MOODY'S
INVESTORS SERVICE

Credit Opinion: Aktia Bank p.l.c.

Global Credit Research - 03 Nov 2014

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]**6-14**	[3]**12-13**	[3]**12-12**	[3]**12-11**	[3]**12-10**	**Avg.**
Total Assets (EUR million)	**10,910.4**	**10,933.8**	**11,240.2**	**9,993.1**	**9,924.3**	[4]**2.4**
Total Assets (USD million)	**14,938.0**	**15,066.1**	**14,819.0**	**12,972.6**	**13,313.9**	[4]**2.9**
Tangible Common Equity (EUR million)	**471.4**	**473.7**	**451.0**	**326.0**	**320.4**	[4]**10.1**
Tangible Common Equity (USD million)	**645.4**	**652.8**	**594.6**	**423.2**	**429.8**	[4]**10.7**
Net Interest Margin (%)	**1.0**	**1.1**	**1.1**	**1.3**	**1.5**	[5]**1.2**
PPI / Average RWA (%)	**2.1**	**1.8**	**1.7**	**1.3**	**2.3**	[6]**2.1**
Net Income / Average RWA (%)	**1.7**	**1.4**	**1.4**	**0.7**	**1.5**	[6]**1.7**
(Market Funds - Liquid Assets) / Total Assets (%)	**17.6**	**20.8**	**22.5**	**30.0**	**26.8**	[5]**23.5**
Core Deposits / Average Gross Loans (%)	**58.8**	**53.7**	**49.8**	**52.9**	**52.5**	[5]**53.5**
Tier 1 Ratio (%)	**13.8**	**12.3**	**11.8**	**10.6**	**10.1**	[6]**13.8**
Tangible Common Equity / RWA (%)	**13.3**	**13.7**	**12.5**	**8.8**	**8.7**	[6]**13.3**
Cost / Income Ratio (%)	**65.5**	**70.7**	**71.1**	**73.1**	**59.3**	[5]**68.0**
Problem Loans / Gross Loans (%)	**--**	**1.6**	**1.5**	**1.6**	**1.2**	[5]**1.5**
Problem Loans / (Equity + Loan Loss Reserves) (%)	**--**	**16.7**	**16.6**	**30.4**	**20.7**	[5]**21.1**

Source: Moody's

[1] All figures and ratios are adjusted using Moody's standard adjustments [2] Basel III - transitional phase-in; IFRS [3] Basel II; IFRS [4] Compound Annual Growth Rate based on IFRS reporting periods [5] IFRS reporting periods have been used for average calculation [6] Basel III - transitional phase-in & IFRS reporting periods have been used for average calculation

Opinion

SUMMARY RATING RATIONALE

Aktia Bank P.l.c's (Aktia) A3/Prime-2 global local currency (GLC) deposit ratings and A3 senior unsecured debt rating are supported by (1) its C- standalone bank financial strength rating (BFSR) and; (2) a high probability of systemic support from the Aaa rated Finnish sovereign, in light of Aktia's importance to the Finnish economy although the weakening of Aktia's historical ties with the POP banks (local co-operative banks) and Savings Banks could lessen the probability of support. Consequently, Aktia's GLC deposit rating benefits from a two-notch uplift from the BFSR.

Aktia's standalone C- BFSR, which is equivalent to a baseline credit assessment (BCA) of baa2, is supported by Aktia'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 a competitive market and the bank's reliance on wholesale funding, the latter a common feature of Nordic banks.

Rating Drivers

- Franchise is negatively affected by the weakening relationship with the POP and savings banks

- Profitability remains moderate as a result of the highly competitive Finnish lending market

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

- Slightly lower reliance on market funding

Rating Outlook

The outlook on Aktia's BFSR is stable. The outlook on its long-term debt and deposit ratings is negative as a result of the bank's weaker relationship with the POP and savings banks that may reduce the probability of systemic support from the sovereign.

