S&P Global Ratings

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New Issue: BKS Bank AG (Mortgage Covered Bond Program)

Primary Credit Analyst:
Natalie Swiderek, Madrid + 34 91 788 7223; natalie.swiderek@spglobal.com

Secondary Contact:
Andreas M Hofmann, Frankfurt + 49 693 399 9314; andreas.hofmann@spglobal.com

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Ratings Detail

Reference Rating Level	--
Resolution Regime Uplift	+2
Systemic Importance	Very Strong
Resolution Counterparty Rating	--
Issuer Credit Rating	--

+

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

+

Maximum Achievable Covered Bond Rating	aaa
Collateral Support Uplift	+3
Overcollateralization Adjustment	-1
Liquidity Adjustment	--
Potential Collateral Based Uplift	+4

=

Covered Bond Rating	AAA/Stable
Rating Constraints	aaa
Counterparty Risk	aaa
Sovereign Risk	aaa

Major Rating Factors

Strengths

- The cover pool comprises mostly seasoned Austrian residential mortgage loans for owner occupation.
- Both residential and commercial mortgage loans have relatively low current cover pool loan-to-value (LTV) ratios compared with peer transactions.
- The mortgage pool predominantly contains first lien mortgage loans.

Weaknesses

- Relatively high original LTV ratios and a high level of self-employed borrowers in the residential loan subportfolio, which we have considered in our determination of default frequency.
- There is a relatively high mismatch between the cover pool assets' weighted-average maturity and that of the outstanding covered bonds, which increases refinancing risk as is reflected in the target credit enhancement.
- The current small subportfolio of commercial mortgage loans attracts a 95% default probability assumption under our analytical approach.

Outlook: Stable

S&P Global Ratings' stable outlook on the covered bond ratings reflects one unused notch of collateral-based support that would protect the ratings on the covered bonds in the event of a deterioration of our view of the issuer's creditworthiness, all else being equal.

We would lower our ratings on the covered bonds if the available credit enhancement became insufficient to cover the credit enhancement required for the current rating, because of a reduction of the available credit enhancement, and/or because of deteriorations of the cover pool's credit risk profile.

Rationale

S&P Global Ratings assigned its 'AAA' credit ratings to BKS Bank AG's mortgage covered bond program and related issuances. 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. Accordingly, we performed a legal and regulatory review, an operational risk review, a resolution regime analysis, a jurisdictional support analysis, a collateral support analysis, and a counterparty and sovereign risk analysis.

From our analysis of the Austrian legal and regulatory framework, we consider that it effectively isolates the cover pool assets from the issuer's insolvency estate for the benefit of the covered bondholders. The protection of the cover pool assets and the continued management of the cover pool allows us to elevate the rating on the covered bonds above BKS's creditworthiness.

Based on our operational risk analysis, which covered a review of BKS Bank's lending process, collection and default management procedures, as well as cover pool management and administration, we believe that the ratings on the covered bonds are not constrained by operational risk.

BKS Bank is domiciled in Austria, 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 Austria. These factors increase the likelihood that BKS Bank 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. We have therefore assigned two notches of uplift above our assessment of BKS Bank's creditworthiness to determine the covered bonds' reference rating level (RRL).

We considered the likelihood for the provision of jurisdictional support. Based on a very strong jurisdictional support assessment for mortgage programs in Austria, we assigned three notches of uplift from the RRL to determine the jurisdiction-supported rating level (JRL).

We have reviewed the cover pool information provided as of Dec. 31, 2023. The €188 million of outstanding covered are secured by a €509 million cover pool comprising Austrian residential (94.84% of the cover pool balance) and commercial mortgage loans (5.16% of the cover pool balance).

We assessed the residential mortgage cover pool's credit quality by estimating the credit risk associated with each loan in the pool. We base this loan-level analysis on the specific adjustments defined for Austria under our global residential loans criteria (see "Global Methodology And Assumptions: Assessing Pools Of Residential Loans," published on Jan. 25, 2019).

