Moody's Investors Service

Credit Opinion: SpareBank 1 Nord-Norge

Global Credit Research - 29 Jul 2009

Tromso, Norway

Ratings

Category	Moody's Rating
Outlook	Negative
Bank Deposits	A1/P-1
Bank Financial Strength	C
Senior Unsecured	A1
Subordinate	A2
Jr Subordinate MTN	A2
Preferred Stock	A3

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Key Indicators

SpareBank 1 Nord-Norge

	[1]2009	2008	[2]2007	2006	2005	[3]Avg.
Total assets (NOK billion)	63.57	65.51	60.97	54.96	48.63	[4]9.88
Total assets (EUR billion)	7.09	6.73	7.68	6.69	6.09	--
Total capital (NOK billion)	5.94	5.92	5.51	4.90	4.24	[4]8.92
Return on average assets	0.94	0.57	1.23	1.51	1.23	1.10
Recurring earnings power [5]	1.46	0.64	1.18	1.45	1.55	1.31
Net interest margin	2.04	2.30	2.23	2.25	2.47	2.40
Cost/income ratio (%)	50.84	70.88	58.62	55.18	55.44	58.62
Problem loans % gross loans	1.61	1.47	1.12	1.64	2.31	1.84
Tier 1 ratio (%)	10.13	9.06	8.92	9.77	9.60	9.46

[1] As of March 31. [2] Statement period in which the bank switched to Basel II accounting framework. [3] The average calculations are based on Basel I and Basel II data where applicable. [4] Compound annual growth rate. [5] Preprovision income % average assets.

Opinion

SUMMARY RATING RATIONALE

Moody's assigns a bank financial strength rating (BFSR) of C to SpareBank 1 Nord-Norge (formerly known as Sparebanken Nord-Norge), which translates into a baseline credit assessment (BCA) of A3. The BFSR reflects the bank's dominant regional market position, good risk management and satisfactory financial metrics. The key factor constraining the rating is SpareBank 1 Nord-Norge's limited geographic outreach, which, combined with its strong commitment to supporting local industry, translates into a higher credit risk concentration. The financial result in 2008 was weaker than in the past four years, reflecting increased loan loss provisions and poorly performing financial investments. On the other hand, profitability was supported by a "badwill" profit in relation to the acquisition of BNbank (previously known as Glitnir Bank) in Q4 2008.

SpareBank 1 Nord-Norge is the leading player in northern Norway, where it benefits from strong local brand name recognition and has a regional market share of around 30% in retail lending and around 25% in corporate lending. The bank benefits from being a member of SpareBank 1 Alliance, created in 1996, which has provided member banks with a stronger brand, more sophisticated products provided by SpareBank 1 Gruppen (of which SpareBank 1 Nord-Norge owns 19.9%) and cost synergies. Although the member banks have retained their local brandings, they continue to learn from each other's best practices. After a number of positive years, SpareBank 1 Gruppen's contribution to the owner banks' profitability turned negative in 2008, reflecting particularly poor financial results in the life insurance operations.

SpareBank 1 Nord-Norge's global local currency (GLC) deposit rating of A1 receives a two-notch uplift from the A3 BCA on the basis of a very high probability of systemic support and a low probability of support from SpareBank 1 Alliance for the bank in the event of a stress situation.

Credit Strengths

- Strong regional market position and brand recognition in northern Norway

- Membership of SpareBank 1 Alliance reflected in the bank's franchise through shared operations and active benchmarking

- Comprehensive risk management practices

- Satisfactory capitalisation

- Good core profitability of banking operations

Credit Challenges

- To preserve asset quality in a more challenging economic environment

- High credit risk concentration reflecting strong commitment to supporting local industry and limited geographic reach

- To contain earnings volatility stemming from financial investments

- To improve risk-weighted earning power

- Tight liquidity by international standards, although similar to that of other Norwegian banks

- To improving cost efficiency

- Earnings volatility in SpareBank 1 Gruppen

Rating Outlook

On 22 July 2009, Moody's changed the outlook on SpareBank 1 Nord-Norge's A1 long-term ratings to negative and affirmed its C BFSR with negative outlook. The negative outlook on SpareBank 1 Nord-Norge's BFSR reflects the uncertainty associated with potential further impairments in financial strength greater than those identified in Moody's base stress assumptions, in light of the weakened Norwegian economy.

