MOODY'S INVESTORS SERVICE

Credit Opinion: SpareBank 1 SR-Bank ASA

Global Credit Research - 11 Dec 2012

Stavanger, Norway

Ratings

Category	Moody's Rating
Outlook	Rating(s) Under Review
Bank Deposits	*A2/*P-1
Bank Financial Strength	C-
Baseline Credit Assessment	(baa2)
Adjusted Baseline Credit Assessment	(baa1)
Issuer Rating	**A2
Senior Unsecured	**A2
Subordinate	**Baa3 (hyb)
Jr Subordinate MTN	**(P)Baa3
Pref. Stock Non-cumulative	***Ba1 (hyb)

* Rating(s) within this class was/were placed on review on December 6, 2012
** Placed under review for possible downgrade on December 6, 2012
*** Placed under review for possible downgrade on March 9, 2012

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Key Indicators

SpareBank 1 SR-Bank ASA (Consolidated Financials) [1]

	[2]9-12	[2]12-11	[2]12-10	[2]12-09	[2]12-08	Avg.
Total Assets (NOK billion)	138.7	131.1	134.8	124.9	125.8	[3]2.5
Total Assets (EUR million)	18,827.3	16,927.5	17,284.3	15,070.7	12,922.7	[3]9.9
Total Assets (USD million)	24,221.5	21,974.4	23,187.6	21,622.5	17,963.2	[3]7.8
Tangible Common Equity (NOK billion)	9.7	9.2	8.9	7.2	5.1	[3]17.2
Tangible Common Equity (EUR million)	1,316.7	1,193.6	1,144.1	871.4	527.9	[3]25.7
Tangible Common Equity (USD million)	1,693.9	1,549.4	1,534.8	1,250.3	733.8	[3]23.3
Net Interest Margin (%)	1.3	1.4	1.4	1.4	1.5	[4]1.4
PPI / Avg RWA (%)	1.5	1.3	1.7	1.8	0.9	[5]1.4
Net Income / Avg RWA (%)	1.3	0.9	1.4	1.3	0.1	[5]1.0
(Market Funds - Liquid Assets) / Total Assets (%)	35.4	38.1	41.8	44.7	41.0	[4]40.2
Core Deposits / Average Gross Loans (%)	67.2	61.1	61.7	56.4	56.1	[4]60.5
Tier 1 Ratio (%)	11.5	10.6	10.2	9.6	6.4	[5]9.7
Tangible Common Equity / RWA (%)	8.8	9.1	9.6	8.5	5.8	[5]8.4
Cost / Income Ratio (%)	53.8	60.3	51.5	50.5	66.7	[4]56.6
Problem Loans / Gross Loans (%)	1.4	1.1	1.1	1.2	1.6	[4]1.3
Problem Loans / (Equity + Loan Loss Reserves) (%)	10.9	11.0	11.0	12.7	24.3	[4]14.0

Source: Moody's

[1] All 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

RECENT CREDIT DEVELOPMENTS

On 6 December 2012, Moody's downgraded SpareBank 1 SR-Bank's standalone credit assessment to C-/baa2 from C-/baa1 and its long-term senior debt ratings to A2 from A1. The rating action reflects our view that the asset quality in SpareBank 1 SR-Bank's corporate loan book is undermined by the bank's substantial exposure to the real estate and construction sectors (27% of on-balance-sheet loans at end-September 2012) and shipping-related industries (6%), which we view as more volatile. We believe that asset quality in its retail loan book will continue to be supported by low interest rates and high employment but views the marked increase in house prices in Stavanger as a risk factor. The bank's high usage of market funds (41% of total on-balance-sheet funding at end-September 2012) also constitutes a negative rating driver, although we positively note SpareBank 1 SR-Bank's good access to capital markets in the recent months. Positively, SpareBank 1 SR-Bank's ratings benefit from its strong regional franchise and its recently strengthened Tier 1 ratio at 11.5% (including transitional floor) at end-September 2012.

