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OP Corporate Bank PLC

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OP Corporate Bank PLC

SACP	a+

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

+

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

+

Additional Factors	0

Issuer Credit Rating
AA-/Negative/A-1+

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

Major Rating Factors

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

Outlook: Negative

The negative outlook on OP Corporate indicates the possibility of a downgrade in the next 24 months if we anticipate that deterioration in the economic and operating conditions in Finland were more severe or the recovery took longer than expected. The negative outlook on Pohjola Insurance reflects that on its parent.

Downside scenario

Even if economic risks were to abate materially, we could lower the ratings if we considered organic capital generation insufficient to sustainably preserve the group's RAC ratio above 15% and our view of its risk profile does not compensate a lower level of capital.

Lastly, all else being equal, we could take a negative rating action if the group's additional loss-absorption capacity (ALAC) buffer is unlikely to exceed our threshold of 5% of S&P Global Ratings' risk-weighted assets over a two-to-four-year ramp-up period as we currently expect.

Upside scenario

An outlook revision to stable would depend on the recovery of the overall economy and the banking business in Finland. We would also revise the outlook to stable if the bank manages to absorb the effects of the pandemic without meaningfully impairing profitability, capital and asset quality.

Rationale

The ratings on OP Corporate reflect the dominant franchise and high capitalization of the wider OP Financial Group, comprising 141 member cooperative banks; OP Cooperative, the group's central institution; OP Corporate; insurance businesses; and specialized institutions. OP Corporate, 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 revenue stability.

The capitalization level remains a key strength of the rating assessment, because the sustained organic capital generation--despite lower profitability in 2020 and 2021--will lead OP to build up its risk-adjusted capital (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 2020 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 an unsupported group credit profile (GCP) of 'a+'.

Our assessment of ALAC at OP Financial leads us to incorporate one notch of uplift to the GCP. Consequently, the issuer credit rating on OP Corporate is aligned with the 'aa-' supported 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 that starts our bank rating. The anchor for OP Corporate is 'a-', in line with the anchor used for commercial banks based in Finland, We classify Finland's banking sector in group '2' under our BICRA, alongside Sweden, Norway, Austria, and Germany.

We see economic risk for Finland's BICRA to be on a negative trend. If we saw more pronounced economic distress or weaker and delayed recovery, with cost of risk for the banking system exceeding our current expectations, we could negatively reassess economic risk on the Finnish banking sector.

We view Finland as an innovative, wealthy, and small open economy, with mature political and institutional structures. The pandemic, however, will send the country into deep recession in 2020, in our opinion. After an anaemic final quarter in 2019, Finland was already facing a muted growth outlook, with lower exports, weakening consumer confidence, and only moderate credit demand from households. Although we expect recovery in 2021, it is likely going to be less pronounced than in other Nordic countries. That said, the wide-ranging fiscal, monetary, and regulatory support measures will, in our view, partially mitigate this sharp shock to the Finnish economy, supporting the banking system's stability.

We do not see major domestic economic imbalances in the Finnish economy because house prices have stabilized nationwide over the past years and despite the decreased activity, and we do not project a correction in the real estate market. However, we see a risk of weaker private-sector debt-servicing capacity, especially from SMEs, which could lead to materially higher credit losses for banks. The historically high indebtedness of Finnish households could also be a mounting credit risk for the banking sector (if not curbed by macroprudential measures). Still, in our base-case scenario, we forecast moderate credit losses from households despite increasing unemployment, increasing use of amortization, and more muted credit demand, before returning to pre-pandemic level in 2021-2022.

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 and we expect banks to maintain their restrained risk appetite. We therefore expect the Finnish banking sector to be well prepared to weather the 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 investments 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. Also, the Nordic banking system remains highly interconnected, which results in potential spill-over risks on the Finnish economy from external events.

