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Aktia Bank PLC

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Aktia Bank PLC

SACP	bbb+		+	Support	+1	+	Additional Factors	0

Anchor	a-	
Business Position	Moderate	-1
Capital and Earnings	Strong	+1
Risk Position	Moderate	-1
Funding	Average	0
Liquidity	Adequate	

GRE Support	0
Group Support	0
Sovereign Support	+1

Issuer Credit Rating
A-/Negative/A-2

Major Rating Factors

Strengths:	Weaknesses:
• Well-established local retail franchise in Finland. • Strong projected capitalization underpinned by sound earnings capacity. • Focus on low-risk collateralized lending to retail clients and small and midsize enterprises (SMEs).	• Concentration risk, due to focus on residential mortgage lending in Finland. • Limited geographic, business, and earnings diversification. • Reliance on wholesale funding market as covered bond issuer.

Outlook: Negative

Standard & Poor's Ratings Services' negative outlook on Finland-based Aktia Bank PLC indicates that we may downgrade the bank by year-end 2015 if we believe there is a greater likelihood that senior unsecured liabilities may incur losses if the bank fails. Specifically, we may lower the long-term counterparty credit rating by one notch if we consider that extraordinary government support is less predictable under the new EU legislative framework.

The negative outlook also reflects our view that the growing economic risks in Finland's export-oriented economy could adversely affect the Finnish banking sector's performance over the next two years. If this were to occur, we would revise downward our anchor--the starting point in assigning an issuer credit rating--for Finnish banks, including Aktia Bank. This could in turn lead us to revise down our assessment of the bank's stand-alone credit profile (SACP) and lower our ratings on Aktia Bank, unless we considered its asset quality and performance to be materially better than that of the Finnish banking sector.

We consider an outlook revision to stable unlikely at this stage.

Rationale

Our ratings on Aktia Bank reflect our 'a-' anchor for Finnish banks, as well as the bank's "moderate" business position as a regional bank with a concentrated business model focused on retail mortgage lending, and its "strong" capital and earnings, mainly due to our expectation of an increase in the risk-adjusted capital (RAC) ratio to about 14% in the next 12-18 months. The ratings equally reflect the bank's "moderate" risk position, due to concentration risks on its loan book, partly mitigated by a high level of collateralization, its "average" funding, and "adequate" liquidity, owing to a sound level of customer deposits and demonstrated access to capital markets as a covered bond issuer. The SACP is 'bbb+'.

Given Aktia Bank's status as the fourth-largest retail bank in Finland in terms of assets, where Pan-Nordic groups have sizable operations, and its market share of 4.1% in mortgage loans and 3.9% in customer deposits, we consider the bank to have "moderate" systemic importance in Finland's banking sector. We consequently factor one notch of extraordinary government support into our 'A-' long-term counterparty credit rating on Aktia Bank.

Anchor: 'a-' for banks operating only in Finland

Our bank criteria use our Banking Industry Country Risk Assessment's economic risk and industry risk scores to determine a bank's anchor, the starting point in assigning an issuer credit rating. Our anchor for a commercial bank operating only in Finland is 'a-', based on an economic risk score of '2' and an industry risk score of '3'.

We view Finland as a competitive and resilient economy, with high education levels. But it also depends on exports in cyclical industries, which subjects its economy to increasing pressure from Europe's worsening recession. Moreover, a lack of reforms to increase competiveness could hamper the economy. Comparably low corporate and moderate household debt levels and a very strong payment culture contribute to debt in the economy.

Diverse Nordic banking groups largely control Finland's concentrated banking industry, which, in our view, is underpinned by robust profitability metrics and stability. Deposits dominate funding, but the sector is a net external debtor, reflecting significant loan growth over the past decade and the country's lack of a deep domestic debt market.