What Could Change the Rating - Up

Given the negative outlook on the ratings, an upward movement of is viewed as unlikely.

What Could Change the Rating - Down

The BFSR could be adversely affected by a weakening in credit quality that exceeds Moody's base stress scenario, which would exert pressure on the bank's capitalisation.

SpareBank 1 Nord-Norge's GLC deposit rating could be downgraded in the event of (i) the BFSR being downgraded and/or (ii) an unlikely decline in Moody's assessment of the probability of systemic support for the bank.

Recent Results and Company Events

SpareBank 1 Nord-Norge's pre-tax profit in 2008 was NOK493 million compared with NOK900 million in 2007. The main reason for the lower pre-tax profit was an increase in loan losses to NOK183 million from NOK17 million in 2007. Earnings were also affected by the poor performance of SpareBank 1 Gruppen, which resulted in a negative contribution of NOK150 million compared with a positive NOK229 million in 2007. In addition, the result was further affected by net losses on shares and bonds. Moody's notes that, following the amendment of IAS 39, the bank has reclassified the major part of its NOK5.0 billion interest-bearing portfolio out of the fair value through profit and loss category. This reclassification improved the bank's 2008 profit by NOK212 million.

In Q1 2009, the pretax profit was NOK189 million, a 60% increase quarter-on-quarter, mainly as a result of NOK61 million positive valuation in investment securities compared to a negative NOK195 million in Q4 2008. The loan losses stood at NOK53 million, a significantly lower level than in Q4 2008 (NOK114 million) and the net income for the quarter was NOK152 million.

On 21 October 2008, SpareBank 1 Nord-Norge, together with the other banks in SpareBank 1 Alliance, acquired BNbank (previously known as Glitnir Bank) from Iceland's Glitnir banki for NOK300 million (EUR 33 million). SpareBank 1 Nord-Norge holds 20% of BNbank. The "badwill" profit in relation to the acquisition resulted in a gain of NOK415 million for SpareBank 1 Nord-Norge in 2008. However this profit does not offset the weaker financial results and therefore the pre-provision profit in 2008 was 40% lower than in the previous year.

The core banking operations continued to perform well in 2008. Net interest income increased by 10%, which is attributable to 7% annual loan growth (including SpareBank 1 Boligkreditt) and slightly improved customer margins (to 2.3% from 2.2%), which have been compensating for higher funding costs. However, fee and commission income was 10% lower than in 2007, which is mainly due to the bank's decision to make certain services free for its prioritised customers and reduced commission income related to mutual funds. In Q1 2009, the positive trend in net interest income seen in the previous quarter reversed and the fee and commission income somewhat recovered.

SpareBank 1 Nord-Norge's asset quality has deteriorated, albeit to a lesser extent than that of many of its peers. Problem loans accounted for 1.5% of total loans at YE2008 compared with 1.1% at YE2007. They increased slightly to 1.6% in Q1 2009. Although the performance of the Norwegian banking sector has been satisfactory so far during the crisis, the weakening domestic economic environment is putting pressure on asset quality. Economic growth in Norway has slowed significantly and we expect the economic downturn to continue and unemployment to increase from its current low levels. However, we note that in northern Norway the public sector is an important employer, which should be a mitigating factor in the downturn. The housing market has also cooled and on average house prices have decreased by several percentage points.

At YE2008, the Tier 1 and total capital ratios were 9.1% and 10.6%, respectively, as calculated in accordance with the transitional rules towards Basel II. The corresponding ratios in Q1 2009 were 10.1% and 11.7%. These ratios show a slight improvement compared with figures of 8.9% and 10.0% in 2007. In addition, we note that the Norwegian government's second set of measures to support the banking sector focuses on the banks' solidity. In February 2009, the government announced that it will establish two funds - one to provide core capital to Norwegian banks and another to invest in fixed income securities issued by Norwegian banks and other corporates. The government's earlier initiative in October was to establish a swap arrangement whereby banks could swap covered bonds to government bonds to support liquidity. All banks eligible to sign up to Norges Bank's fixed-rate lending facility (F-loans), which is the case for SpareBank 1 Nord-Norge, can use the swap arrangement, which amounts to NOK350 billion of issued government bonds and maturities up to five years.

