MOODY'S
INVESTORS SERVICE

CREDIT OPINION
28 December 2018

Update

Rate this Research

RATINGS

Aktia Bank p.l.c.

Domicile	Finland
Long Term CRR	Aa3
Type	LT Counterparty Risk Rating - Fgn Curr
Outlook	Not Assigned
Long Term Debt	A1
Type	Senior Unsecured - Dom Curr
Outlook	Stable
Long Term Deposit	A1
Type	LT Bank Deposits - Fgn Curr
Outlook	Stable

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.

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Aktia Bank p.l.c.

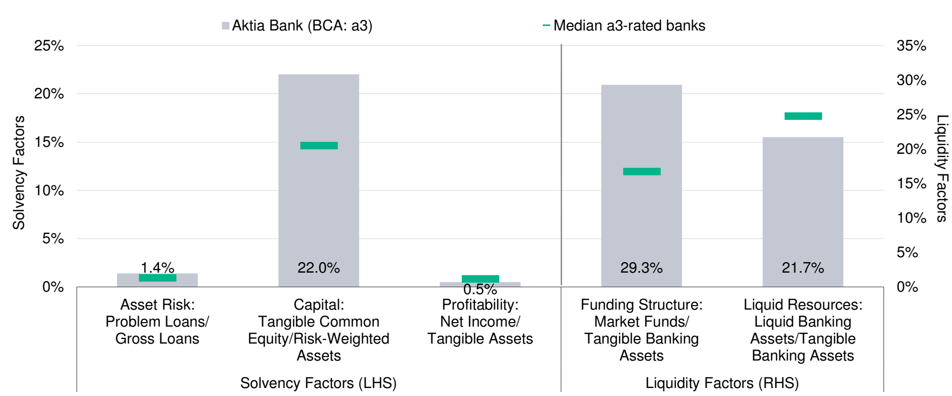
Update to credit analysis

Summary

Aktia Bank p.l.c's (Aktia) deposit ratings of A1/Prime-1 and its long-term senior unsecured debt rating of A1 incorporate (1) the bank's baseline credit assessment (BCA) of a3; (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 of rating uplift for Aktia's deposit and senior unsecured debt ratings; (3) our assumption of "low" government support from Finland (Aa1, stable[1]), which does not result in further ratings uplift. The counterparty risk rating of Aa3/P-1 incorporates the BCA of a3, and three notches as indicated by LGF. The bank's Counterparty Risk (CR) Assessment is Aa3(cr)/P-1(cr), also reflecting the BCA and three notches as indicated by LGF. The long-term ratings have a stable outlook due to the bank's expected stable fundamentals during the next 18 months, and because we expect that income diversification will remain also in a changing operating environment.

Aktia Bank's BCA of a3 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 some reliance on wholesale funding, the latter a common feature of Nordic banks.

Exhibit 1
Rating Scorecard - Key Financial Ratios



These represent our Banks methodology scorecard ratios, whereby asset risk and profitability reflect the weaker of either the three year average and the latest annual figure. Capital ratio is the latest reported figure. Funding structure and liquid resource ratios reflect the latest fiscal year-end figures
Source: Moody's Financial Metrics

Credit strengths

» Very strong asset quality

» High capitalisation and solid capital leverage ratios

Credit challenges

» Reliance on market funding

» Modest profitability as a result of low efficiency metrics, but improving income mix

Rating outlook

The stable outlook on Aktia Bank's long-term ratings reflects Moody's expectation that the bank's financial performance will be sustained over the outlook period (up to 18 months) and that the increased diversification of income sources will remain, also in a changing operating environment.

Factors that could lead to an upgrade

The ratings could be upgraded due to: 1) improvements in the fundamentals of the bank, such as lower levels of impaired loans, higher capitalization and a sustained improvement in profitability; and/or 2) a significantly higher cushion of loss absorbing obligations, providing protection to creditors and depositors in case of failure.

