

**Credit Opinion: SpareBank 1 SR-Bank**

**Sparebanken Rogaland**

Stavanger, Norway

**Ratings**

Category	Moody's Rating
Outlook	Stable
Bank Deposits	Aa3/P-1
Bank Financial Strength	C+
Issuer Rating	Aa3
Senior Unsecured	Aa3
Subordinate	A1
Jr Subordinate	A1
Preferred Stock	A2

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**Key Indicators**

**Sparebanken Rogaland**

	[1]2007	2006	2005	2004	2003	5-Year Avg.
Total assets (NOK billion)	88.03	85.04	67.24	59.14	52.64	[2]11.90
Total assets (EUR billion)	10.83	10.36	8.42	7.18	6.27	--
Total capital (NOK billion)	7.19	7.29	6.17	4.87	4.69	[2]9.43
Return on average assets	1.04	1.23	1.36	1.10	1.06	1.07
Recurring earnings power [3]	1.05	1.17	1.44	1.61	1.84	1.50
Net interest margin	1.42	1.57	1.87	2.14	2.20	2.00
Cost/income ratio (%)	57.30	57.24	52.74	51.24	45.72	49.68
Problem loans % gross loans	0.41	0.42	0.75	1.08	1.73	1.26
Tier 1 ratio (%)	7.06	7.39	8.98	9.09	9.11	8.36

[1] As of March 31. [2] Compound annual growth rate. [3] Preprovision income % average assets.

**Opinion**

**SUMMARY RATING RATIONALE**

Moody's assigns a Bank Financial Strength Rating (BFSR) of C+ to SpareBank 1 SR-Bank (formerly Sparebanken Rogaland), which translates into a Baseline Risk Assessment of A2. The BFSR reflects SR-Bank's dominant market position, good risk management and improved earning-generation capacity. The bank is the leading player in south-western Norway, where it benefits from strong local brand name recognition. In the area, SR-Bank has over 40% market shares for retail and SME customers. Strategy is based on regional franchise and membership of the SpareBank 1 Group (also known as SpareBank 1 Alliance). Particular focus areas are cross-selling, profitability and risk profile. This has led to successful, but gradual, penetration of the wealth management market (life insurance, mutual and pension funds).

The bank benefits from being part of the SpareBank 1 Group, created in 1996, which has provided member banks with a stronger brand, more sophisticated products and cost synergies. Although the member banks have retained their local brandings, they continue to learn from each other's best practices. The successful restructuring of the

SpareBank 1 Group has become a strong positive contributor to its owners' financials.

The global local currency deposit rating of Aa3 for Sparebanken Rogaland is supported by the bank's own A2 Baseline Risk Assessment and the Aaa local currency deposit ceiling of Norway, which is considered the underlying support provider. As a result of Rogaland's importance to its region and the region's importance to the national economy of Norway, Moody's assesses a very high probability of government support for the bank in the event of a stress situation. The bank also benefits from a low probability of support from the SpareBank 1 Alliance.

### **Credit Strengths**

- Strong regional market position and brand recognition in central Norway
- Strategic alliance with other Norwegian savings banks aids efficiency, product offering, staff and management quality and IT through shared operations and active benchmarking
- Comprehensive risk management practices and systems have lowered risk profile
- Efficiency indicators are better than those of other SpareBank 1 Group members
- Sound capitalisation supports growth

### **Credit Challenges**

- Continued top line growth in light of margin pressure
- Concentration risk remains, however mitigated by good collaterals
- Similar to other Norwegian banks, liquidity remains tight by international standards

### **Rating Outlook**

The outlook on all ratings is stable.

### **What Could Change the Rating - Up**

Upward movement of the BFSR rating is unlikely in the short term, but could over time be achieved on the back of improved liquidity and further improvement in the risk profile in terms of concentrations.

SR-Bank's Global Local Currency Rating may be upgraded if a) the bank's BFSR is upgraded, b) the support coming from the coop group is substantially increased, and/or c) systemic support is increased.

### **What Could Change the Rating - Down**

The BFSR could be negatively affected by any deterioration in liquidity or worsening credit quality of the large customers; neither is likely given current strategy and economic conditions.

SR-Bank's Global Local Currency Deposit Rating would be downgraded in case that a) the BFSR is downgraded, and/or b) in the unlikely case of a decline in Moody's view of the probability of systemic support for the bank.

### **Recent Results and Developments**

In April 2007, the banks' long- and short-term deposit ratings were upgraded to Aa3/Prime 1 from A2/Prime 1 respectively due to the implementation of joint-default analysis.

