S&P Global
Ratings

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Aktia Bank PLC

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Aktia Bank PLC

SACP	a-
Anchor	a-	
Business Position	Moderate	-1
Capital and Earnings	Very Strong	+2
Risk Position	Moderate	-1
Funding	Average	0
Liquidity	Adequate	

\+

Support	0
ALAC Support	0
GRE Support	0
Group Support	0
Sovereign Support	0

\+

Additional Factors	0

Issuer Credit Rating

A-/Stable/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.	• Concentration risk in loan book, due to focus mainly on residential mortgage lending in Finland. • Limited geographic, business, and earnings diversification. • Reliance on wholesale funding market as covered bond issuer.

Outlook: Stable

S&P Global Ratings' stable outlook on Aktia Bank reflects our view that the bank will continue to maintain its market position as a well-established local retail franchise in Finland. The outlook also reflects our expectation that the bank's capitalization will be supported by sound earnings capacity over the next 24 months. The improving economic conditions in Finland further underpin this view.

We could take a negative rating action if we saw Aktia's position weaken, such that the bank's profitability and market shares decline. The termination of cooperation with independent local savings banks and co-operative banks has had a temporary hurt Aktia's risk-adjusted capital (RAC) ratio. If we saw the bank's lending growth were to lead to a lower projected RAC ratio we could also take a negative rating action, however we do not believe this would lead to a two-notch downgrade given Aktia's potential additional loss-absorbing capacity (ALAC) buffer.

We consider a positive rating action unlikely at this time.

Rationale

Our ratings on Aktia Bank reflect our 'a-' anchor for Finnish banks and the bank's moderate business position as a regional bank with a concentrated business model focused primarily on retail mortgage lending. Our ratings also encompass Aktia Bank's very strong capital and earnings, mainly due to our expectation of the RAC ratio being above 15% in the next 12-24 months. They equally reflect the bank's moderate risk position, due to concentration risks on its loan book, partly mitigated by a high level of collateralization and a track record of low credit losses, 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 stand-alone credit profile (SACP) is 'a-'.

Given Aktia Bank's status as a top-five retail bank in terms of assets in Finland--where pan-Nordic groups have sizable operations--and its market share of 4.1% in mortgage loans and 3.7% in customer deposits, we consider the bank to have moderate systemic importance to Finland's banking sector. We believe, however, that the prospect of extraordinary government support for the country's banking sector is uncertain and no longer incorporate any uplift above Aktia Bank's SACP for government support.

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

We 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 an innovative and wealthy economy with high education levels. After a mild economic downturn experienced in 2012-2014, we expect economic growth to gradually recover over the next two years, supported by private consumption and starting from 2018 by recovery of exports. We believe that the risk of house price correction is becoming more remote as the economic prospects and consumer confidence improve. We expect banks' asset quality to remain strong in the next two years, based on the sound financial position of the household and corporate sectors, the banking sector's moderately conservative underwriting standards, and the persisting low interest rate environment.

We do not consider the banking sector's competitive landscape to be distorted despite concentration stemming from the presence of large pan-Nordic banks and the domestic cooperative banking group OP Financial Group. We also deem the sector's overall profitability and capitalization to be resilient and expect banks to maintain their restrained risk appetite. That said, the sector remains highly interconnected with other Nordic banking systems, which results in potential spillover risks on the Finnish economy from external events. We expect deposits to continue to dominate the banks' funding profiles, and foresee that banks will rely moderately on external funding, given the limited size of domestic capital markets.

Table 1

Aktia Bank PLC Key Figures					
		--Year-ended Dec. 31--			
(Mil. €)	**2017***	**2016**	**2015**	**2014**	**2013**
Adjusted assets	8,659.7	8,699.1	9,163.0	10,125.1	10,447.6

Table 1

Aktia Bank PLC Key Figures (cont.)					
		--Year-ended Dec. 31--			
(Mil. €)	**2017***	**2016**	**2015**	**2014**	**2013**
Customer loans (gross)	5,873.0	5,765.4	5,911.3	6,475.5	6,867.2
Adjusted common equity	397.1	396.0	446.8	518.6	512.3
Operating revenues	157.6	205.2	209.0	214.5	225.4
Noninterest expenses	118.7	148.4	144.4	144.5	157.2
Core earnings	31.1	43.8	51.6	55.0	52.4

*Data as of Sept. 30.

Business position: Moderate, due to solid local retail franchise as one of the top-five banks in Finland

Our assessment of Aktia Bank's business position reflects its concentrated business model focused primarily on low-risk collateralized lending to retail clients and small and midsize enterprises.

