AIB Mortgage Bank

Mortgage Covered Bonds

Full Rating Report

Ratings/Outlook

Mortgage Covered Bonds	AA+/Positive

Rating Rationale

IDR/Outlook	BB+/Positive
IDR uplift	2 notches
PCU (notches)	5 notches
Tested Rating on a PD basis	'AA-'
Recovery uplift	2 notches
Covered bonds rating	'AA+'
AP Fitch considers in analysis (%)	39.0
'AAA' breakeven AP (%)	29.0

Key Data

	Sep 16
Asset type	Residential mortgages
Cover assets (EURbn)	13.9
Covered bonds (EURbn)	7.7
Nominal OC (%)	81
WAL of assets (years)	10
WAL of liabilities (years)	3

Source: Fitch, AIBMB

Related Research

Covered Bonds Surveillance Snapshot (October 2016)

Fitch Affirms Bank of Ireland and Allied Irish Banks; Outlook Positive (December 2016)

Allied Irish Banks, plc - Ratings Navigator (January 2016)

Allied Irish Banks, plc (October 2015)

Global Housing and Mortgage Outlook - 2016 (January 2016)

2017 Outlook: Covered Bonds (December 2016)

'B' Portfolio Loss Rates for Covered Bonds (September 2016)

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Key Rating Drivers

Rating Upgrade on Criteria Implementation: Fitch Ratings upgraded AIB Mortgage Bank's (AIBMB) covered bonds rating to 'AA+' from 'A+' in November 2016 following the application of the revised Covered Bonds Rating Criteria. The rating reflects the Long-Term Issuer Default Rating (IDR) of 'BB+' on Allied Irish Banks, plc (AIB, AIBMB's parent), an IDR uplift of two notches, a Payment Continuity Uplift (PCU) of five notches and a Recovery Uplift (RU) of two notches.

AIBMB's publicly committed over-collateralisation (OC) of 39.0% provides more protection than the 'AA+' breakeven OC of 29.0%, which supports a 'AA-' rating on a probability of default (PD) basis and a two-notch RU. The Positive Outlook on the covered bonds reflects that on AIB.

Two-Notch IDR Uplift: This reflects the exemption of Irish covered bonds from bail-in in a resolution scenario and the low risk of under-collateralisation of covered bonds at the point of resolution. Fitch believes resolution of the issuer will not result in the direct enforcement of recourse against the cover pool due to the operational integration of the specialised mortgage institution into AIB, one of the two pillar banks in Ireland.

PCU of Five Notches: The programme has a 12-month principal maturity extension for the soft bullet bonds and a reserve fund that covers three-month interest payment plus a buffer. The lack of clear provisions to find a refinancing solution after the recourse switches to the cover pool upon a maturity extension results in a reduction of the PCU from six to five notches.

Two-Notch Recovery Uplift: The OC Fitch takes into account compensates for the 'AA+' credit losses and there is no FX exposure to recoveries as assets and covered bonds are denominated in the same currency (euros), leading to the two-notch RU.

'AA+' Breakeven OC Lowered: The 'AA+' breakeven OC has decreased compared to last year due to lower refinancing spread assumptions (RSL) for Irish mortgages under the revised criteria. The 'AA-' asset disposal loss component at 24.4% remains the main driver of the 'AA+' breakeven OC as a result of a large asset and liability maturity mismatch. The 'AA-' credit loss was 16.3% whereas the 'AA-' cash flow (CF) valuation component reduces the breakeven OC by 11.7%, reflecting high excess spread in the programme.

Programme Highlights

Stable Cover Pool: The mortgage pool is well seasoned, with a weighted average seasoning of over 90 months and a stable original loan/value (LTV) ratio of 76% compared with the analysis in July 2015. Owner-occupied loans make up about 86% of the pool while 14% are buy-to-let or second homes. Only 1% are interest-only loans. Arrears within 30 days past due remain very low at 0.2%. There are no arrears over 30 days due to the regular removal of delinquent loans of 30 days or more.

No Credit to Swap: The agency models the cash flow without giving credit to the interest-rate swap (IRS) between AIB and AIBMB. AIB does not have a rating to be an eligible swap counterparty to support the covered bond rating at 'AA+'. In addition, although the standby account bank agreement with Barclays Bank plc (A/Stable/F1) has been activated, the cash swap collateral posted by AIB under the IRS is deposited with AIB, which also does not have an eligible account bank's rating to support the covered bond rating.

Peer for Comparison

Issuer/ Programme	IDR/ Outlook	CVB rating
EBS Mortgage Finance	BB+/ Positive[a]	AA/ Stable

[a] The IDR refers to EBS d.a.c.
Source: Fitch

Peer Comparison

The key rating drivers for AIBMB are in line with those of another Fitch-rated mortgage covered bond programme of EBS Mortgage Finance Limited (EBSMF). EBSMF is wholly owned by EBS d.a.c. (EBS; BB+/Positive), which is wholly owned by AIB (BB+/Positive), the parent of AIBMB. See the *Covered Bond Surveillance Snapshot* and related Excel file (October 2016) under *Related Research* for a detailed comparison of rating drivers across Fitch-rated covered bond programmes.

Peer Comparison: Key Rating Drivers

	AIBMB	EBSMF
Referenced IDR/Outlook	BB+/Positive	BB+/Positive
IDR uplift	2	2
PCU	5	5
B portfolio loss rate (%)	3.5	5.5
Covered bonds' rating breakeven OC (%)	29.0 (AA+)	31.5 (AA)
Breakeven OC components (%)		
Credit loss (%)	16.3	20.9
Cash flow valuation (%)	-11.7	-4.7
Asset disposal loss (%)	24.4	15.3

Source: Fitch

Sovereign Impact

Ireland has a Country Ceiling of 'AAA' and all residential mortgages in the cover pool are located in Ireland. Therefore, Fitch does not adjust the calculated rating default and recovery rates applied in its analysis.

