

## CREDIT OPINION

17 October 2018

Update

✓ Rate this Research

### RATINGS

#### Sparebanken Sogn og Fjordane

Domicile	Norway
Long Term CRR	A1
Type	LT Counterparty Risk Rating - Fgn Curr
Outlook	Not Assigned
Long Term Debt	Not Assigned
Long Term Deposit	A2
Type	LT Bank Deposits - Fgn Curr
Outlook	Stable

Please see the [ratings section](#) at the end of this report for more information. The ratings and outlook shown reflect information as of the publication date.

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# Sparebanken Sogn og Fjordane

## Update to Credit Analysis

### Summary

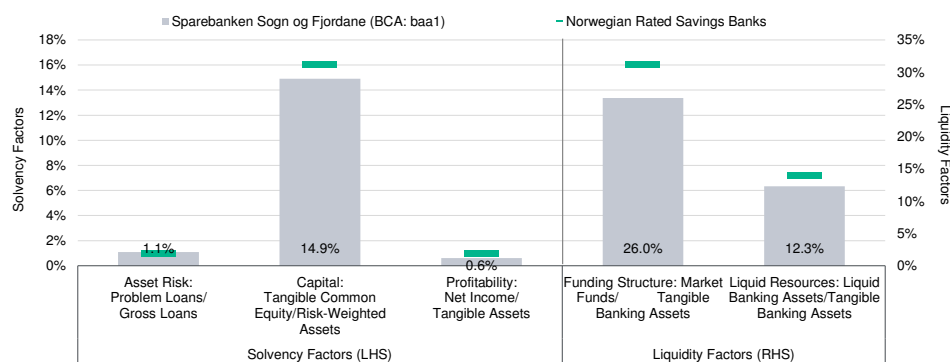
We assign a baa1 baseline credit assessment (BCA) and A2 long-term deposit and issuer ratings to Sparebanken Sogn og Fjordane (SSF). We also assign a long and short term Counterparty Risk Assessment (CRA) of A1(cr)/Prime-1(cr) to the bank.

SSF's baa1 BCA reflects the bank's Very Strong - operating environment, with problem loan levels that are broadly in line with peers (problem loans equivalent to 1.1% of gross loans at end-June 2018), improving capital metrics with a Common Equity Tier 1 ratio of 14.8%, but also its relatively high reliance on the domestic capital markets. Our assessment of the bank also incorporates its high sector and credit concentrations, which could result in higher provisioning requirements in a weak operating environment, although we expect SSF's large residential mortgage portfolio to remain resilient.

The bank's A2 long-term deposit and issuer ratings incorporate two notches of rating uplift from the bank's baa1 standalone baseline credit assessment (BCA) based on our Advanced Loss Given Failure (LGF) analysis. LGF takes into account the risks faced by the different debt and deposit classes across the liability structure should the bank enter into resolution.

Exhibit 1

### Rating Scorecard - Key Financial Ratios



Note: \* average of other Moody's rated Norwegian savings banks

Source: Moody's Banking Financial Metrics

## Credit strengths

- » Sparebanken Sogn og Fjordane's BCA is supported by its Very Strong- Macro Profile
- » Capital levels are adequate and improving
- » Problem loan levels in line with peers
- » Large volume of deposits and junior debt resulting in deposit and issuer ratings benefiting from a very low loss-given-failure rate

## Credit challenges

- » There are elevated asset risks from sector and credit concentrations
- » Market funding reliance renders the bank vulnerable to fluctuations in investor sentiment, despite a large deposit base

## Outlook

The stable outlook on the banks ratings reflects our view that the bank's financials will remain broadly resilient over the next 12-18 months.

## Factors that could lead to an upgrade

- » Upward rating pressure could develop if SSF demonstrates (1) sustained strong asset quality in its retail and corporate loan books, including in the more volatile segments, and further reduction in credit concentrations; (2) stronger earnings generation without an increase in its risk profile.

## Factors that could lead to a downgrade

- » Future downward rating pressure would emerge if (1)SSF's risk profile increases as a result of increased concentration, for example if construction and real-estate concentration or top-20 client concentration as a percent of Core Tier 1 Capital exceeds 150% or if the problem loan ratio increases above market system wide expectation of approximately 2%; (2) financing conditions become more difficult;

This publication does not announce a credit rating action. For any credit ratings referenced in this publication, please see the ratings tab on the issuer/entity page on [www.moody.com](http://www.moody.com) for the most updated credit rating action information and rating history.

