

CREDIT OPINION

4 November 2016

Update

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RATINGS

Sparebanken Sor

Domicile	Kristiansand, Norway
Long Term Debt	(P)A1
Type	Senior Unsecured MTN - Fgn Curr
Long Term Deposit	A1
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 Sor

Update Following Outlook Change to Stable from Negative

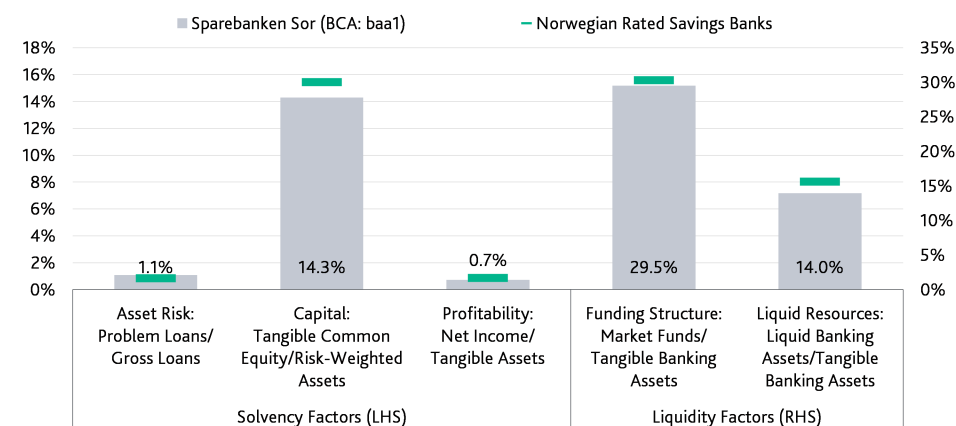
Summary Rating Rationale

On 3 November 2016 we affirmed Sparebanken Sor's ratings, including its baseline credit assessment (BCA) of baa1, long-term deposit rating of A1, and issuer rating of A1. We also assign a Counterparty Risk Assessment (CR Assessment) of Aa3(cr) long term and Prime-1(cr) short term to the bank.

Sparebanken Sor's baa1 BCA reflects the bank's strong asset quality metrics, with ratios of non-performing loans (NPLs) to gross loans of 1.13% and Loan Loss Reserves to NPLs of 59% as of September 2016. The bank's baa1 BCA also captures the increase in Sparebanken Sor's capital buffers which reached 14.5% as of September 2016 when we include 80% of interim profit from 12.7% in December 2015. Finally the bank's baa1 BCA incorporates its moderate profitability with a 0.9% return on tangible assets and its high reliance on market funding, a common attribute of Norwegian banks, with market funds adjusted to exclude 50% of covered bonds accounting for 43% of assets as of September 2016.

Exhibit 1

Rating Scorecard- Key Financial Ratios (as of June 2016)



Source: Moody's Banking Financial Metrics

Credit Strengths

- » Sparebanken Sor's BCA is supported by its Very Strong- Macro Profile
- » Improved capital levels driven by higher regulatory targets
- » Sparebanken Sor's asset quality metrics have been resilient and broadly in line with domestic peers
- » Large volume of deposits and debt result in a two notch uplift to the deposits and issuer ratings
- » Issuer and deposit ratings benefit from one notch of uplift resulting from our assumption of a Moderate probability of support from the government in case of need

Credit Challenges

- » Despite resilient loan book performance, high single borrower and sector loan concentration increases asset risk
- » Reliance on market funding renders the bank vulnerable to fluctuations in investor sentiment
- » Profitability is supported by efficient operations, but re-pricing puts margins under pressure

Rating Outlook

Sparebanken Sor's deposit and issuer ratings carry a stable outlook to capture our opinion that the bank's financial performance will remain resilient in the context of Norway's slower economic growth due to low oil prices and reduced petroleum sector investments.

Factors that Could Lead to an Upgrade

- » Over time, upward pressure could develop if the bank demonstrates a combination of: (1) reduced exposure to more volatile sectors such as construction and real estate sectors; (2) sustained strong asset quality and (3) a strengthening in core earnings generation.

