

**Credit Opinion: Sparebanken Pluss**

Global Credit Research - 04 Jul 2013

Kristiansand, Norway

**Ratings**

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

\* Rating(s) within this class was/were placed on review on July 3, 2013

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**Key Indicators**

**Sparebanken Pluss (Consolidated Financials)[1]**

	[2]3-13	[2]12-12	[2]12-11	[2]12-10	[2]12-09	Avg.
Total Assets (NOK billion)	43.7	44.1	40.5	36.9	35.2	[3]5.6
Total Assets (EUR million)	5,824.8	6,013.5	5,229.1	4,731.3	4,245.7	[3]8.2
Total Assets (USD million)	7,454.5	7,928.1	6,788.1	6,347.2	6,091.4	[3]5.2
Tangible Common Equity (NOK billion)	3.0	3.0	2.7	2.5	2.2	[3]8.0
Tangible Common Equity (EUR million)	404.6	403.6	351.6	326.6	269.1	[3]10.7
Tangible Common Equity (USD million)	517.7	532.0	456.4	438.2	386.0	[3]7.6
Net Interest Margin (%)	1.3	1.3	1.3	1.3	1.3	[4]1.3
PPI / Average RWA (%)	1.4	1.8	1.4	1.8	2.0	[5]1.7
Net Income / Average RWA (%)	0.9	1.2	0.9	1.2	1.3	[5]1.1
(Market Funds - Liquid Assets) / Total Assets (%)	29.1	30.0	37.3	35.1	30.8	[4]32.4
Core Deposits / Average Gross Loans (%)	56.4	56.2	47.6	51.7	53.5	[4]53.1
Tier 1 Ratio (%)	13.2	13.4	12.5	12.8	12.4	[5]12.9
Tangible Common Equity / RWA (%)	12.0	12.0	11.9	12.2	11.2	[5]11.8
Cost / Income Ratio (%)	43.0	36.8	42.8	37.3	33.6	[4]38.7
Problem Loans / Gross Loans (%)	0.6	0.6	0.5	0.7	0.5	[4]0.6
Problem Loans / (Equity + Loan Loss Reserves) (%)	6.3	6.9	6.3	7.8	5.4	[4]6.5

Source: Moody's

[1] All figures and 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

Sparebanken Pluss's C- standalone bank financial strength rating (BFSR), which translates into a standalone credit assessment of baa1, reflects Sparebanken Pluss's well-established local franchise, its solid retail business and sound capital levels. However, the rating is primarily constrained by the bank's large exposure to the real-estate sector, the high borrower concentration in its corporate loan book and its reliance on market funding.

Sparebanken Pluss's global local currency (GLC) deposit rating of A2 benefits from a two-notch uplift from its baa1 standalone credit assessment. 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.

On 3 July 2013 Moody's placed Sparebanken Pluss's A2/P-1 deposit ratings under review for downgrade and affirmed its C- BFSR. The rating action followed the decision of the bank to merge with Sparebanken Sør (deposits A3 stable; BFSR C-/BCA baa2 stable), which was approved by both banks' respective Boards of Trustees on 20 June 2013 and reflected our expectation that the combined bank's rating will largely reflect the two individual banks' credit strengths and challenges.

The review for downgrade on Sparebanken Pluss's ratings primarily reflects (1) our view that Sparebanken Sør's overall standalone credit strength is somewhat weaker than that of Sparebanken Pluss and (2) the potential franchise benefits and synergies that could be derived from the merger, although these positive factors could be counterbalanced by operational risks related to the integration process.

During the review process, we will (1) monitor the progress related to the legal and regulatory hurdles to be overcome before the merger can be implemented; and (2) evaluate potential synergies and operational risks related to the integration process. We expect the review will be concluded in H1 2014, when the merger will be in effect according to plans.

### Rating Drivers

- The merger with Sparebanken Sør, if implemented, will create a strong bank in Southern Norway but will entail some integration risks.
- The bank's franchise is underpinned by a sound market position on the southern coast of Norway.
- It currently shows strong asset quality, although its loan book entails significant credit risk concentrations.
- Despite the recent increase in deposits, its reliance on market funding remains substantial.
- Its profit generation capacity benefits from very good cost efficiency and we see room for further retail lending margin improvement.
- Capital levels are adequate.

### Rating Outlook

Sparebanken Pluss's A2/P-1 deposit ratings are under review for downgrade, as described under the Summary Rating Rationale, above.

### What Could Change the Rating - Up

Although unlikely in the short-term given the rating review for downgrade primarily connected with the merger process, on a standalone basis a rating upgrade could be triggered by: (1) a sustainable improvement in the bank's profitability metrics without an increase in its risk profile; (2) a reduction in the loan-book concentration; and/or (3) bolstered liquidity position and continued good access to capital markets.

