S&P Global Ratings

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Bonum Bank PLC

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Bonum Bank PLC

SACP	bbb+	+	Support	0	+	Additional Factors	-1

Anchor	a-	
Business Position	Weak	-2
Capital and Earnings	Very Strong	+2
Risk Position	Moderate	-1
Funding	Average	0
Liquidity	Adequate	

ALAC Support	0
GRE Support	0
Group Support	0
Sovereign Support	0

Issuer Credit Rating
BBB/Stable/A-2

Major Rating Factors

Strengths:	Weaknesses:
• Very strong risk-adjusted capitalization. • A solid mutual business model. • Sound regional franchise in selected rural areas.	• Concentrated business operations focused on lending to individuals and small and midsize enterprises. • Weak earnings and cost efficiency. • A short operating history under the amalgamation structure.

Outlook: Stable

S&P Global Ratings' stable outlook on Finland-based Bonum Bank PLC reflects our view that the wider POP Bank Group will continue its harmonization, with an ongoing moderate positive impact on efficiency and profitability over the next two years. The group has a short operating history under the current amalgamation structure, and we expect it will realize synergies by increasing the integration of shared support functions. The stable outlook also reflects our expectations that the group will maintain a risk-adjusted capital ratio (RAC) above 15%.

Upside scenario

We could consider a positive rating action if the group were to demonstrate significant improvements in its revenue generation and cost efficiency to generate an earnings buffer more in line with its peers'.

Downside scenario

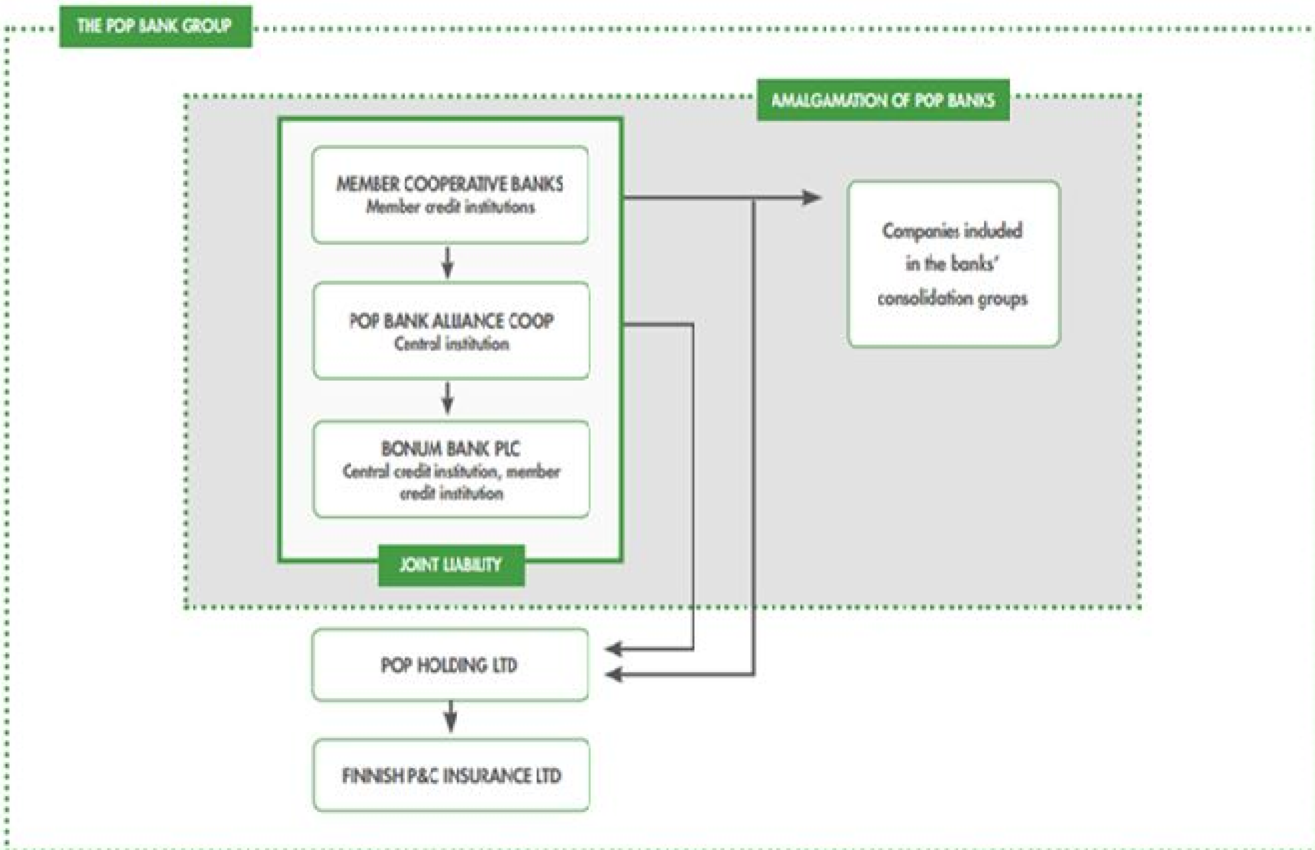
We could lower the ratings if the group's cohesiveness does not further strengthen as we anticipate and if lagging efficiency leads to a weakening of its combined capital and risk position because of a decline of the bank's RAC ratio below 15%.

