MOODY'S
INVESTORS SERVICE

Credit Opinion: Helgeland Sparebank

Global Credit Research - 16 Dec 2015

Norway

Ratings

Category	Moody's Rating
Outlook	Stable
Bank Deposits	A3/P-2
Baseline Credit Assessment	baa2
Adjusted Baseline Credit Assessment	baa2
Counterparty Risk Assessment	A2(cr)/P-1(cr)

Contacts

Analyst	Phone
Efthymia Tsotsani/London	44.20.7772.5454
Sean Marion/London	
Maria del Mar Asensio/London	

Key Indicators

Helgeland Sparebank (Consolidated Financials)[1]

	[2]9-15	[2]12-14	[3]12-13	[3]12-12	[3]12-11	Avg.
Total Assets (NOK billion)	26.6	25.8	25.9	24.6	22.8	[4]3.9
Total Assets (EUR million)	2,789.2	2,843.3	3,103.3	3,352.0	2,943.2	[4]-1.3
Total Assets (USD million)	3,113.5	3,440.6	4,276.2	4,419.2	3,820.7	[4]-5.0
Tangible Common Equity (NOK billion)	2.0	2.0	1.8	1.7	1.5	[4]8.4
Tangible Common Equity (EUR million)	214.0	216.0	219.5	230.1	190.5	[4]3.0
Tangible Common Equity (USD million)	238.9	261.4	302.5	303.3	247.3	[4]-0.9
Problem Loans / Gross Loans (%)	0.7	0.6	0.8	0.6	1.3	[5]0.8
Tangible Common Equity / Risk Weighted Assets (%)	14.1	14.1	13.5	12.6	11.4	[6]14.1
Problem Loans / (Tangible Common Equity + Loan Loss Reserve) (%)	7.2	6.2	8.7	7.2	14.6	[5]8.8
Net Interest Margin (%)	1.8	1.8	1.8	1.5	1.5	[5]1.7
PPI / Average RWA (%)	2.1	2.2	2.1	1.6	1.4	[6]2.1
Net Income / Tangible Assets (%)	0.7	0.8	0.7	0.5	0.4	[5]0.6
Cost / Income Ratio (%)	47.2	46.4	45.3	52.2	54.5	[5]49.1
Market Funds / Tangible Banking Assets (%)	29.6	29.6	33.3	38.5	46.0	[5]35.4
Liquid Banking Assets / Tangible Banking Assets (%)	15.0	17.5	18.3	16.9	18.4	[5]17.2
Gross loans / Due to customers (%)	157.0	151.8	159.4	177.0	174.0	[5]163.8

Source: Moody's

[1] All figures and ratios are adjusted using Moody's standard adjustments [2] Basel III - fully-loaded or transitional phase-in; IFRS [3] Basel II; IFRS [4] Compound Annual Growth Rate based on IFRS reporting periods [5] IFRS reporting periods have been used for average calculation [6] Basel III - fully-loaded or transitional phase-in & IFRS reporting periods have been used for average calculation

Opinion

SUMMARY RATING RATIONALE

Moody's assigns Helgeland Sparebank a baseline credit assessment (BCA) of baa2, a long-term deposit rating of A3 and short-term deposit rating Prime-2. We also assign a Counterparty Risk Assessment (CRA) of A2(cr) long-term and Prime-1(cr) short term.

Helgeland Sparebank's BCA of baa2 primarily reflects the bank's improvements in asset quality and capital. Helgeland Sparebank's problem loan levels have progressively declined, leading to improved problem loan coverage while its capital levels remain strong. The BCA also incorporates the bank's limited geographical reach and high single-name concentrations, as well as a higher-than-average concentration in commercial real-estate exposures (above 180% of Tier 1 Capital at-end 2014) and limited pricing power. The bank's deposit rating takes into account the Loss Given Failure (LGF) analysis of the bank's volume of deposits and debt, and the volume of securities subordinated to them.

Rating Drivers

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

- Positive measures to increase capital levels

- Good asset quality metrics, but downside risks from exposures to more volatile sectors and high credit concentration

- Stable profitability, but intense competition in local market will weigh on margins

- Sizeable deposit base, but material market funding reliance

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

Rating Outlook

The stable outlooks on the bank's long-term senior debt and deposit ratings reflect our view that the bank's financials will remain broadly resilient in the face of a modest slowdown in Norway's still strong economic performance.

