

Research Update:

Bonum Bank Assigned 'BBB+/A-2' Resolution Counterparty Ratings; 'BBB/A-2' Ratings Affirmed; Outlook Positive

June 28, 2024

Overview

- Following increased visibility into Finland-based POP Bank Group's resolution plans, we now believe member banks would be subject to an open bank, bail-in-led resolution approach if they failed.
- We consider that the use of a resolution process on the bank would heighten the chance that its most senior liabilities would continue to be paid on time and in full, even if it failed.
- We therefore assigned our 'BBB+/A-2' long- and short-term resolution counterparty ratings (RCRs) to the group's core subsidiary Bonum Bank PLC while affirming our 'BBB/A-2' long- and short-term issuer credit ratings on the bank.
- The outlook remains positive and reflects our expectation that POP Bank Group will maintain sound earnings generation even as interest rates decline. This would provide improved resilience to absorb a marked uptick in credit or other unexpected costs, and support its investment capacity.

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Rating Action

On June 28, 2024, S&P Global Ratings assigned its long- and short-term 'BBB+/A-2' resolution counterparty ratings (RCRs) to Finland-based Bonum Bank PLC. At the same time, we affirmed our 'BBB/A-2' long- and short-term issuer credit ratings on the bank. The outlook remains positive.

Rationale

We have gained further visibility into the resolution plans for POP Bank Group's member banks and believe the group would be subject to a bail-in-led resolution approach. The Financial Stability Authority in Finland has imposed a minimum requirement for own funds and eligible liabilities (MREL) requirement of 19.99% on total risk-weighted exposure, and 7.75% for the

leverage ratio-based calculation since Jan. 1, 2024. In our view, the MREL level implies an intended full recapitalization of the banking group, if it failed. Furthermore, given POP Bank Group's provision of critical functions in Finland--such as retail deposits and payment services--we see this as consistent with the authorities likely planning for an open-bank, bail-in-led resolution if the group were to fail or likely to fail.

We now consider that member banks would be credibly resolved and have assigned our long- and short-term RCRs to the group. An RCR is a forward-looking opinion of the relative default risk of certain liabilities, in particular those legally exempt from bail-in (such as insured deposits or secured liabilities), that may be better protected from default in an effective resolution scenario than other senior liabilities. Please refer to our jurisdictional assessment for Finland, "Resolution Counterparty Ratings Jurisdiction Assessment For Finland Completed," published June 29, 2018 on RatingsDirect. The long-term RCR generally stands one notch above the long-term issuer credit rating for investment-grade issuers, and two notches above for speculative-grade issuers.

We believe that Bonum Bank could be eligible for additional loss-absorbing capacity (ALAC) uplift if it were to build a sufficient buffer of subordinated debt over time. Finnish midsize banks are not subject to subordination requirements for their MREL instruments. While to date, POP Bank Group has met its MREL with other liabilities, including senior preferred, it has no outstanding subordinated liabilities that would be eligible for our ALAC calculation. To benefit from one notch of ratings uplift, the group's bail-inable buffer must sustainably reach or exceed a minimum ALAC threshold of 4.0% of S&P Global Ratings' risk-weighted assets. This is 100 basis points (bps) higher than the standard threshold, which would be consistent with our treatment of other banks with relatively few ALAC-eligible debt issues or short weighted-average maturities, including other mid-size Finnish peers.

We expect POP Bank Group will maintain sound profitability also when interest rates decline. The group's high share of variable rate loans, coupled with its retail deposit-based funding structure have--in tandem with higher interest rates--resulted in a material earnings improvement in 2023. The net interest income rose by 89% and comparable operating income by 241%, compared to 2022 levels. While we expect the net interest margin has now peaked, our base case sees operating income remaining materially above historical levels in 2024-2025 with net income projected at €75 million-€85 million, from €90 million (adjusted for one-off gains) in 2023. This translates into return on equity of 9%-11% (from 11.5% in 2023) and cost to income slightly above 50% (53%). This is a significant improvement from weak average comparable return on equity of 2% and cost to income of 80% in 2020-2022. Moreover, we expect ongoing streamlining of operations, including centralized pricing initiatives--coupled with a broadened product offering through the partnership with Local Tapiola Group--will support internal efficiency over the coming years.

As such, we believe the earnings profile is now more aligned with that of peers. If we are confident that it would be sustainable over time, this could lead us to remove the negative comparable rating analysis adjustment. At the same time, we continue to note POP Bank Group's smaller franchise, its modest market share in Finland, and somewhat weaker asset quality metrics compared to many peers, which constraints its credit profile.

