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Fitch Affirms Norwegian Sparebanken Ratings Endorsement Policy

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Fitch Ratings-London-19 November 2014: Fitch Ratings has affirmed SpareBank 1 Nord-Norge's (SNN) Long-term Issuer Default Rating (IDR) at 'A', SpareBank 1 SMN's (SMN), SpareBank 1 SR-Bank's (SR) and Sparebanken Vest's (SV) Long-term IDRs at 'A-', and Sandnes Sparebank's (Sandnes) Long-term IDR at 'BBB'. The Outlooks on all Long-term IDRs are Stable. A full list of rating actions is at the end of this rating action commentary.

The rating actions were part of Fitch's periodic review of Norwegian savings banks. We will shortly issue a peer report on the major Sparebanken 1 Alliance banks (SNN, SMN and SR).

KEY RATING DRIVERS - IDRS, VRs AND SENIOR DEBT

The affirmations of SNN's, SMN's, SR's and SV's (collectively Sparebanken) ratings are based on their strong regional franchises, healthy profitability, sound asset quality and strong capitalisation. They also incorporate wholesale funding reliance, sharp rises in property prices in recent years, and concentrated loan books by geography and sector. SNN's ratings are one notch higher than those of its Sparebanken peers, reflecting stronger capital ratios and a more retail-orientated business model, particularly for its funding structure.

Sandnes' rating reflects its healthy profitability, sound asset quality, solid capitalisation, as well as its entrenched regional presence in south-west Norway, although its smaller franchise relative to its Norwegian peers, greater geographical concentration and limited absolute size of capital are rating constraints. The ratings also factor in the bank's wholesale funding reliance.

Underlying profitability for the Sparebanken and Sandnes is strong, underpinning internal capital generation. The banks' regional franchises support stable revenue generation, and operational efficiency is acceptable. Fitch expects continued low loan impairment charges in 2015. The banks benefited from repricing of corporate deposits in 9M14, and Fitch expects this to continue into 2015. Lending margins for retail mortgage loans are beginning to come under pressure, but should remain satisfactory.

The Sparebanken's asset quality is strong, driven by a benign operating environment and strong underwriting standards. Fitch's expectation is that banks' management will continue to implement low risk business models that focus on retail customers and small and medium sized (SME) businesses, and that concentration risks relating to larger corporates will reduce. A downturn in the housing market is a key sensitivity for the banks, and while Fitch does not expect such a scenario to lead to a significant deterioration of the quality of the banks' retail portfolios, reduced consumption would most likely negatively impact their SME portfolios. SNN is less exposed to this risk, given the relatively low house prices in northern Norway compared with other parts of the country, and the large public sector presence. SNN is somewhat more sensitive to larger corporate impairments due to its relatively small equity size compared with its Sparebanken peers. SR has relatively high sector concentration risk, given its exposure to the oil sector in south-west Norway.

Sandnes' unreserved non-performing loans represented a low 0.6% of gross loans at end September 2014. However, impaired exposures, essentially relating to legacy commercial real estate (CRE) loans, represented a more significant 2% (of which 1.5 percentage points are performing) of gross loans at end-September 2014. Although of reasonable credit quality, and management's significant efforts into reducing concentration in this segment since its peak in 2008, Fitch considers the bank's CRE portfolio a key risk, which could put pressure on the bank's ratings. The bank's efforts in shortening maturities and reducing high loan-to-value CRE lending should continue to support the bank's solid asset quality.

Similar to most Nordic peers, the Sparebanken and Sandnes rely on wholesale funding to varying degrees. The Sparebanken have maintained access to domestic and international funding markets, in particular for covered bonds through SpareBank 1 Boligkreditt (S1B; a joint funding vehicle of Alliance member banks) and Sparebanken Vest Boligkreditt. However, they would be affected by a prolonged dislocation of the debt capital markets, and Fitch believes that the banks will retain significant liquidity portfolios to mitigate this risk. SNN's funding profile is stronger than its Sparebanken peers, driven by a greater retail deposit base.

