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Central Bank of Savings Banks Finland Plc

Primary Credit Analyst:
Salla von Steinaecker, Frankfurt (49) 69-33-999-164; salla.vonsteinaecker@standardandpoors.com

Secondary Contact:
Olivia Fleischmann, Stockholm (46) 8-440-5904; olivia.fleischmann@standardandpoors.com

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Central Bank of Savings Banks Finland Plc

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

\+

Support	+1
GRE Support	0
Group Support	0
Sovereign Support	+1

\+

Additional Factors	0

Issuer Credit Rating
A-/Negative/A-2

Major Rating Factors

Strengths:	Weaknesses:
• Very strong capitalization. • Low-risk lending profile and high collateralization. • Mutual business model.	• Concentrated business operations. • Limited geographic presence in Finland's growth centers. • Limited business and earnings diversification.

Outlook: Negative

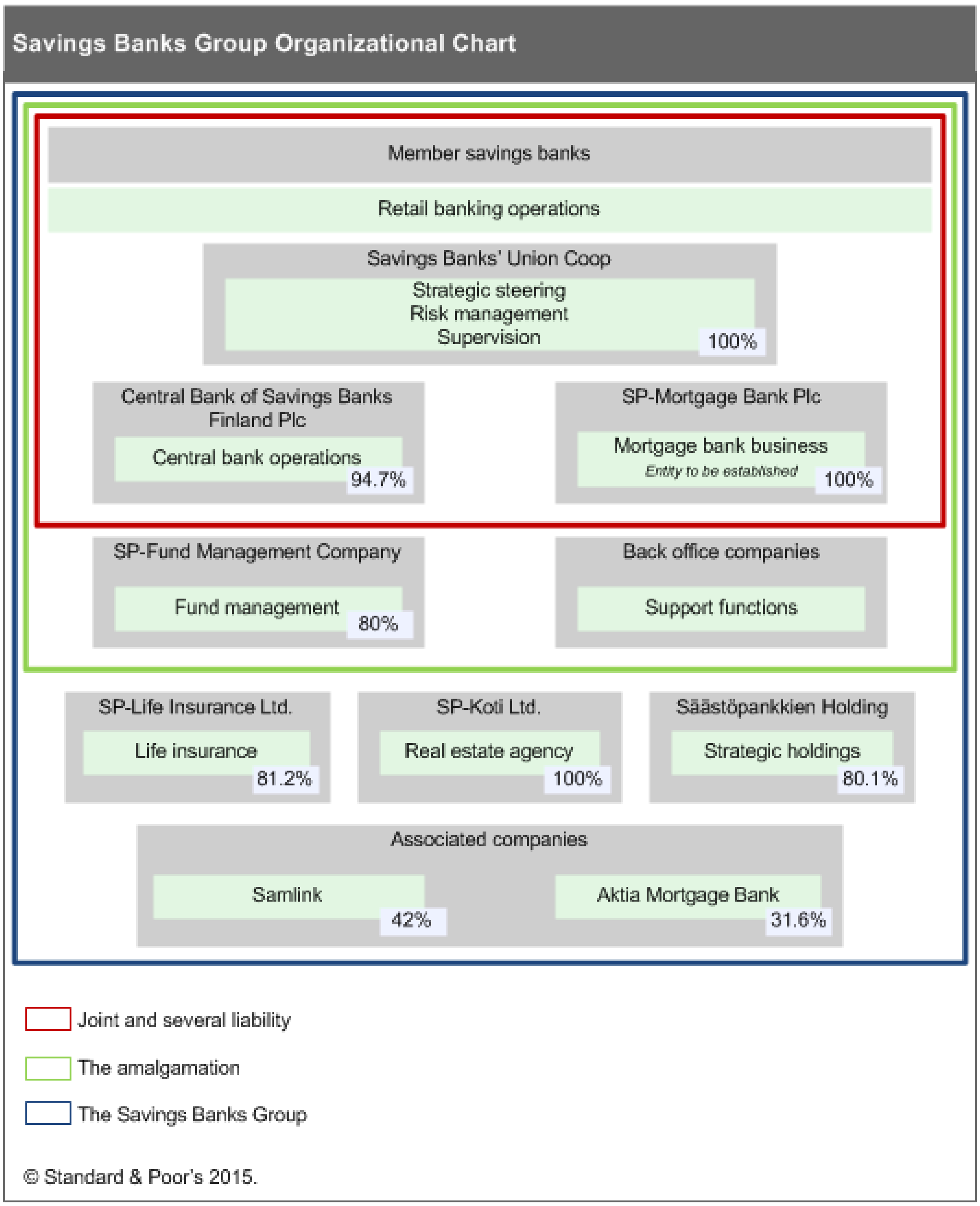
Standard & Poor's Ratings Services' negative outlook on Central Bank of Savings Banks Finland Plc (Sp Central Bank) indicates the possibility of a downgrade by year-end 2015 if there's a greater likelihood that senior unsecured creditors may incur losses if the bank fails after the implementation of EU bank resolution frameworks. We may lower the long-term rating by one notch if we consider that extraordinary government support to Finland's Savings Banks Group is less predictable under the new legal 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 Finnish banks operating mainly domestically, including Sp Central Bank, to 'bbb+' from 'a-'.