Table 1

OP Financial Group--Key Figures					
	--Fiscal year ended Dec. 31--				
(Mil. €)	**Q1 2020**	**2019**	**2018**	**2017**	**2016**
Adjusted assets	128,817.0	127,216.0	121,066.0	117,161.0	109,663.0
Customer loans (gross)	93,634.0	92,018.0	87,606.0	82,731.0	79,112.0
Adjusted common equity	9,606.7	9,573.2	9,183.6	8,546.8	7,397.3
Operating revenues	631.0	3,396.0	2,937.0	3,090.0	2,912.0
Noninterest expenses	579.0	2,152.0	1,916.0	1,990.0	1,773.0
Core earnings	(39.4)	925.8	761.2	834.2	853.9

Q1--First-quarter.

Business position: Leading domestic franchise in banking and insurance.

We expect OP Financial to consolidate its leading position in the Finnish market, where its business lines in corporate and retail banking have market shares of about 40%. 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 €80 billion of customer assets--complements the offer.

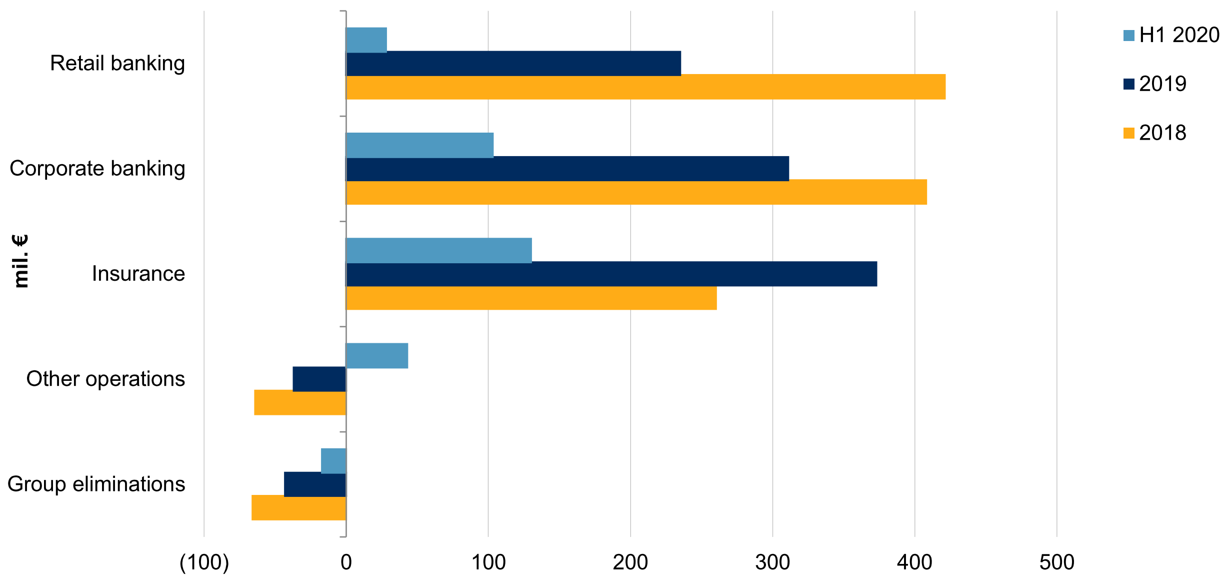
OP Financial--with total assets of €160 billion as of June 30,2020--has a strong retail and corporate banking franchise. It has a countrywide branch network, with about 3.6 million private and 300,000 corporate customers. In our view, the group has a stable operating platform based on consistently strong 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 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'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's revenue (see chart 1) 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 1.2 million in June 2020 from about 700,000 in 2005.

Chart 1

OP Financial Group--Earnings Before Tax Are Well Diversified



Q--Quarter. Source: Company data and S&P Global Ratings.

