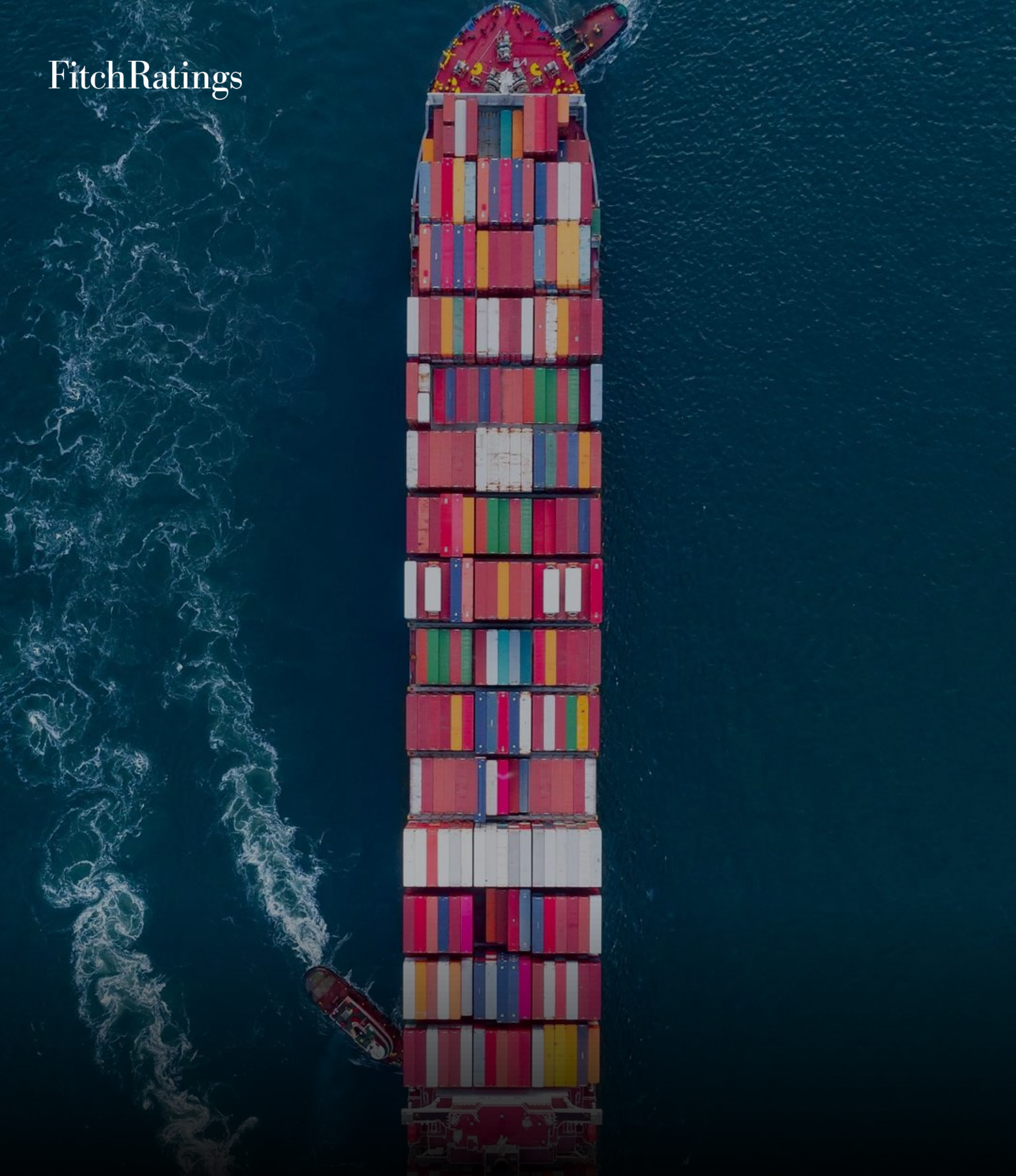
FitchRatings



The Major Sparebanken of the SpareBank 1 Alliance

The Sparebanken Benefit from a Supportive Operating Environment

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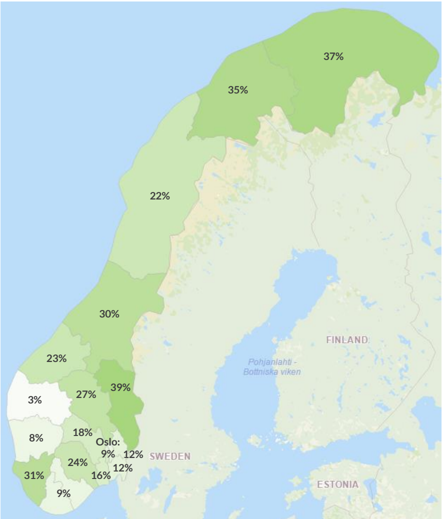
SpareBank 1 Alliance Regional Market Shares



Shading reflects strength of market share in the region.

