Research Update:

Finland-based S-Bank Upgraded To 'BBB+' From 'BBB' On Improved Profitability;Outlook Stable

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Overview

- We expect Finland-based S-Bank PLC will sustain sound profitability despite a gradual decline in market interest rates.
- At the same time, we think the upcoming acquisition of Handelsbanken's private customer business will strengthen S-Bank's retail franchise and market position, supporting the bank's earnings through increased scalability and cross-selling opportunities.
- We therefore raised our long-term issuer credit rating on S-Bank to 'BBB+' from 'BBB' and affirmed our 'A-2' short-term rating on the bank.
- The stable outlook reflects our expectations that S-Bank will sustain a profitable franchise while maintaining robust capitalization; and that the bank will integrate Handelsbanken's retail portfolio.

Rating Action

On June 28, 2024, S&P Global Ratings raised its long-term issuer credit rating on S-Bank to 'BBB+' from 'BBB'. At the same time, we affirmed our 'A-2' short-term rating on the bank. We also raised our long-term resolution counterparty rating to 'A-' from 'BBB+' and affirmed our 'A-2' short-term resolution counterparty rating on S-Bank. The outlook is stable.

Rationale

The upgrade reflects our expectation that S-Bank will sustain its improved sound profitability over the next two years, and our view that we no longer see it as a negative performer in its peer group. The short-term fixing of loans, with the majority tied to 12-month Euribor, coupled with cost effective retail-deposit funding have resulted in a significant earnings uplift for the bank in 2023 and first-quarter 2024. Net interest income and pre-tax profits rose €153 million and €103 million, respectively, in 2023 (up 126% and 230%) and was largely stable quarter-on-quarter in first-quarter 2024. While we expect interest rates will start declining in second-half 2024, we project S-Bank's profitability will remain sound in a more normalized interest rate environment, with return on equity of 11%-13%, compared with 20.5% in first-quarter 2024, and cost to income of 58%-60% (compared with 53%). This is significantly higher than the average return on equity and cost to income ratio of 4.7% and 76% in 2020-2022. Given the improved earnings and operating efficiency, we no longer consider S-Bank an underperformer in its peer group and therefore removed the negative credit rating analysis notch.

Supporting our view of profitability is the upcoming acquisition of Handelsbanken's portfolio. We expect the transaction to finalize in fourth-quarter 2024--including €3.6 billion of loans and €2.6 billion of assets under management (as of March 31, 2023). While we expect this will contribute to a significant cost increase of about 20% in 2024, we think the transaction will strengthen S-Bank's retail franchise by providing scale and cross-selling opportunities if integrated successfully. At the same time, ensuring a smooth transition and appropriate service level for the new customers could prove challenging given cultural differences and S-Bank's digital service model.

Improved earnings and the committed capital injection from its cooperative member owners will support ample capitalization despite significant growth in risk-weighted assets. We consider S-Bank very well-capitalized, as reflected by a common equity Tier 1 ratio of 17.0% against a regulatory requirement of 9.2%, including the systemic risk buffer requirement of 1% that took effect April 1, 2024. We project the bank's risk-adjusted capital (RAC) ratio will be in the 20.5%-21.5% range over the next two years, compared with 18.5% as of 2023. While the acquisition of the Handelsbanken portfolio will drive an estimated 40% increase in risk-weighted assets (RWA) in 2024, we expect the committed €200 million capital injection from its owners alongside profit retention of €80 million-€85 million (85% of net income) will support the capital position and aid further growth ambitions.

S-Bank's granular retail deposits, complemented by covered bond issuance, will support funding stability and profitability. We expect cost-effective core deposits, accounting for 87% of the funding base as of March 31, 2024, will remain the bank's dominant funding source and continue to underpin profitability over the next two years. Still, we expect transferred retail deposit volumes from Handelsbanken to fall short of transferred loan volumes by approximately €2 billion (as of March 31, 2023). To bridge the financing gap, S-Bank issued €500 million covered bonds in both September 2023 and April 2024. We forecast the bank will operate with a loan-to-deposit ratio of 105%-110% over the next two years, compared with 85% as of first-quarter 2024. Moreover, we expect S-Bank's ample liquidity to continue supporting the funding profile, although we expect built-up buffers--with broad-liquid assets equivalent to 25% of assets and 31% of customer deposits as of March 31, 2024--will return toward historical levels of about 20% of deposits when the transaction is completed, a level we consider robust.

