

Rating Action: Moody's upgrades Sparebanken Hedmark's long-term deposit and issuer ratings to A1

Global Credit Research - 11 Oct 2016

Moody's upgrades Sparebanken Hedmark's long-term deposit and issuer ratings to A1

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The bank's BCA is also upgraded to baa1

Limassol, October 11, 2016 -- Moody's Investors Service has today upgraded Sparebanken Hedmark's long-term deposit and issuer ratings to A1 from A2. Moody's also upgraded the bank's baseline credit assessment (BCA) to baa1 from baa2, and also affirmed the bank's adjusted BCA at baa1. The long-term ratings carry a stable outlook.

Today's rating action follows the consolidation of the acquired Bank 1 Oslo Akershus into the Sparebanken Hedmark's June 2016 financial statements and the resulting increased importance of the group within the Norwegian financial system. The bank's long-term Counterparty Risk Assessment (CR Assessment) has also been upgraded to Aa3(cr) from A1 (cr), while the ST deposit ratings of P-1, and the short-term CR Assessment of P-1(cr), have been affirmed.

Today's rating action concludes the bank's BCA review initiated on 28 April 2016.

RATINGS RATIONALE

-- UPGRADE OF THE BCA TO baa1 FROM baa2

Moody's has upgraded Sparebanken Hedmark's BCA to baa1 from baa2 in view of the rating agency's opinion that the acquisition of Bank 1 Oslo Akershus benefits the bank's standalone credit profile. The immediate benefits conferred to the bank include improvements in its asset quality position, as well as deeper loans and earnings geographical diversification, greater reach in the Oslo-Akershus area and opportunities for further expansion of its client base. Although the transaction has placed some downward pressure on the bank's capital and profitability metrics, Moody's believes that such metrics are likely to recover over the medium term, while the combined group still boasts relatively strong financial metrics after becoming the fourth largest savings bank in Norway.

Moody's notes that Sparebanken Hedmark's asset quality has improved with overall problem loans for the group reducing to around 0.7% of gross loans (excluding covered bond loans) in June 2016 from 1.2% in December 2015. This was mainly driven by the strong asset quality of the acquired bank, with a very low level of problem loans (0.2% in 2015) on the back of its predominantly retail credit profile. The combined loan book profile of Sparebanken Hedmark is now geared towards retail borrowers, mostly residential mortgages, accounting for around 75% of total loans including covered bond loans. This will support the bank's asset quality, limiting the downside risks from credit impairments, given the traditionally very low loss rates for residential mortgages in Norway.

Concurrently, the acquisition has brought about some softening of the bank's strong capital and profitability metrics due to the increase in risk-weighted assets and Bank 1 Oslo Akershus' lower net interest margins. The combined group had common equity Tier 1 (CET1) capital ratio of around 16% in June 2016 compared to the reported 17.2% for Sparebanken Hedmark alone in December 2015, while return on tangible assets declined significantly to approximately 0.7% in June 2016 from 1.4% on a standalone basis in December 2015.

However, the rating agency expects that the bank's profit metrics, including its net interest margins, will gradually recover, with the contribution of cost synergies that will come about at around NOK75 million per annum, as estimated by the bank. The rating agency notes that the bank aims to have a long-term target of 10% return on equity, while also maintaining a CET1 ratio of at least 16% on an on-going basis, which is

significantly higher than the respective ratios and targets of other Norwegian savings banks. Such strong positioning will continue to underpin and support the bank's BCA of baa1.

Moody's does not anticipate any major problems with the operational integration of Bank 1 Oslo Akershus and the relevant rebranding, which is likely to be completed in the first half of 2017. In addition, the Sparebanken Hedmark is also planning to conduct an initial public offering (IPO) in 2017 to expand its investor base and also list on the Oslo Stock Exchange. Over the medium to longer term, these initiatives will enhance the bank's capacity to raise more capital if needed and also appeal to foreign investors by making the bank more visible in the international capital markets.

