

Bank of Åland PLC

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Bank of Åland PLC

Rating Score Snapshot

Issuer Credit Rating

BBB+/Negative/A-2

SACP: bbb+ → **Support: 0** → **Additional factors: 0**

Anchor	a-		ALAC support	0	Issuer credit rating BBB+/Negative/A-2
Business position	Constrained	-2	GRE support	0	
Capital and earnings	Strong	+1	Group support	0	
Risk position	Moderate	-1	Sovereign support	0	
Funding	Adequate	0			
Liquidity	Adequate				
CRA adjustment		+1			

ALAC--Additional loss-absorbing capacity. CRA--Comparable ratings analysis. GRE--Government-related entity. ICR--Issuer credit rating. SACP--Stand-alone credit profile.

Credit Highlights

Overview

Key strengths

Business operations in economically robust regions in Finland and Sweden.
 Strong earnings generation and low credit losses.
 Funding position supported by stable customer deposits.

Key risks

Risk concentrations could expose the bank to revenue volatility.
 Lower cost efficiency than peers, affected by nonbanking activities.

Bank of Åland's private banking services will support earnings growth over the next two years. Bank of Åland provides basic and advanced private banking products to its growing customer base of approximately 250,000 customers on the Åland Islands, mainland Finland, and Sweden. We expect net interest income over the next two years will be supported by still high central bank rates and will complement the bank's non-interest income generation. The latter is driven by mortgage and fund brokerage fees, in addition to IT services via Crosskey AB Ltd., leading to annual net profits of about €50 million over 2024-2026. We expect this business mix will lead to a return on adjusted common equity of about 16.5%-17.5% over the next two years, which compares well with peers and supports the rating.

We forecast Bank of Åland's risk-adjusted capital (RAC) ratio will be 13.5%-14.5%, underpinned by higher earnings retention. As of year-end 2022, the bank's RAC ratio was 12.9%. While we expect balance sheet developments will stabilize in 2024, the value of minority shareholdings, such as Bank of Ålands's private shareholdings in more

fintech-like companies, could create uneven risk-adjusted asset growth. Our forecast for the bank's RAC ratio also incorporates our view that distributions will normalize at about 60%-65% of net profits over the next two years, following three years of above-trend shareholder distributions. As of year-end 2023, the bank paid out 83% of net profit in ordinary and extraordinary dividends, which is higher than the average distribution of Nordic peers of about 40% of net profits.

Given Bank of Åland's commitment to certain regions, concentration risks will persist, in our view. We expect about 75%-80% of the bank's loan book will be in Finland, dominated by lending to private individuals and secured by real estate investments. We therefore anticipate that the geographic diversification of Bank of Åland's risk profile will remain moderate, with a small number of client segments and some exposure to large single names. This is somewhat offset by a prudent underwriting approach, which we believe will keep cost of risk contained at 5 basis points (bps) to 15 bps over the next two years, compared with 5 bps as of year-end 2023.

We expect core customer deposits will be the primary funding source for the bank. Bank of Åland's granular deposit base represents approximately 75% of the funding base, given Swedish mortgage lending will primarily be pursued via Borgo. As such, we expect wholesale funding will represent 25% of funding, from about 34% as of year-end 2021, which was prior to loan transfers.

Outlook

The negative outlook on Bank of Åland reflects our view that, while the bank has developed a sound capacity to generate net profits, relative to peers its capital management has led to a slower and uneven capital build.

We think the bank's RAC ratio will likely be about 13.5%-14.5% over 2023-2025. Our view is supported by our forecast that Bank of Åland will deliver approximately €50 million-€55 million in net profits over the next two years.

Downside scenario

We could lower our ratings on Bank of Åland if its earnings did not maintain a stable growth trend and the bank was unable to close the gap with peers on capital retention and level.

This could occur if Bank of Åland fails to build a RAC ratio comfortably within the range we expect, particularly if earnings performance becomes more volatile.

Upside scenario

We could revise the outlook to stable if Bank of Åland's earnings generation, retention, and capitalization exceed our expectations. This would likely lead to the RAC ratio trending close to or above 15%.

