FitchRatings

26 Aug 2020 | Affirmation

Fitch Affirms 3 Norwegian Savings Banks; Outlook Negative

Fitch Ratings-Paris-26 August 2020:

Fitch Ratings has affirmed the Long-Term Issuer Default Ratings (IDRs) of Sparebank 1 Nord-Norge (SNN) at 'A', of Sparebank 1 SR-Bank (SR-Bank) at 'A-' and of SpareBank 1 SMN (SMN) at 'A-'. The Outlooks are Negative.

Fitch has upgraded SMN's long-term senior preferred debt to 'A' from 'A-' following the bank's inaugural issuance of senior non-preferred debt earlier this week to reflect the protection that could accrue to senior preferred debt from the bank's increased junior bank resolution debt and equity buffers.

A full list of rating actions is below.

Key Rating Drivers

IDRs, Viability Ratings (VRs) AND SENIOR DEBT

The ratings of SNN, SMN and SR-Bank (collectively the Sparebanken) reflect their stable and low-risk business models, healthy profitability, sound but weakening asset quality and sound capital ratios. The ratings also factor in risks from the Sparebanken's moderate franchises with geographically concentrated loan portfolios, exposure to potentially volatile oil and property prices, and their sound liquidity management in the context of their reliance on wholesale funding.

SNN's ratings are one notch higher than SMN's and SR-Bank's, reflecting better asset-quality metrics, and, in particular, limited offshore exposure.

Fitch expects Norway to perform better than most other European countries through the current downturn and the agency's latest forecast includes a 3.5% GDP contraction in 2020 and then 3.5% growth in 2021. Unemployment is expected to increase in 2020 to 5% and then recover slightly in 2021.

Fitch expects the Sparebanken's asset quality to weaken but to remain sound, driven by their conservative underwriting standards. Impaired loans (Stage 3 loans under IFRS9) accounted for between 0.5% (SNN) and 1.8% (SMN) of gross loans at end-June 2020. We expect that loan losses will be concentrated in the oil and offshore sector but also arise in other sectors including retail trade and tourism as these are sensitive to the lockdown of the domestic economy.

SR-Bank and SMN operate in regions where contribution from the oil industry is high, but the banks have decreased their exposure to this sector over the past five years. The share of exposures to the offshore sector was around 6% and 3% of gross loans at end-June 2020 for SR-Bank and SMN, respectively. Losses from their exposure to the offshore service vessel segment were the drivers of SMN's and SR-Bank's loan impairment charges (LICs) in 2016-2018 and again in 1H20 and we expect this sub-segment to perform poorly also in the current downturn. This will continue to put pressure on the banks' asset quality.

The Sparebanken's regional franchises and strong client relationships support healthy pre-impairment profitability and stable revenue generation. Net interest income, with healthy margins helped by disciplined loan pricing and wholesale funding costs benefiting from lower interest rates, is the main source of revenue. The banks have also succeeded in strengthening and diversifying fee and commission income from ancillary products such as insurance, accounting services, wealth management and real- estate brokerage. Cost efficiency is acceptable, with cost-to-income ratios in the mid-40 to mid-50s range in 1H20.

Net income for the Sparebanken was negatively affected by higher-than-normal LICs following the weakening of the banks' operating environment. We expect that LICs will remain elevated in 2H20 and in 2021, driven by the economic and financial market fallout from the coronavirus outbreak.

The Sparebanken have solid buffers over their minimum regulatory requirements and their capital ratios compare well with those of international peers. The banks' leverage ratios are strong compared with many European peers', with regulatory leverage ratios of 7%-8%. We expect capitalisation and leverage to remain resilient even if LICs increase materially following the COVID-19 outbreak.

As with most Nordic banks, the Sparebanken rely on wholesale funding to varying degrees. They have maintained access to the domestic and international funding markets, particularly for covered bonds through SpareBank 1 Boligkreditt (S1B), a joint covered bond funding vehicle for member banks of the Alliance group. SR-Bank has continued to reduce loans transferred to S1B as it increasingly uses its own covered bond vehicle. We expect the banks to retain large liquidity portfolios to mitigate refinancing risk.

