S&P Global Ratings

RatingsDirect®

Mortgage Society of Finland (The)

Primary Credit Analyst:
Salla von Steinaecker, Frankfurt + 49 693 399 9164; salla.vonsteinaecker@spglobal.com

Secondary Contact:
Niklas Dahlstrom, Stockholm +46 84405358; niklas.dahlstrom@spglobal.com

Research Contributor:
Daniella Vasilevski, Stockholm; daniella.vasilevski@spglobal.com

Table Of Contents

Ratings Score Snapshot

Credit Highlights

Outlook

Key Metrics

Anchor: 'a'- For Banks Operating Purely In Finland

Business Position: Monoline Profile As Residential Mortgage Financer In Finland

Capital And Earnings: Robust Capitalization Supported By Profit Retention As A Mutual Company

Risk Position: Concentration Risk Is Somewhat Mitigated By Unparalleled Asset Quality And Loan-Loss Track Record

Funding And Liquidity: Elevated Dependence On Wholesale Funding Requires Prudent Liquidity Management

Table Of Contents (cont.)

Support: No Uplift For External Support And No Resolution Counterparty Ratings

Environmental, Social, And Governance

Key Statistics

Related Criteria

Related Research

Mortgage Society of Finland (The)

Ratings Score Snapshot

Issuer Credit Rating
BBB/Stable/A-2

SACP: bbb → **Support: 0** → **Additional factors: 0**

SACP: bbb		
Anchor	a-	
Business position	Constrained	-2
Capital and earnings	Very strong	+2
Risk position	Moderate	-1
Funding	Moderate	-1
Liquidity	Adequate	
CRA adjustment		0

Support: 0	
ALAC support	0
GRE support	0
Group support	0
Sovereign support	0

Issuer credit rating
BBB/Stable/A-2

ALAC--Additional loss-absorbing capacity. CRA--Comparable ratings analysis. GRE--Government-related entity. ICR--Issuer credit rating. SACP--Stand-alone credit profile.

Credit Highlights

Overview

Key strengths	Key risks
Very strong risk-adjusted capitalization (RAC).	Monoline business model as pure residential mortgage financer.
Strong asset quality and exceptional decades-long loan-loss track record.	Concentration and cyclical risk in the lending book.
Very conservative lending and underwriting standards with a focus on urban areas.	Less stable deposit base and higher share of wholesale funding than domestic peers'

We expect The Mortgage Society of Finland (Hypo) will continue to demonstrate superior asset quality and an exceptional loan-loss track record despite a muted macroeconomic landscape. Hypo continues to show robust asset quality in its solely residential real estate loan portfolio, with a nonperforming loan (NPL) ratio of 0.14% and marginal credit losses of 1 basis point as of June 30, 2023. This is thanks to Hypo's conservative and selective underwriting standards and sole focus on residential mortgage lending in growing urban regions in Finland. We do not expect the company to compromise its prudential approach, nor do we foresee NPLs materially increasing in the next two years.

Hypo has a solid capital position, but we remain aware of its modest earnings capacity. Its capital position is such that it could withstand potential shocks, with projected RAC of 18%-19% through 2024 and a RAC ratio of 18.1% as of June 30, 2023. After muted growth--stemming from its decision to focus resources on a core banking system overhaul in 2022--Hypo's loan book has once more started to expand. We expect its operating efficiency to improve over the next few years as it leverages new technologies and benefits from the higher interest rate environment.

Hypo's greater reliance on wholesale funding and its primarily institutional deposit base mean careful liquidity management is key. The bank's funding profile remains more confidence sensitive than those of domestic universal banks. The decline in deposit growth continued in the first half of 2023, with core customer deposits constituting 40% of the funding base, mainly from institutional clients. Hypo refinanced maturing covered bonds in the first half, demonstrating its access to capital markets. Its heavy reliance on wholesale funding requires prudent liquidity management and we expect it will maintain a sound liquidity buffer through 2024.

Outlook

The stable outlook reflects our view that Hypo's creditworthiness will remain resilient over the next two years, supported by the bank's conservative underwriting standards, high and stable asset quality, and very strong capitalization. It also reflects our view that noteworthy changes to the bank's capital management are unlikely over the next two years.

Downside scenario

We could lower the rating on Hypo in the next 12-24 months if it unexpectedly changes its current conservative lending policies or it fails to maintain its very strong capital, for example via more ambitious business growth without corresponding earnings improvements.

