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Aktia Bank PLC

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

Secondary Contact:
Alexander Ekbom, Stockholm (46) 8-440-5911; alexander_ekbom@standardandpoors.com

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Aktia Bank PLC

SACP	bbb+

+

Support	+1

+

Additional Factors	0

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

GRE Support	0
Group Support	0
Sovereign Support	+1

Issuer Credit Rating
A-/Negative/A-2

Major Rating Factors

Strengths:	Weaknesses:
• Well-established local retail franchise in coastal areas and larger cities in Finland. • Strong projected capitalization underpinned by sound earnings capacity. • Moderate systemic importance as the fourth largest retail-bank in Finland.	• Concentration risk due to focus on residential mortgage lending in Finland. • Limited geographic, business, and earnings diversification. • Reliance on wholesale funding market as covered bond issuer.

Outlook: Negative

Standard & Poor's Ratings Services' outlook on Finland-based Aktia Bank is negative, reflecting 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. We expect Aktia Bank's organizational streamlining to improve its cost efficiency and capital management, which we incorporate into our risk-adjusted capital (RAC) ratio for the Aktia group. We anticipate that Aktia Bank will report increased earnings in 2013 and 2014, which should gradually strengthen its capital base and enable it to reach a RAC ratio of about 12-13% 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. In our view Aktia Bank's decision to phase-out the cooperation with the independent local savings and cooperative banks by 2015 won't impact its stand-alone credit profile (SACP).

We could take a negative rating action if Aktia Bank's funding position were to deteriorate, for example if access to the wholesale market were 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%.

We consider a positive rating action unlikely at this stage.

Rationale

Our ratings on Aktia Bank reflect its anchor of 'a-', its "moderate" business position, "strong" capital and earnings, "moderate" risk position, "average" funding and "adequate" liquidity, as our criteria define these terms. The stand-alone credit profile is 'bbb+'.

We consider Aktia Bank as having moderate systemic importance and consequently factor one notch of potential extraordinary government support into the ratings to arrive at our 'A-' long-term counterparty credit rating on Aktia Bank.

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

Our bank criteria 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 a competitive and resilient economy with high education levels. But it also depends on exports in cyclical industries, which subjects its economy to increasing pressure from Europe's worsening recession. Moreover, a lack of reforms to increase competiveness could hamper the economy. Low corporate and moderate household debt levels and a very strong payment culture contribute to sound leverage in the economy.

Diverse Nordic banking groups largely control Finland's concentrated banking industry, which in our view is underpinned by robust profitability metrics and stability. Deposits dominate funding, but the sector is a net external debtor, reflecting significant loan growth over the past decade and the country's lack of a deep domestic debt market.

Table 1

Aktia Bank PLC Key Figures				
	--Year ended Dec. 31--			
(Mil. €)	**2012**	**2011**	**2010**	**2009**
Adjusted assets	10,214	9,991	9,921	9,532
Customer loans (gross)	7,313	7,181	6,711	6,172
Adjusted common equity	398	404	385	358
Operating revenues	183	178	204	197
Noninterest expenses	136	130	120	112
Core earnings	26	29	53	39

Business position: Solid local retail franchise as the fourth largest bank in Finland

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 with some 400,000 customers, 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 these businesses and their contribution to revenues will in our view increase (14% of Aktia Bank's operating revenues and 19% of operating profit in 2012). Furthermore, sister company Aktia Life Insurance (not rated) provides the Aktia group with insurance and investment products. Due to the limited size and market share of around 2% in Finnish life insurance market, the insurance operations bring only moderate diversification benefits to the group in our opinion.

Aktia Bank currently acts as the central funding institution for 30 independent local savings banks and 34 local co-operative banks in Finland. The bank announced in January 2013 that the cooperation will be phased out by the beginning of January 2015, due to changes in regulatory requirements under Basel III which would burden the bank's profitability and liquidity. Although the revenue contribution from this activity is minor relative to Aktia Bank's total revenues (some €2 million-€3 million per year), it has provided the bank with some benefits in terms of funding stability in our opinion. We anticipate that the discontinuation of the cooperation will allow Aktia to focus its resources on its own growth going forward and as such won't have a negative impact on our assessment of the bank's business position.

We consider the management of Aktia Bank to be prudent and well aware of the limits set by the size and the product offer of the group. Aktia Bank has tightened its risk management and lending standards since 2010 and we believe that it will maintain these standards going forward, which we expect to provide stability to Aktia's financial position.