The current small size of the commercial mortgage loan subportfolio, comprising fewer than 150 nonrelated mortgage loans, implies that this portfolio is not necessarily in scope of our commercial real estate (CRE) criteria, "Methodology And Assumptions: Analyzing European Commercial Real Estate Collateral In European Covered Bonds," published on March 31, 2015, and would likely require additional analytical considerations. Therefore, we have borrowed these criteria to analyze this portion of the portfolio because we believe the higher concentration risk of this subportfolio is already adequately captured through the application of a small pool adjustment factor to the default frequency of the commercial subportfolio as described in these criteria, which given the current composition of the pool, ultimately results in a default frequency assumption of 95%.

In our opinion, the use of the existing loss severity assumptions outlined in the CRE criteria represent a sufficiently robust approach to analyze the small sub-set of commercial mortgage loans in this cover pool. Finally, in our view, the underlying commercial mortgage loans exhibit characteristics similar to those generally observed in other rated covered bonds secured by CRE assets.

Based on our collateral support analysis, the available overcollateralization of 170.59% exceeds the target credit enhancement of 16.26% commensurate with a potential four-notch uplift above the JRL. From these four notches, we deduct one due to uncommitted overcollateralization. We do not apply a reduction for the lack of 180 days of liquid assets when we assign a covered bond rating that exceeds the foreign currency rating on the covered bond issuer's sovereign of domicile because our structured finance sovereign risk criteria already limit the number of notches of uplift above the long-term sovereign rating if refinancing risk is not addressed. Consequently, the assigned collateral support uplift is three notches above the JRL, permitting the covered bonds to achieve a 'AAA' rating (see table 1).

There are no rating constraints to the 'AAA' rating relating to legal, counterparty, or sovereign risks.

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

Program Description

Table 1

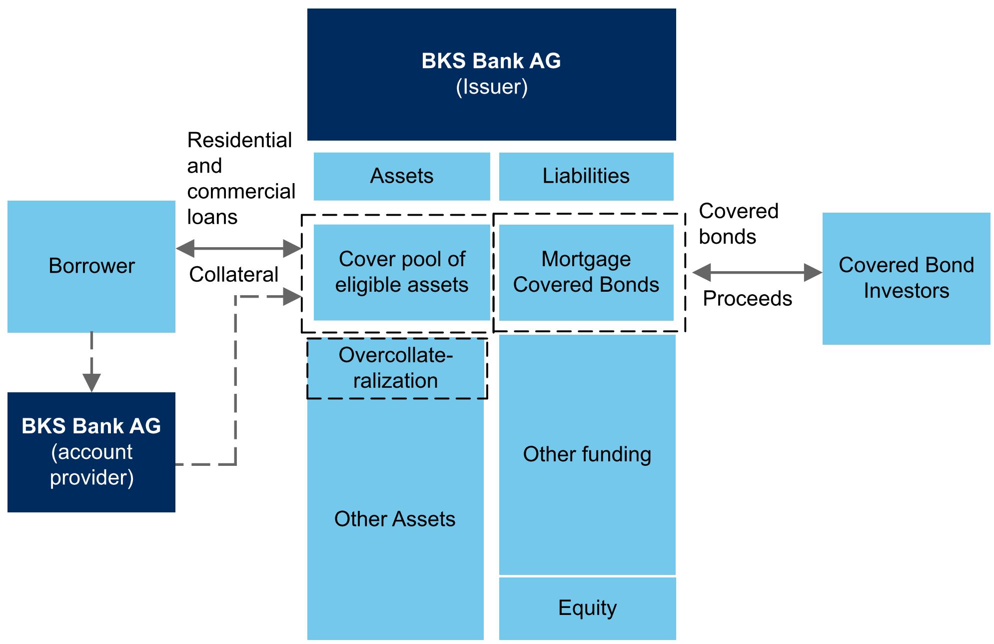
Program overview	
Jurisdiction	Austria
Covered Bond Rating	AAA/Stable
Covered bond type	Legislation-enabled (Austrian Pfandbriefgesetz)
Cover pool assets	Residential and commercial mortgages
Cover pool notional amount (mil. €) as of Dec. 31, 2023	508.71
Outstanding covered bonds (mil. €) as of Dec. 31, 2023	188.00
Redemption profile	Hard bullet
Resolution regime uplift	2

