

## CREDIT OPINION

9 September 2020

Update

✓ Rate this Research

### RATINGS

#### SpareBank 1 SMN

Domicile	Trondheim, Norway
Long Term CRR	A1
Type	LT Counterparty Risk Rating - Fgn Curr
Outlook	Not Assigned
Long Term Debt	A1
Type	Senior Unsecured - Fgn Curr
Outlook	Stable
Long Term Deposit	A1
Type	LT Bank Deposits - Fgn Curr
Outlook	Stable

Please see the [ratings section](#) at the end of this report for more information. The ratings and outlook shown reflect information as of the publication date.

### Contacts

Katarzyna Szymanska +44.20.7772.1047  
Associate Analyst  
katarzyna.szymanska@moodys.com

Simon Ainsworth +44 207 772 5347  
Associate Managing Director  
simon.ainsworth@moodys.com

Sean Marion +44.20.7772.1056  
MD-Financial Institutions  
sean.marion@moodys.com

## SpareBank 1 SMN

Update to credit analysis following rating affirmation

### Summary

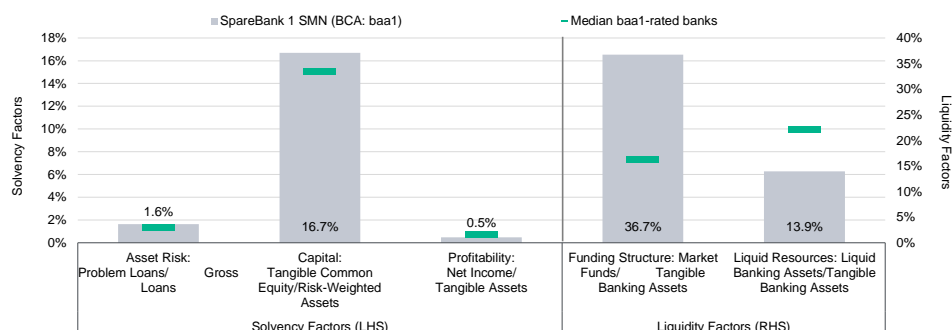
[SpareBank 1 SMN](#)'s long-term deposit and senior unsecured debt ratings of A1 take into account the bank's baseline credit assessment (BCA) of baa1, but also our loss given failure (LGF) analysis which results in three notches of rating uplift from its BCA.

SpareBank 1 SMN's BCA of baa1 reflects its resilience through the economic cycle, coupled with Moody's expectation of steady profitability and low levels of asset risk. This is supported by our view of the bank's strong retail franchise in central Norway, which delivers robust core earnings and its solid capital metrics with a CET 1 capital ratio of 17.2% at end-June 2020. These are balanced against the bank's high reliance on market funding, a common feature among all local savings banks, its relatively narrow geographic focus and downside credit risks stemming from its oil-related exposures. Nonetheless, the bank has been able to maintain sound asset quality metrics despite the recent coronavirus pandemic and oil price drop, which induced an uptick in stage 3 loans to 1.4% of total gross loans (including covered bond loans) in June 2020 from 1.2% in June 2019.

The bank's A1 deposit and senior unsecured debt ratings take into account our forward-looking LGF analysis taking into consideration the MREL-eligible securities that it is likely to issue by the end of 2023, with NOK1 billion of inaugural senior non-preferred (SNP) debt already issued in August 2020. This results in three notches of rating uplift from the bank's BCA.

Exhibit 1

### Rating Scorecard - Key Financial Ratios



These are our [Banks methodology](#) scorecard ratios. Asset risk and profitability reflect the weaker of either the three-year average and latest annual figure. Capital is the latest reported figure. Funding structure and liquid resources reflect the latest fiscal year end figures.

Source: Moody's Financial Metrics

## Credit strengths

- » SpareBank 1 SMN's BCA is supported by its Very Strong- Macro Profile, despite the economic challenges in 2020
- » Solid capital metrics provide a buffer against potential future credit losses
- » Resilient earnings benefit from a strong regional retail franchise
- » Large volume of deposits and junior debt resulting in deposit ratings benefiting from a very low loss-given-failure rate

## Credit challenges

- » Credit concentrations from operating in more limited geographic areas than many international peers
- » Downside risks from the bank's oil-related exposure, although problem loans are low
- » Dependence on market funding renders it vulnerable to fluctuations in investor sentiment, but liquidity is comfortable

## Outlook

The stable outlook on the bank's deposit and debt ratings reflect the robust positioning, when compared to local and international peers. In addition, the stable outlook also reflects the bank's resilient core earnings, loan growth and asset quality through the cycle balanced by challenges induced by the coronavirus and reduced oil prices.