## Key indicators

Exhibit 2

### Sparebanken Sogn og Fjordane (Consolidated Financials) [1]

	6-18 <sup>2</sup>	12-17 <sup>2</sup>	12-16 <sup>2</sup>	12-15 <sup>2</sup>	12-14 <sup>2</sup>	CAGR/Avg. <sup>3</sup>
Total Assets (NOK billion)	54	52	49	46	43	6.9 <sup>4</sup>
Total Assets (EUR million)	5,652	5,279	5,430	4,777	4,697	5.4 <sup>4</sup>
Total Assets (USD million)	6,600	6,339	5,728	5,190	5,683	4.4 <sup>4</sup>
Tangible Common Equity (NOK billion)	4.2	4.1	3.7	3.4	3.2	8.3 <sup>4</sup>
Tangible Common Equity (EUR million)	437	414	413	356	348	6.8 <sup>4</sup>
Tangible Common Equity (USD million)	511	497	435	386	421	5.7 <sup>4</sup>
Problem Loans / Gross Loans (%)	1.1	1.1	0.7	1.1	1.8	1.2 <sup>5</sup>
Tangible Common Equity / Risk Weighted Assets (%)	14.9	15.2	14.4	13.5	13.5	14.3 <sup>6</sup>
Problem Loans / (Tangible Common Equity + Loan Loss Reserve) (%)	12.1	11.6	7.4	11.9	19.8	12.6 <sup>5</sup>
Net Interest Margin (%)	1.6	1.7	1.6	1.7	1.8	1.7 <sup>5</sup>
PPI / Average RWA (%)	2.1	2.2	2.0	1.8	2.3	2.1 <sup>6</sup>
Net Income / Tangible Assets (%)	0.8	0.7	0.6	0.5	0.8	0.7 <sup>5</sup>
Cost / Income Ratio (%)	42.8	44.5	44.8	46.7	41.2	44.0 <sup>5</sup>
Market Funds / Tangible Banking Assets (%)	24.6	26.0	28.4	29.4	27.7	27.2 <sup>5</sup>
Liquid Banking Assets / Tangible Banking Assets (%)	12.4	12.3	11.9	12.2	11.1	12.0 <sup>5</sup>
Gross Loans / Due to Customers (%)	169.1	171.2	172.3	174.7	167.0	170.9 <sup>5</sup>

[1] All figures and ratios are adjusted using Moody's standard adjustments [2] Basel II; IFRS [3] May include rounding differences due to scale of reported amounts [4] Compound Annual Growth Rate (%) based on time period presented for the latest accounting regime [5] Simple average of periods presented for the latest accounting regime. [6] Simple average of Basel II periods presented

Source: Moody's Financial Metrics

## Profile

Sparebanken Sogn og Fjordane (SSF) is the largest bank in the county of Sogn og Fjordane and offers retail and corporate customers products in banking, financing, insurance, savings, pensions and payment services. SSF's main geographical market is Sogn og Fjordane in western Norway, but the bank has expanded the scope of its retail operations to include several larger cities around Norway. As of 30 June 2018, the bank reported total consolidated assets of NOK54 billion (€5.66 billion).

## Detailed credit considerations

### SSF's BCA is supported by its Very Strong- Macro Profile

As a domestically focused bank, SSF's Macro Profile is aligned with that of Norway at Very Strong-. Banks in [Norway](#) (Aaa stable) benefit from operating in a wealthy and developed country with very high economic, institutional and government financial strength as well as very low susceptibility to event risk. Norway has a diversified and growing economy, which demonstrated resilience to the recent weakening in the oil sector. The main risks to the banking system stem from the high level of household indebtedness, elevated real estate prices and domestic banks' extensive use of market funding. However, these risks are mitigated by the strength of households' ability to service debt, banks' adequate capitalization and the relatively small size of the banking system compared with the total size of the economy.

