MOODY'S
INVESTORS SERVICE

CREDIT OPINION

9 January 2017

Update

Rate this Research

Aktia Bank p.l.c.

Semiannual update

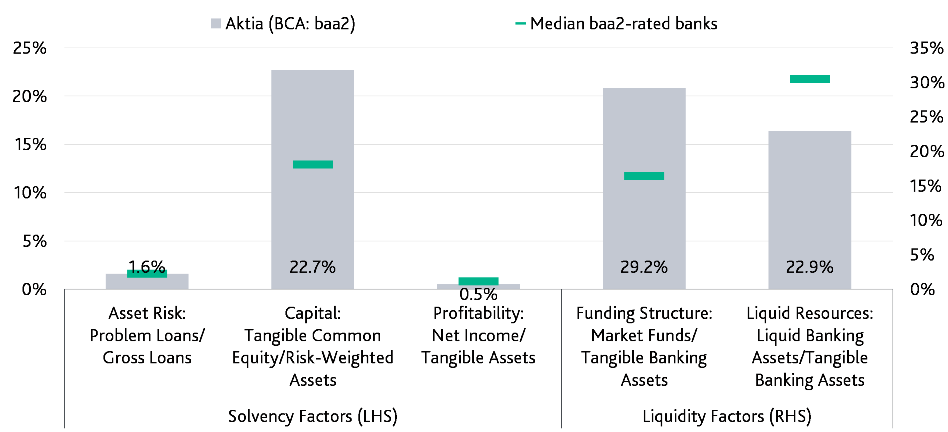
Summary Rating Rationale

Aktia Bank p.l.c's deposit ratings of A3/Prime-2 and its long-term senior unsecured debt rating of A3 incorporate (1) the bank's baseline credit assessment (BCA) of baa2; (2) the results from our Advanced Loss Given Failure (LGF) analysis, which takes into account the severity of loss faced by the different liability classes in resolution , which leads to two notches if rating uplift for Aktia's deposit and senior unsecured debt ratings; (3) our assumption of "low" government support from Finland (Aa1, stable), which does not result in further ratings uplift. The bank's Counterparty Risk (CR) Assessment is A2(cr)/P-1(cr). The long-term ratings have a positive outlook due to the bank's continued improvement in capital and funding.

Aktia Bank's BCA of baa2 reflects the bank's well established - albeit small - franchise, prudent risk and liquidity management and good financial fundamentals, particularly for asset quality and capital adequacy. Key elements constraining the BCA include the bank's limited position in a competitive market, which translates into modest profitability, and reliance on wholesale funding, the latter a common feature of Nordic banks.

Exhibit 1

Rating Scorecard - Key Financial Ratios



Source: Moody's Financial Metrics

RATINGS

Aktia Bank p.l.c.

Domicile	Finland
Long Term Debt	A3
Type	Senior Unsecured - Fgn Curr
Outlook	Positive
Long Term Deposit	A3
Type	LT Bank Deposits - Fgn Curr
Outlook	Positive

Please see the ratings section at the end of this report for more information. The ratings and outlook shown reflect information as of the publication date.

Contacts

Niclas Boheman 44-20-7772-1643
AVP-Analyst
niclas.boheman@moodys.com

Aleksandar Hristov 44-20-7772-1071
Associate Analyst
aleksandar.hristov@moodys.com

Jean-Francois Tremblay 44-20-7772-5653
Associate Managing Director
jean-francois.tremblay@moodys.com

Sean Marion 44-20-7772-1056
Managing Director - Financial Institutions
sean.marion@moodys.com

Credit Strengths

» Very strong asset quality

» High regulatory capitalisation, with Common Equity Tier 1 ratio of 19.2%

» Good level of liquidity

Credit Challenges

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

» High albeit reducing reliance on market funding

» High nominal leverage

» Modest profitability as a result of low efficiency metrics

Rating Outlook

The outlook on Aktia Bank's ratings is positive, reflecting the positive rating pressure that could develop if the improving trends observed in its liquidity and capital metrics are sustained over the outlook period (up to 18 months).

Factors that Could Lead to an Upgrade

Upward pressure on Aktia Bank’s BCA could develop if the improving trends observed in liquidity and capital metrics are sustained over the following months. Upward pressure on the BCA could also follow a sustained improvement in the bank's recurrent profitability, provided that the bank’s risk profile does not deteriorate.

