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22 March 2021

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RATINGS

SpareBank 1 SR-Bank ASA

LT Senior Unsecured	A1
LT Bank Deposits	A1
Baseline Credit Assessment	baa1
LT CR Assessment	A1(cr)
ST CR Assessment	P-1(cr)

SpareBank 1 SMN

LT Senior Unsecured	A1
LT Bank Deposits	A1
Baseline Credit Assessment	baa1
LT CR Assessment	A1(cr)
ST CR Assessment	P-1(cr)

SpareBank 1 Ostlandet

LT Senior Unsecured	Aa3
LT Bank Deposits	Aa3
Baseline Credit Assessment	a3
LT CR Assessment	Aa3(cr)
ST CR Assessment	P-1(cr)

SpareBank 1 Nord-Norge

LT Senior Unsecured	Aa3
LT Bank Deposits	Aa3
Baseline Credit Assessment	a3
LT CR Assessment	Aa3(cr)
ST CR Assessment	P-1(cr)

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SpareBank 1 SR-Bank, SpareBank 1 SMN, SpareBank 1 Ostlandet, SpareBank 1 N-N

SpareBank 1 Alliance banks' 2020 profitability remains above EU banks' average, despite higher provisions

On February 11 2021, the four biggest lenders in Norway's SpareBank 1 Alliance (SpareBank 1 SR-Bank, SpareBank 1 SMN, SpareBank 1 Ostlandet) reported a 28.5% year-on-year decline in their combined net profit for 2020. Despite net profits decreasing by almost one third, the banks' average return on equity of 9.8% remained significantly above that of their European peers. Moreover provisions in most cases fell in Q2 and Q3, indicating that a recovery is on the way during 2021 as provisions reach pre-pandemic levels. The deterioration reflected a surge in COVID-19-related loan loss provisions during the first quarter, as well as low oil prices and margin pressure as a result of cuts in the central bank interest rate. Pandemic-related government support, which helped Norway maintain a relatively strong economic performance, provided some counterbalancing uplift.

Combined net profit drops, but returns still compare well internationally. The banks' combined profit fell to NOK6.9 billion (€683 million) in 2020 from NOK 9.6 billion the previous year. However, their average return on equity (RoE) of 9.8% remained comfortably above the EU average of 5.2% at end-2019, prior to the coronavirus outbreak. SpareBank 1 Nord-Norge was the best performing bank in the SpareBank 1 Alliance, with an RoE of 12.6%.

Oil-exposed banks' asset quality and profitability fell furthest. SpareBank 1 SR-Bank and SpareBank 1 SMN reported higher provisions and lower profitability than their peers. This reflects their higher exposure to the oil sector, which was hit by a sharp drop in oil prices as the coronavirus pandemic halted much economic activity. SpareBank 1 SR-Bank's profitability fell furthest during 2020, with a reported a RoE of 6.4% vs 14% in 2019. We expect both banks' performance to improve in 2021 thanks to a restructuring of their oil related portfolios and an uptick in economic activity.

Costs decrease further. The largest Alliance banks' superior profitability is down to their high level of efficiency which has improved further. The underlying operating costs for three out of the four alliance banks fell by at least 1% during 2020, while efficiency ratios (excluding one-offs) improved by at least 0.4%. SpareBank 1 Nord-Norge achieved the biggest improvement, with its adjusted efficiency ratio declining by 1.1% to 43.7%. We expect efficiency to improve further as the banks implement cost cutting plans.

Capital ratios remain robust. The four banks' Common Equity Tier 1 (CET1) ratio reached an all-time high in 2020, reinforcing our view that their loan loss absorption capacity is robust. SpareBank 1 SR-Bank and SpareBank 1 SMN both had a CET1 ratio of 18.3% at end 2020, the highest of the peer group.

Combined net profit drops but returns still compare well internationally

On 11 February 2021, the SpareBank 1 Alliance's four largest members – SpareBank 1 SR-Bank (SR-Bank), SpareBank 1 SMN, SpareBank 1 Ostlandet and SpareBank 1 Nord-Norge – reported a combined net profit of NOK6.9 billion (€683 million) for 2020, down 28.5% compared with 2019. Despite net profits decreasing by almost one third, the banks' average return on equity of 9.8% remained significantly above that of their European peers. Moreover provisions in most cases fell in Q2 and Q3, indicating that a recovery is on the way during 2021, as provisions reach pre-pandemic levels.