Factors that could lead to a downgrade

The ratings could be downgraded if the bank were to experience: (1) an unexpected 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; or (3) a lower amount of loss absorbing obligations providing protection to depositors and senior creditors in case of failure; and/or (4) a worsening in operating conditions in Finland.

Key indicators

Exhibit 2

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

	9-18[2]	12-17[2]	12-16[2]	12-15[2]	12-14[2]	CAGR/Avg.[3]
Total Assets (EUR million)	9,358	9,544	9,477	9,866	10,424	-2.8[4]
Total Assets (USD million)	10,869	11,461	9,996	10,718	12,613	-3.9[4]
Tangible Common Equity (EUR million)	497	475	480	487	481	0.9[4]
Tangible Common Equity (USD million)	577	571	506	529	583	-0.2[4]
Problem Loans / Gross Loans (%)	1.2	1.3	1.5	1.6	1.6	1.4[5]
Tangible Common Equity / Risk Weighted Assets (%)	22.0	22.9	24.0	24.4	14.8	21.6[6]
Problem Loans / (Tangible Common Equity + Loan Loss Reserve) (%)	13.5	14.6	16.4	17.1	18.7	16.0[5]
Net Interest Margin (%)	0.9	1.0	1.0	1.0	1.0	1.0[5]
PPI / Average RWA (%)	3.5	2.3	2.7	2.7	1.9	2.6[6]
Net Income / Tangible Assets (%)	0.7	0.4	0.5	0.5	0.5	0.5[5]
Cost / Income Ratio (%)	63.8	76.8	73.0	69.7	68.6	70.4[5]
Market Funds / Tangible Banking Assets (%)	28.8	29.3	27.7	29.1	31.1	29.2[5]
Liquid Banking Assets / Tangible Banking Assets (%)	19.1	21.7	21.4	23.2	23.9	21.8[5]
Gross Loans / Due to Customers (%)	150.8	142.9	138.5	150.7	162.7	149.1[5]

[1] All figures and ratios are adjusted using Moody's standard adjustments. [2] Basel III - fully-loaded or transitional phase-in; IFRS. [3] May include rounding differences due to scale of reported amounts. [4] Compound Annual Growth Rate (%) based on time period presented for the latest accounting regime. [5] Simple average of periods presented for the latest accounting regime. [6] Simple average of Basel III periods presented.
Source: Moody's Financial Metrics

Profile

Aktia Bank Plc is a Helsinki-based bank operating in Finland. Along with its subsidiaries, it provides banking and other financial services, including insurance, asset management and real estate finance, mainly to individuals, small companies and entrepreneurs. The bank had 770 employees and operated through 32 offices mainly in the coastal areas, Helsinki and in in-land growth areas as of end-September 2018.

As of March 2018, Aktia was the fifth-largest bank in Finland in terms of total assets, reporting a consolidated asset base of €9.4 billion. The bank reported market shares of 4.1% in housing loans and 3.3% of deposits as of end-August 2018.

Aktia's shares are listed on the Nasdaq Helsinki Ltd stock exchange. As of 1 December 2015, Aktia was included in the OMX Helsinki Benchmark, which consists of the largest and most traded shares on Nasdaq Helsinki. As of 30 November 2018, the bank's largest shareholder was Stiftelsen Tre Smeder Sr, which owned 9.4% of its total share capital.

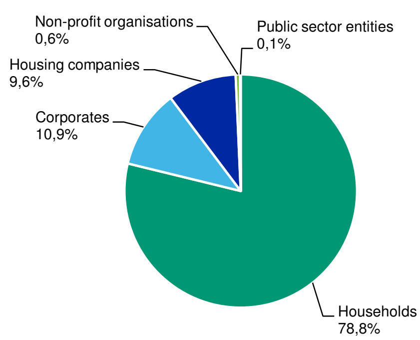
For more information on the bank, please see Issuer Profile - Aktia Bank p.l.c. published 10 July 2018. For information on the Finnish banking system, please see Banking System Outlook - Finland, published 18 October 2017.

