

MOODY'S

INVESTORS SERVICE

CREDIT OPINION

14 August 2018

New Issue

 Rate this Research

RATINGS

SpareBank 1 BV

Domicile	Norway
Long Term CRR	A1
Type	LT Counterparty Risk Rating - Fgn Curr
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.

Analyst Contacts

Nondas Nicolaides +357.2569.3006
VP-Sr Credit Officer
nondas.nicolaides@moodys.com

Louise Eklund +46.8.5025.6569
Associate Analyst
louise eklund@moodys.com

Jean-Francois Tremblay +44.20.7772.5653
Associate Managing Director
jean-francois.tremblay@moodys.com

Sean Marion +44.20.7772.1056
MD-Financial Institutions
sean.marion@moodys.com

» Contacts continued on last page

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SpareBank 1 BV

New issuer: A2/Prime-1 deposit ratings assigned

Summary

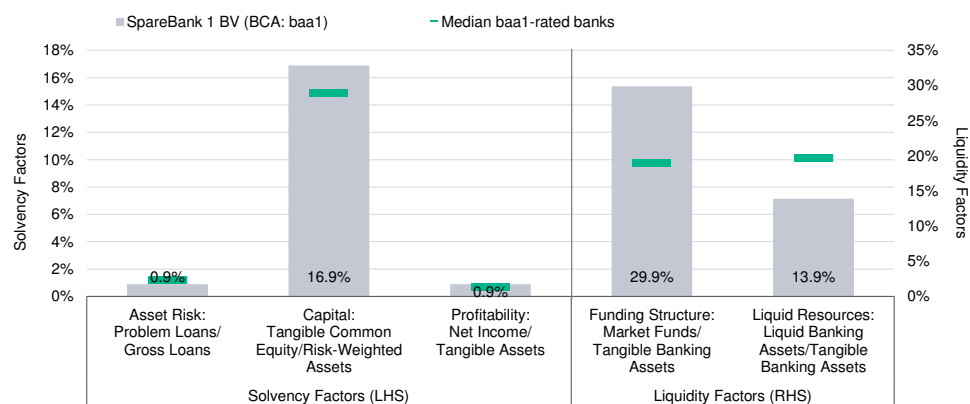
We assign SpareBank 1 BV foreign and local currency deposit ratings of A2/P-1, and foreign and local currency Counterparty Risk Ratings (CRRs) of A1/P-1. The ratings are driven by the bank's baa1 Baseline Credit Assessment (BCA), as well as our assessment of potential loss severity for senior creditors and counterparties through our advanced Loss Given Failure (LGF) analysis.

SpareBank 1 BV's BCA of baa1 reflects the bank's sound asset quality and relatively stable retail operations and earnings, as well as robust capitalisation and a strong retail deposit base. These strengths are balanced against the bank's significant exposure to the real estate sector and concentration in the counties of Buskerud and Vestfold, which elevates its asset risk. The bank's BCA also takes into account its relatively high level of capital markets funding, a common feature among the large savings banks in Norway.

The bank's A2 long term deposit ratings take into account our Loss Given Failure (LGF) analysis, which benefits from a large volume of deposits and substantial layers of subordination resulting in two notches of rating uplift from its BCA.

Exhibit 1

Rating Scorecard – Key financial ratios



These represent our Bank methodology scorecard Methodology Scorecard ratios, whereby asset risk and profitability reflect the weaker of either the latest reported or average of last three year-end and latest reported ratios. Capital is the latest reported figure. Funding structure and liquid resources ratios reflect the latest year-end figures.

Source: Moody's Financial Metrics

Credit strengths

- » SpareBank 1 BV's BCA benefits from Norway's Very Strong - Macro Profile
- » Capitalisation is sound, although capacity to raise new equity capital could prove challenging if needed
- » Good profitability and diversified earnings, although increasing money market rates exert pressure on lending margins

Credit challenges

- » Credit concentration and exposure to Commercial Real Estate elevate asset risk
- » High reliance on confidence-sensitive market funding, which is partly mitigated by access to a resilient covered bond market and a sizeable deposit base
- » Elevated risks in the Norwegian housing market and household sector, mitigated by conservative underwriting standards, high wealth levels and a very strong repayment culture

Rating outlook

The ratings outlook on SpareBank 1 BV is stable as Moody's expects the bank to be able to offset the expected margin pressure with improving efficiency, and to be able to maintain its solid capital base and sound asset quality, over the next 12-18 months.

