CREDIT OPINION

10 October 2024

Update

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RATINGS

SpareBank 1 SMN

Domicile	Trondheim, Norway
Long Term CRR	Aa3
Type	LT Counterparty Risk Rating - Fgn Curr
Outlook	Not Assigned
Long Term Debt	Aa3
Type	Senior Unsecured - Fgn Curr
Outlook	Stable
Long Term Deposit	Aa3
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

Effie Tsotsani +44.20.7772.1712
VP-Senior Analyst
effie.tsotsani@moodys.com

Jonathan Stenbaek +46.851.791.297
Ratings Associate
jonathan.stenbaek@moodys.com

Nondas Nicolaides +357.2569.3006
VP-Sr Credit Officer
nondas.nicolaides@moodys.com

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Americas	1-212-553-1653
Asia Pacific	852-3551-3077
Japan	81-3-5408-4100

SpareBank 1 SMN

Update to credit analysis

Summary

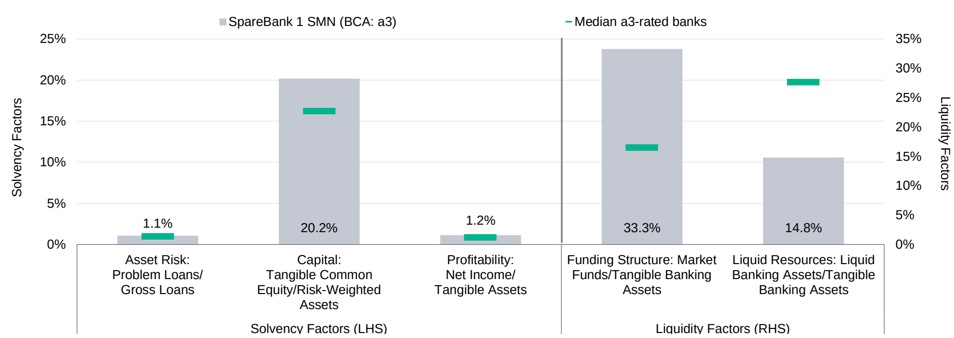
SpareBank 1 SMN's (SMN) long-term deposit and senior unsecured debt ratings of Aa3 take into account the bank's Baseline Credit Assessment (BCA) of a3, but also our forward-looking Loss Given Failure (LGF) analysis. For the deposit and senior ratings, this results in a three-notch uplift from its BCA while the junior senior rating does not benefit from any uplift. SMN's ratings do not benefit from any government support.

SMN's BCA of a3 reflects the bank's resilient financial performance, as illustrated by its sound capital base, strong profitability and improved risk profile, while continuing to grow its retail deposit base, resulting in a somewhat lower use of market funds. Our view is supported by the bank's strong retail franchise in central Norway, which delivers robust core earnings, and our expectation that the strong capital position will be maintained.

These strengths are counterbalanced by a still-high reliance on market funding, a characteristic shared by all local savings banks; the bank's relatively narrow geographical focus; and the credit risks stemming from its exposures to more volatile sectors.

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

» SMN's stand-alone credit profile is supported by its Very Strong- macro profile

» 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 concentration from operating in more limited geographical areas than many international peers

» Risks from the bank's exposure to cyclical sectors, although problem loans are low

» Dependence on market funding renders it vulnerable to fluctuations in investor sentiment, but liquidity is adequate

Outlook

The stable outlook on SMN's long-term deposit, issuer and senior unsecured debt ratings reflect our view that the bank will continue to generate strong earnings supporting its capital base, while prudently managing asset risks and strengthening its deposit base. These are counterbalanced by some of the bank's credit concentration in its home region and its high reliance on market funding.

Factors that could lead to an upgrade

SMN's long-term ratings could be upgraded if it significantly strengthens its capitalisation well above the regulatory minimum requirements; further improves its asset quality while reducing its single-name, sector and regional concentration; strengthens its profitability; and reduces its reliance on market funding with an enlarged retail deposit base.

Factors that could lead to a downgrade

SMN's ratings could be downgraded if it significantly increases its exposure to more volatile sectors compared with current levels; it experiences a substantial deterioration in asset quality and profitability; its use of market funds increases towards previous levels; and its liquidity weakens.

The ratings could also be downgraded as a result of a reduction in the volume of loss-absorbing liabilities protecting creditors and depositors in case of failure.