Source: Fitch Ratings, SpareBank 1 Group Research

Strong Franchises, Regional Concentrations

The ratings for SpareBank 1 SR-Bank (SR-Bank; A-/Stable), SpareBank 1 SMN (SMN; A-/Stable) and SpareBank 1 Nord-Norge (SNN; A/Stable), which are members of the Sparebank 1 Alliance (collectively: the Sparebanken), reflect their stable and low-risk business models, healthy profitability, resilient asset quality and sound capital ratios. The ratings also factor in risks arising from volatility in oil prices, high property prices, 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 better asset-quality metrics, limited oil exposure and a more retail-oriented business model.

Supportive Operating Environment

The Sparebanken's performances are closely linked to that of the Norwegian economy and their respective regions, given their regional focus. Fitch Ratings expects the Norwegian banking sector to continue to benefit from the country's favourable economic environment. However, the Sparebanken remain dependent on oil-related industries, although to varying degrees. A major part of impaired loans at end-September 2019 was related to this industry.

Traditional Banking Business Models

The Sparebanken's business models have proven stable due to their focus on traditional banking and their relatively simple organisational structures. The Sparebank 1 Alliance brand is established throughout Norway as one of the country's most recognised financial brands with about one million retail customers and market shares of about 20% in retail banking and 15% in corporate banking.

Reduced Exposure to Offshore Industry

The Sparebanken's asset quality is strong and compares well with international peers'. Impaired loans were a low 60bp-170bp of gross loans at end-September 2019. We do not expect further oil-related asset-quality weakness, although individual cases may still emerge. The banks have also reduced their exposure to the offshore industry in general and to the offshore service vessel (OSV) segment in particular in recent years.

Earnings Supported by Rate Hikes

The Sparebanken have good profitability, which we expect will continue in 2020. The banks benefit from resilient revenue, reflecting stable banking models weighted towards traditional commercial banking, and supported by their strong regional franchises and the SpareBank 1 Alliance. Net interest income (NII) has recently been supported by raising policy rates in Norway.

Related Research

SpareBank 1 SMN - Ratings Navigator (September 2019)
SpareBank 1 SR-Bank - Ratings Navigator (September 2019)
SpareBank 1 Nord-Norge - Ratings Navigator (September 2019)
SpareBank 1 SMN (January 2020)
SpareBank 1 SR-Bank (January 2020)
SpareBank 1 Nord-Norge (January 2020)

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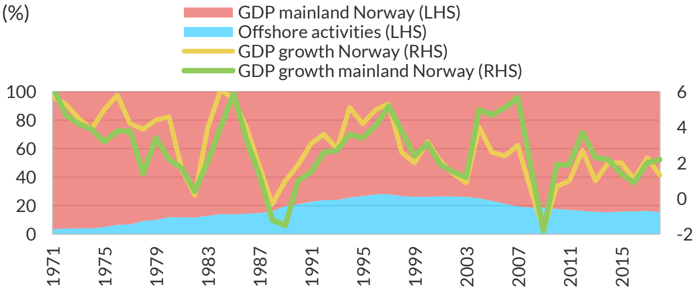
Supportive Operating Environment

Strong and Resilient Norwegian Economy

Fitch believes that central Norway, where SMN operates, has a reasonably diversified economy. Northern Norway, where SNN operates, is supported by a large and stable public sector, strong growth in tourism and faster economic growth in recent years than the Norwegian average. Rogaland, the centre of Norway's oil industry and SR-Bank's main market, has faced pressure in the most recent downturn but macroeconomic conditions have improved significantly over the past two years.