Sensitivity Analysis

AIBMB's mortgage covered bonds' ratings could be upgraded if: AIB's Long-Term IDR were upgraded by one notch or more to 'BBB-' or above; or the PCU increases by one notch to six notches, and at the same time the OC relied on could support the breakeven OC for the then covered bonds ratings.

AIBMB's mortgage covered bonds' 'AA+' rating would be vulnerable to a downgrade if any of the following occurred: AIB's Long-Term IDR were downgraded by one notch or more to 'BB' or below; the total number of notches representing the IDR uplift and PCU uplift were lowered by one notch to six notches; the OC relied on, which is the public voluntary commitment, fell below Fitch's 'AA+' breakeven OC of 29.0%.

Related Criteria

Covered Bonds Rating Criteria (October 2016)

Fitch's Cover Asset Refinancing Spread Level (RSL) Assumptions – Excel File (October 2016)

Counterparty Criteria for Structured Finance and Covered Bonds (September 2016)

Counterparty Criteria for Structured Finance and Covered Bonds: Derivative Addendum (July 2016)

EMEA RMBS Rating Criteria (November 2016)

Criteria Addendum: Ireland – Residential Mortgage Assumptions (November 2016)

Criteria for Interest Rate Stresses in Structure Finance Transactions and Covered Bonds (October 2016)

Abbreviations
PCU: Payment Continuity Uplift
IDR: Issuer Default Rating
OC: Overcollateralisation
PD: Probability of default
WAL: Weighted average life
WAFF: Weighted average frequency of foreclosure
WARR: Weighted average recovery rate

The Issuer

AIBMB is a specialised mortgage institution established under the Asset Covered Securities (ACS) Act and is 100% owned by AIB. AIB is one of the two pillar banks in Ireland, offering a wide range of retail, commercial and corporate banking services. AIB, together with its wholly owned subsidiary, EBS d.a.c., is one of the largest mortgage lenders in Ireland. For details of AIB's credit profile, see the most recent Full Rating Report and Ratings Navigator under *Related Research*.

The covered bond holders benefit from a dual recourse against the issuer on an unsecured and unsubordinated basis, and against the cover pool, which is exclusively available to the covered bondholders and will be segregated from the issuer's insolvency estate by virtue of the ACS Act should the issuer become insolvent (see Appendix 1 for a programme summary).

IDR Uplift: Two Notches

Fitch assigns an IDR uplift of two notches to mortgage covered bond programmes in Ireland. Ireland has adopted an advanced bank resolution regime from which fully collateralised covered bonds and secured debt are exempt.

The agency considered that resolution is not likely to result in direct enforcement of the recourse against the cover pool. The issuer is a specialised mortgage institution established under the ACS Act and is a wholly owned subsidiary of AIB. The operational integration of AIBMB with AIB and its location in the same jurisdiction as AIB make it likely that the resolution of AIBMB will be done at AIB's level. AIB is one of the two pillar banks in Ireland, which means it is more likely to be resolved by other means than liquidation. AIB's IDR is driven by the Viability Rating.

Fitch considers that the risk of under-collateralisation of covered bonds in Ireland is low due to the regulatory framework, which includes mandatory OC, maximum LTV guidelines, periodic revaluation of properties and the role of an independent asset monitor, which monitors the programme's compliance with the ACS regulations. For details, see *Fitch's Jurisdictional Analysis of the Risk of Under-collateralisation of Covered Bonds - Excel file* (October 2016).

PCU: Five Notches

Fitch considers that covered bond payments may continue to be met without any interruption once recourse to the cover pool has been enforced, provided there are satisfactory liquidity protection mechanisms. We view liquidity as the main driver of the smooth transition from the issuer to the cover pool as the source of covered bonds interest and principal payments and therefore normally the main determinant of the PCU, unless other risks constitute a greater threat to payment continuity.

Fitch has assigned this programme a PCU of five notches (formerly a D-Cap of three notches) due to the principal and interest payment protection mechanism summarised in the table below, notably an interest reserve and a 12-month maturity extension feature. Fitch does not consider that other PCU components, "Asset Segregation" and "Alternative Risk Management" present a high risk to payment continuity. However, the agency has reduced the PCU from six to five notches due to the lack of clarity in the document provisions on finding a refinancing solution after the recourse switches to the cover pool, including sales of assets without delay in the event of a maturity extension. Details on the assessment for the asset segregation and alternative risk management component can be found in Appendix 2.

Summary of Liquidity Protection Mechanism

Programme Type	Soft bullets (0.1% hard bullets) Residential mortgages in Ireland
Liquidity Protection for Principal Payments	12-month extension on the soft-bullet covered bonds if the issuer fails to pay the covered bonds on the scheduled maturity date For the hard bullet bonds, the issuer commits to cash collateralise the bonds 12 months in advance of the maturity. While there is no documented pre-maturity test, Fitch considers the small proportion immaterial
Liquidity Protection for Interest Payments	There is a reserve fund to cover three-month interest and a buffer. The reserve fund is with an eligible external account bank, Barclays. The account bank documentation's rating triggers and remedies are in line with Fitch's counterparty criteria
Impact of Counterparty Criteria for Structured Finance and Covered Bonds?	No, as the account bank replacement language is in line with Fitch's criteria
Other Risk Considerations Affecting PCU Assessment?	Yes, the lack of clarity in the document provisions on finding a refinancing solution after the recourse switches to the cover pool, including sales of assets without delay in the event of a maturity extension. Fitch gives some credit for the legislative framework where the alternative manager needs to ensure the covered bonds are paid on a timely basis even after the issuer's insolvency Asset segregation and alternative management do not present a high risk to payment continuity. See Appendix 2.

