STANDARD & POOR'S RATINGS SERVICES
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The Mortgage Society of Finland

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The Mortgage Society of Finland

SACP	bbb		+	Support	0	+	Additional Factors	0

Anchor	a-	
Business Position	Weak	-2
Capital and Earnings	Very Strong	+2
Risk Position	Moderate	-1
Funding	Below Average	-1
Liquidity	Adequate	

GRE Support	0
Group Support	0
Sovereign Support	0

Issuer Credit Rating
BBB/Negative/A-3

Major Rating Factors

Strengths:	Weaknesses:
• Very strong capitalization. • Strong asset quality and exceptional loan loss track record. • Mutual business model.	• Narrow business operations as a residential mortgage financer. • Concentration risk due to focus on residential mortgage lending. • Predominantly wholesale funding profile.

Outlook: Negative

Standard & Poor's Ratings Services' outlook on Finland-based credit institution The Mortgage Society of Finland (Suomen Hypoteekkiyhdistys [Hypo], or the bank) is negative, reflecting our view that the weak economic recovery in Finland's export-oriented economy could adversely affect the Finnish banking sector's performance in the next two years. This could lead us to revise down our anchor for Finnish banks, including Hypo, to 'bbb+' from 'a-', which in turn would likely prompt us to lower our long-term rating on Hypo.

In addition, we could downgrade Hypo if it unexpectedly changed its current conservative lending policies, leading to weakening of its asset quality and ensuing credit losses. We could also take a negative rating action if Hypo increased its business growth more aggressively than we assume and failed to maintain its "very strong" capital and earnings in line with our expectations.

We might revise the outlook to stable if we saw an improvement in the Finnish economy and continued strengthening in Hypo's liquidity, in line with our expectations and lifting our liquidity measure (broad liquid assets to short-term wholesale funding) sustainably above 1.0x.

Rationale

Our ratings on Hypo reflect our anchor of 'a-' for Finnish banks, Hypo's "weak" business position, its "very strong" capital and earnings, "moderate" risk position, "below average" funding, and "adequate" liquidity. We assess the bank's stand-alone credit profile (SACP) at 'bbb'. We consider Hypo to be of "low" systemic importance and consequently do not factor any extraordinary government support into our 'BBB' long-term rating on the bank.

Anchor: 'a-' for banks operating only in Finland

Under our bank criteria, we use our Banking Industry Country Risk Assessment's economic risk and industry risk scores to determine a bank's anchor, the starting point in assigning an issuer credit rating. Our anchor for a commercial bank operating only in Finland, such as Hypo, is 'a-', based on an economic risk score of '2' and an industry risk score of '3'.

We view Finland as a competitive and resilient economy, with high education levels. But it also depends on exports in cyclical industries. Moreover, a lack of reforms to increase competiveness could hamper the economy. The subdued growth and structural issues in the Finnish economy might lead to a deteriorating operating environment for the banking sector. Comparably low corporate and moderate household debt levels and a very strong payment culture contribute to debt in the economy.

Diverse Nordic banking groups largely control Finland's concentrated banking industry, which in our view is underpinned by robust profitability metrics and stability. Deposits dominate funding, but the sector is a net external debtor, reflecting significant loan growth over the past decade and the country's lack of a deep domestic debt market.

Table 1

The Mortgage Society of Finland Key Figures

		--Year ended Dec. 31--			
(€ 000s)	**2015***	**2014**	**2013**	**2012**	**2011**
Adjusted assets	1,699,047.1	1,498,966.2	1,218,856.0	910,864.4	817,479.3
Customer loans (gross)	1,308,753.3	1,204,391.5	978,209.4	725,380.0	615,287.0
Adjusted common equity	99,858.5	96,291.2	89,613.6	82,876.9	79,670.1
Operating revenues	8,344.8	17,256.8	14,047.4	11,946.6	10,109.7
Noninterest expenses	4,126.7	9,727.7	8,060.3	6,695.2	6,258.0
Core earnings	3,476.3	6,167.7	4,889.7	4,092.6	3,360.8

*Data as of June 30.

Business position: Monoline profile as residential mortgage financer in Finland

We consider Hypo's business position to be "weak," reflecting the bank's small size, very low market share in Finland, and its concentrated niche market position focused on residential mortgage lending to households and housing companies, primarily in the Helsinki metropolitan area.