Rationale

The ratings on Bonum Bank reflect the wider group's franchise and creditworthiness. The group benefits from the amalgamation, established in December 2015, which brought together the group's 26 member cooperative banks, POP Bank Alliance, and Bonum Bank to operate as a single entity for regulatory purposes under a joint-liability scheme. The group also includes specialized institutions, such as the non-life insurance company Finnish P&C Insurance Ltd., which operate outside the amalgamation and joint-liability framework.

Chart 1

POP Bank Group Structure



Source:POP Bank Group.

The long-term rating on Bonum Bank reflects our 'a-' anchor for Finnish banks, and our view of POP Bank Group's weak business position, based on its concentrated business operations, which are regionally focused primarily on retail mortgage lending in and around small cities in Finland. We also consider the group's subpar efficiency and short track record of operating under the amalgamation, but take comfort from its very strong capital and earnings position, based on our expectation that the RAC ratio will reach 16.5%-17.0% in the next two 12-24 months. The rating also reflects the group's moderate risk position, due to product and regional concentration risks in the loan book being partly offset by solid collateralization and prudent underwriting standards. We view the bank's funding as average and its liquidity as adequate, owing to sound funding metrics, the dominance of customer-deposit funding, and a comfortable liquidity position.

We do not factor in any extraordinary government support because we regard POP Bank Group as having low systemic importance in Finland and the Finnish government's supportiveness toward the banking sector as uncertain since the implementation of the EU Bank Recovery and Resolution Directive on Jan. 1, 2016.

We deduct one notch from our 'bbb+' assessment of the group credit profile (GCP) because we regard POP Bank Group as a weaker performer than its peers, due to its very low operating efficiency and the group's short track record under its current structure.

Because we continue to view Bonum Bank as integral to the group's operations, we equalize our long-term rating on Bonum Bank with the 'bbb' GCP.

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

To determine a bank's anchor, we use our Banking Industry Country Risk Assessment's (BICRA's) economic risk score and the industry risk score. The anchor is the starting point in assigning an issuer credit rating under our criteria for banks. For a commercial bank like Bonum Bank that operates only in Finland, we determine an anchor of 'a-'. The anchor is based on an economic risk score of '2' and an industry risk score of '3'. We view the economic risk trend and the industry risk trend in the Finnish banking industry as stable.

We classify the banking sector of Finland in group '2' under our BICRA. Countries in group '2' include Sweden, Norway, Switzerland, and Germany.

We view Finland as an innovative, wealthy, and open economy, with mature political and institutional structures. The near-term economic picture has brightened following a prolonged recession over 2012-2015. After strong growth in 2017 supported by healthy domestic demand and a strongly improving external environment benefiting Finnish exports, we forecast growth will slow somewhat as domestic factors and structural constraints will weigh on the economy. House prices have stabilized nationwide and market activity especially in the growth regions is now picking up. While we forecast a moderate credit demand from households in 2018-2019, we observe a gradual increase in household debt. However, we expect Finnish banks' asset quality to remain strong in the next two years, based on the sound financial position of the household and corporate sectors, the banking sector's moderately conservative underwriting standards, and the persisting low interest rate environment.