Source: Fitch

Recovery Uplift: Two Notches

This programme is eligible for a recovery uplift of two notches as the OC relied on compensates for the 'AA+' credit losses and the recoveries after covered bond default are not exposed to FX risk because both assets and covered bonds are denominated in euros.

Cover Pool

AIBMB's Cover Pool

Characteristics as of September 2016

General		**Borrower type (%)**	
Current principal balance (EURbn)	13.9	Prime	100
Average current loan size (EUR)	127,075	Employed[a]	76
Number of loans	109,378	Self-employed[a]	14
WA seasoning (months)	91	Other/Unknown[a]	10
WA DTI (%)[a]	44		
Loan-to-value (LTV) (%)		**Loan type (%)**	
WA original LTV[a]	76	First-ranking	100
WA current LTV	60	Buy-to-let and second home	14
WA indexed current LTV	68	Interest only	1
		Fixed rate	11
Current arrears (%)		Standard variable rate	46
3m+ arrears	0	ECB tracker rate	43
Less than 3m arrears	0.2	Flexible draw	0
Property type (%)		**Geographic distribution (%)**	
Houses	78	Dublin	38
Flats	12	Rest of Ireland	62
Others/Unknown	10		
Restructured loans (%)	4		

[a] Based on the cover pool as of March 2016, calculated by Fitch
Source: Fitch, AIBMB covered bond programme investor report

Cover Pool Credit Analysis

Default Model Output

Rating level	WAFF	WARR	Loss rate
AA+	32.1	42.9	18.3
AA-	27.0	48.0	14.0

Source: Fitch

Fitch analysed the portfolio using its mortgage loss criteria for Ireland (for further details see *EMEA RMBS Rating Criteria* and *Criteria Addendum: Ireland* under *Related Criteria*). Fitch applied its standard default probability adjustments under the criteria.

The majority of the residential mortgages in the cover pool were initially originated by AIB and transferred to AIBMB in 2006 through a statutory transfer mechanism provided for in the ACS Act. Since then, all mortgages originated from AIB's branches are originated in the name of AIBMB although AIB still provides various functions for AIBMB, including treasury, mortgage origination, underwriting, servicing, administration, human resources and IT services. Fitch has reviewed the underwriting, servicing and collection practices of AIB (see Appendix 4) and deems that AIB's operational capability is satisfactory.

The 'AA+' loss rate was 18.3%, reflecting a 'AA+' WAFF of 32.1% and a 'AA+' WARR of 42.9%. The cover pool has remained stable as the issuer does not need to top up the pool actively given the significant buffer of OC level versus the breakeven OC. The cover pool therefore remains well seasoned and the current indexed LTV is also moderate at 68%. The portfolio is 38% concentrated in Dublin, which is representative of the Irish mortgage market, driven by the higher proportion of the population and higher property values in the capital than other regions. The regular removal of loans in arrears for 30 days or more by AIBMB also results in the cover pool having a notably better credit quality than the Irish mortgage sector's average.

In its asset analysis, Fitch has made conservative assumptions on partially missing information, which is mostly related to old-dated loans. This includes applying an additional 20% hit to the PD for loans where the employment type is either missing or unknown (this concerns 10% of the cover pool by current balance), and assuming an income so that the debt/income ratio falls to the worst class of the five brackets (this concerns 7% of the cover pool).

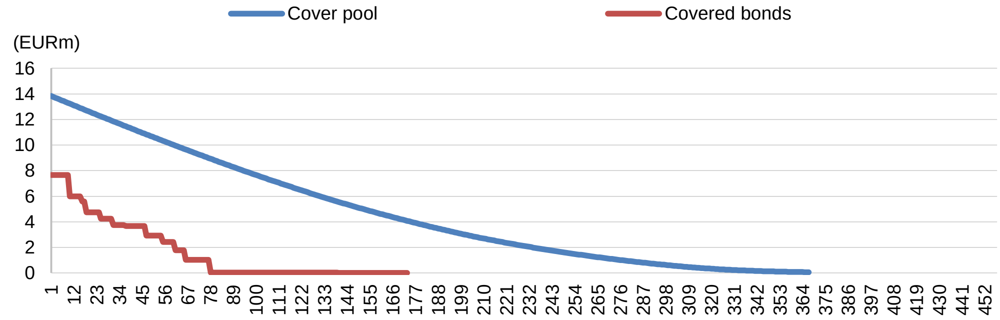
In common with the Irish mortgage market, AIBMB's origination volume has reduced significantly since the financial crisis in 2008. While origination increased significantly in 2015, it is still well below the pre-crisis level. As a result, the agency does not expect the cover pool to be topped up materially in the next 12 months. In the longer term, the composition and credit quality of the cover pool may change due to the dynamic nature of the programme.

Cash Flow Analysis

Fitch's cash flow model simulates the asset cash flows to reflect prepayment, servicing costs, delinquencies, defaults and recoveries in multiple stress scenarios under various issuer default timings.

In case of a liquidity shortfall, Fitch assumes that an alternative manager would be able to realise part of the mortgage portfolio within the extended 12-month maturity period of the covered bonds. However, there is no guarantee that a portfolio could be realised in any prevailing economic environment. Fitch estimates the stressed price for assets sold to bridge maturity mismatches to be on average 73% of par in an 'AA-' scenario, which represents the tested rating on a PD basis.