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

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 23 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 on Sp Central Bank reflects our 'a-' anchor for Finnish banks, and Savings Banks Group's "weak" business position based on its concentrated business operations, focused primarily on retail mortgages and lending to small and midsize companies, and the group's "very strong" capital and earnings, mainly due to our expectation of an increase in our risk-adjusted capital (RAC) ratio to about 16.0%-16.5% in the next 12-18 months. The ratings equally reflect the group's "moderate" risk position, due to concentration risks in its loan book, partly mitigated by a high level of collateralization; its "average" funding and "adequate" liquidity, owing to sound funding metrics; its funding profile dominated by customer deposits; and its comfortable liquidity position. We assess the unsupported group credit profile (GCP) at 'bbb+'.

In terms of customer deposits, Savings Banks Group is the fourth-largest banking group in Finland, with a 5% share of customer deposits. We therefore consider the group to have "moderate" systemic importance in Finland, which we regard as supportive of its banking sector. Consequently, we factor one notch of uplift for extraordinary government support into the long-term rating on Sp Central Bank. We view Sp Central Bank as integral to the group's operation, and therefore equalize our long-term rating with the supported GCP.

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

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 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. But it also depends on exports in cyclical industries. Moreover, a lack of reforms to increase competiveness 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.

Table 1

Savings Banks Group Key Figures		
	--Year ended Dec. 31--	
(Mil. €)	**2014**	**2013**
Adjusted assets	7,942.3	7,358.4
Customer loans (gross)	5,648.9	5,301.4
Adjusted common equity	821.3	763.8
Operating revenues	226.7	226.3
Noninterest expenses	153.0	149.4
Core earnings	46.6	66.0

Business position: Concentrated business model and still-low presence in Finnish growth centers

We consider Savings Banks Group's business position to be "weak," reflecting the group's concentrated business model, its weak franchise in growth centers and untested set-up of operating as cohesive banking group.

Savings Banks Group is a midsize banking group in Finland, with total assets of €8.4 billion as of Dec. 31, 2014. The group consists of 23 member savings, Sp Central Bank (covering central bank operations), Savings Banks' Union Coop (the central institution in charge of strategic steering, risk management, and supervision) and specialized institutions, such as Sp Fund Management Company and Sp Life Insurance. Due to the very small size of some of the member banks, we expect to see mergers within the amalgamation in the coming two years.

The group has a sound retail franchise with a countrywide branch network and some 468,000 customers. Although the group holds a stable market share of 4.7% in customer lending and 4.9% in customer deposits, we consider the group's limited presence in domestic growth centers as a weakness. We understand that the group targets expansion into such regions, but we consider this challenging given the harsher competition and well-established presence of larger players. By customer group, we understand the group will focus on young adults, families and savers in the private customer group and small businesses, self-employed professionals, and forestry and agricultural customers in small and midsize enterprises (SMEs).

In our viewn Savings Banks Group's geographic concentration and narrow product focus on mainly residential mortgage lending and SME lending represent the main weaknesses to the business model. These factors may expose the bank to potential volatility in the real estate market in Finland or to a downturn in the Finnish economy.

The group's product offering is rounded out its asset management and life insurance companies, with a contribution to revenues that is still minor (combined, 5% of operating revenues and 3% of operating profit as of Dec. 31, 2014). Due to their limited size and low market shares in fund savings (2.7%) and insurance savings (1.0%) in Finland, the asset management and insurance operations currently bring only marginal diversification benefits to the group, in our view.