### What Could Change the Rating - Down

The ratings could be downgraded if there is: (1) a deterioration in asset quality or capitalisation that exceeds Moody's expectations; (2) an increase in the bank's risk profile, for example as a result of increased exposures to

more volatile sectors; and/or (3) any indication that the bank cannot sustain its market positions. In addition, we believe that downward pressure could be exerted on the ratings due to external factors, such as less supportive macroeconomic environment and/or substantially adverse developments in the Norwegian real-estate market.

In addition, if the merger with Sparebanken Sør is implemented, we expect Sparebanken Pluss's ratings will converge towards those of Sparebanken Sør (A3 stable; C-/baa2 stable). In addition, potential operational risks related to the integration process, which we will assess during the review period, could weight on the combined bank's rating.

## **RECENT CREDIT DEVELOPMENTS**

### **THE MERGER WITH SPAREBANKEN SØR, IF IMPLEMENTED, WILL CREATE A STRONG BANK IN SOUTHERN NORWAY BUT WILL ENTAIL SOME INTEGRATION RISKS**

On 12 March 2013, Sparebanken Pluss and Sparebanken Sør announced their intention to merge. They received approvals from their respective Boards of Directors on 15 May 2013 and from their respective Boards of Trustees on 20 June 2013. Whilst the transaction is still subject to the clearance of further legal and regulatory requirements, including approvals from the Norwegian Ministry of Finance and Competition Authority, we note that the recent approvals received mark key advances towards the implementation of the merger.

Sparebanken Pluss and Sparebanken Sør are similar-sized regional savings banks (total assets of NOK43.7 billion and NOK44.8 billion at end-March 2013, respectively) which both operate in southern Norway. We believe that if implemented, the merger will create a bank with a strong franchise in the region where it will have major market shares. We also view the two banks' operations as broadly aligned, in particular with regard to the retail and SME focus of their operations and their significant usage of covered bond funding to complement their substantial deposit bases. Whilst we expect these similarities will facilitate the establishment of a coherent strategy for the merged bank, during the aforementioned review process on the two banks' ratings we will assess the extent to which synergies can be derived from the merger and also evaluate the operational risk related to the integration process.

For more details, please see Moody's Comments on the Intended Merger of Sparebanken Sør and Sparebanken Pluss: [http://www.moody.com/research/Moodys-Comments-on-the-Intended-Merger-of-Sparebanken-Sr-and-Issuer-Comment-PBC\\_151607](http://www.moody.com/research/Moodys-Comments-on-the-Intended-Merger-of-Sparebanken-Sr-and-Issuer-Comment-PBC_151607)

## **DETAILED RATING CONSIDERATIONS**

### **FRANCHISE VALUE - 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, where Moody's estimates it commands market shares of 17% for lending and 20% for deposits. However, its national market share is limited at around 1% (based on total lending and deposits by county and nationwide according to Statistics Norway). 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).

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, 20%).

Although we acknowledge Sparebanken Pluss's strong presence in its operational region, our assessment of the bank's franchise value is constrained by its low geographical diversification and by our view that competition in southern Norway is fierce and that, like most other regional savings banks, Sparebanken Pluss lacks pricing power against larger banks such as DNB and Nordea.

### **ASSET QUALITY - STRONG, ALBEIT SIGNIFICANT CREDIT RISK CONCENTRATIONS**

Problem loans (defined as gross defaulted loans and other loans subject to individual write-downs) at Sparebanken Pluss accounted for a very low 0.6% of gross loans at end-March 2013 (year-end 2012: 0.6%, year-end 2011: 0.5%); we note that this level is the lowest among rated Norwegian peers of the bank.

The bank's asset quality is underpinned by a relatively large portion of loans to retail customers, mostly mortgages, which comprised approximately 62% of total loans at year-end 2012 (around half of which were part of Pluss Boligkreditt's covered pool).

Nevertheless, Sparebanken Pluss's loan book exhibits some industry concentration, with the real estate sector (including construction) representing around 23% of total loans at year-end 2012. We view this relatively high exposure to a sector that has historically generated high losses for banks as a potential vulnerability. In addition, the bank's corporate book has significant single-borrower exposure, a feature that could heighten the extent and pace of any asset quality deterioration. In addition, the sustained increase in house prices coupled with high household indebtedness pose downside risks to Sparebanken Pluss's currently strong asset quality.

#### LIQUIDITY - HIGH RELIANCE ON MARKET FUNDING

Sparebanken Pluss' liquidity is underpinned by a strong deposit base, which accounted for almost 50% of total funding at year-end 2012, approximately 40% of which consisted of retail deposits. Deposits grew significantly in 2012 (+27%), largely reflecting the establishment of a dedicated deposit centre in 2012 and incentive programmes for employees based on deposit volumes. Whilst we positively view the bank's increased focus on deposits, we note that a substantial portion of the deposit growth was in the form of corporate deposits, which we deem typically less sticky than retail deposits.

