S&P Global
Ratings

# RatingsDirect®

# OP Corporate Bank PLC

**Primary Credit Analyst:**
Antonio Rizzo, Madrid + 34 91 788 7205; Antonio.Rizzo@spglobal.com

**Secondary Contacts:**
Salla von Steinaecker, Frankfurt + 49 693 399 9164; salla.vonsteinaecker@spglobal.com
Manuel Adam, Frankfurt + 49 693 399 9199; manuel.adam@spglobal.com

## Table Of Contents

# OP Corporate Bank PLC

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

\+

| Support | +1 |
| --- | --- |
| ALAC Support | +1 |
| GRE Support | 0 |
| Group Support | 0 |
| Sovereign Support | 0 |

\+

| Additional Factors | 0 |
| --- | --- |

| Issuer Credit Rating |
| --- |
| AA-/Stable/A-1+ |

| Resolution Counterparty Rating |
| --- |
| AA-/--/A-1+ |

## Major Rating Factors

| Strengths: | Weaknesses: |
| --- | --- |
| • Successful bancassurance strategy and solid domestic retail and corporate franchise.<br>• Solid capitalization underpinned by sound retained earnings and profit shares issuance.<br>• Deeply rooted cooperative banking model with joint liability between OP Corporate Bank and member credit institutions. | • Geographic concentration in Finland.<br>• Weaker cost efficiency than peers', although improving. |

**Outlook: Stable**

The stable outlook reflects our view that the creditworthiness of the wider OP Financial Group is unlikely to change over the next two years, and the support mechanisms within the group--underpinned by the joint liability between OP Cooperative and the group's member credit institutions--will remain a supportive factor. Moreover, leveraging on further integration in the group, a leaner structure, and digitalization, we expect OP Financial Group to gradually improve its efficiency and, in turn, boost profitability.

The outlook also reflects our expectation that our risk-adjusted capital (RAC) ratio for the bank will be able to reach and stay above 15% in the next two years, on the back of stable retained earnings and the issuance of additional profit shares.

Furthermore, the bank should continue to build its bail-in-able buffers, which we already consider a rating strength and therefore allot one notch of uplift for additional loss-absorbing capacity (ALAC).

### Downside scenario

We could lower the rating if we considered that the bank's ALAC buffer was unlikely to exceed our threshold of 5% of S&P Global Ratings' risk-weighted assets over the two-to-four-year ramp-up period.

### Upside scenario

An upgrade during the outlook horizon through to 2022 is unlikely at present, given that our rating on the bank is now among the highest of those on rated commercial banks globally. Moreover, we do not currently see OP Financial Group as a positive outlier compared with these banks.

The stable outlook on Pohjola Insurance Ltd. reflects that on its parent, OP Corporate Bank.

## Rationale

The ratings on OP Corporate reflect the dominant bancassurance franchise and high capitalization of the wider OP Financial Group, comprising 137 member cooperative banks; OP Cooperative, the group's central institution; OP Corporate; insurance businesses; and specialized institutions. OP Corporate is a wholly owned subsidiary of OP Cooperative that acts as the cooperative's corporate bank for large clients and small and midsize enterprise (SME) customers. It is also the central bank of the wider OP Financial Group. The group's member cooperative banks have operated since 1997 as a single entity for regulatory purposes under a joint liability scheme, established under Finnish law. Given OP Corporate's role as central financial institution for the group and the full ownership by the OP Cooperative, we view the bank as integral to the group.

We anticipate that the group will maintain its dominant position within the Finnish market, where its business lines have market shares of 20%-40%. Moreover, the group's cooperative nature translates into a stable customer base and supports its revenue stability.

The capitalization level remains a key strength of the rating assessment because sustained organic capital generation--despite lower profitability in 2020 and 2021--will lead OP to build up its RAC ratio to about 16% by December 2021. At the same time, our ratings incorporate the bank's geographical concentration in Finland-- by contrast with more-diversified international peers--and its exposure to the Finnish real estate sector, mainly income-producing real estate.

The risk profile continues to benefit from the strong loan-loss track record, in line with Nordic peers. We, however, believe that the loan losses and nonperforming loan ratio will increase in the next 12 months given the overall business scenario following the pandemic, and stabilize from 2022.

