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Bank of Aland PLC

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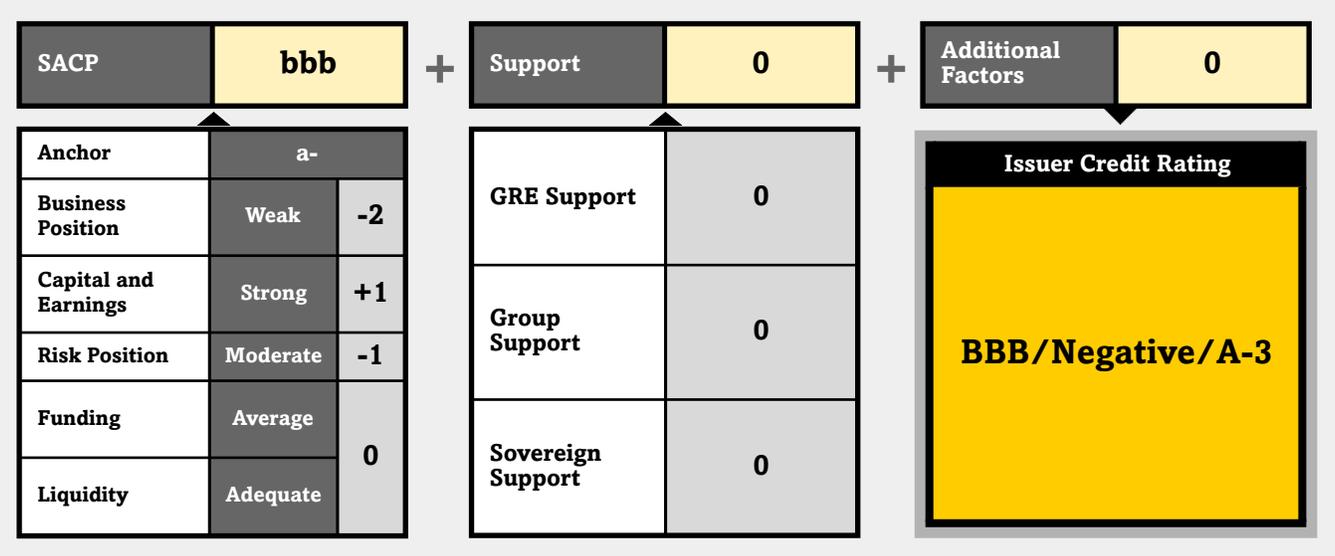
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Bank of Åland PLC



Major Rating Factors

Strengths:	Weaknesses:
<ul style="list-style-type: none"> • Strong capitalization. • Business operations in economically robust regions in Finland. • Sound funding profile benefitting from stable customer deposits. 	<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. • Still low earnings capacity and cost efficiency.

Outlook: Negative

Standard & Poor's Ratings Services' outlook on Finland-based Bank of Åland is negative, reflecting our view that Finland's weak economic recovery could hamper the banking sector's performance over the next two years, which could have a negative impact on Finnish banks, including Bank of Åland. This could lead us to lower our anchor on Finnish banks, including Bank of Åland, to 'bbb+' from 'a-'.

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

We consider a positive rating action remote but it could materialize if we conclude that the integration of the Swedish operations is proving 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 'a-' anchor for Finnish banks, and our assessments of its "weak" business position, "strong" capital and earnings, "moderate" risk position, "average" funding, and "adequate" liquidity, as our criteria define these terms. The stand-alone credit profile (SACP) is '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

Our bank criteria use our Bank Industry Country Risk Assessment (BICRA) 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 our economic risk score of '2' and our industry risk score of '3'. The 'a-' anchor for Bank of Åland draws on our BICRA methodology and our view of the weighted-average economic risk in countries the bank is exposed to, namely Finland and Sweden.

We view Finland as a competitive and resilient economy with high education levels. However, the country depends on exports by cyclical industries linked to investments, and its economy is subject to sub-par growth due to the fragile recovery in Europe. Moreover, lack of reforms to increase competitiveness 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

Bank of Åland PLC Key Figures					
	--Year-ended Dec. 31--				
(Mil. €)	2014*	2013	2012	2011	2010
Adjusted assets	4,175.0	3,877.6	3,626.3	3,389.0	3,465.2
Customer loans (gross)	3,275.4	3,120.5	2,919.3	2,745.8	2,684.5
Adjusted common equity	179.7	171.3	168.9	158.4	127.5
Operating revenues	86.6	108.0	96.6	100.0	99.1
Noninterest expenses	70.6	92.0	94.0	97.4	92.2
Core earnings	11.6	8.9	(1.6)	(0.2)	(2.2)

*Data as of Sept. 30.