Savings Banks Group's revenues consist of interest income (50%-55% of total income), fee and commission income (30% of total income), and other income (about 15% of income)--a split that we expect will remain unchanged in the coming years.

We consider that Savings Banks Group shares prudent strategy and risk policies, in line with its domestic peers. The group's strategy and risk management are steered by the central institution, Savings Banks Union Coop. We believe that despite its ambitions to grow the franchise over the next years the group will maintain a low risk appetite and conservative lending standards, which we expect will provide stability to its financial position. 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.

Table 2

Savings Banks Group Business Position		
	--Year ended Dec. 31--	
(%)	**2014**	**2013**
Loan market share in country of domicile	4.7	N/A
Deposit market share in country of domicile	4.9	N/A
Total revenues from business line (mil. €)	226.7	226.3
Commercial & retail banking/total revenues from business line	99.0	88.4

Table 2

Savings Banks Group Business Position (cont.)		
Return on equity	5.8	N/A

N/A--Not applicable.

Capital and earnings: Very strong capitalization, underpinned by stable earnings

We assess Savings Banks Group's capital and earnings as "very strong." This is primarily due to our expectation that our RAC ratio for Savings Banks Group will grow in the range of 16.0%-16.5% over the next 12-18 months, mainly due to profit retention, compared with 15.0% on Dec. 31, 2014. Our projection does not currently include issuance of additional loss absorbing capital.

In our view, Savings Banks Group's earnings are relatively stable. We expect the group will be able to maintain healthy margins in new loans, resulting in overall net interest margins of 1.65%-1.70% (versus 1.71% in 2013) in the loan portfolio in 2015-2016. Combined with lower funding costs, this should support relatively stable net interest income. Furthermore, we anticipate improving net fee and commission income, driven by fees from payment transfers, lending and mutual funds (plus 8% in 2014). We estimate net profits at €50 million-€55 million in 2015-2016 (€47 million in 2014). This will likely enable steady capital build up because the profits are almost fully retained.

We expect moderate loan growth of 3% in Savings Banks Group's loan origination, owing to still-sluggish demand for mortgage and consumer loans in Finland. Furthermore, we expect Savings Banks Group will transfer its share of loans, amounting to €0.48 billion as of May 31, 2015, from Aktia Real Estate Mortgage Bank (AREMB), to its own balance sheet in 2015-2016, leading to a 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 risk-weighted assets (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.

A revision of our view of currently low economic risk in Finland would lead us to lower our RAC ratio on Savings Banks Group because we would use higher risk weights on exposures in our calculation. However, we do not think that such a scenario would change our assessment of the bank's "very strong" capital and earnings, underpinned by a projected RAC ratio that is well beyond the 15% mark.

We consider Savings Banks Group's quality of capital, consisting mainly of paid-in capital, and its earnings, to be adequate. We expect the group's earnings capacity will improve over time, owing to stable operating revenues and expenses and our expectation of low loan losses. This is reflected in our three-year average earnings buffer of about 80-90 basis points (bps) for the group, which nevertheless lags those of other Nordic regional banks.

Table 3

Savings Banks Group Capital And Earnings		
	--Year ended Dec. 31--	
(%)	2014	2013
Tier 1 capital ratio	16.9	15.8
S&P RAC ratio before diversification	15.0	N.M.
S&P RAC ratio after diversification	12.3	N.M.
Adjusted common equity/total adjusted capital	100.0	100.0
Net interest income/operating revenues	53.8	48.9

Table 3

Savings Banks Group Capital And Earnings (cont.)		
Fee income/operating revenues	28.0	26.0
Market-sensitive income/operating revenues	10.6	11.3
Noninterest expenses/operating revenues	67.5	66.0
Preprovision operating income/average assets	0.9	N/A
Core earnings/average managed assets	0.6	N/A

RAC--Risk-adjusted capital. N/A--Not applicable. N.M.--Not meaningful.