The group's funding mix is well balanced, and mostly reliant on customer deposits. It also has proven access to capital markets. The group has gradually increased its liquidity buffers, which exceed its maturing short-term wholesale debt by a comfortable amount. Based on the above, we assign a group stand-alone credit profile (SACP) of 'a+'.

Our assessment of ALAC at OP Financial Group leads us to incorporate one notch of uplift to the group credit profile (GCP). Consequently, the issuer credit rating on OP Corporate is aligned with the 'aa-' GCP.

### Anchor: Reflects Finland's cyclical-but-resilient economy and low debt

Under our bank criteria, we use our Banking Industry Country Risk Assessment (BICRA) economic risk and industry risk scores to determine the anchor, the starting point for our bank rating. The anchor for OP Corporate is 'a-', in line with that used for commercial banks based in Finland. We classify Finland's banking sector in group '2' under our BICRA, alongside Austria, Switzerland, Canada, Sweden, Norway, Belgium, and Germany.

We have revised the economic risk trend for Finland's BICRA back to stable from negative.

We view Finland as an innovative, wealthy, and small open economy, with mature political and institutional structures. In our view, the Finnish economy has fared better than expected with the challenges induced by the COVID-19 pandemic. We project a more moderate GDP contraction of 3.8% in 2020 followed by rebound of 2.3% in 2021 and settling at about 1.5% thereafter. This owes to the firm management of the pandemic, strong social welfare, effective and wide-ranging policy responses, and the society's advanced digital preparedness. The economy adapted quickly to remote working, owing to advanced digitalization; manufacturing production continued throughout the lockdowns. At the same time, temporary furloughs took the burden off corporates. The decline in investments has been less severe than we anticipated, and manufacturing and construction continued through lockdowns. However, Finnish exports and the order books remain below the levels seen in 2019 and could weaken economic recovery. We expect private consumption--which has quickly bounced back after lockdowns to be the backbone of recovery in 2021. As such, the economic challenges induced by COVID-19, and the associated downside risks for the banking sector, have abated in our view.

We currently do not see material economic imbalances in the Finnish economy since house prices have stabilized nationwide and housing market activity has normalized after the lockdowns. However, increasing private sector debt--in particular at households--could lead to higher credit losses for banks over time. Still, in our base case, we forecast moderate credit losses despite increased bankruptcies, active use of loan installment-free periods, and more muted credit demand.

In our view, regulatory standards and bank supervision in Finland are in line with those of European peers. Despite the concentrated banking sector--dominated by the two major banking groups OP Financial Group and Nordea and underpinned by intense competition and low lending margins--we believe the sector's overall profitability and capitalization will remain resilient despite the COVID-19 driven dip in profitability in 2020. We also expect banks to maintain their restrained risk appetite. We therefore view the Finnish banking sector as well prepared to weather the current shock, although business prospects will weaken through 2021. We believe that the risk of tech disruption remains moderate given the banks' digital customer offerings and ongoing investment in innovation.

In our view, the dependence on external funding makes Finnish banks vulnerable to changes in confidence sensitivity, but they continue to demonstrate good access to capital markets. Additionally, the Nordic banking system remains highly interconnected, which results in potential spillover risks on the Finnish economy from external events.

**Table 1**

| OP Financial Group -- Key Figures | | | | | |
|---|---|---|---|---|---|
| | | **--Fiscal year ended Dec. 31--** | | | |
| | **2020*** | **2019** | **2018** | **2017** | **2016** |
| Adjusted assets | 140,044 | 127,216 | 121,066 | 117,161 | 109,663 |
| Customer loans (gross) | 94,818 | 92,018 | 87,606 | 82,731 | 79,112 |
| Adjusted common equity | 9,827 | 9,573 | 9,184 | 8,547 | 7,397 |
| Operating revenues | 2,357 | 3,396 | 2,937 | 3,090 | 2,912 |
| Noninterest expenses | 1,604 | 2,152 | 1,916 | 1,990 | 1,773 |
| Core earnings | 451 | 926 | 761 | 834 | 854 |

*Data is to September 2020.

### Business position: Leading domestic franchise in banking and insurance.

We expect OP Financial Group to consolidate its leading position in the Finnish market, where its business lines in corporate and retail banking have market shares of about 35%. This is further supported by the group's life and nonlife insurance operations enjoying strong market shares of 18% and 34%, respectively. The group's asset management--managing €85 billion of customer assets--complements the offer.