Amortisation Profile



Asset and bond cashflow data as of 1 Oct 16
Source: Fitch; AIBMB

Summary of Hedging in AIBMB's Programme

Swap type	Currency	(%)	Swap provider	Rating	Documentation versus Fitch criteria
Fixed floating (assets) Basis risk (assets) Standard variable rate to floating (assets)	No	11 43 46	AIB	BB+/Positive/B	AIB's current rating does not make it eligible to be a swap counterparty and the cash swap collateral is deposited with AIB
Fixed floating (liability)	No	69	AIB	BB+/Positive/B	

Source: Fitch, AIBMB. As of June 2016

Fitch models all assets' and liabilities' CF without giving credit to the IRS. AIB's rating is 'BB+', which is below the minimum counterparty rating to support the covered bonds rating at 'AA+'. In addition, despite the activation of the standby account bank agreement with Barclays, AIB is posting cash collateral with itself, in the name of AIBMB. AIB does not have an eligible account bank rating to support the covered bond rating. As a result, the agency assumes that the cash collateral would not be available when needed for a swap novation if AIB fails.

For the reasons above, Fitch considers the swap to be ineffective in the cash flow analysis and the agency stresses the interest rate mismatches between assets and liabilities in line with its criteria. As of September 2016, 11% of the assets were paying fixed rate, with most reverting to a standard variable rate in two to three years. In comparison, 69% of liabilities pay a fixed rate of interest, but the weighted average remaining life of the covered bonds (three years) is shorter than the assets' (10 years).

Forty-three percent of mortgages track the ECB base rate. Fitch has applied a haircut of 200bp in the first year and 50bp thereafter to the tracker rate mortgages to account for the basis risk between the base rate and the stressed Euribor. The tracker rate after the haircut is floored at zero.

Irrespective of whether the swap is effective or not, the agency assumes that mortgages paying a standard variable rate (SVR; 46%) pay Euribor +200bp in the interest rate up stress scenario in its CF modelling, which is in line with the assumptions in the Irish *Criteria Addendum*. In the interest rate base and down scenario, the agency models the SVR margin as 3.15%, which is equal to the current SVR rate at 3.65% minus a 50bp haircut. The agency considers the SVR swap not replaceable because the SVR is linked to the lender's discretionary pricing policy.

Breakeven OC for the Rating

Fitch calculated a 'AA+' breakeven OC of 29.0%, which is lower than the 32.0% published in July 2016 and is due to the lower RSL assumptions in the revised criteria. In the 'AA-' rating scenario, the RSL of Irish owner-occupied mortgages is 379bp (479bp in the former criteria).

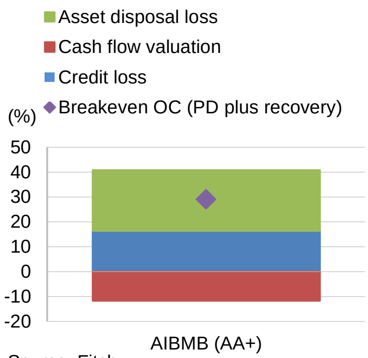
The asset disposal loss component is the main driver of the 'AA+' breakeven OC. This component factors in the impact of modelling the stressed sale of the assets to achieve a timely payment in an 'AA-' stress scenario. The large maturity mismatch between assets and liabilities with the WA life of assets at about 10 years and liabilities at three years, and the application of the RSL of 394bp in an 'AA-' stress scenario on a PD basis results in a high asset disposal loss of 24.4%. The RSL is calculated based on the respective RSL assumptions of owner-occupied mortgages and buy-to-let mortgages in Ireland, weighted by the cover pool's respective proportion of each loan type.

The second driver is the 'AA-' credit loss component at 16.3%, representing the impact of the 'AA-' WAFF at 27.0% and 'AA-' WARR at 48.0%.

The cash flow valuation component lowers the 'AA+' breakeven OC by 11.7% due to a much longer WA life of the assets than the liabilities and excess spread, which leads the stressed present value of the assets to be higher than the present value of the liabilities.

The breakeven OC for the rating will be affected, among other things, by the credit quality of the cover pool and the profile of the cover assets relative to the outstanding covered bonds, which can change over time.

Breakeven OC Components



Source: Fitch

OC Fitch Relies On

Fitch bases its analysis on the OC of 39.0%, which is committed by AIBMB through a voluntary public notice.

Programme Review

Fitch will periodically review the credit quality of the cover pool and perform a cash flow analysis to assess whether the OC taken into account by the agency provides protection against identified risks commensurate with the rating of the covered bonds issued by AIBMB under this programme. Cover pool and covered bonds information will be updated regularly and displayed on Fitch's covered bond surveillance tool (available at www.fitchratings.com) and in the quarterly *Covered Bonds Surveillance Snapshot*.

Appendix 1: Programme Summary

The scope of the activities of AIBMB, a designated mortgages financial institution, is defined in the ACS Act. AIBMB's principal purpose is to finance residential mortgages through the issuance of mortgage covered bonds in accordance with the ACS Act.

Under this programme, AIBMB can issue covered bonds up to EUR20bn secured by a dynamic pool of eligible mortgage assets, including up to 15% of eligible substitution assets per the ACS Act. Although the Act permits the inclusion of loans backed by commercial properties or residential properties in any eligible country, as well as eligible mortgage backed securities, the issuer only includes Irish residential mortgages and substitution assets (deposits) in the cover pool.

The covered bonds rank pari passu among themselves and represent direct, unsecured and unconditional obligations of AIBMB and are secured by the cover assets which are ring-fenced from the issuer's insolvency estate. The programme is regulated by the Central Bank of Ireland (CBOI) under the ACS Act established in 2001 and amended in 2007 and the issuer needs to adhere to the regulations per the ACS Act (see Appendix 5 for a summary of the regulatory framework).

