

RatingsDirect®

Bank of Aland PLC

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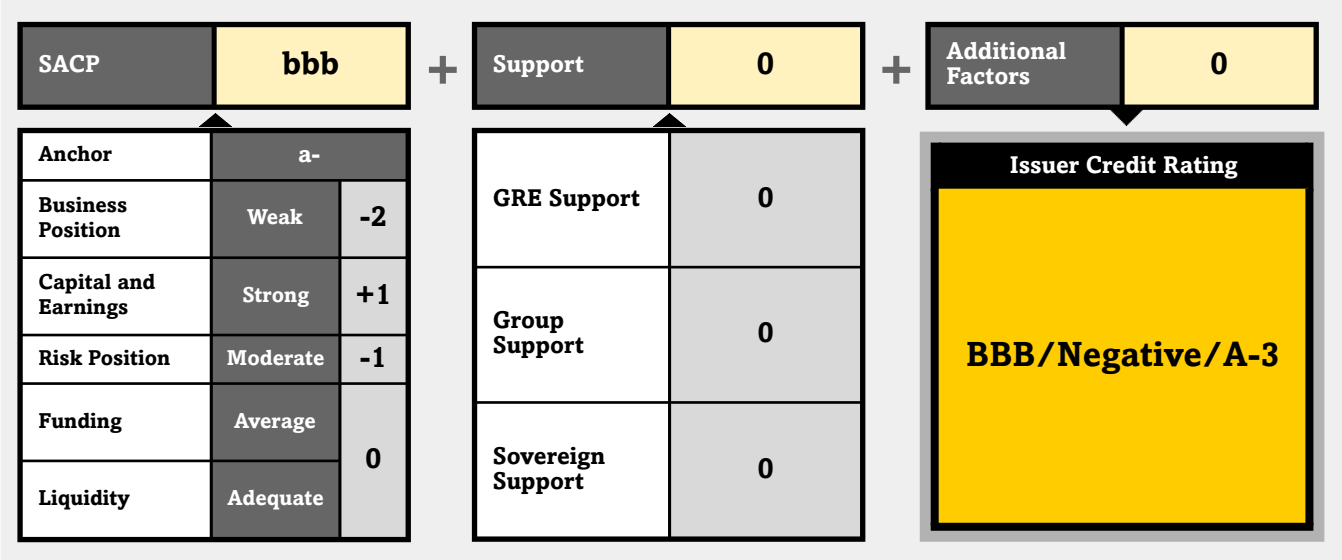
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Related Criteria And Research

Bank of Åland PLC



Major Rating Factors

Strengths:	Weaknesses:
<ul style="list-style-type: none"> • Strong capitalization. • Business operations in Finland's economically stronger regions. • Funding profile that depends less on external wholesale markets than Nordic peers. 	<ul style="list-style-type: none"> • Concentration risk due to focus on retail and private banking in Finland. • Limited but improving geographic, franchise, and earnings diversification. • Low earnings capacity and low cost efficiency.

Outlook: Negative

Standard & Poor's Ratings Services' outlook on Finland-based Bank of Åland is negative, reflecting our view that the growing economic risks in the export-oriented Finnish economy could adversely affect the Finnish banking sector's performance. This could lead us to lower our baseline assessment (the anchor) on Finnish banks, including Bank of Åland, to 'bbb+' from 'a-'.

We could take a negative rating action if the bank's operations were to deteriorate substantially, resulting in loan losses that drove our risk-adjusted capital (RAC) ratio for Bank of Åland below 10% or led us to reassess the bank's risk position and the concentration risks in its lending book.

We could consider a positive rating action if we concluded that the bank's integration of the Swedish operations is successful and meaningfully broadens the bank's franchise and diversity by reducing concentrations in its business position.

Rationale

Our ratings on Bank of Åland reflect the bank's anchor of 'a-', its "weak" business position, "strong" capital and earnings, "moderate" risk position, "average" funding, and "adequate" liquidity, as our criteria define these terms. We assess the bank's stand-alone credit profile (SACP) at 'bbb'.