Detailed credit considerations

Evolving business franchise, with growth prospects supported by improving economic trends

Aktia Bank's loan book is predominantly exposed to households loans (mainly in the Helsinki area) representing 78.8% and 20.5% of corporate lending – consisting of SMEs at 10.9% and housing associations at 9.6% - at end-September 2018 (see exhibit 3). Total corporate lending amounted to EUR655 million (as of end-September 2017: EUR592 million) and loans to housing companies increased by 18%, totalling EUR580 million. Aktia's new lending to private households amounted to EUR616 million (as of end-September 2017: EUR652 million). In March 2018, the Finnish Financial Supervisory Authority (FFSA) announced to tighten the maximum loan-to-collateral (LTC) ratio for residential mortgages, other than loans to first time buyers to, 85%. This took effect on 1 July 2018, which reduces the risk of borrowers having negative equity if house prices decline. (see Finnish banks and covered bonds will benefit from tightened limits on residential mortgages, published 22 March 2018).

Exhibit 3
Aktia's loan book breakdown per Q3 2018



Sources: Moody's Investor Service, company reports

We expect that Aktia Bank's focus on expanding its own brand, growing customer base and improving profitability will benefit from the supportive operating environment and positive albeit moderating growth forecasts (real GDP growth of 2.7%, 2.0% and 1.8% in 2018, 2019 and 2020 respectively). The bank has successfully launched its new core banking system during 2017, which we expect to bring longer term cost benefits for the continuous digitalisation of Aktia's business offering, allowing it to be in a better position to compete with the larger market participants.

Due to the increasingly diversified income and earnings mix, the negative adjustment notch for "monoline" is no longer incorporated in the ratings. Asset management and insurance income has gradually grown in importance, resulting in more than half of operating income and earnings during 2017 coming from non-mortgage related activities (approximately the same level for end-September 2018), effectively mitigating lower income from the retail mortgage book due to lower interest rates.

Strong asset quality and solid capitalisation

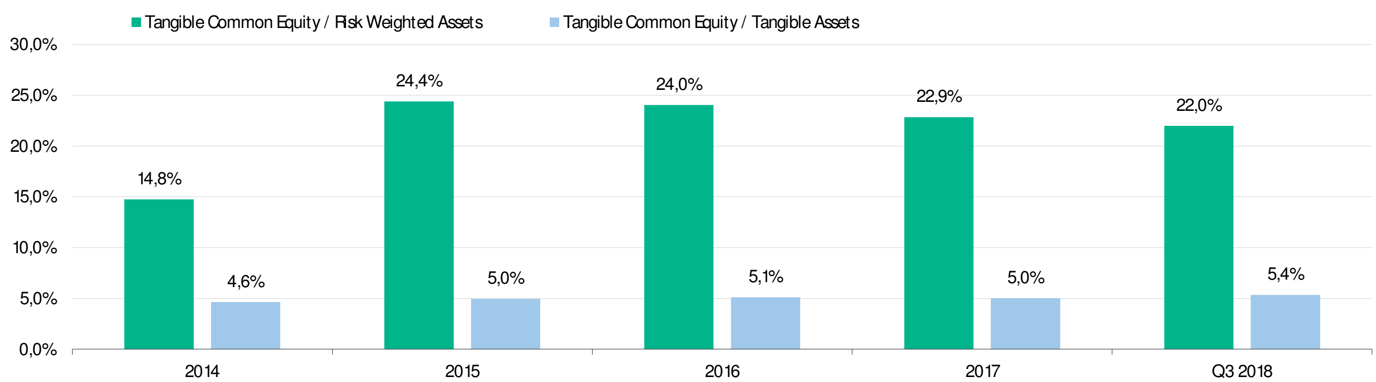
Aktia's history of strong and stable asset quality reflecting its portfolio of loans dominated by Finnish mortgages, with the problem loans ratio decreasing to 1.19% as of end-September 2018 from 1.29% as of year-end 2017, mainly due to the implementation of IFRS9 (see FAQ: Limited impact from IFRS 9 first time adoption, but disclosure uneven so far, published 30 April 2018). The loan loss provisions stood around 1.19% of pre-provision income during first nine months of 2018, and was in line with 1.18% at end-December 2017. We assign Aktia Bank's asset risk position an a1 score, consistent with the bank's historic low problem loan ratio of 1.4%.

