MOODY'S
INVESTORS SERVICE

CREDIT OPINION

18 October 2017

Update

Rate this Research

RATINGS

Sparebanken Sogn og Fjordane

Domicile	Norway
Long Term Deposit	A2
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.

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Sparebanken Sogn og Fjordane

Update following rating affirmations and change in outlook

Summary Rating Rationale

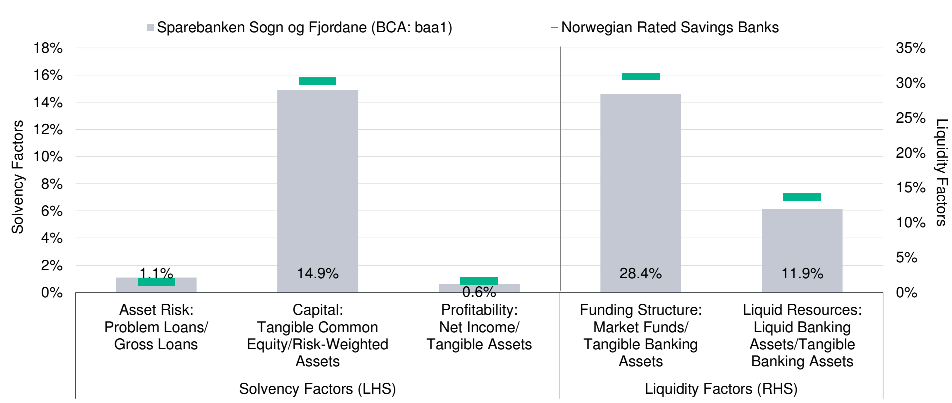
On October 11, we changed the outlook to stable from negative on the deposit and issuer ratings of Sparebanken Sogn og Fjordane (SSF), reflecting the rating agency's expectation that the bank's financials will remain broadly resilient supported by Norway's gradually improving economy. At the same time, Moody's affirmed SSF's long-term deposit and issuer ratings of A2 and the bank's long-term counterparty risk assessment (CRA) of A1(cr).

The rating affirmation mainly reflects the resilient performance of SSF despite the challenging economic conditions in Norway over the last two years, as well as our forward-looking expectation the bank's asset quality, profitability and capitalization will remain robust in a gradually recovering operating environment. The bank's A2 long-term deposit and issuer ratings, also incorporate two notches of rating uplift from the bank's baa1 standalone baseline credit assessment (BCA) based on our Advanced Loss Given Failure (LGF) analysis. LGF takes into account the risks faced by the different debt and deposit classes across the liability structure should the bank enter into resolution.

SSF's baa1 BCA reflects the bank's Very Strong- operating environment, with problem loan levels that are broadly in line with peers (problem loans equivalent to 0.9% of gross loans at end-June 2017), improving capital metrics with a common equity Tier 1 ratio of 14.8%; but also its relatively high reliance on the domestic capital markets.

The stable outlook on SSF's deposit and issuer ratings reflects our view that the bank's financials will remain broadly resilient over the next 12-18 months.

Exhibit 1
Rating Scorecard - Key Financial Ratios



Note: * average of other Moody's rated Norwegian savings banks
Source: Moody's Banking Financial Metrics

Credit strengths

» Sparebanken Sogn og Fjordane's BCA is supported by its Very Strong- Macro Profile

» Capital levels are adequate and improving

» Problem loan levels in line with peers

» Large volume of deposits and junior debt resulting in deposit and issuer ratings benefiting from a very low loss-given-failure rate

Credit challenges

» There are elevated asset risks from sector and credit concentrations

» Market funding reliance renders the bank vulnerable to fluctuations in investor sentiment, despite a large deposit base

Rating outlook

The stable outlook on the banks ratings reflects our view that the bank's financials will remain broadly resilient over the next 12-18 months.

Factors that could lead to an upgrade

» Upward rating pressure could develop if SSF demonstrates (1) sustained strong asset quality in its retail and corporate loan books, including in the more volatile segments, and further reduction in credit concentrations; (2) stronger earnings generation without an increase in its risk profile.

