STANDARD & POOR'S
RATINGS SERVICES

RatingsDirect®

Pohjola Bank PLC

Primary Credit Analyst:
Alexander Ekbom, Stockholm (46) 8-440-5911; alexander.ekbom@standardandpoors.com

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

Table Of Contents

Pohjola Bank PLC

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

+

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

+

Additional Factors	0

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

Major Rating Factors

Strengths:

- Conservative strategy and capital policy underpinned by solid domestic franchise.
- Cooperative banking model with joint and several guarantee by all member banks.
- Sound asset quality that proved resilient through the recent economic downturn.

Weaknesses:

- Geographic concentration in Finland.
- Weaker cost efficiency than peers.
- Declining but still volatile insurance income.

Outlook: Negative

Standard & Poor's Ratings Services' outlook on Finland-based Pohjola Bank PLC is negative, reflecting our belief that the bank is exposed to the possibility of increasing risk in the Finnish banking sector. We believe ongoing profit retention will increase the wider OP-Pohjola Group's risk-adjusted capital (RAC) ratio above 10%. We believe loan losses will remain at their current low level although we note the bank's relatively concentrated exposure to Finland's commercial real estate sector. We expect reduced earnings volatility due to lower risk levels at the group's insurance subsidiaries as a result of declining investments in equities.

We could take negative rating actions if there was a significant worsening of the Finnish economy, which could increase our assessment of the risk in the country's banking sector and possibly lower the group's RAC ratio below 10% on a sustainable basis. A negative revision could also occur if we were to observe a significant increase in loan losses, increased earnings volatility, or meaningful growth of high-risk exposure.

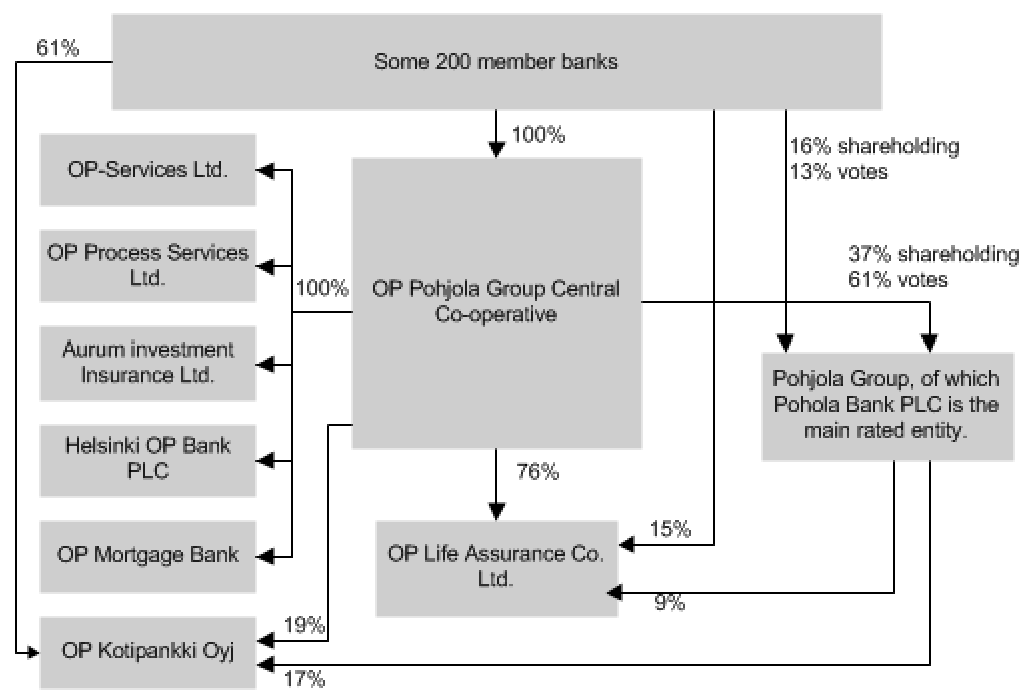
A positive rating action is currently unlikely.

Rationale

The ratings on Pohjola Bank reflect the franchise and creditworthiness of the wider OP-Pohjola Group. Pohjola Bank is currently 37% owned by the group's central cooperative, an additional 16% is directly owned by the group's member banks, 10% is owned by Ilmarinen Mutual Pension Insurance Co. and the remaining 37% is in free float. OP-Pohjola Group is mainly composed of about 200 cooperative banks (as of Dec. 31, 2012) and Pohjola Bank. The bank acts as the group's central bank and provides financial services to large corporate entities. OP-Pohjola Group also includes leading non-life and life insurance businesses.

