

## CREDIT OPINION

25 October 2017

Update

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### RATINGS

#### OP Corporate Bank plc

Domicile	Finland
Long Term Debt	Aa3
Type	Senior Unsecured - Fgn Curr
Outlook	Stable
Long Term Deposit	Aa3
Type	LT Bank Deposits - Fgn Curr
Outlook	Stable

Please see the [ratings section](#) at the end of this report for more information. The ratings and outlook shown reflect information as of the publication date.

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## OP Corporate Bank plc

### Semiannual update

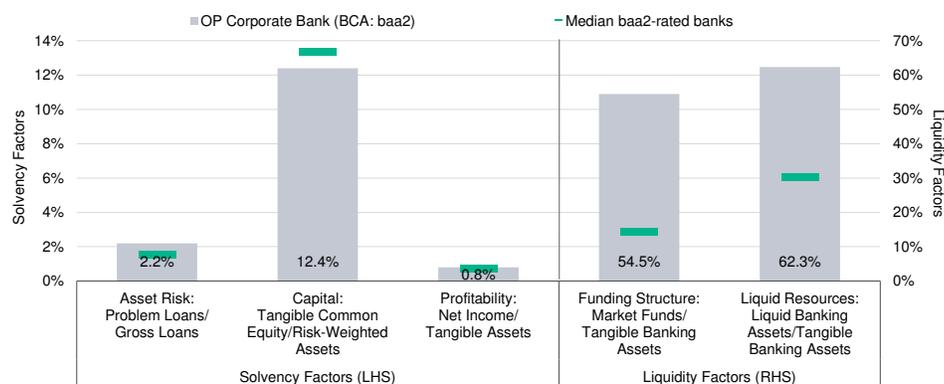
#### Summary

OP Corporate Bank Plc's Aa3/Prime-1 deposit and senior unsecured debt ratings incorporate: (1) the bank's standalone baseline credit assessment (BCA) of baa2, (2) our assumption of affiliate support from the OP Financial Group (BCA a3) which results in two notches uplift from the bank's BCA, (3) the results from our Advanced Loss Given Failure (LGF) analysis, which takes into account the severity of loss faced by the different liability classes in resolution, and which leads to two notches of rating uplift for OP Corporate Bank's deposit and senior unsecured ratings, and (4) our assumption of moderate likelihood of support from the [Finnish Government](#) (Aa1, stable) in case of need, which results in one notch of additional uplift. The bank's Counterparty Risk Assessment (CR Assessment) is Aa2(cr)/Prime-1(cr).

OP Corporate Bank's BCA of baa2 is supported by [Finland's Macro Profile of Strong+](#), and reflects the bank's strong national franchise, focused mainly on corporate lending, its stable asset quality and improving capitalisation. The BCA is constrained by the bank's high sector concentration and reliance on market funding.

Exhibit 1

#### Rating Scorecard - Key Financial Ratios



Source: Moody's Financial Metrics

Due to joint liability amongst OP Financial Group's central institution, OP Cooperative, and member credit institutions, one may also read Moody's research on the entire [OP Financial Group](#), in conjunction with this research on OP Corporate Bank plc.

## Credit Strengths

- » Strong domestic franchise in corporate banking although some functions might be transferred to other parts of the OP Financial Group
- » Asset quality is stable in spite of some sector concentration
- » Good capital position, close to management target
- » Profitability is sound, but could suffer as functions are transferred away from the bank

## Credit Challenges

- » Downward pressure on net interest margins due to the low interest rate environment
- » High reliance on short-term funding, although partly due to group treasury role taking excessive liquidity from OP Financial group entities.

## Rating Outlook

The outlook on OP Corporate Bank's issuer, deposit and senior unsecured ratings is stable. This reflects our expectation that the financial fundamentals of the Group will remain in line with its current ratings over the next 12 to 18 months.

## Factors that Could Lead to an Upgrade

An upgrade of OP Financial Group's BCA would lead to increased uplift from affiliate support and thereby trigger an upgrade of OP Corporate bank's ratings, assuming that the liability structure of the group is unchanged. Upward pressure on the ratings could develop as a result of a combination of: (1) stronger profitability; (2) reduced reliance on market funding and a longer debt maturity profile; and (3) a sustained reduction in sector concentration risks, particularly related to real estate, together with an upgrade of the group's BCA. An upgrade of OP Corporate Bank's BCA on its own, would not automatically lead to an upgrade of the bank's ratings, but rather reduce the number of notchings from affiliate support as the BCAs of the bank and the group align.