We consider Bank of Åland as having "low" systemic importance and consequently factor no potential extraordinary government support into the ratings. Our long-term counterparty credit rating on Bank of Åland is 'BBB'.

Anchor: 'a-' for banks operating in Finland

We use our economic risk and industry risk scores under our Banking Industry Country Risk Assessment (BICRA) to determine an anchor, the starting point in assigning an issuer credit rating to a bank under our bank criteria. 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 pressure from Europe's subpar growth. Moreover, lack of reforms to increase competitiveness could dampen the economy. Low corporate and moderate household debt 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

Bank of Åland Key Figures					
	--Year-ended Dec. 31--				
(Mil. €)	2013*	2012	2011	2010	2009
Adjusted assets	3,777.0	3,626.3	3,389.0	3,465.2	3,372.8
Customer loans (gross)	3,034.5	2,919.3	2,745.8	2,684.5	2,552.0
Adjusted common equity	169.0	169.8	159.6	127.5	150.2
Operating revenues	49.4	96.6	100.0	99.1	87.5
Noninterest expenses	46.2	94.0	97.4	92.2	77.2
Core earnings	1.7	(1.6)	(0.2)	(2.2)	6.5

*Data as of June 30.

Business position: Weak due to concentrated franchise in Finland

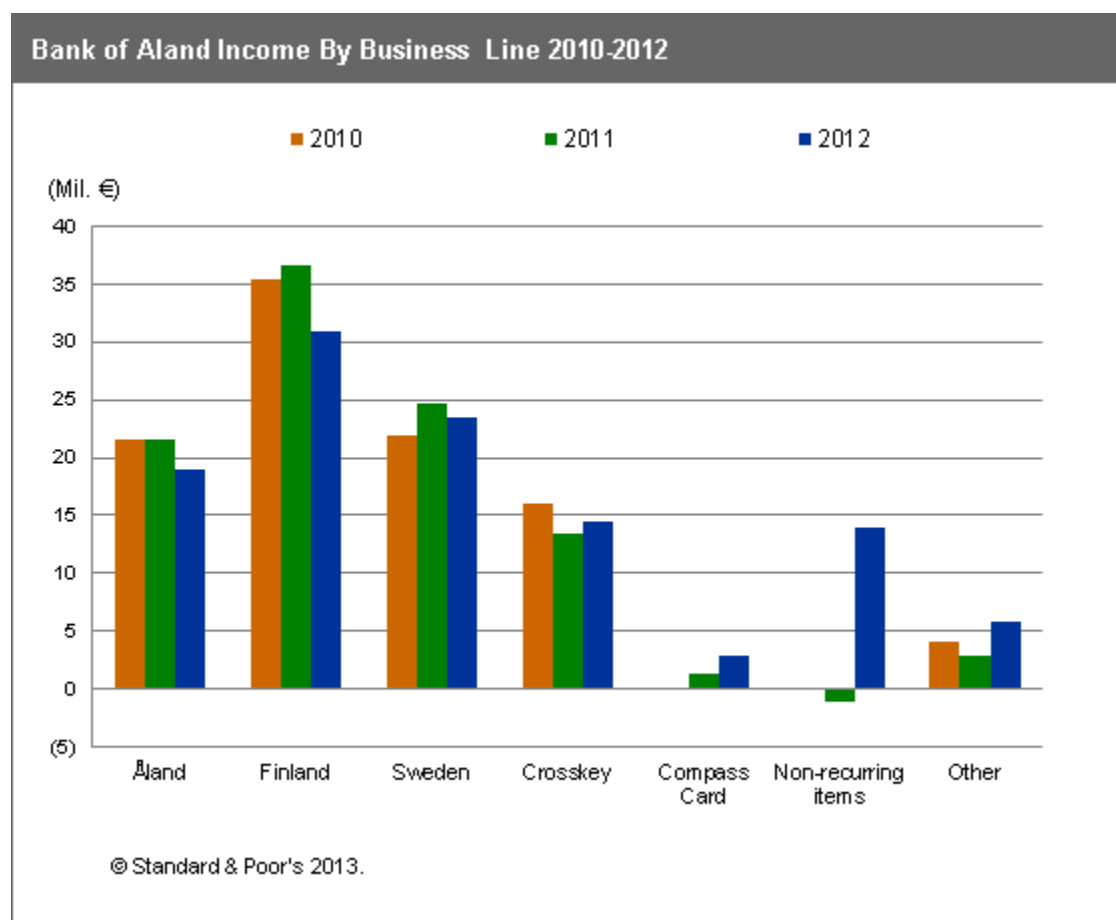
We consider Bank of Åland's business position to be "weak," reflecting its significantly concentrated retail bank franchise in the Åland Islands, Finland, and its niche position in the Swedish market.

