Credit Opinion: Sparebanken More

Global Credit Research - 28 Apr 2010

Norway

Ratings

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

Contacts

Analyst	Phone
Oscar Heemskerk/London	44.20.7772.5454
Janne Thomsen/London	
Simon Harris/London	
Soline Poulain/London	

Key Indicators

Sparebanken More

	[1]2009	[2]2008	2007	2006	2005	[3]Avg.
Total assets (NOK billion)	41.39	40.80	35.62	31.76	26.86	[4]10.86
Total assets (EUR billion)	4.99	4.19	4.49	3.87	3.36	--
Total capital (NOK billion)	3.90	3.30	2.93	2.72	2.60	[4]9.66
Return on average assets	0.82	0.88	0.99	0.93	1.02	0.93
Recurring earnings power [5]	1.34	1.43	1.38	1.30	1.51	1.39
Net interest margin	2.10	2.30	2.20	2.21	2.46	2.25
Cost/income ratio (%)	48.02	46.36	49.29	52.73	51.07	49.49
Problem loans % gross loans	2.95	2.66	3.08	2.56	2.43	2.74
Tier 1 ratio (%)	11.55	9.12	9.34	10.28	11.43	10.34

[1] As of December 31. [2] Statement period in which the bank switched to Basel II accounting framework. [3] The average calculations are based on Basel I and Basel II data where applicable. [4] Compound annual growth rate. [5] Preprovision income % average assets.

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, strengthened in Q3 2009

- Around 60% of lending to retail customers (including loans transferred to Møre Boligkreditt), mostly mortgage loans

Credit Challenges

- Growing revenue, given the high competition and economic slowdown 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 and Company Events

Sparebanken Møre reported pre-tax profits of NOK126 million in Q1 2010, a slight increase from NOK124 million in Q4 2009. Lower loan loss provisions of NOK12 million during the quarter (NOK20 million in Q4 2009) largely compensated for a fall in income from a positive mark-to-market revaluation.

At end-Q1 2010, the Tier 1 and total capital ratios, as calculated under Basel II's standardised approach and excluding interim profits, stood at 11.6% and 13.4%.

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)

Factor 1: 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, and is characterised by high retail and corporate market shares that are underpinned by a loyal customer base. The bank reports a market share of almost 30% in retail lending and around 20% in corporate lending (mainly to SMEs) in the municipalities where it is present. At YE2008, the bank was the seventh-largest savings bank in Norway by assets and had national market shares below 2% in deposits and 1% in lending.

Sparebanken Møre 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 AS) and real estate brokerage (Møre Eiendomsmegling AS), and established its own covered bond company, Møre Boligkreditt AS, in late 2008 for funding purposes.

In the region where it operates, Sparebanken Møre faces competition from larger players such as Nordea and DnB NOR, 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. In that respect, we positively view the acquisition of Tingvoll Sparebank (a small local savings bank with some NOK1 billion in assets) in November 2009, which strengthens the bank's presence in the north part of Møre and Romsdal. Going forward, the June 2009 regulation of savings bank's equity certificates (EC) may lead to more small-scale acquisition opportunities.

Although we acknowledge Sparebanken Møre's strong presence in the region in which it operates, the C- score for franchise value is constrained by the bank's low geographic diversification.

Factor 2: Risk Positioning

Trend: Neutral

As a Norwegian savings bank, Sparebanken Møre's EC holders have, contrary to shareholders, ownership rights only to specific parts of the bank's capital. In addition, the governing bodies of the bank have a broader representation than those of a commercial bank. The ECs of Sparebanken Møre are listed on the Oslo Stock Exchange. No EC holders have a stake of more than 10% and the 20 largest EC holders owned less than 40% of the shares at YE 2009. Since the acquisition of Tingvoll Sparebank, the bank's largest EC holder is Sparebankstiftelsen Tingvoll with 9.8% of ECs.

Sparebanken Møre follows the recommendations of the Oslo Stock Exchange for corporate governance. The bank's board of directors comprises seven members, including one employee representative. CEO Olav Arne Fiskerstrand is not a member of the board. Several members of the management group have extensive experience at the bank. Overall, Moody's does not believe there are corporate governance problems at Sparebanken Møre.