Aktia Bank reports a strong regulatory capitalisation, with a reported Common Equity Tier 1 (CET1) ratio of 16.6% and a total capital ratio of 20.1% at end-September 2018. The CET1 ratio declined from 18.0% in year-end 2017 mainly because of the implementation of the Finnish risk weight floor on mortgages of 15%, which has resulted in additional EUR188 million of risk weighted assets, as of end-September 2018. The bank however still has a very high headroom of 630 bps against the regulatory requirements of CET1.

The FFSA announced in June 2018 an increase of systemic risk-buffer requirement that will strengthen Finnish banks' ability to withstand adverse market developments. The requirement varies depending on the size of the credit institution and its contribution to systemic risks. This will be implemented on 1 July 2019 (see Finnish banks' increased capital requirements will be positive for unsecured and covered bonds, published 2 July 2018). For Aktia, a 1% systemic risk-buffer has been concluded and will be met with CET1 capital.

Aktia Bank solid capital position is also reflected by its Tangible Common Equity (TCE) to risk weighted assets ratio of 22% as of end-September 2018 (see exhibit 4). This ratio is considerably higher compared to year-end 2014, because in February 2015 the FFSA 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. The bank's tangible common equity to tangible assets reached 5.4% at end-September 2018 compared to 5.0% at year-end 2017. However, historically Aktia's leverage ratio was on a weaker side as a consequence of lower internal capital generation. To reflect this low leverage ratio we adjust Aktia Bank's Capital score down by two notches to aa3.

Exhibit 4
Aktia Bank's capitalisation metrics

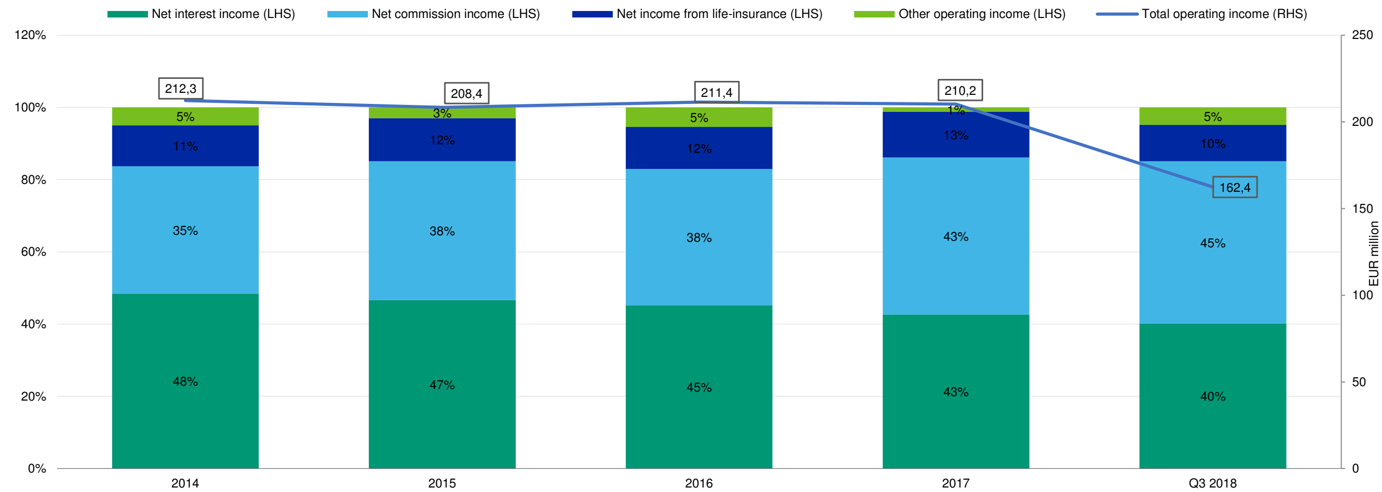


Source: Moody's Investors Service

Increased commission income and cost savings mitigate lower net interest rate income