Table 1

Aktia Bank PLC--Key Figures					
	--Year ended Dec. 31--				
(Mil. €)	**2014**	**2013**	**2012**	**2011**	**2010**
Adjusted assets	10,125	10,448	10,865	10,752	10,728
Customer loans (gross)	6,476	6,867	7,267	7,122	6,645
Adjusted common equity	519	512	494	467	444
Operating revenues	214	225	218	225	251
Noninterest expenses	144	157	154	167	159
Core earnings	55	52	43	37	58

Business position: Solid local retail franchise as the fourth-largest bank in Finland

We consider Aktia Bank's business position to be moderate, reflecting the bank's concentrated business model focused primarily on residential mortgage lending.

Aktia Bank is a midsize commercial bank in Finland, with total assets of €10.7 billion as of Dec. 31, 2014. The bank has a well-established local retail franchise in growth regions in Finland's coastal areas and larger cities, with about 300,000 customers. Aktia Bank enjoys a stable market share of 4.1% in residential mortgage lending and 3.9% in customer deposits.

However, we view Aktia Bank's regional concentration and narrow product focus on residential mortgage lending as the main weaknesses to its business model. These factors may expose the bank to potential volatility in Finland's real estate market. The diversity benefits from the bank's small corporate banking activities are limited, and we expect no material increase in the medium term.

We view positively that the bank's asset-management and life-insurance activities complement its product offering, and their contribution to revenues will, in our view, increase over time. Together, they made up 20% of Aktia Bank's operating revenues and 32% of its operating profit as of Dec. 31, 2014. Its asset management activities, with assets under management of €6.8 billion as of Dec. 31, 2014, are steadily growing and hold a 7% market share in mutual funds in Finland. Furthermore, Aktia Life Insurance provides banking clients with insurance and investment products.

However, due to the Aktia Life's limited size and market share of about 3% in the Finnish life insurance market, the insurance operations bring only moderate diversification benefits to the group, in our opinion. We don't expect the bank will expand its network to further regions in Finland, but believe that it could gain market share by increasing cross-selling, namely of insurance and savings products, to its existing customer base.

Aktia Bank terminated its cooperation with independent local savings banks and co-operative banks at the start of 2015. We expect this will allow Aktia Bank to focus its resources on its own growth. As such, this change doesn't have a negative impact on our assessment of the bank's business position. Two local savings banks merged with Aktia Bank. Yet, due to the limited size of these single banks, Aktia Bank's size or market share did not increase substantially.

We consider Aktia Bank's management to be prudent and well aware of the limits set by the group's size and product offering. We believe that Aktia Bank will maintain a low risk appetite and conservative lending standards, which we expect to provide stability to its financial position.

Table 2

Aktia Bank PLC--Business Position

	--Year ended Dec. 31--				
(%)	**2014**	**2013**	**2012**	**2011**	**2010**
Loan market share in country of domicile	4.1	4.1	4.3	4.2	4.3
Deposit market share in country of domicile	3.9	3.7	3.4	3.5	3.6
Total revenues from business line (mil. €)	214	225	228	225	251
Commercial & retail banking/total revenues from business line	78.9	79.0	70.5	73.9	75.1
Insurance activities/total revenues from business line	20.3	20.3	12.2	20.4	17.2
Asset management/total revenues from business line	N/A	N/A	11.6	9.6	8.4
Other revenues/total revenues from business line	0.8	0.6	5.7	(3.9)	(0.7)

N/A--Not applicable.

Capital and earnings: Strong capitalization underpinned by sound earnings capacity and asset reduction

We assess Aktia Bank's capital and earnings as strong. This is mainly due to our expectation that our RAC ratio for Aktia Bank will increase to about 14% over the next 12-18 months, compared with 13.5% on Dec. 31, 2014.

