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

Primary Credit Analyst:
Ana Galdo, Madrid (34) 91-389-6947; ana.galdo@spglobal.com

Secondary Contact:
Matteo Lanza, London (44) 20 7176 6026; matteo.lanza@spglobal.com

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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**

N/A--Not applicable.

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

Major Rating Factors

Strengths

- The issuer manages available credit enhancement so it exceeds the required credit enhancement for the current rating.
- Since our last review, Bank of Aland has removed all commercial assets from the cover pool, assets, which we generally consider as having higher credit risk compared to residential assets.
- There is a public commitment from the issuer to cover 180 days of liquidity risk and maintain a level of overcollateralization consistent with the current rating.

Weaknesses

- The cover pool's expected loss is high when compared to 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, which are penalized in 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.

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 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 April 30, 2018 and we have run cash flows based on aggregated information as of June 2018. 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.

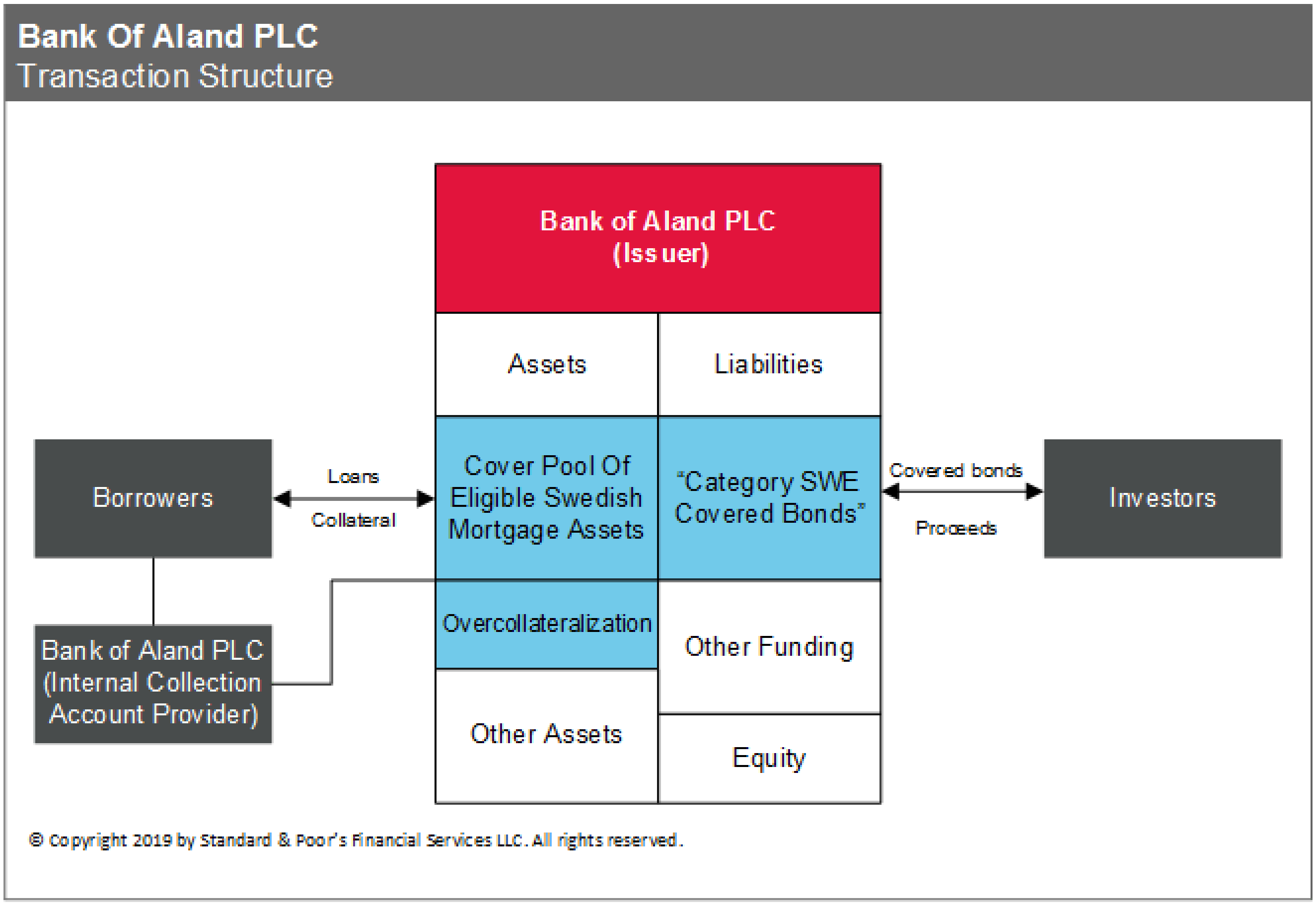
Program Description

Table 1

Program Overview*	
Jurisdiction	Finland
Year of first issuance	2014
Covered bond type	Legislation-enabled
Outstanding covered bonds (bil. SEK)	4.25
Redemption profile	Hard bullet
Underlying assets	Swedish residential mortgage loans
Jurisdictional support uplift	3
Unused notches for jurisdictional support	0
Target credit enhancement (%)	61.21
Available credit enhancement (%)	54.76
Credit enhancement required for current rating (%)§	51.98
Collateral support uplift	3
Unused notches for collateral support	0
Total unused notches	0

*Based on data as of April 30, 2018. §Given the JRL of 'aa-', overcollateralization that covers 'AAA' credit risk and 75% of refinancing costs or 51.98% of credit enhancement is required to achieve the 'AAA' rating.

