

Research Update:

Bank of Aland PLC Upgraded To 'BBB+' On Increased Capital; Outlook Stable

July 13, 2022

Overview

- We expect Bank of Aland's risk-adjusted capital (RAC) ratio to improve to approximately 15%-16%--a level we consider very strong--over 2022-2024, from 13.8% as of year-end 2021.
- The bank has delivered steady and strong returns over the past few years, which, in conjunction with the carve-out of the Swedish loan portfolio to the mortgage platform Borgo AB, will lead to an increase in capital as a share of S&P Global Ratings risk-weighted assets (RWAs).
- Bank of Aland's business strategy focuses on delivering a broad product suite to its private and premium banking customers, enabling the bank to generate stable revenue.
- We raised our long-term issuer credit rating on Bank of Aland to 'BBB+' from 'BBB' and affirmed the 'A-2' short-term rating.
- The stable outlook reflects our expectation that the bank will maintain a sound financial position despite the more challenging operating environment for banks over the coming quarters.

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Rating Action

On July 12, 2022, S&P Global Ratings raised its long-term issuer credit rating on Bank of Aland to 'BBB+' from 'BBB'. The outlook is stable. At the same time, we affirmed our 'A-2' short-term issuer credit rating on the bank.

Rationale

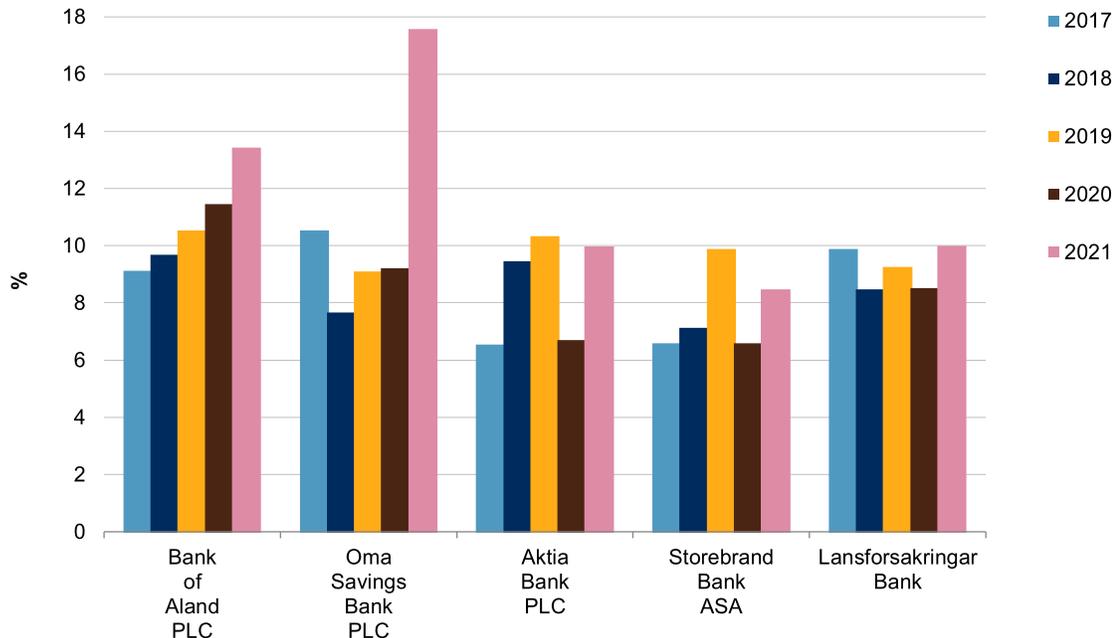
The upgrade reflects our forecast that Bank of Aland's capitalization will strengthen sustainably through 2024. We now expect the bank's RAC ratio will improve by about 200 basis points to 16% by 2024 from 13.8% as of year-end 2021. We think Bank of Aland will continue to demonstrate steady earnings generation supporting capital build-up. We project the bank will post annual net profits of approximately €40 million-€50 million over 2022-2024 (2021: €39.9 million). Combined with the transfers of about €1.0 billion-€1.5 billion of mortgage loans to Borgo

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AB, a Swedish mortgage platform launched by Bank of Aland and its partner banks, we expect the bank's RWAs to decline by about 8% in 2022. We expect further, smaller loan transfers to occur in 2023 with only a minor effect on the RAC ratio.

Chart 1

Bank of Aland's Returns Compare Well To Peers With Similar Capitalization Return on average common equity



Source: S&P Global Ratings.

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We forecast Bank of Aland will post return on average common equity just below 15% over

2022-2024. We expect the bank will continue to deliver steady returns, which have compared well relative to small and mid-sized Nordic peers historically and support our view of the bank (chart 1).

