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Research Update:

Ratings On Three Finnish Banks Affirmed On Subdued Economic Recovery; Outlooks Remain Negative

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Overview

- We have reviewed Finland's banking sector after our downgrade of Finland (AA+/Stable/A-1+) on Oct. 10, 2014.
- We think subdued growth and structural issues in the Finnish economy might lead to more challenging operating conditions for the Finnish banking sector.
- We are maintaining our view of the trend for Finland's economic risks as negative, while continuing to see a stable trend for industry risks for Finnish banks.
- We are therefore affirming our ratings on Aktia Bank, Bank of Åland, and Pohjola Bank; the outlooks remain negative.

Rating Action

On Oct. 22, 2014, Standard & Poor's Ratings Services affirmed its long- and short-term counterparty credit ratings on three Finland-based banks: Aktia Bank PLC, Bank of Åland PLC, and Pohjola Bank PLC (see 'Ratings List' below). The outlooks on the long-term ratings on these banks remain negative.

Rationale

The affirmations take into account our view that Finland's economic recovery is weaker than we expected and could lead to a deteriorating operating environment for the country's banks. We consequently continue to assess the trend in Finland's economic risks as negative under our Banking Industry Country Risk Assessment (BICRA) methodology. The sluggish conditions could hamper the banking sector's performance and translate into increased cost of risk and asset quality deterioration exceeding our expectations. Such a scenario could lead us to revise down the anchor for commercial banks operating mainly in Finland to 'bbb+' from 'a-' (the anchor is our starting point for assigning a rating to a bank under our bank criteria).

Standard & Poor's forecasts that real GDP will decrease by 0.5% in 2014, followed by subdued economic growth of about 0.5% in 2015 and 1.5% in 2016. Although we anticipate that a gradual improvement in domestic demand will follow a pick-up in external demand, we believe that future low growth in real wages and elevated unemployment could lead to weaker credit demand from households and modest falls in house prices. These conditions could be

commensurate with a correction phase under our assessment of economic imbalances.

We anticipate that private-sector credit will grow only moderately--at 2%-3% annually--in the next two years due to the economic uncertainty. However, owing to the banking industry's sound financial position in both the household and corporate sectors, we expect asset quality to remain strong and estimate cost of risk at about 15 basis points of the total loan stock in 2014-2015. We believe the steady rise in house prices in 2002-2007 was accompanied by an increase in leverage while to a large extent following growth in household incomes. However, we think part of the income growth followed faster increases in unit labor costs than in peer countries, which have in turn reduced the Finnish economy's competitiveness. Given the strong urbanization trend in Finland, we expect the housing market to evolve on two tracks, with prices in the capital city of Helsinki continuing to rise and nationwide prices stabilizing at their current level.

We continue to see a stable banking industry risk trend in Finland. The Finnish market is concentrated, with the three largest financial institutions commanding over 75% of the market. The banking sector carries a sound track record in profitability. In addition, we expect profitability, measured as return on equity, to remain at roughly 8%-9% in 2014. Finnish banks depend slightly more on external market funding than many other banking systems in Europe, excluding other Nordic countries. We think this reflects Finnish banks' credit expansion over the past decade and the lack of a deep domestic debt market.

Outlook

The outlooks on Aktia Bank, Bank of Åland, and Pohjola Bank remain negative. Our outlooks on the three banks mainly reflect bank-specific factors, as well as country risks linked to operating in Finland. The outlooks on Aktia Bank and Pohjola Bank--the two banks we view as systemically important--are negative in part because we expect that potential extraordinary government support for European banks will likely decrease as resolution frameworks are put in place.

Aktia Bank

The negative outlook on Aktia Bank also reflects that we could lower the ratings if the bank's funding position deteriorates. The bank currently derives 46% of its funding from fairly stable customer deposits.

Bank of Åland

We could take a negative rating action on Bank of Åland if its operations were to deteriorate substantially, resulting in loan losses that drove our risk-adjusted capital (RAC) ratio for the bank below 10% or led us to reassess

the bank's risk position and the concentration risks in its lending book. We could consider a positive rating action if we concluded that the bank's integration of the Swedish operations is successful and meaningfully broadened the bank's franchise and diversity by reducing concentrations in its business position.

Pohjola Bank

The negative outlook on Pohjola Bank also incorporates our uncertainty about the capitalization process following the buyback of its shares in May 2014 and the bank's ability to achieve and maintain a RAC ratio of more than 10% in the next 18-24 months. We also factor in our view of the bank's ability to strengthen its funding and liquidity.

BICRA Score Snapshot*

Finland

BICRA Group	2
Economic risk	2
Economic resilience	Low risk
Economic imbalances	Low risk
Credit risk in the economy	Low risk
Trend	Negative
Industry risk	3
Institutional framework	Intermediate risk
Competitive dynamics	Low risk
Systemwide funding	Intermediate risk
Trend	Stable

*Banking Industry Country Risk Assessment (BICRA) economic risk and industry risk scores are on a scale from 1 (lowest risk) to 10 (highest risk). For more details on our BICRA scores on banking industries across the globe, please see "Banking Industry Country Risk Assessment Update," published monthly on RatingsDirect.

Related Criteria And Research

Related Criteria

- Bank Hybrid Capital And Nondeferrable Subordinated Debt Methodology And Assumptions, Sept. 18, 2014
- Group Rating Methodology, Nov. 19, 2013
- 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
- Use Of CreditWatch And Outlooks, Sept. 14, 2009

Related Research

- Finland Long-Term Ratings Lowered To 'AA+' On Weak Economic Growth; Outlook Stable, Oct. 10, 2014
- Banking Industry Country Risk Assessment Update: October 2014:, Oct. 8, 2014
- Credit FAQ: The Rating Impact Of Resolution Regimes For European Banks, April 29, 2014

Ratings List

Ratings Affirmed

Aktia Bank PLC

Counterparty Credit Rating	A-/Negative/A-2
Senior Unsecured	A-

Bank of Aland PLC

Counterparty Credit Rating	BBB/Negative/A-3
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Pohjola Bank PLC

Counterparty Credit Rating	AA-/Negative/A-1+
Senior Unsecured	AA-
Subordinated	A-

NB: This list does not include all the ratings affected.

Additional Contact:

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Complete ratings information is available to subscribers of RatingsDirect at www.globalcreditportal.com and at spcapitaliq.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.

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