MOODY'S INVESTORS SERVICE

Credit Opinion: Aktia Bank p.l.c.

Global Credit Research - 14 Feb 2013

Helsinki, Finland

Ratings

Category	Moody's Rating
Outlook	Negative(m)
Bank Deposits	A3/P-2
Bank Financial Strength	C-
Baseline Credit Assessment	(baa2)
Adjusted Baseline Credit Assessment	(baa2)
Senior Unsecured -Dom Curr	A3
Other Short Term -Dom Curr	(P)P-2

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Key Indicators

Aktia Bank p.l.c. (Consolidated Financials)[1]

	[2]9-12	[2]12-11	[2]12-10	[2]12-09	[2]12-08	AVERG
Total Assets (EUR million)	10,234.8	9,993.1	9,924.3	9,539.5	9,519.9	[3]1.8
Total Assets (USD million)	13,167.1	12,972.6	13,313.9	13,686.7	13,233.1	[3]-0.1
Tangible Common Equity (EUR million)	361.5	326.2	320.4	309.3	300.0	[3]4.8
Tangible Common Equity (USD million)	465.1	423.4	429.8	443.7	417.0	[3]2.8
Net Interest Margin (%)	1.2	1.3	1.5	1.7	0.4	[4]1.2
PPI / Average RWA (%)	1.5	1.3	2.3	2.5	-0.7	[5]1.4
Net Income / Average RWA (%)	0.9	0.7	1.5	1.1	-0.5	[5]0.7
(Market Funds - Liquid Assets) / Total Assets (%)	28.3	30.0	26.8	26.6	11.6	[4]24.6
Core Deposits / Average Gross Loans (%)	50.3	52.9	52.5	52.1	56.8	[4]52.9
Tier 1 Ratio (%)	11.8	10.6	10.1	9.5	9.3	[5]10.3
Tangible Common Equity / RWA (%)	9.7	8.8	8.7	8.9	9.1	[5]9.0
Cost / Income Ratio (%)	69.0	73.0	59.3	56.8	204.9	[4]92.6
Problem Loans / Gross Loans (%)	-	1.6	1.2	-	-	[4]1.4
Problem Loans / (Equity + Loan Loss Reserves) (%)	-	30.4	20.7	-	-	[4]25.6

[1] All figures and ratios are adjusted using Moody's standard adjustments [2] Basel II; IFRS [3] Compound Annual Growth Rate based on IFRS reporting periods [4] IFRS reporting periods have been used for average calculation [5] Basel II & IFRS reporting periods have been used for average calculation; Source: Moody's

Opinion

RECENT CREDIT DEVELOPMENTS

On 12 February 2013, Moody's affirmed Aktia Bank's A3 long-term debt and deposit rating, P-2 short term debt and deposit rating and C- bank financial strength rating (BFSR) which is equivalent to a standalone credit assessment of baa2. The outlook on the long term debt and deposit rating was revised to negative from stable. The stable outlook on the BFSR is unchanged.

The rating action follows Aktia's announcement on 29 January 2013 that it will terminate its services as the central credit institution for the local cooperative banks (POP banks) and savings banks in Finland due to concerns about the profitability and liquidity implications of the Basel III regulations. This followed an earlier announcement in September 2012 that the bank would apply for a concession to issue covered bonds off its own balance sheet rather than through its subsidiary Aktia Real Estate Mortgage Bank plc (REMB), which will be effectively run-off over time.

The negative outlook on the long term ratings reflects Moody's view that the weakening of the relationship with the POP and Savings Banks will likely reduce the probability of systemic support moving forwards, although the rating agency understands that a large number of smaller agreements between Aktia and the POP and savings banks still exist.

SUMMARY RATING RATIONALE

Aktia Bank's bank's standalone C- financial strength rating (BFSR), which maps to baa2 on the long term scale, is supported by Aktia Bank's established - albeit small - franchise, prudent risk and liquidity management and good financial fundamentals, particularly asset quality and capital adequacy. Key elements constraining the BFSR include the bank's limited position in the competitive banking market, which is likely to lead to continued pressure on its profitability and a high borrower risk concentration.

Aktia Bank's A3/Prime-2 global local currency (GLC) deposit ratings and A3 unsecured debt rating are supported by (i) the bank's baa2 standalone financial strength and (ii) the Aaa local currency deposit ceiling of Finland, which we consider the underlying support provider. As a result of Aktia Bank's importance to the Finnish economy Moody's assesses a high probability of systemic support for the bank in the event of a stress situation, although the weakening of Aktia's historical ties with the POP and Savings Banks will lessen the probability of support. Consequently, Aktia Bank's GLC deposit rating benefits from a two-notch uplift from the standalone financial strength.

