Credit Opinion: SpareBank 1 SR-Bank

SpareBank 1 SR-Bank

Stavanger, Norway

Ratings

Category	Moody's Rating
Outlook	Stable
Bank Deposits	Aa3/P-1
Bank Financial Strength	C+
Issuer Rating	Aa3
Senior Unsecured	Aa3
Subordinate	A1
Jr Subordinate	A1
Preferred Stock	A2

Contacts

Analyst	Phone
Eeva Antila/London	44.20.7772.5454
Janne Thomsen/London	
Reynold R. Leegerstee/London	

Key Indicators

SpareBank 1 SR-Bank

	[1]**2007**	**2006**	**2005**	**2004**	**2003**	**Avg.**
Total assets (NOK billion)	**103.12**	**85.04**	**67.24**	**59.14**	**52.64**	[2]**15.79**
Total assets (EUR billion)	**12.99**	**10.36**	**8.42**	**7.18**	**6.27**	**--**
Total capital (NOK billion)	**8.52**	**7.29**	**6.17**	**4.87**	**4.69**	[2]**16.22**
Return on average assets	**1.09**	**1.23**	**1.36**	**1.10**	**1.06**	**1.17**
Recurring earnings power [3]	**1.12**	**1.17**	**1.43**	**1.61**	**1.84**	**1.43**
Net interest margin	**1.52**	**1.55**	**1.87**	**2.14**	**2.20**	**1.86**
Cost/income ratio (%)	**56.80**	**57.24**	**52.74**	**51.24**	**45.72**	**52.75**
Problem loans % gross loans	**0.84**	**0.42**	**0.75**	**1.08**	**1.73**	**0.96**
Tier 1 ratio (%)	**7.51**	**7.39**	**8.98**	**9.09**	**9.11**	**8.42**

[1] As of December 31. [2] Compound annual growth rate. [3] Preprovision income % average assets.

Opinion

SUMMARY RATING RATIONALE

Moody's assigns a Bank Financial Strength Rating (BFSR) of C+ to SpareBank 1 SR-Bank (formerly Sparebanken Rogaland), which translates into a Baseline Credit Assessment (BCA) of A2. The BFSR reflects the bank's dominant regional market position, good risk management and solid financials, particularly asset quality and capital adequacy.

The bank is the leading player in south-western Norway, where it benefits from strong local brand name recognition. SpareBank 1 SR-Bank has about 40% regional market share in the retail lending and over 20% in corporate lending. The bank's strategy is based on regional franchise and membership of SpareBank 1 Alliance. Particular focus areas are cross-selling, profitability and risk profile. This has led to successful, albeit gradual, penetration of the wealth management market (life insurance, mutual and pension funds).

The bank benefits from being a member of SpareBank 1 Alliance, created in 1996, which has provided member banks with a stronger brand, more sophisticated products provided by SpareBank 1 Gruppen (of which SpareBank 1 SR-Bank owns 19.5%) and cost synergies. Although the member banks have retained their local brandings, they continue to learn from each other's best practices. The successful restructuring of SpareBank 1 Gruppen has become a strong positive contributor to its owners' financials.

The Global Local Currency (GLC) deposit rating of Aa3 for SpareBank 1 SR-Bank is supported by the bank's own A2 BCA and the Aaa local currency deposit ceiling of Norway, which is considered the underlying support provider. As a result of the bank's importance to its region and the region's importance to the national economy of Norway, Moody's assesses a very high probability of systemic support for the bank in the event of a stress situation. The bank also benefits from a low probability of support from SpareBank 1 Alliance. Consequently, there is a two-notch uplift for the GLC deposit rating from the bank's A2 BCA.

Credit Strengths

- Strong regional market position and brand recognition in south-west Norway

- Membership of SpareBank 1 Alliance reflected in the bank's franchise through shared operations and active benchmarking

- Comprehensive risk management practices

- Contained market risk appetite

- Good asset quality

- Sound capitalisation

Credit Challenges

- Continued top line growth in light of margin pressure and intense competition

- High credit risk concentration, mitigated, however, by good collaterals

- Tight liquidity by international standards, although similar to other Norwegian banks

- Improving efficiency

- Retaining good asset quality across the economic cycle

Rating Outlook

The outlook on all ratings is stable.

What Could Change the Rating - Up

Upward movement of the BFSR is unlikely in the near future, but could over time be achieved on the back of improved liquidity, profitability, efficiency and further improvement in the risk profile in terms of concentrations.

SpareBank 1 SR-Bank's GLC deposit rating may be upgraded if (a) the bank's BFSR is upgraded, (b) the probability of support from SpareBank 1 Alliance is substantially increased, and/or (c) systemic support is increased.