The main impetus for the increase in the RAC ratio is the ongoing run-off of Aktia Bank's subsidiary, Aktia Real Estate Mortgage Bank (AREMB), and the resulting reduction in risk-weighted assets. AREMB's loan book--amounting to €1.94 billion, including €1.40 billion of mortgage loans through partner local savings and cooperative banks--is currently fully consolidated on Aktia Bank's balance sheet, and we expect the run-off of AREMB's activities to reduce gradually the share of partner banks' loans. Combined with only moderate growth of 2%-3% in Aktia Bank's own loan origination, due to slower demand for mortgage loans in Finland, we expect this will lead to a decrease of €1.0 billion in Aktia Bank's overall loan book in the next two years. Consequently, we forecast a lower level of Standard & Poor's risk-weighted assets.

While we expect the margins on new loans will remain relatively stable, the decreasing contribution from maturing hedging transactions will put pressure on the overall net interest margin, which we forecast will decrease to about 1.00%-1.05% over the next two years from 1.08% as of Dec. 31, 2014.

Furthermore, we anticipate that the improving net fee and commission income and a stable dividend payout ratio of 50% will support the capital buildup. We expect Aktia Bank's organizational streamlining--achieved partly through staff cuts and optimization of its branch network--to support its cost-efficiency target of reducing operating expenses by 5% annually.

We currently don't incorporate any reduction in AREMB's capital base in our forecast, but we believe that it will become likely at the latest in 2016, given that AREMB's wind-down is progressing and its loan book is maturing or being sold back to the originating banks (AREMB's common equity tier-1 (CET1) capital ratio stood at 19.6% as of Dec. 31, 2014). However, we don't expect a potential reduction to change our view of Aktia Bank's strong capital position.

We consider Aktia Bank's quality of capital, consisting mainly of paid-in capital, and its earnings, to be adequate. We believe that the bank's earnings capacity will improve over time, owing to stable operating revenues, planned cost cuts, and our expectation of low loan losses. This is reflected in our three-year average earnings buffer of about 120 basis points (bps) for the group, which is in line with that of other Nordic regional banks.

Aktia Bank obtained approval to apply the internal-rating-based model for credit risk on retail exposures when calculating regulatory capital starting March 31, 2015. Although this will not directly impact our capital ratios, we understand that the application will raise the CET1 capital ratio from 14.6% as of Dec. 31, 2014, by about four percentage points. The positive effects of this could be partly offset by changes in new capital regulations under the EU Capital Requirements Directive related to deductions for holdings in insurance companies and for minority holders' paid-in equity. However, we do not expect these to have a negative impact on Aktia Bank's regulatory capital base in 2015, given that the holdings do not exceed the 10% CET1 threshold. We understand, however, that Aktia Bank is already compliant with the Basel III capital requirement.

Table 3

Aktia Bank PLC--Capital And Earnings

	--Year ended Dec. 31--				
(%)	**2014**	**2013**	**2012**	**2011**	**2010**
Tier-1 capital ratio	14.6	12.3	11.8	10.6	10.1
S&P RAC ratio before diversification	13.5	12.7	11.5	11.1	N.M.
Standard & Poor's RAC ratio after diversification	12.2	11.6	10.6	10.7	N.M.
Adjusted common equity/total adjusted capital	100	100	100	100	100
Net interest income/operating revenues	47.9	50.0	53.7	57.3	59.5
Fee income/operating revenues	34.9	31.4	29.9	26.5	22.7
Market-sensitive income/operating revenues	3.4	3.7	1.3	(6.6)	(2.2)
Noninterest expenses/operating revenues	67.3	69.8	70.6	74.1	63.4
Preprovision operating income/average assets	0.6	0.6	0.6	0.5	0.9
Core earnings/average managed assets	0.5	0.5	0.4	0.3	0.5

RAC--Risk-adjusted capital. N.M.--Not meaningful.