Rating Drivers

- Franchise negatively impacted by weakening of relationship with POP and Savings Banks

- High reliance on market funding

- Profitability remains moderate following the running off of the interest rate derivate portfolio and continued difficult operating conditions

- Strong asset quality and capitalisation despite high single-borrower concentration

Rating Outlook

The outlook on Aktia's BFSR is stable. The outlook on the supported long term debt and deposit rating is negative.

What Could Change the Rating - Up

Over time, a return to sustainable earnings growth while maintaining strong asset quality could provide upward pressure on the standalone rating of Aktia Bank.

What Could Change the Rating - Down

A larger-than-expected deterioration of asset quality and/or renewed earnings compression would place negative pressure on the bank's standalone ratings.

The gradual running off of its central credit institution role could create negative ratings pressure for Aktia's long term ratings, together with any additional further weakening of the relationship between the bank and the POP and Savings Banks.

DETAILED RATING CONSIDERATIONS

Detailed considerations for Aktia Bank's currently assigned ratings are as follows:

Bank Financial Strength Rating

Moody's assigns a BFSR of C- to Aktia Bank which is in line with the result of the banking financial strength scorecard.

- Franchise negatively impacted by weakening of relationship with POP and Savings Banks

Aktia Bank is the fourth-largest bank in Finland by total assets, with a market share of 4% of loans at end-2011. Around 85% of its loan portfolio is to retail customers (89% if housing associations are included) with smaller amounts of corporate (10%) and non-profit organisation (1%) lending at end-September 2012. Aktia Bank had 70 own branches, located mainly in the coastal areas of Finland, around Helsinki and the country's largest inland towns.

It has historically also benefitted from its role as a strategic partner for independent savings banks and local co-operative banks, both in terms of its role as the central credit institution for these banks, as well as through product distribution and many smaller agreements.

The announcements that Aktia Bank will cease to act as the central credit institution and that the REMB will now concentrate on the management and refinancing of the current book rather than funding new loans means that the relationship between Aktia and the POP and savings banks has been reduced. That said, we understand that there remain many other smaller agreements between the banks.

- High reliance on market funding

Aktia Bank's funding profile has gradually shifted over the past twenty years from deposits towards market funding which constituted around 50% of total funding at end-September 2013 (46% if interbank liabilities are excluded). Covered bonds issued by Aktia Real Estate Mortgage Bank represent a growing proportion of market funds, 72% as at end 2011. We view the increase in market funding as credit negative as it increases the bank's susceptibility to any sudden changes in investor sentiment, although we recognise that Aktia, and the Finnish banking sector in general, has been less impacted than other European banking systems in recent years.

With regards to market funding, we note that the covered bonds (rated Aa1 by Moody's) issued via the REMB are included in Aktia Bank's market funding as a whole, although approximately half of the loans at year-end 2011 were granted and are managed by independent savings banks and local co-operative banks. Aktia Bank has 70% of votes and 50.9% of shares in Aktia Real Estate Mortgage Bank with the rest owned by 30 savings banks (37.2% of equity and 20% of votes) and 34 POP banks (11.9% of equity and 10% of votes). This reflects the origination of mortgage loans that are distributed by the branch network of the co-operating banks and funded through the Mortgage Bank.

The bank's liquid assets account for around 21% of total assets (end-September 2012) and historically have consisted mainly of highly rated covered bonds and senior bonds of financial institutions.

We consider Aktia's reliance on market funding as a risk in view of the continued fragility of global capital markets and believe that the bank may be negatively affected by these difficulties as well as increase its funding costs, which would put additional pressure on the already depressed margins. More positively, we think that the running-off of the REMB and Aktia's plan to issue only their own covered bonds off their balance sheet may have positive implications for the banks ability to underwrite new business, given that it currently provides liquidity and short term funding support to the REMB, effectively supporting business written by the POP and savings banks.

- Profitability remains moderate following the running off of the interest rate derivate portfolio and continued difficult operating conditions

Aktia Bank reports moderate profitability which reflects its relatively low risk, retail banking focus and comparatively inefficiency, with a cost to income ratio of around 69% at end-September 2012. Nine months to end-September 2012 pre-tax profit amounted to EUR 35.2 million, up from EUR 31.6 million for the same period in 2011, with the decline in net interest income due to the expiration of beneficial long term interest rate hedges being outweighed by improved commission income, lower losses on financial transactions and reduced operating expenses.

Total net interest income - including hedge income - declined to EUR 87.4 million for nine months to end-September 2012 from EUR 98.0 million in 2011, with the largest contributing factor being the run off of interest rate hedges, income from which fell to EUR21.8 million compared to EUR27.9 million for the same period in 2011.