Key indicators

Exhibit 2
SpareBank 1 SMN (Consolidated Financials) [1]

	06-24[2]	12-23[2]	12-22[2]	12-21[2]	12-20[2]	CAGR/Avg.[3]
Total Assets (NOK Billion)	311.8	299.2	281.7	246.9	236.1	8.3[4]
Tangible Common Equity (NOK Billion)	24.0	24.7	21.3	19.9	18.0	8.5[4]
Problem Loans / Gross Loans (%)	0.8	0.9	1.0	1.7	1.2	1.1[5]
Tangible Common Equity / Risk Weighted Assets (%)	20.2	21.5	20.3	20.2	19.4	20.3[6]
Problem Loans / (Tangible Common Equity + Loan Loss Reserve) (%)	7.6	8.1	9.1	15.4	11.5	10.3[5]
Net Interest Margin (%)	1.8	1.6	1.4	1.4	1.4	1.5[5]
PPI / Average RWA (%)	3.8	3.6	2.8	2.8	2.7	3.2[6]
Net Income / Tangible Assets (%)	1.3	1.2	1.0	1.2	0.8	1.1[5]
Cost / Income Ratio (%)	41.6	42.6	46.5	47.0	53.0	46.1[5]
Market Funds / Tangible Banking Assets (%)	33.3	33.3	35.5	33.9	37.5	34.7[5]
Liquid Banking Assets / Tangible Banking Assets (%)	16.0	14.8	18.1	14.9	15.7	15.9[5]
Gross Loans / Due to Customers (%)	173.2	177.9	173.2	175.6	187.5	177.5[5]

[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 Ratings and company filings

Profile

SpareBank 1 SMN (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 the end of June 2024, its consolidated assets (including loans transferred to covered bond companies) totalled NOK312 billion (€27.3 billion).

Recent developments

In September 2023, SMN completed the acquisition of SpareBank 1 Søre Sunnmøre, a local savings bank with a strong market position in Sore Sunmore, following the initial announcement in 2020. Following the consolidation, SMN bank covers large sections of the Sunmore region, which further strengthens its position in Fjordane.

Detailed credit considerations

Norway's Very Strong- macro profile remains supportive towards the bank's stand-alone credit profile

SMN operates only in Norway and thus its operating environment is reflected by the Very Strong - macro profile we assign to the country. Norwegian banks benefit from operating in a wealthy and developed country with very high economic, institutional and government financial strength, and very low susceptibility to event risk. Norway has a diversified and growing economy, which demonstrated resilience amid the weakening in the oil sector in 2014-15 and again in 2020.

The main risks to the banking system stem from the high level of household debt, high 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.

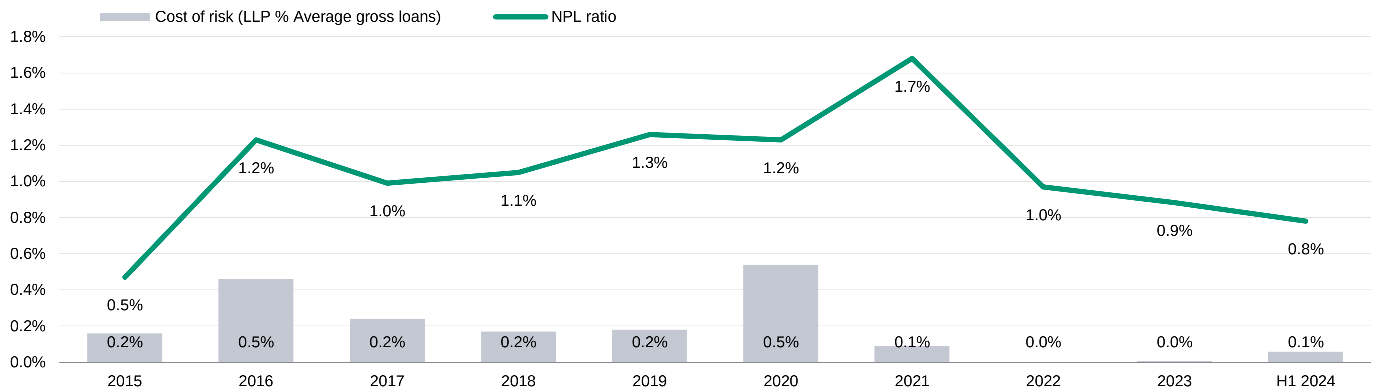
Nonetheless, we expect the Norwegian mainland economy (excluding any oil-related activity) to expand by 1.3% in 2024, up from 0.7% in 2023. Unemployment rose to around 10.6% in March 2020, but fell back to 4.0% in July 2024, below the pre-pandemic level.