SR-Bank reported net profit of NOK223 million (EUR27 million) for the first quarter of 2007, compared to NOK200 million for Q1/2006. Both net interest and commission income increased. Growth in lending volumes compensated for lower interest margin that stood at 1.35% compared to 1.59% in Q1/2006. The cost/income ratio for the quarter was 55%. At 31 March 2007, total assets amounted to NOK88 billion (EUR11 billion). Tier 1 and capital ratios reached 7.1% and 10.5%, respectively. The public rights primary capital certificate issue, that was carried out in March, will improve capital adequacy figures starting from the second quarter of 2007.

### **DETAILED RATING CONSIDERATIONS**

Detailed considerations for SpareBank 1 SR-Bank currently assigned ratings are as follows:

## Bank Financial Strength Rating

Moody's assigns a C+ BFSR to SpareBank 1 SR-Bank. The key positive drivers behind the assigned rating are strong regional market position and brand recognition in central Norway, and the strategic alliance with other Norwegian savings banks. In addition good efficiency and capitalization indicators are influential factors on the assigned BFSR rating.

The key negative drivers behind the assigned BFSR rating are SR Bank's operations in a limited geographical area as well as a low score in the liquidity ratio.

Finally, Moody's believes that a BFSR rating of C+ to be a correct estimation of the bank's current financial strength, given not only the assessment of historical trends and strategic direction, but also due to the scorecard outcomes on qualitative and quantitative factors which are C+ and C+, respectively.

### Qualitative Factors (50% weighting)

#### Factor 1: Franchise Value

Trend: Neutral

SR-Bank has a solid, defensible franchise in south-western Norway, characterised by a loyal customer base, high regional market shares and stable earnings. Nevertheless, the bank operates in a limited geographic area. We expect the bank will be able to maintain a leading position in the region due to tight relations with its clients, a broad product offering and its ability to respond to the shifting demands of the market.

#### Factor 2: Risk Positioning

Trend: Improving

SR-Bank's management practices and systems provide comprehensive guidelines and tools for risk-taking, which will reflect the overall risk culture of the organisation.

SR-Bank enjoys a solid risk profile overall and good economic capitalisation. However, there are concentrations by customer sector and by geographic region; these represent possible sources of vulnerability. We nevertheless take comfort in the high quality of the largest exposures. Provisioning is adequate. In addition, compared to European peers, SR-Bank has less liquid assets on balance sheet. That said, the bank's liquidity management is well developed, which is typical for a Norwegian bank as liquidity has historically been tight. Liquidity measures should also benefit from planned issuance of covered bonds going forward. Furthermore, SR-Bank has only a limited appetite for market risk.

#### Factor 3: Regulatory Environment

Trend: Neutral

All Norwegian banks are subject to the same score on the regulatory environment. This factor does not address bank-specific issues; instead, it evaluates whether or not regulatory bodies are independent and credible, demonstrate enforcement powers and adhere to global standards of best practices for risk control. The regulatory environment for Norway is solid as the country, despite not being part of EU, complies with all EU practices. The supervisor actively benchmarks the Norwegian banks.

#### Factor 4: Operating Environment

Trend: Improving

The adjusted score for Norway's operating environment is A-. In our opinion mainland GDP should be a better proxy for economic stability because of the segregation of oil income from the public finances that has been in place for the last decade. Regarding the time horizon, we also think that the last 5 year standard deviation would be a better indicator due to the material changes in economic policies after the crisis of the early 1990's. These two factors considered together lead to an A- adjusted operating environment score.

### Quantitative Factors (50% weighting)

#### Factor 5: Profitability

Trend: Improving

In our analysis, we take comfort from the improving trend when looking at profitability ratios and expect Sparebanken 1 SR to be able to at least maintain the current level of profitability going forward through good efficiency, the focus on cross-selling, strong asset quality and the positive contribution from the SpareBank 1 Group. The C+ score on profitability is in line with the BFSR we have on the institution.

#### Factor 6: Liquidity

Trend: Improving

While liquidity is structurally tight in Norway, it is to a degree balanced by good liquidity management. In addition, we note that SR-Bank aims to issue covered bonds jointly with other members of the SpareBank 1 Group. This should have a positive effect on the liquidity score even in the short term. The D+ score for liquidity, although lower than European counterparts, is in line with other Norwegian banks.

#### Factor 7: Capital Adequacy

Trend: Neutral

SR-Bank's capital adequacy compares well to its peer group and remains a positive ratings factor.

#### Factor 8: Efficiency

Trend: Neutral

The bank's strong efficiency ratios are in line with its peers. In a competitive market such as Norway, we continue to see efficiency as key for the financial flexibility of the institution.

#### Factor 9: Asset Quality

Trend: Improving

The high asset quality scores, are a reflection of the continuous improvements of SR Bank's risk management, but also of the current benign economy of Norway - hence subsequent numbers may not remain at these record levels.

