

# The Major Sparebanken of the SpareBank 1 Alliance

## Special Report

### Ratings

#### SpareBank 1 SR-Bank

##### Foreign Currency

Long-Term IDR	A-
Short-Term IDR	F2

##### Viability Rating

Viability Rating	a-
Support Rating	3
Support Rating Floor	BB+

#### SpareBank 1 SMN

##### Foreign Currency

Long-Term IDR	A-
Short-Term IDR	F2

##### Viability Rating

Viability Rating	a-
Support Rating	3
Support Rating Floor	BB+

#### SpareBank 1 Nord-Norge

##### Foreign Currency

Long-Term IDR	A
Short-Term IDR	F1

##### Viability Rating

Viability Rating	a
Support Rating	3
Support Rating Floor	BB+

#### SpareBank 1 Boligkreditt AS

##### Foreign Currency

Long-Term IDR	A-
Short-Term IDR	F2

##### Support Rating

Support Rating	1
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#### Sovereign Risk

Long-Term Foreign-Currency IDR	AAA
Long-Term Local-Currency IDR	AAA
Country Ceiling	AAA

### Outlooks

SpareBank 1 SR-Bank	Stable
Long-Term Foreign-Currency IDR	
SpareBank 1 SMN	Stable
Long-Term Foreign-Currency IDR	
SpareBank 1 Nord-Norge	Stable
Long-Term Foreign-Currency IDR	
SpareBank 1 Boligkreditt	Stable
Long-Term Foreign-Currency IDR	
Sovereign Long-Term	Stable
Foreign-Currency IDR	
Sovereign Long-Term	Stable
Local-Currency IDR	

### Related Research

- [SpareBank 1 SR-Bank \(December 2016\)](#)
- [SpareBank 1 SMN \(December 2016\)](#)
- [SpareBank 1 Nord-Norge \(December 2016\)](#)
- [SpareBank 1 Boligkreditt AS \(December 2016\)](#)
- [Fitch: Norway Mortgage Rules to Slow, Not Reverse, House Prices \(January 2017\)](#)

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### Key Rating Drivers

**Strong Franchises, Regional Concentrations:** The ratings for SpareBank 1 SR-Bank (SR), SpareBank 1 SMN (SMN) and SpareBank 1 Nord-Norge's (SNN), collectively the Sparebanken, reflect their strong regional franchises, healthy profitability, resilient asset quality and sound capital ratios. The ratings also factor in risks arising from low oil prices and significant rises in property prices in recent years, geographically concentrated lending and liquidity management in the context of the banks' wholesale funding reliance.

SNN's ratings are one notch higher than its Sparebanken peers', reflecting stronger capital ratios and a more retail-oriented business model.

**Benefits from Alliance Membership:** The Sparebanken are the three largest savings banks rated by Fitch Ratings in Norway's SpareBank 1 Alliance (the Alliance). They benefit from cost efficiencies and income diversification via the jointly owned SpareBank 1 Gruppen AS, whose services include life and non-life insurance and fund management products. SpareBank 1 Boligkreditt AS's (S1B) ratings are aligned with those of the largest Alliance members, SR and SMN, and reflect its role as the Alliance members' primary covered bond funding vehicle.

**Healthy Profitability:** The banks' pre-impairment profitability is strong, and their regional franchises support stable revenue generation and solid internal capital generation. Cost efficiency is acceptable. We expect higher loan impairment charges (LICs) for SR and SMN in 2016 and 2017, mainly from offshore service vessel (OSV) lending, but these should remain easily absorbable for both banks. Mortgage lending margins came under pressure in 9M16 due to competition, but we expect a slight rebound in 2017 in most parts of the country.

**Resilient Asset Quality:** We expect impaired loans to remain low, supported by prudent underwriting, low-risk business models focusing on retail and SME customers, and a stable operating environment. Oil-related asset-quality problems for SMN and SR should be constrained to their OSV portfolios, where both banks restructured a material amount of exposures in 2016. SNN's asset quality is supported by a large retail loan book.

**Wholesale Funding Reliance:** The Sparebanken rely on wholesale funding to varying degrees and have maintained access to domestic and international funding markets, in particular for covered bonds issued through S1B. Fitch expects the banks to maintain strong liquidity buffers to mitigate refinancing risks. Since 2015, SR has also operated a fully owned covered bond issuance company.

**Robust Capitalisation:** The Sparebanken's risk-weighted capital ratios compare well with those of international peers. Leverage is low in a European context. SNN's risk-weighted capitalisation and its leverage are stronger than its Sparebanken peers'.