Sparebanken Møre's reports under IFRS and the accounts are audited by Ernst & Young. 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 a/o credit risk, market risk and funding risk, in line with board approved guidelines, and reports to the CEO. Sparebanken Møre currently applies the standardised approach of Basel II to calculate its credit risk. For some time it has been aiming to build a relevant modelling tool to receive the Foundation IRB approval, but the timing of the application is uncertain. 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 (see Asset Quality, below).

Sparebanken Møre's market risk remains modest. Its exposure to interest rates is limited: interest rate risk at the parent bank was NOK1 million in relation to a 100 bps change in interest rates at YE 2009. Investments in shares and ECs amounted to NOK131 million at YE 2009, corresponding to around 8% of Tier 1 capital. This figure includes a 1.3% ownership in Eksportfinans. The bank also has limited foreign currency exposure.

Sparebanken Møre's liquidity management is covered under the Liquidity section, below.

High credit risk concentration is a constraining factor in the score for risk positioning and pushes it to C-.

Factor 3: Regulatory Environment

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

Factor 4: Operating Environment

Trend: Neutral

The score for the operating environment takes into account the economic stability, integrity and corruption of a country and its legal system. The score for Norway's operating environment is B+. For a further discussion about the operating environment, please see Moody's latest Banking System Outlook on Norway.

Quantitative Factors (50% weighting)

Factor 5: Profitability

Trend: Weakening

Sparebanken Møre reported more stable earnings than some of its Nordic peers during the financial crisis, reflecting its limited involvement in trading activities as well as the relatively high proportion of its pre-tax earnings (over 40%) that are derived from the retail segment, which we deem less volatile.

Sparebanken Møre is reliant on net interest income, which represented almost 80% of its operating income in 2009. However this source of earnings was negatively affected by reduced interest income from its investment activities (real estate management and Møre Boligkreditt). Going forward, we expect that strong competition will keep pressure on the net interest margin, particularly in the retail sector. Fee & commission income accounted for around 12% of operating income during the year and is mainly related to fees from credit cards and loans.

In line with most of its European peers in 2009, the bank reported record trading income, although the year-on-year increase was relatively limited. However, we note that some of the volatility in the market value of instruments was offset by the effect of the fair value option on the bank's own debt.

Loan loss provisions have affected the bank's net profitability in 2008 and 2009, increasing from NOK65 million to NOK82 million. The year-on-year increase is even more substantial when adjusting for a NOK35 million provision related to the guarantee provided to Eksportfinans that was booked in 2008 and largely reversed in 2008.

The score for profitability is C with a weakening trend, mainly reflecting our expectations that growth in net interest income is uncertain as lending growth is to remain contained.

Factor 6: Liquidity

Trend: Neutral

Sparebanken Møre's liquidity is underpinned by a strong deposit base, which accounts for almost 60% of its total funding, and retail deposits that represent more than half of total deposits.

At YE 2009 the deposit-to-gross loan ratio was 60%, 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: approximately 85% 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, something that Moody's views favourably. In 2009, covered bonds were mainly used in the government swap arrangement, whereby these instruments can be exchanged for government bonds. Due to improved market conditions, this scheme has now been phased out, although we expect that covered bonds will remain an attractive source of funding for Sparebanken Møre.

At YE 2009 liquid assets accounted for 10% of total assets, including cash and deposits with the central bank and the securities portfolio, which mainly comprise senior bonds of banks and municipalities, as well as some corporate bonds and shareholdings. The bank does not have exposure to structured products. However, we note that holdings are concentrated on Norwegian securities, which could be a source of vulnerability.

Sparebanken Møre's liquidity score of D+ is lower than those of its European peers and reflects a relatively low amount of liquid assets in relation to market funding.

Factor 7: Capital Adequacy

Trend: Neutral

Sparebanken Møre exhibits good capitalisation. At YE 2009, the Tier 1 and total capital ratios, as calculated under Basel II's standardised approach, stood at 11.6% and 13.4%, respectively. The improvement from 9.1% and 10.8% reported at YE 2008 is largely due to a NOK277 million Tier 1 hybrid issue that was raised in the market in August 2009.