Table 2

Aktia Bank PLC Business Position				
	--Year ended Dec. 31--			
(%)	**2012**	**2011**	**2010**	**2009**
Loan market share in country of domicile*	4.30	4.20	4.30	4.23

Table 2

Aktia Bank PLC Business Position (cont.)				
Deposit market share in country of domicile	3.40	3.50	3.60	2.80
Total revenues from business line (mil. €)	183	178	204	197
Commercial & retail banking/total revenues from business line	84.01	89.35	88.70	94.31
Asset management/total revenues from business line	14.44	12.15	10.37	7.92
Other revenues/total revenues from business line	1.55	(1.49)	0.93	(2.23)
Return on equity	6.31	7.59	14.65	N/A

*Housing loans to households. N/A--Not applicable.

Capital and earnings: Strong capitalization underpinned by sound earnings capacity

We assess Aktia Bank's capital and earnings as "strong." We expect our RAC ratio for Aktia group to be in the range of 12%-13% over the next 18-24 months, compared with 11.5% on Dec. 31, 2012. We forecast the RAC ratio at group level because of 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 €1.9 billion of mortgage loans through 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 of low losses. This is reflected in our three-year average earnings buffer of about 110 basis points for the group which is in line with other Nordic regional banks.

Aktia aims to implement the internal-rating based model for credit risk when calculating regulatory capital in the course of 2013. The bank expects this to raise the Tier 1 capital ratio from the current 11.8% by about 4 percentage points to around 15%. However, we understand that capital won't be managed down at the bank level, i.e. there won't be extra dividend payouts. We note that Aktia Bank already fulfills the Basel III capital requirement.

Table 3

Aktia Bank PLC Capital And Earnings				
	--Year ended Dec. 31--			
(%)	**2012**	**2011**	**2010**	**2009**
Tier 1 capital ratio	11.80	10.60	10.10	9.50
S&P RAC ratio before diversification	11.50	11.10	N.M.	N.M.
S&P RAC ratio after diversification	10.60	10.70	N.M.	N.M.
Adjusted common equity/total adjusted capital	100.00	100.00	100.00	100.00
Net interest income/operating revenues	63.66	72.20	73.19	77.35
Fee income/operating revenues	32.56	30.39	25.13	20.65
Market-sensitive income/operating revenues	1.60	(5.22)	(2.74)	0.30
Noninterest expenses/operating revenues	74.33	73.04	58.88	56.73
Preprovision operating income/average assets	0.46	0.48	0.86	N/A
Core earnings/average managed assets	0.26	0.29	0.54	N/A

Table 3

Aktia Bank PLC Capital And Earnings (cont.)

N/A--Not applicable.

Table 4

Aktia PLC Risk-Adjusted Capital Framework Data

(€)	Exposure*	Basel II RWA	Average Basel II RW (%)	Standard & Poor's RWA	Average Standard & Poor's RW (%)
Credit risk					
Government and central banks	722,882,972	0	0	21,973,737	3
Institutions	2,264,280,710	260,893,634	12	400,545,586	18
Corporate	670,249,391	489,947,628	73	485,193,474	72
Retail	6,621,612,898	2,432,885,405	37	1,966,378,531	30
Of which mortgage	5,724,208,225	2,002,169,348	35	1,374,446,445	24
Securitization§	0	0	0	0	0
Other assets	74,026,099	57,811,153	78	73,232,963	99
Total credit risk	10,353,052,071	3,241,537,819	31	2,947,324,291	28
Market risk					
Equity in the banking book†	24,510,303	7,387,511	106	284,432,999	1,160
Trading book market risk	--	0	--	0	--
Total market risk	--	7,387,511	--	284,432,999	--
Insurance risk					
Total insurance risk	--	--	--	577,387,500	--
Operational risk					
Total operational risk	--	362,284,104	--	485,953,434	--
		Basel II RWA		**Standard & Poor's RWA**	**% of Standard & Poor's RWA**
Diversification adjustments					
RWA before diversification		3,611,209,434		4,295,098,223	100
Total Diversification/Concentration Adjustments		--		374,553,200	9
RWA after diversification		3,611,209,434		4,669,651,423	109
		Tier 1 capital**	**Tier 1 ratio (%)**	**Total adjusted capital**	**Standard & Poor's RAC ratio (%)**
Capital ratio					
Capital ratio before adjustments		426,399,881	11.8	493,923,861	11.5
Capital ratio after adjustments‡		426,399,881	11.8	493,923,861	10.6

*Exposure at default. §Securitisation exposure includes the securitisation tranches deducted from capital in the regulatory framework. †Exposure and Standard & Poor's risk-weighted assets for equity in the banking book include minority equity holdings in financial institutions. ** Tier 1 capital of Aktia Bank Group. ‡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 Dec. 31, 2012, Standard & Poor's.

