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Transaction Update: AIB Mortgage Bank (Mortgage Covered Bonds)

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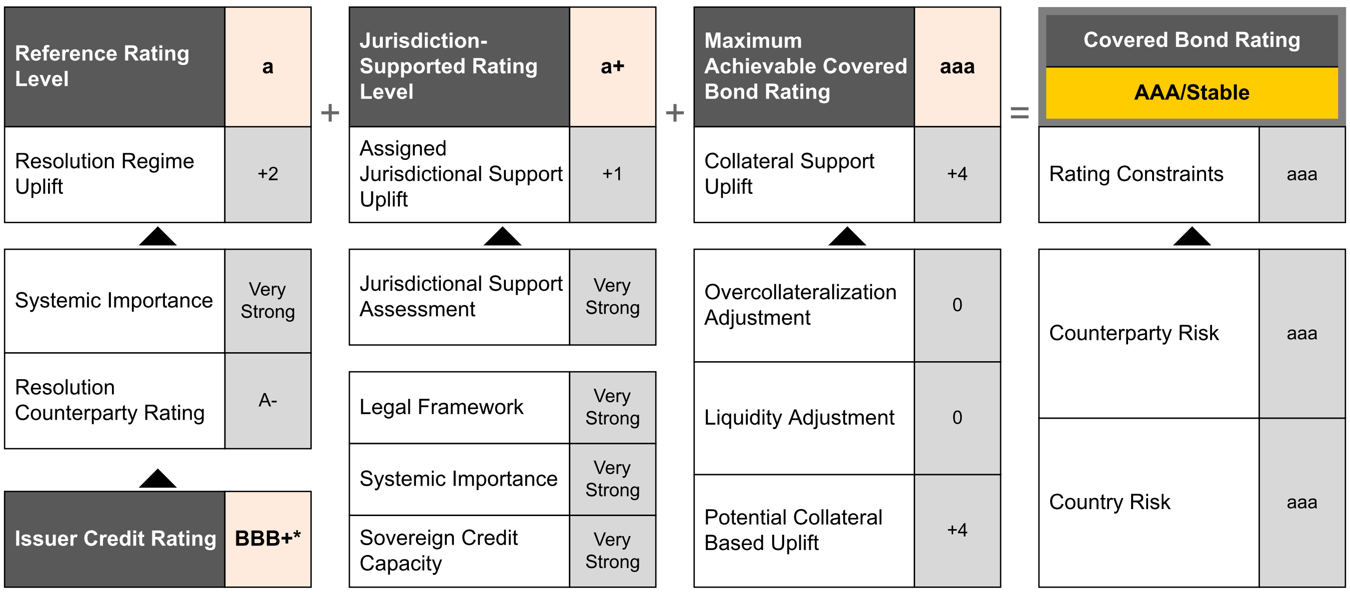
Ratings Detail



*We use the long-term rating on Allied Irish Banks PLC, to which the isuer is deemed a core entity.

Major Rating Factors

Strengths

- The program benefits from two unused notches of jurisdictional support.
- There is a public commitment to maintain a minimum level of overcollateralization of 22%. Furthermore, liquidity risk is mitigated by the soft-bullet repayment profile of most of the bonds.

Weaknesses

- The swap documentation does not support the current rating on the program and therefore we don't give credit to the hedging in our cash-flow analysis.
- The Irish real estate market shows signs of overvaluation, in our view.

Outlook: Stable

The stable outlook on AIB Mortgage Bank's (AIBMB) mortgage covered bonds' rating reflects the fact that the ratings on the covered bonds benefit from two unused notches of jurisdictional support under our covered bonds criteria.

Therefore, if we were to lower our long-term issuer credit rating (ICR) on the issuer by up to two notches, we would not lower our ratings on the covered bonds, all else being equal.

Rationale

We are publishing this transaction update following our periodic review of AIBMB's mortgage covered bond program.

Our covered bond ratings process follows the methodology and assumptions outlined in our "Covered Bonds Criteria," published on Dec. 9, 2014 and "Covered Bond Ratings Framework: Methodology And Assumptions," published on June 30, 2015.