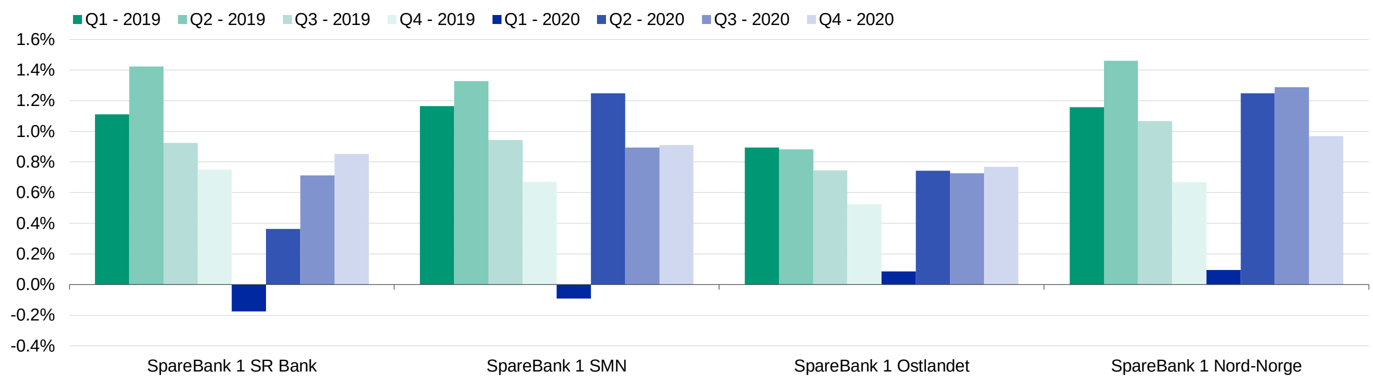
The decline primarily reflects a significant increase in loan loss provisions as the banks revised their expected credit losses higher in response to Norway's coronavirus-induced economic slowdown.

The reported figures for all four banks include one-off contributions in both 2019 and 2020 from the 2019 merger of the SpareBank 1 Alliance's insurance subsidiary, Fremtind Forsikring AS, with Norway's DNB Bank. Since these contributions were larger in 2019 than in 2020, the banks' 2020 earnings excluding one-offs were down by a more moderate 27.6%. Their underlying average return on equity (RoE) of 8% remained comfortably above the European Union (EU) average of 5.2% at end-2019, before the coronavirus outbreak.

SpareBank 1 Nord-Norge was the best performing bank in the SpareBank 1 Alliance in 2020, with profits down by only 10% during the year, and an RoE of 10% excluding one offs. The bank's reported RoE was 12.6%, in-line with its long-term target of at least 12%. During 2020, the bank reinforced its position as the dominant bank in northern Norway for retail and SME loans, despite strong competition.

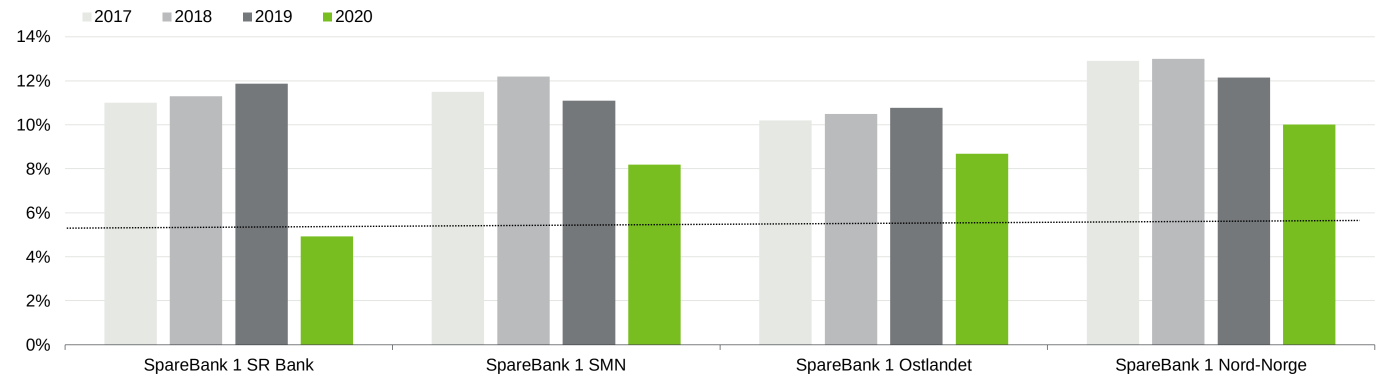
Exhibit 1

Net profits declined during 2020 due to higher provisions in the first half of the year...
(Net income, NOK million)



** 2019 and 2020 reported figures are net of the one-off contribution of Fremtind Forsikring AS*
Source: Company reports, Moody's Investors Service