Factors that Could Lead to a Downgrade

- » Downward rating pressure would develop on Sparebanken Sor's ratings if: (1) the bank's NPLs were to be expected to increase substantially, above our system-wide expectation of approximately 2%; (2) its profitability were to deteriorate materially from its current level and/or (3) the macroeconomic environment weakens meaningfully. Also, any change in the liability structure of the bank that would cause a reduction in the rating uplift under Moody's LGF analysis or, similarly, a revision of the government support assumptions, could lead to downward rating pressure

Note: The numbers presented in the Key Indicators Exhibit below for the years 2013 and 2012 are for Sparebanken Pluss before its merger with Sparebanken Sor

Key Indicators

Exhibit 2

Sparebanken Sor (Consolidated Financials) [1]

	6-16 ²	12-15 ²	12-14 ²	12-13 ²	12-12 ²	Avg. ³
Total Assets (NOK billion)	106.6	101.3	94.1	45.8	44.1	24.7 ³
Total Assets (EUR million)	11,468.7	10,539.0	10,367.9	5,473.7	6,013.5	17.5 ³
Total Assets (USD million)	12,741.1	11,448.4	12,545.7	7,542.5	7,928.1	12.6 ³
Tangible Common Equity (NOK billion)	8.7	7.7	7.1	3.1	2.8	32.5 ³
Tangible Common Equity (EUR million)	933.2	805.0	786.7	371.1	383.1	24.9 ³
Tangible Common Equity (USD million)	1,036.7	874.4	951.9	511.3	505.1	19.7 ³

This publication does not announce a credit rating action. For any credit ratings referenced in this publication, please see the ratings tab on the issuer/entity page on www.moody's.com for the most updated credit rating action information and rating history.

Problem Loans / Gross Loans (%)	1.1	1.5	2.0	0.9	0.6	1.2 ⁴
Tangible Common Equity / Risk Weighted Assets (%)	14.3	12.8	13.2	12.0	11.4	12.7 ⁵
Problem Loans / (Tangible Common Equity + Loan Loss Reserve) (%)	10.5	15.6	21.0	10.8	7.2	13.0 ⁴
Net Interest Margin (%)	1.4	1.6	1.8	1.4	1.3	1.5 ⁴
PPI / Average RWA (%)	1.7	1.7	2.3	1.7	1.8	1.8 ⁵
Net Income / Tangible Assets (%)	0.7	0.6	0.7	0.6	0.7	0.7 ⁴
Cost / Income Ratio (%)	43.6	45.9	43.0	38.1	37.0	41.5 ⁴
Market Funds / Tangible Banking Assets (%)	29.5	31.5	30.1	32.0	36.8	32.0 ⁴
Liquid Banking Assets / Tangible Banking Assets (%)	14.0	11.4	12.3	15.9	17.8	14.3 ⁴
Gross loans / Due to customers (%)	177.2	184.3	169.2	179.4	184.3	178.9 ⁴

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

Source: Moody's Financial Metrics

Detailed Rating Considerations

Sparebanken Sor's BCA is supported by its very strong- macro profile

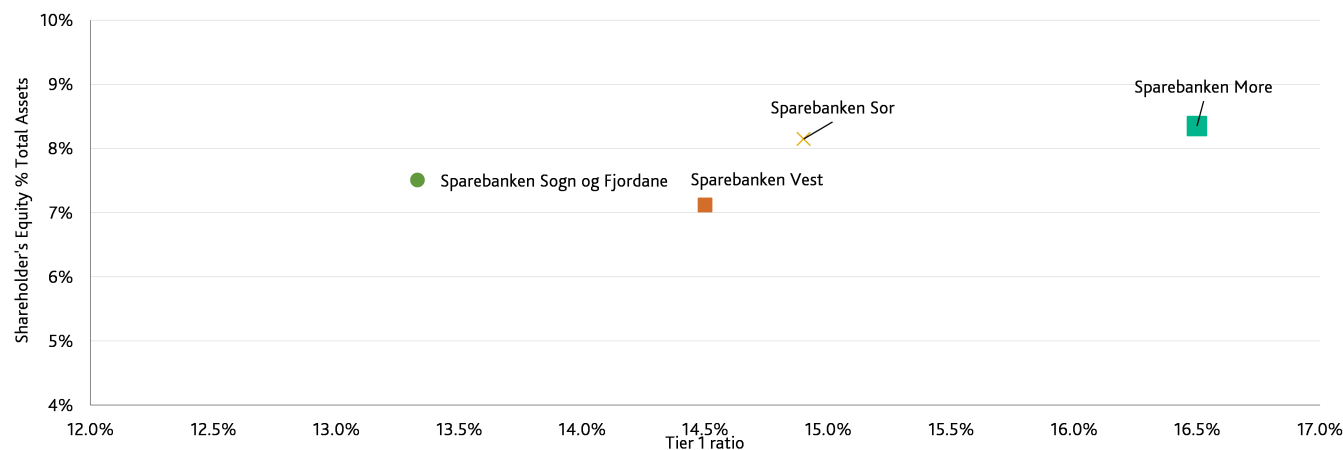
Sparebanken Sor's operations are entirely in Norway. As a result we apply the Very Strong- Macro Profile we have assigned to banks operating in Norway. Banks in Norway benefit from operating in a wealthy and developed country with very high economic, institutional and government financial strength, as 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 system stem from a high level of household indebtedness, elevated real estate prices and domestic banks' reliance on 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 to the total size of the economy.

