

# RatingsDirect®

---

**Research Update:**

## The Mortgage Society of Finland 'BBB/A-2' Ratings Affirmed On Unchanged Asset Quality And Capitalization; Outlook Stable

**Primary Credit Analyst:**

Cihan Duran, Frankfurt (49) 69-33-999-242; cihan.duran@spglobal.com

**Secondary Contact:**

Salla von Steinaecker, Frankfurt (49) 69-33-999-164; salla.vonsteinaecker@spglobal.com

### Table Of Contents

---

Overview

Rating Action

Rationale

Outlook

Ratings Score Snapshot

Related Criteria

Related Research

Ratings List

## Research Update:

# The Mortgage Society of Finland 'BBB/A-2' Ratings Affirmed On Unchanged Asset Quality And Capitalization; Outlook Stable

## Overview

- The Mortgage Society of Finland (Hypo) continues to expand in its small niche focusing on well-collateralized mortgage loans to households and housing companies in the Helsinki metropolitan area.
- We project that Hypo will maintain high capital ratios offsetting its loan portfolio concentrations, but it remains more dependent on wholesale funding and therefore on preserving appropriate levels of liquidity for stress events than peers.
- We are affirming our 'BBB/A-2' long- and short-term issuer credit ratings on Hypo.
- The stable outlook reflects our projection of continued sound economic conditions in Finland and our view that changes to the bank's conservative lending policies and capital management are unlikely over our 12-24 months outlook horizon.

## Rating Action

On July 25, 2018, S&P Global Ratings affirmed its 'BBB/A-2' long- and short-term issuer credit ratings on Finland-based The Mortgage Society of Finland (Hypo). The outlook is stable.

## Rationale

The affirmation reflects our view that Hypo maintains its prudent underwriting standards and very strong capitalization while potentially growing its loan book at a relatively high pace of about 15% annually over the next two to three years. Despite its growth, Hypo remains a small niche player in Finland. It also continues to rely more strongly on senior unsecured wholesale funding despite growing issuance of covered bonds recently.

Hypo operates with a concentrated business model focused on residential mortgage lending to housing companies and households in Helsinki, southern Finland, and in specified growth centers in the rest of the country. Despite strong loan growth in recent years, nearly doubling its customer loans since 2014, it holds only a small market share in Finland, with total assets of €2.7 billion as of March 31, 2018. Moreover, the growth did not result in stronger

profitability as its cost-to-income ratio deteriorated and surpassed 60% in 2017--for the first time since 2012. The ratio was 67.6% in first-quarter 2018, weaker than most banks in the Nordic countries, but we note Hypo's sizable one-time contribution to Finland's Financial Stability Fund. We project that profitability will improve, however, mainly reflecting a higher net interest margin from lower funding costs.

Hypo offsets this rating weakness with very strong capitalization. We expect its risk-adjusted capital ratio to reach 16.0%-16.5% over the next 24 months, compared with 17.1% as of Dec. 31, 2017. The projected decline results from the continued high loan growth outpacing earnings retention.

Its regionally focused mortgage business makes the bank vulnerable to real estate price development in some regions of Finland. That said, its loan loss track record is strong, with a negligible nonperforming loan ratio of 0.13% on March 31, 2018. Also, the bank has very conservative lending policies, in our view. This is demonstrated, for example, by its reported average loan-to-value (LTV) ratio on mortgage loans of 36.5% as of March 31, 2018.

We continue to view Hypo's funding and liquidity as weaker than Finnish peer banks. Funding comes predominantly from wholesale markets, with 43% of total funds representing wholesale instruments as of March 31, 2018. In our view, these are generally more confidence-sensitive and prone to volatility during adverse market and economic conditions. The elevated loan-to-deposit ratio of 156% at the end of first-quarter 2018 is weaker than most banks in Finland and underpins our conservative assessment. We view as positive the increasing share of covered bonds, which leads to an improving funding profile given the long-term lending business on the asset side. Moreover, Hypo's broad liquidity asset to short-term wholesale funding multiple was at 1.4x, an average metric in comparison to rated banks on a global scale. However, Hypo's monoline business model, small size, and relatively high share of wholesale funding may require stronger liquidity buffers in a stress event than at larger more diversified peers.

## **Outlook**

The stable outlook reflects our view that sound construction activity in Finland on the back of an improving economic environment will support Hypo to reach its growth ambitions without diluting its asset quality. It also reflects our view that material changes to the bank's capital management are unlikely over our outlook horizon.

### **Downside scenario**

We could lower the ratings on Hypo in the next 18-24 months if:

- Hypo unexpectedly changes its current conservative lending policies;
- Hypo fails to maintain its very strong capital (for example, by more aggressive business growth without corresponding earnings improvements);

or

- Hypo manages its liquidity buffers more aggressively than currently, leading to a substantial weakening of its liquidity ratios. We view this scenario as unlikely, however.

### Upside scenario

A positive rating action is, in our view, remote at this stage. It could be triggered by an improved funding profile demonstrated by a more diversified funding mix and funding metrics in line with domestic peers'.

