MOODY'S
INVESTORS SERVICE

Credit Opinion: Sparebanken More

Global Credit Research - 02 Apr 2014

Norway

Ratings

Category	Moody's Rating
Outlook	Stable
Bank Deposits	A3/P-2
Bank Financial Strength	C-
Baseline Credit Assessment	baa2
Adjusted Baseline Credit Assessment	baa2

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Key Indicators

Sparebanken More (Consolidated Financials)[1]

	[2]12-13	[2]12-12	[2]12-11	[2]12-10	[2]12-09	Avg.
Total Assets (NOK billion)	54.6	51.6	48.5	44.4	41.4	[3]7.2
Total Assets (EUR million)	6,534.5	7,032.1	6,256.1	5,699.2	4,994.0	[3]7.0
Total Assets (USD million)	9,004.2	9,271.1	8,121.4	7,645.8	7,165.0	[3]5.9
Tangible Common Equity (NOK billion)	5.0	4.3	3.4	3.3	2.9	[3]14.9
Tangible Common Equity (EUR million)	600.1	588.4	442.7	419.2	347.2	[3]14.7
Tangible Common Equity (USD million)	826.9	775.7	574.7	562.4	498.1	[3]13.5
Net Interest Margin (%)	2.1	2.0	2.0	2.1	2.0	[4]2.0
PPI / Average RWA (%)	2.2	2.1	2.0	2.4	2.1	[5]2.1
Net Income / Average RWA (%)	1.5	1.4	1.3	1.7	1.3	[5]1.5
(Market Funds - Liquid Assets) / Total Assets (%)	23.8	23.2	23.3	21.9	27.0	[4]23.9
Core Deposits / Average Gross Loans (%)	62.1	64.5	64.2	66.3	61.4	[4]63.7
Tier 1 Ratio (%)	15.6	13.7	12.0	12.0	11.6	[5]13.0
Tangible Common Equity / RWA (%)	15.0	13.2	11.2	11.4	10.5	[5]12.3
Cost / Income Ratio (%)	44.2	48.4	48.8	43.4	46.4	[4]46.2
Problem Loans / Gross Loans (%)	1.2	1.3	1.9	2.4	3.0	[4]2.0
Problem Loans / (Equity + Loan Loss Reserves) (%)	9.9	12.4	20.3	24.6	32.0	[4]19.8

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

Sparebanken Møre's C- standalone bank financial strength rating (BFSR), which is equivalent to a standalone credit assessment (BCA) of baa2, incorporates our assessment of the bank's sound local franchise but is primarily constrained by the bank's high borrower concentration and its exposures to more volatile corporate sectors.

Sparebanken Møre's global local currency (GLC) deposit rating of A3 receives a two-notch uplift from its baa2 BCA. This is based on our assessment of a high probability of systemic support for the bank if necessary and its importance to its local region.

Rating Drivers

- Robust local franchise in Western Norway

- Substantial deposit base, but reliance on market funds

- Exposure to cyclical industries and credit concentration pose downside risk to asset quality

- Strong capital ratios given recent management actions

- Expected focus on margins, but upside limited by strong competition and uncertainties regarding provisioning levels

Rating Outlook

All Sparebanken Møre's ratings carry stable outlooks.

What Could Change the Rating - Up

Upward rating momentum could develop if Sparebanken Møre demonstrates: (1) sustained good asset quality in its retail and corporate loan books, including in the more volatile segments, (2) continued good access to capital markets and improved liquidity position, and/or (3) stronger earnings generation without an increase in its risk profile.

What Could Change the Rating - Down

The bank's ratings could see downward pressure if: (1) Sparebanken Møre's asset quality deteriorates more than we anticipate, (2) financing conditions become more difficult and/or (3) its risk profile increases, for example as a result of increased exposures to more volatile sectors. In addition, we believe that downward pressure could be exerted on the ratings due to external factors, such as less supportive macroeconomic environment and/or substantially adverse developments in the Norwegian real-estate market.

DETAILED RATING CONSIDERATIONS

ROBUST LOCAL FRANCHISE IN WESTERN NORWAY

Sparebanken Møre is a regional savings bank with a robust market position in western Norway in the county of Møre and Romsdal, where Moody's estimates it commands market shares of around 17% for lending and just over 30% for deposits. It operates as an independent savings bank and uses an open-architecture business model to broaden its offering of financial services and products.

Its national market share is however limited, at just above 1% on loans and 1.5% on deposits. In addition, despite the strong local market share, Sparebanken Møre faces keen competition and, similarly to most regional savings banks, it lacks pricing power against the two national market leaders.

The bank's limited geographic diversification is another key constraint in our assessment of Sparebanken Møre's franchise value, as it means that the performance of its operations is closely linked to local economic developments.

SUBSTANTIAL DEPOSIT BASE, BUT RELIANCE ON MARKET FUNDS

Sparebanken Møre's funding position is underpinned by a strong deposit base, which accounts for just under 60% of its total funding, and retail deposits that represent almost 60% of total deposits. At end-2013 the deposit-to-gross loan ratio was 62%, meaning the bank has a significant reliance on market funding, which we see as a credit negative, due to the inherent confidence sensitivity of this funding source.

At end-2013, around 65% of market funds was in the form of covered bonds issued through Møre Boligkreditt, the bank's wholly-owned covered bond company. Whilst we positively view the diversification benefit and the typically longer maturity of these funding instruments (4 years on average at end-2013, although this falls to around 2.5 years if we use an average weighted by outstanding amount), we caution that extensive use of covered bond funding results in the structural subordination of Sparebanken Møre's unsecured creditors, including depositors.

