Moody's Investors Service

Credit Opinion: Sparebanken Pluss

Global Credit Research - 16 Aug 2012

Kristiansand, Norway

Ratings

Category	Moody's Rating
Outlook	Stable
Bank Deposits	A2/P-1
Bank Financial Strength	C-
Baseline Credit Assessment	(baa1)
Adjusted Baseline Credit Assessment	(baa1)

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Key Indicators

Sparebanken Pluss (Consolidated Financials)[1]

	[2]**3-12**	[2]**12-11**	[2]**12-10**	[2]**12-09**	[2]**12-08**	**Avg.**
Total Assets (NOK billion)	**40.7**	**40.5**	**36.9**	**35.2**	**30.5**	[3]**7.5**
Total Assets (EUR million)	**5,359.2**	**5,229.1**	**4,731.3**	**4,245.7**	**3,133.1**	[3]**14.4**
Total Assets (USD million)	**7,136.9**	**6,788.1**	**6,347.2**	**6,091.4**	**4,355.1**	[3]**13.1**
Tangible Common Equity (NOK billion)	**2.8**	**2.7**	**2.4**	**2.2**	**2.0**	[3]**8.9**
Tangible Common Equity (EUR million)	**368.0**	**351.5**	**307.4**	**269.0**	**204.1**	[3]**15.9**
Tangible Common Equity (USD million)	**490.0**	**456.3**	**412.4**	**385.9**	**283.7**	[3]**14.6**
Net Interest Margin (%)	**1.3**	**1.3**	**1.3**	**1.3**	**1.6**	[4]**1.3**
PPI / Avg RWA (%)	**2.1**	**1.4**	**1.7**	**2.0**	**1.4**	[5]**1.7**
Net Income / Avg RWA (%)	**1.4**	**0.9**	**1.2**	**1.3**	**0.8**	[5]**1.1**
(Market Funds - Liquid Assets) / Total Assets (%)	**49.8**	**52.1**	**47.5**	**46.0**	**41.5**	[4]**47.4**
Core Deposits / Average Gross Loans (%)	**48.3**	**47.8**	**51.6**	**53.5**	**54.4**	[4]**51.1**
Tier 1 Ratio (%)	**13.3**	**12.5**	**12.8**	**12.4**	**11.4**	[5]**12.5**
Tangible Common Equity / RWA (%)	**12.0**	**11.9**	**11.4**	**11.2**	**10.4**	[5]**11.4**
Cost / Income Ratio (%)	**35.5**	**43.4**	**37.5**	**33.7**	**42.8**	[4]**38.6**
Problem Loans / Gross Loans (%)	**0.5**	**0.5**	**0.7**	**0.5**	**0.9**	[4]**0.6**
Problem Loans / (Equity + Loan Loss Reserves) (%)	**6.3**	**6.3**	**8.2**	**5.4**	**11.3**	[4]**7.5**

Source: Moody's

[1] All ratios are adjusted using Moody's standard adjustments [2] Basel II; IFRS [3] Compound Annual Growth Rate based on IFRS reporting periods [4] IFRS reporting periods have been used for average calculation [5] Basel II & IFRS reporting periods have been used for average calculation

Opinion

SUMMARY RATING RATIONALE

The C-/baa1standalone credit assessment, reflects (i) Sparebanken Pluss' sound local franchise; (ii) its solid retail business; and (iii) sound capital levels. However, the BFSR is constrained by the bank's large exposure to the real-estate sector and its high borrower concentration.

The global local-currency (GLC) deposit rating of A2 is supported by the bank's baa1 standalone credit assessment and the Aaa local-currency deposit ceiling of Norway, which we assume to be the underlying support provider. Given the bank's importance to its region - and the region's importance to the national economy of Norway - Moody's assesses a high probability of systemic support in the event of a stress situation. Consequently, Sparebanken Pluss' GLC deposit rating benefits from a two-notch uplift from its BCA.

Rating Drivers

- Sound market position on the southern coast of Norway

- Good asset quality supported by a good capital buffer albeit significant credit risk concentrations

- Resilient earnings from retail banking operations but increased pressure on profitability in the highly competitive Norwegian market

- High reliance on market funds

Rating Outlook

The outlook is stable on all the bank's ratings.

What Could Change the Rating - Up

An upgrade of the BFSR or the GLC deposit ratings could be triggered by: (i) an improvement in the bank's profitability metrics; or (ii) a reduction in the loan-book concentration.

What Could Change the Rating - Down

The BFSR could be downgraded if there is: (i) any deterioration in asset quality or capitalisation that exceeds Moody's expectations; (ii) any change in the bank's risk profile; or (iii) any indication that the bank cannot sustain its market positions. The GLC deposit rating could be downgraded if: (i) the BFSR deteriorates; or (ii) Moody's current assessment of the probability of systemic support for the bank declines.

