MOODY'S
INVESTORS SERVICE

Rating Action: Moody's affirms the A1 deposit ratings of four SpareBank 1 alliance banks in Norway; negative outlook remains unchanged

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SpareBank1 SR-Bank's BCA is upgraded to baa1 from baa2

Limassol, September 22, 2017 -- Moody's Investors Service ("Moody's") has today affirmed the A1 deposit rating assigned to the SpareBank 1 alliance banks (SpareBank 1 SR-Bank ASA, SpareBank 1 SMN, SpareBank 1 Ostlandet and SpareBank 1 Nord-Norge), and has also upgraded the baseline credit assessment (BCA) of SpareBank 1 SR-Bank ASA to baa1 from baa2 to be in line with the other three banks' BCA.

The rating affirmations mainly reflect the resilient performance of the four banks despite the challenging economic conditions in Norway over the last two years, as well as Moody's forward-looking expectation that these banks' asset quality, profitability and capitalization will remain robust in a gradually recovering operating environment. SpareBank 1 SR-Bank ASA's baseline credit assessment (BCA) upgrade considers its improving earnings profile and capital base, despite the asset quality challenges it has been facing through its oil-related exposure, amid a slump in oil prices in recent years. The rating agency said that the rating affirmations for all banks are also driven by its unchanged loss given failure (LGF) and government support assumptions.

The negative rating outlook assigned to all four banks remains unchanged, owing to the proposed legislation introduced to the Norwegian parliament on 21 June 2017 by the Ministry of Finance, to implement the EU's bank recovery and resolution directive (BRRD). If the proposed law is enacted, the rating agency expects that Norwegian banks will benefit from a lower probability of government support, which will exert downward pressure on the ratings.

A full list of the affected bank ratings is shown at the end of this press release.

RATINGS RATIONALE

The affirmation of the four banks' ratings reflects their resilient financial performance during challenging economic conditions, in addition to Moody's expectation that such performance will remain intact over the next 12-18 months as the operating environment in Norway gradually improves in 2017-18.

These regional banks had to content with a slowdown in Norway's economy as GDP reduced to 1% in 2016 from 1.6% in 2015, driven mainly by the decline in oil prices that caused petroleum activity to fall by almost 30% during 2014-16 and unemployment to increase, especially in the oil-affected western regions. In addition there was also an increase in vacancy rates in commercial properties in these areas, which raised some concerns regarding the significant commercial real estate exposure that banks have.

Nonetheless, the Norwegian economy was supported by other exporting sectors in 2016-17, such as fisheries and tourism in some regions, with positive momentum occurring in private consumption and mainland private investment. Concomitantly, the unemployment rate has moderated, although it remains high by Norwegian standards, falling to 4.3% in the second quarter 2017 from close to 5.0% throughout most of 2016. The rating agency projects GDP growth to pick up to 1.5% in 2017 and 2% in 2018.

The Norwegian authorities have also been vigilant by the high increase in house prices, especially in the Oslo region, and have implemented measures to strengthen banks' resilience including: a) the increase in the relevant risk-weights for mortgage loans, b) the introduction of a debt-to-income limit of up to five times, which complemented the loan-to-value (LTV) limit of 85%, and c) the household affordability test considering a 5% interest rate hike.

In this context, the four SpareBank 1 alliance banks were able to weather the challenging economic conditions in the last two years with the help of their robust risk management systems, and are currently well positioned to benefit from the pick-up in economic activity in 2017-18. The banks' core earnings were more than sufficient to absorb the increased loan losses, especially from any oil-related exposures, while the good performance of their mortgage books supported their asset quality and revenue growth. Concurrently, banks have been strengthening their capital base, in anticipation of higher capital requirements with an increased countercyclical buffer (2%) introduced in December 2017.

NO CHANGES IN BANKS' LOSS GIVEN FAILURE (LGF) AND GOVERNMENT SUPPORT ASSUMPTIONS

The rating affirmations also take into account the unchanged LGF assumptions and analysis of each of the banks' liability structure, which translates into two notches of rating uplift from their BCAs for deposits and senior debt obligations. This reflects the high level of protection to these creditors in a bank resolution scenario, due to these banks' sizeable subordinated obligations and large pool of liabilities available to absorb any potential losses.