Chart 1



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.

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 European 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 issuer credit rating (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. The register also includes the counterparties to derivative contracts, which must be able to survive the issuer's insolvency.

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 factor 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: 1.) 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 2.) 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 Oct. 16, 2018). 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 April 30, 2018. The cover pool comprises Swedish residential loans backed by single family houses and tenant owner rights. At the time of our last publication (December 2015 data) the cover pool included loans backed by multifamily housing and housing associations, which we analyze through our criteria for analyzing European commercial real estate collateral in covered bonds. These loans have since been removed from the pool, which is currently 100% residential.

Since December 2015, the weighted-average foreclosure frequency (WAFF) has decreased to 21.06% from 28.08% and the weighted-average loss severity (WALS) has increased to 73.02 from 24.47%.

The decrease in the WAFF is mainly the result of the application of our new residential loans criteria and the absence in the current pool of commercial loans, which according to our criteria, have a higher probability of default (see

"Methodology And Assumptions: Assessing Pools Of European Residential Loans," published on Aug. 4, 2017). Additionally, the portfolio's historical performance has been good, which we believe reflects the quality of the loan origination and underwriting processes. Our positive pool-level adjustment factor in our analysis reflects this factor.

Our European residential loans criteria take into account the effect of overvaluation when analyzing the loss severity. As this is the first time we have applied these criteria, it has resulted in an increase in the WALS. 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, in our view, that we now consider in our analysis. This overvaluation is reflected in the determination of our loss severity, which has significantly increased. Additionally the pool has high percentages of loans with jumbo valuations and loans secured by tenant-owner rights, which are now penalized in our European residential loans criteria

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 April 2018		As of December 2015	
Asset type (mortgage loans)	**Value (SEK)**	**Percentage of cover pool**	**Value (SEK)**	**Percentage of cover pool**
Residential assets (single family homes and condo apartments)	6,886,690,983	100.00	1,980,159,771	64.55
Commercial assets (multifamily housing and condo associations)	0	0.00	1,087,621,855	35.45
Total	6,886,690,983	100.00	3,067,781,626	100.00

Table 4

Key Credit Metrics

	As of April 2018	As of December 2015
Weighted-average whole loan-to-value (LTV) ratio (%)	53.50	58.98
Weighted-average loan seasoning (months)*	25.00	24.48
Balance of loans in arrears (%)	0.05	0.00
Jumbo valuations (%)	79.24	N/A
Loans secured by tenant owner rights (%)	51.42	N/A
Credit analysis results		
WAFF (%)	21.06	28.08
WALS (%)	73.02	24.47
WAFF x WALS (%)	15.38	6.87
Asset default risk (%)	24.29	12.33

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

Table 5

Pool Assets By Loan Size

Residential

	As of April 2018	As of December 2015
Loan size ('000 SEK)	Percentage of the residential mortgage loan cover pool	Percentage of the residential mortgage loan cover pool
0 to 500	1.38	3.04
500 to 1,000	3.82	8.57
1,000 to 1,500	6.1	14.9
1,500 to 2,000	8.0	15.2
2,000 to 2,500	8.48	15.86
2,500 to 3,000	9.7	15.6
3,000 to 3,500	8.35	7.79
More than 3,500	54.14	18.98

Table 6

Loan-To-Value Ratios

Residential

	As of April 2018	As of December 2015
Weighted-average whole loan LTV ratios (%)	Percentage of the residential mortgage loan cover pool	Percentage of the residential mortgage loan cover pool
0 to 50	40.17	23.16
50 to 60	24.99	19.73
60 to 70	25.67	25.38
70 to 80	5.76	25.76
80 to 90	1.08	5.86
90 to 100	0.12	0.12
More than 100	2.20	0.00

Table 7

Loan Seasoning Distribution

Residential

	As of April 2018	As of December 2015
Seasoning (months)*	Percentage of the residential mortgage loan cover pool	Percentage of the residential mortgage loan cover pool
Less than 18	42.60	37.55
18 to 60	51.64	62.45
Above 60	5.76	0.00

*Seasoning refers to the elapsed loan term.

