

ISSUER IN-DEPTH

15 January 2018

[Rate this Research](#) >>

RATINGS

SpareBank 1 SR-Bank ASA

LT Senior Unsecured	A1 negative
LT Deposits	A1 negative
Baseline Credit Assessment	baa1
CR Assessmen (LT/ST)	Aa3(cr) / P-1(cr)

SpareBank 1 SMN

LT Senior Unsecured	A1 negative
LT Deposits	A1 negative
Baseline Credit Assessment	baa1
CR Assessmen (LT/ST)	Aa3(cr) / P-1(cr)

SpareBank 1 Ostlandet

LT Deposits	A1 negative
Baseline Credit Assessment	baa1
CR Assessmen (LT/ST)	Aa3(cr) / P-1(cr)

SpareBank 1 Nord-Norge

LT Senior Unsecured	A1 negative
LT Deposits	A1 negative
Baseline Credit Assessment	baa1
CR Assessmen (LT/ST)	Aa3(cr) / P-1(cr)

Contacts

Nondas Nicolaidis +357.2569.3006
VP-Sr Credit Officer
 nondas.nicolaides@moody.com

Effie Tsotsani +44.20.7772.1712
Analyst
 effie.tsotsani@moody.com

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

Sean Marion +44.20.7772.1056
MD-Financial Institutions

SpareBank 1 SR-Bank, SpareBank 1 SMN, SpareBank 1 Ostlandet and SpareBank 1 NN

FAQ: Sparebank 1 banks illustrate Moody's approach to non-consolidated covered bonds

The four rated Sparebank 1 Alliance savings banks ([SpareBank 1 SR-Bank](#), [SpareBank 1 SMN](#), [SpareBank 1 Ostlandet](#) and [SpareBank 1 Nord-Norge](#)) in Norway (Aaa stable) do not consolidate their covered bond loans into their financial statements. This is because the banks issue covered bonds through jointly-owned companies that none of them individually hold a majority stake in. However, we incorporate the assets and liabilities associated with these instruments in the banks' balance sheets in our credit analysis, as we believe this better captures the Sparebank 1 Alliance banks' true financial and economic position. Below we answer frequently-asked questions regarding the rationale for our approach, and the consequent adjustments we make to the banks' financials.

The four savings banks have traditionally issued covered bonds through their jointly-owned covered bond entities, SpareBank 1 Boligkreditt (residential mortgages loans) and SpareBank 1 Naeringskreditt (commercial real estate mortgages). Neither the assets transferred to these companies, nor the liabilities they issue, are consolidated into the banks' audited financial statements. The four banks' reported financial ratios are therefore not directly comparable with those of other Norwegian and global banks, which fully own their covered bond companies.

In our credit analysis we consolidate the banks' covered bonds reflecting the fact that the banks in practice retain the credit risk associated with the underlying mortgage loans, even though these are transferred on a "true sale" basis to the covered bond entities for accounting purposes. Our approach is underpinned by the fact that the banks have typically, in practice, replaced any loans in the cover bond pool that are more than 30 days overdue with new performing loans or those whose loan-to-value ratio has increased above a certain threshold. The consolidation of these loans therefore enables a direct comparison between these banks and their local/global peers, and allows for less qualitative adjustment on each of the banks' scorecards to derive their standalone credit profiles.