At the same time, Moody's maintained its current moderate government support assumptions, which also result in one notch of rating uplift for deposits and senior unsecured debt. The systemic importance of these banks and the very important role they play in their own regions, suggest that they are likely to benefit from some kind of government support in case of need.

NEGATIVE RATING OUTLOOK MAINTAINED FOR ALL FOUR BANKS

On 21 June 2017, the Norwegian Ministry of Finance forwarded to the parliament proposed draft legislation with a new set of rules to prevent and manage bank failures, which fully corresponds to the EU's bank recovery and resolution directive (BRRD). The legislative proposal entails a new set of rules regarding recovery and resolution plans, early intervention and resolution tools, including bail-in powers.

The proposal designates the Financial Authority (FSA) of Norway as the resolution authority and allows it to impose losses on creditors at the point of non-viability, through a "bail-in" of an amount equal to 8% of an entity's total assets. In accordance with the stricter approach towards government support included in the newly proposed legislation, which is more closely in line with the EU's BRRD, Moody's has maintained the deposit and senior debt rating negative outlook on the four alliance banks (SpareBank 1 SR-Bank ASA, SpareBank 1 SMN, SpareBank 1 Ostlandet and SpareBank 1 Nord-Norge). These four Norwegian banks' ratings currently incorporate one notch of rating uplift due to the rating agency's moderate government support assumption driven by their systemic importance. Moody's said that its government support assumptions are likely to be revised lower, once the proposed legislation is passed into law by the parliament. Accordingly, the negative outlook reflects the future direction of these banks' deposits and senior debt ratings over the next 12-18 months.

INDIVIDUAL BANKS' MAIN RATING DRIVERS

SpareBank 1 SR-Bank ASA - BCA upgraded to baa1 from baa2, Deposits A1 negative

The upgrade of the bank's BCA to baa1 from baa2 considers its improving profitability and capitalisation, despite the asset quality challenges it still faces through its oil-related exposure, amid a slump in oil prices in recent years. Moody's said that SpareBank 1 SR-Bank ASA's improving financial performance and standing in the first half 2017 has exerted upward pressure on its standalone credit profile. The bank's asset quality has also stabilised, while the rating agency expects the bank's non-performing loans (NPLs) to start gradually to decline as economic conditions in Norway improve and the side effects from the lower oil investments diminish. The rating agency has also commended the bank' strong funding capacity in the international capital markets, both through its own covered bond vehicle and EMTN programme.

The bank reported a 15.8% year-on-year increase in its half-year 2017 profit after tax as of June 2017, driven primarily by improved net interest margins (increased to 1.52% in June 2017 from 1.47% in June 2016) and reduced impairment loan losses (down to 0.33% of gross loans from 0.5% in Jun 2016). The bank's return on equity (RoE) also increased to 9.9% in June 2017 from 9.3% in June 2016, while the Moody's adjusted ratio of net profit to tangible assets used in the relevant scorecard was at 0.79%. The bank's NPL ratio has stabilized at around 1.2% of gross loans (including covered bond loans) as of June 2017, while its common equity Tier 1 (CET1) ratio increased to 14.7% in June 2017 from 13.5% in June 2016. The rating agency believes that these profitability and capital buffers are more than sufficient to absorb any losses from the bank's restructured loans and overall offshore/oil and gas exposure, which is the highest among its peers at around 6.3% of gross loans as of June 2017 (June 2016: 6.5%).

Despite the bank's BCA upgrade, its deposit and debt ratings are affirmed at their current levels due to the elimination of any affiliate support that Moody's incorporated into SpareBank 1 SR-Bank ASA's ratings so far. The bank's higher BCA is now in line with that of the other three SpareBank 1 alliance banks, and thus the presumed affiliate support does not result in any rating uplift. In addition, SpareBank 1 SR-Bank ASA has increasingly become more independent in its funding plans, by setting-up its own covered bond company and

EMTN programme. These initiatives were driven by the bank's efforts to further strengthen its position and reputation in both the local and international capital markets, and differentiate itself from its peers within the SpareBank 1 alliance.