We expect continued asset quality pressures in 2024-2025. We expect the muted growth outlook and delayed effects from high interest rates and inflation on household and SME customers will continue to weigh on the group's asset quality and loan provisioning needs. We project the nonperforming asset (NPA) ratio will peak at 3.5%-3.7% in 2024, from 3.3% as of Dec.

31, 2023, before slowly declining toward 3% over 2025-2026. Subsequently, we expect cost of risk will remain elevated at 40-45 bps this year before reverting toward its 2020-2022 average of 25bps. While nonperforming assets are higher than most Nordic and domestic peers', we expect the group's collateralized lending focus, adequate coverage, and generally smaller loan sizes--due to its focus on smaller cities and surroundings--to provide a cushion to a more pronounced deterioration.

We believe POP Bank Group's regional retail deposit franchise will continue to support

profitability. We consider the member banks' high customer loyalty and their strong access to cost-effective core deposits, accounting for 82% of the funding base as of first-quarter 2024, will continue to underpin profitability. While we expect competition for deposits will remain fierce and result in moderate deposit outflow and further migration to term deposits from sight deposits, the group sustained largely stable deposit volumes in 2023. As such, we believe the sensitivity of POP Bank Group's deposit base to be somewhat lower than most peers. The funding profile is further supported by the group's sound liquidity buffers, which after haircuts, represented 18% of assets and 25% of customer deposits as of Dec. 31, 2023.

Improved earnings and high profit retention will further underpin already robust capitalization.

We project the group's RAC ratio will be 21%-22% over the next two years, compared with 19.4% as of 2023. POP Group's capitalization is supported by its high quality of capital, solely comprising common equity tier 1, and full earnings retention as the group member banks, as cooperatives, do not pay dividends. As of Dec. 31, 2023, the group's total capital ratio stood at 20.3% (excluding 2023 profits) against a total capital requirement of 12.8% including the systemic risk buffer requirement of 1% that entered into force on April 1, 2024. This will support the group's future growth ambitions while providing a robust buffer to absorb unexpected losses, in our opinion.

Outlook

The positive outlook on Bonum Bank reflects our base case expectation that the wider POP Bank Group will maintain sound earnings generation capacity even as interest rates decline. This would provide improved resilience to absorb a marked uptick in credit or other unexpected costs, and support its investment capacity and growth ambitions.

Downside scenario

We could revise the outlook to stable if the group's earnings improvement is not durably sustained as expected. A negative rating action could also follow if weaker-than-peer asset quality metrics further deteriorated beyond our base case, weakening the combined capital and risk profile.

Upside scenario

We could upgrade Bonum Bank if POP Bank Group's improved revenue generation and cost efficiency proves to be sustainable over time, enabling it to maintain an earnings buffer more in line with that of its peers. In such a scenario, we would no longer apply a one-notch negative comparable ratings analysis adjustment. An upgrade would also need to be supported by resilient asset quality.

Ratings Score Snapshot

Issuer Credit Rating	BBB/Positive/A-2
Stand-alone credit profile	bbb
Anchor	a-
Business position	Constrained -2
Capital and earnings	Very strong +2
Risk position	Moderate -1
Funding and liquidity	Adequate 0
Comparable ratings analysis	-1
Support	0
ALAC support	0
GRE support	0
Group support	0
Sovereign support	0
Additional factors	0

Related Criteria

- Criteria | Financial Institutions | General: Risk-Adjusted Capital Framework Methodology, April 30, 2024
- 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
- 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

- Banking Industry Country Risk Assessment Update: May 2024, May 30, 2024
- Finland, April 29, 2024
- Top Nordic Banks Cut Costs As Revenue Growth Flattens, Feb. 19, 2024
- Nordic Banks In 2024: Ploughing Through Tough Terrain, Feb. 7, 2024
- Banking Industry Country Risk Assessment: Finland, Nov. 28, 2023

- Bonum Bank PLC, Nov. 7, 2023
- Bonum Bank Outlook Revised To Positive On POP Group's Improved Earnings Trajectory; 'BBB/A-2' Ratings Affirmed, Oct. 5, 2023
- POP Bank Group's Insurance Divestment Will Boost Earnings And Present Growth Opportunities, March 17, 2023

Ratings List

New Rating

Bonum Bank PLC

Resolution Counterparty Rating BBB+/-/A-2

Ratings Affirmed

Bonum Bank PLC

Issuer Credit Rating 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.spglobal.com/ratings for further information. A description of each of S&P Global Ratings' rating categories is contained in "S&P Global Ratings Definitions" at <https://disclosure.spglobal.com/ratings/en/regulatory/article/-/view/sourceld/504352>. Complete ratings information is available to RatingsDirect subscribers at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.spglobal.com/ratings. Alternatively, call S&P Global Ratings' Global Client Support line (44) 20-7176-7176.

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