Hypo, founded in 1860, is a licensed bank and mutual company operating under Finland's Act on Mortgage Societies and is governed by its members. The purpose of the mortgage society is to grant long-term loans against a mortgage or other safeguarding collateral. The customers are members of the society as long as they have loans outstanding and no arrears. The bank grants loans to Finnish households and housing companies solely against housing or residential property collateral and had total assets of €1.7 billion and a loan portfolio of €1.3 billion as of June 30, 2015.

The bank is only active in the Helsinki metropolitan area, the Uusimaa region, and in specified growth centers in Finland. As such, we consider Hypo will be less exposed to adverse market price development in rural areas of Finland. Hypo operates solely from its headquarters in Helsinki and services its clients through online and telephone banking, allowing it, in our view, to operate more cost efficiently than its larger domestic peers.

Hypo's niche position will continue to provide stability to the bank's business position and opportunities for risk-averse growth, in our opinion. Due to its small size and marginal market share of 0.4% in mortgage lending in Finland, Hypo does not compete with the larger market players on retail banking products but exclusively on mortgages. Owing to its solid reputation and special product offerings, such as loans to housing companies and reverse loans for elderly people (backed by real estate property), Hypo can be seen as an alternative bank to its customers. Therefore, the growth targets for the coming years--annual loan growth of €200 million-€250 million or 20%-25% in 2015-2016--are in our view not overly aggressive, as might be indicated by the absolute growth figures, and are small compared with the mortgage loan market.

We view Hypo's narrow product focus on residential mortgage lending as the main weakness to its business model, which may expose the bank to potential volatility in the real estate market in Finland. We don't anticipate any changes to Hypo's strategy, which is clearly defined by the Act of Mortgage Societies. As such, the bank will not be allowed to expand into corporate lending or commercial real estate financing, for example. Furthermore, it has no trading activities and no foreign business activities.

Hypo's revenues consist of interest income from first-lien mortgages related to Finnish residential mortgages and loans to housing companies (37% of total operating revenues in 2014), income from investments in housing and land property owned by Hypo (25%), and fee and commission income from lending, deposits, residential property trustee services (21%), and other income (17%), a split that we expect will remain unchanged in the foreseeable future.

Notwithstanding the concentrations in Hypo's business profile, we consider that management has a prudent approach to risks and a very low risk appetite. Furthermore, we believe that, despite the elevated growth targets for the next two years, management will maintain the bank's conservative underwriting standards, and Hypo's niche position will allow it to continue growing very selectively. The bank's conservative culture is also underpinned by the mutual legal structure of Hypo, which subordinates short-term financial profitability targets.

Table 2

The Mortgage Society of Finland Business Position					
		--Year ended Dec. 31--			
(%)	**2015***	**2014**	**2013**	**2012**	**2011**
Total revenues from business line (€ 000s)	8,344.8	17,256.8	14,047.4	11,946.6	10,109.7
Retail banking/total revenues from business line	43.4	58.0	57.7	48.3	37.5
Commercial & retail banking/total revenues from business line	43.4	58.0	57.7	48.3	37.5
Return on equity	7.2	6.7	5.8	5.3	4.5

*Data as of June 30.

Capital and earnings: Very strong capitalization and high profit retention as a mutual company

We assess Hypo's capital and earnings as "very strong," due mainly to our expectation that our projected risk-adjusted capital (RAC) ratio for the bank will be in the range of 17%-18% over the next 12-18 months, compared with 19.7% as of Dec. 31, 2014. The decrease in our projected RAC ratio over the next two years results from the bank's targeted loan growth, which translates into an increase in our calculation of risk-weighted assets that exceeds our anticipation of the bank's potential capital buildup, absent any additional capital measures. We anticipate that the loan growth will be balanced between retail and housing company loans.

We expect that Hypo's interest income from loan business will strengthen in 2015-2016, driven primarily by improved margins and secondly by portfolio growth. However, the low interest rate environment and the increase in the liquidity portfolio will be at the expense of lower net interest income. Furthermore, we expect Hypo's housing property investments will provide stable recurring income of about €4.0 million-€4.5 million over the next two years.

As a mutual company, Hypo does not pay out dividends. Consequently, the retained profits are solely used for capital buildup. Furthermore, we view the mutual structure as a positive as it minimizes the focus on short-term financial targets--the return on equity has been close to 5% in the past five years.

We consider Hypo's quality of capital to be adequate due to the small absolute size of its capital base (€99 million as of June 30, 2015) and the bank's limited flexibility to raise additional core capital in the market. Hypo's total adjusted capital, our measure of loss-absorbing capital, consists solely of core capital. We have not included any additional capital measures into our forecast, but Hypo could make use of hybrid capital issues if required to support loan growth. The quality of earnings is, in our view, adequate, because net interest income and net fee and commission income constitute a major part of revenues (57% as of 2014), while the stable income from property holding constitutes the remainder. The income from property holding is unusual when compared with peers; however, we understand Hypo is holding high-quality assets without any opportunistic approach to gain quick market value gains.