DETAILED RATING CONSIDERATIONS

Detailed considerations for SpareBank 1 Nord-Norge's currently assigned ratings are as follows:

Bank Financial Strength Rating

Moody's assigns a C BFSR to SpareBank 1 Nord-Norge, which is in line with the outcome of Moody's bank financial strength scorecard. The key positive drivers of the assigned rating are the bank's strong regional market position and brand recognition in northern Norway, and the positive effects of membership in SpareBank 1 Alliance. In addition, satisfactory capitalisation is an influential factor in the assigned BFSR. The key drivers restricting the BFSR are the bank's operations in a limited geographic area, high credit risk concentration and high dependence on market funding, as reflected in the liquidity ratio. In addition, risk-adjusted profitability deteriorated in 2008 and is likely to remain under pressure in 2009.

Qualitative Factors (50% weighting)

Factor 1: Franchise Value

Trend: Neutral

SpareBank 1 Nord-Norge has a solid, defensible footprint in northern Norway, characterised by a loyal customer base, high market shares and stable earnings. The bank has 245,000 retail and 40,500 corporate (mainly SMEs) and public sector customers and market shares of around 30% in retail lending and around 25% in corporate lending in the three most northerly counties of Norway. It is also well positioned in the public sector.

In addition, the bank opened a representative office in Murmansk, Russia, in 2007 and acquired a 10% stake in Tavrichesky Bank in May 2008. The deal includes plans for the sale of Tavrichesky Bank's branch in Murmansk to a separate bank that is 75% owned by SpareBank 1 Nord-Norge and 25% owned by Tavrichesky Bank. More recently, the banks in the SpareBank 1 Alliance announced the acquisition of BNbank, the Norwegian subsidiary of Glitnir banki, which is a relatively small bank, with market shares of less than 2% in lending and deposits in Norway. Although we expect the acquisition to strengthen the overall franchise of the alliance, the direct impact on SpareBank 1 Nord-Norge's franchise is considered to be limited given that BNbank's strongest presence is in central Norway (corporate) and the Oslo area (retail).

Over 60% of the bank's lending is to retail customers, mostly in the form of mortgages. The rest is corporate lending and has been growing at a slower pace recently. The bank has also increased its focus on cross-selling and fee and commission income now represents some 20% of operating income. Over 60% of the bank's earnings are derived from stable income sources including retail banking.

The SpareBank 1 Nord-Norge's franchise value is positively affected by its membership of SpareBank 1 Alliance, which was established in 1996 in response to the increasing competitive pressures in the Norwegian banking sector. Currently, the alliance has 22 saving banks as members. The alliance includes joint-product companies (including fund management and life and non-life insurance), joint marketing and the development of common IT and Internet platforms. Therefore, membership of the alliance facilitates cost sharing, economies of scale and critical mass among members. The sales strategy remains decentralised in order to safeguard close customer relationships.

We expect the bank to maintain a leading position in the region due to its close client relationships, a broad product offering and synergies related to its membership of SpareBank 1 Alliance. Nevertheless, the bank operates in a limited geographic area, which limits the overall score for franchise value to C+.

Factor 2: Risk Positioning

Trend: Neutral

SpareBank 1 Nord-Norge's management practices and systems provide comprehensive guidelines and tools for risk-taking. This prudent approach has over time come to characterise the risk culture of the organisation. The bank also benefits from the common unit of SpareBank 1 Alliance focusing on credit risk modelling. The overall risk profile of SpareBank 1 Nord-Norge is good although the borrower concentration risk remain a constraining factor for the score on risk management.

The largest owner, Pareto Aksjer Norge, has 4.9% of primary capital certificates (PCC) and the 20 largest owners hold 27% of PCCs. The main difference between PCCs and shares is that PCCs give ownership rights to specific parts of a bank's capital. In addition, the governing bodies of a savings bank have a broader representation than in a commercial bank. The PCCs of SpareBank 1 Nord-Norge are listed on the Oslo Stock Exchange. The board consists of eight members of whom one represents employees. A number of members of the management board, including the chief executive officer, have been with the bank for several years. We do not view SpareBank 1 Nord-Norge as having corporate governance problems.

