

SpareBank 1 SMN

Key Rating Drivers

Low-Risk Model, Regional Concentration: SpareBank 1 SMN's (SMN) ratings reflect its stable and low-risk business model, healthy profitability, resilient asset quality, and sound capital ratios. The ratings also factor in risks arising from a moderate franchise with a geographically concentrated loan portfolio, from exposure to potentially volatile oil and property prices, as well as from its liquidity management in the context of its reliance on wholesale funding.

Focus on Retail and SMEs: Fitch Ratings expects SMN to continue to implement its solid strategy based on a low-risk business model and a focus on retail and SME customers. SMN has successfully reduced concentration risks relating to large exposures.

Strong Asset Quality: Fitch expects SMN's asset quality to remain strong, driven by its conservative underwriting standards and a stable operating environment. Impaired loans (defined as Stage 3 loans under IFRS9) accounted for 1.7% of gross loans at end-September 2019. A large part of SMN's offshore exposure is to offshore service vessels (OSVs), and this may continue to pressurise SMN's asset quality, although this is manageable.

Healthy Profitability: SMN's regional franchise and strong client relationships support healthy pre-impairment profitability and stable revenue generation. Interest margins are healthy and cost-efficiency acceptable, with an average cost/income ratio of slightly above 50% in the past four years. Loan impairment charges have been moderate at around 12% of pre-impairment profitability on average in the past four years. Loan impairment charges are expected to be low in the medium term, and largely limited to the OSV segment.

Strong Capitalisation: SMN's risk-weighted capital ratios compare well with those of international peers. We expect the bank to maintain sound buffers over its minimum regulatory requirements. Its leverage ratio is strong in a European context with a Basel leverage ratio of 7.4% at end-September 2019.

Wholesale Funding Reliance: Like most Nordic banks, SMN relies on wholesale funding, in particular covered bonds issued through SpareBank 1 Boligkreditt (S1B), a joint funding vehicle for members of the SpareBank 1 Alliance. We expect SMN to retain a large liquidity portfolio to mitigate refinancing risk.

Rating Sensitivities

Stable Outlook: The Stable Outlook reflects Fitch's expectation that the operating environment in Norway will remain strong, with loan impairment charges largely contained to the OSV segment. We expect the bank to further reduce single-name concentration, continue to strengthen capital ratios and maintain healthy liquidity buffers.

Rating Upside: Positive rating pressure could arise in the medium term from sustained asset-quality improvements, most likely through the successful restructuring of the OSV portfolio. Rating upside is limited due to the geographical concentration.

Sensitive to Severe Correction: SMN's ratings are sensitive to a severe home-price correction. Fitch does not expect such a scenario to lead to significant deterioration of the quality of the bank's mortgage lending, although reduced consumption would likely negatively affect its SME portfolio. This is likely to be followed by difficulties in obtaining competitively priced funding.

Ratings

Foreign Currency

Long-Term IDR	A-
Short-Term IDR	F2

Viability Rating	a-
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Support Rating	5
Support Rating Floor	NF

Sovereign Risk

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

Outlooks/Watches

Long-Term Foreign-Currency IDR	Stable
Sovereign Long-Term Foreign-Currency IDR	Stable
Sovereign Long-Term Local-Currency IDR	Stable

Applicable Criteria

[Bank Rating Criteria \(October 2018\)](#)

[Short-Term Ratings Criteria \(May 2019\)](#)

Related Research

[SpareBank 1 SMN - Ratings Navigator \(September 2019\)](#)

[The Major Sparebanken of the SpareBank 1 Alliance \(January 2020\)](#)

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Debt Rating Classes

Rating level	Rating
Senior preferred	A-/F2
Tier 2 subordinated	BBB+

Source: Fitch Ratings

Senior preferred notes are rated in line with SMN's Issuer Default Ratings. Subordinated debt instruments are rated one notch below the bank's Viability Rating for loss severity, reflecting our expectation of below-average recovery prospects relative to senior unsecured creditors. No notching is applied for incremental non-performance risk because write-down of the notes will only occur once the point of non-viability is reached and there is no coupon flexibility before non-viability.

On 15 November 2019, Fitch published *Exposure Draft: Bank Rating Criteria*, which included proposals to alter the notching of certain debt securities.

