MOODY'S INVESTORS SERVICE

Credit Opinion: Sparebanken More

Global Credit Research - 11 Dec 2012

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]**9-12**	[2]**12-11**	[2]**12-10**	[2]**12-09**	[2]**12-08**	**Avg.**
Total Assets (NOK billion)	**50.2**	**48.4**	**44.4**	**41.4**	**40.8**	[3]**5.3**
Total Assets (EUR million)	**6,822.6**	**6,248.1**	**5,699.2**	**4,994.0**	**4,191.4**	[3]**13.0**
Total Assets (USD million)	**8,777.2**	**8,111.0**	**7,645.8**	**7,165.0**	**5,826.3**	[3]**10.8**
Tangible Common Equity (NOK billion)	**3.8**	**3.6**	**3.3**	**2.9**	**2.5**	[3]**11.3**
Tangible Common Equity (EUR million)	**510.7**	**464.5**	**419.2**	**347.2**	**252.1**	[3]**19.3**
Tangible Common Equity (USD million)	**657.1**	**603.0**	**562.4**	**498.1**	**350.5**	[3]**17.0**
Net Interest Margin (%)	**2.0**	**2.0**	**2.1**	**2.0**	**2.2**	[4]**2.0**
PPI / Avg RWA (%)	**2.0**	**1.9**	**2.4**	**2.1**	**1.9**	[5]**2.1**
Net Income / Avg RWA (%)	**1.4**	**1.3**	**1.7**	**1.3**	**1.1**	[5]**1.3**
(Market Funds - Liquid Assets) / Total Assets (%)	**33.4**	**34.2**	**32.1**	**35.2**	**35.5**	[4]**34.0**
Core Deposits / Average Gross Loans (%)	**63.4**	**64.2**	**66.3**	**61.4**	**60.8**	[4]**63.2**
Tier 1 Ratio (%)	**11.6**	**12.0**	**12.0**	**11.6**	**9.1**	[5]**11.3**
Tangible Common Equity / RWA (%)	**11.8**	**11.7**	**11.4**	**10.5**	**8.8**	[5]**10.8**
Cost / Income Ratio (%)	**48.5**	**49.0**	**43.6**	**46.5**	**48.1**	[4]**47.1**
Problem Loans / Gross Loans (%)	**1.3**	**1.9**	**2.4**	**3.0**	**2.7**	[4]**2.2**
Problem Loans / (Equity + Loan Loss Reserves) (%)	**13.0**	**19.4**	**24.6**	**32.0**	**32.8**	[4]**24.4**

Source: Moody's

[1] All 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

RECENT CREDIT DEVELOPMENTS

On 6 December 2012 Moody's downgraded Sparebanken Møre's standalone credit assessment to C-/baa2 from C-/baa1, its long-term senior debt ratings to A3 from A2 and its short-term ratings to P-2 from P-1.

The downgrade of the bank's ratings primarily reflects Moody's view that asset quality at Sparebanken Møre could be undermined by its sizeable exposures to the real estate and construction (20% of loans excluding those transferred to the bank's covered bond company, Møre Boligkreditt at end-September 2012) and shipping (5%) sectors as well as its relatively less sophisticated risk management practices in Moody's view. The ratings agency also views the bank's substantial usage of market funds (just over 40% of total funding at end-September 2012) as a risk to its funding profile. Nevertheless, mitigating factors were also considered: the bank's lower problem loans (1.7% of loans excluding those transferred to Møre Boligkreditt at end-September 2012) and its good Tier 1 ratio at 12.05% (standardised method including year to date profit) at end-September 2012.

Unless otherwise stated, all figures shown are from the bank's annual and interim financial reports.

SUMMARY RATING RATIONALE

Moody's currently rates Sparebanken Møre A3/C-/P-2. The current C- standalone bank financial strength rating (BFSR, mapping to a baseline credit assessment, BCA, of baa2) incorporates Sparebanken Møre's sound local franchise but is primarily constrained by the bank's high borrower concentration and its exposures to more volatile corporate sectors.

The current global local currency (GLC) deposit rating of A3 is supported by Sparebanken Møre's standalone rating of C-, tracking to baa2 BCA, and the Aaa local currency deposit ceiling of Norway, which is deemed the underlying support provider. As a result, 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 the support uplift as regulators globally consider implementing bank resolution regimes.