What Could Change the Rating - Down

The BFSR could be negatively affected by any deterioration in liquidity or profitability as well as worsening credit quality of the large customers; none of these is likely in the near future given current strategy and economic conditions.

SpareBank 1 SR-Bank's GLC deposit rating would be downgraded (a) in the event that the BFSR is downgraded, and/or (b) in the unlikely event of a decline in Moody's view of the probability of systemic support for the bank.

Recent Results and Developments

The core operating performance of SpareBank 1 SR-Bank remained solid in Q1 2008. Net interest income was 31% higher than in Q1 2007 reflecting strong loan growth whereas the interest margin has been stable for the past three quarters. Net commission income increased 9% from Q1 2007. The bank's result was however negatively affected by unrealised losses on financial instruments, mainly in the bond portfolio. We also note a 16% increase in personnel expenses. Overall, the cost/income ratio weakened to 65% in Q1 2008. Pretax profit for the first quater in 2008 was NOK186 million (EUR 24 million) compared to NOK276 million a year ago. So far, asset quality has remained strong but we note high loan growth especially in the corporate portfolio - +39% from end-March 2007. The bank's Tier 1 ratio increased slightly to 7.6% from 7.5% at year-end 2007.

Economic environment in Norway has remained favourable, and in western Norway economic activity is still high. There area however some challenges facing the banking sector. Economic growth is expected to slow down and in the near future risks are related to shortage of labour, increasing prices and higher interest rates. In addition housing market has been stabilising and demand for investment products decreased. We also note that competition in financial services remains intense.

DETAILED RATING CONSIDERATIONS

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

Bank Financial Strength Rating

Moody's assigns a C+ BFSR to SpareBank 1 SR-Bank which is in line with the Moody's scorecard outcome. The key positive drivers behind the assigned rating are strong regional market position and brand recognition in south-west Norway, and positive effects related to membership in SpareBank 1 Alliance. In addition good asset quality and capitalisation indicators are influential factors on the assigned BFSR. The key drivers restricting the BFSR are the bank's operations in a limited geographical area, high credit risk concentration as well as high dependence on market funding reflected in the liquidity ratio.

Moody's considers a BFSR of C+ to be a correct estimation of the bank's current financial strength and franchise, given the assessment of historical trends and the bank's strategic direction.

Qualitative Factors (50% weighting)

Factor 1: Franchise Value

Trend: Neutral

SpareBank 1 SR-Bank has a solid, defensible franchise in south-western Norway, characterised by a loyal customer base, high regional market shares and stable earnings base. The bank has over 200,000 customers and market shares of about 40% in retail lending and over 20% in corporate lending in the main market of Rogaland. In addition, the bank has been expanding to the neighbouring counties of Adger and Hordaland.

About 60% of the bank's lending is to retail customers, mostly in the form of mortgages but in recent years corporate lending has been growing strongly. In recent years the bank has also increased its focus on cross-selling and as a result fee and commission income now represent some 25% of operating income compared to less than 20% in 2005. In 2007, over 60% of the bank's earnings were derived from stable income sources including retail banking, asset management and leasing.

The franchise of SpareBank 1 SR-Bank is positively affected by the membership in SpareBank 1 Alliance which was established in 1996 in response to the increasing competitive pressures in the Norwegian banking sector. Currently, the Alliance has 22 saving banks as members. The Alliance includes joint product companies (including fund management, insurance and real estate), joint marketing and the development of common IT and Internet platforms. Therefore, belonging to the Alliance allows cost sharing, economies of scale and critical mass among members. The sales strategy remains decentralised so as to safeguard a close customer relationship.

We expect the bank will be able to maintain a leading position in the region due to close relations with its clients, a broad product offering and synergies related to the membership of SpareBank 1 Alliance. Nevertheless, the bank operates in a limited geographic area which limits the overall score for the bank's franchise value to C+.

Factor 2: Risk Positioning

Trend: Neutral

SpareBank 1 SR-Bank enjoys a solid risk profile overall. The bank's management practices and systems provide comprehensive guidelines and tools for risk-taking, which will reflect the overall risk culture of the organisation. The bank also benefits from common unit of SpareBank 1 Alliance focusing on credit risk modelling.

There are no corporate governance issues at SpareBank 1 SR-Bank. The largest owner has 5% of primary capital certificates and 20 largest owners have 30%.