Bank of Åland, with reported total assets of €3.8 billion on June 30, 2013 and some 80,000 customers, holds a leading position in its wealthy home region, Finland's Åland Islands. In addition, the bank is a niche provider of retail, private banking, and asset management operations in selected regions in Finland since the 1980s and in Sweden since 2009.

We recognize the bank's efforts to diversify its franchise with the recent acquisition of parts of Kaupthing Bank in Sweden (private banking, asset management, and initially institutional brokerage, which has since been shut down), with the aim to grow in private banking and asset management activities. Although 25% of the bank's lending operations are in Sweden, we consider that the revenue diversification that these operations provide is not enough for us to change our assessment of the bank's narrow franchise in the near future. However, we expect the Swedish portfolio to be the main contributor to growth and increased earnings in the next couple of years.

The non-bank activities--including IT-company, CrossKey, and credit card company, Compass Card--contribute to Bank of Åland's income stream. But we understand that the bank is considering the possibility of divesting its majority shareholding in CrossKey in the near term.

Chart 1



Positively, we believe Bank of Åland benefits from a loyal customer base and generally stable earnings owing mainly to interest and fee income. However, fee income is to a large extent related to asset management and capital market activity. In our view, the management's focused and risk-averse long-term strategy including the acquisition of Kaupthing, continues to support the bank's strengths. In addition, we believe that the bank's strong and stable shareholder group, including the local insurance companies and the wealthiest man on Åland, Anders Wiklöf, are supportive owners promoting local ownership of the bank.

Table 2

Bank of Åland Business Position					
	--Year-ended Dec. 31--				
(%)	2013*	2012	2011	2010	2009
Total revenues from business line (Mil. €)	N/A	110.4	99.2	99.1	110.6
Retail banking/total revenues from business line	N.M.	66.4	65.8	67.3	77.6
Commercial & retail banking/total revenues from business line	N.M.	66.4	65.8	67.3	77.6
Trading and sales income/total revenues from business line	N.M.	9.1	1.9	4.8	3.6
Brokerage/total revenues from business line	N.M.	8.7	16.1	15.5	10.5
Payments and settlements/total revenues from business line	N.M.	6.8	5.3	3.5	3.3
Asset management/total revenues from business line	N.M.	8.9	10.9	8.9	5.0
Investment banking/total revenues from business line	N.M.	9.1	1.9	4.8	3.6
Return on equity	4.0	6.4	(3.9)	(1.8)	18.0

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

Capital and earnings: Strong capitalization supported by gradually improving earnings

We assess Bank of Åland's capital and earnings as "strong." This is based on our expectation that the bank's RAC ratio will remain in the range of 10.5%-11.0% over the next 18-24 months, compared with 10.8% as of Dec. 31, 2012. We incorporate into our projection Bank of Åland's cost control efforts to reduce its high cost base compared with peers, its improving earnings reflecting the growth of the Swedish operations, the repricing of the existing Finnish corporate loan book, and higher margins on new household lending. We believe these margin increases to be achievable as they follow the general trend in the Finnish banking sector. Our capital assessment is also underpinned by a strong quality capital base composed entirely of common equity.

We believe that the low interest rates, especially the 12-month EURIBOR to which Finnish mortgages are linked, and the increasing but still-low activity in the stock market will continue to keep the bank's net fee and interest income low in 2013. We expect this income to start recovering in 2014. We believe that any meaningful increase in interest rates will have a substantial positive effect on Bank of Åland's net interest income. In the next few years, we anticipate a balanced revenue contribution from net interest and net fee income, as the asset management and private banking operations gain importance in the bank's strategy. We further expect the Swedish operations to grow in both lending and assets under management and to contribute positively to profits from 2014.

