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## Research Update:

# Central Bank of Savings Banks Finland Ltd. Rated 'A-/A-2'; Outlook Negative

### Primary Credit Analyst:

Salla von Steinaecker, Frankfurt +496933999164; [salla.vonsteinaecker@standardandpoors.com](mailto:salla.vonsteinaecker@standardandpoors.com)

### Secondary Contact:

Olivia Fleischmann, Stockholm +46 (8) 440 5904; [olivia.fleischmann@standardandpoors.com](mailto:olivia.fleischmann@standardandpoors.com)

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## Research Update:

# Central Bank of Savings Banks Finland Ltd. Rated 'A-/A-2'; Outlook Negative

## Overview

- Central Bank of Savings Banks Finland Ltd. (Sp Central Bank) is a core member of the Savings Bank Group, which we consider has a weak business position, very strong capital and earnings, a moderate risk position, average funding, and adequate liquidity.
- With a 5% market share in customer deposits, the group has moderate systemic importance in Finland, in our view, so we add one notch of uplift for extraordinary government support to our 'bbb+' assessment of the group credit profile.
- We are assigning our 'A-/A-2' ratings to Sp Central Bank.
- The negative outlook reflects our view that extraordinary government support becomes less predictable as resolution frameworks take effect and our view of weak economic recovery in the Finnish economy, which could adversely affect the Finnish banking sector's performance.

## Rating Action

On April 7, 2015, Standard & Poor's Ratings Services assigned its 'A-/A-2' long- and short-term counterparty credit ratings to Central Bank of Savings Banks Finland Ltd. (Sp Central Bank). The outlook is negative.

## Rationale

Sp Central Bank is the central credit institution of Savings Banks Group, and the ratings therefore reflect the wider group's franchise and creditworthiness. Since December 2014, the group's 25 member savings banks, the Savings Banks' Union Coop, and Sp Central Bank have operated as a single entity for regulatory purposes under a joint and several guarantee scheme established by Finland's Act on Amalgamation.

The long-term rating reflects our 'a-' anchor for rating Finnish banks, and Savings Banks Group's "weak" business position, "very strong" capital and earnings, "moderate" risk position, "average" funding and "adequate" liquidity, as our criteria define these terms. We assess the group credit profile (GCP) at 'bbb+'.

We view Sp Central Bank as integral to the group's operation, and therefore equalize our long-term rating with the supported GCP. In terms of customer deposits, Savings Banks Group is the fourth-largest banking group in Finland, with a market share of 5% in customer deposits. We therefore consider the

group to have "moderate" systemic importance in Finland, which we regard as supportive of the banking sector. Consequently, we factor one notch of uplift for extraordinary government support into the long-term rating on Sp Central Bank.

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 'a-' anchor for commercial banks operating in Finland, such as Savings Banks Group, reflects our view of low economic risk and intermediate industry risk.

We view Finland as a competitive and resilient economy, with high education levels. But it also depends on exports in cyclical industries. Moreover, a lack of reforms to increase competitiveness could hamper the economy. The subdued growth and structural issues in the Finnish economy might lead to a deteriorating operating environment for the banking sector. Comparably low corporate and moderate household debt levels and a very strong payment culture contribute to debt 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.

We consider Savings Banks Group's business position to be "weak," reflecting the group's concentrated business operations, focused primarily on retail mortgages and lending to small and midsize companies. Savings Banks Group has a countrywide franchise in Finland and is a midsize banking group, with assets totaling €8.4 billion at the end of 2014 and a sound market share of 4%-5% in lending and deposits. However, the group has a weak position in Finland's growth centers and limited geographic and earnings diversification from its small asset management and life insurance business. This makes it vulnerable to a potential downturn in the Finnish economy and changes in the domestic housing market. Although Savings Banks Group still has a fairly short track record of operating as a cohesive banking group, we regard its legal set-up as a mutual group as positive. We believe this will support the group's long-term financial targets, and aligns well with the group's prudent approach in managing risks.

