

Rating Action: Moody's affirms OP Corporate Bank's Aa3 rating; stable outlook

04 Dec 2018

London, 04 December 2018 -- Moody's Investors Service ("Moody's") has today affirmed OP Corporate Bank plc's (OP Corporate Bank) Aa3 long-term deposit ratings and senior unsecured ratings, the Prime-1 short-term debt and deposit rating, and the Baa1 subordinate and Baa3(hyb) preferred stock non-cumulative ratings. OP Corporate Bank's Baseline Credit Assessment (BCA) was upgraded to a3 from baa2 and the Adjusted BCA of a3 was affirmed. The long- and short-term Counterparty Risk Assessments of Aa2(cr)/Prime-1(cr) and the foreign - and local - currency Counterparty Risk Rating of Aa2/P-1 were affirmed for OP Corporate Bank. The outlook on the long-term deposits and senior unsecured ratings remain stable.

The upgrade of OP Corporate Bank's BCA reflects Moody's decision to fully incorporate the credit implications arising from the joint liability agreement shared by the key credit institutions operating under the OP Financial Group (OPFG). This agreement effectively links these entities and align the BCA of the bank with that of the group. Consequentially, OPFG's BCA and adjusted BCA of a3, the long- and short-term Counterparty Risk Assessments of Aa2(cr)/Prime-1(cr) and the foreign and local currency Counterparty Risk Rating of Aa2/P-1 were withdrawn, as the credit strength of the group is now fully incorporated into Moody's assessment of the bank's credit profile.

The stable outlook on the long-term ratings incorporate Moody's view that over the next 12 to 18 months, OP Financial group will maintain stable asset risk, keep building capital through steady recurring profitability and keep its current share of market funding.

The full list of affected ratings is provided at the end of the press release.

RATINGS RATIONALE

BASELINE CREDIT ASSESSMENT

OP Corporate Bank's BCA of a3 reflects the group's: 1) very strong capitalization with CET 1 of 20.0% at end-September 2018, 2) low asset risk with a problem loan ratio at 1.54% at end-September 2018, and 3) stable earnings due to good business growth and low provisioning needs. These strengths remain balanced against a modest reliance on market funding.

The group's capitalisation remains very strong, with Common Equity Tier 1 of 20.0% as of end-September 2018, slightly down from 20.1% at year-end 2017. Current capitalisation includes the 15% risk weight on Finnish housing loans in effect from January 2018. Furthermore the group's leverage ratio is very strong, at 7.9% as of end-September 2018. Moody's expects that the group will continue strengthening its capitalisation in accordance with its internal targets to reach a CET1 of 22% by 2019, through internal capital generation.

Asset risk will remain low going forward in the continued supportive Finnish operating environment. Problem loans to gross loans under IFRS 9 was 1.54% as of end-September 2018 (non-performing loans ratio was 1.76% at year-end 2017). Moody's expects the problem loan ratio to be stable going forward while loans that have previously been classified as performing forborne, around 2% of the loan book, will reduce as loans convert into performing loans.

Profitability and efficiency has weakened recently mainly due to ongoing IT investments but Moody's expects that cost efficiency measures and income growth will enable the group to continue reporting relatively stable earnings. Moody's notes that a gradual increase in interest rates would be beneficial for net interest earnings. Moody's forecasts that the group will perform in line with previous years' level of net income to tangible assets of 0.6%-0.7% during the outlook period.

OP Financial Group relies substantially on market funding, amounting to 24.5% of tangible banking assets as of end-September 2018. The level of market funding, however, has been stable in recent years and Moody's expects the level to remain consistent going forward. The deposit base is broad reflecting its large branch network in Finland. The group has a centralized treasury in OP Corporate Bank to monitor liquidity, with an evenly spread maturity profile and adequate liquid resources to manage refinancing risks.

LOSS GIVEN FAILURE

Finland is subject to the EU Bank Recovery and Resolution Directive (BRRD), which Moody's considers to be an Operational Resolution Regime and applies its Advanced loss given failure analysis (LGF). Under the LGF, Moody's assumes residual tangible common equity of 3% and losses post-failure of 8% of tangible banking assets, a 25% run-off in "junior" wholesale deposits, a 5% run-off in preferred deposits, and assign a 25% probability to deposits being preferred to senior unsecured debt. In line with large European banks, the rating agency assume 26% of deposits are junior. These are in line with Moody's standard assumptions.

