Fitch Ratings

11 Sep 2019 | Affirmation

Fitch Affirms 3 Norwegian Savings Banks; Outlook Stable

Fitch Ratings-Stockholm-11 September 2019:

Fitch Ratings has affirmed the Long-Term Issuer Default Ratings (IDRs) of Sparebank 1 Nord-Norge (SNN) at 'A' of Sparebank 1 SR-Bank (SR-Bank) at 'A-' and of Sparebank 1 SMN (SMN) at 'A-'. The Outlooks are Stable. The Viability Ratings (VR) of SR-Bank and SMN have been affirmed at 'a-' and the VR of SNN at 'a'.

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

Key Rating Drivers

IDRS, VRS AND SENIOR DEBT

SNN's, SMN's and SR-Bank's (collectively Sparebanken) ratings reflect their stable and low-risk business models, healthy profitability, resilient asset quality and sound capital ratios. The ratings also factor in risks from moderate franchises with geographically concentrated loan portfolios, exposures to potentially volatile oil and property prices, and their liquidity management in the context of their reliance on wholesale funding.

SNN's ratings are one notch higher than those of its two peers, reflecting better asset quality metrics, and in particular limited offshore exposure.

Fitch expects the Sparebanken's asset quality to remain strong, driven by their conservative underwriting standards and the stable operating environment. Impaired loans (defined as Stage 3 loans under IFRS9) accounted for between 0.5% and 1.6% of gross loans at end-June 2019. 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.

SR-Bank and SMN operate in regions where contribution from the oil industry is high, but they have decreased their exposure to this sector over the past five years. The share of offshore exposures was 4.5% and 3.0% of gross loans at end-June 2019 for SR-Bank and SMN, respectively. Losses from their exposure to the offshore service vessel (OSV) segment were the drivers of SMN's and SR-Bank's loan impairment charges (LICs) in 2016-18. Despite recent indications of a more favourable economic environment, the OSV segment remains characterised by oversupply, ageing fleets and high fixed costs. This will continue to put pressure on the banks' asset quality, although this is manageable.

A significant property price correction is another key sensitivity for the banks. Fitch does not expect such a scenario to lead to significant deterioration of the quality of the banks' mortgage lending, although reduced consumption would likely negatively affect their SME portfolios. SNN and SR-Bank are less exposed to this risk, due to lower house prices in the north and south-west of Norway compared with the national average.

The Sparebanken's regional franchises and strong client relationships support healthy pre-impairment profitability and stable revenue generation. Net interest income with healthy margins is the main source of revenue, but the banks have also succeeded in strengthening and diversifying fee and commission income from ancillary products such as insurance, accounting services, wealth management and real estate brokerage. Cost-efficiency is acceptable, with cost-to-income ratios between 51% and 41% in 1H19 (adjusted for one-off items).

LICs for the Sparebanken averaged between 0% and 8% of pre-impairment profitability in 1H19. For-Bank and SMN, Fitch expects that the material part of their problem portfolio restructuring has been completed, and LICs should remain low in 2019 and 2020.

The Sparebanken have solid buffers over their minimum regulatory requirements and their capital ratios compare well with those of international peers. The implementation of the EU's capital requirements directive (CRD IV) and regulation (CRR) were incorporated into the EEA Agreement in March 2019 and when fully implemented in domestic regulations these are expected to have a positive impact on the Norwegian banks' ratios as loans to certain SMEs will attract lower risk weights. The common equity Tier 1 capital ratios are expected to increase between 1.9pp and 2.4pp, based on 2Q numbers (all other things being equal) with the largest positive estimated effect for SMN. The Norwegian FSA has communicated that it intends to increase the systemic risk buffer requirement from 3.0% to 4.5% and introduce temporary Pillar-1 risk weight floors for residential and commercial real estate loans. The banks' leverage ratios are strong compared with many European peers, with regulatory leverage ratios of around 7.5%.

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-Bank has continued to decrease loans transferred to S1B to increasingly use its own covered bond vehicle. We expect the banks to retain large liquidity portfolios to mitigate refinancing risk.

SR-Bank's and SMN's 'F2' Short-Term IDRs are the lower of two Short-Term IDRs that map to a 'A-' Long-Term IDR, reflecting our 'a-' assessment of the banks' funding and liquidity profile. SNN's 'F1' Short-Term IDR maps to the lower of the two options for the 'A' Long-Term IDRs, also reflecting our 'a-' assessment of SNN's funding and liquidity score.

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 was adopted in Norway on I 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, the Sparebanken are not systemically important banks in Norway.

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-Bank'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 commercial real estate 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 SMEs. 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 largely contained 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-Bank, positive rating pressure could result from sustained asset quality improvements, most likely through the successful and continued restructuring and reduction of their OSV portfolios. For SNN, an upgrade is unlikely due to its already high ratings in the context of its company profile and geographical 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-Bank 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.

ESG Considerations

Unless otherwise disclosed in this section, 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.

SpareBank 1 Nord-Norge; Long Term Issuer Default Rating; Affirmed; A; RO:Sta
; Short Term Issuer Default Rating; Affirmed; F1
; Viability Rating; Affirmed; a
; Support Rating; Affirmed; 5
; Support Rating Floor; Affirmed; NF
----senior unsecured; Long Term Rating; Affirmed; A
----senior unsecured; Short Term Rating; Affirmed; F1

SpareBank 1 SR-Bank; Long Term Issuer Default Rating; Affirmed; A-; RO:Sta
; Short Term Issuer Default Rating; Affirmed; F2
; Viability Rating; Affirmed; a-
; Support Rating; Affirmed; 5
; Support Rating Floor; Affirmed; NF
----senior unsecured; Long Term Rating; Affirmed; A-
----subordinated; Long Term Rating; Affirmed; BBB+
----senior unsecured; Short Term Rating; Affirmed; F2
SpareBank 1 SMN; Long Term Issuer Default Rating; Affirmed; A-; RO:Sta
; Short Term Issuer Default Rating; Affirmed; F2
; Viability Rating; Affirmed; a-
; Support Rating; Affirmed; 5
; Support Rating Floor; Affirmed; NF
----senior unsecured; Long Term Rating; Affirmed; A-
----subordinated; Long Term Rating; Affirmed; BBB+
----senior unsecured; Short Term Rating; Affirmed; F2

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Additional information is available on www.fitchratings.com

Applicable Criteria

Bank Rating Criteria (pub. 12 Oct 2018)

Short-Term Ratings Criteria (pub. 02 May 2019)

Additional Disclosures

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

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