### Problems loan levels marginally increased due to corporate exposures

We expect SSF's asset quality to remain broadly unchanged in the next twelve months, supported by the increased granularity and lower top client concentration in the bank's loan book stemming from its high allocation to mortgages (approximately 70% of gross lending), a market segment with low delinquencies and losses historically. SSF has been growing its retail book more actively outside its home county (in Hordaland and other counties) driven by lower population growth in Sogn og Fjordane compared to other regions. We believe that, for the moment, the benefits of some regional diversification are balanced against the risks of managing this more diverse portfolio.

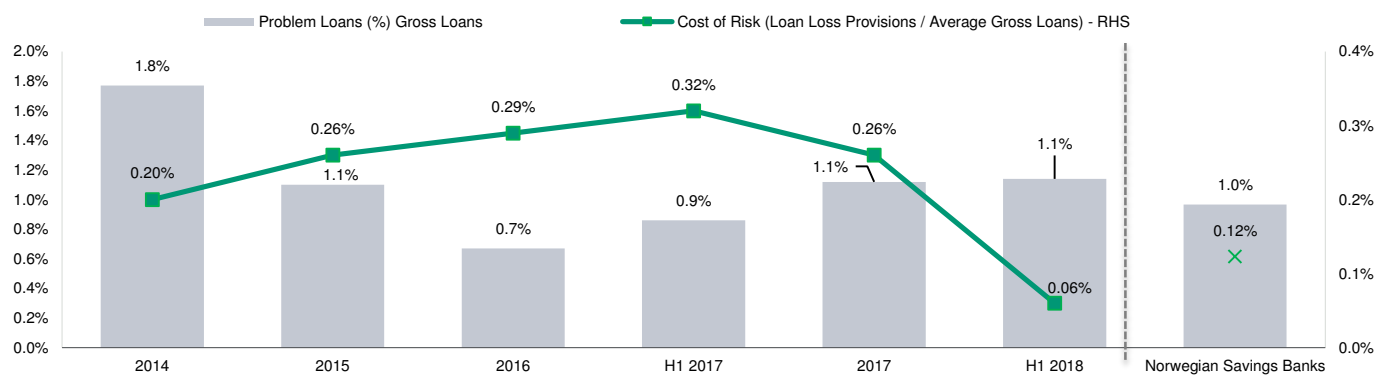
The bank's problem loans as a percentage of gross loans declined to 1.1% at end-June 2018 from 1.8% at end-2014 (see Exhibit 3), but are still slightly higher than domestic peers reflecting its increased corporate exposures. The bank's problem loan coverage ratio was

54% at end-June 2018, while credit costs declined substantially to 0.06% in the first half of 2018 compared to 0.32% basis points in the same period last year.

Exhibit 3

### SSF's Asset Quality Evolution

The bank's problem loans are somewhat elevated, cost of risk is however low and compares well with peers



Note: \* average of other Moody's rated Norwegian savings banks  
Source: Moody's Banking Financial Metrics

The bank's portfolio mainly comprises retail customers, at over 70% of loans as of end-June 2018. This lending category has performed well in the past and we expect it will remain resilient since, despite the risks from an increasing level of household indebtedness, we expect Norway's households to continue to service their debts as interest rates remain low and unemployment benefits remain generous. SSF has been growing its retail book more actively outside its home county (in Hordaland and other counties) driven by lower population growth in Sogn og Fjordane compared to other regions.

SSF's exposure to the real-estate and construction sectors stood at around 10% of total loans as of end-June 2018. Similar to most of its Nordic peers, the bank exhibits high single-name concentration, which could heighten the pace and the extent of any deterioration in asset quality. However, over the past years the bank has decreased significantly its single name concentrations, which we view positively.

### Capital levels are adequate and improving

We consider SSF's capital levels as adequate for the bank's risk profile and in line with Norwegian peers. The bank's tangible common equity to risk-weighted assets remained broadly unchanged at 14.9% as of June 2018, from 15.2% at the end of 2017. SSF reported common equity Tier 1 (CET1) ratio of 14.8% at end-June 2018 (excluding profit for the period), already in line with the bank's internal target of 14.5% and regulatory minimum capital requirement of 13.9%.

Our assigned Capital score reflects this strength, as well as the bank's tangible common equity/tangible banking assets ratio of 7.8% at end-June 2018, which compares well within international standards.