We do not consider the banking sector's competitive landscape to be distorted despite concentration due to the presence of large pan-Nordic banks and the domestic cooperative banking group OP Financial Group. We also deem the sector's overall profitability and capitalization to be resilient and expect the banks to maintain their restrained risk appetite. That said, the sector remains highly interconnected with the Nordic banking systems, which results in potential spillover risks on the Finnish economy from external events. As a key industry risk, we see that Finnish banks depend more on international market funding than many other banking systems in Europe. That said, we consider that the banks continue to have good access to the euro-denominated unsecured and secured market.

Table 1

POP Bank Group Key Figures

	--Fiscal year ended Dec. 31--			
(Mil. €)	**2017**	**2016**	**2015**	**2014**
Adjusted assets	4,219	4,173	4,021	3,812
Customer loans (gross)	3,349	3,210	3,031	2,943
Adjusted common equity	424	417	410	380
Operating revenues	119	111	104	101

Table 1

POP Bank Group Key Figures (cont.)				
	--Fiscal year ended Dec. 31--			
(Mil. €)	2017	2016	2015	2014
Noninterest expenses	90	91	86	84
Core earnings	20	8	9	7

Business position: A concentrated business model with a high cost structure

We assess POP Bank Group's business position as weak due to the group's small domestic market share of roughly 1% in systemwide assets, and its concentrated business model with a regional focus on retail banking and small-and-midsize enterprise (SME) lending, mainly in less urban regions in Finland. We believe that the short track record of operating as an amalgamation creates uncertainties.

The POP Bank Group had total assets of €4.3 billion as of Dec. 31, 2017. In our view, the amalgamated structure allows the POP banks to act as a unified group for regulatory purposes and compete better in the market, owing to an enhanced common market presence and expected efficiency improvements through shared back-office operations and other services, leading to advantages of scale. In 2017, we observed slight efficiency improvements, but we believe more efficiency and profitability gains need to be demonstrated and proven in the future. We believe the legal set-up as a mutual group will continue to support the group's long-term financial targets and aligns well with its strategy and prudent approach in managing risks. We also believe that the group has implemented appropriate risk management and governance policies and processes for all 26 member banks, but are mindful that it has not been tested through a full cycle. We view the possibility of member banks leaving the group, curbing the benefits of the remaining group, as remote, not least due to the joint-liability obligation that runs for five years after a member exits.

The POP banks are focused on retail banking, mainly residential real estate lending, but they also engage in SME and agricultural lending and service 250,000 customers through 85 branches, mainly in Finland's less urban regions. In our view, concentration in terms of customer segments and geographic reach presents the main weakness of the group's business model as it may expose POP banks to potential volatility in Finland's real estate market or a downturn in the domestic economy, which we currently see as remote.

Although the group lacks a significant position nationwide, most of the POP banks hold sound local franchises in their regions. The group appears to have a loyal customer base, which in our view allows it to take higher lending margins than larger peers and provides business stability. POP Bank Group earns about 53% of its revenues from net interest income, 24% from fees and commissions, and 23% from its non-life insurance business and other sources. We expect fees and commission income to increase somewhat as the group's integration improves.

We expect that over time the non-life insurance business Finnish P&C Insurance Ltd (POP Insurance) will provide the group with improved revenue diversification. Finnish P&C Insurance Ltd was founded in 2012 and operates solely as a digital insurance firm offering its services through the web. In 2017, Finnish P&C Insurance Ltd exceeded 100,000 customers and although it is currently not profitable, we expect that improved operational efficiency will lead to this segment becoming profitable after 2018.

Table 2

POP Bank Group Business Position				
	--Fiscal year ended Dec. 31--			
%	**2017**	**2016**	**2015**	**2014**
Total revenues from business line (currency in millions)	119	115	104	101
Loan market share in country of domicile	1.81	1.51	1.39	N/A
Deposit market share in country of domicile	3.31	2.28	2.78	N/A
Commercial & retail banking/total revenues from business line	91.50	92.97	94.88	95.69
Insurance activities/total revenues from business line	8.50	7.03	4.96	1.35
Other revenues/total revenues from business line	N/A	N/A	0.15	2.96
Return on equity	3.33	2.32	2.28	N/A

N/A--Not applicable.

