MOODY'S INVESTORS SERVICE

Credit Opinion: Aktia Bank p.l.c.

Global Credit Research - 26 Feb 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

Contacts

Analyst	Phone
Richard (Blake) B. Foster/London	44.20.7772.5454
Kim Bergoe/London	
Simon Harris/London	
Forssen, Daniel/London	

Key Indicators

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

	[2]**12-13**	[2]**12-12**	[2]**12-11**	[2]**12-10**	[2]**12-09**	**Avg.**
Total Assets (EUR million)	**10,933.8**	**10,215.8**	**9,993.1**	**9,924.3**	**9,539.5**	[3]**3.5**
Total Assets (USD million)	**15,066.1**	**13,468.4**	**12,972.6**	**13,313.9**	**13,686.7**	[3]**2.4**
Tangible Common Equity (EUR million)	**475.7**	**359.8**	**326.0**	**320.4**	**309.3**	[3]**11.4**
Tangible Common Equity (USD million)	**655.5**	**474.4**	**423.2**	**429.8**	**443.7**	[3]**10.2**
Net Interest Margin (%)	**1.1**	**1.2**	**1.3**	**1.5**	**1.7**	[4]**1.3**
PPI / Average RWA (%)	**1.9**	**1.3**	**1.3**	**2.3**	**2.5**	[5]**1.9**
Net Income / Average RWA (%)	**1.5**	**0.6**	**0.7**	**1.5**	**1.1**	[5]**1.1**
(Market Funds - Liquid Assets) / Total Assets (%)	**20.8**	**28.0**	**30.0**	**26.8**	**26.6**	[4]**26.4**
Core Deposits / Average Gross Loans (%)	**53.6**	**50.0**	**52.9**	**52.5**	**52.1**	[4]**52.2**
Tier 1 Ratio (%)	**12.3**	**11.8**	**10.6**	**10.1**	**9.5**	[5]**10.9**
Tangible Common Equity / RWA (%)	**13.7**	**10.0**	**8.8**	**8.7**	**8.9**	[5]**10.0**
Cost / Income Ratio (%)	**70.1**	**74.2**	**73.1**	**59.3**	**56.8**	[4]**66.7**
Problem Loans / Gross Loans (%)	**--**	**1.5**	**1.6**	**1.2**	**--**	[4]**1.4**
Problem Loans / (Equity + Loan Loss Reserves) (%)	**--**	**22.3**	**30.4**	**20.7**	**--**	[4]**24.5**

Source: Moody's

[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

Opinion

SUMMARY RATING RATIONALE

Aktia Bank's 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 will 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 which is likely to limit Aktia's profitability. The bank's BFSR is also constrained by high borrower concentration.

Rating Drivers

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

- High reliance on market funding

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

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

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.

What Could Change the Rating - Up

Sustained strong profitability and asset quality combined with unchanged franchise strength (in spite of a weaker relationship with the POP and savings banks) could exert upward pressure on Aktia's ratings.

What Could Change the Rating - Down

A greater-than-expected deterioration of asset quality and/or weaker profitability would result in negative pressure on the bank's standalone ratings.

Negative ratings pressure could be exerted on Aktia's long-term ratings as a result the gradual run-off of its central credit institution role, together with any additional weakening of the relationship with the 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 3.7% of deposits at end-December 2013. Around 88% of its loan portfolio is to households (91% if housing associations are included) with smaller loan amounts granted to corporates (8%) and not-for-profit organisations (1%) at end-December 2013. Aktia has 60 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 July 2013, Aktia Bank plc merged with Aktia plc (unrated holding company) in order to streamline the Group structure and reduce costs; we view the credit implications of the corporate action as limited (https://www.moodys.com/research/Organisational-Changes-at-Aktia-Bank-Have-Limited-Credit-Implications-Issuer-Comment--CMT_0000682103). In October 2013, the bank announced that it had signed a merger agreement with two small savings banks: Saaristosaastopankki and Vöyrin Säästöpankki with assets of EUR69 million and EUR70 million, respectively, as at year-end 2012. Given their small size compared to Aktia, we view the credit implications of the mergers as limited.

HIGH RELIANCE ON MARKET FUNDING

Aktia's funding profile has gradually shifted over the past 20 years from deposits towards market funding which constituted around 60% of average total funding at end-2013. Covered bonds represented around 72% of market funding at year-end 2013. We view the increase in market funding as credit negative, as it increases the bank's susceptibility to sudden changes in investor sentiment although 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. We also note that issuance of covered bonds results in the structural subordination of senior creditors including depositors

We note that the covered bonds (rated Aa3) 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 30 savings banks (37.2% of equity and 20% of votes) and 34 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. Almost 53% of investments are rated Aaa and more than 95% of investments are rated at least A1.The liquidity portfolio accounted for around 22% of total assets. (data as of 31 December 2013)

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

The cessation of Aktia's role as the central financial institution for the local banks will result in an immediate fall in revenues. However, had Aktia continued to act as a central financial institution, it would have faced significantly increased capital charges under Basel III, the savings from which should more than outweigh the revenue fall. We also believe that measures announced under "Action Plan 2015" are likely to improve efficiency in the long- term rating horizon; these measures include investment in the bank's IT systems, consolidation of branches and some staff reduction

STRONG ASSET QUALITY AND CAPITALISATION DESPITE HIGH SINGLE-BORROWER CONCENTRATION

In spite of its high single borrower concentration, Aktia displays relatively strong asset quality, reflecting its focus on the retail sector. Aktia Bank has yet to report its 2013 impaired loans and therefore the latest public problem loan data is for end-2012 when problem loans constituted 1.49% of gross loans. However, we are unaware of any significant movement in this ratio during 2013.. High borrower 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's total capital and Tier 1 ratios stood at 19.3% and 12.3%, respectively, at end-2013, up from 20.2% and 11.8% at year-end 2012. The bank currently applies the standardised Basel II 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.

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.