Table 1

Program overview (cont.)	
Jurisdictional support uplift	3
Target credit enhancement (%)	16.26
Credit enhancement commensurate with current rating (%)	14.40
Available credit enhancement (%)	170.59
Assigned collateral support uplift	2
Unused notches for collateral support	1

Transaction structure

BKS Bank AG Mortgage Covered Bond Program



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BKS Bank issued its first covered bond in 2012. The covered bonds are issued under BKS Bank's base prospectus for the issuance of bonds or under stand-alone documentation. As of Dec. 31, 2023, there are €188 million of mortgage covered bonds outstanding, representing about 1.8% of BKS Bank's total funding. The covered bonds constitute senior secured unsubordinated obligations of the issuer and rank pari passu with all other obligations secured by the mortgage cover pool register. Covered bondholders have recourse to BKS Bank and in the instance of its insolvency to the assets in the cover pool register. As of Dec. 31, 2023, the cover pool comprises €508.7 million Austrian residential and commercial mortgage loans. The available overcollateralization stood at 170.6%.

BKS Bank provides the bank account for the covered bond program. In the absence of structural mitigants, we have taken the associated counterparty risk into account when determining the required credit enhancement at a 'AAA' rating level.

There are no derivatives registered in the cover pool to mitigate interest and foreign exchange rate risk in the cover pool. Interest rate risk arises from differences in the interest received on the cover pool assets (68.50% floating rate) versus the interest payable on the covered bonds (94.68% fixed rate paying). Cover pool assets are predominantly denominated in euros with a small share of 3.58% denominated in Swiss francs. We have taken the resulting interest rate and currency risk into account in our cash flow modelling.

Table 2

Program Participants

Role	Name	Rating	Rating dependency
Issuer	BKS Bank AG	--	Yes
Originator/servicer	BKS Bank AG	--	No
Collection account	BKS Bank AG	--	No

Rating Analysis

Legal and regulatory risks

We base our legal analysis on our "Structured Finance: Asset Isolation And Special-Purpose Entity Methodology," criteria, published on March 29, 2017, and our covered bond ratings framework.

Most of BKS Bank's outstanding mortgage covered bonds were issued under the Austrian Law on Secured Bank Bonds ("Gesetz betreffend fundierte Bankschuldverschreibungen") while covered bonds issued from the program after July 7, 2022, are issued under Austria's new Pfandbriefgesetz (Austrian Covered Bond Act) which implemented the EU's Covered Bonds Directive. The revised law merged the three laws in force prior to July 8, 2022 ("Hypothekenbankgesetz," "Pfandbriefgesetz," and the "Gesetz betreffend fundierte Bankschuldverschreibungen") into one, reducing the legal complexity for Austrian covered bonds. Issuances made before July 8, 2022, are not required to fulfill the requirements of the Austrian Covered Bond Act and are grandfathered with their original designation. BKS Bank received its license from the Austrian Financial Market Authority to issue covered bonds under the Austrian Covered Bond Act in February 2023, and issued its first covered bond under the revised law in March 2023.

The covered bonds constitute direct, unconditional, and unsubordinated obligations of the issuer and rank pari passu among themselves and with all other obligations secured by the cover pool register. Covered bondholders and registered derivative counterparties have recourse to the issuer and--in the event of an issuer insolvency--to the assets comprised in the cover register.

The Austrian Covered Bond Act includes--among others--a 180-day liquidity buffer requirement, a 2% minimum overcollateralization requirement, the possibility for the special cover pool administrator to extend the maturity of the covered bonds by a maximum of 12 months subject to certain conditions, the appointment of a cover pool monitor (which can be internal or external at the issuer's choice), and the requirement of a borrower's consent for a loan to be registered as a cover pool asset.

Derivatives are allowed for risk hedging purposes and must be registered in the cover register subject to prior consent of the counterparty.

Under the Austrian Covered Bond Act, LTV ratio limits can be deduced from the reference of eligible cover assets to CRR Art 129 (1), including an LTV ratio limit of 80% of the value of the property for residential real estate, and 60% for commercial real estate. For commercial real estate, a limit of up to 70% is also possible. At the same time, issuers can set lower LTV ratio limits in their articles of association.