Upside scenario

We could raise the rating if the bank's funding profile improves, demonstrated by a more diversified funding mix and funding metrics in line with domestic peers. We could also reassess the bank's capital and earnings and risk positions if it keeps demonstrating greater resilience than similarly rated peers.

Key Metrics

Mortgage Society of Finland (The)--Key ratios and forecasts

	--Fiscal year ended Dec. 31 --				
(%)	**2021a**	**2022a**	**2023f**	**2024f**	**2025f**
Growth in operating revenue	16.1	-5.6	7.5-9.2	10.5-12.9	4.9-6.0
Growth in customer loans	5.0	4.3	5.4-6.6	5.4-6.6	5.4-6.6
Growth in total assets	3.5	4.1	4.6-5.6	4.6-5.6	4.6-5.7
Net interest income/average earning assets (NIM)	0.6	0.5	0.6-0.7	0.7-0.7	0.7-0.7
Cost to income ratio	69.0	71.2	67.9-71.4	63.8-67.1	63.6-66.8
Return on average common equity	4.7	3.9	5.0-5.5	4.7-5.2	4.7-5.2
Return on assets	0.2	0.2	0.2-0.3	0.2-0.2	0.2-0.2
New loan loss provisions/average customer loans	0.0	0.0	0.0-0.0	0.0-0.0	0.0-0.0
Gross nonperforming assets/customer loans	0.1	0.1	0.2-0.2	0.1-0.2	0.1-0.2

Mortgage Society of Finland (The)--Key ratios and forecasts (cont.)					
	--Fiscal year ended Dec. 31 --				
(%)	**2021a**	**2022a**	**2023f**	**2024f**	**2025f**
Risk-adjusted capital ratio	17.9	18.0	17.5-18.4	17.6-18.5	17.8-18.7

All figures are S&P Global Ratings-adjusted. a--Actual. f--Forecast. NIM--Net interest margin.

Anchor: 'a'- For Banks Operating Purely In Finland

Under our bank criteria, we use our Banking Industry Country Risk Assessment (BICRA) economic risk and industry risk scores to determine the anchor, the starting point for our bank rating. The anchor for Hypo is 'a-', in line with that for commercial banks based in Finland. We classify Finland's banking sector in group '2' under our BICRA, alongside Sweden, Norway, Belgium, and Switzerland. The economic and industry risk trends for Finland's BICRA are stable.

We view Finland as an innovative, wealthy, small, and open economy that has mature political and institutional structures. After GDP growth of 2.1% in 2022, we now project the Finnish economy will stagnate in 2023 followed by moderate growth of 1.1%-1.4% in 2024-2025. Even though inflation has likely peaked, interest rates remain high. The resulting decrease in real disposable incomes of households affects their purchasing power. More muted consumer and business confidence could weaken the banking sector's growth prospects.

We do not see material economic imbalances in the Finnish economy, but house prices are expected to be 5%-7% lower across Finland this year, with an expected rebound in 2024 and thereafter. That said, increasing household debt, a weaker labor market combined with weaker consumer and business confidence could eventually lead to higher credit losses for banks.

In our view, regulatory standards and bank supervision in Finland are in line with those of European peers. The banking sector is dominated by two major banking groups, OP Financial Group and Nordea, and characterized by intense competition and low lending margins. That said, we believe that overall profitability and capitalization will remain resilient. We also expect banks to maintain their restrained risk appetites. In our view, the risk of technology disruption remains moderate given that banks are at the forefront of digitalization and continue to invest in innovation and digital capabilities.

Finnish banks will remain dependent on external funding, which makes them vulnerable to changes in confidence sensitivity and higher interest rates. That said, they continue to demonstrate good access to capital markets. In addition, the Nordic banking system remains highly interconnected, which results in potential spillover risks from external events.