Finnish household lending space is competitive, and Aktia has a limited ability to influence lending rates and consequently its profitability. However, its focus on asset management has diversified the bank's income sources, and has mitigated lower net interest income in the retail business, contributing increasingly to both income and earnings. Net commission income increased by 8%, to EUR73 million, in end-September 2018 compared to same period in 2017, contributing with 45% of the bank's total operating income of EUR162.4 million (end-September 2017: EUR157.6 million), driven mainly by fees from assets management (see exhibit 5). Especially Aktia's expertise in fixed income has allowed it to increase sales to institutional investors.

Exhibit 5
Breakdown of Aktia's operating income

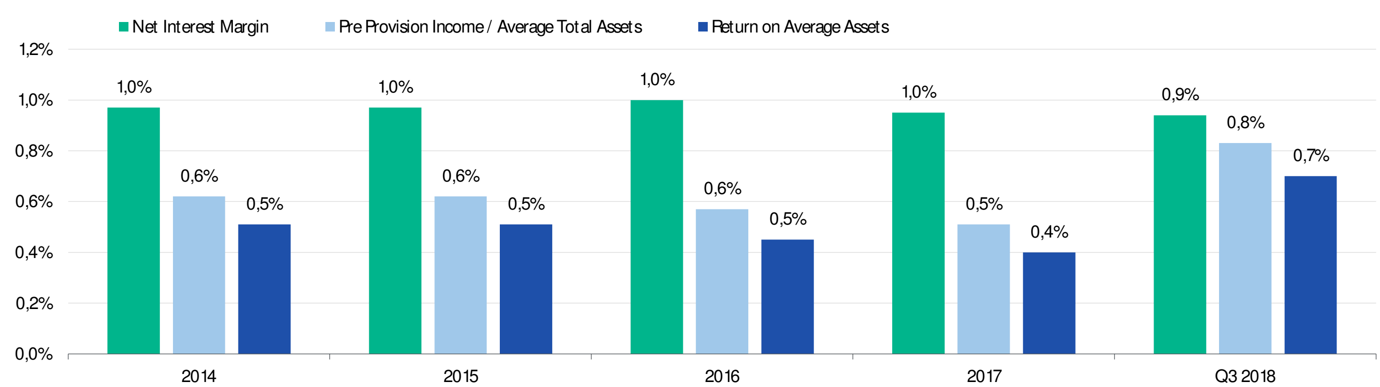


Sources: Moody's Investor Service, company reports

Aktia Bank's overall profitability is impacted by the bank's low efficiency metrics, even though the first nine months of 2018 (cost to income ratio of 64%) was better than the bank's previous years, with a cost-to-income ratio of 75% during first nine months of 2017. To improve the performance of the bank, in October 2017, the board of directors renewed its strategies and set an objective to reduce the cost to income ratio to 61% by the end of 2022. One major undertaking the bank has successfully concluded is the implementation of the new core banking system and IT platform. The total investments exceeds EUR62 million, and from year end 2017 the bank expects the investments to translate into lower running technology costs and new solutions for customers. Aktia's operating expenses excluding loan loss provisions decreased by 13% in end-September 2018 compared to same period in 2017, due to decreased staff costs and IT expenses as part of the bank's strategy plan.