Chart 1

OP-Pohjola Group Structure



Note: percentages are ownership unless otherwise stated.

All of the group's cooperative banks as well as Pohjola Bank itself have operated since 1997 as a single entity for regulatory purposes under a joint and several guarantee scheme, established under Finnish law. Given Pohjola Bank's systemic importance, we view the bank as integral to the group.

We believe the group will maintain its leading position within the Finnish market where its business lines have market shares of 25%-35%. For this reason and because of the cooperative nature of the group, we assess its business position as "strong". We assess the group's capital and earnings as "strong" in the belief that it will report gradually increasing profits, enabling it to achieve a RAC ratio of 10.5% by 2014. On the basis of its strong loan-loss track record, which compares favorably with those of its peers we consider the bank's risk position to be "adequate". This is partly offset by some concentration risk through exposure to the Finnish real estate sector. We assess the bank's funding as "average" and its liquidity as "adequate". The bank's funding mix is sound and dominated by deposits, and we expect ongoing government support for the wider banking sector to ensure access to funding and liquidity.

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

Our bank criteria use our Banking Industry Country Risk Assessment economic risk and industry risk scores to determine a bank's anchor, the starting point in assigning an issuer credit rating. Our anchor for a commercial bank operating only in Finland is 'a-', based on an economic risk score of '2' and an industry risk score of '3'.

We view Finland as a competitive and resilient economy with high education levels. However, the country depends on exports by cyclical industries, which subjects its economy to increasing pressure from Europe's worsening contraction. Moreover, lack of reforms to increase competiveness could pressure the economy. Low corporate and moderate household debt levels and a very strong payment culture contribute to sound leverage.

Diverse Nordic banking groups largely control Finland's concentrated banking industry, which in our view is underpinned by robust profitability and stability. Deposits dominate funding, but the sector is a net external debtor, reflecting significant loan growth over the past decade and the country's lack of a deep domestic debt market.

Table 1

OP-Pohjola Group--Key Figures

		--Year-ended Dec. 31--			
(Mil. €)	**2013***	**2012**	**2011**	**2010**	**2009**
Adjusted assets	86,301.0	85,784.0	80,907.0	72,102.0	69,819.0
Customer loans (gross)	67,980.0	65,574.0	60,700.0	57,177.0	53,263.0
Adjusted common equity	5,578.0	5,362.9	5,429.4	5,348.4	4,944.0
Operating revenues	1,292.0	2,353.0	2,145.0	2,160.0	2,032.0
Noninterest expenses	861.0	1,652.0	1,527.0	1,436.0	1,390.0
Core earnings	301.0	483.0	429.0	440.0	337.0

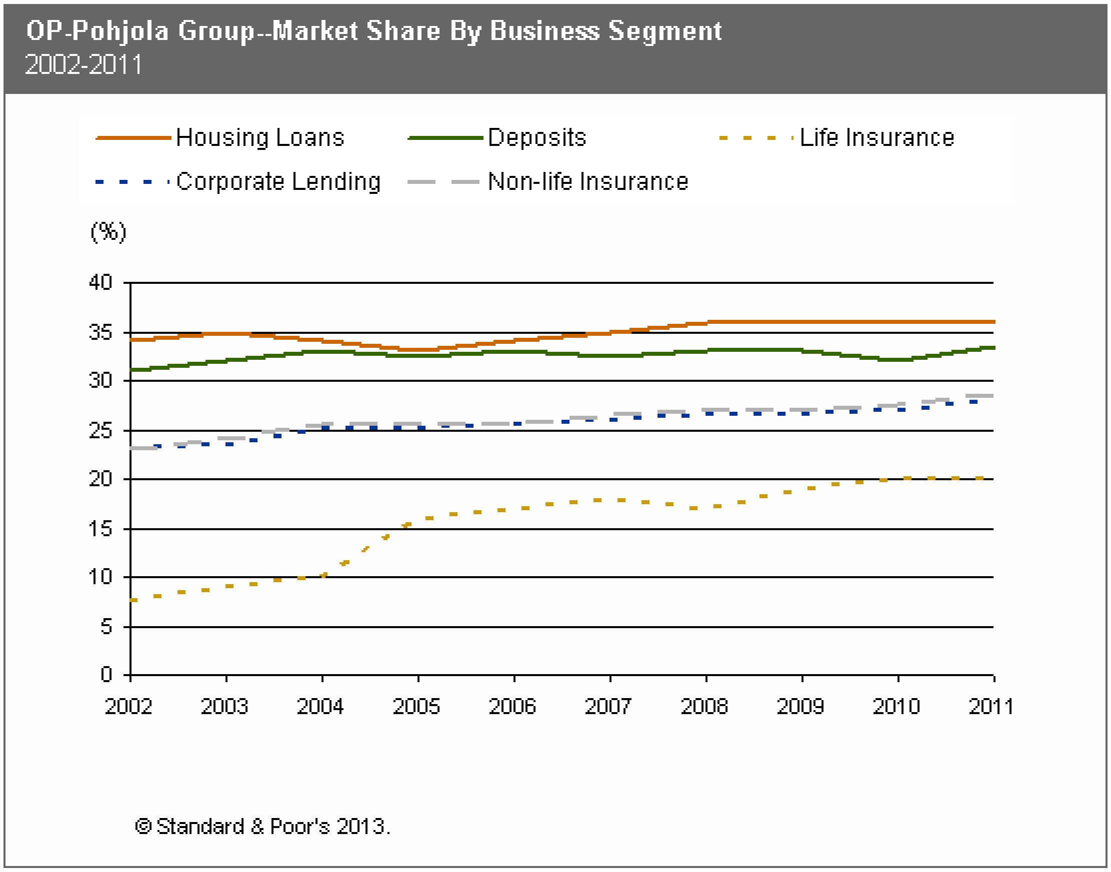
*Data as of June 30.