Capital and earnings: Very strong risk-adjusted capitalization

We expect POP Bank Group's capital and earnings to remain very strong. This is mainly based on our projection of POP Bank Group's RAC ratio in the range of 16.5%-17.0% in the next 24 months, slightly below its RAC ratio of 17.1% as of Dec. 31, 2017. This reflects our expectation of higher risk-weighted assets which will likely outstrip a capital build up from earnings due to the group's elevated cost base and higher IT investments in the next two years.

In our view, the group benefits from relatively predictable revenues, based on POP banks' sound regional positions in household lending and payments. This is further underscored by the proven price insensitivity of its customer base, since the POP banks' average margins are somewhat above most of its peers'. Even though net interest margins declined in 2017 due to increased pressure on lending rates, we expect that reduced funding costs and an improved rate environment will result in an increased net interest margin in our forecast horizon through 2020. POP Bank group's capitalization is supported by profit retention because member banks, as mutually owned cooperatives, do not pay dividends. Also, the first-time implementation of International Financial Reporting Standard No. 9 (IFRS 9) will have a negative capital impact of around €7.0 million in 2018 because of the transition to IFRS 9.

We expect an increasing cost base in 2018 and 2019 primarily due to investments in IT. This will likely initially lower the earnings buffer, but, through the group's stable revenue streams, the earnings buffer should stabilize in 2020. We estimate a three-year average of 0.50% by 2019 (an earnings buffer of about 1.0% indicates adequate earnings capacity). A risk of capital erosion remains if interest rates were to fall further or if the cost of risk were to increase unexpectedly.

The group's cost-to-income ratio reached 73.1% at year-end 2017 and remains high in comparison with Nordic peers' and the EU average. We do not regard the cost base as particularly flexible due to the group's decentralized structure, but we anticipate that the amalgamation will offset increasing operational cost by improving the group's efficiency over the coming years.

POP Bank Group exceeds current and expected future regulatory capital requirements with a CET1 ratio of 20.9% as of year-end 2017. The regulatory leverage ratio was also very high at 11.7% in 2017. We consider POP Bank Group's quality of capital to be adequate because its core capital--S&P Global Rating's total adjusted capital--comprises only equity that can be used to absorb losses. The group has no hybrid instruments in its capital base. That said, the group's financial flexibility is somewhat limited because of its small size and limited potential to build up capital, but the individual member banks could issue additional cooperative capital in the form of POP shares, if needed. As of year-end 2017, member banks had an outstanding amount of €53.6 million in POP shares, which is roughly 11% of total equity capital.

Table 3

POP Bank Group Capital And Earnings				
	--Fiscal year ended Dec. 31--			
%	**2017**	**2016**	**2015**	**2014**
Criteria reflected in RAC ratios	2017	2017	N/A	N/A
Tier 1 capital ratio	21.10	21.20	20.70	19.50
S&P RAC ratio before diversification	17.10	17.31	N/A	N/A
S&P RAC ratio after diversification	13.02	12.93	N/A	N/A
Adjusted common equity/total adjusted capital	100.00	100.00	100.00	100.00
Net interest income/operating revenues	52.55	56.31	58.98	60.44
Fee income/operating revenues	23.93	25.59	29.12	26.73
Market-sensitive income/operating revenues	11.37	7.21	3.63	9.06
Noninterest expenses/operating revenues	76.03	82.24	82.82	83.07
Preprovision operating income/average assets	0.67	0.47	0.45	N/A
Core earnings/average managed assets	0.46	0.19	0.23	N/A

N/A--Not applicable.

Table 4

POP Bank Group Risk-Adjusted Capital Framework Data					
	Exposure*	**Basel III RWA**	**Average Basel III RW (%)**	**S&P Global RWA**	**Average S&P Global RW (%)**
Credit risk					
Government and central banks	502,185,598	5,519,947	1	18,078,617	4
Institutions and CCPs	82,499,383	17,912,486	22	13,792,747	17
Corporate	651,537,150	590,515,817	91	415,636,920	64
Retail	2,805,197,510	1,101,743,226	39	822,581,368	29
Of which mortgage	2,276,194,404	787,549,088	35	528,532,345	23
Securitization§	0	0	0	0	0
Other assets†	124,049,134	114,998,577	93	121,710,456	98
Total credit risk	4,165,468,775	1,830,690,052	44	1,391,800,108	33
Credit valuation adjustment					
Total credit valuation adjustment	--	270,024	--	0	--
Market risk					
Equity in the banking book	225,348,807	334,377,258	148	829,133,786	368
Trading book market risk	--	25,571,244	--	38,356,865	--
Total market risk	--	359,948,501	--	867,490,651	--
Operational risk					
Total operational risk	--	204,682,320	--	220,546,997	--

Table 4

POP Bank Group Risk-Adjusted Capital Framework Data (cont.)