Ratings Navigator – Standalone Assessment

SpareBank 1 SMN

ESG Relevance:

Banks
Ratings Navigator

	Peer Ratings	Operating Environment	Company Profile	Management & Strategy	Risk Appetite	Asset Quality	Earnings & Profitability	Capitalisation & Leverage	Funding & Liquidity	Viability Rating	Support Rating Floor	Issuer Default Rating
aaa										aaa	AAA	AAA
aa+		↑								aa+	AA+	AA+
aa										aa	AA	AA
aa-										aa-	AA-	AA-
a+					↑		↑	↑	↑	a+	A+	A+
a	↑		↑	↑	↑	↑	↑	↑	↑	a	A	A
a-	↑		↑	↑	↑	↑	↑	↑	↑	a-	A-	A- Stable
bbb+	↑		↑	↑	↑	↑	↑	↑	↑	bbb+	BBB+	BBB+
bbb	↑		↑	↑	↑	↑	↑	↑	↑	bbb	BBB	BBB
bbb-	↑		↑	↑	↑	↑	↑	↑	↑	bbb-	BBB-	BBB-
bb+	↑		↑	↑	↑	↑	↑	↑	↑	bb+	BB+	BB+
bb	↑		↑	↑	↑	↑	↑	↑	↑	bb	BB	BB
bb-	↑		↑	↑	↑	↑	↑	↑	↑	bb-	BB-	BB-
b+	↑		↑	↑	↑	↑	↑	↑	↑	b+	B+	B+
b	↑		↑	↑	↑	↑	↑	↑	↑	b	B	B
b-	↑		↑	↑	↑	↑	↑	↑	↑	b-	B-	B-
ccc+										ccc+	CCC+	CCC+
ccc										ccc	CCC	CCC
ccc-										ccc-	CCC-	CCC-
cc										cc	CC	CC
c										c	C	C
f										f	NF	D or RD

Sovereign Support Assessment

Support Rating Floor	Value		
Typical D-SIB SRF for sovereign's rating level (assuming high propensity)	A+ to A-		
Actual country D-SIB SRF	NF		
Support Rating Floor:	NF		
Support Factors	Positive	Neutral	Negative
Sovereign ability to support system			
Size of banking system relative to economy			✓
Size of potential problem	✓		
Structure of banking system			✓
Liability structure of banking system		✓	
Sovereign financial flexibility (for rating level)		✓	
Sovereign propensity to support system			
Resolution legislation with senior debt bail-in			✓
Track record of banking sector support		✓	
Government statements of support		✓	
Sovereign propensity to support bank			
Systemic importance			✓
Liability structure of bank		✓	
Ownership		✓	
Specifics of bank failure		✓	
Policy banks			
Policy role			
Funding guarantees and legal status			
Government ownership			

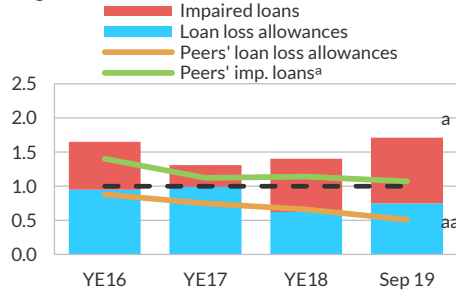
Bar Chart Legend

Vertical bars – VR range of Rating Factor
 Bar Colors – Influence on final VR
 ■ Higher influence
 ■ Moderate influence
 ■ Lower influence
 Bar Arrows – Rating Factor Outlook
 ↑ Positive ↓ Negative
 ⇅ Evolving □ Stable

The Bank Resolution and Recovery Directive was adopted in Norway on 1st of January 2019. It provides 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. In addition, SMN is not defined as a systemically important bank in Norway. We assign a Support Rating of '5' and a Support Rating Floor of 'No Floor' for SMN.

Asset Quality

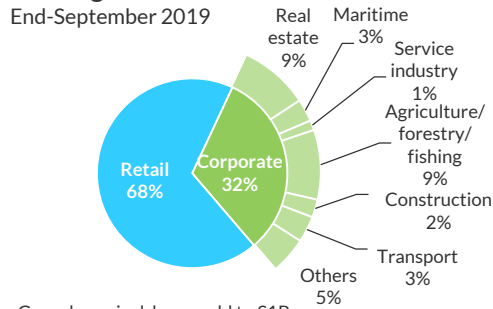
(% gross loans)