At end- 2013 liquid assets accounted for around 13% 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 we see as a vulnerability from a concentration perspective.

EXPOSURE TO CYCLICAL INDUSTRIES AND CREDIT CONCENTRATION POSE DOWNSIDE RISK TO ASSET QUALITY

Problem loans (defined as commitments in default and other bad and doubtful commitments) accounted for 1.2% of gross loans at end-2013, continuing the steady downward trend from their peak at 3.1% at year-end 2007. This level is now in-line with that of most other Moody's-rated Norwegian savings banks, while it had historically been somewhat higher.

Sparebanken Møre's loan portfolio is well diversified with over 65% of the bank's lending being to retail customers, mainly in the form of mortgages. At end-2013, just under 50% of these retail loans were part of Møre Boligkreditt's covered pool and we note that the remaining mortgages - available to unsecured creditors in a liquidation - typically have higher loan-to-value and are therefore more exposed to any decline in house prices.

A key risk to Sparebanken Møre's future asset quality is its substantial exposure to sectors that we view as more volatile: the real estate sector (property management and construction, around 14% of total loans at end-2013), fish-related industries (primarily fishing vessels and exposures backed by fishing quotas, around 6%) and shipping (around 3%). Exposures to these sectors have accounted for a substantial portion of Sparebanken Møre's problem loans in recent years and we expect exposures to these sectors will continue to be a source of vulnerability for the bank's future asset quality.

In addition, operating in only one region means that Sparebanken Møre exhibits significant single-borrower concentration - whilst common at Nordic banks, this feature could accelerate the extent and pace of any deterioration in asset quality. Furthermore, less favourable interest rate and house price levels, combined with highly indebted Norwegian households, could undermine the bank's retail asset quality. We also note the small Norwegian house price falls towards the end of 2013, which may indicate an end to several years of almost continuous inflation in recent years.

STRONG CAPITAL RATIOS GIVEN RECENT MANAGEMENT ACTIONS

Sparebanken Møre reported a tier 1 ratio of 15.6% at end-2013, up from 13.7% at end-2012. This improvement is attributable to three capital issuances in 2013 (a NOK275 million new equity certificate issuance in Q3, NOK100 million repair issue and a NOK3.5 million employee issue). The bank's Board of Trustees has approved that 63% of the year's profit should be retained to further enhance its capital strength.

We have seen similar levels of capital improvement in many Norwegian savings banks as they continue to position themselves in accordance with the increasing regulatory capital requirements. We view such capital increases positively as it enhances the bank's buffer against potential losses and are above the current regulatory minimum level of 9% Core Equity Tier 1 ratio and the 10% minimum due to be implemented in July 2014.

EXPECTED FOCUS ON MARGINS, BUT UPSIDE LIMITED BY STRONG COMPETITION AND UNCERTAINTIES REGARDING PROVISIONING LEVELS

Sparebanken Møre's profitability is slightly above average for rated Norwegian savings banks, recording a pre-provision income of NOK719 million over 2013. The bank remains reliant on net interest income, which has represented around 80% of its operating income over recent years. This source of earnings grew by 11% in 2013, driven by higher margins across the industry as banks raised loan rates to fund the increasing capital requirements and lower funding rates. It was also helped by 6% growth in balance sheet loans over the year. Despite this increase in net interest income, the bank's profitability fell over the year due to the positive impact of pension plan changes on the 2012 results. Sparebanken Møre's efficiency also supports its profitability; its 2013 cost-to-income was just below 45% as per Moody's calculations. This meets the bank's management's target of a cost-to-income ratio below 50 % and ranks well among Moody's-rated regional savings banks in Norway.

2013 Loan loss provisions were moderate at NOK54 million in the period (NOK47 million in 2012), but we note that the bank's relatively high exposure to more volatile segment heightens the uncertainty over the sustainability of these low levels.

NOTE ON DATA

Unless noted otherwise, all figures shown in this report are sourced from the bank's latest annual and interim financial reports and our Banking Financial Metrics. These metrics are based on our own chart of account, and are adjusted for analytical purposes. Please refer to the document entitled " Financial Statement Adjustments in the Analysis of Financial Institutions" published on 19 December 2013.

Global Local Currency Deposit Rating (Joint Default Analysis)

Moody's assigns a GLC deposit rating of A3 to Sparebanken Møre. The rating is supported by its baa2 standalone credit assessment 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 A3.

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 A3.

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						**A-**	**Neutral**
Economic Stability		x					
Integrity and Corruption	x						
Legal System	x						
Financial Factors (50%)						**C**	
Factor: Profitability						**C**	**Neutral**
PPI % Average RWA (Basel II)			2.06%				
Net Income % Average RWA (Basel II)			1.41%				
Factor: Liquidity						**D-**	**Neutral**
(Market Funds - Liquid Assets) % Total Assets					23.44%		
Liquidity Management				x			
Factor: Capital Adequacy						**A**	**Neutral**
Tier 1 Ratio (%) (Basel II)	13.75%						
Tangible Common Equity % RWA (Basel II)	13.11%						
Factor: Efficiency						**B**	**Neutral**
Cost / Income Ratio		47.11%					
Factor: Asset Quality						**B**	**Neutral**
Problem Loans % Gross Loans		1.47%					
Problem Loans % (Equity + LLR)		14.20%					
Lowest Combined Financial Factor Score (15%)						**D-**	
Economic Insolvency Override						**Neutral**	
Aggregate BFSR Score						**C**	
Aggregate BCA Score						**a3**	
Assigned BFSR						**C-**	
Assigned BCA						**baa2**	

[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.