	Basel III RWA		S&P Global RWA	% of S&P Global RWA
Diversification adjustments				
RWA before diversification	2,395,590,897		2,479,837,756	100
Total Diversification/Concentration Adjustments	--		777,359,273	31
RWA after diversification	2,395,590,897		3,257,197,029	131
	Tier 1 capital	**Tier 1 ratio (%)**	**Total adjusted capital**	**S&P Global RAC ratio (%)**
Capital ratio				
Capital ratio before adjustments	499,693,949	20.9	424,033,722	17.1
Capital ratio after adjustments‡	499,693,949	20.9	424,033,722	13.0

*Exposure at default. §Securitisation Exposure includes the securitisation tranches deducted from capital in the regulatory framework. †Other assets includes Deferred Tax Assets (DTAs) not deducted from ACE. ‡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, 2017, S&P Global.

Risk position: Concentration risk, due to focus on retail lending in sparsely populated areas

We expect POP Bank Group's risk position to remain moderate, because the regional concentration of households and SMEs in selected Finnish regions exposes the group to potential economic shocks in the country. However, we anticipate the credit conditions in Finland will remain stable, and expect national house prices to rebound in 2018-2019. Therefore, we expect that the risk of a house price correction is remote.

POP Bank Group focuses mainly on low-risk lending to private customers (66% of the loan portfolio in 2017), lending to small agricultural and forestry clients (17.5%) and SMEs (16.5%). We believe this concentration is partly mitigated by the loan book's high granularity and adequate collateralization, while mortgage lending is mainly focused on less urbanized low-growth areas with moderate loan sizes in the retail portfolio. In addition, the group's SME lending--targeted principally to small businesses across different sectors--shows a conservative approach to loan sizes and collateralization, in our view. For example, the risk concentration to a single client cannot exceed €10 million because of the small size of the bank, and the top 10 largest customer exposures represent less than 1% of its total loan book.

We consider that POP Bank Group's loan portfolio has a sound collateralization, mainly by residential real estate which made up 66% of total collateral. The majority of mortgage loans have loan-to-value (LTV) ratios below 60%, while the LTV on new mortgage loans averaged 75%, somewhat higher than the domestic average. We note that member banks do not have trading books and take no currency risk.

We expect POP Bank Group to maintain its prudent risk culture and underwriting standards. Throughout 2017, the group harmonized its internal standards and implemented unified risk policies, limits, and guidelines at the group level. We understand that there is a monthly monitoring of targets and performance to keep risk limits and accelerate efficiency of member banks. We expect the group to continue harmonizing its products, processes and operating models through automation.

Consequently, we believe that the group's asset quality will remain sound over the coming years. The ratio of nonperforming loans to customer loans slightly increased to 0.80% at year-end 2017, which is in line with the peer average. That said, the share of forborne loans is higher than the domestic average, but we expect loan loss provisions to remain very low on the back of Finland's benign economic environment. The group's cost of risk is very low, we estimate about 17 bps in 2018-2019, but somewhat higher than the peer average.

Table 5

POP Bank Group Risk Position				
	--Fiscal year ended Dec. 31--			
%	**2017**	**2016**	**2015**	**2014**
Growth in customer loans	4.31	5.92	2.99	N/A
Total diversification adjustment / S&P RWA before diversification	31.35	33.86	N/A	N/A
Total managed assets/adjusted common equity (x)	10.08	10.14	9.93	10.16
New loan loss provisions/average customer loans	0.15	0.22	0.17	N/A
Gross nonperforming assets/customer loans + other real estate owned	0.89	0.75	0.76	0.96
Loan loss reserves/gross nonperforming assets	78.21	89.99	73.37	57.75

N/A--Not applicable.