Business Position: Monoline Profile As Residential Mortgage Financer In Finland

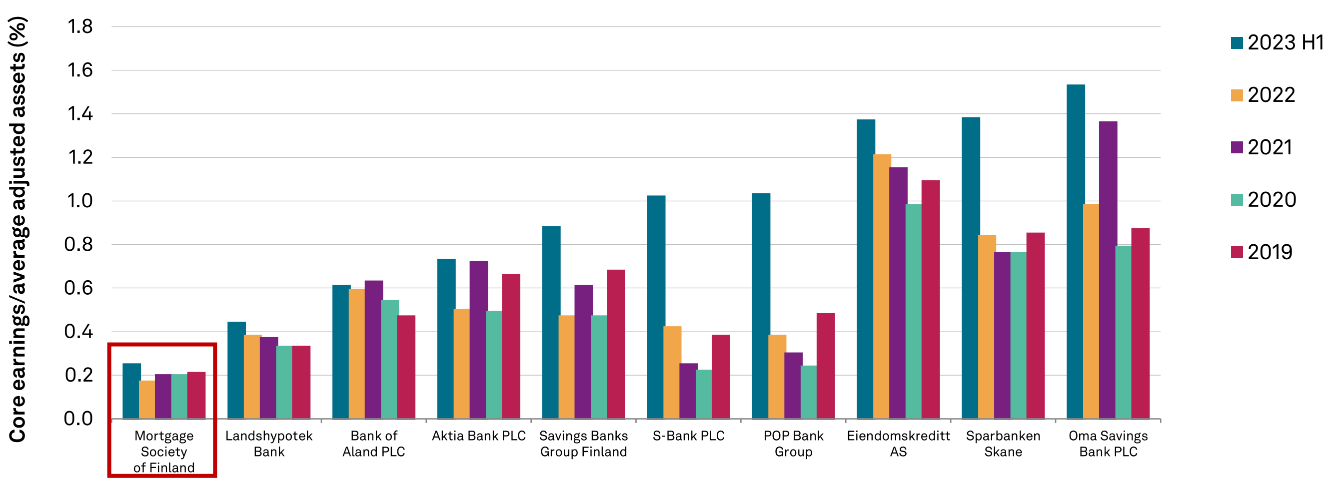
With total assets of €3.5 billion and a loan portfolio of €2.8 billion as of June 30, 2023, we view Hypo as a small player in the Finnish banking sector (market share of 1% in 2022). Its niche focus is purely on low-risk residential mortgage lending to households and housing companies. Finnish households account for 30% of the portfolio and housing companies 69%, all secured by residential property collateral. Hypo underwrites solely in urban areas in Finland--Helsinki, southern Finland, and other growth centers--benefitting from ongoing urbanization trends.

We continue to view Hypo's narrow product focus on residential mortgage lending as the main constraint on its business model. It could expose the bank to potential volatility in the real estate market in Finland. However, our expectation of ongoing business stability given Hypo's selective business underwriting partly offsets this concentration. Its business profile is also underpinned by its mutual legal structure, which subordinates short-term financial profitability targets in favor of providing long-term value to customers while maintaining conservative capital management.

Following the successful implementation of a core banking system in early 2022, we believe Hypo is well positioned to resume loan growth. Combined with the expected improvement in operating efficiency, this will support Hypo's ambition to increase its profitability in the medium term.

Chart 1

Hypo's low-risk lending translates into low core profitability compared with peers



Source: S&P Global Ratings.

The rapid increase in interest rates is putting some pressure on the Hypo's profitability in the form of higher funding costs and delays in repricing the loan side in a highly competitive mortgage market. Consequently, its net interest margin declined to 0.55% in first-half 2023, from its peak of 0.62% in 2021, and is significantly lower than its more diversified peers. Given the high share of wholesale funding weighing on funding costs, we expect only a small increase in the net interest margin in 2023-2024. The cost-to-income ratio materially improved to 59% in first-half 2023 from 71% in 2022, but we expect ongoing IT investments to weigh on Hypo's cost-to-income ratio in the next two years.

Capital And Earnings: Robust Capitalization Supported By Profit Retention As A Mutual Company

Hypo's capitalization should remain very strong over the next two years based on our projected RAC ratio remaining 18.0%-19.0% throughout 2024, after reaching 18.1% in first-half 2023.

We do not foresee Hypo's management strategy changing. We project loan growth of 4.0%-6.0% in the next two years depending on overall market activity and we believe management will focus on maintaining relatively stable but low margins. Loan growth will be balanced between retail and housing company loans, underlining Hypo's low risk appetite.

Hypo's revenue largely stems from net interest income (58% in first half of 2023) and net fee and commission income (18%), while stable income from property holdings constitutes a minor part. Although Hypo's income stream from property holdings, comprising mainly buy-to-let residences and parking spaces, is unusual compared with domestic banks, its assets are high quality and it does not have an opportunistic approach to achieving quick market-value gains.

