S&P Global
Ratings

RatingsDirect®

Aktia Bank PLC

Primary Credit Analyst:
Salla von Steinaecker, Frankfurt (49) 69-33-999-164; salla.vonsteinaecker@spglobal.com

Secondary Contact:
Antonio Rizzo, Madrid (34) 91-788-7205; Antonio.Rizzo@spglobal.com

Table Of Contents

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 risk-adjusted 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

The stable outlook on Finland-based Aktia Bank reflects our view that it will maintain its market position as a well-established local retail franchise in Finland with expanding wealth management operations. The outlook also reflects our expectation that improving earnings capacity will support the bank's RAC ratio over the next 12-24 months. The sound economic conditions in Finland further underpin this view.

Downside scenario

We could take a negative rating action if Aktia Bank's position weakens, such that the bank's profitability and market shares decline. If the bank's lending growth leads to a lower RAC ratio than we expect, we could also take a negative rating action. However, we do not believe this would lead to a two-notch downgrade given Aktia Bank's potential ALAC buffer.

Upside scenario

We currently consider a positive rating action unlikely. Insights into the resolution strategy to be applied to Aktia Bank, a potential subordination requirement on minimum requirements for own funds and eligible liabilities (MREL), and clarity on the bank's senior nonpreferred instruments issuance plan, could lead us to consider an ALAC-uplift. The upgrade would be conditional of Aktia Bank's overall creditworthiness being in line with that of higher rated international peers.

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 focus primarily on retail mortgage lending and small-and midsize enterprises (SMEs) in selected areas in Finland. The bank's growing wealth and asset management operations to both retail and institutional clients provide positive diversification to revenues and net income. Our ratings also encompass Aktia Bank's very strong risk-adjusted capitalization and stable earnings, underpinned by our expectation the the risk-adjusted capital (RAC) ratio will be close to 16% in the next 24 months. They equally reflect the concentration risks in Aktia Bank's loan portfolio, partly mitigated by a high level of collateralization and a good track record of low credit losses, its funding profile in line with the domestic peers, 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 second-tier retail bank in terms of assets in Finland and its market share in mortgage loans and 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. We could consider incorporating uplift for additional loss-absorbing capacity (ALAC) into the ratings on Aktia Bank once we have further insights into the resolution strategy applied to the bank and its plans to build up sustainable ALAC buffers through issuance of senior nonpreferred instruments.

Anchor: 'a-' for banks operating solely 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, wealthy, and open economy, with mature political and institutional structures. After a prolonged recession in 2012-2015, growth has picked up substantially. We forecast GDP growth will reach 2.7% in 2018, supported by strong domestic and external demand. However, we project growth will slow to around 1.5% by 2020. We expect structural factors, such as low real wage growth and still elevated unemployment, will weigh on the economy. At the same time, we observe improving consumer confidence and household demand for unsecured lending. This, combined with strong growth in housing corporation loans, has led to a further increase in household debt to a record 128.7% of disposable income, although this is lower than that of Nordic peers. Still, we believe Finnish banks' asset quality will remain strong over the next two years, based on the sound financial positions of the household and corporate sectors, banks' conservative underwriting standards (combined with stricter regulatory requirements), and the very low interest rate environment. However, a departure from prudent lending standards, combined with increases in interest rates, could strain households' debt-servicing capacity in the medium term. As such, we view the economic risk trend in Finland as stable, with stable house prices, and a government committed to addressing structural reform needs, as well as increased investments and net exports, which are supporting robust economic growth.

We see industry risk in Finland as moderate, the competitive landscape as stable, and we expect risk appetite to remain moderate. The redomicile of Nordea to Finland in October 2018 will not, in our view, change the competitive situation in the Finnish banking sector because the bank's actual operations in other Nordic markets will remain unchanged. However, the move increased the size of Finland's banking sector to GDP to about 400% and could make it more vulnerable to external factors. We expect the banking sector to maintain stable and sound profitability as well as strong capitalization. The main weakness for Finnish banks remains their structural funding gap and high dependence on international market funding, which makes them vulnerable to confidence sensitivity. That said, the banks continue to demonstrate good access to both secured and unsecured capital markets.

Table 1

Aktia Bank PLC Key Figures

		--Year-ended Dec. 31--			
(Mil. €)	**2018***	**2017**	**2016**	**2015**	**2014**
Adjusted assets	8,472.6	8,676.3	8,699.1	9,163.0	10,125.1
Customer loans (gross)	6,070.0	5,884.8	5,765.4	5,911.3	6,475.5
Adjusted common equity	421.0	391.4	396.0	446.8	518.6
Operating revenues	163.8	210.7	205.2	209.0	214.5
Noninterest expenses	103.6	160.7	148.4	144.4	144.5
Core earnings	49.5	39.2	43.8	51.6	55.0

*Data as of Sept. 30.