Factors that could lead to a downgrade

» Future downward rating pressure would emerge if (1)SSF's risk profile increases as a result of increased concentration, for example if construction and real-estate concentration or top-20 client concentration as a percent of Core Tier 1 Capital exceeds 150% or if the problem loan ratio increases above market system wide expectation of approximately 2%; (2) financing conditions become more difficult;

Key indicators

Exhibit 2

Sparebanken Sogn og Fjordane (Consolidated Financials) [1]

	6-17[2]	12-16[2]	12-15[2]	12-14[2]	12-13[2]	CAGR/Avg.[3]
Total Assets (NOK billion)	51	49	46	43	40	7.7[4]
Total Assets (EUR million)	5,369	5,430	4,777	4,696	4,734	3.7[4]
Total Assets (USD million)	6,123	5,728	5,190	5,683	6,524	-1.8[4]
Tangible Common Equity (NOK billion)	3.9	3.7	3.4	3.2	2.9	8.8[4]
Tangible Common Equity (EUR million)	408	413	356	348	347	4.8[4]
Tangible Common Equity (USD million)	466	435	386	420	478	-0.7[4]
Problem Loans / Gross Loans (%)	0.9	0.7	1.1	1.8	1.3	1.1[5]
Tangible Common Equity / Risk Weighted Assets (%)	14.9	14.4	13.5	13.5	13.0	13.9[6]
Problem Loans / (Tangible Common Equity + Loan Loss Reserve) (%)	9.2	7.4	11.9	19.8	14.8	12.6[5]
Net Interest Margin (%)	1.7	1.6	1.7	1.8	1.7	1.7[5]
PPI / Average RWA (%)	2.2	2.0	1.8	2.3	2.4	2.1[6]
Net Income / Tangible Assets (%)	0.7	0.6	0.5	0.8	0.9	0.7[5]
Cost / Income Ratio (%)	43.3	44.8	46.7	41.2	39.4	43.1[5]
Market Funds / Tangible Banking Assets (%)	24.7	28.4	29.4	27.7	28.6	27.8[5]
Liquid Banking Assets / Tangible Banking Assets (%)	13.4	11.9	12.2	11.1	11.5	12.0[5]
Gross Loans / Due to Customers (%)	164.0	172.3	174.7	167.0	168.9	169.4[5]

[1] All figures and ratios are adjusted using Moody's standard adjustments [2] Basel II; IFRS [3] May include rounding differences due to scale of reported amounts [4] Compound Annual Growth Rate (%) based on time period presented for the latest accounting regime [5] Simple average of periods presented for the latest accounting regime. [6] Simple average of Basel II periods presented

Source: Moody's Financial Metrics

Profile

Sparebanken Sogn og Fjordane (SSF) is the largest bank in the county of Sogn og Fjordane and offers retail and corporate customers products in banking, financing, insurance, savings, pensions and payment services. SSF's main geographical market is Sogn og Fjordane in western Norway, but the bank has expanded the scope of its retail operations to include several larger cities around Norway. As of 30 June 2017, the bank reported total consolidated assets of NOK51 billion (€5.37 billion).