### Rating Sensitivities

**Asset-Quality Deterioration:** The Sparebanken's ratings are mainly sensitive to deteriorating asset quality, particularly if prolonged low oil prices lead to higher unemployment, a deterioration in commercial real estate (CRE) exposure or a significant property price correction, if the banks are unable to absorb higher credit losses via earnings.

**Upgrades Unlikely:** Upgrades to the banks' ratings are unlikely given the already high ratings in the context of their company profiles, size and geographical concentrations and lending. Any unmitigated weakening of access to capital markets would also be negative for the ratings.

Summary Rating Navigators for the Sparebanken

Sparebanken	Operating environment	Company profile	Management & strategy	Risk appetite	Asset quality	Earning & profitability	Capitalisation & leverage	Funding & liquidity	Viability Rating
SpareBank 1 Nord-Norge	aa	a-	a-	a	a	a	a	a-	a
SpareBank 1 SMN	aa	a-	a-	a	a	a	a-	a-	a-
SpareBank 1 SR-Bank	aa	a-	a-	a	a-	a	a-	a-	a-

Source: Fitch (Bar colours = Influence on final VR; Red = Higher Influence, Dark blue = Moderate Influence, Light blue = Lower Influence)

Operating Environment

Strong 'AAA'-Rated Norwegian Sovereign; Low Oil Prices Affect Growth

As regional banks, the Sparebanken's performance is closely linked to that of the Norwegian economy. Norway has maintained its 'AAA' rating for 20 years and Fitch expects the Norwegian banking sector to continue to benefit from the country's favourable economic environment. Continued low oil prices and lower investment and demand from the oil sector have led Fitch to lower its forecast for GDP growth for mainland Norway (excluding oil and gas extraction and shipping) from 1.0% to 0.8% for 2016 as a whole, with a gradual acceleration in 2017 and 2018. Fitch expects unemployment to peak at its current level, which is low by international standards, although it has been increasing in the oil-producing regions in the south and west of the country.

The lower oil prices since 2014, and subsequent lower investment in the oil sector, is translating into slower growth in the broader Norwegian economy. The high share of industries supplying goods and services to the oil sector means that the impact is spilling over to the rest of the economy, with weakening demand in non-oil sectors. This is mitigated by exchange-rate depreciation (as the weaker krone improves competitiveness and boosts non-oil exports) and a monetary policy response by the authorities (the key policy rate was been cut to 0.50% from 0.75% in 2016).

Their regional footprint means the prospects of the Sparebanken are also closely linked to the economic development of the regions in which they are active. Fitch believes central Norway, where SMN operates, has a reasonably diversified economy and the impact from low oil prices should be limited here. Northern Norway's economy, where SNN operates, is supported by a large and stable public sector, and the economy in this region is growing faster than the Norwegian average.

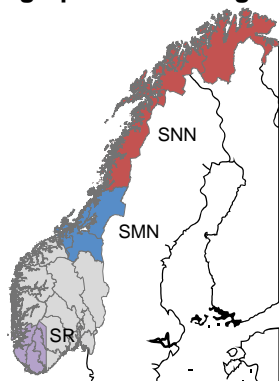
Falling oil investments in and around Rogaland, the centre of Norway's oil industry and SR's main operating market, have put more substantial pressure on local economic activity, but the local unemployment rate is still low by international standards. Fitch expects the local operating environment to remain subdued but stable, partly aided by public-sector infrastructure investments. Housing investments in the region have been stable, while regional property prices have fallen after several years of rapid increases.

Strong Regulator

The Norwegian regulatory environment is highly developed and transparent, in Fitch's view. The authorities have taken a strict view on risk-weight optimisation and have, for example, introduced floors in calculating risk-weights for mortgage loans (effectively 20%-25%). They have also introduced an 85% cap on loan/value (LTV) ratios for residential mortgage loans, a mandatory 5% interest-rate stress when assessing borrowers' debt-servicing ability, and amortisation on mortgage loans above an LTV of 70%.

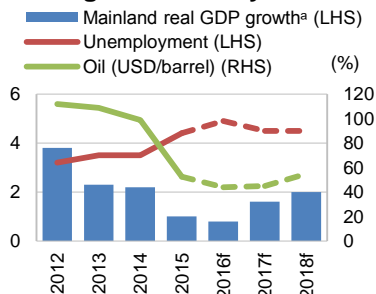
Newly adopted regulation by the Ministry of Finance call for some further tightening of residential mortgage lending practices in response to household debt and property prices rising faster than household incomes in recent years, in particular in the Oslo area (see "Property Prices" chart on Page 5). Fitch expects this to contribute to a slowdown in the growth of property prices in 2017.