Business position: Weak due to concentrated franchise in Finland

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

Bank of Åland, with reported total assets of €4.2 billion (assets under management, €4.8 billion) as of Sept. 30, 2014, and some 85,000 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 to affluent customers 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 acquisition of parts of Kaupthing Bank in Sweden in 2009 (private banking, asset management and initially also institutional brokerage which has been closed since then) with the aim to grow in private banking and asset management activities. We expect the revenue and profit contribution of the Swedish franchise to increase over time (23% of revenues and 4% of net operating profit in the first nine months 2014), driven by the volume growth above the domestic business. But we don't believe these operations provide a significant income diversification for the bank that could change our assessment of the bank's narrow franchise in the near future.

The nonbank activities, including IT-company CrossKey and card company Compass Card, contribute Bank of Åland's stable income stream (23% of revenues and 29% of net operating profit in the first nine months 2014).

Positively, we believe Bank of Åland benefits from a loyal customer base and earnings dominated by interest and fee income (about 40% of revenues, each) although the latter is to a meaningful extent related to asset management and capital market activity, which creates volatility. In our view, the management's focused and risk-averse long-term strategy, including the acquisition of Kaupthing Bank, underpinned by a strong local shareholder collective, continues to support the bank's strengths.

Table 2

Bank of Åland PLC Business Position					
	--Year-ended Dec. 31--				
(%)	2014*	2013	2012	2011	2010
Total revenues from business line (mil. €)	86.6	108.0	110.4	99.2	99.1
Retail banking/total revenues from business line	64.2	56.6	66.4	65.8	67.3
Commercial & retail banking/total revenues from business line	64.2	56.6	66.4	65.8	67.3
Trading and sales income/total revenues from business line	N/A	3.3	9.1	1.9	4.8
Payments and settlements/total revenues from business line	7.5	7.5	6.8	5.3	3.5
Asset management/total revenues from business line	28.3	32.6	17.7	27.0	24.4
Return on equity	7.6	3.7	6.4	(3.9)	(1.8)

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

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 10.5% as of December 2013. We incorporate Bank of Åland's cost control efforts to contain the cost base while growing revenues, its improving earnings reflecting the growth of the Swedish operations, and the repricing of the Finnish loan book into our projections. We expect the bank's dividend policy with payout ratio of 35%-50% to support a further capital buildup. Our capital assessment is also underpinned by a strong quality capital base composed entirely of common equity.

Despite the low interest rate environment, we expect Bank of Åland will post improved net interest income supported by improving margins in part of its portfolio and growing lending volumes, especially in the Swedish operations. We expect this trend will continue in 2015 and 2016, and a more pronounced increase in interest rates will have a substantial positive effect on Bank of Åland's net interest income.

In the medium term, we anticipate a balanced revenue contribution from net interest and net fee income as the asset management and private banking operations gain importance in Bank of Åland's strategy. Furthermore, we expect the Swedish operations will grow in both lending and assets under management and therefore contribute positively to profits from the second half of 2014 onward.

We assume the bank will continue improving its cost efficiency and will attain a cost income ratio of about 75% in 2015, compared with 85% in 2013. The historically weak cost level reflects, among other things, the bank's restructuring measures and headcount reduction of its Swedish operations, the optimization of the branch network in Finland and Åland Islands, and the centralizing of group functions. The ratio is also somewhat distorted by the inclusion of expenses linked to the IT-subsiary CrossKey. We expect the recurring cost level in 2013 of approximately €95 million will be relatively stable until 2015 despite a meaningful increase in revenues.

We believe that Bank of Åland's results in 2014 will improve meaningfully compared with 2013 (€14.8 million as of Sept. 30, 2014, versus €10.4 million in full year 2013). Although we expect profits to gradually improve in 2014 and 2015 due to higher asset under management, larger loan volumes and improving margins, our three-years' average earnings buffer metric, which measures the capacity of a bank to cover our estimation of its normalized losses, remains at modest level of about 50 basis points (bps) given the bank's relatively high cost base.