The negative outlook also takes into account the recent adoption of the Bank Recovery and Resolution Directive (BRRD) and the Single Resolution Mechanism (SRM) regulation in the EU. In particular, this reflects that, with the legislation underlying the new resolution framework now in place and the explicit inclusion of burden-sharing with unsecured creditors as a means of reducing the public cost of bank resolutions, the balance of risk for banks' senior unsecured creditors has shifted to the downside. Although our support assumptions are unchanged for now, the probability has risen that they will be revised downwards to reflect the new framework. For further details, please refer to our Special Comment entitled "Reassessing Systemic Support for EU Banks," published on 29 May 2014.

What Could Change the Rating - Up

Sustained strong profitability, efficiency and good asset quality could exert upward pressure on Aktia's ratings.

What Could Change the Rating - Down

Deterioration of asset quality and/or weaker profitability would result in negative pressure on the bank's standalone ratings.

Negative ratings pressure could also arise as a consequence of a lower support assumption from the Finnish sovereign. We could lower that assumption as a result of Aktia playing a less important role in the Finnish banking system following its decision to reduce its cooperation with POP and savings banks.

DETAILED RATING CONSIDERATIONS

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

Bank Financial Strength Rating

FRANCHISE IS NEGATIVELY AFFECTED BY THE WEAKENING RELATIONSHIP WITH THE POP AND SAVINGS BANKS

Aktia is the fourth-largest bank in Finland by total assets. It reported a market share of 4.1% of housing loans and 3.8% of deposits at end-June 2014. Around 88% of its loan portfolio is to households (92% if housing associations are included) with smaller loan amounts granted to corporates (7%) and not-for-profit organisations (1%) at end-June 2014. Aktia has 57 branches, located mainly in the coastal areas of Finland, around Helsinki and the country's largest inland towns.

Aktia's franchise has historically 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. That said, in January 2013, Aktia announced that it would cease to act as the central credit institution for the POP and savings banks. This decision followed another announcement in September 2012 that it would issue covered bonds from its own balance sheet and that Aktia Real Estate Mortgage Bank (Aktia-REMB) will be run-off.

We note that the relationship between Aktia and the POP and savings banks has been weakened as the result of (1) Aktia's plans to cease to act as central credit institution; and (2) Aktia-REMB's decision to focus on the management and refinancing of the current book rather than funding new loans. That said, we understand that many other smaller agreements between the banks remain in place.

In October 2013, the bank announced that it had signed a merger agreement with two small savings banks: Saaristosäästöpankki and Vöyrin Säästöpankki with assets of EUR69 million and EUR70 million, respectively, as at year-end 2012. Given their small size compared to Aktia, its franchise is not materially impacted by these corporate actions.

PROFITABILITY REMAINS MODERATE AS A RESULT OF THE HIGHLY COMPETITIVE FINNISH LENDING MARKET

The Finnish banking environment is competitive although it effectively consists of only four players (excluding Svenska Handelsbanken's branch in Finland). The system-wide (rated banks - which form the bulk of the banking system) net interest margin is at around 50 basis points, compared to for example Norway, where the equivalent number is well in excess of 100 basis points. Aktia, as a small player in the Finnish household lending space, has limited ability to influence lending rates and consequently its profitability.

It is on the above background that Aktia has introduced multiple measures under "Action Plan 2015". Our assessment is that the purpose of these measures is to improve Aktia's efficiency which historically has not been as good compared to its larger Finnish peers.

Under Action Plan 2015, Aktia (1) no longer act as central financial institution (debt office) for many smaller savings and POP banks in Finland, (2) reduces its number of staff (by around 50) and branches (eight), (3) introduces a new banking system, and (4) simplifies the group organisation structure. At this stage the impact of these measures is unclear although Aktia reported a slightly lower cost-to-income ratio of 68% at the end of June 2014 compared to 74% at year end-2012.

STRONG ASSET QUALITY AND CAPITALISATION DESPITE HIGH SINGLE-NAME CONCENTRATION

Aktia displays relatively strong asset quality as a reflection of its focus on the Finnish retail sector. The institution's problem loans ratio stood at a low 1% at year end-2013 which is a tiny bit higher compared to previous years. Write-downs tend to fall within a 0.01% to 0.03% range every quarter which is further evidence of Aktia's strong asset quality.