Overall strong asset quality but still affected by some sector concentrations

We consider SMN's asset quality to be strong and improving. 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 0.8% in June 2024, lower than 0.9% as of year-end 2023. This reflects the improved conditions in the oil and offshore sectors, which have been the main source of problem loans in the past years, as well as the bank's proactive approach towards restructuring these exposures.

We expect the bank's asset quality to remain resilient despite uncertainties in the operating environment stemming from higher inflation and higher interest rates, which could result in lower consumption spending and increased defaults in the small and medium-sized enterprise sector.

Exhibit 3
SMN's problem loans as a percentage of gross loans and cost of risk evolution



Gross loans include covered bond loans.
Sources: Bank's disclosures and Moody's Ratings

The bank's overall asset quality is favourable and comparable to its similarly rated peers both locally and internationally. SMN's well-diversified loan book (including loans transferred to SpareBank 1 Boligkreditt and SpareBank 1 Naeringskreditt), of which around 74% 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 exposures to volatile sectors. The strong performance of the bank's retail banking business continued in the first half of 2023, with a net recovery on loans to personal customers of NOK12 million and pre-tax record profit of NOK2,469 million.

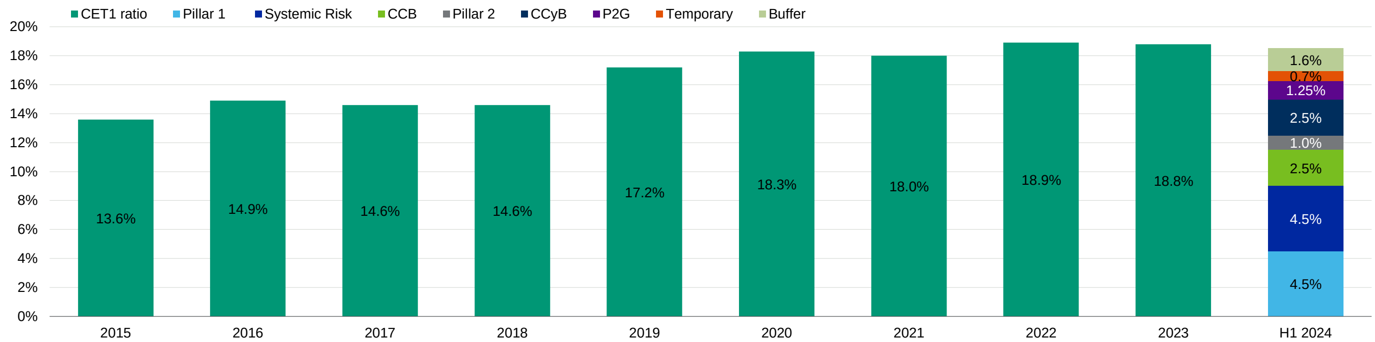
Although the bank's corporate book is quite diversified across different industries, it exhibits some concentration to the commercial real estate (10% of gross loans at end June 2024) and fishing and fish farming (5% of gross loans), representative of the bank's significant local market share. The bank has reduced its exposure to the oil and offshore sector, accounting for around 2.01% of lending at end of second quarter 2024, compared to 4.3% at end 2016, reflective of the bank's tighter underwriting criteria on the sector. The recent increase in demand for oil and related services has led to an improvement in several of the bank's problem loans within the sector, which have consequently been transferred to Stage 2. However, there are still long-term risks as a result of the volatile nature of these sectors, and because some of these borrowers fall within the bank's top 20 group loans.

Our assigned Asset Risk score incorporates negative adjustments, taking into account the bank's relatively limited geographical diversification, as well as sector concentrations on the corporate book, namely to CRE and oil and offshore sectors, as stated above. We make similar adjustments in the asset risk scores of other rated regional savings banks in Norway.