## Factors that Could Lead to a Downgrade

OP Corporate Bank's ratings could be downgraded as a result of deterioration in asset quality or capitalisation. A downgrade of OP Financial Group's BCA would lead to a reduced uplift from affiliate support incorporated in the bank's ratings. A smaller cushion of loss absorbing obligations, such as junior debt, senior debt, and junior deposits (on consolidated OP Financial Group level) or less likely government support would also result in downward rating pressure.

## Key Indicators

Exhibit 2

### OP Corporate Bank plc (Consolidated Financials) [1]

	6-17 <sup>2</sup>	12-16 <sup>2</sup>	12-15 <sup>2</sup>	12-14 <sup>2</sup>	12-13 <sup>3</sup>	CAGR/Avg. <sup>4</sup>
Total Assets (EUR million)	58,476	58,186	55,520	45,111	40,664	10.9 <sup>5</sup>
Total Assets (USD million)	66,695	61,372	60,311	54,587	56,033	5.1 <sup>5</sup>
Tangible Common Equity (EUR million)	2,952	2,909	2,735	2,301	1,970	12.2 <sup>5</sup>
Tangible Common Equity (USD million)	3,367	3,068	2,971	2,784	2,714	6.3 <sup>5</sup>
Problem Loans / Gross Loans (%)	1.2	2.2	2.3	3.1	3.3	2.4 <sup>6</sup>
Tangible Common Equity / Risk Weighted Assets (%)	12.4	13.2	12.8	10.5	12.3	12.2 <sup>7</sup>
Problem Loans / (Tangible Common Equity + Loan Loss Reserve) (%)	7.5	13.1	13.6	19.3	22.2	15.1 <sup>6</sup>
Net Interest Margin (%)	0.4	0.4	0.5	0.6	0.6	0.5 <sup>6</sup>

This publication does not announce a credit rating action. For any credit ratings referenced in this publication, please see the ratings tab on the issuer/entity page on [www.moody's.com](http://www.moody's.com) for the most updated credit rating action information and rating history.

PPI / Average RWA (%)	2.5	2.6	3.1	2.8	3.2	2.87
Net Income / Tangible Assets (%)	0.8	0.7	0.9	1.1	1.1	0.9 <sup>6</sup>
Cost / Income Ratio (%)	48.3	46.8	41.1	46.6	52.5	47.1 <sup>6</sup>
Market Funds / Tangible Banking Assets (%)	54.0	54.5	48.4	58.9	59.3	55.0 <sup>6</sup>
Liquid Banking Assets / Tangible Banking Assets (%)	60.5	62.3	61.8	55.0	54.2	58.8 <sup>6</sup>
Gross Loans / Due to Customers (%)	123.9	117.1	99.3	137.8	145.0	124.6 <sup>6</sup>

[1] All figures and ratios are adjusted using Moody's standard adjustments [2] Basel III - fully-loaded or transitional phase-in; IFRS [3] Basel II; IFRS [4] May include rounding differences due to scale of reported amounts [5] Compound Annual Growth Rate (%) based on time period presented for the latest accounting regime [6] Simple average of periods presented for the latest accounting regime. [7] Simple average of Basel III periods presented

Source: Moody's Financial Metrics

## Profile

OP Corporate Bank Plc (formerly, Pohjola Bank Plc) is part of the OP Financial Group - a leading Finnish financial services entity - and acts as the central treasury within the group. The group's strong franchise is underpinned by its position as a leading financial services provider in Finland, with products ranging from banking to non-life insurance and wealth management services.

At end-2016, OP Financial Group reported domestic market shares of 35.3% in loans and 37.5% in deposits. In addition, OP Financial Group is also Finland's largest non-life insurer, and is also currently building its mutual fund business, reporting a 22.0% market share as of December 2016 and targeting a better market position. In addition, it was the largest non-life insurer in Finland in terms of premiums written.

## Detailed Credit Considerations

### Strong domestic franchise in corporate banking, although some functions are transferred to other parts of the OP Financial Group

OP Corporate Bank's strong franchise supports its asset quality and profitability, and is underpinned by its strong domestic market position in corporate banking. The bank is also a leading player in non-life insurance. In addition, the bank benefits from being part of OP Financial Group - a leading financial services group in Finland - where it acts as the central financial institution.

OP Corporate Bank has a lesser role within the Group since end of 2015 and this negatively impacts the bank's earnings. On 30 December 2015, OP Corporate Bank announced that it had executed its de-merger plan by which Group treasury, corporate bank activities, equities and non-life insurance remained with OP Corporate Bank plc while all other operations, namely wealth management, card and property management operations were transferred to a newly-created company.