OP Financial Group--with total assets of €159 billion as of Sept. 30,2020--has a strong retail and corporate banking franchise. It has a countrywide branch network, with about 3.6 million private and 300,000 corporate customers. In our view, the group has a stable operating platform based on consistently strong and recurring revenue; a pre-provision income on average adjusted assets at about 1% from 2014-2019; and its retail focus and coherent long-term strategy.

We expect the current strategy, focused on digitalization, will support successful cross-selling between banking and insurance in the rapidly evolving operating environment. OP Financial Group aims to transform into a fully digitalized group and follows a collaborative fintech strategy. More than 98% of private customers' payments and services come through digital channels and more than 45% of clients are active digital users. Amid the coronavirus pandemic, digital service channels have been actively used, with OP Financial Group's mobile app being the main service channel. Moreover, the group is focusing on artificial intelligence to improve its banking offer and customer interaction; it is also pioneering digital home selling in Finland and blockchain solutions.

Moreover, the group's revenue diversity through its banking and insurance operations is a strength in the relatively consolidated Finnish banking sector. Net of nonrecurring items, OP Financial Group's revenue broadly consists of interest income representing about half of total income, fee and commission income about one-third, and 15%-20% net insurance income--a split that we expect to continue in coming years. We think the group still has significant room to further exploit its cross-selling opportunities over the medium term. The group's efforts in this respect have been positive, with a continuous increase in joint clients to 1.3 million in September 2020 from about 700,000 in 2005.

We believe that the stable cooperative ownership structure underpins the strengths and stability of the business model. OP Cooperative, all 137 member cooperative banks, and other member credit institutions operate with joint liability, defined by the Finnish Act on the Amalgamation of Deposit Banks. At the same time, we expect management to continue to streamline the structure of the group to better focus on its strategy, providing the owners with better efficiency and ultimately stable returns.

**Table 2**

| OP Financial Group -- Business Position | | | | | |
|---|---|---|---|---|---|
| | **2020*** | **2019** | **2018** | **2017** | **2016** |
| | | **--Year ended Dec. 31--** | | | |
| Total revenues from business line (mil. €) | 2,402 | 3,396 | 2,979 | 3,115 | 2,988 |
| Commercial & retail banking/total revenues from business line | 72.98 | 68.08 | 64.15 | 60.03 | 64.39 |
| Insurance activities/total revenues from business line | 21.15 | 34.86 | 18.23 | 19.71 | 18.64 |
| Asset management/total revenues from business line | N/A | N/A | 15.14 | 16.28 | 12.22 |
| Other revenues/total revenues from business line | 5.87 | (2.94) | 2.48 | 3.98 | 4.75 |
| Return on average common equity | 4.40 | 5.51 | 6.93 | 8.03 | 9.42 |

*Data is to September 2020.

## Capital and earnings: Strong prospective capitalization supported by solid retained profits and issuance of profit share

Our capital and earnings assessment primarily reflects our expectation that the bank's capitalization, as measured by our projected RAC ratio before diversification adjustments, will be comfortably over 15% over the next 24 months, compared with 13.8% as of June-end 2020. The capital build-up will be supported by the expectation of additional profit shares issuance, stable earnings generation, and conservative capital policy in the cooperative network. Our measure of capital (total adjusted capital [TAC]) has already benefited by €2.9 billion in member profit shares issued to retail owner-customers since 2014 through the member cooperative banks, which is an integral part of recapitalizing the group. We consider profit shares part of our TAC, in line with the regulatory approach.

We expect our earnings buffer metric on OP Financial Group, which measures the capacity of a bank to cover its normalized losses, will remain slightly lower than peers, at 80-100 bps. This will lead to a lower buildup of capital. However, even if OP Financial Group's cost efficiency improves, it still somewhat lags that of its large Nordic peers; it reported a cost to income ratio of about 63% as of year-end 2019 (and 68% as of September 2020)--a reflection of its cooperative group structure.

The group reported a Common Equity Tier 1 (CET1) ratio of 18.3%, as of Sept. 30, 2020, a meaningful decline from 19.5% as of December 2019. The lower ratio was mainly explained by the stricter definition of default adopted in accordance with new European Banking Authority guidelines and higher loan growth. Management has also disclosed a negative impact of 2.2% on CET1 stemming from additional regulatory changes such as the review of the internal models and standardized approach for counterparty risk, among others. The bank aims to offset the regulatory capital hit with organic capital generation, member profit shares, and Tier 2 debt instruments. Moreover, it expects that the Capital Requirements Regulation 2 changes will reduce the group's CET1 ratio by 0.5% during 2021. At the same time, OP's CET1 ratio comfortably meets the regulatory requirements and remains above management's target of 13.7% (400 bps above the Maximum Distributable Amount level).