Geographical Coverage



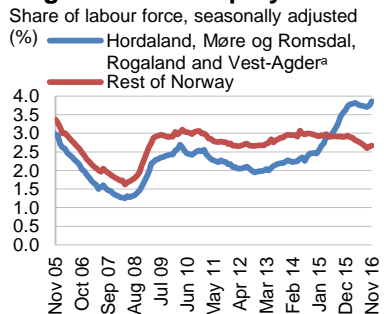
Source: Fitch

Norwegian Economy



<sup>a</sup> Excluding oil and gas extraction and shipping  
Source: Fitch

Registered Unemployment



<sup>a</sup> Oil-dependent regions in the south and west of the country  
Source: Norwegian Labour and Welfare Administration, Norges Bank

Related Criteria

Global Bank Rating Criteria (November 2016)

### Changes in Mortgage Regulation<sup>c</sup>

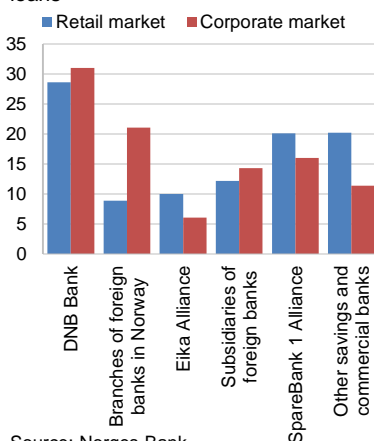
**Mortgage lending: Regulatory requirements**

	Previous	1 Jan 17 <sup>b</sup>
Max LTV (%)	85	85
Max LTV for home credit equity (%)	70	60
Max debt/income	N	Y: 5x
Amortisation: 2.5% a year	Over 70%	Over 60%
Speed limit <sup>a</sup> (%)	10	10

<sup>a</sup> The % of annual new mortgage loans that can be exempt from the above regulation  
<sup>b</sup> Valid until 30 June 2018  
<sup>c</sup> Specific requirements now apply to the Oslo region, includes an 8% speed limit and 60% LTV cap on secondary homes  
 Source: Norwegian FSA

### Lending Market Shares

End-June 2016; % of total loans



Source: Norges Bank

## Company Profile

### Independent Regional Savings Banks in Nationwide Alliance

In 1996, SNN, SMN, SR and Sparebanken Vest founded the Alliance along with Samspar, a group of smaller savings banks. Sparebanken Vest withdrew from the venture in January 2004 to pursue an independent strategy. At end-2015, the Alliance members had about 350 branches across Norway. Lending across all banks of the Alliance totalled over NOK700bn at end-June 2016, making the alliance the second-largest banking group in Norway, behind DNB ASA.

The Sparebanken operate as universal banks for retail and SME customers in their regions, where they hold leading market shares (at least 30%) in deposits and loans. Their business models, although regionally concentrated, have proved stable due to the focus on traditional retail banking and relatively simple organisational structures. The Alliance has a market share of about 20% nationally in retail lending and about 16% among SMEs. The SpareBank 1 brand has been established as one of Norway's most recognised financial brands.

### Benefits from Alliance Subsidiaries

The Alliance banks benefit from co-operation agreements between the members in areas such as marketing and IT. They own S1B, their funding vehicle for covered bonds. They also own a sister company to S1B, SpareBank 1 Naeringskreditt AS (S1N), a covered bond funding vehicle primarily backed by commercial property. The Alliance banks also jointly own the holding company SpareBank 1 Gruppen, which provides insurance and fund management services through its subsidiaries. In addition, SpareBank 1 Gruppen is also responsible for some product development, which creates scale benefits for its members. Capital markets services are provided by SpareBank 1 Markets, which is owned directly by the Alliance banks (except SR), and not via SpareBank 1 Gruppen.

## Management and Strategy

The Sparebanken's management teams have deep local knowledge and there are strong corporate cultures within the banks. Senior management turnover has been low. The strategic direction in the Alliance has been consistent since its creation, benefiting all its members.

SR converted into a limited liability savings bank in 2011 to make it easier to access capital and funding. Fitch understands that SMN and SNN have no plans to follow SR's conversion. SMN and SNN have a distinctive ownership status, whereby the control of the banks resides with local community stakeholders. External investors own equity capital certificates in the banks, entitling them to a proportionate share of the banks' profit, but as a per the Norwegian savings banks law, holders of equity capital certificates will never have a majority vote.