## Factors that could lead to an upgrade

Over time, upward rating pressure could develop if the bank demonstrates (1) it can effectively manage with low credit losses its exposure to more volatile sectors such as commercial real estate and oil/offshore; (2) strong asset quality with a low level of problem loans and credit impairments relative to its similarly-rated peers; (3) strong recurring earnings generation without an increase in its risk profile, combined with an improved non-interest income; and (4) continued good access to capital markets combined with strong liquidity.

## Factors that could lead to a downgrade

Future downward rating pressure would emerge if (1) SpareBank 1 SMN's problem loan ratio increases to levels significantly above its similarly-rated peers; (2) its profitability deteriorates from weakening revenues or high credit costs; (3) the bank fails to sustain its leading market position in its home region; (4) the macroeconomic environment deteriorates more than currently anticipated, leading to a lower Macro Profile; (5) a lower than expected issue of junior securities, including senior non-preferred (SNP) debt, which will result in a lower rating uplift in our LGF analysis.

This publication does not announce a credit rating action. For any credit ratings referenced in this publication, please see the ratings tab on the issuer/entity page on [www.moody's.com](http://www.moody's.com) for the most updated credit rating action information and rating history.

## Key indicators

Exhibit 2

### SpareBank 1 SMN (Consolidated Financials) [1]

	03-20 <sup>2</sup>	12-19 <sup>2</sup>	12-18 <sup>2</sup>	12-17 <sup>2</sup>	12-16 <sup>2</sup>	CAGR/Avg. <sup>3</sup>
Total Assets (NOK Billion)	225.3	208.2	199.9	188.6	171.8	8.7 <sup>4</sup>
Total Assets (USD Million)	21,455.5	23,689.0	23,080.4	23,052.1	19,963.2	2.2 <sup>4</sup>
Tangible Common Equity (NOK Billion)	16.5	17.3	16.0	15.0	14.1	5.0 <sup>4</sup>
Tangible Common Equity (USD Million)	1,571.9	1,969.2	1,847.6	1,838.0	1,638.1	(1.3) <sup>4</sup>
Problem Loans / Gross Loans (%)	1.6	1.3	1.0	1.0	1.2	1.2 <sup>5</sup>
Tangible Common Equity / Risk Weighted Assets (%)	16.7	18.8	15.8	15.9	15.9	16.6 <sup>6</sup>
Problem Loans / (Tangible Common Equity + Loan Loss Reserve) (%)	15.6	11.5	10.0	9.1	11.2	11.5 <sup>5</sup>
Net Interest Margin (%)	1.5	1.5	1.5	1.5	1.5	1.5 <sup>5</sup>
PPI / Average RWA (%)	1.8	2.4	2.3	2.3	2.2	2.2 <sup>6</sup>
Net Income / Tangible Assets (%)	0.5	1.2	1.0	1.0	0.9	0.9 <sup>5</sup>
Cost / Income Ratio (%)	62.8	53.7	53.8	52.5	51.9	54.9 <sup>5</sup>
Market Funds / Tangible Banking Assets (%)	40.3	36.7	38.1	38.7	39.5	38.7 <sup>5</sup>
Liquid Banking Assets / Tangible Banking Assets (%)	16.5	13.9	14.1	15.5	13.6	14.7 <sup>5</sup>
Gross Loans / Due to Customers (%)	189.9	195.3	198.9	194.5	204.8	196.7 <sup>5</sup>

[1] All figures and ratios are adjusted using Moody's standard adjustments. [2] Basel III - fully loaded or transitional phase-in; IFRS. [3] May include rounding differences because of the scale of reported amounts. [4] Compound annual growth rate (%) based on the periods for the latest accounting regime. [5] Simple average of periods for the latest accounting regime. [6] Simple average of Basel III periods.

Sources: Moody's Investors Service and company filings

## Profile

SpareBank 1 SMN is a leading regional savings bank in central Norway. It provides a range of retail banking, corporate banking and capital markets related products and services. Furthermore, through its subsidiaries and associated companies, it offers real estate agency, investment, asset management and other financial services. As of end-June 2020, its consolidated assets (including loans transferred to covered bond companies) totalled NOK235 billion (€21.6 billion).

## Recent developments

We have revised our 2020 baseline growth forecast for all G-20 economies because of the coronavirus outbreak. The full extent of the economic costs will be unclear for some time but global recession risks have risen. In Europe, Coronavirus outbreak adds to late cycle risks for European banks. While the direct negative credit impact on the on Norwegian banking sector is expected to be limited, a failure to contain the virus would have a more severe outcome, weighing on the banks' loan quality and profitability. We expect fiscal policy measures, as already announced by a variety of European nations to mitigate the economic contraction caused by the outbreak.