Source: Fitch Ratings, Banks

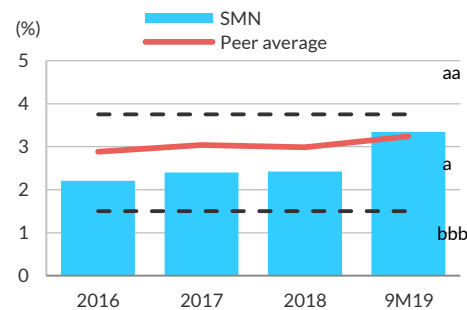
Lending Structure

End-September 2019



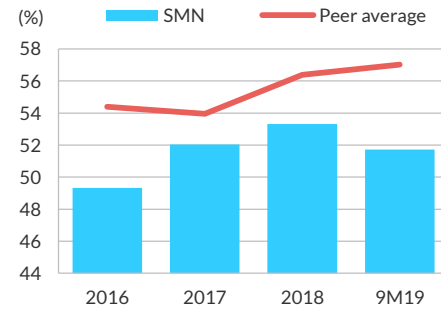
Gross loans incl. loans sold to S1B
Source: Fitch Ratings, Bank

Operating Profit/RWAs



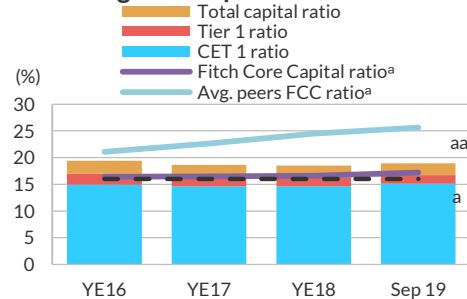
Source: Fitch Ratings, Banks

Cost Efficiency



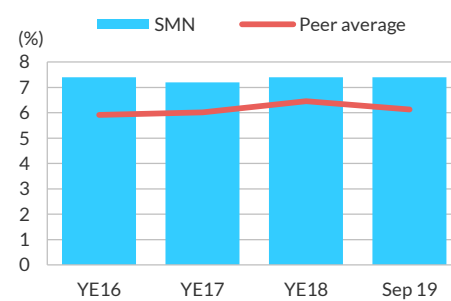
Source: Fitch Ratings, Banks

Risk-Weighted Capital Ratios



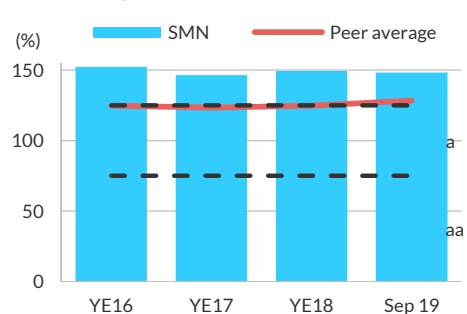
^a Fitch Core Capital used as benchmark line
Source: Fitch Ratings, Banks

Reported Basel Leverage Ratios



Source: Fitch Ratings, Banks

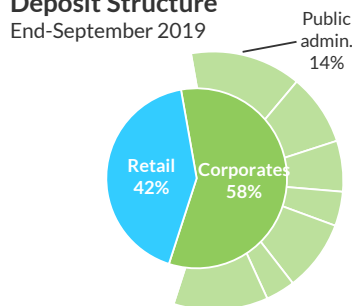
Loans/Deposits Ratios



Source: Fitch Ratings, Banks

Deposit Structure

End-September 2019



Source: Fitch Ratings, Bank

Note on Peer Charts:

Peer average includes Caja Rural de Navarra, Sociedad Cooperativa de Credito (CRN, VR: 'bbb+'), SMN (a-), SpareBank 1 Nord-Norge (a), SpareBank 1 SR-Bank (a-), Leeds Building Society (Leeds, a-), Belfius Bank SA/NV (Belfius, a-), Skipton Building Society (Skipton, a-), Coventry Building Society (Coventry, a-), de Volksbank N.V. (deVolks, a-) and ABN AMRO Bank N.V. (ABN, a).

Leeds, Belfius, Skipton, Coventry ABN and de Volks' interim six months results were included in the latest average calculation while CRN was excluded from the latest average calculation due to data unavailability.