Given Hypo's mutual legal status, implying no dividend distributions, retained profits are used solely for capital building, which we believe will remain reasonably predictable over the next two years.

Hypo's regulatory capital position remains strong with significant buffers to the regulatory requirements. At the end of June 2023, the CET1 and total capital ratio stood at 13.90%, against a capital requirement of 11.25%. Furthermore, Hypo's quality of capital remains strong as its capital base consists solely of core capital. However, its status as a mutual company may pose a constraint if it needs to raise additional core capital in the market. We consider this weakness to be captured in our combined view of Hypo's capital and risk position.

Risk Position: Concentration Risk Is Somewhat Mitigated By Unparalleled Asset Quality And Loan-Loss Track Record

In our view, the regionally focused mortgage loan book, combined with some concentrations in larger housing companies, makes the bank vulnerable to real estate price developments in some areas of Finland. This concentration risk is partly mitigated by Hypo's prudent underwriting standards, demonstrated by a very low loan-to-value ratio of 30.5%, which we do not expect it to compromise.

The bank clearly distinguishes itself through its historically superior asset quality--NPLs, measured as Stage 3 loans, were 0.14% in the first half of 2023--further underpinned by its high level of collateralization. Hypo's loss experience, defined as new loan loss provisions to average customer loans, also outperforms the market and stood at 1 basis point as of June 30, 2023.

We understand that since the Finnish banking crisis in the 1990s Hypo has experienced no credit losses from housing companies, housing companies with properties under construction, or housing investors, which demonstrates the bank's risk approach. Hypo's loan-loss track record in recent decades and the pandemic-induced downturn is outstanding compared with peers', in our view.

Chart 2

Hypo demonstrates superior asset quality compared with peers

Gross nonperforming assets to customer loans + other real estate owned

*Figure refers to Q1. Source: S&P Global Ratings.

We do not expect the bank will abandon its conservative credit policies and high collateralization for targeted loan growth. This is why we anticipate Hypo's exceptional loan-loss track record will continue in 2023-2024, with NPLs remaining close to current levels and well below the average of peer banks.

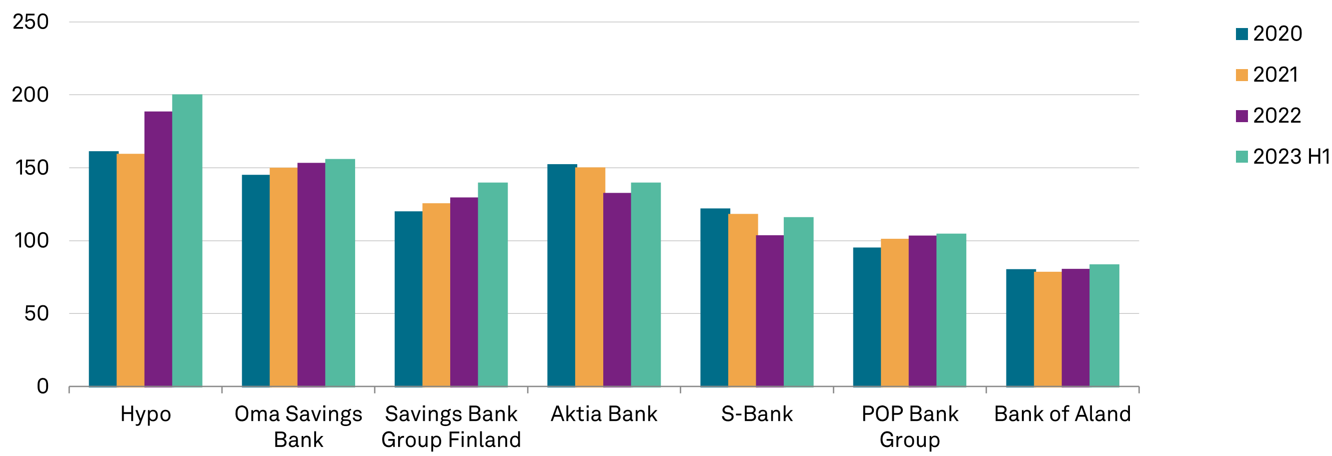
Funding And Liquidity: Elevated Dependence On Wholesale Funding Requires Prudent Liquidity Management

Hypo's funding profile remains more confidence-sensitive and prone to volatility during adverse market and economic conditions than domestic peers'. This reflects Hypo's largely wholesale funding profile, with covered bonds representing 46% of total funds on June 30, 2023. Despite capital markets volatility, Hypo has demonstrated its access to the bond market by issuing a €300 million covered bond in March 2023, replacing a maturing issuance. Through the issuance of covered bonds, Hypo continues to improve its funding maturity, resulting in a well-matched funding profile.