Table 8

Geographic Distribution Of Loan Assets

Residential

	As of April 2018	As of December 2015
Region	**Percentage of the residential mortgage loan cover pool**	**Percentage of the residential mortgage loan cover pool**
Götaland	21.85	30.81
Norrland	0.05	0.00
Svealand	78.11	69.19

Table 9

Collateral Uplift Metrics

	June 2018 analysis	December 2015 analysis
Asset WAM (years)	23.18	18.17
Liability WAM (years)	3.09	3.57
Available credit enhancement *	54.76	68.26
AAA' credit risk (%)	24.29	12.33
Required credit enhancement for first notch of collateral uplift (%)	33.52	19.10
Required credit enhancement for second notch of collateral uplift (%)	42.75	26.02
Required credit enhancement for third notch of collateral uplift (%)	51.98	32.93
Target credit enhancement for maximum uplift (%)	61.21	39.85
Potential collateral-based uplift (notches)	3	4
Adjustment for liquidity (Y/N)	N	N
Adjustment for committed overcollateralization (Y/N)	N	N
Collateral support uplift (notches)	3	4

*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 61.21%. This exceeds the 39.85% target credit enhancement in April 2016. The increase is results from the significantly higher credit risk for mortgage assets ('AAA' credit risk has increased to 24.29% from 12.33% previously), the effect of the application of our updated residential loans criteria, and an increased asset-liability mismatch. This is partially due to the removal of commercial assets, which typically have a lower term to maturity and partially due to a reduction of the liabilities' weighted-average maturity.

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 51.98%. This is lower than the available credit enhancement after our adjustments of 54.76% (68.26% in December 2015).

Counterparty risk

We believe there are several potential counterparty risks to which the covered bonds are exposed. However, these are either mitigated through structural mechanisms, or we have taken them into account in our modelling. Accordingly, we consider that they do not constrain our ratings on the covered bonds.

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 4.21% % 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 deposit amounts 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. Additionally, we adjust 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 by 3.18% (4.97% in our last published review).

There are no derivatives registered in the cover pool.

Given all of the above, we believe that counterparty risk is addressed and that therefore does not constrain the maximum achievable ratings on the covered bonds.

Country risk

We assess country risk by applying our structured finance ratings above the sovereign criteria (see "Ratings Above The Sovereign - Structured Finance: Methodology And Assumptions," published on Aug. 8, 2016). We consider the sensitivity of the underlying mortgage assets to country risk to be moderate. 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 proposed criteria changes

Our ratings are based on our applicable criteria, including our "Counterparty Risk Framework Methodology And Assumptions," published on June 25, 2013, "Counterparty Risk Analysis In Covered Bonds," published on Dec. 21, 2015, and "Ratings Above The Sovereign - Structured Finance: Methodology And Assumptions," published on Aug. 8, 2016.

However, these criteria are under review (see "Request For Comment: Counterparty Risk Framework: Methodology And Assumptions," published on Oct. 9, 2018, and "Request For Comment: Ratings Above The Sovereign - Structured Finance: Methodology And Assumptions," published on Nov. 20, 2018). As a result of these reviews, we may amend certain paragraphs of our rating above the sovereign criteria and our analysis of counterparty risk in a covered bond program. These changes may affect the ratings on the outstanding covered bonds issued under this covered bond program. Until this time, we will continue to rate and surveil these covered bonds using our existing criteria (see "Related Criteria").

Related Criteria

- 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 - General: Ratings Above The Sovereign - Structured Finance: Methodology And Assumptions, Aug. 8, 2016
- Criteria - Structured Finance - Covered Bonds: Counterparty Risk Analysis In Covered Bonds, Dec. 21, 2015
- Methodology And Assumptions: Analyzing European Commercial Real Estate Collateral In European Covered Bonds, March 31, 2015
- 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
- Criteria - Structured Finance - General: Counterparty Risk Framework Methodology And Assumptions, June 25, 2013
- 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 Q4 2018, Dec. 12, 2018
- Global Covered Bond insights Q4 2018, Dec. 12, 2018.
- Request For Comment: Ratings Above The Sovereign - Structured Finance: Methodology And Assumptions, Nov. 20, 2018
- Assessments For Jurisdictional Support According To Our Covered Bonds Criteria, Oct. 16, 2018
- Assessments For Target Asset Spreads According To Our Covered Bonds Criteria, Oct. 16, 2018
- Request For Comment: Counterparty Risk Framework: Methodology And Assumptions, Oct. 9, 2018
- Bank of Aland PLC, Aug. 17, 2018
- Criteria Guidance: Covered Bonds Criteria, May 2, 2018
- Glossary Of Covered Bond Terms, April 27, 2018
- Banking Industry Country Risk Assessment: Sweden, Nov. 24, 2017
- What Factors Do We Consider When Analyzing Commingling And Account Bank Risk In Covered Bonds?, Nov. 26, 2012