We note that since 13 March 2020, Norway's central bank, the Ministry of Finance and the Norwegian FSA have taken a number of actions aiming to alleviate the impact on the economy from both the Coronavirus lockdown and the plunge in oil prices. These measures include the reduction of the key policy rate by 150 basis points (bps), reducing banks' countercyclical buffer requirement by 150 bps, providing special F-loans to banks to help manage any funding and liquidity stress, as well as extension of unemployment benefits and various social policy schemes to support individuals. We believe these measures will help alleviate the negative impact stemming from the coronavirus outbreak, and will largely sustain borrowers' solvency in the longer term.

Nonetheless, the inevitable negative impact on both the economy and banks in the next 12-18 months, have triggered on 16 April 2020 the change of our Banking System Outlook (BSO) for Norway to negative from stable. The outlook change was also driven by our expectation that sectors such as tourism, hospitality and transportation are more vulnerable to the pandemic, and by the fact that very low oil prices have historically strained Norway's oil/offshore industry that remains a significant pillar of the economy.

## Detailed credit considerations

### A deteriorating operating environment will likely pressure the bank's financial fundamentals in 2020, although overall strength of the Norwegian government finances remain supportive to the banking system

Although Norway's operating environment is deteriorating as a result of the global outbreak of Coronavirus and the plunge in oil prices, we believe that the banking system still benefits from the government's generally strong fiscal flexibility and countercyclical buffers available through its sovereign oil fund to respond to economic shocks.

SpareBank 1 SMN operates only in Norway and thus its operating environment is reflected through the 'Very Strong -' Macro Profile we assign for Norway. Norwegian banks benefit from operating in a wealthy and developed country with very high economic, institutional and government financial strength, as well as a very low susceptibility to event risk. Norway has a diversified and growing economy, which demonstrated resilience to the last weakening in the oil sector in 2014-15.

The main risks to the banking system stem from the high level of household debt, elevated real estate prices and domestic banks' extensive use of market funding. However, these risks are mitigated by the strength of households' ability to service debt, banks' adequate capitalisation and the relatively small size of the banking system compared with the total size of the economy.

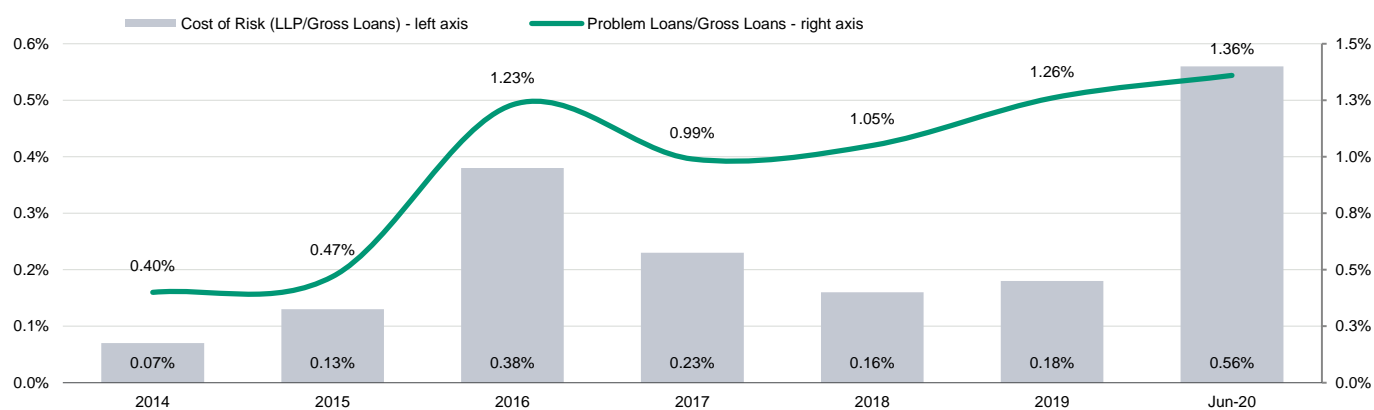
Nonetheless, we expect the Norwegian mainland economy (excluding any oil-related activity) to contract significantly in 2020 (-3.5%), and recover to around +3.8% in 2021. Unemployment rose to around 10.6% as of March 2020 (although it has significantly fallen since then), which combined with the low economic activity will inevitably impact banks' credit growth, asset quality and earnings that will be strained from elevated credit costs.