Main Parties

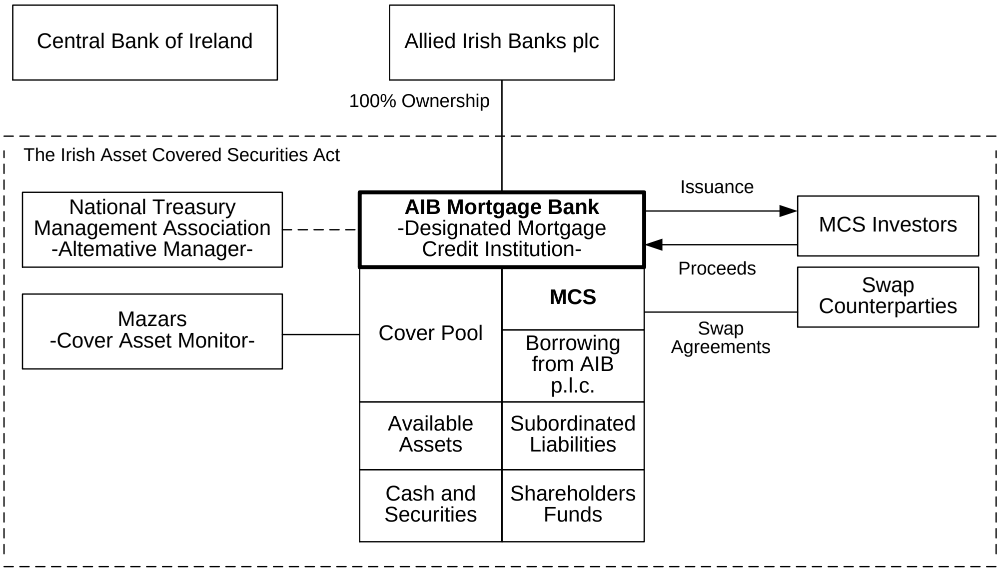
AIB Mortgage Bank	Issuer Originator
Allied Irish Banks, plc	Asset and liability swap provider Cash swap collateral deposit bank Collection account bank Servicer
Barclays Bank plc	Account bank
The Bank of New York Mellon	Principal paying agent Calculation agent Registrar and transfer agent
Mazars	Cover assets monitor

Source: Programme documents

Through a statutory transfer mechanism provided for in the ACS Act, AIB transferred almost all of its branch-originated Irish residential loans and related security held by it to AIBMB in 2006, and almost all its intermediary-originated Irish mortgages to AIBMB in 2011. Since February 2006, all new Irish branch residential mortgage loans have been originated directly in the name of AIBMB.

Under the outsourcing agreement entered into between AIB and AIBMB, AIB has agreed to provide AIBMB with administration and agency services in relation to the origination, maintenance and enforcement of AIBMB's Irish residential mortgages and related treasury, funding and other activities, such as administration of customer accounts, risk management, regulatory matters, human resources and technology matters.

Simplified Group Structure Diagram



Source: Fitch, Transaction document.

Appendix 2: Other Payment Continuity Risk Considerations

Asset Segregation

The ring-fencing of the cover assets from the rest of an issuer's balance sheet is a prerequisite for any payment to be directed to covered bondholders and for Fitch to rate a programme above the issuer's senior unsecured debt rating. Fitch has assessed the strength of the asset segregation and considers the ring-fencing effective and not to represent a high risk to the PCU.

Due to AIB being the collection account bank, there is a bi-weekly commingling risk exposure with AIB (see below). Fitch has modelled the potential commingling loss in its CF analysis.

Asset Segregation

Component driver	Fitch assessment
Segregation of cover pool from other creditors of the issuer	The ACS Act enacted in 2001 and amended in 2007 provides a high degree of clarity to the segregation of assets securing the covered bonds. The issuer must be a special designated credit institution established under the ACS Act with limited permissible business activities, centred on the issuance of ACS to finance the cover assets. The ACS Act requires the issuer to maintain a cover register of the cover assets. The assets in the register are segregated from the insolvency estate of the issuer by law.
Excess OC immune from claims from other creditors	The claims of the covered bondholders extend over all the assets in the register, including OC levels above the legal minimum requirement and the programme's contractual levels.
Asset and liability claw-back risk	This is addressed through the registration of the cover assets and the statutory preferred creditor status of covered bondholders. In addition, the limited permissible business activities of the issuer that are centred on the issuance of covered bonds to finance the cover assets mitigate the potential asset and liability claw-back risk.
Commingling risk	This is limited to a bi-weekly commingling exposure at the collection bank account of AIB. As AIB's rating at 'BB+' is not eligible to support the covered bond rating at 'AA+', Fitch has considered potential commingling risk in the CF analysis. The issuer account bank is an external account bank which has an eligible rating trigger and remedy in place.
Set-off risk for deposits and flexible re-draw facilities	The borrower set-off risk is subordinated by law to the full satisfaction of covered bondholders. The ACS Act states that the cover assets are not liable to attachment, sequestration or other forms of seizure, or to set-off by any persons, so long as the claims of both the covered bondholders and the hedging counterparties remain unsatisfied.

Source: Fitch

Alternative Management

Fitch takes into consideration the framework or contractual clauses governing the appointment of a substitute manager, the availability of suitable alternative management parties in a given market, any potential conflict of interest (in cases where a single administrator in a bankruptcy takes care of covered bonds and other creditors), the manager's responsibilities in the servicing and liquidation of the cover assets to meet payments due on the covered bonds and any further protection from the oversight or potential support for regulated covered bonds.

Systemic Alternative Management

This regulated programme benefits from the statutory role of the National Treasury Management Agency (NTMA) to appoint a suitably qualified alternative manager for the covered bond programme to manage a designated institution's covered bond activities upon an issuer's insolvency. If no alternative manager is found, NTMA is required to act as the manager of last resort by the ACS Act. Therefore, alternative management does not represent a high risk to the PCU.

