

Research

Research Update:

Finland-Based Pohjola Bank 'AA-/A-1+' Ratings Remain On CreditWatch Negative Following Government Support Review

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Overview

- We consider that potential extraordinary government support for European banks will likely decrease as resolution frameworks are put in place.
- Pohjola Bank's credit profile could weaken as a result, and combined with our concerns about the bank's capital after its announced share buybacks, could lead to a downgrade.
- We are therefore keeping our 'AA-/A-1+' counterparty credit ratings on Pohjola Bank on CreditWatch negative, where we placed them on Feb. 6, 2014.
- We intend to resolve the CreditWatch within 90 days, or once we have greater clarity regarding the transaction's impact on the group's capitalization. We could lower the ratings by one notch if, among other factors, we believed the bank unlikely to recapitalize in line with our current expectations.

Rating Action

As previously announced on April 29, 2014, Standard & Poor's Ratings Services said its 'AA-/A-1+' counterparty credit ratings on Finland-based Pohjola Bank PLC remain on CreditWatch, where they were placed with negative implications on Feb. 6, 2014.

Similarly, the 'AA-' long-term counterparty credit and financial strength ratings on Pohjola Bank's core subsidiary Pohjola Non-Life Insurance Co. Ltd. remain on CreditWatch negative.

Rationale

The CreditWatch update follows the completion of our review of potential extraordinary government support for European banks (see "Standard & Poor's To Review Government Support In European Bank Ratings," published March 4, 2014, on RatingsDirect). We originally placed the ratings on CreditWatch negative on Feb. 6, 2014, on the group's announcement of a share buyback at the bank.

We observe that European authorities are taking steps to increase the resolvability of banks and require creditors rather than taxpayers to bear the burden of the costs of failure (see "Standard & Poor's Takes Various Rating Actions On European Banks Following Government Support Review," published on

April 29, 2014). In the near term, we expect that governments will remain supportive of systemically important banks' senior unsecured creditors while resolution frameworks take shape.

From January 2016, however, the EU Bank Recovery and Resolution Directive (BRRD) is set to introduce the mandatory bail-in of a minimum amount of eligible liabilities, potentially including certain senior unsecured obligations, before governments could provide solvency support. Accordingly, we believe that the potential extraordinary government support available to Pohjola Bank's senior unsecured bondholders will likely diminish within our two-year rating horizon.

Currently, we consider that Pohjola Bank has "high" systemic importance in Finland, which we view as "supportive" of private-sector commercial banks. As a result, and in line with our criteria, the 'AA-' long-term counterparty credit rating on Pohjola Bank stands one notch above the bank's 'a+' stand-alone credit profile (SACP). We could remove this notch shortly before the January 2016 introduction of the BRRD's powers to bail-in senior unsecured liabilities. These rules would indicate to us that EU governments would be much less able to support senior unsecured bank creditors, even though it may take several more years to eliminate concerns about the financial stability and resolvability of systemically important banks.

Specifically, if we perceive that support for senior unsecured creditors is less predictable under the new legislative framework, we would likely remove the government-support notch from our ratings on Pohjola Bank. This would most likely arise from a reclassification of Finland's support for private-sector commercial banks to "uncertain" under our criteria. Any decision to reclassify government support would be subject to our review of the final resolution legislation and technical standards, and other relevant information.

If, on the other hand, our view was that extraordinary government support may still be forthcoming to Pohjola Bank's senior unsecured creditors, we could retain the notch of support in the ratings. This would be the case if authorities publicly confirmed their supportive stance toward senior unsecured creditors, or if we believed that precautionary capital injections would still be likely under the new legislation to minimize the wider economic impact of the resolution of a systemically important bank. In this case, we may consider that Finland remained "supportive" and that Pohjola Bank had "high" or "moderate" systemic importance. We could revise our view of Pohjola Bank's systemic importance to "moderate" from "high" if we considered that its resolution under the new framework would have a material, but manageable, adverse impact on the country's financial system and economy.