Resilient Norwegian Economy



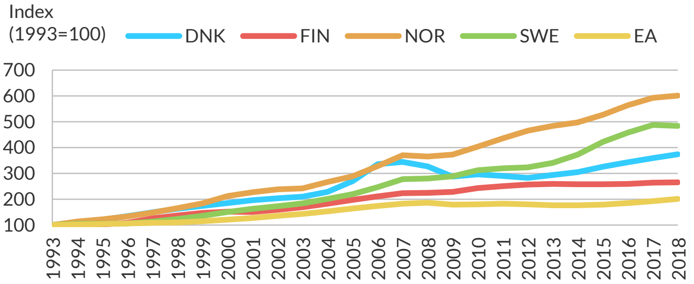
Source: Fitch Ratings, Statistics Norway

Fitch expects the Norwegian banking sector to continue to benefit from the country's favourable economic environment. The economy has proven resilient to the weaker global growth in 2019. Fitch expects growth to rise to 2.5% in 2019 driven by internal demand and supported by strong spillover effects from large petroleum investments, high capacity utilisation and positive labour market dynamics. The Norwegian economy is still dependent on oil-related activities.

High Property Prices, but Risks Are Modest

Nominal house prices in Norway have increased significantly in the past decades, in comparison with peer countries.

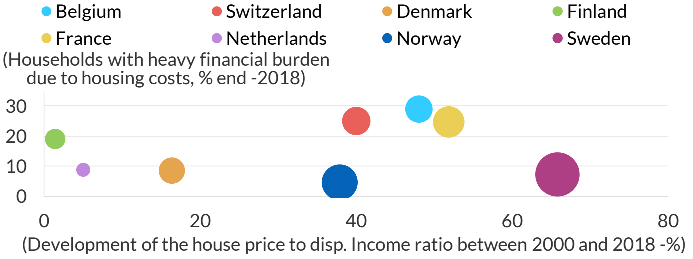
High Property Prices



EA: European Area Average
Source: Fitch Ratings, OECD

However, the increase in house prices in relation to disposable income has been more modest compared with peers. Owing to low interest rates and strong wage growth, Norway has one of the lowest shares of households with heavy financial burden due to housing costs in Europe. With 95% of residential mortgage loans being flexible rates, debt service burdens could escalate if interest rates were to rise faster than expected. However, we believe that the risks for overheating in the residential property market are modest as recent macro-prudential measures have led to a more moderate price increase in recent quarters. Additionally, Fitch believes there is a better balance between demand and supply compared with previously.

Low Interest Burden and Modest Increase in Housing Prices to Disposable Income

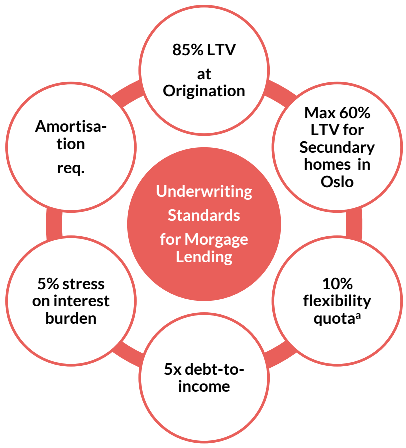


Size of bubbles represents real price development of housing since 2000.
Source: Fitch Ratings, Eurostat, OECD

In contrast, there are signs of overheating in the commercial property market. Fitch believes that prices are rising fast, especially in Oslo. The Sparebanken do not have significant exposure to the commercial real-estate market in Oslo, where overheating risks are most visible. Fitch believes that overheating risks are lower in the banks' regions.

Strong Regulator Enforces Conservative Risk Appetite

The Norwegian regulatory environment is highly developed and transparent. In recent years, the authorities have introduced a range of measures to tackle rising property prices and household debt. The rules in the diagram below were introduced in 2015 and again renewed recently, hence effective until 31 December 2020.



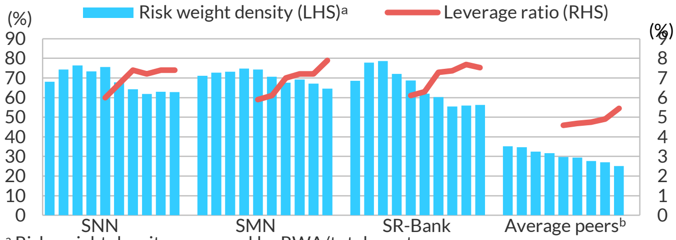
[a] The flexibility quota is defined as the share of loans for which Norwegian banks can deviate from the requirements. These are reported quarterly to Finanstilsynet.