Exhibit 2
...but return on equity remains above the pre-coronavirus EU average of 5.2%
(Return on Equity, %)



**2019 and 2020 reported figures are net of the one-off contribution of Fremtind Forsikring AS*
Source: Company reports, Moody's Investors Service

Oil-exposed banks' asset quality and profitability fell furthest

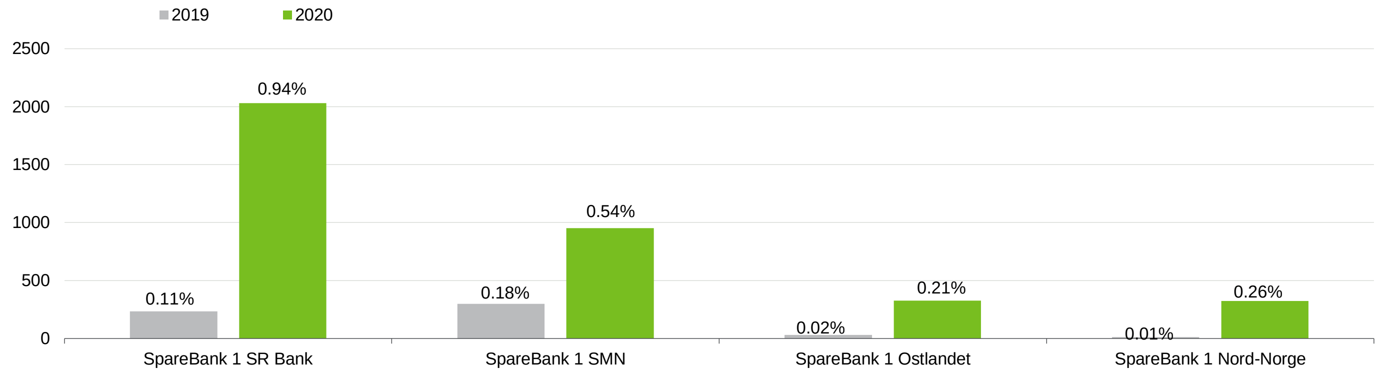
SR-Bank's profitability fell furthest during 2020, with its adjusted RoE more than halving to 4.9% from 11.9% in 2019. The decline reflected a sharp increase in provisions to 0.94% of gross loans from just 0.11% the previous year. The bulk of the bank's loan losses relate to its oil & gas and offshore lending book, which includes some of the bank's largest borrowers. Although the bank has actively reduced its exposure to these sectors, which were hit hard in 2020 by a coronavirus-driven slump in oil prices, they still accounted for approximately 3% of its total gross loans at the end of 2020.

SpareBank 1 SMN reported the second highest level of loan losses at 0.54% of gross loans (up from 0.18% in 2019), of which more than half related to the oil and offshore sector. Unlike its peers, the bank booked higher provisions in Q3 and Q4 than in the first half of the year, reflecting credit losses related to specific corporate clients. Nevertheless, SpareBank 1 SMN reported an RoE of 8.2% (adjusted for one offs) for the year, reflecting strong fee and commission income from "product companies" – specialist subsidiaries offering fee-based services such as accounting.

Credit losses at SpareBank 1 Ostlandet and SpareBank 1 Nord-Norge were largely model-generated rather than linked to specific borrower defaults. As a result we expect the banks to release some of the associated provisions over the next 12-18 months. Loan losses for both of these banks remained quite low in 2020 at 0.21% and 0.26% of gross loans respectively, but were still up from the very low levels reported in 2019.

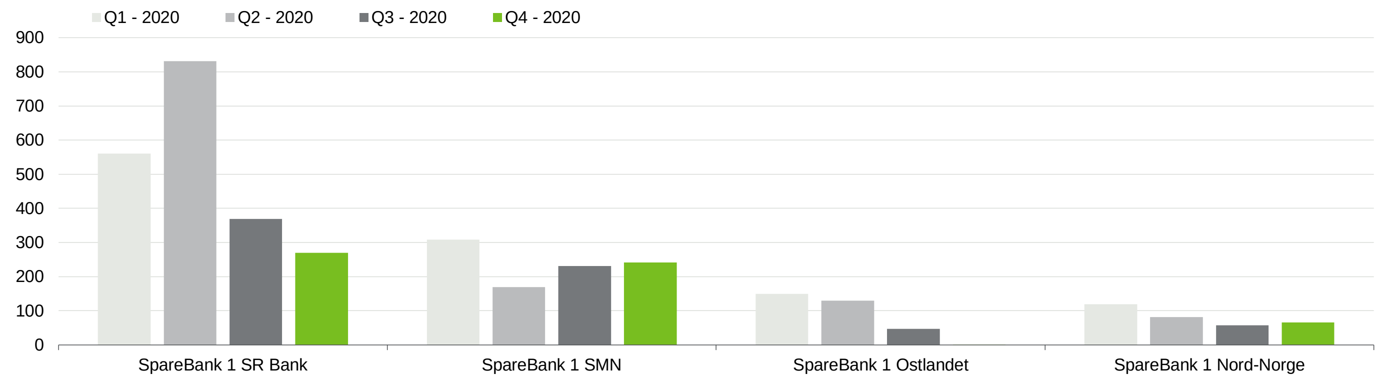
We expect the banks' performance to improve in 2021, as oil-related exposures have been restructured and the sector benefits from a pick up in overall economic activity.