Business position: Leading domestic franchise in banking and insurance

We believe the group will maintain its leading position within the Finnish market where its business lines in corporate and retail banking have market shares of 25%-35%. For this reason, we assess its business position as "strong." This is further supported by the group's stable life and non-life insurance operations. In our view, the group's expected consistently strong revenue and return on equity of about 7%, supported by its retail focus and coherent long-term strategy will provide a stable operating platform.

These attributes are partly offset in our view by the group's slightly concentrated geographic profile and inherently volatile insurance revenues. Although we note that the group has actively been reducing risk levels by lowering its exposure to equity investments, we do not expect the geographic concentration of the group to change anytime soon. Positively, the group's revenue diversity through its banking and insurance operations proved helpful in 2012 and we think the group still has significant room to further exploit cross-selling opportunities. The group's efforts in this respect have been very successful and are reflected by a sharp increase in joint clients to about 1.42 million in 2012 from about 700,000 in 2005.

Chart 2



We believe the cooperative model, whereby the cooperative banks and Pohjola Bank operate under a joint and several liability guarantee, defined by the Act on the Amalgamation of Deposit Banks, to be a very stable ownership structure. We believe it should enable the bank to continue to focus less on short-term returns and management to adhere to its strategy providing the owners with stable returns. We believe the ownership structure underpins the strengths and stability of the business model.