Rating Drivers

- Sound market position of around 20% in Western Norway, the county 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 with 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 carry stable outlooks.

What Could Change the Rating - Up

Rating upgrades are unlikely in the near future, in light of the recent rating downgrades. A limited amount of upward rating momentum could develop if Sparebanken Møre demonstrates (i) sustained good asset quality in its retail and corporate loan books, including in the more volatile segments, (ii) continued good access to capital markets and improved liquidity position, and/or (iii) stronger earnings generation without an increase in its risk profile.

What Could Change the Rating - Down

While the current standalone rating already incorporates a degree of expected further deterioration, it could decline further if (i) Sparebanken Møre's asset quality deteriorates more than we anticipate, (ii) financing conditions become more difficult and/or (iii) its risk profile increases, for example as a result of increased exposures to more volatile sectors.

Recent Results

During the first 9 months of 2012 the bank reported a pre-provision income of NOK 462million, up nearly 10%% year-on-year largely due to an increase in fee and commission income and gains on financial instruments

At end-September 2012 Sparebanken Møre's Tier 1 and total capital ratios remained stable at 12.05% and 13%, respectively.

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 primarily reflects 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% on loans and 1.5% on deposits.

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 real estate brokerage (Møre Eiendomsmegling) and a covered bond company, Møre Boligkreditt. In September 2012 Sparebanken Møre merged with Møre Finans AS and is now offering leasing products and services directly from the bank. 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 in our 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 YE 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. At end-September 2012, the maturity profile of the bank's debt, of which approximately 50% consists of covered bonds, is relatively well diversified where 73% 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 results 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.

During 2011, the gross and net transfer of retail loans to Møre Boligkreditt, amounted to NOK5.7 billion and NOK2.6 billion respectively, compared to NOK3.9 billion and NOK1.9 billion at YE 2010.

At YE 2011 liquid assets accounted for approximately 15% 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 point of view.

In Moody's view, Sparebanken Møre's liquidity position is in line with that of most other Norwegian banks but remains 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 YE 2011 32% of retail loans were part of Møre Boligkreditt'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 YE 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 also note a somewhat unseasoned loan portfolio, which reflects high pre-crisis lending growth. Furthermore, the bank's mortgage loan portfolio displays 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 1.9% at YE 2011, continuing the steady downward trend from 3.1% at YE2007. At end-September 2012, the figure had decreased further to 1.3%. We also note the positive trend as regards loan loss reserve levels which increased to 60% at end-September 2012, an increase from 50% at end-2011 and from 36% at YE2007. We note however that the bank has historically had a somewhat higher problem loan ratio and a lower problem loan coverage ratio than other Moody's-rated Norwegian savings 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.

Sparebanken Møre exhibits good capitalisation. At YE 2011 the Tier 1 and total capital ratios, as calculated under Basel II's standardised approach, stood at 12.0% and 13.6%, respectively. We view the bank's capital buffer as adequate to withstand potential credit losses. We note that Sparebanken Møre issued a new NOK 500 million hybrid in September 2012 with effect from October 2012 (i.e. not included in the Q3 2012 capital figures). The new capital issuance is part of the bank's plan to focus on bigger clients in their region. According to Norwegian regulations, hybrid capital of various forms can contribute up to 35% of tier 1 capital - with this issue, Sparebank More's hybrid capital contributes in total around 25% of tier 1 capital.

-- 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 supported by both good loan growth in 2010 and 2011. Nevertheless, we caution that strong competition and increased funding costs could put pressure on top-line earnings. 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 2011 cost-to-income ratio is good at around 50% as per Moody's calculations. 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.

In Moody's opinion the trend for the bank's profitability is weakening due to concerns regarding future lower loan growth affecting net interest income.

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 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 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						**D+**	**Neutral**
Corporate Governance [2]							
- Ownership and Org. 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						**A-**	**Neutral**
Economic Stability		**x**					
Integrity and Corruption	**x**						
Legal System	**x**						
Financial Factors (50%)						**D+**	

Factor: Profitability						C	Weakening
PPI / Average RWA - Basel II			2.15%				
Net Income / Average RWA - Basel II			1.44%				
Factor: Liquidity						E	Neutral
(Market funds - Liqud 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			2.43%				
Problem Loans / (Shareholders' Equity + Loan Loss Reserves)			25.35%				
Lowest Combined Financial Factor Score (15%)						E	
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.