From our analysis of the covered bond program, we have concluded that the assets in the cover pool are isolated from the risk of the issuer's insolvency. This asset isolation allows us to potentially assign a higher rating to the covered bond program than our long-term ICR on the issuer.

We conducted a review of AIB's mortgage operations. We believe there are sufficiently prudent and effective underwriting and servicing procedures in place to support our ratings on the covered bonds.

The issuer is domiciled in Ireland, which is subject to the EU's Bank Recovery and Resolution Directive (BRRD). We assess the systemic importance of covered bonds in Ireland as very strong, under our "Assessments For Jurisdictional Support According To Our Covered Bonds Criteria," published on Oct. 16, 2018. These factors increase the likelihood that AIB 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. Therefore, under our covered bonds criteria, we assess the rating reference level (RRL) as 'a'.

We then consider the likelihood of jurisdictional support, which for mortgage programs in Ireland we assess as very strong. This could result in a potential uplift from the RRL of up to three notches under our covered bonds criteria. The support is capped at the long-term rating on the sovereign. Given that its RRL is 'a' and the long-term sovereign rating on Ireland is 'A+', the covered bonds benefit from one notch of jurisdictional-support uplift and two unused notches. Therefore, we assess a jurisdiction-supported rating level (JRL) at 'a+', equal to the sovereign rating.

We have reviewed the asset information provided as of March 31, 2019. The program's underlying assets comprise €14.3 billion of Irish residential mortgage loans. Based on our cash flow analysis, the available credit enhancement in the program exceeds the target credit enhancement, which means that covered bonds are eligible for up to four notches of collateral-based uplift. We do not reduce the total collateral-based uplift by any notches owing to AIB's commitment to maintain a minimum level of overcollateralization of 22% and because the soft-bullet structure on 99.3% of the liabilities covers liquidity risk.

There are currently no rating constraints to the 'AAA' ratings relating to counterparty and country risks.

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

Program Description

Table 1

Program Overview*	
Jurisdiction	Ireland
Year of first issuance	2006
Covered bond type	Legislation-enabled
Outstanding covered bonds (bil. €)	9.5
Redemption profile	Soft bullet§
Underlying assets	Residential mortgages
Jurisdictional support uplift	1
Unused notches for jurisdictional support	2
Target credit enhancement (%)	14.97
Available credit enhancement (%)	51.76
Collateral support uplift	4
Unused notches for collateral support	0
Total unused notches	2

*Based on cover pool data as of June 30, 2019. §Two issuances, which represent less than 1% of the liability are hard-bullet covered bonds.

AIBMB's mortgage covered securities program is a €20 billion covered bond program backed by residential mortgage assets all located in the Republic of Ireland. The first issuance was in 2006.

AIBMB, the issuer, was incorporated in Ireland as a public limited company in 2005, and subsequently re-registered as a public unlimited company. It obtained an Irish banking license and was registered as a designated mortgage credit institution in 2006.

AIBMB is a wholly owned subsidiary of Allied Irish Banks PLC, one of the two main Irish banks, with a high and resilient market share. It operates principally in Ireland with a limited, but focused, overseas presence, which includes the U.K.

The issuer's main purpose is to finance loans secured on residential property, in particular through the issuance of mortgage covered securities in accordance with the Irish Asset Covered Securities (ACS) Acts. The issuer may either grant these loans directly or purchase them from AIB and other members of the group or third parties.

