Research Update:

Finland-Based S-Bank Assigned 'BBB+/A-2' Resolution Counterparty Ratings; 'BBB/A-2' Ratings Affirmed; Outlook Stable

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Overview

- We believe that the Finnish midsize bank S-Bank PLC would likely be subject to an open bank, bail-in-led resolution approach if it failed.
- S-Bank continues to build up buffers to meet its minimum requirements for own funds and eligible liabilities (MREL), mainly through senior preferred issuance.
- We consider that the use of a resolution process on the bank would heighten the chance that its most senior liabilities would continue to be paid on time and in full, even if it failed.
- We therefore assigned our 'BBB+/A-2' long- and short-term resolution counterparty ratings to S-Bank.
- At the same time, we affirmed our 'BBB/A-2' issuer credit ratings on the bank and maintained the stable outlook.

Rating Action

On Jan. 26, 2023, S&P Global Ratings assigned its long- and short-term 'BBB+/A-2' resolution counterparty ratings (RCRs) to Finland-based S-Bank PLC. At the same time, we affirmed the 'BBB/A-2' long-and short-term issuer credit ratings. The outlook remains stable.

Rationale

We have gained further visibility into S-Bank's resolution plans and believe that S-Bank would be subject to a bail-in-led resolution approach. The Financial Stability Authority in Finland has imposed on S-Bank a MREL requirement of 20.34% on total exposure amounts and 8.41% on leverage ratio-based calculation with full requirement entering into force on Jan. 1, 2024. In our view, this indicates that the MREL would imply a full recapitalization of the banking business, and, given S-Bank's provision of critical functions such as retail deposits, we would expect the authorities to plan for an open-bank, bail-in-led resolution if S-Bank were to fail or likely to fail.

We now consider that S-Bank would be credibly resolved and have assigned our long- and short-term RCRs to the bank. An RCR is a forward-looking opinion of the relative default risk of certain liabilities, in particular those legally exempt from bail-in (such as insured deposits or secured liabilities), that may be better protected from default in an effective resolution scenario than other senior liabilities. Please refer to our jurisdictional assessment for Finland, "Resolution Counterparty Ratings Jurisdiction Assessment For Finland Completed," published June 29, 2018, on RatingsDirect. The long-term RCR generally stands one notch above the long-term issuer credit rating for investment-grade issuers, and two notches above for speculative-grade issuers.

We believe that S-Bank could be eligible for additional-loss absorbing capacity (ALAC) uplift if it were to build a sufficient buffer of subordinated debt over time. We estimate that as of year-end 2022, S-Bank held an ALAC buffer of about 3.5% as a share of S&P Global Ratings' risk-weighted assets, consisting of subordinated debt instruments. However, in the absence of new issuance, the buffer will gradually decrease to 2.8% by 2024 as its existing subordinated debt instruments are annually amortized. Furthermore, Finnish midsize banks are not subject to subordination requirements for their MREL instruments and S-Bank may meet its MREL with other liabilities, including senior preferred.

In order to benefit from one notch of ratings uplift, S-Bank must reach a minimum ALAC threshold of 4.0%. This is 100 basis points higher than the standard threshold, reflecting--as for other midsize Finnish banks--the concentration of the bank's ALAC in a small number of instruments, which exposes the bank to higher refinancing risks.

We believe that S-Bank's earnings will benefit from rising interest income. We project that the bank's earnings will have material tailwind from the increased interest rates as the loan book is primarily tied to Euribor 12-month rates and will reprice faster than the bank's liabilities. We project the bank will report net interest income improved by almost 30% in 2022, but the primary impact will be seen in 2023 when the loan book is repriced. Consequently, we anticipate the bank's return on equity will reach 9%-10% in 2023-2024 from a modest 4.4% as of the third quarter of 2022, and the cost-to-income ratio will gradually decrease toward 65% through 2024 (81% in the third quarter of 2022). Our projection assumes also somewhat weakening asset quality and an uptick in credit losses. This is based on the expectation of a more muted economic outlook in Finland in 2023 potentially reducing borrower repayment capacity and the seasoning of S-Bank's fairly young mortgage loan book.

We see the potential use of resolution tools as reinforcing our view that S-Bank could be resilient to parental distress. We rate S-Bank above the group credit profile of S Group. 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, and would expect regulatory authorities in Finland to ringfence at least part of the bank in the event of potential credit stress at the group level, to preserve customer confidence in the Finnish financial markets and banking industry. The potential use of resolution tools on the bank (as opposed to liquidating it) would further confirm the bank's position as a critical service provider in Finland, as well as reinforce its financial and operational independence. Nevertheless, we remain mindful that, to a degree, 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.

Outlook

The stable outlook reflects our expectation that S-Bank will continue to follow its growth strategy while maintaining a sound financial profile over the next 12-24 months. The expected improvement in earnings on the back of rising interest rates will allow the bank to continue to cover its high investment needs and to absorb potential increase in credit losses from the weaker macro environment in Finland.

We expect that S-Bank will maintain its robust risk-adjusted capitalization above 15% over the next two years. The outlook also incorporates somewhat weakening asset quality as higher inflation will challenge the borrower's repayment capacity and the bank's fairly young mortgage loan book matures.

Downside scenario

We could lower our rating on the bank if we perceive a weakening in the bank's intrinsic creditworthiness, and there was no offsetting positive development, for example due to ALAC. Negative developments could include S-Bank's loan growth turning more aggressive or the bank departing from its underwriting standards, alongside increased credit losses. This could translate into a risk-adjusted capital ratio below the 15% threshold for a downgrade.

We could also lower our long-term rating on S-Bank if stress on the parent's creditworthiness increases leading to potential negative intervention or if the S Group brand weakens, which we expect could also harm the bank.

Upside scenario

We could raise our rating on the bank if it were to build an ALAC buffer sustainably above the 4% threshold.

We could also raise the rating if, all else equal, we saw a strengthening in the bank's intrinsic creditworthiness, for example due to a demonstrated sustained improvement in its operating profitability and efficiency in line with its higher rated peers.

Ratings Score Snapshot

Issuer Credit Rating	BBB/Stable/A-2
SACP	bbb
Anchor	a-
Business position	Constraint (-2)
Capital and earnings	Very strong (+2)
Risk position	Moderate (-1)
Funding and liquidity	Adequate and adequate (0)
Comparable ratings analysis	-1
Support	
ALAC support	0

Issuer Credit Rating	BBB/Stable/A-2
GRE support	0
Group support	0
Sovereign support	0
Additional factors	0

SACP--Stand-alone credit profile.

ESG credit indicators: E-2, S-2, G-2

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

- The Resolution Story For Europe's Banks: The Final Push To Resolvability, Sept. 30, 2022
- S-Bank PLC, Sept. 22, 2022
- Banking Industry Country Risk Assessment: Finland, June 1, 2022
- Ratings On Nine Finnish Financial Institutions Affirmed Under Revised Criteria; Outlooks Unchanged, Feb. 4, 2022
- ESG Credit Indicator Report Card: EMEA Banks, Jan 19, 2022
- Resolution Counterparty Ratings Jurisdiction Assessment For Finland Completed, June 29, 2018

Ratings List

New Rating	
S-Bank PLC	
Resolution Counterparty Rating	BBB+/--/A-2
Ratings Affirmed	
S-Bank PLC	
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 for further information. A description of each of S&P Global Ratings' rating categories is contained in "S&P Global Ratings Definitions" at https://www.standardandpoors.com/en_US/web/guest/article/-/view/sourceId/504352 Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at 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; or Stockholm (46) 8-440-5914