Borrowers do not have the right to set off any deposits they have with the issuer against their mortgages in the cover pool register. The prohibition of setoff does not apply to derivative contracts, when netting occurs for receivables arising under one and the same master agreement.

In our view, the Austrian Covered Bond Act effectively segregates cash received after the issuing bank's insolvency, but cash received shortly before insolvency and not reinvested in cover pool assets could be exposed to commingling risk. We address this risk in our counterparty risk analysis. The mortgage cover pool provides sufficient overcollateralization to mitigate this potential loss at its current rating level of 'AAA'.

From our legal analysis of the Austrian Covered Bond Act, we conclude that it addresses the main legal aspects that we assess in a covered bond legislation. Our analysis concluded that the cover pool register is effectively isolated from the issuer's insolvency estate for the benefit of the covered bondholders.

If the issuer becomes insolvent, a bankruptcy court, after consultation with the Austrian Financial Market Authority will appoint a cover pool administrator to continue the cover pool's management and to satisfy the covered bondholders' claims.

The cover pool assets' protection and the cover pool's continued management allows us to assign a higher rating to the covered bond program than BKS Banks's creditworthiness.

Operational and administrative risks

In our opinion, there is no operational risk from the cover pool's management and loan origination that would constrain the covered bond rating to the same level as BKS Bank's creditworthiness.

We believe that a replacement cover pool manager would be available to manage the cover pool if the issuer were to become insolvent. We consider Austria to be an established covered bond market and we believe that the mortgage assets in BKS Bank's cover pool do not comprise product features that would materially limit the range of available replacement cover pool managers or servicers.

With total assets of €10.6 billion as of Sept. 30, 2023, BKS Bank is a small universal Austrian bank headquartered in Klagenfurt. Its share of the lending market in Austria is about 1.4%. The bank primarily lends to corporate and small to medium enterprises (SMEs) as well as retail clients. It has a strong regional focus in its home market of Carinthia, where it has a market share of about 20% in corporate lending. BKS Bank's local focus is complemented by operations in Croatia, Slovenia, and (to a lesser extent) Slovakia and Germany. BKS Bank is part of the 3 Banken Group, a partnership-based cooperation with two other regional banks in Austria--Oberbank AG and BTV Bank AG.

In August 2022, the Austrian Financial Market Authority introduced a number of binding borrower-based measures to limit potential systemic risks from residential real estate financing. The guidelines include an upper limit of 90% for LTV ratios, a maximum debt service-to-income ratio of 40%, and a maximum loan maturity of 35 years.

Mortgage loan origination occurs mainly through BKS Bank branches and to a limited extent intermediaries, but all loan decisions are retained at the bank level. Loans are mostly repayment loans where borrowers pay monthly installments of principal and interest. The interest rate on the loans is predominantly variable or fixed over a certain term.

For residential loans, BKS Bank requires a 20% equity share, which is analyzed in conjunction with the above-stated regulatory requirements. The examination of the creditworthiness of the consumer always precedes any granting of a loan. As part of the origination process, the bank requires proof of income and conducts affordability and credit history checks.

For CRE loans, the required equity contribution depends on the customer's creditworthiness as determined by the bank, which also conducts a stressed affordability calculation. CRE loans are limited to a maximum term of 20 years.

Mortgage loans are mostly euro-denominated. The share of foreign-currency-denominated loans in BKS Bank's loan book overall is about 1% as of Dec. 31, 2022, and is declining since the Austrian Financial Market Authority largely prohibited new foreign exchange lending to unhedged households starting in 2010. Therefore, BKS Bank does not grant any new foreign currency loans except those that meet Austrian Financial Market Authority's minimum standards.

Collateral valuations are carried out before the loan is approved and are independent of the loan approval. The value of real estate collateral is reassessed once a year supported by automated monitoring procedures.

BKS Bank does not include loans with the following characteristics in the cover pool: among other speculative financings; foreign currency loans (apart from the existing small share of legacy Swiss franc-denominated loans that is declining, the cover pool only includes euro-denominated loans); and loans to borrowers having a bank internal rating of below a certain threshold. The cover pool does not currently include loans in arrears.