Operating in and being supportive to its small geographic region means that SpareBank 1 SR-Bank has large customer exposures - the bank's top 20 exposures represent over 200% of its Tier 1 capital. However, industry concentration is relatively lower, but we note that loans to the real estate sector represent 18% of the total loan portfolio. We also note that although exposure to shipping-related industries has grown rapidly, it represents only 4% of the total loan portfolio. These credit concentrations represent possible sources of vulnerability. We nevertheless take comfort from the high quality of the largest exposures as well as good collateral.

Compared to European peers, SpareBank 1 SR-Bank has fewer liquid assets on balance sheet, amounting to about 10% of total assets. That said, the bank's liquidity management is well developed, which is typical for a Norwegian bank as liquidity has historically been tight. Liquidity measures also benefit from access to covered bond market going forward - SpareBank 1 Boligkreditt, which is partly owned by SpareBank 1 SR-Bank, started to issue covered bonds in 2007. By the end of 2007, SpareBank 1 SR-Bank had transferred mortgage bonds worth NOK5 billion to the covered bond company. The liquidity portfolio displays good quality - the portfolio consists of mainly bonds issued by domestic or international financial institutions and includes also some covered bonds and domestic corporate bonds. The portfolio does not include other structured products. Majority of the portfolio is repo eligible. On the funding side, SpareBank 1 SR-Bank benefits from a good deposit base but due to strong loan growth its reliance on market funding has increased. At year-end 2007, 55% of funding consisted of deposits and 45% of wholesale funds. The bank has an EMTN programme and also issues in the local market - at year-end 2007 about 50% of wholesale funding was from the Norwegian market. The maturity profile of long-term funding is diversified - about NOK5 billion (about EUR 620 million) is maturing in 2008.

The bank has a limited appetite for market risk although we note that it established a capital markets division in 2007 which is also involved in proprietary trading. The exposure to interest rate risk is limited to NOK30 million in relation to 100bps change in interest rates. The bank's shareholdings on the balance sheet amounted to NOK589 million at year-end 2007 and consist mainly of shares in Norwegian companies, including both listed and unlisted companies. In addition, SpareBank 1 SR-Bank's currency position is limited.

High credit risk concentration pushes the overall score on risk positioning to a C-.

Factor 3: Regulatory Environment

For a discussion of the regulatory environment, please see Moody's Banking System Outlook on Norway, published in November 2007.

Factor 4: Operating Environment

Trend: Improving

The unadjusted score for Norway's operating environment is B+. However, in our opinion, mainland GDP should be a better proxy for economic stability because of the segregation of oil income from the public finances that has been in place for the last decade. Regarding the time horizon, we also believe that the last five-year standard deviation would be a better indicator due to the material changes in economic policies after the crisis of the early 1990s. These two factors considered together lead to an A- adjusted operating environment score.

Quantitative Factors (50% weighting)

Factor 5: Profitability

Trend: Neutral

SpareBank 1 SR-Bank is reliant on net interest income which represents 56% of its operating income. Decreasing net interest margin is therefore putting pressure on profitability which has been in recent years compensated by strong volume growth. Commission income represents about 25% of the operating income and is mainly related to payment services, securities trading, and insurance products. Trading income comprises less than 10% of the operating income. Good performance of SpareBank 1 Gruppen, of which SpareBank SR-Bank owns 19.5%, has also positively influenced the bank's profitability. We, however, note that risk-weighted profitability is on a negative trend - preprovision income in relation to risk-weighted assets has decreased from 2.2% in 2005 to 1.6% in 2007.

The score for profitability is in line with the bank's BFSR at C+. We expect SpareBank 1 SR-Bank to be able to maintain the current level of profitability going forward through the focus on cross-selling, strong asset quality and a positive contribution from SpareBank 1 Gruppen. Intense competition in Norway is however keeping pressure on the margins and therefore we view the trend as neutral.

Factor 6: Liquidity

Trend: Improving

While liquidity is structurally tight in Norway, it is - to a degree - balanced by good liquidity management. As mentioned above, SpareBank 1 SR-Bank is reliant on domestic and international wholesale funding but benefits also from good deposit base. Particularly, corporate deposits have been growing, reflecting current good cash situation of Norwegian corporates. In addition, we note that SpareBank 1 SR-Bank has started to issue covered bonds jointly with other members of SpareBank 1 Alliance. This should have a positive effect on the liquidity score even in the short term.

The D+ score for liquidity, although lower than European counterparts, is in line with other Norwegian banks. It reflects reliance on market funding but we positively note good liquidity management of the bank as well as the access to covered bonds based on which we see a positive trend in liquidity.