Representatives of the owners, together with public appointees, employees and customer representatives, sit on the supervisory board, whose nomination committee appoints the board of directors. Corporate governance principles are in line with the Norwegian code on corporate governance.

## Risk Appetite

### Risk Management Systems Benefit from Cooperation

Risk systems and expertise are shared across the Alliance and the largest members use the internal ratings-based (IRB) approach to calculate capital requirements for credit risk. During 2015 the banks moved to the advanced IRB approach for corporate exposures.

Underwriting standards for mortgage lending are conservative and focus on debt servicing capacity. SME and corporate lending involves greater risks, although Fitch believes this is also done in a prudent manner with good knowledge of their customers. The banks have been increasingly focusing on retail and SME customers and are reducing concentration risk related to larger clients.

**Note on Charts**

Black dashed lines in the *Asset Quality* chart and further in the report represent indicative quantitative ranges and corresponding implied scores for Fitch's core financial metrics for banks operating in the environments that Fitch scores in the 'aa' category.

The peers include: Sparebanken Vest, Sandnes Sparebank (VR: bbb), Coventry Building Society (a), Leeds Building Society (a-), Principality Building Society (bbb+), Credit du Nord (CdN) (bbb+).

Lending growth for SNN and SMN was fairly high in 9M16 at an annualised 6.7% and 6.6% (including S1B and S1N). Fitch understands that this was partly driven by gaining market shares from some of the country's larger banks that have reduced their presence in smaller communities to optimise their branch networks. However, total lending growth at SR was close to zero (0.1%) in the 12 months to end-September 2016 and we expect the bank to remain cautious in the muted local economic environment. We expect loan growth for SNN and SMN to slow in 2017 to a level more in line with GDP growth.

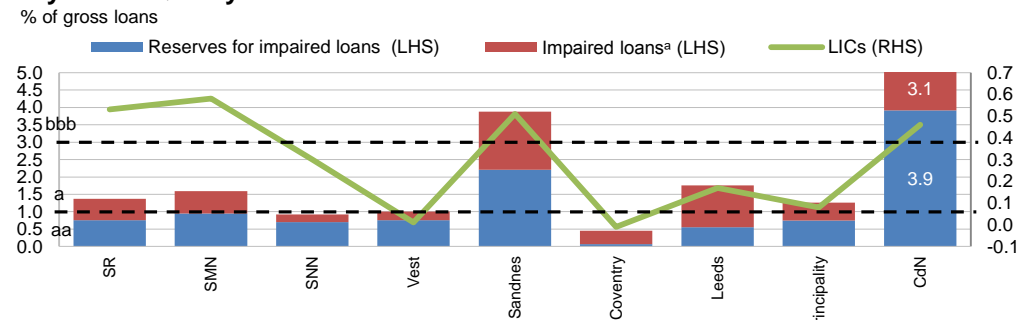
**Moderate Exposure to Market Risk**

Market risk arises from the financial instruments held by the banks, as well as indirectly through the jointly owned holding company SpareBank 1 Gruppen, in particular in its insurance investment portfolio. Interest-rate risk is mitigated by the banks' ability to change rates on most mortgage loans after a six-week notice period (Fitch understands that interest rates on corporate loans can be adjusted even faster), and is managed using gap and duration analysis. The banks' sensitivity (and set limits) to a 100bp parallel shift in interest rates is small.

**Financial Profile**

Sound Asset Quality; Property and Oil Prices Are Main Sensitivities

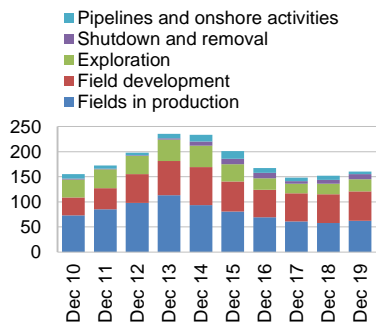
**Key Asset-Quality Metrics**



End-September 2016 for all banks except end-2015 for Coventry, Leeds, Principality and CdN  
<sup>a</sup> Core metric for asset quality  
 Source: Banks, Fitch

**Petroleum Investment**

Constant 2016 prices in NOKbn



Source: Statistics Norway and Norges Bank

The Sparebanken's asset quality is strong and compares well with peers'. Impaired loans represented a low 90bp-160bp of gross loans at end-September 2016, and LICs less than 60bp of average gross loans in 9M16. Fitch expects the quality of lending to remain resilient, supported by a relatively stable operating environment and conservative underwriting standards, and we believe the banks' loan portfolios can withstand a moderate property price correction. The sharp fall in oil prices and the consequent slowdown of economic growth in the country are translating into some asset quality pressure in certain portfolios, particularly in lending to the OSV segment, but we do not expect more widespread asset-quality weakening, although individual companies may well face difficulties.