Key Metrics

Bank of Åland PLC--Key ratios and forecasts					
	--Fiscal year ends Dec. 31--				
(%)	2022a	2023a	2024f	2025f	2026f
Growth in operating revenue	4.6	9.9	4.0-6.0	0.0-2.0	0.0-2.0
Growth in customer loans	(10.1)	(10.3)	0.0-2.0	2.0-4.0	2.5-4.5
Net interest income/average earning assets (NIM)	1.24	1.96	1.9-2.1	1.8-2.0	1.6-1.8
Cost-to-income ratio	71.6	68.36	67.5-68.5	67.5-68.5	67.5-68.5
Return on average common equity	12.48	16.41	15.5-17.5	16.0-18.0	15.5-17.5
New loan loss provisions/average customer loans	0.14	0.054	0.05-0.15	0.05-0.15	0.00-0.10
Gross nonperforming assets/customer loans	1.61	1.61	1.0-2.0	0.5-1.5	0.5-1.5
Risk-adjusted capital ratio	12.89	13.5-14.5	13.5-14.5	13.5-14.5	13.5-14.5

All figures are S&P Global Ratings-adjusted. a--Actual. e--Estimate. f--Forecast. NIM--Net interest margin.

Anchor: 'a-' For Bank Of Åland's Operations In Finland And Sweden

Under our Banking Industry Country Risk Assessment (BICRA), our anchor for banks operating mainly in Finland and Sweden is 'a-', based on an economic risk score of '2' and an industry risk score of '3' (on a scale of 1 to 10, with '10' signifying the highest risk). The 'a-' anchor for Bank of Åland considers the weighted-average economic risk in all countries the bank is exposed to, primarily Finland and Sweden. Under our BICRA methodology, Finland's economic and industry risk scores are similar to those of Sweden. The economic and industry risk trends are currently stable in both countries.

We view Finland as an innovative, wealthy, small, and open economy with mature political and institutional structures. After GDP growth of 2.1% in 2022, we expect that the Finnish economy has stagnated in 2023 and that it will expand by 1.25%-1.50% over 2024-2025. Even though inflation has likely peaked, interest rates remain high. The resulting decrease in households' real disposable incomes affects their purchasing power. More muted consumer and business confidence could weaken the banking sector's growth prospects.

Yet, we do not see material economic imbalances in the Finnish economy. We expect house prices have declined by about 5%-7% across Finland in 2023 and will rebound in 2024 and thereafter. That said, increasing household debt and a weaker labor market, combined with weaker consumer and business confidence, could eventually increase banks' credit losses.

In our view, regulatory standards and bank supervision in Finland are in line with those of European peers. The banking sector is dominated by two major banking groups, OP Financial Group and Nordea Bank Abp, and characterized by intense competition and low lending margins. That said, we believe overall profitability and capitalization will remain resilient. We also expect banks will maintain their restrained risk appetites. In our view, the risk of technology disruption remains moderate, given that the banks are at the forefront of digitalization and are continuing to invest in innovation and digital capabilities.

Finnish banks will remain dependent on external funding, which makes them vulnerable to changes in confidence sensitivity and higher interest rates. That said, they continue to demonstrate good access to capital markets. In addition, the Nordic banking system remains highly interconnected, which results in potential spillover risks from external events.

