

Credit Opinion: Sparebanken More

Global Credit Research - 13 Jan 2012

Norway

Ratings

Category	Moody's Rating
Outlook	Negative(m)
Bank Deposits	A2/P-1
Bank Financial Strength	C-
Baseline Credit Assessment	(Baa1)
Adjusted Baseline Credit Assessment	(Baa1)

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Key Indicators

Sparebanken More (Consolidated Financials)[1]

	[2]9-11	[2]12-10	[2]12-09	[2]12-08	[3]12-07	Avg.
Total Assets (NOK billion)	48.8	44.4	41.4	40.8	35.6	[4]8.2
Total Assets (EUR million)	6,198.1	5,699.2	4,994.0	4,191.4	4,486.2	[4]8.4
Total Assets (USD million)	8,316.0	7,645.8	7,165.0	5,826.3	6,559.1	[4]6.1
Tangible Common Equity (NOK billion)	3.5	3.3	2.9	2.5	2.3	[4]10.6
Tangible Common Equity (EUR million)	444.9	419.2	347.2	252.1	294.8	[4]10.8
Tangible Common Equity (USD million)	596.9	562.4	498.1	350.5	431.0	[4]8.5
Net Interest Margin (%)	2.0	2.1	2.0	2.2	2.1	[5]2.1
PPI / Avg RWA (%)	2.0	2.4	2.1	1.9	2.0	[6]2.1
Net Income / Avg RWA (%)	1.4	1.7	1.3	1.1	1.4	[6]1.4
(Market Funds - Liquid Assets) / Total Assets (%)	32.8	32.1	35.2	35.5	31.8	[5]33.4
Core Deposits / Average Gross Loans (%)	64.8	66.3	61.4	60.8	65.2	[5]63.7
Tier 1 Ratio (%)	11.1	12.0	11.6	9.1	9.3	[6]11.0
Tangible Common Equity / RWA (%)	11.3	11.4	10.5	8.8	9.4	[6]10.5
Cost / Income Ratio (%)	48.5	43.6	46.5	48.1	49.5	[5]47.2
Problem Loans / Gross Loans (%)	2.0	2.6	3.9	2.7	3.1	[5]2.8
Problem Loans / (Equity + Loan Loss Reserves) (%)	21.0	26.4	41.9	32.8	35.4	[5]31.5

Source: Moody's

[1] All ratios are adjusted using Moody's standard adjustments [2] Basel II; IFRS [3] Basel I; IFRS [4] Compound Annual Growth Rate based on IFRS reporting periods [5] IFRS reporting periods have been used for average calculation [6] Basel II & IFRS reporting periods have been used for average calculation

Opinion

SUMMARY RATING RATIONALE

Moody's rates Sparebanken Møre A2/C-/P-1. The C- bank financial strength rating (BFSR), which translates into a baseline credit assessment (BCA) of Baa1, reflects Sparebanken Møre's sound local franchise and adequate financial fundamentals. However, the rating is constrained by the bank's high borrower concentration, its exposures to volatile corporate sectors and its less-seasoned loan book on the back of double-digit growth in 2006-2008.

The global local currency (GLC) deposit rating of A2 assigned to Sparebanken Møre is supported by the bank's Baa1 BCA and the Aaa local currency deposit ceiling of Norway, which is deemed the underlying support provider. Given the bank's importance to its region, and the region's importance to the national economy of Norway, Moody's assesses a high probability of systemic support in the event of a stress situation. Consequently, Sparebanken Møre's GLC deposit rating benefits from a two-notch uplift from its BCA.

Credit Strengths

- Sound market position in Møre and Romsdal
- Resilient earnings from banking operations
- Satisfactory capitalisation
- Around 60% of lending to retail customers (including loans transferred to Møre Boligkreditt), mostly mortgage loans

Credit Challenges

- Growing revenue, given the high competition in Norway
- Reducing credit risk concentrations, especially by single-name borrower
- Managing its exposure to volatile sectors, including property management, fisheries and the maritime industry
- Maintaining asset quality across the economic cycle
- Strengthening its liquidity position, which is heavily geared towards market funding
- Further developing risk management practices

Rating Outlook

The outlook on the C- BFSR is stable. Based on Moody's global bank financial strength rating methodology, a C- BFSR can be mapped to a BCA of Baa1 or Baa2. In light of the bleak outlook for some key sectors in the Møre and Romsdal county, namely export-related and local ship building industries, potential further impairments exceeding Moody's base stress assumptions could lead to a reassessment of the BFSR mapping. Lowering of the bank's BCA to Baa2 from Baa1 would result in a downgrade of the deposit rating. Therefore, a negative outlook has been assigned to the A2 deposit

rating.