Single-name concentration risk - measured by the 20 largest exposures in relation to Tier 1 capital or pre-provision profit - is a constraint on the overall risk positioning score although such concentration is in line with other Nordic banks. Industry concentration risk is relatively well contained given the bank's focus on the retail sector, with real estate the largest sector exposure.

Aktia group's total capital and Tier 1 ratio stood at 17.8% and 13.8%, respectively, at 30 June 2014, up from 15.5% and 12.1% at year-end 2013. The bank currently applies the standardised approach when assessing the capital requirements for credit risk. In 2011, Aktia sought authorisation from the Finnish Financial Supervisory Authority (FSA) to implement the Internal Ratings-Based (IRB) approach when calculating required regulatory capital. Aktia expects introduction of the IRB approach to increase its Tier 1 capital ratio by at least 4% points.

SLIGHTLY LOWER RELIANCE ON MARKET FUNDING

Aktia is gradually reducing its reliance on market funding which we view positively because it reduces susceptibility to sudden changes in investor sentiment. We also note that issuance of covered bonds results in the structural subordination of senior creditors including depositors. At the same time we recognise that Aktia, and the

Finnish banking sector in general, have been less affected by volatility in financial markets than other European banking systems in recent years. All of the above said, average market funds amounted to 51% of average total funding at 30 June 2014.

Covered bonds (rated Aa2) issued via Aktia-REMB are included in Aktia's consolidated balance sheet although these bonds partially fund loans originated by the POP and savings banks. Indeed, Aktia has 70% of votes and 50.9% of shares in Aktia-REMB with the rest owned by 25 savings banks (37.2% of equity and 20% of votes) and 32 POP banks (11.9% of equity and 10% of votes). We believe that the run-off of Aktia-REMB and the fact that Aktia now issues covered bonds (rated Aaa by Moody's) from its own balance sheet may have positive implications for the bank's ability to underwrite new business. This view takes into account that Aktia currently provides capital-consuming liquidity support to Aktia-REMB, effectively supporting business written by the POP and savings banks.

Aktia's liquidity portfolio is large and of good quality. Liquid assets mainly include covered bonds and highly rated sovereign debt. 50% of investments are rated Aaa and 94% of investments are rated at least A1. Average liquid assets accounted for around 28% of average total assets at 30 June 2014.

Global Local Currency Deposit Rating (Joint Default Analysis)

We assign a long-term GLC deposit rating of A3 to Aktia.

This rating is supported by (1) the bank's baa2 BCA and (2) the Aaa local currency deposit ceiling of Finland, its underlying support provider. In view of Aktia'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, we assess 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

Aktia's A3 foreign currency deposit rating and A3 unsecured debt rating 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-	Weakening
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	--	--	--	--	--		
- Borrower Concentration	--	--	--	--	--		
- Industry Concentration	--	--	--	--	--		
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						**D+**	**Neutral**
PPI % Average RWA (Basel II)			1.63%				
Net Income % Average RWA (Basel II)				0.94%			
Factor: Liquidity						**E**	**Neutral**
(Market Funds - Liquid Assets) % Total Assets					28.24%		
Liquidity Management					x		
Factor: Capital Adequacy						**A**	**Neutral**
Tier 1 Ratio (%) (Basel II)	10.83%						
Tangible Common Equity % RWA (Basel II)	9.17%						
Factor: Efficiency						**D**	**Improving**
Cost / Income Ratio				68.88%			
Factor: Asset Quality						**C+**	**Neutral**
Problem Loans % Gross Loans		1.44%					
Problem Loans % (Equity + LLR)			24.49%				
Lowest Combined Financial Factor Score (15%)						**E**	
Economic Insolvency Override						**Neutral**	
Aggregate BFSR Score						**C-**	
Aggregate BCA Score						**baa1/baa2**	
Assigned BFSR						**C-**	
Assigned BCA						**baa2**	

[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.

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