Table 4

Savings Banks Group Risk-Adjusted Capital Framework Data

	Exposure*	Basel II RWA	Average Basel II RW (%)	Standard & Poor's RWA	Average Standard & Poor's RW (%)
Credit risk					
Government and central banks	534,344,248	311,759	0	16,181,931	3
Institutions	675,035,999	152,484,445	23	117,982,503	17
Corporate	660,896,542	909,635,608	138	422,032,952	64
Retail	5,688,970,787	2,061,815,153	36	1,765,402,584	31
Of which mortgage	4,272,629,866	1,361,652,409	32	1,025,710,870	24
Securitization§	0	0	0	0	0
Other assets	313,414,634	277,652,388	89	237,907,935	76
Total credit risk	7,872,662,211	3,401,899,353	43	2,559,507,905	33
Market risk					
Equity in the banking book†	537,364,031	530,800,115	108	2,437,466,691	454
Trading book market risk	--	46,953,758	--	70,430,637	--
Total market risk	--	577,753,873	--	2,507,897,328	--
Insurance risk					
Total insurance risk	--	--	--	0	--
Operational risk					
Total operational risk	--	387,988,164	--	414,665,957	--
		Basel II RWA		**Standard & Poor's RWA**	**% of Standard & Poor's RWA**
Diversification adjustments					
RWA before diversification		4,367,641,390		5,482,071,190	100
Total diversification/concentration adjustments		--		1,215,642,588	22
RWA after diversification		4,367,641,390		6,697,713,778	122
		Tier 1 capital	**Tier 1 ratio (%)**	**Total adjusted capital**	**Standard & Poor's RAC ratio (%)**
Capital ratio					
Capital ratio before adjustments		737,558,676	16.9	824,157,700	15.0
Capital ratio after adjustments‡		737,558,676	16.9	824,157,700	12.3

Table 4

Savings Banks Group Risk-Adjusted Capital Framework Data (cont.)
*Exposure at default. §Securitization exposure includes the securitization tranches deducted from capital in the regulatory framework. †Exposure and Standard & Poor's risk-weighted assets for equity in the banking book include minority equity holdings in financial institutions. ‡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, 2014, Standard & Poor's.

Risk position: Concentration risk, due to the focus on retail mortgage and SME lending in Finland

We view Savings Banks group's risk position as "moderate." This reflects concentration risk in the group's loan book, which in our view exposes it to potential volatility in the domestic real estate market and a potential downturn in the Finnish economy.

Saving Banks Group focuses mainly on low-risk lending to private customers (71% of the portfolio) and lending to SMEs, including agricultural and forestry clients (about 19% of the portfolio) based on prudential underwriting standards. However, we still consider that the regionally focused retail mortgage loan book (60% of the total loan book) exposes the bank to concentration risk and makes it vulnerable to real estate price developments in Finland. The concentration is partly mitigated by the retail loan book's high granularity and adequate collateralization. We note that about 5% of the total loan stock has loan-to-value ratios above 80% and 13% above 70%, which is somewhat weaker than other rated Finnish peers.

Savings Banks Group's SME loan book of €1.2 billion does not show, in our view, significant single-name or sector concentration and we understand it is well collateralized by residential or other real estate collateral. We believe that these exposures are adequately captured in our RAC framework.

We expect Savings Banks Group will maintain its prudential risk culture and underwriting standards especially in mortgage lending. The central institution monitors the risk indicators. Consequently, we believe that the group's asset quality will remain sound over the next two years. The ratio of nonperforming loans was 1.07% of customer loans on Dec. 31, 2014, which in our view reflects the group's portfolio structure.

Despite our view of growing economic imbalances in the Finnish household sector, we expect Savings Banks Group will maintain a low level of credit losses, at about 8-10 bps over the next two years (19 bps in 2014 due to harmonizing of the group impairment policy), which is in line with the average impairments of the amalgamation in 2004-2014. We believe that the potential increase in credit losses could result from the group's SME exposures, rather than the private customer portfolio.

Table 5

Savings Banks Group Risk Position

	--Year ended Dec. 31--	
(%)	**2014**	**2013**
Growth in customer loans	6.6	N.M.
Total diversification adjustment/S&P RWA before diversification	22.2	N.M.
Total managed assets/adjusted common equity (x)	10.2	10.1
New loan loss provisions/average customer loans	0.2	N/A
Net charge-offs/average customer loans	0.2	N/A
Gross nonperforming assets/customer loans + other real estate owned	1.1	1.1

Table 5

Savings Banks Group Risk Position (cont.)
RWA--Risk-weighted assets. N/A--Not applicable. N.M.--Not meaningful.