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

Operating in and being supportive of its small geographic region means that SpareBank 1 Nord-Norge has large customer exposures. Therefore, SpareBank 1 Nord-Norge exhibits high borrower concentration as measured by the 20 largest exposures in relation to Tier 1 capital or pre-provision profit, whichever provides the lowest ratio. Industry concentration is lower, but we note that real estate-related loans represent around 16% of the total loan portfolio. We note that the bank's fishing-related exposures are limited - fishing vessels account for about 3% of the portfolio, fishing industry about 1% and fish farming 0.5%.

Compared with many of its European peers, SpareBank 1 Nord-Norge has fewer liquid assets on the balance sheet, amounting to around 16% of total assets at YE2008. That said, the bank's liquidity management is well developed, which is typical for a Norwegian bank as liquidity has historically been tight. Liquidity measures also benefit from access to the covered bond market given that SpareBank 1 Boligkreditt, which is partly owned by SpareBank 1 Nord-Norge, started to issue covered bonds in 2007. In 2008, SpareBank 1 Nord-Norge transferred to the covered bond company mortgage bonds worth NOK5.2 billion, which represents 9% of total loans.

The liquidity portfolio consists mainly of bonds issued by domestic or international financial institutions and covered bonds, but also includes around 6% of structured products. On the funding side, SpareBank 1 Nord-Norge benefits from a good deposit base that has been growing at a similar rate as lending in the past few years. In 2008, 60% of funding consisted of deposits and 40% of wholesale funds. The bank issues in the local market and also has an EMTN programme, with over 50% of funding from the Norwegian market. The maturity profile of long-term funding is relatively diversified, but mainly concentrates on 2009-11, with about NOK5 billion (about EUR 500 million) maturing in 2009.

The bank has a limited appetite for market risk, but we note that some of the shareholdings have recently resulted in write-downs. The exposure to interest rate risk is limited to NOK30 million in relation to a 100-basis-point change in interest rates. The bank's shareholdings on the balance sheet amount to NOK472 million (12% of Tier 1 capital) and are mainly domestic companies. Its currency position is limited. The bank also has some indirect exposure to market volatility via its shareholding in SpareBank 1 Gruppen.

We note the risks related to operations in Russia. Nevertheless, we take comfort from the fact that the branch in Murmansk would be focusing on serving those Norwegian customers in the area who are already the bank's customers. As regards risks related to the newly acquired BNbank, we note that it has a high credit risk concentration both in terms of borrowers and industries (about 50% of its loan portfolio is to commercial real estate). However, the good quality of the retail mortgage book and the fact that the ownership is split between the banks in the alliance are seen as mitigating factors.

A high credit risk concentration weakens the overall score for risk positioning to C-.

Factor 3: Regulatory Environment

For a discussion of the regulatory environment, please see Moody's latest Banking System Outlook on Norway, published in November 2008.

Factor 4: Operating Environment

Trend: Neutral

The score for the operating environment takes into account the economic stability, integrity and corruption in the country as well as the legal system. The score for Norway's operating environment is B+. For further discussion of the operating environment, please see Moody's latest Banking System Outlook on Norway, published in November 2008.

Quantitative Factors (50% weighting)

Factor 5: Profitability

Trend: Weakening

SpareBank 1 Nord-Norge is reliant on net interest income, which represents almost 80% of its core operating income (excluding income from financial investments). The net interest margin has been relatively stable in recent years, 2.30% in 2008 compared with 2.23% in 2007, but volume growth has been somewhat slower compared with that of the other rated Norwegian savings banks. Commission income represents around 20% of core operating income and is mainly related to payment services, insurance products and securities trading. In addition, it also includes commissions received from mortgages transferred to SpareBank 1 Boligkreditt.

In Q1 2009, the positive trend in net interest income seen in the previous quarter reversed and the fee and commission income somewhat recovered.