Detailed credit considerations

SSF's BCA is supported by its Very Strong- Macro Profile

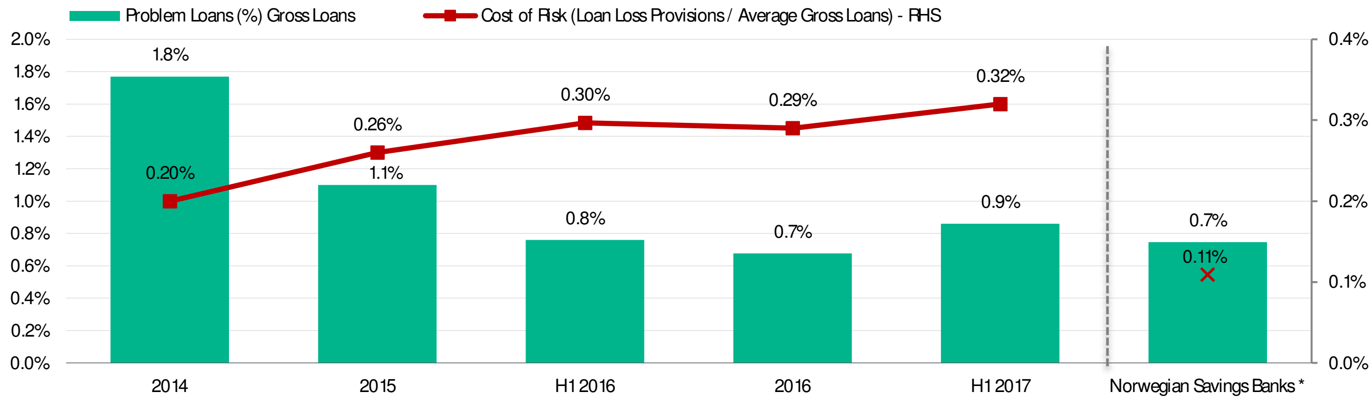
As a domestically focused bank, SSF's Macro Profile is aligned with that of Norway at Very Strong-. Banks in Norway (Aaa stable) benefit from operating in a wealthy and developed country with very high economic, institutional and government financial strength as well as low susceptibility to event risk. Norway has a diversified and growing economy, which demonstrates resilience to the ongoing weakness in the oil sector. The main risks to the banking system stem from the high level of household indebtedness, elevated real estate prices and domestic banks' extensive use of market funding. However, these risks are mitigated by the strength of households' ability to service debt, banks' adequate capitalization and the relatively small size of the banking system compared with the total size of the economy.

Problems loan levels marginally increased due to corporate exposures

We expect SSF's asset quality to remain broadly unchanged in the next twelve months, supported by the increased granularity and lower top client concentration in the bank's loan book stemming from its high allocation to mortgages (70% of gross lending), a market segment with low delinquencies and losses historically. SSF has been growing its retail book more actively outside its home county (in Hordaland and other counties) driven by lower population growth in Sogn og Fjordane compared to other regions. We believe that, for the moment, the benefits of some regional diversification are balanced against the risks of managing this more diverse portfolio.

The bank's problem loans as a percentage of gross loans declined to 0.9% at end-June 2017 from 1.8% at end-2014 and remains in line with domestic peers (see Exhibit 3). The impairment charges in the period largely originate from a number of exposures to the real estate and retail sector. The bank's problem loan coverage ratio was 70% at end-June 2017, while credit costs remained elevated and higher than peers.

Exhibit 3
SSF's Asset Quality Evolution
The bank's problem loans have come down and are in line with peers, however cost of risk remained elevated in H1 2017



Note: * average of other Moody's rated Norwegian savings banks
Source: Moody's Banking Financial Metrics

The bank's portfolio mainly comprises retail customers, at over 70% of loans as of end-June 2017. This lending category has performed well in the past and we expect it will remain resilient since, despite the risks from an increasing level of household indebtedness, we expect Norway's households to continue to service their debts as interest rates remain low and unemployment benefits remain generous. SSF has been growing its retail book more actively outside its home county (in Hordaland and other counties) driven by lower population growth in Sogn og Fjordane compared to other regions.

SSF's exposure to the real-estate and construction sectors stood at 11% of total loans as of end-June 2017. Similar to most of its Nordic peers, the bank exhibits high single-name concentration, which could heighten the pace and the extent of any deterioration in asset quality. However, over the past years the bank has decreased significantly its single name concentrations, which we view positively.

Capital levels are adequate and improving
We consider SSF's capital levels as adequate for the bank's risk profile and in line with Norwegian peers. We also expect the bank's capitalisation to continue to increase, in line with stricter regulatory requirements. Specifically the countercyclical capital buffer for Norwegian banks will increase to 2% from 1.5%, effective as of 31 December 2017.