We believe that the stable cooperative ownership structure underpins the strengths and stability of the business model. OP Cooperative, all 141 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

	--Fiscal year ended Dec. 31--				
(%)	**Q1 2020**	**2019**	**2018**	**2017**	**2016**
Total revenues from business line (currency in millions)	813.0	3,396.0	2,979.0	3,115.0	2,988.0
Commercial and retail banking/total revenues from business line	71.6	68.1	64.1	60.0	64.4
Insurance activities/total revenues from business line	3.4	34.9	18.2	19.7	18.6
Asset management/total revenues from business line	N/A	N/A	15.1	16.3	12.2
Other revenues/total revenues from business line	25.0	(2.9)	2.5	4.0	4.8
Return on average common equity	3.1	5.5	6.9	8.0	9.4

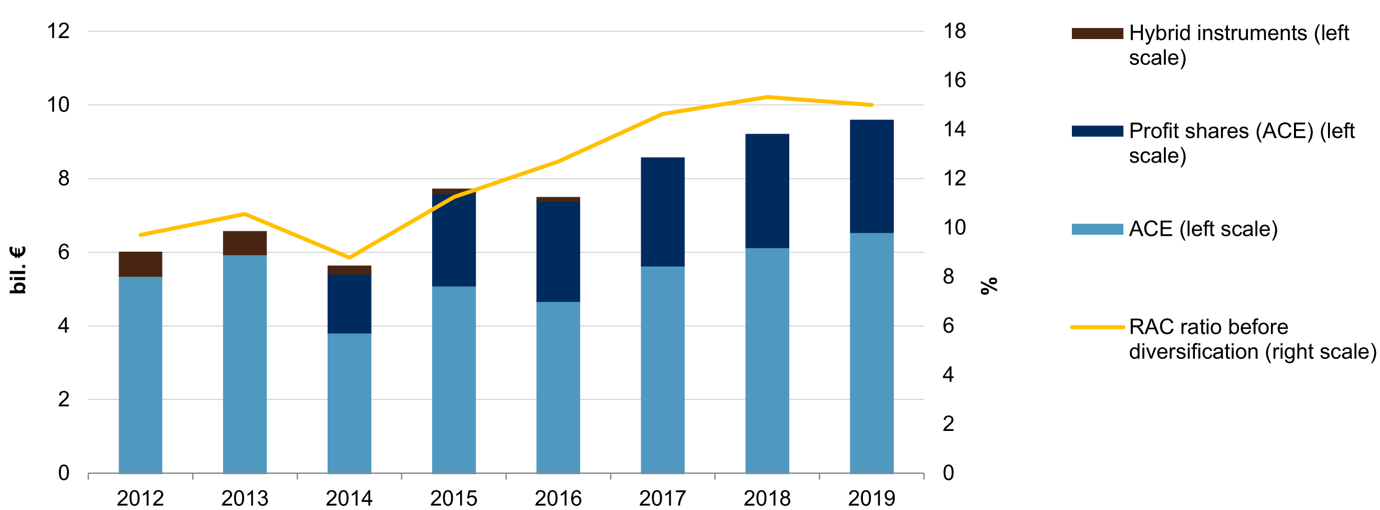
Note: Asset management included mainly in commercial banking since Jan. 1, 2019. N/A--Not applicable. Q1--First quarter.

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 about 16% over the next 24 months, compared with 15% as of year-end 2019. 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 of €3 billion in member profit shares issued to retail owner-customers since 2014 (see chart 2) 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 do factor in our projections the interest payment distribution on the preference shares (€97 million) for financial year 2019 that the group has postponed until October 2020 in line with the recommendations issued by the European Central Bank (ECB) and the Financial Supervisory Authority (FIN-FSA).

Chart 2

OP Financial Group--Capitalization Statistics Show Its Growing Equity Base
TAC components and RAC ratio development



TAC--Total adjusted capital. RAC--Risk-adjusted capital. ACE--Adjusted common equity. Source: S&P Global Ratings.

The pandemic and resulting recession in Finland will, in our view, materially affect the bank's earnings in 2020, followed by a rebound in 2021. Our RAC projection for the next 18-24 months incorporates the following assumptions:

- Revenue will be about 10% lower in 2020 due to weaker non-interest income, followed by a rebound in 2021.
- Costs will rise very modestly and much slower than earlier, as efficiency gains materialize. Improving cost efficiency will allow continuous investment in the digitalization and service improvements.
- Loan impairments should increase by 2.5x year over year in 2020, for a cost of risk of 23 basis points (bps) from 10

bps in 2019. The cost of risk should decline towards 10 bps by 2022.