What Could Change the Rating - Up

An upgrade of the BFSR or the GLC deposit rating is unlikely, as reflected in the aforementioned negative outlook on the deposit rating.

What Could Change the Rating - Down

The BFSR could be downgraded if there is: (i) any deterioration in asset quality or capitalisation that exceeds Moody's expectations; or (ii) any sign that the bank is unable to sustain its market positions. The GLC deposit rating could be downgraded if: (i) the BFSR deteriorates; or (ii) Moody's current assessment of the probability of systemic support for the bank declines.

Recent Results

Sparebanken Møre reported pre-tax income of NOK411 million at end-September 2011, down from NOK462 million at end-September 2010. The decrease is largely due to a non-recurring gain in 2010 and lower income on financial instruments in 2011. Total operating costs were up by around 5% mainly attributable to an increase in headcount. Positively, we note that loan loss provisions fell during Q1-Q3 2011 to NOK13 billion (compared to NOK35 million at end-September 2010). Core banking income in the form of net interest income improved by around 7% year-on-year, primarily reflecting higher volumes which more than offset funding cost pressure and strong competition, although still leading to a decrease of NOK59 million in the overall result for the period compared to Q1-Q3 2010. The bank's Tier 1 ratio stood at 11.1% (excluding 50% of the interim profit) at Q3 2011.

DETAILED RATING CONSIDERATIONS

Detailed considerations for Sparebanken Møre's currently assigned ratings are:

Bank Financial Strength Rating

The assigned BFSR is one notch lower than the outcome of Moody's bank financial strength scorecard. Based on Moody's loss expectations for Sparebanken Møre's loan portfolio as well as high credit risk concentration, we believe that the bank's financial strength is more consistent with a C- BFSR.

Qualitative Factors (50% weighting)

Franchise Value

Trend: Neutral

Sparebanken Møre is a regional savings bank with a sound market position in western Norway in the county of Møre and Romsdal, where Moody's estimates it commands market shares of around 20% for lending and almost 30% for deposits. Its national market share is however limited, just above 1%.

The bank operates as an independent savings bank, using an open-architecture business model to offer financial services including insurance and investment products. The bank has subsidiaries in leasing (Møre Finans) and real estate brokerage (Møre Eiendomsmegling), and a covered bond company, Møre Boligkreditt. In the region where it operates, Sparebanken Møre faces competition from larger players such as Nordea and DNB, as well as from other local and regional savings banks. As a result, one of the bank's main challenges is maintaining and improving its market share.

Although we acknowledge Sparebanken Møre's strong presence in the region in which it operates, we note that the Norwegian banking market is highly competitive and that savings banks generally lack pricing power against the two national market leaders. In addition, the D+ score for franchise value is

constrained by the bank's low geographic diversification.

Risk Positioning

Trend: Neutral

Sparebanken Møre's board of directors comprises seven members, including one employee representative. The CEO is not a member of the board. Overall, Moody's does not believe there are corporate governance problems at Sparebanken Møre. The bank's equity certificates (ECs) are listed on the Oslo Stock Exchange. The bank's largest EC holder is Sparebankstiftelsen Tingvoll with 10.2% of ECs and the 20 largest EC holders owned less than 40% of the shares at Q3 2011. The annual financial disclosure is relatively good but we note that quarterly reports are not as extensive as some of its Nordic peers.

Risk management procedures at the bank are considered adequate. The overall guidelines for management and control are assessed at least annually by the board of directors. The head of risk management is responsible for establishing policies for credit risk, market risk and funding risk, in line with board approved guidelines, and reports to the CEO. The overall score for risk management is constrained by limitations in risk management - e.g. in terms of credit risk modelling and risk pricing, stress testing as well as high risk concentrations in the loan portfolio.

Sparebanken Møre's market risk remains modest. Its exposure to interest rates is limited: interest rate risk at the parent bank was NOK5.7 million in relation to a 100 bps change in interest rates at YE 2010. Investments in shares and ECs amounted to NOK209 million at Q3 2011, corresponding to around 6% of Tier 1 capital. The bank also has limited foreign currency exposure. High credit risk concentration is a constraining factor in the score for risk positioning and pushes it to C-.

Regulatory Environment

For a discussion about the regulatory environment, please see Moody's Banking System Outlook on Norway.