### Downside risks from the bank's oil-related exposure, although problem loans are low

SpareBank 1 SMN's stage 3 gross loans as a percentage of total loans, including loans transferred to the jointly-owned and non-consolidated SpareBank 1 Boligkreditt and Naeringskreditt) was at 1.4% in June 2020, marginally higher than 1.2% reported in June 2019. The bank's problem loans mainly originate from the challenges that it faces in its oil and offshore sector exposures as well as other oil dependent industries and services, which face difficulties mainly due to drop in oil price since the coronavirus outbreak and also due to some historical overcapacity of older offshore service vessels (OSVs).

Exhibit 3

#### SpareBank 1 SMN's problem loans % gross loans and cost of risk evolution



Note: Gross loans include covered bond loans; June 2020 figures are as reported by the bank.

Source: Moody's Financial Metrics and bank's reports

We note that the bank's exposure at default (EAD) to oil-related activity accounted for around NOK4.6 billion at end-June 2020, which comprised around 2.5% of the bank's total credit risk (including loans transferred to the covered bond companies), while total write-downs related to the offshore portfolio amounted to 16.5% of the overall EAD as of June 2020. We also note that some of these borrowers fall within the bank's top 20 group loans, elevating the bank's credit risk profile. At end-June 2020, the bank's exposure to the more risky sub-sea vessel segment constituted around 45% of the total exposure to the offshore industry.

We understand that any restructurings are time consuming since the companies' debt structure involves several banks with special lending facilities along with bond debt outstanding. The solutions recommended include injection of fresh equity by shareholders or new investors, deferment of installment payments and renegotiation/extinction/conversion of bond debt. SpareBank 1 SMN booked credit losses of NOK478 million in the first six months of 2020, of which NOK167 million related to the offshore industry. We believe that OSV exposures, despite restructurings in recent years, continue to pose downside risks for the bank.

Looking at the coronavirus-related defaults and impairments, we understand that the negative effects on the bank's borrowers are moderating and that the bank has been receiving increasingly less applications for payment holidays on the retail front and on the corporate side the number of companies requesting loan payment deferrals has been declining significantly since April 2020. In addition, corporate customers with only around NOK1.5 billion of EAD, or approximately 0.8% of the bank's total EAD, have received support through the government's compensation arrangement, which will assist their longer-term viability.

However, the bank's overall asset quality is favourable and comparable to its similarly-rated peers both locally and internationally. SpareBank 1 SMN's well-diversified loan book (including loans transferred to SpareBank 1 Boligkreditt and SpareBank 1 Naeringskreditt), of which around 68% comprises loans to retail customers (mainly in the form of mortgages), and strong risk management practices counterbalance to some degree any negative effects from its oil-related exposures. The strong performance of the bank's retail banking business continues in the first half of 2020, with only NOK50 million of impairments (out of NOK478 million) linked to retail customers.

Our assigned asset risk score incorporates negative adjustments, indicating the downside risks the bank still faces as stated above. In addition, our adjustments take into account the bank's relatively limited geographical diversification, but also its vulnerability to a potential material reduction in property prices given its exposure to commercial real-estate (14.8% of total gross loans at end-June 2020) and residential mortgages.

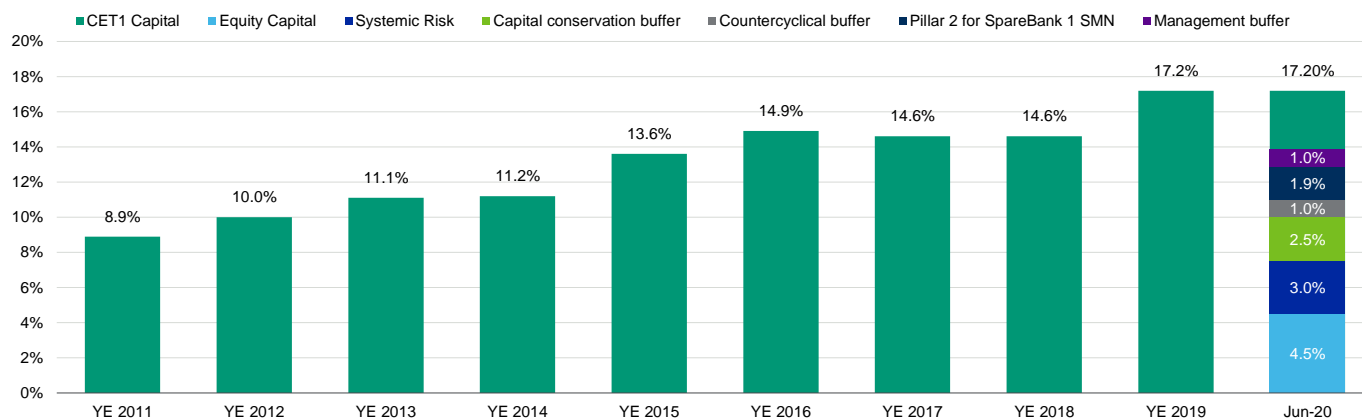
#### **Solid capital metrics provide a buffer against potential future credit losses**

In response to the global coronavirus outbreak and resulting economic stress, the Norwegian FSA has revised banks' capital requirements during the first quarter of 2020. Accordingly, the countercyclical capital buffer requirement has been lowered by 150 basis points to allow more flexibility, while banks were requested to reconsider their dividend payments for 2019.