Table 3

The Mortgage Society of Finland Capital And Earnings					
		--Year ended Dec. 31--			
(%)	**2015***	**2014**	**2013**	**2012**	**2011**
Tier 1 capital ratio	14.4	15.1	14.0	15.9	15.4
S&P RAC ratio before diversification	N.M.	19.7	N.M.	N.M.	N.M.
S&P RAC ratio after diversification	N.M.	11.5	N.M.	N.M.	N.M.
Adjusted common equity/total adjusted capital	100.0	100.0	100.0	100.0	100.0
Net interest income/operating revenues	30.4	37.2	37.7	28.9	17.4
Fee income/operating revenues	22.0	20.9	19.4	18.8	20.1
Market-sensitive income/operating revenues	6.0	16.1	0.7	0.1	0.1
Noninterest expenses/operating revenues	49.5	56.4	57.4	56.0	61.9
Preprovision operating income/average assets	0.5	0.6	0.6	0.6	0.5
Core earnings/average managed assets	0.4	0.5	0.5	0.5	0.5

*Data as of June 30. RAC--Risk-adjusted capital. N.M.--Not meaningful.

Table 4

The Mortgage Society of Finland Risk-Adjusted Capital Framework Data

(€ 000s)	Exposure*	Basel III RWA	Average Basel III RW (%)	Standard & Poor's RWA	Average Standard & Poor's RW (%)
Credit risk					
Government and central banks	159,087	0	0	9,381	6
Institutions	62,457	15,615	25	9,990	16
Corporate	177,160	142,041	80	108,748	61
Retail	1,111,759	352,100	32	277,210	25
Of which mortgage	1,051,370	326,732	31	252,329	24
Securitization	0	0	0	0	0
Other assets	58,709	58,688	100	58,080	99
Total credit risk	1,569,171	568,444	36	463,409	30
Market risk					
Equity in the banking book†	226	113	100	2,336	1,032
Trading book market risk	--	0	--	0	--
Total market risk	--	113	--	2,336	--
Insurance risk					
Total insurance risk	--	--	--	0	--
Operational risk					
Total operational risk	--	26,525	--	22,841	--
(€ 000s)		**Basel II RWA**		**Standard & Poor's RWA**	**% of Standard & Poor's RWA**
Diversification adjustments					
RWA before diversification		595,562		488,585	100
Total Diversification/Concentration Adjustments		--		346,465	71
RWA after diversification		595,562		835,050	171
(€ 000s)		**Tier 1 capital**	**Tier 1 ratio (%)**	**Total adjusted capital**	**Standard & Poor's RAC ratio (%)**
Capital ratio					
Capital ratio before adjustments		89,758	15.1	96,291	19.7
Capital ratio after adjustments‡		89,758	15.1	96,291	11.5

*Exposure at default. †Exposure and Standard & Poor's risk-weighted assets for equity in the banking book include minority equity holdings in financial institutions. ‡Adjustments to Tier 1 ratio are additional regulatory requirements (e.g. transitional floor or Pillar 2 add-ons). RWA--Risk-weighted assets. RW--Risk weight. RAC--Risk-adjusted capital. Sources: Company data as of Dec. 31, 2014, Standard & Poor's.

Risk position: Exceptional asset quality, but concentration risk on retail mortgage lending in Finland

In our view, Hypo's risk position is "moderate," reflecting the concentration risk in the bank's loan book, which exposes it to potential volatility in the domestic real estate market, as well as to single names.

We view positively Hypo's focus on low-risk lending, consisting of mortgage loans to domestic retail customers and housing companies, and high granularity in its loan portfolio book. However, we still consider that the regionally focused retail loan book exposes the bank to concentration risk and makes it vulnerable to real estate price developments in some regions of Finland.

This is partly mitigated by Hypo's conservative underwriting standards. We consider that Hypo's loan book of €1.3 billion demonstrates strong asset quality underpinned by a high level of collateralization, with a weighted average loan-to-value ratio (LTV) of 43.0% as of June 30, 2015, which we assess to be lower than that of many specialized mortgage lenders in Europe. We understand that Hypo uses more conservative haircuts than competitors on the market values of real estate, depending on the type of residential collateral, and we consider the collateral to be relatively liquid because Hypo is active only in the Helsinki metropolitan area and larger cities in Finland. The average maturity of the new loans is about 16 years, but the average duration of the total loan portfolio is much shorter, at 5-6 years.