Funding and liquidity: Granular deposit base and adequate liquidity buffers

We anticipate that POP Bank Group's funding will remain average, reflecting the group's stable and granular deposit base rooted in a sound retail franchise and proximity to customers.

We expect POP Bank Group to maintain its sound and sticky customer deposit base (which represents 96% of its total funding base), owing to its steady market share of about 3% of domestic customer deposits. About 75% of customer deposits stem from retail customers, 17% from SME, and 8% from agricultural clients.

As a result of the group's improved access under the amalgamation structure (owing to joint liability within the amalgamation) and its loan growth targets, we anticipate an increase in the share of wholesale funding. The group issued a €100 million senior unsecured bond in 2016 and €10 million certificate of deposit in 2017. We understand that the group is also in a position to use its mortgage pool for covered bond issuances in the future, something that we consider to be positive for POP Bank Group's funding diversification and refinancing costs. The bank's stable funding ratio was at a comfortable level of 115% as of Dec. 31, 2017, and in line with its peers in Finland.

We assess that POP Bank Group's liquidity remains adequate. At year-end 2017, the group had a liquidity position of about €580 million, consisting mainly of cash at the Finnish Central Bank and highly liquid certificate of deposits toward Finnish regional governments. We believe that under stressful conditions involving the closure of access to capital market funding and a significant deposit outflow, POP Bank Group could survive for more than six months. Also, the amalgamation structure implies improved transferability of liquidity across the member banks. We estimate the bank's one-year liquidity ratio (broad liquid assets to short-term funding) at an elevated 35.0x as of Dec. 31, 2017, but anticipate it will decrease over the next two years due to the group's increased use of wholesale market funding. More importantly because of the gradual shift from term to sight deposits, the group's net broad liquid assets cover about 17% of the short-term customer deposits.

POP Bank Group's adequate liquidity profile is also demonstrated by its sound liquidity coverage ratio (LCR) of 149% as of year-end 2017. In the previous year, the group had an LCR ratio of 220%. The decrease is due to the exemption of member banks from the LCR requirement granted by the Finnish Financial Supervisory Authority in 2017. As a result, the group downsized and reorganized the excess liquidity holdings.

Table 6

POP Bank Group Funding And Liquidity				
	--Fiscal year ended Dec. 31--			
%	**2017**	**2016**	**2015**	**2014**
Core deposits/funding base	96.14	95.92	94.48	96.57
Customer loans (net)/customer deposits	93.56	90.97	90.16	90.11
Long term funding ratio	99.60	99.71	97.12	99.83
Stable funding ratio	114.17	113.70	110.98	109.02
Short-term wholesale funding/funding base	0.46	0.33	3.21	0.18
Broad liquid assets/short-term wholesale funding (x)	34.93	48.22	5.03	62.11
Net broad liquid assets/short-term customer deposits	16.89	22.29	18.86	16.16
Short-term wholesale funding/total wholesale funding	11.82	8.10	58.20	5.38

External support: No uplift for external support

We do not factor any external support into our assessment of the group's credit profile. We believe the prospect of extraordinary government support for Finnish banks is uncertain, following the full implementation of the EU Bank Recovery and Resolution Directive, including bail-in powers in case of resolution. We assess the POP Bank Group to have low systemic importance in Finland, and the Finnish authorities have not identified POP Bank Group as subject to a well-defined bail-in process. Consequently, we do not include support from additional loss-absorbing capacity into the long-term rating on Bonum Bank.