Funding and liquidity: Stable customer deposits dominate the funding profile

We consider Savings Banks Group's funding to be "average." Our view is based on the group's sound retail franchise and proximity to customers that should continue to provide the group with a comparably stable and granular inflow of deposits (83% of funding base). Savings Banks Group holds a healthy market share of about 5% in the customer deposits in Finland. A major part of the customer deposits is from households, followed by SME clients. Therefore, we expect Savings Banks Group's stable funding ratio will remain at a comfortable level of about 110% over 2015-2016 (108% as of Dec. 31, 2014).

We believe that Savings Banks Group will diversify its funding mix by increasing capital market funding through its unsecured issuance under its €2 billion Euro Medium Term Note Program, and starting from 2016, via secured issuance by launching covered bond operations at Sp-Mortgage Bank. This will allow the group to accelerate its loan growth, following sluggish development over the past two years caused by funding constraints. In our view, the group's funding mix will continue to represent a relatively balanced asset-liability structure, demonstrated by a long-term funding ratio of about 92% that is in line with the ratios of domestic competitors. The group's loan-to-deposit ratio stands out at about 97%, well below that of domestic peers operating purely in retail banking. However, the transfer of assets from AREMB will, in our view, lead to a ratio of about 100%.

Our assessment of Savings Banks Group liquidity as "adequate" mirrors our estimate of the bank's one-year liquidity ratio (broad liquid assets to short-term funding) at 2.0x as of Dec. 31, 2014. The planned increase in wholesale funding is likely to reduce the ratio, but we believe it will remain well above 1.0x in 2015-2016. The group had a liquidity position of about €1.2 billion, consisting mainly of cash and securities, which we understand to a high extent are eligible for repurchase (repo) agreement transactions at the Finnish Central Bank. Consequently, we believe that in a severe liquidity crisis involving closure of access to capital market funding and a significant deposit outflow, Savings Banks Group could survive for more than 12 months with access to the central bank through the repo activity in its liquidity book.

Table 6

Savings Banks Group Funding And Liquidity

	--Year ended Dec. 31--	
(%)	**2014**	**2013**
Core deposits/funding base	83.2	86.7
Customer loans (net)/customer deposits	97.3	94.5
Long term funding ratio	92.2	93.9
Stable funding ratio	108.3	108.1
Short-term wholesale funding/funding base	8.8	6.8
Broad liquid assets/short-term wholesale funding (x)	2.0	2.3
Net broad liquid assets/short-term customer deposits	11.4	11.2
Short-term wholesale funding/total wholesale funding	52.1	51.1
Narrow liquid assets/3-month wholesale funding (x)	4.2	3.2

External support: No notches of uplift to the group credit profile

In terms of customer deposits, Savings Banks Group is the fourth-largest banking group in Finland, with a share of almost 5% in customer deposits. We therefore consider Savings Banks Group to have "moderate" systemic importance in Finland, which we regard as supportive of its banking sector. Consequently, we factor one notch of uplift for extraordinary government support into the long-term rating on Sp Central Bank.

We could remove this notch shortly before the January 2016 introduction of the Bank Recovery and Resolution Directive's bail-in powers for senior unsecured liabilities in Finland. These rules would indicate to us that the Finnish government would be much less able to support senior unsecured bank creditors, although it may take several more years to eliminate concerns about financial stability and the resolvability of systemically important banks.

Additional rating factors: None

No additional factors affect this rating.

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

- Banking Industry Country Risk Assessment Update: May 2015, May 6, 2015
- Central Bank of Savings Banks Finland Ltd. Rated 'A-/A-2'; Outlook Negative, April 7, 2015
- Finland Ratings Affirmed At 'AA+/A-1+' On Still-Strong External And Government Balance Sheets; Outlook Stable, March 27, 2015
- Nordic Banks Face Credit Pressures From Bail-In Regulations And Economic Risks, March 9, 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

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 June 3, 2015)

Central Bank of Savings Banks Finland Plc	
Counterparty Credit Rating	A-/Negative/A-2
Senior Unsecured	A-
Counterparty Credit Ratings History	
07-Apr-2015	A-/Negative/A-2
Sovereign Rating	
Finland (Republic of)	AA+/Stable/A-1+

*Unless otherwise noted, all ratings in this report are global scale ratings. Standard & Poor's credit ratings on the global scale are comparable across countries. Standard & Poor's 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.

Additional Contact:

Financial Institutions Ratings Europe; FIG_Europe@standardandpoors.com