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Research Update:

Finland-Based Aktia Bank Assigned 'A-/A-2' Long- And Short-Term Ratings; Outlook Negative

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Overview

- In our view, Aktia Bank, a midsize retail bank focusing on residential mortgage lending in Finland, has a moderate business position, strong capital and earnings, a moderate risk position, average funding, and adequate liquidity, underpinning our assessment of the bank's stand-alone credit profile at 'bbb+'.
- We consider that Aktia Bank has moderate systemic importance in Finland and consequently factor one notch of extraordinary government support into the ratings on the bank.
- We are consequently assigning our 'A-/A-2' long- and short-term ratings to Aktia Bank.
- The outlook is negative, reflecting our view of growing economic risks in the export-oriented Finnish economy, which could adversely affect the Finnish banking sector's performance.

Rating Action

On Dec. 12, 2012, Standard & Poor's Ratings Services assigned its 'A-/A-2' long- and short-term counterparty ratings to Finland-based Aktia Bank PLC. The outlook is negative.

Rationale

The ratings reflect Aktia Bank's "moderate" business position, "strong" capital and earnings, "moderate" risk position, "average" funding and "adequate" liquidity, as our criteria define these terms.

We assess Aktia Bank's stand-alone credit profile (SACP) at 'bbb+'.

Under our banking criteria we use our Banking Industry Country Risk Assessment to determine a bank's anchor, the starting point in assigning a long-term rating to a bank. Our anchor for a commercial bank operating only in Finland, such as Aktia Bank, is 'a-', based on an economic risk score of '2' (low risk) and an industry risk score of '3' (intermediate risk).

We consider Aktia Bank's business position to be "moderate," reflecting its well-established local retail franchise in the coastal areas and in the larger cities in Finland and its stable market share of 4% in customer lending and deposits. However, we view the bank's business model as concentrated, given that it focuses primarily on residential mortgage lending, while its limited corporate banking activities are chiefly targeted at small businesses and entrepreneurs. The bank's asset management activities, amounting to a 7% market share in Finland, complement those businesses and their contribution to revenues will in our view increase. Furthermore, sister company Aktia Life Insurance (not rated) provides the Aktia group with insurance and investment products. Due to their limited size, the insurance operations bring only moderate diversification benefits to the group in our opinion.

Aktia Bank also acts as the central funding institution for 30 independent local savings banks and 34 local co-operative banks in Finland. Although the revenue contribution from this activity is minor relative to Aktia Bank's total revenues, it should continue providing the bank with some benefit in terms of funding stability in our opinion.

We assess Aktia Bank's capital and earnings as "strong". We expect our risk-adjusted capital (RAC) ratio for Aktia group to increase to about 11% over the next 18-24 months, compared with 9.8% on Dec. 31, 2011. We forecast the RAC ratio at group level due to the planned merger of Aktia Bank with its parent company Aktia PLC by midyear 2013, which in turn has also led us to incorporate Aktia PLC's insurance operations. The loan book of Aktia Bank's subsidiary, Aktia Real Estate Mortgage Bank (AREMB), which includes mortgage loans through the partner local savings and cooperative banks, is currently fully consolidated on Aktia Bank's balance sheet. As a result of the planned run off of AREMB's activities, we expect the share of partner banks' loans to decline, leading to a decrease in Aktia Bank's loan book and risk-weighted assets. We consider Aktia Bank's quality of capital, consisting mainly of paid-in capital, and its earnings to be adequate. We believe that the bank's earnings capacity will improve over time owing to stable operating revenues, planned cost cuts, and our expectation for low losses. This is reflected in our three-year average earnings buffer of about 110 basis points for the group.

We view Aktia Bank's risk position as "moderate" due to the concentration risk resulting from a focus on retail lending (85% of the loan portfolio). This is partly mitigated by the retail loan book's high granularity. Mortgage loans are principally granted in the larger cities, and less than 5% of the loan stock has loan-to-value ratios above 70%. Furthermore, the small corporate lending book does not show any significant single-name or sector concentration. We recognize that the bank has tightened underwriting standards during the past two years, which we believe will continue to result in relatively low loan losses (the ratio of nonperforming loans to total loans was 0.73% at end-September 2012). Single exposures burden the quality of the corporate portfolio, which however we understand is well collateralized. In addition, the bank is actively managing down the risks in its run-off portfolio (where loan volumes totaled €250 million at end-September 2012). We believe that the potential increase in impairment costs will result from corporate exposures rather than from household mortgage lending. Aktia Bank's market risk is minor since it has no trading book.

