MOODY'S
INVESTORS SERVICE

# Credit Opinion: Aktia Bank p.l.c.

Global Credit Research - 27 Mar 2015

*Helsinki, Finland*

## Ratings

| Category | Moody's Rating |
|---|---|
| Outlook | Rating(s) Under Review |
| Bank Deposits | *A3/P-2 |
| Baseline Credit Assessment | baa2 |
| Adjusted Baseline Credit Assessment | baa2 |
| Senior Unsecured -Dom Curr | **A3 |
| Other Short Term -Dom Curr | (P)P-2 |

* Rating(s) within this class was/were placed on review on March 17, 2015
** Placed under review for possible downgrade on March 17, 2015

## Contacts


| Analyst | Phone |
|---|---|
| Jan Skogberg/London | 44.20.7772.5454 |
| Kim Bergoe/London | |
| Sean Marion/London | |
| Forssen, Daniel/London | |


## Key Indicators

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

| | [2]**9-14** | [3]**12-13** | [3]**12-12** | [3]**12-11** | [3]**12-10** | **Avg.** |
|---|---|---|---|---|---|---|
| Total Assets (EUR million) | **10,955.2** | **10,933.8** | **11,240.2** | **9,993.1** | **9,924.3** | [4]**2.5** |
| Total Assets (USD million) | **13,839.1** | **15,066.1** | **14,819.0** | **12,972.6** | **13,313.9** | [4]**1.0** |
| Tangible Common Equity (EUR million) | **480.5** | **473.7** | **451.0** | **326.0** | **320.4** | [4]**10.7** |
| Tangible Common Equity (USD million) | **607.0** | **652.8** | **594.6** | **423.2** | **429.8** | [4]**9.0** |
| Problem Loans / Gross Loans (%) | **--** | **1.6** | **1.5** | **1.6** | **1.2** | [5]**1.5** |
| Tangible Common Equity / Risk Weighted Assets (%) | **14.0** | **13.7** | **12.5** | **8.8** | **8.7** | [6]**14.0** |
| Problem Loans / (Tangible Common Equity + Loan Loss Reserve) (%) | **--** | **19.9** | **21.1** | **29.9** | **21.4** | [5]**23.1** |
| 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 / Tangible Assets (%) | **0.5** | **0.5** | **0.4** | **0.3** | **0.5** | [5]**0.4** |
| Cost / Income Ratio (%) | **65.4** | **70.7** | **71.1** | **73.1** | **59.3** | [5]**67.9** |
| Market Funds / Tangible Banking Assets (%) | **45.8** | **47.9** | **49.8** | **54.4** | **55.6** | [5]**50.7** |
| Liquid Banking Assets / Tangible Banking Assets (%) | **28.7** | **26.5** | **26.3** | **24.3** | **29.4** | [5]**27.0** |
| Gross Loans / Total Deposits (%) | **132.8** | **140.4** | **155.0** | **150.4** | **153.7** | [5]**146.5** |

Source: Moody's

[1] All figures and ratios are adjusted using Moody's standard adjustments [2] Basel III - fully-loaded or 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 - fully-loaded or transitional phase-in & IFRS reporting periods have been used for average calculation

## Opinion

### SUMMARY RATING RATIONALE

On March 17th we placed Aktia's A3 bank deposit and senior unsecured ratings on review for downgrade. The introduction of an operational resolution regime in Finland will translate into a lower likelihood of government support for the bank. Our advanced loss given failure analysis indicates that Aktia's cushion of liabilities eligible for bail-in, assuming a currently unlikely failure scenario, is insufficient to compensate for the likely loss of government support.

Aktia's baseline credit assessment (BCA) of baa2 is supported by the 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 BCA include the bank's limited position in a competitive market and reliance on wholesale funding, the latter a common feature of Nordic banks.

AKTIA'S BCA IS SUPPORTED BY FINLAND'S STRONG+ MACRO PROFILE

Finland is one of only five Aaa-rated countries in the euro region, powered by an innovation-driven economy, high living standards and a predictable economic policy framework. Post- crisis, the country's public finances are in much better shape than those of many other advanced economies despite similar struggles to revive economic growth. This stable framework benefits the Finnish banking sector which however exhibits significant reliance on wholesale funding, exposing banks to swings in investor sentiment. This risk is more pronounced in Finland compared to Nordic peers, because the country benefits to a lesser extent from an established, captive, investor community like countries like Sweden and Denmark.