SR-Bank's and SMN's 'F2' Short-Term IDRs are the lower of two options mapping to a 'A-' Long-Term IDR, reflecting our 'a-' assessment of the banks' funding and liquidity profiles. SNN's 'F1' Short-Term IDR maps to the lower of two options for the 'A' Long-Term IDRs, also reflecting our 'a-' assessment of SNN's funding and liquidity score.

SR-Bank's senior unsecured debt is rated in line with the bank's IDRs.

The long-term ratings of SNN's and SMN's senior preferred notes are one notch above the banks' respective Long-Term IDRs, reflecting Fitch's expectation that SNN and SMN will meet their resolution buffer requirements with senior non-preferred and junior debt and equity instruments. The short-term senior preferred debt ratings are mapped from the respective long-term ratings and reflect our assessment of the banks' funding and liquidity.

We have assigned SMN deposit ratings of 'A'/'F1'. SNN's and SMN's long- and short-term deposit ratings are rated in line with the senior preferred debt because deposits benefit from the same level of protection as senior preferred creditors from the planned build-up of bank-resolution debt and equity buffers.

Senior non-preferred notes of SNN are rated in line with its Long-Term IDR because they are direct, unsecured and senior obligations of the bank. Senior non-preferred debt will be bailed-in before senior debt in insolvency or resolution.

SUPPORT RATING AND SUPPORT RATING FLOOR

The Support Ratings (SRs) of '5' and Support Rating Floors (SRFs) of 'No Floor' reflect Fitch's view that senior creditors of the Sparebanken cannot rely on receiving full extraordinary support from the sovereign in the event of them becoming non-viable. The EU's Bank Recovery and Resolution Directive was adopted in Norway on I January 2019. It provides a framework for resolving banks that is likely to require senior creditors participating in losses, if necessary, instead of or ahead of a bank receiving sovereign support. In addition, the Sparebanken are not systemically important banks in Norway.

For the Sparebanken, there is also a possibility of institutional support from Alliance members. However, Fitch understands from management that membership of Alliance does not confer an obligation to support and therefore does not factor this into the ratings.

SUBORDINATED DEBT

SMN's and SR-Bank's subordinated debt instruments are rated two notches below the banks' respective VRs for loss severity, reflecting our expectation of poor recovery prospects. No notching is applied for incremental non-performance risk because write-down of the notes will only occur once the point of non-viability is reached and there is no coupon flexibility before non-viability.

RATING SENSITIVITIES

IDRS, VRS AND SENIOR DEBT

The most immediate downside for IDRs and VRs relates to the economic and financial market fallout from the coronavirus outbreak as this represents a clear risk to our assessment of asset quality and earnings. The extent to which government and central bank support packages can mitigate pressure on the banks' ratings will depend on the amount and form of such support.

Factors that could, individually or collectively, lead to negative rating action/downgrade:

The Sparebanken ratings have headroom in their IDRs and VRs due to the strength of their risk appetite, earnings and capitalisation. However, this will depend on the ultimate depth and duration of the coronavirus shock to the Norwegian economy.

The Sparebanken's ratings would likely be downgraded if prospects that the health crisis is resolved globally in 2H20 become less likely, which would make a sharp recovery in global growth in 2021 more remote. A delay to this sharp recovery would likely result in more permanent damage to the banks' asset quality. A material weakening of earnings that is difficult to restore within a short period of time, combined with deterioration of the impaired loan ratio to above 2% for SNN and 3% for SMN and SR-Bank without expectation of rapid recovery, would likely lead to downgrades of the banks. The Sparebanken's structural reliance on wholesale funding means an unmitigated weakening of access to capital markets would also be negative for their ratings.