Chart 1

AIB Mortgage Bank Covered Bond Program Structure

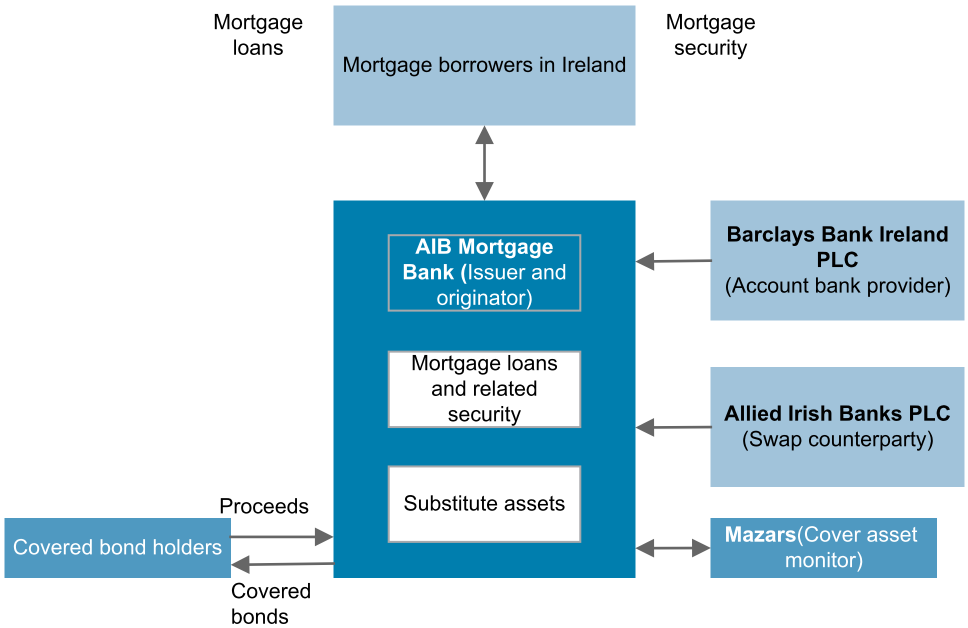


Table 2

Program Participants

Role	Name	Rating	Rating dependency
Issuer	AIB Mortgage Bank	NR	Yes
Originator	AIB Mortgage Bank	NR	No
Seller	Allied Irish Banks PLC	BBB+/Stable/A-2	No
Servicer, cash manager, interest rate swap provider, and covered bond swap provider	Allied Irish Banks PLC	BBB+/Stable/A-2	No
Account provider	Barclays Bank Ireland PLC	A/Stable/A-1	Yes
Cover asset monitor	Mazars	NR	No

NR--Not rated.

Rating Analysis

Legal and regulatory risks

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

AIBMB's mortgage covered bonds benefit from the protection of specialist covered bond legislation under the Irish ACS Acts.

As an ACS issuer, AIBMB holds its cover pool assets on its balance sheet. Under the ACS Acts, the cover pool assets are ringfenced from the ACS issuer's other assets for the benefit of ACS holders. The cover pool assets along with any hedge contracts are registered in a cover register. The cover register may only be amended with the consent of the cover asset monitor.

ACS holders also benefit from a statutory preference created by the ACS Acts. ACS holders have recourse to cover pool assets ahead of all other non-preferred creditors. The ACS Acts further protect ACS holders by restricting the ACS issuer's business activities, in particular, by limiting the scope of non-core ACS activities. Hence, the ACS issuer cannot hold more than 15% of substitution assets (as opposed to mortgage assets and hedge contracts) in the cover pool.

Furthermore, if the ACS issuer becomes insolvent, all ACS issued remain outstanding and hedge contracts are not affected. We believe the Irish covered bond legal framework addresses legal risks outlined in our criteria. This enables us to assign ratings to the covered bonds that are above the long-term ICR on AIB. We have concluded that legal and regulatory risks do not constrain the covered bond ratings.

Our analysis incorporates the impact of the European Union's BRRD, applicable in the Republic of Ireland, in our determination of the RRL.

Operational and administrative risks

Based on information provided to us by the issuer, we believe the issuer's underwriting and servicing standards are prudent and aligned with the market standards.

In our opinion, there is no operational risk from the cover pool's management and loan origination that would constrain the covered bond ratings to the same level as the long-term ICR. Furthermore, we believe that it is highly likely that a replacement servicer would be appointed if the issuer were to become insolvent. We consider Ireland to be an established covered bond market and we believe that the mortgage assets in AIBMB's cover pool do not have product features that would materially limit the range of available replacement cover pool managers or servicers.