The nonlife and life insurance operations have solvency II ratios of 146% and 169%, respectively as of Sept. 30, 2020 (without transitional measures) of the solvency capital requirement under Solvency II, with any excess capital to continue heading to the ultimate parent, OP Financial Group.

Under our RAC framework, we deduct from the numerator the equity invested and risk weight at 1.250% subordinated debt held by the life and nonlife subsidiaries. We consider this commensurate with the risk level in the insurance businesses.

**Table 3**

**OP Financial Group -- Capital And Earnings**

| | 2020* | 2019 | 2018 | 2017 | 2016 |
|---|---|---|---|---|---|
| | | --Year ended Dec. 31-- | | | |
| Tier 1 capital ratio | 18.30 | 19.50 | 20.60 | 20.30 | 20.30 |
| S&P Global Ratings' RAC ratio before diversification | N/A | N/A | 15.32 | 14.65 | N/A |
| S&P Global Ratings' RAC ratio after diversification | N/A | N/A | 14.07 | 13.43 | N/A |
| Adjusted common equity/total adjusted capital | 100.00 | 100.00 | 100.00 | 100.00 | 98.97 |
| Net interest income/operating revenues | 40.73 | 36.54 | 40.01 | 35.40 | 36.33 |
| Fee income/operating revenues | 28.81 | 27.56 | 30.20 | 30.03 | 29.50 |
| Market-sensitive income/operating revenues | 12.13 | 27.21 | 7.93 | 21.00 | 21.05 |
| Cost to income ratio | 68.05 | 63.37 | 65.24 | 64.40 | 60.89 |
| Preprovision operating income/average assets | 0.66 | 0.87 | 0.74 | 0.81 | 0.88 |
| Core earnings/average managed assets | 0.39 | 0.64 | 0.55 | 0.62 | 0.66 |

*Data is to September 2020. RAC--Risk-adjusted capital. N/A--Not applicable.

**Table 4**

**OP Financial Group--Risk-Adjusted Capital Framework Data**

| (€) | Exposure* | Basel III RWA | Average Basel III RW(%) | S&P Global Ratings RWA | Average S&P Global Ratings RW (%) |
|---|---|---|---|---|---|
| **Credit risk** | | | | | |
| Government and central banks | 31,085,957,078 | 31,998,147 | 0.1 | 290,699,815 | 0.9 |
| Of which regional governments and local authorities | 4,374,577,992 | 0 | 0.0 | 158,592,462 | 3.6 |
| Institutions and CCPs | 8,812,993,368 | 1,063,693,835 | 12.1 | 1,302,133,413 | 14.8 |
| Corporate | 45,274,699,735 | 30,094,388,906 | 66.5 | 31,903,280,561 | 70.5 |
| Retail | 55,479,600,744 | 13,325,830,969 | 24.0 | 15,787,854,782 | 28.5 |
| Of which mortgage | 45,599,402,179 | 9,366,652,860 | 20.5 | 10,377,988,923 | 22.8 |
| Securitization§ | 560,968,888 | 112,193,778 | 20.0 | 112,193,778 | 20.0 |
| Other assets | 3,433,820,288 | 2,411,368,905 | 70.2 | 3,655,939,562 | 106.5 |