In addition to our view of the SACP and potential extraordinary government support, future rating actions on Pohjola Bank may result from other factors. These may include the bank's measures to mitigate bail-in risks to senior unsecured creditors, for example, by building a large buffer of subordinated instruments (see "Credit FAQ: The Rating Impact Of Resolution Regimes For European Banks," published on April 29, 2014).

The ratings on Pohjola Non-Life Insurance Co. Ltd. reflect our view of its core status in the OP-Pohjola financial services group, based on its successful bancassurance business model in Finland and contributions to the group's earnings through insurance commission revenues. The CreditWatch on our ratings on this entity reflects that on Pohjola Bank.

The potential reduction of extraordinary government support has no impact on our ratings on Pohjola Bank's subordinated debt. The reason for this is that we have long believed that subordinated creditors would not receive extraordinary government support in a stress scenario and rate these instruments by notching downward from the bank's SACP.

CreditWatch

We aim to resolve the CreditWatch within 90 days or after the share buyback transaction has been approved and concluded. By that time we would expect to have more clarity on the impact of the announced share buyback and other capital measures on the group's capital position. In addition to potential changes to the bank's SACP and government support, we will review other relevant factors before taking a rating decision. These might include any steps Pohjola Bank takes to reduce bail-in risks for senior unsecured creditors.

We could lower the ratings on Pohjola Bank by one notch if, after the share buyback, we believe the bank's capital is unlikely to remain at least strong, as shown by a projected risk-adjusted capital ratio that is higher than 10% within the next 24 months.

In addition, we may lower the ratings by one notch by year-end 2015 if we believe there is a greater likelihood that senior unsecured creditors may incur losses if the bank fails. This could occur if we considered extraordinary government support to be less predictable under the new EU legislative framework. Furthermore, in our view, Finland's weak economic recovery could hamper the banking sector's performance over the next two years, which could lead us to lower our anchor for Finnish banks, including Pohjola Bank.

However, we could affirm the ratings if we consider the group able to comfortably reach its capital targets within the next two years and continue its conservative capital policy.

Ratings Score Snapshot

Issuer Credit Rating AA-/Watch Neg/A-1+

SACP	a+
Anchor	a-
Business Position	Strong (+1)
Capital and Earnings	Strong (+1)
Risk Position	Adequate (0)
Funding and Liquidity	Average and Adequate (0)
Support	+1
GRE Support	0
Group Support	0
Sovereign Support	+1
Additional Factors	0

Related Criteria And Research

Related Criteria

- Group Rating Methodology, Nov. 19, 2013
- Banks: Rating Methodology And Assumptions, Nov. 9, 2011
- Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- Bank Hybrid Capital Methodology And Assumptions, Nov. 1, 2011
- Banks: Bank Capital Methodology And Assumptions, Dec. 6, 2010
- Use Of CreditWatch And Outlooks, Sept. 14, 2009

Related Research

- 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
- Standard & Poor's To Review Government Support In European Bank Ratings, March 4, 2014
- Finland-Based Pohjola Bank 'AA-/A-1+' Ratings On CreditWatch Negative On Announced Share Buyback Transaction, Feb. 6, 2014
- Banking Industry Country Risk Assessment: Finland, Jan. 3, 2014
- Pohjola Bank, July 31, 2013

Ratings List

CreditWatch Update

Pohjola Bank PLC

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

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Pohjola Non-Life Insurance Co. Ltd.

Counterparty Credit Rating	AA-/Watch Neg
Insurer Financial Strength	AA-/Watch Neg

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Complete ratings information is available to subscribers of RatingsDirect at www.globalcreditportal.com and at spcapitaliq.com. All ratings affected by this rating action can be found on Standard & Poor's public Web site at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following Standard & Poor's numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; Stockholm (46) 8-440-5914; or Moscow 7 (495) 783-4009.

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