We note that Hypo also finances housing companies under construction in the Helsinki metropolitan area and growth centers (3% of total loan portfolio), which in our view represents higher risk than residential lending. The lending is solely against housing property collateral and the drawings under the facility are possible only according to the statement of readiness, such that the amount lent is always lower than the collateral value. Accordingly, the average LTV ratio on housing companies in the construction phase in Hypo's portfolio is 41%, below the average LTV of Hypo's overall portfolio. These exposures have an average tenor of 1.0-1.5 years and turn into housing company loans once the construction phase is over. We positively note that these financing projects (so-called RS-loans) are under close scrutiny by the Finnish regulator and regulated under the Housing Transaction Act since the crises in the 1990s.

We consider Hypo's targeted loan growth of 20%-25%, which we anticipate will be split relatively evenly between retail and housing companies, as challenging but not overly aggressive, considering that it has intentionally slowed loan portfolio increases in the past. We do not expect the bank will compromise its cornerstone conservative lending policies and high level of collateralization.

Furthermore, we do not expect Hypo's property investment portfolio, amounting to €62 million as of June 30, 2015 (3.7% of its assets), will weaken the bank's overall risk profile. The portfolio consists of Hypo's headquarters, holdings in non-listed property funds with investment in residential property land (with long-term rental agreements for multifamily housing companies, typically 50 years), and rented apartments mainly in highly valued residential areas in the Helsinki metropolitan area. That Hypo has no investments in commercial real estate further supports our assessment of the bank's risk position.

Hypo demonstrates an exceptional loan loss track record. Total credit losses are almost nonexistent, and losses in the past have resulted solely from household customers. To date, Hypo has not experienced credit losses from housing companies, housing companies with properties under construction, or housing investors, which demonstrates the bank's risk approach. We anticipate that total nonperforming loans will remain at the current low level of 0.2% of the loan portfolio (0.24% as of June 30, 2015). Given the liquidity and high level of the collateral, we consider the reserve level adequate for Hypo's minor nonperforming loans.

Table 5

The Mortgage Society of Finland Risk Position

		--Year ended Dec. 31--			
(%)	2015*	2014	2013	2012	2011
Growth in customer loans	17.3	23.1	34.9	17.9	18.1
Total diversification adjustment/S&P RWA before diversification	N.M.	70.9	N.M.	N.M.	N.M.
Total managed assets/adjusted common equity (x)	17.0	15.6	13.6	11.0	10.3
New loan loss provisions/average customer loans	(0.0)	0.0	(0.0)	0.0	(0.0)
Gross nonperforming assets/customer loans + other real estate owned	0.2	0.2	0.1	0.1	0.2
Loan loss reserves/gross nonperforming assets	N/A	12.6	32.3	30.7	24.0

*Data as of June 30. RWA--Risk-weighted assets. N/A--Not applicable. N.M.--Not meaningful.

Funding and liquidity: Matched funding profile but dependence on wholesale funding

We consider Hypo's funding to be "below average," due to its predominantly wholesale funding profile, and its liquidity position to be "adequate."

Much of Hypo's funding is done via wholesale funding, representing about 52% of total funding as of June 30, 2015, and is composed mainly of senior unsecured bonds issued under a €900 million medium-term note program and certificates of deposit (CD) under a €200 million CD program. Short-term wholesale funding share has decreased to about 19% of wholesale funding as of June 30, 2015. As a consequence of the predominantly wholesale profile, Hypo's loan-to-deposit ratio continues to be weak. It exceeded 175% as of midyear 2015 and is consequently substantially higher than that of its domestic peers. We view positively the well-matched funding profile, with the long-term funding ratio equaling about 83%.

Hypo has gradually increased the customer deposits collected through deposit-taking subsidiary AsuntoHypoPankki (AHP), which now constitute about 48% of the funding base (versus less than one-third as of year-end 2013). We expect their share to be around 50% over the next two years, still below the level of domestic peers. Furthermore, the deposits are mainly collected from housing companies and institutional clients, which we consider in general to be less stable than retail customer deposits, in times of stress. Approximately 15% of Hypo's customer deposits are covered by the Finnish deposit guarantee fund.

In order to improve its funding profile, Hypo aims to spread the maturities of its senior unsecured funding, which we believe will result in a Standard & Poor's stable funding ratio of about 100%, compared with 95% as of June 30, 2015. Hypo's current asset encumbrance is, in our view, very low.