Table 2

OP-Pohjola Group--Business Position

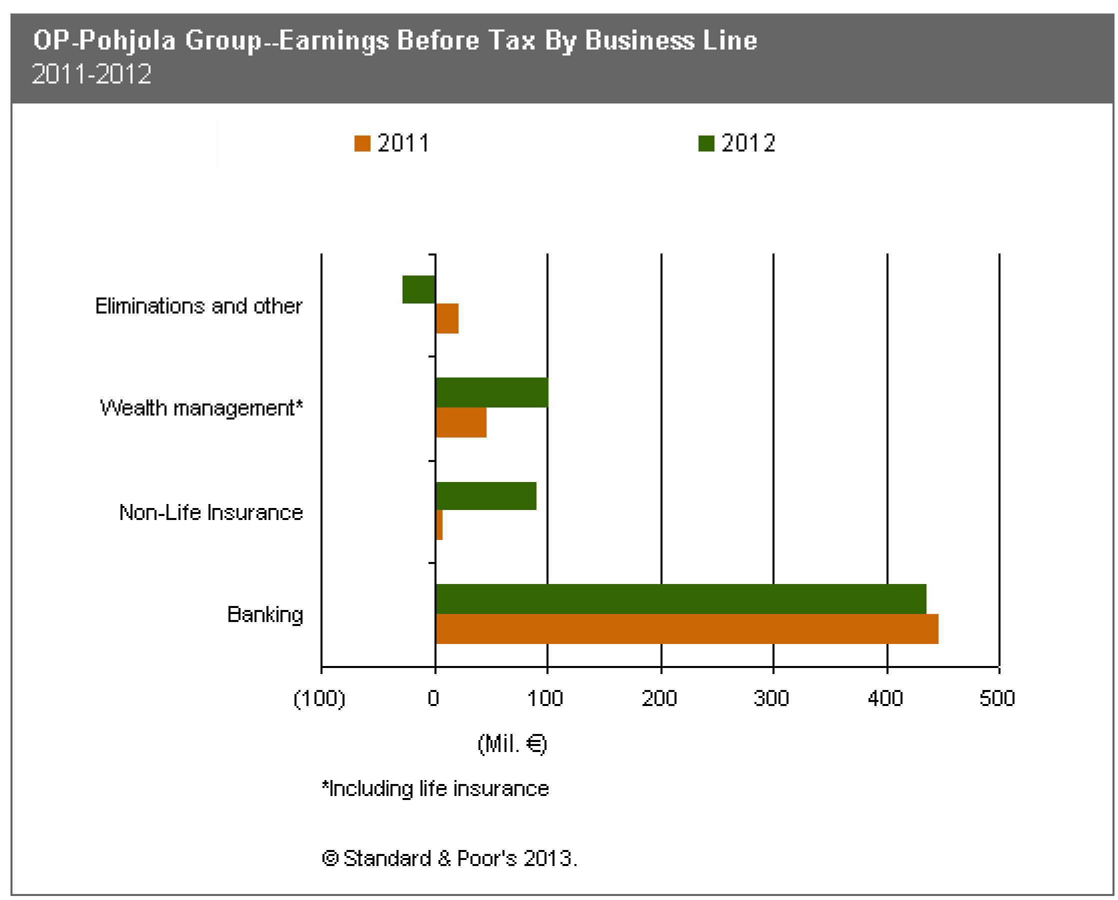
		--Year-ended Dec. 31--			
(%)	**2013***	**2012**	**2011**	**2010**	**2009**
Total revenues from business line (currency in millions)	1,292.0	2,353.0	2,145.0	2,160.0	2,032.0
Commercial & retail banking/total revenues from business line	64.5	71.9	78.9	73.9	83.7
Insurance activities/total revenues from business line	21.7	19.5	20.9	24.3	16.0
Asset management/total revenues from business line	12.3	10.1	N/A	N/A	N/A
Other revenues/total revenues from business line	1.5	(1.4)	0.2	1.9	0.3
Return on equity	8.4	7.1	6.5	6.8	5.9

*Data as of June 30.N/A--Not applicable.

Capital and earnings: Still strong capital position despite higher economic risk in Finland

In our view, OP-Pohjola Group's relatively stable earnings generation and a conservative capital policy in the cooperative will not change. For this reason, we assess the group's capital and earnings as "strong." We expect the group's RAC ratio to increase to 10.5% by the end of 2014, compared with 9.7% at the end of 2012. This level is lower than our previous forecast due to the higher credit risk weighting we now incorporate in the bank's Finnish exposure. We expect the group to manage capital conservatively and target a 15% Tier 1 common equity ratio under Basel III rules (depending on the prospective countercyclical buffer to be assigned in Finland).