**Table 4**

| OP Financial Group--Risk-Adjusted Capital Framework Data (cont.) | | | | | |
|---|---|---|---|---|---|
| Total credit risk | 144,648,040,101 | 47,039,474,539 | 32.5 | 53,052,101,912 | 36.7 |
| **Credit valuation adjustment** | | | | | |
| Total credit valuation adjustment | -- | 241,742,604 | -- | 5,187,215,489 | -- |
| **Market risk** | | | | | |
| Equity in the banking book | 231,975,088 | 326,106,610 | 140.6 | 2,079,472,284 | 896.4 |
| Trading book market risk | -- | 2,016,277,168 | -- | 3,024,415,751 | -- |
| Total market risk | -- | 2,342,383,778 | -- | 5,103,888,036 | -- |
| **Operational risk** | | | | | |
| Total operational risk | -- | 3,963,753,825 | -- | 5,677,022,798 | -- |
| | **Exposure** | **Basel III RWA** | **Average Basel II RW (%)** | **S&P Global Ratings RWA** | **% of S&P Global Ratings RWA** |
| **Diversification adjustments** | | | | | |
| RWA before diversification | -- | 54,377,312,174 | -- | 69,020,228,234 | 100.0 |
| Total diversification/concentration adjustments | -- | -- | -- | 4,851,764,931 | 7.0 |
| RWA after diversification | -- | 54,377,312,174 | -- | 73,871,993,165 | 107.0 |
| | | **Tier 1 capital** | **Tier 1 ratio (%)** | **Total adjusted capital** | **S&P Global Ratings RAC ratio (%)** |
| **Capital ratio** | | | | | |
| Capital ratio before adjustments | | 10,885,124,903 | 20.0 | 9,535,934,872 | 13.8 |
| Capital ratio after adjustments | | 10,885,124,903 | 17.7 | 9,535,934,872 | 12.9 |

*Exposure at default. Securitization exposure includes the securitization tranches deducted from capital in the regulatory framework. Exposure and S&P Global Ratings' 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 'June 30 2020', S&P Global Ratings.

## Risk position: A bank with a retail profile predominately concentrated in Finland

Our risk position assessment reflects OP Financial Group's geographically concentrated business in Finland and commercial real estate sector, partially compensated for by the generally conservative underwriting standards. Still, we consider the combined capital and earnings, and risk position assessment to be a rating strength for the group.

We expect the pandemic to result in a OP Financial Group's asset quality worsening--albeit within manageable levels--in 2020 and 2021. As a leading bank in the country and with the commitment to also play a valuable social role, OP offered repayment holidays for residential mortgages and SME loans, free of charge, to 184,000 customers (as of September 2020) whose finances have been hit by the pandemic. We expect the fallout of the pandemic to materialize with a lag into the bank's balance sheet, as asset quality indicators should peak in 2021. Both the retail and corporate portfolio might translate in nonperforming loans as, for example, the amount of forborne loans has increased by 52% since December 2019 and represents 3.8% of gross loans, of which most are classified as performing. On the corporate side, we estimate that sectors most vulnerable to the current stress environment, such as trade, services, commercial real estate, construction and transportation and storage, make up almost 20% of OP Financial Group's overall loan portfolio.

As a result, we expect OP Financial Group's gross nonperforming loans ratio to increase up to 2.8% in 2021 from 2.3% in September 2020, which is above the levels at large Nordic peers. Loan losses have averaged a low 8 bps of the loan book over the past five years, and we expect the group to provision about 20bps, on average, in 2020-2021.

Overall, granular retail loans (57% of total loans as of Sept. 30, 2020) dominate the group's gross loan book. Growth has mainly come through the retail mortgage loans, which constitute more than two thirds of the retail portfolio. OP Financial Group has maintained cautious lending policies, with adequate collateralization (new mortgages are stressed for a 6% interest rate and 25 years' maturity).

OP Financial Group's corporate loan book, including housing associations, comprises about one fourth of the total loan portfolio and is predominantly housed at OP Corporate Bank (one third is booked in member banks). The group's strong loan-loss record is offset by some concentration risk arising from exposure to Finland's commercial real estate sector (about 18% of corporate exposures as of June 31, 2020). This excludes the exposure toward housing associations, about 10% of loans, which mostly relate to income-producing real estate. We therefore consider this exposure moderate. The single-name concentrations are gradually decreasing and are generally well-rated corporate customer groups.

Market risk in the insurance subsidiaries has declined because the group steered life insurance business toward less-capital intensive, unit-linked products instead of guaranteed solutions.