We expect the bank to continue improving its cost efficiency and to attain a cost-to-income ratio of about 80%-85% in 2013-2014, compared with 97% in 2012. The weak cost level reflects, among other things, the bank's restructuring of its Swedish operations and the related redundancy expenses, which to a large extent were planned for within the acquisition budget. Other ongoing or finalized restructuring measures include the optimization of the branch network in Finland and Åland Islands, closure of institutional equities in Finland and Sweden, and centralizing of group functions. These measures have reduced costs since 2011 and the full impact, a €10 million reduction in overheads, started from 2013.

We believe that the bank's result in 2013 will be positive and based on recurrent earnings from core operations, after four years of the meaningful adverse impact on net profits related to the acquisition of Kaupthing in 2009. For 2014 and 2015 we expect profits to gradually improve due to higher assets under management, larger loan volumes, and

improving margins. However, our forecast of Bank of Åland's three-year average earnings buffer, which measures the capacity of a bank to cover our estimation of its normalized losses, is at a very modest 12 basis points (bps) given the bank's generally low earnings.

Table 3

(%)	--Year-ended Dec. 31--				
	2013*	2012	2011	2010	2009
Tier 1 capital ratio	10.8	10.9	8.4	7.3	N/A
S&P RAC ratio before diversification	N.M.	10.8	11.1	N.M.	N.M.
S&P RAC ratio after diversification	N.M.	9.4	9.7	N.M.	N.M.
Adjusted common equity/total adjusted capital	100.0	100.0	100.0	100.0	100.0
Net interest income/operating revenues	39.5	42.6	43.1	37.1	44.7
Fee income/operating revenues	38.9	33.9	38.7	37.2	32.1
Market-sensitive income/operating revenues	5.7	7.6	2.0	6.3	5.1
Noninterest expenses/operating revenues	93.5	97.3	97.4	93.1	88.2
Provision operating income/average assets	0.2	0.1	0.1	0.2	0.3
Core earnings/average managed assets	0.1	(0.0)	(0.0)	(0.1)	0.2

*Data as of June 30. RAC--Risk-adjusted capital. N/A--Not applicable. N.M.--Not meaningful.