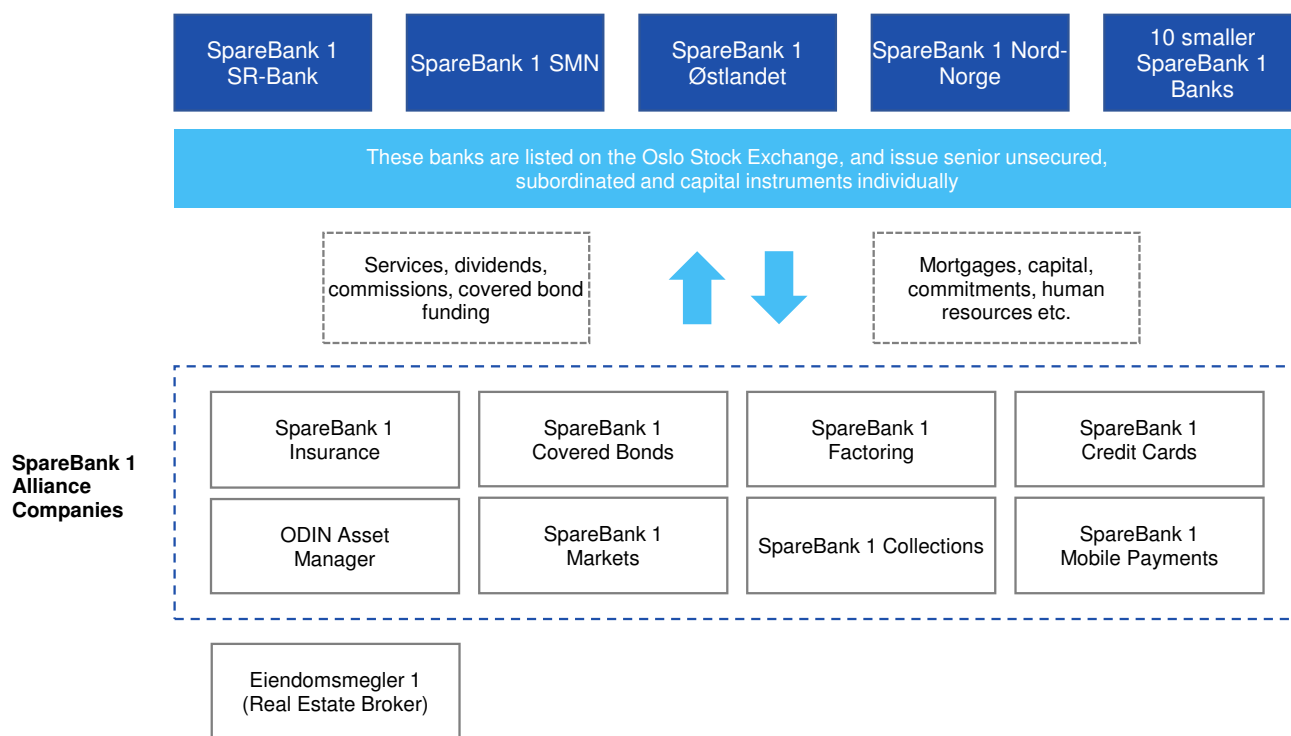
In general, our consolidation adjustments have not had any impact on the banks' fundamental credit standing, as the aforementioned adjustments made to their financial ratios have remained limited in scope. In particular, our assessment of asset risk, profitability, market funding, and liquidity have been affected only marginally.

Why do the SpareBank 1 Alliance Banks not consolidate the covered bond loans issued by their jointly-owned covered bond companies?

The SpareBank 1 Alliance consists of 14 independent savings banks, which cooperate on branding and use a shared platform for other services, including their jointly-owned covered bond companies (see Exhibit 1). These entities are not majority-owned by any of the banks (the four rated Alliance banks have a combined shareholding of around 68% of SpareBank 1 Boligkreditt, the residential mortgage covered bond entity; see Exhibit 2). As a result, none of the Alliance banks records the mortgage loans that they transfer to the covered bond companies in their consolidated balance sheets. We believe this approach does not fully and accurately reflect the banks' true underlying financial position, nor the credit risks they face.

