

Credit Opinion: Sparebanken More

Global Credit Research - 19 May 2015

Norway

Ratings

Category	Moody's Rating
Outlook	Stable
Bank Deposits	A2/P-1
Baseline Credit Assessment	baa1
Adjusted Baseline Credit Assessment	baa1

Contacts

Analyst	Phone
Efthymia Tsotsani/London	44.20.7772.5454
Kim Bergoe/London	
Sean Marion/London	

Key Indicators

Sparebanken More (Consolidated Financials)[1]

	[2]12-14	[2]12-13	[2]12-12	[2]12-11	[2]12-10	Avg.
Total Assets (NOK billion)	56.3	54.6	51.6	48.5	44.4	[3]6.1
Total Assets (EUR million)	6,206.2	6,534.5	7,037.0	6,256.1	5,699.2	[3]2.2
Total Assets (USD million)	7,509.8	9,004.2	9,277.6	8,121.4	7,645.8	[3]-0.4
Tangible Common Equity (NOK billion)	4.8	4.4	3.7	3.2	3.0	[3]12.1
Tangible Common Equity (EUR million)	526.8	529.1	503.8	411.9	388.6	[3]7.9
Tangible Common Equity (USD million)	637.4	729.0	664.2	534.7	521.4	[3]5.2
Problem Loans / Gross Loans (%)	0.8	1.1	1.3	1.9	2.4	[4]1.5
Tangible Common Equity / Risk Weighted Assets (%)	13.3	13.2	11.5	10.4	10.6	[5]11.8
Problem Loans / (Tangible Common Equity + Loan Loss Reserve) (%)	7.7	11.3	14.5	21.9	26.7	[4]16.4
Net Interest Margin (%)	2.0	2.0	1.9	2.0	2.0	[4]2.0
PPI / Average RWA (%)	2.2	2.0	2.6	1.9	2.3	[5]2.2
Net Income / Tangible Assets (%)	1.0	0.8	1.1	0.8	1.0	[4]0.9
Cost / Income Ratio (%)	43.1	45.9	35.0	48.4	44.1	[4]43.3
Market Funds / Tangible Banking Assets (%)	37.6	36.7	36.0	36.8	33.5	[4]36.1
Liquid Banking Assets / Tangible Banking Assets (%)	10.9	13.4	13.0	14.0	12.4	[4]12.7
Gross Loans / Total Deposits (%)	170.0	159.5	147.8	135.4	129.0	[4]148.3

Source: Moody's

[1] All figures and ratios are adjusted using Moody's standard adjustments [2] Basel II; IFRS [3] Compound Annual Growth Rate based on IFRS reporting periods [4] IFRS reporting periods have been used for average calculation [5] Basel II & IFRS reporting periods have been used for average calculation

Opinion

SUMMARY RATING RATIONALE

On 11 May we upgraded Sparebanken More's baseline credit assessment to baa1 from baa2 the long term

deposit rating to A2 from A3 and the short term obligation rating to Prime-1 from Prime-2 following the upgrade of the adjusted BCA.

The strengthening of Sparebanken More's BCA to baa1 from baa2 is driven by the ongoing improvement in the bank's asset quality results and resilience in the face of the expected slowdown in the operating environment. In addition we expect that the bank's strong capital metrics are likely to improve further, given management's willingness to increase capital buffers through greater earnings retention. The upgrade of the bank's deposit rating to A2 from A3 takes into account both the higher BCA as well as the LGF analysis of the bank's own volume of deposits and debt, and the volume of securities subordination to them, which offsets the decrease in government support assumptions.

SPAREBANKEN MORE'S BCA IS SUPPORTED BY ITS VERY STRONG- MACRO PROFILE

As a purely domestic bank, Sparebanken More's operating environment and hence the bank's Macro Profile is aligned with that of Norway at Very Strong-. Norwegian banks benefit from operating in an affluent and developed country with very high economic, institutional and government financial strength as well as low susceptibility to event risk. The main risks to the system stem from high level of household indebtedness and domestic banks' reliance on market funding. However, these risks are offset by the strength of households' ability to service debt, banks' adequate capitalisation and the relatively small size of the banking system compared to GDP.

Rating Drivers

- Strong capital metrics
- Asset quality is strong albeit exposed to cyclical industries and credit concentration
- Limited upside on profit margins and uncertainties regarding provisioning levels
- Substantial deposit base and improving quality of market funding sources
- Large volume of deposits and junior debt resulting in deposit ratings benefiting from a very low loss-given-failure rate and a two-notch uplift from the BCA.

