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Research Update:

Finland-Based Credit Institution Bonum Bank PLC Rated 'BBB/A-2'; Outlook Stable

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Overview

- Bonum Bank PLC is a core member of the POP Bank Group, which we consider has a weak business position, very strong capital and earnings, a moderate risk position, average funding, and adequate liquidity, as well as weak operating efficiency in a peer comparison and a short track record.
- With a 3% market share in customer deposits, the group has low systemic importance in Finland.
- Consequently, we are assigning our 'BBB/A-2' long- and short-term ratings to Bonum Bank.
- The stable outlook reflects our view that the expected integration within the POP Bank Group, leading to improving efficiency and profitability in the next 12-24 months, will mitigate what we consider to be a weak recovery of the Finnish economy.

Rating Action

On May 23, 2016, S&P Global Ratings assigned its 'BBB/A-2' long- and short-term counterparty credit ratings to Bonum Bank PLC. The outlook is stable.

Rationale

Bonum Bank PLC is the central credit institution of the cooperative POP Bank Group, which operates under the Finnish amalgamation act. The ratings therefore reflect the wider group's franchise and creditworthiness. The amalgamation, established in December 2015, brought together the group's 26 member cooperative banks, POP Bank Alliance (the central organization), and Bonum Bank, to operate as a single entity for regulatory purposes under a joint-liability scheme.

The long-term rating on Bonum Bank reflects our 'a-' anchor for Finnish banks, and POP Bank Group's weak business position, based on its concentrated business operations, which are focused primarily on retail mortgages in and around small cities in Finland. It further mirrors the group's lagging efficiency and short track record of operating under the amalgamation, and its very strong capital and earnings, based on our expectation that the group's risk-adjusted capital (RAC) ratio will reach 16.5%-17.0% by year-end 2017. The ratings are also reflective of the group's moderate risk position, due to concentration risks in its loan book partly offset by a sound level of

collateralization and the group's prudent underwriting standards. We view the bank's funding as average and its liquidity as adequate, owing to sound funding metrics, its funding profile dominated by customer deposits, and its comfortable liquidity position.

We do not factor any extraordinary government support into the group credit profile, due to our assessments that the POP Bank Group has low systemic importance in Finland, and that the Finnish government's supportiveness toward the banking sector is uncertain since the full implementation of EU bank recovery and resolution directive on Jan. 1, 2016.

We incorporate a negative adjustment notch in our group credit profile (GCP) as we regard POP Bank Group as a weaker performer in peer comparison, based on its poor operating efficiency and the uncertainties linked to the group's short track record under its current structure. As a result, the GCP is 'bbb'.

We view Bonum Bank as integral to the group's operations, and therefore equalize our long-term rating on Bonum Bank with the GCP.

We 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 under our criteria. Our anchor for a commercial bank operating only in Finland, such as POP Bank Group members, 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. However, the country depends on exports of investment goods, and therefore on cyclical industries or sectors, and its economy is subject to sub-par growth due to the fragile recovery in Europe. Moreover, a lack of reforms to increase competitiveness could weaken the economy. Low corporate and moderate household debt, as well as a very strong payment culture, contribute to sound leverage.

Diverse Nordic banking groups largely control Finland's concentrated banking industry, which in our view is underpinned by robust profitability 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 POP Bank 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 and agricultural clients. POP Bank Group is a tier 3 banking group in Finland, with assets totaling €4.1 billion at the end of 2015 and a market share of 3% in lending and deposits. It holds a sound regional franchise through its 26 member banks, mainly in less urbanized areas. However, the group has in our view a weak position in Finland's growth centers and limited geographic and earnings diversification from its small non-life insurance business. This makes it vulnerable to a potential downturn in the Finnish economy and changes in the domestic housing

market. We view its legal set-up as a mutual group as positive but believe that the group still needs to enhance the integration of members in order to create advantages of scale and align risk policies and guidelines.