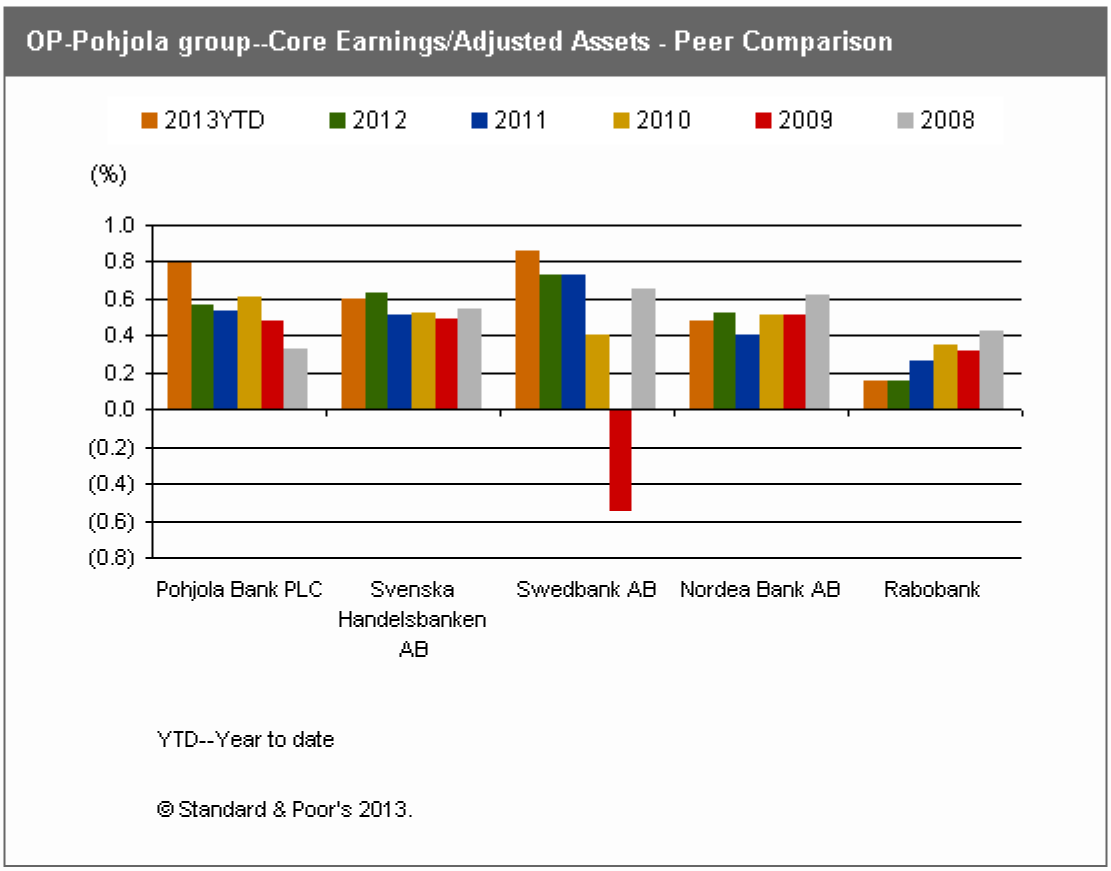
Chart 3



We expect OP-Pohjola Group's profit before tax in 2013 to increase from 2012, reaching €600 million-€700 million and then to further increase in 2014 reflecting the full impact of ongoing margin increases in the mortgage and corporate portfolios. Over the past few months we have noted that residential mortgage lending margins on new loans have materially increased, which we expect to reduce the adverse impact of low market rates on profitability. We assume the bank's dividend policies will remain in line with previous years (53% of dividends announced are reinvested back into the group).

We expect the group's net interest income to decrease by 5%-10% in 2013 due to low interest rates, though insurance-related income is likely to compensate, demonstrating, in our view, the positive effects of a diverse revenue stream. OP-Pohjola Group's earnings are dominated by interest and fee income, but traditionally 20%-30% of the group's earnings have been derived from more volatile insurance-linked income. Pre-tax earnings from non-life insurance and wealth management (including life insurance) recovered to €193 million in 2012, having dropped sharply to €55 million in 2011. The recovery was mainly caused by improved investment returns and strong premium growth. We note that investment risk has declined over the past two years, as equity exposures have been reduced, but that it still remains relatively high.

Chart 4



We expect our earnings buffer metric, which measures the capacity of a bank to cover its normalized losses, to be in the range of 60-80 basis points to support a build-up of capital. However, the bank is less efficient than its Nordic peers, with a cost-to-income ratio averaging 69% (63% excluding returns to owner-members) over the past five years reducing its earnings potential. We expect the group to continue with a cost cutting program, under which 560 full-time employees were made redundant in 2012. We also expect that further consolidation among the cooperative's banks (which declined in number to 196 in 2012 from 227 in 2008) will help to increase efficiency.

Table 3

OP-Pohjola Group--Capital And Earnings

		--Year-ended Dec. 31--			
(%)	**2013***	**2012**	**2011**	**2010**	**2009**
Tier 1 capital ratio	13.7	14.1	14.0	12.8	12.6
Adjusted common equity/total adjusted capital	89.6	89.6	89.7	89.2	88.8
Net interest income/operating revenues	33.7	41.8	47.4	41.9	51.8
Fee income/operating revenues	24.5	24.8	26.8	26.1	24.4
Market-sensitive income/operating revenues	7.9	5.7	3.7	5.0	5.1
Noninterest expenses/operating revenues	66.6	70.2	71.2	66.5	68.4
Preprovision operating income/average assets	0.9	0.7	0.7	0.9	0.8
Core earnings/average managed assets	0.6	0.5	0.5	0.5	0.4

*Data as of June 30.