**Table 5**

**OP Financial Group -- Risk Position**

| | 2020* | 2019 | 2018 | 2017 | 2016 |
|---|---|---|---|---|---|
| | | --Year ended Dec. 31-- | | | |
| Growth in customer loans | 4.06 | 5.04 | 5.89 | 4.57 | 4.53 |
| Total diversification adjustment/S&P Global Ratings' RWA before diversification | N/A | N/A | 8.88 | 9.05 | 5.04 |
| Total managed assets/adjusted common equity (x) | 16.22 | 15.36 | 15.29 | 16.06 | 18.08 |
| New loan loss provisions/average customer loans | 0.26 | 0.10 | 0.05 | 0.06 | 0.10 |
| Net charge-offs/average customer loans | 0.12 | 0.05 | 0.06 | 0.08 | 0.08 |
| Gross nonperforming assets/customer loans + other real estate owned | 2.29 | 1.61 | 1.58 | 1.77 | 1.73 |
| Loan loss reserves/gross nonperforming assets | 29.72 | 37.53 | 38.04 | 33.52 | 37.22 |

*Data is to September 2020. RWA--Risk-weighted assets. N/a--Not applicable.

### Funding and liquidity: A balanced funding profile dominated by customer deposits

We base our view on the group's dominant franchise and proximity to customers through the local member banks, which should continue to provide the cooperative with stable and granular customer deposits. Furthermore, we factor into our assessment the group's wholesale funding profile and its sound liquidity position.

The group has one of the highest ratios of deposit funding among large Nordic banks--61% as of June 30, 2020, of the total funding base. Although this is still below that of international peers, the deposit base's structure is well balanced between corporate, institutional, and retail clients (the latter represent more than two-third of total deposits), and does not show single-name concentration risk. About 55% of the deposits are covered by the Finnish Deposit Guarantee

Fund.

To cover the funding gap (loans minus deposits), the group has optimized its long-term funding position by issuing both covered bonds and senior instruments (both preferred and nonpreferred). The group's diversified funding profile (by source and maturity) is underpinned in OP Financial Group's stable funding ratio of 106.4% as of June 30, 2020, and we expect the ratio will remain at about 100% in the next two years.

The group is also taking advantage of €6 billion of ECB long-term refinancing operations taken in June last year.

By our measures, the group's one-year liquidity ratio (broad liquid assets to short-term wholesale funding) has strengthened considerably, to 1.8x as of June 30, 2020 (1.5x at year-end 2019), owing to a high liquidity position of about €31.5 billion, including €21.9 billion held with the central bank and €8.3 billion of adjusted liquid securities eligible as collateral as of June 2020.. We understand the bank established stringent liquidity and stress tests; the liquidity buffer is sufficient to cover the need for short-term funding for known and predictable payment flows and in a liquidity stress scenario.

Relative to its Nordic peers, OP Financial Group's asset encumbrance level, at about 20% as of June 30, 2020, is moderate and there is room for further covered bond issuance.

We understand that the group comfortably fulfils the regulatory requirements on liquidity, with a liquidity coverage ratio of 180% as of June 2020 (well above the minimum requirement of 100%). Although the member cooperative banks have no stand-alone liquidity coverage ratio requirements, the central cooperative closely monitors the member banks' liquidity.

**Table 6**

**OP Financial Group -- Funding And Liquidity**

| | 2020* | 2019 | 2018 | 2017 | 2016 |
|---|---|---|---|---|---|
| | | --Year ended Dec. 31-- | | | |
| Core deposits/funding base | 61.42 | 63.13 | 62.61 | 63.45 | 61.44 |
| Customer loans (net)/customer deposits | 129.64 | 139.16 | 141.99 | 141.82 | 143.38 |
| Long-term funding ratio | 86.56 | 87.15 | 87.55 | 88.83 | 86.10 |
| Stable funding ratio | 107.68 | 99.64 | 99.15 | 98.08 | 99.17 |
| Short-term wholesale funding/funding base | 14.74 | 14.23 | 13.77 | 12.34 | 15.28 |
| Broad liquid assets/short-term wholesale funding (x) | 1.80 | 1.49 | 1.66 | 2.05 | 1.51 |
| Net broad liquid assets/short-term customer deposits | 18.74 | 10.68 | 13.57 | 18.31 | 11.71 |
| Short-term wholesale funding/total wholesale funding | 38.22 | 38.59 | 36.82 | 33.76 | 39.53 |
| Narrow liquid assets/3-month wholesale funding (x) | 3.34 | 2.72 | 2.75 | 3.61 | 2.15 |

## Support: One notch of uplift for ALAC support

Owing to its dominant market share of customer loans and deposits, we see OP Financial Group as having a high systemic importance in Finland. We believe that the prospect of extraordinary government support for Finnish banks is uncertain, following the full implementation of the EU Bank Recovery and Resolution Directive (BRRD), including bail-in powers in 2016.