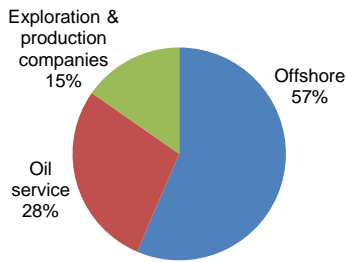
**Large Residential Mortgage Lending**

About 65% of the loan books consist of residential mortgage lending, including loans transferred to S1B (about 75% for SNN). The vast majority of mortgage loans have an LTV ratio of less than 70%, in line with S1B's criteria for loan transfers. Various tax incentives to borrow (interest tax deductibility and limited or no capital gains tax on main residence) have increased households' indebtedness to more than 210% of disposable income at end-2015. Combined with strong wage growth and low interest rates, this has fuelled increases in property prices. The pace of property price increases nationally is unsustainable, in Fitch's opinion, and we expect a slowdown to about 6% in 2017, about half the rate of 2016.

Fitch expects households' ability to service their debt to remain strong, but high debt levels have made them more sensitive to interest-rate increases, which would be likely to manifest itself in lower consumption in a stress scenario. The quality of mortgage lending should be able to sustain

a moderate fall in property prices before impaired mortgage loans markedly increase. However, lower consumption could affect Norwegian businesses and the Sparebanken's SME lending.

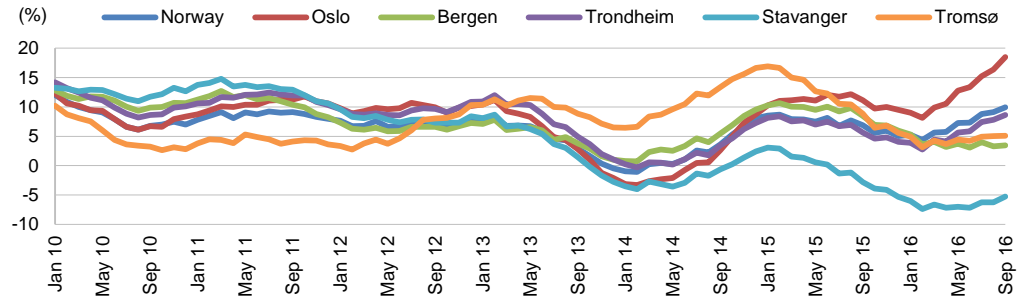
**SR's Oil-Related Exposure**  
End-June 2016; NOK 17.0bn (EAD)



Source: SR, Adjusted by Fitch

**Property Prices**

12-month change. January 2010-September 2016

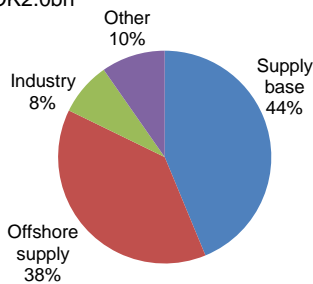


Note: SMN is based in the city of Trondheim, SNN in the city of Tromsø and SR in the city of Stavanger  
Source: Norges Bank: Real Estate Norway, Finn.no and Eiendomsverdi

*Material Oil and Gas Exposures, but Well Managed*

The petroleum industry has inevitably been affected by the fall in oil prices, which has created ripple effects for local suppliers and service companies. The Sparebanken's exposures to oil- and gas-related activities vary significantly as a result of their geographical focus and Fitch believes these remain manageable. The banks have good knowledge of their customers and appear to work proactively with them to identify potential problems at an early stage. Nonetheless, these exposures will remain under scrutiny in 2017.

**SNN's Oil-Related Exposure**  
End-September 2016; NOK2.0bn



Source: SNN, adjusted by Fitch

SR has the most substantial oil and gas exposure, at 8.5% of total exposure at default (EAD) at end-June 2016. The corresponding figure for SMN and SNN was 4.2% (almost exclusively OSV lending) and 2.1%, respectively at end-September 2016. We understand that OSV companies are particularly under pressure due to a combination of high fixed costs and reduced demand for vessels, and we expect higher LICs in this segment in 4Q16 and 2017 for SR and SMN as more vessels' contracts come up for renewal. SR and SMN have restructured a material part of their OSV portfolios in recent years and for SR total restructured exposures was NOK5.7bn (3.6% of gross loans) at end-September 2016.