Table 4

OP-Pohjola Group Risk-Adjusted Capital Framework Data

(Mil. €)	Exposure*	Basel II RWA	Average Basel II RW (%)	Standard & Poor's RWA	Average Standard & Poor's RW (%)
Credit risk					
Government and central banks	7,814	50	1	244	3
Institutions	5,712	1,200	21	1,181	21
Corporate	28,722	19,813	69	18,405	64
Retail	46,243	8,363	18	13,214	29
Of which mortgage	39,936	5,338	13	9,528	24
Securitization§	322	638	198	836	260
Other assets	1,018	1,013	99	1,007	99
Total credit risk	89,831	31,075	35	34,886	39
Market risk					
Equity in the banking book†	501	1,500	299	4,022	803
Trading book market risk	--	725	--	1,088	--
Total market risk	--	2,225	--	5,109	--
Insurance risk					
Total insurance risk	--	--	--	17,650	--
Operational risk					
Total operational risk	--	2,950	--	3,968	--
(Mil. €)		**Basel II RWA**		**Standard & Poor's RWA**	**% of Standard & Poor's RWA**
Diversification adjustments					
RWA before diversification		36,250		61,613	100
Total Diversification/Concentration Adjustments		--		(2,175)	(4)
RWA after diversification		36,250		59,439	96

Table 4

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

(Mil. €)	Tier 1 capital	Tier 1 ratio (%)	Total adjusted capital	Standard & Poor's RAC ratio (%)
Capital ratio				
Capital ratio before adjustments	5,352	14.8	5,985	9.7
Capital ratio after adjustments‡	5,352	14.0	5,985	10.1

*Exposure at default. §Securitization exposure includes the securitization tranches deducted from capital in the regulatory framework. †Exposure and Standard & Poor's risk-weighted assets for equity in the banking book include minority equity holdings in financial institutions. ‡Adjustments to Tier 1 ratio are additional regulatory requirements (e.g. transitional floor or Pillar 2 add-ons). RWA--Risk-weighted assets. RW--Risk weight. RAC--Risk-adjusted capital. Sources: Company data as of Dec. 31, 2012, Standard & Poor's.

Risk position: Low risk retail profile concentrated in Finland

We view Pohjola Bank's risk position as "adequate", reflecting our opinion that the group's RAC ratio adequately captures its different risks including risk related to the group insurance business. OP-Pohjola Group's mainly retail loan book (60% of total loans) grew by 8% in 2012, though its strong loan-loss record is offset by some concentration risk arising from exposure to Finland's commercial real estate sector (30% of the corporate book). However, this exposure is mostly related to income-producing real estate (two-thirds residential rental housing) and is therefore considered to be of moderate risk and in line with our RAC model risk weights. Loan losses have averaged 0.19% of the loan book over the past five years, peaking at 0.34% in 2009. These levels compare favorably within the bank's peer group and with our expectations of normalized losses. In our base-case scenario, we expect the bank will broadly maintain its 2012 impairment level in 2013 before a decline in 2014, although second quarter data for 2013 indicate a lower level than we currently expect.

Despite growing imbalances in the Finnish household sector, we anticipate no significant credit losses in OP-Pohjola Group's mortgage portfolio over the near term, provided interest rates do not increase sharply. However, a dampening of consumption could hurt the corporate and small and midsize enterprises sectors in particular.

We expect recently high lending growth to slow, primarily as a result of lower demand for household mortgage lending, while we expect the proportion of lending to the corporate sector, an area where the group's market share has historically been lower than those of its main business lines, to increase. We expect this will involve some additional but manageable risk.

Investment risk in the insurance subsidiaries has been reduced as the group has decreased their equity investments and steered the life insurer toward unit-linked products instead of guaranteed solutions (62% of the business as of end-2012 was unit-linked). Under our RAC framework, we convert equity invested (€1,412 million as of Dec. 31, 2012) in the life and non-life subsidiaries into risk weighted assets with a 1,250% risk weighting. We believe this to be commensurate with the risk level in the insurance businesses (See "Finland-Based Pohjola Non-Life Insurance Co. Ltd. Affirmed At 'AA-' After Insurance Criteria Change; Outlook Negative," published July 5, 2013).