Table 4

Aktia Bank PLC Risk-Adjusted Capital Framework Data

(€)	**Exposure at default**	**Basel II RWA**	**Average Basel II RW (%)**	**Standard & Poor's RWA**	**Average Standard & Poor's RW (%)**
Credit risk					
Government and central banks	913,293,525	187,950	0	28,410,143	3
Institutions	2,231,554,917	350,333,563	16	312,101,643	14
Corporate	340,700,478	148,553,188	44	180,713,333	53
Retail	6,225,711,760	2,110,555,475	34	1,545,365,234	25
Of which mortgage	5,625,199,968	1,967,956,288	35	1,344,462,628	24
Securitization*	0	0	0	0	0
Other assets	87,240,010	71,648,850	82	83,845,582	96
Total credit risk	9,798,500,690	2,681,279,025	27	2,150,435,935	22
Market risk					
Equity in the banking book§	49,877,643	174,727,775	664	541,114,884	1,085
Trading book market risk	--	0	--	0	--
Total market risk	--	174,727,775	--	541,114,884	--
Insurance risk					
Total insurance risk	--	--	--	577,387,500	--
Operational risk					
Total operational risk	--	363,185,500	--	563,219,419	--
		Basel II RWA		**Standard & Poor's RWA**	**% of Standard & Poor's RWA**
Diversification adjustments					
RWA before diversification		3,263,317,713		3,832,157,738	100

Table 4

Aktia Bank PLC Risk-Adjusted Capital Framework Data (cont.)				
Total adjustments to RWA	--		421,563,210	11
RWA after diversification	3,263,317,713		4,253,720,948	111
	Tier-1 capital	**Tier-1 ratio (%)**	**Total adjusted capital**	**Standard & Poor's RAC ratio (%)**
Capital ratio				
Capital ratio before adjustments	476,140,000	14.6	518,559,171	13.5
Capital ratio after adjustments†	476,140,000	15.0	518,559,171	12.2

*Includes the securitization tranches deducted from capital in the regulatory framework. §Includes minority equity holdings in financial institutions. †Adjustments to Tier-1 ratio are additional regulatory requirements (e.g., transitional floor or Pillar-2 add-ons). RWA--Risk-weighted assets. RW--Risk weight. RAC--Risk-adjusted capital. Sources: Company data as of Dec. 31, 2014, Standard & Poor's.

Risk position: Sound risk management, but concentration risk, due to focus on retail mortgage lending

We view Aktia Bank's risk position as moderate, due mainly to the concentration risk of the bank's loan book, which exposes it to potential volatility in the domestic real estate market.

We view positively Aktia Bank's focus on low-risk lending, mortgage loans, and loans to SMEs. However, we still consider that the regionally focused retail loan book (89% of the total loan book as of Dec. 31, 2014) exposes the bank to concentration risk and makes it vulnerable to real estate price developments in specific regions in Finland.

The concentration is partly mitigated by the retail loan book's high granularity and sound collateralization. Mortgage loans are principally granted in Finland's larger cities, which we consider to be economically stronger and where we assume housing prices remain more stable. Less than 5% of the total loan stock has loan-to-value ratios above 70%. We note that the credit quality in AREMB's loan portfolio is excellent. The portfolio has no nonperforming loans (NPLs) and there have been no credit losses reported throughout the bank's history. Furthermore, Aktia Bank's declining SME loan book of €420 million (6.5% of the total loan book as of Dec. 31, 2014) does not show any significant single-name or sector concentration.

We consider Aktia Bank's risk culture to be sound. Aktia Bank revised its underwriting standards in 2010, which resulted in improved asset quality. The ratio of NPLs to total loans was 0.7% at Dec. 31, 2014, marginally above the previous year's level. The small SME portfolio shows somewhat weaker credit quality, but we understand that it is well collateralized. We acknowledge that the bank has actively managed down the risks in its run-off portfolio, which consists of loans that are no longer in line with the credit policy.

Despite our view of growing economic imbalances in the Finnish household sector, we anticipate Aktia Bank will maintain a low level of credit losses at about 8 bps in the near term, up slightly from 3 bps in 2014. We believe that the potential increase could result from Aktia Bank's SME exposures. The bank's market risk is minor, since it has no trading book.

