

Research Update:

# Finland-Based S-Bank Ltd. Assigned 'BBB/A-2' Ratings; Outlook Negative

July 31, 2020

S&PGR Rates Finland's S-Bank Ltd. 'BBB/A-2'; Outlook Negative

## Overview

- In our view, S-Bank Ltd. has a small but expanding retail banking franchise linked to S Group; very strong capital and earnings; sound asset quality; a comprehensive deposit-based funding profile; and adequate liquidity.
- We apply a negative adjustment to the issuer credit rating to reflect its lower efficiency and profitability than that of domestic peers.
- Although we consider S-Bank partially insulated from Finnish retailer S Group, which allows us to rate the bank above the group's creditworthiness, we still view its overall franchise as strongly connected to the group.
- We are assigning our 'BBB/A-2' long- and short-term issuer credit ratings to S-Bank.
- The outlook is negative because of the deteriorating economic environment in Finland related to the COVID-19 pandemic and its potential effect on S-Bank's asset quality and capitalization over the next two years.

## Rating Action

On July 31, 2020, S&P Global Ratings assigned its 'BBB/A-2' long- and short-term issuer credit ratings to Finnish retail bank S-Bank Ltd. The outlook is negative.

## Rationale

S-Bank is a small digital retail bank that had total assets of €6.6 billion as of Dec. 31, 2019, and more than 430,000 active customers. The bank's primary focus is to provide free daily banking services for S Group's cooperative member customers and consumer and mortgage loans to retail customers. The banking operations are complemented by the expanding wealth management franchise, operated through fully owned subsidiary FIM Asset Management Ltd., which holds €9.1 billion of assets under management.

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The long term rating on S-Bank benefits from the comparably low banking sector risks in Finland, which translate into our 'a-' starting point for rating banks operating in the country. That said, we believe the COVID-19 pandemic and expected deep recession in the Finnish economy in 2020 will weigh on the banking sector. Consequently, we now consider the economic risk trend to be negative, because we see significant downside risks for Finnish banks' operating environment if the recession is more severe and/or longer than we expect, and if the economic rebound is delayed or fiscal countermeasures prove ineffective.

In our view, S-Bank has a small but expanding retail banking franchise. The key weakness is its concentrated business model--which still has unused potential, despite the close link to cooperative retailer S Group's customer base and brand--and its still-modest market share in the domestic lending market. Despite this, we still consider that the bank has a competitive advantage because it can cater to S Group's more than three million customers and make use of customer data from the group's membership program S-Bonus. In our view, this scheme could form a strong banking product distribution platform, enabling S-Bank to diversify its income in the future. Although still at an early stage, we believe that cross-selling opportunities through FIM Asset Management could provide the bank with significant growth opportunities and revenue diversification over the medium term.

We expect capitalization to remain S-Bank's main rating strength, which we primarily base on our risk-adjusted capital (RAC) ratio remaining above 15% for the next two years. This ratio was 17.5% on Dec. 31, 2019. That said, we expect growth in risk-weighted assets will exceed capital build up from earnings, leading to a moderate decline in the RAC ratio from year-end 2019 levels. The current challenging operating environment amid COVID-19 will burden S-Bank's growth prospects and earnings in the next two years. We project a balanced result in 2020, followed by a gradual rebound in 2021. We also expect the bank's material information-technology-related investments to weigh on its cost efficiency in the near term. However, we believe that S-Bank's currently underutilized client data is key to boosting its performance. We anticipate that S-Bank's profitability, measured by return on equity (ROE), will remain modest in the near term, compared with 5.3% in 2019. That said, we believe that it can reach its strategic financial targets of ROE above 8% and a cost-to-income ratio below 60% beyond the two year outlook period.

Although still unseasoned, we consider asset quality in S-Bank's €4.7 billion loan book to be similar to other retail-focused domestic banks in Finland, with somewhat higher exposure to consumer loans. We consider the bank's concentration in retail exposures, mainly in Finnish growth centers, to be partly offset by solid collateralization on mortgages and strong margins on other retail products. We expect the bank's loan growth to exceed the market average over the next two years, with underwriting standards remaining sound. Despite the current COVID-19 pandemic, we project the bank will maintain adequate asset-quality metrics, with nonperforming loans increasing to 0.8%-1.0% and cost of risk at 35-45 basis points in 2020-2021.

We expect the bank's funding and liquidity profile will continue to compare well with that of other Finnish retail banks. This rests on its dominant customer deposit base (98% of funding base), and comfortable liquidity buffers. We consider S-Bank's deposit base stable, since it refrains from being a price leader in deposits but is connected to the stability of the group's franchise. We expect S-Bank to diversify its funding profile by issuing unsecured bonds to meet the minimum requirement for own funds and eligible liabilities (MREL) and, as a second step, covered bonds issuance to allow further cost-efficient loan growth. Therefore, we anticipate that the bank's funding metrics will remain sound--the stable funding ratio stood at about 114% as of Dec. 31, 2019. This is comparable with domestic peers' and in line with our assessment of systemwide funding in Finland. Due to the immaterial use of wholesale funding, our assessment of liquidity as adequate primarily reflects our broad liquid assets/customer deposits ratio which, at 15.7%, is commensurate with other domestic banks.