A potential downward revision of the BICRA score on Finland would negatively affect Bank of Åland's RAC ratio, because the economic risks we associate with exposures to Finnish counterparties would increase. However, we expect the bank would maintain its strong capital position under such a scenario, supported by improving earnings capacity, earnings retention, and any potential capital measures.

Table 3

Bank of Åland PLC Capital And Earnings					
	--Year-ended Dec. 31--				
(%)	2014*	2013	2012	2011	2010
Tier 1 capital ratio	11.1	10.8	10.9	8.4	7.3
S&P RAC ratio before diversification	N.M.	10.5	10.7	11.0	N.M.
S&P RAC ratio after diversification	N.M.	9.0	9.4	9.6	N.M.
Adjusted common equity/total adjusted capital	100	100	100	100	100
Net interest income/operating revenues	42.4	39.2	42.6	43.1	37.1
Fee income/operating revenues	36.6	39.3	33.9	38.7	37.2
Market-sensitive income/operating revenues	5.2	6.8	7.6	2.0	6.3
Noninterest expenses/operating revenues	81.5	85.2	97.3	97.4	93.0
Provision operating income/average assets	0.5	0.4	0.1	0.1	0.2
Core earnings/average managed assets	0.4	0.2	0	0	(0.1)

*Data as of Sept. 30. RAC--Risk-adjusted capital. N.M.--Not meaningful.

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	182,192	0	0	5,466	3
Institutions	512,926	87,513	17	79,413	15
Corporate	817,064	620,613	76	487,434	60
Retail	2,417,368	578,775	24	762,490	32
Of which mortgage	1,699,386	280,575	17	393,476	23
Securitization	0	0	0	0	0
Other assets	68,971	36,504	53	68,232	99
Total credit risk	3,998,521	1,323,404	33	1,403,035	35
Market risk					
Equity in the banking book§	3,025	0	0	23,601	780
Trading book market risk	--	0	--	0	--
Total market risk	--	0	--	23,601	--
Insurance risk					
Total insurance risk	--	--	--	0	--
Operational risk					
Total operational risk	--	158,088	--	205,192	--
(€ 000s)	Basel II RWA		Standard & Poor's RWA		% of Standard & Poor's RWA
Diversification adjustments					
RWA before diversification	--	1,639,829	--	1,631,827	100
Total adjustments to RWA	--	--	--	261,987	16
RWA after diversification	--	1,639,829	--	1,893,814	116
(€ 000s)	Tier 1 capital	Tier 1 ratio (%)	Total adjusted capital	Standard & Poor's RAC ratio (%)	
Capital ratio					
Capital ratio before adjustments	--	159,994	9.8	171,336	10.5
Capital ratio after adjustments†	--	159,994	9.8	171,336	9.0

*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, 2013, 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," reflecting the concentration risks in its loan book.

We expect the bank to continue to have a limited geographic diversity, limited number of client segments, and some large single exposures. We anticipate that the bank's loan portfolio will continue to be retail focused (63% of the loan

portfolio), while the growth in corporate portfolio will mainly result from collateralized real estate financing in Sweden. We believe that the bank's planned expansion in the Swedish market and some reductions in shipping finance portfolio (expected to decrease to about €50 million by 2015) will be positive from a diversification perspective, and we do not anticipate any meaningful exposure to build up in the 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. Moreover, the bank's product offer concentrates mainly on plain vanilla retail banking and asset management products and 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 ten years thanks to its focus on high net-worth retail clients with average loan losses of about 15 bps annually. For the next two years, we expect a level of about 10-12 bps (5 bps in the first nine months of 2014 and 14 bps in 2013) as we believe the bank has adequately provisioned for its exposure to the troubled shipping exposure and that new lending in Sweden is prudently underwritten.

