MOODY'S INVESTORS SERVICE

Credit Opinion: SpareBank 1 SR-Bank

Global Credit Research - 04 Mar 2011

Stavanger, Norway

Ratings

Category	Moody's Rating
Outlook	Stable
Bank Deposits	A1/P-1
Bank Financial Strength	C-
Issuer Rating	A1
Senior Unsecured	A1
Subordinate	A2
Jr Subordinate	Baa2 (hyb)
Preferred Stock	Ba1 (hyb)

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Key Indicators

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

	[2]**12-10**	[2]**12-09**	[2]**12-08**	[2]**12-07**	[3]**12-06**	**Avg.**
Total Assets (NOK billion)	**134.8**	**124.9**	**125.7**	**103.1**	**85.0**	[4]**12.2**
Total Assets (EUR million)	**17,284.3**	**15,070.7**	**12,910.6**	**12,989.5**	**10,357.0**	[4]**13.7**
Total Assets (USD million)	**23,187.6**	**21,622.5**	**17,946.3**	**18,991.3**	**13,657.3**	[4]**14.1**
Tangible Common Equity (NOK billion)	**8.2**	**7.2**	**5.1**	**5.1**	**4.1**	[4]**18.7**
Tangible Common Equity (EUR million)	**1,046.7**	**871.4**	**523.2**	**638.4**	**501.0**	[4]**20.2**
Tangible Common Equity (USD million)	**1,404.2**	**1,250.3**	**727.2**	**933.4**	**660.7**	[4]**20.7**
PPI / Avg RWA (%)	**1.8**	**1.8**	**1.1**	**1.5**	**1.5**	[5]**1.6**
Net Income / Avg RWA (%)	**1.5**	**1.3**	**0.4**	**1.5**	**1.6**	[5]**1.2**
(Market Funds - Liquid Assets) / Total Assets (%)	**44.8**	**46.6**	**45.0**	**37.7**	**40.4**	[6]**42.9**
Core Deposits / Average Gross Loans (%)	**61.7**	**56.4**	**56.1**	**60.7**	**55.0**	[6]**58.0**
Tier 1 Ratio (%)	**10.2**	**9.6**	**6.4**	**7.4**	**7.4**	[5]**8.4**
Tangible Common Equity / RWA (%)	**8.8**	**8.5**	**5.8**	**7.4**	**7.0**	[5]**7.6**
Cost / Income Ratio (%)	**49.8**	**51.1**	**63.5**	**56.0**	**56.7**	[6]**55.4**
Problem Loans / Gross Loans (%)	**1.1**	**1.2**	**1.6**	**0.8**	**0.4**	[6]**1.0**
Problem Loans / (Equity + Loan Loss Reserves) (%)	**11.9**	**12.7**	**24.5**	**12.3**	**6.9**	[6]**13.6**

Source: Moody's

[1] All ratios are adjusted using Moody's standard adjustments [2] Basel II; IFRS [3] Basel I; IFRS [4] Compound Annual Growth Rate based on IFRS reporting periods [5] Basel II & IFRS reporting periods have been used for average calculation [6] IFRS reporting periods have been used for average calculation

Opinion

SUMMARY RATING RATIONALE

Moody's rates SpareBank 1 SR-Bank A1/P-1/C-.

The C- Bank Financial Strength Rating (BFSR), which maps to a Baseline Credit Assessment (BCA) of Baa1, reflects the bank's solid regional market position, good risk management and improved capital buffer. The key factor constraining the rating is SpareBank 1 SR-Bank's limited geographic outreach, which translates into a higher credit risk concentration.

SpareBank 1 SR-Bank's global local currency (GLC) deposit rating of A1 receives a three-notch uplift from its Baa1 BCA. This is based on our assessment of a very high probability of systemic support for the bank in case of need, reflecting its position in the Norwegian market and its membership of the SpareBank 1 Alliance, although we only factor in a low probability of support from SpareBank 1 Alliance.

Credit Strengths

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

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

- Resilient earnings from core banking operations

- Improved capital position

Credit Challenges

- Asset quality vulnerable to potential house price falls or rising interest rates

- High credit risk concentration reflecting limited geographic reach and very strong loan growth in 2006-2008, especially in the corporate sector

- Core profitability under pressure in the competitive Norwegian banking market

- Heavy reliance on market funding

Rating Outlook

The outlook on all ratings is stable. On 7 September 2010, Moody's changed the outlook on SpareBank 1 SR-Bank's ratings to stable from negative, primarily reflecting SpareBank 1 SR-Bank's good capital levels and improved performance in recent quarters. We believe asset quality will continue to weigh on the bank's earnings but do not foresee incremental loan impairment beyond our scenario analysis (see "Moody's Approach to Estimating Nordic Banks' Credit Losses" published on 16 July 2009).