The bank's tangible common equity to risk-weighted assets was 14.9% as of June 2017, up from 14.4% at the end of 2016. SSF also reported a common equity Tier 1 (CET1) ratio of 14.6% at end-June 2017 (excluding profit for the period),already in line with the bank's internal target of 14.5% and higher regulatory capital requirements of 13.4%. The bank's sound capital levels are supported by an additional NOK 100 million issuance of hybrid debt during 2017, resulting in a total hybrid capital of NOK 250 million. The bank had set a target CET1 ratio of 15% for 2017, similar to other Norwegian savings banks.

In addition, SSF announced at end September 2017, that it is planning to convert a part of the equity certificates (ECs) to primary capital. The conversion will be directed towards Sparebankstiftinga Sogn og Fjordane, that currently holds 93.9% of the EC, which will give part of their ECs back to the bank as a gift. The bank will have the same amount of equity after the conversion, and the capital ratios will not be affected. The goal is to increase the ratio of primary capital to ECC, which over time will give SSF increased financial flexibility in relation to dividend payments and capital retention.

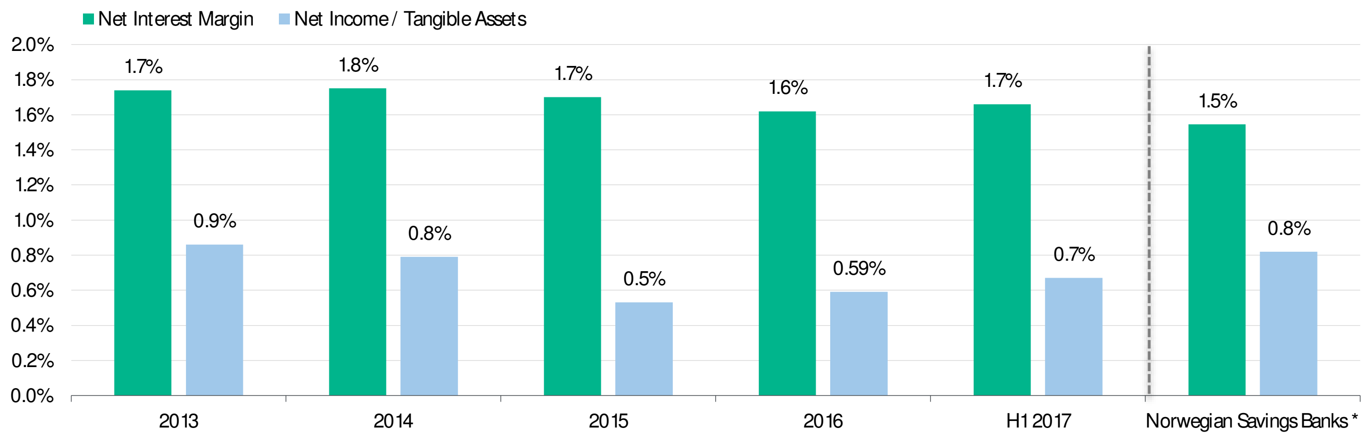
Our assigned Capital score reflects this strength, as well as the bank's tangible common equity / tangible banking assets ratio of 7.6% at end-June 2017, which compares well within international standards.

Profitability shows first signs of stabilization but costs remain high
SSF's profitability showed the first signs of stabilization in the first half of 2017, a trend that we expect to continue in the second half of the year, as a result of declining credit costs despite higher operating expenses.

In the first half of 2017, the bank's reported net interest margin increased to 1.7% (see Exhibit 4) from 1.6% in the first six months of 2016 due to increased volumes of customer deposits and low credit costs. Lending to retail clients increased by almost 8% in the past 12 months, but tighter lending regulation will result into lower growth for the rest of 2017.

SSF's profitability weakened significantly during 2015 and 2016 driven mainly by higher corporate loan losses in combination with margin pressure. However, during the first half of 2017 we saw the first signs of normalization, driven by higher net interest income and strong contribution from financial instruments, we estimate that the return on tangible assets was 0.7% for the first half of 2017 (excluding one-offs) compared to 0.5% for the same period last year.