Chart 3

Hypo has a higher funding gap to fill than its domestic peers

Customer loans (net)/customer deposits (%)



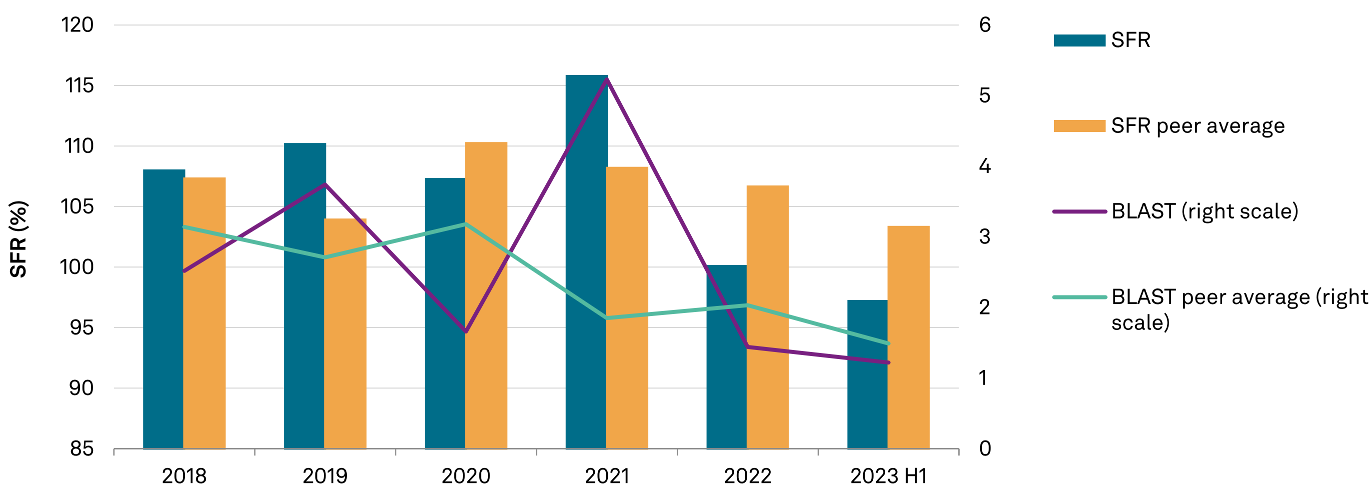
Source: S&P Global Ratings.

Core customer deposits (collected through 100% subsidiary Suomen AsuntoHypoPankki) comprised about 44% of funding as of June 30, 2023, and showed a declining trend in the first half of the year. Institutional clients make up most deposits at 46%, which we view as less stable in times of stress, especially given that only 17% of total deposits are covered by the Finnish deposit guarantee scheme. This translates into an elevated loan-to-deposit ratio of 200% in 2023, which is weaker than domestic and Nordic peers'.

Chart 4

Hypo's funding and liquidity metrics reflect the dependence on wholesale funding

SFR and BLAST of Hypo and its domestic peers



Note: SFR- Stable Funding Ratio. BLAST- Broad liquid assets/short-term wholesale funding. Peer set includes OP Financial Group, Eiendomskreditt, Oma Savings Bank, Savings Banks Group Finland, Aktia Bank, S-Bank, Bank of Aland, POP Bank, Sparbanken Skane and Landshypotek. S-Bank was excluded from BLAST Peer average. Source: S&P Global Ratings.

As of June 30, 2023, the bank had a stable funding ratio of 97.2%, covering the loan book and other stable funding needs. Although its covered bonds issuance caused asset encumbrance to exceed 50% at year-end 2022, we believe Hypo still has the capacity for further issuances.