In March 2019, the EU's Capital Requirements Directive IV and Capital Requirements Regulation were incorporated into the European Economic Area Agreement. Once fully implemented in domestic regulations, they are expected to lead to positive impacts on Norwegian banks' capital ratios due to the introduction of SME discounts and the removal of Basel I floors. The Norwegian Financial Supervisory Authority (Finanstilsynet) and the Ministry of Finance have stipulated that these rules' implementation should not lead to a decrease in capital. The Ministry of Finance has decided to increase the systemic risk buffer requirement to 4.5% from 3.0% and to introduce risk-weight floors for residential (at

20%) and for commercial real-estate (at 35%) exposure. In addition the countercyclical buffer has increased to 2.5% from 2.0%, effective as of 31 December 2019.

The Sparebanken's overall risk-weight densities are more conservative compared with peers.

Conservative Risk Weights in Sparebanken



[a] Risk weight density measured by RWA/total assets
[b] From left to right: end-2010 to end-Spetember 19 for Sparebanken and end-2018 for peers
Source: Fitch Ratings, Banks

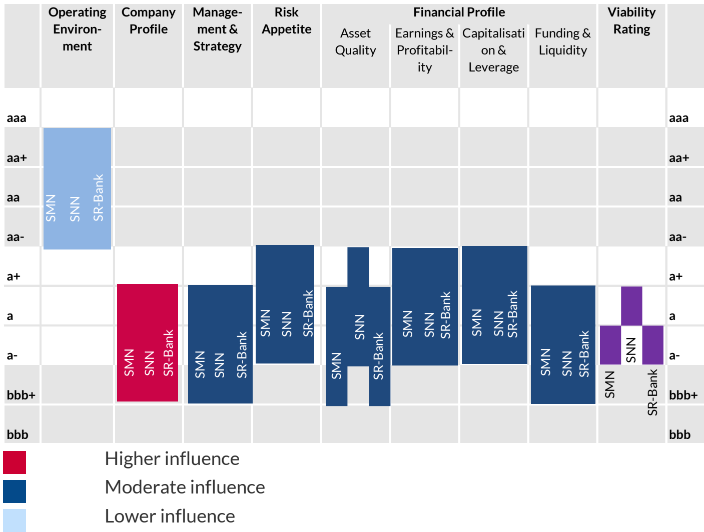
Norwegian insolvency laws are tough and function properly. Combined with significant customer data transparency, including the national debt register, this creates a significant incentive for households not to default on mortgage obligations. The Sparebanken further mitigate the default risks through low average loan to value (LTV). More than 90% of mortgage loans at SNN, SR-Bank and Sparebank 1 Boligkreditt AS (S1B) (no disclosure for SMN) have an LTV below 85%.

MREL Requirements Announced

Regulation for minimum requirement for own funds and eligible liabilities (MREL) was entered into Norwegian legislation in 2019 in connection with the implementation of EU's Bank Recovery and Resolution Directive. The resolution authority (Finanstilsynet) communicated specific requirements for each of the Sparebanken in December 2019. The subordination requirement must be fulfilled before end-2022 and the Finanstilsynet has stated that banks will not be able to use senior preferred debt to meet their requirements, which is why we expect the banks to gradually replace their senior debt with senior non-preferred debt. The Sparebanken have MREL ranging from NOK34 billion (SR-Bank) to NOK19 billion (SNN). We believe the requirements will be manageable for the Sparebanken within the framework of ordinary maturities of their outstanding senior unsecured debt.

Stable Business Models

Peer Ratings Navigator



Independent Regional Savings Banks in Nationwide Alliance

In 1996, SNN, SMN and SR-Bank founded the Sparebank 1 Alliance along with Sparebanken Vest and Samspar, a group of smaller savings banks. Sparebanken Vest withdrew from the venture in January 2004 to pursue an independent strategy. The Alliance is the second-largest banking group in Norway, behind DNB ASA, with total lending of about NOK850 billion at end-2018.

The Sparebanken operate as universal banks for retail and SME customers in their respective regions, where they hold leading market shares (at least 30%) in deposits and loans. They also operate in surrounding regions, although often with a lower market share. The Alliance has national market shares of about 20% in retail banking and 15% in corporate banking.

The Sparebanken have diversified into areas such as real-estate brokerage and accounting services. The Alliance banks jointly own SpareBank 1 Gruppen AS (S1G), which holds the stakes in the specialised subsidiaries in life-insurance, non-life insurance, asset management and factoring services. S1G's non-life insurance entity, SpareBank 1 Skadeforsikring AS, merged with DNB Forsikring AS to create Norway's third-largest and fastest growing non-life insurer, Fremtind (in which S1G holds 65%). Combined, these additional revenue streams create earnings diversification and stability for the member banks.

