FITCH AFFIRMS 3 NORWEGIAN SAVINGS BANKS; OUTLOOK STABLE

Fitch Ratings-London-28 September 2018: Fitch Ratings has affirmed the Long-Term Issuer Default Rating (IDR) of three Norwegian banks, with Stable Outlooks.

The affected banks are Sparebank 1 Nord-Norge (SNN), Sparebank 1 SR-Bank (SR) and SpareBank 1 SMN (SMN).

A full list of rating actions is at the end of this rating action commentary.

KEY RATING DRIVERS

IDRS, VRS AND SENIOR DEBT

The affirmations of the ratings of SNN, SMN and SR (collectively Sparebanken) are based on their stable and low risk business models, healthy profitability, resilient asset quality and sound capital ratios. The ratings also factor in risk arising from potentially volatile oil and property prices, moderate franchises with geographically concentrated lending and from liquidity management in the context of the banks' wholesale funding reliance.

SNN's ratings are one notch higher than those of Sparebanken peers, reflecting better asset-quality metrics, in particular limited offshore exposures, and a more retail-oriented business model.

Fitch expects the Sparebanken's asset quality to remain strong, despite continued issues in oil-related portfolios for some banks, driven by their conservative underwriting standards and a stable operating environment. The banks have successfully reduced concentration risks relating to large exposures and Fitch expects them to continue to maintain their low-risk business models focussed on retail and SME customers. Impaired loans (defined as Stage 3 exposures under IFRS9) for the Sparebanken represented between 0.5% and 1.7% of gross loans at end-June 2018.

The sharp fall in oil prices seen in 2014-2015, and subsequent economic slowdown in Norway, led to a marked deterioration in oil-related portfolios. SR and SMN were particularly affected due to their exposure to the offshore service vessel (OSV) segment. Although Norway is now going through a recovery, with expected GDP growth of 2.6% in 2018, the OSV segment remains characterised by oversupply, ageing fleets and high fixed costs, which continue to put pressure on the banks' asset portfolios. SMN's oil-related lending is almost entirely in OSVs, whereas for SR it is around 60%, and we expect loan impairment charges (LICs) to largely be contained to this sub-segment. SR's lending book is concentrated in south-west Norway, the primary base for the oil industry, making the bank sensitive to more widespread contagion from potential oil price volatility and reduced activity.

A significant property price correction is a key sensitivity for the banks. Fitch does not expect such a scenario to lead to significant deterioration of the quality of the banks' retail lending, although reduced consumption would likely negatively affect their SME portfolios. SNN is less exposed to this risk, due to lower house prices in north Norway than elsewhere in the country and a large public-sector presence in that region.

The Sparebanken have healthy pre-impairment profitability and the regional franchises support stable revenue generation. Net interest income, with healthy margins, is the main source of revenue, but the banks are also looking to strengthen fee income from ancillary products such as insurance, wealth management and real-estate brokerage. Cost-efficiency is acceptable, with cost-to-income ratios between 44% and 52% in 1H18.

LICs for the Sparebanken have averaged below 20% of pre-impairment profitability in recent years. Fitch expects that for SR and SMN, the material part of their problem portfolio restructuring has been completed, and therefore LICs should be lower in 2018 than in 2017, and remain low in 2019.

Fitch has positively reassessed its view of SR's capitalisation, and is of the opinion that the Sparebanken's capital adequacy ratios compare well with those of international peers. Their Fitch Core Capital (FCC) ratios were between 15.5% and 16.4% at end-June 2018, despite Norwegian risk-weight floors. Leverage is low in a European context, with tangible equity/ tangible assets ratios of between 8.8% and 11.1%.

Like most Nordic banks, the Sparebanken rely on wholesale funding to varying degrees. The Sparebanken have maintained access to domestic and international funding markets, particularly for covered bonds through SpareBank 1 Boligkreditt (S1B), a joint covered bonds funding vehicle for member banks of the Alliance group. SR has recently set up its own covered bond vehicle and this is now the main source of covered bond funding for the bank. We expect the banks to retain large liquidity portfolios to mitigate refinancing risk.

The 'F2' Short-Term IDRs of SR and SMN, map to the lower of the two options for the 'A-' Long-Term IDRs. Fitch believes the banks have sound funding and liquidity, but their liquidity is not notably better than their rating levels would suggest.

SUPPORT RATING AND SUPPORT RATING FLOOR

The Support Ratings (SRs) of '5' and Support Rating Floors (SRFs) of 'No Floor' reflect Fitch's view that senior creditors of the Sparebanken cannot rely on receiving full extraordinary support from the sovereign in the event of them becoming non-viable. The EU's Bank Recovery and Resolution Directive (BRRD) 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, and it is Fitch's expectation that this legislation will be transposed into Norwegian law in the short term.

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

SUBORDINATED DEBT

SMN's and SR's subordinated debt instruments are rated one notch below the banks' respective VRs 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.

RATING SENSITIVITIES

IDRS, VRS AND SENIOR DEBT

The Sparebanken's ratings are primarily sensitive to deteriorating asset quality, particularly if there is another oil price shock leading to high unemployment and deterioration in CRE exposure, and if the banks are unable to absorb losses through earnings. They are also sensitive to a severe house price correction, which would likely lead to lower consumption impacting on SME portfolios. Either scenario would likely be followed by difficulties in obtaining competitively priced funding.

The Stable Outlooks on the Sparebanken's ratings reflect Fitch's expectation that the operating environment in Norway will remain strong, with LICs contained largely to the OSV segment. We expect the banks to further reduce their single-name concentration, and that they will continue to strengthen capital ratios and maintain healthy liquidity buffers.

For SMN and SR, positive rating pressure could in the medium term result from sustained asset-quality improvements, most likely through the successful restructuring of the OSV portfolios. For SNN, an upgrade is unlikely due to its already high ratings in the context of its company profile and geographical and lending concentration. The Sparebanken's structural reliance on wholesale funding means unmitigated weakening of access to capital markets would also be negative for their ratings.

SUPPORT RATING AND SUPPORT RATING FLOOR
An upgrade of the Sparebanken's SRs or upward revision of their SRFs would be contingent on a positive change in Norway's propensity to support its banks. This is highly unlikely, in Fitch's view.

SUBORDINATED DEBT
The ratings of the subordinated debt issued by SMN and SR are primarily sensitive to a change in the VRs from which they are notched. The securities' ratings are also sensitive to changes in Fitch's assessment of loss severity or non-performance risk relative to that captured in the banks' VRs, although these are unlikely.

The rating actions are as follows:

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 '5'
Support Rating Floor affirmed at 'No Floor'
Senior unsecured debt affirmed at 'A-'/'F2'
Subordinated debt affirmed at 'BBB+'

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 '5'
Support Rating Floor affirmed at 'No Floor'
Senior unsecured debt affirmed at 'A-'/'F2'
Subordinated debt affirmed at 'BBB+'

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 '5'
Support Rating Floor affirmed at 'No Floor'
Senior unsecured debt affirmed at 'A'/'F1'

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Additional information is available on www.fitchratings.com

Applicable Criteria
Bank Rating Criteria (pub. 22 Jun 2018)
https://www.fitchratings.com/site/re/10034713