As the bank's deposit and senior unsecured debt ratings are linked to its BCA, a positive change in the bank's BCA would likely affect all ratings.

Factors that Could Lead to a Downgrade

Downward pressure could be exerted on Aktia Bank's BCA as a result of: (1) an unexpected considerable worsening in the bank's asset quality indicators; (2) a weakening of the bank's risk-absorption capacity through earnings-generation capacity or capital levels; and/or (3) any worsening, beyond our current expectations, in operating conditions in Finland.

Aktia Bank's deposit and senior unsecured debt ratings could also gave downwards pressure as a result of changes in the bank’s liability structure, which could indicate a higher loss-given-failure to be faced by these instruments.

Key Indicators

Exhibit 2

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

	9-16[2]	12-15[2]	12-14[2]	12-13[3]	12-12[3]	Avg.
Total Assets (EUR million)	9,536.7	9,866.2	10,423.8	10,907.3	11,240.2	-4.0[4]
Total Assets (USD million)	10,717.3	10,717.6	12,613.3	15,029.6	14,819.0	-7.8[4]
Tangible Common Equity (EUR million)	479.8	487.2	481.4	473.7	451.0	1.6[4]
Tangible Common Equity (USD million)	539.2	529.3	582.5	652.8	594.6	-2.4[4]
Problem Loans / Gross Loans (%)	-	1.6	1.6	1.6	1.5	1.5[5]
Tangible Common Equity / Risk Weighted Assets (%)	22.7	24.4	14.8	13.7	12.5	20.6[6]
Problem Loans / (Tangible Common Equity + Loan Loss Reserve) (%)	-	17.1	18.7	19.9	21.1	19.2[5]
Net Interest Margin (%)	1.0	1.0	1.0	1.1	1.1	1.0[5]
PPI / Average RWA (%)	2.9	2.7	1.9	1.8	1.7	2.5[6]
Net Income / Tangible Assets (%)	0.5	0.5	0.5	0.5	0.4	0.5[5]

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 www.moodys.com for the most updated credit rating action information and rating history.

Cost / Income Ratio (%)	70.4	69.7	68.6	70.7	71.1	70.1[5]
Market Funds / Tangible Banking Assets (%)	27.8	29.2	31.1	36.3	52.9	35.5[5]
Liquid Banking Assets / Tangible Banking Assets (%)	20.2	22.9	23.9	22.3	21.7	22.2[5]
Gross loans / Due to customers (%)	137.4	150.7	162.7	180.8	200.1	166.4[5]

[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
Source: Moody's Financial Metrics

Detailed Rating Considerations

Aktia bank's BCA is supported by Finland's Strong+ Macro Profile

Aktia Bank only has business in Finland (Aa1 stable), which is powered by an innovation-driven economy, with high living standards and a predictable economic policy framework. However, the country is experiencing weak economic growth, attributable to the ongoing economic restructuring against the backdrop of a decline in the electronics and to a lesser extent the forest industry, and the corresponding transfer of labour into lower-productivity services. The Finnish population is also ageing more rapidly than many other advanced countries, and the economically active population is already shrinking. The government has embarked on an ambitious structural reform programme and fiscal consolidation. Proactive macroeconomic and fiscal policies also benefit the Finnish banking system, which at the same time relies significantly on wholesale funding, exposing banks to swings in investor sentiment. This risk is more pronounced in Finland than in other Nordic countries, because the system does not have the same level of an established, captive, investor community.

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

Aktia Bank is the fourth-largest bank in Finland by total assets. It reported a market share of 4.1% in housing loans and 3.8% of deposits at September 2016. Loans to households comprise 84.5% of its loan portfolio (or 90.2% if loans to housing companies are included), with the smaller portfolio shares allocated to corporates (9.1%) and not-for-profit organisations (0.7%) at September 2016. Aktia Bank operates through 47 branches, located mainly in the coastal areas of Finland, around Helsinki and the country's largest inland towns.

For a long period, Aktia Bank'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. We consider the termination of the cooperation, following announcements in 2012 and 2013, as negative for Aktia Bank's franchise.

In October 2015, Aktia Bank announced that it had reached an agreement with the minority owners of Aktia Real Estate Mortgage Bank (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 Bank.

As a result of Aktia's business being predominantly focused on mortgage lending, we apply a negative one notch qualitative adjustment to the bank's BCA for Business Diversification.