Overall, we believe there are sufficiently prudent and effective underwriting and servicing procedures in place to support our rating on the covered bonds.

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

As part of our covered bonds criteria, our analysis considers the resolution regime in place in Austria to determine the RRL. The RRL on BKS Bank is two notches above our assessment of its creditworthiness. We consider the following factors:

- BKS Bank is domiciled in Austria, which is subject to the EU's BRRD, which excludes covered bonds from bail-in-able debt.
- We assess the systemic importance for Austrian mortgage covered bonds as very strong.

Therefore, the RRL is the greater of (i) our assessment of the issuer's creditworthiness plus two notches; and (ii) the resolution counterparty rating (RCR) on the issuer, where applicable.

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 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 an issuer would continue to service its covered bonds without accessing the cover pool or receiving jurisdictional support, even if it were to face failure.

Jurisdictional support analysis

In our jurisdictional support analysis, we determine the covered bonds' JRL, which is our assessment of the likelihood that a covered bond program facing stress would receive support from a government-sponsored initiative instead of liquidating cover assets in the open market.

Our jurisdictional support analysis assesses three factors: the legal framework's strength, the covered bonds' systemic importance, and the sovereign's credit capacity. For Austrian mortgage covered bonds, we assess all three factors as very strong leading to an overall jurisdictional support assessment of very strong. In addition, our long-term sovereign rating on Austria (AA+/Stable/A-1+) does not constrain the JRL. As a result, the covered bonds benefit from three notches of jurisdictional support uplift above the RRL.

Collateral support analysis

Our credit analysis is based on loan-by-loan cover pool information as of Dec. 31, 2023. The €509 million cover pool includes residential (94.84%) and commercial loans (5.16%) granted to borrowers, on some occasions, backed by different properties.

The residential mortgage loan portfolio contains about 3,397 loans with on average a cover pool current LTV ratio of 45.36% after house price indexation. The weighted-average seasoning of the residential portfolio is about 4.4 years and the interest rate on most of the loans is floating. Most of the residential loans are for owner occupation with about 2% being for buy-to-let purposes.

The current commercial mortgage loan subportfolio contains a small number of loans, with the largest exposure group being multifamily housing.

The tables below provide an overview of the cover pool's composition.

Table 3

Cover pool composition (as of Dec. 31, 2023)

Asset type	Value (€)	Percentage of cover pool (%)
Residential mortgages	482,463,583	94.84
Commercial mortgages	26,250,846	5.16
Total	508,714,429	100

Table 4

Key credit metrics (as of Dec. 31, 2023)

Residential mortgages	
Average loan size (€)	152,129
Weighted-average effective LTV ratio (%)*	78.19

Table 4

Key credit metrics (as of Dec. 31, 2023) (cont.)	
Weighted-average original LTV ratio (%)	84.81
Weighted-average cover pool LTV ratio (%)	45.36
Weighted-average loan seasoning (months)§	53.18
Balance of loans to self-employed borrowers (%)	28.92
Balance of loans in arrears (%)	0.00
Residential mortgages credit analysis results	
WAFF (%)	23.92
WALS (%)	26.50
Commercial mortgages	
Weighted-average whole-loan LTV ratio (%)	46.99
Weighted-average cover pool LTV ratio (%)	43.45
Commercial mortgages credit analysis results	
WAFF (%)	94.95
WALS (%)	38.98
Combined mortgage pool credit analysis results	
WAFF (%)	27.55
WALS (%)	27.13
'AAA' credit risk (%)	8.81

*Calculated weighting 80% of the OLTV and 20% of the CLTV. LTV ratios are based on the loan balances secured on the property, including loan parts outside the asset pool and prior- and second-ranking balances if any. Adjusted for developments in the house-price index. §Seasoning refers to the elapsed loan term. LTV--Loan-to-value. WAFF--Weighted-average foreclosure frequency. WALS--Weighted-average loss severity.

