MOODY'S INVESTORS SERVICE

Credit Opinion: Sparebanken Vest

Global Credit Research - 04 Apr 2016

Bergen, Norway

Ratings

Category	Moody's Rating
Outlook	Negative
Bank Deposits	A1/P-1
Baseline Credit Assessment	baa1
Adjusted Baseline Credit Assessment	baa1
Counterparty Risk Assessment	Aa3(cr)/P-1(cr)
Senior Unsecured	A1
Subordinate MTN	(P)Baa2
Jr Subordinate MTN	(P)Baa3
Other Short Term	(P)P-1

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Key Indicators

Sparebanken Vest (Consolidated Financials) [1]

	[2]**12-15**	[2]**12-14**	[2]**12-13**	[2]**12-12**	[2]**12-11**	**Avg.**
Total Assets (NOK billion)	**156.4**	**142.7**	**133.1**	**126.7**	**116.0**	[3]**7.8**
Total Assets (EUR million)	**16,265.4**	**15,724.3**	**15,919.6**	**17,266.4**	**14,971.1**	[3]**2.1**
Total Assets (USD million)	**17,669.1**	**19,027.3**	**21,936.3**	**22,763.9**	**19,434.6**	[3]**-2.4**
Tangible Common Equity (NOK billion)	**10.5**	**8.8**	**7.9**	**7.1**	**5.7**	[3]**16.3**
Tangible Common Equity (EUR million)	**1,091.1**	**971.2**	**939.2**	**969.4**	**740.5**	[3]**10.2**
Tangible Common Equity (USD million)	**1,185.2**	**1,175.2**	**1,294.2**	**1,278.1**	**961.3**	[3]**5.4**
Problem Loans / Gross Loans (%)	**1.1**	**1.1**	**1.3**	**1.3**	**1.4**	[4]**1.2**
Tangible Common Equity / Risk Weighted Assets (%)	**14.2**	**12.9**	**11.8**	**11.2**	**9.2**	[5]**11.9**
Problem Loans / (Tangible Common Equity + Loan Loss Reserve) (%)	**12.6**	**13.7**	**16.9**	**18.3**	**21.5**	[4]**16.6**
Net Interest Margin (%)	**1.6**	**1.7**	**1.7**	**1.5**	**1.5**	[4]**1.6**
PPI / Average RWA (%)	**2.1**	**2.5**	**2.7**	**1.8**	**1.6**	[5]**2.1**
Net Income / Tangible Assets (%)	**0.7**	**0.8**	**0.7**	**0.6**	**0.4**	[4]**0.6**
Cost / Income Ratio (%)	**48.9**	**46.4**	**50.0**	**56.6**	**61.4**	[4]**52.6**
Market Funds / Tangible Banking Assets (%)	**32.4**	**29.8**	**28.7**	**31.1**	**46.4**	[4]**33.7**
Liquid Banking Assets / Tangible Banking Assets (%)	**14.9**	**13.7**	**12.8**	**13.3**	**11.1**	[4]**13.2**
Gross loans / Due to customers (%)	**203.3**	**179.8**	**181.6**	**179.0**	**188.1**	[4]**186.3**

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

Moody's assigns Sparebanken Vest a baseline credit assessment (BCA) of baa1, long-term deposit and senior unsecured debt ratings of A1, a Baa2 senior subordinated rating, Baa3 junior subordinated rating and a short term obligation rating of Prime-1.

Sparebanken Vest's BCA of baa1 is supported by the bank's strong regional retail franchise, good capital metrics and improving asset quality. These factors counterbalance the bank's high loan-risk concentrations to historically volatile sectors, including commercial real estate and construction. The bank's A1 deposit and senior unsecured debt ratings take into account our Loss Given Failure (LGF) analysis of the bank's own volume of deposits and debt, as well as the volume of securities subordinated to them. Sparebanken Vest benefits from a large volume of deposits and substantial layers of subordination, resulting in very low loss-given-failure.

Sparebanken Vest's deposit and debt ratings carry a negative outlook to capture downward pressure on earnings and increased asset risk on the bank's corporate book as a result of the slowdown in Norway's economic growth driven by a reduction in petroleum investments.