Improved capital levels driven by higher regulatory targets

Sparebanken Sor's recently increased capital buffers, which positions the bank well relative to the regulatory minimum ahead of the 1 January 2017 implementation update. At end-September 2016, Sparebanken Sor reported a Core Tier 1 Capital Ratio of 13.6%, while the ratio increases to 14.5% when we include 80% of interim profit. In addition Sparebanken Sor's leverage ratio was 7.7% (8.2% when we include 80% of interim profit), on the upper end of its domestic peers range levels.

Exhibit 3

Capital levels have improved and compare favorably with peers



Source: Moody's Financial Metrics, Sparebanken Sor

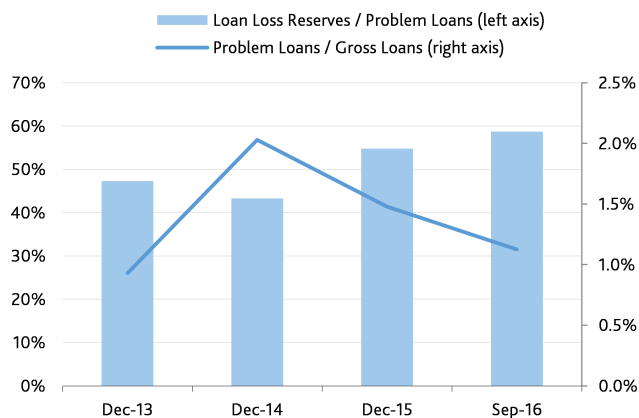
The bank's CET 1 capital was strengthened through a NOK584 million capital increase completed in the second-quarter of 2016 while the increase in the bank's total regulatory capital ratio to 16.9% as of September 2016 from 15.5% in December 2015 also reflects the issuance of \$315 million of hybrid capital in the second quarter.

Resilient asset quality with problem loans metrics in line with domestic peers, although concentrations elevate asset risk

Sparebanken Sor's problem loan ratio (impaired loans as a percentage of total loans) declined to 1.13% at end-September 2016 from 1.48% at end-December 2015. Sor's asset quality metrics are broadly in line with its Norwegian peers' average. Following the merger between Sparebanken Pluss and Sparebanken Sor in 2013, the new merged bank took several actions to improve its credit quality and limit future losses. The bank carried out a comprehensive review of its corporate portfolio in 2014 which resulted in individual write-downs of loans and a spike in credit costs to 0.37% of average gross loans in FY2014 from 0.07% in FY2013. However, Sparebanken Sor's credit costs normalised to 0.11% of average gross loans for FY2015 and declined further to 0.05% for the six-months to June 2016. Sor's NPLs coverage at 59% as of September 2016 is broadly in-line with peers.