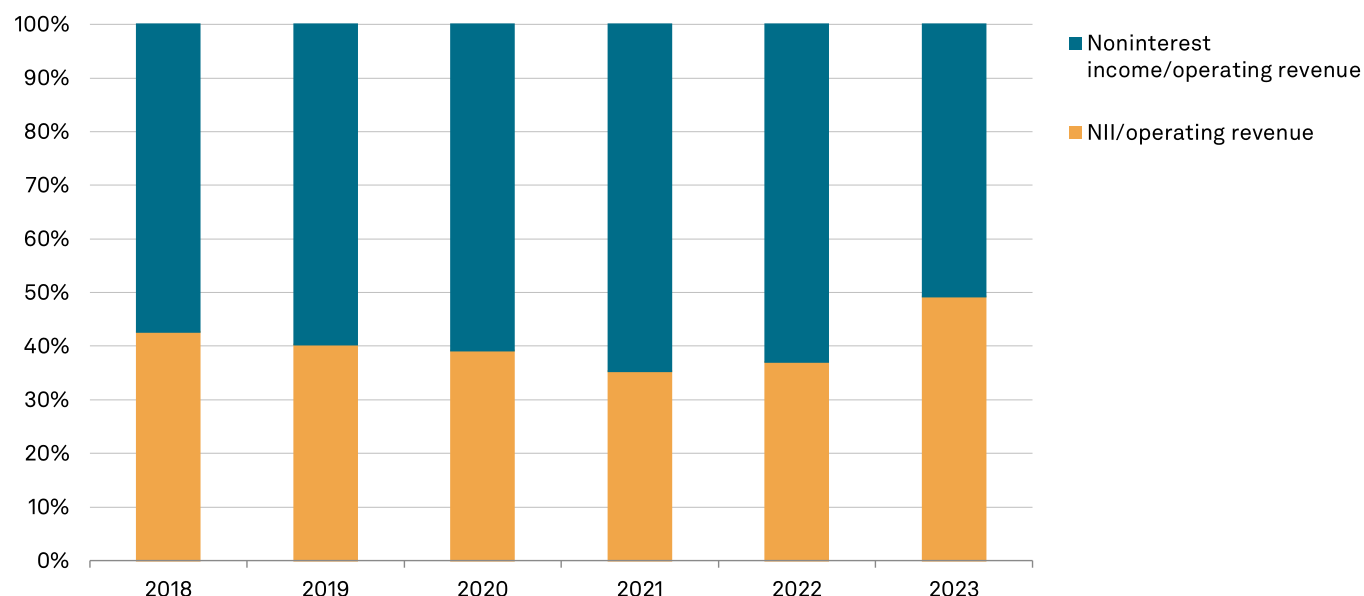
Business Position: Wealth Management, Retail Banking, And IT Service Franchises In Growth Regions Of Finland And Sweden

With assets of about €5.3 billion as of Dec. 31, 2023 (assets under management of about €9.8 billion), Bank of Åland will maintain its small but specialized retail premium and private banking franchise on Finland's Åland Islands and in certain selected areas in mainland Finland and Sweden. The bank has a modest market share of 1% in Finland. Even so, it holds a leading position in its wealthy, but very small, home region of the Åland Islands, with an estimated loan market share of 50% in its core business of private and premium retail banking.

As of fourth-quarter 2023, net interest income and non-interest income were roughly balanced, with higher interest rates providing a boost to net interest income (see chart 1). More generally, the bank benefits from a business mix that leverages on-balance sheet and off-balance sheet product offerings. Over the course of several years, the bank has advanced its fund offerings and continued to invest in Crosskey, a subsidiary that provides certain IT services to several Nordic partners, including Borgo. We also expect the bank will expand distribution channels by continuing to explore innovative cooperations with fintechs, such as Doconomy AB--with which it worked on the carbon footprint calculator "Åland Index"--Dreams, and Trustly.

Chart 1**Bank of Åland's revenues reflect the mix of its on- and off-balance-sheet product suite**

Breakdown of operating revenues



NII--Net interest income. Source: S&P Global Ratings.

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In terms of strategy, management seeks to deliver a return on equity above 15% over the long term. As of fourth-quarter 2023 Bank of Åland reported a return on equity of 17.2% for the full-year. While the cost-to-income ratio remains relatively higher than that of peers, we expect management will continue to focus on delivering stable earnings, which will translate into improved efficiency metrics. Similarly, customer surveys have ranked Bank of Åland as the top bank for private banking in Finland for several years, indicating client support for the bank's strategy.