Strong asset quality and capitalisation

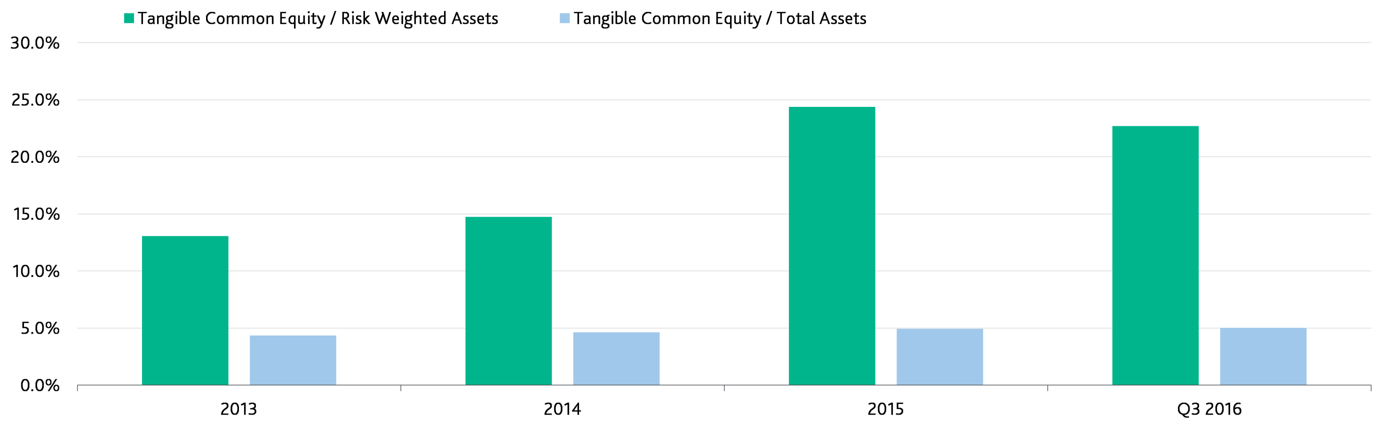
Aktia Bank displays relatively strong asset quality, as a reflection of its focus on the Finnish retail sector. The institution's problem loan ratio is consistently below 2%, which is comparable with many Nordic banks. It shows a very low credit costs burden, with loan loss provisions representing around 1.6% of pre-provision income in the first nine months of 2016. We assign Aktia Bank's asset risk position an a1 score, consistent with the bank's historic problem loan ratio of 1.6%.

Aktia Bank has a strong capital position, with a tangible-common-equity (TCE)-to-risk-weighted-assets ratio of 22.7% as of September 2016 (see Exhibit 3). This ratio is considerably higher compared to year-end 2014, because in February 2015 the Finnish FSA granted the Aktia Bank group permission to use the internal ratings based approach, 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 nearly a third in the first quarter of 2015.

Similarly, Aktia Bank shows a strong regulatory capitalisation, with a reported common equity tier 1 ratio of 19.2% and a total capital ratio of 25.5% at September 2016. The announcement of the acquisition of the minority interest of Aktia REMB in October 2015 had a negative impact in the regulatory capital of Aktia Bank of approximately 200 basis points, because the minority interest was reclassified as a liability. However, it will concurrently rise for a similar amount once the savings banks and POP banks repurchase their respective shares of Aktia REMB's loan book. The acquisition of the minority interest was neutral in terms of TCE, given that TCE does not include the minority interest as a capital component. However, TCE will benefit from the decline in risk-weighted assets following the repurchase of Aktia REMB loans.

Our assessment of Aktia Bank's capitalisation remains constrained by the bank's high leverage, which has not improved in parallel with the TCE ratio after the introduction of the internal ratings based approach. The leverage ratio of Aktia Bank, measured as TCE to total assets, was 5.1% as of September 2016, slightly improved from 5.0% in 2015 and 4.5% in 2014. Owing to the high leverage, we adjust Aktia Bank's Capital score down by three notches to a1. Nevertheless, we acknowledge that the bank's leverage is gradually improving as a consequence of the balance sheet's reduction and, to a lesser extent, internal capital generation.