- We expect loan growth of about 4%, and will translate into a similar increase in S&P Global Ratings' risk-weighted assets amid the uncertainties associated with the pandemic.

We expect our earnings buffer metric on OP Financial, which measures the capacity of a bank to cover its normalized losses, will remain slightly lower, at 80-90 bps. This will lead to a lower buildup of capital. However, even if OP Financial Group's cost efficiency improves, it still lags somewhat behind that of its large Nordic peers; it reported a cost to income ratio of about 63% as of year-end 2019 (and 67% as of June 2020).

The group reported common equity Tier 1 (CET1) ratio of 17.7%, as of June 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 EBA 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, preference shares and Tier 2 debt instruments. 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 MDA level).

The nonlife and life insurance operations have solvency II ratios of 139% and 152%, respectively as of June 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.

Under our RAC framework, we deduct the equity invested and risk weight at 1.250% subordinated debt held by the life and nonlife subsidiaries (see chart 3). We consider this commensurate with the risk level in the insurance businesses.

Table 3

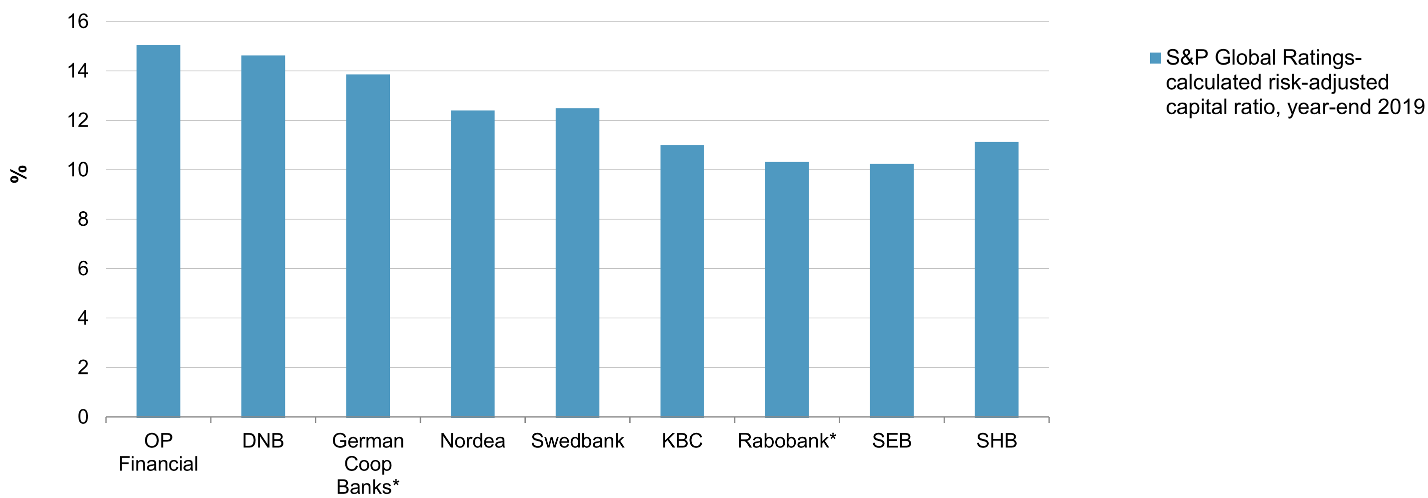
OP Financial Group--Capital And Earnings