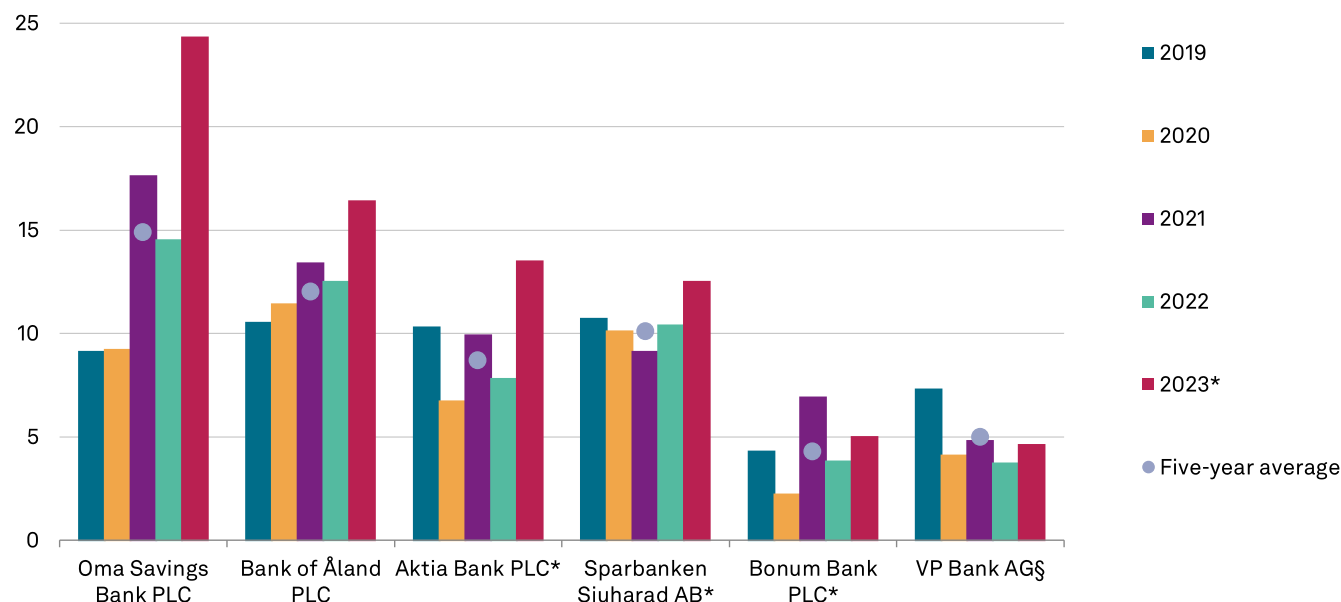
Capital And Earnings: Robust Earnings Thanks To The Business Mix

Bank of Åland's strategy has generated stable net profit growth over the past several years. This, coupled with hybrid capital instrument issuance, has led to a solid capital build and means the bank's earnings generation compares well with that of peers (see chart 2).

Chart 2

Bank of Åland delivers stable returns, comparing well with peers

Return on average common equity (%)



*Figures reflect reported return on equity. \$As of June 2023. Source: S&P Global Ratings.

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We forecast Bank of Åland's RAC ratio will be 13.5%-14.5% over 2023-2025, compared with 12.9% in December 2022. Developments related to Borgo have affected the bank's balance sheet and risk-weighted assets, which, in turn, has led to fluctuations in the capital ratio. With one minor transfer of mortgages set to occur in 2024, we forecast the underlying annual lending growth of about 2%-4% will sustain a stable level of net interest income for Bank of Åland. While this will likely lead to marginal risk-weighted asset growth, we note that developments related to minority shareholdings could lead to volatility in our capital ratio metric, given that we apply more conservative risk weights to unlisted private shareholdings in more fintech-like companies, such as Doconomy and Dreams.