Solid capital metrics provide a buffer against potential future credit losses

SMN's ratings are supported by its solid capital position, with a Common Equity Tier 1 (CET1) capital ratio of 18.5% as of June 2024 compared with 18.8% as of year-end 2023. The bank's capital level is higher than the regulatory requirement of 16.95%, and includes a 0.7% temporary add-on to the Pillar 2 requirement while the FSA reviews the revised IRB models as well as a Pillar 2 guidance of 1.25%. SMN is targeting a management buffer of 1.25% above the minimum requirement, in line with the Pillar 2 guidance, which the bank already meets adequately (see Exhibit 4).

Exhibit 4
SMN benefits from strong capital buffers, with a CET1 ratio 1.55% above the 16.95% minimum requirement at end June 2023(SpareBank 1 SMN's CET1 ratio evolution)



The temporary requirement of 0.7%, which is a Pillar 2 add-on, is implemented until the FSA approves the revised IRB models.
Source: Bank's disclosures and Moody's Ratings

The bank's tangible common equity has strengthened in recent years, driven by strong earnings generation. SMN's hybrid debt (NOK1.8 billion) and subordinated debt (NOK2.7 billion) contributed to the strong Tier 1 ratio of 20.4% and overall capital adequacy ratio of 23.1% as of the end of June 2024. These solid capital levels provide a buffer against potential future credit losses, driving the bank's BCA and ratings.

We expect the bank to maintain a payout ratio in line with their target of 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 leverage ratio of 7.1% as of the end of June 2024, which, although high by international standards, is marginally lower than the average for similarly rated local peers.

Resilient earnings benefit from a strong regional retail franchise

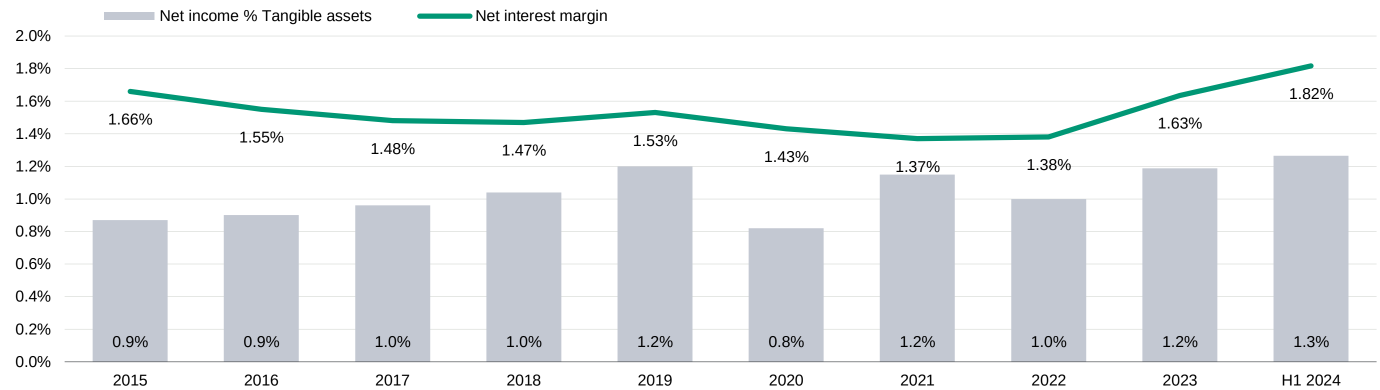
SMN benefits from strong profitability, reflected by its (annualized) net income/tangible assets of 1.3% in H1 2024, supported by strong growth in net interest income (including fees from covered bond companies), which grew by 24% year over year. The bank's profitability has been resilient, as illustrated by its stable performance through the economic cycle, with a return on tangible assets (including assets transferred to covered bond companies) of 0.82% during the peak of the coronavirus pandemic in 2020. This compares favourably to peers with similar lending activities.

SMN's net interest income comprised 61% of total revenue in H1 2024, a significant increase from the 56% in 2020, a result of both the expansion of interest-earning business volumes and the rise in rates. The higher rates are reflected by the higher net interest margin of 1.82% over H1 2024, compared with 1.63% in 2023. We expect profitability to remain strong, supported by the high interest rate environment.

SMN net profit was NOK1,964 million in H1 2024, which is an increase from NOK1,562 million in the same period in 2023. SMN's operating expenses increased 14% year-over-year. This was driven in part by investments in technology, and in part by variable renumeration increases related to growth in SMN's subsidiaries. However the cost-to-income ratio has improved over time to 42% in H1 2024, down from 53% in 2020. The bank's reported return on equity was 15.6% in H1 2024 compared with 13.9% a year earlier.

