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Research Update:

Finland's Municipal Guarantee Board 'AA+/A-1+' Ratings Affirmed; Outlook Stable

Primary Credit Analyst:
Carina Johansson, Stockholm (46) 8-440-5918; carina.johansson@spglobal.com

Secondary Contact:
Carl Nyrerod, Stockholm (46) 8-440-5919; carl.nyrerod@spglobal.com

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Overview

- Municipal Guarantee Board (MGB) is one of the pillars of Finland's municipal funding system through Municipal Finance PLC, and its creditworthiness is underpinned by that of Finland's robust local government sector.
- We are affirming our 'AA+/A-1+' ratings on MGB.
- The stable outlook partly reflects that on the sovereign. If we lowered our ratings on Finland, we would lower our ratings on MGB. However, if we raised our ratings on Finland, a possible upgrade of MGB would hinge on our view of MGB's and Municipality Finance's joint creditworthiness.

Rating Action

On Dec. 21, 2017, S&P Global Ratings affirmed its 'AA+/A-1+' long- and short-term issuer credit ratings on Finland-based Municipal Guarantee Board (MGB). The outlook is stable.

Rationale

The ratings reflect the joint support of the local government sector in Finland (AA+/Stable/A-1+), which strongly backs the guarantees that MGB extends on Municipality Finance's senior debt funding. This is done via a joint and pro rata guarantee from MGB's member municipalities, which represent all of mainland Finland's population (that is, excluding the autonomous Åland Islands). Consequently, as one of the main pillars of the municipal funding system, MGB is closely linked to the local government sector, in our view. We therefore cap our ratings on MGB at the level of the sovereign rating, in line with our approach for individual local and regional governments (LRGs). To analyze MGB, we use "Principles Of Credit Ratings," published Feb. 16, 2011, on RatingsDirect, under which we assess the strength of the joint guarantee structure and the stand-alone credit profile of Municipality Finance PLC, to which MGB exclusively extends guarantees.

The ratings on MGB are underpinned by our view of the robust creditworthiness of the Finnish local government sector, thanks to strong systemic support features and the institutionalized and unlimited ability of municipalities to increase local income tax rates. We also consider MGB's special public-policy role and status--as described in specific legislation--within the funding system for Finnish local governments, as well as its proactive approach to risk management. In addition, the ratings reflect MGB's focus on providing guarantees solely for the financial obligations of Municipality Finance, which under the current set-up is the primary credit institution for Finnish local governments and the central government's subsidized housing sector. Importantly, we believe it is highly unlikely that MGB will be called upon to honor its guarantees of Municipality Finance because Municipality Finance has very solid financial standing and very low risk in its operations. These strengths are somewhat mitigated by some uncertainty about the timeliness of the pro rata guarantee from MGB's member municipalities. In addition, we note MGB's thin capitalization and financial resources compared with the amount of guarantees outstanding.

MGB's role and scope of activities are regulated by specific legislation, the MGB Act, which defines the agency's special public-policy role and sole mission of ensuring the viability of a joint funding system for Finnish local governments. Essentially, this means MGB provides guarantees solely for Municipality Finance's financial obligations, and we are not aware of any concrete plans to extend the scope of MGB's remit. If Municipality Finance were to default on its financial obligations, MGB could, without a court order, turn to its members on a pro rata basis to obtain funds, which it would receive through the guarantee mechanism for repaying investors.

We note that, unlike a joint and several guarantee commitment, there could be a time lag in determining and acquiring the required pro rata amount from each member local government if the guarantee were to be triggered. Although it has yet to be tested, the process could take up to one month, in our view. Even so, if the guarantee were called, we anticipate that MGB would remain proactive and secure timely payment through the flexibilities that exist within the MGB Act. In addition, MGB has its own liquidity in the form of securities and liquid funds, which totaled €18.3 million in June 2017, together with a committed credit line of €150 million. These liquidity sources serve as a first line of defense, allowing for the injection of capital into Municipality Finance in the unlikely event that it faces financial difficulty. We expect that MGB will review its liquidity position at certain intervals to keep pace with its expanding guarantee commitments to Municipality Finance and its assessment of risk related to Municipality Finance's derivatives portfolio. As a second line of defense, MGB may be able to obtain additional funds from its members if its own liquidity sources are insufficient.