Exhibit 1

The SpareBank 1 Alliance cooperation creates efficiencies and scale benefits

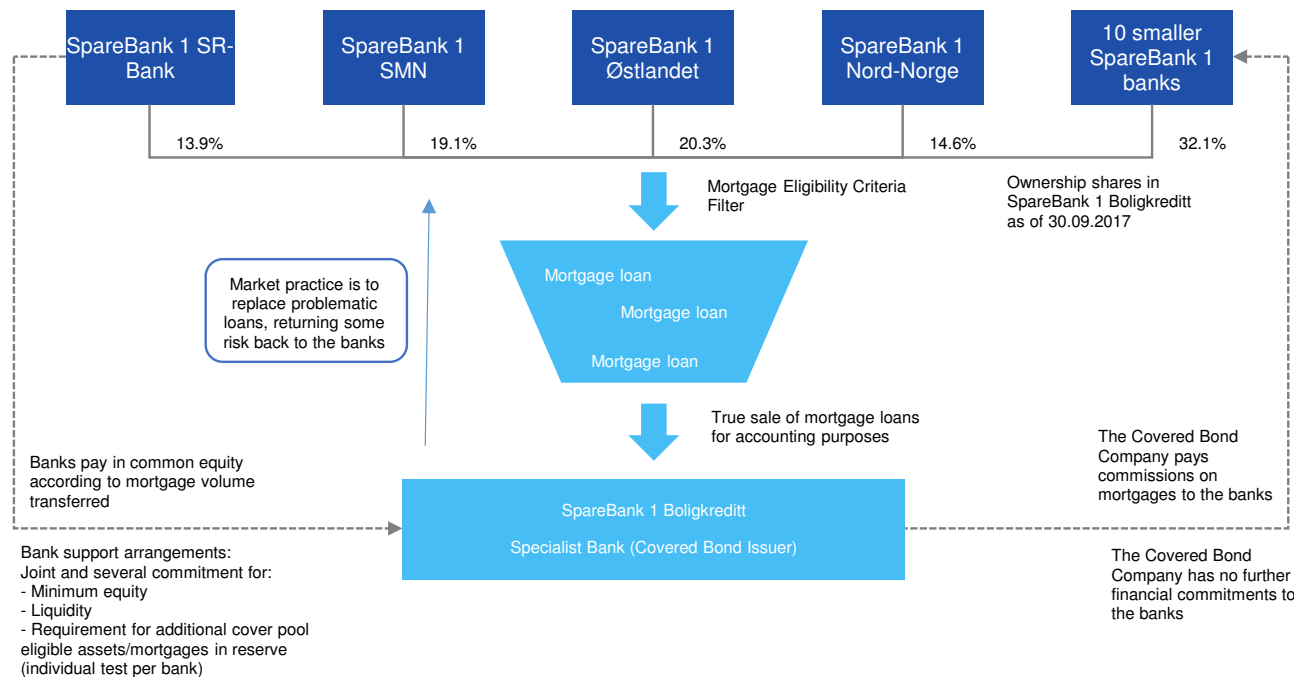


Source: Company reports and presentations

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.

Exhibit 2

Sparebank 1 Boligkreditt is jointly owned by all 14 Alliance banks



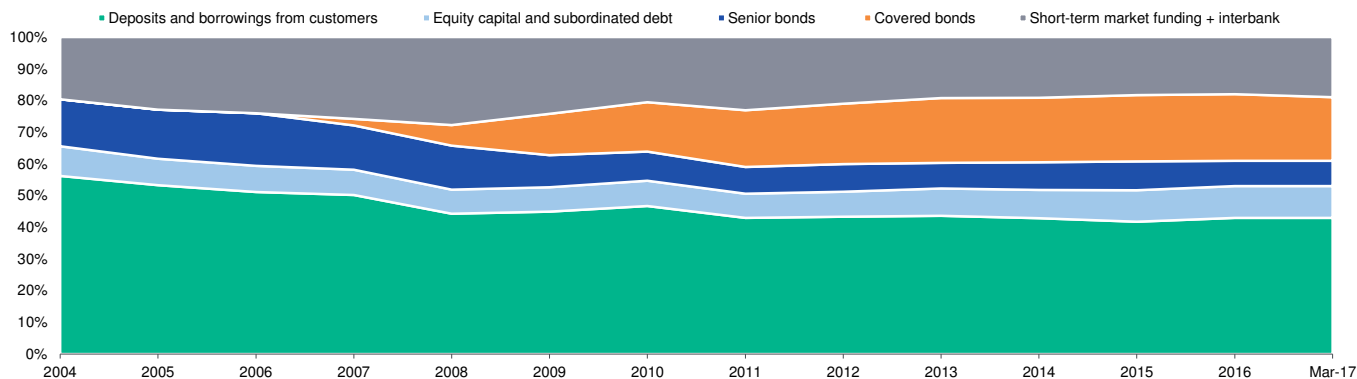
Source: Company reports and presentations

How important is covered bond funding for these banks, and what is the advantage of using these specialist covered bond companies?

Covered bonds are of significant importance in the funding structure of the Norwegian banking system (see Exhibit 3). Most rated Norwegian banks use wholly-owned companies to issue covered bonds, which are therefore fully consolidated into the banks' financial statements.

Exhibit 3

Covered bond funding has become Norwegian banks' largest source of wholesale funding



