

Credit Opinion: Sparebanken More

Global Credit Research - 27 Mar 2012

Norway

Ratings

Category	Moody's Rating
Outlook	Rating(s) Under Review
Bank Deposits	*A2/*P-1
Bank Financial Strength	*C-

* Placed under review for possible downgrade on March 9, 2012

Contacts

Analyst	Phone
Kristin Dahlberg/London	44.20.7772.5454
Richard (Blake) B. Foster/London	
Simon Harris/London	
Jessica Svantesson/London	

Key Indicators

Sparebanken More (Consolidated Financials)[1]

	[2]12-11	[2]12-10	[2]12-09	[2]12-08	[3]12-07	Avg.
Total Assets (NOK billion)	48.4	44.4	41.4	40.8	35.6	[4]8.0
Total Assets (EUR million)	6,248.1	5,699.2	4,994.0	4,191.4	4,486.2	[4]8.6
Total Assets (USD million)	8,111.0	7,645.8	7,165.0	5,826.3	6,559.1	[4]5.5
Tangible Common Equity (NOK billion)	3.6	3.3	2.9	2.5	2.3	[4]11.4
Tangible Common Equity (EUR million)	464.5	419.2	347.2	252.1	294.8	[4]12.0
Tangible Common Equity (USD million)	603.0	562.4	498.1	350.5	431.0	[4]8.8
Net Interest Margin (%)	2.0	2.1	2.0	2.2	2.1	[5]2.1
PPI / Avg RWA (%)	1.9	2.4	2.1	1.9	2.0	[6]2.1
Net Income / Avg RWA (%)	1.3	1.7	1.3	1.1	1.4	[6]1.3
(Market Funds - Liquid Assets) / Total Assets (%)	34.2	32.1	35.2	35.5	31.8	[5]33.7
Core Deposits / Average Gross Loans (%)	64.2	66.3	61.4	60.8	65.2	[5]63.6
Tier 1 Ratio (%)	12.0	12.0	11.6	9.1	9.3	[6]11.2
Tangible Common Equity / RWA (%)	11.7	11.4	10.5	8.8	9.4	[6]10.6
Cost / Income Ratio (%)	49.0	43.6	46.5	48.1	49.5	[5]47.3
Problem Loans / Gross Loans (%)	2.1	2.6	3.0	2.7	3.1	[5]2.7
Problem Loans / (Equity + Loan Loss Reserves) (%)	21.5	26.4	32.0	32.8	35.4	[5]29.6

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

RECENT CREDIT DEVELOPMENTS

On 9 March 2012 Moody's placed the A2/P-1 long and short term deposit ratings of Sparebanken Møre on review for downgrade. Our current expectation is that the bank's senior debt ratings may be lowered by up to two notches. The bank's stand alone rating of C- was also placed on review.

The rating action reflects Moody's view that it may become difficult for Sparebanken Møre to maintain its asset quality going forward. In our opinion, increased house prices, elevated household indebtedness and high proportion of variable rate mortgages render Norwegian banks', herunder Sparebanken Møre's, retail loan books vulnerable. In addition, we note that Sparebanken Møre as other Norwegian banks are increasingly transferring their best collateralised retail mortgage loans to the bank's subsidiary for covered pools as covered bond funding remain an attractive source of funding; this means that the remaining loan book, on which unsecured bondholders have a claim, consists of increasingly risky assets. We also continue to regard loans to the commercial real estate and shipping industries - which we view as more volatile - as more likely to deteriorate in a downturn. In addition, high borrower concentration in the corporate books could potentially heighten the pace and the extent of any deterioration in asset quality. In addition, Moody's 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.

SUMMARY RATING RATIONALE

Moody's currently rates Sparebanken Møre A2/C-/P-1, all ratings are on review for possible downgrade. The current C- bank financial strength rating (BFSR equals a baseline credit assessment (BCA) of Baa1). The ratings incorporates Sparebanken Møre's sound local franchise but is constrained by the bank's high borrower concentration and its exposures to volatile corporate sectors.