What Could Change the Rating - Up

Upward rating momentum could develop if Helgeland Sparebank demonstrates (1) good asset quality in its retail and corporate books, including in more volatile segments; (2) continued good access to capital markets and improved liquidity; and/or (3) stronger earnings generation without an increase in its risk profile.

What Could Change the Rating - Down

Future downward rating pressure would emerge if (1) Helgeland Sparebank's problem loan ratio increases significantly above our system-wide expectation of approximately 2%; (2) financing conditions become more difficult; (3) its risk profile increases, for example as a result of increased exposures to more volatile sectors; and/or (4) the macroeconomic environment deteriorates more than estimated, leading to adverse developments in the Norwegian real-estate market.

DETAILED RATING CONSIDERATIONS

HELGELAND SPAREBANK'S BCA IS SUPPORTED BY ITS VERY STRONG- MACRO PROFILE

As a purely domestic bank, Helgeland Sparebank's operating environment is within Norway. We therefore align the bank's Macro Profile with that of Norway at Very Strong-. Norwegian banks benefit from operating in an affluent and developed country. Norway has very high economic, institutional and government financial strength, as well as low susceptibility to event risk. The main risks to the system stem from a high level of household indebtedness and domestic banks' reliance on market funding. However, these risks are offset by the strength of households' ability to service debt, banks' adequate capitalisation and the banking system's relatively small size compared with GDP.

POSITIVE MEASURES TAKEN TO INCREASE CAPITAL LEVELS

We view the bank as being adequately capitalised in light of its risk profile. Its capitalisation is in line with its rated Norwegian peer group, with Tangible Common Equity (TCE) at 14.1% of risk-weighted assets at end-September 2015, an increase from 2012 levels (12.6%). The bank has determined a new capital plan for 2014-18, and aims to increase its capital ratio in line with new capital requirements. It is also considering the use of subordinate loans or tier 1 instruments if necessary. Our assigned Capital score reflects this strength, as well as the bank's 8% TCE/tangible banking assets ratio, which is well within international standards.

GOOD ASSET QUALITY METRICS, BUT DOWNSIDE RISKS FROM EXPOSURES TO MORE VOLATILE SECTORS AND HIGH CREDIT CONCENTRATIONS

Helgeland Sparebank's problem loan ratio (impaired loans as percentage of total loans) has progressively declined, reaching 0.7% at end-September 2015 in-line with most of its Norwegian peers. The bank has a retail focus, with mortgages accounting for 70% of the bank's loan book. This asset class has historically proven more resilient and is supported by Norwegian households' sound financial position. However, the sustained increase in house prices combined with the high level of household indebtedness pose long-term risks to the banking sector in general, and may undermine Helgeland Sparebank's ability to sustain the currently strong asset quality metrics of its retail book in the future.

We note that a large portion of problem loans relate to the real-estate and construction sectors. Moreover, the bank's substantial involvement in these industries (at 17% of gross loans in 2014), which are typically cyclical, poses a risk to its future asset quality. In addition, the bank's loan book exhibits high single-borrower concentration; while this is typical at Nordic banks, it could accelerate the extent and pace of any deterioration in asset quality. Our assigned Asset Risk score reflects our view that the bank is vulnerable to less favourable economic conditions owing to declining oil and gas prices as well as falling investment levels.

STABLE PROFITABILITY BUT INTENSE COMPETITION IN THE LOCAL MARKET WILL WEIGH ON MARGINS

Helgeland Sparebank derived almost 60% of its 2014 pre-tax income from its retail operations, excluding other, not divided operations. We view retail operations as being typically more resilient. Its primary source of earnings is net interest income, which has accounted for over 80% of its net revenue in the last few years. Net interest income improved in 2014, primarily as a result of higher lending margins and loan growth, with 4% growth year-on-year. So far in 2015 the bank's net interest margin remained at the same level as the previous year, at 1.77%, following interest rate reductions in mortgages and deposits. We expect margins to remain under pressure as the competitive situation is persistently strong, especially in the retail market.