Business position: Moderate, due to a solid local retail and SME franchise in Finland

Our assessment of Aktia Bank's business position reflects its concentrated business model as a regional retail bank focused primarily on low-risk collateralized lending to retail clients and SMEs.

Aktia Bank is a midsize commercial bank with total assets of €9.4 billion as of Sept. 30, 2018. The bank has a well-established, local retail franchise in growth regions in Finland's coastal areas and larger cities, with about 350,000 customers catered through 32 branches. Aktia Bank enjoys a stable market share of 4.1% in residential mortgage lending and 3.3% in customer deposits. Aktia has gradually increased its wealth management business and, in our view, improved cross selling via asset management and life insurance products could have a positive impact on the bank's market position in future periods. In terms of geography, the focus is expected to remain contained to the bank's core regions in Finland, mainly the Helsinki metropolitan area and west coast of Finland.

We view Aktia Bank's regional concentration and narrow product focus on residential mortgage lending as the main weaknesses of 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 entrepreneurs and SMEs, which should enable further cross-selling potential.

Aktia Bank's wealth management activities complement its core product offering and, in our opinion, the segment brings moderate diversification benefits to the group. Together, these activities make up about one-third of Aktia Bank's operating revenues and operating profit as of Sept. 30, 2018. Its asset management activities, with assets under management of €10.8 billion as of Sept. 30, 2018, are steadily growing. Aktia Life remains relatively small in the Finnish life insurance market.

While there have been changes to Aktia Bank's management team, we expect the new CEO Mr. Mikko Ayub to further develop the bank's current strategy. Moreover, the bank has now launched its updated core banking system, which should allow for continued digital development and improve cost efficiency going forward. The costs related to both IT and personnel have decreased and we believe the bank will be able to reach its cost income target over the strategy period by 2022.

Table 2

Aktia Bank PLC Business Position

		--Year-ended Dec. 31--			
(%)	**2018***	**2017**	**2016**	**2015**	**2014**
Loan market share in country of domicile	4.1	4.2	4.1	4.1	4.1
Deposit market share in country of domicile	3.3	3.5	3.7	3.8	3.9
Total revenues from business line (currency in millions)	163.8	210.9	212.1	209.0	214.5
Commercial & retail banking/total revenues from business line	55.1	76.9	77.2	79.1	78.9
Insurance activities/total revenues from business line	29.1	25.5	21.7	22.2	20.3
Other revenues/total revenues from business line	15.9	(2.4)	1.1	(1.3)	0.8
Return on average common equity	11.2	6.5	8.0	8.4	8.7

*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 hover close to 16% over the next 12-24 months, compared to 15.9% on June 30, 2018, and 15.7% as of year-end 2017 (see table 4). This is supported by a positive earnings 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.

Looking ahead, lending growth is expected to be broadly in line with the market. 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. We forecast that Aktia Bank's average net interest margin will likely bottom out in 2019 as the positive impact from the winddown of interest rate hedges fades out. Furthermore, we anticipate positive developments in net fee and commission income, owing to the bank's asset management and life insurance businesses. This should lead to an increased contribution of non-interest income to the bank's operating revenues. We also expect Aktia Bank's organizational streamlining will enable it to meet its cost-efficiency target to reduce the cost-to-income ratio to around 62% by 2020. This supports our view that core earnings will gradually increase to €60 million-€65 million over 2019-2020. Following the higher-than-average dividend payout of 80% of net profits in 2016 (resulting from various one-off effects), we expect the bank to distribute about 70% of its earnings (guidance is a 60% to 80% payout ratio).

We expect our three-year average earnings buffer on Aktia Bank to exceed 200 basis points (bps). This reflect our view that Aktia Bank's earnings capacity is expected to strengthen, owing to stable operating revenues, planned cost cuts, and our expectation of continued low loan losses.