Systemic Alternative Management

Component driver	Fitch assessment
Administrator takes exclusive care of covered bondholders? When are they appointed?	NTMA is obliged to appoint an alternative manager in the event of the issuer's insolvency and this is a role the NTMA will take on if it cannot find a third party to perform this role. Further, the CAM (cover asset monitor) is expected to continue its role after the issuer's insolvency under the ACS Act, thus may help to smooth the transfer to an alternative manager as the CAM will already have an understanding of the issuer's IT systems and business.
Importance of timeliness of payments in the legal provisions	Yes. Even if the issuer or the issuer's parent entity becomes subject to an insolvency procedure, all asset-covered securities issued by the institution remain outstanding, subject to the terms and conditions specified in the security documents under which those securities are created.
Can assets be sold by alternative manager?	The substitute manager shall assume control of all cover assets and act in the commercial interest of the covered bondholders under the ACS Act. The ACS Act also states that the proceeds of realising cover assets form part of the cover assets pool and can be used to discharge covered bonds claims.
Regulatory Oversight	Highly regulated by the CBOI through the ACS Act. The Act also requires the issuer to appoint an independent CAM to oversee the activities of the issuer and monitor and report any non-compliance with the requirements set under the ACS Act to the regulator.

Source: Fitch

Cover Pool-Specific Alternative Management

Fitch focuses on the likely ease of the transferability of relevant data and IT systems to an alternative manager and buyer, also judging by the quality and the quantity of the data provided to it. The agency considers that the cover pool-specific alternative management is satisfactory and does not represent high risk for the PCU.

Cover Pool Alternative Management

Component drivers	Fitch assessment
Cover assets, debtors' accounts and privileged swaps clearly identified within IT systems	The data sent to Fitch indicates that AIB's systems are capable of identifying cover assets, debtors' accounts and privileged swaps clearly.
Standardised or custom-made IT systems used	The covered bond management and reporting system is an internally developed system.
Automation and speed of cover pool reporting	All Fitch templates are provided on a timely basis upon request, with some data missing which is mostly related to old dated loans. The investor reports are published quarterly and are available within a month after each quarter end. However, unlike a typical UK covered bond issuer, AIBMB does not generate prepayment data and static delinquency data without taking into account cures. Fitch relies on market and peer data to assess the appropriateness of using the prepayment and foreclosure frequency matrix in line with the Irish *Criteria Addendum*.
Adequate filing of loan documentation, evidence of security	Yes. Loan documentation is deemed sufficient based on the loan file reviews performed by Fitch.

Source: Fitch

Privileged Derivatives

Fitch does not expect privileged derivatives to represent a high risk for the payment continuity of covered bonds programmes upon a resolution.

In this programme, there is no foreign-exchange exposure as both assets and liabilities are denominated in euros. Fitch has not given credit to the IRS in its CF analysis because the IRS counterparty, AIB, does not have an eligible rating to support the covered bond rating and it is posting cash swap collateral with an account held by itself, although it is registered with the regulator. The committed OC by AIBMB can withstand the interest rate stresses arising from the fixed- and floating-rate mismatch and basis risk.

Privileged Derivatives

Component drivers	Fitch assessment
Replacement provision of swap counterparties post issuer default	The rating triggers are in line with Fitch criteria to support a 'AAA' rated security. As the covered bond rating is at 'AA+', the rating triggers are more conservative. The remedial period for replacement and guarantee upon losing 'BBB-' or 'F3' is 30 calendar days, which is in line with Fitch's counterparty criteria. The swap collateral posting period upon the swap counterparty's rating below 'A' or 'F1' is 30 calendar days (compared to the criteria specification of 14 calendar days). Despite the above rating triggers and remedies, and AIB's posting of cash swap collateral, no credit was given to the swap because AIB does not have an eligible rating to be the swap counterparty and the cash collateral is deposited with AIB, which does not have an eligible account bank rating to support the covered bond rating.
Intra-group or external counterparties	Interest rate swap is provided by AIB on the cover pool and covered bonds.
Magnitude of swap exposure. Is it standard?	Materiality is considered relatively low with no foreign-exchange exposures and therefore only limited to interest rate exposures.
Termination payments to swap counterparties raking pari passu with covered bonds	Termination payment to swap counterparties is subordinated to covered bonds if the swap counterparty is the defaulting party.
Cover assets isolated in an SPV or under an integrated template	Cover assets are not isolated in an SPV but the cover assets and cover pool hedges are registered by the issuer and are segregated from the non-cover assets by the ACS Act.

Source: Fitch

Appendix 3: Originator and Servicer Operational Review

The details below are for the AIB group, which includes AIBMB and EBS. The origination, underwriting and servicing policies and procedures of residential mortgages of AIBMB and EBS follows that of AIB. Most of the staff involved in mortgage processing, underwriting and servicing are based at the Dublin head office.

Origination

AIB originates under AIBMB, EBS and Haven Mortgages Limited (a subsidiary of EBS) and uses branch, intermediary and direct channels. Most originations are sourced through the branch network. Since September 2013 all intermediary applications are sourced solely through the Haven network. Originations reduced significantly after the housing crash in Ireland in 2008-2009, but there have been signs of a pick-up since 2014, along with the recovery of the Irish economy and property price increases. The origination level in 2015 was significantly higher than 2014 but is still well below the pre-crisis level. Most draw down is for owner-occupied mortgages with limited buy-to-let (BTL) business. AIB has stopped offering interest only product since March 2010.

Underwriting

All mortgage applications are subject to a dual review process prior to mortgage offer. Firstly, an initial review, assessment and documentation verification is carried out by the business channel. The application approved by the business will be then subject to a more detailed review by the underwriters in the Mortgage Lending Unit (MLU) in Dublin before a letter of offer is issued. The MLU underwrites mortgages from both AIBMB and EBS. About 15% of applications are declined at the second stage. AIB monitors any trends in declined applications and addresses these where necessary.