DETAILED RATING CONSIDERATIONS

Our detailed considerations for Sparebanken Pluss' currently assigned ratings are as follows.

Bank Financial Strength Rating

The assigned BFSR is in line with the outcome of Moody's bank financial strength scorecard.

Sound Market Position On The Southern Coast Of Norway

Sparebanken Pluss is a regional savings bank with a sound market position on the southern coast of Norway in the counties of Vest-Agder and Aust-Agder. The bank is characterised by high retail and SME market shares that are underpinned by a loyal customer base. Moody's estimates that the bank has a market share of approximately 14% in lending and approximately 20% in deposit-taking in the counties where it operates (as per Statistics Norway and Annual reports). In addition, Sparebanken Pluss is the market leader in providing financial services to Christian organisations in Norway, largely as a result of its agreement with the Norwegian Christian Purchasing Organisation (KNIF). Though the bank enjoys some geographical diversification through its position in this niche market, the bank is a marginal national player.

Sparebanken Pluss operates as an independent savings bank, using an open-architecture business model to offer financial services including life and non-life insurance products (Tennant Forsikring, a subsidiary of Gjensidige Forsikring). In addition, Sparebanken Pluss jointly owns a real-estate brokerage company (Plussmegleren, 25%) and established its own covered bond company, Pluss Boligkreditt AS, in January 2009 for funding purposes.

Although we acknowledge Sparebanken Pluss' strong presence in its operational region, the franchise value score is constrained by its low geographical diversification. We also expect that it will be difficult for the bank to retain and gain market shares, due to the fierce competition with for example larger banks such as DNB and Nordea in southern Norway.

Resilient Earnings From Retail Banking Operations But Increased Pressure On Profitability In The Highly Competitive Norwegian Market

Sparebanken Pluss is reliant on net interest income, which represents roughly 90% of its operating income at end-December 2011. Net interest income has been supported by relatively steady loan-book growth in recent years. At end-December 2011, the loan book consisted of approximately 62% loans to retail customers, with loans to corporates - mostly SMEs - representing approximately 38% of total loans. Of total retail lending approximately 50% is transferred to the bank's covered bond company.

Sparebanken Pluss' efficiency as measured by its cost-to-income ratio has historically been among the best in the Nordic region, consistently keeping the ratio at good levels (below 40%) in recent years. According to Moody's calculations, the cost-to-income ratio in 2011 increased to 43% compared to 37.5% in 2010 reflecting lower income in 2011 and a NOK 20 million one-off reductions in expenses due changes in pension rules (AFP) in 2010.

Similar to most of its European peers, Sparebanken Pluss experienced volatility in its earnings as a result of variations in the value of its financial investments mainly reflecting spread movements on the bank's fixed-income securities. At year-end 2011 the bank reported a loss of NOK 31 million for this item, whilst in 2010 they reported a gain of NOK 33 million (of which NOK 20 million was a one-off gain from shares in Nordito A/S). Moody's notes that loan loss provisions are appreciably lower than most of its Norwegian rated peers, and at end-December 2011 loan provisions stood at NOK20 million representing a decrease of 20% year-on-year.

At end-March 2012 Sparebanken Pluss reported a pre-provision income of NOK 120 million, up 46% year-on-year, following an increase in net interest income of 17% and gains on the bank's securities portfolio.

Sparebanken Pluss' profitability score is in line with those of most its Nordic peers. However, we believe profitability will remain under pressure going forward; especially as fierce competition in southern Norway is compressing margins.

High Reliance On Market Funds

Sparebanken Pluss' liquidity is underpinned by a strong deposit base, which accounts for approximately 41% of total funding; with retail deposits representing around 43% of total deposits. At year-end 2011 the deposit-to-gross loan ratio was 46%, meaning that the bank relies on market funding, most of which comes from the domestic market.

In January 2009, Sparebanken Pluss established its wholly-owned covered bond company, Pluss Boligkreditt. This provides the bank with an additional source of funding, a factor that Moody's views as credit positive. We expect that covered bonds will remain an important source of funding for Sparebanken Pluss but caution that extensive use of covered bond funding through these structures, whereby prime assets are moved from the bank's balance sheet, might result in the structural subordination of Sparebanken Pluss' unsecured creditors, including depositors. Any significant structural subordination might impact the bank's senior debt and deposit ratings. Furthermore, under the amended guidelines, the central bank will no longer accept securities issued by banks as collateral for loans from February 2012, although covered bonds will continue to be accepted.

At year-end 2011, liquid assets accounted for 16.5% of total assets, comprising cash and deposits with the central bank and the securities portfolio. The portfolio mainly includes senior bonds from the government as well as other issuers and a limited amount of equity investments. We note that these holdings are concentrated on Norwegian securities, which could be a source of vulnerability from a concentration-risk perspective.