Clear and Long-Term Strategic Focus

The Sparebanken's strategies are well articulated and focused on providing core banking services to their regional customers. The management teams are experienced with a fair degree of stability. This, combined with the banks' retail-focused business models, has resulted in high revenue stability in the past decade, compared with peers. NII and net fees and commission are the main contributors to operating income. Management's execution records have been strong.

Cost Base Benefits from the Alliance

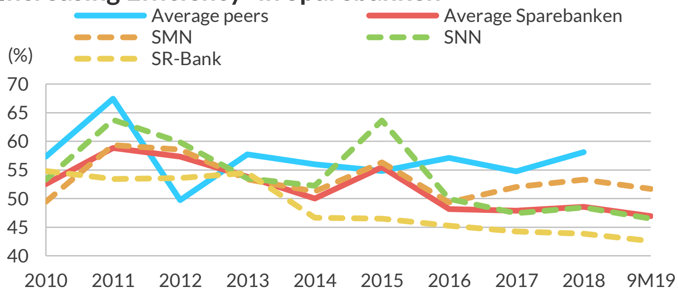
The Alliance banks benefit from co-operation agreements between the members in areas ranging from marketing and IT to risk modelling. They own S1B, which has traditionally been their funding vehicle for residential mortgage covered bonds.

Sparebank 1 Boligkreditt AS (S1B): S1B issues covered bonds and buys mortgage loans from the individual savings bank in the alliance. The owners of S1B are legally bound to provide liquidity and capital support to S1B in case of need. They would provide capital if S1B's common equity Tier 1 ratio decreases below the regulatory requirement and subscribe to new covered bond issues in case there is a disruption in the covered bond market.

To mitigate credit risk, S1B only buys mortgage loans with an LTV at or below 75% and has the right to off-set any losses incurred on individual mortgage loans against the commissions due to all banks for the remainder of the calendar year. S1B has not had to use this off-set mechanism.

S1G is also responsible for some product development and marketing activities, which creates scale benefits for its members. This, combined with improvements at the individual Sparebanken, has resulted in better cost efficiency than peers'.

Increasing Efficiency[a] in Sparebanken



[a] Efficiency measured as non-interest expenses/gross revenues
Source: Fitch Ratings, Banks

Financial Profile

Note on Peer Charts: Peer average includes Caja Rural de Navarra, Sociedad Cooperativa de Credito (Viability Rating (VR): bbb+), SMN (a-), SNN (a), SR-Bank (a-), Leeds Building Society (a-), Belfius Bank SA/NV (a-), Nykredit Realkredit A/S (a), Coventry Building Society (a-), de Volksbank N.V. (a-), Skipton Building Society (a-), ABN AMRO Bank N.V. (a) and Santander UK Group Holdings plc (a).

Black dashed lines in charts represent indicative quantitative ranges and corresponding implied scores for Fitch's core financial metrics for banks operating in environments that Fitch scores in the 'aa' category.

Resilient Asset Quality

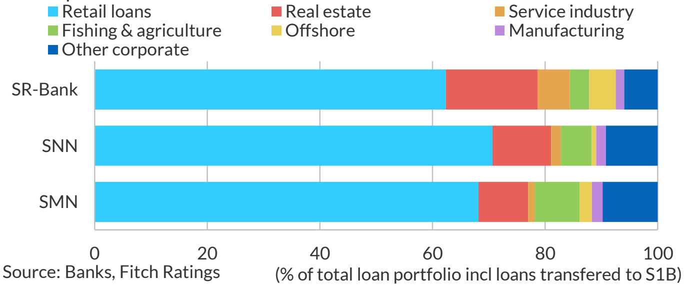
The Sparebanken's asset quality is sound and compares well with international peers. Impaired loans were low to modest at end-September 2019, between 60bp-170bp of gross loans. SMN's impaired loans ratio increased by 31bp in 9M19, driven by a few individual customers.

Fitch's asset-quality metrics do not include loans sold to S1B. These are predominantly high-quality retail mortgage loans. Taking these loans into account, SNN's impaired loans ratio would fall to about 40bp, SR-Bank's to about 110bp and SMN's to about 130bp at end-September 2019.

The Sparebanken's loan portfolios are predominantly in retail mortgage loans. Corporate exposures are generally diversified although regionally concentrated. SR-Bank has a greater proportion of exposure to the real-estate and offshore sectors, SMN is relatively more exposed to the agriculture sector and SNN to the real-estate sector and the fishing industry.