Aktia Bank is a midsize commercial bank with total assets of €9.5 billion as of Sept. 30, 2017. The bank has a well-established, local retail franchise in growth regions in Finland's coastal areas and larger cities, with about 380,000 customers. Aktia Bank enjoys a stable market share of 4.1% in residential mortgage lending and 3.7% in customer deposits. Improved cross selling via asset management and life insurance products could have a positive impact on their market position in future periods. However, the focus is expected to remain contained to the bank's core regions in Finland.

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 the real estate market in Finland, or to a downturn in the Finnish economy, although we currently see these scenarios as remote. We understand that Aktia Bank maintains a targeted lending growth strategy to small and midsized enterprises (SME), which should enable further cross-selling potential. In terms of lending to housing corporations, the bank remains opportunistic, as this remains a highly competitive segment in the Finnish banking sector.

Aktia bank's asset management and life insurance activities complement its core product offering, and we expect their contribution to revenues will increase over time. Together, these activities make up about 23% of Aktia Bank's operating revenues and 33% of its operating profit. Its asset management activities, with assets under management of €8.0 billion as of Dec. 31, 2016, are steadily growing and hold an estimated 8.5% market share in mutual funds in Finland. Aktia Life remains relatively small, with a market share of about 3% in the Finnish life insurance market. In our opinion, the life segment brings only moderate diversification benefits to the group.

While there have been a changes to Aktia Bank's lead management team, we do not expect this to materially change the bank's business model and traditionally low risk appetite. Moreover, the bank has now launched its updated core banking system, which should allow for continued digital development and cost efficiency going forward. Costs related to both IT and the restructuring have increased, however, we anticipate expenses will decrease over time. This is underscored by Aktia Bank's strategy to consolidate branch offices and establish 10 regional competence centers to focus on customer advice and proactive sales.

Table 2

Aktia Bank PLC Business Position					
		--Year-ended Dec. 31--			
(%)	2017*	2016	2015	2014	2013
Loan market share in country of domicile	4.2	4.1	4.1	4.1	4.1
Deposit market share in country of domicile	3.6	3.7	3.8	3.9	3.7
Total revenues from business line (mil. €)	157.6	212.1	209.0	214.5	225.4
Commercial & retail banking/total revenues from business line	77.2	77.2	79.1	78.9	79.0
Insurance activities/total revenues from business line	24.7	21.7	22.2	20.3	20.3
Other revenues/total revenues from business line	(2.0)	1.1	(1.3)	0.8	0.6
Return on equity	6.9	8.0	8.4	8.7	8.9

*Data as of Sept. 30.

Capital and earnings: Very strong capitalization underpinned by sound earnings capacity and asset reduction

We consider Aktia Bank's capital and earnings to be very strong. This is mainly due to our expectation that our RAC ratio for the bank will return and remain above 15% over the next 24 months, compared to 14.7% on June 30, 2017 (table 4). This is supported by a positive earning buffer and strong capital sustainability ratio, in addition to very high quality of capital consisting mainly of paid-in capital and a granular shareholder base.

The main driver for the bank's evolving RAC ratio has been the ongoing run-off of Aktia Real Estate Mortgage Bank (AREMB). Based on the arrangement between Aktia Bank and the partner banks in 2015, where Aktia Bank terminated its cooperation with the partner banks and acquired the remaining minority stakes in AREMB, AREMB was merged with Aktia Bank at the beginning of 2017. The transaction decreased Aktia Bank's equity by €65 million and consequently our total-adjusted capital (TAC), our measure of loss-absorbing capital, leading to an anticipated decline in the RAC ratio compared with the June 2015 RAC figure of 16.0%.

At the same time, we anticipated there would be a decline in risk-weighted assets as a result of loan transfers to the partner banks to counter some of the recent decline in TAC. Both the loan transfers and the wind-down of AREMB were completed in the first half of 2017. While there has been a decline in mortgage lending as a result, it was offset by an increase in SME lending, which is in line with Aktia Bank's updated strategy. Looking ahead, lending growth is expected to be broadly in line with the market, and given the increased SME focus, this leads to our expectation of risk-weighted asset growth of about 3.0% per year.