The current global local currency (GLC) deposit rating of A2, on review for downgrade, is supported by Sparebanken Møre's stand alone rating of C- tracking to Baa1 BCA and the Aaa local currency deposit ceiling of Norway, which is deemed the underlying support provider. Sparebanken Møre's GLC deposit rating benefits from a two-notch uplift from its BCA. This is based on our assessment of a high probability of systemic support for the bank if necessary and its importance to the Norwegian market. Moody's is however likely to gradually reduce such unusual support uplift as regulators globally consider implementing bank resolution regimes.

Rating Drivers

- Sound market position of around 20% in Western Norway, the counties of Møre and Romsdal
- Satisfactory capitalisation given retail focus of the bank
- Around 60% of lending to retail customers (including loans transferred to Møre Boligkreditt), mostly mortgage loans
- Pressure on profitability given high competition in Norway
- Asset quality uncertainties as well as exposure to volatile sectors, including property management, fisheries and the maritime industry
- High dependence on market funding
- Somewhat less sophisticated risk management practices compared to peers

Rating Outlook

All ratings of Sparebanken Møre are on review for downgrade.

What Could Change the Rating - Up

An upgrade of the BFSR or the GLC deposit rating is unlikely as all ratings are on review for downgrade.

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.

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. This is due to Moody's loss expectations for Sparebanken Møre's loan portfolio, especially in light of its exposure to sectors more vulnerable to deteriorating economic trends.

Robust Local Franchise in Western Norway

Sparebanken Møre is a regional savings bank with a good 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 pronounced 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. The main constraint for the rating assessment of Sparebanken Møre's franchise is the bank's limited geographic diversification.

Funding from Domestic Covered Bonds and Deposits

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 Q4 2011 the deposit-to-gross loan ratio was 63%, meaning the bank is reliant on market funding, most of which comes from the domestic market. The maturity profile of the bank's debt, of which 41% consists of covered bonds, is relatively well diversified where 75% 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 Sparebanken 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 has transferred retail mortgages worth NOK5.7 billion to Møre Boligkreditt in 2011, the covered bond company of the bank, compared to NOK3.9 billion at YE 2010, corresponding to 14% and 10% of total loans respectively.

At Q4 2011 liquid assets accounted for approximately 14% 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 lead to some vulnerability.

In Moody's view Sparebanken Møre's liquidity position is in line with that of other Norwegian banks but remain affected by a high reliance on market funding.

Cyclical Lending Vulnerability but Robust Capitalisation

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 Q4 2011 32% of retail loans were part of Møre Boligkredit's covered pool. We note some concentration towards the property management sector of around 13%, fishing related industry of around 8% (primarily fishing vessels and exposures backed by fishing quotas) and shipping of around 4% of total loans at end Q4 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.

Problem loans (defined as commitments in default and other bad and doubtful commitments) accounted for 2.1% of gross loans for 2011, down from 2.6% at YE2010. 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 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 asset quality trend to be weakening.

Sparebanken Møre exhibits good capitalisation. At Q4 2011 the Tier 1 and total capital ratios, as calculated under Basel II's standardised approach, stood at 12.1% and 13.6%, 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 Q4 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.

Margin Pressure and Asset Quality Uncertainties are Risks to Profitability

Sparebanken Møre is reliant on net interest income, which represented some 80% of its operating income in 2011. 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 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 50% for FY2011. At this level, the bank just 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 problem loans by NOK107 million although reported loan losses rose marginally to 10bps for 2011 from 8bps for 2010. In Moody's opinion the trend for the bank's profitability is weakening due to concerns for future lower growth affecting asset quality and net interest margin pressure.

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 (on review for downgrade) 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 .(on review for downgrade).

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.

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					x		
- 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			2.15%				
Net Income / Average RWA - Basel II			1.44%				
Factor: Liquidity						D+	Neutral
(Mkt funds-Liquid Assets) / Total Assets					24.10%		
Liquidity Management			x				
Factor: Capital Adequacy						A	Neutral
Tier 1 Ratio - Basel II	11.86%						

Tangible Common Equity / RWA - Basel II	11.21%						
Factor: Efficiency						B	Neutral
Cost / Income Ratio		46.33%					
Factor: Asset Quality						C	Weakening
Problem Loans / Gross Loans			2.56%				
Problem Loans / (Equity + LLR)			26.65%				
Lowest Combined Score (15%)						D+	
Economic Insolvency Override						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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