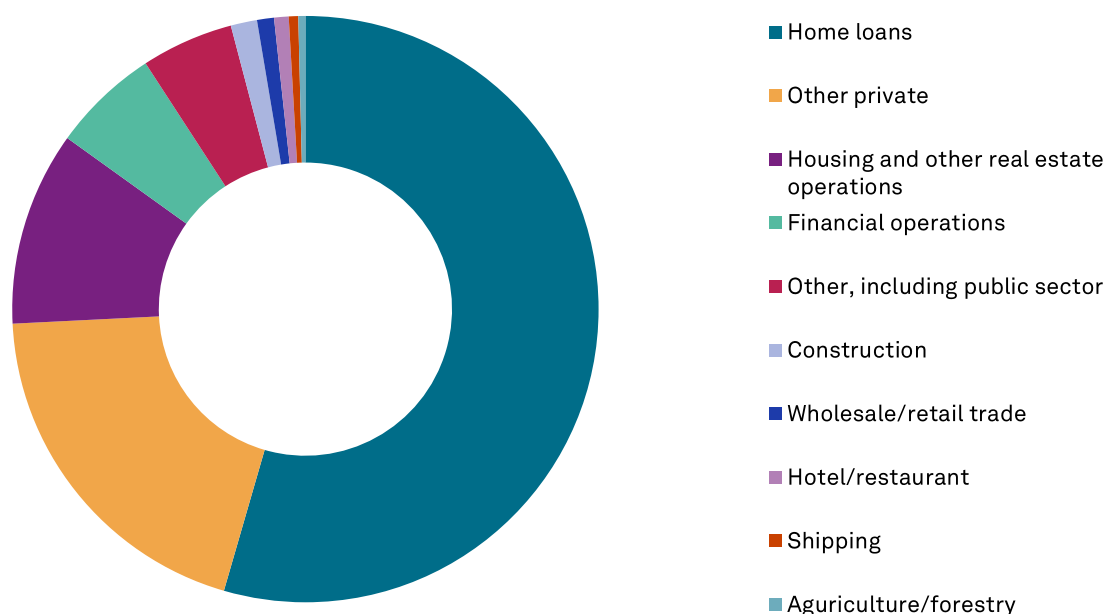
In terms of regulatory capital, the bank reported a total capital ratio of 17.1%, a buffer of about 460 bps above a total capital minimum requirement of 12.5% as of fourth-quarter 2023. Included in Bank of Åland's measure of total adjusted capital (TAC) are two tier 2 instruments of about €32 million that qualify for intermediate equity in our TAC, in addition to one additional tier 1 instrument of SEK300 million (about €28 million). The TAC-eligible instruments represent approximately 21%-22% of TAC, underpinning a somewhat weaker quality of capital, compared with Nordic peers with no hybrid instruments included in TAC.

Risk Position: High Share Of Low-Risk Collateralized Lending Partly Offsets Geographic And Business Concentration

Bank of Åland's loan portfolio amounted to €3.9 billion as of Dec. 31, 2023, and remains focused on retail lending, which accounted for 75% of the net loan book in Finland and Sweden (see chart 3). We expect asset quality will remain robust and, more generally, note that the bank's product offering, and daily operations lack complexity. Furthermore, Bank of Åland's foreign-currency exposure and interest rate risk in the banking book are not significant.

Chart 3

Private lending and real-estate related lending are the prevailing lending exposures



Sources: Bank of Åland's Q4 2023 report, S&P Global Ratings.

Bank of Åland's geographic concentration is somewhat offset by its focus on wealthy individuals, entrepreneurs, and their related corporations, as well as its strategy of engaging mainly in collateralized lending. Of the 25% of net lending that is considered more corporate-like, just under 45% is related to commercial and residential real estate. Much of this business is a result of the bank's focus on long-term customer relationships. The remaining portion of the corporate loan book is granular and well diversified across sectors.

Over the next two years, Finland will likely account for approximately 75% of lending, with Borgo underwriting most of the bank's Swedish mortgage growth. Sound collateralization levels are anticipated to prevail. We therefore believe asset quality will remain manageable, with the cost of risk at about 5 bps-15 bps over the next two years, compared with 5 bps as of end-December 2023. Non-performing loans (NPLs) remained at 1.6% as a share of lending as of year-end 2023, partly because of lower lending volumes. Based on our expectation that the Finnish economy will recover over 2024-2025, we forecast economic conditions will stabilize and anticipate that NPLs will decline over

2024-2025.