Exhibit 3
Aktia Bank's capitalisation metrics



Source: Moody's Investors Service

Profitability remains moderate as a result of low efficiency metrics

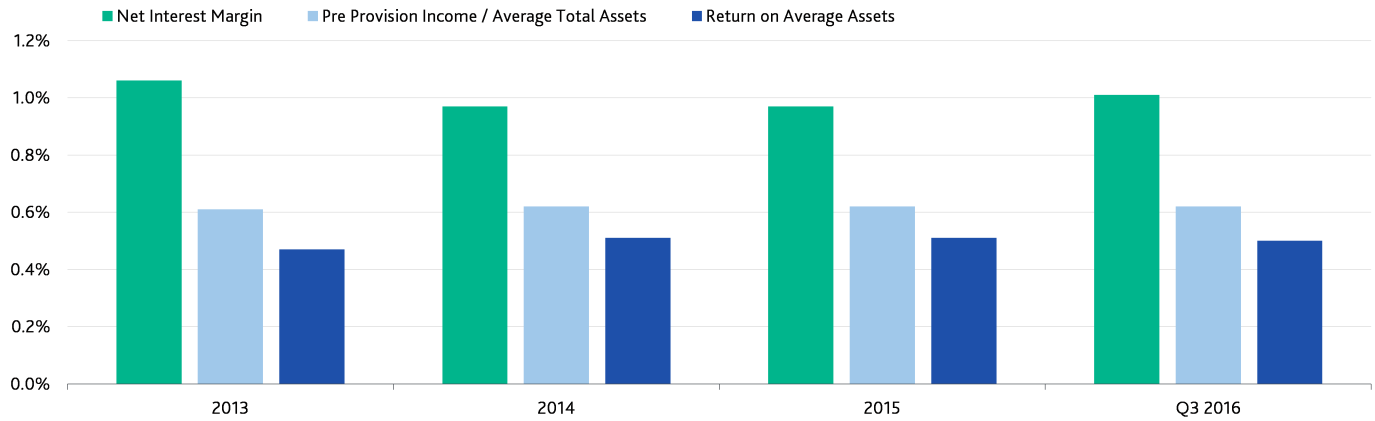
Finnish banks operate in a highly competitive market effectively concentrated around four players. In this context, Aktia Bank as a small player in the Finnish household lending space, has a limited ability to influence lending rates and consequently its profitability.

Aktia Bank's overall profitability is impacted by the bank's low efficiency metrics, with a cost-to-income ratio of 70% as of September 2016, which has been at that level for a number of years. This compares poorly with the average for the rated Finnish banks which was 47% in 2015. Nonetheless, Aktia has set an objective of reducing the cost to income ratio by at least 10 percentage points by the end of 2018. With this purpose, the bank introduced multiple measures under its "Action Plan 2015", of which the most relevant is the introduction of a new core banking platform. The total investment exceeds EUR55 million, and from 2017 the bank expects the investment to translate into lower running technology costs. While the benefits of the new platform are yet to materialise, we see the bank's low efficiency as a profitability weakness.

On the positive side, Aktia Bank's modest profitability shows a high degree of stability, with minimum fluctuations in profitability ratios over the past few years (see Exhibit 4). In the first three quarters of 2016, the bank's net profit was EUR 42.8 million, at the same level as in the corresponding period in 2015. During the period, Aktia's net interest income declined only marginally by 1% year-on-year despite the challenging low interest environment and the declining loan volumes following the run-off of Aktia REMB. Similarly, there was a small decline in net commission income by 2% year-on-year. These pressures on core revenues were mitigated by a 10% year-on-year growth in life insurance income and the income from the sale of Visa Europe to Visa Inc, which the bank reported under income from financial transactions.

Aktia Bank's historic earnings suggest a Profitability score of baa2.

Exhibit 4
Aktia Bank's profitability metrics



Source: Moody's Investors Service

Gradually reducing reliance on market funding combined with good liquidity buffer

Aktia Bank is gradually reducing its reliance on market funding, which we view positively because it reduces its susceptibility to sudden changes in investor sentiment. Moreover, the majority of market funding is in the form of covered bonds, which we consider subject to lower refinancing risk compared to unsecured bonds. The banks' Moody's-calculated market funds to tangible banking assets ratio decreased to 28% at September 2016, compared to 36% at the end of 2013.