We expect LICs to be largely contained to the OSV segment, but the risk is heightened in the entire oil and gas portfolios. SR, in particular, would be sensitive to more widespread contagion effects from lower oil activity given that its lending is concentrated in south-west Norway, where the oil industry is concentrated. Fitch understands that the Sparebanken's overall exposure to the early stages of the value chain – for example, oil exploration (ie seismic, field development and start-up drilling) – which will most likely be the first hit by a decline in the oil industry, is limited but not immaterial.

*SME Lending of Good Quality, Concentration Reducing*

The Sparebanken's corporate lending is predominately to local SME customers. The regional nature of their franchises means there is some single-name concentration in their loan books, although they have focused on reducing borrower concentrations in recent years. Corporate lending represents about 35% of SMN and SR's total lending and about 25% for SNN.

CRE lending accounted for 12% of SNN, 14% of SMN and 17% of SR's total loan portfolios at end-September 2016. The quality of these portfolios benefits from still relatively modest vacancy rates and, when disclosed, the share of impaired loans in these portfolios is roughly the same as for the banks' other corporate loans. An economic slowdown could harm the quality of these exposures through weakening cash flows and falling collateral values. The combination of high real-estate prices, increasing vacancy rates and declining rental prices in areas exposed to the petroleum industry is a risk for the banks. In particular, Fitch views SR's direct exposure to the letting of real estate related to oil operations (12% of the CRE portfolio's

EAD at end-2015) as a vulnerability.

Exposures to commercial property mostly relate to buy-to-let investments and are typically in long-term contracts with high-quality tenants. A modest proportion is to development projects, and then largely to residential housing projects with a high degree of pre-sales. Exposure to other cyclical industries, such as fish farming, is moderate at 5%-10% of gross loans/EAD for the three banks.

**Earnings and Profitability**

*Stable Performance; Margin Focus from Increasing Regulatory Requirements*

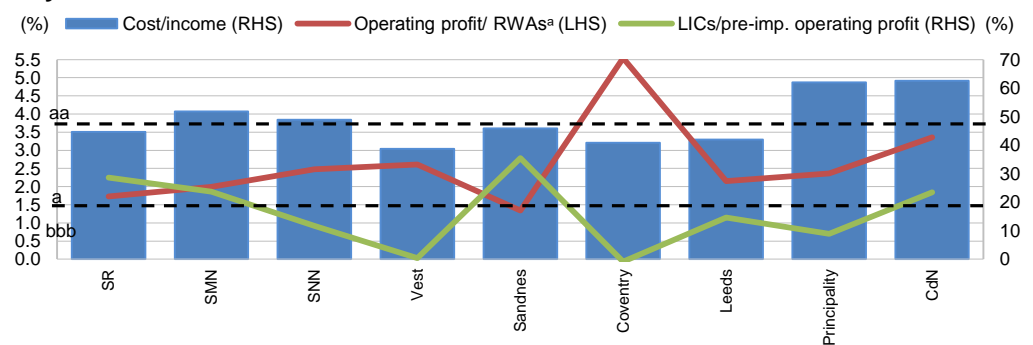
Fitch expects the Sparebanken to maintain good pre-impairment profitability in 2017. They benefit from resilient revenue generation, reflecting stable banking models tilted towards traditional commercial banking, and supported by their strong regional franchises. Net interest income generally represents between 40% and 60% of total income.

The prolonged low-interest-rate environment and strong competition for retail mortgage lending has put pressure on margins. Nonetheless, Fitch does not expect a return to pre-crisis levels with predominately volume and market share targets, and believes retail lending margins will stabilise and improve marginally in 2017 for most banks, with corporate lending margins remaining steady.

Commission income is increasing as a proportion of total revenues for the Sparebanken and is a reflection of the Alliance banks' focus on the cross-selling of ancillary products, such as insurance, wealth management and real-estate brokerage, and the support from the jointly owned SpareBank 1 Gruppen.

Cost efficiency is adequate and remains a strong focus for the management teams. The three banks improved their cost/income ratios in 9M16 and Fitch expects this to continue in 2017 on the back of announced cost-cutting programmes. Cost/income ratios are reasonably low in a European context. LICs for the Sparebanken have averaged below 20% of pre-impairment profitability in recent years. In 4Q16 and 2017, we expect SR's and SMN's to report LICs in line with 9M16 (29% and 24% of pre-impairment profit, respectively), a level easily absorbable for the banks.

