the JRL of 'aa-', overcollateralization that covers 'AAA' credit risk and 75% of refinancing costs or 47.61% of credit enhancement is required to achieve the 'AAA' rating.

Bank of Aland PLC

Transaction structure



Bank of Aland is a relatively small regional Scandinavian bank with a strong presence in the Finnish region of the

Aland Islands. The bank's operations in Finland are concentrated in the Aland Islands and South-West of the country. The bank focuses on offering private banking to high-net-worth clients, complemented by operations in Sweden's largest cities with branches in Stockholm, Gothenburg, and Malmö with focus on the same type of clients. We believe Bank of Aland follows a prudent approach in its loan underwriting, demonstrated in its good asset quality and very low arrears levels.

On Sept. 20, 2019, Bank of Åland announced that it had signed an agreement to establish a new Swedish mortgage company together with four partners: ICA Bank (belonging to retailer ICA Group), IKANO Bank (IKANO Group, belonging to the Kamprad family), Söderberg & Partners (advisor in wealth management, insurance, and pensions), and Borgo (digital mortgage company). The purpose is to create a platform to allow the distribution of mortgage loans granted to Swedish customers from each of the partners and to refinance them in an efficient way through the issuance of covered bonds. During fourth-quarter 2019, the collaboration with Swedish based ICA Bank began, and ICA Bank started to distribute mortgage loans to the Bank of Åland.

Under its €2 billion covered bond program, Bank of Aland maintains two separate cover pools, each backing a separate set of covered bonds. The "Category FIN" covered bonds have a preferential claim on a pool of Finnish mortgage assets, while the "Category SWE" covered bonds are collateralized by a pool of Swedish mortgages. Both sets of covered bonds are issued under the terms of Finnish Covered Bond Act. This transaction update covers the Category SWE covered bonds only.

The covered bonds constitute a senior secured unsubordinated obligation and rank pari passu with other obligations secured by the same cover register. In the event of bankruptcy, the pools would be separate and independent of each other.

Table 2

Program Participants

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

Rating Analysis

Legal and regulatory risks

In our legal risk analysis, we applied our legal criteria (see "Asset Isolation And Special-Purpose Entity Methodology," published on March 29, 2017). The Finnish Covered Bond Act of 2010 sets out the legal framework for issuing Finnish covered bonds. In our opinion, the Finnish covered bond legal framework is in line with the relevant legal requirements of our covered bonds criteria. This enables us to rate the covered bonds above the long-term ICR on the issuer.

If the issuer defaults, bondholders can initiate regular insolvency proceedings. In addition, under the Covered Bond

Act, they have a preferential claim to a cover pool. The cover pool can comprise residential mortgage loans, commercial mortgage loans, public-sector loans, and substitute assets from European Economic Area countries.

Under the legal framework, the cover pool's assets must be registered in the issuer's cover pool, in order to be isolated from the issuer's other assets if it becomes insolvent. The issuer must report the information in the register to the Finnish regulator monthly.

If the issuer were to become insolvent, the Finnish regulator would appoint a special cover pool administrator to supervise the covered bondholders' interests. If necessary, the administrator can sell assets or accelerate the payment of the covered bonds if it considers this to be in the bondholders' best interests, subject to Finnish regulatory approval.

To facilitate liquidity management, up to 20% of a mortgage cover pool can include substitute assets, such as state, municipal, or other public-sector/financial entities.

Under the Covered Bond Act, the issuer's bankruptcy would not result in the covered bonds' early redemption, or the suspension of payments to bondholders. Accordingly, we rate the covered bonds on the basis of their legal final maturity.

Operational and administrative risks

In our last 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.

In our view, operational risk is mitigated by internal policies and procedures and does not represent a rating constraint; we view the origination and servicing procedures as prudent and in line with market peers. On top of that, in our cash flow analysis, we model a stressed servicing fee that we feel is sufficient to incentivize a replacement servicer in an active market with several players should the need arise.

The criteria apply a pool-level adjustment of 0.7x-1.3x to reflect the observed historical performance of various pools from different originators or lenders within each jurisdiction.

We have reflected the prudent origination standards and pool performance by applying a positive pool-level adjustment factor in our analysis.

Our analysis of operational and administrative risk follows the principles laid out in our covered bond ratings framework.

Resolution regime analysis

As part of our covered bonds criteria, our analysis considers any resolution regime in place in Finland in order to determine the RRL. As Finland is part of the EU and is required to implement the EU's Bank Recovery And Resolution Directive (BRRD), this analysis considers the support provided by its eventual adoption. The RRL is equal to the greater of: (i) the issuing bank's ICR, plus up to two notches for programs in jurisdictions with effective resolution regimes that exempt covered bonds from bail-in, and (ii) the RCR on the issuing bank, where applicable. As for Bank of Aland there is no RCR assigned, the resulting RRL is 'a-', two notches of uplift from the ICR.