We view the Finnish resolution regime as effective under our ALAC criteria because, among other factors, we believe it contains a well-defined bail-in process under which authorities would permit nonviable systemically important banks to continue critical functions as going concerns following a bail-in of eligible liabilities. We have added one notch of uplift within the GCP, and thus to the long-term rating on OP Corporate, because we believe that the group is likely to increase its ALAC materially over the next four years. We estimate that the ALAC buffer equaled to 193 bps of S&P Global Ratings-calculated risk-weighted assets at year-end 2019 and project that it will grow sustainably above our threshold of 5.0% for a one-notch uplift by end-2022. This reflects our expectation that the group's earnings will support a further capital buildup, reflected in the excess amount of TAC included in the GCP; the group will gradually replace maturing capital instruments with ALAC-eligible instruments and issue about €5 billion of bail-in-able debt in the next three years, while regulatory requirements would lead the group to maintain or moderately increase its existing buffer of loss-absorbing capacity.

We include in our ALAC assessment all subordinated instruments issued by OP Financial Group and OP Corporate (apart from those we expect to be called within the next 12 months) because we believe they have capacity to absorb losses without triggering a default on the bank's senior obligations.

### Issue ratings on hybrid instruments

We rate OP Corporate's senior nonpreferred debt instruments one notch below the 'a+' group SACP, reflecting our standard notching for investment-grade (higher than 'BB+') entities issuing an instrument contractually or statutorily subordinated to preferred senior unsecured debt. In our view, holders of senior nonpreferred notes face a higher default risk than holders of senior preferred notes and other senior liabilities, because the former would be bailed in before more senior debt in the event of a resolution.

We rate OP Corporate's nondeferrable subordinated debt instruments two notches below the 'a+' unsupported GCP, reflecting the debt's contractual subordination as Tier 2 instruments and our view that the BRRD creates the equivalent of a contractual write-down clause. The starting point for the notching is the unsupported GCP.

### Resolution counterparty ratings

We have assigned our 'AA-/A-1+' resolution counterparty ratings (RCRs) to OP Corporate, the same level as the long-term issuer credit ratings. The RCRs also reflect our jurisdiction assessment for Finland. An RCR is a forward-looking opinion of the relative default risk of certain senior liabilities that might be protected from default through an effective bail-in resolution process for the issuing financial institutions. RCRs apply to issuers in jurisdictions where we assess the resolution regime to be effective and believe the issuer likely to be subject to a resolution that entails a bail-in if it reaches nonviability.

### Environmental, social, and governance (ESG)

ESG credit factors for OP Financial Group are broadly in line with industry and Finnish peers. Social factors are gaining importance, considering that the cooperative is the largest lender in the country and the largest taxpayer, with the 137 independent member banks paying their taxes locally in their operating region. OP Financial Group is owned by 2 million owner-customers, mainly individuals. Aside from their business role, the cooperative banks play a significant social role in Finland, in particular in times of stress.

Like the rest of the financial sector, OP Financial Group's most notable risks are related to financial crime and abuses, preventing misselling to the retail clientele, and eliminating anti-competitive practices. The group is committed to providing financial access in low-populated or economically disadvantaged areas through its vast branch network, which solidifies its business position.

The group's governance supports the strong assessment of its business position, but we do not consider it a positive distinctive factor compared with that of local peers. Although the group replaced its group CEO in 2019, we consider its strategy clear and consistent, with a strong social and local community role.

The majority of the group's board comprises independent directors. OP Financial Group's environmental framework is advanced and aims to be carbon-positive on its direct operations by 2025. In addition, the group published its own Green Bond Framework in February 2020, and issued its first senior unsecured green bond in 2019. The bank is exposed to transition risks in its retail and corporate portfolio, as environment legislation and norms evolve.