Rating Outlook

The stable outlooks on the bank's long-term senior debt and deposit ratings reflect our view that the bank's financial will remain broadly resilient in the face of a modest slowdown in Norway's still strong economic performance.

What Could Change the Rating - Up

Upward rating momentum could develop if Sparebanken More demonstrates (1) continued good asset quality in its retail and corporate books, including in the more volatile segments, (2) continued good access to capital markets and improved liquidity, and/or (3) stronger earnings generation without an increase in its risk profile.

What Could Change the Rating - Down

Future downward rating pressure would emerge if (1) Sparebanken More's asset quality deteriorates more than anticipated from current levels, (2) financing conditions become more difficult and/or (3) its risk profile increases, for example as a result of increased exposures to more volatile sectors and/or (4) macroeconomic environment deteriorates more than estimated, leading to adverse developments in the Norwegian real-estate market.

DETAILED RATING CONSIDERATIONS

STRONG CAPITAL METRICS

In line with many Norwegian savings banks, Sparebanken More has improved its capital ratios which remain positioned in accordance with the increasing regulatory capital requirements (11% Core Equity Tier1 ratio as of July 2015).

Sparebanken More had a Tangible Common Equity (TCE)-to-risk weighted assets (RWA) ratio of 14.6% at March 2015 (including 50% of earnings), and we expect this metric to improve over the medium term, as the bank's Board of Trustees signalled approval for 57% of the year's profit to be retained in order to further enhance the bank's capital base. We view positively any such measures that lead to capital increases, as they enhance the

bank's buffer against potential losses. Sparebanken More's assigned capital score reflects this strength, as does the bank's TCE-to-tangible banking assets ratio of 9.4% which is well within international standards.

ASSET QUALITY IS STRONG ALBEIT EXPOSED TO CYCLICAL INDUSTRIES AND CREDIT CONCENTRATION

The bank's reported problem ratio (impaired loans as a percentage of total loans) declined to below 0.8% at end-March 2015, from 1.15% at end-December 2013, continuing the steady downward trend from its peak at 3.1% at year-end 2007. The ratio reported for 2014 is below most other Moody's-rated Norwegian savings banks, although it had historically been somewhat higher.

Sparebanken More's asset risk score indicates that overall, asset risk remains a relative strength for the bank, although the bank remains substantially exposed to sectors that we view as more volatile: the real estate sector (property management and construction, accounting for almost 13% of total loans at December 2014), fishing-related industries (primarily fishing vessels and exposures backed by fishing quotas, around 7%), and shipping (around 3%). Exposures to these sectors have accounted for a substantial portion of Sparebanken More's problem loans in recent years, and we note the risk of that declining oil and gas prices and falling investment levels could trigger a mild asset quality deterioration from the currently strong current position.

Sparebanken More's loan portfolio is well diversified, with retail customers accounting for over 65% of the bank's lending, mainly in the form of mortgages. At December 2014, almost 50% of these retail loans were part of the bank's wholly-owned covered bond company More Boligkreditt; and the cover pool is available to unsecured creditors in the event of liquidation. In addition, given that Sparebanken More operates in only one region, it exhibits significant single-borrower concentration - and whilst this is a common feature at Nordic banks, it could accelerate the extent and pace of any deterioration in asset quality.

LIMITED UPSIDE ON PROFIT MARGINS, AND UNCERTAINTIES REGARDING PROVISIONING LEVELS

Net interest income is Sparebanken More's main source of revenue, which has represented around 80% of its operating income in recent years. This source of earnings grew by 5% in 2014 compared to 11% in 2013, as the generally lower level of interest rates combined with strong competition for both loans and deposits towards H2 2014 has affected the development of net interest income.

Sparebanken More's efficiency also supports its profitability; its cost-to-income was just above 40% as at year-end 2014 as per Moody's calculations. This meets the management's target ratio of below 50%, and ranks favourably among Moody's-rated regional savings banks in Norway. In 2014, loan loss provisions were low at NOK22 million (NOK54 million in 2013) but we note that the bank's relatively high exposure to more volatile segments such as construction real estate and shipping heightens uncertainty over the sustainability of these low levels.

The net income-to-tangible banking assets ratio has averaged 1% over the last three years, in line with most regional savings banks, but given uncertainty over the level of provisions and additional margin pressure, we expect this metric to be somewhat lower over the next 12 months which is reflected in our profitability score.

Sparebanken More reported total income of NOK1.408 billion for 2014, NOK164 million higher compared to 2013. This increase is mainly attributable to the sale of shares in Nets AS (a payment provider service) and slightly improved margin.