We expect asset quality will remain sound, but project S-Bank's larger share of consumer loans will continue to drive higher-than-peers' provisioning needs. We forecast high interest rates and tight conditions for borrowers will drive a moderate increase in nonperforming assets (defined as stage 3 loans) to 1.5%-1.7% of gross loans over 2024-2025, compared with 1.4% as of first-quarter 2024. At the same time, we expect organic loan growth will remain muted, at about 2% in 2024, due to the weak operating environment in Finland, before rebounding to 3%-5% in 2025-2026 as economic recovery picks up. Business volumes from Handelsbanken will increase the loan stock by an estimated 40%-45% in late 2024, and in general, we expect the asset quality of transferred mortgage loans from Handelsbanken will be sound and do not expect a material impact on asset quality metrics.

We continue to expect that S-Bank could be resilient to parental distress. We rate the bank above S Group's group credit profile. This reflects our view of S-Bank as an independent and severable entity within the group, with no funding dependency, and separated accounting and reporting procedures. We see the group as having a strong and compelling economic incentive to preserve the bank's credit strength. The authorities' apparent intent to resolve the bank if it failed (as opposed to liquidating it) further confirms S-Bank's position as a critical service provider in Finland, and also reinforces its financial and operational independence. Nevertheless, we think the group could have a negative influence on the bank, as a confidence-sensitive business where there is a wider crossover of franchise and customers with the group.

S-Bank could be eligible for additional loss-absorbing capacity (ALAC) if it were to build a sufficient buffer of subordinated debt instruments. We estimate that as of year-end 2023, the bank held an ALAC buffer of about 3.1% of S&P Global Ratings RWA, consisting of subordinated debt instruments. This is below our minimum threshold of 4%, including a 100 basis point upward adjustment for maturity concentration. Moreover, Finnish midsize banks are not subject to subordination requirements, and S-Bank comfortably meets its minimum requirement for own funds and eligible liabilities (20.64% of the total risk-exposure amount and 7.71% of the leveraged-based calculation) with other liabilities, including senior preferred debt. Absent new issuance, we expect the ratio will gradually decrease through 2025 as the instruments are annually amortized.

Outlook

The stable outlook reflects our expectations that S-Bank will sustain a profitable franchise while maintaining an RAC ratio above 15% over the next 12-24 months despite rising operating expense and moderately deteriorating asset quality. The outlook also incorporates our expectation that the bank will successfully integrate the retail portfolio from Handelsbanken, and remain resilient even in an adverse scenario where the broader S-Group faces difficulty.

Downside scenario

We could take a negative rating action if execution problems related to the Handelsbanken transaction emerged or customer retention following the acquisition proves materially weaker than expected. A negative rating action could also follow if S-Bank's loan growth is more aggressive or it departs from its underwriting standards, alongside increased credit losses. This could translate into an RAC ratio below the 15% threshold.

While less likely, we could lower our long-term rating on S-Bank if the parent's creditworthiness weakens and the bank proves either less resilient or more vulnerable to potential negative intervention than we expect.

Upside scenario

We could take a positive rating action if the bank were to build an ALAC buffer sustainably and comfortably above our adjusted threshold of 4%.

Ratings Score Snapshot

S-Bank PLC	To	From
Issuer Credit Rating	**BBB+/Stable/A-2**	**BBB/Positive/A-2**
Stand-alone credit profile	bbb+	bbb
Anchor	a-	a-
Business position	Constrained (-2)	Constrained (-2)
Capital and earnings	Very strong (+2)	Very strong (+2)
Risk position	Moderate (-1)	Moderate (-1)
Funding and liquidity	Adequate (0)	Adequate (0)
Comparable ratings analysis	0	-1
Support	0	0
ALAC support	0	0
GRE support	0	0
Group support	0	0
Sovereign support	0	0
Additional factors	0	0

Related Criteria

- Criteria | Financial Institutions | General: Risk-Adjusted Capital Framework Methodology, April 30, 2024
- General Criteria: Hybrid Capital: Methodology And Assumptions, March 2, 2022
- 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
- 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: May 2024, May 30, 2024
- Finland, April 29, 2024
- Top Nordic Banks Cut Costs As Revenue Growth Flattens, Feb. 19, 2024
- Nordic Banks In 2024: Ploughing On Through Tough Terrain, Feb. 7, 2024
- Banking Industry Country Risk Assessment: Finland, Nov. 28, 2023
- S-Bank PLC, Aug. 1, 2023
- S-Bank PLC Outlook Revised To Positive On Improved Earnings Capacity And Strengthening Franchise; Affirmed At ‘BBB/A-2’, June 29, 2023

Ratings List

Upgraded; Outlook Action; Ratings Affirmed

	To	From
S-Bank PLC		
Issuer Credit Rating	BBB+/Stable/A-2	BBB/Positive/A-2

Upgraded; Ratings Affirmed

	To	From
S-Bank PLC		
Resolution Counterparty Rating	A-/--/A-2	BBB+/--/A-2

Upgraded

	To	From
S-Bank PLC		
Senior Unsecured	BBB+	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.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 Ratings' Global Client Support line (44) 20-7176-7176.