Exhibit 4

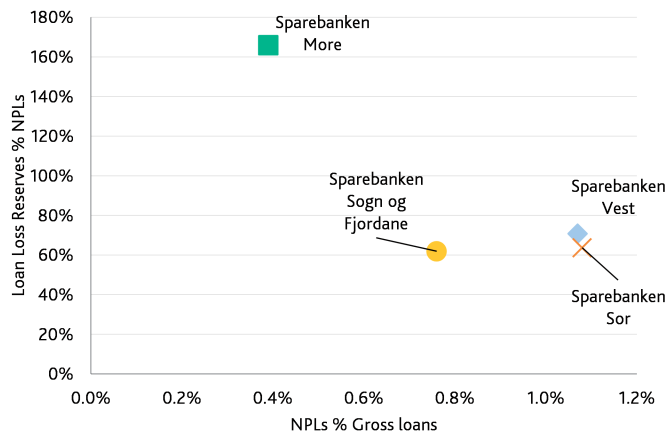
Sparebanken Sor's Asset Quality metrics have been resilient



Source: Moody's Financial Metrics, Sparebanken Sor

Exhibit 5

..and in line with similarly rated domestic peers



Data as of June 2016

Source: Moody's Financial Metrics

Sparebanken Sor's loan book is dominated by retail loans, mostly in the form of mortgages, which represent around 66% of the total loan book at end-September 2016, an asset class has been more resilient historically. However, Sparebanken Sor's significant concentration to the real-estate and construction sectors has generated a significant proportion of the bank's problem loans over the years and poses downside risks to future loan book performance. Furthermore, the bank's business book exposes significant single-borrower concentrations making the bank vulnerable to a potential default of one of its large customers. Our adjustment to the bank's asset risk score by four notches to a3 captures these concentration risks.

Profitability is supported by efficient operations, but re-pricing puts margins under pressure

Sparebanken Sor receives stable income from lending: net interest income represented over 74% of net revenue for the first nine months of 2016. For this period, this source of income remained in line with 2015 levels, despite 5.5% loan growth, as a result of lower lending margins. While deposit rates will be adjusted on a selective basis in order to mitigate the effect of the reduced mortgage lending rates, we expect the bank to experience increasing pressure on net interest margins notwithstanding increases on lending margins of the corporate portfolio announced in December 2015.

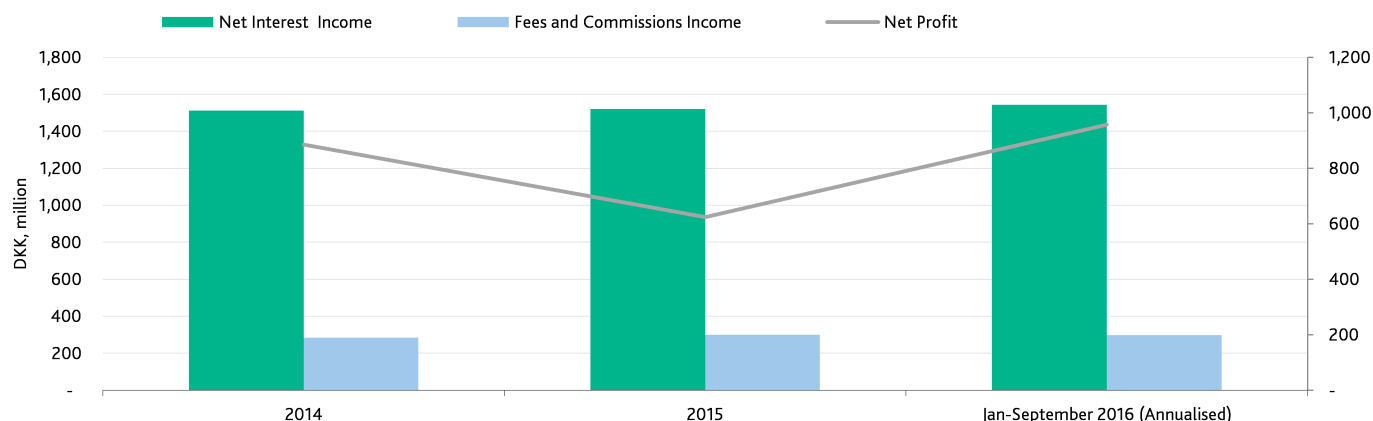
Sparebanken Sor's cost efficiency is among the best in the Nordic region, with a cost-to-income ratio of 40.0% for the nine months to September 2016 (45.9% in 2015 and 42.9% in 2014). Following the aforementioned merger, the bank consolidated its branch network, while workforce downsizing is being carried out as planned. We expect the bank to achieve further cost-related synergies going forward.