Following the rating downgrades of three of the four rated members of the SpareBank 1 alliance, Moody's placed SpareBank 1 SR-Bank's A2/P-1 long-term and short-term debt and deposit ratings under review for downgrade. During the review period, Moody's will assess the impact of alliance members' reduced credit strengths on their ability to provide support to each other. Currently the ratings agency expects that the banks' debt ratings may be lowered by up to one notch.

Unless otherwise stated, all figures shown are from the bank's annual and interim financial reports.

SUMMARY RATING RATIONALE

The current C- BFSR, which maps to a baseline credit assessment (BCA) of baa2 on the long-term scale, primarily reflects SpareBank 1 SR-Bank's good regional market position and strengthened capital buffer but is constrained by the bank's limited geographic outreach, resulting in high credit risk concentrations, its sizeable exposure to more volatile sectors and its substantial usage of market funds, whose availability and cost largely depends on investor sentiment.

SpareBank 1 SR-Bank's current global local currency (GLC) deposit rating of A2, receives a three-notch uplift from its baa2 BCA. This is based on our assessment of a high probability of systemic support for the bank if necessary and its importance to the Norwegian market. Moody's is however likely to gradually reduce such unusual support uplift as regulators globally consider implementing bank resolution regimes. Furthermore, we factor in a low probability of support from its membership of the SpareBank 1 Alliance; however, the availability of such support in light of the recent rating downgrades of three of the four rated members of the SpareBank 1 alliance will be reassessed during the review of the bank's debt ratings.

Rating Drivers

- Solid regional market position and brand recognition in south-western Norway

- Resilient earnings from core banking operations, but the Norwegian banking market remains competitive

- Heavy reliance on market funding

- Sound asset quality but risks posed by substantial exposure to the real estate, construction and shipping sectors

- High credit risk concentration due to limited geographic reach and strong pre-crisis loan growth

- Benefits of membership in the SpareBank 1 Alliance in terms of cross selling opportunities, shared operations and risk management practices

Rating Outlook

SpareBank 1 SR-Bank's baa1 BCA carries a stable outlook. The bank's A2/P-1 long-term and short term debt and deposit ratings are under review for downgrade, as Moody's reassesses the availability of support from other banks in the SpareBank 1 alliance in light of the recent rating downgrades of three of the four rated members of the SpareBank 1 alliance.

What Could Change the Rating - Up

Rating upgrades are unlikely in the near future, for the reasons described in the "Recent Credit Development" section above. A limited amount of upward rating momentum could develop if SpareBank 1 SR-Bank demonstrates (i) sustained good asset quality in its retail and corporate loan books, including in the more volatile segments, (ii) continued good access to capital markets and improved liquidity position, and/or (iii) stronger earnings generation without an increase in its risk profile.

What Could Change the Rating - Down

While the current standalone rating already incorporates a degree of expected further deterioration, it could decline further if (i) SpareBank 1 SR-Bank's asset quality deteriorates more than we anticipate, (ii) financing conditions become more difficult and/or (iii) its risk profile increases, for example as a result of increased exposures to more volatile sectors.

Downwards pressures on the bank's debt ratings are more imminent, as reflected by the current review for downgrade. Debt ratings could be downgraded if Moody's assesses that the availability of support from other banks in the SpareBank 1 alliance has been reduced.

Recent Results

SpareBank 1 SR-Bank reported a pre-tax income of NOK1.303 billion in Q1-Q3 2012, up from NOK1.005 billion in Q1-Q3 2011. The improvement is primarily due to higher returns on investment securities. Core banking income in the form of net interest income and fee & commission income was roughly stable year on year.

At end-September 2012, SpareBank 1 SR-Bank reported a Tier 1 ratio of 11.5% including the transitional floor; this ratio has been bolstered by a rights issue with proceeds totalling NOK1.52 billion completed in June 2012.