What Could Change the Rating - Up

An upgrade of the banks' ratings could be triggered by a sustainable improvement in earnings without an increase in its risk profile. A reduction of loan concentrations may also result in upward pressure on the ratings.

What Could Change the Rating - Down

The BFSR could be negatively affected if credit quality weakens to a greater extent than envisaged in Moody's base-case stress scenario, which would exert pressure on the bank's capitalisation.

SpareBank 1 SR-Bank's GLC deposit rating could be downgraded in the event of (i) the BCA being lowered to Baa2 or the BFSR being downgraded, and/or (ii) a decline in Moody's assessment of the probability of systemic support for the bank.

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 loss expectations for SpareBank 1 SR-Bank's loan portfolio as well as high credit risk concentration, we believe that the bank's financial strength is more consistent with a C- BFSR.

Qualitative Factors (50% weighting)

Factor 1: Franchise Value

Trend: Neutral

SpareBank 1 SR-Bank has a sound, defensible franchise in the county of Rogaland, south-western Norway, where it has 53 branches, with over 200,000 customers. Moody's estimates the bank has market share of above 20% for lending and almost 30% for deposits in Rogaland. In addition, the bank has been expanding into the neighbouring counties of Agder and Hordaland, notably through the acquisition of Kvinnherad Sparebank, a small SpareBank 1 bank, toward the end of 2010. The national market share is limited, at around 3-4%.

In addition, SpareBank 1 SR-Bank's franchise value benefits from its membership in the SpareBank 1 Alliance, which consists of 21 savings banks across Norway together representing the third largest banking group in Norway. The SpareBank 1 brand enjoys strong name recognition in a wide range of segments including fund management, life and non-life insurance, which are provided by joint product companies owned by SpareBank 1 Gruppen (Baa1/P-2, a holding company owned by the member banks including SpareBank 1 SR-Bank which owns 19.5%) and distributed by the member banks.

In November 2010, SpareBank 1 SR-Bank's supervisory board decided to convert the bank into a limited liability company (subject to approval from the Ministry of Finance). We do not expect any material change in the strategy as a result of the conversion; however we caution that this could result in less protection against a hostile takeover. We will monitor the change and its effect on the Alliance.

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. Additionally, the limited geographic diversification constrains the overall score for the bank's franchise value to C-.

Factor 2: Risk Positioning

Trend: Neutral

SpareBank 1 SR-Bank's management practices and systems provide comprehensive guidelines and tools for risk-taking. Over time, this approach has come to characterise the risk culture of the organisation. The bank also benefits from SpareBank 1 Alliance's focus on credit risk modelling and from the fact that members of the Alliance continue to share best practices.

After the private placements in 2010, Gjensidige has become the largest owner in the bank with 16.3% of the bank's equity certificates (EC). The 20 largest owners had 43% of ECs at YE 2010. The ECs of SpareBank 1 SR-Bank are listed on the Oslo Stock Exchange.

SpareBank 1 SR-Bank's board consists of seven members, one of whom represents employees. We do not view SpareBank 1 SR-Bank as having corporate governance problems. Nevertheless, we note that the CEO and the CFO were both appointed in 2010.

SpareBank 1 SR-Bank reports according to IFRS and its accounts are audited by PricewaterhouseCoopers. In our view, the quality of financial reporting is good when compared with that of its peers.

The bank has limited appetite for market risk. Exposure to interest rate risk is limited to NOK50 million in relation to a 100 basis point parallel movement in interest rates. The bank's on-balance sheet shareholdings increased to NOK661 million at YE 2010 (7% of Tier 1 capital). The exposure is mainly to listed and unlisted Norwegian companies, largely via investments in mutual funds. In addition, SpareBank 1 SR-Bank's currency position is limited In the past years, some further volatility has arisen from the bank's investments in related companies, primarily SpareBank 1 Gruppen (19.5%), BNBank (23.5%) and Bank 1 Oslo (19.5%).

Its overall risk profile is good, although the risk concentrations remain a constraint on the C- score for risk positioning.

Factor 3: Regulatory Environment

Moody's assessment of Norway's regulatory environment does not address bank-specific issues; instead, it evaluates whether or not regulatory bodies are independent and credible, demonstrate enforcement powers and adhere to global standards of best practices for risk control. Refer to Moody's latest Banking System Outlook on Norway to obtain a detailed discussion of the regulatory environment.