In addition, OP Financial Group is assessing whether the bank should continue to play the role of central treasury for the group or whether the treasury operations should be separated as a detached subsidiary, wholly owned by OP Cooperative (the central institution of OP Financial Group). Since a more specific plan or schedule for the structural change of the non-life insurance segment (potentially transferring from OP Corporate Bank to the direct ownership of OP Cooperative) has not yet been decided, it is reported together with Banking and Other Operations in OP Corporate Bank's financial reporting.

As OP Corporate Bank and other member credit institutions of OP Financial Group are responsible for each other's liabilities, as outlined in the Act on the Amalgamation of Deposit Banks, OP Corporate Bank can issue debt at more advantageous interest rates, a credit positive.

### Asset quality is stable in spite of some sector concentrations

OP Corporate Bank has a track record of strong asset quality for a corporate bank: the impaired loan ratio was 1.2% in June 2017, slightly below 1.3% at the end of 2016, and 1.5% in 2015. If we take into account all doubtful receivables the problem loan ratio would be 2.2% at the end of 2016, from 2.3% in 2015. The improvement between 2014-16 is primarily driven by loan book growth, although the stock of impaired loans has also seen a decline. This ratio is higher compared to some of the large Nordic banks and mainly explained by the fact that OP Corporate Bank is focused more exclusively on corporate lending. Nordic banks with a high share of household mortgage lending tend to benefit from a lower level of problem loans.

We expect Finnish real GDP to grow at 1.5%-2% in 2017 and 2018, compared to 1.4% in 2016, as the country has emerged from a multi-year recession which ended in 2015. We believe that the operating environment, with supportive investment and consumption, will help stabilise asset quality.

OP Corporate Bank's asset quality is constrained by its high sector concentration, which is a result of its focus on corporates which make up about 88% of the bank's exposures. As of June 2017, the most significant exposures included energy 12.6%, trade 10.1%, and renting and operating of non-residential real estate 8.0%. In mitigation, a significant proportion of exposures within renting and operating of real estate were guaranteed by the Finnish government.

The bank's Asset Risk at baa2 score reflects the above-mentioned constraints.

#### **Good capital position, close to management target**

We consider OP Corporate Bank to be well capitalised. The bank reported a CET1 ratio of 14.6% as of H1 2017 slightly below 14.9% in 2016, but improved from 12.4% at year-end 2014. The Total Capital ratio of the bank is 20.1% as of H1 2017 a slight decrease from 20.9% in 2016.

The bank's updated financial goals include a CET1 ratio target of 15%. On top of this, the bank aims to achieve a 22% return on economic capital (versus a 18.7% ratio during the first half of 2017). OP Corporate Bank is expected to maintain a 50% profits payout as dividends.

The assigned score of baa1 reflects OP Corporate bank's capital position and recent trends.

#### **Profitability is sound, but could suffer as functions are transferred away from the bank**

We expect OP Corporate Bank's profitability to remain strong, owing to the bank's corporate banking focus which is a higher return/risk business compared to household mortgage lending.

During H1 2017, the net profit improved to EUR232 million (+24% year-on-year) mainly due to higher net investment income (+127% year-on-year increase to EUR186 million when compared to H1 2016) resulted by increased gains from investment securities. Moreover, we recognise that the core revenues of the bank have increased, namely higher net interest income (+3% year-on-year to EUR120 million) but net insurance income slightly declined (-3% year-on-year to EUR248 million). As a result, we calculate that the annualised return on average assets and return on average equity were 0.8% and 12%, respectively.

In absolute terms, OP Corporate Bank's profits decreased in the recent year as the wealth management and other businesses were transferred away from the bank at year-end 2015. Further decrease would be significant if non-life operations were eventually moved out of the bank, as they accounted for 35% of OP Corporate Bank's earnings before tax during H1 2017.

OP Corporate Bank has a track record of strengthening its efficiency over many years. Moreover, we note that due to the improved revenues, the cost to income ratio improved marginally to 48.3% in H1 2017 from 49.5% in H1 2016.

Our assigned Profitability score of baa2 reflects the bank's earnings volatility as a corporate bank and to the negative impact on bottom-line profitability as a result of the transfer of wealth management and other businesses away from the bank. The assigned score does not, however, incorporate the impact on the bank's profitability if non-life operations are also transferred.

#### **High reliance on short-term wholesale funding, although mitigated by liquidity buffer**

OP Corporate Bank currently has the role of central treasury for OP Financial Group. Among other things, the bank is responsible for issuing senior unsecured debt and short-term debt as well as managing the group's liquidity buffer.