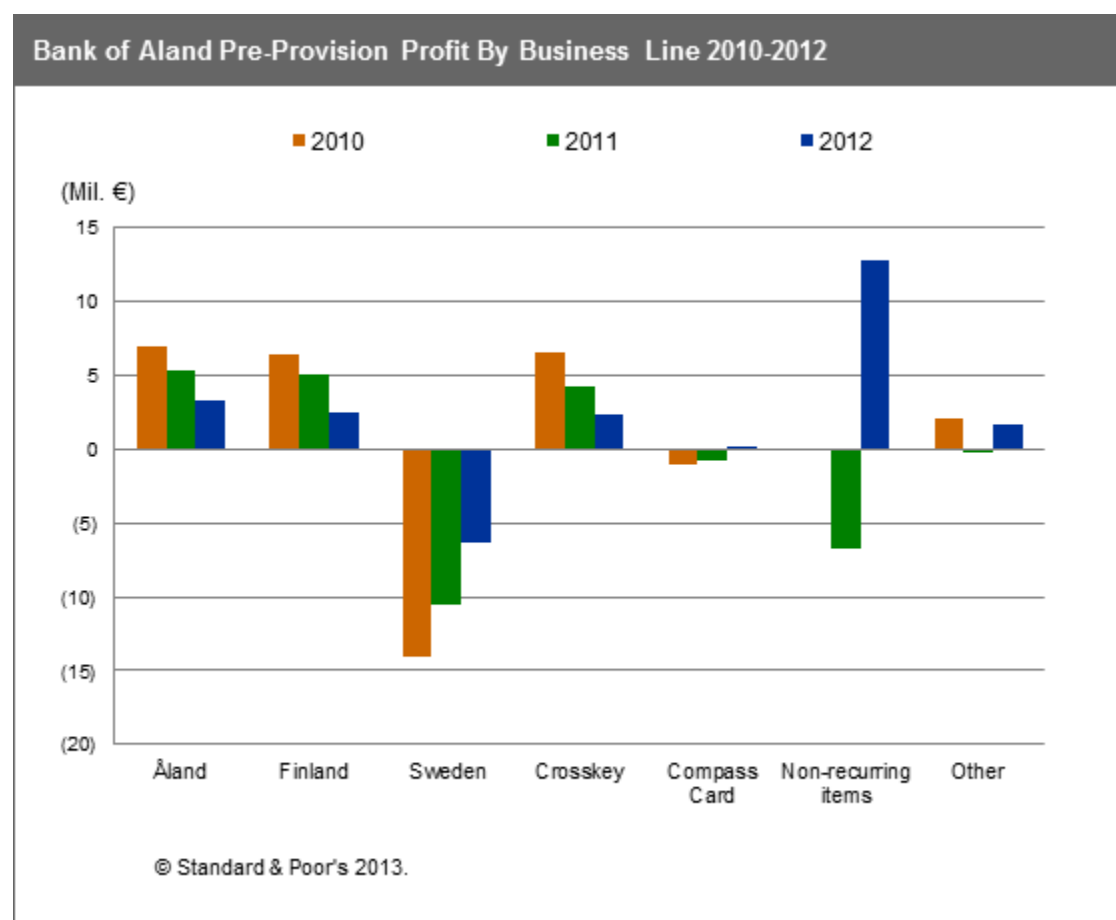
Chart 2

Table 4

Bank of Åland PLC Risk-Adjusted Capital Framework Data					
(€ 000s)	Exposure*	Basel II RWA	Average Basel II RW (%)	Standard & Poor's RWA	Average Standard & Poor's RW (%)
Credit risk					
Government and central banks	308,401	13	0	9,252	3
Institutions	369,915	60,425	16	56,021	15
Corporate	769,976	561,581	73	404,945	53
Retail	2,215,008	563,650	25	683,097	31
Of which mortgage	1,564,333	258,063	16	364,815	23
Securitization§	0	0	0	0	0
Other assets	88,400	32,500	37	87,453	99
Total credit risk	3,751,700	1,218,169	32	1,240,768	33
Market risk					
Equity in the banking book†	11,421	7,500	72	52,579	460
Trading book market risk	--	0	--	0	--
Total market risk	--	7,500	--	52,579	--
Insurance risk					
Total insurance risk	--	--	--	0	--
Operational risk					
Total operational risk	--	176,263	--	282,213	--
(€ 000s)	Basel II RWA		Standard & Poor's RWA		% of Standard & Poor's RWA
Diversification adjustments					
RWA before diversification	1,401,931		1,575,561		100
Total Diversification/Concentration Adjustments	--		225,466		14
RWA after diversification	1,401,931		1,801,027		114
(€ 000s)	Tier 1 capital	Tier 1 ratio (%)	Total adjusted capital	Standard & Poor's RAC ratio (%)	
Capital ratio					
Capital ratio before adjustments	156,141	11.1	169,839	10.8	
Capital ratio after adjustments‡	156,141	11.1	169,839	9.4	

*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: Moderate due to concentration risks, both geographic and single-name exposures

We view Bank of Åland's risk position as "moderate." We don't expect any change in the bank's concentration risk as a result of its limited geographic exposure, small number of client segments, and some large single-name exposures. We anticipate that retail lending will continue to dominate the loan portfolio (63% of the total), while growth in the corporate portfolio should mainly stem from real estate financing in Sweden. We believe that the bank's planned expansion in the Swedish market and some reductions in its shipping finance portfolio (which we think will decrease

by €30 million to about €50 million by 2015) will be positive from a diversification perspective. We do not expect any meaningful exposure to build up in high-risk segments.

We view positively the bank's focus on wealthy individuals and their related corporations, its prudent underwriting standards, and its strategy of engaging mainly in collateralized lending. Furthermore the bank's product offering concentrates mainly on plain vanilla retail banking and asset management products. It has no exposures to European peripheral countries or complex financial instruments.