SpareBank 1 SMN - BCA baa1, Deposits A1 negative

The ratings affirmation for SpareBank 1 SMN takes into account its comfortable capitalization and liquidity, ability to manage its problematic oil-sector exposures, and strong performance by its retail clients supporting its earnings. Despite the marginal decrease in SpareBank 1 SMN's first half 2017 net profit to NOK 759 million from NOK 771 million the year before, Moody's notes that the bank was able to strengthen its operating profit and reduce its loan loss provisions by almost 40%. The bank's RoE was at 9.9% as of June 2017, from 10.9% in June 2016, although on the back of a stronger capital base with a CET1 ratio of 15% in June 2017 (June 2016: 14.1%).

SpareBank 1 SMN is also exposed to the oil sector with its offshore-related exposure amounting to around 3.5% of total credit, although reduced in absolute terms to NOK 5.5 billion in June 2017 from NOK 6.3 billion in June 2016. The bank's overall problem loans were fairly stable comprising around 0.98% of total gross loans (including covered bond loans) in June 2017 from 0.99% in June 2016, following a number of successful restructurings in the offshore segment. Going forward, Moody's expects the bank's credit losses to further moderate as oil prices stabilise and the relevant investments start increasing from 2018 onwards.

SpareBank 1 Ostlandet - BCA baa1, Deposits A1 negative

SpareBank 1 Ostlandet's ratings affirmation reflects its solid capital buffers, recently expanded client base and franchise into the Oslo area, and very low level of problem loans. The bank's RoE and return on average assets (RoAA) stood at 9.2% and 1.1% respectively as of June 2017, from 8.2% and 1.1% in June 2016, as the bank gradually reaps the benefits of its recent acquisition of Bank 1 Oslo Akershus AS (B1OA). Accordingly, most of the reported figures are not comparable on a year-on-year basis. The bank's NPL to gross loans (including covered bond loans) ratio was very low at around 0.4% as of June 2017 driven by the bank's sizeable housing loans exposure and no exposure to the oil sector, while it had no loan losses during the first half of 2017 but certain write-backs amounting to NOK 21 million.

In addition, the bank boasts the strongest capitalization among its peers, with a CET1 ratio of 16.7% in June 2017, up from 16% in June 2016. The rating agency notes that the bank is in the process of fully integrating the operations of B1OA, which will gradually bring about efficiencies and improve its cost-to-income ratio that deteriorated to 56.7% in June 2017 from 49.7% in June 2016.

SpareBank 1 Nord-Norge - BCA baa1, Deposits A1 negative

SpareBank 1 Nord-Norge's ratings affirmation reflects its robust earnings profile and profitability, as the bank has benefited in recent years from the better economic conditions in its region of Northern Norway, and especially from the thriving sectors of fisheries and tourism. The bank's profit after tax increased by around 6.5% year-on-year as of June 2017 as net interest margins improved to 1.85% in June 2017 from 1.77% in June 2016 and the bank grew its loan book by around 9.2% year-on-year. Loan losses were marginally lower standing at round 0.17% of gross loans (including covered bond loans) in June 2017 from 0.19% the year before, while its NPLs ratio was down to 0.53% (including covered bond loans) in June 2017 from 0.64% in June 2016.

The rating agency notes that the bank also possesses the lowest cost-to-income ratio among its peers at 41.5% in June 2017. The bank's CET1 capital ratio improved to 15.4% in June 2017 from 14.2% in June 2016, with a comfortable leverage ratio of 7.5% in June 2017. Looking ahead, the rating agency expects SpareBank 1 Nord-Norge to maintain its robust performance and to continue to benefit from the favourable economic conditions in the Northern part of Norway, exerting some positive pressure on its standalone credit profile.

WHAT COULD CHANGE THE RATING UP/DOWN

Upward rating momentum is currently unlikely given the negative outlook on all four savings banks affected by this rating action. Over time, upward pressure could develop if these banks demonstrate: (1) reduced exposure to more volatile sectors such as the oil and commercial real estate related sectors; (2) diversified access to capital markets and improved liquidity; and/or (3) stronger earnings generation without an increase in risk profiles.