Risk position: Concentration risk due to focus on retail mortgage lending

We view Aktia Bank's risk position as "moderate." We don't expect any change in the concentration risk resulting from the focus on retail lending (86% of the loan portfolio). The concentration is partly mitigated by the retail loan book's high granularity and sound collateralization. Mortgage loans are principally granted in the larger cities, which we consider economically stronger areas and where we assume prices to be more stable. Less than 5% of the total loan stock has loan-to-value ratios above 70%. Furthermore, the small corporate lending book of €713 million (10% of the total loan 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 level of nonperforming loans (the ratio of nonperforming loans to total loans was 0.68% at year-end 2012). The corporate portfolio shows somewhat weaker credit quality, but to our understanding 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 year-end 2012. While the impairment costs, at 11 bps of total lending, remained low in 2012, we believe that the potential increase will result from corporate exposures rather than from household mortgage lending. Aktia Bank's market risk is minor since it has no trading book.

Table 5

Aktia Bank PLC Risk Position				
	--Year ended Dec. 31--			
(%)	**2012**	**2011**	**2010**	**2009**
Growth in customer loans	1.85	6.99	8.73	N.M.
Total managed assets/adjusted common equity (x)	25.69	24.74	25.80	26.66
New loan loss provisions/average customer loans	0.11	0.15	0.20	N/A
Net charge-offs/average customer loans	(0.13)	(0.17)	(0.26)	N/A
Gross nonperforming assets/customer loans + other real estate owned	0.68	0.84	0.54	0.55
Loan loss reserves/gross nonperforming assets	130.10	105.94	159.98	142.76

N/A--Not applicable. N.M.--Not meaningful.

Funding and liquidity: Stable funding supported by stable retail deposits and covered bonds issuance

Aktia Bank's funding is "average" in our opinion, reflecting a stable retail deposit base (39% of funding as of December 2012) 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 74%, 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 146%, slightly above that of domestic peers.

Aktia Bank was granted a covered bond license by the Finnish Supervisory Authority in March 2013. Consequently Aktia Bank aims to issue covered bonds directly, likely starting from the end of the second quarter of 2013 while AREMB is to focus on the management and refinancing of the current stock. Consequently the owners of AREMB grant new loans from their own balance sheets, which will gradually reduce Aktia Bank's balance sheet and refinancing needs.

As a result of the termination of Aktia Bank's services as a central credit institution, the role of excess liquidity placed by independent local savings and cooperative banks with Aktia Bank will decrease over time. When adjusting for transaction accounts, the share of local banks' deposits in Aktia's funding base is, at around 3%, of minor importance.

We assess the bank's liquidity as "adequate." On Dec. 31, 2012, Aktia Bank had a liquidity position of about €1.86 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 reduced its investments in covered bonds in eurozone periphery countries (Ireland, Italy, Spain, and Portugal) to around €113 million as of Feb. 28 2013, and the bank has no sovereign exposure to these countries. 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.

Table 6

Aktia Bank PLC Funding And Liquidity

	--Year ended Dec. 31--			
(%)	**2012**	**2011**	**2010**	**2009**
Core deposits/funding base	39.13	39.46	36.89	34.40
Customer loans (net)/customer deposits*	198.50	194.34	195.38	201.72
Long term funding ratio	73.52	74.45	78.21	69.53
Broad liquid assets/short-term wholesale funding (x)	1.10	1.13	1.69	1.18
Net broad liquid assets/short-term customer deposits	6.82	7.74	35.51	15.55
Narrow liquid assets/3-month wholesale funding (x)	5.25	3.34	4.40	3.73
Net short-term interbank funding/total wholesale funding	15.97	18.30	15.72	28.46
Short-term wholesale funding/total wholesale funding	38.85	36.27	28.27	43.33

*Including Aktia Real Estate Mortgage Bank's loans sold by partner banks.

External support: One notch of government support

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.

Additional rating factors: None

No additional factors affect this rating.

Related Criteria And Research

All articles listed below are available on RatingsDirect on the Global Credit Portal.

- Banking Industry Country Risk Assessment: Finland, Jan. 25, 2013
- Finland Outlook Revised To Stable; 'AAA/A-1+' Ratings Affirmed, Jan. 14, 2013
- Finland-Based Aktia Bank Assigned 'A-/A-2' Long- And Short-Term Ratings; Outlook Negative, Dec. 12, 2012
- 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
- Bank Capital Methodology And Assumptions, Dec. 6, 2010

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 March 28, 2013)

Aktia Bank PLC	
Counterparty Credit Rating	A-/Negative/A-2
Counterparty Credit Ratings History	
12-Dec-2012	A-/Negative/A-2
Sovereign Rating	
Finland (Republic of)	AAA/Stable/A-1+

*Unless otherwise noted, all ratings in this report are global scale ratings. Standard & Poor's credit ratings on the global scale are comparable across countries. Standard & Poor's credit ratings on a national scale are relative to obligors or obligations within that specific country.

Additional Contact:
Financial Institutions Ratings Europe; FIG_Europe@standardandpoors.com