Factors that could lead to an upgrade

Upward rating momentum could develop if SpareBank 1 BV demonstrates (1) sustained low level of problem loans in both its retail and corporate books, combined with reduced sector concentration to commercial real estate; (2) continued good access to capital markets and improved liquidity; and/or (3) stronger earnings generation without compromising its risk profile.

Factors that could lead to a downgrade

Future downward rating pressure would emerge if (1) SpareBank 1 BV's problem loan ratio was to deteriorate materially; (2) financing conditions were to become more difficult; (3) its risk profile were to increase, for example as a result of increased exposure to more volatile sectors such as commercial real estate; and/or (4) macroeconomic environment were to deteriorate more than estimated, leading to adverse developments in the Norwegian real-estate market. Also a reduction in the rating uplift as a result of our LGF analysis could lead to downward rating pressure.

Key indicators

Exhibit 2

SpareBank 1 BV (Consolidated Financials) [1]

	3-18 ²	12-17 ²	12-16 ²	12-15 ²	12-14 ²	CAGR/Avg. ³
Total Assets (NOK billion)	46	46	33	31	30	14.4 ⁴
Total Assets (EUR million)	4,812	4,651	3,591	3,197	3,304	12.3 ⁴
Total Assets (USD million)	5,918	5,585	3,788	3,473	3,998	12.8 ⁴
Tangible Common Equity (NOK billion)	4.1	4.1	2.8	2.6	2.2	22.1 ⁴
Tangible Common Equity (EUR million)	427	420	313	267	238	19.8 ⁴
Tangible Common Equity (USD million)	525	504	330	290	287	20.4 ⁴
Problem Loans / Gross Loans (%)	0.6	0.7	0.7	1.7	1.7	1.1 ⁵
Tangible Common Equity / Risk Weighted Assets (%)	16.9	23.1	21.0	18.4	16.4	19.2 ⁶
Problem Loans / (Tangible Common Equity + Loan Loss Reserve) (%)	5.5	6.5	6.1	16.0	18.8	10.6 ⁵
Net Interest Margin (%)	1.5	1.6	1.4	1.4	1.4	1.5 ⁵
PPI / Average RWA (%)	2.2	2.7	2.4	1.7	2.6	2.3 ⁶
Net Income / Tangible Assets (%)	0.9	0.9	0.9	0.6	0.8	0.9 ⁵

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's.com for the most updated credit rating action information and rating history.

Cost / Income Ratio (%)	54.8	56.8	56.7	62.9	52.5	56.7 ⁵
Market Funds / Tangible Banking Assets (%)	30.9	29.9	29.9	31.7	31.6	30.8 ⁵
Liquid Banking Assets / Tangible Banking Assets (%)	13.5	13.9	14.1	14.1	15.7	14.3 ⁵
Gross Loans / Due to Customers (%)	188.0	184.1	184.8	190.8	179.9	185.5 ⁵

[1] All figures and ratios are adjusted using Moody's standard adjustments [2] Basel III - fully-loaded or transitional phase-in; 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 III periods presented

Source: Moody's Financial Metrics

Profile

SpareBank 1 BV is a Norwegian local savings bank that provides retail and corporate financial products and services, from loans and deposit facilities to insurance, pension, payment, leasing, real estate brokerage and accounting services. As of 30 June 2018, the bank had total consolidated assets of NOK47.7 billion (including assets transferred to jointly own covered bond companies). SpareBank 1 BV is the 8th largest savings bank and 11th largest commercial bank in Norway. SpareBank 1 BV is the fifth largest bank in the SpareBank 1 Alliance, which constitutes of 14 independent regional savings banks. The purpose of the SpareBank 1 Alliance is to provide competitive financial services while exploiting economies of scale in terms of both low costs and high quality products and services. In addition, the alliance helps secure the member banks' value creation for the benefit of their own region and the banks' owners.