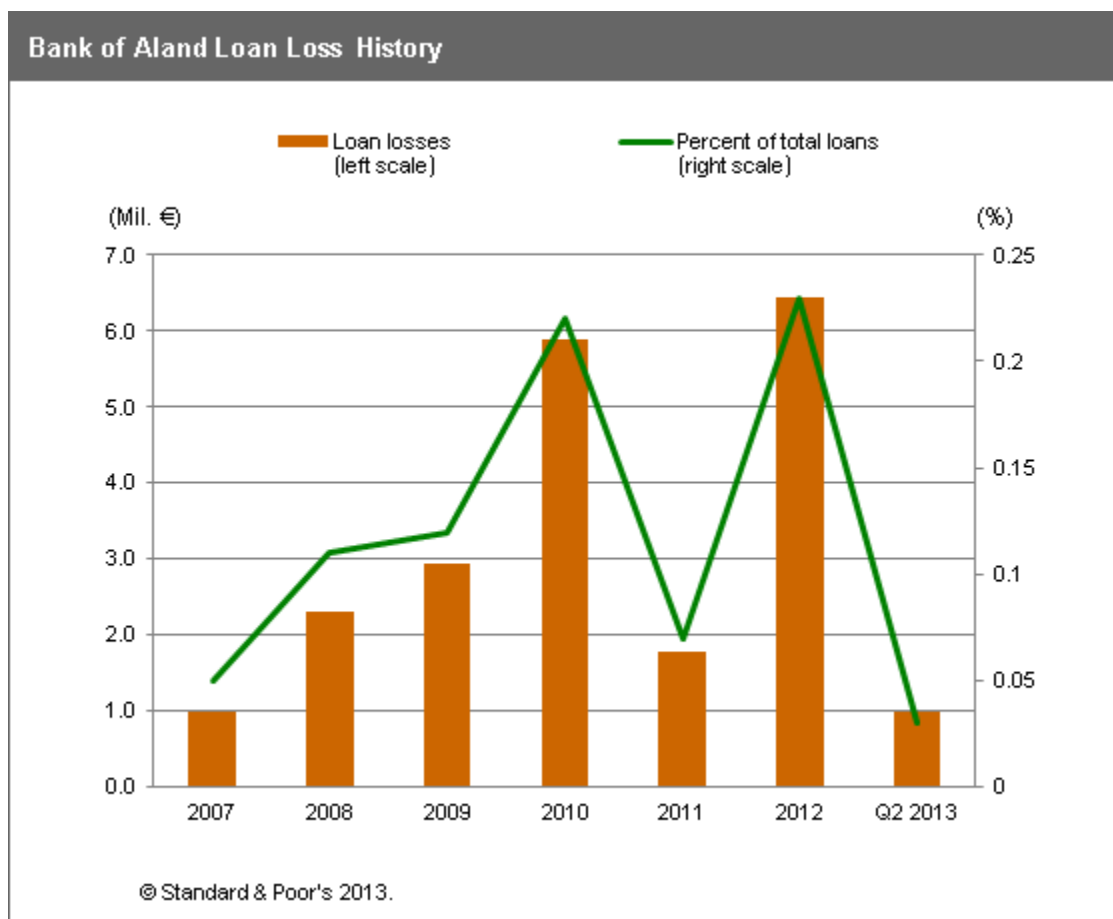
We note that the bank's adequate loan-loss track record outperforms the Finnish market average over the past five years thanks to its focus on high-net-worth retail clients with average loan losses of about 15 bps annually. For 2013, we expect 15-20 bps (losses in the second quarter benefitted from a recovery of an old problem loan, but underlying losses seem to match our expectations), reflecting the lower asset quality in the shipping portfolio and the corporate portfolio in the Finnish mainland.