Factor 7: Capital Adequacy

Trend: Weakening

SpareBank 1 SR-Bank's capital adequacy compares well to its peer group and remains at a good level. We, however, note that the Tier 1 ratio has decreased to 7.5% from 9.0% in 2005, reflecting strong loan growth. We see the trend in capital adequacy weakening since loan growth is expected to remain high reflecting booming industry at the coastal area. The bank's Tier 1 capital includes a USD75 million hybrid instrument to which Moody's has assigned a basket B (i.e. 25% equity). The Tier 1 ratio adjusted for the hybrid capital remains at a satisfactory level of 7.0% as at year-end 2007. The bank's board has set lower limits for Tier 1 and total capital ratios of 7% and 11%, respectively.

For Basel II purposes, SpareBank 1 SR-Bank applies IRB Foundation Approach for corporate credit risk and Advanced Approach for retail credit risk. Given the bank's large retail loan book, the capital requirement is estimated to decrease under Pillar 1.

Factor 8: Efficiency

Trend: Neutral

The bank's efficiency has been weakening and was at 57% in 2007; however, it is in line with the other rated SpareBank 1 banks, which all score C for efficiency. On the one hand, we continue to see pressure on expenses due to the tight labour market as well as increased funding cost. On the other hand, SpareBank 1 SR-Bank should benefit from cost advances related to SpareBank 1 Alliance.

In a competitive market such as Norway, we continue to see efficiency as key for the financial flexibility of the institution.

Factor 9: Asset Quality

Trend: Weakening

The high asset quality is a reflection of the continuous improvements of SpareBank 1 SR-Bank's risk management, but also of the current benign economy of Norway - hence subsequent numbers may not remain at these record levels. Problem loans are still low but have increased somewhat, accounting for 0.8% of gross loans compared to 0.4% at year-end 2006. Also the net write-backs on loan losses in 2005 and 2006 were reversed in 2007 but provisions were still only slightly negative.

In addition to risks related to borrower and industry concentration, the lending growth has been rapid in recent years and resulted in a less seasoned loan portfolio - in 2007 corporate lending increased by 28%. We also note that the loan loss coverage has decreased which is partly related to changes in accounting standards to IFRS (IAS 39).

We do not expect the record low level of problem loans to be sustainable and have therefore adjusted the score for asset quality from B+ to B, and see the trend as weakening.

Global Local Currency Deposit Rating (Joint Default Analysis)

Moody's assigns a global local currency (GLC) deposit rating of Aa3 to SpareBank 1 SR-Bank. The rating is supported by the A2 Baseline Credit Assessment and the Aaa local currency deposit ceiling of Norway, which is considered the underlying support provider. As a result of the bank's importance to its region and the region's importance to the national economy of Norway, Moody's assesses a very high probability of systemic support for the bank in the event of a stress situation. Further, the bank also benefits from a low probability of support coming from SpareBank 1 Alliance. Finally, the dependence between SpareBank 1 SR-Bank and SpareBank 1 Alliance is high due to the substantial degree of integration and shared business lines between the two.

Notching Considerations

The rating of any junior obligations should be notched from the fully supported deposit rating.

Foreign Currency Deposit Rating

Foreign Currency deposit ratings are unconstrained given that Norway has a country ceiling of Aaa. SpareBank 1 SR-Bank's foreign currency deposit rating is Aa3.

Foreign Currency Debt Rating

Foreign Currency debt ratings are unconstrained given that Norway has a country ceiling of Aaa. SpareBank 1 SR-Bank's senior unsecured foreign currency debt rating is Aa3.

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						**C+**	**Neutral**
Market Share and Sustainability	**x**						
Geographical Diversification					**x**		
Earnings Stability		**x**					
Earnings Diversification [2]							
Factor: Risk Positioning						**C-**	**Neutral**
Corporate Governance [2]							
- Ownership and Organizational 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						**B+**	**Improving**
Economic Stability			**x**				
Integrity and Corruption	**x**						
Legal System	**x**						
Financial Factors (50%)						**C**	
Factor: Profitability						**C+**	**Neutral**
PPP % Avg RWA			1.84%				
Net Income % Avg RWA		1.80%					
Factor: Liquidity						**D+**	**Improving**
(Mkt funds-Liquid Assets) % Total Assets					32.08%		
Liquidity Management			x				
Factor: Capital Adequacy						**B**	**Weakening**

Tier 1 ratio (%)			7.96%				
Tangible Common Equity % RWA	7.88%						
Factor: Efficiency						**C**	**Neutral**
Cost/income ratio			55.59%				
Factor: Asset Quality						**B+**	**Weakening**
Problem Loans % Gross Loans	0.67%						
Problem Loans % (Equity + LLR)		10.22%					
Lowest Combined 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