Aktia Bank's funding is "average" in our opinion, reflecting a stable retail deposit base (41% of funding) but also its continuous access to capital markets through AREMB's issuance of covered bonds. This funding mix allows Aktia Bank to achieve a relatively balanced asset-liability structure with a long-term funding ratio of 76%, which is in line with ratios of its domestic competitors. Furthermore, if we adjust Aktia Bank's loan book for mortgage loans sold by the partner banks, its loan-to-deposits ratio stands at about 140%, broadly in line with domestic peers'. We understand that Aktia Bank aims to apply for a covered bond license from the Finnish Supervisory Authority in 2013 to issue covered bonds directly while AREMB is to focus on the management and refinancing of the current stock. We believe that Aktia Bank will continue to benefit from the placement by independent local savings and cooperative banks of their excess liquidity with Aktia Bank.

We assess the bank's liquidity as "adequate". On Sept. 30, 2012, Aktia Bank had a liquidity position of about €2 billion consisting of cash and securities, mainly covered bonds, which are all eligible for repurchase (repo) agreement transactions at the Finnish central bank. The bank runs various stress tests. In a severe liquidity crisis involving closure of access to capital market funding and a significant deposit outflow, we think Aktia Bank could survive for more than 12 months with access to the central bank through the repo activity in its liquidity book.

As the fourth-largest retail bank in Finland, where Pan-Nordic groups have sizable operations, and with a significant share of retail deposits, we consider Aktia Bank to have "moderate" systemic importance in Finland's banking sector and consequently factor one notch of extraordinary government support into the ratings.

Outlook

The negative outlook on Aktia Bank reflects our view that the growing economic risks in the export-oriented Finnish economy could adversely affect the Finnish banking sector's performance. This could lead us to lower our baseline assessment (the anchor) on Finnish banks, including Aktia Bank, to 'bbb+' from 'a-'.

We believe that the planned merger of Aktia Bank with its parent company Aktia PLC in 2013 won't markedly change the group's business model or strategy, including its cooperation with independent savings and cooperative banks. We expect Aktia Bank's organizational streamlining to improve its cost efficiency and capital management, which we incorporate into our RAC ratio for the Aktia group. We anticipate that Aktia Bank will report increased earnings in 2013 and 2014, which would gradually strengthen its capital base and enable it to reach a RAC ratio of about 11% by year-end 2014. We also expect the bank to maintain its prudent underwriting standards in lending and grow at most in line with the market.

We could take a negative rating action if Aktia Bank's funding position were to deteriorate due to discontinued cooperation with the independent local banks or if access to the wholesale market were to be hindered. Furthermore, we could revise our assessment of Aktia Bank's capital and earnings position if its operations were to deteriorate substantially due to a downturn in the Finnish economy, in turn resulting in higher loan losses than in our current base-case scenario and leading to a decline in our projected RAC ratio to below 10%.

Ratings Score Snapshot

Issuer Credit Rating	A-/Negative/A-2
SACP	bbb+
Anchor	a-
Business Position	Moderate (-1)
Capital and Earnings	Strong (+1)
Risk Position	Moderate (-1)
Funding and Liquidity	Adequate (0)
Support	0
GRE Support	0
Group Support	0
Sovereign Support	+1
Additional Factors	0

Related Criteria And Research

All articles listed below are available on RatingsDirect on the Global Credit Portal, unless otherwise stated.

- Outlooks on Two Finnish Banks Revised to Negative Due To Rising Economic Risks, Nov. 20, 2012
- Banks: Rating Methodology And Assumptions, Nov. 9, 2011
- Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- Group Rating Methodology and Assumptions, Nov. 9, 2011
- Principles Of Credit Ratings, Feb. 16, 2011
- BICRA On Finland Revised To Group '2' From Group '1', Nov. 9, 2011
- Bank Capital Methodology And Assumptions, Dec. 6, 2010

Ratings List

New Rating

Aktia Bank PLC

Counterparty Credit Rating	A-/Negative/A-2

Additional Contact:

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Complete ratings information is available to subscribers of RatingsDirect on the Global Credit Portal at www.globalcreditportal.com. All ratings affected by this rating action can be found on Standard & Poor's public Web site at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following Standard & Poor's numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; Stockholm (46) 8-440-5914; or Moscow 7 (495) 783-4009.