SpareBank 1 SMN's BCA of baa1 is supported by its solid capital position, with its common equity Tier 1 (CET1) ratio of 17.2% at end-June 2020 from 15% reported in June 2019. We note that the FSA has set a Pillar 2 requirement of 1.9% with effect from first quarter of 2019 for SpareBank 1 SMN, which combined with other regulatory requirements result in a CET1 minimum of 12.9%. The bank aims for a management buffer of 1% above its regulatory requirement (see Exhibit 4). The Ministry of Finance has announced that the systemic risk buffer for IRB banks is to rise by 150 basis points to 4.5% with effect from 31 December 2020, which will accordingly increase the CET1 requirement to 14.4% at end-2020, and to 15.4% including the management buffer, which the bank already meets with a good headroom.

Exhibit 4

## Development in CET1 ratio



Source: Source: Company reports and presentations

The bank's tangible common equity has strengthened in recent years, as good earnings generation has supported its capital levels. We note that SpareBank 1 SMN's hybrid debt (NOK1.3 billion) and subordinated debt (NOK1.8 billion) contributed to the strong Tier 1 ratio of 18.9% and overall capital adequacy ratio of 21.1% at end-June 2020. Such solid capital levels provide a buffer against potential future credit losses, driving the bank's BCA and ratings.

Going forward, we expect the bank to maintain a payout ratio of around 50%, and retain sufficient profit in order to continue meeting its internal CET1 targets. Our assigned capital score reflects this strength, as well as the bank's reported leverage ratio, which at 6.9% at end-June 2020 is satisfactory for the Norwegian regulator's requirement and high compared with international standards.

### Resilient earnings benefit from a strong regional retail franchise

In response to the economic stress from the coronavirus outbreak the Norges Bank has carried out three rate cuts totaling 150 basis points since March 2020, while prior to this period the key policy rate was on a rising trend. Low loan rates (interest rate adjustment was implemented quicker than the usual 6 weeks notice) coupled with an already fierce competition among Norwegian banks will put pressure on SpareBank 1 SMN's net interest margin and profitability metrics in 2020.

SpareBank 1 SMN's reported net profit for the first six months of 2020 declined by 42% to around NOK1 billion from NOK1.7 billion in the same period in 2019, with a reported return on equity (RoE) of 10.3% compared to 19.0% a year earlier. The lower net profit was mainly driven by increased loan losses booked to account for uncertainty of the impact of coronavirus outbreak and drop in oil price, as well as lower return on financial investments due to losses since the outset of the pandemic.

The bank has recorded NOK478 million in loan losses during the first six months of 2020, compared with just NOK126 million a year earlier, which corresponds to credit losses of 0.27% of gross loans (including transferred loans) in the first half of the year. However, we note that the bank reported lower impairments in the second quarter compared to March 2020 and anticipates even lower for the rest of the year.

SpareBank 1 SMN's reported net interest income increased year-on-year by 4.8% as of June 2020, although the Q2 2020 net interest income was significantly lower due to the quicker repricing of loans lower. After a period of rising rates during 2019, net interest income was affected recently by the sharp fall in key policy rate from Norges Bank. As a result, we expect the bank's interest margins to be under pressure going forward, especially on the bank's retail portfolio.