Generally, we expect margins on new loans to remain low given there has been strong competition in the Finnish market, and we forecast that Aktia Bank's average net interest margin will likely to remain at about 1.1% over the next two years. Furthermore, we anticipate positive developments in net fee and commission income via the bank's asset management and life insurance businesses. We also expect Aktia Bank's organizational streamlining will enable it to meet its cost-efficiency target to reduce the cost-to-income ratio by approx. 8-10 percentage points by 2022. This supports our view that core earnings will average €44 million over 2017-2019. While the dividend payout for 2016 was higher than average at about 80% of net profits, as a result of various one-off effects, we expect in the near term that the bank will return to a 50%-60% payout ratio.

Our three-year average earnings buffer of close to 150 basis points (bps) for the group reflects our view that Aktia Bank's earnings capacity is expected to improve, owing to stable operating revenues, planned cost cuts, and our expectation of low loan losses. We note that upcoming Basel III reforms could also lead the bank to hold higher level of capital, and a target to maintain a management buffer of 1.5%-3.0% above the regulatory capital requirements is also supportive of the view that Aktia Bank's capitalization level will increase to be above 15% over the next two years.

Table 3

Aktia Bank PLC Capital And Earnings

		--Year-ended Dec. 31--			
(%)	**2017***	**2016**	**2015**	**2014**	**2013**
Criteria reflected in RAC ratios	2017 RAC Criteria	2017 RAC Criteria	2010 RAC Criteria	2010 RAC Criteria	2010 RAC Criteria
Tier 1 capital ratio	17.3	19.5	20.7	14.6	12.3
S&P Global Ratings' RAC ratio before diversification	N.A.	15.1	14.5	13.5	12.7
S&P Global Ratings' RAC ratio after diversification	N.A.	10.3	12.5	12.2	11.6
Adjusted common equity/total adjusted capital	100.0	100.0	100.0	100.0	100.0
Net interest income/operating revenues	43.0	46.6	46.6	47.9	50.0
Fee income/operating revenues	43.0	38.8	38.3	34.9	31.4
Market-sensitive income/operating revenues	1.0	0.7	1.6	3.4	3.7
Noninterest expenses/operating revenues	75.3	72.3	69.1	67.3	69.8
Preprovision operating income/average assets	0.6	0.6	0.6	0.6	0.6
Core earnings/average managed assets	0.4	0.5	0.5	0.5	0.5

*Data as of Sept. 30. N.A.--Not applicable.

Table 4

Aktia Bank PLC Risk-Adjusted Capital Framework Data

	Exposure*	**Basel III RWA**	**Average Basel III RW (%)**	**S&P Global Ratings' RWA**	**Average S&P Global Ratings' RW (%)**
Credit risk					
Government and central banks	777,990,055	1,361,309	0	25,574,110	3
Institutions and CCPs	1,502,132,158	209,153,900	14	209,420,548	14
Corporate	541,207,667	307,233,625	57	350,031,998	65
Retail	5,501,877,578	1,014,765,688	18	1,350,420,181	25
Of which mortgage	5,244,946,471	878,774,400	17	1,202,357,887	23
Securitization§	0	0	0	0	0
Other assets†	115,435,509	97,417,088	84	198,336,548	172
Total credit risk	8,438,642,967	1,629,931,609	19	2,133,783,386	25
Credit valuation adjustment					
Total credit valuation adjustment	--	9,124,563	--	0	--
Market risk					
Equity in the banking book	10,195,608	36,048,838	354	98,171,343	963
Trading book market risk	--	0	--	0	--

Table 4

Aktia Bank PLC Risk-Adjusted Capital Framework Data (cont.)

Total market risk	--	36,048,838	--	98,171,343	--
Operational risk					
Total operational risk	--	348,748,588	--	490,956,387	--
		Basel III RWA		**S&P Global Ratings' RWA**	**% of S&P Global Ratings' RWA**
Diversification adjustments					
RWA before diversification	--	2,122,903,596	--	2,722,911,116	100
Total Diversification/Concentration Adjustments	--	--	--	1,202,568,673	44
RWA after diversification		2,122,903,596		3,925,479,788	144
		Tier 1 capital	**Tier 1 ratio (%)**	**Total adjusted capital**	**S&P Global Ratings' RAC ratio (%)**
Capital ratio					
Capital ratio before adjustments	--	382,298,584	18.0	399,389,033	14.7
Capital ratio after adjustments‡	--	382,298,584	18.0	399,389,033	10.2

*Exposure at default. §Securitization exposure includes the securitization tranches deducted from capital in the regulatory framework. †Other assets includes Deferred Tax Assets (DTAs) not deducted from ACE. ‡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 June. 30, 2017, S&P Global Ratings.