Source: Norwegian FSA

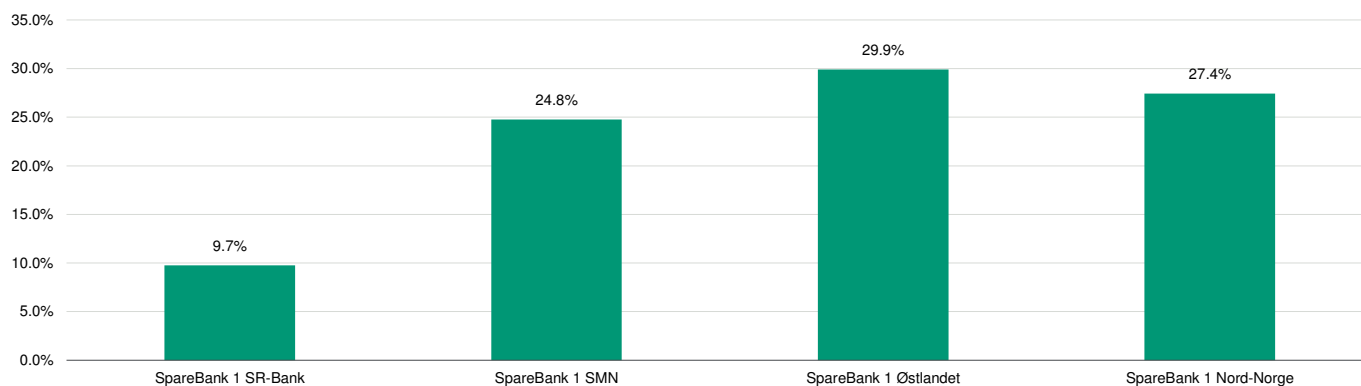
Covered bonds are a vital source of finance for the four rated SpareBank 1 Alliance Banks, funding around 23% of their total loans (including transferred loans) on average (see Exhibit 4). SpareBank 1 SR-Bank's lower reliance on SpareBank 1 Boligkreditt reflects the bank's decision in March 2015 to set-up a fully-owned covered bond company (SR-Boligkreditt AS) as part of its contingency funding plans. SpareBank 1 SR-Bank has since then channeled only part of its covered bond issuances through the jointly owned SpareBank 1

Boligkreditt entity, and has increasingly opted to use its own covered bond company in recent quarters. Including covered bonds issued through its own SR-Boligkreditt entity, the proportion of SpareBank 1 SR-Bank's loans (including transferred loans) funded by covered bonds stood at around 30% as of September 2017.

Exhibit 4

The banks transfer a high share of their gross loans to the jointly-owned covered bond companies

Transferred loans as a % total gross loans (including transferred loans)



Note: As of September 2017

Source: Company reports and presentations

Using SpareBank 1 Boligkreditt provides a funding cost benefit to the SpareBank 1 Alliance banks, as the company's proven track record in local and international markets helps attract strong investor interest in its bond issues. This makes the banks' covered bond funding more predictable and stable. Covered bonds are eligible for liquidity coverage ratio (LCR) purposes, and also qualify for repo transactions with the Norwegian central bank. Using SpareBank 1 Boligkreditt also allows banks to issue in a cost efficient manner, reflecting the company's scale and lean cost structure.

Why does Moody's consolidate the banks' covered bond assets, and how are the necessary adjustments made?

We have consolidated both the loans transferred to, and the liabilities issued by, the jointly--owned covered bond companies into the banks' financial data for the last three years, including their latest quarterly 2017 results. This adjustment allows us to incorporate these items in our calculation of the four rated Alliance banks' financial metrics. We believe this provides a more accurate picture of their financial and economic position.

A key consideration behind this approach is that the Alliance banks, although not legally obliged to do so, have over the years voluntarily exchanged any loans transferred to the covered bond pool that become delinquent by 30 days or more with new performing loans. As a result, the underlying credit risk in practice remains with the banks at all times, even though these loans are transferred to the covered bond entities on a true sale basis. Alliance banks have a strong incentive to replace covered bond pool loans that become delinquent, as this helps avert potential solvency problems at the covered bond entities, which they are legally obliged to bail out.

The relationship between the covered bond companies and the banks is governed by bilateral contracts as well as Norwegian law. The legislation requires that covered bonds are issued by specialist credit institutions that must finance their lending primarily through covered bond issuance, while contractual arrangements stipulate that the owner banks must support these entities with equity and liquidity in times of stress. The owner banks must also hold a reserve of mortgages eligible for the cover pool, and use them to replace any mortgages that no longer meet the eligibility criteria. If the loan-to-value (LTV) ratio of the mortgages in the cover pool were to rise above 75%¹ because of a decline in house prices, then the margin paid to the banks is reduced by 50% for those loans, such that the banks are incentivized to replace the loans. As such, the banks have voluntarily replaced any loans exceeding an LTV of 75% in the past. We note however that the mortgages in the cover pool are consistently of prime quality, limiting downside risk for the Alliance banks.

Our practice of consolidating the covered bond loans of the SpareBank 1 Alliance banks also enables more consistent direct comparisons between these banks and their local and global peers, and allows for less qualitative adjustment and fine-tuning on each of the banks' scorecards to derive their standalone credit profile.

