MOODY'S
INVESTORS SERVICE

Credit Opinion: Sparebanken Vest

Global Credit Research - 27 Mar 2015

Bergen, Norway

Ratings

Category	Moody's Rating
Outlook	Rating(s) Under Review
Bank Deposits	*A2/P-1
Baseline Credit Assessment	baa1
Adjusted Baseline Credit Assessment	baa1
Senior Unsecured	**A2
Subordinate MTN	(P)Baa2
Jr Subordinate MTN	(P)Baa3
Other Short Term	(P)P-1

* Rating(s) within this class was/were placed on review on March 17, 2015
** Placed under review for possible upgrade on March 17, 2015

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Key Indicators

Sparebanken Vest (Consolidated Financials)[1]

	[2]12-14	[2]12-13	[2]12-12	[2]12-11	[2]12-10	Avg.
Total Assets (NOK billion)	147.1	134.4	127.7	116.0	105.3	[3]8.7
Total Assets (EUR million)	16,210.6	16,076.5	17,407.2	14,971.1	13,500.7	[3]4.7
Total Assets (USD million)	19,615.7	22,152.5	22,949.6	19,434.6	18,111.8	[3]2.0
Tangible Common Equity (NOK billion)	8.6	7.6	6.7	5.8	5.2	[3]13.4
Tangible Common Equity (EUR million)	948.3	914.9	920.0	744.6	666.2	[3]9.2
Tangible Common Equity (USD million)	1,147.4	1,260.6	1,212.9	966.6	893.7	[3]6.4
Problem Loans / Gross Loans (%)	1.1	1.3	1.3	1.4	1.4	[4]1.3
Tangible Common Equity / Risk Weighted Assets (%)	12.5	11.5	10.7	9.3	12.2	[5]11.2
Problem Loans / (Tangible Common Equity + Loan Loss Reserve) (%)	14.0	17.3	19.2	21.3	21.1	[4]18.6
Net Interest Margin (%)	1.7	1.7	1.5	1.5	1.5	[4]1.6
PPI / Average RWA (%)	2.4	2.6	2.1	1.6	1.8	[5]2.1
Net Income / Tangible Assets (%)	0.7	0.7	0.7	0.4	0.5	[4]0.6
Cost / Income Ratio (%)	46.9	51.1	48.5	60.9	57.0	[4]52.9
Market Funds / Tangible Banking Assets (%)	46.3	45.1	45.3	46.4	46.1	[4]45.8
Liquid Banking Assets / Tangible Banking Assets (%)	14.2	12.9	13.4	11.1	13.7	[4]13.0
Gross Loans / Total Deposits (%)	179.8	175.6	164.9	165.4	150.7	[4]167.3

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

On 17 March, we placed Sparebanken Vest's long-term deposit and senior unsecured debt ratings under review for upgrade. The bank's baa1 standalone baseline credit assessment (BCA), all junior debt ratings and short-term ratings remain unchanged.

Sparebanken Vest's standalone credit assessment - as defined by the BCA - primarily benefits from the bank's strong regional franchise and capital metrics, the retail focus of its operations, and its currently good asset quality, but is constrained by the bank's high credit risk concentration and its reliance on market funding.

The review was prompted by the implementation of Loss Given Failure, which is a component of our new methodology for rating banks globally, in combination with potential downward pressure on current government support assumptions. LGF takes into account the risks faced by the different debt and deposit classes across the liability structure if the bank enters resolution.

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

As a pure domestic bank, Sparebanken Vest's operating environment is in Norway, and the bank's Macro Profile is thus 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. 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.

Rating Drivers

-Strong capital metrics

-Asset quality 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 deposit ratings benefiting from a very low loss-given-failure rate and a likely two-notch uplift from the BCA

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

Rating Outlook

The review on Sparebanken Vest's long-term deposit and senior unsecured debt ratings was triggered by the introduction of our new methodology, and specifically our advanced Loss Given Failure analysis, which applies to institutions subject to an operational resolution regime. While not subject to the EU's Bank Recovery and Resolution Directive (BRRD), we expect that Norway- as a European Economic Area (EEA) member -will seek to introduce legislation or other tools that include mechanisms similar to those in the BRRD; our expectations are based on publicly stated comments from Norwegian authorities, as well as the government's track record of mirroring EU banking regulations. Our advanced LGF analysis on Sparebanken Vest's long-term deposits and senior unsecured debt led us to place the ratings on review for upgrade.

The review will focus on the liability structure, in particular the amount of deposits, senior long-term debt outstanding and the amount of debt subordinated to it. We believe that the probability of government support for Sparebanken Vest's long-term deposits and senior unsecured debt will be moderate, translating into one-notch uplift from its unsupported level. We expect both the long-term deposits and senior unsecured ratings to be upgraded by one notch.

What Could Change the Rating - Up

As stated in the Summary Rating Rationale, Sparebanken Vest's ratings are under review for upgrade in response to the implementation of LGF, which is a component of our new banking methodology.

What Could Change the Rating - Down

After the above-mentioned review is completed, future downward rating pressure would develop on Sparebanken Vest's ratings if: (1) the credit quality in its loan book weakens beyond our expectations, (2) profitability deteriorates; and/or (3) Sparebanken Vest fails to sustain its market position.

DETAILED RATING CONSIDERATIONS

STRONG CAPITAL METRICS

Sparebanken Vest reported a ratio of Tangible Common Equity (TCE) to risk weighted assets(RWA) of 12.6% at December 2014 (including Basel I floor), already in excess of the 11% minimum regulatory requirement that will come into force 1 July 2015. The bank aims to be capitalised on a par with the country's biggest institutions, and hence it has increased its goal for the Core Equity Tier 1 ratio to 13.5% by 2016. The Capital score reflects this strength as well as the bank's TCE-to-tangible banking assets ratio of 6.67%, which is well in line with international requirements.