The bank is reliant on market funding, which exposes it to swings in investor sentiment. Market funds accounted for 54% of tangible banking assets as of H1 2017, just slightly below 55% at end-2016 and from 59% at end-2014. More than half of all liabilities were short term in nature, including borrowings from banks (35% of market fund), and commercial paper (23% of market funds). While reliance on market funding is usually considered a credit weakness, we note that OP Corporate bank's funding profile is geared toward supporting the group's liquidity, and that approximately half of borrowings from banks is excess liquidity from OP Financial Group entities. We also note positively that the bank has taken steps to lengthen its debt maturity profile. However, the potential reorganisation of functions within OP Financial Group could result in the bank losing its central treasury role, and may therefore change the bank's funding profile. A decision to strip OP Corporate Bank of its central treasury role has not been taken nor has another suitable entity been identified by the group.

The bank maintains a large, high quality liquidity buffer, in accordance with its central treasury role. The buffer (at market value and after haircuts) amounted to EUR20.3 billion, or 59% of wholesale funds as of H1 2017. Most securities are eligible for Central Bank repo transactions, which gives the bank some flexibility in a currently unlikely stress scenario. The liquid assets as proportion of tangible assets ratio were 61% as of the same date.

The bank's funding and liquidity buffer is captured in the baa2 Combined Liquidity Score.

## Notching Considerations

### Affiliate Support

We assess the probability of parental support from OP Financial Group as very high based on the relationship between the two entities, the close brand association, and the existing joint liability.

This assessment leads to two notches of uplift from OP Corporate bank's baa2 BCA to an adjusted BCA of a3.

### Loss Given Failure

Finland is subject to the EU Bank Recovery and Resolution Directive (BRRD), which we consider to be an Operational Resolution Regime. We assume residual tangible common equity of 3% and losses post-failure of 8% of tangible banking assets, a 25% run-off in "junior" wholesale deposits, a 5% run-off in preferred deposits, and assign a 25% probability to deposits being preferred to senior unsecured debt. In line with large European banks, we assume 26% of deposits are junior. These are in line with our standard assumptions.

Our advanced LGF analysis is based on the balance sheet of the entire OP Financial Group (including OP Corporate Bank), because all member credit institutions in OP Financial Group (excluding insurance companies and some other group companies) liable each other's obligations, in accordance with the Amalgamations Act.

This results in a Preliminary Rating Assessment (PRA) of a1 for the deposits and senior unsecured debt, two notches above the Adjusted BCA, reflecting a very low loss-given failure.

For junior securities issued by OP Corporate Bank, our advanced LGF analysis confirms a high loss-given failure, given the small volume of debt and limited protection from more subordinated instruments and residual equity. We also incorporate additional notching for junior subordinated and preference share instruments reflecting the coupon features.

### Government Support

The implementation of an operational resolution regime in Finland has caused us to reconsider the potential for government support to benefit certain creditors. Following the introduction of BRRD, we believe the probability of government support for OP Corporate Bank's long-term and deposits ratings to be moderate, translating into one notch of uplift from its unsupported rating level, reflecting OP Corporate Bank's profile as one of the leading financial institutions in Finland. This results in one notch of uplift for the deposit and senior unsecured debt ratings to Aa3.

For other junior securities, we continue to assume that potential government support is low and as such these ratings do not include any related uplift. As a result, we assign a Baa1 rating for the bank's "plain vanilla" junior subordinated debt and Baa3(hyb) for the preference shares it is Baa3(hyb). The ratings are one and three notches, respectively below the bank's adjusted BCA of a3.

### Counterparty Risk Assessment

Counterparty Risk (CR) Assessments are opinions of how counterparty obligations are likely to be treated if a bank fails and are distinct from debt and deposit ratings in that they (1) consider only the risk of default rather than both the likelihood of default and the expected financial loss suffered in the event of default and (2) apply to counterparty obligations and contractual commitments rather than debt or deposit instruments. The CR assessment is an opinion of the counterparty risk related to a bank's covered bonds, contractual performance obligations (servicing), derivatives (e.g., swaps), letters of credit, guarantees and liquidity facilities.

The CR Assessment of OP Corporate Bank is positioned at Aa2(cr)/Prime-1(cr), three notches above the Adjusted BCA of a3, based on the cushion against default provided to the senior obligations. In addition, the low probability of government support does not result in any uplift.

#### **About Moody's Bank Scorecard**

Our Scorecard is designed to capture, express and explain in summary form our rating committee's judgment. When read in conjunction with our research, a fulsome presentation of our judgment is expressed. As a result, the output of our Scorecard may materially differ from that suggested by raw data alone (though it has been calibrated to avoid the frequent need for strong divergence). The Scorecard output and the individual scores are discussed in rating committees and may be adjusted up or down to reflect conditions specific to each rated entity.