Trading- and securities-related income has historically constituted less than 5% of operating income, but in 2008 net losses on share and bond holdings significantly affected profitability. Going forward, the reclassification of a large proportion of interest-bearing assets should limit the impact on earnings, but we note that the main drivers of the weaker profit in 2008 were the share investments and the negative contribution of SpareBank 1 Gruppen, of which SpareBank 1 Nord-Norge owns 19.9%. We note that the negative effect was more than offset by the recognition of "badwill" profit following the takeover of BNbank by the banks of the SpareBank 1 alliance. In Q1 2009, SpareBank 1 Gruppen's contribution was a positive NOK2 million and, regarding BNbank, SpareBank 1 Nord-Norge, booked a NOK1.8 million profit as a result of the amortisation of "lesser value" of the book value of its share of the equity capital in BNbank.

The net result for 2008 was also negatively affected by loan loss provisions of NOK183 million compared with NOK17 million in 2007 and write-back of NOK43 million in 2006. The corresponding figure in Q1 2009 was NOK53 million. Overall, risk-weighted profitability deteriorated in 2008, with pre-provision income in relation to risk-weighted assets having decreased to 1.0% in 2008 from 1.9% in 2007, but recovered above 2% in Q1 2009.

The profitability score on Moody's scorecard reflects risk-adjusted profitability under Basel II (transitional rules) and therefore only includes the profitability ratios for 2008. The scorecard-derived score is D, but when adjusting for the reclassification of financial assets permitted by the amendment of IAS39 the score is E+. The profitability trend is weakening given the more challenging economic outlook, especially for the corporate sector, which is likely to result in further loan loss provisions.

Factor 6: Liquidity

Trend: Neutral

While liquidity is structurally tight in Norway, it is, to a degree, balanced by good liquidity management. As mentioned above, SpareBank 1 Nord-Norge is reliant on domestic and international wholesale funding, but also benefits from a good deposit base. The deposit-to-gross loans ratio was 67% at YE2008 and deposit growth was 8% in 2008 compared with slightly lower loan growth. In addition, we note that SpareBank 1 Nord-Norge has started to issue covered bonds jointly with other members of SpareBank 1 Alliance. This should have a positive effect on liquidity. Covered bonds could also be used under the government's swap arrangement in exchange for Norwegian government securities.

SpareBank 1 Nord-Norge's D+ score for liquidity, although lower than that of its European counterparts, is in line with that of other Norwegian banks. Although it reflects the bank's reliance on market funding, we positively note its good liquidity management and its access to covered bonds.

Factor 7: Capital Adequacy

Trend: Neutral

SpareBank 1 Nord-Norge has maintained its capital adequacy at a good level. The Tier 1 ratio increased to 9.1% at YE2008 from 8.9% at YE2007 (reported under Basel II transitional rules), and is higher than that of many Norwegian peers partly due to slower loan growth in the past few years. The total capital ratio was 10.6% at YE2008. The bank's Tier 1 capital includes a US$60 million hybrid instrument to which Moody's has assigned a basket B (i.e. 25% equity). The Tier 1 ratio, adjusted for the hybrid capital, remains at a satisfactory level, 8.4% at YE2008. The tier 1 and total capital ratios in Q1 2009 were 10.1% and 11.7%, respectively.

The bank's board has set a target for Tier 1 and total capital ratios of at least 9% and at least 12%, respectively.

SpareBank 1 Nord-Norge had excess capital above the regulatory limit of 8% (total capital) amounting to NOK1.1 billion or 2.2% of gross loans (excluding loans transferred to SpareBank 1 Boligkreditt) at YE2008.

For Basel II purposes, SpareBank 1 Nord-Norge applies the (internal ratings-based) IRB Foundation Approach for credit risk. Given the bank's large retail loan book, the capital requirement is decreasing under Basel II. However, due to some concentrations issues as well as the more challenging economic outlook, we expect the bank to maintain its prudent capital management and not to release capital.

The score for capital adequacy is B+.