Moody's advanced LGF analysis is based on the tangible banking assets of OPFG (including OP Corporate Bank), because all member credit institutions in OPFG (excluding insurance companies and some other group companies) are liable for each other's obligations, in accordance with the Amalgamations Act. Moody's expects a single point of entry resolution for OPFG.

This results in a Preliminary Rating Assessment (PRA) of a1 for the deposits and senior unsecured debt, two notches above the Adjusted BCA, reflecting a very low loss-given failure.

For the CRA and CRR, the LGF indicates three notches of uplift, reflecting the substantial amounts of subordinated loss absorbing obligations.

For junior securities issued by OP Corporate Bank, LGF analysis indicates a high loss-given failure, given the small volume of debt and limited protection from more subordinated instruments and residual equity. The ratings also incorporate additional negative notchings for junior subordinated and preference share instruments reflecting coupon features. Current AT1's are perpetual non-cumulative, non-convertible subordinated debt.

GOVERNMENT SUPPORT

Following the introduction of BRRD, Moody's believes the probability of government support for OP Corporate Bank's long-term and deposits ratings to be moderate, translating into one notch of uplift from its unsupported rating level, reflecting OP Corporate Bank's profile as one of the leading financial institutions in Finland and systemically important. This results in one notch of uplift for the deposit, senior unsecured debt, and counterparty risk ratings.

The stable outlook on the long-term ratings incorporate Moody's view that over the next 12 to 18 months, OP Financial Group will maintain stable asset risk, keep building capital through steady recurring profitability and keep its current share of market funding.

FACTORS THAT COULD LEAD TO AN UPGRADE/DOWNGRADE

Factors that could lead to an upgrade include a combination of: (1) sustained improvements in asset risk; (2) stronger recurring profitability; (3) reduction in the overall wholesale funding dependence in favour for a higher proportion of deposit funding for the group.

Factors that could lead to a downgrade include: (1) a deterioration of the group's funding conditions; (2) a weakening of asset quality beyond our current expectations; and (3) a significant lower recurring profitability. Furthermore, if the volumes of outstanding loss absorbing obligations protecting creditors and depositors in case of failure decline in relation to tangible banking assets of the group, it could lead to a downgrade.

LIST OF AFFECTED RATINGS

Issuer: OP Corporate Bank plc

..Upgrade:

....Baseline Credit Assessment, upgraded to a3 from baa2

..Affirmations:

....Long-term Counterparty Risk Ratings, affirmed Aa2

....Short-term Counterparty Risk Ratings, affirmed P-1

....Long-term Bank Deposits, affirmed Aa3, outlook remains Stable

...Short-term Bank Deposits, affirmed P-1
...Long-term Counterparty Risk Assessment, affirmed Aa2(cr)
...Short-term Counterparty Risk Assessment, affirmed P-1(cr)
...Long-term Issuer Rating, affirmed Aa3, outlook remains Stable
...Adjusted Baseline Credit Assessment, affirmed a3
...Senior Unsecured Regular Bond/Debenture, affirmed Aa3, outlook remains Stable
...Senior Unsecured Medium-Term Note Program, affirmed (P)Aa3
...Subordinate Regular Bond/Debenture, affirmed Baa1
...Subordinate Medium-Term Note Program, affirmed (P)Baa1
...Preferred Stock Non-cumulative, affirmed Baa3(hyb)
...Commercial Paper, affirmed P-1
...Other Short Term, affirmed (P)P-1

..Outlook Action:

...Outlook remains Stable

Issuer: OP Financial Group

..Withdrawals:

...Long-term Counterparty Risk Ratings, previously rated Aa2
...Short-term Counterparty Risk Ratings, previously rated P-1
...Long-term Counterparty Risk Assessment, previously rated Aa2(cr)
...Short-term Counterparty Risk Assessment, previously rated P-1(cr)
...Baseline Credit Assessment, previously rated a3
...Adjusted Baseline Credit Assessment, previously rated a3

..Outlook Action:

...Outlook changed to Rating Withdrawn from Stable

Moody's has decided to withdraw the ratings for its own business reasons. Please refer to the Moody's Investors Service's Policy for Withdrawal of Credit Ratings, available on its website, www.moody's.com.

PRINCIPAL METHODOLOGY

The principal methodology used in these ratings was Banks published in August 2018. Please see the Rating Methodologies page on www.moody's.com for a copy of this methodology.

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