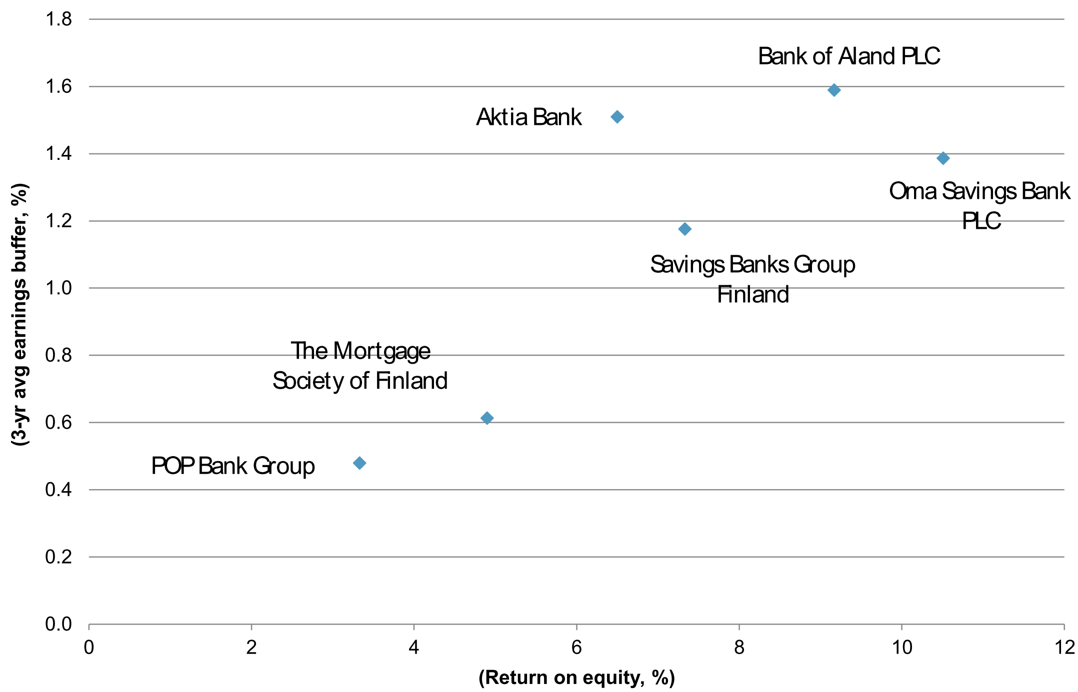
Additional rating factors: A poor performer in its peer group with an untested group structure

We deduct one notch based on our expectation that the group will continue to demonstrate a weaker earnings profile than most of its peers in the medium term. Because of POP Bank Group's high cost base, we expect its three-year average earnings buffer to remain at a low 0.50% until 2019. An earnings buffer of about 1.0% indicates adequate earnings capacity, while a negative buffer would indicate that earnings are insufficient to cover normalized losses and a bank is potentially loss-making through the cycle. Although the inner group's harmonization has shown improvements in return on equity and cost to income, both metrics still lag behind in comparison with its rated peers. The group's return on equity was low at 3.3% in 2017, while its cost-to-income ratio remained elevated at 73%.

Furthermore, there remain uncertainties regarding the functionality of the new group structure, given the short track record of the amalgamation agreement. The structure and governance will likely continue to improve over the coming years and will be tested in a more stressed environment. In our view, these uncertainties translate into overall risks that are more comparable with banks rated 'BBB'.

Chart 2

POP Bank Group Earnings Buffer And Return On Equity Versus Peers (Year-End 2017)



Source: S&P Global Ratings.

Related Criteria

- Criteria - Financial Institutions - General: Methodology For Assigning Financial Institution Resolution Counterparty Ratings, April 19, 2018
- Criteria - Financial Institutions - General: Risk-Adjusted Capital Framework Methodology, July 20, 2017
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- Criteria - Financial Institutions - Banks: Bank Rating Methodology And Assumptions: Additional Loss-Absorbing Capacity, April 27, 2015
- General Criteria: Group Rating Methodology, Nov. 19, 2013
- Criteria - Financial Institutions - Banks: Quantitative Metrics For Rating Banks Globally: Methodology And Assumptions, July 17, 2013
- Criteria - Financial Institutions - Banks: Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- Criteria - Financial Institutions - Banks: Banks: Rating Methodology And Assumptions, Nov. 9, 2011

- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Related Research

- Banking Industry Country Risk Assessment: Finland, Feb. 2, 2018

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 May 29, 2018)	
Bonum Bank PLC	
Issuer Credit Rating	BBB/Stable/A-2
Senior Unsecured	BBB
Issuer Credit Ratings History	
23-May-2016	BBB/Stable/A-2
Sovereign Rating	
Finland	AA+/Stable/A-1+

*Unless otherwise noted, all ratings in this report are global scale ratings. S&P Global Ratings' credit ratings on the global scale are comparable across countries. S&P Global Ratings' credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.

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