Lower market funding reliance is primarily a consequence of the run-off of Aktia REMB, as the vehicle has redeemed a large part of its market funding as its assets amortises. Given that deposits have remained broadly stable, the share of Aktia Bank's balance sheet funded through customer deposits has increased. The decline in market funding is not only happening in terms of covered bonds, but also in terms of unsecured debt and short-term funding.

The issuance of covered bonds results in the structural subordination of senior creditors, including depositors. At the same time, we recognise that Aktia Bank, 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 Bank's liquidity portfolio accounts for approximately a quarter of the balance sheet and is of good quality. Its liquid assets mainly include covered bonds and highly rated sovereign debt.

Notching Considerations

Loss Given Failure

We apply our advanced LGF analysis to Aktia Bank as the bank is subject to the EU Bank Recovery and Resolution 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 also assign a 10% proportion of junior deposits over total deposits (compared to our standard assumption of 26%), reflecting the bank's predominantly retail oriented deposit franchise.

We consider that Aktia Bank's deposits are likely to face very low loss-given-failure, owing to the loss absorption provided by subordinated and senior unsecured debt (if deposits were 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 Bank's long-term deposit ratings consequently receive a two-notch rating uplift to A3.

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

Government Support

Aktia Bank's ratings do not benefit from government support.

Counterparty risk assessment

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.

The CR Assesment of Aktia Bank is positioned at A2(cr), three notches above the Adjusted BCA of baa2, based on the cushion against default provided to the senior obligations. In addition, the low probability of government support does not result in any uplift. The short-term CR assessment is P-1(cr).

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 Methodology and Scorecard Factors

Exhibit 5

Aktia Bank p.l.c.

Macro Factors						
Weighted Macro Profile	**Strong +**	**100%**				

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	22.7%	aa1	←→	a1	Nominal leverage	
Profitability						
Net Income / Tangible Assets	0.5%	baa2	←→	baa2	Earnings quality	
Combined Solvency Score		a1		a2		
Liquidity						
Funding Structure						
Market Funds / Tangible Banking Assets	29.2%	baa2	←→	baa2	Extent of market funding reliance	
Liquid Resources						
Liquid Banking Assets / Tangible Banking Assets	22.9%	baa1	←→	baa1	Stock of liquid assets	
Combined Liquidity Score		baa2		baa2		
Financial Profile				a3		
Business Diversification				-1		
Opacity and Complexity				0		
Corporate Behavior				0		
Total Qualitative Adjustments				-1		
Sovereign or Affiliate constraint:				Aa1		
Scorecard Calculated BCA range				a3-baa2		
Assigned BCA				baa2		
Affiliate Support notching				0		
Adjusted BCA				baa2		

Balance Sheet	**in-scope (EUR million)**	**% in-scope**	**at-failure (EUR million)**	**% at-failure**
Other liabilities	2,678	32.5%	2,975	36.1%
Deposits	4,254	51.7%	3,956	48.1%
Preferred deposits	3,829	46.5%	3,637	44.2%
Junior Deposits	425	5.2%	319	3.9%
Senior unsecured bank debt	819	9.9%	819	9.9%
Junior senior unsecured bank debt	236	2.9%	236	2.9%
Equity	247	3.0%	247	3.0%
Total Tangible Banking Assets	8,233	100%	8,233	100%

Debt class	De jure waterfall		De facto waterfall		Notching		LGF notching guidance versus BCA	Assigned LGF notching	Additional notching	Preliminary Rating Assessment
	Instrument volume + Subordination	Sub-ordination	Instrument volume + Subordination	Sub-ordination	De jure	De facto				
Counterparty Risk Assessment	19.7%	19.7%	19.7%	19.7%	3	3	3	3	0	a2 (cr)
Deposits	19.7%	5.9%	19.7%	15.8%	2	3	2	2	0	a3
Senior unsecured bank debt	19.7%	5.9%	15.8%	5.9%	2	1	2	2	0	a3

Instrument class	Loss Given Failure notching	Additional Notching	Preliminary Rating Assessment	Government Support notching	Local Currency Rating	Foreign Currency Rating
Counterparty Risk Assessment	3	0	a2 (cr)	0	A2 (cr)	--
Deposits	2	0	a3	0	A3	A3
Senior unsecured bank debt	2	0	a3	0	A3	A3

Source: Moody's Financial Metrics

Ratings

Exhibit 6

Category	Moody's Rating
AKTIA BANK P.L.C.	
Outlook	Positive
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

Source: Moody's Investors Service

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