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Research Update:

Finland-Based Aktia Bank 'A-/A-2' Ratings Affirmed On Government Support And ALAC Review; Outlook Negative

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Overview

- We believe the prospect of extraordinary government support for Finnish banks is now uncertain in view of the country's well-advanced and effective resolution regime.
- We are therefore removing the one notch of uplift for government support that we had previously incorporated in the long-term counterparty credit ratings on Aktia Bank PLC.
- We consider that Aktia Bank is unlikely to maintain its additional loss-absorbing capacity (ALAC) above our 4.25% threshold within a four-year projection period.
- We have also recognized a strengthening in Aktia Bank's intrinsic creditworthiness and changed our capital and earnings assessment to "very strong" from "strong" leading to a stand-alone credit profile (SACP) of 'a-'.
- Consequently, we are affirming the long- and short-term counterparty credit ratings on Aktia Bank at 'A-/A-2'.
- The negative outlook reflects our view that Finland's weak economic recovery could hamper the banking sector's performance over the next two years, leading us to lower the anchor for Finnish banks.

Rating Action

As previously announced on Dec. 2, 2015, Standard & Poor's Ratings Services affirmed the long- and short-term counterparty credit ratings on Finland-based Aktia Bank PLC at 'A-/A-2'. The outlook is negative.

Rationale

We believe that the prospect of extraordinary government support for the Finnish banking sector is now uncertain following the expected full implementation of the EU Bank Recovery and Resolution Directive, including bail-in powers, from Jan. 1, 2016. We do not completely exclude the possibility of such support and we consider that systemically important Finnish institutions face several more years of structural and balance sheet reforms to address their "resolvability" in order to mitigate the systemic impact if they fail. Nevertheless, we believe the Finnish government's ability and willingness to provide support is lower and less predictable under the enhanced resolution framework. We have therefore reclassified the tendency of

Finland to support private sector commercial banks as "uncertain" under our criteria, and removed the one notch that we previously included for government support in the long-term counterparty credit rating on Aktia Bank.

We view the Finnish resolution regime as "effective" under our ALAC criteria because, among other factors, we believe it contains a well-defined bail-in process under which authorities would permit non-viable systemically important banks to continue critical functions as going concerns following a bail-in of eligible liabilities. However, we have not included notches in the long-term rating on Aktia Bank under our ALAC criteria because we believe its ALAC ratio is unlikely to sustainably exceed the designated 4.25% threshold over a four-year projection period. Furthermore, the Finnish authorities have not yet identified Aktia Bank as subject to a well-defined bail-in process, which is a pre-condition for us to include ALAC support into our ratings on a bank.

We calculate that Aktia Bank's ALAC was 5.8% of Standard & Poor's risk-weighted assets at year-end 2014, but we see the ratio decreasing to below 4.0% over our projection period as the relevant instruments mature. We include in this assessment Aktia Bank's subordinated Tier 2 debt instruments, which were issued under Finnish law. We believe these issues could have capacity to absorb losses without triggering a default on senior obligations. We use a 4.25% threshold for Aktia Bank, as opposed to the usual 5.0%, because we qualitatively adjust for the portion of Aktia Bank's insurance operations that we expect would be outside the scope of required bail-in capitalization.

In our view, Aktia Bank continues to deliver a sound operating performance and the run-down of the Aktia Real Estate Mortgage Bank (AREMB) is proceeding in line with our expectations. With a risk-adjusted capital (RAC) ratio of 16% as of June 30, 2015, the bank has strengthened its RAC ratio to a level we consider "very strong". Based on the agreement between Aktia Bank and the partner banks, Aktia will acquire minority shares in AREMB and the mortgage bank will be merged with Aktia Bank in 2017. The transaction will decrease Aktia Bank's equity by €65 million and consequently our total-adjusted capital (TAC), our measure of loss-absorbing capital, at year-end 2015. The transfer of AREMB's loan book to partner banks and the resulting reduction in risk-weighted assets will, however, counter the reduction in TAC. Combined with only moderate loan growth of 2%-3% in Aktia Bank's own loan origination, due to low demand for mortgage loans in Finland, we expect Aktia Bank's overall loan book to decrease to about €5.2 billion-€5.3 billion by year-end 2016. Consequently, we forecast a lower level of Standard & Poor's risk-weighted assets in the next two years and project the RAC ratio to remain well above 15% over the next 12-18 months. Consequently, we have revised our assessment of the bank's capital and earnings position to "very strong" from "strong", leading to an uplift in its stand-alone credit profile (SACP) to 'a-' from 'bbb+'.