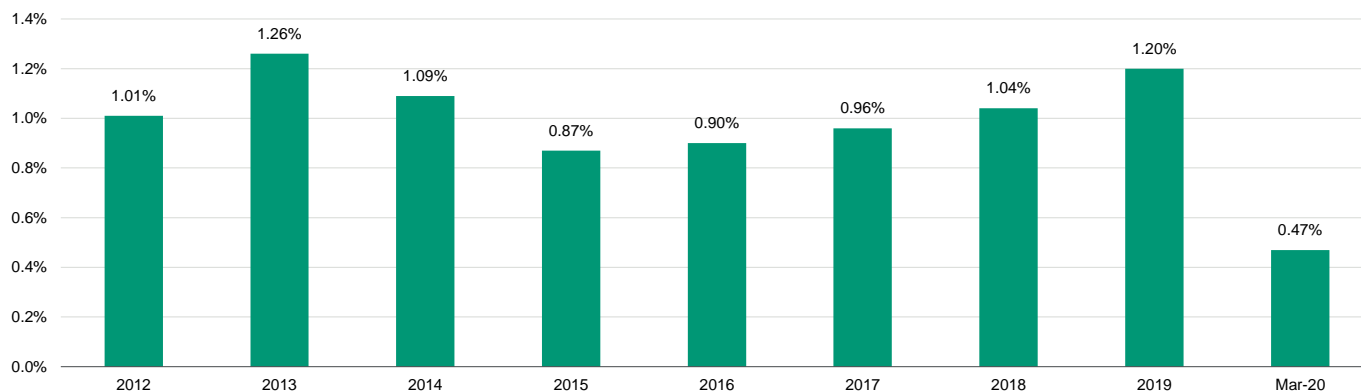
The bank reported a cost-to-income ratio of 46% as of June 2020, up from 40% in the same period in 2019. Operating costs for the group were kept broadly in line over past 12 months, although we note that the bank is committing substantial digitalisation investments as a step towards enhancing the customer experience and improving efficiencies.

Our profitability score for the bank takes into account our adjusted return on tangible assets (including assets transferred to covered bond companies) that was at 0.47% in the first three months of 2020 (see Exhibit 5), but also our forward-looking view on the bank's

resilient recurring pre-provision earnings causing a positive adjustment on our assigned score. Despite lower interest rates and intense competition for retail mortgages, we expect the bank to maintain its satisfactory profitability metrics in the coming 12-18 months.

Exhibit 5

**Moody's adjusted Net income / Tangible assets ratio evolution  
(including assets transferred to covered bond companies)**



Source: Moody's Financial Metrics

**Dependence on market funding renders the bank vulnerable to fluctuations in investor sentiment...**

SpareBank 1 SMN's deposits accounted for around 44% of total liabilities (including covered bonds issued through the covered bond companies) at end-June 2020, which have proven to be resilient and growing over many years. The year-on-year growth in total deposits was a high 8.9% at end-June 2020, with retail deposits increasing by a high 13.2% and corporate deposits by 5.9%. Retail deposits, which we consider to be more stable, represented 43% of the bank's total deposits at the end-June 2020.

SpareBank 1 SMN uses covered bonds as an important funding source, which is done off-balance sheet through specialised companies it jointly owns together with other savings banks of the SpareBank 1 Alliance (SpareBank 1 Boligkreditt for residential mortgages and SpareBank 1 Næringskreditt for commercial mortgages). At end-June 2020 the bank had transferred retail mortgages worth NOK43.1 billion and commercial real estate loans worth NOK1.4 billion to these vehicles (i.e. 25% of its gross loan book including the transferred loans). While we view positively the diversification benefit of covered bond funding, its extensive use increases the amount of pledged assets unavailable for unsecured bondholders, including depositors in liquidation.

As per our methodology, we globally reflect the relative stability of covered bonds compared to unsecured market funding through a standard adjustment in our scorecard. Our Funding Structure Score reflects our view that SpareBank 1 SMN's reliance on market funding - a common feature at Nordic banks - is of sufficient scale (market funds comprised around 40.3% of tangible banking assets at end-March 2020) to represent a source of vulnerability because, in times of market stress, market funding can become more expensive and/or restricted.

**...although liquidity is comfortable**

Risk related to market funding is mitigated somewhat as SpareBank 1 SMN maintains a sizeable liquidity buffer of NOK38 billion and funding that can cover needs for three years without any new external financing. The bank's liquid assets as a percent of total banking assets (a Moody's scorecard ratio) amounted to a high 16.5% at end-March 2020. We also note that this ratio does not take into account the liquid assets held by SpareBank 1 Boligkreditt and SpareBank 1 Næringskreditt, the bank's covered bond vehicles.

The liquid reserves mainly consists of covered bonds from other Norwegian banks; most of it is useable as collateral for loans from Norges Bank, municipal bonds and balances with central banks. Accordingly, we believe that the covered bond holdings increase the interconnection among local banks, a common feature among all rated banks, which also raises the vulnerability and contagion risks of the banking system. SpareBank 1 SMN reported a commendable liquidity coverage ratio (LCR) of 163% at end-June 2020, compared to 100% requirement.

## Environmental, social and governance considerations

In line with our general view of the banking sector, SpareBank 1 SMN has low exposure to Environmental risks and moderate exposure to Social risks. See our [Environmental](#) and [Social](#) risk heatmaps for further information.