DETAILED RATING CONSIDERATIONS

Detailed considerations for SpareBank 1 SR-Bank's currently assigned ratings are as follows:

Bank Financial Strength Rating

The assigned BFSR is one notch lower than the outcome of Moody's bank financial strength scorecard. Based on Moody's loan loss expectations and given high credit risk concentration we believe that the bank's financial strength is more consistent with a C- BFSR.

-- Sound Franchise in South-Western Norway

SpareBank 1 SR-Bank has a sound franchise in the county of Rogaland, south-western Norway with 53 branch offices. Moody's estimates the bank has market shares of above 20% for lending and almost 30% for deposits in Rogaland (based on total lending in the county at YE2011 according to Statistics Norway). The bank is expanding into the neighbouring counties but has a limited national market share at around 3-4%. The franchise value benefits from the bank's membership in the SpareBank 1 Alliance, which consists of 17 savings banks across Norway together representing one of the leading banking groups in Norway.

In January 2012, SpareBank 1 SR-Bank was converted to a limited liability company (ASA) from an equity certificate company. We do not expect any material change in the strategy as a result of the conversion. Moody's will continue to monitor the change and its impact on the dynamics of the Alliance.

Going forward we expect the bank to be able to maintain a leading position in south-western Norway but note that the Norwegian banking market is highly competitive and that savings banks generally lack pricing power against the two national market leaders. In addition, the limited geographic diversification is a key constraint in our assessment of the franchise value of the bank.

-- Substantial Usage of Market Funding

The bank's liquidity buffer (NOK18.2 billion or almost 15% of total assets at year-end 2011) consists mainly of covered bonds, financial institution, governments and municipality bonds and some domestic corporate bonds. Most of the portfolio is repo eligible.

SpareBank 1 SR-Bank benefits from a good deposit base, which covers almost 60% of on-balance-sheet loans. However, almost half of the bank's funding is in the form of domestic and international wholesale funding. We view the bank's high reliance on market funding - a common feature at Nordic banks - as a material source of risk because, in times of market stress, market funding can become more expensive or/and restricted.

The bank has access to covered bond funding, jointly with other members of the SpareBank 1 Alliance through SpareBank 1 Boligkreditt (covered bonds backed by residential mortgages) and SpareBank 1 Næringskreditt (covered bonds backed by commercial mortgages). During 2011 NOK19 billion were transferred to Sparebank 1 Boligkreditt, the mortgage company of the Sparebank 1 Alliance. Although, Sparebank 1 SR-Bank has significantly reduced the transfer of portfolios to Sparebank 1 Boligkreditt since then, Moody's cautions that extensive use of covered bond funding through these structures, whereby prime assets come off the bank's balance sheet, might result in the structural subordination of SpareBank 1 SR-Bank's unsecured creditors, including depositors. Any significant structural subordination might impact the bank's senior debt and deposit ratings.

The bank had good access to capital markets in 2012 so far and had issued senior unsecured debt worth around NOK11.4 billion (of which around 90% have maturities over 5 years) at the time of writing.

The liquidity position for the bank is in line with that of other Norwegian banks. It reflects SpareBank 1 SR-Bank's reliance on market funding, although we note the positive impact of the bank's liquidity management as well as its access to covered bond markets.

-- Improving Capital Strengthens The Buffer Against Potential Future Credit Losses

SpareBank 1 SR-Bank's loan portfolio is relatively well diversified, with around half of lending being to retail customers at year-end 2011 (over 60% including loans transferred to SpareBank 1 Boligkreditt), almost all in the form of mortgages. As most Nordic peers, SpareBank 1 SR-Bank has a high borrower concentration (as measured by the 20 largest exposures in relation to Tier 1 capital or pre-provision profit) and concentration to the real estate industry, which represents over 20% of on-balance-sheet loans. In addition, we note that pre-crisis loan growth has been rapid and has resulted in a less well-seasoned loan portfolio.