Table 3

Aktia Bank PLC Capital And Earnings

		--Year-ended Dec. 31--			
(%)	**2018***	**2017**	**2016**	**2015**	**2014**
Tier 1 capital ratio	16.6	18.0	19.5	20.7	14.6
S&P Global Ratings' RAC ratio before diversification	N/A	15.6	15.1	14.5	13.5
S&P Global Ratings' RAC ratio after diversification	N/A	10.5	10.3	12.5	12.2
Adjusted common equity/total adjusted capital	100.0	100.0	100.0	100.0	100.0
Net interest income/operating revenues	39.8	42.5	46.6	46.6	47.9
Fee income/operating revenues	44.6	43.4	38.8	38.3	34.9
Market-sensitive income/operating revenues	3.7	0.3	0.7	1.6	3.4
Noninterest expenses/operating revenues	63.2	76.3	72.3	69.1	67.3
Preprovision operating income/average assets	0.8	0.5	0.6	0.6	0.6
Core earnings/average managed assets	0.7	0.4	0.5	0.5	0.5

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

Table 4

Aktia Bank PLC RACF [Risk-Adjusted Capital Framework] Data

(Mil. €)	Exposure*	Basel III RWA	Average Basel III RW (%)	S&P Global RWA	Average S&P Global RW (%)
Credit risk					
Government and central banks	619.9	0.8	0	20.2	3
Of which regional governments and local authorities	228.8	0.8	0	8.2	4
Institutions and CCPs	1,317.4	154.0	12	170.9	13
Corporate	668.1	393.7	59	432.0	65
Retail	5,631.4	991.8	18	1,401.6	25
Of which mortgage	5,330.0	832.2	16	1,223.5	23
Securitization§	0.0	0.0	0	0.0	0
Other assets†	114.1	113.5	99	112.6	99
Total credit risk	8,350.9	1,653.8	20	2,137.3	26
Credit valuation adjustment					
Total credit valuation adjustment	--	14.1	--	0.0	--
Market risk					
Equity in the banking book	9.7	36.2	373	90.7	935
Trading book market risk	--	0.0	--	0.0	--
Total market risk	--	36.2	--	90.7	--
Operational risk					
Total operational risk	--	349.9	--	362.3	--
		Basel III RWA		**S&P Global RWA**	**% of S&P Global RWA**
Diversification adjustments					
RWA before diversification		2,149.9	0.0	2,590.3	100
Total Diversification/Concentration Adjustments		--	0.0	948.2	37
RWA after diversification		2,149.9	0.0	3,538.5	137
		Tier 1 capital	**Tier 1 ratio (%)**	**Total adjusted capital**	**S&P Global RAC ratio (%)**
Capital ratio					
Capital ratio before adjustments		377.0	17.5	410.6	15.9
Capital ratio after adjustments‡		377.0	17.5	410.6	11.6

*Exposure at default. §Securitisation Exposure includes the securitisation 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, 2018, S&P Global.

Risk position: Moderate, given its retail mortgage lending concentration in Finland but underpinned by a good loan loss track record

Our view of Aktia Bank's risk position reflects the bank's concentrated loan book, which exposes the company to Finnish economic trends and potential 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 collateralized loans to SMEs. However, we still consider that the regionally focused retail loan book (78% of the total loan book as of Sept. 30, 2018) 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 and economically stronger regions where we assume housing prices remain more stable. The weighted average loan-to-value (LTV) ratio in the mortgage book is estimated at around 50%, and less than 5% of the total loan stock has LTV ratios above 70%.

We expect the SME portfolio will gradually increase to about 12%-15% of the total loan portfolio over the next few years. As of Sept. 30, 2018, Aktia Bank's SME loan book was €655 million, or 11% of the total loan book, and did not show any significant single-name or sector concentration. Lending to housing corporations represented about 10% of the loan book as of third-quarter 2018, but we do not believe Aktia will target further growth in this highly competitive segment.

We consider Aktia Bank's risk culture to be sound, and we do not expect the bank to depart from its underwriting standards. The ratio of nonperforming loans to total loans was 0.68% as of Sept. 30, 2018, and consists mainly of household mortgages that were originated before the bank revised its underwriting standards in 2009. The SME portfolio shows somewhat weaker credit quality, but it is well collateralized. Furthermore, our view of low risk of economic imbalances underpins our anticipation that Aktia Bank will maintain a low level of credit losses in the near term, following marginal credit losses of 2 basis points (bps) in 2017 and in first nine months 2018. The bank's market risk is minor, since it has no trading book.

Table 5

Aktia Bank PLC Risk Position

		--Year-ended Dec. 31--			
(%)	**2018***	**2017**	**2016**	**2015**	**2014**
Growth in customer loans	4.2	2.1	(2.5)	(8.7)	(5.7)
Total diversification adjustment/S&P Global Ratings' RWA before diversification	N/A	48.6	46.9	15.8	11.0
Total managed assets/adjusted common equity (x)	22.2	24.4	24.0	22.1	20.6
New loan loss provisions/average customer loans	0.02	0.02	0.04	0.01	0.03
Net charge-offs/average customer loans	N.M.	0.02	0.14	0.09	0.11
Gross nonperforming assets/customer loans + other real estate owned	0.68	0.61	0.80	0.74	0.71
Loan loss reserves/gross nonperforming assets	100.5	127.8	104.3	125.0	129.3

*Data as of Sept. 30. N/A--Not applicable. 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 retail franchise and proximity to customers that should continue to provide the bank with a relatively stable and granular inflow of deposits.