Low Risk Loan Portfolios

End-September 2019

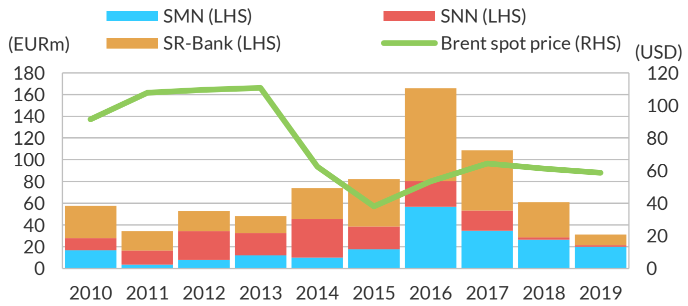


Source: Banks, Fitch Ratings

Sharply falling oil prices in 2014-2016 translated into asset-quality pressure among certain portfolios. Losses from their OSV exposure were the main driver of SMN's and SR-Bank's loan impairment charges (LICs) in 2016-2018. The OSV segment remains characterised by oversupply, ageing fleets and high fixed costs, despite recent indications of a more favourable economic environment and higher activity.

SNN is less exposed to the offshore industry as the north of Norway's economy is less dependent on oil-related activity. This translated into lower loan losses during the oil-crisis compared with the other Sparebanken and continues to partly explain SNN's better asset-quality metrics.

LICs Linked to Oil Prices

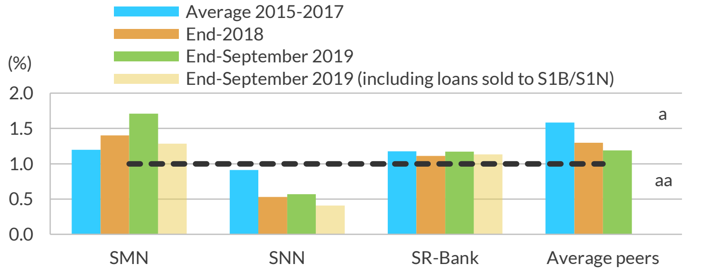


Source: Fitch Ratings, Banks

In 2019, offshore exposures still account for the majority of Stage 3 loans (impaired loans). Losses from the retail segment have been very limited and we believe that they will continue to be very low due to conservative underwriting standards, a well-functioning labour market and an advanced social infrastructure backed by the sovereign wealth fund. A significant property price correction is a key sensitivity for the banks, but we do not expect such a scenario to lead to significant deterioration of quality in the banks' mortgage lending. A sharp correction in house prices could result in reduced private consumption that would negatively affect banks' SME portfolios. SNN and SR-Bank are less exposed to this risk due to relatively lower house prices in the north and south-west of Norway.

Sound Impaired Loans Ratios

Impaired loans/gross loans

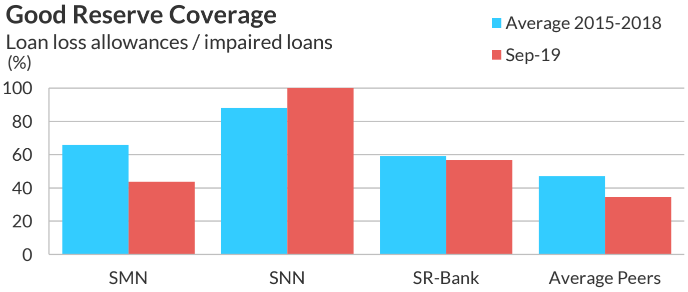


Source: Fitch Ratings, Banks

Reserve coverage by loan allowances is good and ranged from 44% of impaired loans for SR-Bank to 100% for SNN. We believe that the banks' reserve coverages are solid given robust collateralisation, underpinned by moderate LTV ratios and healthy lending diversification by industry (although regionally concentrated).

Good Reserve Coverage

Loan loss allowances / impaired loans



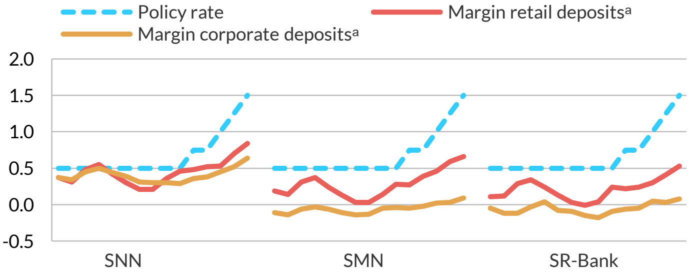
Data for peer banks is end-June 2019
Source: Fitch Ratings, Banks

We believe that the supportive operating environment, strict underwriting standards and their low risk appetite have helped the Sparebanken maintain their strong asset-quality metrics and we expect these to remain strong.