Our Profitability score for the bank takes into account not only our adjusted return on tangible assets (including assets transferred to covered bond companies) of 1.26% in H1 2024 (see Exhibit 5) but also our forward-looking view on the bank's resilient recurring pre-provision earnings, which we expect to remain satisfactory over the coming 12-18 months.

Exhibit 5
Profitability evolution
Moody's-adjusted figures



Includes assets transferred to covered bond companies.
Sources: Bank's disclosures and Moody's Ratings

Deposit franchise is strengthening but reliance on market funding still renders the bank vulnerable to fluctuations in investor sentiment...

SMN's deposit base continued to grow in recent years, following the strong growth witnessed during 2020, accounting for around 49% of total liabilities (including covered bonds issued through the covered bond companies) as of the end of June 2024. Although the bank still remains reliant on market funding, its market funds to tangible banking assets ratio has improved to 34.0% in 2022-2024 compared to an average of 36.6% in 2018-21, as the bank increased its focus on strengthening its deposit franchise.

Deposits went down by 0.8% year over year as of June 2024, mainly driven by the decrease in deposits from corporate customers, while retail deposits continued their strong growth at 7.4%. This comes after the 2020-22 period, during which growth exceeded 10% because of various lockdown measures implemented during the pandemic. We expect growth to normalize closer to 5%-7% in organic growth over the next 12-18 months, and most deposits to originate from the retail side as the bank will continue to strengthen its franchise following its recent acquisition. Retail deposits, which we consider to be more stable, accounted for 50% of total deposits as of June 2024.

SMN relies on covered bonds as an important source of funding. These bonds are issued off balance sheet through specialised companies that it jointly owns with other savings banks of the SpareBank 1 Alliance, namely SpareBank 1 Boligkreditt for residential mortgages and SpareBank 1 Næringskreditt for commercial mortgages. As of June 2024, the bank had transferred loans worth NOK68 billion to these vehicles, or around a quarter of its gross loan book including the transferred loans. Although the diversification benefit of covered bond funding is a credit positive, its extensive use increases the amount of pledged assets unavailable for unsecured bondholders, including depositors in liquidation. The relative stability of covered bonds compared with unsecured market funding is reflected by a standard adjustment in our scorecard.

Our Funding Structure score reflects our view that SMN's reliance on market funding, although improved, still represents a source of vulnerability because, in times of market stress, market funding can become more expensive and/or restricted.

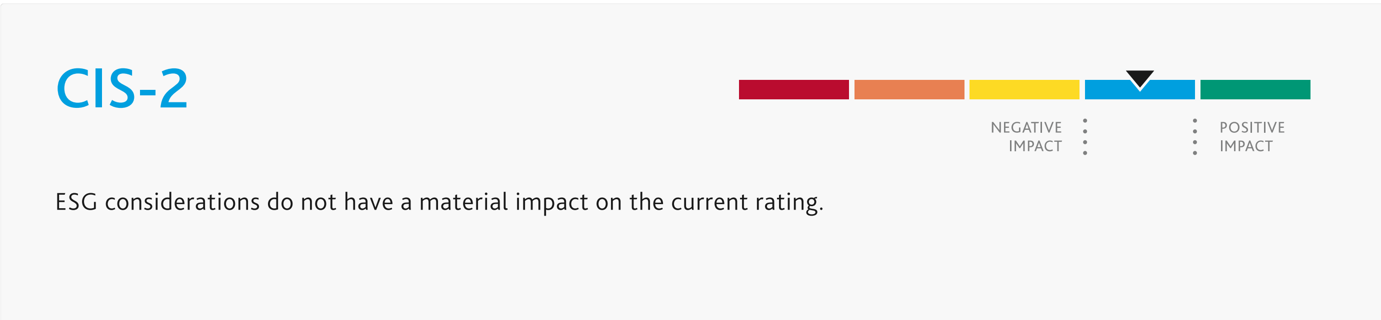
...although liquidity is adequate

A mitigating factor to the bank's use of market funding is its sizeable liquidity buffer that can cover its needs for three years without any new external financing. The bank's liquid assets as a percentage of total banking assets (a Moody's scorecard ratio) was high at 16.0% as of the end of June 2024 and consisted of covered bonds from other Norwegian banks, most of which can be used as collateral for loans from Norges Bank, municipal bonds and balances with central banks. SMN reported a commendable liquidity coverage ratio (LCR) and NSFR ratio of 188% and 132% respectively as of the end of June 2024, compared with the requirement of 100% for both ratios.