Net income as a share of tangible assets stood at 0.70% at end September 2015, in-line with the bank's three-year average but lower than 2014 (at 0.82%), due to losses on interest bearing securities as a result of significant credit spread widening. Loan loss provisions represented 0.12% of average loans at end September 2015, lower than 0.21% at end 2014, while the cost-to-income ratio remained unchanged at 47%. We expect the bank's profitability to be further challenged due to lower margins and widening markets spreads resulting into higher funding costs and additional losses on the bank's liquidity book, which is reflected in the bank's Profitability score.

SIZEABLE DEPOSIT BASE BUT MATERIAL MARKET FUNDING RELIANCE

Helgeland Sparebank's funding profile reflects a sizeable deposit base, largely from retail customers, which constituted almost 60% of funding at year-end 2014. We view this positively, particularly given the relatively diverse nature of the deposit base.

Market funding accounted for almost 30% of the bank's tangible assets at year-end 2014. Covered bond funding has grown significantly since 2009, when Helgeland Boligkreditt AS (the bank's wholly owned covered bond company) was established. Under our methodology, we reflect the stability of covered bonds relative to unsecured market funding through a standard adjustment in our scorecard. However, we do not expect that, size-wise, Helgeland Sparebank will have the capacity to make larger benchmark issuance. This ultimately restricts its investor base.

Helgeland Sparebank's Funding score reflects that its overall funding profile remains a fundamental weakness for the bank. In addition, extensive use of covered bond funding causes structural subordination of Helgeland Sparebank's unsecured creditors, including depositors.

At year-end 2014, liquid assets accounted for 5.5 billion, or almost 18% of total assets and comprised cash, cash equivalents and assets in the bank's securities. As of year-end 2014, 91% of securities in the portfolio were rated single-A or higher. However, we note that these holdings mostly consist of Norwegian securities, which could lead to concentration risk.

Notching Considerations

LOSS GIVEN FAILURE AND ADDITIONAL NOTCHING

We expect that Norway will seek to introduce legislation to implement the EU Bank Resolution and Recovery Directive. In the LGF analysis we assume residual tangible common equity of 3%; losses post-failure 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. These are in line with our standard assumptions.

For Helgeland Sparebank's long-term deposit ratings, our upgrade has considered the likely impact on loss-given-failure of the volume of deposits and the amount of debt subordinated to them. This has result in a Preliminary Rating Assessment of two notches above the BCA, reflecting very low loss-given-failure.

GOVERNMENT SUPPORT

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

Helgeland Sparebank is a local savings bank with a well-established market position in Helgeland, a district in the county of Nordland. Although its national market share is negligible, based on the bank's latest audited annual report and Statistics Norway, we estimate that Helgeland Sparebank commands a market share of approximately 13% for lending and 17% for deposits in the county. In addition, we view the banking market across most of Norway as being competitive. We consider that Helgeland has very limited pricing power, compared with the larger national and regional players. Therefore, we consider the likelihood of government support for debt and deposits as being low resulting in no ratings uplift.

COUNTERPARTY RISK ASSESSMENT

We assign a long-term and short-term CR assessment of A2(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

Helgeland Sparebank's A3 foreign-currency deposit rating is unconstrained, given that Norway has a country ceiling of Aaa.

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 Factors

Helgeland Sparebank

Macro Factors	
Weighted Macro Profile	**Very Strong -**

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	0.7%	aa1	←→	baa1	Geographical concentration	Sector concentration
Capital						
TCE / RWA	14.1%	aa3	←→	aa3	Risk-weighted capitalisation	
Profitability						
Net Income / Tangible Assets	0.7%	baa2	←→	baa3	Expected trend	
Combined Solvency Score		aa3		a3		
Liquidity						
Funding Structure						
Market Funds / Tangible Banking Assets	29.6%	baa2	←→	ba1	Market funding quality	
Liquid Resources						
Liquid Banking Assets / Tangible Banking Assets	17.5%	baa2	←→	baa2	Stock of liquid assets	
Combined Liquidity Score		baa2		baa3		

Financial Profile	**baa1**

Qualitative Adjustments	**Adjustment**
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	**baa2**
Affiliate Support notching	**0**
Adjusted BCA	**baa2**

Instrument Class	Loss Given Failure notching	Additional notching	Preliminary Rating Assessment	Government Support notching	Local Currency rating	Foreign Currency rating
Deposits	2	0	a3	0	A3	A3