Whilst the bank's profitability is likely to be decreased slightly by the termination of its role as the central credit institution for the POP and savings banks, we believe that the investment in the bank's IT systems which was announced in January 2013, will likely mitigate this loss and improve efficiency over the long run.

Write-downs on credits and other commitments decreased to EUR 4.6 million over the nine months to end-September 2012 from EUR 6.3 million in 2011.

- Strong asset quality and capitalisation despite high single-borrower concentration

Aktia Bank enjoys relatively good asset quality, reflecting its focus on the retail sector and despite high single borrower concentration, a trait it shares with the majority of Nordic banks. Problem loans (defined as impaired loans plus loans over 90 days overdue) as a proportion of gross loans rose to 1.63% at end-2011 from 1.21% at end-2010.

Aktia Bank's total loan book stood at EUR 7.3 billion at end June 2012, with around EUR 4.1 billion of this on the balance sheet of its mortgage company, which is consolidated into Aktia Bank's accounts. Lending growth in 2011 for Aktia Bank (including loans in the mortgage company) was 7% (10% for 2010). Excluding the loans from savings and POP banks the loan growth was 3%.

The borrower concentration risk - as measured by the 20 largest exposures in relation to Tier 1 capital or pre-provision profit - is high. Although this is a constraint on the overall risk positioning score, it is in line with many other Nordic banks of similar size. When excluding exposures rated above A3, the concentration is more limited at around 73% of Tier 1 capital. Industry concentration risk is relatively well contained due to the bank's dominating focus on the retail sector. The largest industry sector is commercial real estate, which constituted around 4% of total lending and around 80% of Tier 1 capital at end-2011.

Aktia Bank's total capital and Tier 1 ratios stood at 19.9% and 11.8% respectively at end-September 2012, up from 16.2% and 10.6% at end-2011. The bank is currently applying the standardised Basel II approach when assessing the capital requirements for credit risk but has also applied for the IRB approach to the Finnish FSA.

Global Local Currency Deposit Rating (Joint Default Analysis)

Moody's assigns a long-term GLC deposit rating of A3 to Aktia Bank.

This rating is supported by (i) the bank's baa2 standalone financial strength and (ii) the Aaa local currency deposit ceiling of Finland, its underlying support provider. In view of Aktia Bank's moderate market shares in both deposits and loans and its diminishing role as the central financial institution to independent savings banks and local co-operative banks, Moody's assesses a high probability of systemic support for the bank in the event of a stress situation, resulting in a two-notch uplift from the baa2 BCA.

Foreign Currency Deposit Rating

The A3 foreign currency deposit rating and (P)A3 unsecured debt rating of Aktia Bank are unconstrained given that Finland has a country ceiling of Aaa.

ABOUT MOODY'S BANK RATINGS

Bank Financial Strength Rating

Moody's Bank Financial Strength Ratings (BFSRs) represent Moody's opinion of a bank's intrinsic safety and soundness and, as such, exclude certain external credit risks and credit support elements that are addressed by Moody's Bank Deposit Ratings. BFSRs do not take into account the probability that the bank will receive such external support, nor do they address risks arising from sovereign actions that may interfere with a bank's ability to honor its domestic or foreign currency obligations. Factors considered in the assignment of BFSRs include bank-specific elements such as financial fundamentals, franchise value, and business and asset diversification. Although BFSRs exclude the external factors specified above, they do take into account other risk factors in the bank's operating environment, including the strength and prospective performance of the economy, as well as the structure and relative fragility of the financial system, and the quality of banking regulation and supervision.

Global Local Currency Deposit Rating

A deposit rating, as an opinion of relative credit risk, incorporates the BFSR as well as Moody's opinion of any external support. Specifically, Moody's Bank Deposit Ratings are opinions of a bank's ability to repay punctually its deposit obligations. As such, they are intended to incorporate those aspects of credit risk relevant to the prospective payment performance of rated banks with respect to deposit obligations, which includes: intrinsic financial strength, sovereign transfer risk (in the case of foreign currency deposit ratings), and both implicit and explicit external support elements. Moody's Bank Deposit Ratings do not take into account the benefit of deposit insurance schemes which make payments to depositors, but they do recognize the potential support from schemes that may provide assistance to banks directly.

According to Moody's joint default analysis (JDA) methodology, the global local currency deposit rating of a bank is determined by the incorporation of external elements of support into the bank's Baseline Credit Assessment. In calculating the Global Local Currency Deposit rating for a bank, the JDA methodology also factors in the rating of the support provider, in the form of the local currency deposit ceiling for a country, Moody's assessment of the probability of systemic support for the bank in the event of a stress situation and the degree of dependence between the issuer rating and the Local Currency Deposit Ceiling.