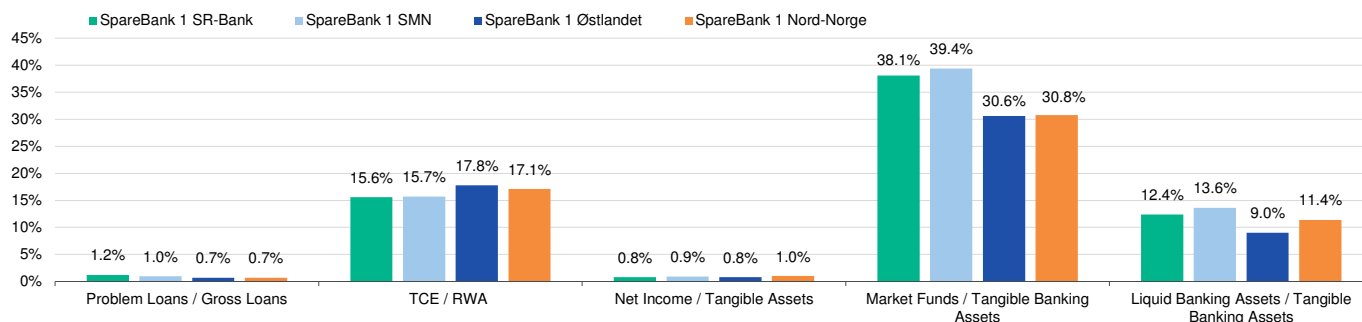
The consolidation adjustments we make generally involve adding the loans transferred to the covered bond entities back to the banks' loan books, and simultaneously adding the corresponding covered bonds to the banks' liabilities. We make a further adjustment affecting commissions on the transferred loans that the covered bond companies pay to the banks, which the banks report as part of their fee and commission income. These payments, calculated as the difference between the rate paid by the mortgage borrower and the bank's funding cost, are equivalent to the net income that the bank would have generated from the mortgage loan. We therefore deduct them from the banks' fee and commission income, and add them back to their net interest income. Covered bond companies also have the right to recover any credit losses on the purchased mortgages from the commissions they pay out to the banks.

What impact do these adjustments have on the banks' financial ratios?

In general, the consolidation adjustments that we make have no impact on the SpareBank 1 Alliance banks' fundamental credit standing, despite some changes in the financial ratios we use in assessing their baseline credit assessments (BCA), a measure of their standalone creditworthiness. In particular, our assessment of asset risk, profitability, market funds, and liquidity are affected only marginally (see Exhibits 5 and 6).

Exhibit 5

Moody's BCA scorecard ratios with the consolidation of the covered bond assets and liabilities

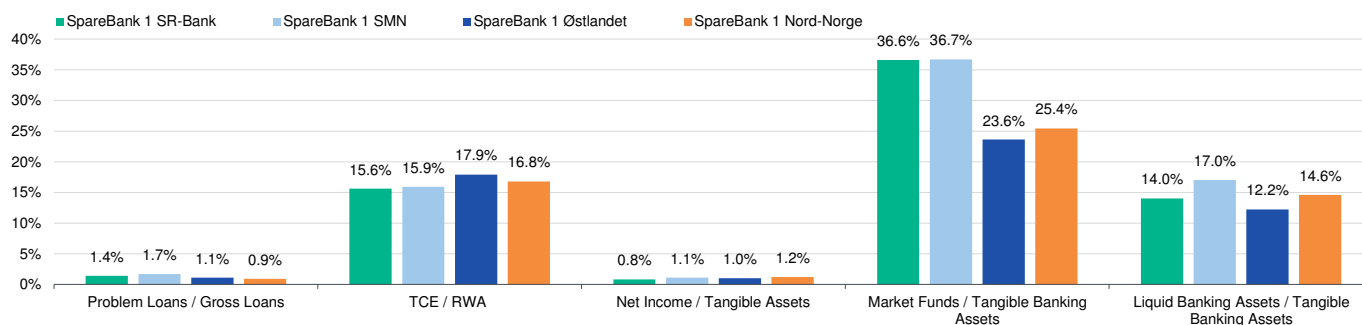


Note: Scorecard ratios include Q3 2017 financial data

Source: Moody's Investors Service

Exhibit 6

Moody's scorecard ratios with no consolidation of the covered bond assets and liabilities



Note: Scorecard ratios include year-end 2016 financial data

Source: Moody's Investors Service

The problem loan ratio (non-performing and doubtful loans to gross loans) of all four rated banks improves when the transferred loans are added back, reflecting the larger volume of gross loans. We see no increase in the banks' problem loans as a result of the adjustment, as the mortgages eligible for inclusion in the cover pool are of high quality.

