

Global Credit Research - 10 Apr 2016

Norway

Ratings

Category	Moody's Rating
Outlook	Stable
Bank Deposits	A2/P-1
Baseline Credit Assessment	baa1
Adjusted Baseline Credit Assessment	baa1
Counterparty Risk Assessment	A1(cr)/P-1(cr)
Issuer Rating	A2

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Key Indicators

Sparebanken More (Consolidated Financials) [1]

	[2]12-15	[2]12-14	[2]12-13	[2]12-12	[2]12-11	Avg.
Total Assets (NOK billion)	60.1	56.3	54.6	51.6	48.5	[3]5.5
Total Assets (EUR million)	6,252.6	6,206.2	6,534.5	7,037.0	6,256.1	[3]0.0
Total Assets (USD million)	6,792.2	7,509.8	9,004.2	9,277.6	8,121.4	[3]-4.4
Tangible Common Equity (NOK billion)	5.0	4.8	4.4	3.7	3.2	[3]11.8
Tangible Common Equity (EUR million)	518.1	526.8	529.1	503.8	411.9	[3]5.9
Tangible Common Equity (USD million)	562.9	637.4	729.0	664.2	534.7	[3]1.3
Problem Loans / Gross Loans (%)	0.5	0.8	1.1	1.3	1.9	[4]1.1
Tangible Common Equity / Risk Weighted Assets (%)	15.5	13.3	13.2	11.5	10.4	[5]12.8
Problem Loans / (Tangible Common Equity + Loan Loss Reserve) (%)	4.5	7.7	11.3	14.5	21.9	[4]12.0
Net Interest Margin (%)	1.9	2.0	2.0	1.9	2.0	[4]1.9
PPI / Average RWA (%)	2.2	2.2	2.0	2.6	1.9	[5]2.2
Net Income / Tangible Assets (%)	0.8	1.0	0.8	1.1	0.8	[4]0.9
Cost / Income Ratio (%)	45.1	43.1	45.9	35.0	48.4	[4]43.5
Market Funds / Tangible Banking Assets (%)	26.2	25.1	24.1	36.0	36.8	[4]29.6
Liquid Banking Assets / Tangible Banking Assets (%)	11.9	10.9	13.4	13.0	14.0	[4]12.7
Gross loans / Due to customers (%)	175.7	173.3	165.8	161.5	160.7	[4]167.4

Source: Moody's

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

Opinion

SUMMARY RATING RATIONALE

Moody's assigns Sparebanken More a baa1 baseline credit assessment (BCA), an A2 long-term issuer rating, an A2 long term deposit rating and a short term rating of Prime-1. We also assign a Counterparty Risk Assessment (CRA) of A1(cr) long-term and Prime-1 (cr) short-term.

Sparebanken More's BCA of baa1 is supported by our expectation of ongoing improvement in the bank's asset quality and resilience in the face of the ongoing slowdown in the operating environment. In addition we expect that the bank's strong capital metrics are likely to improve further, given management's intention to increase capital buffers through greater earnings retention. The bank's A2 deposit and issuer ratings take into account the baa1 BCA as well as our Loss Given Failure (LGF) analysis of the bank's own volume of deposits and debt, and the volume of securities subordination to them.

Rating Drivers

- Sparebanken More's BCA is supported by its Very Strong- macro profile
- Strong capital metrics
- Asset quality is strong albeit exposed to cyclical industries and credit concentration
- Limited upside on profit margins
- Substantial deposit base and improving quality of market funding sources
- Large volume of deposits and junior debt resulting in deposit ratings benefiting from a very low loss-given-failure rate and a two-notch uplift from the BCA.

Rating Outlook

The stable outlooks on the bank's long-term senior debt and deposit ratings reflect our view that the bank's financials will remain broadly resilient in the face of the current modest slowdown in Norway's economic performance.

What Could Change the Rating - Up

Upward rating momentum could develop if Sparebanken More demonstrates (1) continued good asset performance in its retail and corporate books, including in the more volatile segments, (2) continued good access to capital markets and further issuance of LCR eligible covered bonds, as well as improved liquidity, and/or (3) stronger earnings generation without a material increase in risk profile.

What Could Change the Rating - Down

Future downward rating pressure would emerge if (1) Sparebanken More's problem loan ratio increases above our system wide expectation of approximately 2%, (2) financing conditions become more difficult, (3) the bank's risk profile increases as a result of increased exposures to more volatile sectors, for example if CRE concentration as a percent of Core Tier 1 Capital exceeds 150%, or if the quality of oil related portfolio deteriorates on the back of lower oil prices and/or (4) the macroeconomic environment deteriorates more than currently anticipated, leading to a lower macro profile and net profitability falling to below 0.4% of tangible assets. Also, a reduction in uplift as a result of our LGF analysis could lead to downward rating pressure.