We consider Hypo's liquidity to be "adequate," because we believe that the bank will be able to survive under stressful conditions for more than six months. In order to comply with new regulatory requirements in Finland, Hypo has optimized its liquidity portfolio, amounting to €312 million, by increasing the size and by shifting the allocation chiefly to government and covered bonds. Currently, about one-half of investments are in central governments and the remainder is invested in covered bonds and in financial institutions, and 97% is invested in counterparties with a rating of 'A' or above. The liquidity portfolio consists almost fully of European Central Bank-eligible securities. As anticipated, these planned measures have improved our liquidity metrics for Hypo--namely broad liquid assets to short-term wholesale funding--to about 0.9x as of June 30, 2015, compared with 0.74x on Dec. 31, 2013. We have incorporated the expected further strengthening of liquidity metrics to 1.0x by year-end 2015 into our assessment of the bank's liquidity as adequate.

Table 6

The Mortgage Society of Finland Funding And Liquidity					
		--Year ended Dec. 31--			
(%)	2015*	2014	2013	2012	2011
Core deposits/funding base	47.6	34.0	28.4	33.1	27.6
Customer loans (net)/customer deposits	175.4	257.2	310.2	270.0	309.6
Long-term funding ratio	82.5	82.0	83.2	73.9	72.4
Stable funding ratio	94.8	93.3	92.6	79.8	79.4
Short-term wholesale funding/funding base	18.6	19.3	18.1	28.7	30.5
Broad liquid assets/short-term wholesale funding (x)	0.9	0.8	0.7	0.4	0.4
Net broad liquid assets/short-term customer deposits	(4.3)	(10.1)	(20.5)	(72.4)	(102.2)
Short-term wholesale funding/total wholesale funding	35.5	29.2	25.2	42.9	42.1
Narrow liquid assets/3-month wholesale funding (x)	4.7	1.5	1.8	1.2	1.4

*Data as of June 30.

External support: No notches of uplift to the SACP

We consider Hypo to be of "low" systemic importance and consequently do not factor any extraordinary government support into the ratings.

Additional rating factors: None

No additional factors affect this rating

Related Criteria And Research

Related Criteria

- Revised Market Risk Charges For Banks In Our Risk-Adjusted Capital Framework, June 22, 2012
- Banks: Rating Methodology And Assumptions, Nov. 9, 2011
- Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- Bank Capital Methodology And Assumptions, Dec. 6, 2010
- Methodology For Mapping Short- And Long-Term Issuer Credit Ratings For Banks, May 4, 2010
- Use Of CreditWatch And Outlooks, Sept. 14, 2009

Related Research

- The Mortgage Society of Finland Rated 'BBB/A-3'; Outlook Negative, Aug. 31, 2015
- Banking Industry Country Risk Assessment Update, August 2015, Aug. 20, 2015
- Capital Continues To Drive Improvements in Nordic Banks' Credit Profiles, July 27, 2015
- Banking Industry Country Risk Assessment: Finland, Jan. 29, 2015

Anchor Matrix

Industry Risk	Economic Risk									
	1	**2**	3	4	5	6	7	8	9	10
1	a	a	a-	bbb+	bbb+	bbb	-	-	-	-
2	a	a-	a-	bbb+	bbb	bbb	bbb-	-	-	-
3	a-	**a-**	bbb+	bbb+	bbb	bbb-	bbb-	bb+	-	-
4	bbb+	bbb+	bbb+	bbb	bbb	bbb-	bb+	bb	bb	-
5	bbb+	bbb	bbb	bbb	bbb-	bbb-	bb+	bb	bb-	b+
6	bbb	bbb	bbb-	bbb-	bbb-	bb+	bb	bb	bb-	b+
7	-	bbb-	bbb-	bb+	bb+	bb	bb	bb-	b+	b+
8	-	-	bb+	bb	bb	bb	bb-	bb-	b+	b
9	-	-	-	bb	bb-	bb-	b+	b+	b+	b
10	-	-	-	-	b+	b+	b+	b	b	b-

Ratings Detail (As Of September 17, 2015)

The Mortgage Society of Finland	
Counterparty Credit Rating	BBB/Negative/A-3
Counterparty Credit Ratings History	
31-Aug-2015	BBB/Negative/A-3
Sovereign Rating	
Finland (Republic of)	AA+/Stable/A-1+

*Unless otherwise noted, all ratings in this report are global scale ratings. Standard & Poor's credit ratings on the global scale are comparable across countries. Standard & Poor's credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.

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