Detailed credit considerations

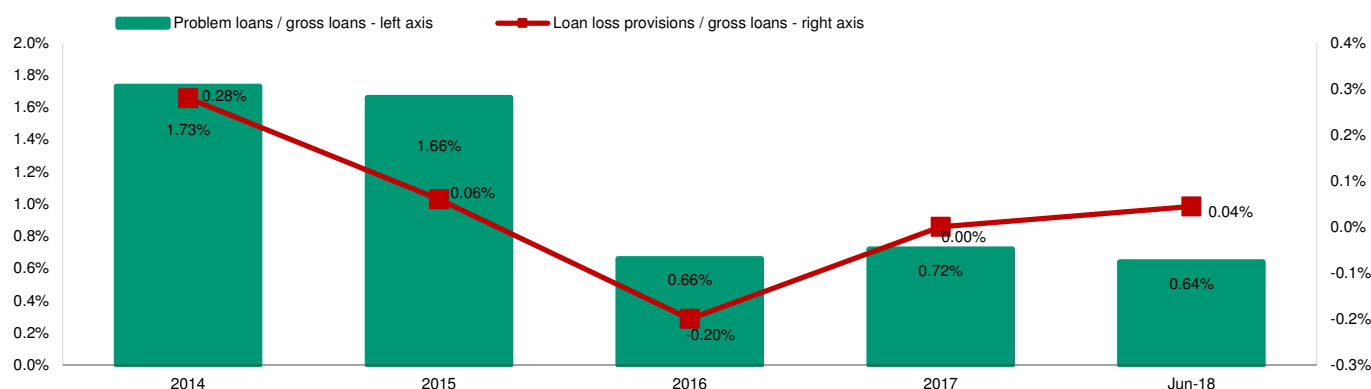
Credit concentration and exposure to Commercial Real Estate elevate asset risk

SpareBank 1 BV's problem loans ratio (Stage 3 loans according to IFRS 9 % gross loans, including loans transferred to the covered bond companies) declined to 0.64% as of end-June 2018 compared to 1.73% as of end-December 2014 (see Exhibit 3). The strengthened credit quality of the bank's loan book reflects refined credit processes and an increasingly sophisticated risk management framework.

The sound credit quality of the bank translates into low credit costs with loan loss provisions amounting to 0% of gross loans in 2017. Credit costs peaked in 2014, reaching 0.28% of gross loans, which is considered low in an international context and compares well with peers. However, SpareBank 1 BV's operations are geographically concentrated in the counties of Vestfold and Buskerud (over 90% of gross loans at end-December 2017), located in South-Eastern Norway. The bank is deeply entrenched in the local community (around a quarter of the population are public servants), a common feature among the Norwegian savings banks, as the business model entails a social responsibility and commitment to the community.

Exhibit 3

Sound asset quality of retail-dominated loan book translates into low loan losses



From 1 January 2018 and onwards, problem loans are defined as IFRS 9 Stage 3 loans

Source: Moody's Financial Metrics

The healthy asset quality of the bank is supported by a loan book dominated by retail exposures, accounting for over 80% of gross loans (including loans transferred to the covered bond companies) at end-June 2018. The bank reported a twelve month total loan growth of 8.8% at end-June 2018, above the 12 month growth in the Norwegian general public's domestic loan debt of 5.8% at end-June 2018. The loan growth was mainly prompted by retail lending as the volume in the corporate loan book remained relatively stable over the period. Norwegian retail mortgages have historically entailed low risk and we expect the robust asset quality of this segment

to endure in the coming 12-18 months. In addition, SpareBank 1 BV is exposed to the cyclical real estate and construction sector (around 15% of gross loans at end-June 2018), which further renders the bank vulnerable to changes in interest rates and real estate prices in the region.

The relative stability of housing prices in Vestfold and Buskerud in the past few years nevertheless mitigates the risk of asset quality deterioration and we expect Norwegian households to continue servicing their debt without difficulties despite a potential small interest rate increase, which is expected in the second half of 2018. In contrast to Oslo, house prices in the bank's areas of operations have been below the Norwegian average and experienced a stable, positive growth without peaks or corrections.

Accordingly, we assign SpareBank 1 BV an Asset Quality Score of baa1, which implies five notches of negative adjustment to better capture risks stemming from the bank's geographical and sector concentration.