Exhibit 3
Provisions were higher for the Alliance banks with exposure to the oil and offshore sector...
(Loan loss provisions, NOK million)



** percentage figures represent loan losses as % of gross loans including loans transferred to the covered bond companies.*
Source: Company Reports, Moody's Investors Service

Exhibit 4
...but provisions also varied amongst quarters
(Loan loss provisions, NOK million)



Source: Company Reports, Moody's Investors Service

Costs decrease further

The underlying operating costs for three out of the four alliance banks fell by at least 1% during 2020, reinforcing their already strong cost to income (efficiency) ratios. We expect efficiency ratios to improve further for all four banks as they push through cost cutting initiatives and increase earnings generation through their product companies. Ongoing investments in digitalization will partly offset these efficiency gains.

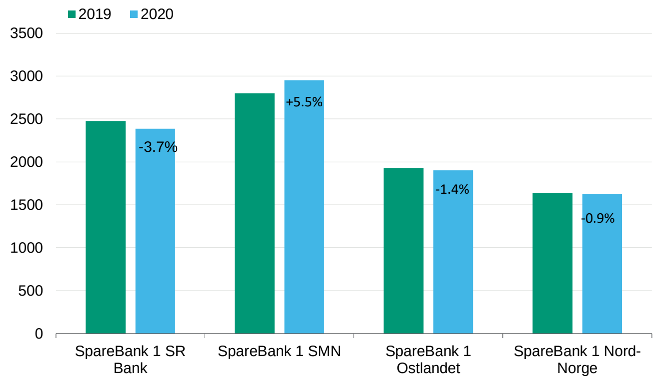
SR-Bank achieved the biggest efficiency improvement in 2020, with costs falling 3.7%. However, the bank's reported efficiency ratio increased marginally by 0.4% to 38.3% due to lower income and higher level of one-offs in 2019. Net of one off income items, the bank's efficiency ratio improved by 0.3% during 2020 to 40.5%, from 40.8%, despite lower revenues highlighting the bank's efforts towards tight cost control. The majority of SR-Bank's cost savings came from lower employee bonus payments, in line with its reduced profitability, as well as a coronavirus-related drop in staff travel expenses.

SpareBank 1 Nord-Norge's costs fell by almost 1% in 2020, while its underlying efficiency ratio (net of one income offs) improved by 1.1 percentage points to 43.7%. The bank has announced the closure of 16 of its 35 branches in northern Norway, targeting annual savings of approximately NOK 40 million. The bank also plans to transfer another 4 branches to Helgeland Sparebank, which it has formed a strategic partnership with[1]

In contrary to its alliance peers, SpareBank 1 SMN's costs increased by 5.5% during 2020, reflecting wage growth, higher digitalization costs and reorganisation costs, resulting into an increase to its efficiency ratio by 1.7% to 47%. SpareBank 1 SMN has launched an efficiency drive designed to cut annual costs by NOK200 million through a simplified distribution structure and better co-ordination of support functions. The plan will lead to a reduction in the number of full time employees in 2021. Net of reorganisation provisions expenses grew more moderately by 2.7%. The bank's efficiency ratio net of one off items improved by 0.6% at 48.3%.