While we expect some benefits of the new platform to materialise in the coming year, we see the bank's low efficiency as a weakness. Although Aktia Bank's profitability is modest, it has shown stability over the past few years as, reflecting the low risk balance sheet. During the first nine months of 2018, the bank's net income over tangible assets was 0.7%, an improvement from the 0.4% in the same period of last year, translating to an increased pre-provision income to average total assets of 0.8% for end-September 2018 (end-December 2017: 0.5%) (see exhibit 6).

Exhibit 6
Aktia Bank's profitability metrics



Source: Moody's Investors Service

Although Aktia's profitability will benefit from the bank's focus on diversifying income, we expect that the low interest environment will continue to be a challenge, and that the cost savings will take time to materialise visibly, which is reflected in our assigned Profitability score of ba1.

Gradually increasing reliance on market funding and solid liquidity buffer

Aktia has gradually increased its reliance on market funding, which we view negatively because it increases susceptibility to sudden changes in investor sentiment. However, a 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 was 28.8% as of end-September 2018, compared to 29.3% at end-December 2017, although we do not expect that this ratio will decline much more but rather increase in the future.

Given that deposits from the public and public sector has gradually decreased in combination with a growing loan portfolio, the share of Aktia Bank's balance sheet funded through customer deposits has decreased. The bank's gross loans to deposits from the public and public sector increased to 151% at end-September 2018 compared to 143% at end-December 2017.

Aktia Bank's liquidity portfolio accounts for approximately 17% of the balance sheet and is of good quality. Its liquid assets mainly include covered bonds and highly rated sovereign debt. The bank's liquidity coverage ratio (LCR) is above the minimum requirements, but decreased to 118% as of end September 2018, compared to 161% at end-December 2017 (end-September 2017: 116%).

Source of facts and figures cited in this report

Unless noted otherwise, the bank specific figures originate from bank's reports and Moody's Banking Financial Metrics. All figures are based on our own chart of accounts and may be adjusted for analytical purposes. Please refer to the document Financial Statement Adjustments in the Analysis of Financial Institutions, published on 9 August 2018.

Support and structural 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.

Moody’s considers that Aktia Bank's junior depositors and senior unsecured investors are likely to face very low loss-given-failure, owing to the substantial cushion of loss absorbing obligations protecting depositors and senior creditors.

The minimum requirement of own funds and eligible liabilities (MREL) do not have any impact on Aktia’s LGF analysis, with the requirement being fulfilled already.

The deposit and senior ratings of A1 continue to incorporate two notches of uplift, from the adjusted BCA of a3, due to the large cushion of loss absorbing obligations protecting depositors and creditors in case of failure, as indicated by Moody’s Advanced Loss Given Failure (LGF) analysis.

Government support

Due to the limited size of Aktia, with market shares of 4.1% in housing loans and 3.3% of deposits as of August 2018, and Finland being part of the EU, which is an operational resolution regime, we expect government support to be low. Thus Aktia Bank's ratings do not benefit from government support.

Counterparty Risk Ratings (CRR)

CRRs are opinions of the ability of entities to honour the uncollateralised portion of non-debt counterparty financial liabilities (CRR liabilities) and also reflect the expected financial losses in the event such liabilities are not honoured. CRRs are distinct from ratings assigned to senior unsecured debt instruments and from issuer ratings because they reflect that, in a resolution, CRR liabilities might benefit from preferential treatment compared with senior unsecured debt. Examples of CRR liabilities include the uncollateralised portion of payable arising from derivatives transactions and the uncollateralised portion of liabilities under sale and repurchase agreements.

The CRR's of Aktia are positioned at Aa3/Prime-1

The counterparty risk rating of Aa3 reflects the adjusted BCA of a3, and three notches of uplift reflecting the extremely low loss-given-failure from the high volume of instruments that are subordinated to CRR liabilities. The short-term CRR is P-1.

Counterparty Risk (CR) 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 Assessment of Aktia are positioned at Aa3(cr)/Prime-1(cr)

The CR Assesment of Aktia Bank is positioned at Aa3(cr), three notches above the Adjusted BCA of a3, 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 7

Aktia Bank p.l.c.