## Ratings Score Snapshot

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

## Related Criteria

- Criteria - Financial Institutions - General: Methodology For Assigning Financial Institution Resolution Counterparty Ratings, April 19, 2018
- 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
- General Criteria: Group Rating Methodology, Nov. 19, 2013
- Criteria - Financial Institutions - Banks: Quantitative Metrics For Rating Banks Globally: Methodology And Assumptions, July 17, 2013
- Criteria - Financial Institutions - Banks: Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011

- Criteria - Financial Institutions - Banks: Banks: Rating Methodology And Assumptions, Nov. 9, 2011
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

## **Related Research**

- Banking Industry Country Risk Assessment: Finland, Feb. 2, 2018
- Nordic Banks' Capitalization Should Remain Stable Despite Revised Basel III Standards, Jan. 24, 2018
- The Mortgage Society of Finland, Sept. 14, 2017

## **Ratings List**

### Ratings Affirmed

The Mortgage Society of Finland

Issuer Credit Rating	BBB/Stable/A-2
Senior Unsecured	BBB

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. 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.

Copyright © 2018 by Standard & Poor's Financial Services LLC. All rights reserved.

No content (including ratings, credit-related analyses and data, valuations, model, software or other application or output therefrom) or any part thereof (Content) may be modified, reverse engineered, reproduced or distributed in any form by any means, or stored in a database or retrieval system, without the prior written permission of Standard & Poor's Financial Services LLC or its affiliates (collectively, S&P). The Content shall not be used for any unlawful or unauthorized purposes. S&P and any third-party providers, as well as their directors, officers, shareholders, employees or agents (collectively S&P Parties) do not guarantee the accuracy, completeness, timeliness or availability of the Content. S&P Parties are not responsible for any errors or omissions (negligent or otherwise), regardless of the cause, for the results obtained from the use of the Content, or for the security or maintenance of any data input by the user. The Content is provided on an "as is" basis. S&P PARTIES DISCLAIM ANY AND ALL EXPRESS OR IMPLIED WARRANTIES, INCLUDING, BUT NOT LIMITED TO, ANY WARRANTIES OF MERCHANTABILITY OR FITNESS FOR A PARTICULAR PURPOSE OR USE, FREEDOM FROM BUGS, SOFTWARE ERRORS OR DEFECTS, THAT THE CONTENT'S FUNCTIONING WILL BE UNINTERRUPTED OR THAT THE CONTENT WILL OPERATE WITH ANY SOFTWARE OR HARDWARE CONFIGURATION. In no event shall S&P Parties be liable to any party for any direct, indirect, incidental, exemplary, compensatory, punitive, special or consequential damages, costs, expenses, legal fees, or losses (including, without limitation, lost income or lost profits and opportunity costs or losses caused by negligence) in connection with any use of the Content even if advised of the possibility of such damages.

Credit-related and other analyses, including ratings, and statements in the Content are statements of opinion as of the date they are expressed and not statements of fact. S&P's opinions, analyses and rating acknowledgment decisions (described below) are not recommendations to purchase, hold, or sell any securities or to make any investment decisions, and do not address the suitability of any security. S&P assumes no obligation to update the Content following publication in any form or format. The Content should not be relied on and is not a substitute for the skill, judgment and experience of the user, its management, employees, advisors and/or clients when making investment and other business decisions. S&P does not act as a fiduciary or an investment advisor except where registered as such. While S&P has obtained information from sources it believes to be reliable, S&P does not perform an audit and undertakes no duty of due diligence or independent verification of any information it receives. Rating-related publications may be published for a variety of reasons that are not necessarily dependent on action by rating committees, including, but not limited to, the publication of a periodic update on a credit rating and related analyses.

To the extent that regulatory authorities allow a rating agency to acknowledge in one jurisdiction a rating issued in another jurisdiction for certain regulatory purposes, S&P reserves the right to assign, withdraw or suspend such acknowledgment at any time and in its sole discretion. S&P Parties disclaim any duty whatsoever arising out of the assignment, withdrawal or suspension of an acknowledgment as well as any liability for any damage alleged to have been suffered on account thereof.

S&P keeps certain activities of its business units separate from each other in order to preserve the independence and objectivity of their respective activities. As a result, certain business units of S&P may have information that is not available to other S&P business units. S&P has established policies and procedures to maintain the confidentiality of certain non-public information received in connection with each analytical process.

S&P may receive compensation for its ratings and certain analyses, normally from issuers or underwriters of securities or from obligors. S&P reserves the right to disseminate its opinions and analyses. S&P's public ratings and analyses are made available on its Web sites, [www.standardandpoors.com](http://www.standardandpoors.com) (free of charge), and [www.ratingsdirect.com](http://www.ratingsdirect.com) and [www.globalcreditportal.com](http://www.globalcreditportal.com) (subscription), and may be distributed through other means, including via S&P publications and third-party redistributors. Additional information about our ratings fees is available at [www.standardandpoors.com/usratingsfees](http://www.standardandpoors.com/usratingsfees).

STANDARD & POOR'S, S&P and RATINGSDIRECT are registered trademarks of Standard & Poor's Financial Services LLC.