Rating Drivers

- Sparebanken Vest's BCA is supported by its Very Strong- Macro Profile

- Improving capital metrics to meet with authorities' expectations

- Asset quality is currently sound, but sizeable exposures to more volatile sectors pose downside risks

- Mild deterioration in profitability caused by renewed margin pressure

- Reliance on market funding renders the bank vulnerable to fluctuations in investor sentiment

- Large volume of deposits and junior debt resulting in senior debt and deposit ratings benefiting from a very low loss-given-failure rate and a two-notch uplift from the BCA

- Moderate probability of government support resulting in the debt and deposit ratings benefiting from a further one-notch uplift from the BCA

Rating Outlook

The negative outlook on the Sparebanken Vest's long-term senior debt and deposit ratings reflects our view that Norway's slowing growth, resulting from reduced petroleum sector investments, will negatively impact the bank's asset quality. We expect that the bank's exposure to the commercial real estate sector (accounting for 12.3% of gross loans at end-December 2015), a significant part of which is located in the county of Rogaland in areas that have witnessed significant increases in vacancy rates, will see deterioration.

What Could Change the Rating - Up

Upward rating momentum is currently limited given the negative outlook. Over time, upward pressure could develop if the bank demonstrates: (1) reduced exposure to more volatile sectors such as the construction and real estate sectors; (2) diversified access to capital markets and improved liquidity; and/or (3) stronger earnings generation without an increase in risk the profile.

What Could Change the Rating - Down

Future downward rating pressure would develop on Sparebanken Vest's ratings if: (1) the bank's problem loan ratio increases above our system-wide expectation of approximately 2%; (2) its profitability deteriorates further from expected levels of around 0.5%; (3) the bank fails to sustain its market position; and/or (4) the macroeconomic environment deteriorates more than currently anticipated, leading to a lower Macro Profile and net profitability falling to below 0.4% of tangible assets. Also, a reduction in uplift as a result of our LGF analysis or a revision of government support assumptions could lead to downward rating pressure.

DETAILED RATING CONSIDERATIONS

SPAREBANKEN VEST'S BCA IS SUPPORTED BY ITS VERY STRONG- MACRO PROFILE

As a domestically oriented bank, Sparebanken Vest's Macro Profile is aligned with that of Norway at Very Strong-. Norwegian banks benefit from operating in an affluent and developed country with very high economic, institutional and government financial strength as well as low susceptibility to event risk. Norway has a diversified and growing economy, which demonstrates resilience to the ongoing weakness in the oil sector. The main risks to the system stem from a high level of household indebtedness and domestic banks' reliance on market funding. However, these risks are offset by the strength of households' ability to service debt, banks' adequate capitalisation and the relatively small size of the banking system compared to GDP.

IMPROVING CAPITAL METRICS TO MEET AUTHORITIES' EXPECTATIONS

Sparebanken Vest reported a Core Equity Tier 1 Ratio of 13.7% at end-December 2015 (including transitional floor), already in excess of the 11.5% minimum regulatory requirement that will come into force on 1 July 2016. The bank increased its capital goal of Core Equity Tier 1 to 14.5% by end 2016 from 13.5% previously to meet the authorities' expectations. In order to reach this target the bank announced a rights issue in the fourth quarter of 2015 raising NOK750 million which increased the Core Equity Tier 1 ratio by approximately 1 percentage point. Sparebanken Vest chose to approach the markets for additional capital because retained earnings alone would not have covered the one-percentage-point increase in the bank's capital target. Although we view this positively, we estimate that the bank will also have to limit growth in risk-weighted assets to around 4% in 2016 to achieve the capital target, down from 7.4% RWA growth in 2015. In addition, our Capital score reflects the bank's tangible common equity to tangible banking assets ratio of 6.7%, which -- although meeting international requirements comfortably -- is below Moody's Norwegian rated average of 8.7%.

ASSET QUALITY IS CURRENTLY SOUND, BUT SIZEABLE EXPOSURES TO MORE VOLATILE SECTORS POSE DOWNSIDE RISKS

We expect to see mild asset quality deterioration from the current position. This follows our anticipation of a somewhat tougher banking operating environment in Norway compared to recent years, owing to declining oil and gas prices, as well as falling investment levels. While Sparebanken Vest is located in Bergen in the western part of Norway, an area that has witnessed an increase in unemployment rates during 2015, the bank's loan portfolio has performed strongly, with problem loans at 1.1% of gross loans at the end of the year. This level is underpinned by the bank's retail-oriented loan book which constituted 76% of gross lending at end-December 2015, largely in the form of mortgages.