Strong Performance, Supported by Rate Hikes

The Sparebanken have good pre-impairment profitability, and we expect this will also be the case in 2020. NII has been supported by raising policy rates in Norway. Norges Bank increased its policy rate on four occasions since June 2018 to 1.5% from 0.5%, going against the general trend. By keeping deposit rates stable, Norwegian banks have been able to benefit from these rate hikes through higher deposit margins.

Policy Rate Hikes Support Net Interest Income



From left to right: 1Q16 to 3Q19
[a] As reported by the banks
Source: Fitch Ratings, Banks

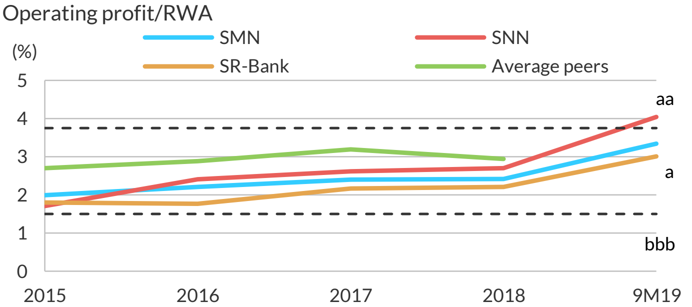
Retail lending margins decreased to a degree in 2019 as a result of rising Norwegian Interbank Offered Rate and higher competitive pressure. Corporate lending margins have been more stable. Fitch expects more competitive pressure in a rising rates environment.

Commission income has been steadily increasing as a proportion of total revenue for the Sparebanken, a result of the Alliance banks' focus on the cross-selling of ancillary products, such as insurance, wealth management and real-estate brokerage.

The Sparebanken performed well in 9M19 helped by large gains of non-recurring nature from the creation of Fremtind and from valuation gains in S1G's life-insurance entity. Excluding these, the banks still generated operating profit/risk-weighted assets ranging from 2.5% (SR-Bank) to 2.9% (SNN). Since 2016, the Sparebanken's profitability metrics have been supported by modest LICs and healthy loan growth. LICs have decreased to a low 4% in 9M19 from an average of 20% of pre-impairment operating profit for the Sparebanken at the peak in 2016.

Strong Profitability at Sparebanken

Operating profit/RWA

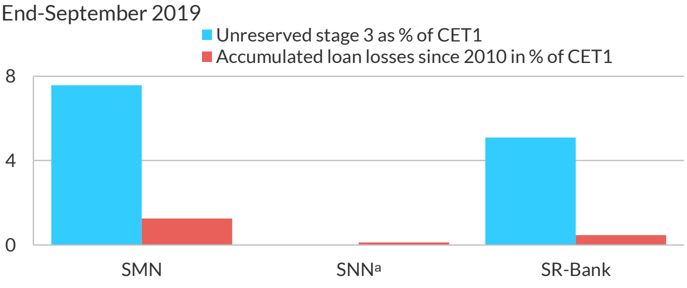


Source: Fitch Ratings, Banks

Sound Capitalisation, Strong Leverage

The Sparebanken's capital ratios compare well with those of international peers. The use of internal ratings-based models is marginal, resulting in higher risk density and, hence, strong leverage ratios in a European context. Reported Basel leverage ratios ranged from 7.4% (SMN) to 7.9% (SNN) at end-September 2019, compared with a minimum regulatory requirement of 5% (for domestic non-systemically important banks in Norway). Unreserved impaired loans were less than 6% of Fitch Core Capital for the three banks at end-2018, a low level compared with most peers.

