

Research Update:

# Oma Savings Bank Outlook Revised To Negative On Governance Shortcomings; 'BBB+/A-2' Ratings Affirmed

June 17, 2024

## Overview

- We believe the non-compliance with internal risk guidelines at Finland-based Oma Savings Bank PLC (OmaSp) resulted in no meaningful related franchise damage, and consider the immediate financial impact to be well manageable, particularly in the context of its strong profitability and ample capitalization.
- Nevertheless, the episode reveals governance and risk management shortcomings in this fast-growing bank.
- We therefore revised our outlook on OmaSp to negative from stable and affirmed our 'BBB+/A-2' ratings.
- The negative outlook reflects that we may lower the rating if OmaSp fails to take sufficient and timely measures to remedy governance and risk management gaps, or if other material shortcomings come to light.

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## Rating Action

On June 17, 2024, S&P Global Ratings revised its outlook on Finland-based Oma Savings Bank PLC (OmaSp) to negative from stable and affirmed its 'BBB+/A-2' long- and short-term issuer credit ratings on OmaSp.

## Rationale

**The non-compliance case highlights governance and risk management gaps.** In April 2024, OmaSp reported that it had detected inconsistencies involving loans to real estate companies of about €200 million, approximately 3% of the bank's €6.1 billion loan book (see "Bulletin: Finland-Based Oma Savings Bank Has Robust Capacity To Absorb Extraordinary Impairment Provisions", published April 30, 2024). Those inconsistencies were revealed through the bank's

internal risk and audit process. The bank took extraordinary loan loss provisions of €19.5 million or 153 basis points (bps) in its first-quarter financials to cover the identified collateral shortfall. The bank has initiated steps to remedy identified gaps, including increasing its risk management staffing, enhancing independence of support functions, and clarifying second-line defense responsibilities.

We see any related financial impact as easily manageable for OmaSp and have observed no meaningful franchise damage from the case. As to the remediation, the sufficiency of these measures will be seen over time. We are mindful also that OmaSp has grown quite rapidly over the past five years--organically and through acquisitions--and will continue to do so, notably through the upcoming acquisition of Handelsbanken's Finnish small and midsize enterprise (SME) business. As a result, this places particular importance not only on effective integration, but a constant investment in and evolution of the risk governance framework, risk monitoring, and controls.

**We expect nonperforming assets and cost of risk will remain elevated in 2024 before gradually recovering.** We understand OmaSp has not identified any further extraordinary provisioning need at this stage. However, we expect further migrations of these real estate exposures to stage 3 loans could push the bank's nonperforming assets ratio toward 3.0%-3.5% in 2024, compared with 2.1% in the first quarter, before slowly recovering toward 2.5% through 2026. At the same time, given the muted macroeconomic environment in Finland and delayed effects from higher interest rates and inflation, we expect OmaSp's general provisioning need will remain relatively elevated over the next two years. We project cost of risk at around 55-60 bps in 2024, well above our expectation for the Finnish banking sector, before subsiding toward the bank's 2021-2023 average of around 20 bps.

**OmaSp has ample capacity to scale up investments, thanks to solid operating efficiency and higher-than-peer earnings.** We forecast OmaSp will generate net income of €115 million-€125 million in 2024 and 2025, compared with €110 million in 2023, implying a solid return on equity of about 20% (24.3%). This reflects our expectations that a still favorable interest rate environment and OmaSp's high operating efficiency, with cost to income at 35% as of first-quarter 2024, will continue to support investment capacity, and provide a comfortable buffer to absorb credit losses. While we expect organic loan growth will remain muted at 2%-3% in 2024, the upcoming takeover of Handelsbanken's SME loan portfolio of about €460 million and gradually accelerating loan growth in 2025 will support revenue growth even if the net interest margin gradually tightens.

**Solid income generation and high profit retention will support ample capitalization, despite high growth in risk-weighted assets.** We consider OmaSp has a robust capital position, as reflected by a regulatory common equity tier 1 capital ratio of 15.4% as of first-quarter 2024 (14.9% as of Dec. 31, 2023) against a requirement of 8.8% including the systemic risk buffer requirement of 1% that entered into force on April 1, 2024. We project OmaSp's risk-adjusted capital (RAC) ratio could moderately weaken in 2024 due to significant growth in risk-weighted assets following the transfer of SME loans from Handelsbanken before recovering over the remainder of our forecast horizon. We project the RAC ratio will temporarily fall to around 15.5% in 2024, compared with 16.3% as of Dec. 31, 2023, and then rebound to 16.5%-17.5% over 2025-2026. Given its high quality of capital, we believe OmaSp could issue hybrid debt instruments to support growth, if needed.

**Stable retail deposits complemented with covered bond issuance underpin funding stability.**

We expect OmaSp's regional retail franchise will continue to support solid and cost-effective deposit funding, accounting for 55% of the funding base as of first-quarter 2024. Moreover, transferred deposit volumes from Handelsbanken are likely to exceed transferred loans--although we would see these as somewhat less sticky than household deposits. That said, with loan growth having outpaced deposit growth over recent years, OmaSp's reliance on wholesale funding has been on the rise and higher than most domestic savings bank peers' which over time could increase the bank's reliance on market funding to cover the funding gap.

**Outlook**

We expect that over the next 12-24 months OmaSp will maintain strong revenue generation and high operating efficiency, supporting a RAC ratio above 15% and ample capacity to absorb unexpected losses. Specifically, we assume also effective remediation of identified risk management gaps and effective integration of the Handelsbanken SME business, although the negative outlook reflects a possibility that it may fall short in this regard.

**Downside scenario**

We could lower the rating if OmaSp fails to take sufficient and timely measures to remedy governance and risk management gaps, or if other material shortcomings come to light.

We could also take a negative rating action if the RAC ratio sustainably declined below 15%, asset quality deteriorates sharply, or if unexpected undue execution risk related to the Handelsbanken acquisition emerged.

**Upside scenario**

We could revise the outlook to stable if we saw sufficient evidence of a strengthened risk management framework at OmaSp that supports controlled growth, while maintaining a sound financial position.

**Ratings Score Snapshot**

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

GRE support:	(0)
Group support:	(0)
Sovereign support:	(0)
Additional factors:	(0)

**Environmental, social, and governance (ESG) credit factors for this change in credit rating/outlook and/or CreditWatch status:**

- Risk management, culture, and oversight

**Related Criteria**

- Criteria | Financial Institutions | General: Risk-Adjusted Capital Framework Methodology, April 30, 2024
- 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
- Bulletin: Finland-Based Oma Savings Bank Has Robust Capacity To Absorb Extraordinary Impairment Provisions, April 30, 2024
- Finland, April 29, 2024
- Oma Savings Bank PLC, March 7, 2024
- EMEA Financial Institutions Monitor 1Q2024: Banks Adapt To The Increased Economic Turbulence, Feb 19, 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

## Ratings List

### Ratings Affirmed

#### Oma Savings Bank PLC

Senior Unsecured	BBB+
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### Ratings Affirmed; Outlook Action

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#### Oma Savings Bank PLC

Issuer Credit Rating	BBB+/Negative/A-2	BBB+/Stable/A-2
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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](http://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/sourceld/504352>. Complete ratings information is available to RatingsDirect subscribers 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.spglobal.com/ratings](http://www.spglobal.com/ratings). Alternatively, call S&P Global Ratings' Global Client Support line (44) 20-7176-7176.

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