Sparebanken Sor reported a 50% year-on-year increase in profit of NOK718 million and an annualized 10.7% return on equity after tax for the first nine months of 2016 the bank, compared to 8.6% for the same period last year. Profitability was boosted by NOK147 million profit from financial investments due to positive performance of the bank's liquidity portfolio and one off gains, mainly NOK34 million one off gain from the sale of VISA and NOK22 million from the sale of NETS in 2014. We expect the bank to continue to be challenged to grow its core profitability, which is reflected by 1 notch negative adjustment in our scorecard. Fees and commissions as

well as net interest income adjusted for: (1) front loading of the 2016 contribution to the Norwegian deposit Guarantee Fund in the first quarter of 2016 and (2) the reclassification of hybrid securities to capital from debt resulting in reclassifying interest expense to dividend (surplus disposal) were relatively flat year-on-year.

Exhibit 6

Sparebanken Sor Profitability Evolution



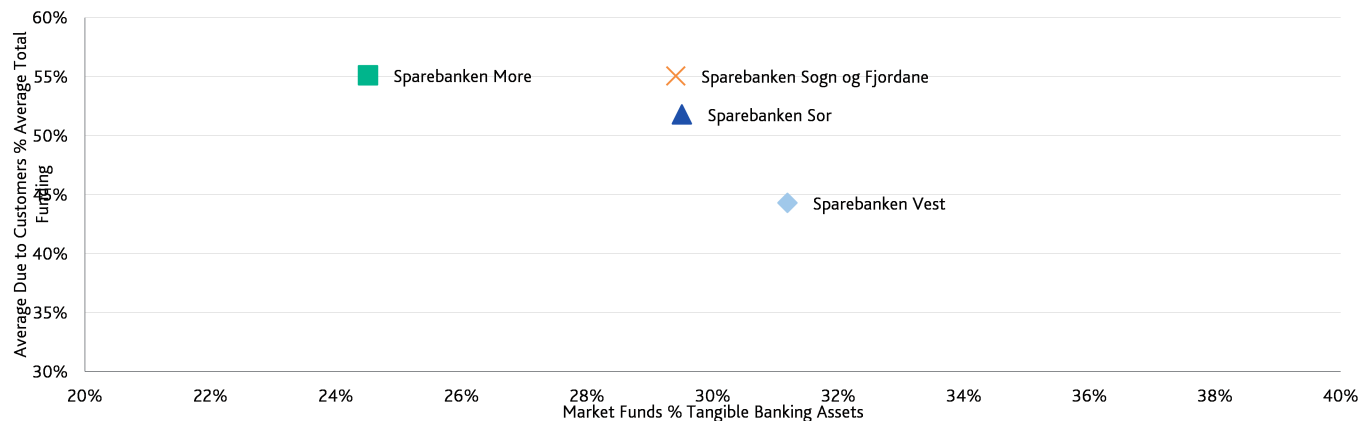
Source: Moody's Banking Financial Metrics

Reliance on market funding renders the bank vulnerable to fluctuations in investor sentiment

Sparebanken Sor's funding is underpinned by a strong deposit base, which accounted for 54% of non-equity funding as of September 2016. Nevertheless, the bank remains reliant on market funding, which accounted for around 27% of tangible banking assets at end-September 2016 (31.5% at end-2015), and which renders the bank susceptible to changes in investor behaviour. While Sparebanken Sor has good access to the domestic capital markets, we expect that the bank will continue accessing the international markets in order to expand its investor base beyond the more limited and concentrated domestic market, owing to the bank's increased size following the Sparebanken Sor-Pluss merger in 2013.

A sizeable and growing portion of market funds are in the form of covered bonds, which provide the bank with an additional source of funding. 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 31.5% as of December 2015. Sparebanken Sor has made its first international larger benchmark issuance through its fully owned covered bond company. We believe the bank will benefit from the depth of the markets, increasing its potential investor base and mitigating its refinancing risk. Our Funding Structure score reflects that the bank's overall funding profile remains a fundamental weakness for Sparebanken Sor.

Exhibit 7



Data as of June 2016

Source: Moody's Financial Metrics

Sparebanken Sor also maintains sizeable buffers of high quality liquid assets. As of September 2016, liquid assets accounted for around 13% of tangible assets, in line with the Norwegian banking average, comprising cash and deposits with the central bank and the securities portfolio. The portfolio primarily includes Norwegian covered bonds, bonds from the government, other public entities and other issuers, and a limited amount of equity investments. We note that these holdings are mostly Norwegian securities, which could be a source of vulnerability from a concentration-risk perspective, but reduces the bank's currency exposure.