Exhibit 4
SSF's Profitability Metrics Evolution
Margins are slowly stabilising



Note: * average of other Moody's rated Norwegian savings banks
Source: Moody's Banking Financial Metrics

Loan loss provisions increased with a cost of risk at 0.31% in the first half of 2017, compared to 0.28% reported for full-year 2016 and above domestic rated peers. Operating expenses (adjusted for the reversal of pension provisions in the first half of 2016), increased by around 9% reflecting IT expenses and the newly introduced financial service tax. Although the bank has announced cost saving measures, such as the closure of 9 branches and investments in efficient IT systems, we expect operating costs to remain elevated until the end of 2017 when cost savings will start to kick in.

Market funding reliance renders the bank vulnerable to fluctuations in investor sentiment, despite a large deposit base

SSF's funding profile benefits from a sizeable deposit base constituting 55% of non-equity funding at year-end 2016 while more than 60% of the bank's deposits come from retail customers and have been stable over the years. However it is also significantly reliant on market funding, rendering it vulnerable to swings in investor sentiment. The bank draws most of this funding in the form of domestically-issued senior debt and covered bonds. Covered bonds are issued through the bank's wholly-owned covered bond company Bustadkreditt Sogn og Fjordane AS that was established in 2009.

Based on our methodology we reflect the stability of covered bonds relative to unsecured market funding through an adjustment to our market funds to tangible assets ratio and our adjusted ratio for the bank is 28.4% as of end-December 2016. Although SSF's size limits somewhat its ability to issue undertake large benchmark issuances, we view the bank's recent larger issuances positively, due to their eligibility as liquid assets under the liquidity coverage ratio rules which extends the bank's investor base.

We consider the bank's stock of liquid assets as broadly adequate, totaling 11.9% of tangible assets at end-December 2016 (12.2% at end-December 2015). Liquid assets mainly comprised government securities and covered bonds. We note that the bank's holdings are mostly Norwegian securities, which leads to concentration risk. Finally, the bank reported a Liquidity Coverage Ratio (LCR) of 120% at year-end 2016 (141% at end-June 2017).

Source of facts and figures cited in this report

Unless noted otherwise, bank specific figures originate from bank's reports and Moody's Banking Financial Metrics. Moody's Banking Financial Metrics figures are based on our own chart of account and may be adjusted for analytical purposes. Please refer to the document: "Financial Statement Adjustments in the Analysis of Financial Institutions" published on 12 February 2016.

Support and structural considerations

Loss Given Failure

Norway is the process of transposing the EU Bank Resolution and Recovery Directive (BRRD) into local legislation and as such we consider the country an Operational Resolution Regime. In accordance with our methodology we therefore apply our Advanced LGF analysis, considering the risks faced by different debt and deposit classes across the liability structure should the bank enter resolution.

In our LGF analysis for the bank we use our standard assumptions and assume residual tangible common equity of 3%, losses post-failure of 8% of tangible banking assets, a 25% runoff in "junior" wholesale deposits, and a 5% run-off in preferred deposits. We assign a 25% probability to deposits being preferred to senior unsecured debt.

Under these assumptions, SSF's deposits and senior unsecured debt are likely to face very low loss-given-failure, due to the volume of the deposits and senior debt themselves and the amount of debt subordinated to them. This results in a Preliminary Rating Assessment (PRA) of two notches above the BCA for both the deposit and issuer ratings of the bank.

Government support

We do not incorporate government support uplift to SSF's deposit and issuer ratings as a result of the expected implementation of resolution legislation in Norway. SSF is a regional savings bank with a strong market position in the county of Sogn og Fjordane (Western Norway), where we estimate that it commands a 51% market share in lending and about 51% in deposits at end-December 2016. Despite its dominant local position, the bank lacks geographical diversification and its national franchise is limited by a national market share of less than 2% (based on total lending nationwide, using Statistics Norway data). We therefore consider the probability of government support for Sparebanken Sogn og Fjordane's debt and deposits to be low (in line with similarly-sized domestic peers), resulting in no ratings uplift.