**Key Performance Metrics**



End-September 2016 for all banks except end-2015 for Coventry, Leeds, Principality and Cdn  
<sup>a</sup> Core metric for earnings & profitability. Source: Banks, Fitch

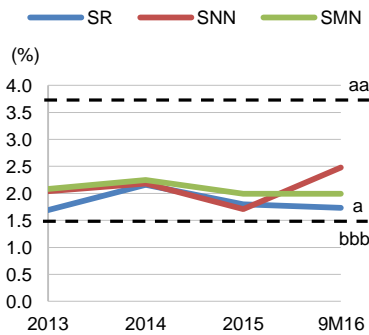
**Capitalisation and Leverage**

*Solid Capitalisation and Low Leverage*

The Sparebanken's capital adequacy ratios compare well with those of international peers', despite Norwegian floors on the computation of risk weights. They benefit only marginally from the use of IRB models, as highlighted by strong leverage in a European context. Reported Basel leverage ratios are above the 5%<sup>1</sup> minimum requirement for all three banks. SNN has a

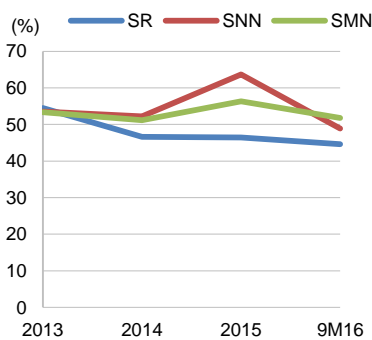
<sup>1</sup> As announced by the Norwegian Ministry of Finance in December 2016, the formal leverage requirement for non-DSIFs (including SR, SMN and SNN) will be 5% from 30 June 2017, with a 1% add-on for DSIFs.

**Operating Profit/RWAs**



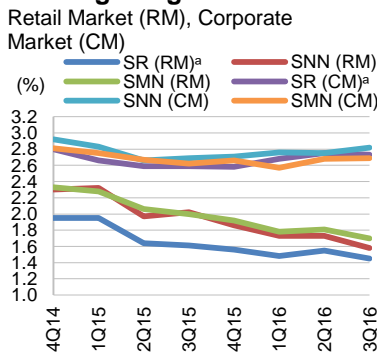
Source: Banks, adjusted by Fitch

**Cost-Efficiency**



Source: Banks, adjusted by Fitch

**Lending Margin**

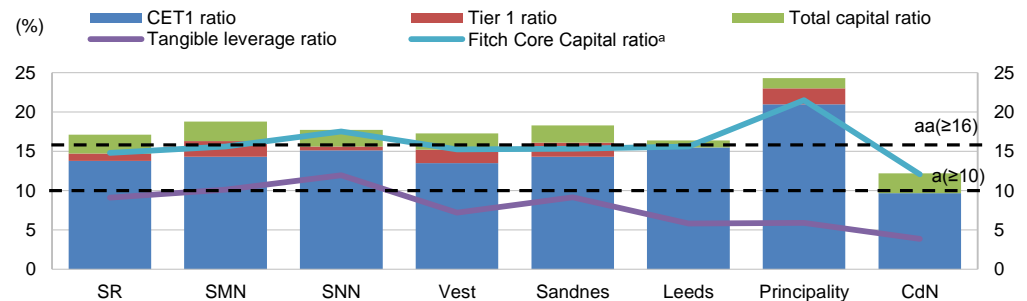


Avg. customer interest rate measured against 3m moving avg. or avg. NIBOR  
<sup>a</sup> Margin includes loans transferred to covered bond companies  
 source: Banks

stronger capital position than its Sparebanken peers' and benefits from lower leverage. Unreserved impaired loans represented less than 6% of Fitch Core Capital for the three banks at end-September 2016, a manageable amount in Fitch's view.

Fitch expects the Sparebanken to continue to build capital to maintain a buffer above the 13.5% common equity Tier 1 (CET1) minimum regulatory requirement for domestic systemically important financial institutions (D-SIFIs) from 2016, even though they have not at this stage been classified as D-SIFIs. The D-SIFI CET1 requirement includes a 1.5% countercyclical buffer from 30 June 2016. The three banks all target a CET1 ratio of 14.5% for 2017 and have been building their capital bases in recent years to satisfy the new requirements. SNN hit the target at end-September 2016, reporting a CET1 ratio of 15.1%, while SR (13.8%) and SMN (14.3%) are well under way to reach their targets. The regulator has in its preliminary assessment set an individual Pillar 2 add-on requirement of 1.5%, 2.0% and 2.3% for SNN, SR and SMN, respectively.