Overall, the bank reported a moderate weakening in credit quality through the global economic downturn, with problem loans peaking in 2008. Since then, they have been gradually decreasing to 1.1% of gross loans at year-end 2011. Coverage of problem loans by loan loss reserves increased to around 70% at year-end 2011, a level which we view as satisfactory.

The current strong asset quality may however not be sustainable across the economic cycle given the still fragile economic recovery which may particularly affect the corporate sector. According to Moody's, SpareBank 1 SR-Bank's loan book concentration and its exposure to the real estate and shipping sector render it vulnerable to an economic downturn and could potentially result in substantial balance sheet and profitability stress on the bank. While the performance in the bank's retail book has been very strong so far, we believe it could be undermined by less favourable interest rate and house price levels - especially as the mortgage loans remaining on the bank's balance sheet have higher loan-to-values than those transferred to the Alliance's covered bond vehicles.

At year-end 2011, the bank's Tier 1 and total capital ratios (including the transitional floor) stood at 10.6% and 11.4%, respectively. In June 2012, the bank raised capital through a rights issue with proceeds totalling NOK1.52 billion, which strengthened its Tier 1 ratio to 11.5% at end-September 2012. These levels exceed the board's minimum Tier 1 ratio target of 10%. SpareBank 1 SR-Bank was converted into a limited liability company from an equity certificate company in January 2012. The key rationale is to broaden the investor base. The conversion should not have a significant impact on the bank's capital levels; however, should it be paired with less prudent growth or an increase in risk taking, it could jeopardize the bank's solidity.

In light of the currently strong asset quality metrics, we view the current capital levels as an adequate buffer to absorb expected further losses.

-- Competitive Pressures May Hinder Future Profitability

Earnings from core banking activities at SpareBank 1 SR-Bank are showing a positive underlying trend. Net interest income, corresponding to almost 60% of the bank's operating income, has increased slightly, partly due to loan growth, but remains constrained by increasing funding costs and strong competition. Commission income, contributing by 25% of income, has been growing in recent years partly due to cross-selling of the Alliance's products and also due to the fact that interest income on loans transferred to SpareBank 1 Boligkreditt is reported as commissions instead of interest income.

Net profitability has also been helped by an improving loan loss provision trend recently. SpareBank 1 SR-Bank's cost efficiency remained good in 2011, as reflected by a cost-to-income ratio of just over 50%.

Overall, SpareBank 1 SR-Bank's underlying profitability (excluding volatility from investments) has proven resilient but the bank's profitability continues to be undermined by higher costs of funding and keen competition in Norway, especially for retail mortgages. We see the bank's ability to overcome those challenges and maintaining low loan loss provisions, even in a less favourable environment, as key rating drivers.

Global Local Currency Deposit Rating (Joint Default Analysis)

Moody's assigns a GLC deposit rating of A2 to SpareBank 1 SR-Bank. Under Moody's Joint Default Analysis, the rating receives a three-notch uplift from the baa2 BCA. As a result of SpareBank 1 SR-Bank's importance to the region and the region's importance to the national economy of Norway (local currency deposit ceiling of Aaa), Moody's assesses a very high probability of systemic support for the bank from Norway in the event of a stress situation. We are however likely to gradually reduce such unusual support uplift as such support mechanisms are phased out, as banks' stand-alone profiles improve, and as regulators globally consider implementing bank resolution regimes. Furthermore, SpareBank 1 SR-Bank also benefits from a low probability of support from SpareBank 1 Alliance.

Notching Considerations

The ratings for the Bank's hybrid obligations are notched off the BCA according to "Moody's Guidelines for Rating Bank Hybrid Securities and Subordinated Debt" released on 17 November 2009.

On 6 December 2012, Moody's downgraded the bank's subordinated, junior subordinated and non-cumulative Tier 1 securities ratings to Baa3(hyb), Baa3(hyb) and Ba1(hyb), respectively.