SMN's exposure to oil and off-shore sector is a source of environmental risk for the bank in the face of eventual transition to low-carbon economy. However, the bank's exposure is relatively low at around 2.5% of the bank's total portfolio (including loans transferred to the covered bond companies), and considered manageable. Furthermore, Norway, similarly to the European Union, has policies in place that ensure new housing constructed is energy-efficient, which enables banks to gather mortgages for asset pools for green bond issuances. Such policies also help limit environmental risks for Norwegian banks with large retail exposure and primarily mortgage lending activity. SpareBank 1 SMN issued its first green covered bond worth €500 million in September 2019 with a seven year term and capital earmarked for green loan portfolios, including sustainable fisheries and fish farming. In addition, we note that in September 2019 SpareBank 1 SMN was one of the five Norwegian banks that signed the UN's principles for responsible banking, aiming to transition to a low-emission economy and meet UN's sustainability goals. In December new products were launched for retail: green residential loans, green loans for energy projects and green consumer loans.

We believe banks face moderate social risks. The most relevant social risks for banks arise from the way they interact with their customers. Social risks are particularly high in the area of data security and customer privacy, which is partly mitigated by sizeable technology investments and banks' long track record of handling sensitive client data. In addition, we regard the coronavirus outbreak as a social risk under our ESG framework, given the substantial implications for public health and safety. See our [social risk heat map](#) for further information.

Governance is highly relevant for SpareBank 1 SMN, as it is to all players in the banking industry. Corporate governance weaknesses can lead to a deterioration in a company's credit quality, while governance strengths can benefit its credit profile. Corporate governance remains a key credit consideration and requires ongoing monitoring. However, we currently do not have any governance related concerns over SpareBank 1 SMN, noting the smooth transition at the top management with a new CEO (former CEO of SpareBank 1 Nord-Norge) taking over earlier in the year.

## Support and structural considerations

### Loss Given Failure and additional notching

The EU Bank Recovery and Resolution Directive (BRRD) has entered into force as of 1 January 2019 in Norway, which confirms our current assumptions regarding LGF analysis. In our advanced LGF analysis, 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 are in line with our standard assumptions.

For SpareBank 1 SMN's long term deposits and senior unsecured debt ratings, we consider the likely impact of loss-given-failure, reflecting the combination of debt and deposit volumes and the amount of debt subordinated to them. We also take into consideration the expected level of MREL eligible debt issuance of around NOK14 billion over the coming 2-3 years. We note that the bank has already issued NOK1 billion of senior non-preferred (SNP) debt in August 2020, which qualifies as MREL instrument.

This has resulted in a Preliminary Rating Assessment of three notches above the BCA, reflecting very low loss-given-failure. For junior securities issued by SpareBank 1 SMN, our LGF analysis confirms a high level 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 reflecting the coupon features.

### Government support

SpareBank 1 SMN has a well-established regional franchise in central Norway, where we estimate it commands market shares of around 22% for lending (including the loans transferred to covered bond companies), although its national market share is limited at around 4%. The implementation of BRRD framework in Norway on 01.01.2019, which is aligned with the EU's bank recovery and resolution directive, has caused us to revise our government support assumptions for the bank. In line with other banks under these frameworks, we recently changed our government support assumptions to low from moderate for debt and deposits, resulting in no additional notches of rating uplift above their PRA, positioning them at A1.



For junior securities, we consider that potential government support is low and therefore 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

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.

#### **SpareBank 1 SMN's CR Assessment is positioned at A1(cr)/Prime-1(cr)**

SpareBank 1 SMN's CR Assessment is positioned at A1(cr)/Prime-1(cr), three notches above the bank's adjusted BCA of baa1, based on the substantial cushion against default provided to the senior obligations represented by the CRA by subordinated instruments. The main difference with our Advanced LGF approach used to determine instrument ratings is that the CRA captures the probability of default on certain senior obligations, rather than expected loss, therefore we focus purely on subordination and take no account of the volume of the instrument class.

### Counterparty Risk Ratings

Moody's Counterparty Risk Ratings (CRRs) are opinions of the ability of entities to honour the uncollateralized portion of non-debt counterparty financial liabilities (CRR liabilities) and also reflect the expected financial losses in the event such liabilities are not honoured. CRR liabilities typically relate to transactions with unrelated parties. Examples of CRR liabilities include the uncollateralized portion of payables arising from derivatives transactions and the uncollateralized portion of liabilities under sale and repurchase agreements. We believe that CRR liabilities have a lower probability of default than the bank's deposit and senior unsecured debt as they will more likely be preserved in order to minimise banking system contagion, minimise losses and avoid disruption of critical functions.