In 2011 Sparebanken Pluss issued NOK 4.2 billion senior unsecured funding with maturities ranging between 3-5 years. Furthermore, NOK 1 billion covered bonds with a maturity of 5 years were issued. At end-2011 NOK 9.6 billion of loans were transferred to Pluss Boligkreditt, the mortgage company of Sparebanken Pluss.

Good Asset Quality Supported By A Good Capital Buffer - Albeit Significant Credit Risk Concentrations

Sparebanken Pluss exhibits some industry concentration, with the real estate sector (including construction) representing around 24% of gross loans at year-end 2011. We view this relatively high exposure to a sector that has historically generated high losses for banks as potentially vulnerable. We do however take some comfort from the fact that the loan book comprises approximately 62% retail loans. We however note that around 50% of retail mortgages (29% of total loans) were part of Pluss Boligkreditt's covered pool. Furthermore the single-borrower exposure, as measured by the 20 largest exposures in relation to Tier 1 capital is significant and is constraining the bank's overall risk management score.

We also note that the loan portfolio is relatively unseasoned, reflecting high lending growth (a year-on-year increase of 15.4% in 2008, 7.6% in 2009, 12% in 2010 and around 8.6% in 2011). Nevertheless, problem loans (defined as gross defaulted loans and other loans subject to individual write-downs) accounted for a very low 0.5% of gross loans at end-December 2011, down from 0.7% in 2010 (based on Moody's calculations). Moody's notes that this level is the lowest among rated Norwegian peers of the bank.

While we positively view Sparebanken Pluss' sound asset quality, we caution that the sustained increase in house prices in Norway may have understated the level of impairment because of inflated collateral values. Additionally, household indebtedness has increased in recent years, making customers more vulnerable to interest-rate rises, although overall, unemployment is low in Norway. We believe it will be challenging for Sparebanken Pluss to sustain the very low asset-quality metrics.

We believe that Sparebanken Pluss' capitalisation is sound. At end-December 2011, the Tier 1 and total capital ratios - as calculated under Basel II's standardised approach - were 12.5% and 14.3%, respectively. The bank did not need to increase its capital during the financial crisis, unlike many of its European peers and we assess its current capital buffer to be adequate to withstand potential credit losses. Sparebanken Pluss applies the Basel II standardised approach in calculating its capital adequacy requirement for credit risk. It has stated that it is assessing whether it should apply for IRB approval.

Moody's notes that at end-March 2012 Sparebanken Pluss reported tier 1 and total capital ratio of 13.3%.

Unless otherwise stated all figures are from Sparebank Pluss' full year or interim accounts.

Global Local Currency Deposit Rating (Joint Default Analysis)

Moody's assigns a GLC deposit rating of A2 to Sparebanken Pluss. The rating is supported by its baa1 BCA and the Aaa local-currency deposit ceiling of Norway, which we consider to be the underlying support provider. Given the bank's importance to its region, and the region's importance to the national economy of Norway, Moody's assesses as high the probability of systemic support in the event of a stress situation. We are likely to gradually reduce such unusual support uplift as such support mechanisms are phased out, as banks' stand-alone profiles improve, and as regulators globally consider implementing bank resolution regimes.

Foreign Currency Deposit Rating

The bank's foreign-currency deposit ratings are unconstrained, because Norway has a country ceiling of Aaa. Sparebanken Pluss' foreign-currency deposit rating is A2.

Foreign Currency Debt Rating

The bank's foreign-currency debt ratings are unconstrained, because Norway has a country ceiling of Aaa. Sparebanken Pluss' foreign-currency debt rating is A2.

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 Moody's Bank Deposit Ratings. BFSRs do not take into account the probability that the bank will receive such external support, nor do they address risks arising from sovereign actions that may interfere with a bank's ability to honour its domestic or foreign currency obligations. Factors considered in the assignment of BFSRs include bank-specific elements such as financial fundamentals, franchise value, and business and asset diversification. Although BFSRs exclude the external factors specified above, they do take into account other risk factors in the bank's operating environment, including the strength and prospective performance of the economy, as well as the structure and relative fragility of the financial system, and the quality of banking regulation and supervision.

Global Local Currency Deposit Rating

A deposit rating, as an opinion of relative credit risk, incorporates the BFSR as well as Moody's opinion of any external support. Specifically, Moody's Bank Deposit Ratings are opinions of a bank's ability to repay punctually its deposit obligations. As such, they are intended to incorporate those aspects of credit risk relevant to the prospective payment performance of rated banks with respect to deposit obligations, which includes: intrinsic financial strength, sovereign transfer risk (in the case of foreign currency deposit ratings), and both implicit and explicit external support elements. Moody's Bank Deposit Ratings do not take into account the benefit of deposit insurance schemes which make payments to depositors, but they do recognise the potential support from schemes that may provide assistance to banks directly.