We expect that the bank's exposure to the real estate and construction sectors (accounting for 11.5% of gross loans at end-December 2015), a significant part of which is located in the county of Rogaland in areas that have witnessed significant increases in vacancy rates, will see deterioration. In addition, Sparebanken Vest exhibits significant single-borrower concentrations, common at Nordic banks, which in a stress scenario could accelerate the extent and pace of any deterioration in asset quality.

MILD DETERIORATION IN PROFITABILITY CAUSED BY RENEWED MARGIN PRESSURE

Sparebanken Vest's profitability is in line with the Norwegian savings banks average, as illustrated by its return on tangible banking assets of 0.7%. The bank recorded a NOK1.4 billion pre-tax profit in 2015 (2014: NOK1.5 billion), as it booked mark-to-market losses on financial instruments held in the bank's liquidity portfolio. Sparebanken Vest has actively established several product companies, enabling it to gain a foothold in life and non-life insurance (Frende Forsikring, 39.7% ownership), securities brokerage (Norne Securities, 47.6%), leasing (Brage Finans, 49.9%) and real-estate agency services (Eiendomsmegler Vest, 100%). The bank also owns 40% of Verd Boligkreditt, a covered bond company used by eight other independent savings banks for funding purposes in addition to its own 100%-owned covered bond issuing entity Sparebanken Vest Boligkreditt AS. While these companies have performed well, we consider that the ownership stakes render the bank vulnerable to changes in the companies' financial values.

The third-party generation of products has improved overall efficiency, as measured by the bank's reported cost-to-income ratio, which remained strong at around 49% at end-December 2015. This improvement reflects the efforts towards the rationalisation of the bank's operations, which were only partially offset by higher pension expenses as a result of falling interest rates. We do not expect further significant improvement in Sparebanken Vest's efficiency as it is already in line with other banks in the Nordic region. Loan losses fell in

2015 with the cost of risk at 0.15%, following an increase to 0.37% at end 2014, as the bank carried out several challenging restructuring processes in the corporate market portfolio.

Sparebanken Vest's net income to tangible banking assets ratio averaged 0.7% for the three years to December 2015, in line with end-December 2015 (0.66%). Our assigned Profitability score reflects our expectation of lower future earnings on the back of a weakening operating environment, further margin pressure, increased funding costs and additional provisions resulting from exposure to sectors more vulnerable to economic downturn and greater uncertainty driven by lower oil prices. The bank reduced the interest rates on housing loans during 2015 resulting in renewed margin pressure.

RELIANCE ON MARKET FUNDING RENDERS THE BANK VULNERABLE TO FLUCTUATIONS IN INVESTOR SENTIMENT

Sparebanken Vest, similarly to the rest of Norwegian Moody's rated banks, depends highly on market funding, which accounted for 32% of the bank's tangible banking assets at end-December 2015.

As reflected in our methodology, we take into account at a global level the relative stability of covered bonds compared to unsecured market funding through a standard adjustment in our Scorecard. Our assigned Funding Structure score indicates that the overall funding profile remains a modest fundamental weakness for Sparebanken Vest because of inherent confidence sensitivity of the wholesale markets, and the potential for the availability and cost of market-based funding. This weakness is partially mitigated by good access to capital markets, including the Norwegian covered bond market; the bulk of the bank's outstanding debt consists of Norwegian krone- and euro-denominated covered bonds.

Sparebanken Vest maintains a liquidity portfolio to cover short-term liquidity risks; at end-December 2015, liquid assets accounted for just below 15% of tangible banking assets, which is in line with the Norwegian banking average. The liquidity portfolio was primarily invested in covered bonds and other investment grade rated bonds.

Notching Considerations

LOSS GIVEN FAILURE AND ADDITIONAL NOTCHING

We expect that Norway will introduce legislation to cover the EU's Bank Resolution and Recovery Directive in 2017. We assume residual tangible common equity of 3% and losses post-failure of 8% of tangible banking assets, a 25% run-off in "junior" wholesale deposits, a 5% run-off in preferred deposits, and assign a 25% probability to deposits being preferred to senior unsecured debt. These metrics are in line with our standard assumptions.

