

Rating Action: Moody's Assigns A1/Prime 1 Deposit Ratings and C- Financial Strength Rating to Sparebanken Hedmark

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First-time ratings

London, 24 March 2011 -- Moody's Investors Service has today assigned a C- bank financial strength rating (BFSR) and A1 long-term and Prime-1 short-term local and foreign currency deposit ratings to Sparebanken Hedmark, a Norwegian savings bank. The outlook on all ratings is stable.

RATINGS RATIONALE

Sparebanken Hedmark' C- BFSR, which maps to a Baseline Credit Assessment (BCA) of Baa1, reflects the bank's solid regional franchise, sound capital levels and resilient retail business. However, the rating is primarily constrained by the bank's limited geographic reach and some borrower and industry concentration in its loan book.

Sparebanken Hedmark enjoys a sound market position in the county of Hedmark, Eastern Norway, where it commands a market share of almost 40% for lending and around 50% for deposits. In addition, Sparebanken Hedmark benefits from its membership in the SpareBank 1 Alliance, which consists of 17 savings banks across Norway, together constituting the third largest banking group in Norway. In light of the bank's regional importance and the bank's membership in the SpareBank 1 Alliance, Moody's assesses a high probability of support from the government of Norway in a stress scenario. It also factors a low probability of support from the other banks in the Alliance. As a result, the bank's A1 long-term deposit rating incorporates a three-notch uplift from the Baa1 BCA, under Moody's Joint Default Analysis methodology.

The bank delivered good income levels throughout the financial crisis, primarily on the back of moderate loan loss provisions and resilient core banking earnings supported by positive loan growth and improving fee and commission income. However, Moody's notes that the keen competition in Norwegian banking market, especially in the retail sector, could make it difficult for Sparebanken Hedmark to sustain the positive trend in income.

Loans to retail customers (including loans transferred to SpareBank 1 Boligkreditt, the Alliance's covered bond company) account for almost 70% of the bank's loan book. The rest of the loan portfolio is to corporate customers, which are mainly SMEs. The rating agency notes that the loan portfolio exhibits high borrower concentration, albeit somewhat lower than most of its rated Norwegian peers. In addition, it comprises a sizeable exposure to property management and construction (14%), which we assess as relatively more volatile sectors.

At year-end 2010, the bank reported a Tier 1 ratio of 15.1% (Basel II, standardised approach), which is one of the strongest levels in the region. So far, the bank's asset quality has remained good, though we observed an increasing trend in the problem loans, which stood at around 2.5% of gross loans at year-end 2010. Moody's cautions that future developments in asset quality remain uncertain, especially in the context of expected hikes in interest rates combined with a housing market bubble possibly developing in Norway. Nevertheless, according to the rating agency's estimations of potential credit losses, Sparebanken Hedmark's current capital level allows it to absorb anticipated deterioration in asset quality at its current BFSR level.

Sparebanken Hedmark's funding profile is underpinned by a large deposit base, which covers around 70% of gross loans. The bank is also reliant on market funding (one third of total external funding), though to a lesser extent than most of its Nordic rated peers, and is increasingly funding itself on the booming Norwegian covered bond market through the SpareBank 1 alliance's jointly-owned covered bond company, SpareBank 1 Boligkreditt.

Any upgrade of the BFSR would have to be accompanied by a sustained improvement in core banking earnings and some reduction in the bank's credit risk concentrations, combined with sustained 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 more volatile sectors or any other 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 this rating were "Bank Financial Strength Ratings: Global Methodology", published February 2007 and "Incorporation of Joint-Default Analysis into Moody's Bank Ratings: A Refined Methodology", published in March 2007.

Headquartered in Hamar, Norway, Sparebanken Hedmark reported total assets of almost NOK42 billion (EUR5.3 billion) at year-end 2010.

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