According to Moody's joint default analysis (JDA) methodology, the global local currency deposit rating of a bank is determined by the incorporation of external elements of support into the bank's Baseline Credit Assessment. In calculating the Global Local Currency deposit rating for a bank, the JDA methodology also factors in the rating of the support provider, in the form of the local currency deposit ceiling for a country, Moody's assessment of the probability of systemic support for the bank in the event of a stress situation and the degree of dependence between the issuer rating and the Local Currency Deposit Ceiling.

National Scale Rating

National scale ratings are intended primarily for use by domestic investors and are not comparable to Moody's globally applicable ratings; rather they address relative credit risk within a given country. An Aaa rating on Moody's National Scale indicates an issuer or issue with the strongest creditworthiness and the lowest likelihood of credit loss relative to other domestic issuers. National Scale Ratings, therefore, rank domestic issuers relative to each other and not relative to absolute default risks. National ratings isolate systemic risks; they do not address loss expectation associated with systemic events that could affect all issuers, even those that receive the highest ratings on the National Scale.

Foreign Currency Deposit Rating

Moody's ratings on foreign currency bank obligations derive from the bank's local currency rating for the same class of obligation. The implementation of JDA for banks can lead to high local currency ratings for certain banks, which could also produce high foreign currency ratings. Nevertheless, it should be noted that foreign currency deposit ratings are in all cases constrained by the country ceiling for foreign currency bank deposits. This may result in the assignment of a different, and typically lower, rating for the foreign currency deposits relative to the bank's rating for local currency obligations.

Foreign Currency Debt Rating

Foreign currency debt ratings are derived from the bank's local currency debt rating. In a similar way to foreign currency deposit ratings, foreign currency debt ratings may also be constrained by the country ceiling for foreign currency bonds and notes; however, in some cases the ratings on foreign currency debt obligations may be allowed to pierce the foreign currency ceiling. A particular mix of rating factors are taken into consideration in order to assess whether a foreign currency bond rating pierces the country ceiling. They include the issuer's global local currency rating, the foreign currency government bond rating, the country ceiling for bonds and the debt's eligibility to pierce that ceiling.

About Moody's Bank Financial Strength Scorecard

Moody's bank financial strength model (see scorecard below) is a strategic input in the assessment of the financial strength of a bank, used as a key tool by Moody's analysts to ensure consistency of approach across banks and regions. The model output and the individual scores are discussed in rating committees and may be adjusted up or down to reflect conditions specific to each rated entity.

Rating Factors

Sparebanken Pluss

Rating Factors [1]	A	B	C	D	E	Total Score	Trend
Qualitative Factors (50%)						C-	
Factor: Franchise Value						D+	Neutral
Market Share and Sustainability				x			
Geographical Diversification					x		
Earnings Stability		x					
Earnings Diversification [2]							
Factor: Risk Positioning						D	Neutral
Corporate Governance [2]	--	--	--	--	--		
- Ownership and Org. Complexity	--	--	--	--	--		
- Key Man Risk	--	--	--	--	--		
- Insider and Related-Party Risks	--	--	--	--	--		
Controls and Risk Management		x					
- Risk Management			x				
- Controls	x						
Financial Reporting Transparency			x				
- Global Comparability	x						
- Frequency and Timeliness	x						
- Quality of Financial Information				x			
Credit Risk Concentration	--	--	--	--	--		
- Borrower Concentration	--	--	--	--	--		
- Industry Concentration	--	--	--	--	--		
Liquidity Management					x		
Market Risk Appetite	x						
Factor: Operating Environment						A-	Neutral
Economic Stability		x					
Integrity and Corruption	x						
Legal System	x						
Financial Factors (50%)						C	
Factor: Profitability						C	Weakening
PPI / Average RWA - Basel II			1.72%				
Net Income / Average RWA - Basel II			1.12%				
Factor: Liquidity						E	Neutral
(Market funds - Liqud Assets) / Total Assets					34.50%		
Liquidity Management					x		
Factor: Capital Adequacy						A	Neutral
Tier 1 Ratio - Basel II	12.59%						
Tangible Common Equity / RWA - Basel II	11.49%						
Factor: Efficiency						A	Neutral
Cost Income ratio	38.21%						
Factor: Asset Quality						A	Weakening
Problem Loans / Gross Loans	0.56%						
Problem Loans / (Shareholders' Equity + Loan Loss Reserves)	6.66%						
Lowest Combined Financial Factor Score (15%)						E	
Economic Insolvency Override						Neutral	
Aggregate Score						C-	
Assigned BFSR						C-	

[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.