ESG considerations

SpareBank 1 SMN's ESG credit impact score is CIS-2

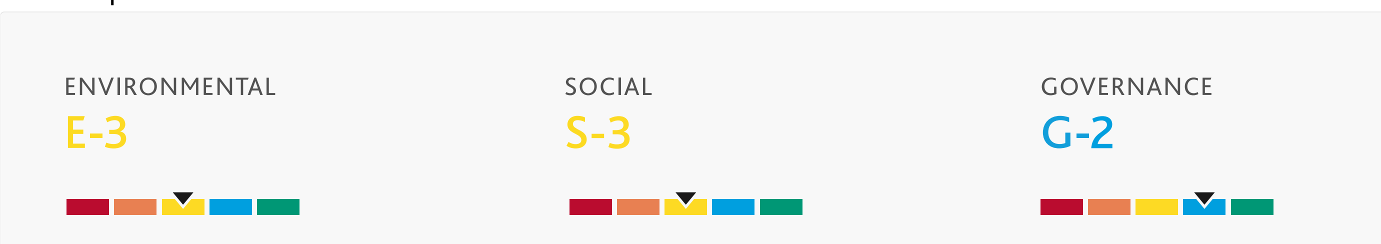
Exhibit 6
ESG credit impact score



Source: Moody's Ratings

SpareBank 1 SMN's **CIS-2** indicates that ESG considerations do not have a material impact on current ratings. This reflects the limited credit impact of environmental and social risk factors on the ratings to date, and the low governance risks.

Exhibit 7
ESG issuer profile scores



Source: Moody's Ratings

Environmental

SpareBank 1 SMN faces moderate environmental risks primarily because of its portfolio exposure to carbon transition. These risks are primarily related to its corporate portfolio, however, exposures to the oil, offshore and shipping business are limited. In line with its peers, the bank is facing mounting business risks and stakeholder pressure to meet broader carbon transition goals. In response, the bank is developing its climate risk and portfolio management capabilities.

Social

SpareBank 1 SMN faces moderate social risks related to customer relations and associated regulatory and litigation risks, requiring high compliance standards. The exposure to customer relation risks is lower than its international peers, given the bank's untarnished customer conduct track record supported by the social mandate of the Savings Bank's model. SpareBank 1 SMN is a digitally advanced bank in Norway, with a robust IT infrastructure and strong capabilities to mitigate cyber and personal data risks, supported by its participation in the SpareBank 1 Alliance.

Governance

Sparebank 1 SMN's governance risks are low., Despite sectoral and geographical concentrations, due to its limited reach, the bank benefits from strong underwriting standards which mitigate some of these concerns. The bank has a track record of sound capital and liquidity management and earnings stability while losses have been low, even at times of market turbulence. Being a regional savings bank, 36% of the bank is owned by the central Norwegian community and 64 % by private investors. The bank's Supervisory Board, comprises EC holders, employees and representatives of the public authorities. Related governance risks are however mitigated by Norway's developed institutional framework.

ESG Issuer Profile Scores and Credit Impact Scores for the rated entity/transaction are available on Moodys.com. In order to view the latest scores, please click here to go to the landing page for the entity/transaction on MDC and view the ESG Scores section.

Support and structural considerations

Loss Given Failure and additional notching

Norway implemented the EU's Bank Recovery and Resolution Directive (BRRD) on 1 January 2019, and subsequently, BRRD2 was incorporated into Norwegian law on 1 June 2022, which has resulted in lower subordination requirements for non-preferred senior volumes. For our resolution analysis, we assumed residual tangible common equity of 3% and post-failure losses of 8% of tangible banking assets, a 25% run-off in “junior” wholesale deposits and 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. We apply a standard assumption for the large European banks that 26% of deposits are junior.

For 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 total NOK12.9 billion in senior non-preferred issuances completed to date, which qualify as MREL instruments. This has resulted in a Preliminary Rating Assessment (PRA) that is three notches above the BCA for the bank's deposit and senior unsecured ratings, reflecting very low loss given failure. For junior senior securities (senior non-preferred debt) issued by SMN, our LGF analysis indicates a moderate loss level, positioning the rating at the same level as its a3 BCA.