	--Fiscal year ended Dec. 31--				
(%)	**Q1 2020**	**2019**	**2018**	**2017**	**2016**
Tier 1 capital ratio	17.7	19.5	20.6	20.3	20.3
S&P Global Ratings' RAC ratio before diversification	N/A	15.0	15.3	14.7	12.7
S&P Global Ratings' RAC ratio after diversification	N/A	13.7	14.1	13.4	12.1
Adjusted common equity/total adjusted capital	100.0	100.0	100.0	100.0	99.0
Net interest income/operating revenues	50.6	36.5	40.0	35.4	36.3
Fee income/operating revenues	38.7	27.6	30.2	30.0	29.5
Market-sensitive income/operating revenues	(16.2)	27.2	7.9	21.0	21.1
Noninterest expenses/operating revenues	91.8	63.4	65.2	64.4	60.9
Preprovision operating income/average assets	0.1	0.9	0.7	0.8	0.9
Core earnings/average managed assets	(0.1)	0.6	0.5	0.6	0.7

RAC--Risk adjusted capital. Q--First quarter. N/A--Not applicable.

Chart 3

OP Financial Corp.--Risk-Adjusted Capital Ratio: A Relative Capital Strength



*Rabobank & Coop Banking Sector's RAC are as of December 2018. Source: S&P Global Ratings.

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	19,687,517,429	24,516,099	0.1	261,816,777	1.3
Of which regional governments and local authorities	4,254,434,263	0	0.0	156,907,357	3.7
Institutions and CCPs	8,624,188,883	1,031,372,315	12.0	1,330,665,103	15.4
Corporate	43,861,601,474	28,249,572,032	64.4	30,700,831,182	70.0
Retail	56,196,899,528	10,710,626,608	19.1	16,040,666,955	28.5
Of which mortgage	46,110,541,480	6,997,953,534	15.2	10,486,731,958	22.7
Securitization§	623,614,745	46,272,214	7.4	124,722,949	20.0
Other assets	2,700,785,742	1,953,952,099	72.3	3,027,237,425	112.1
Total credit risk	131,694,607,801	42,016,311,367	31.9	51,485,940,391	39.1
Credit valuation adjustment					
Total credit valuation adjustment	--	191,411,461	--	0	--
Market risk					
Equity in the banking book	486,970,222	451,012,232	92.6	4,589,222,242	942.4
Trading book market risk	--	1,309,214,456	--	1,963,821,684	--
Total market risk	--	1,760,226,688	--	6,553,043,926	--

Table 4

OP Financial Group--Risk-Adjusted Capital Framework Data (cont.)

Operational risk					
Total operational risk	--	4,232,204,530	--	5,761,386,975	--
	Exposure	**Basel III RWA**	**Average Basel II RW (%)**	**S&P Global Ratings RWA**	**% of S&P Global Ratings RWA**
Diversification adjustments					
RWA before diversification	--	48,715,171,584	--	63,800,371,291	100.0
Total diversification/concentration adjustments	--	--	--	6,100,093,840	9.6
RWA after diversification	--	48,715,171,584	--	69,900,465,131	109.6
		Tier 1 capital	**Tier 1 ratio (%)**	**Total adjusted capital**	**S&P Global Ratings RAC ratio (%)**
Capital ratio					
Capital ratio before adjustments		10,879,466,824	22.3	9,573,218,420	15.0
Capital ratio after adjustments		10,879,466,824	19.6	9,573,218,420	13.7

*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 'Dec. 31 2019', S&P Global Ratings.

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

Our risk position assessment reflects OP Financial'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.

Given the economic uncertainties associated with the pandemic, we expect gradual worsening of OP Corporate's asset quality over the near term, despite the government support to the economy. As a leading bank in the country and with the commitment to play also a valuable social role, OP offered repayment holidays for residential mortgages and small and medium sized enterprises (SME) loans, free of charge, to 140,000 customers (as of June 2020) whose finances have been affected by the pandemic. While the negative impact of the pandemic on the retail portfolio might take time to materialize, we anticipate that the dampening in the consumption could hurt the corporate sector, particularly SMEs. 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 Bank's overall loan portfolio, and that there might be an adverse medium-term impact on its broader corporate portfolio--including commercial real estate--depending on the length of the lockdown and the recovery in Finland.