### **Global Local Currency Deposit Rating (Joint Default Analysis)**

Moody's assigns a global local currency deposit rating of Aa3 to SpareBank 1 SR-Bank. The rating is supported by the A2 Baseline Risk Assessment and the Aaa local currency deposit ceiling of Norway, which is considered the underlying support provider. As a result of the bank's importance to its region and the region's importance to the national economy of Norway, Moody's assesses a very high probability of systemic support for the bank in the event of a stress situation. Further, the bank also benefits from low probability of support coming from the SpareBank 1 Alliance. Finally, the dependence between SR-Bank and SpareBank 1 Alliance is high due to the substantial degree of integration and shared business lines between the two.

### **Notching Considerations**

The rating of any junior obligations should be notched from the fully supported deposit rating.

### **Foreign Currency Deposit Rating**

Foreign Currency ratings are unconstrained given that Norway has a country ceiling of Aaa. SR Bank's foreign currency deposit rating is Aa3.

### **Foreign Currency Debt Rating**

Foreign Currency ratings are unconstrained given that Norway has a country ceiling of Aaa. SR Bank's senior unsecured foreign currency debt rating is Aa3.

### **ABOUT MOODY'S BANK RATINGS**

#### Bank Financial Strength Rating

Moody's Bank Financial Strength Ratings (BFSRs) represent Moody's opinion of a bank's intrinsic safety and soundness and, as such, exclude certain external credit risks and credit support elements that are addressed by



Rating Factors [1]	A	B	C	D	E	Total Score	Trend
<b>Qualitative Factors (50%)</b>						<b>C+</b>	
<b>Factor 1: Franchise Value (20%)</b>						<b>C+</b>	<b>Neutral</b>
<b>Market Share and Sustainability</b>	x						
<b>Geographical Diversification</b>					x		
<b>Earnings Stability</b>		x					
<b>Earnings Diversification [2]</b>							
<b>Factor 2: Risk Positioning (20%)</b>						<b>C-</b>	<b>Improving</b>
<b>Corporate Governance [2]</b>							
- Ownership and Organizational Complexity							
- Key Man Risk							
- Insider and Related-Party Risks							
<b>Controls and Risk Management</b>		x					
- Risk Management		x					
- Controls	x						
<b>Financial Reporting Transparency</b>		x					
- Global Comparability	x						
- Frequency and Timeliness	x						
- Quality of Financial Information			x				
<b>Credit Risk Concentration</b>	--	--	--	--	--		
- Borrower Concentration	--	--	--	--	--		
- Industry Concentration	--	--	--	--	--		
<b>Liquidity Management</b>			x				
<b>Market Risk Appetite</b>		x					
<b>Factor 3: Regulatory Environment (5%)</b>	-	-	-	-	-	-	<b>Neutral</b>
<b>Factor 4: Operating Environment (5%)</b>						<b>B+</b>	<b>Improving</b>
<b>Economic Stability</b>			x				
<b>Integrity and Corruption</b>	x						
<b>Legal System</b>	x						
<b>Financial Factors (50%)</b>						<b>C+</b>	
<b>Factor 5: Profitability (7.9%)</b>						<b>C+</b>	<b>Improving</b>
<b>PPP % Avg RWA</b>			2.13%				
<b>Net Income % Avg RWA</b>		1.84%					
<b>Factor 6: Liquidity (7.9%)</b>						<b>D+</b>	<b>Improving</b>
<b>(Mkt funds-Liquid Assets) % Total Assets</b>					31.42%		
<b>Liquidity Management</b>			x				
<b>Factor 7: Capital Adequacy (7.9%)</b>						<b>B+</b>	<b>Neutral</b>
<b>Tier 1 ratio (%)</b>		8.49%					
<b>Tangible Common Equity % RWA</b>	7.96%						
<b>Factor 8: Efficiency (3.5%)</b>						<b>B</b>	<b>Neutral</b>
<b>Cost/income ratio</b>		53.74%					
<b>Factor 9: Asset Quality (7.9%)</b>						<b>B+</b>	<b>Improving</b>
<b>Problem Loans % Gross Loans</b>	0.75%						
<b>Problem Loans % (Equity + LLR)</b>		11.38%					
<b>Lowest Combined Score (15%)</b>						<b>D+</b>	
<b>Economic Insolvency Override</b>						<b>Neutral</b>	
<b>Total Scorecard Implied BFSR</b>						<b>C+</b>	
<b>Assigned BFSR</b>						<b>C+</b>	

[1] - Where dashes are shown for a particular factor (or sub-factor), the score is based on non public information

[2] - A blank score under Earnings diversification or Corporate Governance indicates the risk is neutral

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