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

Resolution regime analysis

AIB is domiciled in Ireland, which adopted the EU's BRRD. We assess the systemic importance of Irish mortgage covered bond programs as 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 the RRL will be the greater of: (i) the ICR on the issuing bank, plus two notches, that is, 'a'; and (ii) the resolution counterparty rating (RCR) on the issuing bank, 'A-'. As a result, the RRL is 'a', two notches above the ICR.

This uplift recognizes that resolution regimes like the BRRD increase the probability that an issuer could service its covered bonds even following a default on its senior unsecured obligations. This is because the law exempts covered bonds from bail-in risk if there is a bank resolution. We consider this as an internal form of support, because the bail-in of certain creditors of the issuer does not require direct government support. This increases the likelihood that AIBMB would continue servicing its covered bonds without accessing the cover pool or receiving jurisdictional support, even if it were to face insolvency.

Jurisdictional support analysis

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 mortgage programs in the Republic of Ireland is very strong. Under our covered bonds criteria, this means that the program can receive up to three notches of jurisdictional uplift over the RRL. However, the JRL cannot exceed the rating on the sovereign providing the support to the covered bond. Since the sovereign rating is that on the Republic of Ireland (A+/Stable/A-1), the JRL is therefore capped at 'a+'.

Collateral support analysis

We base our analysis on loan-by-loan data as of a cut-off date of March 31, 2019.

The pool comprises loans for Irish residential properties (see table 3).

Table 3

Cover Pool Composition

	As of March 31, 2019		As of March 31, 2018	
Asset type	**Value (mil. €)**	**Percentage of cover pool (%)**	**Value (mil. €)**	**Percentage of cover pool (%)**
Irish residential Mortgages	14,315	99.90	13,802	99.75
Cash	14	0.10	35	0.25
Total	14,329	100.00	13,837	100.00

We have analyzed the portfolio and applied stresses commensurate with a 'AAA' rating scenario to estimate the level of defaults, as shown by our risk measure, the weighted-average foreclosure frequency (WAFF), and the level of losses given default, or weighted-average loss severity (WALS). We base our loan level analysis of the AIBMB cover pool on our European residential loans criteria.

As of the cut-off date, the WAFF is 21.05% and the WALS is 26.82%, based on a 'AAA' stress level. Both the WAFF and the WALS have decreased since our previous analysis mainly due to the cover pool now being concentrated in the lower loan-to-value ratio buckets. The portfolio is well seasoned, has no excessive geographical concentration according to our criteria, and has a very low level of arrears (see tables 4 and 8).

Table 4

Key Credit Metrics

	As of March 31, 2019	As of March 31, 2018
Weighted-average LTV ratio (S&P Global Ratings' stresses; %)	58.28	63.99
Weighted-average LTV ratio (based on the investor report; %)	54.5	57.2
Weighted-average loan seasoning (months)*	94.82	94.18
Balance of loans in arrears (%)	0.1	0.09
Buy-to-let loans (%)	10.7	11.22
Credit analysis results:		
Weighted-average foreclosure frequency (%)	21.05	25.58
Weighted-average loss severity (%)	26.82	31.97
AAA credit risk (%)	2.5	5.69

*Seasoning refers to the elapsed loan term. LTV--Loan to value.

Table 5

Loan Seasoning Distribution*

	As of March 31, 2019	As of March 31, 2018
Less than 18 months	14.63	12.66
18-24	4.06	3.71
24-36	7.18	6.02
36-48	5.29	4.78
48-60	4.22	3.62
60-72	3.16	3.89
72-84	3.36	2.54
84-96	2.20	4.74
96-108	4.06	8.35
108-120	7.33	10.86
More than 120	44.51	38.82
Weighted-average loan seasoning (months)	94.82	94.18

*Seasoning refers to the elapsed loan term.