Table 5

Aktia Bank PLC--Risk Position

	--Year ended Dec. 31--				
(%)	**2014**	**2013**	**2012**	**2011**	**2010**
Growth in customer loans	(5.7)	(5.5)	2.0	7.2	9.1
Total diversification adjustment/Standard & Poor's RWA before diversification	11.0	N.M.	N.M.	N.M.	N.M.
Total managed assets/adjusted common equity (x)	20.6	21.3	22.8	23.7	24.8
New loan loss provisions/average customer loans	0.0	0.0	0.1	0.2	0.2
Net charge-offs/average customer loans	0.1	0.0	0.1	0.1	0.1
Gross nonperforming assets/customer loans + other real estate owned	0.7	0.7	0.7	0.8	0.5
Loan loss reserves/gross nonperforming assets	129.3	144.4	130.1	105.9	160.0

RWA--Risk-weighted assets. N.M.--Not meaningful.

Funding and liquidity: Sound funding profile benefiting from regional deposit franchise and covered bonds issuance

We consider Aktia Bank's funding to be average. Our view is based on Aktia Bank's sound regional franchise and proximity to customers that should continue to provide the bank with a relatively stable and granular inflow of deposits (46% of funding as of Dec. 31, 2014). Aktia Bank has increased customer deposits gradually over the past five years, demonstrating, in our view, a relatively low sensitivity to customer confidence. A major part of customer deposits is from households, followed by SME clients, and three quarters of all deposits are covered by the Finnish deposits insurance scheme. Therefore, we expect Aktia Bank's stable funding ratio will remain at an adequate level of 105%-110% over 2015-2016 (105% as of Dec. 31, 2014).

The funding profile also benefits from the bank's access to capital markets through issuance of covered bonds. Aktia Bank was granted a covered bond license in March 2013 and has issued covered bonds totaling €1 billion. We believe that there is healthy demand from the investor side for further issuances. AREMB, in turn, plans to focus on managing and refinancing current stock. We understand that AREMB will refinance the redeeming covered bonds by selling the underlying assets back to the distributing banks. As the owners of AREMB will grant new loans from their own balance sheets, the run-off will gradually reduce Aktia Bank's balance sheet and refinancing needs.

In our view, Aktia Bank's funding mix will continue to represent a relatively balanced asset-liability structure with a long-term funding ratio of about 80%, which is in line with the ratios of its domestic competitors. Furthermore, if we adjust Aktia Bank's loan book for mortgage loans sold by the partner banks, its loan-to-deposits ratio stands at about 125%, slightly above that of domestic peers operating solely in retail banking. We believe that the ongoing run-off of AREMB will gradually improve Aktia Bank's funding and liquidity metrics.

Our assessment of Aktia Bank's liquidity as adequate mirrors our estimate of the bank's one-year liquidity ratio (broad liquid assets to short-term funding) of 1.5x as of Dec. 31, 2014. Aktia Bank has a liquidity position of about €2.8 billion, consisting of cash and securities, mainly covered bonds, which to a high extent are eligible for repurchase (repo) agreement transactions at the Finnish Central Bank. The bank reduced its investments in covered bonds in eurozone (European Economic and Monetary Union) periphery countries (Portugal, Ireland, Italx, Greece, and Spain) to about €27 million as of Dec. 31, 2014 in Italy, and the bank has no sovereign exposure to these countries. Consequently, we believe that in a severe liquidity crisis involving closure of access to capital market funding and a significant deposit outflow, Aktia Bank could survive for more than 12 months, with the access to the central bank through the repo activity in its liquidity book.

We understand that Aktia Bank already comfortably fulfils the future funding and liquidity requirements under the Basel III framework.