### Profitability shows first signs of stabilization

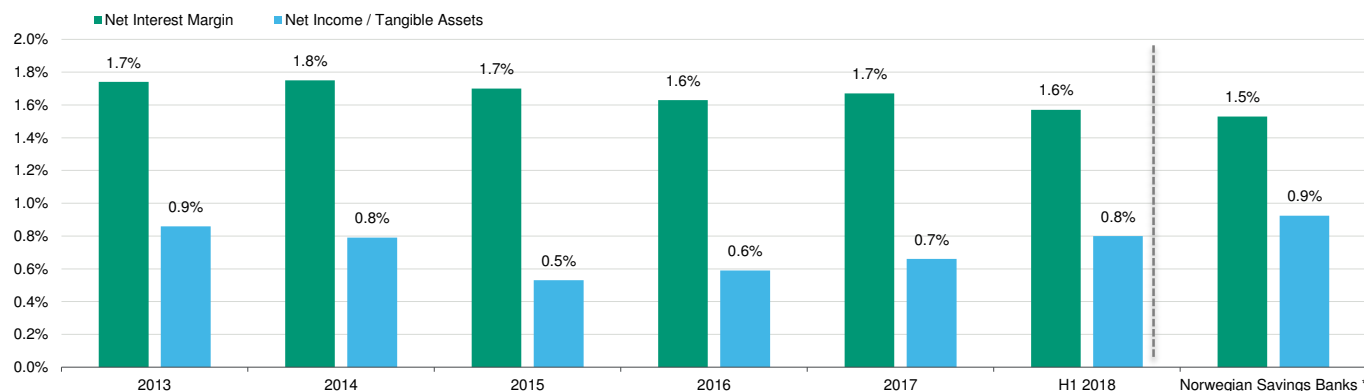
SSF's profitability stabilized during the past two years driven mainly by declining credit costs, coupled with the higher net interest income. The bank's annualised reported Return on Equity (ROE) increased to 10.2% in the first half of 2018 from 9.8% in the same period last year, reflecting higher operating income as well as lower operating expenses and loan losses, a trend we expect to continue in the second half of the year.

In the first half of 2018, the bank's reported net interest margin declined slightly to 1.6% (see Exhibit 4) from 1.7% in the first six months of 2017 as a result of lower customer margins and higher funding costs due to the higher NIBOR. Lending to retail clients grew by around 7% in the past 12 months ending at end-June 2018, partly supported by the acquisition of a loan portfolio from Eiendoms-kreditt AS but also growing business volumes. The return on tangible assets was 0.8% for the first half of 2018 (excluding one-offs) compared to 0.7% for the same period last year.

Exhibit 4

**SSF's Profitability Metrics Evolution**

Margins are stabilising



Note: \* average of other Moody's rated Norwegian savings banks

Source: Moody's Banking Financial Metrics

Loan loss provisions declined with a cost of risk at 0.06% in the first half of 2018, compared to 0.26% reported for full-year 2017 and below domestic rated peers. Operating expenses decreased in 2017 compared to 2016, reflecting cost effective measures implemented by bank during the year. The bank has introduced cost saving measures, such as the closure of 9 branches in 2017 and investments in efficient IT systems. The NOK220 million operating expenses incurred in the first half of 2018 translated into a reported cost to income ratio (including income from financial instruments) of 42.3%, in line with the 42.9% in the first half of 2017.

**Market funding reliance renders the bank vulnerable to fluctuations in investor sentiment, despite a large deposit base**

SSF's funding profile benefits from a sizeable deposit base constituting 56% of non-equity funding at end-June 2018 while more than 60% of the bank's deposits come from retail customers and have been stable over the years. However it is also significantly reliant on market funding, rendering it vulnerable to swings in investor sentiment. The bank draws most of this funding in the form of domestically-issued senior debt and covered bonds. Covered bonds are issued through the bank's wholly-owned covered bond company Bustadkreditt Sogn og Fjordane AS that was established in 2009.

Based on our methodology we reflect the stability of covered bonds relative to unsecured market funding through an adjustment to our market funds to tangible banking assets ratio and our adjusted ratio for the bank is 26.0% at end-2017 (24.6% at end-June 2018). Although SSF's size limits somewhat its ability to undertake large benchmark issuances, we view the bank's larger issuances positively, due to their eligibility as liquid assets under the liquidity coverage ratio rules which extends the bank's investor base.