Notwithstanding an increased deposit-to-gross loan ratio at 55% at end-March 2013 (year-end 2012: 54%; year-end 2011: 46%), the bank remains reliant on market funding. In particular, a sizeable and growing portion of market funds (year-end 2012: 33%; year-end 2010: 17%) are in the form of covered bonds issued via Pluss Boligkreditt, the bank's wholly-owned covered bond company. This provides the bank with an additional source of funding, a factor that we view as credit positive, but we caution that the use of covered bond funding results in the structural subordination of Sparebanken Pluss's unsecured creditors, including depositors.

At end-March 2013, liquid assets accounted for around 16% of total assets, comprising cash and deposits with the central bank and the securities portfolio. The portfolio primarily includes Norwegian covered bonds, bonds from the government or other public entities as well as other issuers and a limited amount of equity investments. We note that these holdings are mostly Norwegian securities, which could be a source of vulnerability from a concentration-risk perspective.

#### PROFITABILITY - SUPPORTED BY GOOD EFFICIENCY; ROOM FOR FURTHER RETAIL LENDING MARGIN IMPROVEMENT

Sparebanken Pluss is reliant on net interest income, which represented over 80% of its 2012 net revenue. This source of income grew by 15% during the year, supported by good loan growth (about 7%) and increased lending margins which more than offset the pressure on deposit margins. In our view, there is room for further improvement, as a general repricing movement is under way in the Norwegian banking market in light of expectations of increased regulatory capital requirements.

Sparebanken Pluss's efficiency is among the best in the Nordic region. The bank's cost-to-income ratio was 37% in 2012 and we note it has consistently kept the ratio at good levels in recent years (below 40% on average). These good levels are largely due to Sparebanken Pluss's lean organisation, which comprises smaller headcount (182 man years at year-end 2012) and branch network (14 branches) than its similar-size peers.

In addition, Moody's notes that loan loss provisions are appreciably lower than most of its Norwegian rated peers; in 2012 loan loss provisions amounted to NOK21 million (2011: NOK20 million).

#### CAPITAL - AT ADEQUATE LEVELS

Sparebanken Pluss exhibits sound capitalisation. At end-March 2013, the bank's Tier 1 ratio was 13.2% (standardised approach). The bank does not have Tier 2 supplementary capital.

Sparebanken Pluss increased its capital base gradually over the years without using external sources (Tier 1 ratio at year-end 2008: 11.4%). The current capital levels compare well with other rated Norwegian savings banks and we deem them adequate relative to the bank's risk profile.

#### NOTE ON DATA

Unless noted otherwise, all figures shown in this report are sourced from the bank's latest annual and interim financial reports and our Banking Financial Metrics. These metrics are based on our own chart of account, and are adjusted for analytical purposes. Please refer to the documents entitled "Moody's Approach to Global Standard Adjustments in the Analysis of the Financial Statements of Banks, Securities Firms and Finance Companies" and "Frequently Asked Questions: Moody's Approach to Global Standard Adjustments in the Analysis of the Financial

Statements of Banks, Securities Firms and Finance Companies", both published on 19 July 2012.

### **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 standalone credit assessment 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's foreign-currency deposit 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
<b>Qualitative Factors (50%)</b>						<b>C-</b>	
<b>Factor: Franchise Value</b>						<b>D+</b>	<b>Neutral</b>
Market share and sustainability				x			
Geographical diversification					x		
Earnings stability		x					
<b>Earnings Diversification [2]</b>							
<b>Factor: Risk Positioning</b>						<b>D</b>	<b>Neutral</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: Operating Environment</b>						<b>A-</b>	<b>Neutral</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: Profitability</b>						<b>C</b>	<b>Neutral</b>
PPI % Average RWA (Basel II)					1.66%		
Net Income % Average RWA (Basel II)					1.12%		
<b>Factor: Liquidity</b>						<b>E</b>	<b>Weakening</b>
(Market Funds - Liquid Assets) % Total Assets						34.12%	
Liquidity Management						x	
<b>Factor: Capital Adequacy</b>						<b>A</b>	<b>Neutral</b>
Tier 1 Ratio (%) (Basel II)				12.90%			
Tangible Common Equity % RWA (Basel II)				12.00%			
<b>Factor: Efficiency</b>						<b>A</b>	<b>Neutral</b>
Cost / Income Ratio				38.96%			
<b>Factor: Asset Quality</b>						<b>A</b>	<b>Weakening</b>
Problem Loans % Gross Loans				0.61%			
Problem Loans % (Equity + LLR)				6.99%			
Lowest Combined Financial Factor Score (15%)							<b>E</b>
<i>Economic Insolvency Override</i>							<b>Neutral</b>
Aggregate BFSR Score							<b>C-</b>
Aggregate BCA Score							<b>baa1/baa2</b>
Assigned BFSR							<b>C-</b>
Assigned BCA							<b>baa1</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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