Government support

SMN has a well-established regional franchise in central Norway, although its national lending market share is limited to around 4% as of June 2024. Since the implementation of the BRRD legal framework in Norway on 1 January 2019, which aligns with that of the EU, our assumption of government support for the bank's debt and deposits stands is low, resulting in no additional notches of rating uplift above the PRA.

Similarly, 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.

Foreign-currency deposit rating

SMN's foreign-currency deposit rating of Aa3 is unconstrained because Norway has no country ceiling.

Foreign-currency debt rating

SMN's senior unsecured foreign-currency debt rating of Aa3 is unconstrained because Norway has no country ceiling.

Rating methodology and scorecard factors

Exhibit 8

Rating Factors

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		1.1%	aa2	↔	baa1		
Capital							
Tangible Common Equity / Risk Weighted Assets (Basel III - transitional phase-in)		20.2%	aa1	↔	aa2		
Profitability							
Net Income / Tangible Assets		1.2%	a2	↔	a3		
Combined Solvency Score			aa2		a2		
Liquidity							
Funding Structure							
Market Funds / Tangible Banking Assets		33.3%	baa3	↔	ba1		
Liquid Resources							
Liquid Banking Assets / Tangible Banking Assets		14.8%	baa3	↑	baa2		
Combined Liquidity Score			baa3		baa3		
Financial Profile					a3		
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					a2 - baa1		
Assigned BCA					a3		
Affiliate Support notching					0		
Adjusted BCA					a3		

Balance Sheet	**in-scope (NOK Million)**	**% in-scope**	**at-failure (NOK Million)**	**% at-failure**
Other liabilities	106 604	34.3%	120 850	38.9%
Deposits	139 661	45.0%	125 416	40.4%
Preferred deposits	103 349	33.3%	98 182	31.6%
Junior deposits	36 312	11.7%	27 234	8.8%
Senior unsecured bank debt	37 402	12.0%	37 402	12.0%
Junior senior unsecured bank debt	12 921	4.2%	12 921	4.2%
Dated subordinated bank debt	2 728	0.9%	2 728	0.9%
Preference shares (bank)	1 895	0.6%	1 895	0.6%
Equity	9 316	3.0%	9 316	3.0%
Total Tangible Banking Assets	310 527	100.0%	310 527	100.0%

Debt Class	De Jure waterfall		De Facto waterfall		Notching		LGF Notching Guidance vs. Adjusted BCA	Assigned LGF notching	Additional Notching	Preliminary Rating Assessment
	Instrument volume + subordination	Sub-ordination	Instrument volume + subordination	Sub-ordination	De Jure	De Facto				
Counterparty Risk Rating	29.5%	29.5%	29.5%	29.5%	3	3	3	3	0	aa3
Counterparty Risk Assessment	29.5%	29.5%	29.5%	29.5%	3	3	3	3	0	aa3 (cr)
Deposits	29.5%	8.6%	29.5%	20.7%	3	3	3	3	0	aa3
Senior unsecured bank debt	29.5%	8.6%	20.7%	8.6%	3	3	3	-	-	-
Junior senior unsecured bank debt	8.6%	4.5%	8.6%	4.5%	0	0	0	0	0	a3
Dated subordinated bank debt	4.5%	3.6%	4.5%	3.6%	-1	-1	-1	-1	0	baa1

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	aa3	0	Aa3	Aa3
Counterparty Risk Assessment	3	0	aa3 (cr)	0	Aa3(cr)	
Deposits	3	0	aa3	0	Aa3	Aa3
Senior unsecured bank debt	-	-	-	0		Aa3
Junior senior unsecured bank debt	0	0	a3	0	A3	(P)A3
Dated subordinated bank debt	-1	0	baa1	0		(P)Baa1

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

Ratings

Exhibit 9

Category	Moody's Rating
SPAREBANK 1 SMN	
Outlook	Stable
Counterparty Risk Rating	Aa3/P-1
Bank Deposits	Aa3/P-1
Baseline Credit Assessment	a3
Adjusted Baseline Credit Assessment	a3
Counterparty Risk Assessment	Aa3(cr)/P-1(cr)
Issuer Rating	Aa3
Senior Unsecured	Aa3
Junior Senior Unsecured -Dom Curr	A3
Junior Senior Unsecured MTN	(P)A3
Subordinate MTN	(P)Baa1

Source: Moody's Ratings

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CLIENT SERVICES

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