Factor 4: Operating Environment

Trend: Neutral

The score for operating environment takes into account the economic stability, integrity and corruption in the country as well as the legal system. The unadjusted score for Norway's operating environment is B and is constrained by a score of C for economic stability, primarily as a result of volatility in oil prices. To reflect the fact that offshore revenues are allocated to the Government Pension Fund and have a limited impact on the mainland economy, we calculate the score for economic stability as the average of the standard deviations of GDP growth both including (75% weight) and excluding offshore revenue (25% weight), which results in an adjusted score of B. Consequently, the adjusted score for operating environment is B+.

For further discussion of the operating environment, please see Moody's latest Banking System Outlook on Norway.

Quantitative Factors (50% weighting)

Factor 5: Profitability

Trend: Weakening

Earnings from core banking activities at SpareBank 1 SR-Bank have been on a continuous positive trend despite the challenging environment in the most recent years. In 2010, net interest income, which remains the bank's main income source (over 50% of total operating income), has been supported by good loan growth in the retail market and widening lending margins in the corporate market.

Commission income accounted for over 20% of operating income. This source of income has been growing in the recent years and reflects the successful cross-selling of the Alliance's products, as well as the increasing amount of loans transferred to the Alliance's mortgage company, SpareBank 1 Boligkreditt, therefore generating commission income rather than interest income

In addition, we note that financial investments remain a significant source of earnings volatility due to their high reliance on market conditions. These investments continued to yield higher-than-average returns in 2010, though not as generous as in 2009. In addition, the bank's profitability was inflated by one-off gain from the merger between PBS and Nordito in 2010.

Net profitability was helped by lower loan loss provisions in 2010, amounting to NOK234 million (NOK368 million in 2009). While we view positively the stabilisation of provision levels in the two most recent years, we do not expect the level of loan loss provision to revert to their extremely low pre-crisis levels in the short to medium term.

The scorecard outcome is D+ and is constrained by the lower profitability levels in 2008. We note that, overall, profitability improved in 2009 and 2010 mainly as a result of financial investments and lower provisions. We, however, view the trend as weakening given the slow growth environment and uncertainties related to the economic outlook, especially for the corporate sector.

Factor 6: Liquidity

Trend: Neutral

SpareBank 1 SR-Bank's asset buffer totalled around 15% of total assets at YE 2010. The bank's liquidity portfolio consists mainly of covered bonds and also includes bonds issued by domestic or international financial institutions, governments and municipalities, and some domestic corporate bonds. The portfolio does not include structured products other than covered bonds. Most of the portfolio is repo eligible.

On the funding side, SpareBank 1 SR-Bank benefits from a good deposit base, which covers almost 60% of on-balance-sheet loans (close to 50% including loans transferred to SpareBank 1 Boligkreditt). However, almost half of the bank's funding is in the form of domestic and international wholesale funding. The bank has a euro medium-term note programme and also issues bonds in the local market.

In addition, SpareBank 1 SR-Bank benefits from access to covered bonds, jointly with other members of the SpareBank 1 Alliance through

SpareBank 1 Boligkreditt. Covered bonds have become an increasingly important funding source for SpareBank 1 SR-Bank, as for several of its Norwegian peers. By YE 2010, SpareBank 1 SR-Bank had transferred retail mortgages worth NOK26.2 billion to the Alliance's covered bond company (around 20% of the loan portfolio). The bank has used covered bonds worth NOK9.3 billion in the now phased out government swap scheme. The SpareBank 1 banks have also established a company issuing covered bonds backed by commercial mortgage loans, SpareBank 1 Næringskreditt, but so far only BNbank has transferred loans to the entity.

However, 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 D+ score for liquidity, although lower than that of European counterparts, 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 bonds.

Factor 7: Capital Adequacy

Trend: Neutral

At YE 2010, the bank's Tier 1 and total capital ratios - calculated in accordance with the transitional rules towards Basel II - stood at 10.2% and 12.4%, respectively. These levels exceed the board's minimum Tier 1 ratio target of 9% and are well above those reported in 2008, primarily as a result of a NOK1.23 billion EC issue and a NOK800 million Tier 1 hybrid instrument in Q4 2009.

SpareBank 1 SR-Bank has recently communicated it intends to broaden its investor base by converting into a limited liability company. 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.

The score for capital adequacy is B+. We view the current capital levels as an adequate buffer to absorb expected further losses and hence view the trend as neutral.

