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Research Update:

Pohjola Bank 'AA-/A-1+' Ratings Affirmed On Government Support And ALAC Review; Outlook Negative

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Overview

- We believe the prospect of extraordinary government support for Finnish banks is now uncertain in view of the country's well-advanced and effective resolution regime.
- We are therefore removing the one notch of uplift for government support that we had previously incorporated in the long-term counterparty credit ratings on Pohjola Bank.
- However, we now include one notch in the long-term ratings because we consider that the wider OP Financial Group will build substantial additional loss-absorbing capacity (ALAC).
- We are affirming the long- and short-term counterparty credit ratings on Pohjola Bank at 'AA-/A-1+'.
- The negative outlook reflects our view that Finland's weak economic recovery could hamper the banking sector's performance over the next two years.

Rating Action

As previously announced on Dec. 2, 2015, Standard & Poor's Ratings Services has affirmed its 'AA-/A-1+' long- and short-term counterparty credit ratings on Finland-based Pohjola Bank. The outlook remains negative.

We also affirmed our 'A-' issue ratings on subordinated debt instruments issued by Pohjola Bank.

Rationale

We believe that the prospect of extraordinary government support for Finland's banking sector is now uncertain, following the expected full implementation of the EU Bank Recovery and Resolution Directive, including bail-in powers, from Jan. 1, 2016. We do not completely exclude the possibility of such support, and we consider that systemically important Finnish institutions such as Pohjola Bank face several more years of structural and balance sheet reforms to address their "resolvability" (mitigating the systemic impact if they fail). Nevertheless, we believe the Finnish government's ability and willingness to provide support is lower and less predictable under the enhanced resolution framework. We have therefore reclassified the tendency of Finland to support private sector commercial banks as "uncertain" under our

criteria, and removed the one notch that we previously included for government support in the long-term counterparty credit rating on Pohjola Bank.

The ratings on Pohjola Bank reflect the franchise and creditworthiness of the wider OP Financial Group, comprising some 186 member cooperative banks (as of June 30, 2015). Pohjola Bank acts as the cooperative's central bank and treasury department; it also serves as the bank for large corporate entities within the group.

We have added one notch of uplift within OP Financial Group's group credit profile (GCP), and so within the long-term ratings on Pohjola Bank, because we consider that the group is likely to increase ALAC above our designated 4.0% threshold. We use an adjusted threshold for Pohjola Bank, as opposed to the usual 5.0%, because we qualitatively adjust for the portion of Pohjola Bank's material insurance operations that we expect would be outside the scope of required bail-in capitalization.

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 include in our ALAC assessment most of the capital instruments issued by OP Financial Group and Pohjola Bank because we believe they have capacity to absorb losses without triggering a default on senior obligations of Pohjola Bank and they meet our other criteria for inclusion. On this basis, we calculate that the ALAC ratio for OP Financial Group was 1.4% of Standard & Poor's risk-weighted assets at year-end 2014, following the share buyback transaction on Pohjola Bank. We expect that the ALAC ratio will grow to 4.3% by end-2016, above the adjusted 4.0% threshold. This reflects our expectation that: (i) the group's strong earnings and the issuance of profit shares will support the further capital buildup reflected in the excess amount of total adjusted capital included in the GCP; (ii) the group will gradually replace maturing capital instruments with ALAC-eligible instruments; and (iii) that future regulatory requirements will lead the group to maintain or maybe moderately increase its existing buffer of loss-absorbing capacity.

As a result of the above, we have maintained the supported GCP, which now includes one notch of ALAC support instead of government support, at 'aa-'.

We affirmed the 'A-' rating on the subordinated debt instruments issued by Pohjola Bank because we already assumed that they would not benefit from either extraordinary government or ALAC support.

Outlook

The negative outlook reflects our view of Finland's weak economic recovery, which could hamper the banking sector's performance over the next two years.