No automatic decision system is implemented, although this is being considered in a longer term. AIB has rolled out a pilot scheme during 2016 to delegate authority to 21 dedicated staff in the business channel to approve a ‘sanction in principle’ for the lowest risk mortgage applications. Applications eligible for business ‘sanction in principle’ need to meet a set of parameters, including a good credit grading. The business ‘sanctioned in principle’ applications under the pilot scheme are still subject to a final full assessment and sanction by the MLU before a letter of offer is issued and therefore the original sanction in principle can be declined by the MLU at this point. These cases will be also subject to sample checks for quality assurance. Given that these 21 selected staff generated about 8% of total mortgage approval by volume, mortgage applications that meet the eligibility criteria for business approval are expected to be within a manageable size.

Mortgage applications are submitted through the Mortgage Application System for AIBMB mortgages and all supporting documentation are scanned and uploaded to the application system.

The underwriters are mandated according to their experience and skills. Key areas of underwriting focus are affordability and sustainability of income review, loan-to-income multiple and loan to value ratio check, adverse credit history check through Irish Credit Bureau (ICB), and where appropriate, through the internal credit grading system, and fraud prevention check, by using ICB information and applicants documents.

AIB does not offer “fast-track” or “self-certification” mortgages. Employed applicant income is verified mainly by salary payslips up to three months, most recent P60 and a salary certificate by the applicant’s employer. For self-employed applicants, three years of audited accounts are reviewed. AIB carries out an affordability check by using the net disposable income after regular monthly outgoings and a stressed interest rate of two percentage points above the variable rate, subject to a floor of 6.0% (or a floor of 4% for ECB tracker rate).

The underwriting policy is subject to annual review through AIB group policy governance process. AIB has aligned its key policy parameters to mirror the CBI macro-prudential regulation effective since February 2015. The maximum loan to income (LTI) for owner-occupied loans is 3.5x and the LTV limit is 80%. However, for first-time buyers, the LTV limit is 90% on the first EUR220,000 of the value of the property and 80% on any value thereafter. The LTV of BTL is capped at 70% with no LTI cap. The CBI macro-prudential regulation also allows 15% of owner-occupied and 10% of BTL on the book level to be above the regulatory LTV limit, and 20% of total mortgages to have a LTI above the cap (allowable exception). AIB monitors such allowable exception and the maximum LTV granted for owner-occupied mortgages has not exceeded 90%.

Servicing

AIB is responsible for servicing the mortgage portfolio. The processing team based in Dublin are responsible for all general administration tasks, customer queries and branch correspondence. AIB use the CACS system for arrears management, providing control of workflows and timeline management. Automated correspondence is produced to provide process efficiency.

Early arrears (up to 90 days in arrear) and late arrears (over 90 days in arrear) are dealt with by separate teams. Early arrears management’s focus is on borrower contact and payment encouragement. A standard financial statement is completed when a borrower misses a payment. This statement is used to assess the borrower’s financial situation. If a long-term solution is needed, the account is passed to the resolution and recovery teams, who will carry out a thorough review of the borrower’s financial position, including bank statements and proof of income, and identify the most appropriate sustainable solution. AIB benchmarks living expenses against those of the Insolvency Service of Ireland, with an additional 20% increment.

AIB uses a wide range of forbearance measures to borrowers in financial difficulty, but the restructuring solutions focus on sustainability based on borrowers’ individual situation. Arrears capitalisation is only adopted when the borrower can pay the mortgage instalment payment for six months.

If a borrower is classified as non-co-operative, or a sustainable and realistic solution cannot be agreed upon, the account is referred to the recoveries team where the focus moves from resolution to loss mitigation. The team focuses on those accounts being progressed through the appropriate legal process, while maintaining communication with the borrower to find a resolution where possible. AIB uses external asset managers to market any repossessed property at an appropriate value.

Appendix 4: Outstanding Liabilities

List of Outstanding Covered Bonds

Series	Currency	Size/m	Fixed/ Floating	Coupon/ Rate	Payment frequency	Maturity	ISIN
4.1	EUR	1,500	Fixed		Annually	29 Jun 17	XS0308936037
4.2	EUR	175	Fixed		Annually	29 Jun 17	XS0308936037
11	EUR	850	Floating		Monthly	3 Feb 18	XS0483912068
12	EUR	10	Fixed		Annually	12 Feb 30	XS0486207870
13	EUR	10	Fixed		Annually	1 Mar 30	XS0489775535
14	EUR	5	Fixed		Annually	28 Apr 28	XS0504676510
U1	EUR	15	Fixed		Annually	23 Sep 19	n.a.
U2	EUR	50	Fixed		Annually	30 Sep 19	n.a.
23	EUR	400	Floating		Monthly	13 Dec 17	XS0866317760
25	EUR	500	Fixed		Annually	10 Sep 18	XS0969616779
26	EUR	500	Fixed		Annually	26 Mar 21	XS1048644907
27	EUR	650	Floating		Monthly	15 Sep 21	XS1110511356
28	EUR	500	Floating		Monthly	15 Mar 19	XS1110511273
29	EUR	750	Fixed		Annually	3 Feb 22	XS1179936551
30	EUR	750	Fixed		Annually	27 Jul 20	XS1265810686
31	EUR	1000	Fixed		Annually	4 Feb 23	XS1357663050

[a] Data as of 1 October 2016
Source: AIBMB

Appendix 5: Legal Framework

Main Characteristics of Irish Asset Covered Securities

The asset covered securities act 2001; Asset covered securities (amendment) act 2007; All subsequent regulatory notices