Our view of POP Bank Group's capital and earnings as very strong is based primarily on our RAC ratio for POP Bank Group, which we project will be in the range 16.5%-17.0% by year-end 2017, compared with 15.5% as of Dec. 31, 2015. Our risk-weighted assets (RWAs) measure for the bank will be affected mainly by POP Bank 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 2%, in line with the market in the next two years, will lead to an increase in credit risk RWAs by about 4% in 2016 and 1.5% in 2017, and to a decrease in market risk RWAs related to the declining stake in AREMB.

We expect POP Bank Group to generate relatively predictable earnings, dominated by net interest income, which, combined with slowly improving efficiency, should enable a further capital buildup over the next 18-24 months.

In our view, POP Bank Group risk position is moderate, reflecting concentration risk from retail mortgage loans (63% of total lending book as of Dec. 31, 2015). This exposes the group to potential volatility in Finland's residential real estate market. The risk is partly offset by the loan book's high granularity, adequate collateralization, and our expectation that the group will maintain adequate asset quality. Furthermore, the group extends loans to small agricultural and forestry clients (19% of the portfolio) as well as SMEs (17% of the portfolio), underpinned by small ticket sizes and sound collateralization. We expect the group will grow with the market average over the next two years, while maintaining its underwriting standards. This should continue to translate into improving asset quality metrics and moderate cost of risk of about 15-16 basis points in 2016-2017.

We consider POP Bank Group's funding to be average and its liquidity position adequate. About 95% of funding is through customer deposits and we view positively that funding is well matched, with the long-term funding ratio exceeding 97%. We expect the group to diversify its funding profile via unsecured issuance. Therefore, we believe the group will maintain its sound funding metrics, with a stable funding ratio of 105%-110%. Our assessment of liquidity as adequate reflects that we forecast our liquidity ratio--broad liquid assets to short-term wholesale funding--for the group to remain well above 1.0x despite the increased use of wholesale funding going forward (4.0x as of Dec. 31, 2015).

We adjust the GCP of POP Bank Group down one notch based on its weaker earnings than peers and uncertainties regarding the future structure and functionality of the group. The group exists under the amalgamation only since Dec. 31, 2015, and we expect its structure and governance to evolve over the coming years. In our view, these uncertainties lead the overall risks facing

the group to a level more comparable with banks rated 'BBB'. Our assessment results in a GCP of 'bbb' and subsequently a long-term rating on Bonum Bank of 'BBB', as a core entity of the group.

Outlook

The stable outlook on Bonum Bank reflects our view that the impact of a potential weakening of Finland's economic recovery could be partly offset by the group's ongoing integration process which we expect to improve efficiency and profitability over our two year outlook horizon. The group has a short operating history under the current amalgamation structure, and we expect it to realize synergies, mainly by increasing integration of shared support functions.

We could lower the rating if the Finnish economic recovery weakens, while at the same time the expected cohesiveness within the group does not play out as we anticipate, or if we observe weakening asset quality combined with increased credit losses.

We could consider a positive rating action if our overall assessment of the Finnish banking system improves alongside successful integration within the POP Bank Group, with clear improvements in revenue generation, cost structure, and profitability, leading to an earnings buffer more in line with peers.

Ratings Score Snapshot

Issuer Credit Rating	BBB/Stable/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	0
GRE Support	0
Group Support	0
Sovereign Support	0
Additional Factors	-1

Related Criteria And Research

Related Criteria

- Group Rating Methodology, Nov. 19, 2013
- Quantitative Metrics For Rating Banks Globally: Methodology And Assumptions, July 17, 2013
- Revised Market Risk Charges For Banks In Our Risk-Adjusted Capital Framework, June 22, 2012
- Bank 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
- Commercial Paper I: Banks, March 23, 2004

Related Research

- Banking Industry Country Risk Assessment Update: May, May 17, 2016
- Banking Industry Country Risk Assessment: Finland, Jan. 25, 2016

Ratings List

New Rating

Bonum Bank PLC

Counterparty Credit Rating

BBB/Stable/A-2

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Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. 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 the S&P Global Ratings public website at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following S&P Global Ratings 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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