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

Factor	**Historic Ratio**	**Initial Score**	**Expected Trend**	**Assigned Score**	**Key driver #1**	**Key driver #2**
Solvency						
Asset Risk						
Problem Loans / Gross Loans	1.4%	aa3	←→	a1	Quality of assets	
Capital						
TCE / RWA	22.0%	aa1	←→	aa3	Nominal leverage	
Profitability						
Net Income / Tangible Assets	0.5%	baa2	←→	ba1	Earnings quality	
Combined Solvency Score		aa3		a2		
Liquidity						
Funding Structure						
Market Funds / Tangible Banking Assets	29.3%	baa2	←→	baa2	Extent of market funding reliance	
Liquid Resources						
Liquid Banking Assets / Tangible Banking Assets	21.7%	baa1	←→	baa1	Stock of liquid assets	
Combined Liquidity Score		baa2		baa2		
Financial Profile				a3		
Business Diversification				0		
Opacity and Complexity				0		
Corporate Behavior				0		
Total Qualitative Adjustments				0		
Sovereign or Affiliate constraint:				Aa1		
Scorecard Calculated BCA range				a2-baa1		
Assigned BCA				a3		
Affiliate Support notching				0		
Adjusted BCA				a3		

Balance Sheet	**in-scope (EUR million)**	**% in-scope**	**at-failure (EUR million)**	**% at-failure**
Other liabilities	2,930	35.6%	3,212	39.0%
Deposits	4,025	48.9%	3,743	45.5%
Preferred deposits	3,623	44.0%	3,441	41.8%
Junior Deposits	403	4.9%	302	3.7%
Senior unsecured bank debt	821	10.0%	821	10.0%
Dated subordinated bank debt	208	2.5%	208	2.5%
Equity	247	3.0%	247	3.0%
Total Tangible Banking Assets	8,231	100%	8,231	100%

Debt class	De Jure waterfall		De Facto waterfall		Notching		LGF Notching Guidance vs. Adjusted 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 Rating	19.2%	19.2%	19.2%	19.2%	3	3	3	3	0	aa3
Counterparty Risk Assessment	19.2%	19.2%	19.2%	19.2%	3	3	3	3	0	aa3 (cr)
Deposits	19.2%	5.5%	19.2%	15.5%	2	3	2	2	0	a1
Senior unsecured bank debt	19.2%	5.5%	15.5%	5.5%	2	1	2	2	0	a1

Instrument class	Loss Given Failure notching	Additional Notching	Preliminary Rating Assessment	Government Support notching	Local Currency Rating	Foreign Currency Rating
Counterparty Risk Rating	3	0	aa3	0	Aa3	Aa3
Counterparty Risk Assessment	3	0	aa3 (cr)	0	Aa3 (cr)	--
Deposits	2	0	a1	0	A1	A1
Senior unsecured bank debt	2	0	a1	0	A1	--

[1] Where dashes are shown for a particular factor (or sub-factor), the score is based on non-public information.
Source: Moody's Financial Metrics

Ratings

Exhibit 8

Category	Moody's Rating
AKTIA BANK P.L.C.	
Outlook	Stable
Counterparty Risk Rating	Aa3/P-1
Bank Deposits	A1/P-1
Baseline Credit Assessment	a3
Adjusted Baseline Credit Assessment	a3
Counterparty Risk Assessment	Aa3(cr)/P-1(cr)
Senior Unsecured -Dom Curr	A1
Senior Unsecured MTN (Domestic)	(P)A1
Other Short Term -Dom Curr	(P)P-1

Source: Moody's Investors Service

Endnotes

1 The ratings shown in this report are the long-term issuer rating

REPORT NUMBER 1152203

CLIENT SERVICES

Americas	1-212-553-1653
Asia Pacific	852-3551-3077
Japan	81-3-5408-4100
EMEA	44-20-7772-5454

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