Table 6

Original LTV Ratios

	As of March 31, 2019	As of March 31, 2018
(%)	**Percentage of cover pool (%)**	
0-40	8.03	9.33
40-50	8.50	8.71
50-60	9.23	9.07
60-70	11.54	10.68
70-80	17.75	15.49
80-90	23.93	20.57
90-100	16.10	17.22
Above 100	4.92	8.93

Table 6

Original LTV Ratios (cont.)		
	As of March 31, 2019	As of March 31, 2018
(%)	Percentage of cover pool (%)	
Weighted-average original LTV ratios	76.08	79.09

LTV--Loan to value.

Table 7

Indexed LTV Ratios (Percentage Of Cover Pool)

(%)	As of March 31, 2019 (%)	As of March 31, 2018 (%)
0-60	53.2	44.9
60-70	14.3	14.4
70-80	12.8	13.9
80-90	9.7	11.0
90-100	7.48	7.91
Above 100	2.49	7.89
Weighted-average LTV ratios	58.30	63.99

LTV--Loan to value.

Table 8

Geographic Distribution Of Loan Assets

	As of March 31, 2019	As of March 31, 2018
Top five concentrations	Percentage of cover pool (%)	
Dublin	38.2	38.5
Cork	13.5	13.7
Galway	5.6	5.6
Kildare	5.4	5.3
Limerick	3.6	3.6
Total	66.3	66.7
Dublin	38.2	38.5
Outside Dublin	61.8	61.5

We apply our covered bonds criteria and our European residential loans criteria to analyze the cash flows in the transaction.

Our analysis of the covered bonds' payment structure determines that cash flows from the cover pool assets would be sufficient, at the current rating level, to make timely payment of interest and ultimate payment of principal to the covered bondholders.

As there is an active secondary market for Irish residential mortgages such as those found in the cover pool, the program can benefit from up to four notches of collateral-based uplift, according to our covered bonds criteria.

The bonds' maturities are extendible, which structurally mitigates liquidity risk on 99.3% of the bonds. While two covered bonds maturing in September 2019 have no extendible features, in our view liquidity risk is mitigated by the cover pool's scheduled cash collection. Furthermore, the issuer has made a public overcollateralization commitment to maintain a minimum level of 22%. As a result, we do not deduct notches from the potential collateral-based uplift for liquidity risk nor uncommitted overcollateralization.

We analyze the cash flows applying our credit stresses as determined in the credit section, as well as liquidity and interest rate stresses. We also run different default timing and prepayment patterns. For assessing market value risk, we apply a target asset spread in our cash flow analysis. We apply a spread of 1,000 basis points (bps) which reflects the Irish mortgage assets in the portfolio, as outlined in "Assessments For Target Asset Spreads According To Our Covered Bonds Criteria," published on Oct. 16, 2018.

The program benefits from swaps with Allied Irish Banks both on the assets and on the liabilities side. However, the documentation does not support the 'AAA' rating on the program. As our covered bond ratings are above the long-term ICR on the swap counterparty, we consider that the latter could default and leave the covered bond program unhedged. Conversely, we also look at the case where the swap counterparty performs and look at the cash flows including the swaps. We then retain the most conservative output, which is the result of the scenario without the benefit of the swaps.

As of June 2019, the credit enhancement needed for coverage of 'AAA' credit risk is 2.50%, down from 5.69% in our previous review. The target credit enhancement that is commensurate with the four notches of maximum collateral-based uplift is 14.97%, down from 21.23%. Both measures have improved since our previous review mainly due to the cover pool's decreased WAFF and WALS and to an improvement in the program's asset-liability structure, which narrows the maturity gap between the cover pool and the outstanding covered bonds.

The program's available credit enhancement is 51.76%, which exceeds the target credit enhancement, allowing the program to achieve four notches of collateral-based uplift, and therefore to reach a 'AAA' rating under our covered bonds criteria (see table 9).