Jurisdictional support analysis

Under our analysis of jurisdictional support in our covered bonds criteria, we determine a JRL, 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 liquidation of collateral assets in the open market. Our assessment of the expected jurisdictional support for Finnish mortgage covered bond programs is very strong (see "Assessments For Jurisdictional Support According To Our Covered Bonds Criteria," published on March 3, 2020). Under our covered bonds criteria, this means that the program can receive up to three notches of jurisdictional uplift from the RRL. This results in a JRL for these mortgage covered bonds of 'aa-'.

Collateral support analysis

We base our analysis on the loan-level data provided by the issuer as of Dec. 31, 2019. The cover pool comprises Swedish residential loans backed by single-family houses and tenant-owner rights.

Since our previous review, both the weighted-average foreclosure frequency (WAFF) and the weighted-average loss severity (WALS) decreased marginally to 18.55% and 59.59%, respectively, from 18.93% and 60.93%.

Additionally, the portfolio's historical performance has been good, which we believe reflects the quality of the loan origination and underwriting processes. The positive pool-level adjustment in our analysis reflects this factor.

The reasons for the high WALS in this program, compared with the Finish program, for example, are the effect of overvaluation and the percentage of jumbo valuations and loans with tenant-owner rights. Our European residential loans criteria consider the effect of overvaluation when analyzing the loss severity. Swedish property prices have recently stabilized following a considerable increase over the past years when house prices outpaced income levels, leading to a material overvaluation in the housing market. Additionally, the pool has high percentages of loans with jumbo valuations and loans secured by tenant-owner rights, to which we apply an adjustment under our European residential loans criteria (see table 4).

There are no substitute assets in this cover pool.

The tables below summarize the results of our collateral support analysis.

Table 3

Pool Composition

	As of December 2019		As of December 2018	
Asset type (mortgage loans)	**Value (SEK)**	**Percentage of cover pool**	**Value (SEK)**	**Percentage of cover pool**
Residential assets (single family homes and condo apartments)	4,001,890,571	100.00	6,815,208,362	100.00
Commercial assets (multifamily housing and condo associations)	0	0.00	0	0.00
Total	4,001,890,571	100.00	6,815,208,362	100.00

Table 4

Key Credit Metrics

	As of December 2019	As of December 2018
Weighted-average whole loan-to-value ratio (%)	51.71	52.96
Weighted-average loan seasoning (months)*	47.19	30.30
Balance of loans in arrears (%)	0.40	0.00
Jumbo valuations (%)	78.40	79.70
Interest-only loans (%)	51.30	47.40
Loans secured by tenant-owner rights (%)	50.00	50.80
Credit analysis results		
WAFF (%)	18.93	18.55
WALS (%)	59.59	60.93
WAFF x WALS (%)	11.28	11.30
Asset default risk (%)	15.69	17.38

*Seasoning refers to the elapsed loan term. SEK--Swedish krona. WAFF--Weighted-average foreclosure frequency. WALS--Weighted-average loss severity.

Table 5

Current Loan-To-Value Ratios

Residential

	As of December 2019	As of December 2018
Weighted-average whole-loan LTV ratios (%)	**Percentage of the residential mortgage loan cover pool (%)**	
0 to 50	43.60	46.31
50 to 60	23.79	21.77
60 to 70	22.54	21.43
70 to 80	9.06	9.72
80 to 90	1.01	0.77
90 to 100	0.00	0.00
More than 100	0.00	0.00

LTV--Loan to value, after S&P adjustments.

Table 6

Loan Seasoning Distribution

Residential

	As of December 2019	As of December 2018
Seasoning (months)*	**Percentage of the residential mortgage loan cover pool (%)**	
Less than 18	2.23	28.61
18 to 60	73.34	60.86
Above 60	24.43	10.53

*Seasoning refers to the elapsed loan term.

Table 7

Geographic Distribution Of Loan Assets

Residential

	As of December 2019	As of December 2018
Region	**Percentage of the residential mortgage loan cover pool (%)**	
East Middle Sweden	1.15	0.10
North Middle Sweden	0.06	0.00
Smaland and the islands	0.07	0.00
South Sweden	10.94	10.80
Stockholm	73.87	75.70
Upper Norrland	0.00	0.00
West Sweden	13.91	13.40

Table 8

Collateral Uplift Metrics

	March 2020 Analysis	March 2019 Analysis
Asset WAM (years)	31.77	22.74
Liability WAM (years)	4	3.18
Available credit enhancement*	54.41	55.16
'AAA' credit risk (%)	15.69	17.38
Required credit enhancement for first notch of collateral uplift (%)	26.33	25.60
Required credit enhancement for second notch of collateral uplift (%)	36.97	33.83
Required credit enhancement for third notch of collateral uplift (%)	47.61	42.05
Target credit enhancement for maximum uplift (%)	58.25	50.27
Potential collateral-based uplift (notches)	3	3
Adjustment for liquidity (Y/N)	N	N
Adjustment for committed overcollateralization (Y/N)	N	N
Collateral support uplift (notches)	3	3

*After our adjustments. WAM--Weighted-average maturity.