SpareBank 1 SR-Bank's subordinated (dated) and junior subordinated (undated) debt instruments are rated two notches below SpareBank 1 SR-Bank's baa1 adjusted BCA (which is one notch above its BCA, reflecting support from the SpareBank 1 alliance). There is no coupon deferral option for subordinated debt while the issuer remains a going concern but junior subordinated debt features a coupon skip mechanism, which requires coupon suspension on a cumulative basis if a minimum regulatory capital trigger is breached. The wider notching compared to similar instruments issued by banks in other Nordic countries primarily reflects the ability of rated Norwegian issuers such as SpareBank 1 SR-Bank to permanently write-down principal in a going concern scenario if net assets are less than 25% of share capital and after the bank's share capital has been fully written down.

SpareBank 1 SR-Bank's Tier 1 securities continue to be rated three notches below its adjusted BCA. They are deeply subordinated, as they are senior only to equity. The loss absorption for Tier 1 securities stems from the non-cumulative coupon skip mechanism while the issuer remains a going concern. Coupon skip is mandatory upon the breach of minimum regulatory capital requirements or if the issuer does not have sufficient available distributable funds (balance-sheet trigger). The securities also feature a permanent principal write-down if the share capital has been reduced to zero and a temporary principal write-down if capital falls below the regulatory minimum.

The ratings do not include systemic support uplifts, reflecting Moody's view that systemic support for subordinated debt may no longer be sufficiently predictable or reliable to be a sound basis for incorporating uplift into Moody's ratings.

Foreign Currency Deposit Rating

SpareBank 1 SR-Bank's foreign currency deposit rating of A2 is unconstrained given that Norway has a country ceiling of Aaa.

Foreign Currency Debt Rating

SpareBank 1 SR-Bank's foreign currency debt rating of A2 is unconstrained given that Norway has a country ceiling of Aaa.

ABOUT MOODY'S BANK RATINGS

Bank Financial Strength Rating

Moody's Bank Financial Strength Ratings (BFSRs) represent Moody's opinion of a bank's intrinsic safety and soundness and, as such, exclude certain external credit risks and credit support elements that are addressed by Moody's Bank Deposit Ratings. BFSRs do not take into account the probability that the bank will receive such external support, nor do they address risks arising from sovereign actions that may interfere with a bank's ability to honor its domestic or foreign currency obligations. Factors considered in the assignment of BFSRs include bank-specific elements such as financial fundamentals, franchise value, and business and asset diversification. Although BFSRs exclude the external factors specified above, they do take into account other risk factors in the bank's operating environment, including the strength and prospective performance of the economy, as well as the structure and relative fragility of the financial system, and the quality of banking regulation and supervision.

Global Local Currency Deposit Rating

A deposit rating, as an opinion of relative credit risk, incorporates the BFSR as well as Moody's opinion of any external support. Specifically, Moody's Bank Deposit Ratings are opinions of a bank's ability to repay punctually its deposit obligations. As such, they are intended to incorporate those aspects of credit risk relevant to the prospective payment performance of rated banks with respect to deposit obligations, which includes: intrinsic financial strength, sovereign transfer risk (in the case of foreign currency deposit ratings), and both implicit and explicit external support elements. Moody's Bank Deposit Ratings do not take into account the benefit of deposit insurance schemes which make payments to depositors, but they do recognize the potential support from schemes that may provide assistance to banks directly.

According to Moody's joint default analysis (JDA) methodology, the global local currency deposit rating of a bank is determined by the incorporation of external elements of support into the bank's Baseline Credit Assessment. In calculating the Global Local Currency Deposit rating for a bank, the JDA methodology also factors in the rating of the support provider, in the form of the local currency deposit ceiling for a country, Moody's assessment of the probability of systemic support for the bank in the event of a stress situation and the degree of dependence between the issuer rating and the Local Currency Deposit Ceiling.

National Scale Rating

National scale ratings are intended primarily for use by domestic investors and are not comparable to Moody's globally applicable ratings; rather they address relative credit risk within a given country. A Aaa rating on Moody's National Scale indicates an issuer or issue with the strongest creditworthiness and the lowest likelihood of credit loss relative to other domestic issuers. National Scale Ratings, therefore, rank domestic issuers relative to each other and not relative to absolute default risks. National ratings isolate systemic risks; they do not address loss expectation associated with systemic events that could affect all issuers, even those that receive the highest ratings on the National Scale.