Table 5

Bank of Åland PLC Risk Position					
	--Year-ended Dec. 31--				
(%)	2014*	2013	2012	2011	2010
Growth in customer loans	6.6	6.9	6.3	2.3	5.2
Total diversification adjustment / S&P RWA before diversification	N.M.	16.1	14.3	14.7	N.M.
Total managed assets/adjusted common equity (x)	23.3	22.7	21.5	21.5	27.3
New loan loss provisions/average customer loans	0.1	0.1	0.2	0.1	0.2
Net charge-offs/average customer loans	0.0	0.1	0.1	0.0	0.2
Gross nonperforming assets/customer loans + other real estate owned	0.5	0.5	0.6	0.7	1.0
Loan loss reserves/gross nonperforming assets	98.9	105.4	73.7	45.7	25.7

*Data as of Sept. 30. RWA--Risk-weighted assets. N.M.--Not meaningful.

Funding and liquidity: Average owing to stable customer deposit base

Bank of Åland's funding is "average" in our opinion, owing to its stable and granular deposit base covering 60% of the funding needs and its stable funding ratio of 93% as of Dec. 31, 2013. The customer deposits do not show significant concentrations, and we expect them to remain a stable source of funding.

As lending has expanded quicker than deposits, the bank has issued more wholesale funding primarily in the forms of covered bonds building a curve with tenors from two to ten years. The former exclusively domestic investor base is shifting, and the bank targets other European covered bond investors and local unsecured Swedish krona investors. We expect issuance in 2014 will exceed redemptions and prolong the average maturity of the wholesale funding. We consider the bank's repayment of debt securities issued to institutional investors of about €200 million in 2015 manageable, owing to the average funding profile.

Bank of Åland launched a covered bond program in the second half of 2012 and issued covered bonds with Swedish mortgage loans as collateral for the first time in June 2014. We believe that the bank will replace most of its wholesale

funding needs with lower cost and longer maturity cover bond issuances in the medium term.

We assess the bank's liquidity as "adequate" reflecting the bank's one-year liquidity ratio (broad liquid assets to short-term wholesale funding) of 0.79 as of Dec. 31, 2013. The ratio continues to show volatility driven by maturing long-term funding and changes in asset position held with other banks. Bank of Åland has gradually increased its total liquidity reserve to approximately €550 million as of Sept. 30, 2014, consisting of cash and securities which all are eligible for repurchase agreement transactions at the Finnish or Swedish central bank. The asset mix of the liquidity portfolio is not aligned with the full implementation requirements for liquidity coverage ratios under Basel III. However the bank intends to phase this in over the next few years, which will also benefit our calculation of the broad liquid assets.

Table 6

Bank of Åland PLC Funding And Liquidity					
	--Year-ended Dec. 31--				
(%)	2014*	2013	2012	2011	2010
Core deposits/funding base	58.1	60.4	64.0	69.4	67.0
Customer loans (net)/customer deposits	145.1	142.6	136.6	127.5	125.1
Long term funding ratio	77.6	82.0	84.1	76.5	84.0
Stable funding ratio	89.4	92.6	93.6	85.3	98.4
Short-term wholesale funding/funding base	23.5	18.9	16.7	24.7	16.7
Broad liquid assets/short-term wholesale funding (x)	0.7	0.8	0.9	0.6	1.1
Net broad liquid assets/short-term customer deposits	(11.1)	(6.7)	(3.6)	(14.2)	2.9
Short-term wholesale funding/total wholesale funding	56.0	47.6	46.4	80.9	50.6
Narrow liquid assets/3-month wholesale funding (x)	1.3	1.4	1.6	1.3	1.6

*Data as of Sept. 30.

External support: No notches of uplift to the stand-alone credit profile

We consider Bank of Åland to have "low" systemic importance due to the marginal market share on customer loans and deposits in Finland, and we consequently don't factor any extraordinary government support into the ratings.

Additional rating factors:none

No additional factors affect this rating

Related Criteria And Research

Related Criteria

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

Related Research

- Ratings on Three Finnish Banks Affirmed On Subdued Economic Recovery; Outlooks Remain Negative, Oct. 22, 2014

- Finland Long-Term Ratings Lowered To 'AA+' On Weak Economic Growth; Outlook Stable, Oct. 10, 2014
- Finland-based Bank of Aland Category FIN Mortgage Covered Bonds, €2 Billion Program affirmed At 'AA'; Outlook negative, June 30, 2014
- Finland-Based Bank Of Aland's Category SWE Covered Bonds Assigned 'AA' Ratings; Outlook Negative, June 20, 2014
- Banking Industry Country Risk Assessment: Finland, Jan. 3, 2014

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 November 28, 2014)

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) AA+/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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