The bank reported return on equity of 14% in 2021 and we project profitability to reach 15% by 2024. We anticipate that the bank's revenue from private and premium banking (together 66% of operating revenue in 2021), asset management business (10%), and IT operations (14%) will continue to grow over the medium term. This will support a gradual operating efficiency improvement while the nonbank activities will weigh on the cost-to-income ratio (69.3% in 2021).

Furthermore, we expect the bank's sound asset quality to translate into contained credit losses through 2024 despite the weaker economic environment in Finland and Sweden due to secondary effects from the Russia-Ukraine conflict. We incorporate dividends of about 60% of net profits to be distributed over our rating horizon, demonstrating sound financial flexibility in terms of capital management. That said, any capital optimization including extraordinary capital distributions or

share buyback program could weigh negative on Bank of Aland's RAC trajectory.

The bank has a well-honed business model that delivers stable revenue. Over the past three decades, Bank of Aland has provided private and premium banking services and products to selected growth regions in mainland Finland and since 2009 in Sweden. It is also the market leader of banking services on the Åland Islands, its home region. The bank's subsidiary, CrossKey, provides IT services across the Nordics, further complementing Bank of Aland's offering. Although the carve-out of its Swedish mortgage loan book will decrease the contribution of net interest income from 2022 onward, the bank will benefit from increased fee income through loan intermediation to and servicing of the Borgo platform.

The economic backdrop could provide headwinds for the bank. We expect Bank of Aland to navigate a more challenging market environment with more muted GDP growth in both its home markets of Finland and Sweden. We note that increased equity market volatility and slower real estate markets could dampen revenue over the medium term. Similarly, although CrossKey has increased its Nordic customer coverage, increased staffing needs have continued to weigh on the bank's efficiency metrics. As such, despite the bank's successful strategy, aided by various innovative offerings, we also recognize its revenue and cost base may be vulnerable in the current weaker economic climate.

Outlook

The stable outlook on Bank of Aland reflects our view that the bank will maintain a sound financial profile and continue to make progress in building its capital base through earnings, leading to a RAC ratio of 15%-16% in the next 12-24 months. Supporting this view is our expectation that Bank of Aland's strong earnings capacity will allow for further business growth despite the more muted operating environment, along with stable shareholder distributions while bringing capitalization closer to domestic peers'.

Downside scenario

We could take a negative rating action if Bank of Aland failed to sustainably improve its RAC ratio above 15% in line with our base case, in which we assume sound business growth capacity and a robust ability to retain capital.

Furthermore, we could lower our rating if the bank's earnings profile materially weakened, asset quality unexpectedly deteriorated leading to higher credit losses, or the bank failed to curb cost pressures, which could arise in a more difficult market environment.

Upside scenario

We currently view a positive rating action as remote given Bank of Aland's business and regional risk concentration with generally financially stronger, but smaller, customer population.

Ratings Score Snapshot

Ratings Score Snapshot

	To	From
Issuer Credit Rating	BBB+/Stable/A-2	BBB/Positive/A-2
Stand-alone credit profile	bbb+	bbb
Anchor	a-	a-
Business position	Constrained -2	Constrained -2
Capital and earnings	Very Strong +2	Strong +1
Risk position	Moderate -1	Moderate -1
Funding	Adequate 0	Adequate 0
Liquidity	Adequate	Adequate
Comparable ratings analysis	0	0
Support	0	0
Additional loss-absorbing capacity support	0	0
Government-related entity support	0	0
Group support	0	0
Sovereign support	0	0
Additional factors	0	0

Related Criteria

- Criteria | Financial Institutions | General: Financial Institutions Rating Methodology, Dec. 9, 2021
- Criteria | Financial Institutions | Banks: Banking Industry Country Risk Assessment Methodology And Assumptions, Dec. 9, 2021
- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- General Criteria: Hybrid Capital: Methodology And Assumptions, July 1, 2019
- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Financial Institutions | General: Risk-Adjusted Capital Framework Methodology, July 20, 2017
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Related Research

- Finland 'AA+/A-1+' Ratings Affirmed; Outlook Stable, July 1, 2022
- Banking Industry Country Risk Assessment Update: June 2022, June 28, 2022
- Banking Industry Country Risk assessment: Finland, June 1, 2022

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- Sweden, May 2, 2022
- How The Conflict In Ukraine Is Affecting Financial Institutions Ratings, March 4, 2022
- Ratings On Nine Finnish Financial Institutions Affirmed Under Revised Criteria; Outlooks Unchanged, Feb. 4, 2022
- Bank of Aland PLC, Dec. 9, 2021

Ratings List

Upgraded; Outlook Action; Ratings Affirmed

	To	From
Bank of Aland PLC		
Issuer Credit Rating	BBB+/Stable/A-2	BBB/Positive/A-2

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. A description of each of S&P Global Ratings' rating categories is contained in "S&P Global Ratings Definitions" at https://www.standardandpoors.com/en_US/web/guest/article/-/view/sourceId/504352 Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following S&P Global Ratings 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; or Stockholm (46) 8-440-5914

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