Hypo holds adequate liquidity reserves to withstand stress with an adjusted liquidity portfolio of about €569 million (16% of total assets) on June 30, 2023. Some 83% of cash is at the Finnish Central Bank and in European Central Bank-eligible debt securities with a credit rating of at least 'AA-'. Moreover, Hypo's multiple of broad liquid assets to short-term wholesale funding improved to 1.22x as of June 30, 2023, indicating an adequate ability to cover maturing short-term wholesale debt. Hypo's sound liquidity buffer is also demonstrated by its regulatory liquidity coverage ratio of 256.1% as of June 30, 2023, meeting the regulatory minimum of 100% by a large margin.

In our view, Hypo may need stronger liquidity buffers in a stress event due to its monoline business model, small size, and less stable funding profile compared with more diversified peers. We could therefore take a more negative view of Hypo's liquidity profile if the bank manages its liquidity buffers more aggressively, leading to a substantial weakening of its liquidity ratios.

Support: No Uplift For External Support And No Resolution Counterparty Ratings

In our view, Finland has had a fully-fledged resolution regime in place since January 2016. Because Hypo has low systemic importance, with a market share of less than 1% in customer deposits, we believe the response, were Hypo to become nonviable, would not be a bail-in resolution. Therefore, we do not apply our additional loss-absorbing criteria, nor do we view Hypo as eligible for our resolution counterparty rating (RCR). RCRs recognize the default risk of certain bank liabilities that rank senior to other liabilities in a resolution.

Environmental, Social, And Governance

We consider ESG factors for Hypo to be broadly in line with those of industry and domestic peers, and expect the company will formalize its ESG framework over the next two years.

We believe that Hypo's focus on providing purely residential mortgages and housing company loans, in particular for renovation purposes, will help extend the life of buildings and thereby support general environmental goals.

Social factors remain neutral for our credit assessment of Hypo. We see the maintenance of sound and reliable corporate governance as critical for Hypo. As a mutual company operating under the Act on Mortgage Societies, it remains governed by its member customers and provides financing and other services for the benefit of its owners. Overall, we consider the bank to have a stable senior management team and business strategy, with effective execution and internal controls.

Key Statistics

Table 1

Mortgage Society of Finland (The)--Key figures					
	--Fiscal year end Dec. 31--				
(Mil. €)	**2023**	**2022**	**2021**	**2020**	**2019**
Adjusted assets	3,514.2	3,450.8	3,315.7	3,206.2	3,227.0
Customer loans (gross)	2,805.4	2,750.1	2,637.2	2,511.2	2,586.4
Adjusted common equity	144.6	140.1	134.1	129.2	125.4
Operating revenues	13.7	24.6	26.1	22.5	20.7
Noninterest expenses	8.1	17.5	18.0	14.4	12.3
Core earnings	4.4	5.8	6.6	6.6	6.8

Table 2

Mortgage Society of Finland (The)--Business position					
	--Fiscal year end Dec. 31--				
(%)	**2023**	**2022**	**2021**	**2020**	**2019**
Loan market share in country of domicile	1.0	1.0	1.0	1.0	1.0
Deposit market share in country of domicile	0.7	0.7	0.8	0.8	1.0

Table 2

Mortgage Society of Finland (The)--Business position (cont.)					
	--Fiscal year end Dec. 31--				
(%)	**2023**	**2022**	**2021**	**2020**	**2019**
Total revenues from business line (currency in millions)	13.7	24.6	26.1	22.5	20.7
Commercial & retail banking/total revenues from business line	100.0	100.0	100.0	100.0	100.0
Return on average common equity	5.8	3.9	4.7	4.9	5.5

Table 3

Mortgage Society of Finland (The)--Capital and earnings					
	--Fiscal year end Dec. 31--				
(%)	**2023**	**2022**	**2021**	**2020**	**2019**
Tier 1 capital ratio	13.9	13.8	13.6	13.9	13.4
S&P Global Ratings' RAC ratio before diversification	N/A	18.0	17.9	18.3	16.9
S&P Global Ratings' RAC ratio after diversification	N/A	10.8	10.6	10.2	10.0
Adjusted common equity/total adjusted capital	100.0	100.0	100.0	100.0	100.0
Net interest income/operating revenues	58.3	62.0	66.2	64.8	69.8
Fee income/operating revenues	18.4	14.6	15.6	16.4	17.2
Market-sensitive income/operating revenues	(0.7)	11.4	6.7	4.1	(0.5)
Cost to income ratio	59.4	71.2	69.0	63.9	59.6
Preprovision operating income/average assets	0.3	0.2	0.2	0.3	0.3
Core earnings/average managed assets	0.3	0.2	0.2	0.2	0.2

N/A--Not applicable.