We consider the bank's stock of liquid banking assets as broadly adequate, totaling 12.3% of tangible banking assets at end-2017 (12.4% at end-June 2018). Liquid assets mainly comprised government securities and covered bonds. We note that the bank's holdings are mostly Norwegian securities, which leads to concentration risk. Finally, the bank reported a Liquidity Coverage Ratio (LCR) of 146% at end-June 2018 (146% at year-end 2017).

**Source of facts and figures cited in this report**

Unless noted otherwise, bank specific figures originate from bank's reports and Moody's Banking Financial Metrics. Moody's Banking Financial Metrics figures are based on our own chart of account and may be adjusted for analytical purposes. Please refer to the document: "[Financial Statement Adjustments in the Analysis of Financial Institutions](#)" published on 09 August 2018.

**Support and structural considerations****Loss Given Failure**

Norway is in the process of transposing the EU Bank Resolution and Recovery Directive (BRRD) into local legislation and as such we consider the country an Operational Resolution Regime. In accordance with our methodology we therefore apply our Advanced LGF analysis, considering the risks faced by different debt and deposit classes across the liability structure should the bank enter resolution.

In our LGF analysis for the bank we use our standard assumptions and assume residual tangible common equity of 3%, losses post-failure of 8% of tangible banking assets, a 25% runoff in "junior" wholesale deposits, and a 5% run-off in preferred deposits. We assign a 25% probability to deposits being preferred to senior unsecured debt.

Under these assumptions, SSF's deposits and senior unsecured debt are likely to face very low loss-given-failure, due to the volume of the deposits and senior debt themselves and the amount of debt subordinated to them. This results in a Preliminary Rating Assessment (PRA) of two notches above the BCA for both the deposit and issuer ratings of the bank.

### Government support

We do not incorporate government support uplift to SSF's deposit and issuer ratings as a result of the expected implementation of resolution legislation in Norway. SSF is a regional savings bank with a strong market position in the county of Sogn og Fjordane (Western Norway), where we estimate that it commands a 35% market share in lending at end-December 2017. Despite its dominant local position, the bank lacks geographical diversification and its national franchise is limited by a national market share of around 1% (based on total lending nationwide, using Statistics Norway data). We therefore consider the probability of government support for Sparebanken Sogn og Fjordane's debt and deposits to be low (in line with similarly-sized domestic peers), resulting in no ratings uplift.

### Counterparty Risk (CR) Assessment

We assign long- and short-term CR assessments of A1(cr) and Prime-1 (cr) respectively to SSF. CR Assessments are opinions of how counterparty obligations are likely to be treated if a bank fails and are distinct from debt and deposit ratings in that they (1) consider only the risk of default rather than the likelihood of default and the expected financial loss suffered in the event of default and (2) apply to counterparty obligations and contractual commitments rather than debt or deposit instruments. The CR Assessment is an opinion of the counterparty risk related to a bank's covered bonds, contractual performance obligations (servicing), derivatives (e.g., swaps), letters of credit, guarantees and liquidity facilities.

#### SSF's CR Assessment is positioned at A1(cr)/P-1(cr)

SSF's CR Assessment is positioned at A1(cr)/P-1(cr), three notches above the bank's Adjusted BCA of baa1, based on the cushion against default provided by junior deposits, senior unsecured, subordinated debts and preference shares. The bank's CR Assessment does not benefit from any government support, in line with deposits and senior unsecured debt ratings.

### Counterparty Risk Ratings (CRRs)

CRRs are opinions of the ability of entities to honour the uncollateralised portion of non-debt counterparty financial liabilities (CRR liabilities) and also reflect the expected financial losses in the event such liabilities are not honoured. CRRs are distinct from ratings assigned to senior unsecured debt instruments and from issuer ratings because they reflect that, in a resolution, CRR liabilities might benefit from preferential treatment compared with senior unsecured debt. Examples of CRR liabilities include the uncollateralised portion of payables arising from derivatives transactions and the uncollateralised portion of liabilities under sale and repurchase agreement.