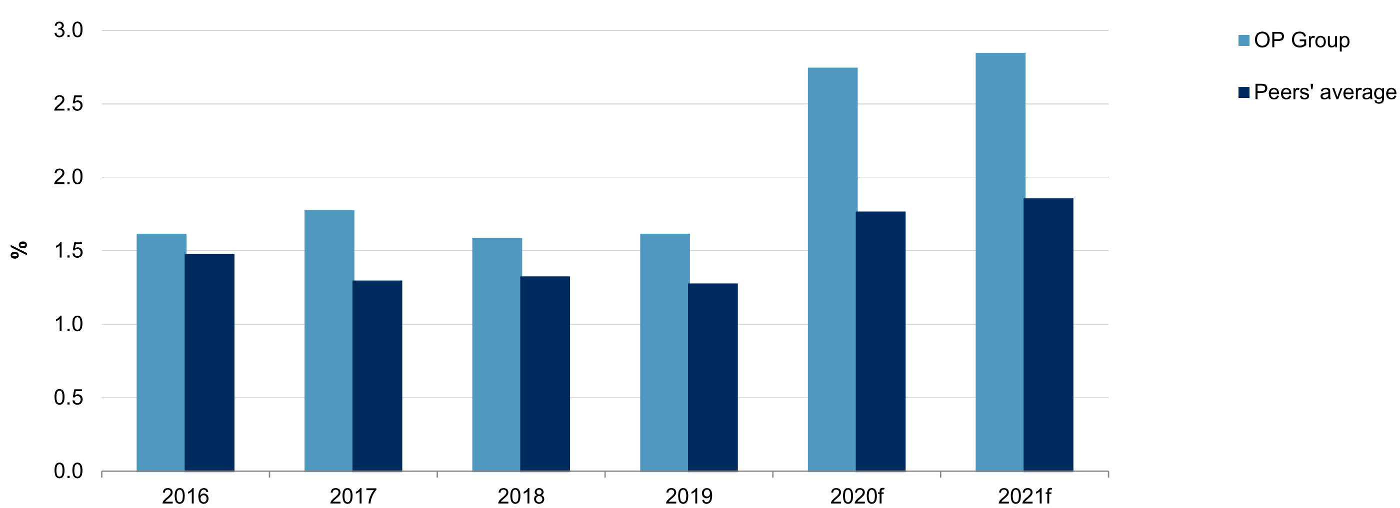
As a result, we expect OP Financial Group's gross nonperforming loans ratio increasing up to 2.8% in the next two years from 2.3% in June 2020, which is above the levels at large Nordic peers. Loan losses have averaged 9 bps of the loan book over the past five years, and expect the group's impairments to increase to about 25 bps in 2020 and will gradually normalize in 2021 at 15 bps.

Overall, granular retail loans (56% of total loans as of June 30, 2020) dominates 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 has maintained cautious lending policies, with adequate collateralization (new mortgages are stressed for a 6% interest rate and 25 years' maturity).

OP Financial's corporate loan book, including housing associations, comprises about one-fourth of the total loan portfolio and is predominantly housed at OP Corporate (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 March 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.

Chart 4

OP Financial Group--Asset Quality Metrics To Lag Peers
NPA ratio



f--Forecast. NPA-Nonperfroming Assets. Peers include: Aktia, Savings banks group Finland, Zuercher Kantonal bank,Swedbank, SEB, DNB, SHB, KBC Group, Danske,Nordea. Source: S&P Global Ratings.

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					
	--Fiscal year ended Dec. 31--				
(%)	Q1 2020	2019	2018	2017	2016
Growth in customer loans	7.0	5.0	5.9	4.6	4.5
Total diversification adjustment/S&P Global Ratings’ RWA before diversification	N/A	9.6	8.9	9.0	5.0

Table 5

OP Financial Group--Risk Position (cont.)

	--Fiscal year ended Dec. 31--				
(%)	**Q1 2020**	**2019**	**2018**	**2017**	**2016**
Total managed assets/adjusted common equity (x)	15.3	15.4	15.3	16.1	18.1
New loan loss provisions/average customer loans	0.5	0.1	0.1	0.1	0.1
Net charge-offs/average customer loans	0.1	0.1	0.1	0.1	0.1
Gross nonperforming assets/customer loans + other real estate owned	2.1	1.6	1.6	1.8	1.7
Loan loss reserves/gross nonperforming assets	32.7	37.5	38.0	33.5	37.2

Q1--First quarter. N/A.--Not applicable.