Our ratings on Aktia Bank now reflect the bank's 'a-' anchor, its "moderate" business position, "very strong" capital and earnings, "moderate" risk position, "average" funding, and "adequate" liquidity, as our criteria define these terms.

Outlook

The negative outlook reflects our view of Finland's weak economic recovery, which could hamper the banking sector's performance over the next two years. Gradually increasing unemployment could further impede loan growth in Finland and lead to asset price corrections. If this meaningfully increased the risk costs for the banking sector, we could revise downward our 'a-' anchor for Finnish banks, including Aktia Bank. This could, in turn, lead us to revise down our assessment of the bank's SACP and lower our ratings on Aktia Bank.

If we were to revise our view of the currently low economic risk in Finland, this would lead us to lower our projected RAC ratio for Aktia Bank because we would use higher risk weights on exposures in our calculation. However, we do not believe that this would lead to a two-notch downgrade of Aktia Bank given the presence of a meaningful ALAC buffer.

We consider an outlook revision to stable unlikely at this stage.

Ratings Score Snapshot

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

Related Criteria And Research

Related Criteria

- Banks: Rating Methodology And Assumptions - Nov. 9, 2011
- Banks: Banking Industry Country Risk Assessment Methodology And

Assumptions - Nov. 9, 2011

- Banks: Bank Capital Methodology And Assumptions - Dec. 6, 2010
- Banks: Quantitative Metrics For Rating Banks Globally: Methodology And Assumptions - Jul. 17, 2013
- Commercial Paper I: Banks - Mar. 23, 2004
- Methodology For Mapping Short- And Long-Term Issuer Credit Ratings For Banks - May 4, 2010
- Banks: Bank Rating Methodology And Assumptions: Additional Loss-Absorbing Capacity, Apr.27, 2015
- Banks: Bank Hybrid Capital And Nondeferrable Subordinated Debt Methodology And Assumptions - Jan. 29, 2015
- Bank: Assessing Bank Branch Creditworthiness, Oct. 14, 2013
- Banks: Revised Market Risk Charges For Banks In Our Risk-Adjusted Capital Framework, June 22, 2012
- Use Of CreditWatch And Outlooks - Sep. 14, 2009
- Group Rating Methodology - Nov. 19, 2013
- Ratings Above The Sovereign--Corporate And Government Ratings: Methodology And Assumptions, Nov. 19, 2013
- Criteria For Assigning 'CCC+', 'CCC', 'CCC-', 'CC' Ratings, Oct. 1, 2012
- S&P's National And Regional Scale Mapping Tables, Sep. 30, 2014
- National And Regional Scale Credit Ratings, Sep. 22, 2014
- Principles For Rating Debt Issues Based On Imputed Promises, Dec. 19, 2014
- Rating Government-Related Entities: Methodology And Assumptions, March 25, 2015
- Use Of 'C' And 'D' Issue Credit Ratings For Hybrid Capital And Payment-In-Kind Instruments, Oct. 24, 2013

Related Research

- Most European Bank Ratings Affirmed Following Government Support And ALAC Review, Dec. 2, 2015
- Credit FAQ: How Standard & Poor's Applied Its Government Support And ALAC Criteria To European Banks In December 2015, Dec. 2, 2015
- Standard & Poor's To Conclude Its Review Of Systemic Support For Remaining EU Banks By Early December 2015, Oct. 1, 2015
- Government And ALAC Support Ratings Uplift For Systemically Important European Banking Groups, Oct. 1, 2015
- Aktia Bank Plc, March 31, 2015
- How The Regulatory Reform Process Could Reshape Banks' Business Models And Affect Issuer Ratings, Aug. 18, 2014
- Standard & Poor's Takes Various Rating Actions On European Banks Following Government Support Review, April 29, 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-

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