Risk position: Moderate, given its retail mortgage lending concentration in Finland

Our view of Aktia Bank's risk position reflects the bank's concentrated loan book, which exposes the company to the Finnish economic trends and volatility in the domestic real estate market. This risk is partially offset by the high level of loan granularity, strong underwriting standards, and sound collateralization levels.

More specifically, we take a positive view of 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 (81% of the total loan book as of Sept. 30, 2017) exposes the bank to concentration risk and makes it vulnerable to real estate price developments in specific Finnish regions. 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. The weighted average loan-to-value (LTV) ratio is estimated at around 50% and less than 5% of the total loan stock has LTV ratios above 70%. We note that Aktia Bank has maintained prudent underwriting standards and, for example, did not offer amortization holidays on mortgage loan borrowers, which were observed in the Finnish market in 2015.

In line with Aktia Bank's revised strategy, we expect the SME portfolio will gradually increase to about 12%-15% of total loan portfolio over the next few years. As of Sept. 30, 2017, Aktia Bank's SME loan book was €605 million or 10% of the total loan book and did not show any significant single-name or sector concentration. Lending to housing corporations represented about 8% of the loan book as of third-quarter 2017, up from 4% in 2015, in line with Aktia Bank's growth strategy.

We consider Aktia Bank's risk culture to be sound, and we do not expect the bank to loosen its underwriting standards. The ratio of nonperforming loans to total loans was 0.8% as of Dec. 31, 2016, and consists of mainly household mortgages that were originated before the bank revised its underwriting standards in 2009. This figure decreased to 0.66% as of Sept. 30, 2017, with total write-downs amounting to 0.01% as a share of lending. The small SME portfolio shows somewhat weaker credit quality, but it is well collateralized. Furthermore, our view of low risk of economic imbalances in the Finnish household sector underpins our anticipation that Aktia Bank will maintain a low level of credit losses at about 0.05%-0.06% of loans in the near term, compared with almost non-existent credit losses in 2016. The bank's market risk is minor, since it has no trading book.

Table 5

Aktia Bank PLC Risk Position					
		--Year-ended Dec. 31--			
(%)	**2017***	**2016**	**2015**	**2014**	**2013**
Growth in customer loans	2.5	(2.5)	(8.7)	(5.7)	(5.5)
Total diversification adjustment / S&P RWA before diversification	N/A	46.9	15.8	11.0	N/A
Total managed assets/adjusted common equity (x)	24.0	24.0	22.1	20.6	21.3
New loan loss provisions/average customer loans	0	0	0	0	0
Net charge-offs/average customer loans	N.M.	0.1	0.1	0.1	0.0
Gross nonperforming assets/customer loans + other real estate owned	0.7	0.8	0.7	0.7	0.7
Loan loss reserves/gross nonperforming assets	120.5	104.3	125.0	129.3	144.4

*Data as of Sept. 30. RWA--Risk-weighted assets. N/A--Not available. N.M.--Not meaningful.

Funding and liquidity: Sound funding profile, benefitting from its regional deposit franchise and covered bonds issuances

Our view of Aktia Bank's funding as average is based on its sound regional franchise and proximity to customers that should continue to provide the bank with a relatively stable and granular inflow of core deposits (63% of funding as of Sept. 30, 2017). Aktia Bank has increased customer deposits gradually over the last five years, demonstrating funding flexibility, in our view. 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 to remain at the adequate level of 105.0%-110.0% over 2017-2018 (versus 110.4% as of Sept. 30, 2017).

The funding profile also benefits from the bank's access to capital markets through the issuance of covered bonds. Aktia Bank was granted a covered bond license in March 2013 and has issued covered bonds totaling €1.67 billion by third-quarter 2107. We believe that there is sound demand from the investors for further issuances, generally though, with the final transfer of AREMB's assets there has been a decrease in refinancing need.

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 88.4% as of Sept. 30, 2017. This is in line with the ratios of its domestic peers. As of third-quarter 2017, Aktia Bank's loan-to-core deposits ratio was about 141%, slightly above that of domestic peers operating solely in retail banking.

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 2.3x as of Sept. 30, 2017. Aktia Bank has an ample liquidity position of about €1.9 billion (Sept. 30, 2017), consisting of cash and securities, mainly covered bonds, which, to a large extent, are eligible for repurchase agreement (repo) transactions at the Finnish Central Bank. This level of liquidity is the result of sound liquidity management in order to smoothly handle upcoming maturities that can at times be sizable relative to the bank's balance sheet. With a regulatory liquidity coverage ratio of 116%, as of Sept. 30, 2017, Aktia Bank comfortably fulfils the future funding and liquidity requirements under the Basel III framework. Consequently, we believe that under stressful conditions involving the closure of access to capital market funding and a significant deposit outflow, Aktia Bank could survive for more than six months, but dependence on the central bank through the repo activity could become significant thereafter.