Factor 8: Efficiency

Trend: Neutral

The bank's efficiency has been weakening significantly and stood at 71% in 2008. However, it is in line with that of the other rated SpareBank 1 banks, which all score C for efficiency. In Q1 2009, the cost-to-income was 51%; the improvement was largely due to the improved performance in investment securities. On the one hand, we continue to see pressure on expenses due to increased funding costs. On the other hand, SpareBank 1 Nord-Norge should benefit from cost advances related to SpareBank 1 Alliance. In 2008, cost efficiency was negatively affected by losses on financial instruments and lower fee and commission income. The number of employees increased only slightly in 2008, but personnel costs increased by 15% in comparison with 2007. In light of slower growth, the bank has implemented cost-reduction measures.

In a competitive market such as Norway, we continue to view efficiency as key for the financial flexibility of an institution. SpareBank 1 Nord-Norge has set a target for the cost-to-income ratio of 50%.

The bank scores C for efficiency.

Factor 9: Asset Quality

Trend: Weakening

The improvements in SpareBank 1 Nord-Norge's risk management and the benign Norwegian economy over the past few years have been reflected in the bank's asset quality metrics. Asset quality is still satisfactory, but we have seen increases in problem loans (impaired and not impaired non-performing commitments) and in losses, although from a very low level. Problem loans accounted for 1.6% of gross loans at Q1 2009 compared with 1.5% at YE2008, 1.1% at YE2007 and 3.1% at YE2003. The increase in problem loans was largely related to two exposures in fish farming and the fishing industry.

We also note risks related to borrower and industry concentration (the largest sector being property management), but as a mitigating factor loan growth has been somewhat slower compared with that of the other rated SpareBank 1 banks and larger competitors. In 2008, corporate and public sector lending increased annually by 5.4% and retail lending 8.5% (including loans transferred to SpareBank 1 Boligkreditt). In addition, retail loans represent about 60% of the loan book (excluding loans transferred to SpareBank 1 Boligkreditt). We also note that loan loss reserve coverage has remained over 50%, although this represents a decrease from historically higher levels, mainly as a result of changes in accounting standards to IFRS (IAS 39).

The Norwegian economic environment is still satisfactory; however, we caution that recent economic developments may weigh on the construction and real estate sectors as well as export-related sectors. In the retail sector, credit risk is lower, but we note that house prices have been falling for over a year, the debt of households has been increasing and unemployment is likely to increase from the current low levels. As a mitigating factor, we note that mortgage loans are secured both by property and personal liability. In addition, lower interest rates should be helpful in terms of borrowers' ability to service loans since most loans have floating rates.

The score for asset quality is B. We do not expect current asset quality to be sustainable across the economic cycle given the weaker outlook for 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 Nord-Norge. The rating is supported by the bank's A3 BCA and the Aaa local currency deposit ceiling of Norway, which is considered the underlying support provider. As a result of SpareBank 1 Nord-Norge's importance to its region and the region's importance to the national economy of Norway, Moody's assesses a very high probability of systemic support for the bank in the event of a stress situation. Furthermore, SpareBank 1 Nord-Norge also benefits from a low probability of support from SpareBank 1 Alliance. The dependence between SpareBank 1 Nord-Norge and SpareBank 1 Alliance is high due to the substantial degree of integration and shared business lines between the alliance banks.

Notching Considerations

The rating of any junior obligations should be notched from the fully supported deposit rating.

Foreign Currency Deposit Rating

SpareBank 1 Nord-Norge's foreign currency deposit rating of A1 is unconstrained given that Norway has a country ceiling of Aaa.

Foreign Currency Debt Rating

SpareBank 1 Nord-Norge's senior unsecured 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 Nord-Norge

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
PPP % Avg RWA - Basel II				1.03%			
Net Income % Avg RWA - Basel II				0.90%			
Factor: Liquidity						D+	Neutral
(Mkt funds-Liquid Assets) % Total Assets					24.87%		
Liquidity Management			x				
Factor: Capital Adequacy						B+	Neutral
Tier 1 ratio (%) - Basel II		8.99%					
Tangible Common Equity / RWA - Basel II	8.31%						
Factor: Efficiency						C	Neutral
Cost/income ratio			61.42%				
Factor: Asset Quality						B	Weakening
Problem Loans % Gross Loans		1.41%					
Problem Loans % (Equity + LLR)		15.96%					
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

Moody's Investors Service

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