Downward rating pressure would develop on these banks ratings if: (1) Moody's expects their problem loan ratios to increase above its current system-wide expectation of approximately 2%; (2) profitability deteriorates from expected levels; (3) the banks fail to sustain their market position; and/or (4) government support reduces due to the implementation of a resolution regime in Norway.

LIST OF AFFECTED RATINGS

Issuer: SpareBank 1 SR-Bank ASA

Upgrades:

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

Affirmations

....LT Issuer Rating, Affirmed A1, Outlook Remains Negative

....LT Bank Deposits, Affirmed A1, Outlook Remains Negative

....ST Bank Deposits, Affirmed P-1

....Senior Unsecured Regular Bond/Debenture, Affirmed A1, Outlook Remains Negative

....Subordinate, Affirmed Baa2 (hyb)

....Senior Unsecured MTN Program, Affirmed (P)A1

....Subordinate MTN Program, Affirmed (P)Baa2

....Junior Subordinate MTN Program, Affirmed (P)Baa3

....Adjusted Baseline Credit Assessment, Affirmed baa1

....LT Counterparty Risk Assessment, Affirmed Aa3(cr)

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

Outlook Actions:

....Outlook, Remains Negative

Issuer: SpareBank 1 Nord-Norge

Affirmations:

....LT Issuer Rating, Affirmed A1, Outlook Remains Negative

....LT Bank Deposits, Affirmed A1, Outlook Remains Negative

....ST Bank Deposits, Affirmed P-1

....Senior Unsecured Regular Bond/Debenture, Affirmed A1, Outlook Remains Negative

....Pref. Stock Non-cumulative, Affirmed Ba1 (hyb)

....Senior Unsecured MTN Program, Affirmed (P)A1

....Subordinate MTN Program, Affirmed (P)Baa2

....Junior Subordinate MTN Program, Affirmed (P)Baa3

....Adjusted Baseline Credit Assessment, Affirmed baa1

....Baseline Credit Assessment, Affirmed baa1

....LT Counterparty Risk Assessment, Affirmed Aa3(cr)

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

Outlook Actions:

....Outlook, Remains Negative

Issuer: SpareBank 1 Ostlandet

Affirmations:

....LT Issuer Rating, Affirmed A1, Outlook Remains Negative

....LT Bank Deposits, Affirmed A1, Outlook Remains Negative

....ST Bank Deposits, Affirmed P-1

....Adjusted Baseline Credit Assessment, Affirmed baa1

....Baseline Credit Assessment, Affirmed baa1

....LT Counterparty Risk Assessment, Affirmed Aa3(cr)

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

Outlook Actions:

....Outlook, Remains Negative

Issuer: SpareBank 1 SMN

Affirmations:

....LT Issuer Rating, Affirmed A1, Outlook Remains Negative

....LT Bank Deposits, Affirmed A1, Outlook Remains Negative

....ST Bank Deposits, Affirmed P-1

....Senior Unsecured Regular Bond/Debenture, Affirmed A1, Outlook Remains Negative

....Subordinate, Affirmed Baa2 (hyb)

....Senior Unsecured MTN Program, Affirmed (P)A1

....Subordinate MTN Program, Affirmed (P)Baa2

....Junior Subordinate MTN Program, Affirmed (P)Baa3

....Adjusted Baseline Credit Assessment, Affirmed baa1

....Baseline Credit Assessment, Affirmed baa1

....LT Counterparty Risk Assessment, Affirmed Aa3(cr)

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

Outlook Actions:

....Outlook, Remains Negative

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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Nondas Nicolaides
VP - Senior Credit Officer
Financial Institutions Group
Moody's Investors Service Cyprus Ltd.
Porto Bello Building
1, Siafi Street, 3042 Limassol
PO Box 53205
Limassol CY 3301
Cyprus
JOURNALISTS: 44 20 7772 5456
Client Service: 44 20 7772 5454

Sean Marion
MD - Financial Institutions
Financial Institutions Group
JOURNALISTS: 44 20 7772 5456
Client Service: 44 20 7772 5454

Releasing Office:
Moody's Investors Service Cyprus Ltd.
Porto Bello Building
1, Siafi Street, 3042 Limassol
PO Box 53205
Limassol CY 3301
Cyprus
JOURNALISTS: 44 20 7772 5456
Client Service: 44 20 7772 5454

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