National Scale Rating

National scale ratings are intended primarily for use by domestic investors and are not comparable to Moody's globally applicable ratings; rather they address relative credit risk within a given country. A Aaa rating on Moody's National Scale indicates an issuer or issue with the strongest creditworthiness and the lowest likelihood of credit loss relative to other domestic issuers. National Scale Ratings, therefore, rank domestic issuers relative to each other and not relative to absolute default risks. National ratings isolate systemic risks; they do not address loss expectation associated with systemic events that could affect all issuers, even those that receive the highest ratings on the National Scale.

Foreign Currency Deposit Rating

Moody's ratings on foreign currency bank obligations derive from the bank's local currency rating for the same class of obligation. The implementation of JDA for banks can lead to high local currency ratings for certain banks, which could also produce high foreign currency ratings. Nevertheless, it should be noted that foreign currency deposit ratings are in all cases constrained by the country ceiling for foreign currency bank deposits. This may result in the assignment of a different, and typically lower, rating for the foreign currency deposits relative to the bank's rating for local currency obligations.

Foreign Currency Debt Rating

Foreign currency debt ratings are derived from the bank's local currency debt rating. In a similar way to foreign currency deposit ratings, foreign currency debt ratings may also be constrained by the country ceiling for foreign currency bonds and notes; however, in some cases the ratings on foreign currency debt obligations may be allowed to pierce the foreign currency ceiling. A particular mix of rating factors are taken into consideration in order to assess whether a foreign currency bond rating pierces the country ceiling. They include the issuer's global local currency rating, the foreign currency government bond rating, the country ceiling for bonds and the debt's eligibility to pierce that ceiling.

About Moody's Bank Financial Strength Scorecard

Moody's bank financial strength model (see scorecard below) is a strategic input in the assessment of the financial strength of a bank, used as a key tool by Moody's analysts to ensure consistency of approach across banks and regions. The model output and the individual scores are discussed in rating committees and may be adjusted up or down to reflect conditions specific to each rated entity.

Rating Factors

Aktia Bank p.l.c.

Rating Factors [1]	**A**	**B**	**C**	**D**	**E**	**Total Score**	**Trend**
Qualitative Factors (50%)						**C**	
Factor: Franchise Value						**C-**	**Neutral**
Market share and sustainability				**x**			
Geographical diversification				**x**			
Earnings stability		**x**					
Earnings Diversification [2]							

Factor: Risk Positioning						**D+**	**Neutral**
Corporate Governance [2]							
- Ownership and Organizational Complexity							
- Key Man Risk							
- Insider and Related-Party Risks							
Controls and Risk Management		**x**					
- Risk Management			x				
- Controls	x						
Financial Reporting Transparency		**x**					
- Global Comparability	x						
- Frequency and Timeliness	x						
- Quality of Financial Information		x					
Credit Risk Concentration					**x**		
- Borrower Concentration					x		
- Industry Concentration		x					
Liquidity Management					**x**		
Market Risk Appetite		**x**					
Factor: Operating Environment						**B+**	**Neutral**
Economic Stability			**x**				
Integrity and Corruption	**x**						
Legal System	**x**						
Financial Factors (50%)						**D+**	
Factor: Profitability						**C**	**Weakening**
PPI % Average RWA (Basel II)			2.04%				
Net Income % Average RWA (Basel II)			1.10%				
Factor: Liquidity						**E**	**Weakening**
(Market Funds - Liquid Assets) % Total Assets					27.78%		
Liquidity Management					x		
Factor: Capital Adequacy						**B+**	**Neutral**
Tier 1 Ratio (%) (Basel II)		10.07%					
Tangible Common Equity % RWA (Basel II)	8.83%						
Factor: Efficiency						**C**	**Weakening**
Cost / Income Ratio			63.05%				
Factor: Asset Quality						**C+**	**Neutral**
Problem Loans % Gross Loans	--	--	--	--	--		
Problem Loans % (Equity + LLR)	--	--	--	--	--		
Lowest Combined Financial Factor Score (15%)						**E**	
Economic Insolvency Override						**–**	
Aggregate BFSR Score						**C-**	
Aggregate BCA Score						**baa1/baa2**	
Assigned BFSR							
Assigned BCA						**baa1**	

[1] - Where dashes are shown for a particular factor (or sub-factor), the score is based on non-public information.
[2] - A blank score under Earnings Diversification or Corporate Governance indicates the risk is neutral.