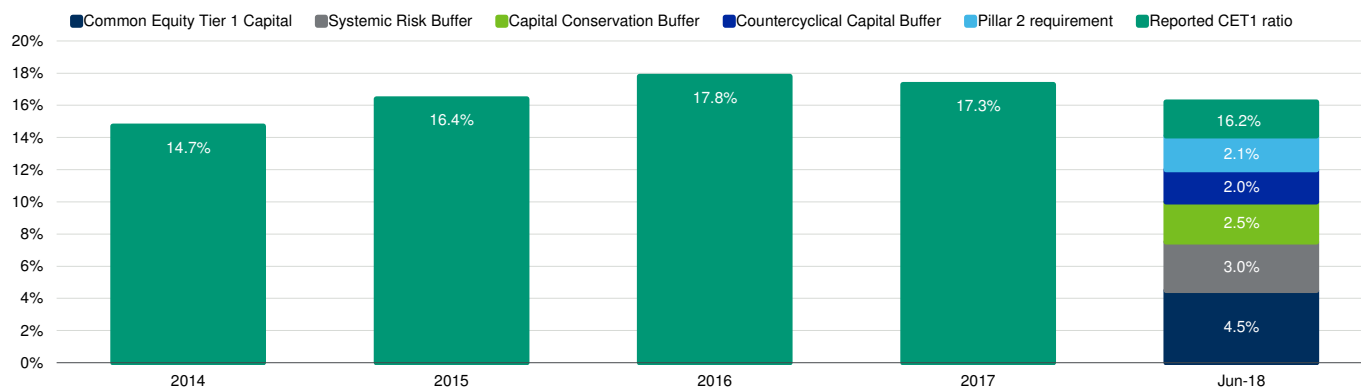
Capitalisation is sound, although capacity to raise new equity capital could prove challenging if needed

SpareBank 1 BV's capitalisation is very strong, as evidenced by its reported Common Equity Tier 1 (CET1) ratio and total capital ratio of 17.3% and 19.6% at end-December 2017. The CET1 ratio however dropped to 16.2% at end-June 2018 compared to 17.1% at end-June 2017 (see Exhibit 4). The decline is due to the consolidation of collaborative groups reflecting the 100% phase-in of CRD IV that came into force as of 1 January 2018, which increases the bank's RWAs significantly. RWAs increased by close to 40% at end-June 2018 (group level, including consolidation of collaborative groups) compared to end-June 2017, while the increase for the parent bank in isolation was around 5% at the same time. Consequently, tangible common equity over RWAs (Moody's definition) decreased to 16.9% at end-March 2018 from 23.1% at end-December 2017.

The bank fulfilled its regulatory capital requirement of 14.1%, including a pillar 2 requirement of 2.1% and the increased countercyclical buffer of 2.0%, with a sizeable headroom at end-June 2018. Consequently, SpareBank 1 BV met its CET1 ratio target of 15% and we expect the bank to continue doing so with a sound margin.

Exhibit 4

SpareBank 1 BV's reported CET 1 ratio declined in Q2 2018 due to full implementation of CRD IV



Source: Issuer reports

SpareBank 1 BV applies the standardised approach to calculating its regulatory capital requirements, meaning that its assets are assigned higher risk weights than it would under the Internal Ratings Based (IRB) approach. The low risk of the bank's loan book is however demonstrated in its unweighted capital metrics. The bank reported a leverage ratio of 8.2% as of end-June 2018, high in an international context and well above the regulatory minimum requirement of 5%. The bank applied to the Norwegian Financial Service Authority (FSA) for approval to implement the IRB method in 2015, but the process was postponed due to the merger between SpareBank 1 BV and SpareBank 1 Nøtterøy-Tønsberg. The bank's application was rejected by the FSA in June 2018 due to the bank's very small corporate loan book that does not enable an accurate evaluation of the level of risk in the portfolio. The FSA has conveyed that it would not be able to assess whether changes in default rates are temporary or if these reflect an actual increase/decrease in the level of risk in the loan book.

Equity certificates are an important part of SpareBank 1 BV's capital base (58% in June 2018), a common feature among Norwegian savings banks. The bank's equity consists of primary capital (no owners) and the equity certificate holders. Raising capital in case of need could be challenging for SpareBank 1 BV given its ownership structure in view of the potential dilution effect. This limits the bank's flexibility in terms of dividend payments (target of 50% at least) and capital retention, and could make it difficult for the bank to access new capital. The two foundations, Sparebankstiftelsen BV and Sparebankstiftelsen Nøtterøy – Tønsberg, are the two largest stakeholders in the bank. The foundations are a long-term and financially strong owners with its bylaws stating that it shall maintain its interest through participation in equity certificate issues.