Funding And Liquidity: Predominantly Funded By Customer Deposits

Bank of Åland's funding profile reflects a stable core customer deposit base, which is expected to account for about 70%-75% of the bank's funding. Previously, Bank of Åland had increased its use of wholesale funding via covered bonds to support lending growth. While the Finnish covered mortgage bonds will remain with Bank of Åland, the Swedish covered bonds and the underlying assets have been transferred to Borgo.

Just over half of the deposit base consists of stable retail deposits. The remaining portion relates to corporates, which we view as a less stable funding source. We note that Bank of Åland exhibited a well-matched funding profile with a S&P Global Ratings stable funding ratio of about 105% as of Dec. 31, 2023. The bank's balanced approach to funding is also reflected by a regulatory net stable funding ratio of 109% for the same period.

We expect Bank of Åland's liquidity position, expressed as a ratio of broad liquid assets to short-term wholesale funding of about 1.5x as of the end of fourth-quarter 2023, will remain broadly stable. Given the decline in the stock of longer-term funding, we expect the ratio will be somewhat volatile. Bank of Åland's liquidity reserves amounted to approximately €1.25 billion as of Dec. 31, 2023, leading to a regulatory liquidity coverage ratio of 156%. This is in line with that of Finnish peers and well above the regulatory minimum of 100%. Bank of Åland's portfolio consists of cash and securities, which are all eligible for repurchase agreement transactions at the Finnish or Swedish central banks.

Support: No Uplift To The SACP

We do not factor any external support into our assessment of Bank of Åland. We consider Finland has had an effective resolution regime since January 2016. However, as we assess Bank of Åland to have low systemic importance in Finland (market share of about 1% in customer deposits as of June 30, 2023), we believe the response to Bank of Åland's nonviability would not primarily be a bail-in resolution. Therefore, we do not consider that our additional loss-absorbing capital criteria are applicable to the bank, nor do we think that Bank of Åland is eligible for our resolution counterparty rating (RCR). RCRs recognize the default risk of certain bank liabilities that rank senior to other liabilities in a resolution.

Additional Rating Factors

No additional factors affect this rating.

Environmental, Social, And Governance

We consider ESG credit factors for Bank of Åland are broadly in line with industry and country peers.

Bank of Åland remains dedicated to several environmental and social projects in its banking and asset management operations. For example, it remains committed to the "Baltic Sea Project," which promotes the health of the Baltic Sea.

Moreover, the bank has launched a fund that invests in small and midsize companies in the Nordics by focusing on responsible investment rules and guidelines. In addition, Bank of Åland launched the Baltic Sea Card, a credit card made from environmentally friendly materials that enables customers to use the "Åland Index," calculate the environmental impact of each credit card transaction, and offset the carbon footprint of their purchases. Furthermore, the bank collaborates with Swedish fintech Doconomy to provide a digital banking solution that measures consumption patterns to reduce carbon emissions. These partnerships demonstrate Bank of Åland's unique innovative and environmental approach to its banking business.

In terms of governance, we note that Bank of Åland has dedicated IT investment spend over the past three years to improve the efficiency of monitoring clients and accounts and advance their ability to report on developments to authorities. With the bank's relationship-based approach to product delivery, internal systems have been developed to ensure customer data is accessible. Know-your-customer documentation is in place, in line with anti-money-laundering guidelines.

Key Statistics

Table 1

Bank of Åland PLC--Key figures					
	--Year ended Dec. 31--				
(Mil. €)	2023	2022	2021	2020	2019
Adjusted assets	5,321.0	5,877.1	6,611.6	6,010.7	5,582.2
Customer loans (gross)	3,879.2	4,323.0	4,802.5	4,389.8	4,122.5
Adjusted common equity	216.5	208.0	220.1	263.9	214.4
Operating revenues	202.3	184.1	176.0	150.1	133.9
Noninterest expenses	138.3	131.8	121.9	105.6	97.5
Core earnings	48.7	36.8	39.9	31.5	26.3