Table 5

OP-Pohjola Group--Risk Position					
		--Year-ended Dec. 31--			
(%)	**2013***	**2012**	**2011**	**2010**	**2009**
Growth in customer loans	7.3	8.0	6.2	7.3	2.7
Total managed assets/adjusted common equity (x)	20.3	18.6	17.0	15.7	16.3
New loan loss provisions/average customer loans	0.1	0.2	0.2	0.3	0.3
Net charge-offs/average customer loans	0.0	0.1	0.1	0.1	0.0
Gross nonperforming assets/customer loans + other real estate owned	1.4	1.4	1.3	1.4	1.3
Loan loss reserves/gross nonperforming assets	45.2	45.7	45.2	42.9	39.5

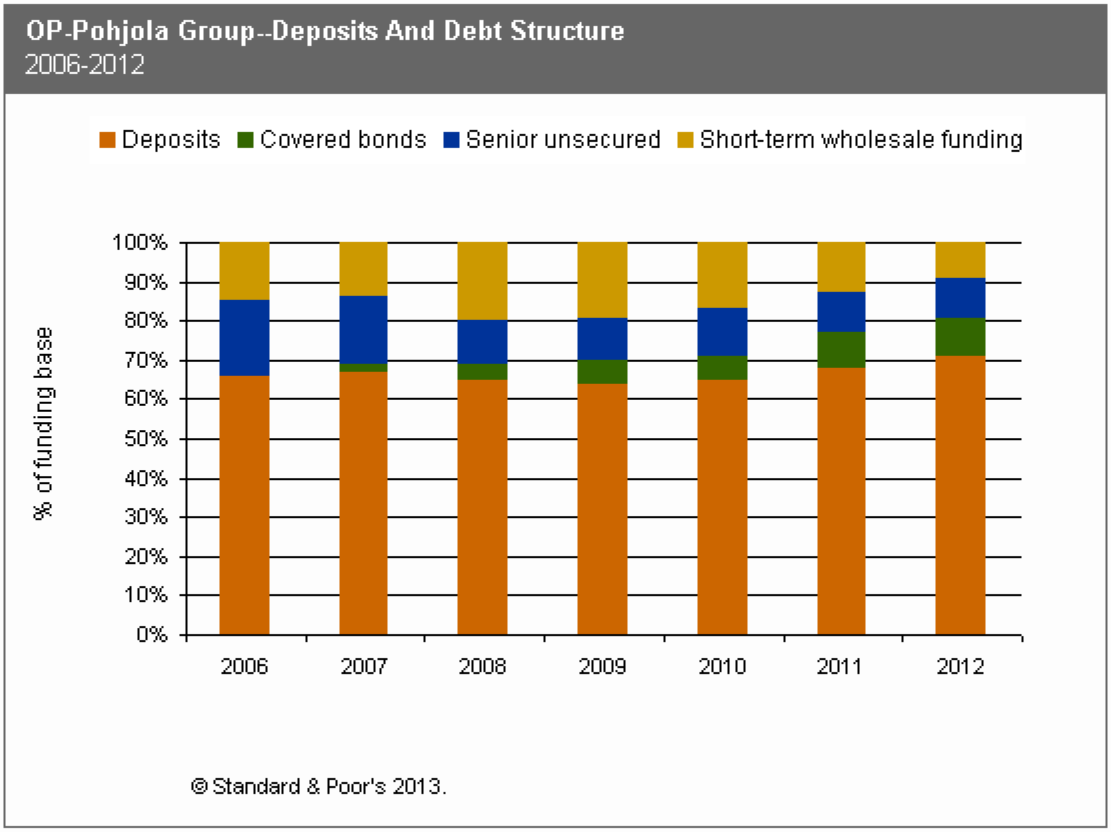
*Data as of June 30.

Funding and liquidity: Average, with deposit base funding the retail loan portfolio

We consider OP-Pohjola Group's funding "average" and its liquidity "adequate," as we expect it to further reduce its reliance on short-term wholesale funding. The group has one of the highest ratios of deposit funding in the Nordic countries (70% at end-2012), but some structural reliance on wholesale funding makes it vulnerable to dislocations in funding markets.

OP-Pohjola Group's stable funding ratio (89% at end-2012) has been improving over the past three years as the group has been increasing the duration of its wholesale exposure while reducing short-term funding by €4 billion. However, its funding structure still demonstrates some weakness given our expectations that banks should fund their long-term assets with appropriate forms of stable long-term funding, plus a margin for unanticipated loss of customer deposits. Relative to its Nordic peers, the group's asset encumbrance levels are among the lowest in the 10%-15% range. A significant majority of investors in Pohjola Bank's debt are based abroad given the small domestic debt market in Finland and we consider this a weakness for the bank's funding profile, though in line with our assessment of Finland's system-wide funding profile.