Foreign Currency Deposit Rating

Moody's ratings on foreign currency bank obligations derive from the bank's local currency rating for the same class of obligation. The implementation of JDA for banks can lead to high local currency ratings for certain banks, which could also produce high foreign currency ratings. Nevertheless, it should be noted that foreign currency deposit ratings are in all cases constrained by the country ceiling for foreign currency bank deposits. This may result in the assignment of a different, and typically lower, rating for the foreign currency deposits relative to the bank's rating for local currency obligations.

Foreign Currency Debt Rating

Foreign currency debt ratings are derived from the bank's local currency debt rating. In a similar way to foreign currency deposit ratings, foreign currency debt ratings may also be constrained by the country ceiling for foreign currency bonds and notes; however, in some cases the ratings on foreign currency debt obligations may be allowed to pierce the foreign currency ceiling. A particular mix of rating factors are taken into consideration in order to assess whether a foreign currency bond rating pierces the country ceiling. They include the issuer's global local currency rating, the foreign currency government bond rating, the country ceiling for bonds and the debt's eligibility to pierce that ceiling.

About Moody's Bank Financial Strength Scorecard

Moody's bank financial strength model (see scorecard below) is a strategic input in the assessment of the financial strength of a bank, used as a key tool by Moody's analysts to ensure consistency of approach across banks and regions. The model 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.

Rating Factors

SpareBank 1 SR-Bank

Rating Factors [1]	A	B	C	D	E	Total Score	Trend
Qualitative Factors (50%)						C-	
Factor: Franchise Value						D+	Neutral
Market Share and Sustainability			x				
Geographical Diversification					x		
Earnings Stability			x				
Earnings Diversification [2]							
Factor: Risk Positioning						D+	Neutral
Corporate Governance [2]	--	--	--	--	--		
- Ownership and Org. Complexity	--	--	--	--	--		
- Key Man Risk	--	--	--	--	--		
- Insider and Related-Party Risks	--	--	--	--	--		
Controls and Risk Management		x					
- Risk Management			x				
- Controls	x						
Financial Reporting Transparency		x					
- Global Comparability	x						
- Frequency and Timeliness	x						
- Quality of Financial Information			x				
Credit Risk Concentration	--	--	--	--	--		
- Borrower Concentration	--	--	--	--	--		
- Industry Concentration	--	--	--	--	--		
Liquidity Management				x			
Market Risk Appetite		x					
Factor: Operating Environment						A-	Neutral
Economic Stability		x					
Integrity and Corruption	x						
Legal System	x						
Financial Factors (50%)						C	
Factor: Profitability						C	Weakening
PPI / Average RWA - Basel II			1.60%				
Net Income / Average RWA - Basel II			1.21%				
Factor: Liquidity						D-	Neutral
(Market funds - Liqud Assets) / Total Assets					25.40%		
Liquidity Management				x			
Factor: Capital Adequacy						B+	Neutral
Tier 1 Ratio - Basel II		10.15%					

Tangible Common Equity / RWA - Basel II	9.08%						
Factor: Efficiency						**B**	**Neutral**
Cost Income ratio		54.11%					
Factor: Asset Quality						**B**	**Weakening**
Problem Loans / Gross Loans		1.15%					
Problem Loans / (Shareholders' Equity + Loan Loss Reserves)		11.57%					
Lowest Combined Financial Factor Score (15%)						**D-**	
Economic Insolvency Override						**Neutral**	
Aggregate Score						**C**	
Assigned BFSR						**C-**	

[1] - Where dashes are shown for a particular factor (or sub-factor), the score is based on non-public information.
[2] - A blank score under Earnings Diversification or Corporate Governance indicates the risk is neutral.