#### **SpareBank 1 SMN's CRR's are positioned at A1/Prime-1**

The CRR is positioned three notches above the adjusted BCA of baa1, reflecting the extremely low loss given failure from the high volume of instruments that are subordinated to CRR liabilities.

### Foreign currency deposit rating

SpareBank 1 SMN's foreign-currency deposit rating of A1 is unconstrained given that Norway has no country ceiling.

### Foreign currency debt rating

SpareBank 1 SMN's senior unsecured foreign-currency debt rating of A1 is unconstrained given that Norway has no country ceiling.

## Rating methodology and scorecard factors

Exhibit 6

### SpareBank 1 SMN

#### Macro Factors

**Weighted Macro Profile**                      **Very Strong -**                      **100%**

Factor	Historic Ratio	Initial Score	Expected Trend	Assigned Score	Key driver #1	Key driver #2
Solvency						
Asset Risk						
Problem Loans / Gross Loans	1.6%	aa3	↔	baa1	Geographical concentration	Sector concentration
Capital						
Tangible Common Equity / Risk Weighted Assets (Basel III - transitional phase-in)	16.7%	aa2	↔	aa2	Risk-weighted capitalisation	
Profitability						
Net Income / Tangible Assets	0.5%	baa3	↔	baa1	Expected trend	
Combined Solvency Score		a1		a2		
Liquidity						
Funding Structure						
Market Funds / Tangible Banking Assets	36.7%	ba2	↔	ba2		
Liquid Resources						
Liquid Banking Assets / Tangible Banking Assets	13.9%	baa3	↔	baa2	Stock of liquid assets	
Combined Liquidity Score		ba1		ba1		
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		
BCA Scorecard-indicated Outcome - Range				a3 - baa2		
Assigned BCA				baa1		
Affiliate Support notching				0		
Adjusted BCA				baa1		

Balance Sheet	in-scope (NOK Million)	% in-scope	at-failure (NOK Million)	% at-failure
Other liabilities	77,570	34.6%	86,562	38.6%
Deposits	88,152	39.3%	79,160	35.3%
Preferred deposits	65,232	29.1%	61,971	27.6%
Junior deposits	22,920	10.2%	17,190	7.7%
Senior unsecured bank debt	48,649	21.7%	48,649	21.7%
Dated subordinated bank debt	1,793	0.8%	1,793	0.8%
Preference shares (bank)	1,531	0.7%	1,531	0.7%
Equity	6,733	3.0%	6,733	3.0%
Total Tangible Banking Assets	224,428	100.0%	224,428	100.0%

Debt Class	De Jure waterfall		De Facto waterfall		Notching		LGF	Assigned LGF	Additional Notching	Preliminary Rating Assessment
	Instrument volume + subordination	Sub-ordination	Instrument volume + subordination	Sub-ordination	De Jure	De Facto				
Counterparty Risk Rating	33.8%	33.8%	33.8%	33.8%	3	3	3	3	0	a1
Counterparty Risk Assessment	33.8%	33.8%	33.8%	33.8%	3	3	3	3	0	a1 (cr)
Deposits	33.8%	4.5%	33.8%	26.2%	2	3	2	3	0	a1
Senior unsecured bank debt	33.8%	4.5%	26.2%	4.5%	2	2	2	3	0	a1
Dated subordinated bank debt	4.5%	3.7%	4.5%	3.7%	-1	-1	-1	-1	0	baa2

Instrument Class	Loss Given Failure notching	Additional notching	Preliminary Rating Assessment	Government Support notching	Local Currency Rating	Foreign Currency Rating
Counterparty Risk Rating	3	0	a1	0	A1	A1
Counterparty Risk Assessment	3	0	a1 (cr)	0	A1(cr)	
Deposits	3	0	a1	0	A1	A1
Senior unsecured bank debt	3	0	a1	0		A1
Dated subordinated bank debt	-1	0	baa2	0		Baa2 (hyb)

[1] Where dashes are shown for a particular factor (or sub-factor), the score is based on non-public information.

Source: Moody's Investors Service

## Ratings

Exhibit 7

Category	Moody's Rating
<b>SPAREBANK 1 SMN</b>	
Outlook	Stable
Counterparty Risk Rating	A1/P-1
Bank Deposits	A1/P-1
Baseline Credit Assessment	baa1
Adjusted Baseline Credit Assessment	baa1
Counterparty Risk Assessment	A1(cr)/P-1(cr)
Issuer Rating	A1
Senior Unsecured	A1
Subordinate	Baa2 (hyb)

Source: Moody's Investors Service

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