The upgrade of the bank's BCA to baa1 from baa2 does not have a direct impact on the bank's deposit and issuer ratings, reflecting the fact that Sparebanken Hedmark's adjusted BCA was already at baa1, taking into account one notch of rating uplift due to Moody's expectation of affiliate support from the Sparebank 1 Alliance (a consortium of 16 Norwegian savings banks). Sparebanken Hedmark's BCA is now aligned with its adjusted BCA at baa1, as affiliate support no longer results in a rating uplift.

-- LONG-TERM DEPOSIT AND ISSUER RATINGS UPGRADED TO A1 FROM A2 DUE TO GOVERNMENT SUPPORT, STABLE OUTLOOK

The primary driver behind the upgrade of Sparebanken Hedmark's long-term deposit and issuer ratings to A1 from A2 is the moderate government support assumption that the rating agency now incorporates into the bank's ratings. Following the Bank 1 Oslo Akershus acquisition, Sparebanken Hedmark has become the fourth largest savings bank in Norway (ranked sixth before), having presence now in the most important and economically developed region of Oslo-Akershus. This triggered the change in the rating agency's government support assumption for the new larger group to moderate, from low, in line with the rating agency's support assumptions for other similarly-sized Norwegian savings banks.

The bank already had a dominant franchise in the Hedmark region with market share in both retail and corporate of around 50%, which is now enhanced with around 8% retail market share and 5% in corporates in the Oslo-Akershus region. Accordingly, in Moody's opinion, the bank is now considered to be systemically important and a vital intermediary in financing the region. In effect, the moderate probability of government support translates into one notch of rating uplift for the bank's deposit and issuer ratings.

The government support rating uplift overlays the two-notches rating uplift incorporated into the deposit and issuer ratings, based on the loss given failure (LGF) analysis of the bank's liability structure, which remains broadly unchanged. The ratings 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.

As a result, the bank's long-term deposit and issuer ratings are positioned at A1, three notches higher (two notches due to LGF, plus one notch due to government support) than its BCA of baa1. The stable outlook on the bank's 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) solid sustainable asset quality and low impairments in its retail and corporate books; (2) uninterrupted access to capital markets and comfortable liquidity on an on-going basis; and/or (3) stronger earnings generation without an increase in its risk profile. In addition, further upward pressure could emerge following the takeover of Bank 1 Oslo Akershus if the bank is able to further strengthen its customer base, and enhance its product offering and franchise, which in turn will support the bank's revenues and profitability.

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; (4) the macroeconomic environment deteriorates more than Moody's estimates, leading to adverse developments in the Norwegian real-estate market; and/or (5) Moody's revises lower its government support assumptions for all rated Norwegian savings banks due to the introduction of an official resolution regime in the country.

The rating agency intends to reassess its government support assumptions for all Norwegian savings banks,

including Sparebanken Hedmark, once there is more clarity regarding the timing of the implementation of an official resolution regime through the enactment of a relevant local legislation. This is likely to be aligned with the EU's bank recovery and resolution directive (BRRD), as indicated by the domestic authorities in the past.

List Of Affected Ratings

Issuer: Sparebanken Hedmark

Upgrades:

.... LT Bank Deposits (Local & Foreign Currency), Upgraded to A1 Stable from A2 Stable

.... LT Issuer Rating (Local & Foreign Currency), Upgraded to A1 Stable from A2 Stable

.... Baseline Credit Assessment, Upgraded to baa1 from baa2

.... LT Counterparty Risk Assessment, Upgraded to Aa3(cr) from A1(cr)

Affirmations:

.... ST Bank Deposits (Local & Foreign Currency), Affirmed P-1

.... Adjusted Baseline Credit Assessment, Affirmed baa1

.... ST Counterparty Risk Assessment, Affirmed P-1(cr)

Outlook Actions:

..Issuer: Sparebanken Hedmark

....Outlook, Remains Stable

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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