MOODY'S INVESTORS SERVICE

Credit Opinion: Aktia Bank p.l.c.

Global Credit Research - 16 Dec 2015

Helsinki, Finland

Ratings

Category	Moody's Rating
Outlook	Stable
Bank Deposits	A3/P-2
Baseline Credit Assessment	baa2
Adjusted Baseline Credit Assessment	baa2
Counterparty Risk Assessment	A2(cr)/P-1(cr)
Senior Unsecured	A3
Other Short Term -Dom Curr	(P)P-2

Contacts

Analyst	Phone
Alberto Postigo/Madrid	34.91.768.8200
Giovanni Fontana/London	44.20.7772.5454
Sean Marion/London	
Malika Takhtayeva/London	

Key Indicators

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

	[2]9-15	[2]12-14	[3]12-13	[3]12-12	[3]12-11	Avg.
Total Assets (EUR million)	9,723.1	10,423.8	10,907.3	11,240.2	9,993.1	[4]-0.7
Total Assets (USD million)	10,853.4	12,613.3	15,029.6	14,819.0	12,972.6	[4]-4.4
Tangible Common Equity (EUR million)	484.4	481.4	473.7	451.0	326.0	[4]10.4
Tangible Common Equity (USD million)	540.7	582.5	652.8	594.6	423.2	[4]6.3
Problem Loans / Gross Loans (%)	--	1.6	1.6	1.5	1.6	[5]1.6
Tangible Common Equity / Risk Weighted Assets (%)	22.8	14.8	13.7	12.5	8.8	[6]18.8
Problem Loans / (Tangible Common Equity + Loan Loss Reserve) (%)	--	18.7	19.9	21.1	29.9	[5]22.4
Net Interest Margin (%)	1.0	1.0	1.1	1.1	1.3	[5]1.1
PPI / Average RWA (%)	2.9	1.9	1.8	1.7	1.3	[6]2.4
Net Income / Tangible Assets (%)	0.6	0.5	0.5	0.4	0.3	[5]0.5
Cost / Income Ratio (%)	66.4	68.6	70.7	71.1	73.1	[5]70.0
Market Funds / Tangible Banking Assets (%)	32.6	40.2	48.0	52.9	54.4	[5]45.6
Liquid Banking Assets / Tangible Banking Assets (%)	22.6	23.9	22.3	21.7	24.3	[5]23.0
Gross loans / Due to customers (%)	152.9	162.7	180.8	200.1	196.1	[5]178.5

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

Aktia's deposit ratings of A3/Prime-2 and senior debt ratings of A3 reflect (1) the bank's baa2 baseline credit assessment (BCA); (2) the rating uplift from our Advanced Loss Given Failure (LGF) analysis; and (3) our assumption of low government support which results in no uplift. Aktia's Counterparty Risk Assessment (CR Assessment) is A2(cr)/Prime-1(cr).

Aktia's baseline credit assessment of baa2 reflects the bank's well 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.

Under our Advanced LGF analysis, Aktia's long-term deposit and senior unsecured debt ratings take into account the bank's very low loss-given-failure because of its high volume of subordinated and senior unsecured debt outstanding and large deposit base, leading to two notches of uplift from the bank's baa2 adjusted BCA.

RATING DRIVERS

- Aktia's BCA is supported by Finland's strong+ macro profile

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

- Strong asset quality and capitalisation

- Profitability remains moderate although efficiency shows signs of improving

- Gradually reducing reliance on market funding

- Very low loss given failure leads to two notches uplift to senior debt and deposit ratings

RATING OUTLOOK

The outlook on Aktia's ratings is stable.

WHAT COULD CHANGE THE RATING - UP

Upward pressure on the bank's ratings could develop if it exhibits sustained strong profitability, efficiency combined with strong asset quality.

WHAT COULD CHANGE THE RATING - DOWN

Downward rating pressure could develop as a result of deteriorated asset quality and/or weaker profitability. A smaller cushion of liabilities eligible for bail-in could also trigger a downgrade under our Advanced LGF analysis.

DETAILED RATING CONSIDERATIONS

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

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

Aktia is doing business only in Finland which is powered by an innovation-driven economy, characterised by 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 and increasing debt. 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.

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 30 September 2015. Loans to households comprise 88% of its loan portfolio (92% if housing associations are included) with smaller loan amounts granted to corporates (7%) and not-for-profit organisations

(1%) at 30 September 2015. Aktia operates through 50 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 these banks in order to allocate capital more effectively and to strengthen its own profitability. 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. Overall, we deem the termination of the cooperation as negative for Aktia's franchise.

In October 2015 Aktia announced that it had reached an agreement with the minority owners of Aktia-REMB (savings banks and POP banks) to acquire their minority stake in the funding vehicle. The parties also agreed to reduce the balance sheet of Aktia-REMB before the acquisition is completed, which is expected to take place in early 2017, once the financial statements of Aktia-REMB for 2016 are published. Subsequently to the acquisition, Aktia-REMB will merge with Aktia.

STRONG ASSET QUALITY AND CAPITALISATION

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%, which is comparable with many Nordic banks.

Industry concentration is well contained given the bank's focus on the retail sector, with commercial real estate being the largest sector exposure, representing less than 3% of the total loan book at year end-2014.

Aktia has a strong capital position, with a tangible-common-equity (TCE)-to-risk-weighted-assets (RWAs) ratio of 22.8% as of 30 September 2015. This ratio is considerably higher compared to year end-2014 because in February 2015 the Finnish FSA granted the Aktia group permission to use the internal ratings based approach (IRB), starting from end-March 2015, to calculate credit risks and capital ratios. As a consequence of this development, the bank's risk weighted assets declined by 31.5% in the first quarter of 2015.