Table 2

Bank of Åland PLC--Business position					
	--Year ended Dec. 31--				
(%)	2023	2022	2021	2020	2019
Loan market share in country of domicile	N/A	1.0	1.0	1.0	1.1
Deposit market share in country of domicile	N/A	1.3	1.4	1.3	1.4
Total revenues from business line (currency in millions)	202.3	184.1	176.0	150.1	133.9
Retail banking/total revenues from business line	81.7	79.3	75.2	79.0	78.4
Commercial & retail banking/total revenues from business line	81.7	79.3	75.2	79.0	78.4
Other revenues/total revenues from business line	18.3	20.7	24.8	21.0	21.6
Return on average common equity	16.4	12.5	13.4	11.4	10.5

N/A--Not applicable.

Table 3

Bank of Åland PLC--Capital and earnings					
	--Year ended Dec. 31--				
(%)	2023	2022	2021	2020	2019
Tier 1 capital ratio	15.3	13.6	13.6	14.3	13.4
S&P Global Ratings' RAC ratio before diversification	N/A	12.9	13.8	14.4	12.7
S&P Global Ratings' RAC ratio after diversification	N/A	10.4	11.2	11.7	10.3
Adjusted common equity/total adjusted capital	78.0	77.4	77.0	93.9	92.6
Double leverage	N.M.	4.0	8.8	N.M.	N.M.
Net interest income/operating revenues	49.3	37.1	35.4	39.2	40.3
Fee income/operating revenues	38.1	42.6	44.9	44.2	43.3
Market-sensitive income/operating revenues	(1.5)	7.0	(0.4)	1.2	2.9
Cost to income ratio	68.4	71.6	69.3	70.3	72.8
Preprovision operating income/average assets	1.1	0.8	0.9	0.8	0.7
Core earnings/average managed assets	0.9	0.6	0.6	0.5	0.5

N/A--Not applicable. N.M.--Not meaningful.

Table 4

Bank of Åland PLC--Risk-adjusted capital framework data					
(Mil. €)	Exposure*	Basel III RWA	Average Basel III RW(%)	S&P Global Ratings RWA	Average S&P Global Ratings RW (%)
Credit risk					
Government & central banks	986.2	0.0	0.0	20.6	2.1
Of which regional governments and local authorities	123.8	0.0	0.0	4.5	3.6
Institutions and CCPs	609.8	83.6	13.7	81.9	13.4
Corporate	1,184.7	549.6	46.4	438.2	37.0
Retail	3,607.7	708.6	19.6	950.7	26.4
Of which mortgage	2,972.5	521.2	17.5	685.2	23.1
Securitization§	0.0	0.0	0.0	0.0	0.0
Other assets†	86.6	79.3	91.5	85.4	98.6
Total credit risk	6,475.0	1,421.0	21.9	1,576.8	24.4
Credit valuation adjustment					
Total credit valuation adjustment	--	0.6	--	0.0	--
Market Risk					
Equity in the banking book	26.0	26.1	100.6	225.1	866.8
Trading book market risk	--	7.4	--	11.1	--
Total market risk	--	33.5	--	236.2	--
Operational risk					
Total operational risk	--	243.6	--	273.3	--

Table 4

Bank of Åland PLC--Risk-adjusted capital framework data (cont.)					
	Exposure	Basel III RWA	Average Basel II RW (%)	S&P Global Ratings RWA	% of S&P Global Ratings RWA
Diversification adjustments					
RWA before diversification	--	1,938.5	--	2,086.3	100.0
Total diversification/ Concentration adjustments	--	--	--	506.4	24.3
RWA after diversification	--	1,938.5	--	2,592.7	124.3
		Tier 1 capital	Tier 1 ratio (%)	Total adjusted capital	S&P Global Ratings RAC ratio (%)
Capital ratio before adjustments		262.7	13.6	268.8	12.9
Capital ratio after adjustments†		262.7	13.6	268.8	10.4

*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. CCPS--Central counterparty clearing house. Sources: Company data as of Dec. 31, 2022, S&P Global Ratings.