DETAILED RATING CONSIDERATIONS

SPAREBANKEN MORE'S BCA IS SUPPORTED BY ITS VERY STRONG- MACRO PROFILE

As a domestically oriented bank, Sparebanken More's operating environment and hence the bank's Macro Profile is aligned with that of Norway at Very Strong-. Norwegian banks benefit from operating in an affluent and developed country with very high economic, institutional and government financial strength as well as low susceptibility to event risk. The country's economy is growing and well diversified, and has demonstrated resilience to the ongoing weakness in the oil sector. The main risks to the system stem from the high level of household indebtedness, elevated real estate prices and domestic banks' extensive use of market funding. However, these risks are offset by the strength of households' ability to service debt, banks' adequate capitalisation and the relatively small size of the banking system compared with GDP.

STRONG CAPITAL METRICS

In line with many Norwegian savings banks, Sparebanken More has improved its capital ratios in accordance with the increasing regulatory capital requirements (11.5% Common Equity Tier 1 ratio as of July 2016).

Sparebanken More reported a Common Equity Tier 1 (CET1) ratio of 14.2% at end December 2015, compared to 12% at year-end 2014, and we expect this metric to improve over the medium term, as the bank's Board of Trustees approved 55% of the year's profit to be retained. We view such capital-enhancing measures positively, as they increase the bank's buffer against potential losses. Sparebanken More's assigned capital score reflects the bank's TCE-to-tangible banking assets ratio of 8.3% at end-December 2015 (8.5% at year-end 2014), which is well within international standards, and its increasing trend.

ASSET QUALITY IS STRONG ALBEIT EXPOSED TO CYCLICAL INDUSTRIES AND CREDIT CONCENTRATION

Sparebanken More's reported problem ratio (impaired loans as a percentage of total loans) declined to 0.5% at end-December 2015 from 0.8% at year-end 2014 and 1.15% at end-December 2013, continuing the steady downward trend from its peak at 3.1% at year-end 2007. The problem loan ratio reported for 2015 is below most other Moody's-rated Norwegian savings banks, although historically it has been somewhat higher.

Sparebanken More's asset risk score indicates that overall, asset risk remains a relative strength for the bank, albeit that the bank remains substantially exposed to sectors that we view as more volatile: the real estate sector (property management and construction, accounting for almost 13% of total loans at December 2015), fishing-related industries (primarily fishing vessels and exposures backed by fishing quotas, around 6.4%), and shipping (around 2.3%). Exposures to these sectors have accounted for a substantial portion of Sparebanken More's problem loans in recent years, and we note the risk that declining oil and gas prices and falling investment levels could trigger a mild asset quality deterioration from the currently strong current position.

As a mitigant, Sparebanken More's loan portfolio is well diversified, with retail customers accounting for over 67% of the bank's lending, mainly in the form of mortgages. At December 2015, almost 49% of these retail loans had been transferred to the bank's wholly-owned covered bond company More Boligkreditt. In addition, given that Sparebanken More operates in only one region, the bank's loan portfolio exhibits significant single-borrower concentration - and whilst this is a common feature at Nordic banks, it could accelerate the extent and pace of any deterioration in asset quality.

LIMITED UPSIDE ON PROFIT MARGINS

Net interest income, which has represented around 84% of operating income in recent years, is Sparebanken More's main source of revenue. The growth of NII fell to 0.5% in 2015, compared to 5% in 2014, reflecting lower interest rates with low return on free capital combined with strong competition for both loans and deposits in 2015.

Sparebanken More's efficiency supports its profitability; the bank's cost-to-income ratio was 45.1% at end-December 2015 in-line with the 43.2% at year-end 2014 as per Moody's calculations. This meets the management's target ratio of below 50%, and ranks favourably among Moody's-rated Norwegian regional savings banks. In 2015, loan loss provisions increased significantly with cost of risk at 0.10% of loans (0.05% in 2014), as the bank increased the generic reserves in the second half of the year due to relatively high exposure to more volatile sectors such as construction real estate and shipping.

The bank's net income-to-tangible banking assets ratio was 0.8% in 2015 lower compared to 1% in 2014 but aligned with the average of the last three years, and in line with most regional savings banks. However, given uncertainty over the bank's margins, we expect this metric to be somewhat lower over the next 12 months which is reflected in our profitability score.

SUBSTANTIAL DEPOSIT BASE AND IMPROVING QUALITY OF MARKET FUNDING SOURCES

Sparebanken More's funding position is underpinned by a strong deposit base, of which 61% are retail deposits, which accounts for just below 53% of total funding. Market funding accounted for just over 26.2% of the bank's tangible banking assets at end-December 2015, and has been stable in recent years. Our funding structure score indicates that the overall funding profile remains a modest fundamental weakness for Sparebanken More because of the inherent confidence sensitivity of this funding source.

