

Research Update:

Central Bank of Savings Banks Finland Outlook Revised To Stable On Reduced Member-Exit Risk; 'A-/A-2' Ratings Affirmed

October 20, 2023

Overview

- Savings Banks Group Finland continues to defend its loan franchise despite the muted credit outlook, and is repositioning in southwestern Finland following the exit of a local savings bank from the group in early 2023.
- In light of the improved earnings outlook in 2023-2024, the group has announced IT investments of more than €100 million over the next five years as part of its joint digitalization strategy.
- As a result, we think that the 14 group members remain strongly committed to the group strategy, and we consider it unlikely that further members will depart the amalgamation.
- We therefore revised our outlook to stable from negative on the core entity Central Bank of Savings Banks Finland PLC (Sp Central Bank) and affirmed our long- and short-term ratings on the group at 'A-/A-2'.
- The stable outlook indicates that the group will continue to defend its retail and small and midsize enterprise (SME) franchise and improve unity, while maintaining a sound financial position underpinned by improving earnings capacity and robust risk-adjusted capitalization.

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Rating Action

On Oct. 20, 2023, S&P Global Ratings revised the outlook on Central Bank of Savings Banks Finland PLC (Sp Central Bank) to stable from negative and affirmed the 'A-/A-2' long- and short-term ratings. At the same time, we affirmed the 'A/A-1' resolution counterparty ratings on the bank.

Rationale

Savings Banks Group has taken steps to counter the lost regional franchise and demonstrates loan growth even in a recessionary environment. The revision of the outlook on our ratings on Sp Central Bank reflects our expectation that the broader Savings Banks Group members will remain committed to the group strategy and continue to defend the market position in retail and SME lending in Finland. Despite the loss of an important member savings bank in southwestern Finland in early 2023, leading to a slight drop in market share to 4.9% in retail mortgages by mid-2023, Savings Banks Group remains the fourth-largest player in Finnish retail banking. The group has demonstrated its ability to reposition in the southwestern region, with two member savings banks rapidly expanding their operations to the Turku region. In the first half of 2023, Savings Banks Group reported loan growth of 2.2% year-on-year in the continued operations against a 1.2% drop in the overall market. In our view, this indicates that the group has swiftly stabilized its franchise.

We consider the current group setup as intact, rendering further member exits unlikely.

Savings Banks Group has seen two member savings banks leaving the amalgamation over the past four years. These unexpected departures revealed vulnerabilities in the group's framework and shortcomings in its ability to protect its franchise. Following strategic discussions, the group members codified new rules in a first-refusal right agreement. The agreement provides group members with effective negotiation powers to counteract potential takeover bids by a third party or a sale of business outside the group. This comes on top of the joint and several liability scheme in place within the amalgamation, shared by the Savings Banks Union Coop, 14 member savings banks, Sp Central Bank, and Sp Mortgage Bank. As such we believe the amalgamation now has a clear rule book and framework to safeguard the franchise.

We expect the group's earnings capacity to improve in 2023-2025. Savings Banks Group is well positioned to benefit from the sharply rising interest rates, and it has announced significant investment plans following its strategy review. The group's loan book is predominantly linked to variable rates (85% of the total loan book) and is repricing with higher market rates while the pass-through to deposits remains slower. We therefore project a 45% boost to the group's net interest income and a 25% rise in total revenue in 2023, to be sustained into 2024-2025. Although we project that operating expenses will increase on the back of the higher staff costs, general cost inflation, and normalization of the cost of risk (10-15 basis points), we expect the group's earnings capacity will strengthen through 2025. We will closely monitor the group's asset quality and cost of risk while a muted economic outlook, higher-interest-rate environment, and inflation continue to weigh on Finnish households' and businesses' debt-servicing capacity. We expect the group's return on average common equity to peak in 2023 but remain durably in the range of 8%-9% in 2024-2025, a comfortable level given the group's high capital base and mutual nature.

Savings Banks Group plans material investments in a joint digital strategy. The improved earnings will allow the group to make €100 million in IT investments over the next five years to improve efficiency and its customer offering, under the joint "Digital Vision 2027". The investments will include an overhaul of lending and customer relationship management systems, as well as investments in cloud technology. While the group's cost-to-income ratio improved to 62% as of June 2023 thanks to the income boost, we expect the efficiency gains from these investments will materialize over the medium term. Furthermore, we do not exclude further intra-group mergers between the savings banks as the group seeks further efficiency gains.

Outlook

The stable outlook on Sp Central Bank reflects our expectation that the wider Savings Banks Group will continue to defend its regional retail and SME franchise in Finland and that the member banks remain strongly committed to the principles of the amalgamation and cohesive group strategy. Furthermore, the strategic investments in IT and digitalization over the next five years will allow the group to further strengthen its customer offering and operating efficiency.

The outlook also indicates that Savings Banks Group will maintain a sound financial position, materially improved earnings capacity, and superior risk-adjusted capitalization in the next two years.

Downside scenario

We could take a negative rating action on Sp Central Bank if, contrary to our expectations, the group fails to strengthen the cohesiveness of the local savings banks within its common framework, which limits its efficiency and management's steering ability. A negative rating action could also follow a deterioration of the group's underwriting standards or asset-quality.

Upside scenario

We could take a positive rating action on Sp Central Bank if Savings Banks Group was to build up a material additional loss-absorbing capacity (ALAC) buffer that we consider sufficient to protect senior bondholders.

Ratings Score Snapshot

	To	From
Issuer Credit Rating	A-/Stable/A-2	A-/Negative/A-2
SACP	a-	a-
Anchor	a-	a-
Business position	Moderate (-1)	Moderate (-1)
Capital and earnings	Very strong (+2)	Very strong (+2)
Risk position	Moderate (-1)	Moderate (-1)
Funding and liquidity	Adequate and adequate (0)	Adequate and adequate (0)
Comparable ratings analysis	0	0
Support		
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.

Related Criteria

- 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

Related Research

- Nordic Banks: Resilient To Economic Weakening, Oct. 18, 2023
- Banking Industry Country Risk Assessment Update: September 2023, Sept. 28, 2023
- Finland's Savings Banks Group Needs To Reshape Operations And Strengthen Unity After Second Member's Likely Exit, June 28, 2022
- Central Bank of Savings Banks Finland PLC, Aug. 3, 2022
- Banking Industry Country Risk Assessment: Finland, June 1, 2022

Ratings List

Ratings Affirmed; Outlook Action

	To	From
Central Bank of Savings Banks Finland PLC		
Issuer Credit Rating	A-/Stable/A-2	A-/Negative/A-2

Ratings Affirmed

Central Bank of Savings Banks Finland PLC		
Resolution Counterparty Rating	A/--/A-1	
Senior Unsecured	A-	

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/sourceId/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

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