Factors that could, individually or collectively, lead to positive rating action/upgrade:

The Outlooks could be revised to Stable if the banks manage to contain the negative impact of the health crisis on asset quality and earnings. In the event SR-Bank and SMN withstand rating pressure arising from the coronavirus outbreak, positive rating pressure could result from sustained asset-quality improvements, most likely through the successful and continued restructuring and reduction of their offshore service vessel portfolios. In the event SNN withstands rating pressure arising from the coronavirus outbreak, an upgrade would be unlikely given its already high ratings and limited franchise and small size compared with more highly rated peers. In the longer term, an upgrade would be contingent on SNN decreasing its borrower diversification and improving its franchise.

The long- and short-term deposit and debt ratings of the Sparebanken are primarily sensitive to changes to the Long- and Short-Term IDRs, which are sensitive to changes to the banks' VRs. The long-term senior preferred and deposit ratings are also sensitive to changes to our expectation that the banks will not use senior preferred debt to meet its resolution buffer from 2024. The build-up of a combined buffer of senior non-preferred and junior debt sustainably above 10% of risk-weighted assets would also allow uplift to the senior preferred and deposit ratings.

SUPPORT RATING AND SUPPORT RATING FLOOR

An upgrade of the Sparebanken's SRs or upward revision of their SRFs would be contingent on a positive change in Norway's propensity to support domestic banks. This is highly unlikely, in Fitch's view.

SUBORDINATED DEBT

The ratings of the subordinated debt issued by SMN and SR-Bank are primarily sensitive to a change in the VRs from which they are notched. The securities' ratings are also sensitive to changes in Fitch's assessment of loss severity or non-performance risk relative to that captured in the banks' VRs, although this is unlikely.

Best/Worst Case Rating Scenario

International scale credit ratings of Financial Institutions and Covered Bond issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of four notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit [https://www.fitchratings.com/site/re/10111579]

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

ESG Considerations

The highest level of ESG credit relevance, if present, is a score of 3. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity(ies), either due to their nature or to the way in which they are being managed by the entity(ies). For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg.

SpareBank 1 Nord-Norge; Long Term Issuer Default Rating; Affirmed; A; RO:Neg

; Short Term Issuer Default Rating; Affirmed; F1

; Viability Rating; Affirmed; a

; Support Rating; Affirmed; 5

; Support Rating Floor; Affirmed; NF

----long-term deposits; Long Term Rating; Affirmed; A+

----Senior preferred; Long Term Rating; Affirmed; A+

----Senior non-preferred; Long Term Rating; Affirmed; A

----Senior preferred; Short Term Rating; Affirmed; F1

----short-term deposits; Short Term Rating; Affirmed; F1

SpareBank 1 SR-Bank; Long Term Issuer Default Rating; Affirmed; A-; RO:Neg

; Short Term Issuer Default Rating; Affirmed; F2

; Viability Rating; Affirmed; a-

; Support Rating; Affirmed; 5

; Support Rating Floor; Affirmed; NF

----senior unsecured; Long Term Rating; Affirmed; A-

----subordinated; Long Term Rating; Affirmed; BBB

----senior unsecured; Short Term Rating; Affirmed; F2

SpareBank 1 SMN; Long Term Issuer Default Rating; Affirmed; A-; RO:Neg

; Short Term Issuer Default Rating; Affirmed; F2

; Viability Rating; Affirmed; a-

; Support Rating; Affirmed; 5

; Support Rating Floor; Affirmed; NF

----senior unsecured; Long Term Rating; Upgrade; A

----subordinated; Long Term Rating; Affirmed; BBB

----long-term deposits; Long Term Rating; New Rating; A

----senior unsecured; Short Term Rating; Upgrade; F1

----short-term deposits; Short Term Rating; New Rating; F1

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Additional information is available on www.fitchratings.com

Applicable Criteria

Bank Rating Criteria (pub. 28 Feb 2020) (including rating assumption sensitivity)

Additional Disclosures

Dodd-Frank Rating Information Disclosure Form
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