

Research Update:

Bank of Aland Outlook Revised To Negative On Capitalization Shift; 'BBB+' Ratings Affirmed

June 29, 2023

Overview

- While Bank of Aland has delivered steady returns over the past few years, a higher-than-anticipated pace of capital distributions and growth in private shareholdings have resulted in a lower than expected S&P Global Ratings' risk-adjusted capital (RAC) ratio.
- The bank has robust earnings capacity relative to peers, however, we now forecast its RAC ratio at 13.5%-14.5% over the next two years, which is lower than our previous forecast.
- We therefore revised our outlook on Bank of Aland to negative from stable. At the same time, we affirmed our 'BBB+' long-term issuer credit rating and 'A-2' short-term rating.
- The negative outlook reflects our view that Bank of Aland's risk-adjusted capitalization may not markedly increase.

Rating Action

On June 29, 2023, S&P Global Ratings revised its outlook on Bank of Aland to negative from stable. At the same time, we affirmed our 'BBB+/A-2' long-term and short-term issuer credit ratings on the bank.

Rationale

As of year-end 2022, Bank of Aland's RAC ratio was 12.9%, compared with our forecast of above 15%. Under our methodology we deduct the bank's minority shareholdings in financial institutions, such as those in mortgage platform Borgo AB, from our total adjusted capital (TAC) measure.

Furthermore, we risk-weight the bank's additional unlisted private shareholdings in more fintech-like companies, which weighs on its risk-weighted assets. Note our risk weights take into consideration that unlisted stocks typically carry higher leverage and are less liquid in nature.

While loan sales to Borgo should lead to a further fall in risk-adjusted assets, which would raise Bank of Aland's RAC ratio, growth in minority shareholdings could slow this progress and continue

PRIMARY CREDIT ANALYST

Olivia K Grant
Stockholm
+ 46 84 40 5904
olivia.grant
@spglobal.com

SECONDARY CONTACTS

Niklas Dahlstrom
Stockholm
+46 84405358
niklas.dahlstrom
@spglobal.com

Salla von Steinaecker
Frankfurt
+ 49 693 399 9164
salla.vonsteinaecker
@spglobal.com

to create uneven risk-adjusted asset growth.

We recognize Bank of Aland's business model delivers stable net profits. Over the past two decades, Bank of Aland has worked to provide retail private banking services and products to select regions in Finland and Sweden, in addition to being a market leader of banking services on the Åland Islands. Typically, these services include lending and investment advice given the asset management fund platform. The product suite is further complemented by subsidiary CrossKey, which provides IT services across the Nordics.

This business mix has led to an average return on adjusted common equity of about 11.1% over the past five years, which we view as a supportive factor for the rating.

That said, capital build has been less pronounced relative to peers. During 2022, Bank of Aland bought back about €12.1 million in shares, in addition to distributing roughly €31.1 million in dividends (ordinary and extra). This is equivalent to just over 85% of net profits and was above our forecast.

The bank's earnings retention, and therefore capital build, appears lower relative to peers. In addition, Bank of Aland's TAC comprises 25% loss absorbing hybrids, whereas smaller sized peers tend to have a much higher quality capital base that includes few, if any, hybrids.

We now expect the bank's RAC ratio to be 13.5%-14.5% over the next two years. We view this level of capital as strong, and it is supported by our forecast of about €40 million-€50 million net income per year over the next two years. Net income will be aided by both net interest income and noninterest income as both asset management fees, and IT income are expected to pick up over 2024.

Our earnings forecast incorporates there could be potential headwinds for net profits in the current operating environment. We further include in our view that risk-weighted asset growth will be marginal over 2023-2024 and dividends will be about 65% of net profits.

Despite weaker than expected capitalization, for now we see the rating comparable with peers.

The bank's close peers are smaller scale Nordic banks considered geographically concentrated from a risk and revenue perspective.

Assuming sustained solid earnings and a RAC ratio that moves much closer to 15%, we see the bank's 'bbb+' stand-alone credit profile as comparatively well-positioned.

Outlook

The negative outlook on Bank of Aland 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 risk-adjusted capital (RAC) ratio will likely be about 13.5%-14.5% over 2023-2025. Our view is supported by our forecast that Bank of Aland will deliver approximately €40 million-€50 million in net profits over the next two years.

Downside scenario

We could lower our ratings on Bank of Aland 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 Aland 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 Aland's earnings generation, retention, and capitalization exceed our expectations. This would likely lead to the RAC ratio trending close to or above 15%.

Ratings Score Snapshot

	To	From
Issuer credit rating	BBB+/Negative/A-2	BBB+/Stable/A-2
SACP	bbb+	bbb+
Anchor	a-	a-
Business position	Constrained -2	Constrained -2
Capital and earnings	Strong +1	Very strong +2
Risk position	Moderate -1	Moderate -1
Funding	Adequate 0	Adequate 0
Liquidity	Adequate	Adequate
Comparable ratings analysis	+1	0
Support	0	0
ALAC support	0	0
GRE support	0	0
Group support	0	0
Sovereign support	0	0
Additional factors	0	0

SACP--Stand-alone credit profile.

ESG credit indicators: E-2, S-2, G-2

Related Criteria

- General Criteria: Hybrid Capital: Methodology And Assumptions , March 2, 2022
- Criteria | Financial Institutions | Banks: Banking Industry Country Risk Assessment Methodology And Assumptions , Dec. 9, 2021
- Criteria | Financial Institutions | General: Financial Institutions Rating Methodology , Dec. 9, 2021
- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings , Oct. 10, 2021

- 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

Ratings List

Ratings Affirmed; Outlook Action

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