Our view of Savings Banks Group's capital and earnings as "very strong" is based primarily on our risk-adjusted capital ratio (RAC) for Savings Banks Group, which we project will be at 16.0%-16.5% over the next 12-18 months, compared with 15.0% as of Dec. 31, 2014. Our risk-weighted assets (RWAs) measure for the bank will be affected mainly by Savings Banks Group's transfer of high-quality retail mortgage loans--currently on Aktia Real Estate Mortgage Bank's (AREMB) books--to the group's own balance sheet and the expected reduction in the group's investment in AREMB. This, combined with anticipated annual loan growth of 3%, will lead to an increase in credit risk RWAs by more than 10% per year in 2015 and 2016, and to a decrease in market risk RWAs related to the declining stake in AREMB.

We expect Savings Banks Group to generate relatively stable earnings, dominated by net interest income, which should enable a further capital buildup over the next 18-24 months.

In our view, Savings Banks Group's risk position is "moderate," reflecting concentration risk from retail mortgage loans (60% of total lending book). This exposes the group to potential volatility in Finland's residential real estate market. The risk is partly mitigated by the loan book's high granularity, adequate collateralization, and our expectation of the group maintaining robust asset quality. We expect that, given the group's new structure and assuming more favorable funding conditions, the group will expand slightly faster than the market average over the next two years, while maintaining its underwriting standards. This should continue to translate into sound asset quality metrics and low cost of risk of about eight basis points (bps) to 10bps in 2015-2016, underscoring our view of low risk in Savings Banks Group's lending book.

We consider Savings Banks Group's funding to be "average" and its liquidity position "adequate." About 83% of funding is through customer deposits and we view positively that funding is well matched, with the long-term funding ratio exceeding 92%. We expect the group to diversify its funding profile via unsecured issuance under its new Euro medium-term note program and, starting from 2016, via covered bond issuance. Therefore, we believe the group will maintain its sound funding metrics with a stable funding ratio close to 110%. Our assessment of liquidity as "adequate" reflects that we forecast our liquidity ratio for the group to remain at about 2.0x.

## **Outlook**

The negative outlook indicates the possibility of a downgrade by year-end 2015 if we see a greater likelihood that senior unsecured creditors may incur losses if the bank fails. Specifically, we may lower the long-term rating by one notch if we consider that extraordinary government support to Savings Banks Group is less predictable under the new EU legislative framework.

The negative outlook also reflects our view that the weak recovery of Finland's export-oriented economy could weigh on the banking sector's performance over the next two years. This could lead us to lower our anchor for rating Finnish banks, including Sp Central Bank, to 'bbb+' from 'a-'.

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

## Ratings Score Snapshot

Issuer Credit Rating	A-/Negative/A-2
Group Credit Profile	bbb+
Anchor	a-
Business Position	Weak [-2]
Capital and Earnings	Very strong [+2]
Risk Position	Moderate [-1]
Funding and Liquidity	Average [0] and Adequate
Support	+1
GRE Support	0
Group Support	0
Sovereign Support	+1
Additional Factors	0

## Related Criteria And Research

### Related Criteria

- 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 Ratings Affirmed At 'AA+/A-1+' On Still-Strong External And Government Balance Sheets; Outlook Stable, March 27, 2015
- Banking Industry Country Risk Assessment: Finland, Jan. 29, 2015
- Standard & Poor's Takes Various Rating Actions On European Banks Following Government Support Review, April 29, 2014

## Ratings List

New Rating

Central Bank of Savings Banks Finland Ltd  
Counterparty Credit Rating A-/Negative/A-2

**Additional Contact:**

*Research Update: Central Bank of Savings Banks Finland Ltd. Rated 'A-/A-2'; Outlook Negative*

Financial Institutions Ratings Europe; FIG\_Europe@standardandpoors.com

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