Table 5

Bank of Aland Risk Position					
	--Year-ended Dec. 31--				
(%)	2013*	2012	2011	2010	2009
Growth in customer loans	7.9	6.3	2.3	5.2	16.1
Total diversification adjustment / S&P RWA before diversification	N.M.	N.M.	14.7	N.M.	N.M.
Total managed assets/adjusted common equity (x)	22.4	21.4	21.3	27.3	22.5
New loan loss provisions/average customer loans	0.1	0.2	0.1	0.2	0.1
Gross nonperforming assets/customer loans + other real estate owned	0.5	0.6	0.7	1.0	N/A
Loan loss reserves/gross nonperforming assets	88.2	73.7	45.7	25.8	N/A

*Data as of June 30. RWA--Risk-weighted assets. N/A--Not applicable. N.M.--Not meaningful.

Chart 3



Funding and liquidity: Average owing to stable customer deposits base

Bank of Åland's funding is "average," in our opinion, owing to its stable and granular deposit base covering 64% of funding needs, and its stable funding ratio of 92% as of Dec. 31, 2012. Customer deposits do not show pronounced concentrations and have been stable in recent years.

Wholesale funding, which makes up 40% of the bank's funding base, is almost exclusively domestic. In addition, about 35%-40% of the investor base is made up of bank clients. This compares favorably with other domestic banks, which rely more on wholesale funding and external investors. However, we expect a change, resulting in less domestic investors, after the bank expands its market funding by issuing covered bonds. We regard the bank's yearly repayments of about €160 million in debt securities issued to institutional investors in the next two years as manageable, in the context of its average funding profile.

Bank of Åland launched a covered bond program in the second half of 2012 and had issued €474 million in bonds by yearend. We understand the bank's aim is to replace most of its wholesale funding needs with lower-cost and longer-maturity covered bonds over the next few years and to extend the available cover pool of €1.2 billion consisting of Finnish residential mortgage loans with Swedish residential mortgage loans.

We assess Bank of Åland's liquidity as "adequate," reflecting the bank's one-year liquidity ratio of 86% as of year-end

2012, which we expect will improve. We include as short-term wholesale funding the €130 million long-term refinancing operations with the European Central Bank, but we expect longer dated covered bonds to gradually replace this funding. Bank of Åland had gradually increased its liquidity portfolio to about €480 million as of Dec. 31, 2012, with cash and securities that are all eligible for repurchase agreement transactions at the Finnish central bank.

Table 6

Bank of Åland Funding And Liquidity					
	--Year-ended Dec. 31--				
(%)	2013*	2012	2011	2010	2009
Core deposits/funding base	62.9	64.0	69.4	67.0	65.7
Customer loans (net)/customer deposits	136.5	136.6	127.5	125.1	124.8
Long term funding ratio	81.9	84.1	76.5	84.0	83.1
Stable funding ratio	93.2	93.6	85.3	98.4	N/A
Short-term wholesale funding/funding base	18.9	16.7	24.7	16.7	17.8
Broad liquid assets/short-term wholesale funding (x)	0.8	0.9	0.6	1.1	N/A
Net broad liquid assets/short-term customer deposits	(5.5)	(3.6)	(14.2)	2.9	N/A
Short-term wholesale funding/total wholesale funding	51.1	46.4	80.9	50.6	51.9
Narrow liquid assets/3-month wholesale funding (x)	1.7	1.6	1.3	1.6	N/A

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

External support: No notches of uplift to the SACP

We consider Bank of Åland to have "low" systemic importance due to the bank's marginal market share in customer loans and deposits in Finland. Consequently, we do not factor any potential extraordinary government support from the SACP into the ratings.

Additional rating factors: None

No additional factors affect this rating

Related Criteria And Research

- Group Rating Methodology, May 7, 2013
- Banking Industry Country Risk Assessment: Finland, Jan. 25, 2013
- 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
- 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 October 17, 2013)

Bank of Aland PLC

Counterparty Credit Rating

BBB/Negative/A-3

Senior Secured

AA

Senior Secured

AA/Negative

Counterparty Credit Ratings History

20-Nov-2012

BBB/Negative/A-3

10-Aug-2012

BBB/Stable/A-3

Sovereign Rating

Finland (Republic of)

AAA/Stable/A-1+

*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.

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