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

Summary Financials and Key Ratios

	30 September 2019	31 December 2018	31 December 2017	31 December 2016
	9 months	Year end	Year end	Year end
	(NOKm)	(NOKm)	(NOKm)	(NOKm)
	Unaudited	Audited - unqualified	Audited - unqualified	Audited - unqualified
Summary income statement				
Net interest & dividend income	2,005	2,411	2,231	1,952
Net fees and commissions	920	1,219	1,222	1,118
Other operating income	1,962	1,707	1,536	1,413
Total operating income	4,887	5,337	4,989	4,483
Operating costs	2,077	2,624	2,369	2,003
Pre-impairment operating profit	2,810	2,713	2,620	2,480
Loan & other impairment charges	198	263	341	516
Operating profit	2,612	2,450	2,279	1,964
Other non-operating items (net)	n.a.	149	-1	69
Tax	395	509	450	352
Net income	2,217	2,090	1,828	1,681
Other comprehensive income	-13	-27	8	-116
Fitch comprehensive income	2,204	2,063	1,836	1,565
Summary balance sheet				
Assets				
Gross loans	123,967	120,473	112,071	102,325
- Of which impaired	2,123	1,682	1,468	1,688
Loan loss allowances	930	745	1,112	971
Net loans	123,037	119,728	110,959	101,354
Interbank	4,432	5,074	4,214	3,892
Derivatives	4,052	4,119	4,351	4,752
Other securities & earning assets	29,998	28,319	27,321	24,737
Total earning assets	161,519	157,240	146,845	134,735
Cash and due from banks	1,279	883	3,313	315
Other assets	3,677	2,581	3,096	3,030
Total assets	166,475	160,704	153,254	138,080
Liabilities				
Customer deposits	83,641	80,615	76,476	67,168
Interbank and other short-term funding	8,942	9,606	9,607	10,509
Other long-term funding	46,693	45,673	43,912	38,054
Trading liabilities and derivatives	3,531	3,013	3,587	4,255
Total funding	142,807	138,907	133,582	119,986
Other liabilities	3,314	2,640	1,679	1,350
Pref. shares and hybrid capital	1,454	1,514	1,476	1,441
Total equity	18,900	17,643	16,517	15,303
Total liabilities and equity	166,475	160,704	153,254	138,080

Summary Financials and Key Ratios (Cont.)

	30 September 2019 9 months (NOKm) Unaudited	31 December 2018 Year end (NOKm) Audited - unqualified	31 December 2017 Year end (NOKm) Audited - unqualified	31 December 2016 Year end (NOKm) Audited - unqualified
Ratios (annualised as appropriate)				
Profitability				
Operating profit/RWAs	3.3	2.4	2.4	2.2
Net interest income/average earning assets	1.7	1.6	1.6	1.5
Non-interest expense/gross revenues	51.7	53.3	52.0	49.3
Net income/average equity	16.3	12.4	11.5	11.6
Asset quality				
Impaired loans ratio	1.7	1.4	1.3	1.7
Growth in gross loans	2.9	7.5	9.5	8.9
Loan loss allowances/impaired loans	43.8	44.3	75.8	57.5
Loan impairment charges/average gross loans	0.2	0.2	0.3	0.5
Capitalisation				
Fitch Core Capital ratio	17.2	16.6	16.5	16.4
Tangible common equity ratio	10.9	10.5	10.3	10.6
CET 1 ratio	15.1	14.6	14.6	14.9
Basel leverage ratio	7.4	7.4	7.2	7.4
Net impaired loans/FCC	6.6	5.6	2.3	4.9
Funding & liquidity				
Loans/customer deposits	148.2	149.4	146.5	152.3
LCR	181.0	183.0	164.0	129.0
Customer deposits/funding	59.4	58.7	58.1	57.2
NSFR	n.a.	n.a.	n.a.	n.a.

Source: Fitch Ratings, Fitch Solutions

Environmental, Social and Governance Considerations

FitchRatings SpareBank 1 SMN

Banks
Ratings Navigator

Credit-Relevant ESG Derivation

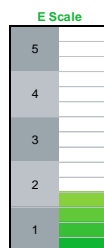
SpareBank 1 SMN has 5 ESG potential rating drivers

- SpareBank 1 SMN has exposure to compliance risks including fair lending practices, mis-selling, repossession/foreclosure practices, consumer data protection (data security) but this has very low impact on the rating.
- Governance is minimally relevant to the rating and is not currently a driver.