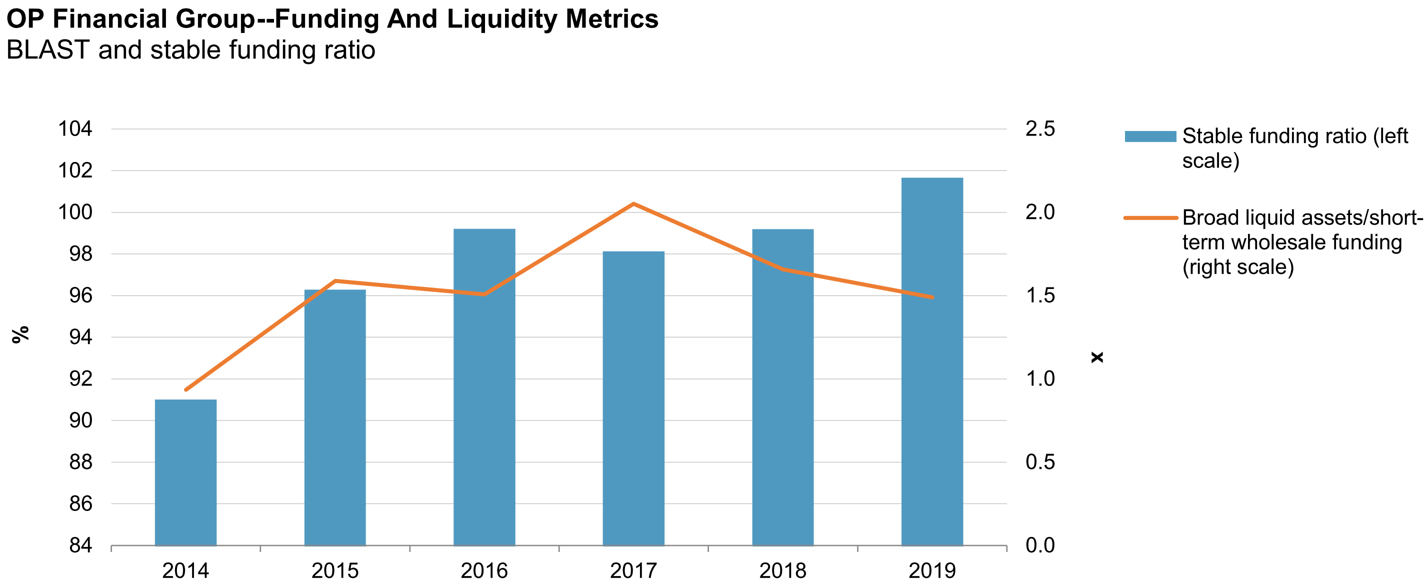
Funding and liquidity: A balanced funding profile dominated by customer deposits

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--63% as of Dec. 31, 2019, 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. Almost 60% 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's stable funding ratio of 99.6% at December 2019 (see chart 5), and we expect the ratio will remain near 100% in the next two years.

Chart 5



Source: S&P Global Ratings.

By our measures, the group's one-year liquidity ratio (broad liquid assets to short-term wholesale funding) has strengthened considerably, to 1.5x as of December 2019 (0.76x at year-end 2013), owing to a high liquidity position of about €31.5 billion, including €21.8 billion held with the central bank and €8.3 billion of adjusted liquid securities eligible as collateral as of June 2020. We believe the group will maintain sound liquidity metrics as credit growth might be partially funded with additional ECB long-term refinancing operations. 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's asset encumbrance level, at about 20% as of Dec. 31, 2019, is moderate and there is room for further covered bond issuance.