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

- Gradually reducing reliance on market funding

RATING OUTLOOK

Aktia's deposit and senior unsecured ratings are under review for downgrade as a result of a lower likelihood of government support for the bank given the introduction of an operational resolution regime in Finland. Our advanced loss given failure analysis indicates that Aktia's cushion of liabilities eligible for bail-in, assuming a currently unlikely failure scenario, is insufficient to compensate for the likely loss of government support.

The review will focus on the likelihood of taxpayer funded support for Aktia and the bank's liability structure, in particular the amount of senior long-term debt outstanding, the volume of junior deposits and the amount of subordinated debt.

Currently, we expect Aktia's deposits and senior unsecured debt to be downgraded by up to one notch, depending on the likelihood of government support and the proportion of bail-in-able liabilities under our advanced loss-given-failure analysis.

WHAT COULD CHANGE THE RATING - UP

Upward pressure on the bank's BCA could develop if the bank shows sustained strong profitability, efficiency and good asset quality.

An upgrade of Aktia's deposit and senior unsecured ratings is currently unlikely given the review for downgrade.

WHAT COULD CHANGE THE RATING - DOWN

We could adjust downwards Aktia's BCA as a result of (i) deteriorated asset quality and/or (ii) weaker profitability, Aktia's debt and deposit ratings could be downgraded as a result of a lower likelihood of government support for the bank and/or if the bank's cushion of liabilities eligible for bail-in would shrink.

## DETAILED RATING CONSIDERATIONS

The financial data in the following sections are sourced from Aktia's financial statements unless otherwise stated.

### 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 3.9% of deposits at year end-2014. 89% of its loan portfolio is to households (93% if housing associations are included) with smaller loan amounts granted to corporates (7%) and not-for-profit organisations (1%) at year end-2014. Aktia operates through 57 branches, located mainly in the coastal areas of Finland, around Helsinki and the country's largest inland towns.

For a long period, Aktia's franchise 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. 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 the shared funding vehicle, Aktia Real Estate Mortgage Bank (Aktia-REMB), will be run-off.

The 2013 merger with two small savings banks, with assets of around EUR 70 million each as at year-end 2012 was non-material to the overall franchise.

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

Finnish banks operate in a highly competitive market effectively concentrated around four players. The rated system-wide net interest margin is at around 50 basis points, which is quite low 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, as Aktia reported a cost-to-income ratio of 71% at year end-2014 only slightly below the 72% reported in 2013.

### 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 loan ratio is consistently below 2% and that is comparable with many Nordic banks.

Single-name concentration risk - measured by the 20 largest exposures in relation to Tier 1 capital or pre-provision profit - is a constraint, albeit a feature that Aktia shares with other Nordic banks. Industry concentration is relatively well contained given the bank's focus on the retail sector, with real estate the largest sector exposure (33% of corporate loan book at year end-2014).

Aktia is well capitalized with a reported core equity tier 1 ratio of 14.6% and a total capital ratio of 19.1% at year end-2014. These ratios are likely to change because in February 2015 the Finnish FSA granted Aktia group the permission to use the internal ratings based approach (IRBA), starting from end-March 2015, to calculate credit risks and capital ratios. The bank has indicated that its core tier 1 ratio will increase by 4 to 5 percentage points when the new calculation approach is implemented.

### GRADUALLY REDUCING 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.

Covered bonds (rated Aa2) issued via Aktia-REMB are included in Aktia's consolidated balance sheet, even though these bonds partially fund loans originated by the POP and savings banks. Indeed, Aktia retains 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 accounts for approximately a quarter of the balance sheet and is of good quality. Liquid assets mainly include covered bonds and highly rated sovereign debt. 51% of investments were rated Aaa and 94% of investments were rated at least A1 at year end-2014.

NOTCHING CONSIDERATIONS

LOSS GIVEN FAILURE AND ADDITIONAL NOTCHING

We apply our advance loss-given-failure analysis to Aktia as the bank is subject to the EU Bank Resolution and Recovery Directive (BRRD), which we consider to be an Operational Resolution Regime. For this analysis we assume that equity and losses stand at 3% and 8%, respectively, of tangible banking assets in a failure scenario. We also assume a 25% run-off of "junior" wholesale deposits and a 5% run-off in preferred deposits. Moreover, we assign a 25% probability to junior deposits being preferred to senior unsecured debt. These are in line with our standard assumptions.