The customer deposits make up 56% of the bank's funding base as of Sept. 30, 2018, and a major part is from households, followed by SME clients. About three-quarters of all deposits are covered by the Finnish deposits insurance scheme. As of third-quarter 2018, Aktia Bank's loan-to-core customer deposits ratio was about 150%, slightly above that of domestic peers operating solely in retail banking.

As a mitigant to the structural funding gap, Aktia demonstrates proven access to capital markets through the issuance of covered bonds. Aktia Bank was granted a covered bond license in March 2013 and had issued covered bonds totaling €1.67 billion (or 22% of funding base) by third-quarter 2018. We believe that there is sound demand from investors for further issuances.

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 82.2% as of Sept. 30, 2018, in line with the structure of its domestic peers. Furthermore, we expect Aktia Bank's stable funding ratio to remain in the range of 105%-110% over 2018-2019 (100.4% as of Dec. 2017 and five-year average of 107%). We believe the bank will continue to refinance the redemption ahead of the maturities, which might lead to temporary volatility in 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 wholesale funding) of 1.34x as of Sept. 30, 2018. Aktia Bank has an ample liquidity position of about €1.9 billion (Sept. 30, 2018), 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 any upcoming maturities that can at times be sizable relative to the bank's balance sheet. 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--			
(%)	**2018***	**2017**	**2016**	**2015**	**2014**
Core deposits/funding base	54.3	54.5	55.7	50.1	45.8
Customer loans (net)/customer deposits	149.8	141.8	137.3	149.3	161.2
Long-term funding ratio	82.2	81.9	89.9	87.8	79.6
Stable funding ratio	99.6	103.0	114.0	114.2	105.2
Short-term wholesale funding/funding base	19.1	19.3	10.8	13.1	22.0
Broad liquid assets/short-term wholesale funding (x)	1.3	1.5	2.8	2.5	1.5
Net broad liquid assets/short-term customer deposits	11.3	16.6	33.0	41.1	25.5
Short-term wholesale funding/total wholesale funding	41.7	42.5	24.4	26.3	40.5
Narrow liquid assets/3-month wholesale funding (x)	25.8	27.9	46.2	47.2	2.9

*Data as of Sept. 30.

Support: No uplift for ALAC support

Given Aktia Bank's status as a second-tier retail bank in terms of retail mortgages and customer deposits, we consider the bank of moderate systemic importance to Finland's banking sector.

Furthermore, the Finnish resolution authority's MREL are twice Aktia Bank's minimum regulatory capital requirement (effective as of Dec. 31, 2018), fortifying our view that the bank conducts critical functions in Finland. We view the Finnish resolution regime as effective under our ALAC criteria. This is because, among other factors, we believe it contains a well-defined bail-in process under which authorities would permit nonviable systemically important banks to continue critical functions as going concerns following a bail-in of eligible liabilities.

However, our assessment of Aktia Bank's ALAC does not lead us to add any uplift to the ratings. We could consider incorporating uplift for ALAC once we have further insight regarding the resolution strategy applied to the bank and its plans to build up sustainable ALAC buffers through issuance of subordinated instruments in the medium term.

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
- Criteria - Financial Institutions - Banks: Bank Hybrid Capital And Nondeferrable Subordinated Debt Methodology And Assumptions, Jan. 29, 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

- Finland-Based Aktia Bank Ratings Affirmed At 'A-/A-2' On Improving Earnings Capacity; Outlook Stable, Nov. 22, 2018
- Banking Industry Country Risk Assessment Update: November, Nov. 23, 2018
- Nordic Banks Sport Strong Capital--And It's Not Likely To Soften, Oct. 17, 2018
- Nordic Bank Ratings Continue To Stand Tall, Aug. 16, 2018
- Second Chapter Of Nordic Resolution Regimes Approaches An End, But The Book Is Not Complete, Feb. 14, 2018
- Banking Industry Country Risk Assessment: Finland, Feb. 2, 2018

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 18, 2018)

Aktia Bank PLC	
Issuer Credit Rating	A-/Stable/A-2
Senior Unsecured	A-
Issuer Credit Ratings History	
17-Nov-2016	A-/Stable/A-2
12-Dec-2012	A-/Negative/A-2
Sovereign Rating	
Finland	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.