The Sparebanken's capital adequacy ratios compare well with those of international peers, but lag those of their larger Nordic peers partly due to higher risk weights. Leverage is low in a European context, with tangible common equity/tangible assets generally between 6%-12% at end-September 2014. SNN's risk-weighted capitalisation, as well as its leverage, is somewhat stronger than its Sparebanken peers.

Sandnes uses the standardised approach to calculate its capital requirements for both retail and corporate exposures, which leads to higher risk weights than peers and slightly lower reported capital ratios. However, leverage is low in a European context and compares well with its Norwegian peers, with a tangible equity to tangible assets ratio of 7% at end-September 2014. Nonetheless, the small absolute volume of capital makes it vulnerable to shocks.

RATING SENSITIVITIES - SPAREBANKEN'S VRS, IDRS AND SENIOR DEBT

The Stable Outlooks on the Sparebanken's ratings reflects Fitch's view that a rating action is not expected. It factors in Fitch's expectation that house prices are likely to stabilise or moderately fall in the near term, and that banks will continue to strengthen capital ratios and maintain healthy liquidity buffers

An upgrade is unlikely given the already high ratings in the context of their company profiles and geographical concentration. The structural reliance on wholesale funding is also a somewhat limiting factor.

The Sparebanken's ratings could be downgraded if credit growth surpassed internal capital generation, materially weakening capitalisation. The ratings are also sensitive to a significant house price correction, should the banks be unable to absorb losses via earnings. The correction would probably lead to a drop in private consumption, affecting corporate lending quality, which Fitch expects to be the key driver for losses. In addition, this scenario would likely also be followed by difficulties in obtaining competitively priced funding in the wholesale funding markets which is a further ratings sensitivity.

RATING SENSITIVITIES - SANDNES'S VR, IDRS AND SENIOR DEBT
The Stable Outlook reflects Fitch's expectation of the operating environment in Norway remaining sound, supporting Sandnes' asset quality and working out of impaired exposures, and maintained access to market funding.

An upgrade is currently unlikely because the bank's small size makes it relatively sensitive to shocks, particularly in the context of its narrow geographical operating market and still some exposure to legacy CRE exposures.

Sandnes' ratings are sensitive to reduced activity in the region should it lead to a significant house price correction or increased losses in the corporate sector. A dislocation in debt capital markets making Sandnes unable to obtain competitively priced funding is a further sensitivity.

RATING DRIVERS - SUPPORT RATINGS AND SUPPORT RATING FLOORS
The Sparebanken's Support Ratings of '3' and Support Rating Floors of 'BB+' reflect Fitch's view that there is a moderate probability of support, if required from the Norwegian authorities, given their strong regional franchises.

In addition, there is a possibility of institutional support from the members of the Alliance. However, Fitch understands that no legal obligation arises from membership of the Alliance to support member banks and therefore does not factor this into the ratings.

Sandnes' Support Rating reflects Fitch's view of an only low extraordinary support probability from the Norwegian authorities, given the bank's very limited market shares in Norway, hence its Support Rating Floor is 'No Floor'.

RATING SENSITIVITIES - SUPPORT RATINGS AND SUPPORT RATING FLOORS
The Support Ratings and Support Rating Floors are potentially sensitive to any change in Fitch's assumptions about the ability (as reflected in its ratings) or willingness of the Norwegian state to provide timely support to the bank, if required. They are also sensitive to a change in Fitch's assumptions around the availability of sovereign support for banks more generally.

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. Norway is not an EU member country and has done little so far to update its bank resolution framework. Fitch's base case is that it will look to adopt a flexible approach to bank support/resolution decisions for its largest banks. All the Sparebanken banks have SRs of '3' and SRFs of 'BB+', and these are unlikely to be affected unless Norway adopts a much less flexible approach to resolution than Fitch currently anticipates. Sandnes' SRF of 'No Floor' is also unlikely to change.