Likewise, Aktia shows a strong capitalisation from a regulatory perspective, with a reported common equity tier 1 ratio of 22.4% and a total capital ratio of 27.7% at 30 June 2015. The acquisition of the minority interest of Aktia-REMB will have a negative impact in the regulatory capital of Aktia following the reclassification of the minority interest as a liability (estimated by the bank at approximately 200 percentage points), but will concurrently rise for a similar amount with savings banks and POP banks repurchasing their respective shares of Aktia-REMB's loan book. The acquisition of the minority interest will be broadly neutral in terms of TCE, given that it does not include the minority interest as a capital component, but it will however benefit from the decline in RWAs following the repurchase of Aktia-REMB loans.

Our assessment of Aktia's capitalisation also captures its nominal leverage, which has traditionally been high with a ratio of TCE over total assets below 5%, which has not increased as significantly as its TCE ratio after the introduction of the IRB approach. Overall, we adjust Aktia macro-adjusted score of aa1 for capital, consistent with its TCE ratio as of September 2015, negatively by three notches to a1 in order to account for the bank's relatively high nominal leverage.

PROFITABILITY REMAINS MODERATE ALTHOUGH EFFICIENCY SHOWS SIGNS OF IMPROVING

Finnish banks operate in a highly competitive market effectively concentrated around four players. The rated system-wide net interest margin stands at approximately 50 basis points, which is low compared to Norway, for example, where the equivalent figure is well in excess of 100 basis points. Aktia, as a small player in the Finnish household lending space, has a limited ability to influence lending rates and consequently its profitability.

It is in the above context that Aktia introduced multiple measures under its "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 announced (1) no longer to act as central financial institution (debt office) for many smaller savings and POP banks in Finland; (2) to reduce its number of staff (by around 50) and branches (eight); (3) to introduce a new core banking platform; and (4) to simplify the group organisation structure. The implementation of the cited plan, the benefits of which are still pending to materialise, should allow the bank to reduce the cost-to-income ratio, which stood at 66% at 30 September 2015.

Aktia's operating revenues have remained broadly stable in the first nine months of 2015, despite the challenging low interest rate environment. The bank's net interest income has declined by 5% year-over-year, but Aktia has more than compensated the decline with higher fee and commission income (9% increase). Overall, operating income declined by 3% year-over-year, owing to smaller profits arising from financial transactions.

Aktia's historic earnings suggest a Profitability score of baa2, which we adjust negatively by one notch to account for the negative developments on the bank's franchise (see Franchise section above).

GRADUALLY REDUCING RELIANCE ON MARKET FUNDING

Aktia is gradually reducing its reliance on market funding on the back of increased funding through customer deposits, which we view positively because it reduces susceptibility to sudden changes in investor sentiment. Moreover, the majority of market funding is in the form of covered bonds, which are subject to lower refinancing risk compared to unsecured bonds. Moody's calculated market funds to tangible banking assets ratio decreased to 32.6% at 30 September 2015 compared to 53% at the end of 2012.

The 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.

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.

Notching Considerations

LOSS GIVEN FAILURE AND ADDITIONAL NOTCHING

We apply our advance LGF analysis to Aktia as the bank is subject to the EU Bank Resolution and Recovery Directive, 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 very low loss-given-failure, owing to the loss absorption provided by subordinated 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. Aktia's long-term deposit ratings consequently receive a two-notch uplift to A3.

Aktia's senior unsecured debt ratings also receive a two-notch uplift to A3, owing to a cushion of subordinated debt and a large volume of senior unsecured debt that would share losses under our Advanced LGF analysis given a currently unlikely failure scenario.

GOVERNMENT SUPPORT

Aktia's ratings do not benefit from government support.

COUNTERPARTY RISK ASSESSMENT

We assign a long-term and short-term CR assessment of A2(cr) and P-1(cr) respectively.

CR Assessments are opinions of how counterparty obligations are likely to be treated if a bank fails and are distinct from debt and deposit ratings in that they (1) consider only the risk of default rather than the likelihood of default and the expected financial loss suffered in the event of default and (2) apply to counterparty obligations and contractual commitments rather than debt or deposit instruments. The CR assessment is an opinion of the counterparty risk related to a bank's covered bonds, contractual performance obligations (servicing), derivatives (e.g., swaps), letters of credit, guarantees and liquidity facilities.

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	22.8%	aa1	←→	a1	Nominal leverage	
Profitability						
Net Income / Tangible Assets	0.5%	baa2	←→	baa3	Expected trend	
Combined Solvency Score		a1		a2		
Liquidity						
Funding Structure						
Market Funds / Tangible Banking Assets	40.2%	b1	←→	b1	Extent of market funding reliance	
Liquid Resources						
Liquid Banking Assets / Tangible Banking Assets	23.9%	baa1	←→	baa1	Stock of liquid assets	
Combined Liquidity Score		ba1		ba1		

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	**0**

notching	
Adjusted BCA	**baa2**

Instrument Class	**Loss Given Failure notching**	**Additional notching**	**Preliminary Rating Assessment**	**Government Support notching**	**Local Currency rating**	**Foreign Currency rating**
Deposits	2	0	a3	0	A3	A3
Senior unsecured bank debt	2	0	a3	0	A3	A3

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.

applicable) have, prior to assignment of any rating, agreed to pay to MJKK or MSFJ (as applicable) for appraisal and rating services rendered by it fees ranging from JPY200,000 to approximately JPY350,000,000.
MJKK and MSFJ also maintain policies and procedures to address Japanese regulatory requirements.