Operating Environment

Trend: Neutral

The operating environment score takes into account the economic stability, integrity and corruption in the country as well as the legal system. The unadjusted score for Norway's operating environment is B and is constrained by a score of C for economic stability, primarily as a result of volatility in oil prices. To reflect the fact that offshore revenues are allocated to the Government Pension Fund and have a limited impact on the mainland economy, we calculate the score for economic stability as the average of the standard deviations of GDP growth both including (25% weight) and excluding offshore revenue (75% weight), which results in an adjusted score of B. Consequently, the adjusted score for operating environment is B+.

For further discussion of the operating environment, please see Moody's latest Banking System Outlook on Norway.

Quantitative Factors (50% weighting)

Profitability and Efficiency

Trend: Weakening

Sparebanken Møre is reliant on net interest income, which represented some 70% of its operating income in 2010. This source of earnings has been affected by both good loan growth and strong competition. Fee and commission income accounted for around 12% of operating income during Q1-Q3 2011 and is mainly

related to fees from credit cards and loans.

Valuation changes in financial instruments has made a positive contribution to results recently but remains inherently volatile due to their high reliance on market conditions. Sparebanken Møre's efficiency as measured by its cost-to-income ratio is good at around 49% for Q1-Q3 2011. At this level, the bank meets management's target of a cost-to-income ratio below 50% and ranks well among Moody's-rated regional savings banks in Norway.

Recently Sparebanken Møre's net profitability has benefitted from a reduction in loan loss provisions in Q1-Q3 2011 at NOK12 million vs. NOK32 million in Q1-Q3 2010. The score for profitability is C with a weakening trend, mainly reflecting our expectations that further growth in net interest income is uncertain.

Liquidity

Trend: Neutral

Sparebanken Møre's liquidity is underpinned by a strong deposit base, which accounts for around 60% of its total funding, and retail deposits that represent more than half of total deposits. At Q3 2011 the deposit-to-gross loan ratio was 62%, meaning the bank is reliant on market funding, most of which comes from the domestic market. The maturity profile of the bank's debt is relatively diversified: almost 90% of the market funding has a maturity longer than 12 months.

In addition, Sparebanken Møre's wholly-owned covered bond company, Møre Boligkreditt, provides it with an additional source of funding and we expect that covered bonds will remain an important source of funding for the bank. Moody's cautions that extensive use of covered bond funding through these structures where prime assets come off the bank's balance sheet might result in the structural subordination of SpareBank 1 Møre's unsecured creditors, including depositors. If such structural subordination were to be significant, this might impact the bank's senior debt and deposit ratings.

In 2011 Sparebanken Møre issued NOK0.7 billion senior unsecured funding all with a maturity of 3 years. Sparebanken Møre has also transferred retail mortgages worth NOK7.6 billion to Møre Boligkreditt in 2011, the covered bond company of the SpareBank 1 group, compared to NOK5.4 billion at YE 2010.

At Q3 2011 liquid assets accounted for approximately 10% of total assets, including cash and deposits with the central bank and the securities portfolio, which mainly comprise covered bonds, Norwegian government bonds and senior bonds in Norwegian savings banks as well as some corporate bonds and shareholdings. However, we note that holdings are concentrated on Norwegian securities, which could be a source of vulnerability.

The D+ score for liquidity, although lower than that of European counterparts, is in line with that of other Norwegian banks and reflects Sparebanken Møre's reliance on market funding.

Capital Adequacy

Trend: Neutral

Sparebanken Møre exhibits good capitalisation. At Q3 2011 the Tier 1 and total capital ratios, as calculated under Basel II's standardised approach, stood at 11.1% and 12.6%, respectively. We view the bank's capital buffer as adequate to withstand potential credit losses. However, hybrid capital made up close to 15% of the bank's Tier 1 capital at Q3 2011, which is the maximum amount that can be included in Tier 1 in Norway. We caution that the quality to absorb losses of hybrid capital is below that of pure equity. In addition, these instruments could be excluded from Tier 1 capital according to the Basel Committee's propositions as they are currently presented.

Sparebanken Møre applies a standard approach in calculating its capital adequacy requirement for credit risk. Given the bank's large retail loan book, the capital requirement is estimated to be lower under Basel

II IRB model, which the bank has applied for in 2011. However, due to concentration issues, we do not expect the bank to release capital. Sparebanken Møre scores A for capital adequacy.