We view this measure positively as it strengthens the bank's capital buffer to withstand potential credit losses. However, 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. At YE 2009 hybrid capital made up 15% of the bank's Tier 1 capital, which is the maximum amount that can be included in Tier 1 in Norway.

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. However, due to concentration issues, we do not expect the bank to release capital.

In 2009, the board updated its minimum capital ratio targets: it now aims for a core capital ratio of 10% (previously 9%) and a total capital ratio of 12% (10%). Moody's regards this change favourably, given the bank's high credit risk concentration and its exposure to a small geographic area.

Sparebanken Møre scores B+ for capital adequacy.

Factor 8: Efficiency

Trend: Neutral

Sparebanken Møre's efficiency as measured by its cost-to-income ratio is relatively good at 48% at YE 2009 (46% at YE 2008). At this level, the bank meets management's target of a ratio below 50% and ranks it among the most efficient Moody's-rated regional savings banks in Norway. The bank uses third party providers when selling services such as insurance and investment products, avoiding the fixed costs that would be related to in-house production. The acquisition of Tingvoll Sparebank did not have a substantial impact on Sparebanken Møre's efficiency given its small scale (9 employees). However, we note that operating costs, mainly driven by salaries, increased by 8% in 2009. Additionally, going forward, cost containment might prove to be more difficult as an independent bank.

The bank scores B for cost efficiency. However, given the revenue pressure from a challenging operating environment, we would not expect an improvement in the cost-to-income ratio in the coming years.

Factor 9: Asset Quality

Trend: Weakening

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. The bank also has some industry concentration, with the property management sector representing around 10% of gross loans. Corporate lending includes lending to fishing-related (8% of gross loans) and shipping (6% of gross loans) industries. These sectors have historically been characterised by higher volatility and could be a source of vulnerability in the current downturn.

In addition, we note a somewhat unseasoned loan portfolio, which reflects high lending growth (a year-on-year increase of 13% in 2008 and 14% in 2007). Nevertheless, growth in gross loans was moderate at 1.7% in 2009, especially in the corporate sector.

At YE 2009, problem loans (defined as commitments in default in excess of three months and other bad and doubtful commitments) accounted for 3% of gross loans (2.7% at YE 2008). We note that the bank has historically had a higher problem loan ratio than the other Moody's-rated Norwegian banks. On the other hand, actual losses have remained at a low level in the past five years, although we do note an increasing trend in recent quarters.

The bank's problem loan coverage according to loan loss reserves is relatively low at below 40% of problem loans, although this reflects that around 60% of lending is to the retail sector, largely in the form of first-priority mortgages. We caution that the sustained increase in house prices in Norway may have underrated the level of provisioning by inflating collateral value. We further note that at YE 2009, 17% of retail mortgages were part of Møre Boligkreditt's covered pool.

The score for asset quality is D+. The economic environment in Norway, and in the county of Møre and Romsdal, is still satisfactory, but slower economic growth, fewer exports and weaker domestic demand are challenges 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.

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.

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.

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

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Rating Factors [1]	**A**	**B**	**C**	**D**	**E**	**Total Score**	**Trend**
Qualitative Factors (50%)						**C**	
Factor: Franchise Value						**C-**	**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**
PPP % Avg RWA - Basel II			2.00%				
Net Income % Avg RWA - Basel II			1.22%				
Factor: Liquidity						**D+**	**Neutral**
(Mkt funds-Liquid Assets) % Total Assets					27.74%		
Liquidity Management			x				
Factor: Capital Adequacy						**B+**	**Neutral**
Tier 1 ratio (%) - Basel II		10.34%					
Tangible Common Equity / RWA - Basel II	9.19%						
Factor: Efficiency						**B**	**Neutral**
Cost/income ratio		47.89%					
Factor: Asset Quality						**D+**	**Weakening**
Problem Loans % Gross Loans			2.89%				
Problem Loans % (Equity + LLR)				32.98%			
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