

Research Update:

# Bonum Bank Outlook Revised To Positive On POP Group's Improved Earnings Trajectory; 'BBB/A-2' Ratings Affirmed

October 5, 2023

## Overview

- In our view, Finland-based POP Bank Group is in a good position to materially strengthen its earnings profile thanks to higher interest rates and its retail deposit-based funding structure.
- POP Bank Group's efforts to streamline its operations, alongside its broadened insurance offering, may also allow the group to improve its internal efficiency and close the gap to peers in terms of earnings capacity and operating efficiency.
- We are therefore revising our outlook on our ratings on the group's core subsidiary, Bonum Bank PLC, to positive from stable and affirming our 'BBB/A-2' long- and short-term issuer credit ratings.
- The positive outlook reflects that we expect POP Bank Group's profitability and cost efficiency metrics to approach those of higher rated peers while it maintains its capital, asset quality, and funding position.

### PRIMARY CREDIT ANALYST

**Niklas Dahlstrom**  
Stockholm  
+46 84405358  
niklas.dahlstrom  
@spglobal.com

### SECONDARY CONTACT

**Salla von Steinaecker**  
Frankfurt  
+ 49 693 399 9164  
salla.vonsteinaecker  
@spglobal.com

## Rating Action

On Oct. 05, 2023, S&P Global Ratings revised its outlook on the ratings on Bonum Bank PLC to positive from stable. At the same time, we affirmed our 'BBB/A-2' long- and short-term issuer credit ratings on Bonum Bank.

## Rationale

**The net interest income tailwind will materially boost POP Bank Group's earnings capacity in 2023-2025, in our view.** The group is enjoying a marked improvement in revenue generation because most of its member banks' loan books are tied to 12-month Euribor, and repricing of its deposit book has been very limited. As a result, POP Bank Group's net interest income (NII) almost doubled in the first half of 2023, compared with the same period in 2022. While the group's net

interest margin is likely to peak in second-half 2023, we expect the rise in NII will endure over 2024-2025, contributing close to 75% of group revenues. Although we foresee increasing operating costs and cost of risk, we project this will materially strengthen POP Bank Group's operating profits. Coupled with internal efficiency gains, we expect this will close the profitability gap to peers.

While the NII rise demonstrates POP's franchise strength, we continue to note POP Bank Group's smaller franchise and more limited revenue breadth than many peers. The cooperation with LocalTapiola Group allows the group to broaden its insurance offering, although we expect only a small contribution to group earnings. We forecast net income adjusted for one-offs of €65 million-€70 million in 2023 and €60 million-€63 million in 2024-2025, compared with €21 million in 2022, translating into return on average equity of 8%-11% and cost-to-income of 55%-60% (78% in 2022).

**We believe member banks' granular retail deposits will ensure funding stability and support profitability.** In our view, core retail deposits--accounting for 82% of the funding base as of June 30, 2023--will remain POP Bank Group's main source of funding over the next two years. Although tightened credit conditions for households and businesses could weigh on deposit volumes and pricing, we anticipate the group will fare comparatively well considering its regional focus and less price-sensitive deposit base than peers. We also note the group's sizable liquidity buffer--after haircuts estimated to represent 22.5% of customer deposits as of June 30, 2023--and ample room to issue covered bonds through its POP Mortgage Bank subsidiary.

**We expect improving earnings and high profit retention will support already robust capitalization.** We project POP Bank Group's risk-adjusted capital ratio will significantly strengthen toward 22.5%-23.5% until 2025, from 17.0% in 2022. Similarly, we expect the group to further improve its Common Equity Tier 1 ratio from 21.1% against a regulatory requirement of 11.8% as of June 30, 2023. The capitalization is strengthened by the proceeds (€38 million) and freed-up capital from the sale of its majority stake in Finnish P&C Insurance Ltd. (Suomen Vahinkovakuutus Oy). The capital position is also supported by full earnings retention as the group member banks, as cooperatives, do not pay dividends. This will support the group's future growth ambitions while providing a robust buffer to absorb unexpected losses.

**We expect asset quality metrics to deteriorate moderately until 2024.** The higher interest rate environment and stubborn inflation will increasingly weigh on Finnish households and businesses and adversely affect member banks' asset quality and cost of risk, in our view. We project POP Bank Group's nonperforming loans (defined as stage 3 loans) ratio will rise modestly to 2.9%-3.2%, from 2.7% as of June 30, 2023, with a cost of risk of 25 basis points (bps)-30 bps over the next two years. While nonperforming assets are higher than most Nordic and domestic peers', we expect the group's collateralized lending focus (95% of loans in 2022), and generally smaller loan sizes--due to its focus on smaller cities and surroundings--to provide a cushion to a more pronounced deterioration.

## Outlook

The positive outlook on Bonum Bank reflects that we expect the wider POP Bank Group to benefit materially from the higher interest environment over the next two years and sustainably improve its earnings generation capacity and operating efficiency, thereby closing the profitability gap to domestic and similarly rated peers.

We expect this will allow POP Bank Group to strengthen its financial position, underpinned by very strong risk-adjusted capitalization and adequate asset quality, while continually improving its group structure and operating efficiency over the next two years.

## Downside scenario

We could revise the outlook to stable if the group's earnings profile does not durably strengthen as expected. A negative rating action could also follow a deterioration in the group's underwriting standards and asset quality metrics, weakening the combined capital and risk profile.

## Upside scenario

We could upgrade Bonum Bank if POP Bank Group sustainably improves its revenue generation and cost efficiency, enabling it to build an earnings buffer more in line with that of its peers. In such a scenario, we would no longer apply a one-notch negative comparable ratings analysis adjustment.

## Ratings Score Snapshot

	To	From
<b>Issuer Credit Rating</b>	<b>BBB/Positive/A-2</b>	<b>BBB/Stable/A-2</b>
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	-1	-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 | 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
- 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: September 2023, Sept. 28, 2023
- POP Bank Group's Insurance Divestment Will Boost Earnings And Present Growth Opportunities, March 17, 2023
- Nordic Banks In 2023: Robust Fundamentals And Strong Performance Despite Economic Slowdown, March 6, 2023
- Bonum Bank PLC, Sept. 26, 2022
- Banking Industry Country Risk Assessment: Finland, June 1, 2022

## Ratings List

### Ratings Affirmed; Outlook Action

	To	From
<b>Bonum Bank PLC</b>		
Issuer Credit Rating	BBB/Positive/A-2	BBB/Stable/A-2

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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