Asset Quality

Trend: Weakening

Sparebanken Møre's loan portfolio is well diversified and around 60% of the bank's lending is to retail customers, mainly in the form of mortgages. We note that at Q3 2011 31% of retail loans were part of Møre Boligkreditt's covered pool. We note some concentration towards the property management sector of around 10%, fishing related industry of around 8% and shipping of around 4% of total loans at end 3Q 2011. These sectors have historically been characterised by higher volatility and could be a source of vulnerability.

Operating in a small geographic region means the bank has significant single-borrower exposure, as measured by the 20 largest exposures in relation to Tier 1 capital or pre-provision income. We note a somewhat unseasoned loan portfolio, which reflects high pre-crisis lending growth. Furthermore, the bank's mortgage loan portfolio has a relatively high loan-to-value level, which may pose a risk to asset quality, especially in light of the rapid and sizable property price appreciation in Norway.

At end 3Q 2011, problem loans (defined as commitments in default in excess of three months and other bad and doubtful commitments) accounted for 2.1% of gross loans, down from 2.6% at YE 2010. The bank's loan loss reserve coverage is relatively low at around 45% of problem loans. We further note that the bank has historically had a higher problem loan ratio and a lower problem loan coverage ratio than other Moody's-rated Norwegian banks. On the other hand, actual losses have remained at a low level in the past five years.

The score for asset quality is C. The economic environment in Norway, and in the county of Møre and Romsdal, is satisfactory, but slower economic growth, fewer exports and weaker domestic demand have been a challenge for the corporate sector. Further, with regards to retail loans, household indebtedness has increased in recent years, making customers more vulnerable to interest rates rises, although we take comfort in the still low unemployment levels in Norway. Overall, we consider the trend to be weakening but note lower levels of problem loans in 2010.

Global Local Currency Deposit Rating (Joint Default Analysis)

Moody's assigns a GLC deposit rating of A2 to Sparebanken Møre. The rating is supported by its Baa1 BCA and the Aaa local currency deposit ceiling of Norway, which is considered the underlying support provider. Given the bank's importance to its region, and the region's importance to the national economy of Norway, Moody's assesses as high the probability of systemic support in the event of a stress situation. We are however likely to gradually reduce such unusual support uplift as such support mechanisms are phased out, as banks' stand-alone profiles improve, and as regulators globally consider implementing bank resolution regimes.

Foreign Currency Deposit Rating

Foreign currency deposit ratings are unconstrained given that Norway has a country ceiling of Aaa. Sparebanken Møre's foreign currency deposit rating is A2.

Foreign Currency Debt Rating

Foreign currency senior unsecured debt ratings are unconstrained given that Norway has a country ceiling of Aaa. Sparebanken Møre's foreign currency senior unsecured debt rating is A2.

ABOUT MOODY'S BANK RATINGS

Bank Financial Strength Rating

Moody's Bank Financial Strength Ratings (BFSRs) represent Moody's opinion of a bank's intrinsic safety and soundness and, as such, exclude certain external credit risks and credit support elements that are addressed by Moody's Bank Deposit Ratings. BFSRs do not take into account the probability that the bank will receive such external support, nor do they address risks arising from sovereign actions that may interfere with a bank's ability to honor its domestic or foreign currency obligations. Factors considered in the assignment of BFSRs include bank-specific elements such as financial fundamentals, franchise value, and business and asset diversification. Although BFSRs exclude the external factors specified above, they do take into account other risk factors in the bank's operating environment, including the strength and prospective performance of the economy, as well as the structure and relative fragility of the financial system, and the quality of banking regulation and supervision.

Global Local Currency Deposit Rating

A deposit rating, as an opinion of relative credit risk, incorporates the BFSR as well as Moody's opinion of any external support. Specifically, Moody's Bank Deposit Ratings are opinions of a bank's ability to repay punctually its deposit obligations. As such, they are intended to incorporate those aspects of credit risk relevant to the prospective payment performance of rated banks with respect to deposit obligations, which includes: intrinsic financial strength, sovereign transfer risk (in the case of foreign currency deposit ratings), and both implicit and explicit external support elements. Moody's Bank Deposit Ratings do not take into account the benefit of deposit insurance schemes which make payments to depositors, but they do recognize the potential support from schemes that may provide assistance to banks directly.

According to Moody's joint default analysis (JDA) methodology, the global local currency deposit rating of a bank is determined by the incorporation of external elements of support into the bank's Baseline Credit Assessment. In calculating the Global Local Currency Deposit rating for a bank, the JDA methodology also factors in the rating of the support provider, in the form of the local currency deposit ceiling for a country, Moody's assessment of the probability of systemic support for the bank in the event of a stress situation and the degree of dependence between the issuer rating and the Local Currency Deposit Ceiling.