Gradually increasing unemployment could further reduce loan growth in Finland and lead to asset price corrections. If this meaningfully increased the risk costs for the banking sector, we could revise downward our 'a-' anchor for Finnish banks, including Pohjola Bank.

We could revise the outlook to stable if we concluded that the Finnish banking sector remained resilient to the weak economic recovery. We would also expect to see improvement in Pohjola Bank's funding and liquidity, which still compares somewhat unfavorably with peers'.

Ratings Score Snapshot

	To	From
Issuer Credit Rating	AA-/Negative/A-1+	AA-/Negative/A-1+
SACP	a+	a+
Anchor	a-	a-
Business Position	Strong (+1)	Strong (+1)
Capital and Earnings	Strong (+1)	Strong (+1)
Risk Position	Adequate (0)	Adequate (0)
Funding and Liquidity	Average and Adequate(0)	Average and Adequate (0)
Support	(+1)	(+1)
ALAC Support	(+1)	(0)
GRE Support	(0)	(0)
Group Support	(0)	(0)
Sovereign Support	(0)	(+1)
Additional Factors	(0)	(0)

Related Criteria And Research

Related criteria

- Bank Rating Methodology And Assumptions: Additional Loss-Absorbing Capacity, April 27, 2015
- Rating Government-Related Entities: Methodology And Assumptions, March 25, 2015
- Bank Hybrid Capital Methodology And Assumptions, Jan. 25, 2015
- Principles For Rating Debt Issues Based On Imputed Promises, Dec. 19, 2014
- Standard & Poor's National And Regional Scale Mapping Tables, Sept. 30, 2014
- National And Regional Scale Credit Ratings, Sept. 22, 2014
- Group Rating Methodology, Nov. 19, 2013
- Ratings Above The Sovereign-Corporate And Government Ratings: Methodology And Assumptions, Nov. 19, 2013

- Use Of 'C' And 'D' Issue Credit Ratings For Hybrid Capital And Payment-In-Kind Instruments, Oct. 24, 2013
- Assessing Bank Branch Creditworthiness, Oct. 14, 2013
- Quantitative Metrics For Rating Banks Globally: Methodology And Assumptions, July 17, 2013
- Criteria For Assigning 'CCC+', 'CCC', 'CCC-', And 'CC' Ratings, Oct. 1, 2012
- Revised Market Risk Charges For Banks In Our Risk-Adjusted Capital Framework, June 22, 2012
- 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
- Methodology For Mapping Short- And Long-Term Issuer Credit Ratings For Banks, May 4, 2010
- Use Of CreditWatch And Outlooks, Sept. 14, 2009
- Commercial Paper I: Banks, March 23, 2004

Related research

- Most European Bank Ratings Affirmed Following Government Support And ALAC Review, Dec. 2, 2015
- Credit FAQ: How Standard & Poor's Applied Its Government Support And ALAC Criteria To European Banks In December 2015, Dec. 2, 2015
- Standard & Poor's To Conclude Its Review Of Systemic Support For Remaining EU Banks By Early December 2015, Oct. 1, 2015
- Government And ALAC Support Ratings Uplift For Systemically Important European Banking Groups, Oct. 1, 2015
- Pohjola Bank Ratings Affirmed At 'AA-/A-1+' Following Sovereign Rating Action; Outlook Negative, Sept. 29, 2015
- Pohjola Bank PLC, Aug. 24, 2015
- How The Regulatory Reform Process Could Reshape Banks' Business Models And Affect Issuer Ratings, Aug. 18, 2014
- Standard & Poor's Takes Various Rating Actions On European Banks Following Government Support Review, April 29, 2014
- Credit FAQ: The Rating Impact Of Resolution Regimes For European Banks, April 29, 2014

Ratings List

Ratings Affirmed

Pohjola Bank PLC

Counterparty Credit Rating	AA-/Negative/A-1+
Senior Unsecured	AA-
Senior Unsecured	cnAAA
Subordinated	A-
Commercial Paper	A-1+

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