Counterparty Risk assessment

We assign long- and short-term CR assessments of A1(cr) and Prime-1 (cr) respectively to SSF. CR Assessments are opinions of how counterparty obligations are likely to be treated if a bank fails and are distinct from debt and deposit ratings in that they (1) consider only the risk of default rather than the likelihood of default and the expected financial loss suffered in the event of default and (2) apply to counterparty obligations and contractual commitments rather than debt or deposit instruments. The CR Assessment is an opinion of the counterparty risk related to a bank's covered bonds, contractual performance obligations (servicing), derivatives (e.g., swaps), letters of credit, guarantees and liquidity facilities.

About Moody's Bank Scorecard

Our Scorecard is designed to capture, express and explain in summary form our Rating Committee's judgment. When read in conjunction with our research, a fulsome presentation of our judgment is expressed. As a result, the output of our Scorecard may materially differ from that suggested by raw data alone (though it has been calibrated to avoid the frequent need for strong divergence). The Scorecard 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 Methodology and Scorecard Factors

Exhibit 5

Sparebanken Sogn og Fjordane							
Macro Factors							
Weighted Macro Profile	**Very Strong -**	**100%**					
Factor	**Historic Ratio**	**Macro Adjusted Score**	**Credit Trend**	**Assigned Score**	**Key driver #1**	**Key driver #2**
Solvency						
Asset Risk						
Problem Loans / Gross Loans	1.1%	aa2	↓	baa1	Single name concentration	Sector concentration
Capital						
TCE / RWA	14.9%	aa3	←→	aa3	Risk-weighted capitalisation	
Profitability						
Net Income / Tangible Assets	0.6%	baa2	←→	baa2	Return on assets	
Combined Solvency Score		a1		a3		
Liquidity						
Funding Structure						
Market Funds / Tangible Banking Assets	28.4%	baa2	↓↓	baa3	Market funding quality	
Liquid Resources						
Liquid Banking Assets / Tangible Banking Assets	11.9%	baa3	←→	baa3	Stock of liquid assets	
Combined Liquidity Score		baa2		baa3		
Financial Profile				baa1		
Business Diversification				0		
Opacity and Complexity				0		
Corporate Behavior				0		
Total Qualitative Adjustments				0		
Sovereign or Affiliate constraint:				Aaa		
Scorecard Calculated BCA range				a3-baa2		
Assigned BCA				baa1		
Affiliate Support notching				0		
Adjusted BCA				baa1		

Balance Sheet	in-scope (NOK million)	% in-scope	at-failure (NOK million)	% at-failure
Other liabilities	16,144	31.5%	18,900	36.9%
Deposits	27,015	52.7%	24,260	47.4%
Preferred deposits	19,991	39.0%	18,992	37.1%
Junior Deposits	7,024	13.7%	5,268	10.3%
Senior unsecured bank debt	6,028	11.8%	6,028	11.8%
Dated subordinated bank debt	500	1.0%	500	1.0%
Equity	1,537	3.0%	1,537	3.0%
Total Tangible Banking Assets	51,224	100%	51,224	100%

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 Assessment	26.0%	26.0%	26.0%	26.0%	3	3	3	3	0	a1 (cr)
Deposits	26.0%	4.0%	26.0%	15.7%	2	3	2	2	0	a2

Instrument class	Loss Given Failure notching	Additional Notching	Preliminary Rating Assessment	Government Support notching	Local Currency Rating	Foreign Currency Rating
Counterparty Risk Assessment	3	0	a1 (cr)	0	A1 (cr)	--
Deposits	2	0	a2	0	A2	A2

Source: Moody's Financial Metrics

Ratings

Exhibit 6

Category	Moody's Rating
SPAREBANKEN SOGN OG FJORDANE	
Outlook	Stable
Bank Deposits	A2/P-1
Baseline Credit Assessment	baa1
Adjusted Baseline Credit Assessment	baa1
Counterparty Risk Assessment	A1(cr)/P-1(cr)
Issuer Rating	A2

Source: Moody's Investors Service

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