

Rating Action: Sparebanken Sor

Moody's assigns A3/P-2/C- to Sparebanken Sor (Norway); stable outlook

First-time ratings

London, 19 August 2010 -- Moody's Investors Service has today assigned a C- bank financial strength rating (BFSR) and A3 long-term and Prime-2 short-term local and foreign currency deposit ratings to Sparebanken Sør, a Norwegian savings bank. The outlook on all ratings is stable.

RATINGS RATIONALE

Sparebanken Sør's C- BFSR, which maps to a Baseline Credit Assessment (BCA) of Baa2, reflects the bank's sound regional franchise, solid retail business and sound capital levels. However, Moody's notes that the rating is constrained by the bank's large exposure to the real estate sector, its high borrower concentration and its less sophisticated risk management procedures.

Sparebanken Sør enjoys a sound market position in southern Norway in the counties of Vest-Agder, Aust-Agder and Telemark, where it reports a market share of almost 15% in retail lending and around 20% in corporate lending. In light of the bank's regional importance, Moody's believes that there is a high probability that the government of Norway would support the bank in a stress scenario. Given this systemic support assessment, under Moody's Joint Default Analysis methodology, the bank's A3 long-term deposit rating incorporates a two-notch uplift from the Baa2 BCA.

The bank has a good regional franchise, serving over 100,000 retail customers and about 8,000 corporate customers with a full range of products, but Moody's also notes that the Norwegian banking market is highly competitive, especially in the retail sector. Loans to retail customers (including loans transferred to Sør Boligkreditt, the bank's wholly owned covered bond company) account for 65% of the bank's loan book. Loans to corporate customers -- mainly SMEs -- account for the rest of the loan portfolio. The rating agency notes that Sparebanken Sør's loan portfolio exhibits high borrower concentration as well as a sizeable exposure to property management and construction (around 20%), which Moody's assesses as a relatively more volatile sector.

At the end of March 2010, the bank reported a Tier 1 ratio of 13.9%. The capital base was strengthened in August 2009 by an issuance of a Tier 1 instrument amounting to NOK400 million (EUR 50million) from the government's State Finance Fund. To date, the bank boasts one of the lowest problem loan ratios among Moody's-rated Norwegian savings banks. The rating agency believes that, going forward, the bank could face challenges in maintaining its asset quality in the context of a still uncertain economic outlook combined with fears over a collapse in house prices. According to Moody's estimations of potential credit losses, Sparebanken Sør's current capital level enables it to absorb anticipated deterioration in asset quality at its current BFSR level.

The bank's funding profile is underpinned by a good deposit base, but is also reliant on wholesale funds, which accounts for almost 40% of total funding. In common with many other Norwegian banks, Sparebanken Sør is increasingly funding itself on the booming Norwegian covered bond market through Sør Boligkreditt. Moody's notes that around 30% of market funds are in the form of covered bonds.

Any upgrade of Sparebanken Sør's BFSR would have to be accompanied by a significant reduction in the bank's credit risk concentrations and further improvements in its risk management practices, combined with sustained profitability, capitalisation and liquidity position. Conversely, the BFSR would be negatively affected in the event of any increase in credit risk related to the bank's large exposures or to more volatile sectors, or in the event of any significant weakening of asset quality. Moody's notes that deterioration in the bank's capital or market positions could also have adverse rating implications.

The principal methodologies used in rating Sparebanken Sør were "Bank Financial Strength Ratings: Global Methodology" published in February 2007, and "Incorporation of Joint-Default Analysis into Moody's Bank Ratings: A Refined Methodology" published in March 2007. Other methodologies and factors that may have been considered in the process of rating this issuer can also be found on Moody's website.

Headquartered in Arendal, Norway, Sparebanken Sør reported total assets of NOK35.5 billion (EUR4.4 billion) at end-March 2010.

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