Table 9

Collateral Uplift Metrics

	As of June 30, 2019	As of March 31, 2018
Asset WAM (years)	10.71	10.71
Liability WAM (years)	5.77	5.72
Available credit enhancement	51.76	84.75
Required credit enhancement for first notch of collateral uplift (%)	2.50	9.58
Required credit enhancement for second notch of collateral uplift (%)	8.58	13.46
Required credit enhancement for third notch of collateral uplift (%)	11.78	17.35
Target credit enhancement for maximum uplift (%)	14.97	21.23
Potential collateral-based uplift (notches)	4	4
Adjustment for liquidity (Y/N)	N	N
Adjustment for committed overcollateralization (Y/N)	N	N
Collateral support uplift (notches)	4	4

WAM--Weighted-average maturity.

Counterparty risk

There are no counterparty risks in the program to constrain the program rating, in our opinion.

Liquidity risk on the bonds' interest payments arising from potential commingling risk is mitigated by amounts held with Barclays Bank Ireland PLC (A/Stable/A-1). This bank account has downgrade language that is in line with our current counterparty criteria. Therefore, commingling risk is effectively structurally mitigated at a level that is commensurate with the current ratings on the bonds.

Allied Irish Banks is the interest rate and covered bond swap counterparty, providing a hedge against mismatches between the interest rates on the assets and covered bonds. Allied Irish Banks is a related counterparty to the issuer. According to the swap documentation, Allied Irish Banks is committed to replace itself, at its own cost and within 30 days, upon its rating being lowered below 'BBB-'. If the counterparty fails to meet this commitment, an additional termination event would allow the issuer to terminate the derivative agreement. Furthermore, the swap is also committed to post collateral sufficient to cover the issuer's exposure to the counterparty plus certain volatility risk in the swap value. We categorize the current counterparty's collateral-posting framework in the derivative contract as moderate according to our criteria.

Our counterparty criteria combine the collateral framework assessment with the replacement trigger to derive the maximum potential rating, which is below the 'AAA' rating on the program. As a result, we model the transaction on an unhedged basis and we have accounted for interest rate mismatch risk in our target credit enhancement for the maximum achievable rating on the covered bonds. On an unhedged basis, the available credit enhancement in the program supports the 'AAA' rating.

There are no foreign currency mismatches between the assets and liabilities in the program.

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

Sovereign risk

Under our structured finance sovereign risk criteria, covered bonds issued in a jurisdiction that is within a monetary union that include structural coverage of refinancing need over a 12-month period to exhibit low sensitivity to country risk. As a result, we can rate these covered bonds up to five notches above the sovereign rating (see "Incorporating Sovereign Risk In Rating Structured Finance Securities: Methodology And Assumptions," published Jan. 30, 2019). Of the bonds, 99.3% have a 12-month maturity extension feature and two private placements do not. In our view, the pool's scheduled cash collections mitigate the limited liquidity risk.

Potential Effects Of Proposed Criteria Changes

Our ratings are based on our applicable criteria, including our "Methodology And Assumptions: Assessing Pools Of European Residential Loans," published on Aug. 4, 2017. However, these criteria are currently under review (see "Request For Comment: Global Methodology And Assumptions: Assessing Pools Of Residential Loans (Ireland)," published on July 3, 2019). As a result of this review, ratings on the outstanding covered bonds issued under this covered bond program may be affected. Until this time, we will continue to rate and surveil these covered bonds using our existing criteria (see "Related Criteria").

Related Criteria

- Counterparty Risk Framework: Methodology And Assumptions, March 8, 2019
- 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
- Criteria - Structured Finance - General: Global Derivative Agreement Criteria, June 24, 2013
- General Criteria: Methodology: Credit Stability Criteria, May 3, 2010
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Related Research

- Request For Comment: Global Methodology And Assumptions: Assessing Pools Of Residential Loans (Ireland), July 3, 2019
- Global Covered Bond Insights Q2 2019, June 27, 2019
- Global Covered Bond Characteristics And Rating Summary Q2 2019, June 27, 2019
- S&P Global Ratings' Covered Bonds Primer, June 20, 2019
- 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
- Glossary Of Covered Bond Terms, April 27, 2018