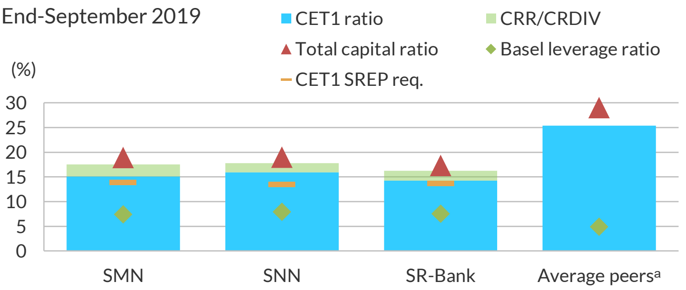
Low Risk in Sparebanken
End-September 2019



[a] SNN's loan loss allowance fully covers gross stage 3 loans at end-September 2019
Source: Fitch Ratings, Banks

The Sparebanken have been building buffers over their minimum regulatory requirements, and Fitch expects these to be maintained, even taking into account the recent increase in the counter-cyclical buffer requirement to 2.5%.

Strong Capital Positions
End-September 2019



[a] End-June 2019 used for peers.
Source: Fitch Ratings, Banks

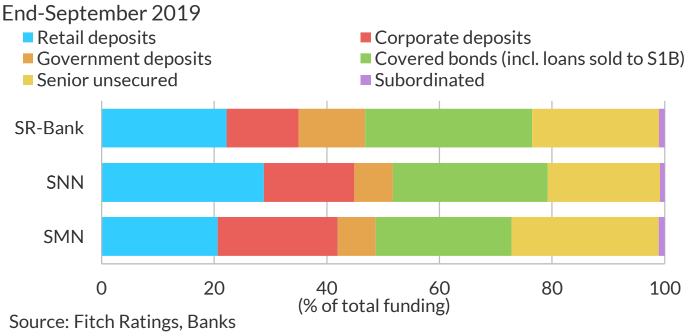
Fitch believes the Sparebanken need to maintain strong capital ratios to offset their regional focus, since a negative development in regional economies, although not our base case, could affect the banks' management buffers.

Reliance on Wholesale Funding, Sound Liquidity

The Sparebanken rely on wholesale funding to varying degrees, with SNN's funding mix being slightly more deposit-based. The banks use covered bonds funding through S1B and Sparebank 1 Naeringskreditt AS (S1N), although due to the ownership structure of these issuing entities, their balance sheets are not consolidated. Indirect use of wholesale funding is not included in the bank's reported balance sheet. At end-September 2019, the Sparebanken had transferred up to about 30% (SNN) of total lending to S1B and S1N. Since 2015, SR-Bank has decreased the amount of loans sold to S1B. Instead, SR-Bank set up its own covered bond entity, SR-Boligkreditt AS.

The Sparebanken's funding profiles benefit from stable regional deposit franchises, with loans/deposits ratios ranging from about 130% (SNN) to 200% (SR-Bank), excluding loans sold to S1B. When including loans sold to S1B, the Sparebanken all have a ratio ranging from 180% to 200%.

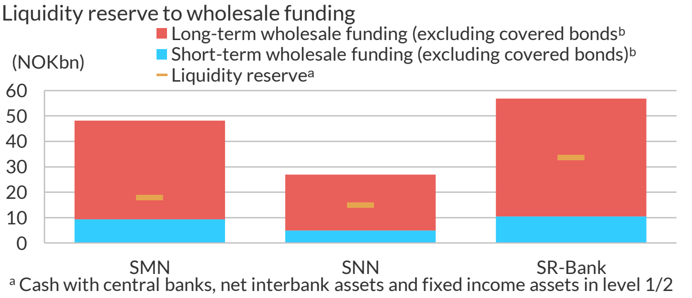
Reliant on Wholesale Funding
End-September 2019



Source: Fitch Ratings, Banks

Fitch expects the Sparebanken to continue to retain access to the capital markets, particularly for covered bond issuance. The relatively small size of Norway's domestic funding market means that covered bonds and senior preferred notes are issued within Norway in krone and abroad, predominantly in euro. International funding creates a larger investor base, but could prove less reliable in times of stress. Fitch believes the banks will retain significant liquidity portfolios to mitigate the risk.

Sound Liquidity
Liquidity reserve to wholesale funding



[a] Cash with central banks, net interbank assets and fixed income assets in level 1/2
[b] Senior unsecured debt, subordinated debt and hybrid capital
Source: Fitch Ratings, Banks

The banks' liquidity portfolios predominantly consist of highly rated (AA or higher) Nordic covered bonds and other central bank-eligible assets. Contingent liquidity sources include loan sales to the covered bond vehicles. The Sparebanken conduct internal stress tests and maintain sufficient liquidity to be able to continue to operate without access to the wholesale markets for 12 months, based on their assumptions. The liquidity coverage ratios (LCR) were 153% for SR-Bank, 144% for SNN and 181% for SMN at end-September 2019.