

Rating Action: Moody's affirms Sparebanken Hedmark's A2/P-1 deposit ratings, assigns A2 long-term issuer rating

Global Credit Research - 28 Apr 2016

The bank's BCA of baa2 is placed on review for upgrade

Limassol, April 28, 2016 -- Moody's Investors Service has today affirmed Sparebanken Hedmark's A2/P-1 deposit ratings and assigned A2 long-term issuer rating. The long-term ratings carry a stable outlook. Moody's also placed on review for upgrade the bank's baseline credit assessment (BCA) of baa2, but affirmed the bank's adjusted BCA, which incorporates affiliate support from the Sparebank 1 Alliance, at baa1. Today's rating action follows the regulatory approval provided to Sparebanken Hedmark on 18 April 2016 for the acquisition of Bank 1 Oslo Akershus (B1OA). The bank's Counterparty Risk Assessment (CR Assessment) has been affirmed at A1(cr)/P-1(cr).

RATINGS RATIONALE

-- BCA REVIEW FOR UPGRADE

Moody's has placed Sparebanken Hedmark's BCA of baa2 on review for upgrade as the rating agency considers that the acquisition of B1OA could bring about certain benefits that currently exert upward pressure on the bank's standalone credit profile. These would include improvements in its asset quality and funding profile, as well as deeper geographical and earnings diversification, greater reach in the Oslo area and opportunities for further expansion of its customer base. Although the transaction could also place some downward pressure on the bank's capital and profitability metrics over the medium term, Moody's notes that the combined group, that would be the fourth largest savings bank in Norway, will still boast relatively strong financial metrics.

Moody's considers that B1OA's strong asset quality position with a very low level of problem loans (0.24% in 2015, compared to 1.2% for Sparebanken Hedmark) on the back of its predominantly retail credit profile will be supportive to the combined group's asset quality, limiting the downside risks from credit impairments. In addition, the consolidated group's funding profile is unlikely to change significantly to that of Sparebanken Hedmark, with market funding reliance to be around 31% of total tangible banking assets, mainly driven by the issuance of covered bonds. Similarly, the bank's liquidity position is also likely to remain modest following the acquisition, with the consolidated liquid assets to total tangible banking assets to be around 14% based on both banks' financial statements as of December 2015.

Concurrently, the acquisition is also likely to pose some challenges to the bank, such as operational integration of the two entities and the related execution risk. There will also be some softening of its strong capital and profitability metrics due to the increase in risk-weighted assets and B1OA's lower net interest margins. We expect the combined group's common equity Tier 1 (CET1) capital ratio to be around 15.3% based on December 2015 figures (compared to the reported 17.2% for Sparebanken Hedmark alone), while return on tangible assets could drop significantly to below 0.8% from 1.45% on a standalone basis.

-- FACTORS TO BE CONSIDERED IN THE RATING REVIEW

Moody's expects the underlying financial fundamentals of the group to remain relatively strong and commensurate with a BCA higher than baa2, according to the banking scorecard using pro-forma consolidated ratios for the two entities. The BCA review for upgrade will predominantly focus on the availability of the consolidated financial statements for the group in the second half of 2016, and the relative impact on its banking scorecard that underpins its BCA. Once these official figures are published, Moody's will re-examine the bank's credit metrics in order to confirm its projections and the higher scorecard outcome.

Moreover, Moody's will also assess (1) the expected qualitative benefits for the bank from this acquisition, (2) the bank's plans for operational integration of the two entities, and (3) any potential challenges in realizing efficiencies and economies of scale.

-- DEPOSIT RATINGS AFFIRMATION

Despite a potential upgrade of the bank's BCA to baa1 from baa2, the bank's deposit ratings are unlikely to be affected. This reflects that, currently, Sparebanken Hedmark's adjusted BCA reflects one notch uplift due to Moody's expectation of affiliate support from the Sparebank 1 Alliance (a consortium of 17 Norwegian banks). If Sparebanken Hedmark's BCA were upgraded to baa1, affiliate support will no longer provide rating uplift, reflecting the relative strength of the Sparebank 1 Alliance. This drives the current stable outlook on deposit ratings.

The affirmation of Sparebanken Hedmark's deposit ratings reflects the balance between the potential improvement in the bank's stand-alone credit profile following the acquisition of B1OA, and the constrained affiliate support from the Sparebank 1 Alliance, which is incorporated into the bank's deposit ratings. As a result, Moody's has also affirmed the bank's adjusted BCA of baa1, which incorporates affiliate support.

-- A2 ISSUER RATING ASSIGNED

The A2 issuer rating assigned to Sparebanken Hedmark takes into account the bank's "Very High--" Macro Profile, its baa1 adjusted BCA, the analysis of the bank's balance sheet structure through Moody's Advanced Loss Given Failure (LGF) framework, and the rating agency's assessment of probability of government support. 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 issuer ratings also take into account Moody's LGF analysis of the combined entity's volume of deposits and senior unsecured debt, as well as the volume of securities subordinated to them. This results in an assessment of very low loss given failure and leads to two notches of rating uplift for the issuer ratings, which is the same uplift afforded for the bank's deposit ratings. Finally, Moody's assigns a "low" likelihood of government support in the event of its failure, based on the bank's regional market share and the significance of its main county of operation within Norway, leading to no uplift to the bank's preliminary ratings.

The stable outlook on the bank's issuer ratings also reflects our view that the bank's financials will remain broadly resilient in the face of a modest slowdown in Norway's economic performance.

WHAT COULD CHANGE THE RATING UP/DOWN

Upward rating pressure could develop if Sparebanken Hedmark demonstrates: (1) Good asset quality in its retail and corporate books; (2) continued access to capital markets and improved liquidity; and/or (3) stronger earnings generation without an increase in its risk profile. In addition, further upward pressure could emerge following the takeover of B1OA, if the bank is able to further strengthen its customer base, and enhance its product offering and franchise.

Future downward rating pressure could arise if: (1) Sparebanken Hedmark's problem loan ratio increases above our system-wide expectation of approximately 2%; (2) financing conditions become more difficult; (3) its risk profile increases, as a result of increased exposures to more volatile sectors, for example, resulting in asset quality deterioration; and/or (4) the macroeconomic environment deteriorates more than Moody's estimates, leading to adverse developments in the Norwegian real-estate market.

PRINCIPAL METHODOLOGY

The principal methodology used in these ratings was Banks published in January 2016. Please see the Rating Methodologies page on www.moodys.com for a copy of this methodology.

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