The banks' return on tangible assets (as calculated by Moody's) decreases marginally as a result of the adjustment, reflecting their larger asset base. Their net income, meanwhile, remains unchanged, as fee and commission income is simply reclassified as net interest income. Nevertheless, this re-classification enables a more complete analysis of the banks' earnings streams and net interest margins.

The consolidation of covered bonds issued through SpareBank 1 Boligkreditt and SpareBank 1 Næringskreditt highlights the banks' significant reliance on confidence-sensitive wholesale funding. Although the banks' market funds to tangible assets ratio increases, their funding structure scores remain unchanged, partly because of qualitative analytical refinement already made for these off-balance sheet assets. The impact of re-consolidating the covered bonds is further moderated by a standard scorecard adjustment that we apply globally, as per our rating methodology for banks, to reflect the relative stability of covered bonds compared to unsecured market funding. This involves accounting for 50% of the covered bonds as deposit-like funding.

The liquid banking assets to tangible banking assets ratio declines somewhat as a result of the adjustments. The underlying core liquidity of the banks is however marginally understated by the adjusted liquidity ratio, as it does not recognize the liquid assets held by SpareBank 1 Boligkreditt and SpareBank 1 Næringskreditt, relative to peers that fully consolidate their own cover bond companies. We incorporate a positive qualitative adjustment to Alliance banks' liquidity score to reflect this additional potential source of core liquidity.

The capital score remains unaffected, because we use the regulatory risk-weighted assets and the reported regulatory capital ratios of these banks as part of our analysis. However, we focus on banks' tangible common equity (TCE), which is not necessarily the same as banks' reported common equity Tier 1 (CET1) capital.

In general, our consolidation adjustments have not had any impact on the banks' fundamental credit standing so far, as any changes in their financial ratios are immaterial. The adjustments we apply in our analysis are not significant enough to trigger at this point of time any change in our scorecard outcomes, or in the banks' ratings.

Peer Group:

- » [SpareBank 1 SR-Bank ASA](#)
- » [SpareBank 1 SMN](#)
- » [SpareBank 1 Ostlandet](#)
- » [SpareBank 1 Nord-Norge](#)
- » [Sparebanken Vest](#)

Moody's Related Research

Rating actions:

- » [Moody's affirms the A1 deposit ratings of four SpareBank 1 alliance banks in Norway; negative outlook remains unchanged, September 2017 \(372888\)](#)
- » [Moody's changes rating outlook to negative for five Norwegian banks following proposed BRRD legislation; ratings affirmed, July 2017 \(369249\)](#)

Credit opinions:

- » [SpareBank 1 SR-Bank ASA - Update following the upgrade of the bank's BCA to baa1 and ratings affirmations, September 2017 \(1092805\)](#)
- » [SpareBank 1 SMN - Update following ratings affirmations, September 2017 \(1092814\)](#)
- » [SpareBank 1 Ostlandet - Update following ratings affirmations, September 2017 \(1092877\)](#)
- » [SpareBank 1 Nord-Norge - Update following ratings affirmations, September 2017 \(1092933\)](#)

Banking System Outlook:

- » [Banking System Outlook - Norway, August 2017 \(1076131\)](#)

Rating Methodology

- » [Banks, September 2017 \(1065675\)](#)

Analysis:

- » [Government of Norway – Aaa stable, October 2017 \(1094390\)](#)

Endnotes

- 1 The maximum 75% LTV for residential mortgage loans is set under the covered bonds law and refers to the prudent market value.

© 2018 Moody's Corporation, Moody's Investors Service, Inc., Moody's Analytics, Inc. and/or their licensors and affiliates (collectively, "MOODY'S"). All rights reserved.