Table 5

Loan-to-value ratios (as of Dec. 31, 2023)	
WAFF-effective LTV ratios/whole LTV ratios (%)	
Residential mortgages - effective LTV ratios (%)	
0-40	17.65
40-50	8.10
50-60	8.84
60-70	11.82
70-80	10.87
80-90	12.51
90-100	10.31
>100	19.89
Weighted-average effective LTV ratio	78.19
Commercial mortgages – whole-loan LTV ratios (%)	
0-40	40.30
40-50	22.71
50-60	4.82
60-70	12.72
70-80	11.85
80-90	5.81

Table 5

Loan-to-value ratios (as of Dec. 31, 2023) (cont.)	
90-100	0.77
>100	1.01
Weighted-average whole LTV ratio	46.99
WALS-cover pool LTV ratios (%)	
Residential mortgages - current LTV ratios after HPI, based on cover pool balance (%)	
0-40	46.23
40-50	14.94
50-60	13.15
60-70	8.82
70-80	9.44
80-90	4.93
90-100	1.30
>100	1.20
Weighted-average cover pool LTV ratio	45.36
Commercial mortgages - current LTV ratios, based on cover pool balance (%)	
0-40	43.80
40-50	21.33
50-60	16.21
60-70	12.24
70-80	6.42
80-90	0.00
90-100	0.00
>100	0.00
Weighted-average current LTV ratio	43.45

WAFF--Weighted-average foreclosure frequency. LTV--loan to value. WALS--Weighted-average loss severity.

Table 6

Residential loan seasoning distribution (as of Dec. 31, 2023)*	
	Percentage of current residential mortgage loan balance (%)
In arrears	0.00
<=5 years	65.29
>5 and <=6 years	10.06
>6 and <=7 years	7.40
>7 and <=8 years	8.60
>8 and <=9 years	5.17
>9 and <=10 years	1.20
>10 years	2.30
Weighted-average residential loan seasoning (months)	53.18

*Seasoning refers to the elapsed loan term.

Table 7

Geographic distribution of loan assets (as of Dec. 31, 2023)

	Percentage of residential assets in the pool (%)	Percentage of commercial assets in the pool (%)
Burgenland	8.85	9.38
Carinthia (Kaernten)	38.15	19.49
Lower Austria (Niederoesterreich)	11.41	27.05
Upper Austria (Oberoesterreich)	0.81	0.00
Salzburg	0.68	0.00
Styria (Steiermark)	22.65	24.21
Tyrol (Tirol)	0.04	0.00
Vorarlberg	0.00	0.00
Vienna (Wien)	17.42	19.87

We assess a typical residential mortgage cover pool's credit quality by estimating the credit risk associated with each loan in the pool. We base this loan-level analysis on the specific adjustments defined for Austria under our global residential loans criteria (see "Global Methodology And Assumptions: Assessing Pools Of Residential Loans," published on Jan. 25, 2019).

The current small size of the commercial mortgage loan subportfolio comprising fewer than 150 nonrelated mortgage loans implies that this portfolio is not necessarily in scope of our criteria "Methodology And Assumptions: Analyzing European Commercial Real Estate Collateral In European Covered Bonds," published on March 31, 2015 (CRE criteria), and would likely require additional analytical considerations. Therefore, we have borrowed these criteria to analyze this portion of the portfolio because we believe the higher concentration risk of this subportfolio is already adequately captured through the application of a small pool adjustment factor to the default frequency of the commercial subportfolio as described in these criteria, which given the current composition of this subportfolio, ultimately results in a default frequency assumption of 95%. Furthermore, in our opinion, the use of the existing loss severity assumptions outlined in the CRE criteria represent a sufficiently robust approach to analyze the small sub-set of commercial mortgage loans in this cover pool. Finally, in our view, the underlying commercial mortgage loans exhibit characteristics similar to those generally observed in other rated covered bonds secured by CRE assets.

We then calculate the aggregate risk to assess the cover pool's overall credit quality. In order to quantify the potential losses associated with the entire pool, we weight each loan's foreclosure frequency and loss severity by its percentage of the total pool balance. The product of this weighted-average foreclosure frequency (WAFF) and weighted-average loss severity (WALS) estimates the required loss protection, assuming all other factors remain unchanged.

Our analysis determined a residential WAFF of 23.92% and a WALS of 26.50%. For the current commercial mortgage loan subportfolio, our WAFF after applying our small pool adjustment factor is 94.95% and our WALS is 38.98%. The combined residential and commercial mortgage loan portfolio's WAFF is 27.55% and WALS is 27.13%. We based these metrics on the 'AAA' credit stresses that we applied.