At December 2015, over 60% of market funds were in the form of covered bonds issued through More

Boligkreditt. We view the diversification benefit and the typically longer maturity of these funding instruments positively, in particular recent bigger size issuance because of its eligibility under liquidity coverage ratio (LCR) rules.

At end- December 2015, liquid assets accounted for around 12% of tangible banking assets in line with other Norwegian peers, including cash and deposits with the central bank and the securities portfolio, which mainly comprise domestic and European covered bonds, government and supranational bonds, with minor holdings of senior and corporate bonds as well as minor shareholdings. Bond holdings in the liquidity portfolio are generally equally divided by foreign (European) and domestic issuers. Euro-denominated issues are hedged into Norwegian krone, and fixed-rate bonds are swapped into floating interest rates (mainly three months floating).

Notching Considerations

LOSS GIVEN FAILURE AND ADDITIONAL NOTCHING

Norway is in the process of introducing legislation to implement the EU Bank Resolution and Recovery Directive (BRRD). In our LGF analysis we assume residual tangible common equity of 3% and losses post-failure of 8% of tangible banking assets, a 25% run-off in "junior" wholesale deposits, a 5% run-off in preferred deposits, and assign a 25% probability to deposits being preferred to senior unsecured debt. These metrics are in line with our standard assumptions.

For Sparebanken More's short-term and long-term deposit ratings, our ratings have considered the likely impact on loss-given-failure of the combination of their own volume and the amount of debt subordinated to them. This results in Preliminary Rating Assessment (PRA) of two notches above the BCA, reflecting very low loss-given-failure.

GOVERNMENT SUPPORT

The expected implementation of resolution legislation has caused us to reconsider the potential for government support to benefit certain creditors.

Sparebanken More is a regional savings bank with a robust market position in western Norway in the county of More and Romsdal where we estimate it commands market shares of 18% for lending and just over 30% for deposits. However, its national market share is limited at just above 1% of loans and 1.5% on deposits. Therefore we now expect a low probability of government support for deposits, resulting to no uplift.

COUNTERPARTY RISK ASSESSMENT

We assign a long-term and short-term CR assessment of A1 (cr) and P-1 (cr) respectively to Sparebanken More.

CR Assessments are opinions of how counterparty obligations are likely to be treated if a bank fails and are distinct from debt and deposit ratings in that they (1) consider only the risk of default rather than the likelihood of default and the expected financial loss suffered in the event of default and (2) apply to counterparty obligations and contractual commitments rather than debt or deposit instruments. The CR assessment is an opinion of the counterparty risk related to a bank's covered bonds, contractual performance obligations (servicing), derivatives (e.g., swaps), letters of credit, guarantees and liquidity facilities.

Foreign Currency Deposit Rating

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

About Moody's Bank Scorecard

Our Scorecard is designed to capture, express and explain in summary form our Rating Committee's judgment. When read in conjunction with our research, a fulsome presentation of our judgment is expressed. As a result, the output of our Scorecard may materially differ from that suggested by raw data alone (though it

has been calibrated to avoid the frequent need for strong divergence). The Scorecard 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

Macro Factors	
Weighted Macro Profile	Very Strong

Financial Profile						
Factor	Historic Ratio	Macro Adjusted Score	Credit Trend	Assigned Score	Key driver #1	Key driver #2
Solvency						
Asset Risk						
<i>Problem Loans / Gross Loans</i>	0.8%	aa2	← →	a3	Geographical concentration	Sector concentration
Capital						
<i>TCE / RWA</i>	15.5%	aa3	← →	aa3	Risk-weighted capitalisation	
Profitability						
<i>Net Income / Tangible Assets</i>	0.8%	baa1	↓	baa2	Expected trend	
Combined Solvency Score		a1		a2		
Liquidity						
Funding Structure						
<i>Market Funds / Tangible Banking Assets</i>	26.2%	baa2	← →	ba1	Extent of market funding reliance	Market funding quality
Liquid Resources						
<i>Liquid Banking Assets / Tangible Banking Assets</i>	11.9%	baa3	← →	baa3	Stock of liquid assets	
Combined Liquidity Score		baa2		ba1		

Financial Profile

baa1

Qualitative Adjustments

Adjustment

Business Diversification	
Opacity and Complexity	
Corporate Behavior	
Total Qualitative Adjustments	0

0
0
0
0

Sovereign or Affiliate constraint

Aaa

Scorecard Calculated BCA range	a3 - baa2
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Assigned BCA	baa1
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Affiliate Support notching	0
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Adjusted BCA	baa1
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Instrument Class	Loss Given Failure notching	Additional notching	Preliminary Rating Assessment	Government Support notching	Local Currency rating	Foreign Currency rating
Deposits	2	0	a2	0	A2	A2

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