

## **FITCH DOWNGRADES IRISH MORTGAGE COVERED BONDS TO 'A-'; OUTLOOK POSITIVE**

Fitch Ratings-London-21 May 2015: Fitch Ratings has downgraded AIB Mortgage Bank's (AIBMB) and EBS Mortgage Finance's (EBSMF) mortgage covered securities (MCS) to 'A-' from 'A'. The Outlook is Positive.

### **KEY RATING DRIVERS**

The downgrades reflect the downgrade of Allied Irish Banks plc's (AIB; BB/Positive) Long-term Issuer Default Rating (IDR) to 'BB'/Positive from 'BBB'/Negative and the upgrade of AIB's Viability Rating to 'bb' from 'b+' (see 'Fitch Downgrades Irish Banks' IDRs; Upgrades 3 VRs' dated 19 May 2015).

The MCS's rating is based on AIB's Long-term IDR of 'BB' acting as reference IDR, an unchanged IDR uplift of 1, an unchanged Discontinuity Cap (D-Cap) of 2 (high risk) and the overcollateralisation (OC) that Fitch takes into account in its analysis, which provides more protection than the 'A-' breakeven OC for AIBMB at 36.0% and for EBSMF at 47.5%. The Positive Outlook of the MCS's rating reflects that of the AIB. AIB's IDR is used as reference IDR for the MCS programmes as AIBMB and EBSMF are specialised wholly-owned subsidiaries (either directly or indirectly) of AIB.

For both programmes, the respective 'A-' breakeven OC support timely payments in the 'BBB' scenario and recoveries given default of at least 91% in the 'A-' scenario.

For AIBMB, the 36.0% 'A-' breakeven OC is largely driven by the asset disposal loss component of 35.7%, due to large maturity mismatches (the weighted average life, WAL, of assets at 11 years versus bonds' at three years) and the high refinancing spreads (511bps in a BBB stress scenario) applied. This is followed by the cover pool's credit loss of 10.5% in a 'A-' scenario. The cash flow valuation component subtracts 7.5% from the 'A-' breakeven OC due to high excess spread and the longer WAL of the assets versus the liabilities.

For EBSMF, the 47.5% 'A-' breakeven OC is primarily driven by the asset disposal loss component of 44.7% due to large maturity mismatches (the WAL of assets at 12 years versus bonds' at one year) and the high refinancing spreads applied. This is followed by the cover pool's credit loss of 16.6% in a 'A-' scenario. The cash flow valuation component subtracts 9.6% from the 'A-' breakeven OC due to high excess spread and a much longer remaining life of the assets than liabilities.

The 'A-' credit loss component of EBSMF is higher than AIBMB because of a higher proportion of restructuring loans in EBSMF as well as an underwriting hit on the cover pool of EBSMF applied by Fitch to reflect the historically poorer performance of EBS Limited (a subsidiary of AIB, also currently the seller of mortgages to EBSMF) than its peers.

The unchanged D-Cap of 2 is due to the weak link of the liquidity risk and systemic risk component which we assess as high risk. Both programmes' MCS are soft bullet with a 12-month maturity extension and have sufficient liquidity reserve coverage for timely interest payment.

The unchanged IDR uplift of 1 reflects the covered bonds exemption from bail-in, and that AIB is one of two pillar banks in Ireland. AIB is systemically important in its domestic market so that Fitch considers resolution by other means than liquidation as likely.

Fitch takes into account of the issuers' publicly committed OC of 40.0% for AIBMB and 49.0% for EBSMF.

## RATING SENSITIVITIES

For the MCS of both AIBMB and EBSMF, the 'A-' rating could be upgraded if any of the following occurs: (i) the IDR of AIB is upgraded by one or more notches to 'BB+' or higher; or (ii) the number of notches represented by the IDR uplift and the D-Cap is increased to four or higher; or (iii) the OC that Fitch considers in its analysis is higher than Fitch's breakeven OC given the MCS's rating at that time.