CREDIT RATINGS ISSUED BY MOODY'S INVESTORS SERVICE, INC. AND ITS RATINGS AFFILIATES ("MIS") ARE MOODY'S CURRENT OPINIONS OF THE RELATIVE FUTURE CREDIT RISK OF ENTITIES, CREDIT COMMITMENTS, OR DEBT OR DEBT-LIKE SECURITIES, AND MOODY'S PUBLICATIONS MAY INCLUDE MOODY'S CURRENT OPINIONS OF THE RELATIVE FUTURE CREDIT RISK OF ENTITIES, CREDIT COMMITMENTS, OR DEBT OR DEBT-LIKE SECURITIES. MOODY'S DEFINES CREDIT RISK AS THE RISK THAT AN ENTITY MAY NOT MEET ITS CONTRACTUAL, FINANCIAL OBLIGATIONS AS THEY COME DUE AND ANY ESTIMATED FINANCIAL LOSS IN THE EVENT OF DEFAULT. CREDIT RATINGS DO NOT ADDRESS ANY OTHER RISK, INCLUDING BUT NOT LIMITED TO: LIQUIDITY RISK, MARKET VALUE RISK, OR PRICE VOLATILITY. CREDIT RATINGS AND MOODY'S OPINIONS INCLUDED IN MOODY'S PUBLICATIONS ARE NOT STATEMENTS OF CURRENT OR HISTORICAL FACT. MOODY'S PUBLICATIONS MAY ALSO INCLUDE QUANTITATIVE MODEL-BASED ESTIMATES OF CREDIT RISK AND RELATED OPINIONS OR COMMENTARY PUBLISHED BY MOODY'S ANALYTICS, INC. CREDIT RATINGS AND MOODY'S PUBLICATIONS DO NOT CONSTITUTE OR PROVIDE INVESTMENT OR FINANCIAL ADVICE, AND CREDIT RATINGS AND MOODY'S PUBLICATIONS ARE NOT AND DO NOT PROVIDE RECOMMENDATIONS TO PURCHASE, SELL, OR HOLD PARTICULAR SECURITIES. NEITHER CREDIT RATINGS NOR MOODY'S PUBLICATIONS COMMENT ON THE SUITABILITY OF AN INVESTMENT FOR ANY PARTICULAR INVESTOR. MOODY'S ISSUES ITS CREDIT RATINGS AND PUBLISHES MOODY'S PUBLICATIONS WITH THE EXPECTATION AND UNDERSTANDING THAT EACH INVESTOR WILL, WITH DUE CARE, MAKE ITS OWN STUDY AND EVALUATION OF EACH SECURITY THAT IS UNDER CONSIDERATION FOR PURCHASE, HOLDING, OR SALE.

MOODY'S CREDIT RATINGS AND MOODY'S PUBLICATIONS ARE NOT INTENDED FOR USE BY RETAIL INVESTORS AND IT WOULD BE RECKLESS AND INAPPROPRIATE FOR RETAIL INVESTORS TO USE MOODY'S CREDIT RATINGS OR MOODY'S PUBLICATIONS WHEN MAKING AN INVESTMENT DECISION. IF IN DOUBT YOU SHOULD CONTACT YOUR FINANCIAL OR OTHER PROFESSIONAL ADVISER. ALL INFORMATION CONTAINED HEREIN IS PROTECTED BY LAW, INCLUDING BUT NOT LIMITED TO, COPYRIGHT LAW, AND NONE OF SUCH INFORMATION MAY BE COPIED OR OTHERWISE REPRODUCED, REPACKAGED, FURTHER TRANSMITTED, TRANSFERRED, DISSEMINATED, REDISTRIBUTED OR RESOLD, OR STORED FOR SUBSEQUENT USE FOR ANY SUCH PURPOSE, IN WHOLE OR IN PART, IN ANY FORM OR MANNER OR BY ANY MEANS WHATSOEVER, BY ANY PERSON WITHOUT MOODY'S PRIOR WRITTEN CONSENT.

CREDIT RATINGS AND MOODY'S PUBLICATIONS ARE NOT INTENDED FOR USE BY ANY PERSON AS A BENCHMARK AS THAT TERM IS DEFINED FOR REGULATORY PURPOSES AND MUST NOT BE USED IN ANY WAY THAT COULD RESULT IN THEM BEING CONSIDERED A BENCHMARK.

All information contained herein is obtained by MOODY'S from sources believed by it to be accurate and reliable. Because of the possibility of human or mechanical error as well as other factors, however, all information contained herein is provided "AS IS" without warranty of any kind. MOODY'S adopts all necessary measures so that the information it uses in assigning a credit rating is of sufficient quality and from sources MOODY'S considers to be reliable including, when appropriate, independent third-party sources. However, MOODY'S is not an auditor and cannot in every instance independently verify or validate information received in the rating process or in preparing the Moody's publications.

To the extent permitted by law, MOODY'S and its directors, officers, employees, agents, representatives, licensors and suppliers disclaim liability to any person or entity for any indirect, special, consequential, or incidental losses or damages whatsoever arising from or in connection with the information contained herein or the use of or inability to use any such information, even if MOODY'S or any of its directors, officers, employees, agents, representatives, licensors or suppliers is advised in advance of the possibility of such losses or damages, including but not limited to: (a) any loss of present or prospective profits or (b) any loss or damage arising where the relevant financial instrument is not the subject of a particular credit rating assigned by MOODY'S.