Issuers	Specialised credit institutions which have received designated status from the CBOI. Issuers can be designated residential, commercial or public sector credit institutions with permitted business activities in accordance with the ACS Act, limited to the scope of funding cover assets, taking deposits and issuing covered bonds, and entering into hedges and contracts to reduce or minimise financial loss such as credit and market risks.
Supervision	The CBOI is the regulator. Issuer needs to comply with the regulations in the ACS Act. These include the compliance to the legal minimum OC on a prudent market value basis and the contractual OC, meeting assets eligibility criteria, and various limits set by the ACS Act.
Bankruptcy remoteness	The ACS Act states that cover assets do not form part of the bankruptcy estate of a designated credit institution or the institution's parent entity or a related company until the claims of super-preferred creditors – cover asset monitor and the manager, and preferred creditors – covered bonds and cover assets hedge contracts have been fully satisfied. If the claims of the preferred creditors are not fully satisfied after the disposal of the cover pool, they will then become unsecured creditors of the designated credit institution. If the designated institution or its parent becomes insolvent, all covered bonds and preferred hedges remain outstanding and due according to their original schedule.
Cover register	The issuer is required to maintain a register of the cover assets, which are held on the issuer's balance sheet. The cover register includes cover assets and cover assets constituting overcollateralisation, which support the covered bonds issuance. The issuer is also required to register the substitution assets, cover assets and covered bonds hedges (together as pool hedge) and pool hedge collaterals.
Asset monitor	Every designated credit institution is required to appoint an independent cover assets monitor approved by CBOI. The appointment of the CAM survives the insolvency of the issuer or the issuer's parent. The CAM is required to monitor the issuer's compliance to the ACS Act and is required to inform CBOI for incompliance. The compliance to the legal minimum OC and the contractual OC is monitored by CAM at least quarterly, or when assets are removed or substituted, or prior to any issue of covered securities. The Act has not defined explicitly whether the contractual OC also refers to the committed OC published by the issuers; in practice, the issuer advised that the CAM also monitors the compliance of the committed OC on a quarterly basis.
Mortgage collateral	• Residential or commercial mortgages. • RMBS and CMBS issued by entities governed by the laws of an EEA country, and the securities have a rating equivalent to credit quality step 1. Such securities should represent less than 10% of total mortgage covered securities issued. • Mortgage loans secured on development property can be included as far as the asset is attributed a nil value for the legal and contractual OC calculation purpose. • Substitution assets.
Loan-to-value limits for mortgages	• ≤ 100% on an aggregate basis for all mortgages held on the issuer's balance sheet (both cover pool and non-cover pool). • ≤ 75% for residential real-estate loans. • ≤ 60% for commercial real-estate loans. The limits above are based on the prudent market value (PMV) of the real estate property, calculated in accordance with the valuation methodology published in the relevant regulatory notices. Loans exceeding the last two thresholds are eligible for covered bonds funding although the portion above the limit is disregarded for the legal minimum over-collateralisation purpose. The real estate property's PMV is calculated based on an indexed property value. If the indexed property value is higher than the original value, a discount specified by the issuer as required by the regulatory notices is applied to the indexed property value. The discount is generally set at 15% by the issuers. The PMV of the residential property is calculated at least on an annual basis based on the latest regulatory notice.

Main Characteristics of Irish Asset Covered Securities (Cont.)

The asset covered securities act 2001; Asset covered securities (amendment) act 2007; All subsequent regulatory notices

Public-sector assets	• Financial obligations of Ireland, or any other EEA country, Canada, Japan, Switzerland and the US. • Financial obligations of a country (other than those listed in first bullet) that is a full member of the OECD and has not rescheduled its external debt during the immediately preceding five years, further subject to the creditworthiness and risk-weighting standards specified in paragraph 68(b) of Annex VI to the Codified Banking Directive. • Financial obligations of any governmental or public entity established in the eligible country, further subject to the creditworthiness and risk-weighting standards specified in paragraph 68(b) of Annex VI to the Codified Banking Directive. • For second and third bullet points, these are limited to 20% of covered bond outstanding. • European Communities or the European Investment Bank • Substitution assets.
Substitution assets	• Deposits with an eligible financial institution (EFI) which has a credit quality assessment of Credit Quality Step 1 (i.e. 'AAA' to 'AA-') or for deposits with an EFI within the EEA with maturity not exceeding 100 days, a minimum credit quality assessment of Credit Quality Step 2 (i.e. 'A' rating category or equivalent short-term ratings). • At most 15% of the outstanding covered bonds. • Substitution assets do not include pool hedge collaterals.
Legal minimum OC	• At least 3% on a PMV basis for residential mortgage and public-sector cover pools. • At least 10% on a PMV basis for commercial mortgage cover pools.
Non-performing assets	Mortgages in arrears for three months or more (3m+) are not eligible to be included to the cover pool. For registered mortgages that become in arrears subsequently, the issuers typically remove delinquent mortgages (one-month or six-month delinquencies, depends on programmes) from the pool, although this is not an explicit regulatory requirement.
Asset & liability management	Interest and currency risk must be hedged or eliminated. Currency of denomination of assets must match that of the covered securities post-hedging in nominal terms. The total amount of interest payable from the cover pool in a given period of 12 months is not less than the total amount of interest payable to mortgage covered securities during that period.
Treatment of swap counterparties	Registered swaps benefit from the same priority of payments as covered bondholders by the ACS Act, unless the swap counterparty does not perform in accordance with the swap contracts, in this case, the payment due to the swap counterparty will be subordinated under the ACS Act.
Alternative manager	The ACS Act empowers the NTMA to identify and appoint a suitably qualified alternative manager for the covered bond programme upon the issuer's insolvency. If no alternative manager is found, NTMA is required to act as the manager of last resort.
Disclosure	The parent company must include in its annual consolidated financial statements the name of the designated credit institution, the outstanding principal of the cover pool and covered bonds. The issuer must include in its annual consolidated financial statements the number, size and geographical location of assets, and details of defaults and arrears, substitutions and repayments on each cover pool.

Source: Fitch, ACS Act

The ratings above were solicited by, or on behalf of, the issuer, and therefore, Fitch has been compensated for the provision of the ratings.