Under our global residential loans criteria, we apply multiples to the base foreclosure frequency based on the effective LTV ratio, weighting 80% of the original LTV ratio and 20% of the whole-loan current LTV ratio. In this context, the criteria use an LTV ratio curve to make upward and downward adjustments to the foreclosure frequency of a loan, depending on whether its LTV ratio is higher or lower than 73%, which we consider as the archetypal (neutral) level for an Austrian residential loan under our residential loan criteria. We have determined a weighted-average effective LTV (ELTV) ratio for the residential cover pool of 78.19% (see table 5).

A further key factor influencing the residential WAFF in this portfolio is the share of self-employed borrowers (29% of the residential portfolio), which attracts an increase to the base foreclosure frequency by a multiple of 1.25x. Another influence on the residential WAFF is the seasoning of the loans. About 34.7% of residential loans are more than five years seasoned, which we view as credit positive and therefore apply a reduction to the base foreclosure frequency of these loans. On the other hand, exposure of residential loans in Carinthia that exceed the regional concentration limit of 15%, defined in our residential loan criteria, attracts a 20% increase to their base foreclosure frequency on the excess above the limit.

The main drivers behind the WALS for residential properties are current LTV ratios after house price indexation and our repossession market value decline assumption adjusted for over-or undervaluation. In this context, we have determined a relatively low weighted-average current LTV ratio for the cover pool of 45.36%. We currently incorporate an overvaluation assumption for Austrian residential properties of 40%. In addition, the cover pool's residential WALS is affected by jumbo valuations. Our analysis shows that jumbo valuations (properties with a value exceeding €1 million for Vienna and €700,000 for the rest of Austria) account for about 28% of the residential pool. We believe properties with higher valuations could experience higher loss severities, owing to their smaller and less liquid market. To consider this, we increase our market value decline assumptions for jumbo valuations by applying an adjustment of 20% on the excess above the jumbo valuation threshold.

The commercial cover pool's WALS is driven by current LTV ratios. We have determined a relatively low weighted-average current LTV ratio for the commercial cover pool of 43.45%.

The results of our credit analysis, including the combined cover pool's WAFF of 27.55% and weighted-average recovery rate (1-WALS) equivalent to 72.87%, represent inputs to our cash flow analysis. Our analysis of the covered bonds' payment structure shows that cash flows from the cover pool assets would be sufficient, at the given rating, to make timely payment of interest and ultimate principal to the covered bond on its legal final maturity. We have performed our cash flow analysis using asset and liability cash flow projections provided by BKS Bank as of Sept. 30, 2023.

We stress the cover pool's cash flows, incorporating various default patterns, default timings, interest rate paths, and currency stresses to address foreign exchange rate fluctuations between the small share of Swiss franc-denominated assets and the euro-denominated covered bonds. We also stress cash flows under different prepayment rate, and delinquency assumptions, which we run at different points over the weighted-average life of the covered bonds.

The program is exposed to structural asset-liability mismatch risk because the covered bonds' repayment profile is not aligned with that of the assets. Our model simulates a stressed sale of assets whenever a liquidity shortfall occurs in our analysis. The discount applied for the combined portfolio of mortgage assets is 454.35 basis points, on top of the stressed interest rate at the time of the shortfall.

The cover pool register does not include derivatives to mitigate interest rate and foreign exchange rate risk. We have taken both into account in our cash flow analysis. In addition, we considered the possibility that the spread on the mortgage loans reduces over time, due to defaults, prepayments, and product switches. To account for this, we reduce margins, assuming that a percentage of the higher-yielding loans exit the portfolio.

We also considered commingling risk by sizing a portion of collections to be lost in our cash flow model because cash collections from the cover pool assets are not segregated in the cover pool before the insolvency of the issuer.