Chart 5



By our measures, the group's one-year liquidity ratio (broad liquid assets to short-term wholesale funding) is adequate (106% at end-2012) and a significant improvement over the 87% recorded in 2011, reflecting reduced short-term funding. We consider the bank's liquidity coverage to be adequate, indicating availability of sufficient liquid assets to withstand lack of access to wholesale funding for more than one year, including a contingency buffer for some loss of deposit funding.

Table 6

OP-Pohjola Group--Funding And Liquidity

		--Year-ended Dec. 31--			
(%)	**2013***	**2012**	**2011**	**2010**	**2009**
Core deposits/funding base	68.1	66.8	64.5	61.9	59.6
Customer loans (net)/customer deposits	135.8	144.8	146.1	156.0	153.1
Long term funding ratio	87.2	86.3	81.4	79.5	74.7
Stable funding ratio	N.A.	89.3	84.8	N/A	N/A
Short-term wholesale funding/funding base	13.9	15.0	20.3	22.6	27.7
Broad liquid assets/short-term wholesale funding (x)	N.A.	1.1	0.8	N/A	N/A
Net broad liquid assets/short-term customer deposits	(1.7)	1.4	(4.5)	N/A	N/A
Short-term wholesale funding/total wholesale funding	42.5	44.0	55.7	57.7	66.9
Narrow liquid assets/3-month wholesale funding (x)	1.3	1.5	1.3	N/A	N/A

*Data as of June 30. N.A.--Not available. N/A--Not applicable.

External support: One notch of government support

Owing to OP-Pohjola Group's 33% market share of customer loans and 34% share of customer deposits we consider the bank to have "high" systemic importance in Finland, which we classify as supportive, and accordingly add one notch of uplift above the bank's stand-alone credit profile.

Additional factors

No additional factors affect this rating.

Core subsidiary: Pohjola Non-Life Insurance Ltd.

We equalize the rating on "core" subsidiary Pohjola Non-Life Insurance Co. Ltd., with the ratings on the bank, according to our group methodology, reflecting our view of its strong integration and key role in the group's retail strategy.

Related Criteria And Research

- General Criteria: Group Rating Methodology, May. 7, 2013
- Banking Industry Country Risk Assessment: Finland, Jan. 25, 2013
- S&PCORRECT: Outlooks On Two Finnish Banks Revised To Negative Due To Rising Economic Risks, Nov. 20, 2012
- Banks: Rating Methodology And Assumptions, Nov. 9, 2011
- Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- Group Rating Methodology And Assumptions, Nov. 9, 2011
- Bank Hybrid Capital Methodology And Assumptions, Nov. 1, 2011
- Bank Capital Methodology And Assumptions, Dec. 6, 2010

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 31, 2013)	
Pohjola Bank PLC	
Counterparty Credit Rating	AA-/Negative/A-1+

Ratings Detail (As Of July 31, 2013) (cont.)		
Commercial Paper		
Local Currency		A-1+
Senior Unsecured		AA-
Short-Term Debt		A-1+
Subordinated		A
Counterparty Credit Ratings History		
20-Nov-2012	*Foreign Currency*	AA-/Negative/A-1+
07-Sep-2006		AA-/Stable/A-1+
12-Sep-2005		AA-/Negative/A-1+
20-Nov-2012	*Local Currency*	AA-/Negative/A-1+
07-Sep-2006		AA-/Stable/A-1+
12-Sep-2005		AA-/Negative/A-1+
Sovereign Rating		
Finland (Republic of)		AAA/Stable/A-1+
Related Entities		
OP Mortgage Bank		
Senior Secured		AAA
Senior Secured		AAA/Stable
Pohjola Non-Life Insurance Co. Ltd.		
Financial Strength Rating		
Local Currency		AA-/Negative/--
Issuer Credit Rating		
Local Currency		AA-/Negative/--

*Unless otherwise noted, all ratings in this report are global scale ratings. Standard & Poor's credit ratings on the global scale are comparable across countries. Standard & Poor's credit ratings on a national scale are relative to obligors or obligations within that specific country.

Additional Contact:
Financial Institutions Ratings Europe; FIG_Europe@standardandpoors.com