As of June 30, 2017, MGB's outstanding guarantees totalled €28.7 billion, compared with its current maximum guarantee limit of €45.1 billion. Although the volume of outstanding guarantees appears very high relative to MGB's capital base and liquidity facilities, we believe that ultimately MGB's ability to fulfill its guarantee commitment to Municipality Finance depends on the creditworthiness of Finland's local government sector. Furthermore, we believe the likelihood of the guarantee ever being called is very low, given Municipality Finance's very strong asset quality, capitalization, and liquidity, as well as its low-risk lending and prudent asset-liability management.

We view MGB as having a proactive approach to risk management. Since 2010, MGB has performed quantitative analyses of the risk held in Municipality Finance's swap portfolio. This has created differing target levels for MGB's equity fund, depending on the stresses applied in the scenario analyses, and MGB is gradually increasing its equity fund in response to the conclusions of its risk analyses. In addition, we think MGB and Municipality Finance continue to proactively manage regulatory risk.

We note the ongoing discussions about reorganization of Finland's public sector by establishing county councils whose main responsibility will be health care. If this reform were to be implemented, MGB would not, without an amendment to the MGB Act, automatically be in scope of extending guarantees for the benefit of loans to entities belonging to this new tier of government. We will monitor these developments and assess possible implications for MGB.

Outlook

The stable outlook on MGB partly reflects that on the sovereign. If we were to lower our ratings on Finland, we would also lower our ratings on MGB. However, if we were to raise our ratings on Finland, a possible upgrade of MGB would hinge on our view of MGB's and Municipality Finance's joint creditworthiness.

Our ratings on MGB continue to reflect our two-year expectation that the structure of Finland's joint municipal funding system will remain in its current form, and that Municipality Finance will remain the sole recipient of MGB's guarantees. In addition, we anticipate that the creditworthiness of the Finnish municipal sector, even after the introduction of a possible reform of the LRG structure, will remain stable. We expect the current legislative structure--including the MGB Act and MGB's status as a special public-policy agency--will remain broadly unchanged.

Independently of any rating action on the sovereign, we could lower the ratings on MGB if its legal status or institutional set-up were to change or if Municipality Finance's credit quality were to deteriorate significantly. Similarly, the ratings could come under pressure if other credit institutions were allowed to benefit from MGB's guarantees. We could also downgrade MGB if we thought the credit quality of the Finnish local government sector was declining.

Related Criteria And Research

Related Criteria

- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings - April 07, 2017
- General Criteria: Methodology And Assumptions For Rating Jointly Supported Financial Obligations - May 23, 2016
- General Criteria: Rating Government-Related Entities: Methodology And Assumptions - March 25, 2015
- Criteria - Governments - International Public Finance: Methodology: Rating Non-U.S. Local And Regional Governments Higher Than The Sovereign - December 15, 2014
- General Criteria: Ratings Above The Sovereign--Corporate And Government Ratings: Methodology And Assumptions - November 19, 2013
- General Criteria: Principles Of Credit Ratings - February 16, 2011
- General Criteria: Use Of CreditWatch And Outlooks - September 14, 2009

Related Research

- Research Update: Finland Ratings Affirmed At 'AA+/A-1+'; Outlook Stable - September 15, 2017

Ratings List

	Rating	
	To	From
Municipal Guarantee Board		
Issuer Credit Rating		
Foreign and Local Currency	AA+/Stable/A-1+	AA+/Stable/A-1+

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. 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; Stockholm (46) 8-440-5914; or Moscow 7 (495) 783-4009.

Additional Contact:
International Public Finance Ratings Europe; PublicFinanceEurope@spglobal.com