Factor 8: Efficiency

Trend: Neutral

SpareBank 1 SR-Bank's cost efficiency remained good in 2010, as reflected by the cost-to-income ratio of 50%.

Despite being helped by a NOK106 million one-off positive effect of a change in the pension legislation, personnel expenses continued to be the largest cost. In addition, the bank's expansion in Hordaland and Agder and increased activity in EiendomsMegler 1 SR-Eiendom bring upward pressure on expenses.

We believe it will be challenging for SpareBank 1 SR-Bank to materially improve cost efficiency and continue to expand at the same time. Nevertheless, SpareBank 1 SR-Bank should enjoy further synergies from being part of the SpareBank 1 Alliance, which facilitates cost sharing, economies of scale and critical mass among members.

In a competitive market such as Norway, we continue to see efficiency as key for the financial flexibility of SpareBank 1 SR-Bank. The bank scores B for efficiency.

Factor 9: Asset Quality

Trend: Weakening

SpareBank 1 SR-Bank's loan portfolio is well diversified, with around half of on-balance sheet lending being to retail customers as at YE 2010 (over 60% including loans transferred to SpareBank 1 Boligkreditt), mostly in the form of mortgages. However, the bank exhibits some concentration in the real estate business (mainly the letting of commercial property), which represents over 20% of total on-balance sheet loans. The exposure to foreign trade and shipping, pipeline and other transport services represents around 6% of the total loan portfolio, and is mostly related to offshore supply vessels. In addition, as most of its Nordic peers, SpareBank 1 SR-Bank exhibits high borrower concentration as measured by the 20 largest exposures in relation to Tier 1 capital or pre-provision profit.

In addition to risks related to borrower and industry concentration, lending growth has been rapid in the past years (+20% in 2008 including loans transferred to SpareBank 1 Boligkreditt), resulting in a less seasoned loan portfolio. After contracting slightly in 2009, the loan book grew by around 12% in 2010.

Overall, the bank has reported relatively moderate weakening in credit quality through the global economic downturn. Problem loans (non-performing and problem commitments) continued to decrease and accounted for just over 1% of gross loans, down from 1.2% at YE 2009 and the 1.6% peak at YE 2008. Concurrently, coverage of problem loans by loan loss reserves increased to over 60% at YE 2010, a level which we view as satisfactory.

Asset quality deterioration has been relatively limited in the bank's retail loan book but highly leveraged Norwegian households are vulnerable to interest rate hikes or drops in potentially overestimated house prices, though we take comfort in the still low unemployment levels in Norway.

The economic environment in Norway has been supportive throughout the global turnaround, but subdued economic growth, low exports and domestic demand remain threats to Norwegian corporates' creditworthiness. Petroleum investments are still high and support the corporate sector in the region, but we caution slow economic recovery could negatively impact the order books in the coming years.

The score for asset quality is B. We do not expect the current asset quality to be sustainable across the economic cycle given the still fragile recovery in the Norwegian economy and therefore we see a weakening trend for this factor.

Global Local Currency Deposit Rating (Joint Default Analysis)

Moody's assigns a GLC deposit rating of A1 to SpareBank 1 SR-Bank. Under Moody's Joint Default Analysis, the rating receives a three-notch uplift from the Baa1 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. Furthermore, SpareBank 1 SR-Bank also benefits from a low probability of support from SpareBank 1 Alliance. The dependence between SpareBank 1 SR-Bank and SpareBank 1 Alliance is high due to the substantial degree of integration between the alliance banks and shared products.

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.

Foreign Currency Deposit Rating

SpareBank 1 SR-Bank's foreign currency deposit rating of A1 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 A1 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						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+	Neutral
Economic Stability		x					
Integrity and Corruption		x					
Legal System	x						
Financial Factors (50%)						C	
Factor: Profitability						D+	Weakening
PPI / Average RWA - Basel II			1.56%				
Net Income / Average RWA - Basel II				1.05%			
Factor: Liquidity						D+	Neutral
(Mkt funds-Liquid Assets) / Total Assets					32.02%		
Liquidity Management			x				
Factor: Capital Adequacy						B+	Neutral
Tier 1 Ratio - Basel II		8.75%					
Tangible Common Equity / RWA - Basel II	7.72%						
Factor: Efficiency						B	Neutral
Cost / Income Ratio		54.78%					
Factor: Asset Quality						B	Weakening
Problem Loans / Gross Loans		1.33%					
Problem Loans / (Equity + LLR)		16.35%					
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

professional adviser.