Sparebanken Vest's long-term deposit rating and senior unsecured ratings take into consideration the likely impact on loss-given-failure of the combination of the bank's own volume of debt and deposits and the amount of debt subordinated to them. This has resulted in a Preliminary Rating Assessment of two notches above the BCA, reflecting very low loss-given-failure.

For junior securities issued by Sparebanken Vest, our LGF analysis confirms a high loss-given-failure, given the small volume of debt and limited protection from more subordinated instruments and residual equity. We also incorporate additional notching for junior subordinated instruments reflecting the coupon features.

GOVERNMENT SUPPORT

The expected implementation of resolution legislation has caused us to reconsider the probability that government support would benefit certain creditors. Sparebanken Vest is the second-largest regional savings bank in Norway by total assets, and benefits from a sound market position in western Norway, in counties such as Hordaland, Sogn og Fjordane and Rogaland. We calculate that Sparebanken Vest's lending market share is around 20% in Hordaland where the bank does most of its business.

We therefore expect a moderate probability of government support for senior debt and deposits, resulting in one notch of uplift.

For junior securities, we continue to believe that the probability of government support is low and these ratings do not include any related uplift. Junior securities also include additional downward notching from the BCA reflecting coupon suspension risk ahead of a potential failure.

COUNTERPARTY RISK ASSESSMENT

We assign a Aa3(cr) long-term and P-1(cr) short-term CR assessment to Sparebanken Vest.

CR Assessments are opinions of how counterparty obligations are likely to be treated if a bank fails and are distinct from debt and deposit ratings in that they (1) consider only the risk of default rather than the likelihood of default and the expected financial loss suffered in the event of default and (2) apply to counterparty obligations and contractual commitments rather than debt or deposit instruments. The CR Assessment is an opinion of the counterparty risk related to a bank's covered bonds, contractual performance obligations (servicing), derivatives (e.g., swaps), letters of credit, guarantees and liquidity facilities.

Foreign Currency Deposit Rating

Sparebanken Vest's foreign-currency deposit ratings are unconstrained, given that Norway has a country ceiling of Aaa. The bank's foreign-currency deposit rating is A1.

Foreign Currency Debt Rating

Sparebanken Vest's foreign-currency debt ratings are unconstrained, given that Norway has a country ceiling of Aaa. The bank's senior unsecured foreign-currency debt rating is A1.

Rating Factors

Sparebanken Vest

Macro Factors	
Weighted Macro Profile	**Very Strong -**

Financial Profile						
Factor	**Historic Ratio**	**Macro Adjusted Score**	**Credit Trend**	**Assigned Score**	**Key driver #1**	**Key driver #2**
Solvency						
Asset Risk						
Problem Loans / Gross Loans	1.2%	aa2	←→	a3	Geographical concentration	Sector concentration
Capital						
TCE / RWA	14.2%	a1	←→	a2	Risk-weighted capitalisation	Nominal leverage
Profitability						
Net Income / Tangible Assets	0.7%	baa2	↓	baa3	Expected trend	
Combined Solvency Score		a1		a3		
Liquidity						
Funding Structure						
Market Funds / Tangible Banking Assets	32.4%	baa3	←→	baa3	Market funding quality	
Liquid Resources						
Liquid Banking Assets / Tangible Banking Assets	14.9%	baa3	←→	baa3	Stock of liquid assets	
Combined Liquidity Score		baa3		baa3		

Financial Profile	**baa1**

Qualitative Adjustments	**Adjustment**
Business Diversification	0
Opacity and Complexity	0
Corporate Behavior	0
Total Qualitative Adjustments	**0**

Sovereign or Affiliate constraint	Aaa

Scorecard Calculated BCA range	**a3 - baa2**

Assigned BCA	**baa1**

Affiliate Support notching	**0**

Adjusted BCA	**baa1**

Instrument Class	**Loss Given Failure notching**	**Additional notching**	**Preliminary Rating Assessment**	**Government Support notching**	**Local Currency rating**	**Foreign Currency rating**
Deposits	2	0	a2	1	A1	A1
Senior unsecured bank debt	2	0	a2	1		A1
Dated subordinated bank debt	-1	0	baa2	0		(P)Baa2
Junior subordinated bank debt	-1	-1	baa3	0		(P)Baa3

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