Based upon our assessment of the bank's capitalisation, we assign SpareBank 1 BV a Capital Score of aa3. One notch of negative adjustment is incorporated to reflect the lack of access to capital.

Good profitability and diversified earnings, although increasing money market rates exert pressure on lending margins

SpareBank 1 BV has maintained a sound profitability in a competitive market place and the merger with SpareBank 1 Nøtterøy-Tønsberg only exerted limited pressure on the bank's profitability, as evidenced by a net income to tangible assets (Moody's adjusted) of around 0.95% in 2016-18.

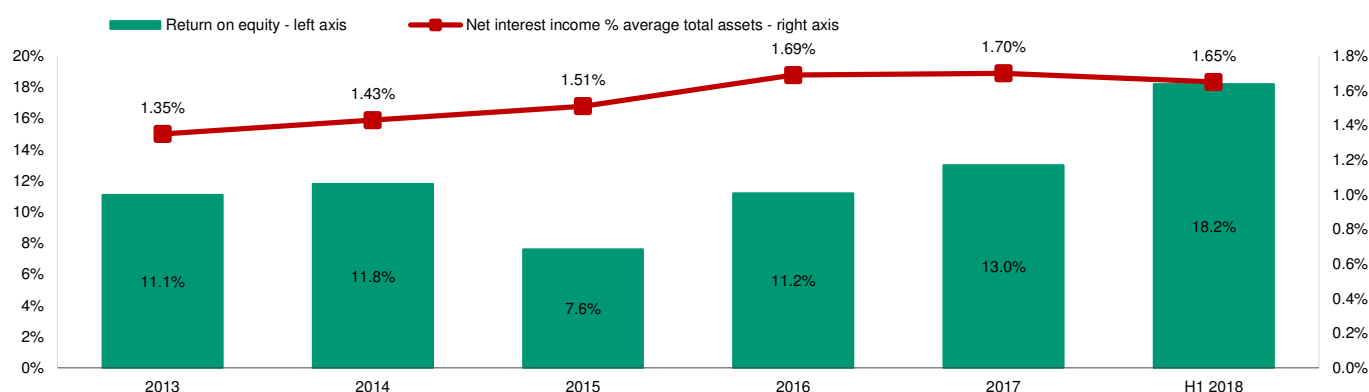
Stable retail banking operations supports SpareBank 1 BV's profitability, constituting around 30% of the bank's profit before losses in the first half of 2018. Net interest income, including net interest income from the covered bond companies booked as commission income, is the most important source of income for SpareBank 1 BV. Net interest income constituted 57% of operating income (excluding gains from financial investments) in the first half of 2018, a decline compared to 68% in both 2017 and 2016. The declining share is largely explained by the bank's sale of property in the first half of 2018, which caused a spike in other operating income in the first half of 2018 compared to the same period last year. Increasing money market rates in anticipation of an expected hike in the key policy rate later this fall also explains the pressure on the bank's lending margins, although this would be beneficial in the longer term.

The bank's earnings are relatively diversified, although net interest income is the primary source of income. Net commission and other operating income reflects income from associated companies jointly owned within the SpareBank 1 Alliance and the bank's own subsidiaries. The wide range of products offered by the bank and its subsidiaries creates valuable opportunities for cross-selling to the acquired customers from SpareBank 1 Nøtterøy-Tønsberg and enables the bank to interact frequently with its customers.

The reported Return on Equity (ROE) of 18.2% in the first half of 2018 reflects significant one off gains, but the bank has nevertheless reported a sound ROE in the past five years (see Exhibit 5).

Exhibit 5

SpareBank 1 BV's ROE is mostly above 10%



Source: Issuer reports

Competition is intense in the bank's area of operations, and it has a limited pricing power compared to the largest national players, which usually reprice their loan books before smaller banks do. Consequently, we expect the pressure on the bank's margins to remain in the third quarter of 2018 before starting to ease off towards the end of 2018 or early 2019.

SpareBank 1 BV's reported cost to income ratio (excluding financial investments) of 31.5% in the first half of 2018 decreased from high 62.5% in the same period last year, although positively affected by significant one off gains. The bank's cost to income ratio has been elevated in the past years and the bank reported a high cost to income ratio of 62% in 2017. The bank is however a member of the SpareBank 1 Alliance, which benefits from economies of scale, and increased digitalisation will enable the bank to operate with a lighter cost base. In addition, we expect the bank's efficiency to improve as cost synergies following the merger can be fully realised in 2019.