Table 6

Aktia Bank PLC--Funding And Liquidity					
	--Year ended Dec. 31--				
(%)	**2014**	**2013**	**2012**	**2011**	**2010**
Core deposits/funding base	45.8	45.7	43.4	39.5	37.0
Customer loans (net)/customer deposits	161.2	165.4	178.9	193.6	193.9
Long term funding ratio	79.6	82.2	76.6	74.0	77.7
Stable funding ratio	105.2	106.5	97.4	92.0	98.8
Short-term wholesale funding/funding base	22.0	19.1	25.0	22.8	18.6
Broad liquid assets/short-term wholesale funding (x)	1.5	1.6	1.2	1.3	1.7
Net broad liquid assets/short-term customer deposits	25.5	31.6	13.8	16.4	37.7
Short-term wholesale funding/total wholesale funding	40.5	35.1	44.2	37.7	29.5
Narrow liquid assets/3-month wholesale funding (x)	2.9	2.8	6.1	3.9	4.5

External support: One notch of government support

We consider that Aktia Bank has moderate systemic importance to Finland, which we view as "supportive" of private-sector commercial banks. We base our assessment on Aktia Bank's position as the fourth-largest retail bank in Finland, where Pan-Nordic groups have sizable operations, and it market share of 4.1% in mortgage loans and 3.9% in customer deposits. As a result, and in line with our criteria, the 'A-' long-term counterparty credit rating on Aktia Bank stands one notch above its 'bbb+' SACP.

We could remove this notch of support shortly before the January 2016 introduction of the EU Bank Recovery and Resolution Directive's bail-in powers for senior unsecured liabilities in Finland. These rules would indicate to us that the Finnish government would be much less able to support senior unsecured bank creditors, even though it may take several more years to eliminate concerns about financial stability and the resolvability of systemically important banks.

Related Criteria And Research

Related Criteria

- Banks: Rating Methodology And Assumptions, Nov. 9, 2011
- Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- Bank Capital Methodology And Assumptions, Dec. 6, 2010

Related Research

- Nordic Banks Face Credit Pressures From Bail-In Regulations And Economic Risks, March 9, 2015
- Banking Industry Country Risk Assessment Update: March 2015, March 6, 2015
- Banking Industry Country Risk Assessment: Finland, Jan. 29, 2015
- Capital Strengthening Is At The Forefront Of Nordic Banks' Improved Credit Profiles, Dec. 18, 2014

- Ratings on Three Finnish Banks Affirmed On Subdued Economic Recovery; Outlooks Remain Negative, Oct. 22, 2014
- Finland Long-Term Ratings Lowered To 'AA+' on Weak Economic Growth; Outlook Stable, Oct. 10, 2014
- Ratings On Finland-Based Aktia Bank Affirmed At 'A-/A-2' Following Government Support Review; Outlook Remains Negative, April 30, 2014

Anchor Matrix

Industry Risk	Economic Risk									
	1	**2**	3	4	5	6	7	8	9	10
1	a	a	a-	bbb+	bbb+	bbb	-	-	-	-
2	a	a-	a-	bbb+	bbb	bbb	bbb-	-	-	-
3	a-	**a-**	bbb+	bbb+	bbb	bbb-	bbb-	bb+	-	-
4	bbb+	bbb+	bbb+	bbb	bbb	bbb-	bb+	bb	bb	-
5	bbb+	bbb	bbb	bbb	bbb-	bbb-	bb+	bb	bb-	b+
6	bbb	bbb	bbb-	bbb-	bbb-	bb+	bb	bb	bb-	b+
7	-	bbb-	bbb-	bb+	bb+	bb	bb	bb-	b+	b+
8	-	-	bb+	bb	bb	bb	bb-	bb-	b+	b
9	-	-	-	bb	bb-	bb-	b+	b+	b+	b
10	-	-	-	-	b+	b+	b+	b	b	b-

Ratings Detail (As Of March 31, 2015)

Aktia Bank PLC	
Counterparty Credit Rating	A-/Negative/A-2
Senior Unsecured	A-
Counterparty Credit Ratings History	
12-Dec-2012	A-/Negative/A-2
Sovereign Rating	
Finland (Republic of)	AA+/Stable/A-1+

*Unless otherwise noted, all ratings in this report are global scale ratings. Standard & Poor's credit ratings on the global scale are comparable across countries. Standard & Poor's credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.

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