To the extent permitted by law, MOODY'S and its directors, officers, employees, agents, representatives, licensors and suppliers disclaim liability for any direct or compensatory losses or damages caused to any person or entity, including but not limited to by any negligence (but excluding fraud, willful misconduct or any other type of liability that, for the avoidance of doubt, by law cannot be excluded) on the part of, or any contingency within or beyond the control of, MOODY'S or any of its directors, officers, employees, agents, representatives, licensors or suppliers, arising from or in connection with the information contained herein or the use of or inability to use any such information.

NO WARRANTY, EXPRESS OR IMPLIED, AS TO THE ACCURACY, TIMELINESS, COMPLETENESS, MERCHANTABILITY OR FITNESS FOR ANY PARTICULAR PURPOSE OF ANY SUCH RATING OR OTHER OPINION OR INFORMATION IS GIVEN OR MADE BY MOODY'S IN ANY FORM OR MANNER WHATSOEVER.

Moody's Investors Service, Inc., a wholly-owned credit rating agency subsidiary of Moody's Corporation ("MCO"), hereby discloses that most issuers of debt securities (including corporate and municipal bonds, debentures, notes and commercial paper) and preferred stock rated by Moody's Investors Service, Inc. have, prior to assignment of any rating, agreed to pay to Moody's Investors Service, Inc. for appraisal and rating services rendered by it fees ranging from \$1,500 to approximately \$2,500,000. MCO and MIS also maintain policies and procedures to address the independence of MIS's ratings and rating processes. Information regarding certain affiliations that may exist between directors of MCO and rated entities, and between entities who hold ratings from MIS and have also publicly reported to the SEC an ownership interest in MCO of more than 5%, is posted annually at www.moody's.com under the heading "Investor Relations — Corporate Governance — Director and Shareholder Affiliation Policy."

Additional terms for Australia only: Any publication into Australia of this document is pursuant to the Australian Financial Services License of MOODY'S affiliate, Moody's Investors Service Pty Limited ABN 61 003 399 657 AFSL 336969 and/or Moody's Analytics Australia Pty Ltd ABN 94 105 136 972 AFSL 383569 (as applicable). This document is intended to be provided only to "wholesale clients" within the meaning of section 761G of the Corporations Act 2001. By continuing to access this document from within Australia, you represent to MOODY'S that you are, or are accessing the document as a representative of, a "wholesale client" and that neither you nor the entity you represent will directly or indirectly disseminate this document or its contents to "retail clients" within the meaning of section 761G of the Corporations Act 2001. MOODY'S credit rating is an opinion as to the creditworthiness of a debt obligation of the issuer, not on the equity securities of the issuer or any form of security that is available to retail investors. It would be reckless and inappropriate for retail investors to use MOODY'S credit ratings or publications when making an investment decision. If in doubt you should contact your financial or other professional adviser.

Additional terms for Japan only: Moody's Japan K.K. ("MJJK") is a wholly-owned credit rating agency subsidiary of Moody's Group Japan G.K., which is wholly-owned by Moody's Overseas Holdings Inc., a wholly-owned subsidiary of MCO. Moody's SF Japan K.K. ("MSFJ") is a wholly-owned credit rating agency subsidiary of MJJK. MSFJ is not a Nationally Recognized Statistical Rating Organization ("NRSRO"). Therefore, credit ratings assigned by MSFJ are Non-NRSRO Credit Ratings. Non-NRSRO Credit Ratings are assigned by an entity that is not a NRSRO and, consequently, the rated obligation will not qualify for certain types of treatment under U.S. laws. MJJK and MSFJ are credit rating agencies registered with the Japan Financial Services Agency and their registration numbers are FSA Commissioner (Ratings) No. 2 and 3 respectively.

MJJK or MSFJ (as applicable) hereby disclose that most issuers of debt securities (including corporate and municipal bonds, debentures, notes and commercial paper) and preferred stock rated by MJJK or MSFJ (as applicable) have, prior to assignment of any rating, agreed to pay to MJJK or MSFJ (as applicable) for appraisal and rating services rendered by it fees ranging from JPY200,000 to approximately JPY350,000,000.

MJJK and MSFJ also maintain policies and procedures to address Japanese regulatory requirements.

REPORT NUMBER 1095188

Contacts

Nondas Nicolaidis +357.2569.3006
 VP-Sr Credit Officer
 nondas.nicolaides@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

Effie Tsotsani +44.20.7772.1712
 Analyst
 effie.tsotsani@moodys.com

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

CLIENT SERVICES

Americas 1-212-553-1653

Asia Pacific 852-3551-3077

Japan 81-3-5408-4100

EMEA 44-20-7772-5454