				Overall ESG Scale
key driver	0	issues	5	
driver	0	issues	4	
potential driver	5	issues	3	
not a rating driver	4	issues	2	
	5	issues	1	

Environmental (E)

General Issues	E Score	Sector-Specific Issues	Reference
GHG Emissions & Air Quality	1	n.a.	n.a.
Energy Management	1	n.a.	n.a.
Water & Wastewater Management	1	n.a.	n.a.
Waste & Hazardous Materials Management; Ecological Impacts	1	n.a.	n.a.
Exposure to Environmental Impacts	2	Impact of extreme weather events on assets and/or operations and corresponding risk appetite & management; catastrophe risk; credit concentrations	Company Profile; Management & Strategy; Risk Appetite; Asset Quality



How to Read This Page

ESG scores range from 1 to 5 based on a 15-level color gradation. Red (5) is most relevant and green (1) is least relevant.

The Environmental (E), Social (S) and Governance (G) tables break out the individual components of the scale. The left-hand box shows the aggregate E, S, or G score. General Issues are relevant across all markets with Sector-Specific Issues unique to a particular industry group. Scores are assigned to each sector-specific issue. These scores signify the credit-relevance of the sector-specific issues to the issuing entity's overall credit rating. The Reference box highlights the factor(s) within which the corresponding ESG issues are captured in Fitch's credit analysis.

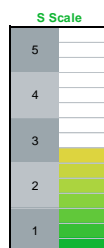
The Credit-Relevant ESG Derivation table shows the overall ESG score. This score signifies the credit relevance of combined E, S and G issues to the entity's credit rating. The three columns to the left of the overall ESG score summarize the issuing entity's sub-component ESG scores. The box on the far left identifies the [number of] general ESG issues that are drivers or potential drivers of the issuing entity's credit rating (corresponding with scores of 3, 4 or 5) and provides a brief explanation for the score.

Classification of ESG issues has been developed from Fitch's sector and sub-sector ratings criteria and the General Issues and the Sector-Specific Issues have been informed with SASB's Materiality Map.

Sector references in the scale definitions below refer to Sector as displayed in the Sector Details box on page 1 of the navigator.

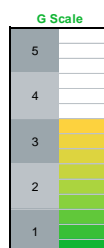
Social (S)

General Issues	S Score	Sector-Specific Issues	Reference
Human Rights, Community Relations, Access & Affordability	2	Services for underbanked and underserved communities; SME and community development programs; financial literacy programs	Company Profile; Management & Strategy; Risk Appetite
Customer Welfare - Fair Messaging, Privacy & Data Security	3	Compliance risks including fair lending practices, mis-selling, repossession/foreclosure practices, consumer data protection (data security)	Operating Environment; Company Profile; Management & Strategy; Risk Appetite
Labor Relations & Practices	2	Impact of labor negotiations, including board/employee compensation and composition	Company Profile; Management & Strategy
Employee Wellbeing	1	n.a.	n.a.
Exposure to Social Impacts	2	Shift in social or consumer preferences as a result of an institution's social positions, or social and/or political disapproval of core banking practices	Company Profile; Financial Profile



Governance (G)

General Issues	G Score	Sector-Specific Issues	Reference
Management Strategy	3	Operational implementation of strategy	Management & Strategy
Governance Structure	3	Board independence and effectiveness; ownership concentration; protection of creditor/stakeholder rights; legal/compliance risks; business continuity; key person risk; related party transactions	Management & Strategy; Earnings & Profitability; Capitalisation & Leverage
Group Structure	3	Organizational structure; appropriateness relative to business model; opacity; intra-group dynamics; ownership	Company Profile
Financial Transparency	3	Quality and frequency of financial reporting and auditing processes	Management & Strategy



CREDIT-RELEVANT ESG SCALE	
How relevant are E, S and G issues to the overall credit rating?	
5	Highly relevant, a key rating driver that has a significant impact on the rating on an individual basis. Equivalent to "higher" relative importance within Navigator.
4	Relevant to rating, not a key rating driver but has an impact on the rating in combination with other factors. Equivalent to "moderate" relative importance within Navigator.
3	Minimally relevant to rating, either very low impact or actively managed in a way that results in no impact on the entity rating. Equivalent to "lower" relative importance within Navigator.
2	Irrelevant to the entity rating but relevant to the sector.
1	Irrelevant to the entity rating and irrelevant to the sector.

The highest level of ESG credit relevance is a score of '3'. ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or to the way in which they are being managed by the entity. For more information on our ESG Relevance Scores, visit www.fitchratings.com/esg.

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