

Research Update:

Oma Savings Bank PLC Ratings Downgraded To 'BBB/A-2' On Deteriorated Asset Quality; Outlook Revised To Stable

November 14, 2024

Overview

- Credit losses at Finland-based Oma Savings Bank PLC (OmaSp) have grown beyond our base case after the identified case of noncompliance with internal risk-guidelines reported earlier in 2024.
- While the bank has taken extensive measures to remedy gaps to its risk management and governance, the effect on the bank's asset quality from the detected shortcomings has been greater than previously assessed.
- We therefore downgraded our long-term issuer credit rating (ICR) to 'BBB' from 'BBB+' and affirmed our short-term issuer credit rating at 'A-2'. The outlook was revised to stable from negative.
- The stable outlook reflects our expectation that OmaSp will have the capacity to remedy identified governance and risk management deficiencies while maintaining very strong risk-adjusted capitalization aided by its solid core profitability.

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Rating Action

On Nov. 14, 2024, S&P Global Ratings downgraded Finland-based OmaSp to 'BBB' from 'BBB+' and affirmed the short-term ICR at 'A-2'. The outlook was revised to stable from negative.

Rationale

Significant asset quality deterioration at OmaSp led us to downgrade the bank. The nonperforming assets (NPAs) and credit losses related to the case of noncompliance with internal risk-guidelines, as reported by OmaSp earlier in 2024, continued to grow over the third quarter of 2024 (see "Oma Savings Bank Outlook Revised To Negative On Governance Shortcomings; 'BBB+/A-2' Ratings Affirmed", published on June 17, 2024). The portfolio of NPAs now amounts to

€355 million, or 5.5% of total loans, the vast majority is connected to the above-mentioned case. This led OmaSp to book additional loan loss provisions of €13.3 million in the third quarter, and the bank's cost of risk for the first nine months of 2024 now stands at €75.8 million, or an annualized 161 basis points (bps).

While we acknowledge that the bank has taken extensive measures to remedy identified gaps, the effect on the bank's asset quality from detected shortcomings has been greater than previously assessed. In our view, this could indicate a prolonged timeline for the remediation process and work-out of NPAs and in a downside scenario even further asset quality pressures. In turn, this could have negative repercussions on the bank's franchise and financial position. Additionally, the outcome of ongoing regulatory investigations related to securities market offences and anti-money laundering (AML) deficiencies at OmaSp remains uncertain. Therefore, we lowered our risk position assessment to constrained from moderate.

The bank has launched an extensive action plan to improve its risk management and internal controls. We understand OmaSp has devoted material resources, internal and external, and has reportedly completed several actions since launching its remediation plan in June 2024. Among other items these include an updated risk taxonomy and decision-making procedures, a strengthened operational mandate for the risk management function, and enhanced system support and guidelines for handling conflicts of interest. In parallel with strengthening its risk management framework, the bank is taking measures related to know-your-customer and AML processes. In our view, securing sufficient resources and capabilities within these areas will be crucial for running a bigger bank and balance sheet. OmaSp is also rapidly growing-- most recently through the acquisition of Handelsbanken's Finnish small and midsize enterprise (SME) business which was completed in early September-- which places particular importance on constant investments in and evolution of the risk governance framework, risk monitoring, and controls.

OmaSp's underlying core profitability remains robust. Notwithstanding elevated cost of risk, OmaSp has maintained strong earnings momentum over 2024 and we expect the bank will remain a positive outlier in terms of profitability over our forecast horizon. Still, we project OmaSp's earnings, as for the broader Finnish banking sector, will trend lower with falling interest rates. We forecast pre-provision operating profits will increase by 5%-7% to €163 million-€166 million in 2024 compared to 2023, before gradually declining to €125 million-€145 million over 2025-2026 on a tightening net interest margin and increasing operating expenses including elevated development spending. We understand OmaSp does not foresee any meaningful additional provisioning need related to the noncompliance case at this stage and in our base case we expect cost of risk will normalize toward 15 bps-25 bps over 2025-2026, from an estimated 130 bps for full-year 2024. While lending volumes have increased with its recent acquisition of Handelsbanken's SME portfolio, we expect loan growth in the Finnish market will remain muted over the near term before gradually rebounding from the second half of 2025. This translates into return on average equity of 14%-17% over 2025-2026, from a projected 12% for 2024, still comparing favorably to domestic midsize peers.

Strong earnings and high profit retention will support risk-adjusted capitalization despite recent balance sheet growth. Including the recent absorption of €500 million of SME loans from Handelsbanken, OmaSp's loan book increased by 7.7% for the first three quarters of 2024. Regulatory risk-weighted assets increased by close to 10% over the same period with the regulatory common equity tier 1 (CET1) capital ratio declining to 14.2% as of Sept. 30, 2024, from 14.8% at year-end 2023. Still, this is comfortably above the regulatory CET1 requirement of 8.9%

for the bank. Similarly, we expect our risk-adjusted capital (RAC) ratio will weaken in 2024 before recovering over the remainder of our forecast horizon. We forecast RAC will move temporarily lower to about 15.5% in 2024, compared with 16.3% as of Dec. 31, 2023, and then rebound to 16.5%-17.5% over 2025-2026. In our view, the bank's capital and earnings will provide a strong buffer to cover the risks in OmaSp's operations.

Outlook

The stable outlook reflects our expectation that OmaSp will maintain its solid earnings generation capacity and very strong capitalization in the next two years. This will enable the bank to continue to invest in and improve its internal risk management and control capabilities while gradually working out elevated NPAs.

Downside scenario

We could downgrade OmaSp if the bank failed to take sufficient and timely measures to remedy governance and risk management gaps or if the regulatory investigation identified further shortcomings.

We could also lower the rating if we saw further material asset quality deterioration, or if the RAC ratio sustainably declined below 15%.

Upside scenario

We could raise the rating if we saw sufficient evidence of a strengthened risk management framework at OmaSp that supports controlled growth, and residual downside risks fall away. This would also be consistent with OmaSp demonstrating a sound financial position with asset quality indicators comparable to domestic peers.

Ratings Score Snapshot

	To	From
Issuer Credit Rating	BBB/Stable/A-2	BBB+/Negative/A-2
SACP	bbb	bbb+
Anchor	a-	a-
Business Position	Constrained (-2)	Constrained (-2)
Capital and Earnings	Very strong (+2)	Very strong (+2)
Risk Position	Constrained (-2)	Moderate (-1)
Funding and Liquidity	Adequate and adequate (0)	Adequate and adequate (0)
Support	(0)	(0)
ALAC Support	(0)	(0)
GRE Support	(0)	(0)
Group Support	(0)	(0)
Sovereign Support	(0)	(0)

	To	From
Additional Factors	(0)	(0)

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

- Governance structure
- Risk management, culture, and oversight

Related Criteria

- Criteria | Financial Institutions | General: Risk-Adjusted Capital Framework Methodology, April 30, 2024
- Criteria | Financial Institutions | Banks: Banking Industry Country Risk Assessment Methodology And Assumptions, Dec. 9, 2021
- Criteria | Financial Institutions | General: Financial Institutions Rating Methodology, 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

Ratings List

Downgraded

	To	From
Oma Savings Bank PLC		
Issuer Credit Rating	BBB/Stable/A-2	BBB+/Negative/A-2
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.

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