High reliance on confidence-sensitive market funding, which is partly mitigated by access to a resilient covered bond market and a sizeable deposit base

SpareBank 1 BV's funding profile is dominated by deposits and covered bonds, similar to other Norwegian savings banks. As of end-June 2018, customer deposits accounted for approximately 50% on the bank's non-equity funding (including covered bonds issued by the jointly owned covered bond companies). The deposit volume was stable at end-June 2018 compared to the same period in 2017. The bulk of the bank's deposits is derived from the retail market, constituting around 60% of total deposits as of end-June 2018. This strengthens SpareBank 1 BV's funding profile as we consider retail deposits to be a more stable source of funding compared to corporate deposits.

The bank is highly dependent on confidence-sensitive market funding to finance its operations since deposit growth is lagging lending growth (including Q2 2018 year-on-year loan growth), as indicated by our market funding ratio (market funds to tangible banking assets including covered bond loans) of 30% as of end-2017. We view this as a weakness in the bank's funding profile as market funding can become more expensive or/and restricted in times of market stress.

The majority of the bank's market funding is in the form of covered bonds issued through covered bond companies jointly owned with other members of the SpareBank 1 Alliance (SpareBank 1 Boligkreditt for residential mortgages and SpareBank 1 Næringskreditt for commercial mortgages). At end-June 2018 the bank had transferred retail mortgages worth NOK11.6 billion and commercial real estate loans worth NOK93 million to these vehicles (i.e. around 30% of its gross loan book including the transferred loans).

While we view positively the diversification benefit of covered bond funding, its extensive use increases the amount of pledged assets unavailable for unsecured bondholders, including depositors in liquidation. As reflected in our methodology, we globally reflect the relative stability of covered bonds compared to unsecured market funding through a standard adjustment.

SpareBank 1 BV's sizeable liquid reserves, constituting 13.9% of the bank's tangible banking assets as of end-2017, partly mitigates risks associated with its high reliance on market funding. However, we note that this ratio understates the core liquidity of the bank, given that it does not take into account the liquid assets held by SpareBank 1 Boligkreditt and SpareBank 1 Næringskreditt. Accordingly, we incorporate a positive adjustment in the assigned Liquid Resources Score to reflect the additional source of liquidity stemming from the covered bond companies.

The main components of the bank's liquidity reserves are covered bonds, sovereign- and municipality bonds. The bank's Liquid Coverage Ratio (LCR) of 165% is well above the regulatory minimum requirement of 100% as of end-June 2018 and we expect the bank to maintain a relatively conservative liquidity in order to curb refinancing risk.

Support and structural considerations

Loss Given Failure

Norway will shortly implement the EU's Bank Recovery and Resolution Directive (effective as of 1 January 2019), which we consider to be an Operational Resolution Regime. We therefore apply our advanced LGF analysis, in which we assume residual tangible common equity of 3% and losses post-failure of 8% of tangible banking assets, a 25% run-off in "junior" wholesale deposits, a 5% run-off in preferred deposits, and assign a 25% probability to deposits being preferred to senior unsecured debt. These are in line with our standard assumptions. We apply a standard assumption for European banks that 26% of deposits are junior.

For SpareBank 1 BV's long-term deposit ratings, we have considered the likely impact on loss-given-failure of the volume of deposits and the amount of debt subordinated to them. This has resulted in a Preliminary Rating Assessment of two notches above the Adjusted BCA, reflecting very low loss-given-failure.

Government support

SpareBank 1 BV benefits from a well-established market position in the counties of Buskerud and Vestfold. Whilst the bank's market share in this region is significant, it is small in a national context. We also note that the close proximity of the bank's home region to Oslo means that a number of other Norwegian banks are present in the area. We therefore assume a low probability of government support for SpareBank 1 BV's deposits, CRA, and CRR ratings resulting in no rating uplift. Moreover, our government support assumptions are driven by the upcoming implementation of the EU's BRRD in Norway (effective as of 1 January 2019).