Table 5

Bank of Åland PLC--Risk position					
	--Year ended Dec. 31--				
(%)	2023	2022	2021	2020	2019
Growth in customer loans	(10.3)	(10.0)	9.4	6.5	2.2
Total diversification adjustment/S&P Global Ratings' RWA before diversification	N/A	24.3	22.3	23.7	23.6
Total managed assets/adjusted common equity (x)	24.7	28.4	30.1	22.9	26.2
New loan loss provisions/average customer loans	0.1	0.1	0.1	0.1	0.1
Net charge-offs/average customer loans	0.0	0.0	0.0	0.1	0.1
Gross nonperforming assets/customer loans + other real estate owned	1.6	1.6	1.2	0.9	0.8
Loan loss reserves/gross nonperforming assets	32.3	28.7	24.8	30.5	37.1

N/A--Not applicable.

Table 6

Bank of Åland PLC--Funding and liquidity					
	--Year ended Dec. 31--				
(%)	2023	2022	2021	2020	2019
Core deposits/funding base	74.7	77.1	66.2	64.7	65.0
Customer loans (net)/customer deposits	107.3	102.9	117.6	121.4	122.0
Long-term funding ratio	85.9	87.1	82.9	84.2	89.9
Stable funding ratio	104.9	108.1	105.4	104.9	110.9
Short-term wholesale funding/funding base	15.1	13.7	18.1	16.6	10.6
Regulatory net stable funding ratio	109.0	108.0	109.0	106.0	115.0
Broad liquid assets/short-term wholesale funding (x)	1.5	1.7	1.4	1.4	2.1
Broad liquid assets/total assets	20.8	21.5	23.3	22.0	21.1
Broad liquid assets/customer deposits	31.0	30.4	38.0	36.8	35.0
Net broad liquid assets/short-term customer deposits	10.7	12.7	10.6	11.1	18.7

Table 6

Bank of Åland PLC--Funding and liquidity (cont.)					
	--Year ended Dec. 31--				
(%)	2023	2022	2021	2020	2019
Regulatory liquidity coverage ratio (LCR) (x)	156.0	138.0	151.9	159.0	138.8
Short-term wholesale funding/total wholesale funding	57.0	56.9	51.9	46.8	30.0
Narrow liquid assets/3-month wholesale funding (x)	2.6	2.8	2.5	2.5	5.0

Bank of Åland PLC--Rating component scores	
Issuer Credit Rating	BBB+/Negative/A-2
SACP	bbb+
Anchor	a-
Economic risk	2
Industry risk	3
Business position	Constrained
Capital and earnings	Strong
Risk position	Moderate
Funding	Adequate
Liquidity	Adequate
Comparable ratings analysis	+1
Support	0
ALAC support	0
GRE support	0
Group support	0
Sovereign support	0
Additional factors	0

ALAC--Additional loss-absorbing capacity. GRE--Government-related entity. SACP--Stand-alone credit profile.

Related Criteria

- Criteria | Financial Institutions | General: Financial Institutions Rating Methodology, Dec. 9, 2021
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- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
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- EMEA Financial Institutions Monitor 1Q2024: Banks Adapt To The Increased Economic Turbulence, Feb. 19, 2024
- SLIDES: Nordic Banks In 2024: Ploughing On Through Tough Terrain, Feb. 7, 2024
- Banking Industry Country Risk Assessment: Finland, Nov. 28, 2023
- EMEA Financial Institutions Monitor 4Q2023: Standing Firm Against Slow Economic Growth, Oct. 31, 2023
- Research Update: Bank of Aland Outlook Revised To Negative On Capitalization Shift; 'BBB+' Ratings Affirmed, June 29, 2023

Ratings Detail (As Of March 11, 2024)*

Bank of Aland PLC

Issuer Credit Rating	BBB+/Negative/A-2
Senior Secured	AAA/Stable

Issuer Credit Ratings History

29-Jun-2023	BBB+/Negative/A-2
13-Jul-2022	BBB+/Stable/A-2
22-Jan-2021	BBB/Positive/A-2
19-May-2020	BBB/Negative/A-2

Sovereign Rating

Finland	AA+/Stable/A-1+
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