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

Asset quality is strong and the bank's problem loan ratio (as measured by impaired loans as a percentage of total loans) amounted to 1.1% at end-December 2014. This level is underpinned by the bank's retail-oriented loan book which constituted 76% of gross lending at end-December 2014, largely in the form of mortgages.

Our assigned Asset Risk score indicates that, overall, asset risk remains a relative strength for Sparebanken Vest, notwithstanding its industry concentration to the real estate and construction sectors (together accounting for 12% of gross loans at end-December 2014) and the shipping sector (around 4% of gross loans), all of which have historically been characterised by higher volatility. In addition, Sparebanken Vest exhibits significant single-borrower concentration, common at Nordic banks, which in a stress scenario could accelerate the extent and pace of any deterioration in asset quality. We expect to see mild asset quality deterioration from its current position as we expect Norway to experience a somewhat tougher bank operating environment compared to recent years due to declining oil and gas prices, as well as falling investment levels.

MILD DETERIORATION IN PROFITABILITY CAUSED BY RENEWED MARGIN PRESSURE

Sparebanken Vest recorded an improved NOK1.493 billion pre-tax profit in 2014 (2013: NOK1.221 billion) mainly as a result of (1) increased income from payment transfers and increased commissions on insurance; (2) higher contribution from associated companies; and (3) the proceeds from the sale of shares in payment provider Nets AS.

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). We expect these stakes to provide additional revenue streams for Sparebanken Vest in the future.

The third-party generation of products also improves bank efficiency, as measured by the bank's reported cost-to-income ratio, which remained strong at just over 44% at end-December 2014. 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. However, we do not expect further significant improvement in Sparebanken Vest's efficiency as it is already in line with those of other banks in the Nordic region. In 2014, loan losses were at NOK410 million, slightly higher than usual as the bank carried out several challenging restructuring processes in the corporate market portfolio.

The net income-to-tangible banking assets ratio averaged 0.7% for the three years to December 2014, and we expect only a mild deterioration from these levels as a result of additional margin pressure and uncertainty over provisioning levels as reflected in our assigned Profitability score. The bank reduced the interest rates on housing loans twice during 2014, and a further reduction was announced in the beginning of 2015 resulting in renewed margin pressure. Moreover, the bank will likely incur further loan losses from volatile segments such as real-estate and construction, albeit at a level that will have a limited impact on profitability.

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

Sparebanken Vest's funding position is underpinned by a strong deposit base, which accounted for approximately 50% of its total funding at end-December 2014, while almost 60%of the bank's deposits originate from the retail sector.

Market funding accounted for over 46% of the bank's tangible banking assets at end-December 2014. As reflected in our methodology, we reflect 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 its inherent confidence sensitivity, 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 consist of Norwegian krone- and euro-denominated covered bonds). Whilst we note positively that covered bond funding has helped Sparebanken Vest to extend its maturity profile, we also note the risk that the use of covered bonds could result in the structural subordination of the bank's unsecured creditors, including depositors.

Sparebanken Vest maintains a liquidity portfolio to cover short-term liquidity risks; at end-December 2014, liquid assets accounted for just over 14% of tangible banking assets. They were primarily invested in covered bonds and other investment grade rated bonds.

Notching Considerations

LOSS GIVEN FAILURE AND ADDITIONAL NOTCHING

We expect that Norway will seek to introduce legislation or other tools that include mechanisms similar to those in the EU's Bank Resolution and Recovery Directive (BRRD). 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.

Our review of Sparebanken Vest's long-term deposit rating and senior unsecured ratings will consider the likely impact on loss-given-failure of the combination of their own volume and the amount of debt subordinated to them. We expect this will result in Preliminary Rating Assessment (PRA) of two notches above the BCA, reflecting very low loss-given-failure.

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 the counties such as Hordaland, Sogn og Fjordane and Rogaland. We calculate that Sparebanken Vest's lending market share is around 20% in the county of Hordaland where the bank does most of its business. Therefore we now expect a moderate probability of government support for debt and deposits, likely resulting in one notch of uplift to the PRA.

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 A2 (under review for upgrade).

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 A2 (under review for upgrade).

About Moody's Bank Scorecard

Our Scorecard is designed to capture, express and explain in summary form our Rating Committee's judgment. When read in conjunction with our research, a fulsome presentation of our judgment is expressed. As a result, the output of our Scorecard may materially differ from that suggested by raw data alone (though it has been calibrated to avoid the frequent need for strong divergence). The Scorecard 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.

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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	12.5%	a2	←→	a2	Risk-weighted capitalisation	
Profitability						
Net Income / Tangible Assets	0.7%	baa2	←→	baa2	Expected trend	
Combined Solvency Score		a2		a3		
Liquidity						
Funding Structure						
Market Funds / Tangible Banking Assets	46.3%	b1	↑↑	baa3	Lack of market access	
Liquid Resources						
Liquid Banking Assets / Tangible Banking Assets	14.2%	baa3	←→	baa3	Stock of liquid assets	
Combined Liquidity Score		ba2		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	--	--	--	--	A2 RUR Possible Upgrade	A2 RUR Possible Upgrade
Senior unsecured bank debt	--	--	--	--		A2 RUR Possible Upgrade
Dated subordinated bank debt	-1	0	baa2	0		(P)Baa2
Junior subordinated bank debt	-1	-1	baa3	0		(P)Baa3

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