KEY RATING DRIVERS AND SENSITIVITIES - SMN'S, SR'S and SV'S SUBORDINATED DEBT AND OTHER HYBRID SECURITIES
Subordinated debt and other hybrid capital issued by the Sparebanken are all notched down from the banks' VRs. Therefore, their respective ratings have been affirmed and are sensitive to any change in the banks' VRs.

The ratings are in accordance with Fitch's criteria 'Assessing and Rating Bank Subordinated and Hybrid Securities' reflecting each instrument's respective non-performance and relative loss severity risk profiles, which vary considerably.

SNN's and SMN's subordinated debt instruments are notched down once from the banks' VRs to reflect the notes' higher expected loss severity relative to senior unsecured creditors.

SV's hybrid Tier 1 securities are rated four notches below the bank's VRs to reflect the higher loss severity risk of these securities relative to average recoveries (two notches from the VR) as well as high risk of non-performance (an additional two notches).

KEY RATING DRIVERS AND SENSITIVITIES - SUBSIDIARY AND AFFILIATED COMPANY
S1B's IDRs are aligned with those of the largest Alliance members, SR and SMN, and reflect its role as a covered bond funding vehicle for its shareholder banks. Given S1B's close integration in the Alliance, including operational support and servicing of the mortgage assets, no VR is assigned. S1B's ratings are sensitive to the same factors that might drive a change in the parent banks' ratings.

These rating actions have no impact on the ratings of the covered bonds issued by S1B and Sparebanken Vest Boligkreditt.

The rating actions are as follows:
SpareBank 1 Nord-Norge:
Long-term IDR affirmed at 'A'; Outlook Stable
Short-term IDR affirmed at 'F1'
Viability Rating affirmed at 'a'
Support Rating affirmed at '3'
Support Rating Floor affirmed at 'BB+'
Senior unsecured debt affirmed at 'A'/'F1'

Subordinated debt affirmed at 'A-'

SpareBank 1 SMN:
Long-term IDR affirmed at 'A-'; Outlook Stable
Short-term IDR affirmed at 'F2'
Viability Rating affirmed at 'a-'
Support Rating affirmed at '3'
Support Rating Floor affirmed at 'BB+'
Senior unsecured debt affirmed at 'A-'/'F2'
Subordinated debt affirmed at 'BBB+'

SpareBank 1 SR-Bank:
Long-term IDR affirmed at 'A-'; Outlook Stable
Short-term IDR affirmed at 'F2'
Viability Rating affirmed at 'a-'
Support Rating affirmed at '3'
Support Rating Floor affirmed at 'BB+'
Senior unsecured debt affirmed at 'A-'/'F2'

SpareBank 1 Boligkreditt:
Long-term IDR affirmed at 'A-'; Outlook Stable
Short-term IDR affirmed at 'F2'
Support Rating affirmed at '1'

Sparebanken Vest:
Long-term IDR affirmed at 'A-'; Outlook Stable
Short-term IDR affirmed at 'F2'
Viability Rating affirmed at 'a-'
Support Rating affirmed at '3'
Support Rating Floor affirmed at 'BB+'
Senior unsecured debt affirmed at 'A-'/'F2'
Hybrid capital instruments affirmed at 'BB+'

Sandnes Sparebank:
Long-term IDR affirmed at 'BBB'; Outlook Stable
Short-term IDR affirmed at 'F3'
Viability Rating affirmed at 'bbb'
Support Rating affirmed at '5'
Support Rating affirmed at 'No Floor'

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Additional information is available on www.fitchratings.com

Applicable criteria, 'Global Financial Institutions Rating Criteria', dated 31 January 2014, are available at www.fitchratings.com.

Applicable Criteria and Related Research:
Global Financial Institutions Rating Criteria

Additional Disclosure
Solicitation Status