SUBSTANTIAL DEPOSIT BASE AND IMPROVING QUALITY OF MARKET FUNDING SOURCES

Sparebanken More's funding position is underpinned by a strong deposit base, which accounts for just under 60% of its total funding, of which 60% are retail deposits. Market funding accounted for just over 37% of the bank's tangible banking assets at end-December 2014, and has been stable recent years. Our funding structure score indicates that the overall funding profile remains a modest fundamental weakness for Sparebanken More because of the inherent confidence sensitivity of this funding source.

At December 2014, almost 65% of market funds were in the form of covered bonds issued through More Boligkreditt. Whilst we view positively the diversification benefit and the typically longer maturity of these funding instruments, we note the risk that extensive use of covered bond funding could result in the structural subordination of Sparebanken More's unsecured creditors, including depositors. Nevertheless we view positively recent issuances of bigger size instruments because of their eligibility under liquidity coverage ratio (LCR) rules.

At end-December 2014, liquid assets accounted for around 11% of tangible banking assets, including cash and

deposits with the central bank and the securities portfolio, which mainly comprise domestic and European covered bonds, government and supranational bonds, with minor holdings of senior and corporate bonds as well as minor shareholdings. Bond holdings in the liquidity portfolio are generally equally divided by foreign (European) and domestic issuers. Euro-denominated issues are hedged into Norwegian krone, and fixed-rate bonds are swapped into floating interest rates (mainly three months floating).

Notching Considerations

LOSS GIVEN FAILURE AND ADDITIONAL NOTCHING

We expect that Norway will introduce legislation to implement the EU Bank Resolution and Recovery Directive (BRRD). In our LGF analysis 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 metrics are in line with our standard assumptions.

For Sparebanken More's short-term and long-term deposit ratings, our ratings have considered the likely impact on loss-given-failure of the combination of their own volume and the amount of debt subordinated to them. This results in Preliminary Rating Assessment (PRA) of two notches above the BCA, reflecting very low loss-given-failure.

GOVERNMENT SUPPORT

The expected implementation of resolution legislation has caused us to reconsider the potential for government support to benefit certain creditors.

Sparebanken More is a regional savings bank with a robust market position in western Norway in the county of More and Romsdal where we estimate it commands market shares of 18% for lending and just over 32% for deposits. However, its national market share is limited at just above 1% of loans and 1.5% on deposits. Therefore we now expect a low probability of government support for deposits, resulting in zero notches of uplift..

COUNTERPARTY RISK ASSESSMENT

We also assign a long-term and short-term CR assessment of A1 (cr) and P-1 (cr) respectively.

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.

Foreign Currency Deposit Rating

Foreign-currency deposit ratings are unconstrained given that Norway has a country ceiling of Aaa. Sparebanken More's foreign currency deposit rating is A2.

Foreign Currency Debt Rating

Foreign-currency senior unsecured debt ratings are unconstrained given that Norway has a country ceiling of Aaa. Sparebanken More's foreign currency senior unsecured debt rating is A2

About Moody's Bank Scorecard

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Rating Factors

SparebankenMore

Macro Factors	
Weighted Macro Profile	Very Strong -

Financial Profile						
Factor	Historic Ratio	Macro Adjusted Score	Credit Trend	Assigned Score	Key driver #1	Key driver #2
Solvency						
Asset Risk						
<i>Problem Loans / Gross Loans</i>	1.1%	aa2	← →	a3	Geographical concentration	Sector concentration
Capital						
<i>TCE / RWA</i>	13.3%	a2	← →	a2	Risk-weighted capitalisation	
Profitability						
<i>Net Income / Tangible Assets</i>	0.9%	baa1	← →	baa1	Expected trend	
Combined Solvency Score		a1		a3		
Liquidity						
Funding Structure						
<i>Market Funds / Tangible Banking Assets</i>	37.6%	ba2	← →	ba1	Extent of market funding reliance	Market funding quality
Liquid Resources						
<i>Liquid Banking Assets / Tangible Banking Assets</i>	10.9%	baa3	← →	baa3	Stock of liquid assets	
Combined Liquidity Score		ba1		ba1		

Financial Profile	baa1
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Qualitative Adjustments	Adjustment
Business Diversification	0
Opacity and Complexity	0
Corporate Behavior	0
Total Qualitative Adjustments	0

Sovereign or Affiliate constraint	Aaa
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Scorecard Calculated BCA range	a3 - baa2
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Assigned BCA	baa1
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Affiliate Support notching	0
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Adjusted BCA

baa1

Instrument Class	Loss Given Failure notching	Additional notching	Preliminary Rating Assessment	Government Support notching	Local Currency rating	Foreign Currency rating
Deposits	2	0	a2	0	A2	A2

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