Counterparty Risk Rating (CRR)

Moody's Counterparty Risk Ratings are opinions of the ability of entities to honour the uncollateralized portion of non-debt counterparty financial liabilities (CRR liabilities) and also reflect the expected financial losses in the event such liabilities are not honoured. CRR liabilities typically relate to transactions with unrelated parties. Examples of CRR liabilities include the uncollateralized portion of payables arising from derivatives transactions and the uncollateralized portion of liabilities under sale and repurchase agreements. CRRs are not applicable to funding commitments or other obligations associated with covered bonds, letters of credit, guarantees, servicer and trustee obligations, and other similar obligations that arise from a bank performing its essential operating functions.

SpareBank 1 BV's CRR is positioned at A1/Prime-1

The CRRs are positioned three notches above the Adjusted BCA of baa1, reflecting the extremely low loss-given-failure from the high volume of instruments that are subordinated to CRR liabilities.

Counterparty Risk (CR) Assessment

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.

SpareBank 1 BV's CR Assessment is positioned at A1(cr)/Prime-1(cr)

SpareBank 1 BV's CR Assessment is positioned at A1(cr)/Prime-1(cr), three notches above the bank's Adjusted BCA of baa1, based on the substantial cushion against default provided to the senior obligations represented by the CRA by subordinated instrument. The main difference with our Advanced LGF approach used to determine instrument ratings is that the CRA captures the probability of default on certain senior obligations, rather than expected loss, therefore we focus purely on subordination and take no account of the volume of the instrument class.

About Moody's Bank Scorecard

Our scorecard is designed to capture, express and explain in summary form our Rating Committee's judgement. When read in conjunction with our research, a fulsome presentation of our judgement 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 6

SpareBank 1 BV

Macro Factors

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

Factor	Historic Ratio	Macro Adjusted Score	Credit Trend	Assigned Score	Key driver #1	Key driver #2
Solvency						
Asset Risk						
Problem Loans / Gross Loans	0.9%	aa2	↓	baa1	Sector concentration	Geographical concentration
Capital						
TCE / RWA	16.9%	aa2	← →	aa3	Access to capital	
Profitability						
Net Income / Tangible Assets	0.9%	baa1	← →	baa2	Expected trend	
Combined Solvency Score		aa3		a3		
Liquidity						
Funding Structure						
Market Funds / Tangible Banking Assets	29.9%	baa2	← →	baa3	Expected trend	
Liquid Resources						
Liquid Banking Assets / Tangible Banking Assets	13.9%	baa3	← →	baa2	Stock of liquid assets	Quality of liquid assets
Combined Liquidity Score		baa2		baa3		
Financial Profile				baa1		
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	14,934	32.2%	17,077	36.8%
Deposits	21,013	45.2%	18,870	40.6%
Preferred deposits	15,550	33.5%	14,772	31.8%
Junior Deposits	5,463	11.8%	4,098	8.8%
Senior unsecured bank debt	8,459	18.2%	8,459	18.2%
Dated subordinated bank debt	390	0.8%	390	0.8%
Preference shares (bank)	250	0.5%	250	0.5%
Equity	1,393	3.0%	1,393	3.0%
Total Tangible Banking Assets	46,439	100%	46,439	100%

Debt class	De Jure waterfall		De Facto waterfall		Notching		LGF	Assigned	Additional	Preliminary
	Instrument volume + subordination	Sub-ordination	Instrument volume + subordination	Sub-ordination	De Jure	De Facto	Notching Guidance vs. Adjusted BCA	LGF notching	notching	Rating Assessment
Counterparty Risk Rating	31.4%	31.4%	31.4%	31.4%	3	3	3	3	0	a1
Counterparty Risk Assessment	31.4%	31.4%	31.4%	31.4%	3	3	3	3	0	a1 (cr)
Deposits	31.4%	4.4%	31.4%	22.6%	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 Rating	3	0	a1	0	A1	A1
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 7

Category [Moody's Rating](#)

SPAREBANK 1 BV

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)

Source: Moody's Investors Service

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Analyst Contacts

Nondas Nicolaides +357.2569.3006
VP-Sr Credit Officer
nondas.nicolaides@moodys.com

Jean-Francois Tremblay +44.20.7772.5653
Associate Managing
Director
jean-francois.tremblay@moodys.com

Louise Eklund +46.8.5025.6569
Associate Analyst
louise eklund@moodys.com

Sean Marion +44.20.7772.1056
MD-Financial Institutions
sean.marion@moodys.com

CLIENT SERVICES

Americas 1-212-553-1653

Asia Pacific 852-3551-3077

Japan 81-3-5408-4100

EMEA 44-20-7772-5454