### Core subsidiary: Pohjola Insurance

Although we also regard Pohjola Insurance as a core entity, we anticipate that the Finnish resolution framework will exclude insurance activities from a bail-in process. For this reason, we equalize our long-term ratings on the subsidiary with our 'a+' assessment of OP Financial Group's unsupported GCP. The stable outlook is aligned with that of its parent and reflects our view that the subsidiary will remain integral to the enlarged group's strategy. It also takes into account that group will maintain its sound business franchise, strong earnings capacity, and an adequate capital and risk profile. Pohjola Insurance could further build up its market-leading position of around 34% in Finland, despite a stagnating nonlife insurance market. Underwriting earnings in nonlife improved for the first nine months 2020 with an operating combined ratio of 86.0%, compared with 92.7% as of December 2019 and 91.8% in Q3 2019. Claims incurred were down year-on-year mainly driven by the lower economic activity as a result of the pandemic. Excluding any extraordinary effects of changes in the discount rate, we expect Pohjola to further deliver sound and stable underwriting profitability with an operating combined ratio of 90%-93% and sustainable growth in the nonlife segment during 2020-2022. This assumption is based on the ongoing risk-adequate pricing, and efficient management of claims expenses. In addition, Pohjola is constantly modernizing its insurance business in terms of claims handling processes and digitalization to retain its market-leading position.

In the life insurance segment, OP Life (unrated) is gradually shifting its business to unit-linked. Its unit-linked provision increased to €10.3 billion in June 2020 from €3.1 billion in 2010, and constitutes about 80% of the total reserves for with-profit and unit-linked insurance (excluding Suomi-Mutual portfolios). We regard this shift to capital-light products as positive.

In addition, commission and fee income has increased, which makes the overall life insurance earnings less interest-rate-sensitive. OP Financial Group is steering its insurance subsidiaries' capitalization according to Solvency II targets: life insurance has a Solvency II ratio of 169% (limit: 130%) and the nonlife insurance of 146% (limit: 120%) as of Sept. 30, 2020, excluding transitional measures. We do not expect OP Financial Group to overcapitalize its insurance subsidiaries and therefore, we expect ongoing dividend payouts to the parent from the subsidiaries and a relatively stable development of capitalization levels.

**Additional rating factors: None**

No additional factors affect this rating.

## Related Criteria

- General Criteria: Group Rating Methodology, July. 1, 2019
- General Criteria: Hybrid Capital: Methodology And Assumptions, July 1, 2019
- 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
- Banks: Bank Rating Methodology And Assumptions: Additional Loss-Absorbing Capacity, April 27, 2015
- 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
- Principles Of Credit Ratings, Feb. 16, 2011
- Criteria - Financial Institutions - Banks: Commercial Paper I: Banks, March 23, 2004

## Related Research

- Low-For-Even-Longer Interest Rates Maintain Margin Pressure On European Banks, Feb. 2, 2021
- Lower and Later: The Shifting Horizon For Bank Credit Losses, Feb. 2, 2021
- European Banks' 2021 Stress Test Contemplates A Tough Adverse Macroeconomic Scenario, Feb. 1, 2021
- Outlooks On Seven Finnish Banks Revised Due To Their Resilience In The COVID-19-Induced Downturn, Jan. 22, 2021
- OP Corporate Bank PLC, July 24, 2020
- COVID-19: Resilient Fundamentals And Assertive Policy Measures Will Buoy Nordic Banking Systems, June 16, 2020
- Seven Finnish Banks Outlooks Revised To Negative On Deepening COVID-19 Downside Risks, May 19, 2020
- Banking Industry Country Risk Assessment: Finland, Oct. 9, 2019

## 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 February 5, 2021)*

| | |
|---|---|
| **OP Corporate Bank PLC** | |
| Issuer Credit Rating | AA-/Stable/A-1+ |
| Resolution Counterparty Rating | AA-/--/A-1+ |
| Commercial Paper | |
| *Local Currency* | A-1+ |
| Senior Subordinated | A |
| Senior Unsecured | AA- |
| Short-Term Debt | A-1+ |
| Subordinated | A- |
| **Issuer Credit Ratings History** | |
| 22-Jan-2021 | AA-/Stable/A-1+ |
| 19-May-2020 | AA-/Negative/A-1+ |
| 17-Nov-2016 | AA-/Stable/A-1+ |
| **Sovereign Rating** | |
| Finland | AA+/Stable/A-1+ |
| **Related Entities** | |
| **OP Mortgage Bank** | |
| Senior Secured | AAA/Stable |
| **Pohjola Insurance Ltd** | |
| Financial Strength Rating | |
| *Local Currency* | A+/Stable/-- |
| Issuer Credit Rating | |
| *Local Currency* | A+/Stable/-- |

*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.

**Additional Contact:**
Industrial Ratings Europe; Corporate_Admin_London@spglobal.com