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The stand-alone credit profile (SACP) on S-Bank is 'bbb+'. We consider S-Bank to have moderate systemic importance in Finland owing to its 4% market share in customer deposits. The bank is subject to MREL, but we do not believe the Finnish Financial Stability Authority would apply a well-defined bail-in process to S-Bank, under which the Finnish resolution authority would permit nonviable systemically important banks to continue as going concerns following a bail-in of eligible liabilities. As a result, we do not factor any rating uplift from the SACP for additional loss-absorbing capacity.

We deduct one notch from our long-term issuer credit rating on S-Bank because we consider the rating constrained by the bank's still-weak profitability and cost efficiency. The bank is likely to continue to demonstrate a weaker earnings profile than most of its peers in the medium term. We forecast that its three-year average earnings buffer--which demonstrates the capacity of the bank to cover its normalized losses--will remain poor at 0.2% in the coming years. An earnings buffer of about 1.0% indicates adequate earnings capacity, while a negative buffer would indicate that earnings are insufficient to cover normalized losses--in other words, a bank with a negative buffer could be loss-making through the cycle. Nevertheless, we consider that S-Bank is in a transition phase--as it builds capacity to cater for a larger set of clients, it has the potential to expand its loan book and earnings to make the business model sustainable in the long term.

We consider S-Bank an insulated member of S Group, which allows us to rate the bank above the group's creditworthiness. However, we consider S-Bank's overall franchise to be strongly connected to the group's fortunes and therefore cap the rating at 'BBB'.

The insulation of S-Bank is based on its legal separation from the wider group and prudential regulation, which makes any capital and liquidity transfers between the bank and S Group companies subject to Financial Supervisory Authority approval. In addition, we consider the minority shareholding of insurance group LocalTapiola General Mutual Insurance Co. (financial strength rating: 'A') and its associated companies an effective influence on decision making, which could protect the credit quality of S-Bank from potential credit stress at the group level. The decision by the Finnish resolution authority and S-Bank's MREL requirements indicate that the authority wants to ensure sufficient bail-in-able buffers at the bank level to protect customer deposits if the group or the bank run into financial distress. In a nonviability scenario, we expect the resolution authority to have the intent and act according to the resolution strategy, similar to our view on other banks that are subject to the bank recovery and resolution directive in Europe.

## Outlook

The outlook is negative because of the deteriorating economic environment related to the COVID-19 pandemic and its potential effect on S-Bank's asset quality and profitability over the next two years.

## Downside scenario

A deeper than anticipated recession and delayed economic recovery in Finland's export-oriented economy could adversely affect the Finnish banking sector's performance. This could lead us to revise down our anchor for Finnish banks, including S-Bank, to 'bbb+' from 'a-', which in turn would likely prompt us to lower our long-term rating on S-Bank.

We could also lower the ratings if the bank incurred higher losses beyond our base case that hamper its capitalization, and the projected RAC ratio trends below 15%. Furthermore, we could lower the ratings if we considered S-Bank's financial position to be affected by weakening creditworthiness at its majority owner, S Group, or if we believed its insulation from the overall

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group had decreased.

In addition, we could incorporate a negative adjustment notch into the SACP if lagging cost efficiency or deteriorating asset quality, combined with increased provisions, does not lead to an expected profitability improvement in the medium term.

### Upside scenario

We could revise the outlook to stable if the Finnish economy proved more resilient than we expect over the next 12-24 months.

We consider a positive rating action remote. We view S-Bank as an insulated member of S Group, which allows us to rate the bank above the group's creditworthiness. However, we consider S-Bank's overall franchise to be strongly connected to the group's fortunes and therefore cap the ratings at 'BBB'.

### Ratings Score Snapshot

Issuer Credit Rating	BBB/Negative/A-2
SACP	bbb+
Anchor	a-
Business Position	Weak (-2)
Capital and Earnings	Very Strong (+2)
Risk Position	Moderate (-1)
Funding and Liquidity	Average and Adequate (0)
Support	(0)
ALAC Support	(0)
GRE Support	(0)
Group Support	(0)
Sovereign Support	(0)
Additional Factors	(-1)

### Related Criteria

- 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
- Criteria | Financial Institutions | Banks: Bank Rating Methodology And Assumptions: Additional Loss-Absorbing Capacity, April 27, 2015
- Criteria | Financial Institutions | Banks: Quantitative Metrics For Rating Banks Globally: Methodology And Assumptions, July 17, 2013
- Criteria | Financial Institutions | Banks: Banks: Rating Methodology And Assumptions, Nov. 9,

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2011

- Criteria | Financial Institutions | Banks: Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

## Related Research

- COVID-19: Resilient Fundamentals And Assertive Policy Measures Will Buoy Nordic Banking Systems, June 16, 2020
- Seven Finnish Banks Outlooks Revised To Negative On Deepening COVID-19 Downside Risks, May 19, 2020
- Banking Industry Country Risk Assessment: Finland, Oct. 9, 2019

## Ratings List

### New Rating

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#### S-Bank Ltd.

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Issuer Credit Rating BBB/Negative/A-2

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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](http://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](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](http://www.capitaliq.com). All ratings affected by this rating action can be found on S&P Global Ratings' public website at [www.standardandpoors.com](http://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; Stockholm (46) 8-440-5914; or Moscow 7 (495) 783-4009.

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