Table 6

Aktia Bank PLC Funding And Liquidity					
		--Year-ended Dec. 31--			
(%)	**2017***	**2016**	**2015**	**2014**	**2013**
Core deposits/funding base	54.8	55.7	50.1	45.8	45.7
Customer loans (net)/customer deposits	140.9	137.3	149.3	161.2	165.4
Long term funding ratio	88.4	89.9	87.8	79.6	82.2
Stable funding ratio	110.4	114.0	114.2	105.2	106.5
Short-term wholesale funding/funding base	12.4	10.8	13.1	22.0	19.1
Broad liquid assets/short-term wholesale funding (x)	2.3	2.8	2.5	1.5	1.6
Net broad liquid assets/short-term customer deposits	27.7	33.0	41.1	25.5	31.6
Short-term wholesale funding/total wholesale funding	27.5	24.4	26.3	40.5	35.1
Narrow liquid assets/3-month wholesale funding (x)	35.0	46.2	47.2	2.9	2.8

*Data as of Sept. 30.

External Support: No uplift for government or ALAC support

We consider Aktia Bank to have moderate systemic importance for Finland. This is based on our assessment of its position as the fourth-largest retail bank in Finland, where the bank has a meaningful market share of 3.7% in customer deposits in a market with other pan-Nordic groups that have sizable operations.

We believe the prospect of extraordinary government support for Finnish banks is now uncertain, following the full implementation of the EU Bank Recovery and Resolution Directive, including bail-in powers. We therefore classify Finland's tendency to support private sector commercial banks as uncertain.

Our assessment of Aktia Bank's ALAC does not lead us to add any uplift to the ratings. We view the Finnish resolution regime as effective under our ALAC criteria because, among other factors, we believe it contains a well-defined bail-in process under which authorities would permit non-viable systemically important banks to continue critical functions as going concerns following a bail-in of eligible liabilities. The Finnish FSA has given Aktia a minimum required eligible liabilities (MREL) requirement, which will be effective by the end of 2018. While Aktia is already compliant due to a stock of outstanding Tier 2 capital instruments that the bank has issued to its retail customers, the instruments are issued on an ad-hoc basis, and as a result, it is difficult to assess the stability of future issuance and the stability of our ALAC buffer. Increased clarity on potential replacement issuance via senior-non-preferred instruments, in addition to more specific recovery plans, might create more permanence over time and generally, we view Aktia Bank's Tier 2 capital instruments to be a stabilizing factor for our rating on the bank.

Related Criteria

- Criteria - Financial Institutions - General: Risk-Adjusted Capital Framework Methodology, July 20, 2017
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- Criteria - Financial Institutions - Banks: Bank Rating Methodology And Assumptions: Additional Loss-Absorbing Capacity, April 27, 2015
- General Criteria: Group Rating Methodology, Nov. 19, 2013
- Criteria - Financial Institutions - Banks: Quantitative Metrics For Rating Banks Globally: Methodology And Assumptions, July 17, 2013
- Criteria - Financial Institutions - Banks: Banks: Rating Methodology And Assumptions, Nov. 9, 2011
- Criteria - Financial Institutions - Banks: Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Related Research

- Banking Industry Country Risk Assessment Update: December 2017, Dec. 7, 2017
- Finland Ratings Affirmed At 'AA+/A-1+'; Outlook Stable, Sept. 15, 2017
- Banking Industry Country Risk Assessment: Finland, Jan. 30, 2017
- Various Positive Rating Actions On Finnish Banks On Improved Economic Conditions, Nov. 17, 2016

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 December 22, 2017)	
Aktia Bank PLC	
Counterparty Credit Rating	A-/Stable/A-2
Senior Unsecured	A-
Counterparty Credit Ratings History	
17-Nov-2016	A-/Stable/A-2
12-Dec-2012	A-/Negative/A-2

Ratings Detail (As Of December 22, 2017) (cont.)	
Sovereign Rating	
Finland (Republic of)	AA+/Stable/A-1+

*Unless otherwise noted, all ratings in this report are global scale ratings. S&P Global Ratings' credit ratings on the global scale are comparable across countries. S&P Global Ratings' 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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