According to Fitch's counterparty criteria, AIB is no longer an eligible swap counterparty to support a 'A-' covered bond rating. If the swap counterparty risk is not mitigated, the agency will stress the interest rate risk in the programmes. Based on the analysis, the OC Fitch relies upon can withstand the interest rate stress even in the absence of the swap. AIB is currently the cover pool swap counterparty for both programmes and the covered bond swap counterparty in AIBMB programme; there is no covered bond swap in EBSMF programme.

The Fitch breakeven OC for the covered bond rating will be affected, amongst others, by the profile of the cover assets relative to outstanding covered bonds, which can change over time, even in the absence of new issuance. Therefore the breakeven OC to maintain the covered bond rating cannot be assumed to remain stable over time.

Contact:

Primary Analyst  
Kate Lin  
Director  
Fitch Ratings Limited  
30 North Colonnade  
London E14 5GN  
+44 20 3530 1706

Secondary Analyst  
Roger Bickert  
Associate Director  
+44 20 3530 1667

Committee Chairperson  
Helene Heberlein  
Managing Director  
+33 144299140

Media Relations: Christian Giesen, Frankfurt am Main, Tel: +49 69 768076 232, Email: christian.giesen@fitchratings.com.

Additional information is available on [www.fitchratings.com](http://www.fitchratings.com)

Applicable criteria, 'Covered Bonds Rating Criteria', dated 8 August 2014; 'Counterparty Criteria for Structured Finance and Covered Bonds' and 'Counterparty Criteria for Structured Finance and Covered Bonds: Derivative Addendum', both dated 14 May 2014; 'EMEA Residential Mortgage Loss Criteria', dated 31 March 2015; 'Criteria Addendum - Irish Mortgage Loss and Cash Flow Assumptions', dated 14 September 2014, 'EMEA RMBS Master Rating Criteria', dated 31 March 2015; 'Covered Bonds Rating Criteria - Mortgage Liquidity and Refinancing Stress Addendum', dated 16 February 2015 and 'Criteria for Interest Rate Stresses in Structured Finance Transactions and Covered Bonds', dated 19 December 2014, are available at [www.fitchratings.com](http://www.fitchratings.com).

Applicable Criteria and Related Research:

Covered Bonds Rating Criteria

[http://www.fitchratings.com/creditdesk/reports/report\\_frame.cfm?rpt\\_id=753052](http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=753052)

Covered Bonds Rating Criteria – Mortgage Liquidity and Refinancing Stress Addendum - Effective from 16 February 2015 to 20 May 2015

[http://www.fitchratings.com/creditdesk/reports/report\\_frame.cfm?rpt\\_id=861806](http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=861806)

Counterparty Criteria for Structured Finance and Covered Bonds

[http://www.fitchratings.com/creditdesk/reports/report\\_frame.cfm?rpt\\_id=744158](http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=744158)

Counterparty Criteria for Structured Finance and Covered Bonds: Derivative Addendum

[http://www.fitchratings.com/creditdesk/reports/report\\_frame.cfm?rpt\\_id=744175](http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=744175)

EMEA Residential Mortgage Loss Criteria

[http://www.fitchratings.com/creditdesk/reports/report\\_frame.cfm?rpt\\_id=864266](http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=864266)

Criteria Addendum: Ireland - Residential Mortgage Loss and Cash Flow Assumptions

[http://www.fitchratings.com/creditdesk/reports/report\\_frame.cfm?rpt\\_id=777549](http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=777549)

EMEA RMBS Master Rating Criteria

[http://www.fitchratings.com/creditdesk/reports/report\\_frame.cfm?rpt\\_id=864273](http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=864273)

Criteria for Interest Rate Stresses in Structured Finance Transactions and Covered Bonds

[http://www.fitchratings.com/creditdesk/reports/report\\_frame.cfm?rpt\\_id=838868](http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=838868)

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