We believe that Aktia's deposits are likely to face low loss-given-failure, due to the loss absorption provided by subordinated debt and senior unsecured debt (should deposits be treated preferentially in a resolution). In addition, the bank has a large deposit base, meaning that any losses would be spread over a large base, thus translating into low losses for the individual depositor. All of that said, our Preliminary Rating Assessment (PRA) is that deposits could be rated one notch above the bank's adjusted BCA without considering the role of government support. That would mean a one-notch downgrade of Aktia's deposit ratings if government support entirely is removed from the ratings.

Aktia's senior unsecured debt also benefits from a sizable cushion of liabilities eligible for bail-in. This could also translate into a deposit rating positioned one-notch above based on our advanced loss-given-failure analysis. Like deposit ratings, this would mean a one-notch downgrade of debt ratings if government support is removed entirely.

GOVERNMENT SUPPORT

The implementation of the BRRD has caused us to reconsider the potential for government support to benefit certain creditors. We are likely to entirely remove government support from Aktia's deposit and debt ratings, thus likely resulting in a one-notch downgrade of both ratings.

About Moody's Bank Scorecard

Our Scorecard is designed to capture, express and explain in summary form our Rating Committee's judgment. When read in conjunction with our research, a fulsome presentation of our judgment is expressed. As a result, the output of our Scorecard may materially differ from that suggested by raw data alone (though it has been calibrated to avoid the frequent need for strong divergence). The Scorecard 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.**

| Macro Factors | |
|---|---|
| **Weighted Macro Profile** | **Strong +** |

| **Financial Profile** | | | | | | |
|---|---|---|---|---|---|---|
| **Factor** | **Historic Ratio** | **Macro Adjusted Score** | **Credit Trend** | **Assigned Score** | **Key driver #1** | **Key driver #2** |
| **Solvency** | | | | | | |
| **Asset Risk** | | | | | | |
| *Problem Loans / Gross Loans* | 1.6% | a1 | ←→ | a1 | Quality of assets | |
| **Capital** | | | | | | |
| *TCE / RWA* | 14.0% | a1 | ↑↑ | a1 | Risk-weighted capitalisation | |
| **Profitability** | | | | | | |
| *Net Income / Tangible Assets* | 0.4% | ba1 | ←→ | ba2 | Expected trend | |
| **Combined Solvency Score** | | a2 | | a3 | | |
| **Liquidity** | | | | | | |
| **Funding Structure** | | | | | | |
| *Market Funds / Tangible Banking Assets* | 47.9% | b1 | ←→ | ba2 | Market funding quality | |
| **Liquid Resources** | | | | | | |
| *Liquid Banking Assets / Tangible Banking Assets* | 26.5% | a3 | ←→ | a3 | Stock of liquid assets | |
| **Combined Liquidity Score** | | ba1 | | baa3 | | |

| | |
|---|---|
| **Financial Profile** | **baa1** |
| | |
| **Qualitative Adjustments** | **Adjustment** |
| Business Diversification | -1 |
| Opacity and Complexity | 0 |
| Corporate Behavior | 0 |
| **Total Qualitative Adjustments** | **-1** |
| | |
| Sovereign or Affiliate constraint | Aaa |
| | |
| Scorecard Calculated BCA range | **baa1 - baa3** |
| | |
| **Assigned BCA** | **baa2** |
| | |
| Affiliate Support notching | **0** |
| | |
| **Adjusted BCA** | **baa2** |

| **Instrument Class** | **Loss Given Failure notching** | **Additional notching** | **Preliminary Rating Assessment** | **Government Support notching** | **Local Currency rating** | **Foreign Currency rating** |
|---|---|---|---|---|---|---|
| Deposits | -- | -- | -- | -- | A3 RUR | A3 RUR |

| | | | | | | |
|---|---|---|---|---|---|---|
| | | | | | Possible Downgrade | Possible Downgrade |
| Senior unsecured bank debt | -- | -- | -- | -- | A3 RUR Possible Downgrade | |

This publication does not announce a credit rating action. For any credit ratings referenced in this publication, please see the ratings tab on the issuer/entity page on http://www.moodys.com for the most updated credit rating action information and rating history.