By applying our credit and cash flow stresses, we calculate a target credit enhancement of 16.26%, below the available credit enhancement of 170.59%, allowing for a potential four notches of collateral-based uplift above the JRL. As outlined above, a one-notch deduction applies resulting in a maximum collateral-based uplift of three notches above the JRL (see table 8). The covered bonds use two notches to achieve a 'AAA' rating with a required credit enhancement of 14.40% ('AAA' credit risk and 75% refinancing costs). This results in one unused notch of collateral support, which would protect the ratings on the covered bonds in the event of a deterioration of our view of the issuer's creditworthiness, all else being equal.

Table 8

Collateral support uplift metrics (as of Dec. 31, 2023)	
Asset WAM (years)	10.77
Liability WAM (years)	4.68
Maturity gap (years)	6.09
Available credit enhancement	170.59
'AAA' credit risk (%)	8.81
Required credit enhancement for first notch of collateral uplift (%)	10.67
Required credit enhancement for second notch of collateral uplift (%)	12.54
Required credit enhancement for third notch of collateral uplift (%)	14.40
Target credit enhancement for maximum uplift (%)	16.26
Potential collateral-based uplift (notches)	4
Adjustment for liquidity (Y/N)	N
Adjustment for committed overcollateralization (Y/N)	Y
Collateral support uplift (notches)	3

WAM--Weighted-average maturity.

Counterparty risk

The rating on the covered bonds is not constrained from a counterparty risk perspective (see "Counterparty Risk Framework: Methodology And Assumptions," published on March 8, 2019).

Borrowers effect their payments into the accounts held with BKS Bank. Based on our legal risk analysis, we have concluded that cash collections from the cover assets received after an issuer insolvency, upon which a special administrator will be appointed to manage the cover assets, would form part of the separate cover pool estate and therefore are not available to the issuer's general creditors. However, cover pool collections accumulated in the collection account pre issuer insolvency are potentially exposed to commingling risk because these collections are not segregated in the cover pool.

There is no documented replacement mechanism in place, which would protect the covered bondholders from the bank account providers' credit deterioration. Therefore, we considered the risk that cover pool collections may be lost if they have not been reinvested in cover assets or used to pay the covered bonds.

There are no derivatives registered in the cover pool.

Sovereign risk

We analyze sovereign risk by applying our structured finance sovereign risk criteria (see "Incorporating Sovereign Risk In Rating Structured Finance Securities: Methodology And Assumptions," published on Jan. 30, 2019).

Under these criteria, covered bonds issued in a jurisdiction that is within a monetary union that do not include structural coverage of refinancing needs over a 12-month period exhibit moderate sensitivity to country risk. This means we can rate the covered bonds up to four notches above the sovereign rating. Given our 'AA+' long-term sovereign rating on Austria, sovereign risk does not constrain our rating on the covered bonds.

Environmental, Social, And Governance

Environmental and social credit factors have no material influence on our credit rating analysis of BKS Bank's mortgage covered bonds. However, governance factors are a moderately negative consideration in our credit rating analysis. The issuer is not committed to maintain a minimum level of overcollateralization in the program. This introduces the risk that the available credit enhancement could decrease in the future to levels that are not commensurate with the current ratings. This reduces the unused notches of uplift by one and increases the required credit enhancement for the current rating.

Related Criteria

- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- Criteria | Structured Finance | General: Global Framework For Payment Structure And Cash Flow Analysis Of Structured Finance Securities, Dec. 22, 2020
- Criteria | Structured Finance | General: Counterparty Risk Framework: Methodology And Assumptions, March 8, 2019
- Criteria | Structured Finance | General: Incorporating Sovereign Risk In Rating Structured Finance Securities: Methodology And Assumptions, Jan. 30, 2019
- Criteria | Structured Finance | RMBS: Global Methodology And Assumptions: Assessing Pools Of Residential Loans, Jan. 25, 2019
- 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: Methodology And Assumptions: Analyzing European Commercial Real Estate Collateral In European Covered Bonds, March 31, 2015

- Criteria | Structured Finance | Covered Bonds: Covered Bonds Criteria, Dec. 9, 2014
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Related Research

- Global Covered Bond Insights Q1 2024, Dec. 15, 2023
- Austria 'AA+/A-1+' Ratings Affirmed ; Outlook Stable, Aug. 25, 2023
- S&P Global Ratings Definitions, June 9, 2023
- Glossary Of Covered Bond Terms, April 27, 2018

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