#### SSF's CRRs are positioned at A1/P-1

The CRR is positioned three notches above the Adjusted BCA of baa1 and at the same level as the counterparty risk assessment, reflecting the buffer against default provided by more junior instruments to the CRR liabilities.

### About Moody's Bank Scorecard

Our Scorecard is designed to capture, express and explain in summary form our Rating Committee's judgment. When read in conjunction with our research, a fulsome presentation of our judgment is expressed. As a result, the output of our Scorecard may materially differ from that suggested by raw data alone (though it has been calibrated to avoid the frequent need for strong divergence). The Scorecard 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 methodology and scorecard factors

Exhibit 5

### Sparebanken Sogn og Fjordane

#### Macro Factors

**Weighted Macro Profile**                      **Very Strong -**                      **100%**

Factor	Historic Ratio	Initial Score	Expected Trend	Assigned Score	Key driver #1	Key driver #2
Solvency						
Asset Risk						
Problem Loans / Gross Loans	1.1%	aa2	← →	baa1	Single name concentration	Sector concentration
Capital						
TCE / RWA	14.9%	aa3	← →	aa3	Risk-weighted capitalisation	
Profitability						
Net Income / Tangible Assets	0.6%	baa2	↓	baa2	Return on assets	
Combined Solvency Score		a1		a3		
Liquidity						
Funding Structure						
Market Funds / Tangible Banking Assets	26.0%	baa2	← →	baa3	Market funding quality	
Liquid Resources						
Liquid Banking Assets / Tangible Banking Assets	12.3%	baa3	← →	baa3	Stock of liquid assets	
Combined Liquidity Score		baa2		baa3		
Financial Profile						
Business Diversification				0		
Opacity and Complexity				0		
Corporate Behavior				0		
Total Qualitative Adjustments				0		
Sovereign or Affiliate constraint:				Aaa		
Scorecard Calculated BCA range				a3-baa2		
Assigned BCA				baa1		
Affiliate Support notching				0		
Adjusted BCA				baa1		

Balance Sheet	in-scope (NOK million)	% in-scope	at-failure (NOK million)	% at-failure
Other liabilities	16,541	30.8%	19,382	36.1%
Deposits	27,850	51.8%	25,009	46.6%
Preferred deposits	20,609	38.4%	19,579	36.4%
Junior Deposits	7,241	13.5%	5,431	10.1%
Senior unsecured bank debt	6,868	12.8%	6,868	12.8%
Dated subordinated bank debt	600	1.1%	600	1.1%
Preference shares (bank)	250	0.5%	250	0.5%
Equity	1,612	3.0%	1,612	3.0%
Total Tangible Banking Assets	53,721	100%	53,721	100%

Debt class	De Jure waterfall		De Facto waterfall		Notching		LGF Notching Guidance vs. Adjusted BCA	Assigned LGF notching	Additional notching	Preliminary Rating Assessment
	Instrument volume + subordination	Sub-ordination	Instrument volume + subordination	Sub-ordination	De Jure	De Facto				
Counterparty Risk Rating	27.5%	27.5%	27.5%	27.5%	3	3	3	3	0	a1
Counterparty Risk Assessment	27.5%	27.5%	27.5%	27.5%	3	3	3	3	0	a1 (cr)
Deposits	27.5%	4.6%	27.5%	17.4%	2	3	2	2	0	a2

Instrument class	Loss Given Failure notching	Additional Notching	Preliminary Rating Assessment	Government Support notching	Local Currency Rating	Foreign Currency Rating
Counterparty Risk Assessment	3	0	a1 (cr)	0	A1 (cr)	--
Deposits	2	0	a2	0	A2	A2

[1] Where dashes are shown for a particular factor (or sub-factor), the score is based on non-public information.

Source: Moody's Financial Metrics

## Ratings

Exhibit 6

Category	Moody's Rating
<b>SPAREBANKEN SOGN OG FJORDANE</b>	
Outlook	Stable
Counterparty Risk Rating	A1/P-1
Bank Deposits	A2/P-1
Baseline Credit Assessment	baa1
Adjusted Baseline Credit Assessment	baa1
Counterparty Risk Assessment	A1(cr)/P-1(cr)
Issuer Rating	A2

Source: Moody's Investors Service



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