Exhibit 5

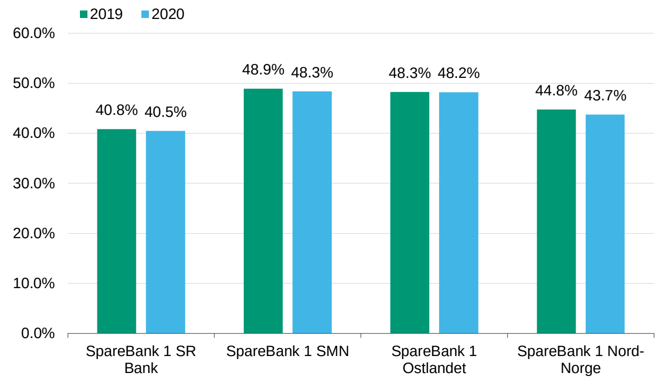
Costs decreased further for most of the large Alliance banks...
(Total operating costs, NOK million)



Source: Company Reports, Moody's Investors Service

Exhibit 6

...resulting into improved efficiency ratios
(Cost to Income ratio, %)



**reported figures are net of the one-off contribution of Fremtind Forsikring AS*
Source: Company Reports, Moody's Investors Service

Capital ratios remain robust

All four banks reported capital buffers significantly above both regulatory requirements and their own targets. Their capital cushions have widened as a result of a reduction in minimum regulatory requirements in response to the coronavirus outbreak, with the countercyclical buffer falling to 1% from 2.5%. Although Norway's central bank will not consider increasing the buffer requirement until the end of the first quarter of 2021, the systemic buffer rose by 1.5% to 4.5% in December 2020, brining minimum capital requirements to pre-crisis levels.

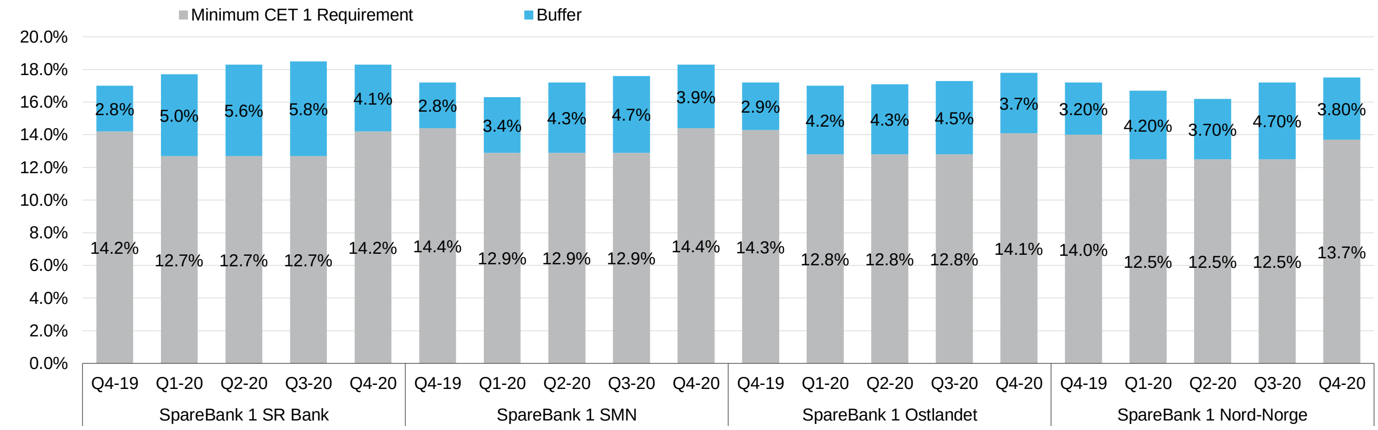
At the end of 2020, SR-Bank and SpareBank 1 SMN reported the highest core equity tier 1 (CET 1) ratio of 18.3%, 4.1 and 3.9% percentage points respectively above the regulatory minimum levels of 14.2% and 14.4%.

We expect the larger SpareBank 1 Alliance banks to maintain very strong buffers in the months ahead, given the persistently uncertain operating environment and our expectation that they will comply with regulatory guidance. Our view takes into account the banks' upcoming dividend payments, which are in line with regulatory guidance.

In January 2021, Norway's Ministry of Finance lifted a nine-month dividend suspension put in place during the coronavirus pandemic, but said it expects banks to keep total dividends within a maximum of 30% of cumulative annual profits for the years 2019 and 2020 until 30 September 2021.

Exhibit 7

The banks have a significant capital cushion over and above minimum requirements



Source: Company Reports, Moody's Investors Service

Peer Group:

» SpareBank 1 SR-Bank ASA

» SpareBank 1 SMN

» SpareBank 1 Ostlandet

» SpareBank 1 Nord-Norge

Credit Opinions:

» SpareBank 1 SR-Bank ASA - February 2021

» SpareBank 1 SMN - January 2021

» SpareBank 1 Ostlandet - September 2020

» SpareBank 1 Nord-Norge - September 2020

Endnotes

1 https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC_1246141).

REPORT NUMBER 1267554

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