National Scale Rating

National scale ratings are intended primarily for use by domestic investors and are not comparable to Moody's globally applicable ratings; rather they address relative credit risk within a given country. A Aaa rating on Moody's National Scale indicates an issuer or issue with the strongest creditworthiness and the lowest likelihood of credit loss relative to other domestic issuers. National Scale Ratings, therefore, rank domestic issuers relative to each other and not relative to absolute default risks. National ratings isolate systemic risks; they do not address loss expectation associated with systemic events that could affect all issuers, even those that receive the highest ratings on the National Scale.

Foreign Currency Deposit Rating

Moody's ratings on foreign currency bank obligations derive from the bank's local currency rating for the same class of obligation. The implementation of JDA for banks can lead to high local currency ratings for certain banks, which could also produce high foreign currency ratings. Nevertheless, it should be noted that foreign currency deposit ratings are in all cases constrained by the country ceiling for foreign currency bank deposits. This may result in the assignment of a different, and typically lower, rating for the foreign currency deposits relative to the bank's rating for local currency obligations.

Foreign Currency Debt Rating

Foreign currency debt ratings are derived from the bank's local currency debt rating. In a similar way to foreign currency deposit ratings, foreign currency debt ratings may also be constrained by the country

ceiling for foreign currency bonds and notes; however, in some cases the ratings on foreign currency debt obligations may be allowed to pierce the foreign currency ceiling. A particular mix of rating factors are taken into consideration in order to assess whether a foreign currency bond rating pierces the country ceiling. They include the issuer's global local currency rating, the foreign currency government bond rating, the country ceiling for bonds and the debt's eligibility to pierce that ceiling.

About Moody's Bank Financial Strength Scorecard

Moody's bank financial strength model (see scorecard below) is a strategic input in the assessment of the financial strength of a bank, used as a key tool by Moody's analysts to ensure consistency of approach across banks and regions. The model output and the individual scores are discussed in rating committees and may be adjusted up or down to reflect conditions specific to each rated entity.

Rating Factors

Sparebanken More

Rating Factors [1]	A	B	C	D	E	Total Score	Trend
Qualitative Factors (50%)						C-	
Factor: Franchise Value						D	Neutral
Market Share and Sustainability				x			
Geographical Diversification					x		
Earnings Stability			x				
Earnings Diversification [2]							
Factor: Risk Positioning						C-	Neutral
Corporate Governance [2]	--	--	--	--	--		
- Ownership and Organizational Complexity	--	--	--	--	--		
- Key Man Risk	--	--	--	--	--		
- Insider and Related-Party Risks	--	--	--	--	--		
Controls and Risk Management		x					
- Risk Management			x				
- Controls	x						
Financial Reporting Transparency		x					
- Global Comparability	x						
- Frequency and Timeliness	x						
- Quality of Financial Information			x				
Credit Risk Concentration	--	--	--	--	--		
- Borrower Concentration	--	--	--	--	--		
- Industry Concentration	--	--	--	--	--		
Liquidity Management			x				
Market Risk Appetite	x						
Factor: Operating Environment						B	Neutral
Economic Stability			x				
Integrity and Corruption		x					
Legal System	x						
Financial Factors (50%)						C+	

Factor: Profitability						C	Weakening
PPI / Average RWA - Basel II			2.13%				
Net Income / Average RWA - Basel II			1.36%				
Factor: Liquidity						B-	Neutral
(Mkt funds-Liquid Assets) / Total Assets	-						
Liquidity Management	24.18%		x				
Factor: Capital Adequacy						A	Neutral
Tier 1 Ratio - Basel II	10.90%						
Tangible Common Equity / RWA - Basel II	10.23%						
Factor: Efficiency						B	Neutral
Cost / Income Ratio		46.05%					
Factor: Asset Quality						D+	Weakening
Problem Loans / Gross Loans			3.04%				
Problem Loans / (Equity + LLR)				33.71%			
Lowest Combined Score (15%)						D+	
<i>Economic Insolvency Override</i>						Neutral	
Aggregate Score						C	
Assigned BFSR						C-	

[1] - Where dashes are shown for a particular factor (or sub-factor), the score is based on non public information [2] - A blank score under Earnings diversification or Corporate Governance indicates the risk is neutral



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