According to our covered bonds criteria, the maximum potential collateral-based uplift on a covered bond program above the JRL is four notches. We then look to make adjustments to the maximum collateral-based uplift by reviewing the coverage of six months of liquidity and the level of commitment for the overcollateralization. The issuer has a liquidity commitment and an overcollateralization commitment published on its website that are both in line with our criteria. Therefore, we do not adjust the collateral support uplift for liquidity or committed overcollateralization.

By applying our credit and cash flow stresses, we calculate a target credit enhancement of 58.25%. This exceeds the 50.27% target credit enhancement at our previous review. The increase is mainly driven by an increased asset-liability maturity mismatch, resulting from the eight-year increase in the assets' weighted-average maturity. Additionally, considering that there is only one bond outstanding now, maturing in 2022, the mismatch is likely to increase, all else being equal.

Given the JRL of 'aa-', overcollateralization that covers 'AAA' credit risk and 75% of refinancing costs is required to achieve the maximum rating, as we do not deduct any notches of collateral uplift for uncommitted overcollateralization or liquidity risk not covered, as both are covered with the issuers' public statement. We calculate the credit enhancement needed to cover 'AAA' credit risk and 75% of refinancing costs at 47.61%. The program's available credit enhancement after adjusting for bank employee loans and set-off risk of 54.41% is above the required credit enhancement for a 'AAA' rating.

Counterparty risk

We have identified account bank and commingling risk as a relevant counterparty risk that is not addressed structurally or by law. We have considered the frequency of our access to information on the program's available credit enhancement to estimate the size of the account bank and commingling risk--currently 2.01% of the additional credit enhancement--and take the view that overcollateralization sufficiently mitigates this risk.

We have also identified set-off risk to be relevant for this transaction. As we believe that loans to borrowers with deposits with the issuer are exposed to set-off risk and that loan repayment could potentially be unavailable to service the covered bondholders' claims, we have reduced the available credit enhancement by the amount at risk. We have also adjusted the available credit enhancement by removing loans granted to the bank's employees from the cover pool, due to the risk of such loans being set off if the issuer were to become insolvent. As a result, the available collateral has been reduced for our analysis.

There are no derivatives registered in the cover pool.

We believe that counterparty risk is addressed and that therefore does not constrain the maximum achievable ratings on the covered bonds.

Sovereign risk

We assess country risk by applying our structured finance ratings above the sovereign criteria (see "Incorporating Sovereign Risk In Rating Structured Finance Securities: Methodology And Assumptions," published on Jan. 30, 2019). Given that assets in this cover pool are domiciled in Sweden and the current unsolicited ratings on Sweden (AAA/Stable/A-1+), our rating on the program is not limited by the application of these criteria.

Potential effects of COVID-19

S&P Global Ratings acknowledges a high degree of uncertainty about the rate of spread and peak of the coronavirus outbreak. Some government authorities estimate the pandemic will peak about midyear, and we are using this assumption in assessing the economic and credit implications. We believe the measures adopted to contain COVID-19 have pushed the global economy into recession (see our macroeconomic and credit updates here: www.spglobal.com/ratings). As the situation evolves, we will update our assumptions and estimates accordingly.

Related Criteria

- 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 - General: Methodology And Assumptions: Assessing Pools Of European Residential Loans, Aug. 4, 2017
- 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: Methodology: Credit Stability Criteria, May 3, 2010
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Related Research

- Global Covered Bond Characteristics And Rating Summary Q1 2020, March 31, 2020
- Global Covered Bond insights Q1 2020, March 31, 2020
- Global Covered Bonds: Assessing The Credit Effects Of COVID-19, March 25, 2020
- COVID-19 Macroeconomic Update: The Global Recession Is Here And Now, March 17, 2020
- COVID-19 Credit Update: The Sudden Economic Stop Will Bring Intense Credit Pressure, March 17, 2020
- Assessments For Jurisdictional Support According To Our Covered Bonds Criteria, March 3, 2020
- Assessments For Target Asset Spreads According To Our Covered Bonds Criteria, March 3, 2020
- Bank of Aland PLC, Oct. 28, 2019
- Banking Industry Country Risk Assessment: Sweden, April 11, 2019
- Glossary Of Covered Bond Terms, April 27, 2018