Table 5

Mortgage Society of Finland (The)--Risk position					
	--Fiscal year end Dec. 31--				
(%)	**2023**	**2022**	**2021**	**2020**	**2019**
Growth in customer loans	4.0	4.3	5.0	(2.9)	(0.1)
Total diversification adjustment/S&P Global Ratings' RWA before diversification	N/A	65.9	69.3	78.6	68.2
Total managed assets/adjusted common equity (x)	24.4	24.7	24.8	24.9	25.8
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	0.1	0.1	0.1	0.1	0.1
Loan loss reserves/gross nonperforming assets	7.5	6.0	5.4	11.3	9.1

Table 6

Mortgage Society of Finland (The)--Funding and liquidity					
	--Fiscal year end Dec. 31--				
(%)	**2023**	**2022**	**2021**	**2020**	**2019**
Core deposits/funding base	44.0	46.3	53.0	51.9	53.6
Customer loans (net)/customer deposits	199.6	187.9	158.8	160.7	158.8
Long-term funding ratio	86.0	89.0	96.6	88.7	96.2
Stable funding ratio	97.2	100.1	115.8	107.3	110.2
Short-term wholesale funding/funding base	14.6	11.5	3.6	11.8	3.9

Table 6

Mortgage Society of Finland (The)--Funding and liquidity (cont.)					
	--Fiscal year end Dec. 31--				
(%)	**2023**	**2022**	**2021**	**2020**	**2019**
Regulatory net stable funding ratio	109.9	106.5	114.1	N/A	N/A
Broad liquid assets/short-term wholesale funding (x)	1.2	1.4	5.2	1.7	3.7
Broad liquid assets/total assets	16.1	15.2	17.7	18.3	13.8
Broad liquid assets/customer deposits	40.5	35.9	35.4	37.7	27.4
Net broad liquid assets/short-term customer deposits	7.4	11.0	28.5	14.9	20.1
Regulatory liquidity coverage ratio (LCR) (x)	256.1	201.6	179.9	N/A	N/A
Short-term wholesale funding/total wholesale funding	26.1	21.5	7.6	24.5	8.5
Narrow liquid assets/3-month wholesale funding (x)	N/A	9.2	20.3	21.1	77.7

N/A--Not applicable.

The Mortgage Society of Finland--Rating component scores	
Issuer Credit Rating	**BBB/Stable/A-2**
SACP	bbb
Anchor	a-
Economic risk	2
Industry risk	3
Business position	Constrained
Capital and earnings	Very strong
Risk position	Moderate
Funding	Moderate
Liquidity	Adequate
Comparable ratings analysis	0
Support	0
ALAC support	0
GRE support	0
Group support	0
Sovereign support	0
Additional factors	0

ALAC--Additional loss-absorbing capacity. GRE--Government-related entity. SACP--Stand-alone credit profile.

Related Criteria

- Criteria | Financial Institutions | General: Financial Institutions Rating Methodology, Dec. 9, 2021
- Criteria | Financial Institutions | Banks: Banking Industry Country Risk Assessment Methodology And Assumptions, 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

- Banking Industry Country Risk Assessment Update: August 2023, Aug 31, 2023
- Global Banks Midyear Outlook 2023: Resilience Will Be Tested, July 20, 2023
- European Housing Markets: Sustained Correction Ahead, Jul 20, 2023
- Global Banks: Our Credit Loss Forecasts: Rising Losses Amid Growing Risks, July 13, 2023
- Banking Risk Indicators: May 2023 Update, May 2, 2023
- Norwegian And Finnish Covered Bond Market Insights 2023, Apr 18, 2023
- Banking Industry Country Risk Assessment: Finland, June 1, 2022

Ratings Detail (As Of September 21, 2023)*	
Mortgage Society of Finland (The)	
Issuer Credit Rating	BBB/Stable/A-2
Senior Secured	AAA/Stable
Issuer Credit Ratings History	
22-Jan-2021	BBB/Stable/A-2
19-May-2020	BBB/Negative/A-2
26-Apr-2017	BBB/Stable/A-2
Sovereign Rating	
Finland	AA+/Stable/A-1+

*Unless otherwise noted, all ratings in this report are global scale ratings. S&P Global Ratings' credit ratings on the global scale are comparable across countries. S&P Global Ratings' 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.