**Capital and Tangible Leverage**



Tangible leverage ratio: Tangible common equity/tangible assets. End-September 2016 for all banks except end-2015 for Coventry (FCC ratio: 31.2%), Leeds, Principality and CdN. <sup>a</sup> Core metric for capitalisation & leverage. Source: Banks, Fitch

**Funding and Liquidity**

*Market Funding Dependence Makes Sparebanken Sensitive to Investor Confidence*

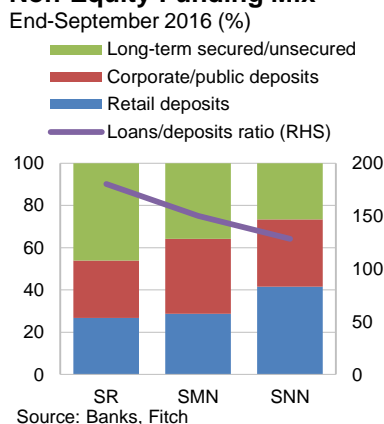
The Sparebanken rely on wholesale funding to various degrees, with SNN's funding mix somewhat more deposit based. All the Sparebanken use covered bonds funding through S1B, although due to the ownership structure the balance sheet is not fully consolidated, meaning the full indirect use of wholesale funding is not included in the Sparebanken's financial reporting. At end-September 2016, the Sparebanken had transferred 14% (SR) to 27% (SNN) of total lending to S1B and S1N (SR and SMN; 0.3% and 1.4% of total loans transferred to S1N respectively).

The funding profiles benefit from stable regional deposit franchises, with loans/deposits ratios ranging from about 130% (SNN) to 180% (SR). Retail deposits account for about half of the banks' deposit bases, with the rest relating to the corporate and public sectors. SNN has a larger retail deposit base.

Fitch expects the funding markets to remain open for the Sparebanken, particularly for issuance of covered bonds. However, the relatively small size of Norway's domestic funding market means that covered bonds are predominately issued abroad. SR, as the largest senior unsecured issuer among the Sparebanken, has had to diversify internationally. While international diversification creates a larger investor base, it could also lead to greater difficulties in times of stress, as international investors could be less sticky. Fitch believes the Sparebanken will retain significant liquidity portfolios to mitigate this risk.

The Sparebanken have announced their intention to set up individual covered bonds companies to supplement S1B. Only SR has completed this and had issued NOK5.0bn in the Norwegian market and EUR1.75bn in three international covered bonds at end-September 2016. Fitch understands that the primary reason for establishing these wholly owned funding

**Non-Equity Funding Mix**



Source: Banks, Fitch

vehicles is to avoid breaching large exposure restrictions, particularly in a stress when additional covered bonds issuance could be used as liquidity contingency for repos with the central bank or in the market. Fitch does not expect this to fundamentally alter the shape of the Sparebanken, nor of S1B, although SR is likely to use this as an active alternative source of funding (we believe SNN and SMN will use this primarily as a back-up facility). The new vehicles also open up the possibility of additional loan transfers outside S1B's criteria (but still within Norwegian covered bonds legislation).

Fitch expects liquidity to be kept high to mitigate wholesale funding risks. The Sparebanken conduct internal stress tests and maintain sufficient liquidity to be able to continue to operate without access to wholesale markets for 12 months, based on the banks' assumptions. Contingent liquidity sources include loan sales to S1B and central bank repo facilities and will be supplemented by the individual covered bond companies. The banks' liquidity portfolios predominantly consist of highly rated (AA or higher) Nordic covered bonds and other central bank-eligible assets.

## Support

### Moderate Probability of Sovereign Support

In Fitch's view, there is a clear intention ultimately to reduce implicit state support for financial institutions in the EU, as demonstrated by a series of legislative, regulatory and policy initiatives. The EU's Bank Recovery and Resolution Directive (BRRD) and the Single Resolution Mechanism for eurozone banks provide a framework for resolving banks that is likely to require senior creditors participating in losses, if necessary, instead of or ahead of a bank receiving sovereign support.

A bank resolution framework has not taken centre stage in Norway, although Fitch expects drafting and implementation to progress during 2017. As a member of the European Economic Area, Norway is bound to implement the BRRD, although Fitch expects that it will aim to do so in the most flexible format possible. It is also likely that Norwegian banking authorities will take into consideration what is implemented in other Nordic countries, particularly in Sweden, but again providing the most flexibility possible to decide on a process of resolution.

The Support Rating of '3' and Support Rating Floor of 'BB+' of the larger Norwegian regional banks reflect their strong franchises and market shares in the regions in which they operate, particularly in the retail and SME sectors. Fitch considers that there remains a moderate probability that the Norwegian authorities would support the Sparebanken if required, due to their local systemic importance.



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