We understand that the group already comfortably fulfils the regulatory requirements on liquidity, with 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					
	--Fiscal year ended Dec. 31--				
(%)	**Q1-2020**	**2019**	**2018**	**2017**	**2016**
Core deposits/funding base	64.4	61.9	62.6	63.5	61.4
Customer loans (net)/customer deposits	139.3	139.2	142.0	141.8	143.4
Long-term funding ratio	87.8	87.4	87.5	88.8	86.1

Table 6

OP Financial Group--Funding And Liquidity (cont.)					
	--Fiscal year ended Dec. 31--				
(%)	**Q1-2020**	**2019**	**2018**	**2017**	**2016**
Stable funding ratio	97.3	101.6	99.2	98.1	99.2
Short-term wholesale funding/funding base	13.5	14.0	13.8	12.3	15.3
Broad liquid assets/short-term wholesale funding (x)	1.5	1.5	1.7	2.1	1.5
Net broad liquid assets/short-term customer deposits	9.7	10.7	13.6	18.3	11.7
Short-term wholesale funding/total wholesale funding	37.8	36.7	36.8	33.8	39.5
Narrow liquid assets/3-month wholesale funding (x)	2.6	2.7	2.7	3.6	2.2

Q--Quarter.

Support: One notch of uplift for ALAC support

Owing to its dominant market share of customer loans and deposits, we see OP Financial 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 group credit profile, and thus to the long-term ratings 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 150 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-2021. 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 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 stand-alone credit profile, 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 (RCR) to OP Corporate, the same level as the long-term issuer credit ratings. The RCR 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 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 141 independent member banks paying their taxes locally in their operating region. OP Financial 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'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.

OP Financial'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 changed 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'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 November 2018, and issued its first senior unsecured green bond last year. 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's unsupported GCP. The stable outlook 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 strong business franchise, strong earnings capacity, and an adequate capital and risk profile. Pohjola Insurance could further build up its market-leading position of 34% in Finland, despite a stagnating nonlife insurance market. Underwriting earnings in nonlife slightly decreased in June 2020 with an operating combined ratio of 89.3%, compared with 92.7%

as of December 2019. 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 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 is steering its insurance subsidiaries capitalization according to Solvency II targets: life insurance has a Solvency II ratio of 152% (limit: 130%) and the nonlife insurance of 139% (limit: 120%) as of June 2020, excluding transitional measures. We do not expect OP Financial 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: Hybrid Capital: Methodology And Assumptions, July 1, 2019
- General Criteria: Group Rating Methodology, 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
- Criteria | Financial Institutions | 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
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009
- Criteria | Financial Institutions | Banks: Commercial Paper I: Banks, March 23, 2004

Related Research

- COVID-19: Resilient Fundamentals And Assertive Policy Measures Will Buoy Nordic Banking Systems, June 16, 2020
- Bank Regulatory Buffers Face Their First Usability Test, June 11, 2020
- How COVID-19 Is Affecting Bank Ratings: June 2020 Update, June 11, 2020
- Seven Finnish Banks Outlooks Revised To Negative On Deepening COVID-19 Downside Risks, May 19, 2020
- Europe Braces For A Deeper Recession In 2020, April 20, 2020
- European Banks Count The Cost Of Inefficiency, Oct. 22, 2019
- 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 July 24, 2020)*

OP Corporate Bank PLC		
Issuer Credit Rating		AA-/Negative/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		
19-May-2020	*Foreign Currency*	AA-/Negative/A-1+
17-Nov-2016		AA-/Stable/A-1+
30-May-2014		AA-/Negative/A-1+

Ratings Detail (As Of July 24, 2020)*(cont.)		
19-May-2020	*Local Currency*	AA-/Negative/A-1+
17-Nov-2016		AA-/Stable/A-1+
30-May-2014		AA-/Negative/A-1+
Sovereign Rating		
Finland		AA+/Stable/A-1+
Related Entities		
Pohjola Insurance Ltd		
Financial Strength Rating		
Local Currency		A+/Negative/--
Issuer Credit Rating		
Local Currency		A+/Negative/--
OP Mortgage Bank		
Senior Secured		AAA/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.