Notching Considerations

Loss Given Failure

We expect that Norway will transpose 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 postfailure of 8% of tangible banking assets, a 25% run-off 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, Sparebanken Sor's deposits and issuer ratings 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) two notches above the BCA.

Government Support

Our expectation of the implementation of resolution legislation has caused us to reconsider the probability that government support would benefit certain creditors.

Sparebanken Sor is a regional savings bank with a sound market position on the southern coast of Norway, in the counties of Vest-Agder, Aust-Agder and Telemark, where we estimate it commands combined market shares of almost 26% for lending and 35% for deposits. Headquartered in Kristiansand, Norway, Sparebanken Sor is the fourth-largest savings bank in Norway with total assets of NOK105.2 billion at end- September 2016 (NOK101.3 billion at end December 2015). Sparebanken Sor is the market leader in providing financial services to Christian organisations in Norway, largely as a result of its agreement with the Norwegian Christian Purchasing Organisation (KNIF).

We regard the probability of government support for Sparebanken Sor's debt and deposits as moderate, which results in one notch of rating uplift.

Counterparty Risk Assessment

We assign a long-term and short-term CR Assessment of Aa3(cr) and P-1(cr) respectively.

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.

Foreign Currency Deposit Rating

The bank's foreign-currency deposit ratings are unconstrained, because Norway has a country ceiling of Aaa. Sparebanken Sor's foreign-currency deposit rating is A1.

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 8

Sparebanken Sor

Macro Factors

Weighted Macro Profile	Very Strong -	100%
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Financial Profile

Factor	Historic Ratio	Macro Adjusted Score	Credit Trend	Assigned Score	Key driver #1	Key driver #2
Solvency						
Asset Risk						
Problem Loans / Gross Loans	1.4%	aa2	← →	a3	Geographical concentration	
Capital						
TCE / RWA	14.3%	a1	↑	a1	Risk-weighted capitalisation	
Profitability						
Net Income / Tangible Assets	0.7%	baa2	↑	baa2	Expected trend	
Combined Solvency Score		a1		a3		
Liquidity						
Funding Structure						
Market Funds / Tangible Banking Assets	31.5%	baa3	← →	baa3	Extent of market funding reliance	
Liquid Resources						
Liquid Banking Assets / Tangible Banking Assets	11.4%	baa3	← →	baa3	Stock of liquid assets	
Combined Liquidity Score		baa3		baa3		
Financial Profile						
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	33,208	31.2%	38,433	36.1%
Deposits	51,227	48.1%	46,002	43.2%
Preferred deposits	37,908	35.6%	36,013	33.8%
Junior Deposits	13,319	12.5%	9,989	9.4%
Senior unsecured bank debt	17,762	16.7%	17,762	16.7%
Dated subordinated bank debt	1,203	1.1%	1,203	1.1%
Junior subordinated bank debt				
Preference shares (bank)				
Senior unsecured holding company debt				
Dated subordinated holding company debt				
Junior subordinated holding company debt				
Preference shares (holding company)				
Equity	3,198	3.0%	3,198	3.0%
Total Tangible Banking Assets	106,598	100%	106,598	100%

Debt class	De jure waterfall		De facto waterfall		Notching		LGF notching guidance versus 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	30.2%	30.2%	30.2%	30.2%	3	3	3	3	0	a1 (cr)
Deposits	30.2%	4.1%	30.2%	20.8%	2	3	2	2	0	a2
Senior unsecured bank debt	30.2%	4.1%	20.8%	4.1%	2	2	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)	1	Aa3 (cr)	--
Deposits	2	0	a2	1	A1	A1
Senior unsecured bank debt	2	0	a2	1	A1	A1

Source: Moody's Financial Metrics

Ratings

Exhibit 9

Category	Moody's Rating
SPAREBANKEN SOR	
Outlook	Stable
Bank Deposits	A1/P-1
Baseline Credit Assessment	baa1
Adjusted Baseline Credit Assessment	baa1
Counterparty Risk Assessment	Aa3(cr)/P-1(cr)
Issuer Rating	A1
Senior Unsecured MTN	(P)A1

Source: Moody's Investors Service

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