## Rating Methodology and Scorecard Factors

Exhibit 3

### OP Corporate Bank plc

#### Macro Factors

**Weighted Macro Profile**                      **Strong +**    **100%**

Factor	Historic Ratio	Macro Adjusted Score	Credit Trend	Assigned Score	Key driver #1	Key driver #2
Solvency						
Asset Risk						
Problem Loans / Gross Loans	2.2%	a2	← →	baa2	Single name concentration	Sector concentration
Capital						
TCE / RWA	12.4%	a3	← →	baa1	Expected trend	
Profitability						
Net Income / Tangible Assets	0.8%	baa1	← →	baa2	Expected trend	
Combined Solvency Score		a3		baa2		
Liquidity						
Funding Structure						
Market Funds / Tangible Banking Assets	54.5%	b3	← →	ba3	Market funding quality	
Liquid Resources						
Liquid Banking Assets / Tangible Banking Assets	62.3%	aa2	← →	aa2	Quality of liquid assets	
Combined Liquidity Score		baa3		baa2		
Financial Profile						
Business Diversification				0		
Opacity and Complexity				0		
Corporate Behavior				0		
Total Qualitative Adjustments				0		
Sovereign or Affiliate constraint:				Aa1		
Scorecard Calculated BCA range				baa1-baa3		
Assigned BCA				baa2		
Affiliate Support notching				2		
Adjusted BCA				a3		

Balance Sheet	in-scope (EUR million)	% in-scope	at-failure (EUR million)	% at-failure
Other liabilities	43,187	36.2%	49,450	41.4%
Deposits	61,405	51.5%	55,142	46.2%
Preferred deposits	45,440	38.1%	43,168	36.2%
Junior Deposits	15,965	13.4%	11,974	10.0%
Senior unsecured bank debt	9,737	8.2%	9,737	8.2%
Junior subordinated bank debt	1,424	1.2%	1,424	1.2%
Equity	3,580	3.0%	3,580	3.0%
Total Tangible Banking Assets	119,333	100%	119,333	100%

Debt class	De Jure waterfall		De Facto waterfall		Notching		LGF Notching Guidance vs. Adjusted BCA	Assigned LGF notching	Additional notching	Preliminary Rating Assessment
	Instrument volume + subordination	Sub-ordination	Instrument volume + subordination	Sub-ordination	De Jure	De Facto				
Counterparty Risk Assessment	22.4%	22.4%	22.4%	22.4%	3	3	3	3	0	aa3 (cr)
Deposits	22.4%	4.2%	22.4%	12.4%	2	3	2	2	0	a1
Senior unsecured bank debt	22.4%	4.2%	12.4%	4.2%	2	1	2	2	0	a1
Dated subordinated bank debt	4.2%	4.2%	4.2%	4.2%	-1	-1	-1	-1	0	baa1
Non-cumulative bank preference shares	3.0%	3.0%	3.0%	3.0%	-1	-1	-1	-1	-2	baa3 (hyb)

Instrument class	Loss Given Failure notching	Additional Notching	Preliminary Rating Assessment	Government Support notching	Local Currency Rating	Foreign Currency Rating
Counterparty Risk Assessment	3	0	aa3 (cr)	1	Aa2 (cr)	--
Deposits	2	0	a1	1	Aa3	Aa3
Senior unsecured bank debt	2	0	a1	1	Aa3	Aa3
Dated subordinated bank debt	-1	0	baa1	0	Baa1	Baa1
Non-cumulative bank preference shares	-1	-2	baa3 (hyb)	0	Baa3 (hyb)	Baa3 (hyb)

Source: Moody's Financial Metrics

## Ratings

Exhibit 4

Category	Moody's Rating
<b>OP CORPORATE BANK PLC</b>	
Outlook	Stable
Bank Deposits	Aa3/P-1
Baseline Credit Assessment	baa2
Adjusted Baseline Credit Assessment	a3
Counterparty Risk Assessment	Aa2(cr)/P-1(cr)
Issuer Rating	Aa3
Senior Unsecured	Aa3
Subordinate	Baa1
Pref. Stock Non-cumulative	Baa3 (hyb)
Commercial Paper -Dom Curr	P-1
Other Short Term -Dom Curr	(P)P-1
<b>PARENT: OP FINANCIAL GROUP</b>	
Outlook	Stable
Baseline Credit Assessment	a3
Adjusted Baseline Credit Assessment	a3
Counterparty Risk Assessment	Aa2(cr)/P-1(cr)
<b>OP INSURANCE LTD</b>	
Outlook	Stable
Insurance Financial Strength	A3

Source: Moody's Investors Service

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